Financial News
cba
time for more.

MPC retains status quo as it expresses caution over impact of taxes on inflation

- The Monetary Policy Committee (MPC) met today for its bi-monthly review of monetary policy. Against a backdrop of rising inflation expectation, the policy body maintained a cautiously dovish tone, electing to hold the Central Bank Rate at 9.00%.

- Although fairly confident that inflation may remain within target, the MPC indicated that the neutral position on the current stance should give it time to assess the second round effects arising from the reintroduction of VAT (8.0%) on petroleum products on overall price stability and any perverse response to its previous decisions.

- The policy posture was supported by prevailing exchange rate stability which the monetary authority credits to improvement in the current account deficit to 5.3% of GDP in the 12 months to August from 5.6% in June.

- Additionally, the CBK remained confident that USD 8.51Bn in foreign exchange reserves will continue to provide an adequate buffer against short term shocks.

- Meanwhile, despite the potential loss of output during the fiscal consolidation cycle, the MPC was silent on the productivity gap only underlining the optimism from its Private Sector Market Perception Survey. The relative bullishness was however tempered by expected effects of VAT on overall production and consumption.

- That said, we expect focus later in the year to shift back to plugging the output gap, potentially triggering more stimulatory response by the Central Bank. Potential reduction in aggregate demand due to the consolidation could help keep underlying inflation subdued as the effect of VAT fades off towards end of the year. This could provide room for further accommodation.

- Although credit growth has picked up somewhat rising to 4.3% in August from 2.4% in March, the current pace of expansion remains significantly low to provide the much needed stimulation in private sector activity. Credit expansion is expected to remain fairly lethargic, due to the inefficiencies in signal transmission induced by interest rate capping.

- With the status quo maintained, markets are likely to remain calm. The currency should remain relatively stable although with a mild weakening bias. Meanwhile short-term interest rates may maintain the gradual adjustment downwards supported by sound liquidity and steady appetite for short-term government securities. However, the scope downwards for interest rates could be limited by likely pick up in government borrowing to finance the KES 2.56 Trillion 2018/19 budget.