Cytonn Monthly – November 2021

Fixed Income

Money Markets, T-Bills & T-Bonds Primary Auction:

During the month of November, T-bills remained undersubscribed, with the overall subscription rate coming in at 87.9%, an increase from the 57.9% recorded in October 2021. The increase in the subscription rate is partly attributable to the ample liquidity in the money market, with the average interbank rate declining to 5.0%, from the 5.3% recorded in October 2021. Overall subscription rates for the 91-day, 182-day and 364-day papers came in at 112.0%, 64.8% and 101.4%, an increase from 97.5%, 62.1% and 37.9%, respectively, in October 2021. The yields on the 91-day, 182-day and 364-day papers increased by 15.0 bps, 30.0 bps and 59.0 bps to 7.1%, 7.7% and 8.7%, respectively. For the month of November, the government accepted a total of Kshs 98.2 bn, out of the Kshs 105.5 bn worth of bids received, translating to a 93.0% acceptance rate.

During the week, T-bills recorded an undersubscription, with the overall subscription rate coming in at 95.2%, an increase from the 64.6% recorded the previous week, partly attributable to the ample liquidity in the money markets. The 91-day paper recorded the highest subscription rate, receiving bids worth Kshs 8.7 bn against the offered Kshs 4.0 bn, translating to a subscription rate of 217.3%, a significant increase from the 98.4% recorded the previous week. The oversubscription is partly attributable investors having a bias towards the shorter-dated paper in order to avoid duration risk given the current rising political temperatures preceding the elections in August 2022. The subscription rate for the 364-day paper declined to 89.0%, from 90.4% recorded the previous week, while the subscription rate for the 182-day paper increased to 52.5%, from 25.2% recorded the previous week. The yields on the 91-day, 182-day and 364-day papers increased by 5.1 bps, 1.9 bps and 7.2 bps, to 7.2%, 7.9% and 9.0%, respectively. The government continued to reject expensive bids accepting Kshs 19.5 bn of the Kshs 22.8 bn worth of bids received, translating to an acceptance rate of 85.6%.

In the Primary Bond Market, the government re-opened one bond, FXD1/2019/20 and issued a new 5 year bond, FXD1/2021/5, for the month of November. The bonds recorded an oversubscription of 168.3%, attributable to the ample liquidity in the market coupled with the bonds attractive yields. The coupons for the two bonds were; 12.9% and 11.3%, and the weighted average yield for the issues were; 13.5% and 11.3%, for FXD1/2019/20 and FXD1/2021/5, respectively. The government sought to raise Kshs 50.0 bn for budgetary support, received bids worth Kshs 84.2 bn and accepted bids worth Kshs 69.5 bn, translating to an 82.6% acceptance rate. Investors preferred the shorter-tenure issue i.e. FXD1/2021/5, which received bids worth Kshs 66.6 bn, representing 79.1% of the total bids received, owing to the higher returns on a risk-adjusted basis.

For the month of December, the government has re-opened two bonds, namely; FXD4/2019/10 and FXD1/2018/20, with effective tenors of 8.0 years, and 16.4 years, respectively, in a bid to raise Kshs 40.0 bn for budgetary support. The period of sale for the issue runs from 22nd November to 7th December 2021. The coupon rates are 12.3% and 13.2% for FXD4/2019/10 and FXD1/2018/20, respectively. We expect investors to prefer the shorter dated paper, FXD4/2019/10, as they search for higher returns on a risk-adjusted basis. The bonds are currently trading in the secondary market at yields of 12.3% and 13.0%, for FXD4/2019/10 and FXD1/2018/20, respectively, and as such, our recommended bidding range for the two bonds is: 12.1%-12.5% for FXD4/2019/10 and 12.8%-13.2% for FXD1/2018/20 within which bonds of similar tenor are trading at.

In the money markets, 3-month bank placements ended the week at 7.7% (based on what we have been offered by various banks), while the yield on the 91-day T-bill increased by 5.1 bps to 7.2%. The average yield of the Top 5 Money Market Funds remained relatively unchanged at 9.8% while the yield on the Cytonn Money Market Fund increased marginally by 0.01% points to 10.58%, from 10.57% recorded the previous week.

The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 3rd December 2021:

Money Market Fund Yield for Fund Managers as published on 3rd December 2021

Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund	10.58%
2	Zimele Money Market Fund	9.91%
3	Nabo Africa Money Market Fund	9.70%
4	Madison Money Market Fund	9.54%
5	Sanlam Money Market Fund	9.50%
6	CIC Money Market Fund	9.26%
7	Apollo Money Market Fund	8.95%
8	GenCapHela Imara Money Market Fund	8.95%
9	Co-op Money Market Fund	8.74%
10	Dry Associates Money Market Fund	8.66%
11	British-American Money Market Fund	8.50%
12	Orient Kasha Money Market Fund	8.37%
13	ICEA Lion Money Market Fund	8.37%
14	NCBA Money Market Fund	8.33%
15	Old Mutual Money Market Fund	7.41%
16	AA Kenya Shillings Fund	6.83%

Source: Business Daily

Secondary Bond Market:

In the month of November, the yields on government securities in the secondary market remained relatively stable with the FTSE NSE bond index declining marginally by 0.1%, to close the month at Kshs 96.6, from Kshs 96.7 recorded in October 2021, bringing the YTD performance to a decline of 1.4%. The secondary bond turnover increased marginally by 0.2% to Kshs 63.8 bn, from Kshs 63.6 bn recorded in October. On a year on year basis, bonds turnover increased by 41.7% to Kshs 867.7 bn, from Kshs 612.1 bn worth of T-bonds transacted over a similar period last year. The chart below shows the yield curve movement during the period;

Liquidity:

Liquidity in the money markets eased in the month of November, with the average interbank rate declining to 5.0%, from 5.3% recorded in October attributable to government payments which offset tax remittances. During the week, liquidity in the money market remained ample, with the average interbank rate remaining unchanged at 5.2%, as was recorded the previous week. The average interbank volumes traded declined by 31.2% to Kshs 7.0 bn, from Kshs 9.7 bn recorded the previous week.

Kenya Eurobonds:

During the month, the yields on the Eurobonds were on an upward trajectory with the 10-year Eurobond issued in 2014 and 12-year Eurobond issued in 2019 increasing by 0.7% points and 0.4% points to 4.4% and 7.1%, from 3.7% and 6.7%, respectively, as was recorded in October 2021. Additionally, the 10-year Eurobond issued in 2018, 30-year Eurobond issued in 2018, 7-year Eurobond issued in 2019 and 12-year Eurobond issued in 2021 all increased by 0.5% points to 6.2%, 8.4%, 6.0% and 7.0%, from 5.7%, 7.9%, 5.5% and 6.5%, respectively, as recorded in October 2021.

During the week, yields on Eurobonds recorded mixed performance, with yields on the 10-year issue issued in 2014, 10-year bond issued in 2018, 30-year bond issued in 2018, and 12-year bond issued in 2019 all increasing by 0.1% points to 4.4%, 6.1%, 8.3% and 7.1%, respectively, while yields on the 7-year bond issued in 2019 and 12-year bond issued in 2021 declined by 0.3% and 0.1% to 5.5% and 6.9%, respectively. Below is a summary of the performance:

Kenya Eurobond Performance

	2014	2018		2019		2021
Date	**10-year issue**	**10-year issue**	**30-year issue**	**7-year issue**	**12-year issue**	**12-year issue**
31-Dec-20	3.9%	5.2%	7.0%	4.9%	5.9%	-
29-Oct-21	3.7%	5.7%	7.9%	5.5%	6.7%	6.5%
26-Nov-21	4.3%	6.0%	8.2%	5.8%	7.0%	6.9%
29-Nov-21	4.4%	6.1%	8.3%	5.9%	7.1%	6.9%
30-Nov-21	4.4%	6.2%	8.4%	6.0%	7.1%	7.0%
1-Dec-21	4.6%	6.1%	8.4%	5.9%	7.1%	6.9%
2-Dec-21	4.4%	6.1%	8.3%	5.5%	7.1%	6.9%
Weekly Change	**0.1%**	**0.1%**	**0.1%**	**(0.3%)**	**0.1%**	**(0.1%)**
M/m Change	**0.7%**	**0.5%**	**0.5%**	**0.5%**	**0.4%**	**0.5%**
YTD Change	**0.5%**	**0.9%**	**1.3%**	**0.6%**	**1.2%**	**-**

Source: CBK

Kenya Shilling:

During the month, the Kenya Shilling depreciated by 1.1% against the US Dollar to close the month at Kshs 112.5, from Kshs 111.2 recorded at the end of October 2021. Notably, the shilling hit an all-time low during the month of November, driven by the increased dollar demand from oil and merchandise importers on the back of increased global oil prices against slower recovery of exports and tourism sector.

During the week, the Kenyan shilling depreciated marginally by 0.2% against the US dollar to close the week at Kshs 112.6, from Kshs 112.4 recorded the previous week, mainly attributable to increased dollar demand from general importers. Key to note, these is the lowest the Kenyan shilling has ever depreciated against the dollar. On a YTD basis, the shilling has depreciated by 3.2% against the dollar, in comparison to the 7.7% depreciation recorded in 2020. We expect the shilling to remain under pressure for the remainder of 2021 as a result of:

a. Rising uncertainties in the global market due to the Coronavirus pandemic, which has seen investors continue to prefer holding their investments in dollars and other hard currencies and commodities,
b. Increased demand from merchandise traders as they beef up their hard currency positions in anticipation for more trading partners reopening their economies globally,
c. Widening current account deficit which stood at 5.4% of GDP in the 12-months to October 2021 compared to the 4.8% of GDP in the 12 months to October 2020 attributable to a higher import bill which offset increased receipts from agricultural and services exports and remittances,
d. Rising global crude oil prices on the back of supply constraints at a time when demand is picking up with the easing of COVID-19 restrictions and as economies reopen. Key to note, risks abound this global recovery following the emergence of the new COVID-19 Omicron variant. We are of the view that should the variant continue to spread, most nations will respond swiftly by adopting stringent containment measures to curb the spread.

The shilling is however expected to be supported by:

i. The Forex reserves, currently at USD 8.7 bn (equivalent to 5.3-months of import cover), which is above the statutory requirement of maintaining at least 4.0-months of import cover, and the EAC region's convergence criteria of 4.5-months of import cover. In addition, the reserves were boosted by the USD 1.0 bn proceeds from the Eurobond issued in July, 2021 coupled with the USD 407.0 mn IMF disbursement and the USD 130.0 mn World Bank loan financing received in June, 2021, and,
ii. Improving diaspora remittances evidenced by a 28.2% y/y increase to USD 337.4 mn in October 2021, from USD 263.1 mn recorded over the same period in 2020, which has continued to cushion the shilling against further depreciation.

Weekly Highlights:

I. **November MPC Meeting**

The Monetary Policy Committee (MPC) met on Monday, 29th November 2021 to review the outcome of its previous policy decisions and recent economic developments, and to decide on the direction of the Central Bank Rate (CBR). The MPC retained the CBR at 7.00%, in line with our expectations, for the eleventh consecutive time. Below are some of the key highlights from the meeting:

i. Inflation remains well anchored and within the Government's target range of 2.5%-7.5%. The overall inflation declined to 6.5% in October 2021, from 6.9% in September, mainly attributable to decrease in fuel prices with Super Petrol prices decreasing by 3.7% to Kshs 129.7 per litre, from Kshs 134.7 per litre. Diesel and Kerosene prices also declined by 4.3% and 6.6% to Kshs 110.6 and Kshs 103.5 per litre, from Kshs 115.6 and Kshs 110.8 per litre, respectively,
ii. Private sector credit growth has been recovering, having grown by 7.8% in October 2021 as compared to 7.0% in August 2021. The key sectors that have experienced increased lending include consumer durables at 16.5%, manufacturing at 10.9% and transport and communications at 9.6%,
iii. The recently released GDP data pointed to a strong economic rebound in H1'2021 with real GDP growing by 10.1% in Q2'2021, compared to a 4.7% contraction in Q2'2020. The economic growth

reflects the recovery in economic activities following the easing of COVID-19 restrictions,

iv. The current account deficit to GDP is estimated at 5.4% in the 12 months to October, a 0.6% points increase from 4.8% recorded over the same period in 2020. Exports of goods remained strong, growing by 10.8% in the 10 months to October 2021 compared to a similar period in 2020. Receipts from exports of horticulture and manufactured goods increased by 19.1% and 35.3%, respectively, in period January to October 2021 compared to a similar period in 2020. However, receipts from tea exports declined by 6.2%, partly attributable to the impact of accelerated purchases in 2020, and,

v. The Economic Stimulus Programme and Economic Recovery Strategy implemented by the Government to shield the economy from adverse effects of COVID-19 are expected to continue boosting domestic demand. The MPC also noted that the rebound in revenue performance reflects strong economic recovery and improvement of the business environment.

The MPC concluded that the current accommodative monetary policy stance remains appropriate and therefore decided to retain the Central Bank Rate (CBR) at 7.00%. The Committee will meet again in January 2022, but remains ready to re-convene earlier if necessary.

II. November Inflation

The y/y inflation for the month of November declined for the second consecutive month to 5.8%, from the 6.5% recorded in October, lower than our expectations of 6.0% - 6.4%. On a m/m basis, the inflation rates increased by 0.5%, driven by a 0.9% increase in food & non-alcoholic beverages coupled with a 0.5% increase in housing, water, electricity, gas and other fuels. Notably, the transport index was the only decliner on a m/m basis, declining by 0.2%, given that fuel prices remained unchanged at Kshs 129.7 per litre for Super Petrol, Kshs 110.6 per litre for Diesel and Kshs 103.5 per litre for Kerosene during the month. The table below shows a summary of both the year on year and month on month commodity groups' performance;

Major Inflation Changes – November 2021

Broad Commodity Group	Price change m/m (November-21/October-21)	Price change y/y (November-21/ November-20)	Reason
Food & Non-Alcoholic Beverages	0.9%	9.9%	The m/m increase was mainly contributed by increase in prices of sugar, cooking oil and potatoes among other food items. The increase was however mitigated by a decline in prices of tomatoes, kales and carrots
Housing, Water, Electricity, Gas and other Fuel	0.5%	6.2%	The m/m increase was as a result of increase in the cooking gas and single room house rent. The increase was however mitigated by a decline in electricity price
Transport Cost	(0.2%)	8.1%	The m/m decline was as a result of the remained unchanged for super petrol, diesel and kerosene in the month of November
Overall Inflation	**0.5%**	**5.8%**	**The m/m increase was due to a 0.9% increase in the Food & Non-Alcoholic Beverages index coupled with a 0.5% increase in housing, water, electricity, gas and other fuels**

Source: KNBS

Going forward, we expect the inflation rate to remain within the government's set range of 2.5% - 7.5%. Despite the decline in November's inflations rates, we anticipate inflation pressures to remain elevated in the short term as global fuel prices continue to rise due to supply bottlenecks. Key to note, the emergence of the new Omicron COVID-19 variant is a concern since it could lead to adoption of new containment measures in various countries further disrupting the supply chains and consequently increase the fuel prices. However, we expect continued pressure on the government to keep the inflation under control before the next IMF evaluation test date which is this month.

III. **Real People Medium Term Note Restructuring**

During the week, Real People Kenya Limited (The Issuer), issued a notice to the holders of the Kshs 1.3 bn floating rate Senior Unsecured Notes of the Kshs 5.0 bn Medium Term Note (MTN) program that was issued in 2015 after approval by the Capital Markets Authority, CMA, on June 25th 2015. In the meetings held by the Noteholders on various occasions since 3rd August 2018, the noteholders had resolved to extend the MTNs maturity, with the issuer indicating that these extensions would allow the firm to look for a strategic investor to buy a stake in the firm and help settle the debt. Real People Kenya has received a formal expression of interest from Chike Africa, a company registered in Port Louis, Mauritius to restructure the distressed notes with some of the following conditions;

i. The Noteholders will agree to an immediate 70.0% haircut on the principal amount of the Notes outstanding that 30.0% of the principal amount outstanding will be repaid to the Noteholders in three equal instalments,
ii. Chike will acquire 100.0% of the shares of the Issuer from the shareholders for a nominal consideration, and,
iii. Chike will subscribe for the amount of USD 6.0 million in a maximum of two tranches of USD 3.0 million each.

The meeting with the noteholders will be held on 21st December 2021 for the purpose of considering and, if thought fit, passing the following resolutions which will be proposed as Extraordinary Resolutions:

1. **Resolution 1:**

a. The Noteholders consent to the Meeting being convened at a shorter notice than the 21 days' clear day notice required under the Trust Deed.

2. **Resolution 2:**

a. 0% of the principal amount of each outstanding Note be waived, cancelled and forgiven, and each Noteholder consequently waives, cancels and forgives payment by the Issuer of the Forgiven Debt and further waives any claim or demand with respect to the Forgiven Debt,
b. The Maturity Date for the Restructured Notes be extended to 28th February 2025,
c. The principal amount outstanding on the Restructured Notes shall be redeemed in three equal tranches on 28th February 2023, 28th February 2024, and, 28th February 2025, and,
d. The Issuer shall utilize any proceeds of any tax refund received by it from the Kenya Revenue Authority (KRA) towards the settlement of the outstanding principal amount of the Restructured Notes. The Issuer shall make such payment as soon as possible upon receipt of the tax refund, but in any event no later than fourteen days after such receipt. Upon such redemption, the outstanding amount of the Restructured Notes shall be redeemed in accordance with the schedule set out in resolution 2(c).

3. **Resolution 3:**

a. The interest accrued and payable on the Restructured Notes for the period commencing 3rd August 2020 and ending on 28th February 2022 be waived,
b. Interest on the outstanding principal amount of the Restructured Notes shall begin accruing with effect from 1st March 2022, and,

c. Interest on the Restructured Notes shall be calculated and determined and paid on the 28th February 2023, 28th February 2024, and, 28th February 2025.

4. **Resolution 4:**

a. The Trustee be authorized to concur to the modifications referred to in these Extraordinary Resolutions and execute all documents, notices, forms, instruments, consents or agreements, amendments to the Trust Deed, the pricing supplement and the Conditions required to give effect to these Extraordinary Resolutions on such terms and conditions as the Trustee may in its discretion decide.

In our view, although the proposal offers a solution for noteholders whose maturity dates have been extended 6 times, the 70.0% haircut, which would amount to approximately Kshs 0.9 bn, would represent a significant loss to investors and in turn dampen investor confidence in public markets. Key to note, the Noteholders had been offered an equity stake in the company in order to decrease the liability and interest expense while also boosting working capital as it scouted for a strategic partner. The Real People MTN adds to the list of regulated entities that have led to losses for investors in Kenya, amounting to approximately Kshs 209.4 bn, and further debunks the myth that regulated products are always safer. The table below highlights some of the regulated products that have recently run into trouble leading to billions of losses:

Shareholders' Loss for Regulated Entities Largely Due to Poor Corporate Governance

Firm	Peak Share Price	Current Share Price	No. of Shares (bn)	Loss in Value (Kshs bn)
Kenya Airways**	58.0	3.8	1.5	81.5
Mumias Sugar	20.7	0.3	1.5	31.2
Athi River Mining (ARM)	33.0***	5.6*	1.0	27.4
Transcentury	57.0	1.4	0.4	22.2
Uchumi*	10.9	0.3	0.4	3.9
Imperial Bank				36.0
Chase Bank				4.8
CMC Motors				1.2
Real People Kenya				0.9
Amana Capital				0.3
Total				**209.4**

Last trading price before suspension
*****Peak share price since the 2012 rights issue***
******Represents the median share price for the 10 years to the suspension***

Source: Cytonn Research, NSE, Reuters

In our view, the Capital Markets Authority (CMA) should put in place sufficient mechanisms to protect investors' funds in the capital markets, such as a Capital Markets Compensation Fund which would pool funds from market transactions and step in to compensate investors in the event of losses or illiquidity. Currently, investors in the capital markets are only protected by the Investor Compensation Fund (ICF), which only secures investors from failure of a licensed broker or dealer to meet contractual obligations.

Monthly Highlights:

i. The Kenya Revenue Authority (KRA) released the Revenue Performance as at October 2021, highlighting that the cumulative total revenue collected for the current fiscal year was Kshs 631.1 bn, against the target of Kshs 603.9 bn, representing an out-performance rate of 104.5%, partly attributable to improved business performance following the relaxation of COVID-19 containment measures. For more information, see our Cytonn Weekly #44/2021,
ii. The headline Purchasing Manager's Index (PMI) for the month of October 2021 increased to 51.4, from 50.4 recorded in September 2021, an indication that business activities in the country strengthened and new business continued to grow. Notably, this is the highest PMI recorded in the five months leading to October 2021, attributable to a moderate improvement in business conditions and a significant increase in new business volumes on the back of increased customer spending. For more information, see our Cytonn Weekly #44/2021,
iii. The International Monetary Fund (IMF) and the Kenyan authorities reached a staff level agreement on the second review of the 38-month Extended Fund Facility (EFF) and Extended Credit Facility (ECF) - funded program. IMF noted that subject to the completion of the review by the IMF Board, Kenya would access approximately USD 264.0 mn (Kshs 29.5 bn), bringing the total support from IMF to Kenya to USD 984.0 mn (Kshs 109.8 bn) in 2021. For more information, see our Cytonn Weekly #44/2021,
iv. The Kenya National Bureau of Statistics released the Quarterly Gross Domestic Product Report, highlighting that the Kenyan economy recorded a 10.1% growth in Q2'2021, up from a 0.7% growth in Q1'2021 and the 4.7% contraction recorded in Q2'2020, pointing towards an economic rebound. Consequently, the average GDP growth rate for the 2 quarters in 2021 is a growth of 5.4%, an increase from the 0.2% decline registered during a similar period of review in 2020. For more information, see our Cytonn Weekly #45/2021 and our GDP Note,
v. The National Treasury released the Draft 2022 Budget Policy Statement, projecting a 7.7% increase in the target Excise Duty for FY'2021/2022 to Kshs 259.6 bn, from Kshs 241.0 bn as highlighted in the original budget estimates. The increase in the Excise duty revenue collection target follows the publishing of the Legal Notice 217 of 2021, which allowed the Kenya Revenue Authority, (KRA) to adjust the specific rates of excise duty upwards by 5.0% in line with average annual inflation rate for the FY'2020/2021. For more information, see our Cytonn Weekly #46/2021, and,
vi. The National Treasury gazetted the revenue and net expenditures for the first four months of FY'2021/2022, highlighting that the total revenue collected as at the end of October 2021 amounted to Kshs 598.5 bn, equivalent to 33.7% of the original estimates of Kshs 1.8 tn and is 101.1% of the prorated estimates of Kshs 591.9 bn, while the total expenditure amounted to Kshs 906.9 bn, equivalent to 28.4% of the original estimates of Kshs 3,193.0 bn, and is 85.2% of the prorated expenditure estimates of Kshs 1.1 tn. For more information, see our Cytonn Weekly #46/2021.

Rates in the fixed income market have remained relatively stable due to the tightened but sufficient levels of liquidity in the money markets. The government is 16.6% ahead of its prorated borrowing target of Kshs 291.3 bn having borrowed Kshs 339.5 bn of the Kshs 658.5 bn borrowing target for the FY'2021/2022. We expect a gradual economic recovery going into FY'2021/2022 as evidenced by KRAs collection of Kshs 598.5 bn in revenues during the first four months of the current fiscal year, which is equivalent to 101.1% of the prorated revenue collection target. However, despite the projected high budget deficit of 7.5% and the lower credit rating from S&P Global to 'B' from 'B+', we believe that the support from the IMF and World Bank will mean that the interest rate environment will remain stable since the government is not desperate for cash.