Nairobi Metropolitan Area Residential Report 2017/2018 & Cytonn Weekly #26/2018

Fixed Income

T-Bills & T-Bonds Primary Auction:

T-bills were oversubscribed during the week with the subscription rate coming in at 146.0%, up from 126.0% recorded the previous week. Yields on the 91-day paper remained unchanged at 7.7%, while yields on the 182 and 364-day paper declined to 9.5% and 10.4% from 9.6% and 10.5% the previous week, respectively. T-bill yields continue to decline as the government continues to reject expensive bids in the primary market due to the reduced pressure to borrow, given the reduction in the domestic borrowing target in the 2018/2019 fiscal year to Kshs 271.9 bn, 8.6% lower than the 2017/2018 fiscal year's target of Kshs 297.6 bn. The acceptance rate for T-bills declined to 70.8%, from 88.5% the previous week, with the government accepting Kshs 24.8 bn of the Kshs 35.0 bn worth of bids received. The subscription rates for the 91, 182 and 364-day papers came in at 18.7%, 77.1%, and 265.9%, compared to 115.0%, 57.5%, and 198.9%, respectively, the previous week as investors participation was more skewed towards the longer dated papers.

Liquidity:

The average interbank rate increased to 6.4%, from 6.2%, the previous week, while the average volumes traded in the interbank market increased by 28.5% to Kshs 25.7 bn, from Kshs 20.0 bn the previous week. The increase in the average interbank rate points to declined liquidity, which the Central Bank of Kenya attributed to some banks seeking funds in the interbank market for quarterly tax remittances.

Kenya Eurobonds:

According to Bloomberg, the yield on the 10-year Eurobond issued in 2014 remained unchanged at 7.1%, while the 5-year Eurobond declined by 70 bps to 4.6%, from 5.3% the previous week, a reflection of improved investor sentiment following the expansion of Kenya's economy by 5.7% in Q1'2018, higher than the estimated 2018 growth projection of 5.5%. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.2% points and 2.6% points for the 5-year and 10-year Eurobonds, respectively, an indication of the relatively stable macroeconomic conditions in the country.

For the February 2018 Eurobond issue, during the week, the yields on the 10-year Eurobond declined by 20 bps to 7.6% from 7.8% the previous week, while the 30-year Eurobonds declined by 10 bps to 8.7%, from 8.8% the previous week. Since the issue date, yields on the 10-year and 30-year Eurobonds have both increased by 0.4% points.

We have noted the recent rise in Kenya Eurobond yields and this may be attributed to the current corruption scandals erupting in the country that seem to have led to varying sentiments across the market.

The Kenya Shilling:

During the week, the Kenya Shilling appreciated by 0.3% to close at Kshs 100.8, from Kshs 101.1 the previous week, which the CBK attributed to increased inflows from Kenyans living abroad. In our view, the shilling should remain relatively stable against the dollar in the short term, supported by:

i. The narrowing of the current account deficit, which stood at 6.1% of GDP as at March 2018 from 6.4% in December 2017,
ii. Stronger inflows from principal exports, which include coffee, tea and horticulture, which increased by 9.3% during the month of April to Kshs 21.9 bn from Kshs 20.0 bn in a similar period the previous year, with the exports from coffee, and horticulture increasing by 6.7%, and 25.0% y/y, respectively, while tea exports have declined marginally by 1.6% y/y,
iii. Improving diaspora remittances, which increased by 16.9% to USD 253.7 mn in May 2018, from USD 217.1 mn in April 2018, with the bulk contribution coming from North America at USD 122.8 mn attributed to (a) recovery of the global economy, (b) increased uptake of financial products by the diaspora due to financial services firms, particularly banks, targeting the diaspora, and (c) new partnerships between international money remittance providers and local commercial banks making the process more convenient, and,
iv. High forex reserves, currently at USD 8.9 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.

Weekly Highlights:

According to Kenya National Bureau of Statistics (KNBS), Kenya's economy expanded by 5.7% in Q1'2018, higher than 4.8% in Q1'2017. This was due to; (i) recovery in agriculture, which recorded a growth of 5.2% due to improved weather conditions, (ii) improved business and consumer confidence, and (iii) increased output in the real estate, manufacturing, and wholesale & retail trade sectors, which grew by 6.8%, 2.3% and 6.3%, respectively. The agriculture & forestry sector had the highest sectoral contribution to the overall GDP growth, with a weighted contribution of 1.3% of the 5.7% growth. For a more comprehensive analysis on the economic growth review, see Kenya Q1'2018 GDP Review and Outlook.

According to the Stanbic Bank's Monthly Purchasing Manager's Index (PMI), the business environment in the country continued to improve in June 2018, mainly driven by favorable economic conditions and continued strong demand from international markets. The improvement however was at a slower pace compared to May owing to slower rise in output and new business. The seasonally adjusted PMI declined to 55.0 in June from 55.4 in May, the lowest since February. A PMI reading of above 50 indicates improvements in the business environment, while a reading below 50 indicates a worsening outlook. Firms reported growth in value of outputs due to the continued rise in new export orders. This was despite high input costs attributed to an increase in fuel prices, leading to upward pressure on production costs, and consequently a rise in average selling prices with the cost burden being transferred to customers. In response to increased output requirements, firms also raised their staffing levels at a steady pace. We expect output to continue rising, driven by a recovery in agricultural produce, mainly horticulture, as the Eurozone (Kenya's main horticultural export destination) continues to recover and boost demand. The private sector has remained resilient, since the index is still above 50.0, which is a signal of improved business conditions. The rate cap, however, continues to limit private sector credit growth, which stood at an average growth of 2.0% in Q1'2018, compared to 3.8% in Q1'2017. However, if the proposal by the National Treasury CS in the FY2018/19 budget to repeal the interest rate cap law is approved by Parliament,

we expect it to spur growth of the private sector driven by better access to credit as banks will be able to price borrowers appropriately.

Kenya’s current account deficit improved during Q1’2018, coming in at Kshs 107.9 bn from Kshs 129.7 bn in Q1’2017, a decline of 16.8%, equivalent to 8.9% of GDP in Q1’2018, from 11.3% recorded in Q1’2017. This was due to export growth outpacing the growth in imports, growing at 7.1% to Kshs 162.9 bn from Kshs 152.1 bn in Q1’2017, compared to the 6.5% increase in imports to Kshs 432.1 bn from Kshs 406.4 bn in Q1’2017. In addition, there was a 28.0% increase in the services trade balance, coupled with the 26.9% increase in the secondary income (transfers) balance, whose increase could be attributed to the 46.1% increase in diaspora remittances. While the improvement in the trade deficit is commendable, we are still of the view that the government still has to focus on putting further practical measures in place to move to a surplus from the current deficit. This includes: (i) supporting the growth of the domestic manufacturing sector in order to reduce importation of goods that can be produced and sourced locally and strengthening a national marketing body for such products abroad to boost exports, and (ii) providing incentives for exporters, which the government is already planning for through the rolling out of Special Economic Zones (SEZs). For a more comprehensive analysis see the Q1’2018 Quarterly Balance of Payments Note

Rates in the fixed income market have remained stable, and had been on a declining trend towards the tail end of the fiscal year 2017/18, as the government rejected expensive bids given it had been under no pressure to borrow. The government is however likely to remain behind its borrowing target for the better part of the first half of the 2018/19 financial year as per historical data. The newly released 2018/19 budget gives a domestic borrowing target of Kshs 271.9 bn, 8.6% lower than the 2017/2018 fiscal year’s target of Kshs 297.6 bn, which may result in reduced pressure on domestic borrowing. However, the National Treasury has proposed to repeal the interest rate cap, which if repealed can result in upward pressure on interest rates, as banks would resume pricing of loans to the private sector based on their risk profiles. With the cap still in place, we maintain our expectation of stability in the interest rate environment. 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.