Financial News

cba
time for more.

April 10th, 2018

Highlights

- ✓ *Fundamentals remain in place to support yet another year of robust global growth. The synchronized expansion that started in 2017 will be underpinned by tailwinds from increased trade, stronger labor markets and higher commodity prices. However, the recent increase in the use of restrictive trade policies, especially the decisive protectionist shift by the US, could prove detrimental to growth. In search for reciprocity in trade practices, the US last month imposed $60Bn worth of tariffs on Chinese goods. China retaliated with tariffs on 106 US imports and promised a tit-for-tat response to any new restrictions by the US.*

- ✓ *The evolving trade war could aggravate the slowdown in China, which accounts for a significant proportion of global growth. Moreover, its impact on the broader integrated global supply chain and on global investor and consumer sentiment cannot be gainsaid. An escalation of the trade tension could trigger a fresh wave of risk sell off which could undermine confidence in emerging and developing markets.*

- ✓ ***Kenya** - The economic outlook remains fairly upbeat underpinned by favorable weather, accommodative monetary policy and a relatively stable macroeconomic environment. We maintain a baseline GDP growth forecast of 5.2% in 2018 with increased upside from reduced political fragility.*

- ✓ ***Tanzania** - Strong growth in Tanzania will be supported by robust infrastructure spending and a recovery in agricultural production. We maintain that GDP will expand by 6.7% in 2018 compared to 6.5% a year earlier. However, a downshift from our baseline forecast may result from the unpredictable regulatory environment.*

- ✓ ***Uganda** - The economy is expected to maintain the strong momentum of the last half of 2017 supported by an improved agricultural performance, a fairly stable macroeconomic framework, an accommodative monetary policy and a slight uptick in public expenditure. The economy is projected to expand by 6.5% this year from an estimated 4.8% in 2017.*

- ✓ ***Rwanda** - A spillover of the strong growth momentum in the latter half of 2017 could support a 7.0% economic expansion in 2018. This will be bolstered by the recovery in the agricultural sector, increased government spending and monetary accommodation. More upside may stem from targeted policies that could see a reduction in the external deficit while protecting the local producers.*

Forecasts

GDP (%) forecasts			
Region	**2016**	**2017**	**2018**
Global	3.2	3.7	3.9
Advanced Economies	1.7	2.3	2.2
Emerging and Developing Economies	4.4	4.7	4.9
Sub-Saharan Africa	1.4	2.7	3.3
Middle East and North Africa*	4.9	2.5	3.6

Source: IMF, World Economic Outlook Update, January 2018

Rise in protectionist trade policies heralds some downside risks to the upbeat global economic growth outlook

Fundamentals remain in place to support yet another year of robust global growth. The synchronized global expansion that started in 2017 is rolling on, underpinned by tailwinds from increased trade, stronger labor markets and higher commodity prices. The US fiscal stimulus has also added impetus to the healthy outlook although prospects of above target inflation, as a result of the tax cuts, and increased government spending could escalate the risk of aggressive monetary tightening by the Fed.

Global growth is expected to accelerate to a consensus 3.5% in 2018, its fastest pace in the post financial crisis era. The bulk of this growth will be drawn from emerging economies which have seen an increase in the pace and breadth of expansion. Meanwhile, the 2.7% peak performance in the US suggests increased contribution from advanced markets. Growth in the Eurozone and Japan will remain solid at an estimated 2.0% and 1.5% respectively, although this will be a slight moderation from the 2017 performance.

That said, risks to the outlook remain tilted to the downside. While geopolitical tensions have somewhat dissipated, protectionist trade tendencies and liquidity withdrawal present the biggest threat to the global outlook. According to the World Trade Organization trade is projected to expand between 2.1% and 4.0% in 2018, an increase from an estimated 2.5% expansion in 2017. However, this growth is contingent upon the right policy mix with a focus on liberalized trade.

Increasing protectionist trade barriers to weigh on sentiments

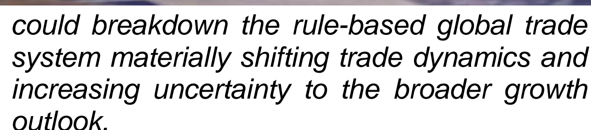
The recent increase in the use of restrictive trade policies especially the decisive protectionist shift by the US, could prove detrimental to global growth. The downside risks from the ongoing trade spat between the US and China was clearly evidenced by the erosion in risk sentiment which triggered a sell off across equity markets.

In an effort to cut the trade deficit with China by $100Bn and seek reciprocity in trade and the use of intellectual property, the US announced $60Bn worth of tariffs targeting China with the initial 25% and 10% tariffs on steel and Aluminum imports sparking risk aversion across the globe. Fears that this could deteriorate to a full blown trade war were underlined by China's response with tariffs on manufacturing and agricultural goods. Despite US officials downplaying potential escalation of the trade tensions, president Trump indicated that the US could impose an additional $100Bn in tariffs on Chinese goods to force them to level playing ground for trade, a move to which China has promised a tit-for-tat retaliation. The EU had also promised a proportionate response to US tariffs on steel and aluminum before the US administration announced their exemption.

Closer home, the US suspended duty free access to Rwandan textile imports under the Africa Growth and Opportunity Act (AGOA) in response to a decision by Rwanda.

For global economic growth, the primary concern is the likely escalation of China's slowdown. For the US, the uncertainty for exporters, likely higher inflation due to supply constraints and the stock market selloff could impede growth in the US. While the estimated impact of the tariffs so far is minimal, the risk of escalation could have more severe implications for the two economies. Moreover, the detrimental effects on the broader integrated supply chain which involves a broader spectrum of countries cannot be gainsaid. To be sure, the fear of Chinese exports flooding other markets as the US market shrinks could see the US-China trade spat snowball into a global tariff conflict.

That said, markets will be keen to see the US' reaction to the decision by the World Trade Organization on its latest tariff tiff with Canada. Besides the tariff on steel and aluminum, the US has made some restrictive moves against Canadian lumber, bombardier planes and newsprint. Ignoring the ruling



could breakdown the rule-based global trade system materially shifting trade dynamics and increasing uncertainty to the broader growth outlook.

The more immediate concern from the escalating trade tensions is the impact on producer and consumer sentiments which could undermine growth in spending as well as capital investments. Confidence could be further dented by aggravated volatility in global equities market. This could see increased flow of capital out of markets perceived riskier towards safer havens.

Meanwhile, while risks of a full blown trade war may be somewhat discounted, bilateral and multilateral trade negotiations between major economies could help avert a full blown trade war.

Additional risks from potentially aggressive tightening by the US

Additional risk to growth stems from potential liquidity withdrawal by major central banks. As the economic slack considerably dissipate, the regulators are expected to fast track plans to unwind the post crisis unconventional monetary policies including ultra-low interest rates and bond purchases.

The Fed in March raised its Fed Fund Rate by 25bps to between 1.50-1.75%. Moreover, the committee revised its growth forecasts for 2018 and 2019 upwards to 2.7% from 2.5% and to 2.4% from 2.1% respectively. While holding inflation forecast at 1.9% in 2018, the Fed is confident that consumer prices will overshoot the 2.0% target in 2019 to 2.1%. Moreover, unemployment is seen dropping further to 3.8% from the current 4.0% and further to 3.6% in 2019.

The prospect of inflation overshooting target could suggest scope for more aggressive tightening than the market is currently factoring in. An endorsement of four hikes could see yield on US treasuries rise by an additional, at least, 25bps and could support a resurgent greenback.

Decoupling of emerging market policies to the Fed's

That said, despite the Fed being the only major Central Bank with a definitive tightening cycle, the dollar remains fairly weak. This somewhat reflects stronger growth prospects in other economies, concerns over trade war escalation and perhaps the indicative shift to a weaker dollar policy bias by the current US administration.

More interesting is the limited traditional response to the US' policy decisions by other central banks especially in emerging markets (EMs), suggesting reduced sensitivity to US policy shifts.

The decoupling of policy actions by emerging market central banks could be buttressed by their recent economic resilience. EMs are projected to grow by 4.9% in 2018 from an estimated 4.8% in 2017. Moreover, despite higher interest rates in the US, the dollar has remained generally weak supporting the recovery in commodity prices. The resultant rally in EM currencies has reduced inflation concerns providing headroom for more accommodative policy in support of economic recovery. Moreover, the recovery in commodity prices, especially oil, has added impetus by improving the current account position and moderating debt concerns in the economies.

While China hasn't adjusted its policy rate, the tightening monetary policy bias reflects the efforts to tighten bank funding in a bid to manage the concerns over public sector debt. The government has expressed its willingness to tolerate slower growth to fend off potential systemic risks within the financial system due to elevated debt concerns. Growth will be further undermined by its direct exposure to the US trade protectionism due to the high trade surplus.

Kenya

- The economic outlook remains fairly upbeat underpinned by favorable weather, accommodative monetary policy and a relatively stable macroeconomic environment. Moreover, the recent reconciliatory tone between President Kenyatta and the former Prime Minister Hon. Odinga mellowed political tensions in the country bolstering investor and consumer confidence. We maintain a baseline GDP growth forecast of 5.2% in 2018 with increased upside especially from reduced political fragility. Even so, persistent structural challenges revealed by weaker corporate performance and increasing company layoffs suggest that growth will remain below the estimated 5.8% potential. The negative output gap could be a result of government brakes on spending in a bid to reign in deficit and debt as well as the persistent lethargy in credit markets, monetary accommodation notwithstanding.

- After cutting the Central Bank Rate by 50bps in February, we see scope for further accommodation supported by a benign inflation outlook. The increase in consumer prices is expected to remain within the 2.5-7.5% target band, averaging 5.1% in 2018, a slight upward revision from our earlier forecast of 4.8%. The outlook is supported by expected increase in food supply on the back of favorable weather, currency stability and mute demand pressure. However, risks may stem from higher oil prices. Brent crude prices have increased to about $70 a barrel bolstered by uptick in sentiment across markets, thinner supply from OPEC members and a weaker US dollar. However, further adjustments in the policy rate may be contingent to how effectively the recent policy signal is transmitted given the implied breakdown in the transmission channels and the persistently high government debt appetite.

- The government has maintained an insatiable appetite for local debt even after the receipt of $2.0Bn in Eurobond proceeds. Revenue performance has remained below expectations with the government raising KES 933.49Bn in the first eight months of the year, just about 57% of this year’s target. Spending amounted to KES 1,258Bn about 55% of the approved expenditure in the year of which 78% was channeled to the recurrent budget. Public debt is estimated to have increased to above KES 4.80 trillion following the Eurobond issue. This could reduce slightly this month with the repayment of the $750mn syndicated loan. Whereas the government has committed to reducing its deficit to 7.2% of GDP, this could be an onerous task given the persistent structural challenges to revenue collection and the downside risks of aggressive spending cuts on growth

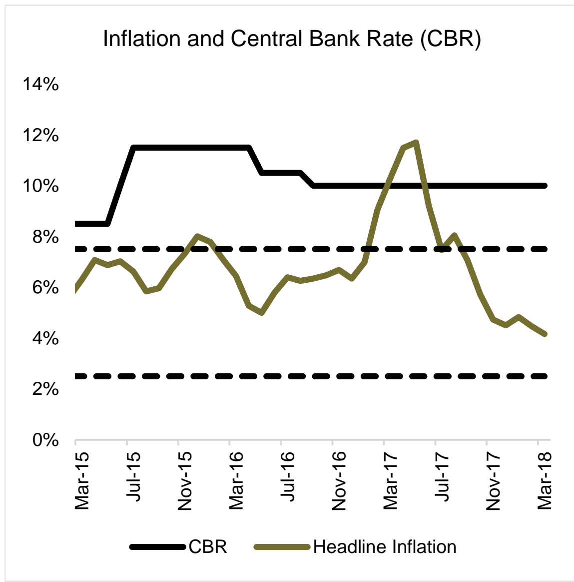
- The combination of challenging monetary policy transmission and a high fiscal deficit could keep yields relatively stable across the curve. Any downshift in yields could be capped by persistent fiscal dominance. Even so, the likely modification of the Banking Amendment Act (2016), that exacerbated the slowdown in private sector credit, could alter interest rate dynamics with a higher risk of an upward shift in the yield curve on renewed competition for available liquidity and higher inflation in the second half of the year. Even so, a suspension of the caps could give the CBK some flexibility which could support further rate cut supported by within target consumer prices.

- Against expectations, the shilling strengthened in the last quarter to just top 101.00 versus the US dollar. Besides an improving current account position on the back of better export earnings, and some potential upside from flows within the tax amnesty window, demand has remained fairly lethargic reflecting reduced expenditure across the public and private sectors. Moreover, the keen surveillance and proactive intervention by the Central Bank should limit sharp devaluation in the local unit. While local yields have continued to deviate from the US, higher real returns on government securities could limit capital flight on this front.

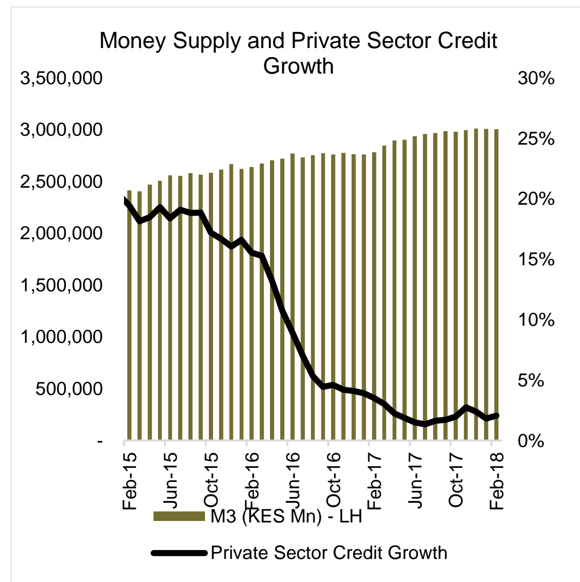
Forecasts

Quarter ending	March 2018	June 2018	Sept 2018	Dec 2018
GDP	5.34%	6.01%	5.56%	5.16%
Inflation	4.13%	4.10%	6.07%	7.07%
USDKES	101.08	102.80	103.61	103.90
CBR	9.50%	9.50%	9.00%	9.00%

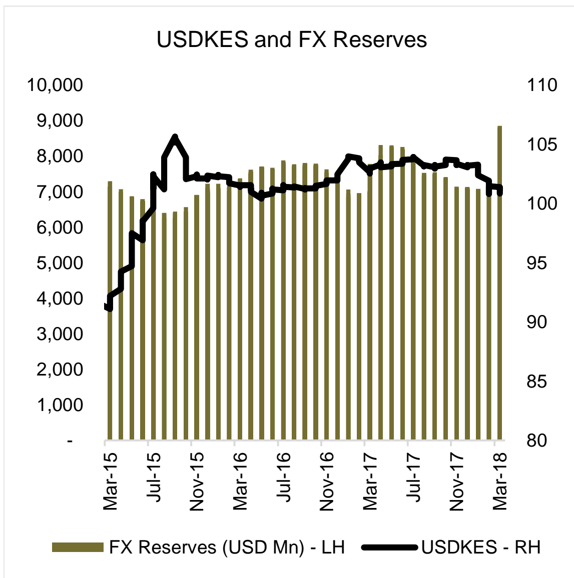
Source: CBA Research, Bloomberg



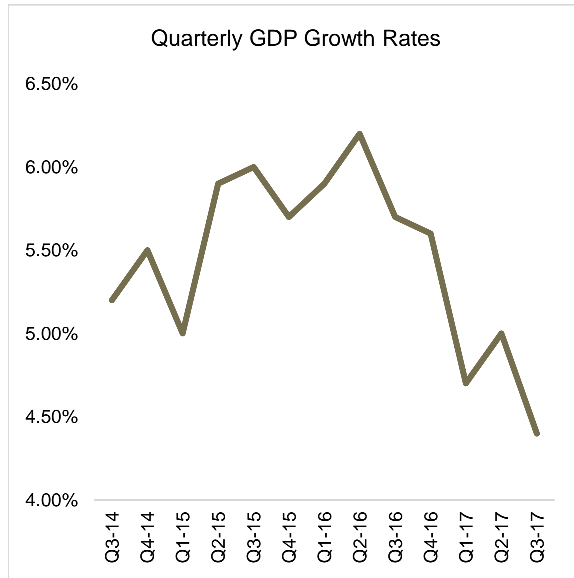
Source: Central Bank of Kenya, CBA Research



Source: Central Bank of Kenya, CBA Research



Source: Central Bank of Kenya, Bloomberg, CBA Research



Source: Central Bank of Kenya, CBA Research

Tanzania

- Strong growth in Tanzania will be supported by robust infrastructure spending and recovery in agricultural production. We maintain that GDP will expand by 6.7% in 2018 compared to 6.5% a year earlier. However, a downshift from our baseline forecast may result from the unpredictable regulatory climate. Resultant weak business sentiment has undermined investments in new capacity as well as general consumption within the economy. At the same time, the primary focus on public governance has slowed overall government spending with budget absorption averaging just about 50% in the last two years. Prioritization of reigning in corruption, although welcome, could plausibly reduce the public sector's contribution to GDP, estimated at about 25% due to weaker public spending.

- Low budget absorption has engendered a low fiscal deficit reducing the government's need for debt. In the first seven months of the year, the budget deficit amounted to TZS 0.46 Trillion, against a target of TZS 3.81 Trillion. As a result, the government has only borrowed TZS 0.26 Trillion from the local market against a target of TZS 1.48 Trillion for the period. This has complemented the easing signal by the Bank of Tanzania by exerting remarkable pressure on yields on government securities. On a brighter note, after two years of realignment, government expenditure is expected to pick up. Budget absorption improved to 60.9% in the first seven months of this fiscal year from an average of about 50% over the last two years. Even so, with a potentially high risk premium due to a negative credit outlook and rising US yields, we expect bias to remain on local markets for deficit financing.

- The Bank of Tanzania has signaled an easing policy bias, cutting both repo and discount rates to provide more liquidity. Complemented by the tame government borrowing, this has seen yields fall across the spectrum with the one-year T-bill rate dropping by 331bps to 5.12% in the three months to March 2018. The liquidity was further bolstered by partial settlement of arrears by the government which has reinforced asset quality for banks and improved risk profiles for borrowers. That notwithstanding, credit growth is unlikely to pick up considerably unless the business uncertainty dissipates.

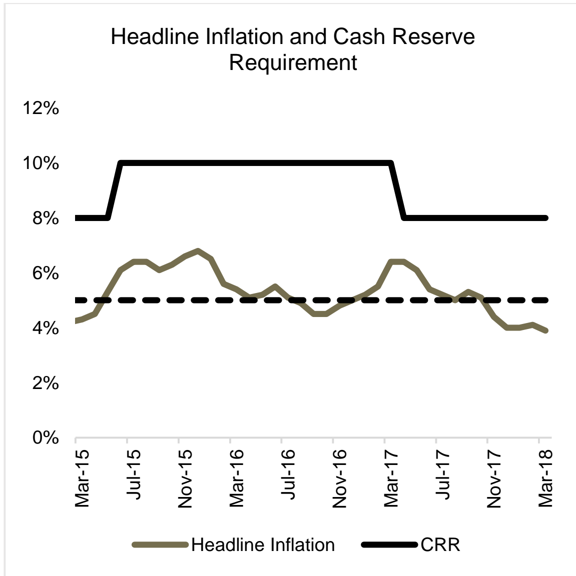
- Inflation hovered around 4.0%, the lowest levels in three-years in the first quarter of the year. Domestic prices remain checked by improved food supply and soft demand for non-food non-fuel commodities. That said, higher fuel prices could see a mild uptick in inflation although base effects could keep pressures mute in the interim. However, we expect the increase in consumer prices to pick up towards 5.0% in the latter half of the year.

- The local currency softened to 2249/2265 against the US dollar on the back of a mild uptick in dollar demand. However, the tight control by both the Central Bank and the government could keep the shilling below the 2300 levels this year. Even so, fundamentals including reduced capital flows due to policy uncertainty, weaker exports earnings due to the ban on mineral exports and risks from wider trade deficit due to high oil prices could support further weakening. Prospects of a Eurobond issue could support local currency sentiment going forward.

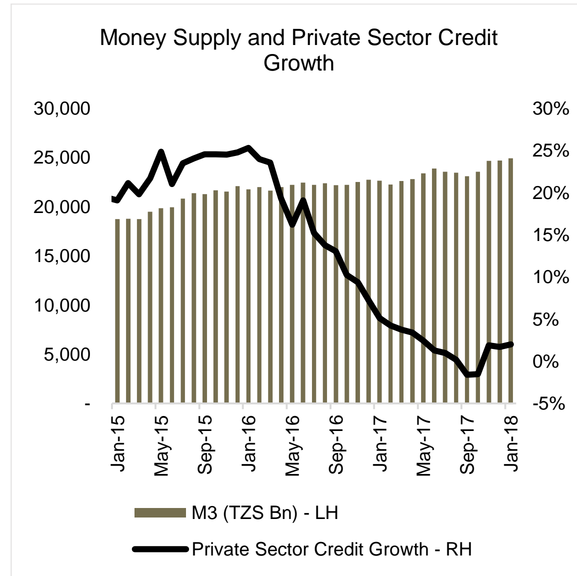
Forecasts

Quarter ending	March 2018	June 2018	Sept 2018	Dec 2018
GDP	6.60%	6.70%	6.67%	6.76%
Inflation	3.90%	3.77%	4.52%	4.73%
USDTZS	2260.00	2271.55	2279.30	2288.25
CRR	5.25%	5.25%	5.25%	5.25%

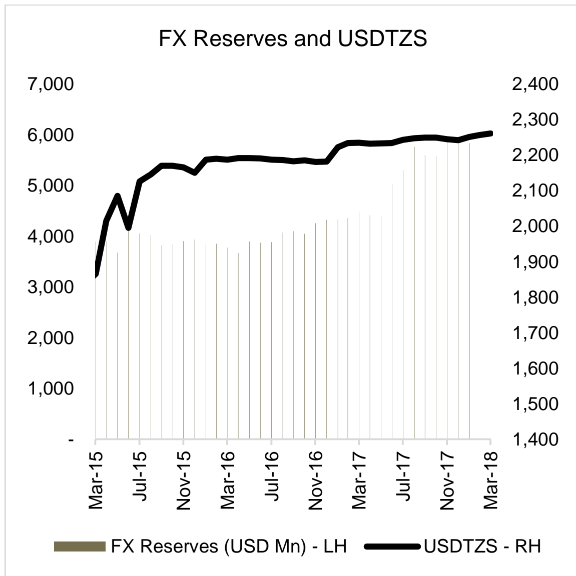
Source: CBA Research, Bloomberg



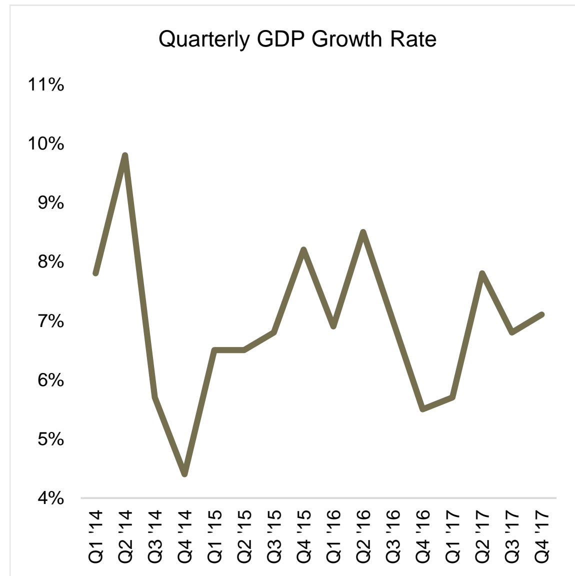
Source: Bank of Tanzania, CBA Research



Source: Bank of Tanzania, CBA Research



Source: Bank of Tanzania, CBA Research



Source: National Bureau of Statistics, CBA Research

Uganda

- The economy will maintain the strong momentum of the last half of 2017 as signaled by the 1.1% increase in the Bank of Uganda's Composite Index of Economic Activity in the first quarter of 2018 after rising by 1.9% in the second half of 2017. This is supported by improved agricultural performance, a fairly stable macroeconomic framework, an accommodative monetary policy and a slight uptick in public expenditure. The economy is projected to expand by 6.5% this year from an estimated 4.8% in 2017. However, the continuous decline in the Business Tendency Index over the last 5 months could suggest persistent weakness in the private sector.

- Bank of Uganda has pursued a relatively aggressive easing cycle cutting the CBR by a total of 750bps over the last 2 years. In spite of the accommodative monetary policy, the pass through to actual lending to the private sector remains slow. Credit growth averaged 5.7% over the last one year in spite of 250bps reduction in the central bank rate over the period. This is also in spite of a 203bps drop in the cost of credit/lending rates and a fairly disciplined fiscal authority over the same period. The slowdown could be linked to structural challenges within the economy reflecting increased aversion by banks from sectors perceived riskier. Credit growth could therefore remain in the single digit but could pick up in the latter half of the year with the improving credit risk environment. Nonperforming loan ratio has dropped to 5.59% at the end of 2017 from highs of 10.5% in 2016.

- That said, potential increase in government borrowing risks crowding out the private sector. Despite the accommodative signal from the Bank of Uganda, pressure is emerging on interest rates mostly attributed to the anticipated wider fiscal deficit. The increase in borrowing appetite has been evident in the growing size of treasury issues with the quantum of the bi-monthly T-bill auctions increasing by about UGX20.0Bn over the last six months. As a result, yields on the local bonds and bills have ticked up, defying the monetary easing bias and the record low inflation. Yields have risen to 8.765% (Up 19.60bps), 9.066% (Up 68.00bps) and 9.590% (Up 61.10bps) on the 91, 182 and 364 day papers respectively during the quarter. This comes against a backdrop of rising benchmark yields on US Treasuries which means borrowing will remain inclined towards local markets.

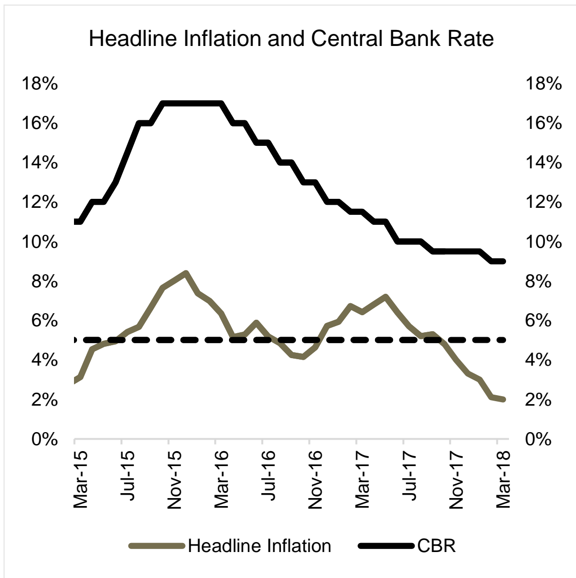
- Consumer Inflation decelerated to 2.0% at the end of the first quarter of 2018 from 3.30% at the end of 2017 respectively buoyed by easing food price pressures. Core inflation also reduced from 3.00% to 1.70% over the same period supported by the low credit expansion. Inflation is expected to remain around the 5.0% medium term target supporting the BoU easing bias.

- However, concerns are emerging over the local currency's vulnerability. The shilling has so far lost 1.5% this year to exchange at 3680/3700 versus the US dollar. The fragility stems from increased demand for dollars which has outpaced hard currency flows. Moreover, low yields in the market have encouraged some capital flight especially from short term investments although the fairly high real returns may limit the severity of potential attrition. While the $3.5Bn (five months import cover) foreign exchange reserve may allow for regulatory smoothing of further depreciation, vulnerability to external shocks could limit its use. Higher oil prices and prospects of aggressive US tightening are key risks to stability. We expect further depreciation of the local unit towards 3800 this year.

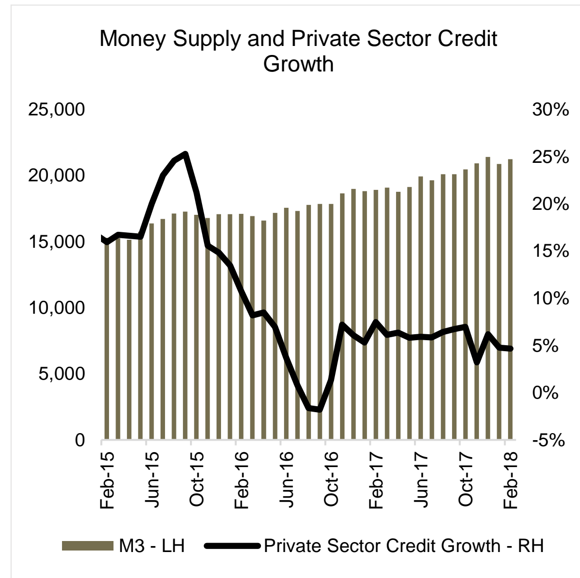
Forecasts

Quarter ending	March 2018	June 2018	Sept 2018	Dec 2018
GDP	7.50%	7.00%	6.50%	6.50%
Inflation	2.00%	2.58%	5.50%	6.00%
USDUGX	3660.10	3719.60	3775.40	3785.16
CBR	9.00%	9.00%	9.00%	9.00%

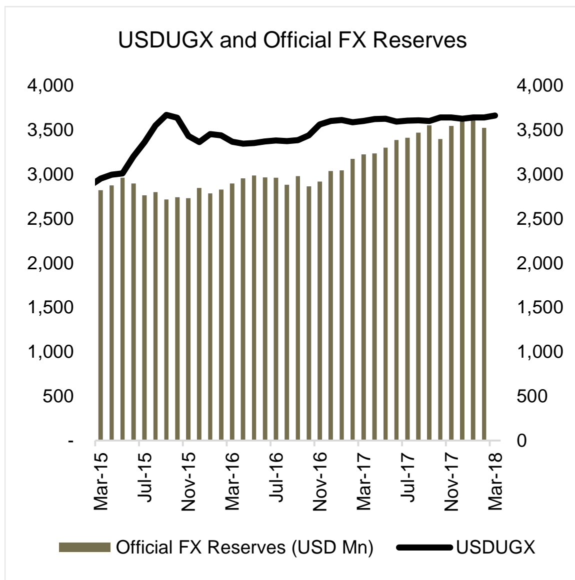
Source: CBA Research, Bloomberg



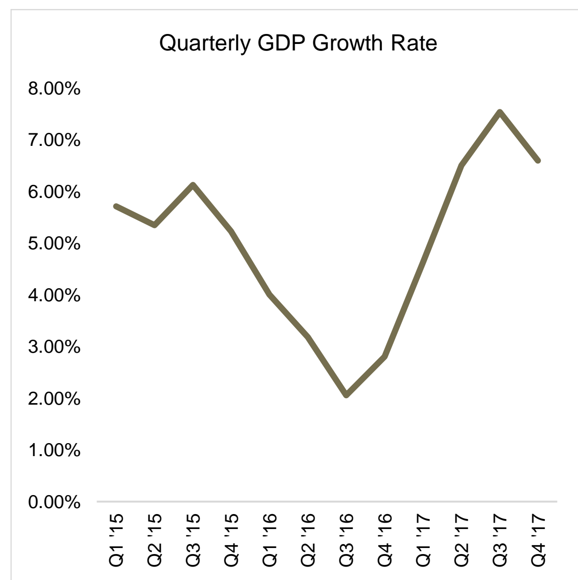
Source: Bank of Uganda, Bloomberg, CBA Research



Source: Bank of Uganda, Bloomberg, CBA Research



Source: Bank of Uganda, Bloomberg, CBA Research



Source: Bank of Uganda, Bloomberg, CBA Research

Rwanda

- A spillover of the strong growth momentum in the latter half of 2017 could support a 7.0% economic expansion in 2018. This will be driven by the recovery in the agricultural sector, increased government spending as well as monetary accommodation. In support of higher growth, targeted policies could see a reduction in the external deficit while protecting local industries and employment. GDP expanded by 6.1% in the year 2017, outpacing the projected 5.2% growth following a strong performance in the second half of 2017. This was driven by a rebound in activity in agriculture, industry and services. The sectors are estimated to have expanded by a 7.0%, 4.0% and 8.0%, contributing about 31.0%, 16.0% and 46.0% of growth respectively.

- Government revenue collection is expected to pick up and could conceivably narrow the fiscal deficit to 3.7% of GDP in the fiscal year 2017/18 compared to the 4.7% of GDP a year earlier. This will be supported by the combination of an improved economic landscape and higher commodity prices. Meanwhile, the current account deficit is expected to narrow in the medium term as economic policies strengthen particularly in the promotion of the Made in Rwanda Campaign and in export diversification. The policies are expected to consolidate private sector activities, create jobs and boost economic growth.

- On the monetary policy front, the National Bank of Rwanda may continue to anchor growth through an accommodative policy leaning. Inflation was fairly mute in the quarter driven by improved food supply on a backdrop of better weather conditions. According to latest estimates, inflation eased to 1.20% in February 2018 and is expected to remain fairly mute in the near term though risks from higher fuel prices could place pressure on domestic prices.

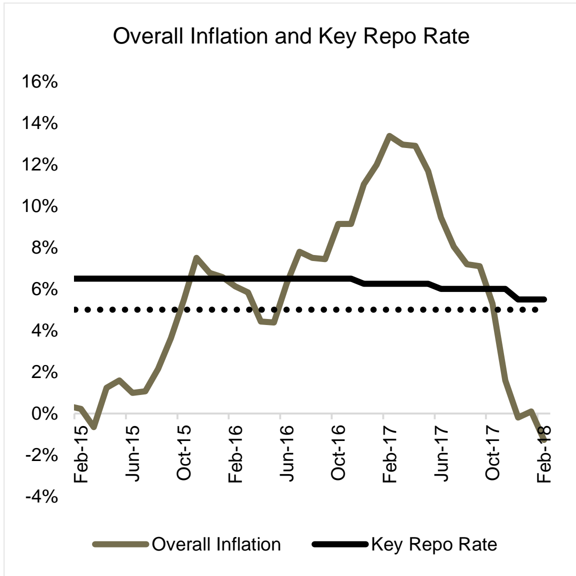
- As a result, the interbank market remains fairly liquid. This is despite an uptick in private sector lending to 10.53% in February. Treasury yields declined to 4.991% (Down 157.40bps), 6.317% (Down 123.60bps) and 6.990% (Down 149.50bps) for the 91, 182 and 364 day papers respectively in the quarter.

- Despite the Central Bank's inclination towards a more market driven exchange rate, risks to the Franc from limited US dollar supply has necessitated regular interventions by the monetary authority. This has limited losses on the franc at 0.91% to 852.68 in the first quarter. Meanwhile, abating external exchange rate pressure due to higher export receipts and reduced imports could support the Franc.

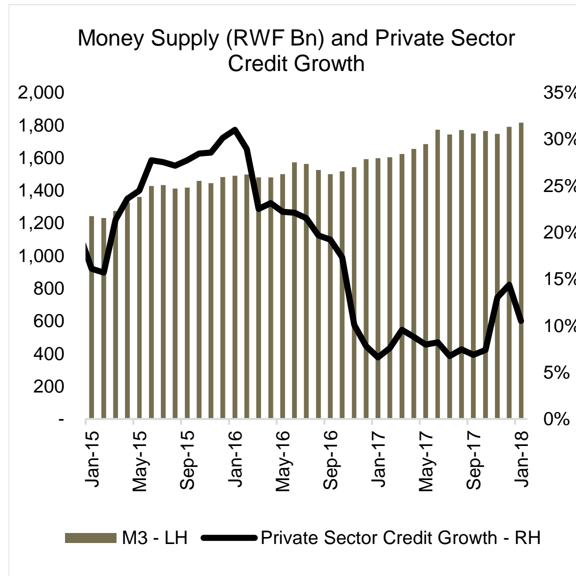
Forecasts

Quarter ending	March 2018	June 2018	Sept 2018	Dec 2018
GDP	6.25%	6.30%	6.50%	7.00%
Overall Inflation	-1.90%	2.00%	2.60%	8.60%
USDRWF	852.68	861.21	871.54	879.49
Repo Rate	5.50%	5.00%	5.00%	5.00%

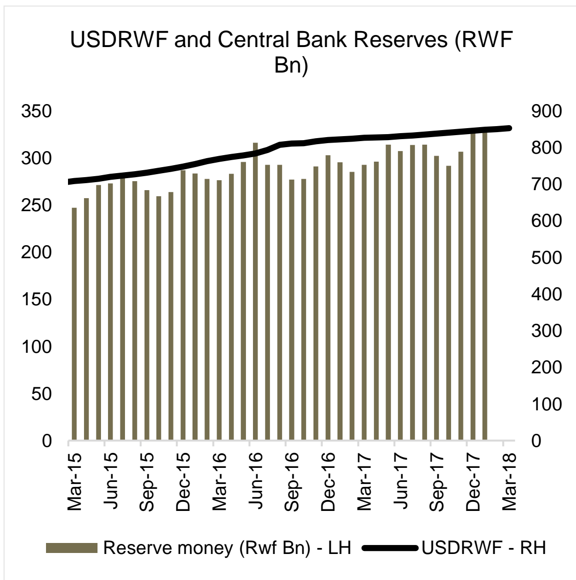
Source: CBA Research, Bloomberg



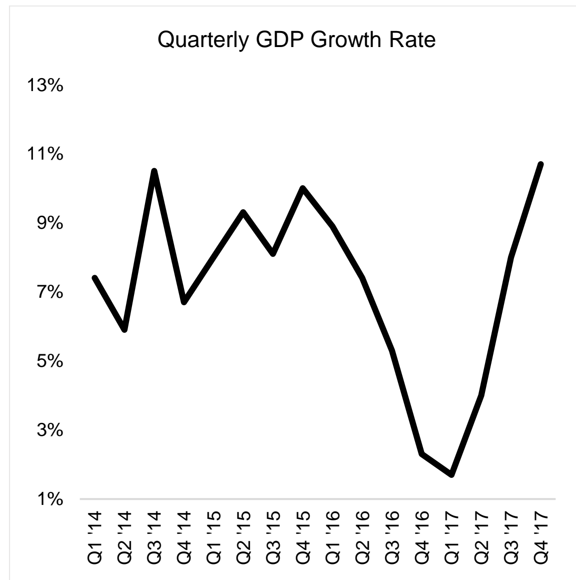
Source: National Bank of Rwanda, CBA Research



Source: National Bank of Rwanda, CBA Research



Source: National Bank of Rwanda, CBA Research



Source: National Bank of Rwanda, CBA Research

Disclaimer:

Any opinion or other information in this document is not an invitation to buy or sell any asset class. Legally binding obligations can only arise for or be entered into on behalf of Commercial Ba of Africa by means of a written instrument signed by a duly authorized signatory. You are cautioned to ensure that you have made an independent decision in accordance with your own objectives, experience, operational and financial resources and any other appropriate factors including independent professional advice. No guarantee, warranty, or representation is made in respect of the performance or return on any transaction.

Commercial Bank of Africa Limited

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

P O Box 30437 00100, Nairobi, Kenya

Telephone: 2884000; Fax: 2734635

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

Website: www.cbagroup.com