Ruaka Real Estate Investment Opportunity, & Cytonn Weekly #11_2019

Fixed Income

T-Bills & T-Bonds Primary Auction:

T-bills recorded an over-subscription during the week, with the performance rate rising to 156.9%, from 90.9% recorded the previous week. The oversubscription is attributable to favorable liquidity conditions in the money market during the week following the end of the monthly Cash Reserve Requirement (CRR) cycle. The yields on the 91-day, 182-day, and 364-day papers declined by 4.9 bps, 4.6 bps, and 3.0 bps to 6.8%, 8.3%, and 9.4%, respectively. The acceptance rate for T-bills dropped to 63.5%, from 89.4% the previous week, with the government accepting Kshs 23.9 bn of the Kshs 37.6 bn worth of bids received. The subscription rate for the 91-day, 182-day, and 364-day papers rose to 76.7%, 79.6% and 266.2% from 16.9%, 61.4% and 149.9%, recorded the previous week, respectively, with investors' participation remaining skewed towards the longer dated paper. The demand for the longer-dated paper is attributable to the scarcity of newer short-term bonds in the primary market.

For the month of March, the Kenyan Government has issued a 25-year Infrastructure Bond issue no: IFB, 1/2019/25 with a coupon rate of 12.2%, which is the longest infrastructure bond issue in history, in a bid to raise Kshs 50.0 bn for partial funding of infrastructure projects in the transport, water and energy sectors. The long tenor of the bond is in line with the CBK's objective of lengthening the maturity profile of public debt in order to reduce refinancing risk. Despite IFB's historically recording higher subscription rates than other Treasury Bonds due to the tax-free incentive translating to higher investment yields, we do not expect the issue to generate significant interest due to duration risk associated with long-term papers. We expect the weighted average of accepted bids to come in at 12.5% - 12.7%.

Liquidity:

The average interbank rate rose marginally to 3.9%, from 3.8% the previous week, while the average volumes traded in the interbank market declined by 72.4% to Kshs 2.8 bn, from Kshs 10.3 bn the previous week. Despite the marginal rise in the inter-bank rate, liquidity conditions remained favorable following the end of the monthly Cash Reserve Requirement (CRR) cycle and driven by government payments.

Kenya Eurobonds:

According to Bloomberg, the yield on the 10-year and 5-year Eurobonds issued in 2014 declined by 0.3% points and 0.1% points to 6.3% and 4.1% from 6.6% and 4.2%, the previous week, respectively. Since the mid-January 2016 peak, yields on the Kenyan Eurobonds have declined by 4.7% points and 3.3% 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 0.3-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 0.3% points and 0.4% points to 7.1% and 8.1%, from 7.3% and 8.5% the previous week, respectively. Since the issue date, the yields on both the 10-year and 30-year Eurobond have declined by 0.2% points.

The Kenya Shilling:

During the week, the Kenya Shilling edged down by 0.5% against the US Dollar to Kshs 100.2, from Kshs 99.7 the previous week. The performance was attributable to high dollar demand from the manufacturing and energy sector, which outweighed inflows from diaspora remittances. The Kenya Shilling has appreciated by 1.6% 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 with preliminary data on balance of payments indicating continued narrowing to 4.6% of GDP in the 12-months to January 2019, from 5.5% recorded in January 2018. The decline has been attributed to improved agriculture exports, increased diaspora remittances, strong receipts from tourism, and lower food and SGR-related equipment relative to 2017,

i. 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;

    ?. Increased uptake of financial products by the diaspora due to financial services firms, particularly banks, targeting the diaspora, and,

    a. New partnerships between international money remittance providers and local commercial banks making the process more convenient,

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 8.1 bn, equivalent to 5.3-months of import cover, above the statutory requirement of maintaining at least 4.0-months of import cover, and the EAC region’s convergence criteria of 4.5-months of import cover.

Highlights of the Week:

During the week, the Energy Regulatory Commission (ERC) released their monthly statement on the maximum retail fuel prices in Kenya effective from 15th March 2019 to 14th April 2019. Below are the key take-outs from the statement:

Petrol prices have increased by 1.3% to Kshs 101.4, from Kshs 100.1 per litre previously, while diesel and kerosene prices have increased by 0.7% and 3.1% to Kshs 96.6 and 99.5 per litre, respectively, from Kshs 96.0 and 96.5 per litre, previously. The changes in prices are attributable to:

?. An increase in the average landing costs of imported super petrol by 3.7% to USD 568.6 per ton in February, from USD 548.2 per ton in January. Landing costs for diesel and kerosene as well increased by 2.8% and 9.2% to USD 561.6 per ton and USD 650.2 per ton in February, respectively, from USD 546.4 per ton and USD 595.8 per ton in January, and,

i. The Free on Board (FOB) price of Murban crude oil lifted in February 2018 also increased by 8.9% to USD 66.4 per barrel from USD 61.0 per barrel in January 2019.

The increase in prices was, however, mitigated by the 1.1% appreciation of the Kenyan Shilling against the US Dollar to Kshs 100.2 in February, from Kshs 101.3 in January. Consequently, we expect a rise in the transport index, which carries a weighting of 8.7% in the total consumer price index (CPI), due to the increased petrol and diesel prices. We will release our inflation projection for the month of March 2019 in next week’s report.

Rates in the fixed income market have remained stable as the government rejects expensive bids, despite being 2.7% behind its domestic borrowing target for the current financial year, having borrowed Kshs 220.4 bn against a pro-rated target of Kshs 226.6 bn.

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.

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