Cytonn Note on the 5th December 2023 Monetary Policy Committee (MPC) Meeting

The Monetary Policy Committee (MPC) is set to meet on Tuesday, 5th December 2023, 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 3rd October 2023, the committee noted that they will closely monitor the impact of the policy measures taken, as well as developments in the global and domestic economy, and stood ready to reconvene earlier if necessary. Additionally, the MPC decided to Maintain the Central Bank Rate at 10.50%, citing that the policy stance adopted in June, and maintained in the August 2023 sitting, which saw a 100 bps raise, was having the intended effects on the economy. This was in line with our expectations as per our MPC Note with our view having being informed by:

i. Inflation had remained within the bank's target of 2.5% -7.5% on account of the relatively stable food prices being experienced in the country at the time as a result of the favourable weather conditions. Given that one of the main goals of monetary policy is to ensure price stability, we believed that the stable inflation rate which came in at 6.8% in the month of September would not exert pressure on the MPC to tighten further the central bank rate, and
ii. The recently released GDP data for the second quarter of 2023 showed continued strong performance of the Kenyan economy, with real GDP growing by 5.4%. This was attributable to a strong rebound in the agriculture sector due to favourable weather conditions and resilient performance of the services sector. Leading indicators of economic activity pointed to continued strong performance in 2023. Despite the global uncertainties, the economy is expected to continue to strengthen in 2023, supported by resilient services sector, the rebound in agriculture, and implementation of measures to boost economic activity in priority sectors by the Government

The Monetary Policy Committee noted that the then ongoing implementation of the FY2023/24 Government Budget, particularly the performance in tax revenue collection will continue to reinforce fiscal consolidation. Notably, the total revenue collected as at the end of September 2023 amounted to Kshs 540.0 bn, equivalent to 21.0% of the original estimates of Kshs 2,571.2 bn for FY'2023/2024 and was 84.0% of the prorated estimates of Kshs 642.8 bn. Additionally, the Monetary Policy committee noted that the leading economic indicators pointed to a strong performance of the Kenyan economy mainly driven by the activities in services sector and recovery of the Agricultural sector. The committee further noted that goods exports remained strong having a year on year growth of 0.5% in the 12 months to August 2023. Notably, receipts from tea and manufacturing goods exports increased by 4.5% and 23.2% respectively on the back improved prices due to demand from the traditional market. Additionally, imports decreased by 11.9% in the 12 months to August 2023, compared to the 16.0% growth recorded in a similar period last year, due to drop of imports of infrastructure related equipment mainly on the back of completed projects as well as decline in imports of manufactured goods. Remittances in the 12 months to August 2023 amounted to USD 4,120.0 mn, representing a 3.2% gain compared to a similar period last year. However, the current account deficit was estimated at 3.7% of GDP in the 12 months to August 2023, and was projected to improve from the estimate of 5.1% of GDP recorded in 2022. Notably, private sector credit growth had increased to 12.6% in August 2023 from 10.3% in July 2023. Strong credit growth was observed in transport and communication, manufacturing, consumer durables and trade of 24.9%, 19.6%, 12.7% and 9.4% respectively, with the number of loan application and approval remaining strong, highlighting increased demand and resilient economic activities

Below, we analyze the trends of the macro-economic indicators since the October 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 October 2023	Our Expectation Going forward	CBR Direction (October)	Probable CBR Direction (December)

Government Revenue Collection	• Total revenue collected as at the end of September 2023 amounted to Kshs 540.0 bn, equivalent to 21.0% of the original estimates of Kshs 2,571.2 bn for FY'2023/2024 and was 84.0% of the prorated estimates of Kshs 642.8 bn. Cumulatively, tax revenues amounted to Kshs 514.3 bn, equivalent to 20.6% of the original estimates of Kshs 2,495.8 bn and 82.4% of the prorated estimates of Kshs 642.0 bn, • We note that the government was not able to meet its prorated revenue targets for the first three months of the FY'2023/2024 partly attributable to the deteriorated macroeconomic environment in the country as evidenced by Purchasing managers' index which decreased to 46.2 in October, down from 47.8 recorded in September. Additionally, The October inflation came in at 6.9% an increase from the 6.8% recorded in September 2023. However, inflation has eased again in the month of November to 6.8%.	• In the short term, we expect the revenue collections to lag behind the prorated targets given the subdued business environment on the back of elevated inflationary pressures as a result of high fuel and electricity prices, coupled with the sustained depreciation of the shilling against the dollar which continue to put pressure on the economic environment • However, the government's continued efforts to broaden the tax base will lead to increased tax revenue collection, evidenced by the provisions in the current Finance Act Among the key provisions in the Act included an increase of the VAT on Petroleum from 16.0% to 8.0%, introduction of a higher personal income tax rate of 35.0% on the income of individuals earning above Kshs 500,000.0 per month from the then existed 30.0%, introduction of tax of 3.0% on income derived from the transfer or exchange of digital assets, and an increase in turnover tax to 3.0% from the then existed 1.0%. As such, we expect the tax collections to increase in the long-term and thus boost the government's efforts of meeting it revenue collection target, • Nevertheless, given the subdued general business environment which is underpinned by depreciation of the Kenyan shilling, tightened liquidity in the money market, and elevated inflationary pressures, we expect the subdued business environment to weigh down the tax revenue given that consumers have cut back on their spending due to reduction in disposable income	**Neutral**	**Neutral**
Government Borrowing	• The government, as at 1st December 2023, was 4.1% behind of its prorated borrowing target of Kshs 135.4 having borrowed Kshs 129.8 bn of the total borrowing target of Kshs 316.0 bn. The government has domestic maturities worth Kshs 530.0 bn and will have to borrow Kshs 103.9 bn monthly to meet the upcoming domestic maturities and the budget deficit in the FY'2023/2024 • Total Borrowings as at the end of September 2023 amounted to Kshs 205.0 bn, equivalent to 13.2% of the original estimates of Kshs 1,558.4 bn for FY'2023/2024 and are 52.6% of the prorated estimates of Kshs 389.6 bn. The cumulative domestic borrowing of	• Kenya's rising debt sustainability remains a significant concern with the government's borrowing appetite remaining high given the subdued economic environment coupled with an ever-present fiscal deficit. Additionally, the rising debt servicing with Kenya's external debt service costs is expected to rise sharply by 53.6% to USD 4.3 bn in FY'2023/2024 up from USD 2.8 bn that was spent on debt service in the previous year, FY'2022/2023 mainly due to the upcoming maturities such as the 10-year USD 2.0 bn (Kshs 226.0 bn) Eurobond maturing in June 2024. This has led to Credit rating agencies such as Moody's Credit Rating Agency, S&P	**Negative**	**Negative**

	Kshs 688.2 bn comprises of Net Domestic Borrowing KSh. 313.7 bn and Internal Debt Redemptions (Rollovers) Kshs 374.5 bn. • Kenya has continued to receive financing from the World Bank and other bilateral lenders such as the International Monetary Fund (IMF). Recently, the IMF announced that it had reached a staff-level agreement with Kenya on a sixth review of Kenya's EFF and ECF. Notably, the discussions took into account Kenya's request for an augmentation under the EFF/ECF arrangement and the RSF, leading to a potential total commitment of approximately USD 4.4 bn (Kshs. 670.1 bn) over the program's duration. Upon completion of the reviews, Kenya will receive an immediate access of USD 682.3 mn (Kshs 103.9 bn).	Global Rating and Fitch to downgrade their outlook of Kenya. Notably, Kenya's latest rating by moody was at B3 for both local issuer and foreign currency issuer an indication of a high credit risk		
Inflation	• Year on year (y/y) inflation rate for October 2023 came in at 6.9%, an increase from 6.8% recorded in September 2023, while the month on month (m/m) inflation increased marginally by 1.0% points. The headline inflation for October 2023 was majorly driven by an increase in prices for Transport; Food and Non-alcoholic beverages; and housing, water, electricity, gas and other fuels of 13.6%, 7.8% and 7.8% respectively. • Notably, the significant increase of Transport index by 13.6% year on year is on the back of the increase in fuel prices which increased by 2.7%, 2.2% and 1.2% to Kshs 217.4, Kshs 205.5 and Kshs 205.1, per litre of Super Petrol, Diesel and Kerosene, respectively. The high fuel prices is attributable the high cost of fuel imports as a result of the sustained depreciation of the shilling against the US dollar, as well as the high taxation of petroleum products as provided in the finance Act 2023. • The overall increase of the headline inflation in the month of October 2023 compared to September 2023 came despite the monetary policy committee decision to maintain the Central Bank Rate at 10.5% in October 2023 a move which aimed to anchor inflation. Notably, the November inflation has eased marginally by 0.1% points to 6.8%. The headline inflation still remains within the Central Bank of Kenya target range of 2.5% - 7.5% .	• We expect inflation rates to remain elevated but within the CBK's target range of 2.5% - 7.5% supported by the current fiscal stance by the Monetary Policy Committee, having Maintained the Central Bank Rate for two consecutive meetings at 10.5% in October 2023. • However, the sustained depreciation of the Kenyan shilling against major currencies is also expected to underpin inflationary pressures in the country as manufacturers pass on the high cost of importation to consumers through hikes in consumer prices in order to maintain their margins	**Positive**	**Neutral**

Currency (USD/Kshs)	• Since the last meeting, the Kenyan Shilling has depreciated by 3.3% against the US Dollar to Kshs 153.2 as at 1st December 2023, from Kshs 148.3 recorded on 3rd October 2023 mainly attributable to persistent high dollar demand from importers, especially in the oil and energy sector • However, the Forex Reserves have decreased by 2.5% to USD 6.7 bn (equivalent to 3.6 months of import cover) as of 30th November 2023 from USD 6.9 bn (equivalent to 3.8 months of import cover) recorded in 5th October 2023. Notably, the forex reserves are below the statutory requirement of maintaining at least 4.0 months of import cover and lower than the EAC region's convergence criteria of 4.5 months of import cover	• We expect the Kenyan Shilling to remain under significant pressure in the medium term as demand for the dollar continues to increase in the oil and energy sectors. However, the government-government dealing involving firms such as the Saudi Aramco (ARAMCO), Abu Dhabi National Oil Company (ADNOC) and Emirates National Oil Company (ENOC) to supply Kenya with diesel and super petrol on credit was extended to December 2024. As such we expect that this will lead to an ease in dollar demand by oil importers • Additionally, the shilling performance and strength is expected to be supported by the sufficient forex reserves currently at USD 6.7 bn (equivalent to 3.6-months of import cover), which is slightly below the statutory requirement of maintaining at least 4.0-months of import cover. Moreover, tourism receipts have significantly increased by 82.9% to Kshs 268.1 bn in 2022, from Kshs 146.5 bn inflow receipts recorded in 2021. The tourism receipts is expected to increase evidenced by the increased number of visitor arrivals through the Jomo Kenyatta and Moi International airports, which has increased by 34.0% 2in August 2023 up from 235,982 recorded in July 2023	**Negative**	**Negative**
GDP Growth	• Kenyan's economy recorded a 5.4% growth in Q2'2023, faster than the 5.2% growth recorded in Q2'2022, pointing towards a faster economic growth. The performance was driven by; i. The positive growth recorded in all sectors. However, most sectors recorded subdued growth compared to Q2'2022 with Accommodation and Food Services, Mining and Quarrying, and Professional Administration sectors recording the highest growth declines of 31.8% points, 11.3% points, and 5.4% points, respectively. Other sectors that recorded expansion in growth rate, from what was recorded in Q2'2022 were Real Estate, Health, Education, and Wholesale and Retail Trade sectors, of 0.8%, 0.6%,	• We expect Kenya's GDP to continue growing at a slower pace in line with the global economy trends. However, the economy will be supported by sustained recovery in sectors like accommodation and food services sector, as well as recent fiscal policies such as subsidizing costs of crucial farm inputs such as fertilizer that are expected to support growth in the agriculture sector, which remains to be Kenya's largest contributor to GDP, • However, the continued depreciation of the Kenya shilling has continued to weigh down on the business environment, by increasing the cost of imported inputs and adding the finance cost of the foreign currency denominated debts • Notably, the country's PMI for the month of October 2023 declined to	**positive**	**Neutral**

	0.1% and 0.1% points, respectively. ii. The rebound of Agricultural Sectors with Agriculture, Forestry and Fishing activities recording a growth of 7.7% compared to a contraction of 2.4% points in Q2'2022. The performance was an increase of 1.9% points, from the growth of 5.8% recorded in Q1'2023. The positive growth recorded during the quarter was mainly attributable to sufficient rainfall experienced in the quarter under review resulting to increased agricultural production. Notably, during the quarter, production of key food crops and cash crops increased with a significant increase in the production of tea, coffee, milk, vegetables and fruit during the quarter under review.	46.2, down from 47.8, an indication of a deteriorated business environment in the country. However, according to CEO's survey-July 2023 report, optimism regarding growth prospects for the Kenyan economy improved due to the easing of inflation rate and the expected increase agricultural production.		
Private Sector Credit Growth	• The latest data from CBK indicates that private sector credit growth continues to recover having grown by 12.6% in August 2023, attributed to strong credit growth in sectors such as; transport and communication, manufacturing, consumer durables, and trade of 24.9%, 19.6%, 12.7% and 9.4% respectively. Additionally, the number of loan applications and approvals remained strong, reflecting resilience in economic activities.	• We anticipate continued adoption of the risk-based pricing model in the banking sector to continue to unlock access to credit to individuals and businesses who were not captured by the previous frame works due to being considered too risky, • However, the increased government borrowing is expected to continue crowding out the private sector in the short term as seen by the weighted average yield for T-Bonds coming at 17.9% in the month of November effectively edging out majority of the corporate bonds currently in the trading in market • Additionally, banks have adjusted their lending rates in line with the CBR rate which was maintained at 10.5% in October MPC meeting. This is expected to slow down the private sector credit demand	**Positive**	**Neutral**
Liquidity	• Liquidity levels in the money markets eased, with the average interbank rate since the previous MPC meeting increasing by 1.1% points to 11.0% as of 1st December 2023, from 12.1% recorded in 6th October 2023, partly attributable to Government payments that offset tax remittances	• We expect liquidity in the money markets to be supported by the high domestic debt maturities that currently stand at Kshs 368.3 bn worth of T-bill maturities and Kshs 161.7 bn worth of T-bond maturities for FY'2023/2024.	**Positive**	**Positive**

Conclusion

Out of the seven factors that we track, four are neutral, two are negatives and one is positive. Notably, most of the Central Banks of developed economies around the world have continued to raise their rates with the aim of anchoring inflation within their target ranges.

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 the current rate of 10.50% with their decision mainly being supported by:

i. The ease in y/y inflation in November 2023 to 6.8%, from 6.9% recorded in October 2023 marking the fifth consecutive month that inflation has fallen within the CBK target range of 2.5%-7.5%. However, the risk lies on the back of elevated fuel prices which has seen the recent rise in y/y inflation for the month of October to 6.9%, from the 6.8% in September following the increase in Fuel importation costs. As such, we expect the MPC to maintain the CBR as the current monetary stance still transmits in the economy, and

ii. The need to support the economy by adopting an accommodative policy that will ease financing activities. The Purchasing Managers Index (PMI) has for the last 2 months remained below the 50.0 no change threshold, with the October 2023 PMI recording dropping to 46.2 from 47.8 recorded in September 2023 and indication of greater deterioration in the business environment. An additional hike in the CBR rate might curtail economic growth given the current macroeconomic and business environment, which cannot accommodate further hikes