Monetary Policy Committee (MPC) Meeting for May 2017

Cytonn Weekly

The Monetary Policy Committee (MPC) is set to meet on Monday 29th May 2017 to review the prevailing macro-economic conditions and give direction on the Central Bank Rate (CBR). In their previous meeting, held in March 2017, the MPC maintained the CBR at 10.0% on account of (i) the currency remaining stable due to a narrower current account deficit and high forex reserves, and (ii) the banking sector remaining resilient, with the average commercial banks liquidity ratio and capital adequacy ratio at 43.2% and 19.7%, respectively. Inflation was projected to remain above the government target range of 2.5% - 7.5% due to high food prices. There are still risks to economic growth brought about by (i) the slow-down in private sector credit growth that slumped to 4.0% in the first quarter of 2017, and (ii) uncertainty in the global market due to Brexit and changes as a result of the Trump administration.

Below, we analyse the macro-economic indicators trend since the March 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 2016/17 Fiscal Year	Experience since the last MPC meeting in March 2017	Going forward	Probable CBR Direction (March)	Probable CBR Direction (May)

Budget Deficit	The government expected to borrow Kshs 229.6 bn domestically for the 2016/2017 financial year and Kshs 462.3 bn from the foreign market, while KRA expected to meet its revenue collection target of Kshs 1.5 tn	The government is behind its overall borrowing target, having borrowed Kshs 554.3 bn against a target of Kshs 756.9 bn (assuming a domestic borrowing target of Kshs 294.6 bn throughout the financial year as per the supplementary budget), representing 73.2% of the target. The government is also behind its spending target with total expenditure for the first half of the 2016/17 fiscal year coming in at Kshs 928.5 bn, which represents 83.6% of the pro-rated target of Kshs 1.1 tn	(i) The government is expected to meet its domestic borrowing target, while missing its foreign borrowing target (ii) KRA fell 6.2% behind its target as at the third quarter of the current fiscal year (iii) Expenditure is also behind target, with government having spent 83.6% of its pro-rated half year target Overall, there isn?t significant pressure as government can easily borrow from the domestic market	Neutral	Neutral
Inflation	To remain within the government annual target of between 2.5% - 7.5%	Increased to 11.5% in the month of April from 10.3% in March, due to a rise in food prices attributed to the ongoing drought	We expect upward inflationary pressures to persist in the first half of 2017, and average 11.8% 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.	Negative	Negative

Currency (USD/Kshs)	To remain stable supported by dollar reserves and improved foreign exchange inflows through increased diaspora remittances and tea exports	The shilling has depreciated by 0.3% against the dollar since the last meeting on account of increased dollar demand from oil and retail goods importers and by 0.8% on a YTD basis	We expect the currency to depreciate against the dollar driven by (i) global strengthening of the dollar as the Fed increases the pace of rate hikes in 2017, and (ii) recovery of the global oil prices. However, it is important to note that the CBK has sufficient reserves (equivalent to 5.5 months of import cover) to support the shilling in the short term	Neutral	Neutral
Private Sector Credit Growth	Private sector credit growth expected to average around the government set target of 18.3%	The latest data from CBK indicates that private sector credit growth slowed to 4.0% at the beginning of 2017	Private sector credit growth has remained low at 4.0%. The slow-down in credit has been attributed to structural factors in the banking sector, evidenced by increasing levels of non-performing loans and subsequent provisioning, as opposed to monetary policy	Neutral	Neutral
Liquidity	Liquidity expected to improve given high maturities of government securities	The money market has been relatively liquid since March, with bank?s excess reserves at Kshs 4.7 bn, while the average interbank volumes have decreased to Kshs 7.9 bn from Kshs 13.2 bn over the same period	(i) Money supply growth is high, at 23.7% in February, and the trend could be inflationary (ii) There are heavy maturities of government securities leading to more liquidity in the market	Neutral	Neutral

Conclusion

Looking at the current operating environment;

- the currency is relatively stable but could come under pressure due to Fed rate hikes and a widening current account deficit caused by increased oil importation,
- economic growth for 2017 is projected to come in lower than the 5.8% registered in 2016 due to subdued growth in the agriculture sector and financial intermediation,
- private sector credit growth is at an 8-year low,

- there is reduced pressure on government to borrow in this fiscal year, and
- the current political environment is heating up ahead of the August elections.

Given the above factors, we expect that the MPC shall hold rates steady at 10.0%, despite the high inflation rate, since it is more supply driven. However, the high growth in money supply is something that may be of concern.

Kind regards,

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