Cytonn Note on the 27th January 2021 Monetary Policy Committee (MPC) Meeting

The Monetary Policy Committee (MPC) is set to meet on Wednesday, 27th January 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 26th November 2020, the committee decided to reconvene in January 2021, while highlighting that they would remain ready to reconvene earlier if necessary, as they continue to closely monitor the impact of the policy measures. Additionally, the MPC maintained the CBR at 7.0% citing that the accommodative policy stance adopted in March, and all the other sittings in 2020, which saw a cumulative 125 bps cut, 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 has remained with the bank's target of 2.5% -7.5% on account of the 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 would not exert pressure on the MPC to implement inflationary control, and,

ii. Despite the need to stimulate the economy, we believed that additional rate cuts would not necessarily further support a rise in the Private sector Credit growth given that the subdued economic activity is elevating credit risk.

The Monetary Policy also noted that the Current account deficit was projected at about 5.1% of GDP in 2020 from 5.8% in 2019 as exports of goods had strengthened from the disruptions of COVID-19, growing by 2.8% in the 10 months to October 2020. Receipts from tea exports rose by 13.2% during this period, largely reflecting increased output. Horticulture and flower exports have rebounded, reflecting the normalization of demand in the international market, and the availability of adequate cargo space.

Below, we analyze the trends of the macro-economic indicators since the November 2020 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 November 2020	Going forward	Probable CBR Direction (November)	Probable CBR Direction (January)
Government Revenue Collection	• Following the release of the Q1' 2020/2021 fiscal year budget outturn figures, the fiscal measures implemented by the Government to cushion Kenyans against the adverse impact of the pandemic is estimated to cost the exchequer Ksh 41.7 bn in revenue. Total revenue collected in Q1 of FY' 2020/2021 amounted to Kshs 378.7 bn against a revised target of Ksh 428.9 bn, a 10.1% shortfall. This led the government to reverse some of the tax incentives implemented in April 2020 as part of COVID-19 economic stimulus relief.	• We expect a gradual economic recovery going into 2021 as evidenced by KRA surpassing its December collection targets, by collecting Kshs 166.0 bn against a target of Kshs 164.0 bn which was a 3.5% growth y/y, this is despite the current environment. • The reversal of the COVID related tax incentives and the introduction of digital taxes will boost revenue collection	**Neutral**	**Neutral**
Government Borrowing	• The Government, as at 15th January 2021, was 5.0% ahead its current borrowing target having borrowed Kshs 274.9bn against a prorated borrowing target of Kshs 261.8 bn against a domestic borrowing target of Kshs 486.2 bn and has domestic maturities worth Kshs 531.6 bn	• There is increased demand for shorter-dated government debt due to increased uncertainty in the current environment, • Due to the inability for fiscal consolidation this financial year, we project a relatively higher fiscal deficit due to the lower revenue collection, to pile pressure on the	**Neutral**	**Neutral**

		government borrowings leading top higher rates.		
Inflation	• Y/Y inflation for December came in at 5.6%, while the m/m inflation came in at 1.0%. This was mainly attributable to a 2.5% increase in the Food and Non-Alcoholic Drinks' Index coupled with a 1.2% increase in the Transport Index,	• Inflation averaged 5.2% in 2020 and we expect it to remain stable, mainly supported by stable food prices due to favourable weather conditions and stable fuel prices, on the back of muted demand pressures in the global economy.	**Positive**	**Positive**
Currency (USD/Kshs)	• Since the last meeting, the Kenyan Shilling has depreciated by 0.2% against the US Dollar to Kshs 110.1 as at 15th January,2021, from Kshs 109.9 on 26th November, 2020,mainly attributable to increased dollar demand as people prefer holding onto hard currency during such times and also a decline in dollar inflows from both exports of goods and services like tourism and the subsequent improvement in business activity as evidenced by a marginal improvement in the country's PMI to 51.4 in December 2020 from 51.3 in November 2020, • Forex Reserves have declined to USD 7.8 bn (equivalent to 4.8 months of import cover) from USD 8.5 bn (equivalent to 5.2months of import cover) since the last meeting, but are still adequate to provide a buffer to the shilling against foreign exchange shocks	• We project the Kenya Shilling to remain stable and trade within the of between Kshs 107.0 and Kshs 110.0 against the USD in 2021, supported by the improving current account position which narrowed to 4.9% of GDP in the 12 months to October 2020 compared to 5.3% of GDP during a similar period in 2019,	**Negative**	**Negative**
GDP Growth	• Kenya's economy contracted by 5.7% in Q2'2020, a decline from the 5.3% recorded in Q2'2019, which was mainly due to: i. An 83.3% contraction in the accommodation and food services sector, compared to an expansion of 12.1% in Q2'2019. This sector was the worst hit by the COVID -19 pandemic as businesses in the sector either operated under minimum capacity or completely closed down, ii. This contraction was mitigated by the 6.4% growth in the agricultural sector, compared to 2.9% recorded in Q2'2020, supported by favourable weather conditions,	• We expect gradual recovery in 20221 following improved business activity in the fourth quarter with the average PMI coming in at 53.9 in Q4'2020	**Negative**	**Neutral**
Private Sector Credit Growth	• The latest data from CBK indicates that private sector credit growth recorded a decline in the 12 months to November 2020 to 7.7% from 8.3% recorded in August 2020, lower than the 5-year average of 8.0%,	• The tough economic conditions brought about by the pandemic have increased cash constraints by businesses as well as households with most businesses struggling to keep afloat due to subdued revenues. Consequently, this led to an increase in the Gross Non-Performing Loans to 13.6%,	**Neutral**	**Neutral**
Liquidity	• Liquidity levels in the money markets declined with the average interbank rate on 15th January 2021 coming in at 3.7%, a marginal increase from the 3.6% recorded	• Liquidity is expected to remain favorable due to: i. High domestic debt maturities in H1 2021 that currently stand at Kshs 473.0 bn worth	**Positive**	**Positive**

	during the last meeting on 26th November 2020, supported by government payments,	of T-bill maturities and Kshs 58.5 bn worth of T-bond maturities, 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		

Conclusion

Of the factors that we track, four are neutral, two are positive and one is negative, an improvement from November 2020, where three were neutral, two were negative and two were positive.

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. Stable Inflation which is projected to be within the 2.5%- 7.5% on account of stable; food and fuel prices,
ii. Support for the shilling as the fundamentals supports a more stable shilling i.e. the current account position has been improving despite the decline in the forex reserve. The most recent reprieve from the debt servicing is meant to support the shilling
iii. The need to support the economy by continuously pumping money into the economy. The current macro and business environment fundamentals might constrain the transmission of further accommodative cuts, despite the need to stimulate economic growth. Therefore, we believe that any additional rate cuts will not lead to a rise in Private sector credit growth as elevated credit risks still persist in the current environment.