# Investment Options for Your Pension Upon Retirement, & Cytonn Weekly #34/2019

## Fixed Income

T-bills were undersubscribed during the week, with the overall subscription rate decreasing to 71.6%, from 86.8% recorded the previous week. The yield on the 91-day and 364-day papers remained unchanged at 6.4% and 9.2%, respectively, while the yield on the 182-day paper fell by 0.1% points to 7.0% from 7.1% recorded the previous week. The acceptance rate for all treasury bills bid decreased to 89.2%, from 99.6% the previous week, with the government accepting Kshs 15.3 bn of the Kshs 17.2 bn worth of bids received, lower than the weekly quantum of Kshs 24.0 bn. The 91-day paper recorded improved subscription to 129.5%, from 68.8% recorded the previous week, while the 182-day and 364-day papers recorded a downturn in subscription to 12.3% and 107.9% from 29.4% and 151.5% recorded the previous week, respectively.

For the month of September, the Government is set to re-open two 15-year bonds, (FXD 1/2018/15) and (FXD 2/2019/15) for a total of Kshs 50.0 bn for budgetary support. The Government has issued the two medium-tenor bonds, in a bid to plug in the budget deficit, while at the same time trying to reduce the maturity risk profile of government debt.  We expect the bonds to be oversubscribed as per recent trends, mainly driven by the perception that risks may not be adequately priced on the longer end of the yield curve, which is relatively flat due to saturation of long-term bonds, which has resulted in a lot of interest in the short and medium term bonds. We will give our bidding range in next week's report.

In the money markets, 3-month bank placements remained unchanged, ending the week at 8.6% (based on what we have been offered by various banks). The 91-day T-bill was also unchanged, ending the week at 6.4%, while the average of Top 5 Money Market Funds came in at 9.5% compared to 9.6% last week, with the Cytonn Money Market Fund closing the week at 11.0%, compared to 11.1% last week.

The table below is an extract showing the growth of money market funds of the fund managers who have released their H1'2019 results so far;

| No. | Fund Managers | H1'2018 Money Market Fund(Kshs mn) | FY'2018 Money Market Fund (Kshs mn) | H1'2019 Money Market Fund(Kshs mn) | Annualized H1'2019 growth |
|---|---|---|---|---|---|
| 1 | Cytonn Money Market Fund | 19.7 | 62.8 | 306.9 | 777.4% |
| 2 | Commercial Bank of Africa | 4,238.3 | 4,946.9 | 5,837.0 | 36.0% |
| 3 | CIC Asset Managers | 15,204.9 | 19,756.7 | 23,279.2 | 35.7% |

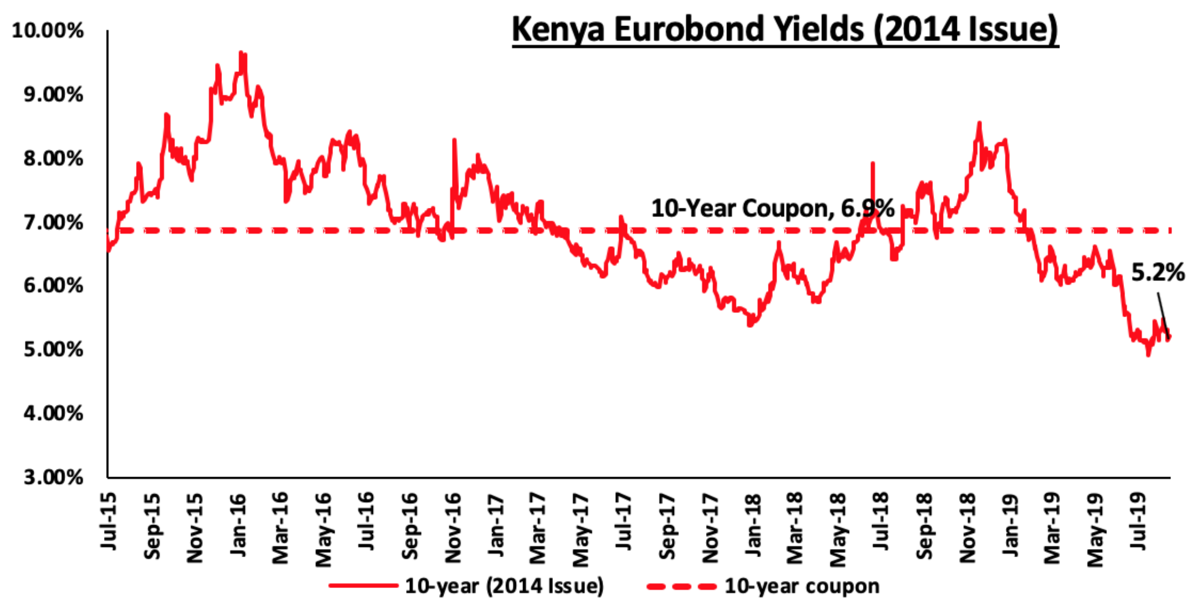
| No. | Fund Managers | H1'2018 Money Market Fund(Kshs mn) | FY'2018 Money Market Fund (Kshs mn) | H1'2019 Money Market Fund(Kshs mn) | Annualized H1'2019 growth |
|---|---|---|---|---|---|
| 4 | ICEA Lion | 5,253.8 | 5,916.3 | 6,438.6 | 17.7% |
| 5 | British American Asset | 5,267.8 | 5,871.1 | 6,303.6 | 14.7% |
| 6 | Stanlib Kenya | 2,267.9 | 2,141.0 | 1,890.1 | (23.4%) |
| 7 | Alpha Africa | - | - | 30.5 | - |
| | **Total** | **32,252.4** | **38,694.8** | **44,055.4** | **32.7%** |

**Liquidity:**

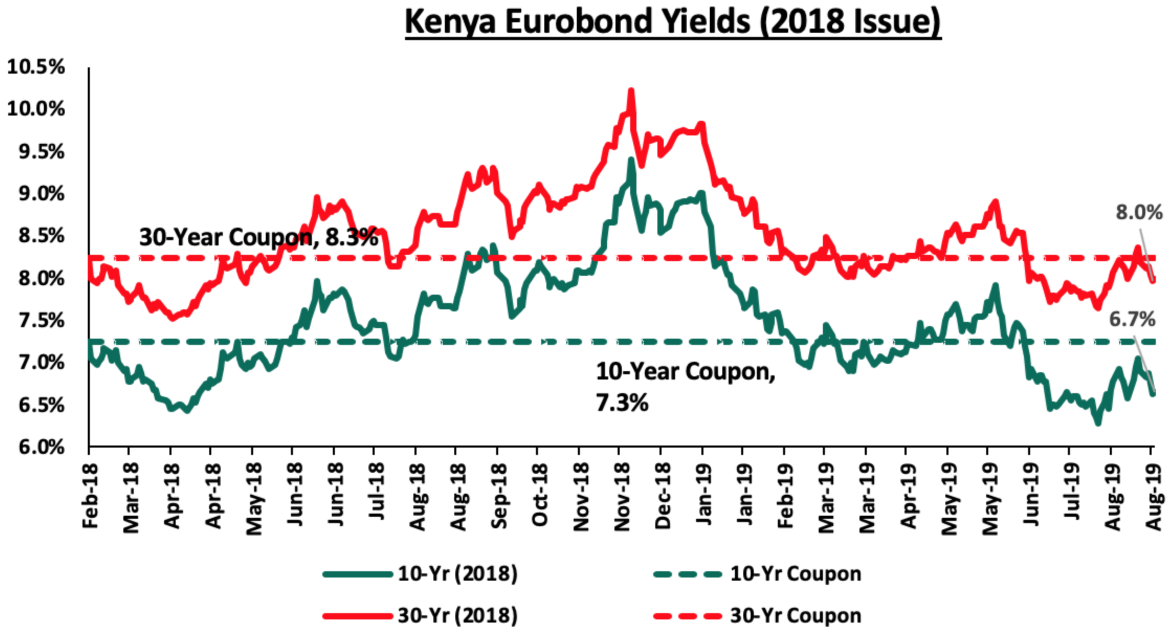
Liquidity in the market improved during the week, with the average interbank rate dropping to 3.3% from 3.6% recorded the previous week supported by government payments, which partly offset tax payments. Commercial banks' excess reserves stood at Kshs 8.3 bn in relation to the 5.25% cash reserves requirement (CRR). The average volumes traded in the interbank market rose by 88.5% to Kshs 16.1 bn from Kshs 8.5 bn the previous week.

**Kenya Eurobonds:**

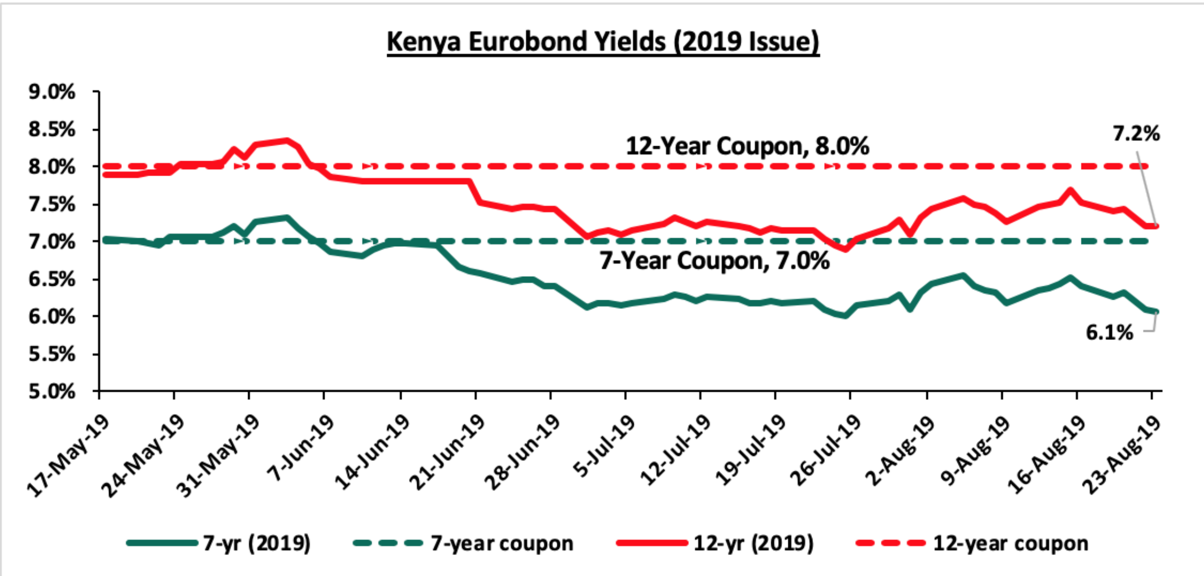
The yield on the 10-year Eurobond issued in 2014 fell by 0.1% points to 5.2%, from 5.3% recorded the previous week. The continued decline in yields has been attributed to increased demand for emerging market fixed-income securities in the wake of the pause by the US Fed on its three-year cycle of tightening its monetary policy, which had made returns from fixed income securities more attractive as highlighted in our H1'2019 SSA Eurobond Performance Note.




For the February 2018 Eurobond issue, yields on both the 10-year Eurobond and the 30-year Eurobond dropped by 0.2% points to 6.7% and 8.0%, from 6.9% and 8.2% recorded the previous week, respectively.




For the newly issued dual-tranche Eurobond with 7-years and 12-years tenor, priced at 7.0% for the 7-year tenor and 8.0% for the 12-year tenor, respectively, the yields on both the 7-year bond and the 12-year bond dropped by 0.3% points to 6.1% and 7.2% from 6.4% and 7.5% recorded the previous week, respectively.




**The Kenya Shilling:**

During the week, the Kenya Shilling appreciated marginally against the US Dollar to close at Kshs 103.1, from Kshs 103.3 recorded the previous week, supported by inflows from diaspora remittances and portfolio investors buying government debt amid dollar demand from merchandise importers. The Kenya Shilling has depreciated by 1.2% year to date, in comparison to the 1.3% appreciation in 2018. Despite the recent depreciation, we still expect the shilling to remain relatively stable to the dollar in the short term, supported by:

i. The narrowing of the current account deficit, with preliminary data indicating that the current account deficit narrowed to 4.2% of GDP in the 12-months to June 2019, from 5.4% recorded in June 2018. The decline has been attributed to the resilient performance of exports particularly horticulture and coffee, strong diaspora remittances, and higher receipts from tourism and transport services. Growth of imports also slowed mainly due to lower imports of food,
ii. Improving diaspora remittances, which have increased cumulatively by 13.6% in the 12-months to

June 2019 to USD 2.8 bn, from USD 2.4 bn recorded in a similar period of review in 2018. The rise is due to:

   a. Increased uptake of financial products by the diaspora due to financial services firms, particularly banks, targeting the diaspora, and,
   b. New partnerships between international money remittance providers and local commercial banks making the process more convenient,

iii. CBK's supportive activities in the money market, such as repurchase agreements and selling of dollars, and,
iv. High levels of forex reserves, currently at USD 9.4 bn (equivalent to 5.9-months of import cover), 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.

**Weekly Highlights**

The National Treasury released the budgetary review for the 2018/2019 financial year. Below are the key take-outs:

*Amounts in Kshs bns unless stated otherwise*

**Q4' FY 2018/2019 Budget Outturn**

| Item | FY'2017/2018 | FY'2018/2019 | | | |
|---|---|---|---|---|---|
| | **Collected/Spent** | **Collected/Spent** | **Target** | **% met** | **Change y/y** |
| Total revenue | 1,522.4 | 1,671.1 | 1,794.3 | 93.1% | 9.8% |
| External grants | 26.5 | 19.7 | 34.7 | 56.7% | -25.6% |
| **Total revenue & external grants** | **1,548.9** | **1,690.8** | **1,829.0** | 92.4% | 9.2% |
| Recurrent expenditure | 1,349.7 | 1,496.2 | 1,574.1 | 95.1% | 10.9% |
| Development expenditure & Net Lending | 469.7 | 542.0 | 598.1 | 90.6% | 15.4% |
| County Governments + Contingencies | 327.3 | 367.7 | 369.7 | 99.5% | 12.4% |
| Total expenditure | 2,146.7 | 2,405.9 | 2,541.9 | 94.7% | 12.1% |
| **Fiscal deficit excluding grants** | **(597.7)** | **(715.2)** | **(712.8)** | | 19.6% |
| Deficit(excluding grants) as % of GDP | 7.0% | 7.5% | 7.5% | | |
| Net foreign borrowing | 355.0 | 414.5 | 391.2 | 106.0% | 16.8% |
| Net domestic borrowing | 273.7 | 303.7 | 255.4 | 118.9% | 10.9% |
| Other domestic financing | 2.6 | 2.9 | 3.9 | 73.3% | 9.7% |
| Total borrowing | 631.3 | 721.1 | 650.5 | 110.8% | 14.2% |
| GDP Estimate | 8,524.7 | 9,510.4 | 9,510.4 | | |

i. **Revenue collection**: Total revenue collected in FY'2018/2019 amounted to Kshs 1.7 tn, a 9.2% increase from Kshs 1.5 tn collected during the same period the previous year, meeting 93.1% of the budgetary target for the year of Kshs 1.8 tn. Ordinary revenue collection from taxes excluding Appropriation in Aid was at Kshs 1.5 tn a 9.7% increase from Kshs 1.4 tn collected in FY'2017/2018, against a target of Kshs 1.6 tn, thus the Kenya Revenue Authority managed to meet 94.3% of the set target as per the budget, equivalent to 17.9% of GDP,
ii. **Expenditure**: Total expenditure amounted to Kshs 2.4 tn, a 12.1% increase from Kshs 2.1 tn recorded the same period last year. This was 94.7% of the Kshs 2.5 tn target, with a significant share of the expenditure being on recurrent expenditure, which accounted for 62.2% of total

expenditure, a slight decline from 62.9% in FY'2017/2018. Development expenditure only accounted for 22.5%. Total expenditure was, however, 6.3% lower than the targeted expenditure as per the budget, an indication that the austerity measures undertaken by the government were taking effect. The lower expenditure was mainly attributed to lower expenditure recorded in operation and maintenance, pension and wages and salaries expenditures, which came in at Kshs 590.9 bn, Kshs 70.8 bn, and Kshs 417.5 bn, respectively, against target expenditures of Kshs 647.4 bn, Kshs 84.8 and Kshs 428.0 bn, respectively.

We are of the view that revenue mobilization still remains a concern, with the government having managed to meet 93.1% of its target, although it was an improvement from the 91.7% recorded in FY'2017/2018. The key concern, however, remains on the expenditure side, which has continued to grow faster recording a 12.1% growth, compared to the 9.8% growth in revenue collection. This has led to widening of the fiscal deficit to Kshs 715.2 bn, 7.5% of GDP from Kshs 597.7 bn, 7.0% of GDP in FY'2017/2018. This in effect has led to increased total government borrowing, both foreign and domestic to plug in the deficit, with domestic borrowing having increased by 10.9% to Kshs 303.7 bn from Kshs 273.7 bn in FY'2017/2018, while foreign borrowing has increased by 16.8% to Kshs 414.5 bn, from Kshs 355.0 bn in FY'2017/2018. In the Budget Statement for the fiscal year 2019/20, of interest were the various measures put in place to improve revenue collection, with the Government having an ambitious target of Kshs 2.1 tn from Kshs 1.9 tn as per the revised FY'2018/2019 revised Budget. In order to achieve this, the CS of the National Treasury highlighted the following changes and proposals through which the government will widen the tax net in order to increase revenue collection, and consequently mitigate the rise in the fiscal deficit;

a. **Increase in capital gains tax rate (CGT)** - The CS increased capital gains tax charged on property transfer from 5.0% to 12.5%. CGT, the tax chargeable on the entire gain accruing to a company or an individual upon the transfer of property situated in Kenya, was re-introduced in 2015 after being suspended in 1985. Transfer of property necessitated by the restructuring of corporate entities will, however, be exempt from this tax to allow for the seamless restructuring of corporate entities with the aim of increasing efficiency and market penetration. We expect the increased CGT rate to result in increased government revenue collection from the real estate sector,
b. **Re-introduction of the turnover tax**- The CS re-introduced the turnover tax at the rate of 3.0% on the gross turnover accounted for every month, which will affect taxpayers whose business income does not exceed Kshs 5.0 mn per annum. The turnover tax will apply in addition to the presumptive tax that was introduced through the Finance Act 2018. We, however, do not expect the turnover tax to lead to increased revenues owing to non-compliance by the largely informal sector, which had initially led to it being scrapped off as the target (informal sector), proved hard to police, coupled with high administrative costs and capacity constraints,
c. **Withholding Tax**- In a bid to expand the tax base and increase revenue collection, the CS proposed to add the following services, for the purposes of withholding tax, as part of professional services. They include; security services, cleaning and fumigation, catering services offered outside hotel premises, transportation of goods excluding air transport services, and sales, promotion, marketing, and advertising. We expect that through this initiative, the government will enhance tax compliance by widening the tax net. However, this will be accompanied by a subsequent increase in administrative burdens to be incurred in the collection and remittance of the withholding tax,
d. **Introduction of excise duty on betting activities**- the CS proposed the introduction of excise duty on betting activities charged at 10.0% of the amount wagered. This measure aims to curb the negative social effects brought about by betting in the country, and
e. **Increased excise duty on cigarettes, wines, and spirits**- the CS proposed to increase the excise duty rates on cigarettes, wines, and spirits by 15.0% in addition to the inflationary increase, effective as from 1st July 2019. This increase in the excise duty rate on cigarettes, wines,

and spirits, is on account of a decline in the excise duty revenue over the years.

We still expect the Government to find it difficult to meet its ambitious revenue target of Kshs 2.1 tn for the current fiscal year, which is 10.5% higher than the previous fiscal year revenue target of Kshs 1.9 tn. This has also seen the Government adjusting its domestic borrowing target for the FY'2019/2020 upwards by 5.9% to Kshs 300.3 bn from the initial Kshs 283.5 bn, through a gazette notice during the week, which we deduce might be in anticipation of a shortfall in tax receipts during the year.

**Inflation Projections:**

We are projecting the Y/Y inflation rate for the month of August to come in within the range of 5.7% - 6.1%, compared to 6.3% recorded in July. The Y/Y inflation for the month of August is expected to decline due to:

i. A decline in the food and non-alcoholic beverages index, which has a weighting of 36.0%, mainly driven by a decline recorded in food prices such as tomatoes and potatoes with the prices of maize flour, which is a key commodity remaining unchanged during the month,
ii. A decline in the transport index following the 2.5% and 3.2% declines in petrol and diesel prices, respectively during the month,
iii. We however expect a rise in the housing, water, electricity, gas and other fuels during the month owing to the 1.9% rise in kerosene prices.

Going forward, we expect the inflation rate to remain within the Government set range of 2.5% - 7.5%.

***Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. A budget deficit is likely to result from depressed revenue collection with the revenue target for FY'2019/2020 at Kshs 2.1 tn, creating uncertainty in the interest rate environment as additional borrowing from the domestic market goes to plug the deficit. Despite this, we do not expect upward pressure on interest rates due to increased demand for government securities, driven by improved liquidity in the market owing to the relatively high debt maturities. Our view is that investors should be biased towards medium-term fixed income instruments to reduce duration risk associated with long-term debt, coupled with the relatively flat yield curve on the long-end due to saturation of long-term bonds***.