Cytonn INVESTMENTS

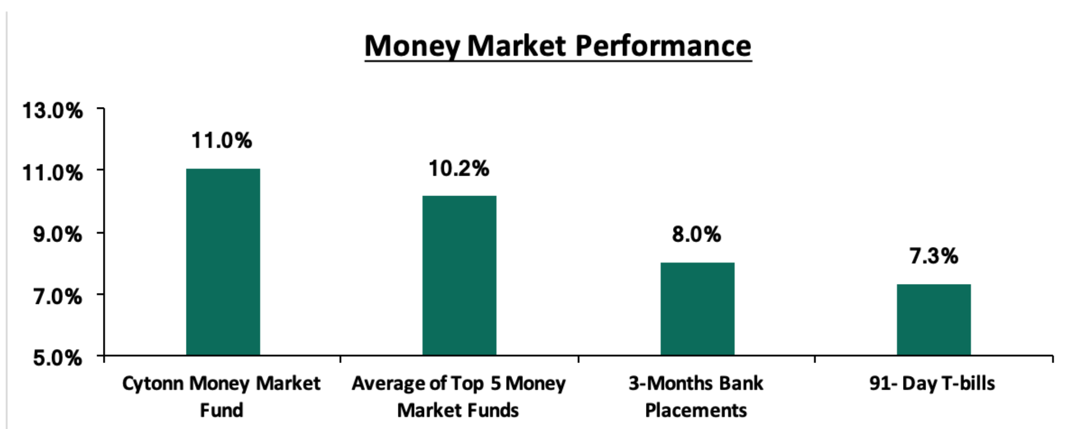
Student Housing Market in Kenya, & Cytonn Weekly #10/2020

Fixed Income

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

During the week, T-bills remained oversubscribed, with the subscription rate coming in at 195.1%, down from 226.6% the previous week. The oversubscription is attributable to the continued favorable liquidity in the money market, evidenced by the average interbank rate having declined from 4.1% to 4.0%, as a result of government disbursements and local debt maturities. We note the continued pent up demand for the 364-day paper, having recorded the highest subscription rate of the three papers, which we attribute to the market having a bias to the shorter-dated papers to avoid duration risk. The scarcity of shorter-dated bonds in the primary market due to the government issuing medium-term and longer-dated papers in a bid to increase the debt maturity profile, 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 yield on the 91-day and 182-day papers remained unchanged at 7.3% and 8.2%, respectively, while the yield on the 364-day paper declined by 0.4% points to 9.3%, from the 9.7% recorded the previous week. This decline is mainly due to increased demand for the 364-day paper with the average subscription rate for the year 2020 coming in at 308.1% versus the 2019 average of 188.6%, coupled with increased liquidity in the money market as well as the government being ahead of its borrowing target giving it the leeway to reject expensive bids. The acceptance rate rose to 46.0%, from 27.6% recorded the previous week, with the government accepting Kshs 21.5 bn of the Kshs 46.8 bn bids received.

During the week, the National Treasury announced that it will reopen two bonds, namely FXD1/2018/20 and FXD1/2018/25, with effective tenors of 18.1-years and 23.3-years, respectively, with a total value of Kshs 50.0 bn, to raise capital for budgetary support. The period of sale is from 3rd March 2020 to 17th March 2020. Our recommended bidding ranges are 12.9% - 13.0% and 13.4% - 13.6%, for the FXD1/2018/20 and FXD1/2018/25, respectively, given that they are currently trading at 12.9% and 13.4%, respectively. We expect the bidding ranges to stay above the current yield to maturities mainly because of oversupply of long term bonds and lower demand for longer-dated bonds from investors trying to avoid duration risk.



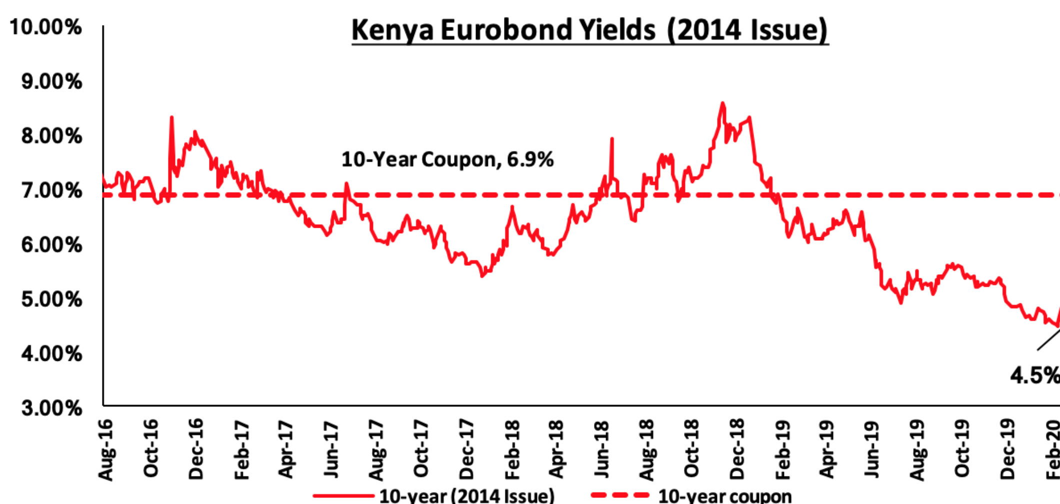
In the money markets, 3-month bank placements ended the week at 8.0% (based on what we have been offered by various banks), the 91-day T-bill came in at 7.3%, while the average of Top 5 Money Market Funds came in at 10.2%, up from 10.1% recorded the previous week. The yield on the Cytonn Money Market came in at 11.0%, unchanged from the previous week.

Liquidity:

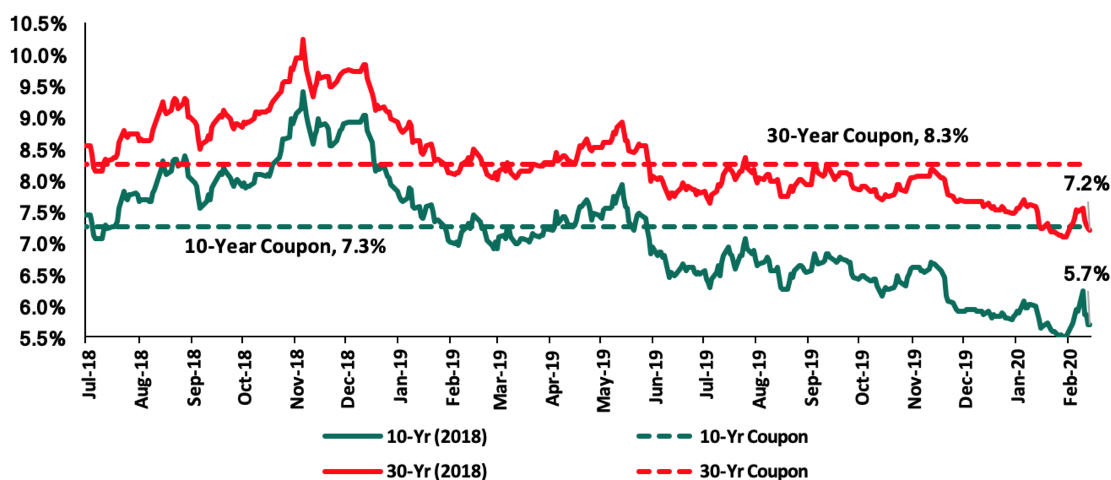
During the week, the average interbank rate declined to 4.0%, from 4.1% recorded the previous week, pointing to increased liquidity in the money markets mainly as a result of government disbursements and local debt maturities. Commercial banks' excess reserves came in at Kshs 20.9 bn, in relation to the 5.25% cash reserves requirement (CRR). The average interbank volumes declined by 63.7% to Kshs 5.7 bn, from Kshs 15.7 bn recorded the previous week.

Kenya Eurobonds:

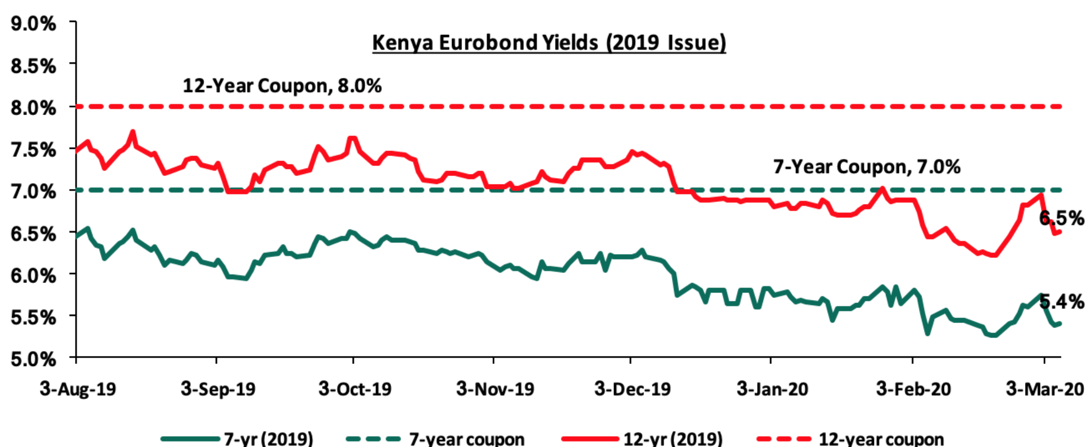
According to Reuters, the yield on the 10-year Eurobond issued in June 2014 declined marginally by 0.1% points to 4.5%, from 4.6% recorded the previous week. We attribute the decline across the Eurobonds to the adoption of a looser monetary policy regime in the Eurozone and the United States, thus leading to a decline in yields in advanced economies. As a result, there was increased investor interest in Africa's debt market, which increased demand pushing the prices up and consequently the yield down.



During the week, the yields on the 10-year and 30-year Eurobonds issued in 2018 declined by 0.2% points and 0.3% points to 5.7% and 7.2%, respectively, from 5.9% and 7.5% recorded the previous week.



During the week, the yields on the 7-year and 12-year Eurobonds issued in 2019 declined by 0.2% points and 0.3% points, respectively, to 5.4% and 6.5%, from 5.6% and 6.8% recorded the previous week.



Kenya Shilling:

During the week the Central Bank of Kenya (CBK) publicly announced its intention to buy US Dollar (USD) worth Kshs 40.5 bn between March and June 2020 to increase its dollar reserves amid rising uncertainty on global markets due to the coronavirus outbreak. CBK, however, announced that it would buy the dollars at the prevailing market rate to ensure the purchase does not introduce volatility in the market. This was not the case, since during the week, the Kenya Shilling depreciated by 1.6% against the US Dollar to Kshs 102.6, from Kshs 101.0 recorded last week, due to increased demand for the dollar by the banks and importers who are looking to stockpile the dollar for a chance to sell to CBK. On a YTD basis, the shilling has depreciated by 1.2% 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, on the back of:

i. The narrowing of the current account deficit, with preliminary data indicating that Kenya's current account deficit was equivalent to 4.6% of GDP in 2019, from 5.0% recorded in 2018. This was mainly driven by lower imports of SGR-related equipment, resilient diaspora remittances which stood at USD 0.3 bn in January 2020, a 5.9% increase from the USD 0.2 bn recorded in January 2019, and strong receipts from transport and tourism services with preliminary data indicating that the number of tourists landing in the country stood at 132,019 in December 2019, which was a 9.0% increase, compared to the 121,070 recorded in November 2019,

ii. High levels of forex reserves, currently at USD 8.4 bn (equivalent to 5.1-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,
iii. Foreign capital inflows, with investors looking to participate in the domestic equities market, and,
iv. CBK's supportive activities in the money market, such as repurchase agreements and selling of dollars.

We, however, expect pressure on the shilling to arise from:

i. Rising uncertainties in the global market due to the Coronavirus outbreak. The virus outbreak is likely to cause supply-side shortages which may result in inflationary pressure as prices readjust to the forces of demand and supply. The Central Bank of Kenya (CBK) is looking to purchase Kshs 40.5 bn from banks in the next four months, which will bolster the forex reserves that stood at Kshs 8.7 bn on 28th February 2020.

Weekly Highlight:

According to Stanbic Bank's Monthly Purchasing Manager's Index (PMI), the Kenyan private sector economy suffered another difficult month with the February PMI declining to 49.0, from 49.7 in January 2020, pointing towards a decline in business conditions. A reading of above 50 indicates an improvement in the business environment, while a reading of below 50 indicates a worsening outlook. Weak cash flow continued to cause a notable decline in consumer demand and consequently a solid drop in output in February, affecting business sales and operations with firms reducing their business activities. Confidence in a positive outlook for the market led to an increase in employment at Kenyan firms with the rate of growth being the strongest since November 2019. Cost pressures, however, accelerated to a six-month high driven by the prices of fuel and foodstuff coupled with a shortage of raw materials attributable to reduced imports from China due to the Coronavirus outbreak. Kenya has been increasingly dependent on imports from China with the country's total imports from China standing at 21.1% in 2018, and 20.3% of total imports in the 11 months to November 2019. With a temporary closure of business to manage spread in China, we expect the prices of major imports such as electronics and heavy machinery to rise due to forces of demand and supply. The tourism sector, which is a major contributor to the country's economy, is also likely to decline due to continued suspension of flights by major airlines as well as cruises.

Rates in the fixed income market have remained relatively stable as the government rejects expensive bids. The government is 46.2% ahead of its domestic borrowing target, having borrowed Kshs 312.3 bn against a pro-rated target of Kshs 213.7 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.