Kenya Listed Banks Q3’2017 Report, & Cytonn Weekly #49/2017

Fixed Income

During the week, T-bills were undersubscribed, with the overall subscription rate rising marginally to 79.5%, from 75.3% recorded the previous week, as liquidity improved supported by government payments amounting to Kshs 47.8 bn. The subscription rates for the 91, 182 and 364-day papers came in at 125.5%, 64.2%, and 76.4% compared to 212.7%, 29.3% and 66.4%, respectively, the previous week. Yields on the 91 and 182-day papers remained unchanged at 8.0% and 10.5%, respectively, while the yield on the 364-day paper rose to 11.1% from 11.0% last week. The overall acceptance rate came in at 94.9%, compared to 84.7% the previous week, with the government accepting a total of Kshs 18.1 bn of the Kshs 19.1 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 72.1 bn, against a target of Kshs 181.4 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 improved during the week, with a net liquidity injection of Kshs 29.3 bn, compared to a net liquidity withdrawal of Kshs 11.7 bn the previous week, supported by the government payments of Kshs 47.8 bn. Consequently, the average interbank rate declined to 8.0% from 8.6% recorded the previous week, while the average volumes traded in the interbank market increased by 27.8% to Kshs 27.3 bn from Kshs 21.4 bn the previous week. It is important to note that for this week, banks holding of excess liquidity (Cash Reserve Requirement (CRR)) stood at Kshs 7.0 bn above the 5.25% requirement, from a shortfall of Kshs 1.7 bn the previous week.

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

all values in Kshs bn, unless stated otherwise			
Weekly Liquidity Position – Kenya (Week 49/2017)			
Liquidity Injection		**Liquidity Reduction**	
Government Payments	47.8	Transfer from Banks - Taxes	16.3
T-bills Redemption	21.8	T-bills (Primary issues)	17.3
Reverse Repo Purchases	21.5	Reverse Repo Maturities	28.2
Total Liquidity Injection	**91.1**	**Total Liquidity Withdrawal**	**61.8**
		Net Liquidity Injection	**29.3**

For December’s auction, the Kenyan Government has reopened two bonds, a 15-year (FXD 1/2008/15) and a 10-year (FXD 1/2017/10) with effective tenors of 5.3 years and 9.6 years, respectively. The government will be seeking to raise Kshs 30.0 bn for budgetary support and the coupons are at 12.5% and 13.0% for the 15-year and 10-year bonds, respectively. The bonds are

currently trading at yields of 12.5% and 12.8% for the 15-year and 10-year bonds in the secondary market, respectively, thus we expect bids at yields of between 12.5% - 13.0% and 12.8%-13.3% for the 15-year and 10-year bonds, respectively.

According to Bloomberg, yields on the 5-year and 10-year Eurobonds remained unchanged during the week, to close at 3.8% and 5.8%, respectively. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 5.0% points and 3.8% 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) are indications that Kenya's macro-economic environment remains stable and hence an attractive investment destination. However, concerns from Moody's and the International Monetary Fund (IMF) around Kenya's rising debt to GDP levels may see Kenya receive a downgraded sovereign credit rating.

The Kenya Shilling remained relatively unchanged against the US Dollar during the week to close at Kshs 103.1 after hitting a high of 102.9 on Wednesday since mid-September. The stability of the shilling during the week was supported by foreign investor inflows into the local debt market, which offset dollar demand from importers. 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) 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 8.0% year to date, though the dollar could gain if the Federal Reserve hikes rates leading to a depreciation of the shilling, and (iii) the CBK's intervention activities, as they have sufficient forex reserves, currently at USD 7.1 bn (equivalent to 4.8 months of import cover).

The Kenyan economy appears to be on a path of recovery after a challenging economic environment in the better part of this year, with drought and the elongated election period being the key challenges. According to the Stanbic Bank's Monthly Purchasing Manager's Index (PMI), the index rose to 42.8 in the month of November from a low of 34.4 in October, an indication of better economic sentiments. Private sector economic activity is expected to rebound going forward, supported by (i) the favourable weather conditions supporting agricultural activity, (ii) political uncertainty easing after the election period, and (iii) inflation remaining within a range favourable for economic growth. However, the World Bank has cut its economic growth projections for Kenya in 2017 to 4.9% from 5.5% previously, due to (i) lower than historical private sector credit growth at 2.0% in October 2017 compared to a 5-year average of 14.4%, and (ii) political uncertainty that surfaced during the year. The bank has also cut the projections for 2018 and 2019 to 5.5% and 5.8% from 5.8% and 6.1% previously, respectively, highlighting that the country needs to employ austerity measures in regards to government borrowing and focus on private lending instead to spur job creation and economic growth. This comes after the International Monetary Fund (IMF) lowered its projection to 5.0% from 5.3% in October due to political jitters. We still expect the economy to grow at a rate of between 4.7% - 5.2% for 2017, supported by (i) the continuing government expenditure on infrastructure, (ii) the continuing recovery of the tourism sector, and (iii) the continuing growth of the real estate sector, but to rebound in 2018 and remain stable in the medium to long-term.

The United States Federal Open Market Committee (FOMC) is set to meet on 12th and 13th December 2017 to assess the current state of the US economy and shed light on a possible rate hike. During the Fed's previous meeting held in October, the committee decided to maintain the Fed rate within the band of 1.00% - 1.25%, citing (i) low inflation at 1.7% in September, that remained below the set target of 2.0%, and (ii) instability in the labour market, creating only 18,000 jobs in September due to adverse effects of the hurricane, compared to 156,000 jobs created in August. Previously, the Fed highlighted plans to accelerate its rate-hiking pace, hinting at three rate hikes in 2017 on expectations of improved economic performance this year. We expect the Fed to raise rates for the third time this year to a band of 1.25% - 1.50%, given that, (i) core inflation rose to 1.8% y/y

in October, closer to the target of 2.0%, (ii) the labour market has since strengthened amid a challenging economic environment, adding approximately 261,000 new jobs in October, from 18,000 jobs in September, with the unemployment rate currently at 4.1%, which is below the full employment rate of 5.0%, and (iii) relatively strong economic growth, coming in at 3.3% in Q3'2017 compared to 2.8% in Q3'2016.

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.