Accra, Ghana Real Estate Investment Opportunity, & Cytonn Weekly #47

Fixed Income

During the week, T-bills were undersubscribed, with the overall subscription rate coming in at 66.0%, compared to 72.6% recorded the previous week, due to relatively tight liquidity in the money market, as a result of transfer of taxes by banks amounting to Kshs 32.8 bn that fell due on 20th November. The subscription rates for the 91, 182 and 364-day papers came in at 108.4%, 48.6%, and 66.5% compared to 44.2%, 91.1% and 65.6%, respectively, the previous week. Yields on the 91, 182 and 364-day papers remained unchanged at 8.0%, 10.5% and 11.0%, respectively. The overall acceptance rate came in at 96.6%, compared to 99.4% the previous week, with the government accepting a total of Kshs 15.3 bn of the Kshs 15.9 bn worth of bids received, against the Kshs 24.0 bn on offer. The government is still behind its domestic borrowing target for the current fiscal year, having borrowed Kshs 86.8 bn, against a target of Kshs 165.7 bn (assuming a pro-rated borrowing target throughout the financial year of Kshs 410.2 bn budgeted for the full financial year as per the Cabinet-approved 2017 Budget Review and Outlook Paper (BROP)).

Liquidity in the money market was tight during the week, with a net liquidity injection of Kshs 2.2 bn, compared to a net injection of Kshs 1.8 bn the previous week. The CBK was active in the Repo market, injecting Kshs 3.1 bn through Reverse Repo Purchases in a bid to counter the tight liquidity. The average interbank rate declined marginally to 9.0% from 9.4% recorded the previous week, while the average volumes traded in the interbank market decreased by 19.1% to Kshs 18.7 bn from Kshs 23.2 bn the previous week. It is important to note that for this week, banks holding of excess liquidity stood at Kshs 10.4 bn above the 5.25% requirement, from Kshs 4.4 bn the previous week, as banks accumulated liquidity needed for transfer of taxes that fell due on 20th November, as can be seen below from the Kshs 32.8 bn liquidity reduction in transfer of taxes from banks.

Below is a summary of the money market activity during the week:

all values in Kshs bn, unless stated otherwise

Weekly Liquidity Position – Kenya			
Liquidity Injection		Liquidity Reduction	
Term Auction Deposit Maturities	0.0	T-bond sales	0.0
Government Payments	23.9	Transfer from Banks - Taxes	32.8
T-bond Redemptions	27.9	T-bill (Primary issues)	17.3
T-bill Redemption	0.0	Term Auction Deposit	0.0
T-bond Interest	9.7	Reverse Repo Maturities	3.7
T-bill Re-discounts	0.0	Repos	8.6
Repos Maturities	0.0		

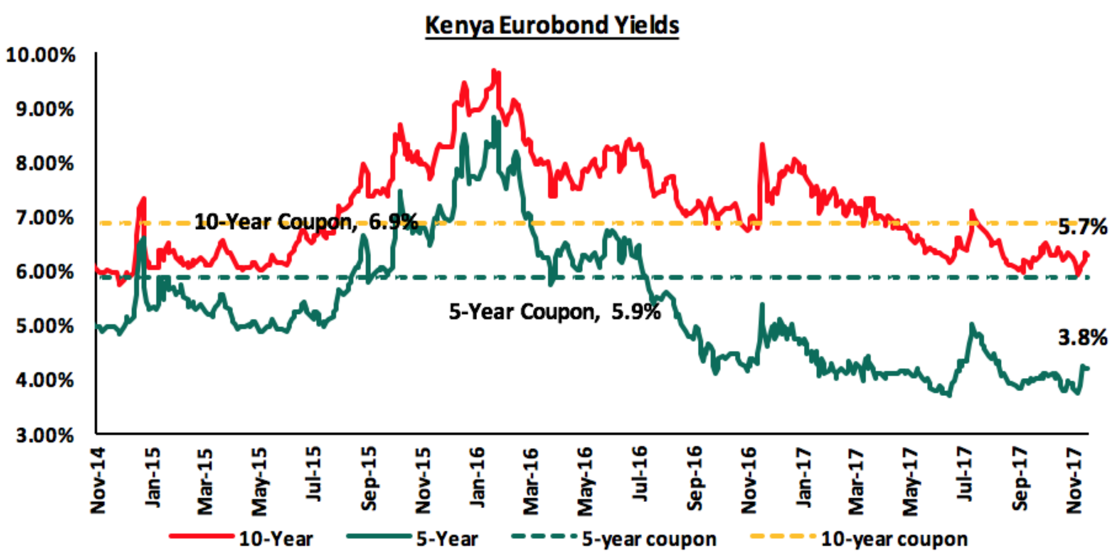
all values in Kshs bn, unless stated otherwise

Weekly Liquidity Position – Kenya

Liquidity Injection		Liquidity Reduction	
Reverse Repo Purchases	3.1		
Total Liquidity Injection	64.6	Total Liquidity Withdrawal	62.4
Net Liquidity Injection			2.2

Last week, the Kenyan Government issued a 7-year amortized Infrastructure Bond (IFB 1/2017/7), with an effective tenor of 6.0 years, and a coupon of 12.5%, in a bid to raise Kshs 30.0 bn for partial support of infrastructural projects in the roads (Kshs 10.0 bn), energy (Kshs 15.0 bn) and water (Kshs 5.0 bn) sectors. The overall subscription rate for the bond issue came in at 153.0%, with the market average bid rate coming in at 12.3%, slightly above the accepted rate of 12.2%, and higher than the 11.4% after-tax yield on a similar tenor bond trading in the secondary market. The government accepted Kshs 42.0 bn out of the Kshs 45.9 bn worth of bids received, translating to an acceptance rate of 91.5%.

According to Bloomberg, yields on the 5-year and 10-year Eurobonds declined by 20 bps and 30 bps, respectively, during the week, to close at 3.8% and 5.7%, from 4.0% and 6.0% the previous week, respectively. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 5.0% points and 4.0% points for the 5-year and 10-year Eurobonds, respectively, due to the relatively stable macroeconomic conditions in the country. The declining Eurobond yields and stable rating by Standard & Poor (S&P), in spite of the political uncertainty around the presidential poll re-run, are indications that Kenya's macro-economic environment remains stable and hence an attractive investment destination. However, concerns from Moody's around Kenya's rising debt to GDP levels may see Kenya receive a downgraded sovereign credit rating.



The Kenya Shilling appreciated by 0.6% against the US Dollar during the week to close at Kshs 103.3, from Kshs 103.9 recorded the previous week, due to increased foreign investor inflows into the equities market and primary bond auction. On a year to date basis, the shilling has depreciated against the dollar by 0.7%. In our view, the shilling should remain relatively stable against the dollar in the short term supported by (i) expected calm in the political front following the conclusion of the presidential elections, (ii) the weakening of the USD in the global markets as indicated by the US Dollar Index, which has shed 9.1% year to date, and (iii) the CBK's activity, as they have sufficient forex reserves, currently at USD 7.1 bn (equivalent to 4.7 months of import cover).

We are projecting the inflation rate for the month of November to decline to a range of between 5.0% - 5.3%, from 5.7% in October, mainly due to an expected decline in food prices following favourable weather conditions in the month, despite an increase in fuel prices during the month. Going forward to the end of 2017, we expect inflationary pressures to be subdued given food prices are expected to stabilize on account of the ongoing rains. We expect inflationary pressures to ease in the last two months of 2017, but average 8.1% over the course of the year, which is above the upper bound of the government target range of 2.5% - 7.5%.

The International Monetary Fund (IMF) this week expressed concerns about Kenya's debt levels, stating that, despite the country's resilience through the 2016/17 drought and the elongated election period, debt vulnerability should be addressed. According to CBK data, Kenya's total debt has continued to grow, and has risen 21.0% y/y to Kshs 4.5 tn in September 2017 from Kshs 3.7 tn in September 2016. Furthermore, the budget deficit to GDP was expected to increase to 7.9% in the fiscal year 2017/18 from 6.2% previously and public debt to GDP ratio was expected to hit 59.0% by December 2017 from 51.8% previously targeted, that being 900 bps above the 50.0% IMF threshold, which is what is raising concerns over Kenya's debt vulnerability. The Treasury is also contemplating taking on a syndicated loan and floating another Eurobond in a bid to meet its foreign borrowing target of Kshs 277.3 bn, which will further add to Kenya's debt exposure. We are of the same view as the IMF that the debt levels need to be kept sustainable, and be driven towards recommended levels, such as the 50.0% IMF threshold. As mentioned in our topical on Post-Election Areas of Focus, the government should manage the debt levels by (i) enhanced tax revenue collection, (ii) more Public-Private Partnerships (PPPs) to involve the private sector in development funding, and (iii) reduce recurrent expenditure, which as per the BROP is actually expected to increase by 7.1% in FY 2017/18 mainly due to increased expenditure on the presidential re-run.

The Monetary Policy Committee (MPC) met this week, on Thursday 23rd November 2017, to review the prevailing macroeconomic conditions and give direction on the Central Bank Rate (CBR). The MPC maintained the CBR at 10.0%, which was in line with our expectations as per our MPC Note. The Committee indicated that the decision was on the back of a relatively stable macroeconomic environment, given:

i. Inflation declined to 5.7% in October, from 7.1% in September, primarily due to reduced food prices,
ii. The foreign exchange market has remained relatively stable,
iii. The foreign reserves at USD 7.1 bn translating to 4.7 months of import cover, with a standby facility of USD 1.5 bn from the IMF, provide an adequate buffer for short term pressure on the shilling, and,
iv. A resilient banking sector, with the average commercial banks liquidity ratio and capital adequacy ratio at 44.7% and 18.8%, against statutory limits of 20.0% and 14.5%, respectively, as at August 2017, with the gross NPL ratio improving slightly to 10.6% in October, from 10.7% in August.

See the CBK release.

Key to note is that private sector credit growth improved slightly once again to 2.0% in October, from 1.7% in September, however this remains way below the government set annual target of 18.3%.

Rates in the fixed income market have remained stable, and we expect this to continue in the short-term. However, a budget deficit that is likely to result from depressed revenue collection creates uncertainty in the interest rates environment as any additional borrowing in the domestic market to plug the deficit could lead to upward pressures on interest rates. Our view is that investors should be biased towards short-to medium term fixed income instruments to reduce duration risk.

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