Sub-Saharan Africa (SSA) Eurobonds, & Cytonn Weekly #03/2019

Fixed Income

T-Bills & T-Bonds Primary Auction:

T-bills were over-subscribed during the week, with the overall subscription rate coming in at 161.4%, a decline from 281.6% recorded the previous week. The continued over-subscription has been attributed to favorable liquidity conditions in the interbank market, despite slight tightening towards the close of the week, due to the start of the new cash reserve requirement (CRR) cycle, as well as tax payments due on 20th of every month. There was a decline in subscription rates across the board for the 91-day, 182-day and the 364-day papers, with subscription rates falling to 180.8%, 138.8% and 176.2%, from 355.8%, 244.6% and 288.8% recorded the previous week, respectively. The yields on the 91-day paper declined to 7.1%, from 7.2% recorded the previous week, while yields on the 182-day and 364-day papers remained unchanged from the previous week at 8.9% and 10.0%, respectively. The acceptance rate rose to 73.6%, from 72.4% recorded the previous week, with the government accepting Kshs 28.5 bn of the Kshs 38.7 bn worth of bids received.

For the month of January, the Kenyan Government has issued two new bonds; issue no FXD 1/2019/2 and issue no FXD 1/2019/15, with 2.0-years and 15.0-years to maturity, and market determined coupon rates. The government will be seeking to raise Kshs 40.0 bn from the two bonds for budgetary support, whose issue will close on 22nd January 2019. The long-term bonds already issued in the FY'2018/2019 in a bid to lengthen the average time to maturity for the Kenyan Government's debt portfolio and mitigate the potential rollover risks have continued to record a lackluster performance due to the saturation of long end offers. Due to this, we are of the view that the government is issuing the shorter-term 2-year bond in a bid to catch up with its borrowing schedule due to the pent-up in demand for the shorter-term papers, which has seen T-bills over-subscribed in all the 2019 auctions.

Treasury bonds with the same tenor (2.0-years and 15.0-years) are currently trading at a yield of 10.7% and 12.6% respectively. We expect bids to come in at between 10.7% - 10.9% and 12.6% - 12.8% for the 2-year and 15-year bonds, respectively.

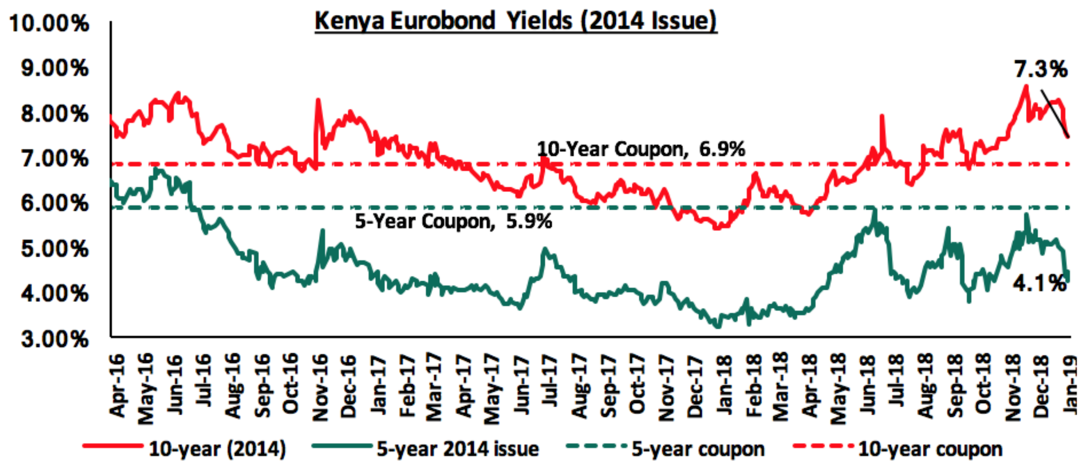
Liquidity:

The average interbank rate declined to 2.5%, from 3.1% the previous week, while the average volumes traded in the interbank market rose by 32.0% to Kshs 14.4 bn, from Kshs 10.9 bn the previous week. The lower interbank rate points to improved liquidity conditions, experienced during the start of the week partly attributed to government payments. Liquidity however declined as at the end of the week, with the interbank rate rising to 3.3% as at 18th January 2018, from a low of 1.6% as at the start of the week, mainly attributed to tax payments due on 20th of every month.

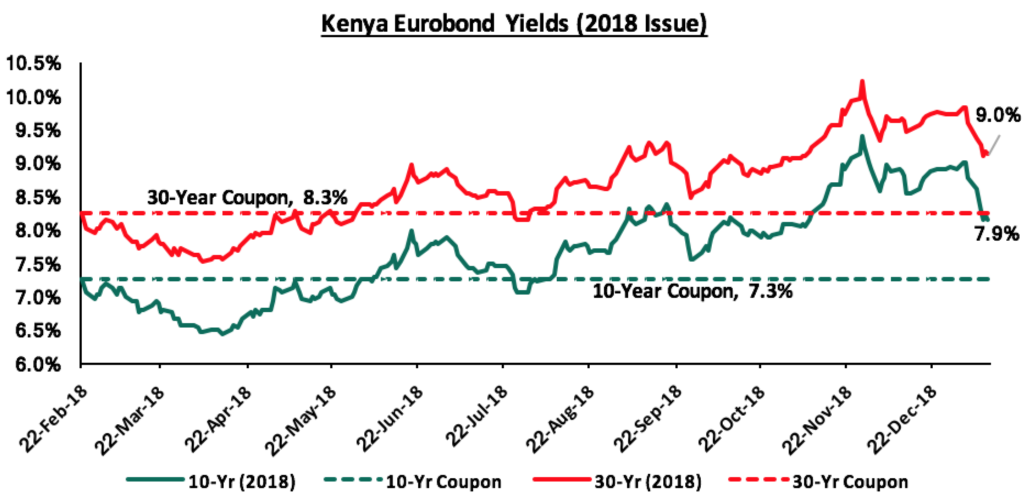
Kenya Eurobonds:

According to Bloomberg, the yields on the 5-year and 10-year Eurobonds issued in 2014 declined by

0.4% points and 0.1% points to 4.1% and 7.3% from 4.5% and 7.4%, respectively. Since the mid-January 2016 peak, yields on the Kenyan Eurobonds have declined by 2.3% points and 4.7% points for the 10-year and 5-year Eurobonds, respectively, an indication of the relatively stable macroeconomic conditions in the country. Key to note is that these bonds have 0.4-years and 5.4-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 declined by 0.3% points and 0.1% points to 7.9% and 9.0% from 8.2% and 9.1% the previous week, respectively. Since the issue date, the yield on the 10-year Eurobond has increased by 0.4% points while that of the 30-year Eurobonds has increased by 0.7% points.



Kenya Shilling:

During the week, the Kenya Shilling remained relatively flat against the US Dollar, to close at Kshs 101.7, from Kshs 101.8 recorded the previous week, which was attributed to reduced merchant and oil importer demand supported by tight liquidity in the market and inflows from diaspora remittances. The Kenya Shilling has appreciated against the US Dollar by 0.1% year to date, and in our view the shilling should remain relatively stable to the dollar in the short term, supported by:

?. The narrowing of the current account deficit to 5.3% in the 12-months to September 2018, from 6.5% in September 2017, attributed to improved agriculture exports, increased diaspora remittances and strong receipts from tourism,

i. Improving diaspora remittances, which increased by 6.9% m/m in the month of October 2018 to USD 219.2 mn, from USD 205.1 mn recorded in September. Cumulatively, total diaspora remittances rose by 39.5% in the 12-months to October 2018, to USD 2.6 bn, from USD 1.9 bn recorded in a similar period in 2017. This has been attributed to; (a) increased uptake of financial products by the diaspora due to financial services firms, particularly banks, targeting the diaspora, and (b) new partnerships between international money remittance providers and local commercial banks making the process more convenient. For more analysis on this see our October Diaspora Remittances Note,

ii. CBK's activities in the money market, such as repurchase agreements and selling of dollars, and,
iii. High levels of forex reserves, currently at USD 8.0 bn, equivalent to 5.2-months of import cover, compared to the one-year average of 5.1-months and above the EAC Region's convergence criteria of 4.5-months of imports cover.

Highlight of the Week:

During the week, the Energy Regulatory Commission (ERC) released their monthly statement on the Maximum Retail Prices in Kenya for the period 15th January 2019 to 14th February 2019. Below are the key take-outs from the statement:

?. Petrol prices have declined by 8.2% to Kshs 104.2 from Kshs 113.5 per litre previously, while diesel and kerosene prices have declined by 8.9% and 3.3% to Kshs 102.2 and 101.7 per litre, respectively, from Kshs 112.3 and 105.2 per litre, previously,
i. The changes in prices has been attributed to the decline in average landing cost of imported super petrol by 14.9% to USD 590.9 per ton in December from USD 694.2 per ton in November. Landing costs for diesel and kerosene declined by 14.7% and 8.6% to USD 616.0 per ton and USD 620.1 per ton in December, respectively, from USD 722.2 per ton and USD 678.6 per ton in November, and,
ii. A 12.5%, decline in Free on Board (FOB) price of Murban crude oil lifted in December 2018 to USD 59.5 per barrel, from USD 68.0 per barrel in November 2018.

We expect a decline in the transport index, which carries a weighting of 8.7% in the total consumer price index (CPI), due to the decline in petrol and diesel prices. We will release our inflation projection for the month of January 2019 in next week's report.

Rates in the fixed income market have remained stable as the government rejects expensive bids despite being 34.7% behind its domestic borrowing target for the current financial year, having borrowed Kshs 113.0 bn against a pro-rated target of Kshs 173.0 bn. However, a budget deficit that is likely to result from depressed revenue collection creates uncertainty in the interest rate environment as any additional borrowing in the domestic market goes to plug the deficit. Despite this, we do not expect upward pressure on interest rates due to increased demand on government securities, driven by improved liquidity in the market owing to the relatively high debt maturities. Our view is that investors should be biased towards medium-term fixed income instruments to reduce duration risk associated with long-term debt, coupled with the relatively flat yield curve on the long-end due to saturation of long-term bonds.