Kenya's IMF Standby Facility, & Cytonn Weekly #31/2018

Fixed Income

T-Bills & T-Bonds Primary Auction:

T-bills were oversubscribed during the week, with the overall subscription rate coming in at 102.2%, a significant increase from 57.4% recorded the previous week due to improved liquidity, which the Central Bank of Kenya has attributed to reduced pressure on banks due to the fact they had attained the average monthly Cash Reserve Requirements threshold for the month of August. Yields on the 91-day, 182-day and 364-day papers remained unchanged at 7.7%, 9.0% and 10.0%, respectively. The acceptance rate for T-bills declined to 95.8% from 96.8% the previous week with the government accepting Kshs 23.5 bn of the Kshs 24.5 bn worth of bids received. The subscription rate for the 91-day, 182-day and 364-day papers improved to 153.9%, 72.8% and 110.9%, from 15.1%, 20.5% and 111.1% the previous week, respectively.

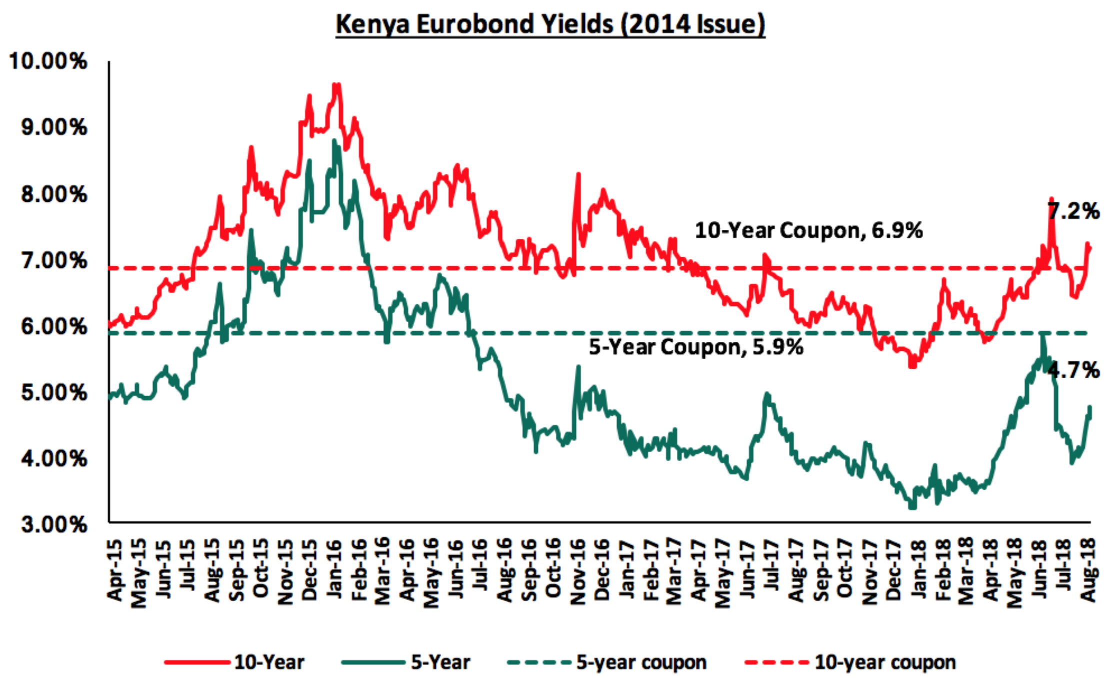
During the month of August 2018, the Kenyan Government has issued a new medium-term 10-year Treasury bond (FXD 1/2018/10) with a market-determined coupon rate, in a bid to raise Kshs 40.0 bn for budgetary support. The government has been issuing long-term bonds in a bid to lengthen the average time to maturity for the total debt portfolio which stood at 7.1 years as at the end of FY'2017/2018, a decline from 7.8 years as at the end of FY'2016/2017 as per data from the Medium Term Debt Management Strategy FY2018/19-FY2020/21 and FY2017/18-FY2019/20. The government has not achieved much in lengthening their liability profile mainly due to the poor performance of the longer dated bonds in the auction market. We attribute the low-performance rate to the relatively flat yield curve on the long-end making it relatively unattractive to hold longer-term bonds considering the current uncertainties in the interest rate environment. Given that the Treasury bonds with the same tenor are currently trading at a yield of 12.7%, we expect bids to come in at between 12.7% and 13.0%.

Liquidity:

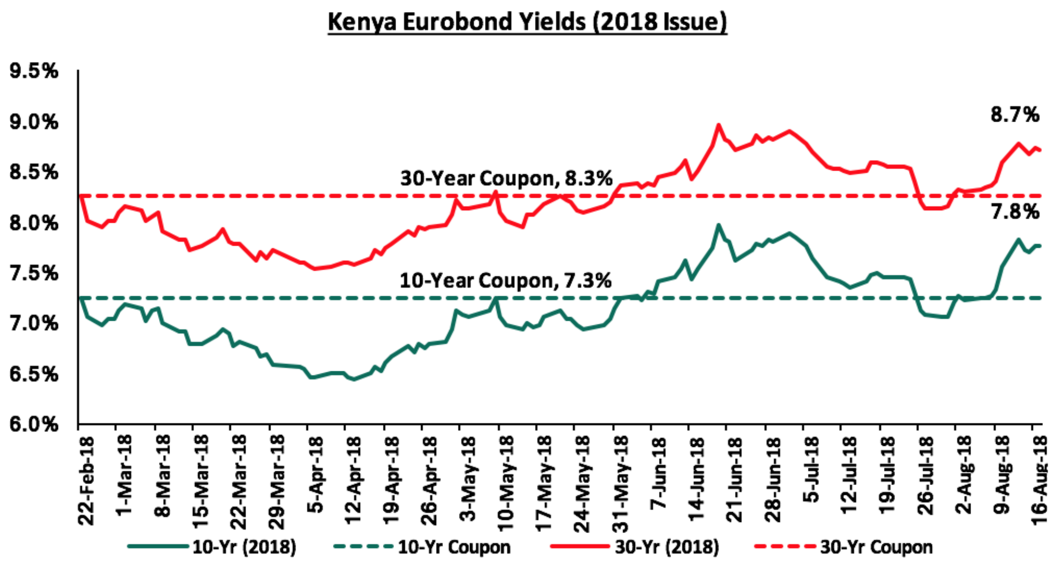
The average interbank rate declined to 7.0%, from 8.3% the previous week, while the average volumes traded in the interbank market declined by 20.6% to Kshs 9.1 bn, from Kshs 11.4 bn the previous week. The decline in the average interbank rate points to improved liquidity, which the Central Bank of Kenya has attributed to reduced pressure due to the fact banks had attained the average monthly Cash Reserve Requirements threshold towards the end of cycle on August 14th, 2018.

Kenya Eurobonds:

According to Bloomberg, the yield on the 5-Year and 10-year Eurobonds issued in 2014 increased by 0.3% points and 0.4% points to 4.7% and 7.2% from 4.4% and 6.8% the previous week, respectively. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.1% points and 2.4% points for the 5-year and 10-year Eurobonds, respectively, an indication of the relatively stable macroeconomic conditions in the country. Key to note is that these bonds have 1-year and 6-years to maturity for the 5-year and 10-year, respectively.



For the February 2018 Eurobond issue, during the week, the yields on both the 10-year and 30-year Eurobonds increased by 0.2% points and 0.1% points to 7.8% and 8.7% from 7.6% and 8.6% the previous week, respectively. Since the issue date, the yields on the 10-year and 30-year Eurobonds have increased by 0.5% points and 0.4% points, respectively.



Key to note is that yields on all the Eurobond issues continued to rise this week, reflecting the general trend in the international bond market, which the CBK attributed to the adjustments of global yields to normalisation of monetary policies in the advanced economies.

The Kenya Shilling:

During the week, the Kenya Shilling depreciated by 0.4% against the US dollar to close at Kshs 100.8 from Kshs 100.4 the previous week, driven by dollar demand from traders and oil importers coupled with subdued inflows from exporters. The Kenyan shilling has appreciated by 2.3% year to date and in our view the shilling should remain relatively stable against the dollar in the short term, supported by:

?. The narrowing of the current account deficit to 5.8% in the 12-months to June 2018, from 6.3% in March 2018, attributed to improved agriculture exports, and lower capital goods imports following the completion of Phase I of the Standard Gauge Railway (SGR) project,

i. Stronger inflows from principal exports, which include coffee, tea and horticulture, which increased by 10.8% during the month of May to Kshs 24.3 bn from Kshs 21.9 bn in April, with the exports from coffee, tea and horticulture improving by 11.0%, 19.1% and 2.0% m/m, respectively,

ii. Improving diaspora remittances, which increased by 71.9% y/y to USD 266.2 mn from USD 154.9 mn in June 2017 and 4.9% m/m, from USD 253.7 mn in May 2018, with the largest contributor being North America at USD 130.1 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,

iii. High forex reserves, currently at USD 5.8 bn (equivalent to 8.7 months of import cover) and the USD 1.5 bn stand-by credit and precautionary facility by the IMF, still available until September 2018.

Highlights of the Week:

According to the Energy Regulatory Commission (ERC), petrol prices have increased by 1.3% to Kshs 113.7 from Kshs 112.2 per litre previously, while diesel and kerosene prices have declined by 0.5% and 0.9% to Kshs 102.7 and 85.0 per litre, respectively, effective 15th August – 14th September 2018. The changes in prices have been attributed to the rise in average landing costs of imported super petrol by 3.1% to USD 761.6 per ton in July from USD 738.8 in June. Landing costs for diesel as well increased marginally by 0.2% to USD 683.3 in July from USD 682.0 in June, while kerosene's landing cost declined by 1.3% to USD 721.6 in July from USD 731.3 in June. The mean monthly USD to Kenyan Shilling exchange rate mitigated the rise in prices with the Kenyan Shilling appreciating by 0.4% to Kshs 100.6 in July from Kshs 101.0 in June. The faster rise in super petrol prices is expected to more than offset the decline in diesel prices, pushing the transport index up. We will release our inflation projection for the month of August 2018 in next week's report.

Rates in the fixed income market have been on a declining trend, as the government continues to reject expensive bids as it is currently 31.3% ahead of its pro-rated borrowing target for the current financial year, having borrowed Kshs 54.9 bn against a prorated target of Kshs 41.8 bn. The 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 an 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-term fixed-income instruments.