Key Investment highlights

- Global interest rates maintain an upward trajectory as Central banks hike policy rates
- Soaring inflation sustains high-interest rate expectations
- The dollar clings to a record high

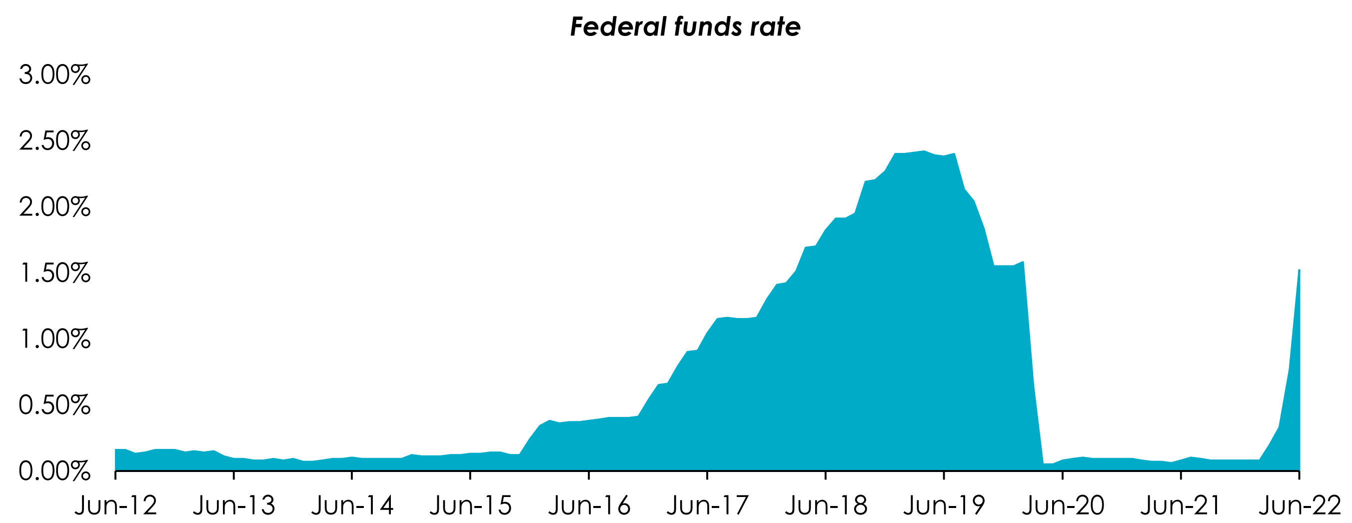
Global macro-economic update

The US Fed hiked the benchmark interest rate by 75bps in line with our expectations, bringing the federal funds rate to a range of 1.5%-1.75%. This marks the biggest increase since 1994. US inflation remained elevated at 8.6% in May with the main drivers being food and energy indices which rose by1.2% and 3.9% respectively year on year.

Higher inflation expectations should continue to filter through to the yield curve, more so on the short end. The US 2-year yield jumped 9 basis points to 3.37%, reaching its highest since December 2007. The benchmark 10-year Treasury note traded 4 basis points higher at 3.44% and the yield on the 30-year Treasury bond climbed more than 3 basis points to 3.446%.

The yield curve is regarded as a critical recession indicator; any enduring inversion, in which 2-year yields rise above longer yields (10-year and 30-year), is seen as an indicator of a recession. This curve had momentary inversions last Friday.

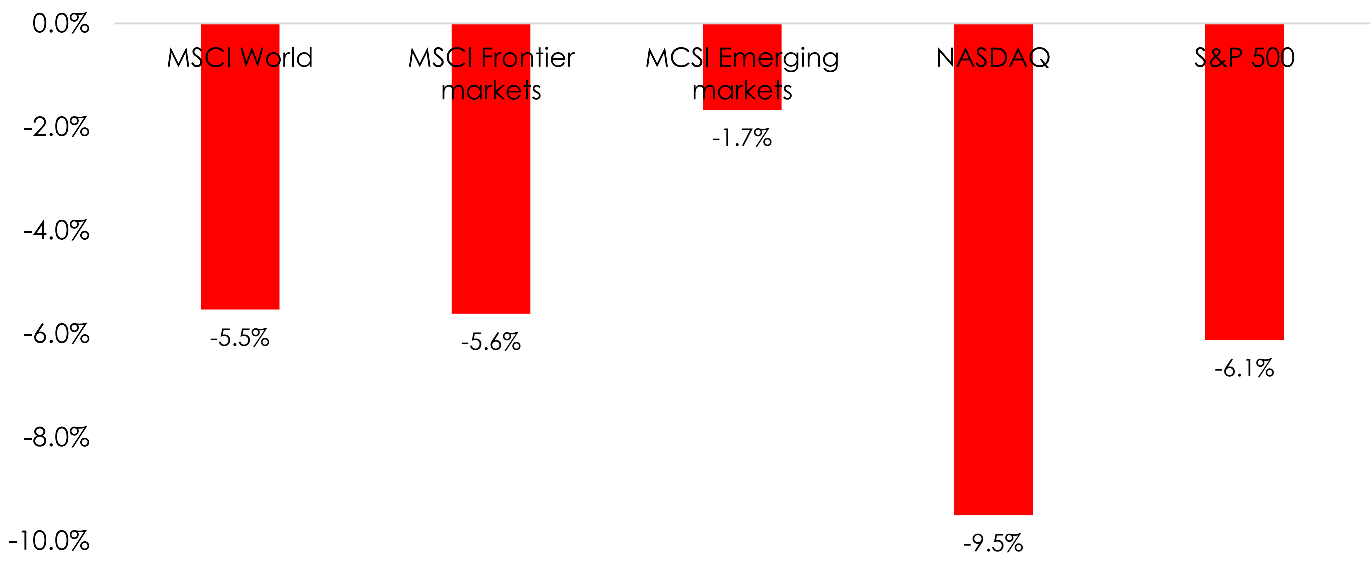
The Fed estimates raising the federal funds rate to 3.4% by year-end, which implies further 175 basis points of tightening. With pertinent firming in the stance of monetary policy, the Committee expects inflation to return to its 2 percent objective and the labor market to remain strong. The economic growth outlook has subsequently been revised to a target of 1.7% down from 2.8% in March.



We expect the rate hikes to be sustained in the subsequent meetings in what looks like a pitched battle against inflation as the policy maker looks to get inflation to the target of 2% and maintain low unemployment statistics.

The Fed highlighted the point that many drivers of inflation are beyond the monetary policy's control. The price of oil and other commodities depends on the vagaries of the war in Ukraine and the Chinese response to Covid-19.

The market selloff has been driven at least as much by uncertainty over rates as depicted by the performance of the indices;



Source: Bloomberg, NCBA IB Research

The Fed isn't the only central bank to have reached a critical juncture- the Swiss National Bank raised rates for the first time in 15 years by 50 basis points.

The Bank of England raised interest rates by 25 basis points to bring the bank rate to 1.25%, its highest level in 13 years, on the back of an updated economic outlook and inflationary pressures. UK inflation soared to 9% in the period May 2021 to May 2022, a 40year high. They face the unenviable task of bringing consumer prices back under control against a backdrop of slowing growth and a major cost of living crisis.

The Bank of Japan maintained interest rates unchanged at -0.1% on its resolve to keep borrowing costs low, signaling its resolve to focus on supporting economic growth. The decision left the BOJ's stance at odds with other major central banks, which are aggressively tightening policy to curb surging inflation. This monetary policy divergence between the BOJ and other central banks has pushed the yen to 24-year lows, threatening to cool consumption by boosting already rising import costs.

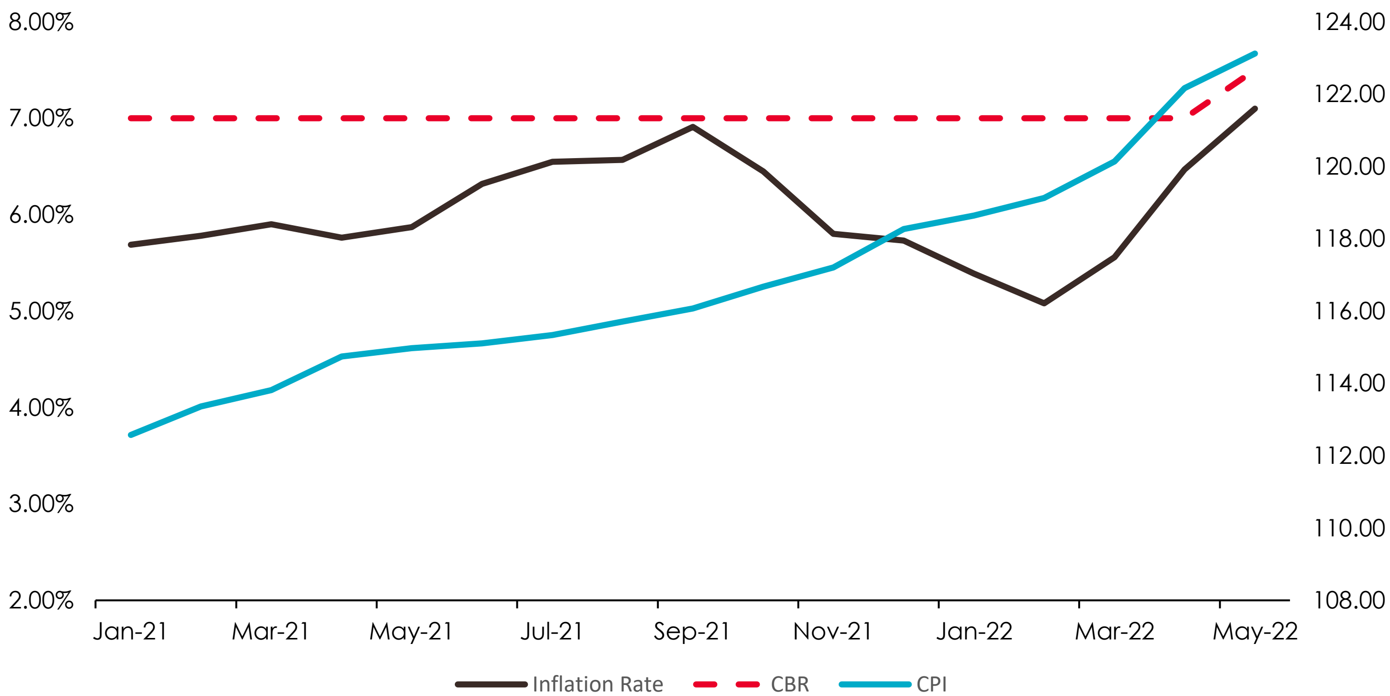
On another matter: The Russo-Ukrainian war continues to disrupt supply of commodities to the rest of the world, effectively maintaining the high global oil and commodity prices. This war could yet turn everything, in either a positive or negative direction. The last few days suggest that Russia is gaining an upper hand, and a much stronger negotiating position. A settlement in which Russia gets to hold on to all of the Donbas and the West stops sending arms to Ukraine would relieve uncertainty, but it would remain very difficult for normal economic relations to resume.

Soaring inflation to sustain high-interest rate expectations

As inflation rises to record highs, policymakers have instituted measures to manage the situation in the medium term. There is consensus that in the short run, inflation will continue to be a major challenge for the remainder of 2022.

The main cause of high inflation around the globe is; surging energy and food prices exacerbated by the war in Ukraine and supply fears in agricultural commodities. The interventions have been around moderating energy costs, easing supply disruptions related to the pandemic, and normalization of monetary policy.

Locally, inflation escalated to 7.1% in May 2022, the steepest monthly rise in prices in nearly two years. Elevated food prices have been a result of increased input costs as well as climate change disruptions that have weakened production. Russia's invasion of Ukraine, and the resulting supply chain disruptions to the energy and the agricultural sectors, have made it likely that inflation will be higher and more persistent.



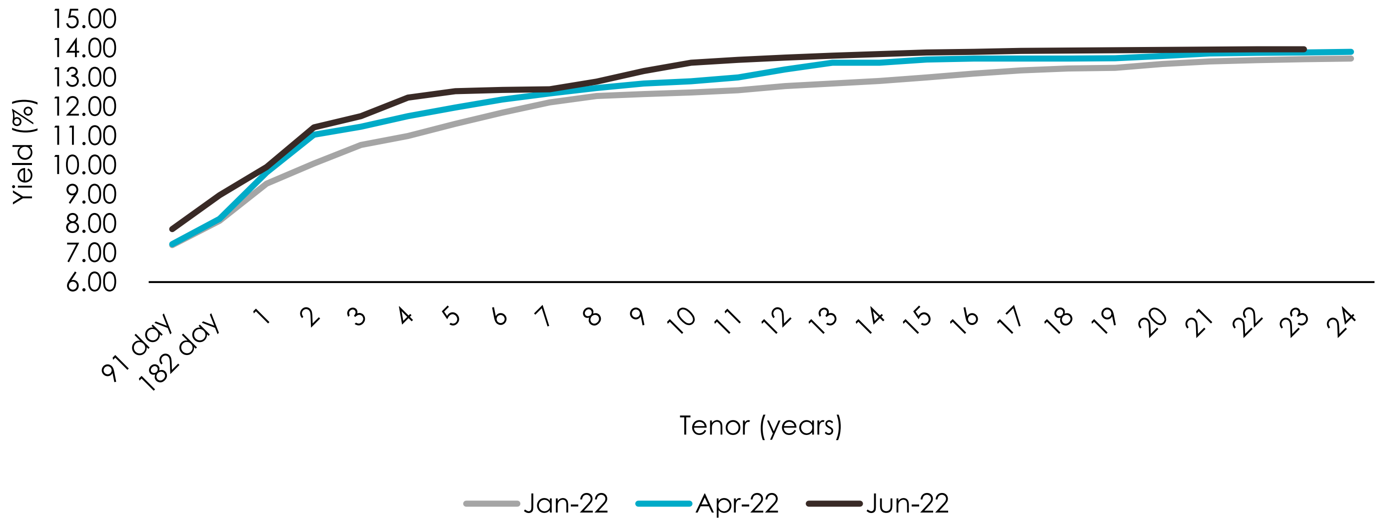
Source: KNBS, NCBA IB Research

Monetary framework monitor

The Central Bank Rate signals the monetary policy stance and forms the base of all monetary policy operations. The CBR is transmitted through the interest rates, exchange rates, bank credit, and other channels which include the stock market with the result being an influence on the economy by way of aggregate demand and supply as well as inflation expectations.

A study on monetary transmission data by CBK shows that a 1% increase in the CBR immediately increases the rate on the 91-day T-bill with the peak rise being recorded after 2 months with the impact lasting up to 4 months. This means that the recent hike of the CBR from 7.00% to 7.50% will impact local interest rates up to October 2022. It is also expected that holding all factors constant, will have an impact on lowering the inflation rate within 2 months.

Local government securities yield curve

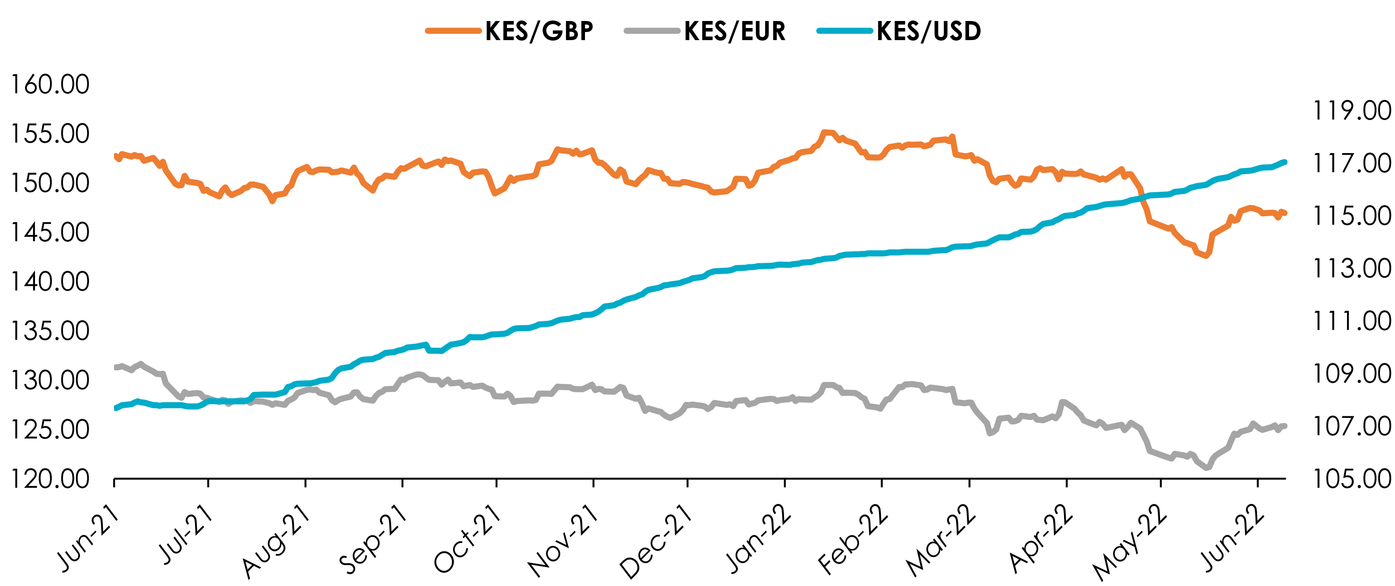


Source: NSE, NCBA IB Research

Our recommendation for local currency Kenya bonds is to invest in new short tenor (10 years and below) issues. We expect these tenors to command attractive coupon rates driven by investor sentiment surrounding interest rates. Liquidity conditions will influence how fast interest rates rise, but we are of the view that this will be a secondary theme if the global interest rates rise, persists.

The Dollar clings to a record high

The Kenya shilling lost further ground against the USD, depreciating 0.2% to trade at 117.05 from 116.81 at the close of last week. On a YTD basis, the shilling has depreciated 3.3% against the US dollar. The raise in the CBR is expected to impact the exchange rate, with the latter expected to stabilize within 4 months.

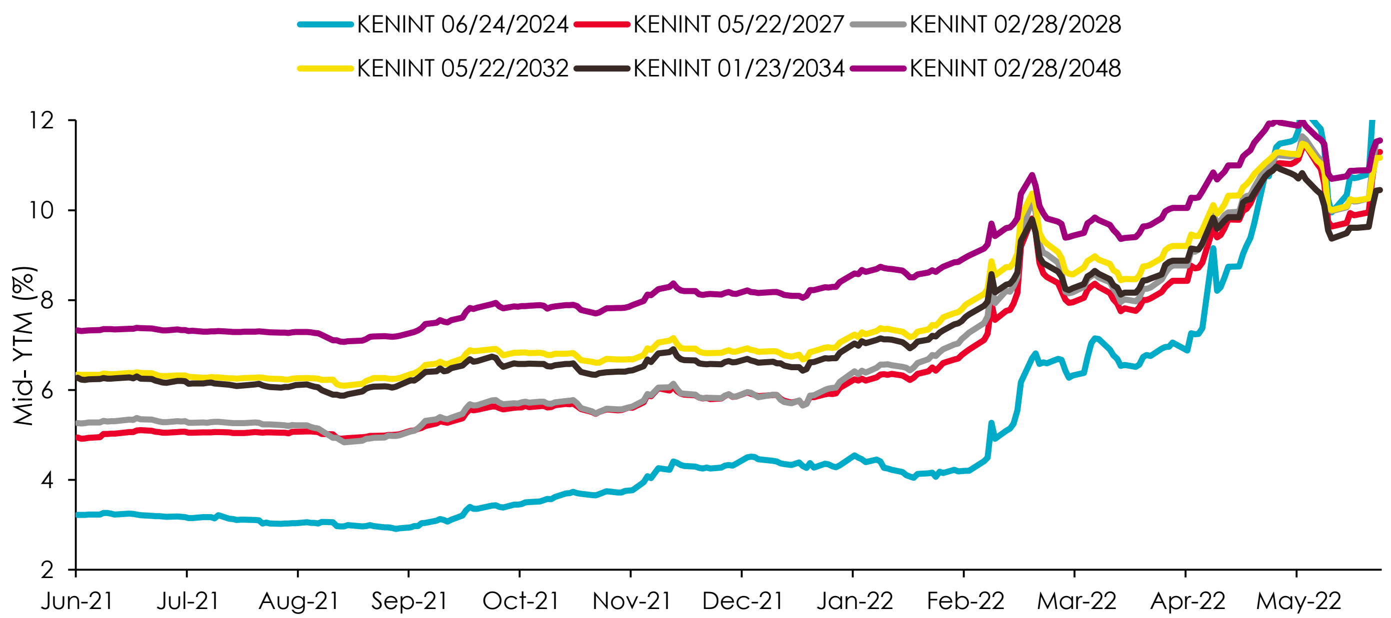


Source: CBK, NCBA IB Research

Kenya Euro bond performance

Kenyan Eurobonds are currently trading at huge discounts. This trend is reflected on all non-investment grade Eurobonds. In particular, KENINT24 has depreciated from a yield of 4.3% at the beginning of the year to 12.7% on 10th June 2022.

Our bias is to invest in short-tenor Eurobonds maturing in 5years. We opine that the bonds are less sensitive to volatility compared to long tenor Eurobonds. We are of the view that the current discounts to face value are huge and this offers an attractive entry point.



Source: Bloomberg, NCBA IB Research

Macroeconomic factors	
Inflation	7.1%
Policy rate	7.5%
Real GDP	7.5% (FY2021)
Sovereign rating	B+ negative outlook
3 month T-bill	7.93%
6 month T-bill	9.09%
Equity index (NASI)	121.60
USD/KES	117.40

We wish you a happy investing week!

About NCBA Investment Bank

NCBA Investment Bank is a subsidiary of NCBA Group. The services offered by the brokerage department include equities trading for listed securities, fixed income trading for both corporate and government bonds, Over the Counter (OTC) equity transactions as well as execution of equities transactions across the East African countries. Additionally, NCBA Investment Bank backs these activities with solid advice from the research team to enable investors meet their return objectives. NCBA Investment Bank deploys simple and convenient client driven technologies, robust risk management, highly competent and experienced staff and has the backing of robust research capabilities to differentiate itself from other players in the market.

Physical Address

NCBA Annex,
Hospital Road, Upper Hill, Tel: +254 20 2884444
Mobile: +254 711 056444/+254 732 156444

Certification

The following analyst(s) who prepared this research report: Victoria Mututu hereby certifies(y) that:

(i) all of the views and opinions expressed in this research report accurately reflect the research analyst's(s') personal views about the subject investment(s) and companies (y) and

(ii) (ii) no part of the analyst's(s') compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed by the analyst(s) in this research report.

Disclaimer

Any opinion or other information in this document is not an invitation to buy or sell any asset class. Legally binding obligations can only arise for or be entered into on behalf of NCBA Group by means of a written instrument signed by a duly authorized signatory. You are cautioned to ensure that you have made an independent decision in accordance with your own objectives, experience, operational and financial resources and any other appropriate factors including independent professional advice. No guarantee, warranty, or representation is made in respect of the performance or return on any transaction.

Key Contacts: Research Team

ncbaibresearch@ncbagroup.com

victoria.mututu@ncbagroup.com

Key Contacts: Trading Team

dealing@ncbagroup.com