Debt Relief Amidst the COVID-19 Pandemic, & Cytonn Monthly - April 2020

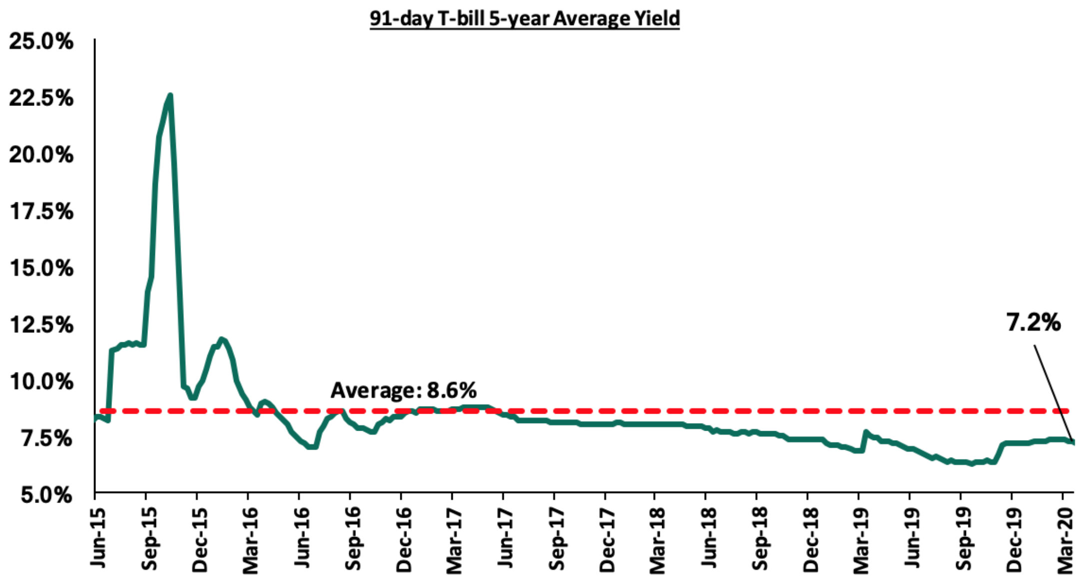
Fixed Income

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

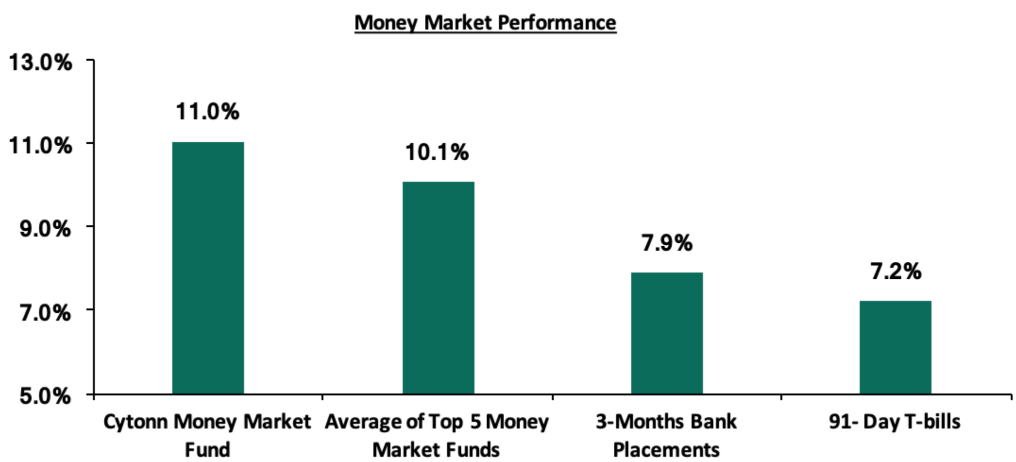
During the month of April, T-bill auctions recorded an undersubscription, with the overall subscription rate coming in at 72.8%, compared to 151.0% recorded in the month of March. The undersubscription is partly attributable to investor’s preference to hold on to their cash due to low confidence in the market attributable to the Coronavirus outbreak. The subscription rates for the 91-day paper rose to 86.8%, from 81.6% recorded in March. The subscription rates for the 182-day and 364-day papers on the other hand declined, coming in at 28.4% and 111.7%, lower than the 65.2% and 264.5% recorded in March, respectively. We note that the 364-day paper continued to receive the most interest from investors, having recorded the highest subscription rate of the 3 papers, at 111.7%. This is attributable to the market currently pricing that the government will be under pressure to meet its domestic borrowing target, and as such a bias to shorter-dated papers in order to avoid duration risk, which has seen most investors still keen on the primary fixed income market, finding the 364-day T-bill more attractive on a risk-adjusted return basis, compared to a two year bond with a yield of 10.4%. The Central Bank remained disciplined in rejecting expensive bids in order to ensure the stability of interest rates as evidenced by the yield on the 91-day paper declining marginally to 7.2% from 7.3% recorded in March while the 182-day and 364-day papers remained unchanged at 8.1%, and 9.1%, respectively. The T-bills acceptance rate came in at 97.2% during the month, compared to 53.0% recorded in March, with the government accepting a total of Kshs 84.9 bn of the Kshs 87.4 bn worth of bids received.

During the week, T-bills were undersubscribed, with the subscription rate coming in at 74.6%, down from 81.7% the previous week. The subscription rate of the 91-day and 182-day papers declined to 111.8% and 26.8%, respectively, from 219.7% and 44.5% recorded the previous week, respectively. The subscription rate for the 364-day paper however improved to 107.5%, from 63.8% recorded the previous week. The yields on the 91-day, 182-day and 364-day papers remained unchanged at 7.2%, 8.1% and 9.1%, respectively, similar to what was recorded the previous week. The acceptance rate declined to 87.5%, from 99.5% recorded the previous week, with the government accepting Kshs 15.7 bn of the Kshs 17.9 bn bids received.

The 91-day T-bill is currently trading at a yield of 7.2%, which is below its 5-year average of 8.6%. The yield has, however, increased surpassing the 2019 average of 6.9% mainly attributable to the repeal of interest rate cap, which has seen banks prefer lending to the private sector, forcing the government to accept expensive bids in order to secure funds from investors.



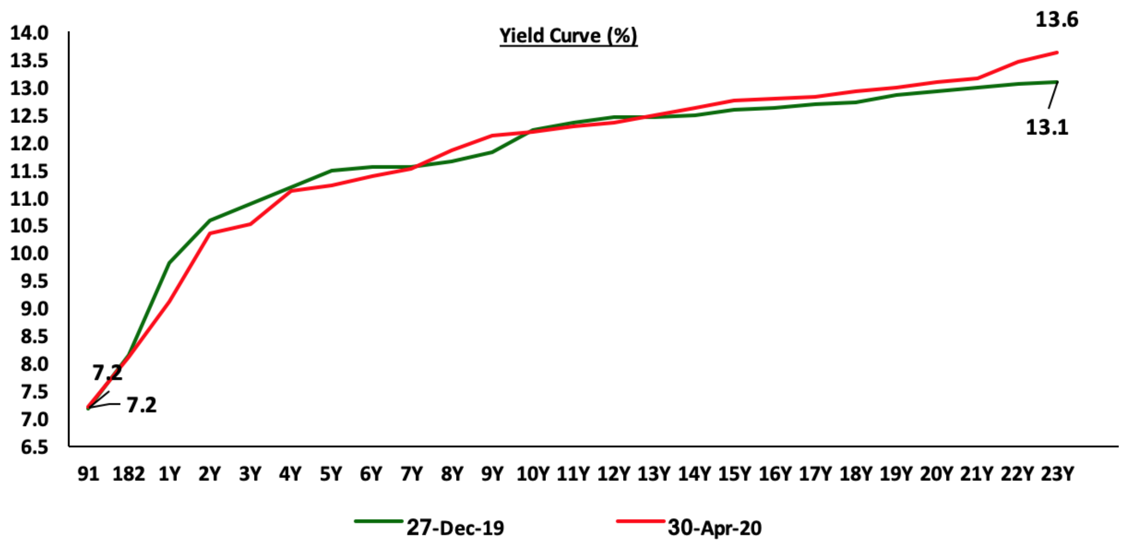
For the month of April, the Kenyan Government issued a 9-year infrastructure bond, IFB1/2020/9 with an effective tenor of 9.0-years and a coupon rate of 10.9%, in a bid to raise Kshs 60.0 bn for funding of infrastructure projects in the FY'2019/20 budget estimates. The bond was oversubscribed, with the government receiving bids worth Kshs 68.4 bn, higher than the quantum of Kshs 60.0 bn, translating to a subscription rate of 114.0%. The high subscription rate is mainly attributable to the short tenor of the bond as well as the tax free incentive for infrastructure bonds which translates to a higher return. The yield on the tax-free bond came in at 12.3%, with the government accepting Kshs 39.0 bn out of the Kshs 68.4 bn worth of bids received, translating to an acceptance rate of 57.0%. During the month, the government had a tap-sale for the same bond in a bid to raise an additional Kshs 21.0 bn. The tap-sale was an oversubscribed with the government receiving bids worth Kshs 37.8 bn, higher than the issue's quantum of Kshs 21.0 bn, translating to a subscription rate of 180.2%. The yield on the tap sale for the bond came in at 12.1%, with the government accepting Kshs 35.4 bn out of the Kshs 37.8 bn worth of bids received, translating to an acceptance rate of 93.5%. Given the tax-free nature of the bond, this is comparable to a Yield to Maturity (YTM) of 13.3%, on a normal bond with the assumption of a 15.0% withholding tax for a bond with the same effective tenor.



In the money markets, 3-month bank placements ended the week at 7.9% (based on what we have been offered by various banks), the 91-day T-bill remained unchanged at 7.2%, similar to what was recorded the previous week. The average of Top 5 Money Market Funds remained unchanged at 10.1%, similar to what was recorded the previous week. The yield on the Cytonn Money Market also remained unchanged at 11.0%.

Secondary Bond Market:

The yields on government securities in the secondary market remained relatively stable during the month of April. Most papers have declined YTD as yields readjust upwards with the exception of the 182-day paper, 1 – 7 year papers, 11-year, and 12-year papers.

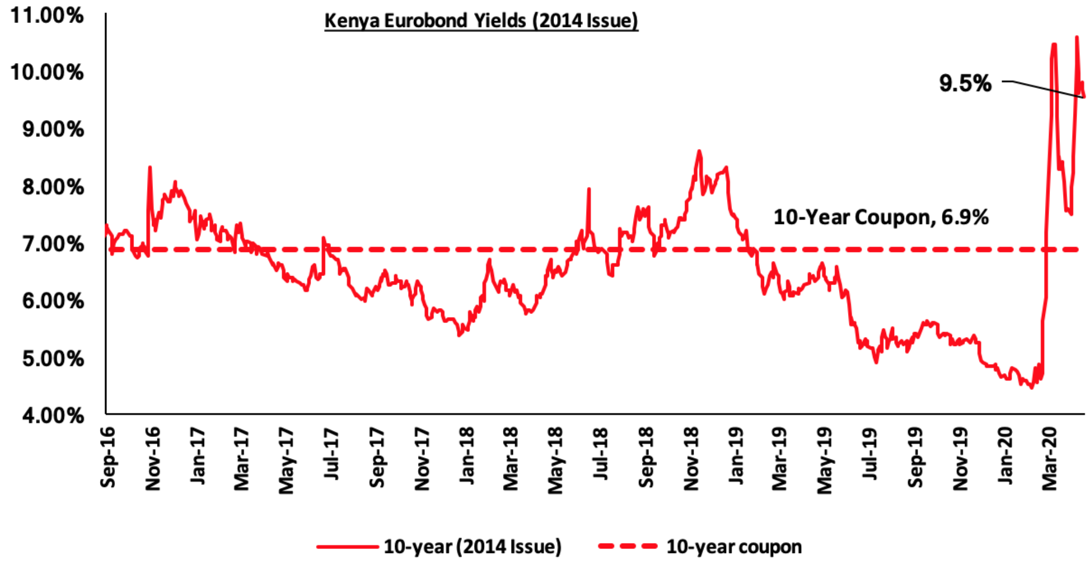


Liquidity:

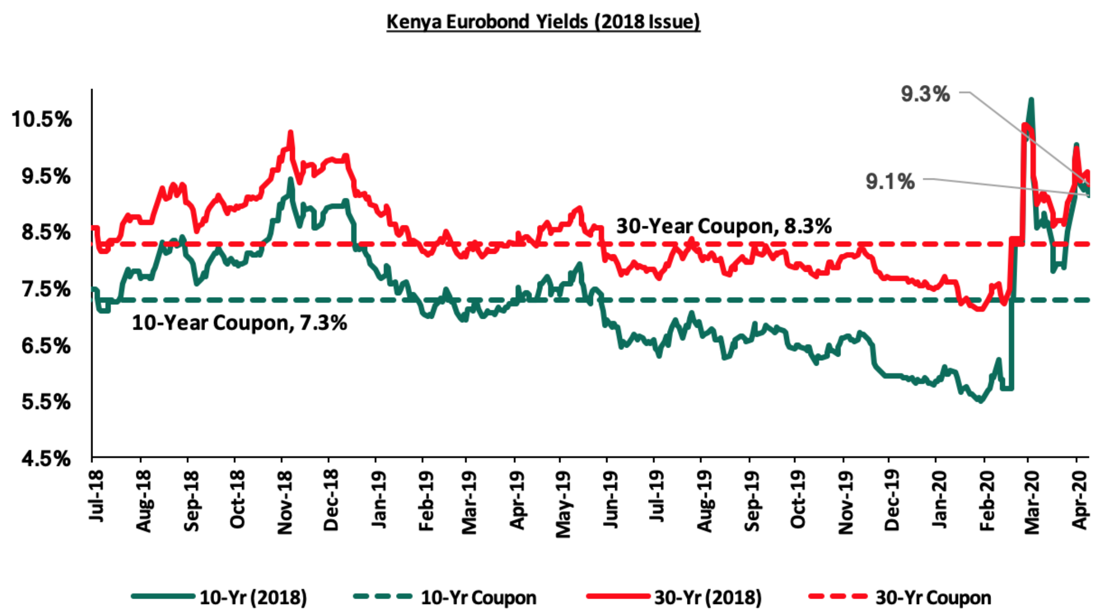
Liquidity in the money markets tightened during the month of April with the average interbank increasing to 5.3%, from 4.4% recorded in March as banks mobilize funds to pay for tax remittances such as corporate tax payments for the first quarter of the year. During the week, the average interbank rate declined to 4.5% from 5.5% recorded the previous week, pointing to easing liquidity in the money markets due to pending bill payments and tax refunds. The average interbank volumes rose by 88.0% to Kshs 13.6 bn, from Kshs 7.3 bn recorded the previous week.

Kenya Eurobonds:

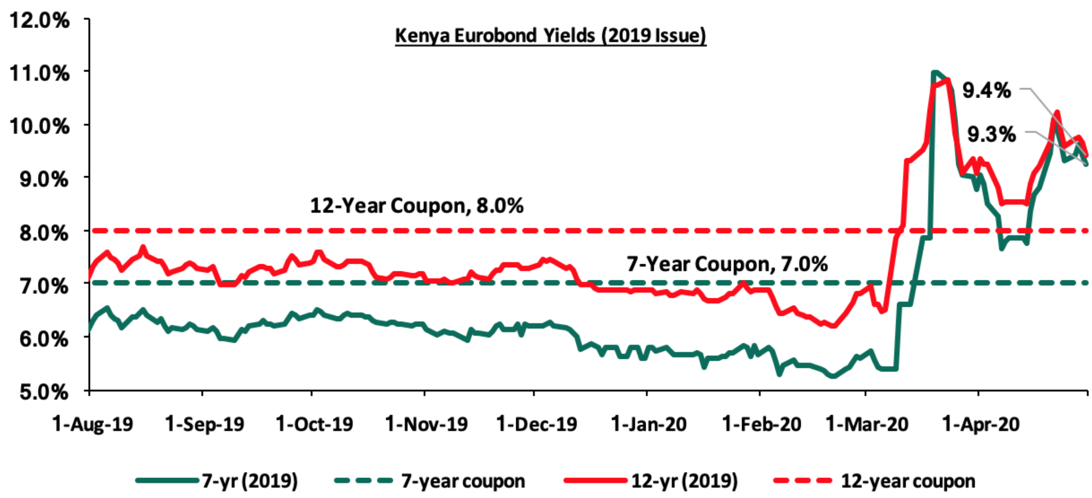
According to Reuters, the yield on the 10-year Eurobond issued in June 2014 increased by 1.2% points to 9.5% in April, from 8.3% in March. During the week, the yield on the 10-year Eurobond declined by 0.1% points to 9.5% from 9.6% recorded the previous week. Notably however, all the Eurobonds yields increased significantly in April, an indication that investors are now attaching a higher risk premium on the country due to the anticipation of slower economic growth attributable to the locust invasion, coupled with the entry of the novel COVID-19 in Kenya's borders, further dampening the country's economic growth prospects. Kindly see our Eurobond Note for more information



During the month, the yields on the 10 and 30 year Eurobonds issued in February 2018 increased by 0.5% points and 0.3% points to close at 9.1% and 9.3%, respectively from 8.6% and 9.0% in March. During the week, the yield on the 10-year Eurobond declined by 0.2% points to close at 9.1% from 9.3% recorded the previous week. The 30-year Eurobond declined marginally by 0.1% point to 9.3%, from 9.4% recorded the previous week



During the month, the yields on the newly issued dual-tranche Eurobond with 7-years increased by 0.5% points to 9.3% from 8.8% in March. The 12-year Eurobond increased by 0.2% points to 9.4% from 9.1% in March. During the week, the yields on the 7-year remained unchanged at 9.3% while that of the 12-year Eurobond declined by 0.2% points to 9.4% from 9.6% recorded the previous week.



Kenya Shilling:

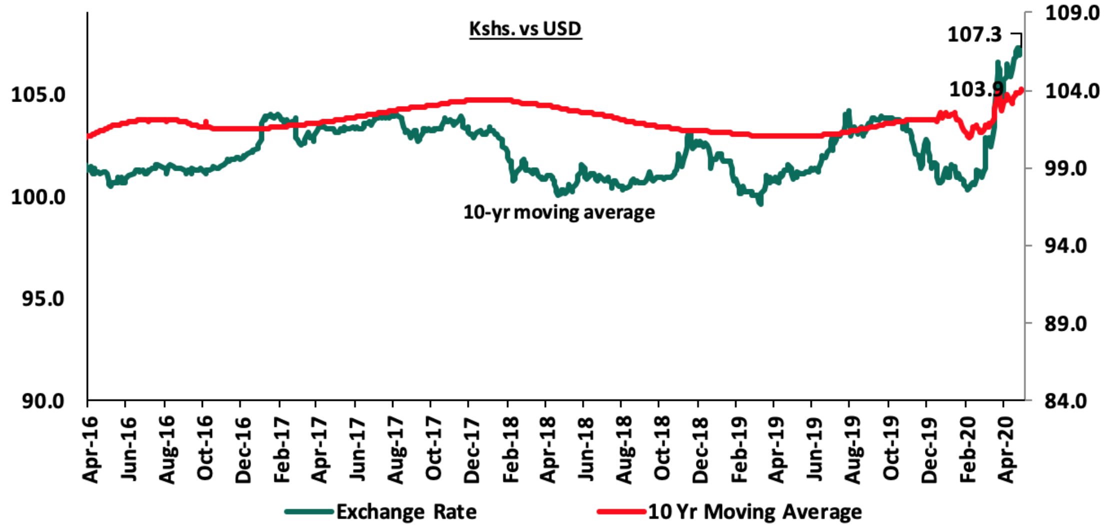
During the month, the Kenya Shilling depreciated by 2.5% against the US Dollar to close at Kshs 107.3, from Kshs 104.7 recorded at the end of March, mostly attributable to the rising uncertainties in the global markets due to the COVID-19 outbreak, which has seen the disruption of global supply chains. 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.

During the week, the Kenya Shilling depreciated marginally against the US Dollar to close at Kshs 107.3, from Kshs 107.2 recorded the previous week, attributable to a slight increase in dollar demand from merchandise and oil importers as they move to meet their end-month obligations. This was a 9-year low since Kshs 107.0 recorded in 11th October 2011. On a YTD basis, the shilling has depreciated by 5.9% against the dollar, in comparison to the 0.5% appreciation in 2019. We expect continued pressure on the shilling due to:

i. High dollar demand from foreigners exiting the market as they direct their funds to safer havens, as well as merchandise and energy sector importers beefing up their hard currency positions amid a slowdown in foreign dollar currency inflows to meet the dollar demand, and,
ii. Subdued diaspora remittances growth, 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 7.9 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 CBK having already indicated that it's looking to purchase USD 400.0 mn from banks for four months beginning from March 2020 to bolster the forex reserves.



Inflation

The y/y inflation for the month of April declined marginally to 5.6%, from the revised figure of 5.5% recorded in March 2020 (based on the new CPI base period, February 2019), which was not in line with our projections of 6.0% - 6.2%. Month-on-month inflation came in at 0.9%, which was attributable to:

i. A 1.8% increase in the food and non-alcoholic drinks' index, due to an increase in prices of significant food items such as loose maize-grain, kales, onions, Irish potatoes and carrots which increased by 4.0%, 4.4%, 6.9%, 6.4% and 3.6%, respectively,
ii. A 0.4% increase in the housing, water, electricity, gas and other fuels index, as a result of an increase in prices of electricity and cooking gas which outweighed the decreased in the cost of kerosene by 19.1%, and,
iii. A 1.3% increase in the transport index on account of increases in the prices of matatu and taxi fares despite the decline in petrol and diesel prices by 16.3% and 4.3%, respectively.

Major Inflation Changes – April 2020

Broad Commodity Group	Price change m/m (April-20/March-20)	Price change y/y (April-20/April-19)	Reason
Food & Non-Alcoholic Beverages	1.8%	11.6%	The m/m increase was due to an increase in prices of some food items such as loose maize-grain, kales, onions, Irish potatoes and carrots
Transport Cost	1.3%	5.5%	The m/m increase was mainly on account of increases in the prices of matatu and taxi fares
Housing, Water, Electricity, Gas and other Fuels	0.4%	2.3%	The m/m marginal decline was as a result of an increase in prices of electricity and cooking gas
Overall Inflation	**0.9%**	**5.6%**	**The m/m increase was due to: a 1.8% increase in the food index which has a revised CPI weight of 32.9%, a 1.3% increase in transport cost and the 0.4% increase in housing, water, electricity, gas and other fuels.**

Going forward, we expect the inflation rate to remain within the government set range of 2.5% - 7.5%. We expect inflation to remain stable despite supply side disruption due to COVID-19 as low demand for commodities compensates for the cost-push inflation, coupled with the low oil prices in the international markets.

Monetary Policy

The Monetary Policy Committee (MPC) met on 29th April 2020 to review the prevailing macroeconomic conditions and decide on the direction of the Central Bank Rate (CBR). The MPC lowered the CBR by 25 bps to 7.00% from 7.25%, which in line with our expectations in our MPC April 2020 Note. In their previous meeting held on 23rd March 2020, the committee decided to reconvene within a month for an early assessment of the impact of these measures and the evolution of the COVID-19 pandemic. In the last sitting, they lowered the CBR by 100 bps to 7.25% from 8.25% and reduced the Cash Reserve Requirement (CRR) to 4.25% from 5.25% citing that the Coronavirus pandemic was expected to adversely affect economic growth and as such, the need to cushion the economy against the effects of the pandemic and whilst preventing the COVID-19 health crisis from becoming a severe economic and financial crisis. The MPC decided to augment its accommodative monetary policy, necessitated by the continuing adverse economic outlook due to the COVID-19 pandemic. They however noted that;

i. Inflation is expected to remain within the Government's 2.5% - 7.5% target range, largely supported by lower fuel prices and favorable weather conditions,
ii. Taking into consideration the impact of COVID-19, the current account deficit is expected to remain at 5.8% in 2020, with the lower oil imports more than offsetting the projected reduction in remittances. However, horticulture exports and receipts from transport and tourism services are expected to decline due to the impact of COVID-19, and,
iii. There was an Improvement in private sector credit growth, coming in at 8.9% in the 12-months to March 2020, despite being below the 5-Year historical average, of 8.2%. Strong credit growth was observed in the Manufacturing sector (17.4%), building and construction (9.5%) and trade (7.8%).

The committee noted that the measures put in place from the previous meeting were having the intended effect on the economy and as such decided to augment their accommodative policy stance, having considered the continuing adverse economic outlook. We maintain our view that monetary policy stimulus measures may not be highly effective in combating the effects emanating from the COVID-19 pandemic especially in some sectors such as the tourism sector which have been hit by demand-side issues. We believe what businesses and the economy as a whole needs is financial relief as highlighted in our report on COVID-19 Economic Containment Policies in order to ensure survival during this period of uncertainties.

Weekly Highlights

During the week, the Kenya National Bureau of Statistics (KNBS) released the Economic Survey 2020, indicating that the economy had grown by 5.4% in 2019, from 6.3% recorded in 2018. Despite the slower growth, it is important to note that the growth was spread across all the sectors in the economy. The slower growth can be attributed to;

i. A slower 3.6% growth in the agriculture, forestry and fishing sector, compared to the 6.0% recorded in 2018. This was brought about by poor weather conditions experienced during the first half of the year resulting to reduced production of select crops. Maize production declined by 10.8% to 39.8 mn bags in 2019 from 44.6 mn bags in 2018, tea production also declined by 6.9% to 458,500 tonnes while sugar cane production decreased by 12.5% to 4.6 mn tonnes,
ii. Growth in the manufacturing sector was slower in 2019 recording a 3.2% growth, down from the 4.3% growth recorded in 2018. This growth is attributed to declines in some sub-sectors such as production of wood, sugar, electrical equipment and other non-metallic mineral products. These declines were mitigated by increased production of motor vehicles, trailers, plastics, animal and vegetable fats and oils, and pharmaceutical products,
iii. Financial and Insurance sector grew by 6.6% compared to 5.3% in 2018, while real estate

activities grew by 5.3% to support the economy despite the decelerated growths in other sectors,

iv. Tourism earnings grew by 3.9% from Kshs 157.4 bn in 2018 to Kshs 163.6 bn as hotel bed-night occupancy expanded by 6.3% to 9,160.8 thousand. The number of international visitor arrivals increased marginally by 0.4% to 2,035.4 from a growth of 14.0% in 2018, and,
v. Under money, banking and finance, the CBK reviewed the Central Bank Rate (CBR) downwards during the year to 8.5% from 9.0% to ease monetary policy and boost economic growth. Similarly, the Interest rate cap was repealed through the enactment of the Finance Act 2019 in an effort to enhance access to credit for the private sector. This saw, the Inter-bank, savings and lending rates declining by 2.2%, 1.1% and 0.3% to 6.0%, 4.0 and 12.2%, respectively from, 8.2%, 5.1% and 12.5% in 2018.

Some other key highlights from the report include:

i. **Employment:** During the year, total new jobs created were 846,300, a marginal increase from the 840,600 recorded in 2018. Out of the total new jobs created, 78,400 were from the formal sector while 767,900 came from the informal sector,
ii. **Money Supply:** Broad money supply increased from Kshs 3,337.8 bn in December 2018 to Kshs 3,524.0 in December 2019. Total domestic credit grew by 6.1% to Kshs 3,660.5 bn compared to a growth of 5.2% seen in 2018,
iii. **Liquidity**: Overall liquidity of the banking system grew by 8.3% to Kshs 4,927.1 bn in 2019 as money outside banks declined to Kshs 157.7 bn in September 2019 from Kshs 196.9 bn seen in June 2019 due to the demonetization exercise done by the Central Bank,
iv. **Imports & Exports:** Total exports declined by 2.9% to Kshs 596.7 bn (equivalent to 6.1% of GDP) in 2019, compared to Kshs 614.4 bn in 2018. Total imports on the other hand increased by 2.4% to Kshs 1,806.3 bn (equivalent to 18.5% of GDP) in 2019, compared to Kshs 1,764.5 bn in 2018. This resulted to a deterioration in the balance of trade by 5.2% to a deficit of Kshs 1,209.7 bn (equivalent to 12.4% of GDP) from Kshs 1,150.1 bn recorded in 2018. The total value of trade transactions increased from Kshs 2,378.8 bn in 2018 to Kshs 2,403.0 bn in 2019,
v. **Balance of Payments:** The overall Balance of Payments position improved to a surplus of Kshs 106.4 bn from a surplus of Kshs 103.4 bn in 2018. This is attributed to a build-up in official reserves, and,
vi. **Current Account:** The current account worsened to a deficit of Kshs 567.0 bn from Kshs 511.3 bn recorded in 2018. Similarly, the financial account net inflows declined by 3.9% to a surplus of Kshs 636.3 bn from a surplus of Kshs 662.0 bn, mainly occasioned by declines in net inflows of direct investment and other investment liabilities.

In our view, we expect the country's GDP for 2020 to come in at a range of 1.4% - 1.8% depending on the severity of the effects brought about by the virus, and how fast the country recovers. The key sectors of the economy affected by the Coronavirus pandemic include the Tourism, Agricultural, and Manufacturing sectors which were hit the hardest hit due to shutdowns in major markets and the disruption of the global supply chain. Combined, the 3 sectors account for 43.8% of Kenya's GDP in 2018.

During the week, the World Bank released the Kenya Economic Update, April 2020, highlighting that the Kenyan economy was estimated to have grown by 5.6% in 2019. Further to this, they expect the effects of the ongoing COVID-19 pandemic will further reduce growth in 2020 with significant impacts on service based sectors (such as transport, retail trade and tourism) and industries (manufacturing and construction). According to the report, Kenya's GDP growth for 2020 is expected to come in at (1.0%) - 1.5%, depending on how long the economic disruptions in the country last. Below are some of the key take-outs from the report:

i. **Economic Growth:** The economy will be weighed down by both external and domestic supply and demand shocks which will be transmitted to the economy through:
   a. Global supply chain disruptions which will reduce the availability of intermediate and capital

goods brought about by the lockdowns and restrictions in various economies across the globe,
    b. Shocks in domestic supply and demand due to the restrictions put in place by the government in an effort to curb the spread of the novel Coronavirus,
    c. A reduction in the value of Kenya's primary exports such as tea, coffee and horticulture,
    d. Reduced earnings from tourism, and,
    e. A slowdown in diaspora remittances.
ii. **Inflation:** Headline inflation for the year is projected to come in at 6.0% which is within the government's target range of between 2.5% - 7.5%. This will be supported by a recovery in the agricultural sector and low oil prices,
iii. **Current Account:** The current account deficit is expected to widen to (4.5%) of GDP over the medium term due to the expectations of a larger decline in exports of goods and services compared to imports during the year,
iv. **Fiscal Deficit:** the World Bank projects the country's fiscal deficit to come in at 8.0% in 2020 from a pre-COVID-19 target of 6.3%. This considers a situation where fiscal consolidation efforts are postponed until after the crisis is contained. The rise in fiscal deficit is expected to emanate from the additional fiscal stimulus directed towards containing the novel Coronavirus,
v. **Debt:** According to the report, Kenya's gross public debt stood at Kshs 6.4 tn (63.1% of GDP) in 2019/20. Debt vulnerabilities for the country have risen because of the increasing debt service obligations while export receipts and government revenues decrease due to the effects of the pandemic,
vi. **Currency:** Given the fact that over half of the country's debt stock is external, exposure to foreign currency risk remains high. This means that the weakening of the local currency will exacerbate debt service obligations, and,
vii. Considering the above and the current uncertainties, the World Bank is projecting the country's growth through the below two scenarios:
    a. In the first scenario, economic activity is assumed to be severely disrupted for two months (starting from Mid-March through to Mid-May), followed by a relatively rapid normalization. In this case, growth is projected to come in at 1.5%,
    b. In the second scenario, economic activity is assumed to be severely disrupted for a longer three-month period (starting from Mid-March through to Mid-June), this means that the effects will be more significant in the affected sectors and as such the growth is projected to come in at (1.0%).

Below is a table showing Kenya's GDP growth estimates for 2020 from various organizations, having factored in the effects of the Coronavirus and the locust invasion experienced earlier during the year:

Kenya 2020 Annual GDP Growth Outlook

No.	Organization	2020 Projections	Revised Projections
1	**International Monetary Fund***	**6.0%**	**1.0%**
2	**World Bank****	**6.0%**	**1.5%**
3	**Cytonn Investments Management PLC***	**5.7%**	**1.6%**
4	**McKinsey & Company ***	**5.2%**	**1.9%**
5	**Central Bank of Kenya***	**6.2%**	**2.3%**
6	United Nations Conference on Trade and Development (UNCTAD)	5.5%	5.5%
7	Capital Economics	5.9%	5.9%
8	African Development Bank	6.0%	6.0%
9	National Treasury	6.0%	6.0%

Kenya 2020 Annual GDP Growth Outlook

No.	Organization	2020 Projections	Revised Projections
10	African Development Bank (AfDB)	6.0%	6.0%
11	Citigroup Global Markets	6.2%	6.2%
	Average	**5.9%**	**4.2%**

Organizations that have revised their projections for 2020

*****Figure is based on the best-case scenario according to the World Bank***

Also during the month, The Finance Bill 2020 was tabled before Parliament, and some of the proposed amendments include;

With regard to Capital Markets Act;

1. The Bill seeks to bring private equity and venture capital firms that access public funds (pensions scheme funds) under the regulatory oversight of the Capital Markets Authority. Currently, the private equity and venture capital firms are not regulated,
2. The Bill also seeks to remove the function of payment of beneficiaries from collected unclaimed dividends when they resurface. This function is currently domiciled under the Unclaimed Financial Assets Authority.

With regard to Retirements Benefits Act;

3. The Bill seeks to enhance supervisory role of the Retirements Benefits Authority on pension schemes by providing powers to charge a penalty for failure by trustees to submit actuarial valuation reports within the period specified in the Retirements Benefits Regulations. If successfully adopted, a trustee who fails to submit a copy of the accrual report to the Chief Executive Officer by the due date specified in the regulations shall pay a penalty of Kshs 100,000.0. In addition, where the report remains unsubmitted, the trustee will pay a further penalty of Kshs 1,000.0 for each day the report remains unsubmitted.

If successfully adopted and approved, we expect the amendments to enhance transparency and accountability in the case of private equity and venture capital firms, and thus additional protection of public funds; however, private equity and venture capital firms are typically unregulated, and may shy away from investing in pension funds if that will lead to their regulation. In addition, we expect the introduction of a penalty for trustees who fail to submit valuation reports in time, will enhance operational efficiency thus complement the RBA's core mandate which is to protect the interests of its members and sponsors of the scheme, and also prompt adherence to the set Regulations on submission of actuarial evaluations which are used to measure the long term sustainability of the subject scheme.

Monthly Highlights

1. World Bank released the Africa's Pulse, April 2020. According to the report, Sub-Saharan Africa's economic growth is projected to enter into the negative territory, with the World Bank projecting it at (2.1%) to (5.1%) from a growth of 2.4% recorded in 2019, which will be the region's first recession in 25-years. For more information, see our Cytonn Weekly #15/2020,
2. International Monetary Fund released the first chapter of the World Economic Outlook (The Great Lockdown), where they revised Kenya's 2020 GDP growth rate for 2020 to 1.0%, from the 6.0% growth rate projected at the beginning of the year. For more information, see our, Cytonn Weekly #16/2020,
3. National Assembly approved the Tax Amendment Bill 2020, which was necessitated by the Presidential directive dated 25th March 2020 to mitigate the economic effects arising from the novel COVID-19 virus. On 25th April 2020, President Uhuru Kenyatta, signed into law the Tax

Laws (Amendment) Bill. Some of the key amendments include: (i) reduction of the Corporate Tax rate to 25.0% from 30.0% in an effort to increase corporate tax savings, and, (ii) a reduction of Value Added Tax (VAT) to 14.0% from 16.0% in an effort to lower the prices for basic commodities. For more information, see our, Cytonn Weekly #17/2020, and,

4. National Assembly approved the supplementary budget for the fiscal year 2019/20, leading to a Kshs 9.7 bn decline in the gross total supplementary budget to Kshs 2,803.1 bn, from Kshs 2,812.8 bn. For more information, see our, Cytonn Weekly #17/2020.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 23.2% behind of its current domestic borrowing target of 404.4bn, having borrowed Kshs 262.9 bn against a prorated target of Kshs 342.2 bn. The uncertainty brought about by the novel Coronavirus will make it harder for the government to access foreign debt due to uncertainty affecting the global markets which might see investors attaching a high-risk premium on the country. A budget deficit is likely to result from the depressed revenue collection with the revenue target for FY'2019/2020 at Kshs 1.9 tn, creating uncertainty in the interest rate environment as additional borrowing from the domestic market goes to plug the deficit. Owing to this uncertain environment, our view is that investors should be biased towards short-term fixed income securities to reduce duration risk.
