Financial News

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July 10th, 2018

Highlights

- ✓ *The second quarter of 2018 was characterized by increased volatility and the third quarter promises anything but calmness. While fundamentals remain healthy for the world economy, there are warning signs that could warrant caution among both investors and policy makers. To be sure, tailwind risks from ongoing trade wars, concerns over stability of the Eurozone and the path of Brexit should sustain the recent volatility. For emerging markets, potentially stronger US dollar due to solid economic growth and Fed's policy normalisation path could undermine the outlook.*

- ✓ ***Kenya**: Economic growth could exceed 5.5% thanks to the strong momentum witnessed in the first half of the year. Agriculture is projected to rebound strongly pulling with it the agro-processing segment of the manufacturing sector. Overall, the economy has benefited from the relative political stability with investments and spending picking up somewhat. Looking forward, fiscal and monetary policy will remain supportive as focus shifts towards plugging the negative output gap. Monetary accommodation will be underpinned by a benign inflation outlook, stable currency and strengthening business confidence.*

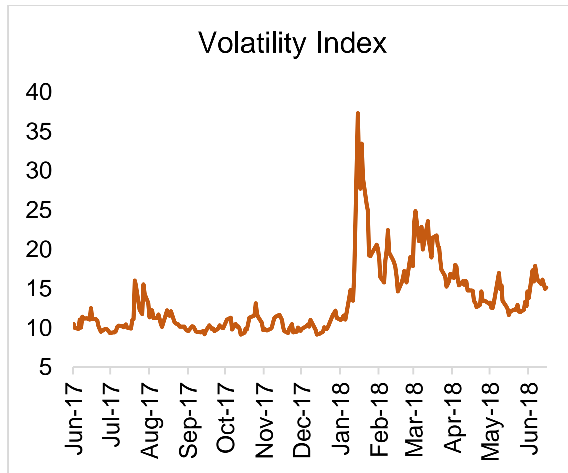
- ✓ ***Tanzania**: The economy maintained the strong impetus of the second half of 2017 buoyed by a vibrant mining and quarrying sector - the policy uncertainty notwithstanding, increased government spending on infrastructure as well as a pickup in agriculture and tourism sectors. This is likely to be maintained in the second half of 2018, promising yet another year of solid growth.*

- ✓ ***Uganda**: The economy is estimated to have expanded by 6.37% in the first quarter compared to 4.46% in a comparable period in 2017. Going forward, growth will be supported by the aggressive infrastructure pipeline, rebound in agriculture as well as increased trade. The latter may be bolstered by restoration of peace in South Sudan, which is the biggest export market for Uganda goods..*

- ✓ ***Rwanda**: After the impressive 10.60% economic expansion in the first quarter of 2018, the World Bank is projecting that the economy will accelerate to 7.20% in 2018. This growth will be buttressed by the stronger performance in the agriculture and services sectors. The latter has been underpinned by a stable macroeconomic space, supportive of domestic consumption and production. Additionally, the economy is expected to get a boost from increased government investments in infrastructure especially in transport and construction.*

More volatility in the second half as tail risks to growth increase

The second quarter of 2018 was characterized by increased volatility and the third quarter promises anything but calmness.



Source: Bloomberg, CBA Research

While underlying fundamentals remain healthy for the world economy, there are warning signs that could warrant caution among investors. To be sure, tailwind risks from ongoing trade wars, concerns over stability of the Eurozone and the path of Brexit could sustain volatility in coming months. The path of monetary policy among major central banks could also contribute to the anticipated volatility.

Strong global outlook but risks increasingly tilting to the downside

After hitting a soft patch at the beginning of the year due to weaker Euro area performance, global output saw a mild improvement in the second quarter. Output growth, as measured by JP Morgan's World Composite PMI, accelerated to a four-month high in June with stronger service sector performance offsetting the lethargy or near stagnation in manufacturing.

In the quarter, developed markets outperformed their emerging market counterparts. The US resumed its leadership of global growth buttressed by the effect of the recent tax cuts on demand, solid labour markets and accommodative financial conditions. For the first time since the financial crisis of 2008/09, the economy is estimated to have had a positive output gap in the second quarter.

Meanwhile, growth in the Euro area remained soft. While activity improved in June, the average PMI reading for the quarter was the weakest since the fourth quarter of 2016. Going forward, confidence could be dented by potential Euro-skeptic anti-establishment sentiment from Italy, immigration crisis in Germany and concerns over the efficacy of monetary policy in the economic bloc. Moreover, the ongoing trade tensions portend a significant threat to growth given exports account for roughly about 48% of the region's GDP.

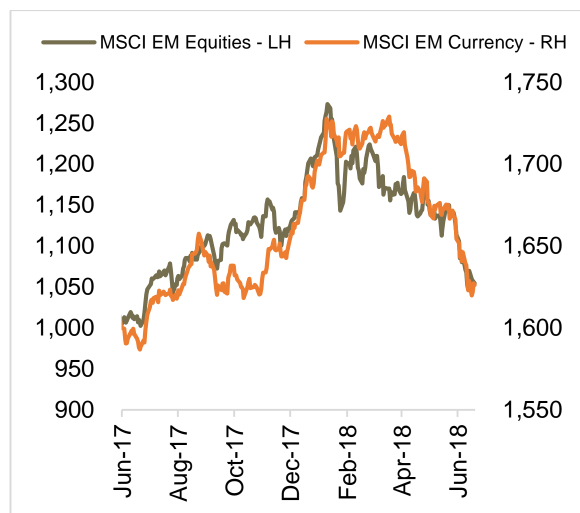
In the UK, growth accelerated in the second quarter as business activities across manufacturing, construction and service sectors recovered from the extreme winter induced lassitude. GDP growth is estimated to have doubled to 0.4% in the second quarter compared to Q1. Even then, sustaining the momentum amid trade wars and Brexit uncertainties will be an onerous task.

In Emerging Markets (EM), despite the faltering risk outlook, the threat of a crisis remains fairly low although with varied magnitudes across economies. Overall, the economies have been anchored by stronger commodity prices and pro-growth economic and structural reforms.

Even then, risks to the rather sanguine EM outlook have increased. Souring external environment due to escalating trade wars and effects of US monetary policy normalization could impair prospects for the economies. Moreover, the deleveraging policy agenda in China could soften growth

in the World's top emerging market. Markets are already pricing in the potential threats to the outlook.

Emerging markets currencies and equities reflected this fragility in the second quarter albeit with varying outcomes across markets.



Source: Bloomberg, CBA Research

Would trade wars fundamentally impair global economic outlook?

Trade protectionism arguably pose the most acute risk to global expansion. For most part of this year, the risk of the trade spurts degenerating into an actual trade war had remained hypothetical, as markets hoped for some deal that will see both the US and China back down.

But after months of rhetoric, the US trade tariffs finally took effect with a 25% levy on $34Bn worth of Chinese goods. China immediately hit back with duties on US goods including automobiles, soybeans, pork among others. Despite investors' discomfort, the US has threatened to raise the stakes with tariffs on all $500Bn worth of goods imported from China, a move China has promised to respond to in kind. At the same time, America's unprecedented discord with the other members of the G7 has also unnerved markets. The G6 have collectively imposed tariffs on $75Bn worth of US goods.

With little recent historical precedence, quantifying the exact impact of the ongoing trade wars on global expansion remain challenging. Even then, strains to global growth outlook are fairly obvious given the dire consequences on global supply chains and investments. The US Fed has warned that the heightened trade tensions were already hurting business investments and further escalation threatened to undermine the otherwise strong business outlook. The IMF has also warned of the potential negative disruption to global growth by the tariff wars.

Monetary policy within the context of trade wars.

The lackluster global economic recovery has in part been attributed to waning effectiveness of unconventional monetary policies. Its efficacy could be further undermined by the fresh complexities in the regulatory space within the context of trade wars.

The potential impact on growth, employment and inflation could see increased caution among the policy makers. Moreover, possible fiscal responses to the trade wars may make it difficult for monetary policy to be proactive. On inflation, trade wars could increase the cost of affected goods exerting upward pressure on inflation. Central banks which operate on the demand side may not have the right tools to respond to supply side risks should the trade spat escalate.

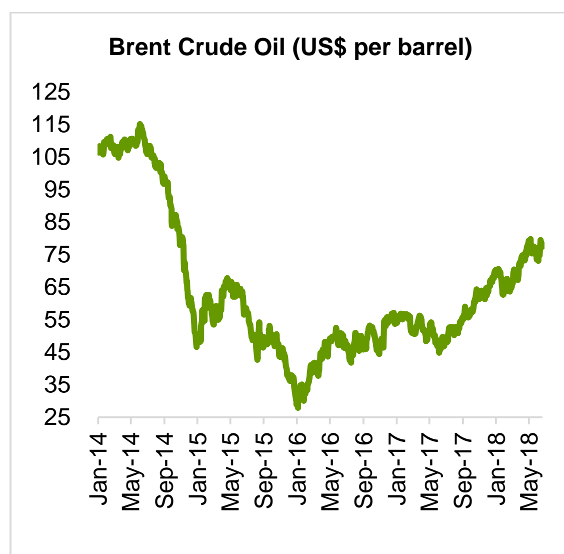
That said, the Fed has indicated that monetary policy normalization will remain on course although trade induced uncertainty could be reason for increased caution. At the same time, the ECB will delay any rate increases until Mid-2019 due to renewed economic lethargy, political concerns in the euro-zone and rising global trade tensions.

For the UK, while sentiments have turned rather hawkish following some upbeat economic data, prospects of rate increases

remain fairly moderate given lurking risks from Brexit, Euro zone crisis and trade concerns.

Closer home,

Sub-Saharan Africa growth gained some traction accelerating by an estimated 3.0% in the first quarter of 2018 from 2.7% in the final quarter. The region is expected to benefit from higher oil prices, solid domestic demand and infrastructure spending in some regions.

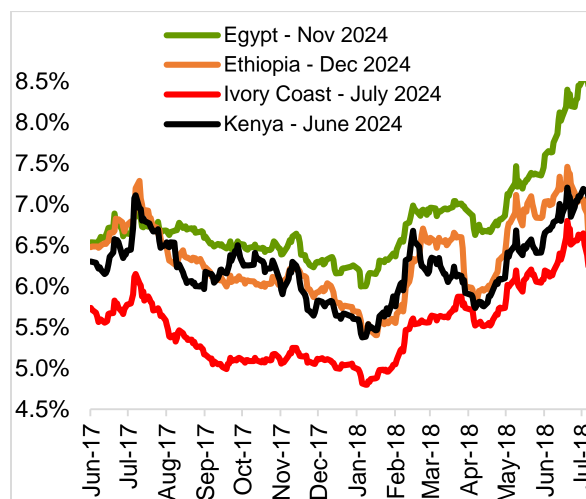


Source: Bloomberg, CBA Research

Meanwhile, the region has benefitted immensely from a fairly sanguine external environment. Even then, it is obvious that the emerging fluidity in the external environment will present some downside risks to growth. While direct effect on trade is still uncertain, and may perhaps be limited given the strong intra-regional trade, further deterioration in global sentiments could reignite global risk aversion hurting capital flows to the region.

Already, markets have shown some jitters with global markets responding with rising costs of insurance against default for their sovereign bonds.

Select African Eurobond yields



Source: Bloomberg, CBA Research

Further spiraling of the conflict could support the US dollar as demand for US Treasuries increase. This may however require market conviction of a full blown tariff war with further escalation from the initial tariffs! China doesnt seem ready to make serious concessions while the US is unlikely to back down!

The upshot is that, the calmness that typified markets for most of 2017 is unlikely to recommence. While fundamentals remain healthy for the global economy, increased downside risks from growing trade tensions and concerns over the overall health of the global economy could be a source of volatility going into the second half of the year. The uncertainty may complicate the policy environment with reduced predictability of both fiscal and monetary responses expected to inject some level of volatility in markets with increased risk aversion. Closer home, while the exact impact of the wars on trade remain uncertain and possibly limited, the region may be far from immunity. Souring global risk sentiment could intensify sell off in the region, reigniting currency depreciation, inflation and debt concerns.

Kenya

- Kenya's economic growth could exceed 5.5% thanks to the strong momentum witnessed in the first half of the year. Agriculture is projected to rebound strongly bolstered by favorable weather, pulling along the agro-processing segment of the manufacturing sector. Overall, the economy has benefited from relative political stability with investments and spending picking up somewhat, evident by the pickup in wholesale and retail trade and real estate sectors. Despite on-going consolidation, fiscal policy will remain supportive as spending shifts towards the Big Four Agenda. Whereas private sector activity has improved, downside risks from weak credit growth - policy accommodation notwithstanding, could sustain a negative output gap.

- In response to fiscal sustainability concerns, the government will be initiating a consolidation cycle in a bid to reduce the budget deficit and borrowing. In its projections, Treasury plans to spend KES 2.56 Trillion, equivalent of 26.0% of GDP. Revenues are projected to increase by 17.5% to KES 1.90 Trillion (20.0% of GDP), bolstered by stronger economic performance and better tax administration. This should reduce the deficit to 5.7% of GDP from an estimated 7.2% in previous year. Even then, the revenue outlook could be fairly ambitious given the slow recovery in the private sector. Accordingly, the risk of running a higher deficit remains high and may compel the government to cut expenditure given the fairly narrow fiscal space.

- That said, the government will be looking to borrow KES 272Bn and KES 287Bn from local and external markets respectively for deficit financing. Notable was a 20% reduction in the external debt target. While this restructuring is welcome given the anticipated swings in external markets, potential to further crowd out the private sector could undermine economic activities. Meanwhile, alterations in the tax regime could destabilize some businesses undermining the medium term revenue outlook.

- On the monetary policy front, the combination of low inflation, stable currency and stronger business sentiment will support the current easing bias. Inflation ticked up to 4.28% from 3.95% in May but remained well anchored within the statutory target band. That said, risks from higher oil prices, transitory effects of recent tax increases and the ongoing crackdown on contrabands could see further acceleration in prices. The spotlight is now on the proposed legislative amendments that could potentially see a repeal of interest rate controls. This could create room for policy maneuver, buttressing our call for an additional 50bps policy rate cut by the end of the year. That said, the souring external environment could be cause for caution in terms of policy response.

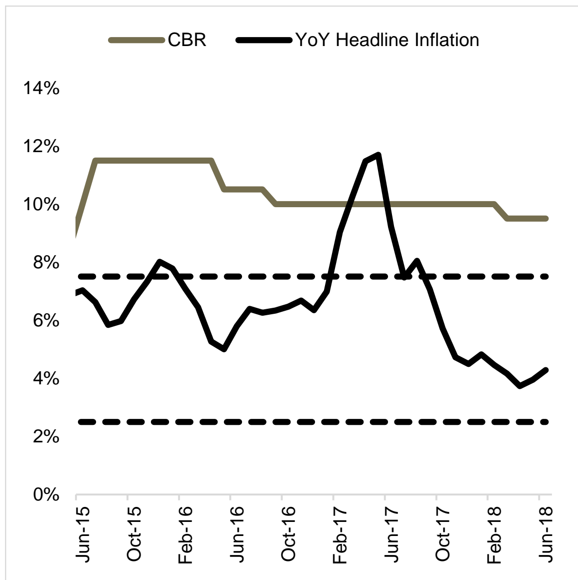
- The policy bias coupled with slow private sector lending will keep interest rates fairly subdued. In June, yields dropped by an average of 48bps on T-bills driven by heavy demand and a fairly stable inflation environment. That said, the pressure to fund upcoming heavy maturities and potential frontloading of borrowing to support the Big Four Agenda projects could limit the downside for interest rates. So far this financial year, the government has KES 1,050Bn in outstanding maturities with 56.2% set to be rolled over in the first six months.

- The shilling has continued to outperform our forecasts bolstered by steady dollar inflows and regulatory support amid tepid demand. While unfavorable interest rate differentials and a wider current account deficit due to increased oil prices and renewed machinery imports may herald risk to the exchange rate, we believe the CBK will continue to anchor the shilling allowing for only a mild depreciation from the levels. Besides supporting a benign inflation outlook, a stable currency will help rein in concerns over debt sustainability. To this we expect the shilling to end this quarter at 101.80 against the US dollar having gained 55 cents to 100.80/90 in June.

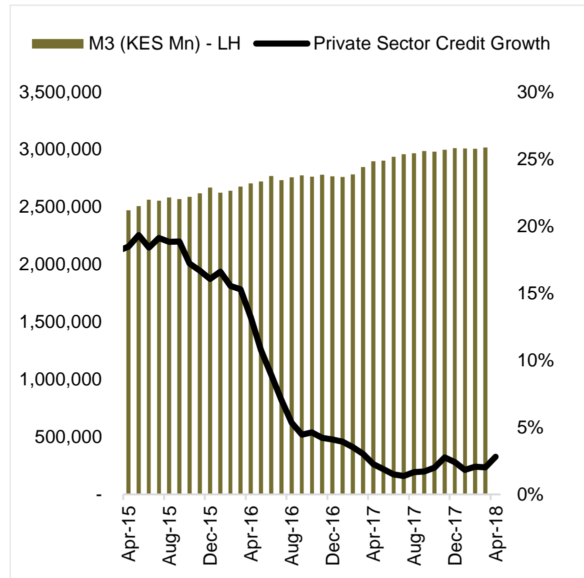
Forecasts

Quarter ending	March 2018 *(A)*	June 2018	Sept 2018	Dec 2018
GDP	5.70%	6.01%*(F)*	5.56%	5.16%
Inflation	4.16%	4.28%	6.07%	6.53%
USDKES	100.85	101.05	101.80	102.50
CBR	9.50%	9.50%	9.00%	9.00%

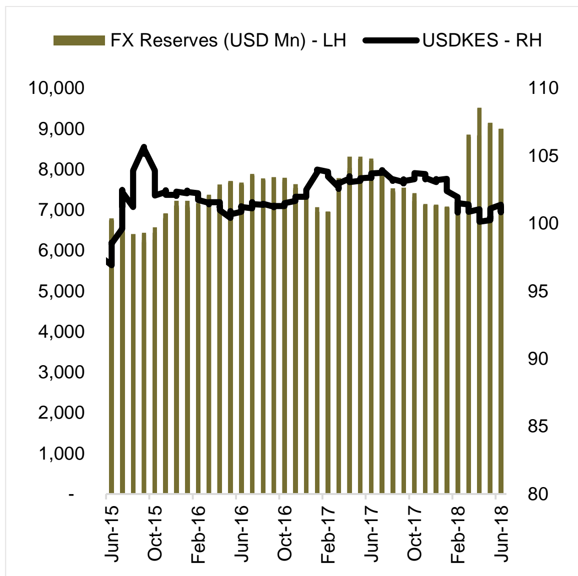
Source: CBA Research, Bloomberg



Source: Central Bank of Kenya, CBA Research



Source: Central Bank of Kenya, CBA Research



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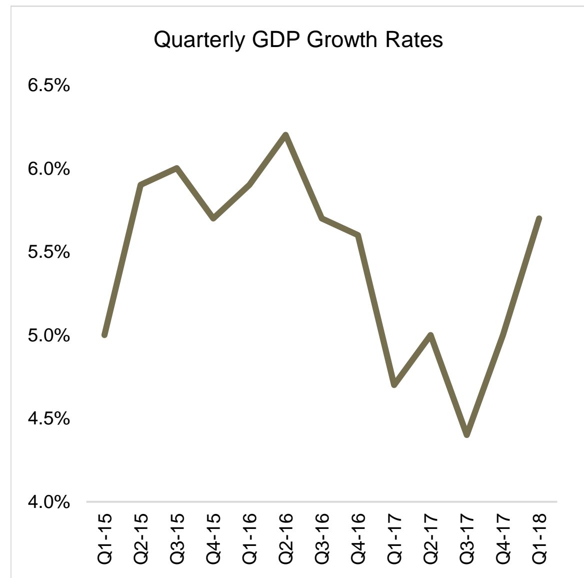


Source: Central Bank of Kenya, CBA Research

Tanzania

- The economy maintained the strong impetus of the second half of 2017 buoyed by a vibrant mining and quarrying sector - the policy uncertainty notwithstanding; increased government spending on infrastructure as well as recovery in agriculture and tourism sectors. This is likely to be maintained in 2018 with the government projecting a 7.0% economic expansion in the current financial year.

- In driving its Industrialization agenda, the government plans to spend TZS 32.48 trillion (Up 13%) in 2018/19 of which 37% will be channeled towards development spending while the rest will fund recurrent expenditure and debt service. Revenues are projected to increase to TZS 20.89 Trillion driven by continued tax reforms and stronger economic activities. To fund the deficit, government will borrow a gross of TZS 4.71 Trillion from the local market and TZS 5.79Trillion from external markets. Net local borrowing (less redemptions) will be TZS 1.19 Trillion, a slight decrease from the previous fiscal year. This could help keep the local environment fairly steady although potential increase in the cost of external financing could see the government revert to local markets to plug the gap, risking this stability.

- Monetary policy has remained supportive with heavy liquidity supporting a drop in lending rates. Overnight rates oscillated between 1.60% - 2.42% in June mostly supported by low debt appetite by Treasury and continued liquidity support by the Bank of Tanzania (BoT). Yields performance was mixed across the T-bill curve at 2.85% (Up 96bps), 2.68% (Down 5bps) and 6.89% (Up 141bps) for the 91, 182 and 34 day papers respectively. The auctions were undersubscribed during the month as the market demanded higher yields. Even so this failed to translate to stronger credit growth. Private sector credit has stagnated below 2.0% over the last one year and expanded by a meagre 0.7% in May 2018. Growth is expected to remain in lower single digits dogged by concerns over policy fluidity.

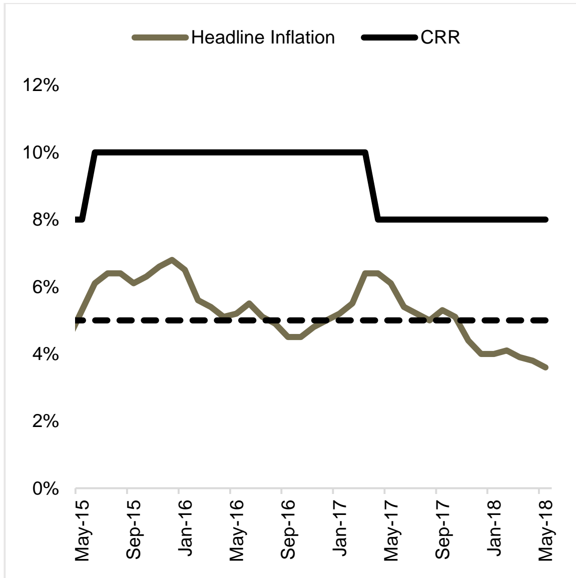
- Inflation is expected to remain relatively stable in the second half of 2018 owing to improved food supply and a stable exchange rate. This in line with the Bank of Tanzania's (BoT) medium term target of 5.0%. This stability supports a relatively loose monetary policy that could further anchor the economic growth outlook. However, the upward momentum in global crude oil prices may lead to inflationary pressures.

- The Tanzania shilling was marooned in the 2268 – 2281 range against the US dollar as matched dollar demand and supply was complemented by the Bank of Tanzania's intervention in the foreign exchange market. The local currency is expected to remain within this range in the near term given favorable current account dynamics and adequate foreign exchange reserves. Moreover, effective import substitution especially in energy has helped reduce overall demand for dollars in the market.

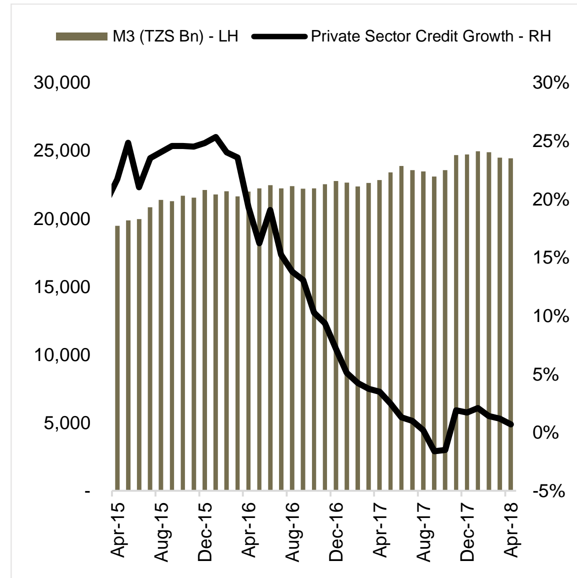
Forecasts

Quarter ending	March 2018	June 2018	Sept 2018	Dec 2018
GDP	6.60%*(F)*	6.70%*(F)*	6.67%	6.76%
Inflation	3.90%	3.77%*(F)*	4.52%	4.73%
USDTZS	2255.94	2271.55	2279.30	2288.25
CRR	5.25%	5.25%	5.25%	5.25%

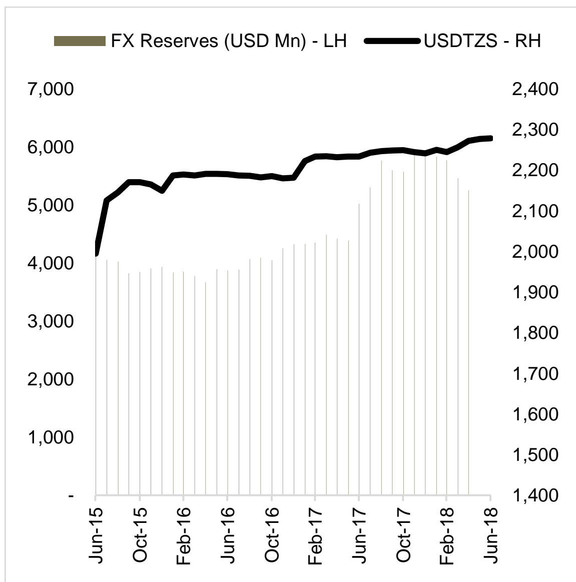
Source: CBA Research, Bloomberg



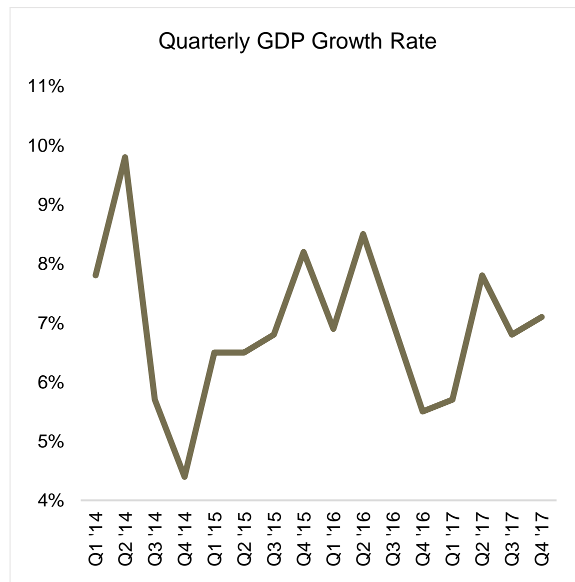
Source: Bank of Tanzania, CBA Research



Source: Bank of Tanzania, CBA Research



Source: Bank of Tanzania, CBA Research



Source: National Bureau of Statistics, CBA Research

Uganda

- The economy is estimated to have expanded by 6.37% in the first quarter compared to 4.46% in a comparable period in 2017. This momentum could be sustained by an aggressive infrastructure pipeline, rebound in agriculture and increased trade. Trade in the country could be buttressed by potential restoration of peace in South Sudan, which accounted for close to 30% of Uganda's GDP growth before the unrest in 2016. Renewed funding and exports to South Sudan as a result could reignite activity in the private sector.

- Meanwhile, the policy environment is expected to remain generally supportive. The government will spend UGX 25.48 (+14.2%) Trillion this year, with increased allocation towards the development budget. This will be funded by a 14.16% increase in revenues to UGX 16.36 Trillion (+8.6%). To this, the budget deficit of UGX 7.43 trillion (Up 35.30%) – (6.6% of GDP) will primarily be financed through external borrowing to the tune of UGX 5.44 Trillion (+96.7%). Local borrowing was maintained at UGX 1.99 Trillion, a deliberate move to help restore private sector credit growth.

- Meanwhile, although scope for further easing has reduced considerably due to currency volatility, monetary policy will remain accommodative in a bid to increase lending to the private sector. Credit growth has picked up somewhat to 8.74% in May 2018 – the fastest growth in 27 months. As economic activity picks up, a gradual increase in credit growth should be anticipated although banks have growth wary of NPLs especially on dollar loans which account for roughly 35% of the sector's loan book. Inflation remained low at 2.20% and is expected to trend higher towards 5.0% by year end.

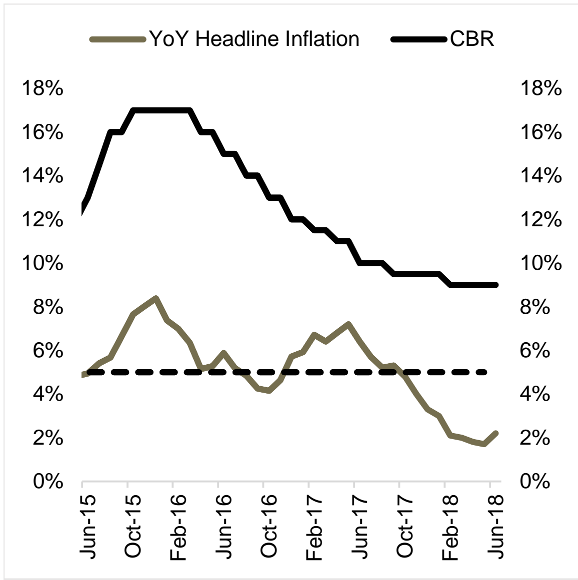
- The combination of higher deficit and currency volatility will likely see some upward pressure on interest rates. Yields surged in June to 10.516% (Up 172bps), 12.028% (Up 253.80bps) and 14.502% (Up 421.90bps) for the 91, 182 and 364 day papers respectively. While this could have been due to cyclical demand towards the end of the financial year, the surge in yields may also have been deliberate to prevent further depreciation of the shilling. Given the relative low foreign exchange reserves at USD 3.31 Bn (4.9 months import cover) and the high government demand for dollars especially for debt servicing. The economy remains fairy dollarized suggesting steady dollar demand.

- The Uganda shilling turned bearish in the month of June shedding a whopping 2.80% to 3875/3885 against the US dollar. The weakness was as a result of augmented dollar demand, primarily from the private sector, as economic activity improves. The shilling is expected to remain vulnerable to widening deficit and volatility in the external environment although long run trends suggests that the shilling could depreciate further towards 3900.

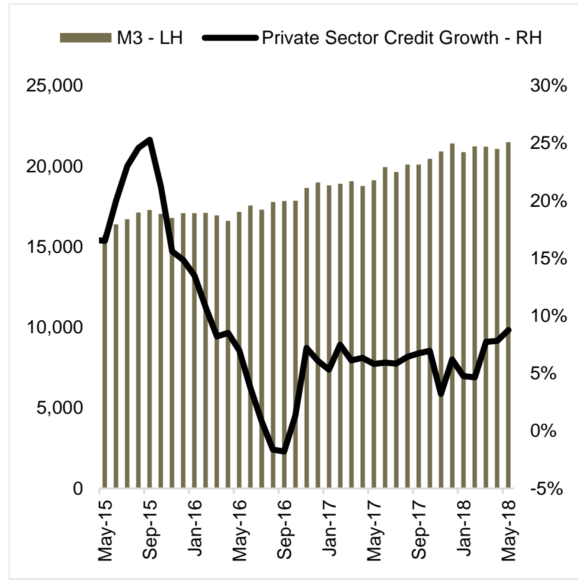
Forecasts

Quarter ending	March 2018*(A)*	June 2018	Sept 2018	Dec 2018
GDP	6.37%	7.00%*(F)*	6.00%	5.00%
Inflation	2.00%	2.00%	4.50%	6.00%
USDUGX	3660	3840	3844	3890
CBR	9.00%	9.00%	9.00%	9.00%

Source: CBA Research, Bloomberg



Source: Bank of Uganda, Bloomberg, CBA Research



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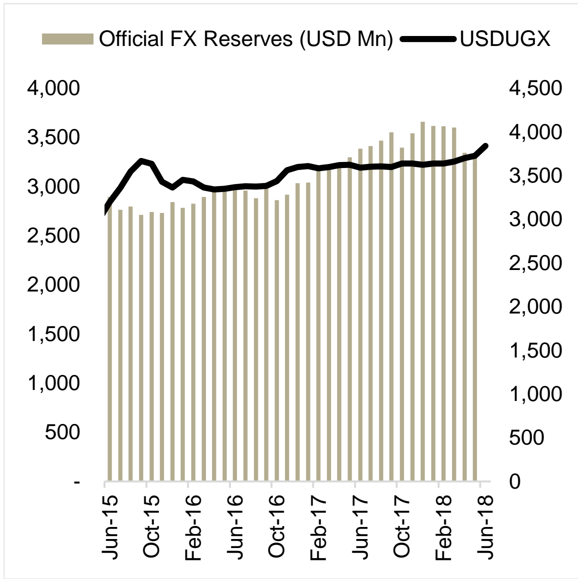

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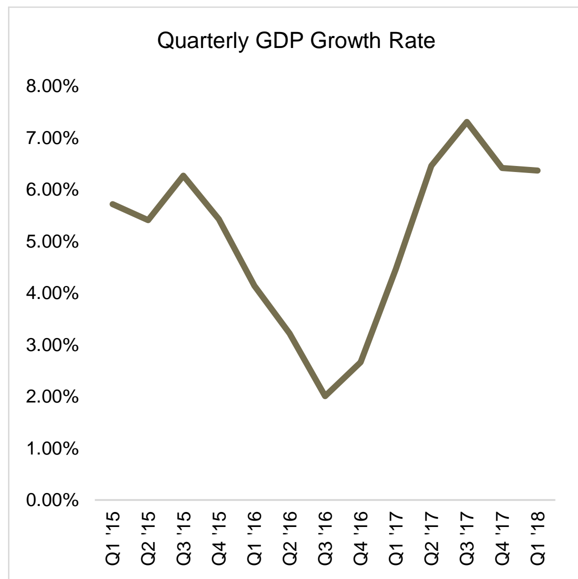


Source: Bank of Uganda, Bloomberg, CBA Research

Rwanda

- After an impressive 10.60% GDP growth rate in the first quarter of 2018, the World Bank is projecting that the economy will accelerate to 7.20% in 2018. This growth will be buttressed by the stronger performance in the agriculture and services sectors. The latter has been underpinned by a stable macroeconomic space, supportive of domestic consumption and production. Additionally, the economy is expected to get a boost from increased government investments in infrastructure especially in transport and construction.

- The government is expected to spend RWF 2,290 Bn (Up 10.69%) in the fiscal year 2018/19 that will be funded, in part, by RWF 1,920Bn (Up 8.41%) in revenues. This will translate to a wider budget deficit of RWF 310.10Bn, equivalent of 4.90% of GDP. The deficit will primarily be financed through the domestic market as the government seeks to reduce its exposure to volatile external debt markets.

- Meanwhile, monetary policy is expected to remain supportive. Private sector credit has been on a four-month slowdown easing to 7.59% in April 2018. Additionally, the International Finance Corporation (IFC) invested USD 10 million in the banking sector in June in support of Small and Medium Enterprises (SMEs) due to the lack sufficient financing. The government is also supporting the private sector through its “Made in Rwanda” initiative. Some of the incentives for this initiative include 0% import duty on all capital machinery used in the textile and leather industry, 0% import duty on certain raw materials and a reversal of the total ban on second hand clothes and shoes which will now attract a high tax of US$4/Kg and US$5/Kg respectively.

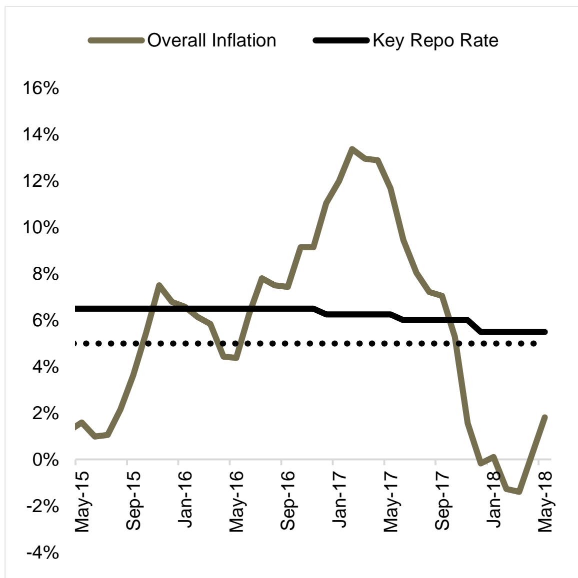
- Meanwhile, Treasury bill auctions recorded mixed performance during the month with yields closing at 5.475% (Up 32.70bps), 6.412% (Down 28.50bps) and 6.825% (Up 77.500bps) for the 91,182 and 364 day papers respectively. The Treasury bill auctions were as well undersubscribed.

- The Rwandese Franc ended the month lower at 859.76 against the US dollar from 857.38 at the start of the month. The Franc is expected to maintain the gradual depreciation driven by the persistent dearth of dollar in the market. Even so, the tight control by the National Bank of Rwanda will ensure a smooth depreciation.

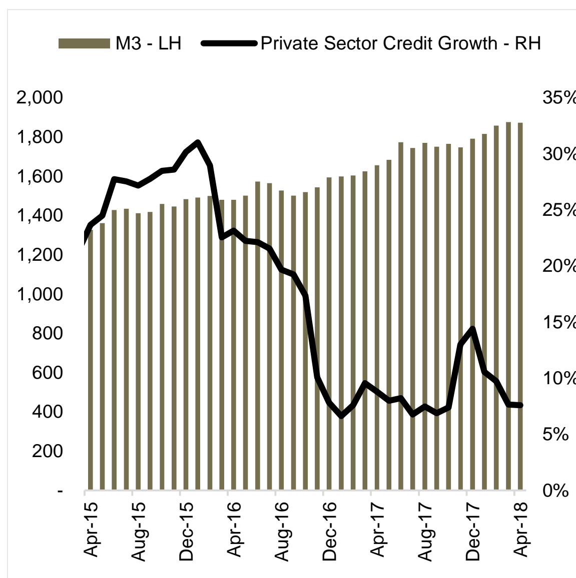
Forecasts

Quarter ending	March 2018*(A)*	June 2018	Sept 2018	Dec 2018
GDP	10.60%	6.30%*(F)*	6.50%	7.00%
Overall Inflation	-1.40%	3.00%*(F)*	4.60%	8.60%
USDRWF	852.68	859.76	884.38	892.43
Repo Rate	5.50%	5.00%	5.00%	5.00%

Source: CBA Research, Bloomberg



Source: National Bank of Rwanda, CBA Research



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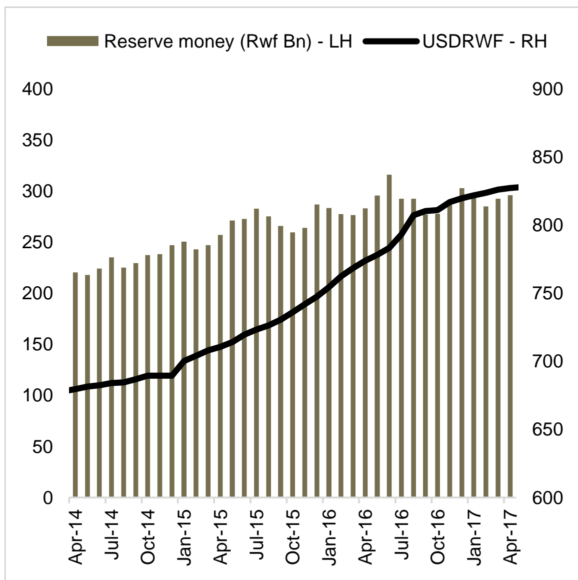

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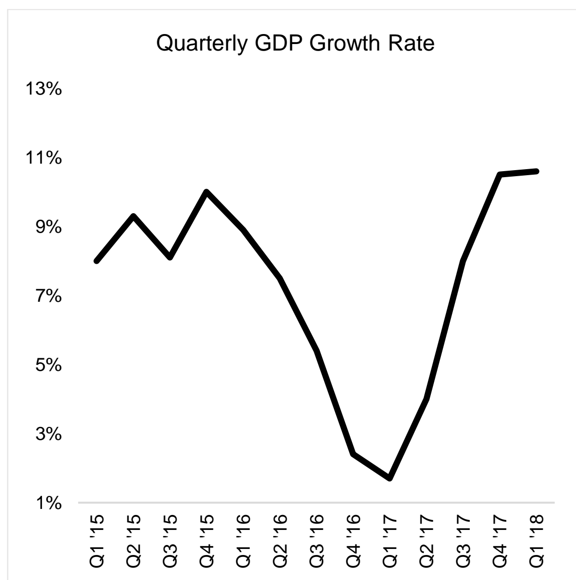

Source: National Bank of Rwanda, CBA Research

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