Things could get better if first quarter trend is sustained

By Duncan Lumwamu

The past quarter saw the economy remain stable at the macro level with inflation holding out at an average of 6.78 percent after marginally declining from 7.21 percent in January to 6.27 percent in March. This was occasioned partly by lower fuel costs and forex adjustment charges thereby significantly reducing the cost of electricity compared to the same period last year.

Notably though, prices of food, electricity and water components have been rising over the same period mainly due to errant weather conditions in the country.

Another key indicator, the 91 day Treasury bill averaged at 9.12 percent over the period, declining from a high of 9.38 percent in January 2014 to a low of 8.85 percent as at the close of the quarter. The decline is attributed to increased liquidity of the banks and of the investors from a number of redemptions and maturities of Treasury bonds thereby increasing demand that could have led to over subscription.

On the currencies front, the Kenya Shilling put up a spirited fight to remain stable against major currencies in the first quarter as the US dollar exchanged at an average rate of Kes.86.32, oscillating between a high of Kes.86.96 and a low of Kes.85.46. The gainers from this trend were obviously import and export businesses that enjoyed relative stability over the period.

The stocks market was on a bullish streak as the NSE 20 Index gained 0.4 percent (18.81 points) to close at 4,945.78 points up from 4,926.98 in December last year while the NSE All Share Index was up 5.3 percent (7.24 points) to close at 143.89 points compared to 136.65 at the close of 2013. This may have been a sign of increased investor confidence and the stable macros could be a good indication of better things to come and if this trend continues the economy is likely to close the year on a very positive note.

The banking sector was the most vibrant in the economy in the first quarter going by the announcements of the full year 2013 results. Although the sector experienced a lower growth in loan books, the first quarter of 2014 may have been a turning point as more investors were attracted to bank stocks and rushed to take positions early.

As the year advances, the country is expected to enjoy a stable macroeconomic environment in the second quarter, in spite of security threats and runaway government spending.

However, we may see little deterioration in several macro factors. Inflation will be of major interest, with our expectations showing a rise in the rate. This rise may be occasioned by higher food prices and high transport costs. However, the inflation is expected to continue to remain in the single digit level.

On the interest rates, we expect no major shifts from this average. Thematically, overall interest rates will remain stable over the second quarter. Central Bank has continued to maintain the CBR at 8.5 percent and we project that the rate will remain unchanged in the medium term.

The Eurobond issue will continue to dominate fixed income investors' expectations this quarter, as the government has already indicated that plans are underway to issue the bond. Proceeds of the bond will be used to fund national budget deficit, finance several infrastructural projects and consequently, it will support CBK's foreign exchange reserves and aid in exchange rate stability.

The key factors among them inflation and a stable interest rate environment, however, will be some of the determinants that will influence the pricing of the bond.

Over the second quarter, we expect the Kenya shilling to continue the trend in the first quarter to remain stable against the major currencies.

A key concern, however, is the government's fiscal policy. Public sector spending and the much talked about wage bill have created an unsustainable trend. Government may have to review its tax policies within this quarter. This may involve more and/or new tax lines, to increase the overall revenue collection. The government has already taken a step in curbing the wage bill, but our expectations call for more than just a cut on spending but a keen eye on tax collection to seal the loopholes that have previously bled the public coffers unabated.

In the equities market we expect heightened activity towards the mid of the quarter as majority of the companies will be having books closure and payment of the dividends declared. We expect the overall banking sector to register strong Q1 results compared year on year, with the slow Q1 in 2013.

Security remains a key concern for the overall investment community. With the recent terror threats around major cities in the country, we note that this may withhold potential investment flows, especially foreign flows into the country. The existing investments are also at stake, with the retail segment already feeling the heat.

Duncan Lumwamu is a Research Analyst at ABC Capital Ltd.