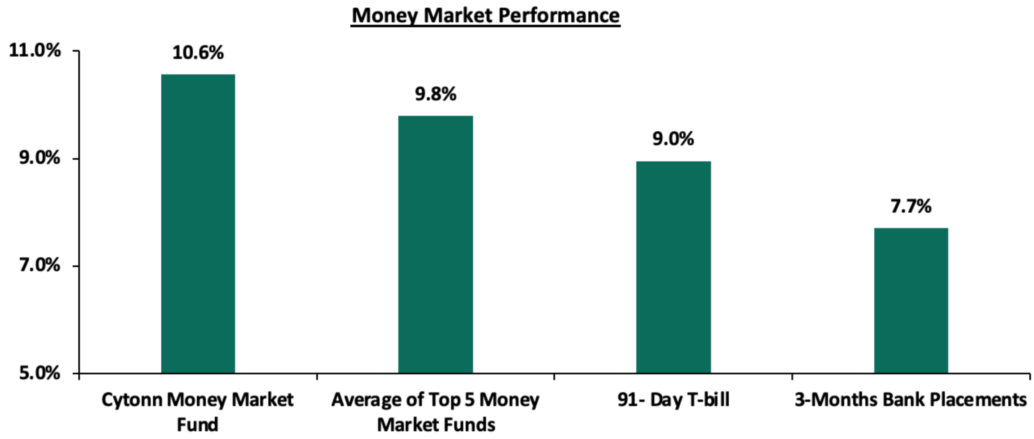
Administration as a Business Restructuring Option & Cytonn Weekly #37/2022

Fixed Income

During the week, T-bills were undersubscribed, with the overall subscription rate coming in at 97.0%, a decline from the 153.0% recorded the previous week, partly attributable to the concurrent bond issue in the primary bond market. Investor's preference for shorter 91-day paper persisted, with the paper receiving bids worth Kshs 9.9 bn against the offered Kshs 4.0 bn, translating to a subscription rate of 248.4%, from 675.4% recorded the previous week. It is worth noting that the 91-day paper's rate has been increasing for the sixteenth consecutive week, with the rate quickly heading to 9.0% levels which has consistently countered the need to invest in the longer tenure papers. The subscription rate for the 182-day paper increased to 113.9% from 34.8% while that of the 364-day paper declined to 19.6%, from 62.3% 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 1.6 bps and 4.0 bps to 9.6% and 9.0%, respectively, while the yields on the 364-day paper declined by 0.2 bps to 9.9%. We however believe that the 91-day paper rates are not sustainable and this will likely lead to a reversal in the rates in the short term. The government continued to reject expensive bids, accepting a total of Kshs 17.4 bn worth of bids out of the Kshs 23.3 bn worth of bids received, translating to an acceptance rate of 74.6%.

In the primary bond market, the Central Bank of Kenya released the auction results for the recently re-opened bonds; FXD1/2022/10 and FXD1/2022/15, with tenors to maturity of 10 years and 15 years, and coupons of 13.5% and 13.9%, respectively. In line with our expectations, the bonds recorded an undersubscription of 92.3% despite the ample liquidity in the money market and the eased tensions in the country following the peaceful elections. The government issued the bonds seeking to raise Kshs 50.0 bn for budgetary support, received bids worth Kshs 46.1 bn and accepted bids worth Kshs 39.0 bn translating to an 84.6% acceptance rate. The weighted average yields were 13.9% for the FXD1/2022/10 and 14.0% for FXD1/2022/15.



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 4.0 bps to 9.0%. The average yield of the Top 5 Money Market Funds and Cytonn Money Market Fund remained relatively unchanged at 9.8% 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 16th September 2022:

Money Market Fund Yield for Fund Managers as published on 16th September 2022

Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund	10.6%
2	Zimele Money Market Fund	9.9%
3	Dry Associates Money Market Fund	9.6%
4	Sanlam Money Market Fund	9.5%
5	NCBA Money Market Fund	9.4%
6	Nabo Africa Money Market Fund	9.4%
7	Apollo Money Market Fund	9.3%
8	Old Mutual Money Market Fund	9.3%
9	Madison Money Market Fund	9.3%
10	Co-op Money Market Fund	9.2%
11	GenCap Hela Imara Money Market Fund	9.1%
12	CIC Money Market Fund	9.0%
13	Orient Kasha Money Market Fund	8.7%
14	ICEA Lion Money Market Fund	8.6%
15	AA Kenya Shillings Fund	8.3%
16	British-American Money Market Fund	6.4%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets eased, with the average interbank rate declining to 4.0% from 4.3% recorded the previous week, partly attributable to government payments that offset tax remittances. The average interbank volumes traded increased by 103.1% to Kshs 27.3 bn from Kshs 13.5 bn recorded the previous week.

Kenya Eurobonds:

During the week, the yields on Eurobonds recorded mixed performance with the yield on the 30-year Eurobond issued in 2018 being the only gainer, increasing by 0.1% points to 11.8% from 11.7% recorded the previous week. The yield on the 10-year Eurobond issued in 2014 recorded the highest decline having declined by 0.7% points to 11.9% from 12.6% recorded the previous week. The decline in the yields points towards improving investor confidence as elections related uncertainties dissipate. The table below shows the summary of the performance of the Kenyan Eurobonds as of 15th September 2022;

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%
31-Aug-22	15.3%	13.2%	12.4%	14.5%	13.1%	11.5%
9-Sep-22	12.6%	12.3%	11.7%	13.3%	12.5%	10.9%
12-Sep-22	12.1%	11.7%	11.4%	12.5%	11.9%	10.4%
13-Sep-22	11.5%	11.7%	11.3%	12.3%	11.8%	10.5%
14-Sep-22	11.9%	12.1%	11.7%	12.8%	12.3%	10.9%
15-Sep-22	11.9%	12.2%	11.8%	12.8%	12.4%	10.9%
Weekly Change	**(0.7%)**	**(0.1%)**	**0.1%**	**(0.5%)**	**(0.1%)**	**0.0%**
MTD Change	**(3.3%)**	**(1.0%)**	**(0.6%)**	**(1.8%)**	**(0.7%)**	**(0.6%)**
YTD Change	**7.5%**	**4.2%**	**3.7%**	**7.2%**	**5.7%**	**4.3%**

Source: Central Bank of Kenya (CBK)

Kenya Shilling:

During the week, the Kenyan shilling depreciated by 0.1% against the US dollar to close the week at Kshs 120.4, from Kshs 120.3 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 6.4% 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. An ever-present current account deficit due to an imbalance between imports and exports, with Kenya's current account deficit estimated at 5.1% of GDP in the 12 months to July 2022 compared to the 5.2% within a similar period in 2021, and,
c. The aggressively growing government debt which is not translating into GDP growth thus putting pressure on forex reserves to service some of the public debt. Notably, Kenya's public debt has 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 while the average GDP growth over the same period has been 3.9%.

The shilling is however expected to be supported by:

i. Sufficient Forex reserves currently at USD 7.3 bn (equivalent to 4.2-months of import cover), which is above the statutory requirement of maintaining at least 4.0-months of import cover, and,
ii. Sufficient diaspora remittances evidenced by a 14.7% y/y increase to USD 3,992.0 mn cumulative remittances as of August 2022, from USD 3,481.0 mn recorded over the same period in 2021, which has continued to cushion the shilling against a faster depreciation.

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 September 2022 to 14th October

2022. Notably, Super Petrol, Diesel and Kerosene prices increased by 12.7%, 17.9% and 15.7% to Kshs 179.3 per litre, Kshs 165.0 per litre and Kshs 147.9 per litre from Kshs 159.1 per litre, Kshs 140.0 per litre and Kshs 127.9 per litre, respectively. The performance was attributable to:

i. Full removal of subsidy on super petrol, and partial removal of subsidies on Diesel and Kerosene which reduced by 68.5% and 64.6% to Kshs 20.8 per litre and Kshs 26.3 per litre from Kshs 66.2 and Kshs 74.2 per litre in the month of August 2022, respectively,
ii. The 7.2% increase in the Free On Board(FOB) price of Murban crude oil to USD 117.5 per barrel from USD 109.7 per barrel in the month of July, and,
iii. The Kenyan shilling continued depreciation having declined by 0.6% to Kshs 120.6 in August 2022 from Kshs 119.9 in July.

We however believe that the fuel prices were cushioned from a further hike by the decline in the average landed cost of super petrol, diesel and kerosene by 24.3%, 13.9% and 19.1% to USD 812.9 per cubic metre, USD 949.7 per cubic metre and USD 899.6 per cubic metre in August 2022 from USD 1,074.0 per cubic metre, USD 1,103.0 per cubic metre and USD 1,115.0 per cubic metre in July 2022.

Over the last two months, Kenya's fuel prices have remained stable primarily due to the subsidy program from the Petroleum Fund. However, we believed that the fuel subsidy was unsustainable and recommended it be eliminated given that it was a burden on the country's expenditure. Notably, the Kenyan government partially removed the fuel subsidy in the month of September 2022 setting fuel prices to historic highs. Going forward, we expect the new administration to completely phase out the fuel subsidy program and adjust the domestic fuel prices to ease pressure on expenditure and consequently reduce the need for excessive borrowing. Consequently, we expect the cost of living to remain elevated given that fuel is a major contributor to Kenya's inflation. Additionally, the business environment is expected to remain unfavorable 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 second month of FY'2022/2023, ending 31st August 2022. Below is a summary of the performance:

FY'2022/2023 Budget Outturn - As at 31st August 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	280.2	13.5%	345.3	81.1%
Non-Tax Revenue	69.7	3.1	4.5%	11.6	26.9%
Total Revenue	**2,141.6**	**284.0**	**13.3%**	**356.9**	**79.6%**
External Loans & Grants	349.3	31.8	9.1%	58.2	54.6%
Domestic Borrowings	1,040.5	54.8	5.3%	173.4	31.6%
Other Domestic Financing	13.2	13.4	101.5%	2.2	608.8%
Total Financing	**1,403.0**	**100.0**	**7.1%**	**233.8**	**42.8%**
Recurrent Exchequer issues	1,178.4	149.4	12.7%	196.4	76.1%
CFS Exchequer Issues	1,571.8	183.5	11.7%	262.0	70.1%
Development Expenditure & Net Lending	424.4	20.8	4.9%	70.7	29.3%
County Governments + Contingencies	370.0	30.2	8.2%	61.7	49.0%
Total Expenditure	**3,544.6**	**383.9**	**10.8%**	**590.8**	**65.0%**

FY'2022/2023 Budget Outturn - As at 31st August 2022

Amounts in Kshs billions unless stated otherwise

Item	12-months Original Estimates	Actual Receipts/Release	Percentage Achieved	Prorated	% achieved of prorated
Total Borrowing	**1,389.8**	**86.6**	**6.2%**	**231.6**	**37.4%**

The Key take-outs from the release include;

a. Total revenue collected as at the end of August 2022 amounted to Kshs 284.0 bn, equivalent to 13.3% of the original estimates of Kshs 2,141.6 bn for FY'2022/2023 and is 79.6% of the prorated estimates of Kshs 356.9 bn. We note that the government has not been able to meet its prorated revenue targets two months into the FY'2022/2023 partly attributable to the deterioration of the business environment following the increased cost of living that has seen consumers continue to cut on spending. Cumulatively, tax revenues amounted to Kshs 280.2 bn, equivalent to 13.5% of the original estimates of Kshs 2,071.9 bn and 81.1% of the prorated estimates of Kshs 345.3 bn,
b. Total financing amounted to Kshs 100.0 bn, equivalent to 7.1% of the original estimates of Kshs 1,403.0 bn and is equivalent to 42.8% of the prorated estimates of Kshs 233.8 bn. Additionally, domestic borrowing amounted to Kshs 54.8 bn, equivalent to 5.3% of the original estimates of Kshs 1,040.5 bn and is 31.6% of the prorated estimates of Kshs 173.4 bn,
c. The total expenditure amounted to Kshs 383.9 bn, equivalent to 10.8% of the original estimates of Kshs 3,544.6 bn, and is 65.0% of the prorated target expenditure estimates of Kshs 590.8 bn. Additionally, the net disbursements to recurrent expenditures came in at Kshs 149.4 bn, equivalent to 12.7% of the original estimates and 76.1% of the prorated estimates of Kshs 196.4 bn,
d. Consolidated Fund Services (CFS) Exchequer issues came in at Kshs 183.5 bn, equivalent to 11.7% of the original estimates of Kshs 1,571.8 bn, and are 70.1% of the prorated amount of Kshs 262.0 bn. The cumulative public debt servicing cost amounted to Kshs 177.9 bn which is 12.8% of the original estimates of Kshs 1,393.1 bn, and is 76.6% of the prorated estimates of Kshs 232.2 bn. Additionally, the Kshs 177.9 bn debt servicing cost is equivalent to 59.6% of the actual revenues collected as at the end of August 2022, further emphasizing on how much public debt weighs on the country's expenditure, and,
e. Total Borrowings as at the end of August 2022 amounted to Kshs 86.6 bn, equivalent to 6.2% of the original estimates of Kshs 1,389.8 bn for FY'2022/2023 and are 37.4% of the prorated estimates of Kshs 231.6 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 second month of the FY'2022/2023 is not plausible mainly due to the economic uncertainties that emanated from the elevated inflationary pressures and the prolonged electioneering period. The slow-down in economic environment is expected to persist 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 new regime implements its economic growth related initiatives. However, risks lie on the downside given the high global commodity prices coupled with the persistent supply bottlenecks which continue to weigh on the economy.

Rates in the Fixed Income market have remained relatively stable due to the relatively ample liquidity in the money market. As it is still early in the financial year, the government is 13.4% behind its prorated borrowing target of Kshs 124.7 bn having borrowed Kshs 141.3 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% 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.