Cytonn Annual Markets Review - 2020

Fixed Income

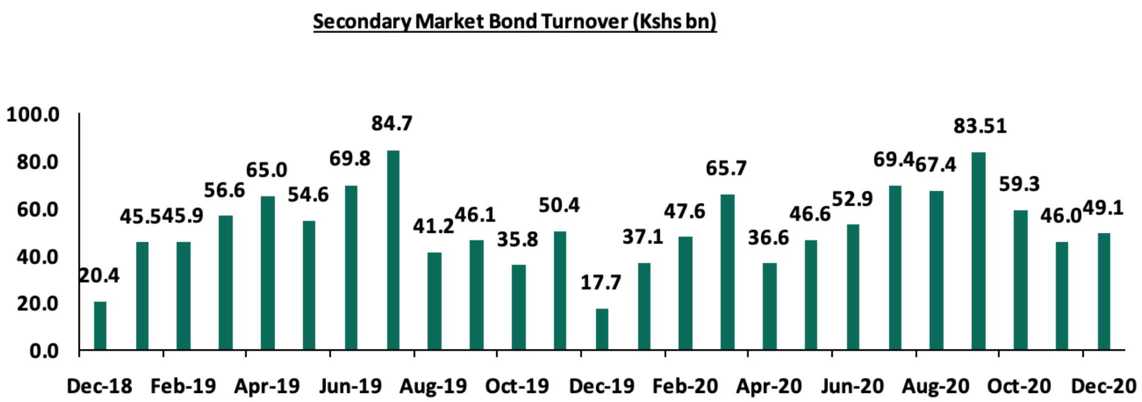
T-Bills & T-Bonds Primary Auction:

During the year 2020, T-bills auction recorded an oversubscription with the average subscription rate coming in at 130.3% compared to an average of 118.7% in 2019. The yields on the 91-day, 182-day and 364-day T-bills declined to 6.9%, 7.4% and 8.3% in 2020 from 7.2%, 8.2% and 9.8% at the end of 2019, respectively. This is mainly attributed to the Central Bank of Kenya's (CBK's) efforts to keep rates low by rejecting expensive bids in the auction market as well as increased demand as Banks shied away from lending to the public due to the increased credit risk.

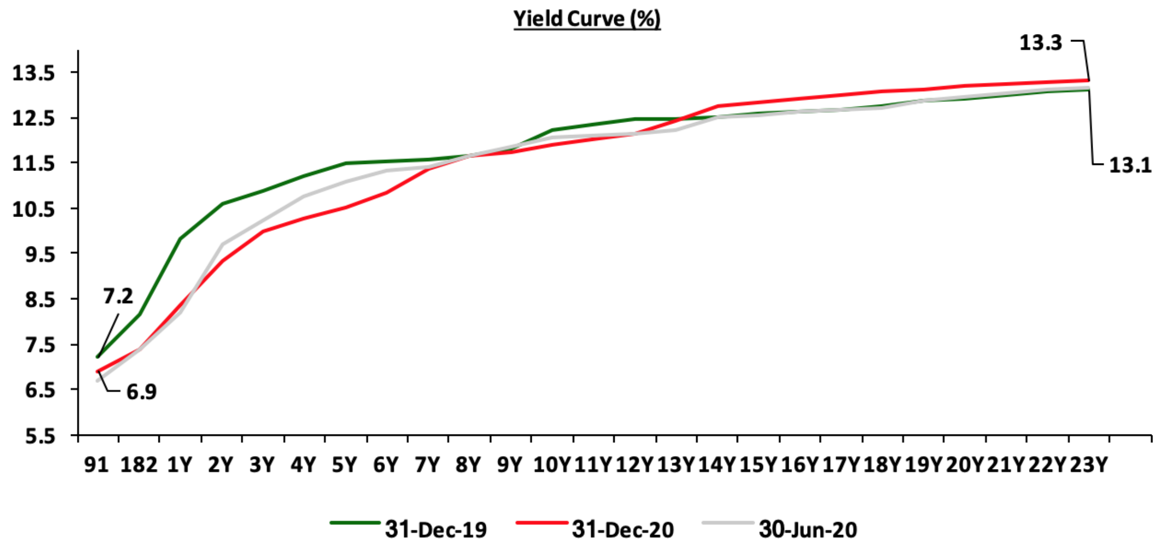
Primary T-bond auctions in 2020 were oversubscribed with the subscription rate averaging 130.6%, which was higher than 109.7% average subscription rate in 2019. The market maintained a bias towards the medium-term bonds mainly driven by the perception that risks may not be adequately priced on the longer end of the yield curve. The average acceptance rate declined by 0.7% points to 68.5% in 2020, from the 69.2% recorded in 2019, as the market adjusted to the efforts of the CBK to maintain the rates at low levels by rejecting expensive bids.

Secondary Bond Market Activity:

The secondary bond market recorded increased activity with the turnover having increased by 7.8% to Kshs 661.2 bn from Kshs 613.2 bn in 2019. This is attributable to local institutional investors increasing their allocation to treasury bonds as they sort for stable returns, after increased volatility in other asset classes.



In 2020, the yield curve steepened during the year, readjusting downwards for the shorter-dated papers but adjusting upwards for the longer-dated papers. The FTSE NSE bond index increased by 2.6% to close the year at 98.0 from 95.5 at the end of 2019. The chart below is the yield curve movement during the period;



Liquidity:

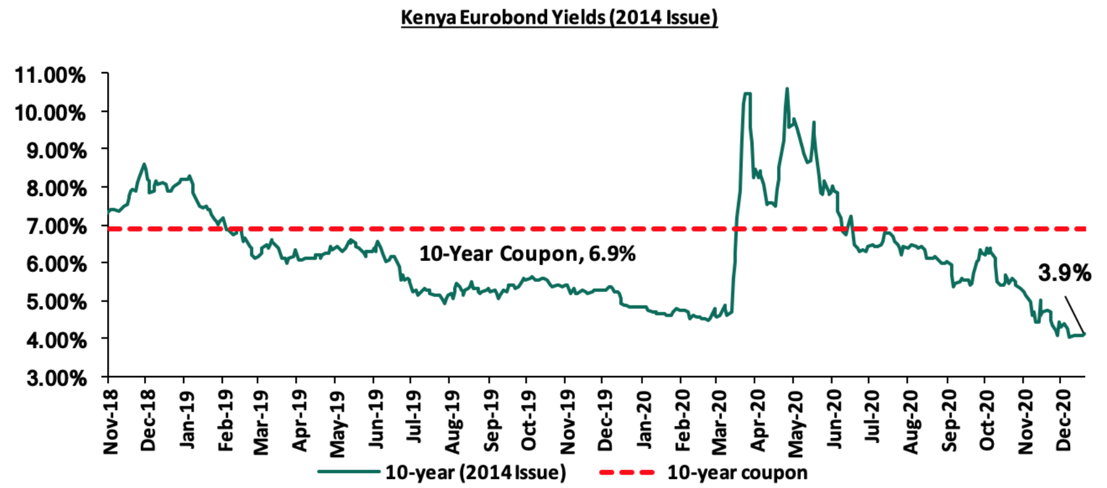
During the year, liquidity levels remained stable and well distributed in the market as indicated by the decline in the average interbank rate to 3.7% in 2020 from 4.3% in 2019, coupled with the 7.0% decline in the average volumes traded in the interbank market to Kshs 10.7 bn in 2020 from Kshs 11.5 bn recorded in 2019. The improvement in liquidity was mainly driven by government payments and mitigation measures including the reduction of the Cash Reserve Ratio (CRR) from 5.25% to 4.25% in April 2020, introduced by the CBK against potential effects of COVID 19 pandemic on the economy.

Kenya Eurobonds:

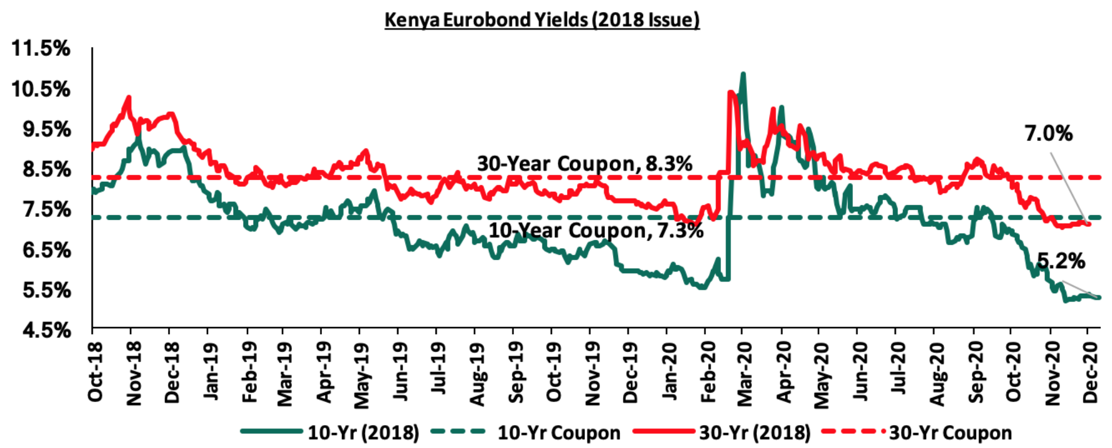
Yields on all Kenyan Eurobonds generally declined in 2020. Key to note is that there was a spike recorded during Q2'2020 due to the heavy outflows recorded by emerging market funds as investors dumped risky assets amid the coronavirus crisis. The decline was partly attributed to:

I. The global hunt for higher yields as a result of massive monetary easing, through economic stimulus packages, in developed markets,
II. Recovering private capital inflows resulting in increased demand for emerging market securities, and,
III. The positive news surrounding the economic cushioning through intervention by global bodies, such as the announcement of a USD 2.3 bn IMF drawdown facility to help mitigate Covid-19 related economic shocks and the news of Kenya's intention to join the Paris club - Debt Service Suspension Initiative (DSSI) that will aid in debt sustainability,

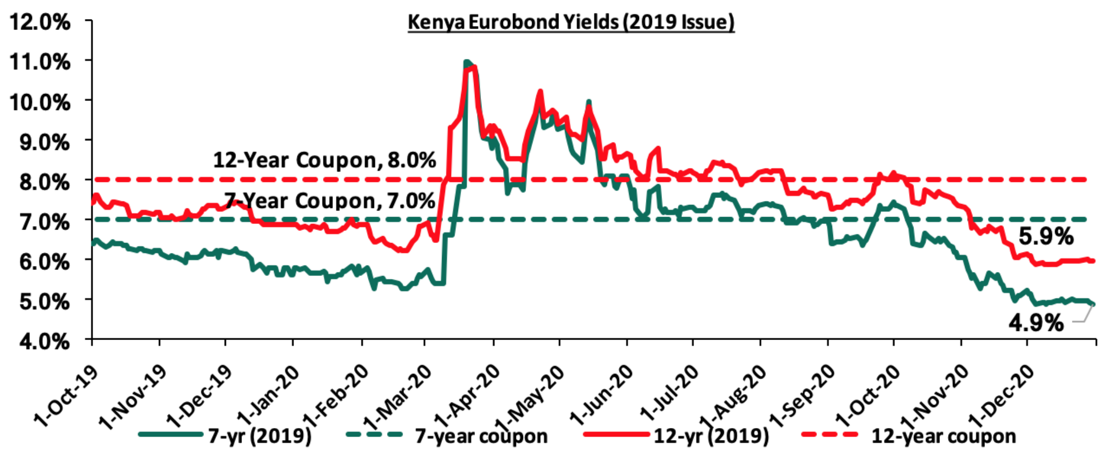
According to Reuters, the yields on the 10-Year Eurobond issued in 2014 declined by 0.9% points to 3.9%, from 4.8% recorded at the end of 2019.



For the 2018 Eurobond issue, the yields on the 10-year Eurobond and the 30-year Eurobond both declined by 0.7% points to close the year at 5.2% and 7.0% from a yield of 5.9% and 7.7% at the close of 2019 respectively.



For the 2019 Dual-tranche Eurobond issue, the yields on the 7-year Eurobond and the 12-year Eurobond declined to close the year at 4.9% and 5.9% from a yield of 5.6% and 6.9% at the close of 2019, respectively.



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 11.1% ahead of its prorated borrowing target of Kshs 243.1 bn having borrowed Kshs 270.1 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.

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