Cytonn Q3'2020 Markets Review

Kenya Macroeconomic Review

Kenya's economy grew by 4.9% in Q1'2020, a decline from the 5.5% recorded in Q1'2019, which was due to: 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; the agricultural sector which recorded a slightly faster growth of 4.9%, compared to 4.7% seen in Q1'2019, and, 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;

Economic growth for Kenya is projected to be significantly lower with the IMF projecting a growth of 1.0% while the treasury projected 2.5% growth. For the first quarter of 2020, the impacts of the virus had not taken a big toll and we saw growth coming in at 4.9% a 2 – year low, compared to 5.5% recorded in a similar period of review in 2019. The economic prospects have been improving with the Stanbic Bank's Monthly Purchasing Manager's Index (PMI), for August coming in at 53.0 after a recording of 54.2 in July 2020, which is higher than the H1'2020 average of 42.2. For more information, see our Q1'2020 GDP Note;

Inflation:

Inflation rates have remained relatively stable with the quarterly average at 4.3% down from 5.0% recorded in Q3'2019. The September inflation rate came in at 4.2%. The low inflation rate can be attributed to the low food prices which has more than offset the increases in oil prices over the year. Below chart is the inflation chart

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. The recent reopening of a majority of the global markets will also address supply chain issues causing import prices to stabilize.

The Kenya Shilling:

The Kenya Shilling depreciated by 1.9% during the quarter bringing the YTD deprecation to 7.1% against the US Dollar to close at Kshs 108.5, from Kshs 101.3 at the end of December 2019. The depreciation can be attributed to the uncertainty in the global economy and also the decline in dollar inflows as trade is impacted. Going forward the shilling shall remain under pressure due to:

1. Continued uncertainty globally making people prefer holding dollars and other hard currencies,
2. A deteriorating current account position: we saw current account deficit deteriorate by 10.2% during Q1'2020, coming in at Kshs 110.9 bn, from Kshs 100.6 bn in Q1'2019 attributable to;
    a. 0% decline in the secondary income (transfers recorded in the balance of payments whenever an economy provides or receives goods, services, income or financial items) balance, to Kshs 124.1 bn, from Kshs 128.0 bn in Q1'2019, and,
    b. A 67.0% decline in the services trade balance (the difference between the imports and exports of services) to Kshs 20.4 bn, from Kshs 61.9 bn.
3. Demand from merchandise and energy sector importers as they beef up their hard currency

positions amid a slowdown in foreign dollar currency inflows,

However the shilling is expected to have support from;

i. The high levels of forex reserves, currently at USD 8.5 bn (equivalent to 5.2-months of import cover), above the statutory requirement of maintaining at least 4.0-months of import cover, and the EAC region's convergence criteria of 4.5-months of import cover,
ii. Relatively strong Diaspora remittances that increased by 27.9% to USD 274.1 million in August compared to USD 214.3 million in August 2019, despite being 1.0% lower than the USD 277.0 million in July 2020.

Monetary Policy:

During the quarter the Monetary Policy Committee met twice and, in both instances, held the both the Central Bank Rate stable at 7.0% and the Cash Reserve ratio remained unchanged at 4.25%. This move was after a reduction of the Central Bank Rate to 7.00% from 8.25% and Cash Reserve Ratio to 4.25% from 5.25% at the beginning of the year. The Committee's move was supported by the fact that the economy was positively reacting to the changes earlier in the year.

Budget Watch 2020/2021

During Q3'2020 the Parliamentary Budgetary Office highlighted in their Budget watch 2020/21 and the Medium Term, that the current budget would most likely not steer the country out of the current crisis. Some of the highlights from the report included;

i. **Revenue Prospects during the Pandemic**: The ordinary revenue collected as of June 2020 was Kshs 1.6 tn, Kshs 300.0 bn (16.0%) below the set target of Kshs 1.9 tn according to the Budget estimates. The National Treasury projects ordinary revenue to decline from Kshs 1,643.4 bn in 2019/20 (revised estimates II) to Kshs 1,621.4 bn in 2020/21. A decline in income tax collection is expected to be among the major drivers of the expected decline in revenue due to income loss by workers across most sectors. According to the treasury, the ministry is targeting a fiscal deficit of 7.3% for FY2021/2022, down from the current financial year's deficit of 8.4%,
ii. **Debt Management FY'2020/21:** The country's debt servicing will be a significant source of liquidity pressures in FY'2020/21. Public debt service expenses are projected to increase by Kshs 157.7bn (about 20.0%) to Kshs 925.9 bn in FY'2020/21, and,
iii. **Monetary Policy:** To support the economy, the Central Bank initiated various measures to ensure there is ample liquidity in the economy. These include; the lowering of the Central Bank Rate so as to make loans more affordable, lowering the cash reserve ratio by 100 bps to 4.25%, and increasing the maximum tenor of repurchase agreements from 28 days to 91 days. As a result of the accommodative stance, lending rates have declined to 11.9% as of June 2020, from 12.3% seen in December 2019. For more information, see our Cytonn Weekly #37/2020