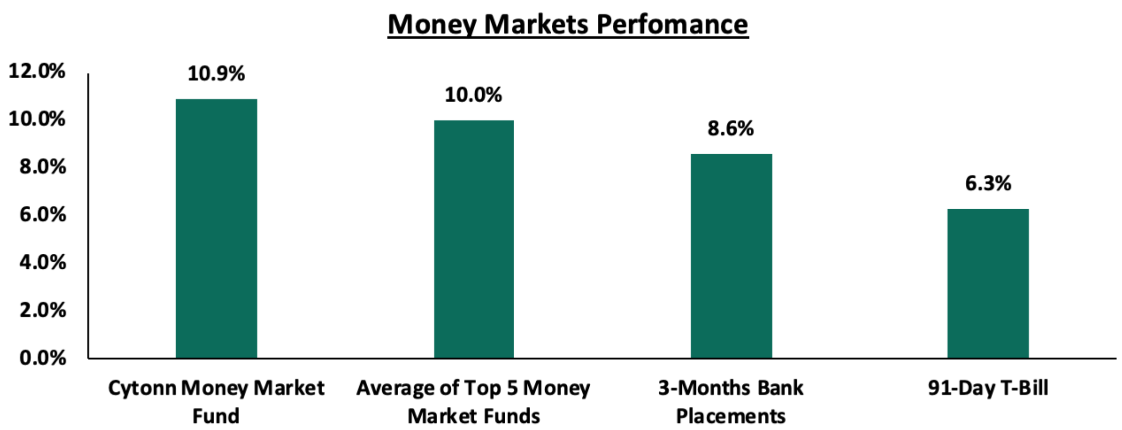
Kenya Listed Banks H1'2019 Report, & Cytonn Weekly #39/2019

Fixed Income

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

During the week, T-bills were undersubscribed, with the overall subscription rate falling to 98.4%, from 103.7% recorded the previous week. The undersubscription is partly attributable to tightened liquidity in the money market during the week attributable to a disruption in the budget cycle with delays in cash disbursements by the government. The yields on the 91-day paper declined by 0.1% points to 6.3%, from 6.4% recorded the previous week, while the yields on the 182-day paper remained unchanged at 7.2%. The 364-day paper rose by 0.1% point to 9.8%m from 9.7% recorded the previous week. The acceptance rate also fell to 64.9%, from 85.4% recorded the previous week, with the government accepting Kshs 15.3 bn out of the Kshs 23.6 bn worth of bids received.

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

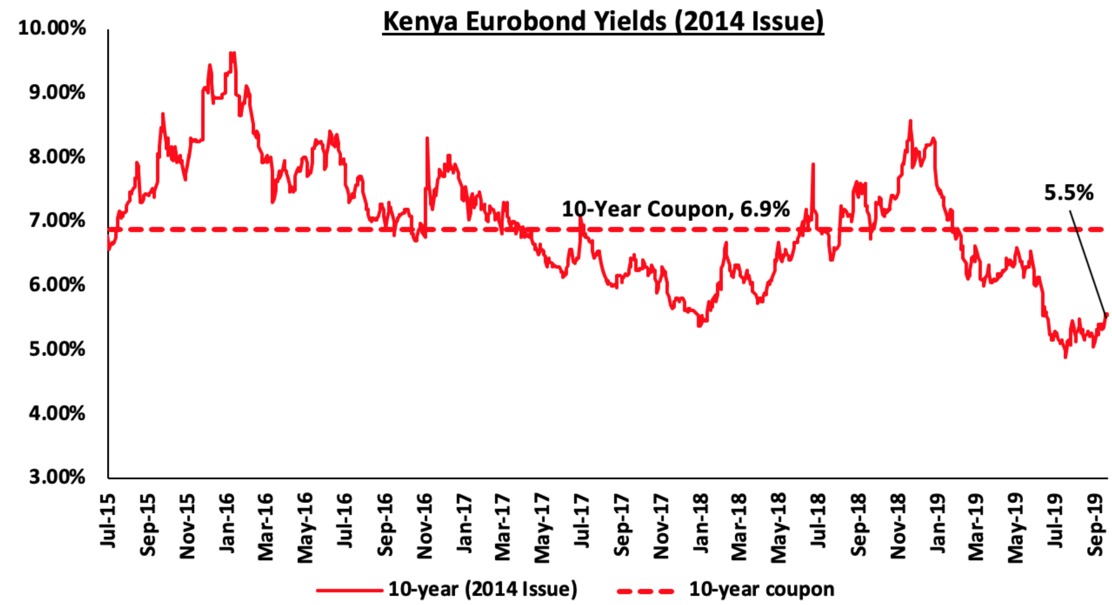


Liquidity:

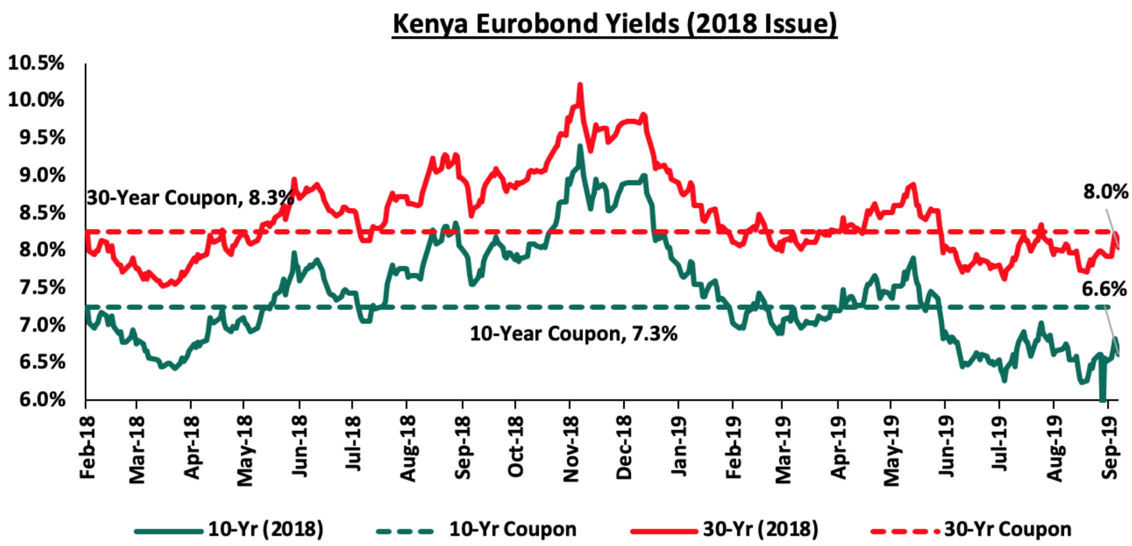
During the week, liquidity tightened with the average interbank rate increasing to 7.3%, from 6.6% recorded the previous week. This is attributable to a glitch in the budget cycle with delays in cash disbursements by the government. This saw commercial banks' excess reserves increase to come in at Kshs 14.4 bn in relation to the 5.25% cash reserves requirement (CRR), from Kshs 11.4 bn the previous week. The average volumes traded in the interbank market increased by 40.6% to Kshs 8.4 bn, from Kshs 6.0 bn the previous week.

Kenya Eurobonds:

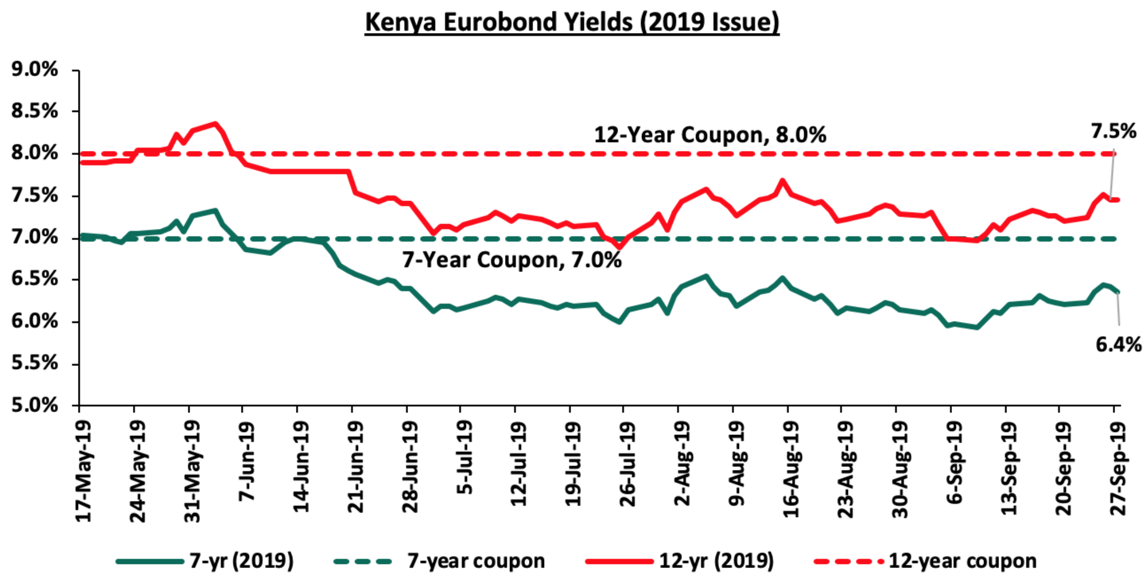
According to Reuters, the yield on the 10-year Eurobond issued in 2014 increased by 0.1% points to 5.5% during the week, from 5.4% the previous week. The rise in Eurobond yields in the past three weeks has been attributable to news that global rating firm Moody's could further lower Kenya's creditworthiness 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 yields on the 2018, 10-year and 30-year Eurobond issues both increased by 0.1% points to 6.6% and 8.0%, from 6.5% and 7.9% recorded the previous week, respectively.



During the week, the yield on the 7-year Eurobond issued in 2019 rose by 0.2% points to 6.4%, from 6.2% recorded the previous week, while the yield on the 12-year Eurobond rose by 0.3% points to come in at 7.5%, from 7.2% recorded the previous week.



Kenya Shilling:

During the week, the Kenya Shilling remained stable against the US Dollar to close at Kshs 103.8, unchanged from the previous week, due to subsiding dollar demand from the energy sector and tightening liquidity in the money market. On a YTD basis, the shilling has depreciated by 1.9% 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:

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 July 2019, from 5.5% recorded in July 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 and SGR-related equipment,
ii. Improving diaspora remittances, which have increased cumulatively by 8.9% in the 12-months to August 2019 to USD 2.8 bn, from USD 2.6 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 9.0 bn (equivalent to 5.6-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 Monetary Policy Committee (MPC) met on 23rd September 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, falling to 5.0% in August, from 6.3% in July, largely driven by a decline in food inflation to 6.7% in August from 7.9% in July, attributed to decreases in the prices of both vegetable and non-vegetable food crops, due to improved 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 July 2019, from 5.5% in July 2018, driven by resilient performance of exports particularly horticulture and manufactured goods, strong diaspora remittances and higher receipts from tourism and transport services, coupled with lower imports of food and SGR-related equipment. The foreign exchange market has also been supported by adequate forex reserves currently at USD 9.1 bn (equivalent to 5.7-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 6.3% in the 12-months to August, compared to 6.1% in July. Strong growth in credit to the private sector was being observed in the consumer durables (23.0%), private households (8.6%) and trade (8.4%).

As such, the MPC concluded that the current policy stance was still appropriate and that the economy was operating close to its potential, noting the prospective tightening of the fiscal policy which would provide scope for accommodative monetary policy in the near term. The committee also pointed out that there was a need to remain vigilant on possible effects of the increased uncertainties in the external environment. In the short and medium-term, we expect the Central Bank Rate to remain stable, however, if the government will be able to sustain efforts to cut the budget deficit to 5.9% in the FY 2019/20, from the actual deficit of 7.6% in FY 2018/19 by taming expenditure, then we might see the MPC committee loosen the monetary policy, in order to spur economic growth.

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.
