Performance by Retirement Benefits Schemes in Kenya & Cytonn Weekly #10_2019

Fixed Income

T-Bills & T-Bonds Primary Auction:

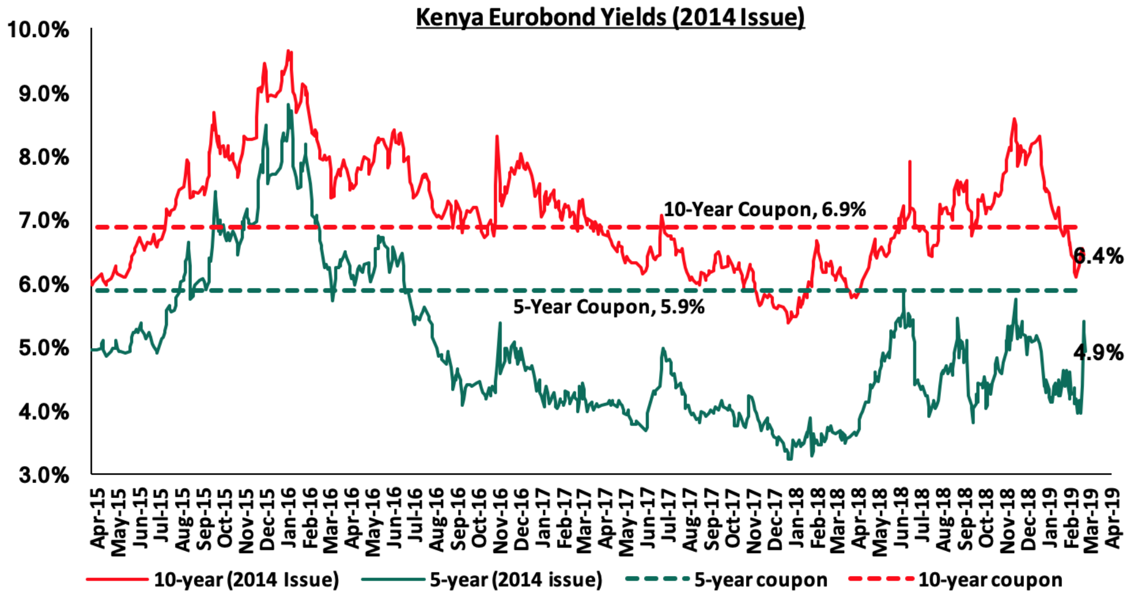
T-bills were undersubscribed during the week, with the overall subscription rate coming in at 90.9%, a rise from 78.2% recorded the previous week. The continued under subscription is attributable to the relatively tight liquidity conditions in the money market during the week due to tax payments, with Pay As You Earn (PAYE) due on the 9th of every month. The yields on the 91-day, 182-day, and 364-day papers remained unchanged at 6.9%, 8.3%, and 9.5%, respectively. The acceptance rate for T-bills dropped to 89.4%, from 90.0% the previous week, with the government accepting Kshs 19.5 bn of the Kshs 21.8 bn worth of bids received. The subscription rate for the 91-day paper and 182-day paper declined to 16.9% and 61.4%, from 73.4% and 77.6% recorded the previous week, respectively, while the subscription rate for the 364-day paper gained to 149.9%, from 80.8% recorded the previous week, with investors' participation being skewed towards the longer dated paper.

Liquidity:

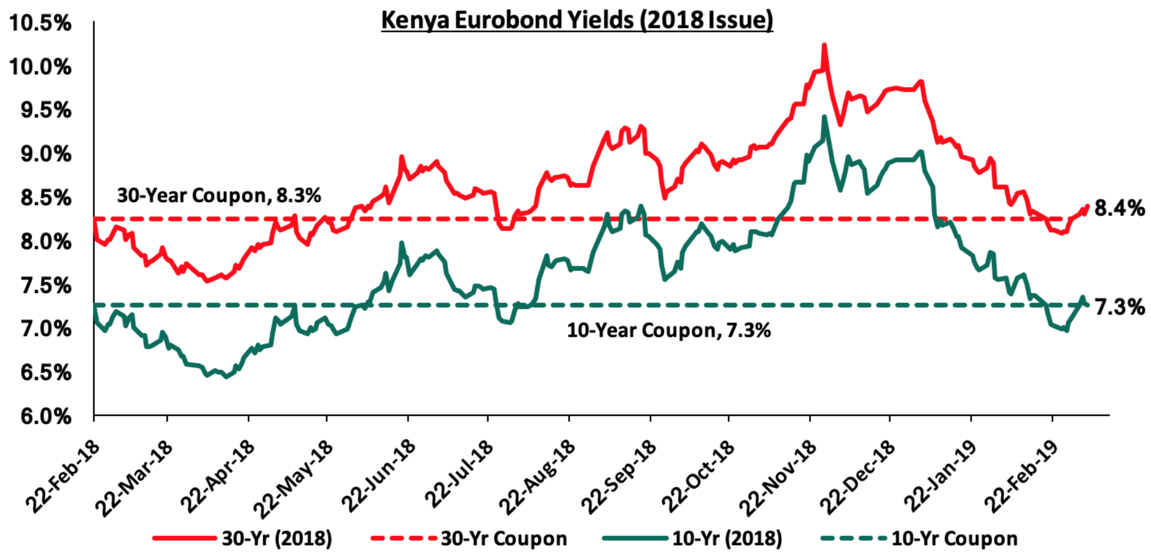
The average interbank rate decreased to 3.8%, from 4.4% the previous week, pointing to improved liquidity in the market, while the average volumes traded in the interbank market decreased by 45.6% to Kshs 10.3 bn, from Kshs 18.9 bn the previous week. Despite the slight improvement from the previous week, liquidity conditions remained tight attributable to tax payments with PAYE due during the week.

Kenya Eurobonds:

According to Bloomberg, the yield on the 10-year and 5-year Eurobonds issued in 2014 gained by 0.1% points and 0.9% point to 6.4% and 4.9% from 6.3% and 4.0%, the previous week, respectively. Since the mid-January 2016 peak, yields on the Kenyan Eurobonds have declined by 3.9% points and 3.2% 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 0.7-years and 5.7-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 gained by 0.2% points to 7.3% and 8.4%, from 7.1% and 8.2% the previous week, respectively. Since the issue date, the yield on the 10-year Eurobond has remained constant while the yield for the 30-year Eurobond has increased by 0.1% points.



The Kenya Shilling:

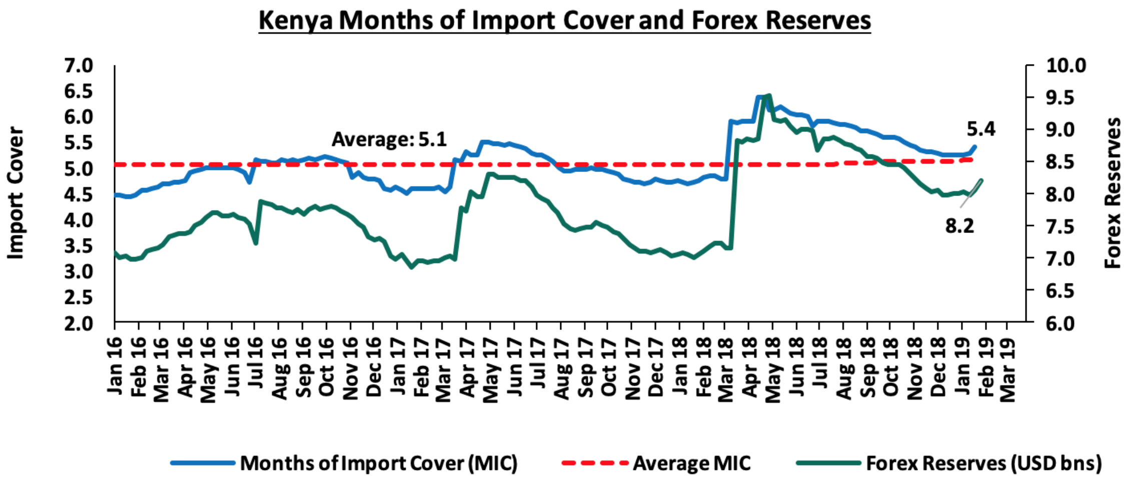
During the week, the Kenya Shilling gained by 0.3% against the US Dollar to Kshs 99.7, the strongest level since 3rd July 2015, from Kshs 100.0 the previous week. The Kenya Shilling's performance was supported by ample dollar supply from offshore portfolio investors buying government debt amid weak dollar demand from the energy sector. The Kenya Shilling has appreciated by 2.1% 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 lower food and SGR-related equipment relative to 2017,
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 8.2 bn, equivalent to 5.4-months of import cover, compared to the one-year average of 5.1 months, as highlighted below:



Highlights of the Week:

According to Stanbic Bank's Monthly Purchasing Manager's Index (PMI), the business environment in the country improved at a slower rate in February 2019. The seasonally adjusted PMI came in at 51.2 in February, a decline from 53.2 recorded in January, an indication of only a modest improvement in the health of the Kenyan private sector economy. A PMI reading of above 50 indicates improvements in the business environment, while a reading below 50 indicates a worsening outlook. The decline in the PMI was attributed to a slowdown in the growth of new orders with 25% of firms surveyed seeing a fall in sales owing to easing demand in the domestic economy. Foreign sales however increased as new export order growth increased to a 4-month high, driven by the influx of new business and stronger client bases. The overall weaker demand instigated slower output growth for Kenyan firms in February, driven by cash flow problems and unfavorable weather conditions. Despite the rise in new orders, employment continued to grow at a moderate rate in February. Selling prices charged by Kenyan private sector firms were broadly unchanged in February, following 14 months of successive increases. Input prices increased albeit at the slowest rate in 16 months attributed to cooling inflationary pressures but were offset by increases in food and raw material prices as well as the impact of taxation on input costs. 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 as well as improved weather conditions following the conclusion of the first quarter of the year usually associated with dry weather.

Rates in the fixed income market have remained stable as the government rejects expensive bids, as it is currently 2.3% ahead of its domestic borrowing target for the current financial year, having borrowed Kshs 225.6 bn against a pro-rated target of Kshs 220.6 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 for 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.