Cytonn 2020 Markets Outlook

Fixed Income

The government is currently 8.6% behind its prorated domestic borrowing target, currently having borrowed Kshs 153.1 bn domestically, against the pro-rated target of Kshs 167.5 bn, going by the revised government domestic borrowing target of Kshs 300.3 bn as per the Budget Review and Outlook Paper (BROP) 2019. In order to meet the domestic borrowing target, the government has to borrow an average of Kshs 119.5 bn on a monthly basis, in the 2nd half of the current fiscal year. We expect upward pressure on interest rates following the repeal of the interest rate cap, which in effect is expected to result in increased competition for bank funds from both the private and public sectors as it will allow banks to price risk appropriately and thus admit riskier borrowers including SMEs and individuals. Since its repeal, T-bill subscription in the primary auction market has declined from an average of 125.4%, from January 2019 to November 7th 2019 before the repeal of the rate cap, to 48.4% in the post interest rate cap period between November 7th 2019 and 31st December 2019. Considering Banks are the largest holders of domestic debt, we expect this to force an upward readjustment on the yield curve to incentivize more uptake.

Below is a summary of treasury bills and bonds maturities and the expected borrowings over the same period. The government will need to borrow Kshs 119.5 bn on average each month for the rest of the fiscal year to meet the revised domestic borrowing target of Kshs 300.3 bn, and cover T-bill and T-bond maturities, as illustrated in the graph below:

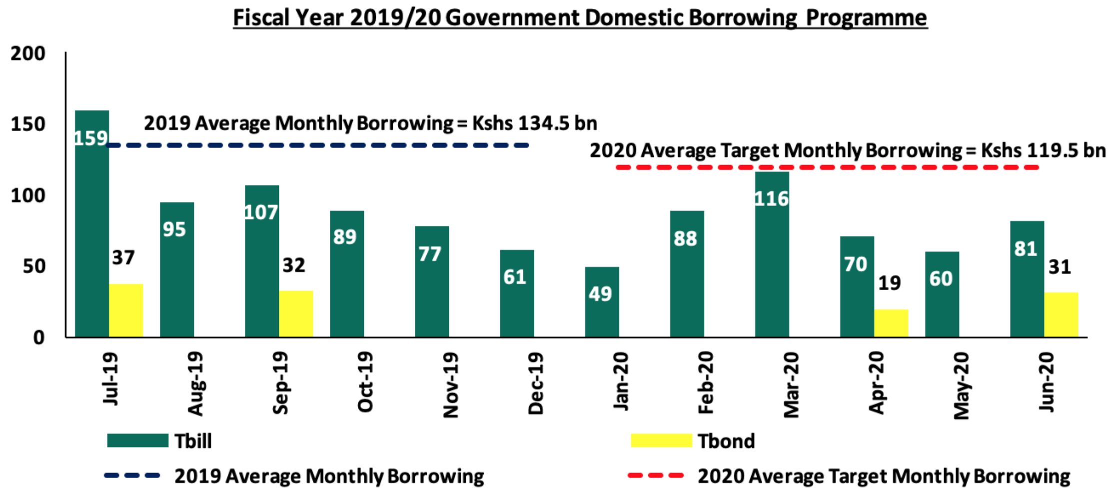

Fig: Schedule of Treasury bills and bonds maturities and the expected target borrowings in the 2019-2020 fiscal year to cater for the maturities and additional government borrowing.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 8.6% behind its domestic borrowing target, having borrowed Kshs 153.1 bn against a pro-rated target of Kshs 167.5 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, resulting in upward pressure on interest rates.

OUR VIEW IS THAT INVESTORS SHOULD BE BIASED TOWARDS SHORT-TERM FIXED-INCOME SECURITIES TO REDUCE DURATION RISK.
