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

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The Monetary Policy Committee (MPC) is set to meet on Wednesday, 29th July 2020, 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 25th June 2020, the committee decided to reconvene within a month for an early assessment of the impact of the measures already in place, and the evolution of the COVID-19 pandemic. In the last sitting, the MPC maintained the CBR at 7.00% citing that the accommodative policy stance adopted in March, April and May 2020 sittings, which saw a cumulative 125bps 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 having remained within the government's target range of 2.5% -7.5%. The projected pressure due to increased oil prices is not expected to have significant impact on inflation as food prices remain stable and the purchasing power is reduced as people lose jobs due to the pandemic. The high Liquidity in the money market is not expected to be inflationary as most of the cash is in the banking sector and not necessarily in great circulation,
ii. The economic growth is expected to have been impacted significantly by the recent Kshs 56.6 bn Economic Stimulus Package that was unveiled by the President in June 2020. The funds were expected to help both the Medium, Small and Medium Enterprises (MSMEs) as well as promote tourism through provision of credit guarantee loans. As such, we believed that this would reduce pressure on the MPC to pursue additional policy measures, and,
iii. The currency has been depreciating, having lost 6.0% to USD since the beginning of the year attributable to high dollar demand from foreigners exiting the market as they direct their funds to safer havens. As such, further rate cut would put the shilling under pressure thus making Kenya a less attractive investment destination.

The Monetary Policy also noted that the current account deficit was projected to remain stable at 5.8% of GDP in 2020, from the previously recorded deficits of 5.0% and 4.3% of GDP in 2018 and 2019 respectively. Additionally, the MPC noted that there was a recovery in the month of May supported by improved agricultural output as well as government efforts, which continued to moderate the impact of the pandemic.

Below, we analyze the trends of the macro-economic indicators since the June 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 June 2020	Going forward	Probable CBR Direction (June)	Probable CBR Direction (July)
Government Revenue collections	• For the first half of 2020, revenue collection activities of the government have been affected due to the ongoing pandemic with major economic sectors such as tourism, manufacturing and agriculture feeling the brunt effects of the pandemic following supply-side shocks, • The government projects that total revenue in FY'2020/2021 will contract by 2.1% to Kshs 1.85 tn from the Kshs 1.89 tn in FY'2019/2020 attributable to low revenue collections	• Given the fiscal measures unveiled by the president to cushion businesses and individuals against the effects of the pandemic, we are pessimistic on the government's ability to meet its revenue collection targets in this current environment	N/A	Neutral
Government Borrowing	• The Government, as at 17th July 2020, was 87.4% ahead its current borrowing target having borrowed Kshs 52.6 bn against a prorated borrowing target of Kshs 28.1 bn and has to borrow on average, Kshs 115.7 bn monthly in FY'2020/2021 to meet its domestic borrowing target of Kshs 486.2 bn and has domestic maturities worth Kshs 955.3 bn	• There is increased demand for government debt due to increased liquidity in the money market hence leading to a decline in interest rates, • Despite the low ability for fiscal consolidation, we project that the government will easily raise cash from local borrowing given the increased demand for government securities. We also believe that the government will also raise cash through the international markets as the development organizations come to help developing countries	Negative	Neutral
Inflation	• Y/Y inflation for the month of June came in at 4.6%, while the m/m decreased marginally by 0.3%. Y/Y inflation increased mainly driven by an 8.2% increase in the food and non-alcoholic beverages index and a 4.9% increase in the transport index on account of increase in the fuel prices with petrol prices increasing by 6.8%	• We expect inflation to remain stable despite supply side disruption due to COVID-19 as low demand for commodities compensates for the cost-push inflation, coupled with the low oil prices in the international markets. The recent reopening of majority of the global markets will also address supply chain issues causing import prices to stabilize	Positive	Positive
Currency (USD/Kshs)	• The Kenya Shilling has depreciated by 0.9% against the US Dollar to Kshs 107.4, from Kshs 106.4 during the last meeting, attributable to increased dollar demand from importers as global economies continue easing movement restrictions. • Increased levels of Forex Reserves to USD 9.7 bn (equivalent to 5.9 months of import cover) from USD 9.2 bn (equivalent to 5.6 months of import cover) since the last meeting, thereby providing adequate buffer to the shilling against foreign exchange shocks	• We maintain our view on the continued pressure on the Kenyan shilling, with the performance being on the back of increased dollar demand from merchandise importers as the easing of coronavirus restrictions jumpstart economic activities, thus boosting demand for hard currency	Negative	Negative
GDP Growth	• Kenya's economy grew by 4.9% in Q1'2020, a decline from the 5.5% recorded in Q1'2019, which was due to: 1. A 9.3% slowdown in the Accommodation and Food Services Sector compared with the growth of 11.0% recorded in Q1'2019, The decline was however mitigated by; 2. The Agricultural sector which recorded a slightly faster growth of 4.9%, compared to 4.7% seen in Q1'2019, and, 3. Faster growth in the: Mining and Quarrying, Education, Health and Agriculture and Forestry sectors which grew by 9.5%, 5.3%, 5.8% and 4.9% in Q1'2020, from 1.4%, 4.3%, 5.4% and 4.7%, respectively, recorded in Q1'2019;	• We expect subdued performance for the rest of the year mostly informed by the slower business activity experienced during the first half of the year in the country evidenced by the PMI's decline to lows of 34.8 recorded in April, and, • Based on the impacts witnessed so far we 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 May 2020 to 8.1% from 7.1% recorded in December 2019 but below the 5-year average of 11.2%	• The tough economic conditions have brought about by the pandemic has increased the cash constraint on businesses as well as households with most businesses struggling to keep afloat due to subdued revenues. Consequently, this led to high Gross Non-Performing Loans in Q1'2020 of 11.3%, from 10.4% recorded in Q1'2019 • 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

Indicators	Experience since the last MPC meeting in June 2020	Going forward	Probable CBR Direction (June)	Probable CBR Direction (July)
Banking Sector Liquidity	• Liquidity levels in the money markets increased with the average interbank rate on 17th June 2020 coming in at 1.8% from the 2.6% during the last meeting on 25th June, supported by government payments and maturing TADS of Kshs 162.2 mn. (TADs are used when the securities held by the CBK for Repo purposes are exhausted or when CBK considers it desirable to offer longer tenor options).	• Liquidity is expected to remain favorable due to: 1. High domestic debt maturities in 2020 that currently stand at Kshs 832.7 bn worth of T-bill maturities and Kshs 122.6 bn worth of T-bond maturities, 2. 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	Neutral	Neutral

Conclusion

Of the factors that we track, four are neutral, two are negative and one is positive, with one change in our government borrowing projections from negative to neutral, between June 2020 and July 2020. Central Banks around the world have adopted a wait and see approach by maintaining the Central Bank Rate at the previous levels citing that the accommodative policy stance was helping their economies. The table below shows how Central Banks of major global economies have moved to maintain/cut their interest rates so far:

Central Bank of Malaysia

Malaysia

[illegible]		
Federal Reserve	USA	0% / 0-0.25%
Reserve Bank of Australia	Australia	0.25% / 0.50%

Rate		
	People's Bank of China	[illegible]
	Bank of England	[illegible]

The main goal of the monetary policy is to maintain price stability and support economic growth by controlling 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. The high liquidity in the money market especially given that the previous reduction in CRR ratio has not resulted in significant increase in lending to the private sector. Furthermore, we believe that additional rate cuts will not lead to Private sector growth given the reduced economic activities in Kenya's key sectors as well as the reduced lending by banks,
ii. For economic growth stimulations, the government is already employing some fiscal stimulus such as the Kshs 5.0 COVID-19 Stimulus benefit package to Small and Medium (SMEs). The government has recently announced that it would disperse the funds under the Credit Guarantee Schemes to aid the SMEs affected by the virus,
iii. Additional rate cuts would lead to a further depreciation of the Shilling thus reducing

Kenya’s attractiveness as an investment destination, and,

iv. Inflation is expected to remain stable and within the government’s target range of 2.5% -7.5% on account of the reopening of the Global markets which will address supply chain issues causing import prices to stabilize coupled with depressed global oil prices. Given that one of the main goals of monetary policy is to ensure price stability, we believe that the stable inflation rate will not exert pressure on the MPC to implement inflationary control.

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