FUNDAMENTALS

KENYA MPC UPDATE: SWEET SPOT WITH 50BPS CUT

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IN BRIEF

- The CBK Monetary Policy Committee (MPC) is scheduled to meet on 05 December 2024, and we see scope for a 50bps rate cut with the meeting coming at a more favourable time compared to a similar period a year ago.
- The MPC meeting will also have four new external members; appointed last month by the National Treasury Cabinet Secretary (CS). A long-standing issue with Kenya's MPC setting is that the Committee is synonymous to a "one-man show", with the Governor being the face of the Committee.
- Headline inflation in November came in at 2.8% y/y, and the combination of favourable base effect and the lagged impact of the previous tightening posture resulting in the disinflation trend. On a monthly basis, headline inflation rose gradually to 0.26% in November from 0.19% in September, limiting the slide in the preferred inflation print below the lower target.
- FX sales by commercial banks to the apex bank have somewhat improved KES liquidity. Given the Open Market Operations (OMO) biased towards liquidity injections, we have noted the amount of OMO instruments outstanding at any given point has reduced significantly. Considering this and coupled with elevated liquidity levels in select SOEs, demand for Treasury Bills has been outsized with a bid-cover ratio averaging 2.0x quarter-to-date compared to 1.2x in 3Q2024
- We think the post MPC briefing on Friday will give colour to the non-committal by the fiscal authorities to the domestic bond switch auction as penciled in the FY25 Annual Borrowing Plan. Domestic borrowing outturn is currently ahead of the curve and giving authorities the flexibility to exercise the domestic liability management operations.

50bps cut is a sweet spot as the authorities balances the risk

The CBK Monetary Policy Committee (MPC) is scheduled to meet on 05 December 2024, and we see scope for a 50bps rate cut. The meeting comes at a more favourable time compared to a similar period a year ago. The lagged impact of the prior aggressive rate hikes has partly contributed to inflation trending lower. The Kenya Shilling has steadied in the subsequent months following the sharp adjustment in 1Q2024. Yields at the short end of the curve have fallen off since the last MPC meeting. Against this backdrop, the direction of travel is for a rate cut. Nevertheless, the uncertain global environment of rising protectionism with an inflationary bias call for some restraint and we thus see 50bps cut offering the sweet spot.

New external MPC members but is the MPC independent?

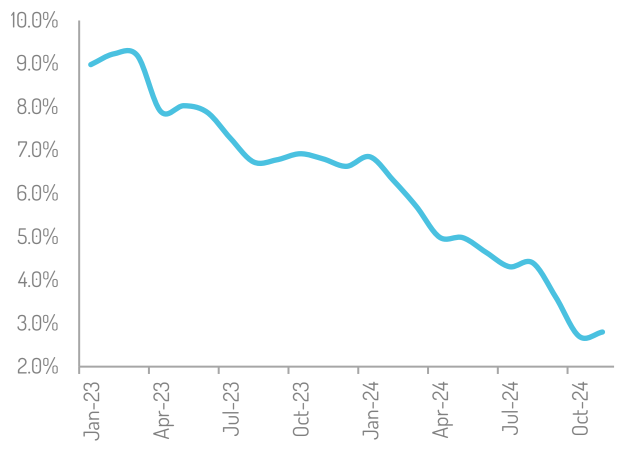
The MPC meeting will also have four new external members; appointed last month by the National Treasury Cabinet Secretary (CS). A long-standing issue with Kenya's MPC setting is that the Committee is synonymous to a "one-man show", with the Governor being the face of the Committee while the other MPC members take a back seat. Whether deliberate or not, the individual thoughts by the other MPC members should be refreshing, if not welcome.

But we may be getting ahead of ourselves. The MPC as currently constituted also has in its membership a representation from the National Treasury, with the Permanent Secretary (PS) a sitting member. Broadly, this amplifies monetary policy independence, or lack of. Over the weekend, local media quoted the National Treasury CS promising that, "*The interest rates are something we must lower….*" (emphasis added). Notwithstanding the PS sits as a non-voting member of the MPC, the CS comments strike at the heart of monetary policy independence.

Disinflation but sequential trend offers some cause for concern

Headline inflation in November came in at 2.8% y/y, steadied by the cooling food and fuel inflation, and 30bps above the lower target of 2.5%. The combination of favourable base effect and the lagged impact of the previous tightening posture has resulted in the disinflation trend. The core inflation remained muted at 3.2%, and the anemic private sector credit mediation has exacerbated the stickiness in this inflation metric. Notwithstanding the low inflation readings, the higher pace in the sequential readings should be a concern to the policymakers. On a monthly basis, headline inflation rose gradually to 0.26% in November from 0.19% in September, limiting the slide in the preferred inflation print below the lower target. We think this uptrend in the sequential reading will add impetus towards caution amongst the policymakers.

INFLATION TREND

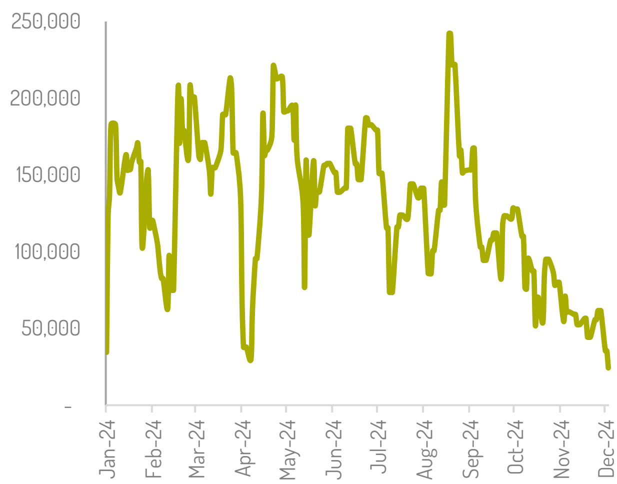


SOURCE: KENYA NATIONAL BUREAU OF STATISTICS

KES stability cushions imported inflation risk

The Kenyan Shilling's stability has padded the risk of imported inflation. KES is up 21.1% YTD and has been trading in a range of 128 – 130 levels. Monthly volumes at the FX interbank market have nosedived to c. USD 200.0mn levels recently from an average of USD 1.0bn in late 1Q2024, cementing the range bound trading. Furthermore, anecdotal evidence suggests the apex bank has been purchasing dollars in the market and i). the decline in commercial banks' net foreign assets by USD 618.2mn between July and September 2024, and ii). build up in FX reserves by USD 1.2bn from July to-date, lends credence to this claim. That said, diaspora remittance outturn has been a positive offset on the current account and shored KES stability.

OUTSTANDING REVERSE REPO (KES, MN's)

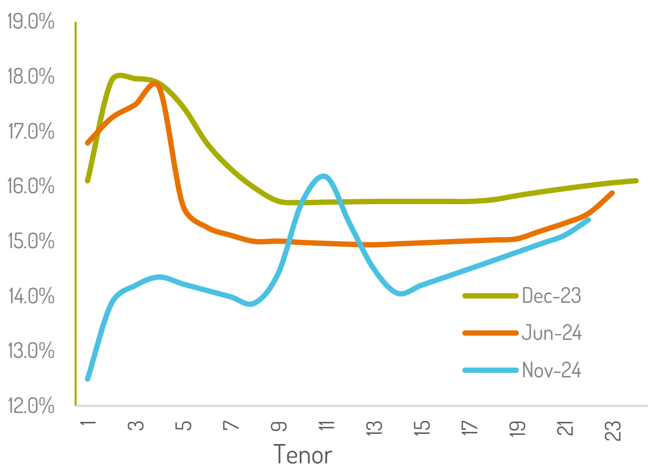


SOURCE: BLOOMBERG

Short end of the curve benefitting from higher liquidity

Inadvertently, the FX sales by commercial banks to the apex bank have somewhat improved KES liquidity. Given the Open Market Operations (OMO) biased towards liquidity injections, we have noted the amount of OMO instruments outstanding at any given point has reduced significantly. Considering this and coupled with elevated liquidity levels in select SOEs, demand for Treasury Bills has been outsized with a bid-cover ratio averaging 2.0x quarter-to-date compared to 1.2x in 3Q2024. As a result, T-Bill yields have reduced by an average 468bps across the three tenors and shifting the yield curve. Given these shifts at the short end, a policy rate cut decision offers a much needed "catch up" and to readjust lower the other non-market rates, interbank and discount lending rates. Refreshingly, there has been a sizable uptake in horizontal repos amongst banks shifting away from the discount lending instrument.

TREND OF YIELD CURVE



SOURCE: NAIROBI SECURITIES EXCHANGE

Post MPC briefing should give clues on FY25 switch auctions, if at all

We think the post-MPC briefing on Friday will give colour to the non-committal by the fiscal authorities to the domestic bond switch auction as penciled in the FY25 Annual Borrowing Plan. Domestic borrowing outturn is currently ahead of the curve and giving authorities the flexibility to exercise the domestic liability management operations, but this could shift as, i). the spending plan for counties has been finally approved with a slightly higher amount, ii). impact of the tax revenue plans contained in the Tax Laws (Amendment) Bill, 2024 and Tax Procedures (Amendment) Bill, 2024, and finally iii). revised spending plan with the anticipated tabling of the second FY25 Supplementary budget in January 2025.

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