Cytonn INVESTMENTS

Home Ownership Savings Plan, “HOSP”, Schemes in Kenya, & Cytonn Weekly #37/2019

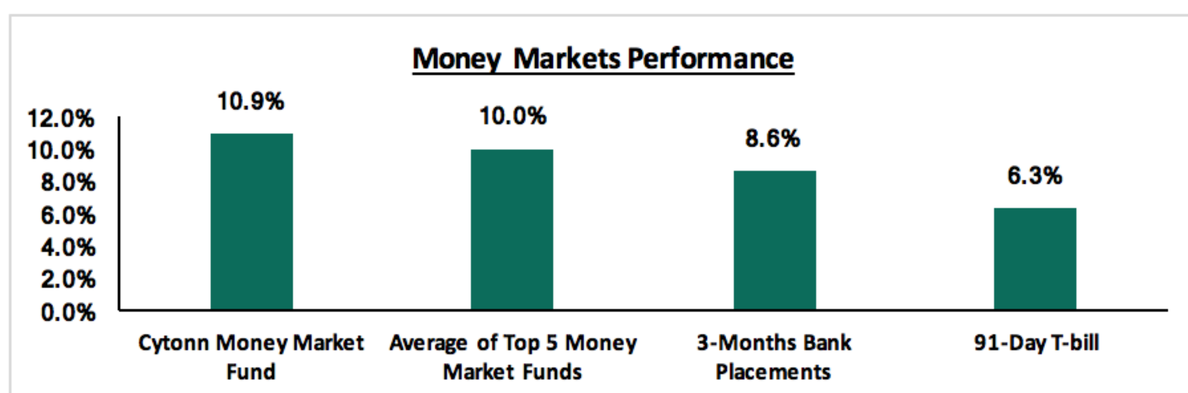
Fixed Income

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

During the week, T-bills remained undersubscribed, but with the subscription rate rising to 78.6%, from 62.6% recorded the previous week. The undersubscription is partly attributable to a continued period of tightened liquidity in the money market as a result of tax payments with Pay as You Earn (PAYE) having been due as at the start of the week of 9th September 2019, and banks trading cautiously in the interbank market in order to meet their CRR requirements for the cycle ending August 14th. The yield on the 91-day paper declined by 6.0 bps to 6.3% while the yields on the 182-day and 364-day papers rose by 14.8 bps and 6.2 bps to 7.1% and 9.6%, respectively. The acceptance rate declined to 77.3%, from 99.9% recorded the previous week, with the government accepting Kshs 14.6 bn out of the Kshs 18.6 bn worth of bids received.

The National Treasury’s mobile-based bond, M-Akiba, which was reopened in August managed to raise Kshs 263.0 mn, meeting 52.6% of its Kshs 500.0 mn target, bringing the total amounts raised to date to Kshs 1.0 bn since its 1st issuance in 2017 against the Kshs 1.9 bn floated, resulting in an overall subscription rate of 52.6%. The M-Akiba initiative sought to leverage on the increased mobile phone penetration to deepen financial inclusion with its terms being favourable to retail investors with the minimum subscription set at Kshs 3,000 compared to the other infrastructure bonds, whose minimum subscription amount is set at Kshs 100,000, with the bond offering an interest rate of 10.0% that is tax-free, currently with a tenor of 1 year with the maturity date set at 7th September 2020 and is thus trading at a discount compared to a 364-day T-bill which has a similar tenor to maturity that currently trading at a yield of 9.6%.

In the money markets, 3-month bank placements ended the week at 8.6% (based on what we have been offered by various banks), the 91-day T-bill came in at 6.3%, while the average of Top 5 Money Market Funds came in at 10.0%, compared to 10.1% last week, with the Cytonn Money Market Fund closing the week at 10.9%, a decline from 11.0% last week.

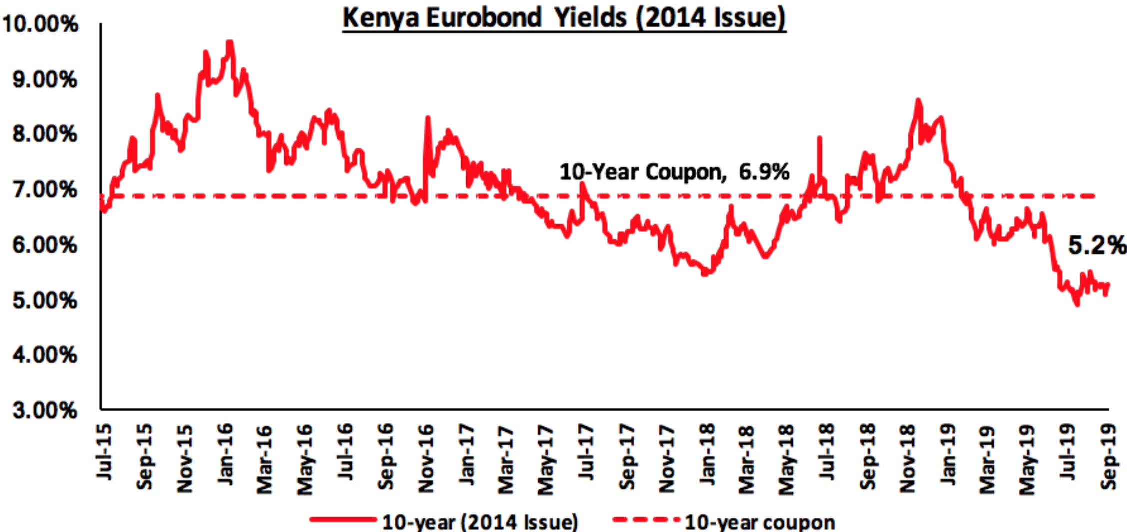


Liquidity:

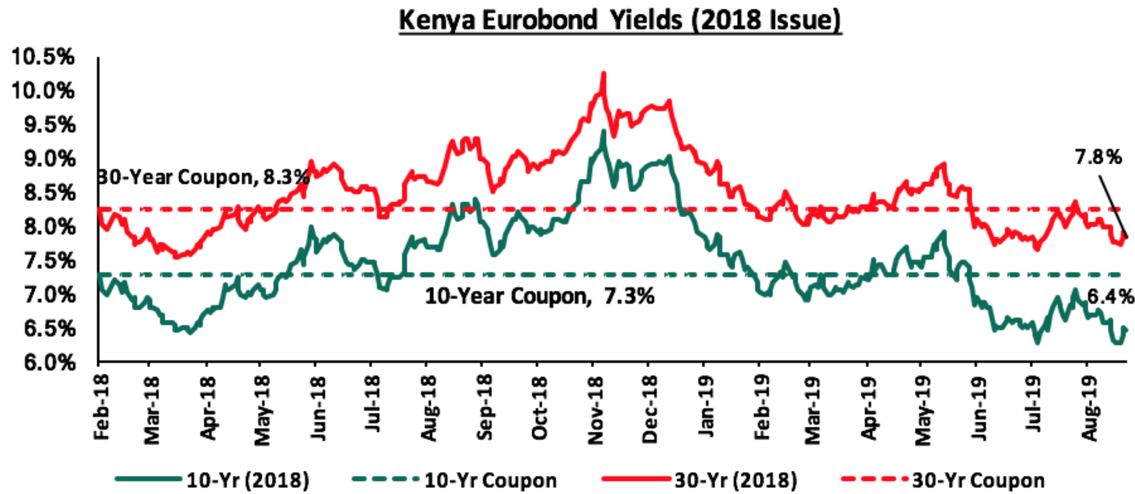
During the week, the average interbank rate increased to 6.4%, from 5.5% recorded the previous week, pointing to tightened liquidity conditions in the money market attributable to tax payments with Pay as You Earn (PAYE) having been due as at the start of the week on 9th September, and banks trading cautiously in the interbank market in order to meet their CRR requirements for the cycle ending August 14th. This saw commercial banks' excess reserves decline to come in at Kshs 4.1 bn in relation to the 5.25% cash reserves requirement (CRR), from Kshs 6.6 bn the previous week. The average volumes traded in the interbank market increased by 35.8% to Kshs 10.1 bn, from Kshs 7.4 bn the previous week.

Kenya Eurobonds:

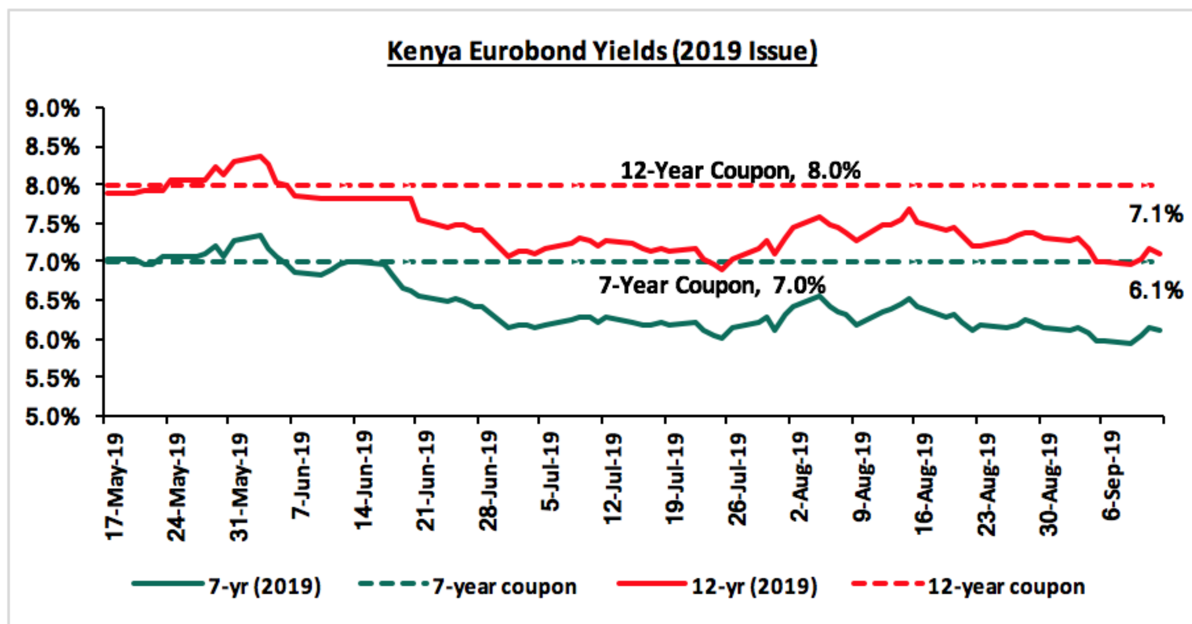
According to Reuters, the yield on the 10-year Eurobond issued in 2014 increased by 0.1% points to 5.2% during the week, from 5.1% the previous week, following news that Global rating firm Moody's could further lower Kenya's creditworthiness currently at '*B2 stable*' following the completion of their periodic review on Kenya, where they raised concern over the country's very low fiscal strength, ballooning debt and rampant corruption.



During the week, the yield on the 2018, 10-year and 30-year Eurobond both increased by 0.1% points to 6.4% and 7.8%, from 6.3% and 7.7% recorded the previous week, respectively.



During the week, the yields on both the 7-year and 12-year Eurobonds rose by 0.1% points to come in at 6.1% and 7.1%, from 6.0% and 7.0% recorded the previous week, respectively.



Kenya Shilling:

During the week, the Kenya Shilling appreciated by 0.1% against the US Dollar to close at Kshs 103.8, from Kshs 103.9 recorded the previous week, supported by inflows from diaspora remittances amidst thin dollar demand from merchandise importers. On a YTD basis, the shilling has depreciated by 2.0% against the dollar, in comparison to the 1.3% appreciation in 2018. In our view, the shilling should remain relatively stable against the dollar in the short term, supported by:

?. 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 July 2019, from 5.0% recorded in December 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,

i. Improving diaspora remittances, which have increased cumulatively by 11.1% in the 12-months to July 2019 to USD 2.8 bn, from USD 2.5 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,

ii. CBK’s supportive activities in the money market, such as repurchase agreements and selling of dollars, and,

iii. 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 4.0-months of import cover, and the EAC region’s convergence criteria of 4.5-months of import cover.

Weekly Highlight:

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

?. Petrol prices have increased by 0.2% to Kshs 112.8 from Kshs 112.5 per litre previously, while diesel prices have increased by 2.4% to Kshs 103.4 from Kshs 100.6, previously,

i. Kerosene prices, however, have declined by 3.2% to Kshs 100.6 from Kshs 104.0 per litre

The changes in prices are attributable to:

?. A decline in the average landing cost of imported super petrol by 0.2% to USD 497.4 in August from USD 498.5 per cubic metre in July 2019. The decline was however offset by the 0.1% depreciation of the mean monthly US Dollar to Kenya Shilling exchange rate to Kshs 103.4 in August from Kshs 103.3 in July, and
i. An increase in the average landing costs of imported diesel by 4.4% to USD 503.6 per cubic metre in August 2019, from 482.5 per cubic metre in July 2019, and Kerosene declining by 5.6% to USD 484.3 in August from USD 513.1 per cubic metre in July 2019.

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 increase in petrol and diesel pump 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. 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.