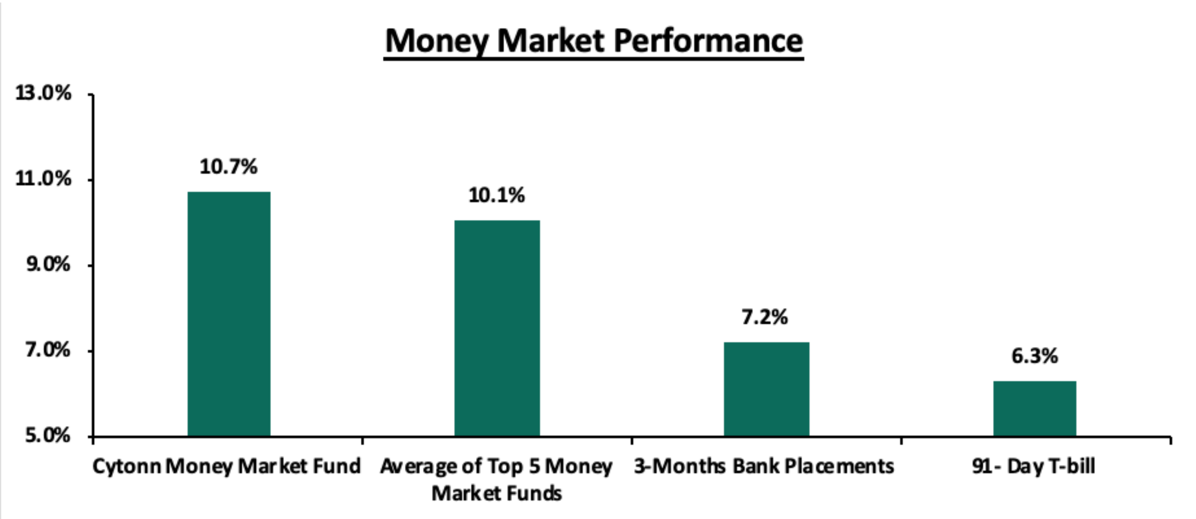
Fintech Amid COVID-19 & Cytonn Weekly #34/2020

Fixed Income

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

During the week, T-bills remained undersubscribed, with the subscription rate coming in at 40.4% down from 92.8% the previous week, mainly due to investors' preference to participate in the primary bond market where there was a tap-sale for the 11-year amortized infrastructure bond namely, IFB1/2020/11, which recorded a performance rate of 145.0%. The yield on the 91-day paper increased marginally to 6.3%, from 6.2% recorded the previous week, while that of the 182-day paper and 364-day papers remained unchanged at 6.6% and 7.5%, respectively. The acceptance rate increased to 100.0%, from 83.8% recorded the previous week, with the government accepting Kshs 9.6 bn worth of bids received.

On the primary bond auction, the period of sale for the recently opened Infrastructure bond, IFB1/2020/11 with an effective tenor of 11-years, closed on 19th August 2020. The issue was oversubscribed in line with our expectations, with the average subscription rate coming in at 145.0%, as the government received bids worth Kshs 101.5 bn, higher than the Kshs 70.0 bn offered, mainly attributable to the high liquidity in the money markets, and the attractive tax-free nature of the bond. The market weighted average rate for the bond came in at 11.4%, which was in-line with our expectations of 11.4%-11.6%. The government rejected high bids only accepting Kshs 78.6 bn out of the Kshs 101.5 bn worth of bids received, translating to an acceptance rate of 77.5%.



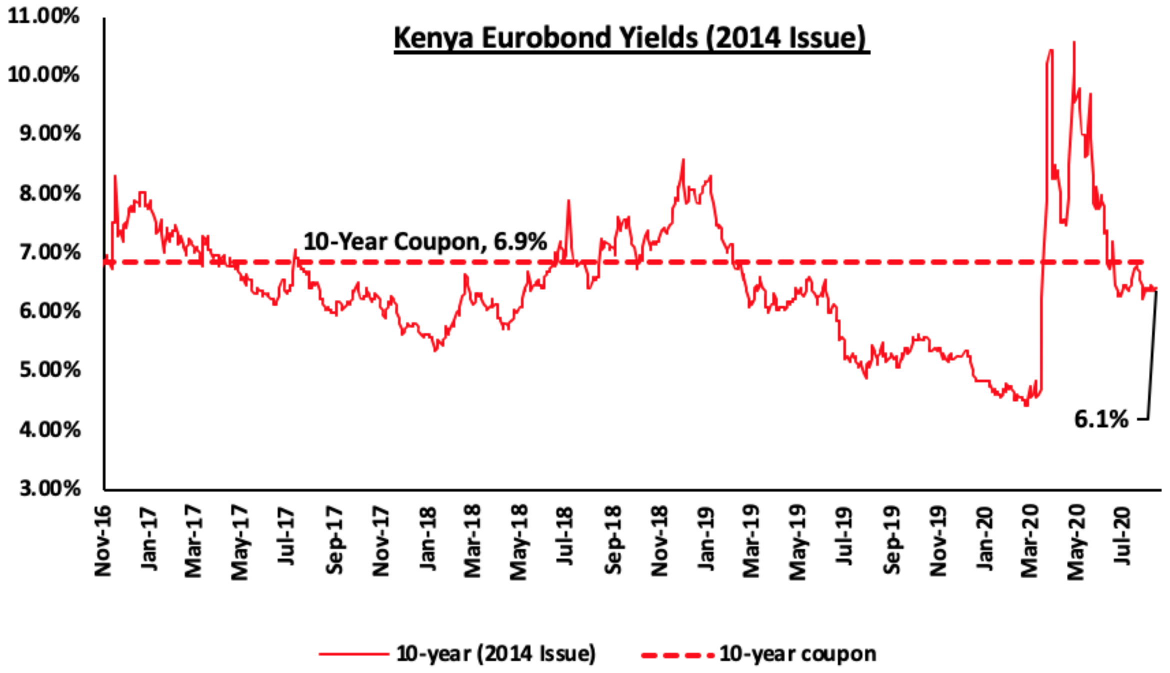
In the money markets, 3-month bank placements ended the week at 7.2% (based on what we have been offered by various banks), while the yield on the 91-day T-bill increased marginally to 6.3%, from 6.2% recorded the previous week. The average yield of Top 5 Money Market Funds increased marginally to 10.1% from 10.0% recorded the previous week. The yield on the Cytonn Money Market also increased marginally to close at 10.7%, from 10.6% recorded the previous week.

Liquidity:

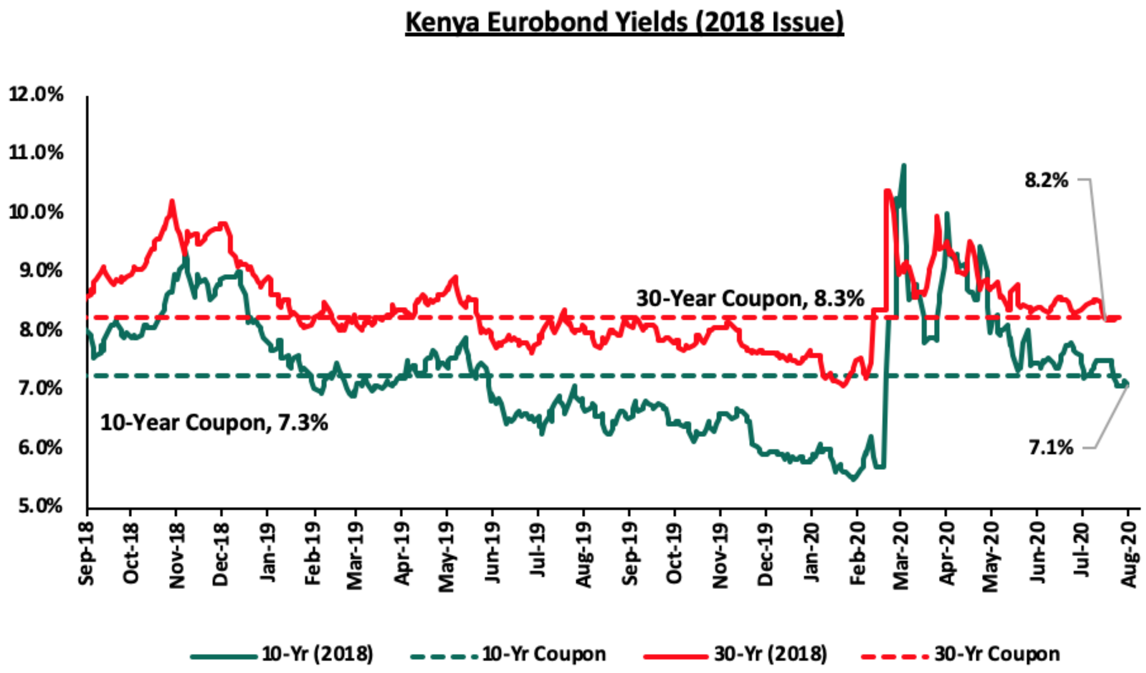
The money markets remained liquid during the week, despite the average interbank rate increasing to 2.6%, from 1.9% recorded the previous week, mainly supported by government payments and maturing TADS of Kshs 811.0 bn. (TADs are used when the securities held by the CBK for Repo purposes are exhausted or when CBK considers it desirable to offer longer tenor options). The average interbank volumes increased by 12.2% to Kshs 13.8 bn, from Kshs 12.3 bn recorded the previous week. The commercial banks' excess reserves came in at Kshs 23.2 bn.

Kenya Eurobonds:

According to Reuters, the yield on the 10-year Eurobond issued in June 2014 remained unchanged at 6.1%.



The yields on the 10-year and 30-year Eurobonds issued in 2018 both remained unchanged at 7.1% and 8.2%, respectively.



Kenya Shilling:

During the week, the Kenya Shilling appreciated by 0.3% against the US Dollar to close the week at

Kshs 108.0, from Kshs 108.3, recorded the previous week, attributable to slower dollar demand from oil and merchandise importers. On an YTD 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:

?. Demand from merchandise and energy sector importers as they beef up their hard currency positions,
i. 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;

?. 3.0% decline in the secondary income balance (transfers recorded in the balance of payments whenever an economy provides or receives goods, services, income or financial items), to Kshs 124.1 bn, from Kshs 128.0 bn in Q1’2019, and,
a. 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.

Weekly Highlight:

During the week, the National Treasury gazetted the statement of actual revenue collection and net exchequer issues in the month of July 2020. According to the release, ordinary revenue collection came in at Kshs 95.9 bn, 11.0% lower than the Kshs 107.8 bn recorded last year. The slump is largely attributable to the recent macroeconomic headwinds where a general slump in economic activity is expected. Other key highlights from the statement include;

- Revenue collection for the year July 2019 to June 2020 reached a new high of Kshs 1,607.0 bn, 1.7% higher than the Kshs 1,580.0 bn recorded previously,
- The Kenya Revenue Authority managed to collect Kshs 97.1 bn in form of agency fees, which includes road maintenance levy, airport revenue, aviation revenue and petroleum development fund among others, and,
- Exchequer revenue grew by 2.2% to Kshs 1,510.0 bn, from the Kshs 1,477.0 bn recorded in FY2018/19.

Inflation Projections

We are projecting the y/y inflation rate for August 2020 to increase marginally to between 4.8% - 5.1%, compared to the 4.4% recorded in July since the gains from the stable food prices are watered down by the increasing fuel prices. Specifically:

- Petrol and diesel prices having increased by 3.3% and 3.0%, respectively. The increase in pump prices is likely to have upward pressure on the transport index which holds a weighting of 8.7%. Additionally, we expect the increased fuel prices to not only affect the transport index, but also have a trickle-down effect on the prices of other commodity basket food prices due to 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, and,
- Food prices have remained relatively stable during the month given the favorable weather and an improvement in agricultural output.

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 141.1% ahead of its prorated borrowing target of Kshs 74.8 bn having borrowed Kshs 180.3 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 because of the current subdued economic performance in the country brought about by the spread of COVID-19, 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.