Kenya Listed Banks FY'2018 Report & Cytonn Weekly #16/2019

Fixed Income

T-Bills & T-Bonds Primary Auction:

T-bills were undersubscribed during the week, with the overall subscription rate declining to 88.7% from 148.1%, recorded the previous week. The decline in subscription rate was attributable to low liquidity levels in the money markets following cyclical liquidity tightness due to the start of the new cash reserves requirement (CRR) cycle. The yield on the 91-day and 182-day papers declined to 7.3% and 8.0% from 7.4% and 8.1%, respectively, while the 364-day paper remained unchanged at 9.4%. The acceptance rate improved to 87.1% from 79.2% recorded the previous week, with the government accepting a total of Kshs 18.5 bn of the Kshs 21.3 bn worth of bids received. The subscription rate for the 91-day, 182-day and 364-day papers declined to 104.0%, 46.8% and 124.4% from 122.7%, 76.4% and 230.0%, recorded the previous week, respectively. Investors' participation however remained skewed towards the 364-day paper, with the continued demand being attributable to the scarcity of newer short-term bonds in the primary market.

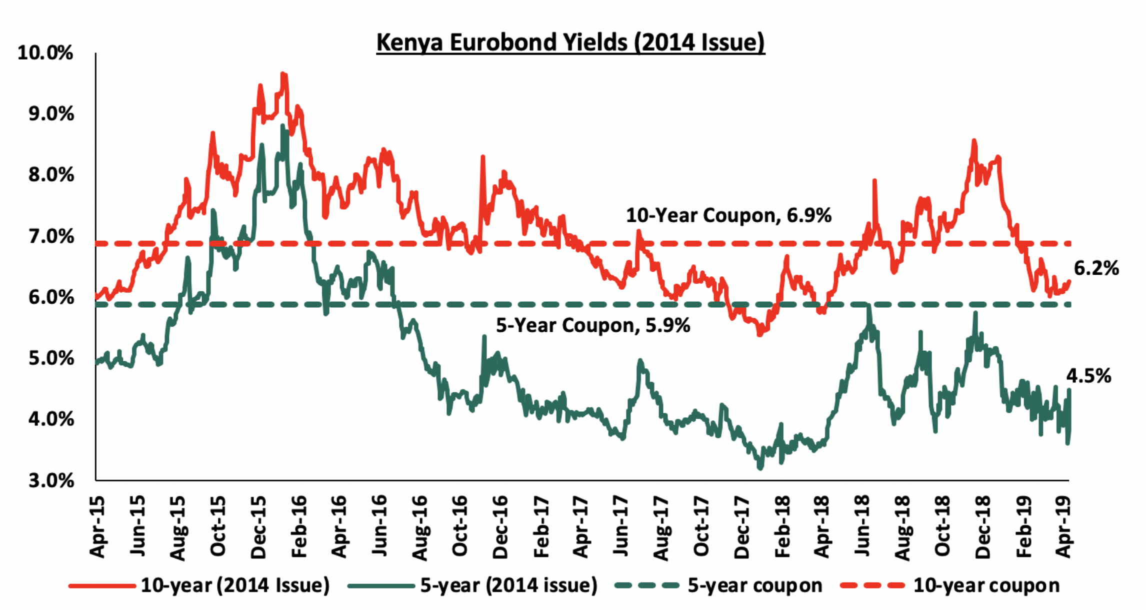
For the month of May, the Treasury is issuing a 5-year (FXD2/2019/5) and a 15-year (FXD2/2019/15) bond for a total of KES 50.0 bn for budgetary support. The Government has stuck to last month's approach of a blended issue with a short-tenor and a long-tenor bond, in a bid to plug in the budget deficit while at the same time trying to reduce the short-term maturity risk. The market is expected to maintain a bias towards the shorter tenor 5-year paper as per the recent trends mainly driven by the perception that risks may not be adequately priced on the longer end of the yield curve, which is relatively flat due to saturation of long-term bonds. We shall give our bidding range for the primary auction in next week's report.

Liquidity:

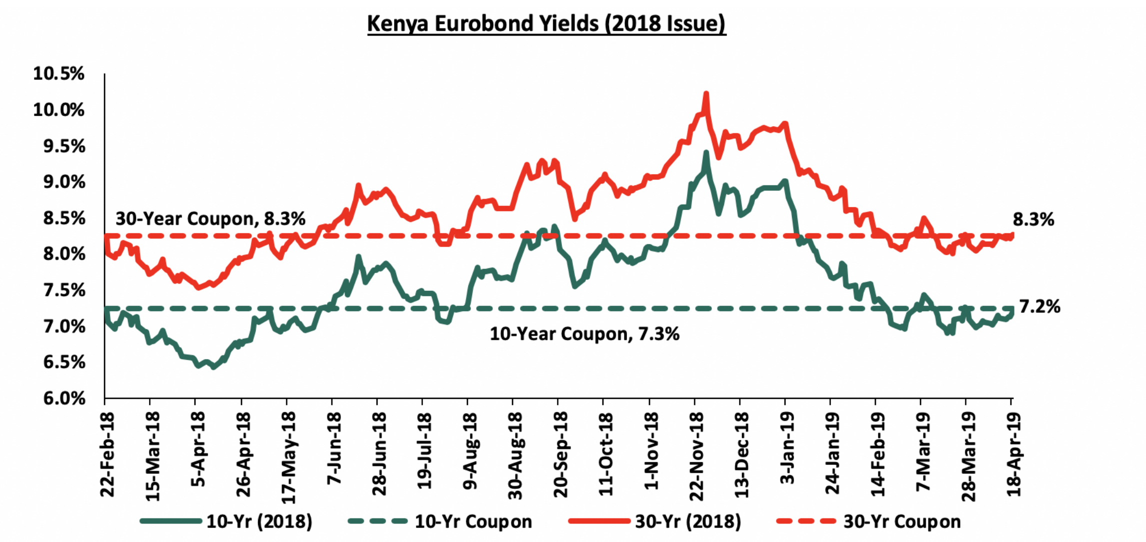
During the week, cyclical liquidity tightness due to the start of the new cash reserves requirement (CRR) cycle was recorded as evidenced by a rise in the average interbank rate to 3.4% from 1.7%, recorded the previous week. The average volumes traded in the interbank market increased by 197.3% to Kshs 18.8 bn, from Kshs 6.3 bn the previous week.

Kenya Eurobonds:

According to Bloomberg, the yield on the 10-year Eurobond issued in 2014 remained unchanged at 6.2%, while that of the 5-year rose by 0.2% points to 4.5% from 4.3% the previous week. The rise is attributable to increased risk perception due to the downgrading of Kenya's growth prospects both by the World Bank and the International Monetary Fund (IMF). 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, yields on the 10-year Eurobond rose by 0.1% points to 7.2% from 7.1%, recorded the previous week while the yield on the 30-year Eurobond remained unchanged at 8.3%. Since the issue date, the yields on the 10-year Eurobond has declined by 0.1% points while that of the 30-year Eurobond has remained unchanged at 8.3%.



The Kenya Shilling:

During the week, the Kenya Shilling lost by 0.3% against the US Dollar to close at Kshs 101.3, from Kshs 101.0 the previous week attributable to increased dollar demand from merchandise importers. The Kenya Shilling has appreciated by 0.9% year-to-date in addition to 1.3% 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 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,

ii. Improving diaspora remittances, which increased by 17.2% m/m in January 2019 to USD 244.8 mn from USD 208.9 mn recorded in a similar period of review in 2018. 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 supportive 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, 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:

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

I. Petrol prices have increased by 5.2% to Kshs 106.6 from Kshs 101.4 per litre previously, while
II. Diesel and kerosene prices have increased by 5.7% and 2.8% to Kshs 102.1 and Kshs 102.2 per litre, respectively, from Kshs 96.6 and 99.5 per litre, previously.

The changes in prices are attributable to:

I. An increase in the average landing cost of imported super petrol by 9.1% from USD 568.6 per ton in February 2019 to USD 620.5 per ton in March 2019, diesel by 11.2% from USD 561.6 per ton to USD 624.5 per ton and kerosene by 1.9% from USD 650.3 per ton to USD 662.6 per ton,
II. The Free on Board (FOB) price of Murban crude oil lifted in March 2019 also increased by 3.4% to USD 68.6 per barrel from USD 66.4 per barrel in February 2019, and,
III. The mean monthly US dollar to Kenya Shilling exchange rate also depreciated by 0.3% to Kshs 100.5 in March from Kshs 100.2 in February.

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 also expect inflationary pressure in the food and non-alcoholic beverages index, which has a weight of 36.0% in the consumer price index (CPI), mainly driven by a rise in food prices following the delay of the March-May long rains, which has seen the prices of basic food items such as a 1 kg packet of maize flour recording a 25.0% rise in April to retail at Kshs 55 from Kshs 44 recorded in March, while milk prices also rose by 10.0% for a 500 ml packet to Kshs 55 from Kshs 50 previously. Based on the factors mentioned, we are projecting the y/y inflation rate for the month of April to come in within the range of 4.6% - 5.0%, a rise compared to 4.4% recorded in March.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids, as they are currently 21.7% ahead of its domestic borrowing target for the current financial year, having borrowed Kshs 312.1 bn against a pro-rated target of Kshs 256.4 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.