Cytonn Note on the Monetary Policy Committee (MPC) Meeting for April 2020

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The Monetary Policy Committee (MPC) is set to meet on Wednesday, 29th April 2020, to review the outcome of its previous policy decisions and recent economic developments, and to make a decision on the direction of the Central Bank Rate (CBR). In their previous meeting held on 23rd March 2020, the committee decided to reconvene within a month for an early assessment of the impact of these measures and the evolution of the COVID-19 pandemic. In the last sitting, they lowered the CBR by 100 bps to 7.25% from 8.25% and reduced the Cash Reserve Requirement (CRR) to 4.25% from 5.25% citing that the Coronavirus pandemic was expected to adversely affect economic growth and as such, the need to cushion the economy against the effects of the pandemic and whilst preventing the COVID-19 health crisis from becoming a severe economic and financial crisis. This was in line with our expectations as per our MPC Note with our view having being informed by:

i. Expectations of cost-Push Inflation due to supply-side shortages caused by lockdowns across the globe which would have seen prices of consumer and capital goods in the market rising to exorbitant levels as the supply would be unable to meet the demand in the market. We foresaw the locust invasion which had plagued the country since the end of 2019 greatly affecting the agricultural sector, causing a further increase in food prices, and,
ii. The instability of the Kenyan Shilling which had already lost by 2.0% YTD in 2020, then and having recorded the lowest performance since October- 2019 reflecting a less stable economic environment due to high dollar demand from foreigners exiting the market as they directed their funds to safer havens.

The Monetary Policy Committee also noted that the current account deficit was projected to come in at 4.0%-4.6% of GDP in 2019 compared to 5.0% in 2018, supported by a lower petroleum products import bill which was expected to moderate the impact of COVID-19 on the current account.

Below, we analyze the trends of the macro-economic indicators since the March 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 March 2020	Going forward	Probable CBR Direction (March)	Probable CBR Direction (April)
Government Borrowing	· The Government, as at 24th April 2020, was 22.1% behind its current borrowing target having borrowed 266.5 bn against a prorated borrowing target of 342.2 bn and has to borrow on average Kshs 175.8 bn monthly in the current financial year to meet its domestic borrowing target of Kshs 404.4 bn and has domestic maturities worth 226.7 bn ·	· In the recently approved Supplementary Budget estimates II, the Government raised its net domestic borrowing target by 34.7% to Kshs 404.4 bn for FY'2019/20 from Kshs 300.3 bn. Given the current market conditions and with the Government currently having a net domestic borrowing of Kshs 222.8 bn, with only 2 months remaining to the end of the FY'2019/20, we expect this to exert pressure on the domestic borrowing front to plug in the deficit. · Given the current uncertainty in the Global Financial markets, the government may also find it hard to access foreign debt with investors attaching a high-risk premium on the country due to the economic risks abound from the effects of the COVID-19 pandemic.	**Negative**	**Negative**
Inflation	· Inflation for the month of March came in at 6.1%, bringing the m/m increase to 0.2%. Y/Y inflation increased mainly driven by an 11.9% increase in the food and non-alcoholic beverages index.	· Inflationary pressure is expected to emanate from the locust invasion which has plagued the country since the end of 2019 greatly affecting the agricultural sector. The country is expecting a second wave of locust invasion and this is likely to cause a further increase in food prices which has a new weighting of 32.9% in the Consumer Price Index (CPI). Inflationary pressure will be mitigated by the decline in oil prices across the globe due to a decline in demand. We expect a decline in the transport index, which has a new weighting of 9.7% in the total consumer price index (CPI), due to the decrease in petrol and diesel prices.	**Neutral**	**Neutral**
Currency (USD/Kshs)	· The Kenya Shilling has depreciated by 0.9% against the US Dollar to Kshs 107.0, from Kshs 106.0 during the last meeting, attributable to due to a slowdown in foreign dollar currency inflows from diaspora remittances and fewer offshore investors to meet dollar demand. Forex reserves have however declined to USD 8.0 bn (equivalent to 4.8 months of import cover) from USD 8.3 bn (equivalent to 5.0 months of import cover) since the last meeting. This however still meets the CBK's statutory requirement to endeavor to maintain at least 4 months of import cover and the EAC region's convergence criteria of 4.5 months of import cover, thus providing an adequate buffer for the Kenyan Shilling from external shocks	· In our view, we expect continued pressure on the shilling with the sentiments being on the back of high dollar demand from foreigners exiting the market as they direct their funds to safer havens as well as merchandise, and energy sector importers beefing up their hard currency positions amid a slowdown in foreign dollar currency inflows from diaspora remittances and fewer offshore investors to meet dollar demand.	**Negative**	**Negative**

Indicators	Experience since the last MPC meeting in March 2020	Going forward	Probable CBR Direction (March)	Probable CBR Direction (April)
GDP Growth	· Kenya's economy expanded by 5.1% in Q3'2019, a decline from the 6.4% recorded in Q3'2018, which was due to: i. A slowdown in the Agricultural sector to 3.2% in Q3'2019 from 6.9% in Q3'2018 attributed to a drop in production of key crops in the country such as tea, vegetable, and fruit exports ii. A slowdown in the manufacturing sector to 3.1% in Q3'2019 compared to a growth of 4.6% in Q3'2018, largely attributed to the decline in agro-processing activities that were also subdued as a result of the reduced production of tea and sugar	· The key sectors of the economy affected by the Coronavirus pandemic include the Tourism, Agricultural, and Manufacturing sectors which were hit the hardest hit due to shutdowns in major markets and the disruption of the global supply chain. Combined, the 3 sectors account for 43.8% of Kenya's GDP in 2018. · Based on the impacts witnessed so far we have also lowered the GDP growth estimates to 1.4%- 1.8% for the year 2020 depending on the severity of the outbreak and economic implications for Kenya.	**Negative**	**Negative**
Private Sector Credit Growth	· The latest data from CBK indicates that private sector credit growth recorded a growth in the 12 months to February 2020 to 7.7% from 7.1% recorded in December 2019 but below the 5-year average of 11.2%	· The effects of the coronavirus pandemic are expected to negatively affect the financial sector. We expect to see increased caution on lending especially to businesses that rely on imports hence inhibiting private credit sector growth due to the high risk of credit default, with the possibility of heightened Non Performing Loans if the pandemic is to continue	**Neutral**	**Neutral**
Liquidity	· Liquidity levels in the money markets tightened with the average interbank rate to 22nd April 2020 coming in at 5.7% up from the 4.6% recorded on 23rd March 2020, due to tax payments that offset government payments.	· Liquidity is expected to remain favorable with the heavy maturities of domestic debt in 2020 that currently stand at Kshs 176.3 bn worth of T-bill maturities and Kshs 50.35 bn worth of T-bond maturities. The government has also approved a Kshs 40.0 bn package to cushion needy households in urban areas from economic shocks following reduced activity in the wake of the coronavirus pandemic. Out of this, Kshs 10.0 bn has been set aside for VAT tax refunds and this is likely to increase liquidity in the market.	**Neutral**	**Neutral**

Conclusion

Of the six factors that we track, three are neutral and three are negative, with no changes between March 2020 and April 2020. Central Banks around the world have been moving to cut the Central Bank Rate in a bid to boost the economy amid the economic uncertainty brought about by the Coronavirus. This has seen the Central Bank of Kenya cut its country's growth prospects to 3.4% from their earlier projections of 6.2%. Most Central Banks around the world have taken a dovish monetary policy stance in a bid to boost the economy amid the negative macroeconomic effects emanating from the coronavirus outbreak. The table below shows how Central Banks of major global economies that have moved to cut interest rate so far;

No.	Country	Central Bank	Rate in March 2020	Current Rate	Variance
1	USA	Federal Reserve	0%-0.25%	0%-0.25%	0.00%
2	Australia	Reserve Bank of Australia	0.5%	0.25%	(0.25%)
3	China	People's Bank of China	4.1%	3.85%	(0.25%)
4	Malaysia	Central Bank of Malaysia	2.75%	2.50%	(0.25%)
5	England	Bank of England	0.25%	0.10%	(0.15%)

We expect the MPC to further cut the Central Bank Rate (CBR) by 25 bps to 7.00% from 7.25%, with their decision mainly being supported by:

i. Cost-Push Inflation which continues to be a threat to the economy due to the locust invasion which has plagued the country since the end of 2019. Experts have warned that the country is likely to experience a second wave of locust invasion and this may greatly affect the agricultural sector, causing a further increase in food prices which has a new weighting of 32.9% in the Consumer Price Index (CPI). Inflation may, however, be slowed down by the decline in oil prices across the globe due to a decline in demand. We, therefore, expect a decline in the transport index, which has a new weighting of 9.7% in the total consumer price index (CPI), due to the decrease in petrol and diesel prices,
ii. The instability of the Kenyan Shilling having already lost by 5.6% YTD in 2020 reflecting a less stable economic environment. The country is experiencing high dollar demand from foreigners exiting the market as they direct their funds to safer havens as well as merchandise, and energy sector importers beefing up their hard currency positions amid a slowdown in foreign dollar currency inflows from diaspora remittances and fewer offshore investors to meet dollar demand, and,
iii. The MPC may also cut the rate further to continue encouraging financial institutions to lend money to the private sector as most businesses may need to take up loans for business continuity purposes due to subdued revenues.

We maintain our view that monetary policy stimulus measures may not be highly effective in combating the effects emanating from the COVID-19 pandemic especially in some sectors such as the tourism sector which have been hit by demand-side issues. We believe what businesses and the economy as a whole needs is financial relief as highlighted in our report on COVID-19 Economic Containment Policies in order to ensure survival during this period of uncertainties. So far, the government has announced tax relief through the reduction of tax rates for both individual and corporate incomes. In addition to the ongoing public health initiatives, the government can also explore the following additional options:

i. Initiating an enhanced Economic Stimulus Package to help spur the economy and hasten its recovery following the effects of the novel coronavirus. This will be directed to the affected sectors such as tourism and horticulture,
ii. Social transfers to vulnerable persons, laid-off workers, and self-employed persons in the informal sector for 3 months. This can be done through a "Lifeline Fund" where these payouts will cushion the affected households and ultimately help enforce the set curfews and movement restrictions in an effort to curb the spread of the novel coronavirus,
iii. Setting up a credit facility to lend to businesses that have kept their staff on payroll to help reduce job losses attributable to the current economic situation,
iv. Reaching out to external partners to help mobilize response capacity putting into consideration the country's current fiscal position. International organizations such as the IMF & World Bank can provide financial aid to be directed towards containing the spread and adverse effects of COVID-19,
v. Initiate conversations with our foreign debtors regarding the existing repayment arrangements of the country's debt and propose a debt relief, having considered the current market conditions. Restructuring the existing bilateral, multilateral and foreign commercial debt will help ensure the livelihoods of the citizenry is not compromised,
vi. Encourage banks to give concessionary loans at lower rates to facilitate businesses, and as well provide moratoriums on loans that are due, and,
vii. Strengthen the local supply chain for traders to be able to access import substitute goods.

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