Accelerating Funding to Affordable Housing, & Cytonn Weekly #21/2020

Fixed Income

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

During the week, T-bills remained oversubscribed, with the subscription rate coming in at 149.3%, up from 100.4% the previous week. The oversubscription is partly attributable to the high liquidity in the money markets as well as the increased preference to shorter-dated papers by investors. The subscription rate for the 91-day, 182-day, and 364-day papers increased to 271.0%, 104.9%, and 145.0%, respectively, from 191.8%, 44.9%, and 119.3% recorded the previous week, respectively. The yields on the 91-day, 182-day, and 364-day papers all remained unchanged at 7.3%, 8.2%, and 9.2%, respectively. The acceptance rate declined to 74.1%, from 99.5% recorded the previous week, with the government accepting Kshs 26.6 bn of the Kshs 35.8 bn bids received.

The recently issued five-year bond, FXD1/2020/5, was undersubscribed, with the subscription rate coming in at 68.6%, as they received bids worth Kshs 20.6 bn, lower than the offered amount Kshs 30.0 bn. The yield on the bond came in at 11.7%, in-line with our recommended bidding range of 11.5% - 11.7%. Despite the undersubscription the government rejected high bids only accepting Kshs 8.9 bn out of the Kshs 20.6 bn worth of bids received, translating to an acceptance rate of 43.5%.

In the money markets, Yield on the short term papers remained unchanged at 7.9%, 7.3%, and 10.0% for 3-month bank placements, 91-day T-bill and the average yield of top 5 money market funds. The yield on the Cytonn Money Market Fund remained flat closing the week at 10.8%.

Liquidity:

During the week, liquidity remained high in the money market with the average interbank rate remaining unchanged at 4.2%, following the end of the monthly Cash Reserve Requirement (CRR) cycle and support from government payments. The average interbank volumes declined by 11.2% to Kshs 11.5 bn, from Kshs 12.9 bn recorded the previous week. The favourable liquidity in recent weeks has also partly been attributable to the reduction of the Cash Reserve Ratio (CRR) to 4.25%, from 5.25% previously, by the Monetary Policy Committee (MPC) during its March 2020 sitting, consequently freeing up Kshs 35.2 bn 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 38.9 bn in relation to the 4.25% cash CRR.

Kenya Eurobonds:

During the week, the yields on all the Eurobonds declined owing to improved investor sentiments as the market reacted to the news by the World Bank that they had approved USD 1.0 bn funding to support the economy. According to Reuters, the yields on the 10-year Eurobond issued in June 2014 declined by 1.4% points to 8.0%, from 9.4% recorded the previous week.

During the week, the yields on the 10-year and 30-year Eurobonds issued in 2018 declined by 1.1% points and 0.6% points to 8.2% and 8.8%, respectively, from 9.3% and 9.4% recorded previous week, respectively.

During the week, the yields on the 7-year and 12-year Eurobonds issued in 2019 declined by 1.1% points and 0.8% points, to 8.1% and 8.8%, respectively, from 9.2% and 9.6% recorded the previous week, respectively.

Kenya Shilling:

During the week, the Kenya Shilling remained relatively stable depreciating marginally by 0.1% against the US Dollar to close the week at Kshs 106.9, from Kshs 106.8, recorded the previous week. The shilling was supported by increased forex reserves, which rose to a four-month high USD 8.5 bn as the Central bank received the USD 750.0 mn from the International Monetary Fund for economic support. On a YTD basis, the shilling has depreciated by 5.5% 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,
ii. Increased demand as merchandise and energy sector importers beef up their hard currency positions amid a slowdown in foreign dollar currency inflows, and,
iii. Subdued diaspora remittances, due to the decline in economic activities globally coupled with increased prices of household items leading to lower disposable income.

The shilling is however expected to be supported by:

i. High levels of forex reserves, currently at USD 8.5 mn (equivalent to 5.1-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. As a result of inflows from the IMF Rapid Credit Facility (RCF) approved during the week reserves rose by 8.7% to USD 8.4 mn from USD 7.8 mn,

Inflation Projection:

We are projecting the y/y inflation rate for May 2020 to remain stable within the range of 5.5% - 5.7%, compared to 5.6% recorded in April attributable to the following factors:

i. The decline in oil prices (petrol prices by 10.3% and diesel prices by 19.7%), which has not led to a reduction in transport prices due to the measures taken by the government to curb the spread of COVID-19,
ii. Food prices have remained relatively stable during the month but there is an upward bias due to expected lower supply of foodstuffs as the effects of the locust invasion and recent floods take a toll on food production, and
iii. The reclassification of Food Index in the Consumer Price Index from 36.0% to 32.9%, which is expected to have an impact on the final inflation figures.

Monetary Policy:

The Monetary Policy Committee (MPC) is set to meet on Wednesday, 27th May 2020, to review the outcome of its previous policy decisions and recent economic developments, and to make a decision on the direction of the Central Bank Rate (CBR). In their previous meeting held on 29th April 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, the MPC lowered the CBR by 25 bps to 7.00% from 7.25% after 1.00% revision the previous sitting. In their note, they indicated that the previous cut in CBR rate was having the intended outcome but they noted that the Coronavirus pandemic had continued to affect economic growth and as such, there would be a need to further cushion the economy. This was in line with our expectations as per our MPC Note.

During the meeting on Wednesday, 27th May 2020, we expect the MPC to maintain the Central Bank Rate (CBR) at 7.00%, with their decision mainly being supported by:

i. High liquidity in the money markets from their previous action i.e. lowering of Cash Reserve Ratio (CRR) to 4.25%, from 5.25% in March 2020 meeting and the revision of the CBR rate by 25% over the previous two sittings,
ii. Inflation has remained stable and within the government target of 2.5% - 7.5%, and
iii. The need to monitor the effects the initial cuts will have on the economy as banks lend to businesses and individuals. Lower rates would make lending unattractive to banks as they might not reflect the true risk levels.

For our detailed MPC analysis, please see our MPC Note for the 27th May 2020 meeting here.

Weekly Highlight:

During the week, the World Bank approved US Dollar 1.0 bn financing for Kenya to address the COVID-19 financing gap and support the economy through this period. This is the second-ever such lending from the World Bank after the first in May 2019 where the government received USD 750.0 mn for budgetary support. The country undertook policy reforms to secure the financing and ultimately, directly benefit low-income households in the country. Through this policy, small scale farmers will benefit from better targeting of subsidized agricultural inputs through electronic vouchers. The supply of affordable housing is similarly expected to increase on the back of the updating of antiquated legislation that hindered the development of the housing market.

The approved financing will comprise of USD 750.0 mn credit from the International Development Association (IDA), to be repaid over 30 years after a 5 year grace period with 1.4% interest and a further loan of USD 250 from the International Bank for Reconstruction and Development (IBRD) which will attract a market-based interest of 2.0%. In our view, the move by the government is welcomed as it helps move the country’s loans to more concessional and commercial loans as opposed to bilateral and multilateral loans. Aside from the financial benefit, the initiative is also supporting more transparency in public financial management and as such, ordinary Kenyans will for the first time be able to review details of public procurement contracts through the public procurement information portal.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 17.7% behind of its current domestic borrowing target of 404.4bn, having borrowed Kshs 294.4 bn against a prorated target of Kshs 357.7 bn. The government had also borrowed 98.4 bn (42.3%) of the 232.8 bn foreign borrowing target, as at 31st March 2020. 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 2.1 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.