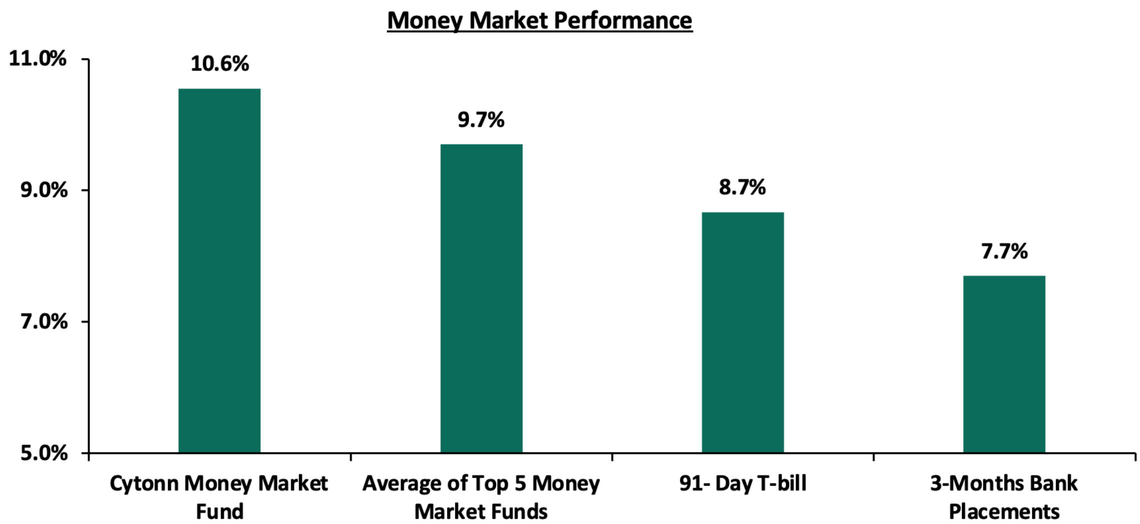
Post Elections Economic Focus, & Cytonn Weekly #33/2022

Fixed Income

Money Markets, T-Bills Primary Auction:

During the week, T-bills remained undersubscribed, with the overall subscription rate coming in at 82.1%, up from the 72.4% recorded the previous week. The increase in the subscription rate was partly attributable to the relatively eased liquidity in the money market as well as the prevailing high yields on the government securities. Investors' preference for the shorter 91-day paper persisted, with the paper receiving bids worth Kshs 11.8 bn against the offered Kshs 4.0 bn, translating to a subscription rate of 294.3%, down from the 299.8% recorded the previous week. The subscription rate for the 182-day paper increased to 68.0% from 39.3% while that of the 364-day paper declined to 11.4% from 14.5% recorded the previous week. The yields on the government papers recorded mixed performance with the yields on the 182-day and 91-day papers increasing by 5.9 bps and 10.4 bps to 9.5% and 8.7%, respectively, while the yields on the 364-day paper declined by 1.3 bps to 9.9%. The government accepted a total of Kshs 19.7 bn worth of bids, translating to an acceptance rate of 99.9%.

In the Primary Bond Market, the Central Bank of Kenya released results for the recently re-opened bonds; FXD1/2022/03, FXD2/2019/10 and FXD1/2021/20 with effective tenors of 2.7 years, 6.7 years and 19.1 years and coupon rates of 11.8%, 12.3% and 13.4%, respectively. In line with our expectations, the bonds recorded an undersubscription of 98.3%, partly attributable to investors' preference for the shorter dated papers as they sought to avoid duration risks and partly due to the tightened liquidity during the period of issue. The government issued the bonds seeking to raise Kshs 50.0 bn for budgetary support, received bids worth Kshs 49.1 bn and accepted bids worth Kshs 38.5 bn, translating to a 78.4% acceptance rate. The weighted average yields for the three bonds were 12.4% for FXD1/2022/03, 13.9% for FXD2/2019/10 and 14.0% for FXD1/2021/20.



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 10.4 bps to 8.7%. The average yield of the Top 5 Money Market Funds and the Cytonn Money Market Fund remained relatively unchanged at 9.7% and 10.6% respectively, as was recorded last week. The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 19th August 2022:

Money Market Fund Yield for Fund Managers as published on 19th August 2022

Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund	10.6%
2	Zimele Money Market Fund	9.9%
3	Sanlam Money Market Fund	9.6%
4	Old Mutual Money Market Fund	9.3%
5	Apollo Money Market Fund	9.2%
6	Nabo Africa Money Market Fund	9.2%
7	Dry Associates Money Market Fund	9.2%
8	Madison Money Market Fund	9.1%
9	NCBA Money Market Fund	9.1%
10	CIC Money Market Fund	9.0%
11	Co-op Money Market Fund	8.9%
12	GenCap Hela Imara Money Market Fund	8.9%
13	ICEA Lion Money Market Fund	8.6%
14	Orient Kasha Money Market Fund	8.4%
15	AA Kenya Shillings Fund	7.7%
16	British-American Money Market Fund	7.4%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets relatively eased, with the average interbank rate declining to 5.56% from 5.61% recorded the previous week, partly attributable to government payments that offset tax remittances. The average interbank volumes traded declined by 13.9% to Kshs 22.3 bn from Kshs 25.9 bn recorded the previous week.

Kenya Eurobonds:

During the week, the yields on all Eurobonds were on an upward trajectory, partly attributable to investors heightened perceived risks arising from increasing inflationary pressures and the persistent local currency depreciation. Yields on the 10-year Eurobond issued in 2014 recorded the highest increase of 2.8% points to 14.7% from 11.9%, recorded the previous week. The table below shows the summary of the performance of the Kenyan Eurobonds as of 18th August 2022;

Kenya Eurobonds 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-Jul-22	16.2%	14.9%	13.3%	16.3%	14.0%	13.3%

Kenya Eurobonds Performance

	2014	2018		2019		2021
Date	**10-year issue**	**10-year issue**	**30-year issue**	**7-year issue**	**12-year issue**	**12-year issue**
12-Aug-22	11.9%	11.8%	11.2%	12.5%	11.5%	10.2%
15-Aug-22	12.2%	12.1%	11.3%	12.6%	11.7%	10.3%
16-Aug-22	14.6%	12.4%	11.7%	13.3%	12.3%	10.8%
17-Aug-22	14.8%	12.5%	11.7%	13.7%	12.4%	10.9%
18-Aug-22	14.7%	12.8%	11.9%	14.1%	12.6%	10.8%
Weekly Change	**2.8%**	**1.0%**	**0.7%**	**1.6%**	**1.1%**	**0.6%**
MTD Change	**(1.5%)**	**(2.1%)**	**(1.4%)**	**(2.2%)**	**(1.4%)**	**(2.5%)**
YTD Change	**10.3%**	**4.7%**	**3.8%**	**8.5%**	**5.9%**	**4.2%**

Source: Central Bank of Kenya (CBK)

Kenya Shilling:

During the week, the Kenyan shilling continued to depreciate against the US dollar to close the week at Kshs 119.6, a 0.2% depreciation from Kshs 119.3 recorded the previous week, partly attributable to increased dollar demand from the oil and energy sectors against a slower supply of hard currency. On a year to date basis, the shilling has depreciated by 5.7% against the dollar, higher than the 3.6% depreciation recorded in 2021. We expect the shilling to remain under pressure in 2022 as a result of:

a. High global crude oil prices on the back of persistent supply chain bottlenecks coupled with high demand as most economies gradually recover,
b. Increased demand from merchandise traders as they beef up their hard currency positions in anticipation for increased demand as economies pick up,
c. An ever-present current account deficit due to an imbalance between imports and exports, with Kenya's current account deficit estimated at 5.3% of GDP in the 12 months to May 2022 compared to the 5.0% within a similar period in 2021. The wider deficit reflects a higher import bill, particularly for petroleum products, with the imports for Q1'2022 increasing by 14.5%, 5.7% points higher than the 8.8% increase in exports, and,
d. The aggressively growing government debt, with Kenya's public debt having increased at a 10-year CAGR of 18.2% to Kshs 8.6 tn in May 2022, from Kshs 1.6 tn in May 2012 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%, indicating that the increase in debt is not translating into GDP growth.

The shilling is however expected to be supported by:

i. Sufficient Forex reserves currently at USD 7.6 bn (equivalent to 4.4-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 USD 235.6 mn funding from the International Monetary Fund (IMF), and,
ii. Sufficient diaspora remittances which stood at USD 319.4 mn as of July 2022, which have continued to cushion the shilling against a faster depreciation. Notably, US remains the largest source of remittances to Kenya accounting for 58.0% in the period as of July 2022.

Weekly Highlights:

I. Fuel Prices

During the week, the Energy and Petroleum Regulatory Authority (EPRA) released their monthly statement on the maximum retail fuel prices in Kenya effective 15th August 2022 to 14th September 2022. Notably, fuel prices remained unchanged at Kshs 159.1 per litre for Super Petrol, Kshs 140.0 per litre for Diesel and Kshs 127.9 per litre for Kerosene. The performance was attributable to:

i. The fuel subsidy program under the Petroleum Development Levy which resulted in subsidies of Kshs 54.9 on Super Petrol, Kshs 66.2 on Diesel and Kshs 74.2 on Kerosene during the month, and,
ii. Removal of suppliers margins of Kshs 6.3 on Super Petrol, Kshs 5.5 on Diesel and Kshs 7.7 on Kerosene since October 2021.

The performance was despite;

i. The increase in the average landed costs of Super Petrol, Diesel and Kerosene by 3.0%, 8.2% and 14.9% to USD 1074.0 per cubic meter, USD 1103.0 per cubic meter, and USD 1,111.5 in July 2022, from USD 1,042.9 per cubic meter, USD 1019.3 per cubic meter, and USD 967.4 per cubic meter in June 2022,
ii. The 5.0% increase in the Free on Board (FOB) price of Murban crude oil to USD 109.7 per barrel, from USD 104.5 per barrel in June 2022, and,
iii. The Kenyan shilling continued depreciation having declined by 1.2% to Kshs 119.9 in July 2022, from Kshs 118.5 in June 2022.

Despite the performance, global fuel prices have remained high since the beginning of the year, having recorded a 26.1% year to date gain to USD 98.2 per barrel as of 18th August 2022, from USD 77.9 per barrel recorded on 3rd January 2022. The increase is mainly driven by persistent supply chain constraints against an increasing demand as economies continue to normalize. However, Kenyans have continued to get cushioned against the elevated fuel price, owing to the National Treasury's fuel subsidy program, which we believe is unsustainable given the continued increase in the landed cost of fuel. As such, we expect the government to gradually eliminate the programme and adjust the domestic fuel prices to ease the pressure on expenditure and consequently reduce the need for excessive borrowing. We also expect the cost of living to remain elevated given that fuel is a major contributor to Kenya's headline inflation it's a major input cost in majority of Kenya's sectors such as manufacturing, transport and energy. Consequently, the business environment is expected to remain unfavourable because of a diminishing consumer purchasing power.

II. Revenue and Net Exchequer for FY'2022/2023

The National Treasury gazetted the revenue and net expenditures for the first month of FY'2022/2023, ending 29th July 2022. Below is a summary of the performance:

FY'2022/2023 Budget Outturn - As at 29th July 2022

Amounts in Kshs billions unless stated otherwise

Item	12-months Original Estimates	Actual Receipts/Release	Percentage Achieved	Prorated	% achieved of prorated
Opening Balance		0.6			
Tax Revenue	2,071.9	130.6	6.3%	172.7	75.6%
Non-Tax Revenue	69.7	1.9	2.8%	5.8	33.6%
Total Revenue	**2,141.6**	**133.2**	**6.2%**	**178.5**	**74.6%**
External Loans & Grants	349.3	27.9	8.0%	29.1	95.7%
Domestic Borrowings	1,040.5	15.6	1.5%	86.7	18.0%
Other Domestic Financing	13.2	2.8	21.0%	1.1	251.5%

FY'2022/2023 Budget Outturn - As at 29th July 2022

Amounts in Kshs billions unless stated otherwise

Item	12-months Original Estimates	Actual Receipts/Release	Percentage Achieved	Prorated	% achieved of prorated
Total Financing	**1,403.0**	**46.2**	**3.3%**	**116.9**	**39.5%**
Recurrent Exchequer issues	1,178.4	66.8	5.7%	98.2	68.0%
CFS Exchequer Issues	1,571.8	89.5	5.7%	131.0	68.4%
Development Expenditure & Net Lending	424.4	0.0	0.0%	35.4	0.0%
County Governments + Contingencies	370.0	23.0	6.2%	30.8	74.6%
Total Expenditure	**3,544.6**	**179.3**	**5.1%**	**295.4**	**60.7%**
Total Borrowing	**1,389.8**	**43.5**	**3.1%**	**115.8**	**37.5%**

The Key take-outs from the release include;

a. Total revenue collected as at the end of July 2022 amounted to Kshs 133.2 bn, equivalent to 6.2% of the original estimates of Kshs 2,141.6 bn for FY'2022/2023 and is 74.6% of the prorated estimates of Kshs 178.5 bn. The performance is attributable to the deterioration of the business environment seen during the month of July as evidenced by the decline in the purchasing managers index (PMI) to 46.3, from 46.8 that was recorded in July 2022. Cumulatively, tax revenues amounted to Kshs 130.6 bn, equivalent to 6.3% of the original estimates of Kshs 2,071.9 bn and 75.6% of the prorated estimates of Kshs 172.7 bn,
b. Total financing amounted to Kshs 46.2 bn, equivalent to 3.3% of the original estimates of Kshs 1,403.0 bn and is equivalent to 39.5% of the prorated estimates of Kshs 116.9 bn. Additionally, domestic borrowing amounted to Kshs 15.6 bn, equivalent to 1.5% of the original estimates of Kshs 1,040.5 bn and is 18.0% of the prorated estimates of Kshs 86.7 bn,
c. The total expenditure amounted to Kshs 179.3 bn, equivalent to 5.1% of the original estimates of Kshs 3,544.6 bn, and is 60.7% of the prorated target expenditure estimates of Kshs 295.4 bn. Additionally, the net disbursements to recurrent expenditures came in at Kshs 66.8 bn, equivalent to 5.7% of the original estimates and 68.0% of the prorated estimates of Kshs 98.2 bn. We note that the absorption rate is very slow with the main culprit being the development expenditure which recorded no activity during the period,
d. Consolidated Fund Services (CFS) Exchequer issues came in at Kshs 89.5 bn, equivalent to 5.7% of the original estimates of Kshs 1,571.8 bn, and are 68.4% of the prorated amount of Kshs 131.0 bn. The cumulative public debt servicing cost amounted to Kshs 84.0 bn which is 6.0% of the original estimates of Kshs 1,393.1 bn, and is 72.3% of the prorated estimates of Kshs 116.1 bn. Additionally, the Kshs 84.0 bn debt servicing cost is equivalent to 11.2% of the actual revenues collected as at the end of July 2022, and,
e. Total Borrowings as at the end of July 2022 amounted to Kshs 43.5 bn, equivalent to 3.1% of the original estimates of Kshs 1,389.8 bn for FY'2022/2023 and are 37.5% of the prorated estimates of Kshs 115.8 bn. The cumulative domestic borrowing target of Kshs 1,040.5 bn comprises of adjusted Net domestic borrowings of Kshs 579.1 bn and Internal Debt Redemptions (Roll-overs) of Kshs 461.4 bn.

As expected, the revenue performance for the first month of the FY'2022/2023 is not plausible mainly due to the economic uncertainties that emanated from the elevated inflationary pressures as well as the heated political environment. The slow-down in economic environment was evidenced by the decline in the July PMI to 46.3, from 46.8 in June 2022 and is expected to remain subdued in the short term as consumers continue to cut on spending. As such, we believe that the performance of revenue collection in the coming months will be largely determined by how soon the country's business environment stabilizes and how fast the incoming regime implements its economic growth related initiatives. However, risks lie on the downside given the high global commodity prices which continue to weigh on the economy.

Rates in the Fixed Income market have remained relatively high due to the relatively heightened perceived risk by investors. As it is still early in the financial year, the government is 43.1% behind its prorated borrowing target of Kshs 79.9 bn having borrowed Kshs 45.5 bn of the Kshs 581.7 bn borrowing target for the FY'2022/2023. We expect sustained gradual economic recovery as evidenced by the revenue collections of Kshs 2.0 tn in the FY'2021/2022, equivalent to a 2.8% outperformance. Despite the performance, we believe that the projected budget deficit of 6.2% for the FY'2022/2023 is relatively ambitious given the downside risks and deteriorating business environment occasioned by high inflationary pressures. We however expect the support from the IMF and World Bank to finance some of the government projects and thus help maintain a stable interest rate environment 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.
