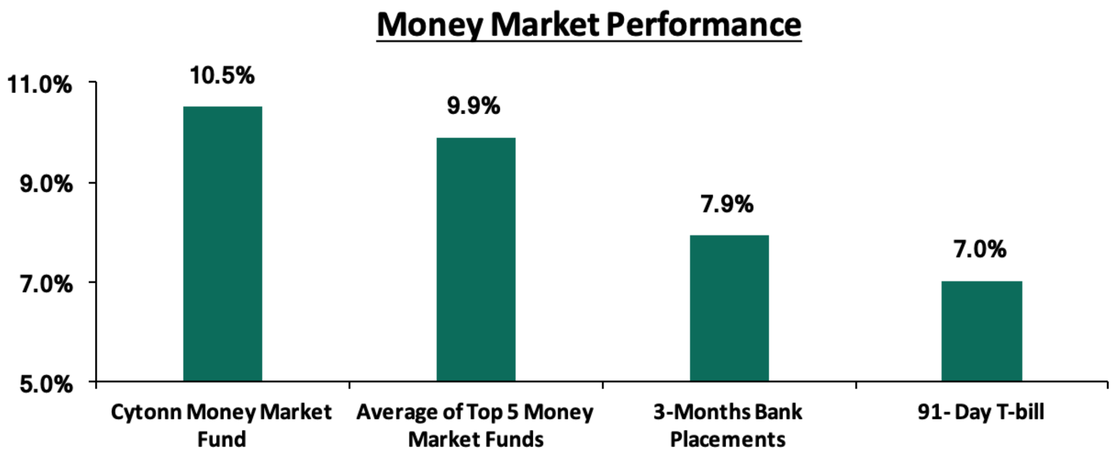
# Financial Planning for Education, & Cytonn Weekly #10/2021

## Fixed Income

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

During the week, T-bills recorded an undersubscription, with the overall subscription rate coming in at 94.3% down from 141.0% recorded the previous week, attributable to the concurrent bond issue coupled with the tightened liquidity in the money markets. The highest subscription rate was in the 364-day paper, which declined to 121.9% from 190.2% recorded the previous week. The subscription rate for the 91-day and 182-day papers also declined to 108.8% and 60.8%, from 176.1% and 77.7% recorded the previous week, respectively. The yield on the 91-day paper remained unchanged at 7.0%, while the yields on 364-day and 182-day papers rose by 7.3 bps and 6.7 bps to 9.1% and 7.8%, respectively. The government accepted 100.0% of bids received, amounting to Kshs 22.6 bn.

On the Primary Bond Market, there was an undersubscription for this month's bond offers, with the overall subscription rate coming in at 97.4%, attributable to the relatively tight but recovering money market liquidity. The Central Bank of Kenya had re-opened 2 bonds, FXD1/2019/10 and FXD2/2018/20 with effective tenors of 8.0 and 17.4 years, and coupons of 12.4% and 13.2%, respectively, in a bid to raise Kshs 50.0 bn for budgetary support. The government received bids worth Kshs 48.7 bn, and accepted only Kshs 48.3 bn, translating to an acceptance rate of 99.2%. Investors preferred the 20-year bond issue i.e. FXD2/2018/20, which received bids worth Kshs 32.8 bn, representing 65.6% of the total bids received. The weighted average rate of accepted bids for the two bonds came in at 12.4% and 13.4%, for FXD1/2019/10 and FXD2/2018/20, 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 remained unchanged at 7.0%, same as recorded last week. The average yield of the Top 5 Money Market Funds declined marginally by 0.1% points to come in at 9.9%, from 10.0% recorded last week. The yield on the Cytonn Money Market also declined during the week by 0.4% points to come in at 10.5%, from 10.9% recorded the previous week.

**Liquidity:**

During the week, liquidity in the money market tightened, with the average interbank rate increasing marginally by 0.1% points to 5.0%, from the 4.9% recorded the previous week, attributable to the government payments which were partly offset by tax remittances. The average interbank volumes increased by 12.6% to Kshs 13.0 bn, from Kshs 11.6 bn recorded the previous week. According to the Central Bank of Kenya's weekly bulletin released on 12th March 2021, commercial banks' excess reserves came in at Kshs 11.7 bn in relation to the 4.25% Cash Reserve Ratio.

**Eurobonds performance:**

During the week, the yields on Eurobonds were on an upward 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 increased by 0.1%, 0.6%, 0.3%, 0.2% and 0.3% points to 3.3%, 5.9%, 7.5%, 4.9% and 6.5% respectively, from 3.2%, 5.3%, 7.3%, 4.6% and 6.3%.

**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% |
| 5-Mar-21 | 3.2% | 5.4% | 7.3% | 4.8% | 6.4% |
| 8-Mar-21 | 3.4% | 5.7% | 7.4% | 5.0% | 6.7% |
| 9-Mar-21 | 3.4% | 5.6% | 7.5% | 5.0% | 6.6% |
| 10-Mar-21 | 3.4% | 5.7% | 7.6% | 5.0% | 6.7% |
| 11-Mar-21 | 3.3% | 5.9% | 7.5% | 4.9% | 6.5% |
| **Weekly Change** | **0.1%** | **0.6%** | **0.3%** | **0.2%** | **0.3%** |
| **Monthly Change** | **(0.3%)** | **0.2%** | **0.2%** | **0.0%** | **0.3%** |
| **YTD Change** | **(0.7%)** | **0.6%** | **0.5%** | **0.0%** | **0.6%** |

*Source: CBK Bulletin*

**Kenya Shilling:**

During the week, the Kenyan shilling appreciated marginally by 0.03% against the US dollar to Kshs 109.6, from Kshs 109.7 recorded the previous week. This was mainly attributable to market participants anticipating a positive economic recovery following the arrival of the Covid-19 vaccine in the country. 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. The Forex reserves have been declining and are now at the same level as the EAC criteria for import cover. Countries use foreign currency reserves to keep a fixed or quasi-fixed rate value, maintain competitively priced exports, remain liquid in case of crisis, and provide confidence for investors. Therefore, the dwindling in the forex reserves may mean the government of Kenya will struggle to support the local currency when it depreciates,
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:**

During the week, Standard & Poor's, a US-based credit rating agency, lowered its long-term foreign and local currency sovereign credit ratings on Kenya to 'B' from 'B+', on the back of the effects of the ongoing pandemic which resulted in GDP contraction of 5.7% and 1.1% in Q2' and Q3'2020, respectively, and increasing debt levels, which in turn increase the country's vulnerability to debt defaults.  Below is a summary of the credit rating on Kenya so far:

| Rating Agency | Previous Rating | Previous Outlook | Date Released | Current Rating | Current Outlook | Date Released |
|---|---|---|---|---|---|---|
| S&P Global | B+ | Negative | 14th July 2020 | **B** | **Stable** | 5th March 2021 |
| Moody's | B2 | Stable | 13th February 2018 | **B2** | **Negative** | 7th May 2020 |
| Fitch Ratings | B+ | Stable | 9th February 2018 | **B+** | **Negative** | 19th June 2020 |

The agency changed its outlook on Kenya to 'Stable' from 'Negative' in the last release in July 2020, as it expects Kenya's GDP to grow by 4.4% in 2021, from their projected growth of 0.2% in 2020.

The table below shows Kenya's 2021 GDP projections from 6 organizations with the consensus GDP growth expected to come in at 5.2%:

**Kenya 2021 Annual GDP Growth Outlook**

| No. | Organization | 2021 Projections |
|---|---|---|
| 1. | International Monetary Fund | 4.7% |
| 2. | S&P Global | 4.4% |
| 3. | Cytonn Investments Management PLC | 4.0% |
| 4. | Central Bank of Kenya | 6.4% |
| 5. | National Treasury | 7.0% |
| 6. | World Bank | 4.7% |
| **Average** | | **5.2%** |

Some of the key challenges identified included: i) Risk of delay in fiscal consolidation as the fiscal deficit remain high due to the poor performance of the economy due to the pandemic, and ii) Risk of getting worse of debt rearrangement terms of the current maturing bonds.

Other key take-outs from the press release include:

- The agency affirmed the 'B' short-term foreign and local currency ratings, as the foreign exchange market remained largely stable compared to regional and global currencies. The agency noted that the currency was however affected by the strengthening of the US Dollar in the global markets as investors preferred the harder currency,
- The pandemic has led Kenya to have large fiscal deficits with FY'2021 deficit estimated to rise to 8.7% of GDP, from a pre-pandemic plan of 6.3%, while the FY'2022 deficit is forecasted at 7.7%, pre-pandemic 4.9%. The agency expects Kenya to embark on broad fiscal consolidation given its recent deal with the International Monetary Fund (IMF) of a USD 2.4 bn facility, to help the next phase of the country's COVID-19 response and a strong multi-year effort to stabilize and begin reducing debt levels relative to GDP, and,
- The general outlook for Kenya is stable mostly due to expectations of economic recovery and supportive foreign donor facilities.

The recovery is also likely to be supported by Kenya's diversified economic base and high liquidity in the domestic market with domestic debt making up 47.9% of the nation's total fiscal debt as of December 2020. Kenya also benefits from flexible monetary settings, supported by its relatively deep and dynamic domestic capital markets (with local currency debt market capitalization at over 25.0% of GDP), and relatively well developed institutional framework compared to peers. The table below shows the local currency public debt to GDP ratio of select countries for comparison:

**Local Currency Public Debt Market Capitalization to GDP Ratio**

| No. | Country | Local Currency Debt to GDP |
|---|---|---|
| 1. | Kenya | 25.0% |
| 2. | Ghana | 21.7% |
| 3. | South Africa | 51.0% |
| 4. | Nigeria | 16.5% |
| **Emerging Markets Economies Average** | | **68.4%** |

*Source: World Bank*

Local currency public debt levels have remained low in some African countries and deepened significantly. A higher level of local currency public debt points to deeper capital markets while indicating a well-developed banking sector, which would facilitates trading of the debt instruments Foreign investments in local currency debts can help them to develop the markets by increasing liquidity – helping to lengthen maturities, develop secondary markets and create a more diversified investor base but they can also increase financial vulnerability as markets become more exposed to the risks of international financial contagion and sudden outflows of capital.

According to the release, Kenya enjoys more sophisticated checks and balances than other African peers, but possible ethnic tensions remain a concern amid an expected referendum on constitutional reforms to be held in 2021. The constitutional changes and the upcoming 2022 general elections could hamper the government's efforts for fiscal consolidation.

Overall, the ratings downgrade will mean Kenya will find it harder to borrow from the international market and may have to pay more on interest to borrow money from the foreign lenders, due to the perceived higher risk.

***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 government is 5.4% behind its prorated borrowing target of Kshs 385.5 bn having borrowed Kshs 364.5 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.***