Nyeri Real Estate Investment Opportunity 2019, & Cytonn Weekly #08/2019

Fixed Income

T-Bills & T-Bonds Primary Auction:

T-bills remained over-subscribed during the week, with the overall subscription rate coming in at 104.6%, a decline from 140.3%, recorded the previous week. The decline in subscription is partly attributable to the 5-year and 10-year bond sale that closed during the week. There was mixed performance, with the 91-day paper recording an increase in subscription rates to 127.6%, from 121.5%, recorded the previous week, while the 182-day and 364-day papers recorded declines in subscription to 115.7% and 84.3%, from 117.1% and 170.9%, recorded the previous week, respectively. The yields on the 91-day, 182-day, and 364-day papers declined by 5.3 bps, 10.8 bps and 5.9 bps to 7.0%, 8.4%, and 9.5%, respectively. The acceptance rate improved to 91.1% from 90.9% recorded the previous week, with the government accepting Kshs 22.9 bn of the Kshs 25.1 bn worth of bids received, an indication that bids were largely within ranges the Central Bank of Kenya (CBK) deemed acceptable.

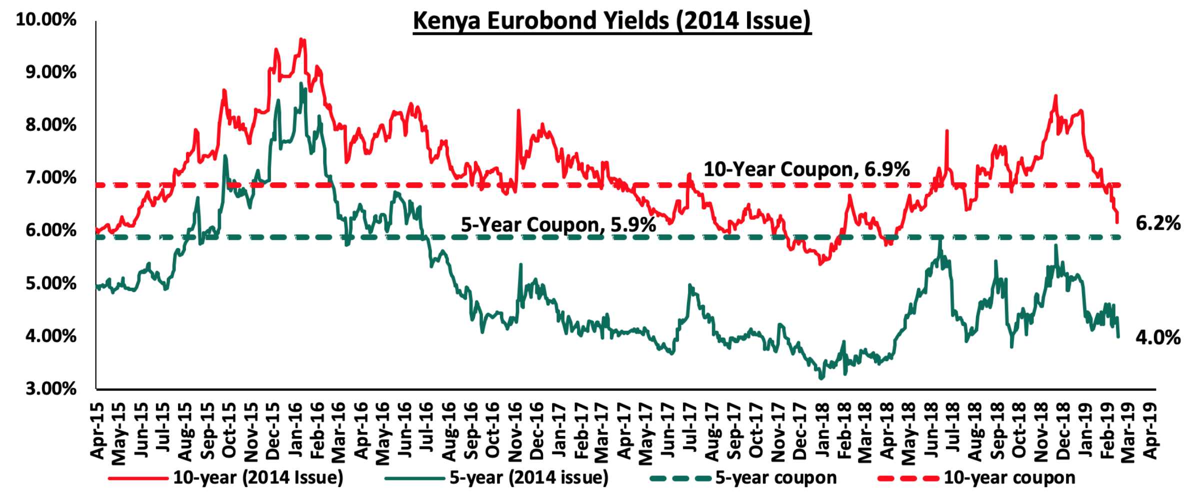
This week, the government issued a 5-year tenor (FXD1/2019/5) and a 10-year tenor (FXD1/2019/10) bond, which recorded an over-subscription of 156.5%, mainly attributable to the relative favorable liquidity conditions. The yields came in at 11.3% and 12.4% for the 5-year and 10-year bonds, respectively, in line with our expectations, with the government accepting Kshs 53.4 bn out of the Kshs 78.3 bn worth of bids received against Kshs 50.0 bn on offer, translating to an acceptance rate of 68.2%.

Liquidity:

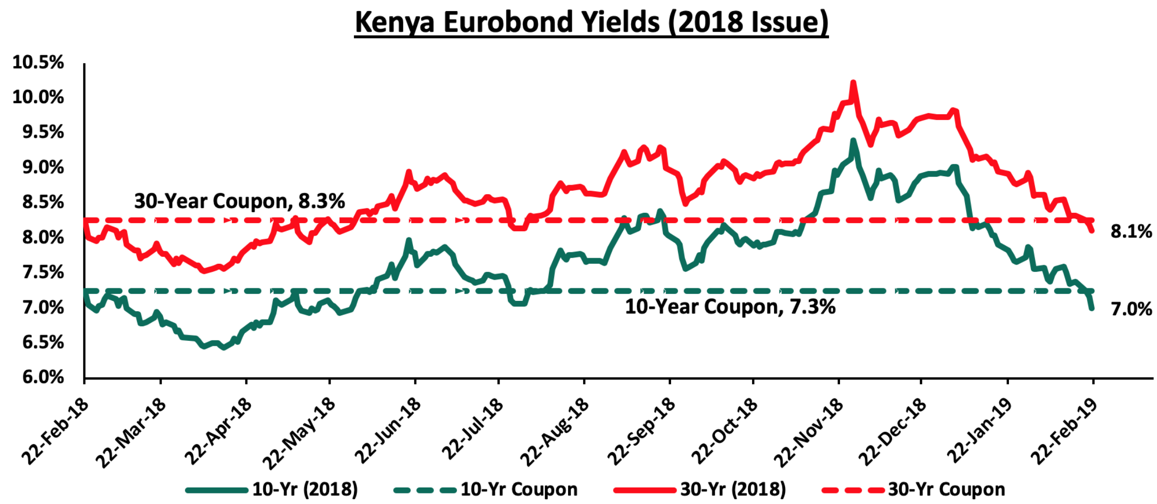
The average interbank rate increased to 1.9% from 1.4% the previous week, while the average volumes traded in the interbank market declined by 41.6% to Kshs 10.4 bn, from Kshs 17.8 bn the previous week. The low interbank rate points to improved liquidity conditions, with the rate declining to an 8-year low of 1.2% as at 14th February 2019 partly attributed to government payments and net redemption of government securities.

Kenya Eurobonds:

According to Bloomberg, the yields on the 5-year and 10-Year Eurobonds issued in 2014 declined by 0.3% points and 0.4% points, respectively, to 4.0% and 6.2% from 4.3% and 6.6% the previous week. The continued decline in yields signals improving country risk perception by investors, which is partly attributed to bullish expectations of improved economic growth in 2019 as well as increased Eurobond demand in emerging markets, with a similar trend observed in other Sub-Saharan African Eurobonds, driving the prices up and effectively the yields down. 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 and 30-year Eurobonds declined by 0.4% points and 0.2% points to 7.0% and 8.1% from 7.4% and 8.3%, respectively. Since the issue date, the yields on the 10-year Eurobond has declined by 0.3% points while the 30-year Eurobonds has declined by 0.2% points.



Kenya Shilling:

During the week, the Kenya Shilling remained stable closing at Kshs 100.2, similar to the previous week, supported by inflows from horticulture exports and Diaspora remittances, which offset the dollar demand from manufacturers and oil importers. The Kenya Shilling has appreciated against the US Dollar by 1.6% year to date, in addition to the 1.4% appreciation in 2018, 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:

During the week, The National Treasury announced its plan to re-open the sale of the mobile-based infrastructure bond M-Akiba in an effort to attract more takers after the low uptake in 2017, which saw the Government collect Kshs 247.0 mn against a target of Kshs. 1.0 bn. The sale of the mobile-based bond is scheduled to begin on 25th February 2019 and run up to 8th March 2019, with the Treasury targeting Kshs. 250.0 mn. In total, the government plans to raise Kshs 1.0 bn with the next sales scheduled for May, July and August, each targeting Kshs. 250 mn. The bond aims to attract investors with a minimum investment of Kshs 3,000 to be locked in for a period of three years, with the interest at 10.0%. Interest is then earned every six months and principal amount upon reaching maturity date. We expect this year's sale to spark more investor interest and higher subscription owing to: (i) increased public awareness, (ii) a minimum Kshs. 3,000 investments, below the minimum Kshs. 50,000 required to buy other conventional bonds and thus can access a larger audience, and, (iii) its relatively shorter term with the current demand for shorter term papers.

The National Treasury released the budgetary review for the first half of the 2018/2019 financial year as summarized in the table below:

Amounts in Kshs bns unless stated otherwise

Item	H1'2017/2018	H1'2018/2019			
	Collected/Spent	Collected/Spent	Target	% met	Change y/y
Total revenue	709.4	794.7	855.7	92.9%	12.0%
External grants	7.8	8.8	20.5	43.0%	12.8%
Total revenue & external grants	717.2	803.5	876.2	91.7%	12.0%
Recurrent expenditure	647.0	643.9	768.6	83.8%	(0.5%)
Development expenditure & Net Lending	173.8	308.9	232	133.2%	77.7%
County governments + contingencies	86.1	122.6	130	94.2%	42.4%
Total expenditure	907.0	1,075.5	1,130.7	95.1%	18.6%
Fiscal deficit excluding grants	(197.6)	(280.8)	(275.0)		42.1%
Fiscal deficit including grants (Cash basis)	(209.2)	(276.2)	(254.5)		32.0%
Fiscal deficit including grants (Commitment basis)	(189.7)	(272.0)	(254.5)		43.3%
Deficit(excluding grants) as % of GDP	2.3%	2.8%	2.8%		
Net foreign borrowing	24.1	144.4	34.8	415.2%	499.7%
Net domestic borrowing	183.6	130.8	217.7	60.1%	(28.7%)
Other domestic financing	1.6	1.0	2.0	49.1%	(39.0%)
Total borrowing	209.2	276.2	254.5	108.6%	32.0%
GDP Estimate	8,654.6	9,990.0	9,990.0		

Key takeout from the table above are as follows:

I. Total cumulative revenue in H1'2018/2019 amounted to Kshs. 794.7 bn against a target of Kshs. 855.7 bn (92.9% of the target). This performance was 12.0% above the Kshs 709.4 bn recorded over the same period in the 2017/2018 fiscal year. Ordinary revenue collection was Kshs. 722.3 bn against a target of Kshs. 775.0 bn (93.2% of the target), which constituted an under performance of Kshs. 52.7 bn. This was mainly driven by poor performance in collection of other income tax, which was 17.7% below target and excise duty, which was 16.1% below target,
II. The total expenditure for the period under review amounted to Kshs. 1,075.5 bn, against a target of Kshs. 1,130.7 bn (95.1% of the target). The shortfall of Kshs. 55.2 bn was attributed to under-absorption in both recurrent and development expenditures by the National Government,
III. The cumulative overall fiscal balance (on a commitment basis and excluding grants), amounted to Kshs. 280.8 bn (equivalent to 2.8% of GDP) against a targeted deficit of Kshs. 275.0 bn (equivalent to 2.75% of GDP),

IV. Cumulative external financing for the period between July 1st 2018 and December 31st 2018 amounted to a net borrowing of Kshs. 144.4 bn, a significant increase of 499.7% from Kshs 24.1 bn recorded over the same period in the 2017/2018 fiscal year. This was driven by disbursements of government project loans, and,
V. Net domestic borrowing amounted to Kshs. 130.8 bn against a target borrowing of Kshs. 217.7 bn (60.1% of the target) and a 28.7% decline from Kshs 183.6 bn recorded over the same period in the 2017/2018 fiscal year.

Revenue collection remains an area of focus, with the government having managed to meet 92.9% of its target, which is a slight improvement from the 91.2% recorded in H1'2017/2018 reflecting the impact of the government's efforts of improving revenue collection. The key concern, however, remains on the expenditure side, which has continued to grow faster than revenue, recording an 18.6% growth, compared to the 12.0% growth in revenue collection. This has led to widening of the fiscal deficit to Kshs 280.8 bn, (2.8% of GDP) from Kshs 197.6 bn, (2.3% of GDP) in H1'2017/2018. This in effect has led to increased total government borrowing, to plug in the deficit, with foreign borrowing increasing by a staggering 499.7% to Kshs 144.4 bn from Kshs 24.1 bn. This data is consistent with our analysis as presented in our Annual markets outlook where we indicated a *negative* outlook on government borrowing.

Inflation Projection:

We are projecting the y/y inflation rate for the month of February to come in within the range of 4.1% - 4.5%, a decline compared to 4.7% recorded in January. The m/m inflation for the month of February is however expected to rise due to the following factors:

I. A rise in the food and non-alcoholic beverages index, which has a weighting of 36.0%, mainly driven by the rise in food prices with a significant rise being recorded in tomato and onion prices that have gone up. Potato prices have also been on the rise driven by the 1.7 million tons of Irish potatoes shortage due to farmers' over-reliance on uncertified seeds that yield less, which has seen prices in the local retail markets increase, and,
II. The rise in food and non-alcoholic beverages index is expected to be mitigated by a decline in the transport index with petrol prices having declined by 4.0% to Kshs 100.1 from Kshs 104.2 per litre previously, while diesel prices have declined by 6.1% to Kshs 96.0 per litre from Kshs 102.2 per litre, previously.

Rates in the fixed income market have remained stable as the government rejects expensive bids, as it is currently 26.0% ahead of its domestic borrowing target for the current financial year, having borrowed Kshs 254.2 bn against a pro-rated target of Kshs 201.8 bn. However, a budget deficit is likely to result from depressed revenue collection, creating uncertainty in the interest rate environment as 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.
