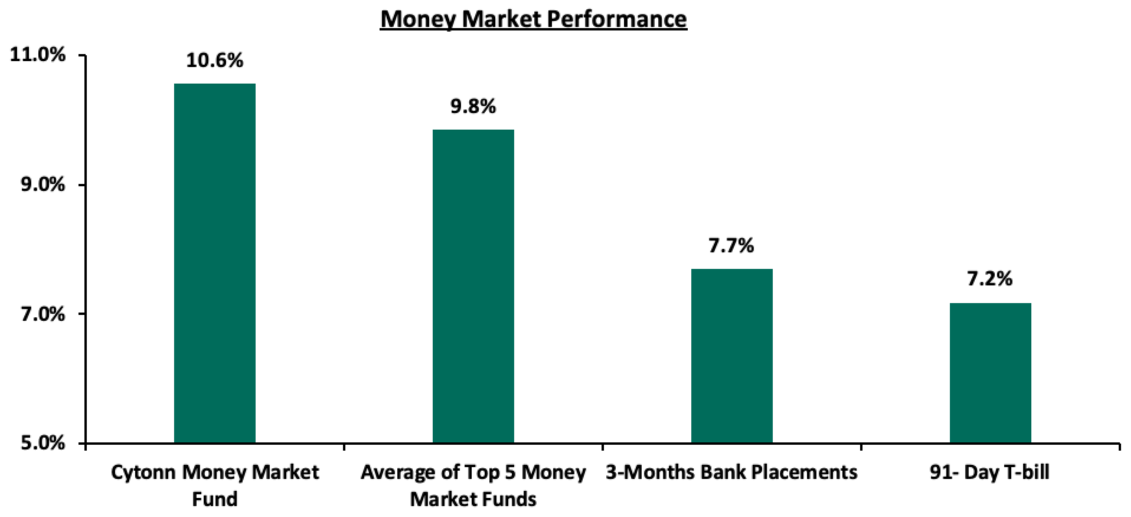
Regulatory Changes in the Kenyan Pensions Industry, & Cytonn Weekly #47/2021

Fixed Income

Money Markets, T-Bills Primary Auction:

During the week, T-bills recorded an undersubscription, with the overall subscription rate coming in at 64.5%, down from the 108.6% recorded the previous week, partly attributable to tightened liquidity in the money market. The 91-day paper recorded the highest subscription rate, receiving bids worth Kshs 3.9 bn against the offered Kshs 4.0 bn, translating to a subscription rate of 98.4%, a decline from the 209.9% recorded the previous week. The subscription rate for the 364-day and 182-day papers declined to 90.3% and 25.2%, from 92.0% and 84.8%, respectively, recorded the previous week. The yields on the 91-day, 182-day and 364-day papers increased by 6.7 bps, 8.8 bps and 10.4 bps, to 7.2%, 7.8% and 8.9%, respectively. The government continued to reject expensive bids accepting Kshs 13.0 bn of the Kshs 15.5 bn worth of bids received, translating to an acceptance rate of 83.9%.

In the Primary Bond Market, the government reopened two bonds, FXD4/2019/10 and FXD1/2018/20, with effective tenors of 8.0 years, and 16.4 years, respectively, in a bid to raise Kshs 40.0 bn for budgetary support. The period of sale for the issue runs from 22nd November to 7th December 2021. The coupon rates are 12.3% and 13.2% for FXD4/2019/10 and FXD1/2018/20, respectively. We expect investors to prefer the longer dated paper, FXD1/2018/20, as they search for higher yields. The bonds are currently trading in the secondary market at yields of 12.3% and 13.0%, for FXD4/2019/10 and FXD1/2018/20, respectively, and as such, our recommended bidding range for the two bonds is: 12.1%-12.5% for FXD4/2019/10 and 12.8%-13.2% for FXD1/2018/20 within which bonds of a similar tenor are trading at.



In the money markets, 3-month bank placements ended the week at 7.7% (based on what we have been offered by various banks), while the yield on the 91-day T-bill increased by 6.7 bps to 7.2%. The average yield of the Top 5 Money Market Funds increased by 0.1% points to 9.8%, from 9.7% recorded last week, while the yield on the Cytonn Money Market Fund remained relatively unchanged at 10.6%.

The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 26th November:

Money Market Fund Yield for Fund Managers as published on 26th November 2021

Rank	Fund Manager	Effective Annual Rate
1	Cytonn Money Market Fund	10.57%
2	Zimele Money Market Fund	9.91%
3	Nabo Africa Money Market Fund	9.70%
4	Madison Money Market Fund	9.54%
5	Sanlam Money Market Fund	9.52%
6	CIC Money Market Fund	9.19%
7	Apollo Money Market Fund	8.95%
8	GenCapHela Imara Money Market Fund	8.95%
9	Co-op Money Market Fund	8.74%
10	Dry Associates Money Market Fund	8.65%
11	British-American Money Market Fund	8.55%
12	Orient Kasha Money Market Fund	8.39%
13	ICEA Lion Money Market Fund	8.37%
14	NCBA Money Market Fund	8.36%
15	Old Mutual Money Market Fund	7.33%
16	AA Kenya Shillings Fund	6.81%

Source: Business Daily

Liquidity:

During the week, liquidity in the money market tightened, with the average interbank rate increasing by 4.2 bps to 5.24% from 5.20% recorded the previous week, partly attributable to tax remittances which partly offset government payments. The average interbank volumes traded declined by 11.5% to Kshs 9.7 bn, from Kshs 11.0 bn recorded the previous week.

Kenya Eurobonds:

During the week, yields on all Eurobonds increased, with yields on the 10-year issue issued in 2014, 10-year bond issued in 2018, and 12-year bond issued in 2021 all increasing by 0.3% points to 4.1%, 5.9% and 6.7%, respectively, while yields on the 30-year bond issued in 2018, 7-year bond issued in 2019 and 12-year bond issued in 2019 all increased by 0.2% to 8.1%, 5.6% and 6.8%, respectively. Below is a summary of the performance:

Kenya Eurobond Performance

	2014	2018		2019		2021
Date	**10-year issue**	**10-year issue**	**30-year issue**	**7-year issue**	**12-year issue**	**12-year issue**
31-Dec-20	3.9%	5.2%	7.0%	4.9%	5.9%	-
29-Oct-21	3.7%	5.7%	7.9%	5.5%	6.7%	6.5%
19-Nov-21	3.8%	5.6%	7.9%	5.5%	6.6%	6.4%
22-Nov-21	4.0%	5.7%	7.9%	5.6%	6.7%	6.5%
23-Nov-21	4.1%	5.9%	8.1%	5.7%	6.8%	6.7%
24-Nov-21	4.1%	6.0%	8.1%	5.8%	6.9%	6.7%
25-Nov-21	4.1%	5.9%	8.1%	5.6%	6.8%	6.7%
Weekly Change	**0.3%**	**0.3%**	**0.2%**	**0.2%**	**0.2%**	**0.3%**
MTD Change	**0.3%**	**0.0%**	**0.1%**	**0.1%**	**0.0%**	**0.0%**
YTD Change	**0.2%**	**0.7%**	**1.1%**	**0.7%**	**0.9%**	**-**

Kenya Shilling:

During the week, the Kenyan shilling depreciated marginally by 0.2% against the US dollar to close the week at Kshs 112.4, from Kshs 112.2 recorded the previous week, mainly attributable to increased dollar demand from commodity and energy sector importers outweighing the supply of dollars from exporters. Key to note, these is the lowest the Kenyan shilling has ever depreciated against the dollar. On a YTD basis, the shilling has depreciated by 2.9% against the dollar, in comparison to the 7.7% depreciation recorded in 2020. We expect the shilling to remain under pressure for the remainder of 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,
b. Increased demand from merchandise traders as they beef up their hard currency positions in anticipation for more trading partners reopening their economies globally, and,
c. Rising global crude oil prices on the back of supply constraints at a time when demand is picking up with the easing of COVID-19 restrictions and as economies reopen.

The shilling is however expected to be supported by:

i. The Forex reserves, currently at USD 8.8 bn (equivalent to 5.4-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. In addition, the reserves were boosted by the USD 1.0 bn proceeds from the Eurobond issued in July, 2021 coupled with the USD 407.0 mn IMF disbursement and the USD 130.0 mn World Bank loan financing received in June, 2021, and,

ii. Improving diaspora remittances evidenced by a 28.2% y/y increase to USD 337.4 mn in October 2021, from USD 263.1 mn recorded over the same period in 2020, which has continued to cushion the shilling against further depreciation.

Weekly Highlights:

I. **November MPC Meeting**

The Monetary Policy Committee (MPC) is set to meet on Monday, 29th November 2021 to review the outcome and effectiveness 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 (CRR). In their previous meeting held on 28th September 2021, the committee maintained the CBR at 7.00%, in line with our expectations, citing that the accommodative policy stance adopted in March 2020 and all other sittings ever since, remained appropriate and were having the desired effects on the economy. We expect the MPC to maintain the Central Bank Rate (CBR) at 7.00% with their decision mainly being supported by;

i. We foresee the MPC taking a wait and see approach as it monitors the recovery of the economy. Kenya's economy recorded a 10.1% growth in Q2'2021, up from the 0.7% growth in Q1'2021 and the 4.7% contraction recorded in Q2'2020. We believe that despite this recovery, the slow vaccine inoculation and the emergence of the new variants will continue to weigh down the recovery of the economy. As such, we believe that the MPC will keep monitoring the macro-economic indicators before pursuing any additional policy measures,
ii. Inflation is expected to remain stable and within the government's target range of 2.5% -7.5% on account of the stable fuel prices. October inflation declined to 6.5%, from 6.9% recorded in September, supported by the decline in fuel prices following the re-instatement of the Fuel Subsidy program. However, we believe that the stabilization under the fuel subsidy program by the National Treasury is unsustainable should the average landed costs of fuel keep rising. We anticipate inflation pressures to remain elevated in the short term driven by the rising global fuel prices due to supply bottlenecks, and,
iii. The need to support the shilling from further depreciations having depreciated by 1.6% to Kshs 112.2 as of 19th November 2021, from Kshs 110.4 recorded in September 2021. We believe that the forex reserve of USD 8.9 bn (equivalent to 5.4 months of import cover) as of 19th November 2021 will continue to support the shilling from foreign exchange shocks in the short term. As such, this will reduce pressure on the Central Bank to pursue any additional policy measures.

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

II. **November Inflation projections**

We are projecting the y/y inflation rate for November 2021 to fall within the range of 6.0% - 6.4%. The key drivers include:

- Fuel prices for the period 15th November 2021 to 14th December 2021 remained unchanged at Kshs 129.7 per litre for Super Petrol, Kshs 110.6 per litre for Diesel and Kshs 103.5 per litre for Kerosene. With fuel being a major contributor to Kenya's headline inflation, maintaining constant fuel prices is expected to have a muted impact on the inflation basket,
- Food prices have remained relatively stable during the month attributable to improvement in agricultural output due to the ongoing rains in some parts of the country, and,
- Downward readjustment of the foreign exchange fluctuation tariff for electricity usage, which

significantly declined by 40.3% to Kshs 73.0 cents per Kilowatt hour (KWh) in November, from Kshs 1.0 per Kilowatt hour (KWh) in October 2021. However, the fuel cost charge on electricity bills increased by 6.0% to Kshs 4.2 per Kilowatt hour (KWh) in November, from Kshs 4.0 per Kilowatt hour (KWh) in October. The readjustments will decrease the cost of electricity consumption for households.

Going forward, we expect the inflation rate to remain within the government's set range of 2.5% - 7.5%. However, concerns remain high on the widening trade deficit as global fuel prices continue to rise due to supply bottlenecks. We expect the CBK and the Government to employ conducive monetary and fiscal policies in-order to comply with the conditions set by the IMF in the Extended Credit facility agreement in February 2021. In the agreement, IMF indicated that Kenya's inflation should remain well anchored and between the government target range so that Kenya can continue accessing the loan facility already approved. Given that the IMF announced it had reached a Staff Level Agreement on the Second Reviews of the Extended Fund Facility, the government has to ensure that inflation does not surge above the current levels in order to access the USD 264.0 mn loan facility.

Rates in the fixed income market have remained relatively stable due to the sufficient levels of liquidity in the money markets. The government is 21.8% ahead of its prorated borrowing target of Kshs 278.6 bn having borrowed Kshs 339.4 bn of the Kshs 658.5 bn borrowing target for the FY'2021/2022. We expect a gradual economic recovery going into FY'2021/2022 as evidenced by KRAs collection of Kshs 598.5 bn in revenues during the first four months of the current fiscal year, which is equivalent to 101.1% of the prorated revenue collection target. However, despite the projected high budget deficit of 7.5% and the lower credit rating from S&P Global to 'B' from 'B+', we believe that the support from the IMF and World Bank will mean that the interest rate environment will remain stable since the government is not desperate for cash.