Cytonn INVESTMENTS

Rate Cap Review Should Focus More on Stimulating Capital Markets, & Cytonn Weekly #19/2018

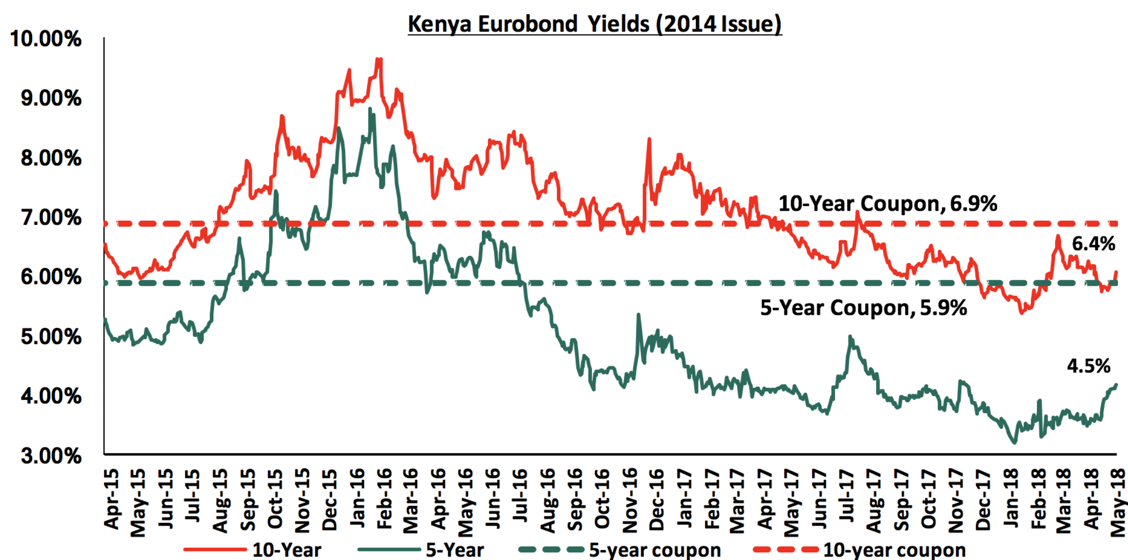
Fixed Income

T-bills were oversubscribed during the week, with the subscription rate coming in at 165.7%, up from 136.8%, the previous week. The subscription rates for the 91, 182 and 364-day papers came in at 120.8%, 150.8%, and 198.4% compared to 122.9%, 124.2%, and 155.1%, 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 improved to 91.2% from 81.1%, the previous week, with the government accepting a total of Kshs 36.3 bn of the Kshs 39.8 bn worth of bids received, against the Kshs 24.0 bn on offer. The government is currently 33.0% ahead of its pro-rated domestic borrowing target for the current fiscal year, having borrowed Kshs 342.5 bn, against a target of Kshs 257.5 bn (assuming a pro-rated borrowing target throughout the financial year of Kshs 297.6 bn).

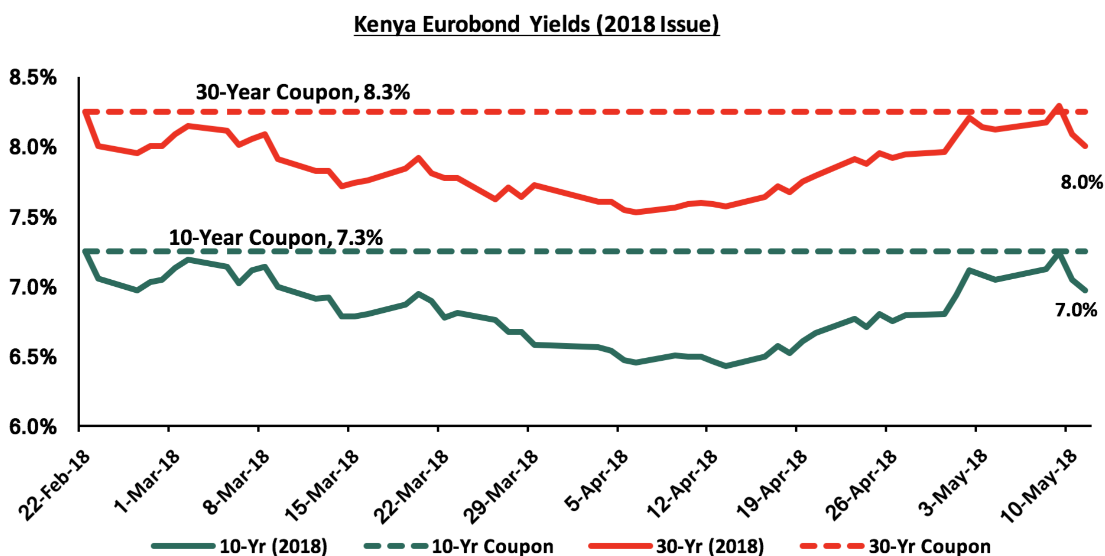
For the month of May 2018, the Kenyan Government has issued a new 15-year Treasury bond (FXD 1/2018/15) with the coupon set at 12.7%, in a bid to raise Kshs 40.0 bn for budgetary support. The sale period ends on 22nd May, and we shall give our view on a bidding range in next week's report.

Liquidity levels declined in the money market as indicated by the increase in the average interbank rate to 5.0%, from 4.8% recorded the previous week, following tax remittances by banks. There was an increase in the average volumes traded in the interbank market by 4.7% to Kshs 15.5 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 4.5% from 4.4%, the previous week, while the yield on the 10-year Eurobond remained unchanged at 6.4%. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.3% points and 3.2% 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 1.1 and 6.1-years to maturity for the 5-year and 10-year bonds, respectively.



For the February 2018 Eurobond issue, during the week, the yield on the 10-year Eurobond remained unchanged at 7.0%, while the yield on the 30-year Eurobond declined by 10 bps to 8.0%, from 8.1%, the previous week. Since the issue date, yields on the 10-year and 30-year Eurobonds have both declined by 0.3% points each, indicating foreign investor confidence in Kenya's macroeconomic prospects.



During the week, the Kenya Shilling depreciated by 0.2% against the US Dollar to close at Kshs 100.4, from Kshs 100.2 the previous week, as a result of increased dollar demand from oil importers. On a YTD basis, the shilling has gained 2.7% against the USD. In our view, the shilling should remain relatively stable against the dollar in the short term, supported by:

i. Stronger horticulture export inflows driven by increasing production and improving global prices,
ii. Improving diaspora remittances, which increased by 50.6% to USD 222.2 mn in March 2018 from USD 147.5 mn in March 2017, attributed to (i) increased uptake of financial products by the diaspora due to financial services firms, particularly banks, targeting the diaspora, and (ii) new partnerships between international money remittance providers and local commercial banks making the process more convenient. Key to note is that in 2017, diaspora remittances became the largest foreign exchange earner at Kshs 202.9 bn, exceeding tea exports and tourism receipts, which earned Kshs 119.9 bn and Kshs 147.2 bn, respectively,
iii. High forex reserves, currently at USD 9.1 bn (equivalent to 6.1 months of import cover), which is a decline from USD 9.5 bn (equivalent to 6.4 months of import cover) as at 26th April, attributed to repayment of the outstanding balance of the matured USD 750 mn syndicated loan taken in

October 2015, and,

iv. 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.

From the Treasury's programme-based budget of the National Government of Kenya for the year ending 30th June 2019, loan repayments to China are set to increase by 129.0% in the fiscal year 2019/20, to an estimated Kshs 82.9 bn from an estimated Kshs 36.2 bn in the financial year 2018/19, as the grace period that had been extended to Kenya for the Standard Gauge Railway (SGR) loan comes to an end. Principal payments for the loan to the Kenyan Government from the Export-Import Bank of China of USD 3.2 bn, to build Phase I of the SGR, are set to increase by 36.1% to Kshs 8.3 bn in financial year 2018/19, and Kshs 34.8 bn in financial year 2019/20, from Kshs 6.1 bn this financial year as the grace period extended comes to an end. The loan comprised of a (i) USD 1.6 bn semi-concessional loan at an interest rate of 2.0%, paid over 20-years, with a grace period of 7-years, and (ii) USD 1.6 bn commercial loan at an interest rate of 3.6% above the prevailing 6 month-LIBOR, paid over 15-years, with a grace period of 5-years. This comes at a time when the World Bank, in its Pulse Report, raised concerns over the rising public debt levels in Sub-Saharan Africa, citing the composition of debt has changed, as countries have shifted away from traditional concessional sources of financing toward more market-based ones. Higher debt burdens and the increasing exposure to market risks raise concerns about debt sustainability. As discussed in our topical on Kenya's Public Debt, Should We Be Concerned?, we maintain that the government should implement decisive policies to curtail the growth of Kenya's public debt burden and reduce the risk of the country joining the list of debt defaulters.

During the week, the IMF released their Regional Economic Outlook report for Sub-Saharan Africa (SSA) dated April 2018, with a focus on domestic revenue mobilization and private investment. The key take-outs from the report were:

i. GDP growth in SSA is projected to come in at 3.4% in 2018, up from 2.8% in 2017, supported by higher commodity prices, and improved capital markets access,
ii. The average current account deficit in SSA is estimated to have narrowed to 2.6% of GDP in 2017, from 4.1% in 2016. The improvement was due to an increase in international receipts in about half of the region's economies. For large oil exporters, external balances improved due to higher oil production, improvement in oil prices, and reduced imports with the current account deficit in the Central African Economic and Monetary Community (CEMAC) declining to 4.3% of GDP in 2017, from 13.8% of GDP in 2016. In non-resource intensive countries, the current account deficits remained high in 2017, due to a combination of low exports, high capital goods imports, high food and fuel imports, and increased imports related to public infrastructure projects, and,
iii. Regional annual inflation in SSA fell to just over 10.0% in 2017, from 12.5% in 2016, and is expected to fall further in 2018, driven by declining food prices due to improved weather conditions.

The report points to an improved operating environment in SSA with (i) projected higher GDP growth in 2018 of 3.4%, compared to 2.8% in 2017, (ii) the average current account deficit narrowing to 2.6% of GDP in 2017, from 4.1% in 2016, and (iii) average annual inflation declining to 10.0% in 2017 from 12.5% in 2016, and expected to fall further in 2018. The key concern, however, remains the rising debt burden, as public debt continued to rise in 2017, with about 40.0% of low-income developing countries in the region being in debt distress or at a high risk of debt distress, and the median level of public debt in SSA exceeding 50.0% of GDP. With the rise in debt, interest payments have also been on the rise, with the median interest payments-to-revenue ratio close to 10.0%, up from 5.0% in the period between 2013 and 2017.

The IMF, however, maintained their 2018 GDP projection for Kenya at 5.5%, bringing the average of projections as at Q2'2018 to 5.5%, as shown in the table below. We shall continue to update this table as these organizations release their updated 2018 projections.

Kenya 2018 Annual GDP Growth Outlook			
No.	**Organization**	**Q1'2018**	**Q2'2018**
1	Central Bank of Kenya	6.2%	
2	Kenya National Treasury	5.8%	
3	Oxford Economics	5.7%	
4	African Development Bank (AfDB)	5.6%	
5	Stanbic Bank	5.6%	5.6%
6	Citibank	5.6%	
7	**International Monetary Fund (IMF)**	**5.5%**	**5.5%**
8	World Bank	5.5%	5.5%
9	Fitch Ratings	5.5%	
10	Barclays Africa Group Limited	5.5%	
11	**Cytonn Investments Management Plc**	**5.4%**	**5.5%**
12	Focus Economics	5.3%	
13	BMI Research	5.3%	5.2%
14	Standard Chartered	4.6%	
	Average	**5.5%**	**5.5%**

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 as: (i) they are currently ahead of their domestic borrowing target by 33.0%, (ii) they have met 72.9% of their total foreign borrowing target and 84.2% of their pro-rated target for the current fiscal year, and (iii) the KRA is not significantly behind target in revenue collection. 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. We are currently revising our view on fixed income investments and shall include a comprehensive analysis of this in next week’s report.