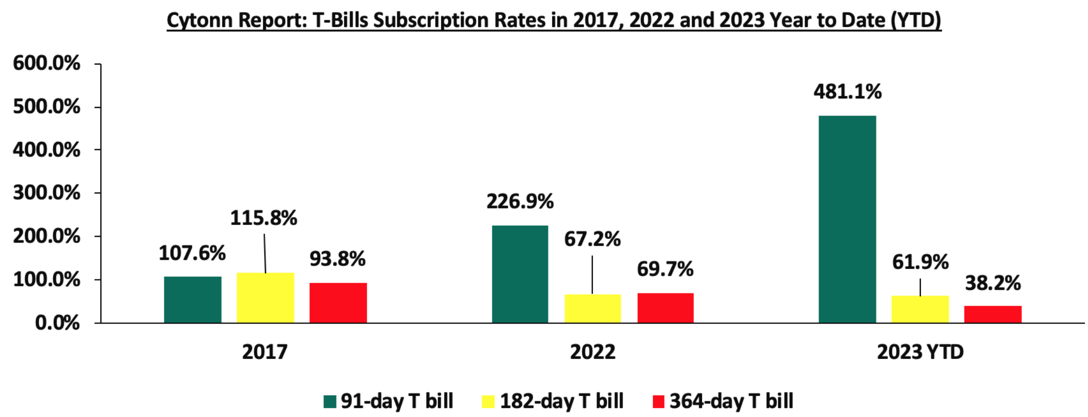
Kenya’s FY'2023/2024 Budget Review, & Cytonn Weekly #25/2023

Fixed Income

Money Markets, T-Bills Primary Auction:

During the week, T-bills were undersubscribed for the second consecutive week, with the overall subscription rate coming in at 63.9% a decrease from the under-subscription rate of 94.2% 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 11.0 bn against the offered Kshs 4.0 bn, translating to an oversubscription rate of 275.3%, albeit lower than the 454.9% recorded the previous week. The subscription rate for the 364-day paper increased to 23.4%, from 17.5% recorded the previous week. However, the subscription rate for the 182-day paper decreased to 19.9%, from 26.6% recorded the previous week. The government accepted all the bids of Kshs 15.3 bn. 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 20.0 bps, 21.4 bps, and 14.5 bps to 11.9%, 11.9%, and 11.8%, respectively. The chart below compares the overall average T- bills subscription rates obtained in 2017, 2022 and 2023 Year to Date (YTD):

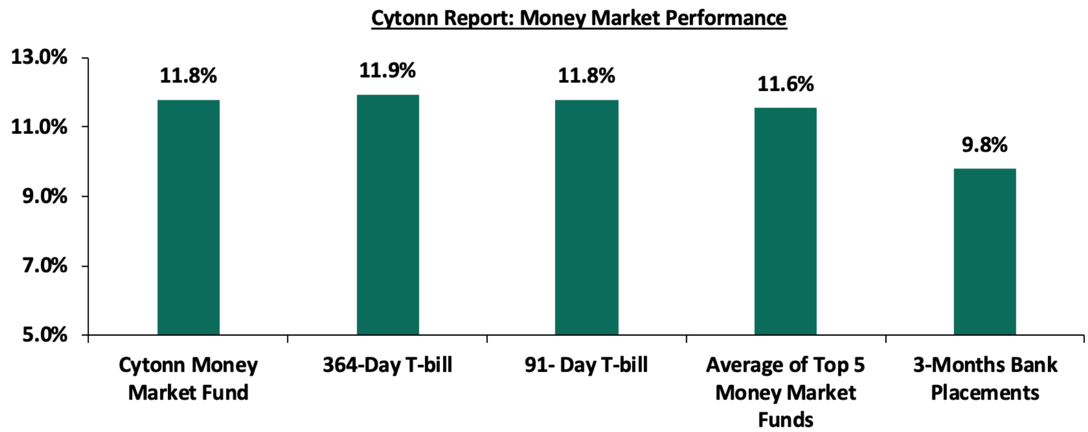


In the primary bond market, the Central Bank of Kenya released the auction results for the third tap sale of FXD1/2023/03 with a tenor to maturity of 2.9 years, with the government seeking to raise Kshs 15.0 bn for budgetary support. In line with our expectations, the bond was oversubscribed, receiving bids worth Kshs 18.6 bn, against the offered Kshs 15.0 bn, translating to an oversubscription rate of 123.7%, partly attributable to investors’ preference for shorter-dated bonds as they seek to avoid duration risk. The government accepted all the Kshs 18.6 bn. The yield on the bond and coupon rate is at 14.2%.

Key to note is that, on its first auction, the FXD1/2023/003 received bids worth Kshs 20.7 bn against the offered Kshs 20.0 bn, translating to an oversubscription rate of 103.7% with the government accepting bids worth Kshs 20.3 bn, translating to an acceptance rate of 97.8%. The bond’s first tap sale received bids worth Kshs 10.6 bn against the offered Kshs 10.0 bn, translating to an oversubscription rate of 106.0%, with the government accepting bids worth Kshs 10.6 bn translating to an acceptance rate of 100.0%. The second tap-sale received bids worth Kshs 27.2 bn against the offered 20.0 bn translating to an oversubscription rate of 136.0%, with the government accepting bids worth Kshs 27.2 bn translating to an acceptance rate of 100.0%.

Money Market Performance:

In the money markets, 3-month bank placements ended the week at 9.8% (based on what we have been offered by various banks), while the yields on the 364-day and 91-day paper increased by 20.0 bps and 14.5 bps to 11.9% and 11.8% respectively. The yield of Cytonn Money Market Fund increased by 1.0 bps to remain relatively unchanged at 11.8% from what was recorded in the previous week, while the average yields of Top 5 Money Market Funds increased by 28.0 bps to 11.6%, from 11.3% recorded the previous week.



The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 23 June 2023:

Cytonn Report: Money Market Fund Yield for Fund Managers as published on 23 June 2023

Rank	Fund Manager	Effective Annual Rate
1	Enwealth Money Market Fund	12.0%
2	Etica Money Market Fund	12.0%
3	Cytonn Money Market Fund (dial *809# or download the Cytonn app)	11.8%
4	Madison Money Market Fund	11.0%
5	GenAfrica Money Market Fund	11.0%
6	Dry Associates Money Market Fund	10.8%
7	Apollo Money Market Fund	10.8%
8	Kuza Money Market fund	10.8%
9	Jubilee Money Market Fund	10.7%
10	AA Kenya Shillings Fund	10.6%
11	Co-op Money Market Fund	10.5%
12	KCB Money Market Fund	10.5%
13	Old Mutual Money Market Fund	10.5%
14	Sanlam Money Market Fund	10.4%

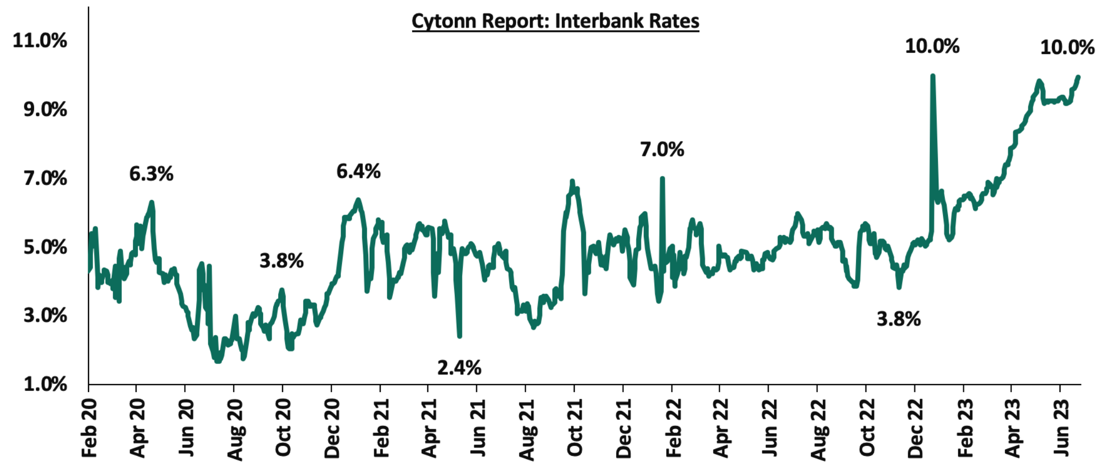
Cytonn Report: Money Market Fund Yield for Fund Managers as published on 23 June 2023

Rank	Fund Manager	Effective Annual Rate
15	NCBA Money Market Fund	10.2%
16	GenCap Hela Imara Money Market Fund	10.2%
17	Nabo Africa Money Market Fund	10.1%
18	Zimele Money Market Fund	9.9%
19	ICEA Lion Money Market Fund	9.8%
20	CIC Money Market Fund	9.6%
21	British-American Money Market Fund	9.5%
22	Orient Kasha Money Market Fund	9.4%
23	Absa Shilling Money Market Fund	9.2%
24	Mali Money Market Fund	8.8%
25	Equity Money Market Fund	8.2%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets tightened, with the average interbank rate increasing to 9.8% from 9.4% recorded the previous week, partly attributable to tax remittances that offset government payments. The average interbank volumes traded declined by 25.9% to Kshs 12.7 bn, from Kshs 17.2 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 mix performance, with the yield on the 10-year Eurobond issued in 2018 gaining by 0.1% points to 11.1% from 11.0% recorded the previous week, while the yield on the 10-year Eurobond issued in 2014 declined the most by 0.4% points to 12.7% from 13.1% recorded the previous week. The table below shows the summary of the performance of the Kenyan Eurobonds as of 22 June 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	**1.1**	**4.8**	**24.8**	**4.0**	**9.0**	**11.1**
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%
1-Jun-23	15.5%	11.9%	11.5%	13.0%	11.9%	11.0%
15-Jun-23	13.1%	11.0%	11.0%	11.3%	11.1%	10.3%
16-Jun-23	12.4%	10.9%	10.9%	11.1%	11.0%	10.2%
19-Jun-23	12.4%	10.9%	10.9%	11.1%	11.0%	10.2%
20-Jun-23	12.3%	10.9%	10.9%	11.1%	11.0%	10.2%
21-Jun-23	12.5%	11.0%	11.0%	11.3%	11.0%	10.3%
22-Jun-23	12.7%	11.1%	11.0%	11.3%	11.0%	10.3%
Weekly Change	**(0.4%)**	**0.1%**	**0.0%**	**0.0%**	**(0.1%)**	**0.0%**
MTD change	**(2.8%)**	**(0.8%)**	**(0.5%)**	**(1.7%)**	**(0.9%)**	**(0.7%)**
YTD Change	**(0.2%)**	**0.6%**	**0.1%**	**0.4%**	**0.2%**	**0.4%**

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 140.4, from Kshs 139.9 recorded the previous week, partly attributable to the persistent high dollar demand from importers, especially in the oil and energy sectors. On a year-to-date basis, the shilling has depreciated by 13.8% 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. 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, and,
ii. The need for government debt servicing, continues to put pressure on forex reserves given that 67.3% of Kenya's external debt was US Dollar denominated as of March 2023, and,

The shilling is however expected to be supported by:

i. Diaspora remittances standing at a cumulative USD 1,688.0 mn in 2023 as of May 2023, albeit 1.8% lower than the USD 1,718.6 mn recorded over the same period in 2022, and,
ii. The tourism inflow receipts 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 is that Kenya's forex reserves decreased during the week by 1.1% to USD 7.4 bn as of June 22, 2023, from USD 7.5 bn as of June 15, 2023. The country's month of import cover remained relatively unchanged at 4.1 months of import cover, which is above 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:

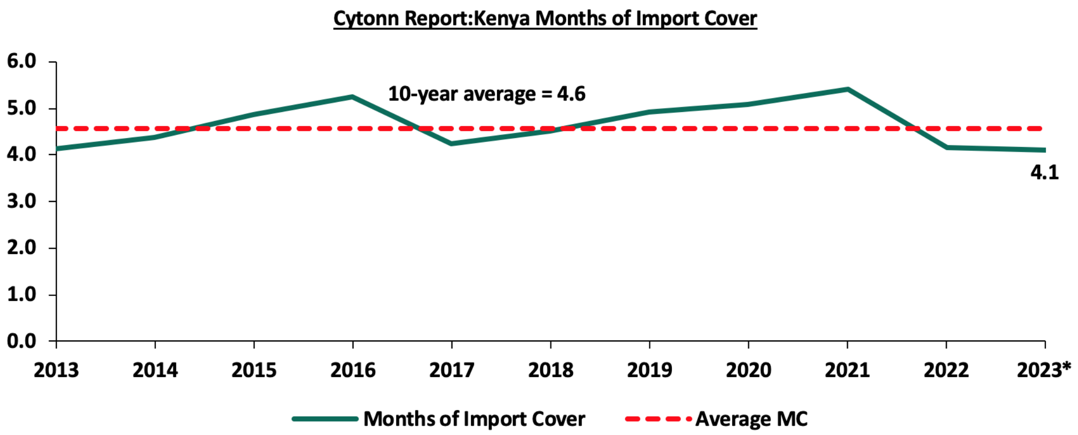


***Figure as at 22 June 2023**

Weekly Highlights:

June 2023 Inflation Projection

We are projecting the y/y inflation rate for June 2023 to come in at the range of 7.7%-8.1% mainly on the back of:

i. **High Fuel Prices** –The Fuel prices in the country remain elevated despite the global fuel prices dropping by 8.6% to USD 76.8 per barrel as of 22 June 2023, from a high of USD 84.1 per barrel recorded on 1 April 2023 and the average landed costs declining during the month of May except for Diesel. Notably, for the period between 15 June 2023 to 14 July 2023, the prices for Kerosene increased by 0.2% to Kshs 161.48, from Kshs 161.13 per liter. However, the prices for Diesel and Super Petrol declined slightly by 0.7% and 0.4% to Kshs 167.28 and Kshs 182.04, from Kshs 168.40 and 182.70 per liter, respectively. The fuel prices remain high mainly on the back of the government's decision to completely remove fuel subsidy program coupled with the continued currency depreciation being experienced in the economy hence elevating the cost of fuel importation,

ii. **Elevated food prices** - Food prices have remained elevated mainly on the back of uneven weather patterns as well as supply chain bottlenecks experienced globally. The elevated prices were evidenced by the 10.2% y/y increase in the prices of food and non-alcoholic beverages in May 2023. Given that food is a major input in the inflation index, we expect the resulting high prices to underpin inflationary pressures.

The high commodity prices in the country are also attributed to the sustained depreciation of the Kenya Shilling which has inflated the import bill. As a result, manufacturers pass on the cost to consumers through increases in commodity prices. Going forward, we expect inflationary pressures to persist in the short term, however, to ease in the medium term to CBK's target range of 2.5% to 7.5% aided by easing in global fuel prices and easing of domestic food prices on account of favorable weather conditions. We also expect the measures taken by the government to subsidize major inputs of agricultural production such as fertilizers to lower the cost of farm inputs and support the easing of inflation in the long term.

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 34.3% ahead of its prorated borrowing target of Kshs 423.5 bn having borrowed Kshs 568.7 bn of the revised domestic borrowing target of Kshs 428.3 bn for the FY'2022/2023. Revenue collections are lagging behind, with total revenue as of May 2023 coming in at Kshs 1.8 tn in the FY'2022/2023, equivalent to 82.7% of its revised target of Kshs 2.2 tn and 90.2% of the prorated target of Kshs 2.0 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.