Cytonn 2023 Markets Outlook

Cytonn

Date: Monday, January 30th 2023

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I. Global Markets Outlook

Cytonn

Global Market Summary

India is projected to record the highest growth rate in 2023 at 6.6%, with Kenya's projected growth rate coming in at 5.0%

World GDP Growth Rates							
	Region	2018	2019	2020	2021	2022e	2023f
1.	India	6.5%	4.0%	(6.6%)	8.7%	**6.9%**	**6.6%**
2.	Kenya	6.3%	5.0%	(0.3%)	7.5%	**5.5%**	**5.0%**
3.	China	6.6%	6.0%	2.2%	8.1%	**2.7%**	**4.3%**
4.	Sub-Saharan Africa*	2.6%	2.5%	(2.0%)	4.3%	**3.4%**	**3.6%**
5.	Middle East, North Africa	0.8%	0.9%	(3.6%)	3.7%	**5.7%**	**3.5%**
6.	South Africa	0.8%	0.1%	(6.3%)	4.9%	**1.9%**	**1.4%**
7.	Japan	0.8%	(0.2%)	(4.3%)	2.2%	**1.2%**	**1.0%**
8.	Brazil	1.3%	1.2%	(3.3%)	5.0%	**3.0%**	**0.8%**
9.	United States	2.9%	2.3%	(2.8%)	5.9%	**1.9%**	**0.5%**
10.	Euro Area	1.9%	1.6%	(6.1%)	5.3%	**3.3%**	**0.0%**
	Global Growth Rate	**3.0%**	**3.1%**	**(3.2%)**	**5.9%**	**2.9%**	**1.7%**
	**including South Africa*						

Source: World Bank

Factors Shaping Global Markets in 2023

A slowdown in Global trade, tightened monetary policy declining commodity prices and high debt levels are the factors that will likely shape Global Markets in 2023

Global Trade

- Global trade growth is expected to slow to 1.6% in 2023 as compared to a growth of 4.0% in 2022 and is expected to be driven by persisting supply chain constraints and the elevated inflationary pressures. The Russian invasion into Ukraine is expected to further weigh down on global trade due to trade restrictions imposed on the two countries. Additionally, Monetary tightening and risk aversion have led to currency depreciations and steep capital outflows from EMDEs that will lead to a weaker-than-expected global demand

Monetary Policy Stance

- Economies are expected to continue tightening monetary policies that despite the aggressive interest hikes witnessed in 2022, inflation levels hare still above target ranges. For instance the US raised its Federal interest rates to the range of 4.25%-4.50% but the corresponding inflation level declined to 6.5% from 7.1% remaining among the Federal target 2.0%. Developing economies are also expected to tighten the monetary policy stances due to high inflation as a result of supply chain constraints amid elevated fuel prices globally

Declining Commodity Prices

- Global commodity prices registered positive performance in the first half of 2022, but began easing in the last quarter 0f 2022. Despite the decline in aggregate global prices, most commodity prices remain above the pre-pandemic levels. Agricultural prices rose by 13.0% in 2022 but are projected to decline by 5.0% in 2023 on the back of decline in input costs especially fertilizers. Metal prices are also expected to decline by 15.0% in 2023 due to weakening demand in China’s property market

Source: World Bank

Factors Shaping Global Markets in 2023

A slowdown in Global trade, tightened monetary policy declining commodity prices and high debt levels are the factors that will likely shape Global Markets in 2023

High Public debt

- Global public debt is expected to increase rapidly in 2023 driven by widened current account deficits and surging debt service costs on the back of declining global trade and currency depreciation in most economies. Further, given the perceived interest hikes in 2023, especially in developed economies such as the US that have strengthened the dollar, global public debt is expected to increase significantly due to increase of debt servicing costs with a huge chunk of the external debt in most economies being dollar denominated

Source: International Monetary Fund

Global Market Outlook

The global economy in 2023 is expected to be shaped by continued tightening of monetary policies in advanced economies on the back of elevated inflationary pressures

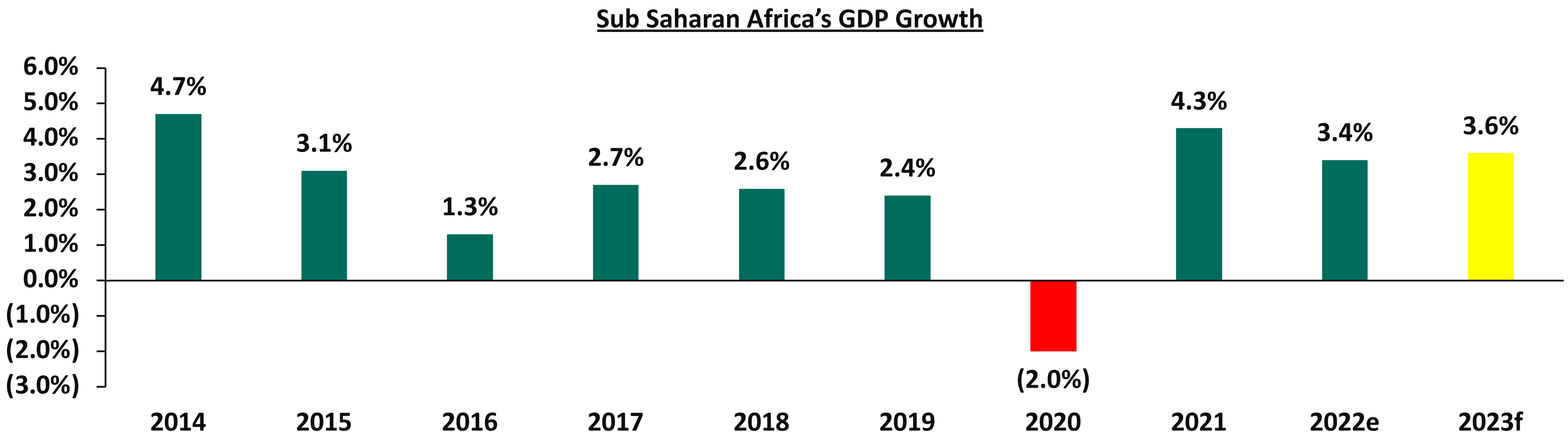
United States	• The US economy is expected to deteriorate to a 0.5% growth from the 1.9% growth of 2022 due to the high food and energy prices that are still above the pre-pandemic levels, and worsened by the supply chain disruptions. Tightening of the monetary policy is expected to continue to anchor inflation to a range of 2.0% and this will weigh down on US activity in 2023
Eurozone	• The Eurozone growth is expected to record an economic growth of 0.0% in 2023 with neither an expansion nor a contraction driven by the persistent high energy prices on the back of supply chain constraints especially for Natural gas. In addition, the expected tightening of both monetary and fiscal policies will stifle economic growth with fiscal tightening expected to increase to 2.0% of the GDP from the 1.2% of GDP achieved in 2022. However, the economy is expected to rebound in the second half of 2023 due to moderate growth in inflation and easing of the labor market
China	• The Chinese economy is expected to rebound by 4.3% in 2023, from the 2.6% expected growth in 2022. In 2023, lifting of pandemic restrictions is expected to drive consumer spending. However, extreme weather conditions and prolonged effects of the real estate sector underperformance will be the key inhibitors of the 2023 economic growth

Source: World Bank

II. Sub Saharan Africa Regional Market Outlook

Regional GDP Growth

Sub Saharan Africa Region is expected to grow by 3.6% in 2023, according to the World Bank

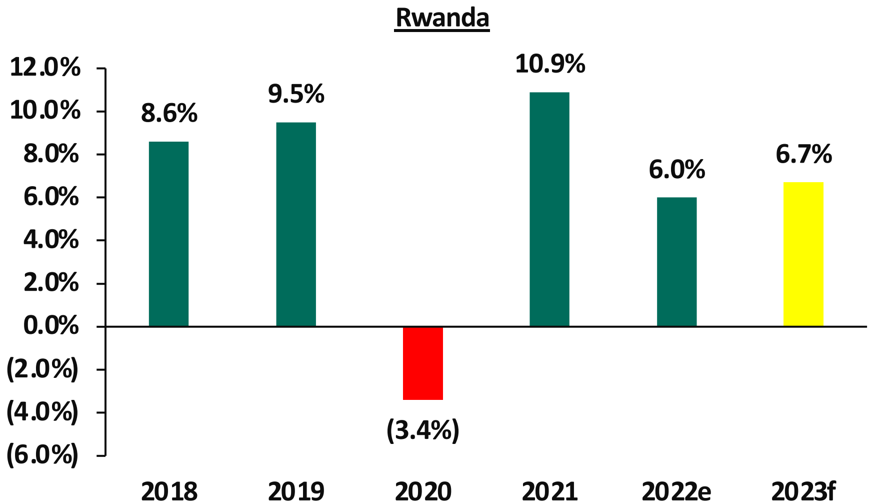


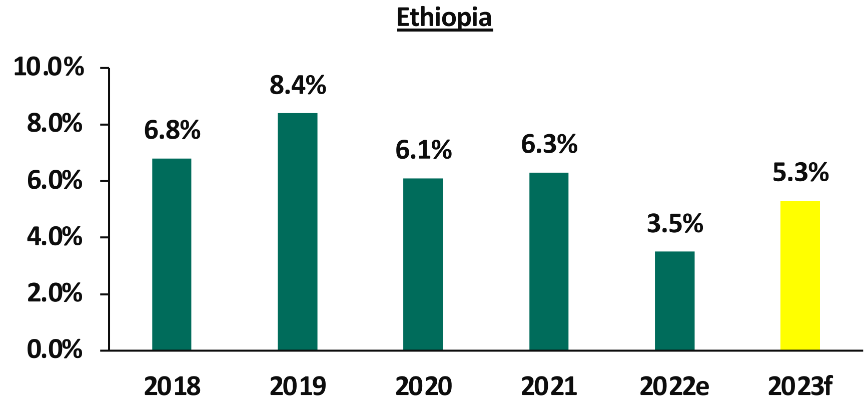
- The SSA region is expected to grow by 3.6% in 2023, 0.2% points higher than the estimated 3.4% in 2022. The slightly higher growth in 2023 is to be driven by expected increase in oil and gas exports from the region, an expected slight ease in the cost of living following reduction in prices of key imports such as fertilizers, and expected increase in domestic demand
- The countries expected to drive growth in 2022 are Rwanda, Ethiopia, Kenya and Nigeria, with expected economic growth rates of 6.7%, 5.3%, 5.0% and 2.9%, respectively
- Key risks expected to affect the regional economic recovery include; imported inflation driven by elevated global inflationary pressures, degree of global and domestic monetary tightening, tight food markets due to limited imports coupled with erratic weather conditions, and increased credit risks amplified by high debt-levels and debt servicing costs, which are expected to hinder capital flows to the region

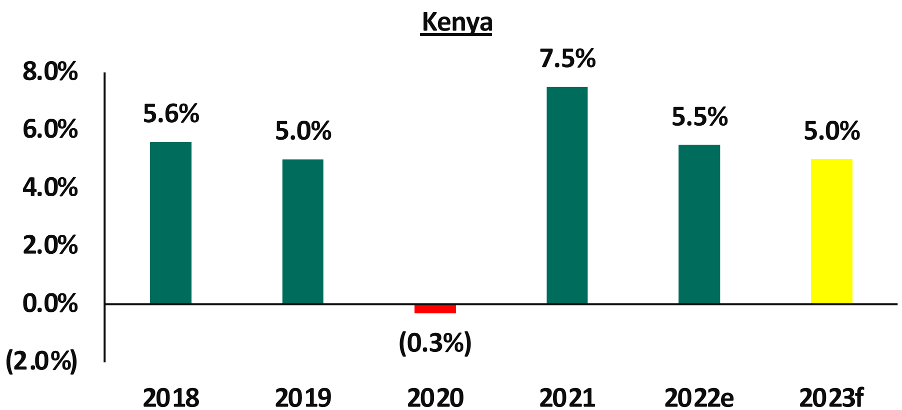
Source: World Bank

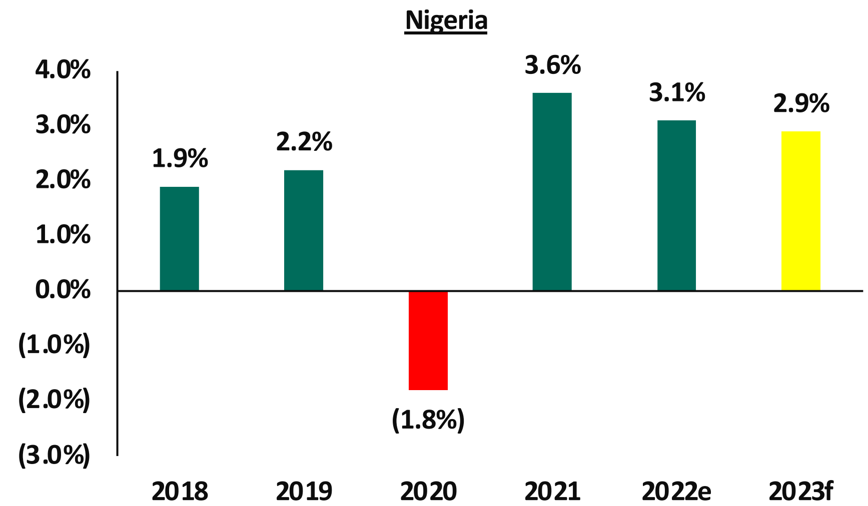
GDP Growth – Selected SSA Countries

Sub Saharan Africa Region is expected to grow by 3.6% in 2023, with the main countries driving growth being Rwanda, Ethiopia, Kenya and Nigeria







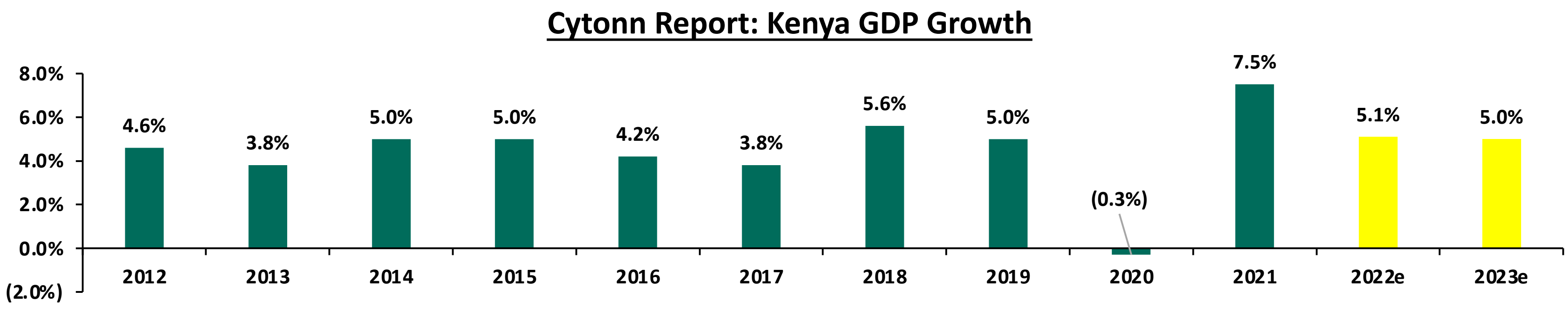


Source: World Bank

III. Kenya Macro Economic Outlook

Kenya GDP Growth

Kenya's economy is projected to grow by 5.0% in 2023



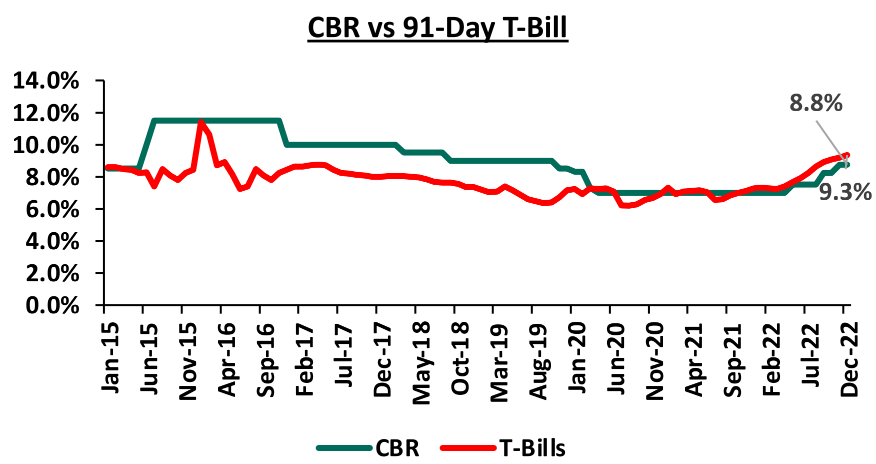
**Average estimate from IMF, World Bank, National Treasury, Cytonn estimate and S&P Global*

- We expect Kenya's 2022 GDP growth to range between 4.8% and 5.2%, driven by:
    i. Expected rebound in the agricultural, transport and most of the economic sectors in 2023 as a result of subsidy programs introduced by the government on major farm inputs and reduced drought severity which shall mitigate the soaring food prices. Other economic sectors such as Transport and Accommodation shall also witness continued recovery post pandemic and this shall be enhanced with the political stability after the peaceful general elections,
    ii. Gradual increase in access to credit with the credit to the private sector expected to remain strong on the back of existing policy measures, including the MSMEs Credit Guarantee Scheme, and continued economic recovery. Additionally, we expect the Hustler Fund to scale up the risk based pricing model to mitigate against credit risk
- Key risks to the economic growth however include:
    i. Debt sustainability which continues to be a key concern, with the public debt to GDP ratio at 62.3% as of October 2022,
    ii. Elevated inflation averaging 7.6% in 2022 above the CBK's range of 2.5%-7.5% hence aggressive monetary tightening currently at 8.75% stifling economic growth,
    iii. Tightened monetary policy currently at 8.75% which is expected to stifle economic growth

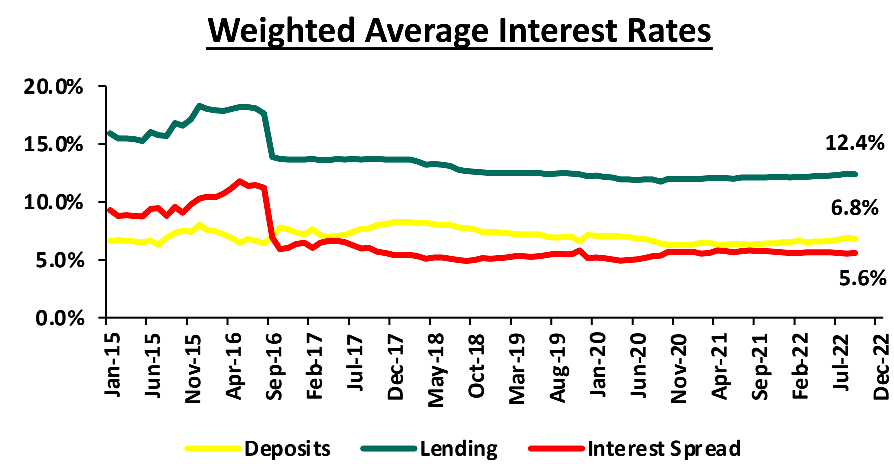
Interest Rates and Monetary Policy

We expect the interest rate environment to increase slightly in 2023 Medium Term

Kenya
Central Bank Rate vs 91-day T-bill



Interest Rates:
Deposit, Savings and Lending Rates



- In 2022 the CBR increased by 175.0 bps to 8.75%, with the Monetary Policy Committee (MPC) citing the sustained inflationary pressures, the elevated global risks and their potential impact on the domestic economy and decided to tighten the monetary policy in order to anchor inflationary expectations
- We expect the CBR rate to increase in the medium term to anchor inflation below the 7.5% CBK target. Additionally, we may see continued upward pressure on the 91-day T-bill rate in 2023 as the government compensates investors for the increased risks posed by elevated inflation and the depreciating currency

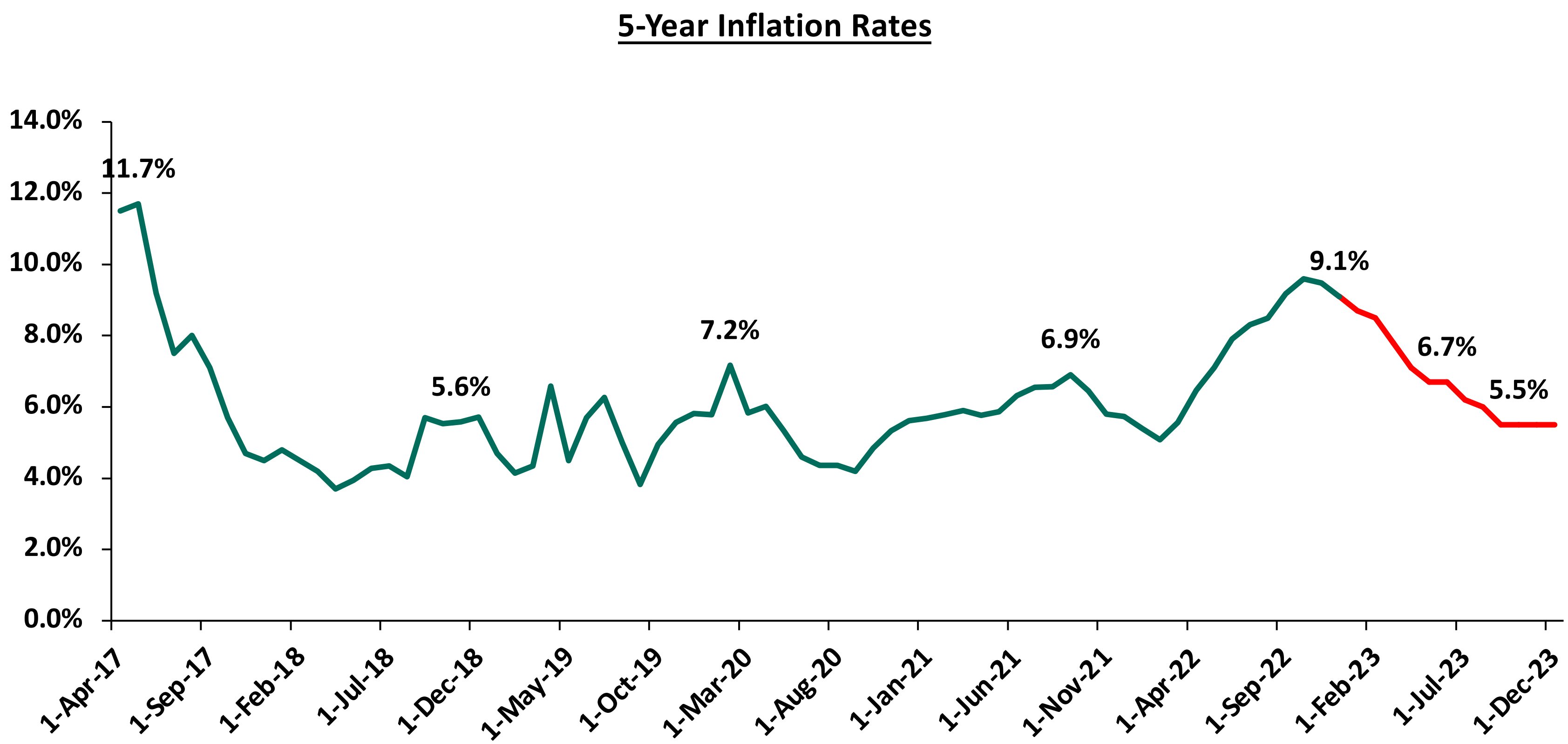
We expect monetary policy to SLIGHTLY INCREASE in the Medium Term in 2023

Source – Central Bank of Kenya

Inflation Forecast

Kenya inflation rate is expected to average 6.6% in 2022, within the Government's target of 2.5%-7.5%

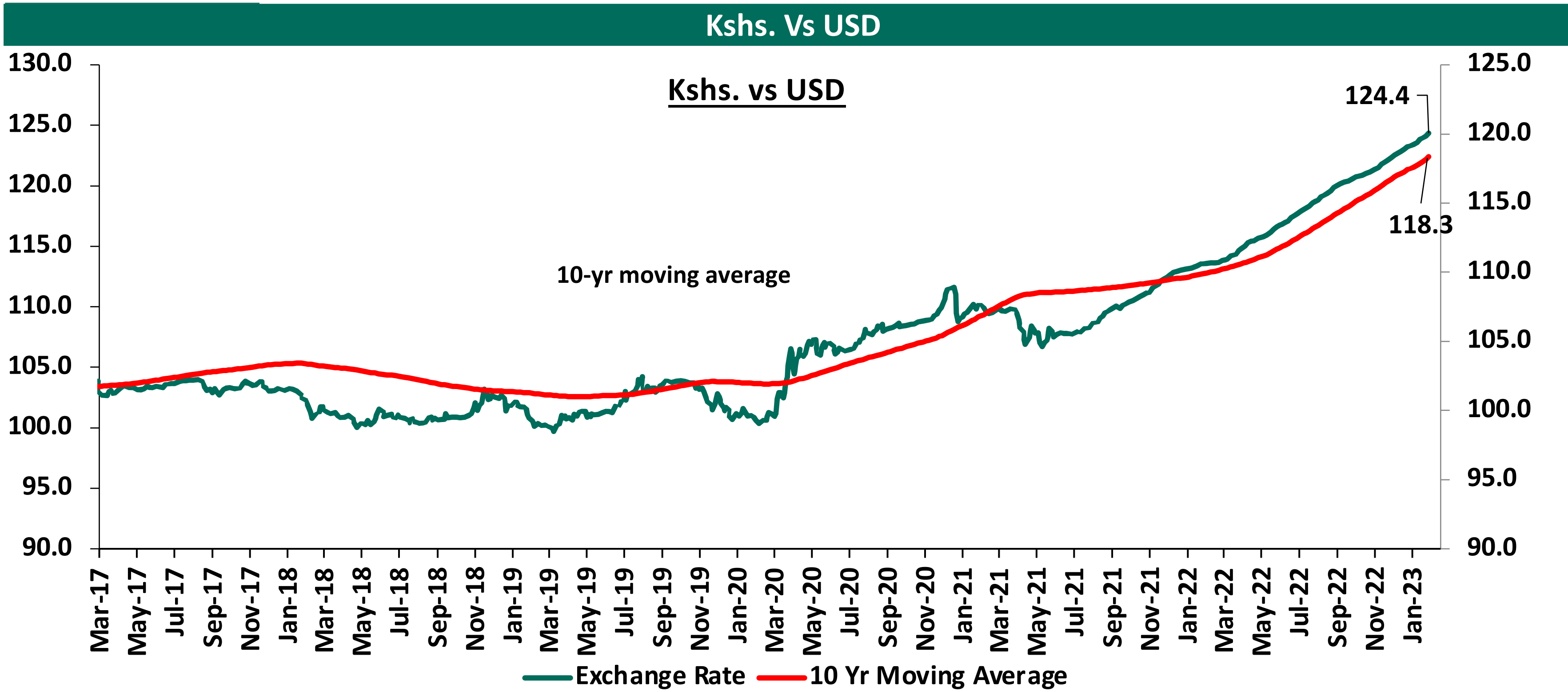
Kenya's Inflation Rate Forecast 2023



In 2023 we expect inflation to average 6.6%, within the Government target range of 2.5% - 7.5%

Exchange Rate

We expect the Shilling to range between Kshs 130.21 and Kshs 134.40 to the USD



In 2023, <u>the shilling is likely to depreciate</u> due to:

1. ***High global crude oil prices on the back of persistent supply chain bottlenecks coupled with high demand , and,***
2. ***High foreign debt servicing costs putting pressure on foreign reserves given 69.3% of Kenya's External Debt was US dollar denominated as of October 2022***
3. ***Continued hike in the USD Fed Interest rates***

2023 Macroeconomic Outlook - Summary

3 indicators are negative, 3 are neutral and 1 is positive. Overall effect is Neutral

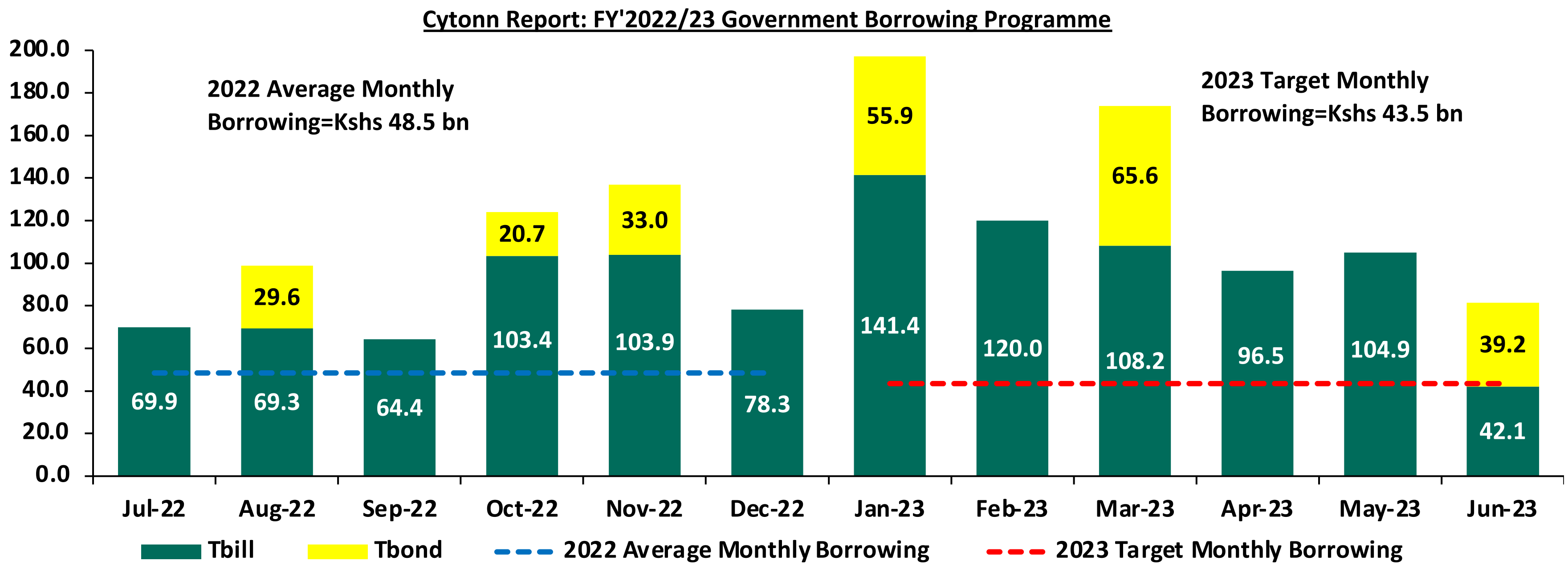
Macro-Economic & Business Environment Outlook		
Indicators	**2023 Outlook**	**Effect**
Government borrowing	• On the domestic front, we expect the government to borrow aggressively from the domestic market as it aims to plug in the fiscal deficit, which is projected to come in at Kshs 689.2 bn in the FY'2023/24, 4.3% of the GDP. Domestic debt provides the government with a cheaper source of debt compared to foreign currency-denominated debts that have higher interest rates and have currency risks attached to them. • In our view, the level of foreign borrowing will also increase in 2023 due to; i)Need to service the upcoming maturities such as the 10-year USD 2.0 bn (Kshs 226.0 bn) Eurobond maturing in 2024 with the government having phased out on the two Eurobonds that it had announced to issue by June 2022, and (ii) disbursements from the multilateral loan from IMF as part of the 3-year disbursing program agreed in April 2021.	**Negative**
Exchange Rate	• We expect the Shilling to range between Kshs 130.21 and Kshs 134.4 to the USD with a bias to a 6.4% depreciation by the end of the year	**Negative**
Interest Rates	• Given the restrictive policy stance utilized in 2022, we expect the CBK to be maintain the same through 2022 with the intention of anchoring the elevated inflation	**Negative**
Inflation	• We expect inflation to average 6.6% in 2023 and within the government target range of 2.5% - 7.5%	**Neutral**
GDP	• We project GDP growth for 2023 to continue expanding at a slower pace within a range of 4.8% - 5.2%. GDP growth is expected to be supported by the continued economic recovery, expected rebound in sectors such as Transport, accommodation and agriculture especially with the introduction of farm input subsidies. However, risks abound due to high risk of debt distress, the erratic weather conditions expected to adversely affect the Agricultural sector, which is the largest contributor to Kenya's GDP, elevated inflationary pressures, currency depreciation and restrictive monetary policy	**Neutral**
Investor Sentiment	• We expect 2023 to register lower investor sentiments mainly due to; i) elevated inflation in the country currently at 9.1%, and ii) Continued depreciation of the Kenyan currency as a result of increased dollar demand from importers, especially for oil and energy sectors against a lower supply of hard currency and high debt servicing. However, we expect the business environment to improve in the medium term with the PMI averaging 51.1 since September 2022 indicating continued improvement in business environment.	**Neutral**
Security	• We expect security to be maintained in 2023 with a stable political environment since there are no impending elections hence less political activities	**Positive**

IV. Fixed Income Market Outlook

Cytonn

Government Domestic Debt

The government will have to borrow an average of Kshs 43.5 bn locally on a monthly basis to meet both its domestic borrowing target in the current fiscal year and maturity obligations



- The government is 4.8% behind of its prorated domestic borrowing target, having borrowed Kshs 324.0 bn domestically, against the pro-rated target of Kshs 340.4 bn
- Current Maturities = Kshs 686.2 bn
- Domestic borrowing target = Kshs 43.5 bn

Target Monthly Borrowing = Kshs 43.5 bn

Fixed Income Market Outlook, continued

Of the 7 indicators we track, 2 are positive, 3 are negative and, 2 are neutral. It is due to this that we find it prudent for investors to be biased towards medium-term papers

Macro-Economic Indicators	2023 Outlook	Current View
Domestic Borrowing	• We expect the government to borrow aggressively from the domestic market given the challenging external source of financing as it aims to plug in the fiscal deficit, which is projected to come in at Kshs 876.7 bn in the revised FY2022/23 representing 5.8% of the GDP, and decline further to an estimate of Kshs 743.3 bn, for the FY'2023/2024, translating to 4.3% of GDP. Domestic debt provides the government with a cheaper source of debt compared to foreign currency-denominated debts that have higher interest rates and have currency risk attached to them. Despite this, we expect the interest rate environment to remain relatively stable in the country owing to the support from concessional multilateral loans from IMF reducing the government's	Negative
Revenue Collection	• Revenues for the current financial year are projected at Kshs 2.5 tn with ordinary revenues at Kshs 2.2 tn. On the other hand, expenditures are projected at Kshs 3.4 tn with recurrent expenditures projected at Kshs 2.4 tn while development expenditures are projected at Kshs 596.6 bn. The fiscal deficit is therefore projected at Kshs 876.7 bn • According to KRA, Total revenue collected in for the last fiscal year amounted to Kshs 2.03 tn against a revised target of Ksh 1.98 tn, an outperformance of 102.8%. • As of December 2022, total revenue collected amounted to Kshs 987.9 bn, equivalent to 92.3% of the prorated estimates of Kshs 1,070.8 bn. Total expenditure amounted to Kshs 1.4 tn, equivalent to 38.6% of the original estimates of Kshs 3.5 tn, and is 77.3% of the prorated expenditure estimates of Kshs 1.7 tn • We expect revenue collection for FY'2022/2023 to improve given the current administration's focus on expanding the tax base to include the informal sector, increasing the exercise duty tax, and the roll-out of the e-TIMS system to improve VAT collection margins. However, the risks lie on the downside given that business environment remains subdued, underpinned by the elevated inflationary pressures and the aggressive depreciation of the Kenyan shilling that has suppressed business production levels. As such, the low production performance will weigh down on the projected revenue performance	Positive
Monetary Policy	• The Central Bank is expected to continue tightening monetary policy stance in the medium term with the intention of anchoring inflation which is currently above the target range. Additionally, we may see slight upward pressure on the interest rates as the government compensates investors for the increased risks posed by currency depreciation and elevated inflation	Negative
Inflation	• We expect the annual average inflation rate to fall back within the government's target of 2.5%-7.5% coming in at an average of 6.6% as compared to 7.6% in 2022. We expect the decline in inflation to be driven by an expected cooling in inflation, both globally and locally as the tightened monetary policy continues to take effect. However, the current high global crude oil prices as well as high food prices, will continue putting pressure on the inflation rate in the short term. Additionally, the current administration is keen to phase out consumption subsidies that will see increases in prices of fuel and electricity;	Neutral

Fixed Income Market Outlook, continued…

Our view is that investors, should be biased towards Short-term Fixed Income Instruments

Macro-Economic Indicators	2023 Outlook	Current View
Exchange Rate	• We project the Kenya Shilling to trade within the range of between Kshs 130.21 and Kshs 134.40 with a bias towards 6.4% depreciation against the USD in 2023, driven by the high global crude oil prices that will lead to increased dollar demand from oil and energy importers who will have to increase the amounts they pay for oil imports and hence depleting dollar supply in the market, hiked Fed rates and high debt servicing	**Negative**
Investor Sentiments	• Foreign investors remained net sellers in 2022, with a net outflow of USD 204.3 mn, compared to net outflows of USD 91.9 mn recorded in FY'2021. The foreign-investor outflows during the year can be largely attributed to investors fleeing emerging markets such as Kenya, to advanced economies such as United States and United Kingdom following interest rate hikes as well as increased concerns on macroeconomic deterioration. In 2022, the market valuation closed the year at a price to earnings ratio (P/E) of 6.7x, 42.0% lower than the 11.5x recorded at the end of 2021 and 47.0% below the 12-year historical average of 12.6x due to poor performance in the equities, with NASI, NSE20 and NSE 25 declining by 23.7%, 12.4% and 16.6%, respectively. The corporate earnings growth is expected to grow slightly due to an improved business environment in 2023, • We expect 2023 to register lower investor sentiments in the short term mainly due to elevated inflation in the country currently at 9.1%, and continued depreciation of the Kenyan currency as a result of increased dollar demand from importers, especially for oil and energy sectors against a lower supply of hard currency and high debt servicing, • Notably, yields on all Kenyan Eurobonds generally increased in 2022, pointing towards increased concerns on the elevated inflationary pressures and currency depreciation. As a result, investors attached higher premiums to the country's Eurobonds	**Neutral**
Security	• We expect security to be maintained in 2023 with a stable political environment, following the peaceful conclusion of general elections in 2022	**Positive**

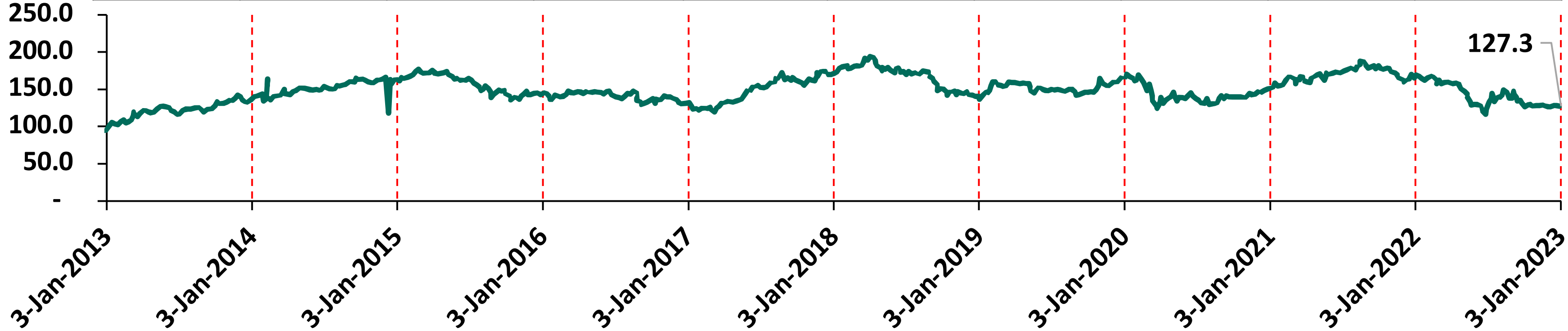
Our view is that investors, should be biased towards:
SHORT-TERM FIXED INCOME INSTRUMENTS
Investors need to reduce duration risks associated with the long-term debt coupled with the relatively flat yield curve on the long-end due to saturation of long-term bonds

V. Kenya Equities Market Outlook

Kenya Equities Performance

NASI declined by 23.7% in 2022, compared to the 9.5% gain recorded in 2021

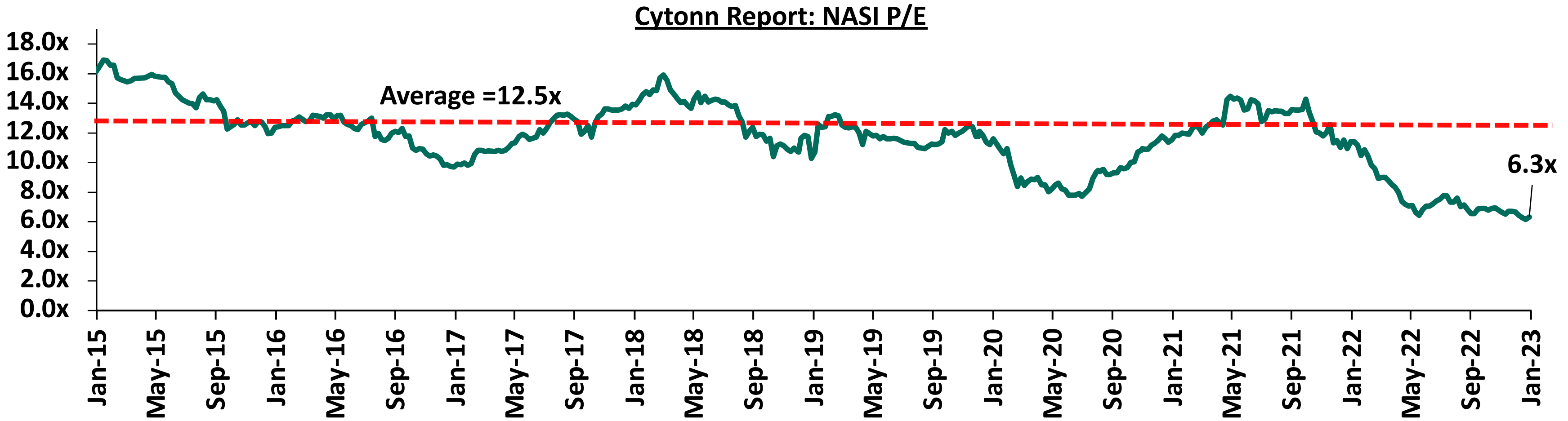
Annual NASI Performance									
2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
43.0%	19.3%	(10.7%)	(8.4%)	29.1%	(18.0%)	18.7%	(8.4%)	9.5%	(23.7%)

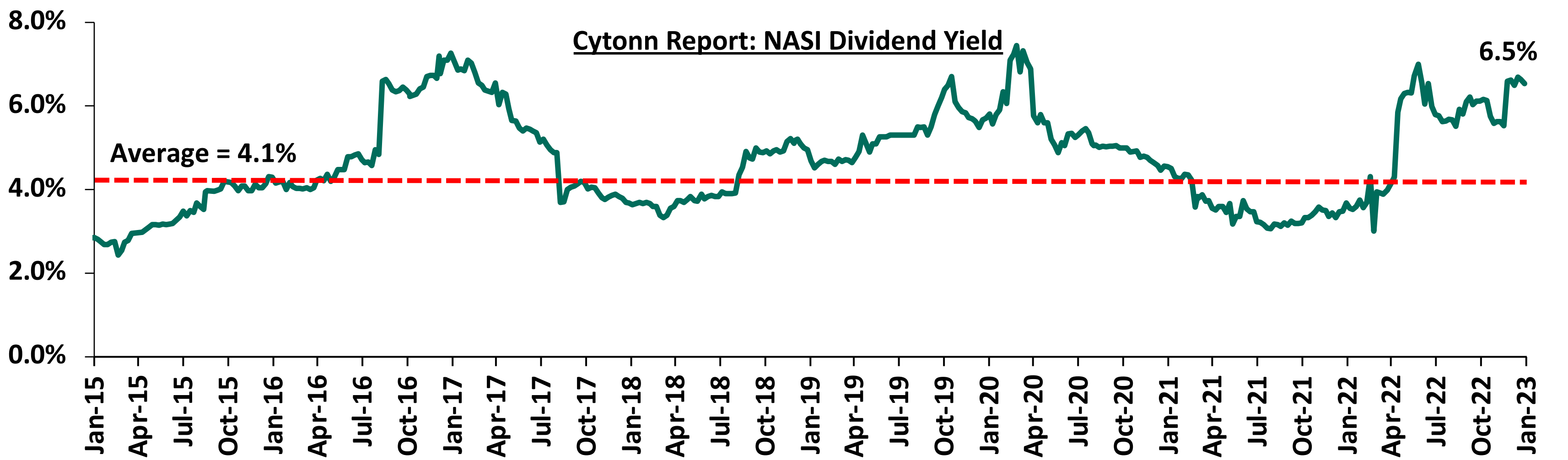


- The negative performance of NASI in 2022 was driven by losses recorded by large cap stocks such as Safaricom of 36.7%, Bamburi of 17.5%, as well as banking stocks such as KCB Group, Diamond Trust Bank Kenya, Equity Group and Co-operative Bank Kenya of 16.4%, 16.0%, 15.6%, and 5.4% respectively, during the year, mainly due to uncertainty in the Kenyan equities markets, which resulted in massive capital outflows as investors sought less riskier investments such as government papers and other investment alternatives
- The losses were however mitigated by gains recorded by other banking stocks such as NCBA Group, Standard Chartered Bank Kenya (SCBK)and ABSA Bank Kenya of 54.6%, 9.8% and 4.7%, respectively, while BAT Kenya and EABL gained by 4.5%, and 1.2%, respectively

NASI P/E and Dividend Yield

NASI is currently trading at a P/E of 6.3x, 49.5% below the historical average of 12.5x





Equities Outlook - Neutral for 2023

Of the 4 indicators we track for Equities market performance, 1 presents a positive outlook

Equities Market Indicators	Outlook for 2023	Current View
Macro-Economic Environment	• We expect the economy to grow at a slower pace given the gradual improvement in the general business environment in the country which has been dented by the elevated inflationary pressures occasioned by high fuel and food prices. Additionally, the Central Bank of Kenya's Monetary Policy Committee decision to hike the Central Bank Rate (CBR) in a bid to curb inflation and maintain price stability is expected to curtail economic growth • Further, we expect the Agricultural sector to remain subdued largely due to erratic weather conditions. However, we expect the sector to be supported by the long rains witnessed across the country at the end of the year, coupled with recent fiscal policies such as subsidizing costs of crucial farm inputs such as fertilizers that will enhance growth in the sector	Neutral
Corporate Earnings Growth	• We expect a slight improvement in the listed sector's earnings growth in 2023, largely driven by the continued improvement in the country's business environment. Additionally, the growth in Corporate Earnings is expected to be boosted by the successful expansion of operations into Ethiopian telecommunication industry by Safaricom, which continues to control the largest bourse in the Nairobi Stock Exchange, • Further, we anticipate growth in the banking sector's earnings as a result of expected increase in lending with the continued adoption of risk-based lending as well as revenue diversification strategies by banks	Neutral
Valuations	• With the market closing the year 2022 at a P/E of 6.7x, and having an expected earnings growth of 10.6% in 2023, it is currently trading at a Forward P/E of 8.7x. This represents a potential upside of 32.2% compared to historical levels	Positive
Investor Sentiment and Security	• We expect the equities market to register muted foreign interest in 2023, attributable to the uncertainties in the Kenyan macro-economic conditions occasioned by the elevated inflationary pressures. This caused high capital flights in 2022 as investors sought less risky investments such as government papers and other investment alternatives • On the flipside, we believe pockets of value still exist in the equities market due to the attractive valuations, with NASI trading 49.5% below its historical average	Negative

Top 10 Stock Picks: 2023

Jubilee Holdings presents the highest upside at 58.0%

No.	Stock	Current Price*	Fair Price	Dividend Yield**	Total Upside	Recommendation
1	Jubilee Holdings	194.25	305.94	0.51%	58.0%	**Buy**
2	Kenya Reinsurance	1.80	2.51	5.56%	45.0%	**Buy**
3	KCB Group	38.30	52.49	7.81%	44.1%	**Buy**
4	Liberty	4.80	6.75	0.00%	40.6%	**Buy**
5	EABL	172.00	192.54	4.72%	35.4%	**Buy**
6	Equity	45.40	58.35	6.52%	35.1%	**Buy**
7	I&M Group	17.00	20.82	8.77%	31.3%	**Buy**
8	BAT	449.25	482.78	7.14%	14.9%	**Accumulate**
9	Standard Chartered	157.00	166.26	3.87%	9.7%	**Hold**
10	Stanbic Holdings	112.00	112.00	8.05%	8.0%	**Hold**

** Prices as at 27th January 2023*
*** Estimated Dividend Yield*

Our top stock picks for 2023 are based on a risk-adjusted return basis. We took into account stocks with medium risk levels, are liquid and have strong fundamentals

Top Stock Picks: 2023

We recommend investors to take a BUY position on Safaricom

- In their H1'2023 results, Safaricom recording a decline in core earnings per share of 10.0% to Kshs 0.8 in H1'2023, from Kshs 0.9 in H1'2022. The decline was largely attributable to a 32.2% increase in operating expenses to Kshs 31.0 bn from Kshs 23.4 bn recorded in H1'2022, with its Ethiopian subsidiary incurring Kshs 6.0 bn in operating expenses representing 24.0% of the group's total operating expenses. The Ethiopian subsidiary recorded a total revenue of Kshs 98.3 mn, with service revenue coming at Kshs 9.1 mn and operating cost at Kshs 6.0 bn leading to a loss after tax of Kshs 7.3 bn which weighed down on the group's overall performance
- We expect Safaricom to register muted earnings growth in 2023 attributable to the high cost of setting up operations in the Ethiopian subsidiary. On the flipside, revenue growth is expected to be supported by increased service revenue, which recorded a 4.6% y/y gain to Kshs 144.8 bn, from Kshs 138.4 bn recorded in H1'2022 with MPESA revenue and mobile data revenue increasing by 8.8% and 11.3%, respectively
- In 2022, Safaricom registered a 36.7% decline, mainly attributable to increased sell off by foreign investors as they exited the market due to hiked interest rates in developed economies such as United States making dollar investments more appealing and thus lowering their appetite for risky investments in emerging markets such as Kenya. However, Safaricom continued to exert its dominance in the bourse, with its market cap closing the year at 49.6% of the entire bourse as at 30th December 2022, a decline from 59.5% recorded in 2021
- Given the firms strong fundamentals and expansion to Ethiopia, we remain positive on Safaricom. We however recommend investors to take a **BUY** position on the stock based on sound fundamentals

Equities Market Outlook

We are "Neutral" on the Equities markets in the short term due to the current adverse operating environment and huge foreign investor outflows

- We are **Positive** for 1 indicator that we track which is;
  i. Valuations
- We are however **Neutral** for 2 indicators we track which include;
  i. Macro Economic Environment,
  ii. Corporate Earnings Growth, and
- We are also Negative for 1 indicator that we tract that is;
  i. Investor Sentiment and Security,
- We are "NEUTRAL" on equities for investors as the Neutral outlook on the macro-environment, corporate earnings growth and subdued investor confidence and security could inhibit the market's performance

We have a ''NEUTRAL" outlook on the Kenyan Equities market in the short term. However, we maintain our bias towards a "BULLISH" equities markets in the medium to long term, with the expectations of a slower growth in corporate earnings and the cheap valuations currently in the market..

VI. Real Estate Market Outlook

Market Outlook 2023 - Real Estate in Kenya Overview

We had a NEUTRAL outlook for the Real Estate sector in 2022

- In 2022, the general Real Estate sector witnessed considerable growth in activity in terms of property transactions and development activities. Property selling and rental prices also continued to soar, driven by continued inflationary pressures on the back of supply chain disruptions, and a weakened shilling against the United States dollar that saw a rise in costs of construction materials. Consequently, the Real Estate Sector in Q3'2022 grew by 5.1%, 0.2% points slower than the 7.1% growth recorded in Q3'2021 when the economy was recovering from the impacts of COVID-19 pandemic, according to the Quarterly GDP Report Q3'2022 by the Kenya National Bureau of Statistics' (KNBS)
- In terms of performance in the Nairobi Metropolitan Area (NMA), the Residential, Commercial Office, Retail, Hospitality, and Mixed-Use Development sectors realized average rental yields of 5.1%, 7.6%, 7.9%, 6.2%, and 7.4%, respectively in FY'2022. This resulted to an overall rental yield of 6.8%, 0.3% points higher than the 6.5% recorded in FY'2021
- We had a **NEUTRAL** outlook for the Real Estate sector in 2022 supported by factors such as; i) continued launch and implementation of various infrastructure projects, ii) aggressive expansion efforts by retailers, iii) focus by the government and private sector to provide affordable housing, iv) provision of long-term, low-interest home loans to potential buyers by the Kenya Mortgage Refinance Company (KMRC), v) increased mergers and acquisitions in the hospitality sector, and, vi) positive demographics promoting demand for Real Estate developments. However, factors such as; i) prevailing inflationary pressures from local and external shocks, ii) limited credit access partly due to the rising non-performing loans in the property sector, iii) low absorption of physical space due to the continued oversupply in the commercial office and retail sectors, v) reduced funding in the infrastructural sector, v) uncoordinated land use due to lack of proper urban planning, and, vi) subdued growth of the Real Estate Investment Trusts (REITs) market continued to impede the optimal performance of the sector

Key Factors Driving the Real Estate Sector

Improving infrastructure, recovery of the hospitality sector, expansion by retailers and positive demographics continue to drive Kenya's Real Estate sector performance

Factors	DESCRIPTION
Infrastructural development	The government has continued to launch and implement various infrastructure projects, with an aim of improving the country's economic status, as well as positioning Kenya as a regional hub. This is expected to enhance performance of the sector by opening up areas for Real Estate development
Affordable housing initiative	There has been an ongoing focus by the government and private sector to provide decent housing to Kenyans through the Affordable Housing Program (AHP). Currently, the AHP pipeline boasts about 30 affordable housing projects, with an estimated target of 200,000 units to be delivered per year
Focus on mortgage financing by the KMRC	The Kenya Mortgage Refinance Company (KMRC) has continued to advance its efforts to make home ownership more accessible to Kenyans by providing long-term, low-interest home loans to potential home buyers. To source funding, KMRC issued the first tranche of its Kshs 10.5 bn Medium Term Note (MTN) in February 2022, aiming to raise Kshs 1.4 bn, which recorded an oversubscription of 478.6%. The company intends to issue the subsequent tranches over the years, so as to expand its lending to Kenyan home buyers, which stood at Kshs 1.3 bn in 2021
Recovery of the hospitality sector	The hospitality sector has seen various mergers and acquisitions, signifying investor appetite and confidence in a bid to gain market dominance coupled by the recovery of the sector away from the pandemic lockdowns. Driven by the sector's gradual recovery away from the slowdown that was caused by pandemic lockdowns and travel restrictions, these expansionary efforts will continue to boost the performance of the sector
Aggressive expansion in the retail sector	The sector has seen rapid expansion efforts by both local and international retailers such as Naivas, Carrefour and Quickmart, among others, in a bid to increase their share of the market and ensure dominance, as Kenya's formal retail penetration stands at approximately 30.0% according to the Nielsen Report
Positive Demographics	Kenya has relatively high urbanization and population growth rates averaging 3.7% and 1.9% compared to the global averages of 1.6% and 0.9%, respectively, according to the World Bank as of 2021. This will continue to provide sustained demand for more housing units in the country

Key Challenges Facing the Real Estate Sector

Constrained financing to developers is a challenge affecting the Real Estate sector's performance

Factors	DESCRIPTION
Increased construction costs	Rising construction costs as a result of prolonged inflationary pressures and supply chain shortages continue to hamper optimum development activities in the Real Estate sector. Consequently, the consumption of cement declined by 14.7% to 2.2 mn metric tonnes in Q3'2022, from 2.6 mn metric tonnes realized in Q3'2021
Constrained Financing for Developers	Lenders continue to tighten their lending requirements and demand more collateral from developers as a result of the high credit risk in the real estate sector. This is evidenced by a 9.2% increase in gross non-performing loans in the sector to Kshs 75.6 bn in Q3'2022 from Kshs 69.2 bn recorded during the same period in 2021
Underdeveloped Capital Markets	It is difficult to develop pools of capital focused on projects, particularly in the private markets, to supplement government efforts in providing housing. Banks in Kenya are the primary source of funding for real estate developers, providing nearly 99.0% of funding as opposed to 40.0% in developed countries. This means that capital markets contribute only 0.1% of Real Estate development funding, compared to 60.0% in developed countries
Uncoordinated development	In many urban areas, a lack of urban planning has resulted in uncoordinated land use, with the proliferation of large, sprawling developments that are not connected to public transportation, water supply, and other services
Oversupply in Select Sectors	The existing oversupply of physical space in select sectors, with approximately 6.7 mn SQFT in the NMA commercial office market, approximately 3.0 mn SQFT in the NMA retail market, with the rest of the Kenyan retail market having an oversupply of approximately 1.7 mn SQFT, continues to be a challenge for the Real Estate sector in the respective themes
Subpar performance of listed Real Estate	With just one REIT listed on the Nairobi Securities Exchange (NSE), the Kenyan REITs market has remained subdued. This is largely as a 'result of the large minimum capital requirements, prolonged approval process, scant investor knowledge, and only a few entities capable of incorporating REITs

Real Estate Themes Outlook

2023 Real Estate Sector Outlook

The overall outlook for the sector in 2023 remains NEUTRAL

Thematic Performance and Outlook		
Themes	**2023 Outlook**	**Effect**
Residential	• In 2023, the demand for housing is expected to continue growing on the back of Kenya’s attractive demographic profile. In addition, continued infrastructural development, the ongoing focus by the government and private sector to provide housing, and, the drive by the KMRC to avail affordable mortgage facilities to potential home buyers are expected to cushion the performance of the residential sector • However, we expect the prevailing inflationary pressure coupled with a weakened shilling, high construction costs, and the low penetration of mortgages in the country to continue impeding the performance of the sector	**Neutral**
Commercial Office	• We expect the yields to realize a slight improvement of 0.1% points attributed to the expected improvements in the overall occupancies and rental rates supported by i) gaining traction in co-working spaces, ii) slow but rising expansion in the sector, and, iii) reduced developments in the pipeline which we expect will help curb the oversupply challenge by allowing room for the absorption of available and fewer incoming spaces. However, we expect the overall performance to be subdued by the existing oversupply of office space in the NMA at 6.7 mn SQFT thereby crippling the overall demand for physical space	**Neutral**
Retail	• We expect a slight increase in the rental yields by 0.1% as a result of increased rental charges of retail spaces and demand for existing supply amid the aggressive expansion by retailers taking up new and previously occupied spaces, infrastructure developments opening areas for investments, and positive demographics. However oversupply, increased adoption of e-commerce, tougher economic environment for businesses, and presence of informal retail spaces are expected to undermine the performance of the sector in turn affecting rental yields of the sector	**Neutral**
Hospitality	• We expect the sector to be on an upward trajectory in following the ambitious international marketing of Kenya to key tourism markets, positive accolades, sustained sector recovery, anticipated increase in international arrivals, mass vaccinations, increased promotion of local tourism and improved security. However, newly issued travel advisory by the UK government, government’s directive to indefinitely suspend hotel meetings, conferences and trainings, financing difficulties, projected reduced investments within the hospitality industry due to increased associated costs attributable to the increase in capital gains tax and existing inflationary pressures on the back of a depreciating currency to weigh down sector performance	**Neutral**

2023 Real Estate Sector Outlook, Cont'…

With 2 themes having a positive outlook, 4 neutral and 1 being negative, the general outlook for the sector therefore remains NEUTRAL

Thematic Performance and Outlook		
Themes	**2023 Outlook**	**Effect**
Land	• We expect the NMA land sector will realize a 3.2% annual capital appreciation in 2023 driven by; i) a greater emphasis on Affordable Housing projects and private projects, ii) tax policies such as increased property rates in some counties which might provoke landowners and landlords to demand higher land prices and rents, in efforts to recover additional costs incurred from higher rates set to be charged iii) positive population demographics, and iv) rapid growth of satellite towns amid increased delivery of infrastructural developments which are improving accessibility, property prices and demand in the regions. However, factors such as: i) the increase in capital gains tax may dampen property transaction volumes as most investors may rethink their decisions to dispose their investments amid the increased tax, ii) relatively high land costs in certain areas, and, iii) lengthy land processes may discourage investments, weighing down optimum performance of the sector	**Positive**
Infrastructure	• we expect to continue seeing the launching, execution, and completion of more infrastructural developments in 2022. However, we expect the government to reduce Infrastructure, Energy, and ICT allocations by 4.4% to 398.2 bn for the FY'2023/2024 from the Kshs 416.4 bn in FY'2022/2023.The decrease in spending will affect the government's ability to fund new infrastructure projects across the country	**Neutral**
Listed Real Estate	• Having opened the year with a trading price of Kshs 6.8 per share, we expect the Fahari I-REIT to continue trading at low prices due to various challenges such as general lack of knowledge and interest in the REITs market, only few entities capable of incorporating REITs, high capital requirements for Trustees, protracted processes required in order to establish REITs, and, high minimum investment amounts set at Kshs 5.0 mn	**Negative**

With 1 theme having a positive outlook, 5 neutral and 1 being negative, the general outlook for the sector therefore is NEUTRAL. The sector's performance will be supported by; i) infrastructural development, ii) government and private sector focus on affordable housing, iii) focus on mortgage financing through the KMRC, iv) improved investor confidence amid recovery of the hospitality sector, v) aggressive expansion by both local and international retailers in a bid to maintain market dominance, and, vi) Kenya's positive demographics driving housing demand. However, factors such as increased construction costs on the back of inflation, constrained financing to developers with increased underdeveloped capital markets, oversupply in select sectors and low of investor appetite in Real Estate Investments Trusts (REITs) are expected to continue impeding performance of the sector

2023 Key Areas of Opportunities in the RE Sector

The table below shows the investment opportunities across the themes

The Key Areas of Opportunities by Theme in Real Estate Sector			
Sector	**Themes**	**Locations**	**2022 Performance**
Residential Sector	**High End (Detached)**	**Rosslyn and Kitisuru**	Relatively high annual returns averaging 6.5%, and 6.4%, respectively, compared to the high-end market's average of 5.8%, while the average rental yields stood at 5.0% and 4.8%, respectively, compared to the market average of 4.4% and price appreciations averaging 1.5% and 1.6%, respectively
	Upper Middle (Detached)	**Redhill/Sigona and Ridgeways**	Relatively high annual returns averaging 6.4% for Redhill/Sigona and 6.3% for Ridgeways, compared to the Upper-Middle market's average of 5.6%, with price appreciations of 1.5% and 1.6%, respectively, compared to the market average capital appreciation of 1.1%
	Lower Middle (Detached)	**Ruiru, Juja and Ngong**	Relatively high annual returns for Ruiru at 7.8%, with Juja and Ruiru recording total returns of 6.9% and 6.5%, respectively, compared to the Lower-Middle market's average of 6.0% total returns to investors
	Upper Mid-End (Apartments)	**Westlands and Kilimani**	Relatively high annual returns averaging 6.4% and 6.0%, respectively in comparison to the Upper Mid-End market's average of 5.9% with relatively high rental yields averaging 5.9% and 5.8%, respectively, while price appreciation came in at 0.5% and 0.2%, respectively
	Lower Mid-End (Suburb Apartments)	**Waiyaki Way and South C**	Relatively high annual returns averaging 8.6% and 8.5%, respectively, compared to the market's average of 7.1% with relatively high rental yields averaging 6.3% and 6.1% , respectively, while price appreciation came in at 2.3% and 2.4%, respectively
	Lower Mid-End (Satellite Apartments)	**Ruaka, Ruiru, and Ngong**	Relatively high annual returns averaging 7.5%, 7.4% and 7.2%, respectively, compared to the Lower Mid-End market's average of 6.9% with relatively high rental yields averaging 5.2%, 5.8% and 5.5%, respectively, while price appreciation came in at 2.3%, 1.6% and 1.7%, respectively

2023 Key Areas of Opportunities in the RE Sector Cont'

The table below shows the investment opportunities across the themes

The Key Areas of Opportunities by Theme in Real Estate Sector			
Sector	**Themes**	**Locations**	**2022 Performance**
Commercial Office Sector	**Grade A Offices**	**Gigiri, Westlands, and Karen**	They offered high returns with average rental yields at 8.6%, 8.1%, and, 7.7%, respectively, compared to the market average of 7.3%, as a result of their superior locations characterized by Grade A spaces that attract high-end clients and offer premium rental rates
Retail Sector	**Suburban Malls**	**Westlands, Karen, and Kilimani**	Relatively higher returns of 9.8%, 9.4%, and 8.7% respectively, compared to the market average of 7.9%, attributed to presence of high quality retail spaces fetching the high rents, coupled with the availability of quality infrastructure services. Additional opportunity also lies in the undersupplied regions of the country such as Mount Kenya, Western and the Coast
Hospitality Sector	**Serviced Apartments**	**Westlands, Kilimani, and Kileleshwa/ Lavington**	They recorded average rental yields of 9.3%, 7.2% and 6.6%, respectively against a market average of 6.2% in 2022. This attributed to proximity to the CBD, presence of high quality serviced apartments which attract premium rates, accessibility, and proximity to international organization which drive the demand for serviced apartments in the nodes
Land Sector	**Unserviced Land**	**Juja, Utawala, and Limuru**	Increased demand for development evidenced by their high capital appreciations of 16.6%, 14.8% and 13.4%, respectively, in FY'2022 compared to the market average of 11.1% and, increased infrastructure developments enhancing accessibility to areas
	Serviced Land	**Syokimau and Ruiru-Juja**	Relatively high demand for land for development having recorded capital appreciations of 19.2% and 13.0%, respectively against the serviced average of 8.0% driven by; i) adequate infrastructural developments serving the areas such as the Nairobi Expressway and Thika-Nairobi Superhighway

Q&A

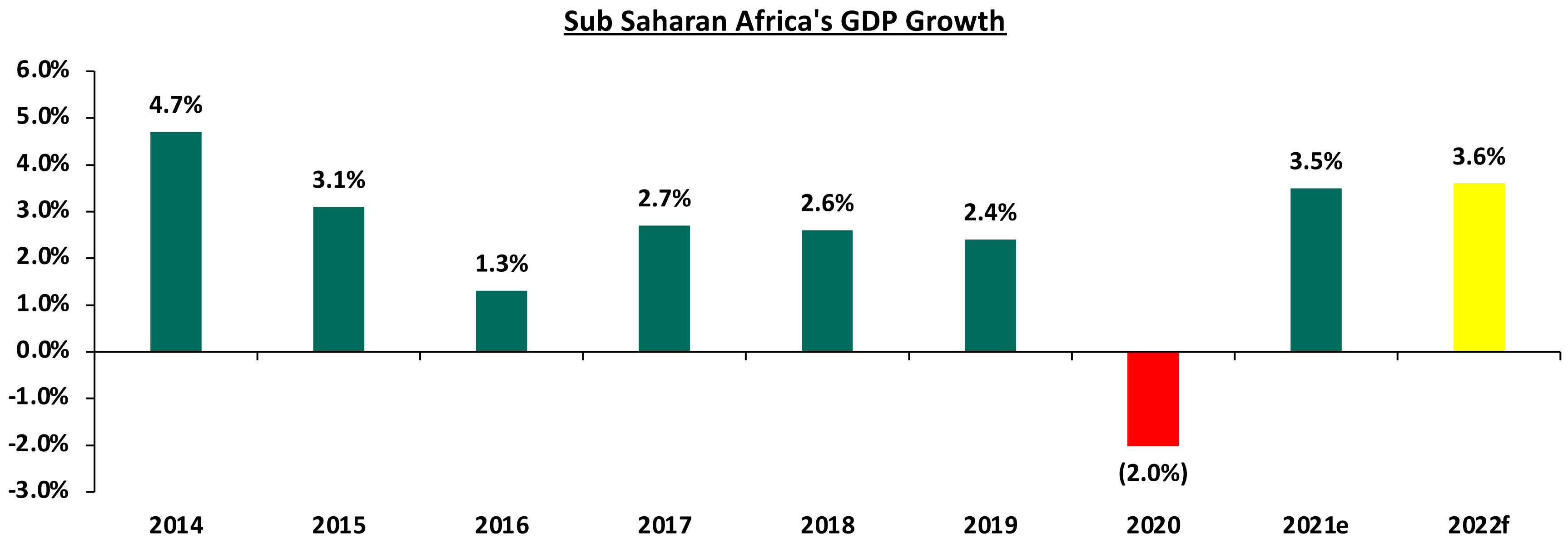
Cytonn

VII. Appendix

I. Sub Saharan Africa Regional Market Outlook

Regional GDP Growth

Sub Saharan Africa Region is expected to grow by 3.6% in 2022, according to the World Bank



- The SSA region is expected to grow by 3.6% in 2022, 0.1% points higher than the estimated 3.5% in 2021, supported by elevated commodity prices as activity continues to rebound in the region's main trading partners coupled with gradual recovery in the tourism sector
- The countries expected to drive growth in 2022 are Rwanda, Ghana, Kenya and Nigeria with expected economic growth rates of 7.1%, 5.5%, 5.1% and 2.5%, respectively
- Key risks expected to affect the regional recovery include the possible emergence of new COVID-19 variants such as Omicron and the slow rollout of vaccine in the region

Source: World Bank

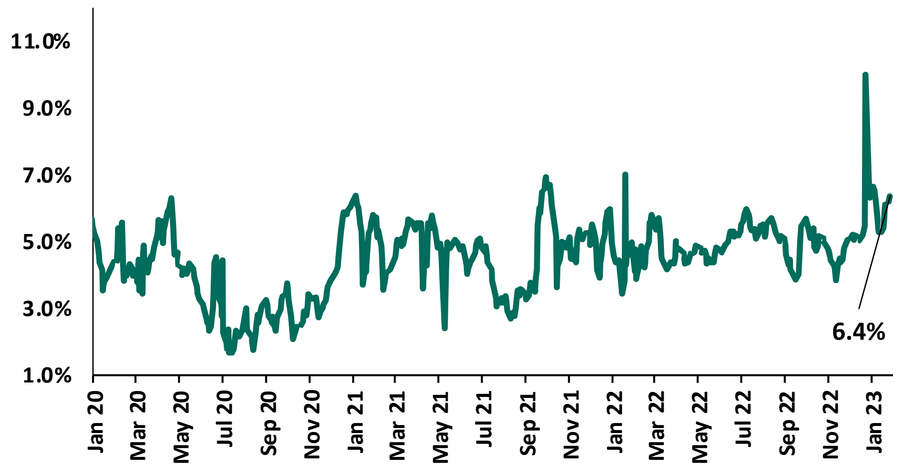
II. Kenya Macro Economic Outlook

Cytonn

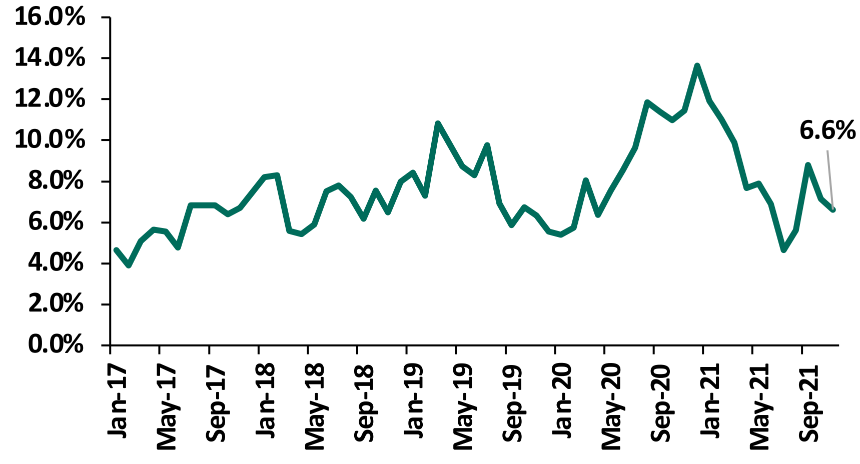
Market Liquidity and Money Supply

We expect liquidity to improve in 2023 driven partly by increased access to credit

Interbank Rates (%)



Money Supply Growth (M3) (y/y)

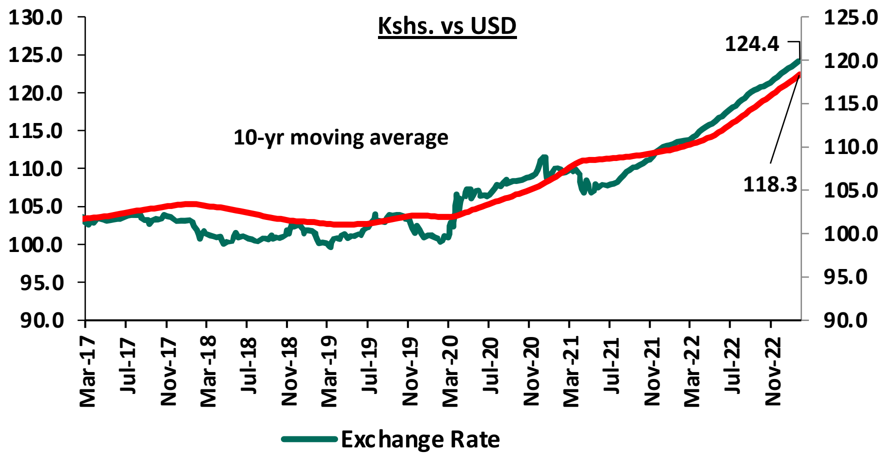


- In 2022, liquidity levels tightened as evidenced by the increase in the average interbank rate to 4.9% in 2022, from 4.7% in 2020, while the average volumes traded in the interbank market increased significantly by 74.7% to Kshs 18.6 bn in 2022, from Kshs 10.7 bn recorded in 2021,
- The tightened liquidity is partly due to government remittances which offset payments
- Cash Reserve Ratio (CRR) remained unchanged at 4.25% in 2022, a reduction from 5.25% in March 2020, by the CBK against potential effects of COVID 19 pandemic on the economy. A decrease in CRR increases the supply of money with commercial banks and helps boost liquidity
- We expect liquidity to improve in 2022 driven by increased access to credit as banks gradually increase their lending to the private sector and the continued adoption of risk-based lending by banks. However, should the government structure some of its local debt in the bid to increase the debt tenors, we may see the liquidity growth being hampered

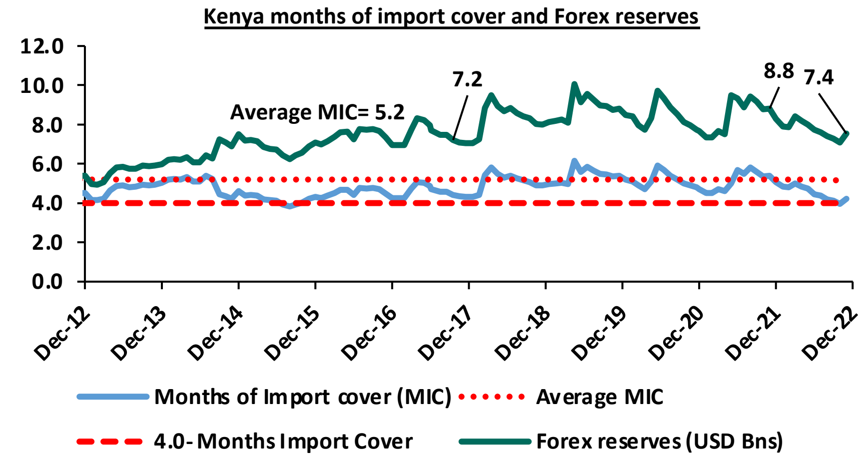
Exchange Rate

We expect the Shilling to range between Kshs 130.21 and Kshs 134.40 to the USD with a bias to a 6.4% depreciation by the end of the year

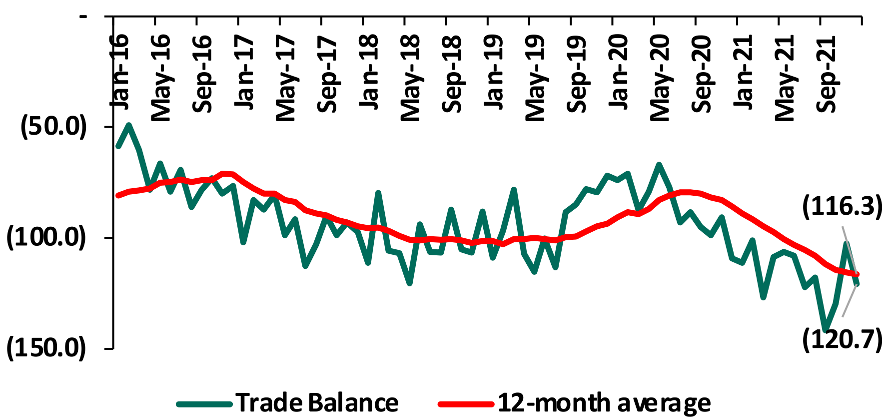
Kshs. Vs USD



Kenya Months of Import Cover and Forex Reserves



Trade Balance (Kshs bns)



- **In 2023, we expect the Shilling to range between Kshs 130.21 and Kshs 134.40 to the USD with a bias to a 6.4% depreciation by the end of the year due to:**

i. High global crude oil prices on the back of persistent supply chain coupled with high demand,

ii. High debt servicing costs putting pressure on forest reserves, and,

iii. A continued hike in the USA Fed interest rates which has strengthened the dollar against the Kenya shillings

2023 Macroeconomic Outlook –Government Borrowing

Government borrowing is overall Negative with the government expected to borrow aggressively in 2023 to plug in the fiscal deficit and help service its existing loans

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicator	**Factors**	**2023 Outlook**	**Effect**
Government borrowing	**Revenue Collection**	• On revenue collection, we expect continued improvement in 2023 due to the raft of measures the new administration has put in place to boost tax collection such as the draft regulations for the Excise Duty Regulations 2023. • We expect to see improved revenue collection which will help lower the budget deficit, and reduce the need for more borrowing. KRA registered a performance rate of 102.8% in FY'2021/2022. Additionally, KRA has also embarked on various efforts to raise more revenue through its strategies as explained in the Budget Policy Statement, 2023 such as reducing the Value Added Tax (VAT) gap to 19.8% from 38.9%, minimizing Corporate Income Tax gap to 30.0% from the current 32.2% recorded in FY'2022/23, integrating KRA tax system with telecommunication companies, and expanding the tax base to include the informal sector targeting 2,800 SMEs. However, the upward revision of taxes comes at a time when the business environment remains subdued, underpinned by the elevated inflationary pressures and the aggressive depreciation of the Kenyan shilling that has suppressed business production levels weighing down on the projected revenue performance.	**Neutral**
	Foreign Borrowing	• Going into 2023, the new administration has been trying to focus more into bilateral and multilateral lending, a move from the commercial lending which is deemed to be more expensive. This has seen the contribution from both Multilateral and Bilateral foreign increase, with multilateral debt increasing by 3.4% points to 45.4% in October 2022 from 42.0% of total external debt in October 2021 while commercial debts declined by 1.6% points to 6.4% in October 2022 from 8.0% in October 2021 • In our view, the level of foreign borrowing will also increase in 2023 due to the following reasons; i) Need to service the upcoming maturities such as the 10-year USD 2.0 bn (Kshs 226.0 bn) Eurobond maturing in 2024 with the government having phased out on the two Eurobonds that it had announced to issue by June 2022, and (ii) disbursements from the multilateral loan from IMF as part of the 3-year disbursing program agreed in April 2021.	**Negative**
	Domestic Borrowing	• On the domestic front, we expect the government to borrow aggressively from the domestic market as it aims to plug in the fiscal deficit, which is projected to come in at Kshs 689.2 bn in the FY/2023/24, 4.3% of the GDP. Domestic debt provides the government with a cheaper source of debt compared to foreign currency-denominated debts that have higher interest rates and have currency risk attached to them.	**Negative**

2023 Macroeconomic Outlook -Currency

We expect the Shilling to range between Kshs 130.21 and Kshs 134.4 to the USD with a bias to a 6.4% depreciation by the end of the year

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicator	**Factors**	**2023 Outlook**	**Effect**
Currency	Balance of Payment	• Kenya's balance of payments deteriorated during Q3'2022, coming in at a deficit of Kshs Kshs 112.7 bn from a deficit of Kshs 29.3 bn in Q3'2021. • The performance of Kenya's Balance of Payments reflects the tough macroeconomic performance in the country evidenced by the slowdown in the country's economic growth to 4.7% in Q3'2022 from the 9.3% recorded in Q3'2021. As such, we expect the country's reliance on imports coupled with high global commodity prices to continue weighing down on the country's Balance of payments. However, the current administration's initiatives to increase exports especially agricultural products through multilateral partnerships such as the US- Kenya Strategic Trade and Investment Partnership and the Africa Continental Free Trade Area (AfCFTA) are also expected to ensure relative stability in the Kenya's Balance of Payments	Negative
	Forex Reserves	• The Country's forex reserves, as at the close of 2022, stood at USD 7.4 bn (equivalent to 4.2-months of import cover), which is above the statutory requirement of maintaining at least 4.0-months of import cover, but below the EAC region's convergence criteria of 4.5-months of import cover, • On the downside, Kenya's forex reserves have been declining due to subdued inflows from exports and repayment of debts. Despite this, we expect the same to be supported by the improving diaspora remittances as well as the gradual economic recovery with the easing of supply chain constraints	Neutral
	Differentials in Interest Rates	• The United States Federal Bank hiked their interest rate in 2022 to a range of 4.25% - 4.50% , as the Federal bank aims to control inflation in the country. This will lead to a depreciation in the Kenyan shilling relative to the US Dollar as more investors prefer the dollar to the higher yield offered. • Fed Rate hikes essentially increases the investment attractiveness of the US market while impacting the risk return profile of emerging market economies thus leading to capital flight. The effects to Kenya and the emerging markets are expected to be benign if the fed rate hike is gradual since the interest rate differential from a small hike may not be attractive enough to incentivize investors to move their capital entirely from the emerging markets. As such in the short term we only anticipate continued pressure on the shilling as a result of the strengthening dollar • We expect the MPC to slightly increase the CBR from the current 8.75% in the medium term to anchor inflation back to the CBK's target range of 2.5%-7.5%	Negative
	Diaspora Remittances	• Diaspora remittances has been improving standing at a cumulative USD 4.0 bn for the year 2022, representing an 8.3% y/y increase from a cumulative USD 3.7 bn recorded in 2021. The improving remittances have continued to cushion the shilling against further depreciation and are attributable to financial innovations that have provided Kenyans in the diaspora more convenient channels to transact,	Neutral

2023 Macroeconomic Outlook – Interest Rates

We expect upward pressure on interest rates due to increased pressure on the government to meet its domestic borrowing target and raise funds for budgetary support

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicator	**Factors**	**2023 Outlook**	**Effect**
Interest Rates	Economic Growth	• In Q3'2022, the Kenyan economy recorded a 4.7% growth, up from the 9.3% contraction recorded in a similar period in 2021, pointing towards continued economic recovery. Consequently, the average GDP growth rate for the 3 quarters in 2022 is a growth of 5.6%, a decline from the 6.9% expansion recorded during a similar period of review in 2021. The average GDP growth rate for 2022 is expected to be 5.1%, a decline from the 7.5% improvement witnessed in 2021 • We project GDP growth for 2023 to continue expanding at a slower pace within a range of 4.8% - 5.2%. GDP growth is expected to be supported by the continued economic recovery, expected rebound in sectors such as Transport, accommodation and agriculture especially with the introduction of farm input subsidies. However, risks abound due to high risk of debt distress, the erratic weather conditions expected to adversely affect the Agricultural sector, which is the largest contributor to Kenya's GDP, elevated inflationary pressures, currency depreciation and restrictive monetary policy	Neutral
	Exchange Rate	• We expect the Shilling to range between Kshs 123.4 and Kshs 113.1 to the USD with a bias to a 6.4% depreciation by the end of the year	Negative
	Inflation	• We expect the annual average inflation rate to fall back within the government's target of 2.5%-7.5% coming in at an average of 6.6% as compared to 7.6% in 2022. We expect the decline in inflation to be driven by an expected cooling in inflation, both globally and locally as the tightened monetary policy continues to take effect. However, the current high global crude oil prices as well as high food prices, will continue putting pressure on the inflation rate in the short term. Additionally, the current administration is keen to phase out consumption subsidies that will see increases in prices of fuel and electricity	Neutral
	Government Borrowing	• On the domestic front, we expect the government to borrow aggressively from the domestic market as it aims to plug in the fiscal deficit, which is projected to come in at Kshs 689.2 bn in the FY'2023/24, 4.3% of the GDP. Domestic debt provides the government with a cheaper source of debt compared to foreign currency-denominated debts that have higher interest rates and have currency risks attached to them. • In our view, the level of foreign borrowing will also increase in 2023 due to; i)Need to service the upcoming maturities such as the 10-year USD 2.0 bn (Kshs 226.0 bn) Eurobond maturing in 2024 with the government having phased out on the two Eurobonds that it had announced to issue by June 2022, and (ii) disbursements from the multilateral loan from IMF as part of the 3-year disbursing program agreed in April 2021.	Negative

2023 Macroeconomic Outlook - GDP

Kenya's economy is expected to register growth between 4.8% - 5.2% in 2023

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicator	**Drivers**	**2028Outlook**	**Effect**
GDP	**Private Sector Credit Growth**	• As of November 2022, the private sector credit growth rate increased by 4.7% to 12.5%, from 7.7% recorded in November 2021 according to CBK. Growth of credit to the private sector is expected to remain strong on the back of existing policy measures, including the MSMEs Credit Guarantee Scheme, and continued economic recovery • Despite the elevated Gross Non-Performing Loans Ratio in Q3'2022, which increased to 13.7%, as compared to 12.0% in Q3'2021, the banks continued to advance credit to the private sector albeit cautiously. Notably, the risk based pricing models, already adopted by majority of commercial banks will see banks offer different rates to clients depending on their risk category to mitigate default risk exposure	Neutral
	Infrastructural Development	• We expect to continue seeing the launching, execution, and completion of more infrastructural developments in 2023 mainly supported by the government's aggressiveness to; i) initiate and implement projects, ii) increase its diplomacy and partnerships in development among neighbouring nations, and, iii) step up on competition for attracting regional and international investors against other countries in Eastern Africa like Tanzania through railway connections and ports infrastructure • However, according to the Draft 2023 Budget Policy Statement, the government's Infrastructure, Energy, and ICT allocations for the FY'2023/2024 are forecast to be Kshs 398.2 bn, representing a 4.4% decline from the Kshs 416.4 bn in FY'2022/2023. The decrease in spending will affect the government's ability to fund new infrastructure projects;	Neutral
	Key Sectors (Agriculture, Manufacturing, Construction, Tourism, Real Estate)	• Despite Agriculture being the largest contributor to the Kenyan GDP, it recorded a decline of 0.6% in Q3'2022, but is expected to witness increased growth in 2023 due to subsidies on farm inputs • Manufacturing sector recorded a slower growth of 2.4% in Q3'2022 compared to a growth of 10.2% in similar period. We expect the sector to continoue expanding in 2023 though at a slower pace as seen in the growth in sugar production . Additionally, we expect the Hospitality sector to continoue registering growth, however, this ill be weighed down by the travel advisory issued by the UK and elevated inflation, currency depreciation • In 2023, we will also expect to see increased GDP output from sectors such as Real Estate and Construction as the government pursues the Affordable housing agenda	Neutral
	Fiscal and Monetary Policy	• In 2022, the MPC increased the MPR by 175.0 bps to 8.75% in a bid to anchor inflation back to CBK's target range of 2.5%-7.25. We expect the government to continoue with its restrictive monetary policy stance in the medium term • We expect the government to continue its fiscal consolidation efforts by aiming to reduce its expenditure through freezing of employment in non-priority sectors and abandonment of stalled projects. With regards to revenue, given that it is an election year, we may see few additional taxes being introduced in the fiscal year 2022/23; with focus instead on widening the tax base and more efficient tax collection measures in order to increase tax revenue	Negative

2023 Macroeconomic Outlook – Investor Sentiment

Investor sentiment is Neutral, but with a negative outlook on stock Eurobond Yields

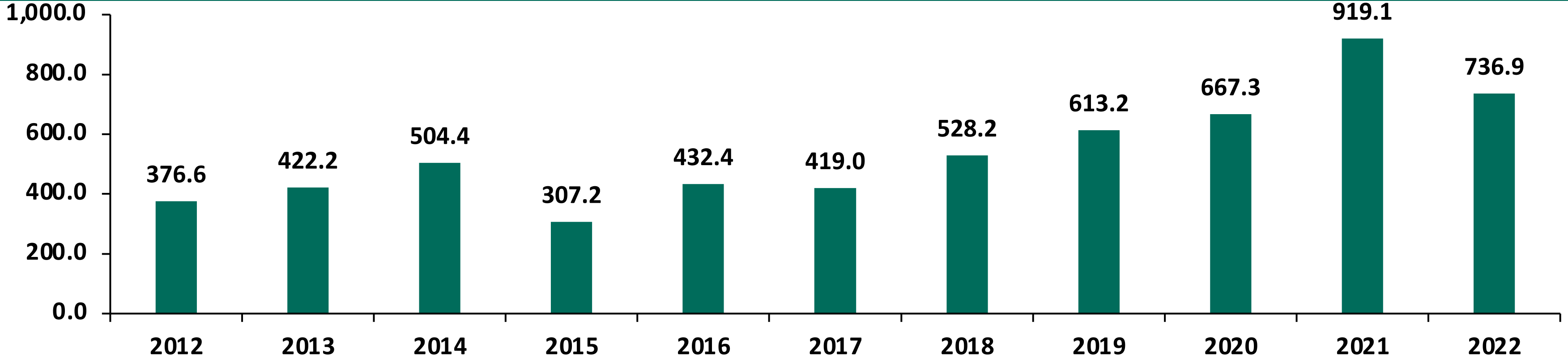
Macro-Economic & Business Environment Outlook			
Macro-Economic Indicator	**Measures**	**2023 Outlook**	**Effect**
Investor Sentiment	Eurobond Yields	• Yields on all Kenyan Eurobonds generally increased in 2022, pointing towards concerns by the investors on the economic status of the country. We can attribute this performance partially to rising inflation rates and declining sentiments • Generally, we expect a slight increase in the yields during the year due to; i) the elevated inflation and increase, ii) High risk of debt distress with Kenya debt service to revenue standing at 51.0% as of December 2022. The country's debt to GDP stood at 62.3% as of October 2023 higher than IMF's threshold of 50.0% for developing economies.	Negative
	Foreign Direct Investment (FDI)	• Kenya is one of the largest recipients of FDI in Africa, with FDI inflows significantly increasing from 2010 up to 2017 at a 7-year CAGR of 34.3% to USD 1.4 bn from USD 0.2 bn • However, according per UNCTAD's World Investment Report 2022, FDI inflows have been on the decline since 2017 decreasing by 71.4% to USD 0.4 bn in 2021 from USD 1.4 bn in 2017, and by 37.5% in 2021 alone, despite Kenya continually doing well on the Ease of Doing Business Reports. It ranked 56 in 2020 and 61 in 2019 from lows of rank 113 in 2015 • However, the peaceful general elections and the recovering economy will improve investor sentiments leading to a potential of more FDIs in Kenya	Neutral
	Stock Market Valuations	• Foreign investors remained net sellers in 2022, with a net outflow of USD 204.3 mn, compared to net outflows of USD 91.9 mn recorded in FY'2021. The foreign-investor outflows during the year can be attributed mainly to increased sell offs by foreign investors as they exited the market and interest rate hike in developed economies such as US making dollar investments to be more appealing. In 2022, the market closed the year with P/E of 6.7x, 42.0 lower than the 11.5% recorded in 2021 and 47.0% below the 12-year historical average of 12.9x. This indicates that there may be pockets of value in the Kenyan equities market • We expect the equities market to register muted foreign investments in 2023attributable to uncertainties in the macro environment attributable to elevated inflation	Neutral
	Currency	• In 2023, the shilling is likely to face continued pressure due to: i) Oil prices which are expected to increase on the back of limited supply, increased demand and political uncertainty in some oil producing regions, and, ii) high debt servicing costs. However, we also expect improved diaspora remittances to support the shilling coupled with sufficient forex reserve	Neutral

III. Fixed Income Market Outlook

Fixed Income Market Outlook

We expect secondary bond market activity and turnover to slightly increase in 2023 due to attractive interest rates and security offered by Government papers

Bond Turnover (Kshs bns)



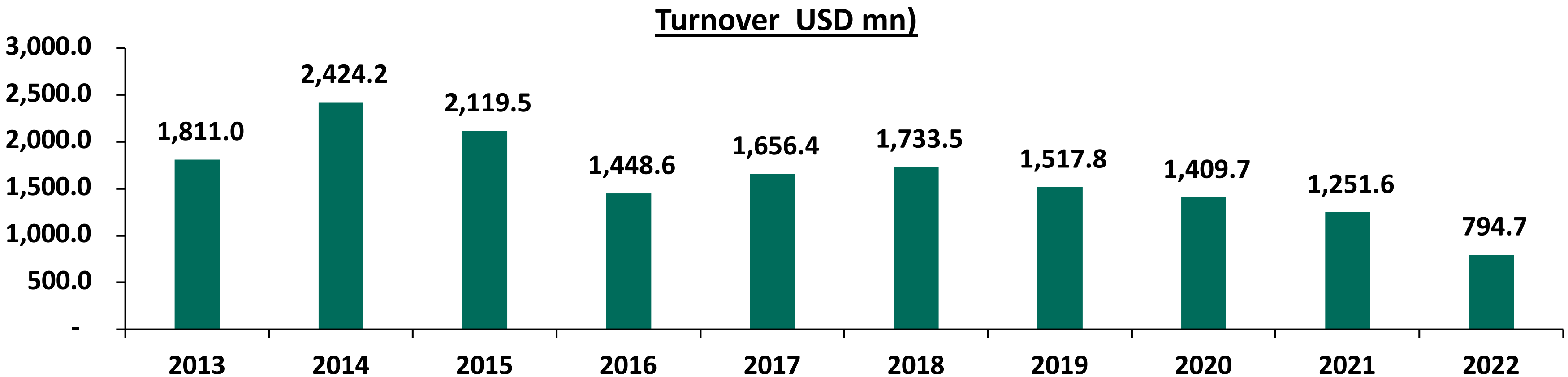
- The secondary bond market recorded reduced activity with the turnover having declined by 19.8% to Kshs 736.9 bn, from Kshs 919.1 bn in 2021. This is attributable to local institutional investors decreasing their allocation to treasury bonds as most of them increased lending to the private sector, higher interest rates in developed countries leading to capital flight by foreign investors and tightened liquidity in the market.
- We expect a slightly reduced appetite for government papers and in turn improved lending to the private sector; we, however, expect high yields offered to the government's papers to continue boosting activity in the secondary market higher as compared to 2021

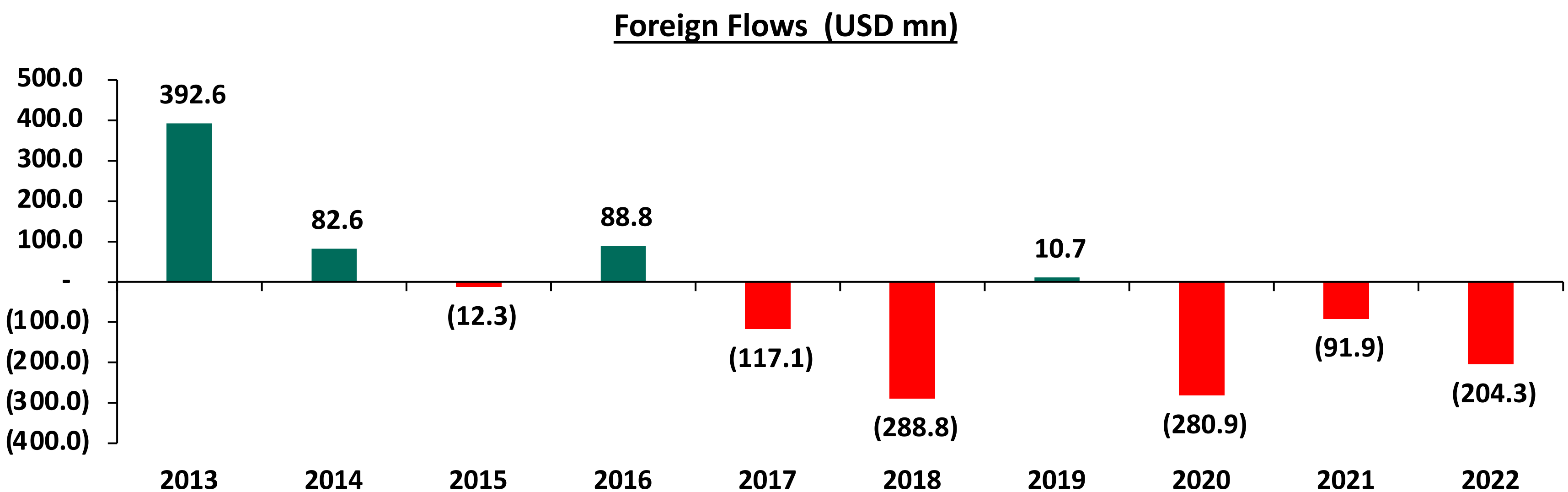
Source- Central Bank of Kenya (CBK)

IV. Kenya Equities Market Outlook

Market Turnover and Foreign Flows

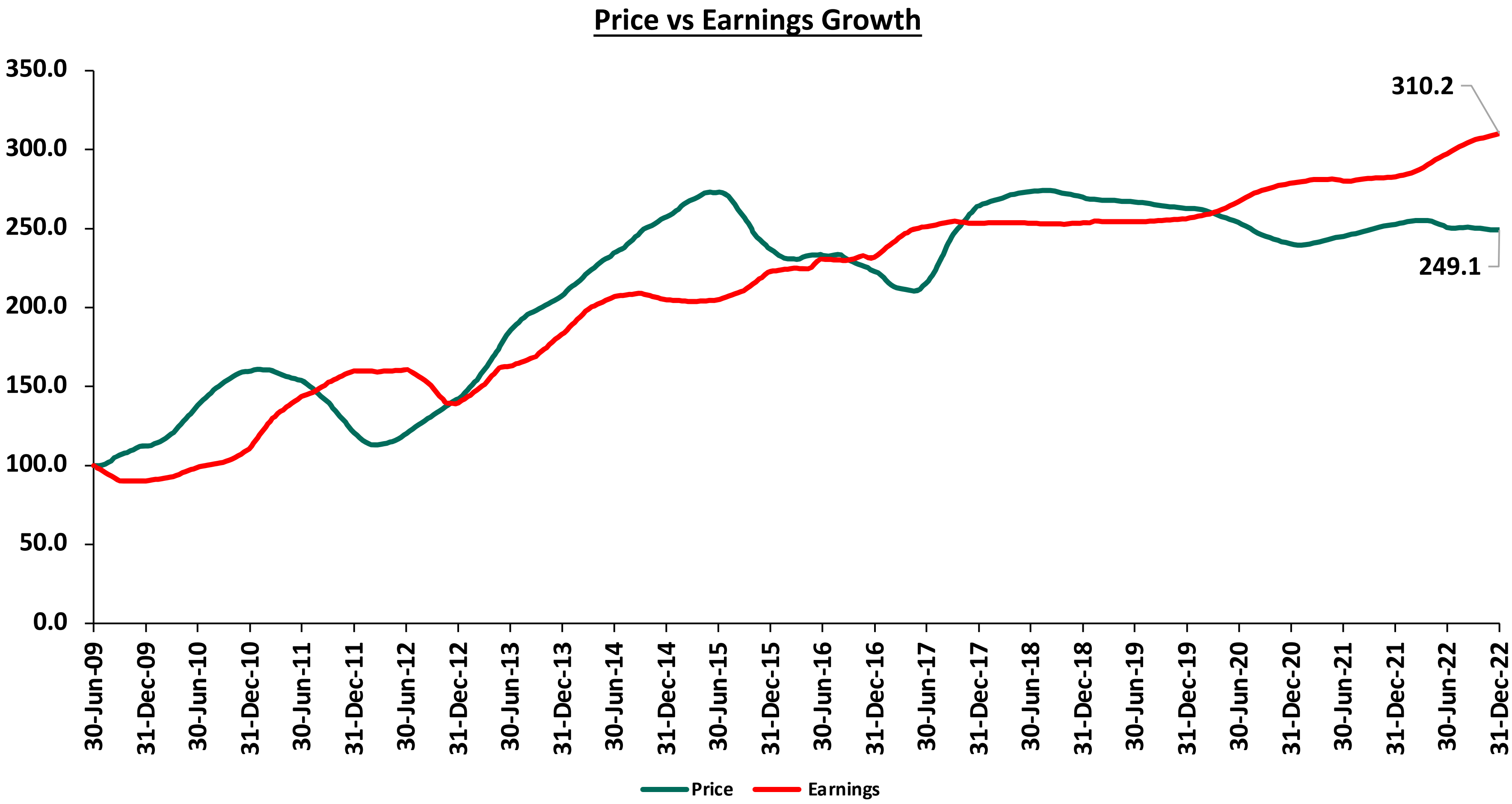
Equity turnover during the year declined by 36.5% to USD 794.7 mn. Foreign investors remained net sellers with a net outflow of USD 204.3 mn





NASI Price vs Earnings Growth

The decline in prices was driven by low investor confidence in 2022 as result macroeconomic performance uncertainties due to high inflation rates



Factors that will affect the Equities Market in 2023

We expect a slight improvement in the listed sector's earnings growth in 2023, largely driven by the continued improvement in the country's business environment

Factor	Effect on Equities Market
Corporate Earnings	• We expect a slight improvement in the listed sector's earnings growth in 2023, largely driven by the continued improvement in the country's business environment • Additionally, the growth in Corporate Earnings is expected to be boosted by the successful expansion of operations into Ethiopian telecommunication industry by Safaricom, which continues to control the largest bourse, with its market cap at 48.3% of the entire bourse as at 27th January 2023. • Further, we anticipate growth in the banking sector's earnings as a result of expected increase in lending with the continued adoption of risk-based lending as well as revenue diversification strategies by banks
Capital Markets Investor Sentiment	• We expect the equities market to register muted foreign interest in 2023, attributable to the uncertainties in the Kenyan macro-economic conditions occasioned by the elevated inflationary pressures • On the flipside, we believe pockets of value still exist in the equities market due to the attractive valuations, with NASI trading 49.5% below its historical average
Interest Rates	• In line with the expectation of a bias towards continued tightening monetary policy in 2023, we expect slight pressure on interest rates. Additionally, increase in the CBR will result in higher yields in the fixed income market, which will in turn make government bonds more attractive compared to equities. • In the short term, Inflation is expected to remain above the target range driven by the high fuel prices even as the government plan to fully do away with subsidy program. Key risks also remain the erratic weather conditions that have reduced agricultural output
Diversification of Capital Markets and New Listings	• We expect a number of activities to be undertaken by NSE in 2023 including i. Increasing the number of Single Stock Futures traded on the derivative market. Currently, the bourse offers 6 Single Stock Futures, and, ii. Additionally, we expect increased listing with the current administration in September 2022 announcing a target of 10 listings in one year

V. Real Estate Market Outlook

2023 Residential Sector Outlook (Demand)

Of the five factors we track on the residential demand, two are positive, two are neutral and one is negative, thus our outlook for demand in 2023 is neutral with a bias on the positive

Metric	2023 Outlook	Effect
Demographics	• Kenya has relatively high urbanization and population growth rates averaging 3.7% and 1.9% compared to the global averages of 1.6% and 0.9%, respectively, according to the World Bank as of 2021. This will continue to provide sustained demand for more housing units in the country	**Positive**
Infrastructure	• In 2023, we expect to see completion of various infrastructural activities thus opening up areas for investment, with the government having set aside Kshs 416.4 bn in FY'2022/23 for infrastructural development, an 8.6% increase from Kshs 383.3 bn allocation in FY'2021/22 according to the FY'2022/23 Budget Statement. With the ongoing construction of the Lamu Port-South Sudan-Ethiopia-Transport Corridor, Navaisha-Kisumu Standard Gauge Railway, Kenol-Marua Highway, Lamu-Garissa Highway, Dongo-Kundu Bypass, Eldoret Southern Bypass, Nairobi Railway Commuter Transport System, and Ngong-Suswa Highway, we expect increased investments thereby boosting residential sector activity	**Positive**
Investor Returns	• In 2022, the residential sector recorded an improvement in investor returns to 6.2%, from 6.1% in 2021 owing to increased selling prices and rents which came in at Kshs 119,609 and Kshs 540, respectively, from Kshs 119,494 and Kshs 508, respectively, recorded in 2021 • We expect investors to focus on lower satellite towns which offer relatively affordable land and relatively high total returns for detached houses, which came in at 6.0% in 2022, 0.2% points higher than the detached market average of 5.8%. Apartments in satellite towns recorded an average return of 6.9%, 0.7% points higher than the apartments market average of 6.2%	**Neutral**

2023 Residential Sector Outlook (Demand), cont'd…

Of the five factors we track on the residential demand, two are positive, two are neutral and one is negative, thus our outlook for demand in 2023 is neutral with a bias on the positive

Metric	2023 Outlook	Effect
Purchasing Power	• The reduced purchasing power among buyers amid the tough economic environment brought about by inflationary pressure on the back of a weakened shilling against the dollar is expected to further hamper the purchasing power of buyers. This is as prices of essential items continue to soar, thereby leading to slow uptakes of residential units consequently affecting the residential performance. However, we expect the growing middle class to pivot demand for residential units	Negative
Access to Credit	• The provision of affordable mortgage loans through Kenya Mortgage Refinance Company (KMRC), is expected to drive growth of the local mortgage market and increase home ownership • The approval of bond programs by the capital markets, such as the KMRC's Medium Term Note (MTN) program which aimed to raise a total of Kshs 1.4 bn in the first tranche, and received bids worth Kshs 8.1 bn, recording an oversubscription of 478.6% is expected to boost the sector • However, it is not clear to the public how KMRC will sustain the lower borrowing rates once it exhausts the funding that was contributed by the original shareholders. A 20-year government bond currently costs about 14.0% whereas KMRC's last corporate bond raised in the market cost 12.5% in 2022, hence deeming clarity on how KMRC can sustainably fund mortgages at 9.0% with its cost of capital at 12.5%	Neutral

2023 Residential Sector Outlook (Supply)

Of the five factors we expect to affect residential supply, two are positive, two are neutral, and one is negative, thus our outlook for supply this year is neutral with a bias to positive

Metric	2023 Outlook	Effect
Developer Returns	• In 2022, the residential market recorded a 0.1% marginal drop in uptake averaging 14.7% from 16.2% in 2021, and a capital appreciation of 1.1%. Average occupancy rate declined to 86.7% in 2022 from 86.9% recorded in 2021, while the average rental yields recorded a 0.3% marginal increase from 4.8% recorded in 2021 to 5.1% realized in 2022 • We also note that the satellite town submarkets recorded relatively high returns of up to 6.9%. Developers in 2023 are likely to invest in satellite towns that offer relatively high returns. However, they may exercise a conservative approach in 2023 due to increasing construction costs	Neutral
Access to Financing	• Developers face difficulty in the access of funding owing to Kenya's under developed capital markets given that there exists only one listed REIT in the country since inception of the investment regime in 2013. Due to this, most property developers rely on conventional sources of funding such as banks which make up 99.0%, compared to other developed countries at 60.0% • Given that bank lending rates continue rising, we expect developers in 2023 going forward to look towards alternative financing options such as off-plan development pre-sales, equity financing, Public-Private Partnerships (PPPs). These will supplement to solutions such as the National Housing Development Fund (NHDF) in a bid to answer the government's call to reduce the housing deficit though affordable housing	Neutral
Development Costs	• Rising cost of construction costs to developers on the back of inflationary pressure are expected to further subdue optimum construction activities in 2023. The Construction Sector grew by 4.3% in the third quarter of 2022, 2.4% points lower than the 6.7% growth recorded in Q3'2021. The performance was also a 1.5% points q/q decline, from the 5.8% growth recorded in Q2'2022. The trend is expected to continue in 2023 thereby subduing the residential sector	Negative

2023 Residential Sector Outlook (Supply), cont'd…

Of the five factors we expect to affect residential supply, two are positive, two are neutral, and one is negative, thus our outlook for supply this year is neutral with a bias to positive

Metric	2023 Outlook	Effect
Infrastructure	• According to the Draft 2023 Budget Policy Statement, the government's infrastructure, energy, and ICT allocations for the FY'2023/2024 are forecast to be Kshs 398.2 bn, representing a 4.4% decline from the Kshs 416.4 bn in FY'2022/2023. This reduction in spending is a result of the current government placing importance on finishing already stalled projects from the previous administration and being reluctant to start costly new initiatives. The decline in government spending may reduce construction of new roads, bridges, and other support services that are essential for the development of housing, thereby subduing the sector. However, we expect alternative solutions such as PPPs to allow the implementation of infrastructural projects thereby driving the sector	**Positive**
Government Incentives	• The government has made efforts to increase the supply of housing which is currently curtailed by a deficit of 2.0mn units. These include; i) availing land to county governments for the construction of affordable housing units, ii) exemption of VAT on importation and local purchase of goods for the construction of houses under the affordable housing scheme, iii) lower corporate tax rate to 15.0% for developers of over 100 units, iv) exemption from 4.0% (urban areas) and 2.0% (rural areas) stamp duty for first time buyers of houses under the affordable housing scheme, and, vi) tax relief of 15.0% of savings to drive contributions towards home ownership. These are expected to cushion the state incentive to provide affordable housing to Kenyans	**Positive**

2023 Residential Sector Outlook, cont'd…

Our outlook on residential sector performance in 2023 remains NEUTRAL

Residential Sector Performance Review and Outlook			
Theme	**2022 Performance**	**2023 Outlook**	**Outlook**
Residential Sector	• The NMA residential sector recorded improvement in performance in 2022 with the average total return to investors coming at 6.2%, a 0.1%-points increase from the 6.1% recorded in 2021, attributable to average rental yield of 5.1% and y/y appreciation of 1.1% in 2022. • Rental yields recorded an increase by 0.5% points to 4.7% in 2022 from the 4.3% recorded in 2021, majorly driven by increase in selling and rental prices to Kshs 137,970 and Kshs 549, respectively, from Kshs 136,031 and Kshs 505, respectively in 2021	• The demand for housing is expected to continue growing on the back of Kenya's attractive demographic profile. In addition, continued infrastructural development, the ongoing focus by the government and private sector to provide housing, and, the drive by the KMRC to avail affordable mortgage facilities to potential home buyers are expected to cushion the performance of the residential sector. However, we expect the prevailing inflationary pressure coupled with a weakened shilling, high construction costs, and the low penetration of mortgages in the country to continue impeding the performance of the sector • For detached units, investment opportunity lies in areas such as Ruiru, Juja, and Ngong, while for apartments, investment opportunity lies in Ruaka, Waiyaki Way, and Ruiru due to their remarkable returns driven by relatively high returns to investors	**Neutral**

Our outlook for the residential sector is NEUTRAL. On the supply side, our outlook is neutral, as we expect the government and private sector's focus on affordable housing to support supply of residential units, boosted by infrastructural development and positive demographics in the country. On the demand side, our outlook is neutral, due to the expected tough economic environment with reduced consumer spending. Investment opportunities lie in areas that continue to exhibit growing demand from homebuyers such as satellite towns offering investors attractive returns and relatively high uptake rates.

2023 Commercial Office Sector Outlook

We expect space absorption rates to improve attributed to reduced developments in the pipeline

Summary of Commercial Office Returns in Nairobi Metropolitan Area (NMA) Over Time											
Year	**FY'16**	**FY'17**	**FY'18**	**FY'19**	**FY'20**	**FY'21**	**FY'22**	**Forecasted Annualized Change**	**2023F**	**Reason for Forecast**	**Outlook**
Occupancy (%)	88.0%	82.6%	83.3%	80.2%	77.7%	77.6%	79.4%	**0.9% points**	**80.3%**	We expect the occupancy rates to improve slightly by 0.9% points mainly attributed to resumption of working from office policies by most companies and reduced developments expected to enter the market in 2023. This we expect will boost absorption rates, potentially increasing occupancy rates	**Positive**
Asking Rents (Kshs/Sqft)	103	101	101	96	93	94	96	**1.6%**	**98**	We forecast a 1.6% increase in asking rents in FY'2023 owing to an expected increased supply of prime offices fetching higher rents such as the CCI HQ in Tatu City scheduled to enter the market in Q4'2023, among other spaces such as GTC and Karen Green	**Positive**
Average Prices (Kshs/Sqft)	13,003	12,649	12,573	12,638	12,280	12,106	12,223	**(0.2%)**	**12,194**	Asking prices are expected to realize a 0.2% decline as a result of the gaining traction in co-working spaces which offer an alternative to buying office space, flexibility and cost effectiveness. Furthermore, forecasted prolonged tough economic conditions such as rising inflation may negatively affect demand for office space as businesses may decide to downsize in order to cut costs	**Negative**
Average Rental Yields (%)	8.4%	7.9%	8.1%	7.5%	7.0%	7.3%	7.6%	**0.1% Points**	**7.7%**	We expect the yields to realize a slight improvement of 0.1% points attributed to the expected improvements in the overall occupancies and rental rates. However, existing oversupply of 6.7 mn continues to pose a challenge to sector's optimum performance	**Positive**

2023 Commercial Office Sector Outlook, cont….

We retain a NEUTRAL outlook as we expect sector performance to be cushioned by improved occupancy rates and asking rents, and subdued by the existing oversupply of 6.7 mn SQFT

Commercial Office Performance Review and Outlook			
Theme	**2022 Performance**	**2023 Outlook**	**Outlook**
Commercial Office Sector	• In FY'2022, the commercial office sector recorded an improvement with the general average rental yield coming in at 7.6% from 7.3% recorded in FY'2021, due to improved occupancy and rental rates of 1.8% and 2.1% respectively • The improvement in performance was mainly driven by increased supply of Grade A offices fetching higher rents such as Karen Green and Global Trade Centre (GTC) Office Tower, coupled with a slow but rising demand for physical space on the back of various firms such as Call Centre International (CCI) Group and Nairobi Garage expansion strategies and most businesses resuming full operations hence boosting occupancy rates	• We expect the yields to realize a slight improvement of 0.1% points attributed to the expected improvements in the overall occupancies and rental rates respectively, towards pre pandemic era levels. This we expect will be facilitated by i) gaining traction in co-working spaces, ii) slow but rising expansion in the sector, and, iii) reduced developments in the pipeline which we expect will help curb the oversupply challenge by allowing room for the absorption of available and fewer incoming spaces. Key to note, we expect yields increase in 2023 to be lower at 0.1% points compared to the 0.3% points increase realized in both 2021 and 2022, on the back of the sector recovering from COVID-19 disruptions during this period • However, we expect the overall performance to be subdued by the existing oversupply of office space in the NMA at 6.7 mn SQFT thereby crippling the overall demand for physical space • Investment opportunity lies in Gigiri, Westlands, and Karen which continue to record high returns at 8.6%, 8.1%, and, 7.7%, respectively, compared to the market average of 7.3%	**Neutral**
Our overall outlook for the NMA commercial office sector is NEUTRAL owing to reduced developments in the pipeline, coupled with the slow but rising expansion in the sector, we expect that this will help curb the oversupply challenge by allowing room for the absorption of available and fewer incoming spaces. Conversely, the existing oversupply of office spaces at 6.7 mn SQFT in the NMA thereby crippling the overall demand for physical space			

2023 Retail Sector Outlook

We expect retail space supply to increase to 8.9 mn SQFT in 2023 due to new developments

	Cytonn Report: Nairobi Metropolitan Area (NMA) Retail Sector Performance 2016-2023F										
Item	**FY'16**	**FY'17**	**FY' 18**	**FY'19**	**FY'20**	**FY'21**	**FY'22**	**Forecasted Annualized Change**	**2023F**	**Reason for Forecast**	**Outlook**
Asking Rents (Kshs/SQFT)	187	185	178	176	169	170	174	**1.5%**	**177**	We expect asking rents to increase by 1.5% mainly attributed to the improved business environment in post election period and continuous recovery of the economy towards pre-COVID-19 levels. Additionally, most prime retail spaces in Kilimani, Karen and Westlands fetching rents in dollars will continue to increase upon conversion to Kenyan shilling due to the ongoing depreciating Kenyan shilling against the dollar	**Positive**
Supply in Nairobi (mn SQFT)	5.9	6.2	6.5	7.3	7.3	7.3	8.2	**8.1%**	**8.9**	We expect retail space supply to increase to 8.9 mn per SQFT in 2023 as result of major incoming developments such as the completion and ready for occupation of phase 1 of BBS Mall in Eastleigh Nairobi County and opening of Crystal Rivers Mall in Athi River Machakos County, among others	**Positive**
Occupancy (%)	89.3%	80.3%	79.8%	75.9%	75.2%	76.8%	77.6%	**(0.5%) Points**	**77.1%**	The existing oversupply at 3.0 mn SQFT, increasing rental charges on retail properties, tougher economic environment attributed by upward adjustment of taxes on goods and businesses and MPC rates by current government coupled with increased popularity and adoption of e-commerce might cause businesses to downsize their spaces for operations or exercise a conservative approach in their expansion activities which will weigh down on occupation of physical spaces in the formal retail sector. However, on a positive side, we continue to expect expansion and new entries of more local and international retailers in the market amid increased operations and taking advantage of the gap existing in new regions, in turn affecting the occupier demand	**Neutral**

2023 Retail Sector Outlook

We expect slight decrease in rental yields by 0.1% due to increased rental charges and continuous expansion of retailers but underpinned by existing oversupply affecting occupancy rates

Average Rental Yields	10.0%	9.6%	9.0%	7.8%	7.5%	7.8%	7.9%	**0.2% Points**	**8.1%**	We expect a slight increase in rental yields by 0.1% points as a result of increased rental charges of retail spaces and demand for existing supply amid the aggressive expansion by retailers taking up new and previously occupied spaces, infrastructure developments opening areas for investments, and positive demographics. However oversupply, increased adoption of e-commerce, tougher economic environment for businesses, and presence of informal retail spaces are expected to undermine the performance of the sector in turn affecting rental yields of the sector	**Neutral**

2023 Retail Sector Outlook, cont….

We have a NEUTRAL outlook for the sector with performance expected to be cushioned by continuous expansion campaign of both local and foreign retailers

Cytonn Report: Retail Performance Review and Outlook			
Theme	**2022 Performance**	**2023 Outlook**	**Outlook**
Retail Sector	• The sector recorded a 0.1% points increase in average rental yields to 7.9%, from 7.8% in 2020. Average rents and occupancies also increased by 2.4% and 0.8% points to Kshs 174 per SQFT and 76.8%, respectively, • The improved performance was due to; i) an increased presence of quality retail spaces which attract high rents such as the Global Trade Centre (GTC) in Westlands., ii) aggressive expansion by local and international retailers, iii) increased infrastructure developments promoting accessibility to retail centres, and, iv) positive demographics facilitating demand for spaces, goods and services	• We expect a slight increase in the rental yields by 0.1% as a result of increased occupancy rates and rental charges of retail spaces of the existing supply amid the aggressive expansion by retailers taking up new and previously occupied spaces, infrastructure developments opening areas for investments, and positive demographics. However oversupply, increased adoption of e-commerce and presence of informal retail spaces are expected to undermine the performance of the sector in turn affecting rental yields of the sector • Investment opportunity lies in areas such as Westlands, Karen and Kilimani which continue to record impressive returns. This is in addition to the undersupplied regions of the country such as Mount Kenya, Western and the Coast	**Neutral**

we have a NEUTRAL outlook on the retail sector's performance which is expected to be driven by the continuous aggressive expansion by both local and foreign retailers, continuous developments of public infrastructure boosting accessibility in new areas for investments, and positive demographics facilitating increasing demand. However, the slow growth in the sector is expected to be facilitated by some negative factors such as; i) oversupply currently at 1.7 mn SQFT in the Kenyan retail sector and 3.0 mn SQFT in the NMA retail sector, ii) growing adoption of e-commerce by most retailers which continues to undermine occupier demand, and, iii) limited access to financing for developments, expansion and improvement in operations towards technological levels by small and medium-sized enterprises

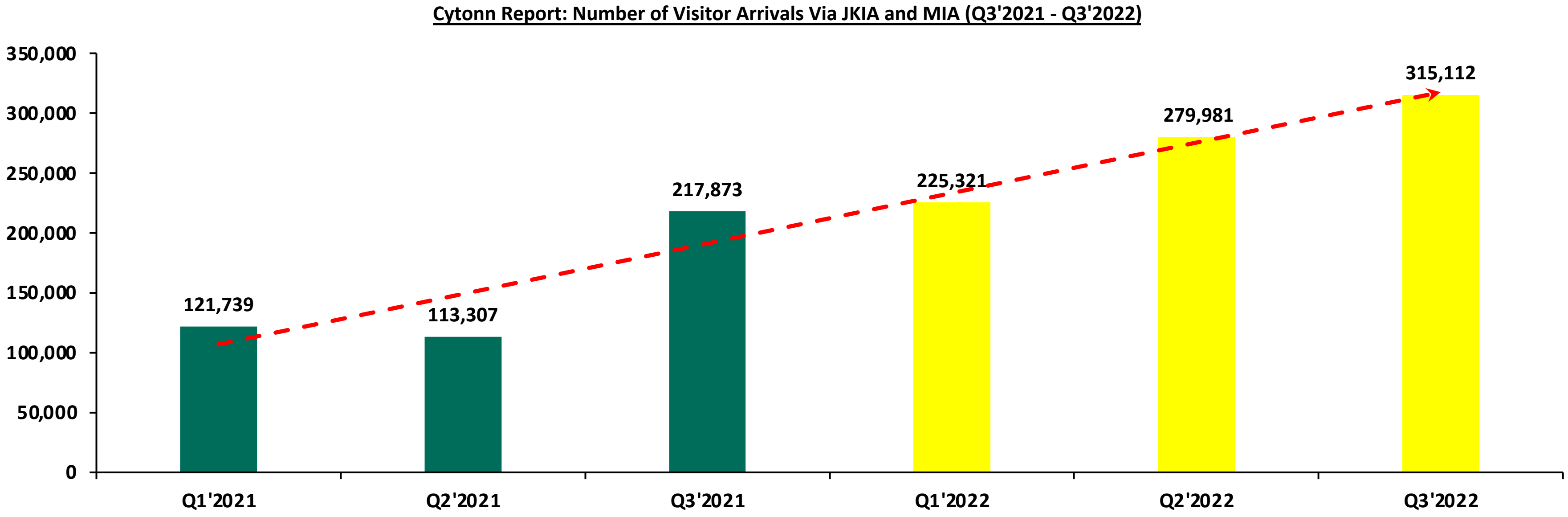
2023 Hospitality Sector Outlook

Domestic tourism is among the key 9 initiatives of the Tourism Strategy 2021 – 2025

- In 2022, the number of international tourist arrivals into the country, the number of hotels in operation, bed occupancies and hotel bookings all increased, demonstrating the sector's sustained progress towards its recovery path, according to the Leading Economic Indicators (LEI) October 2022 report and Central Bank of Kenya.
- Overall, serviced apartments' year on year (y/y) performance improved, with occupancy rates increasing by 4.3% points to 65.8%, from 61.5% recorded in 2021. Monthly charges per SQM increased by 6.6% to Kshs 2,716 in 2022, from Kshs 2,549 recorded in 2021. Additionally, average rental yields increased by 0.7% points to 6.2% in 2022, from 5.5% recorded in 2021
- We expect the performance of the hospitality sector in 2023 to be cushioned by: i) Intensive marketing of Kenya's tourism market which will improve tourist arrivals, ii) sustained sector recovery, iii) mass vaccinations, iv) positive accolades according Kenya's tourism industry international recognition, v) hospitality sector support events, vi) increased promotion of local tourism promoted by the Ministry of Tourism under its Tourism Strategy 2021-2025, which highlights domestic tourism as one of the key nine initiatives it intends to promote under the program, and vi) improved security
- However, factors such as: i) newly issued travel advisory by the UK government, ii) government's directive to indefinitely suspend hotel meetings, conferences and trainings, iii) financing difficulties, iv) projected reduced investments within the hospitality industry due to increased associated costs, attributable to the increase in capital gains tax to weigh down the optimum performance of the sector in 2023

2023 Hospitality Sector Outlook cont….

Expected increased international arrivals to be among the key factors that will cushion the hospitality sector in 2023



Source Kenya National Bureau of Statistics (KNBS)

- In 2022, international tourist arrivals into the country improved evidenced by a 44.6% Year-on-Year (y/y) increase in the number of international arrivals through Jomo Kenyatta International Airport (JKIA) and Moi International Airport (MIA) in Q3’2022 to 315,112, from the 217,873 recorded in Q3’2021 according to the LEI October 2022 report
- This was attributed to the intensive marketing of Kenya’s tourism market through an ambitious marketing plan formulated by the Ministry of Tourism in conjunction with the Kenya Tourism Board that is currently ongoing under the ‘Real Deal Kenya’ slogan. We anticipate a further increase in international arrivals as a result of the marketing initiative

2023 Hospitality Sector Outlook, cont'd…

Sector investment opportunities in 2023 lie in Westlands, Kilimani and Kileleshwa/Lavington

Theme	2022 Performance	2023 Outlook	Effect
Hospitality Sector	• In 2022, serviced apartments' year on year (y/y) performance improved, with occupancy rates increasing by 4.3% points to 65.8%, from 61.5% recorded in 2021. Monthly charges per SQM increased by 6.6% to Kshs 2,716 in 2022, from Kshs 2,549 recorded in 2021. Additionally, average rental yields increased by 0.7% points to 6.2% in 2022, from 5.5% recorded in 2021 • The sector's overall performance improved attributable to increasing number of hotels in operation, hotel bookings and bed occupancies during the year, in addition to aggressive local and international marketing of Kenya's tourism industry	• We expect the sector to be on an upward trajectory in following the ambitious international marketing of Kenya to key tourism markets, positive accolades, sustained sector recovery, anticipated increase in international arrivals, mass vaccinations, increased promotion of local tourism and improved security. However, newly issued travel advisory by the UK government, government's directive to indefinitely suspend hotel meetings, conferences and trainings, financing difficulties, projected reduced investments within the hospitality industry due to increased associated costs attributable to the increase in capital gains tax and existing inflationary pressures on the back of a depreciating currency to weigh down sector performance • Investment opportunity lies in Westlands, Kilimani and Kileleshwa/Lavington which recorded average rental yields of 9.3%, 7.2% and 6.6%, respectively against a market average of 6.2% in 2022. This attributed to proximity to the CBD, presence of high quality serviced apartments which attract premium rates, accessibility, and proximity to international organization which drive the demand for serviced apartments in the nodes	**Neutral**

- ***Our outlook for the hospitality sector is NEUTRAL. We expect the sector to continue registering improved performance moving forward in terms of overall hotels in operations, hotel bookings, and hotel occupancies. However, we anticipate the above mentioned factors to weigh down sector performance***

2023 Land Sector Outlook

We expect land in satellite towns will record the highest annual capital appreciations in 2023

All Prices in Kshs (mn) Unless Stated Otherwise											
Nairobi Metropolitan Area Land Performance Trend											
Location	Price in 2017	Price in 2018	Price in 2019	Price in 2020	Price in 2021	Price in 2022	YoY Year CAGR	Averages	Increase (Kshs)	2023F	Annual Capital Appreciation 2023 F
Unserviced land- Satellite Towns	20.4	22.7	24.9	12.7	13.5	15.1	-5.8%	9.8%	1.5	16.6	**9.8%**
Serviced land- Satellite Towns	14.4	14.3	14.3	14.8	16.4	17.8	4.3%	4.4%	0.8	18.6	**4.2%**
Nairobi High End Suburbs- Low and High Rise Residential Areas	120.4	124.7	127.2	126.8	130.3	137.4	2.7%	2.7%	3.7	141.0	**2.6%**
Nairobi Middle End Suburbs- High Rise Residential Areas	77.6	77.8	81.7	83.6	83.0	80.9	0.8%	0.9%	0.7	81.5	**0.8%**
Nairobi Suburbs - Commercial Areas	429.8	447.3	428.5	413	410.8	403.4	-1.3%	-1.2%	-5.1	398.3	**(1.3%)**
Average	**132.5**	**137.4**	**135.3**	**130.2**	**130.8**	**130.9**	**0.1%**		**0.3**	**131.2**	**3.2%**

- High land prices coupled with limited supply of land within Nairobi have prompted investors to shift their investments to satellite towns owing to their affordability
- Land in these areas is relatively affordable recording average selling prices per acre at Kshs 16.5 mn, compared to the market average of Kshs 131.0 mn in FY'2022. This has created demand for land in satellite towns which we expect will persist thus driving land prices up. As such, we expect land in satellite towns will record the highest annual capital appreciations in 2023 at 9.8% and 4.2% for unserviced and serviced schemes respectively
- We expect land prices in NMA Suburbs Commercial Areas will realize a 1.3% decline attributed to shifted demand to land in satellite towns

2023 Land Sector Outlook, cont….

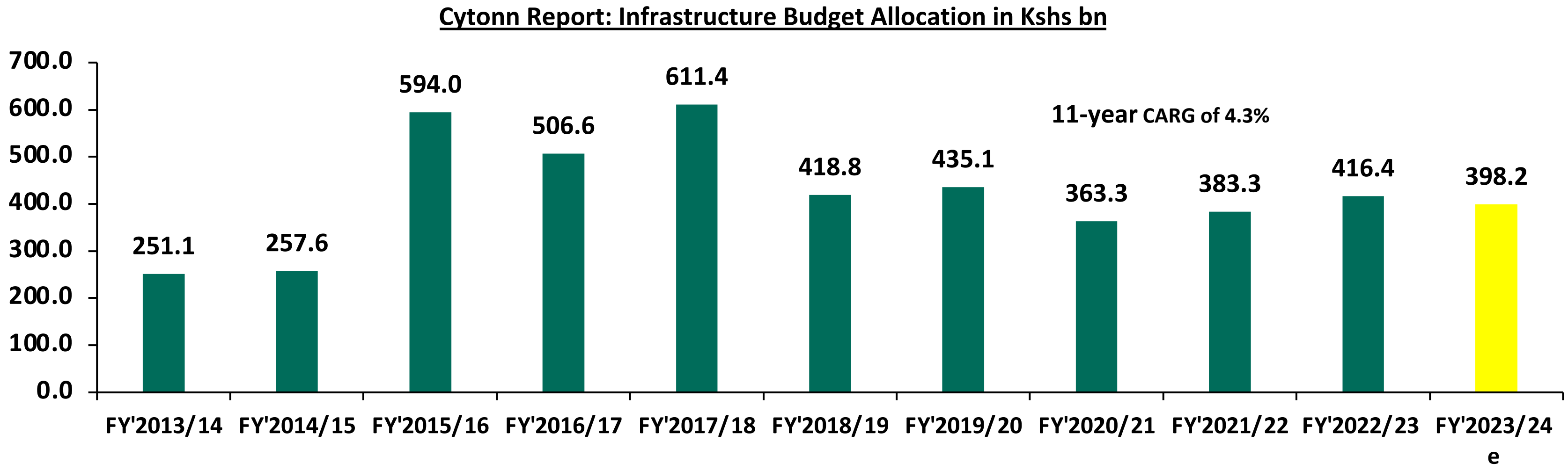
We retain a POSITIVE outlook for the the NMA land sector which continues to establish itself as a reliable investment opportunity, displaying great resilience

Sector	2022 Performance	2023 Outlook	Outlook
Land Sector	• The Nairobi Metropolitan Area (NMA) land sector recorded an average annualized capital appreciation of 4.3% in FY'2022, • The overall asking prices for Unserviced and serviced land in the satellite towns of the NMA recorded the highest average capital appreciations of 11.1% and 8.0%, which is 6.8% and 3.7% points higher than the market average of 4.3% • This was mainly attributed to an increased demand resulting from their affordability, having recorded average selling prices per acre at Kshs 16.5 mn, compared to the market average of Kshs 131.0 mn in FY'2022, and increased infrastructure developments enhancing accessibility to these areas	• In 2023, we expect the performance of the sector to remain positive, with an expected annual capital appreciation of 3.2%, supported by; i) the completion of major infrastructure projects, ii) rising demand for development land in satellite towns, iii) increasing demand for land on the back of Kenya's positive demographics, and, iv) tax policies such as increased property rates in some counties which might provoke landowners and landlords to demand higher land prices and rents, in efforts to recover additional costs incurred from higher rates set to be charged. However, it is worth noting that various factors may impede optimum performance of the sector in 2023 including; i) increased Capital Gains Tax (CGT), ii) relatively high land costs in certain areas such as the NMA commercial zones, and, iii) lengthy land transaction processes discouraging investments • The investment opportunity lies satellite towns; Juja, Utawala and Limuru for unserviced land, which recorded annualized capital appreciations of 16.6%, 14.8% and 13.4%, respectively, in FY'2022 compared to the market average of 11.1%. For serviced land, investment opportunity lies in Syokimau and Ruiru-Juja which recorded the highest annualized capital appreciations at 19.2% and 13.0%, respectively against the serviced average of 8.0%	**Positive**

We retain a NEUTRAL outlook for the Nairobi Metropolitan Area land sector as we expect sector performance to continue improving in terms of international arrivals, bed occupancies, and hotel bookings. However, various factors such as lengthy land processes, high land costs in select areas and increased property taxes may deter optimum performance of the sector

2023 Infrastructure Sector Outlook

Budget allocation for the infrastructure sector increased by 8.6% to Kshs 416.4 bn in FY’2022/23 from Kshs 383.3 bn allocation in FY’ 2022/23



- In the FY’2022/2023, infrastructure expenditure saw an increase of 8.6%, totaling Kshs 416.4 billion from Kshs 383.3 bn in FY’2021/2022. This increase aligns with the government's efforts to enhance critical infrastructure in the road, rail, energy, and water sectors, with the aim of improving transportation, lowering business costs, increasing access to amenities, and boosting Kenya's competitiveness on the global stage
- The entry of the Democratic Republic of Congo (DRC) into East African Community (EAC) in April 2022 has made the region more attractive to businesses. Key infrastructural nodes such as major road highways, oil pipelines and depots, airports and the port, have been targeted to be a boost for Kenya becoming an economic powerhouse in the region

2023 Infrastructure Sector Outlook, cont….

It is evident that infrastructural development remains among the top priorities for the government

Cytonn Report: Sectoral Budget Allocation of Development Expenditure for the Past Five Years (Kshs bn)							
Item	FY'2018/2019	FY'2019/2020	FY'2020/2021	FY'2021/2022	FY'2022/2023	y/y Change	5-Year CAGR
Interest Payments, pensions & Net Lending	493.0	553.3	586.5	718.3	869.3	21.0%	12.0%
Education	444.1	494.8	505.1	503.9	544.4	8.0%	4.2%
Infrastructure, Energy and ICT	418.8	435.1	363.3	383.3	416.4	8.6%	(0.1%)
County shareable Revenue	314.0	310.0	316.5	370.0	370.0	0.0%	3.3%
Public Admin & Int. Relations	270.1	298.9	289.3	299.7	342.2	14.2%	4.8%

- From the table above, it is evident that infrastructural development remains among the top priorities for the government, as it consistently accounts for the largest portion of development expenditure
- However, the government is still experiencing financial shortfall in its expenditure budget and hence financing some of the projects will be capital-intensive and higher-risk. Therefore, the government has been adopting various sources of financing the infrastructure budget such as;

2023 Infrastructure Sector Outlook, cont….

The government has indulged in adoption of various alternatives to fund the infrastructural budget such as Issuing of Infrastructure bonds, grants, loan and Joint Ventures

i) **Public-Private Partnerships with local and foreign private firms** like China Roads and Bridges Corporation in construction of Phase 2A of Standard Gauge Railway from Naivasha to Kisumu,

ii) **Issuing of Infrastructure bonds:** The government through the National Treasury has so far floated several infrastructure bond in FY'2022/2023 such as IFB1/2022/14 valued at Kshs 60.0 bn, a subsequent tap sale of Kshs 5.0 bn, a switch auction of three treasury bills issues No. 2494/091, 2454/182 and 2380/364, and T-Bond issue No. FXD1/2021/2 to an infrastructure bond issue No. IFB1/2022/6, and a subsequent tap sale of Kshs 20.0 bn,

iii) **Concessional loans from multilateral organizations** such as World Bank, International Monetary Fund, Japan International Cooperation Agency, Africa Development Bank Group, International Finance Corporation, Export-Import Bank of the United States (Ex-Im Bank) and many more,

iv) **Grants and loans from foreign countries** like United States of America (Dualling of Nairobi-Mombasa and Nairobi-Nakuru Highways), United Kingdoms (Nairobi Railway City), South Korean (Konza Metropolis City), Chinese governments, and many more, and,

v) **Joint ventures with several parastatals and agencies**: the government is in joint venture with Kenya Ports Authority and JICA in construction of Dongo-Kundu Special Economic Zone which includes the Dongo-Kundu Bypass

2023 Infrastructure Sector Outlook, cont….

We expect a 4.4% decrease in the budget allocation for the infrastructure sector to Kshs 398.2 bn in FY'2023/24 from Kshs 416.4 bn allocation in FY' 2022/23

- According to Draft 2023 Budget Policy Statement, the allocation to Infrastructure, Energy and Information and Technology (ICT) is projected at Kshs 398.2 bn in FY'2023/2024, a decrease of 4.4% from FY'2022/2023. The decline in expenditure is attribute to the current government focusing on completion of stalled projects from the previous regime and shying away from commencing new projects which will be more expensive for the government. This puts into consideration the continuous global inflationary pressures, weakening of the Kenyan Shilling against the Dollar, and high energy and fuel prices negatively impacting the economy. Additionally, President Ruto's decision to decrease funding for infrastructural development demonstrates a divergence from the former President Uhuru Kenyatta's focus on high-level infrastructure projects across the country during his last tenure
- This decision clearly places a different approach and emphasis on development in the current tenure. Focusing on the economic recovery of the nation, President Ruto has devoted his attention to mobilization financing for the social development, digital transformation, creative industry growth, agriculture modernisation and the enhancement of Micro, Small and Medium Enterprises. Emphasizing their significance to achieve inclusive expansion, the government has pinpointed these sectors as the most crucial needs for the nation

2023 Infrastructure Sector Outlook, cont….

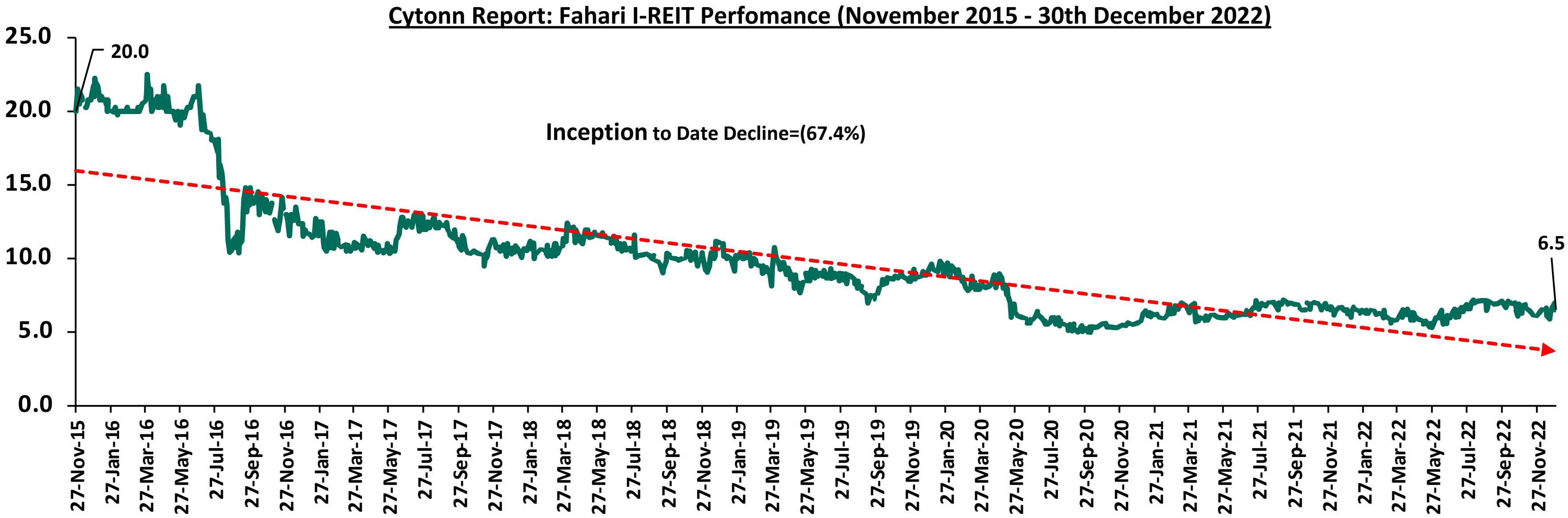
Sector's outlook is Neutral supported by the aggressiveness of the government to complete stalled projects whereas decrease in spending affecting government's ability to fund new projects

Sector	2022 Performance	2023 outlook	Effect
Infrastructure Sector	• The government continued to make considerable efforts in advancing infrastructural developments across the country amid focus on achieving the Vision 2030 and Big Four Agenda • However, there was a slight slowdown in the completion and commissioning of projects on the back of the • recently concluded election season, and change of government regime • In FY'2021/2022, the sector was allocated Kshs 182.5 bn, 0.61% higher than the 181.4 bn allocated in the 2020/2021 budget • Some of the key projects implemented in 2021 included; Dualling of Eastern, Western, and Northern Bypasses, and the Nairobi Express Way	• In 2023, we expect to continue seeing completion of more infrastructural developments mainly supported by the government's aggressiveness to; i) initiate and implement projects, ii) increase its diplomacy and partnerships in development among neighbouring nations, and, iii) step up on competition for attracting regional and international investors against other countries in Eastern Africa • Some of the major projects in the pipeline include; Lamu Port-South Sudan-Ethiopia-Transport (LAPSSET) Corridor, Standard Gauge Railway Phase 2b (Navaisha-Kisumu line), Phase 3 and 4 of Kenol-Marua Highway (36.0km), Lamu-Garissa Highway (263.0km), Dongo-Kundu Special Economic Zone, and many more • However, according to the Draft 2023 Budget Policy Statement, the government's Infrastructure, Energy, and ICT allocations for the FY'2023/2024 are forecast to be Kshs 398.2 bn, representing a 4.4% decline from the Kshs 416.4 bn in FY'2022/2023.The decrease in spending will affect the government's ability to fund new infrastructure projects	**Neutral**

We have a Neutral outlook for the infrastructure sector and we expect to continue seeing the launching, execution, and completion of more infrastructural developments in 2022. However, we expect the government to reduce Infrastructure, Energy, and ICT allocations by 4.4% to 398.2 bn for the FY'2023/2024 from the Kshs 416.4 bn in FY'2022/2023.The decrease in spending will affect the government's ability to fund new infrastructure projects across the country

2023 Listed Real Estate Sector Outlook

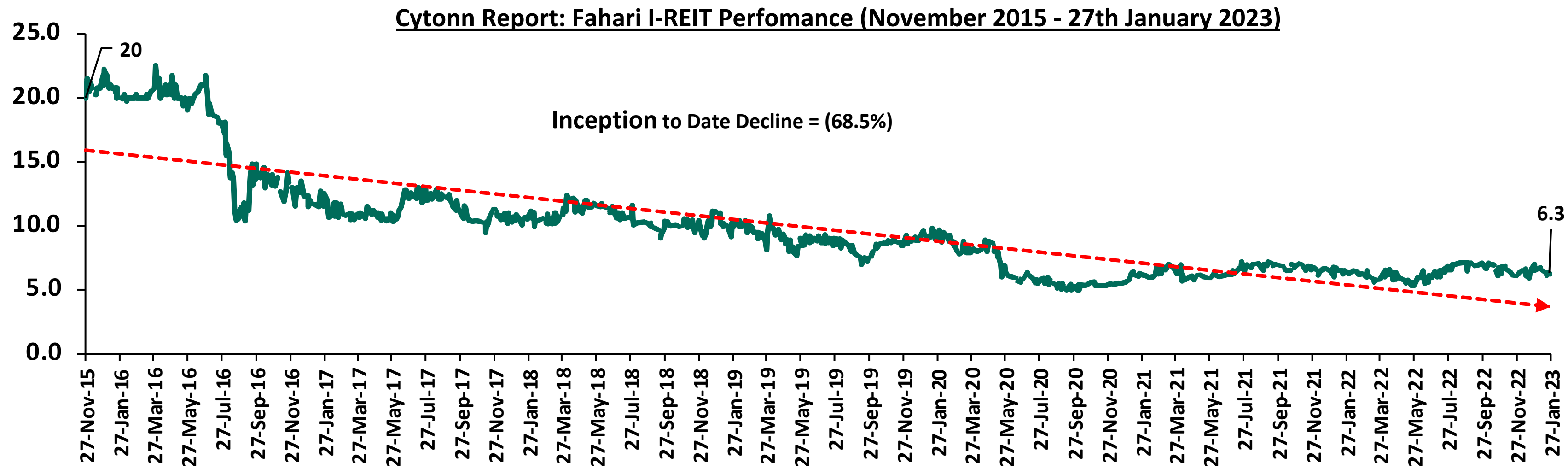
Fahari I-REIT closed the year 2022 trading at Kshs 6.5 per share, representing a 67.4% Inception-to-Date (ITD) loss from the Kshs 20.0 price as at November 2015



- In Nairobi Securities Exchange, ILAM Fahari I-REIT closed the year 2022 trading at an average price of Kshs 6.5 per share. The performance represented a 1.8% decline from Kshs 6.6 per share recorded the previous week, taking it to a 1.6% Year-to-Date (YTD) gain from Kshs 6.4 per share recorded at the beginning of 2022. However, the performance represented a 67.4% Inception-to-Date (ITD) loss from the Kshs 20.0 price
- The Fahari I-REIT ended the year fetching a dividend yield of 7.7%. This was at the back of several challenges that continue to weigh down on the REITs market such as insufficient investment knowledge and awareness of the REITs market and high minimum amounts leading to reduced investor appetite on listed Real Estate

2023 Listed Real Estate Sector Outlook

Fahari I-REIT opened the year trading at Kshs 6.8 per share, representing a 66.4% Inception-to-Date (ITD) loss from the Kshs 20.0 inception price as at November 2015



- The Fahari I-REIT opened the year 2023 trading at an average price of Kshs 6.8 per share. As at 27th January 2023, the REIT traded at an average price of Kshs 6.3 per share. The performance represented a 0.9% decline from Kshs 6.4 per share recorded the previous week, taking it to a 7.1% Year-to-Date (YTD) decline from Kshs 6.8 per share recorded at the beginning of the year
- In addition, the performance represented a 68.5% Inception-to-Date (ITD) loss from the Kshs 20.0 price. The dividend yield stood at 7.9%
- We expect the Fahari I-Real Estate to continue trading in low volumes in 2023, having opened the year with a low trading price of Kshs 6.7 per share, and low investor appetite amid high investment amounts required

2023 Listed Real Estate Sector Outlook, cont'd…

Listed Real Estate performance will be constrained by continued lack of investor appetite

Sector	2022 Performance	2023 Outlook	Outlook
Listed Real Estate	• The Fahari I-REIT continued to underperform closing the year 2022 at Kshs 6.5 per share, representing a 67.4% decline on an Inception-to-Date (ITD) basis from its initial price of Kshs 20.0. The instrument traded at an average of Kshs 6.4 per share in 2022 compared to Kshs 6.5 per share in 2021 • The underperformance in the REIT market was 2 attributable to; i) oversupply in some Real Estate sectors such as commercial office and retail sectors, ii) general lack of knowledge and interest in the REITs, iii) high minimum investment amounts set at Kshs 5.0 mn • In the Unquoted Securities Platform,, Acorn D-REIT and I-REIT closed the year 2022 trading at Kshs 23.8 and Kshs 20.9 per unit, respectively. The performance represented a 19.2% and 4.4% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price. The volumes traded for the D-REIT and I-REIT came in at 5.5 mn and 15.5 mn shares, respectively, with a turnover of Kshs 117.0 mn and Kshs 320.7 mn, respectively, since inception in February 2021	• The Acorn D-REIT and I-REIT opened the year 2023 trading at Kshs 23.9 and Kshs 20.9 per unit, respectively. Having opened the year with a trading price of Kshs 6.8 per share, we expect the Fahari I-REIT to continue trading at low prices due to various challenges such as general lack of knowledge and interest in the REITs market, only few entities capable of incorporating REITs, high capital requirements for Trustees, protracted processes required in order to establish REITs, and, high minimum investment amounts set at Kshs 5.0 mn • Moving forward, with the admission of Vuka platform and LapTrust Imaara I-REIT in the market, we expect the Capital Markets Authority to further streamline the capital markets framework and incorporate proposed policies and regulations suggested by stakeholders in the sector in 2022	**Negative**

Our outlook for the REIT market is NEGATIVE with some of the factors that will continue to hinder the optimal performance of the sector market include; i) reduced investors' appetite in trading and investing in the market, ii) lengthy registration, licensing, and approval process, iii) high Minimum Investment Amounts Set at Kshs 5.0 mn, iv) insufficient Investment Knowledge and Awareness of the REITs Market v) subdued performance in some Real Estate sectors with oversupply of spaces in Commercial Office Sector at 7.3 mn SQFT and Retail Sector at 3.0 mn SQFT in the NMA expected to affect performance of the instrument due to low rental yields, vi) high Minimum Capital Requirements for a Trustee of Kshs 100.0 mn, and, vii) adverse conflicts of interests with trustees

Q & A

Cytonn