Review of the Interest Rate Cap, & Cytonn Weekly #25/2019

Fixed Income

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

T-bills remained oversubscribed during the week, with the overall subscription rate increasing to 236.7%, from 130.6% recorded the previous week. The continued oversubscription is attributable to favourable liquidity in the market supported by government payments, which more than offset the tax payments by banks. The yields on the 91-day and the 182-day T-bills declined by 0.1% points to 6.8% and 7.6%, respectively, while yields on the 364-day T-bills declined by 0.2% points to 9.1%, from 6.9%, 7.7% and 9.3% for the 91-day, 182-day and 364-day T-bills, respectively, recorded in the previous week. The acceptance rate declined to 17.4%, from 35.1% recorded the previous week, with the government accepting a total of Kshs 9.9 bn of the Kshs 56.8 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 subscriptions for the 91-day, 182-day and 364-day T-bills rose to 161.2%, 64.0%, and 439.7% from 26.1%, 28.5%, and 274.2%, respectively.

In the money markets, 3-month bank placements ended the week at 8.8% (based on what we have been offered by various banks), 91-day T-bill at 6.8%, average of Top 10 Money Market Funds at 8.4%, with the Cytonn Money Market Fund closing the week at 11.0%.

Liquidity:

During the week, the average interbank rate declined to 2.8% from 3.2% recorded the previous week, pointing to improved liquidity conditions in the money market supported by government payments, which offset tax remittances by banks 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 increased by 226.2% to Kshs 14.3 bn, from Kshs 4.4bn the previous week.

Kenya Eurobonds:

The yield on the 10-year Eurobond issued in 2014 declined by 0.5% points to 5.6%, from 6.1% recorded the previous week, while that of the 5-year remained unchanged at 5.0%. Key to note is that the 5-year bond is set to mature on 24th June 2019, while the 10-year bond currently has 5.0-years to maturity.

For the February 2018 Eurobond issue, yields on the 10-year Eurobond and 30-year Eurobond declined by 0.6% points to 6.8% and 8.0% from 7.4% and 8.6% recorded the previous week, respectively.

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 declined by 0.4% points to 6.6% from 7.0% recorded in the previous week, while the 12-year bond declined by 0.7% points to 6.8% from 7.5% recorded in the previous week.

The Kenya Shilling:

During the week, the Kenya Shilling depreciated by 0.3% against the US Dollar to close at Kshs 101.9, from Kshs 101.5 the previous week, due to a spike in dollar demand from oil and merchandise importers resulting in the depreciation of the shilling. The Kenya Shilling has depreciated by 0.1% year to date; compared 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 6.1% in April 2019 to USD 991.2 mn, from USD 858.6 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 9.2 bn (equivalent to 5.8-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 Federal Reserve Bank (Fed) of the U.S through its Federal Open Market Committee (FOMC), has maintained its benchmark policy rate within the band of 2.25% - 2.50%, during its 20th June Meeting, unchanged from its March projection. However, the FOMC left open the possibility for an interest rate cut depending on how macroeconomic conditions developed during the year. The decision was based on improved economic activity and reduced inflationary pressures. The Fed also highlighted that overall inflation on a 12-month basis for the month ending May 2019 was at 1.8%, which is slightly below the Fed’s target rate of 2.0%. We expect the Fed to reduce the policy rate by 25 bps to a band of 2.0%-2.25%, given uncertainties on the economic outlook.

Inflation projections

We are projecting the Y/Y inflation rate for the month of June to come in within the range of 5.8% - 6.2%, compared to 5.5% recorded in May. The Y/Y inflation for the month of June is expected to rise due to the base effect as well as:

I. A rise in the transport index, which has a weight of 8.7%, with petrol prices having increased by 2.7% to Kshs 115.1, from Kshs 112.0 per liter previously, while diesel recorded a 0.4% rise to Kshs 104.8, from Kshs 104.4 per liter previously.

M/M inflation is however expected to decline, with the rise in the transport index being mitigated by a decline in the food and non-alcoholic beverages index, which has a weighting of 36.0%, mainly driven by a decline in food prices such as tomatoes and maize flour, following the release of 2 million bags of maize from the strategic food reserves the previous month at a subsidized cost of Kshs 2,300 per 90 kg bag against Kshs 3,200 in the open market, to ease the grains shortage, hence curbing

rising flour prices. We also expect a decline in the housing, water, electricity, gas and other fuels index, following the 0.3% decline in kerosene prices to Kshs 104.3, from Kshs 104.6 per litre previously. Going forward, we expect food inflation to be subdued, following the directive to open the duty free import window for maize from July to plug the grain shortage, which will allow traders to import up to 12.0 mn bags.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids as they are currently 3.6% ahead of their domestic borrowing target for the current financial year, having borrowed Kshs 332.5 bn against a pro-rated target of Kshs 321.0 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.

Liason House, StateHouse Avenue
The Chancery, Valley Road
www.cytonn.com
Generated By Cytonn Report

A product of Cytonn Technologies