Cytonn H1’2020 Markets Review

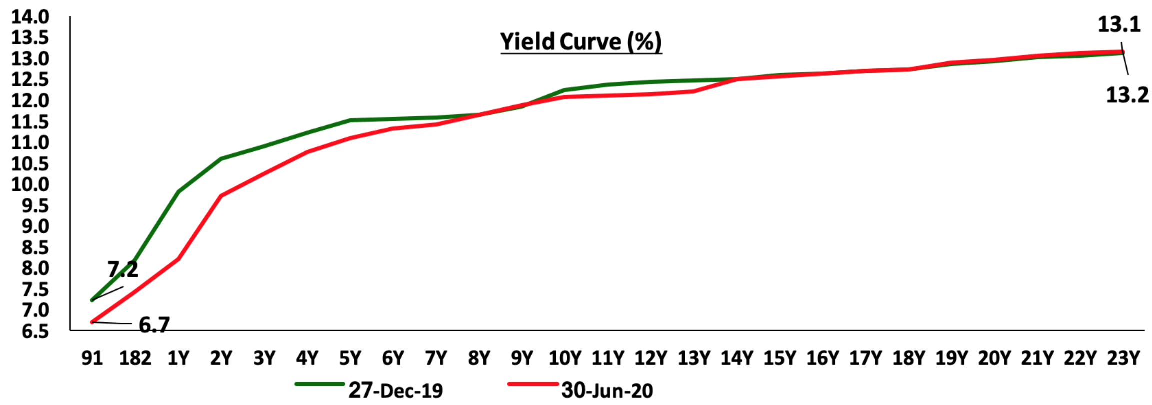
Fixed Income

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

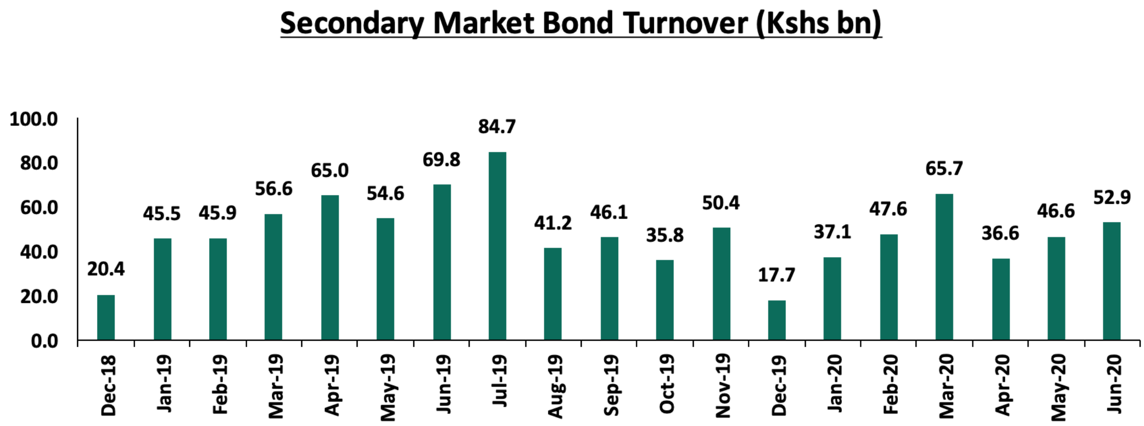
Demand for government securities remained high in the first half of 2020 with Treasury bills being 152.6% subscribed, attracting bids worth Kshs 916.7 bn, and the government accepting Kshs 551.0 bn while Treasury bonds received a 119.6% subscription, Kshs. 414.7 bn worth of bids and the government accepting only Kshs 278.3 m. The yields on the 91-day T-bill and 182-day T-bill declined to 6.7%, 7.4%, and 8.2% in H1’2019, from 7.2%, 8.2%, and 9.8% recorded as at the end of 2019.

During the week, T-bills remained oversubscribed, with the subscription rate coming in at 317.4% up from 245.6% the previous week. The subscription rates for the 91-day paper increased to 511.3% from 245.6% recorded the previous week with investors preferring to hold the shortest dated paper due to uncertainty in the market. The subscription for the 182-day and 364-day papers also increased to 267.5% and 289.8%, respectively, from 140.3% and 284.4%, recorded the previous week. The yields on the 91-day, 182-day, and 364-day papers declined by 15.4 bps, 34.2 bps, and 42.5 bps respectively to 6.5%, 7.0%, and 7.8%. The acceptance rate increased to 57.6%, from 23.3% recorded the previous week, with the government accepting only Kshs 43.9 bn of the Kshs 76.2 bn worth of bids received.

The Central bank of Kenya was keen to ensure that rates remained low and therefore continued to reject expensive bids and this led to a decline in the yields on the short end of the yield curve. Yields on longer-dated papers experienced some slight pressure leading to a 1.0% decline in The FTSE bond index in the first half. The chart below is the yield curve movement during the period.

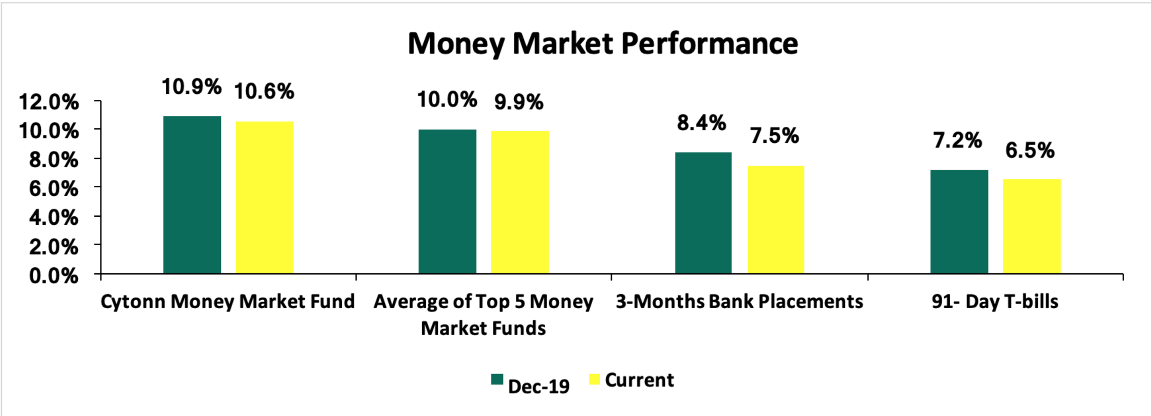


Secondary Bond Market Activity:



The secondary bond market recorded decreased activity, with the turnover declining by 15.1% to Kshs 286.5 bn from Kshs 337.4 bn in H1'2019. The decline in secondary bond turnover can be attributed to investors' preference to hold safe assets at the moment due to the uncertainty in the market affecting the performance of riskier asset classes.

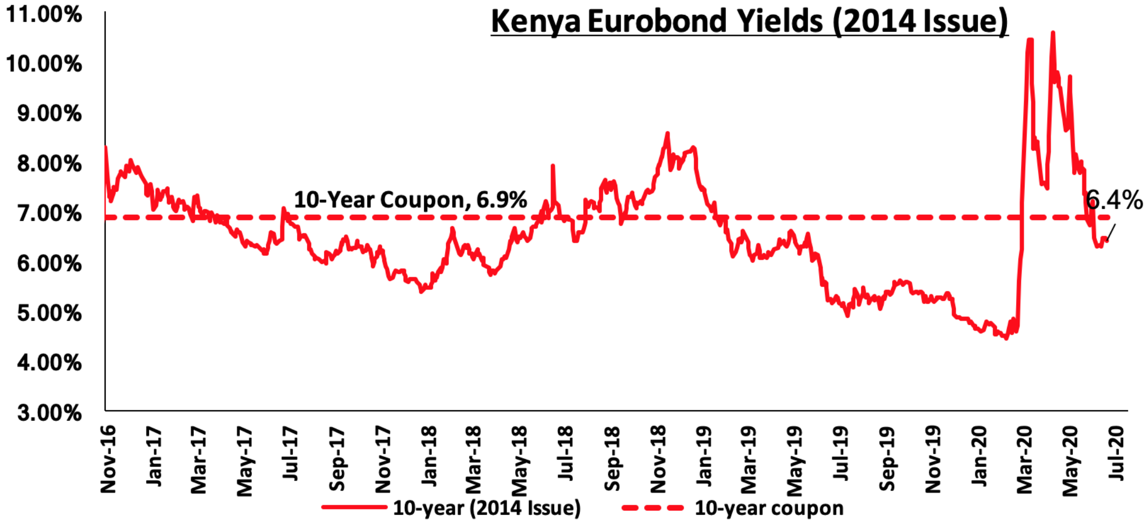
Yields on the money markets remained relatively stable losing slightly as can be seen in the chart below.



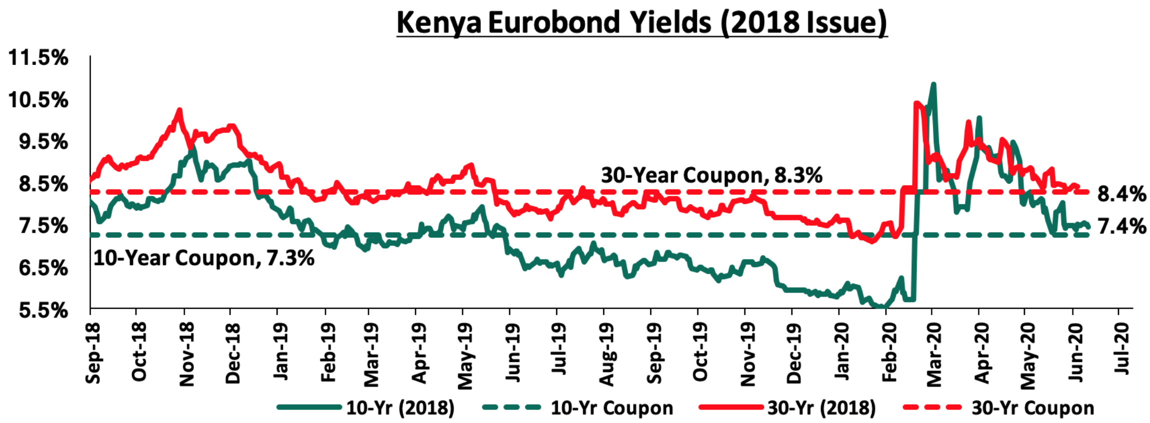
Kenya Eurobonds:

During H1'2020, specifically in March 2020, the yield on all Eurobonds increased significantly attributable to investors attaching a higher risk premium on the country. In the third week of March, there was a sharp increase in the yields of all the issued Eurobonds due to Kenya announcing its first Coronavirus case. Since the jump recorded in March, the investor sentiments have been improving over the past two months attributable to the market reacting to the news by the World Bank that they had 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. For more information, see our Cytonn Weekly #19/2020 and Cytonn Weekly #20/2020.

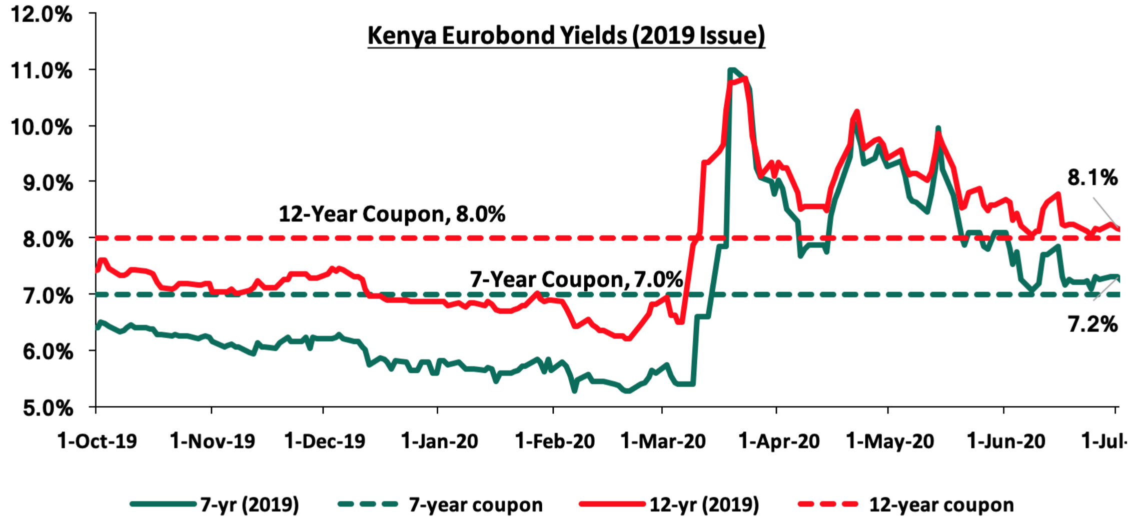
According to Reuters, the yield on the 10-year Eurobond issued in 2014, increased by 1.7% points to close at 6.5%, in H1'2020, from 4.8% at the end of 2019. Key to note is that this bond has 4.0-years to maturity. During the week, the yield on the 10-year Eurobond issued in June 2014 remained unchanged at 6.4%, recorded the previous week.



During H1’2020, the yield on the 10-year Eurobond issued in 2018 increased by 1.6% points to close at 7.5% from 5.9% in December 2019. The yield on the 30-year Eurobonds, issued in 2018, remained unchanged at 8.4% similar to what was recorded in December 2019. These bonds have a 7.7-years and 27.7-years to maturity for the 10-year and 30-year, respectively. During the week, the yield on the 30-year Eurobond issued in 2018 remained unchanged at 8.4% while, the yield on the 10-year Eurobonds decreased by 0.1% points to 7.4%, from 7.5% recorded previous week.



During H1’2020, the yields on the 7-year and 12-year Eurobonds issued in 2019 increased by 1.7% points and 1.3% points, to close at 7.3% and 8.2% from 5.6% and 6.9% recorded at the close of Q4’2019, respectively. Key to note is that these bonds have 6.9-years and 11.9-years to maturity respectively. During the week, the yield on the 7-year Eurobond issued in 2019 declined by 0.1% points, to 7.2%, from 7.3% recorded the previous week while the yields on the 12-year Eurobond issued in 2019 remaining unchanged at 8.1% similar to what was recorded the previous week.



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.

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