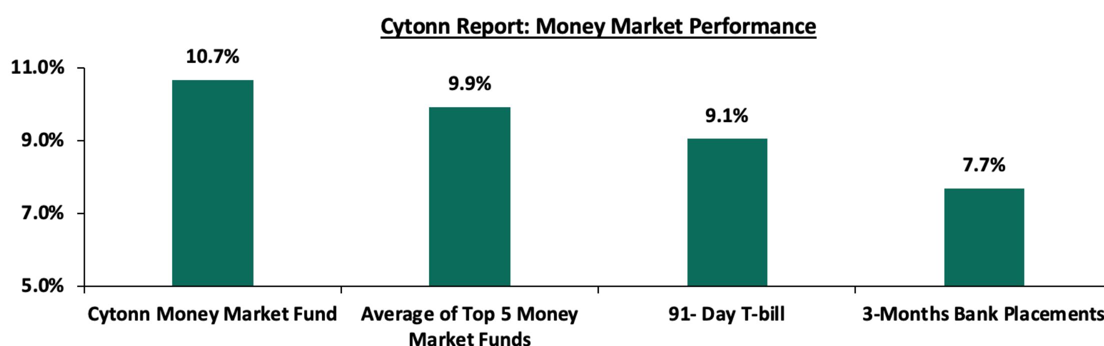
Cytonn INVESTMENTS

The Nairobi Metropolitan Area (NMA) Mixed-Use Developments Report, & Cytonn Weekly #43/2022

Fixed Income

During the week, T-bills were undersubscribed, with the overall subscription rate coming in at 75.8%, a decline from the 117.9% recorded the previous week. Investor's preference for the shorter 91-day paper persisted, with the paper receiving bids worth Kshs 12.0 bn against the offered Kshs 4.0 bn, translating to a subscription rate of 299.8%, down from 488.0% recorded the previous week. Similarly, the subscription rates for the 364-day and 182-day papers declined to 21.5% and 40.4%, from 39.7% and 48.2% 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 91-day papers increasing by 3.7 bps, 1.4 bps and 2.7 bps to 10.0%, 9.7% and 9.1%, respectively.

In the Primary Bond Market, the government is seeking to raise Kshs 60.0 bn for infrastructure projects by opening an infrastructure bond, IFB1/2022/14, with a tenor of 14 years whose offer period ends on 8th November 2022. Key to note, the bond's coupon rate will be market determined. Given the ample liquidity in the market, as well as the attractive tax-free nature of the infrastructure bond, we anticipate an oversubscription and a higher acceptance rate. Our recommended bidding range for the bond is: 13.8%-14.1% 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 increased by 2.7 bps to 9.1%. The average yields of the Top 5 Money Market Funds and the Cytonn Money Market Fund remained unchanged at 9.9% and 10.7%, respectively.

The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 28th October 2022:

Cytonn Report: Money Market Fund Yield for Fund Managers as published on 28th October 2022

Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund	10.7%
2	Zimele Money Market Fund	9.9%
3	NCBA Money Market Fund	9.6%
4	Dry Associates Money Market Fund	9.5%
5	Sanlam Money Market Fund	9.5%
6	Madison Money Market Fund	9.4%
7	Old Mutual Money Market Fund	9.3%
8	Apollo Money Market Fund	9.2%
9	Co-op Money Market Fund	9.2%
10	CIC Money Market Fund	9.1%
11	GenCap Hela Imara Money Market Fund	8.9%
12	Nabo Africa Money Market Fund	8.9%
13	ICEA Lion Money Market Fund	8.5%
14	Orient Kasha Money Market Fund	8.5%
15	AA Kenya Shillings Fund	8.4%
16	British-American Money Market Fund	7.7%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets eased, with the average interbank rate declining to 5.0% from 5.1% recorded the previous week, partly attributable to government payments offsetting tax remittances. The average interbank volumes traded declined by 6.1% to Kshs 29.8 bn from Kshs 31.7 bn recorded the previous week.

Kenya Eurobonds:

During the week, the yields on Eurobonds were on a downward trajectory, an indication of declining risk concerns over the economy. The yield on the 10-year Eurobond issued in 2014 declined the most by 1.1% points to 16.2% from 17.3% recorded in the previous week. The table below shows the summary of the performance of the Kenyan Eurobonds as of 27th October 2022;

Cytonn Report: 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%
30-Sep-22	17.6%	14.7%	14.0%	15.6%	14.7%	13.2%
20-Oct-22	17.3%	14.8%	13.8%	15.8%	14.7%	13.3%
21-Oct-22	17.9%	14.9%	14.1%	16.3%	15.0%	13.5%

Cytonn Report: 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**
24-Oct-22	18.0%	15.0%	14.1%	16.1%	15.2%	13.5%
25-Oct-22	17.6%	15.0%	14.1%	16.1%	15.0%	13.4%
26-Oct-22	17.4%	14.7%	13.7%	15.6%	14.7%	13.2%
27-Oct-22	16.2%	14.1%	13.4%	15.1%	14.4%	12.8%
Weekly Change	**(1.1%)**	**(0.7%)**	**(0.4%)**	**(0.7%)**	**(0.3%)**	**(0.5%)**
MTD Change	**(1.3%)**	**(0.7%)**	**(0.6%)**	**(0.6%)**	**(0.3%)**	**(0.4%)**
YTD Change	**11.8%**	**6.0%**	**5.3%**	**9.5%**	**7.7%**	**6.2%**

Source: Central Bank of Kenya (CBK)

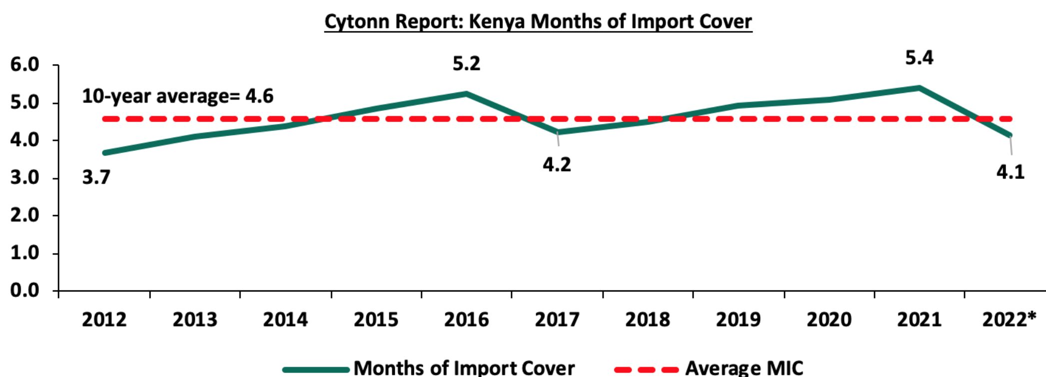
Kenya Shilling:

During the week, the Kenyan shilling depreciated by 0.1% against the US dollar to close the week at Kshs 121.3, from Kshs 121.1 recorded the previous week, partly attributable to increased dollar demand from importers, especially oil and energy sectors against a slower supply of hard currency. On a year to date basis, the shilling has depreciated by 7.2% 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:

i. High global crude oil prices on the back of persistent supply chain bottlenecks coupled with high demand,
ii. An ever-present current account deficit estimated at 5.2% of GDP in the 12 months to August 2022, same as what was recorded in a similar period in 2021, and,
iii. The need for Government debt servicing which continues to put pressure on forex reserves given that 68.1% of Kenya's External debt was US Dollar denominated as of July 2022.

The shilling is however expected to be supported by:

a. Improved diaspora remittances standing at a cumulative USD 4.0 bn as of September 2022, representing a 14.3% y/y increase from USD 3.5 bn recorded over the same period in 2021, and,
b. Sufficient Forex reserves currently at USD 7.3 bn (equivalent to 4.1 months of import cover), which is above the statutory requirement of maintaining at least 4.0-months of import cover, however it's important to note that Forex reserves have dropped by 16.5% YTD from USD 8.8 bn. The chart below summarizes the evolution of Kenya months of import cover over the last 10 years;



Weekly Highlight:

IMF Sub-Saharan Africa (SSA) Regional Economic Outlook

According to the International Monetary Fund (IMF) Regional Economic Outlook Report October 2022, the Sub-Saharan Region's economic growth rate is projected to grow at 3.6% in 2022 and rise marginally to 3.7% in 2023, with both projections lower than the 4.7% economic growth rate recorded in 2021. The main drivers behind the slower growth are elevated inflationary pressures driven by high global food and energy prices, persistent currency depreciation, capital outflows and debt sustainability concerns. Inflation within the SSA is expected to remain elevated at 14.4% and 11.9% for 2022 and 2023, respectively, from 11.1% recorded in 2021.

Below is a table showing GDP projections of select African countries against projected inflation rates:

Cytonn Report: Select African Countries GDP vs Inflation Projections

	GDP Projection			**Inflation Projection**		
Country	**2021**	**2022f**	**2023f**	**2021**	**2022f**	**2023f**
Senegal	6.1	4.7	8.1	2.2%	7.5%	3.1%
Rwanda	10.9	6.0	6.7	0.8%	9.5%	8.0%
Uganda	6.7	4.4	5.9	2.2%	6.4%	6.4%
Mauritius	4.0	6.1	5.4	4.0%	10.6%	6.1%
Tanzania	4.9	4.5	5.2	3.7%	4.0%	5.3%
Kenya	7.5	5.3	5.1	6.1%	7.4%	6.6%
Zambia	4.6	2.9	4.0	22.0%	12.5%	9.5%
Botswana	11.4	4.1	4.0	6.7%	11.2%	5.8%
Nigeria	3.6	3.2	3.0	17.0%	18.9%	17.3%
Ghana	5.4	3.6	2.8	10.0%	27.2%	20.9%
Malawi	2.2	0.9	2.5	9.3%	18.4%	16.5%
South Africa	4.9	2.1	1.1	4.6%	6.7%	5.1%
Sub-Saharan Africa	**4.7**	**3.6**	**3.7**	**11.1%**	**14.4%**	**11.9%**

Source: IMF

Key take-outs from the table;

i. Senegal is projected to have the highest GDP growth rate at 8.1% in 2023, majorly attributable to mining sector with the country set to roll out its first natural gas production from Sangomar and Grand Tortue Ahyemim (GTA) fields in Q3'2023 with a daily production target of 70.0 mn cubic Ft of natural gas. This is expected to boost Senegal's GDP through increased exports and subsequently ease the current account deficit as a percentage of GDP to 6.6% in 2023 from 10.5% in 2022. Additionally, Senegal's inflation is projected to decline to 3.1% in 2023 from 7.5% in 2022,
ii. Nigeria's economy is expected to grow by 3.0% in 2023, 0.2% points lower than the 3.2% projections in 2022 as a result of uncertainties surrounding the 2023 electioneering period, coupled with a high persistent inflation which came in at 20.5% in August 2022 and decline in fuel prices evidenced by a 16.1% decline in average oil prices to USD 88.2 per barrel in September 2022, from USD 105.1 per barrel in July 2022,
iii. South Africa's GDP growth is expected to come in at 1.1% in 2023, a significant decline from 2.1% growth in 2022 attributable to continued infrastructure constraints such as electricity supply, a projected erosion of the current account balance to a deficit of 1.0% in 2023, from a surplus of 3.7% in 2021 driven by increasing import bill against reduced exports. South Africa is also expected to have a weak macroeconomic environment, stemming from elevated inflationary pressures, tightened monetary policies with the interest rate increasing by 25.0 bps to 6.25% in September 2022 and a high debt to GDP ratio coming in at 69.0% in 2021,
iv. Kenya's growth rate is projected to slow to 5.1% in 2023, from 5.3% in 2022, with the slower growth mainly attributable to expected persisting of the elevated inflationary pressures. This stems from the fact that Kenya is a net importer and has seen an inflated import bill due to the high global fuel and commodity prices. Additionally, the Agricultural sector, Kenya's largest contributor to GDP, continues to suffer from unfavorable weather patterns, hence food unsustainability. Further the tightening of monetary policy by hiking of the Central Bank Rate by 75.0 bps to 8.25% in September 2022 in a bid to curb inflation that is currently at 9.2% is expected to stifle economic growth. However, average inflation is projected to slow to 6.6% in 2023, and,
v. Notably, Uganda, Rwanda and Tanzania are expected to record higher economic growth rates than Kenya mainly due to lower inflation rates, better revenue performances and increased reforms to promote commercial agriculture.

Going forward, we expect that the slow growth in 2023 will further be driven by heightened food crisis on the back of unfavorable weather patterns hindering agricultural production in the Agriculture-dependent region, coupled with supply chain disruptions with Russia supplying 65.0% of wheat imports into Africa. The SSA region has also seen heightened debt unsustainability concerns as the region's debt to GDP stands at 60.0% with 19 out of the 35 low-income countries being in debt distress or at a high risk of distress. Additionally, the tightened monetary policy in majority of the region's economies in a bid to curb inflation against a backdrop of declining local currencies are stifling economic activity in the region. To offset the downsides, SSA countries must focus on increased adoption of modern agriculture and shifting from traditional rain fed agriculture to enhance domestic production, and develop contingency plans to help mitigate food unsustainability crises. Additionally, SSA economies must pursue fiscal consolidation, revenue mobilization, develop domestic bond markets and opt for low cost multilateral borrowing as compared to commercial borrowing to plug fiscal deficits.

Rates in the Fixed Income market have remained relatively stable due to the relatively ample liquidity in the money market. The government is 20.3% behind its prorated borrowing target of Kshs 191.8 bn having borrowed Kshs 152.9 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 486.0 bn in the first quarter of FY'2022/2023,

equivalent to a 22.7% of its target of 2.1 tn. 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.

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