DYER & BLAIR INVESTMENT BANK
MACROECONOMIC OUTLOOK 2022

Founder Member of the Nairobi Securities Exchange

February 18TH 2022

DYER & BLAIR
INVESTMENT BANK
WE KNOW. YOU KNOW.

KENYA: 2022 MACROECONOMIC OUTLOOK

- Global economic growth is projected to moderate to 4.4% in 2022 from an estimated 5.9% in 2021. The weaker growth forecast is predicated on the spread of the Omicron variant, rising energy prices, supply chain disturbances (expected to weigh on inflation) and tighter monetary policy conditions globally.
- In 2022, we expect the Kenyan economy to continue to rebound largely on the back of the full reopening of the economy. We expect GDP growth to range between 5.5% and 6.5% in 2022.
- We don't expect the elections to have a significant negative impact on the economy in 2022. We opine that there has been a notable pivot in the attitude of voters that might positively influence how this year's general elections play out.
- We expect average inflation to moderate in 2022 and to range between 5.25% and 5.75%. We believe that in 2022, fuel inflation will generally moderate. Given the unpredictable weather patterns, we see food prices continuing to come under pressure at least before the commencement of the March-April-May (MAM) rainfall season.
- We expect the current account deficit to narrow in 2022 (ranging between 5.0% and 5.2% of GDP) largely on the back of an expected deceleration in the growth of the import bill, improving international travel and robust growth in remittances.
- We see the Kenya Shilling depreciating further in 2022. As much as we expect the current account deficit to narrow in 2022, the expected rate hikes in 2022 by the Federal Reserve are anticipated to result in the strengthening of the USD and reduced capital flows.
- Overall, our expectation is that the yield curve will rise further especially in 1H22. In the period after the general elections, we anticipate interest rates to decline as the government attempts to reduce its borrowing costs. We recommend that investors buy longer dated papers, hold/buy shorter dated papers and sell intermediate papers.
- In our view, we expect the pre-election period to be marked by subdued investor interest in the stock market in favor of the fixed income market especially in light of the current global factors. However, in the post-election period, we expect to see renewed interest in the stock market (this will be predicated on how disputes will be resolved).

KEY RATES & INDICATORS (%, END OF YEAR)

	2017	2018	2019	2020	2021
CBR	10.0	9.0	8.5	7.0	7.0
Inflation	8.0	4.7	5.2	5.3	6.1
Interbank	6.9	6.7	5.5	6.2	5.0
91-Yield	8.0	7.3	7.23	6.9	7.3
182-Yield	10.6	9.0	8.2	7.4	8.1
364-Yield	11.1	10.0	9.8	8.3	9.4
5YR-Yield	12.5	11.6	11.5	10.5	11.4
10YR-Yield	13.1	12.5	12.1	11.9	12.5
15YR-Yield	13.2	12.6	12.56	12.8	13.0

Source: CBK, KNBS, NSE

CONTENTS

Research Analyst

JOHN JUMWA

jjumwa@dyerandblair.com

+254 709930127

Global Economic Environment

Based on the IMF's January 2022 World Economic Outlook (WEO) report, global economic growth is projected to moderate to 4.4% in 2022 from an estimated 5.9% in 2021. The weaker growth forecast is predicated on (i) continued adverse effects of the spread of the Omicron variant (especially in 1Q22), (ii) rising energy prices, (iii) supply chain disturbances which are both expected to weigh on inflation and (iv) tighter monetary policy conditions globally.

Omicron

The emergence of the Omicron variant of COVID-19 in November 2021 led to an unprecedented rise in infections globally. Despite the variant being but less virulent than the Delta variant, it proved to be more transmissible (therefore increasing the chances for increased hospitalizations) necessitating the need for various restrictions; nationwide lockdowns (Austria and Netherlands), travel measures (Japan, Thailand) and gathering restrictions (Germany). However, as new case numbers have started falling in the past one month, more countries have eased restrictions (Austria, UK) giving rise to the notion that the economic fall-out from Omicron might not be long lived.

The IMF's January WEO report expects adverse health outcomes to decline in most countries by the end of 2022 as most countries ramp up their vaccination efforts. Furthermore, the economic impact of the pandemic isn't expected to drag past 1Q22. We believe that the key risk to this outlook is the disparity in vaccination rates, especially between advanced and emerging market & developing economies and the impact this has on the potential emergence of new variants which could prompt further restrictions.

Supply-chain disruptions

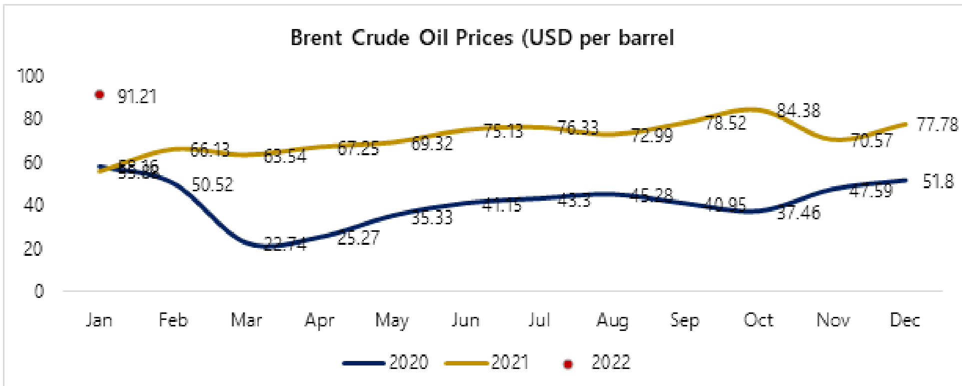
The release of pent up consumer demand (specifically for goods) as the GDP growth of advanced economies began to recover from the pandemic resulted in supply chain networks being overwhelmed. In the US, this was especially concentrated in the manufacturing, construction and trade sectors. The supply chain imbalances were further exacerbated by logistical bottlenecks as well as pandemic induced mobility restrictions which impacted transport and distribution. The main resulting impact of the supply chain disturbances has been a shortage of consumer goods thus contributing to higher inflation and subdued consumption. The IMF's January WEO report estimated that supply chain issues cut 0.5 – 1.0 percentage point off global economic growth and added 1.0 percentage point to core inflation.

With the rollback of Omicron-related restrictions, we see the severity of supply chain disruption easing globally. Additionally, we expect to see businesses adapt their business models to be more comfortable with supply chain volatility while leveraging increased adoption of digital supply chain technologies.

Inflation

In 2021, inflation averaged 3.1% in advanced economies (from 0.7% in 2020) and 5.7% in emerging markets & developing economies (5.1% in 2020). The higher jump in advanced economies was occasioned by the release of excess savings accumulated during the pandemic driving up consumer spending coupled with the aforementioned supply chain issues. Globally, higher inflation in 2021 was also precipitated by a recovery in crude oil prices and higher global food prices.

Compared to 2020, global crude oil prices rose in 2021 as increasing vaccination rates, easing pandemic related restrictions and a recovering global economy elicited a faster growth in global petroleum demand vis-à-vis supply. In 2021, average Brent crude oil prices stood at USD 70.95 per barrel, 64.2% y-o-y higher than USD 43.21 average price in 2020.



Source: Bloomberg

Crude oil prices have recently soared to a precipitous seven year high on the back of supply-demand imbalances; Brent crude oil prices rose above USD 90 a barrel in the last week of January 2022.

Despite the ongoing post-pandemic recovery in global fuel consumption (spearheaded by countries such as India and China), a number of supply issues amongst OPEC+ nations are fueling credence to the expectation that oil supply may fail to keep up with rising demand, lending to a bullish outlook on the oil market.

In February 2022, the OPEC+ decided to increase output by 400,000 barrels a day in March, however, a recent survey by Bloomberg has shown that the alliance is struggling to fulfill its supply commitments. According to the Bloomberg survey, OPEC's 13 nations increased production by only 50,000 barrels a day in January weighed down by a 140,000 barrel-a-day decline in Libya (losses arose from military unrest). Furthermore, the 10 OPEC nations partaking in an agreement with non-OPEC members such as Russia ramped up supply by 160,000 barrels a day in January, roughly two-thirds of the targeted amount.

Spare capacities (which provide a back-up in the event of disruptions) are also under pressure. Spare capacity in the oil market is mainly concentrated in Gulf nations (Saudi Arabia, the United Arab Emirates, Iraq and Kuwait). As OPEC+ nations struggle to fulfil their supply pledges, there's growing concern that this will place undue burden on the aforementioned Gulf nations' spare capacity, hindering their ability to cover disruptions. The potential for disruption in the oil market remains high due to tensions between Russia and the US over Ukraine, disturbances in Libya due to military unrest as well as the potential for further terrorist attacks in Abu Dhabi.

According to the United Nations Food and Agriculture Organization (FAO), global food prices rose by more than 30.0% in 2021. The higher prices were occasioned by disruptions in supplies, factory closures, political tensions and the rise in global crude oil prices. The prices that were most affected were those of wheat, cereals and vegetable oils. Cereal prices were affected by poor harvests in Canada, Russia and the US while vegetable oil prices were buoyed by higher costs of palm, soy, sunflower and rapeseed oils.

The IMF's January WEO report anticipates inflation to remain elevated in 2021; 3.9% in advanced economies and 5.9% in emerging markets & developing economies. This outlook is hinged on the ongoing supply chain disruptions and high energy prices. According to the February Short-Term Energy Outlook (STEO) by the U.S. Energy Information Administration (EIA), Brent crude oil prices are expected to average USD 90 a barrel in February, owing to continued pressure on global oil inventories. However, as the year progresses, the growth in oil production (from OPEC+, the United States, and other non-OPEC countries) is expected to exceed the growth in global oil consumption (influenced in part by tighter monetary conditions), exerting downward pressure on prices. Consequently, Brent oil prices are forecast to decline from an average of USD 88.13 per barrel in 1Q22 to USD 74.98 per barrel in 4Q22. The average of 2022 is projected at USD 82.93 per barrel reflecting a 16.9% y-o-y growth. While oil prices are expected to remain elevated in 2022, their increase is expected to moderate in 2022.

Food prices are generally also expected to moderate in 2022 (rising by about 4.5%) on the back of an improvement in the supply chain issues, higher output (palm oil) and moderating crude oil prices, amid rising demand (supported by population growth and economic recovery). However, some conditions that led to higher food prices are expected to persist in 2022 such as: supply – demand mismatches (wheat) and detrimental weather (affecting rapeseed production in Canada), posing downside risks to the outlook.

Tighter monetary policies

The higher inflation witnessed across the globe has triggered a pivot to a less accommodative monetary policy response across monetary authorities. In the US (where the CPI jumped by 7.0% in 2021, highest since 1982), the Federal Reserve is accelerating its tapering of asset purchases and has already signaled several rate hikes for 2022 with expectations ranging between 4 and 5 rate hikes.

In Europe, the European Central Bank in its December meeting announced that it will cease net purchases under the Pandemic Emergency Purchase Programme at the end of March, while committing to uphold key interest rates at current levels until inflation stabilizes. In the UK, the Bank of England imposed subsequent interest rate hikes, raising the bank rate from 0.1% to 0.25% in December 2021 and to 0.5% in February 2022 as inflation ascended to a 30-year high in December. The Russian Central Bank raised its key rate by 100 basis points to 8.5% (7th hike) in December and signaled another rate hike in the coming months as inflation hovers near 6 year high. The same case was observed in major Latin American economies (Brazil, Mexico, Chile and Costa Rica). However the case was different amongst some Asian countries (Indonesia and the Philippines) owing to less severe supply chain interruptions.

Emerging market & developing economies are anticipated to bear the brunt of tighter monetary policy responses in advanced economies. Higher rates in advanced economies are expected to spur a wave of capital outflows from emerging market & developing economies consequently applying pressure on currencies and by extension raising inflationary pressures. Owing to this expectation of a rise in inflationary pressures, rate hikes are expected in some Asian countries in 2022.

The tighter monetary policies are also bound to affect the fiscal positions of economies with foreign currency loans (owing to higher debt service on account of weaker currencies) while making it more expensive to raise foreign currency loans (impact of higher rates).

Sub-Saharan Africa (SSA)

The IMF anticipates GDP growth in Sub-Saharan Africa (SSA) to weaken slightly to 3.7% in 2022 from an estimated growth of 4.0% in 2021. The robust growth in 2021 represents (i) the base effect from a contraction of 1.7% in 2020 (occasioned by the implementation of COVID-19 restrictions) (ii) the partial recovery of tourism (iii) a rebound in commodity prices and (iv) the relaxation of COVID-19 restrictions.

	2020	**2021**	**2022F**
Advanced Economies	(4.5)	(5.0)	3.9
Emerging Markets	(2.0)	(6.5)	4.8
SSA	(1.7)	(4.0)	3.7

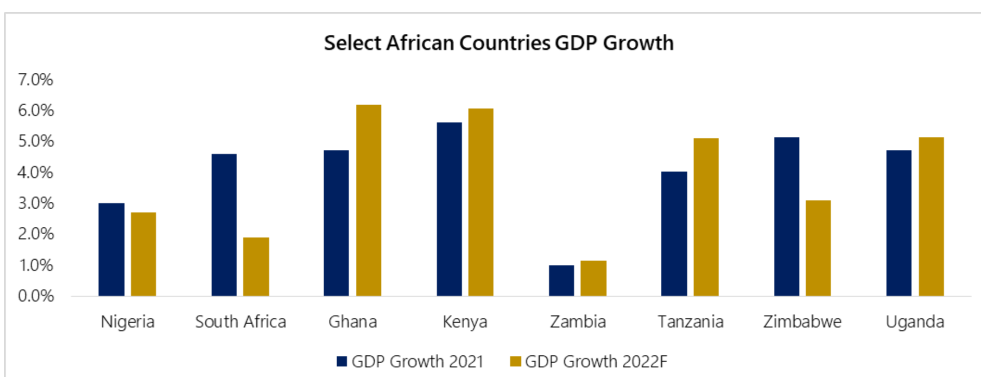
Source: IMF WEO Jan 22

Commodity-dependent nations such as Nigeria (oil), Angola & Zambia (copper) and Ghana (gold) are expected to fare better than their non-resource-intensive counterparts on the back of elevated commodity prices.

One of the main threats to economic recovery in SSA is the lagging vaccination rates (in comparison to advanced economies) which could result in the emergence of new variants prompting the need for restriction measures which could potentially dampen growth prospects.

Persistent high inflation also remains a key risk especially in light of elevated food and crude oil prices amid tightening global financial conditions which may negatively affect capital flows, thus weakening currencies and further exacerbating inflationary pressures.

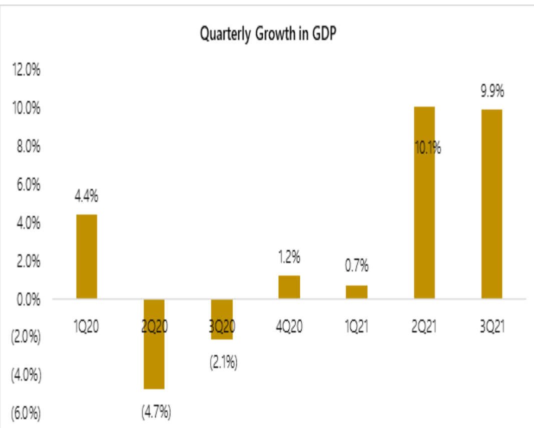
Debt sustainability is another area of concern given the decline in tax revenues and higher expenditures to manage the impact of the COVID-19 pandemic. Furthermore, as interest rates rise globally, countries saddled with foreign denominated debt may experience some strain in servicing their debt and raising capital in foreign markets (Ghana, Nigeria and Kenya).



Source: IMF WEO Jan22/Oct21

Country	GDP 2021	GDP 2022F	Inflation 2021	Inflation 2022F	Currency 2021	10 Yr Bond Yield
Nigeria	3.0	2.7	16.9	13.3	(5.9)	12.5
South Africa	4.6	1.9	4.4	4.5	(5.2)	9.6
Ghana	4.7	6.2	9.3	8.8	(8.5)	21.6
Kenya	5.6	6.0	6.0	5.0	(3.7)	12.7
Zambia	1.0	1.1	22.8	19.2	21.2	21.7
Tanzania	4.0	5.1	3.2	3.4	0.6	11.2
Zimbabwe	5.1	3.1	92.5	30.7	(32.9)	N/A
Uganda	4.7	5.1	2.2	5.0	2.7	14.1

Source: IMF WEO Jan 22/Oct 21, Bloomberg



Source: KNBS

Kenya Economic Growth

The Kenyan economy continued to recover from the effects of the pandemic in 3Q21. According to the Kenya National Bureau of Statistics, real GDP grew by 9.9% in the 3Q21 compared to a contraction of 2.1% in 3Q20. The growth in 3Q21 was more or less commensurate with the growth of 10.1% achieved in the 2Q21 due to base effects of lower growth rates in comparable periods in 2020.

Growth in 3Q21 was especially catalyzed by the gradual relaxation of containment measures put in place to curtail the spread of COVID-19. The key sectors that supported growth in 3Q21 were: education (+64.7%), transportation and storage (+13.0%), manufacturing (+9.5%) and wholesale & retail trade (+6.9%).

Agriculture

Growth was however constrained by the performance of the agriculture sector which contracted by 1.8% (compared to a growth of 4.2% in 3Q20) adversely affected by unfavorable weather conditions prevalent in most parts of the country. The poor performance of the sector was manifested in the significant decline in fruit exports, cane deliveries, tea production and coffee exports. On a positive note, the sector was buoyed by higher milk production as well as increase in exports of cut flower and vegetables. Owing to the growth contraction the contribution of the agriculture sector to GDP declined to 16.3% in 3Q21 from 18.2% in 3Q20.

Manufacturing

The manufacturing sector is estimated to have advanced by 9.5% in the 3Q21 compared to a growth of 1.7% in the 3Q20, supported mainly by the food sub-sector which expanded by 8.6%, as the non-food sector recorded mixed performance.

Construction

Growth in the construction sector decelerated to 6.4% in 3Q21 from 12.5% in 3Q20. We opine the decelerated growth in 3Q21 was attributable to a slowdown in construction activities following a surge in 2020. The construction sector recorded robust growth of 11.8% in 2020, higher than 5.6% in 2019 on the back of continued infrastructure focus by the government (bridges, ports, dams, roads, bypasses and road interchanges) and a rise in construction activities by individuals (who took advantage of restriction measures to start/complete construction projects). Growth was especially notable in the value of public buildings completed which surged to KES 9.1 BN in 2020 from KES 1.5 BN in 2019. Growth in cement consumption was still robust in 3Q21, rising by 27.5% y-o-y to 2,586.2 thousand metric tons in the 3Q21, demonstrating continued activity in the sector.

Finance and Insurance

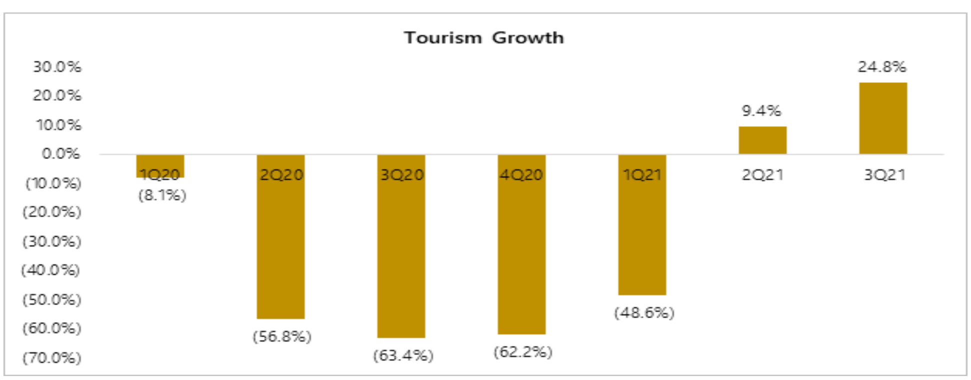
The financial and insurance sector advanced by 6.7% in the 3Q21 compared to 3.0% in 3Q20 largely anchored on improved economic conditions.

Transportation and Storage

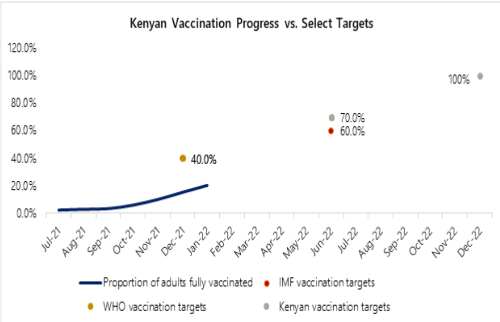
The transportation and storage sector expanded by 13.0% in 3Q21 compared to a contraction of 10.1% in 3Q20.The growth was anchored on a gradual recovery of the sector activities after lifting of restrictions on domestic and international travel.

Accommodation and Food Service Activities

In the 3Q21, the accommodation and food services sector continued on the path to recovery rising by 24.8% compared to a 63.4% contraction in the 3Q20. In 2020, the sector was egregiously impacted by the implementation of restriction measures globally to combat the spread of the virus in 2020. However, with the lifting of restrictions locally and the relaxation of measures globally, sector activities rebounded in 3Q21. This was most visible in the significant upsurge in the number of visitor arrivals from 34,701 in the 3Q20 to 217,873 visitors in the 3Q21.



Source: KNBS



Source: IMF, WHO and MOH

Outlook

In 2022, we expect the economy to continue to rebound largely on the back of the full reopening of the economy as the risks associated with the emergence of the Omicron variant continue to abate. The positivity rate (the proportion of positive tests) has adopted a declining bias, falling from 37.6% on 27th December, 2021 to 1.0% as at 9th February 2022. This progress has also been complimented by the acceleration of the vaccine roll-out. By 9th February 2022, 7.0 MN people had been partially vaccinated while 6.5 MN people had been fully vaccinated bringing the proportion of fully vaccinated adults to 24.0%. Kenya is currently targeting to fully vaccinate 70.0% of adults by the end of June 2022 and the entire adult population by the end of 2022. We believe that as the vaccination drive intensifies, the severity of the potential emergence of other COVID-19 variants will be reduced in both its impact on health outcomes and restriction measures, aiding economic growth.

We also expect to see the recovery in economic activities providing additional support to consumer spending by households amidst improving employment circumstances and rising household incomes. In 2022, we expect growth to be buoyed by continued growth in the education, manufacturing, construction, trade, finance and transport sectors. The education, finance and transport sectors are expected to continue enjoying the benefits of the lifting of economically disruptive restrictive measures while construction sector will be supported by continued government investment in infrastructure amidst mounting pressure to complete several projects under the Big Four agenda ahead of the general elections.

Despite the global supply chain disruptions, growth in the trade sector has remained resilient. Thus, as the global supply chain issues abate throughout 2022, we expect growth witnessed in the trade sector to sustain. Growth in the agricultural sector is expected to continue being constrained by unpredictable weather conditions. The recovery trajectory witnessed in the tourism sector will continue to remain highly susceptible to global vaccination rollout, the potential emergence of new variants/new waves and the implementation of restrictive measures.

In view of the foregoing, we expect GDP growth to range between 5.5% and 6.5% in 2022, also reflecting the high base effects of rebounded growth in 2021 from a contraction of 0.3% in 2020. The major risks to this outlook are the general elections, higher inflation, weaker Kenya Shilling and fiscal concerns (which we discuss further in the subsequent sections).

Election Impact

Kenya is slated to hold its annual general elections on 9th August 2022. In the past, election years have typically been characterized by uncertainty around the political direction of the country and the potential effect on socio-economic activities, investments and future policy implications. Generally, the period leading up to the elections has been characterized by shifting political alliances as candidates assess the political landscape as well as voter sentiments, and strategize on which coalitions, parties and political aspirants to associate with in order to increase their likelihood of securing electoral seats. As political alliances coalesce and we move closer to the election date, key policy ideologies on which major parties/ coalitions are running on begin to crystalize usually in the form of manifestos.

As it stands, based on the aforementioned sequence of phases, the country is currently in the political re-alignment phase. Two major coalitions are already taking shape; the Kenya Kwanza Alliance linked to Deputy President William Ruto and the Azimio La Umoja Movement led by Former Prime Minister Raila Odinga. The coalition proclivity that is common occurrence in the country has been given a formal legal backing following the signing of the Political Parties (Amendment) Act signed by the President which allows coalitions of parties whereby constituent parties can conduct joint nominations and support one presidential candidate while retaining their individual identities.

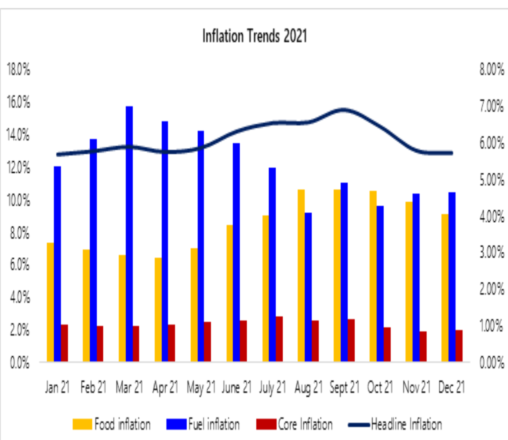
As opposed to previous elections, we opine that there has been a notable pivot in the attitude of voters that might positively influence how this year's general elections play out. For one, an apparent shift amongst voters from ethnic associations towards more socio-economic narratives is starting to emerge giving rise to hopes that the outcome to the election results might not be significantly met with ethnic tensions. This idea is also entrenched by the famous "Handshake" in 2018 between President Uhuru Kenyatta and Former Prime Minister Raila Odinga which laid the roots for a transition away from ethnically charged divisive politics especially after a protracted election period involving the two candidates. We also believe that with the economy reeling from the COVID-19 shock, amidst growing concerns around corruption, debt sustainability, high cost of living and higher taxation more and more Kenyans will be inclined to focus on the election as a one-off event that doesn't outweigh their more pressing concerns.

With the nullification of the Presidential Elections by the Supreme Court in 2017, the High Court Ruling (May 2021) on the unconstitutionality of the Building Bridges Initiative (BBI) and the Court of Appeal's decision to uphold this ruling (October 2021) there has been increased confidence in judicial independence in Kenya. We believe that this bodes well for any electoral dispute that may emerge in 2022, increasing the odds for an amicable conflict resolution.

In view of the aforementioned arguments, we don't expect the elections to have a significant negative impact on the economy in 2022. We opine that the momentum achieved post the contraction in 2020 (-0.3%) will spill-over into 2022 as businesses pursue capital spending (albeit cautiously) as household spending recovers (amidst rising inflationary pressures). Government expenditure is also set to support economic growth. According to the supplementary budget, total expenditure for the FY21/22 is set at KES 2.07 TN (a 6.5% rise from the original estimates provided in the budget). The key areas of expenditure are expected to be on the general elections, pandemic-related interventions, drought mitigation, recurrent expenditure, fuel price stabilization measures and infrastructure developments.

Inflation

In 2021, the average headline inflation stood at 6.11%, higher than 5.29% registered in 2020. The higher average inflation in 2021 was predominantly attributable to higher average fuel and core inflation relative to 2020. The rise in core inflation was emblematic of a recovery in demand side activities.



Source: KNBS, CBK

Generally, a rebound in global crude oil prices to pre-pandemic levels due to production cuts by OPEC+ nations led to higher fuel inflation in 2021. However, the impact of higher energy prices on fuel inflation was mitigated by a subsidy program initiated by the government between April and September to provide stability to fuel prices. The implementation of the subsidy, however, had a fair share of hiccups throughout the year; in 1Q21 higher fuel inflation was augmented by delays in setting up the fuel subsidy plan while in September the discontinuation of the subsidy scheme introduced adversely impacted fuel prices. The subsidy program was however reinstated in 4Q21.

Average	2020	2021
Headline Inflation	5.29%	6.11%
Food inflation	8.68%	8.57%
Fuel Inflation	7.77%	12.26%
Core Inflation	2.08%	2.38%

Source: KNBS, CBK

The prices of cooking gas (a major component of fuel inflation) were impacted by the introduction of a 6.0% VAT in July 2021 (elevating the prices to a 6 year high) and the persistent rise in the global prices of butane and propane (by-products of crude oil used in the manufacture of cooking gas). Unlike fuel prices, the prices of cooking gas aren't subject to price controls.

Food inflation maintained a steady downward trend in the first 4 months of the year easing from 7.4% in January to a year low of 6.4% in April. This decline was linked to lower sugar prices (due to increased production), falling maize prices (as supply exceeded demand) even as the prices of wheat, bread and cooking oil experienced upward pressures.

Between May and October food inflation encountered an upward bias, rising from 7.0% to 10.6%. This period was marked by higher prices of wheat and cooking oil (higher international prices and supply chain constraints), beef (lower supply of livestock), cabbages (drought conditions), milk (higher producer prices), sugar (production hitches) and maize flour (as farmers hoarded their produce in anticipation of higher prices).

In November and December, food inflation moderated to an average of 9.5% due to the onset of the October-November-December short rains season -- aided by declining maize prices (as the harvesting season begun in Kenya's breadbasket).

Outlook

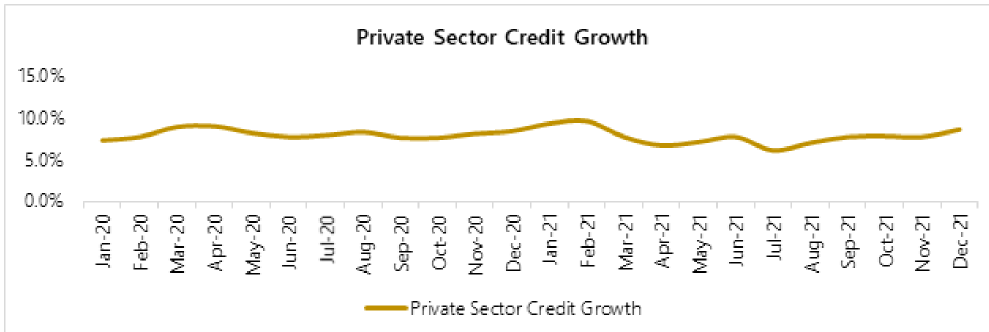
We believe that in 2022, fuel inflation will generally moderate on the back of the expected stabilization in global crude oil prices. We see the OPEC+ raising output in 2022 as global demand rises with the relaxation of several containment measures globally. Additionally, fuel inflation is also anticipated to be contained by the reinstatement of the fuel subsidy scheme by the government (the Ministry of Petroleum and Mining was recently allocated an additional KES 24.73 BN in the Supplementary Budget). The concerted effort by the government to lower electricity costs in 2022 should further aid in keeping fuel inflation subdued.

As the economic recovery persists in 2022 we expect to see a pick-up in consumer demand bestow a rise in core inflation which we see as being further augmented by elections campaigns which generally tends to result in higher liquidity in the economy.

Given the unpredictable weather patterns, we see food prices continuing to come under pressure at least before the commencement of the March-April-May (MAM) rainfall season. Furthermore with higher input costs (owing to supply chain constraints and elevated crude oil prices), we expect some food prices to remain elevated. Globally, as food prices moderate in 2022 (on the back of an improvement in the supply chain issues, higher output and moderating crude oil prices), we also expect the effects to be witnessed locally, especially as the year progresses.

Taking the aforementioned factors into account, we expect average inflation to moderate in 2022 and to range between 5.25% and 5.75% (remaining below the CBK's upper limit of 7.5%). The persistence of supply chain issues globally, the delayed onset of the MAM rainfall season/insufficient rainfall and sustained rise in global food and crude oil prices pose significant downside risks to our outlook.

Private Sector Credit Growth



Source: CBK

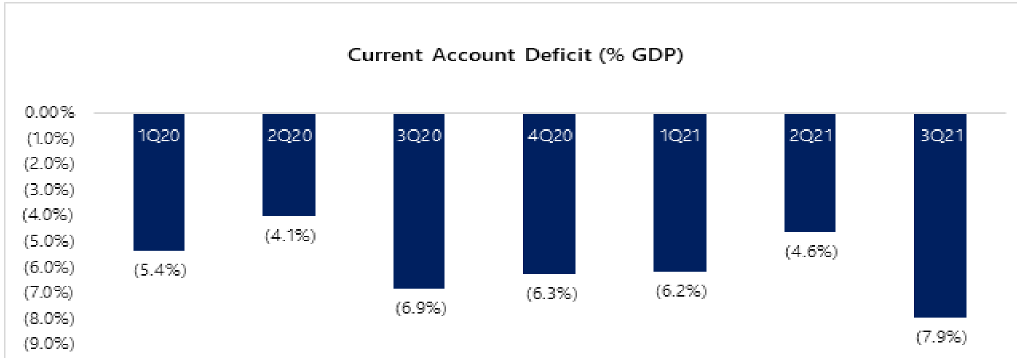
In 2021, growth in credit to the private sector averaged 7.8%, lower than 8.1% recorded in 2020. We opine that the higher average growth in 2020 was largely influenced by a number of measures initiated by the Central Bank (such as lowering of the CBR rate to 7.0% and the subsequent impact on lending rates & the easing of the Cash Reserve Ratio to 4.25%) to support access to credit at the height of the COVID-19 pandemic. Despite the economic rebound in 2021, the credit market in the private sector suffered owing to banks' overall preference for investing in government securities (in lieu of lending to customers) as well as delayed payments to contractors & suppliers by State corporations.

Outlook

Going forward, we don't expect significant changes to growth in credit to the private sector. This is because we see most of the conditions that influenced the performance in 2021 as more-or-less perpetuating in 2022; Banks' preference for government securities, despite improving economic conditions owing to elevated risks in the credit market (also influenced in part by delays in government payments).

Current Account Deficit

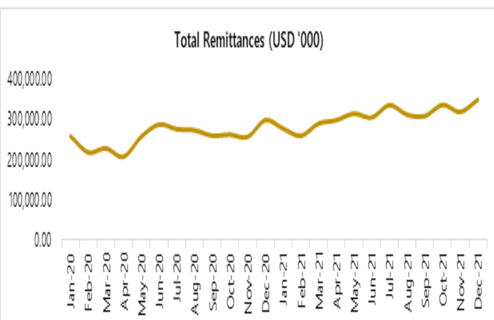
The current account deficit widened by 27.4% from KES 145.0 BN (6.9% of GDP) in the 3Q20 to KES 184.6 BN (7.9% of GDP) in the 3Q21.



Source: KNBS

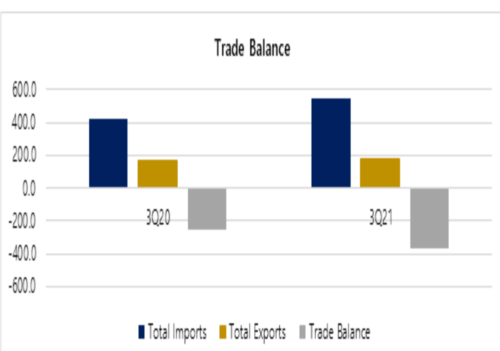
The wider deficit was predominantly occasioned by a 39.6% y-o-y rise in the merchandise trade deficit to KES 321.8 BN – which in turn was driven by a faster growth in imports f.o.b (+26.5% y/y to KES 498.0 BN) against a slower growth in exports f.o.b (7.9% y/y to KES 176.2 BN).

Trade in international services recorded impressive growth, rising by 272.0% y/y to a surplus of KES 12.0 BN in 3Q21 and this was emblematic of a recovery in the services sector. Services receipts rose by 40.1% y-o-y to KES 125.9 BN anchored by increase in travel and transport services receipts following resumption in international travel.



Source: CBK

Secondary income account balance advanced by 30.1% y/y to a surplus of KES 169.7 BN boosted by remittance inflows which went up by 21.9% y/y to KES 106.9 BN.



Source: KNBS

The trade balance deficit increased by 42.3% y/y to KES 365.9 BN in the 3Q21 (3Q20: KES 257.1 BN) owing to a 28.8% y/y jump in import expenditure to KES 541.9 BN vs. a 7.5% y/y rise in export earnings to KES 176.0 BN.

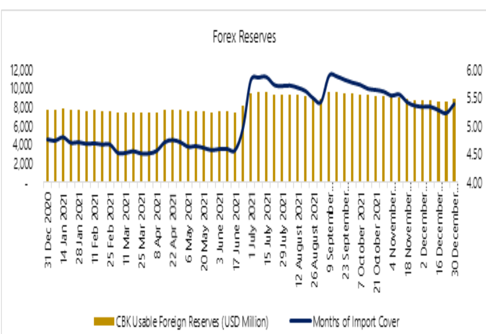
The growth realized in exports was supported by increased exports of horticulture (earnings were boosted by the easing of Covid-19 restrictions in Europe), articles of apparel and clothing accessories, edible products and preparations, and titanium ores and concentrates. However, earnings from export of tea declined from KES 30.5 BN in the 3Q20 to KES 27.7 BN in the 3Q21. The decline was largely attributable to the decline in the export quantities (fell from 138.6 thousand metric tonnes in 3Q20 to 124.5 thousand metric tonnes in 3Q21) owing to accelerated purchases in 2020.

The significant growth in import expenditure was largely on account of increase in imports of petroleum products, and iron and steel, which recorded an increase of 84.3% and 78.0%, respectively. This was occasioned by higher crude oil prices and persistent disruptions in global supply chains which adversely impacted shipping costs.

Outlook

As the increase in global crude oil prices moderates in 2022 and global supply chain pressures abate, we expect the growth in the country's import bill to decelerate in 2022 relative to 2021. We expect the current account balance to be further supported by growth in export earnings as the global economy continues to open up. We remain concerned about the expected subdued global demand, quality issues (there currently exists a ban on certain avocado varieties) and increased competition for exports (especially horticulture) weighing on export earnings in 2022. As international travel continues to improve (on the back of the vaccination roll-out and reopening of economies) we expect services receipts to improve further in 2022. The persistent rise in remittances is expected to persist in 2022. The Central Bank estimates current account deficit at 5.4% of GDP in 2021, wider than 4.6% in 2020. In light of the above factors, we expect the current account deficit to narrow in 2022 (ranging between 5.0% and 5.2% of GDP) largely on the back of an expected deceleration in the growth of the import bill, improving international travel and robust growth in remittances.

Forex Reserves



Source: CBK

From the beginning of 2021 to mid-June, forex reserves remained relatively stable averaging USD 7,553 MN. However, towards the end of June, forex reserves jumped by 28.7% from USD 7,474 MN to USD 9,621 MN in mid-July largely reflecting foreign currency inflows from concessional loans from the World Bank and the International Monetary Fund (IMF) (> USD 2.0 BN) and a Eurobond issuance (USD 1.0 BN).

From mid-July forex reserves took a hit, decreasing by 7.7% to USD 8,883 MN in early September on the back of debt repayments and efforts to stabilize the persistent volatility of the Kenya Shilling. From this point, forex reserves encountered a boost from Dollar inflows looking to invest in infrastructure bonds, consequently forex reserves jumped by 8.4% w-o-w to USD 9,629 MN.

Thereafter, between September and December, forex reserves adopted a declining bias, easing by 8.3% to USD 8,817 MN at the end of the year strained by external debt repayments, a rising import bill and possible efforts to support the depreciating Kenya Shilling.

Outlook

We see the same interplay of forces arising in 2022. We expect the infrastructure bond issue (IFB/2022/19), the planned Eurobond issue later on in the year, rising diaspora remittances and the expected recovery in services receipts (from tourism) to buoy forex reserves. On the flipside, we expect external debt service costs to weigh down forex reserves.

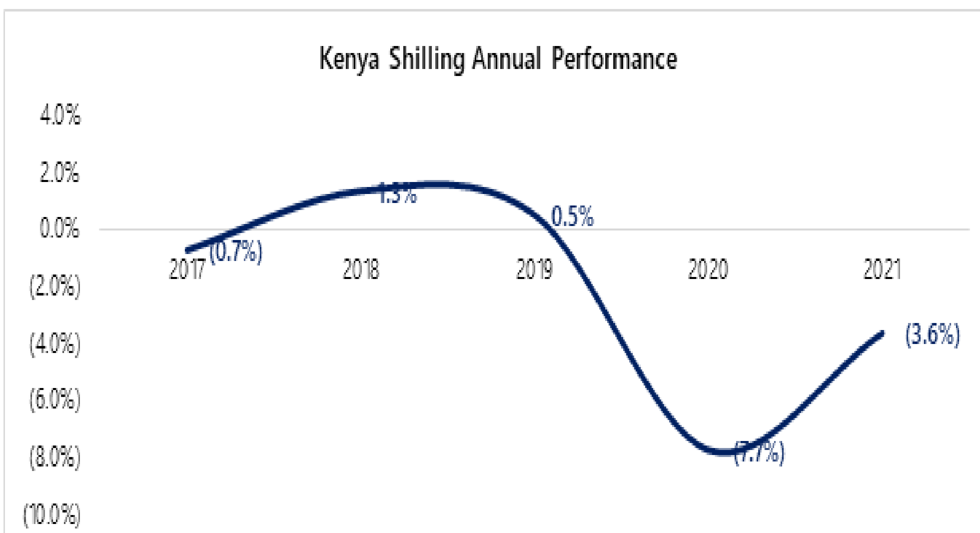
In terms of CBK intervention on the Kenya Shilling's volatility, we definitely expect support in instances of excessive volatility (expected to be exacerbated by a tighter monetary policy in the US). However, we do not expect the level of intervention to be as significant as seen in the past. The CBK governor has alluded to a pivot towards largely letting the Kenya Shilling respond to market forces while only intervening in dire situations.

Debt Service (KES BN)	FY20/21	FY21/22F	FY22/23F
External Interest	106.3	130.9	144.1
% of Revenue	6.8	7.2	6.7
External Principal Repayments	128.3	210.2	250.0
% of Revenue	8.2	11.6	11.7

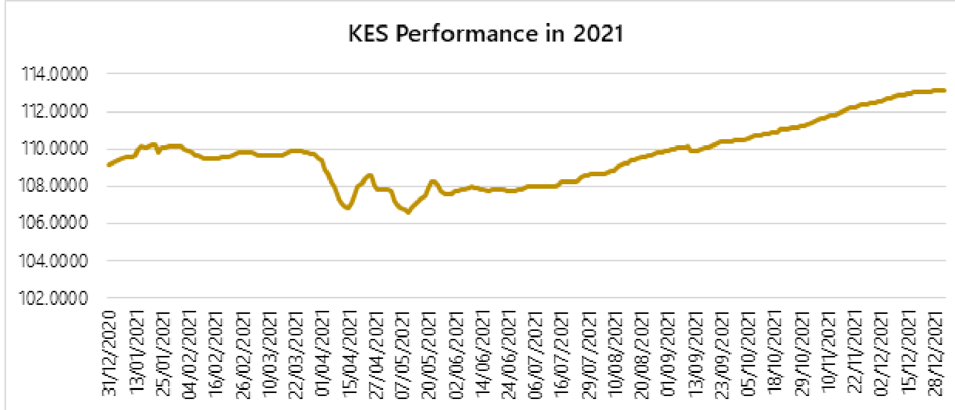
Source: National Treasury

Kenya Shilling

The Kenya Shilling extended losses in 2021, depreciating by 3.6% against the U.S. Dollar, to exchange at 113.3941 units to the US Dollar at the end of 2021. This was however a marked improvement from a depreciation of 7.7% in 2020.



Source: CBK



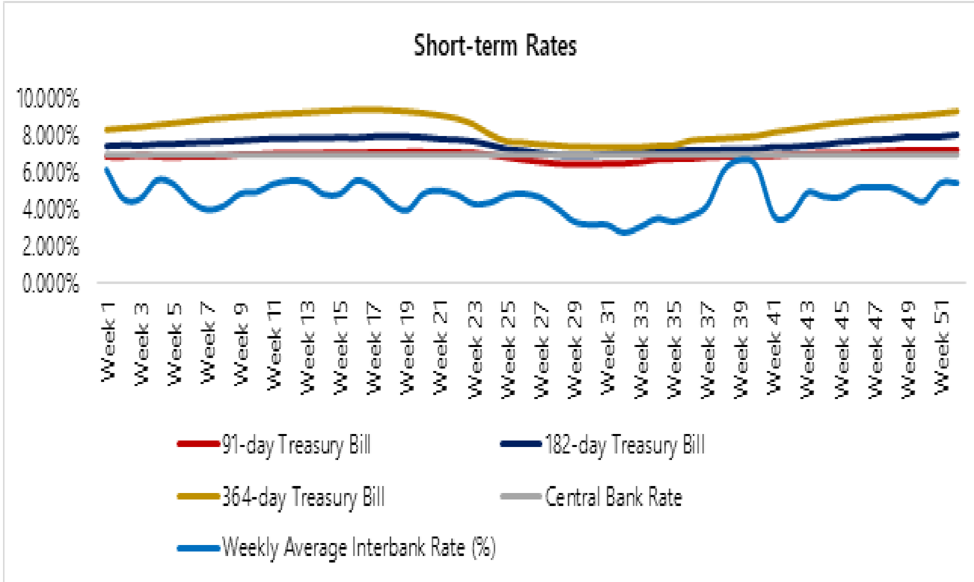
Source: CBK

The Kenya Shilling's performance throughout 2021 was largely impacted by supply -demand mismatches characterized by higher demand for US Dollars by corporates (to pay dividends) and importers (against the back drop of rising crude oil prices) against subdued supply for US Dollars constrained by weak performance of tourism receipts. The sustained depreciation of the Kenya Shilling was also exacerbated by a general reluctance to unwind US Dollar positions predicated on the anticipation of a further depreciation in the Kenya Shilling.

Outlook

Into 2022, the Kenya Shilling has shown no signs of paring its persistent decline against the US Dollar. By the end of January 2022, the Kenya Shilling had depreciated by 0.4% to close at 113.5735. As much as we expect the current account deficit to narrow in 2022, the expected rate hikes in 2022 by the Federal Reserve are anticipated to provide an exogenous shock to the Kenya Shilling through the expected strengthening of the USD and reduced capital flows. Owing to this, we see the Kenya Shilling depreciating further in 2022 especially given the CBK's pivot towards largely letting market forces determine the USD/KES exchange rate.

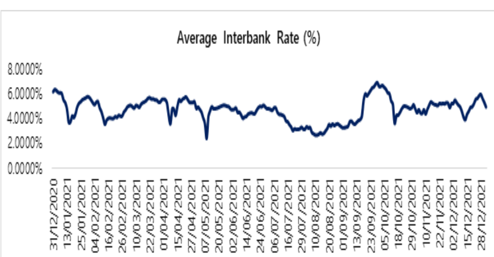
Interest Rates



Source: CBK

Central Bank Rate

In the six meetings held by the Monetary Policy Committee (MPC) in 2021, the Central Bank Rate remained unchanged at 7.0% throughout the year. According to the CBK's Monetary Policy Committee, the key rate was maintained in light of the expansionary fiscal policy adopted by the government at the onset of the pandemic to support economic recovery even as inflationary pressures mounted.



Source: CBK

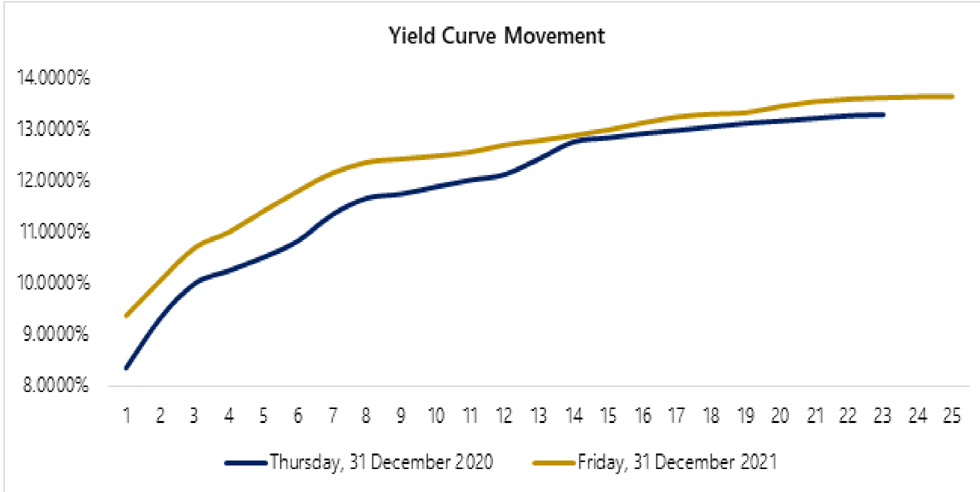
Interbank Rate

Overall, in 2021 the money market was relatively liquid with the interbank rate averaging 4.7129% throughout the year. Instances of tight liquidity were characterized by issuances of infrastructure bonds, open market operations by the CBK and tax remittances. On the contrary, moments of high liquidity were influenced by government payments offsetting tax remittances.

Treasury Bill Rates

In 2021, Treasury Bill rates adopted an upward trend; the 91-day, 182-day and 364-day Treasury Bill yields rose by 36.5 bps, 69.5 bps and 101.9 bps respectively. Generally Treasury Bills were undersubscribed in 2021 at 91.68%; total bids received were KES 1.14 TN against offered amount of KES 1.25 TN as investor appetite for Treasury Bills waned in favor of Treasury Bonds owing to higher yields. The acceptance rate for Treasury Bills was 85.18%; total amount accepted was KES 974.58 BN vs. KES 1.14 TN in bids received as the government aimed to reduce its reliance on Treasury Bills in order to lengthen its maturity profile to lessen its settlement and refinancing risks.

Treasury Bonds



Source: CBK

Generally, in 2021, the yield curve rose by 51 bps on average across all maturities. The upward shift in the yield curve was more pronounced in the shorter end of the yield curve (across the 1 to 5 year maturities) as it rose by 82.0 bps on average across those maturities in comparison to a 27 bps rise in the longer end of the yield curve (across the 16 to 23 year maturities). The intermediate part of the yield curve (across the 6 to 15 year maturities) rose by 55 bps. We believe that the disparity in the magnitude of the rise in the yield is due to the fact that shorter dated papers tend to have higher interest rate volatility (rise faster in a rising interest rate environment) than longer dated papers.

Treasury Bonds were oversubscribed in 2021 (calendar year) at 150.77%; total bids received were KES 1.10 TN against offered amount of KES 728.0 BN while the acceptance rate for Treasury Bonds was 76.05%; total amount accepted was KES 834.66 BN vs. KES 1.10 TN in bids received.

Rates (%)	Subscription	Acceptance
Treasury Bills	91.68	85.18
Treasury Bonds	150.77	76.05

Source: CBK, DBIB Analysis

The government continued its efforts to lengthen its maturity profile as the most frequent tenor of Treasury bonds issued was 25 years. According to the CBK governor, the average time to maturity for bonds has risen to 9 years (from 7.5 years in 2019) and this strategy has also been reflected in the decline in the ratio of Treasury bills/Treasury bonds which currently stands at 17.5%/82.5% (as at 28th January 2022) from 31.1%/68.9% (as at 27th December 2019).

In the secondary market, the value of treasury bonds traded in 2021 increased by 38.4% y/y to KES 956.1 BN from KES 690.7 BN in 2020. This was a significant jump from the 6.0% y/y rise realized in 2020. We believe the rise in bond turnover was catalyzed by the issuance of infrastructure bonds (three in the 2021 calendar year) and the continued investor preference for fixed income securities over equities amidst concerns about the economic recovery post-COVID.

Outlook

Overall, our expectation is that the yield curve will rise further especially in 1H22 occasioned by the ongoing fiscal pressures facing the government. The recent supplementary budget tabled before parliament includes new priority expenditures such as the 2022 general elections (KES 8.81 BN), COVID-19 related government interventions (KES 9.84 BN), infrastructure (KES 7.3 BN), maintenance of the fuel subsidy programme (KES 24.73 BN), education (KES 11.23 BN) and financial aid to Kenya Airways (KES 26.56 BN). The supplementary budget is expected to increase the fiscal deficit (including grants) as a proportion of GDP to 8.1% in the current fiscal year (FY21/22) from 7.5% in the approved budget.

The fiscal pressures are further expected to be intensified by the 2022 Treasury securities maturity and payment profile. The Treasury bill maturity profile poses the greatest pressure especially in the months leading up to May. The coupon payment schedule for the remainder of FY21/22 appears moderately intense with at least KES 24.8 BN due every month. The bond maturity profile seems the least intense, as 3 bond maturities remain in the current FY21/22 while 3 more are expected in 1H22/23.

KES BN	Coupon	Bond Maturities	Bills Maturities	Total
February	34.9	-	108.6	143.6
March	28.3	3.7	99.9	131.8
April	33.2	-	94.1	127.3
May	41.7	-	85.1	126.8
June	24.8	68.0	47.0	139.8

Source: NSE, CBK and DBIB Analysis

Issue No.	Maturity	Amount KES BN	Coupon
FXD1/2007/015	Mar 7, 2022	3.7	14.5%
FXD2/2007/015	Jun 6, 2022	32.7	13.5%
FXD1/2012/010	Jun 13, 2022	35.3	12.7%
FXD1/2017/005	Aug 22, 2022	29.6	12.5%
FXD2/2017/005	Oct 17, 2022	20.7	12.5%
FXD3/2007/015	Nov 7, 2022	33.0	12.5%

Source: NSE and DBIB Analysis

However, we do not expect the rise in the yield curve to persist throughout the year. We believe that at some point, the rise in interest rates will peak. We opine this peak will occur in the period between the tail-end of the current fiscal year FY21/22 and the general elections, as the government eases on domestic borrowing. In the period after the general elections, we anticipate interest rates to decline as the government attempts to reduce its borrowing costs.

In light of our outlook on interest rates, we recommend the following general strategies:

- **Buy longer dated papers; owing to their high interest rate sensitivity (duration), longer dated papers are more likely to offer higher capital gains as interest rates begin to decline.**
- **Buy/hold shorter dated papers; buy -- in order to lock in the current high rates and hold -- with the government increasingly offering longer dated papers these papers are expected to be scarce.**
- **Sell intermediate papers; in order to re-allocate funds to longer dated papers or shorter dated papers.**

Equities

In 2021, the NASI, NSE 20 and NSE 25 all edged up, rising by 9.43%, 1.83% and 9.62% y-o-y respectively. This was emblematic of positive investor sentiments spurred by both strong corporate earnings and economic recovery following the dismal performance witnessed in 2020; the NASI, NSE 20 and NSE 25 eased by 8.59%, 29.61% and 16.71% in 2020 respectively.

Performance	2020	2021
NASI	(8.59%	9.43%
NSE 20	(29.61%)	1.83%
NSE 25	(16.71%)	9.62%

Source: NSE

Trading activity however declined in 2021 as both the volume of shares traded as well as the turnover eased by 23.05% and 7.50% respectively. We believe the decline in trading activity was in part influenced by investor preference for the bond market, whose turnover rose by 38.4% y-o-y to KES 956.1 BN.

Performance	2020	2021	Change
Volume (BN)	5.3	4.0	(23.05%)
Turnover (BN)	148.3	137.2	(7.50%)
Mkt Cap (KES BN)	2,336.7	2,592.92	10.97%
Market P/E (x)	13.19	22.49	70.53%

Source: NSE and Bloomberg

Foreign investor participation in 2021 dropped to 57% from 65% in 2020. We opine that this was caused by (i) the issuance of three infrastructure bonds by the CBK and (ii) a general global rally in equities in 2021 spurred by economic recovery and solid corporate earnings, resulting in capital flight.

	2020	2020
Foreign participation	65%	57%
Foreign purchases	55%	53%
Foreign sales	74%	60%

Source: NSE and DBIB Analysis

In spite of the lower volumes traded in 2021 vis-à-vis 2020, market capitalization edged up by 10.97% y-o-y to KES 2,592.92 BN reflecting improved investor sentiment which was evident in the remarkable capital gains witnessed in a number of counters (top gainers in 2021) such as:

- Car and General +54.32%
- Equity Group +44.32%
- Nairobi Business Ventures +41.59%
- BK Group +41.46%
- Absa Kenya +22.67%

Car and General's performance was mostly hinged on improved financial performance (after tax profits in FY20 jumped by 50.4% y-o-y on the back of reduced costs and a higher tax credit), the rally also stretched in 2022 on the back of news that the firm planned to venture into selling electric vehicles and tuk-tuks, a 223.7% y-o-y rise in after tax profits with respect to FY21 and a dividend payment of KES 3.20 (FY20: KES0.80).

Equity Group and Absa Kenya's performance were supported by impressive results posted throughout the reporting seasons (in 3Q21 Equity's after tax profits rose by 78.6% y-o-y to KES 26.9BN while Absa's rose by 328.3% y-o-y to KES 8.2 BN) and the expectation of resumption in dividend payments.

NBV's performance was sustained by increased investor speculation (and lack of price discovery) following news of its reverse takeover by Delta International FZE and the introduction of new subsidiaries.

Safaricom rose from KES 34.25 at the end of December 2020, and rallied to an all-time high of KES 44.95 during the year. This rally was mostly hinged on market excitement around the expected entry into Ethiopia and economic recovery upon lifting of COVID-19 related restrictions. However, towards the tail end of the year, investors turned bearish on the counter following escalating conflict between the government of Ethiopia and forces in the northern Tigray region raised concerns about the stability of the country and consequently, Safaricom's ability to operationalize expansion into the country.

Outlook

As it stands, we opine investor sentiment towards the market remains somewhat muddied by the prospect of a series of interest rate hikes by the Federal Reserve (which tends to result in capital flight away from risky assets), global supply chain issues, geo-political tensions and elevated global crude oil prices.

Domestically, there is increased concern about the upcoming 2022 Kenyan general elections (that more often than not results in a wait-and-see attitude amongst investors) and fiscal issues (high taxation, debt sustainability).

Overall, given the aforementioned factors, we expect investors to proceed with caution as such we don't expect to see much interest in the stock market (both from local and foreign investors), even in fundamentally strong counters such as banks. We believe there is some room for price action on banks precipitated on the release of FY21 results and the expected dividend payments. However we see this as being limited as we feel that the stellar performance of FY21 has more or less already been priced in. Post FY21 banking earnings season we anticipate a lull triggered by the prevalent global and domestic risks.

Generally, the run-up to the general elections in Kenya has been characterized by quite a bit of uncertainty. Historically, the stock market tends to be highly responsive to both positive and negative electoral news. For instance, the NASI index surged by 30.10% from the end of 2016 to 28th August 2017 (this period marked a recovery in the stock market following a bear run in 2016 initiated by the implementation of the Banking (Amendment) Act 2015) and then dipped by 5.22% the day of the nullification (1st September 2017). The period after the nullification was marked with uncertainty resulting in a 3.37% drop in the NASI index to 154.93 in 19th October 2017. However, given the clear guidance offered by the Supreme Court (as per the Constitution) and investor confidence egged on by the acceptance of the nullification by President Uhuru Kenyatta, the NASI index rallied by 13.60% between 19th October 2017 and 11th December 2017 unperturbed by the 26th October election re-run.

In our view, we expect the pre-election period to be marked by subdued investor interest in the stock market in favor of the fixed income market especially in light of the current global factors. As we approach the election period, depending on the turn of events we could see some volatility in this period. However, in the post-election period, we expect to see renewed interest in the stock market (this will be predicated on how disputes will be resolved); at this point, the Fed rate hikes will already be fully priced in most global stocks as the new presidential era in Kenya begins to take shape.

In terms of market timing, we opine the best time to invest would be the period prior to the elections; when political alliances are finalized and manifestos begin to crystalize – as this will provide more clarity on the economic direction of the country after the elections -- buoying investor confidence.

Disclaimer

While every care has been taken in preparing this report and it has been prepared from sources believed to be reliable, no representation, warranty, or undertaking (express or implied) is given and no responsibility is accepted by Dyer and Blair Investment Bank Limited, its related companies, subsidiaries, affiliates, its employees and agents, as to the accuracy and completeness of the information contained herein or in respect of any reliance on or use thereof. This report is solely intended for distribution to clients of Dyer and Blair Investment Bank Limited. Any information may be changed after distribution at any time without any notice.