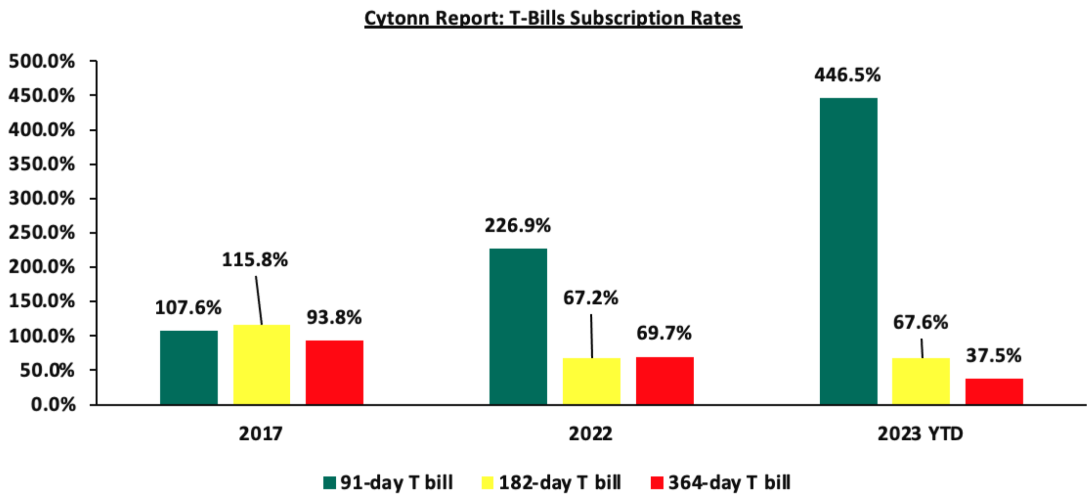
Nairobi Metropolitan Area Residential Report 2023, & Cytonn Weekly #18/2023

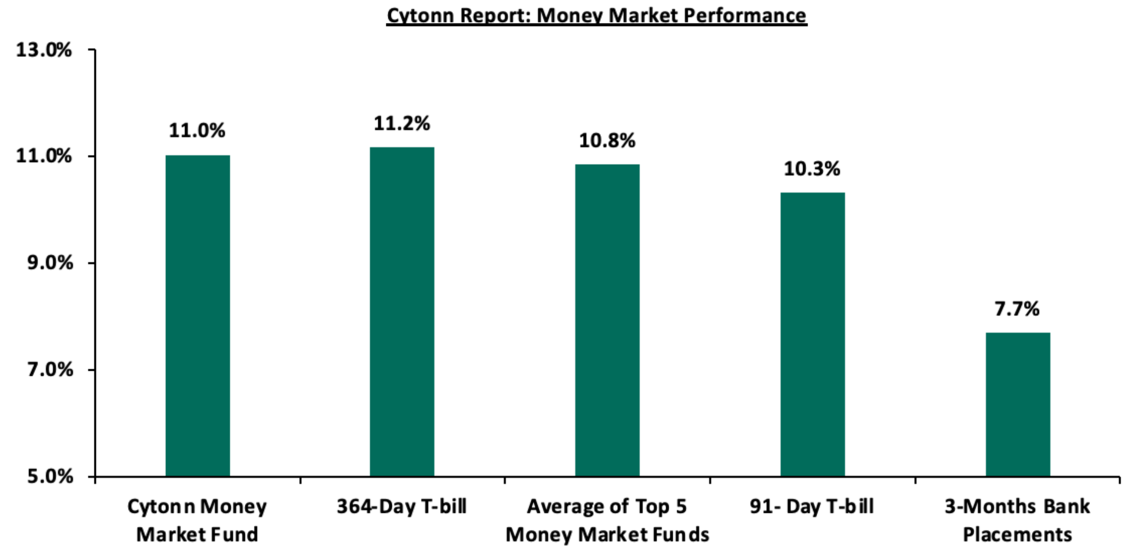
Fixed Income

Money Markets, T-Bills Primary Auction:

During the week, T-bills were oversubscribed, with the overall subscription rate coming in at 110.7%, up from the 37.5%, 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 19.3 bn against the offered Kshs 4.0 bn, translating to an oversubscription rate of 508.0%, significantly higher than the 167.2% recorded the previous week. The subscription rate for the 182-day and the 364-day papers increased to 53.4% and 9.2%, from 14.4% and 8.7%, respectively, recorded the previous week. The government accepted bids worth Kshs 25.5 bn out of the Kshs 26.6 bn total bids received, translating to an acceptance rate of 96.1%. The yields on the government papers were on an upward trajectory, with the yields on the 364-day paper, 182-day and 91-day papers increasing by 4.6 bps, 16.7 bps and 4.3 bps to 11.2%, 10.7% and 10.3%, respectively. The chart below compares the overall average T- bills subscription rates obtained in 2017, 2022 and 2023 Year to Date (YTD):



Money Market Performance:



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 yields on the 364-day and average yields on the Top 5 Money Market Funds increased by 4.6 bps and 11.6 bps to 11.2% and 10.8%, respectively. The yields on the 91-day paper increased by 4.3 bps to remain relatively unchanged at 10.3%, while the yield of Cytonn Money Market Fund decreased by 2.0 bps to remain relatively at 11.0%, similar to what was recorded the previous week.

The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 5 May 2023:

Cytonn Report: Money Market Fund Yield for Fund Managers as published on 5 May 2023

Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund (dial *809# or download Cytonn App)	11.0%
2	Etica Money Market Fund	11.0%
3	GenAfrica Money Market Fund	10.9%
4	Dry Associates Money Market Fund	10.8%
5	Apollo Money Market Fund	10.6%
6	Jubilee Money Market Fund	10.5%
7	Kuza Money Market fund	10.2%
8	Enwealth Money Market Fund	10.1%
9	Old Mutual Money Market Fund	10.1%
10	Madison Money Market Fund	10.1%
11	AA Kenya Shillings Fund	10.1%
12	NCBA Money Market Fund	10.0%
13	Zimele Money Market Fund	9.9%
14	Nabo Africa Money Market Fund	9.8%
15	Sanlam Money Market Fund	9.8%
16	Co-op Money Market Fund	9.7%
17	GenCap Hela Imara Money Market Fund	9.6%

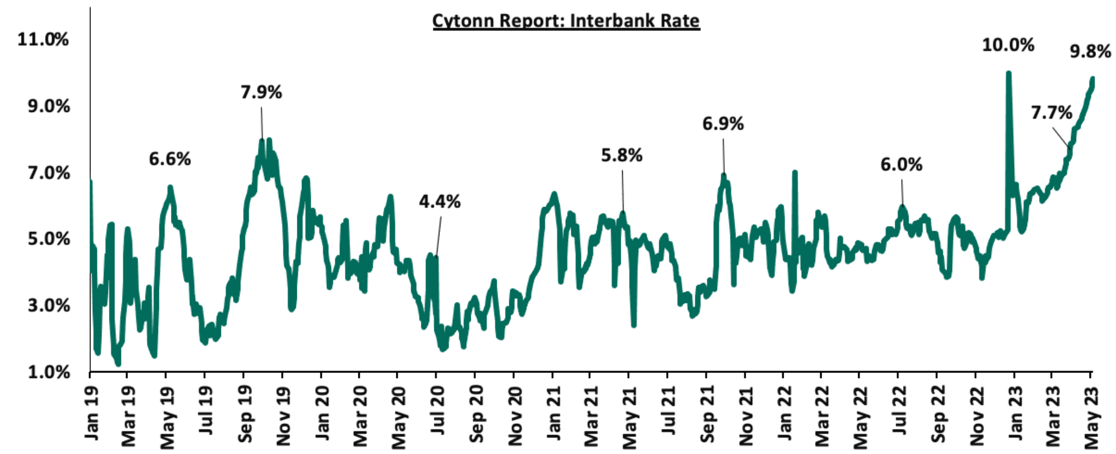
Cytonn Report: Money Market Fund Yield for Fund Managers as published on 5 May 2023

Rank	Fund Manager	Effective Annual Rate
18	KCB Money Market Fund	9.6%
19	CIC Money Market Fund	9.5%
20	British-American Money Market Fund	9.4%
21	Orient Kasha Money Market Fund	9.3%
22	ICEA Lion Money Market Fund	9.3%
23	Absa Shilling Money Market Fund	8.4%
24	Mali Money Market Fund	8.3%
25	Equity Money Market Fund	7.2%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets tightened, with the average interbank rate increasing to 9.7%, from 9.2% recorded the previous week, partly attributable to tax remittances that offset government payments. The average interbank volumes traded increased by 11.3% to Kshs 19.0 bn, from Kshs 17.1 bn recorded the previous week. The chart below shows the interbank rates in the market over the years:



Source: CBK

Kenya Eurobonds:

During the week, the yields on Eurobonds recorded mixed performances with the yield on the 10-year Eurobond issued in 2018 recording the largest decline having declined by 0.4% points to 13.7%, from 14.1%, recorded the previous week, while the yield on the 7-year Eurobond issued in 2019 remained unchanged at 15.4%. The table below shows the summary of the performance of the Kenyan Eurobonds as of 4 May 2023;

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**
Amount Issued (USD)	**2.0 bn**	**1.0 bn**	**1.0 bn**	**0.9 bn**	**1.2 bn**	**1.0 bn**
Years to Maturity	**1.2**	**4.8**	**24.9**	**4.1**	**9.1**	**11.2**
Yields at Issue	**6.6%**	**7.3%**	**8.3%**	**7.0%**	**7.9%**	**6.2%**
2-Jan-23	12.9%	10.5%	10.9%	10.9%	10.8%	9.9%
31-Mar-23	14.2%	12.3%	11.6%	13.4%	11.7%	11.3%
27-Apr-23	20.0%	14.1%	12.7%	15.4%	13.2%	12.4%
28-Apr-23	20.6%	14.1%	12.7%	15.5%	13.2%	12.4%
1-May-23	20.6%	14.1%	12.7%	15.5%	13.2%	12.4%
2-May-23	20.9%	14.2%	12.8%	15.7%	13.2%	12.4%
3-May-23	20.4%	14.1%	12.7%	15.6%	13.2%	12.4%
4-May-23	19.7%	13.7%	12.6%	15.4%	13.0%	12.3%
Weekly Change	**(0.3%)**	**(0.4%)**	**(0.1%)**	**0.0%**	**(0.2%)**	**(0.1%)**
MTD Change	**(0.8%)**	**(0.4%)**	**(0.1%)**	**(0.0%)**	**(0.1%)**	**(0.1%)**
YTD Change	**6.8%**	**3.2%**	**1.7%**	**4.5%**	**2.3%**	**2.5%**

Source: Central Bank of Kenya (CBK) and National Treasury

Kenya Shilling:

During the week, the Kenya Shilling depreciated by 0.4% against the US dollar to close the week at Kshs 136.4, from Kshs 135.9 recorded the previous week, partly attributable to the persistent 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 10.5% against the dollar, adding to the 9.0% depreciation recorded in 2022. We expect the shilling to remain under pressure in 2023 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 4.9% of GDP in twelve months to January 2023, from 5.6% recorded in a similar period last year,
iii. The need for Government debt servicing which continues to put pressure on forex reserves given that 63.0% of Kenya's External debt was US Dollar denominated as of December 2022, and,

The shilling is however expected to be supported by:

i. Diaspora remittances standing at a cumulative USD 1,015.5 mn in 2023 as of March 2023, albeit 0.8% lower than the USD 1,023.8 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.

Key to note, Kenya's forex reserves declined by 0.6% during the week to remain relatively unchanged at USD 6.5 bn as at 4 May 2023. As such, the country's months of import cover also remained unchanged at 3.6 months, similar to what was recorded the previous week, and remained below the statutory requirement of maintaining at least 4.0-months of import cover. The chart below summarizes the evolution of Kenya months of import cover over the last 10 years:

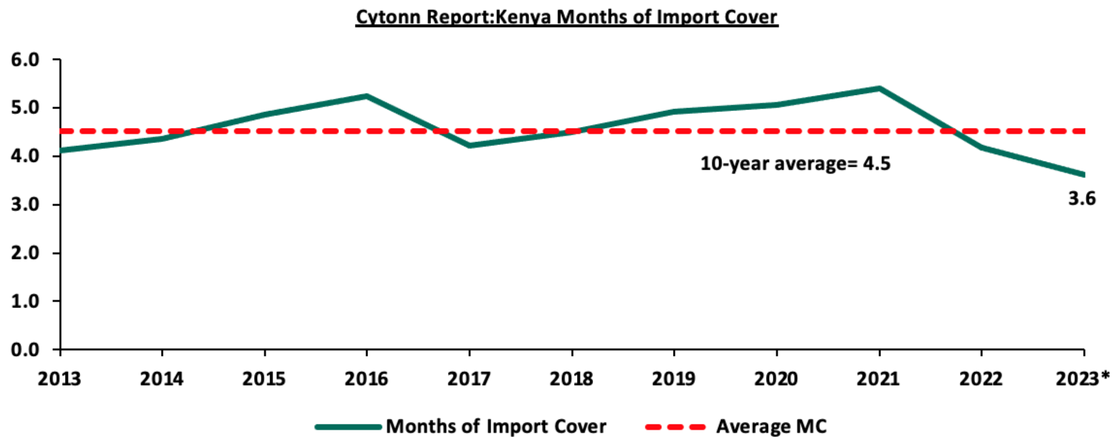


Figure as at 4 May 2023

Weekly Highlights:

I. **Launch of the Kenya Quick Response Code Standard**

During the week, the Central Bank of Kenya announced the issuance and usage of the Kenya Quick Response Code Standard 2023 (KE-QR Code Standard 2023). The Standard is aimed at guiding banks and payment service providers that are approved and regulated by the Central Bank in issuing of Quick Response Codes to consumers and businesses that accept digital payments. The launch of the QR code is in line with the Central Bank's efforts to improve the efficiency and effectiveness of the National Payment System (NPS) for the period 2022-2025. The issuance of the Standard is a great step in facilitating payments with the following key take outs;

i. Improve interoperability of the NPS through digital payments. Since digital payment system has made significant strides in Kenya with majority of institutions using payment channels such as M-PESA, the introduction of the QR Code will enhance interoperability by allowing the Central Bank of Kenya to develop, review and adopt common standard towards digital payments,
ii. Tackle the issue of friction and fragmentation among payment service providers and banking institutions to allow for uniform payments and financial inclusion, given that payment institutions have developed innovative products and services to meet the varied needs of Kenyan businesses,
iii. The adoption of the QR Code Standard will enable Kenya to join other countries that have implemented a standardized issuance of QR Codes for digital payment purposes. Some of the known countries include India, China, and Saudi Arabia, while closer home, South Africa is leading in the Sub-Sahara Africa, and,
iv. The QR Codes will be rolled out in two phases, with phase 1 to include formulation of the standardized QR codes for the retail payments industry, and phase 2 will enable the Central Bank of Kenya and Payment Service Providers to identify and resolve any payment fragmentation identified during the initial phase to enhance digital payment interoperability.

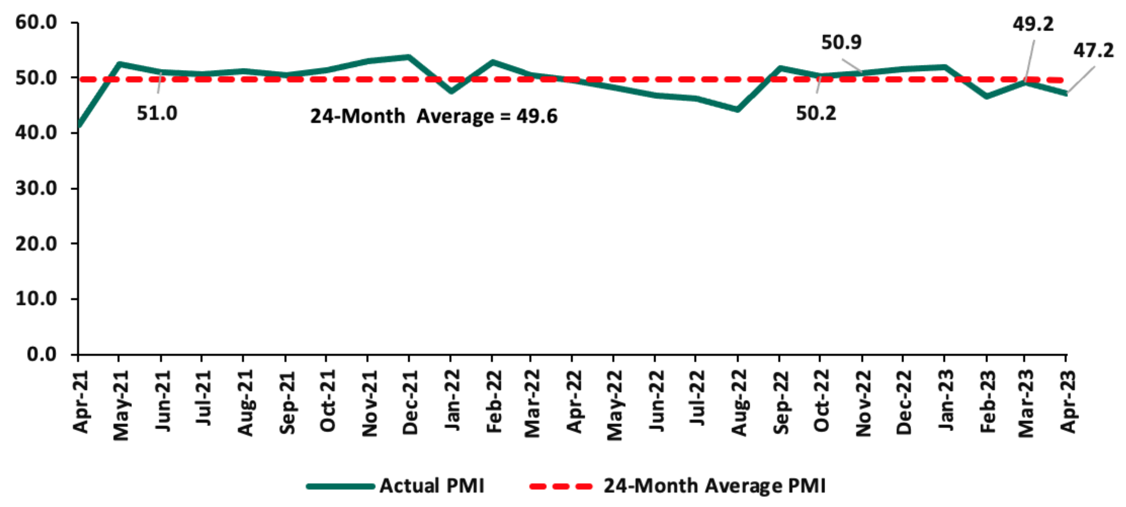
The adoption of the QR Code is a commendable move by the Central bank of Kenya in improving efficiency through fast tracking the implementation and adoption of cashless transactions. As such, we expect that common QR Code Standard will unify payment modules across the financial services industry, increase security of payment transactions as well as simplify the process of digital payment transactions. Additionally, the standardized QR codes will benefit the retail players especially supermarkets and other outlet stores by facilitating digital payments for customers at various points of sale.

II. **Stanbic Bank’s April 2023 Purchasing Manger’s Index (PMI)**

During the week, Stanbic bank released its monthly Purchasing Manager’s Index (PMI), highlighting that the index for the month of April 2023 came in at 47.2, down from 49.2 in March 2023, pointing towards further deterioration in the business environment for the third consecutive month in 2023. The decline in the general business environment business was driven by subdued consumer spending on the back of elevated inflationary pressures despite the April inflation rate dropping by 1.3% points to 7.9% in April 2023, from 9.2% in March 2023. Further, the ongoing political protests, coupled with aggressive depreciation of the Kenyan shilling contributed significantly to the fall in aggregate consumer demand, and consequently production output by most businesses. The prices of both inputs and commodities continue to remain high amidst low cash flow circulation evidenced by the tightened liquidity in the money market with the average interbank rate coming in at 8.6% in April, up from an average interbank rate of 7.0%, recorded in March 2023.

On sectoral performances, activities declined in most sectors, with sectors such as manufacturing and services recording decline in sales volumes, while other sectors such as wholesale and retail, construction, and agriculture recorded expansion in sales volumes, albeit at lower rates. Key to note, a PMI reading of above 50.0 indicates an improvement in the business conditions, while readings below 50.0 indicate a deterioration. The chart below summarizes the evolution of PMI over the last 24 months:

Cytonn Report: Kenya's Purchasing Manager's Index for the Last 24 Months



We maintain a cautious outlook in the short-term owing to the elevated inflationary pressures, despite April inflation rate easing to 7.9% in April 2023. The cost of production continues to remain elevated increasing the prices of commodities, and as a result stifling consumer spending. As such, we expect that the general business environment to remain subdued in the short term as a result of the elevated inflationary pressures and continued depreciation of the shilling that have continued to weigh on consumer spending. Additionally, the elevated production costs occasioned by the high input costs on the back of the high fuel and electricity prices are expected to impede production levels in the private sector. However, the improvement in the general business environment in the country is largely pegged on the stability in the global economy.

III. **Finance Bill 2023**

During the week, the Cabinet Secretary for the National Treasury submitted the Finance Bill 2023 to the National Assembly for discussion and consideration for enactment into the Finance Act 2023. Key to note, while the Finance Bill is yet to be published to the general public for review, the current draft proposes the following changes;

1. **Under the Income Tax Act;**

a. **Increase in personal income tax brackets –** The Finance Bill 2023 proposes to introduce a higher personal income tax rate of 35.0% on the income of individuals earning above Kshs 500,000.0 per month (an annual above Kshs 6.0 mn). Notably, the income tax bracket is currently subjected to an income tax rate of 30.0%,
b. **Housing Fund deductions on salaried workers** – The treasury is proposing 3.0% deduction on an individual's basic salary to be channelled to the National Housing Development Fund and matched by another 3.0% from the employer. Key to note, the Bill gives four exit routes that can be done voluntarily or one can exit the fund upon retirement, based on which happens first,
c. **Expansion of the scope of withholding tax –** Additionally, the bill proposes withholding tax charges to the payments made to resident persons as follows;

   i. Payments made in relation to sales, promotion, marketing and advertising services at the rate of 5.0% of the gross amount the aggregate value of which is at least Kshs 24,000.0 in a month, and,
   ii. In the 3rd Schedule of the income tax, payments made in relation to digital content monetization at the rate of 15.0%, with the aim of targeting content creators in various platforms such as YouTube, Instagram, Facebook and Tiktok, inclusive of all paid partnerships,

d. **Introduction of tax on digital assets –** Digital Asset Tax is proposed at the rate of 3.0% applicable to income derived from the transfer or exchange of digital assets. The Bill defines digital assets to include anything of value that is not tangible and cryptocurrencies, token codes, numbers held in digital form and generated through cryptographic means or otherwise, by whatever name called, providing a digital representation of value exchanged with or without consideration that can be transferred, stored or exchanged electronically, as well as, a non-fungible token or any other token by whatever name called, and,
e. **Increase of turnover tax -** The National Treasury is proposing that turnover tax rate to be increased upwards to 3.0%, from the current 1.0% while the tax bands eligible for turnover tax revised downwards to include a minimum band of Kshs 0.5 mn - 15.0 mn, from the current minimum band of Kshs 1.0 mn- 50.0 mn. This proposal is aimed at expanding the tax base to include the informal sector, targeting 2800 SMEs, in line with the Budget Policy Statement 2023.

2. **Under the Excise Duty Act;**

a. **Removal of Kenya Revenue Authority's power to implement inflation-adjusted exercise duty -** The Finance Bill proposes to repeal section 10 of the Excise Duty Act which empowers KRA, with the approval of the Cabinet Secretary, to by notice in the Gazette adjust the specific rate of excise duty once every year to take into account the annual inflation adjustments depending on the economic circumstances in the relevant year. We expect that this proposal, if adopted, is a move to stabilize the cost of living, given that inflation has persistently remained above the government target range of 2.5% - 7.5%, despite easing to 7.9% in April 2023, from 9.2% recorded in March 2023,
b. **Introduction of exercise duty on items used in the beauty and cosmetics industry -** The Finance Bill 2023 seeks to introduce excise duty on various goods such as wigs, false beards, eyebrows, eyelashes, artificial nails, and human hair at a rate of 5.0%, and,
c. **Payment of excise duty within 24 hours** - The Finance Bill is proposing to introduce a requirement for excise duty on betting and gaming firms to remit exercise taxes to KRA by a bookmaker within 24 hours from midnight of the relevant day,

3. **Under the Value Added Tax Act;**

a. **Exported services** – The Finance Bill 2023, proposes re-introduction of exemption from VAT of exported services, a move that is commended by the public seeking to venture in job seeking opportunities abroad, and,
b. **Liquefied petroleum gas (LPG) -** The Bill also proposes to delete the 8.0% VAT applicable to

LPG and make LPG exempt from VAT. Notably, the rate of 8.0% VAT on LPG was revised downward in 2022, from the rate of 16.0%. In addition, the importation of LPG is proposed to be exempted from import declaration fees and railway development levy, in a bid to make LPG affordable, and consequently lower the cost of living.

4. **Other Key Proposals**;

a. **Requirement to deposit 20.0% of the disputed amount before lodging a tax appeal at the High Court** - The Bill proposes to introduce a requirement for taxpayers to deposit with the KRA 20.0% of the disputed tax or provide a security equivalent to 20.0% of the disputed tax before filing an appeal of a decision of the Tax Appeals Tribunal at the High Court. If the Court makes a decision in favour of the taxpayer, the KRA would be required to credit the amount or security within 30 days after the determination of the appeal.

The proposed tax measures in the Finance Bill 2023 are in line with the Budget Policy Statement 2023 in increasing the tax revenue by 15.3% to Kshs 2.9 tn in FY’2023/24, from the estimated Kshs 2.5 tn in FY’2022/2023. Notably, the proposals are consistence with the government’s focus on increasing tax revenue to above 17.8% of the GDP in FY’2023/2024, from the expected 17.4% expected in FY’2022/2023 by reducing the corporate tax gap to 30.0%, from the current 32.2%, as well as expand the tax base to include informal small and medium enterprises (SMEs). However, we maintain our view that the proposals are overly ambitious given the subdued general business environment, underpinned by depreciation of the Kenyan shilling, tightened liquidity in the money market, and elevated inflationary pressures that have suppressed both consumer spending and business production levels. Additionally, we note that the proposed increase in taxation, especially the turnover tax, may act as a disincentive to most SMEs, and further dampen the production levels in the country.

IV. **Economic Survey 2023**

During the week, the Kenya National Bureau of Statistics released the Economic Review 2023, highlighting that Kenyan economic recorded a 4.8% expansion in 2022, a 2.8% points decline from 7.6% recorded in 2021. The economic growth recorded in 2022 is an indication of resilience following multiple shocks such as supply chain constrains, soaring global fuel prices, elevated inflationary pressures and currency depreciation. Some of the key take outs of the macroeconomic performance include;

i. **GDP growth;**

The Kenyan economic growth slowed down in 2022 as evidenced by an average GDP growth of 4.8%, a decline from 7.6% recorded in 2021, supported by strong performance in the services sector, which came in at 7.0%, albeit a lower growth compared to the 9.8% growth recorded in 2021. Notably, the key sub-sectors that supported growth were Financial and Insurance, Information and Communication, and Transportation and Storage with growths of 12.8%, 9.9%, and 5.6%, respectively. Despite the decline in the economic growth, the relatively high growth recorded in 2022 is an indication of resilience following multiple shocks such as supply chain constrains, soaring global fuel prices, elevated inflationary pressures and currency depreciation. Similarly, the global economy grew at a slower rate of 3.4% in 2022, from an expansion of 6.0% recorded in 2021. The slow down in global economic growth was mainly attributable to supply chain disruption worsened by geopolitical tensions between Russia and Ukraine, tightened monetary policies and elevated inflationary pressures. Additionally, in 2022, the Sub-Saharan and East African economies recorded growths of 3.9% and 4.9%, respectively,

ii. **Inflation;**

Kenya’s inflation rate averaged at 7.7% in 2022, up from an average of 6.1% recorded in 2021, mainly driven by high food and non-alcoholic beverage index, housing as well as fuel index. Similarly, the world inflation increased to 8.7% in 2022, from 4.7% in 2021, driven by high fuel prices and supply chain bottlenecks, while the inflation for the Sub-Saharan Africa rose to 14.5%, from 11.0% in 2021,

iii. **Current account deficit;**

The Kenyan current account deficit deteriorated by 7.9% to Kshs 679.7 bn in 2022, from a deficit of Kshs 629.8 bn recorded in 2021. The deterioration was attributable to a 17.6% widening of the trade balance deficit to Kshs 1.6 tn, from 1.4 tn recorded in 2021, on the back of a 17.5% increase in merchandise imports to Kshs 2.5 tn, relative to a 17.4% growth in export earnings to Kshs 0.9 tn,

iv. **Monetary Policy;**

In 2022, the Monetary Policy Committee raised the Central Bank Rate (CBR) by a cumulative 175.0 bps to 8.75% in December 2022, from 7.00% in December 2021, with the aim of anchoring inflation that averaged at 7.7% in 2022, 0.2% points above the government's target range of 2.5%-7.5%, as well as support the Kenyan shilling that depreciated by 9.0% in 2022. Notably, the key interest hikes were witnessed in June, October and December to 7.50%, 8.25% and finally 8.75%, respectively. Consequently, lending interest rates for loans and advances increased to 12.7% as at the end of December 2022, from 12.2% in December 2021,

v. **Public Finance;**

The total debt stock of the National Government increased by 9.5% to Kshs 8.8 tn in June 2022, from Kshs 8.1 tn in June 2021. Additionally, the total revenue including grants increased by 21.6% to Kshs 2.2 tn in FY'2021/2022, from Kshs 1.8 tn in FY'2020/2021, while total expenditure grew by 12.2% to Kshs 2.9 tn in FY'2021/2022, from Kshs 2.6 in FY'2020/2021. Despite the high growth of revenue, the total expenditure continues to outweigh revenue performance. Going forward, the total revenue including grants is expected to increase by 14.9% to Kshs 2.6 tn in FY'2022/2023, up from Kshs 2.2 tn recorded in FY'2021/2022. Similarly, total expenditure is also expected to increase, at a lower rate of 11.4% to Kshs 3.3 tn in FY'2022/2023, from Kshs 2.9 tn in FY'2021/2022,

Going forward, we expect the global economic growth to remain subdued in 2023, attributable to the tightening of monetary policies, high inflation rates, ongoing geopolitical tensions that has been worsened by the effects of Russia-Ukraine war, as well as, the lingering effects of COVID-19 pandemic. Despite the expected slowdown in global growth, we expect that Kenya's economy will remain resilient in 2023, supported by a robust performance in the services sector and expected recovery in agriculture, following the ongoing rainfall in most parts of the country. However, on the downside, we expect the growth in the Kenya economy to be affected by high inflation pressures, tightened monetary policy and high production costs.

Rates in the Fixed Income market have been on an upward trend given the continued government's demand for cash and the highly tightened liquidity in the money market. The government is 0.9% behind its prorated borrowing target of Kshs 363.2 bn having borrowed Kshs 359.8 bn of the* revised domestic borrowing target *of Kshs 425.1 bn for the FY'2022/2023. We believe that the projected budget deficit of 5.7% is relatively ambitious given the downside risks and deteriorating business environment occasioned by high inflationary pressures. Further, revenue collections are lagging behind, with total revenue as at March 2023 coming in at Kshs 1.4 tn in the FY'2022/2023, equivalent to 65.9% of its revised target of Kshs 2.2 tn and 87.9% of the prorated target of Kshs 1.6 tn. Therefore, we expect a continued upward readjustment of the yield curve in the short and medium term, with the government looking to bridge the fiscal deficit through the domestic market. Owing to this, our view is that investors should be biased towards short-term fixed-income securities to reduce duration risk.