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Innovative Thinking

Q1 2023
MARKET REPORT

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ACTUARIAL SERVICES EAST AFRICA LIMITED

KENYAN MARKET PERFORMANCE

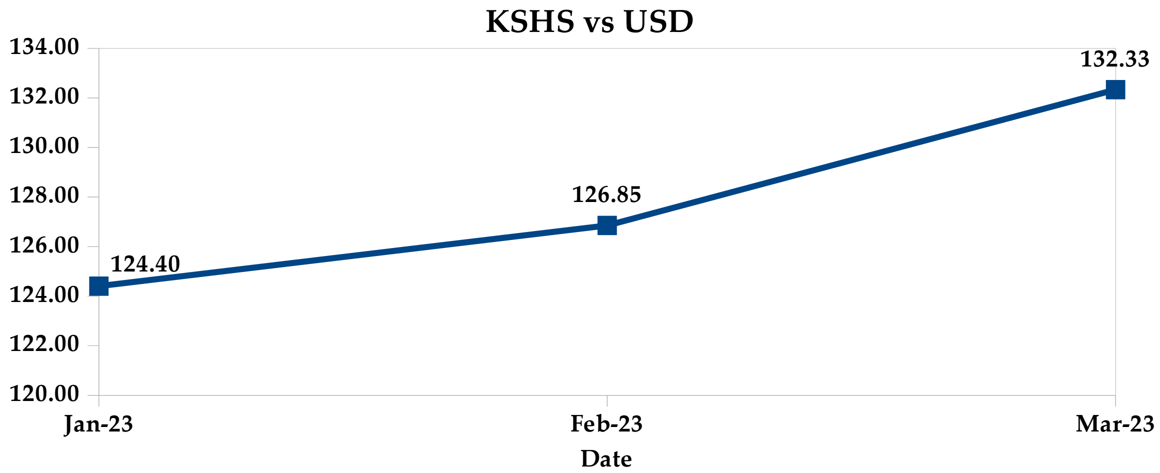
MACROECONOMIC REVIEW

GDP

Kenya's GDP is projected to grow at 5.2%, weighed down by sustained inflationary pressures, a slow recovery in agricultural sector performance and downstream effects of an unstable global market.

Currency

During the quarter, the Shilling slumped further against the US dollar, as the country faced dollar scarcity. The shortage stems from a mismatch between demand from energy and commodity importers and expected inflows from agricultural exports and the service industry. The weak interbank foreign exchange market, combined with parallel trading for the dollar, produced rates that differed from those quoted by CBK, resulting in wider dollar spreads.



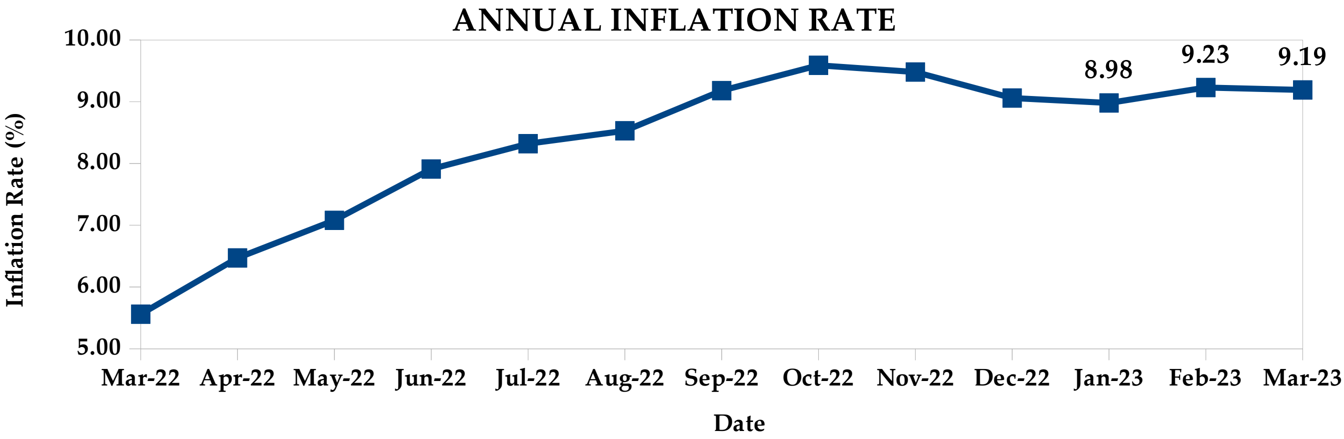
The usable foreign exchange reserves began the year and quarter at USD 7,381 million, translating to 4.13 months of import cover, in line with both CBK's statutory requirement but subpar to EAC's convergence criteria. At the end of January until the end of the quarter, the reserves have been in breach of the 4- and 4.5-months of import cover threshold. This has continued to pile pressure on the Shilling as the country tackles dollar-denominated debt repayments and the high import bill.

The prevailing dollar shortage will also dampen the Shilling's outlook over the next quarter as the market moves into dividend payouts following the release of 2022 financials. This poses a challenge especially for foreign investors seeking to repatriate dividends and returns.

The Government has however taken strides to ease the Shilling pressure, with moves such as the government-to-government agreement to import fuel on a six-month credit basis as well as making payments in Kenya shillings. Additionally, Central Bank's Foreign Exchange Code, requiring quarterly monitoring and reporting of foreign exchange transactions by commercial banks, is set to promote transparency and integrity in the market.

Inflation

During the quarter, inflation averaged 9.13%, with February snapping the three-month downward trend. The period was characterized by rising electricity prices and a sustained increase in gas/LPG prices in February and March. Food prices remained elevated following erratic rainfall patterns.

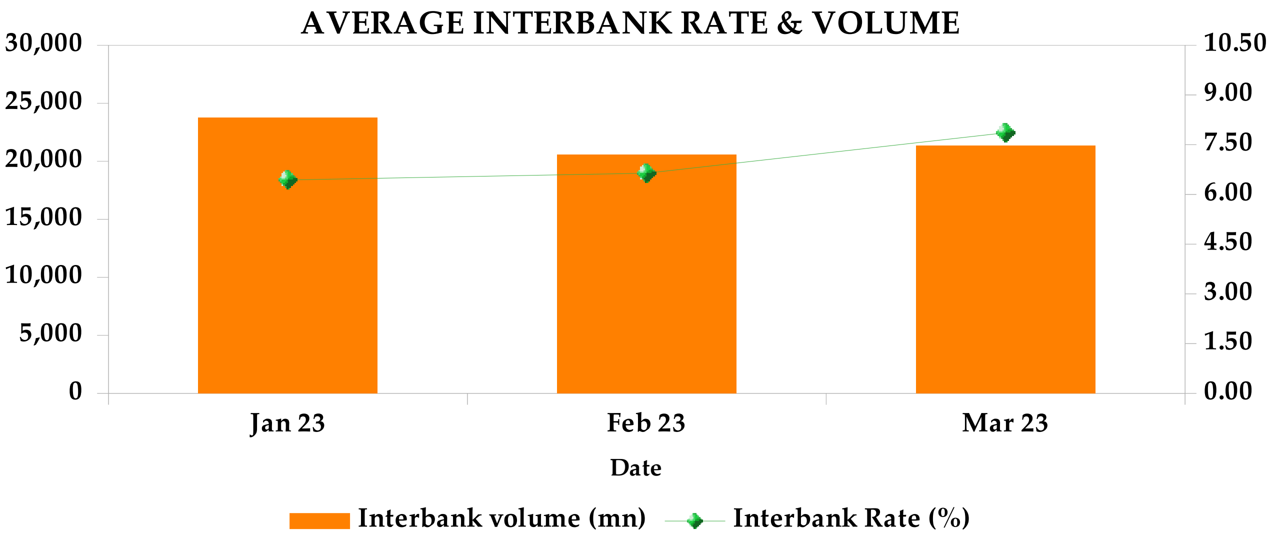


In response to elevated yet retreating inflation, the Monetary Policy Committee (MPC) maintained Central Bank Rate (CBR) at 8.75% in the January meeting. The move was explained as allowing the previous rate adjustment to work its way through the economy. As inflation picked up pace in February against the backdrop of uncertain global financial sector stability, the MPC decided to raise CBR by 75 bps to 9.50%.

Inflation is expected to remain above the 2.5% - 7.5% target band for the next quarter, as persistent pressures keep the headline figure elevated.

Liquidity

Liquidity in the money markets generally tightened over the quarter, with only a few stray days of eased flow of funds. The average interbank rate rose to a three-year high, previously witnessed in October 2019, of 7.86% at the end of the quarter as tax remittances offset government payments. The volume of interbank transactions surged from Kshs 13.26 billion at the beginning of the quarter to Kshs 21.35 billion. Commercial banks excess reserves dropped from Kshs 12.7 billion at the start of the quarter to Kshs 8.9 billion.

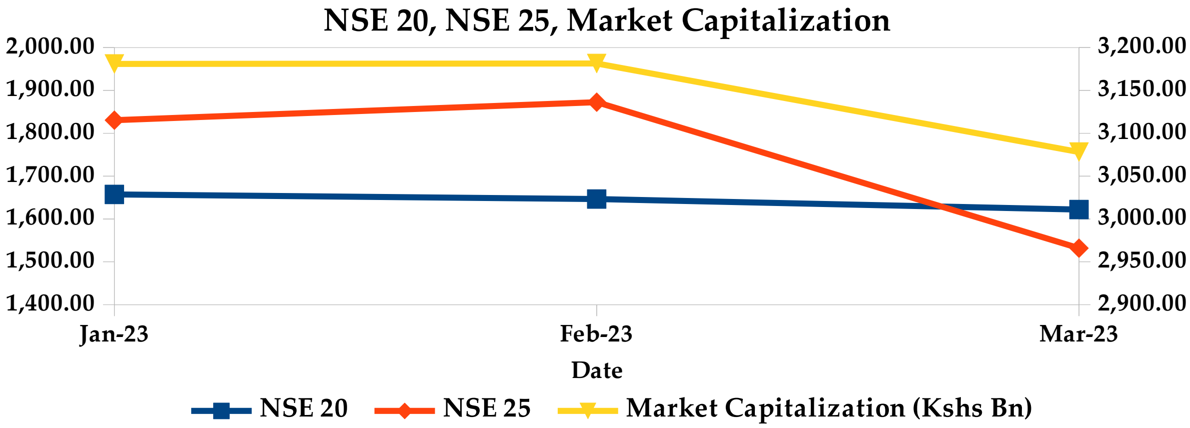


PMI

In January, PMI peaked at an 11-month high of 52, picking up pace from 51.6 in December 2022, pointing to slight improvement in private sector health, stronger demand and a boost in business confidence. In February, the reading dipped to 46.6, chalked up to weaker demand on rising inflation, reports of increased taxes and higher import costs made worse by a battered Shilling. During both months, firms noted cost pressures due to a faster rise in purchasing costs. In March, the headline index scaled higher to 49.2, as firms battled US dollar scarcity, which led to difficulty accessing commodities and prolonged delivery periods.

EQUITIES

NASI, NSE 20 and NSE 25 contracted 11.45%, 3.18% and 5.49% over the quarter. The bourse witnessed record lows in terms of valuation with market capitalization dipping to Kshs 1.61 trillion on 17th March 2023, representing a year to date decline of 18.84%. Most counters traded at year-to-date discounts of 31.68% for KenGen, 31.43% for Kakuzi, 24.74% for Safaricom, 7.43% for KCB and 5.78% for NCBA. Other banking counters were saved by the release of positive year-end financials, leading to quarterly gains. However, sentiment was bolstered by the sale of EABL shares, which were oversubscribed in both the first and second phases of the tender offer.



Top 5 Gainers	QTD Change
Umeme	55.75%
Kenya Orchards	44.23%
I&M Holdings	22.29%
HF Group	20.95%
Flame Tree	17.27%

Top 5 Losers	QTD Change
Unga	-41.88%
Car & General	-40.41%
KenGen	-31.68%
Kakuzi	-31.43%
Safaricom	-24.74%

Foreign investors plight persisted, as evidenced by their net outflow position over the quarter, registering a total Kshs 22.68 billion in sales and Kshs 8.76 billion in purchases. Safaricom recorded Kshs 8.02 billion in total foreign investor turnover, followed by EABL with Kshs 4.85 billion and Equity at Kshs 1.93 billion.

Foreign Investor Activity		
Month	Inflows (Kshs. 'Mn')	Outflows (Kshs. 'Mn')
January	2,522.45	5,399.13
February	1,690.44	2,032.94
March	4,544.36	15,252.15

Top 5 Performers by Market Turnover		
Counter	Turnover (Kshs. 'Mn')	% of Total Market Turnover
EABL	23,476.79	52.39%
Safaricom	12,767.92	28.49%
Equity	3,299.27	7.36%
KCB	1,530.19	3.41%
BAT	923.25	2.06%

Yields on US Treasury bonds have been adjusting upwards, pricing in the high interest rate environment. As a result, foreign investors have been looking towards reducing their risk exposure in frontier markets. This, coupled with the weakening Shilling and US dollar liquidity constraints in the country, sparked concerns about dividend and return repatriation.

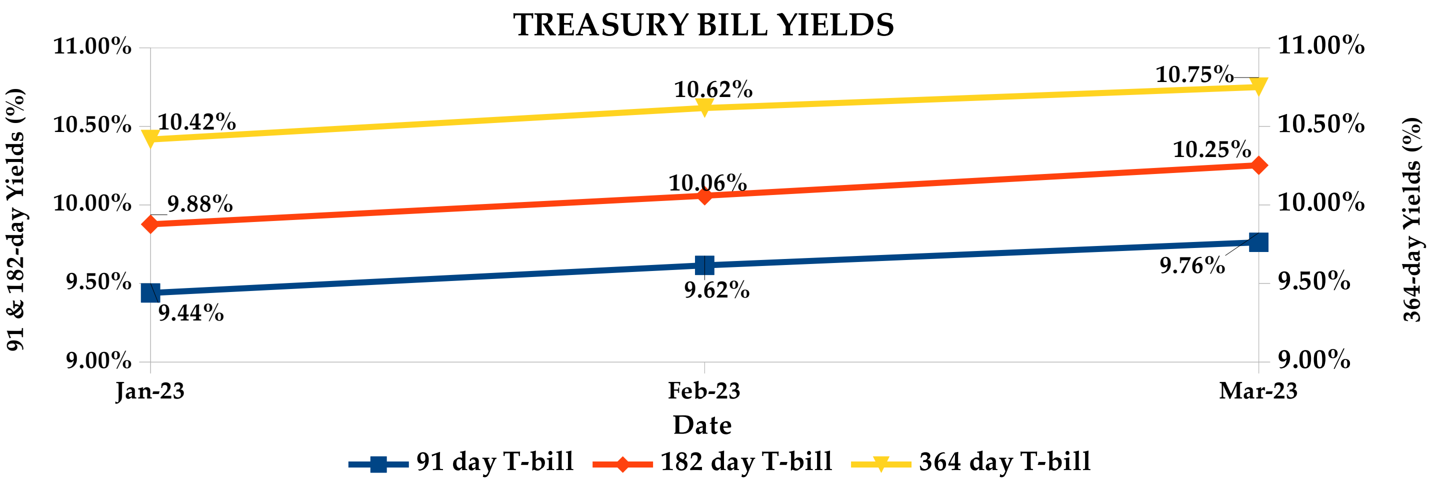
Major highlights within the Equities market

- CBK released the Kenya Foreign Exchange Code (FX Code) to promote integrity and effective functioning of the FX market.
- Cabinet approved the Privatization Bill, 2023 that gives the green light for sale of state-owned entities without seeking Parliament's nod.
- Diageo completed the two phases of the tender offer to take up additional ordinary shares in EABL.
- CMA facilitated an engagement on establishment of Kenya National Real Estate Investment Trust (KNR)
- NSE amended its trading rules to accommodate block trades to drive up liquidity in the market.
- Equity Bank finalized the Assets and Liabilities Purchase of Spire Bank after receiving requisite regulatory approvals.
- Acorn Holdings announced a Kshs 6.7 billion green financing partnership with Absa Bank for the development of an additional 12,000 units of affordable housing units. The balance of the 11 billion financing package is set to be covered by equity raised through the REIT.
- NSE extended the suspension of KQ shares trading for a further 12 months.

FIXED INCOME

Treasury Bills

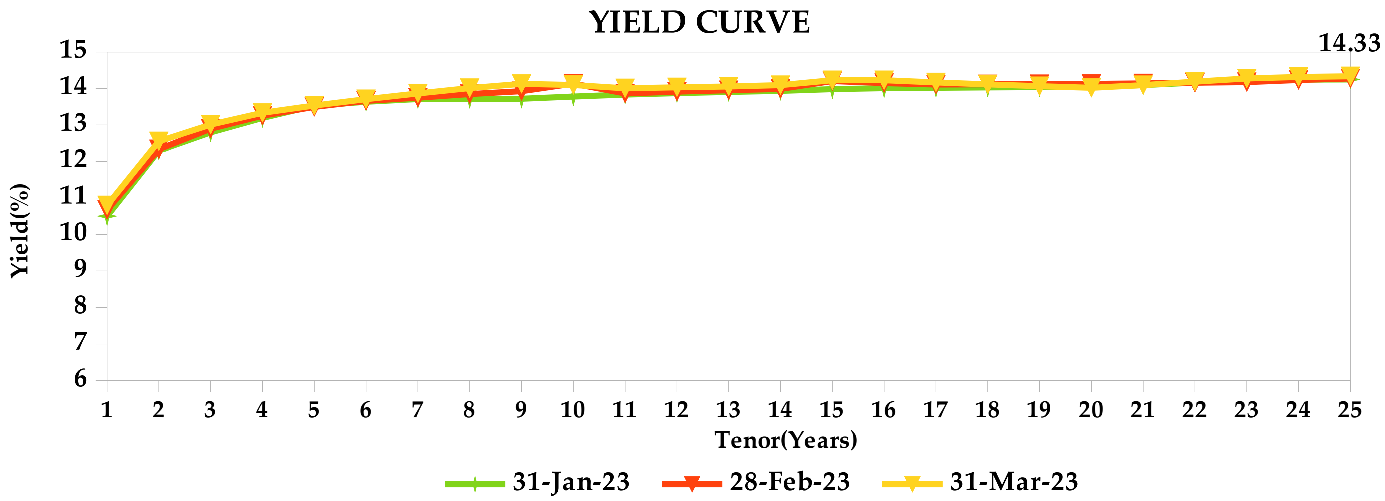
The overall average subscription rate for the quarter came in at 130.53%, an increase from 116.86% recorded in Q4 2022. Investor preference for the shorter term 91-day paper prevailed in a bid to hedge against duration risk. Yields increased by 0.42%, 0.35% and 0.48% to settle at an average 9.62%, 10.08% and 10.61% for the 91-day, 182-day and 364-day issues respectively.



Treasury Bonds

In the primary market, CBK sought a total Kshs 240 billion from bond issuances, a decline from Kshs 272.8 billion targeted in Q4 2022. Average subscription rate dropped 19.42% compared to Q4 2022, attributed to tightened market liquidity. Average yield rose from 13.85% in Q4 2022 to 13.97% as investors pursued higher returns to compensate for inflationary pressure and a weaker Shilling.

In the secondary market, there was a higher demand for bond offers, with total turnover inching 0.57% higher, from Kshs 160.23 billion in Q4 2022 to Kshs 161.15 billion in Q1 2023. Total bond deals rose 18.03% from 6,695 in Q4 2022 to 7,902 in the first quarter.



Eurobonds

In the international market, yields on Kenya's Eurobonds rose by an average 137 basis points over the quarter. The rise is attributed to S&P downgrading Kenya's outlook from stable to negative amid strained domestic debt uptake and increased concerns about the country's debt vulnerability, the current dollar shortage as well as chipping away of the Shilling's value relative to the greenback.

Bond	QTD Change
2014 10-Year Issue	0.79%
2018 10-Year Issue	1.87%
2018 30-Year Issue	0.78%
2019 7-Year Issue	2.35%
2019 12-Year Issue	1.01%
2021 13-Year Issue	1.39%

Major Highlights in the Fixed Income market:

- World Bank expanded Kenya's loan kitty under the Development Policy Operations (DPO) facility by $250 million to $1 billion.
- S&P Global revised Kenya's outlook from Stable to Negative while affirming the 'B/B' long and short-term foreign and local currency sovereign credit ratings.
- Cabinet gave approval for the legislative proposal to revise the nominal debt ceiling from Kshs 10 trillion to a debt anchor set at 55% of GDP.
- CBK announced automation of the process of onboarding for investors of government securities creating portfolio accounts.
- CMA pledged support to Nairobi City County Government on the issue of a green bond and possible listing of state entities to fund development projects.

GLOBAL MARKET PERFORMANCE

MACROECONOMIC REVIEW

According to IMF's World Economic Outlook January 2023 update, global growth for the year was estimated at 2.9%, followed by an upbeat to 3.1% in 2024. The forecast came as a 0.2% upward adjustment from the October 2022 prediction. This outlook was shaped by the step-down in global inflation projection from 8.8% in 2022 to 6.6% in 2023 and 4.3% in 2024. Other influencing factors included China's reopening, contributing both supply chain relaxations and aggregate demand, despite the scale being weighed down by sustained geopolitical risks and tighter global financing conditions, which could worsen debt distress.

Global equity markets rallied strongly in January, while fixed income markets received support from dwindling inflation and the optimism of slow-down in monetary tightening. In February, both markets were under the rubble, with prevailing economic data proving resilient and investors pricing in elevated interest rates on their long-term holdings. In March, the walls holding up the banking system started to show signs of weakness, with the collapse of Silicon Valley Bank rattling the equities market (particularly value stocks) while investors sought refuge in government bonds and growth stocks. Over the quarter, the global aggregate bond index reported a 3% return.

COMMODITIES

Crude Oil

ICE Brent and Crude Oil WTI futures were on a consistent downward streak over the quarter, having lost 2.84% and 1.84% respectively since the beginning of the year. The crude oil futures price fell below $70 in March as the banking sector turmoil pushed investors to sell off risky assets.

At the tail-end of the quarter, a number of OPEC members announced cuts to oil production starting May 2023 and lasting until the end of the year. The voluntary cuts were led by Saudi Arabia, intending to shave off 500,000 barrels per day (bpd), with the aim of supporting stability of the oil market. UAE, Kuwait, Oman, Algeria and Kazakhstan all followed suit, announcing cuts of 144,000bpd, 128,000bpd, 40,000bpd and 78,000bpd respectively. This follows Russia's move to also cut output by 500,000bpd starting March 2023, translating to 5% of its total output.

Oil prices are expected to pick up pace as the second half of the year prospects remain bright, supported by anticipated resilience in the global economy, coupled with China's reopening lending support to demand. Goldman Sachs, among other forecasting banks, doubled down on their year end prices, raising expectations to $95 per barrel.

Gold

January's 5.10% gain in gold prices was supported by continued central bank purchases, a 23.4 basis points drop in the US 10-year Treasury yield, and a weaker exchange rate detrimental to the US dollar. Prices dropped 4.95% in February owing to a stronger US dollar and a 50 basis point surge in Treasury yields. Weaknesses in price translated to gold exchange traded funds, which suffered losses, with European and North American funds leading global outflows.

The murky environment of the US and UK banking systems has lent support to gold prices over the last leg of the quarter, seeing as they rose 6.70% in March. The asset continues to offer a safe-haven trade for investors trying to hedge their exposure to the economic turbulence. The rally in 2023 will be aided by a falling US dollar, expectations of lower interest rates, central bank purchases, recession risk and elevated geopolitical risk.

US MARKET PERFORMANCE

MACROECONOMIC REVIEW

GDP

The World Economic Outlook January update projected US growth as falling from 2.0% in 2022 to 1.4% in 2023 and 1.0% in 2024. The US economy expanded by 2.6% in the fourth quarter of 2022, a deceleration compared to 3.2% in the third quarter. This was ascribed to lower consumer and local government spending, a drag in exports and business investment.

The US Dollar Index retreated 1.97% against major currencies (including the Euro and Japanese Yen) on a quarter-to-date basis. Further declines are expected as the year progresses against the backdrop of modest and a potential end to rate increases, as well as the economic slowdown, bringing into question the attractiveness of the currency to foreign traders.

The US has been faulted with increasing reliance on sanctions and weaponizing access to the greenback, casting doubts on the dollar's supremacy and intensifying talks of an alternative currency.

Inflation

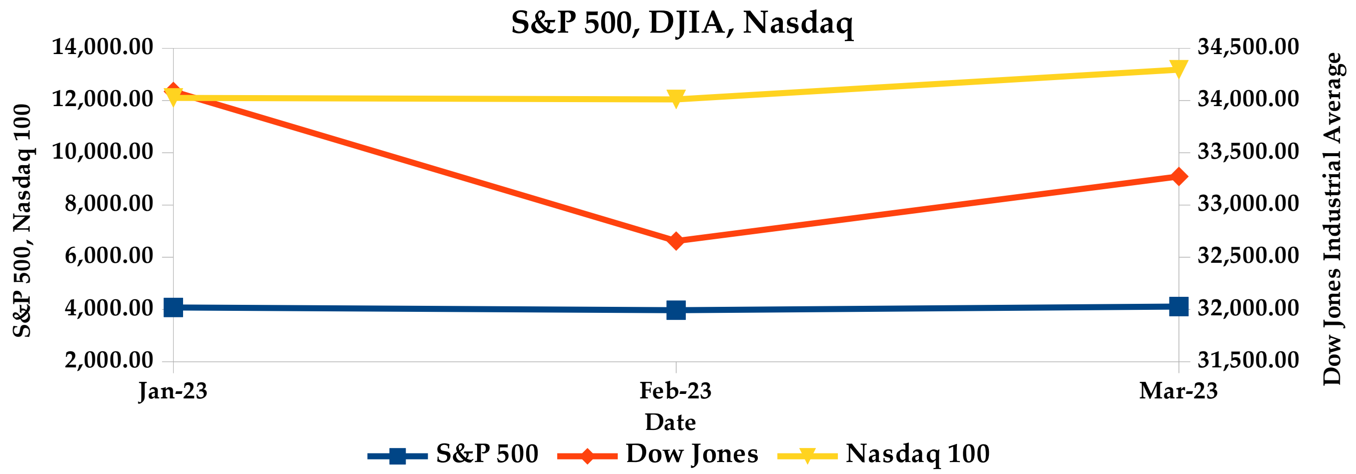
US inflation dipped marginally in January to 6.4% from 6.5% in December 2022. The consumer price index eased further to 6% in February, aided chiefly by a drop in energy prices.

The Federal Reserve, in their second policymaking meeting of the year in March, voted to raise interest rates by 25 basis points. This came after a similar 25 bps hike in January and in the midst of a potential financial crisis surrounding the banking system, stubborn inflation and a tight labor market. Fed officials had likely anticipated raising rates by at least 50 bps, but the banking situation lent some support by bringing down prices without necessitating higher interest rates.

While the central bank's mission to return inflation to its target 2% remains clear, these efforts have been complicated by recent developments within the financial market which are likely to restrict credit access for households and businesses, weighing down the economy. Stringent lending standards by small and mid-size banks could potentially shrink the economy's growth by up to 0.5%, with Goldman Sachs lowering US growth forecast by 0.3% to 1.2% in 2023.

EQUITIES

US indices gained during the first quarter of 2023, proving resilient amidst a period characterized by a shaky banking system, cryptocurrency meltdowns and apprehension with respect to the economy. The S&P 500, Dow Jones and Nasdaq ended the quarter 7.46%, 0.39% and 21.35% higher respectively, although the numbers are not a linear representation of the market's efforts to ride out the turbulence.

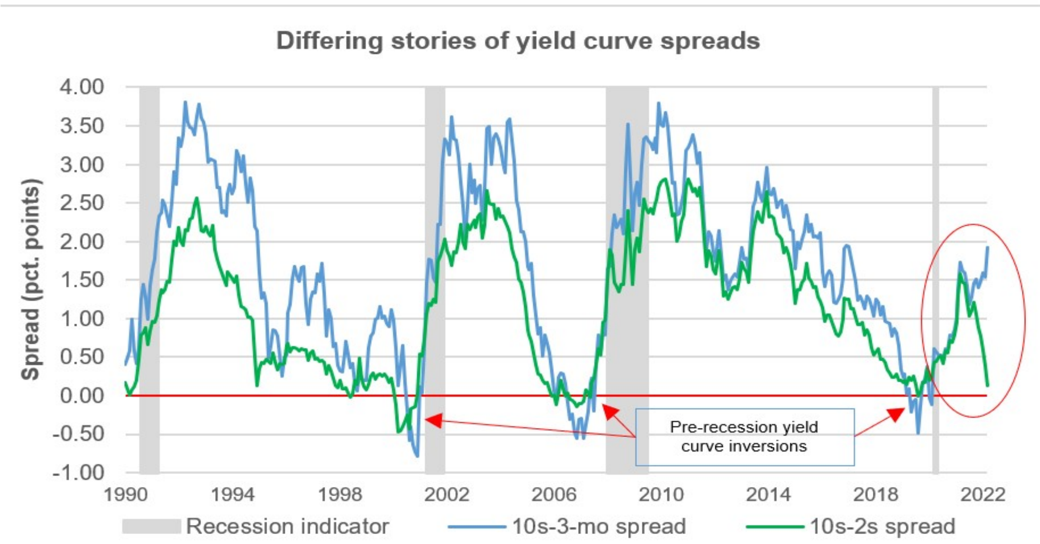


Technology stocks rallied through the quarter, leading sector gains by up to 20% attributed to individual gains posted by Meta, NVIDIA and Advanced Micro Devices, followed closely by communication services which were up 18%. Energy stocks ended 5% lower as oil prices slid over the quarter while defensive stocks lagged as stocks in the value-centric healthcare and utilities sector recorded losses.

FIXED INCOME

The bond market recovered slightly from returns posted in 2022, as prices which move inversely with yields, rose. The 10-year Treasury note opened the year at 3.75% and ended the quarter at 3.47%, dropping to lows of 3.37% and peaking at 4.06%. In the wake of the banking crisis, the higher-quality bonds gained while lower-quality, higher-yield bonds carrying the highest default risk trailed. Interest rates and the Fed's policy outlook fueled bond returns between January and February.

Yields on the 2-year Treasury bond, which tracks expectations for Fed action, began the year at 4.37% before dipping to 3.99% prior to February's inflation reading in March. Yields dropped to 4.03% at the end of the quarter. The spread between the 2-year and 10-year treasury bond shrank narrowly over the quarter, from -0.63% at the beginning of the year to -0.55% at the end of the quarter. A negative 10-2 yield spread has historically been an indicator of a recessionary period, as the wider the spread/inversion, the higher the chance of a recession.



Source: Bloomberg; RSM US

EUROPEAN MARKET PERFORMANCE

MACROECONOMIC REVIEW

GDP

Growth in the Euro area was projected to dip to 0.7% in 2023 before rising to 1.6% in 2024. This was a 0.2% upward revision by IMF, attributing the forecast to the causal effect of the rate hikes by European Central Bank and watered down income levels. This is expected to be offset by lower wholesale energy prices stemming from price controls.

Growth in the United Kingdom was projected at -0.6% in 2023, a 0.9% downward adjustment from IMF's October estimates, indicative of tighter fiscal and monetary policies as well as stringent financial conditions weighing on household income. The UK economy expanded by 0.1% in the final quarter of 2022 following a 0.1% contraction in Q3. This was accredited to growth in household consumption, higher investment spending and higher government consumption. On a full year lens, UK's economy grew 4.1% in 2022, easing from 7.6% in 2021.

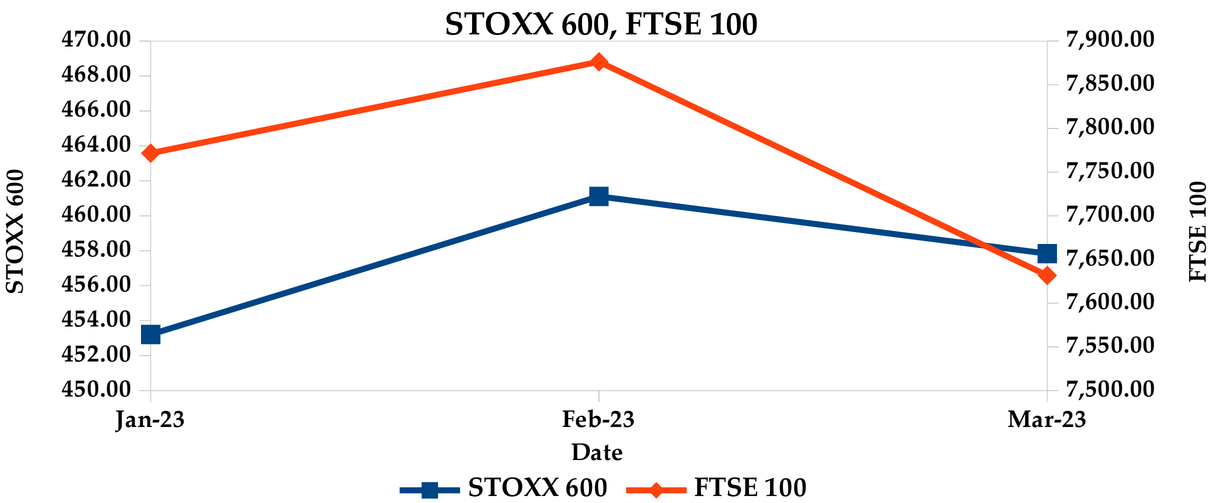
Inflation

UK's annual inflation slightly eased to 10.1% in January 2023, from 10.5% in December 2022, reversing the drop in February by rising to 10.4%. This was reflected in the price increase in the food and energy sectors, sustaining the pressure on households.

To rein in inflation, the European Central Bank (ECB) and Bank of England (BoE) pushed rates 50 bps higher in the February meeting. In March, ECB maintained a 50 bps rise, pushing borrowing costs to the highest level since 2008, while BoE lifted rates by 25 bps. Coddling investor sentiment on the US and UK banking crises, both policymakers insisted on the strong capital and liquidity positions of the sector.

EQUITIES

European indices advanced, with both the Stoxx 600 and FTSE 100 logging 6.74% and 1.03% quarterly gains, despite weeks of tension in the banking sector. With investors anticipating inadequate gas supplies to survive the winter season, the period turned out milder than average as the region stocked up and diversified its energy needs, leading to an influx into European stocks.



Banking stocks in the region were set to ride the wave of stronger than expected euro zone economic data and quarter earnings growth before 10th March, before they felt the heat as a result of the collapse of Silicon Valley Bank and concerns around Credit Suisse. Volatility in the Deutsche Bank shares further fanned the flames of Europe's financial sector after the cost of insuring its debt against risk of default rose to a record four-year high.

ASIAN MARKET PERFORMANCE

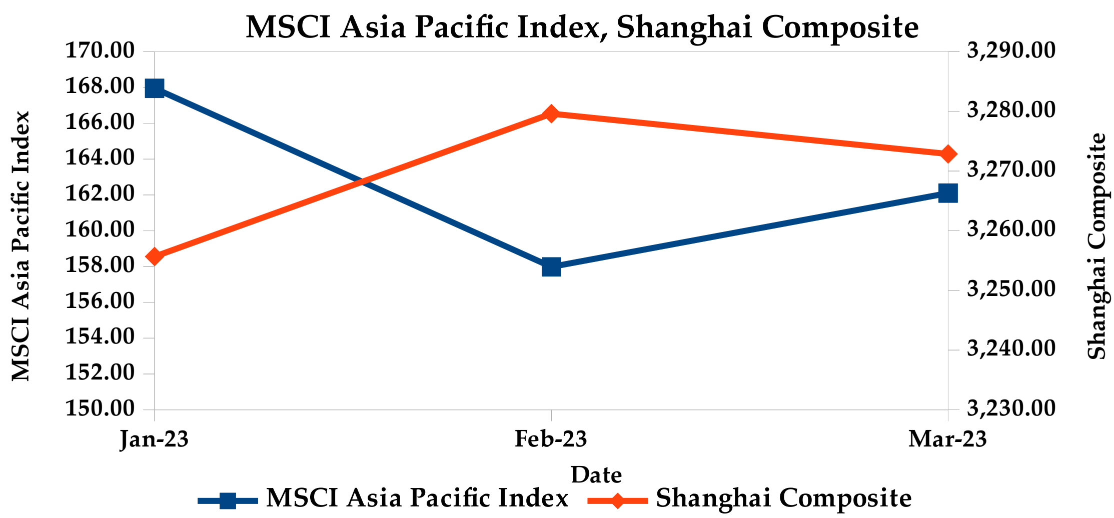
MACROECONOMIC REVIEW

Growth in emerging and developing Asia was projected at 5.3% in 2023 and 5.2% in 2024, from 4.3% in 2022, aided by growth in China's economy and robust domestic demand in India. China's Purchasing Managers' Index (PMI) data for March indicated an acceleration in the service sector, the fastest pace in 12 years, while manufacturing activity slowed, pointing to uneven recovery.

Increased trade relations between Russia and China have resulted in the use of Yuan, with energy importers' payables being settled in the Chinese currency. Russia's dependency on China for semi-conductors has grown stronger over time, while companies issued bonds in the Chinese currency, boosting trade between the yuan and the ruble to the highest daily volume on the Moscow Exchange. In March, the Reserve Bank of India approved Central Banks from 18 countries to open Special Vostro Rupee Accounts (SVRAs) to allow payments be offset using Indian rupees as the country moves towards de-dollarization.

EQUITIES

Asian indices braved the quarter's shake-ups, with the MSCI's broadest index of Asia Pacific shares outside Japan posting a 4.06% gain, while Shanghai Composite recorded a 5.02% uptick. The US dollar index subdued performance lent support to the market sentiments, indicating a weak appeal from local investors for the safe-haven securities.



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Actuarial Services E.A. Limited
26th Floor | Old Mutual Tower | Upper Hill Road |Upper Hill |
Tel. No: +254 20 271 74 03 / +254 20 271 00 28 / +254 708 710 028 / +254 785 710 028 / +254 111 037 100
Email: info@actserv-africa.com| | Website: www.actserv.co.ke