Kenya Listed Banks Q1'2019 Report, & Cytonn Weekly #24/2019

Fixed Income

Money Markets, T-Bills & T-Bonds Primary Auction:

T-bills remained oversubscribed during the week, with the overall subscription rate increasing to 130.6%, from 116.0% recorded the previous week. The continued oversubscription is attributable to favourable liquidity in the market supported by government payments that offset the tax payments. The yields on the 91-day and 364-day paper remained unchanged at 6.9% and 9.3% respectively, while the yield on the 182-day papers increased by 0.1% points to 7.7% from 7.6% recorded the previous week. The acceptance rate declined to 35.1%, from 62.2% recorded the previous week, with the government accepting a total of Kshs 11.0 bn of the Kshs 31.3 bn worth of bids received, lower than the weekly quantum of Kshs 24.0 bn. 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. The 364-day recording improved subscription to 274.2%, from 261.1% the previous week. The subscription rates for the 91-day and 182-day papers also increased to 26.7% and 28.5% from 22.6% and 8.1% recorded the previous week, respectively.

The re-opened bonds for the month of June, issue numbers (FXD1/2012/15) and (& FXD1/2018/15) with effective tenors of 8.4-years and 13.9-years were oversubscribed, with the performance rate coming in at 214.0%. The market had a bias towards the FXD1/2018/15 that had been issued in 2018 generating total bids of Kshs 45.8 bn as investors eyed the higher yield with its coupon at 12.7%. The accepted yields for the FXD1/2012/15 and FXD1/2018/15 came in at 11.6% and 12.5% in line with our expectations. The acceptance rate for the issue came in at 45.5% with the Government accepting Kshs 38.9 bn of the Kshs 85.6 bn worth of bids received, signaling reduced appetite for domestic debt for the current financial year as the government snubbed expensive bids, being currently ahead of its domestic borrowing target.

In the money markets, 3-month bank placements ended the week at 9.0% (based on what we have been offered by various banks), 91-day T-bill at 6.9%, average of Top 10 Money Market Funds at 9.4%, with the Cytonn Money Market Fund closing the week at 11.0%.

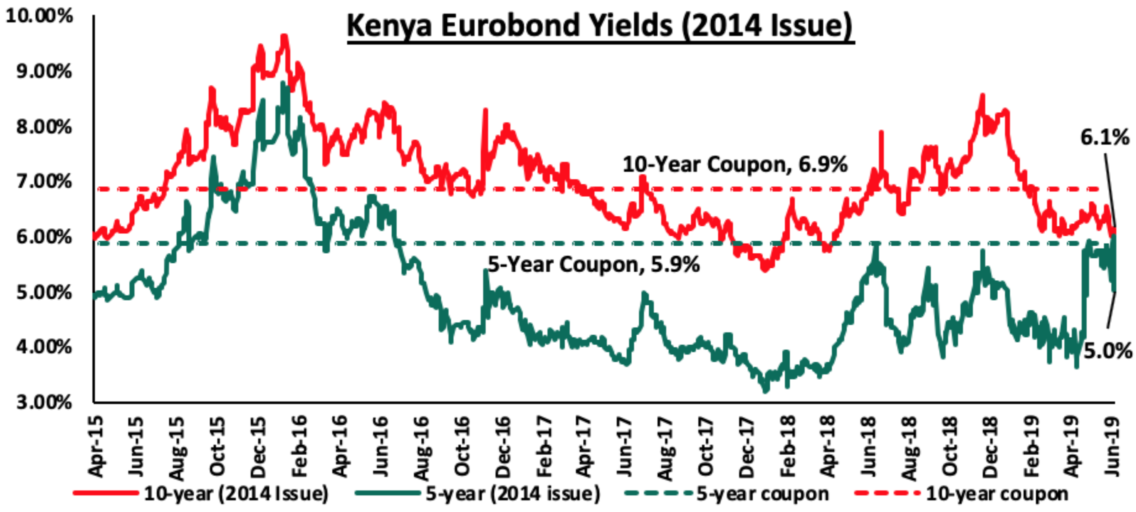
Liquidity:

During the week, the average interbank rate declined to 3.2%, from 4.1% recorded the previous week, pointing to improved liquidity conditions in the money market supported by government payments, which offset tax remittances during the week. This saw commercial banks' excess reserves coming in at Kshs 15.4 bn in relation to the 5.25% cash reserve requirement (CRR). The average volumes traded in the interbank market also declined by 26.9% to Kshs 4.4 bn, from Kshs 6.0 bn the previous week.

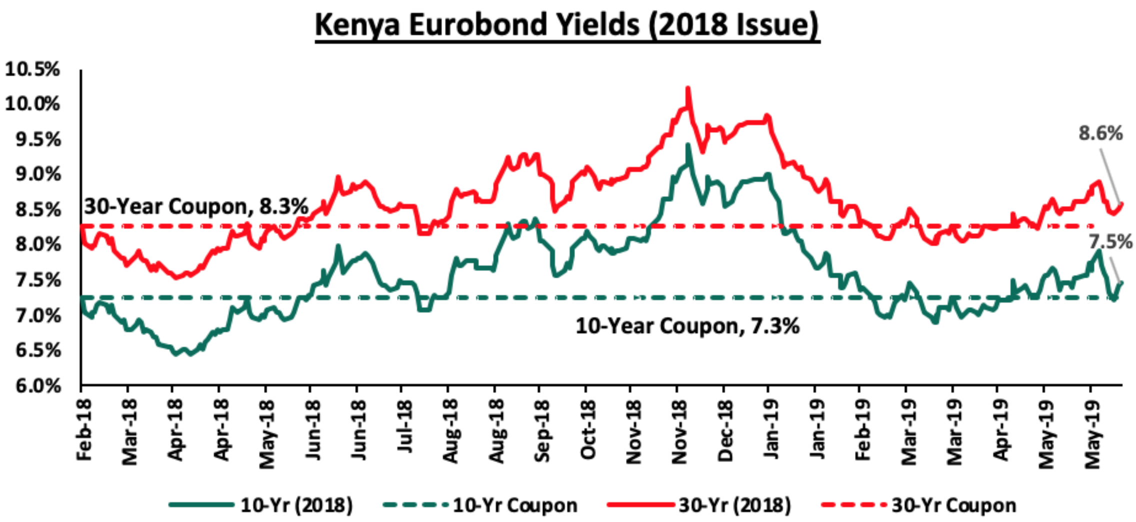
Kenya Eurobonds:

The yield on the 10-year Eurobond issued in 2014 remained unchanged at 6.1%, while that of the 5-

year declined by 0.7% points to 5.0% from 5.7% recorded the previous week. Key to note is that these bonds have 9-days and 5.0-years to maturity for the 5-year and 10-year, respectively.



For the February 2018 Eurobond issue, yields on the 10-year and 30-year Eurobond both gained by 0.1% points to 7.5% and 8.6%, respectively from 7.4% and 8.5% recorded the previous week.



For the newly issued dual-tranche Eurobond with 7-Years and 12-years tenor, priced at 7.0% for the 7-year tenor and 8.0% for the 12-year tenor, respectively, the yield on the 7-year bond remained unchanged at 7.0% while the 12-year bond declined by 0.2% points to 7.8% from 8.0% recorded the previous week.

The Kenya Shilling:

During the week, the Kenyan Shilling depreciated by 0.2% against the US Dollar to close at Kshs 101.5, from Kshs 101.3 the previous week, due to a spike in dollar demand from oil and merchandise importers. The Kenya Shilling has appreciated by 0.5% year to date in addition to the 1.3% appreciation 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 data on balance of payments indicating continued narrowing to 4.5% of GDP in the 12-months to April 2019, from 5.5% recorded in April 2018. The decline has been attributed to the resilient performance of exports particularly horticulture and coffee, strong diaspora remittances, and higher receipts from tourism and transport services. Growth of imports also slowed mainly due to lower imports of food,
ii. Improving diaspora remittances, which have increased cumulatively by 3.8% in Q1’2019 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 10.1 bn (equivalent to 6.4-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.

Highlights of the Week

The National Treasury released the 2019/2020 fiscal year (FY) budget on 13th June 2019. Below are some of the highlights with the revenue and expenditure estimates remaining unchanged as outlined in our FY 2019/20 Pre-Budget Discussion Note:

Item	FY'2018/2019 (Revised)	FY'2019/2020	Change y/y
Total revenue	1,852.6	2,115.9	14.2%
Grants	48.5	38.8	(20.0%)
Total revenue & external grants	**1,901.1**	**2,154.7**	**13.3%**
Total expenditure	**2,509.1**	**2,762.5**	**10.1%**
Fiscal deficit including grants	**(608.0)**	**(607.8)**	0.0%
Deficit(excluding grants) as % of GDP	6.6%	5.4%	
Net foreign borrowing	287.0	324.3	13.0%
Net domestic borrowing	321.0	283.5	(11.7%)
Total borrowing	**608.0**	**607.8**	**0.0%**

Source Budget Summary, 2019

Key take-outs from the table;

- Total revenue collected is expected to increase by 14.2% to Kshs 2.1 tn from the Kshs 1.9 tn as per the revised FY'2018/2019 revised Budget mainly driven by a 12.2% rise in ordinary revenue to Kshs 1.9 tn from an estimated Kshs 1.7 tn in the revised FY'2018/2019 budget
- Total expenditure is set to increase by 10.1% to Kshs 2.8 tn from Kshs 2.5 tn as per the revised FY'2018/19 Budget
- The fiscal deficit is projected at 607.8 billion (5.6% GDP) which will be financed through 324.3 billion in terms of external financing, domestic borrowing of 289.2 billion and other domestic receipts worth 5.7 billion

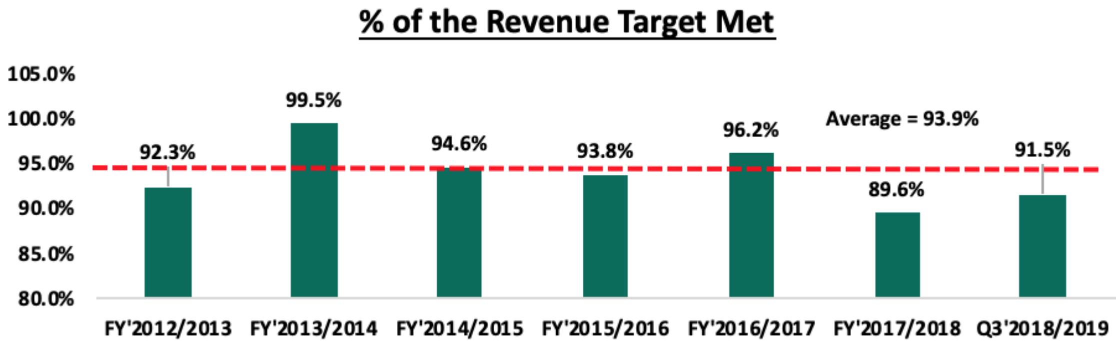
Of interest, however, were the various measures put in place to improve revenue collection, with the Government having an ambitious target of Kshs 2.1 tn, a 14.2% rise from the FY'2018/2019 budget. Some of the measures, as highlighted in the budget, that the Government intends to introduce through the Finance Bill, 2019, expected to generate an additional Kshs 37.0 billion, in tax revenue to the Exchequer include:

1. An increment in the Capital Gains Tax from 5.0% to 12.5%. Transfer of property necessitated by restructuring of corporate entities, will however be exempt from this tax to allow for seamless restructuring of corporate entities with the aim of increasing efficiency and market penetration.
2. Excise duties on cigarettes and alcohol will be increased by 15.0% in efforts to boost excise

revenues which have been on a declining trend.

3. Introduction of Excise duty on betting activities, where a rate of 10.0% will be charged on the amount staked. This is to curb the negative social effects brought about by betting in the country.
4. Expanding the scope of application of withholding tax by subjecting additional services such as security services, cleaning and fumigation services, catering services offered outside hotel premises, sales promotion, marketing and advertising services and transportation of goods excluding air transport to withholding tax. It will enhance compliance by those offering the services.

We expect continued underperformance in revenue collections as per the historical trend with the worst year being FY'2017/2018 where it only managed to raise 89.6% of the targeted total revenue mainly due to a shortfall of Khs 195.0 bn in ordinary revenue.



Despite the measures put in place to enhance revenue collection, we believe that they will not yield a significant growth in ordinary revenue as they are expected to generate only an additional Kshs 37.0 bn in tax revenue which is meagre compared to the expected Kshs 263.3 mn rise in total revenue as per the budget.

The Energy and Petroleum Regulatory Authority released their monthly statement on the maximum retail fuel prices in Kenya effective from 15th June 2019 to 14th July 2019. Below are the key take-outs from the statement:

i. Petrol prices have increased by 2.7% to Kshs 115.1 from Kshs 112.0 per litre previously, while diesel prices have increased by 0.4% to Kshs 104.8 from Kshs 104.4, previously,
ii. Kerosene prices however declined by 0.3% to Kshs 104.3 from Kshs 104.6 per litre

The changes in prices are attributable to:

i. An increase in the average landing cost of imported super petrol by 4.5% to USD 538.1 per cubic metre in May 2019, from 514.7 per cubic metre in April 2019,
ii. An increase in the average landing costs of imported diesel by 0.5% to USD 535.8 per cubic metre in May 2019, from 533.1 per cubic metre in April 2019, and Kerosene decreasing by 0.4% to USD 532.9 per cubic metre in May 2019, from 535.2 per cubic metre in April 2019, and
iii. The Free on Board (FOB) price of Murban crude oil lifted in May 2019 declined by 1.0% to USD 72.4 from USD 73.1, per barrel in April 2019,

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 shall publish our inflation projections in next week's report.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids as they are currently 11.1% ahead of its domestic borrowing target for the current financial year, having borrowed Kshs 345.5 bn against a pro-rated target of Kshs 311.0 bn. A budget deficit is likely to result from depressed revenue collection with the revenue target for FY'2019/2020 at Kshs 2.1 tn, 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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