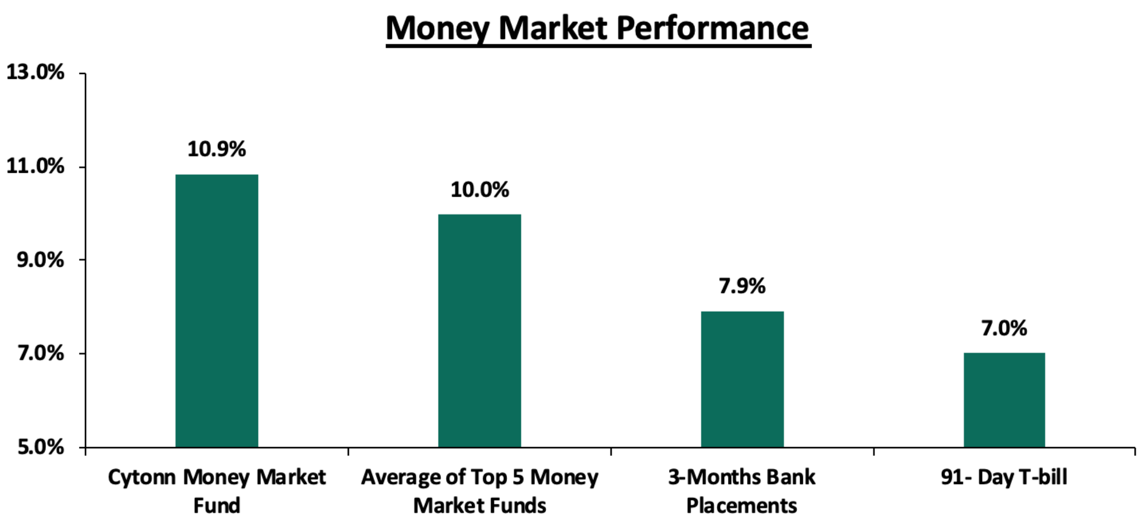
Retirement Benefits Schemes Performance in Kenya, & Cytonn Weekly #09/2021

Fixed Income

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

During the week, T-bills recorded an oversubscription, with the overall subscription rate coming in at 141.0% up from 132.0% recorded the previous week due to the increased liquidity in the money markets as a result of government payments. The highest subscription rate was in the 364-day paper, which increased to 190.2%, from 151.6% recorded the previous week. The increased appetite for the 364-day paper is mainly attributable to growing investor preference for medium-term papers as investors 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 91-day paper also increased to 176.1%, from 157.0% recorded the previous week, while the 182-day paper's subscription rate declined to 77.7%, from 102.3% recorded the previous week. The yields on 364-day, 182-day, and 91-day papers rose by 5.7 bps, 4.3 bps, and 9.3 bps to 9.1%, 7.8%, and 7.0%, respectively, as investors sought higher yields as the government's demand for cash remained high. The government accepted 89.2% of bids received, amounting to Kshs 30.2 bn, out of the Kshs 33.8 bn worth of bids received.

In the primary bonds auction, the government is seeking to raise Kshs 50.0 bn for budgetary support by reopening two bonds, FXD1/2019/10 and FXD2/2018/20, with effective tenures of 8.0 and 17.4 years, respectively. The bonds have coupons of 12.4% and 13.2% and are currently trading at a yield of 12.0% and 13.0%, respectively in the secondary market. Given the tightening liquidity in the market coupled with the under subscription recorded in last month's issues, we anticipate an under a subscription and a high acceptance rate. The bonds will be on offer from 01/03/2021 to 09/03/2021 and we recommend a bidding range of 12.4%-12.5% for FXD1/2019/10 and 13.4%-13.5% for FXD2/2019/20.



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 increased by 9.3 bps to 7.0%. The average yield of the Top 5 Money Market Funds remained unchanged at 10.0% from last week. The yield on the Cytonn Money Market increased marginally by 0.1% points to come in at 10.9%, from 10.8% recorded the previous week.

Liquidity:

During the week, liquidity in the money market tightened, with the average interbank rate increasing to 4.9% from 4.2% recorded the previous week, as the government payments were offset by tax remittances. The average interbank volumes declined by 24.7% to Kshs 11.6 bn, from Kshs 15.3 bn recorded the previous week. According to the Central Bank of Kenya's weekly bulletin released on 5th March 2021, commercial banks' excess reserves came in at Kshs 13.5 bn in relation to the 4.25% Cash Reserve Ratio.

Eurobonds performance:

During the week, the yields on Eurobonds were on a downward trajectory. According to the Central Bank bulletin, the yields on the 10-year Eurobond issued in June 2014, the 10-year and 30-year Eurobonds issued in 2018, and the 7-year and 12-year Eurobonds issued in 2019 all declined by 0.1% points to 3.2%, 5.3%, 7.3%, 4.6%, and 6.3% respectively, from 3.3%, 5.4%, 7.4%, 4.7%, and 6.4%.

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%
26-Feb-2021	3.3%	5.4%	7.4%	4.7%	6.4%
01-Mar-2021	3.3%	5.3%	7.3%	4.6%	6.3%
02-Mar-2021	3.1%	5.3%	7.3%	4.6%	6.3%
03-Mar-2021	3.1%	5.3%	7.3%	4.6%	6.2%
04-Mar-2021	3.2%	5.3%	7.3%	4.6%	6.3%
Weekly Change	**(0.1%)**	**(0.1%)**	**(0.1%)**	**(0.1%)**	**(0.1%)**
Monthly Change	**(0.4%)**	**(0.0%)**	**0.1%**	**(0.2%)**	**0.2%**
YTD Change	**(0.7%)**	**0.1%**	**0.3%**	**(0.3%)**	**0.4%**

Source: CBK Bulletin

Kenya Shilling:

During the week, the Kenyan shilling appreciated by 0.3% against the US dollar to Kshs 109.7, from Kshs 109.8 recorded the previous week. This was mainly attributable to market participants anticipating a positive economic recovery from the coronavirus crisis coupled with the arrival of vaccines in the country during the week. On a YTD basis, the shilling has depreciated by 0.4% against the dollar, in comparison to the 7.7% depreciation recorded in 2020. We expect continued pressure on the Kenyan shilling due to:

i. A slowdown in foreign dollar currency inflows due to reduced dollar inflows from sectors such as tourism and horticulture, 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 7.4 bn (equivalent to 4.5-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 Monthly Purchasing Managers' Index (PMI)

During the week, Stanbic Bank released the Monthly Purchasing Managers' Index (PMI) for February 2021, which came in at 50.9, a decline from the 53.2 recorded in January 2021, attributable to marginal growth in output, the modest increase in new order volumes and weak cash flow which limited household and client spending. Key to note, readings above 50.0 signal an improvement in business conditions on the previous month, while readings below 50.0 indicate a deterioration. This was the first decline recorded after an eight-month run of consecutive growth, following the initial impact of the COVID-19 outbreak. Slower sales were attributed to cash flow constraints in some sectors of the economy, leading to reduced customer spending and travel. New orders from foreign clients recorded modest growth, experiencing the lowest growth since June 2020. Employment numbers increased albeit marginally in February while some businesses cut workers' salaries to maintain current staff levels, leading to the fastest drop in average wage costs in seven months. Cost burdens were driven higher by a sharp increase in purchase prices, attributable to the recent hike in VAT, material shortages, and increased fuel prices. In line with the decline in some of the leading economic indicators, we maintain a cautious outlook in the short term owing to the increasing inflation levels in the country coupled with an increase in COVID-19 infections globally. The speed in distribution and inoculation of the vaccines in some of the key trading partners will affect the number of exports being demanded.

B: The Budget and Appropriations Committee (BAC) report on the 2021/22 Budget Policy Statement

During the week, the Budget and Appropriation Committee (BAC) presented the report on the Budget Policy Statement (BPS) and the Medium Term Debt Strategy (MTDS) for the 2021/2022 Financial Year to parliament. The BAC report, which was approved by the National Assembly on 4th March, set limits on the fiscal deficit to the lower of 7.5% of the country's GDP or Kshs 930.0 bn, for the FY'2021/2022 financial year. The committee raised the concern that the existing expenditure pressures and revenue enhancement measures proposed by the BPS are similar to those that have been unsuccessful in the past, and therefore the set target of reducing the fiscal deficit to 4.5% of GDP by 2023/24 may not be achieved. The BAC, therefore, outlined recommendations that would restructure and limit government borrowing in the coming financial year in line with the aim of reducing the fiscal deficit.

Key take-outs from the report include;

i. The committee recommended that the National Treasury should review ongoing government projects and consider deferment of new projects by one financial year in order to enable adequate funding of stalled projects before the finalization of budget estimates for FY'2021/2022. This will ensure that ongoing projects are completed before embarking on new ones,

ii. State-Owned Enterprises (SoEs) should be restructured, especially the highly indebted ones, with a view of privatizing some of them by the end of FY’2021/2022. This will in turn enhance transparency and efficiency of the enterprises while also improving service delivery,
iii. The revenue collection target for FY’2021/2022 to be set at no less than Kshs 2.0 tn, with the ordinary revenue target being set at Kshs 1.8 tn,
iv. The fiscal deficit (including grants) approved by the National Assembly for FY’2021/2022 is capped at the lower of Kshs 930.0 bn or 7.5% of GDP. This will ensure fiscal discipline and efficiency in the utilization of government resources since parliament will not approve an increase in the fiscal deficit beyond the set limit,
v. The ceiling for foreign loans that the treasury can take be limited to Kshs 530.0 bn and the ceiling for domestic debt be set at Kshs 399.9 bn for the financial year starting July 1st, 2021. This is to limit the government’s increased appetite for foreign debt and ensure that additional borrowing made by the government is low-cost and with minimal currency risk. The committee also set the approved debt mix ratio to 43:57 external to domestic debt, compared to the current debt mix of 52:48 foreign to domestic debt, and,
vi. The National Treasury should stick to its aim of reducing the stock of Treasury Bills by Kshs 200.0 bn and report to the National Assembly how this has been achieved thirty days after the approval of the report by the National Assembly.
vii. The move by the BAC is a commendable one, as the government’s debt, which currently stands at Kshs 7.3 tn, has been growing at a rapid rate, increasing at a 10-year CAGR of 17.1% to Kshs 7.3 tn from Kshs 1.5 tn in 2011. The move to set the debt mix at 57:43 domestic debt to external will also help alleviate increasing debt service obligations arising from servicing debt denominated in foreign currency. The debt ceiling will also enforce fiscal discipline as the government attempts to bridge the fiscal deficit.

Rates in the fixed income market have remained relatively stable but we have seen an upward trend in the short end due to increased borrowing by the government. The liquidity in the money market, coupled with the discipline by the Central Bank as they reject expensive bids has continued to check the rate of the rates increasing. The government is 13.1% behind its prorated borrowing target of Kshs 374.5 bn having borrowed Kshs 325.3 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.