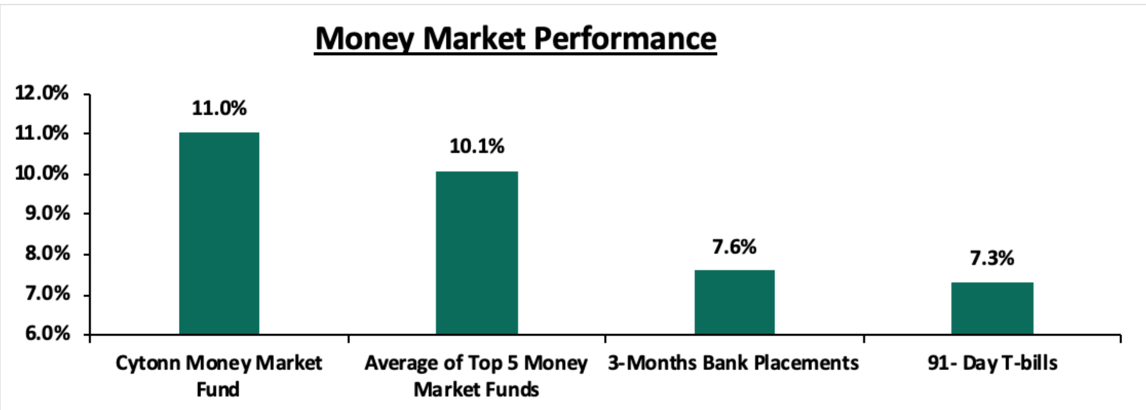
Personal Financial Planning, & Cytonn Weekly #08/2020

Fixed Income

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

During the week, T-bills were oversubscribed, with the overall subscription rate coming in at 207.3%, up from 195.8% recorded the previous week with liquidity remaining favorable following the end of the monthly Cash Reserve Requirement (CRR) cycle and 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 392.8%. 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 and 182-day papers remained unchanged at 7.3% and 8.3%, respectively, while the yield on the 364-day paper declined by 0.1% points to 9.8%, from the 9.9% recorded the previous week. The acceptance rate rose to 69.8%, from 64.2% recorded the previous week, with the government accepting Kshs 34.7 bn of the Kshs 49.8 bn bids received.

During the week, the Central Bank of Kenya released the auction results for the recently issued bond, FXD1/2020/15 and the reopened FXD1/2018/25 with effective tenors of 15.0-years and 23.3-years, respectively, and coupon rates of 12.8% and 13.4%, respectively, in a bid to raise Kshs 50.0 bn for budgetary purposes. The overall subscription rate came in at 85.0%, with the government receiving bids worth Kshs 42.5 bn, lower than the quantum of Kshs 50.0bn. The low performance is mainly attributed to the relatively long tenor periods of the two bonds with most investors trying to minimize duration risk. The yield on the 15-year bond came in at 13.0%, while the yield on the 25-year bond came in at 13.6%. The government accepted Kshs 27.9 bn out of the Kshs 42.5 bn worth of bids received, translating to an acceptance rate of 65.6%.



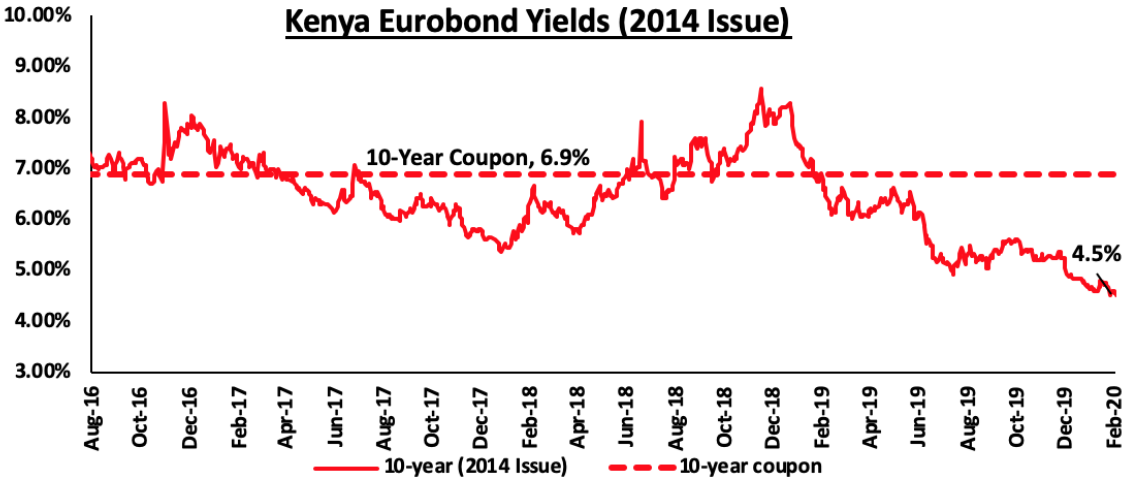
In the money markets, 3-month bank placements ended the week at 7.6% (based on what we have been offered by various banks), the 91-day T-bill came in at 7.3%, while the average of Top 5 Money Market Funds came in at 10.1%, unchanged from the previous week. The yield on the Cytonn Money Market Fund came in at 11.0%, unchanged from the previous week.

Liquidity:

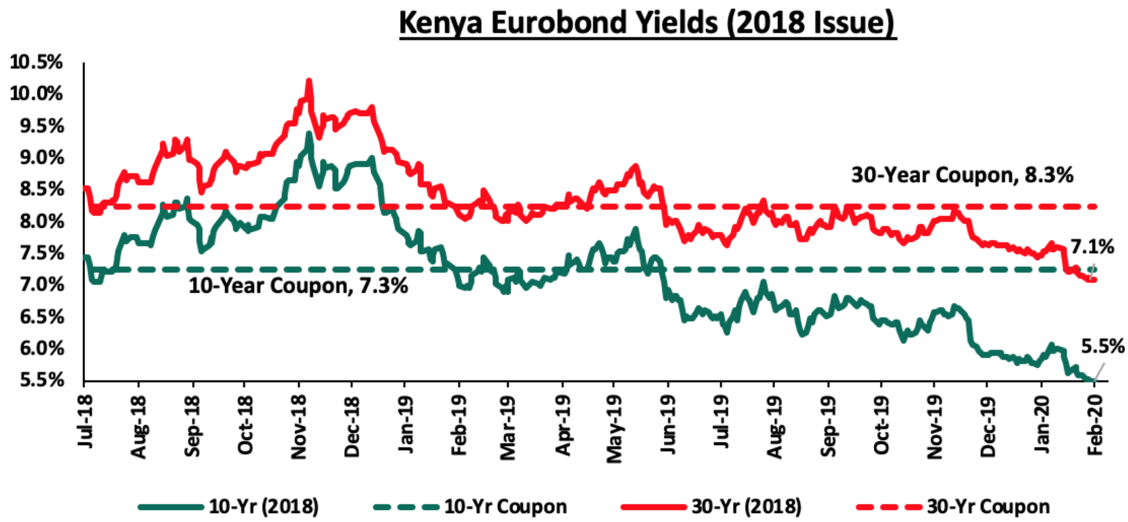
During the week, the average interbank rate decreased to 4.2%, from 4.4% recorded the previous week, pointing to increased liquidity in the money markets, which remained favourable following the end of the monthly Cash Reserve Requirement (CRR) cycle and government payments. Commercial banks' excess reserves came in at Kshs 21.7 bn in relation to the 5.25% cash reserves requirement (CRR). The average interbank volumes increased by 174.9% to Kshs 8.8 bn, from Kshs 3.2 bn recorded the previous week.

Kenya Eurobonds:

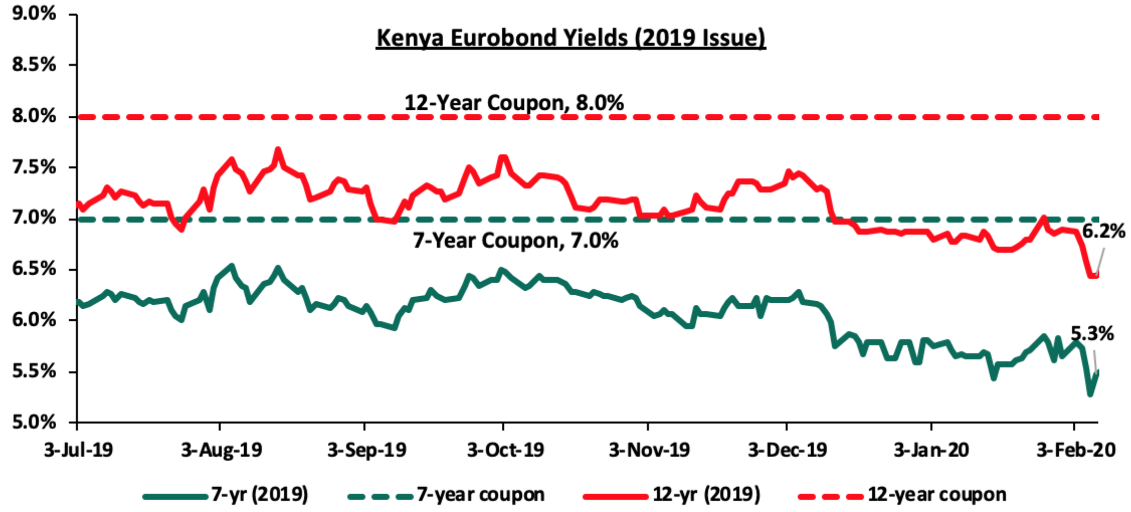
According to Reuters, the yield on the 10-year Eurobond issued in June 2014 decreased marginally by 0.1% points to 4.5%, from 4.6% recorded the previous week. This is an indication that investors are not attaching a higher risk premium on the country.



During the week, the yields on the 10-year and 30-year Eurobonds issued in 2018, decreased by 0.1% points to 5.5% and 7.1%, respectively, from 5.6% and 7.2%, respectively, recorded the previous week.



During the week, the yield on the 7-year Eurobond decreased by 0.1% points to 5.3%, from 5.4% recorded the previous week. The yield on the 12-year Eurobond decreased by 0.2% points to 6.2%, from 6.4% recorded the previous week.



Kenya Shilling:

The Kenya Shilling depreciated by 0.7% against the US Dollar during the week to Kshs 101.3, from Kshs 100.6 recorded last week, as a result of increased end-month dollar demand from multinational companies and merchandise importers. On a YTD basis, the shilling has appreciated by 0.1% 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.

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 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, Moody's Credit Agency released an update highlighting Kenya's international creditworthiness. Kenya's rating by the agency was maintained at B2 with a stable outlook, on the back of relative diversification of the economy and moderate economic strength. The agency, however, warned that Kenya's debt burden coupled with poor revenue collection may negatively affect the country's credit rating. The country's high reliance on commercial external debt imposes a negative impact on the country's rating as the country's national debt currently exceeds Kshs 5.0 tn, with the debt to GDP ratio having increased to 62.0% of the GDP, compared to 58.0% in 2018. The agency also highlighted that the locust invasion may greatly affect the agricultural sector that currently contributes 18.6% of the country’s GDP. In January alone, the insects covered approximately one million hectares of land in Kenya destroying tonnes of produce. The drop in agricultural produce is also expected in Ethiopia and other East African countries that are also being affected by the locust attack. The agency, however, predicts that the country’s diversified economy supported by the growth of private consumption and private investment sector may provide resilience to economic shocks.

The following table shows the current credit rating based on the main agencies: -

No.	Rating Agency	Rating	Last Update	Outlook
1.	Fitch Ratings	B+	December 2019	Stable
2.	Moody’s Corporation	B2	November 2019	Stable
3.	Standard & Poor’s	B+	March 2018	Stable

During the week, Capital Economics, an independent macroeconomic research firm based in London, downgraded the GDP growth projection for Kenya in 2020 by 0.2% points to 5.9% from the previously projected 6.1% given the locust invasion crisis, which it highlighted could lead to a fall in agricultural production in the country. The table below shows GDP projections from 10 firms with the consensus GDP growth as per the 10 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.	Capital Economics	5.9%
9.	**Cytonn Investments Management PLC**	**5.7%**
10	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.

Inflation Projection:

We are projecting the y/y inflation rate for the month of February to come in within the range of 5.9% - 6.2%, an increase compared to 5.8% recorded in January. The m/m inflation for the month of

February is expected to rise due to the following factors:

i. A rise in the food and non-alcoholic beverages index, which has a weighting of 36.0%, mainly driven by the rise in food prices with a significant rise being recorded in tomato mainly due to supply shortages as a result of heavy rainfall, which destroys tomatoes. Tomato prices have gone up by 36.1% to Kshs 130.2 from Kshs 95.7 per kilogram recorded in December 2019, and,
ii. A rise in the transport index, which has a weighting of 8.7% contribution to GDP, with petrol prices having increased by 2.4% to Kshs 113.9, from Kshs 111.2 per litre previously, while diesel prices increased by 2.1% to Kshs 104.4 per litre from Kshs 102.3 per litre, previously.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 52.2% ahead of its domestic borrowing target, having borrowed Kshs 307.6 bn against a pro-rated target of Kshs 202.1 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.