Personal Financial Planning, & Cytonn Weekly #32/2019

Fixed Income

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

T-bills remained oversubscribed during the week, with the overall subscription rate declining to 122.8%, from 137.5% recorded the previous week. The continued oversubscription is attributable to favorable liquidity in the market supported by government payments, coupled with the effects from the ongoing demonetization process, which has increased liquidity in the money markets triggered by the rush to exchange the old currency notes with the new notes. The yields on the 91-day and 182-day papers declined by 9.8 bps and 10 bps to 6.4% and 7.2%, respectively, while the yield on the 364-day paper rose by 11.4 bps to 9.2%. The acceptance rate rose to 90.3%, from 72.7% the previous week, with the government accepting Kshs 26.6 bn of the Kshs 29.5 bn worth of bids received, higher than the weekly quantum of Kshs 24.0 bn. The 91-day and 182-day papers registered lower subscription to 103.7% and 63.9%, from 205.2% and 77.6% recorded the previous week, respectively. The 364-day paper however recorded improved subscription to 189.5%, from 170.4% recorded the previous week.

For the month of August, the government is set to issue a 10-year bond (FXD 3/2019/10) and re-open a 20-year bond (FXD 1/2019/20) for a total of Kshs 50.0 bn for budgetary support. The government has adopted an approach of a blended issue of a medium-tenor and long-tenor bond, in a bid to plug in the budget deficit, while at the same time trying to reduce the maturity risk. Investors are expected to maintain a bias towards the 10-year bond as per recent trends, mainly 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. In the market, bonds with 10-years and 20-years to maturity are currently trading at yields of 11.5% and 12.6%, respectively. We expect bids for the (FXD 3/2019/10) and (FXD 1/2019/20) to come in at 11.5% - 11.7% and 12.6% - 12.8%, respectively.

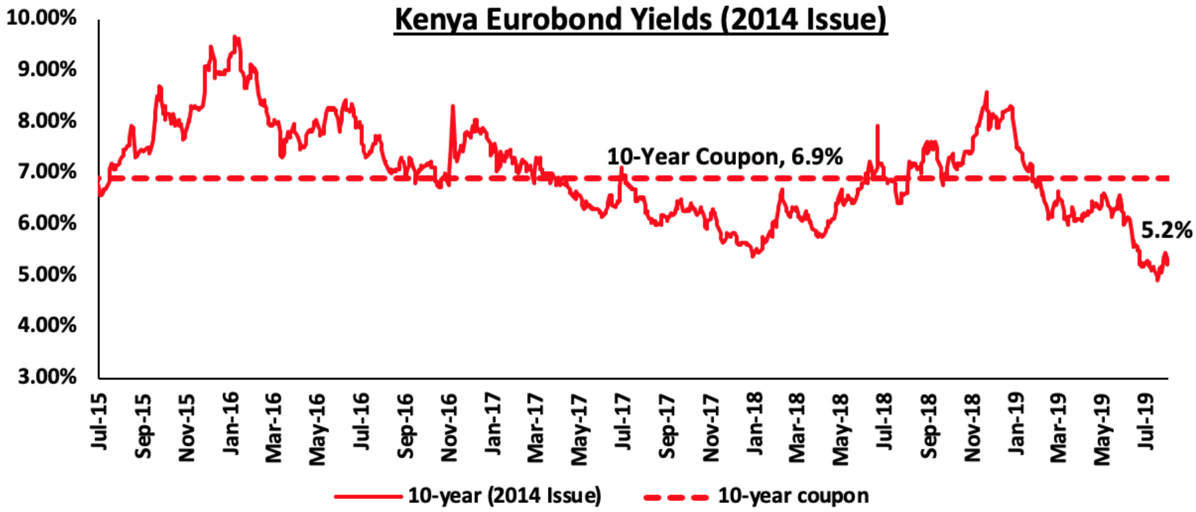
In the money markets, 3-month bank placements ended the week at 8.6% (based on what we have been offered by various banks), 91-day T-bill at 6.4%, the average of Top 5 Money Market Funds at 10.1%, with the Cytonn Money Market Fund closing the week at an average yield of 11.0% p.a.

Liquidity:

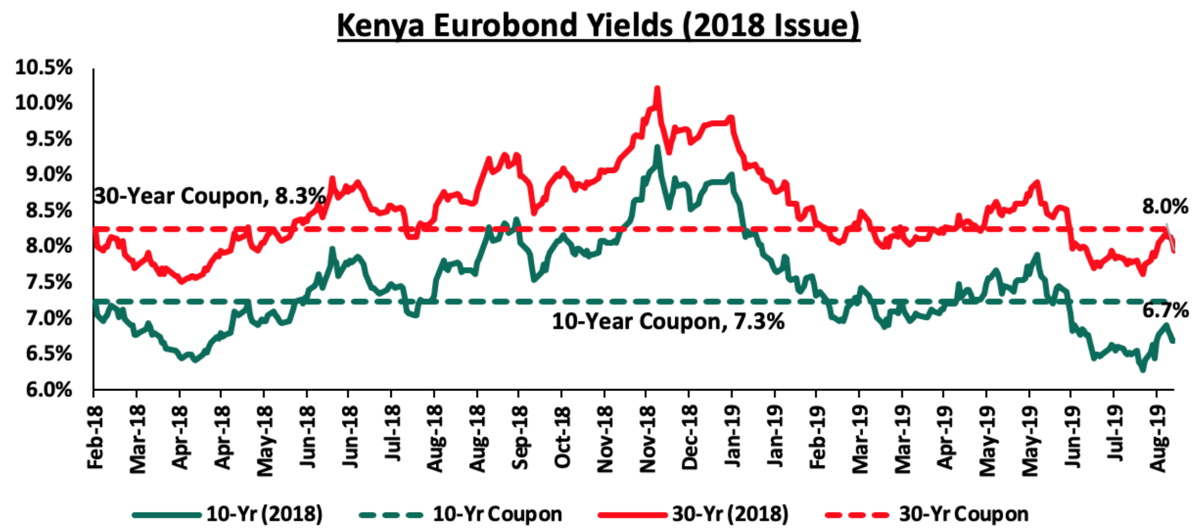
Liquidity in the market remained favorable during the week attributable to government payments as well as effects emanating from the ongoing demonetization process. The average interbank rate however rose to 3.2%, from 2.5% recorded the previous week, due to banks trading cautiously in the interbank market in order to meet their CRR cycle ending August 14th. The average volumes traded in the interbank market declined by 28.7% to Kshs 6.2 bn, from Kshs 8.7 bn the previous week.

Kenya Eurobonds:

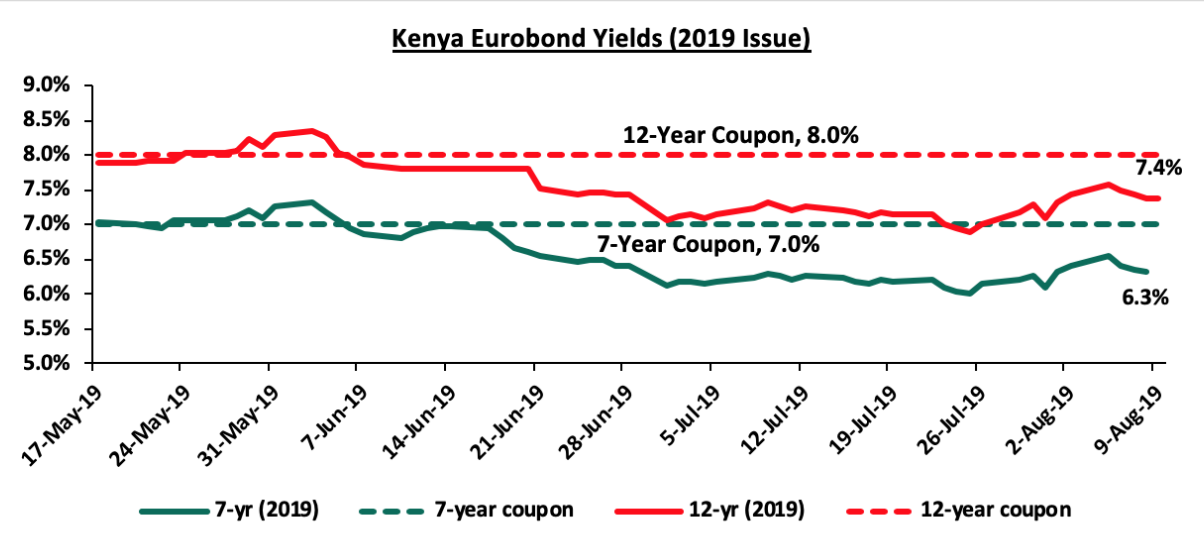
The yield on the 10-year Eurobond issued in 2014 dropped by 0.1% points to 5.2%, from 5.3% recorded the previous week. The continued decline in yields has been attributed to increased demand for emerging market fixed-income securities in the wake of the pause by the US Fed on its three-year cycle of 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 remained stable to close at 6.7% and 8.0%, unchanged from 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 yields on the 7-year bond remained unchanged at 6.3% while the yield on the 12-year bond rose marginally by 0.1% points to 7.4% from 7.3% recorded the previous week.



The Kenya Shilling:

During the week, the Kenya Shilling depreciated by 0.1% against the US Dollar to close at Kshs 103.4, from Kshs 103.2 the previous week, partly driven by a relatively liquid money market. The Kenya Shilling has depreciated by 1.5% 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 9.5 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:

According to Stanbic Bank's Monthly Purchasing Manager's Index (PMI), released earlier during the week, the business environment in the country continued to improve during the month of July. The seasonally adjusted PMI came in at 54.1 in July, a slight decline from 54.3 in June. A PMI reading of above 50 indicates improvements in the business environment, while a reading below 50 indicates a worsening outlook. Firms showed sharp increases in new orders during the month from both domestic and external markets attributed to marketing efforts as well as referrals. Output levels continued to expand, but at a slower pace compared to June, an indication that some businesses lacked the capacity to keep up with the demand growth. This led to a sharp increase in the backlog of work, which was also heightened by insufficient staff numbers. Selling prices rose during the month as firms marked-up the prices in an effort to maintain profit levels, while mitigating the rise in input costs which were as a result of inflationary effects driven by taxes, fuel prices and exchange rate as a result of a weaker shilling in July. The July PMI index reflects the upbeat sentiment from businesses as the government continues to settle its arrears, easing of cash-flow issues, leading to the growth in sales. We expect the trend to continue considering the Kenyan President's directive to ensure consignments are cleared faster at the port going forward, coupled with the proposal in the 2019/2020 Budget that all government suppliers should be paid within 60-days.

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.

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