Cytonn Q3’2024 Markets Review

Kenya Macroeconomic Review

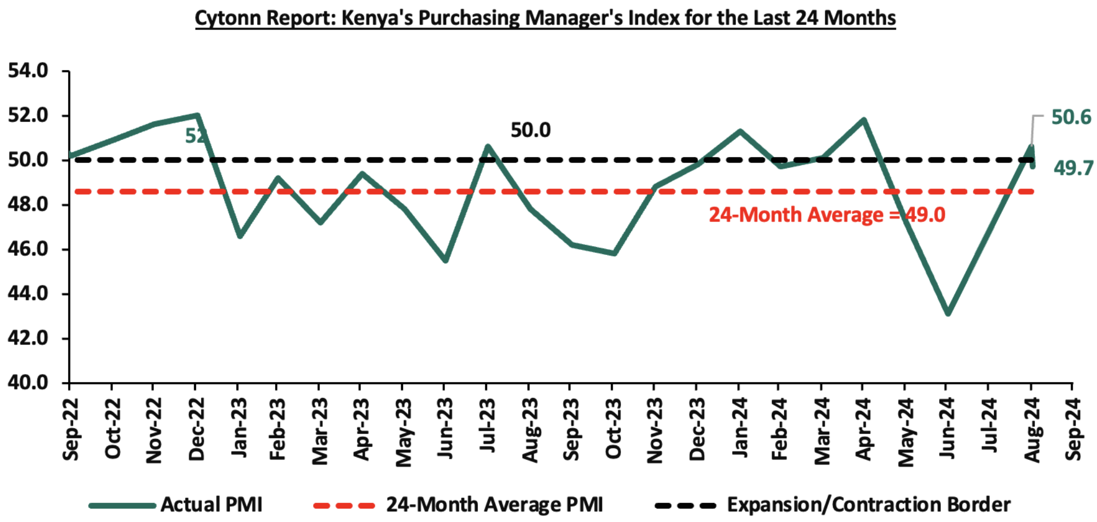
According to the Kenya National Bureau of Statistics (KNBS) Q2’2024 Quarterly Gross Domestic Product Report, the Kenyan economy recorded a 4.6% growth in Q2’2024, slower than the 5.6% growth recorded in Q2’2023. The main contributor to Kenyan GDP remains to be the Agriculture, Fishing and Forestry sector which grew by 4.8% in Q2’2024, lower than the 7.8% expansion recorded in Q2’2023. All sectors in Q2’2024, except Mining and Quarrying and Construction recorded positive growths, with varying magnitudes across activities. Most sectors recorded declining growth rates compared to Q2’2023 with Accommodation and Food Services, Financial & Insurance, and Construction Sectors recording the highest declines of 16.2%, 8.1%, and 5.6% points, respectively. Other sectors that recorded a contraction in growth rate, from what was recorded in Q2’2023 were Financial Services Indirectly Measured, Agriculture and Forestry, and Real Estate sectors, of 4.0%, 3.0%, and 2.1% points respectively. The slowed growth in the economy could be attributed to the still elevated fuel prices which made production more expensive and negatively impacted the business environment and the unrest caused by the anti-finance bill protests in June. The Kenyan Economy is projected to grow at an average of 5.3% in 2024 according to various organizations as shown below:

Cytonn Report: Kenya 2024 Growth Projections

No.	Organization	2024 GDP Projections
1	International Monetary Fund	5.3%
2	National Treasury	5.5%
3	World Bank	5.2%
4	Fitch Solutions	5.2%
5	Cytonn Investments Management PLC	5.4%
Average		**5.3%**

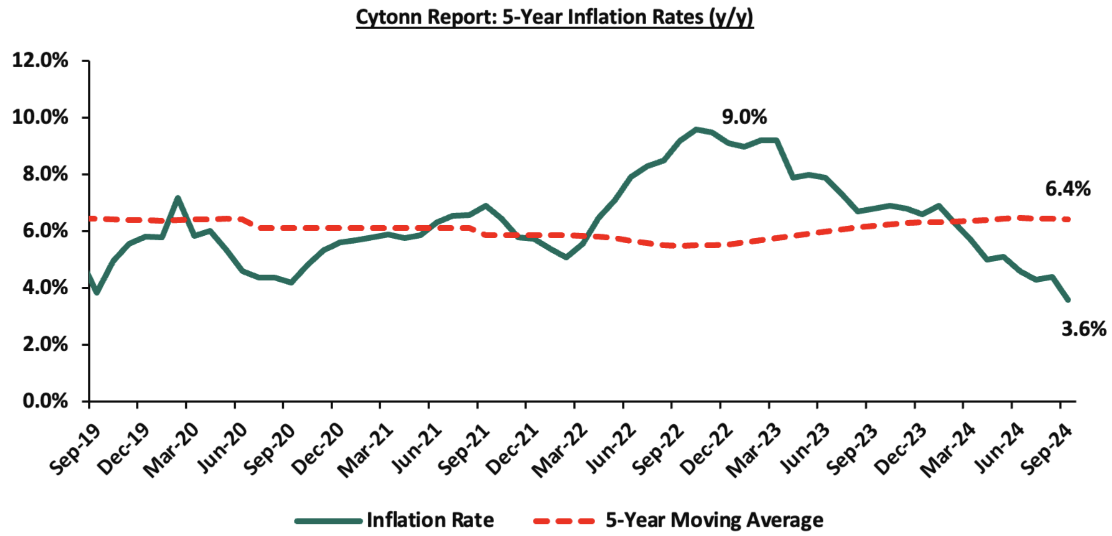
Source: Cytonn Research

Key to note, Kenya’s general business environment slightly deteriorated in Q3’2024, with the average Purchasing Manager’s Index for the last three months coming at 47.8, compared to 48.0 recorded in a similar period in 2023. The deterioration was mainly on the back of anti-finance bill protests which paralyzed economic activity in the month of July, with July PMI coming in at a low of 43.1. The chart below summarizes the evolution of PMI over the last 24 months. (A reading above 50.0 signals an improvement in business conditions, while readings below 50.0 indicate a deterioration):



Inflation:

The average inflation rate decreased to 4.1% in Q3’2024, compared to 6.9% in Q3’2023, attributable to an appreciating Shilling, and stabilized fuel prices. Notably, the maximum allowed price for Super Petrol and Diesel in September remained unchanged from the prices announced for the month of August, while the maximum price allowed for Kerosene decreased by Kshs 3.4 per litre. Consequently, Super Petrol and Diesel will continue to retail at Kshs 188.8 and Kshs 171.6 per litre respectively, while Kerosene will retail at Kshs 158.3 per litre. Inflation for the month of September 2024 eased to 3.6%, from 4.4% recorded in August 2024, mainly driven by a 0.1% decrease in the Housing, water, electricity, gas and other fuels category. Below is a chart showing the inflation trend for the last five years:



For the last 15 months, Kenya’s inflation has persistently remained within the Central Bank of Kenya (CBK) target range of 2.5% - 7.5%, owing to a stronger Shilling and reduced fuel and electricity prices. The risk, however, remains the fuel prices that still remain elevated, and the monetary policy that has now begun to loosen, with the MPC on 6th August, cutting the CBR rate by 25 bps to 12.75% from 13.00%. In their meeting this month, we expect further cuts that would increase the money supply and, therefore, may drive inflation upwards.

Going forward, we expect the inflationary pressures to remain within the CBK’s preferred target, mainly on the back of stronger Shilling, and reduced fuel and electricity prices. However, the loosening monetary policy and the still elevated, though stabilizied fuel prices remain a risk for the inflation rate.

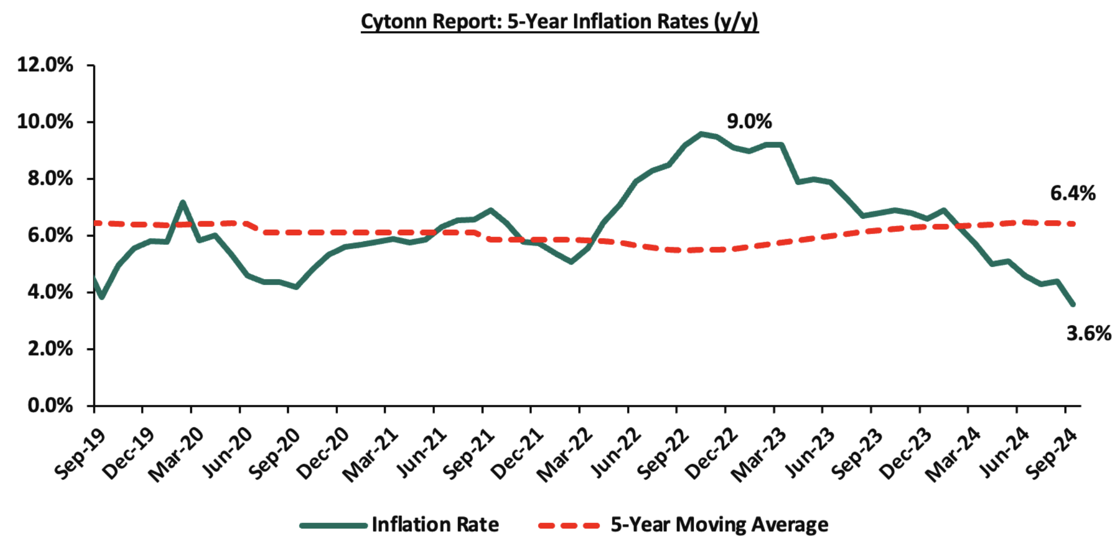
September 2024 Inflation

The y/y inflation in September 2024 decreased by 0.8% points to 3.6%, from the 4.4% recorded in August 2024. This was in line with our expectation of a decrease, but slightly above our projected range of 4.1% to 4.4%. Our decision was mainly driven by reduced electricity prices for September and the stable fuel prices for the month. The headline inflation in September 2024 was majorly driven by increase in prices of commodities in the following categories; Food & Non-Alcoholic Beverages, Housing, Water, Electricity, Gas & other fuels, and Transport by 5.1%, 2.6%, and 0.5% respectively. The table below shows a summary of both the year-on-year and month-on-month commodity indices performance:

Cytonn Report: Major Inflation Changes – September 2024

Broad Commodity Group	Price change m/m (September-2024/August -2024)	Price change y/y (September-2024/September-2023)	Reason
Food and non-alcoholic beverages	0.4%	5.1%	The m/m increase was supported by decrease in prices of sugar, wheat flour and milk by 2.8%, 2.1%, and 0.6%, respectively However, the decrease was mainly driven by decrease in prices of commodities such as oranges, potatoes, and fresh fish by 5.2%, 2.3% and 2.1% respectively.
Transport	0.1%	0.5%	The m/m increase recorded in the transport Index was mainly on the back of a 6.2 bps increase in bus fares while the prices of diesel and petrol remained unchanged from their August 2024 prices of Kshs 171.6 and Kshs 188.8 per litre respectively.
Housing, water, electricity, gas and other fuels	(0.1%)	2.6%	The m/m performance was mainly driven by the decrease in prices of Electricity of 200 kWh and 50 kWh by 68.8 bps and 77.0 bps respectively together with Kerosene prices which dropped by Kshs 3.4 per litre to retail at Kshs 158.4 per litre
Overall Inflation	**0.2%**	**3.6%**	**The m/m increase was mainly attributable to the 0.4% increase in Food and non-alcoholic beverages.**

Notably, September's overall headline inflation declined again after slightly rising in August. Furthermore, it has remained within the Central Bank of Kenya (CBK) target range of 2.5% to 7.5% for the fifteenth consecutive month. The decrease in headline inflation in September 2024 comes amid the maximum allowed price for Super Petrol and Diesel remaining unchanged from the prices announced for the previous month, while the maximum price allowed for Kerosene decreased by Kshs 3.4 per litre. Consequently, Super Petrol and Diesel will continue to retail at Kshs 188.8 and Kshs 171.6 per litre respectively, while Kerosene will retail at Kshs 158.3 per litre. The chart below shows the inflation rates for the past 5 years:



Going forward, we expect inflation to remain within the CBK's preferred range of 2.5%-7.5%, mainly on the back of a strengthened currency, lower electricity prices and reducing fuel prices. The risk, however, lies in the fuel prices which despite their decline over the last months, still remain elevated compared to historical levels. Additionally, favourable weather conditions will also contribute to stabilizing food prices, further supporting lower inflation rates. Key to note is that the Monetary Policy Committee cut the Central Bank Rate by 25 bps to 12.75% from 13.0% in its August 2024 meeting, with the aim of easing the monetary policy and maintaining exchange rate stability. The committee is expected to meet again on Tuesday 8th October 2024, and is expected to cut the rates further on the need to support the economy. This expected further cut may hinder the easing of inflation.

The Kenyan Shilling:

The Kenyan Shilling slightly appreciated against the US Dollar by 0.3% in Q3'2024, to close at Kshs 129.2, from Kshs 129.5 as at the end of H1'2024, mainly attributable to increased foreign inflows during the quarter, and the US Fed cut in mid-September which made the dollar less attractive compared to other currencies, the Kenyan shilling included. During the week, the Kenya Shilling appreciated against the US Dollar by 1.3 bps to remain relatively unchanged from the Kshs 129.2 recorded the previous week.

We expect the shilling to be supported by:

i. Diaspora remittances standing at a cumulative USD 4,645.0 mn in the 12 months to August 2024, 12.7% higher than the USD 4,120.0 mn recorded over the same period in 2023, which has continued to cushion the shilling against further depreciation. In the August 2024 diaspora remittances figures, North America remained the largest source of remittances to Kenya accounting for 56.0% in the period,
ii. The tourism inflow receipts which came in at USD 352.5 bn in 2023, a 31.5% increase from USD 268.1 bn inflow receipts recorded in 2022, and owing to tourist arrivals that improved by 27.2% in the 12 months to June 2024, from the arrivals recorded during a similar period in 2023, and,
iii. High Forex reserves currently at USD 8.2 bn (equivalent to 4.2-months of import cover), which is above the statutory requirement of maintaining at least 4.0-months of import cover, but lower than the EAC region's convergence criteria of 4.5-months of import cover.

The shilling is however expected to remain under pressure in 2024 as a result of:

i. An ever-present current account deficit which came at 0.7% of GDP in Q2'2024 from 0.9% recorded in Q1'2024, and,
ii. The need for government debt servicing, continues to put pressure on forex reserves given that 67.9% of Kenya's external debt was US Dollar-denominated as of March 2024.

Monetary Policy:

The Monetary Policy Committee (MPC) met once in Q3'2024, where the Central Bank Rate was cut by 25 bps to 12.75% from the 13.00% that had been maintained in the June meeting, noting that its previous interventions had successfully mitigated exchange rate pressures, and anchored inflation with inflation coming at 4.4% and 3.6% in August and September 2024 respectively, remaining within the CBK target range of 2.5%-7.5%. Below are some of the Key highlights from the June meeting:

I. The overall inflation eased by 0.3% points to 4.3% in July 2024, from 4.6% in June 2024, positioning it at below the mid-point of the preferred CBK range of 2.5%-7.5%, mainly driven by the decline in fuel inflation. Fuel inflation decreased to 4.5% in July 2024 from 6.4% in June 2024, largely attributable to a downward adjustment in pump prices and lower electricity tariffs. The food inflation remained unchanged at 5.6% in July and June 2024, attributable largely to declines in prices of key non-vegetable food items i.e. maize, sugar, and wheat flour, that offset the price increase of a few vegetables i.e tomatoes, Irish potatoes, and cabbages. The non-food non-fuel inflation slightly decreased to 3.3% in July 2024 from 3.4% in June 2024, reflecting the impact of the monetary policy measures. We expect the overall inflation to remain within the CBK's preferred range of 2.5%-7.5%, mainly on the back of a strengthened currency, reduced fuel prices and reduced electricity prices,

II. The recently released Quarterly Gross Domestic Product Report, for Q1'2024 showed continued strong performance of the Kenyan economy, with real GDP growing by 5.0%, although slower than the growth of 5.5% recorded in a similar period in 2023. This was attributable to strong growth in the agriculture sector due to favourable weather conditions that boosted crop and livestock production and resilient performance of the services sector, particularly wholesale and retail trade, accommodation and food services, financial and insurance, information and communication, and real estate. The economy is expected to continue to strengthen in 2024, supported by a resilient services sector, sustained performance in agriculture, and enhanced exports. However, this positive outlook is tempered by potential risks, including geopolitical tensions,

III. Goods exports increased by 5.0% in the 12 months to June 2024, compared to a similar period in 2023, reflecting a rise in exports of agricultural commodities and re-exports. Receipts from tea and fruits and vegetables exports increased by 4.6% and 12.1% respectively, while re-exports grew by 56.5% in the period. Notably, exports increased 11.8% in the first half of 2024 compared to the same period in 2023. Imports declined by 3.3% in the 12 months to June 2024 compared to a similar period in 2023, mainly reflecting lower imports across all categories except sugar, machinery and transport equipment, crude materials, and miscellaneous manufactures. However, imports increased by 3.6% in the first six months of 2024 compared to the same period in 2023. Tourist arrivals improved by 27.2% in the 12 months to June 2024, compared to a similar period in 2023. Remittances totalled USD 4,535.5 mn in the 12 months to June 2024 and were 12.9% higher compared to USD 4,017.1 mn in a similar period in 2023. The current account deficit is estimated at 3.7% of GDP in the 12 months to June 2024, down from 4.2% of GDP in a similar period in 2023, and is projected at 4.0% of GDP in 2024, reflecting improvement in exports of agricultural products, sustained remittances, recovery in imports supported by stable exchange rate and effects of regional trade integration initiatives,

IV. The CBK foreign exchange reserves, which currently stand at USD 7,340 mn representing 3.8 months of import cover, continue to provide adequate cover and a buffer against any short-term shocks in the foreign exchange market,

V. The banking sector remains stable and resilient, with strong liquidity and capital adequacy ratios. The ratio of gross non-performing loans (NPLs) to gross loans increased to 16.3% in June 2024 compared to 16.1% in April 2024, attributable to the 1.5% decrease in gross loans, that outpaced the 0.7% decrease in gross non-performing loans (NPLs) between the two periods. Decreases in NPLs were noted in the agriculture, real estate, manufacturing, transport and communication, trade, and building and construction sectors. Banks have continued to make adequate,

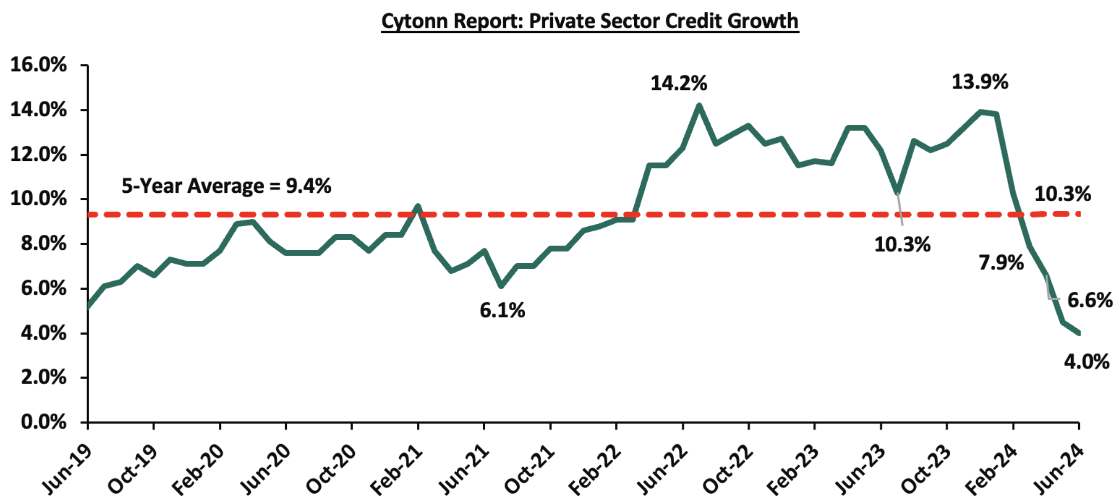
VI. The CEOs Survey and Market Perceptions Survey conducted ahead of the MPC meeting revealed a positive outlook on business activity for the next year. Participants of the survey expressed concerns about the impact of the recent protests on economic activities, the high cost of doing business, and the impact of geopolitical uncertainties on the economy. Despite this, they remained optimistic that economic growth would remain resilient and improve in 2024, supported by increased agricultural production, and a stable macroeconomic activity reflected in the low inflation rate and stability in the exchange rate,

VII. The Survey of the Agriculture Sector for July 2024 revealed an expectation by respondents that inflation was expected to remain unchanged or decrease in the next three months due to an expected rise in food supply due to expected harvests, stable exchange rate, and lower fuel prices,

VIII. Global growth is expected to continue to recover, attributable to strong growth in the United

States and improved growth in several large and emerging markets, particularly India and China. Additionally, headline inflation rates have moderated, with central banks in some major economies lowering their interest rates. Food inflation has continued to decline due to an improved supply of key food items, particularly sugar and cereals. International oil prices have moderated but the risk premium from the Middle East conflict has increased following the recent escalation,

IX. Growth in private sector credit decreased to 4.0% in June 2024 from 4.5% in May 2024, mainly attributed to exchange rate valuation effects on foreign currency-denominated loans due to the appreciation of the Shilling. In June, local currency loans increased by 10.2%, while foreign currency loans, which make up around 26.0% of total loans, decreased by 13.3%. The chart below shows the movement of the private sector credit growth over the last five years:



X. The Committee acknowledged the results of implementing the FY'2024/25 Government Budget and the FY'2024/25 Supplementary Budget I. These measures are anticipated to further support fiscal consolidation, reducing the fiscal deficit to 4.3% of GDP in FY'2024/25, from 5.6% of GDP in FY'2023/24. This medium-term fiscal consolidation is expected to decrease debt vulnerabilities and improve the debt/GDP ratio, steering it toward a more sustainable position.

The MPC noted that its previous measures have successfully reduced overall inflation to below the mid-point of the target range of 2.5%-7.5%, stabilized the exchange rate, and anchored inflationary expectations. The Committee also noted a moderation in NFNF inflation, while central banks in several major economies have started to ease their interest rates in response to easing inflationary pressures, with signs that others may soon follow suit. Consequently, the MPC concluded that there was scope for a gradual easing of monetary policy, while maintaining exchange rate stability, which we expect to gradually ease the interest rates in the country. The MPC will closely monitor the impact of its policy measures, as well as developments in the global and domestic economy, and stands ready to take further action as necessary in line with its mandate. We anticipate that the reduction in the CBR rate will start to lower borrowing costs, leading to increased spending and an uptick in the business environment as well as reduced debt servicing costs for the government, as the MPC closely monitors inflation and exchange rate stability to ensure the continuation of the current trend of stability and eased inflation. The Committee will meet again on 8th October 2024.

Fiscal Policy:

The total Kenyan budget for the FY'2024/2025 National Budget increased by 7.2% to Kshs 4.0 tn from the Kshs 3.7 tn in FY'2023/2024 while the total revenue inclusive of grants increasing by 15.9% to Kshs 3.4 tn from the Kshs 2.9 tn in FY'2023/2024. The increase is mainly due to an 18.8% increase in ordinary revenue to Kshs 2.8 tn for FY'2024/2025, from the Kshs 2.5 tn in FY'2023/2024 with the increase largely dependent on the effectiveness of the Kenya Revenue Authority in collecting taxes as well as an increase in some of the existing taxes to meet its revenue target.

However, following the withdrawal of the 2024 Finance bill that sought to increase revenue by Kshs 302.0 bn, the National Treasury, earlier than is usual, presented the Supplementary Estimates I for the Fiscal Year 2024/25 to the National Assembly.

The table below summarizes the overall change in the FY’2024/25 budget estimates.

Cytonn Report: FY’2024/25 Supplementary Budget Estimates I (Kshs bn)

Item	FY'2023/24 Supplementary Budget II	Original Approved Estimates FY’2024/25	Supplementary Estimates FY’2024/25	% Change between original and current estimates	% Change between supplementary and 23/24 estimates
Recurrent Expenditure	1,719.9	1,632.1	1,598.0	(2.1%)	(7.1%)
Development Expenditure	669.3	746.3	624.0	(16.4%)	(6.8%)
Ministerial National Government Expenditure	**2,389.2**	**2,378.4**	**2,222.0**	**(6.6%)**	**(7.0%)**
Consolidated Fund Services	1,057.7	1,213.5	1,237.2	2.0%	17.0%
County Equitable Allocation	425.1	400.1	411.0	2.7%	(3.3%)
Total Expenditure	**3,872.0**	**3,992.0**	**3,870.2**	**(3.1%)**	**(0.1%)**

Source: The National Treasury

Key take outs from the table include;

i. The recurrent expenditure (Costs incurred to cover regular government expenses such as salaries, operational costs and maintenance costs) decreased by 2.1% to Kshs 1,598.0 bn in the Supplementary Estimates I from Kshs 1,632.1 bn in the original estimates, an indication of the government's initiative to cut expenditure cuts while still to boosting public services, responding to economic growth and ensuring the well-being of its citizens,
ii. Development expenditure (Costs incurred in order to create assets that will provide long term public infrastructure such as roads, hospitals, and schools) declined by 16.4% to Kshs 624.0 bn in the supplementary estimates from Kshs 746.3 bn in the original estimates, a detriment to the sectors such as infrastructure, energy, water and health that require heavy development financing,
iii. Consequently, the Ministerial National Government expenditure estimates for the FY’2024/25 Supplementary Budget I is set to decrease by 6.6% to Kshs 2,222.0 bn from Kshs 2,378.4 bn in the original estimates, translating to a reduction of Kshs 156.4 bn in expenses for the government. This decline is mainly attributed to budget rationalization aimed at reducing expenditure in various sectors and public services,
iv. Consolidated Fund Services (CFS) (refers to the Consolidated Fund established in the Kenya’s constitution into which development partners deposit funds before disbursing to the Exchequer accounts for projects such as servicing of public debt, and subscription to International Organizations) has increased by 2.0% to Kshs 1,237.2 bn from Kshs 1,213.5 bn in the original estimates, and,
v. The County Equitable Share (allocation on national government revenue to county governments) increased by 2.7% to Kshs 411.0 bn from Kshs 400.1 bn in the original approved estimates.

For the FY’2023/2024, the government was not able to meet the revenue collection for FY’2023/24, collecting Kshs 2.4 tn, translating to a shortfall of 4.5% against its revenue target of Kshs 2.8 tn. Notably, for the FY’2024/2025, from the figures released by the National Treasury for revenue and net expenditures collected as at the end of August 2024, total revenue collected amounted to Kshs 331.6 bn, equivalent to 12.6% of the revised estimates of Kshs 2,631.4 bn for FY’2024/2025 and is 75.6% of the prorated estimates of Kshs 438.6 bn.

Going forward, we believe that the coming months’ revenue collection performance will largely depend on how quickly the country’s business climate stabilizes. We therefore expect the government to cut on its expenditure, mostly the development expenditure in order to finance the growing debt maturities and the ballooning recurrent expenditure.
