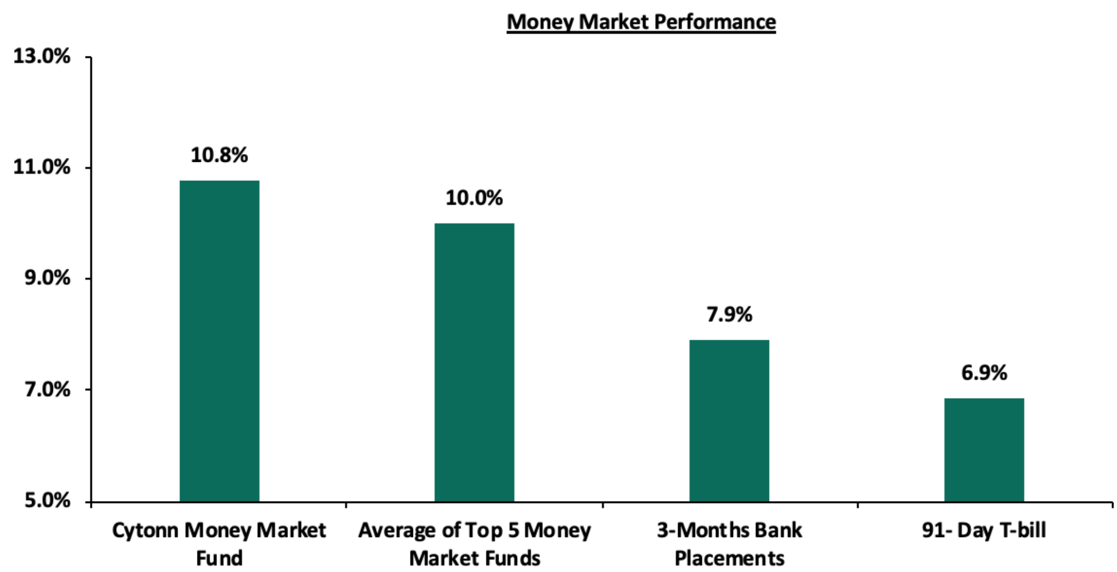
Unit Trust Fund Performance Q3’2020, & Cytonn Weekly #07/2021

Fixed Income

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

During the week, T-bills were oversubscribed with the overall subscription rate increasing to 124.9%, from 90.6% recorded the previous week. This is mainly attributable to improved liquidity in the market as evidenced by interbank rates declining to 3.9%, from 4.9% recorded the previous week. Investors continued their preference on the 364-day paper which had the highest subscription rate of 139.0%, down from 160.8% recorded the previous week. This is mainly attributable to investor preference for medium-term papers as they now believe that the pandemic has been contained but are still worried about possible effects of the current rising political temperatures preceding the elections in August 2022. The subscription rate for the 182-day and 91-day papers increased to 114.0% and 116.9%, from 47.0% and 23.9% recorded the previous week, respectively. The yields on 364-day, 182-day and 91-day papers rose by 10.7 bps, 4.0 bps and 0.6 bps to 8.9%, 7.7% and 6.9%, respectively. The government received bids worth Kshs 30.0 bn, accepting only Kshs 28.8 bn, translating to an acceptance rate of 96.1%.

The Central Bank of Kenya opened two bonds on tap sale, FXD1/2013/15 and FXD1/2012/20, with effective tenors of 7.1 years and 11.8 years, and coupons of 11.3% and 12.0%, respectively. The bonds had an average rate of 11.8% for FXD1/2013/15 and 12.6% for FXD1/2012/20. The issues recorded low demand, with the overall subscription rate coming in at 62.4%, mainly attributable to the short bidding period. The government received bids worth Kshs 11.2 bn, lower than the Kshs 18.0 bn offered and accepted only Kshs 10.9 bn. The acceptance rate came in at 97.1%, with the weighted average rate of accepted bids being 11.8% and 12.6%, respectively.



In the money markets, 3-month bank placements ended the week at 7.9% (based on what we have been offered by various banks), while the yield on the 91-day T-bill rose by 0.6 bps to 6.9%. The average yield of the Top 5 Money Market Funds rose by 0.1% points to 10.0% from the 9.9% recorded last week. The yield on the Cytonn Money Market increased by 21.0 bps to 10.8%, from 10.6% recorded the previous week.

Liquidity:

During the week, liquidity in the money market improved, with the average interbank rate declining to 3.9% from the 4.9% recorded the previous week, as the government payments were offset by tax remittances. The average interbank volumes declined by 7.0% to Kshs 12.0 bn, from Kshs 12.9 bn recorded the previous week. According to the Central Bank of Kenya's weekly bulletin released on 19th February 2021, commercial banks' excess reserves came in at Kshs 10.9 bn in relation to the 4.25% Cash Reserve Ratio.

Eurobonds performance:

During the week, the yields on Eurobonds recorded mixed performances. According to Reuters, the yields on the 10-year Eurobond issued in June 2014 declined by 0.1% points to 3.4% from 3.5% as was recorded the previous week. The yields on the 10-year and 30-year Eurobonds issued in 2018 both increased by 0.2% points to 5.2% and 7.2%, respectively. On the other hand, the yields on the 7-year bond issued in 2019 increased by 0.1% points to 4.6% from 4.5% recorded the previous week while the yields on the 12-year bond increased by 0.4% points to 6.2% from 5.8% recorded the previous week.

Kenya Eurobond Performance

	2014	2018		2019	
Date	**10-year issue**	**10-year issue**	**30-year issue**	**7-year issue**	**12-year issue**
31-Dec-2020	3.9%	5.2%	7.0%	4.9%	5.9%
12-Feb-2021	3.5%	5.0%	7.0%	4.5%	5.8%
15-Feb-2021	3.5%	5.1%	7.0%	4.5%	6.0%
16-Feb-2021	3.5%	5.0%	7.0%	4.6%	5.9%
17-Feb-2021	3.7%	5.3%	7.2%	4.7%	6.2%
18-Feb-2021	3.5%	5.2%	7.2%	4.7%	6.2%
19-Feb-2021	3.4%	5.2%	7.2%	4.6%	6.2%
Weekly Change	**(0.1%)**	**0.2%**	**0.2%**	**0.1%**	**0.4%**
YTD Change	**(0.4%)**	**0.0%**	**0.2%**	**(0.3%)**	**0.3%**

Source: Reuters

Kenya Shilling:

During the week, the Kenyan shilling depreciated by 0.1% against the US dollar to Kshs 109.6, from Kshs 109.5 recorded the previous week. This was mainly attributable to increased dollar demand from the energy sector and other general goods importers. On a YTD basis, the shilling has depreciated by 0.3% against the dollar, in comparison to the 7.7% depreciation recorded in 2020. We expect continued pressure on the Kenyan shilling due to:

i. Demand from merchandise traders as they beef up their hard currency positions,
ii. A slowdown in foreign dollar currency inflows due to reduced dollar inflows from sectors such as

tourism and horticulture, and,

iii. 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 7.6 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 4.8% of GDP in the 12 months to December 2020 compared to 5.8% of GDP during a similar period in 2019, and,
iii. Improving diaspora remittances evidenced by a 19.7% y/y increase to USD 299.6 mn in December 2020, from USD 250.3 mn recorded over the same period in 2019, has cushioned the shilling against further depreciation.

Weekly Highlights:

A: The Energy and Petroleum Regulatory Authority (EPRA)

During the week, the Energy and Petroleum Regulatory Authority (EPRA) released their monthly statement on the Maximum wholesale and retail prices for fuel prices in Kenya effective 15th February 2021 to 14th March 2021. Below are the key take-outs from the statement:

- Petrol prices increased by 7.6% to Kshs 115.3 per litre, from Kshs 107.1 per litre previously, while diesel prices increased by 5.7% to Kshs 101.9 per litre, from Kshs 96.4 per litre. Kerosene prices also increased by 6.1% to Kshs 92.4 per litre, from Kshs 87.1 per litre.
- The changes in prices have been attributed to:

i. An increase in the average landed cost of imported super petrol by 20.9% to USD 391.2 per cubic meter in January 2021, from USD 323.5 per cubic meter in December 2020,
ii. Average landed costs for diesel increased by 13.6% to USD 377.6 Per cubic meter, from USD 332.2 per cubic meter in December 2020,
iii. Landed costs for kerosene also increased by 14.6% to USD 347.2 per cubic meter from USD 303.0 Per cubic meter in December 2020,
iv. An 11.5% increase in Free on Board (FOB) price of Murban crude oil lifted in January 2021 to USD 55.3 per barrel, from USD 49.6 per barrel in December 2020, and,
v. The Kenyan shilling appreciation by 0.6% against the dollar to close at Kshs 109.9 in January 2021, from Kshs 110.5 in December 2020.

We expect an increase in the transport and fuel index which carries a weighting of 8.7% in the total consumer price index (CPI) as a result of the increase in petrol and diesel prices at 7.6% and 5.7% respectively which will consequently result in an increase in the prices of other commodity baskets like food prices due to higher transport costs.

B: The International Monetary Fund (IMF)

During the week, the Kenyan authorities and the International Monetary Fund (IMF) mission team reached an agreement on economic and structural policies that would reinforce a 38-month program under the Extended Fund Facility (EFF) and Extended Credit Facility (ECF). Notably, the credit facility is of approximately USD 2.4 bn (Kshs 262.9 bn) and is meant help Kenya respond to the unprecedented shock of the COVID-19 pandemic as well as reduce Kenya's debt levels. The agreement is subject to approval from IMF's Management and Executive Board consideration, which is expected to happen in the coming weeks. The authorities' program aims at:

i. Reducing debt vulnerabilities through a multi-year fiscal consolidation effort, focused on raising revenue collection and tight control of spending which will deliver a primary balance that would stabilize the debt as a share of GDP and put it firmly on a downward trajectory. In return, resources for private investment will be endorsed, setting a strong base for durable growth,

ii. Advancing the structural reform and governance agenda, by addressing the shortcomings in some State-Owned Enterprises (SOEs) and ongoing efforts to strengthen transparency and accountability through the anti-corruption framework among others, and,
iii. Strengthening the monetary policy framework underpinning financial stability.

Given the uncertainty on the tenor of the pandemic and the continued effects of COVID-19 on the economy, risks abound on the gradual economic recovery. To this regard, the authority indicates that the program charts a clear path that will not only reduce Kenya's debt vulnerabilities but also work towards freeing up investment resources that will provide a strong footing for sustained economic growth in the long term. We believe that the approval of the program will support Kenya's COVID-19 response as well as support the government's fiscal consolidation efforts that were clouded following the pandemic. Additionally, we believe that the switch from expensive commercial debts to concessional loans will help save on the cost of borrowing since such loans have more favourable terms and conditions than those offered by the commercial finance markets including the lower interest rate and deferred or income-contingent repayments. Moreover, revenue performance rate will continue being supported by further implementation of the post Covid-19, 2020-2022 Economic Recovery strategy.

Rates in the fixed income market have remained relatively stable due to the discipline by the Central Bank as they reject expensive bids. The government is 13.3% behind its prorated borrowing target of Kshs 527.7 bn having borrowed Kshs 305.6 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.