Cytonn Note on the Monetary Policy Committee Meeting for November 2016

The Monetary Policy Committee (MPC) is set to meet on Monday 28th November to review the prevailing macroeconomic conditions and give the direction of the Central Bank Rate (CBR). In their previous meeting held in September, MPC lowered the CBR for the second time in 2016 by 50.0 bps to 10.0% on account of (i) the persistent slowdown in private sector credit growth, which stood at 5.5% against the CBK target of 18.3%, and (ii) the fairly stable core inflation that declined from 6.4% in July to 6.3% in August 2016, indicating that inflationary pressure remains at bay.

In their Monday meeting, we are expecting the MPC to retain the CBR at 10.0% since the macroeconomic conditions have held steady since the last meeting, and we are projecting that they will maintain the Central Bank Rate at 10.0% for the remaining part of the fiscal year.

The macro-economic indicators are as summarized below:

Key Macro-Economic Indicators – Kenya					
Indicators	**Expectations at start of 2016/2017 Fiscal Year**	**Experience since the last MPC meeting on 20th September, 2016**	**Going forward**	**Probable CBR Direction (Last MPC Meeting)**	**Probable CBR Direction (This month)**
Government Borrowing	Government is expected to borrow Kshs. 229.6 bn domestically for the 2016/2017 financial year and 462.3 bn from the foreign market	The government has been ahead of its domestic borrowing target having borrowed Kshs. 145.9 bn for the current fiscal year against a target of Kshs 97.1 bn. The Government is in the process of revising the domestic borrowing target upward to Kshs 294.6 bn while reducing the foreign borrowing to Kshs 287.6 bn	Given the signing of the Banking (Amendment) Bill, 2015 into law, we expect that banks will have a preference to lending to the government, hence we do not expect pressure on domestic government borrowing going forward. The only challenge would arise from the foreign borrowing front, however we do not expect significant pressure to raise borrowing.	**Neutral**	**Neutral**
Kenya Revenue Authority	KRA to meet the revenue collection target	The KRA missed their Q1 target by 18.4% having collected 289.0 bn against a target of 342.5 bn. The government is in the process of revising revenue collection downwards by 2.9% from Kshs 1.50 tn to Kshs 1.46 tn	Given the Interest Rate Caps, we expect (i) subdued earnings by the banking sector and (ii) low credit uptake by the SME sector as they will be locked out of funding. As they have already missed their Q1 collection target, we expect them to miss their collection for the whole year	**Neutral**	**Negative**
Inflation	Below the CBK target of 7.5%	Increased to 6.5% in the month of October from 6.3% in September	We expect Inflation rate to increase marginally but to remain below the CBK's upper limit of 7.5%	**Neutral**	**Neutral**

Exchange Rate (USD/Kshs)	To remain stable supported by dollar reserves and improved foreign exchange inflows through improved diaspora remittances and tea exports	The shilling has depreciated by 0.6% against the dollar since the last MPC meeting and has recently been under pressure due to the global strengthening of the dollar as the Fed is expected to hike rates in December	The shilling to remain stable in the short to medium term supported by (i) foreign exchange reserves equivalent to 4.7 months of import cover, and (ii) increased dollar inflows from tourism and remittances. The CBK has come out to say they will support the shilling in case it comes under pressure	**Neutral**	**Neutral**
Banking Sector	We expect improved governance, following the closure of Imperial and Dubai Banks and consolidations within the banking industry	The Banking (Amendment) Act, 2015 was enacted to law capping lending rates above the CBR and deposit rates at 70.0% of the CBR	We expect increased regulations with banks employing strategic initiatives and adopting innovation to derive value as interest rate caps set in	**Neutral**	**Neutral**
Liquidity	Liquidity expected to improve given high maturities of government securities	The money market has been liquid with the interbank averaging 4.05%. however, liquidity has been skewed towards large banks as indicated by the activities in the reverse repo market	We expect the money market to be liquid however skewed towards the larger banks	**Neutral**	**Neutral**

<u>Conclusion</u>

Of the above factors, 5 are neutral and 1 is negative. With the above state of affairs in the money market environment, all indicators, with the exception of one, are neutral towards the MPC decision on CBR.

In light of this, we are of the view that MPC will maintain the CBR at 10.0%.