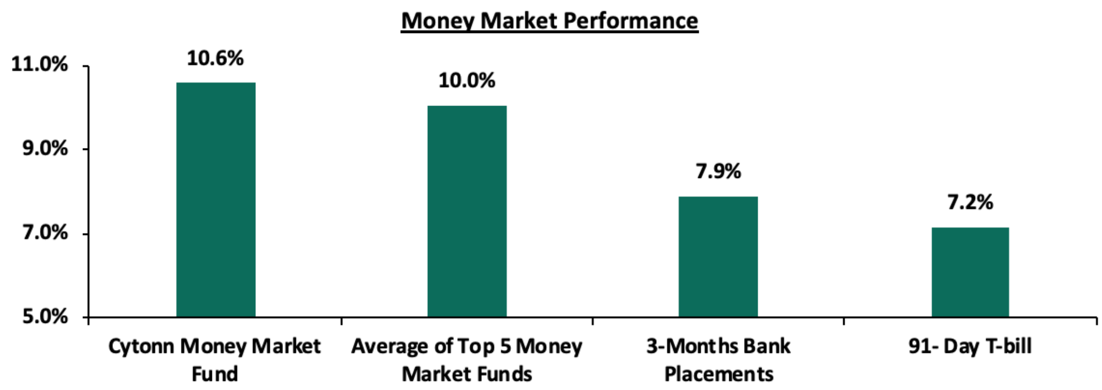
Currency and Interest Rates Outlook, & Cytonn Weekly #20/2021

Fixed Income

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

During the week, T-bills remained oversubscribed, with the overall subscription rate coming in at 162.0%, up from 110.7% recorded the previous week. The demand for the 364-day paper persisted, as it recorded the highest bids worth Kshs 24.1 bn against the offered Kshs 10.0 bn, translating to a subscription rate of 241.3%, an increase from the 222.6% recorded the previous week. Investors' continued interest in the 364-day paper is mainly attributable to the attractive return of 9.3% from the paper which is higher than the rate for most bank placements. The subscription rate for the 182-day paper increased to 101.1%, from 28.9% recorded the previous week, receiving bids worth Kshs 10.1 bn against the Kshs 10.0 bn offered. The subscription rate for the 91-day paper also increased to 116.1%, from 35.7% recorded the previous week, with the paper receiving bids worth Kshs 4.6 bn against the offered amounts of Kshs 4.0 bn. The yields on all the three papers declined; with the 91-day, 182-day and 364-day paper declining by 0.1 bps, 4.2 bps and 8.1 bps, to 7.2%, 8.0 and 9.3%, respectively. The government continued to reject expensive bids, accepting Kshs 22.4 bn out of the Kshs 38.9 bn worth of bids received, translating to an acceptance rate of 57.5%.



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 declined marginally by 0.1 bps to 7.2%. The average yield of the Top 5 Money Market Funds declined to 10.0%, from the 10.1% recorded the previous week. The yield on the Cytonn Money Market Fund remained unchanged at 10.6%, similar to what was recorded the previous week. The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 21st May 2021:

Money Market Fund Yield for Fund Managers as published on 21st May 2021

Rank	Fund Manager	Daily Yield	Effective Annual Rate
1	Cytonn Money Market Fund	10.05%	10.58%

Money Market Fund Yield for Fund Managers as published on 21st May 2021

Rank	Fund Manager	Daily Yield	Effective Annual Rate
2	Nabo Africa Money Market Fund	9.87%	10.33%
3	Zimele Money Market Fund	9.56%	9.91%
4	GenCapHela Imara Money Market Fund	9.35%	9.80%
5	Alphafrica Kaisha Money Market Fund	9.22%	9.62%
6	Madison Money Market Fund	9.06%	9.48%
7	CIC Money Market Fund	9.01%	9.33%
8	Sanlam Money Market Fund	8.79%	9.19%
9	Dry Associates Money Market Fund	8.52%	8.86%
10	Co-op Money Market Fund	8.44%	8.80%
11	British-American Money Market Fund	8.26%	8.58%
12	Apollo Money Market Fund	8.43%	8.50%
13	NCBA Money Market Fund	8.04%	8.35%
14	ICEA Lion Money Market Fund	8.00%	8.33%
15	Old Mutual Money Market Fund	7.19%	7.43%
16	AA Kenya Shillings Fund	6.01%	6.18%

Liquidity:

During the week, liquidity in the money market tightened, with the average interbank rate increasing to 4.9%, from 4.0% recorded the previous week, partly attributable to tax remittances which offset Government payments. The average interbank volumes declined by 32.7% to Kshs 7.6 bn, from Kshs 11.3 bn recorded the previous week.

Kenya Eurobonds:

During the week, the yields on all Eurobonds declined, with the yields on the 10-year Eurobond issued in June 2014, 10-year bond issued in 2018, 30-year bond issued in 2018, 7-year bond issued in 2019 and 12-year bond issued in 2019 declining to 3.1%, 5.4%, 7.4%, 4.7% and 6.3%, from 3.2%, 5.8%, 7.5%, 5.1% and 6.6%, respectively. The yields decline was partly attributable to improved investor confidence, following the announcement by the International Monetary Fund (IMF) that it has reached a staff-level agreement with Kenya to enable the nation access a loan of USD 410.0 mn (Kshs 44.4 bn). For a developing country, like Kenya, that is suffering from ballooning public debt, slow revenue collection and whose economy has been heavily and adversely effected by macroeconomic factors such as the ongoing pandemic, participating in an IMF loan program not only provides relief directly through loan funds but also helps to signal to investors that the IMF believes the nation has adequate fiscal policies in place to support its own recovery. The improved sentiments in turn lead to investors attaching a lower risk to debt instruments issued by the country and hence the decline in the Kenyan Eurobond yields during the week.

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%
14-May-21	3.2%	5.8%	7.5%	5.1%	6.6%
17-May-21	3.1%	5.7%	7.5%	5.0%	6.5%
18-May-21	3.1%	5.5%	7.5%	4.9%	6.3%
19-May-21	3.2%	5.6%	7.5%	5.0%	6.4%
20-May-21	3.2%	5.6%	7.5%	4.9%	6.4%
21-May-21	3.1%	5.4%	7.4%	4.7%	6.3%
Weekly Change	**(0.1%)**	**(0.4%)**	**(0.1%)**	**(0.3%)**	**(0.3%)**
MTD Change	**(0.1%)**	**(0.3%)**	**(0.3%)**	**(0.3%)**	**(0.4%)**
YTD Change	**(0.8%)**	**0.2%**	**0.4%**	**(0.1%)**	**0.4%**

Source: Reuters

Kenya Shilling:

During the week, the Kenyan shilling depreciated against the US dollar by 1.1% to close at Kshs 108.2, from Kshs 107.0 recorded the previous week, mainly attributable to the build-up of dollar demand ahead of the end of the month when firms typically meet their hard currency obligations. On a YTD basis, the shilling has appreciated by 0.5% 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. Demand from merchandise traders as they beef up their hard currency positions in anticipation for more trading partners reopening their economies globally,

The shilling is however expected to be supported by:

i. The Forex reserves, currently at USD 7.5 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 43.8% y/y increase to USD 299.3 mn in April 2021, from USD 208.2 mn recorded over the same period in 2020, has cushioned the shilling against further depreciation.

Weekly Highlights:

I. **International Monetary Fund (IMF) Loan Facility**

During the week, the International Monetary Fund (IMF) announced that it had reached a staff level agreement with the Kenyan authorities that will allow Kenya to access the second tranche of USD 410.0 mn (Kshs 44.4 bn) once the review is formally completed by the IMF Executive Board. The funds are part of an approved 38-month loan facility totaling to USD 2.34 bn (Kshs 253.3 bn) that was announced in April 2021, of which USD 308.0 mn (Kshs 33.3 bn) was released on 3rd April 2021, and subsequent tranches were to be released following frequent loan programme reviews. The credit facility is aimed at assisting Kenya to (i) stabilize its economy, and, (ii) create a sustainable growth path.

The expected receipt of the Kshs 44.4 bn loan funds will increase Kenya's external debt by 1.2% to 3.9 tn from Kshs 3.8 tn and increase the total debt to Kshs 7.4 tn. We expect the economy to continue facing fiscal challenges occasioned by the pandemic as businesses continue to suffer from Covid-19 effects. Despite this, the extension of the IMF loan has improved investor sentiments towards the country as evidenced by the decline in Eurobond yields during the week. Additionally, according to the IMF, Kenya's economy is now projected to recover by 6.3% in 2021, down from the earlier projected annual growth rate of 7.6% released in April 2021.

II. **MPC May 2021**

The Monetary Policy Committee (MPC) is set to meet on Wednesday, 26th May 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) and any other policy measure like the Cash Reserve Ratio. In their previous meeting held on 29th March 2021, the committee maintained the CBR at 7.0%, citing that the accommodative policy stance adopted in March 2020, and all the other sittings since, which saw a cumulative 125 bps cut, was having the intended effects on the economy. This was in line with our expectations.

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

a. Stable Inflation which is projected to remain within the 2.5%-7.5% target range despite the recent increases in fuel prices,
b. The stable macros and limited transmission mechanism to translate any additional cuts into increased economic activity growth due to underlying fundamental and structural challenges. Any additional cuts are not likely to stimulate private sector credit growth which stood at 7.7% as of March 2021, due to the elevated credit risks persist in the current environment, and,
c. The FY'2021/22 budget estimates indicate that the government will set aside Kshs 26.6 bn of funds through the Post - COVID recovery strategy, of which, Kshs 8.6 bn will go towards enhancing liquidity to businesses. We expect that these funds will be directed towards reviving the economy and as such, we believe that this will reduce pressure on the MPC to pursue additional policy measures.

For a more detailed analysis, please see our MPC Note here.

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 1.4% behind of its prorated borrowing target of Kshs 495.6 bn having borrowed Kshs 488.6 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 having collected Kshs. 1,337.4 bn as at 10 months to April 2021, compared to Kshs 1,383.7 bn prorated target collection 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.

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