FUNDAMENTALS

KENYA UPCOMING MPC UPDATE
LINGERING GROWTH CONCERNS

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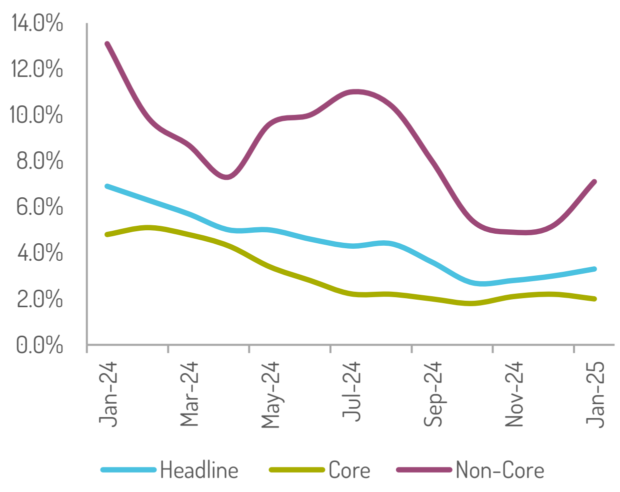
IN BRIEF

- The Monetary Policy Committee (MPC) of the Central Bank of Kenya (CBK) is scheduled to meet on 05 February 2025, and we see scope for a 75bps rate cut. The MPC delivered a cumulative 175bps rate cuts in the second half of 2024 to an effective 11.25% Central Bank Rate, but the long transmission lag means that the easing effects are yet to filter fully to the economy.
- Headline inflation inched higher by 30bps m/m to 3.3% y/y in January 2025, largely driven by elevated food inflation. Given that the monetary policy rate is a blunt instrument on the non-core segment, the policymakers are likely to look beyond the noise of the non-core with focus on the signal from the core segment.
- The policy meeting will offer the first assessment of ex-post 3Q2024 GDP growth data that delivered a negative surprise of 120bps against CBK's expectation of 5.2%. Underpinning the sluggish growth has been anemic credit mediation and the fiscal outturn which amplifies the demand-side economic strains.
- The authorities settled USD 455.0mn external debt payment to China which has resulted in a dip in stock of FX Reserves before rebounding and closing January at USD 8.9bn. Unsurprisingly, the Kenya Shilling remains generally stable, sustaining the good run from last year and capping the risk of imported inflation.
- The fiscal authorities will likely increase the FY25 domestic borrowing target due to the anticipated downward revenue adjustments. Going by the current domestic borrowing target of KES 413.0bn, the authorities are ahead of their domestic financing requirements. This appears to be the proximate cause of the authorities' announced domestic bond buyback which was published on Monday 03 February 2025.

Scope for a successive 75bps rate cut to stimulate demand

The Monetary Policy Committee (MPC) of the Central Bank of Kenya (CBK) is scheduled to meet on 05 February 2025, and we see scope for a 75bps rate cut. The MPC delivered a cumulative 175bps rate cuts in the second half of 2024 to an effective 11.25% Central Bank Rate, but the long transmission lag means that the easing effects are yet to filter fully to the economy. The latest headline inflation print extended the reversal in the entrenched disinflation trend but peeling beneath the core reveals some worrisome trend for the policymakers, specifically the muted demand pressure in the economy. The Kenya Shilling has remained stable YTD and the recent credit actions by Moody's and Fitch Ratings have signalled some nascent bright spots and lower risk premium. Nevertheless, the market will be keenly awaiting clarity on the domestic buyback plan via the reverse auction that was announced earlier this week. Although the CBK has a single mandate on price stability, growth outlook appears sluggish from recently released metrics and further augmented by an anemic private sector credit mediation. Against this backdrop, we expect a 75bps rate cut to 10.50% in the February 2025 MPC meeting to stimulate demand activities.

HEADLINE AND DISAGGREGATED INFLATION



SOURCE: KENYA NATIONAL BUREAU OF STATISTICS, IC INSIGHTS

Despite the uptick in headline print, it is 'rotten to the core'

The January 2025 inflation highlighted a significant pivot with the Statistics agency presenting both the core and non-core inflation prints for the first time. Headline inflation inched higher by 30bps m/m to 3.3% y/y, largely driven by elevated food inflation. Disaggregating the headline print, core inflation declined 20bps m/m to 2.0% whereas non-core inflation galloped 190bps to 7.1%, largely on the runaway volatile food prices. Given that the monetary policy rate is a blunt instrument on the non-core segment, the policymakers are likely to look beyond the noise of the non-core with focus on the signal of the core segment. Core inflation has remained stagnant at 2.0% levels since July 2024, and we think that the reaction function bias will be towards a more accommodative policy stance. Notably, the tweak in core inflation methodology from the previous proxy of non-food non-fuel inflation that had a 53.4% weight to the current 81.1% core weighting means that core prints between June 2024 to December 2024 have been revised lower by an average 113bps under the revised methodology. This should give a more bearish picture of the underlying economic strains.

Weak demand pressure in the economy lingers on from ex-post growth and fiscus outturn

The policy meeting will offer the first assessment of ex-post 3Q2024 GDP growth data that delivered a negative surprise of 120bps against CBK's expectation of 5.2%. Underpinning the sluggish growth has been anemic credit mediation with private sector credit growth in November 2024 on a 12-month rolling basis declining by 1.1%. This is the challenging backdrop which has resulted in lower core inflation reading that the MPC will grapple with. Furthermore, revenue outturn in the current FY25 budget year has underwhelmed the authorities' expectations, more so the consumption tax streams of Value Added Taxes and Excise Duties, which has led to National Treasury signaling a lower recalibration of the targets in the upcoming second FY25 Supplementary budget adjustments. As flagged in our outlook report, there has been a wide discrepancy in double digit revenue growth in an environment where nominal growth has retraced to single digit, and the downward revision in revenue targets shows some realism going forward and ahead of the final IMF review of the current programme.

Sisyphean task of holding KES stable although reduced risk premium is a boost

The authorities settled USD 455.0mn external debt payment to China that has resulted in a dip in stock of FX Reserves before rebounding and closing January at USD 8.9bn. Unsurprisingly, the Kenya Shilling has appreciated 0.1% YTD and reduced the risk of imported inflation. Notably, volumes traded in the FX interbank market edged higher by 10.5% m/m in January 2025 to USD 495.0mn as per our calculations and outside the cyclical corporate stockpiling month. This strengthens our view that the CBK actively sourced USDs from the FX interbank market to shore up its FX reserves and support KES stability following the debt payment. The country's risk premium as proxied by 5year Credit Default Swaps (CDS) has reduced from a peak of 770bps in August 2024 to 506bps as of 04 February 2025, and the recent positive outlook review by Moody's and status quo by Fitch Ratings should soothe investors' concerns albeit in the near-term.

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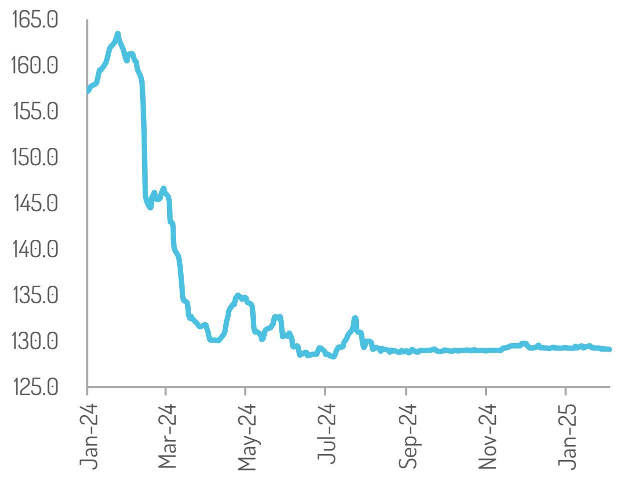

SOURCE: BLOOMBERG, IC INSIGHTS

Choice of buyback over bond switch suggests authorities are mindful of lower rate environment

The fiscal authorities will likely increase the FY25 domestic borrowing target due to the anticipated downward revenue adjustments. Going by the current domestic borrowing target of KES 413.0bn, the authorities are ahead of their domestic financing requirements. This appears to be the proximate cause of the authorities' announced domestic bond buyback which was published on 03 February 2025. The CBK announced a KES 50.0bn buyback sale on three bonds scheduled to mature in April 2025 and May 2025 with an outstanding amount of KES 185.1bn. As the authorities had earlier shelved bond switch auction, the buyback to be conducted via reverse auction surprised the market. Nevertheless, the choice of the reverse auction over bond switch auction suggests the authorities are keen on deflating any uptick in domestic rates that may arise in rollover scenario in the latter transaction. Furthermore, the proceeds from this month's dual tranche infrastructure bond (IFB) sale are likely to fund the buyback as the IFB settlement date of 17 February 2025 coincides with the reverse auction date. Nevertheless, we believe the authorities may have a predetermined counterparty for a successful buyback to wade off any execution risks attendant to this liability management operation. The Pavlovian conditioning that IFB issuance typically flies off the shelf means that the authorities are eyeing to conduct a buyback quantum higher than the offered KES 50.0bn. Given the negative optics of a less successful buyback that will amplify refinancing risks with the high maturity wall in 2Q2025, this solidifies our view that the authorities have a counterparty in mind for this liability management operation.

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