Kenya's Cost of Credit, & Cytonn Monthly – January 2022

Fixed Income

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

During the month of January, T-bills were oversubscribed, with the overall subscription rate coming in at 120.1%, an increase from the 61.5% recorded in December 2021. The increase in the subscription rate is partly attributable to the ample liquidity in the money market partly attributable to government payments which offset tax remittances, with the average interbank rate declining to 4.5%, from the 5.1% recorded in December 2021. The overall subscription rates for the 182-day and 364-day papers increased to 94.3% and 160.2%, from 50.2% and 56.4%, respectively, recorded in December 2021. The subscription rate for the 91-day paper on the other hand declined to 84.3%, from the 102.3% recorded in December 2021. The yields on the 91-day, 182-day and 364-day papers increased by 7.1 bps, 8.9 bps and 31.6 bps to 7.3%, 8.1% and 9.5%, respectively. For the month of January, the government accepted a total of Kshs 106.6 bn out of the Kshs 115.3 bn worth of bids received, translating to a 92.5% acceptance rate.

During the week, T-bills remained oversubscribed, with the overall subscription rate coming in at 115.8%, from 107.9% recorded the previous week, partly attributable to ample liquidity in the money market. The 364-day paper recorded the highest subscription rate, receiving bids worth Kshs 16.2 bn against the offered Kshs 10.0 bn, translating to a subscription rate of 161.7%, a decrease from the 190.6%, recorded the previous week. The continued oversubscription witnessed for the 364-day paper is attributable to investors' preference for the longer-dated paper which offers higher yields of 9.6% compared to the 7.3% and 8.1% yields offered by the 91-day and 182-day papers, respectively. The subscription rate for the 91-day and 182-day papers, on the other hand, increased to 84.6% and 82.4%, from 37.7% and 53.4%, respectively, recorded the previous week. The yields on the government papers recorded mixed performance, with the yields on the 91-day and 182-day papers declining by 2.6 bps and 1.7 bps to 7.3% and 8.1%, respectively, while the yield on the 364-day paper increased by 5.0 bps to 9.6%. The government continued to reject expensive bids, accepting bids worth Kshs 25.8 bn out of the Kshs 27.8 bn worth of bids received, translating to an acceptance rate of 93.0%.

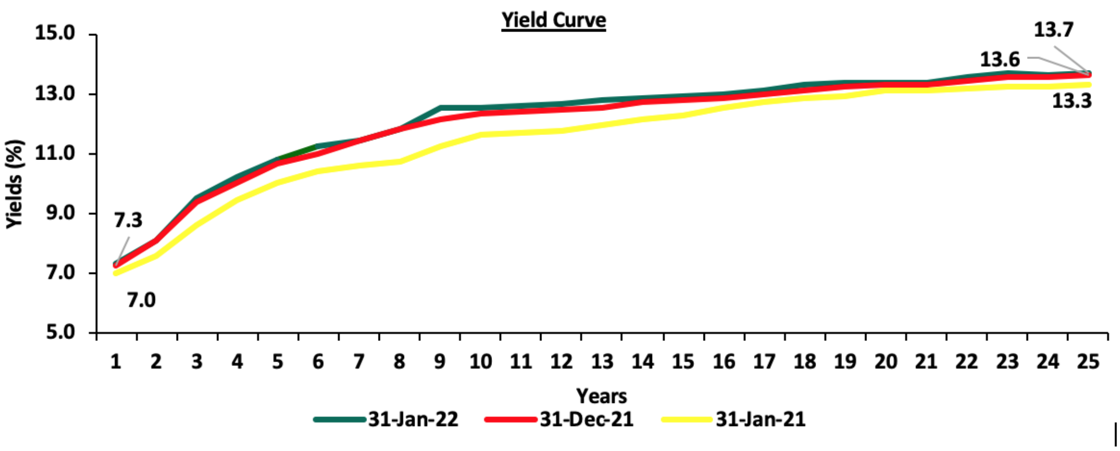
During the month, the government released the auction results for the three re-opened bonds; FXD1/2020/05, FXD2/2018/10 and FXD1/2021/20. The bonds recorded an oversubscription of 111.3% driven by the ample liquidity in the money market during the month coupled with the attractive yields offered by the bonds. The government was keen on maintaining low rates and thus accepted only Kshs 62.3 bn of the Kshs 66.8 bn worth of bids received, translating to an acceptance rate of 93.6%. The table below provides more details on the bonds issued during the month:

Issue Date	Bond Auctioned	Effective Tenor to Maturity (Years)	Coupon	Amount offered (Kshs bn)	Actual Amount Raised (Kshs bn)	Total bids received	Average Accepted Yield	Subscription Rate	Acceptance Rate
20/12/2021	FXD1/2020/05	3.4	11.7%	30.0	27.4	28.4	11.3%	94.6%	96.6%
	FXD2/2018/10	7.0	12.5%	30.0	34.9	38.4	12.7%	128.0%	90.9%
	FXD1/2021/20	19.7	13.4%				13.8%		
January 2022 Average		**10.0**	**12.5%**	**30.0**	**31.2**	**33.4**	**12.6%**	**111.0%**	**93.6%**
December 2021 Average		**12.2**	**12.7%**	**40.0**	**37.8**	**41.2**	**13.0%**	**102.9%**	**91.9%**

For the month of February 2022, the government issued a new 19-year infrastructure bond, IFB1/2022/19 with a tenor of 19 years in a bid to raise Kshs 75.0 bn for funding Infrastructure projects. The period of sale runs from 31st January 2022 to 15th February 2022. Key to note, the bond's coupon rate will be market-determined. We anticipate an oversubscription and a higher acceptance rate given the ample liquidity in the money market coupled with the attractive tax-free nature of the bond. Our recommended bidding range for the bond is: 12.4%-12.5% within which bonds of a similar tenor are trading.

Secondary Bond Market:

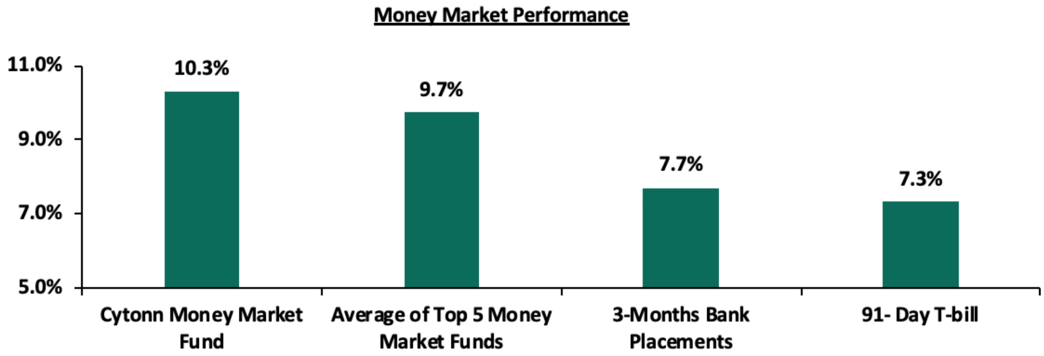
In the month of January 2022, the yields on government securities in the secondary market were on downward trajectory, with the FTSE NSE bond index gaining by 0.3% to close the month at Kshs 96.4, from Kshs 96.1 recorded in December 2021, bringing the YTD performance to a gain of 0.3%. The chart below shows the yield curve movement during the period;



The secondary bond turnover declined by 9.0% to Kshs 46.8 bn, from Kshs 51.4 bn recorded in December 2021. Key to note, this was lowest monthly bond turnover since November 2020 when the turnover was Kshs 46.0 bn, attributable to commercial banks' reduced activity in the secondary bonds market. In our view, we believe that the improving business environment in the country has seen most banks increase their lending activities to the private sector. On a year on year basis, however, the bonds turnover increased by 33.7% to Kshs 913.2 bn, from Kshs 682.9 bn worth of T-bonds transacted over a similar period last year.

Money Market Performance

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 declined by 2.6 bps to 7.3%. The average yield of the Top 5 Money Market Funds and the yield of the Cytonn Money Market Fund declined to 9.7% and 10.3%, from 9.8% and 10.5%, respectively, as was recorded the previous week.



The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 4th February 2022:

Money Market Fund Yield for Fund Managers as published on 4th February 2022

Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund	10.30%
2	Zimele Money Market Fund	9.91%
3	Nabo Africa Money Market Fund	9.70%
4	Sanlam Money Market Fund	9.44%
5	Madison Money Market Fund	9.27%
6	CIC Money Market Fund	8.97%
7	GenCapHela Imara Money Market Fund	8.97%
8	Apollo Money Market Fund	8.95%
9	Dry Associates Money Market Fund	8.81%
10	Orient Kasha Money Market Fund	8.70%
11	Co-op Money Market Fund	8.51%
12	British-American Money Market Fund	8.46%
13	ICEA Lion Money Market Fund	8.33%
14	NCBA Money Market Fund	8.33%
15	AA Kenya Shillings Fund	7.59%

Money Market Fund Yield for Fund Managers as published on 4th February 2022

Rank	Fund Manager	Effective Annual Rate
16	Old Mutual Money Market Fund	7.18%

Source: Business Daily

Liquidity:

Liquidity in the money markets eased in the month of January 2022, with the average interbank rate declining to 4.5%, from 5.1% recorded in December 2021, partly attributable to government payments which offset tax remittances. During the week, liquidity in the money markets eased as well, with the average interbank rate reducing to 4.4%, from 4.7% recorded the previous week. The average interbank volumes traded increased by 6.4% to Kshs 11.5 bn, from Kshs 10.8 bn recorded the previous week.

Kenya Eurobonds:

During the month, the yields on the Eurobonds recorded mixed performance, with the 30-year Eurobond issued in 2018, the 12-year Eurobond issued in 2019 and the 12-year Eurobond issued in 2021, all increasing by 0.5% points, to 8.7%, 7.2% and 7.1%, from 8.1%, 6.7% and 6.6%, respectively, recorded in December 2021. Additionally, the yields on the 10-year Eurobond issued in 2018 and the 7-year Eurobond issued in 2019 increased by 0.8% points and 0.7% points, to 6.6% and 6.3%, from 5.8% and 5.6%, respectively, from what was recorded in December 2021. The yield on the 10-year Eurobond issued in 2014 was the only decliner, declining by 0.2% points to 4.2%, from 4.4% recorded in December 2021.

During the week, the yields on all the Eurobonds were on a downward trajectory, with yields on the 10-year bond issued in 2014, the 10-year bond issued in 2018, the 30-year bond issued in 2018, the 7-year and 12-year bonds issued in 2019, and, the 12-year bond issued in 2021 declining marginally by 0.1% points to 4.1%, 6.5%, 8.5%, 6.2%, 7.2% and 7.1%, respectively:

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-21	4.4%	5.8%	8.1%	5.6%	6.7%	6.6%
3-Jan-22	4.4%	5.7%	8.1%	5.6%	6.7%	6.6%
28-Jan-22	4.2%	6.6%	8.7%	6.3%	7.3%	7.2%
31-Jan-22	4.2%	6.6%	8.7%	6.3%	7.2%	7.1%
1-Feb-22	4.2%	6.6%	8.6%	6.3%	7.3%	7.1%
2-Feb-22	4.1%	6.5%	8.6%	6.2%	7.2%	7.0%
3-Feb-22	4.1%	6.5%	8.5%	6.2%	7.2%	7.1%
Weekly Change	**(0.1%)**	**(0.1%)**	**(0.1%)**	**(0.1%)**	**(0.1%)**	**(0.1%)**
M/M Change	**(0.2%)**	**0.8%**	**0.5%**	**0.7%**	**0.5%**	**0.5%**

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**
YTD Change	**(0.3%)**	**0.8%**	**0.4%**	**0.6%**	**0.5%**	**0.5%**

Kenya Shilling:

During the month, the Kenya Shilling depreciated by 0.4% against the US Dollar, to close the month at Kshs 113.6, from Kshs 113.1 recorded at the end of December 2021. Notably, the shilling hit an all-time low during the month of January, driven by the increased dollar demand from oil and merchandise importers on the back of increased global oil prices against slower recovery in the exports and tourism sector.

During the week, the Kenyan shilling remained relatively stable against the US dollar, closing the week at Kshs 113.6, unchanged from the previous week. On a YTD basis, the shilling has depreciated by 0.4% against the dollar, in comparison to the 3.6% depreciation recorded in 2021. We expect the shilling to remain under pressure in 2022 as a result of:

a. Increased demand from merchandise traders as they beef up their hard currency positions in anticipation for more trading partners reopening their economies globally,
b. Ever present current account deficit due to an imbalance between imports and exports with Kenya's current account deficit estimated to come in at 5.4% of GDP in 2021, having expanded by 27.4% in Q3'2021 to Kshs 184.6 bn, from Kshs 145.0 bn recorded in Q3'2020. This was attributed to a robust increase in merchandise imports by 39.6% to Kshs 321.8 bn in Q3'2021, from Kshs 230.5 bn in Q3'2020,
c. The aggressively growing government debt, with Kenya's public debt having increased at a 10-year CAGR of 18.2% to Kshs 8.0 tn in August 2021, from Kshs 1.5 tn in July 2011 thus putting pressure on forex reserves to repay some of the public debt, and,
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 variants. We are of the view that should the variants continue to spread; most nations will respond swiftly by adopting stringent containment measures to curb transmissions.

The shilling is however expected to be supported by:

i. High Forex reserves, currently at USD 8.2 bn (equivalent to 5.0-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 972.6 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 17.0% y/y increase to USD 350.6 mn in December 2021, from USD 299.6 mn recorded over the same period in 2020, which has continued to cushion the shilling against further depreciation.

Weekly Highlights:

I. **January 2022 Inflation**

The y/y inflation for the month of January 2022 declined for the fourth consecutive month to 5.4%, from the 5.7% recorded in December 2021, lower than our expectations of 5.6% - 6.0%. On a m/m basis, the inflation rates increased by 0.3%, driven by a 1.1% increase in food & non-alcoholic beverages coupled with a 0.7% increase in furnishings, household equipment and routine household maintenance. Notably, housing, water, electricity, gas and other fuels recorded the largest decline, reducing by 0.8%. This was mainly attributable to a 15.7% decrease in the price of electricity in January 2022 marking the first phase of compliance with President Uhuru Kenyatta's directive to cut the cost of electricity by 30.0% in order to reduce the cost of living. Additionally, the transport index declined marginally by 0.1% on a m/m basis 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 – January 2022

Broad Commodity Group	Price change m/m (January-22/ December-21)	Price change y/y (January-22/ January-21)	Reason
Food & Non-Alcoholic Beverages	1.1%	8.9%	The m/m increase was mainly contributed by increase in prices of sifted maize flour, kale, spinach and irish potatoes among other food items. The increase was however mitigated by a decline in prices of mangoes, tomatoes and carrots
Housing, Water, Electricity, Gas and other Fuel	(0.8%)	5.1%	The m/m decrease was mainly attributable to a 15.7% decrease in the price of electricity in January 2022
Transport Cost	(0.1%)	6.8%	The m/m marginal decline was as a result of unchanged prices for super petrol, diesel and kerosene during the month
Overall Inflation	**0.3%**	**5.4%**	**The m/m increase was driven by a 1.1% increase in food & non-alcoholic beverages coupled with a 0.7% increase in furnishings, household equipment and routine household maintenance.**

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 January's inflations rates, concerns remain high on the widening trade deficit as global fuel prices continue to rise due to supply bottlenecks. The rising global fuel prices could deplete the fuel subsidy program currently in place and further lead to a depreciation of the local currency.

II. **Supplementary Budget - FY'2021/22**

During the week, the National Treasury presented the Supplementary Budget for the fiscal year 2021/22 to the National Assembly. The treasury is seeking to increase the gross total budget by 3.3% to Kshs 3,377.8 bn, from the previous estimates of Kshs 3,269.2 bn. The increase in the supplementary budget is mainly on account of a 12.3% increase in funds allocated towards the Ministry of Health to Kshs 136.0 bn from the original estimates of Kshs 121.1 bn as the government amps up its fight against COVID-19, coupled with a 3.7% increase in the infrastructure budget to Kshs 202.5 bn from the earlier approved Kshs 195.2 bn.

The table below illustrates the allocation of the Supplementary Budget 2021/22, showing the components of the estimated expenditure:

Supplementary Gross Budget 2021/2022 (Kshs billions)

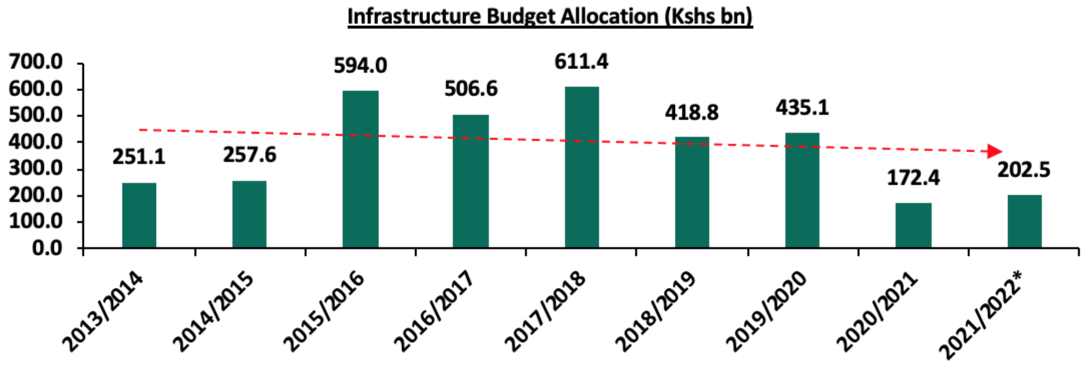
	Approved Estimates	Supplementary I Estimates	Change	% Change
State Department of ICT	22.8	22.3	(0.5)	**(2.3%)**
State Department of Vocational & Technical Training	23.3	23.0	(0.3)	**(1.2%)**
Ministry of Energy	73.9	74.0	0.1	**0.1%**
State Department of Interior	138.6	140.3	1.7	**1.2%**
State Department of Basic Education	103.3	106.4	3.1	**3.0%**
State Department of Infrastructure	195.2	202.5	7.3	**3.7%**
State Department of Water Services	77.6	81.8	4.2	**5.4%**
Other Ministries & State Departments	1,141.3	1,231.9	90.6	**7.9%**
State Department of Agricultural Research	44.9	50.1	5.2	**11.5%**
Ministry of Health	121.1	136.0	15.0	**12.3%**
Total Expenditure	**1,942.0**	**2,068.3**	**126.3**	**6.5%**
Consolidated Fund Services	**1,327.2**	**1,309.5**	**(17.7)**	**(1.3%)**
Grand Total Supplementary Budget	**3,269.2**	**3,377.8**	**108.5**	**3.3%**

Key highlights in the supplementary budget include;

1. The highest notable decline in expenditure was on the State Department of ICT, which saw a 2.3% decline in expenditure to Kshs 22.3 bn, from Kshs 22.8 bn in the previously approved estimates, attributable to a 30.0% decline in the allocation to ICT Infrastructure Connectivity to Kshs 2.5 bn, from the earlier approved estimate of Kshs 3.5 bn,
2. The Ministry of Health recorded the highest increase in the supplementary budget allocation; increasing by 12.3% to Kshs 136.0 bn, from Kshs 121.1 bn. The increase in expenditure is mainly attributable mainly to an additional Kshs 14.1 bn set aside to cater for the establishment of Vaccine Form and Finish Facility, Modern Neuropsychiatric National Teaching and Referral Hospital, acquisition of Covid-19 vaccine, construction of new level III hospitals and also due to increased donor commitments. The funds are expected to help the government in combating COVID-19 and curb its spread, through the acquisition of more vaccines. The current vaccination rate for Kenya stands at 12.7%, that is, those who have received at least one dose of the COVID-19 vaccine,
3. The State Department for Crop Development and Agricultural Research has seen its budget increased by Kshs 5.2 bn to Kshs 50.1 bn from the approved estimates of Kshs 44.9 bn with an additional Kshs 2.9 bn going towards Land and Crop Development while an additional Kshs 1.1 bn to be used on food security initiatives. The overall increase in the State Department for Crop Development and Agricultural Research represents a 11.5% increase from the original approved estimates,
4. The infrastructure docket has seen its budget enhanced by Kshs 7.3 bn to Kshs 202.5 bn from the earlier approved Kshs 195.2 bn. The 3.7% increase is mainly attributable to an additional Kshs 17.4 bn committed towards the Road Maintenance Levy Fund for maintenance of roads. However, the increase was weighed down by Kshs 7.4 bn reduction in the budget allocation towards rehabilitation and construction of roads and bridges. Key to note, some of the road works that shall receive additional funding include the dualling of Nairobi Eastern Bypass, Garissa - Isiolo

road and Nairobi- Nakuru Mau Summit road, construction of Makupa Causeway Bridge, and, upgrading of Lamu-Ijara-Garissa Road.

Overall, the budgetary allocation towards Infrastructure still remains lower than pre-COVID years as shown in the graph below, mainly due to the government's increased allocation towards the fight of COVID-19 including vaccination drives, coupled with expenditure rationalization measures as part of the ongoing fiscal consolidation efforts,



5. Consolidated Fund Services has seen a 1.3% decline in the estimates to Kshs 1.31 tn, from the initial Kshs 1.33 tn. This is attributable to a 22.9% decline in external debt redemptions to Kshs 202.1 bn from Kshs 262.1 bn in the previously approved estimate, with a notable decline being in the loan interests owed to Exim Bank of China by Kshs 19.3 bn to Kshs 54.1 bn from Kshs 73.4 bn. The reduction in debt repayments is attributable to the Debt Service Suspension Initiative (DSSI) which allowed Kenya to restructure some of its debts. Debt servicing expenses, on the other hand, increased by 8.0% to Kshs 605.3 bn, from Kshs 506.3 bn driven by Interest on domestic loans incurred in the 2021/22 fiscal year which was revised upwards to Kshs 479.2 bn, from Kshs 421.9 bn.

In our view, the proposal to allocate more funds to the Ministry of Health in order to combat COVID-19 more effectively is commendable given that we are still in the middle of a pandemic. We note that the revised estimates allocated towards the Independent Electoral and Boundaries Commission (IEBC) for conducting of the general elections stands at Kshs 23.2 bn, lower than the Kshs 40.7 bn allocated for the 2017 electoral related activities and the Kshs 24.2 bn allocated for the 2013 elections. The lower allocation may mean that we will see another supplementary budget and more funds assigned to IEBC, especially after the Commission noted that they require Kshs 40.1 bn for the 2022 general elections. Additionally, the increased expenditure estimates means that KRA will be under pressure improve on its revenue collection further despite the 104.3% outperformance recorded as of December 2021.

The approval of the 2021/22 supplementary budget will increase the fiscal deficit to an estimate of 12.9% of GDP, from the earlier estimated deficit of 11.4% of GDP for FY'2021/22. We expect the government to ramp up its revenue collection initiatives in the remaining 5 months of the current year as well as look increasingly to the domestic credit market to plug in the fiscal deficit; this may lead to possible destabilization of the interest rate environment albeit at a minimal level. Key to note, the government announced its intentions to float two Eurobonds by June 2022 for budgetary support – funds which will help the government meet its needs in the short term but make the fiscal consolidation plan harder to achieve in the medium term.

Monthly Highlights:

i. The headline Purchasing Manager's Index (PMI) for the month of December 2021 increased to 53.7, from 53.0 recorded in November 2021, pointing towards solid improvement of business activities and continued growth of new business. Notably, this is the highest PMI recorded since

October 2020 when the index was 59.1, and it is attributable to upturn in sales and growth in cash flow on the back of continued economic recovery. Key to note, overall cost pressures in the Kenyan private sector increased sharply in December 2021 due to high input purchasing prices driven by higher taxes and higher raw material prices during the month. For more information, see our Cytonn Weekly #01/2022,

ii. The Kenya National Bureau of Statistics released the Quarterly Balance of Payments report for Q3'2021 report highlighting that Kenya's balance of payments improved in Q3'2021, coming in at a deficit of Kshs 34.4 bn, from a deficit of Kshs 103.9 bn in Q3'2020. The improvement was mainly attributable to an 11.9% increase in the stock of gross official reserve to Kshs 1,064.2 bn from Kshs 951.0 bn in Q3'2020. The improvement was however weighed down by a 27.4% expansion of current account balance to Kshs 184.6 bn, from Kshs 145.0 bn in Q3'2020. For more information, see our Cytonn Weekly #01/2022 and our Q3'2021 BOP Note,

iii. The Kenya National Bureau of Statistics released the Quarterly Gross Domestic Product Report, highlighting that the Kenyan economy recorded a 9.9% growth in Q3'2021, down from a 10.1% growth in Q2'2021 but an increase from the 2.1% contraction recorded in Q3'2020, pointing towards continued economic recovery. Consequently, the average GDP growth rate for the 3 quarters in 2021 is a growth of 6.9%, an increase from the 0.8% contraction recorded during similar periods of review in 2020. For more information, see our Cytonn Weekly #01/2022 and our GDP Note,

iv. The World Bank released the Global Economic Prospects and the Sub–Saharan Africa outlook highlighting that the Kenyan economy is expected to grow by 5.0% in 2021 and 4.7% in 2022. The global economy is expected to grow by 4.1% in 2022 following an estimated 5.5% growth in 2021. The Sub-Saharan Africa's economic growth is projected to expand by 3.1% in 2021 and 3.6% in 2022 supported by rising commodity prices as the region's economic trading partners continue to reopen. For more information, see our Cytonn Weekly #02/2022.

v. The National Treasury gazetted the revenue and net expenditures for the first six months of FY'2021/2022, highlighting that the total revenue collected as at the end of December 2021 amounted to Kshs 926.3 bn, equivalent to 52.2% of the original estimates of Kshs 1.8 tn and is 104.3% of the prorated estimates of Kshs 887.8 bn, while the total expenditure amounted to Kshs 1.4 tn, equivalent to 42.7% of the original estimates of Kshs 3.2 tn, and is 85.4% of the prorated expenditure estimates of Kshs 1.6 tn. For more information, see our Cytonn Weekly #02/2022, and,

vi. The Monetary Policy Committee (MPC) met on 26th January 2022 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 twelfth consecutive time, after concluding that the current accommodative monetary policy stance remains appropriate. The Committee will meet again in March 2022, but remains ready to re-convene earlier if necessary. For more information, see our Cytonn Weekly #04/2022.

Rates in the fixed income market have remained relatively stable due to the high liquidity in the money market. The government is 10.1% ahead of its prorated borrowing target of Kshs 446.3 bn having borrowed Kshs 405.2 bn of the Kshs 658.5 bn borrowing target for the FY'2021/2022. We expect a gradual economic recovery as evidenced by the revenue collections of Kshs 926.3 bn in revenues during the first six months of the current fiscal year, which is equivalent to 104.3% of the prorated revenue collection target. However, despite the projected high budget deficit of 11.4% 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.