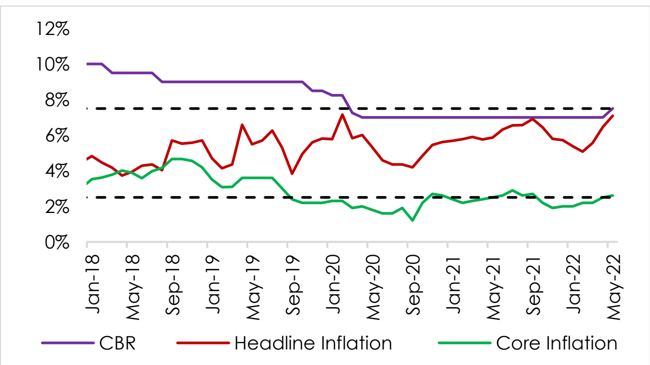
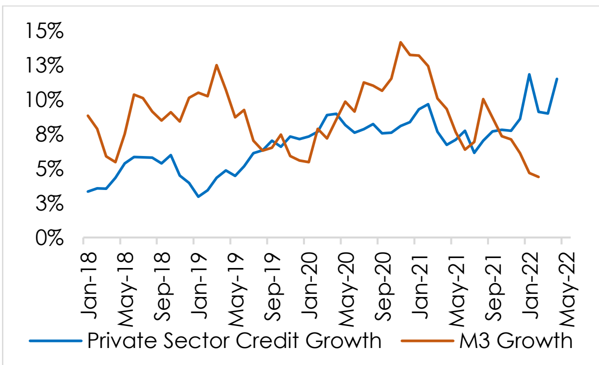
01st June 2022

Central bank tightens monetary policy as inflation pressures mount

- Rising consumer prices have been exacerbated in recent months following a surge in food and fuel costs. In May, headline inflation soared to a 27-month high of 7.10%, up from 6.47% a month before.
- Food inflation accelerated to 12.40% (y/y) up from 12.10% in April driven by a rise in the cost of vegetables due to unseasonal rains and the impact of supply chain disruptions on the cost of cooking oil. As such, the most notable food price increments were recorded on cooking oil (+47.10%), wheat flour (+28.40%), loose maize flour (+14.70%) and sukuma wiki (+11.90%).
- We expect food prices to remain elevated in coming months owing to higher input and as such production costs. Moreover, a shortened crop growing window due to the late onset of the rainfall season and overall poor cumulative rainfall in May is likely to result in poor to failed harvests into the month of June.
- Similarly, fuel inflation has remained stubbornly high despite the government's resolve to continue paying fuel subsidies in an effort to soften the impact on consumer wallets. In May, fuel inflation rose to 9.00% (y/y) from 8.50% a month before. The uptick was anchored on a rising cost of gas/LPG (+43.50%), diesel (+21.50%), kerosene (+21.30%) and petrol (+18.70%).
- We expect fuel prices to remain elevated tracking the surge in the cost of global crude oil. Already, global crude oil prices have touched highs of US$ 123 a barrel as at the end of May 2022. While the rise in global crude oil prices has primarily been linked to constrained supply, especially following the Russia-Ukraine spat, an expected easing of China's anti-COVID lockdowns and subsequent resumption in manufacturing activity is expected to raise demand further aggravating price pressures.
- Meanwhile, demand side pressures have trended higher, albeit modestly, with core inflation (non-food, non-fuel) rising to an 8-month high of 2.60% from 2.50% in April. The uptick in core inflation signals that price growth is gathering pace across most categories of goods and services.
- Overall, consumer price pressures have broadened. We expect inflation to surpass and remain above the 7.50% statutory upper limit from June 2022 through to the third quarter, before beginning to soften in the final quarter of the full year.
- The Central of Bank of Kenya (CBK) has already taken steps to address the surge in inflation by hiking its policy rate (CBR) by 50bps to 7.50% in its most recent monetary policy committee (MPC) meeting at the end of May 2022. While we see scope for an additional 75bps policy rate hike in Q3-2022 in light of the inflation outlook, we expect the CBK to remain cautious of threats to GDP.
- Higher inflation expectations should as well continue to filter through to the yield curve more so on the short end. The upturn in yields will as well reflect increased government borrowing and the policy rate hike.



Source: KNBS, CBK, NCBA Research



Source: CBK, NCBA Research

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