Cytonn Q1'2019 Markets Review

Kenya Macroeconomic Review

During the quarter, we tracked Kenya GDP growth projections for 2019 released by 16 organizations, that comprised of research houses, global agencies, and government organizations. The average, including Cytonn's 2019 growth estimate of 5.8%, came to 5.8%. The common view was that GDP growth would remain stable in 2019, from an estimated growth of 6.0% in 2018, having registered an average of 6.1% in the first 3 quarters of 2018. Economic growth is expected to be driven by:

i. Stable growth in the agriculture sector on the back of favorable weather conditions despite delayed onset of the long rains in most parts of the country,
ii. Implementation of the ***Big 4 Agenda*** projects by the Kenyan Government, and,
iii. Recovery in the business environment as evidenced by the Stanbic Bank Monthly Purchasing Manager's Index (PMI), which albeit easing to 51.2 in February from 53.2 in January, still remains above 50, an indication of improving business conditions.

Below is a table showing average projected GDP growth for Kenya in 2019; noteworthy being that the highest projection is by the Central Bank of Kenya at 6.3%. We shall be updating this table should projections change and shall highlight who had the most accurate projection at the end of the year.

Kenya 2018 Annual GDP Growth Outlook

No.		2018 Outlook	2019 Outlook
1	Central Bank of Kenya	6.2%	6.3%
2	International Monetary Fund (IMF)	5.5%	6.1%
3	Citigroup Global Markets	5.6%	6.1%
4	African Development Bank (AfDB)	5.6%	6.0%
5	PNB Paribas		6.0%
6	UK HSBC		6.0%
7	Euromonitor International		5.9%
8	World Bank	5.5%	5.8%
9	**Cytonn Investments Management Plc**	**5.5%**	**5.8%**
10	Focus Economics	5.3%	5.8%
11	JP Morgan		5.7%
12	Euler Hermes		5.7%
13	Oxford Economics	5.7%	5.6%

Kenya 2018 Annual GDP Growth Outlook

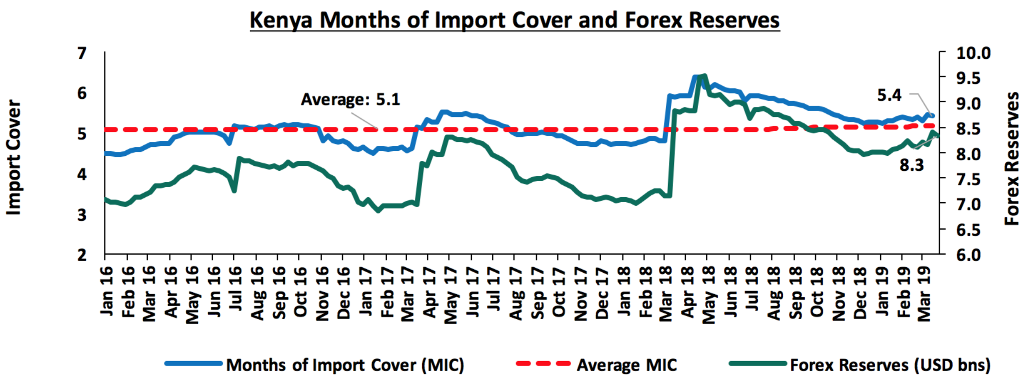
No.		2018 Outlook	2019 Outlook
14	Standard Chartered	4.6%	5.6%
15	Capital Economics		5.5%
16	Fitch Solutions	5.5%	5.2%
	Average	**5.5%**	**5.8%**

The Kenya Shilling:

During Q1’2019, the Kenya Shilling gained against the US Dollar by 1.1% to close at Kshs 100.8, from Kshs 101.8 at the end of December 2018, mainly driven by inflows from diaspora remittances amid thin dollar demand from oil importers. This week, the Kenya Shilling depreciated marginally by 0.05% against the dollar to close at Kshs 100.8, from Kshs 100.7 the previous week, due to end-month demand from the energy and manufacturing sector exceeding dollar inflows from remittances. In our view, the shilling should remain relatively stable to the dollar in the short term, supported by:

i. The narrowing of the current account deficit with preliminary data on balance of payments indicating continued narrowing to 4.6% of GDP in the 12-months to January 2019, from 5.5% recorded in January 2018. The decline has been attributed to improved agriculture exports, increased diaspora remittances, strong receipts from tourism, and lower food and SGR-related equipment relative to 2017,
ii. Improving diaspora remittances, which increased by 38.6% in 2018 to USD 2.7 bn, from USD 1.9 bn recorded in 2017. The rise is due to;
    a. Increased uptake of financial products by the diaspora due to financial services firms, particularly banks, targeting the diaspora, and,
    b. New partnerships between international money remittance providers and local commercial banks making the process more convenient,

iii. CBK’s supportive activities in the money market, such as repurchase agreements and selling of dollars, and,
iv. High forex reserves, currently at USD 8.3 bn, equivalent to 5.4-months of import cover, thus meeting the statutory requirement of maintaining at least 4-months of import cover, and the EAC region’s convergence criteria of 4.5-months of import cover.



Inflation:

The inflation rate declined to an average of 4.4% YTD as compared to 4.5% in a similar period in 2018. Inflation came in at 4.7%, 4.1% and 4.4% for the month of January, February and March, respectively, compared to 4.8%, 4.5% and 4.2% for a similar period of review in 2018. The decline in inflation has been on account of stable food prices, lower electricity and fuel prices, and muted demand driven inflationary pressures. Going forward, however, we expect moderate upward pressure on inflation in the near-term due to:

i. The rise of international oil prices, as experienced in Q1’2019, owing to disruptions in the production of oil in some oil producing areas such as Venezuela and Iran, coupled with OPEC’s agreement to cut oil supply, which may exert moderate upward pressure on prices of fuel, and,
ii. An expected rise in food inflation due to the expected late onset and poor distribution of the March-April-May rains, which is likely to impact negatively on the agricultural sector, leading to food insecurity.

Monetary Policy:

The Monetary Policy Committee (MPC) met twice in Q1’2019 (28th January 2019 and 27th March 2019). In both meetings, the MPC retained the prevailing monetary policy stance leaving the Central Bank Rate (CBR) unchanged at 9.0%, which was in line with our expectations citing that inflation expectations remained well anchored within the target range and that the economy was operating close to its potential as evidenced by:

i. Muted inflationary pressures largely due to stable food prices, lower electricity and fuel prices, and muted demand driven inflationary pressures,
ii. Stability in the foreign exchange market supported by the narrowing of the current account deficit to 4.7% of GDP in the 12 months to February from 5.5% in February 2018 driven by robust performance of exports particularly horticulture, resilient diaspora remittances, and higher receipts from tourism and transport services, and,
iii. Improving private sector credit growth despite being below historical averages coming in at 3.4% in the 12 months to February, compared to 3.0% in the 12 months to January, and is expected to strengthen in 2019, with the anticipated higher economic activity and improved lending to the Micro, Small and Medium Enterprises (MSMEs).

As such, the MPC concluded that the current policy stance was still appropriate, but would continue to monitor any perverse response to its previous decisions and thus the current policy stance was still appropriate. We expect monetary policy to remain relatively stable in 2019, and lean to a possible easing, as the CBK monitors Kenya’s inflation rate and the currency

Q1’2019 Highlights:

i. The National Treasury released the budgetary review for the first half of the 2018/2019 financial year during the month. The total cumulative revenue in H1’2018/2019 amounted to Kshs 794.7 bn against a target of Kshs 855.7 bn (92.9% of the target) while the total expenditure for the period under review amounted to Kshs 1,075.5 bn, against a target of Kshs 1,130.7 bn (95.1% of the target). The cumulative overall fiscal balance (on a commitment basis and excluding grants), amounted to Kshs 280.8 bn (equivalent to 2.8% of GDP), against a targeted deficit of Kshs 275.0 bn (equivalent to 2.8% of GDP). For more information, see our Cytonn Weekly #08/2019.
ii. The Kenya National Bureau of Statistics (KNBS) released the Gross County Product (GCP), which includes a geographic breakdown of Kenya’s Gross Domestic Product (GDP), giving an estimate of the size and structure of county economies. According to the report, the average contribution per county to gross value added over the period 2013-2017 was approximately 2.1%, with Nairobi having the highest contribution at 21.7%, followed by Nakuru and Kiambu at 6.1% and 5.5%, respectively. Isiolo had the lowest contribution coming in at 0.2%, for the same period under review. For more information, see our Cytonn Weekly #07/2019.
iii. The National Treasury released the 2019 Budget Policy Statement (BPS), which outlines the current performance of the Kenyan economy, as well as give the medium-term outlook. The BPS is a Government policy document that sets out the broad strategic priorities and policy goals,

together with a summary of the Government spending plans, as a basis of preparing the FY 2019/20 budget. From the report, the 2019 BPS point to a 7.8% increase of the budget, to Kshs 2.7 tn from Kshs 2.5 tn in the FY' 2018/19 revised budget. The recurrent expenditure is set to increase at a slower rate than the development expenditure; the recurrent increasing by 7.5% to Kshs 1.7 tn from Kshs 1.5 tn as per the revised budget. For more information, see our Cytonn Weekly #07/2019.

Macroeconomic Indicators Table:

The table below summarizes the various macroeconomic indicators, the actual Q1'2019 experience, the impact of the same, and our expectations going forward:

Macro-Economic & Business Environment Outlook

Macro-Economic Indicators	YTD 2019 experience and outlook going forward	Outlook at the Beginning of the Year	Current outlook
Government Borrowing	• We still maintain our expectations of KRA not achieving their revenue targets with the National Treasury reporting ordinary revenue, as at February 2019, at Kshs 945.6 bn; 15.2% below the pro-rated target. This is expected to result in further borrowing from the domestic market to plug in the deficit, which coupled with heavy maturities might lead to pressure on domestic borrowing • On the international debt front, the government has a net external financing target of Kshs 272.0 bn to finance the budget deficit, coupled with the need to retire 3 commercial loans maturing in H1'2019. There are talks that the Government might issue another Eurobond with the targeted amount at USD 2.5 Bn to refinance the USD 750 Mn maturing in June but with the International Monetary Fund (IMF) having raised Kenya's debt distress risk from low to moderate on October we expect investors to demand higher yields to match the risk profile.	**Negative**	**Negative**
Exchange Rate	• The Kenya Shilling has remained stable gaining by 1.1% in Q1'2019 and is expected to remain resilient against the US Dollar, due to the continued narrowing of the current account thus improved balance of payments and the continued support from the CBK in the short term through its sufficient reserves of USD 8.3 bn (equivalent to 5.4-months of import cover).	**Neutral**	**Neutral**
Interest Rates	• The interest rate environment has remained stable in Q1'2019, with the CBR having been retained at 9.0% in the 2 MPC meetings held during the quarter. With the heavy domestic maturities in 2019, we expect slight upward pressure on interest rates going forward, as the government tries to meet its domestic borrowing targets for the fiscal year.	**Neutral**	**Neutral**
Inflation	• Inflation has remained muted in Q1'2019 mainly supported by lower fuel and electricity. Going forward, inflation is expected to average 5.4% and remain within the government target range of 2.5% - 7.5%. However, risks abound in the near-term, including the late onset of the traditionally long rains season will disrupt food supply leading to a gradual flare in food inflation, which stood at 3.3% m/m in March.	**Positive**	**Positive**

Macro-Economic & Business Environment Outlook

Macro-Economic Indicators	YTD 2019 experience and outlook going forward	Outlook at the Beginning of the Year	Current outlook
GDP	• GDP growth is projected to range between 5.7%-5.9% in 2019, lower than the expected growth rate of 6.0% in 2018, but higher than the 5-year historical average of 5.4%	**Positive**	**Positive**
Investor Sentiment	• Eurobond yields were on a declining trend during Q1’2019. An improvement was also recorded in foreign inflows in the capital market to a net buying position of USD 5.6 mn from a net selling position of USD 93.4 mn in Q4’2018, an indication of improved investor sentiments. • We expect improved foreign inflows from the negative position in 2018, mainly supported by long term investors who enter the market looking to take advantage of the current cheap valuations in select sections of the market.	**Neutral**	**Neutral**
Security	• Security is expected to be upheld in 2019, given that the political climate in the country has eased. Despite the recent terror attack experienced during the quarter, Kenya was spared from travel advisories, evidence of the international community’s confidence in the country’s security position.	**Positive**	**Positive**

Of the 7 indicators we track, 3 are positive, 3 are neutral and 1 is negative. The outlook of the 7 indicators has remained unchanged from the beginning of the year. From this, we maintain our positive outlook on the 2019 macroeconomic environment supported by expectations for strong economic growth at between 5.7%-5.9%, a stable currency, inflation rates within the government’s target, and stable interest rates in 2019.