NCBA

MONTHLY ECONOMIC REPORT

SEPTEMBER 2023

ncbagroup.com

Go for it

Highlights

- The global economy continues to face multiple headwinds - including tight monetary policy across most economies, stubborn inflation and seemingly unending geo-political tensions. Nonetheless, growth has remained resilient.
- In the US, the economy has continued to push any signs of a recession further away.
- Positively, data indicates that the US labor market is returning to a more normal supply-demand balance. This would seem to be, what monetary policy makers would view as a signal that the US economy is on a path to a "soft landing."
- Euro Area business activity printed a mixed signal in August as the region's downturn spread further from manufacturing to services.
- Overall, while China still holds a strong commitment to the long-term project of weaning the economy off its dependence on real estate, it is not expected to contribute significantly to global growth, as it did in the past.
- The macroeconomic backdrop in August for both developed economies as well as emerging markets was somewhat muted and thus little aggressive activity was recorded in the commodities market.
- In Kenya, business conditions seemingly improved in August- from the July levels. Notably, headline S&P Global PMI came in at 50.6, slightly above the 50.0 neutral mark and up from 45.5 in July.
- With mounting debt service obligations, CBK official FX reserves dropped by USD 250Mn in the month to USD 7.08Bn, covering only 3.8 months of import cover. Certainly, the central bank has limited headroom to offer any support to the currency.
- Overall, Uganda has managed its prices -inflation, interest rates and currency relatively well. Absent any external shocks, the macroeconomic conditions are likely to remain stable.
- The Tanzanian economy remains stable-except for the exchange rate, which is expected to remain relatively fragile, even with any positive surprise from the tourism peak.
- In Rwanda, hopefully, the policy-makers will be committed to implementing the necessary fiscal policy adjustment in the wake of reduced prospects for external concessional financing. For now, the National Bank of Rwanda appears ready to take further actions to anchor inflation expectations.

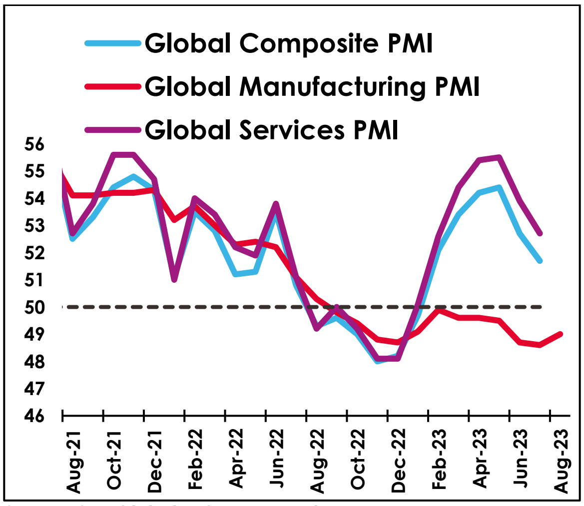
Global Economic Overview

The global economy continues to face multiple headwinds including tight monetary policy across most economies, stubborn inflation and seemingly unending geo-political tensions. Nonetheless, growth has remained resilient.

Following these headwinds, the August Purchasing Managers Index (PMI) readings indicated broad weakness. Reflectively, the global manufacturing sector remained on a downturn. This is largely pointing to the post-pandemic shift toward the services sector. Broadly, it is illustrative of the performance of China and Germany- the key global goods manufacturers.

More recently, activity in the services sector seems to be slowing down too. While the global services PMI printed above 50 in July (latest available data point), it has been declining since May. An analysis of the same across the key economies indicates similar sentiments in the US, UK and the Euro Area and a bit more recently in China.

Figure 1: Global Purchasing Managers' Indices



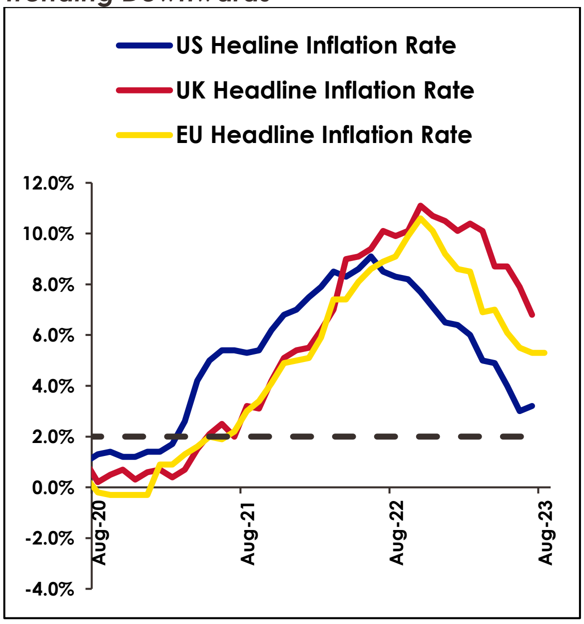
Source: S&P Global, NCBAResearch

Meanwhile, central bankers view this cool down in the level of economic activity as a positive result of monetary policy tightening. Notably, policy-makers in developed, emerging and frontier markets have since mid-last year tightened monetary policy quite aggressively. With inflation falling across most economies, we expect that policy rates in the developed markets are near their peaks. Notably, we anticipate that the Federal Reserve and European Central Bank will probably only hike policy rates once more while the Bank of England could hike two more times.

Relatedly, we expect that most central banks in Emerging and Frontier markets may need to keep monetary policy tight for the remainder of this year.

In summary, with global economic activity levels registering somewhat below trend in August and monetary policy remaining tight across the key markets, global inflation is likely to remain on a downward path.

Figure 2: Inflation in Advanced Economies Trending Downwards



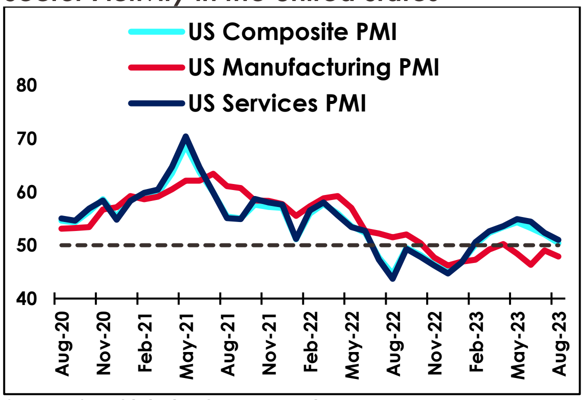
Source: Bloomberg, NCBAResearch

In the US

Aggregate consumer demand levels remained fairly resilient in August, while overall economic growth has recently kept within an above forecast level of 2% quarter-on-quarter. Overall, the US market has continued to push any signs of a recession further away.

Indicatively, at 50.4 in August, the US Composite PMI remained within expansionary territory. That said, even though the services PMI continues to print above the 50 neutral-mark – lately, its trend has been downward. This can be linked to a recent fall in demand on the back of high interest rates and price pressures that have weighed markedly on consumer spending.

Figure 3: Services Continue To Bolster Private Sector Activity in the United States



Source: S&P Global, NCBAResearch

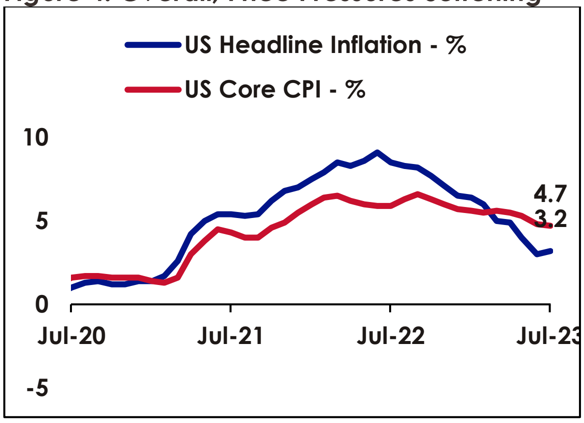
Understandably, the manufacturing PMI fell further to 47 from 49 in July. The shift in demand from goods to services is yet to end - though near.

Surprisingly, the unemployment rate increased to 3.786% in August from 3.495% in July, with employment growth numbers touching 187,000. As a result, wage growth slowed from 0.42% month-on-month in July to 0.24% in August.

Positively, this data indicates that the US labor market is returning to a more normal supply-demand balance. It would seem to be, what monetary policy makers would view as a signal that the US economy is on a path to a "soft landing."

Relatedly, overall inflation has softened, with the headline CPI touching 3.2% in July while core CPI declined year-on-year from 4.8% to 4.7%. The only surprise to the market was another 8% decline in airfares.

Figure 4: Overall, Price Pressures Softening



Source: U.S.BLS, NCBAResearch

Admittedly, the softer July CPI seems reason enough for the US Fed to "skip" hiking at the September meeting.

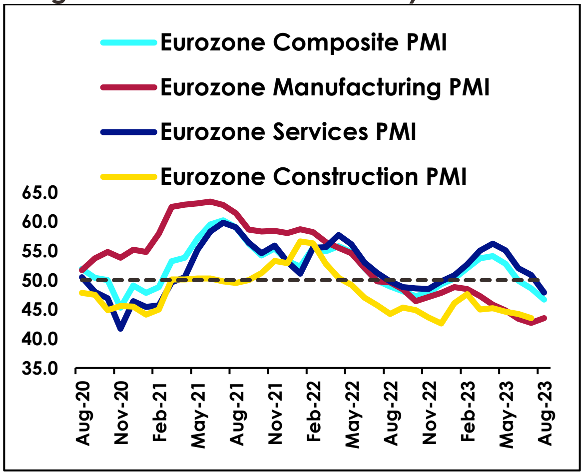
However, a true "soft landing" –with inflation returning to the 2% target without a significant drop in economic growth remains uncertain. Resultantly, this has sparked debate as to whether the 2% inflation target remains appropriate today.

In the Euro Area

Euro Area business activity printed a mixed signal in August as the region's downturn spread further from manufacturing to services. Resultantly, the manufacturing PMI increased by one point to 43.7, a tentative sign of stabilization in the sector which has been suffering from the energy crisis, post-pandemic demand rotation, China weakness and rising interest rates.

However, this was disrupted by a sharp slowdown in the services sector from 50.9 to 48.3, the first print in contraction territory this year. The plunge could have been deeper had it not been for resilience recorded due to the tourism season.

Figure 5: Surprise Slowdown in Services Weighs on Private Sector Activity



Source: Bloomberg, NCBAResearch

Expectedly, the region's performance was heterogeneous- with Germany hit hard by manufacturing weakness against a strong services outcome in Spain and Italy. In its August report, the Bundesbank acknowledged that the current "weak phase" of the German economy is likely to continue following weak external demand, rising interest rates and high inflation. With the summer tourism season closing, the services sector as well as employment are unlikely to remain robust in the coming months.

In as much as it is evident that further policy action is required by the ECB to bring inflation back to target, with overall data confirming subdued economic activity, the decision to hike or hold will be a fine balance. Expectedly, the decision by the European Central Bank (ECB) later this month is uncertain. Comments by various ECB members have not been indicative of any firm stance, with the majority calling for a meeting-by-meeting approach to the future monetary policy path.

For the currency, this uncertainty on future ECB rates decisions is unlikely to offer support to the EURO in the near-term.

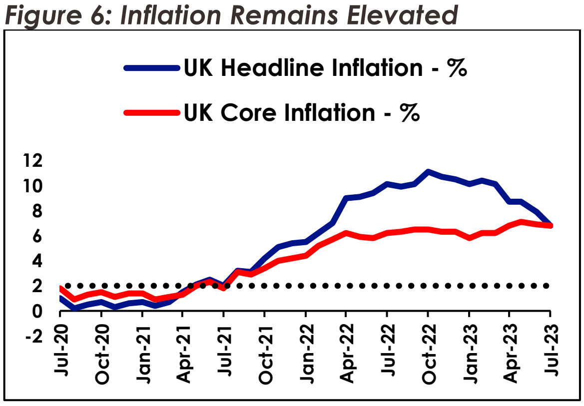
In the UK

According to the S&P, the UK services PMI in August printed at 48.7, weaker than the 51.5 print in July. The manufacturing PMI also fell further to 42.5 from 45.3 in July- in contrast with the rest of Europe. However, the services sector PMI was broadly in line with the greater Europe, touching 48.7 in August from 51.5, previously.

We could also interpret this weaker economic data to mean that tight monetary policy continues to filter into household spending, with several enterprise respondents to the S&P survey reporting a reluctance by households to spend in view of high interest rates.

On the inflation front, UK headline inflation fell to 6.8% year-on-year in July, relative to 7.9% in June, while core inflation was flat-lined at 6.9%- in line with the Bank of England's projection. Overall services inflation re-accelerated to 7.44%, nearly 20bps above the Bank's August forecast – at 7.25%.

Figure 6: Inflation Remains Elevated



Source: BOE, NCBAResearch

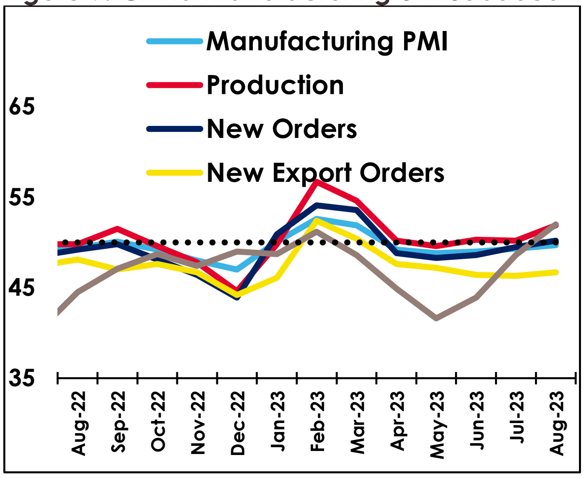
We still expect a further 25bps policy hike by the BOE in September. However, we take note of the fact that there is another round of data on wages and CPI before the committee meets, which could tilt the monetary policy decision. Meanwhile, there is debate as to whether the BoE's inflation target can be attained without any further increase in the policy rate.

China

In August, China faced extreme weather conditions and lingering property sector weakness. Nonetheless, the manufacturing PMI picked up unexpectedly in August by posting 49.7, up from 49.3 in July, against market expectations of a further decline. However, this print was still in the contractionary territory, indicating sustained broad weakness.

Concerningly, the non-Manufacturing PMI eased to 51.0 from 51.5 in July, the lowest reading so far this year. The summer travel boom did not seem to fully offset the fading of the economy's reopening impulse. Given the floods and severe weather as well as the credit events involving the property developers, the property sector is not out of the woods yet, and confidence remains broadly weak across several sectors.

Figure 7: China Manufacturing Still Subdued



Source: Bloomberg, NCBAResearch

For us, this persistent growth decline of China's economy has wide-ranging implications. In some respects, what is bad for China is currently helpful for other Emerging Markets (EM) as well as Frontier Markets (FM) efforts to keep pushing inflation down. Muted Chinese stimulus as well as absence of China-led supply chain price-pressures help Emerging & Frontier markets disinflation narrative. Resultantly, international oil prices have somehow moderated at about US$ 85 a barrel. The same should go for industrial metals.

Overall, while China still holds a strong commitment to the long-term project of weaning the economy off its dependence on real estate, it is not expected to contribute significantly to global growth, as it did in the past.

Commodities: Prices remain muted in August for most global commodities

The macroeconomic backdrop in August for both developed economies as well as emerging markets was somewhat muted and thus little aggressive activity was recorded in the commodities market. Resultantly, month-on-month price movement of key commodities was restricted within the single digit range. Moreover, general price levels are historically not low enough to induce appetite by some economies to import for strategic storage. For example, China's oil import in July and August is reportedly at a normal level given the not-so-attractive oil price of US$85 a barrel.

Figure 8: Global Commodity Prices

Commodity Prices	Jul-23	Aug-23
Brent Crude Oil ($/bbl)	80.10	86.16
Dubai Crude Oil ($/bbl)	80.46	86.61
Coffee Arabica ($/kg)	4.27	4.12
Tea – Mombasa ($/kg)	2.06	2.25
Palm Oil ($/mt)	878.50	860.82
Rice Thai ($/mt)	533.45	635.00
Rice Vietnamese ($/mt)	502.76	541.15
Wheat, US HRW ($/mt)	345.50	315.82
Sugar Global ($/kg)	0.52	0.53
Soybeans ($/mt)	633.85	583.93
Iron Ore ($/dmtu)	114.43	110.20

Source: World Bank – Commodity Prices, NCBAResearch

Agricultural Commodities

Most agricultural commodity prices including that of palm, sugar, corn, soybean, tea, coffee and wheat have remained broadly unchanged in August. This is despite Russia walking away from the Black Sea Trade Initiative in July.

Positively, following favorable weather, crop output has improved across South America and the US; flows into the export markets have been healthy. Moreover, markets did not record any significant build-up of extraordinary reserves by the main importers. Furthermore, speculative positioning remained subdued for most agricultural commodities, as futures trades were range-bound.

However, rice seemed to be an exception-with price increasing by 16% month-on-month in August. This follows India's announcement of an export ban on non-basmati white rice and broken rice, which account for about half of all Indian rice exports. Expectedly, this will pull out at least 20% of the rice exports in the global market.

Looking ahead, the likely El Niño weather pattern presents uncertainty in most regions, but appears more favorable than La Niña for cereal production. That said, rainfall significantly above the long-term-average would destroy crops and adversely turn the grains market from the current price levels.

Oil Market

Oil prices have continued to ease lower to about US$85 in early September, since peaking at US$88 in early August, as concerns on weak economic prospects in China and Europe continue. However, demand for jet fuel has remained robust-though still lower than lower than pre-pandemic levels.

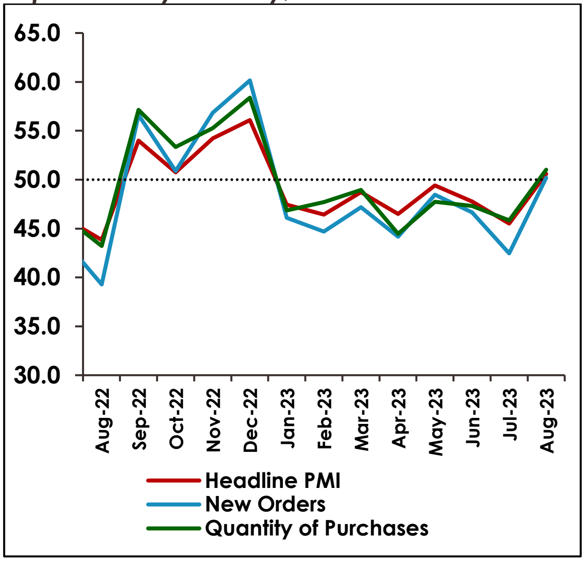
With Europe and China slowing its oil imports, price movement is expected to be low in the coming weeks.

Kenya

Private sector activity expanded in August

According to the latest S&P Global PMI reading, business conditions seemingly improved in August- from the July levels. Notably, headline PMI came in at 50.6, slightly above the 50.0 neutral mark and up from 45.5 in July.

Figure 9: Private Sector Activity Touches Expansionary Territory, First Time in 7-months



Source: S&P PMI, NCBAResearch

With the caution to look at several data points when analyzing business sentiments, it would appear that the dip in July was an outlier point. Thus, the August PMI would seem consistent with the trend in May and June.

Export order flows in August mirrored the trend levels recorded in 2Q2023, following continued demand across the East African Community. Indicatively, household purchasing power in Uganda and Tanzania-the key export destinations for Kenya's manufactured goods has remained firm given a stable currency-especially the UGX as well as very low inflation levels in July and August.

However, high input prices remained a challenge for businesses owing to sustained depreciation of the currency and various tax increments leading to the fastest increase in output prices since June 2022.

Government spending pressure

The month of July signified a positive start of the FY 2023/24. As it stands, the government collected KES 284.46Bn in revenues relative to KES 179.4Bn collected in a similar period in the fiscal year 2022/23 – suggesting the fiscal deficit could narrow if the momentum is sustained.

Of this, either out of pressure to settle short-term liquidity constraints or a deliberate plan to front load domestic borrowing this year, the GOK raised a net of KES 83.56B compared to KES 15.61B in July 2022. Meanwhile, tax collections amounted to KES 155.07Bn in comparison to KES 130.60Bn in the same period last year. External financing came in at KES 43.07Bn – 55% higher than in July 2022.

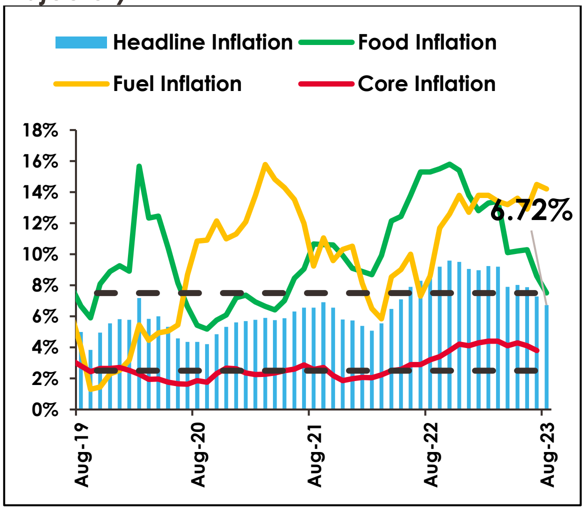
Nevertheless, government spending in the month denoted that pockets of strain could emerge for the sovereign in the coming months. Of the total revenue collections, KES 161.84B was spent on debt service obligations.

Moreover, only 52% of the pro-rated recurrent expenditure was disbursed in the month of July – a total of KES 56.99Bn. Further to this, development spending was muted at KES 1.89Bn in July 2023.

Inflation dips faster than expected in August 2023

Inflation pressures are cooling at a faster pace than previously anticipated. In the latest figures, annual headline inflation fell to 6.7% in August 2023, down from 7.3% in July 2023.

Figure 10: Inflation Sustains Downward Trajectory



Source: KNBS, CBK, NCBAResearch

Notably this is the lowest overall year-on-year inflation level since the monetary policy tightening cycle begun in May 2022. The softening of price pressures was largely driven by a combined decline in key food and energy items on the back of improved weather conditions and reinstatement of the fuel subsidy.

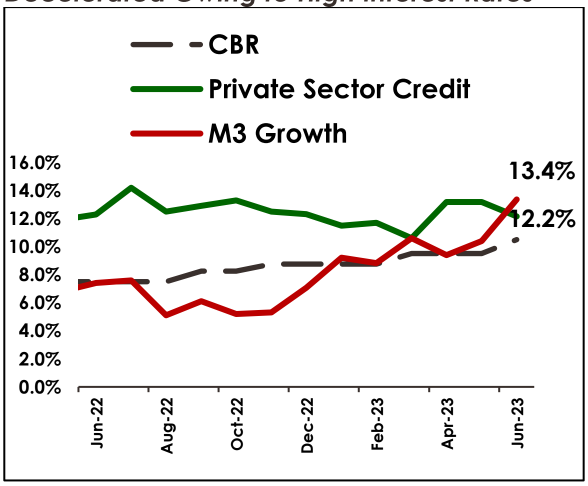
Despite this, overall inflation risk remains on the upside. For example, the S&P output price index in August was at more than a year's high of 58.5 pointing to potential consumer price increase in the short-term. Moreover, the quarterly producer price index (by KNBS) was at a high of 11.37% in June.

Resultantly, monetary policy has remained tight- with the CBR at 10.5%. Already, this policy stance is being felt across markets with credit markets already pointing to slower lending growth. Resultantly, in June 2023, private sector credit growth decelerated to 12.2% from 13.2% in April and May.

Moreover, upward pressure on the yield curve persisted in August. Thus far, interest rates have been rising across the curve, with more aggressive moves on the short end.

In the month, the 91-day, 182-day and 364-day papers rose to 13.73% (+138bps), 13.49% (+110bps) and 14.01% (+129bps) respectively. The curve will continue to be influenced by GOK's appetite for domestic financing, although we posit that the regulator will be keen to subdue rate expectations especially as inflation moderated sharply in August.

Figure 11: Private Sector Credit Growth Decelerated Owing to High Interest Rates

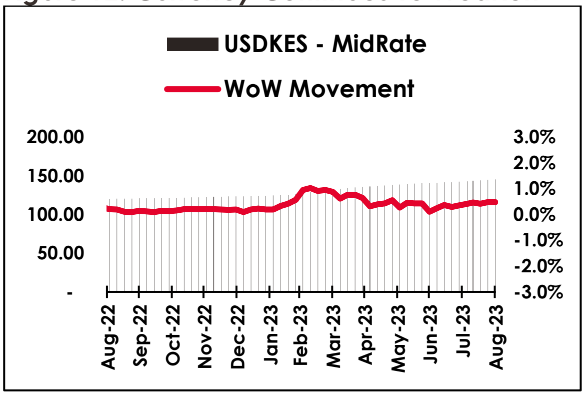


Source: CBK, NCBAResearch

KES to maintain losing streak against major currencies

In August, the shilling ceded 2.3% of its value to the US dollar. With mounting debt service obligations, CBK official FX reserves dropped by USD 250Mn in the month to USD 7.08Bn, covering only 3.83 months of import cover. Certainly, the central bank has limited headroom to offer any support to the currency.

Figure 12: Currency Continues To Weaken



Source: CBK, NCBAResearch

On the external front, in the 12-months to June 2023, exports grew by 14% year-on-year while imports recorded a growth of 4.0%. Nevertheless, the growth in exports only narrowed the trade deficit marginally to KES 1.56 Trillion from KES 1.57 Trillion in a similar period of FY 2021/23, but did not wipe it out.

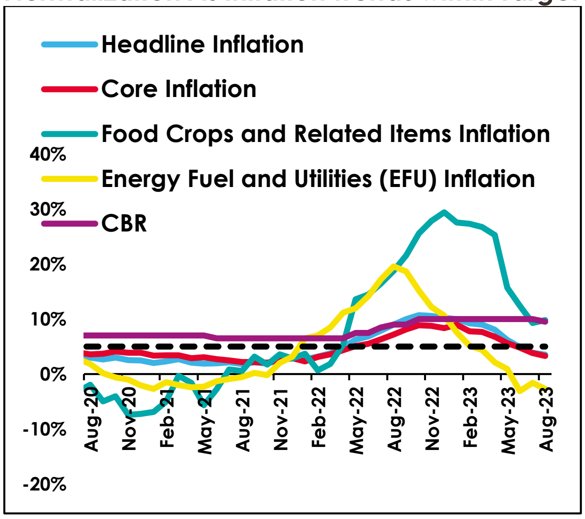
Positively, service receipts from tourism may provide some upside to the currency's outlook. Already, arrivals in the first half of 2023 represented a 92% recovery compared to pre-COVID levels (2019). More vital, forward bookings in the period to October are very close to pre-COVID levels - signaling potential increase in hard currency inflows.

In the interim however, the shilling will remain subject to supply and demand forces – whose mismatch remains protracted.

Uganda

Business activity is showing signs of deceleration, although holding firm in expansionary territory. Headline PMI posted a score of 51.6 in August, down from 53.9 in July indicating a sustained improvement in business conditions, albeit at a slower pace.

Figure 13: BOU Embarks On Monetary Policy Normalization As Inflation Trends within Target



Source: BOU, NCBAResearch

Overall, domestic demand remains robust in the economy, affirmed by continued growth in output and new orders. Broadly, firms remain optimistic about future expansion.

On the fiscal front, there is potential pressure on government revenue following the August withdrawal of new public financing project support by the World Bank. This resulted from the passage of the Anti-Homosexuality Act 2023.

Specifically, projects likely to be affected include $200Mn World Bank Investment for Industrial Transformation Employment (INVITE) Project for SMEs in the manufacturing and export sectors. The Uganda Intergovernmental Fiscal Transfers Program (UGIFT) (valued at $500Mn) which is co-funded by the World Bank and $360Mn Uganda Support to Municipal Infrastructure Development (USMID) programme in collaboration with the World Bank.

The subsequent impact for the Bank of Uganda is that it will remain constrained by the fact that the FX reserves may not increase significantly in the year. Indicatively in July, Uganda's gross FX Reserves dipped from US$4.07Bn in June to US$3.96Bn equivalent to 3.3months of import cover.

Calmingly, annual headline inflation dipped for the eighth consecutive month to 3.5% in August 2023 from 3.9% in July. Meanwhile, the core index dropped to 3.3% from the 3.8% July print - remaining within the medium-term target of 5.0%.

Driven by softening inflation pressures and signs of an output gap, the Bank of Uganda lowered the Central Bank Rate (CBR) by 50bps to 9.5%. Concerningly, demand for credit slowed to 6.2% in June 2023 from 8.9% in May. Thus, a less restrictive stance could see resumption in credit demand, which will then support activity in the private sector.

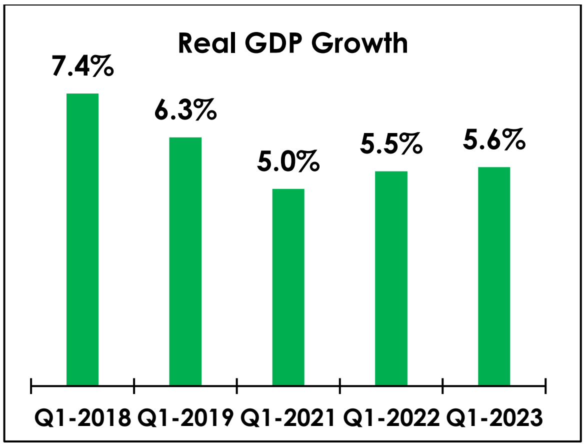
In the local FX market, the Uganda shilling reversed last month's gains because of renewed foreign currency demand from importers likely due to seasonal factors. UGX ceded 2.8% of its value to the US dollar in the month.

Overall, Uganda has managed its prices -inflation, interest rates and currency relatively well. Absent any external shocks, the macroeconomic conditions are likely to remain stable.

Tanzania

Though quite delayed, the official statistics showed that real GDP growth expanded by 5.6% in 1Q2023, relative to 5.5% in the corresponding period of 2022. Growth was supported by strong growth in key sectors of the economy including mining & quarrying services, financial and insurance, accommodation & food services.

Figure 14: Strong Outlook As First Quarter Growth Rebounds to Near Pre-Covid Levels



Source: NBS, NCBAResearch

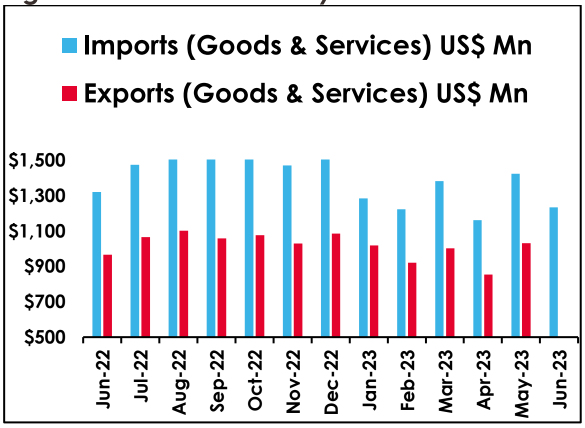
The agricultural sector's overall contribution to growth declined by 4.3% to 15.9% owing to unfavorable weather conditions that dented food production in the economy.

Mining and quarrying activities recorded the fastest growth, expanding their contribution to 12.0% of GDP. This was a result of increased production of some minerals such as coal and natural gas. Increased infrastructure investments in the economy resulted in the construction sector increasing its overall contribution to growth to 15.5%.

Inflation levels in the economy remain low and stable. According to the latest figures, price pressures declined further for the sixth consecutive month to 3.3% in July 2023 from 3.6% in June.

Against this backdrop, the monetary policy committee met on 31 August 2023 and decided to hold the policy rate at 5.0%. Continued accommodative monetary policy has sustained strong private sector growth. Hence, we posit credit growth will remain broadly high- currently at 21.2% as of June 2023.

Figure 15: Balance Of Payments



Source: NBS, NCBAResearch

On the external front, in the wake of global shocks, the current account deficit widened to 6.3% of GDP in 2022/23 from 4.8% in the previous year. Nevertheless, the foreign exchange position remained stable, as reflected in foreign exchange reserves, which remained adequate amounting to USD 5,338.9 million in July 2023, sufficient to cover about 4.8 months of projected imports.

Even with continued support from the bank of Tanzania, the Tanzania shilling has struggled to hold firm against the US dollar. In the month, TZS depreciated by 1.8% as dollar liquidity challenges escalated through August.

Overall, other than the exchange rate, which is expected to remain relatively fragile, barring any positive surprise from the tourism peak, the economy remains broadly stable.

Rwanda

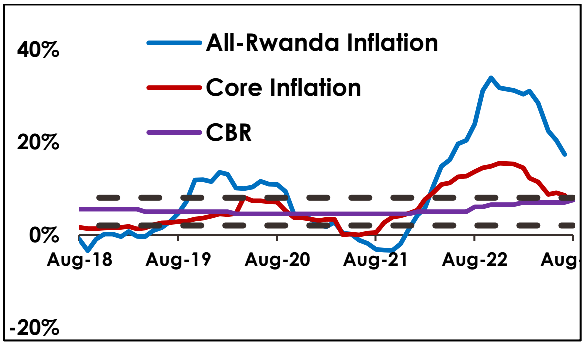
Leading economic indicators are reflecting a slowdown in economic activity. The Index of Industrial Production- declined by 2.7% year-on-year in July 2023.

The decline in production largely emanated from mining and quarrying activities and electricity that dropped by 37.2% and 10.7% respectively. While manufacturing output increased marginally by 2.4%.

Pointedly, we expect lower economic growth in the remainder of the year. That said, the economy is still poised for strong growth in 2023 in comparison to the region, albeit, it will underperform 2022's 8.5% GDP growth on the back of high inflation that continues to dampen private consumption.

To tackle these price pressures, on 17 August 2023, The National Bank of Rwanda raised the Central Bank Rate (CBR) by 50bps to 7.5%. The decision was attributable to high inflation levels at 17.3% as at July 2023. Similarly, the core inflation has remained sticky around 12% – 13% levels. In July 2023, non-food-non-fuel inflation was 12.4%.

Figure 16: Overall Price Pressures Remain Elevated



Source: NISR, NCBAResearch

Upside risks to the inflation outlook, include adverse weather conditions that may aggravate food inflation on the back of low food production. In May 2023, floods in Northern Rwanda affected food production and the subsequent supply of food to the market. A recurrence of the same could be detrimental to the economy.

Further, continued geopolitical tensions may spur an uptick in commodity prices and in turn increase imported inflation in the domestic market. Nevertheless, The MPC forecasts inflation to decelerate below 8.0% by end-year and ease to 5.0% by 2024.

In the external sector, the trade deficit widened by 12.7% in the second quarter of 2023 on account of fast growth in imports that more than offset the growth in exports. Merchandise exports increased by 5.3% on account of high exports of manufactured goods. Meanwhile, merchandize imports rose by 9.9% as import demand increased following still high global commodity prices.

In the local foreign exchange market, the Rwandese Franc continued to face continued strong demand for the US dollar, resulting in a 1.26% month-on-month depreciation. In the near-term, dollar deficits are expected to persist, underpinning further losses for the Franc.

Overall, the economy remains relatively stable. Hopefully, the policy-makers will be committed to implementing the necessary fiscal policy adjustment in the wake of reduced prospects for external concessional financing. For now, the National Bank of Rwanda appears ready to take further actions to anchor inflation expectations.

NCBA Research

Head Office: NCBA Centre, Mara & Ragati Roads, Upper Hill,

P O Box 30437 00100, Nairobi, Kenya

Direct Line: +254 020 288 4548 or +254 020 288 4725

Email: anthony.muli@ncbagroup.com or samantha.njoroge@ncbagroup.com or david.luusa@ncbagroup.com

Telex: 23205 (COMAFBANK); SWIFT BIC: CBAFKENX; Reuters Dealing: CBAF; Reuters Information: CBAN

Website: www.ncbagroup.com