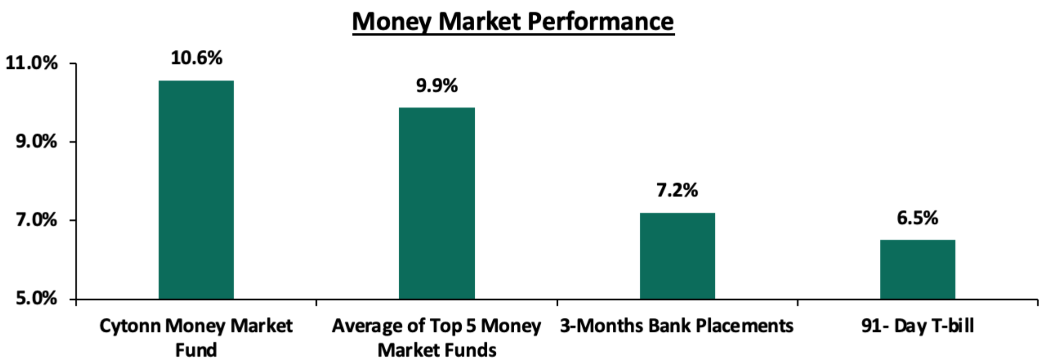
Cytonn Weekly #42/2020

Fixed Income

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

During the week, T-bills were oversubscribed, with the overall subscription rate coming in at 131.6%, up from 110.0% the previous week, supported by the favorable liquidity conditions in the money markets. The highest subscription rate was in the 91-day paper, which came in at 215.2%, up from 186.5% recorded the previous week. The subscription for the 182-day paper increased to 71.0% from 39.3% while that of the 365-day paper rose to 158.9% from 150.1% recorded the previous week. The yields on the 91-day, 182-day and 364-day papers remained unchanged at 6.5%, 6.9% and 7.8%, respectively. The acceptance rate increased to 94.9%, from 93.9% recorded the previous week, with the government accepting bids worth Kshs 30.0 bn out of the Kshs 31.6 bn worth of bids received.

Additionally, there was high demand for this month's bond offers, with the overall subscription rate for the two bonds coming in at 138.3%, partly supported by the favorable liquidity in the market, and financial institutions bias towards the fixed income market in this period of economic uncertainty. The Central Bank of Kenya had re-opened 2 bonds the FXD1/2011/20 and FXD1/2018/25 with coupons of 10.0% and 13.4% and effective tenors of 10.6 years and 22.7 years, respectively. The government received bids worth Kshs 69.1 bn, higher than the Kshs 50.0 bn offered and accepted only Kshs 60 bn. Investors preferred the longer-term paper i.e. FXD1/2018/25, which received bids worth Kshs 46.0 bn, representing 66.5% of the total bids received. The weighted average rate of accepted bids for the two bonds came in at 12.0% and 13.5%, for FXD1/2011/20 and FXD1/2018/25, respectively. The government rejected high bids only accepting Kshs 60.0 bn out of the Kshs 69.1 bn worth of bids received, translating to an acceptance rate of 86.8%.



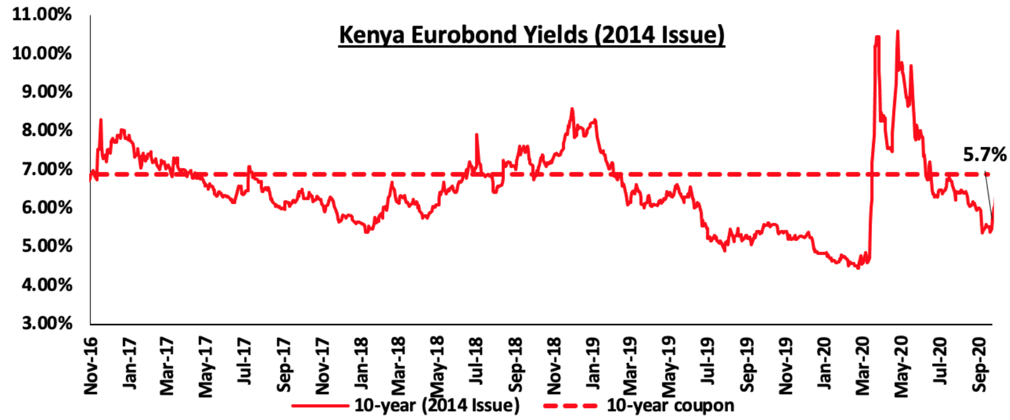
In the money markets, 3-month bank placements ended the week at 7.2% (based on what we have been offered by various banks), while the yield on the 91-day remained unchanged at 6.5% pa. The average yield of the Top 5 Money Market Funds decreased by 0.2% points to 9.9% % from 10.1% recorded the previous week. The yield on the Cytonn Money Market decreased by 0.3% points to close at 10.6%, from the 10.9% recorded the previous week.

Liquidity:

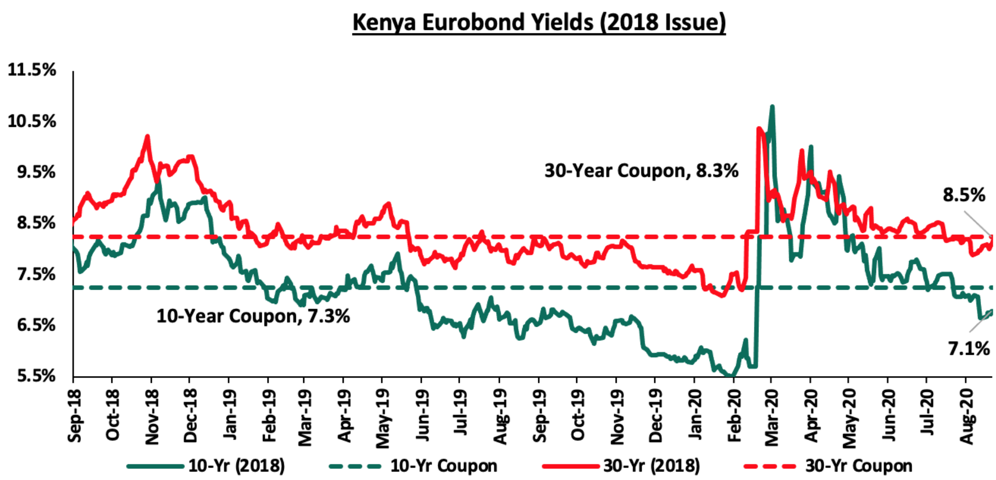
The money markets remained liquid during the week, with the average interbank rate remaining unchanged at 2.4%, mainly supported by government payments which offset tax receipts. The average interbank volumes also were Kshs 8.0 bn the same as the previous week. According to the Central Bank of Kenya, commercial banks’ excess reserves came in at Kshs 14.8 bn in relation to the 4.25% Cash Reserve Ratio.

Kenya Eurobonds:

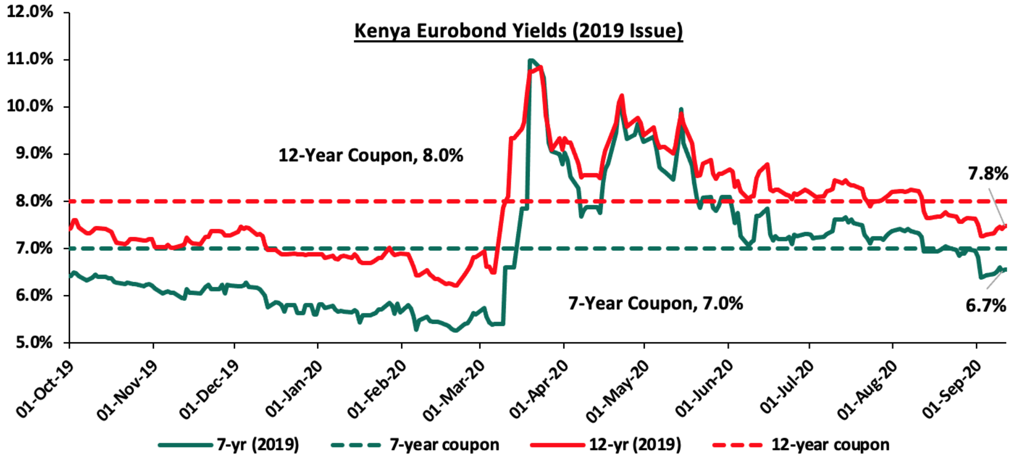
During the week, the yields on all Eurobonds increased, pointing to the perception of increased risk by foreign investors on the country’s outlook, due to the dismal Q2’2020 economic growth numbers released during the week. According to Reuters, the yield on the 10-year Eurobond issued in June 2014 increased by 0.1% points to 5.7%, from 5.6% recorded the previous week.



During the week, the yields on the 10-year and 30-year Eurobonds both increased by 0.3% and 0.2% to close at 7.1% and 8.5%, from the 6.8% and 8.3% recorded the previous week.



During the week, the yields on the 2019 dual-tranche Eurobond issue increased. The 7-years Eurobond increased by 0.3% points to 6.7%, from 6.4%, while the 12-year increased by 0.2% points to close at 7.8%, from the 7.6% recorded the previous week.



Kenya Shilling:

During the week, the Kenyan shilling depreciated marginally against the US dollar to Kshs 108.6 from 108.5, mainly attributable to the dollar demands from energy and merchandise importers exceeding the supply from tourism, remittances and exporters. On a YTD basis, the shilling has depreciated by 7.2% 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 Forex reserves which are currently at USD 8.3 bn (equivalent to 5.0 - 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. Improving current account position as it reduced by 39.9% during Q2'2020 to Kshs 82.2 bn, from Kshs 136.9 bn in Q2'2019, equivalent to 7.0% of GDP down from 10.9% of GDP recorded in Q2'2019.

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 October 2020 to 14th November 2020.

Below are the key take-outs from the statement:

- Petrol prices have increased by 1.4% to Kshs 107.3 per litre from Kshs 105.4 per litre previously, while diesel prices have decreased marginally by 1.4% to Kshs 92.9 per litre from Kshs 94.5 per litre. Kerosene prices remained unchanged.
- The changes in prices have been attributed to:

i. An increase in the average landed cost of imported super petrol by 1.1% to USD 331.7 per cubic meter in September 2020 from USD 327.7 per cubic meter in August 2020,
ii. Average landed costs for diesel decreased by 5.4% to USD 312.0 per cubic meter from USD 329.9 in August 2020,
iii. Landed costs for kerosene remained unchanged at USD 282.1 per cubic meter recorded in August 2020,
iv. A 7.4% decrease in Free on Board (FOB) price of Murban crude oil lifted in September 2020 to USD 42.4 per barrel from USD 45.7 per barrel in August 2020.
v. The Kenyan shilling depreciation by 0.6% against the dollar to close at Kshs 108.6 in September 2020, from Kshs 107.9 in August 2020.

We expect a slight decline in the transport index component of the total consumer price index (CPI) as a result of the 5.4% decline in diesel prices, as well as the unchanged price of kerosene.

GDP growth

During the week, Kenya National Bureau of Statistics (KNBS), released the Quarterly GDP Q2'2020 GDP growth rates where Kenya's economy contracted during the second quarter of 2020 compared to the corresponding quarter in 2019. The economy recorded a contraction of (5.7%) in Q2'2020, from a growth of 5.3% in Q2'2019, this was the first contraction since the third quarter of 2001 when the country recorded a contraction of (2.5%).

The table below shows the weighted sectoral contribution to the overall GDP growth:

Sector	Contribution Q2'2019	Contribution Q2'2020	Q2'2019 Growth	Q2'2020 Growth	Weighted Growth Rate Q2'2019	Weighted Growth Rate Q2'2020	Variance
Agriculture and Forestry	22.8%	25.7%	2.9%	6.4%	0.7%	1.6%	3.5%
Taxes on Products	10.9%	9.9%	4.0%	(14.2%)	0.4%	(1.4%)	(18.3%)
Manufacturing	9.7%	9.9%	4.0%	(3.9%)	0.4%	(0.4%)	(7.9%)
Real estate	8.3%	9.0%	6.0%	2.2%	0.5%	0.2%	(3.8%)
Wholesale and retail trade	7.3%	7.3%	7.8%	(6.9%)	0.6%	(0.5%)	(14.7%)
Education	6.8%	3.2%	6.0%	(56.2%)	0.4%	(1.8%)	(62.1%)
Transport and Storage	6.9%	6.5%	7.6%	(11.6%)	0.5%	(0.7%)	(19.1%)
Financial & Insurance	6.0%	6.5%	7.8%	1.7%	0.5%	0.1%	(6.2%)
Construction	5.5%	6.1%	7.2%	3.9%	0.4%	0.2%	(3.3%)
Information and Communication	3.5%	3.9%	7.8%	4.3%	0.3%	0.2%	(3.6%)
Public administration	4.4%	4.9%	7.5%	6.9%	0.3%	0.3%	(0.6%)
Electricity and Water Supply	2.9%	3.0%	7.3%	(0.6%)	0.2%	(0.0%)	(7.9%)
Professional admin	2.2%	2.0%	4.2%	(15.7%)	0.1%	(0.3%)	(20.0%)
Health	1.8%	2.1%	6.2%	10.3%	0.1%	0.2%	4.1%
Accommodation & Food Services	1.0%	0.2%	12.1%	(83.3%)	0.1%	(0.2%)	(95.4%)
Other services	1.2%	1.2%	5.6%	(8.5%)	0.1%	(0.1%)	(14.1%)
Mining and quarrying	0.9%	1.1%	5.0%	10.0%	0.0%	0.1%	5.0%
Financial Services Indirectly Measured	(2.1%)	(2.4%)	7.3%	4.0%	(0.2%)	0.1%	(3.3%)
GDP at Market Prices	**100.0%**	**100.0%**	**5.3%**	**(5.7%)**	**5.3%**	**(5.7%)**	**(11.0%)**

Our key take-outs include:

i. The biggest gainers in terms of sectoral contribution to GDP were Agriculture, real estate and construction sectors, where agriculture increased by 2.9% points to 25.7% from 22.8% in Q2' 2019 while real estate and construction sectors increased by 0.7% points and 0.6% points, respectively from 8.3% and 5.5% recorded in Q2' 2019. Education was the biggest loser since it decreased by 3.7% points to 3.2% in Q2'2020 from 6.9% in Q2'2019. We attribute the decline to the decreased activity in the sector due to the coronavirus pandemic as the government implemented social distance measures and schools were closed for the whole quarter,

ii. The overall performance was cushioned by growths in Agriculture, Forestry and Fishing activities which grew by 6.4%; Financial and Insurance activities, 1.7%; Construction, 3.9%; Real Estate Activities, 2.2% and Mining and Quarrying activities, 10.0%.

iii. Accommodation & tourism and the Education sectors were the hardest hit, declining by 83.3% and 56.2% respectively.

For a detailed analysis on this see our Q2'2020 GDP Growth rate note.

The Kenya National Bureau of Statistics released the Quarterly Balance of Payments report for

Q2’2020. Kenya’s current account deficit contracted by 39.9% in Q2’2020, to Kshs 82.2 bn, from Kshs 136.9 bn in Q2’2019, equivalent to 7.0% of GDP from the 10.9% of GDP recorded in Q2’2019.

The table below shows the year on year changes in the Balance of payments.

Q2’2020 Current Account Balance

Item	**Q2’ 2019**	**Q2’2020**	**% Change**
Merchandise Trade Balance	(277.8)	(187.4)	**(32.5%)**
Service Trade Balance	38.4	5.8	**(84.8%)**
Primary Income Balance	(46.2)	(33.5)	**(27.4%)**
Secondary Income (Transfers) Balance	148.7	132.9	**(10.7%)**
Current Account Balance	(136.9)	(82.2)	**(39.9%)**
GDP at Current Prices (Q2’2020 Quarterly GDP Report by KNBS)	1,252.2	1,181.9	**(5.6%)**
Current Account Balance as a % of GDP	(10.9%)	(7.0%)	**4.0%**

Key take-outs from the table include:

i. The merchandise trade deficit (a scenario where imports are greater than exports of goods) declined by 32.5% to Kshs 187.4 bn, from Kshs 277.8 bn in Q2’2019, driven by a 23.2% decline in merchandise imports to Kshs 326.5 bn, from Kshs 425.0 bn in Q2’2019, coupled with the 5.5% decline in merchandise exports to Kshs 139.2 bn from Kshs 147.2 bn recorded in a similar period in 2019. The decline in the merchandise exports was mainly on account of a 6.1% decline in the value of horticulture exports to Kshs 28.2 bn from Kshs 30.1 bn. Notably, earnings from tea during the quarter improved by 38.9% to Kshs 34.8 bn from Kshs 25.1 bn in Q2’2019. Earning from coffee during the quarter also improved by 9.2% to Kshs 7.8 bn from Kshs 7.2 bn in Q1’2019,
ii. Service Trade Balance (the difference between the imports and exports of services) recorded an 84.8% decline in Q2’2020 to Kshs 5.8 bn from Kshs 38.4 bn recorded in Q2’2020. Receipts from international trade services declined by 36.4% to Kshs 89.7 bn in Q2’2020 from Kshs 141.0 bn mainly on the back of the sluggish performance recorded in the exports of international travel and transport services. The travel restrictions put in place due to the pandemic saw the total number of visitors arriving through Jomo Kenyatta International Airport (JKIA) and Moi International Airport (MIA) in Q2’2020 decline by 99.5% to 1.8 mn people from 341.3 mn people in Q2’2019,
iii. Secondary income/transfers surplus (The transactions recorded in the secondary income account pertain to those current transfers between residents and non-residents that directly affect the level of gross national disposable income and thus influence the economy’s ability to consume goods and services) declined by 10.7% to Kshs 132.9 bn, from Kshs 148.7 bn in Q2’2019. Despite this, diaspora remittances recorded a 0.7% increase to Kshs 81.4 bn, from Kshs 80.8 bn recorded in Q2’2019,

Kenya’s Balance of payment deficit declined in Q2’2020 to Kshs 44.0 bn from Kshs 93.8 bn in Q2’2019, translating to a balance of payments deficit equivalent to 3.7% of GDP in Q2’2020 from a deficit equivalent to 7.5% of GDP recorded in Q2’2019. This was mainly due to the 36.7% decline in the Financial Account balance.

We expect relative stability in the business environment in the coming quarter given the easing of the lockdown measures by Kenya’s trading partners as well as continued support from the tea, coffee and horticulture exports due to the normalized demand in Kenya’s export. For more information, see our Q2’2020 Balance of Payments Note.

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 64.6 % ahead of its prorated borrowing target of Kshs 130.9 bn having borrowed Kshs 215.2bn. 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.
