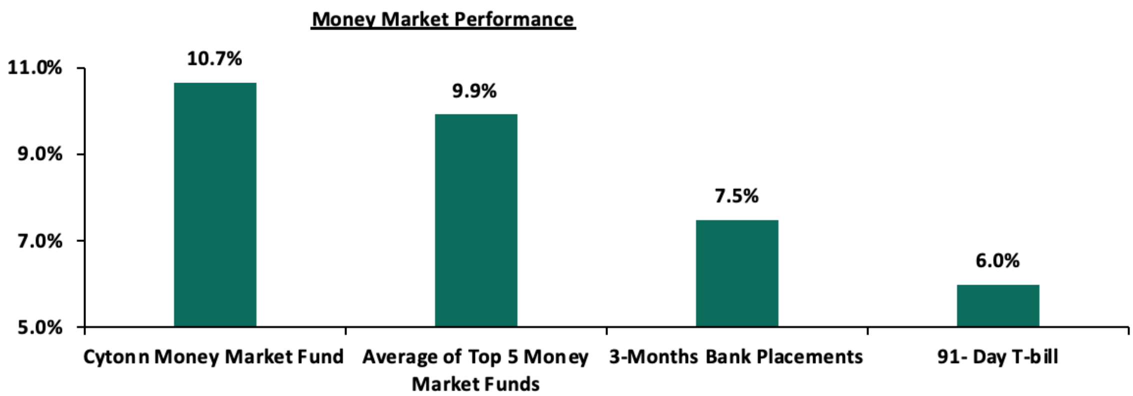
Nairobi Metropolitan 2020 Residential Report, & Cytonn Weekly #30/2020

Fixed Income

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

During the week, T-bills remained oversubscribed, with the subscription rate coming in at 149.6% down from 271.5% the previous week, the decline in the rate can be attributed to the primary bond auction that closed on 21st July 2020 and had an average subscription rate of 303.0%. The highest subscription rate was on the 91-day paper, which came in 270.4%, down from 746.9% recorded the previous week. The subscription for the 182-day paper also declined to 13.9% from 107.8% recorded the previous week, while the subscription of the 364-day paper decreased to 236.9% from 245.1% recorded the previous week. The oversubscription in recent weeks has partly been attributable to the high liquidity in the money market, as well as Banks' preference towards government securities as opposed to lending in the wake of the COVID-19 pandemic which has heightened credit risk. This has seen Bank's 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 paper increased by 10.1 bps to 6.1% from 6.0% recorded the previous week, while that of the 182-day and 364-day papers declined by 8.4 bps and 9.4 bps to 6.4% and 7.4%, respectively. The acceptance rate increased to 99.8%, from 69.8% recorded the previous week, with the government accepting Kshs 35.8 bn of the Kshs 35.9 bn worth of bids received, higher than the weekly quantum of Kshs 24.0 bn.

On the primary bond auction, the period of sale for the recently reopened 3 fixed coupon treasury bonds, FXD1/2020/05, FXD2/2018/10 and FXD1/2019/15 with effective tenors of 5 years, 8 years and 14 years respectively, closed on 21st July 2020. The issue was oversubscribed with the average subscription rate coming in at 303.0%, as the government received bids worth Kshs 181.8 bn, higher than the Kshs 60.0 bn offered, mainly attributable to the high liquidity in the money markets. Yields on the bonds came in at 10.6%, 11.7% and 12.4%, respectively, for the five, ten and fifteen-year papers, which was in-line with our expectations. The government rejected high bids only accepting Kshs 80.9 bn out of the Kshs 181.8 bn worth of bids received, translating to an acceptance rate of 44.5%.



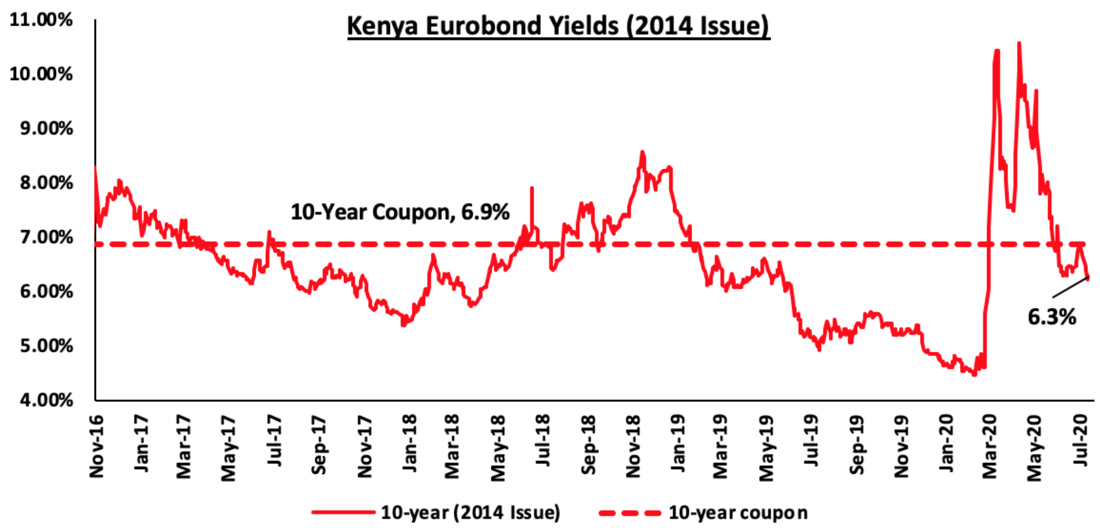
In the money markets, 3-month bank placements ended the week at 7.5% *(based on what we have* *been offered by various banks),* while the yield on the 91-day T-bill declined by 0.3% points to close the week at 6.0%, from 6.3% recorded the previous week. The average yield of Top 5 Money Market Funds recorded declined marginally to 9.9% from 10.0% recorded the previous week. The yield on the Cytonn Money Market gained by 0.2% to close the week at 10.7%, higher than the 10.5% recorded the previous week.

Liquidity:

The money market remained liquid during the week with the average interbank rate coming in at 2.3% a marginal rise from 1.8% recorded the previous week and below the 2019 average of 4.3%, 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). The average interbank volumes declined by 43.0% to Kshs 5.5 bn, from Kshs 9.8 bn recorded the previous week. 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.

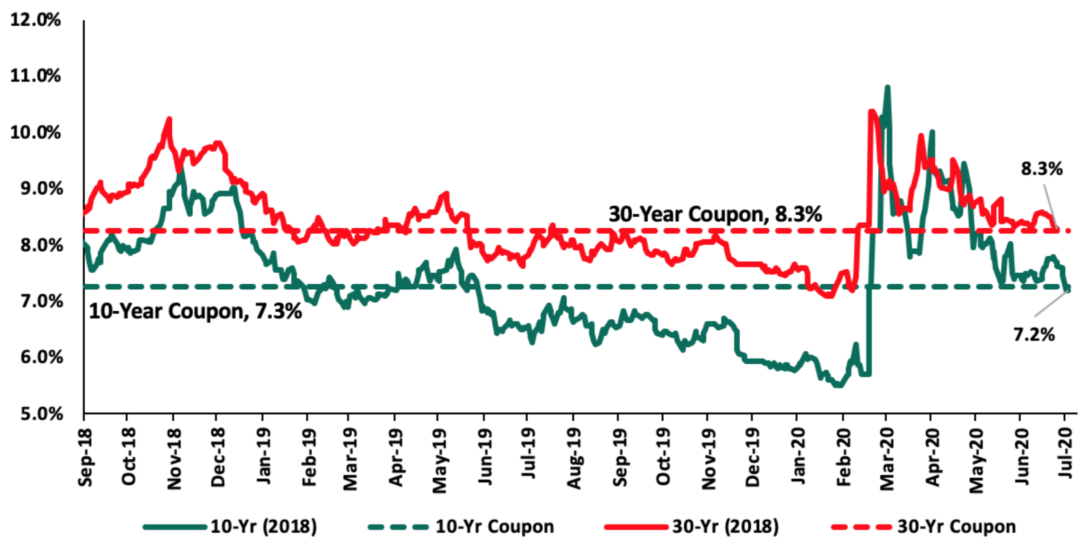
Kenya Eurobonds:

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 0.4% points during the week to close at 6.3% from 6.7% recorded the previous week.

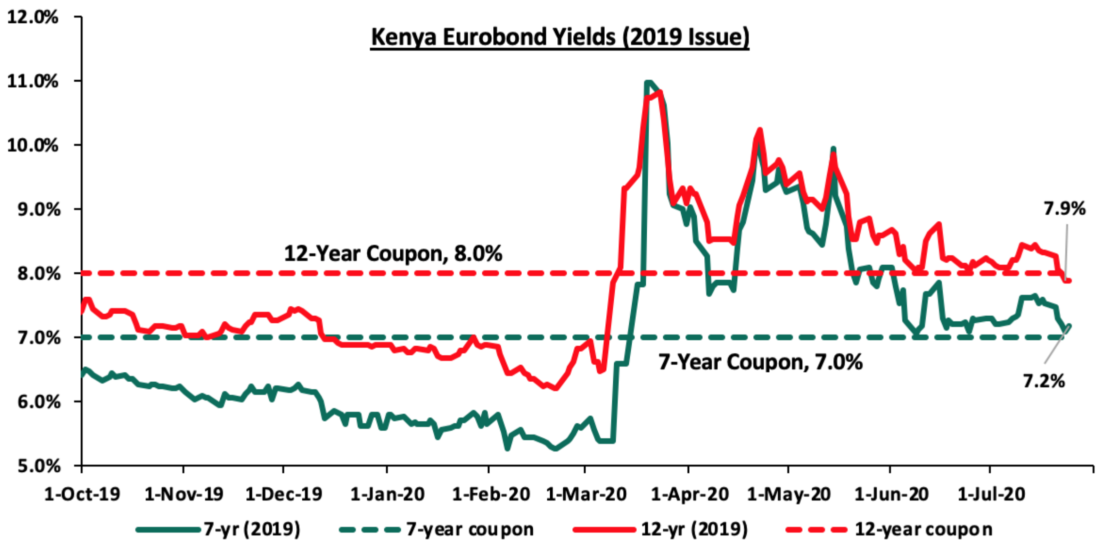


The yields on the 10-year Eurobond issued in 2018 declined by 0.4% points to close at 7.2% from 7.6% recorded the previous week. The yield on the 30-year Eurobonds issued in 2018 also declined by 0.2% points to close at 8.3%, lower than the 8.5% recorded the previous week.

Kenya Eurobond Yields (2018 Issue)



The yields on the 7-year Eurobond and 12-year Eurobond issued in 2019 declined by 0.3% and 0.4%points, respectively to 7.2% and 7.9% from 7.5% and 8.3% 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 108.0, from Kshs 107.5, recorded the previous week, attributable to increased demand for hard currencies by importers who are resuming business after the easing of the pandemic restrictions. On a year-to-date basis, the shilling has depreciated by 6.6% 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,
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), this 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:

Inflation Projections

We are projecting the y/y inflation rate for July 2020 will remain stable within the range of 4.9% - 5.2%, compared to 4.7% recorded in June. The stable inflation figures will be supported by stable food prices despite an expected increase in the transport index due to the increase in the fuel prices where petrol and diesel prices increased by 12.8% and 23.2%, respectively, while kerosene prices increased by 4.8%.

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. 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.
