Cytonn Monthly - February 2021

Fixed Income

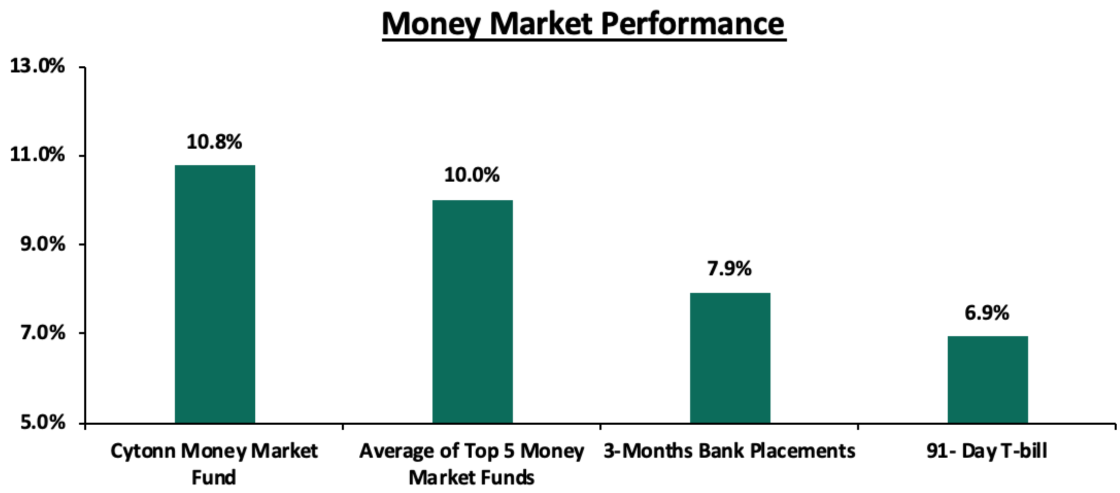
Money Markets, T-Bills & T-Bonds Primary Auction:

During the month of February, T-bill auctions recorded an oversubscription, with the overall subscription rate coming in at 103.4%, an increase from 67.3% recorded in the month of January. This is mainly attributable to the increased liquidity in the money markets as evidenced by the interbank rate declining to 4.5% from 5.2% over the period. Notably, the highest subscription rate was in the 364-day paper, which came in at 146.4%, an increase from 115.9% recorded the previous month. The increased appetite for the 364-day paper is mainly attributable to growing investor preference for medium-term papers (1-2 years) as they now believe the pandemic has been contained but are still worried about the possible effects of the current rising political temperatures preceding the elections in August 2022. The subscription for the 182-day and 91-day papers increased to 70.7% and 62.1%, respectively, from the 33.1% and 45.5% recorded in January. The yields on the 364-day, 182-day and 91-day papers rose by 39.1 bps, 14.4 bps and 3.4 bps to 9.0%, 7.7% and 6.9% respectively from 8.6%, 7.6% and 6.9%. The government continued to reject expensive bids with the acceptance rate declining by 6.3% points to 91.3% during the month, compared to 97.6% recorded the previous month, with the government accepting a total of Kshs 90.6 bn, out of the Kshs 99.3 bn worth of bids received.

During the week, the T-bills subscription rate increased, with the overall subscription rate coming in at 132.0%, from 124.9% recorded the previous week. The highest subscription rate was in the 91-day paper at 157.0%, an increase from 116.9% recorded the previous week. The 364-day paper's subscription rate increased to 151.6% from 139.0% recorded the previous week, attributable to growing investor preference for medium-term papers, while the subscription for the 182-day paper declined to 102.3% from 114.0% recorded the previous week. The yields on 364-day, 182-day and 91-day papers rose by 8.3 bps, 3.8 bps and 2.0 bps respectively, to 9.0%, 7.7% and 6.9%. The government accepted 84.2% of the bids received, amounting to Kshs 26.7 bn, out of the Kshs 31.7 bn worth of bids received.

In the primary bond auction, the Central Bank of Kenya re-opened two bonds, 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 issues recorded an overall subscription rate of 83.7%, mainly attributable to the short bidding period and tightened liquidity in the market during the week of the issue. The government received bids worth Kshs 41.9 bn, lower than the Kshs 50.0 bn offered and accepted only Kshs 32.1 bn, translating to an acceptance rate of 76.7%. The weighted average rate of accepted bids was 11.9% and 12.7%, for the FXD1/2013/15 and FXD1/2012/20, respectively.

During the month, the Central Bank of Kenya re-opened the 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, as the initial reopening had recorded an undersubscription. 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 and over-concentration of similar tenure bonds in the market. 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.

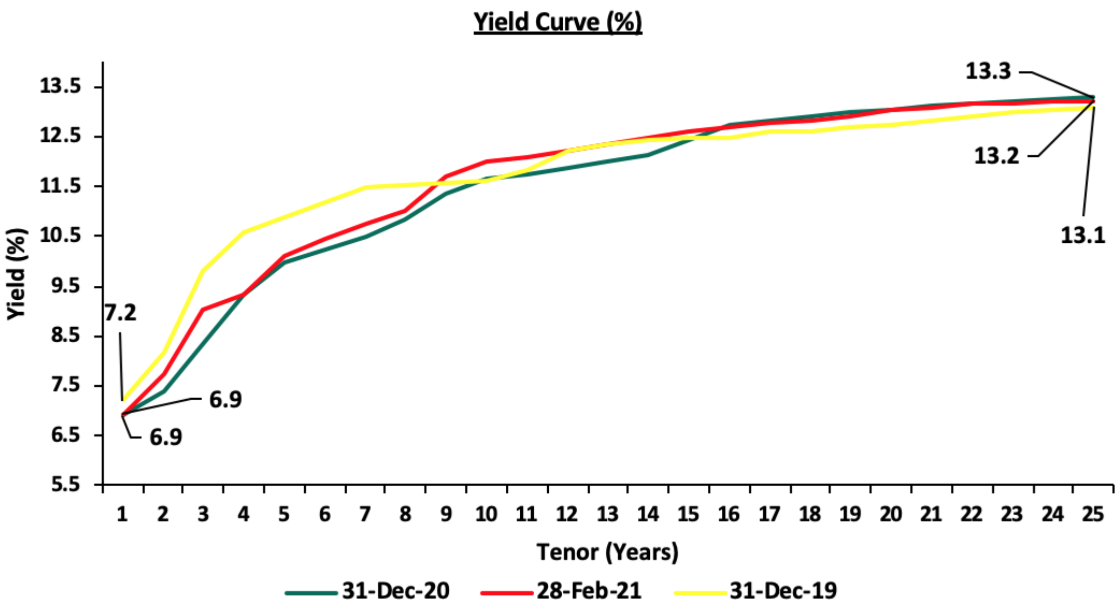


In the money markets, 3-month bank placements ended the week at 7.9% (based on what we have been offered by various banks), while the yield on the 91-day T-bill declined by 2.0 bps to 6.9%. The average yield of the Top 5 Money Market Funds remained unchanged at 10.0%. The yield on the Cytonn Money Market came in at 10.8%, unchanged from the previous week.

Secondary Bond Market:

In the month of February, the yields on government securities in the secondary market remained relatively stable, while the bond turnover increased by 40.6% to Kshs 74.1 bn, from Kshs 52.7 bn recorded in January. The FTSE NSE bond index declined marginally by 0.4%, compared to the 0.0% recorded in January, to close the month at 97.6, from 98.0 recorded in January, bringing the YTD performance to a decline of 0.4%.

The chart below is the yield curve movement during the period;



Liquidity:

The liquidity in the money markets increased during the month of February mainly supported by government payments, with the average interbank rate declining to 4.5%, from 5.2% recorded in January. During the week, liquidity in the market tightened, with the average interbank rate increasing to 4.2% from the 3.9% recorded the previous week, as government payments were offset by tax remittances. The average interbank volumes increased by 32.1% to Kshs 15.3 bn, from Kshs 11.6 bn recorded the previous week. According to the Central Bank of Kenya's weekly bulletin, released on 26th February 2021, commercial banks' excess reserves came in at Kshs 12.5 bn in relation to the 4.25% Cash Reserve Ratio.

Eurobonds performance:

During the month, the yields on all Eurobonds recorded mixed performances. According to the Central Bank bulletin, the yield on the 10-year Eurobond issued in September 2014 declined by 0.3% points to 3.3% in February, from 3.6% in January. The yields on the 10 year and 30 year Eurobonds issued in 2018 remained unchanged to close at 5.3% and 7.2% respectively in February. The yields on the 2019 issued dual-tranche Eurobond with 7-years declined by 0.1% points to 4.7% in February, from 4.8% in January, while the 12-year Eurobond increased by 0.1% points to 6.2% in February, from 6.1% in January.

During the week, the yields on Eurobonds recorded mixed performance. The yields on the 10-year Eurobond issued in June 2014 declined by 0.1% points to 3.3% from 3.4%. The 10 year Eurobond issued in 2018 increased by 0.1% points to 5.3% from 5.2% recorded the previous week. On the other hand, the 30-year bond issued in 2018, the 7-year bond issued in 2019 and the 12-year bond issued in 2019 remained unchanged at 7.2%, 4.7%, and 6.2%, respectively.

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%
29-Jan-2021	3.6%	5.3%	7.2%	4.8%	6.1%
19-Feb-2021	3.4%	5.2%	7.2%	4.7%	6.2%
22-Feb-2021	3.5%	5.4%	7.2%	4.8%	6.3%
23-Feb-2021	3.4%	5.3%	7.3%	4.7%	6.3%
24-Feb-2021	3.4%	5.3%	7.2%	4.6%	6.2%
25-Feb-2021	3.3%	5.3%	7.2%	4.7%	6.2%
Weekly Change	(0.1%)	0.1%	0.0%	0.0%	0.0%
Monthly Change	(0.3%)	0.0%	0.0%	(0.1%)	0.1%
YTD Change	(0.6%)	0.1%	0.2%	(0.2%)	0.3%

Source: CBK Bulletin

Kenya Shilling:

During the month, the Kenya Shilling appreciated marginally by 0.3% against the US Dollar to close the month at Kshs 109.8, from Kshs 110.1 recorded at the end of January 2021 mostly attributable to the decreased dollar demand from general importers due to the two-week long Lunar holiday in the Asian markets who are among the key trading partners. During the week, the Kenyan shilling depreciated marginally against the US dollar by 0.2% to Kshs 109.8 from Kshs 109.6 recorded the previous week. On an YTD basis, the shilling has depreciated by 0.6% 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 as businesses reopen following the festive season,
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 Highlight:

Inflation

The y/y inflation for the month of February increased to 5.8%, from the 5.7% recorded in January. The increase was due to:

i. A 1.0% increase in the Food and Non-Alcoholic Drinks' Index, mainly contributed by increases in prices of cabbages, spinach and cooking oil (salad) of 4.4%, 4.4% and 3.9% respectively, among other food items,
ii. A 0.4% increase in Housing, Water, Electricity, Gas and Other Fuels' Index, mainly attributed to a 6.0% increase in the price of kerosene, and,
iii. A 2.3% increase in the Transport Index, mainly driven by a 5.7% and 7.6% increase in the prices of diesel and petrol, respectively.

Major Inflation Changes – February 2021

Broad Commodity Group	Price change m/m (February-21/January -21)	Price change y/y (February-21/February-20)	Reason
Food & Non-Alcoholic Beverages	1.0%	6.9%	The m/m increase was mainly contributed by increases in prices of cabbages, spinach and cooking oil (salad) among other food items
Housing, Water, Electricity, Gas and other Fuel	0.4%	3.4%	The m/m increase was as a result of increase in the cost of kerosene
Transport Cost	2.3%	16.7%	The m/m increase was mainly on account of an increase in pump prices of diesel and petrol
Overall Inflation	0.7%	5.8%	The m/m increase was due to a 1.0% increase in the food and non-alcoholic drinks' index, mainly driven by the increase in prices of food items

Going forward, we expect the inflation rate to remain within the government's set range of 2.5% - 7.5% despite the recent increases in the fuel prices. Food prices are likely to remain low due to favourable rainfall received.

Monthly Highlights

1. Stanbic Bank released the Monthly Purchasing Managers' Index (PMI) for January 2021, which came in at 53.2, an increase from the 51.4 recorded in December 2020. The reading was the

highest in three months and a seventh consecutive month of growth since the COVID-19 outbreak, pointing to a solid improvement in the private sector. The reopening of businesses and improved cash flow in the economy aided in driving higher customer spending, resulting in the quickest growth in output and new orders since October 2020. For more information, see our Cytonn Weekly #05/2021,

2. The Kenya Revenue Authority (KRA) began the financial year 2021 on a high note, registering a 102.6% performance in revenue collections having collected Kshs 142.0 bn against a target of Kshs 138.0 bn. The collection was a 6.7% increase from last year's collection during a similar period. The positive performance is mainly attributable to the economic resurgence following a 1.1% contraction in the third quarter of 2020, against a 5.5% contraction in the second quarter and partly due to the relaxation of the stiff COVID-19 control measures. For more information, see our, Cytonn Weekly #06/2021,
3. The National Treasury released the Supplementary Budget Estimates I for the 2020/21 fiscal year on the back of a challenging first half of the fiscal year 2020/21, with the challenges including the adverse effects of the COVID-19 pandemic on the economy. The proposed budget was tabled to the National Assembly for debate and approval at a later date. The Treasury proposes an increase in the gross total supplementary budget by Kshs 120.8 bn to Kshs 3,036.5 bn from Kshs 2,915.7 bn previously. The proposed budget increment is attributable to COVID-19 related expenditure and efforts by the government to spur economic activity. For more information, see our Cytonn Weekly #06/2021, and,
4. 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 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 the IMF's Management and Executive Board consideration, which is expected to happen in the coming weeks. For more information, see our Cytonn Weekly #07/2021.

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 10.0% ahead of its prorated borrowing target of Kshs 363.4 bn having borrowed Kshs 327.2 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 shoul