
# MARKET OUTLOOK 2023


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With economies around the world anticipating economic recoveries following the effects of the Covid-19 pandemic in years 2020 and 2021, 2022 appeared to be the year of good fortune. However, this was not the case when the Russia-Ukraine war broke out early in the year. Runaway inflation, the following tightening of monetary policies by central banks of industrialized nations, and supply disruptions globally that particularly affected the oil, food, transportation, and logistics industries dominated this. Further supply shocks were sent throughout the world by China's tougher lockdown measures, which hurt both established and developing markets.

These global events had a significant knock-on effect on Kenya's economy, which was just starting to recover. Foreign investors' capital flight increased after the news of the war's outbreak as they looked for stable returns, primarily in fixed income securities in highly developed markets. Due to this, the market experienced a significant decline, and investor portfolios suffered as a result. General election uncertainty in August also caused a foreign sell-off, with foreign investor participation numbers falling to an average of 46.0% of total transaction at the exchange from previous norms of 60-70%.

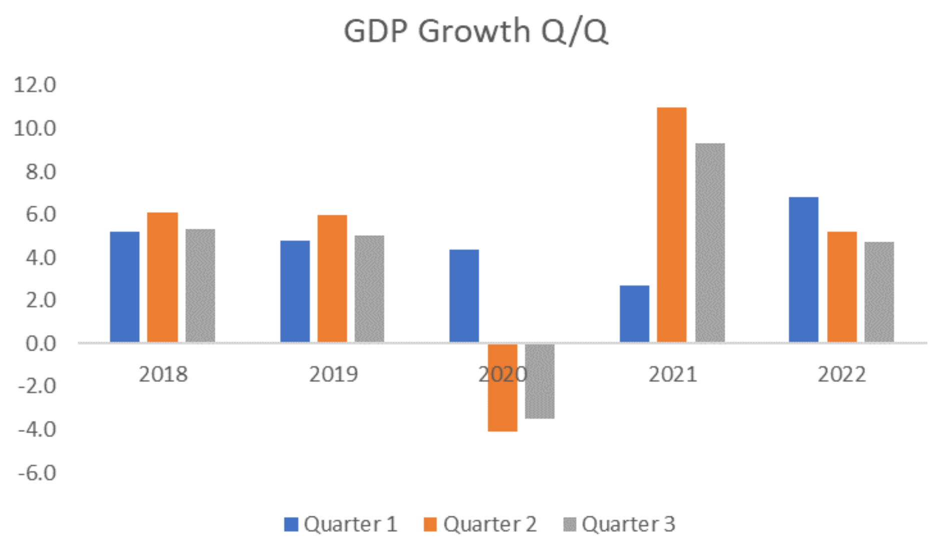
**Global Outlook**

Globally high inflation rates have had a negative impact on economies in both developed and developing nations. In response, central banks tightened their monetary policies, starting a string of benchmark rate increases in the world's largest economy—the United States—to maintain the dollar's strength. As investors acquired positions in the US market, there were significant withdrawals from the local marketplace. China's zero COVID policy shook the global supply chain severely. Looking forward, we see the following affecting global economies

- **Recession probability**: In these developed economies, analysts appear to agree that a recession is likely. When an economy experiences two or more consecutive quarters of negative GDP growth, a recession has occurred. With recent news of the easing of lockdown measures, which is likely to promote economic development in addition to the low inflation rates compared to other developed markets in 2022, China, on the other hand, doesn't seem to be on the same bandwagon.
- **Monetary policy actions**: The US Fed and other Central Banks are generally expected to take it easy on the aggressive tight runs of the previous year. Global economies are likely to experience a recession if tightening measures continue. However, the Fed has publicly stated through its chair that it will keep taking aggressive measures in an effort to contain inflation. As a result of these steps, US inflation has decreased to 6.5% in December 2022, which is still significantly higher than the required rate of 2%.

### Economic Performance

Economic growth in 2022 lagged below comparable years in 2021. Due to a fall in economic activity in the run-up to the general elections in August 2022, growth slowed in the first two quarters. In election years past, the same pattern has been observed: business and investment decisions are delayed pending the results of the elections. The agriculture sector experienced a 0.6% decline, which may be mostly attributable to the unfavorable weather that persisted throughout 2022's first three quarters and the rise in farm input costs that decreased production.

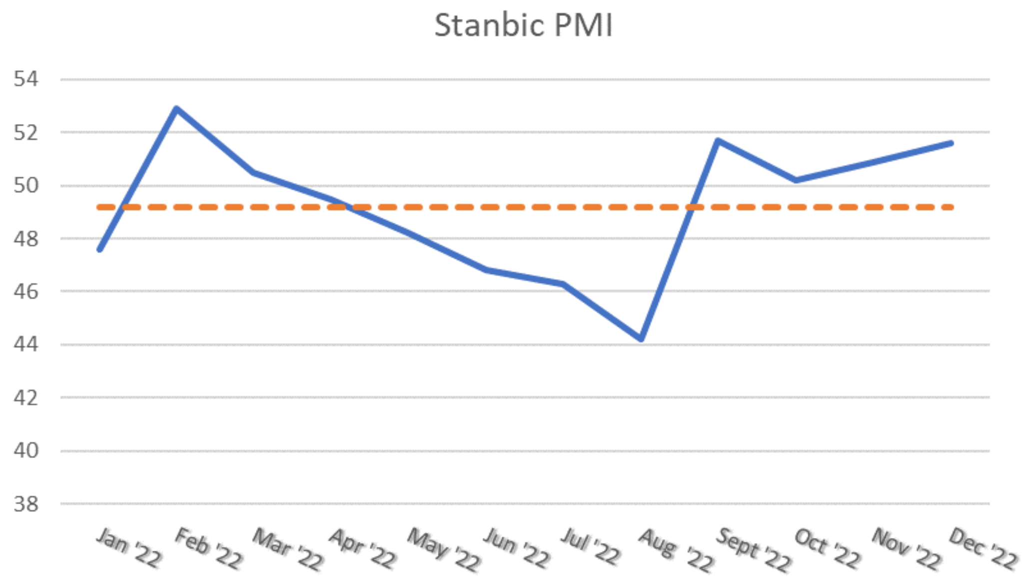



*Source: KNBS*

### Purchasing Mangers' Index (PMI)

The Stanbic Kenya PMI improved in 2022, reaching a three-month high of 51.6 in December after declining steadily for seven straight months from the start of the year to a low of 44.2 recorded in August, which was attributed to decreased business confidence during the run-up to the election. For the second consecutive month, output increased as a result of increased demand, favorable weather, and reduced pricing pressure. New orders, which were helped by an increase in domestic demand, kept growing in the meantime.

However, the decline to a nine-month low in export growth was disappointing. Employment expanded at its quickest pace since March, while work backlogs shrank for the second consecutive month. Input stocks continued to grow as purchasing activity increased for the fourth consecutive month at the same time. Input costs decreased to their lowest level in a year, thanks to decreasing labor expenses and stable energy prices. Output cost inflation, meanwhile, dropped to its lowest level since August. Finally, despite worries about the world economy, business sentiment remained muted. For the remainder of the year, the manufacturing PMI is predicted to continue above 50 points.




*Source: Stanbic PMI*

By the end of 2022, we anticipate Kenya's GDP to rise by 5.0% to 5.5% annually. New government policies that were implemented after a smooth transition period, increased credit growth in the private sector, and decreased fuel prices—which have plummeted to levels seen at the beginning of last year—will all contribute to the rise. Accommodation and food services, wholesale and retail commerce, and

industries still recovering from the epidemic all contributed to the growth, whereas agriculture, forestry and fishing, mining, and quarrying saw a minor decline.
The following factors look to dampen the near-term growth prospects in the economy:

- **Finance Act 2022:** The Act makes significant changes to Kenya's tax system with the main goals of improving revenue collection and bringing tax laws into line. The implementation of these taxes is anticipated to slow down activity in affected industries like financial services, real estate, and ICT as well as reduce investor mood in the private markets because KRA has a tax goal of little over KES 2.0 trillion.
- **Reduced agricultural production:** The agriculture industry, which accounts for more than 30% of Kenya's GDP, is still the foundation of that nation's economy. Reduced rainfall in the previous year is probably a factor in the lower crop yield. Additionally, higher farm input costs are probably going to result in poorer crop and animal yields, which will further hurt overall economic performance.
- **Global issue spillovers:** Because Kenya is still a net importer, world events do have an impact on our local economy. The war between Russia and Ukraine, which is expected to last until 2023, China's COVID problems, which are likely to have an impact on industrial production and cause supply shocks, recessionary fear in developed markets, and the monetary policy actions of top central banks are all potential factors that could slow economic growth.

**Inflation**

The average annual rate of inflation rose to 7.64% in 2022 from 6.11% in 2021. The third quarter saw a jump in inflation, which peaked in November at 9.59%, after two quarters of moderate growth. Food prices have increased as a result of subpar agricultural performance, as have the prices of non-alcoholic beverages. The transit, housing, and utility indexes all saw increases as a result of increasing fuel prices. However, inflation did decrease over the past two months to end December at 9.1%. For the most of the year, inflation is still anticipated to stay over the CBK's top target of 7.5%. The current inflationary pressure will be relieved using a combination of monetary and market forces because the majority of it is imported through a spillover of global inflationary challenges, despite continued efforts by the Monetary Policy Committee (MPC) to tame inflation by raising interest rates. The production of food, the elimination of subsidies for things like power, and local pump prices will all continue to have an impact on how quickly inflation rates change.

### Currency

The value of the shilling relative to the dollar decreased significantly in 2022, falling 9.14% year-over-year to conclude at KES 123.5 from KES 113.15 at the beginning of the year. The shilling lost value against the dollar as a result of increased demand for dollars from importers, rising crude oil prices, uncertainty surrounding Kenya's general elections, and other factors.

The following factors look to have huge impacts on the shilling:

- **Global Oil Prices:** As the year came to a close, oil prices fell back to the levels seen at the beginning of the previous year. The mid-year announcement by OPEC+ members to reduce output to match anticipated lower demand hasn't yet resulted in higher oil prices. Oil importers frequently drive local dollar demand, therefore lower prices will be beneficial to the local currency.
- **Diaspora Remittances:** In 2022, remittances from Kenyans living abroad, which amounted to an average of well over USD 300 million per month, continued to boost the dollar supply. Due to labor exports, Kenyans living in the Middle East have recently become a significant source of foreign income.
- **Revenues from the agriculture sector:** We anticipate that earnings from important dollar-earning commodities including tea, coffee, and horticulture will continue to be a significant source of foreign currency. The resurgence of major coffee and tea competitors, who had been struggling with poor production, is expected to weigh down the positive benefits of the new avocado market in Asia.
- Foreign capital inflows will be a major source of dollars to support the shilling's resistance. These inflows can come from direct foreign investments, the NSE market, and other sources of money.
- **USD Performance:** According to the DXY index, the US dollar increased by 8.2%. As they work to control inflation, the Fed will make an effort to maintain the dollar's strength through Federal Open Market Committee (FOMC) activities. However, concerns of a global recession in the US and other developed nations could cause the dollar to weaken.

### Monetary Policy

Tightening monetary policy: The Monetary Policy Committee met six times throughout the year, and in three of those meetings, interest rates were raised in an effort to control inflation, volatile stock markets, and economic uncertainty. These monetary policy choices aim to encourage economic growth and preserve price stability. We anticipate additional tighter measures in the future.

### Private Sector Growth

Compared to the same period in 2021, the private sector's credit growth improved throughout the year. We attribute the rise on the revival of the economy in industries including manufacturing, trade, and business services. Following robust economic activity and recent governmental initiatives like the credit repair framework and approval of the banking sector risk-based models, we anticipate loan expansion in the private sector in the near future.

Regarding the recently established Hustler Fund, it is not now making a significant contribution to the expansion of the private sector economy. The fund has yet to fulfill its intended function unless ticket size is increased and payback ratios improve.

**Interest rates and Yields on Government Securities**

The government's demand for debt through the CBK remained high due to pressure on tax collection efforts and an expanding fiscal burden. Significant liquidity in the money market over the past year has helped to keep short term interest rates low and steady. We anticipate that short-term interest rates will continue to rise; as an example, the 364-day paper recently crossed the 10% threshold near the end of the year.

The rates on government securities shifted upward last year as a result of investors seeking better returns as compensate for risks taken due to the increased unpredictability in both the global and local economies. We observed that investors preferred the 91-day paper as a means of reducing duration risk.

Moving forward into the year we expect aggressive bidding driven by:

- As evidenced by previously published papers, a 25-year FXD bond recently issued crossed the elusive 14.00% mark in its inaugural offering, demonstrating a growing appetite for higher risk-adjusted yields. Investors are now anticipated to respond to future issuances in a similar way.
- In order to obtain real rates of return, investors will make aggressive bids on future papers given the high levels of inflation that are currently present both locally and worldwide. According to the most recent data, the inflation rate is 9.1% as of December 2022.
- In an effort to reduce the risk of refinancing at the beginning of this year, the government issued a switch bond in the form of a six-year infrastructure paper in November 2022. This could indicate that investors will demand higher returns in order to make up for the increased credit risk, which could indicate a pessimistic outlook on the sustainability of debt.

**Equities Market**

In 2022, the NSE Equities market was in decline. All indices ended the year in the negative, with the NASI, NSE 20, and NSE 25 each experiencing declines of 23.42%, 11.90%, and 16.30%. Shares traded climbed by 1.93%, but market capitalization and equity turnover declined by 23.40% and 31.38%, respectively.

The largest gainers year over year were NCBA Group (51.35%), Olympia Capital (46.74%), and Car General (33.76%). The biggest y/y losers were shares of Centum (41.13%), Jubilee Holdings (37.25%), and Safaricom (35.66%).

Some factors that drove the equities market in 2022 include

- Corporate Actions: Some of the major factors influencing both upside and downside in 2022 included the announcement of bonus shares (Car General), dividends (NCBA, SCBK), rights issues (Trans Century), share buybacks (and takeovers Limuru Tea and EABL), and dividends (NCBA, SCBK). We anticipate that 2023 will see a continuation of the pattern of corporate actions influencing performance, including an increase in dividends, takeovers, and bonus issues.
- Foreign investor involvement When compared to a net selling position of USD 91.90 million in 2021, foreign investors continued to be net sellers, recording net outflows of USD 193.67 million. The depreciation of the KES, heightened investor risk aversion, and profit taking on numerous counters may be to blame for the net outflows of foreign investors.

**Outlook**

Our outlook for 2023 remains mostly tidy based on our view of the local market having incredible wealth creation opportunities that will play out in the long term We expect 2023 investors behavior to be driven by hunt for higher returns following the rise in the yield curve for fixed income assets coupled with hunt for higher real returns following the elevated inflation As such, we believe that investors will not only be enticed by huge capital appreciation but also dividend payments

- Outlook for the manufacturing, commercial, and agricultural sectors These industries faced a challenging operating environment in 2022, which contributed to the most profit warnings. These industries experienced greater operating costs due to local and global inflation causes, currency scarcity and volatility, and decreased consumer demand. With agriculture anticipated to have a stronger year due to rainfall projections, higher foreign profits, and new markets, we anticipate some of the issues to persist in 2023. Investors should think about stocks in the agriculture industry because they send out consistent dividends.
- Outlook for the Banking Sector Given the decreased lending risk, which results in lower impairment provisioning, return to loan book expansion, forex market arbitrage opportunities, and the return of bank to mobile money charges, we anticipate another year of great earnings from the banking industry. On the other hand, there is

a risk component related to the banking industry that investors need to be aware of. Banks largely benefited from the terrible spreads in the FX market in 2022. Questions concerning the exposure of banks' income are raised by the possibility that this FX trading income flow will start to recede in 2023.

- Telco industry Outlook We anticipate that regulatory scrutiny will continue to have an impact on SCOM in Kenya and Ethiopia. Additionally, Mpesa will continue to be SCOM's primary source of revenue and growth thanks to product improvements around it. The anticipated split won't have any detrimental effects, in our opinion.
- Listings: In his visit to the Kenya's Exchange to launch of the Nairobi Securities Exchange Enhanced Marketplace in October 2022, President William Ruto pledged the listing of 10 state owned enterprises in the next 12 months in a bid to awaken the country's capital market, yet to witness another listing since its last in 2015.
  "As we prepare between six and ten companies for listing in the stock exchange in the next 12 months and I promise you we will deliver on that commitment. I also want to encourage the private sector as we bring ten companies, please bring five" President William Ruto
- Corporate Actions: Centum in November 2022 announced the proposed buyback of 10% of its issued share capital over an 18-month period but subject to shareholder approval. This will be the second equity repurchase programme in East Africa after Nation Media Group kicked off the region's first in 2021 when it also sought to buy back 10% of its issued share capital.

Therefore, in the current depressed environment, we recommend investors to

- **Pay attention to overlooked counters** Olympia Capital and Limuru Tea, two under-the-radar stocks that investors had previously neglected, emerged, with increases of 48.74% and 31.25%, respectively, in 2022.
- **Purchase the dip** by acquiring equities at the current low prices, investors should take advantage of the international exits. Most of the listed companies have solid fundamentals, provide a dependable dividend, have growth potential, and historically have produced value.
- **Consider Dividend Paying Counters** It could be a good idea to take another look at counters that have historically paid dividends in a predictable and consistent manner in order to temper any previous bad performance.

## Stock Recommendations

### BUY

### EQUITY GROUP

### Tailwinds

- NPL ratio was the latest industry average
- Non-Funded Income grew y/y mainly driven by trade finance lending and Forex trading
- DRC acquisition is proving to be fruitful with positive growth in PAT

### Headwinds

- Tanzania subsidiary is struggling compared to other regional businesses

## KCB Group

### Tailwinds

- Loan to deposit ratio was driven by growth in mobile loans
- DRC acquisition is likely to expose KCB to a huge reserve of foreign exchange currency given the high usage of dollars in DRC.
- Proposed Payment of KES 1.00 Interim Dividend

### Headwinds

- Increased Gross NPLs

## ABSA Bank Kenya

### Tailwinds

- Growing loan book thus improving interest income.
- Increased traction of digital channels such as WhatsApp Banking and Timiza loans app expected to drive future growth
- Recent launch of the offshore wealth Management Program

### Headwinds

- Gross NPLs grew raising asset quality concerns

## Co-operative Bank

### Tailwinds

- Growth in non-funded income mainly driven by increased forex trading income
- Growth in loan book through a focus on MSME lending, better subsidiary performance and focus
- on improved digital channels
- Loan loss provisions declined indicating reduced lending risk

### Headwinds

- Lack of interim dividend despite an improvement in net earnings
- Gross NPLs increased

## Stanbic Kenya

### Tailwinds

- Growth in non-interest income after growth in digital channels
- Growth in the loan book steered by a resumption in lending and investments in digital banking

### Headwinds

- Increased Gross NPLs

### NCBA Group

### Tailwinds

- Maintained front in digital lending through digital platforms such as M Shwari and Fuliza to drive loan book growth
- Gross NPLs fell

### Headwinds

- Huge capital expenditure expected given the bank's intention to expand to other African countries

### Diamond Trust Bank (DTB)

### Tailwinds

- Enhanced digital transactions increased interest income.
- Increased investment in innovation is a good indication of their shift to digitization
- Net Interest Income increased mainly driven by the current market uptick in the bond yield of government papers

### Headwinds

Asset quality concerns persist as Gross NPLs increased.

### Standard Chartered Bank

### Tailwinds

- Performance from the Wealth Management and financial markets driving non-interest income
- Non-Funded Income grew mainly driven by trade finance lending and Forex trading
- The proposed interim dividend of KES 6 00 is likely to push the share price upwards

### Headwinds

- Loan to deposit ratio declined and is attributable to faster growth in customer deposits compared to Loan book growth.

### EABL

### Tailwinds

- Strong growth in new frontier and mainstream spirits
- Expected growth and improved performance from regional subsidiaries
- Diageo share purchase offer points to undervaluation and is a boost of confidence

### Headwinds

- Proposed tax law on mainstream alcohol may affect gross sales if passed

### Safaricom

### Tailwinds

- Revenues increased in HY' 23 with slowdown in MPESA Voice Revenue reported due to election uncertainty and revised MTR rates
- Improving 4 G subscriber mix, expected growth in both Mpesa and Data and expansion to Ethiopia expected to make the telco more attractive
- Reintroduction of Bank to Mpesa charges likely to drive Safaricom's bottom line upwards

### Headwinds

- Increased CAPEX from entry into Ethiopian market likely to reduce dividends in the short term
- Increased inflationary environment has led to reduced disposable income and reduced consumer purchasing power

### Jubilee

### Tailwinds

- Stable growth in investment income as a result of its diversified portfolio
- Lower operating due to operational efficiencies and cost control
- Stable dividend payment to the allure of investors
- Joint venture operations with Allianz

### Headwinds

- Decline in consumer disposable income due to a slowdown in economic activity and job losses may see a slowdown in insurance premiums growth while seeing a rise in claims and surrenders.

### Bamburi Cement

### Tailwinds

- Volume growth in Kenya and Uganda has greatly contributed to increased turnover in the year ended December 2021
- Expected growth mainly driven by key infrastructure projects in Kenya and Uganda
- Admission of DRC to the EAC will open up regional markets

### Headwinds

- Increasing energy costs, imported clinker and fuel prices are likely to increase operating costs
- Surging cement prices are likely to slow down consumption