



Understanding Retirement Benefits Schemes in Kenya & Cytonn Weekly #19/2019

Fixed Income

T-Bills & T-Bonds Primary Auction:

T-bills remained undersubscribed during the week, with the overall subscription rate increasing to 57.9% from 49.0%, recorded the previous week. The under-subscription is attributable to tight liquidity in the market partly due to tax payments, coupled with the close of the 5-year and 15-year primary bond sale during the week. The yields on the 91-day, 182-day and 364-day papers declined by 5.4 bps, 6.1 bps and 0.4 bps to 7.2%, 7.9% and 9.3%, respectively. The acceptance rate declined slightly to 99.9% from 100.0% recorded the previous week, with the government accepting Kshs 13.88 bn of the Kshs 13.89 bn worth of bids received.

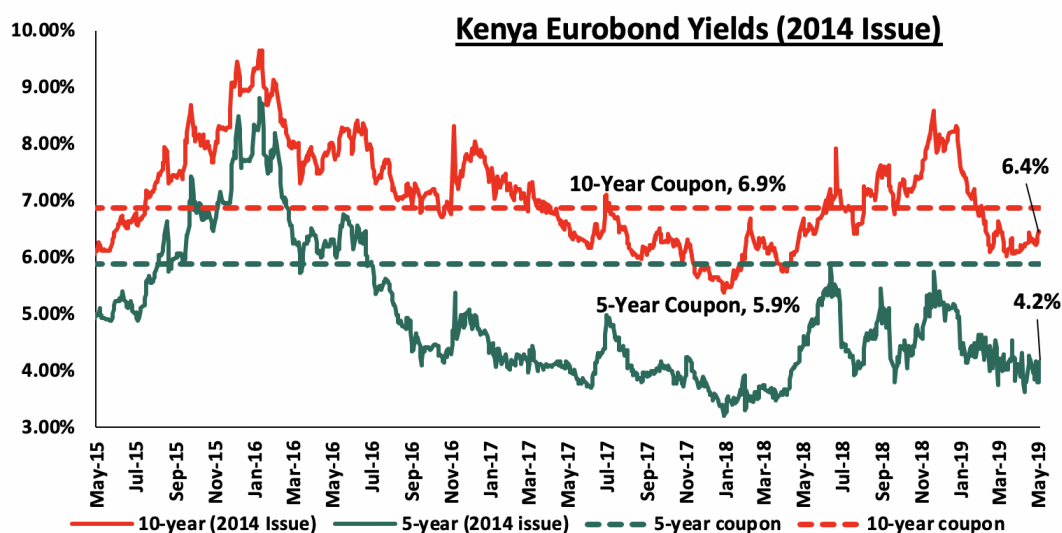
The newly issued bonds for the month of May, issue numbers (FXD 2/2019/5) and (FXD 2/2019/15) with 5-year and 15-year tenors were oversubscribed, with the performance rate coming in at 141.7%. The market maintained a bias towards the 5-year bond that generated total bids of Kshs 39.2 bn as investors continue to avoid the longer-tenor bond 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, coupled with the duration risk associated with longer-term papers. The accepted yields for the 5-year and 15-year bonds came in at 10.9% and 12.7% in line with our expectations of 10.8% - 11.0% and 12.5% - 12.7% for the 5-year and 15-year bonds, respectively.

Liquidity:

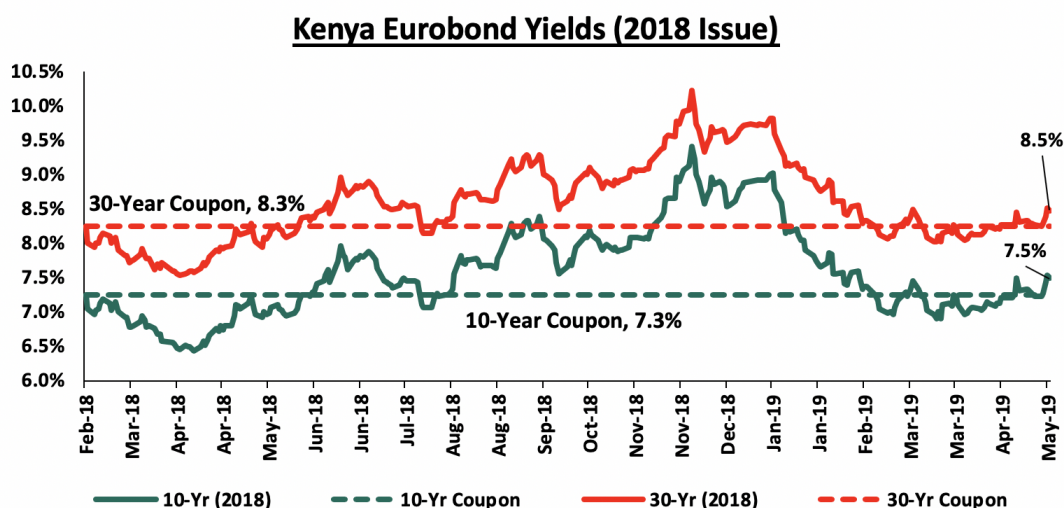
During the week, the average interbank rate rose to 6.4%, from 6.0% the previous week, pointing to tightened liquidity conditions in the money market as banks were mobilizing funds to pay for tax remittances with PAYE due on 9th of May. The average volumes traded in the interbank market also rose by 4.2% to Kshs 13.6 bn, from Kshs 13.0 bn the previous week.

Kenya Eurobonds:

According to Bloomberg, the yield on the 10-year Eurobond issued in 2014 rose by 0.2% points to 6.4% from 6.2% the previous week, while that of the 5-year remained unchanged at 4.2%. The continued rise is partly attributable to increased risk perception due to the downgrading of Kenya's 2019 growth prospects. Key to note is that these bonds have 1.4 months and 5.1-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 0.2% points to 7.5% from 7.3%, recorded the previous week while the yield on the 30-year Eurobond rose by 0.3% points to 8.5% from 8.2%, recorded the previous week. Since the issue date, the yields on both the 10-year Eurobond and 30-year Eurobond have increased by 0.2% points.



The Kenya Shilling:

During the week, the Kenya Shilling remained stable against the US Dollar to close at Kshs 101.1, unchanged from the previous week, supported by inflows from investors buying government securities that matched dollar demand from merchandise importers. The Kenya Shilling has appreciated by 0.7% 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 4.5% of GDP in the 12 months to March 2019, from 5.5% in the 12 months to March 2018. The decline has been supported by resilient horticultural exports, strong diaspora remittances and improved transport service receipts,
- ii. Improving diaspora remittances, which increased cumulatively by 3.8% in the first 3 months of 2019 to USD 665.6 mn from USD 641.5 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 5.2-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 PMI report released during the week, Kenya's business conditions deteriorated for the first time since November 2017 recording a decline to 49.3 in April from 51.0 recorded in March. Readings above 50.0 signal an improvement in business conditions, while readings below 50.0 show a deterioration. The deterioration was driven by the poor weather conditions following the late onset of the traditional long rains season coupled with intensifying cash flow issues as cited by many firms partly due to arrears owed to the private sector by the Government. Private sector sales remained broadly unchanged despite a decline in local orders as this was mitigated by a rise in new export orders. Input prices rose during the month as a consequence of the delayed long rains, which inflated commodity prices. Despite the rise in input costs, output charges recorded a decline as firms looked for new customers to address the slowdown in sales growth. Going forward, we expect business activity to remain in contraction in the short term given the delay in the long rains that has seen commodity and food prices rise as evidenced by the rise in April's inflation to 6.6% from 4.4% recorded in March, coupled with the rise in fuel prices. The delayed rains have also adversely affected the performance of the country's key exports with the value of tea exported recording a decline as the reduced production was not accompanied by a proportionate rise in prices as the supply has substantially increased globally. With the start of the long rains however, we expect the conditions to gradually improve in the medium term as the year progresses.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids as they are currently 26.6% ahead of its domestic borrowing target for the current financial year, having borrowed Kshs 347.4 bn against a pro-rated target of Kshs 274.3 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.

Liason House, StateHouse Avenue

The Chancery, Valley Road

www.cytonn.com

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