Cytonn Q1’2021 Markets Review

Fixed Income

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

During the first quarter of 2021, T-bills were undersubscribed, with the overall subscription rate coming in at 94.1%, up from 84.7% in Q4’2020. The undersubscription was partly attributable to a slight improvement in the liquidity in the market during the quarter, which saw the average interbank rate decline to 5.4%, from 6.0% in Q4’2020, supported by government payments and debt maturities. Overall subscriptions for the 91-day, 182-day, and 364-day papers came in at 69.4%, 54.6% and 139.8% in Q1’2021, from 116.4%, 51.5% and 100.5% in Q4’2020, respectively, with investors’ participation remaining skewed towards the longer 364-day paper. The yields on all the papers increased with the 364-day, 182-day and the 91-day T-bills to 9.3%, 7.9% and 7.1%, from 8.3%, 7.7% and 6.9%, respectively recorded at the end of Q4’2020. The acceptance rate for the quarter declined to 92.6% from 94.2% in Q4’2020, with the government accepting a total of Kshs 264.6 bn of the Kshs 287.1 bn worth of bids received during the quarter.

During the week, T-bills remained undersubscribed, with the overall subscription rate coming in at 29.9%, a decline from the undersubscription of 82.9% recorded last week, partly attributable due to the lower liquidity in the market and renewed fears by investors as they adopt a wait and see attitude, after the new government restrictions following a spike in the number of COVID-19 infections in the country in recent weeks. Investors’ continued interest in the 364-day paper saw it record the highest subscription rate at 44.1%, a decrease from 166.0% recorded the previous week, as the paper has an attractive rate of 9.3%, which is higher than the rate for most bank placements. Additionally, the subscription rate for the 91-day and 182-day papers also declined to 50.5% and 7.6%, from 82.6% and 30.7%, respectively. Yields on the 364-day and 182-day papers rose by 4.9 bps and 2.0 bps to 9.3% and 7.9%, respectively, while the rate on the 91-day paper declined by 0.2 bps to 7.1%. The increase in the yields can be attributable to investors continuing to demand a premium for the elevated market risks following the increase in the number of COVID-19 infections. The government continued to reject expensive bids by accepting Kshs 7.16 bn of the Kshs 7.19 bn bids received, translating to an acceptance rate of 99.6%.

Primary T-bond auctions in Q1’2021

During Q1’2021, there was a trend of the government issuing more than one bond for the month in a bid to raise more money from the market and during the quarter there were six Treasury bond primary issues, with the details in the table below:

Issue Date	Bond Auctioned	Effective Tenor to Maturity (Years)	Coupon Rate	Offered (Kshs bn)	Raised (Kshs bn)	Total bids received	Average Yield	Subscription Rate	Acceptance Rate
11/1/2021	FXD1/2021/002	2.0	9.5%	25.00	55.9	61.2	9.5%	244.6%	91.3%
25/01/2021	IFB1/2021/016	16.0	12.3%	50.0	81.1	125.5	12.3%	250.9%	64.6%
8/2/2021	FXD1/2013/15	7.1	11.3%	50.0	9.4	13.6	11.8%	83.7%	76.7%
	FXD1/2012/20	11.8	12.0%		22.7	28.3	12.6%		

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22/02/2021	FXD1/2013/15 (Tap Sale)	7.1	11.8%	18.0	7.0	7.2	11.8%	62.4%	97.1%
	FXD1/2012/20 (Tap Sale)	11.8	12.6%		3.9	4.1	12.6%		
15/03/2021	FXD1/2019/10	8.0	12.4%	50.0	15.5	15.9	12.4%	97.4%	99.2%
	FXD2/2018/20	17.4	13.2%		32.8	32.8	13.4%		
Q1’2021 Average			**11.7%**	**38.6**	**27.9**	**36.5**	**11.8%**	**147.8%**	**84.9%**
Q4’2020 Average			**11.8%**	**34.4**	**15.4**	**18.0**	**12.2%**	**56.8%**	**85.2%**

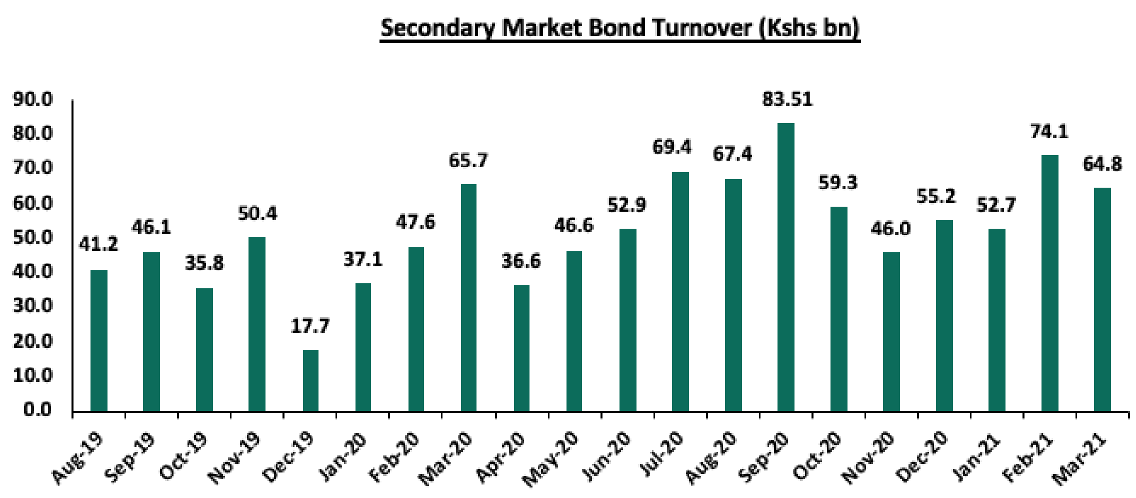
Key take-outs from the table above are:

i. Primary bonds issued in Q1’2021 were oversubscribed, with the subscription rate averaging 147.8% for the quarter, higher than the average subscription rate for Q4’2019, which was 56.8%. This was mainly attributable to investors preference on longer dated papers to lock in the good yields,
ii. The average acceptance rate for the quarter came in at 84.9%, as the CBK continued to reject bids deemed expensive to maintain the rates low, and,
iii. The government reopened two bonds on a tap sale, namely FXD1/2013/15 and FXD1/2012/2020 in the month of February to plug in any deficits from the initial issuances earlier in the month. However, the re-opened bonds were still undersubscribed, recording a subscription rate averaging 62.4%, lower than the 83.7% in the first issuance. The undersubscription was attributable to the short bidding period and the saturation of bonds with similar tenor in the market. The government accepted Kshs 228.3 bn against a target of Kshs 288.4 bn during the quarter.

Secondary Bond Market Activity:

A. **Bond Turnover**

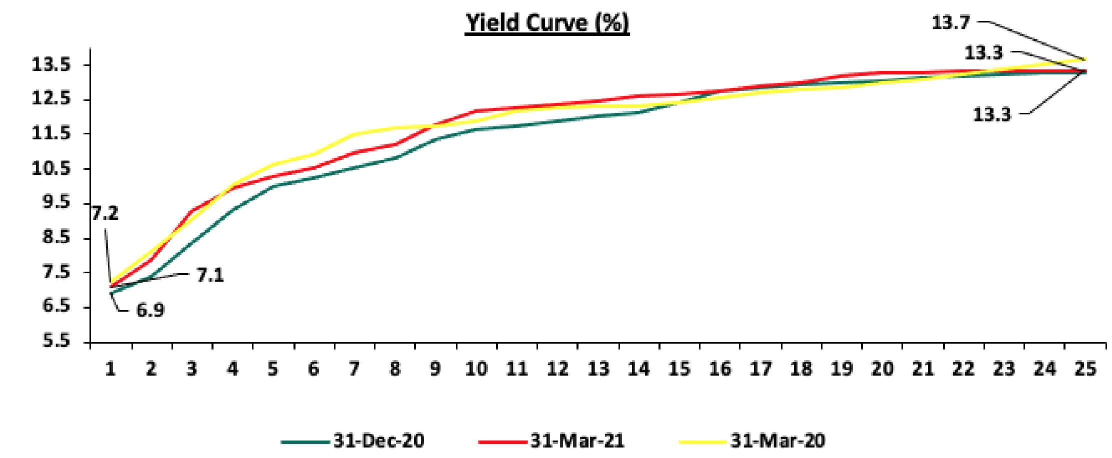
The secondary bond market recorded increased activity, with the turnover increasing by 27.4% to Kshs 191.6 bn, from Kshs 150.4 bn in Q1’2020, partially attributable to local institutional investors increasing their allocation to treasury bonds considered a safe haven in this period of market uncertainties.



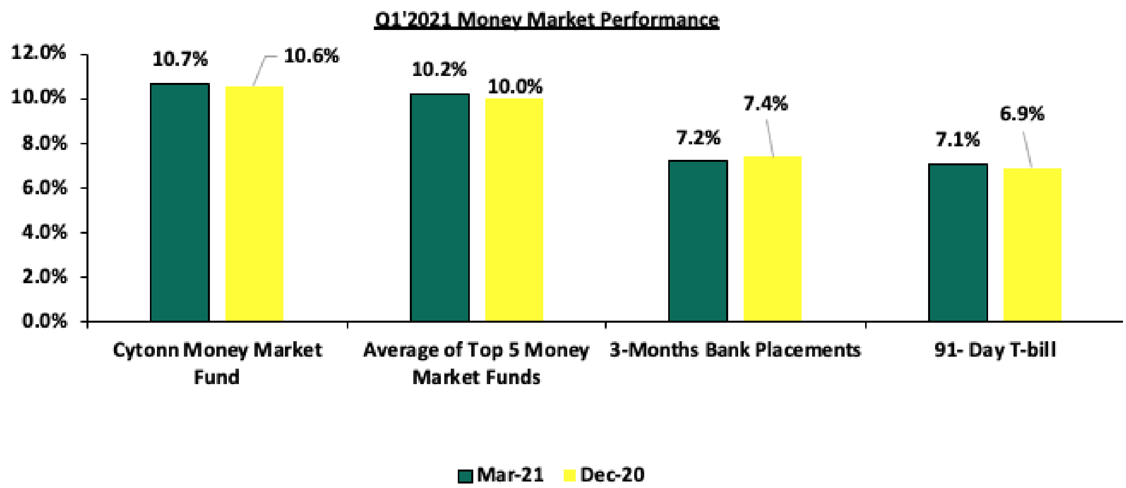
B. **Yield Curve**

The yield curve has readjusted upwards from the December levels as the government sought to raise more cash from the market. The increase led to the FTSE bond Index registering a negative return of

(1.0%). We expect the rise in the yield curve to be sustained in the coming quarter, mainly because increased borrowing appetite by the government coupled with investors hunt for higher yields. The graph below indicates the various movements:



Money Market Performance



In the money markets, 3-month bank placements ended the week at 7.2% lower than 7.4% recorded at the end of Q4'2020 (based on what we have been offered by various banks), the 91-day T-bill remained unchanged at 7.1% during the week, but was 0.2% points higher than the 6.9% at the end of Q4'2020, while the average of Top 5 Money Market Funds remained unchanged at 10.2% during the week, which was higher than the 10.0% at the end of Q4'2020 but averaged at 10.0% during the quarter. The yield on the Cytonn Money Market (CMMF) declined by 0.2% points to 10.7%, from 10.9% recorded the previous week, during Q1'2021 CMMF averaged a 10.7% return.

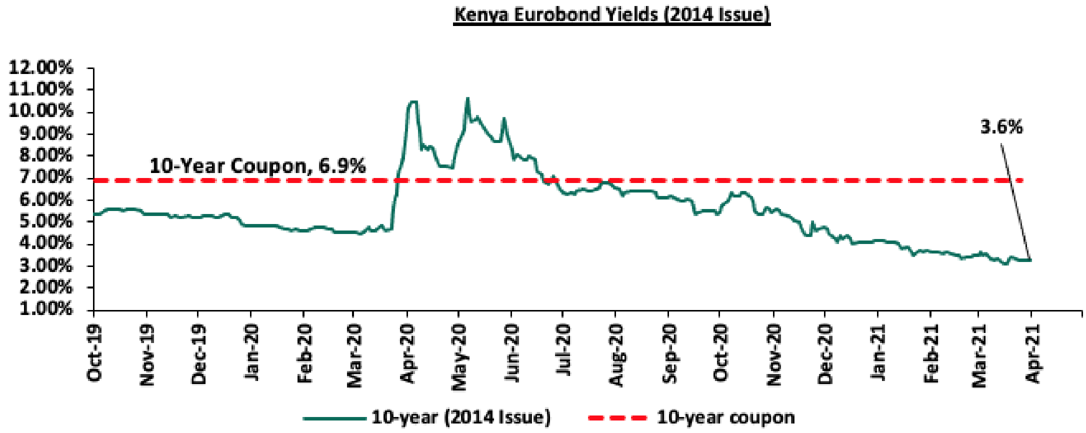
Liquidity:

In Q1'2021, liquidity in the money market eased, as evidenced by the decline in the interbank rate to 5.4%, from 6.0% the previous quarter. Additionally, the average volumes traded in the interbank market increased by 1.6% to Kshs 15.8 bn, from Kshs 15.5 bn recorded in Q4'2020. The increased liquidity in the market was supported by government payments and debt maturities.

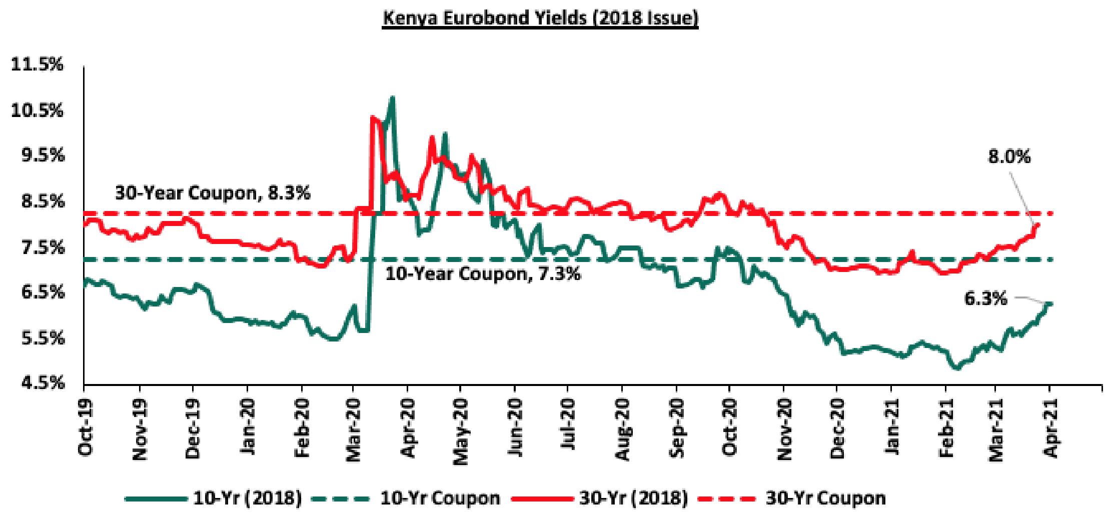
During the week, liquidity eased with the average interbank rate declining to 5.4%, from 5.6% recorded the previous week attributable to government payments which offset tax remittances. Additionally, there was a 43.1% increase in the average volumes traded in the interbank market to Kshs 15.8 bn, from Kshs 11.0 bn the previous week.

Kenya Eurobonds:

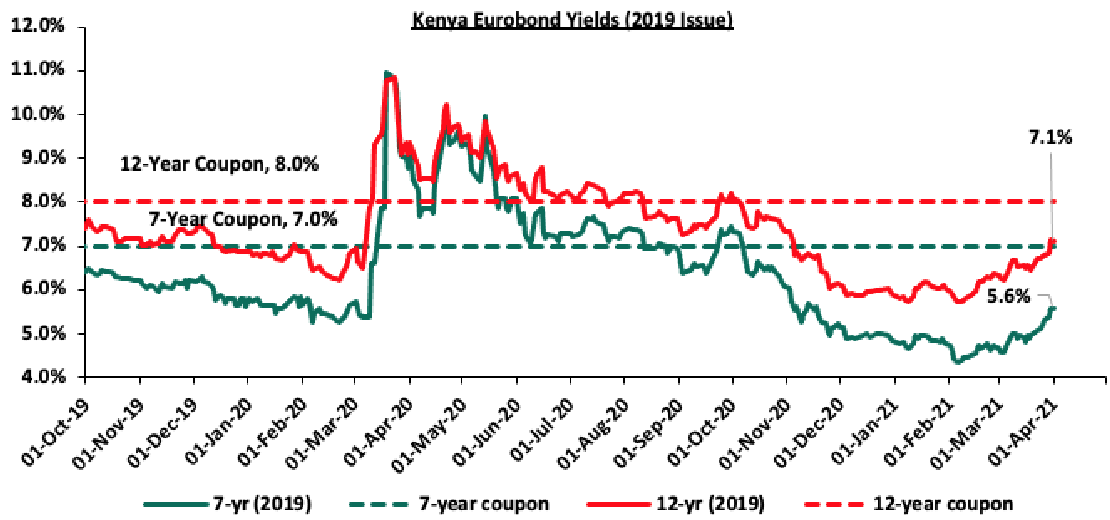
During Q1'2021, there was a mixed performance of the Eurobonds issued, we saw increases in the dual-tranche Eurobonds issued in 2018 and 2019 and decreases in the 10-year Eurobond issued in 2014. The mixed performance points to the fact that investors are still seeking direction as they try to get how the Credit downgrades and the economic expectations are affecting the credit outlook of the country.



During the week, the yield on the 30-year increased marginally by 0.3% points to 8.0%, from the 7.7% recorded last week, while the yield on the 10-year Eurobond increased by 0.4% points to 6.3% from 5.9% recorded last week.



During the week, the yield on the 7-year Eurobond issued in 2019 increased by 0.4% points, to 5.6%, from 5.2% recorded the previous week while the yields on the 12-year Eurobond issued in 2019 increased by 0.3% points to 7.1% from 6.8% recorded the previous week.



Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 17.2% behind its domestic borrowing target, having borrowed Kshs 346.7 bn against a pro-rated target of Kshs 418.5 bn or 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.
