NMA Mixed Use Developments Report 2019 & Cytonn Weekly#45/2019

Fixed Income

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

During the week, T-bills were oversubscribed, with the subscription rate coming in at 132.6%, up from 114.3% the previous week. The oversubscription is partly attributable to favorable liquidity in the money market during the week. The yield on the 91-day and 364-day papers remained unchanged at 6.4% and 9.8%, respectively, while the yield on the 182-day paper increased by 0.1% point to 7.3% from the 7.2% recorded in the previous week. The acceptance rate dropped to 83.5% from 86.5%, recorded the previous week, with the government accepting Kshs 26.5 bn of the Kshs 31.8 bn bids received.

The 91-day T-bill is currently trading at a yield of 6.4%, which is below its 5-year average of 8.6%. The lower yield on the 91-day paper is mainly attributable to the low-interest-rate environment that has persisted since the passing of the law capping interest rates.

During the week, the National Treasury announced that it will issue a 10-year Kshs 50.0 bn bond (FXD 4/2019/10) with market-determined coupon rates for Budgetary Support purposes. The period of sale is from 6th November 2019 to 19th November 2019. As per the historical trend, we expect the market to maintain a bias towards the 10-year bond 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. We shall give our bidding range in next week’s report.

In the money markets, 3-month bank placements ended the week at 8.5% (based on what we have been offered by various banks), the 91-day T-bill came in at 6.4%, while the average of Top 5 Money Market Funds came in at 10.0%, which was a 0.2% decrease from 10.2% recorded in the previous week. The Cytonn Money Market Fund closed the week at 10.9%, from 11.0% recorded the previous week.

Liquidity:

During the week, the average interbank rate dropped to 5.1% from 6.4% recorded the previous week, pointing to increasing liquidity in the money markets. The average interbank volumes dropped by 51.5% to Kshs 8.4 bn, from Kshs 17.4 bn recorded the previous week.

Kenya Eurobonds:

According to Reuters, the yield on the 10-year Eurobond issued in June 2014 decreased by 0.2% points to 5.2% from 5.4% in the previous week. We attribute the decline across all the Kenya Eurobonds to easing risk concerns over the economy by investors following the news of the interest rate cap repeal, which is seen as likely to stimulate credit growth and economic growth.

During the week, the yield on the 10-year and 30-year Eurobond both declined by 0.1% point to 6.3% from 6.4% and 7.7% from 7.8% in the previous week, respectively.

During the week, the yields on the 7-year Eurobond remained unchanged at 6.1% while yields on the 12-year Eurobond declined by 0.2% points to 7.0% from 7.2% the previous week.

Kenya Shilling:

During the week, the Kenya Shilling appreciated by 0.5% against the US Dollar to close at Kshs 102.8 from 103.3 recorded in the previous week. The appreciation was attributed to positive investor sentiment owing to the repeal of interest cap during the week. On a YTD basis, the shilling has depreciated by 0.9% against the US 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 Kenya's current account deficit improved by 11.8% during Q2'2019, coming in at a deficit of Kshs 107.6 bn, from Kshs 122.0 bn in Q2'2018, equivalent to (6.2%) of GDP, from (7.6%) recorded in Q2'2018. This was mainly driven by the narrowing of the country's merchandise trade deficit by 1.7% and a rise in secondary income (transfers) balance by 5.1%,
ii. Improving diaspora remittances, which have increased cumulatively by 8.0% in the 12-months to September 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,

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:

According to the Stanbic Bank Kenya PMI index, Kenya's PMI Index for the month of October came in at 53.2 as compared to the 54.1 recorded in the month of September. Readings above 50.0 indicate an improvement in business conditions while readings below 50.0 show a deterioration.

Businesses saw new orders rise at a sharp pace, despite it being slower than in the month of September. This was mainly supported by increasing client numbers who came in from referrals by previous clients. Demand was mainly driven by improved marketing strategies and service quality. Sales from foreign clients rose at a faster pace than in September. It is key to note that output levels expanded marginally attributable to continuing cash-flow issues in businesses in the country making it hard for companies to keep up with new orders resulting in increased backlogs for the sixth month running. Employment grew at a solid rate with some businesses increasing their labour because of the increased demand, while others reduced staff in an effort to limit staff cost pressures. Based on the slow pace of new order growth, stocks of purchases increased marginally with the increase being the lowest since April. Lead times remained strong in the month of October mainly due to a recorded increase in competition among suppliers. Selling charges reduced for the second time in nearly two years on the back of reduced input price inflation. Overall costs rose at a moderate pace despite the fall in fuel prices, mainly because of the higher commodity prices owing to lack of supply and faster salary inflation. Expectations for future activity fell in October posting the weakest optimism in 2019 so far. Going forward, we are positive that the improving trend in business conditions will continue, supported by the current stable macro-economic conditions.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 31.2% behind its domestic borrowing target, having borrowed Kshs 79.4 bn against a pro-rated target of Kshs 115.5 bn. We expect an improvement in private sector credit growth considering the repeal of the interest rate cap. This will result in increased competition for bank funds from both the private and public sectors, thereby reducing liquidity in the money markets, resulting in upward pressure on interest rates. Owing to this, our view is that investors should be biased towards short-term fixed-income securities to reduce duration risk.
