

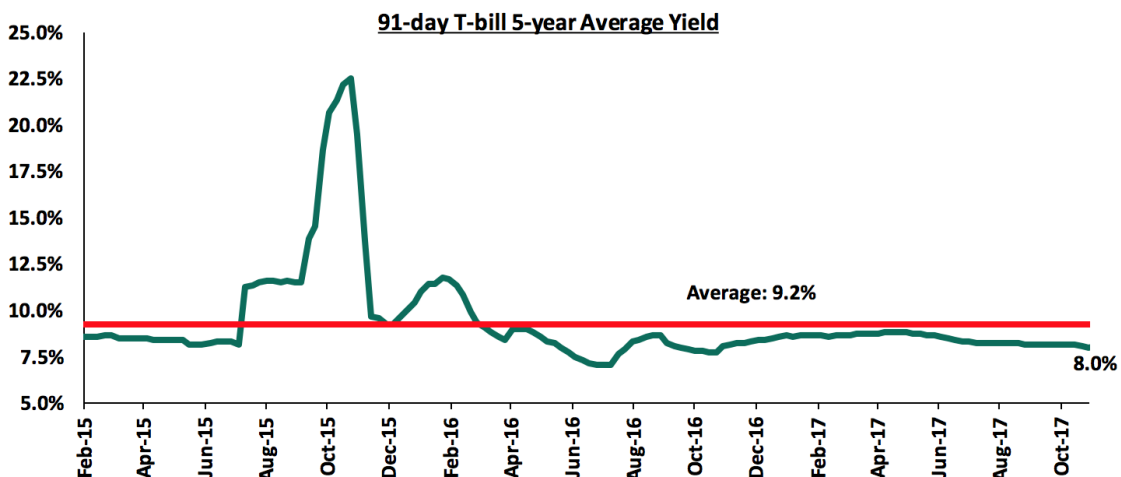
Nairobi Hospitality Report 2017, & Cytonn Monthly – November 2017

Fixed Income

Liquidity in the money market, even with the improvement in November, remained tight with T-bills auctions recording an undersubscription, as the average subscription came in at 75.5%, compared to 48.0% recorded in October. The subscription rates for the 91, 182 and 364-day papers came in at 104.7%, 58.6% and 80.7% from 68.1%, 35.6% and 52.3% the previous month, respectively. The yields on the 91 and 364-day papers remained unchanged at 8.0% and 11.0%, respectively, while the yield on the 182-day paper increased to 10.5% from 10.4%. The T-bills acceptance rate came in at 94.4% during the month, compared to 93.5% in October, with the Kenyan Government accepting Kshs 72.5 bn of the Kshs 76.8 bn worth of bids received, indicating that bids were largely within ranges the Central Bank of Kenya (CBK) deemed acceptable. The government is still behind its domestic borrowing target for the current fiscal year, having borrowed Kshs 84.3 bn, against a target of Kshs 173.5 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”).

This week, T-bills were undersubscribed, with the overall subscription coming in at 75.3%, compared to 66.0% recorded the previous week. Subscription rates for the 91, 182, and 364-day papers came in at 212.7%, 29.3%, and 66.4% from 108.4%, 48.6%, and 66.5%, the previous week, respectively. Yields on the 91, 182 and 364-day T-bills remained unchanged during the week at 8.0%, 10.5%, and 11.0%, respectively.

The 91-day T-bill is currently trading below its 5-year average of 9.2%. The lower yield on the 91-day paper is mainly attributable to the low interest rate environment we have been experiencing since the beginning of the year. We expect this to continue in the short-term, given the discipline of the CBK in stabilizing interest rates in the auction market by rejecting aggressive bids that are priced above market, for both T-bills and T-bonds.



During the month, the Kenyan Government issued a new 7-year amortized Infrastructure Bond (IFB 1/2017/7), with an effective tenor of 6.0 years, and a coupon rate 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 bond was oversubscribed, with the overall subscription rate coming in at 153.0%, with Kshs 45.9 bn worth of bids received compared to the Kshs 30.0 bn on offer. The average market bid rates came in at 12.3%, while the average yields of the accepted bids came in at 12.2%. The acceptance rate for the bids received came in at 91.5%, with the government accepting Kshs 42.0 bn out of the Kshs 45.9 bn worth of bids received.

During the month, the average interbank rate closed at 8.6%, compared to 6.9% at the end of October, as liquidity remained tight in the money market. There was a net liquidity injection of Kshs 2.9 bn compared to a net liquidity withdrawal of Kshs 16.4 bn in October. A significant amount of the liquidity withdrawal came from Transfer of Taxes from Banks and Primary issues of T-bills worth Kshs 98.6 bn and Kshs 72.5 bn, respectively, which was offset by the liquidity injection from Government Payments and Redemptions of T-Bills worth Kshs 94.7 bn and Kshs 81.3 bn, respectively. The CBK was active in the Repo market, injecting Kshs 39.1 bn of Reverse Repo Purchases in a bid to counter the tight liquidity. There was T-bill rediscounting of Kshs 3.7 bn, which indicates that there are some players that faced significant liquidity challenges during the month, since rediscounting is very punitive and is usually done at the prevailing yields plus 3.0% points, thus making the value of the discounted T-bills much lower than their market value.

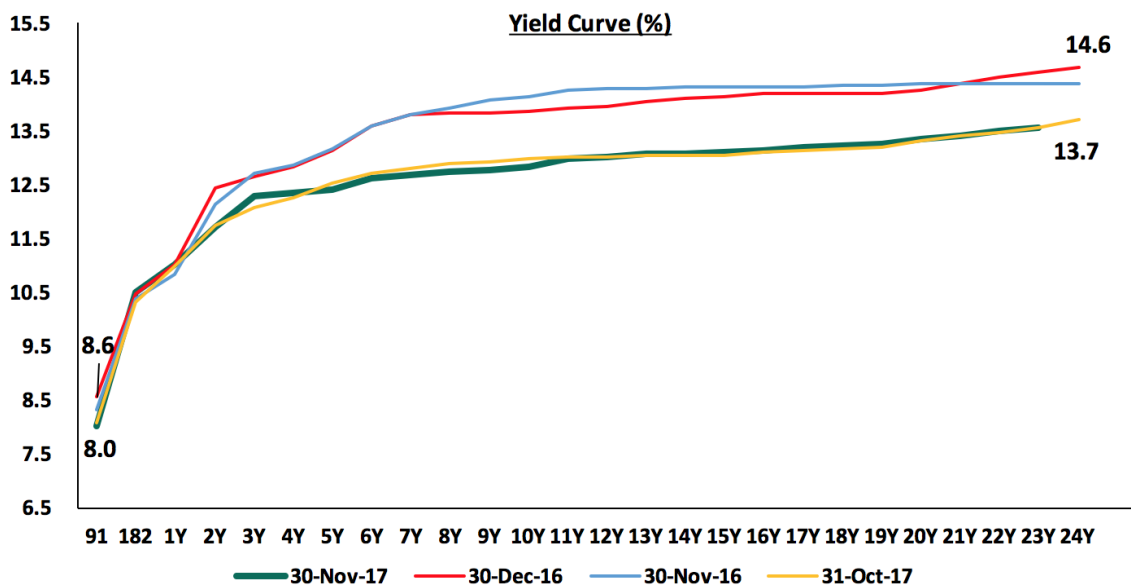
Below is a summary of the money market activity during the month:

all values in Kshs bn, unless stated otherwise

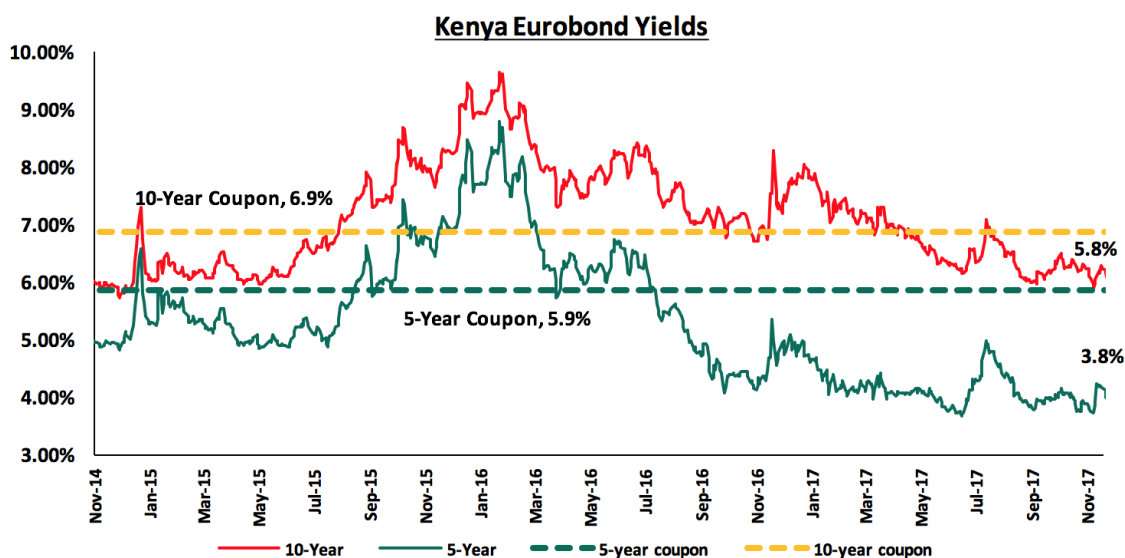
Monthly Liquidity Position - November

Liquidity Injection		Liquidity Reduction	
Government Payments	94.7	T-bonds sales	42.0
T-bonds Redemptions	27.9	Transfer from Banks - Taxes	98.6
T-bills Redemptions	81.3	T-bills (Primary issues)	72.5
T-bonds Interest	14.8	Reverse Repo Maturities	38.2
Reverse Repo Purchases	39.1	OMO Tap Sales	7.3
Repos Maturities	9.8	Repos	9.8
T-bills Re-discounts	3.7		
Total Liquidity Injection	271.3	Total Liquidity Withdrawal	268.4
Net Liquidity Injection			2.9

The yields on government securities in the secondary market remained relatively unchanged during the month, only recording slight upward movement for the tenor of 3-5 years. On a year to date basis, the yield curve has experienced a downward pressure leading to decline in yields. According to the FTSE NSE Bond Index, Treasury bonds listed at the Nairobi Securities Exchange (NSE) gained 1.1% during the month, bringing the YTD performance to 13.6%.

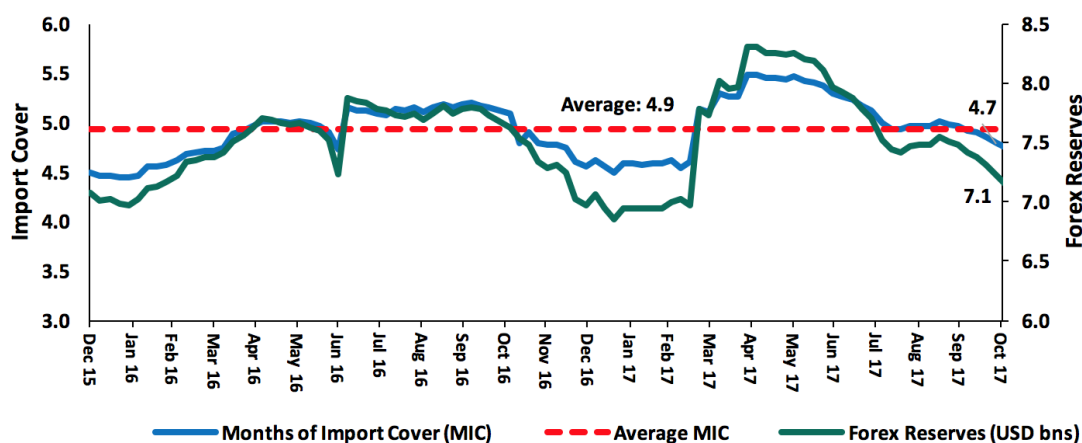


According to Bloomberg, the yield on the 10-year Eurobond declined by 30 bps during the month, to close at 5.8% from 6.1% at the end of October, while the yield on the 5-year Eurobond remained unchanged at 3.8%, despite the uncertainty surrounding the repeat presidential elections. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 5.0% points and 3.9% points for the 5-year and 10-year Eurobonds, respectively, due to stable macroeconomic conditions in the country. The declining Eurobond yields can be attributed to a relatively peaceful electioneering period and stable rating by Standard & Poor (S&P). There has however been concerns from Moody's around Kenya's rising debt to GDP levels and if not resolved may see Kenya receive a downgraded sovereign credit rating.



The Kenya Shilling appreciated by 0.6% against the USD during the month of November to close at Kshs 103.1, from Kshs 103.8 in October, primarily due to increased foreign investor inflows into the equities market and primary bond auction, following a relatively peaceful election period. On a year to date basis, the shilling has depreciated against the dollar by 0.6%. In our view, the shilling should remain relatively stable against the dollar in the short term, supported by (i) the expected calm in the political front, following the conclusion of the presidential elections and the swearing in of the President, (ii) the weakening of the USD in the global markets, as indicated by the US Dollar Index, which has shed 8.7% 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).

Kenya Months of Import Cover and Forex Reserves (USD bns)



The inflation rate for the month of November declined by 1.0% points, to a four-year low of 4.7%, from 5.7% in October. The decline was primarily driven by a drop in food prices, which dropped by 1.3% m/m and 5.8% y/y, due to improved weather conditions in most parts of the country. Some of the indices that increased are (i) a rise of 1.7% m/m in housing, water, electricity, gas and other fuels, brought about by increased cost of electricity, house rents and other cooking fuels, and (ii) an increase of 0.6% in the cost of fuel, following increased pump prices of petrol and diesel. Below is a summary of key changes on the Consumer Price Index (CPI) in November;

Major Inflation Changes in the Month of November 2017

Broad Commodity Group	Price change m/m (Nov 2017/Oct 2017)	Price change y/y (Nov 2017/Nov 2016)	Reason
Food & Non-Alcoholic Beverages	(1.3%)	5.8%	This was due to fall in the cost of most food basket items, mainly attributed to favorable weather conditions
Transport Cost	0.6%	3.8%	This was on account of an increase in pump prices of petrol and diesel
Housing, Water, Electricity, Gas and other Fuels	1.7%	5.3%	This was mainly due to notable increases in the cost of house rents, electricity and other cooking fuels
Overall Inflation	(0.2%)	4.7%	The decline was mainly driven by the decrease in food & non-alcoholic beverages, which has a CPI weight of 36.0%

On a year-to-date basis, inflation has averaged 8.3%. Going forward, we expect inflationary pressures to remain subdued, given food prices are expected to stabilize on account of the improved weather conditions. Despite this, we expect inflation to average 8.0% over the course of the year, which is above the upper bound of the government target range of 2.5% - 7.5%.

The Monetary Policy Committee (MPC) met during the month, 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, provides 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.

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

The International Monetary Fund (IMF) expressed concerns about Kenya's debt levels during the month, stating that, despite the country's resilience through the 2016/17 drought and the long electioneering period, debt vulnerability should be addressed. According to CBK data, Kenya's total debt has continued to grow, and has risen by 21.0% y/y to Kshs 4.5 tn in September 2017 from Kshs 3.7 tn in September 2016. Furthermore, according to the National Treasury, the budget deficit to GDP ratio is expected to increase to 7.9% in the fiscal year 2017/18 from 6.2% previously and public debt to GDP ratio is expected to hit 59.0% by December 2017, from 51.8% previously targeted, that being 900 bps above the 50.0% IMF threshold, it raises 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. This is after data from the treasury revealed that Kenya borrowed Kshs 487.0 bn from China in the year ended September 2017. 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) enhancing tax 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.

Fixed Income Conclusion:

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.