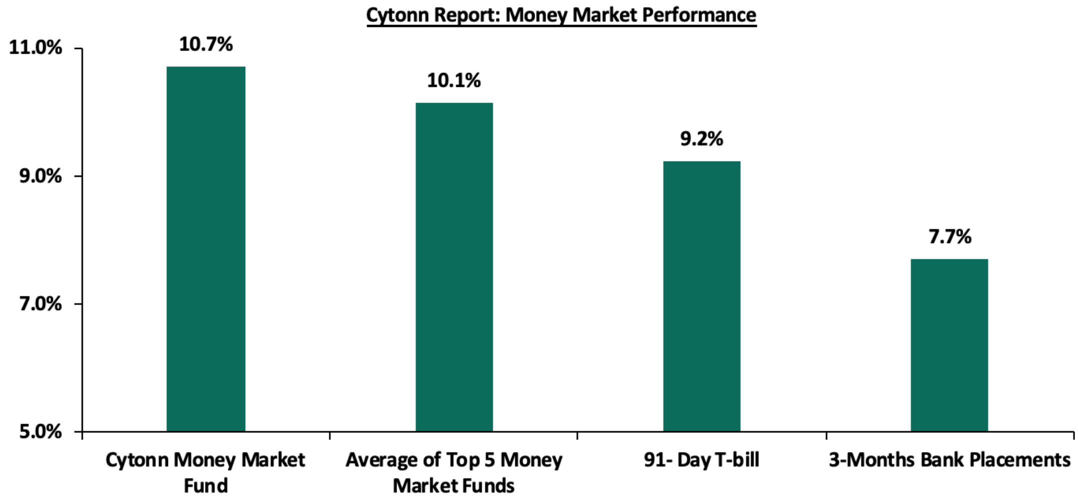
Nairobi Metropolitan Area (NMA) Serviced Apartments Report 2022, & Cytonn Weekly #47/2022

Fixed Income

During the week, T-bills remained oversubscribed, albeit at a lower rate, with the overall subscription rate declining to 113.4%, from the 170.8% recorded the previous week. The lower subscription is partly attributable to tightened liquidity in the money market with the average interbank rate increasing to 4.8% from 4.4% recorded the previous week. Investor's preference for the shorter 91-day paper persisted, with the paper receiving bids worth Kshs 12.7 bn against the offered Kshs 4.0 bn, translating to a subscription rate of 316.8%, down from 406.3% recorded the previous week. The subscription rates for the 364-day and 182-day papers declined to 76.9% and 68.5% from 89.5% and 158.0%, 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 3.8 bps, 1.2 bps and 4.6 bps to 10.2%, 9.7% and 9.2%, respectively.

In the Primary Bond Market, the government is seeking to raise Kshs 87.8 bn to meet upcoming domestic maturities through a switch auction of three Treasury Bills issues No. 2494/91, 2454/182 and 2380/360 and T-Bond issue No. FXD1/2021/002, with an infrastructure bond, IFB1/2022/6. Key to note, this will see the conversion of the short-term securities into a longer-term bond, easing the Government's maturities payments pressures. The sale period ends on 30th November 2022 and the coupon rate will be market determined. Given the ample liquidity in the market, the attractive tax-free nature of the infrastructure bond and high interest rates currently offered in the market, we expect the bond to be oversubscribed. The bond of similar tenor is currently trading in the secondary market at a yield of 12.3%, as such, our recommended bidding range for the bond is 12.5%-13.0%.

Further, the CBK re-opened two bonds in the primary market, FXD1/2008/20 and FXD1/2022/25, with effective tenors of 5.6 years and 24.9 years, respectively, in a bid to raise Kshs 40.0 bn for budgetary support. The coupon rates are 13.8% for FXD1/2008/20 and 14.2% for FXD1/2022/25. We expect investors to prefer the bonds especially the longer dated one as a result of the search for higher yields. The bonds are currently trading in the secondary market at yields of 13.4% and 14.1%, for FXD1/2008/20 and FXD1/2022/25, respectively, and as such, our recommended bidding range for the two bonds are: 13.6%-13.9% for FXD1/208/20 and 14.0%-14.4% for FXD1/2022/25. The period of the sale runs until 6th December 2022.



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 4.6 bps to 9.2%. The average yield of the Top 5 Money Market Funds and the Cytonn Money Market Fund remained unchanged at 10.1% and 10.7%, respectively.

The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 25th November 2022:

Cytonn Report: Money Market Fund Yield for Fund Managers as published on 25th November 2022

Rank	Fund Manager	Effective Annual Rate
1	GenCap Hela Imara Money Market Fund	10.8%
2	Cytonn Money Market Fund	10.7%
3	Zimele Money Market Fund	9.9%
4	NCBA Money Market Fund	9.7%
5	Sanlam Money Market Fund	9.7%
6	Madison Money Market Fund	9.4%
7	Dry Associates Money Market Fund	9.4%
8	Nabo Africa Money Market Fund	9.3%
9	Apollo Money Market Fund	9.3%
10	Old Mutual Money Market Fund	9.2%
11	Co-op Money Market Fund	9.2%
12	CIC Money Market Fund	9.1%
13	British-American Money Market Fund	9.0%
14	AA Kenya Shillings Fund	8.7%
15	ICEA Lion Money Market Fund	8.6%
16	Orient Kasha Money Market Fund	8.6%
17	Absa Shilling Money Market Fund	7.6%
18	Equity Money Market Fund	5.4%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets tightened, with the average interbank rate increasing to 4.8% from 4.4% recorded the previous week, partly attributable to tax remittances that offset government payments. The average interbank volumes traded declined by 0.7% to Kshs 21.0 bn from Kshs 21.1 bn recorded the previous week.

Kenya Eurobonds:

During the week, the yields on Eurobonds were on an upward trajectory, an indication of increasing risk concerns over the economy. The yield on the 10-year Eurobond issued in 2014 increased the most by 1.4% points to 12.8% from 11.4% recorded in the previous week. The table below shows the summary of the performance of the Kenyan Eurobonds as of 25th November 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%
31-Oct-22	15.6%	13.9%	13.2%	14.7%	14.1%	12.7%
17-Nov-22	11.4%	10.2%	10.9%	10.5%	10.6%	9.7%
18-Nov-22	12.3%	10.5%	11.1%	11.0%	10.7%	9.9%
21-Nov-22	12.7%	10.6%	11.1%	11.5%	10.9%	10.2%
22-Nov-22	13.0%	10.7%	11.2%	11.2%	10.9%	10.0%
23-Nov-22	12.8%	10.4%	11.0%	11.0%	10.8%	9.9%
24-Nov-22	12.8%	10.4%	11.0%	11.0%	10.8%	9.9%
Weekly Change	**1.4%**	**0.2%**	**0.1%**	**0.5%**	**0.2%**	**0.2%**
MTD Change	**(2.8%)**	**(3.4%)**	**(2.2%)**	**(3.7%)**	**(3.4%)**	**(2.8%)**
YTD Change	**8.4%**	**2.4%**	**2.9%**	**5.4%**	**4.1%**	**3.3%**

Source: Central Bank of Kenya (CBK)

Kenya Shilling:

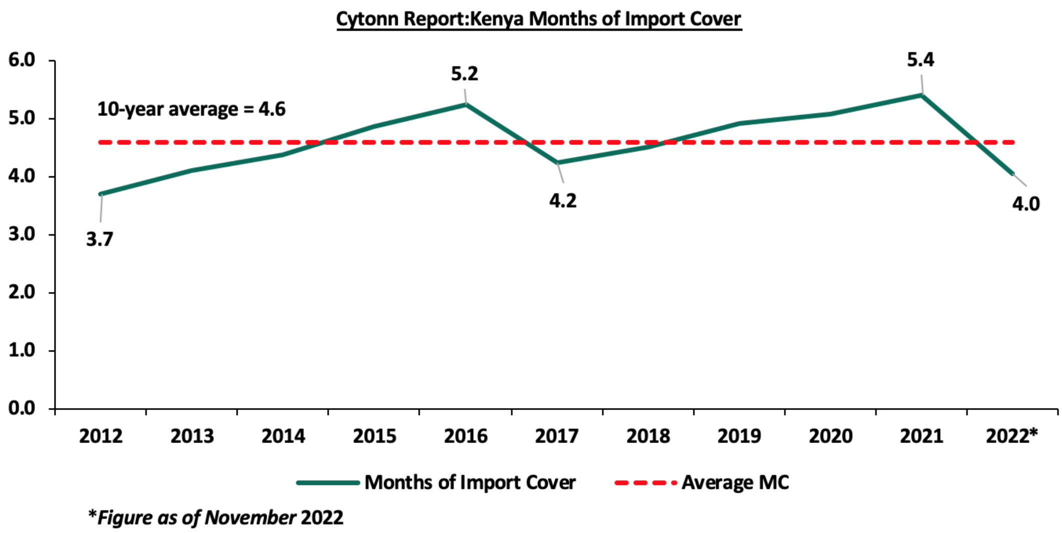
During the week, the Kenyan shilling depreciated by 0.2% against the US dollar to close the week at Kshs 122.3, from Kshs 122.0 recorded the previous week, partly attributable to increased dollar demand from importers, especially oil and energy sectors against a slower supply of hard currency. On a year to date basis, the shilling has depreciated by 8.1% 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 5.3% of GDP in the 12 months to September 2022, same as what was recorded in a similar period in 2021,
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, and,
iv. A continued hike in the USA Fed interest rates in 2022 to a range of 3.75%-4.00% in November

2022 has strengthened the dollar against other currencies by causing capital outflows from other global emerging markets.

The shilling is however expected to be supported by:

a. Improved diaspora remittances standing at a cumulative USD 4.0 bn as of October 2022, representing an 11.1% y/y increase from USD 3.6 bn recorded over the same period in 2021, and,
b. Sufficient Forex reserves currently at USD 7.0 bn (equivalent to 4.0 months of import cover), which is currently at par with 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 19.6% YTD from USD 8.8 bn. The chart below summarizes the evolution of Kenya months of import cover over the last 10 years;



Weekly Highlights:

i. **November 2022 Inflation Projection**

We are projecting the y/y inflation rate for November 2022 to fall within the range of 9.7%-10.1%, mainly on the back of;

I. **High fuel prices**: The fuel prices for the period between 14th November 2022 to 15th December 2022 for Super petrol, Diesel and Kerosene declined slightly by Kshs 1.0 to Kshs 179.3 per litre, Kshs 162.0 per litre and Kshs 145.9 per litre from Kshs 178.3 per litre, Kshs 163.0 per litre and Kshs 146.9 per litre, respectively. This translated to a decline of 0.7% for Kerosene and 0.6% for both Super petrol and Diesel. However, the fuel prices remain high and are expected to remain elevated due to partial removal of the fuel subsidy program by the new regime coupled with the global supply constraints. Given that fuel is a major input to most sectors, we expect the high prices to weigh on the inflation basket in the short term, and,
II. **Increasing food prices:** This was evidenced by the 15.8% y/y increase in the prices of food & non-alcoholic beverages as of October 2022 due to increased costs of production, uneven weather patterns and drought affecting food production. Given that the index constitutes 32.9% of the inflation basket, we expect the prevailing high food prices to exert pressure on the inflation rate.

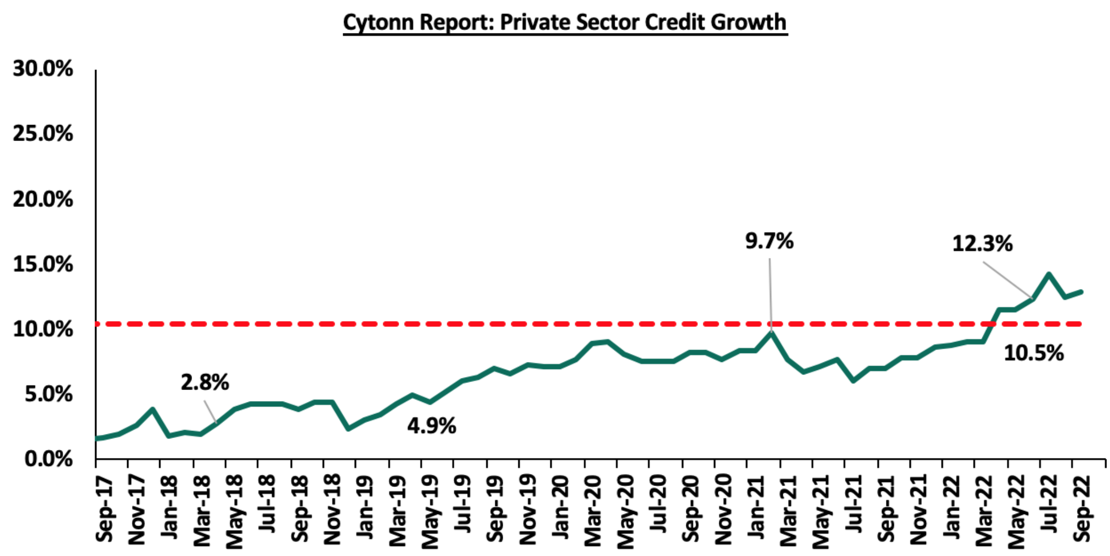
In our view, we expect the inflationary pressures to remain high mainly due to the high fuel and food prices. We also expect food prices to remain elevated for the short term, given the uneven weather patterns and drought. Notably, the Monetary Policy Committee raised the Central Bank Rate to 8.75%, from the previous 8.25% with the aim of anchoring the inflation rate which has continued to increase over the last ten months. Despite the MPC increase, we still believe that the inflationary pressures are due to external shocks and a decline is largely pegged on how soon global supply chains stabilize.

ii. **November 2022 MPC Meeting**

The Monetary Policy Committee (MPC) met on November 23rd 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). In line with our expectation, the MPC increased the CBR rate, albeit by 50.0 bps to 8.75% from the previous 8.25%, higher than our projections of a 25.0 bps hike to 8.50. Below are some of the key highlights from the meeting:

I. The overall inflation rose to 9.6% in October 2022 from 9.2% in September mainly attributable to food and oil prices which rose by 15.8% and 12.6% in October from 15.5% and 11.7% in September, respectively. We expect the Inflation rates to remain high in the short term as the new administration continues to do away with fuel subsidy program and adjust domestic fuel prices to ease pressure on expenditure,

II. Private sector credit growth continues to recover, having grown by 12.3% in October 2022, as compared to 7.8% in the same period last year. The key sectors that experienced increased lending were manufacturing (17.5%), trade (15.3%), business services (13.2%) and consumer durables (14.0%). The chart below shows the movement of the private sector credit growth of the last five years:



Source: CBK

III. The recently released GDP data by Kenya National Bureau of Statistics (KNBS) on the Q2' 2022 Gross Domestic Product Report, indicate that the Kenyan economy recorded a 5.2% growth in Q1'2022, down from the 11.0% growth recorded in Q2'2021 indicating continued economic recovery. The growth was mainly driven by strong activity in transport and storage, wholesale and retail trade, information and communication, real estate and financial and insurance,

IV. The CBK foreign exchange reserves, which currently stand at USD 7.0 mn (4.0 months of import cover), continue to provide adequate cover and a buffer against any short-term shocks in the foreign exchange market,

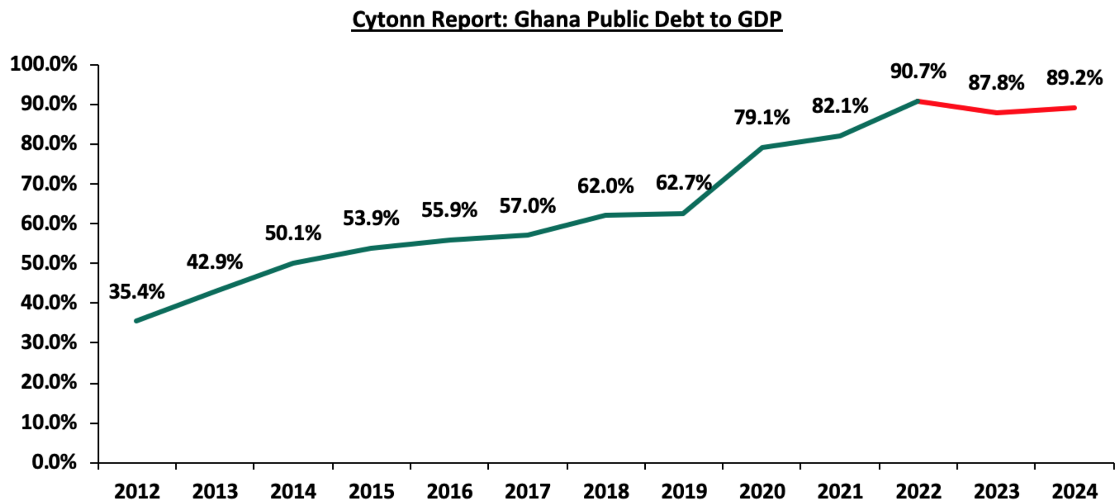
V. The current account deficit to GDP is estimated at 5.3% in the 12 months to September 2022, a 0.3% point lower than the 5.6% that was recorded in a similar period in 2021. Exports of goods remained strong, growing by 13.9% in the 12 months to September 2022 compared to similar period in 2021. Receipts from tea and manufactured goods exports increased by 15.9% and 26.0%, respectively. The increase in tea exports reflects improved prices as a result of improved demand from traditional markets. Key to note, imports of goods increased by 18.0% in 12 months to September 2022 compared to 12.6% for the same period in 2021, and,

VI. The Committee noted the ongoing implementation of the FY2022/23 Government Budget, especially the strong tax revenue collection reflecting enhanced tax administration efforts and increased economic activities under the new administration. Key to note, the government is also working on a supplementary budget

The MPC noted the sustained inflationary pressures, the elevated global risks and their potential impact on the domestic economy and decided to tighten the monetary policy in order to anchor inflationary expectations. The 50.0 bps increase was also driven by the developments in the global economy with countries such as USA and Eurozone hiking their rates and leading to capital outflows from emerging markets. However, we expect that the inflation rate will remain above the CBK's target range of 2.5%-7.5% mainly attributable to the elevated food and fuel prices which are the largest contributors to core inflation. Going forward, the committee will continue to monitor the situation and meet again in January 2023, but remains ready to re-convene earlier if necessary.

iii. **Ghana's Debt Distress**

According to the Ghana's Ministry of Finance, Ghana's Public Debt stood at USD 54.5 bn, equivalent to 77.5% of GDP as at May 2022 with external debt to GDP at 39.9% while that of the domestic debt at 37.5%. The debt service to revenue ratio as of 2021 stood at 47.8%. According to International Monetary Fund (IMF), the government's debt to GDP is projected at 90.7% for 2022 which is 40.7% points above the IMF's threshold of 50.0% for developing countries. The increase in debt to GDP is largely linked to the cedi depreciation, review of payment terms for some loans as well as continued borrowing by the government. As such, the country is expected to be under high debt distress and this has been exacerbated by the high level of inflation which is at an all-time high of 40.4%, coupled with continued depreciation of the cedi, having depreciated by 135.8% to 14.5 cedis in November 2022 from 6.2 cedis in January. Below is a chart showing Ghana's 10-year debt to GDP levels;



Source: IMF

In the month of October, Ghana's delegation and IMF team held a discussion on the post COVID-19 economic growth and associated policies to restore macroeconomic stability and lay foundation for a stronger economy. Ghana's economic situation is evidenced by downgrades by rating agencies such as Moody and Fitch. Key to note, Moody's downgraded Ghana to Caa2 from Caa1 and placed it under review as a result of tough macroeconomic environment and high debt distress leading to high chances of default. Additionally, Fitch downgraded Ghana to CC from CCC due to the potential debt restructuring as among the conditions set by the IMF. The forex reserves have also declined by 20.8% to USD 7.7 bn in June 2022 (equivalent to 3.4 months of import cover) from USD 9.7 bn (equivalent to 4.4 months of import cover) in same period last year further putting pressure on the Cedi. For Ghana to qualify for IMF's USD 3.0 bn assistance, the country will need to take steps to restructure its debt to restore debt sustainability. In aligning with IMF's conditions, Ghana has proposed certain measures to manage its debt levels as explained below;

I. **International bondholders** – International bondholders to get a 30.0% haircut on the bond's principal and forego some interest payments to ensure debt sustainability,

II. **Domestic bondholders** – The finance ministry is proposing to have the domestic bondholders to forego some interest payments. Further, the government is proposing to have domestic bondholders to switch their existing bonds for a new bond offering no coupon in the first year, 5% in the second and 10% in the third, and,
III. **Foreign bonds** – The government is also looking to suspend coupons on foreign bonds for at least three years.

Ghana's public debt crisis highlights the risks associated in the accumulation of public debt that is not being matched by economic growth in the Sub-Saharan Africa region. Key to note, public debt has been increasing steadily in Sub-Saharan Africa escalated by the increasing spending and reduced revenue collection during the COVID-19 pandemic. According to the IMF Regional Economic Outlook for Sub-Saharan Region, at least one-third of the region's economies have debt levels above 70.0% of the GDP resulting to 19 of the region's 35 low-income nations to be in debt distress or at a high risk of such. As such, more than half of the countries in the region are expected to undertake some fiscal consolidation measures which are expected to narrow the region's deficit bringing the region's average debt to an estimate of 55.0% of the GDP. Going forward, Sub Saharan African countries facing debt distress will need to optimize revenue mobilization strategies, prioritize spending where possible and ensuring efficiency in public spending. Besides consolidation, countries should develop medium term strategies to ensure debt management, diversification of financing sources and having effective debt-resolution mechanisms such as the G20 Common Framework.

Rates in the Fixed Income market have remained relatively stable due to the relatively ample liquidity in the money market. The government is 4.4% ahead of its prorated borrowing target of Kshs 238.1 bn having borrowed Kshs 248.6 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 636.4 bn in the FY'2022/2023, equivalent to a 29.7% of its target of Kshs 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.