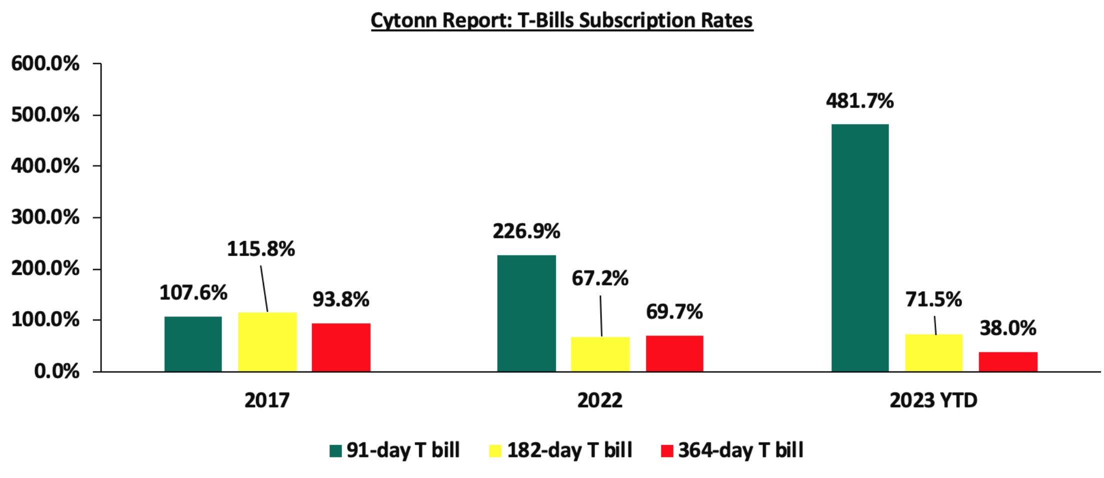
National Housing Development Fund (NHDF), & Cytonn Weekly #19/2023

Fixed Income

Money Markets, T-Bills Primary Auction:

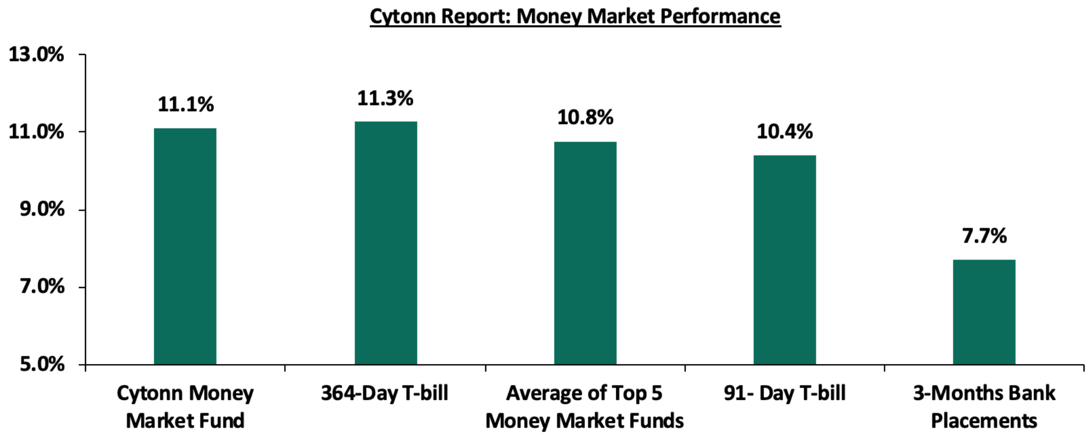
During the week, T-bills were oversubscribed, with the overall subscription rate coming in at 188.9%, up from the 110.7%, recorded the previous week. Investor's preference for the shorter 91-day paper persisted as they sought to avoid duration risk, with the paper receiving bids worth Kshs 34.6 bn against the offered Kshs 4.0 bn, translating to an oversubscription rate of 865.8%, significantly higher than the 508.0% recorded the previous week. The subscription rates for the 182-day and the 364-day papers increased to 88.4% and 18.6%, from 53.4% and 9.2%, respectively, recorded the previous week. The government accepted bids worth Kshs 45.3 bn, translating to an acceptance rate of 99.9%. 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 10.0 bps, 17.5 bps and 9.2 bps to 11.3%, 10.9% and 10.4%, respectively. The chart below compares the overall average T- bills subscription rates obtained in 2017, 2022 and 2023 Year to Date (YTD):



In the primary bond market, the Central Bank of Kenya released the auction results for the newly issued bond FXD1/2023/003 with tenor to maturity of 3 years. In line with our expectations, the bond recorded an oversubscription rate of 103.7%, partly attributable to investors' preference for shorter dated bonds as they seek to avoid duration risk. The government issued the bond seeking to raise Kshs 20.0 bn for budgetary support. The bond received bids worth Kshs 20.7 bn with government accepting bids worth Kshs 20.3 bn, translating to an acceptance rate of 97.8%. The bond was priced at par and both the weighted average yield of accepted bids and the coupon rate came at 14.2%.

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 91-day paper increased by 10.0 bps and 9.2 bps to 11.3% and 10.4% respectively. The yield of Cytonn Money Market Fund increased by 8.0 bps to 11.1%, while the average yields of Top 5 Money Market Funds decreased by 8.2 bps to remain relatively unchanged at 10.8% similar to what was recorded the previous week.



The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 12 May 2023:

Cytonn Report: Money Market Fund Yield for Fund Managers as published on 12 May 2023

Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund (dial *809# or download Cytonn App)	11.1%
2	Etica Money Market Fund	10.9%
3	Dry Associates Money Market Fund	10.7%
4	Madison Money Market Fund	10.6%
5	Jubilee Money Market Fund	10.5%
6	Apollo Money Market Fund	10.5%
7	GenAfrica Money Market Fund	10.3%
8	AA Kenya Shillings Fund	10.3%
9	Kuza Money Market fund	10.1%
10	Sanlam Money Market Fund	10.1%
11	Old Mutual Money Market Fund	10.0%
12	NCBA Money Market Fund	9.9%
13	Zimele Money Market Fund	9.9%
14	Nabo Africa Money Market Fund	9.8%
15	Co-op Money Market Fund	9.8%
16	KCB Money Market Fund	9.8%
17	Enwealth Money Market Fund	9.8%
18	GenCap Hela Imara Money Market Fund	9.7%
19	CIC Money Market Fund	9.5%
20	British-American Money Market Fund	9.4%
21	ICEA Lion Money Market Fund	9.4%
22	Orient Kasha Money Market Fund	9.2%

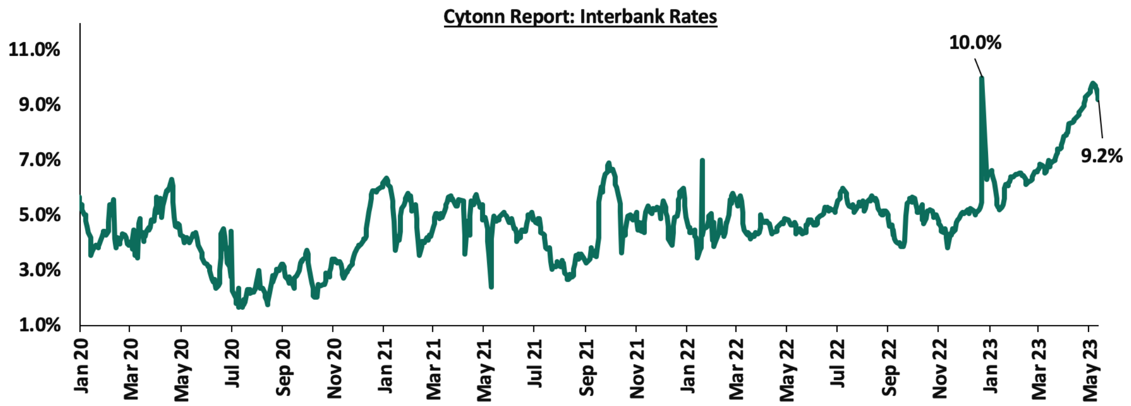
Cytonn Report: Money Market Fund Yield for Fund Managers as published on 12 May 2023

Rank	Fund Manager	Effective Annual Rate
23	Mali Money Market Fund	8.3%
24	Absa Shilling Money Market Fund	8.3%
25	Equity Money Market Fund	5.3%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets eased, with the average interbank rate decreasing to 9.5%, from 9.7% recorded the previous week, partly attributable to government payments that offset tax remittances. The average interbank volumes traded increased by 2.1% to Kshs 19.4 bn, from Kshs 19.0 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 were on a downward trajectory with the yield on the 10-year Eurobond issued in 2014 recording the largest decline having declined by 2.1% points to 17.6%, from 19.7%, recorded the previous week. The downward trajectory of the Eurobond yields is partly attributable to the recent announcement by the International Monetary Fund (IMF) Managing Director Kristalina Georgieva dubbing Kenya as debt sustainable. The IMF Chief also reassured investors that the government is moving swiftly to improve its fiscal position. The table below shows the summary of the performance of the Kenyan Eurobonds as of 11 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%**
02-Jan-23	12.9%	10.5%	10.9%	10.9%	10.8%	9.9%
01-May-23	20.6%	14.1%	12.7%	15.5%	13.2%	12.4%
04-May-23	19.7%	13.7%	12.6%	15.4%	13.0%	12.3%

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%**
05-May-23	19.5%	13.7%	12.5%	15.3%	13.0%	12.3%
08-May-23	19.1%	13.7%	12.5%	15.6%	13.1%	12.3%
09-May-23	19.3%	13.6%	12.5%	15.5%	13.0%	12.3%
10-May-23	18.7%	13.4%	12.4%	15.3%	12.9%	12.3%
11-May-23	17.6%	13.3%	12.3%	15.1%	12.8%	12.1%
Weekly Change	**(2.1%)**	**(0.4%)**	**(0.3%)**	**(0.3%)**	**(0.2%)**	**(0.2%)**
MTD change	**(3.0%)**	**(0.8%)**	**(0.4%)**	**(0.4%)**	**(0.4%)**	**(0.3%)**
YTD Change	**4.7%**	**2.8%**	**1.4%**	**4.2%**	**2.0%**	**2.2%**

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 136.9, from Kshs 136.4 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 10.9% 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 0.4% during the week to remain relatively unchanged at USD 6.5 bn as at 11 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:

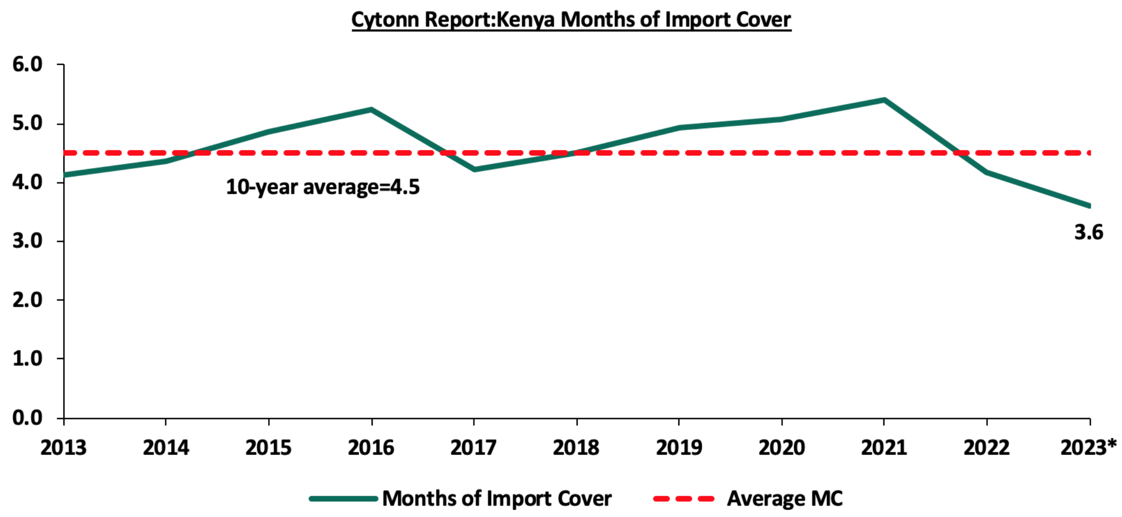


***Figure as at 11 May 2023**

Weekly Highlights:

I. **Revenue and Net Exchequer for FY'2022/2023**

The National Treasury gazetted the revenue and net expenditures for the first 10 months of FY'2022/2023, ending 28 April 2023. Below is a summary of the performance:

Cytonn Report: FY'2022/2023 Budget Outturn - As at 28th April 2023

Amounts in Kshs billions unless stated otherwise

Item	12-months Original Estimates	Revised Estimates	Actual Receipts/Release	Percentage Achieved of the Revised Estimates	Prorated	% achieved of the Prorated
Opening Balance			0.6			
Tax Revenue	2,071.9	2,108.3	1,573.2	74.6%	1,756.9	89.5%
Non-Tax Revenue	69.7	83.7	66.0	78.9%	69.7	94.6%
Total Revenue	**2,141.6**	**2,192.0**	**1,639.8**	**74.8%**	**1,826.7**	**89.8%**
External Loans & Grants	349.3	520.6	264.4	50.8%	433.8	61.0%
Domestic Borrowings	1,040.5	886.5	406.6	45.9%	738.8	55.0%
Other Domestic Financing	13.2	13.2	15.5	117.4%	11.0	140.8%
Total Financing	**1,403.0**	**1,420.3**	**686.6**	**48.3%**	**1,183.6**	**58.0%**
Recurrent Exchequer issues	1,178.4	1,266.0	905.8	71.6%	1,055.0	85.9%
CFS Exchequer Issues	1,571.8	1,552.9	955.6	61.5%	1,294.1	73.8%
Development Expenditure & Net Lending	424.4	393.8	180.1	45.7%	328.2	54.9%
County Governments + Contingencies	370.0	399.6	275.7	69.0%	333.0	82.8%
Total Expenditure	**3,544.6**	**3,612.3**	**2,317.1**	**64.1%**	**3,010.3**	**77.0%**
Fiscal Deficit excluding Grants	**1,403.0**	**1,420.3**	**677.3**	**47.7%**	1,183.6	57.2%

Cytonn Report: FY'2022/2023 Budget Outturn - As at 28th April 2023

Amounts in Kshs billions unless stated otherwise

Item	12-months Original Estimates	Revised Estimates	Actual Receipts/Release	Percentage Achieved of the Revised Estimates	Prorated	% achieved of the Prorated
Total Borrowing	**1,389.8**	**1,407.1**	**671.1**	**47.7%**	**1,172.6**	**57.2%**

The key take-outs from the report include:

a. Total revenue collected as at the end of April 2023 amounted to Kshs 1,639.8 bn, equivalent to 78.4% of the revised estimates of Kshs 2,192.0 bn for FY'2022/2023 and is 89.8% of the prorated estimates of Kshs 1,826.7 bn. We note that the government has not been able to meet its prorated revenue targets ten months into the FY'2022/2023, partly attributable to the tough macroeconomic environment in the country occasioned by elevated inflationary pressures with April 2023 inflation rate coming at 7.9% and remained above the CBK target range of 2.5%-7.5%. Cumulatively, tax revenues amounted to Kshs 1,573.2 bn, equivalent to 74.6% of the revised estimates of Kshs 2,108.3 bn and 89.5% of the prorated estimates of Kshs 1,756.9 bn,
b. Total financing amounted to Kshs 686.6 bn, equivalent to 48.3% of the revised estimates of Kshs 1,420.3 bn and is equivalent to 58.0% of the prorated estimates of Kshs 1,183.6 bn. Additionally, domestic borrowing amounted to Kshs 406.6 bn, equivalent to 45.9% of the revised estimates of Kshs 886.5 bn and is 55.0% of the prorated estimates of Kshs 738.8 bn,
c. The total expenditure amounted to Kshs 2,317.1 bn, equivalent to 64.1% of the revised estimates of Kshs 3,612.3 bn, and 77.0% of the prorated expenditure estimates of Kshs 3,010.3 bn. Additionally, the net disbursements to recurrent expenditures came in at Kshs 905.8 bn, equivalent to 71.6% of the revised estimates of Kshs 1,266.0 bn and 85.9% of the prorated estimates of Kshs 1,055.0 bn, and development expenditure amounted to Kshs 180.1 bn, equivalent to 45.7% of the revised estimates of Kshs 393.8 bn and 54.9% of the prorated estimates of Kshs 328.2 bn,
d. Consolidated Fund Services (CFS) Exchequer issues (refers to the Consolidated Fund established in the Kenya's constitution into which development partners deposit funds before disbursing to the Exchequer accounts for projects such as servicing of public debt, payment of pensions and gratuities, salaries and allowances and subscription to International Organizations) came in at Kshs 955.6 bn, equivalent to 61.5% of the revised estimates of Kshs 1,552.9 bn, and 73.8% of the prorated amount of Kshs 1,294.1 bn. The cumulative public debt servicing cost amounted to Kshs 876.7 bn which is 64.4% of the revised estimates of Kshs 1,361.0 bn, and is 77.3% of the prorated estimates of Kshs 1,134.2 bn. Notably, the Kshs 876.7 bn debt servicing cost is equivalent to 53.5% of the actual revenues collected as at the end of April 2023, further emphasizing on how much public debt servicing weighs on the country's expenditure, and,
e. Total Borrowings as at the end of April 2023 amounted to Kshs 671.1 bn, equivalent to 47.7% of the revised estimates of Kshs 1,407.1 bn for FY'2022/2023, and are 57.2% of the prorated estimates of Kshs 1,172.6 bn. The cumulative domestic borrowing target of Kshs 886.5 bn comprises of adjusted Net domestic borrowings of Kshs 425.1 bn and Internal Debt Redemptions (rollovers) of Kshs 461.4 bn.

The revenue performance for the 10 months of the FY'2022/2023 comes on the back of tough macroeconomic environment exacerbated by elevated inflationary pressures, which came at 7.9% in April 2023 and remained above the Central Bank of Kenya target range of 2.5%-7.5% for 11 months to April 2023. Additionally, the Monetary Policy Committee decision to hike the Central Bank Rate (CBR) by 75.0 bps to 9.5% in March 2023, adding to a cumulative of 175.0 bps raised in 2022, made credit expensive, as such limiting economy activities. However, in the recently released Finance bill 2023, the government has proposed new tax measures aimed at broadening its tax base as well as increase tax revenue. Among the key provisions in the bill are introduction of a higher personal income tax rate of 35.0% on the income of individuals earning above Kshs 500,000.0 per month from the current 30.0%, introduction of tax of 3.0% on income derived from the transfer or exchange of digital assets, and an increase in turnover tax to 3.0% from the current 1.0%. With barely 2 months before the end of current financial year, we are convinced that the government's ability to meet its revenue targets will be significantly impaired by the current challenging macroeconomic environment which has forced businesses to cut production and consumers to cut back on spending,

II. **Kenya's Credit Ratings**

During the week, Moody's Credit Rating agency downgraded Government of Kenya's long-term foreign currency and local-currency issuer ratings and senior unsecured debt ratings to B3 from B2 with a negative outlook. This is an indication of increased material default risk with very limited margin of safety amid tighter liquidity. The downgrade follows a downgrade of Kenya's credit outlook to negative from stable by S&P ratings in February 2023. According to Moody's, the downgrade is mainly driven by;

a. **Increased liquidity risk**

Domestic funding has severely deteriorated in the past 2 months, with very low net domestic issuance, which has led to financing shortfall and delay in government spending. The low domestic issuance is partly attributable to reduced investors' appetite for the longer dated bonds, evidenced by increased demand for the shorter dated papers particularly the 91-day T-bill. This is evidenced by the poor performance of T-bonds issued in April 2023, having been undersubscribed with the overall average subscription rate coming in at 26.7% down from 103.5% recorded in March 2023. Furthermore, the government cancelled its plan to issue a 15-year government bond in April,

b. **Rising cost of domestic financing**

Investors have continued to demand higher rates on government's domestic issuance which has continued to weaken debt affordability, limiting the government's ability to rely on domestic debt financing. A continued relying on the high domestic debt financing is expected to weaken the government's ability to meet its debt obligation, since it increases risk of further credit deterioration,

c. **High external debt service cost**

The tightened domestic financing conditions comes at a time when the government is faced with high debt servicing cost particularly the maturation of the 10-year Eurobond worth USD 2.0 bn in June 2024 as well as the USD 650.0 mn loan from China EXIM bank. Furthermore, the persistent depreciation of Kenya Shilling against the US dollar continues to balloon Kenya's foreign dollar denominated debt in terms of local currency. As a result, the external debt amortizations will increase to USD 3.5 bn in FY'2023/2024, representing 2.9% of GDP, from USD 1.6 bn in FY'2022/2023 equivalent to 1.5% of the GDP. Additionally, after the FY'2023/2024, the government will be faced with amortizations of around 1.5% of GDP per year over the next several years, which includes Eurobond principal payments of USD 300.0 mn per year between 2025 and 2027 and another USD 1.0 bn principal maturing in 2028,

d. **Dwindling Forex Reserves**

Kenya's foreign reserves remains below the statutory minimum requirement of at least 4.0 month of import cover, currently standing at USD 6.5 bn equivalent to 3.6 months of import cover. This comes on the back of the ever-present current account deficit estimated at 4.9% of GDP in twelve months to January 2023.

According to the rating agency, an upward revision or further downgrade of the Kenya's credit rating will largely depend on;

i. Domestic financing conditions. A further deterioration in funding conditions, despite inflows of concessional external financing and commitment to fiscal consolidation under the government's IMF program will likely lead to a further downgrade of the ratings, and
ii. Borrowing cost. A persistent rise in cost of borrowing which weakens debt affordability metrics and threaten the government ability to stabilize its debt, will lead to a downgrade of the ratings.

The downgrade of Kenya's credit ratings is expected to further hinder Kenya's access to international debt markets given that investors are expected to attach higher yields which will further increase debt vulnerabilities. Additionally, domestic investors are expected to demand higher interest rates due to the higher perceived risk of defaulting. Volatility in the stock market is also expected to increase due to capital outflows as foreign investors seek less risky markets. As such, the government needs to expedite its fiscal consolidation measures, through cutting down unnecessary spending which puts pressure on its budget as well as improve its tax policies. In addition, in order to narrow the current account deficit and beef up its foreign reserves, the government need to formulate affirmative policies that will improve domestic production and increase exports while lowering its imports.

Rates in the Fixed Income market have been on upward trend given the continued government's demand for cash as well as tight liquidity in the money market. The government is 1.1% behind its prorated borrowing target of Kshs 371.4 bn having borrowed Kshs 367.1 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 April 2023 coming in at Kshs 1.6 tn in the FY'2022/2023, equivalent to 74.8% of its revised target of Kshs 2.2 tn and 89.8% of the prorated target of Kshs 1.8 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.