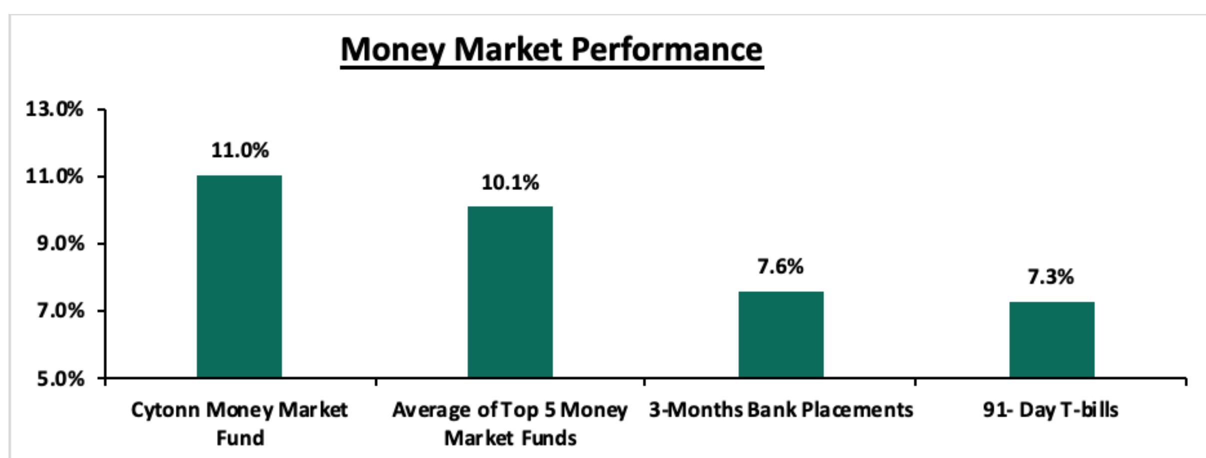
Master-Planned Communities, & Cytonn Weekly #06/2020

Fixed Income

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

During the week, T-bills were oversubscribed, with the subscription rate coming in at 217.4%, up from 135.9% the previous week. The oversubscription is partly attributable to favourable liquidity in the money market during the week due to the ongoing government payments. We note that the 364-day paper continued to receive the most interest from investors, having recorded the highest subscription rate of the 3 papers, at 311.6%. This is attributable to the market currently pricing that the government will be under pressure to meet its domestic target and as such a bias to shorter-dated papers in order to avoid duration risk, which has seen most investors still keen on the primary fixed income market, finding the 364-day T-bill more attractive on a risk-adjusted return basis. The yield on the 91-day, 182-day, and 364-day papers remained unchanged at 7.3%, 8.2% and 9.9%, respectively. The acceptance rate rose to 53.6%, from 95.0% recorded the previous week, with the government accepting Kshs 28.0 bn of the Kshs 52.2 bn bids received.

During the week, the National Treasury announced that it will issue a 15-year (FXD1/2020/15) and a 25-year (re-open – FXD1/2018/25) with an effective tenor of 23.3-years, with a total value of Kshs 50.0 bn for Budgetary Support purposes. The period of sale is from 3rd February 2020 to 18th February 2020. As per the historical trend, we expect the market to maintain a bias towards the 15-year bond 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. Our recommended bidding ranges are 12.6% - 12.8% and 13.2% - 13.4%, for the 15-year and 25-year bonds, respectively, given that bonds with the same tenor are currently trading at 12.5% and 13.1%, respectively.



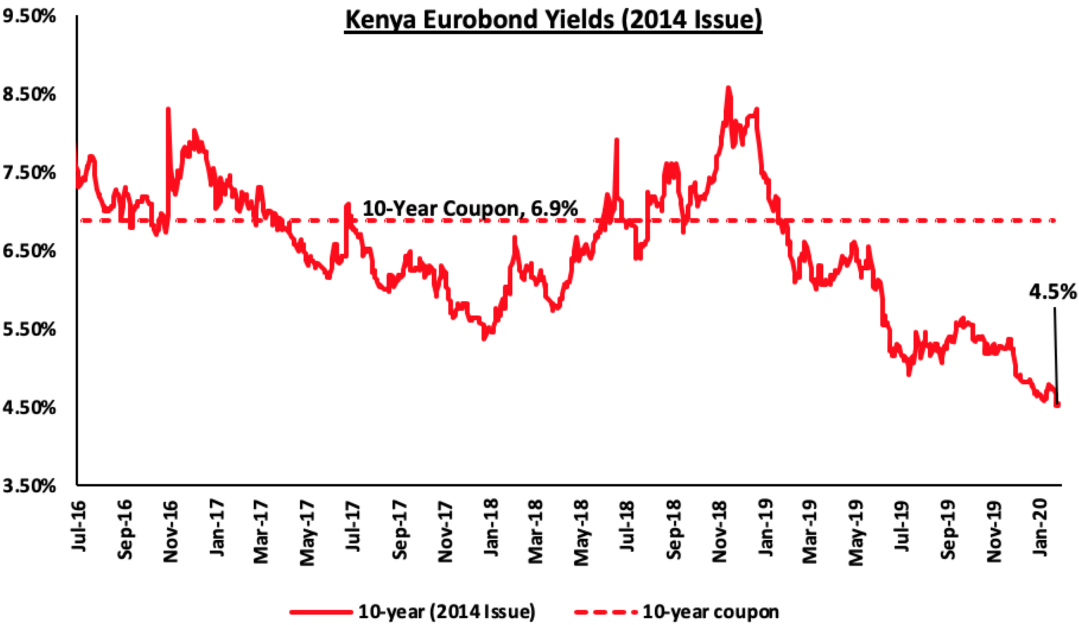
In the money markets, 3-month bank placements ended the week at 7.6% (based on what we have been offered by various banks), the 91-day T-bill came in at 7.3%, while the average of Top 5 Money Market Funds came in at 10.1%, unchanged from the previous week. The yield on the Cytonn Money Market came in at 11.1%, unchanged from the previous week.

Liquidity:

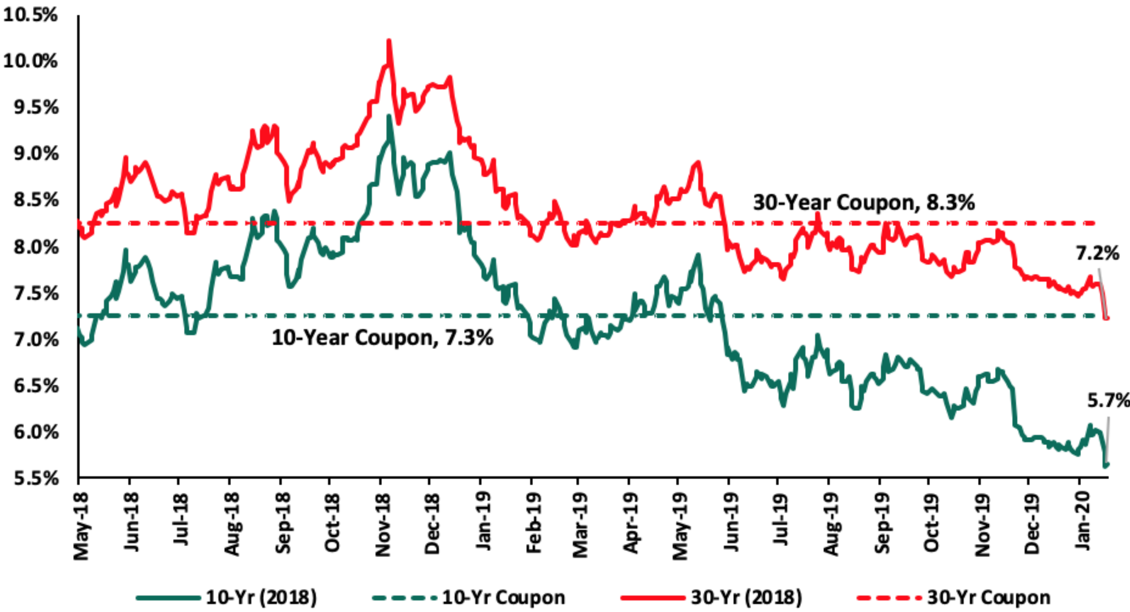
During the week, the average interbank rate increased to 4.9%, from 4.4% recorded the previous week, pointing to tightening liquidity in the money markets. Commercial banks' excess reserves came in at Kshs 21.6 bn in relation to the 5.25% cash reserves requirement (CRR). The average interbank volumes increased by 17.6% to Kshs 13.2 bn, from Kshs 11.2 bn recorded the previous week.

Kenya Eurobonds:

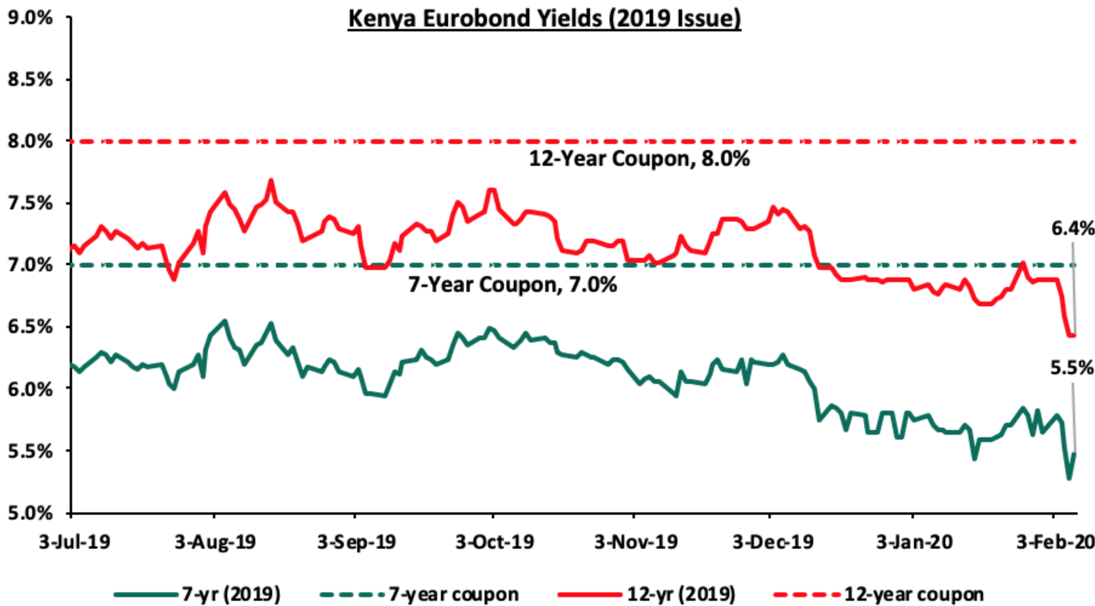
According to Reuters, the yield on the 10-year Eurobond issued in June 2014 decreased marginally to 4.5%, from 4.7% recorded the previous week. This is an indication that investors are not attaching a higher risk premium on the country.



During the week, the yields on the 10-year Eurobond decreased to 5.7%, from 6.0% seen the previous week, while that of the 30-year Eurobond decreased to 7.2%, from 7.6% recorded the previous week.



During the week, the yield on the 7-year Eurobond decreased by 0.1% points to 5.5%, from 5.6% recorded the previous week. The yield on the 12-year Eurobond also decreased by 0.5% points to 6.4%, from 6.9% recorded the previous week.



Kenya Shilling:

The Kenya Shilling appreciated by 0.1% against the US Dollar during the week to Kshs 100.4, from Kshs 100.6 recorded last week, mostly supported by inflows from diaspora remittances and offshore investors buying government debt exceeding the dollar demand from importers. On an YTD basis, the shilling has appreciated by 0.7% against the dollar, in comparison to the 0.5% appreciation in 2019. In our view, the shilling should remain relatively stable against the dollar in the short term with a bias to a 2.4% depreciation by the end of 2020, supported by:

i. The narrowing of the current account deficit, with preliminary data indicating that Kenya's current account deficit was equivalent to 4.6% of GDP in 2019, from 5.0% recorded in 2018. This was mainly driven by lower imports of SGR-related equipment, resilient diaspora remittances which cumulatively stood at USD 2.8 bn in December 2019, a 3.7% increase from the USD 2.7 bn recorded in December, and strong receipts from transport and tourism services with preliminary data indicating that the number of tourists landing in the country stood at 132,019 in month of December, which was a 9.0% increase, compared to the 121,070 recorded in November 2019,
ii. High levels of forex reserves, currently at USD 8.5 bn (equivalent to 5.2-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,
iii. Foreign capital inflows, with investors looking to participate in the domestic equities market, and,
iv. CBK's supportive activities in the money market, such as repurchase agreements and selling of dollars.

We, however, expect pressure on the Kenyan shilling to arise from:

i. Subdued diaspora remittances growth following the close of the 10.0% tax amnesty window in July, which has seen cumulative diaspora remittances increase by a 3.7% in the 12-months to December 2019 to USD 2.8 bn, from USD 2.7 bn in 2018.

Weekly Highlight:

During the week, the African Development Bank (AfDB) released their African Economic Outlook 2020, highlighting the economic projections and prospects for each of the 54 countries and the

continent as a whole. According to the report, Kenya's economy grew by an estimated 5.9% in 2019, lower than the 6.0% seen in 2018, mainly attributable to unfavourable weather and reduced government investment. The economy is expected to expand by 6.0% in 2020 and 6.2% in 2021, mainly driven by

i. Increased crude oil production and exports,
ii. Continuing foreign direct investment,
iii. Benefits from the African Continental Free Trade Agreement, and,
iv. The government's commitment to the Big Four Agenda targeted towards the health, housing, agriculture and manufacturing sector.

The AfDB also noted that the country's fiscal deficit had narrowed to an estimated 7.5% of GDP in 2019, supported by the ongoing fiscal consolidation and greater domestic resources mobilization. Public debt, on the other hand, rose to 58.0% from the 57.0% seen in 2018. The continuous increase in public debt saw the International Monetary Fund elevate Kenya's debt stress rating from low to moderate in 2018.

In summary, the report affirms that the macroeconomic stability in Kenya is expected to continue with inflation expected to remain within the government's set target of 2.5% - 7.5% and with the consensus GDP growth as per the 8 firms below expected to come in at 6.0%.

Kenya 2020 Annual GDP Growth Outlook

No.	Organization	Q1'2020
1.	Central Bank of Kenya	6.2%
2.	Citigroup Global Markets	6.2%
3.	International Monetary Fund	6.1%
4.	African Development Bank	6.0%
5	World Bank	6.0%
6.	National Treasury	6.0%
7.	African Development Bank (AfDB)	6.0%
8.	**Cytonn Investments Management PLC**	**5.7%**
9.	United Nations Conference on Trade and Development (UNCTAD)	5.5%
	Average	**6.0%**

In our view, we expect the country's GDP growth to come in at around 5.6% - 5.8% mainly driven by an improvement in private sector credit growth, stable growth of the agricultural sector, and public infrastructural investments. The risks abound to economic growth include;

i. The country's debt sustainability with the public debt to GDP ratio currently estimated at 62.0%, efforts by the Kenyan Government to reduce country's fiscal deficit, which is currently at 6.2% of GDP, which might adversely affect economic growth due to reduced government spending, and,
ii. The current locust invasion which also poses a systematic risk to agricultural production and food security and could ultimately lead to higher inflation that could slow down economic growth.

According to Stanbic Bank's Monthly Purchasing Manager's Index (PMI), the Kenyan private sector business activity declined at the start of the year, amid the softest uplift in new orders since April 2019. The seasonally adjusted PMI index came in at 49.7, down from the 53.3 seen in December 2019, pointing towards a decline in business conditions since a reading of above 50 indicates improvements in the business environment, while a reading below 50 indicates a worsening outlook. Overall activity levels contracted with firms reporting that lack of money in households led to softer

demand pressure. New orders grew at a much softer rate than in December as a result of weaker customer demand as a result of poor cash flow in the economy. Input buying was also restrained as the softer demand led to a much weaker increase in purchases, despite this, stock levels continued to grow sharply. Selling prices increased for the second month as a result of a steady rise in input costs. We expect the business environment to improve going forward on the back of the ongoing clearance of private sector arrears and recent reforms such as the repeal of the Interest Rate Cap and the MPC actions from the last two meetings which saw the benchmark rate reduce to 8.25% from 9.00%.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 23.6% ahead of its domestic borrowing target, having borrowed Kshs 235.6 bn against a pro-rated target of Kshs 190.6 bn. We expect an improvement in private sector credit growth considering the repeal of the interest rate cap. This will result in increased competition for bank funds from both the private and public sectors, resulting in upward pressure on interest rates. Owing to this, our view is that investors should be biased towards short-term fixed-income securities to reduce duration risk.