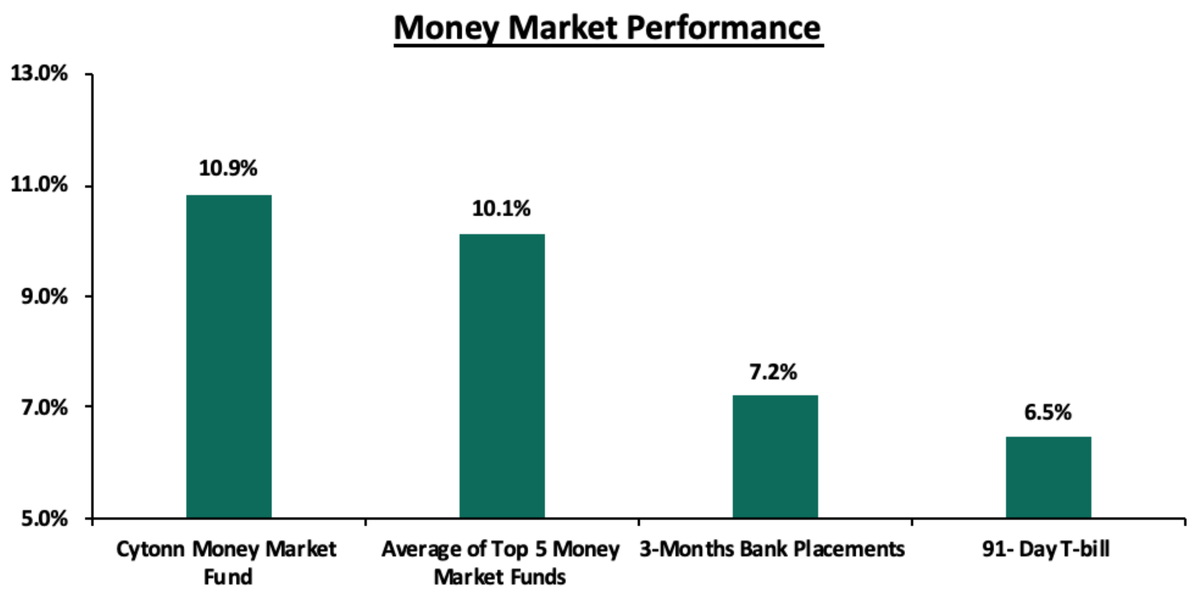
Analysis of new CMA guidelines to Collective Investments Schemes, & Cytonn Weekly #41/2020

Fixed Income

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

During the week, T-bills were oversubscribed, with the subscription rate coming in at 110.0%, up from 64.9% the previous week. The oversubscription is partly attributable to the favorable liquidity in the money markets as evidenced by the decline in the average interbank rate to 2.1% from 3.3%, recorded the previous week. The highest subscription rate was in the 91-day paper, which came in at 186.5%, up from 154.7% recorded the previous week. The subscription for the 182-day paper fell to 39.3% from 40.6% in the previous week, while that of the 365-day paper rose to 150.1% from 53.3% recorded the previous week. The yields on the 91-day, 182-day and 364-day papers rose marginally by 0.1% points, respectively, to 6.5%, 6.9% and 7.8%, from the 6.4%, 6.8% and 7.7% recorded the previous week. The acceptance rate increased to 93.9%, from 68.7% recorded the previous week, with the government accepting bids worth Kshs 24.8 bn out of the Kshs 26.4 bn worth of bids received.



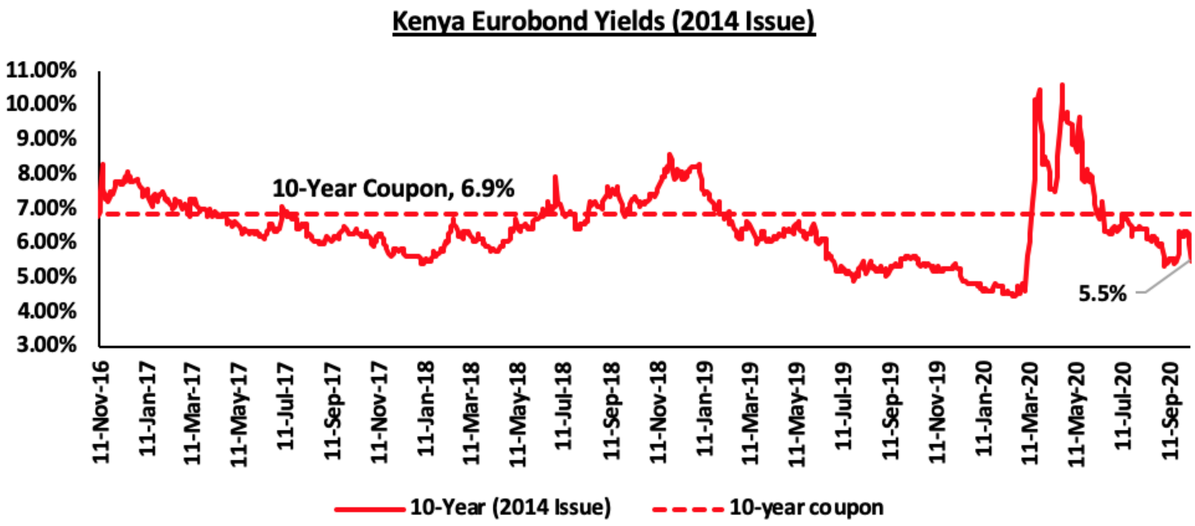
In the money markets, 3-month bank placements ended the week at 7.2% (based on what we have been offered by various banks), while the yield on the 91-day T-bill increased marginally to 6.5%, from 6.4% recorded the previous week. The average yield of the Top 5 Money Market Funds remained unchanged at 10.1%. The yield on the Cytonn Money Market increased by 0.3% points to close at 10.9%, from the 10.6% recorded the previous week.

Liquidity:

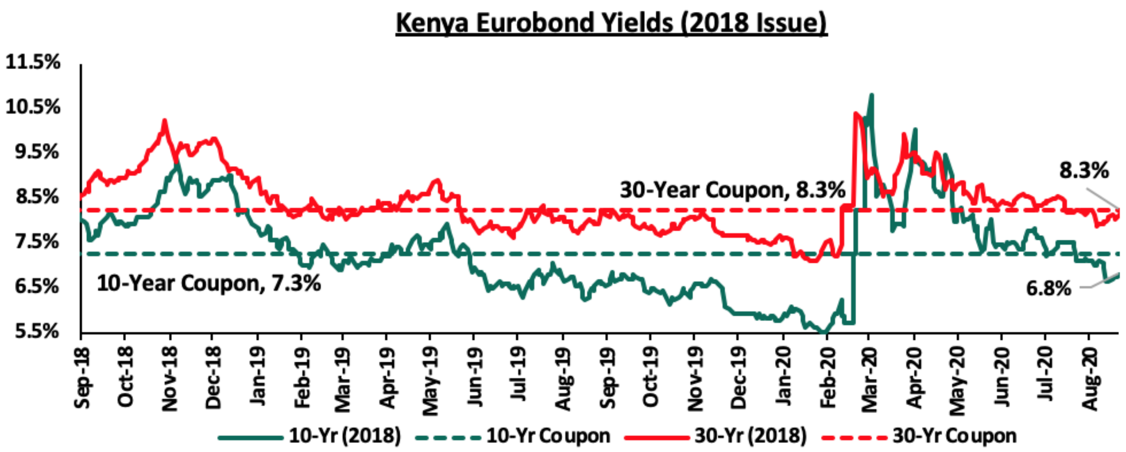
The money markets liquidity improved during the week, with the average interbank rate decreasing to 2.4%, from 3.5% recorded the previous week, mainly supported by government payments. The average interbank volumes declined by 22.0% to Kshs 8.0 bn, from Kshs 10.2 bn recorded the previous week. According to the Central Bank of Kenya, commercial banks' excess reserves came in at Kshs 14.8 bn in relation to the 4.25% Cash Reserve Ratio.

Kenya Eurobonds:

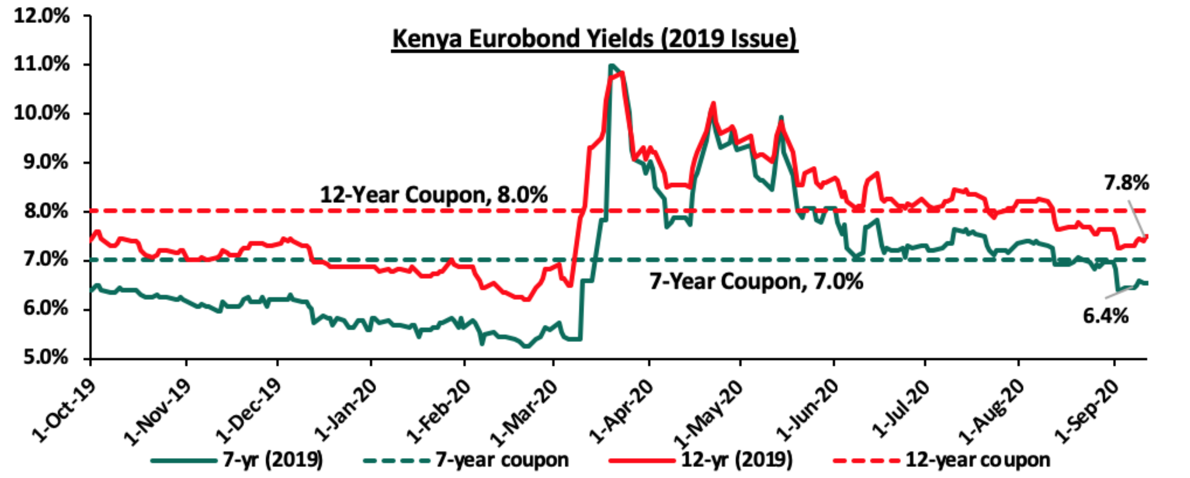
The yields on all Eurobonds decreased during the week, pointing to improved investor sentiment and the perception of reduced risk by foreign investors on the country's outlook. During the week, according to Reuters, the yield on the 10-year Eurobond issued in June 2014 declined by 0.9% points to 5.5%, from 6.4% recorded the previous week.



During the week, the yields on the 10-year and 30-year Eurobonds both declined by 0.6% points and 0.4% points, respectively, to close at 6.8% and 8.3%, respectively, from the 7.4% and 8.7% recorded the previous week.



During the week, the yields on the 7-year and 12-year Eurobonds both declined by 1.0% and 0.7%, respectively to close at 6.4% and 7.4%, from the 7.4% and 8.1% recorded the previous week.



Kenya Shilling:

During the week, the Kenyan shilling remained unchanged against the US dollar, to close at Kshs 108.5, similar to what was recorded the previous week. On an YTD basis, the shilling has depreciated by 7.1% 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 8.5 mn (equivalent to 5.1-months of import cover), which is 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.

Weekly Highlight

During week Stanbic Bank released the Monthly Purchasing Managers' Index (PMI) for September 2020, which came in at 56.3, up from the 53.0 seen in August 2020. Notably, a reading of above 50 indicates improvements in the business environment, while a reading below 50 indicates a worsening outlook. The posting was its highest since April 2018, pointing towards strong improvement in the Kenyan private sector. This comes as the government relaxed corona virus disease restrictions during the third quarter of the year. Firms saw expanded demand as foreign and domestic clients returned to the market. Output levels expanded at a sharp pace and sales grew strongest since January 2016. Consequently, the rising demand increased work backlogs, creating opportunities to hire new workers. This counteracted job cuts at other firms, amid efforts to reduce expenses. As such, employment was broadly level during the month, following a six-month run of declines. Input inflation cost softened but remained solid overall due to increased fuel and commodity prices. Despite the strong upturn and plans to raise investment into new markets, the general sentiment on the 12-month outlook is weak with few expecting continued expansion.

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 51.3% ahead of its prorated borrowing target of Kshs 130.9 bn having borrowed Kshs 198.0 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 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.*

Liason House, StateHouse Avenue
The Chancery, Valley Road
www.cytonn.com