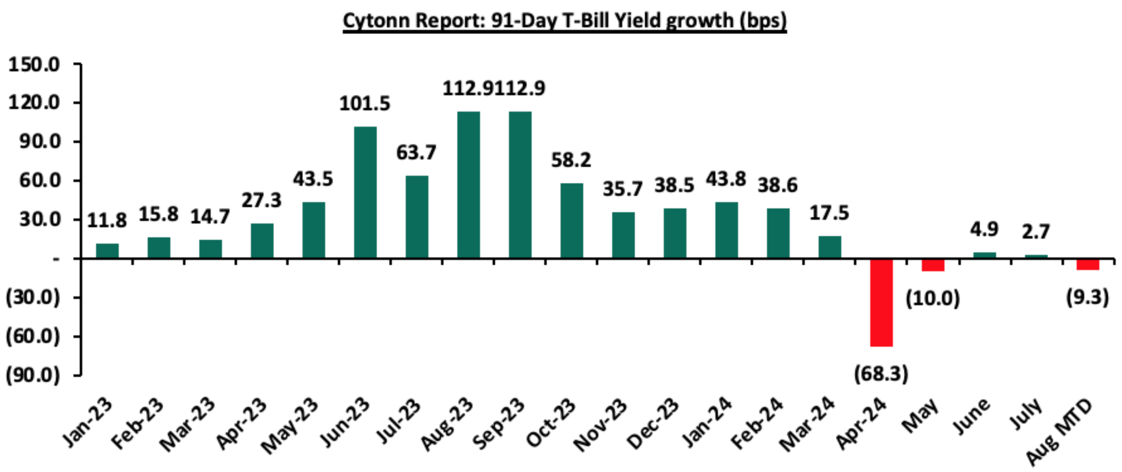
Enhancing the Effectiveness of Kenya's Housing Fund, & Cytonn Weekly #32/2024

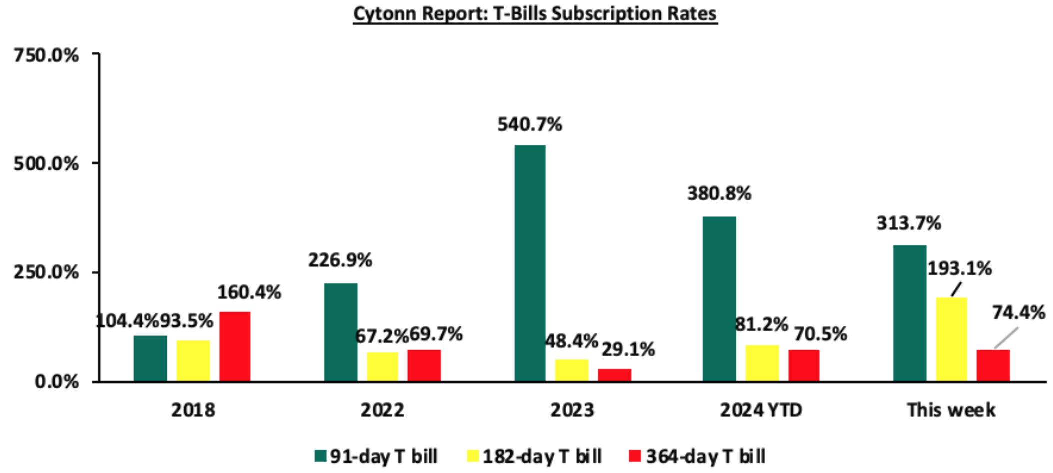
Fixed Income

Money Markets, T-Bills Primary Auction:

During the week, T-bills were oversubscribed for the third consecutive week, with the overall oversubscription rate coming in at 163.7%, higher than the oversubscription rate of 101.7% recorded the previous week. Investors' preference for the shorter 91-day paper persisted, with the paper receiving bids worth Kshs 12.5 bn against the offered Kshs 4.0 bn, translating to an oversubscription rate of 313.7%, albeit lower than the oversubscription rate of 371.5% recorded the previous week. The subscription rates for the 182-day and 364-day papers increased significantly to 193.1% and 74.4% respectively from the 84.7% and 10.8% respectively, recorded the previous week. The government accepted a total of Kshs 34.3 bn worth of bids out of Kshs 39.3 bn bids received, translating to an acceptance rate of 87.4%. The yields on the government papers were on a downward trajectory, with the yields on the 364-day, 182-day, and 91-day papers decreasing by 0.7 bps, 13.5 bps, and 17.1 bps to 16.9%, 16.7%, and 15.8% respectively from 16.9%, 16.9% and 16.0% respectively recorded the previous week. The chart below shows the yield growth rate for the 91-day paper over the period:

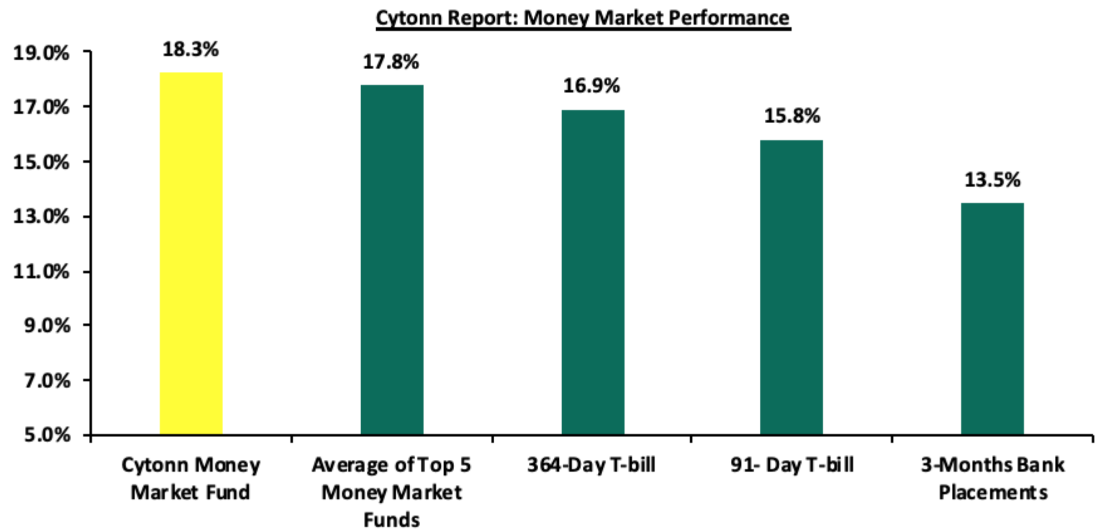


The chart below compares the overall average T-bill subscription rates obtained in 2018, 2022, 2023, and 2024 Year-to-date (YTD):



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 government papers were on a downward trajectory, with the yields on the 364-day and 91-day papers decreasing by 0.7 bps and 17.1 bps to 16.9% and 15.8% from 16.9% and 16.0% respectively recorded the previous week. The yields on the Cytonn Money Market Fund decreased marginally by 9.0 bps to close the week at 18.3% remaining relatively unchanged from last week, while the average yields on the Top 5 Money Market Funds decreased by 4.6 bps to remain relatively unchanged from the 17.8% recorded the previous week.



The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 9th August 2024:

Cytonn Report: Money Market Fund Yield for Fund Managers as published on 9th August 2024

Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund (Dial *809# or download the Cytonn app)	18.3%
2	Etica Money Market Fund	18.3%
3	Lofty-Corban Money Market Fund	18.2%
4	Kuza Money Market fund	17.1%
5	Arvocap Money Market Fund	17.1%
6	GenAfrica Money Market Fund	16.8%

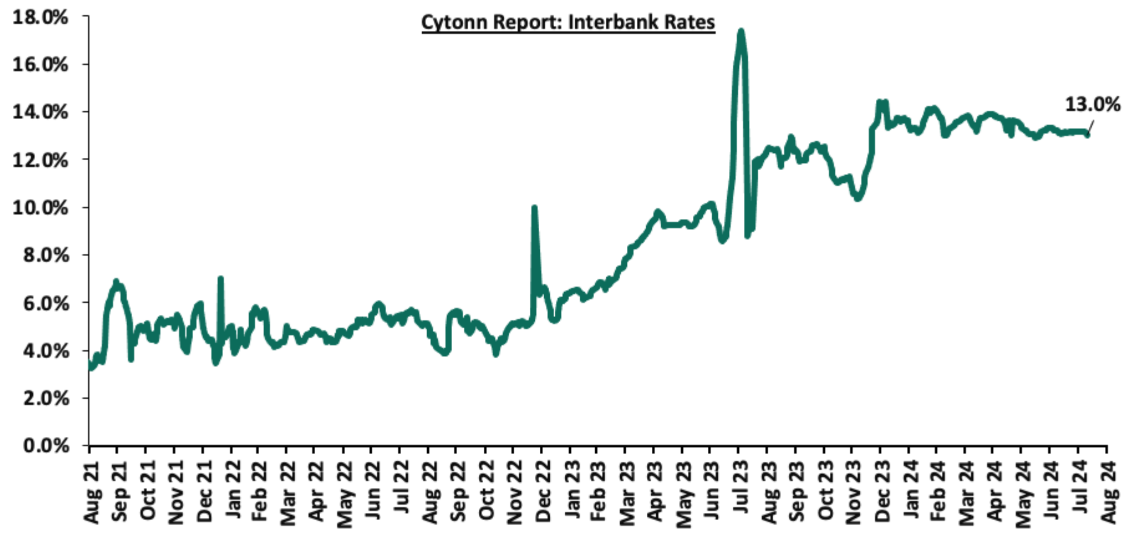
Cytonn Report: Money Market Fund Yield for Fund Managers as published on 9th August 2024

Rank	Fund Manager	Effective Annual Rate
7	Sanlam Money Market Fund	16.4%
8	Nabo Africa Money Market Fund	16.4%
9	GenCap Hela Imara Money Market Fund	16.2%
10	Jubilee Money Market Fund	16.0%
11	Enwealth Money Market Fund	16.0%
12	Co-op Money Market Fund	15.7%
13	Apollo Money Market Fund	15.6%
14	Absa Shilling Money Market Fund	15.5%
15	Mayfair Money Market Fund	15.4%
16	KCB Money Market Fund	15.3%
17	Madison Money Market Fund	15.3%
18	AA Kenya Shillings Fund	15.2%
19	Mali Money Market Fund	15.1%
20	Orient Kasha Money Market Fund	14.6%
21	Dry Associates Money Market Fund	14.0%
22	ICEA Lion Money Market Fund	13.8%
23	CIC Money Market Fund	13.7%
24	Old Mutual Money Market Fund	13.6%
25	Equity Money Market Fund	13.6%
26	British-American Money Market Fund	13.4%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets marginally eased, with the average interbank rate decreasing by 4.4 bps, to 13.1% from the 13.2% recorded the previous week, partly attributable to government payments that offset tax remittances. The average interbank volumes traded decreased by 0.9% to Kshs 33.7 bn from Kshs 34.0 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 an upward trajectory, with the yields on the 7-year Eurobond issued in 2019 increasing the most by 80.0 bps to 11.4% from 10.6% recorded the previous week, partly attributable to the recent downgrading of Kenya's credit rating by Fitch Ratings, few days after Moody's downgrade. The table below shows the summary of the performance of the Kenyan Eurobonds as of 8th August 2024;

Cytonn Report: Kenya Eurobonds Performance

	2018		**2019**		**2021**	**2024**
Tenor	**10-year issue**	**30-year issue**	**7-year issue**	**12-year issue**	**13-year issue**	**7-year issue**
Amount Issued (USD)	**1.0 bn**	**1.0 bn**	**0.9 bn**	**1.2 bn**	**1.0 bn**	**1.5 bn**
Years to Maturity	**3.6**	**23.6**	**2.8**	**7.8**	**9.9**	**6.5**
Yields at Issue	**7.3%**	**8.3%**	**7.0%**	**7.9%**	**6.2%**	**10.4%**
1-Jan-24	9.8%	10.2%	10.1%	9.9%	9.5%	
1-Aug-24	10.7%	11.1%	10.6%	11.0%	10.9%	11.1%
2-Aug-24	11.0%	11.3%	10.8%	11.2%	11.2%	11.3%
5-Aug-24	11.5%	11.7%	11.3%	11.6%	11.6%	11.8%
6-Aug-24	11.5%	11.6%	11.3%	11.7%	11.6%	11.8%
7-Aug-24	11.5%	11.6%	11.4%	11.6%	11.5%	11.7%
8-Aug-24	11.5%	11.6%	11.4%	11.6%	11.5%	11.7%
Weekly Change	**0.8%**	**0.5%**	**0.8%**	**0.6%**	**0.6%**	**0.7%**
MTD Change	**0.8%**	**0.5%**	**0.8%**	**0.6%**	**0.6%**	**0.7%**
YTD Change	**1.7%**	**1.4%**	**1.3%**	**1.7%**	**2.0%**	**11.7%**

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

Kenya Shilling:

During the week, the Kenya Shilling appreciated against the US Dollar by 0.5%, to close at Kshs 129.3, from Kshs 129.9 recorded the previous week. On a year-to-date basis, the shilling has appreciated by 17.7% against the dollar, a contrast to the 26.8% depreciation recorded in 2023.

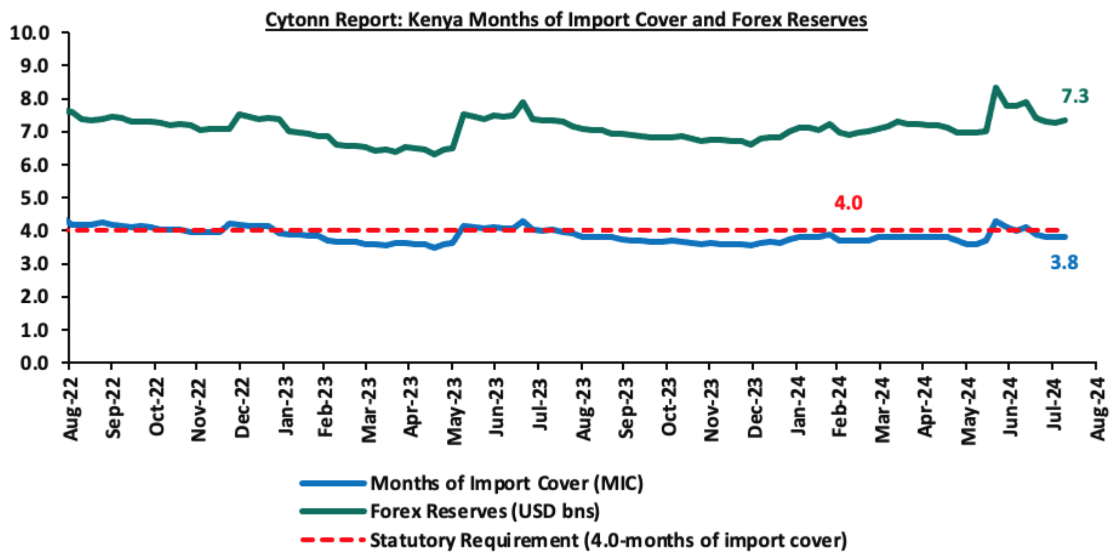
We expect the shilling to be supported by:

i. Diaspora remittances standing at a cumulative USD 4,535.0 mn in the 12 months to June 2024, 12.9% higher than the USD 4,017.0 mn recorded over the same period in 2023, which has continued to cushion the shilling against further depreciation. In the June 2024 diaspora remittances figures, the US remained the largest source of remittances to Kenya accounting for 54.0% in the period, and,
ii. The tourism inflow receipts which came in at USD 352.5 bn in 2023, a 31.5% increase from USD 268.1 bn inflow receipts recorded in 2022, and owing to tourist arrivals that improved by 27.2% in the 12 months to June 2024, from the arrivals recorded during a similar period in 2023.

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 3.2% of GDP in Q1'2024 from 3.0% recorded in Q1'2023,
ii. The need for government debt servicing, continues to put pressure on forex reserves given that 67.9% of Kenya's external debt is US Dollar-denominated as of March 2024, and,
iii. Dwindling forex reserves currently at USD 7.3 bn (equivalent to 3.8-months of import cover), which is below the statutory requirement of maintaining at least 4.0-months of import cover, and also lower than EAC region's convergence criteria of 4.5-months of import cover.

Key to note, Kenya's forex reserves increased by 0.9% during the week to remain relatively unchanged at USD 7.3 bn recorded the previous week, equivalent to 3.8 months of import cover, remaining unchanged from last week, and 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. **Stanbic Bank's July 2024 Purchasing Manager's Index (PMI)**

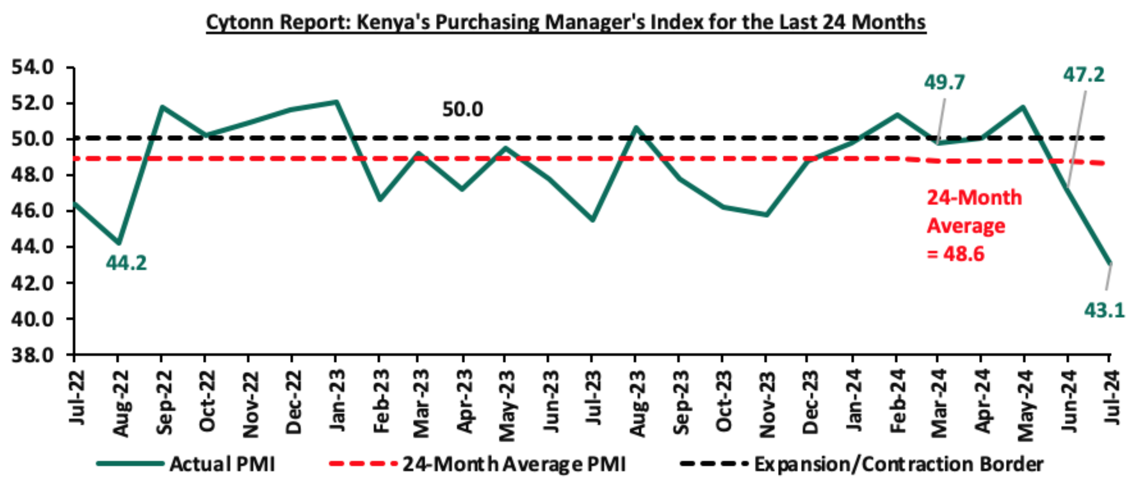
During the week, Stanbic Bank released its monthly Purchasing Managers Index (PMI) highlighting that the index for the month of July 2024 sharply deteriorated, coming in at 43.1, below the 50.0 neutral for the second consecutive month, down from 47.2 in June 2024, signaling a deterioration in the operating conditions across Kenya at the start of the third quarter. This was the second sharpest decline recorded in seven months. Private sector output dropped markedly in the month of July, reflecting a renewed and steep fall in new business intakes. On a year-to-date basis, the index recorded a 13.1% decline from the 49.8 recorded in January 2024. On a y/y basis, the index recorded a 5.3 % decline from the 45.5 recorded in July 2023. This sharp decline in the general business environment is mainly attributable to the anti-government protests in Kenya which caused disruption in the private sector in the month of July.

Disruption from the protests impacted the ability of suppliers to deliver items to companies and the completion of projects by Kenyan firms themselves. As a result, suppliers' delivery times lengthened for the first time in ten months, and backlogs of work accumulated to the greatest extent since March 2023. Despite the ease in inflation coming in at 4.3% in July 2024, from 4.6% in June 2024, well below the CBK's preferred target of 5.0%, and remaining within the Central Bank of Kenya (CBK) target range of 2.5% to 7.5% for the thirteenth consecutive, the business environment still remained constrained, partly due to the high taxes and increased cost of living. Notably, the prices for Super Petrol, Diesel, and Kerosene decreased by Kshs 1.0, Kshs 1.5 and Kshs 1.3 each respectively, and will retail at Kshs 188.8, Kshs 171.6 and Kshs 161.8 per litre respectively from the June 2024 prices of Kshs 189.8, Kshs 173.1 and Kshs 163.1 respectively.

Input costs rose for the second consecutive month, leading to another increase in selling prices attributable to higher taxation on products. Output prices were also up modestly and for the third successive month. While some firms increased charges in response to higher input costs, others lowered selling prices in a bid to boost sales. In July, companies reduced their purchasing activities and input inventories but continued to increase their workforce. However, the rate of job creation was minimal, marking the slowest growth in the current seven-month trend of rising employment levels. Business activity decreased across the sectors covered, with the sharpest decline in agriculture. Manufacturing was the only category to post a rise in output.

Business confidence dropped and was the second-lowest on record, only marginally above the series nadir posted in February. Those companies that remained optimistic about the outlook for business activity generally linked this to plans to open new branches.

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:



Going forward, we expect the business climate to be restrained in the short to medium term as a result of the continued unrest following the anti-government protests and an overall rise in the cost of living. However, we expect firms to benefit from reduced inflationary pressures and an appreciating Shilling, which will lower input prices.

II. **Monetary Policy Committee (MPC) August Meeting**

The monetary policy committee met on August 6, 2024, to review the outcome of its previous policy decisions against a backdrop of improved global outlook for growth, easing in inflation in advanced economies as well as the persistent geopolitical tensions. The MPC decided to lower the CBR rate by 25.0 bps to 12.75%, from 13.00% which was in line with our expectation for the MPC to lower the CBR rate. Our expectation to cut the rate was mainly on the back of rate cuts by some major economies, a stable exchange rate, anchored inflationary pressures, with inflation coming in at 4.3% in July 2024 from 4.6% in June, remaining within the CBK preferred range of 2.5%-7.5% for the thirteenth consecutive month, as well as the need to support the economy by adopting an accommodative policy that will ease financing activities. Key to note, the MPC had maintained the CBR rate at 13.0% in the previous meeting in June. Below are some of the key highlights from the August meeting:

I. The overall inflation eased by 0.3% points to 4.3% in July 2024, from 4.6% in June 2024, positioning it at below the mid-point of the preferred CBK range of 2.5%-7.5%, mainly driven by the decline in fuel inflation. Fuel inflation decreased to 4.5% in July 2024 from 6.4% in June 2024, largely attributable to a downward adjustment in pump prices and lower electricity tariffs. The food inflation remained unchanged at 5.6% in July and June 2024, attributable largely to declines in prices of a key non-vegetable food items i.e. maize, sugar and wheat flour, that offset the price increase of a few vegetables i.e. tomatoes, Irish potatoes and cabbages. The non-food non-fuel inflation slightly decreased to 3.3% in July 2024 from 3.4% in June 2024, reflecting the impact of the monetary policy measures. We expect the overall inflation to remain within the CBK's preferred range of 2.5%-7.5%, mainly on the back of a strengthened currency, reduced fuel prices and reduced electricity prices,
II. The recently released Quarterly Gross Domestic Product Report, for Q1'2024 showed continued strong performance of the Kenyan economy, with real GDP growing by 5.0%, although slower than the growth of 5.5% recorded a similar period in 2023. This was attributable to a strong growth in the agriculture sector due to favourable weather conditions that boosted crop and livestock production and resilient performance of the services sector, particularly wholesale and retail trade, accommodation and food services, financial and insurance, information and communication, and real estate. The economy is expected to continue to strengthen in 2024, supported by resilient services sector, sustained performance in agriculture, and enhanced exports. However, this positive outlook is tempered by potential risks, including geopolitical tensions,
III. Goods exports increased by 5.0% in the 12 months to June 2024, compared to a similar period in 2023, reflecting a rise in exports of agricultural commodities and re-exports. Receipts from tea and fruits and vegetables exports increased by 4.6% and 12.1% respectively, while re-exports grew by 56.5% in the period. Notably, exports increased 11.8% in the first half of 2024 compared to the same period in 2023. Imports declined by 3.3% in the 12 months to June 2024 compared to a similar period in 2023, mainly reflecting lower imports across all categories except sugar, machinery and transport equipment, crude materials, and miscellaneous manufactures. However, imports increased by 3.6% in the first six months of 2024 compared to the same period in 2023. Tourist arrivals improved by 27.2% in the 12 months to June 2024, compared to a similar period in 2023. Remittances totalled USD 4,535.5 mn in the 12 months to June 2024 and were 12.9% higher compared to USD 4,017.1 mn in a similar period in 2023. The current account deficit is estimated at 3.7% of GDP in the 12 months to June 2024, down from 4.2% of GDP in a similar period in 2023, and is projected at 4.0% of GDP in 2024, reflecting improvement in exports of agricultural products, sustained remittances, recovery in imports supported by a stable exchange rate and effects of regional trade integration initiatives,
IV. The CBK foreign exchange reserves, which currently stand at USD 7,340 mn representing 3.8 months of import cover, continue to provide adequate cover and a buffer against any short-term shocks in the foreign exchange market,
V. The banking sector remains stable and resilient, with strong liquidity and capital adequacy ratios. The ratio of gross non-performing loans (NPLs) to gross loans increased to 16.3% in June 2024

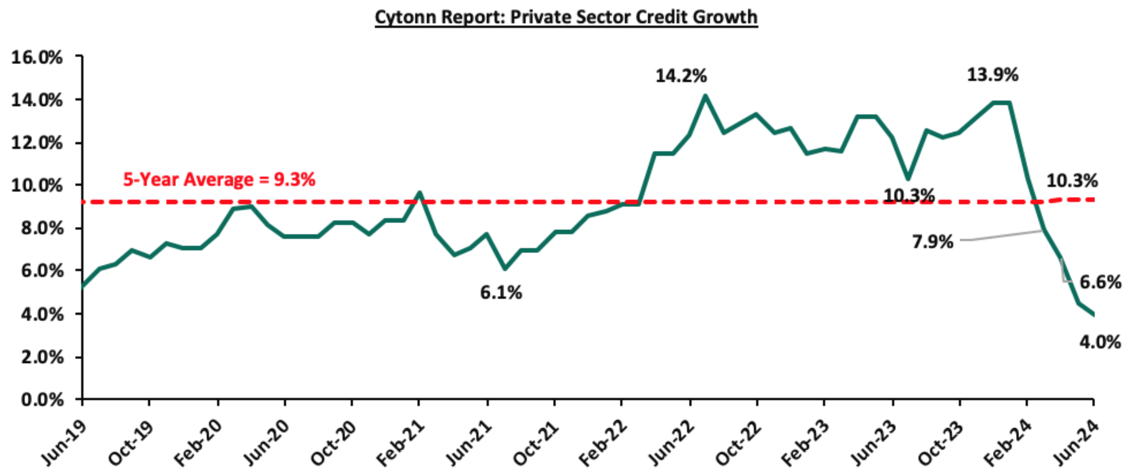
compared to 16.1% in April 2024, attributable to the 1.5% decrease in gross loans, that outpaced the 0.7% decrease in gross non-performing loans (NPLs) between the two periods. Decreases in NPLs were noted in the agriculture, real estate, manufacturing, transport and communication, trade and building and construction sectors. Banks have continued to make adequate,

VI. The CEOs Survey and Market Perceptions Survey conducted ahead of the MPC meeting revealed a positive outlook on business activity for the next year. Participants of the survey expressed concerns about the impact of the recent protests on economic activities, high cost of doing business and the impact of geopolitical uncertainties on the economy. Despite this, they remained optimistic that economic growth would remain resilient and improve in 2024, supported by increased agricultural production, and a stable macroeconomic activity reflected in the low inflation rate and stability in the exchange rate,

VII. The Survey of the Agriculture Sector for July 2024 revealed an expectation by respondents that inflation was expected to remain unchanged or decrease in the next three months due to expected rise in food supply due to expected harvests, stable exchange rate, and lower fuel prices,

VIII. Global growth is expected to continue to recover, attributable to strong growth in the United States and improved growth in several large and emerging markets, particularly India and China. Additionally, headline inflation rates have moderated, with central banks in some major economies lowering their interest rates. Food inflation has continued to decline due to an improved supply of key food items, particularly sugar and cereals. International oil prices have moderated but the risk premium from the Middle East conflict has increased following the recent escalation,

IX. Growth in private sector credit decreased to 4.0% in June 2024 from 4.5% in May 2024, mainly attributed to exchange rate valuation effects on foreign currency-denominated loans due to the appreciation of the Shilling. In June, local currency loans increased by 10.2%, while foreign currency loans, which make up around 26.0% of total loans, decreased by 13.3%. The chart below shows the movement of the private sector credit growth over the last five years:



X. The Committee acknowledged the results of implementing the FY'2024/25 Government Budget and the FY'2024/25 Supplementary Budget I. These measures are anticipated to further support fiscal consolidation, reducing the fiscal deficit to 4.3% of GDP in FY'2024/25, from 5.6% of GDP in FY'2023/24. This medium-term fiscal consolidation is expected to decrease debt vulnerabilities and improve the debt/GDP ratio, steering it toward a more sustainable position.

The MPC noted that its previous measures have successfully reduced overall inflation to below the mid-point of the target range of 2.5%-7.5%, stabilized the exchange rate, and anchored inflationary expectations. The Committee also noted a moderation in NFNF inflation, while central banks in several major economies have reduced interest rates in response to easing inflationary pressures, with signs that others may soon follow suit. Consequently, the MPC concluded that there was scope for a gradual easing of monetary policy, while maintaining exchange rate stability, which we expect to gradually ease the interest rates in the country. The MPC will closely monitor the impact of its policy measures, as well as developments in the global and domestic economy, and stands ready to take further action as necessary in line with its mandate. We anticipate that the reduction in the CBR rate will start to lower borrowing costs, leading to increased spending and an uptick in the business environment as well as reduced debt servicing costs for the government, as the MPC closely monitors inflation and exchange rate stability to ensure the continuation of the current trend of stability and eased inflation. The Committee will meet again in October 2024.

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 14.3% ahead of its prorated net domestic borrowing target of Kshs 49.5 bn, having a net borrowing position of Kshs 56.6 bn. However, we expect a downward readjustment of the yield curve in the short and medium term, with the government looking to increase its external borrowing to maintain the fiscal surplus, hence alleviating pressure in the domestic market. As such, we expect the yield curve to normalize in the medium to long-term and hence investors are expected to shift towards the long-term papers to lock in the high returns.