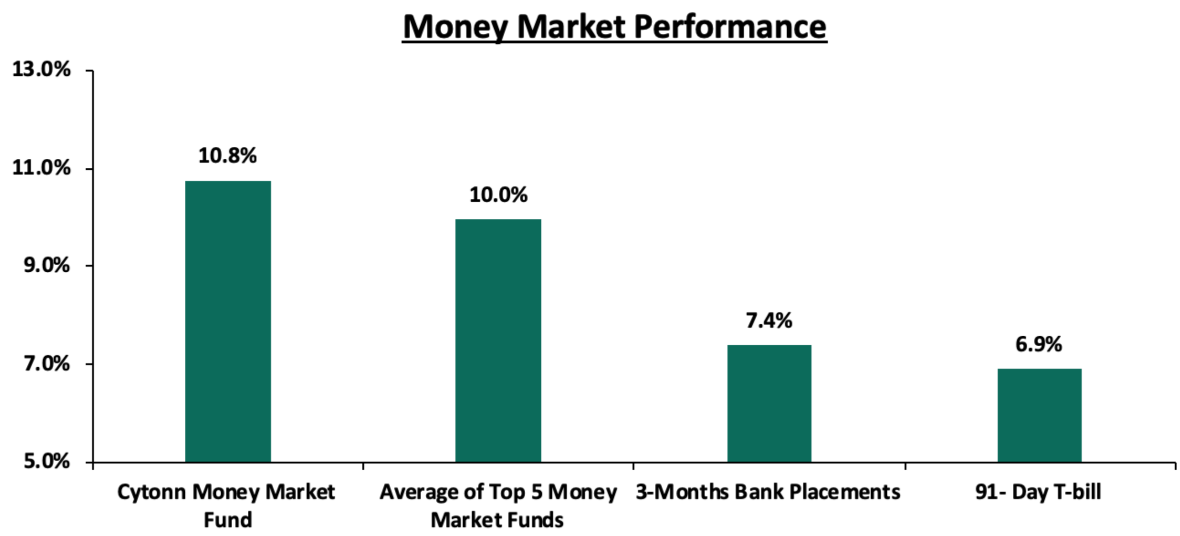
The Role of Kenya's Capital Market on Economic Growth, & Cytonn Weekly #01/2021

Fixed Income

During the week, T-bills remained undersubscribed, with the overall subscription rate coming in at 65.7%, an increase from the 21.6% recorded the previous week. This can be mainly attributed to the concurrent primary bond issue where the government issued a 2-year bond, FXD1/2021/002, which recorded a higher overall subscription rate of 244.6%, coupled with the continued tightening of liquidity in the money markets, evidenced by 0.2% points increase in the average interbank rate to 6.2%, from 6.0% recorded last week. The highest subscription rate was in the 364-day paper, which rose to 100.2%, from 39.5% recorded the previous week. On the other hand, the subscription for both the 182-day and 91-day papers rose to 50.0% and 18.7%, from 5.7% and 16.7% recorded the previous week, respectively. The yields on the 91-day and 182-day papers rose by 11.0 bps and 79.0 bps to 6.9% and 7.5% respectively, while the 364-day paper declined by 15.0 bps to 8.4%. The government continued to reject expensive bids with the acceptance rate declining to 87.8%, from 100.0% recorded the previous week, accepting bids worth Kshs 13.8 bn out of the Kshs 15.8 bn worth of bids received.

On the Primary bond market, there was a high demand for this month's bond offer, with the overall subscription rate coming in at 244.6%, partly supported by investor preference of shorter-dated papers in this period of economic uncertainty. The Central Bank of Kenya issued a bond, FXD1/2021/002, with an effective tenor of 2 years and a coupon of 9.5%. The government received bids worth Kshs 61.1 bn, higher than the Kshs 25.0 bn offered and accepted only Kshs 55.9 bn, translating to an acceptance rate of 91.3%, with the weighted average rate of accepted bids coming in at 9.5%.



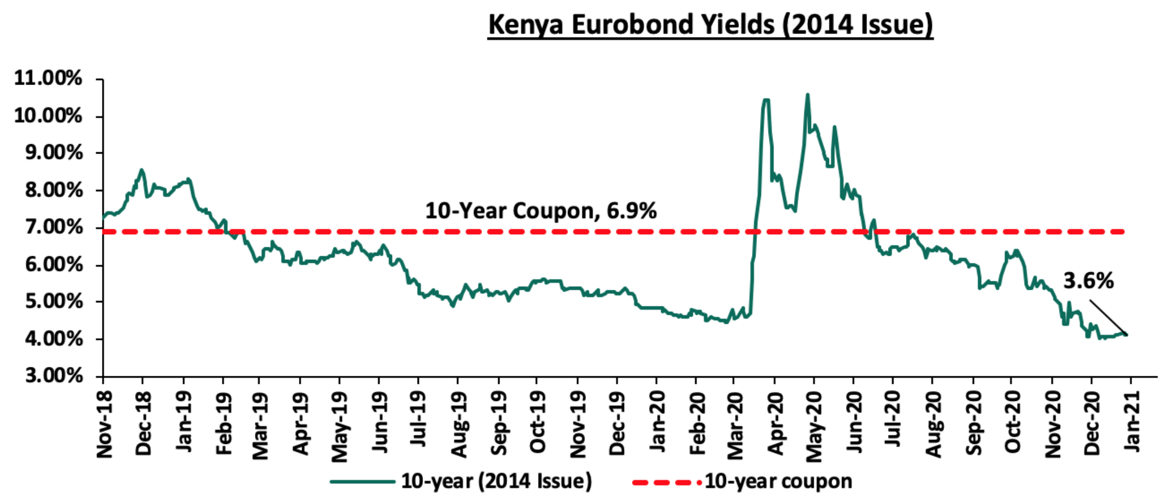
In the money markets, 3-month bank placements ended the week at 7.4% (based on what we have been offered by various banks), while the yield on the 91-day T-bill increased by 11.0 bps to 6.9%. The average yield of Top 5 Money Market Funds remained unchanged at 10.0%, as recorded the previous week. The yield on the Cytonn Money Market increased marginally to 10.8%, from the 10.7% recorded the previous week.

Liquidity:

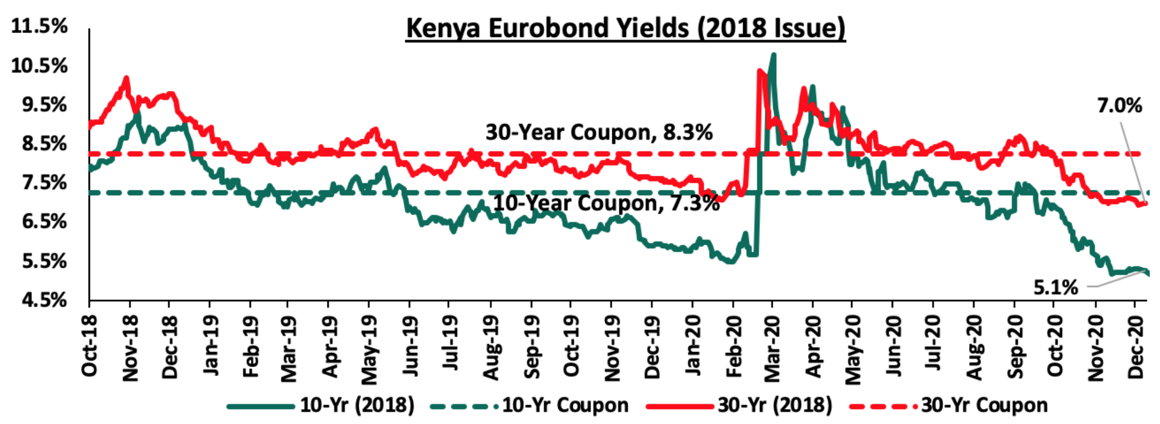
During the week, liquidity in the market continued to tighten with the average interbank rate increasing to 6.2% from 6.0% recorded the previous week, attributable to government payments. The average interbank volumes declined by 57.7% to Kshs 6.6 bn, from Kshs 15.5 bn recorded the previous week. According to the Central Bank of Kenya's weekly bulletin, released on 8th January, 2021, commercial banks' excess reserves came in at Kshs 15.7 bn in relation to the 4.25% Cash Reserve Ratio.

Kenya Eurobonds:

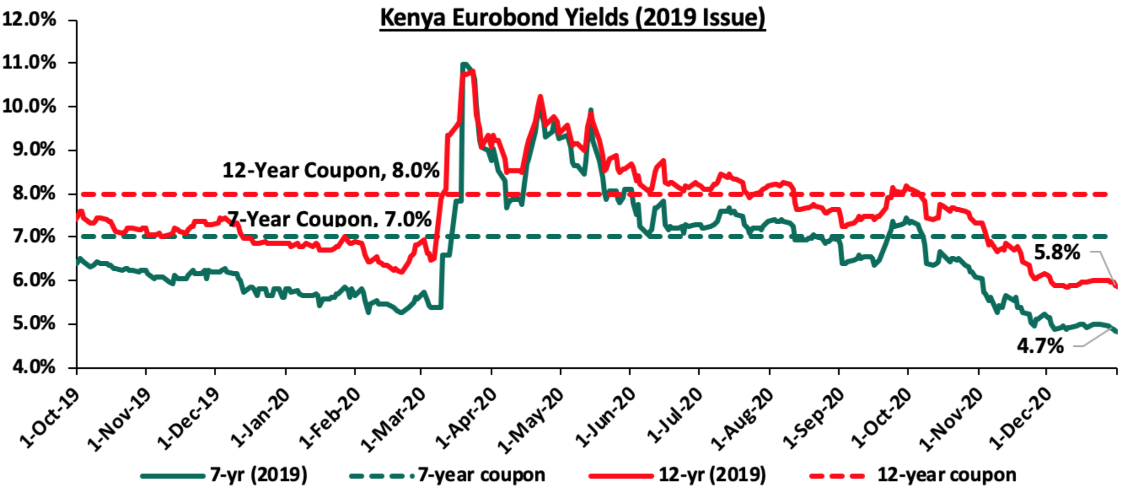
During the week, the yields on all Eurobonds recorded declines, pointing to an improved foreign investor confidence. According to Reuters, the yield on the 10-year Eurobond issued in June 2014 declined marginally by 0.3% points to 3.6% from 3.9%, as was recorded the previous week.



During the week, the yields on the 10-year and 30-year Eurobonds issued in 2018 declined with the 10-year issue declining by 0.2% points to 5.1%, from 5.3% recorded last week. The 30-year issue declined marginally by 0.1% points to 7.0%, from 7.1% recorded last week.



During the week, the yields on both the 2019 dual-tranche Eurobonds declined by 0.2% points with the 7-year Eurobond declining to 4.7%, from 4.9% recorded last week. While, the 12-year Eurobond declined to 5.8%, from the 6.0% recorded last week.



Kenya Shilling:

During the week, the Kenyan shilling depreciated against the US dollar by 0.3% to Kshs 109.5, from Kshs 109.2 recorded the previous week. This is partly attributable to dollar demand from traders as they resume business after the festive season. On an YTD basis, the shilling has depreciated by 0.3% against the dollar, in comparison to the 7.7% depreciation in 2020 and 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 as businesses reopen following 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 7.7 bn (equivalent to 4.7-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. The improving current account position which narrowed to 4.7% of GDP in the 12 months to November 2020 compared to 5.4% of GDP during a similar period in 2019,
iii. 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, and,
iv. The continued reopening of the global economy as the COVID-19 vaccine becomes more accessible.

Weekly Highlight:

Stanbic December PMI

During the week, Stanbic Bank released the Monthly Purchasing Managers' Index (PMI) for December 2020, which came in at 51.4, a marginal increase from the 51.3 recorded in November 2020. Output rose at the slowest rate in six months, although new order growth quickened slightly, expansion was softer than those seen from July to October as the economy recovered from the COVID-19-led downturn. Key to the expansion is the reported improvement in cash flow, looser restrictions and higher customer orders. The month recorded stronger sales leading to a renewed increase in backlogs of work at the end of the year, which supported a third successive monthly rise in employment. The issues with global supply chains as a result of COVID-19 and input shortages led to the stock levels increasing at the slowest rate for six months although the purchasing activity rose further in December, while lead times improved at the weakest rate in seven months. These supplyside issues also led to an accelerated pace of cost inflation, as purchase prices rose at the quickest rate since March, with the uptick slightly easing by a further decline in staff costs. Despite some firms passing higher costs on to customers, average prices charged fell for the second month running in December, as some firms gave discount offerings to attract new clients. Business confidence slipped below November's previous record low at the end of the year as continued worries were surrounding the impact of the COVID-19 pandemic on future activity. We have a cautious outlook in the short term owing to the increase in COVID-19 infections, despite the discovery of vaccines coupled with the recent improvement in some of the leading economic indicators.

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 0.9% ahead of its prorated borrowing target of Kshs 252.5 bn having borrowed Kshs 254.7 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.