November 2020 MPC Note

Cytonn Note on the Monetary Policy Committee (MPC) Meeting for November 2020

The Monetary Policy Committee (MPC) is set to meet on Thursday, 26th November 2020, to review the outcome of its previous policy decisions and recent economic developments, and to decide on the direction of the Central Bank Rate (CBR). In their previous meeting held on 29th September 2020, the committee decided to reconvene in November 2020, while highlighting that they would remain ready to reconvene earlier if necessary, as they continue to closely monitor the impact of the policy measures have had so far. Additionally, the MPC maintained the CBR at 7.00% citing that the accommodative policy stance adopted in March, April and May 2020 sittings, which saw a cumulative 125 bps cut, was having the intended effects on the economy. This was in line with our expectations as per our MPC Note with our view having being informed by:

i. Inflation was expected to remain stable and within the government's target range of 2.5% -7.5% mainly supported by lower food prices coupled with the impact of the reduced VAT and muted demand pressures,
ii. Despite the high liquidity in the money market as a result of the previous reduction in CRR ratio, we believed that additional rate cuts would not lead to a rise in Private sector growth given the tough economic conditions brought about by the pandemic have increased cash constraints by businesses as well as households with most businesses struggling to keep afloat due to subdued revenues. As such, we believed banks would take a cautious stance due to the high risk of credit default, with the possibility of heightened Non Performing Loans if the pandemic is to continue, and,
iii. The currency had been depreciating, having lost 7.1% to USD since the beginning of the year attributable to high dollar demand from merchandise importers. As such, a further rate cut would put the shilling under pressure thus making Kenya a less attractive investment destination.

The Monetary Policy also noted that the current account deficit was projected to remain stable at 5.1% of GDP in 2020, from the previously recorded deficits of 5.0% and 4.3% of GDP in 2018 and 2019 respectively. Additionally, the MPC noted that the leading economic indicators for the Kenyan economy for the third quarter point to a strong recovery in economic activity from the disruptions experienced during the second quarter of the year. This was mainly supported by agricultural production and increased activity in key sectors following the easing of COVID-19 restrictions.

Below, we analyze the trends of the macro-economic indicators since the September 2020 MPC meeting, and how they are likely to affect the MPC decision on the direction of the CBR:

Indicators	Experience since the last MPC meeting in September 2020	Going forward	Probable CBR Direction (September)	Probable CBR Direction (November)
Government Revenue collections	• The National Treasury budgetary review for the 2019/2020 financial year. According to the release, the fiscal measures implemented by the Government to cushion Kenyans against the adverse impact of the pandemic is estimated to cost the exchequer Ksh 172.0 bn in revenue. Total revenue collected in FY' 2019/2020 amounted to Kshs 1.7 tn against a revised target of Ksh 1.9 tn, a 7% shortfall. Ordinary revenue collection from taxes amounted to Ksh 1.57 bn against a target of Ksh 1.62 bn , with tax revenues falling below target in all broad categories.	• Given the fiscal measures unveiled by the president to cushion businesses and individuals against the effects of the pandemic, we are pessimistic on the government's ability to meet its revenue collection targets in this current environment,	Neutral	Neutral
Government Borrowings	• The Government, as at 13th November 2020, was 76.8% ahead its current borrowing target having borrowed Kshs 231.5 bn against a prorated borrowing target of Kshs 130.9 bn and has to borrow on average, Kshs 79.8 bn monthly in FY'2020/2021 to meet its domestic borrowing target of Kshs 486.2 bn and has domestic maturities worth Kshs 703.4 bn	• There is increased demand for government debt due to increased liquidity in the money market hence leading to a decline in interest rates, • Due to the inability for fiscal consolidation this financial year, we project a relatively higher fiscal deficit due to the lower revenue collection, which might put pressure on that the government at the tail end of the financial year	Neutral	Neutral
Inflation	• Y/Y inflation for October came in at 4.8%, while the m/m inflation came in at 1.0%. This was mainly attributable to a 1.1% increase in the Food and Non-Alcoholic Drinks' Index coupled with a 0.6% increase in the Transport Index,	• Inflation this year has averaged 5.1% and we expect it to remain stable, mainly supported by stable food prices due to favourable weather conditions and fuel prices, on the back of muted demand pressures in the global economy.	Positive	Positive
Currency (USD/Kshs)	• Since the last meeting, the Kenya Shilling has depreciated by 0.7% against the US Dollar to Kshs 108.5, from Kshs 107.7 mainly attributable to Increased dollar demand from importers following the relaxation of Coronavirus containment measures and the subsequent improvement in business activity as evidenced by improvement in the country's PMI to 59.1 in October 2020, the sharpest improvement since the beginning of the survey in January 2014, • Forex Reserves declined to USD 8.5 bn (equivalent to 5.2 months of import cover) from USD 9.3 bn (equivalent to 5.7 months of import cover) since the last meeting, and are still adequate to provide an adequate buffer to the shilling against foreign exchange shocks	• We maintain our view on the continued pressure on the Kenyan shilling, with the performance being on the back of: 1. 1. Increased dollar demand from merchandise importers as the easing of coronavirus restrictions continue to jumpstart economic activities, thus boosting demand for hard currency, and, 2. Weaker inflows from foreign currency receipts which have led to dwindling foreign exchange reserves, evidenced by the decline to USD 8.5 bn, from USD 9.3 bn in July 2020,	Negative	Negative
GDP Growth	• Kenya's economy contracted by 5.7% in Q2'2020, a decline from the 5.3% recorded in Q2'2019, which was mainly due to: 1. 1. An 83.3% contraction in the accommodation and food services sector, compared to an expansion of 12.1% in Q2'2019. This sector was the worst hit by the COVID -19 pandemic as businesses in the sector either operated under minimum capacity or completely closed down, 2. This contraction was mitigated by the 6.4% growth in the agricultural sector, compared to 2.9% recorded in Q2'2020, supported by favourable weather conditions,	• We expect subdued performance for the rest of the year mostly informed by the slower business activity experienced during the first half of the year in the country evidenced by the PMI's decline to lows of 34.8 recorded in April, despite it improving to 59.1 as at October 2020,	Negative	Negative

Private Sector Credit Growth	• The latest data from CBK indicates that private sector credit growth recorded a growth in the 12 months to August 2020 to 8.3% from 7.6% recorded in June 2020, similar to the 5-year average of 7.6%	• The tough economic conditions brought about by the pandemic have increased cash constraints by businesses as well as households with most businesses struggling to keep afloat due to subdued revenues. Consequently, this led to high Gross Non-Performing Loans in August of 13.6%, from 13.1% recorded in June • The effects of the coronavirus pandemic are expected to negatively affect the financial sector. We expect to see increased caution on lending especially to businesses that rely on imports hence inhibiting private credit sector growth due to the high risk of credit default, with the possibility of heightened Non Performing Loans if the pandemic is to continue	Neutral	Neutral
Banking Sector Liquidity	• Liquidity levels in the money markets declined with the average interbank rate on 18th November 2020 coming in at 3.0%, from the 3.6% recorded during the last meeting on 29th September 2020, supported by government payments,	• Liquidity is expected to remain favorable due to: 1. 1. High domestic debt maturities in 2020 that currently stand at Kshs 614.1 bn worth of T-bill maturities and Kshs 89.2 bn worth of T-bond maturities, 2. Low Cash Reserve Ratio (CRR) currently at 4.25% from 5.25% previously. Despite the reduction of the CRR, lending to the private sector has remained muted	Positive	Positive

Conclusion

Of the factors that we track, three are neutral, two are negative and two is positive, unchanged between September 2020 and November 2020.

The main goal of the monetary policy is to maintain price stability and support economic growth by controlling the money supply in the economy. We expect the MPC to maintain the Central Bank Rate (CBR) at 7.00%, with their decision mainly being supported by:

i. Inflation is expected to remain stable and within the government's target range of 2.5% -7.5% on account of the stable food prices being experienced in the country as a result of the favourable weather conditions. Given that one of the main goals of monetary policy is to ensure price stability, we believe that the stable inflation rate will not exert pressure on the MPC to implement inflationary control,
ii. Despite the need to stimulate the economy, we believe that additional rate cuts will not lead to a rise in Private sector growth given the reduced economic activity in Kenya's key sectors and elevating credit risk resulting to a cautious lending stance by banks, with the possibility of heightened Non Performing Loans if the pandemic is to continue, and,
iii. Additional rate cuts would lead to a further depreciation of the Shilling thus reducing Kenya's attractiveness as an investment destination.

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