Cytonn Monthly - May 2021

Fixed Income

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

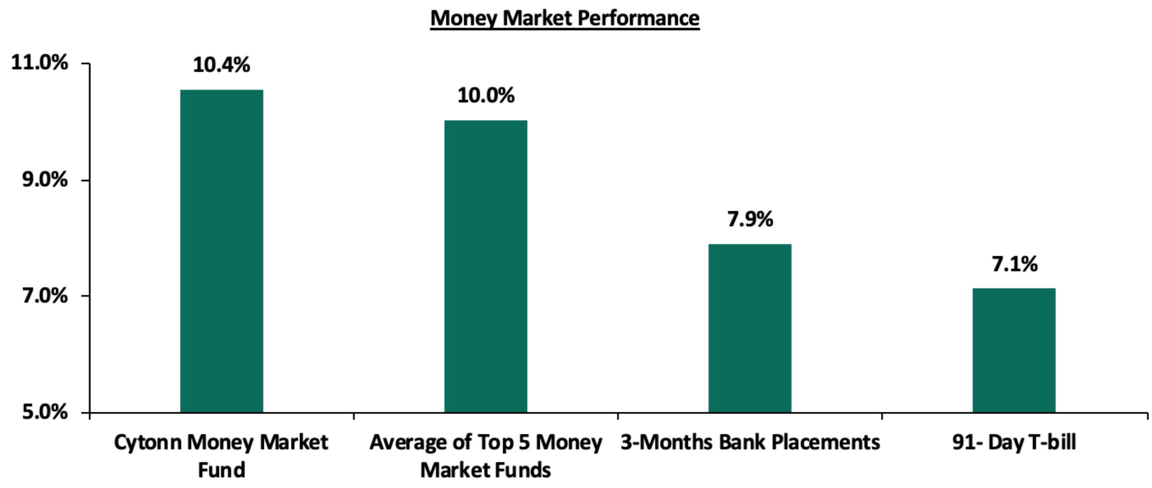
During the month of May, T-bill auctions recorded an oversubscription, with the overall subscription rate coming in at 136.2%, an increase from 89.1% recorded in April. The continued high demand for the 364-day paper was reflected in the increased subscription rate to 144.2%, from 91.0% recorded the previous month. Investors' continued interest in the 364-day paper, during the month, is mainly attributable to the paper's attractive return of 9.0% which is higher than the rate being offered by most banks. The subscription rate for the 182-day papers increased to 21.8% from the 20.6%, while the subscription rate for the 91-day declined to 25.0%, from 68.6% recorded in April. The yields on the 364-day and 182-day papers declined by 31.8 bps and 12.4 bps to 9.0% and 7.8%, respectively, while the yields on the 91-day paper remained unchanged at 7.1%. For the month the government accepted a total of Kshs 104.6 bn, out of the Kshs 163.5 bn worth of bids received as they sought to contain rates.

During the week, T-bills remained oversubscribed with the overall subscription rate coming in at 162.5%, an increase from the 152.4% recorded the previous week. The demand for the 364-day paper persisted, as it recorded the highest bids worth Kshs 27.6 bn against the offered Kshs 10.0 bn, translating to a subscription rate of 276.3%, an increase from the 238.2% recorded the previous week. The continued interest in the 364-day paper is mainly attributable to investors rushing to lock in the paper's attractive return of 9.0% given that the rates have been declining over the past few weeks. The subscription rate for the 182-day paper declined to 100.0%, from 103.1% recorded the previous week, receiving bids worth Kshs 10.0 bn. The subscription rate for the 91-day paper declined to 34.3%, from 116.1% recorded the previous week, with the paper receiving bids worth Kshs 1.4 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 0.2 bps, 4.7bps and 18.3 bps, to 7.1%, 7.8% and 9.0%, respectively. The government continued to reject expensive bids, accepting Kshs 22.9 bn out of the Kshs 39.0 bn worth of bids received, translating to an acceptance rate of 58.7%.

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% for FXD2/2019/15 and 13.9% for FXD1/2021/25. 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%.

During the week, the government reopened bidding for two bonds, FXD1/2019/20 and FXD1/2012/20, with tenors of 17.9 years and 11.4 years, respectively, whose offer period ends on 15th June 2021. The coupon rates are 12.9% for FXD1/2019/20 and 12.0% for FXD1/2012/20. We expect the investors to prefer the longer dated paper, FXD1/2019/20, as they consider the prevailing risks posed by the pandemic. We recommended bidding of the two bonds at 12.9%-13.2% and

12.3%-12.6% for each bond 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 declined marginally by 0.2 bps to 7.1%. The average yield of the Top 5 Money Market Funds remained unchanged at 10.0%, similar to what was recorded the previous week. The yield on the Cytonn Money Market Fund declined to 10.4% from the 10.6%, recorded the previous week.

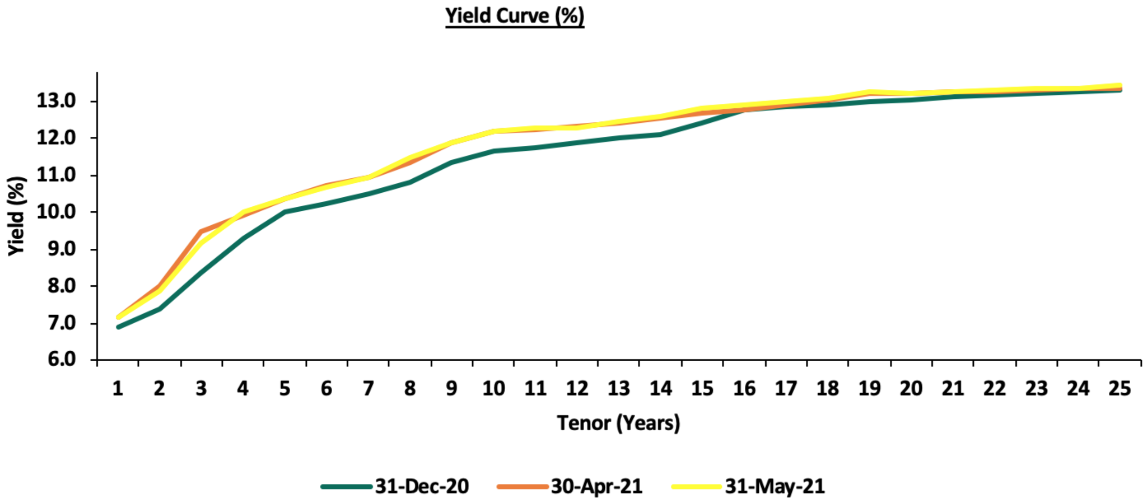
The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 4th June 2021:

Money Market Fund Yield for Fund Managers as published on 4th June 2021

Rank	Fund Manager	Daily Yield	Effective Annual Rate
1	Cytonn Money Market Fund	9.91%	10.41%
2	Nabo Africa Money Market Fund	9.53%	9.96%
3	GenCapHela Imara Money Market Fund	9.50%	9.96%
4	Zimele Money Market Fund	9.56%	9.91%
5	Alphafrica Kaisha Money Market Fund	9.22%	9.62%
6	CIC Money Market Fund	9.08%	9.40%
7	Madison Money Market Fund	8.97%	9.38%
8	Sanlam Money Market Fund	8.82%	9.22%
9	Co-op Money Market Fund	8.53%	8.90%
10	Dry Associates Money Market Fund	8.29%	8.61%
11	Apollo Money Market Fund	8.48%	8.59%
12	British-American Money Market Fund	8.20%	8.52%
13	NCBA Money Market Fund	8.03%	8.33%
14	ICEA Lion Money Market Fund	8.01%	8.33%
15	Old Mutual Money Market Fund	7.06%	7.30%
16	AA Kenya Shillings Fund	5.99%	6.16%

Secondary Bond Market:

In the month of May, the yields on government securities in the secondary market remained relatively stable, while the bond turnover increased by 55.3% to Kshs 102.0 bn, from Kshs 65.2 bn recorded in April. The FTSE NSE bond index declined marginally by 0.1%, to close the month at 96.8, bringing the YTD performance to a decline of 1.2%. The chart below is the yield curve movement during the period;



Liquidity:

Liquidity in the money markets improved, with the average interbank rate ending the month at 5.0%, a 0.2% points decline from the April average rate of 5.2%. During the week, liquidity in the money market eased, with the average interbank rate declining to 4.8%, from 5.0%, recorded the previous week, partly attributable to Government payments which partly offset end of the month obligations. The average interbank volumes increased by 48.0% to Kshs 13.6 bn, from Kshs 9.2 bn recorded the previous week.

Kenya Eurobonds:

During the month, the yields on all Eurobonds were on a downward trajectory. The decline in the yields was partly attributable to improved investor confidence, following the recent announcement by the International Monetary Fund (IMF) that it had reached a staff-level agreement with Kenya to enable the nation access a loan of USD 410.0 mn (Kshs 44.4 bn) to aid in stabilizing Kenya's economy and create a sustainable growth path. The yield on the 10-year Eurobond issued in September 2014 declined to 3.0%, from 3.2% in April. The yields on the 10 year and the 30-year Eurobond issued in 2018 declined to 5.2% and 7.3%, from 5.7% and 7.7%, recorded in April, respectively. Additionally, the yields on the 2019 issued dual-tranche Eurobond with 7-years and 12-years declined to 4.6% and 6.2% in May, from 5.0% and 6.7%, respectively in April.

During the week, the yields on Eurobonds recorded mixed performance. The yields on the 10-year Eurobond issued in June 2014, 10-year bond issued in 2018, 7-year bond issued in 2019 declined to 3.0%, 5.2% and 4.6%, from 3.1%, 5.3% and 4.7%, respectively. On the other hand, the yields on the 30-year bond issued in 2018 and the 12-year bond issued in 2019 remained unchanged at 7.3% and 6.2%, respectively. Below is a summary of the performance:

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%

Kenya Eurobond Performance

	2014	2018		2019	
27-May-21	3.1%	5.3%	7.3%	4.7%	6.2%
28-May-21	3.1%	5.3%	7.3%	4.7%	6.2%
31-May-21	3.1%	5.3%	7.3%	4.7%	6.2%
01-June-21	3.1%	5.3%	7.3%	4.6%	6.2%
02-June-21	3.1%	5.3%	7.3%	4.6%	6.2%
03-June-21	3.0%	5.2%	7.3%	4.6%	6.2%
Weekly Change	**(0.1%)**	**(0.1%)**	**(0.0%)**	**(0.1%)**	**(0.0%)**
M/M Change	**(0.1%)**	**(0.5%)**	**(0.4%)**	**(0.3%)**	**(0.4%)**
YTD Change	**(0.9%)**	**0.0%**	**0.3%**	**(0.3%)**	**0.3%**

Source: Reuters

Kenya Shilling:

During the month, the Kenya Shilling appreciated by 0.2% against the US Dollar to close the month at Kshs 107.6, from Kshs 107.8 recorded at the end of April 2021, mostly attributable to the lackluster dollar demand from general importers.

During the week, the Kenyan shilling depreciated against the US dollar by 0.2% to close the week at Kshs 107.7, from Kshs 107.6 recorded the previous week, mainly due to dollar demand from commodity importers outweighing the supply of dollars from exporters. On a YTD basis, the shilling has appreciated by 1.3% against the dollar, in comparison to the 7.7% depreciation recorded in 2020. Despite the recent appreciation of the shilling, 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 stable current account position which is estimated to be at a deficit of 5.2% of GDP in the 12 months to April 2021 and is projected to remain at the same level in 2021, 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, which has cushioned the shilling against further depreciation.

Weekly Highlights:

Inflation

The y/y inflation for the month of May increased to 5.9%, from the 5.8% recorded in April, with the month on month inflation increasing by 0.2%. The increase was mainly attributable to the increase in food inflation as the increase in prices of some food items outweighed the decline in prices of other foodstuffs. From the table below, it’s clear that the transport index has had the greatest increase for both year on year and month on month.

Major Inflation Changes – May 2021

Broad Commodity Group	Price change m/m (May-21/April -21)	Price change y/y (May-21/May-20)	Reason
Food & Non-Alcoholic Beverages	0.3%	7.0%	The m/m increase was mainly contributed by increase in prices of Onion, Kale and cabbages among other food items
Housing, Water, Electricity, Gas and other Fuel	(0.2%)	3.2%	The m/m increase was as a result of increase in the price of charcoal and electricity
Transport Cost	0.7%	16.8%	The m/m increase was mainly on account of an increase in pump prices of petrol of 2.9% between April and May
Overall Inflation	**0.2%**	**5.9%**	**The m/m increase was due to a 0.3% increase in the food and non-alcoholic drinks’ cost, mainly driven by the increase in prices of food items**

Going forward, we expect the inflation rate to remain within the government’s set range of 2.5% - 7.5% despite the recent increases in the fuel prices. Food prices are likely to remain low due to favorable rainfall received.

Monthly Highlights:

1. The Cabinet Secretary for the National Treasury announced that they had presented the Finance Bill 2021 to Parliament for consideration. Overall, the Finance Bill 2021 is aimed at increasing revenue partly by encouraging manufacturing and industrial activities and increasing tax rates as seen in the case of ordinary bread. For more information, see our Cytonn Weekly#18/2021 and Cytonn Weekly #21/2021 ,
2. The Energy and Petroleum Regulatory Authority (EPRA) released their monthly statement on the maximum wholesale and retail pricesfor fuel prices in Kenya effective 15th May 2021 to 14th June 2021. Super Petrol prices increased by 2.9% to Kshs 126.4 per litre, from Kshs 122.8 per litre recorded in April, while the prices of diesel and kerosene remained unchanged at Kshs 107.7 and 97.9 per litre, respectively. Notably, this is the second consecutive month that the diesel and kerosene prices have remained unchanged. For more information, see our Cytonn Weekly #19/2021,
3. The International Monetary Fund (IMF) announcedthat it had reached a staff level agreement with the Kenyan authorities that would 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 totalling 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. For more information, see our Cytonn Weekly #20/2021,
4. The Monetary Policy Committee (MPC) met on Wednesday, 26thMay 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. 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. For more information, see our Cytonn Weekly #20/2021, and,

5. The National Treasury gazetted the revenue and net expenditures for the first ten months of FY'2021/2021, ending on 30th April 2021. Total revenue collected as at the end of April 2021 amounted to Kshs 2.2 tn, equivalent to 74.1% of the revised target of Kshs 2.9 tn and is 88.9%, the total expenditure amounted to Kshs 2.2 tn, equivalent to 73.6% of the revised budget of Kshs 2.9 tn and is 88.3% of the prorated expenditure estimates. Additionally, Total Borrowings as at the end of April 2021 amounted to Kshs 0.8 tn, equivalent to 66.2% of the revised target of Kshs 1.3 tn. For more information, see our Cytonn Weekly #21/2021

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 4.4% behind its prorated borrowing target of Kshs 517.6 bn having borrowed Kshs 494.6 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. 1,190.6 bn in the first 10 months to April 2021, compared to Kshs 1,224.8 bn prorated target collection for FY'2020/2021, thus leading to a budget deficit of 8.7% larger 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 might create uncertainty in the interest rate environment. In our view, investors should be biased towards short-term fixed income securities to reduce duration risk.