Cytonn INVESTMENTS

Cytonn Note on the Monetary Policy Committee (MPC) Meeting for November 2017

The Monetary Policy Committee (MPC) is set to meet on Thursday, 23rd November 2017 to review the prevailing macro-economic conditions and give direction on the Central Bank Rate (CBR). In their previous meeting held in September 2017, the MPC maintained the CBR at 10.0%, which was in line with our expectations as per our MPC Note. The decision was on the back of a relatively stable macroeconomic environment, driven by:

(i) the inflation rate had declined to 8.0% in August from 9.2% in June, due to a decline in food prices brought about by the rains, experienced between March and May, albeit depressed,

(ii) a relatively stable foreign exchange market, with foreign reserves at USD 7.5 bn (equivalent to 5.0 months of import cover), despite the current account deficit widening to 6.4% of GDP in July from 6.2% in May, and

(iii) a resilient banking sector, with the average commercial banks liquidity ratio and capital adequacy ratio at 45.6% and 19.0%, above the statutory minimum of 20.0% and 14.5%, respectively, as at August 2017.

The committee also noted that (i) inflation was expected to remain low, due to the normalization of food supply, (ii) the current account deficit was expected to narrow to 5.8% of GDP by December 2017, as the bulk of the SGR related imports are complete, coupled with the favourable weather conditions that will improve food production and reduce reliance on imports, and (iii) the economy is expected to remain resilient, supported by the recovery of the agricultural sector, a resilient services sector, continued infrastructure development and stability in the global economy. However, there still remains risks to economic growth, brought about by the slow-down in private sector credit growth (that came in at 1.6% in August, way below the set annual target at 18.3%) and the prolonged electioneering period, following the nullification of the August 2017 presidential election results.

Below, we analyse the macro-economic indicators trend since the September 2017 MPC meeting and how they are likely to affect the MPC decision on the direction of the CBR:

Key Macro-Economic Indicators – Kenya					
Indicators	**Expectations at start of 2017/2018 Fiscal Year**	**Experience since the last MPC meeting in September 2017**	**Going forward**	**Probable CBR Direction (September)**	**Probable CBR Direction (November)**
Budget Deficit	The government expected to borrow Kshs 317.7 bn from the domestic market for the 2017/2018 financial year and Kshs 206.0 bn from the foreign market, while KRA has a revenue collection target of Kshs 1.7 tn for the 2017/18 fiscal year	The government is behind its domestic borrowing target for the current fiscal year, having borrowed Kshs 59.3 bn against a target of Kshs 149.9 bn (assuming a pro-rated borrowing target throughout the financial year of Kshs 410.2 bn budgeted for the full financial year as per the Cabinet-approved 2017 Budget Review and Outlook Paper (BROP))	(i) The government is currently behind its domestic borrowing target for the 2017/18, having borrowed Kshs 59.3 bn against a target of Kshs 149.9 bn (ii) The government has borrowed only 6.8% of its foreign borrowing target in the 2017/18 fiscal year, despite budget estimates having been revised downwards to Kshs 206.0 bn from Kshs 462.3 bn previously (iii) KRA is expected to face challenges in meeting its overall revenue collection target of Kshs 1.7 tn for the 2017/18 fiscal year due to the economic slowdown brought about by political uncertainty and the expected subdued corporate earnings growth We expect that the reduced business activity and political	**Neutral**	**Negative**

			uncertainty has had an adverse impact on development, and subsequent expenditure. However, given KRA is expected to miss its revenue collection target, and the government is significantly behind its borrowing target in the fiscal year 2017/18, the government may come under pressure		
Inflation	To average above the government annual target of between 2.5% - 7.5% in 2017	Inflation declined to 5.7% in the month of October from 7.1% in September, due to improved weather conditions. The YTD average inflation rate is 8.7%, compared to 9.3% at the time of the last MPC meeting and 6.3% in the same period last year	We expect the inflation rate to stabilize going forward due to falling food prices, but average above the 7.5% upper bound government target in 2017 since YTD average is at 8.7%	**Neutral**	**Positive**
Currency (USD/Kshs)	To remain stable supported by dollar reserves	The shilling has depreciated by 0.3% against the dollar since the last meeting, depreciating by 1.1% on a YTD basis, primarily driven by speculation in the forex market in the midst of the political uncertainty and demand from oil importers	Kenya's forex reserves currently stand at USD 7.2 bn (equivalent to 4.8 months of import cover), with the country's current account deficit expanding by 61.5% y/y to USD 5.1 bn in July 2017 from USD 3.1 bn previously, on the back of the country's increased maize importation. We expect the currency to remain relatively stable against the dollar, supported by the CBK activity, since they have sufficient reserves, the stable global oil prices and reduced food importation, following improved weather conditions	**Neutral**	**Neutral**
GDP Growth	GDP growth to come in at between 4.7% - 5.2% in 2017, from 5.8% recorded in 2016	GDP growth for Q2'2017 came in at 5.0%, primarily on account of subdued performance in the agriculture sector and manufacturing sectors	GDP growth is expected to stabilize over the remainder of the year, and come in at 4.7% - 5.2%, following the improved weather conditions	**Neutral**	**Neutral**
Private Sector Credit Growth	Private sector credit growth expected to remain at low levels, below the government set annual target of 18.3%	The latest data from CBK indicates that private sector credit growth came in at 1.6% in August 2017, which is below the government set annual target of 18.3%	Private sector credit growth has remained low, reaching 1.6% in the month of August, and is projected to remain low as the interest rate cap has made it difficult for banks to lend to more riskier borrowers	**Negative**	**Negative**
Liquidity	Liquidity expected to remain high given heavy maturities of government securities and following the capping of interest rates	The money market has been relatively tight over the last two months, with bank's excess reserves at Kshs 2.1 bn, compared to Kshs 11.9 bn at the start of September, while the average interbank rate is at 8.6% from 5.3% at the time of the last meeting. The CBK has been active in the Repo market in a bid to inject liquidity in the market, injecting Kshs 78.7 bn during the month of October	(i) Money supply (M3) growth is stable, at 8.3% as at July (ii) The CBK has been active in the Repo market in a bid to inject liquidity in the market, injecting Kshs 78.7 bn during the month of October	**Negative**	**Negative**

Conclusion

Of the six factors that we track, three are negative, two are neutral, and one positive, with Budget Deficit and Inflation being the economic indicators changing since the last MPC meeting in September, moving to a Negative from Neutral, and Positive from Neutral, respectively. With inflation having eased to 5.7% from 8.0% since the last meeting and the currency having depreciated by only 0.3% over the same period of time, we believe that the MPC should adopt a wait and see approach, given the macro-economic environment is relatively steady, despite the political uncertainty witnessed. We therefore expect the MPC to hold the CBR at 10.0%. The key risk lies in the depressed economic growth that came in at 5.0% in Q2'2017, lower than the 5.8% in 2016, coupled with the subdued private sector credit growth, which came in at 1.6% as at August, way below the government set annual target of 18.3%, and this trend may well adversely impact on economic growth, which we believe will be a key driver in future monetary policy decisions.