Nairobi Metropolitan Area Commercial Office Report 2019 & Cytonn Weekly #14/2019

Fixed Income

T-Bills & T-Bonds Primary Auction:

T-bills recorded an oversubscription during the week, with the subscription rate rising to 250.2%, from 183.7% recorded the previous week. The oversubscription was attributed to favorable liquidity in the market. The yields on the 91-day papers declined by 10 bps to 7.4% from 7.5% recorded the previous week, while those of the 182-day and 364-day papers declined by 1.5 bps and 2.3 bps to 8.2% and 9.4%, respectively. The acceptance rate improved to 70.9%, from 69.3% recorded the previous week, with the government accepting Kshs 42.7 bn of the Kshs 60.2 bn worth of bids received, higher than its weekly quantum of Kshs 24.0 bn. The subscription rate for the 91-day paper declined to 107.2%, from 167.4% recorded the previous week, while that of the 182-day and 364-day papers rose to 102.6% and 456.5% from 73.4% and 300.5% recorded the previous week, respectively. Investors' participation remained skewed towards the longer dated paper, with the continued demand being attributable to the scarcity of newer short-term bonds in the primary market.

For the month of April, the Kenyan Government has issued 10-year (FXD 2/2019/10) and 20-year (FXD 1/2019/20) Treasury bonds, both with market determined coupon rates, in a bid to raise Kshs 50.0 bn for budgetary support. We expect the 10-year bond to generate more interest in the primary market with most investors avoiding the longer-tenor (20-year) bond due to the relatively flat yield curve on the long-end due to saturation of long-term bonds, coupled with the duration risk associated with long-term papers. Given that the Treasury bonds with the same tenor as the FXD 2/2019/10 & FXD 1/2019/20 are currently trading at yields of 12.1% and 12.7%, respectively, we expect bids to come in at 12.1% - 12.3% and 12.7% - 12.9% for the 10-year and 20-year bonds, respectively.

Liquidity:

The market remained relatively liquid with the average interbank rate coming in at 3.2%, which was a marginal rise from 2.8%, recorded the previous week. The marginal rise was due to demand as banks raised funds for tax payments with Pay as You Earn (PAYE) due on Tuesday 9th April. The average volumes traded in the interbank market rose by 23.0% to Kshs 3.6 bn, from Kshs 2.6 bn the previous week. This decline in the interbank rate points towards favourable liquidity conditions, driven partly by government payments, which offset tax remittances by banks.

Kenya Eurobonds:

According to Bloomberg, the yield on the 10-year Eurobonds issued in 2014 declined by 0.1% points to 6.1% from 6.2%, while that of the 5-year remained unchanged at 4.2% as in the previous week. Since the mid-January 2016 peak, yields on the Kenyan Eurobonds have declined by 4.6% points and 3.5% 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 0.2-years and 5.2-years to maturity for the 5-year and 10-year, respectively.

For the February 2018 Eurobond issue, during the week, the yields on 10-year Eurobond and 30-year Eurobond remained unchanged at 7.1% and 8.1%, respectively, from the previous week. Since the issue date, the yields on both the 10-year and 30-year Eurobond have both declined by 0.2% points.

The Kenya Shilling:

During the week, the Kenya Shilling appreciated marginally against the US Dollar to Kshs 100.7, from Kshs 100.8 the previous week propped up by diaspora remittances and reduced dollar demand from oil and merchandise importers. The Kenya Shilling has appreciated by 1.1% 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 with preliminary data on balance of payments indicating continued narrowing to 4.7% of GDP in the 12-months to February 2019, from 5.5% recorded in February 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 17.2% m/m in January 2018 to USD 244.8 mn from USD 208.9 mn recorded in a similar period of review in 2018. 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 supportive 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-months of import cover, and the EAC region’s convergence criteria of 4.5-months of import cover.

Highlight 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 March 2019. The seasonally adjusted PMI fell slightly coming in at 51.0 in March, a decline from 51.2 in February, and a 16-month low since the 42.8 recorded in November 2017. A PMI reading of above 50 indicates improvements in the business environment, while a reading below 50 indicates a worsening outlook. The slower improvement in business conditions was as a result of a slower rise in new orders which was linked to cash flow issues. Consequently, this led to only a modest increase in output levels and a slight rise in employment. Purchase prices rose at a subdued rate during the month as the rate of input inflation cooled for the sixth month in a row, with higher raw material costs being offset by lower fuel prices. We expect the business environment to improve going forward supported by improved purchasing activity due to suppressed inflation as well as improved weather conditions with the long rains expected to commence in April and boost output from the agricultural sector.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids, being currently 14.1% ahead of its domestic borrowing target for the current financial year, having borrowed Kshs 279.0 bn against a pro-rated target of Kshs 244.5 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.
