Cytonn Q3’2018 Markets Review

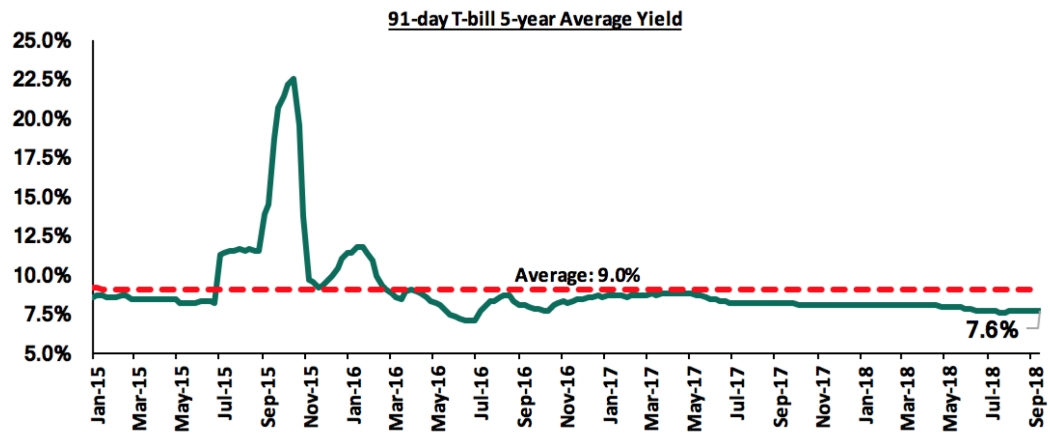
Fixed Income

T-Bills & T-Bonds Primary Auction:

During the third quarter of 2018, T-bills auctions recorded an oversubscription attributed to improved liquidity levels, with the average subscription rate coming in at 133.3% compared to 162.7% in Q2’2018. Overall average subscription rates for the 91-day, 182-day, and 364-day papers in Q3’2018 came in at 99.4%, 91.8% and 188.4%, respectively, from 108.5%, 127.8%, 219.4% in Q2’2018. Yields on T-bills declined by 28 bps, 110 bps and 100 bps in Q3’2017, closing at 7.7%, 9.1%, and 10.0%, from 7.9%, 10.2%, and 11.0% for the 91, 182, and 364-day papers, respectively, as at end of Q2 2018, mainly due to the Central Bank of Kenya’s (CBK’s) efforts to keep rates low by rejecting expensive bids in the auction market.

During the week, T-bills were undersubscribed at a subscription rate of 85.9%, down from 123.9% recorded the previous week. The yields on the 91-day and 364-day papers remained unchanged at 7.6% and 9.7%, respectively while the yield on the 182-day paper declined to 8.6% from 8.7%, the previous week. The acceptance rate declined to 94.8% from 95.8% recorded the previous week, with the government accepting Kshs 19.5 bn of the Kshs 20.6 bn worth of bids received.

The yield on the 91-day T-bill is currently trading at a yield of 7.6%, below its 5-year average of 9.0%. The lower yield on the 91-day paper is mainly attributed to the low interest rate environment we have been experiencing, and we expect this to continue in the short-term because (i) the rate cap is still in place which will make it easier for the government to borrow from the domestic market, as institutions will continue channelling funds more actively towards government securities, which are deemed less risky, since the pricing of loans to the private sector is based on the Central Bank Rate as opposed to their risk profiles, and (ii) the government domestic borrowing requirement for the 2018/19 financial year has been reduced by 8.6%, with revenues expected to increase by 14.5% from the previous fiscal year.

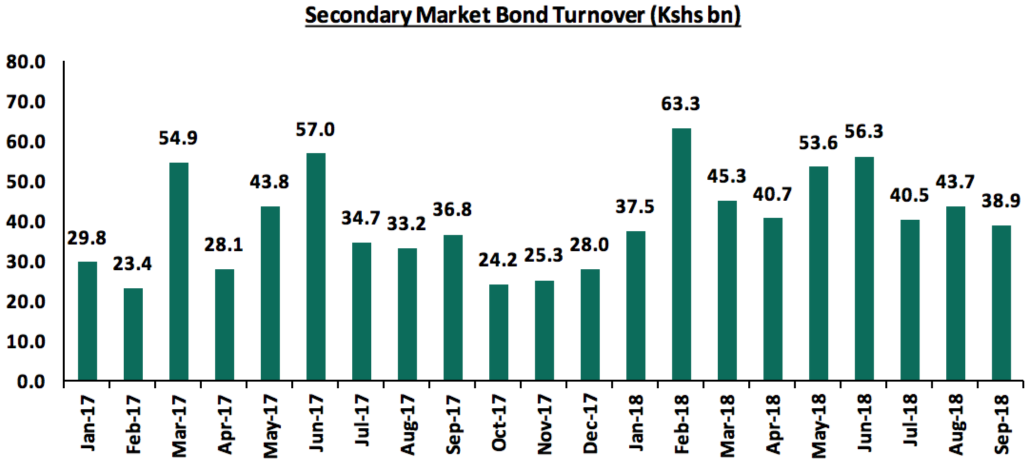


No.	Date	Bond Auctioned	Effective Tenor to Maturity (Years)	Coupon	Amount to be Raised (Kshs bn)	Actual Amount Raised (Kshs bn)	Average Accepted Yield	Subscription Rate	Acceptance Rate
1	30/07/2018	FXD2/2018/20	20.0	13.2%	40.0	10.5	13.4%	34.7%	75.8%
2	27/08/2018	FXD1/2018/10	10.0	12.7%	40.0	19.4	12.7%	74.6%	64.9%
3	24/09/2018	FXD1/2018/10 (Reopen)	10.0	12.7%	40.0	21.2	12.7%	81.2%	81.8%
		FXD2/2018/20 (Re-open)	20.0	12.9%		5.3	12.9%		

Performance in the Primary T-bond auctions in Q3'2018 was varied between the various issues, with the subscription rate averaging 63.5%. The average acceptance rate in Q3'2018 came in at 74.2%, as the CBK continued to reject bids deemed expensive in order to maintain the rates at low levels.

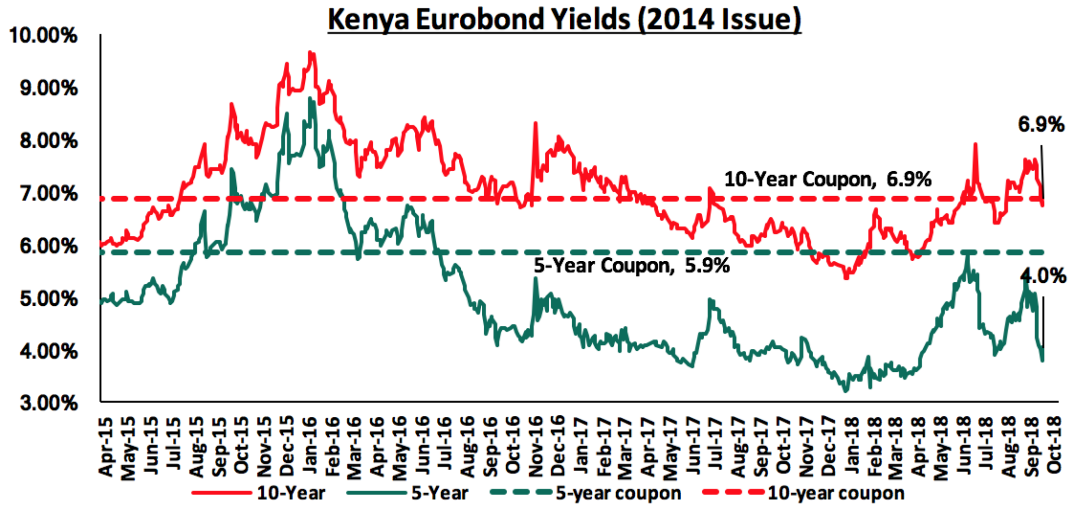
Secondary Bond Market Activity:

The NSE FTSE Bond Index gained by 3.2% during Q3'2018 while the secondary bonds market recorded reduced activity, with turnover decreasing by 22.2% to Kshs 123.2 bn from Kshs 150.6 bn recorded in Q2'2018.

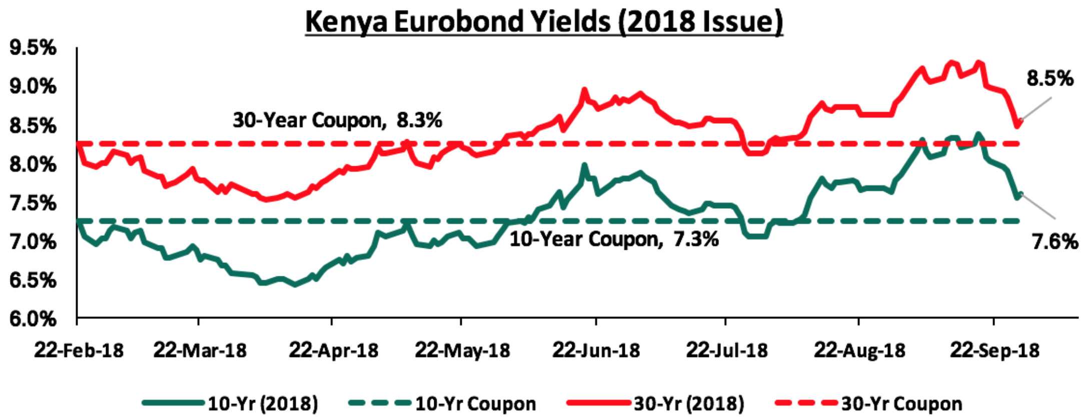


Kenya Eurobonds:

According to Bloomberg, the yield on the 5-year Eurobond issued in 2014 closed at 4.0%, a 1.3% points decline from 5.3% as at end of Q2'2018. Yield on the 10-year Eurobond closed at 6.9%, a 1.0%-point decline from 7.9% as at end of Q2'2018. By year-on-year comparison, yield on the 10-year has increased by 0.5% points from 6.4% as at end Q3'2017 while the 5- year has slightly declined by 0.1% points from 4.1% as at end of Q3'2017. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.7% 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. 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, the yields on the 10-year Eurobond and the 30-year Eurobond decreased by 0.2% points and 0.3% points to 7.6% and 8.5%, respectively in Q3’2018 from 7.8% and 8.8% as at end Q2’2018. Since the issue date, yields on the 10-year and 30-year Eurobonds have increased by 0.4% and 0.3% points respectively.



Rates in the fixed income market have been on a declining trend, as the government continues to reject expensive bids as it is currently 82.8% ahead of its pro-rated borrowing target for the current financial year, having borrowed Kshs 133.8 bn against a pro-rated target of Kshs 73.2 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, with the president having ascended to the Finance Bill 2018, 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.