Cytonn INVESTMENTS

Affordable Housing in Kenya, & Cytonn Weekly #16/2018

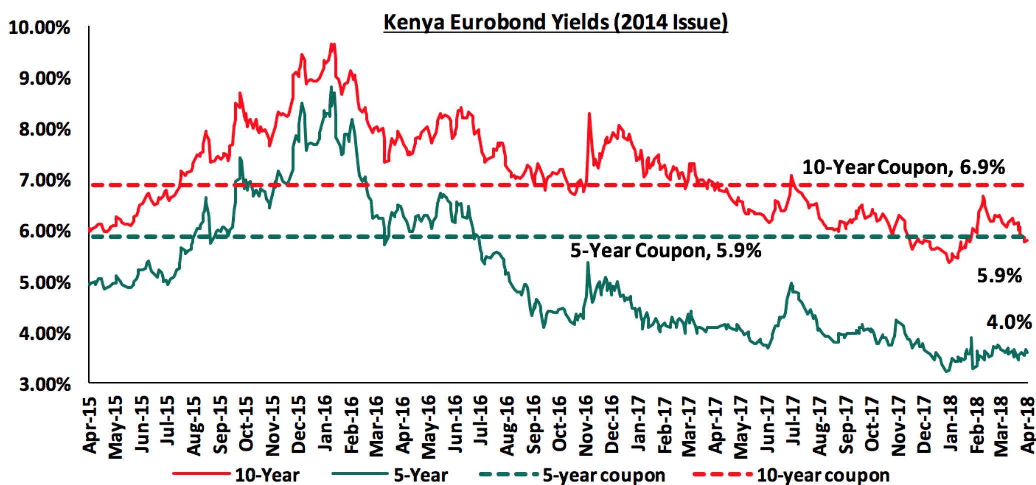
Fixed Income

During the week, T-bills were oversubscribed recording a subscription rate of 162.5%, up from a subscription rate of 87.1% the previous week, due to improved liquidity mainly as a result of government payments during the week. The subscription rates for the 91, 182 and 364-day papers came in at 129.3%, 179.5%, and 158.6% compared to 43.9%, 69.5%, and 121.9%, respectively, the previous week. Yields on the 91, 182 and 364-day papers remained unchanged at 8.0%, 10.3% and 11.1%, respectively. The acceptance rate for T-bills declined to 81.4% from 99.4% last week, with the government accepting a total of Kshs 20.8 bn of the Kshs 20.9 bn worth of bids received, against the Kshs 24.0 bn on offer. The government is currently 17.7% ahead of its domestic borrowing target for the current fiscal year, having borrowed Kshs 283.0 bn, against a target of Kshs 240.4 bn (assuming a pro-rated borrowing target throughout the financial year of Kshs 297.6 bn).

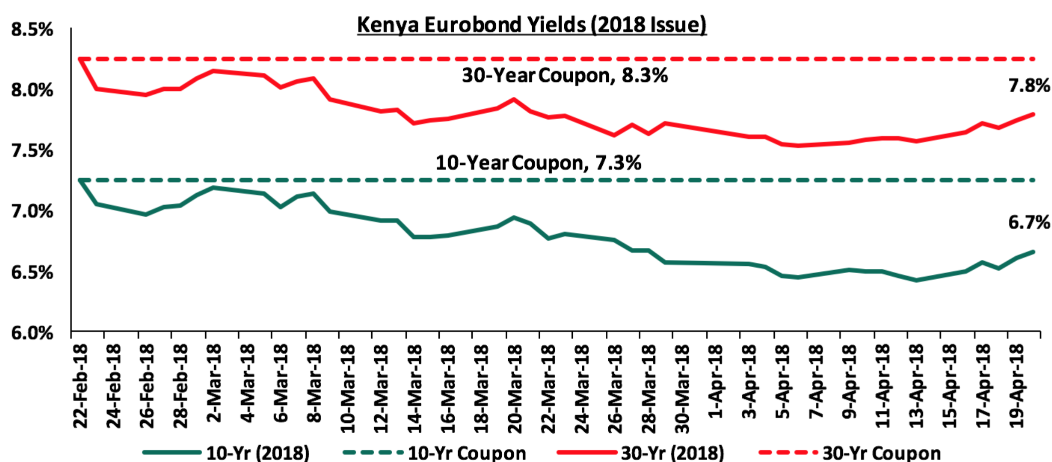
Last week, the Kenyan Government re-opened 2 bonds, FXD 1/2008/15 and FXD 1/2018/20, with 4.9-years and 19.9-years to maturity, and coupons of 12.5% and 13.2%, respectively, in a bid to raise Kshs 40.0 bn for budgetary support. Given that (i) the government is currently 17.7% ahead of its pro-rated domestic borrowing target, and has collected 72.9% of its total foreign borrowing target, which is 90.2% of its pro-rated target, and (ii) the KRA is not significantly behind target, having collected 91.2% of its half year 2017/18 target, we don't expect the government to come under pressure to borrow during the current fiscal year, neither do we expect upward pressure on interest rates in the same period. These Treasury bonds are currently trading at yields of 12.1% and 13.1% in the secondary market, respectively. As such we see the average yield of the bonds coming in between 12.0% and 12.3% for the FXD 1/2008/15 and between 13.0% and 13.3% for the FXD 1/2018/20.

Liquidity levels improved in the money market on account of government payments, as indicated by the decline in the average interbank rate to 4.6%, from 6.1% recorded the previous week. There was a decrease in the average volumes traded in the interbank market by 36.6% to Kshs 14.4 bn, from Kshs 22.7 bn the previous week.

According to Bloomberg, the yield on the 5-year Eurobond issued in June 2014 increased by 40 bps to 4.0% from 3.6%, while the yield on the 10-year Eurobond increased by 10 bps to 5.9% from 5.8% the previous week. According to the CBK, the rise in yields was as a result of varying market sentiments from foreign investors. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.8% points and 3.7% 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 bonds respectively.



For the February 2018 Eurobond issue, during the week, the yields on the 10-year and 30-year Eurobonds increased by 30 bps and 20 bps to 6.7% and 7.8 from 6.4% and 7.6% the previous week, respectively. Since the issue date, yields on the 10-year and 30-year Eurobonds have declined by 0.6% points and 0.5% points, respectively, indicating foreign investor confidence in Kenya's macro-economic prospects.



The Kenya Shilling appreciated by 0.6% against the US Dollar during the week, to close at Kshs 100.3 from Kshs 100.9 the previous week, the highest the Kenya Shilling has been to the USD since July 2015, driven by horticulture export inflows. On a YTD basis, the shilling has gained 2.8% 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 2.0% YTD, as the Euro and the Sterling Pound continue to strengthen against the USD with the continued recovery of the Eurozone,
ii. Stronger horticulture export inflows driven by increasing production and improving global prices. Kenya's value of horticulture exports increased by 13.3% in 2017 to Kshs 115.0 bn from Kshs 101.5 bn in 2016, driven by compliance of Kenyan produce with requirements from main export markets such as the Eurozone. Cut flowers, which contribute 70.0% of total horticulture export earnings, increased by 16.1% to Kshs 82.2 bn from Kshs 70.8 bn in the same periods,
iii. 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,
iv. High forex reserves, currently at USD 9.5 bn (equivalent to 6.4 months of import cover), up from USD 8.8 bn last week, 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.

Rates in the fixed income market have remained stable as the government rejects expensive bids. The government is under no pressure to borrow for this fiscal year due to: (i) they are currently ahead of their domestic borrowing target by 17.7%, (ii) they have met 72.9% of their total foreign borrowing target and 91.2% of its pro-rated target for the current fiscal year, and (iii) the KRA is not significantly behind target in revenue collection, and therefore 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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