Cytonn INVESTMENTS

Cytonn Monthly – February 2022

Fixed Income

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

During the month of February, T-bills were undersubscribed, with the overall subscription rate coming in at 93.6%, a decline from the 120.1% recorded in January 2022. The decline in the subscription rate is partly attributable to the tightened liquidity in the money market with the average interbank rate increasing to 4.7% from 4.5% recorded in January coupled with the concurrent government and corporate bond issues during the month, which recorded oversubscriptions, as investors preferred the higher yields on offer. The overall subscription rates for the 91-day, 182-day and 364-day papers declined to 61.1%, 72.1% and 128.2%, from 84.3%, 94.3% and 160.2%, respectively, recorded in January 2022. The yields on the 364-day and 182-day papers increased by 19.9 bps and 1.1 bps to 9.7% and 8.1%, respectively, while the yield on the 91-day paper declined by 5.5 bps to 7.3%. For the month of February, the government accepted a total of Kshs 84.5 bn out of the Kshs 89.9 bn worth of bids received, translating to a 94.0% acceptance rate.

During the week, T-bills were oversubscribed, with the overall subscription rate coming in at 122.1%, up from the 63.6% recorded the previous week. The oversubscription is partly attributable to the ample liquidity in the money market with the interbank rate remaining unchanged at 5.5%, similar to what was recorded last week, coupled with the rising yields on the government papers, pointing towards higher returns for investors. The 91-day paper recorded the highest subscription rate, receiving bids worth Kshs 9.8 bn against the offered Kshs 4.0 bn, translating to a subscription rate of 246.0%, an increase from the 50.3% recorded the previous week partly attributable to the higher return on a risk-adjusted basis. The subscription rate for the 182-day paper increased to 126.0%, from 40.3% recorded the previous week, while that of the 364-day paper declined to 68.7%, from 92.2% recorded last week. The yields on the government papers were on an upward trajectory, with the yields on the 91-day, 182-day and the 364-day papers increasing by 1.1 bps, 0.1 bps and 1.0 bps to 7.3%, 8.1% and 9.8%, respectively. The government accepted bids worth Kshs 26.5 bn, out of the Kshs 29.3 bn worth of bids received, translating to an acceptance rate of 90.6%.

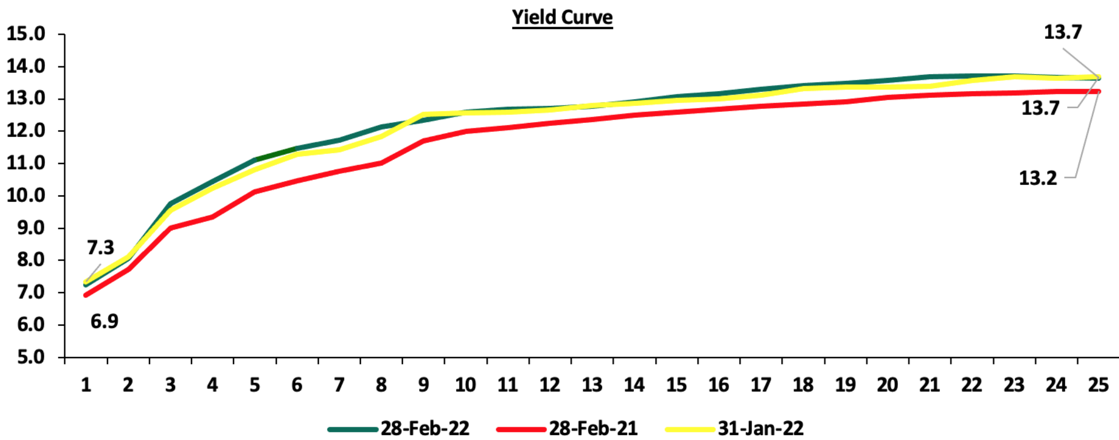
During the month, the government released the auction results for the recently issued nineteen-year Treasury bond, IFB1/2022/19, which recorded an oversubscription of 176.3%. The oversubscription was attributable to the tax-free nature of the bond coupled with the relatively high yield of 13.0% on offer. The government was keen on maintaining low rates and thus accepted only Kshs 98.6 bn of the Kshs 132.3 bn worth of bids received, translating to an acceptance rate of 74.6%. The table below provides more details on the bond 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
21/02/2022	IFB1/2022/19	19.0	13.0%	75.0	98.6	132.3	13.0%	176.3%	74.6%
February 2022 Average		**19.0**	**13.0%**	**75.0**	**98.6**	**132.3**	**13.0%**	**176.3%**	**74.6%**
January 2022 Average		**10.0**	**12.5%**	**30.0**	**31.2**	**33.4**	**12.6%**	**111.0%**	**93.6%**

For the month of March 2022, the government reopened three bonds, FXD1/2021/05, FXD1/2020/15 and FXD1/2021/25, with tenors to maturity of 4.7 years, 12.9 years, and 24.2 years, respectively, in a bid to raise Kshs 50.0 bn for budgetary support. The period of sale for the issue runs from 24th February 2022 to 8th March 2022. The coupon rates are 11.3%, 12.8% and 13.9% for FXD1/2021/05, FXD1/2020/15 and FXD1/2021/25, respectively. We expect investors to prefer the longer dated paper, FXD1/2021/25, in search of higher yields. The bonds are currently trading in the secondary market at yields of 11.5%, 13.1% and 13.8%, for FXD1/2021/05, FXD1/2020/15 and FXD1/2021/25, respectively, and as such, our recommended bidding range for the three bonds is: 11.3%-11.7% for FXD1/2021/05, 12.9%-13.3% for FXD1/2020/15 and 13.6%-14.0% for FXD1/2021/25 within which range bonds of a similar tenor are trading at.

Secondary Bond Market:

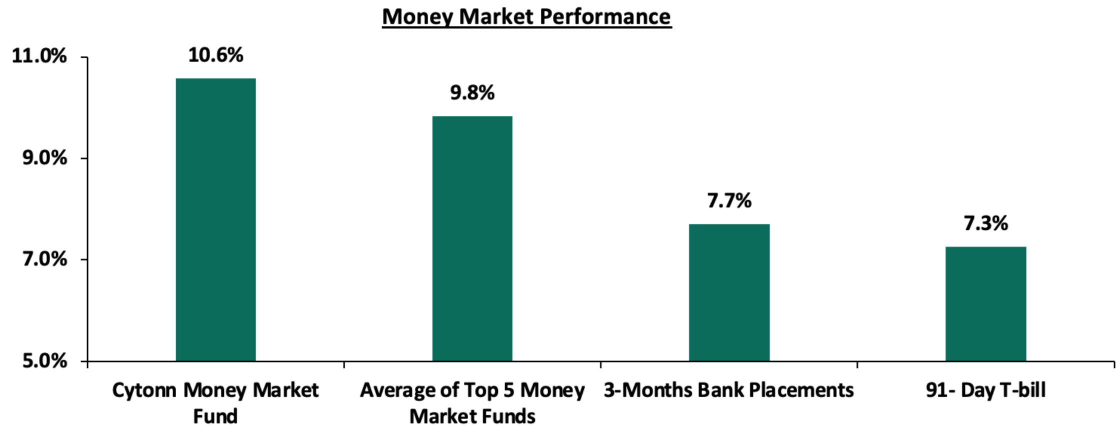
In the month of February 2022, the yields on government securities in the secondary market remained relatively stable, with the FTSE NSE bond index gaining marginally by 0.2% to close the month at Kshs 96.5, from Kshs 96.4 recorded in January 2022, bringing the YTD performance to a gain of 0.5%. The chart below shows the yield curve movement during the period:



The secondary bond turnover increased by 14.9% to Kshs 53.8 bn, from Kshs 46.8 bn recorded in January 2022, pointing towards increased activity by commercial banks in the secondary bonds market. On a year on year basis, the bonds turnover increased by 25.9% to Kshs 892.9 bn, from Kshs 709.4 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 increased by 1.1 bps to 7.3%. The average yield of the Top 5 Money Market Funds remained relatively unchanged at 9.8%, as recorded the previous week while the yield on the Cytonn Money Market Fund increased marginally by 0.2% points to 10.6%, from 10.4% recorded the previous week.



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

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

Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund	10.6%
2	Zimele Money Market Fund	9.9%
3	Nabo Africa Money Market Fund	9.7%
4	Sanlam Money Market Fund	9.6%
5	GenCap Hela Imara Money Market Fund	9.3%
6	Madison Money Market Fund	9.3%
7	Apollo Money Market Fund	9.3%
8	Dry Associates Money Market Fund	8.9%
9	CIC Money Market Fund	8.9%
10	Orient Kasha Money Market Fund	8.7%
11	Co-op Money Market Fund	8.6%
12	ICEA Lion Money Market Fund	8.4%
13	NCBA Money Market Fund	8.4%
14	British-American Money Market Fund	8.3%
15	AA Kenya Shillings Fund	7.7%
16	Old Mutual Money Market Fund	7.3%

Source: Business Daily

Liquidity:

Liquidity in the money markets tightened in the month of February 2022, with the average interbank rate increasing to 4.7%, from 4.5% recorded in January 2022, partly attributable to tax remittances which offset government payments. During the week, liquidity in the money markets remained ample, with the average interbank rate remaining unchanged at 5.5%, as recorded the previous week, partly attributable to government payments which offset tax remittances. The average interbank volumes traded increased by 139.0% to Kshs 12.0 bn, from Kshs 5.0 bn recorded the previous week.

Kenya Eurobonds:

During the month, the yields on the Eurobonds were on an upward trajectory partly attributable to increased selloffs by foreign investors. The yield on the 30-year Eurobond issued in 2018 increased by 0.9% points to 9.6% from 8.7%, recorded in January 2022 while the yields on the 10-year Eurobonds issued in 2014 and 2018 gained by 1.2% points and 1.5% points to 5.4% and 8.1%, from 4.2% and 6.6%, respectively. Similarly, yields on the 7-year and the 12-year Eurobonds issued in 2019 and the 12-year Eurobond issued in 2021, increased by 1.8% points, 1.6% points and 1.5% points to 8.2%, 8.8% and 8.6%, from 6.3%, 7.2% and 7.1%, respectively, recorded in January 2022.

During the week, the yields on Eurobonds were on an upward trajectory partly attributable to increased sell offs by foreign investors partly due to the rising geopolitical tension between Russia and Ukraine, with investors preferring safer havens. The yields on the 10-year Eurobond issued in

2014 and the 12-year bond issued in 2021, both increased by 0.4% points to 5.5% and 8.7%, respectively. Similarly, the 7-year and 12-year Eurobonds issued in 2019 increased by 0.6% points and 0.1% points to 8.4% and 9.0%, respectively. The 10-year Eurobond issued in 2018 increased by 0.2% points to 8.4% while the 30-year 2018 issue remained unchanged at 9.7% as recorded the previous week:

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**
3-Jan-22	4.4%	5.8%	8.1%	5.6%	6.7%	6.6%
31-Jan-22	4.2%	6.6%	8.7%	6.3%	7.2%	7.1%
25-Feb-22	5.1%	8.2%	9.7%	7.8%	8.9%	8.3%
28-Feb-22	5.4%	8.1%	9.6%	8.1%	8.8%	8.6%
1-March-22	5.3%	8.2%	9.7%	8.2%	8.2%	8.5%
2-March-22	5.4%	8.4%	9.7%	8.3%	8.9%	8.5%
3-March-22	5.5%	8.4%	9.7%	8.4%	9.0%	8.7%
Weekly Change	**0.4%**	**0.2%**	**0.0%**	**0.6%**	**0.1%**	**0.4%**
M/M Change	**1.2%**	**1.5%**	**0.9%**	**1.8%**	**1.6%**	**1.5%**
YTD Change	**1.1%**	**2.6%**	**1.6%**	**2.8%**	**2.3%**	**2.1%**

Source: CBK

Kenya Shilling:

During the month, the Kenya Shilling depreciated by 0.2% against the US Dollar, to close the month at Kshs 113.8, from Kshs 113.6 recorded at the end of January 2022, 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, depreciating marginally by 0.1% against the US dollar to close the week at Kshs 113.9, from Kshs 113.8 recorded the previous week, partly attributable to increased dollar demand from the oil and energy sectors. Key to note, this is the lowest the Kenyan shilling has ever depreciated against the dollar. On a year to date basis, the shilling has depreciated by 0.7% 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. An 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, attributable 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 18.4% to Kshs 8.0 tn in December 2021, from Kshs 1.5 tn in December 2011 thus putting pressure on forex reserves to service 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.

The shilling is however expected to be supported by:

i. High Forex reserves currently at USD 7.9 bn (equivalent to 4.8-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 21.7% y/y increase to USD 338.7 mn in January 2022, from USD 278.3 mn recorded over the same period in 2021, which has continued to cushion the shilling against further depreciation.

Weekly Highlights:

I. **February 2022 Inflation**

The y/y inflation for the month of February 2022 declined for the fifth consecutive month to 5.1%, from the 5.4% recorded in January 2022, lower than our expectation of 5.3% - 5.7%. The decline is mainly attributable to the slower 4.5% growth in the transport index compared to the 6.8% growth recorded in January 2022. On a month on month basis, the inflation rate came in at 0.4%, driven by a 0.8% increase in food & non-alcoholic beverages coupled with a 0.7% increase in furnishings, household equipment and routine household maintenance. The table below shows a summary of both the year on year and month on month commodity groups' performance;

Major Inflation Changes – February 2022

Broad Commodity Group	Price change m/m (February-22/ January-22)	Price change y/y (February-22/ February-21)	Reason
Food & Non-Alcoholic Beverages	0.8%	8.7%	The m/m increase was mainly contributed by increase in prices of cooking fat, capsicum, potatoes and sifted maize flour, among other food items. The increase was, however, mitigated by a decline in prices of mangoes, goat milk and cabbages.
Housing, Water, Electricity, Gas and other Fuel	0.1%	4.8%	The m/m increase was mainly attributable to a 0.2% increase in house rent for a single room in February 2022.
Transport Cost	0.1%	4.5%	The m/m marginal increase was as a result of unchanged prices for super petrol, diesel and kerosene during the month.
Overall Inflation	**0.4%**	**5.1%**	**The m/m increase was driven by a 0.8% increase in food & non-alcoholic beverages coupled with a 0.7% increase in furnishings, household equipment and routine household maintenance.**

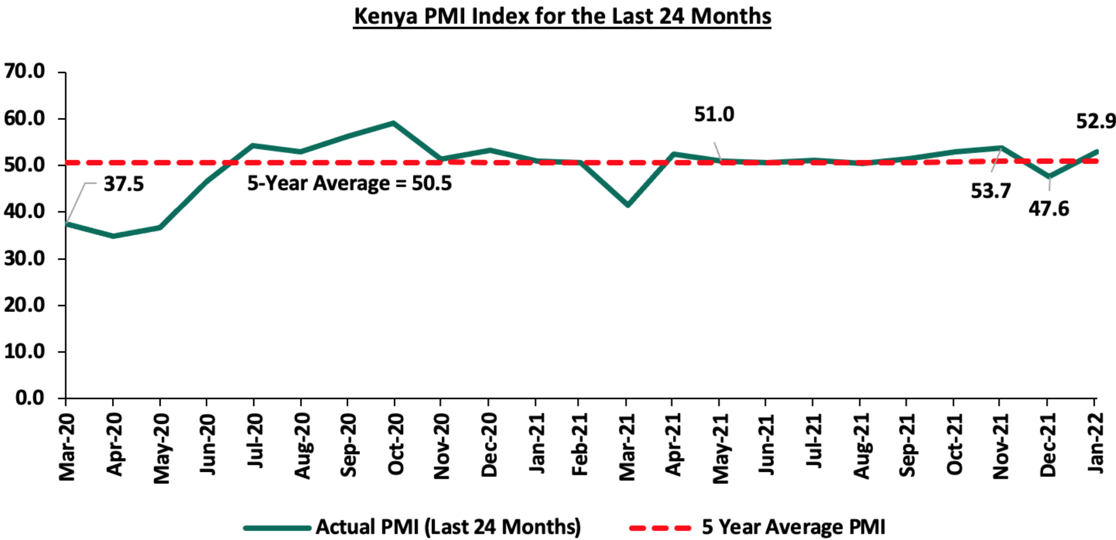
Source: KNBS

We expect the inflation rate to remain within the government's set range of 2.5% - 7.5%. Despite the decline in February'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 price, which stood at USD 117.1 per barrel as of 3rd March 2022, marking a 10-year high, is expected to deplete the fuel subsidy program currently in place and further lead to a depreciation of the local currency.

II. Stanbic Bank's Monthly Purchasing Manager's Index (PMI)

During the week, Stanbic Bank released its monthly Purchasing Manager's Index (PMI) highlighting that the index for the month of February 2022 increased to 52.9 following a nine-month low of 47.6 recorded in January 2022. The index points towards a strengthened business environment in the country on the back of continued economic recovery as COVID-19 cases continue to decline. Notably, purchasing activity grew at the fastest rate in 16 months, allowing businesses to build their inventories amid greater confidence that sales would continue to rise. However, overall input cost pressures in the Kenyan private sector remained elevated in February 2022 marking a 42 month high since September 2018 occasioned by a rise in input demand coupled with higher taxes as well as rising global fuel prices. Additionally, employment growth declined for the first time in ten months on the back of strained cash flows. The chart below summarizes the evolution of the PMI over the last 24 months:



*** *Key to note, a reading above 50.0 signals an improvement in business conditions, while readings below 50.0 indicate a deterioration.*

Despite the improvement in the PMI index in February 2022, we maintain a cautious outlook in the short-term owing to the increasing cost pressures, high cost of living and political pressures ahead of the August 2022 elections. The existence and emergence of new COVID-19 variants still pose economic uncertainty as it may lead to another wave of infections and consequently tighter restrictions that will further negatively affect the general business environment. In the FY'2021/2022 Supplementary Budget I, the Ministry of Health was allocated Kshs 136.0 bn, a 12.3% increase from the Kshs 121.1 bn original estimates to aid in combating the COVID-19 pandemic and curb its spread through the acquisition of more vaccines. As such, we look forward to see these efforts support the economic recovery and consequently trickle down to improving the country's PMI as already seen in the February PMI. However, we note that the private sector credit growth has remained relatively muted, coming in at 8.6% in December 2021, lower than the historical average of 10.3%. Further, with fuel being a major input cost to many businesses, we expect the increasing global fuel prices to further contribute to the deterioration of business conditions in the country. Additionally, we believe the stabilization under the fuel subsidy program by the National Treasury is unsustainable given the continued rise in global fuel prices coupled with the diversion of funds under the program to cater for other government expenditure.

Monthly Highlights:

i. The National Treasury gazetted the revenue and net expenditures for the first seven months of FY'2021/2022, ending 31st January 2022, highlighting that the total revenue collected as at the end of January 2022 amounted to Kshs 1.1 tn, equivalent to 60.6% of the original estimates of Kshs 1.8 tn and is 103.8% of the prorated estimates of Kshs 1.0 tn while the total expenditure amounted to Kshs 1.6 tn, equivalent to 50.2% of the original estimates of Kshs 3.2 tn, and is 86.1% of the prorated expenditure estimates of Kshs 1.9 tn. For more information, see our Cytonn Weekly #07/2022.

Rates in the Fixed Income market have remained stable due to the relatively ample liquidity in the money market. The government is 11.4% ahead of its prorated borrowing target of Kshs 455.9 bn having borrowed Kshs 508.0 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 1.1 tn during the first seven months of the current fiscal year, which was equivalent to 103.8% 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. Owing to this, our view is that investors should be biased towards short-term fixed-income securities to reduce duration risk.