Investment Options in the Kenyan Market, & Cytonn Weekly #30/2019

Fixed Income

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

T-bills remained oversubscribed during the week, with the overall subscription rate rising to 113.5%, from 108.4% recorded the previous week. The continued oversubscription is attributable to favorable liquidity in the market supported by government payments. The yields on the 91-day, 182-day and 364-day papers rose by 9.4 bps, 0.7 bps and 20.3 bps to 6.6%, 7.4% and 9.0%, respectively. The acceptance rate declined to 89.1%, from 96.4% the previous week, with the government accepting Kshs 24.3 bn of the Kshs 27.2 bn worth of bids received, higher than the weekly quantum of Kshs 24.0 bn. The 91-day and 364-day papers registered improved subscription to 201.8% and 164.5% from 187.6% and 115.6%, recorded the previous week, respectively. The 182-day paper however recorded a downturn in subscription to 27.2% from 69.7% recorded the previous week.

For the month of July, the Kenyan Government issued a 15-year bond issue number FXD 3/2019/15, the first T-Bond for the 2019/2020 fiscal year and the third 15-year tenor bond in 2019, in a bid to raise Kshs 40.0 bn for budgetary support. The accepted yield for the issue came in at 12.3% in line with our expectations as highlighted in last week's bidding range of 12.2%-12.4%. The issue recorded a significantly high subscription rate at 216.7%, driven by the current high liquidity in the money markets attributable to the government payments as well as effects emanating from the ongoing demonetization process.

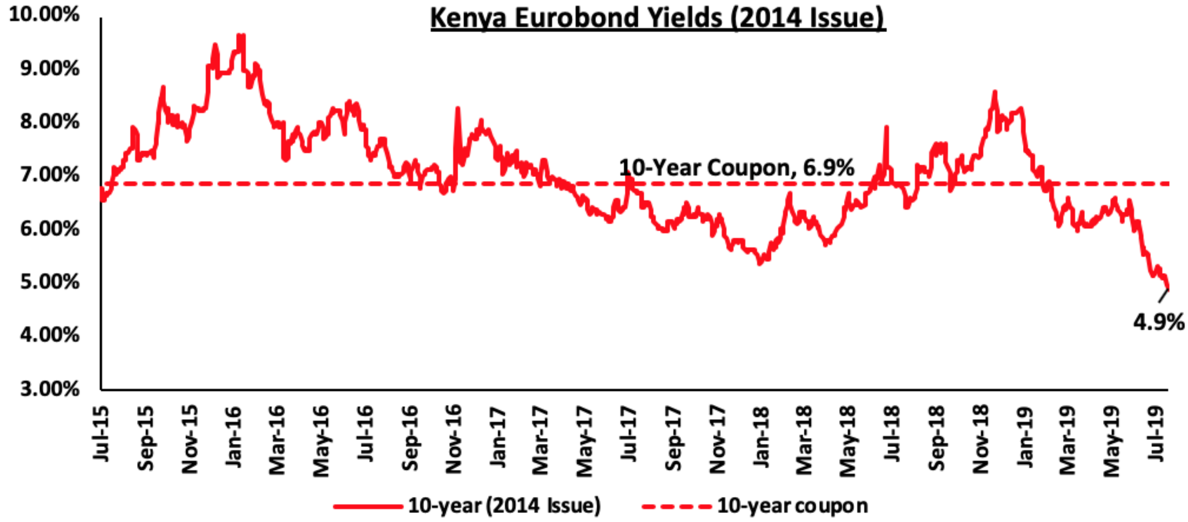
In the money markets, 3-month bank placements ended the week at 8.8% (based on what we have been offered by various banks), 91-day T-bill at 6.6%, the average of Top 5 Money Market Funds at 10.0%, with the Cytonn Money Market Fund closing the week at an average yield of 11.0% p.a.

Liquidity:

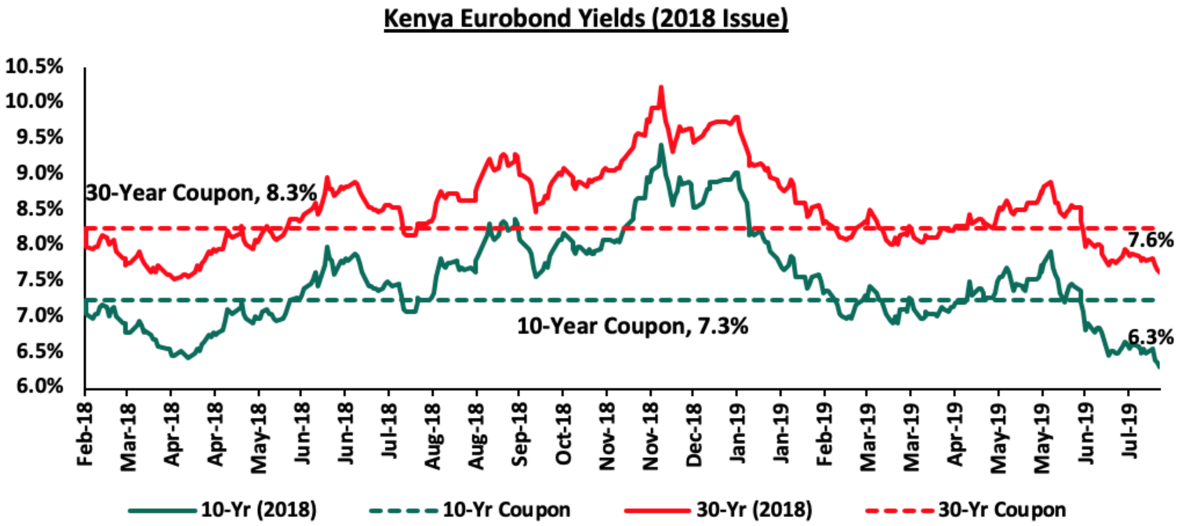
Liquidity in the market remained favorable during the week attributable to the government payments as well as effects emanating from the ongoing demonetization process. This was despite the average inter-bank rate rising slightly to 2.4%, from 2.1% recorded the previous week. The average volumes traded in the interbank market declined by 20.8% to Kshs 8.2 bn, from Kshs 10.4 bn the previous week.

Kenya Eurobonds:

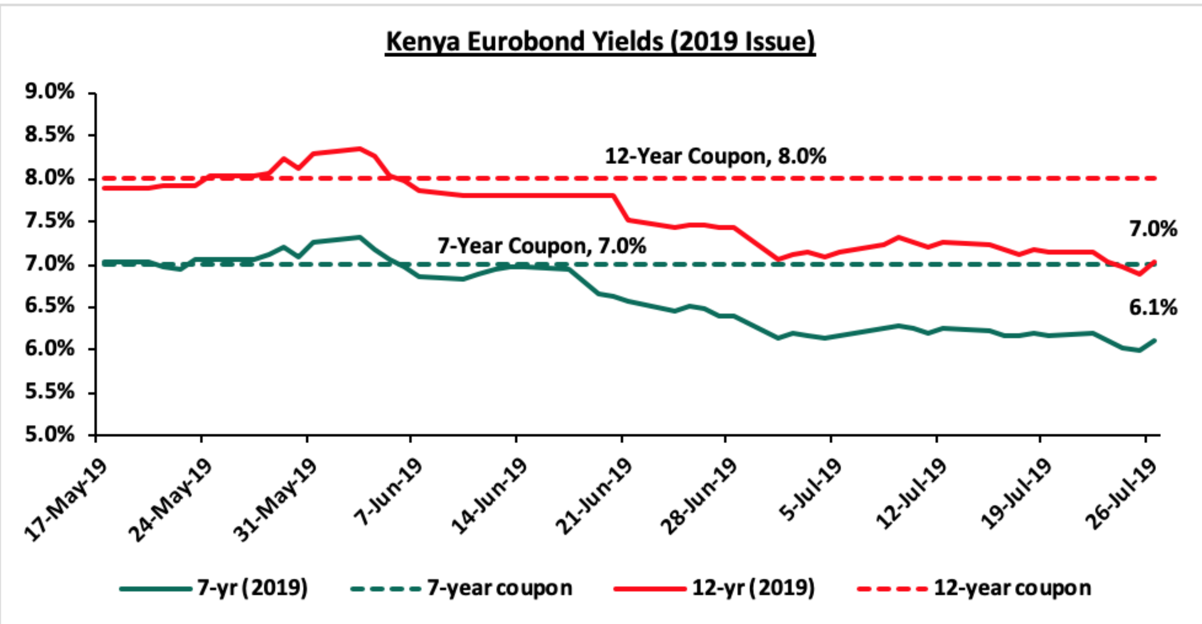
The yield on the 10-year Eurobond issued in 2014 dropped by 0.2% points to 4.9%, from 5.1% recorded the previous week. The continued decline in yields has been attributed to increased demand for emerging market fixed-income securities in the wake of the pause by the US Fed on its three-year cycle of tightening its monetary policy, which had made returns from fixed income securities more attractive as highlighted in our H1'2019 SSA Eurobond Performance Note



For the February 2018 Eurobond issue, yields on both the 10-year and 30-year Eurobonds dropped by 0.2% points to 6.3% and 7.6%, from 6.5% and 7.8% 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 yields on the 7-year bond and the 12-year bond dropped by 0.1% points to 6.1% and 7.0%, from 6.2% and 7.1% recorded the previous week, respectively.



It is noteworthy that yields for all Kenya Eurobonds dropped during the week despite the Cabinet

Secretary and the Principal Secretary for National Treasury having both been charged in court on corruption allegations; an indicator that international bond investors are taking the changes in stride, especially given that the President was quick to appoint their replacements.

The Kenya Shilling:

During the week, the Kenya Shilling depreciated by 0.7% against the US Dollar to close at Kshs 103.8, from Kshs 103.1 the previous week, with the shilling hitting a 3 year low of Kshs 104.0, partly driven by uncertainty caused by Monday's announcement that the Treasury Cabinet Secretary would be charged with financial misconduct, coupled with a relatively liquid money market. The Kenya Shilling has depreciated by 1.9% year to date, in comparison to the 1.3% appreciation in 2018. Despite the recent depreciation we still expect the shilling to remain relatively stable to the dollar in the short term, supported by:

i. The narrowing of the current account deficit, with preliminary data indicating that the current account deficit narrowed to 4.2% of GDP in the 12-months to June 2019, from 5.4% recorded in June 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 13.6% in the 12 months to June 2019 to USD 2.8 bn, from USD 2.4 bn 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 9.6 bn (equivalent to 6.0-months of import cover), above the statutory requirement of maintaining at least 4.0-months of import cover, and the EAC region’s convergence criteria of 4.5-months of import cover.

Weekly Highlights:

The Monetary Policy Committee (MPC) met on 24th July 2019 to review the prevailing macroeconomic conditions and decide on the direction of the Central Bank Rate (CBR). The MPC retained the prevailing monetary policy stance leaving the Central Bank Rate (CBR) unchanged at 9.0%, in line with our expectations citing that inflation expectations remained well anchored within the target range and that the economy was operating close to its potential as evidenced by:

i. Month on month inflation remained within the 2.5% - 7.5%, target range despite rising to 5.7% in June, from 5.5% in May, largely driven by a rise in food inflation to 6.6% in June from 6.0% in May, attributed to increases in the prices of non-vegetable food crops particularly maize, due to uncertain supply,
ii. Stability in the foreign exchange market supported by the narrowing of the current account deficit to 4.2% of GDP in the 12-months to June 2019, from 5.4% in June 2018, driven by resilient performance of exports particularly horticulture, and higher diaspora remittances, and receipts from tourism and transport services, coupled with slower growth in imports of food and SGR-related equipment. The foreign exchange market has also been supported by adequate forex reserves currently at USD 9.6 bn (equivalent to 6.0 months of import cover), that continue to provide adequate cover and a buffer against short-term shocks in the foreign exchange market, and,
iii. Improving private sector credit growth despite being below historical averages coming in at 5.2% in the 12-months to June, compared to 4.4% in the 12-months to May with strong growth being

observed in the consumer durables (21.3%), manufacturing sector (11.4%) and private households (7.6%).

As such, the MPC concluded that the current policy stance was still appropriate, but noted that there was a need to remain vigilant on possible spillovers of recent high food and fuel prices, the ongoing demonetization, and the increased uncertainties in the external environment. We expect monetary policy to remain relatively stable in 2019, as the CBK awaits the direction of the discussion on the possible repeal or modification of the interest rate cap, which has weakened the transmission of monetary policy. As per the assessment by the Monetary Policy Committee in 2018, under the interest rate capping environment, monetary policy produces perverse outcomes. For instance loosening the monetary policy stance by reducing the CBR in a bid to stimulate credit expansion in the current environment would lead to a lower adjustment in lending rates. As a result, individuals with credit risk above the capped rate would be shunned by banks, resulting in a contraction in private sector credit growth, a counteractive reaction to the intention of the looser monetary policy stance.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. 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.