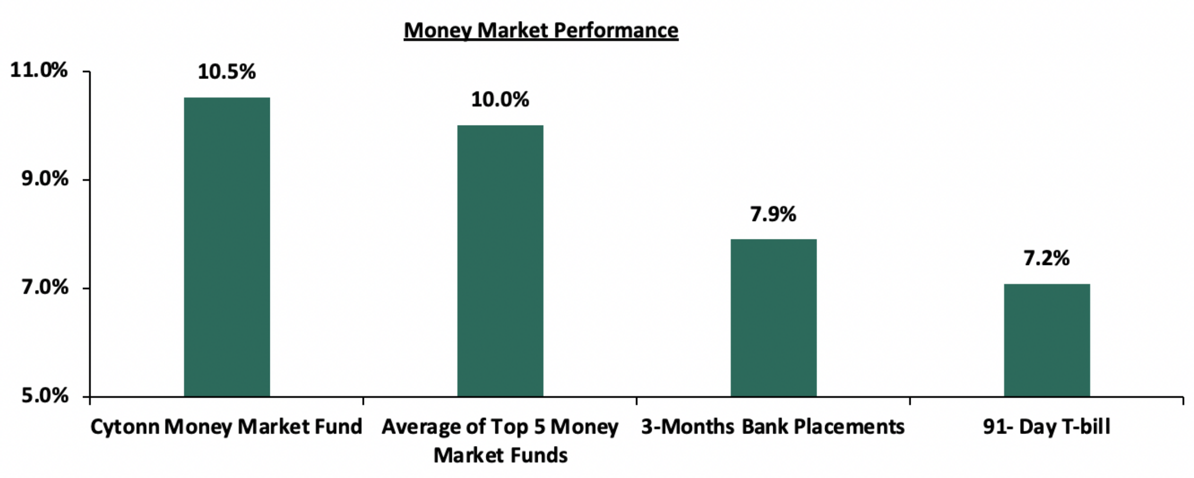
Unit Trust Fund Performance FY'2020, & Cytonn Weekly #18/2021

Fixed Income

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

During the week, T-bills were oversubscribed, with the overall subscription rate coming in at 131.0%, up from 125.0% recorded the previous week. The demand for the 364-day paper remained high, as it recorded the highest bids worth Kshs 25.3 bn against the offered Kshs 10.0 bn, translating to a subscription rate of 253.2%, an increase from the 245.4% recorded the previous week. The subscription rate for the 182-day paper increased to 42.6%, from 37.5% recorded the previous week, receiving bids worth Kshs 4.3 bn against Kshs 10.0 bn offered. The subscription rate for the 91-day paper also increased to 46.5%, from 42.7% recorded the previous week, with the paper receiving bids worth Kshs 1.9 bn against the intended Kshs 4.0 bn. The yields on the 91-day and 182-day papers increased to 7.2% and 8.0%, while the yields on the 364-day paper declined to 9.4%. The government continued to reject expensive bids, accepting 66.2% of the bids received, amounting to Kshs 20.8 bn, out of the Kshs 31.4 bn worth of bids received.

In the Primary Bond Market, the two bonds reopened by the government for the month of May recorded an overall subscription rate of 142.0%. Investors preferred the longer dated paper, FXD1/2021/25, with a tenor of 25 years, which received bids worth Kshs 31.0 bn, against the Kshs 30.0 bn offered amount which translated to a subscription rate of 103.4%. On the other hand, FXD2/2019/15 received bids worth Kshs 11.6 bn against the Kshs 30.0 bn offered, translating to a subscription rate of 38.6%. The average yields on the two bonds were 13.0% and 13.9% for FXD2/2019/15 and FXD1/2021/25, respectively. The government continued rejecting expensive bids by accepting Kshs 20.3 bn of the Kshs 42.5 bn worth of bids received, translating to an acceptance rate of 47.6%.



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 1.3 bps to 7.2%. The average yield of the Top 5 Money Market Funds remained unchanged at 10.0%. Similarly, the yield on the Cytonn Money Market Fund remained unchanged at 10.5%. The table below shows the Money Market Fund Yields for Kenyan fund managers as published on 7th May 2021:

Money Market Fund Yield for Fund Managers as published on 7th May 2021

Rank	Fund Manager	Daily Yield	Effective Annual Rate
1	Cytonn Money Market Fund	10.01%	10.53%
2	Nabo Africa Money Market Fund	9.65%	10.09%
3	Zimele Money Market Fund	9.56%	9.91%
4	Alphafrica Kaisha Money Market Fund	9.41%	9.82%
5	GenCapHela Imara Money Market Fund	9.16%	9.59%
6	Madison Money Market Fund	9.13%	9.55%
7	CIC Money Market Fund	8.97%	9.29%
8	Sanlam Money Market Fund	8.98%	9.22%
9	Dry Associates Money Market Fund	8.60%	8.95%
10	Co-op Money Market Fund	8.31%	8.66%
11	British-American Money Market Fund	8.29%	8.61%
12	Apollo Money Market Fund	8.43%	8.50%
13	NCBA Money Market Fund	8.04%	8.36%
14	ICEA Lion Money Market Fund	8.02%	8.35%
15	Old Mutual Money Market Fund	6.68%	6.89%
16	AA Kenya Shillings Fund	5.53%	5.67%

Liquidity:

During the week, liquidity in the money market improved, with the average interbank rate declining to 4.6%, from 5.2% recorded the previous week, attributable to end-month government payments coupled with Kshs 33.4 bn worth of government securities maturities. The average interbank volumes increased by 25.0% to Kshs 8.0 bn, from Kshs 6.4 bn recorded the previous week. According to the Central Bank of Kenya's weekly bulletin, released on 7th May 2021, commercial banks' excess reserves came in at Kshs 12.3 bn in relation to the 4.25% Cash Reserve Ratio.

Kenya Eurobonds:

During the week, the yields on Eurobonds recorded mixed performance, with the yields on the 10-year Eurobond issued in June 2014, 10-year bond issued in 2018 and 7-year bond issued in 2019 remaining unchanged at 3.2%, 5.7% and 5.0%, respectively, while the yields on the 30-year bond issued in 2018 and the 12-year bond issued in 2019 declined to 7.6% and 6.6%, from 7.7% and 6.7%, 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%
30-April-2021	3.2%	5.7%	7.7%	5.0%	6.7%
03-May-2021	3.2%	5.8%	7.7%	5.0%	6.7%
04-May-2021	3.2%	5.8%	7.6%	5.0%	6.7%
05-May-2021	3.3%	5.8%	7.6%	5.0%	6.7%
06-May-2021	3.2%	5.7%	7.6%	5.0%	6.6%
07-May-2021	3.2%	5.7%	7.6%	5.0%	6.6%
Weekly Change	**0.0%**	**0.0%**	**(0.1%)**	**0.0%**	**(0.1%)**
MTD Change	**0.0%**	**0.0%**	**(0.1%)**	**0.0%**	**(0.1%)**
YTD Change	**(0.7%)**	**0.5%**	**0.6%**	**0.1%**	**0.7%**

Source: Reuters

Kenya Shilling:

During the week, the Kenyan shilling appreciated against the US dollar by 0.9% to Kshs 106.9, from Kshs 107.8 recorded the previous week, attributable to reduced dollar demand from general importers. On a YTD basis, the shilling has appreciated by 2.1% against the dollar, in comparison to the 7.7% depreciation recorded in 2020. We expect the shilling to remain under pressure in 2021 as a result of:

a. Rising uncertainties in the global market due to the Coronavirus pandemic, which has seen investors continue to prefer holding their investments in dollars and other hard currencies and commodities, and,
b. Continued strengthening of the US Dollar against major currencies as evidenced by a YTD gain of 0.9% in the ICE U.S. Dollar Index as compared to a 6.7% decline in 2020. The ICE U.S. Dollar Index is a benchmark index that measures the international value of the US Dollar where investors can monitor the value of the US Dollar relative to a basket of six other world currencies.

The shilling is however expected to be supported by:

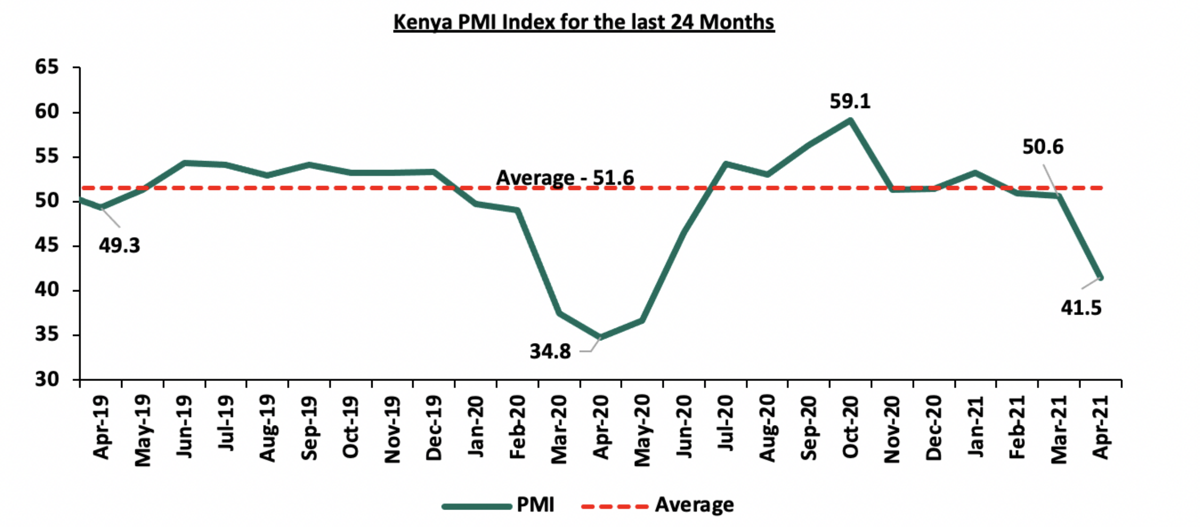
i. The Forex reserves, currently at USD 7.6 bn (equivalent to 4.6-months of import cover), which is above the statutory requirement of maintaining at least 4.0-months of import cover, and the EAC region’s convergence criteria of 4.5-months of import cover,
ii. The improving current account position which 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 27.1% y/y increase to USD 290.8 mn in March 2021, from USD 228.8 mn recorded over the same period in 2020, has cushioned the shilling

against further depreciation.

Weekly Highlights:

A. **April Stanbic PMI Figures**

The headline Purchasing Managers' Index (PMI) for the month of April, 2021 declined to 41.5 from the 50.6 recorded in March 2021, attributable to a decline in new orders, which was mainly driven by the partial lockdown and increased curfew hours seen in major parts of the country. New business declined at a pace mirroring that seen during the initial COVID-19 lockdown in H1'2020, and as a result, firms cut employment numbers for the first time in seven months. See below a chart summarising the evolution of the PMI over the last 24 months:



**** Key to note, a reading above 50.0 signals an improvement in business conditions, while readings below 50.0 indicate a deterioration*

B. **April 2021 KRA Revenue Collection**

The Kenya Revenue Authority (KRA) surpassed the revenue target collection for the month of April 2021 by recording a collection of Kshs 176.7 bn against a target of Kshs 170.2 bn, the collection was a 23.9% increase from the Kshs 144.1 bn collected in April 2020. Notably, this is the fifth month in a row that KRA has surpassed the revenue collection targets, mainly attributable to the enhanced Debt collection program adopted by KRA and the reversal of tax cut measures in January 2021 that had been put in place in April 2020 to cushion the economy from the impact of the COVID-19 pandemic. We expect revenue collection to continue surpassing the set monthly targets given the recent reopening of the economy which will improve the business environment.

Finance Bill 2021

The Cabinet Secretary for National Treasury tabled the Finance Bill 2021 before parliament for consideration as part of the Fiscal year 2021/22 budget cycle to be accented to law by 30th June 2021. The bill seeks to amend several Acts including:

i. The Excise Duty Act which will include an introduction of a 20.0% betting tax which had been scrapped in the Finance Bill 2020. The bill will also remove the 20.0% excise duty charged on bank loans which will bring down the total cost of borrowing,
ii. Value Added Tax (VAT) Act which will see an inclusion of some medical suppliers in to the list of VAT exempt goods, as well as the granting of powers to the National Treasury Cabinet Secretary to alter the VAT Act without seeking the approval of parliament,
iii. The Capital Markets Act Cap 485A which establishes a Capital Markets tribunal, as well as

amending the powers of the Capital Markets and the time the tribunal takes to hear and determine an appeal and,

iv. The Retirement Benefits Act No 2 of 1997, where the managers, administrators and custodians shall be required to be registered under this Act, as well as setting out the regulations for registration and deregistration of these services providers,

The amendments are meant to generate additional tax collection as well as widening the current tax base. We see the changes as part of enhancing and strengthening the capital markets and ensuring that investors' interests are protected. The other amendments will also boost the revenue collection especially given the huge size of the FY'2021/22 budget, standing at Kshs 3.1 tn.

C. **FY'2021/22 Budget Estimates**

On 29th April 2021, the National Treasury presented its Budget Estimates for the next fiscal year, FY'2021/22. The budget is projected to increase by 5.6% to Kshs 3.1 tn from last year's Kshs 2.9 tn. Overall, the country's budget has been growing at a 10 year CAGR of 11.3% to Kshs 2,774.7 bn in FY 2020/21 from Kshs 947.8 bn in FY' 2011/12. The table below shows the budget numbers over the last 10 years;

Comparison of the Budget Numbers over the last 10 years

Item	FY'11/12	FY'12/13	FY'13/14	FY'14/15	FY'15/16	FY'16/17	FY'17/18	FY'18/19	FY'19/20	FY'20/21
Total revenue	748.2	845.1	1,001.0	1,107.8	1,219.1	1,400.6	1,522.4	1,671.1	1,737.0	1,892.6
External grants	15.3	20.9	27.0	28.1	29.6	26.3	26.5	19.7	19.8	40.9
Total revenue & Grants	**763.5**	**866.1**	**1,028.0**	**1,135.9**	**1,248.7**	**1,426.9**	**1548.9**	**1,690.8**	**1,756.8**	**1,933.5**
Recurrent expenditure	647.1	808.3	814.5	895.2	982.6	1,142.4	1,349.7	1,496.2	1,645.2	1,826.7
Development expenditure	300.7	298.9	319.3	510.1	485.4	645.8	469.7	542.0	594.3	589.7
County Transfer	0.0	9.8	193.4	234.7	478.5	320.8	327.3	367.7	325.3	358.3
Total expenditure	**947.8**	**1,117.0**	**1,327.2**	**1,640.0**	**1,946.4**	**2,109.0**	**2,146.7**	**2,405.9**	**2,564.8**	**2,774.7**
Fiscal deficit	**(184.3)**	**(251.0)**	**(299.2)**	**(504.1)**	**(697.8)**	**(708.4)**	**(597.7)**	**(715.2)**	**(808.0)**	**(841.2)**
Deficit as % of GDP	5.7%	5.6%	5.9%	8.7%	10.7%	9.2%	7.0%	7.5%	7.9%	7.5%
Net foreign borrowing	98.5	62.2	104.7	217.5	269.9	385.7	355.0	414.5	340.4	346.8
Net domestic borrowing	73.2	168.9	203.0	254.0	204.6	311.5	276.3	306.5	450.4	494.3
Total borrowing	**171.7**	**231.1**	**307.7**	**471.5**	**474.6**	**697.3**	**631.3**	**721.1**	**790.8**	**841.1**
GDP Estimate	3,244.5	4,506.2	5,044.2	5,811.2	6,508.1	7,695.2	8,524.7	9,510.4	10,175.2	11,275.8

The resources have been aligned to priority programs under the Big Four Agenda, the Third Medium Term Plan (2018-2022) of the Vision 2030 blueprint, and various initiatives under the Post Covid-19 Economic Recovery Strategy.

Below is a summary of the major changes as per the 2021 Budget Estimates:

Comparison of 2020/21 and 2021/22 Fiscal Year Budgets as per The 2021 Budget Estimates

	FY'2020/21 Budget	**FY'2020/21 Supplementary Budget I (a)**	**FY'2021/22 Budget Policy Statement**	**FY'2021/22 Budget Estimates (b)**	**% Y/Y Change (a, b)**
Total revenue	1,892.6	1,848.0	2,033.9	2,038.6	10.3%
External grants	40.9	73.0	46.1	62.0	(15.1%)

Comparison of 2020/21 and 2021/22 Fiscal Year Budgets as per The 2021 Budget Estimates

	FY'2020/21 Budget	FY'2020/21 Supplementary Budget I (a)	FY'2021/22 Budget Policy Statement	FY'2021/22 Budget Estimates (b)	% Y/Y Change (a, b)
Total revenue & external grants	**1,933.5**	**1,921.0**	**2,080.0**	**2,100.6**	**9.3%**
Recurrent expenditure	1,826.7	1,835.1	1,986.0	2,019.2	10.0%
Development expenditure & Net Lending	589.7	653.0	609.1	619.5	(5.1%)
County governments + contingencies	358.3	403.9	414.9	414.8	2.7%
Total expenditure	**2,774.7**	**2,892.0**	**3,010.0**	**3,053.5**	**5.6%**
Fiscal deficit excluding grants	**(841.1)**	**(970.9)**	**(930.0)**	**(952.9)**	**(1.9%)**
Deficit as % of GDP	7.5%	8.7%	7.5%	7.7%	(1.0)
Net foreign borrowing	346.8	427.0	267.2	290.1	(32.1%)
Net domestic borrowing	494.3	543.9	662.8	662.8	21.9%
Total borrowing	**841.1**	**970.9**	**930.0**	**952.9**	**(1.9%)**
GDP Estimate	11,275.8	11,168.5	12,393.1	12,393.1	11.0%

Source: National Treasury, Amounts in Kshs bns

i. The 2021 Budget estimates point to a 5.6% increase of the budget, to Kshs 3.1 tn from Kshs 2.9 tn in the FY’ 2020/21 supplementary budget,
ii. Recurrent expenditure is set to increase by 10.0% to Kshs 2.0 tn, from Kshs 1.8 tn as per the supplementary budget, while development expenditure is projected to decline by 5.1% to Kshs 619.5 bn from Kshs 653.0 bn as per the FY’2020/21 supplementary budget. Under recurrent expenditures, ministerial recurrent expenditures increased by 4.8% to Kshs 1,321.7 bn, from Kshs 1,261.0 bn, while interest payment and pension increased by 21.5% to Kshs 697.5 bn from Kshs 574.1 bn in the FY2020/21 supplementary budget,
iii. The budget deficit is projected to decline to Kshs 952.9 bn (7.7% of GDP) from the projected Kshs 970.9 bn (8.7% of GDP) in the FY’2020/21 supplementary budget; in line with the International Monetary Fund’s (IMF’s) recommendation, in a bid to reduce Kenya’s public debt requirements,
iv. Revenue is projected to increase by 10.3% to Kshs 2.0 tn, from Kshs 1.9 tn in the FY’2020/21 supplementary budget, with measures already in place to work towards increasing the amount of revenue collected in the next fiscal year,
v. Total borrowing is expected to decline by 1.9% to Kshs 952.9 bn from Kshs 970.9 bn as per the FY’2020/21 supplementary budget, and,
vi. Debt financing of the 2021/22 budget is estimated to consist of 30.4% foreign debt and 69.6% domestic debt, from 28.7% foreign and 71.3% domestic as per the FY’2020/21 supplementary budget,

Similar to governments across the world, the FY'2021/2022 budget estimates point to an expansionary budget in a bid to steer the country out of the pandemic-driven economic downturn. The budget is however hinged on meeting the revenue collection targets, expected to be boosted by the relaxation of the tax cushions that had been implemented during the peak of the pandemic last year. This premise however ought to be a factor of economic recovery which is still uncertain given the uncertainty surrounding the persistence of the pandemic. The fiscal deficit is estimated to reduce to 7.7% of GDP, mainly as a result of an expected decline in recurrent expenditure and an improvement in revenues. The latter will be highly dependent on how well the government will be able to implement some of the measures put in place. Debt sustainability continues to be a key concern, with the country’s public debt-to-GDP ratio having increased considerably over the past five years to 69.6% as at December 2020, from 44.3% as at the end of 2013, with half of the debt being external. In our view, there are still concerns on how the government will be able to meet its revenue collection targets given that the country is still experiencing effects from the third wave of the pandemic. However, changes that touch on tax revenues in the current environment where there is heightened uncertainty may have unintended budgetary consequences. For more analysis please see our FY2021-22 Budget Estimates Note.

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 0.1% behind its prorated borrowing target of Kshs 473.6 bn having borrowed Kshs 473.2 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. The high deficit and the lower credit rating from S&P Global to 'B' from 'B+' 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 fixed income securities to reduce duration risk.
