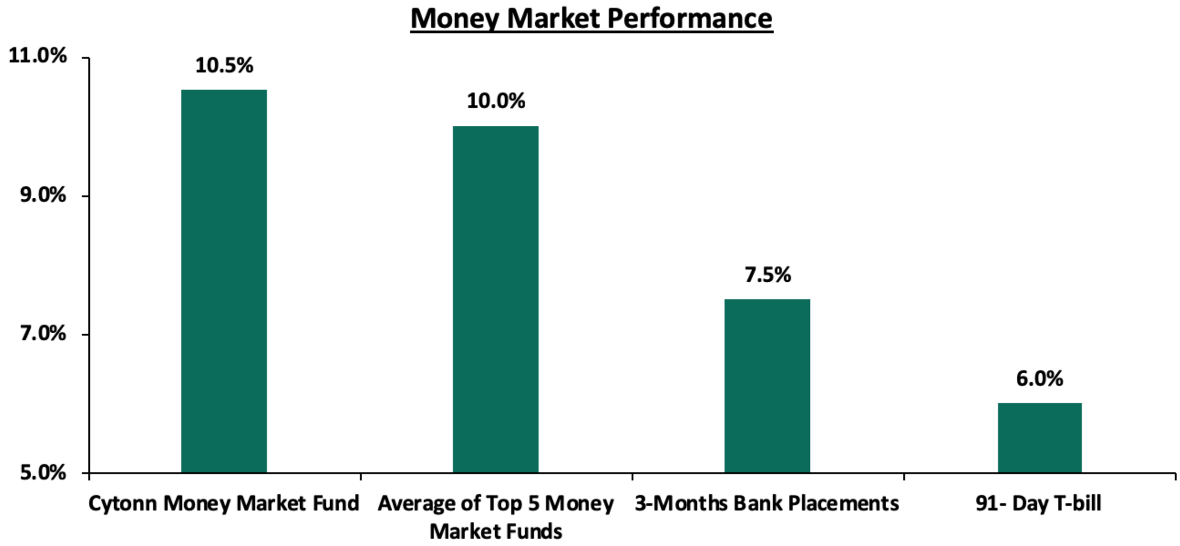
Kenya Public Debt 2020 & Cytonn Weekly #29/2020

Fixed Income

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

During the week, T-bills remained oversubscribed, with the subscription rate coming in at 271.5% down from 358.2% the previous week. The highest subscription rate was on the 91-day paper which came in 746.9%, down from 948.1% recorded the previous week. The subscription for the 182-day paper also declined to 107.8% from 273.7% recorded the previous week, while the subscription of the 364-day paper increased to 245.1% from 206.7% recorded the previous week. The oversubscription is partly attributable to increased liquidity in the money market with the average interbank rate coming in at 1.8% from 1.9% recorded the previous week. We note that banks continue to prefer government securities as opposed to lending, with their holdings in Government domestic debt rising to 54.9% from 54.1% as at the start of the year. The yields on the 91-day, 182-day, and 364-day papers declined by 26.3 bps, 23.5 bps, and 23.6 bps respectively to 6.0%, 6.5%, and 7.5%, attributable to the high liquidity in the money market and increased investments in government securities from financial institutions as they shy away from lending. The acceptance rate increased to 69.8%, from 53.8% recorded the previous week, with the government accepting Kshs 45.2 bn of the Kshs 65.2 bn worth of bids received, higher than the weekly offered amount of Kshs 24.0 bn.

The National Treasury recently reopened 3 fixed coupon treasury bonds, FXD1/2020/05, FXD2/2018/10 and FXD1/2019/15 with effective tenors of 5 years, 10 years and 15 years respectively, for budgetary support purposes. The period of the sale is from 6th July 2020 to 21st July 2020. The coupon rates for the bonds are 11.7%, 12.5% and 12.9%, for the 5-year, 10-year and 15-year bonds, respectively. Our recommended bidding ranges are 10.5% - 10.6% for the 5-year bond, 11.7% - 11.8% for the 10-year bond and 12.3% - 12.4% for the 15 year bond, given that bonds with similar tenors are currently trading at 10.6%, 11.6% and 12.3%, respectively. As per the historic trend, we expect the market to maintain a bias towards the 5-year bond due to its short tenor.



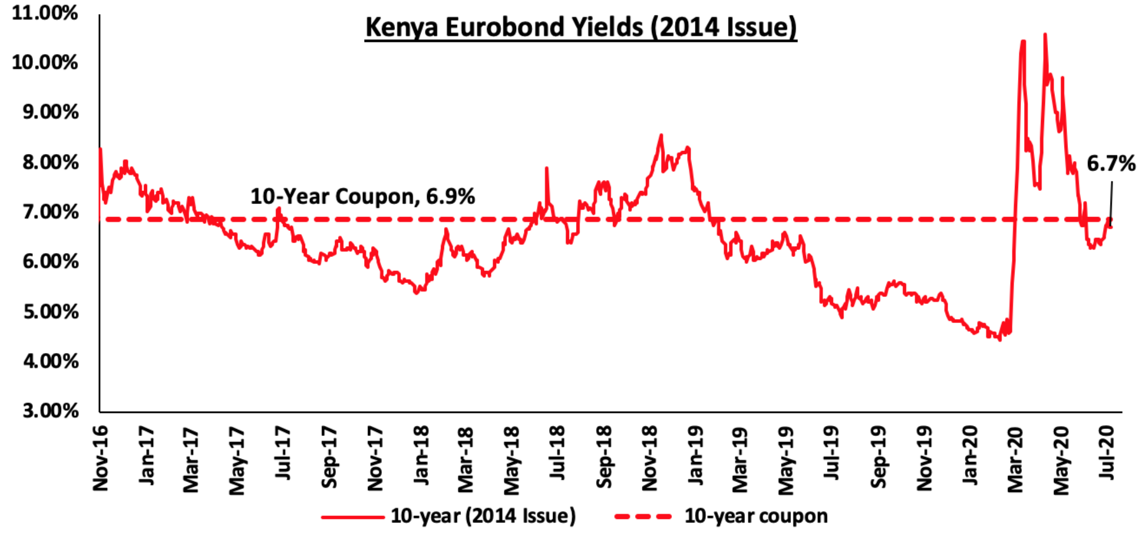
In the money markets, 3-month bank placements ended the week at 7.5% (based on what we have been offered by various banks), while the yield on the 91-day T-bill declined by 0.3% points to close the week at 6.0%, from 6.3% recorded the previous week. The average yield of Top 5 Money Market Funds recorded marginal gains to 10.0% from 9.9% recorded the previous week. The yield on the Cytonn Money Market remained unchanged at 10.5% similar to what was recorded the previous week.

Liquidity:

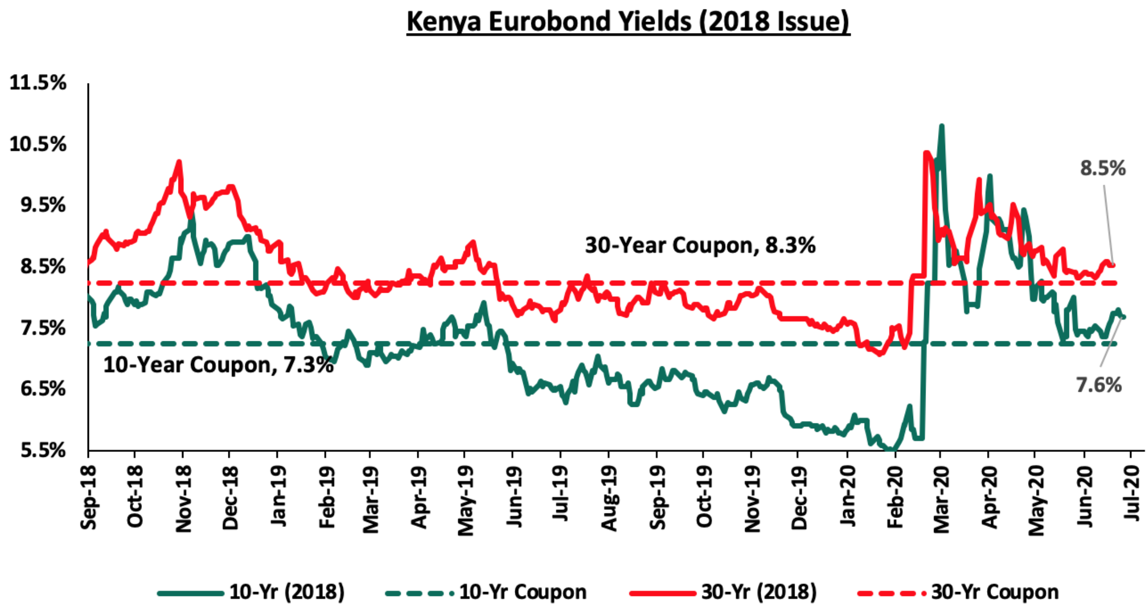
During the week, liquidity in the money market increased leading to a decline in the average interbank rate to 1.8% from 1.9% recorded the previous week while the average interbank volumes increased by 156.0% to Kshs 9.8 bn, from Kshs 3.8 bn recorded the previous week. Liquidity was mainly supported by government payments and maturing TADS of Kshs 162.2 mn. (TADs are used when the securities held by the CBK for Repo purposes are exhausted or when CBK considers it desirable to offer longer tenor options). As per the Central Bank of Kenya, commercial banks' excess reserves came in at Kshs 10.9 bn in relation to the 4.25% Cash Reserve Ratio.

Kenya Eurobonds:

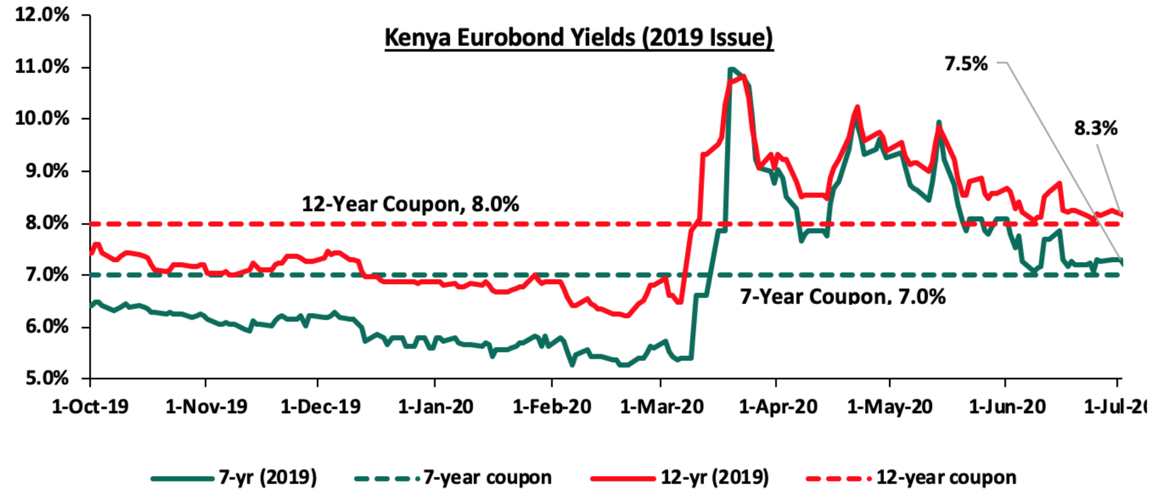
During the week, Eurobond yields were on a downward trend mainly attributable to the improved investor sentiments attributable to the recent easing of coronavirus restrictions. This is despite the continued surge in the coronavirus cases. According to Reuters, the yield on the 10-year Eurobond issued in June 2014 declined by 0.1% points during the week to close at 6.7% from 6.8% recorded the previous week.



The yields on the 10-year Eurobond issued in 2018 declined marginally by 0.2% points to close at 7.6% from 7.8% recorded the previous week. The yield on the 30-year Eurobonds issued in 2018 remained unchanged at 8.5% similar to what was recorded the previous week.



The yields on the 7-year Eurobond and 12-year Eurobond issued in 2019 both declined by 0.1% points, respectively to 7.5% and 8.3% from 7.6% and 8.4% recorded the previous week, respectively.



Kenya Shilling:

During the week, the Kenya Shilling depreciated by 0.5% against the US Dollar to close the week at Kshs 107.5, from Kshs 106.9, recorded the previous week, attributable to increased dollar demands from importers as global economies continued easing movement restrictions. On a YTD basis, the shilling has depreciated by 6.0% 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,
ii. A deteriorating current account position, with the current account deficit deteriorating by 10.2% during Q1'2020, to Kshs 110.9 bn, from Kshs 100.6 bn recorded in Q1'2019 attributable to;

a. 3.0% decline in the secondary income (transfers recorded in the balance of payments whenever an economy provides or receives goods, services, income or financial items) balance, to Kshs 124.1 bn, from Kshs 128.0 bn in Q1'2019, and,
b. A 67.0% decline in the services trade balance (the difference between the imports and exports of services) to Kshs 20.4 bn, from Kshs 61.9 bn.

The shilling is however expected to be supported by:

i. High levels of forex reserves, currently at USD 9.7 bn (equivalent to 5.9-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. Improving diaspora remittances evidenced by the 24.0% increase to USD 258.2 mn in May 2020, from USD 208.2 seen the previous month, mainly due to the improvements in economic activities globally, as countries abroad eased their coronavirus restrictions. In terms of y/y performance, diaspora remittances increased by 6.2% to USD 258.2 mn in May 2020, from USD 243.2 mn recorded in May 2019.

Weekly Highlight

During the week, the Energy and Petroleum Regulatory Authority (EPRA) released their monthly statement on the Maximum Retail Prices in Kenya for the period 15th July 2020 to 14th August 2020. Below are the key take-outs from the statement:

- Petrol prices have increased by 12.8% to Kshs 100.5 per litre from Kshs 89.1 per litre previously, while diesel prices have increased by 23.2% to Kshs 91.9 per litre from Kshs 74.6 per litre. Kerosene prices also increased by 4.8% to Kshs 65.5 per litre from 62.5 per litre, previously,
- The changes in prices have been attributed to the increase in the average landing cost of imported super petrol by 12.6% to USD 279.6 per cubic meter in June 2020 from USD 248.2 per cubic meter in May 2020. Landing costs for diesel increased by 32.2% to USD 302.2 per cubic meter in June 2020, from USD 228.6 per cubic meter in May 2020. Landing costs for Kerosene, on the other hand, remained unchanged at USD 126.4 per cubic meter in June 2020,
- A 54.5%, increase in Free on Board (FOB) price of Murban crude oil lifted in June 2020 to USD 36.3 per barrel, from USD 23.5 per barrel in April 2020, and,
- The Kenya shilling appreciated by 0.2% against the dollar to close at Kshs 106.5 in June 2020, from Kshs 106.7 recorded in May 2020,

The increase will not only affect the transport index, which carries a weighting of 8.7% in the total consumer price index (CPI), but will have a trickle-down effect on the prices of other commodity baskets food prices due to higher transport costs.

During the week, S&P Global lowered Kenya's outlook from stable to negative and affirmed the B+ long term and B short-term credit rating. Key to note, Moody's credit rating agency changed Kenya's sovereign credit outlook to "negative", from a previous outlook of "stable" and affirmed the B2 credit rating. The agency pointed out that the negative outlook was as a result of rising financial risks brought about by the country's high debt and interest burden. Below is a summary of the credit rating and outlook revisions on Kenya so far;

Rating Agency	Rating as at January 2020	Outlook as at January 2020	Current Rating	Current Outlook
Moody's	B2	Stable	B2	Negative
S&P Global	B+ 'short term', B 'Long Term'	Stable	B+ 'short term', B 'Long Term'	Negative
Fitch Ratings	B+	Stable	B+	Negative

The agency cited that the ongoing COVID-19 pandemic will not only slow the country's GDP growth rate but also increase Kenya's debt distress. The agency noted that despite the external financial support from IMF to fund Kenya's fiscal deficits, the country's external debt will reach high levels and remain high in 2020-2023. Given the economic fallout from COVID-19, S&P Global projects that Kenya will record a slow GDP growth rate of 1.0% in 2020 and rebound thereafter to 4.0% in 2021. The table below shows GDP projections from 8 firms with the consensus GDP growth expected to come in at 1.7%.

Kenya 2020 Annual GDP Growth Outlook

No.	Organization	2020 Projections*	Revised Projections**
1.	International Monetary Fund	6.0%	1.0%
2.	S&P Global	6.0%	1.0%
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.	National Treasury	6.0%	2.5%
7.	World Bank	6.0%	1.5%
8.	African Development Bank (AfDB)	6.0%	1.4%
	Average	**5.9%**	**1.7%**
	Median of Revised Growth Estimates		**1.6%**

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

Further to the sluggish growth rate and the expected widening of Kenya's fiscal deficit, the agency highlighted that the country's deficit will widen to 8.7% of GDP in FY'2020 and fall slightly to a deficit of 7.9% of GDP in FY'2021. As such, the financing of these deficits will increase Kenya's debt levels as well as increase the country's external vulnerabilities. On a positive note, the agency notes that Kenya's strong Agricultural and service sectors, as well as Kenya's flexible monetary setting, will help cushion the economy from the effects of the COVID-19 pandemic. However, the agency is biased towards a negative outlook given the country's high current account deficits, high fiscal deficits as well as high debt levels.

In our view, given the negative impact on revenue collection from the pandemic, Kenya's fiscal consolidation will remain elusive. The FY'2020/2021 budget saw a high uptake of semi-concessional loans worth Kshs 124.1 bn and as such, we believe that Kenya will continue to face high debt repayment challenges. We believe that should the government's efforts towards the control of the spread of the virus bear fruit, Kenya will be on a sluggish but steady growth towards economic recovery.

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.