Cytonn Note on the 29th November 2021 Monetary Policy Committee (MPC) Meeting

The Monetary Policy Committee (MPC) is set to meet on Monday, 29th November 2021, to review the outcome of its previous policy decisions and recent economic developments, and to decide on the direction of the Central Bank Rate (CBR). In their previous meeting held on 28th September 2021, the committee decided to reconvene in November 2021, while highlighting that they would remain ready to reconvene earlier if necessary. Additionally, the MPC maintained the CBR at 7.00% for the tenth consecutive time, citing that the accommodative policy stance adopted in March 2020, which saw a cumulative 125 bps cut, was having the intended effects on the economy. However, the committee raised concerns on the rising inflation noting that there was need to monitor the rising inflation rates and respond to any second round effects in a bid to maintain price stability. This was in line with our expectations as per our MPC Note with our view having being informed by:

i. Inflation stability, with the inflation rate having remained within their target range of 2.5%-7.5%. Notably, August's inflation stood at 6.6%, the highest reading since the pandemic begun and above the midpoint of the government's target. We anticipated the Inflation pressures to remain elevated in the short term backed by high food and fuel prices. Therefore, we believed that the MPC would be under pressure in the short term to maintain price stability should the inflation rates continue rising, and,
ii. The need to support the economy and credit growth in the private sector by maintaining an accommodative monetary policy stance to strengthen the ongoing recovery. The macro and business environment fundamentals might have constrained further easing, despite the need to stimulate economic growth. Therefore, we believed that any additional rate cuts would not lead to a rise in private sector credit growth as banks would prefer lending to the government.

In the September meeting, the Monetary Policy Committee also noted that the current account deficit to GDP was estimated at 5.5% in the 12-months to August 2021, a 0.8% point increase from the 4.7% recorded over a similar period in 2020.

Below, we analyze the trends of the macro-economic indicators since the September 2021 MPC meeting, and how they are likely to affect the MPC decision on the direction of the CBR:

Indicators	Experience since the last MPC meeting in September 2021	Going forward	Probable CBR Direction (September)	Probable CBR Direction (November)
Government Revenue Collection	• Total revenue collected as at the end of October 2021 amounted to Kshs 598.5 bn, equivalent to 33.7% of the original estimates of Kshs 1.8 tn and is 101.1% of the prorated estimates of Kshs 591.9 bn • The strong revenue performance, is mainly attributable to; i. Enhanced compliance enforcement efforts and the implementation of new tax measures that are focused on ensuring that that non-compliant taxpayers pay their due taxes, ii. improved business environment due to relaxation of COVID-19 containment measures such as the lift of nationwide dusk curfew, and, iii. The widening of tax base following the implementation of Finance Act 2021 has continued to support the recovery of revenue collection	• We expect the implementation of the Finance Act 2021 which brought changes to the Excise Duty Tax, Income Tax as well as the Value Added Tax to expand the tax base and consequently enhance revenue collection. Additionally, the 7.7% increase in the target Excise Duty for FY'2021/2022 to Kshs 259.6 bn, from Kshs 241.0 bn is expected to further expand the tax base, and, • The gradual economic recovery and the relaxation of the COVID-19 measures such as lift of dusk curfew is also expected to boost KRA's revenue collection for FY'2021/2022	Positive	Positive

Government Borrowing	• The Government, as of 19th November 2021, was 26.7% ahead of its prorated borrowing target of Kshs 265.9 bn having borrowed Kshs 337.6 bn and has domestic maturities worth Kshs 668.0 bn. The government will have to borrow Kshs 43.6 bn monthly to meet its domestic borrowing target of Kshs 658.5 bn in the 2021/2022 fiscal year, and, • The government has raised USD 978.5 mn (Kshs 106.5 bn) from the IMF, USD 280.0 mn (Kshs 30.8 bn) from the World Bank and USD 1.0 bn (Kshs 107.8 bn) from the Eurobond issue, totalling USD 2.0 bn (Kshs 215.6 bn) in external borrowing since April 2021	• The budgetary support received from the IMF under the Extended Fund Facility (EFF)/ Extended Credit Facility (ECF), which is pegged on fiscal and structural reforms aimed at reducing debt-related vulnerabilities, is expected to lead Kenya on a path to interest rate stability, and, • The government's high borrowing appetite could mean that the country is heading towards levels of distress given the high debt servicing obligations. We therefore believe that with the slow recovery in some sectors, fiscal consolidation will continue to remain a concern in the medium term.	**Negative**	**Negative**
Inflation	• Y/Y inflation for October came in at 6.5%, from the 6.9% recorded in September, while the m/m inflation increased by 0.5%. The increase was mainly attributable to a 1.1% increase in food & non-alcoholic beverages coupled with a 0.7% increase in housing, water, electricity, gas and other fuels. Notably, the transport index was the only decliner on a m/m basis, declining by 0.4%, attributable to the decline in fuel prices	• Y/Y inflation declined to 6.5% in October, from the 6.9% recorded in September 2021 and we expect it to remain within the Government's target range of 2.5%-7.5%. The Fuel Subsidy program which was re-instated in October 2021 is expected to help mute pressure on inflation basket as fuel prices remain constant, and, • The stabilization under the fuel subsidy program by the National Treasury will however be unsustainable should the average landed costs of fuel keep rising. We anticipate inflation pressures to remain elevated in the short term attributable to rising food prices and the rise in global fuel prices due to supply bottlenecks	**Negative**	**Neutral**
Currency (USD/Kshs)	• Since the last meeting, the Kenyan Shilling has depreciated by 1.6% against the US Dollar to Kshs 112.2 as of 19th November 2021, from Kshs 110.4 on 28th September 2021, mainly attributable to increased dollar demand from commodity and energy sector importers, and, • Forex Reserves have declined to USD 8.9 bn (equivalent to 5.4 months of import cover) from USD 9.6 bn (equivalent to 5.9 months of import cover) since the last meeting. Despite the decline, Forex reserves remain above the statutory requirement of maintaining at least 4.0-months of import cover, and the EAC region's convergence criteria of 4.5-months of import cover	• We project the Kenyan Shilling to remain stable, supported by the sufficient forex reserves, currently at USD 8.9 bn (equivalent to 5.4 months of import cover), and the improving diaspora remittances evidenced by a 28.2% y/y increase to USD 337.4 mn in October 2021, from USD 263.1 mn recorded over the same period in 2020, and, • The shilling is however expected to remain under pressure in the medium term attributable to increased demand from merchandise traders as they beef up their hard currency positions in anticipation for more trading partners reopening their economies globally	**Neutral**	**Neutral**
GDP Growth	• Kenya's economy expanded by 10.1% in Q2'2021, up from the 4.7% contraction recorded in Q2'2020 supported by; i. A 16.9 % Growth in the Transport and Storage Sector in Q2'2021 compared	• We expect Kenya's economy to continue growing as most sectors of the economy continue to recover. The lifting of the dawn to dusk curfew that was put in place since March 2020 is expected to boost	**Neutral**	**Neutral**

	to the 8.7% contraction recorded in Q1'2021 and 16.8% in Q2'2020, ii. A 9.6% growth in the Manufacturing Sector in Q2'2021 in comparison to the 1.5% growth recorded in Q1'2021 and the 4.7% contraction recorded in Q2'2020, and, iii. Gradual rebound in the Accommodation and food sector which recorded a 9.1 % growth in Q2'2021 compared to the 48.8% and 56.6% contraction recorded in Q1'2021 and in Q2'2020, respectively	economic recovery in sectors such as accommodation and food services. Notably, October's PMI increased to 51.4 from 50.4 recorded in September 2021 an evidence of improving business activities in the country, and, • We however believe that risks abound the economic recovery due to existence and emergence of new COVID-19 variants.		
Private Sector Credit Growth	• The latest data from CBK indicates that private sector credit growth recorded a 7.0% growth in the 12 months to August 2021, as demand recovered following the increased economic activities	• Private sector credit growth is expected to continue being supported by the improving operating environment in the country, • However, we expect to continue seeing continued caution on lending especially to the sectors that continue to record muted growth such as Agriculture and Real Estate, and, • The increased government borrowing is also expected to continue crowding out the private sector	**Neutral**	**Neutral**
Liquidity	• Liquidity levels in the money markets eased, with the average interbank rate on 19th November 2021 coming in at 5.2%, a 1.5% points decrease from the 6.7% recorded during the last meeting on 28th September 2021, supported by government payments	• Liquidity is expected to remain favourable due to: i. High domestic debt maturities that currently stand at Kshs 583.7 bn worth of T-bill maturities and Kshs 84.3bn worth of T-bond maturities as at 19th November 2021, and, ii. Low Cash Reserve Ratio (CRR) currently at 4.25% from 5.25% previously. Despite the reduction of the CRR, lending to the private sector has remained muted	**Positive**	**Positive**

Conclusion

Of the factors that we track, one is negative, four are neutral and two are positive, with changes in inflation and government borrowing which was negative in September 2021 and is now neutral in November 2021. Notably, Central Banks around the world have adopted a wait and see approach anticipating that fuel prices will gradually stabilize as supply chains continue to normalize. Yields on government securities in the secondary market remained relatively stable, with the FTSE bond index declining marginally by 0.3% to close at Kshs 96.5 on 24th November 2021, from Kshs 96.8 recorded in 28th September 2021, bringing the YTD performance to a 1.7% decline.

The main goal of the monetary policy is to maintain price stability and support economic growth by controlling the money supply in the economy. We expect the MPC to maintain the Central Bank Rate (CBR) at 7.00% with their decision mainly being supported by:

i. We foresee the MPC taking a wait and see approach as it monitors the recovery of the economy. Kenya's economy recorded a 10.1% growth in Q2'2021, up from the 0.7% growth in Q1'2021 and the 4.7% contraction recorded in Q2'2020. We believe that despite this recovery, the slow vaccine inoculation and the emergence of the new variants will continue to weigh down the recovery of the economy. As such, we believe that the MPC will keep monitoring the macro-economic indicators before pursuing any additional policy measures,

ii. Inflation is expected to remain stable and within the government's target range of 2.5% -7.5% on account of the stable fuel prices. October inflation declined to 6.5%, from 6.9% recorded in September, supported by the decline in fuel prices following the re-instatement of the Fuel Subsidy program. However, we believe that the stabilization under the fuel subsidy program by the National Treasury is unsustainable should the average landed costs of fuel keep rising. We anticipate inflation pressures to remain elevated in the short term driven by the rising food prices and the rise in global fuel prices due to supply bottlenecks, and,

iii. The need to support the shilling from further depreciations having depreciated by 1.6% to Kshs 112.2 as of 19th November 2021, from Kshs 110.4 recorded in September 2021. We believe that the forex reserve of USD 8.9 bn (equivalent to 5.4 months of import cover) as of 19th November 2021, continue to support the shilling from foreign exchange shocks in the short term. As such, this will reduce pressure on the Central Bank to pursue any additional policy measures.