Cytonn Note on the Kenya Macroeconomic FY'2022 Review

The Kenyan economy recorded an average growth of 5.6% in the period between January to September 2022, with Q3'2022 GDP slowing down to 4.7%, lower than the 5.2% and 6.8% growths recorded in Q2'2022 and Q1'2022, respectively. The average GDP growth of 5.6% marked a decline from the 7.7% average growth recorded in a similar period in 2021. The growth in Q3'2022 was largely driven by the non-agricultural sectors, with accommodation and food, wholesale and retail trade, professional administrative and support, and finance and insurance sectors recording growths of 22.9%, 9.1%, 8.7%, and 5.3%, respectively, in Q3'2022, albeit slower than growth of 127.5%, 6.4%, 13.4%, and 11.8%, respectively recorded in Q3'2021. The growths in these sectors were supported by continued post COVID-19 economy recovery due to lifting of travel restrictions and ease in cross border transactions. However, the sectoral growths remained subdued due to uncertainties of the electioneering period and the adverse macroeconomic conditions in the country. Notably, the agricultural sector recorded a 0.6% contraction in Q3'2022, compared to a corresponding expansion of 0.6% growth in Q3'2021 but a slight improvement from preceding contractions of 2.1% and 0.7% recorded in Q2'2022 and Q1'2022, respectively. The contraction during the quarters is mainly attributable to unfavorable weather conditions witnessed during the period, as well as increased costs of agricultural inputs such as fertilizers.

In 2022, the Kenyan economy is projected to grow at an average of 5.1%, lower than the 7.5% growth recorded in 2021. The slower growth is mainly attributable to a deteriorated business environment for majority of the year brought about by the uncertainties preceding the August 2022 general elections and elevated inflationary pressures driven by the high global fuel prices and the pre-existing supply chain constraints worsened by the Russia-Ukraine conflict. Notably, the unfavorable weather conditions experienced during the period under review has subdued agricultural production, with the sector being the largest contributor to Kenya's GDP. The table below shows the projections of Kenya's 2022 GDP by various organizations:

Cytonn Report: 2022 GDP Projections		
No.	**Organization**	**2022 Projections**
1	International Monetary Fund	5.3%
2	National Treasury	6.0%
3	Cytonn Investments Management PLC	4.5%
4	World Bank	5.5%
5	S&P Global	4.4%
Average		**5.1%**
Median of Growth Estimates		**5.3%**

Source: Cytonn Research, 2022

The table below shows the macro-economic indicators that we track, indicating our expectations for each variable at the beginning of 2022 versus the experience;

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<tr><th colspan="5">Cytonn Report: Kenya Macro-Economic & Business Environment Outlook</th></tr>
<tr><th>Macro-Economic Indicators</th><th>2022 Outlook</th><th>Effect</th><th>2022 Experience</th><th>Effect</th></tr>
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<td>Government Borrowing</td>
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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 1.4 tn in the FY/2021/22 – 11.4% 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
In our view, the level of foreign borrowing will increase in 2022 due to the following reasons; i) the G-20 Debt Service Suspension Initiative (DSSI) expired in December 2021 meaning Kenya will have to begin service about Kshs 58.1 bn in debt payments that were suspended in 2021, (ii) Kenya intends on issuing two Eurobond by June 2022 for budgetary support and (iii) disbursements from the multilateral loan from IMF as part of the 3-year disbursing programme agreed in April 2021.
On revenue collection, we expect continued improvement in 2022 due to the relatively more conducive business environment compared to FY'21 and FY'22. KRA registered an average of 99.5% performance in the years 2019/2020 and 2020/2021. Additionally, KRA has also embarked on various efforts to raise more revenue through its 8th Corporate Plan, including increasing number of taxpayers to 8.2 mn from 6.1 mn by 2024, and, Upgrade IT infrastructure to meet emerging business needs, However, despite the improved revenue collection, we expect continued worsening of the fiscal deficit as the revenues collected will not be enough to bridge the funding gap in Kenya's budget, further highlighting the country's debt unsustainability.
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<td>Negative</td>
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The government's domestic debt stood at Kshs 4.39 tn as of October 2022, 0.6% higher than external debt that came in at Kshs 4.36 tn in the same period. Notably, domestic debt recorded an 8.8% increase from the year's opening position of Kshs 4.0 tn relative to a 4.4% growth in external debt from the year's opening position of Kshs 4.2 tn. The higher growth in domestic debt indicates the government's preference for domestic borrowing in line with our expectation of aggressive borrowing in the domestic front during the year,
The government is 6.3% ahead of its prorated borrowing target of Kshs 290.9 bn having borrowed Kshs 309.1 bn of the Kshs 581.7 bn borrowing target for the FY'2022/2023,
Kenya's debt to GDP ratio came in at an estimated 62.3% as of October 2022, 12.3% points above the IMF recommended threshold of 50.0% for developing nations, but at a 4.4% points decline from 66.7% recorded in January 2022,
The government canceled plans of issuing two Eurobonds that were set to be issued in June 2022, on the back of high interest rates in the international market with yield on the 10-year Eurobond issued in 2014 hitting an all-time high of 22.1% on 14th July 2022,
The total revenue collection came in at Kshs 789.3 bn as at the end of November 2022 (equivalent to 36.9% of FY'2022/23 target estimate of Kshs 2.1 tn), translating to 88.5% achievement of KRA's monthly prorated target of Kshs 892.3 bn, indicating an underperformance in revenue collection,
In our view, we anticipate that the revenue collected will not be enough
</td>
<td>Negative</td>
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Cytonn Report: Kenya Macro-Economic & Business Environment Outlook				
Macro-Economic Indicators	**2022 Outlook**	**Effect**	**2022 Experience**	**Effect**
			to plug in Government's deficit and we therefore expect the government to continue borrowing aggressively in the domestic front to plug in the fiscal deficit which is projected at 6.2% of GDP for the FY'2021/22 budget, mainly due to financing challenges in the international market.	
Exchange Rate	• We expect the Shilling to range between Kshs 112.0 and Kshs 117.0 to the USD with a bias to a 4.7% depreciation by the end of the year. In 2022, 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 expected dollar inflows from issued Eurobonds	**Neutral**	• The Kenya Shilling depreciated by 9.0% against the US Dollar to close at Kshs 123.4 in 2022, compared to Kshs 113.1 at the end of 2021, we note that the continuous depreciation of the shilling caused by increasing dollar demand from energy and merchandise importers as global fuel prices and costs of imports continue to outweigh the dollar inflows with subdued economic recovery in most sectors due to uncertainties surrounding the August 2022 polls, • The forex reserves declined by 15.1% to USD 7.4 bn from USD 8.8 bn at year opening, but remained sufficient to support the Kenyan shilling,	**Negative**
Interest Rates	• Given the accommodative policy stance utilized in 2020 and 2021, we expect the same to be maintained in H1'2022 with the intention of continued support to the economy from the adverse effects of the pandemic. There is however the risk of the yield curve adjusting upwards especially in Q3'2022 as the government compensates investors for the increased risk and uncertainty posed by the elections.	**Neutral**	• Yields on government securities were on an upward trajectory mainly driven by increased borrowing appetite by the government coupled with investors' demand for higher yield to cushion themselves against the high inflation rates recorded throughout the year, • During the year, the MPC increased the central Bank rate by a cumulative 1.75% points to 8.75% from 7.00% in a bid to anchor inflation and also strengthen the Kenyan shilling from further aggressive depreciation	**Negative**
Inflation	• We expect inflation to average 6.3% in 2022 and within the government target range of 2.5% - 7.5%	**Neutral**	• Having averaged at 7.6% in 2022, the inflation rate surpassed the government's set range of 2.5% - 7.5%. Notably, on a monthly basis,	**Negative**

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Macro-Economic Indicators	**2022 Outlook**	**Effect**	**2022 Experience**	**Effect**
			the inflation rate came in at 9.1% in December 2022, 1.6% points above the government's target range, • Concerns on elevated inflationary pressures remain high mainly due to the soaring global fuel prices given that Kenya is a net fuel importer, as well as, the pre-existing supply bottlenecks exacerbated by the Russian-Ukrainian war	
GDP	• We project GDP growth for 2022 to come in at 4.3% - 4.7%, within the same range as the 5-year historical average of 4.5%. GDP growth is expected to be supported by the continued recovery of businesses from the adverse effects of the pandemic owing partly to the continued reopening of the external trading partners, coupled with growth in the Real Estate and Construction sectors. However, risks abound due to the emergence of new COVID-19 variants, uncertainty around the general elections and the erratic weather conditions expected to adversely affect the Agricultural sector, which is the largest contributor to Kenya's GDP.	**Neutral**	• With the economy having grown at average of 5.6% in the first three quarters of 2022, the economy is projected to continue recovering, however at a slower pace with the GDP growth for 2022 projected at 5.1% on the back of elevated fuel prices globally with Kenya being a net fuel importer, supply chain constraints, and the elevated inflationary pressures sniffling both consumer spending and business production	**Neutral**
Investor Sentiment	• We expect 2022 to register lower investor sentiments mainly due to; i) A cautious stance by investors as they monitor the election proceedings, ii) expected increase in Eurobond yields as concerns over Kenya's high debt-to-GDP ratio persists, and, iii) Expected depreciation of the Kenyan currency as a result of increased oil prices globally and high debt servicing costs	**Negative**	• With the adverse macroeconomic conditions in the country coupled with the continuous depreciation of the Kenyan shilling, companies trading in the Nairobi Securities Exchange have recorded low trade volumes throughout the year, • The NSE has experienced capital flights with the NSE equity turnover declining by 36.5% to close the year at USD 794.7 mn in 2022 from USD 1,251.6 mn recorded in 2021, • Further, NSE market capitalization has declined by 23.4% Year to date (YTD) to Kshs 2.0 tn as at 30th December 2022, from Kshs 2.6 tn recorded on 3rd January 2022, translating to an annual loss of Kshs 599.2 bn,	**Negative**

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Macro-Economic Indicators	2022 Outlook	Effect	2022 Experience	Effect
			• Majority of companies are trading at cheaper prices relative to the year opening prices, signaling undervaluation	
Security	• We expect security to be maintained in 2022, although the main concern is the political environment which we expect to heat up gradually as we edge closer to the August 2022 General Elections	**Neutral**	• Security remained sound during the year even during the general elections held on 9th August 2022,	**Positive**

Since the beginning of the year, the notable changes we have seen out of the seven metrics that we track, fall under four metrics, namely; Interest rates, Inflation, Exchange rates, and Security. Key to note, Security changed from neutral to positive while Interest rates, Inflation, and Exchange rate changed from neutral to negative. In conclusion, macroeconomic fundamentals showed mixed performance during the year with most metrics on downward trajectories. We expect a slight recovery in 2023 supported by the improving business conditions in the country evidenced by the November PMI coming in at 50.9, an improvement from 50.2 in October. However, improvement of the business conditions in the country, are largely pegged on how fast global fuel prices stabilize, decline in inflation rates and stabilization of the Kenyan currency. This is because, Kenya, as a net fuel importer suffers from imported inflation levels.