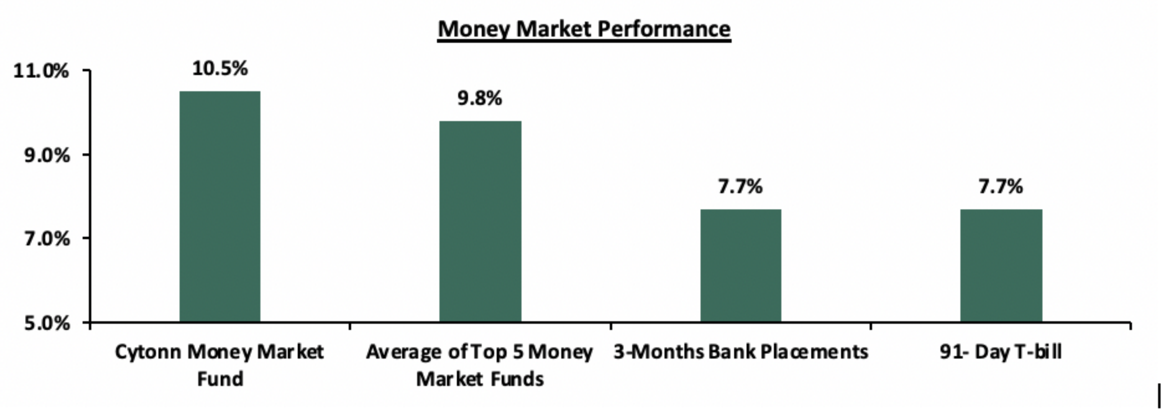
Currency Outlook, & Cytonn Weekly #19/2022

Fixed Income

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

During the week, T-bills were oversubscribed, with the overall subscription rate coming in at 102.3%, up from 70.2% recorded the previous week, on the back of increasing yields and eased liquidity in the money market with the average interbank rates declining to 4.6%, from the 4.8% recorded the previous week. The 91-day paper recorded the highest subscription rate, receiving bids worth Kshs 5.3 bn against the offered Kshs 4.0 bn, translating to a subscription rate of 132.0%, a marginal increase from the 131.3% recorded the previous week. The continued investor preference for the 91-day paper is partly attributable to the higher return on a risk-adjusted basis. The subscription rate for the 364-day and 182-day papers increased to 113.4% and 79.3%, from 78.8% and 37.2%, respectively, recorded the previous week. The yields on the government papers were on an upward trajectory, with the yields on the 364-day, 182-day and the 91-day papers increasing by 2.0 bps, 18.0 bps and 10.3 bps to 9.9%, 8.7% and 7.7%, respectively. The government accepted Kshs 23.1 bn worth of bids out of Kshs 24.5 bn received, translating to an acceptance rate of 94.1%.

In the Primary Bond Market, the government released the auction results for the recently issued ten-year and twenty-five year bonds, FXD1/2022/10 and FXD1/2021/25, which recorded an undersubscription of 71.9%, partly attributable to the relatively tight but recovering money market liquidity. The government sought to raise Kshs 60.0 bn for budgetary support, received bids worth Kshs 43.1 bn and accepted bids worth Kshs 31.7 bn, translating to a 73.6% acceptance rate. The longer dated paper, FXD1/2021/25 had a coupon rate of 13.9% and a market weighted average rate of 14.0% while FXD1/2022/10 had a coupon and weighted average rate of 13.5%.



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 10.3 bps to 7.7%. The average yield of the Top 5 Money Market Funds and the yield on the Cytonn Money Market Fund remained relatively unchanged at 9.8% and 10.5%, respectively as recorded the previous week.

The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 13th May 2022:

Money Market Fund Yield for Fund Managers as published on 13th May 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	Madison Money Market Fund	9.5%
5	Sanlam Money Market Fund	9.2%
6	Apollo Money Market Fund	9.2%
7	CIC Money Market Fund	9.1%
8	Dry Associates Money Market Fund	9.0%
9	Co-op Money Market Fund	8.7%
10	GenCap Hela Imara Money Market Fund	8.7%
11	ICEA Lion Money Market Fund	8.6%
12	Orient Kasha Money Market Fund	8.6%
13	NCBA Money Market Fund	8.4%
14	Old Mutual Money Market Fund	7.8%
15	AA Kenya Shillings Fund	7.8%
16	British-American Money Market Fund	7.1%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets eased, with the average interbank rate declining to 4.6% from 4.8% recorded the previous week, partly attributable to government payments inclusive of Kshs 10.0 bn Term Auction deposits (TADs) maturities, which offset tax remittances. The average interbank volumes traded declined by 36.2% to Kshs 12.5 bn from Kshs 19.6 bn recorded the previous week.

Kenya Eurobonds:

During the week, the yields on Eurobonds were on an upward trajectory, partly attributable to the heightened perceived risks by investors on the back of the rising inflation and the upcoming August 2022 elections. The yields on the 10-year Eurobonds issued in 2014 and 2018 increased by 1.8% and 0.7% to 11.5% and 11.2%, from 9.7% and 10.5%, respectively, recorded the previous week. The 30-year Eurobond issued in 2018, and the 12-year Eurobond issued in 2019 both increased by 0.5% points to 12.0% and 11.5%, from 11.5% and 11.0%, respectively, recorded last week. Similarly, the 7-year bond issued in 2019 and the 12-year Eurobond issued in 2021 increased by 0.8% points and 0.4% points to 12.2% and 11.1%, from 11.3% and 10.7%, 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**
3-Jan-22	4.4%	8.1%	8.1%	5.6%	6.7%	6.6%
29-April-22	8.7%	10.0%	11.0%	10.5%	10.4%	10.0%
06-May-22	9.7%	10.5%	11.5%	11.3%	11.0%	10.7%
09-May-22	10.9%	10.8%	11.7%	11.6%	11.3%	10.0%
10-May-22	10.9%	11.0%	11.9%	11.9%	11.3%	11.1%
11-May-22	11.2%	11.1%	12.0%	11.9%	11.5%	11.1%
12-May-22	11.5%	11.2%	12.0%	12.2%	11.5%	11.1%
Weekly Change	**1.8%**	**0.7%**	**0.5%**	**0.8%**	**0.5%**	**0.4%**
M/m Change	**2.8%**	**1.2%**	**1.0%**	**1.6%**	**1.1%**	**1.1%**
YTD Change	**7.1%**	**3.1%**	**3.9%**	**6.6%**	**4.8%**	**4.5%**

Source: CBK

Kenya Shilling:

During the week, the Kenyan shilling depreciated by 0.2% against the US dollar to close the week at Kshs 116.1, from Kshs 115.9 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 2.6% 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. 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,
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. 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,
d. The aggressively growing government debt, with Kenya's public debt having increased at a 10-year CAGR of 18.6% to Kshs 8.2 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. It is worth noting that the average GDP growth over the same period has been 3.9%, an indicator that the increase in debt is not translating into GDP growth.

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 750.0 mn World Bank loan facility received in March 2022 and are expected to be boosted further by the expected USD 244.0 mn from the International Monetary Fund (IMF), and,

ii. Improving diaspora remittances evidenced by a 25.0% y/y increase to USD 363.6 mn as of March 2022, from USD 290.8 mn recorded over the same period in 2021, the highest figure ever which has continued to cushion the shilling against further depreciation.

Weekly Highlight:

I. Revenue and Net Exchequer for FY'2021/2022

The National Treasury gazetted the revenue and net expenditures for the first ten months of FY'2021/2022, ending 28th April 2022. Below is a summary of the performance:

FY'2021/2022 Budget Outturn - As at 28th April 2022

Amounts in Kshs billions unless stated otherwise

Item	12-months Original Estimates	Revised Estimates	Actual Receipts/Release	Percentage Achieved	Prorated	% achieved of prorated
Opening Balance			21.3			
Tax Revenue	1,707.4	1,741.1	1,456.2	83.6%	1,450.9	100.4%
Non-Tax Revenue	68.2	67.1	59.3	88.4%	55.9	106.1%
Total Revenue	**1,775.6**	**1,808.3**	**1,536.8**	**85.0%**	**1,506.9**	**102.0%**
External Loans & Grants	379.7	433.2	162.5	37.5%	361.0	45.0%
Domestic Borrowings	1,008.4	1,008.0	735.0	72.9%	840.0	87.5%
Other Domestic Financing	29.3	30.4	8.0	26.5%	25.3	31.7%
Total Financing	**1,417.4**	**1,471.5**	**905.6**	**61.5%**	**1,226.3**	**73.9%**
Recurrent Exchequer issues	1,106.6	1,179.4	927.2	78.6%	982.9	94.3%
CFS Exchequer Issues	1,327.2	1,309.5	957.1	73.1%	1,091.2	87.7%
Development Expenditure & Net Lending	389.2	420.9	267.3	63.5%	350.7	76.2%
County Governments + Contingencies	370.0	370.0	261.0	70.5%	308.3	84.6%
Total Expenditure	**3,193.0**	**3,279.8**	**2,412.6**	**73.6%**	**2,733.1**	**88.3%**
Fiscal Deficit excluding Grants	**(1,417.4)**	**(1,471.5)**	**(875.8)**	**59.5%**	(1,226.3)	**71.4%**
Fiscal Deficit(excluding grants) as % of GDP	**8.1%***	**8.1%***	**7.2%**			
Total Borrowing	**1,388.1**	**1,441.1**	**897.6**	**62.3%**	**1,200.9**	**74.7%**

National Treasury estimates

The key take-outs from the report include:

a. Total revenue collected as at the end of April 2022 amounted to Kshs 1,536.8 bn, equivalent to 85.0% of the revised estimates of Kshs 1,808.3 bn and is 102.0% of the prorated estimates of Kshs 1,506.9 bn. Notably, the performance is an improvement from the 100.8% performance recorded in the first eight months to February 2022, which was despite the deterioration of the business environment seen during the month of April as evidenced by the decline in the purchasing managers index (PMI) to 49.5, from 50.5 that was recorded in March 2022. Cumulatively, tax revenues amounted to Kshs 1,456.2 bn, equivalent to 83.6% of the revised estimates of Kshs 1,741.1 bn and 100.4% of the prorated estimates of Kshs 1,450.9 bn,

b. Total financing amounted to Kshs 905.6 bn, equivalent to 61.5% of the revised estimates of Kshs 1,471.5 bn and is equivalent to 73.9% of the prorated estimates of Kshs 1,226.3 bn. Additionally, domestic borrowing amounted to Kshs 735.0 bn, equivalent to 72.9% of the original estimates of Kshs 1,008.0 bn and is 87.5% of the prorated estimates of Kshs 840.0 bn,

c. The total expenditure amounted to Kshs 2,412.6 bn, equivalent to 73.6% of the revised estimates of Kshs 3,279.8 bn, and is 88.3% of the prorated expenditure estimates of Kshs 2,733.1 bn. Additionally, the net disbursements to recurrent expenditures came in at Kshs 927.2 bn, equivalent to 78.6% of the revised estimates and 94.3% of the prorated estimates of Kshs 982.9 bn, and development expenditure amounted to Kshs 267.3 bn, equivalent to 63.5% of the revised estimates of Kshs 420.9 bn and is 76.2% of the prorated estimates of Kshs 350.7 bn,
d. Consolidated Fund Services (CFS) Exchequer issues lagged behind their targets of Kshs 1,091.2 bn after amounting to Kshs 957.1 bn, equivalent to 73.1% of the revised estimates, and are 87.7% of the prorated amount of Kshs 1,091.2 bn. The cumulative public debt servicing cost amounted to Kshs 840.8 bn which is 73.0% of the original estimates of Kshs 1,151.3 bn, and is 86.3% of the prorated estimates of Kshs 974.3 bn. Additionally, the Kshs 840.8 bn debt servicing cost is equivalent to 54.7% of the actual revenues collected as at the end of April 2022 , and,
e. Total Borrowings as at the end of April 2022 amounted to Kshs 897.6 bn, equivalent to 62.3% of the revised estimates of Kshs 1,441.1 bn and are 74.7% of the prorated estimates of Kshs 1,200.9 bn. The cumulative domestic borrowing target of Kshs 1,008.0 bn comprises of adjusted Net domestic borrowings of Kshs 664.0 bn and Internal Debt Redemptions (Roll-overs) of Kshs 343.9 bn.

Despite the historical trend of the government not meeting its revenue targets, revenue performance in the first ten months of the current fiscal year is commendable. The improvement is partly due to the economy's sustained recovery following the ease of COVID-19 containment measures and the effectiveness of the KRA in revenue collection. Additionally, the recent tax initiatives such as the adoption of the Finance Act 2021 which led to the upward readjustment of the Excise Duty Tax, Income Tax as well as the Value Added Tax have played a big role in expanding the tax base and consequently enhancing revenue collection. With less than two months left in the current fiscal year, we expect the government to step up its revenue collection efforts and rely more on the domestic market to close the deficit. As a result, the government's borrowing appetite is expected to remain high as the fiscal year draws to a close. Consequently, we expect sustained gradual increase in government securities' yields in the short term. However, the key concerns remain the emergence of new COVID-19 variants both locally and with trading partners globally as well as the rising cost of living which is likely to have a negative effect on consumer spending.

II. **Fuel Prices**

During the week, the Energy and Petroleum Regulatory Authority (EPRA) released their monthly statement on the maximum fuel price in Kenya effective 15th May 2022 to 14th June 2022. Notably, super petrol, diesel and kerosene prices increased by 3.8%, 4.4% and 4.9% to Kshs 150.1 per litre, Kshs 131.0 per litre and Kshs 118.9 per litre, from Kshs 144.6 per litre, Kshs 125.5 per litre and Kshs 113.4, respectively. Key to note, the current prices are the highest ever recorded in the country. Below are the key take-outs from the statement:

The performance in fuel prices was attributable to:

i. An increase in the average landed costs of Super Petrol by 1.5% to USD 826.8 per cubic meter in April 2022, from USD 814.9 per cubic meter in March 2022,
ii. An increase in the average landed costs of Diesel by 6.5% to USD 899.4 per cubic meter in March2022, from USD 844.6 per cubic meter in 2022,
iii. An increase in the average landed costs of Kerosene by 31.1% to USD 908.7 per cubic meter in April 2022, from USD 693.0 per cubic meter in March 2022,
iv. An increase in the Free on Board (FOB) price of Murban crude oil in April 2022 by 10.4% to USD 94.0 per barrel, from USD 85.1 per barrel in March 2022, and,
v. The depreciation of the Kenyan shilling during the period by 1.0% to Kshs 115.7 in April 2022,

from Kshs 114.6 in March 2022.

However, the fuel prices were supported from further increase by:

i. The fuel subsidy program under the Petroleum Development Fund which resulted in subsidies of Kshs 26.4 on Super Petrol per litre, Kshs 43.9 on Diesel per litre and Kshs 50.3 per litreon Kerosene during the month, and,
ii. The removal of suppliers margins since October 2021.

Global fuel prices have recorded a 40.4% increase since the beginning of the year to USD 109.3 per barrel as of 12th May 2022, from USD 77.9 per barrel recorded on 3rd January 2022, driven by persistent supply chain constraints worsened by the geopolitical pressures occasioned by the Russian invasion of Ukraine. The fuel subsidy program under the National Treasury has largely cushioned Kenyans from the high fuel prices. However, we believe that the program is unsustainable and will be depleted should the average landed costs of fuel continue to rise. Further, the program has come under increasing pressure from the Oil Marketing Companies (OMCs) due to delayed payment of compensation amounts. Key to note, the compensation amounts for Diesel and kerosene in May 2022 increased by 9.2% and 89.8% to Kshs 43.9 per litre and Kshs 50.3 per litre from Kshs 40.2 per litre and Kshs 26.5 per litre, respectively in April 2022. Despite the additional Kshs 24.9 bn for stabilization of oil market prices and the rationalization of Capital expenditure, allocated in the recently assented Supplementary Budget, the National Treasury would have to disburse an estimated Kshs 15.0 bn monthly to meet the full subsidy in the period of review. As such, the additional amount to the program would be depleted in two months. Going forward, we expect the cost of living to remain high given that fuel is a major contributor to Kenya's headline inflation and fuel prices are a major input cost in majority of Kenya's sectors such as manufacturing, transport and energy. Consequently, the business environment is expected to deteriorate even further as consumers are likely to cut on spending.

Rates in the Fixed Income market have remained stable due to the relatively ample liquidity in the money market. The government is 3.5% ahead of its prorated borrowing target of Kshs 587.4 bn having borrowed Kshs 608.1 bn of the Kshs 664.0 bn borrowing target for the FY'2021/2022. We expect a gradual economic recovery as evidenced by the revenue collections of Kshs 1.5 tn during the first eight months of the current fiscal year, which was equivalent to 102.0% of the prorated revenue collection target. However, despite the projected high budget deficit of 8.1% 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.