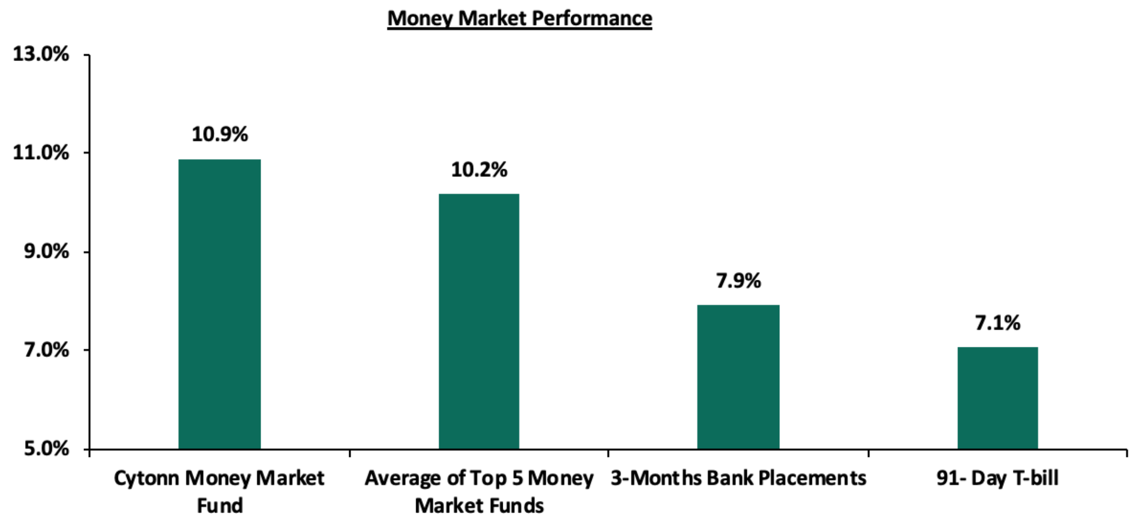
Investment Options in the Kenyan Market, & Cytonn Weekly #12/2021

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 95.7%, a decline from the oversubscription of 115.0% recorded last week, partly attributable to the tightening liquidity in the money markets as evidenced by the interbank rate increasing during the week to 5.6%, from 5.4% recorded last week. Investors' continued interest in the 364-day paper saw it record the highest subscription rate at 166.0%, an increase from 150.8% recorded the previous week, as the paper has an attractive rate of 9.3%, which is higher than the rate for most bank placements. However, the subscription rate for the 91-day and 182-day papers declined to 82.6% and 30.7%, from 135.6% and 71.8%, respectively. The yields on all three papers rose; with the 364-day, 182-day and 91-day papers increasing by 4.6 bps, 0.6 bps and 1.6 bps to 9.3%, 7.9% and 7.1%, respectively. The government continued to reject expensive bids by accepting only Kshs 19.0 bn of the Kshs 23.0 bn bids received, translating to an acceptance rate of 82.9%.

In the Primary Bond market, the Central Bank of Kenya opened bidding for an infrastructure bond IFB1/2021/18, with a tenor of 18 years and the coupon is market determined. The government is seeking to raise Kshs 60.0 bn to fund Infrastructure projects in the FY'2020/21 budget estimates. The bond will be on offer from 26/03/2021 to 06/04/2021. Given the tax-free nature of the bond coupled with the government's increased appetite for domestic borrowing to bridge the budget deficit, we anticipate an oversubscription and a high acceptance rate.



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 marginally by 1.6 bps to 7.1%. The average yield of the Top 5 Money Market Funds remained unchanged at 10.2% as was recorded last week. The yield on the Cytonn Money Market increased marginally during the week 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 declined as evidenced by the average interbank rate increasing to 5.6%, from 5.4% recorded the previous week, attributable to the preparation of the Quarter end tax remittances in the coming week. The average interbank volumes declined by 14.3% to Kshs 11.0 bn, from Kshs 12.9 bn recorded the previous week. According to the Central Bank of Kenya's weekly bulletin released on 26th March 2021, commercial banks' excess reserves came in at Kshs 15.3 bn in relation to the 4.25% Cash Reserve Ratio.

Eurobonds performance:

During the week, the yields on Eurobonds were on an upward trajectory, pointing to increased risk levels following a spike in the number of COVID-19 infections in Kenya coupled with the recent sovereign rating downgrade by Standard & Poor's.

Below is the summary changes as per the Central Bank bulletin:

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%
26-Feb-2021	3.3%	5.4%	7.4%	4.7%	6.4%
18-Mar-21	3.1%	5.7%	7.6%	4.9%	6.5%
19-Mar-21	3.3%	5.8%	7.5%	5.0%	6.5%
22-Mar-21	3.4%	5.9%	7.7%	5.1%	6.7%
23-Mar-21	3.3%	5.8%	7.7%	5.1%	6.7%
24-Mar-21	3.3%	5.8%	7.7%	5.1%	6.7%
25-Mar-21	3.4%	5.9%	7.7%	5.2%	6.8%
Weekly Change	**0.3%**	**0.2%**	**0.1%**	**0.3%**	**0.3%**
YTD Change	**(0.5%)**	**0.7%**	**0.7%**	**0.3%**	**0.9%**

Source: CBK Bulletin

Kenya Shilling:

During the week, the Kenyan shilling appreciated marginally by 0.1% against the US dollar to close at Kshs 109.8, from Kshs 109.9 recorded the previous week. This was mainly attributable to inflows from agricultural products and remittances which outweighed the slowing importer dollar demand. On a 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. A slowdown in foreign dollar currency inflows due to reduced dollar inflows from sectors such as tourism and horticulture,
ii. Continued uncertainty globally making people prefer holding dollars and other hard currencies, and,
iii. Expected dividends pay outs to foreign investors by corporates in the coming months.

However, in the short term, the shilling is expected to be supported by:

i. The Forex reserves, currently at USD 7.3 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 this may mean that the government of Kenya will struggle to support the local currency when it depreciates if the trend continues,
ii. The improving current account position which narrowed to 4.6% of GDP in the 12 months to February 2021 compared to 5.8% of GDP during a similar period in 2020, and,
iii. Improving diaspora remittances evidenced by an 18.9% y/y increase to USD 260.3 mn in February 2021, from USD 219.0 mn recorded over the same period in 2020.

Weekly Highlights

A. **March 2021 Inflation Projections**

We are projecting the inflation rate for March 2021 to range between 5.9% - 6.1%, from 5.8% in February. We expect the y/y inflation rate to increase as a result of rising fuel prices. The m/m inflation is also expected to rise mainly due to:

i. An increase in prices of kerosene and diesel by 5.9% and 5.6% to Kshs 97.9 and, Kshs 107.7 per litre, respectively effective until 14th April,
ii. An increase in electricity prices driven by a 35.6% rise in the fuel levy to Kshs 3.5 per kilowatt-hour (kWh) of electricity consumed in March from Kshs 2.6 per kWh in February. The increase in the fuel levy is linked to the increase in fuel prices as well as the usage of thermal power generation, and,
iii. The continued expectation of an increase in the global oil prices which is attributable to the expected rebound in economic growth and the continued reduction of supply by the Organization of the Petroleum Exporting Countries (OPEC), the oil prices have increased by 20.0% to USD 61.6 per barrel on a YTD basis.

Going forward, we expect inflation to be higher than 5.2% which was the average in 2020 but remain within the government target range of 2.5% - 7.5%.

B. **March MPC Meeting**

The Monetary Policy Committee (MPC) is set to meet on Monday, 29th March 2021 to review the outcome of its previous policy decisions and recent economic developments, and to decide on the direction of the Central Bank Rate (CBR). In their previous meeting held on 27th January 2021, the MPC maintained the CBR at 7.0%, citing that the accommodative policy stance adopted in 2020, which saw a cumulative 125 bps cut, was having the intended effects on the economy.

We expect the MPC to maintain the Central Bank Rate (CBR) at 7.0%, with their decision mainly being supported by:

i. Stable Inflation which is projected to remain within the 2.5%-7.5% target range despite the recent increases in fuel prices. Key to note, February's inflation of 5.8% was an 11 month high, and,
ii. The need to support the economy by adopting an accommodative stance and pumping money into the economy. The current macro and business environment fundamentals might constrain the transmission of further accommodative cuts, despite the need to stimulate economic growth.

We believe that any additional rate cuts will not lead to a rise in Private sector credit growth as elevated credit risks persist in the current environment. The lowering of the government's credit rating by Standard and Poor's however poses the risk of upward pressure on Eurobond rates and the high demand for domestic debt could lead to high domestic rates.

For further analysis on the factors to be considered by the Monetary Policy Committee please see, March 2021 MPC Note.

Rates in the fixed income market have remained relatively stable but we have seen an upward trend in the short-term yields. The government is 6.2% behind its prorated borrowing target of Kshs 407.5 bn having borrowed Kshs 382.2 bn for the financial year 2021/2021. 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. The high deficit and the lower credit rating will mean that the government might be forced to borrow more from the domestic market which will ultimately create uncertainty in the interest rate environment. In our view, investors should be biased towards short-term to medium-term fixed income securities to reduce duration risk.

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