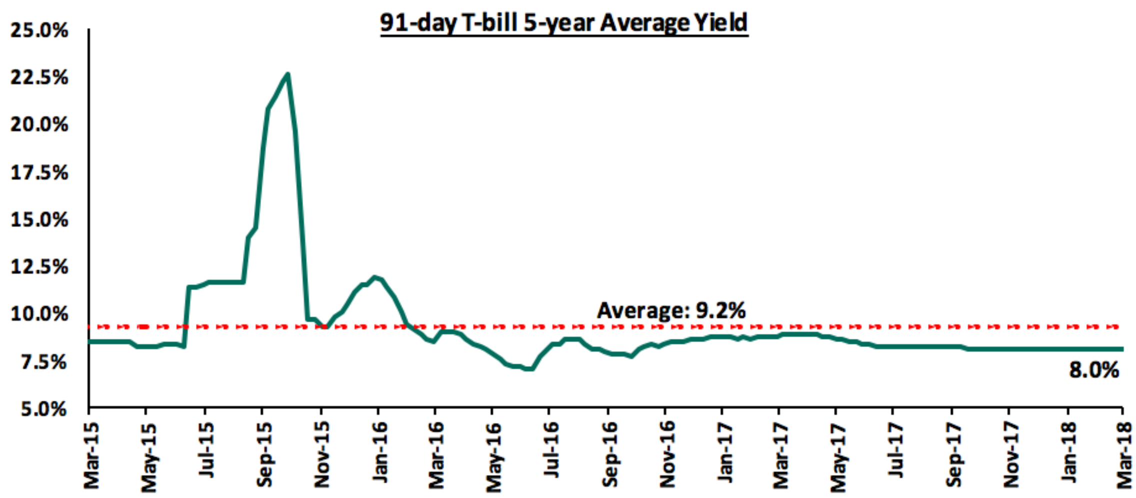
Cytonn Q1'2018 Markets Review

Fixed Income

During the first quarter of 2018, T-bills were oversubscribed, with the overall subscription rate coming in at 115.4% up from 72.5% in Q4'2017. Overall subscriptions for the 91, 182, and 364-day papers in Q1`2018 came in at 94.5%, 109.2% and 130.0% from 84.9%, 61.5% and 78.6% in Q4`2017, respectively. Yields on the 91-day and 364-day T-bills declined by 10 bps each to 8.0% and 11.1% at the end March 2018, from 8.1% and 11.2% as at December 2017, respectively. The yield on the 182-day paper declined by 20 bps to end the quarter at 10.4% from 10.6% at the end of the previous quarter. The average acceptance rate for the quarter came in at 87.7%, down from 92.0% recorded in Q4'2017, with the government accepting a total of Kshs 310.2 bn of the total bids received during the quarter of Kshs 355.8 bn.

This week, T-bills were undersubscribed, with overall subscription coming in at 52.8%, down from 114.0% recorded the previous week, as investors focused on the tap sale that registered a subscription rate of 182.5%. Subscription rates for the 91, 182, and 364-day papers came in at 44.1%, 37.5%, and 71.5% from 54.6%, 78.2%, 173.6%, the previous week, respectively. Yields on the 91, 182 and 364-day T-bills remained unchanged during the week at 8.0%, 10.4%, and 11.1%, respectively. The overall acceptance rate increased to 92.9% compared to 83.8% the previous week, with the government accepting a total of Kshs 11.8 bn of the Kshs 12.7 bn worth of bids received, against the Kshs 24.0 bn on offer. The government is currently 19.8% ahead of its domestic borrowing target for the current fiscal year, having borrowed Kshs 267.4 bn, against a target of Kshs 223.2 bn (assuming a pro-rated borrowing target throughout the financial year of Kshs 297.6 bn).

The 91-day T-bill is currently trading at 8.0%, 1.2% points below its 5-year average of 9.2% as seen in the chart below:



During Q1'2018, the Kenyan Government had 3 Treasury Bond primary issues, one in each month, with the details in the table below:

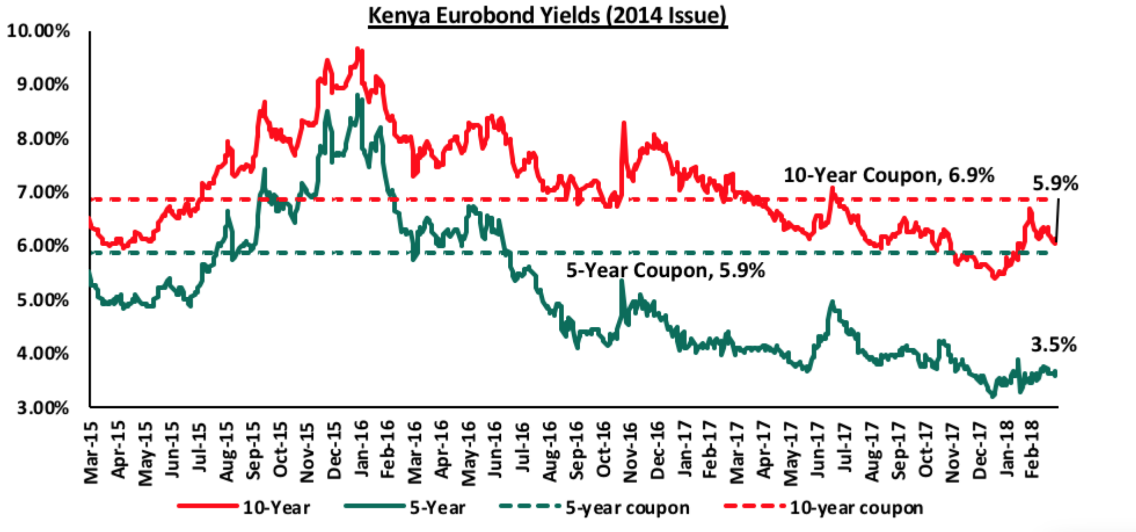
No.	Date	Bond Auctioned	Effective Tenor to Maturity (Years)	Coupon	Amount to be Raised (Kshs bn)	Actual Amount Raised (Kshs bn)	Average Accepted Yield	Subscription Rate	Acceptance Rate
1	16/01/2018	IFB 1/2018/15	15.0	12.5%	40.0	5.0	12.5%	139.4%	9.0%
	30/01/2018	IFB 1/2018/15 (tap sale)			35.0	36.2		103.5%	
2	12/02/2018	FXD/1/2010/15(re-open)	7.1	10.3%	40.0	4.4	12.7%	60.4%	54.7%
		FXD2/2013/15(re-open)	10.2	12.0%		8.8	12.9%		
	27/02/2018	FXD1/2010/15 (tap sale)	7.1	10.3%	27.0	3.8		14.1%	
		FXD2/2013/15(tap sale)	10.2	12.0%					
3	09/03/2018	FXD 1/2018/5	5.0	12.3%	40.0	23.1	12.3%	128.5%	61.4%
		FXD 1/2018/20	20.0	13.2%		8.5	13.3%		
	27/03/2018	FXD 1/2018/5(tap sale)	5.0	12.3%	8.5	15.5		182.5%	
		FXD 1/2018/20(tap sale)	20.0	13.0%					

Primary T-bond auctions in Q1’2018 were oversubscribed, except for the February auction, with the subscription rate averaging 104.7% for the quarter, higher than the average subscription rate for Q4’2017, which came in at 75.2%. The average acceptance rate for the quarter came in at 41.7%, as the CBK continued to reject bids deemed expensive in order to maintain the rates at low levels, with tap sales still being used as a tool to plug in any deficits from primary auction bids. Tap sales were better received by the market during the quarter, with the average subscription rate for tap sales at 100.0%, higher than 41.5% in Q4’2017.

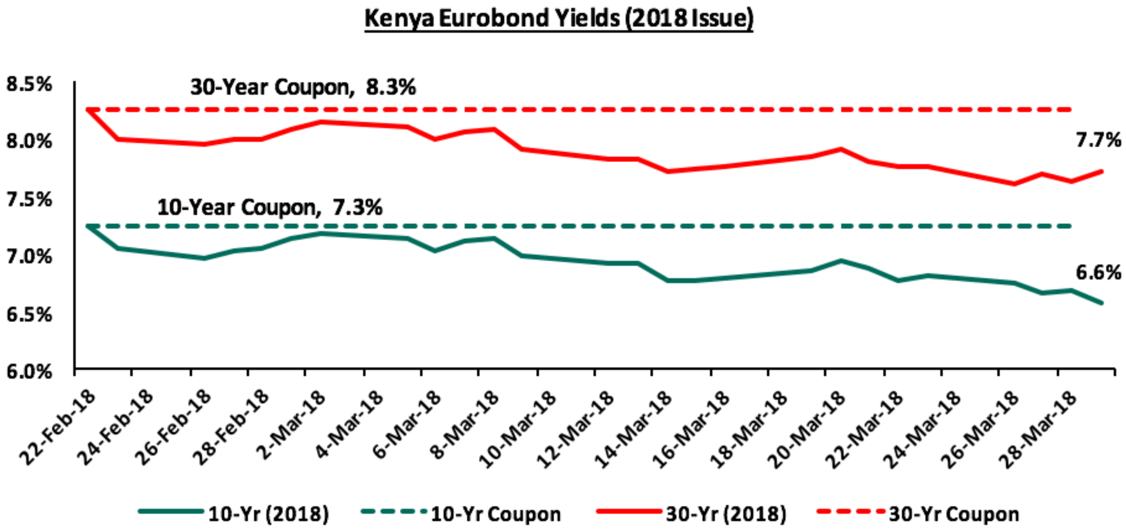
The NSE FTSE Bond Index gained 4.0% during the quarter while secondary market bond turnover increased by 89.9% to Kshs 147.1 bn in Q1’2018 from Kshs 77.5 bn in Q4’2017.

Liquidity levels remained stable and well distributed in the market as indicated by the 36.4% decline in the average volumes traded in the interbank market to Kshs 15.1 bn from Kshs 23.7 bn, recorded in Q4’2017 and the subsequent decline in the interbank rate to 5.4% from 7.9% the previous quarter. During the week, liquidity tightened with the average interbank rate rising to 5.8% from 4.6% recorded the previous week. There was a decrease in the average volumes traded in the interbank market by 2.7% to Kshs 14.8 bn, from Kshs 15.2 bn the previous week.

According to Bloomberg, since the mid-January 2016 peak, yields on the 5-year and 10-year Eurobonds issued in 2014 declined by 5.3% and 3.7% points, respectively, indicating foreign investor confidence in Kenya’s macro-economic prospects. During the week, the yields on the 5-year and 10-year Eurobonds declined by 20 bps and 30 bps to 5.9% and 6.2% from 3.5% and 3.7%, the previous week.



The government issued two Eurobonds during the quarter. Since the issue date in February 2018, yields on the 10-year and 30-year Eurobonds have declined by 0.7% and 0.6% points, respectively. During the week, the yields on the 10-year and 30-year Eurobonds declined by 20 bps and 10 bps to 6.6% and 7.7% from 6.8% and 7.8%, the previous week.



Fitch Ratings, S&P Global Ratings and Moody's affirmed Kenya's outlook as "stable", with Moody's downgrading the government's issuer rating to "B2" from "B1" during the quarter. The table below tracks sovereign credit ratings for the Kenyan Government by various global rating agencies:

Kenya Sovereign Credit Rating

No.	Credit Rating Agency	Long-term External & Internal Rating	Short-term External & Internal Rating	Overall Issuer Rating	Outlook
1	Fitch Ratings	B+	B	-	Stable
2	S&P Global Ratings	B+	B	-	Stable
3	Moody's	-	-	B2	Stable

In a bid to attract investments in sustainable development initiatives, and promote the green economy development agenda, the government plans to issue Kenya's first green bond in the fiscal year 2018/19. In our view, the issuance of a green bond will serve to attract more investors into the renewable energy space, diversifying energy sources and increasing foreign direct investment volumes into the country from foreign social investment entities that support green living. However, while we commend innovation, the M-Akiba Bond introduced in Q1'2017 as a way of providing an avenue for smaller retail investors to invest in government securities and encouraging a savings & investment culture in Kenyans, might not have met its purpose. The pilot issue managed to raise Kshs 150.0 mn, 100.0% of its target but the 2nd round that had a target of Kshs 1.0 bn only managed 12.8% of this. As mentioned in our Cytonn Weekly #6/2018, prior to issuing the green bond, the government should identify viable projects that fit into the green bond objectives and educate investors, in order to appeal to the target market, for the bond to be successful in achieving its purpose.

We recently reviewed our fixed income outlook following changes made to government borrowing targets following the approval of the 2018 Budget Policy Statement (BPS). For the detailed review, see our Cytonn Weekly #10/2018.

Rates in the fixed income market have remained stable as the government rejects expensive bids. The MPC met on 19th March 2018 and lowered the CBR by 0.5% to 9.5% from 10.0%. With the government under no pressure to borrow for this fiscal year as (i) they are currently ahead of their domestic borrowing target by 19.8%, (ii) have met 72.9% of their total foreign borrowing target for the current fiscal year, and (iii) the KRA is not significantly behind target in revenue collection, we expect interest rates to remain stable. With the expectation of a relatively stable interest rate environment, our view is that investors should be biased towards medium to long-term fixed income instruments.