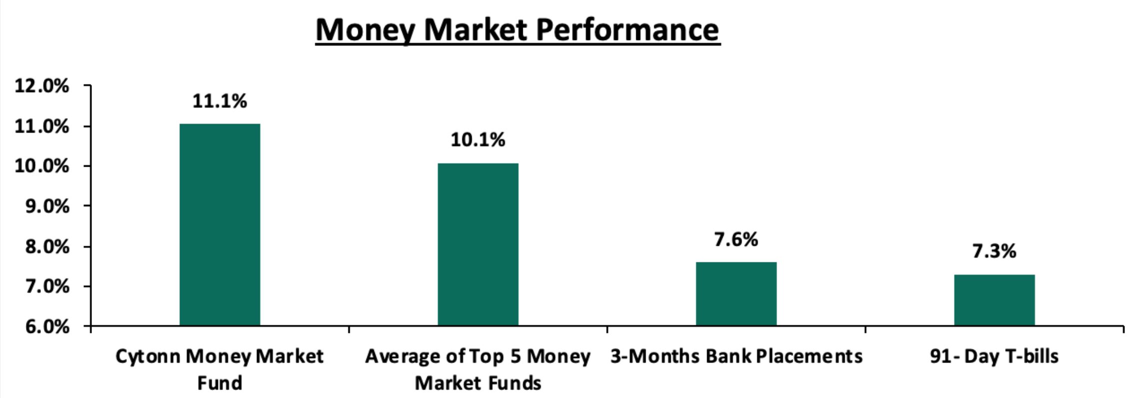
Education Investment Plans in Kenya, & Cytonn Weekly #07/2020

Fixed Income

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

During the week, T-bills were oversubscribed, with the subscription rate coming in at 195.8%, down from 217.4% the previous week. The oversubscription is partly attributable to favorable 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 379.0%. 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%, 8.3% and 9.9%, respectively. The acceptance rate rose to 64.2%, from 53.6% recorded the previous week, with the government accepting Kshs 30.2 bn of the Kshs 47.0 bn bids received.



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.

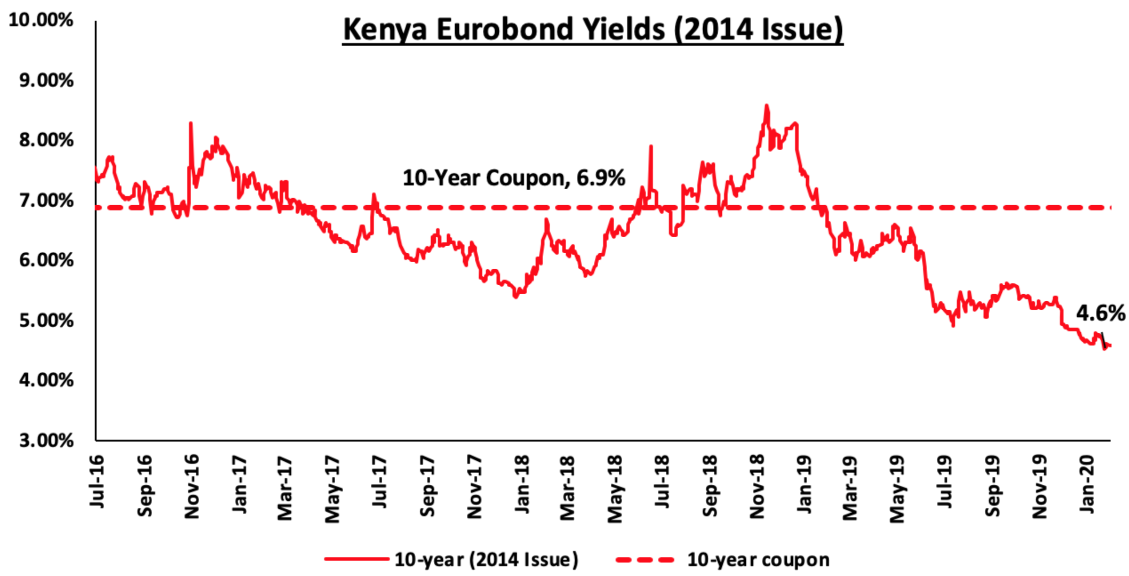
During the week, the Capital Markets Authority, CMA, announced that it “has given a no-objection to a 28-day moratorium to enable the fund manager, Amana Capital Ltd (ACL), work with its Trustee to improve its liquidity position to meet redemption obligations to unit holders with investments in the Amana Shilling Fund.” This effectively means that unit holders cannot withdraw their funds. While the intention here is good, we think that closing of banks, financial institutions and investment funds facing challenges makes it even harder to find a resolution. It would have been better to seek solutions with the funds open because, once closed, reopening a fund becomes even more difficult, and should it reopen investors are likely to rush for the doors. The most optimal solution in our view would have been to oversee a very quick sale process of the troubled fund to a stronger fund manager take over the fund, write down the value of each Amana investor’s value to reflect the value of good assets, do a unit swap of Amana units with units of the new fund manager, and then allow them phased withdrawals after a lock in period.

Liquidity:

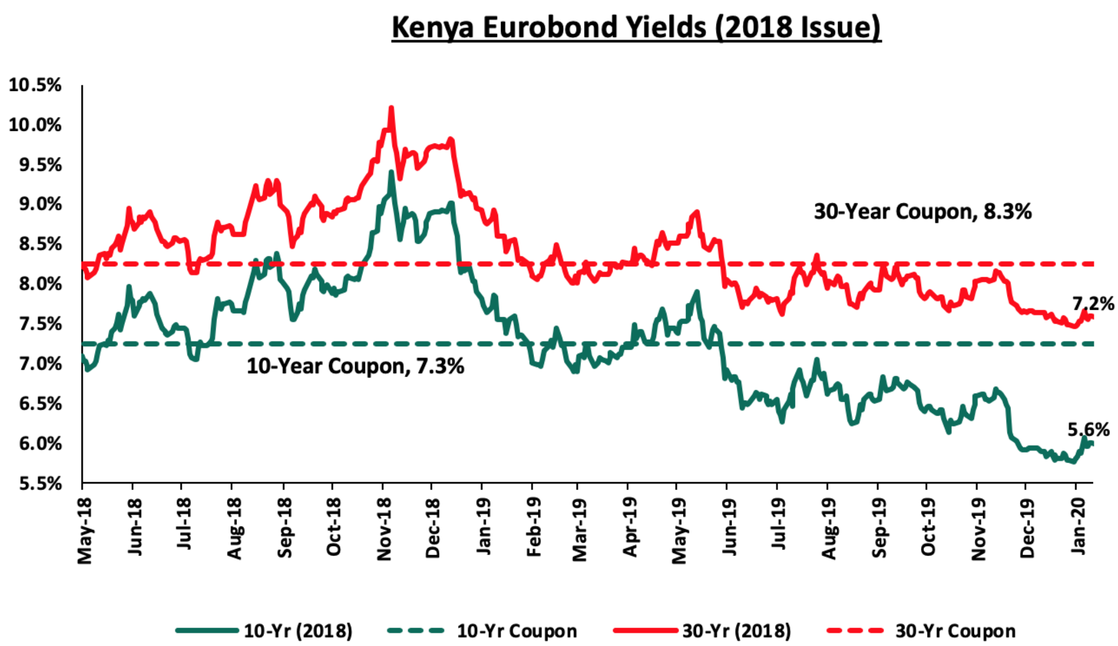
During the week, the average interbank rate decreased to 4.4%, from 5.0% recorded the previous week, pointing to increased liquidity in the money markets. Commercial banks' excess reserves came in at Kshs 21.5 bn in relation to the 5.25% cash reserves requirement (CRR). The average interbank volumes decreased by 64.0% to Kshs 3.2 bn, from Kshs 8.9 bn recorded the previous week.

Kenya Eurobonds:

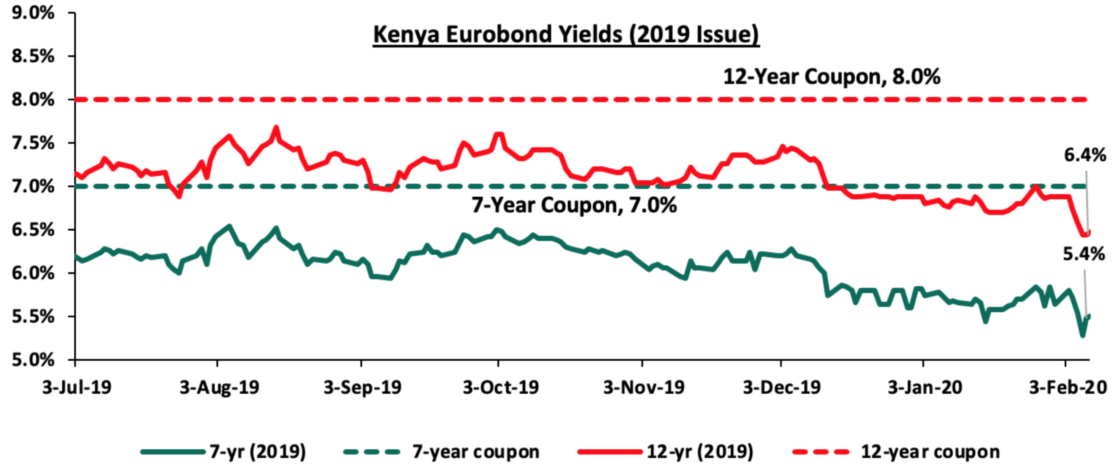
According to Reuters, the yield on the 10-year Eurobond issued in June 2014 increased marginally by 0.1% points to 4.6%, from 4.5% recorded the previous week. This is an indication that investors are not attaching a higher risk premium on the country.



During the week, the yields on the 10-year Eurobond decreased by 0.1% points to 5.6%, from 5.7% seen the previous week, while that of the 30-year Eurobond remained unchanged at 7.2%, similar to what was recorded the previous week.



During the week, the yield on the 7-year Eurobond decreased by 0.1% points to 5.4%, from 5.5% recorded the previous week. The yield on the 12-year Eurobond remained unchanged at 6.4% similar to what was recorded the previous week.



Kenya Shilling:

The Kenya Shilling depreciated by 0.1% against the US Dollar during the week to Kshs 100.6, from Kshs 100.4 recorded last week, mostly supported by increased dollar demand by merchandise and corporate importers as well as increased liquidity in the money market. On a 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 2018, 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 2019, 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. During the week, the CBK had to mop up Kshs 15.0 bn through repurchase agreements to ease liquidity in the market.

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

i. Subdued diaspora remittances growth following the close of the 10.0% tax amnesty window in July 2019, 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 Energy and Petroleum Regulatory Authority (EPRA) released their monthly statement on the Maximum Retail Prices in Kenya for the period 15th February 2020 to 14th March 2020. Below are the key take-outs from the statement:

I. Petrol prices have increased by 2.4% to Kshs 113.9 per litre from Kshs 111.2 per litre previously, while diesel prices have increased by 2.1% to Kshs 104.4 per litre from Kshs 102.3 per litre. Kerosene prices have however decreased by 1.2% to Kshs 102.7 per litre from 104.0 per litre, previously,

II. The changes in prices have been attributed to the increase in the average landing cost of imported super petrol by 3.9% to USD 489.4 per ton in January 2020 from USD 471.0 per ton in December 2019. Landing costs for diesel and kerosene also increased by 2.7% and 2.6% to USD 506.9 per ton and USD 495.3 per ton in January 2020, respectively, from USD 493.7 per ton and USD 508.8 per ton in December 2019, and,

III. A 2.1%, decrease in Free on Board (FOB) price of Murban crude oil lifted in January 2020 to USD 67.8 per barrel, from USD 69.3 per barrel in December 2019.

We expect an increase in the transport index, which carries a weighting of 8.7% in the total consumer price index (CPI), due to the increase in petrol and diesel prices. Consequently, the increase in the transport index will increase inflationary pressures.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 23.3% ahead of its domestic borrowing target, having borrowed Kshs 244.0 bn against a pro-rated target of Kshs 196.4 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.