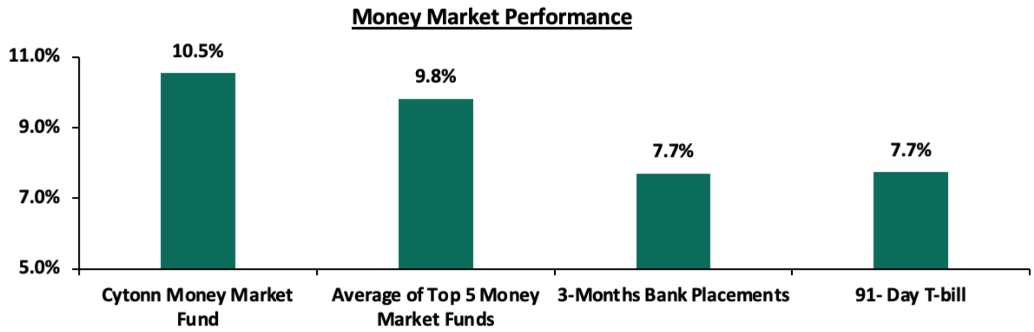
Effects of Elections on Investments Environment in Kenya, & Cytonn Weekly #21.2022

Fixed Income

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

During the week, T-bills were undersubscribed, with the overall subscription rate coming in at 54.4%, down from 116.3% recorded the previous week, partly attributable to the tightened liquidity in the money market with the average interbank rates rising to 4.6%, from the 4.4% recorded the previous week. The 364-day paper recorded the highest subscription rate, receiving bids worth Kshs 9.7 bn against the offered Kshs 10.0 bn, translating to a subscription rate of 97.2%, a decrease from the 121.9% recorded the previous week. The subscription rate for the 182-day and 91-day papers decreased to 28.5% and 12.4%, from 102.5% and 136.9%, respectively, recorded the previous week. The yields on the government papers recorded mixed performance, with the yields on the 364-day and 182-day papers increasing by 0.2 bps and 6.9 bps to 8.9% and 9.9%, respectively while the yields on the 91-day paper declined by 1.4 bps to 7.7%. The government continued to reject expensive bids accepting only Kshs 12.5 bn worth of bids out of Kshs 13.1 bn received, translating to an acceptance rate of 95.8%.

During the week, the government issued a new 18-year infrastructure bond, IFB1/2022/18 with a tenor of 18 years in a bid to raise Kshs 75.0 bn for funding Infrastructure projects. The period of sale runs from 23rd May 2022 to 7th June 2022. Key to note, the bond's coupon rate will be market-determined. We anticipate an oversubscription and a higher acceptance rate given the relatively ample liquidity in the money market coupled with the attractive tax-free nature of the bond and expected high coupon rate. Our recommended bidding range for the bond is 12.8%-13.2% within which bonds of a similar tenor are trading.



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 1.4 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 27th May 2022:

Money Market Fund Yield for Fund Managers as published on 27th 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	Apollo Money Market Fund	9.4%
5	Madison Money Market Fund	9.4%
6	Sanlam Money Market Fund	9.4%
7	CIC Money Market Fund	9.0%
8	Dry Associates Money Market Fund	8.9%
9	Co-op Money Market Fund	8.8%
10	ICEA Lion Money Market Fund	8.7%
11	GenCap Hela Imara Money Market Fund	8.7%
12	Orient Kasha Money Market Fund	8.5%
13	NCBA Money Market Fund	8.4%
14	AA Kenya Shillings Fund	7.9%
15	Old Mutual Money Market Fund	7.7%
16	British-American Money Market Fund	7.4%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets tightened, with the average interbank rate rising to 4.6% from 4.4% recorded the previous week, partly attributable to tax remittances which offset government payments. The average interbank volumes traded decreased by 21.2% to Kshs 14.4 bn from Kshs 18.3 bn recorded the previous week.

Kenya Eurobonds:

During the week, the yields on Eurobonds were on a downward trajectory, an indication of easing risk concerns over the economy by investors despite the prevailing risks surrounding the rising inflation and the upcoming elections. The yields on the 10-year Eurobonds issued in 2014 and 2018 declined by 1.8% and 1.1% points to 10.7% and 10.4%, from 12.5% and 11.5%, respectively, recorded the previous week. Similarly, the 7-year and 12-year Eurobonds issued in 2019 declined by 2.1% points and 1.4% points to 10.5% and 10.3%, from 12.6% and 11.7%, respectively. The 30-year Eurobond issued in 2018, and the 12-year Eurobond issued in 2021 declined by 1.0% and 1.2% points to 11.0% and 9.7% from 12.0% and 10.9% 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**
03-Jan-22	4.4%	8.1%	8.1%	5.6%	6.7%	6.6%
02-May-22	8.8%	10.0%	11.1%	10.5%	10.8%	10.3%
20-May-22	12.5%	11.5%	12.0%	12.6%	11.7%	10.9%
23-May-22	12.1%	11.4%	11.9%	12.2%	11.5%	10.6%
24-May-22	12.1%	11.2%	11.6%	11.8%	11.3%	10.6%
25-May-22	11.7%	11.0%	11.4%	11.3%	11.2%	10.2%
26-May-22	10.7%	10.4%	11.0%	10.5%	10.3%	9.7%
Weekly Change	**(1.8%)**	**(1.1%)**	**(1.0%)**	**(2.1%)**	**(1.4%)**	**(1.2%)**
MTD Change	**1.9%**	**0.4%**	**(0.1%)**	**0.0%**	**(0.5%)**	**(0.6%)**
YTD Change	**6.3%**	**2.3%**	**2.9%**	**4.9%**	**3.6%**	**3.1%**

Source: Central Bank of Kenya (CBK)

Kenya Shilling:

During the week, the Kenyan shilling depreciated by 0.2% against the US dollar to close the week at Kshs 116.7, from Kshs 116.4 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 3.1% 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 5.1% of GDP in the 12 months to April 2022 compared to the 4.8% 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 8.2 bn (equivalent to 4.9-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 an 18.6% y/y increase to USD 355.0 mn as of April 2022, from USD 299.3 mn recorded over the same period in 2021which has continued to cushion the shilling against further depreciation. In the recently released April 2022 diaspora remittances figures, North America remained the largest source of remittances to Kenya accounting for 61.7% in the period, followed by Europe at 17.2% while the rest of the world accounted for 21.1% of the total.

Weekly Highlight:

May 2022 inflation projections

We are projecting the y/y inflation rate for May 2022 to fall within the range of 6.7%-7.1%. The key drivers include:

i. Increasing fuel prices - Fuel prices for the period 15th May 2022 to 14th June 2022 increased by 3.8% to Kshs 150.1 per litre for Super Petrol, 4.4% to Kshs 131.0 per litre for Diesel and 4.9% to Kshs 118.9 per litre for Kerosene. With fuel being a major contributor to Kenya's headline inflation, we expect the increasing fuel prices to continue to exerting upward pressure on the inflation basket,
ii. Increasing food prices - This was evidenced by the 12.2% y/y increase in the prices food & non-alcoholic beverages as of April 2022 due to increased costs of production. Food prices increased by 3.0% m/m from March 2022 mainly due to increases in the prices of potatoes, fresh milk and wheat flour among other food items occasioned by adverse weather conditions in most parts of the country, and,
iii. The price of electricity which reduced by 15.7% 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. The reduction in electricity costs helped prices of goods remain stable during the month of April 2022 due to lower production costs.

Going forward, we expect the inflation rate to remain within the government’s set range of 2.5% - 7.5%. However, concerns remain high on the inflated import bill and widening trade deficit as global fuel prices continue to rise due to supply bottlenecks worsened by the geopolitical tensions arising from the Russia-Ukraine invasion. We expect increased inflationary pressure mainly due to the rising global fuel prices as fuel prices are a substantial input cost in the bulk of Kenya’s sectors such as manufacturing, transport and energy. Further, the erratic rainfall being witnessed in majority of the country is expected to continue driving food prices upwards, which will in turn continue to exert upward pressure on the inflation basket.

Key to note the Central Bank of Kenya’s Monetary Policy Committee (MPC) is set to meet on Monday, 30th May 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). We anticipate the MPC taking a wait-and-see approach as it continues to monitor the country's economic conditions and maintain the Central Bank Rate

(CBR) at 7.00%. For a detailed analysis on this, please see our MPC Note here.

Rates in the Fixed Income market have remained stable due to the relatively ample liquidity in the money market. The government is 1.3% ahead of its prorated borrowing target of Kshs 612.9 bn having borrowed Kshs 620.8 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 ten 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.