Real Estate Investment Trusts (REITs) Progress in Kenya & Cytonn Weekly #50/2022

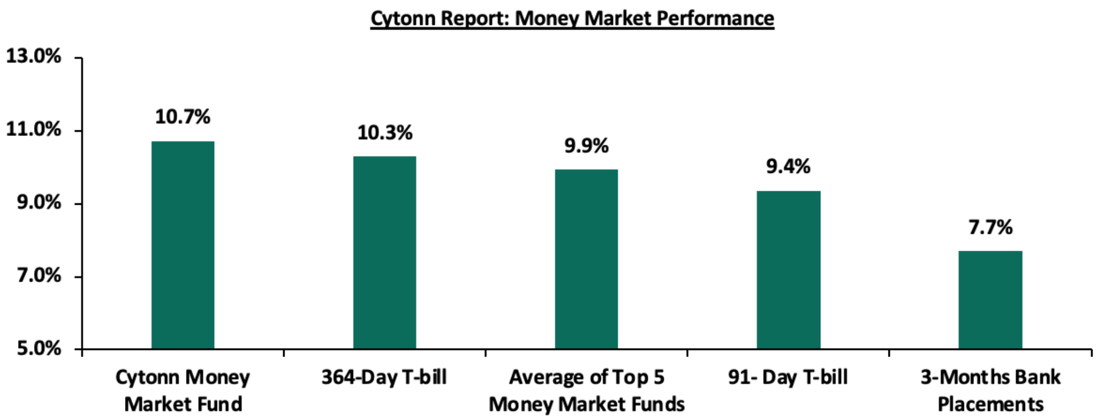
Fixed Income

Money Markets, T-Bills Primary Auction:

During the week, T-bills were oversubscribed, with the overall subscription rate coming in at to 121.8%, up from the 97.1% recorded the previous week, partly attributable to the eased liquidity in the money market with the average interbank rate declining to 5.1% from 5.2% recorded the previous week. Investor's preference for the shorter 91-day paper persisted as they sought to avoid duration risk, with the paper receiving bids worth Kshs 19.5 bn against the offered Kshs 4.0 bn, translating to a subscription rate of 487.7%, up from 416.3% recorded the previous week. The subscription rates for the 364-day and the 182-day papers also increased to 29.9% and 67.2% from 21.5% and 44.9% recorded the previous week, respectively. 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 5.4 bps, 2.5 bps and 2.9 bps to 10.3%, 9.8% and 9.4%, respectively. The Government rejected expensive bids, accepting a total of Kshs 17.4 bn worth of bids out of the Kshs 29.2 bn worth of bids received, translating to an acceptance rate of 59.6%. Key to note, for the 91-day paper, the government only accepted Kshs 7.7 bn worth of bids out of the Kshs 19.5 bn worth of bids received, which translated to a 39.5% acceptance rate.

In the Primary Bond Market, the government is seeking to raise an additional Kshs 20.0 bn for funding infrastructure projects in the FY'2022/2023 by offering a tap sale of the recent December Switch bond, IFB1/2022/6. The tap sale period ends on 22nd December 2022, or upon attainment of the Kshs 20.0 bn quantum. The coupon rate and weighted average accepted yield of the bond is 13.2%. Although the initial switch bond received an undersubscription of 60.3%, we anticipate an oversubscription, given the tax free nature of the bond, and that, it will now allow investors who weren't eligible in the initial switch bond. Additionally, the government re-opened two bonds, namely; FXD1/2020/05 and FXD1/2022/15, with effective tenors to maturity of 2.4 years and 14.3 years respectively, in a bid to raise Kshs 50.0 bn for budgetary support. The coupon rates for the bonds are 11.7% and 13.9% for FXD1/2020/5 and FXD1/2022/15, respectively. However, we expect the bonds to be undersubscribed, with FXD1/2020/5 receiving a higher subscription as investors avoid duration risk. The bonds are currently trading in the secondary market at yields of 12.3% and 13.9% for FXD1/2020/5 and FXD1/2022/15, respectively. As such, the recommended bidding range for the two bonds is 12.4%-12.8% for FXD1/2020/5 and 13.9%-14.3% for FXD1/2022/15. The period of the sale for the bonds runs from 14th December 2022 to 10th January 2023.

The increased activity in the primary bond market points towards the government's high appetite for domestic borrowing driven by the challenging environment to obtain external borrowing, in order to finance the Kshs 862.5 bn fiscal deficit for the FY'2022/2023.



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 364-day T-bill and 91-day T-bill increased by 5.4 bps and 2.9 bps to 10.3% and 9.4%, respectively. The average yield of the Top 5 Money Market Funds and Cytonn Money Market Fund remained relatively unchanged at 9.9% and 10.7%, respectively.

The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 16th December 2022:

Cytonn Report: Money Market Fund Yield for Fund Managers as published on 16th December 2022

Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund	10.7%
2	Zimele Money Market Fund	9.9%
3	GenCap Hela Imara Money Market Fund	9.7%
4	Madison Money Market Fund	9.7%
5	NCBA Money Market Fund	9.7%
6	Apollo Money Market Fund	9.5%
7	Sanlam Money Market Fund	9.5%
8	Nabo Africa Money Market Fund	9.4%
9	Dry Associates 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	ICEA Lion Money Market Fund	8.6%
15	AA Kenya Shillings Fund	8.6%
16	Orient Kasha Money Market Fund	8.6%
17	Absa Shilling Money Market Fund	7.8%
18	Equity Money Market Fund	5.4%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets eased, with the average interbank rate declining to 5.1% from 5.2% recorded the previous week, partly attributable to government payments that offset tax remittances. The average interbank volumes traded increased by 72.9% to Kshs 31.1 bn from Kshs 18.0 bn recorded the previous week.

Kenya Eurobonds:

During the week, the yields on Eurobonds recorded mixed performance with the yield on the 10-year Eurobond issued in 2014 recording the largest increase having gained by 0.3% points to 12.6% from 12.3%, recorded the previous week, partly attributable to increased market sentiments with the paper's maturity coming up in 2024. The table below shows the summary of the performance of the Kenyan Eurobonds as of 15th December 2022;

Cytonn Report: 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%
30-Nov-22	12.0%	10.1%	10.8%	10.7%	10.4%	9.6%
08-Dec-22	12.3%	9.9%	10.6%	10.3%	10.2%	9.4%
09-Dec-22	12.3%	9.9%	10.6%	10.2%	10.2%	9.4%
12-Dec-22	12.4%	9.9%	10.6%	10.2%	10.2%	9.4%
13-Dec-22	12.2%	9.8%	10.5%	10.1%	10.2%	9.3%
14-Dec-22	11.8%	9.7%	10.5%	10.1%	10.1%	9.2%
15-Dec-22	12.6%	9.9%	10.6%	10.4%	10.3%	9.4%
Weekly Change	**0.3%**	**-**	**-**	**0.1%**	**0.1%**	**-**
MTD Change	**0.6%**	**(0.1%)**	**(0.2%)**	**(0.3%)**	**(0.1%)**	**(0.1%)**
YTD Change	**8.2%**	**1.8%**	**2.5%**	**4.8%**	**3.6%**	**2.8%**

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 123.0, from Kshs 122.8 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 8.7% 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:

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 5.5% of GDP in the 12 months to October 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 69.7% of Kenya's External debt was US Dollar denominated as of September 2022, and,

iv. A continued hike in the USA Fed interest rates in 2022 to a range of 4.25%-4.50% in December 2022 has strengthened the dollar against other currencies following 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 November 2022, representing a 9.7% y/y increase from USD 3.7 bn recorded over the same period in 2021, and,
b. Sufficient Forex reserves currently at USD 7.1 bn (equivalent to 4.0 months of import cover), which is 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 19.3% YTD from USD 8.8 bn. The chart below summarizes the evolution of Kenya months of import cover over the last 10 years;

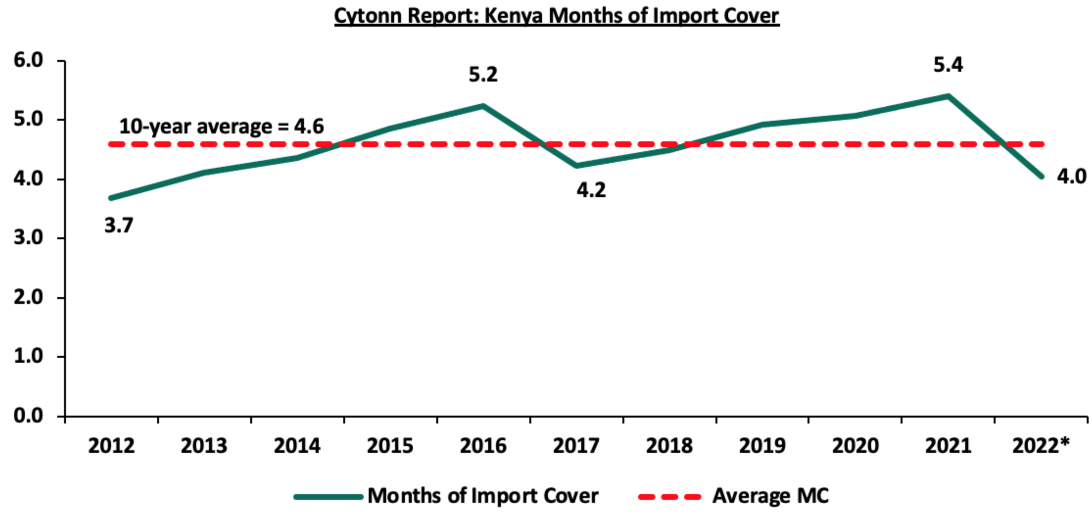


**Figure as of December 2022*

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 December 2022 to 14th January 2023. Notably, fuel prices remained unchanged at Kshs 177.3, Kshs 162.0 and Kshs 145.9 per litres of Super Petrol, Diesel and Kerosene, respectively. The performance was attributable to:

i. The cross subsidization of the price of Diesel with that of Super Petrol and maintaining of Kshs 25.1 subsidy per litre of Kerosene under the Petroleum Development Levy, and,
ii. The 5.7% decrease in the Free On Board (FOB) price in Murban crude oil to USD 92.5 per barrel in November 2022 from USD 98.1 recorded in October 2022.

The performance was despite:

i. The increase in the average landed costs of Super Petrol, Diesel and Kerosene by 2.7%, 6.6% and 6.0% to USD 704.2 per cubic metre, USD 920.4 per cubic metre and USD 851.3 per cubic metre in November 2022 from USD 686.1 per cubic metre, USD 863.8 per cubic metre and USD 803.1 per cubic metre in October 2022, respectively, and,
ii. The continued depreciation of the Kenyan Shilling, having declined by 0.1% to Kshs 124.2 in November 2022 from Kshs 124.1 in October 2022.

Despite the elevated fuel prices in Kenya, global fuel prices have declined by 50.1% to USD 78.4 per barrel as at 14th December 2022 from the peak of USD 117.7 per barrel recorded in the beginning of June 2022, as countries take measures to insulate themselves from the price shocks caused by the Russian Invasion in Ukraine. Over the same period, from June 2022 to date, the fuel prices in Kenya have increased by 11.4%, 15.7% and 14.1% to Kshs 177.3, Kshs 162.0 and Kshs 145.9 in December 2022 from Kshs 159.1, Kshs 140.0 and Kshs 127.9 in June 2022 per litres of Super Petrol, Diesel and Kerosene, respectively. The decoupling from global fuel prices is majorly attributable to the partial removal of fuel subsidies under the Petroleum Development Levy program by the current administration in September 2022. On a YTD basis, the current prices represent a 0.7% increase from the USD 77.9 per barrel recorded on 3rd January 2022, pointing towards stabilization of the global fuel prices. On 3rd December 2022, the G7 member countries formally imposed a USD 60.0 price cap per barrel of Russian oil which took effect on 5th December. This is expected to stabilize global energy prices even further and cool down the global inflation which has been partly attributable the elevated fuel prices. Additionally, the decline in the global oil prices is driven by the global drop in demand of fuel due to the fears of global recession, following another USA Fed interest rate hike in December and the new COVID-19 lock downs in China. Notably, Kenyans have continued to be cushioned against the increase in the average landed costs of fuel due to the continued subsidies, as the Government partially removed the fuel subsidies in September 2022. However, we have maintained that the subsidy program is unsustainable since it is a burden to the country's expenditure. As such, we expect the new administration to completely do away with the fuel subsidies and adjust the domestic fuel prices to ease the pressure on expenditure consequently reducing the need for excessive borrowing. With fuel being a major contributor to Kenya's inflation, we also expect the cost of living to remain elevated, and therefore, the business environment is expected to remain subdued emanating from the decline in consumer spending.

II. **Kenya's Fitch Ratings**

During the week, Fitch Ratings, a global credit rating agency, downgraded Kenya's Long-Term Foreign-Currency Issuer Default Rating (IDR) to 'B' from 'B+'. However, the agency assigned a stable outlook, from the negative outlook in March 2022. Notably, this confirms the S&P ratings in August 2022 which assigned Kenya's sovereign credit ratings at 'B' as both Long and Short term foreign and local currency debt issue with a stable outlook. According to Fitch Ratings, the downgrade in Kenya's IDR was attributable to:

i. **Widened current account deficit and low currency reserves-** Kenya's current account deficit was estimated at 5.5% of GDP in the 12 months to October 2022, same as what was recorded in a similar period in 2021, with Fitch forecasting it to widen to 5.9% of GDP in 2022. Further, Fitch expects it to remain broadly at the same level in 2023 and 2024 leading to a decline the country's foreign exchange reserves to USD 7.4 bn in the end of 2023, despite IMF and World Bank support. Kenya's foreign exchange reserves currently stands at USD 7.1 bn which represents a 19.3% YTD decline from USD 8.8 bn recorded in January 2022, representing 4.0 months of import cover, currently at par with the statutory requirements of 4.0 months,
ii. **High debt to revenue ratio-** At 385.0% of GDP in FY'2022, Kenya's debt to revenue ratio remains elevated, well above the current 'B' category median of 282.0%. Although Kenya's debt to GDP ratio marginally declined to 67.4% in 2022 from 67.7% in the 2021, it is forecasted to remain above 60.0% of the GDP in the short term, and to the projected 2024 55.0% of GDP due to the continued fiscal consolidation, it will still remain above the IMF recommended threshold of 50.0% of GDP for developing countries,
iii. **Increased debt servicing costs especially external debt service-** Owing to the 29.5% increase in interest payments to revenue in 2023 as projected by Fitch Ratings, coupled with the USD 2.0 bn Eurobond set to mature in June 2024, debt servicing continues to weigh down the country's revenue collection, and,
iv. **Elevated Inflation-** Despite the slight decline in the Kenya's inflation to 9.6% in November 2022 from 9.5% in October 2022, Fitch noted that, inflation will still remain elevated at an average of 8.3% in 2023 partly due to the current adverse weather conditions which has adversely affected agricultural production and global supply chain constraints affecting fuel prices.
v. **The Country's high level of corruption**- According to Transparency International, the Kenya's

Corruption Perception Index, an indicator of the relative degree of corruption, came in at 30.0% in 2021, with Kenya ranked 128 out of 180 countries, pointing towards high levels of corruption in the country, that has been hampering economic growth,

vi. **Inequality in the application of the rule of law**- With Kenya being ranked 104 out of 139 countries globally by the World Justice Report (WJP) in their WJP Rule of Law Index 2022 Report, Fitch noted that Kenya has uneven application of the rule of law, and,
vii. **Political instability during electioneering periods**- Fitch noted that, Kenya, having an ESG Relevance Score (RS) of '5', and a low World Bank Governance Indicators (WBGI) of 31.6% reflects a recent track record of difficult political transitions evidenced by the prolonged electioneering periods.

However, the agency assigned the country a stable outlook due to:

i. **Gradual fiscal consolidation-** This is supported by the continued IMF support of USD 2.3 bn under the Extended Fund Facility (EFF) and the Extended Credit Facility (ECF), and, the strong revenue collection, evidenced by the Kshs 2.0 tn collection in FY'2021/2022 which represented 2.8% outperformance, has helped to narrow the fiscal deficit to 6.2% of GDP in FY'2022/2023 from 8.2% in FY2020/2021. Also, the agency commented the new administration directive to partially remove the subsidy on fuels which has been putting pressure on the country's expenditure. As such, it projects the fiscal deficit to further decline to 6.1% of GDP, and,
ii. **Economic Growth-** Fitch forecasts that Kenya's growth will remain steady in 2023 and 2024 driven by the post pandemic recovery, with the real GDP growth, however, declining to 5.4% in 2022 from 7.5% in 2021. Also, improving asset quality will support growth through higher private sector credit growth. However, the elevated inflation, the slower global growth and fiscal tightening poses uncertainty in the country's growth in 2023.

Fitch further warned that Kenya's future rating is pegged on the widened fiscal deficit due to reduced access to external financing sources, widened current account deficit that would reduce the country's international reserves and a slower than expected GDP growth rate. Notably, Kenya's macroeconomic environment continues to remain unfavorable, evidenced by the elevated inflation which came in at 9.5% in November 2022 higher than the CBK target range of 2.5% - 7.5%, hiked interest rates of 8.75% to anchor inflation, high public debt to GDP ratio of 62.0% as of September 2022, continued currency depreciation of 8.7% YTD and the decline in the country's foreign reserves by 19.3% YTD to USD 7.1 bn from USD 8.8 bn in January 2022. Additionally, the fiscal tightening by the new administration to reduce government expenditure is expected to hamper economic development. As such, Kenya's future economic outlook will be determined by how faster the global conditions settle and how well the current administration implements their development agenda. However, we expect the continued support from the IMF and the World Bank will boost the country's reserves and help reduce the perceived risks in the country.

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

The National Treasury gazetted the revenue and net expenditures for the fifth month of FY'2022/2023, ending 30th November 2022. Below is a summary of the performance:

Cytonn Report: FY'2022/2023 Budget Outturn - As at 30th November 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			

Cytonn Report: FY'2022/2023 Budget Outturn - As at 30th November 2022

Amounts in Kshs billions unless stated otherwise

Item	12-months Original Estimates	Actual Receipts/Release	Percentage Achieved	Prorated	% achieved of prorated
Tax Revenue	2,071.9	758.6	36.6%	863.3	87.9%
Non-Tax Revenue	69.7	30.1	43.2%	29.0	103.7%
Total Revenue	**2,141.6**	**789.3**	**36.9%**	**892.3**	**88.5%**
External Loans & Grants	349.3	116.1	33.2%	145.6	79.8%
Domestic Borrowings	1,040.5	218.9	21.0%	433.5	50.5%
Other Domestic Financing	13.2	15.3	115.8%	5.5	278.0%
Total Financing	**1,403.0**	**350.3**	**25.0%**	**584.6**	**59.9%**
Recurrent Exchequer issues	1,178.4	436.5	37.0%	491.0	88.9%
CFS Exchequer Issues	1,571.8	489.3	31.1%	654.9	74.7%
Development Expenditure & Net Lending	424.4	89.5	21.1%	176.8	50.6%
County Governments + Contingencies	370.0	122.1	33.0%	154.2	79.2%
Total Expenditure	**3,544.6**	**1,137.4**	**32.1%**	**1,476.9**	**77.0%**
Fiscal Deficit excluding Grants	**1,403.0**	**348.0**	**24.8%**	**584.6**	**59.5%**
Total Borrowing	**1,389.8**	**335.0**	**24.1%**	**579.1**	**57.9%**

The key take-outs from the release include;

a. Total revenue collected as at the end of November 2022 amounted to Kshs 789.3 bn, equivalent to 36.9% of the original estimates of Kshs 2,141.6 bn for FY’2022/2023 and is 88.5% of the prorated estimates of Kshs 892.3 bn. We note that the government has not been able to meet its prorated revenue targets five months into the FY’2022/2023 partly attributable to the tough macroeconomic environment in the country as a result of elevated inflationary pressures with November 2022 coming in at 9.5%. Cumulatively, tax revenues amounted to Kshs 758.6 bn, equivalent to 36.6% of the original estimates of Kshs 2,071.9 bn and 87.9% of the prorated estimates of Kshs 863.3 bn,
b. Total financing amounted to Kshs 350.3 bn, equivalent to 25.0% of the original estimates of Kshs 1,403.0 bn and is equivalent to 59.9% of the prorated estimates of Kshs 584.6 bn. Additionally, domestic borrowing amounted to Kshs 218.9 bn, equivalent to 21.0% of the original estimates of Kshs 1,040.5 bn and is 50.5% of the prorated estimates of Kshs 433.5 bn,

c. The total expenditure amounted to Kshs 1,137.4 bn, equivalent to 32.1% of the original estimates of Kshs 3,544.6 bn, and is 77.0% of the prorated target expenditure estimates of Kshs 1,476.9 bn. Additionally, the net disbursements to recurrent expenditures came in at Kshs 436.5 bn, equivalent to 37.0% of the original estimates of Kshs 1,178.4 bn and 88.9% of the prorated estimates of Kshs 491.0 bn,
d. Consolidated Fund Services (CFS) Exchequer issues, in which the Consolidated Fund was established in the Kenya's constitution into which development partners deposit funds before disbursing to the Exchequer accounts for onward transfer to projects such as servicing of public debt, payment of pensions and gratuities, salaries and allowances and subscription to International Organizations came in at Kshs 489.3 bn, equivalent to 31.1% of the original estimates of Kshs 1,571.8 bn, and are 74.7% of the prorated amount of Kshs 654.9 bn. The cumulative public debt servicing cost amounted to Kshs 449.6 bn which is 32.3% of the original estimates of Kshs 1,393.1 bn, and is 77.5% of the prorated estimates of Kshs 580.5 bn. Additionally, the Kshs 449.6 bn debt servicing cost is equivalent to 57.0% of the actual revenues collected as at the end of November 2022, further emphasizing on how much public debt weighs on the country's expenditure. Additionally, Recurrent Exchequer issues came in at Kshs 436.5 bn equivalent to 37.0% of the original estimates of Kshs 1,571.8 bn and are 88.9% of the prorated estimates of Kshs 491.0, and,
e. Total Borrowings as at the end of November 2022 amounted to Kshs 335.0 bn, equivalent to 24.1% of the original estimates of Kshs 1,389.8 bn for FY'2022/2023 and are 57.9% of the prorated estimates of Kshs 463.3 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 fifth month of the FY'2022/2023 reflects the economic uncertainties in the country emanating from the elevated inflation and high perceived risk in the country evidenced by downgrading of the country's Issuer Default Rating (IDR) by Fitch ratings to 'B' in December 2022 from 'B+' in March 2022. 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. The government is 11.8% ahead of its prorated borrowing target of Kshs 268.5 bn having borrowed Kshs 300.1 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 789.3 bn in the FY'2022/2023 as at the end of November, equivalent to a 36.9% 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 ease the need for elevated borrowing 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.