Cytonn Note on the Monetary Policy Committee (MPC) Meeting for July 2017

Cytonn Weekly

The Monetary Policy Committee (MPC) is set to meet on Monday, 17th July 2017 to review the prevailing macro-economic conditions and give direction on the Central Bank Rate (CBR). In their previous meeting held in May 2017, the MPC maintained the CBR at 10.0% on account of (i) the foreign exchange market, which remained relatively stable, supported by 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 44.4% and 18.8%, respectively, while the gross NPL ratio for the sector declined slightly to 9.6% in April from 9.7% recorded in February. Inflation was projected to stabilize in the second half of the year due to the rainfall witnessed in the second quarter of 2017, albeit depressed, and government interventions, but the MPC noted that inflation would remain above the government target range of 2.5% - 7.5% due to the elevated food prices. GDP growth for the first quarter of the year came in at 4.7% due to a slow-down in the agriculture and financial services sector, and GDP growth for the year 2017 is expected to come in between 4.7% and 5.2%, mainly supported by ongoing heavy public investment in infrastructure. Despite this, there are still risks to economic growth brought about by (i) the slow-down in private sector credit growth that slumped to 3.3% in March, from 15.5% recorded the same time last year, (ii) the widening current account deficit, which expanded by 36.1% in March 2017 to USD 4.6 bn from USD 3.4 bn the same time last year, and (iii) uncertainty in the global market due to Brexit and changes expected to be brought about by the Trump administration.

Below, we analyse the macro-economic indicators trend since the May 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 2017/2018 Fiscal Year**	**Experience since the last MPC meeting in May 2017**	**Going forward**	**Probable CBR Direction (May)**	**Probable CBR Direction (July)**

Budget Deficit	The government is expected to borrow Kshs 317.7 bn from the domestic market for the 2017/2018 financial year and Kshs 206.0 bn from the foreign market, while KRA has a revenue collection target of Kshs 1.7 tn for the 2017/18 fiscal year	The government surpassed its domestic borrowing target for the 2016/17 fiscal year, having borrowed Kshs 440.1 bn against a target of Kshs 294.6 bn, and hence was under no pressure to borrow, despite lagging in foreign borrowing and KRA being behind its collection target of Kshs 1.5 tn. The government is ahead of its domestic borrowing target for the current fiscal year, having borrowed Kshs 10.6 bn against a target of Kshs 6.1 bn (assuming a pro-rated borrowing throughout the financial year of Kshs 317.7 bn budgeted for the full financial year)	(i) The government is expected to meet its domestic borrowing target for the 2017/18 fiscal year, as reduced credit to private sector following the capping of interest rates will make it easier for government to meet its domestic borrowing target, as banks channel funds more actively towards government securities (ii) The government is expected to meet its foreign borrowing target in the 2017/18 fiscal year, as budget estimates have been revised downwards to Kshs 206.0 bn from Kshs 462.3 bn previously (iii) KRA is expected to face challenges in meeting its overall revenue collection target of Kshs 1.7 tn for the 2017/18 fiscal year due to the expected subdued corporate earnings growth Overall, we don't expect the government to be under pressure in order to meet the borrowing targets for fiscal year 2017/18	**Neutral**	**Neutral**
Inflation	To average above the government annual target of between 2.5% - 7.5% in 2017	Declined to 9.2% in the month of June from 11.7% in May, due to a decline in food and fuel prices	We expect the inflation rate to stabilize in the second half of the year but to average above the 7.5% upper bound government target in 2017	**Negative**	**Neutral**

Currency (USD/Kshs)	To remain stable supported by dollar reserves	The shilling has depreciated by 0.4% against the dollar since the last meeting and by 1.3% on a YTD basis on account of increased dollar demand from oil and retail importers	Kenya's forex reserves fell to a 3-month low of USD 7.9 bn (equivalent to 5.2 months of import cover), with the country's trade of balance position worsening, as the trade deficit increased by 43.1% to Kshs 352.5 bn from January to April 2017 on the back of the country's increased maize importation. Despite this, we expect the currency to remain relatively stable against the dollar, supported by the CBK, which has sufficient reserves, and the low global oil prices	**Neutral**	**Neutral**
Private Sector Credit Growth	Private sector credit growth expected to remain at low levels, below the government set target of 18.3%	The latest data from CBK indicates that private sector credit growth slowed to 3.3% in March 2017, from 15.5% recorded the same time last year, which is below the government set target of 18.3%	Private sector credit growth has remained low at 3.3% and the capping of interest rates has not served to ease the situation as the government crowds out the private sector of credit	**Neutral**	**Negative**
Liquidity	Liquidity expected to remain high given heavy maturities of government securities and following the capping of interest rates	The money market has been relatively liquid since May, with bank's excess reserves at Kshs 6.1 bn and the average interbank rate remaining low and relatively unchanged at 5.0% from the last meeting	(i) Money supply growth is high, at 22.1% as at March, and the trend could be inflationary (ii) There are heavy maturities of government securities leading to more liquidity in the market	**Neutral**	**Negative**

Conclusion

Of the five factors that we track, two have worsened from neutral to negative, two have remained neutral, while one has turned neutral from negative. This indicates that going by these factors, MPC should adopt a tightening monetary policy decision. However, looking at the trend in private sector credit growth, which is now at an 8-year low, and the

slowdown in GDP growth, we expect that the MPC will hold the CBR at 10.0%, in order to support economic growth that came in at 4.7% in the first quarter of 2017 and is projected to be between 4.7% and 5.2% for the year 2017, lower than 5.8% in 2016.