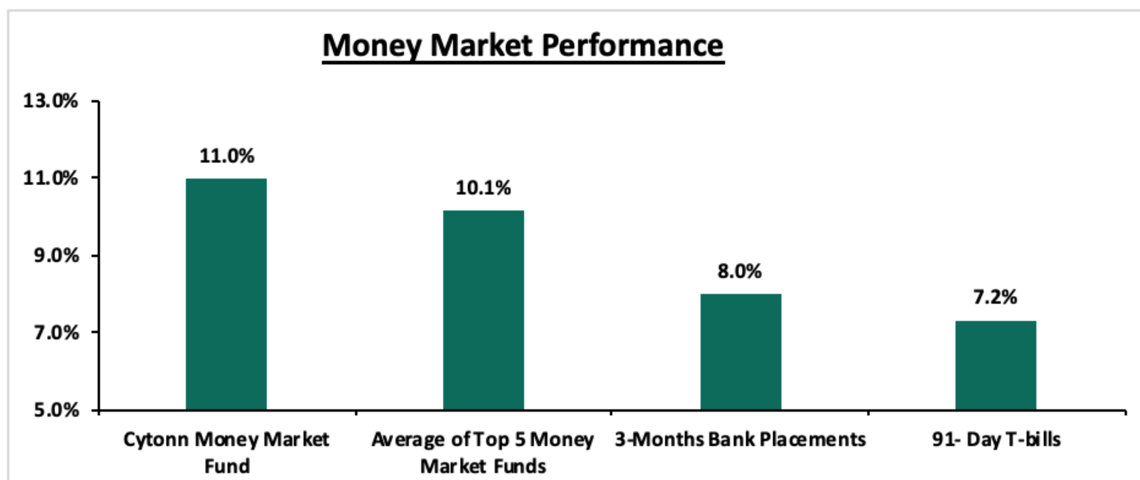
Cytonn Weekly #13.2020

Fixed Income

Money Markets, T-Bills & T-Bonds Primary Auction:

During the week, T-bills were undersubscribed, for the second week in a row, with the subscription rate coming in at 57.0%, down from 87.9% the previous week. The undersubscription is attributable to investor's preference to hold on to their cash due to low confidence in the market attributable to the Coronavirus outbreak. The subscription rate of the 91-day paper increased to 89.6%, from 13.7% the previous week, with most investors showing more interest in the shortest dated paper to avoid duration risk as a result of increased uncertainty due to the outbreak of COVID-19. The subscription on the 182-day and 364-day paper declined to 33.5% and 67.4% from 36.1% and 169.4%, respectively, the previous week. The yields on the 91-day paper and 364-day paper declined by 0.1% point to 7.2% and 9.0% from 7.3% and 9.1%, respectively, recorded the previous week while the yield on the 182-day paper increased by 0.1% point to 8.1%, from the 8.0% recorded the previous week. The acceptance rate decreased to 85.3%, from 99.7% recorded the previous week, with the government accepting Kshs 11.7 bn of the Kshs 13.7 bn bids received.

During the week, the Kenyan government issued a new 9-year amortized (50% of unencumbered outstanding principal amount and a 100% final redemption of all outstanding amount) Infrastructure bond. IFB1/2020/9 has an effective tenor of 9.0 years, and a coupon rate of 10.9% and will be issued in a bid to raise Kshs 60.0 bn for funding of infrastructure projects in the FY 2019/20 budget estimates. The first redemption date will be on 7th April 2025 while the final redemption will be on 2nd April 2029. Compared to the March issue of the FXD1/2018/20 & FXD1/2018/25, which subscription rate came in at 70.3%, we expect the IFB1/2020/9 to attract more interest due to its short tenor as well as the tax-free incentive for infrastructure bonds, translating to a higher return. We expect the weighted average of accepted bids to come in at 11.1% - 11.3% given that an infrastructure bond of a similar tenor is currently trading at 11.1% on the yield curve.



In the money markets, 3-month bank placements ended the week at 8.0% (based on what we have been offered by various banks), the 91-day T-bill declined by 0.1% point to 7.2%, from 7.3% recorded the previous week, while the average of Top 5 Money Market Funds remained unchanged at 10.1%.

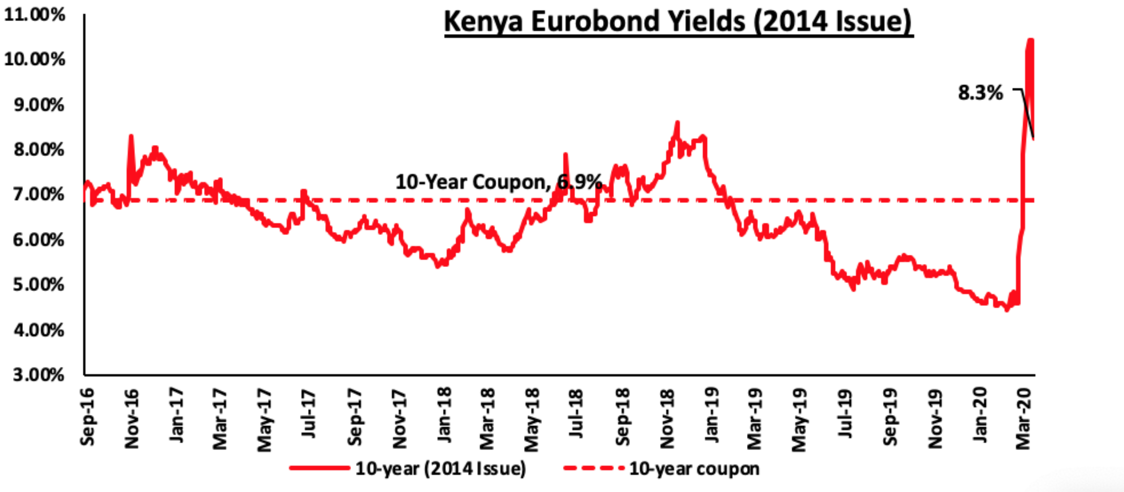
The yield on the Cytonn Money Market came in at 11.0%, unchanged from the previous week.

Liquidity:

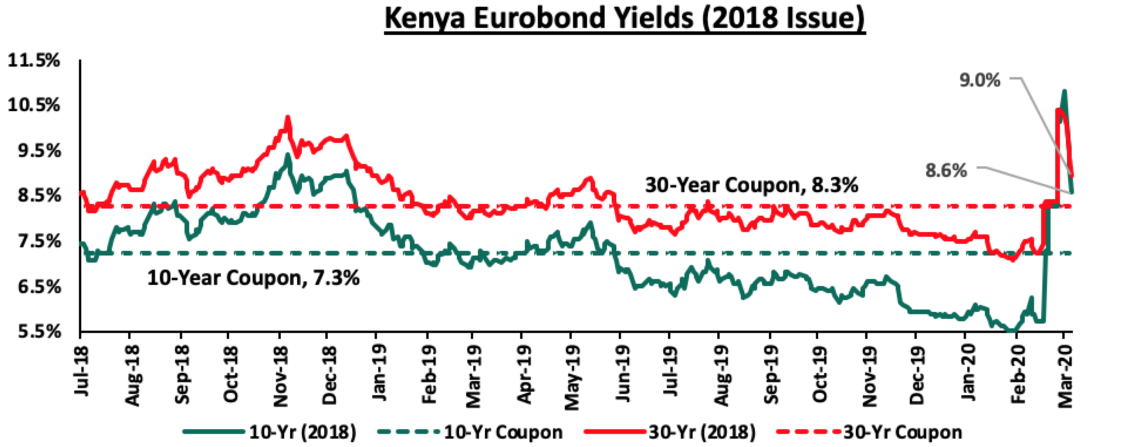
During the week, liquidity in the money markets tightened, with the average interbank rate increasing to 4.6%, from 4.3% the previous week, attributable to the tax payments, which offset government payments. An additional Ksh. 35.2 bn was availed following the reduction of the Cash Reserve Ratio to 4.25% from 5.25% to provide additional liquidity to commercial banks for onward lending to distressed borrowers during the COVID-19 pandemic. Commercial banks' excess reserves came in at Kshs 38.8 bn in relation to the 4.25% cash reserves requirement (CRR). The average interbank volumes increased by 12.6% to Kshs 15.8 bn, from Kshs 14.0 bn recorded the previous week.

Kenya Eurobonds:

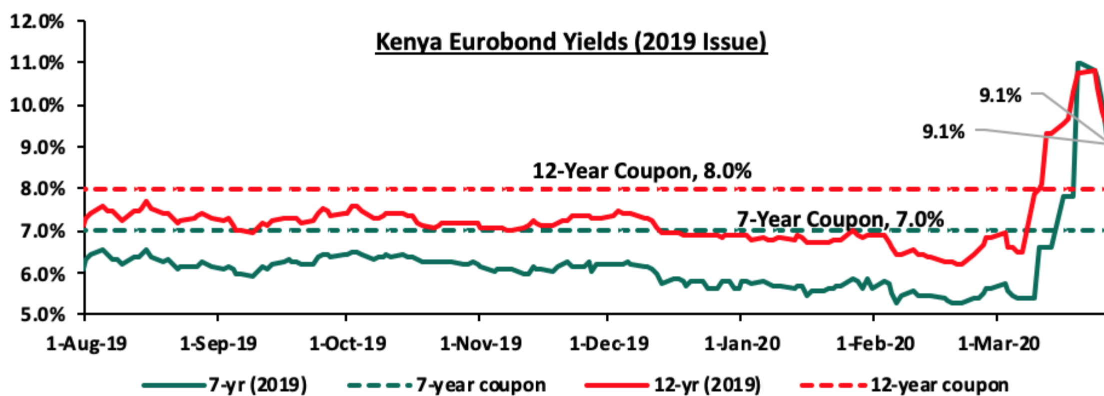
During the week, the yields on all the Eurobonds declined, as the market corrected from the sharp increase recorded in the last two weeks, a trend which was replicated in the performance of other Sub-Saharan African Eurobonds. According to Reuters, the yield on the 10-year Eurobond issued in June 2014 declined by 1.9% point to 8.3%, from 10.2% recorded the previous week.



During the week, both the yields on the 10-year and 30-year Eurobonds issued in 2018, declined by 1.5% points and 1.4% points to 8.6% and 9.0%, respectively, from 10.1% and 10.4% recorded previous week.



During the week, the yields on the 7-year and 12-year Eurobonds issued in 2019 declined by 1.9% points and 1.7% points, respectively, to 9.1% each, from 11.0% and 10.8%, recorded the previous week.



Overall, all Kenyan Eurobond yields have declined as the market corrects from the sharp increase recorded in the last two weeks. The spread between developed markets rates, considering the US 10-year Government Bond and Kenyan Eurobond has increased from 4.0% 2-weeks ago to 8.5% currently.

Kenya Shilling:

The Kenya Shilling remained unchanged against the US Dollar during the week, closing at 105.1. On a YTD basis, the shilling has depreciated by 3.7% against the dollar, in comparison to the 0.5% appreciation in 2019. We expect depreciation of the shilling in 2020 as a result of:

i. Rising uncertainties in the global market due to the Coronavirus outbreak, which has seen the disruption of global supply chains. The shortage of imports from China for instance, which accounts for an estimated 21.0% of the country's imports, is likely to cause local importers to look for alternative import markets, which may be more expensive and as such higher demand for the dollar from merchandise importers, and,
ii. Subdued diaspora remittances growth following the close of the 10.0% tax amnesty window in July 2019. We also foresee reduced diaspora remittances, owing to the decline in economic activities globally hence a reduction in disposable incomes. This coupled with increased prices of household items abroad might see a reduction in money expatriated into the country.

The shilling is however expected to be supported by:

i. High levels of forex reserves, currently at USD 8.0 mn (equivalent to 4.8-months of import cover), above the statutory requirement of maintaining at least 4.0-months of import cover, and the EAC region's convergence criteria of 4.5-months of import cover, and,
ii. CBK's supportive activities in the money markets, with the Central Bank of Kenya (CBK) having already indicated that it's looking to purchase USD 400.0 mn from banks for four months beginning from March to bolster the forex reserves.

Weekly Highlight

The Monetary Policy Committee (MPC) met on 23rd March 2020 to review the prevailing macroeconomic conditions amid the ongoing global COVID-19 pandemic and decide on the direction of the Central Bank Rate (CBR). The MPC lowered the CBR by 100 bps to 7.25%, from 8.25% previously, which was in line with our expectations in our MPC- March 2020 Note, driven by factors such as the instability in the Kenyan Shilling and the expected cost-push inflation caused by shortages arising from supply chain disruptions. The MPC also lowered the Cash Reserve Ratio (CRR) by 100 bps to 4.25% from 5.25% to provide additional liquidity, approximated at Kshs. 35.0 bn, to commercial banks for onward lending to distressed borrowers. From the last MPC briefing, the Central Bank of Kenya (CBK) Governor had indicated that the economy was operating below its potential level concluding that there was room for accommodative monetary policy to support economic activity.

The 100 bps rate cut by the MPC is a move to help mitigate the economic and financial impact of the COVID-19 health crisis. The MPC noted that the effects of the virus are already being felt in the economy as evidenced by:

i. Volatility in the foreign exchange market driven by uncertainties concerning the impact of COVID-19 as evidenced by the recent downward trend of the shilling,
ii. Economic growth, which is expected to decline from a baseline estimate of 6.4% to 3.4% as per the Central Bank of Kenya, attributable to reduced demand by Kenya's main trading partners, disruptions of supply chains and domestic production caused by COVID-19 pandemic. Based on the impact on other economies, Cytonn Investments, have also reduced Kenya's forecasted GDP growth. Based on the impact to other economies, we believe that Coronavirus may have a 10.0% to 25.0% impact on GDP growth for the year 2020. The 10.0% impact is an optimistic case in the event the outbreak is contained, and a 25.0% impact in the event it is not contained. As such, the Coronavirus could reduce Kenya's GDP growth to 4.3% for the year 2020 depending on the severity of the outbreak and economic implications for Kenya. The table below shows GDP projections from 10 firms with the consensus GDP growth as per the 10 firms below expected to come in at 5.5%. **However, we expect this growth rate to be revised downwards as global research houses downgrade their GDP growth estimates for 2020 once they factor in the economic impact of Coronavirus.**

Kenya 2020 Annual GDP Growth Outlook

No.	Organization	Q1'2020*	Q1'2020**
1.	Citigroup Global Markets	6.2%	6.2%
2.	International Monetary Fund	6.0%	6.0%
3.	African Development Bank	6.0%	6.0%
4.	World Bank	6.0%	6.0%
5.	National Treasury	6.0%	6.0%
6.	African Development Bank (AfDB)	6.0%	6.0%
7.	Capital Economics	5.9%	5.9%
8.	United Nations Conference on Trade and Development (UNCTAD)	5.5%	5.5%
9.	**Cytonn Investments Management PLC****	**5.7%**	**4.3%**
10.	**Central Bank of Kenya****	**6.2%**	**3.4%**
	Average	**6.0%**	**5.5%**

***As at the beginning of the year**
****Revised GDP Growth**

The MPC, however, noted that:

i. Month on month inflation remained within the 2.5% - 7.5% target range, largely driven by lower food prices with favorable weather conditions and a decline in international oil prices as a result of an ongoing price war as well as a significant reduction in demand due to the Coronavirus Pandemic. Inflation stood at 6.4% in February, an increase from 5.8% recorded in January 2020, due to an increase in food prices and non-alcoholic beverages, and,
ii. Foreign exchange reserves, which stood at USD 8.3 bn (equivalent to 5.0-months of import cover), above the statutory requirement of maintaining at least 4.0-months of import cover, and the East African Community (EAC) region's convergence criteria of 4.5-months of import cover. The MPC noted that the foreign exchange reserves would continue to provide adequate cover and a buffer

against short-term shocks in the foreign exchange market.

As such, the MPC concluded that due to the adverse economic outlook attributable to the COVID-19 health crisis, it will ensure that the interbank market and liquidity management across the sector continue to function smoothly. The committee also pointed out that it will closely monitor the impact of this change and therefore, reconvene after a month for an early assessment of the COVID-19 pandemic.

During the week, the Kenyan Government announced several measures that would be taken to help cushion the Kenyans as well as the economy against the COVID-19 pandemic. The measures include:

i. A 100.0% tax relief for those earning less than Kshs 24,000, and reduction of the Pay As You Earn (PAYE) to a maximum of 25.0% from 30.0% for all citizens earning above Kshs 24,000. This will effectively reduce the PAYE liability for taxpayers within this bracket and will afford these workers more disposable income. This reduction is effective starting 1st April 2020,
ii. A reduction in resident corporates' income from 30.0% to 25.0%, effective from 1st April 2020.
iii. Reduction of Turnover Tax from 3.0% to 1.0% for SMEs. The reduction should ease the tax burden for micro and small to medium enterprises (MSMEs),
iv. Temporary suspension of listing with the Credit Reference Bureaus (CBR) of individuals, MSMEs, and corporate entities,
v. Reduction of Value Added Tax (VAT) from 16.0% to 14.0%. The Kenya Revenue Authority (KRA) was also directed to expedite payments for all verified VAT refunds within 3-weeks or allow for offsetting of Withholding VAT to improve cash flow for businesses,
vi. The senior members of the Executive arm of the government have also voluntarily agreed to take salary cuts. The President and Deputy President will each take an 80.0% cut, Cabinet Secretaries and Chief Administrative Secretaries will each take a 30.0% pay cut and Principal Secretaries will take a 20.0% pay cut.

These fiscal measures in conjunction with the monetary policy measures taken by the MPC are all in a bid to cushion businesses and the economy at large against the adverse effects of the ongoing COVID-19 virus. In as much as the measures put in place by the government are welcome and we applaud the efforts by the government, we believe that they won't be effective in cushioning a greater multitude of the population with our sentiments guided by:

- Before the 100% tax relief, income tax for an employee earning Kshs 24,000 stood at Kshs 2,955 with a personal relief of Kshs 1,408, thus a net tax payable of Kshs 1,547. By implementing the new PAYE regime, the net tax benefit to such employees would, therefore, be a meagre Kshs 1,547, which may not be enough to cater for the economic disruption,
- The reduction of PAYE to a maximum of 25.0% from 30.0% for all citizens earning above Kshs 24,000 tax rate will also have a minimum effect on the 'take-home' pay for most middle-income earners. According to statistics by the Kenya National Bureau of Statistics (KNBS), about 74.0% of all Kenyans working in the formal sector earn a monthly salary of below Kshs. 50,000. With the new PAYE tax regime, employees who earn a taxable income of Kshs 50,000 will have a meagre tax relief of slightly below Kshs 150 from the reduction in PAYE,
- The pay cut for senior members of the Executive Arm of the Government is in the order of Kshs 800.0 mn per year, merely 0.02% out of the National Government wage bill of Kshs 400.0 bn. The pay cut will save less than 0.05% of the wage bill. Therefore, in our view, the pay cut was in a bid to strengthen Public Relations rather than mitigate the effects of COVID-19, and,
- The suspension of the Credit Reference Bureau (CRB) does not interfere with previous credit rating with more than 3.0 mn Kenyans having been blacklisted for defaulting mobile loans such as Tala and Branch, and as such, they will still not be able to access credit.

In our Topical for this week, we discuss additional economic containment policies for the Kenyan Government to consider.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 15.2 % behind of its domestic borrowing target, having borrowed Kshs 195.9 bn against a pro-rated target of Kshs 231.0 bn. We expect an improvement in private sector credit growth considering the repeal of the interest rate cap. This will result in increased competition for bank funds from both the private and public sectors, resulting in upward pressure on interest rates. Owing to this, our view is that investors should be biased towards short-term fixed-income securities to reduce duration risk.