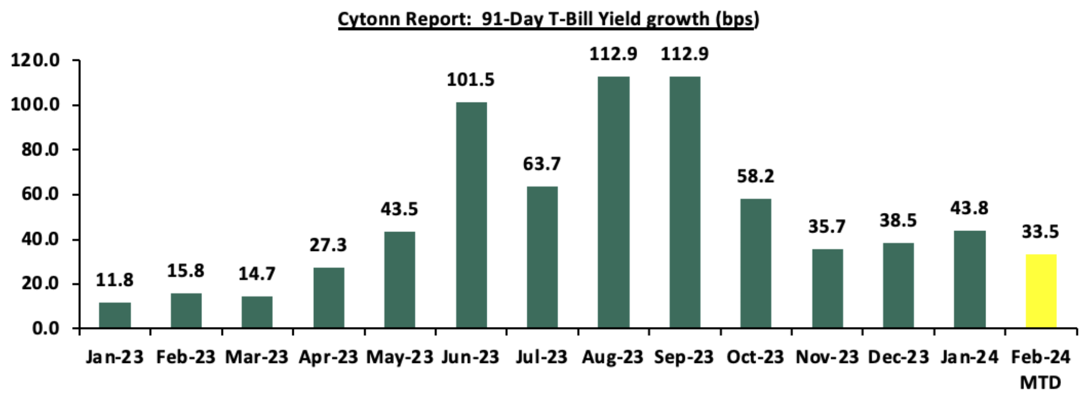
Real Estate Investment Trusts (REITs) Progress Update in Kenya, & Cytonn Weekly #07/2024

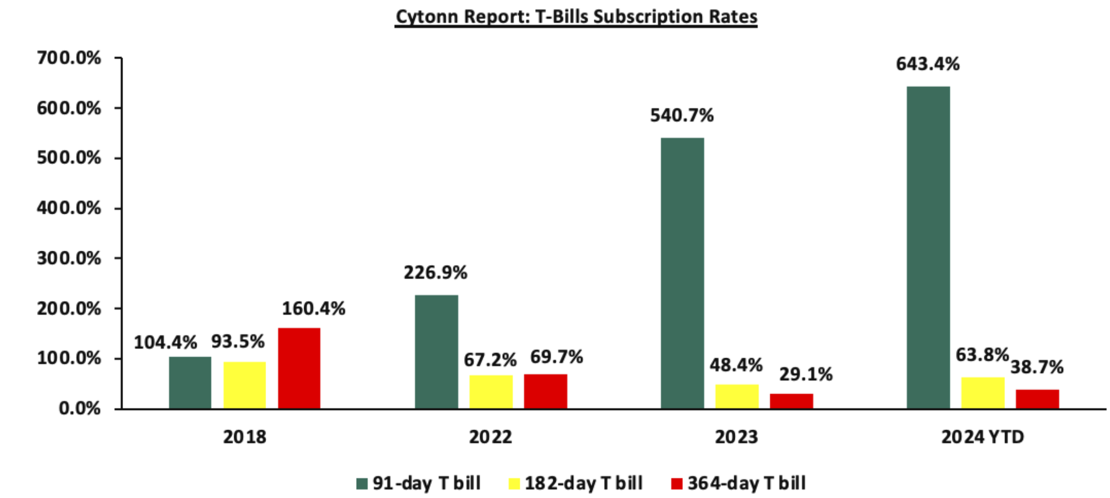
Fixed Income

Money Markets, T-Bills Primary Auction:

During the week, T-bills were oversubscribed for the seventh consecutive week, with the overall oversubscription rate coming in at 177.8%, albeit lower than the oversubscription rate of 213.0% recorded the previous week. Investors' preference for the shorter 91-day paper persisted, with the paper receiving bids worth Kshs 26.2 bn against the offered Kshs 4.0 bn, translating to an oversubscription rate of 654.1%, lower than the oversubscription rate of 867.6% recorded the previous week. The subscription rates for the 182-day paper increased to 112.3% from 94.5% recorded the previous week while the subscription rates for the 364-day paper decreased to 52.8% from the 69.7% recorded the previous week. The government accepted a total of Kshs 39.7 bn worth of bids out of Kshs 42.7 bn of bids received, translating to an acceptance rate of 92.9%. The yields on the government papers remained on an upward trajectory, with the yields on the 364-day, 182-day and 91-day papers increasing by 6.1 bps, 8.2 bps and 5.0 bps to 16.9%, 16.7% and 16.6%, respectively. The chart below shows the yield growth rate for the 91-day paper over the period:



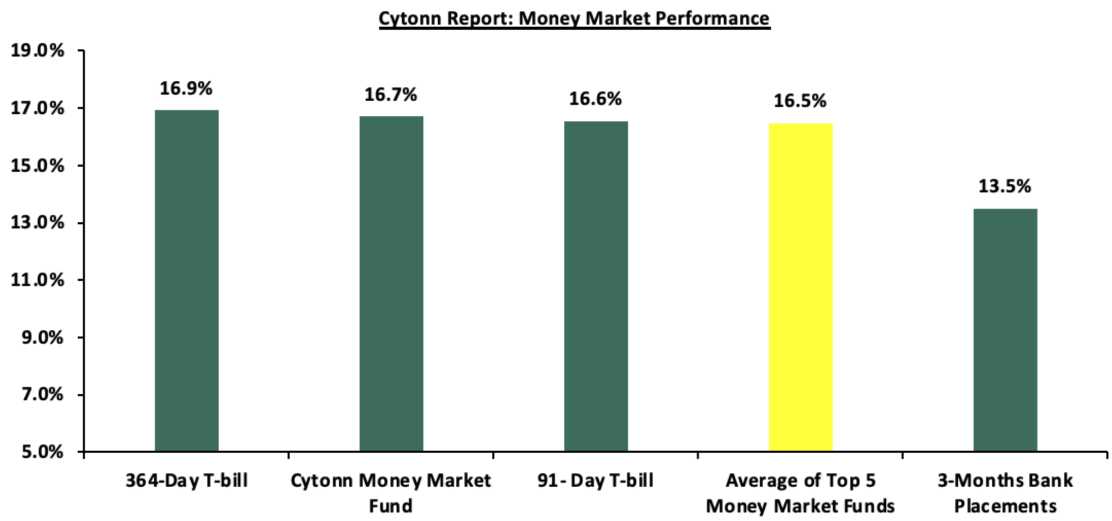
The chart below compares the overall average T-bill subscription rates obtained in 2018, 2022, 2023, and 2024 Year-to-date (YTD):



During the week, The Central Bank of Kenya released the auction results for the newly issued infrastructure bond IFB1/2024/8.5 with a tenor to maturity of 8.5 years. The bond was oversubscribed with the overall subscription rate coming in at 412.4%, with the government receiving bids worth Kshs 288.6 bn against the offered Kshs 70.0 bn. The government accepted bids worth Kshs 240.9 bn, translating to an acceptance rate of 83.5%. The weighted average yield of accepted bids came in at 18.5% and the coupon rate was set at 18.5%, 0.6% points higher than that of the previously issued infrastructure bond IFB1/2023/6.5, whose coupon rate was set at 17.9%.

Money Market Performance:

In the money markets, 3-month bank placements ended the week at 13.5% (based on what we have been offered by various banks), and the yields on the 364-day and 91-day papers increasing by 6.1 bps and 5.0 bps to 16.9% and 16.6%, respectively. The yields of the Cytonn Money Market Fund increased by 8.0 bps to 16.7% from 16.6% recorded the previous week, while the average yields on the Top 5 Money Market Funds decreased marginally by 0.4 bps to remain relatively unchanged from the 16.5% recorded the previous week.



The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 16th February 2024:

Cytonn Report: Money Market Fund Yield for Fund Managers as published on 16th February 2024

Rank	Fund Manager	Effective Annual Rate
1	Etica Money Market Fund	17.1%

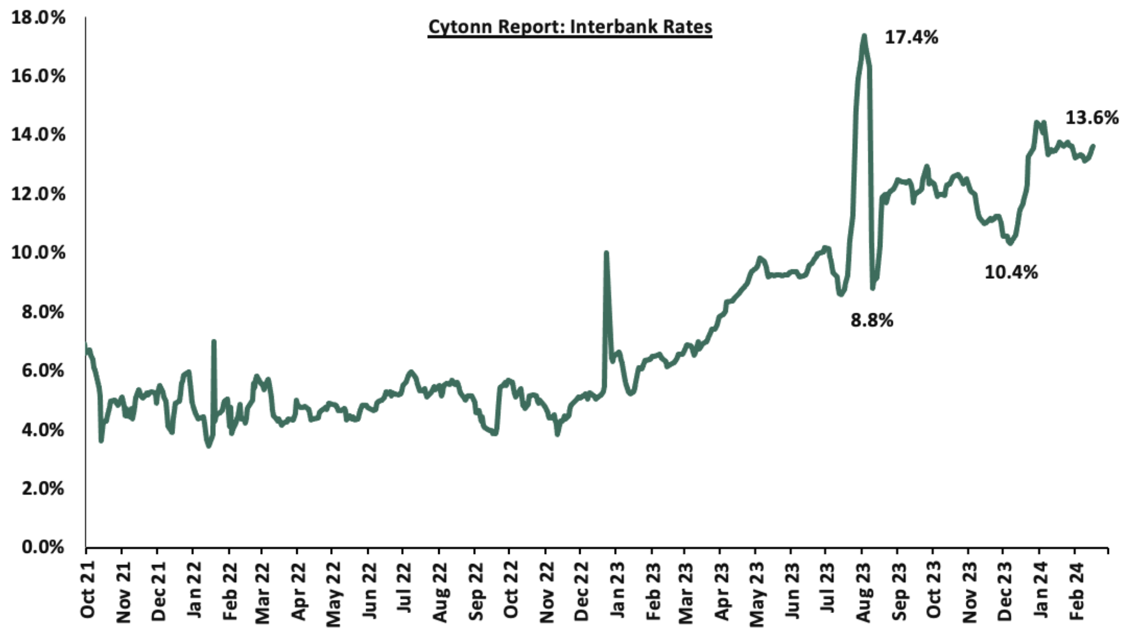
Cytonn Report: Money Market Fund Yield for Fund Managers as published on 16th February 2024

Rank	Fund Manager	Effective Annual Rate
2	Lofty-Corban Money Market Fund	17.0%
3	Cytonn Money Market Fund (*Dial *809# or download the Cytonn App)*	16.7%
4	GenAfrica Money Market Fund	16.0%
5	Apollo Money Market Fund	15.8%
6	Nabo Africa Money Market Fund	15.6%
7	Enwealth Money Market Fund	15.3%
8	Kuza Money Market fund	15.1%
9	Madison Money Market Fund	15.1%
10	GenCap Hela Imara Money Market Fund	15.0%
11	Co-op Money Market Fund	14.8%
12	Absa Shilling Money Market Fund	14.4%
13	Jubilee Money Market Fund	14.4%
14	AA Kenya Shillings Fund	14.2%
15	Mayfair Money Market Fund	14.0%
16	Mali Money Market Fund	13.9%
17	Sanlam Money Market Fund	13.8%
18	KCB Money Market Fund	13.6%
19	Old Mutual Money Market Fund	13.3%
20	Orient Kasha Money Market Fund	13.0%
21	Dry Associates Money Market Fund	12.7%
22	CIC Money Market Fund	12.2%
23	ICEA Lion Money Market Fund	11.9%
24	Equity Money Market Fund	11.5%
25	British-American Money Market Fund	10.2%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets marginally tightened, with the average interbank rate increasing by 0.2% points, to 13.4% from 13.3% recorded the previous week, partly attributable to the tax remittances that offset government payments. The average interbank volumes traded increased significantly by 62.9% to Kshs 40.5 bn from Kshs 24.9 bn recorded the previous week. The chart below shows the interbank rates in the market over the years:



Kenya Eurobonds:

During the week, the yields on Eurobonds were on a downward trajectory, with the yields on the 7-year Eurobond issued in 2019 and the 10-year Eurobond issued in 2018 decreasing the most by 1.5% and 1.2% points respectively, to 9.3% and 9.5% from 10.8% and 10.7% recorded the previous week, attributable to the announcement of the June maturity buyback, indicating improved investor perception on the country. The table below shows the summary of the performance of the Kenyan Eurobonds as of 15th February 2024;

Cytonn Report: Kenya Eurobonds Performance

	2014	**2018**		**2019**		**2021**
Tenor	**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	**0.4**	**4.1**	**24.1**	**3.3**	**8.3**	**10.4**
Yields at Issue	**6.6%**	**7.3%**	**8.3%**	**7.0%**	**7.9%**	**6.2%**
01-Jan-24	13.6%	9.8%	10.2%	10.1%	9.9%	9.5%
01-Feb-24	14.6%	10.6%	10.6%	11.3%	10.5%	10.1%
8-Feb-24	10.3%	10.7%	10.8%	10.8%	10.8%	10.3%
9-Feb-24	10.3%	10.3%	10.5%	10.4%	10.5%	10.1%
12-Feb-24	10.4%	10.1%	10.5%	10.0%	10.4%	10.0%
13-Feb-24	10.4%	10.0%	10.6%	9.9%	10.5%	10.1%
14-Feb-24	10.1%	9.8%	10.5%	9.7%	10.3%	10.0%
15-Feb-24	9.4%	9.5%	10.4%	9.3%	10.1%	9.8%
Weekly Change	**(0.9%)**	**(1.2%)**	**(0.4%)**	**(1.5%)**	**(0.7%)**	**(0.5%)**
MTD Change	**(5.2%)**	**(1.1%)**	**(0.2%)**	**(2.0%)**	**(0.4%)**	**(0.3%)**

Cytonn Report: Kenya Eurobonds Performance

	2014	2018		2019		2021
Tenor	**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	**0.4**	**4.1**	**24.1**	**3.3**	**8.3**	**10.4**
Yields at Issue	**6.6%**	**7.3%**	**8.3%**	**7.0%**	**7.9%**	**6.2%**
YTD Change	**(4.2%)**	**(0.4%)**	**0.2%**	**(0.8%)**	**0.2%**	**0.3%**

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

Kenya Shilling:

During the week, the Kenya Shilling gained against the US Dollar by 8.9% for the third consecutive week, to close at Kshs 145.9, from Kshs 160.1 recorded the previous week. On a year-to-date basis, the shilling has appreciated by 7.1% against the dollar, a contrast to the 26.8% depreciation recorded in 2023.

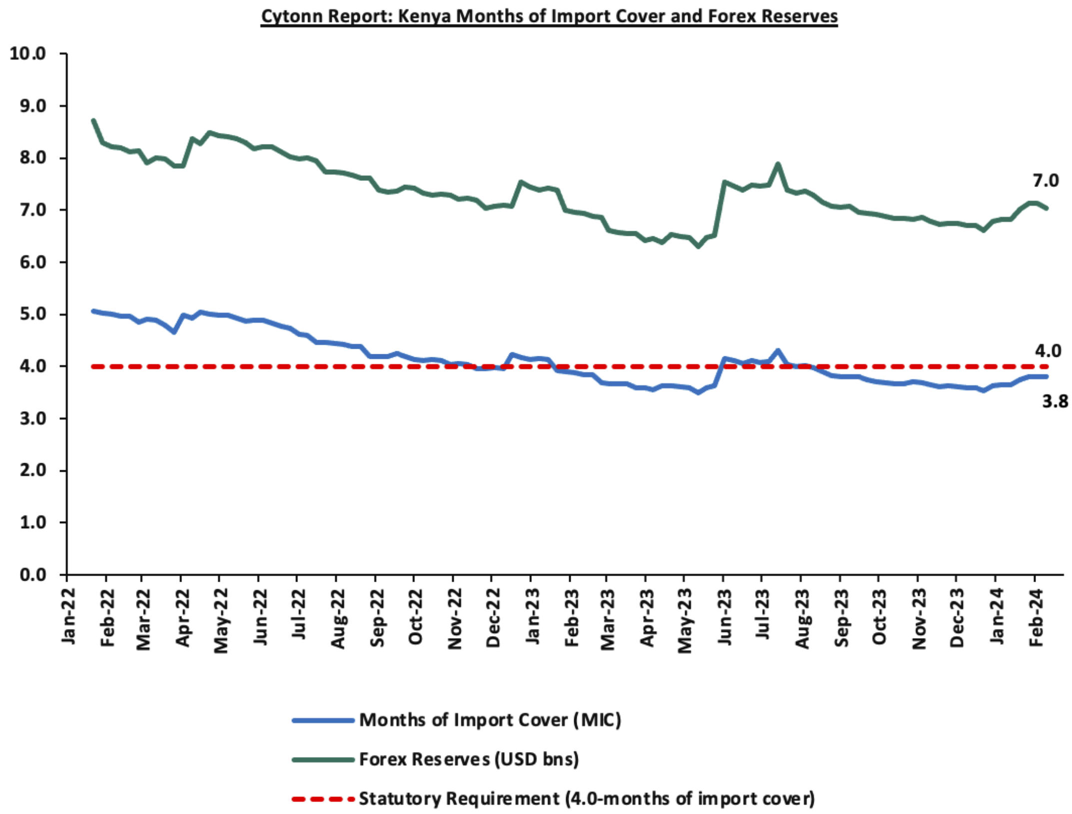
We expect the shilling to be supported by:

i. In the short-term the positive sentiment emanating from the successful Eurobond issuance given that market had priced in significant probability of default should support the shilling,
ii. Diaspora remittances standing at a cumulative USD 4,253.0 mn in the 12 months to January 2024, 5.3% higher than the USD 4,039.0 mn recorded over the same period in 2023, which has continued to cushion the shilling against further depreciation. In the January 2024 diaspora remittances figures, America remained the largest source of remittances to Kenya accounting for 54.0% in the period, and,
iii. The tourism inflow receipts which came in at USD 333.9 mn in 2023, a 24.6% increase from USD 268.1 mn inflow receipts recorded in 2022, and owing to tourist arrivals that improved by 30.7% to 192,000 in the 12 months to December 2023, from 161,000 recorded during a similar period in 2022.

The shilling is however expected to remain under pressure in 2024 as a result of:

i. An ever-present current account deficit which came at 3.5% of GDP in Q3'2023 from 6.4% recorded in a similar period in 2022,
ii. The need for government debt servicing, continues to put pressure on forex reserves given that 67.5% of Kenya's external debt was US Dollar denominated as of September 2023, and,
iii. Dwindling forex reserves, currently at USD 7.0 mn (equivalent to 3.8 months of import cover), which is below the statutory requirement of maintaining at least 4.0 months of import cover.

Key to note, Kenya's forex reserves decreased by 1.4% during the week to USD 7.0 bn from the USD 7.1 bn recorded the previous week, equivalent to 3.8 months of import cover relatively unchanged from the months of import cover 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's months of import cover over the years:



Weekly Highlights

I. **Fuel Prices effective 15th February 2024 to 14th March 2024**

During the week, the Energy and Petroleum Regulatory Authority (EPRA) released their monthly statement on the maximum retail fuel prices in Kenya, effective from 15th February 2024 to 14th March 2024. Notably, the maximum allowed price for Super Petrol, Diesel and Kerosene decreased by Kshs 1.0 each, and will retail at Kshs 206.4, Kshs 195.5 and Kshs 193.2 per litre respectively from the January 2024 prices of Kshs 207.4.4, Kshs 196.5 and Kshs 194.2 respectively.

Other key take-outs from the performance include;

i. The average landing costs per cubic meter for Diesel, Super Petrol, and Kerosene decreased by 3.1%, 1.7%, and 1.2% respectively to USD 728.0, USD 666.2, and USD 718.5 in January 2024, from USD 751.2, USD 677.8 and USD 727.0, respectively, in December 2023.
ii. The Kenyan shilling depreciated against the US Dollar by 3.5% to Kshs 164.4 in January 2024, compared to the mean monthly exchange rate of Kshs 158.8 recorded in December 2023.

We note that fuel prices in the country have decreased largely attributed to the government's efforts to stabilize pump prices through the petroleum pump price stabilization mechanism which has so far expended Kshs 9.9 bn in the FY2023/24 to cushion the increases applied to the petroleum pump prices. Nevertheless, fuel prices in the country remain under pressure from the high cost of fuel imports resulting from the sustained depreciation of the shilling against the US dollar, as well as the high taxation of petroleum products as provided in the Finance Act 2023. We expect that fuel prices will ease in the coming months as a result of the government's efforts to mitigate the cost of petroleum through the pump price stabilization mechanism coupled with the ongoing strengthening of the Kenyan Shilling against the United States Dollar.

II. **Kenya USD 1.5 bn Eurobond Issuance**

During the week, The Government, through the Ministry of National Treasury & Planning announced the successful pricing of a new USD 1.5 bn Eurobond. The new issuance (KENINT2031) has attracted a yield of 10.375% and a coupon rate of 9.75%, in line with our expectations which were informed by the prevailing market conditions, Kenya’s credit ratings, and the unique nature of our buyback and issue plan. Interest payments for the bond are to be paid semi-annually on February 16th and August 16th starting August 2024.

The total proceeds for the bond came in at USD 1.46 bn, with the bond having been priced at a 97.27% discount. Maturity for the bond is set for 16th February 2031, with redemptions in three installments of USD 0.5 bn in 2029 and 2030 February, translating to an annualized average life of 6 years.

This issue follows issues by Ivory Coast and Benin earlier in the year. Continuing the trend for offers by other Sub-Saharan African countries, Kenya’s issue was oversubscribed, with the overall subscription rate coming in at 393.3%. The issue received offers of USD 6.0 bn. The yield is, however, the highest for a bond issued in the SSA region this year, close to Ghana’s 10.8% 2015 bond which they defaulted on.

Kenya is expected to use the proceeds from this issuance to finance the earlier announced buyback of the USD 2.0 bn 2014 10-year tenor Eurobond. The remaining amount of the initial bond will the repaid at maturity through a mix of syndicated financing, multilateral financing, and domestic financing. This issue ends the uncertainty that had hovered over Kenya’s ability to repay the bond that is due for maturity, albeit at very high costs.

The table below shows the comparison between Kenya’s issue and the other two issues in the Sub-Saharan Africa region;

Cytonn Report: Fitch Rating's Long-Term Foreign-Currency Issuer Default Rating (IDR)

Fitch Rating's Long-Term Foreign-Currency Issuer Default Rating (IDR)				2024 Eurobond Issues			
Country	**IDR Credit Rating**	**IDR Credit Outlook**	**Date**	**Value (USD mn)**	**Tenor (Years)**	**Yield at Issue**	**Coupon Rate**
Ivory Coast	BB-	Stable	Feb-2024	1,100.0	8.5	7.650%	7.650%
				1,500.0	12.5	8.250%	8.250%
Benin	B+	Stable	Sep-2023	750.0	14.0	8.375%	8.375%
Kenya	B	Negative	Jul-2023	1,500.0	6.0	10.375%	9.750%

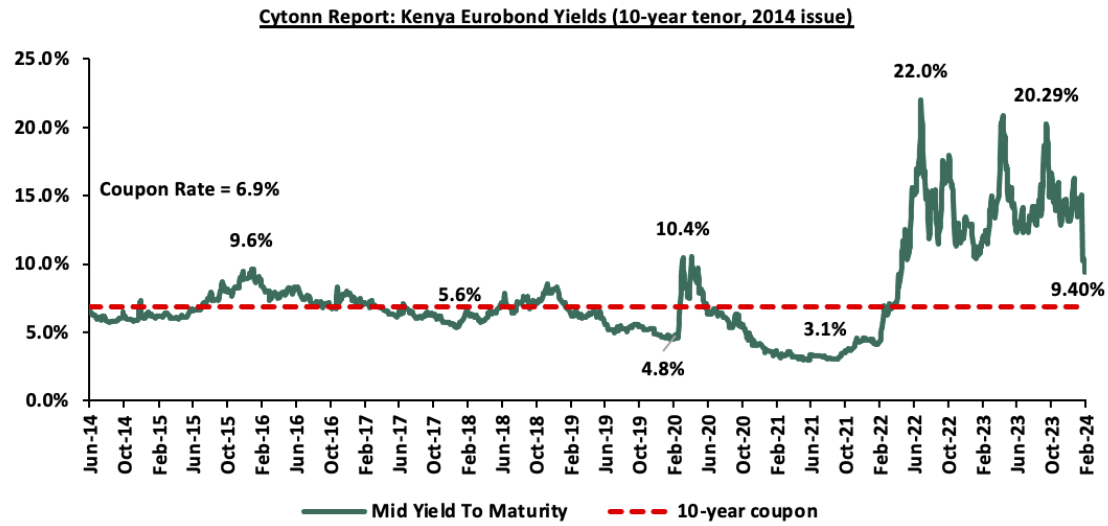
III. **Kenya’s USD 1.4 bn Eurobond Buyback Results**

The Government, on 15th February 2024, announced the results of the Tender offer of its USD 2.0 bn 10-year tenor Eurobond issued in 2014. This follows the end of the tender period which opened from 7th of February 2024 to 14th February 2024 with the intent of purchasing Notes due in 2024 from their holders at par value, for cash. The results also came in two days after Kenya announced a successful pricing of the new USD 1.5 bn Eurobond. The buyback offer received tenders worth 1.5 bn against the offered 1.4 bn, translating to an oversubscription rate of 106.1%, with Kenya accepting bids worth USD1.4 bn, slightly below the offered USD 1.5 bn. This translated to an acceptance rate of 97.0%. The settlement date for the buyback was set on 21st February 2024.

As earlier announced, the buyback will be financed by the new issue of USD 1.5 bn which attracted a yield of 10.375% and a coupon rate of 9.75%. The Purchase Price for the Notes accepted for purchase is USD 1,000 per USD 1,000 in principal amount of such Notes plus the interests accrued.

Consequently, all purchased Notes will be cancelled and will not be reissued or resold. The remaining notes worth USD 0.6 bn not offered or not accepted for purchase as per the Offer will continue to be in circulation and will repaid at maturity through a mix of syndicated financing, multilateral financing, and domestic financing. As announced by the CBK governor earlier, Kenya has in the last few weeks received disbursements of USD 684.0 mn from the IMF and USD 400.0 mn from the Trade Development Bank, and anticipates an additional USD 1.5 bn from the World Bank between March and April.

Kenya decided to proceed to the international markets for funding to meet its debt obligations which were a source of increased concern by all stakeholders. Through its leading dealer managers Citigroup Global Markets Limited and the Standard Bank of South Africa Limited, Kenya managed to have a buyback and new issue run concurrently in the market. As it stands, the cloud of debt default that hanged over the country for a long period seems to have passed, albeit at higher costs. Kenya's credit ratings, however, still remain negative as affirmed by Fitch in the wake of this buyback. The markets reacted positively to this announcement, with the yield on the 10-year 2014 Issue falling to 9.4%, from 10.3% at the end of the previous week. The graph below shows the yields for the bond since it was issued in 2014:



IV. **Revenue and Net Expenditures for FY'2023/2024**

The National Treasury gazetted the revenue and net expenditures for the seventh month of FY'2023/2024, ending 31st January 2024. Below is a summary of the performance:

Cytonn Report: FY'2023/2024 Budget Outturn - As at 31st January 2024

Amounts in Kshs bn 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			2.6			
Tax Revenue	2,495.8	2,495.83	1,216.4	48.7%	1,455.9	83.6%
Non-Tax Revenue	75.3	80.9	41.9	51.8%	47.2	88.8%
Total Revenue	**2,571.2**	**2,576.8**	**1,261.0**	**48.9%**	**1,503.1**	**83.9%**

Cytonn Report: FY'2023/2024 Budget Outturn - As at 31st January 2024

Amounts in Kshs bn unless stated otherwise

Item	12-months Original Estimates	Revised Estimates	Actual Receipts/Release	Percentage Achieved of the Revised Estimates	Prorated	% achieved of the Prorated
External Loans & Grants	870.2	849.8	241.6	28.4%	495.7	48.7%
Domestic Borrowings	688.2	851.9	305.2	35.8%	496.9	61.4%
Other Domestic Financing	3.2	3.2	3.5	111.1%	1.9	190.4%
Total Financing	**1,561.6**	**1,704.9**	**550.4**	**32.3%**	**994.5**	**55.3%**
Recurrent Exchequer issues	1,302.8	1,360.1	700.2	51.5%	793.4	88.2%
CFS Exchequer Issues	1,963.7	2,078.8	831.8	40.0%	1,212.7	68.6%
Development Expenditure & Net Lending	480.8	457.2	103.1	22.5%	266.7	38.6%
County Governments + Contingencies	385.4	385.4	174.3	45.2%	224.8	77.5%
Total Expenditure	**4,132.7**	**4,281.6**	**1,809.3**	**42.3%**	**2,497.6**	**72.4%**
Fiscal Deficit excluding Grants	**1,561.6**	**1,704.9**	**548.3**	**32.2%**	994.5	55.1%
Total Borrowing	**1,558.4**	**1,701.7**	**546.9**	**32.1%**	992.6	**55.1%**

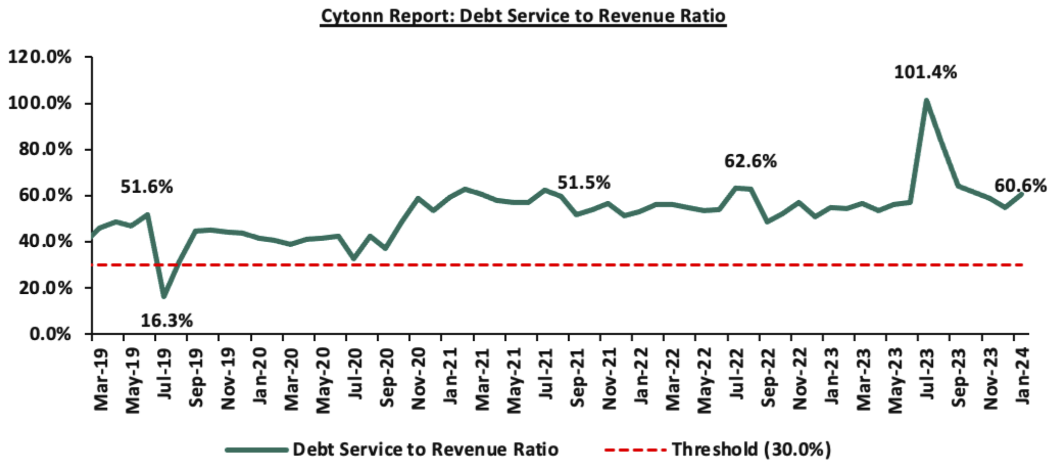
Amounts in Kshs bn unless stated otherwise

The Key take-outs from the release include;

a. Total revenue collected as at the end of January 2024 amounted to Kshs 1,261.0 bn, equivalent to 48.9% of the revised estimates of Kshs 2,576.8 bn for FY’2023/2024 and is 83.9% of the prorated estimates of Kshs 1,503.1 bn. Cumulatively, tax revenues amounted to Kshs 1,216.4 bn, equivalent to 48.7% of the revised estimates of Kshs 2,495.8 bn and 83.6% of the prorated estimates of Kshs 1,455.9 bn,
b. Total financing amounted to Kshs 550.4 bn, equivalent to 32.3% of the revised estimates of Kshs 1,704.9 bn and is equivalent to 55.3% of the prorated estimates of Kshs 994.5 bn. Additionally, domestic borrowing amounted to Kshs 305.2 bn, equivalent to 35.8% of the revised estimates of Kshs 851.9 bn and is 61.4% of the prorated estimates of Kshs 496.9 bn,
c. The total expenditure amounted to Kshs 1,809.3 bn, equivalent to 42.3% of the revised estimates of Kshs 4,281.6 bn, and is 72.4% of the prorated target expenditure estimates of Kshs 2,497.6 bn.

Additionally, the net disbursements to recurrent expenditures came in at Kshs 700.2 bn, equivalent to 51.5% of the revised estimates of Kshs 1,360.1 and 88.2% of the prorated estimates of Kshs 793.4 bn,

d. Consolidated Fund Services (CFS) Exchequer issues came in at Kshs 831.8 bn, equivalent to 40.0% of the revised estimates of Kshs 2,078.8 bn, and are 68.6% of the prorated amount of Kshs 1,212.7 bn. The cumulative public debt servicing cost amounted to Kshs 764.3 bn which is 41.0% of the revised estimates of Kshs 1,866.0 bn, and is 70.2% of the prorated estimates of Kshs 1,088.5 bn. Additionally, the Kshs 764.3 bn debt servicing cost is equivalent to 60.6% of the actual revenues collected as at the end of January 2024. The chart below shows the debt serving to revenue ratio;



e. Total Borrowings as at the end of January 2024 amounted to Kshs 546.9 bn, equivalent to 32.1% of the revised estimates of Kshs 1,701.7 bn for FY'2023/2024 and are 55.1% of the prorated estimates of Kshs 992.6 bn. The cumulative domestic borrowing of Kshs 851.9 bn comprises of Net Domestic Borrowing Kshs 471.4 bn and Internal Debt Redemptions (Rollovers) Kshs 380.5 bn.

January's 83.9% attainment of the revenue target is a 0.9%-points decline from the performance in December where government achieved 84.8% of the revenue targets. This decline can be attributed to the challenges posed by the tough economic conditions evidenced by the high inflation rate that increased by 0.3% points in January to 6.9% from the 6.6% recorded in December. The government's continued failure to achieve its prorated revenue targets for the seventh consecutive month in FY'2023/2024 reflects the challenges posed by the tough economic situation. The revenue collection continues to be impeded by the business environment which still remains in the contraction zone despite showing slight improvement, coming in at 49.8 in January. 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, which is expected to be supported by the ongoing strengthening of the Shilling against the dollar. Notably, the government also continues to implement strategies to enhance revenue collection, such as expanding the revenue base and addressing tax leakages, as well as suspending tax relief payments.

V. **Kenya's S&P Global Issuer Default Rating**

Following Kenya's announcement, to go through with the earlier announced plan of buying back the 10-year tenor USD 2.0 bn Eurobond tenders issued in 2014, S&P Global Ratings affirmed Kenya's long-term sovereign credit rating at 'B' with a negative outlook and assigned a 'B' long-term issue rating to the proposed U.S. dollar-denominated Eurobonds. The government's decision to buy back some of its debt is not seen as a desperate move according to the S&P Global rating criteria. This is because bondholders who opt not to participate in the buyback will still receive their full investment back upon the bond's original maturity date, which is June 24th, 2024.

The negative outlook assigned to Kenya's sovereign credit rating underscores the potential risks and uncertainties that lie ahead. Due to the high inflation which currently stands at 6.9%, liquidity in the domestic capital markets has tightened. Additionally, external debt-servicing capacity remains a key concern amidst high external refinancing requirements. The government revised its budget deficit target to 5.5% of GDP for FY’2023/2024 from the 4.4% approved under the Finance Act, reflecting underperformance in revenue collection as well as rising costs of paying back old debts due to currency pressures.

Acknowledging Kenya's strong GDP growth, dynamic private sector, and diversified economy, the ratings agency also raised concerns over the high fiscal deficits, debt levels, and sizable external financing requirements. These challenges underscore the importance of prudent fiscal management and effective debt sustainability measures to safeguard Kenya's economic stability.

While securing loans can seem like a quick fix, Kenya's access to external financing is a double-edged sword. The disbursements from development partners’ multilateral and regional institutions such as the IMF of a total USD 4.4 bn as of December 2023, an additional USD 400.0 mn from Trade and Development Bank in January 2024 and expected inflows of upto USD 1.5 bn and USD 100.0 mn from the World Bank and African Development Bank respectively; are expected to support the foreign exchange reserves of USD 7.1 bn as of 9th February 2024, with 3.8 months of import cover. Even though these loans help in the short term, they add to Kenya's already high debt burden. Getting loans helps Kenya avoid immediate financial trouble, but long-term solutions like managing debt and boosting exports are crucial for lasting stability.

According to S&P Global, Kenya’s ratings could go lower over the next 6 to 12 months on the back of increased external financing attributable to a decline in the foreign exchange reserves. Additionally, any future debt-repurchase operations related to a distressed currency performance and limited progress on fiscal consolidation could lead to a further decline in the ratings.

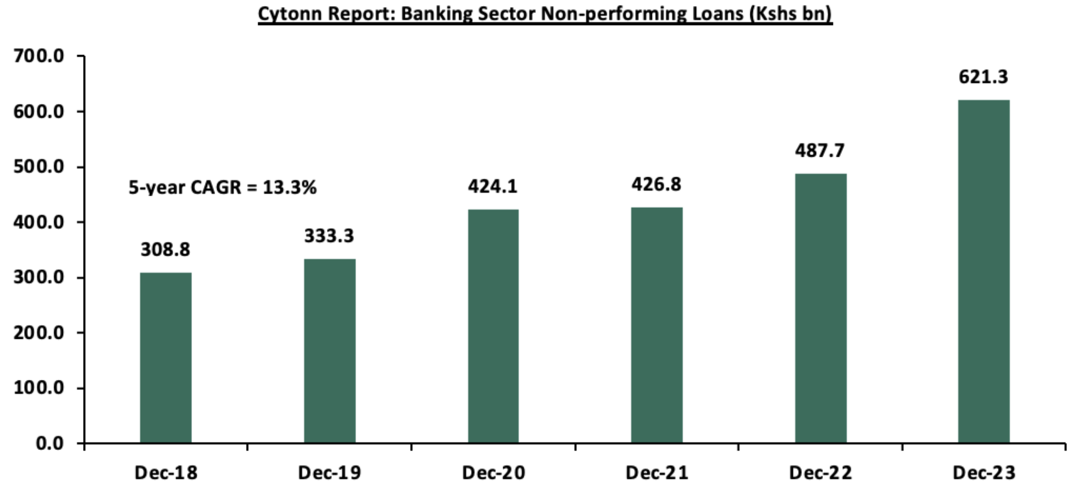
Kenya's economic stability hinges on its ability to manage its debt and external financing while achieving fiscal consolidation. Continued efforts in these areas are crucial to avoid a credit rating downgrade and secure a more stable outlook.

VI. **Moody’s Downgrades Kenyan Banks’ Outlook to Negative**

On February 15th 2024, the global ratings agency, Moody’s announced its revision of the Kenyan banks’ outlook to negative from stable on the back of the high volume of non-performing loans (NPLs), which have thrown a pall over the sector's strong profitability and liquidity.

The loan defaults increased to Kshs 621.3 bn in December 2023 from the Kshs 487.7 bn recorded in December 2022. These number of non-performing loans accounted for 14.8% of the sector's loan book in December 2023, up significantly from 13.3% in 2022, attributable to the high inflation and interest rates and the reduced demand for goods and services that have combined to weaken borrowers’ ability to service loans.

Notably, the Monetary Policy Committee (MPC) raised the Central Bank Rate (CBR) by a cumulative 375 basis points to close the year at 12.5%. In its latest sitting in February 2024, the MPC raised the CBR to 13.0%, the highest in twelve years. The decision by the committee to raise the rate displays efforts to cushion the high inflation rates and to support the local currency, that has since appreciated against the US dollar significantly by 9.0% to Kshs 145.9 as of 16th February 2024 from the Kshs 160.4 recorded on 6th February 2024 when the central bank rate was raised to 13.0%. This increase in the rate however translates to high loan prices that cause borrowers to struggle during repayments. Below is a graph of NPLs over the last five years;



Source: CBK, Treasury

The Moody's outlook is not a credit rating action, but rather an assessment of credit fundamentals in the banking industry for the next 12 to 18 months. The agency's concern about the high amount of non-performing loans stems mostly from the impact on bank profitability, since banks are required to increase their provisioning whenever the number of default loans rises.

The global ratings agency further noted that the positive impact of higher interest income is expected to be offset by the negative impacts of higher loan loss provisioning and higher cost of deposits, resulting in declined profits for banks this year.

As the banking sector's asset quality deteriorates, commercial banks may reduce the issuing of new loans in order to manage the mounting non-performing loans. Banks may use steps similar to those prompted by the Covid-19 crisis to stabilise their loan books, such as extending repayment times to consumers.

Rates in the Fixed Income market have been on an upward trend given the continued high demand for cash by the government and the occasional liquidity tightness in the money market. The government is 10.3% ahead of its prorated net domestic borrowing target of Kshs 301.7 bn, having a net borrowing position of Kshs 332.9 bn out of the domestic net borrowing target of Kshs 471.4 bn for the FY'2023/2024. Therefore, we expect a continued upward readjustment of the yield curve in the short and medium term, with the government looking to maintain the fiscal surplus 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

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