Cytonn Q3’2019 Markets Review

Kenya Macroeconomic Review

According to the Kenya National Bureau of Statistics (KNBS), Kenya’s economy expanded by 5.6% in Q2’2019, similar to the 5.6% recorded in Q1’2019, but lower than 6.4% recorded in Q2’2018. The economic growth was driven by:

i. Recovery in the financial and insurance sector, which recorded a growth of 6.7% compared to the growth of 3.9% seen in Q2’2018,
ii. Increased output in the education, transport and storage and construction sectors, which grew by 6.0%, 7.2% and 7.2%, respectively,
iii. Information and Communication sector which recorded the highest growth of 11.6%, compared to 11.7% recorded in Q2’2018, and,
iv. The agricultural sector which recorded a slower growth of 4.1%, compared to 6.5% seen in Q2’2018.

With the implementation of the Big 4 agenda, various sectors stand to grow significantly with the increased activity such as the manufacturing sector, which will also benefit from the major infrastructural developments taking place. For a more comprehensive analysis, see our Q2’2019 Quarterly GDP Review and Outlook Note.

During Q3’2019, we tracked Kenya 2019 GDP growth projections released by 13 organizations, that comprised of research houses, global agencies, and government organizations. The average GDP growth, including Cytonn’s 2019 growth estimate of 5.9%, came in at 5.9%, unchanged from average projections released in Q2’2019. The common view is that GDP growth will slow in 2019 from a growth of 6.3% in 2018, the fastest economic growth since the 8.4% recorded in 2010.

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 2019 Annual GDP Growth Outlook

No.	Organization	Q1'2019	Q2'2019	Q3’2019
1.	Central Bank of Kenya	6.3%	6.3%	6.3%
2.	Citigroup Global Markets	6.1%	6.1%	6.1%
3.	African Development Bank (AfDB)	6.0%	6.0%	6.0%
4.	PNB Paribas	6.0%	6.0%	6.1%
5.	UK HSBC	6.0%	6.0%	6.0%
6.	Euromonitor International	5.9%	5.9%	6.3%
7.	International Monetary Fund (IMF)	6.1%	5.8%	5.9%

The average inflation rate rose to 5.1% as compared to 4.4% in a similar period in 2018. September's inflation rate declined significantly to 3.8% from 5.0% in August 2019, with the m/m inflation decreasing marginally by 0.1%. The decline in the month-on-month inflation in September was mainly due to:

i. A 0.4% decline in the food and non-alcoholic beverage index, owing to a decrease in prices of some foodstuffs in September 2019 outweighing increases recorded in others, with carrots, cabbages and tomato prices having decreased by 9.8%, 6.3% and 4.1%, respectively.

However, continued upward pressure in prices are coming from:

i. A 0.5% increase in transport cost driven by a raise in pump prices for petrol and diesel, and
ii. A 0.1% increase in Housing, Water, Electricity, Gas and Other Fuels Index stimulated by an increase in house rent and cooking fuel prices.

Major Inflation Changes - September 2019

Broad Commodity Group	Price change m/m (Sep-19/Aug-19)	Price change y/y (Sep-19/Sep-18)	Reason
Food & Non-Alcoholic Beverages	(0.4%)	6.3%	The m/m decline was due to a decrease in prices of some foodstuffs for instance carrots, cabbages and tomatoes
Transport Cost	0.5%	1.9%	The m/m rise was mainly on account of increase in pump prices of petrol and diesel.
Housing, Water, Electricity, Gas and other Fuels	0.1%	1.0%	The m/m rise was as a result of increase in house rent and cooking fuels
Overall Inflation	(0.1%)	3.8%	The m/m decline was due to a 0.4% decline in the food index which has a CPI weight of 36.0%

The Kenya Shilling

The Kenya Shilling depreciated against the US Dollar by 1.6% in Q3'2019, to close at Kshs 103.9, from Kshs 102.3 at the end of Q2'2019. During the week, the Kenya Shilling remained stable against the dollar to close at 103.8, unchanged from the previous week. 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 indicating that Kenya's current account deficit improved by 11.8% during Q2'2019, coming in at a deficit of Kshs 107.6 bn, from Kshs 122.0 bn in Q2'2018, equivalent to (6.2%) of GDP, from (7.6%) recorded in Q2'2018. This was mainly driven by the narrowing of the country's merchandise trade deficit by 1.7% and a rise in secondary income (transfers) balance by 5.1%,
ii. Improving diaspora remittances, which have increased cumulatively by 8.9% in the 12-months to August 2019 to USD 2.8 bn, from USD 2.6 bn recorded in a similar period of review in 2018. The rise is due to:
iii. Increased uptake of financial products by the diaspora due to financial services firms, particularly banks, targeting the diaspora, and,
iv. New partnerships between international money remittance providers and local commercial banks making the process more convenient,
v. CBK's supportive activities in the money market, such as repurchase agreements and selling of dollars, and,
vi. High levels of forex reserves, currently at USD 9.0 bn (equivalent to 5.6-months of import cover),

above the statutory requirement of maintaining at least 4.0-months of import cover, and the EAC region's convergence criteria of 4.5-months of import cover.

Monetary Policy

The Monetary Policy Committee (MPC) met twice in Q3'2019, retaining the Central Bank Rate (CBR) at 9.0% on both occasions. In the July 24th meeting, the committee noted that inflation expectations were well anchored within the target range of 2.5% - 7.5%, and that economic growth prospects were improving, in line with our expectations. This was evidenced by;

i. A stable foreign exchange market, with the current account deficit narrowing to 4.2% in the 12 months to June 2019 from 5.4% in May 2018, and;
ii. A stable and resilient banking sector, with average liquidity and capital adequacy ratios at 50.6% and 18.2%, respectively in June 2018. The committee also noted that the economy was performing stronger than expected supported by agricultural production, strong growth of MSMEs and the service sector, foreign direct investment, and a stable macroeconomic environment.

For more information, see our note on Monetary Policy Committee Meeting for July 2019.

In the September 23rd meeting, the MPC cited that inflation expectations remained well anchored within the target range largely due to lower food prices following improved weather conditions and that there was sustained optimism for stronger economic growth in 2019 as per the private sector market perception survey. This was mainly attributed to implementation of the Big 4 agenda projects, ongoing public infrastructure investments, improved weather conditions, and a stable macroeconomic environment. The MPC noted that there was; however, need to remain vigilant on the possible effects of the increased uncertainties in the external environment. For more information see our note on Monetary Policy Committee Meeting for September 2019. Going forward we expect the MPC to retain the CBR at 9%, similar to their previous meetings with due to the current uncertainty in the market around the Finance Bill 2019, which contained a proposal to remove the interest rate cap.

Q3'2019 Highlights

i. The National Treasury in the Finance Bill 2019 proposed to repeal the current interest rate cap. This proposal was rejected on grounds that it will subject Kenyans to expensive loans from commercial banks. Members of Parliament also cited that banks have continued to be profitable in the interest rate cap regime, and there is no guarantee from banks that a repeal would lead to increased lending to Micro, Small and Medium Enterprises (MSMEs), who have been the most affected by the rate cap. We do expect a review of the Banking (Amendment) Act 2015, given a Member of Parliament proposed a revision of the law to include a ceiling of 6.0% above the limit set by the Banking (Amendment) Act, 2015 for the high-risk borrowers. For more information see Cytonn Weekly #38/2019,
ii. The National Treasury released the budgetary review for the 2018/2019 financial year indicating that revenues collected had increased by 9.2% to Kshs 1.7 tn from Kshs 1.5 tn collected during the 2017/2018 financial year. The revenue collected was 93.1% of the budgetary target for the year as compared to the previous period where revenue collected was 91.7% of the budgetary target. Total expenditure amounted to Kshs 2.4 tn, a 12.1% increase from Kshs 2.1 tn recorded during the same period last year. This was 94.7% of the Kshs 2.5 tn target, with 62.2% of the expenditure being on recurrent expenditure, while development expenditure only accounted for 22.5%. Total expenditure was, however, 6.3% lower than the targeted expenditure as per the budget. The key concern, however, remains the widening of the fiscal deficit where the expenditure side has continued to grow faster recording a 12.1% growth, compared to the 9.2% growth in revenue collection. For more information see our Cytonn Weekly #34/2019,
iii. According to KNBS, Kenya's current account deficit improved by 11.8% during Q2'2019, coming

in at a deficit of Kshs 107.6 bn, from Kshs 122.0 bn in Q2’2018, equivalent to (6.2%) of GDP, from (7.6%) recorded in Q2’2018. This was mainly driven by; (i) A 1.7% narrowing of the merchandise trade deficit from Kshs 277.7 bn in Q2’2018 to Kshs 272.9 billion in Q2’2019, (ii) A marginal decline in net inflows of international trade in services by 0.1% points to Kshs 38.27 bn, from Kshs 38.29 bn recorded in Q2’2018, and (iii) A 5.1% rise in the secondary income (transfers) balance, to a surplus of Kshs 149.2 bn, from a surplus of Kshs 142.0 bn in Q2’2018. For a more comprehensive analysis, see our Q2’2019 Quarterly Balance of Payments Review and Outlook Note

iv. According to Stanbic Bank’s Monthly Purchasing Manager’s Index (PMI), released earlier during the week, a sharper upturn in new business stimulated a stronger improvement in operating conditions during the month of September. The seasonally adjusted PMI came in at 54.1 in September, an improvement from 52.9 in August. A PMI reading of above 50 indicates improvements in the business environment, while a reading below 50 indicates a worsening outlook. The sharper increase in new business saw several firms report higher client numbers since August. Export demand rose at a quicker pace, however, it was still the second lowest in nearly two years. The growth was attributed to greater trade with customers in Tanzania, Burundi and Congo, as well as international markets such as the US and Europe. Nonetheless, output levels rose only modestly as many companies continued to struggle with cash flow problems. This led to an increase in outstanding business as well as further build-up of input stocks. Job numbers grew solidly at its quickest pace since December 2016 as businesses reportedly built up their workforces for future activity. This was as a result of high sentiments towards the 12-month outlook. Price pressures faced by Kenyan firms eased in September, due to the slowed rate of overall input cost inflation, which reached a near two-year low. Firms that saw input prices rise related this to higher taxation and fuel costs, as well as a marginal mark-up of salaries. However, a greater supply of agricultural goods meant that many commodities dropped in price. Consequently, output charges increased only moderately, with the pace of inflation falling to a four-month low. Some attributed the rise in prices of export goods from August to a deterioration in the shilling exchange rate.

Macro-Economic & Business Environment Outlook

Macro-Economic Indicators	YTD 2019 Experience and Outlook Going Forward	Outlook at the Beginning of the Year	Current outlook

Inflation	however abound in the near-term, arising from the late onset of the traditionally long rains season which has disrupted food supply leading to a flare in food inflation, coupled with the continued rise in global fuel prices	Positive	Positive
GDP	· The country's Gross Domestic Product (GDP), adjusted for inflation, rebounded in 2018 having expanded by 6.3% in 2018 from 4.9% recorded in 2017. This was the fastest economic growth since the 8.4% recorded in 2010, and above the 5-year average GDP growth rate of 5.4% · GDP growth is projected to range between 5.7%-5.9% in 2019, lower than the 6.3% growth in 2018, but higher than the 5-year historical average of 5.4%.	Positive	Positive
Investor Sentiment	· Eurobond yields have been on a declining trend YTD. An improvement was also recorded in foreign inflows in the capital market to a net buying position of USD 1.2 mn Q3’2019 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	· The political climate in the country has eased. Despite the terror attack experienced during the first half of 2019, 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.