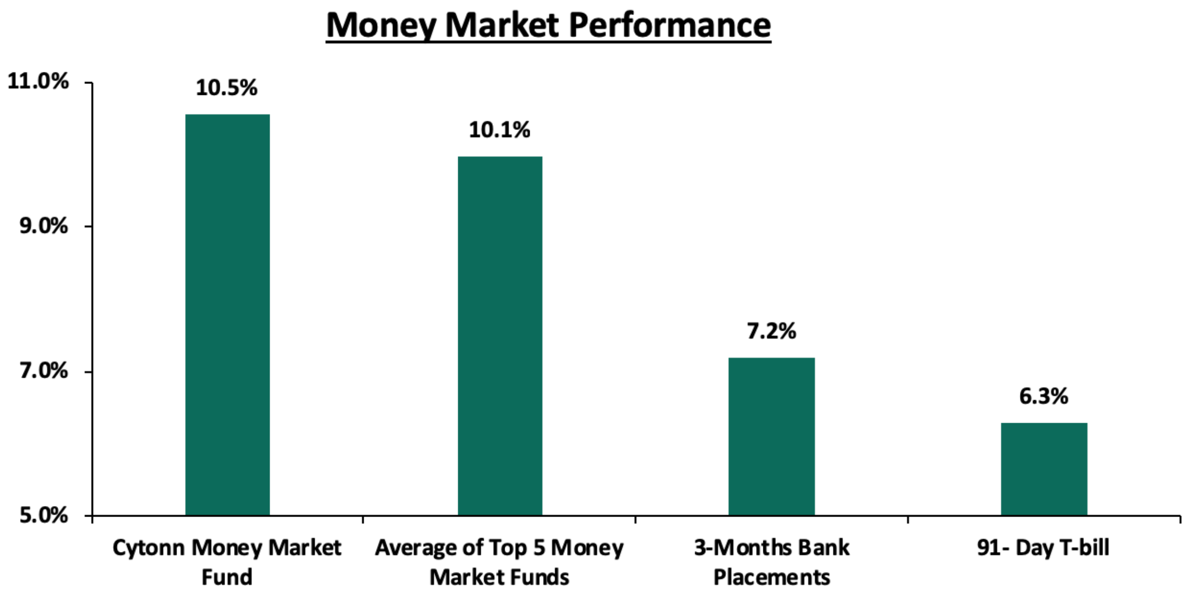
Understanding Collective Investment Schemes, & Cytonn Weekly #39/2020

Fixed Income

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

During the week, T-bills remained undersubscribed, with the subscription rate coming in at 29.7%, down from 70.4% the previous week, this can be attributed to the tightening liquidity conditions in the money markets with the average interbank rate coming in at 3.3%, from the 2.7% recorded last week. The highest subscription rate was in the 364-day paper, which came in at 47.3%, down from 89.2% recorded the previous week. The subscription for the 91-day and 182-day paper also fell to 28.0% and 12.7%, respectively from 151.3% and 19.2% recorded the previous week. The yields on the 91-day paper remained unchanged at 6.3%, while that of the 182-day and 364-day paper increased marginally to 6.8% and 7.7%, respectively from the 6.7% and 7.6% recorded the previous week. The acceptance rate decreased to 93.4%, from 100.0% recorded the previous week, with the government accepting bids worth Kshs 6.7 bn out of the Kshs 7.1 bn worth of bids received



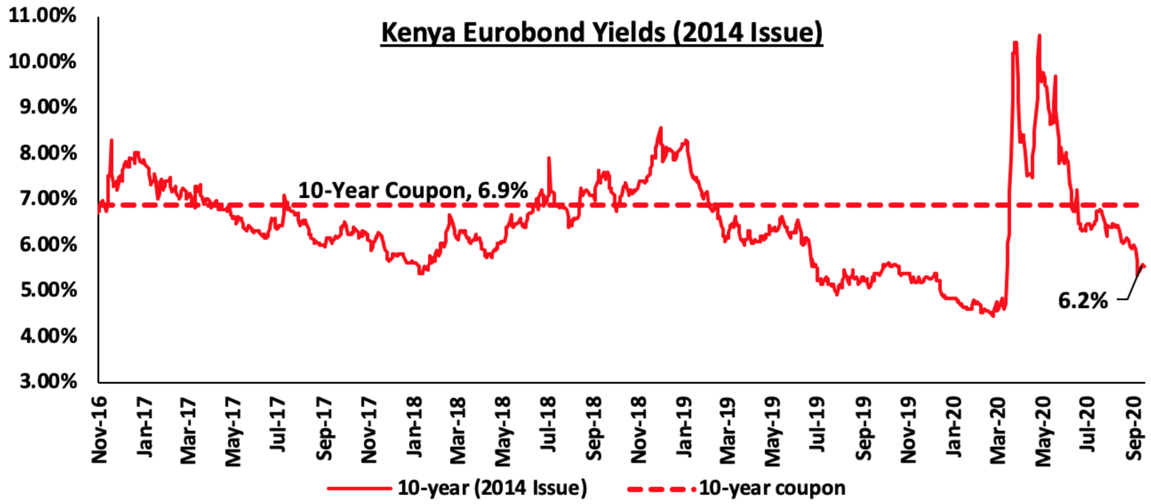
In the money markets, 3-month bank placements ended the week at 7.2% (based on what we have been offered by various banks), while the yield on the 91-day T-bill remained unchanged at 6.3%. The average yield of Top 5 Money Market Funds increased marginally to 10.1%, from 10.0% the previous week. The yield on the Cytonn Money Market declined marginally to close at 10.5%, down from the 10.6% recorded the previous week.

Liquidity:

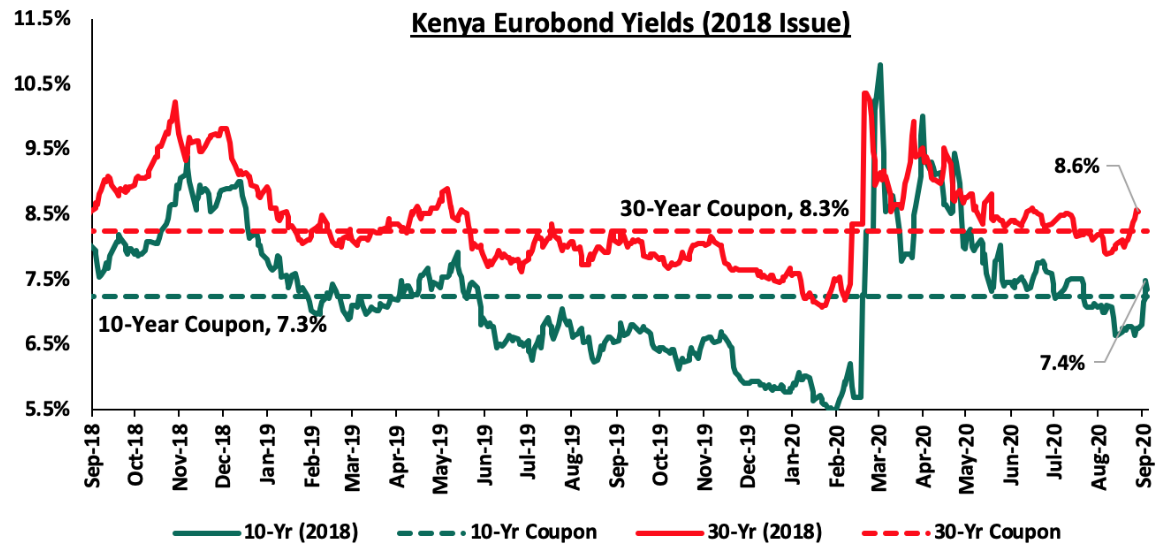
The money markets tightened during the week, with the average interbank rate increasing to 3.3%, from 2.7% recorded the previous week, mainly supported by tax remittances which more than offset government payments. The average interbank volumes declined by 19.0% to Kshs 10.4 bn, from Kshs 12.8 bn recorded the previous week. According to the Central Bank of Kenya, commercial banks' excess reserves came in at Kshs 14.1 bn in relation to the 4.25% Cash Reserve Ratio.

Kenya Eurobonds:

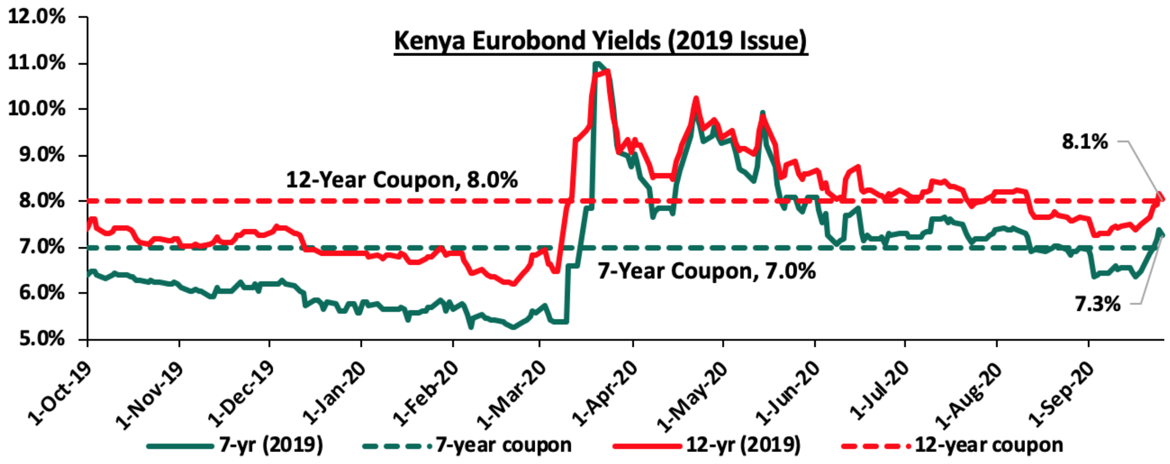
The yields on all Eurobonds increased significantly during the week, pointing to the perception of increased risk by foreign investors on the country's outlook. During the week, according to Reuters, the yield on the 10-year Eurobond issued in June 2014 increased by 0.7% points to 6.2%, from 5.5% the previous week



During the week, the yields on the 10-year and 30-year Eurobonds both increased by 0.6% and 0.5%, respectively to close at 7.4% and 8.6%, from the 6.8% and 8.1% recorded the previous week.



During the week, the yields on the 2019 dual-tranche Eurobond issue with 7-years increasing by 0.8% points to 7.3%, from 6.5% the previous week. The 12-year Eurobond also increased by 0.6% points to close at 8.1%, from the 7.5% recorded the previous week.



Kenya Shilling:

During the week, the Kenyan shilling depreciated marginally by 0.1% against the US dollar, to close at Kshs 108.5, from Kshs 108.4 recorded the previous week, mainly attributable to the build-up of dollar demand ahead of the end of the month when firms typically meet their hard currency obligations. On a YTD basis, the shilling has depreciated by 7.0% against the dollar, in comparison to the 0.5% appreciation in 2019.

In the short term, the shilling is expected to be supported by:

i. The high levels of forex reserves, currently at USD 8.6 mn (equivalent to 5.2-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;
ii. Relatively strong Diaspora remittances that increased by 27.9% to USD 274.1 million in August compared to USD 214.3 million in August 2019, despite being 1.0% lower than the USD 277.0 million in July 2020, leading to the narrowing of the country's current account deficit to 4.7% of GDP in the 12 months to August 2020, similar to the level in July.

Inflation Projections

We are projecting the y/y inflation rate for September 2020 to increase marginally to between 4.6% - 4.9%, compared to the 4.4% recorded in August, supported by the gains from the stable food prices while fuel prices only increased marginally, specifically:

- Petrol prices having increased by 1.3%, while both diesel and kerosene have declined marginally by 0.1% and 0.6% respectively. The current pump prices are likely to have an upward pressure on the transport index which holds a weighting of 8.7%, since it has been on the increase in line with recoveries across the globe. Also, we expect the increased fuel prices to not only affect the transport index, but have a trickle-down effect on the prices of other commodity basket food prices due to higher transport costs, 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 79.2% ahead of its prorated borrowing target of Kshs 121.6 bn having borrowed Kshs 217.9 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, 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 may 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.

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