# Cytonn Weekly Update

## Cytonn Weekly

## The Kenya Shilling Saga?

The Kenya Shilling has slumped to the lowest levels seen since 2011, at 90.1 per USD, and on November 25th, it reached as low as 90.4 per USD. The depreciation is largely due to end month dollar demand from importers. Given where the currency is expected to end the year, it is going to be the fifth straight annual decline.

From trading restrictions, raising interest rates and selling USD in the open market through Repo operations, the Central Bank has tried to protect the currency to no avail. Analysts are speaking of the Shilling reaching KES 100 to the USD by mid-2015, however, what do the fundamentals say:

At current Purchasing Power Parity (PPP), the Shilling should be Trading at KES 91.1 to the USD, an overvaluation of 1.14%. If the PPP was to hold, the increase in inflation domestically is expected to make the Shilling depreciate by approximately 4.73% over the next 12 months to KES 94.3.

Over the last one-year this did not hold as the Kenyan Central Bank continued to support USD appreciation led by improved growth in Western Markets, while in Kenya the high interest rates supported the currency from further depreciation

## What is our view on the Exchange Rate?

We continue to see the intervention of the Central Bank in the market, mopping up liquidity to support the Shilling, which has led to an artificial and protected rate. The government announced plans increase the size of its debut Eurobond, as well as a preliminary agreement with the IMF for a credit line of USD 750 million. With a reduction in the Foreign Exchange reserves following a revaluation loss, we feel at some point the regulator will have to let the forces of Demand and Supply determine the Exchange Rate. Over time, with tourism taking a hit due to travel advisories brought about by militant attacks, combined with lower foreign exchange earnings from falling prices of agriculture commodities critical to the Kenyan Economy, such as Tea, we expect the Shilling to be at KES 96 to the USD by mid ? 2015.

## Growing Appetite for Debt in the local Market?

This week saw a flurry of news with one key theme ? Corporates coming in to the Market looking to raise Capital via Corporate Bond issuances. CBA (KES 8 Bn), CfC Stanbic (KES 4 Bn), Vaell (KES 8.5 Bn) and Home Afrika (KES 0.9 Bn) all expressed their intentions to raise funds from the public.

Large Corporates, especially those in the Financial Services sector, are borrowing to boost their core capital and total capital ratios. The total capital-to-risk weighted assets ratio, meant to tame the risk appetite of lenders so that they do not over-expose themselves, is currently at a statutory 12%, and will be raised to 14.5% in January 2015, outing additional pressure on banks to inject additional funding.

## What is our view on the Corporate Activity?

With the better perception of the Kenyan Economy given it?s size and new status after the GDP rebasing, combined with previous success stories from CIC & Britam, we feel we are likely to see even more firms raising capital in the same way, confident that improving business conditions will allow them to expand, and comfortably pay back Bond Holders.

However, the effect on Interest Rates cannot be underestimated. With firms looking to pay annual coupons in excess of 13.0% per-annum, the question must be asked on whether firms anticipate earnings yields to support this high cost of debt. We feel a divergence between Debt rates from Government Bonds and Corporate Bonds is in the offing, given the unsustainability of the large premiums corporates are willing to pay above Government Debt.

----------------------

*Shiv Arora is an Investment Associate with Cytonn Investments*

*Disclaimer: The views expressed in this publication, are those of the writers where particulars are not warranted- as the facts may change from time to time. This publication is meant for general information only, and is not a warranty, representation or solicitation for any product that may be on offer. Readers are thereby advised in all circumstances, to seek the advice of an independent financial advisor to advise them of the suitability of any financial product for their investment purposes*

---