Nyeri Real Estate Investment Opportunity, & Cytonn Weekly #03/2018

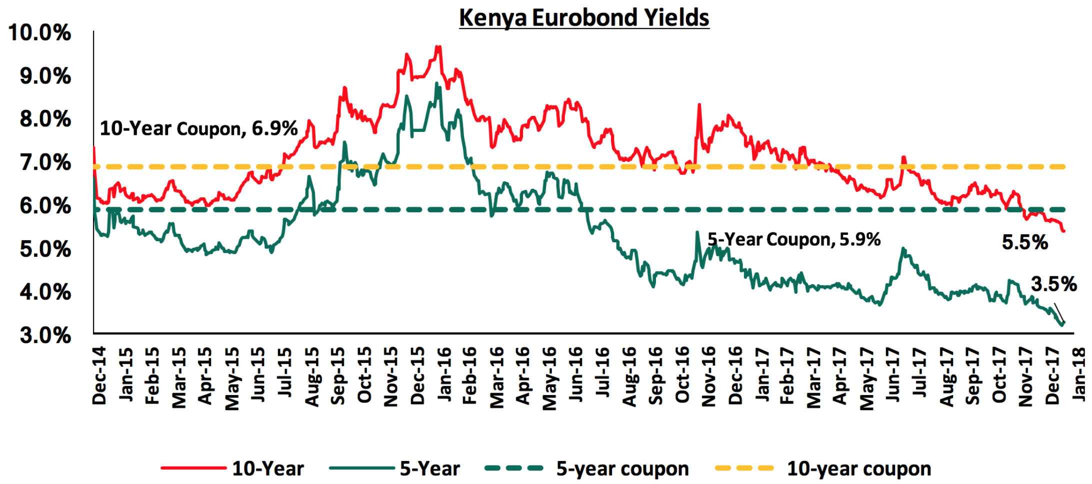
Fixed Income

During the week, T-bills were undersubscribed with the overall subscription rate coming in at 79.9%, compared to 124.4% recorded the previous week. The undersubscription can be attributed to tighter liquidity in the market, as can be seen by the increase in the average interbank rate to 6.1% from 5.3% recorded the previous week. The subscription rates for the 91, 182 and 364-day papers came in at 42.4%, 99.4%, and 75.4% compared to 125.8%, 141.8%, and 106.6%, respectively, the previous week. The yield on the 91-day paper remained unchanged at 8.0% while yields on the 182 and 364-day papers declined to 10.6% and 11.1%, from 10.7%, and 11.2%, respectively, the previous week. The overall acceptance rate remained relatively unchanged at 84.9% compared to 85.0% the previous week, with the government accepting a total of Kshs 16.3 bn of the Kshs 19.2 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 110.6 bn, against a target of Kshs 228.8 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)). The usage of the Central Bank overdraft facility remains high as it stands at Kshs 41.5 bn compared to a nil overdraft at the beginning of this fiscal year.

The average interbank rate rose to 6.1% from 5.3% recorded the previous week, while the average volumes traded in the interbank market decreased by 29.7% to Kshs 11.5 bn from Kshs 16.3 bn the previous week.

The Kenyan Government has issued a 15-year amortized Infrastructure Bond (IFB 1/2018/15), with an effective tenor of 13.0 years, and a coupon of 12.5%, in a bid to raise Kshs 40.0 bn to fund infrastructural projects in the current fiscal year. The weighted average yield accepted on the most recent issued Infrastructural Bond (IFB/1/2017/7), was at a discount of 0.4% to the market yield of 12.6% as the government continued to reject expensive bids. The newly issued bond has a weighted tenor of 13.0 years after adjusting for partial redemptions; a similar taxable bond with the same tenor is currently trading at a yield of 13.1% in the secondary market, and hence we would bid at a yield of between 13.0% and 13.5%.

According to Bloomberg, yields on the 5-year and 10-year Eurobonds remained relatively unchanged during the week, to close at 3.5% and 5.5%, respectively. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 5.3% points and 4.1% 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 if high debt levels persist.



The Kenya Shilling appreciated by 0.2% against the US Dollar during the week to a 6 weeks high of Kshs 102.9 from Kshs 103.1 the previous week, due to continued global weakening of the US Dollar. In our view, the shilling should remain relatively stable against the dollar in the short term, supported by:

i. the calm political environment 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 shed 9.9% in 2017, and 1.8% YTD hitting a 3-year low, and
iii. CBK's intervention activities, as they have sufficient forex reserves, currently at USD 7.0 bn (equivalent to 4.7 months of import cover). Of note is that Reserves have been on a slight declining trend.

The Monetary Policy Committee (MPC) is set to meet on Monday, 22nd January 2018 to review the prevailing macroeconomic conditions and give direction on the Central Bank Rate (CBR). We expect the MPC to maintain rates at the current levels due to a relatively stable macro-economic environment, as evidenced by (i) inflation, which eased to 4.5% in December from 5.7% in October, due to decline in food prices, and (ii) the currency, that has been relatively stable, appreciating by 0.5% since the last meeting (ii) the need to support the economic growth after a slowdown witnessed last year. For our comprehensive analysis on the same, see our MPC Note.

According to the African Economic Outlook for 2018 by the African Development Bank (AfDB), the Eastern African Region shall remain the fastest growing sub-region in Africa, estimated to grow at a rate of 5.6% in 2017, 5.9% in 2018, and 6.1% in 2019. This growth will be driven by (i) continued growth in private consumption, (ii) public investment in infrastructure, (iii) a rebound in the agricultural sector, after a harsh year with unfavourable weather conditions in 2017, and (iv) accelerated construction and real estate activity. The report highlighted that the Sub-Saharan Africa region will rebound to a growth of 3.5% in 2018 and 3.9% in 2019 from the estimated growth of 2.8% in 2017, noting that most African economies are now more resilient and better placed to cope with harsh external conditions. However, AfDB noted that the heavy investment in infrastructure in the region, which is largely financed by external debt, requires careful monitoring to ensure that the economies are not strained, leading to adverse effects on economic growth. AfDB projects that Kenya's economy will expand by 5.6% in 2018 and 6.2% in 2019 after depressed growth in 2017, having averaged 4.7% for the first three quarters of 2017 due to political uncertainty, slowdown in private sector credit growth, and subdued agricultural sector growth. However, the institution has warned Kenya on the rising levels of debt, asserting that high debt levels could strain the economy and have adverse effects on growth. This comes after the World Bank released its growth projections for Kenya for 2018 early in the year, projecting a growth of 5.5%. We shall be releasing our macroeconomic outlook report for Kenya highlighting our expectations for the year on 4th February, 2018.

Rates in the fixed income market have remained stable, and we expect this to continue in the short-term as the government rejects expensive bids despite being behind their borrowing target. However, a budget deficit that is likely to result from depressed revenue collection creates uncertainty in the interest rate environment as any additional borrowing in the domestic market to plug the deficit could lead to an upward pressure on interest rates. Consequently, our view is that investors should be biased towards short- term fixed income instruments to reduce duration risk.

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