STERLING CAPITAL
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Fixed Income Note

October 2022

"Revenue Drag"

Friday, 30 September 2022

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Executive Summary

- Our October 2022 fixed income report is titled **"Revenue drag"** in reference to the Central Bank of Kenya's (CBK) re-opening of two treasury bonds; Ten-year (**FXD1/2022/10)** and fifteen-year (**FXD1/2022/15)** and a new twenty-five-year issue **FXD1/2022/25**.
- The apex bank seeks to raise KES.40Bn through re-opened bonds and KES.20Bn through the new issue**.**
- The three bonds will likely be undersubscribed due to the rising interest rate environment both locally and globally which dissuades investors from holding medium to long-term bonds.
- However, we expect aggressive investor bidding to continue testing the CBK's resolve to keep interest rates below the 14% mark.
- Destpite the foregoing, we feel it prudent to highlight that the long period of sale on the FXD1/2022/25 as well as the relatively low target amount may see close to full subscription.
- Our weighted average bid predictions are as follows:

  FXD1/2017/10: 13.20% – 13.30%
  FXD1/2020/15: 13.95% – 14.05%
  FXD1/2022/25: 14.15% – 14.25%

- Expectation on the benchmark 25-year issue might change based on the outcome of the first auction set for next week.
- The report covers primary auction outcomes, secondary market trading trends, short-term domestic debt interest rates, and market liquidity.
- Domestic maturities have a huge impact on CBK's borrowing strategy and this debt service is analysed in the report.
- Also covered in the report is the country's current fiscal position including Government revenue, expenditure, and fiscal deficit as well as its borrowing needs.
- We also include an analysis of the yield curve over selected periods showing trends in yields of different tenors.
- Our report concludes with our inflation expectations as well as the expected outcome of the Monetary Policy Committee (MPC) decision in its 29th September meeting.

CBK re-opens two bonds and issues new one to raise KES.60Bn in October 2022

- The Central Bank of Kenya (CBK) invites bids to raise KES.40Bn through two re-opened Treasury Bonds (T-Bonds); **FXD1/2017/10** and **FXD1/2020/15;** and KES.20Bn through a newly issued Treasury Bond (T-Bond); **FXD1/2022/25** (Table. 1).
- We anticipate all three bonds will be undersubscribed and foresee investors' aggressively bidding to test the resolve of the CBK to maintain interest rates at or near current levels.
- As has been mentioned in previous reports, the CBK appears intent on keeping interest rates below 14% as observed in recent medium and long-term debt auctions where it largely rejected investor bids above this rate.
- This has resulted in a flat yield curve from the 10-year tenor.
- If CBK persists in suppressing long tenor interest rates, the yield curve will begin to invert.
- We expect some degree of accommodation for aggressive investor bids in this and subsequent auctions.

Table.1: Primary Bond issues' summary

Issue Number	FXD1/2017/10	FXD1/2020/15	FXD1/2022/25
Total Amount Offered	KES.40Bn		KES.20Bn
Tenor	4.9 Years	12.3 Years	25 Years
Coupon Rate (%)	12.966	12.756	Market Determined
Price Quote	Discounted/Premium/Par		
Period of Sale	21/09/2022 to 04/10/2022		21/09/22 to 18/10/22
Auction Date	05/10/2022		19/10/2022
Value Date	10/10/2022		24/10/2022
Yield Curve (%) (Weighted average tenor – 26th Sept 2022)	**12.6625**	**13.8056**	-

Source: Central Bank of Kenya & Sterling Capital Research

Our market weighted average bid predictions

- We arrived at our market-weighted average bid predictions by analysing implied yields of securities of similar tenors on the Nairobi Securities Exchange (NSE) as of 26th September 2022 and discussions with several fixed income traders (Table.2).
- Expectation on the benchmark 25-year issue might change based on the outcome of the first auction set for next week.

Table.2: Auction bid predictions

Rate	FXD1/2017/10	FXD1/2020/15	FXD1/2022/25
Weighted Average bid predictions (%)	13.20 – 13.30	13.95 – 14.05	14.15 – 14.25

Source: Sterling Capital Research

Our predicted rates are guided by historical debt issues

- We used implied yields of bonds of similar tenors to maturity on the NSE as of 22nd September 2022 as a guide for possible investor auction bid levels (Table.3).

Table.3: Benchmark issues to guide investor bids

Treasury Bond	Issue Date	Coupon Rate (%)	Maturity Date	Term to Maturity Years (Days)	Implied Yield to maturity (%)	Yield Curve at time of issue
FXD1/2017/10	31st July 2017	12.966	19th July 2027	1,767	12.6625	13.7012
FXD1/2020/15	21st Sept 2020	12.76	5th Feb 2035	4,525	13.8056	13.9066
FXD1/2021/25	10th May 2021	13.92	9th Apr 2046	8,599	13.9967	13.9240

Source: Central Bank of Kenya

- Historical auction results of 10, 15 and 25-year debt issues since 2018 show general undersubscription as investors shy away from longer-dated debt issues due to perceived higher duration risk.
- Interest in the issues is likely to be limited to asset-liability matching by banks since most institutional buyers would seek to avoid mark-to-market losses on their books if the issues are bought and held for sale.
- The above supports our view that the issues are likely to be undersubscribed. (Table.4).

Table.4: Historical primary market auction performance

Issue	Issue Date	Offered (KES.Bn)	Bids Received (KES.Bn)	Amount Accepted (KES.Bn)	Performance Rate (%)	Coupon Rate (%)	Implied Yield (%)
10-Year							
FXD1/2017/10	31st July 2017	30	19.0	5.2	63.5	12.966	12.6625
FXD1/2018/10	27th Aug 2018	40	29.8	19.4	74.6	12.686	13.3415
FXD2/2018/10	17th Dec 2018	40	28.9	26.2	72.2	12.502	13.4058
FXD1/2019/10	25th Feb 2019	50	36.3	32.8	72.7	12.44	13.5375
FXD2/2019/10	15th April 2019	50	70.9	51.3	141.9	12.30	13.5478
FXD3/2019/10	19th Aug 2019	50	52.8	45.0	105.5	11.52	13.5725
FXD4/2019/10	25th Nov 2019	50	38.4	28.4	76.8	12.28	13.5900
FXD1/2022/10	16th May 2022	60	32.9	28.7	54.8	13.49	13.6908
15-Year							
FXD1/2018/15	28th May 2018	40	20.2	12.9	50.5	12.65	13.7186
FXD2/2018/15	22nd Oct 2018	40	27	7.9	67.6	12.75	13.7411
FXD1/2019/15	28th Jan 2019	40	25.1	14.7	62.7	12.86	13.7552
FXD2/2019/15	13th May 2019	50	21.5	19.3	43.1	12.73	13.7696
FXD3/2019/15	29th July 2019	40	86.7	50.6	216.7	12.34	13.7797
FXD1/2020/15	21st Sept 2020	50	49.8	45.7	99.6	12.76	13.8056
FXD1/2022/15	27th June 2022	25	16	16	64	13.94	13.8846
25-Year							
FXD1/2010/25	28th Jun 2010	15	15.8	15.0	105.3	11.25	13.8184
FXD1/2018/25	25th Jun 2018	40	10.1	5.2	25.3	13.40	13.9875
FXD1/2021/25	10th May 2021	30	31.0	14.2	103.3	13.92	13.9967

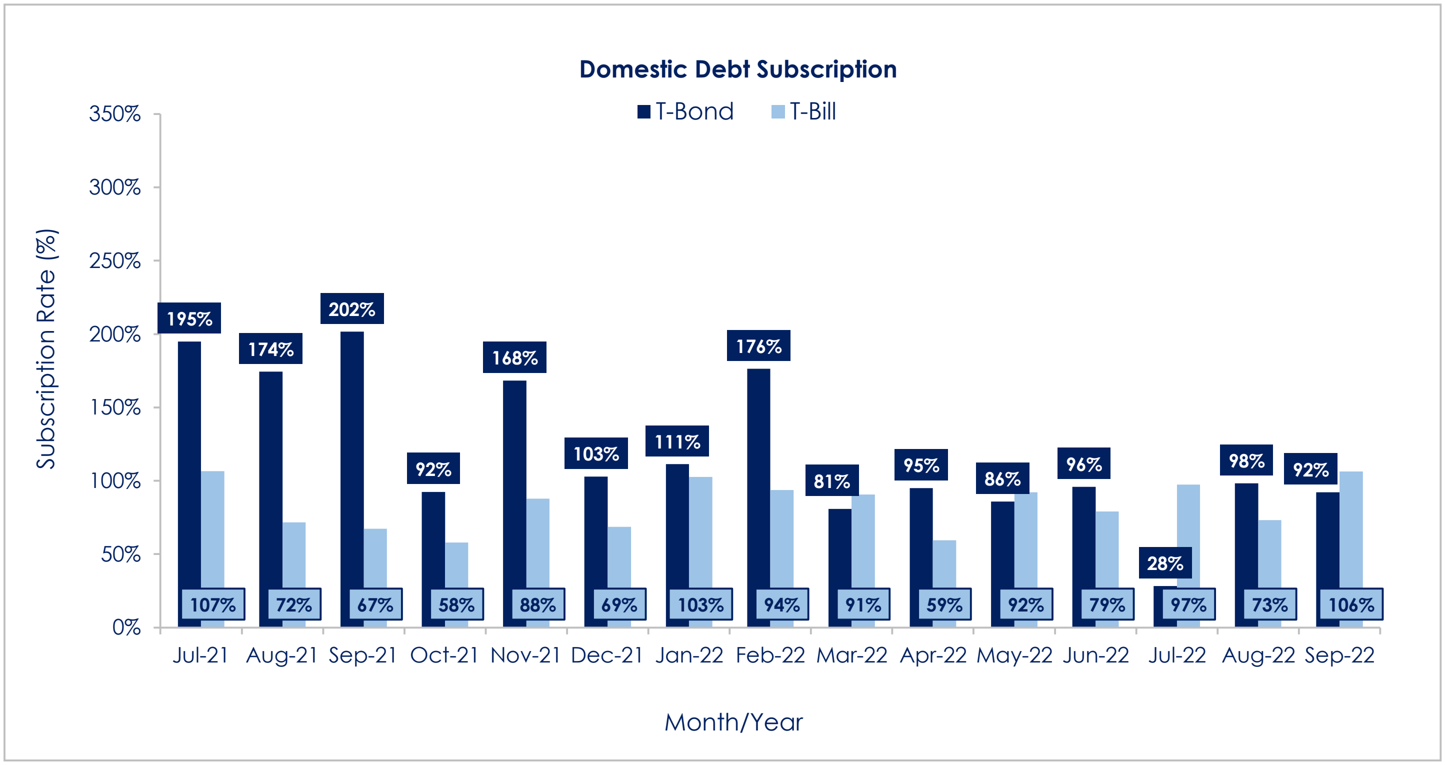
Source: Central Bank of Kenya

T-Bill subscription up as uptake of T-Bonds declines in September 2022

- Aggregate T-Bond subscription declined in September 2022 with KES.46.1Bn bids received against KES.50Bn offered equivalent to a 92.3% subscription rate which was lower than 98.3% the previous month (Figure.1).
- The 91-Day T-Bill recorded a 362% subscription rate compared to 280.6% in August 2022, while the 182-Day T-Bills and 364-Day T-Bills reported subscription rates of 85.7% and 24.7% compared to 40.4% and 22.9% in August respectively.
- It is evident from these auctions that investors are reluctant to lock-in their capital for longer periods in an environment of rising interest rates.
- The CBK re-opened two bonds - **FXD1/2022/10** and **FXD1/2022/15 in August** all of which raised KES.46.1Bn against a target amount of KES.50Bn representing a subscription rate of 92.3% (Figure.2).
- We attribute the undersubscription to increased investor interest I short-term Government paper such as the 91-day T-bill.
- Trading investors also wish to avoid bond revaluation (mark to market losses) losses which are price declines below their purchase cost or original value resulting from rising interest rates.

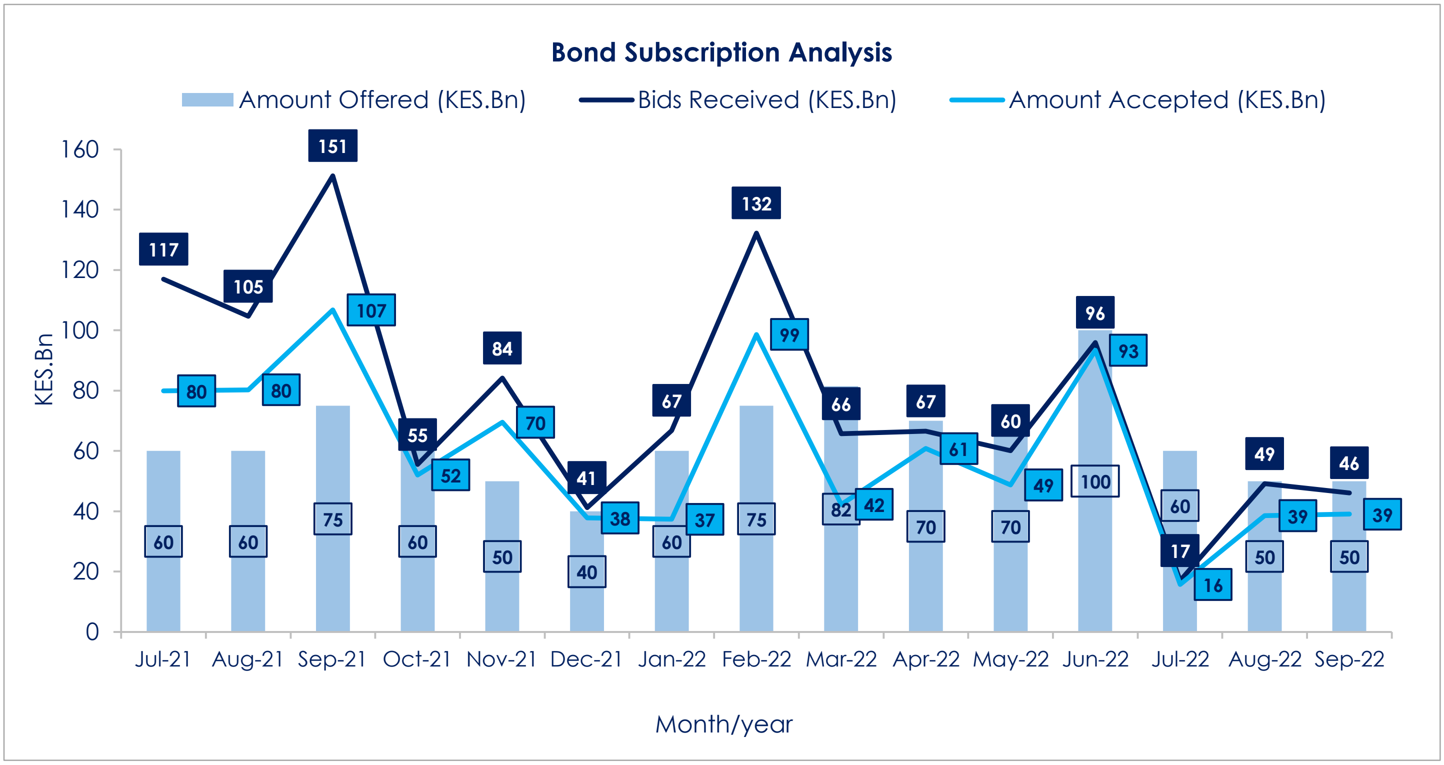
- The CBK continues to reject aggressive bids to keep its borrowing cost below 14%.
- We, however, believe that this psychological mark will be breached before the end of the calendar year to encourage long-term debt subscriptions given low revenue generation and growing expenditure needs.

Figure.1: T-Bill subscriptions up in September 2022



Source: Central Bank of Kenya

Figure.2: Bonds undersubscribed in September 2022

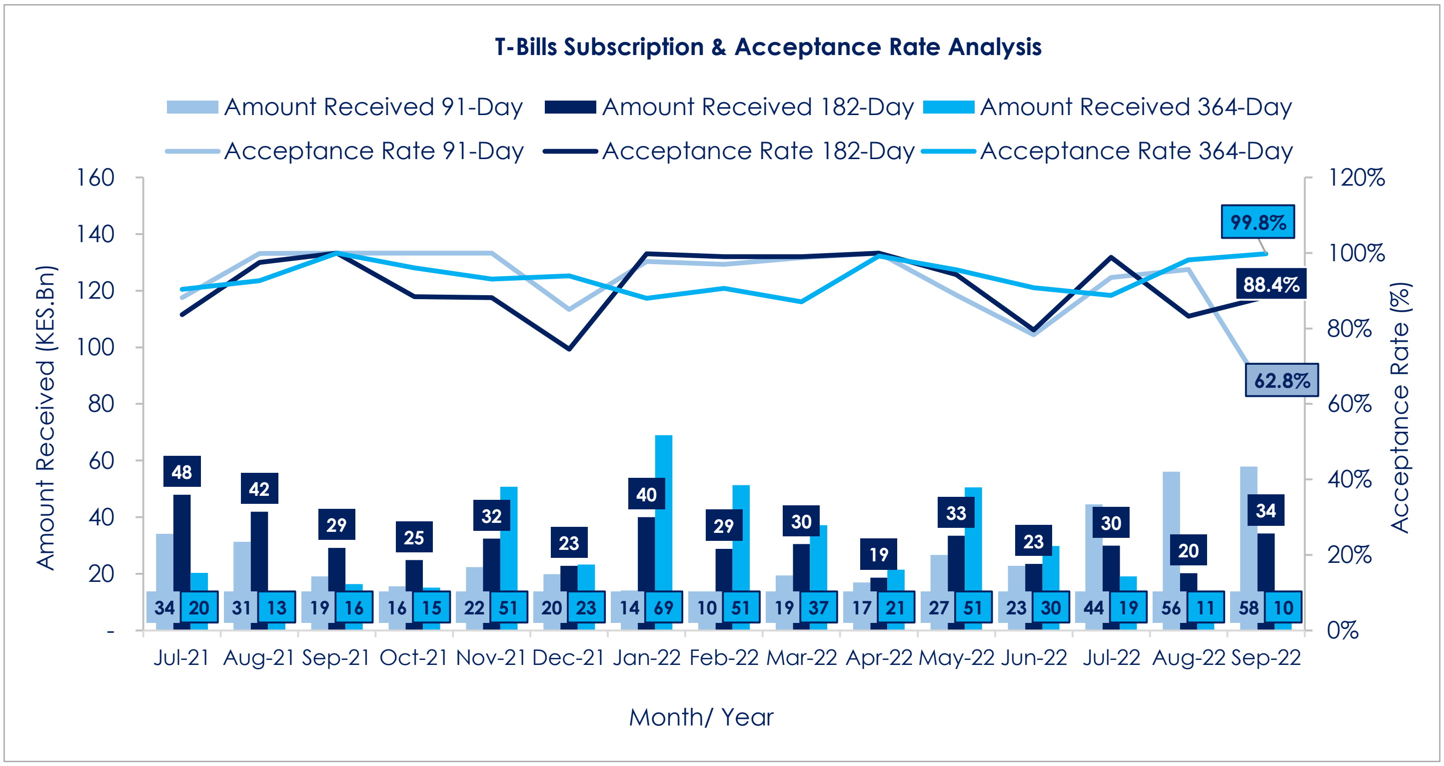


Source: Central Bank of Kenya

364-Day T-Bill acceptance rates close to full acceptance

- CBK's acceptance rate for the 91, 182-Day and 364-Day T-Bills stood at 62.8%, 88.4% and 99.8% in September 2022 compared to 95.6%, 83.3% and 98.2% in August given increased uptake and low bond subscriptions during the month (Figure.3).
- The relatively high acceptance rate for the longer tenor T-Bills is expected as the CBK attempts to lengthen the average term to maturity of public debt especially with the rising cost of debt.

Figure.3: High 182 and 364-Day T-Bill acceptance rate in September 2022

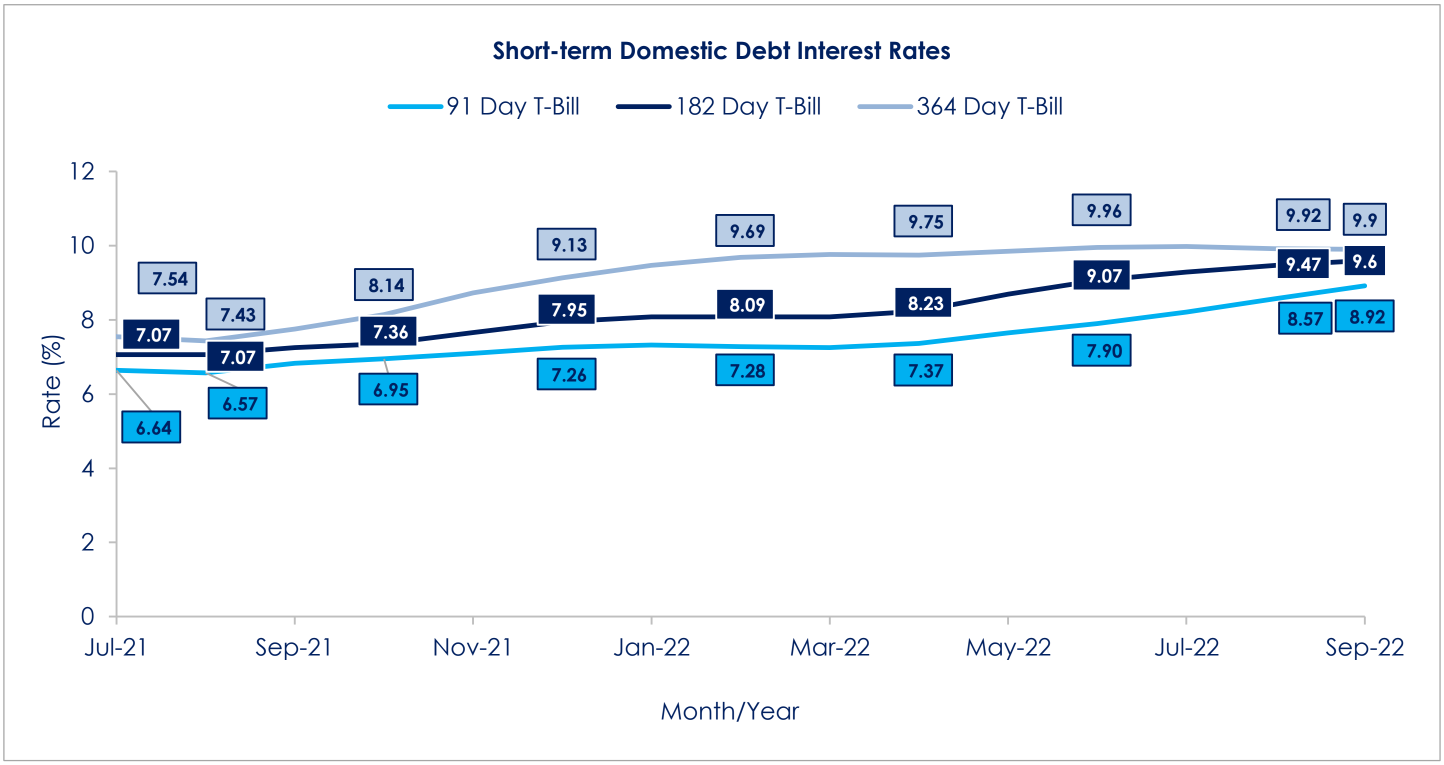


Source: Central Bank of Kenya

T-Bill rates further rise in September 2022 but fail to breach 10%

- Average 91-Day and 182-Day T-Bill rates rose to 8.9% and 9.6% in September 2022 from 8.6% and 9.5% in August, while the 364 T-Bill rate declined marginally to 9.9% from 9.92% (Figure.4).
- We attribute the above several factors amongst them inflationary pressure, investors sense of a "desperate" Government fiscal position and investors' expectations of a general rise in the level of interest rates.
- The CBK continues to keep the 364-day T-bill below the 10% psychological mark.
- Given shortfalls in revenue collection and pressure to meet expenditures, we could see this barrier broken in the next few months.

Figure.4: 91-Day and 182-Day T-Bill rates upward trajectory continues as the 364-Day T-Bill dips slightly

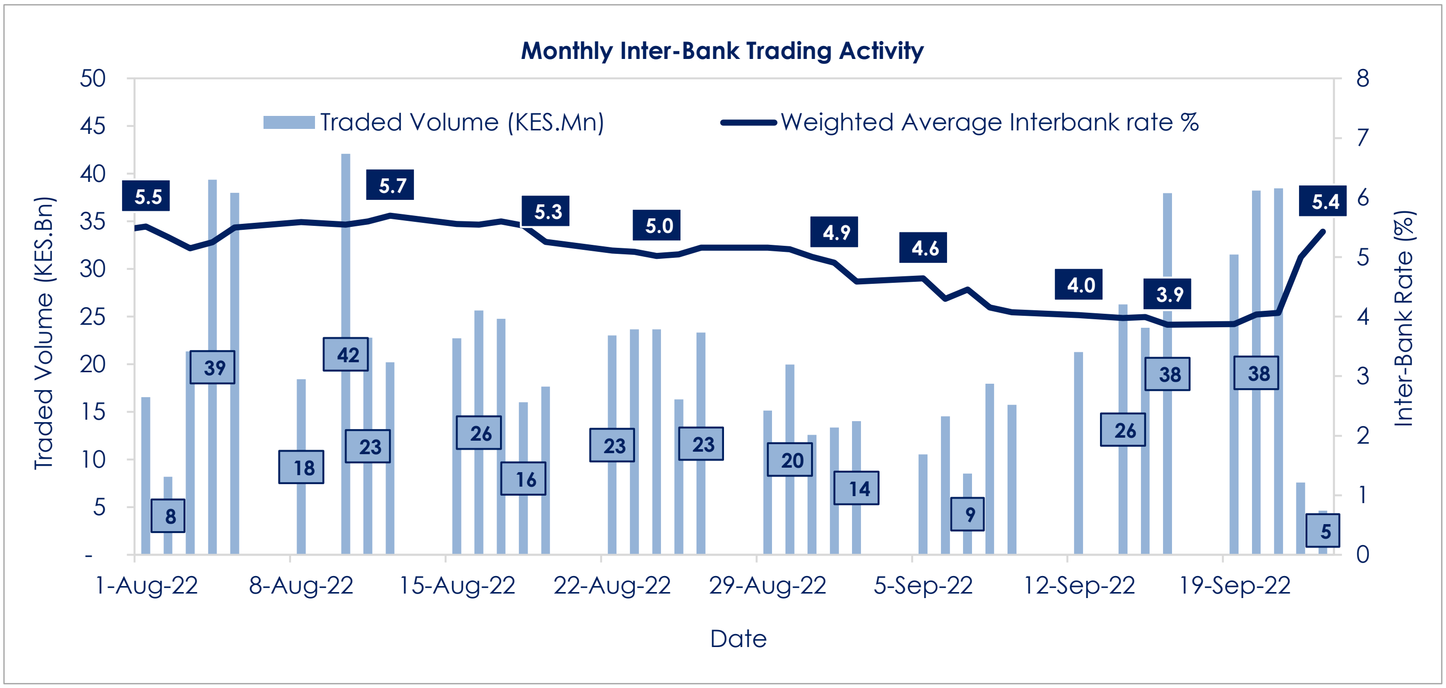


Source: Central Bank of Kenya

Average inter-bank lending rates moderate in October 2022

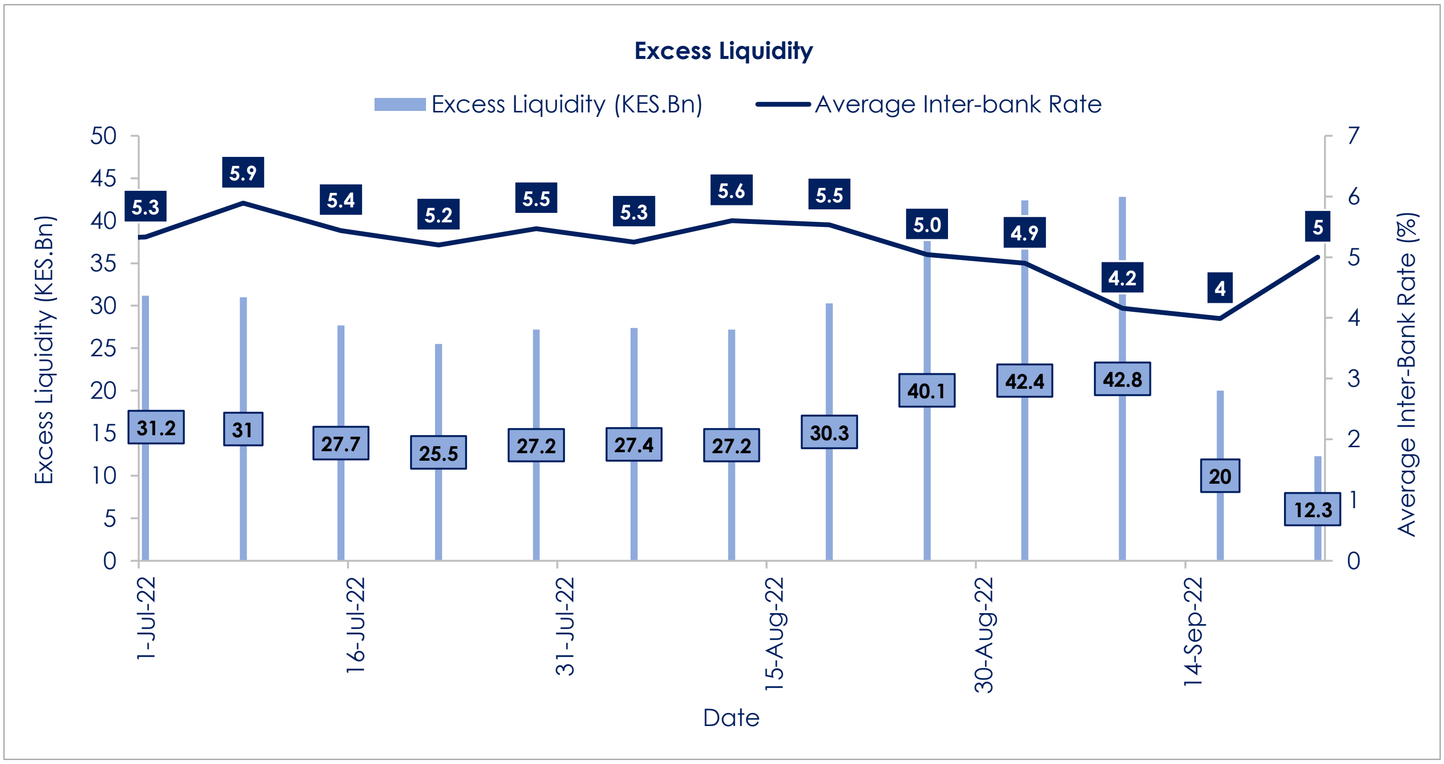
- Average inter-bank rates and trading volumes as at 23rd September 2022 declined to 4.3% and KES.324.4Bn respectively compared to 5.3% and KES.491.4Bn in August 2022 (Figure.5).
- Over the same period, excess reserves (which is the additional liquidity above the minimum 4.25% Cash Reserve Ratio (CRR)) decreased 6% to KES.117.5Bn, compared to KES.125Bn in August 2022 (Figure.6).
- We expect moderate market liquidity levels in October 2022 and forecast average inter-bank rates at 4.5% - 5.5%.

Figure.5: Average inter-bank lending rates to range between 4.5% and 5.5% in October 2022



Source: Central Bank of Kenya

Figure.6: Excess commercial bank reserves decline in September

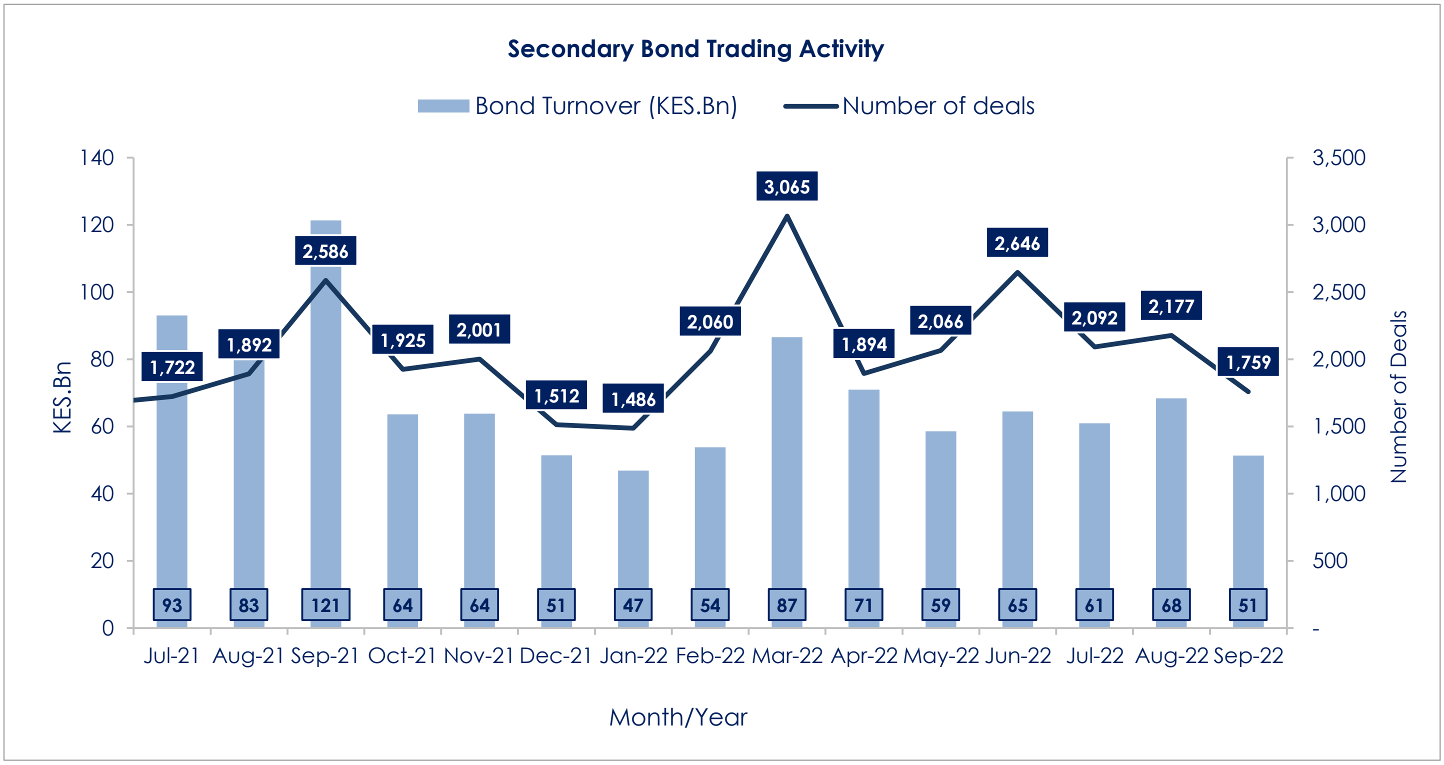


Source: Central Bank of Kenya

Secondary market activity declines 25% in September 2022

- Secondary bond market trading to 23rd September 2022 stood at KES.51.3Bn from KES.68.4Bn in August 2022 with the number of deals over the same period decreasing 19.2% to 1,759 from 2,177 (Figure.7).
- We expect a month on month decline in trading activity by end of September given the shift of investor capital from secondary market trading to shorter dated paper such as the 91-Day T-Bill.

Figure.7: Secondary trading activity decreases in September 2022

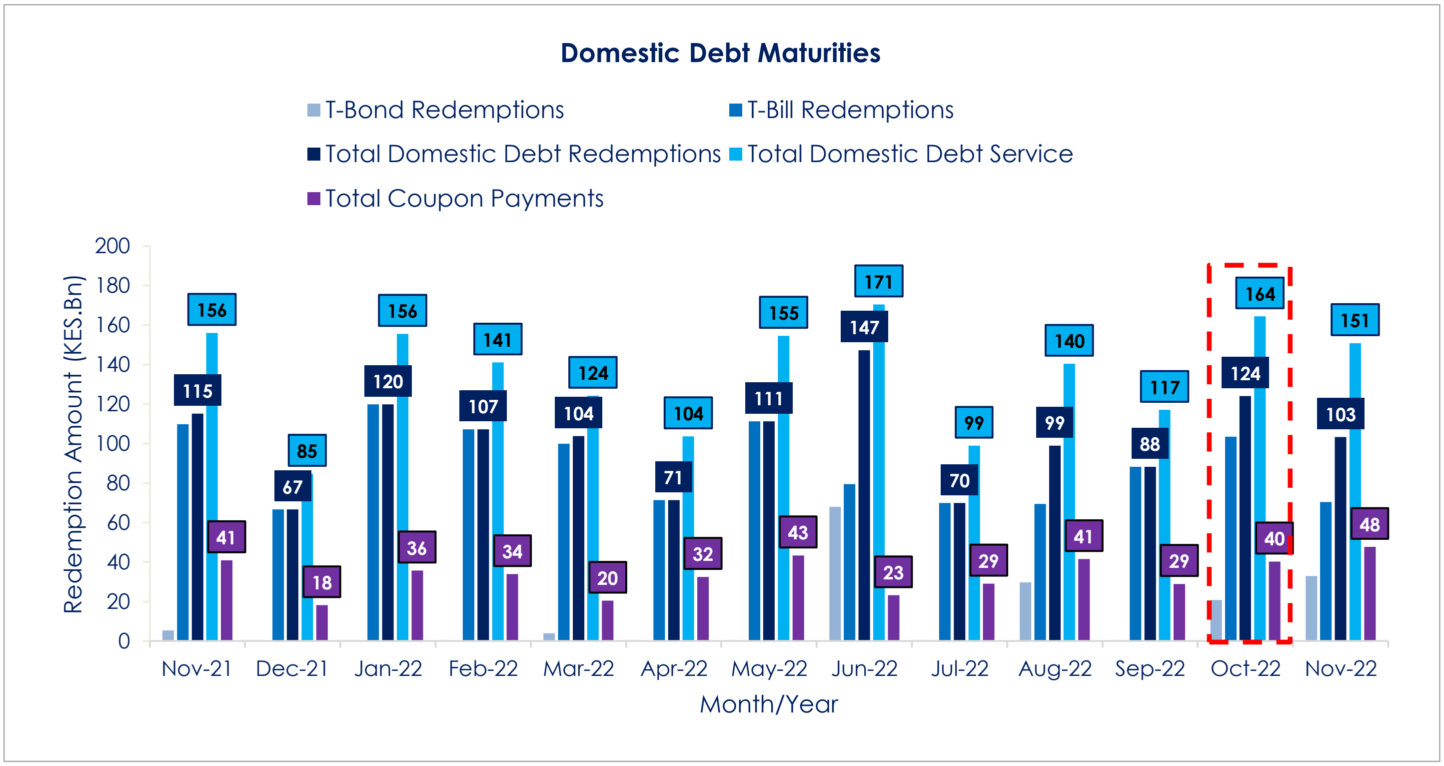


Source: Central Bank of Kenya

KES.164.4Bn in total domestic debt service for October 2022

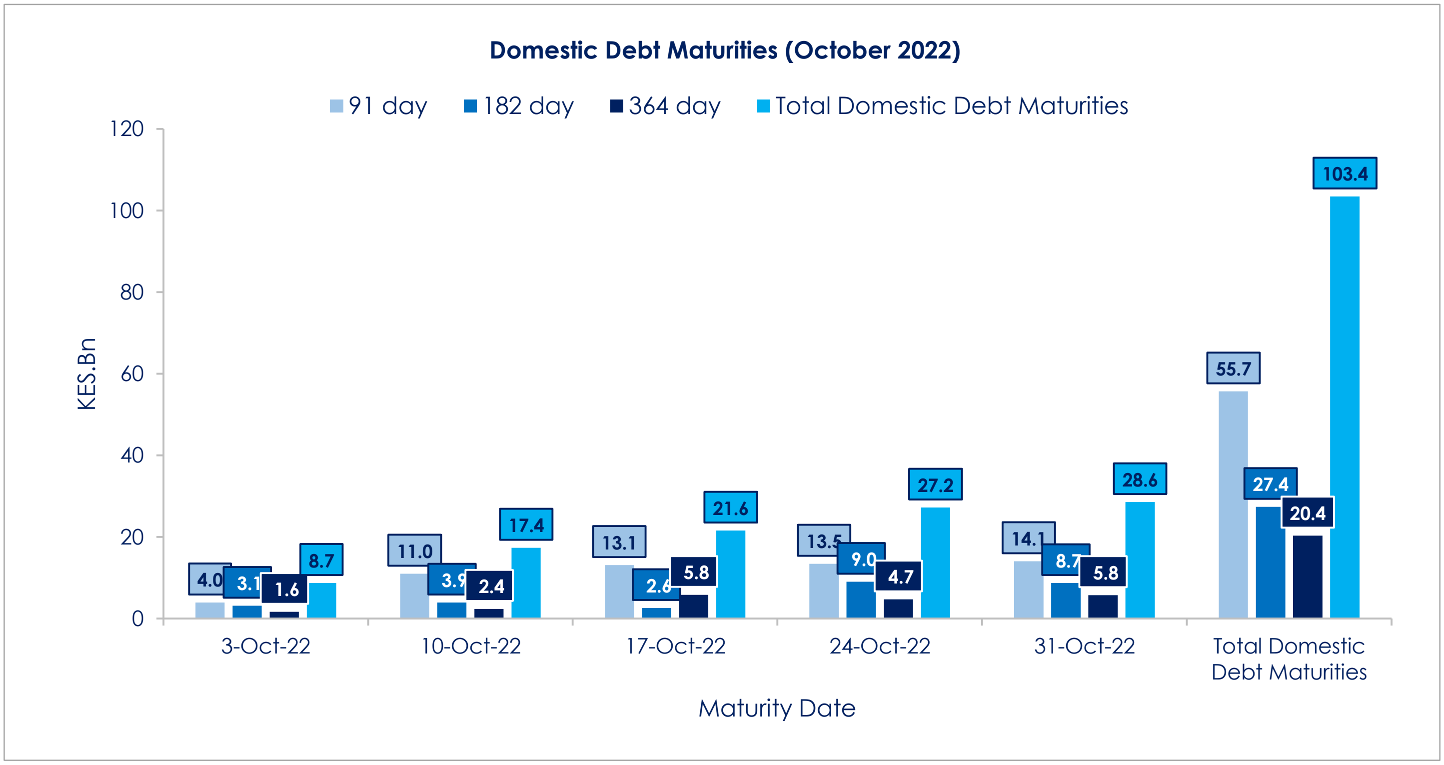
- Total domestic debt service for October is KES.164.4Bn a 40.4% increase from KES.117.1Bn in September 2022 (Figure.8).
- This comprises of T-Bill redemptions (KES.124.2Bn), coupon payments (KES.47.6Bn) and the maturity of **FXD3/2007/15** (KES.33Bn).
- Redemptions for the 91, 182 and 364-day T-Bills amount to KES.55.7Bn, KES.27.4Bn and KES.20.4Bn respectively with the last week of the month having the highest redemptions at KES.28.6Bn (Figure.9).

Figure.8 October debt service KES.164Bn



Source: Central Bank of Kenya

Figure.9: Weekly debt maturities October 2022



Source: Central Bank of Kenya

2022/23 receipts target revised upwards by 6.5%

- Data from the National Treasury at the end of the second month of the 2022/23 fiscal year shows sluggish performance of Government revenue with KES.383.9Bn equivalent to 10.8% of the fiscal year target (Table.5 and Figure.10).
- The underperformance of revenue is clear when compared to the same periods in 2019 (KES.394.1Bn) and 2021(KES.457.1Bn) with only 2020 (KES.370Bn), performing worse due to the Covid-19 pandemic.
- We link this underperformance largely to the shortfalls in tax revenue collection in the run up and during the general elections.
- We are however concerned that total revenue could underperform set targets and the 2021 receipts.
- This would mean an increase in debt financing with the most likely option being to increase domestic borrowing thus exerting pressure on interest rates that have been hovering just below 14%.
- Domestic borrowing for the 2022/23 amounts to KES.1.04Tn which is just 1.8% higher than the revised targets for the 2021/22 fiscal year (KES.1.02Tn).
- However, internal debt redemptions for the current fiscal year at KES.461.4Bn is 34.2% higher than the previous fiscal year.
- This also means that 44.3% of total domestic borrowing in the current year will be used to meet debt redemptions compared to 33.6% further showing the high cost of domestic debt service.

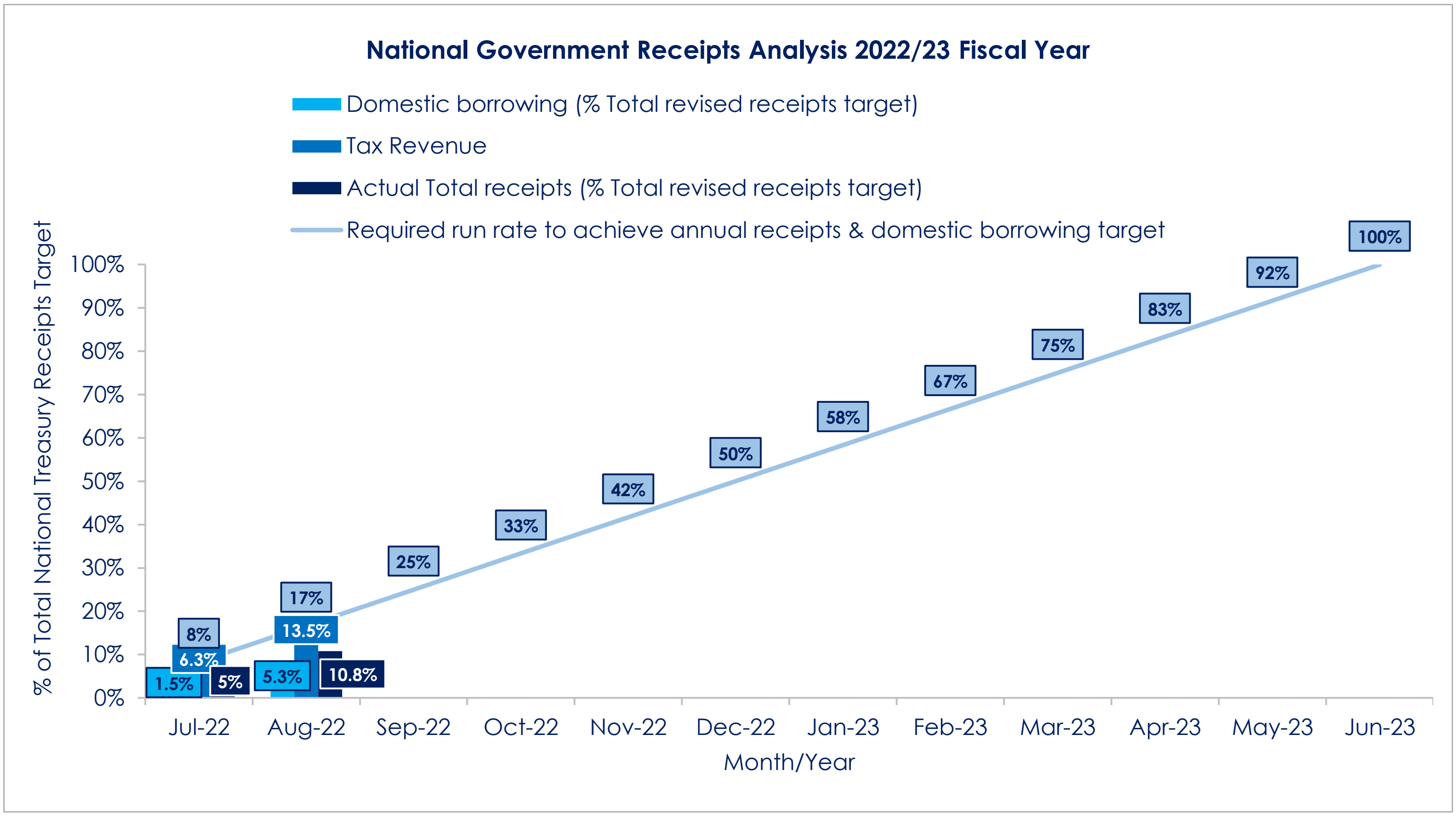
Table.5: Actual 2022/23 receipts below linear target run-rate

Receipts	Original Estimates 2022/21 (KES.Mn)	Original Estimates 2022/23 (KES.Mn)	Variation 2022/23 vs 2021/22	Actual Receipts (KES.Mn) 30th August 2022	Proportion of Total Receipts 30th August 2022
Opening Balance (1st July 2022)	21.3			616.5	
Tax Revenue	**1,784.4**	**2,071.9**	**16.1%**	**280.2**	**13.5%**
Non-Tax Income	67.1	69.7	3.9%	3.1	4.5%
Domestic Borrowing*	**1,022**	**1,040.5**	**1.8%**	**54.8**	**5.3%**
External Loans & Grants	421.2	349.3	-17.1%	31.7	9.1%
Other Domestic Financing	40.1	13.2	-67.1%	13.4	101.2%
Total Revenue	**3,334.8**	**3,544.6**	**6.3%**	**383.4**	**10.8%**
Linear Run Rate target (2 months of fiscal year)					**16.7%**

* Note 1: Domestic Borrowing of KES. 1,040.5Bn = Net Domestic borrowing KES.579.1Bn & Internal Debt Redemptions (Roll-overs) KES.461.4

Source: The Kenya Gazette Vol. CXXIV - No.166 19th August 2022

Figure.10: National Treasury lags behind our 2022/23 fiscal year linear target run-rate

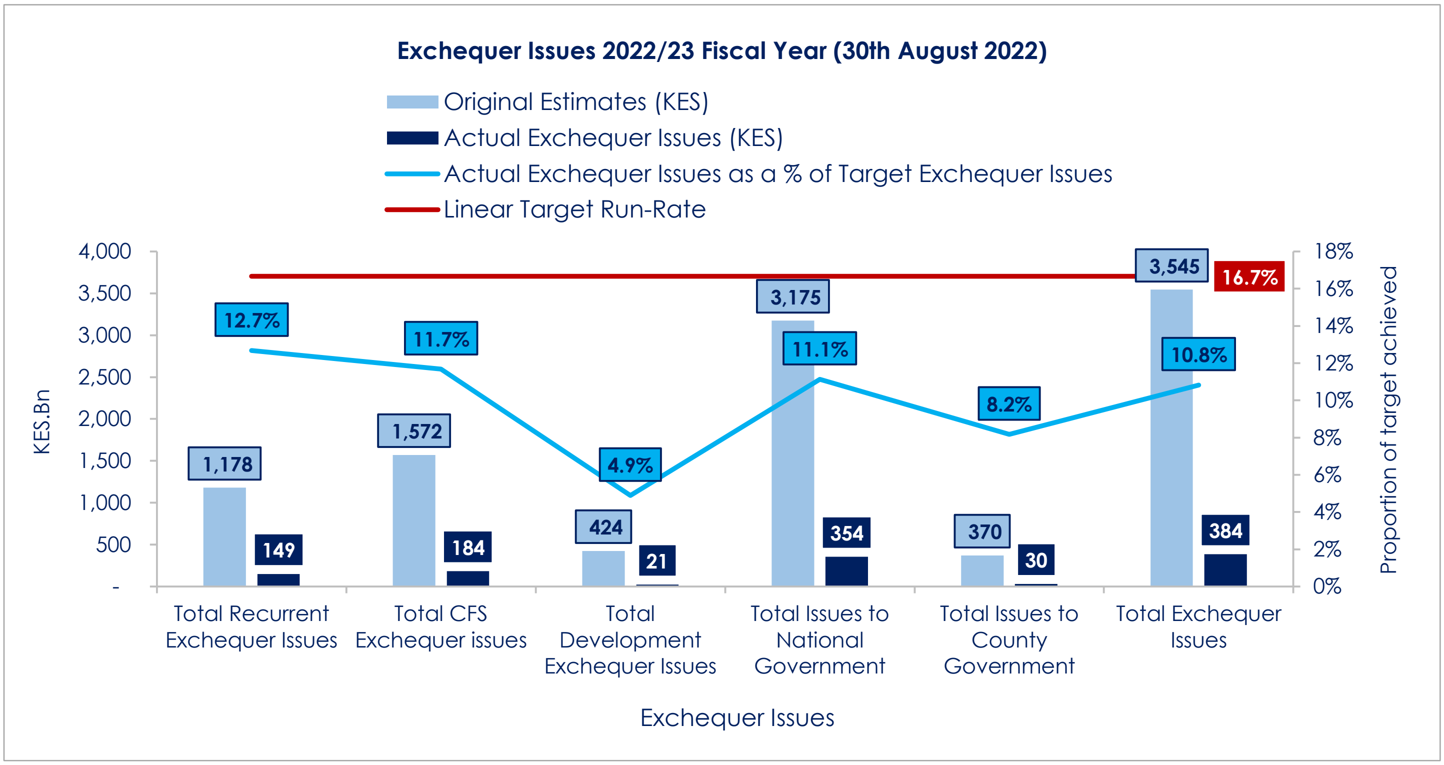


Source: The Kenya Gazette Vol. CXXIV - No.166 19th August 2022

Government continues to fall below 2022/23 fiscal year expenditure targets

- Actual total Government expenditure at the end of August 2022 stood at KES.383.9Bn equivalent to 10.7% of the total fiscal year target of KES.3.54Tn (Figure.11).
- This falls well below our two-months linear target run rate of 16.7%.
- All other expenditure items fell below our linear target run-rate a trend we attribute to the underperformance of Government receipts from taxation and borrowing.

Figure.11: Government expenditure remains below target run-rate estimates

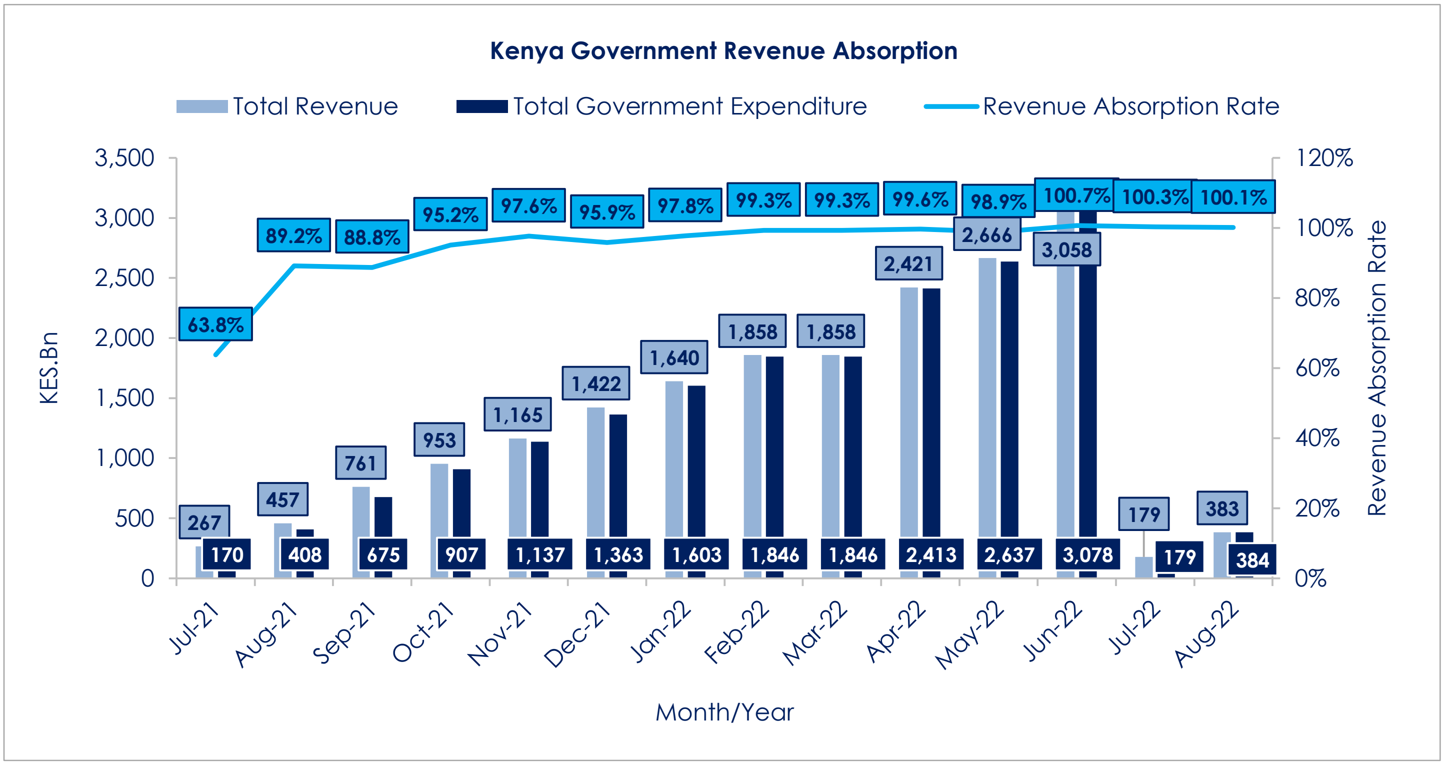


Source: The Kenya Gazette Vol. CXXIV - No.166 19th August 2022

Full revenue absorption reported in August 2022

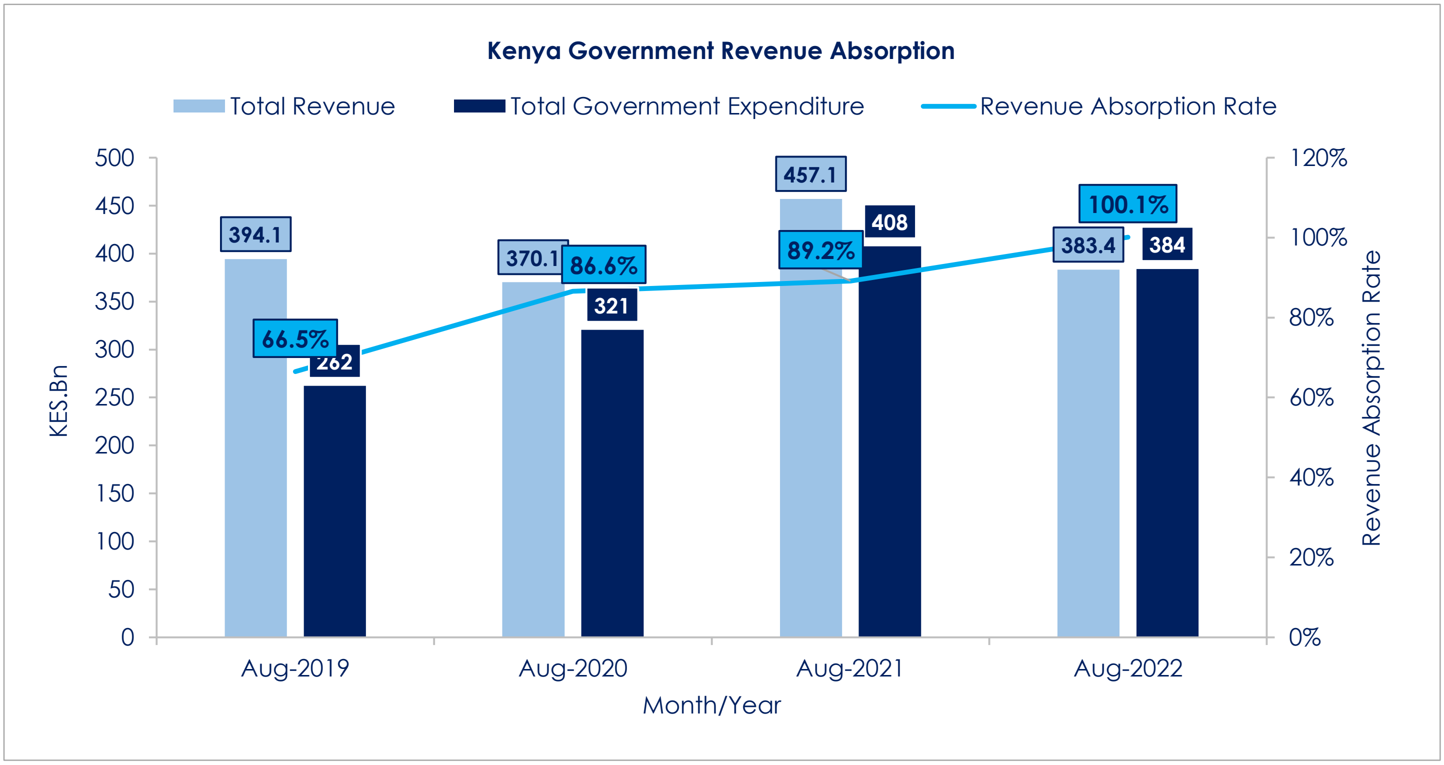
- The National Treasury reported a full Revenue Absorption Rate (RAA) for the third month in a row and second in the 2022/23 fiscal year.
- The RAA refers to the proportion of Government receipts used to finance expenditure (Figure.12 &13).
- This means that the Government is struggling to raise adequate revenue to finance its expenditure a trend we can attribute to a decline in economic activity in the run-up and during the electioneering period.
- We observe a 16.1% decline in year on year revenue at the end of August to KES.383.4Bn and a 5.8% decline in expenditure to KES.383.9Bn (Figure.13).
- This is a great concern because revenue and expenditure targets in the 2022/23 fiscal budget have increased 10.8% and 6.3% respectively.
- We expect revenue collection to gradual increase in the following months now that general elections are out of the way and a new Government is in place.
- However, the revenue authority is likely to struggle to outperform last year's record revenue collection unless there is a significant increase in coming months.

Figure.12: Revenue absorption is high showing close to full utilization



Source: The Kenya Gazette Vol. CXXIV - No.190 16th September 2022

Figure.13: 16% and 5.8% decline in year on year revenue collection and expenditure recorded in August 2022

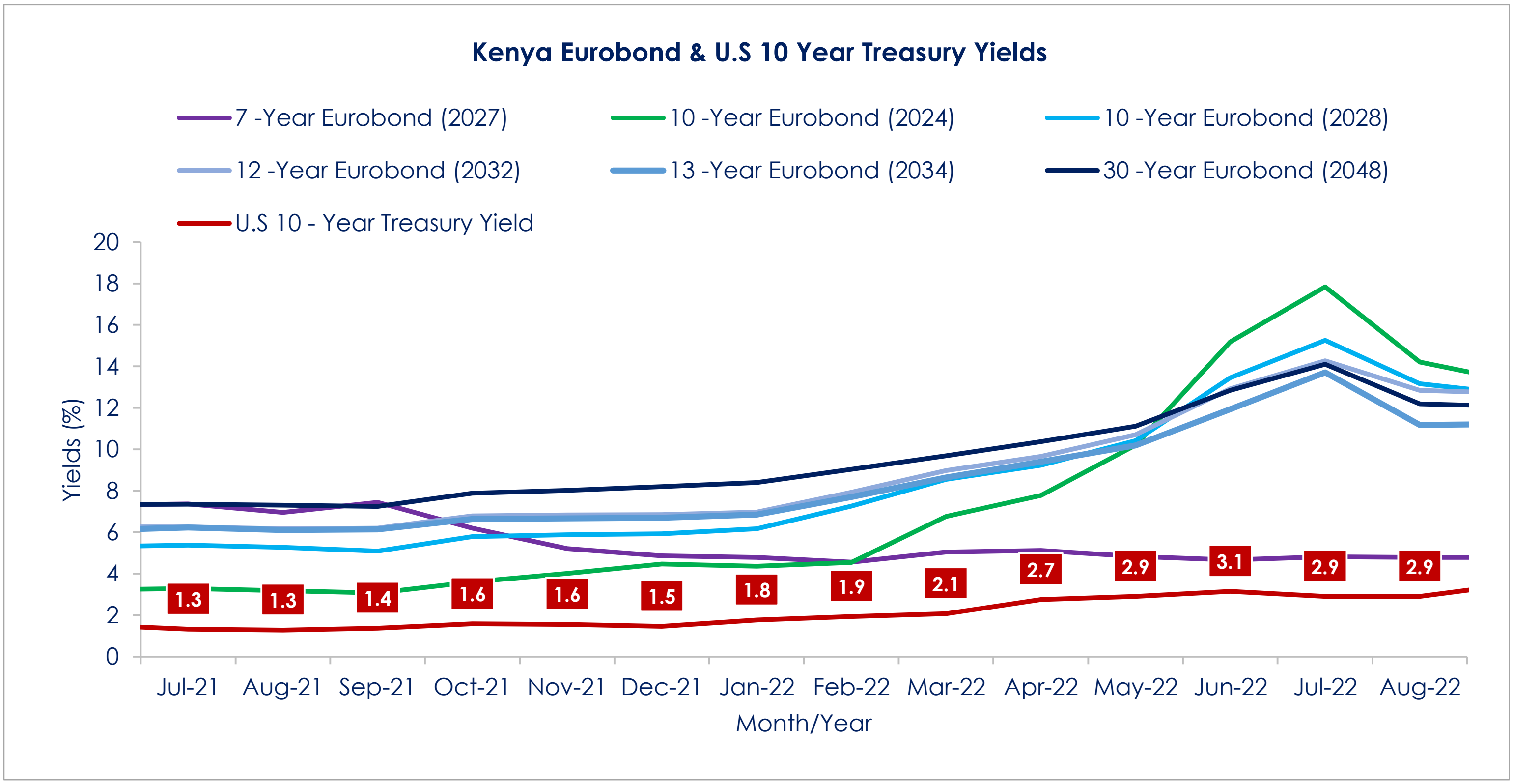


Source: The Kenya Gazette Vol. CXXIV - No.190 16th September

Kenya Eurobond yields drop in September as election jitters ease

- Average Kenya Eurobond yields declined by 42 Bps on average in August 2022 compared to the previous month (Figure.14).
- This decline was attributed to easing investor concerns following the resolution of the presidential election petition.
- Meanwhile the U.S 10-year treasury rate reached its highest levels (3.9%) since April 2010 following the 0.75% Federal Reserve rate hike on 21st September (Fed Rate).
- Kenya Eurobond yields are expected to remain elevated in the near term which presents an attractive investment opportunity for investors with a preference for US$ denominated assets and relatively high risk tolerance.

Figure.14: Kenya Eurobond yields remain elevated

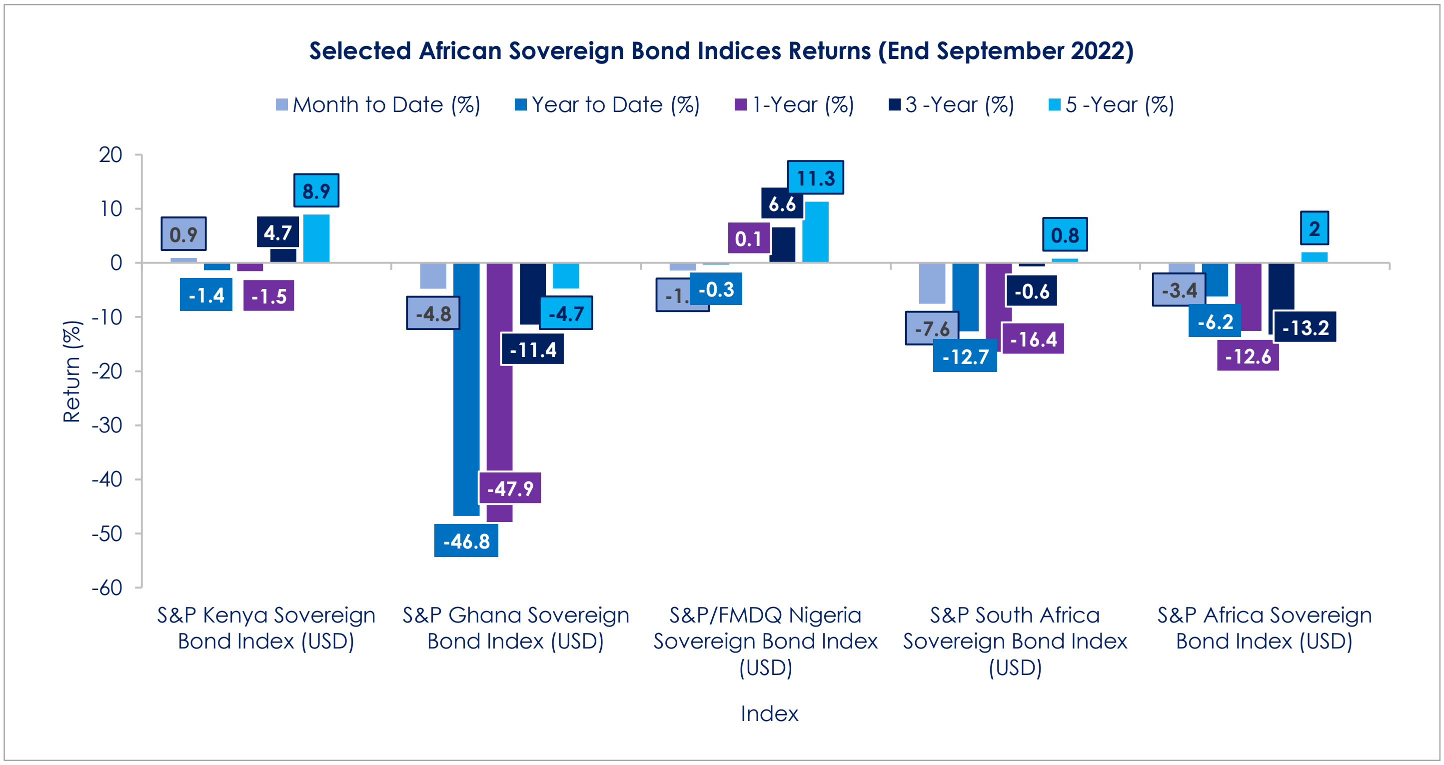


Source: Central Bank of Kenya

Nigeria sovereign bond index continues to outperform selected African sovereign bond indices

- The S&P/FMDQ Nigeria Sovereign Bond Index is the only index amongst our comparable with positive performance over 1, 3 and 5 years (Figure.15).
- This can be attributed to the relatively good performance of the Nigerian Naira against the United States Dollar (US$) during this period.
- Over the last one year, the Naira has depreciated 4.9% lower than the Kenya Shilling (10.2%), South African Rand (20.7%) and Ghanaian Cedi (72.7%).
- The poor performance of the Cedi is reflected the poor performance of the Ghanaian sovereign bond index.
- The Kenya sovereign bond index has performed fairly well month to date and over the 3 and 5-year period but this compares poorly with the return on either investing in the US$ denominated assets such as stocks, the individual Eurobonds or the currency itself.
- Currency depreciation will continue weighing down the performance of the indices bearing in mind further appreciation of the USD is expected following upward revision of the Fed rate thus attracting foreign capital.

Figure.15: S&P Nigeria bond index outperforms selected African sovereign bonds



Source: S&P Global

Yield curve continues to shift upwards

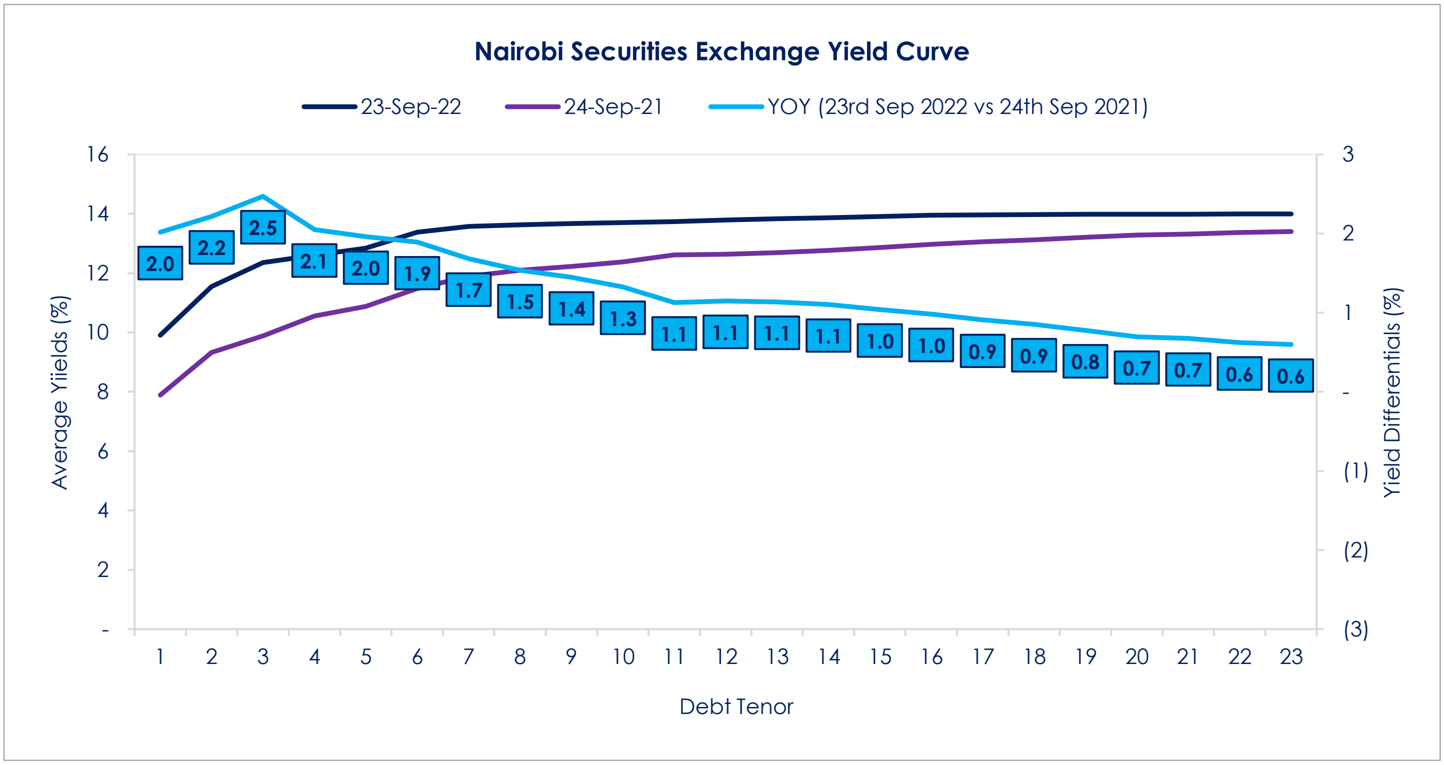
- A comparison of average yields on the NSE on 4th August 2017 (issuance of **FXD1/2017/10**), 28th February 2020 (issuance of **FXD1/2020/10**) and 23rd September 2022 shows an increase in yields across the curve. (Table.6 and Figure.16).
- The same is the case with a comparison of yields at a similar time last year.
- This scenario can be attributed to an increase in the fiscal deficit, rising inflationary pressure and the upward adjustment of the CBR.
- As mentioned earlier in the report, the CBK continues to manage maximum interest rates below 14% as observed in recent debt auctions, a situation that has resulted in flattening of the yield curve in tenors of 10 years and beyond.
- Despite these attempts however, we are of the opinion that the fiscal deficit and upward revision of the Central Bank Rate (CBR) to 7.5% from 7% in May 2022 signals further upward pressure in domestic interest rates.
- We forecast a normalization of the yield curve with rates for longer tenors rising gradually in the next few months as the CBK bows to investor pressure.
- With the above in mind, we expect the average yields on the short-end (91 days - 2 years) to increase by 80 -100 Basis Points (Bps), medium-end (3 - 9 years) to increase by 100 - 150 Basis Points (Bps) and long-end (10+ years) increasing by 60 - 80 Bps in 2022.
- Investors with a high risk tolerance should consider buying the US$ denominated Kenya Eurobonds to take advantage of current attractive yields with an option of holding till maturity or disposing when trading opportunities arise (Table.7).
- We maintain a **BUY** recommendation on medium and long-term papers for interest income play given prevailing rates.
- IFBs are generally attractive due to their tax-free component.

Table.6: Yield curve has significantly shifted upward across all tenors

Tenor	Yields (4th Aug 2017)	Yields (28th Feb 2020)	Yields (24th Sep 2021)	Yields (23rd Sep 2022)	∆ 23rd Sep 2022 vs 4th Aug 2017 (Bps)	∆ 23rd Sep 2022 vs 28th Feb 2022 (Bps)	YoY ∆ 23rd Sep 2022 vs 24th Set 2021 (Bps)	Sterling Capital Yield Curve (Oct 2022)
1	10.8890	9.5000	7.8900	9.9090	↓ 98.0	↑ 40.9	↑ 201.9	10.00%
2	11.6000	10.3307	9.3264	11.5438	↓ 5.6	↑ 121.3	↑ 221.7	11.55%
5	12.2500	11.5250	10.8833	12.8433	↑ 59.3	↑ 131.8	↑ 196.0	12.85%
10	12.9660	12.3167	12.3754	13.7012	↑ 73.5	↑ 138.5	↑ 132.6	13.75%
15	13.2285	12.6000	12.8673	13.9066	↑ 67.8	↑ 130.7	↑ 103.9	13.925%
20	13.4767	13.0521	13.2874	13.9847	↑ 50.8	↑ 93.3	↑ 69.7	13.985%

Source: Nairobi Securities Exchange

Figure.16: Higher year on year differentials across short and medium tenors



Source: Nairobi Securities Exchange

Table.7: Trading ideas - Consider Kenya Eurobonds

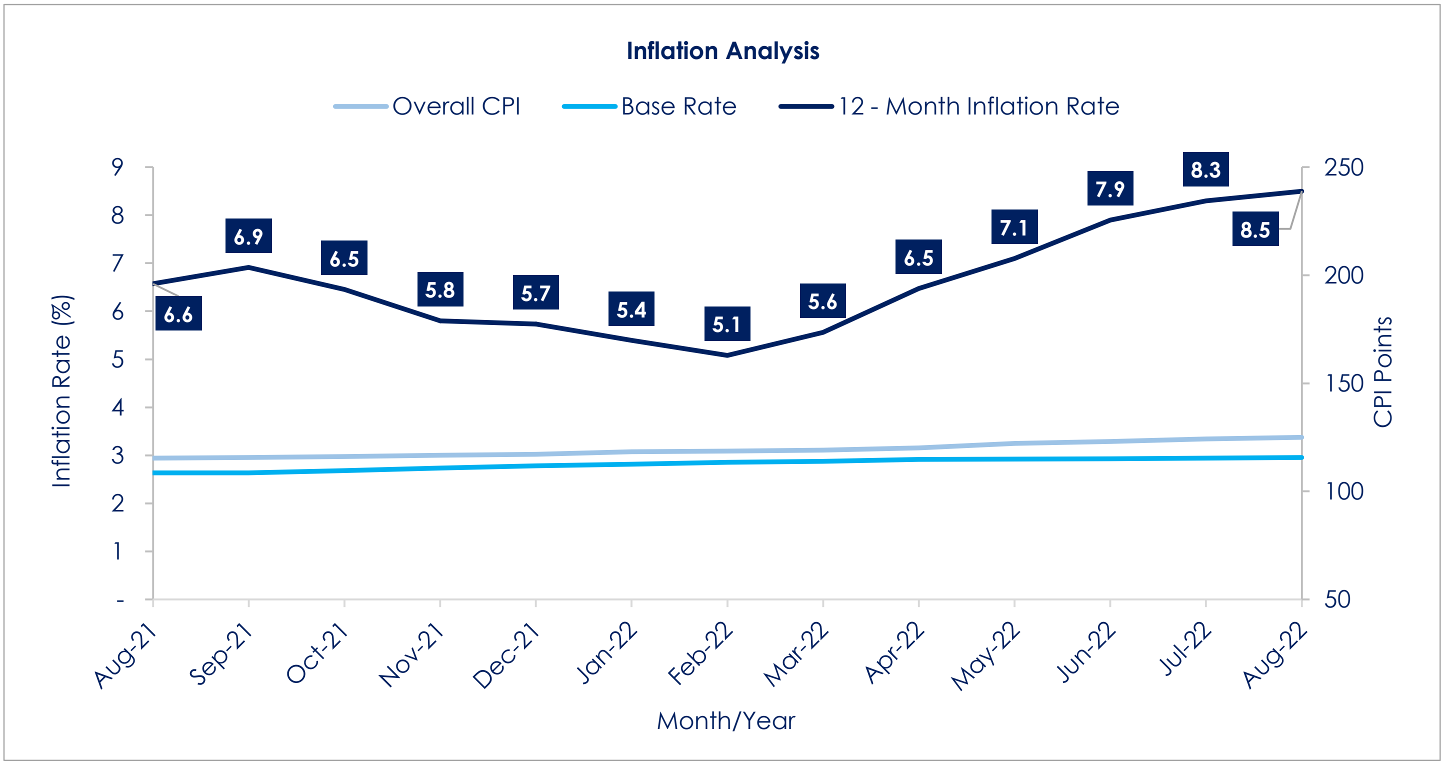
ISIN Code	Issue date	Tenor (Years)	Outstanding amount (US.$ Bn)	Coupon	Yield to maturity (22nd September 2022)	Maturity
XS102895240	Jun-14	10	2	6.875%	12.775	Jun-24
XS184343584	May-19	7	0.9	7%	13.141	May-27
XS178171054	Feb-18	10	1	7.25%	12.612	Feb-28

Source: Bloomberg

Inflation to remain elevated to the end of 2022

- To reiterate the sentiments in our September fixed income report, "Slow start to 2022/23," we noted that inflation for the month of August 2022 rose to 8.5% from 8.3% a month earlier.
- August was the third month that the inflation rate was above the CBK's medium term upper band range of 7.5% since the Covid-19 pandemic begun (Figure.17). Click here.
- Key drivers of this elevated inflation were changes in food and non-alcoholic beverage prices (15.3%), transport (7.6%) and housing, water, electricity, gas and other fuels (5.6%) between August 2021 and August 2022.
- These three weights account for over 57% of the weights of the thirteen broad categories Kenya National Bureau of Statistics (KNBS) measures to assess inflation.
- Our September inflation forecast remains between 8% - 9% on account of continued supply-side pressures such as elevated global fuel and food import prices as well as supply-chain constraints.
- We estimate that inflation will be more pronounced going forward given that the subsidy on fuel prices was partially removed in September with its complete suspension likely to occur in October 2022.
- To further exacerbate the situation is the depreciation of the Kenya shilling, particularly to the US$ which will keep inflation elevated throughout 2022.
- To this effect, we see inflation above 7% throughout the rest of 2022.

Figure.17: September inflation forecast 8% - 9%



Source: Kenya National Bureau of Statistics

STERLING CAPITAL

MPC surprises with a 75Bps upward revision of CBR in September meeting

- In our last fixed income report, we had indicated that Monetary Policy Committee (MPC) might adopt a "wait and see" approach to the new Government's economic policy one of which was to lower the cost of living before making a CBR revision.
- The Monetary Policy Committee (MPC) met on 29th September 2022 to review the impact of previous monetary policy measures on the economy and decided to raise the CBR from 7.5% to 8.25%.
- This was contrary to our view of keeping the rate flat for the period given that inflationary pressures continue to be driven by the supply side (cost push) on price inelastic goods such as fuel and cooking oil, and not consumer spending.
- The following were the main points of discussion:

1) High inflation which is expected to remain elevated in the near term due in part to the scaling down of the Government subsidies resulting in a rise in fuel and electricity prices.

   Further, the impact of tax measures in the FY2022/23 budget and global inflationary pressures will continue to be a recurring theme that will keep elevation inflated for the rest of the year and into 2023.

2) Volatility of global financial markets as a result of significant US$ strengthening against major currencies and rapid changes in policy stance within advanced economies.

   The MPC noted tthat the global economic outlook has weakened, reflecting the impact of a rapid tightening of monetary policy in advanced economies, the ongoing war in Ukraine and lingering pandemic-related distruptions in nations such as China.

3) The committee highlighted 11% YoY growth in Kenya's export market mainly been driven by receipts from tea and manufactured goods during.

   However, imports still largely outweighed exports given 21.4% growth over the same period mainly reflecting the impact of increased imports on oil and intermediate goods.

   1) Foreign currency reserves and the country's current account deficit.

   The MPC observed that the usable foreign exchange reserves have declined to U. S$.7.4Bn (4.24 months of import cover) as at 22nd September 2022. This is a concern due to escalating foreign currency commitments including external debt service costs and import costs.

   The currect account deficit currently stands at 5.2% of GDP and is expected to grow to 5.9% of GDP by the end of 2022 on account of higher international oil prices.

4) Banking sector gross Non-Performing loans (NPLs) to gross loans declined to 14.2% in August compared to 14.7% in June due to recoveries in the manufacturing, construction, transport and communication sectors.

- The revision could have the following impacts:

1) Worsen inflationary pressure as importers dependent on bank credit to finance imports could push the effect of higher financing costs to consumers through higher prices.

2) Given current US$ strengthening and a weakening shilling imposing further liquidity and debt repayment pressures, we find the MPC's stance to tighten as prudent in an attempt to hedge against the same.

- We are however pessimistic that these measures will have minimal impact on reducing inflationary pressure nor will thety stop the pace of local currency depreciation as has been evident by other countries employing the same measures.

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