cba
time for more.

December 11th, 2018

Highlights

Just a year ago, the global economy was enjoying a stronger and synchronized expansion. Growth was robust in the US, Europe, Japan and most emerging markets. Corporate profits were rising, global trade swelling and business optimism at multi-year highs. In fact, overall GDP during the period expanded at its fastest pace in five-years, boosting confidence that the global economy was finally escaping the low-growth trap!

A year later, the exuberance is fast fading and may give way to a broad-based slow down. Markets are already pricing in the probability of a recession, picking signals from a partially inverted US yield curve. While a recession after a protracted period of expansion may not be unusual, investors' greatest fear may perhaps be the likely limitations to policy response should the world slip into a recession. Can governments and central banks handle another downturn?

While most forecasts are not predicting a recession until perhaps in 2020, asset prices will continue to adjust accordingly in 2019 with increased sensitivity to data and any negative rhetoric that could escalate these concerns. Thus, risk aversion may still be the name of the game!

- ✓ ***Kenya**: Robust agricultural production coupled with improved public spending should power the economy to a stronger close in 2018. A stable political environment has supported business investments while low inflation and increased remittances have underpinned personal consumption and investments. While forecasts remain generally bullish, the outcome is still dependent on vagaries of weather, developments in credit markets and pace of consolidation.*

- ✓ ***Tanzania**: Policy uncertainty has been the main headwind for Tanzania over the last two years. This has considerably dampened investor and business sentiment, undermining optimal output growth for the country. To this, the decision by the government to buy cashew nuts from farmers due to what was perceived as poor pricing, though well intended, has made investors jittery by aggravating the uncertainty in the policy space.*

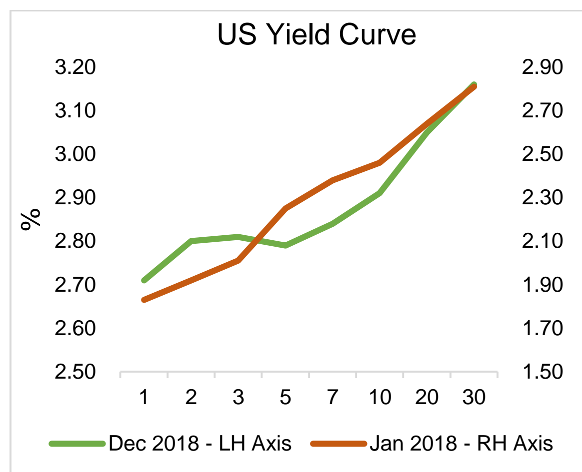
- ✓ ***Uganda**: Strong readings by leading economic indicators including the Composite Index of Economic Activity(CIEA) underline a robust economic growth momentum in Uganda. After growing at 6.1% in the first half of the year, the economy is projected to maintain a solid pace although a higher base may see the pace moderate somewhat on an annualized basis.*

- ✓ ***Rwanda**: The economic outlook remains broadly sanguine. A combination of increased public spending, private sector investments and a resilient service sector will sustain solid growth in to 2019 especially in trade, transport and tourism. Investor sentiment remains generally positive although concerns over the persistent dearth of dollars in the market remain a big impediment for foreign investors*

Risk aversion to persist as fears of a global recession mount…. Can governments and central banks handle another downturn

Just a year ago, the global economy was enjoying a stronger and synchronized expansion. Growth was robust in the US, Europe, Japan and most emerging markets. Corporate profits were rising, global trade swelling and business optimism at multi-year highs. In fact, overall GDP during the period expanded at its fastest pace in five-years, boosting confidence that the global economy was finally escaping the low-growth trap!

A year later, the exuberance is fast fading and may give way to a broad-based slow down. Stocks have been selling off on fears that a global recession may be imminent. Moreover, in what markets consider the strongest signal yet, the continued flattening of the US yield curve, and the recent partial inversion has exacerbated these concerns! Historically, an inverted US yield curve has been a precursor to most recessions.



While a recession after a protracted period of expansion may not be unusual, investors' greatest fear may perhaps be the likely policy response limitations should the world slip into a recession. Can governments and central banks handle another downturn?

The traditional response to recessions has been fiscal expansion, steep interest rate cuts or a combination of the two. In recent years, the US has been running a large fiscal deficit; China has pursued loose fiscal policy and financial conditions in Europe and Japan remain ultra-accommodative.

Accordingly, the wiggle room for both fiscal and monetary authorities has narrowed. Policy arsenals have been somewhat depleted over the last 10 years fighting the effects of the last recession. Fiscal cannons have been fired, evidenced by the rise in government debt across most economies. At the same time, interest rates are still extremely low by historical standards.

While enhanced quantitative easing is still an option, central banks will have to handle a fresh downturn with already swollen balance sheets and little space for rate cuts.

At the same time, the efficacy of quantitative easing (QE) remains arguable, having failed to provide the much-required thrust to growth and inflation in Europe and Japan.

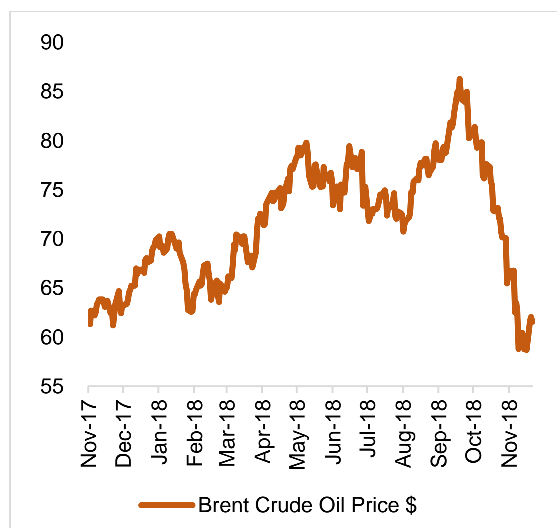
No doubt, fiscal stimulus has had immense success in reducing output gaps. That said, the scope may also be limited by massive public debt build up. Obviously, higher fiscal deficits are not sustainable and cutting back will have some drag on growth!

While most forecasts are not predicting a recession until perhaps in 2020, asset prices will continue to adjust accordingly in 2019 with increased sensitivity to data and any negative rhetoric that could escalate these concerns. Thus, risk aversion may still be the name of the game!

Meanwhile as the year winds up, several events this month are expected to set the tone for markets in 2019:

Will OPEC offer some impetus to oil?

Oil prices recently hit 12-month lows weighed down by surging supply amidst fears that an economic downturn in late 2019 will erode fuel demand. The US decision to exclude eight countries from the embargo on supplies from Iran also fueled the sharp decline in prices. Brent crude prices dropped about 30% in late November to trade at $60/barrel following massive liquidation of long oil positions due to the aforementioned concerns.



That said, oil pared some losses to settle at $62.12/barrel after OPEC announced a 1.2Mn barrel daily output cut. This will help rebalance markets by reducing the surplus, potentially pushing prices back up towards $73/barrel in 2019 - according to recent Reuters survey. However, risks will stem from further decline in demand should the risk of a recession crystalize. Moreover, substantial production by shale companies will continue to exert downward pressure on prices.

Of course, discipline from OPEC members will be crucial in keeping prices anchored. With the deteriorating growth outlook, the temptation to ramp up production to enhance revenues is likely to increase.

For now, low oil prices could help keep global inflation contained, complicating major central banks' ambition to normalize monetary policies. On a positive note, delayed monetary stimulus withdrawal could provide some respite for emerging markets.

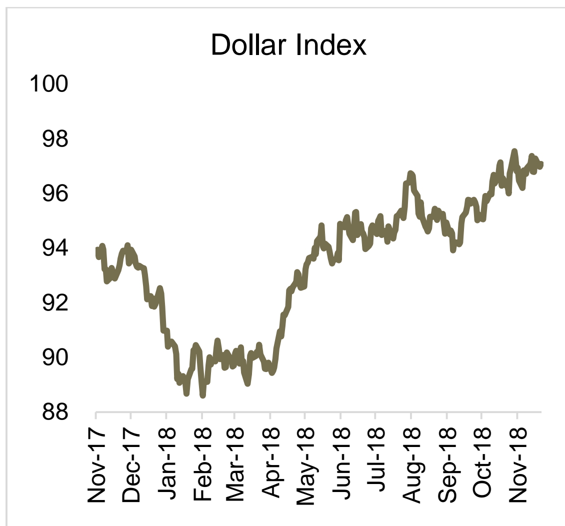
Monetary policy convergence? The dovish US' Fed shift!

Recent signals that the global economy may be sputtering have seen markets start to price in a convergence in monetary policies later in 2019. Throughout this year, the Fed has maintained a largely bullish and divergent interest rate forecast underpinned by above target inflation.

In a complete departure from its earlier predetermined interest rate guidance, the Fed has recently softened its stance, with some members arguing that the pace previously indicated by FOMC risks placing undue slack on growth and inflation. The Fed Chair Jerome Powell also took a dovish stand suggesting that the Fed Fund Rate is near neutral from his previous position that interest rates were still a long way from neutral.

While this does not take away the prospect of a December hike, guidance into 2019 and the tone of the rate setting committee, will likely to be adjusted. For sure, the Fed may pace down on interest rate normalization and hinge its actions on actual data.

That said, without the support from the previously divergent and bullish policy bent, the dollar could be hypersensitive to not only domestic data but external releases as well. For now, persistent risk aversion could still keep the US dollar fairly anchored.



Is the expected QE unwinding by the ECB untimely?

It is obvious that with sluggish growth and weak inflationary pressures, the ECB is far from rising interest rates. GDP is expected to slow down to 1.7% in 2018 from 2.0% in 2017, with already signs of contraction in Germany, the biggest economy in the bloc.

The lethargy in the euro zone has been aggravated by rising populism and sometimes divergent and unique needs of the individual economies, which complicates policy response.

The confrontation between the EU and Italy was central to the intense Euro sell off in the last two months. While Italy could compromise and reduce its projected 2.4% fiscal deficit, which EU had found in breach of the bloc's budgeting rules, risks of more populist uprisings cannot be totally discounted.

Even then, the ECB is due to phase out QE by the end of this month. This is against plausible criticism by a section of European lawmakers that the central bank is moving too soon. That said, the ECB could still reinstate the QE should conditions warrant.

The Brexit options…. Hard landing?

Britain's exit from the European Union is scheduled for March 29, 2019. This week, the UK parliament was to vote on the deal secured by the government with the European Union. Thus far, the tone from parliamentary discussions suggests little scope for ratification. The biggest issue has been the Irish border "backstop" which presumably, will bind the UK in a custom union with the EU, against Brexit wishes.

While the vote has been delayed with the hope of getting more concessions with the EU especially on the Irish border backstop, the hardline position by the latter doesn't promise much change. Should MPs vote down the deal when it comes back to parliament, the ensuing uncertainty will be unhealthy.

A big margin loss may trigger a vote of no confidence in May, who has insisted that she will not step down. A ballot of party members will then vote in a new leader.

Other outcomes could include a general election where there is a vote of no confidence in the government. This will take at least six weeks. Given the Brexit timelines, any government that comes in place will have very limited time to solve the Brexit conundrum.

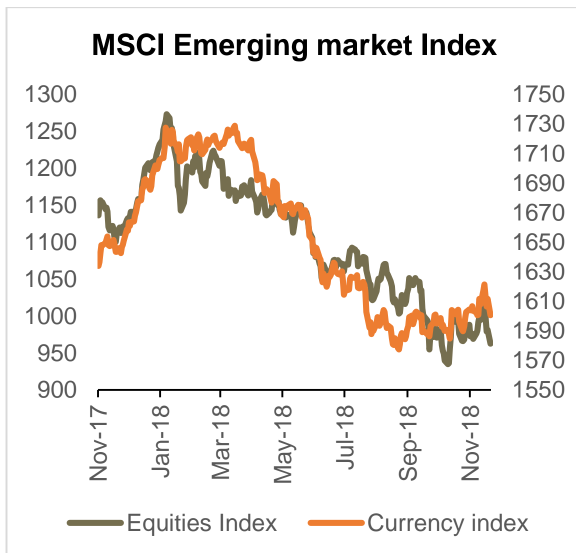
Alternatively, the Labor party has been speaking up a referendum. While the questions remain unclear, speculation is that it could seek people's approval on the current proposed terms, leaving without a deal or even walking back on the earlier position to leave the union. Prospects of the latter are however slim since it betrays the Brexit spirit.

No deal – This is the most dreaded yet, the most plausible outcome of the Brexit negotiations. If the deal is not approved or put on hold, UK will still exit EU on March 29th 2019 without a deal. The Bank of England has warned that such an outcome would trigger a deep recession in the UK cutting GDP by up to 3.9% in two years. But according to the PM, 'a No deal is still better than a bad deal'.

All said, the UK seems headed for difficult economic times. It is almost certain that the UK will exit the EU without a deal or with a "bad deal". The period to March 29 will therefore see augmented volatility on the pound and potentially the Euro.

Emerging markets

Sentiments for emerging markets remain fragile. However, prospects of de-escalation of trade tensions between the US and China coupled with softer stance on the pace of interest rate normalization in the US has provided some respite for emerging markets.



However, the broader fears of an economic downturn could sustain global risk aversion undermining the recovery in emerging market equities and exchange rates.

In China, the economy has continued to show signs of slowdown with trade tension generating additional headwinds. Moreover, slower credit growth will keep growth on the back foot, as domestic demand softens.

Deteriorating sentiment from trade wars could further weaken domestic demand.

All said, December, traditionally a fairly measured month in terms of volatility is likely to see aggravated gyrations across different asset classes. Risk events lined up in the period is likely to keep markets fairly active although risk aversion will remain the dominant theme. Market will be looking out for any signals that could compound or diminish fears of a global recession. This suggests greater sensitivity to not only data but also developments on trade, monetary and fiscal policies rhetoric as well as well as the ever-evolving geopolitics.

Kenya

- Robust agricultural production coupled with improved public spending should power the economy to a stronger close in 2018. A stable political environment has supported business investments while low inflation and increased remittances have underpinned personal consumption and investments. Data expected later this month could show that the economy grew by about 5.8% in the third quarter. This is likely to spill over into the final quarter of the year although a higher base could moderate the pace somewhat.

- That said, the momentum although expected to be maintained into 2019 remains subject to vagaries of weather, developments in credit markets and the pace of fiscal consolidation. The government has reiterated its commitment to fiscal restraint, which should see the deficit reduce from 7.2% of GDP in 2017/18 to 4.7% in the next two years. However, concerns over faltering revenue performance and public debt concerns may support the case for deeper spending cuts.

- In spite of the recent monetary easing, the policy seems 'neutral, with reduced efficacy in stimulating lending and growth. The central bank in its MPC statement reiterated that the interest rate cap continues to undermine the transmission of policy signals, saying, "…transmission of changes in the CBR to growth and inflation takes longer than the period before the cap".

- Credit growth has stagnated in single digits, expanding by 4.4% in the year to October. Further acceleration in lending may be limited by the interest rate cap and the persistently high non-performing loans. The NPL ratio declined marginally to 12.3%, although this is partly due to slower growth in the denominator – lending. At the same time, government appetite for domestic borrowing may remain elevated in light of recent concerns around external debt sustainability. Latest estimates from Treasury reveal that, the government may borrow KES 319Bn locally, a KES 32.00Bn increase from initial estimate. This could further crowd out private sector.

- The current monetary policy stance has been buttressed by stable inflation – 5.58% in November from 5.53% in October. Tame food inflation, lower oil prices and weak domestic demand pressures will keep prices changes within the statutory target band. Having said that, post MPC signals have seen a departure from this guidance. Markets have tightened with the interbank rate rising to 7.4% presently from record lows of 2.0% at the beginning of November.

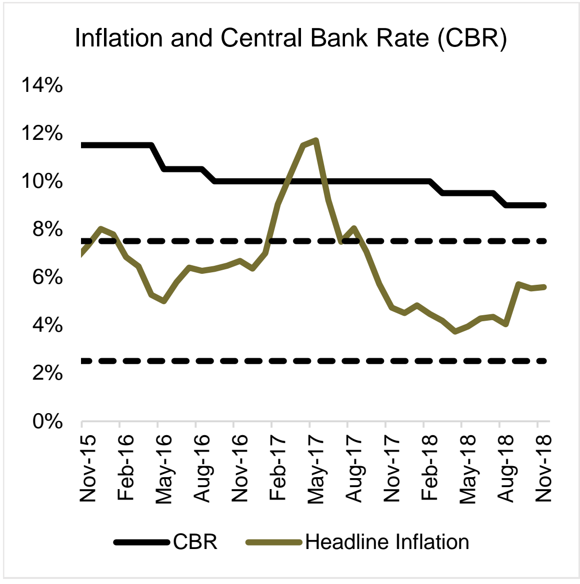
- The apparent bias for smooth exchange rate depreciation has necessitated heightened intervention from the regulator, using a combination of foreign exchange reserves and outright shilling liquidity mop-ups using repos. Repo rates have risen to 8.9% presently, dragging the interbank rate above 8.0%, beyond the yield on the 91-day T-bill currently at 7.343%. The tightness, a clear departure from the MPC guidance, may persist through December as central bank seeks to contain excess volatility on the currency.

- The shilling lost 0.5% to the US dollar to trade at 102.50 levels in November. Persistent pressure in spite of the squeeze in liquidity could suggest genuine underlying demand and potentially push the unit closer to 103.00 by year-end. On a brighter note, the drop in oil prices could provide a much welcome relief for the currency although fragile sentiment due to persistent fiscal concerns may still be a headwind.

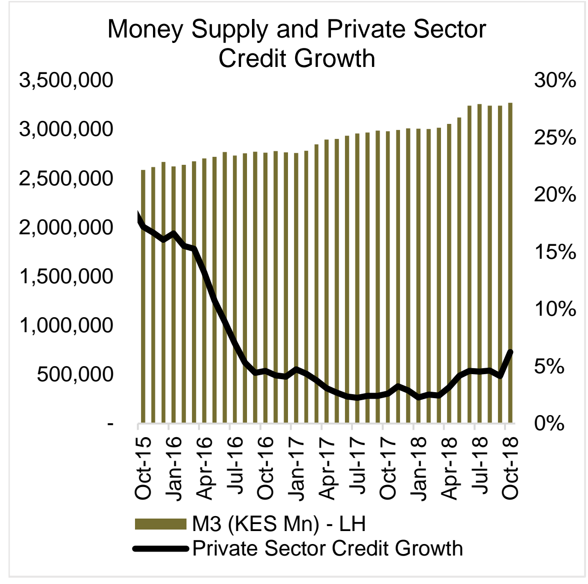
Forecasts

Quarter ending	March 2018 *(A)*	June 2018	Sept 2018	Dec 2018
GDP	5.70%	6.30%	5.70%	6.00%
Inflation	4.16%	4.28%	5.70%	5.40%
USDKES	100.85	101.05	101.05	102.70
CBR	9.50%	9.50%	9.00%	9.00%

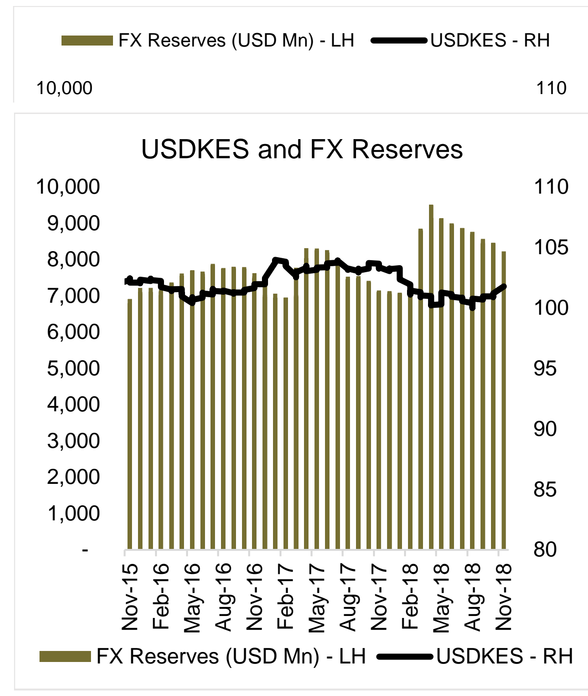
Source: CBA Research, Bloomberg



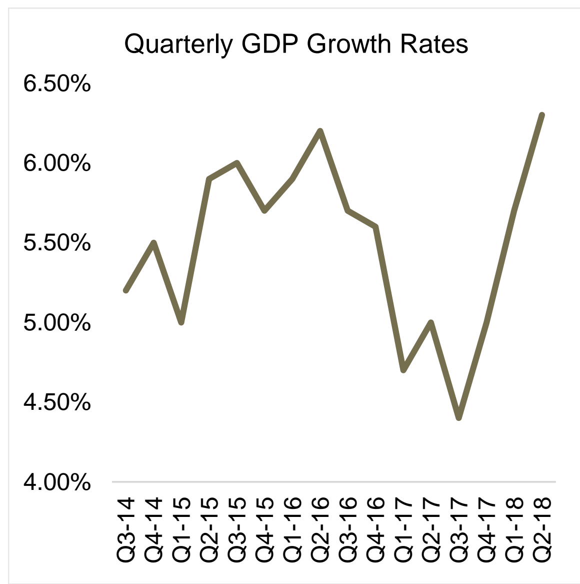
Source: KNBS



Source: KNBS, CBK



Source: KNBS, CBK



Source: KNBS, CBK

Tanzania

- Policy uncertainty has been the main headwind for Tanzania over the last two years. This has considerably dampened investor and business sentiment, undermining optimal output growth for the country. To this, the decision by the government to buy cashew nuts from farmers due to what was perceived as poor pricing, though well intended, has made investors jittery. The impact is far reaching. In addition to a delay in payments that could aggravate the cash crunch in the market hurting domestic demand and investments, the move could further aggravate policy uncertainty the country.

- The extension of these uncertainties to some social issues has soured relationship with some development partners. The World Bank suspended $300Mn loan to the education sector due to 'mistreatment' of pregnant girls in schools. Denmark and the broader EU are also re-evaluating their foreign policy, which could redefine their relationship with Tanzania, over what they termed as a deteriorating human rights situation.

- Donor withdrawal amid revenue underperformance could exert more pressure on government finances. Revenues for the first quarter of the year improved to TZS 4.53Trn, albeit lower than the projected TZS 4.83Trn. Expenditure during the period was TZ 4.31Trn against TZS 5.63 Trn, implying a slight budget surplus in the period. This is due to low budget absorption.

- Meanwhile, government borrowing has remained low, complementing the 'accommodative' signals by the central bank. Inflation remains tame, averaging 3.4% in the last 11 months, and should remain below the 5.0% target, albeit with an upward bias due to normalizing food prices and a weaker shilling.

- However, with the persistent pressure on the currency, maintaining this stance may be challenging given that the weakness is in part due to the historically low interest rates. The shilling has steadily depreciated against the US dollar as dollar flows thinned amid surging demand. Current account deficit has widened considerably to 4.14% of GDP as capital imports for ongoing infrastructure advancements increase amid declining earnings from minerals.

- Currency weakness was aggravated by the central bank's suspension of five banks from trading for breaching the trading code of conduct. This further thinned out dollar liquidity in the market leaving the shilling more vulnerable.

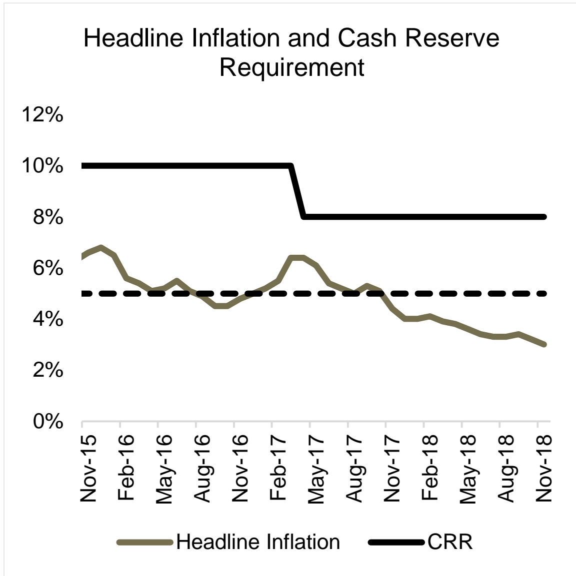
- Meanwhile, monetary policy impact on output remains weak. Credit growth has stunted below 5.0% this year mostly due to increased risk aversion following the poor liquidity and deterioration in asset quality. At the same time, liquidity distribution following the collapse of Bank M has remained skewed thus distorting price discovery in the market. The regulator has maintained daily liquidity injections at rates above 6.0% since September.

- All said, Tanzania is still poised to end the year on a strong footing buoyed by increased government spending, strong agricultural output and investments in the transport sector. GDP is projected to decelerate somewhat to 6.7% in 2018 from 7.1%, still a decent shot above the sub-Saharan Africa average growth of 3.1%.

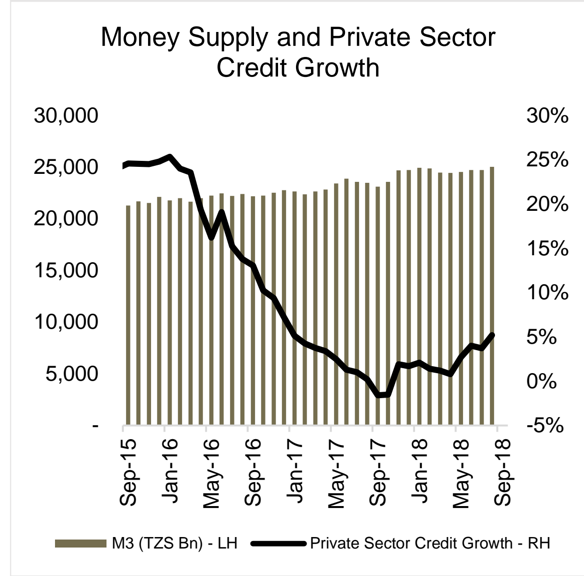
Forecasts

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)*	3.40%	4.50%
USDTZS	2256	2272	2279	2305
CRR	5.25%	5.25%	5.25%	5.25%

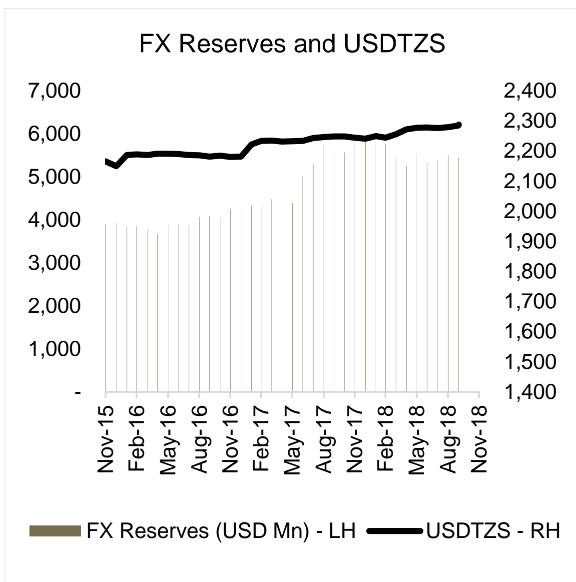
Source: CBA Research, Bloomberg



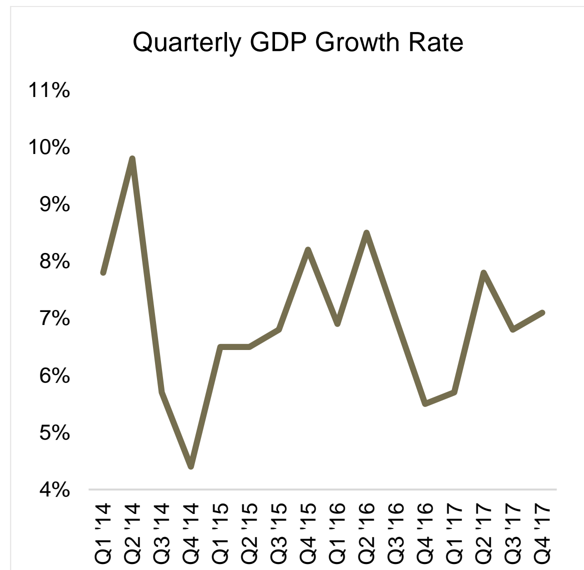
Source: National Bureau of Statistics, BoT



Source: Bank of Tanzania (BoT)



Source: BoT



Source: National Bureau of statistics

Uganda

- Strong readings by leading economic indicators including the composite index of economic activity underline a robust economic growth momentum in Uganda. After growing at 6.1% in the first half of the year, the economy is projected to maintain a solid pace although a higher base may see the pace moderate somewhat on an annualized basis. According to the World Bank, growth is expected to average 6.0% in 2018 bolstered by a pick-up in investments, rising consumer spending and robust agriculture output.

- Looking ahead, headwinds including narrowing fiscal space could soften the momentum. Fiscal deficit, which rose to 4.8% in the year to June 2018 from 3.8% a year earlier, has seen a surge in public debt, increasing the country's vulnerability to shocks. The bulk of public debt in Uganda, currently at 41% of GDP, is offshore borrowing. Stress tests for Uganda suggest that the 50% debt/GDP level may expose the economy to undue strain. Therefore, unless revenues increase considerably, the government may be compelled to reduce its spending to ensure that public debt remains on a sustainable path.

- On a brighter note, private sector activity has picked up markedly bolstered by increased lending as well as arrears settlement by the government. This has been underpinned by accommodative credit conditions. Despite the 100bps rate hike in October, liquidity has remained high, exerting downward pressure on yields as well as lending rates. Government borrowing has also been quite disciplined, crowding in the private sector. Credit growth has averaged 10.8% over the last five months. The effects on output should be largely felt in the last quarter of 2018 into 2019

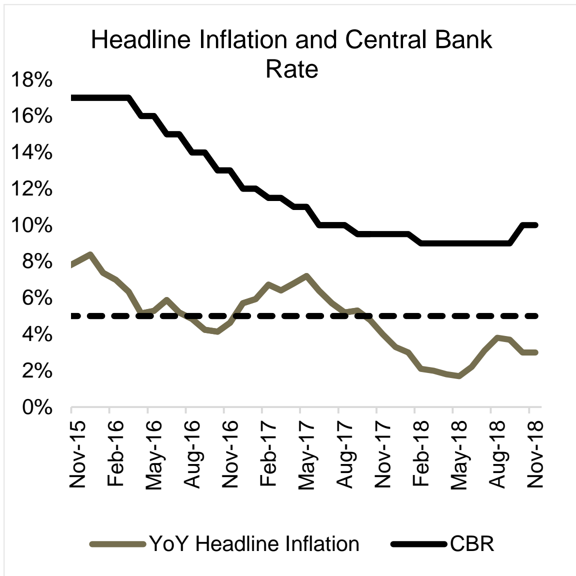
- In November, interest rates eased across the curve on heavy liquidity and subdued inflation expectations. In the period, headline inflation steadied at 3.0% while core inflation edged marginally lower to 3.4% from 3.5% in October. Yields on the 91 and 364-day papers eased by 33.92 and 60.02bps to 11.12% and 13.13% respectively.

- Meanwhile, the currency was bullish, gaining 1.0% to 3725 against the US dollar. The upside was supported by increased flows from NGOs amid subdued demand for dollars in the market. In the near term, the shilling may be supported by lower oil prices as well as some dollar flows during the holiday season.

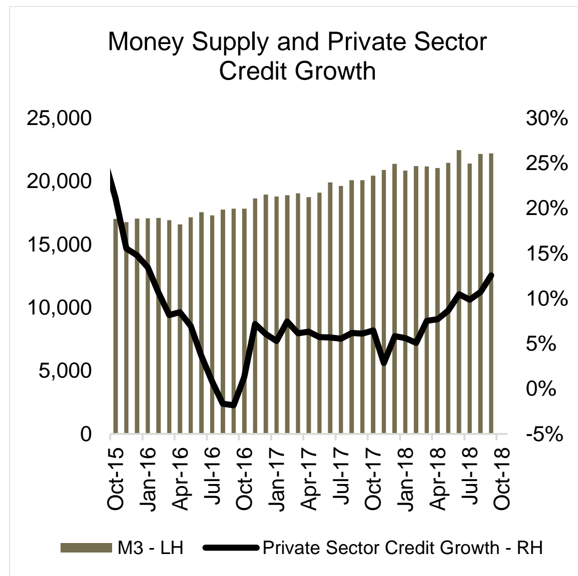
Forecasts

Quarter ending	March 2018*(A)*	June 2018	Sept 2018	Dec 2018
GDP	6.37%	5.0%	6.00%	5.50%
Inflation	2.00%	2.00%	4.50%	6.00%
USDUGX	3660	3840	3844	3830
CBR	9.00%	9.00%	9.00%	9.00%

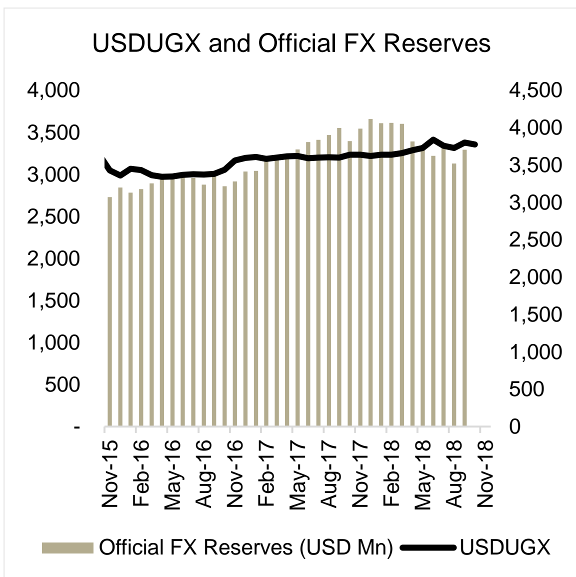
Source: CBA Research, Bloomberg



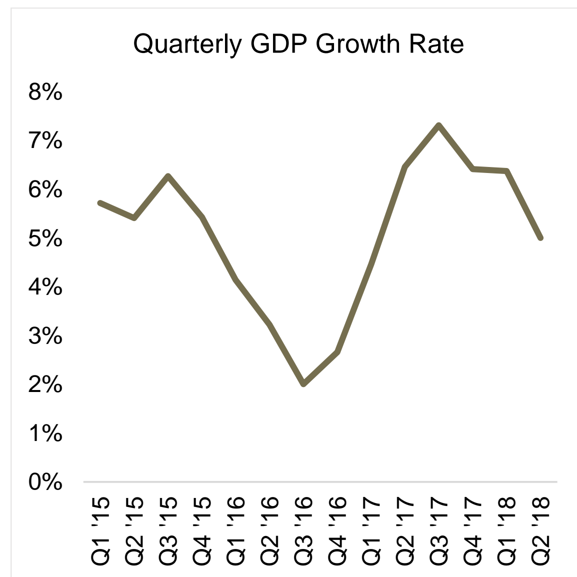
Source: Uganda Bureau of Statistics, Bank of Uganda



Source: Bank of Uganda, Bloomberg, CBA Research



Source: Bank of Uganda, Bloomberg, CBA Research



Source: Uganda Bureau of Statistics (UBOS)

Rwanda

- The economic outlook for Rwanda remains broadly sanguine. A combination of increased public spending, private sector investments and a resilient service sector will sustain solid growth in to 2019 especially in trade, transport and tourism. Investor sentiment remains generally positive although concerns over the persistent dearth of dollars in the market remain a big impediment for foreign investors. GDP is estimated to have expanded by 8.6% and is on course for a 7.2% expansion in line with government estimates.

- The 'Made in Rwanda' campaign has also significantly improved the external position, adding some thrust to the GDP numbers. No doubt, the ongoing focus on soft infrastructure including necessary and friendly policies and institutional reforms will see increased foreign direct inflows into the country, estimated at $713.4Mn in 2017.

- The impetus from agriculture remains healthy. Increased value additions bolstered by incentives under the 'Made in Rwanda' initiatives have elevated the manufacturing sector. Increased demand for cement and steel is encouraging investments in this space. While the sectors may immensely benefit from the ongoing infrastructure improvements, notable mega projects include the Bugasera airport, the inland port as well as the power plant, the sectors' low capacity puts them at a disadvantage.

- Meanwhile, private sector lending has moderated somewhat, averaging 7.2% in the first nine months of the year. The central bank projects a pick up to double digits in 2019 on the back of increased demand and lowers NPL ratio currently at 6.0%. With an effective public private partnership framework, banks are likely to increase their participation in government projects especially in the energy sector.

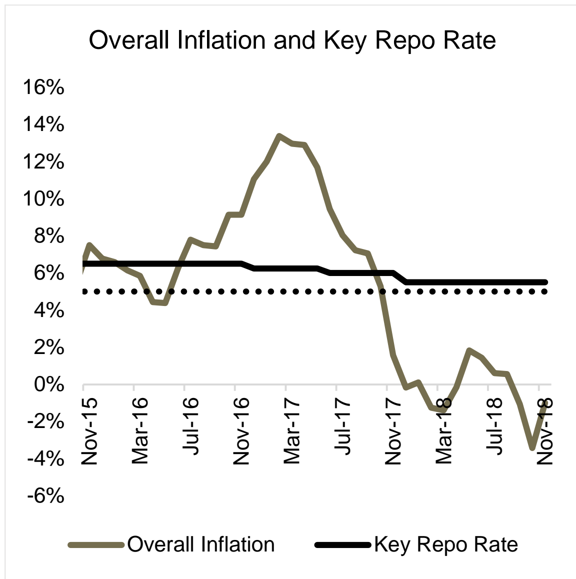
- Interest rates have remained stable although the bias is progressively shifting to the upside. The fiscal deficit is projected to widen to 5.1% from 4.6% last year. This is the result of an increase in expenditure to RwF2.52 Tn from 2.18Tn. Revenues have been well in line with the target and are projected to rise to 2.06Tn from 1.82 Tn in 2017/18. Meanwhile, the deficit will be funded primarily thorough foreign borrowing to avoid crowding out the private sector. The government plans to borrow RwF49.2Bn from the domestic market.

- Meanwhile, the currency could continue to weaken into 2019. Dollar demand continues to build amid a persistent dearth of the hard currency in the market. Due to the increasing demand for the hard currency, the central bank may find it difficult to sustain its intervention given the low levels of foreign exchange reserves currently at 4.2 months import cover. The precautionary facility with IMF expired on December 01st and any delays in renewing it could spell more losses for the currency.

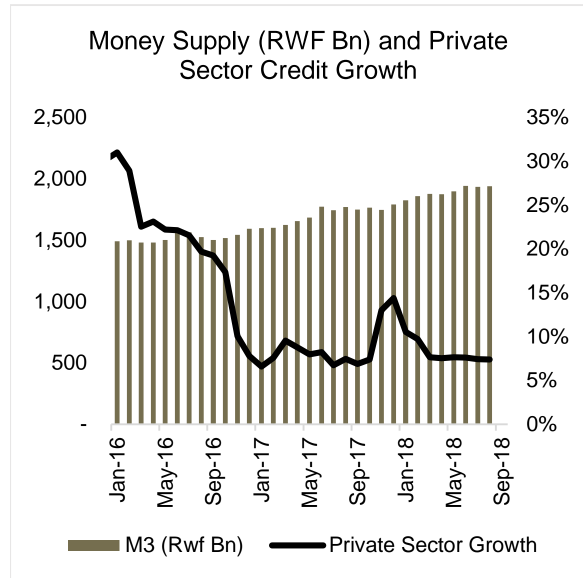
Forecasts

Quarter ending	March 2018*(A)*	June 2018	Sept 2018	Dec 2018
GDP	10.60%	6.70%	6.80%	7.00%
Overall Inflation	-1.40%	3.00%*(F)*	1.20%	3.50%
USDRWF	852.68	859.76	884.38	895.00
Repo Rate	5.50%	5.00%	5.00%	5.00%

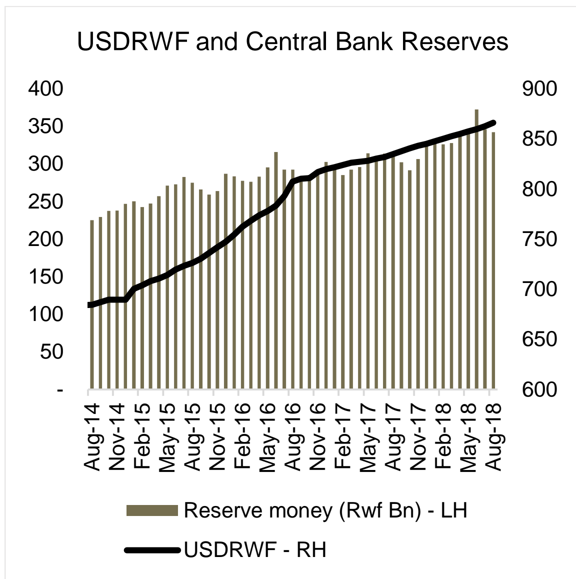
Source: CBA Research, Bloomberg



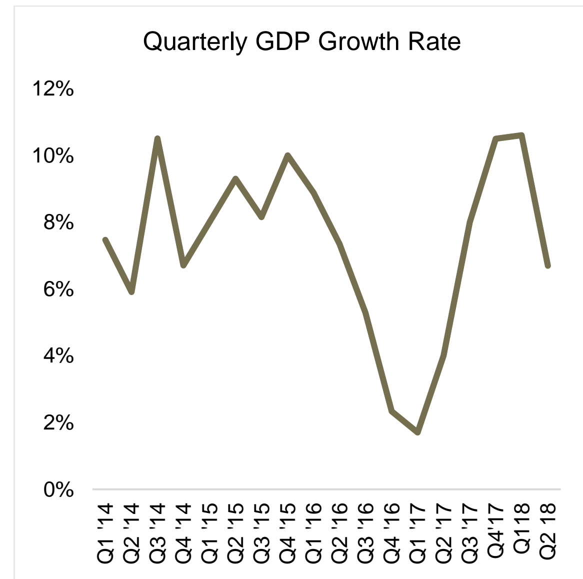
Source: Rwanda Bureau of Statistics



Source: National Bank of Rwanda



Source: National Bank of Rwanda



Source: National Bank of Rwanda

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