NCBA

MONTHLY ECONOMIC REPORT

FEBRUARY 2024

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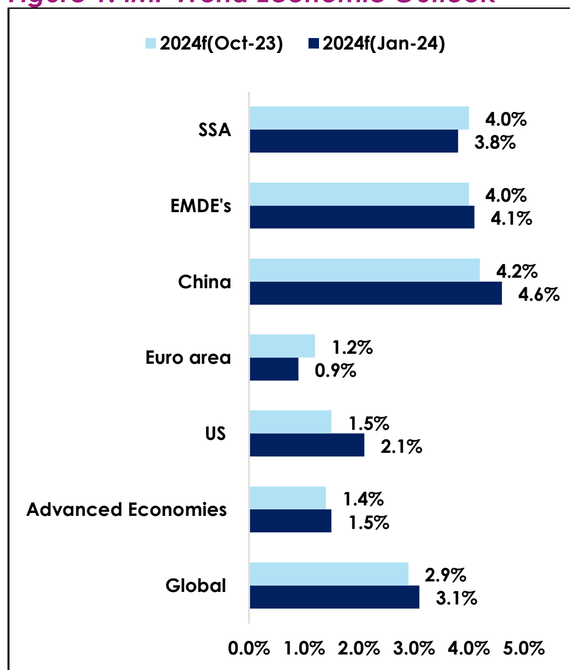
Highlights

- Our view that the global economy is on course to a soft landing remains broadly unchanged.
- We take cognizance of potential surprises against this outlook including a reversal of the disinflation path and several spots of geopolitical risks.
- Nonetheless, the resilience of the US economy continues to remain a constant in most projections. A remarkably healthy labour market in January places a Fed policy pivot more likely to occur in June.
- As of now, markets may not be overly worried about economic growth in the Euro area against the IMF's positive growth forecasts across the key economies.
- However, greater proximity to geopolitical tensions in the Middle East as well as Europe's dependence on the Red Sea Channel for trade portends risks.
- In contrast, the UK markets continue to remain a mixed bag to the markets with growth expected to flat-line in 2024 and concerns still lingering around the much stickier headline inflation.
- In Kenya, the near-term economic growth outlook is positive given the anticipated continued rebound in agriculture. However, fiscal risk remains firmly in focus in 2024 despite receiving IMF funding – although recent developments heralds some optimism.
- Expectedly, inflation remains sticky near the central bank's upper target band - accelerating to 6.9% in January. Inflationary pressure seems to persist in the near term – calling for more restrictive monetary policy. Hence, the regulator upwardly revised the Central Bank Rate by 50bps to 13.0%.
- In Uganda, the sovereign appears to be facing additional complexities on the public finance management front. Markets would be keen to see Uganda extend or enter a new program with the IMF upon expiry of the current 36-months program in June this year.
- In Tanzania, staying on track with regard to the current IMF program continues to appear attractive to both domestic and foreign investors. Market worries remain mostly around the FX market liquidity and the government's ability to secure adequate concessional financing for all the ongoing projects.
- Although Rwanda is forecast to remain a regional outperformer, growth could be dampened by the tight monetary policy, currency weakness and ongoing trade disruption on the Democratic Republic of Congo border.

GLOBAL VIEW

Our view that the global economy is on course to a soft landing remains broadly unchanged. Despite the divergence in growth forecasts by various key institutions- consensus seems to point toward a better-than-earlier forecast economic growth rate. Notably, the latest forecast by the IMF (January 2024 World Economic Update) upgraded its global economic growth forecast to 3.1% in 2024, relative to 2.9% in October last year. In as much as the World Bank's growth forecast released in early January indicated a lower growth rate of 2.4%, this still largely points to the possibility of global inflation declining to target levels without significant sacrifice on economic growth.

Figure 1: IMF World Economic Outlook

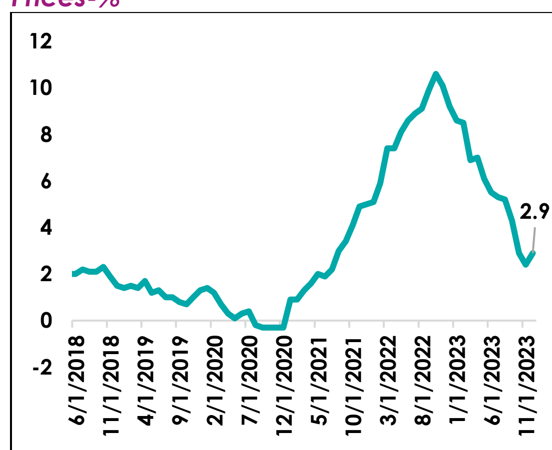


Source: International Monetary Fund, NCBA Research

Understandably, we take cognizance of potential surprises on either side of these forecasts. Already, the New Year has brought some notable surprises. The US labour market seems to have strengthened quite fast in January. Though the unemployment rate kept steady at 3.7% in January, the market created about 353,000 new jobs against a market expectation of 185,000. Essentially, this puts a March Fed rate cut off the table but makes June more likely. Moreover, this seems to reaffirm the most recent remarks by the Fed Chair that a disparity of views remains between the monetary policy committee members.

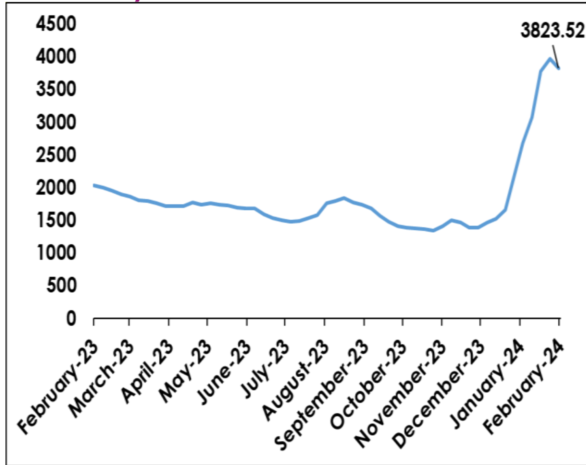
Secondly, several spots of geopolitical risks could pose challenges for global growth. The Israel- Hamas conflict- earlier restricted to only two economies, now seems to have spread into the larger Middle East region. Of concern going forward is the implication on commodity prices and shipping disruptions. Already, global oil prices have gotten volatile while shipping freight costs and volume along the Suez Canal have significantly changed.

Figure 2: Harmonized Index of Consumer Prices-%



Source: Bloomberg, NCBA Research

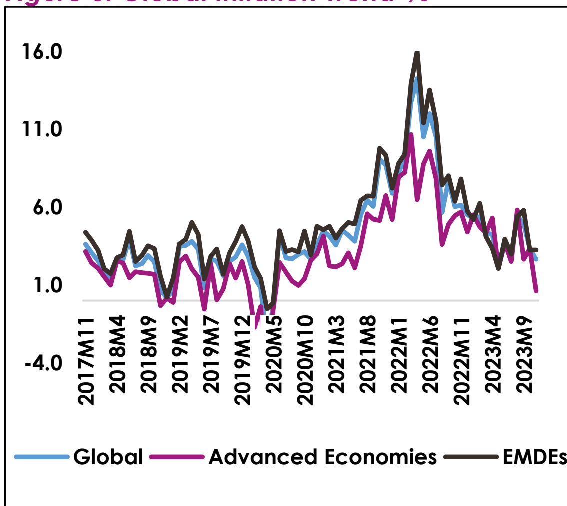
Figure 7: WCI Freight Index Rate Per 40 Foot Box Drewry



Source: Bloomberg, NCBA Research

Consequently, a reversal of the disinflation path- that saw global headline inflation touch 2.7% in November 2023, relative to 6.1% a year earlier, could put the view of a soft landing at risk. Europe remains most exposed, given that about 40% of Europe-Asia trade passes through the Red Sea. In the Middle East region, Egypt's dependence on tourism, as well as shipment revenues from the Suez Canal, could further weaken its external sector outlook.

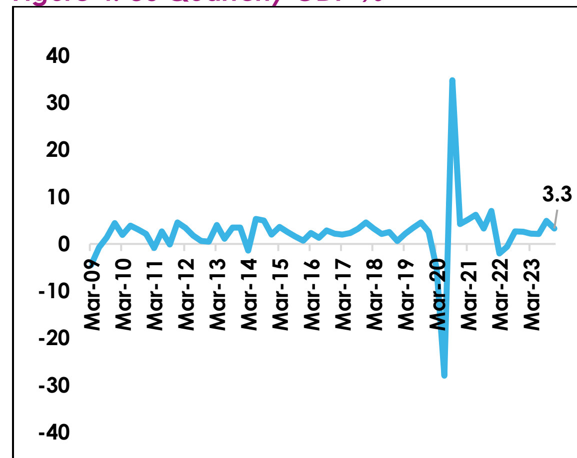
Figure 3: Global Inflation Trend-%



Source: International Monetary Fund, NCBA Research

More specifically, in the US market, growth resilience remains constant in most projections. The 4Q2023 real GDP printed at 3.3% - well above the 2.0% long-run estimates for potential growth, while GDP growth forecast in 2024 by the IMF in January touched 2.1%, still above an earlier projection of 1.4% by the Federal Open Market Committee (FOMC) in December last year. This, together with December's falling inflation print- Personal Consumption Expenditure (PCE) Price Index declined further to 2.9% in December from 3.2% in November - puts the Fed on a path to cut rates in mid-2024.

Figure 4: US Quarterly GDP-%



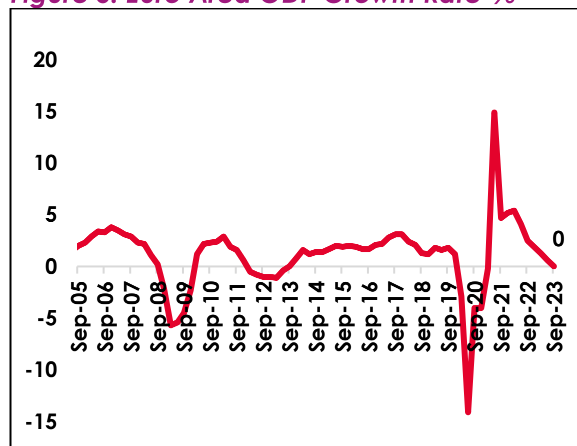
Source: U.S Bureau of Economic Analysis, NCBA Research

However, this landing could be bumpy- upside risks to inflation from the Red Sea trade disruption and rapidly rising home prices mean core inflation is unlikely to slow sustainably to the 2% target. That said, markets seem to have priced in a peak in the US rates, thus significantly slowing the US dollar upside recorded in 2023.

Unlike in 2023, markets may not be overly worried about economic growth in Europe this year. Most of the key

economies in the Euro Area seem to be on a positive growth path this year. Notably, the IMF recently forecasted Germany, France, Italy, and Spain to expand by 0.5%, 1.0%, 0.7%, and 1.5%, respectively, in 2024. More positively, headline inflation is cooling. Nonetheless, the developments on the Red Sea channel portends risks. Resultantly, policy rate changes could be 'further along the disinflationary process.' This puts more market focus on the Harmonized Index of Consumer Prices (HICP) data over the next few weeks.

Figure 5: Euro Area GDP Growth Rate-%



Source: Euro area Statistics, NCBA Research

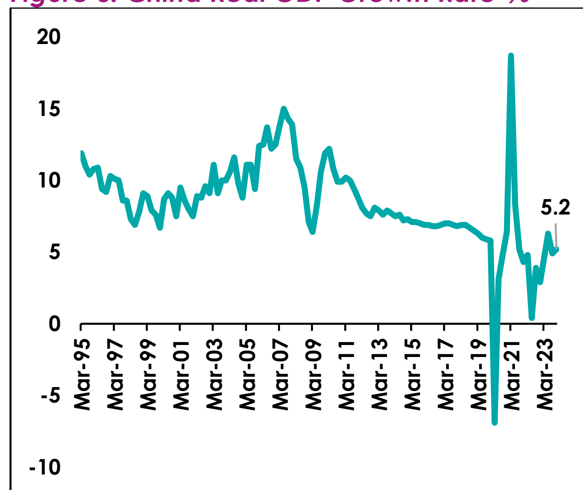
With the European Central Bank (ECB) noting satisfaction with short- and long-term inflation expectations, we thus expect the ECB to closely follow the Fed on a pivot in policy rate – absent any unforeseen shocks. Meanwhile, the Euro is expected to trade around the current levels as markets interpret incoming data.

The United Kingdom (UK) markets continues to remain a mixed bag to the markets. We expect economic growth to remain flat-lined in 2024. The IMF expects growth to increase marginally from 0.5% in 2023 to 0.6% in 2024. Concern lingers around the much stickier headline inflation- at 4% in December 2023 amidst very tight monetary policy. In as much as policymakers are aware that this restrictive monetary policy is hurting growth, the Bank of England seems to be waiting for an assurance that inflation is on an anchoring path.

To reiterate this, when the Bank of England policy committee met on 1st February, it illustrated a lack of a unanimous view on the inflation and growth outlook by voting 6-3 to maintain the bank rate; two members preferred to hike (+25bps), and one member preferred to cut (-25bps). Moreover, the committee revised the inflation outlook-forecast to approach the target in 2Q2024, only to turn higher to 2.75% in end 2024 – dampening optimism. In conclusion, this reinforces our baseline assumption that the Bank of England will lag behind the ECB and Fed in rate cuts. For the currencies, this may offer temporary support to the Sterling Pound, with UK Treasuries remaining attractive.

In China, where growth hit the target of "around 5.0%" at 5.2% year-on-year in 2023, economic prospects this year will be most watched, given its anticipated contribution to overall global growth. Already, China People's Bank has eased monetary policy by cutting the Reserve Ratio Requirement (RRR) by 50 basis points in end January. However, into February, it remains uncertain whether liquidity measures alone will support growth in the absence of stimulus packages to households and enterprises.

Figure 6: China Real GDP Growth Rate-%



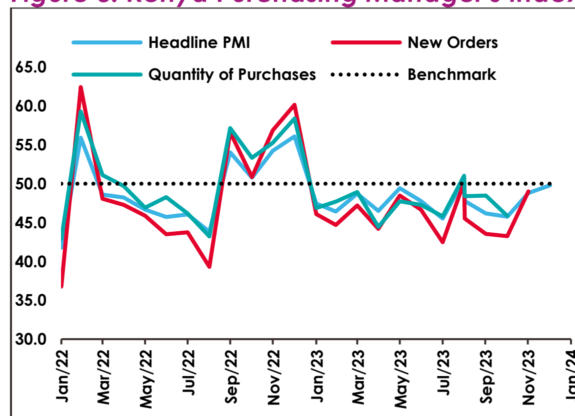
Source: National Bureau of Statistics of China, NCBA Research

KENYA

Kenya's economy continues to expand near its long-term growth rate. Real GDP growth in the third quarter of 2023 expanded by 5.9% compared to 4.3% in the corresponding period in 2022. This notable growth was primarily driven by a rebound in agriculture at 6.7% compared to a contraction of 1.3% in Q3-2022 following favourable weather conditions.

More recently, the Global S&P headline PMI inched up to 49.8 in January 2024 from 48.8 in December. Overall, into the 1H2024, a strong rebound in agriculture is expected to put growth on course to surpass our earlier forecast of 5.0% in 2023 and expand further to 5.7%, according to the CBK.

Figure 8: Kenya Purchasing Manager's Index



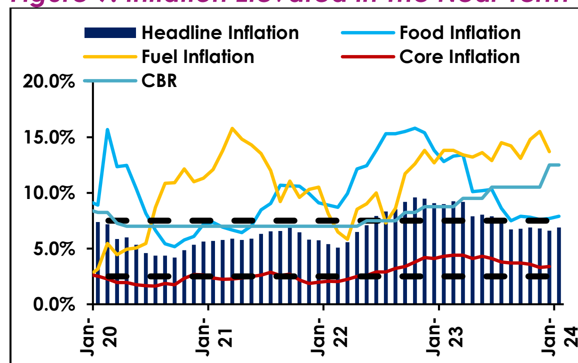
Source: S&P Global, NCBA Research

However, economic activity could be undermined by still elevated inflation pressures and its upside risks in the near term. The headline inflation level accelerated to 6.9% in January from 6.6% in December, primarily on account of continued pass-through of the exchange rate depreciation and higher food costs. Meanwhile, non-food-non-fuel inflation has risen persistently from 3.4% in December to 3.6% in January 2024.

Concerningly, inflationary pressure seems to persist in the near term. On one hand, volatile global oil markets coupled with the uncertain sustainability of the fuel subsidy could increase pressure on domestic prices. On the other, despite reports of decent agricultural output, market price levels are yet to reflect this. Resultantly, farmers continue to hold large stocks and seem unwilling to dispose at current prices.

In addition, prices at the production level still appear elevated as indicated by the Producer Price Index (PPI) inflation that stood at 10.49% in December 2023.

Figure 9: Inflation Elevated in The Near Term



Source: KNBS, NCBA Research

On the upside, prudent monetary policy action by the CBK continues to address elevated inflation expectations. In the February 2024 MPC meeting, CBK raised the policy rate by an additional 50 basis points to 13.0%. Following this, the policy rate hike seeks to address the loose anchor of exchange rate depreciation as well as the sticky inflation.

From our reading of the MPC statement, we see the regulator holding policy rates for a sufficiently long time to allow inflation to establish a firm downward trend and exchange rate to find an equilibrium.

On the public finance front, approval of USD 941.2Mn augmentation from the IMF was quite timely. However, it appears that the government would require more to sustainably address the current fiscal strain.

On the back of repeated augmentation requested by the government, unfavourable market conditions, underperforming tax revenue collections, and increased debt vulnerabilities, the IMF assessed Kenya's program performance as 'mixed', which requires 'strengthened implementation'.

In as much as there is significant effort to achieve revenue objectives - with continued implementation of the Medium-Term Revenue Strategy (MTRS) - tax revenue collection as at December 2023 still fell below the pro-rated level at 42%.

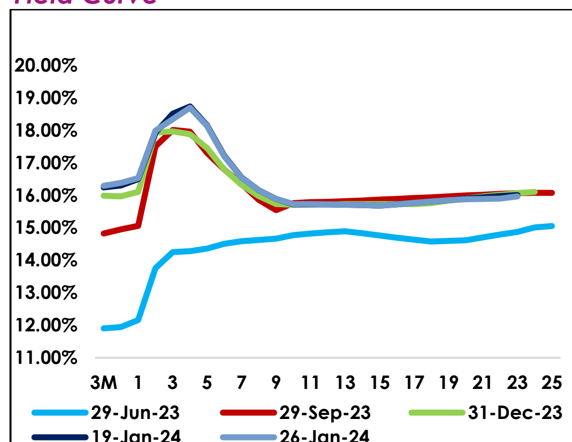
Therefore, external financing for the sovereign still stands critical. Notably, as at December, external loans and grants were only 10% of the fiscal year target. Hence, as the government ramps up negotiations with the World Bank and other international lenders, it is likely that the National Treasury may revise upward domestic borrowing targets in the second supplementary budget for FY 2023/24, which is expected in March 2024.

Still, notwithstanding the current high borrowing cost, there could be an opportunity for the government to tap into the international bonds market. This would see Kenya redeeming the June 2024 Eurobond via a mix of the CBK FX reserves and refinancing.

However, a fine balance may be required to see that the sovereign's Eurobond portfolio yield curve does not shift outwards significantly.

A tighter policy stance and fiscal liquidity strains portends increased pressure on domestic interest rates in the near/medium term. Domestic interest rates continue to trend higher owing to elevated interest rates and inflation expectations aggravated by fiscal liquidity strains. T-bill rates are now eyeing the 17% mark at 16.37%, 16.51% and 16.68% across the 91-day, 182-day and the 364-day papers, respectively.

Figure 10: Kenya Government Securities Yield Curve



Source: NSE, NCBA Research

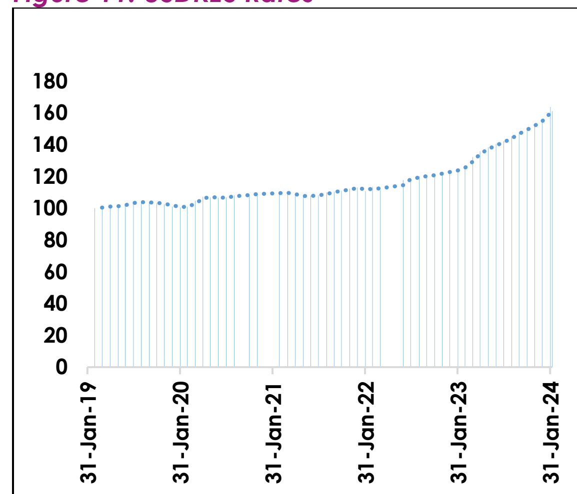
Underscoring the strain, besides the below-target tax revenue collections, net domestic borrowing stands at approximately 35% of the KES 475.4Bn target. Borrowing has been undermined by weak demand at the primaries, while appetite is primarily weighed on the short end.

Indeed, navigating through the second half of the fiscal year could necessitate reliance on attractive primary issuances to support greater participation from investors, who seem to have noted increased fiscal risk on the long end of the yield curve. Resultantly, interest rates are expected to mirror greater appetite for local funds by the sovereign.

On the exchange rate front, the currency expectations still seem unanchored. Notably, the KES lost against the US dollar from an official average of 154.09 in December to 160.75 at the end of January - 4%. Challenges in unlocking liquidity in the FX market could see the exchange rate pressured despite an improved current account deficit- at 3.9% of GDP in December.

That said, we project stronger export flows for the first half of 2024 as weather conditions remain favourable. On the import side, the recovery in demand may be a slower process, given the low appetite for capital expenditure by business enterprises. Hence, we maintain the view that the current account deficit will likely oscillate around 4.2-5.0% of GDP in the next year.

Figure 11: USDKES Rates

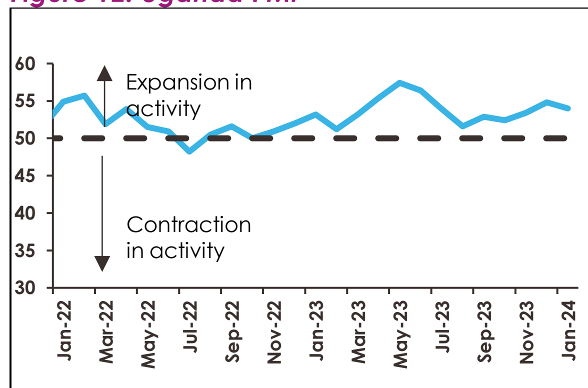


Source: Bloomberg, NCBA Research

UGANDA

Uganda's economic activity level continues on an expansionary path. According to S&P Global, Headline PMI held firm above the 50.0 neutral market at 54.0 – only marginally lower in comparison to the 54.8 recorded in December 2023. This indicates sustained output growth and favourable business conditions.

Figure 12: Uganda PMI



Source: S&P Global, NCBA Research

However, with the first oil expected in 2025, we note delays on this front so far, which could push the timelines further ahead.

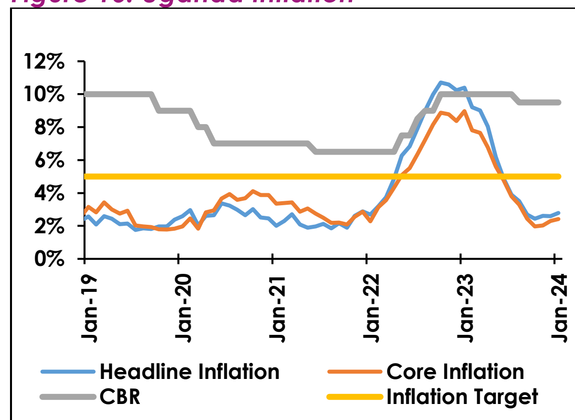
Moreover, the outlook on economic growth is subject to the potential indirect impact of the removal of Uganda from the AGOA trade deal as of January 2024. Though not significant, (AGOA exports from Uganda of about USD 8.2M annually), there could be a risk of reduced sentiment by US organizations in Uganda, or worse, discourage overall Foreign Direct Investments.

Positivity and stable inflation are expected to support private consumption as inflation expectations remain well anchored below the Bank of Uganda's (BoU) target. Although price pressures accelerated marginally to 2.8% in January from 2.6% in December 2023. The increase mainly reflected energy inflation.

The inflation outlook is subject to some risks, including the outcome of the current geopolitical conflict in the Middle East and the Red Sea, which could threaten oil prices if significant supply chain disruptions were to emerge. Nonetheless, inflation is forecast to remain below the medium-term target band of 5%.

Against this assessment, the Bank of Uganda held the Central Bank Rate (CBR) at 9.5% in February 2024. Given the upside risks, the central bank noted the need to anchor inflation in the medium-term.

Figure 13: Uganda Inflation



Source: Uganda Bureau of Statistics, NCBA Research

Meanwhile, the sovereign appears to be facing additional complexities on the public finance management front. Whereas the World Bank's funding freeze placed foreign financing in significant shortfall, domestic revenue outturns have undershot targets, placing domestic borrowing in greater focus. In the six months to December 2023, total revenue collections amounted to UGX 13.30 Trillion, representing a revenue shortfall of UGX 867.9 Billion largely due to disappointing receipts from value-added tax and import duties.

Resultantly, Parliament approved supplementary funding to the tune of UGX 3.49 Trillion for the FY 2023/24.

With regard to public debt, more than half of Uganda's debt stock is in concessional terms. Given the World Bank's recent decision to suspend new

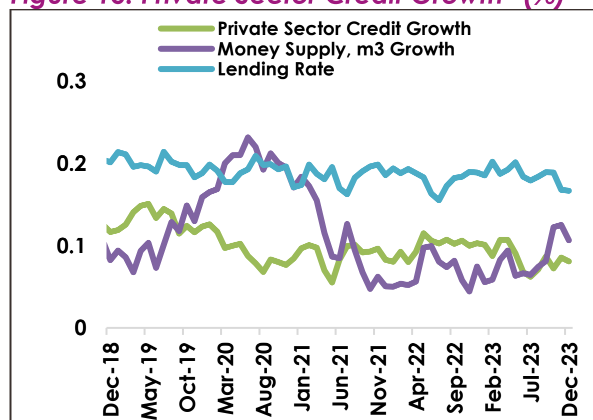
financing, it is likely that Uganda will have to seek more of bilateral and commercial borrowing. In fact, the Ministry of Finance, Planning and Economic Development announced on November 27 that it was negotiating a USD 150Mn loan from the Mainland Chinese Export-Import Bank.

However, that is yet to flow in the central bank's FX reserves that continue to deteriorate on debt service costs. In December, official FX reserves stood at USD 3,733.9Mn – 3.6 months of import cover in comparison to USD 4,074.6Mn (4.0 months of import cover) in June 2023.

With limited access to external credit markets, the sovereign could scale up local borrowing to fund the gap. Positively, subscriptions in the primary auctions have been healthy. While this is expected to support the government's primary surplus, it heralds increased interest rate pressure in the near term.

In the credit market, high borrowing costs have slowed credit demand. As at December 2023, private sector credit expanded by 12% on an annualized basis in comparison to 31% growth in December 2022.

Figure 15: Private Sector Credit Growth -(%)

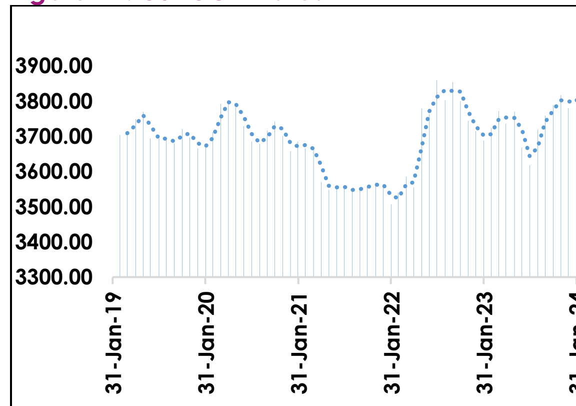


Source: Bank of Uganda, NCBA Research

In the FX market, the Uganda shilling depreciated by 0.9% in January 2024 owing to subdued export receipts amidst elevated demand for foreign currency. The Bank of Uganda has offered no support to the currency, allowing demand and supply forces to guide the USDUGX currency pair. Looking ahead, the shilling will likely remain pressured, though, on the upside, the coffee export peak in the June/July period could cushion the local unit.

For Uganda's policymakers, against the backdrop of low inflation, higher borrowing costs, and weaker credit demand, the central bank may be incentivized to ease monetary policy further in H2-2024. By then, the monetary policy direction of the US Fed could be clear. Developments on Uganda's relations with external financiers- especially the World Bank, which constitutes the largest portfolio of the country's external public debt, would be important for both investors and the Ministry of Finance, Planning & Economic Development. Moreover, markets would be keen to see Uganda extend or enter a new program with the IMF upon the expiry of the current 36-month program in June this year.

Figure 14: USDUGX Rates

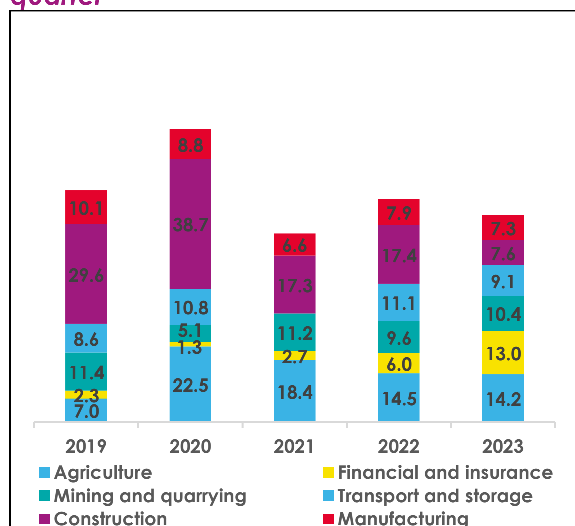


Source: Bloomberg, NCBA Research

TANZANIA

Tanzania's economy continues to expand, supported by various public and private sector factors. Growth in 3Q2023- most recent statics touched 5.3%, underpinned by robust performance in the agriculture, mining, and tourism sectors.

Figure 16: Sectoral Contribution to GDP-Third quarter

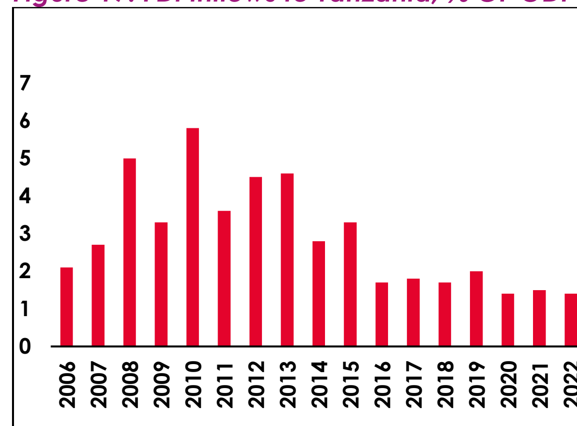


Source: Tanzania National Bureau of Statistics, NCBA Research

In the near-to-medium-term, timely execution of projects will be crucial in pushing growth further. Notably, the Liquified Natural Gas (LNG) project constitutes a significant upside potential for Tanzania's growth. In the coming weeks, we expect Parliament to sign and review the Host Government Agreement (HGA), paving the way for the final investment decision. In its December 2023 review, the IMF noted that this project could potentially unlock about US$42 Billion worth of Foreign Direct Investment (FDI).

For Tanzania, this could more than triple its Foreign Direct Investment/GDP ratio from 1.4% currently. So far, the investment environment seems attractive across all sectors- with the FDI/GDP ratio staying resilient through the pandemic period.

Figure 17: FDI Inflows to Tanzania, % OF GDP

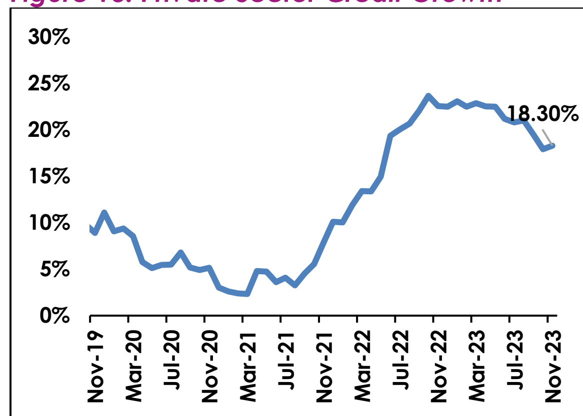


Source: Central Bank of Kenya, NCBA Research

The IMF noted satisfaction with Tanzania's economic reform program in its December 2023 Extended Credit Facility (ECF) review. Moreover, the country's performance under the 40-month IMF program is broadly on track- offering private investors great confidence. Already, an immediate disbursement of about US$ 150.5 million was done in mid-December to help preserve macro-financial stability, strengthen economic recovery, and support structural reforms.

Private sector credit growth remained robust in November 2023, growing at 18.3%, above the 16.4% target set by the end of December 2023. However, growth in November is a decline of 430 basis points year-on-year. As the authorities are committed to enhancing financial sector stability, Tanzania's banking sector asset quality improved, with non-performing loans declining to 4.3% in December 2023 from 5.2% in September 2023.

Figure 18: Private Sector Credit Growth



Source: Bank of Tanzania, NCBA Research

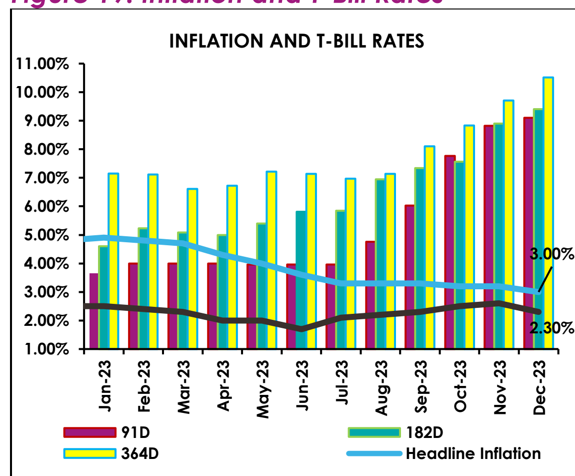
As Tanzania's external debt stock stood at USD 29,541.7 million in December 2023, representing an increase of USD 683.7 million from September 2023, the overall debt to GDP ratio- at 45.5% in the FY 2022/2023 remains healthy. Furthermore, the IMF projects this to flatten at 45% in the near-term before declining to 42% in 2027.

With technical assistance from the IMF, the Bank of Tanzania rolled out a new monetary policy framework that uses the Central Bank Rate (CBR). The CBR was set at 5.5% on the 18th of January 2024 by the Monetary Policy Committee- with expectations that BoT will align the interbank rate to a corridor of +/-200 basis points of the CBR.

Tanzania's budgetary financing seems on course. Of support has been the performance of the issuance of government securities, though preference skewed toward the long-dated papers. Additionally, tax revenue performed relatively well- at TZS 97.1 Billion, below the target by just 2.8%, whereas non-tax revenue was TZS 27.2 billion- 95.9% of the target.

With headline inflation at 3.00% as of December 2023, real returns on the government securities yield curve look attractive to investors even at the long end.

Figure 19: Inflation and T-Bill Rates



Source: Tanzania National Bureau of Statistics, Bank of Tanzania, NCBA Research

In the FX market, the Tanzanian shilling depreciated by 0.5% against the US dollar in January, which is mainly attributed to significant dollar liquidity shortages in the interbank foreign exchange market (IEFM). Against this background, the BoT continued to intervene actively in the FX market.

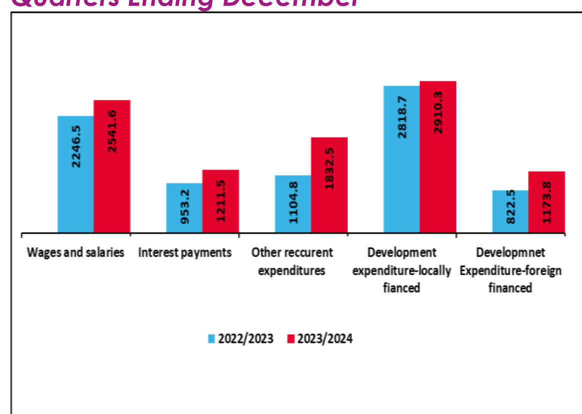
To help unlock liquidity in the FX market, the authorities are reviewing the Interbank Foreign Exchange Market code of conduct and could soon revise it. Overall, the shilling is expected to remain stable in the first quarter of 2024, depreciating moderately.

Meanwhile, Tanzania's FX reserves stood at USD 5.5 billion as of December 2023 from USD 4.9 billion in September 2023. Moreover, the current account deficit improved- declining to USD 1,010.7 million in the fourth quarter of 2023 from USD 1,415.3 million in the corresponding period in 2022 on account of various factors, including a decline in imports

coupled with an increase in foreign inflows from tourism.

For staying on track with regard to the current IMF program, Tanzania continues to appear attractive to both domestic and foreign investors. With strong domestic growth projected in agriculture, mining, tourism, and public sector projects, market worries remain mostly around the FX market liquidity and the government's ability to secure adequate concessional financing for all the ongoing projects.

Figure 20: Government Expenditure for the Quarters Ending December



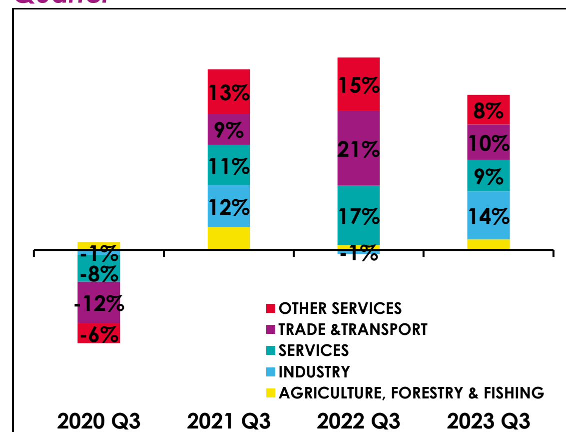
Source: Bank of Tanzania, NCBA Research

RWANDA

The Rwanda economy is forecast remain a regional outperformer in 2024. GDP posted 7.5% growth in Q3-2023 relative to 10.0% in Q3-2022 – markedly above the 5.5% average growth achieved across the region in the same period.

The industry sector recorded strong growth of 14.0% from a contraction of 1.0% previously due to a robust rebound in the construction sector as public infrastructure projects rose. Growth in the service sector declined to 8.8% from 14.8% previously, largely driven by a slowdown in both the transport and wholesale & retail trade sectors aggravated by elevated costs, particularly from international oil price volatility. Meanwhile, agricultural production remains weak – although improved to 2.9% from 1.4% previously.

Figure 21: Sectoral Contribution to GDP-Third Quarter



Source: National Statistics of Rwanda, NCBA Research

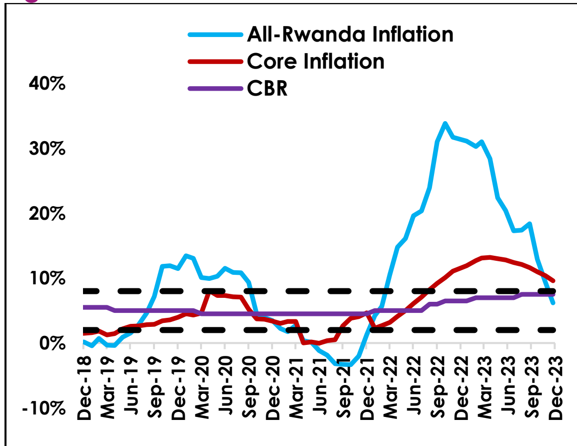
Overall, growth is expected to firm to 6.9% in 2023 and accelerate further to 7.5% in 2024 (World Bank- Jan 2024), supported by a pickup in construction and rising tourism revenues as global demand strengthens on declining price pressures.

That said, for the first time since March 2022, Rwanda inflation registered within the BNR's target band of 2.0% - 8.0%. In December 2023, posting at 6.2%. The moderation in prices mirrored lower food prices as well as base effects.

Non-food-non-fuel inflation similarly dropped to 9.6% from 10.4% previously. Inflation is expected to average 6.0% in 2024. The recent trend in inflation signals that the National Bank of Rwanda is likely done with interest rate hikes. However, risks to this projection include geopolitical tensions and weather-

related threats to agricultural production.

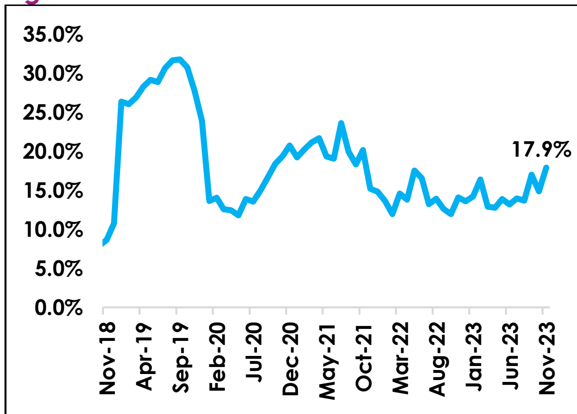
Figure 22: Rwanda Inflation



Source: National Statistics of Rwanda, NCBA Research

Positively, the extension of credit to the private sector remained firmly in double digits despite higher borrowing costs. In the latest figures, credit to the private sector grew by 18% in November 2023, up from 14% growth in November 2022.

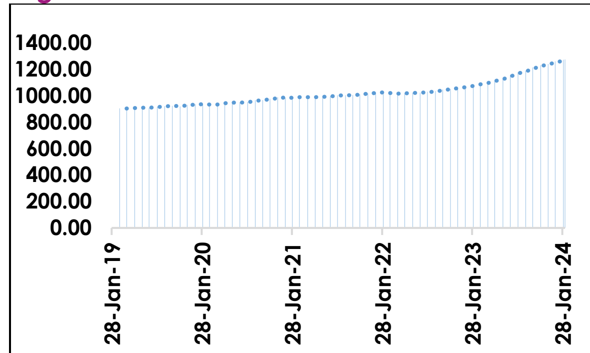
Figure 23: Private Sector Credit Growth



Source: National Statistics of Rwanda, NCBA Research

In the FX market, the Rwanda Franc depreciated by 0.9% in January against the safe haven dollar owing to demand-supply imbalances. In light of this, aside from the usual dollar injection support to the local currency, the Government of Rwanda, through MINECOFIN, put a short-term fund to support strictly fuel importers by providing dollars to banks to settle pending invoices for fuel imports.

Figure 24: USDRWF Rates



Source: Bloomberg, NCBA Research

Into the next couple of weeks, growth could be dampened by the tight monetary policy, currency weakness, and ongoing trade disruption on the Democratic Republic of Congo border. The July general elections could however see increased government spending- thus trading off any likely decline in growth. Against this, we expect a neutral monetary policy stance by the National Bank of Rwanda in the near-term.

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

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

Website: www.ncbagroup.com