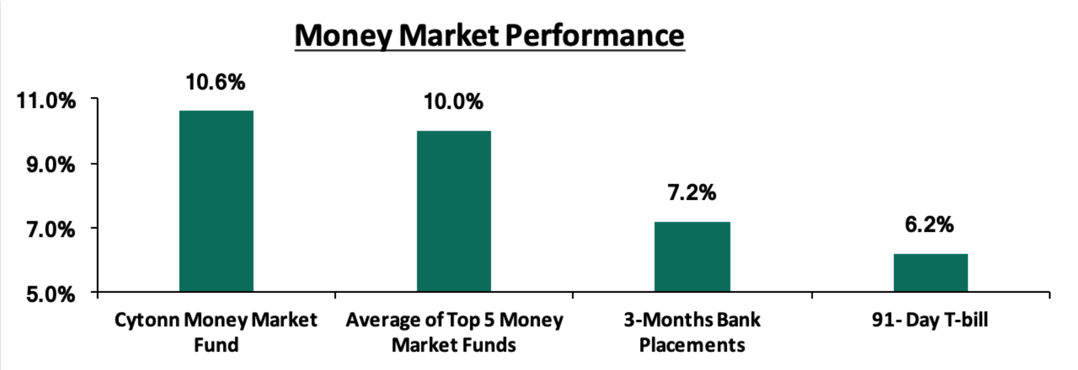
Financial Planning For Retirement, & Cytonn Weekly #33/2020

Fixed Income

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

During the week, T-bills were undersubscribed, with the subscription rate coming in at 92.8% down from 135.0% the previous week, mainly due to investors' preference to participate in the primary bond market where there is a tap-sale for an 11-year amortized infrastructure bond namely, IFB1/2020/11. The yields on the 91-day paper and 182-day paper both increased marginally during the week by 0.1% points to close the week at 6.2% and 6.6%, respectively, from 6.1% and 6.5% recorded the previous week, while that of the 364-day papers remained unchanged at 7.5%, similar to what was recorded the previous week. The acceptance rate decreased to 83.8%, from 94.1% recorded the previous week, with the government accepting Kshs 18.6 bn of the Kshs 22.3 bn worth of bids received.



In the money markets, 3-month bank placements ended the week at 7.2% (based on what we have been offered by various banks), while the yield on the 91-day T-bill increased marginally to 6.2%, from 6.1% recorded the previous week. The average yield of Top 5 Money Market Funds declined marginally to 10.0% from 10.1% recorded the previous week. The yield on the Cytonn Money Market also declined marginally to close at 10.6%, from 10.7% recorded the previous week.

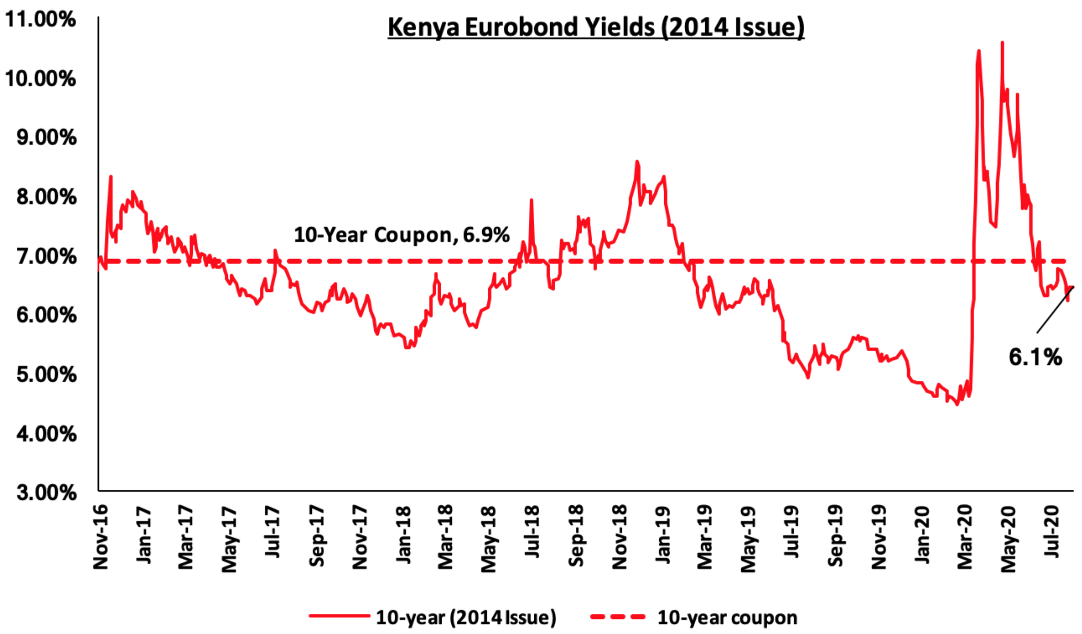
Liquidity:

The money market remained liquid during the week with the average interbank rate declining to 2.0%, down from the 2.5% recorded the previous week mainly supported by government payments. The average interbank volumes increased by 25.3% to Kshs 12.9 bn, from Kshs 10.2 bn recorded the previous week. According to the Central Bank of Kenya, commercial banks' excess reserves came in at Kshs 23.2 bn.

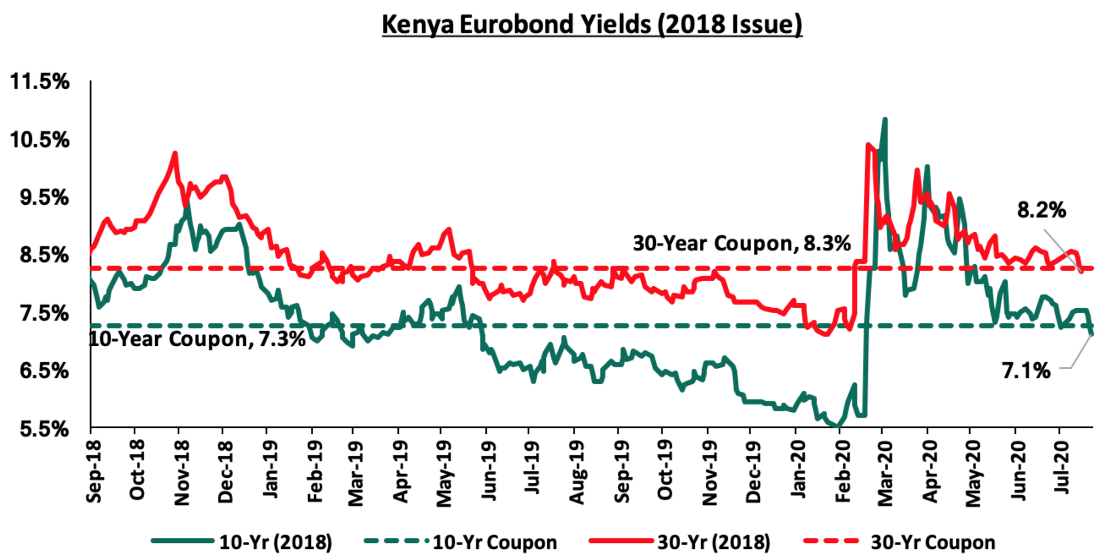
Kenya Eurobonds:

According to Reuters, Kenyan Eurobond yields were on a downward trend during the week, pointing to improving investor confidence in the country. The yield on the 10-year Eurobond issued in June

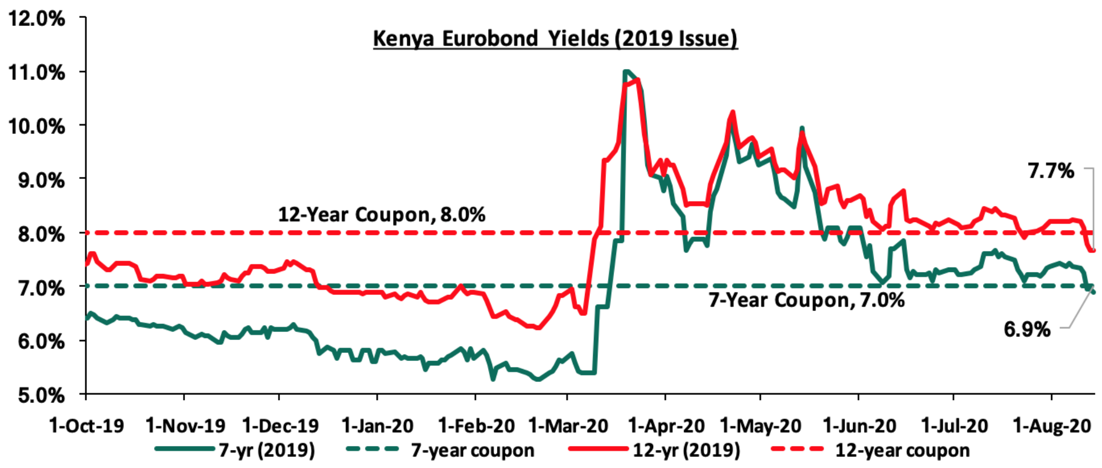
2014 declined by 0.3% points to 6.1%, from 6.4% recorded the previous week.



The yields on the 10-year and 30-year Eurobonds issued in 2018 both declined by 0.4% points and 0.3% points to 7.1% and 8.2%, respectively, from 7.5% and 8.5% recorded the previous week,



The yields on the 7-year Eurobond and 12-year Eurobond issued in 2019 both declined by 0.5% points to 6.9% and 7.7%, respectively, from 7.4% and 8.2% recorded the previous week.



Kenya Shilling:

During the week, the Kenya Shilling depreciated by 0.3% against the US Dollar to close the week at Kshs 108.3, from Kshs 108.0, recorded the previous week, attributable to increased dollar demand from Safaricom ahead of its Kshs 56.1 bn dividend payout, which they have to clear by the end of the month. On an YTD basis, the shilling has depreciated by 6.9% 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 9.3 mn (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, and,
ii. Improving diaspora remittances evidenced by the 11.8% increase to USD 288.5 mn in June 2020, from USD 258.2 seen the previous month. In terms of y/y performance, diaspora remittances decreased by 2.3% to USD 288.5 mn in June 2020, from USD 295.3 mn recorded in June 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 August 2020 to 14th September 2020. Below are the key take-outs from the statement:

- Petrol prices have increased by 3.5% to Kshs 104.0 per litre from Kshs 100.5 per litre previously, while diesel prices have increased by 3.0% to Kshs 94.6 per litre from Kshs 91.9 per litre. Kerosene prices also increased by 27.8% to Kshs 83.7 per litre from 65.5 per litre, previously,
- The changes in prices have been attributed to:
    i. An increase in the average landing cost of imported super petrol by 14.2% to USD 319.2 per cubic meter in July 2020 from USD 279.6 per cubic meter in June 2020,
    ii. Landing costs for diesel increased by 10.3% to USD 333.3 per cubic meter in July 2020, from USD 302.2 per cubic meter in June 2020,

iii. A 127.9% increase in the landing costs for Kerosene to USD 288.0 in July 2020, from USD 126.4 per cubic meter in June 2020. This can be attributed to the lack of imports in July, meaning there was no price change the previous month, hence the sharp rise,
iv. A 21.9%, increase in Free on Board (FOB) price of Murban crude oil lifted in July 2020 to USD 44.3 per barrel, from USD 36.3 per barrel in June 2020, and,
v. The Kenyan shilling depreciated by 0.9% against the dollar to close at Kshs 107.5 in July 2020, from Kshs 106.5. in June 2020

We expect the increase to not only affect the transport index, which carries a weighting of 8.7% in the total consumer price index (CPI) but also have a ripple effect on the prices of other commodity baskets such as food & alcohol prices due to the higher transport costs. We also expect pressures to be experienced in the housing, water, electricity, gas and other fuels index given the 27.8% increase in the price of kerosene.

Rates in the fixed income market have remained relatively stable due to the high liquidity in the money markets, coupled with the discipline by the Central Bank as they reject expensive bids. The government is 79.7% ahead of its prorated borrowing target of Kshs 65.5 bn having borrowed Kshs 117.6 bn. In our view, the government will not be able to meet their revenue collection targets of Kshs 1.9 tn for FY'2020/2021 and therefore leading to a larger budget deficit than the projected 7.5% of GDP, ultimately 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 to medium-term fixed income securities to reduce duration risk.