Cytonn Annual Markets Review – 2019

Fixed Income

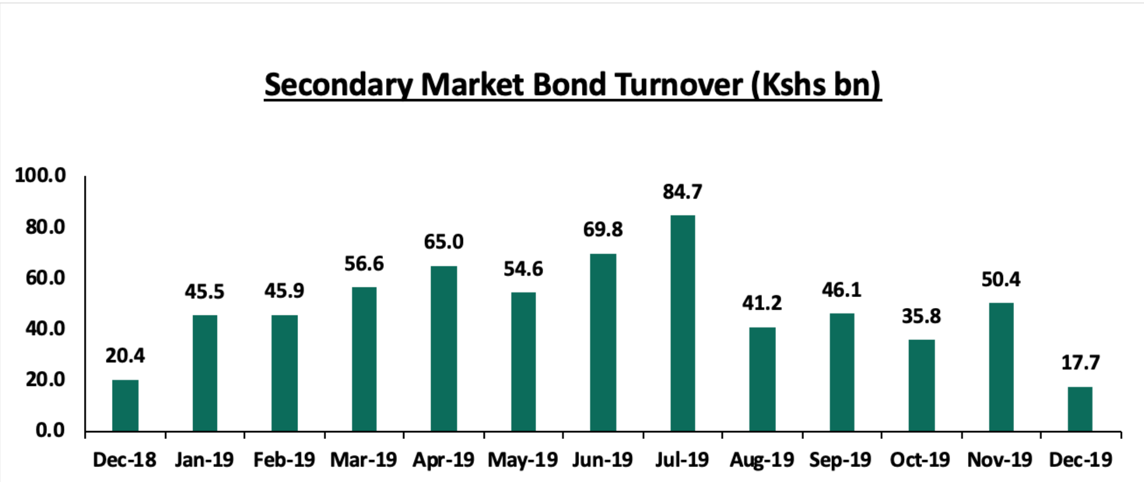
T-Bills & T-Bonds Primary Auction:

During the year 2019, T-bills auction recorded an oversubscription with the average subscription rate coming in at 118.7% compared to an average of 123.2% in 2018. The yields on the 91-day, 182-day and 364-day T-bills declined by 10 bps, 80 bps and 20 bps to close at 7.2%, 8.2% and 9.8% in 2019 from 7.3%, 9.0% and 10.0% at the end of 2018, respectively. This is mainly attributed to the Central Bank of Kenya's (CBK's) efforts to keep rates low by rejecting expensive bids in the auction market. Following the enactment of the Banking (Amendment) Act, 2015, banks had preferred to lend to the less risky government as opposed to the riskier private sector. The repeal of the rate cap during the third quarter of the year however reduced participation of banks in the primary auction market down from an average of 125.4%, from January 2019 to November 7th 2019 before the repeal of the rate cap, to 48.4% for the post interest rate period between November 7th 2019 and 31st December 2019.

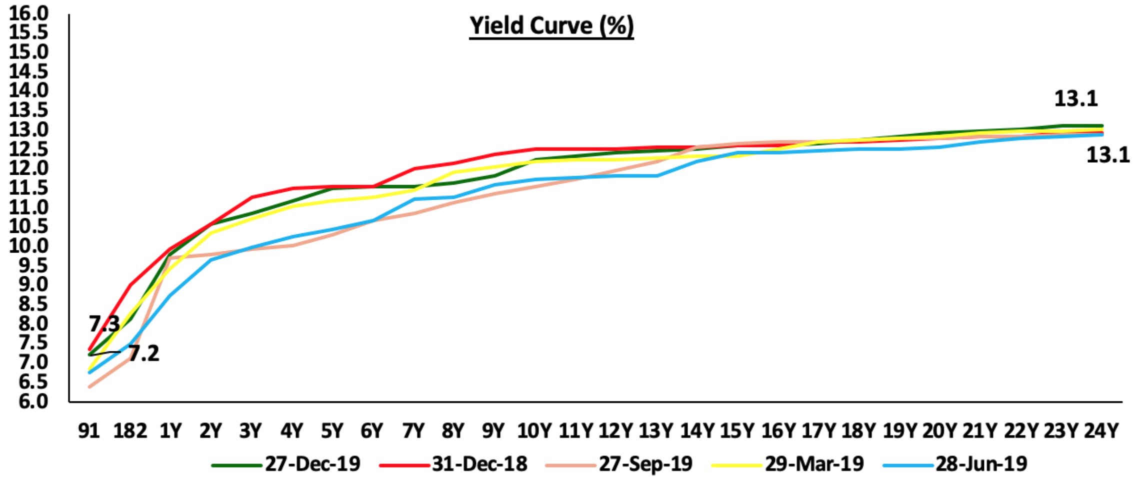
Primary T-bond auctions in 2019 were oversubscribed with the subscription rate averaging 109.7%, which is higher than the average subscription rate for 2018, which came in at 75.8%. The market maintained a bias towards the medium-term bonds mainly driven by the perception that risks may not be adequately priced on the longer end of the yield curve, which is relatively flat due to saturation of long-term bonds coupled with duration risk. The average acceptance rate for 2019 came in at 69.2%, as the market adjusted to the efforts of the CBK to maintain the rates at low levels.

Secondary Bond Market Activity:

The secondary bond market recorded increased activity with the turnover having increased by 16.1% to Kshs 613.2 bn from Kshs 528.2 bn in 2018, as the local institutional investors increased their allocation to treasury bonds while the equity market turnover declined by 12.9%.



The graph below shows the evolution of the yield curve during the year. The yield curve experienced downward pressure for the better part of the year as the Kenyan Government contained rates by rejecting expensive bids in the auction market. The repeal of the rate cap, however, led to the gain of some long-term government securities such as the 20 and 23-year papers, which gained by 0.8% points and 1.4% points in 2019.

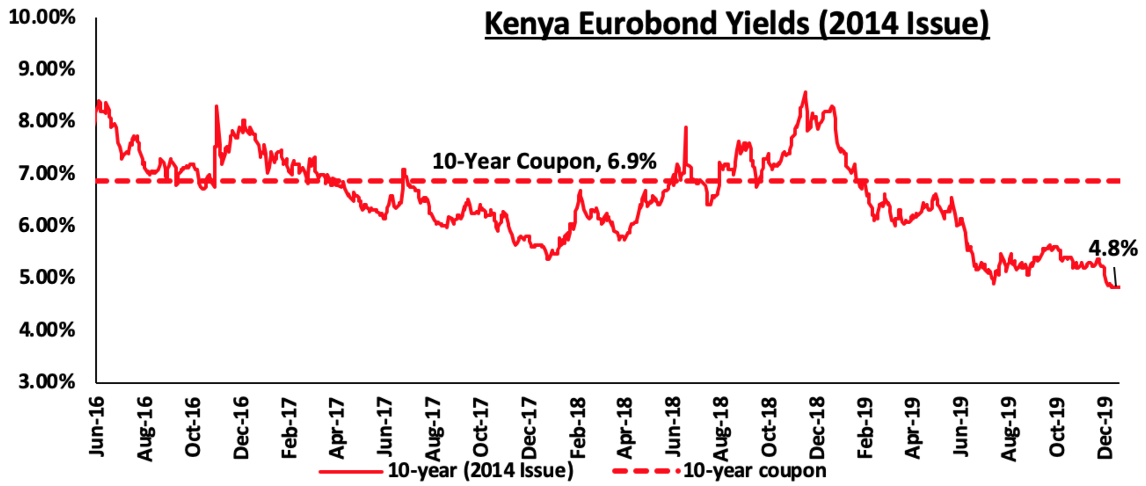


Liquidity:

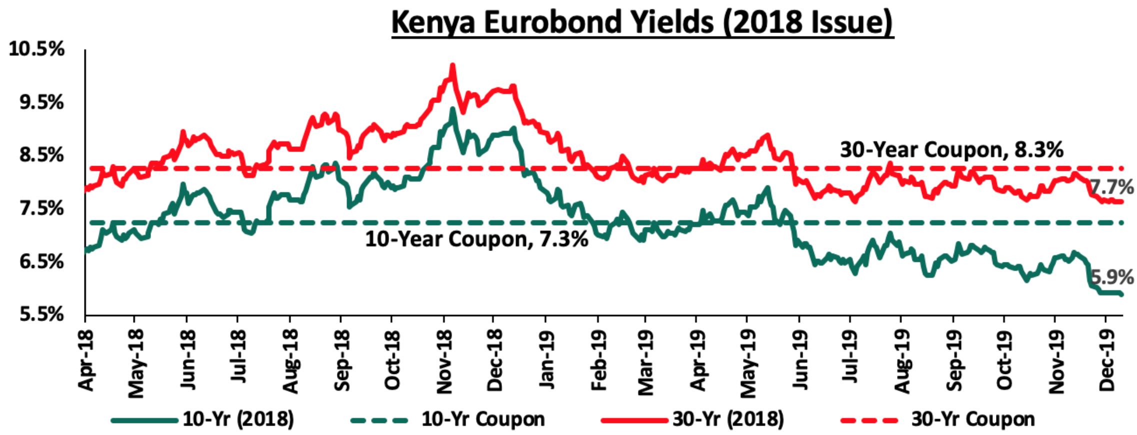
During the year, liquidity levels remained stable and well distributed in the market as indicated by the decline in the average interbank rate to 4.3% in 2019 from 5.2% in 2018, coupled with the 28.6% decline in the average volumes traded in the interbank market to Kshs 11.5 bn in 2019 from Kshs 16.1bn recorded in 2018. The improvement in liquidity was mainly driven by government payments and net redemptions of government securities which came in at Kshs 0.7 bn for the period between July 2019 and December 2019.

Kenya Eurobonds:

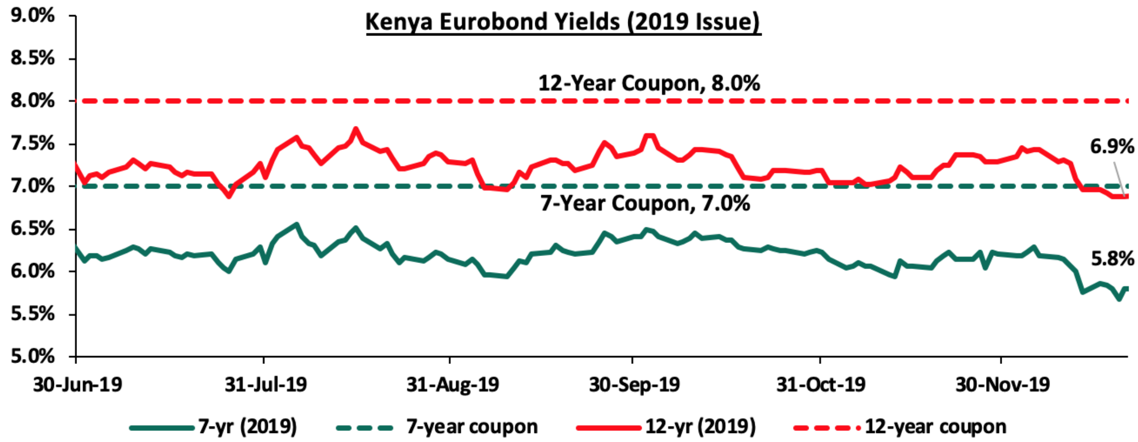
The yields on the 10-Year Eurobond issued in 2014 decreased by 3.5% points to 4.8%, from 8.3% recorded at the end of 2018. The decline in the Eurobond yield is an indication that investors are attaching lower risk premium on the country, attributed to the release of the country's credit rating by Fitch Ratings, which was "B+", highlighting the country's stable outlook.



For the February 2018 Eurobond issue, the yields on the 10-year Eurobond and the 30-year Eurobond declined by 3.1% points and 2.1% points to close the year at 5.9% and 7.7% from a yield of 9.0% and 9.8% at the close of 2018, respectively.



During the year, Kenya issued its 3rd Eurobond, raising USD 2.1 bn (Kshs 210.0 bn) through a dual-tranche Eurobond of 7-year and 12-year tenors, value dated 15th May 2019. The issue was 4.5x oversubscribed attracting orders worth USD 9.5 bn. The yields on the latest issued dual-tranche Eurobond, with 7-years and 12-years tenor, declined by 1.2% points and 1.1% points to close the year at 5.8% and 6.9% from a yield of 7.0% and 8.0% when they were issued in Q3’2019, respectively.



Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 3.2% behind its domestic borrowing target, having borrowed Kshs 156.6 bn against a pro-rated target of Kshs 161.7 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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