Cytonn H1’2019 Markets Review

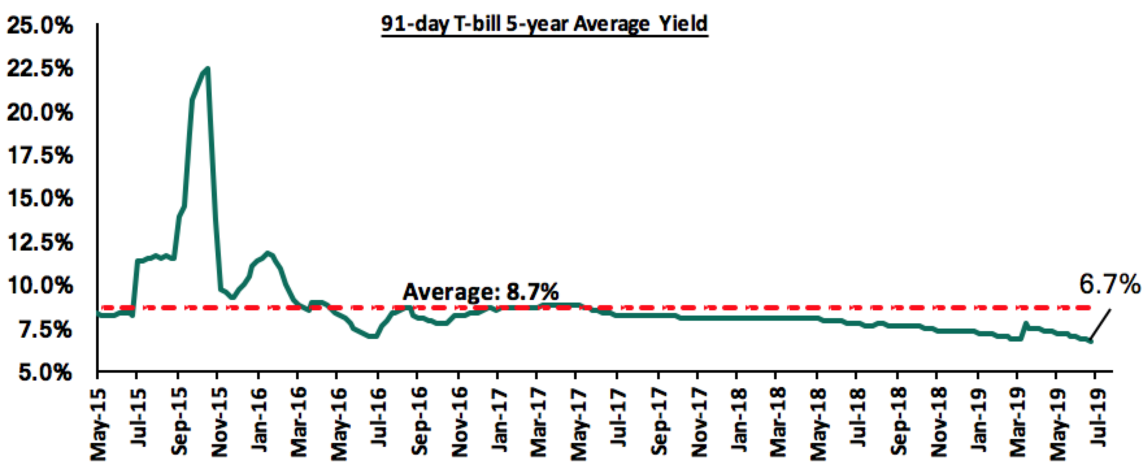
Fixed Income

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

During the first half of 2019, T-bill auctions recorded an oversubscription, with the average subscription rate coming in at 144.6% compared to 142.6% in H1’2018. Overall subscription rates for the 91, 182, and 364-day papers came in at 103.5%, 80.5% and 255.0%, with investors’ participation remaining skewed towards the longer-dated paper, attributable to the scarcity of newer short-term bonds in the primary market. Yields on T-bills declined by 50 bps, 140 bps and 90 bps closing at 6.8%, 7.6%, and 9.1% in H1’2019, from 7.3%, 9.0%, and 10.0% for the 91, 182, and 364-day papers, respectively, recorded as at the end of 2018, mainly due to the Central Bank of Kenya’s (CBK’s) efforts to keep rates low by rejecting expensive bids in the auction market. During the week, T-bills were oversubscribed at a subscription rate of 249.2%, up from 236.7% recorded the previous week. Yields on the 91- day, 182-day and 364- day papers declined by 7.6 bps, 9.1 bps and 29.1 bps to 6.7%, 7.5% and 8.8%, respectively. The acceptance rate rose to 52.0% from 17.4%, recorded the previous week, with the government accepting Kshs 31.1 bn of the Kshs 59.8 bn worth of bids received.

The yield on the 91-day T-bill is currently at 6.7%, below its 5-year average of 8.7%. The lower yield on the 91- day paper is mainly attributed to the low interest rate environment we have been experiencing, and we expect this to continue in the short-term because of:

?. The interest rate cap is still in place which will make it easier for the government to borrow from the domestic market, as institutions will continue channeling funds more actively towards government securities deemed less risky, since the pricing of loans to the private sector is based on the Central Bank Rate as opposed to their risk profiles, and
i. The government domestic borrowing requirement for the 2019/20 financial year has been reduced by 11.7%, to Kshs 283.4 bn from Kshs 321 bn, with revenues expected to increase by 14.2% from the previous fiscal year.



During H1’2019, the Kenyan Government had 7 Treasury Bonds primary issues, with details in the table below:

No.	Date	Bond Auctioned	Effective Tenor to Maturity (Years)	Coupon	Amount to be Raised (Kshs bn)	Actual Amount Raised (Kshs bn)	Average Accepted Yield	Subscription Rate	Acceptance Rate
1	28/1/2019	FXD1/2019/2	2.0	10.7%	40.0	23.8	10.7%	254.9%	37.7%
		FXD1/2019/15	15.0	12.9%		14.7	12.9%		
2	02/11/2019	FXD1/2019/2 (Re-open)	2.0	10.7%	12.0	7.5	10.3%	555.0%	35.2%
		FXD1/2019/15 (Re-open)	15.0	12.9%		16.0	12.8%		
3	25/2/2019	FXD1/2019/5	5.0	11.3%	50.0	20.6	11.3%	156.5%	68.2%
		FXD1/2019/10	10.0	12.4%		32.8	12.4%		
4	25/3/2019	IFB1/2019/25	25.0	12.2%	50.0	16.3	12.7%	58.8%	55.5%
5	15/04/2019	FXD2/2019/10	10.0	12.3%	50.0	51.3	12.3%	171.2%	70.5%
		FXD1/2019/20	20.0	12.9%		9.0	12.9%		
6	13/05/2019	FXD2/2019/5	5.0	10.9%	50.0	39.2	10.9%	141.7%	82.6%
		FXD2/2019/15	15.0	12.7%		19.3	12.7%		
7	17/06/2019	FXD1/2012/15	8.4	11.0%	40.0	21.2	11.6%	214.0%	45.5%
		FXD1/2018/15	13.9	12.7%		17.7	12.5%		

Performance in the Primary T-bond auctions was varied but generally remained over-subscribed averaging 221.7%, with only 1 undersubscription being recorded, attributable to favorable liquidity in the money markets. The average acceptance rate for the first half of the year came in at 56.5%, as the CBK continued to reject bids deemed expensive in order to maintain the rates at low levels.

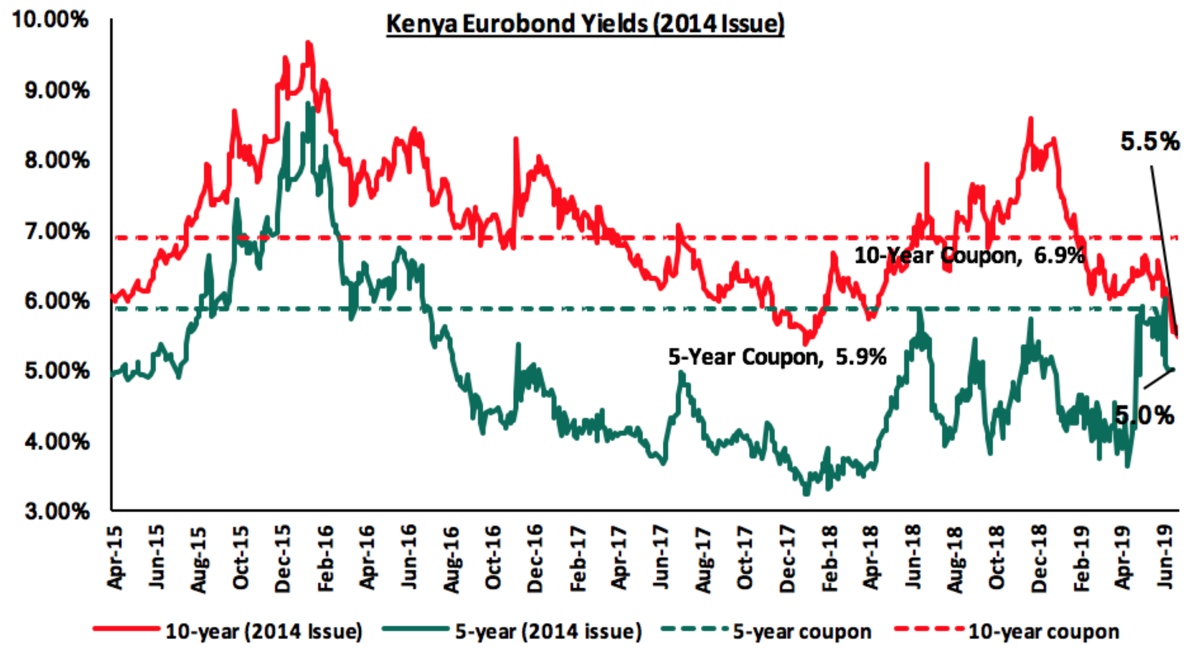
In the money markets, 3-month bank placements ended the week at 8.8% (based on what we have been offered by various banks), 91-day T-bill at 6.7%, average of Top 10 Money Market Funds at 9.4%, with the Cytonn Money Market Fund closing the week at 10.9%.

Liquidity:

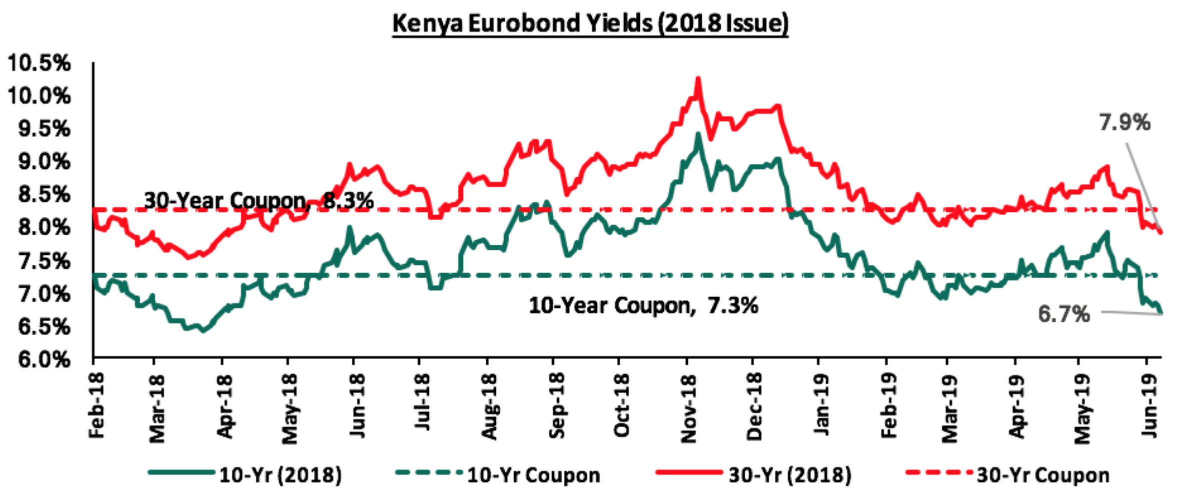
Liquidity improved during H1’2019 as indicated by a decline in the average interbank rate to 3.7% from 5.2% recorded in both H1’2018 and H2’2018, which was mainly attributable to Government payments that offset tax payments. During the week, liquidity continued to improve with the average interbank rate declining to 2.8% from 2.9% recorded the previous week. There was also a decline in the average volumes traded in the interbank market by 55.1% to Kshs 6.4 bn, from Kshs 14.3 bn, the previous week.

Kenya Eurobonds:

The yields on the 5-year and 10-Year Eurobonds issued in 2014 have decreased by 0.4% points and 0.5% points respectively in H1’2019. The 5-year Eurobond matured on 24th June. During the week, the yields on the 5-year Eurobond closed at 5.0%, while the 10-year Eurobond declined by 20 bps to 5.5% from 5.7%, the previous week. It is key to note that the 5-Year Eurobond matured during the week on 24th June 2019, while the 10-year Eurobond has an effective tenor of 5-years to maturity.



For the February 2018 Eurobond issue, since the issue date, yields on the 10-year Eurobond has decreased by 0.6% points while the 30-year Eurobond has decreased by 0.3% points. During the week, the yields on the 10-year Eurobond increased by 20 bps to 6.7% from 6.9% the previous week, while the yield on the 30-year Eurobond decreased by 10 bps to 7.9% from 8.0% the previous week.



For the newly issued dual-tranche Eurobond during H1'2019, 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 12-year bond declined by 0.3% points to 6.3% from 6.6% recorded in the previous week, while the 12-year bond declined by 0.2% points to 7.3% from 7.5% recorded in the previous week.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The Government failed to meet its FY'2018/2019 domestic target narrowly by 1.3%, having borrowed Kshs 317.0 bn against a 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.