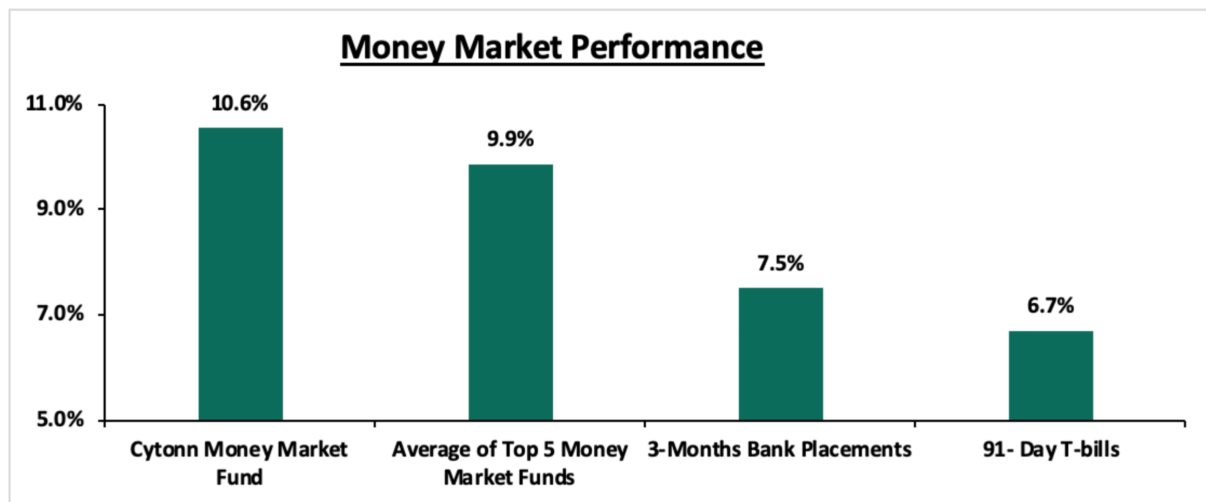
Financial Planning Amidst COVID-19, & Cytonn Weekly #26/2020

Fixed Income

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

During the week, T-bills remained oversubscribed, with the subscription rate coming in at 245.6% up from 188.4% the previous week. The oversubscription is partly attributable to the continued preference for shorter-dated papers by investors. The subscription rates for the 91-day, 182-day and 364-day papers increased to 412.0%, 140.3% and 284.4%, respectively, from 334.4%, 130.6% and 187.8%, recorded the previous week. The yields on the 91-day, 182-day, and 364-day papers declined by 39.0 bps, 34.9 bps, and 47.4 bps, respectively, to 6.7%, 7.4%, and 8.2%, respectively. The acceptance rate declined to 23.3%, from 32.6% recorded the previous week, with the government accepting only Kshs 13.8 bn of the Kshs 59.0 bn worth of bids received, due to reduced borrowing pressure, with the Government having met their FY'2019/2020 borrowing target of Kshs 409.0 as highlighted by the Governor of the Central Bank of Kenya in his post-monetary committee press conference on 26th June 2020.



In the money markets, 3-month bank placements ended the week at 7.5% (based on what we have been offered by various banks), while the yield on the 91-day T-bill declined by 0.4% points to close the week at 6.7%, from 7.1% recorded the previous week. The average yield of Top 5 Money Market Funds remained unchanged at 9.9% similar to what was recorded the previous week. The yield on the Cytonn Money Market remained unchanged at 10.6%, similar to what was recorded the previous week.

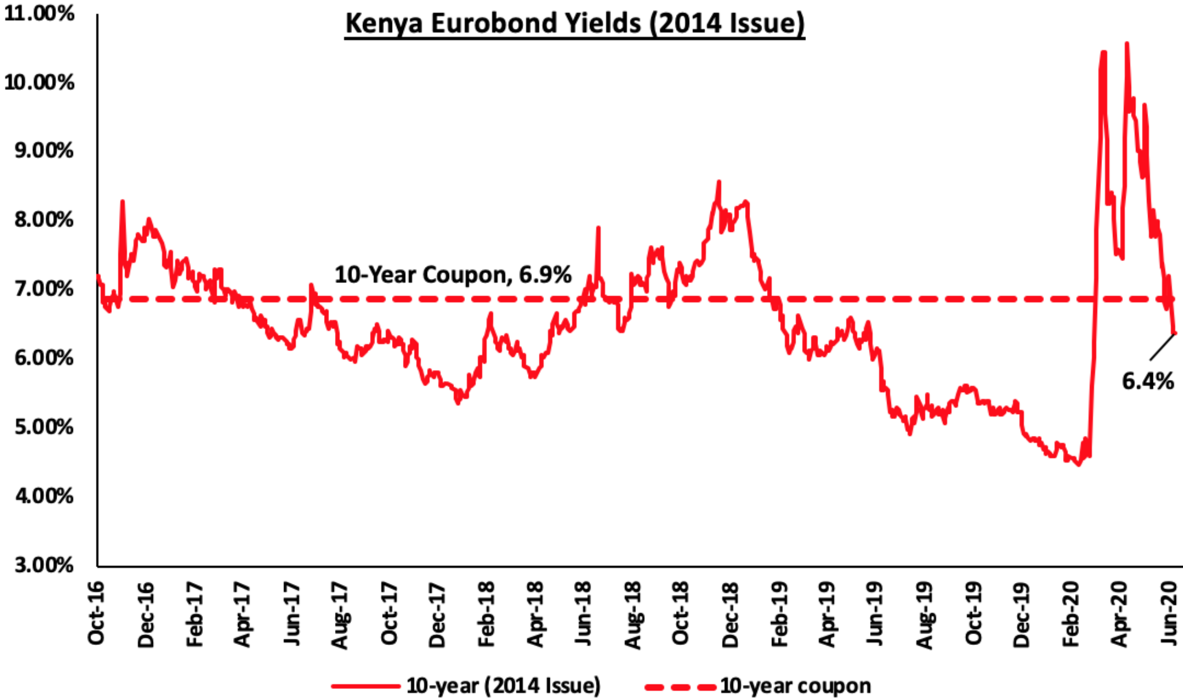
Liquidity:

During the week, market liquidity tightened with the average interbank rate increasing to 3.9% from 3.2% recorded the previous week, attributable to tax remittances due on the 20th of every month. The week also saw the average interbank volumes increase by 132.6% to Kshs 8.9 bn, from Kshs 3.8 bn recorded the previous week. According to the Central Bank of Kenya, commercial banks' excess

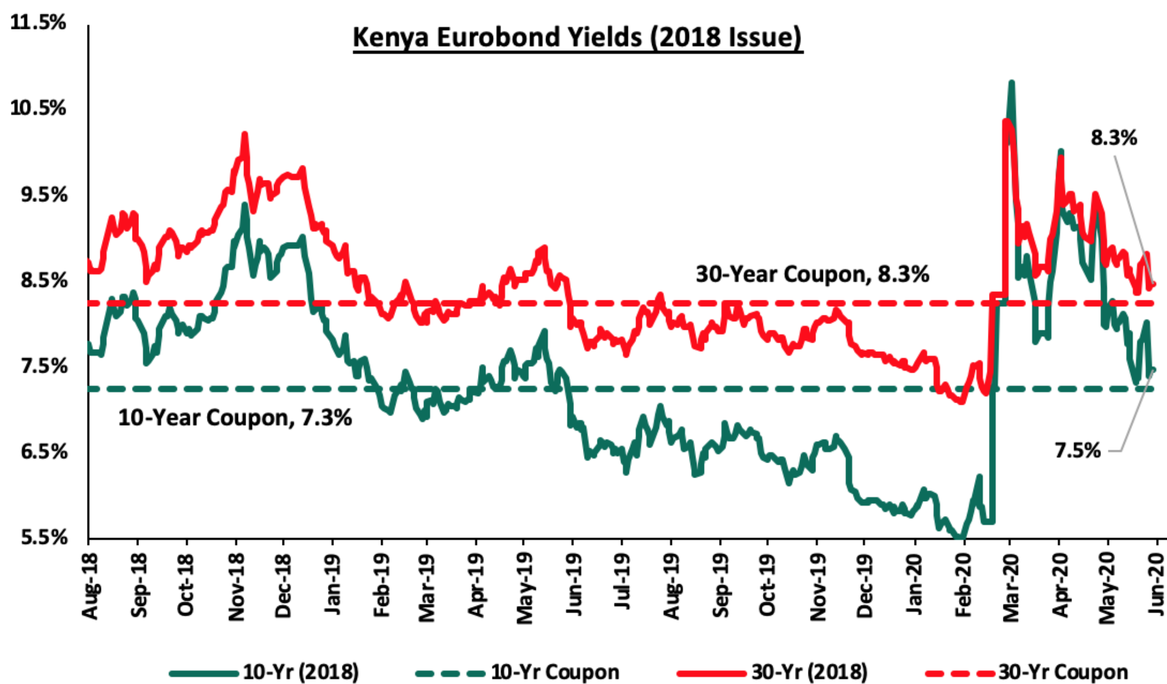
reserves came in at Kshs 41.1 bn in relation to the 4.25% cash CRR. The favourable liquidity since March 2020 has also partly been attributable to the reduction of the Cash Reserve Ratio (CRR) to 4.25%, from 5.25% previously, by the Monetary Policy Committee (MPC) during its March 2020 sitting, consequently freeing up Kshs 35.3 bn of additional liquidity to commercial banks for onward lending to distressed borrowers during the COVID-19 pandemic. The Monetary Policy Committee in its meeting held on 25th June 2020 revealed that 87.6% of the funds have been used for onward lending especially to support the tourism, transport & communication, real estate, and manufacturing sectors.

Kenya Eurobonds:

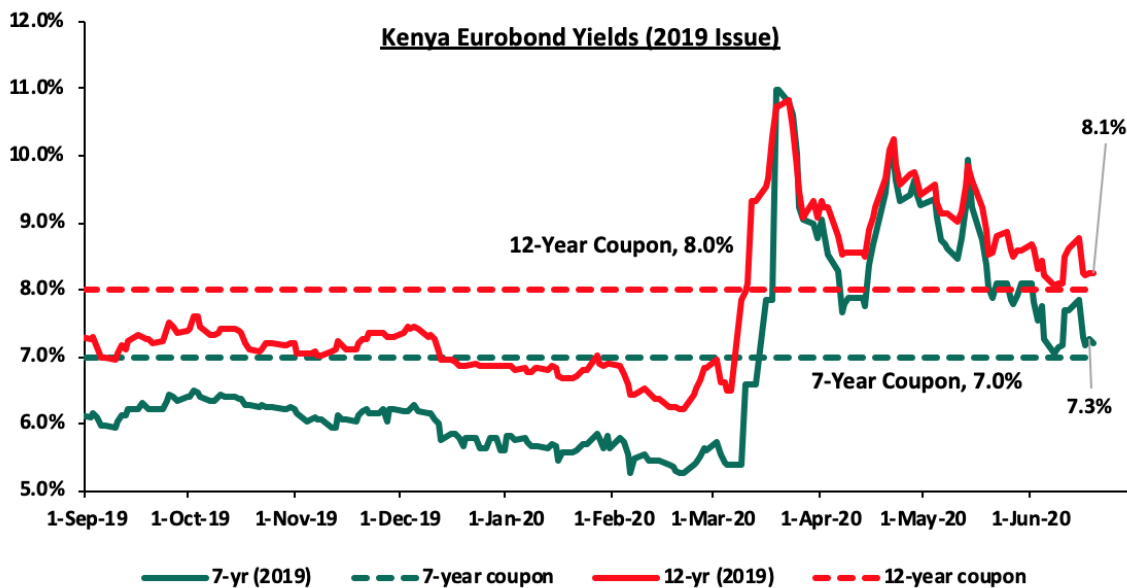
Since the jump we saw in March, investor sentiments have been improving over the past two months as the market reacted to the news by the World Bank having approved USD 1.0 bn funding to support the economy as well as the Rapid Credit Facility (RCF) which reaffirmed investors' confidence despite the recent downgrade by Moody's where Kenya's sovereign credit outlook was changed to negative from stable. According to Reuters, the yield on the 10-year Eurobond issued in June 2014 remained unchanged at 6.4% for the week.



The yields on the 10-year Eurobond issued in 2018 remained unchanged at 7.5% similar to what was recorded the previous week. The yield on the 30-year Eurobonds issued in 2018 declined by 0.2% points to 8.3% from 8.5% recorded the previous week.



The yields on the 7-year Eurobond issued in 2019 increased by 0.1% points to 7.3% from 7.2% recorded the previous week. The yield on the 12-year Eurobonds issued in 2019 declined by 0.1% points to 8.1% from 8.2% recorded the previous week, respectively.



Kenya Shilling:

During the week, the Kenya Shilling depreciated by 0.2% against the US Dollar to close the week at Kshs 106.5, from Kshs 106.3, recorded the previous week, which traders attributed to high, end month, dollar demand from multinational companies and manufacturers importing goods. The demand was, however, offset by the inflows from the horticulture exports as well as diaspora remittances. On an YTD basis, the shilling has depreciated by 5.1% against the dollar, in comparison to the 0.5% appreciation in 2019. We expect continued pressure on the shilling due to:

i. Demand from merchandise and energy sector importers as they beef up their hard currency positions amid a slowdown in foreign dollar currency inflows, and,
ii. Subdued diaspora remittances evidenced by the 9.0% decline to USD 208.2 mn in April 2020, from USD 228.8 seen the previous month, mainly due to the decline in economic activities globally, coupled with increased prices of household items leading to lower disposable income. Key to note, the Central Bank of Kenya (CBK) expects a 12.0% decline in remittances in 2020.

The shilling is however expected to be supported by:

i. High levels of forex reserves, currently at USD 9.2 bn (equivalent to 5.6-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.

Weekly Highlight:

i. **Monetary Policy**

The Monetary Policy Committee (MPC) met on 25th June 2020 to review the prevailing macroeconomic conditions and decide on the direction of the Central Bank Rate (CBR). The MPC maintained the CBR at 7.00%, which was in line with our expectations in our June 2020 MPC Note. The MPC indicated that the previous cuts in the CBR rate in March and April 2020 to the current 7.00%, was having the intended outcome. The key highlights from the meeting:

- Inflation is expected to remain within the Government's target of between 2.5% - 7.5%, largely supported by the improving food supply due to favourable weather conditions, lower international oil prices, reduced VAT rate on some commodities and muted demand pressures,
- The most recent economic indicators points that growth in Q1'2020 was strong, an indication that impact of the COVID-19 virus was majorly pronounced in April 2020. There was a notable recovery in the economy in May 2020 driven by increased agricultural output and exports. The revenues from the services sector likes tourism and aviation remained low,
- Taking into consideration the impact of COVID-19, the current account deficit is expected to remain at 5.8% of GDP in 2020, suported by an increase in exports of tea and horticulture. The service sector, and in particular air travel and tourism, continue to be adversely affected by the COVID-19 pandemic,
- The banking sector recorded an improvement in asset quality with the gross non-performing loans ratio coming in at 13.0% in May 2020 as compared to 13.1% in April 2020. The performance was attributable to repayments and recoveries in the manufacturing and real estate sectors,
- In line with the measures announced by the Central Bank in March 2020 regarding loan restructuring, total loans worth Kshs 679.6 bn had been restructured representing 23.4% of the total banking sector loan book which amounts to Kshs 2.9 tn. A total of Kshs 199.1 bn (25.0% of total personal loans) have been restructured. Other major sectors where loan restructuring has taken place include trade (23.7%), real estate (20.6%), tourism (12.5%), and transport and communication sector (11.2%), and,
- There was an Improvement in private sector credit growth, with the growth at 1% in the 12-months to May 2020, above the 5-Year historical average, of 8.0%. Strong credit growth was observed in the Manufacturing sector (18.6%), consumer durables (16.7%), trade (8.2%), and finance and insurance (7.2%).

The committee noted that the policy measures put in place in March and April were having the intended effect on the economy and are still being transmitted. They concluded that the current accommodative stance is appropriate. The Governor of the Central Bank of Kenya noted that measures put in place to cushion the economy such as waiving transaction charges for transfer of money between banks as well as waiving fees for any mobile transactions below Kshs 1,000.0 were having the intended effect on the economy. The governor also noted that other tools of monetary policy such as Cash Reserve Ratio (CRR) and Repos continue to remain efficient in stimulating the economy.

ii. **Inflation Projection**

We are projecting the y/y inflation rate for June 2020 to remain stable within the range of 5.4% - 5.7%, compared to 5.5% recorded in May. The key drivers include:

i. Petrol prices increased by 6.9% while kerosene and diesel prices declined by 21.7% and 4.8%, respectively. The increase in petrol prices, together with travel restrictions by government in the wake of COVID-19 are likely to have upward pressure on the transport index which holds a weighting of 8.7%,
ii. Food prices have remained relatively stable during the month given the favourable weather and an improvement in agricultural output, and,
iii. The reclassification of the 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.

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. The recent reopening of majority of the global markets will also address supply chain disruptions leading to stable import prices.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. We believe that the uncertainty affecting the global financial markets brought about by the novel Coronavirus will make it harder for the government to access foreign debt, and might result in investors attaching a high-risk premium on the country. As a result of depressed revenue collection with the revenue target for FY'2020/2021 at Kshs 1.9 tn, we expect a higher budget deficit, which the Treasury estimates at 7.5% of GDP, creating uncertainty in the interest rate environment as additional borrowing from the domestic market will be required to plug in 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.