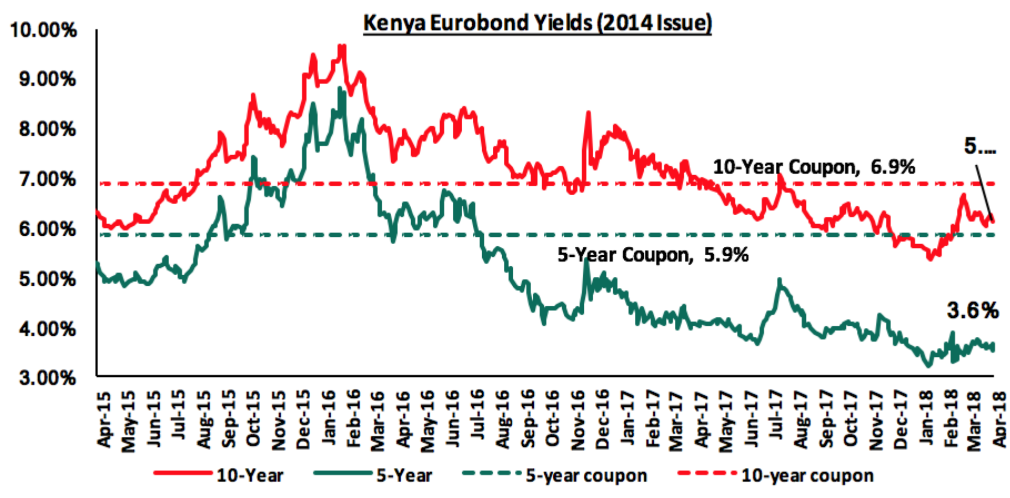
# The Kenya Mortgage Refinancing Company, & Cytonn Weekly #14/2018

## Fixed Income

Treasury bills were oversubscribed during the week, with the overall subscription rate coming in at 107.0%, from an undersubscription of 52.8% recorded the previous week. The subscription rates for the 91, 182 and 364-day papers came in at 73.9%, 71.6%, and 155.6% compared to 44.1%, 37.5%, and 71.5%, respectively, the previous week. Yields on the 91 and 364-day T-bills remained unchanged at 8.0% and 11.1%, respectively, while the yield on the 182-day paper declined by 10 bps to 10.3%, from 10.4% the previous week. The overall acceptance rate increased to 99.4% compared to 92.9% the previous week, with the government accepting a total of Kshs 25.5 bn of the Kshs 25.7 bn worth of bids received, against the Kshs 24.0 bn on offer. The government is currently 20.3% ahead of its domestic borrowing target for the current fiscal year, having borrowed Kshs 275.3 bn, against a target of Kshs 228.9 bn (assuming a pro-rated borrowing target throughout the financial year of Kshs 297.6 bn).

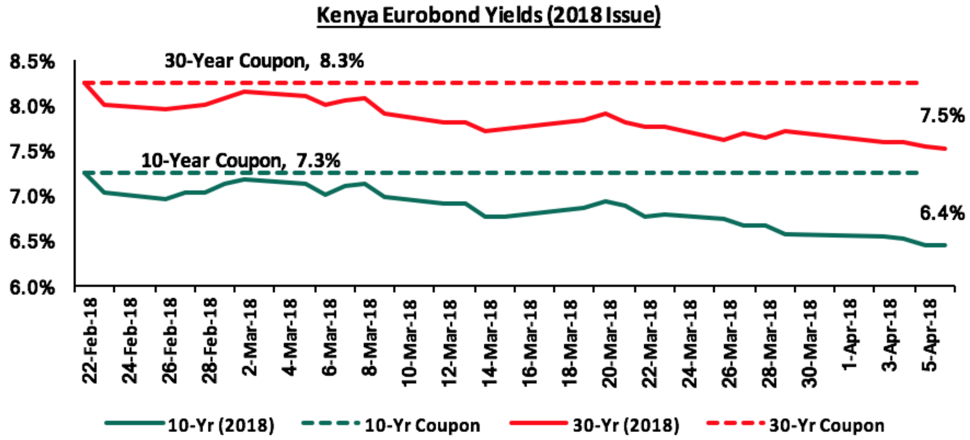
During the week, liquidity levels declined in the money market as indicated by the rise in the average interbank rate to 6.3%, from 5.8% recorded the previous week, owing to government security pricipal payments for the T-bond tap sale and T-bills, both value dated 2 nd April 2018. There was an increase in the average volumes traded in the interbank market by 40.1% to Kshs 20.7 bn, from Kshs 14.8 bn the previous week.

According to Bloomberg, the yield on the 5-year Eurobond issued in June 2014 increased by 10 bps to 3.6% from 3.5%, while the yield on the 10-year Eurobond declined by 20 bps to 5.7%, from 5.9% the previous week. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 5.2% points and 3.9% points for the 5-year and 10-year Eurobonds, respectively, due to the relatively stable macroeconomic conditions in the country. Key to note is that these bonds currently have 1.2 and 6.2-years to maturity for the 5-year and 10-year, respectively.




For the February 2018 Eurobond issue, during the week, the yields on the 10-year and 30-year

Eurobonds declined by 20 bps each to 6.4% and 7.5% from 6.6% and 7.7%, respectively, the previous week. Since the issue date, yields on the 10-year and 30-year Eurobonds have declined by 0.8% points and 0.7% points, respectively, indicating foreign investor confidence in Kenya's macro-economic prospects.




The Kenya Shilling depreciated by 0.2% against the US Dollar during the week, to close at Kshs 101.0 from Kshs 100.8 the previous week, driven by increased dollar demand from importers. On a YTD basis, the shilling has gained 2.1% against the USD. In our view, the shilling should remain relatively stable against the dollar in the short term, supported by:

i. Weakening of the USD in the global markets as indicated by the US Dollar Index, which shed 9.9% in 2017, and has shed 2.1% YTD, as the Euro and the Sterling Pound continue to strengthen against the USD with the continued recovery of the Eurozone,
ii. Improving diaspora remittances, which increased by 47.5% to USD 210.4 mn in February 2018 from USD 142.7 mn in February 2017, driven by continued marketing of Kenya as an attractive investment destination for Kenyans in the diaspora, and,
iii. CBK's intervention activities, as they have sufficient forex reserves, currently at USD 8.8 bn (equivalent to 5.9 months of import cover), and the USD 1.5 bn stand-by credit and precautionary facility by the IMF, still available until September 2018, after which a new facility will be discussed.

The National Treasury decided to maintain the country's Value Added Tax (VAT) rate at 16.0%, against suggestions from a report by the Institute of International Finance (IIF) to raise the VAT rate to 18.0% to match VAT charged by other East African Community (EAC) countries. The tax rise would be in line with plans to reduce the country's budget deficit through increased tax collection and reduced recurrent spending, as recommended by the International Monetary Fund (IMF) in March, and in turn reduce public borrowing. This comes after the decision to introduce VAT on petroleum products in September 2018, in a bid to increase revenue collections and reduce the budget deficit in the next fiscal year. This is a good decision since it is meant to cushion consumers from a rapidly rising cost of living and possibly maintain Kenya's trade competitiveness. The Treasury however still needs to maintain the path towards fiscal consolidation by reducing the budget deficit. This will be achieved through (i) reduction in expenditure, especially recurrent expenditure and the rising public wage bill, (ii) increased revenue collection through either improved administrative efficiency in the tax collection process by the Kenya Revenue Authority (KRA), widening of the tax base to include the large informal sector, increased tax rates, or a combination of all, and (iii) privatisation of some of the state corporations to realise cash and increase efficiency.

***Rates in the fixed income market have remained stable as the government rejects expensive bids. The MPC met on 19 th 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 20.3%, (ii) have met 72.9%***

***of their total foreign borrowing target and 94.8% of its pro-rated 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.***

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