Monetary Policy Committee Meeting for March 2017

Cytonn Weekly

The Monetary Policy Committee (MPC) is set to meet on Monday 27th March 2017 to review the prevailing macro-economic conditions and give direction on the Central Bank Rate (CBR). In their previous meeting, held in January 2017, the MPC maintained the CBR at 10.0% citing (i) robust economic growth in Q3?2016, supported by macro-economic stability, public investment in infrastructure, lower energy prices and the recovery of the tourism sector, (ii) the stability of the currency supported by a narrowing current account deficit, from 6.8% of GDP in 2015, to an estimated 5.5% in 2016, (iii) high forex reserves level at 4.5 months of import cover, as well as the IMF facility, of which the Central Bank of Kenya (CBK) could tap into in case of economic shocks, (iv) stable inflation which remained within the government annual target of between 2.5% - 7.5%, and (v) the stability of banking system in terms of liquidity distribution with the average liquidity ratio for commercial banks at 41.4% in January, from 43.6% in October 2016. However, the MPC noted that the available data at the time was inadequate to make a conclusion as to the impact of the Banking Act (Amendment) 2015 on the banking sector and the economy in general.

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

Key Macro-Economic Indicators ? Kenya					
Indicators	**Expectations at start of 2016/2017 Fiscal Year**	**Experience since the last MPC meeting on 30th January 2017**	**Going forward**	**Probable CBR Direction (Last Meeting)**	**Probable CBR Direction (This month)**

Government Borrowing	Government expected to borrow Kshs. 229.6 bn domestically for the 2016/2017 financial year and Kshs 462.3 bn from the foreign market	The government is ahead of its domestic borrowing target having borrowed Kshs. 188.1 bn against a target of Kshs 163.4 bn (Kshs 209.6 bn if revised). The Government is in the process of revising the domestic borrowing target to Kshs 294.6 while reducing the foreign borrowing to Kshs 287.6 bn (Kshs 203.5 bn borrowed so far, representing 44.0% of the Kshs 462.3 bn target)	There exists possible upward pressure on interest rates as (i) the government has only borrowed 44.0% of the budgeted foreign borrowing, and, (ii) the Kenya Revenue Authority (KRA) having already missed its first half of 2016/17 fiscal year revenue collection target by 3.2%. However, the Central Bank of Kenya (CBK) has remained disciplined in stabilizing interest rates, while reduced credit to private sector, which may make it easier for government to bridge the foreign borrowing deficit through local domestic borrowing	**Neutral**	**Neutral**
Revenue Collection	KRA to meet the revenue collection target	Kenya Revenue Authority (KRA) has already missed its first half of 2016/17 fiscal year revenue collection target by 3.2%, and it is expected to miss its overall revenue collection target of Kshs 1.5 tn for the current fiscal year given the reduced earnings growth by corporates	Given the Interest Rate Caps, we expect subdued earnings by the banking sector. Given that the government is already behind on revenue collection, we expect government not to meet its target	**Negative**	**Negative**

Inflation	To remain within the government annual target of between 2.5% - 7.5%	Increased to 9.0% in the month of February from 7.0% in January, on account of rises in food and fuel prices	We expect upward inflationary pressures to persist in the first half of 2017, and average 8.6% over the course of the year, which is above the upper bound of the government annual target range of 2.5% - 7.5%, despite expectations that the food situation will improve in the second half of 2017.	**Neutral**	**Negative**
Currency (USD/Kshs)	To remain stable supported by dollar reserves and improved foreign exchange inflows through improved diaspora remittances and tea exports	The shilling has appreciated by 1.0% against the dollar since the last meeting on account of reduced dollar demand from oil and retail goods importers coupled with dollar inflows from foreign investors and horticultural produce exporters	We expect the currency to depreciate against the dollar driven by (i) global strengthening of the dollar as the Fed plans to increase the pace of rate hike in 2017, and (ii) recovery of the global oil prices. However, it is important to note that the CBK has sufficient reserves (equivalent to 4.6 months of import cover) to support the shilling in the short term	**Neutral**	**Neutral**

Private Sector Credit Growth	We expected Private Sector credit growth to average around the government set target of 18.0%	The latest data from CBK indicates that private sector credit growth slowed to 4.3% for the 17th consecutive month to December 2016	While it is expected that private sector credit growth will stabilize at low levels, it is yet to be attributed to the interest rate caps, bearing in mind private sector credit growth had slumped for the 13th consecutive month, to 5.4% in August 2016, when the interest rate caps came into play. The slow-down in credit has been attributed to structural factors in the banking sector as opposed to monetary policy	**Neutral**	**Neutral**
Liquidity	Liquidity expected to improve given high maturities of government securities	The liquidity levels in the money market has improved since January, with the interbank rate declining from an average of 7.7% in January to 4.8% currently	We expect improved liquidity in the money market, with heavy maturities of treasury instruments in the last quarter of the fiscal year, and the CBK participating actively in the reverse repo market in a bid to ease any liquidity challenges in the money market	**Neutral**	**Neutral**

Conclusion

Of the six key indicators that we track, four are neutral and two negative, with all the indicators apart from inflation, which has moved from a neutral to a negative, maintaining their position from the last MPC meeting.

Despite the pressure to increase the CBR brought about by an uptick in inflation, we are of the view that MPC will maintain the CBR at 10.0%.

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