PROPPING UP ECONOMIC GROWTH BY LOWERING POLICY RATES

HIGHLIGHTS

- In 2025, global economic growth is expected to remain steady at about 3.2%, supported by declining inflation and financing cost, and possible stimulus in China.
- In the US market, with growth forecast to remain robust in 2025 and as the new administration settles in, we see little urgency for the monetary policy easing early in the year.
- In the Euro Area, economic growth is forecast to remain lukewarm, with possible bright spots on the inflation front.
- For Kenya, a challenging growth outlook next year requires a looser monetary policy stance to spur aggregate demand, a timely resolution of the government pending bills and addressing structural bottlenecks in the industrial sectors.
- Uganda's medium-term prospects could gain support from the projected start of oil production in late 2025, but there are significant headwinds in the meantime, including a risk of a wider fiscal deficit and an exposed currency.
- In Tanzania, we assume that an improvement in FX liquidity and implementation of growth-friendly fiscal consolidation, accommodative monetary policy and exchange rate flexibility could support GDP growth at about 6% next year.
- Rwanda's projected growth outturn of 6.5% in 2025 remains dependent on the success of fiscal priorities and maneuverability as well as weather outcomes.

ECONOMICS AND RESEARCH MONTHLY ECONOMIC REPORT

December 2024

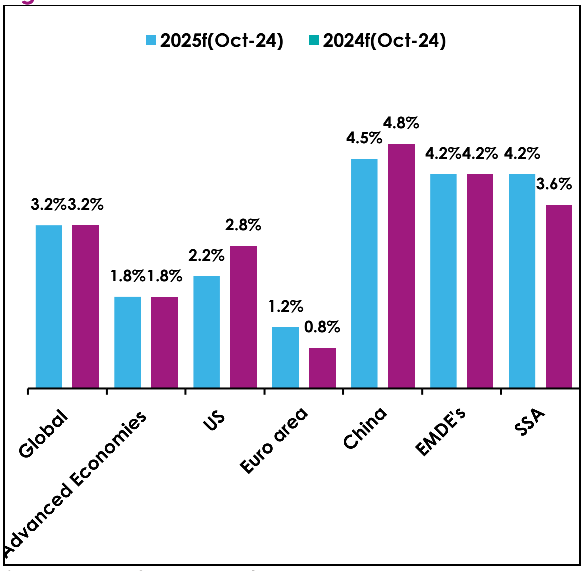
GLOBAL ECONOMIC OUTLOOK

Last year in December, we called for "an open mind" into 2024. As different economies transitioned into a lower interest rate environment, several things were uncertain. Firstly, markets were unsure how Europe would handle the knock-on-effects of high energy prices in the prior year and secondly, we expected that the outcome of several elections across the world would keep markets uneasy in 2024.

Into 2025, we are tempted to extend the same call. But then, we are now more confident about the policy direction, at least outside of the US, which is to prop up economic activity by lowering policy rate across several economies. For the US market, we do see the Federal Open Market Committee (FOMC) keeping an open mind in setting policy given three risks to the outlook namely, an upside risk to inflation, downside risk to employment and a potentially higher neutral rate.

The global economy is forecast to remain steady next year, expanding by about 3.2% according to the IMF's October projections. Even though the fourth quarter has seen amplified geopolitical pressures in the Middle East and potentially from the US elections outcome, global growth is projected to continue on a solid path. A number of important global developments, including stimulus announcements in China, surprisingly strong performance of the US economy, and broad-based central bank rate cuts are expected to support economic growth.

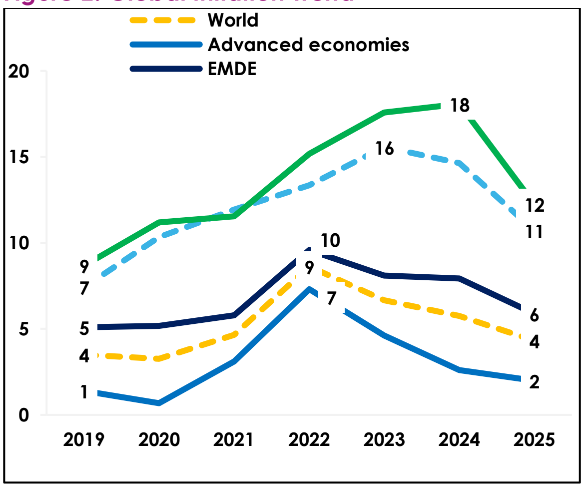
Figure 1: Forecast GDP Growth Rates



Source: IMF, NCBA Research

Aggregate measures of global inflation are largely expected to return to pre-pandemic readings of about 2% next year from a peak of 7% in advanced economies. But the disjuncture between goods and services inflation could give policy makers a challenge. Whereas goods inflation has declined following the unwinding in prices, services inflation continues to be much stickier. Resultantly, monetary policy easing across most of the markets could be measured.

Figure 2: Global Inflation Trend



Source: IMF, NCBA Research

THE US ECONOMY

In the US, with level of economic activity printing higher than expected, we do not foresee the FOMC in any urgency to lower policy rates next year. If anything, with a new administration settling in, the committee is likely to wait for clarity on Trump's fiscal policy. His economic agenda is wide, but markets are unsure what part of it could be implemented. But one thing appears clear, he would want to boost the prospects of American firms and households.

In here lies a likelihood of a cut in domestic taxes and an increase in import tariffs resulting into a wider fiscal deficit and potential for rekindled inflation. Consequently, the FOMC may no longer have great confidence that inflation is moving sustainably toward the target of 2%. This would then imply that the FOMC terminal rate could print higher than expected in a bid to manage any re-emergence of inflationary pressure.

Resultantly, these elevated rates are likely to keep the US dollar strong, with the potential of worsening 2025 economic conditions in some markets. Notably, international trade could be weaker next year, while higher external public debt service could see public debt burden in Sub-Saharan Africa staying high.

Even though not much is disclosed about Trump's implementation of the immigration policy, we see the potential cost of massive deportation as being too high and likely to be an economic burden on the labour market. Reportedly, a substantial proportion of farm workers in the US have no legal status.

THE EUROPEAN ECONOMIES

In Europe, the Euro Area is forecast for a lukewarm year. The IMF's projects gross domestic product (GDP) economic growth of about 1.2% in 2025, a pace below long-term averages. A bright spot is on the inflation front, where the European Central Bank (ECB) could see increased confidence that inflation is trending back down to 2%. Resultantly, this is expected to open the door for more aggressive easing to help unlock credit growth, which was throttled as the ECB hiked rates in 2023 and 2024.

However, the European Central Bank is expected to do this with an eye on the policy developments in the US under the new administration. At a time when Europe faces significant risks to growth, trade policy that is unfriendly to Europe could widen its economic vulnerabilities. Moreover, any likely pressure on Europe to raise its contribution to defence through NATO may lead to fiscal challenges in some of its economies.

Since the start of 2024, the UK has enjoyed stronger than expected GDP growth. This has reflected a stronger recovery as energy prices have fallen from the 2023 levels. We see this momentum continuing next year, with GDP expanding by 1.5% from 1.0% this year, according to the IMF. With headline inflation- now at 2.3%, which is near the 2% target, pressure appears to stem mainly from services inflation. Resultantly, for the MPC, policy rate cuts are less a matter of if, but more a matter of when and how much.

In sum, what all this implies for the main currencies in 2025 is that with most data out of the US likely appearing USD positive, we project a strengthening of the US dollar. Moreover, for the Euro, Trump's trade policy could require a lower ECB terminal rate. However, from a geopolitical angle, if Trump ends the Russia/Ukraine war well, this may increase investor confidence into Europe and support the Euro.

However, any significant pivot away from trade tariff focus for the Trump administration and an implementation of a large China stimulus package could lift expectations for global growth, hence, an outperformance of the US dollar.

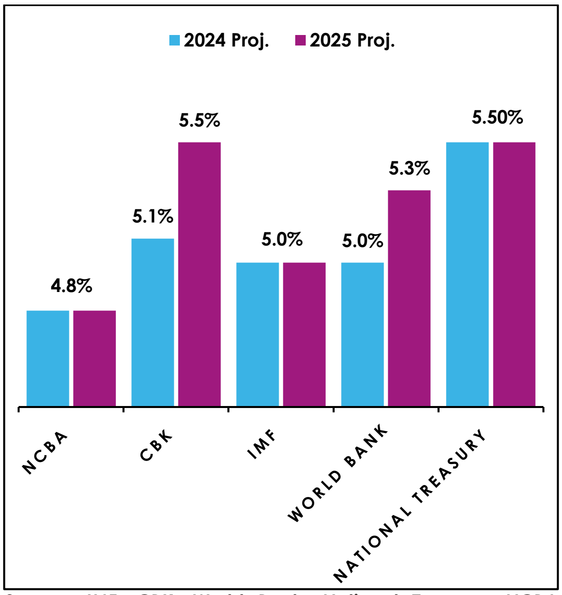
For the JPY, surprisingly, its path may partly depend on domestic politics in 2025. Confidence and market sentiment may be low given that the ruling Liberal Democratic Party (LDP) lost Parliament majority in the October elections and now has to seek for a coalition ally. That said, the Bank of Japan monetary policy meeting in January remains crucial.

KENYA

Kenya seems to have resolved to a considerable degree the exceptional shocks from inflation, currency fluctuation and immediate fiscal risks in 2024. This is after relying on tight monetary and a not so successful fiscal consolidation policy path to manage these shocks.

Into 2025, with economic growth forecast revised down by most research institutions to 4.8%, 5.0%, 5.2%, 5.3% and 5.5% by ourselves, the IMF, National Treasury, World Bank and CBK, respectively, one can easily see that growth could be a challenge. The outcome depends on Kenya's success in spurring economic activity next year by loosening monetary policy further, a timely resolution of the government pending bills- now at KES 709 billion, improvement in business sentiments and addressing structural bottlenecks in the industrial sectors.

Figure 3: Kenya Headline GDP Growth Projections



Source: IMF, CBK, World Bank, National Treasury, NCBA Research

Success here could be mixed, given that fiscal consolidation may undermine medium-term growth prospects, while failure to reach consensus on new taxation measures could see the government falling short of revenue generation leading to more payment arrears. Moreover, agriculture output remains uncertain, as usual, with drier than usual conditions expected over most parts of Kenya, southern Uganda, Rwanda, and north-western Tanzania. Normal to wetter than usual conditions expected over north-western Kenya and most parts of Tanzania may however provide cushion.

On the fiscal side, the sovereign is likely to stay at a cross-road. A need to improve tax revenue generation- stuck at about 14.2% down from 18.2% of GDP amidst low socio-political buy-in may prove challenging. For the fiscal year ending June 2025, we see tax revenue as a percentage of GDP expanding at just 4-5% against the target of 13.2%.

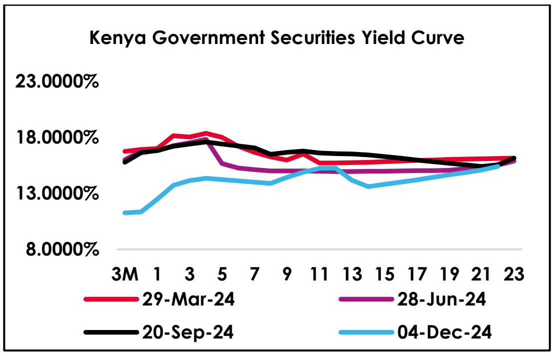
However, on domestic financing, the government is expected to continue frontloading its borrowing next year at a time when the market appears to express a healthy appetite for sovereign risk on the short end.

Moreover, on external financing, receipt of concessional financing from the IMF in November could potentially unlock additional World Bank DPO facility early next year. As a result, meeting the KES 355.50 billion foreign financing target is then now dependent on securing KES 169 billion in commercial financing. Hopefully, Kenya will get a window for this at a good rate. However, there is an opportunity for a second supplementary budget and probably borrow more of this domestically.

With regard to the key prices, 2025 is expected to start at a stable level, with the second half of the year being uncertain. A policy desire to stimulate economic activity through lower lending rates could see the low inflation environment offering comfort to the MPC to deeply cut the policy rate in 2025. Positively, headline inflation is expected to remain within single digit levels. However, unlike the IMF, we see no need for caution with regard to the level of core inflation. Stuck around 3.3%, core inflation appears to point toward distress in economic activity level.

Moreover, with successful frontloading of the fiscal domestic borrowing, yields on the short-end primary market are expected to go below 10%. Even with this fall in yields, the MPC has further room to reduce policy rate given the healthy positive USD/KES real interest rate differential.

Figure 4: Kenya's Yield Curve



Source: NSE, NCBA Research

That's not to say that the local currency is well cushioned. We see about 4% depreciation of the shilling following our projection that importers are likely to carry over no or very limited FX demand backlog into 2025. Moreover, we foresee limited portfolio conversion demand next year. While this could keep the currency stable in the first half of the year, we see a bit of volatility towards the end of the second quarter, as markets interpret the completion of the IMF program.

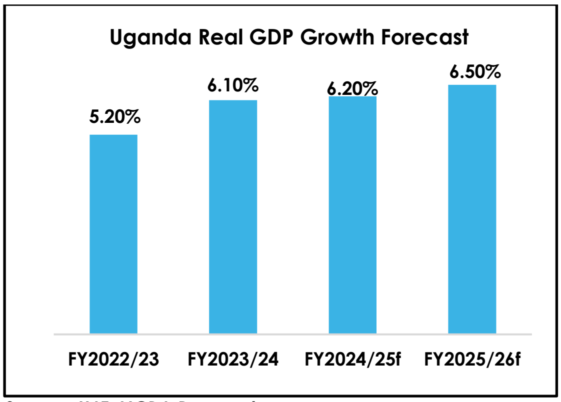
So far, National Treasury's projection show a lower dependence on external budgetary financing into 2027 and thus does not seem to have exceptional external financing needs. Even though this may not show urgency for Kenya to immediately roll over into a new IMF program, markets would prefer that they do so. Thus, a Stand-by Arrangement (SBA) could suffice to manage periods of balance of payments stress and maintain market confidence into 2027.

Overall, Kenya's balance of risk appears tilted down and mainly dominated by domestic factors next year. On the external side, a miscalibration of policy easing especially in the US and further escalation of the Middle East tensions, portends risk. Although we do not foresee any significant weakening in our export markets from this, a deterioration could challenge our growth.

UGANDA

We project Uganda's economic performance to largely stay resilient in 2025 expanding by about 6-6.5% anchored on favourable weather, investments in the extractive industry and timely government program disbursements.

Figure 5: Uganda's Growth Forecast



Source: IMF, NCBA Research

On the fiscal side, with 2024/25 budget estimated at UGX 72.1 trillion, a 36% increase from the FY2023/24 we see the fiscal deficit widening above 5.5% of GDP next year. Moreover, the conclusion of the three-year IMF program in June 2024 could mean lower external financing. That said, revenue collection could surprise on the upside and hit 15% of GDP in June 2025 from 14.3% in prior year.

Concerningly, we expect the current account deficit to remain elevated at about 7% of GDP into mid-2025, before narrowing down further to 5.5% of GDP later in the year. The elevated current account deficit in the first half of 2025 will be largely on account of ongoing importation of capital goods investment in the oil sector. Then, positively, coffee exports, strong remittance inflows and tourism revenues are likely to ease the deficit in the second half of the year.

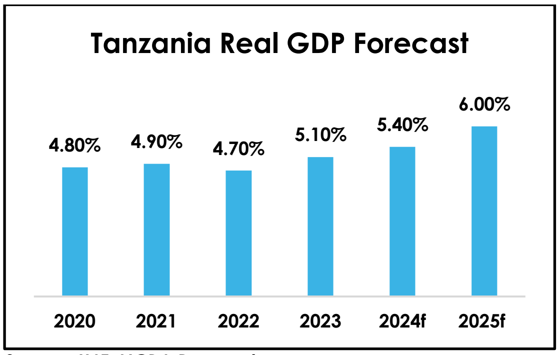
Uganda's currency has held steady, gaining 4% year-to-October. However, it remains exposed to depreciation. Notably, the official FX Reserves stand at USD 3,398 million- covering only 3.1 months of import cover. Thus, the Bank of Uganda may have little fire power to actively intervene in the currencies market next year. Concerningly, Uganda does not seem to have applied for a new IMF program upon expiry of the previous one in June. In that program, delays were noted, while the sixth review could not be completed due to weak performance in several key quantitative and structural targets.

Overall, Uganda's medium-term prospects could gain support from the projected start of oil production in early 2026, but there are significant headwinds in the meantime.

TANZANIA

The economy is projected to grow at 5.4% in 2024 slightly below the Bank of Tanzania's 5.6% projection. Growth has been buoyed partly by improved fiscal disbursements as well as low inflation. Further, implementation of growth-friendly fiscal consolidation, accommodative monetary policy and exchange rate flexibility if sustained could support GDP growth at 6% in 2025. Moreover, government spending around the 2025 presidential elections may be growth positive. That said, should TZS supply shortage spill over into next year, this could potentially undermine growth prospects.

Figure 6: Tanzania's Growth Forecast



Source: IMF, NCBA Research

With this level of economic activity projection, we expect the fiscal side to perform well in 2025. Specifically, we see tax revenue collection to hit 95%, relative to 97% in the last fiscal year, driven by improved collection of employment taxes and trade taxes. However, the government payroll numbers are likely to plateau.

As a result of good revenue performance, disbursement of expenditure funds is expected to remain regular. That said, the scale of infrastructure projects may be lower next year relative to 2024, due to reconstruction exercises following the mudslides this year. This could easily keep the fiscal deficit below 4% next year.

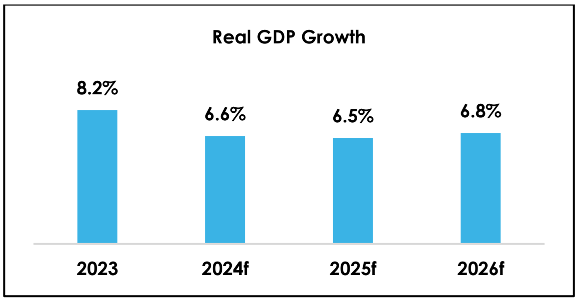
Inflation is expected to largely remain within the medium target of 5.0% on the back of favourable weather and stable power supply. Moreover, with the World Bank commodity index projected to retreat by 5% next year, little inflation pressure is expected from the import side.

Our base case is that the current FX liquidity will not dry out in 2025 and that Foreign Direct Investment flows as well as an additional USD 266 million disbursement from the IMF will augment this. However, the IMF foresees a temporary re-emergence of FX illiquidity in the first half of the year. Resultantly, save for short-term volatility, we project about 4-5% depreciation on the USD/TZS pair, which is close to the 2014-2023 annual average.

RWANDA

The economy has continued its impressive performance, one of the fastest growing economies in the Sub-Saharan African region. The IMF projects the economy to grow at 6.5% in 2025 primarily driven by strong performance in the service and construction sectors and recovery in food crop production. However, fiscal vulnerabilities arising from a not-so-well implemented fiscal consolidation may pose challenges in the near-to-medium term.

Figure 7: Rwanda's Growth Forecast



Source: IMF, NCBA Research

Into 2025, fiscal manoeuvrability could be a concern, particularly with the public debt-to-GDP ratio hitting 80%. With government spending contributing 16% of annual GDP on average, we could see heightened pressure to collect more tax revenue, reform tax policy and review tax exemptions. On broader public finance management, there could be benefit in greater efficiency in health and education spending as well as governance of State-Owned Enterprises (SOEs) to mitigate contingent liabilities.

The current account deficit is set to remain wide due to high capital goods imports and low coffee exports touching 12.1% in December 2024 and then slightly down to 11% in 2025. Moreover, elevated tensions with the neighbouring Democratic Republic of the Congo (DRC) present significant risks to trade outcomes. However, official external finance disbursements could provide cushion. Following an early IMF staff level agreement on the fourth review of the Resilience and Sustainability Facility and second review of the Stand-by Credit Facility, if approved Rwanda would have access to about US$ 185 million in early 2025. Resultantly, the Rwandese Franc, which has recorded 6.6% depreciation against the US dollar this year is likely to see a similar level of depreciation in 2025.

The medium-term outlook indicates moderate inflationary pressures with inflation remaining within the target range at 4.6% in 2024 and forecast at about 6% in 2025. That said, adverse weather conditions could pose risks. This is especially true with climate change expected to increase the frequency of severe weather events in the future.

Overall, while Rwanda’s near-term economic outlook remains positive, risks remain tilted to the domestic side. Resultantly, growth outcomes are dependent on the success of fiscal priorities and manoeuvrability as well as weather outcomes.

NCBA Research
Head Office: NCBA Centre, Mara & Ragati Roads, Upper Hill,
P O Box 30437 00100, Nairobi, Kenya
Direct Line: +254 20 288 4548 | +254 20 288 4752 | +254 709 714 545
Email: anthony.muli@ncbagroup.com
samantha.njoroge@ncbagroup.com
david.ndwiga@ncbagroup.com
Telex: 23205 (COMAFBANK); SWIFT BIC: CBAFKENX; Reuters Dealing: CBAF; Reuters Information: CBAN
Website: www.ncbagroup.com