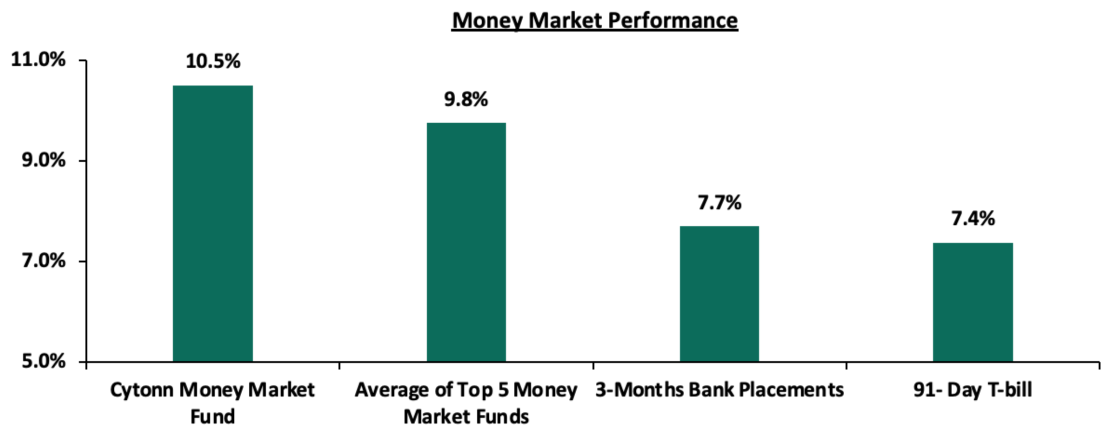
Real Estate Investment Trusts (REITs) Performance in Kenya, & Cytonn Weekly #14/2022

Fixed Income

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

During the week, T-bills remained undersubscribed, with the overall subscription rate coming in at 60.4%, up from the 29.7% recorded last week, partly attributable to the tightened liquidity in the market, with the average interbank rate coming in at 4.8%, from 4.6% recorded the previous week. The 364-day paper recorded the highest subscription rate, receiving bids worth Kshs 8.2 bn against the offered Kshs 10.0 bn, translating to a subscription rate of 81.7%, an increase from the 24.7% recorded the previous week. The higher preference for the 364-day paper is attributable to its higher yield of 9.7% compared to the 7.4% 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 increased to 59.6% and 39.3%, respectively, from 38.1% and 31.3%, recorded the previous week. The yields on the government papers recorded mixed performance with yields on the 91-day and 182-day papers increasing by 7.5 bps and 5.5 bps, to 7.4% and 8.2%, respectively while the yield on the 364-day paper declined by 0.9 bps to 9.7%. The government accepted bids worth Kshs 14.4 bn, out of the Kshs 14.5 bn worth of bids received, translating to an acceptance rate of 99.6%, reflecting the government’s debt appetite.

In the Primary Bond Market, the government released the auction results for the recently issued three-year treasury bond, FXD1/2022/03, which recorded an undersubscription of 85.1%, partly attributable to the tightened liquidity in the money markets. The government sought to raise Kshs 40.0 bn for budgetary support, received bids worth Kshs 34.0 bn and accepted bids worth Kshs 33.1 bn, translating to a 97.3% acceptance rate. The bond had a coupon rate and a market weighted average rate of 11.8%. For the month of April, the Government had opened one other bond, namely; FXD1/2022/15, whose period of sale will end on 19th April 2022 and we expect investors to prefer this longer dated bond in search of higher yields on a risk-adjusted basis. Bonds of a similar tenor to maturity are currently trading at yields in the range of 13.1%-13.6%.



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 7.5 bps to 7.4%. The average yield of the Top 5 Money Market Funds declined marginally by 0.1% points to 9.8%, from 9.9% recorded the previous week while the yield on the Cytonn Money Market Fund remained relatively unchanged at 10.5%, as recorded the previous week.

The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 8th April 2022:

Money Market Fund Yield for Fund Managers as published on 8th April 2022

Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund	10.5%
2	Zimele Money Market Fund	9.9%
3	Nabo Africa Money Market Fund	9.8%
4	Sanlam Money Market Fund	9.3%
5	Apollo Money Market Fund	9.3%
6	Dry Associates Money Market Fund	9.2%
7	CIC Money Market Fund	9.0%
8	Madison Money Market Fund	8.9%
9	GenCap Hela Imara Money Market Fund	8.6%
10	Co-op Money Market Fund	8.5%
11	Orient Kasha Money Market Fund	8.4%
12	NCBA Money Market Fund	8.4%
13	ICEA Lion Money Market Fund	8.3%
14	British-American Money Market Fund	8.0%
15	AA Kenya Shillings Fund	7.9%
16	Old Mutual Money Market Fund	7.7%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets tightened, with the average interbank rate increasing to 4.8%, from 4.6%, recorded the previous week, partly attributable to government payments which offset tax remittances. The average interbank volumes traded increased by 99.8% to Kshs 28.7 bn, from Kshs 14.4 bn recorded the previous week.

Kenya Eurobonds:

During the week, the yields on Kenyan Eurobonds were on an upward trajectory, partly attributable to investors attaching higher risk premium on the country due to increasing inflationary pressures, local currency depreciation and risks abound the August 2022 elections. Yields on the 10-year bond issued in 2014, 10-year and 30-year bonds issued in 2018, 12-year bond issued in 2019 and the 12-year bond issued in 2021 all increased by 0.3% points to 7.0%, 8.3%, 9.7%, 8.8% and 8.6%, respectively. Similarly, yields on the 7-year bond issued in 2019 increased by 0.2% points to 8.3%. 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**
3-Jan-22	4.4%	8.1%	8.1%	5.6%	6.7%	6.6%
1-April-22	6.7%	8.1%	9.4%	8.1%	8.5%	8.3%
4-April-22	6.7%	8.1%	9.4%	8.1%	8.6%	8.3%
5-April-22	6.7%	8.0%	9.4%	8.1%	8.6%	8.3%
6-April-22	6.9%	8.3%	9.5%	8.4%	8.7%	8.6%
7-April-22	7.0%	8.3%	9.7%	8.3%	8.8%	8.6%
Weekly Change	**0.3%**	**0.2%**	**0.3%**	**0.2%**	**0.3%**	**0.3%**
MTD Change	**0.3%**	**0.2%**	**0.3%**	**0.2%**	**0.3%**	**0.3%**
YTD Change	**2.6%**	**0.2%**	**1.6%**	**2.7%**	**2.1%**	**2.0%**

Source: CBK

Kenya Shilling:

During the week, the Kenyan shilling depreciated by 0.3% against the US dollar, to close the week at Kshs 115.3, from Kshs 115.0 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 1.9% 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:

i. Rising global crude oil prices on the back of supply constraints and geopolitical pressures at a time when demand is picking up with the easing of COVID-19 restrictions and as economies reopen. Key to note, risks abound the recovery following the emergence of the new COVID-19 variants,
ii. Increased demand from merchandise traders as they beef up their hard currency positions in anticipation for more trading partners reopening their economies globally,
iii. 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 5.6% of GDP in the 12 months to February 2022 compared to the 4.3% for a similar period in 2021. The wider deficit reflects a higher import bill, particularly for oil, which more than offset increased receipts from agricultural and services exports, and remittances, and,
iv. 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.

The shilling is however expected to be supported by:

i. High Forex reserves currently at USD 8.4 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, USD 972.6 mn IMF disbursement, USD 130.0 mn World Bank loan financing received in June 2021, and, the USD 750.0 mn World Bank loan facility issued in March 2022, and,

ii. Improving diaspora remittances evidenced by a 23.5% y/y increase to USD 321.5 mn as of February 2022, from USD 260.3 mn recorded over the same period in 2021, which has continued to cushion the shilling against further depreciation.

Weekly Highlights:

I. **FY'2021/2022 Budget Statement**

During the week, Cabinet Secretary for the National Treasury presented the FY'2022/2023 Budget Statement before parliament. The table below summarizes the key buckets and the projected changes:

Draft Budget Estimates FY'2022/23 (Kshs billions)

Item	FY'2021/22 Approved Budget	FY'2022/23 Estimates	Change y/y (%)
Total revenue	2,038.6	2,447.0	20.0%
Total grants	62.0	33.3	(46.3%)
Total revenue & grants	**2,100.6**	**2,480.3**	**18.1%**
Recurrent expenditure	2,071.8	2,257.3	9.0%
Development expenditure & Net Lending	667.7	715.5	7.2%
County Transfer & Contingencies	414.9	370.0	(10.8%)
Total expenditure	**3,154.4**	**3,342.8**	**6.0%**
Projected Deficit as % of GDP	8.1%	6.2%	(1.9%) pts
Net foreign borrowing	334.0	280.7	(16.0%)
Net domestic borrowing	661.6	581.7	(12.1%)
Total borrowing	**995.6**	**862.4**	**(13.4%)**

Source: Exchequer Feb 2022 issue and FY'2022/23 Budget Statement, National Treasury of Kenya

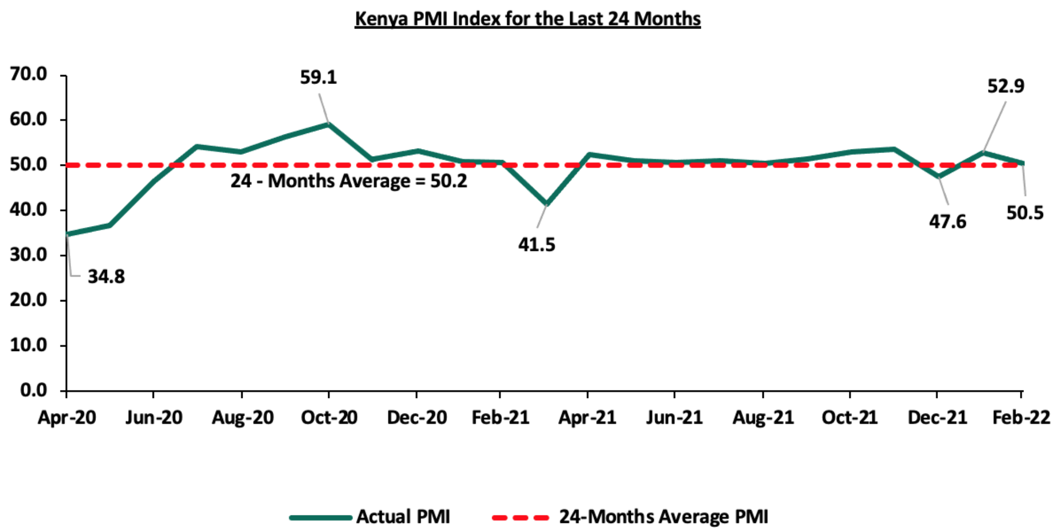
Some of the key take-outs include;

i. The government projects total revenue for FY'2022/23 to increase by 20.0% to Kshs 2.4 tn from the Kshs 2.2 tn in FY'2021/2022. The increase is mainly due to a 25.4% increase in ordinary revenue to Kshs 2.1 tn from the Kshs 1.8 tn collected in FY'2021/22,
ii. Total expenditure is set to increase by 6.0% to Kshs 3.3 tn (equivalent to 23.9% of GDP), from Kshs 3.2 tn (equivalent to 25.0% of GDP) in the FY'2021/22 Budget,
iii. Recurrent expenditure is set to increase by 9.0% to Kshs 2.3 tn in FY'2022/23, from Kshs 2.1 tn in FY'2021/22 budget, while development expenditure is projected to increase by 7.2% to Kshs 715.5 bn in FY'2022/23, from Kshs 667.7 bn as per the FY'2021/22 budget,
iv. Public debt is expected to continue growing in FY'2022/23, as the approximate Kshs 862.5 bn fiscal deficit will be financed through domestic debt totaling Kshs 581.7 bn and foreign debt totaling Kshs 280.7 bn, and,
v. The budget deficit is projected to decline to Kshs 862.4bn (6.2% of GDP) from the projected Kshs 995.6 bn (8.1% of GDP) in the FY'2021/22 budget, mainly as growth in revenues outpace growth in expenditure.

The FY'2022/2023 budget points to an expansionary budget which is meant to accelerate the economic recovery. In our view, however, there are still concerns on how the government will be able to meet its revenue collection targets given that the rising cost of living affecting commodities demand, erratic weather conditions affecting the Agriculture sector and uncertainties around the upcoming August elections. Additionally, despite the fiscal deficit being estimated to decline to 6.2% of GDP, debt sustainability remains a key concern as the debt to GDP ratio remains at 66.2%, significantly above the recommended IMF threshold of 50.0% and debt servicing expenditure to total revenue ratio increasing to 53.8% in FY'2022/23 from 52.4% in FY'2021/22. We shall be focusing on this fiscal year's budget in detail in the coming weeks.

II. **Stanbic Bank's March 2022 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 March 2022 declined to 50.5 from 52.9 recorded in February 2022 pointing towards marginal improvement in the Kenyan private sector. The decline was partly attributable to rise in input costs and output charges which led to increased cost pressures on the consumers. Key to note, purchasing activity continued to increase despite the rise in prices as businesses sought to restock goods amid concerns that supply would worsen. Additionally, firms reported a slight increase in employment in March, as they worked to increase capacity and close new sales. 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.*

Kenya's general business environment has deteriorated in the first three months of 2022 with the average PMI coming in at 50.3, lower than the 51.6 that was recorded in a similar period in 2021. Going forward, we maintain a cautious outlook in the short-term owing to the continued rise in cost of fuel and production materials which has led to reduced consumer spending. 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 that the stabilization under the fuel subsidy program by the National Treasury is unsustainable given the continued rise in the average landed cost of fuel. Further, the uncertainties surrounding the upcoming August elections, are likely to have a negative effect on the business environment due to a possible cautious approach taken by business owners to reduce spending leading to a slowdown in manufacturing activities.

Rates in the Fixed Income market have remained stable due to the relatively ample liquidity in the money market. The government is 8.9% ahead of its prorated borrowing target of Kshs 521.7 bn having borrowed Kshs 568.0 bn of the Kshs 661.6 bn borrowing target for the FY'2021/2022. We expect a gradual economic recovery as evidenced by the revenue collections of Kshs 1.2 tn during the first eight months of the current fiscal year, which was equivalent to 100.8% of the prorated revenue collection target. However, despite the projected high budget deficit of 11.4% and the affirmation of the `B+' rating with

negative outlook by Fitch Ratings, 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.

Liason House, StateHouse Avenue
The Chancery, Valley Road
www.cytonn.com