Mombasa Real Estate Investment Opportunity August 2018, & Cytonn Weekly #34/2018

Fixed Income

T-Bills & T-Bonds Primary Auction:

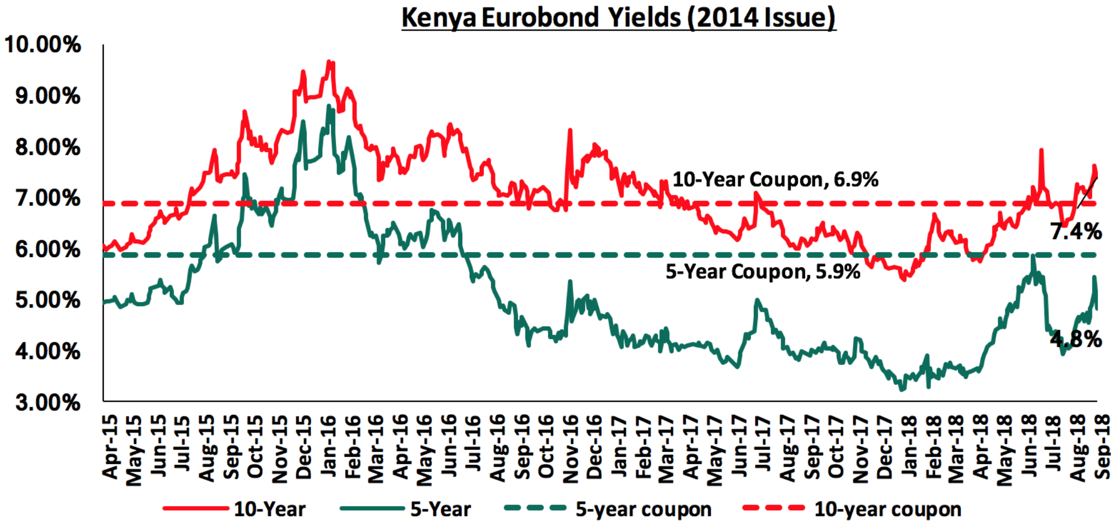
T-bills were oversubscribed during the week, with the overall subscription rate coming in at 148.7%, down from 176.1% recorded the previous week, due to improved liquidity in the money market. Yields on the 91-day, 182-day and 364-day papers declined by 0.1% points to 7.6%, 8.9% and 9.8%, respectively, from 7.7%, 9.0% and 9.9% recorded the previous week. The acceptance rate for T-bills declined to 76.7%, from 77.8% recorded the previous week, with the government accepting a total of Kshs 27.4 bn of the Kshs 35.7 bn worth of bids received. The subscription rate for the 182-day paper improved to 126.1% from 90.0%, the previous week while the subscription rate for the 91-day and 364-day papers declined to 64.0% and 205.1% from 289.6% and 216.9%, the previous week, respectively, with investors' participation remaining skewed towards the longer dated paper attributed to the scarcity of newer short-term bonds in the primary market.

Liquidity:

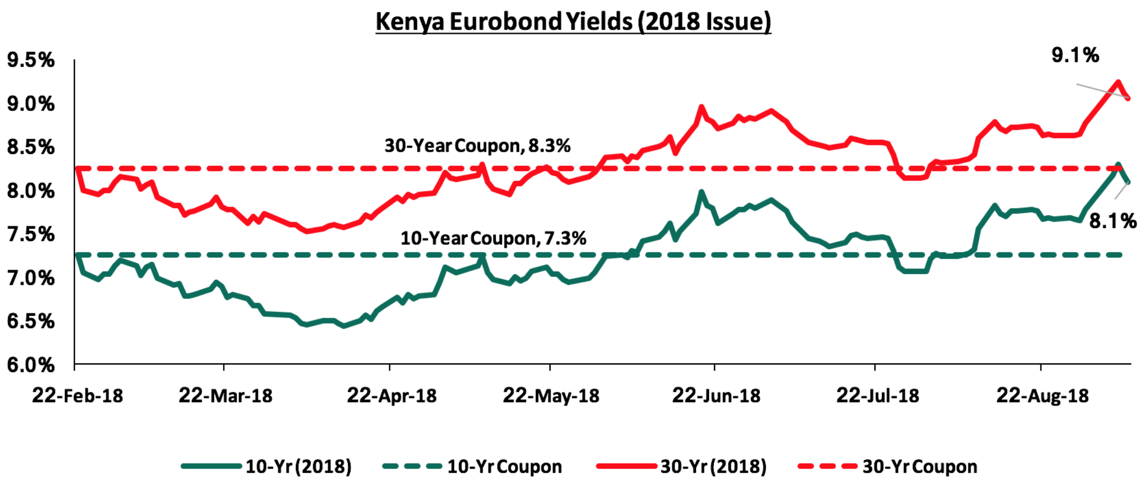
The average interbank rate declined to 5.5%, from 5.8% the previous week, while the average volumes traded in the interbank market declined by 41.7% to Kshs 13.1 bn, from Kshs 22.5 bn the previous week. The decline in the average interbank rate points to improved liquidity, which the Central Bank of Kenya attributed to increased government payments extending from the end of August.

Kenya Eurobonds:

According to Bloomberg, the yield on the 10-Year Eurobond issued in 2014 increased by 0.2% points to 7.4% from 7.2% the previous week, while the yield on the 5-year Eurobond declined by 0.1% points to 4.8%, from 4.9% the previous week. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.0% points and 2.3% 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 0.8 years and 5.8-years to maturity for the 5-year and 10-year, respectively.



For the February 2018 Eurobond issue, during the week, the yields on the 10-year and 30-year Eurobonds increased by 0.2% points and 0.3% points to 8.1% and 9.1% from 7.9% and 8.8% the previous week, respectively. Since the issue date, the yields on the 10-year and 30-year Eurobonds have both increased by 0.8% points.



The Kenya Shilling:

During the week, the Kenya Shilling declined marginally against the US dollar to close at Kshs 100.7, from Kshs 100.6 the previous week, supported by dollar inflows from Non-Governmental Organization's (NGO's) and the Information Technology (IT) sector. The Kenya Shilling has appreciated by 2.4% year to date and 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 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,
ii. 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,
iii. Improving diaspora remittances, which increased by 71.9% y/y to USD 266.2 mn in June 2018 from USD 154.9 mn in June 2017 and by 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,

iv. High forex reserves, currently at USD 5.7 bn (equivalent to 8.6 months of import cover).

Highlights of the Week:

Following the reporting by all fund managers, we analyzed the performance of all unit trust funds for the first half of 2018, and the following were the key highlights:

- The Total Assets Under Management ("AUM") held by Unit Trust Fund Managers grew very slightly, by 0.3%, to Kshs 55.2 bn in H1'2018 from Kshs 55.1 bn recorded in H1'2017; this indicates that the Unit Trust market is not growing,
- The AUM for Money Market Funds grew by 2.1% to Kshs 44.5 bn in H1'2018 from Kshs 43.6 bn recorded in H1'2017; this shows that Money Market Funds are growing faster than the overall market,
- CIC Asset Managers recorded the strongest growth in AUM of 21.4%, to Kshs 15.8 bn in H1'2018 from Kshs 13.0 bn in H1'2017,
- Sanlam Investments declined the most by 34.6% to Kshs 2.0 bn in H1'2018 from Kshs 3.0 bn in H1'2017,
- CIC Asset Managers remains the largest overall Unit Trust Fund Manager with a market share at 28.7% in H1'2018, up from 23.7% in H1'2017, and,
- Highest yielding money market fund as of September 6th was Seriani Money Market Fund, yielding 11.62%.

According to the Stanbic Bank's Monthly Purchasing Manager's Index (PMI), the business environment in the country expanded at a marked pace in August 2018. The seasonally adjusted PMI recovered to 54.6 in August from a 6-month low of 53.6 in July. 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 orders, which rose for the 9th consecutive month. This was despite high input costs attributed to raw material shortages. In response to increased output requirements, firms also raised their staffing levels during the month though at a modest rate. The private sector has remained resilient as the PMI is still above 50; we however expect the private sector to experience increased input costs going forward should the 16.0% VAT on petroleum products be maintained.

The Energy Regulatory Commission (ERC) released an addendum to readjust the maximum pump prices upwards effective 1st September to 14th September. This was prompted by the imposition of the VAT on petroleum products that was enforced from 1st September despite the National Assembly voting unanimously to further postpone it for another 2-years to September 2020. The VAT on fuel was initially introduced through the VAT Act 2013, with a grace period of 3-years to be implemented in September 2016. It was further postponed for another 2-years through the Finance Bill 2016 and was supposed to take effect in September 2018. As per the letter of intent to the IMF by the National Treasury, dated 18th January 2016, the imposition of the charge was part of the commitments Kenya had made to the International Monetary Fund (IMF) aimed at reducing the country's fiscal deficit through increased revenue collections. With the readjustments, taking into account the 16.0% VAT charge, Super Petrol, Diesel and Kerosene prices have gone up by 12.4%, 12.0% and 14.7%, respectively to Kshs 127.8, Kshs 115.1 and Kshs 97.4 from the earlier published prices on 14th August where Super Petrol, Diesel and Kerosene prices were retailing at a maximum price of Kshs 113.7, Kshs 102.7 and Kshs 85.0, respectively. The President is yet to assent to the National's Assembly's proposal of postponing the charge. With the VAT charge in place, we expect inflation to rise in H2'2018, as increased fuel prices will have a ripple effect on all the sectors of the economy, with the transport index, which has a CPI weighting of 8.7%, housing, water, electricity, gas and other fuels with a CPI weighting of 18.3% being affected directly as evidenced by public transport costs, which have already gone up by up to 25.0% since the fuel prices readjustment.

Rates in the fixed income market have been on a declining trend, as the government continues to reject expensive bids as it is currently 38.3% ahead of its pro-rated borrowing target for the current financial year, having borrowed Kshs 79.6 bn against a prorated target of Kshs 57.5 bn. The 2018/19 budget had given 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. With the rate cap still in place, and the national assembly having voted to retain it, now awaiting presidential assent to become law, 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.

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