Kenya Mortgage Refinancing Company Update & Cytonn Weekly #17/2019

Fixed Income

T-Bills & T-Bonds Primary Auction:

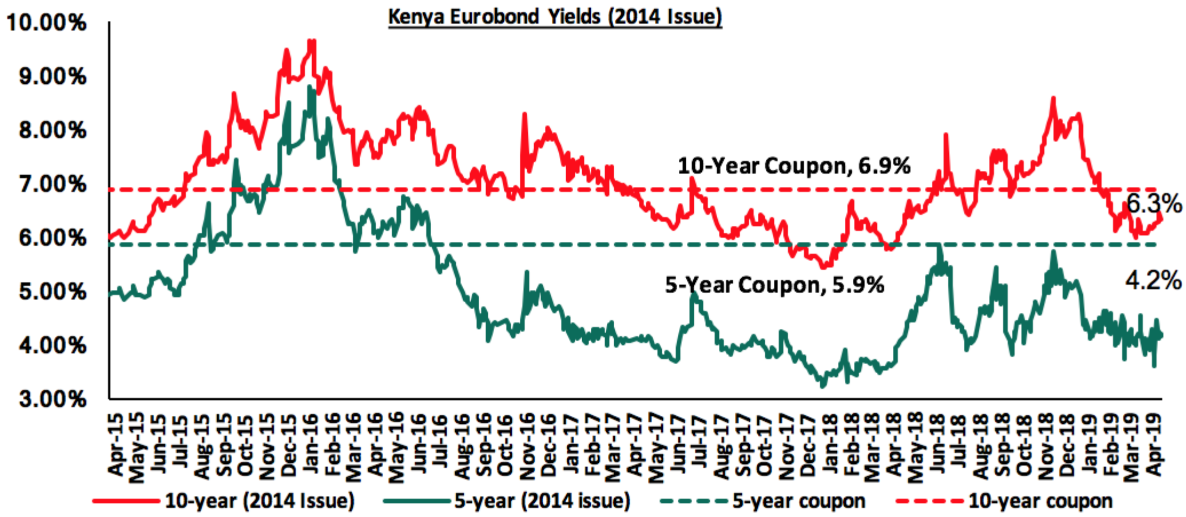
T-bills were oversubscribed during the week, with the overall subscription rate increasing to 113.8% from 88.7% recorded the previous week. The yield on the 91-day and 182-day papers remained unchanged at 7.3% and 8.0%, respectively, while that of the 364-day paper declined to 9.3% from 9.4% recorded the previous week. The acceptance rate improved to 95.3% from 87.1% recorded the previous week, with the government accepting a total of Kshs 26.0 bn of the Kshs 27.3 bn worth of bids received, higher than its weekly quantum of Kshs 24.0 bn. The subscription rate for the 91-day and the 182-day improved to 186.4% and 141.9%, from 104.0% and 46.8% recorded the previous week, while that of the 364-day paper declined to 56.6% from 124.4% recorded the previous week.

Liquidity:

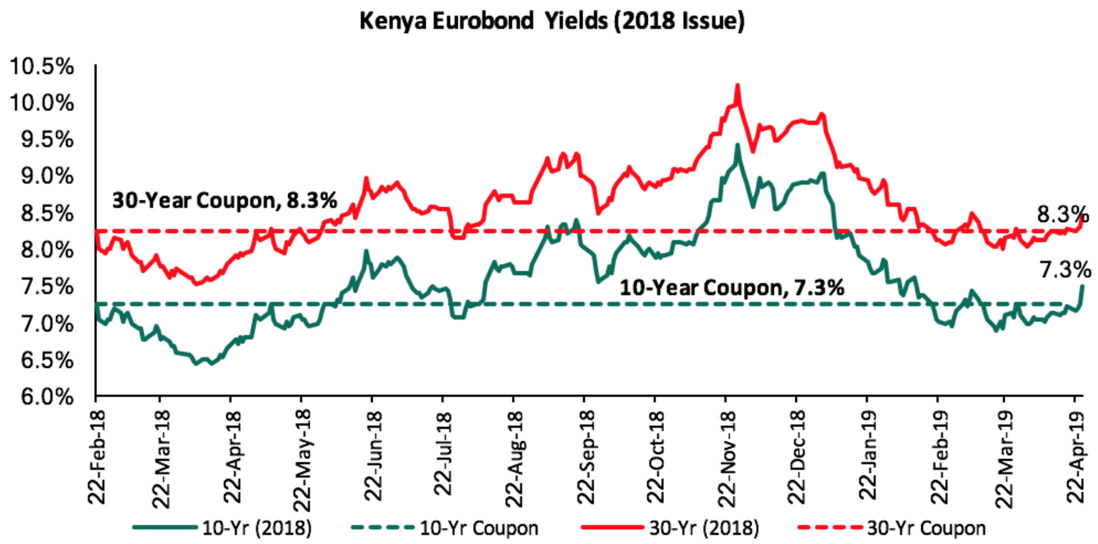
The money market remained relatively tight during the week, with the average interbank rate increasing to 5.1% from 3.8% recorded the previous week. The average volumes traded in the interbank market rose by 23.9% to Kshs 26.7 bn, from Kshs 18.8 bn the previous week, as the markets recovered from tax payments coupled with banks propping up their reserves following the start of the new cash reserves requirement (CRR) cycle the previous week.

Kenya Eurobonds:

According to Bloomberg, the yield on the 10-year Eurobonds issued in 2014 rose by 0.1% points to 6.3% from 6.2%, while that of the 5-year declined by 0.1% points to 4.2% from 4.3% the previous week. Since the mid-January 2016 peak, yields on the Kenyan Eurobonds have declined by 4.4% 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 rose by 0.2% points to 7.3% from 7.1% the previous week, while the yield on the 30-year Eurobond rose by 0.1% points to 8.3% from 8.2% recorded the previous week. Since the issue date, the yields on the 10-year Eurobond have remained the same while those of the 30-year Eurobond have increased by 0.2% points.



The Kenya Shilling:

During the week, the Kenya Shilling lost by 0.2% against the US Dollar to close at Kshs 101.5, from Kshs 101.3 the previous week, attributable to increased dollar demand from the energy sector. The Kenya Shilling has appreciated by 0.3% year to date in addition to 1.3% in 2018. 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 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 supportive activities in the money market, such as repurchase agreements and selling of dollars, and,
iii. High levels of forex reserves, currently at USD 8.4 bn, equivalent to 5.4-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:

During the week, the Kenya National Bureau of Statistics (KNBS) released the Economic Survey 2019 indicating that the economy had expanded by 6.3% in 2018 from 4.9% recorded in 2017. This was the fastest economic growth since the 8.4% recorded in 2010, and above the 5-year average GDP growth rate of 5.6%.

Some of the key highlights from the survey were:

?. There was a rebound recorded in the agriculture sector, which recorded a growth of 6.4% in 2018 from a revised growth of 1.9% in 2017 from the initial reported growth of 1.6%, with growth mainly driven by marked improvement in crops and animal production anchored by favourable weather conditions. Despite the rebound in growth, the sectors' contribution remained unchanged at 21.3%;
i. Growth in the manufacturing sector was robust in 2018 recording a 4.2% growth, up from the 0.5% growth recorded in 2017. Contribution of the sector to total GDP however declined slightly to 9.6% from 9.8% in 2017. Improved growth in the sector was driven by agro-processing activities that improved due to the increased agricultural production during the year. Under manufacturing of food and beverages, the highest growth was recorded in the manufacture of sugar at 30.3% and liquid milk at 18.5%;
ii. There was continued recovery of the tourism sector with accommodation and food service activities improving to 16.6% from 14.3% recorded in 2017, which can be attributed to enhanced security in the country, and a pick-up in the MICE tourism sector, with Kenya being one of the top Meetings, Incentive Group Travel, Conferences and Exhibitions destination in Africa. Growth was further boosted with the visits by heads of states and dignitaries, as well as various international conferences held during the year. These coupled with the withdrawal and relaxation of travel advisories, introduction of charter flights from key cities in Europe, increased flight frequency and routes, and the inauguration of the Nairobi-New York route in October 2018 saw international visitor arrivals rising by 14.0% to 2,027,700 from 1,778,400 in 2017;
iii. The real estate sector performance slowed down in 2018, having grown by 4.1% compared to 6.1% in 2017, owing to a decline in demand for property despite the growing supply, evidenced by the 3.0% decline in the residential sector occupancy rates, and the 4.8% increase in supply of retail space to 6.5 mn SQFT in 2018 from 6.2 mn SQFT in 2017, as per Cytonn's research;
iv. The financial & insurance sector grew by 5.6% in 2018, up from the slow 2.8% growth recorded in 2017, which had been as a result of banks feeling the impact of the introduction of the capping of interest rates. 2018's improved performance was driven by higher banking sector earnings growth, with interest income earned by commercial banks rising by 30.7% to Kshs 379.6 bn from Kshs 368.2 bn in 2017.

We expect the 2019 GDP growth to slow down to a range of 5.7%-5.9%, due to the delayed long rains with most parts of the country expected to experience depressed rainfall that is set to lead to a decline in agricultural production. Consequently, the manufacturing sector is also expected to decline, as the major growth driver in the sector is agro-processing. In addition, ongoing emergency intervention to address food shortages in several counties could impose fiscal pressure constraining capital spending, which has also been a major driver of economic growth especially in the construction sector.

Below is a table showing average projected GDP growth for Kenya in 2019 updated with the World

Bank's and International Monetary Fund (IMF) downward revision to 5.7% and 5.8% from 5.8% and 6.1%, respectively; noteworthy being that the highest projection is by the Central Bank of Kenya at 6.3%, but recently the Central Bank of Kenya (CBK) Governor hinted on a possible downward revision by 1.0% points in the event that the country experiences a severe drought due to the delayed long rains.

No.	Kenya 2019 Annual GDP Growth Outlook	Q1'2019	Q2'2019
1	Central Bank of Kenya	6.3%	6.3%
2	Citigroup Global Markets	6.1%	6.1%
3	African Development Bank (AfDB)	6.0%	6.0%
4	PNB Paribas	6.0%	6.0%
5	UK HSBC	6.0%	6.0%
6	Euromonitor International	5.9%	5.9%
7	International Monetary Fund (IMF)	6.1%	5.8%
8	Cytonn Investments Management Plc	5.8%	5.8%
9	Focus Economics	5.8%	5.8%
10	World Bank	5.8%	5.7%
11	JPMorgan	5.7%	5.7%
12	Euler Hermes	5.7%	5.7%
13	Oxford Economics	5.6%	5.6%
14	Standard Chartered	5.6%	5.6%
15	Capital Economics	5.5%	5.5%
16	Fitch Solutions	5.2%	5.2%
	Average	**5.8%**	**5.8%**

For a more comprehensive analysis see the Kenya 2018 GDP Growth and Outlook note

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids, being currently 21.9% ahead of its domestic borrowing target for the current financial year, having borrowed Kshs 319.9 bn against a pro-rated target of Kshs 262.4 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.