ECONOMIC UPDATE
JUNE 2021

NCBA

Global: Jabs for growth? Recovery in sight but growth will be marred by marked divergence

Since our last publication of the Regional Economic Outlook in November 2020, growth prospects have improved, inviting significant upgrade to growth projections.

The optimism is predicated on the commendable albeit varying progress in containing the pandemic, unprecedented policy support and increased adaptability to a low mobility environment necessitated by containment measures.

Indeed, a year and a half after its outbreak, Covid-19 continues to have a devastating socio-economic impact across countries.

In many respects, the crisis is still unique.

The remarkable uncertainty in its evolution, the prospect of prolonged economic damage and the scale of policy support needed to stabilize output will continue to present challenges to policy makers.

Meanwhile, whereas immediate consumption and investments remain soft on limited spending opportunities, increased savings could boost future consumption as demand pent-up during lockdowns is released with the reopening of economies.

Cross country recovery paths to vary with access to vaccines, policy support.

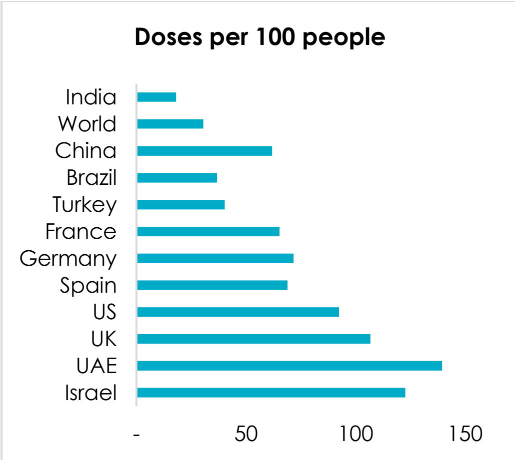
Undoubtedly, the ingenuity in science with the record development and large scale rollout of multiple vaccines is providing a silver lining to the global economy.

While, there remains considerable doubts over the longevity of the pandemic, vaccinations and increased adaptation to living with the pandemic has raised recovery prospects.

To this end, we agree with the OECD that speeding up vaccine development and rollout should be the best economic policy to boost growth and job creation.

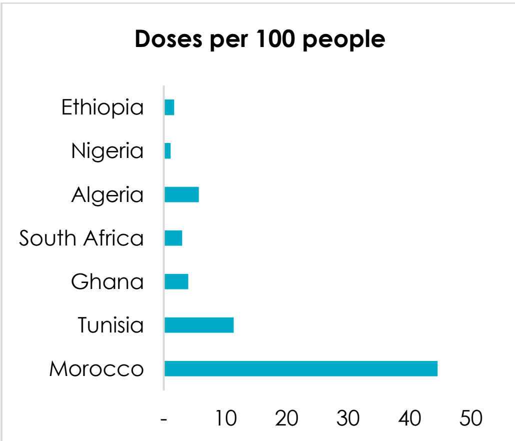
So far, about 2.4 billion vaccines have been administered across the world. However, there are vast differences in the progress across countries.

Vaccine access



Source: The BBC

Whereas some countries have secured and administered the vaccines to more than 70% of their population, many more are yet to receive their first vaccine shipment.

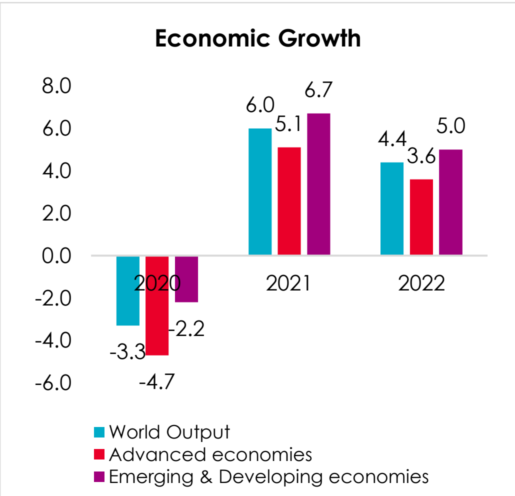


Source: The BBC

So far, no country has reached the herd immunity vaccination threshold estimated at about 80% of the population. Even so, successful vaccine rollout has led to easing of mobility restrictions in some countries.

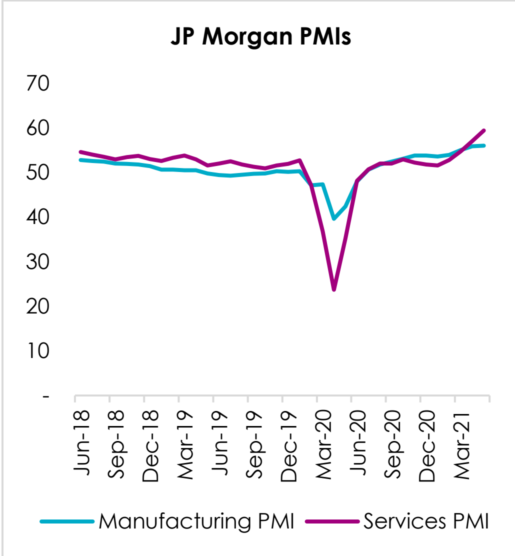
This has seen a substantial increase in economic activities, especially within the mobility dependent services industry, triggering significant upward revisions to the global GDP outlook.

The IMF in its latest Global Economic Update upgraded its global growth projection to 6.0% from its earlier forecast of 5.4% in October of 2020. OECD also updated its growth forecasts to 5.8% from its earlier estimate of 5.4%.



Source: The IMF

Leading indicators corroborates this optimism with a V-shaped recovery in both industrial activity and services, although with a lag in the latter. While services remain below the pre-crisis levels, many countries are gradually emerging from the 2020 recession.



Source: JP Morgan/Markit

However, this favorable outlook masks significant divergence in the pace of recovery across and within economies.

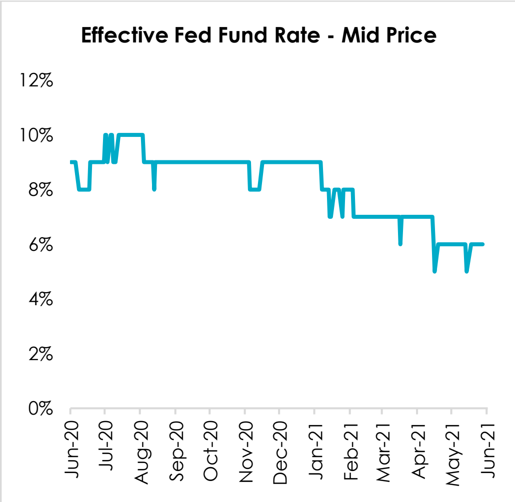
The disproportionate recovery is explained by the stark variations in the pace of inoculation, the scale of policy support and the degree of economic dependence on hard hit sectors like tourism.

The US and the UK are emerging ahead of the curve in advanced economies, outpacing continental Europe and Japan whereas China, Israel, Australia have also set themselves apart among emerging economies in the management of the crisis and therefore, potential economic recovery.

Policy support – Monetary conditions to remain easy but fiscal stimuli could be scaled back

The conduct of monetary policy across the world in response to the pandemic has continued to converge, albeit with varying levels of efficacy.

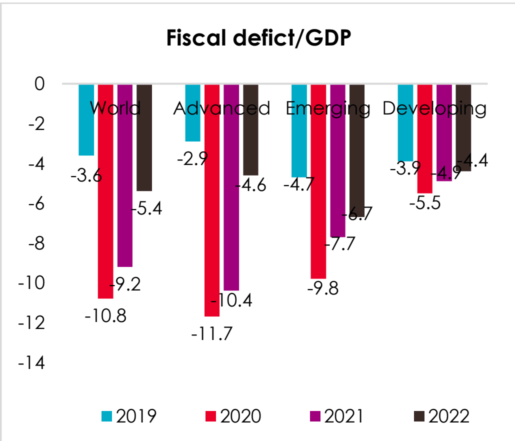
In spite of the sanguine growth prospects, central banks across most countries led by the Fed remain committed to pursuing zero-bound, lower for longer interest rate policies. This will be complimented by the unprecedented liquidity support through bond purchases.



Source: Federal Reserve Bank

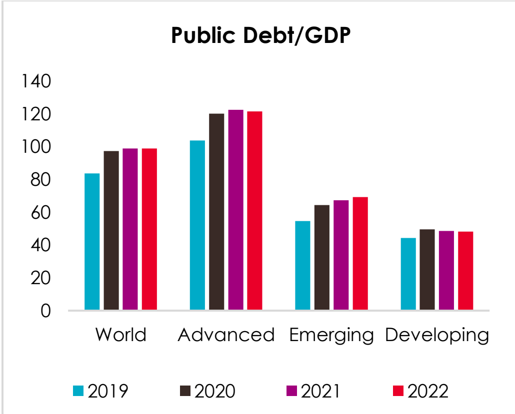
This is likely to be upheld until there is indisputable data suggesting that economies are on a durable or self-sustaining recovery path.

Meanwhile, the extent of fiscal response to the pandemic has been unprecedented.



Source: The IMF

Indeed, the record deficits have been crucial in preventing severe economic contraction and job losses. However, the resultant borrowing to finance the deficit has left immense vulnerabilities in its wake.



Source: The IMF Fiscal Monitor, 2021

Undoubtedly, the need for flexible and supportive fiscal policies remains given the persistent uncertainty around the pandemic.

Even so, keeping debt on a sustainable path over the long term remains a major policy imperative. Accordingly, as evidence of recovery begins to emerge, governments may start to scale back earlier support, including tax respite to avert tipping over fiscal cliffs in some cases.

That said, the divergence in recovery may trigger a deviation in policies, with potential for marked volatility in markets. Faster recovery in advanced economies could see an earlier start to policy normalization. The resultant liquidity reduction, rise in interest rates and buoyancy in currencies could further drag the recovery in emerging and developing markets.

That said, central banks could continue to carry the heavy burden of economic support as government seek to restore buffers against future shocks, with minimal scars.

Emerging and developing markets will continue to benefit from the extension of debt service suspensions under the Debt Service Suspension Initiatives (DSSI).

We believe, that there may be greater flexibility around the debt reorganization plans given the persistence of the pandemic and protracted economic damages.

The uncertainties…..

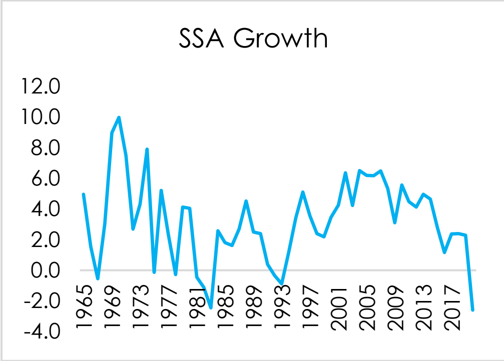
All said, immense uncertainty remains. New more contagious strains of the Covid-19 virus will limit scope for reopening until a vast majority of the population is vaccinated. Moreover, until vaccines are widely available and spare capacity in health care generated, strict containment measures will still hold back output growth in some countries.

Averting divergence and full reopening will require a global resolution to the crisis as "No one is indeed safe until everyone is safe".

Moreover, scope for policy intervention has significantly narrowed and an aggravated crisis could have the potential to trigger a financial crisis.

Sub-Saharan Africa – Slow recovery on virus longevity, deeper structural challenges

The region weathered the global public health crisis much better than initially expected. The human toll in terms of both infections and fatalities has remained below the global average. Even so, the social economic disruption from the public health crisis is severe. The World Bank estimates that SSA growth contracted by 2.6% in 2020, the weakest growth on record.

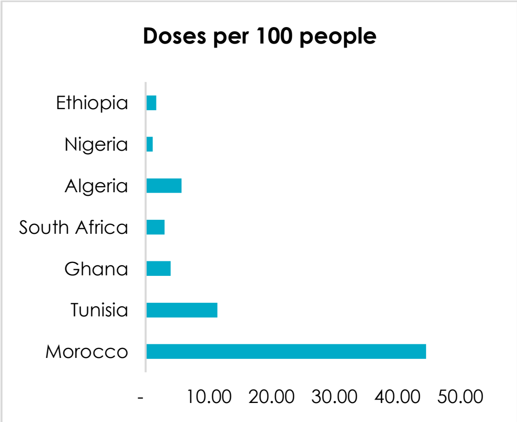


Source: The World Bank

Like the rest of the world, there is no crystal ball on the potential path of long term economic recovery for the region given the persistent uncertainty from the pandemic, which has exacerbated earlier vulnerabilities.

The region is battling fresh and deadlier waves of Covid infection with new and more contagious strains. While vaccines have raised optimism of an end to the public health crisis, this may be a distant prospect for the region given the dire vaccine shortages. For now, it is estimated that the region might only achieve herd immunity from vaccination in 2023, at the earliest.

As such, prospects of episodes of infection flares will warrant stringency in containment measures, with episodes of lockdowns, dampening economic activity.



Source: BBC, World Health Organization

Indeed, the COVAX facility has enhanced the region's access to vaccines although delivery remains subject to production and policies in source countries. That said, approval of more vaccines currently under trial may enhance access and overall inoculation rates.

Weak fiscal space to limit policy support

The region entered the crisis with stretched fiscal and monetary policy space, with 17 countries either in distress or at a high risk of debt distress, according to the IMF.

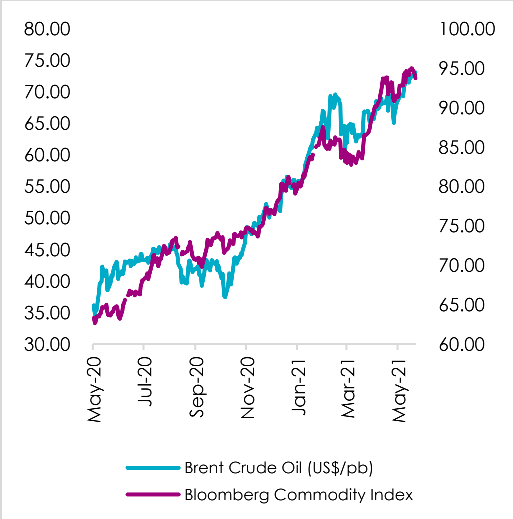
Policy response in the region has so far been limited by weak fiscal space. Whereas the G20 led Debt Service Suspension Initiative (DSSI) is providing a combined total of $6.6Bn in aid and savings in January through June 2021, anchoring public spending, a full recovery could be more dependent on the reopening and restoration of private sector activity.

Evidently, policy makers may continue to confront the tough tradeoff between lives and livelihoods. Occasional escalation in containment measures will make for an erratic path to recovery.

Even as economies begin to bounce back, most will still require support given that the pandemic and attendant shocks are likely to be longer lasting in the region.

Some hope for commodity dependent economies from firming global demand

Crystalizing global demand driven by the gradual reopening of advanced economies will boost exports, underpinning recovery especially in the commodity dependent economies.

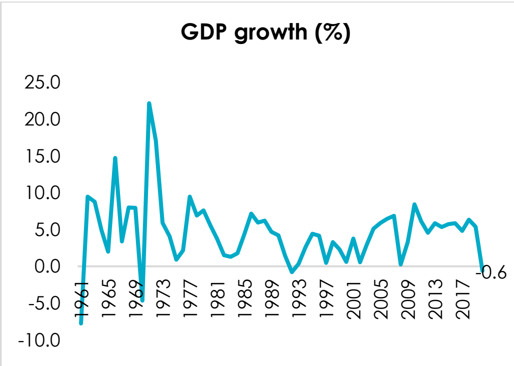


Source: Bloomberg

Commodity prices have seen a remarkable recovery so far this year and evidence of stronger global rebound could provide further upside. This may help repair the teetered fiscal positions, albeit marginally.

Kenya: Outlook brightens but risks tilted to the downside – The Blind vaccine hope?

Kenya seems to be weathering the pandemic much better than initially expected. We estimate that GDP contracted by 0.6% in 2020, the weakest performance in nearly three decades, but notably better than our earlier projection of a 1.8% contraction. The slack in output growth was broad-based except in agriculture, health and the ICT sectors.



Source: The World Bank, NCBA Research

The upside stemmed from the earlier than expected gradual softening of containment measures, increased adaptability by firms and households, confidence boost from vaccines as well as stronger fiscal intervention.

Moreover, the country's diversified economic base helped to engineer a softer landing for the economy.

Outlook – Brightening prospects but risks tilted to the downside

Economic prospects have improved significantly since our last publication in November of 2020. Activity in many sectors has picked up from the 2020 lows as businesses and individuals increasingly adapt to restrictions measures.

Moreover, public spending has become a key lever for growth. Continuation of the Economic Stimulus plan should have some positive spillovers to the public sector.

Moreover, vaccine development and rollout is accentuating the silver lining on hopes of some return to normalcy. However, caution may remain until vaccines are widely available.

Indeed, the recovery path remains somewhat blurred and much will depend on the ability of vaccines to contain risks from emerging strains of Covid-19. While sentiment may be upheld, a sustained reopening and recovery will be subject to achievement of herd immunity, which is not expected until 2023, at the earliest.

That said, growth prospects varies widely across sectors depending on the degree of exposure to the pandemic, scope for adaptability and policy support. Vaccination will undoubtedly remain the main economic policy for a sustained recovery, complemented by interventions from the government and the central bank. Varying base effects will also make for significant heterogeneities in the pace of recovery across sectors.

Epidemiological outlook – More waves and lockdowns as herd immunity is delayed

The confirmed number of positive Covid cases in Kenya has remained lower than initially anticipated. This has been credited to a stronger gene pool and to some degree, a fair efficacy of containment measures.

So far, about 0.18Mn cases have been confirmed out of the 1.87Mn tested samples. Fatalities have risen somewhat to 3,421, although the 1.9% fatality rate remains significantly below the global average of 3.4%.

The case load is expected to continue rising especially with the new, more transmissible variants of Covid-19 amid persistent and deep vaccine deficits that could be aggravated by nationalization of vaccines in source countries.

Kenya Vaccine & Vaccination Update

No. of doses	*1.12Mn*
Distributed doses	*0.99Mn*
Administered doses	*0.70Mn*
Population vaccinated	*0.99Mn (1st doze)* *0.13Mn (2nd doze)*
Total population	*51.00Mn*
Target coverage	*20% (2-dozes)*
Population Fully vaccinated	*<1.0%*
Wastage rate	*10%*

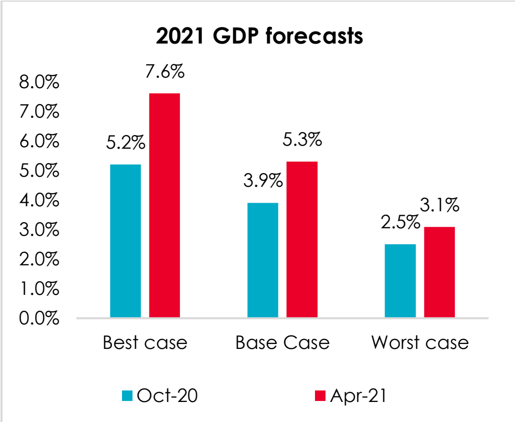
Source: Ministry of Health

For Kenya, access to vaccines remains primarily through the COVAX facility although the sovereign continues to explore other sources to boost the pace of inoculation. Cumulatively, the government expects to vaccinate about 16Mn persons in the period to July 2022, at least with the first dose. At best, this should reduce the strain on health facilities, as the number of persons requiring hospitalization slows.

That said, with many countries still awaiting their first batch of the Covid vaccines, the government could still miss the 16Mn vaccination target, which by all counts is not sufficiently ambitious! This should dampen prospects of a full reopening, with a fair risk of cyclical lockdowns to stem infections.

Some upside could stem from the approval of more vaccines. This could be complemented by active private sector participation in the procurement and distribution of the vaccines although costs remain somewhat prohibitive at the moment and may require significant subsidies.

Growth expectations are positive but could swing widely



Source: NCBA Research

Base Case Scenario

Our baseline estimates now project GDP growth to recover to 5.3% in 2021 after contracting by 0.6% in 2020. This is a significant upgrade from our earlier forecast of 3.9%. The upside stems from increased adaptability to the pandemic, earlier than expected launch of vaccination campaigns as well as stronger policy support through the Economic Recovery Strategy. The latter will run over the next three years and could be a significant catalyst to economic activity.

This scenario assumes that whereas Covid cases will continue to rise, the ongoing vaccination campaigns will enhance confidence among economic players. It assumes that more vaccines are approved and production and distribution improved. In this case, the government vaccinates about 7.5% of the population (3.8Mn people) by year end.

At the same time, increased adaptability by businesses and households is assumed to sustain productivity in a limited mobility environment. Moreover, vaccination complemented by sustained investment in health systems also is assumed to allow for a gradual easing of containment measures, although risks of occasional, clustered lockdowns is also anticipated.

In the year, sustained albeit soft policy support allows for decent growth in consumption.

Best case Scenario

Under this scenario, we project that GDP growth will rebound more aggressively to 7.6% in 2021.

The scenario assumes that the coronavirus pandemic weakens markedly in the second half of 2021 as the government manages to vaccinate about 15% of the population.

Even without herd immunity, containment measures are rapidly relaxed, both locally and internationally as capacity in health systems improves, allowing a fair return to normalcy.

In this case, vaccine science is able to catch up with the mutating virus, limiting their severity. Moreover, businesses and individuals continue to make adjustments to a higher probability of Covid-19 being an endemic disease.

Worst case

Under this scenario, we assume that the pace of infections remains high as the virus continues to mutate to more transmissible, in some cases vaccine-resistant strains.

At the same time, vaccine production and distribution fails to improve and vaccine apathy increases.

Less than 5.0% of the population is vaccinated, at best, necessitating persistence of strict mobility restrictions within and between counties.

Policy support is depleted, limiting any material intervention from the government, monetary policy multiplier remains weak.

Investors and consumers exercise increased caution hurting output growth.

Increased adaptability to the low mobility landscape allows for sustained activity.

In this scenario we expect GDP to expand by 3.1% in 2021.

Fiscal dilemma – the stimulus versus debt sustainability tradeoff

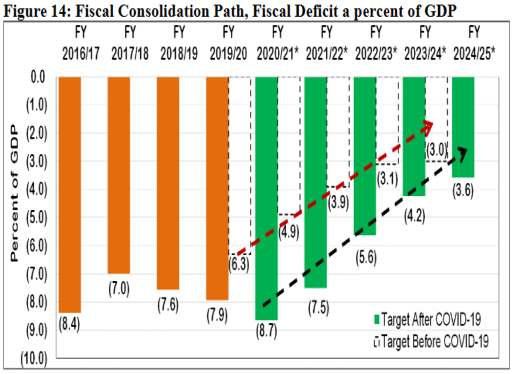
Policy makers continues to confront the difficult task of establishing the optimal policy mix that responds to the combination of shocks from the pandemic while addressing some of the earlier economic imbalances.

Kenya is one of the countries in SSA that entered the crisis with considerably depleted fiscal space.

The fiscal deficit has remained fairly high and sticky over the last five years. Public debt had risen to about 65% of GDP and debt service was already taking up nearly 45% of government revenues even before the onset of the pandemic.

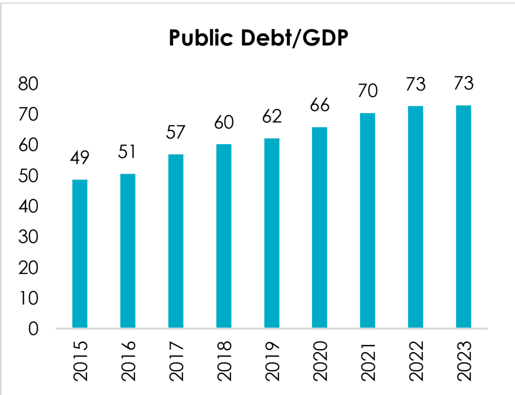
This was exacerbated by the twin shocks – lower revenues and increased spending necessitated by the pandemic.

Figure 14: Fiscal Consolidation Path, Fiscal Deficit a percent of GDP



Source of Data: National Treasury

As a result, the government has continued to steer off the earlier consolidation path that had envisioned stabilization of the deficit and public debt at 3.0% and 50% of GDP respectively, in the medium term.



Source: The IMF

Since our November 2020 publication, several developments have somewhat brought forth relief to the fiscal angst but still not sufficient enough to correct earlier imbalances.

While overall debt has risen to an estimated 70% of GDP, its character and quality continues to improve. Restructuring of both the external and domestic debt portfolios is easing medium term liquidity risks for the sovereign.

Further, revelations by the Kenya National Bureau of Statistics that the country will rebase its GDP numbers this year should improve these metrics somewhat.

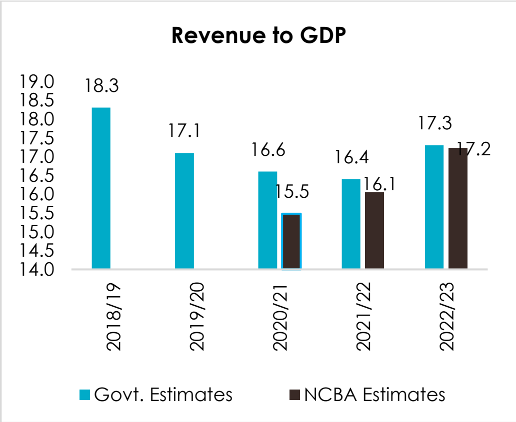
On the external front, debt service relief under the G-20 driven DSSI arrangement is providing over $600Mn in relief and/or saving. We expect that the government should be able to secure extensions on these facilities, providing extended respite.

Moreover, increased access to concessional financing could marginally reduce the overall cost of financing for the government. Grace period on this facilities should provide the government some headroom to further restructure its debt with continued reduction of commercial financing.

Even so, this is not to suggest that the government will stay off commercial borrowing. Subsequent borrowing should however be more sensitive to the cost and duration of the respective debt.

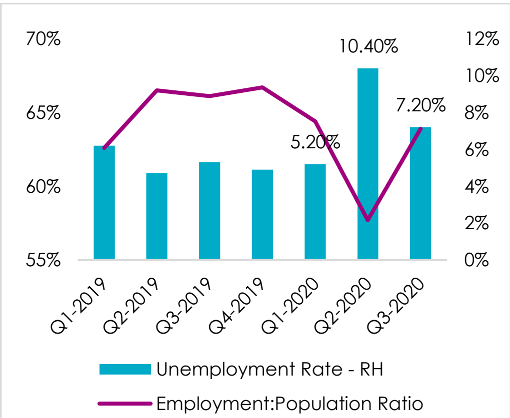
On the domestic front, the government has also managed to stretch the average tenor of debt, reducing prospects of short to medium term liquidity strains. Thanks to easier monetary conditions, the adjustments have been at reduced costs.

Fundamentally, nominal revenue performance could improve with the anticipated economic recovery. However, the growth multiplier on revenues could be weaker, given the deep shocks to household and business balance sheets.



Source: National Treasury, NCBA Research

Moreover, the political costs of raising taxes within the current environment, defined by weak purchasing power for consumers and businesses may dampen prospects for revenue growth. Unemployment rates remains significantly low and under employment is on the rise.



Still, there remains significant room to boost revenue through proper administration and widening of the tax base.

Meanwhile, government spending will remain sticky given the need to enhance the health sector capacity to deal with the fast evolving pandemic and facilitate vaccination as well as the obligation to cushion the economy against further output losses. This should continue to support borrowing although any evidence of recovery may see the fiscal authority scale up revenue mobilization and deficit reduction efforts.

Monetary policy may be required to step up in catalyzing recovery, its efficacy notwithstanding

Fiscal policy limitations could leave the monetary authority with the heavy burden of stimulating domestic demand.

So far, the authority's commitment towards plugging the output gap has been unwavering. Interest rates remain fairly low and liquidity within the financial sector ample. Moreover, prudential support, although time bound remains in place.

	Inflation	Output gap	CBR
Mar-2021	5.9%	-536.60bps	7.00%
Jun-2021	5.5%	223.14bps	7.00%
Sept-2021	5.3%	33.90bps	7.00%
Dec-2021	4.7%	-14.50bps	6.75%

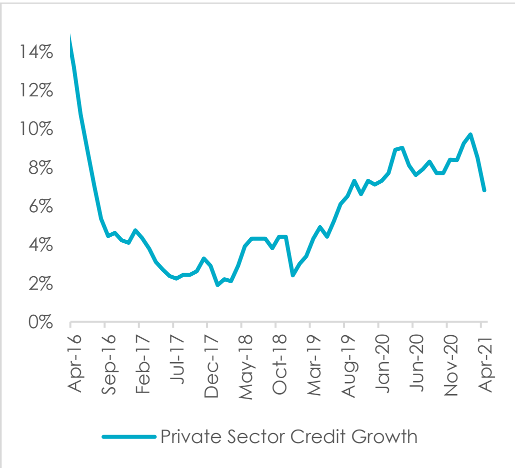
Source: KNBS, NCBA Research

Indeed, the output gap is expected to narrow in 2021. Even then, the risks from the pandemic, with prospects of several false starts to the economy will warrant sustained accommodation. So far, demand pressures remain weak evidenced by the 2.5% core inflation. Accordingly a strong, sustainable recovery may still be a distant prospect.

On a brighter note, inflationary pressures remains well within the statutory target band. Weak domestic demand, muted food price pressures and stable fuel inflation should keep overall price pressures within the 2.5-5.0% range. Inflation is expected to average 5.6% in 2021.

To this end, we expect the central bank to hold the policy rate at the current rate of 7.0%, with an easing bias in the latter half of 2021. Positive output gap, the quality notwithstanding, coupled with limited risks to inflation outlook may support this stance. However, fresh shocks from the pandemic could necessitate further easing.

That said, transmission mechanisms for monetary policy, notably the credit channel remains weak. Despite significant easing of monetary conditions, private sector credit growth has remained in the single digits adding to the economic frailty. So far this year, credit growth has averaged just about 8.0% and is expected to only rise marginally to about 11% in 2021.



Source: The Central Bank of Kenya

The slow lending partly reflects the sharp deterioration in credit risks over the last year. Banks have restructured over 50% of their loan portfolios to avert a sharp deterioration in balance sheets due to high NPLs, so far at about 15% of the book.

Normalization of this loans will be subject to recovery in business activities that may drag beyond 2021. As such, the need for further support to avoid systemic pressure on bank balance sheets cannot be gainsaid.

Moreover, the aforementioned fiscal deficit and the attendant borrowing has to a fair extent dis-incentivized lending to the productive sectors. Amid high credit risk and legacy loan pricing challenges, the double digit returns on government securities has provided a fair risk-return balance for most investors in recent years.

Modest upward pressure on interest rates likely

Despite the prospects of further easing of monetary conditions, the borrowing pressure from the government may continue to offset the respite on the yield curve.

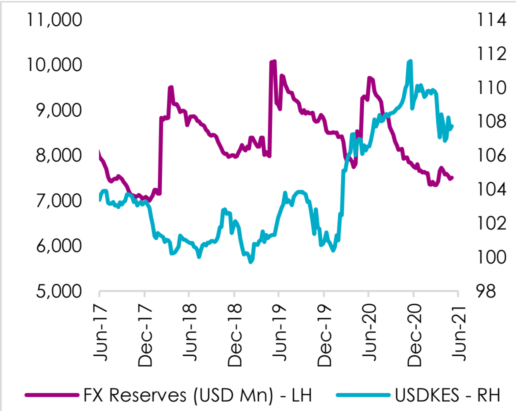
The government is projected to borrow about KES 658Bn from the local market in 2021 as pressure to fund the budget grows. The only upside to yields could stem from a considerable shift in the debt mix away from the local market.

However, given the deterioration in the sovereign risk profile, rising benchmark interest rates in external markets and increased competition for support from development partners, a marked shift in the borrowing mix may be unlikely.

That said, sustained risk aversion, sound liquidity as well as efforts to align the performance of the curve to the policy guidance may only allow for a gradual upward move in yields.

Exchange rate to remain under pressure but depreciation will be softer than initially projected

After depreciating sharply in the second half of 2020, the shilling has been firming against the US dollar in 2021, contrary to initial expectations. To be sure, so far this year, the shilling is up 0.9% against the US dollar.



Source: The Central Bank of Kenya

The directional change for the shilling could be explained by several factors;

- Economic outlook has improved, marginally alleviating fiscal sustainability fears.
- Debt restructuring – The support from the G20 through the DSSI has generated over $600Mn in short term savings for the government. This has reduced public sector demand for dollars.
- IMF support – The USD 2.4Bn three-year facility should boost domestic reserves, economic recover
- Fresh and potentially frequent episodes of clustered lockdowns may keep domestic demand muted, reducing BoP pressures
- Remittances have been steady and could improve further as global labor market conditions improve. Mainstreaming these flows by government could increase their quantum
- Local currency yields have risen somewhat attracting some capital flows – global yield search
- Prospects of the Eurobond sale should further boost FX reserves

Risks to the currency outlook

- Fiscal concerns – High risk of debt distress to continue inviting some caution
- FX reserves – expected to steady at 4.6 months of import cover, further depletion may cause some angst
- Fresh global risk aversion – Flare up in infection could reignite emerging and frontier markets currency sell off

Accordingly, while we expect the shilling to remain under pressure from weak sentiment, primarily on the fiscal side, we believe that any losses will be fairly moderate.

Forecasts

	USDKES (Prev)	Rev
Q1-2021	111.42	109.51
Q2-2021	113.00	108.30
Q3-2021	114.60	110.30
Q4-2021	116.22	110.70

Source: CBK, NCBA Research

Appendix – Projection assumptions

Pandemic	Baseline	Best case	Worst Case
Caseload	✓ Continues to moderately rise, with minimal episodes of flares	✓ The curve is mostly bended with positivity rate below 5.0%	✓ Cases continue to spike with frequent episodes of double digit positivity rate
Vaccination	✓ Production & distribution of vaccines remains the same ✓ Private sector is allowed to acquire & administer approved vaccines but costs remain prohibitive ✓ Vaccine apathy ✓ 15% of the population is fully vaccinated.....No herd immunity	✓ Improved vaccine production and distribution ✓ Vaccine apathy ✓ Active participation by private sector as vaccine costs decline ✓ 30% of the population is vaccinated.......No herd immunity	✓ Nationalism in vaccine distribution ✓ Vaccine resistant variants ✓ Procurement and distribution limited to government ✓ 10% of the population is vaccinated ✓ Covid-19 an endemic disease
Containment measures	✓ Persistence of curfews, Restraunts, hotels, bars remain closed ✓ Minimal mobility restrictions are maintained with occasional, clustered lockdowns.	✓ Containment measures are relaxed more rapidly ✓ Shorter curfews hours, ✓ Restraunts, clubs gradually re-open to vaccinated persons ✓ Low risk of lockdowns.	✓ Longer curfews, extended lockdowns (geographically). ✓ School calendar deviates markedly from the current outline
Policy Support	✓ Expansionary monetary policy ✓ Targeted prudential support ✓ Expansionary fiscal policy but limited direct support	✓ Further easing of monetary conditions ✓ Sustained prudential accommodation ✓ Return of some direct support by government albeit targeted	✓ Monetary policy stance remains easy ✓ Lack of fiscal space inhibits public spending ✓ Risks to depositors warrants a halt of prudential support
Adaptability	✓ Limited disruptions from mobility restrictions on increased business adaptability	✓ A return to some normalcy with limited restrictions and reduced adaptability pressures	✓ Situations evolves faster, forcing the government and business to rethink strategy
Base effects	✓ Continued albeit moderate reduction in excess capacity	✓ Faster reduction in excess capacity in the economy	✓ Marginal reduction in excess capacity

Source: NCBA Research

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