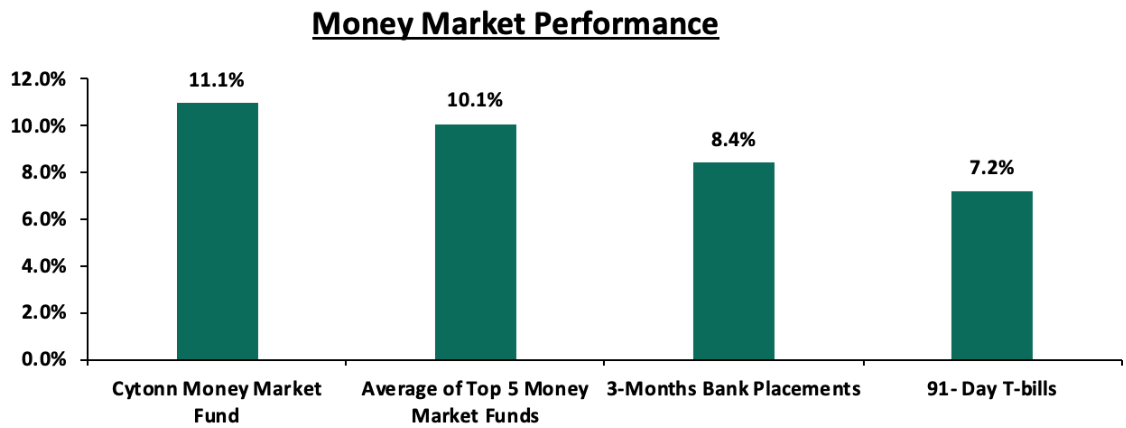
Capital Markets Based Home Ownership Savings Plans, & Cytonn Weekly #03/2020

Fixed Income

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

During the week, T-bills remained oversubscribed, with the subscription rate coming in at 118.1%, down from 178.3% recorded the previous week and lower than the YTD average of 124.9%. The oversubscription is partly attributable to improved liquidity in the market during the week as evidenced by the decline in the average interbank rate to 3.8%, from 4.8% recorded the previous week, supported by government payments and debt maturities. We note that the 364-day paper continued to receive the most interest from investors, having recorded the highest subscription rate of the 3 papers, at 169.9%. This is attributable to the market currently pricing that the government will be under pressure to meet its domestic target and as such a bias to shorter-dated papers in order to avoid duration risk, which has seen most investors still keen on the primary fixed income market, finding the 364-day T-bill more attractive on a risk-adjusted return basis. The yields on the 91-day, 182-day and 364-day papers increased by 3.2 bps, 2.5 bps and 0.9 bps to 7.2%, 8.2% and 9.8%, respectively. The acceptance rate declined to 80.1%, from 92.1% recorded the previous week, with the government accepting Kshs 22.7 bn of the Kshs 28.4 bn worth of bids received.

During the week, the Kenyan Government reopened two bonds namely, FXD1/2019/5 and FXD1/2019/10 with an effective tenor of 4.1 and 9.1 years, respectively, and coupon rates of 11.3% and 12.4%, respectively, in a bid to raise Kshs 50.0 bn for budgetary purposes. We expect the FXD1/2019/5 to attract more interest due to its relatively shorter tenor thus reduced duration risk, coupled with the high liquidity in the market. We expect the weighted average of accepted bids to come in at 11.3% - 11.5% for the FXD1/2019/5 and 12.1% - 12.3% for the FXD1/2019/10, given that they are currently trading at 11.3% and 12.1% on the yield curve, respectively.



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 7.2%, while the average of Top 5 Money

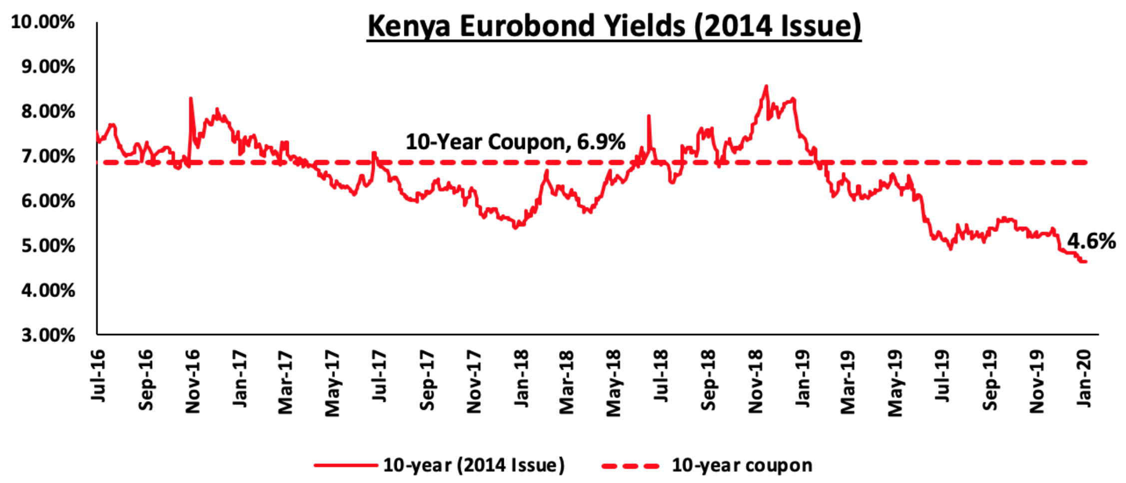
Market Funds came in at 10.1%, unchanged from the previous week. The yield on the Cytonn Money Market increased by 0.6% points to close at 11.1%, from the 10.5% recorded the previous week.

Liquidity:

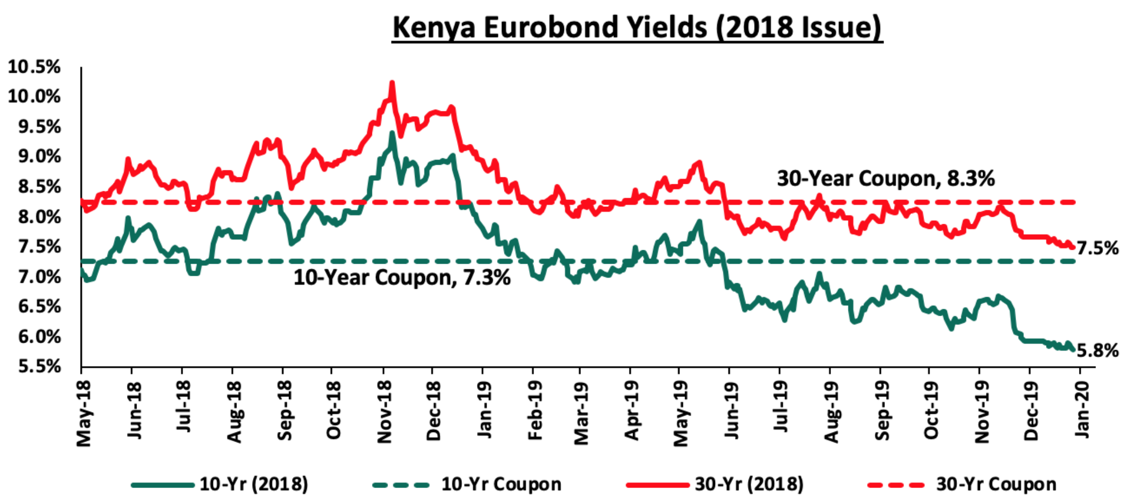
During the week, the average interbank rate decreased to 3.8%, from 4.8% recorded the previous week, pointing to increased liquidity in the money markets. Commercial banks' excess reserves came in at Kshs 16.8 bn in relation to the 5.25% cash reserves requirement (CRR). The average interbank volumes decreased by 38.1% to Kshs 11.2 bn, from Kshs 18.1 bn recorded the previous week.

Kenya Eurobonds:

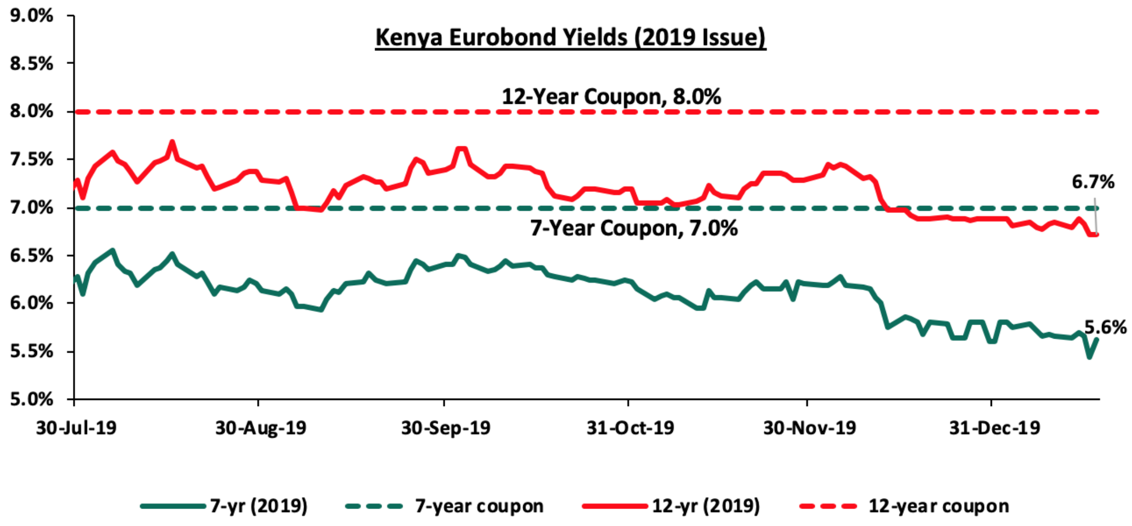
According to Reuters, the yield on the 10-year Eurobond issued in June 2014 remained unchanged at 4.6% similar to what was recorded the previous week. This is an indication that investors are not attaching a higher risk premium on the country, with Rating agencies Moody's and Fitch Ratings having retained the country's credit rating at "B2" and "B+", respectively in 2019, highlighting the country's stable outlook.



During the week, the yields on the 10-year Eurobond and the 30-year Eurobond issued in 2018 both remained unchanged at 5.8% and 7.5%, respectively.



During the week, the yield on the 7-year Eurobond decreased by 0.1% points to 5.6%, from 5.7% recorded the previous week. The yield on the 12-year Eurobond also declined by 0.1% points to 6.7%, from 6.8% recorded the previous week.



Kenya Shilling:

During the week, the Kenya Shilling appreciated by 0.6% against the US Dollar to close at Kshs 101.0, from 101.6 recorded the previous week, mostly supported by inflows from tourism and diaspora remittances amid slow demand from importers. On an YTD basis, the shilling has appreciated by 0.4% against the dollar, in comparison to the 0.5% appreciation in 2019. In our view, the shilling should remain relatively stable against the dollar in the short term with a bias to a 2.4% depreciation by the end of 2020, supported by:

i. The narrowing of the current account deficit, with preliminary data indicating that Kenya's current account deficit in Q3'2018 was equivalent to 8.2% of GDP, from 9.3% recorded in Q3'2018. This was mainly driven by the narrowing of the country's merchandise trade deficit balance (a scenario where imports are greater than exports) by 6.7% and a rise in secondary income transfers (transfers recorded in the balance of payments whenever an economy provides or receives goods, services, income or financial items) by 4.3%,
ii. Foreign capital inflows, with investors looking to participate in the equities market,
iii. CBK's supportive activities in the money market, such as repurchase agreements and selling of dollars.

We, however, expect pressure on the Kenya Shilling to arise from:

i. Increased oil imports bill, as a result of the U.S - Iran diplomatic row, which has seen average crude oil prices increase by 9.9% to an eight-month high to USD 72.0 a barrel, from USD 65.5 a barrel in December 2019, and,
ii. Subdued diaspora remittances growth following the close of the 10.0% tax amnesty window in July which has seen cumulative diaspora remittances increase by a marginal 5.0% in the 12-months to November 2019 to USD 2.8 bn, from USD 2.7 bn, which was slower than the 40.8% growth recorded in a similar period of review in 2018 and the ongoing spat between U.S and Iran which could lead to a slowdown in diaspora remittances.

Weekly Highlight:

During the week, the Energy and Petroleum Regulatory Authority (EPRA) released their monthly statement on the Maximum Retail Prices in Kenya for the period 15th January 2020 to 14th February 2020. Below are the key take-outs from the statement:

i. Petrol prices have increased by 1.6% to Kshs 111.2, from Kshs 109.5 per litre previously, while diesel and kerosene prices have increased by 0.5% and 1.7% to Kshs 102.3 and 104.0 per litre, respectively, from Kshs 101.8 and 102.3 per litre, previously,
ii. The changes in prices have been attributed to the increase in the average landing cost of imported

super petrol by 2.2% to USD 471.0 per ton in December from USD 460.8 per ton in November. Landing costs for diesel and kerosene also increased by 1.7% and 5.8% to USD 493.7 per ton and USD 508.8 per ton in December, respectively, from USD 485.3 per ton and USD 481.1 per ton in November, and,

iii. A 4.0% increase in Free on Board (FOB) price of Murban crude oil lifted in December 2019 to USD 69.3 per barrel, from USD 66.6 per barrel in November 2019.

We expect an increase in the transport index, which carries a weighting of 8.7% in the total consumer price index (CPI), due to the increase in petrol and diesel prices. Consequently, the increase in the transport index will increase inflationary pressures.

During the week, Acorn Holdings, a real-estate developer, listed its Kshs 5.0 bn green bond on the Nairobi Securities Exchange making it Kenya's first listed green bond, with plans to cross-list in London next week, which will also make it the first Kenyan Shilling bond to list on the London Stock Exchange. The 5-year bond was first issued in October 2019, by the company, in partnership with PE Fund Helios, attracting an 85.0% subscription rate, raising Kshs 4.3 bn of the targeted amount of Kshs 5.0 bn as highlighted in our Q3'2019 Markets Review. The bond will be listed in three tranches with the first tranche being floated at Kshs 786.0 mn. The local bond market has not witnessed any corporate bond issue since April 2017 when East African Breweries Ltd (EABL) listed its Kshs 6.0 bn bond expected to stimulate the dead bond market, which has witnessed defaults over the last five-years by issuers such as ARM Cement, Nakumatt and Imperial Bank leading to negative investor sentiments. The bond which attracts an interest of 12.5% annually will be used to finance sustainable and climate-resilient student accommodation with a combined capacity of 40,000 beds.

According to a report done by the IFC, a green bond is a fixed-income instrument whose distinguishing feature is that proceeds are earmarked exclusively for projects with environmental benefits. These include renewable energy, adaptation to climate change, waste management, pollution prevention, water management and green buildings, just to name a few. The green bond market was launched in Kenya in February 2019, through the Green Bonds Programme Kenya, which is a joint initiative between the Central Bank of Kenya, Nairobi Securities Exchange, Climate Bonds Initiative and Kenya Bankers Association, with several other organizations endorsing the program. In our view, the introduction of the green bond is a pro-active and good initiative by the Capital Markets Authority, which will benefit both investors and the stakeholders in the long-run considering its focus on environmental issues and a more sustainable economy.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 11.2% behind its domestic borrowing target, having borrowed Kshs 153.8 bn against a pro-rated target of Kshs 173.3 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.