Nairobi Metropolitan Area Serviced Apartments Report 2019, & Cytonn Weekly #47/2019

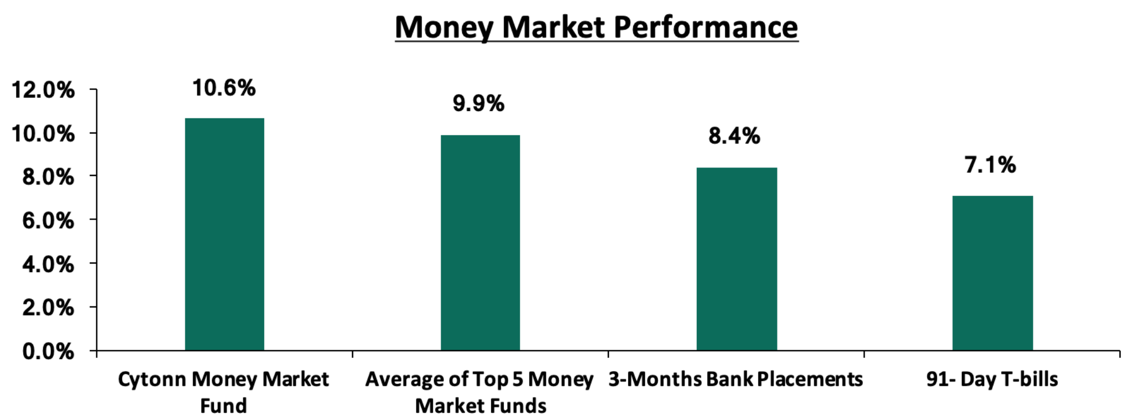
Fixed Income

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

During the week, T-bills continued to be undersubscribed, with the subscription rate coming in at 56.2%, down from 57.7% the previous week. The undersubscription is attributable to the primary auction for the FXD 4/2019/10 treasury bond that closed on 19th November 2019, with market participants focusing on the primary Treasury bond market. The yield on the 91-day papers increased by 0.4% points to 7.1%, from 6.7% while the 182-day paper increased by 0.4% points to 8.2%, from 7.8% recorded the previous week. The 364-day paper, however, remained unchanged at 9.8%. The acceptance rate decreased to 88.4%, from 99.9% recorded the previous week, with the government accepting Kshs 11.9 bn of the Kshs 13.5 bn bids received.

The increase in yields on the 91-day and 182-day papers can be attributed to the expected increase in interest rates due to the recent interest rate cap repeal.

For the month of November, the National Treasury issued a 10-year Kshs 50.0 bn bond (FXD 4/2019/10) with market-determined coupon rates for Budgetary Support. The bond was undersubscribed, with the subscription rate coming in at 76.8%, on the back of an expected increase in private sector credit with banks now looking to lend to the private sector, due to the interest rate cap repeal, and the bond yield coming in at 12.5%. The acceptance rate on the bond was 73.9%, with the government accepting 28.4 bn of the 38.4 bn bids received.



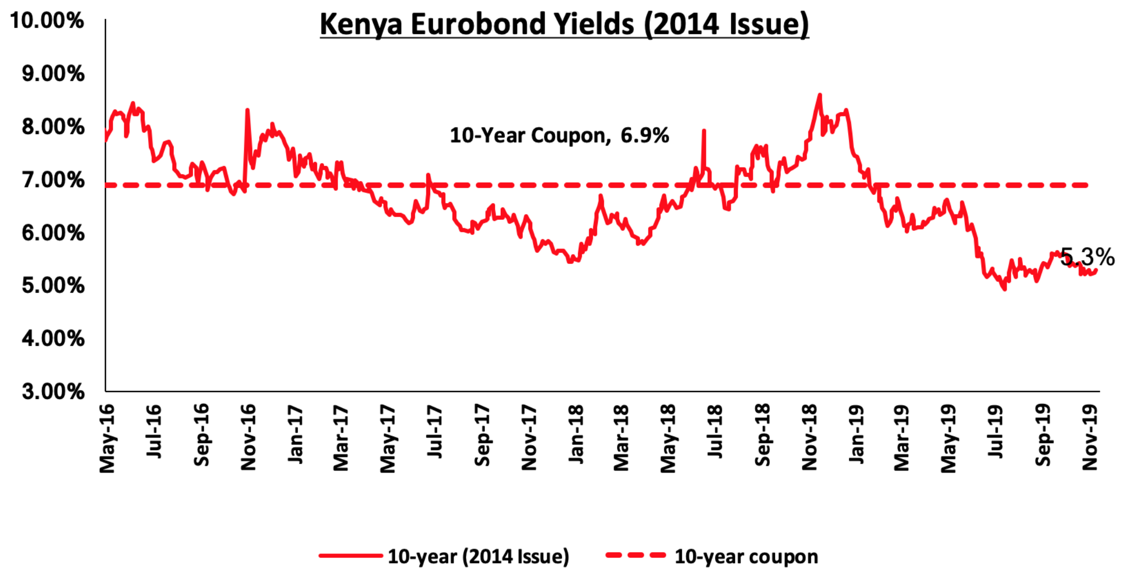
In the money markets, 3-month bank placements ended the week at 8.4% (based on what we have been offered by various banks), the 91-day T-bill came in at 7.1%, while the average of Top 5 Money Market Funds came in at 9.9%, unchanged from the previous week. The Cytonn Money Market Fund closed the week at 10.6%, unchanged from the previous week.

Liquidity:

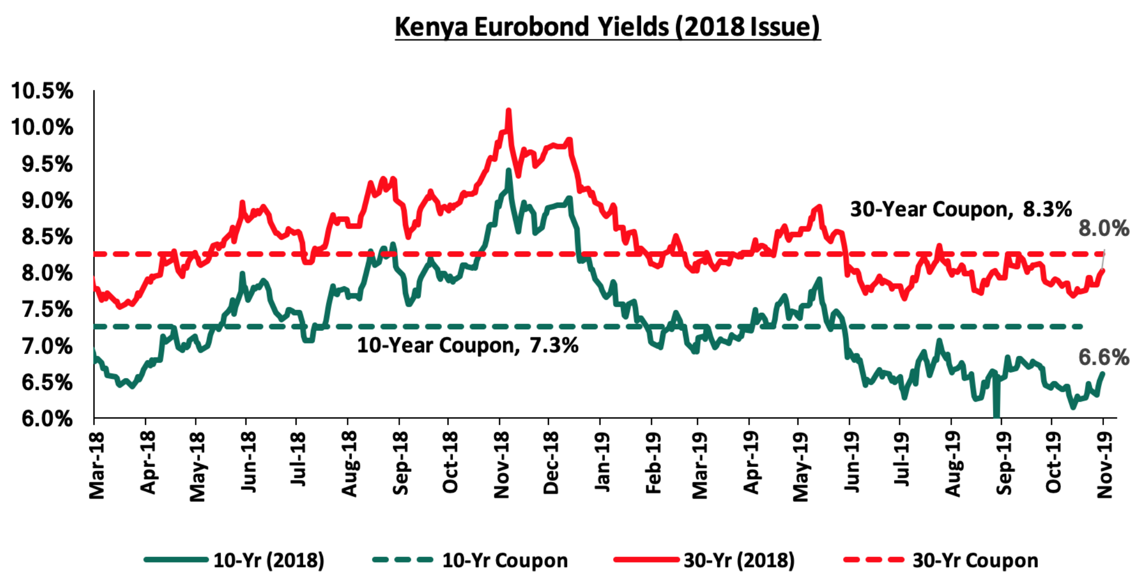
During the week, the average interbank rate dropped to 3.4%, from 3.6% recorded the previous week, pointing to increasing liquidity in the money markets, supported by net redemption of government securities. This saw commercial banks excess reserves come in at Kshs 11.7 bn in relation to the 5.25% cash reserves requirement (CRR). The average interbank volumes increased by 42.0% to Kshs 18.0 bn, from Kshs 12.7 bn recorded the previous week.

Kenya Eurobonds:

According to Reuters, the yield on the 10-year Eurobond issued in June 2014 increased by 10 bps to 5.3%, from 5.2% recorded the previous week. The rise in yields is attributable to the caution by the IMF during the week that Kenya's rising debt levels were a concern and need to be contained to cushion the economy from unplanned shocks.

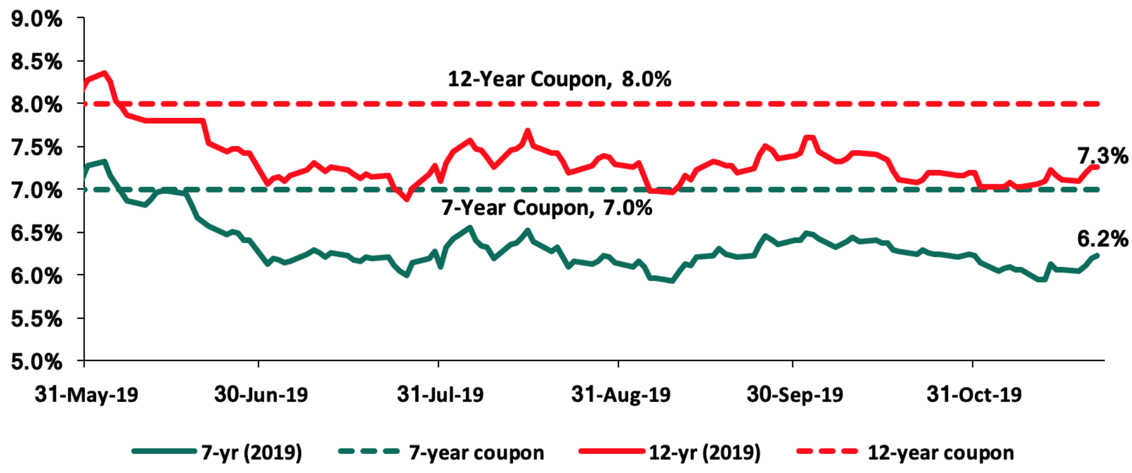


During the week, the yields on the 10-year Eurobond and the 30-year Eurobond both increased by 0.2% points to 6.6% and 8.0%, from 6.4% and 7.8%, respectively.



During the week, the yield on the 7-year Eurobond increased by 0.1% point to 6.2%, from 6.1% recorded the previous week, while the yield on the 12-year Eurobond increased by 0.2% points to 7.3%, from 7.1% recorded the previous week.

Kenya Eurobond Yields (2019 Issue)



Kenya Shilling:

During the week, the Kenya Shilling appreciated by 0.7% against the US Dollar to close at Kshs 101.4, from 102.1 recorded the previous week, the highest it has been since June 14th of this year, when the shilling closed at Kshs 101.6. The surge was attributed to inflows from offshore investors buying banking stocks following the repeal of the interest rate cap. On an YTD basis, the shilling has appreciated by 0.5% 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 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 7.0% to USD 2.8 bn as at October 2019, from USD 2.6 bn recorded in a similar period of review in 2018,
iii. Foreign capital inflows, with investors looking to participate in the equities market,
iv. CBK's supportive activities in the money market, such as repurchase agreements and selling of dollars, and,
v. High levels of forex reserves, currently at USD 8.8 bn (equivalent to 5.4-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.

Monetary Policy:

The Monetary Policy Committee (MPC) is set to meet on Monday, 25th November 2019, to review the outcome of its previous policy decisions and recent economic developments, and to decide on the direction of the Central Bank Rate (CBR). In their previous meeting held on 23rd September 2019, the MPC maintained the CBR at 9.0%, citing that the economy was operating close to its potential and inflation expectations remained anchored within the target range.

We expect the MPC to cut the Central Bank Rate (CBR) by 50 bps to 8.5% from the current 9.0%, with their decision mainly being supported by:

i. The need to stimulate growth, with GDP growth in 2019 having slowed down averaging 5.6% in H1'2019, lower than 6.4% in H1'2018, and below the CBK's estimated growth at 6.3%,
ii. Inflation has remained contained and within the government set target of 2.5% - 7.5%, amid slowed economic growth, thus providing room for moderate stimulus through expansionary monetary policy, and,
iii. A further reduction of the Central Bank Rate (CBR), coupled up with the interest rate cap repeal would provide the requisite stimulus to private sector credit growth which has remained below

the 5-year average, having grown by 6.3% in the 12-months to August 2019, below the 5-year average of 11.0%.

For our detailed MPC analysis, please see our MPC Note for the 25th November meeting here

Inflation Projections:

We are projecting the Y/Y inflation rate for the month of November to come in within the range of 5.2% - 5.4%, compared to 5.0% recorded in October.

The Y/Y inflation for the month of November is expected to rise due to the base effect. The M/M inflation is also expected to rise driven by:

i. An increase in the food and non-alcoholic beverages index, which has a weighting of 36.0%, mainly driven by the higher food prices especially grain and flour prices, as well as milk prices,
ii. We also expect an increase in the transport index following the 2.4% and 2.6% increase in petrol and diesel prices, respectively, during the month, and,
iii. An increase in the housing, water, electricity, gas, and other fuels index following the 2.9% increase in kerosene prices to Kshs 104.1, from Kshs 101.1 in October.

Going forward, we expect the inflation rate to remain within the government set range of 2.5% - 7.5%.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 15.6% behind its domestic borrowing target, having borrowed Kshs 107.3 bn against a pro-rated target of Kshs 127.1 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, 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.

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