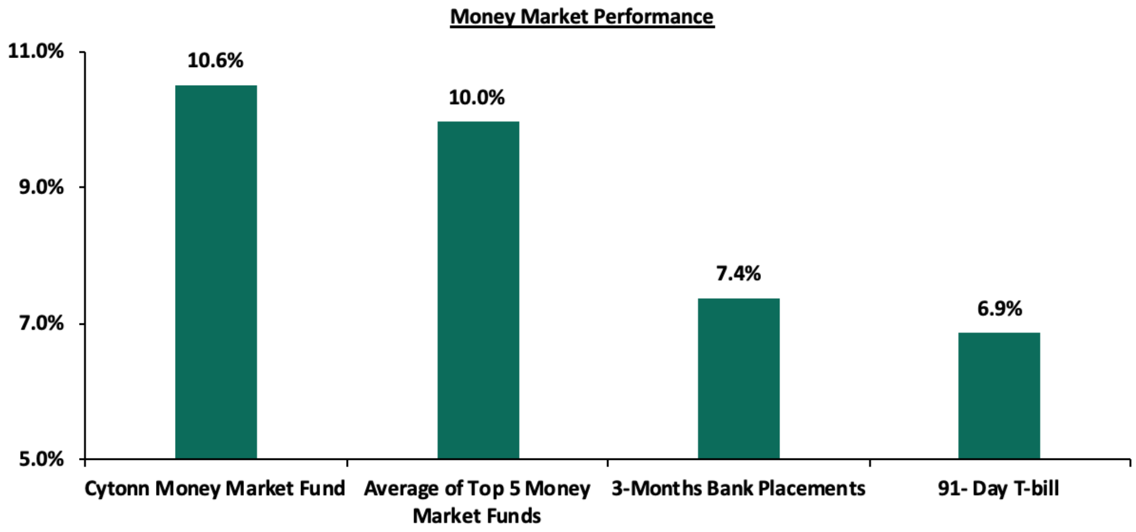
Kenya's Public Debt, & Cytonn Weekly #52/2020

Fixed Income

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

During the week, T-bills remained undersubscribed, with the overall subscription rate coming in at 52.8%, a decrease from the 90.4% recorded the previous week. This can be mainly attributed to the continued tightening of liquidity in the market evidenced by 0.7% points increase in the average interbank rate to 5.8% from 5.1%, recorded last week. Investors continued to prefer the 91-day paper, which had the highest subscription rate but the same decreased to 143.8% from 215.7% recorded the previous week. The subscription for the 182-day paper decreased to 24.2% from 78.6%, while that of the 364-day paper, declined to 44.0% from 52.1% recorded the previous week. The yields on the 91-day, 182-day and 364-day increased by 3.0 bps, 4.0 bps and 9.0 bps to 6.9%, 7.4% and 8.3%, respectively. The government continued to reject expensive bids with the acceptance rate declining to 80.0%, from 98.4% recorded the previous week, accepting bids worth Kshs 10.1 bn out of the Kshs 12.8 bn worth of bids received.

The Treasury has offered two new bonds, FXD1/2021/02 and IFB1/2021/16, with effective tenors of 2 years and 16 years, respectively for a total value of Kshs 25.0 bn and Kshs 50.0 bn, respectively. The bonds will have market-determined coupon rates. The period of sale runs from 21st Dec 2020 to; 5th Jan 2021 for FXD1/2021/002 and 19th Jan 2021 for IFB1/2021/016.



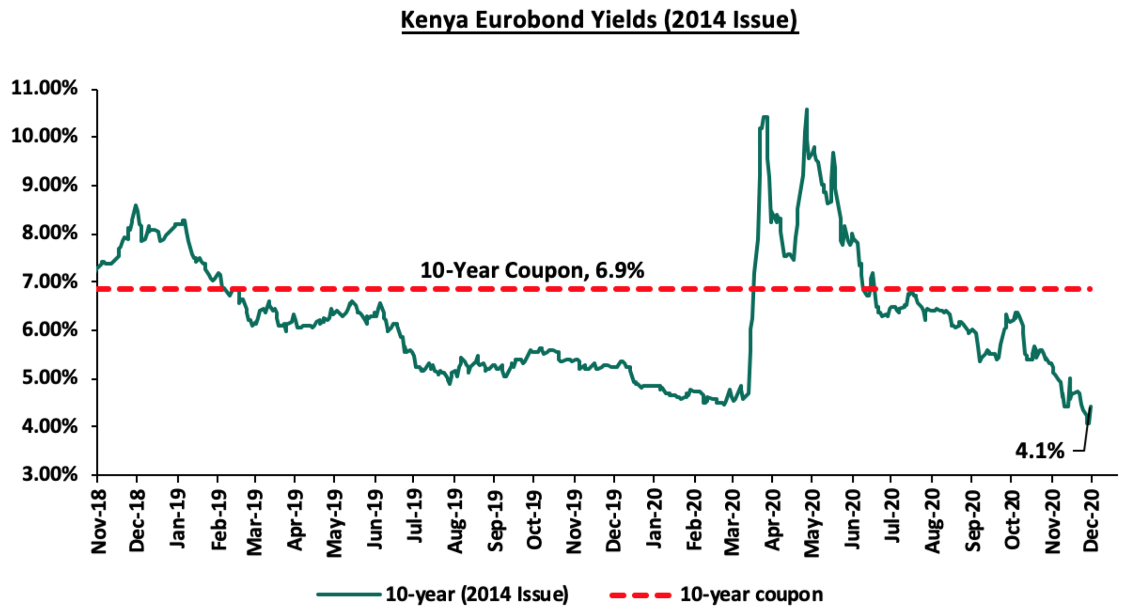
In the money markets, 3-month bank placements ended the week at 7.4% (based on what we have been offered by various banks), while the yield on the 91-day T-bill increased by 2.0 bps to 6.9%. The average yield of Top 5 Money Market Funds remained unchanged at 10.0%, as recorded the previous week. The yield on the Cytonn Money Market also remained unchanged at 10.5%, recorded the previous week.

Liquidity:

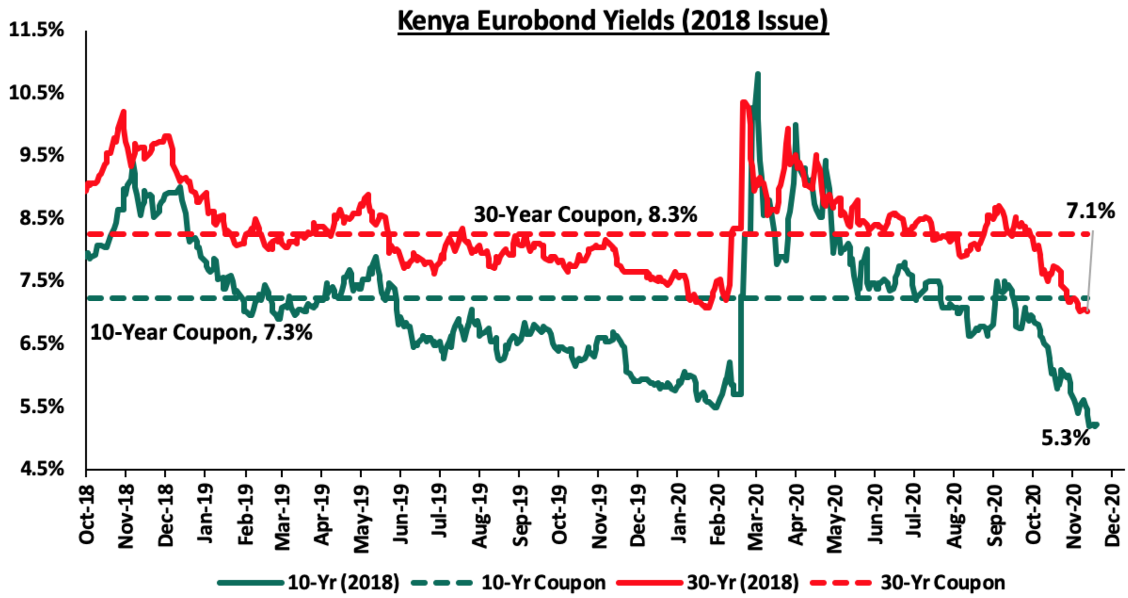
During the week, liquidity in the market continued to tighten with the average interbank rate increasing by 0.7% points, to 5.8% from 5.1% recorded the previous week. The average interbank volumes declined by 24.9% to Kshs 11.2 bn, from Kshs 14.9 bn recorded the previous week.

Kenya Eurobonds:

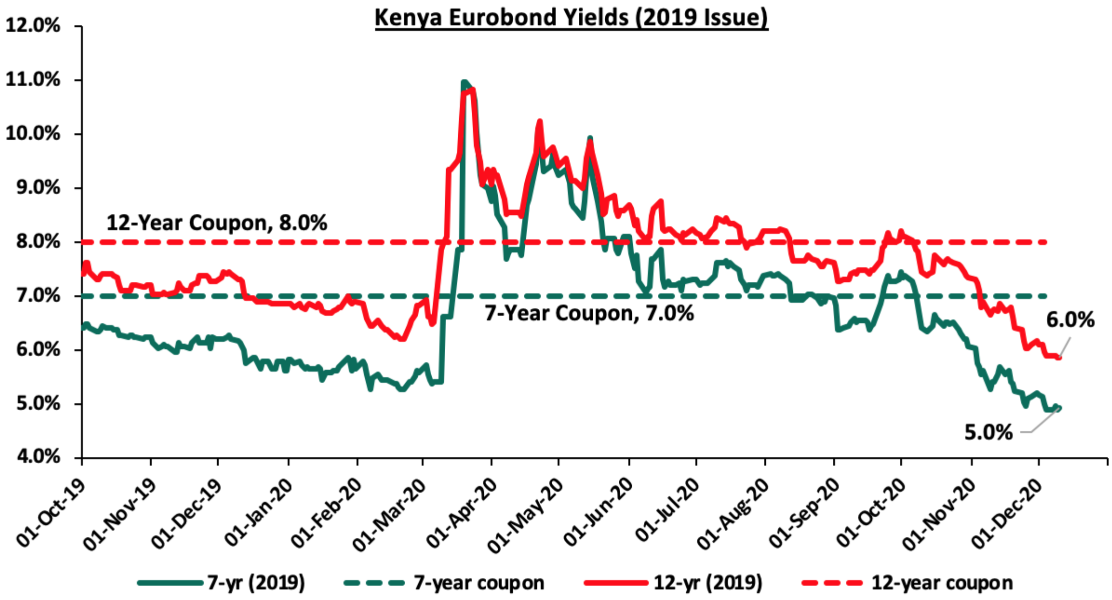
During the week, the yields on all Eurobonds remained unchanged. The yield on the 10-year Eurobond issued in June 2014 remained unchanged at 4.1%.



During the week, the yields on the 10-year and 30-year Eurobonds issued in 2018 both remained unchanged at 5.3%, and the 30-year at 7.1%.



During the week, the yields on the 2019 dual-tranche Eurobonds both remained unchanged at 5.0% for the 7-year Eurobond and, the 12-year Eurobond at 6.0% as recorded last week.



Kenya Shilling:

During the week, the Kenyan shilling appreciated against the US dollar by 2.5% to Kshs 108.8 from Kshs 111.6. This is partly attributable to the easing of the US dollar against other world currencies falling and also the support activity by the Central Bank. On a YTD basis, the shilling has depreciated by 7.4% against the dollar, in comparison to the 0.5% appreciation in 2019. We expect continued pressure on the Kenyan shilling due to:

i. Demand from merchandise traders as they beef up their hard currency positions ahead of the festive season, amid a slowdown in foreign dollar currency inflows, and,
ii. Continued uncertainty globally making people prefer holding dollars and other hard currencies.

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

i. The Forex reserves which are currently at USD 7.8 bn (equivalent to 4.8-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, and,
ii. Improving diaspora remittances evidenced by a 17.3% y/y increase to USD 263.1 mn in October 2020, from USD 224.3 mn recorded over the same period in 2019, has cushioned the shilling against further depreciation,

Weekly Highlight:

During the week, Parliament approved COVID-19 tax reversals to be effective from 1st January 2021 by ratifying the Tax Laws (Amendment) [No.2] Bill, 2020. The incentives had been issued under the economic stimulus package as a way to mitigate the effects of COVID-19 on individual and business incomes. The rates affected include;

i. The rate of pay as you earn (PAYE) and corporation tax rate which will both revert to 30.0% from the current 25.0%, and,
ii. Value-added tax rate which will revert to 16.0% from the current 14.0%,

This comes on the back of revenue underperformance reported in the first quarter of the 2020/21 Fiscal year. The ordinary revenue collection declined by 10.9% to Kshs 342.6 bn against a target of Kshs 384.3 bn, representing a Kshs 41.7 bn reduction. This was mainly attributable to reduced tax collections, whereby PAYE and local VAT collections declined by 27.1% and 30.8%, respectively. Consequently, we are of the view that the reversal will still not help the government achieve its revenue targets since; many people are still jobless following the vast loss of jobs due to the pandemic. The prospects of a sudden recovery are forestalled by the spike in the number of new

COVID-19 infections in the country. The increase in VAT will likely be reflected in an increase in inflation as traders pass the burden to the consumers. What would have been more helpful to the economy was a stimulus to assist businesses recover and hence create jobs.

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 39.3% ahead of its prorated borrowing target of Kshs 215.1 bn having borrowed Kshs 299.5 bn. In our view, due to the current subdued economic performance brought about by the effects of the COVID-19 pandemic, the government will record a shortfall in revenue collection with the target having been set at Kshs 1.9 tn for FY'2020/2021 thus 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.
