Consolidation in Kenya’s Banking Sector to Continue, & Cytonn Weekly #06/2019

Fixed Income

T-Bills & T-Bonds Primary Auction:

T-bills remained over-subscribed during the week, with the overall subscription rate coming in at 198.3%, an increase from 167.4% recorded the previous week. The continued over-subscription in the primary auctions in 2019 has been attributed to improved liquidity in the market, driven by debt maturities as well as government payments. There was mixed performance, with the 91-day and 182-day papers recording an increase in subscription rates to 83.4% and 149.3%, from 59.7% and 81.0% recorded the previous week, respectively, while the 364-day paper subscription rate declined marginally to 293.2%, from 296.9% recorded the previous week.

The yields on the 91-day, 182-day, and 364-day papers declined to 7.0%, 8.6% and 9.6% from 7.1%, 8.8% and 9.9% recorded the previous week, respectively. The acceptance rate declined to 60.8%, from 80.5% recorded the previous week, with the government accepting Kshs 28.9 bn of the Kshs 47.6 bn worth of bids received.

The reopened 2-year (FXD1/2019/2) and 15-year (FXD1/2019/15) Treasury bonds recorded an oversubscription of 555.0%, driven by the 2-year bond, which attracted bids totaling to Kshs 50.2 bn out of the Kshs 66.6 bn bids received for the entire auction, an indication of the pent up demand in the shorter-term papers. The yields came in at 10.3% and 12.8% for the 2-year and 15-year bonds, respectively. The government accepted Kshs 23.4 bn out of the Kshs 66.6 bn worth of bids received against Kshs 12.0 bn on offer, translating to an acceptance rate of 35.2%, indicating that bids were largely not within ranges the Central Bank of Kenya (CBK) deemed acceptable. For the month of February, the Kenyan Government has issued a 5-year and 10-year Treasury bond, with issue No’s. FXD 1/2019/5 and FXD 1/2019/10, respectively, with market-determined coupon rates, in a bid to raise Kshs 50 bn for budgetary support. The period of sale is from 7th February 2019 to 19th February 2019. We shall give our bidding range in next week’s report.

Liquidity:

The average interbank rate declined to 3.0%, from 4.6% the previous week, while the average volumes traded in the interbank market rose by 100.9% to Kshs 4.8 bn, from Kshs 2.4 bn the previous week. The lower interbank rate points to improved liquidity conditions, with the rate declining to a low of 1.8% as at 7th February 2019, from 5.5% as at the start of the week, partly attributed to government payments and net redemption of government securities.

Kenya Eurobonds:

According to Bloomberg, the yields on the 5-year Eurobond issued in 2014 declined by 0.1% points to 4.3%, from 4.4% the previous week, while that of the 10-year Eurobond increased by 0.1% points to 6.9% from 6.8% the previous week. Since the mid-January 2016 peak, yields on the Kenyan Eurobonds have declined by 2.7% points and 4.5% 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 0.3-years and 5.3-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 Eurobond remained unchanged at 7.6%, with the yield on the 30-year Eurobond declining by 0.1% points to 8.5% from 8.6% the previous week, respectively. Since the issue date, the yields on both the 10-year Eurobond and the 30-year Eurobonds have increased by 0.3% points.

Kenya Shilling:

During the week, the Kenya Shilling appreciated by 0.5% against the US Dollar, recording a 9-month high to close at Kshs 100.1, from Kshs 100.6 recorded the previous week. The Kenya Shilling has appreciated against the US Dollar by 1.7% year to date, and in our view the shilling should remain relatively stable to the dollar in the short term, supported by:

i. The narrowing of the current account deficit to 5.1% in the 12-months to November 2018, from 6.5% in November 2017, attributed to improved agriculture exports, increased diaspora remittances, strong receipts from tourism and slower growth in imports due to lower food and SGR–related equipment imports and the decline in international oil prices,
ii. Improving diaspora remittances, which increased by 38.6% in 2018 to USD 2.7 bn from USD 1.9 bn recorded in 2017. The rise is due 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,
iii. CBK’s activities in the money market, such as repurchase agreements and selling of dollars, and,
iv. High levels of forex reserves, currently at USD 8.1 bn, equivalent to 5.3-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.

Weekly Highlights:

According to Stanbic Bank’s Monthly Purchasing Manager’s Index (PMI), the business environment in the country recorded an uptick during the month of January, although at a slower pace than in December 2018. The seasonally adjusted PMI recorded a decline to 53.2 in January 2019 from 53.6 recorded in December 2018. A PMI reading of above 50 indicates improvements in the business environment, while a reading below 50 indicates a worsening outlook. The marginal decline in the PMI reading is partly attributable to a slower increase in new orders in January, recording a four-month low, owing to easing demand in the domestic economy. New export orders however increased at the sharpest rate since October, with many businesses reporting higher foreign demand. There was an uptick in output growth, which was at a three-months high, driven by the influx of new business and stronger client bases. Despite the rise in orders, employment growth remained modest in January. Purchase prices rose at the slowest pace in 16 months, driven by the decline in fuel prices, with petrol prices having declined by 8.2%, while diesel and kerosene prices declined by 8.9% and 3.3%, respectively, which in effect led to a decline in inflation to 4.7% in January, from the 5.7%, recorded in December 2018. We expect the business environment to improve going forward supported by improved purchasing activity due to suppressed inflation with the expectations of lower international oil prices.

African Development Bank (AfDB) released their African Economic Outlook 2019, highlighting economic prospects and projections for the continent as a whole and for each of the 54 countries. According to the report, Kenya’s economy is expected to expand by 6.0% in 2019 and by 6.1% in

2020, supported by the continued macroeconomic stability, improved business confidence and growth in the tourism sector. AfDB recognized the government fiscal consolidation efforts aimed at reducing the fiscal deficit and reducing reliance on debt by enhancing revenue collection, rationalizing expenditure as well as diversifying funding sources. The key concern however remains on the quality of fiscal consolidation, with similar concerns voiced by the World Bank in their Kenya Economic Update, October 2018, having noted the majority cuts to government expenditure fell on development spending, which could potentially compromise the growth potential of the economy. AfDB also noted that the country's public debt–to-GDP ratio had increased considerably over the past five years to 57.0% as at the end of FY'2017/2018, with half of the debt being external. The ballooning levels of public debt have elevated the risk of debt sustainability, which saw the International Monetary Fund, through their debt sustainability analysis elevating the country's risk of debt stress to moderate from low. Additionally, the increase in the portion of external debt, from 43.2% in February 2014 to 50.6% in September 2018, also makes the country more susceptible to external market conditions and shocks.

In summary, the report paints the picture that the country's macro-economic fundamentals are still stable and the outlook going forward is positive with inflation expected to be within the government set target of 2.5%-7.5% and with the consensus GDP growth as per 16 firms expected to come in at 5.8%.

Kenya 2019 Annual GDP Growth Outlook

No.	Research Body	Q1'2019 Estimates
1	Central Bank of Kenya	6.3%
2	International Monetary Fund (IMF)	6.1%
3	Citigroup Global Markets	6.1%
4	African Development Bank (AfDB)	6.0%
5	PNB Paribas	6.0%
6	UK HSBC	6.0%
7	Euromonitor International	5.9%
8	World Bank	5.8%
9	Cytonn Investments Management Plc	5.8%
10	Focus Economics	5.8%
11	JPMorgan	5.7%
12	Euler Hermes	5.7%
13	Oxford Economics	5.6%
14	Standard Chartered	5.6%
15	Capital Economics	5.5%
16	Fitch Solutions	5.2%
	Average	**5.8%**

Private sector credit growth remains a key concern recording anemic growth since the implementation of the interest rate cap, coming in at 2.4% in the 12-months to December 2018, slower than the 3.0% recorded in the 12 months to November 2018, bringing the 2018 average to 3.3%. The Monetary Policy Committee, through its assessment of the impacts of the interest rate cap, has also noted that the implementation of the interest rate cap has weakened the transmission of monetary policy constraining its effectiveness in influencing private sector credit access.

Rates in the fixed income market have remained stable as the government rejects expensive bids as it is currently 3.2% ahead of its domestic borrowing target for the current financial year, having borrowed Kshs 196.4 bn against a pro-rated target of Kshs 190.3 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 from 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.