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11th June 2018

Yield curve to steepen as short term interest rates edge lower, amid persistent stickiness on the longer end

For the most part of 2018, yields have been remarkably stable despite a clear easing bias by the Central Bank. To be sure, the 50bps rate cut in March, is yet to fully feed through the curve, unlike historically when the impact on yields would be almost immediate. The rather atypical response has been primarily credited to heavy local borrowing by the government, which has considerably offset the impact of heavy liquidity and/or demand on yields on the government papers.

That said, the yield curve could steepen in coming weeks as yields on the shorter end of the curve fall faster compared to the longer end. Last week, yields on T-bills fell across the spectrum with the three, six and one year papers auctioning 8.80, 13.50 and 13.40 bps lower at 7.850%, 10.061% and 10.949% respectively. This could be sustained by the combination of waning government debt appetite for the remainder of this fiscal year and heavy liquidity.

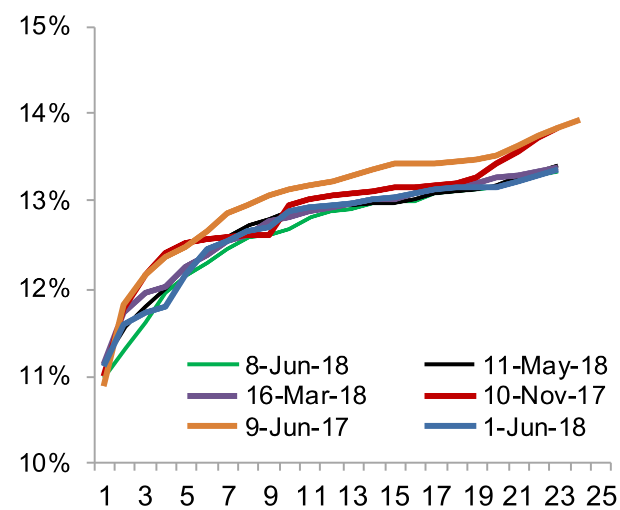
Having surpassed its KES 275.80Bn borrowing target, the government is expected to materially reduce its bids uptake from the market, upholding the current levels of liquidity. This liquidity predicate amidst a dearth of short term profitable, less risky investments will support the recent stampede for T-bills pushing yields lower. Over the last two weeks, the short term papers have been immensely oversubscribed with KES 99.48Bn in bids chasing the KES 48.00Bn worth of bills on issue. Only KES 41.76Bn was accepted, 92% of which was used to re-finance maturing debt.

Looking ahead, the heavy liquidity will be supported by KES 63.26Bn, KES 102.37Bn and KES 101.23Bn in outstanding maturities for June, July and August. Additionally, the traditional lethargy in public expenditure at the onset of a fiscal cycle could also see government pick up less bids from the market. However, the urgency around the implementation of the Big Four Agenda means that this could be short lived. The move by the CBK to issue a 25-year bond, knowing well that the market has little appetite for such tenors reinforces the government's low debt appetite.

Indicative Rates	Previous	Current	Change bps
Avg Overnight	4.825%	3.906%	-91.90
91-Day T-bill	7.938%	7.850%	-8.80
182-Day T-bill	10.196%	10.061%	-13.50
364-Day T-bill	11.083%	10.949%	-13.40
Inflation	3.95%	3.75%	25.00
USD/KES	101.39	101.00	0.38%

Source: Central Bank of Kenya

NSE yield curve



Source: Nairobi Securities Exchange

Government maturities and coupon payments

Government Debt Maturities	KES (Bn)
11-Jun-18	17.01
18-Jun-18	15.88
25-Jun-18	47.38
02-July-18	14.38
09-July-18	18.56
16-July-18	35.14
23-July-18	12.47
30-July-18	21.82
New Cumulative Borrowing	**282.41**
Domestic Borrowing Target	275.80

Source: Bloomberg

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The bond carries a 13.40% coupon rate, just 10.0bps below the maximum lending rate and could auction close to par given limited scope for a discount as the fiscal agent tries to keep risk free rates below the maximum lending rate.

Budget statement eyed for further guidance on direction of interest rates

As earlier indicated, fiscal policy has been a major determinant of interest rates in Kenya. A perennially high deficit has necessitated heavy government borrowing with the resultant surge in public debt raising concerns over the country's increasing fragility to macroeconomic shocks. Public debt has risen to slightly over 60.0% of GDP pushing the debt service/revenue ratio towards 40.0%.

The Budget Statement is expected to highlight the government's measures towards restoring the fiscal balance necessary for broader macroeconomic stability. Treasury has alluded to plans to cut deficit to below 6.0% of GDP which makes consolidation inevitable. For the government, the dilemma lies in cutting the deficit while still sustaining solid economic performance. Currently the inclination is towards enhancing revenues other than outright budget cuts. For credibility in guidance, measures to reduce the deficit need by realistic and sustainable.

Of interest will be tax proposals aimed at boosting revenues and more importantly the government's deficit financing options. Given rising benchmark US dollar interest rates in global markets, potential leaning towards local markets risks reigniting pressure on yields later in the year. This could be enhanced by any prospects of credit growth recovery in the period, although this is likely to be delayed until 2019.

Stocks pare back losses as low valuations draw support

Equities pared back some of the recent losses as the low valuation offered good entry position for investors. Notable was bidding concentration on banking and telco sectors which advanced by 3.25% and 4.42% respectively in the week. This propelled the NSE-20, NASI and NSE-25 0.58%, 2.40% and 2.00% higher respectively.

Weekly T-bill Auction Results

	91-Day	182-Day	364-Day
Yield	7.850%	10.061%	10.949%
Change (Bps)	-8.80	-13.50	-13.40
Amount Offered (Bn)	4.00	10.00	10.00
Bids Received (Bn)	0.875	17.345	32.289
Performance (%)	21.88	173.45	322.89
Amount Accepted	0.875	10.118	5.003
Bid Cover	1.00	1.48	4.12
Redemption (Bn)	3.164	5.904	7.888
New borrowing (Bn)	-2.289	5.846	59.58

Source: Central Bank of Kenya

Regional Equities Market

	01.06.18	08.06.18	Wow
NSE- 20	3,333.36	3,352.85	0.58%
NASI	172.53	176.67	2.40%
NSE- 25	4,470.07	4,559.31	2.00%
USE ASI	2,054.79	2,115.78	2.97%
DSEI	2,306.42	2,316.50	0.44%
TSI	4,176.65	4,176.52	0.00%
RSE ALSI	133.02	131.71	-0.98%

Source: Regional Stock Exchanges

Meanwhile, activity remained stable with turnover increasing marginally to KES 3.39Bn from KES 3.31Bn in the previous week. Trading remained foreign investor driven, as local participation fell to 34.02% in the week.

Foreign investors maintained a net supply position withdrawing USD 10.85Mn from the market compared to USD 4.14Mn in the previous week.

Looking ahead, the budget reading will be a key event for equity players with recommendations towards interest rate controls likely to spur activity in the market. Activity could also pick up driven by the traditional portfolio rebalancing ahead of quarterly reporting.

Regional Market

	UGANDA		TANZANIA		RWANDA	
Period to (2018)	**May 25th**	**June 08th**	**May 18th**	**June 01st**	**June 01st**	**June 08th**
91 Days T-Bill	8.796%	9.051%	1.89%	1.89%	5.275%	5.360%
182 Days T-Bill	9.490%	9.974%	2.67%	2.73%	6.282%	6.454%
364 Days T-Bill	10.283%	10.761%	4.80%	5.48%	7.400%	7.150%
Interbank O/N	8.68%	8.83%*	1.57%	1.60%	5.50%	5.50%
CBR/CRR/ Key Repo Rate	9.00%	9.00%	8.00%	8.00%	5.50%	5.50%

Source: Bank of Uganda, Bank of Tanzania, National Bank of Rwanda

Uganda

The shilling posted further losses during the week breaching the 3,800 mark against its US counterpart. The local currency lost 70 shillings to trade at 3840 to the US dollar at the close of trading on Friday. The weakness was attributed to strong dollar demand from the energy and manufacturing sectors amid weak dollar flows from charity organizations. The sharp move triggered action from the Central Bank which sold dollar in the market to smooth the depreciation. In the week ahead, FX activity could remain mute as investors focus on Thursday budget reading.

On the interest rate front, interbank market remained liquid with overnight rate oscillating between 6.85% - 8.83% in the week. The Central Bank mopped up UGX 1.28 trillion through 2 and 7 day repos at 9.00% and a 56-day deposit auction at 9.397%. This was against UGX 788.93Bn in Treasury maturities primarily repos and deposit auctions. In the week ahead, liquidity conditions will be supported by repo maturities and UGX 1.04 trillion in T-bills redemptions.

Meanwhile, yields went up across the T-bill spectrum although performance of the papers was mixed. Yields edged up across the board with 91 and 182 day papers selling at 9.051% (Up 25.50bps) and 9.974% (Up 48.40bps) respectively in an undersubscribed auction. The yield on the 364-day paper increased by 47.80bps to 10.761% in an oversubscribed auction. Treasury yields are expected to edge higher in the short term as the government increases the size of Treasury issues to cover its widening deficit.

Tanzania

The local currency ended the week marginally stronger against the US dollar as a result of waning dollar demand amid rising dollar flows from cotton exporters. This saw the local currency gain 2 shillings in the week to close at 2267/2277 levels against its US counterpart.

The interbank market was adequately funded with the overnight rate holding in the 1.57% - 1.68% range. The Central Bank stayed out of the interbank market given limited spill over effects of the heavy liquidity to the currency. That said, small tiered banks continue to face some liquidity constraints given capital concerns due to high NPLs in the market.

Meanwhile, the week's 5-year Treasury bond auction registered healthy subscription with the Central Bank receiving TZS 94.17Bn in bids and accepted the TZS 90.00Bn it sought to raise. The yield edged higher to 11.2952% (Up 23.53bps).

Kenya Government Debt Maturities (KES Bn)

Maturity	Issuer	Amount Outstanding	Principal	Interest
11-Jun-18	Treasury Bill	17.01	17.01	
18-Jun-18	Treasury Bill	15.88	15.88	
25-Jun-18	Treasury Bill	19.46	19.46	
25-Jun-18	**FXD2/2013/5**	26.43	26.43	
	Treasury Bond-Coupon Payments			**19.96**
JUNE 2018		**78.77**	**78.77**	**19.96**
2-Jul-18	Treasury Bill	14.38	14.38	
9-Jul-18	Treasury Bill	18.56	18.56	
16-Jul-18	Treasury Bill	13.68	13.68	
16-Jul-18	**FXD2/2008/10**	20.36	20.36	
23-Jul-18	Treasury Bill	12.47	12.47	
30-Jul-17	Treasury Bill	21.82	21.82	
	Treasury Bond-Coupon Payments			**9.48**
JULY 2018		**101.28**	**101.28**	**9.48**
6-Aug-18	Treasury Bill	17.94	17.94	
13-Aug-18	Treasury Bill	29.00	29.00	
13-Aug-18	**FXD1/2006/12**	3.82	3.82	
20-Aug-18	Treasury Bill	25.77	25.77	
27-Aug-18	Treasury Bill	28.26	28.26	
	Treasury Bond-Coupon Payments			**9.42**
AUGUST 2018		**104.79**	**104.79**	**9.42**
3-Sep-18	Treasury Bill	36.01	36.01	
10-Sep-18	Treasury Bill	22.06	22.06	
17-Sep-18	Treasury Bill	15.86	15.86	
17-Sep-18	**FXD3/2008/10**	21.80	21.80	
24-Sep-18	Treasury Bill	10.92	10.92	
	Treasury Bond-Coupon Payments			**19.71**
SEPTEMBER 2018		**106.65**	**106.65**	**19.71**
1-Oct-18	Treasury Bill	7.20	7.20	
8-Oct-18	Treasury Bill	13.74	13.74	
15-Oct-18	Treasury Bill	9.77	9.77	
22-Oct-18	Treasury Bill	20.90	20.90	
29-Oct-18	Treasury Bill	14.66	14.66	
	Treasury Bond-Coupon Payments			**15.95**
OCTOBER 2018		**66.27**	**66.27**	**15.95**