Cytonn Q1’2023 Markets Review

Kenya Macro Economic Review

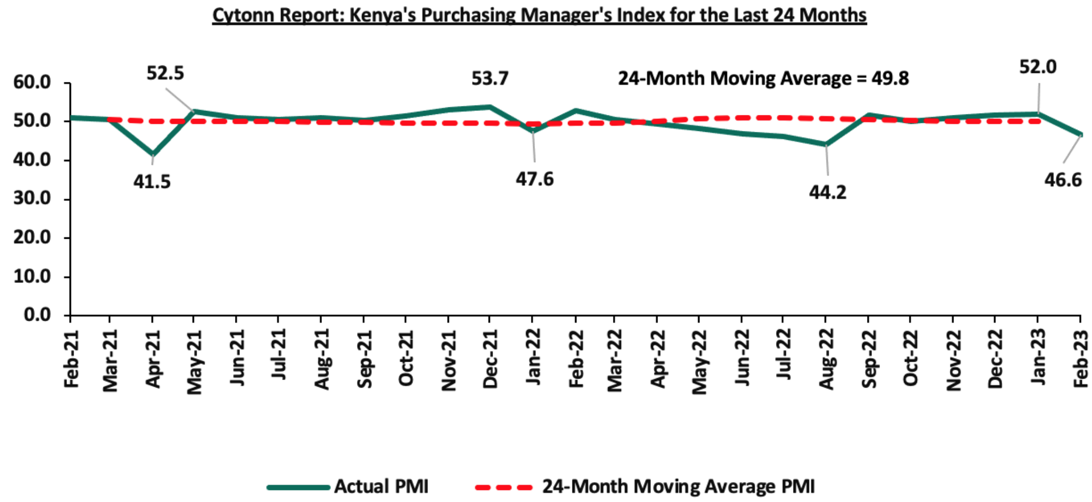
The Kenyan is economy projected to grow at an average of 5.3% in 2023, 0.3% points lower than the 5.6% growth recorded in 2022, attributable to the sustained inflationary pressures, elevated global risks and erratic weather conditions. The table below shows the projections according to various organizations:

Cytonn Report: Kenya 2023 growth Projections

No.	Organization	2023 GDP Projections
1	International Monetary Fund	5.1%
2	National Treasury	6.1%
3	World Bank	5.0%
4	Fitch Solutions	5.1%
5	Cytonn Investments Management PLC	5.0%
Average		**5.3%**

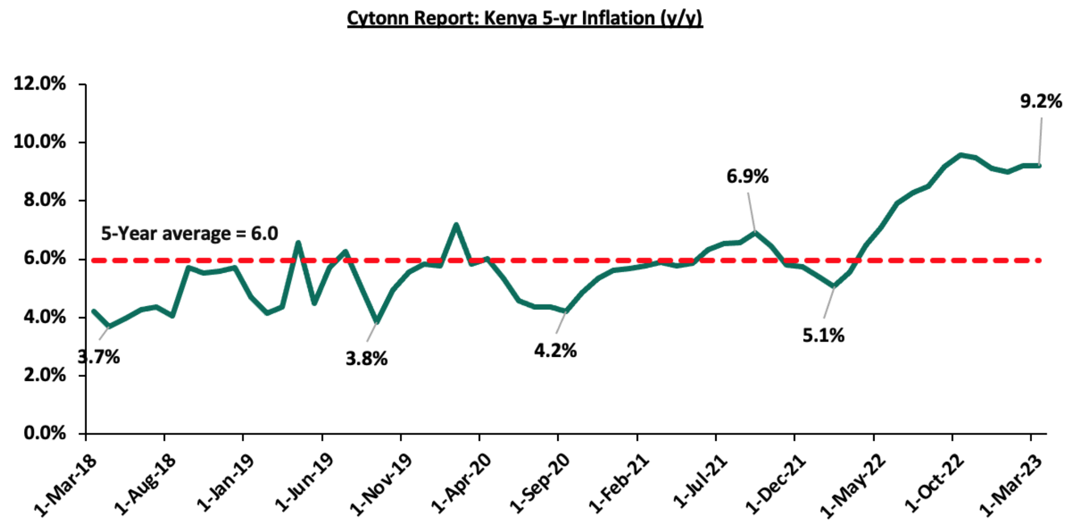
Source: Cytonn Research

Key to note, Kenya’s general business environment deteriorated in Q1’2023, with the average Purchasing Manager’s Index for the first two months of the quarter coming at 49.3, compared to 51.7 recorded in a similar period in 2022, mainly on the back of elevated commodity prices, which have seen consumers cut back on spending. Additionally, during the quarter, S&P Global Ratings downgraded Kenya’s outlook to negative from stable, signaling increased risks of defaults in debt repayments amid weakening liquidity position aggravated by dwindling foreign exchange reserves as well as high debt servicing obligations in the next fiscal year. The chart below summarizes the evolution of PMI over the last 24 months. (A reading above 50.0 signal an improvement in business conditions, while readings below 50.0 indicate a deterioration):



Inflation:

The average inflation rate increased to 9.1% in Q1'2023, significantly higher than the 5.3% in Q1'2022, mainly attributable to the elevated food and fuel prices in the period under review. Notably, the prices of super petrol increased by Kshs 2.0 in March 2023, to Kshs 179.3 per litre representing a 1.1% year-to-date increase, while diesel and kerosene remained unchanged at Kshs 162.0 and Kshs 149.5 per litres from what was recorded at the beginning of the year. Below is the chart showing the inflation trend for the last five years:



March 2023 Inflation

The year on year inflation rate in the month of March 2023 remained constant at 9.2%, from what was recorded in the month of February 2023, while the monthly inflation rate for March 2023 was 0.8%. It was against our expectation of an ease within a range of 8.6%-9.0%. The headline inflation was largely driven by increase in prices of commodities in the following categories, food and non-alcoholic beverages; housing, water, electricity, gas and other fuels; and transport. The table below shows a summary of both the year on year and month on month commodity indices performance:

Cytonn Report: Major Inflation Changes – March 2023

Broad Commodity Group	Price change m/m (February-2023/March-2023)	Price change y/y (Mach-2022/March-2023)	Reason
Food and Non-Alcoholic Beverages	1.6%	13.4%	The m/m increase was mainly driven by increase in price commodities such as cabbages, carrots, potatoes, kales, and fortified maize flour. The increase was, however, mitigated by drop in prices of commodities such onions, cooking oil and tomatoes
Housing, Water, Electricity, Gas and Other Fuel	0.6%	7.5%	The m/m change was mainly due to increase in prices of electricity, cooking gas and monthly house rent
Transport cost	0.3%	12.6%	The m/m change was mainly due to increase in prices of super petrol
Overall Inflation	**0.8%**	**9.2%**	**The m/m was mainly driven by 1.6% increase in prices of food and non-alcoholic Beverages**

Inflationary pressures in the country remain worryingly above the Central Bank of Kenya target range of 2.5%-7.5% for a tenth consecutive month to March 2023, with commodities under food and non-alcoholic beverages being the largest contributors of inflation. The sustained inflationary pressures continue despite the monetary policy committee intervening with subsequent hikes in the Central Bank Rate, raising the CBR rate by a cumulative of 200.0 bps since July 2022 to 9.50% in March 2023. Notably, in move to combat food inflation the government through the Kenya Revenue Authority issued an exemption on duty to Kenya National Trading Corporation for importation of cooking oil, rice, beans and sugar. The state agency will sell the commodities directly to shops, reducing the long value chain that consequentially make commodities expensive. The importation of duty free commodities is also expected to increase competition among other local manufacturers and producers, forcing them to lower prices of commodities.

Going forward, we expect inflationary pressures in the country to persist in the short term due to high fuel and electricity prices following the scaling down of fuel subsidies as well as higher electricity tariffs. However, we expect food inflationary pressures to ease in the medium term following the expected long rains in the coming months. Furthermore, we are of the view that the eventual slowdown in inflationary pressures is largely pegged on how quickly the elevated global inflationary pressure ease.

The Kenyan Shilling:

The Kenyan Shilling depreciated against the US Dollar by 7.3% in Q1'2023, to close at Kshs 132.3, from Kshs 123.4 at the end of 2022, partly attributable to increased dollar demand in the energy, oil and manufacturing sectors. Key to note, this is the lowest the Kenyan shilling has traded against the dollar. During the week, the Kenya Shilling depreciated against the US Dollar by 0.8% to close at 132.3 from 131.3 the previous week. We expect the shilling to remain under pressure in 2023 because of:

i. High global crude oil prices on the back of persistent supply chain bottlenecks coupled with high demand. The high crude oil prices have inflated Kenya's import bill and as a result, petroleum products imports have continued to weigh heavily on the country's import bill, and accounted for 27.6% of the total import bill in Q3'2022, up from 25.6% in Q2'2022 and much higher than 15.2% recorded in Q3'2021,
ii. An ever-present current account deficit projected at 5.4% of GDP in 2023 from the estimate of 4.9% of GDP in 2022,
iii. The need for Government debt servicing which continues to put pressure on forex reserves given that 69.3% of Kenya's External debt was US Dollar denominated as of October 2022, and,
iv. A continued interest rate hikes in the USA and the Euro Area with the Fed and European Central Bank increasing their benchmark rates to 4.75%-5.00% and 3.50% respectively in March 2023, which has strengthened the dollar and sterling pound against other currencies following capital outflows from other global emerging markets.

However, the shilling is expected to be supported by:

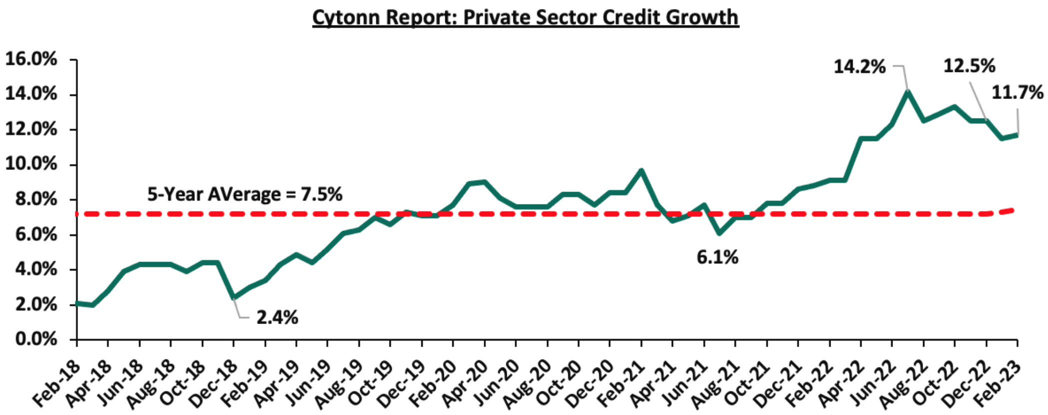
i. Diaspora remittances standing at a cumulative USD 658.6 mn in 2023 as of February 2023, albeit 0.3% lower than the USD 660.3 mn recorded over the same period in 2022, and,
ii. The tourism inflow receipts that came in at USD 268.1 bn in 2022, a significant 82.9% increase from USD 146.5 bn inflow receipts recorded in 2021.

Monetary Policy:

The Monetary Policy Committee (MPC) met on March 29th, 2023 to review the outcome of its previous policy decisions and recent economic developments, and to decide the direction of the Central Bank Rates (CBR). Notably, the MPC decided to raise the Central Bank Rate (CBR) by 75.0 bps to 9.50% from 8.75% in their January2023 sitting, in a bid to contain the elevated inflation rate, which came at 9.2% in March 2023, similar to what was recorded in February 2023, and 1.7% points above the CBK ceiling of 7.5%. The action to tighten the monetary policy was in line, although higher than our expectation of a 25.0 bps increase. Below are some of the key highlights from the meeting:

i. Overall Inflation increased to 9.2% in February 2023 from 9.0% in January 2023 on the back of high food prices in the country. Food inflation rose to 13.3 percent in February from 12.8 percent in January, mainly due to increases in the prices of vegetables, attributed to erratic weather conditions witnessed in the period. Additionally, fuel inflation remained elevated at 13.8% in February 2023 attributable to scaling down of the fuel subsidy and high electricity prices due to higher tariffs. The MPC projected the inflation to remain elevated in the near term partly attributed to increases in electricity prices. However, the anticipated long rains are expected to moderate food inflation in the medium to long term,

ii. The MPC noted that leading economic indicators pointed to a strong performance of the Kenyan economy in the Q1'2023, reflecting robust activity in services sector particularly wholesale and retail trade, accommodation and food services among others. The economy is expected to remain resilient in 2023 supported by continued strong performance of the services sector and expected recovery in agriculture sector,
iii. Private sector credit growth stood at 11.7% in February 2023 compared to 12.7% in December 2022. Key sectors that recorded strong credit growth were transport and communication, manufacturing, consumer durables, and trade of 16.5%, 15.2%, 12.4%, and 11.8%. Consequentially, the number of loan application and approval declined reflecting, reduced demand. The chart below shows the movement of the private sector credit growth of the last five years.



Source: Central Bank of Kenya

iv. Goods exports remained strong having grown by 11.0% in the 12 months to February 2023 compared to 12.1% recorded in a similar period in 2022. Notably, receipts from tea and manufacturing goods exports increased by 13.4% and 27.2%, respectively during the period. The increase in receipts from tea exports is attributed to improved prices due to increased demand from traditional markets. In addition, imports grew by 2.1% in the 12 months to February 2023 compared to 27.3% growth recorded in a similar period in 2022, on the back of lower imports of infrastructure related equipment due to completion of major projects. Remittances stood at USD 4.0 bn in 12 months to February 2023, 4.9% higher than USD 3.8 bn recorded in a similar period in 2022. The current account deficit is projected at 5.4% of GDP in 2023 from the estimate of 4.9% of GDP in 2022, and,
v. The banking sector remains resilient, stable, with strong liquidity, and capital adequacy ratios, despite the deterioration in asset quality. The gross non-performing loans to gross loans ratio increased to 14.0% in February 2023, compared to 13.3% in December 2022. The increase in non-performing loans was noted in sectors such as trade, personal and household, manufacturing and building and construction. However, banks have continued to make adequate provisioning for the NPLs.

The MPC concluded that following the sustained inflationary pressures, the elevated global risks and their potential impact on the domestic economy, there was a need for further tightening of the monetary policy in order to anchor inflation within its target range of 2.5% to 7.5%. Going forward, we expect the inflationary pressures to endure in the short term mainly on the back of elevated fuel prices following the scaling down of fuel subsidies coupled with high electricity prices due to higher tariffs. Additionally, we expect inflationary pressures to persistent as a result of sustained depreciation of the Kenya shilling against the US dollar which continues to inflate the cost of importation and production, forcing manufacturers to transfer the cost to consumers through hike in prices. The Committee will meet again in May 2023, but will closely monitor the impact of the policy measures and remains ready to re-convene earlier if necessary.

Q1'2023 Highlights:

i. Stanbic Bank released its monthly Purchasing Manager's Index (PMI), highlighting that the index for the month of December picked up to a three-month high of 51.6, from 50.9 in November 2022, pointing towards a sustained improvement in the business environment for a fourth consecutive month. The rebound in business activity in the country was linked to factors such as increase in demand, favourable weather conditions and softer price pressures as firms saw input costs increase at the slowest rate in 12 months. For more information, please see our Cytonn Weekly #01/2023,
ii. The National Treasury gazetted the revenue and net expenditures for the first half of FY'2022/2023, ending 30th December 2022, highlighting that the total revenue collected as at the end of December 2022 amounted to Kshs 987.9 bn, equivalent to 92.3% of the prorated estimates of Kshs 1070.8 bn. For more information, please see our Cytonn Weekly #02/2023,
iii. The Energy and Petroleum Regulatory Authority (EPRA) released their monthly statement on the maximum retail fuel prices in Kenya effective 15th January 2023 to 14th February 2023. Notably, fuel prices remained unchanged for the second consecutive month at Kshs 177.3, Kshs 162.0 and Kshs 145.9 per litres of Super Petrol, Diesel and Kerosene, respectively. For more information, please see our Cytonn Weekly #02/2023,
iv. The Kenya Revenue Authority released the draft regulations for the Excise Duty (Excisable Goods Management Systems)(Amendment) Regulations, 2023 having reviewed the previous Excise Duty (Excisable Goods Management Systems)(Amendment) Regulations, 2017, under the Excise Duty Act No. 23 of 2015, seeking to increase the stamp duty fees on various commodities. For more information, please see our Cytonn Weekly #03/2023, and,
v. The National Treasury released the Draft 2023 Budget Policy Statement, projecting a 59.2% increase in tax revenue in the medium term to Kshs 4.0 tn by the end of FY'2026/27 from the Kshs 2.5 tn original FY'2022/23 budget estimates. For more information, please see our Cytonn Weekly #03/2023,
vi. The y/y inflation in January 2023 came at 9.0%, marginally easing from the 9.1% recorded in December 2022. This was against our expectations of an increase within a range of 9.2%-9.6%, driven by an expected increase in the Housing, water Electricity, Gas and other fuel index following the increase in electricity prices. For more information, please see our January 2023 Cytonn Monthly,
vii. The Monetary Policy Committee (MPC) met on January 30th, 2023 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). The MPC retained the CBR rate at 8.75%, which was against our expectation of a 25.0 bps increase to 9.0%. For more information, please see our January 2023 Cytonn Monthly,
viii. Stanbic bank released its monthly Purchasing Managers Index (PMI), highlighting that the index for the month of January 2023 came in at 52.0, up from 51.6 recorded in December 2022, pointing towards a sustained improvement in the business environment for a fifth consecutive month. The improvement was largely attributable to rising demand levels, as well as improved operating conditions which boosted business confidence. For more information, please see our January 2023 Cytonn Monthly,
ix. The National Treasury presented the Supplementary Budget for FY'2022/23 to the National Assembly, seeking to slightly increase the gross total budget by 0.4% to Kshs 3,373.3 bn, from the previous estimates of Kshs 3,358.6 bn. Mainly due to an increase in the recurrent expenditure by 6.6% to Kshs 1,496.9 bn in the Supplementary estimates from Kshs 1,403.9 bn in the Original estimates. On the other hand, Development expenditure was set to reduce by 14.9% to Kshs 609.1 bn in the supplementary estimates from Kshs 715.4 bn in the original estimates. For more information, please see our Cytonn weekly #06/2023,
x. The National Treasury gazetted the revenue and net expenditures for the seven months of FY'2022/2023, ending 31th January 2023. In addition, the National Treasury released the Final 2023 Budget Policy Statement, which was the first to be prepared under the new administration. This follows the release of the Draft of the 2023 Budget Policy Statement in January 2023. The

policy statement stipulates the administration priority programs, policies and reforms to be implemented in the Medium-Term Expenditure Framework (MTEF). For more information, please see our Cytonn weekly #07/2023, and,

xi. The Energy and Petroleum Regulatory Authority (EPRA) released their monthly statement on the maximum retail fuel prices in Kenya effective 15th February 2023 to 14th March 2023. Notably, fuel prices remained unchanged for the third consecutive month at Kshs 177.3, Kshs 162.0 and Kshs 145.9 per litres of Super Petrol, Diesel and Kerosene, respectively. For more information, please see our Cytonn weekly #07/2023,
xii. S&P Global Ratings downgraded Kenya’s outlook to negative from stable, signaling increased risks of defaults in debt repayments amid weakening liquidity position aggravated by sustained decline in foreign exchange reserves as well as high debt servicing obligations in the next fiscal year. Furthermore, the recent undersubscription of domestic bond issuances, as well as constrained access to international capital markets, have heightened Kenya’s medium term fiscal and external refinancing risks. For more information, please see our February 2023 Cytonn Monthly,
xiii. The Kenya National Bureau of Statistics (KNBS) released the y/y inflation for February 2023, which came in at 9.2%, up from the 9.0% recorded in January 2023. This was in contrast to our expectations of an ease within a range of 8.6%-9.0%. For more information, please see our February 2023 Cytonn Monthly,
xiv. Stanbic Bank Kenya released its monthly Purchasing Managers Index (PMI), highlighting that the index for the month of February 2023 came at 46.6, down from an 11-month high of 52.0 recorded in January 2023. This is the first time in six months that the index has registered below the 50.0 no change threshold, pointing towards a solid deterioration in operating conditions. For more information, please see our February 2023 Cytonn Monthly,
xv. The National Treasury gazetted the revenue and net expenditures for the eight months of FY’2022/2023, ending 28th February 2023. For more information, please see our Cytonn weekly #11/2023,
xvi. The Energy and Petroleum Regulatory Authority (EPRA) released their monthly statement on the maximum retail fuel prices in Kenya effective 15th March 2023 to 14th April 2023. Notably, prices of Super Petrol increased by Kshs 2.0 per litre to Kshs 179.3, while prices of Diesel and Kerosene remained unchanged for the fourth consecutive month at Kshs 162.0 and Kshs 145.9 per litres, respectively. For more information, please see our Cytonn weekly #11/2023, and,
xvii. The Central Bank of Kenya announced the issuance of the Foreign Exchange Code (the FX Code) on 22nd March 2023 to commercial banks, in a move to regulate wholesale transactions of the foreign exchange market in Kenya.
