

## Politics

The East African countries' election cycle will gather pace in the next two years. Tanzania's general election is slated for 2020. This shall be closely followed by Uganda's elections in 2021 and, lastly, Kenya in 2022.

With elections scheduled for 2022 in Kenya, there is minimal perceived political risk to the economy in 2020. The key opposition leader, Raila Odinga, has been working with the government on the Building Bridges Initiative (BBI). The initiative proposes constitutional changes to unify the nation which has been plagued by ethnic antagonism, divisive elections and corruption, among other vices. This could potentially be a headwind to economic growth if it warrants the nation to carry out a referendum, otherwise, it is perceived as low risk.

Political activity in Uganda has started to pick up with low-key campaigning around the country, aggressive campaigning during by-elections and increased government spending as new projects are being rolled out. All this is expected to accelerate in 2020. Government spending is expected to increase while direct foreign investment is expected to decrease. The continued tension between Uganda and Rwanda has led to a slowdown in trade.

Tanzania's incumbent President, John Magufuli, is expected to run for elections in 2020 for another five-year term. Despite concerns over Magufuli's authoritarian mode of governance, there exists no strong competition to replace him as President. We therefore expect minimal political risk emanating from election uncertainties.

## Economic Growth

**Kenya:** Economic growth in 2019 remained robust albeit lower than 2018. This was due to the slowdown in the agricultural and manufacturing sectors following the late onset of the long rains. Furthermore, the low base effect in the agricultural sector that supported the impressive growth in 2018 following the drought in 2017 was not present.

The World Bank forecasts 6.0% growth in 2020. This would be driven by, among other factors; macroeconomic conditions, the repeal of the interest rate cap law that may see improved private credit growth and increased government spending to support the "Big Four" agenda. Downside risks emanate from unpredictable weather patterns, weak agricultural commodity markets and the general slowdown in global economic growth.

**Uganda:** Annual GDP growth for the financial year 2018/19 stood at 6.1% compared to 6.2% registered in the previous year, according to the Uganda Bureau of Statistics. This was on the back of the government's investments on roads, hydro-electricity dams and value addition in agriculture. Uganda rebased its GDP (Gross Domestic Product) calculations in October 2019 to 2016/2017 from 2009/2010. This was done to incorporate new sectors such as oil and gold whose output had increased tremendously in recent years. This move saw the FY 2018/19 GDP restated to UGX 122.7 trillion from UGX 109.9 trillion previously (11.6% rise).

The World Bank forecasts a growth of 6.5% in 2019/2020 followed by a drop to 5.8% in 2021. Key drivers will be infrastructural spending and energy sector investments. Lack of fiscal discipline and reduced foreign investment ahead of the elections in 2021 could potentially slacken growth further.

**Tanzania:** The uncertainty of government policy remains a major headwind to economic growth in Tanzania. There are private sector concerns as evidenced by the reduced ease of doing business ranking (World Bank Group, Doing Business 2019) hence a lower contribution by the private sector to the economy. The overall economic growth has, however, remained relatively robust. This has been supported by

construction activities by the government, agriculture and mining activities as well as increased exports boosted by the expansion of the national airline.

The government projects a growth of 7.1% in 2019 compared to 7.0% in 2018. The World Bank has however challenged the official data by the government claiming slower actual growth. The World Bank estimated a growth of 5.2% in 2018, a figure much lower than the government's 7.0%.

## Government Debt and Fiscal Performance

Increased government expenditure amid slower growth in revenue collection is a common theme across East African countries. Kenya's FY 2019/20 budget increased revenue targets to Ksh 2.1 trillion, with expenditure projected at Ksh 2.8 trillion. The expected budget deficit, which is 6.3% of GDP, is to be plugged through external financing of Ksh. 331 billion and domestic financing of Ksh. 300 billion. The ministry of finance raised the budget deficit to 6.3% in September 2019 from the previously stated 5.6%. This, coupled with the fact that the Senate voted to raise the borrowing ceiling from Ksh 6 trillion to Ksh 9 trillion, alludes to the government's struggle to raise revenue. The higher debt ceiling could derail fiscal consolidation efforts and subsequently underpin increased debt to GDP which the IMF estimates to be 61.6% in 2019.

The 2019/20 resource budget for Uganda was UGX 40.5 trillion, an increase of +23.8% from the previous budget. With the rebasing of the economy by the Ministry of Finance, Planning and Economic Development, debt to GDP reduced to 37.2% from the previous 41.8%. Despite the positive change, IMF projections indicate Uganda's debt levels could rise to about 49% of GDP by 2021/22. As of September 2019, government revenue collections fell short by UGX 513 billion since the beginning of FY 2019/20, majorly due to a slowdown in tax collections. Government spending has also been lower than expected in the first quarter of the financial year.

Tanzania has maintained a relatively modest expenditure in relation to its revenue collection. The government projects a deficit of 2.3% in the FY 2019/2020, up from 2.0% in FY 2018/2019.

## Monetary Policies

Muted inflationary pressures and stable macroeconomic environment across East African countries saw the Central Banks adopt a dovish stance on interest rates.

Kenya's Monetary Policy Committee (MPC) reduced its policy rate in 2019 to 8.5% from 9.0% following the repeal of interest rates caps in November 2019. The MPC noted the ongoing tightening of fiscal policy and therefore the necessity for an accommodative monetary policy to spur economic activity. We expect the Central Bank to maintain the accommodative stance into 2020 given our stable inflation outlook and prevailing slow private sector credit growth in the country.

Bank of Uganda (BoU) lowered the Central Bank Rate to 9.0% in October 2019 from 10.0% on account of lower GDP growth and a benign inflation outlook. We expect the BoU to remain accommodative in 2020 to boost GDP growth. A key risk to this outlook would be unpredictable weather patterns which would cause an increase in inflation and lower than expected economic growth.

The Bank of Tanzania (BOT) maintained an accommodative monetary policy in the context of low and stable inflation in 2019. This was to support recovery of credit to the private sector and ultimately to boost economic activities. BOT maintained its discount rate at 7.0% and



continued to supply liquidity to the money markets. We expect BOT to maintain this stance to ensure liquidity is adequate in the market to support the economy.

## Currency

The Kenya Shilling maintained stability in 2019 with an appreciation of 0.7% against the dollar as at the end of December. In our view, the Kenya shilling is susceptible to downward pressure from negative sentiment due to persistent fiscal concerns and concerns over sustained currency intervention by the authorities. Further downward pressure is expected in the long term due increased external financing and debt service. In the near term, the shilling should remain stable with marginal depreciation (103-106) on the back robust diaspora remittances, adequate foreign exchange (FX) reserves and a narrowing current account deficit (4.2% of GDP as at July 2019 from 5.0% in December 2018). We expect continued open market operations by the Central Bank to reduce currency volatility during the year 2020.

The Uganda Shilling also remained stable in 2019, appreciating by 1.1% against the US Dollar, spawning from increased hard currency inflows targeting high yielding government securities. The year 2020 could be a reversal year for the currency due to anticipated political instability and risk aversion from foreign investors. The widening of the current account deficit would exacerbate downside risk on the shilling.

The Tanzania Shilling's performance was flat year to date as at the end of December 2019. Higher exports which offset the import bill underpinned the stability in the currency. The current account deficit narrowed to USD 108.80 million in September from USD 499.77 million in December 2018. We expect the shilling to come under pressure in 2020 as the government makes heavy capital investments on infrastructural projects.

## Inflation

East African countries experienced benign inflation in 2019, supported by low food inflation. In Kenya and Uganda, inflation remained within the target range of their respective governments whereas Tanzania's inflation was below BOT's medium-term target of 5.0%. Kenya's overall average inflation to the end of December 2019 was 5.8% while Uganda's inflation was 3.6% for the same period. In Tanzania, headline inflation steadied at 3.8% in November 2019.

In Kenya, inflation is expected to remain well anchored in 2020, underpinned by improved weather conditions and lower electricity prices. Imprudence in monetary and fiscal policies could undermine the expected stability in inflation. In Tanzania, overall inflation in 2020 is expected remain below the medium-term target. This would be driven mainly by adequate food supply and sustained stable power supply that should counter the expected upward pressure from increased government spending.

Bank of Uganda's projections for inflation remain below the 5% target until December 2020, mainly supported by subdued demand side pressures and a stable currency. However, the expected increased fiscal spending ahead of 2021 elections could put upward pressure on inflation in 2020.

## Credit Markets

Kenya's private sector credit grew by 6.6% in the 12 months to October 2019, compared to 4.4% in a similar period the previous year. The gradual improvement of credit growth has been attributed to deployment of innovative credit products. Growth is expected to pick up on the back of the repeal of interest rate caps.

As at the end of July 2019, credit to the Uganda private sector had risen by 13.8% for the prior 12 months. However, this slightly fell to 13.3% and 10.6% for August and September 2019 respectively. The affected sectors were transport, communication, manufacturing and mining. This could decrease further in 2020, mainly due to a potential change in monetary policy and commercial banks' easing on private sector lending, especially to risky investors, as the country heads into the election cycle.

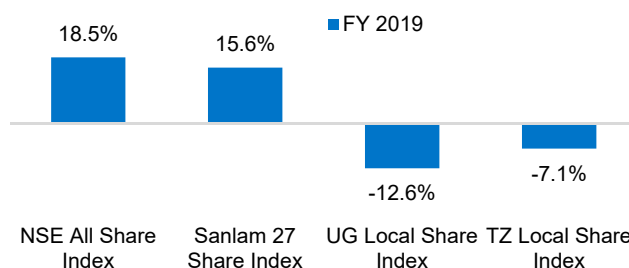
Tanzania private sector credit grew by 9.3%, up from 8.2% in the year ending August 2019, and 4.9% in September 2018. This was largely a reflection of accommodative monetary policy and improvement in asset quality of banks, owing to a reduction of non-performing loans (NPLs) and ongoing measures to improve the business environment in the country.

## Bond Markets

Bond market performance for the year has been humdrum relative to expectations of performance north of 20% (S&P Kenya Bond Index was up 13.5% as at the end of 2019). After a stellar rally at the beginning of the year (up 9.3% by end of Jun-19), bonds were on track to be the best performing asset for the year after the sudden cool-off in the equities market in the second quarter of the year (NASI down 5.1% in Q2 2019 but up 6.5% end of Jun-19). The second half of the year was characterized with volatility as liquidity in the money market built up due to banks, which were resistive to long term bonds in primary auctions. Following the repeal to the interest rate cap, activity in the secondary market declined significantly from a turnover of as high Ksh. 91.7 billion to Ksh 35.8 billion. Furthermore, investors have increased their premium for government securities by 0.5-1.0%.

Uganda bond market also remained awash with liquidity for the most part of 2019, evidenced by high foreign participation in government securities and high repo amounts in the interbank market. The news on the reduction of withholding tax to 10% on longer dated bonds was also taken positively, increasing participation in the fixed income space hence leading to a slight drop in their yields. Given the uncertain outlook on the country's inflation, monetary policy and increased government borrowing ahead of campaigns, interest rates are likely to increase in 2020, particularly around the second half of the year.

## Regional Equity Markets



Source: Sanlam Investments, Nairobi Securities Exchange & Bloomberg

The Nairobi Stock Exchange (NSE) outperformed its East African counterparts in 2019, being the only market to register positive performance as at November 2019. The rally in the market was supported by attractive valuations, improving corporate profitability and positive investor flows post the global market sell off in late 2018.

Banking stocks in Kenya rallied after Parliament's Finance Committee recommended repeal of the interest rate cap. The pricing controls have impacted the ability of individuals and Small and Medium enterprises (SME) to access affordable credit.

With the repeal in place, we expect banks to register double digit loan book growth and higher margins. This should support banking stocks' performance in 2020. The positive knock-on effect of access to credit by the private sector are expected to boost other facets of the economy including manufacturing, trade, consumption and telecommunication. Underwhelming corporate earnings in Uganda and policy uncertainty in Tanzania may undermine the performance of equities in these markets.

The uncertainty surrounding the US-China trade war and the upcoming US Elections may result to risk aversion towards risky markets. This may impact investor sentiment and restrict flows to Emerging and Frontier markets. These factors pose a significant risk to equity market performance in the medium term.

## Global Markets

Global assets had a strong performance in 2019, reversing losses from the previous year. Risky assets experienced a temporal relief resulting in



a rally following the possibility of a phase 1 trade agreement between the US and China that has had an ongoing trade war since 2018. Additionally, the US Federal Reserve (Fed) cutting rates three times in 2019 (2.5% to 1.75%) has further supported risky assets.

The risks to the 2020 global economic outlook remain elevated. Trade wars and geopolitical tensions including delays on closing out on Brexit and muted global growth expectations could dampen performance of global markets in 2020. Additionally, the upcoming US Elections could result in risk aversion that would further undermine performance of global equities.

We note that the ongoing trade disputes could weaken the US economy significantly necessitating more rate cuts in 2020. However, given the already low Fed rates, the ability of further easing monetary policies to restore economic growth is questionable.

### Alternatives - Private Equity & Property

**Private Equity:** A joint report by KPMG and EAVCA estimated that of the total USD 6.4 trillion PE funds raised globally between 2007 and 2018, approximately USD 33.1 billion was earmarked for Africa and USD 3.3 billion for East Africa. The main source of funds were investors from Europe and North America largely comprising of DFIs, high net worth individuals/family offices, along with others such as asset managers and international and local pension funds.

Total exits over the period 2007 to 2018 were reported at 44, with 10 recorded during 2017 to 2018. The most active sector remains Financial Services which recorded 17 exits out of the 44 exits. There has been a decrease in exits over the last two years to 10 compared to 13 over the period 2015 to 2016. Based on the report, actual median gross IRR was 20% against a target of 23%.

In 2020, we project that the momentum of PE deal activity will likely increase in East Africa, backed by its economies' resilience and increasing appetite for private equity investments considering the limited opportunity in listed equity markets.

**Real Estate:** Data from a survey by the Kenya Bankers Association (KBA) indicated that the Kenyan housing market remained subdued during the first six months to June 2019. According to KBA, in the third quarter of 2019, residential house prices declined by 2.28% compared to a 1.72% decline in the second quarter. In our opinion, the real estate slowdown is as a result of increased supply especially within the high-end residential market, falling household income coupled with diminishing credit from commercial banks that reduced demand for houses. The softening of real estate prices could be an indicator of a market correction.

In 2020, we expect the property sector to continue to grow at a lethargic rate due to the supply overhang, especially in high end residential market space, retail space and office space. However, in the medium term, Government initiatives, such as the amendment of the banking act, could likely lead to an increase in lending to the property sector and thus spur property demand over the medium term. The affordable housing agenda, part of the "Big Four" agenda, still lacks a clear funding structure for developers and runs the risk of fading over time. We expect heightened investor activity in the capital markets in 2020, driven by the launch of the Acorn Student housing development and income REITs.

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