Financial News

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Imminent Eurobond sale, persistent heavy liquidity to sustain downward pressure on local yields

Last week, Fitch upgraded Kenya's credit outlook from negative to stable. The optimistic view is supported by the country's expected recovery from political and fiscal shocks of 2017. Fitch projects that Kenya's economic growth will accelerate to 5.5% in 2018 from an estimated 5.0% in 2017. Although fairly positive on the current account and fiscal deficit positions, Fitch underlined the country's sensitivity to the twin deficit and the need to keep the gap at sustainable levels.

The rating sets stage for Kenya's return to the international capital markets for funding. Early indications from Treasury suggest that the government may be looking to raise between $1.5Bn-3.0Bn, primarily for deficit financing. On the upside, a successful issue will water down the government's domestic debt appetite which coupled with persistent heavy liquidity should sustain downward pressure on the yield curve.

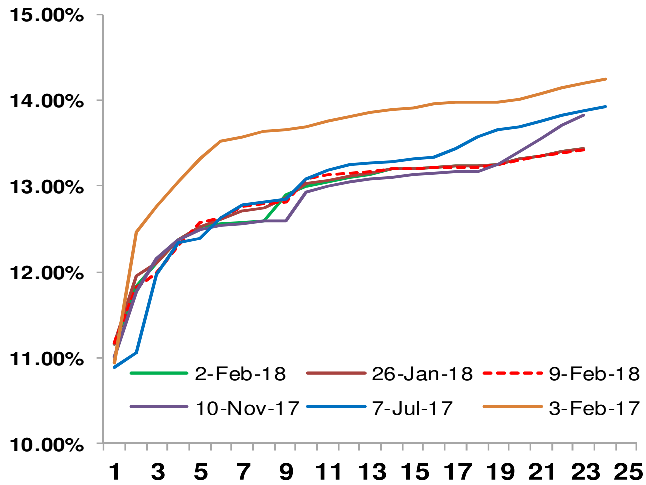
On the flip side, the destabilising effect of further external debt exposure for Kenya cannot be gainsaid. The issue will be against a backdrop of expected liquidity withdrawal by major central banks as they seek to end a near decade of unconventional monetary policies. To be sure, expectations of aggressive rate hikes by the Fed has so far this year, pushed the yield on the US 10 year bond to a four year high of 2.880% (+47.2bps). In response, yields on African Eurobonds have risen steeply with the yield on Kenya's 10 year paper (6.36 years to maturity) rising by 91.0bps to 6.451% over the same period. Continued global risk aversion could steepen the premium on emerging and frontier markets' debt, renewing sustainability concerns in the regions.
Moreover, potential dollar resurgence may destabilize currencies in the markets although gyrations may be milder than those witnessed during the taper tantrum of 2015.

Undoubtedly, international investors continue to seek sovereign exposure to African, given the relatively low yields in advanced economies. With Kenya's stable credit outlook, the success of the issue is almost guaranteed. Given the country's debt maturity profile, the tenor for the bond is likely to be longer perhaps 10 years and may attract a higher yield than the 6.75% recorded at the debut sale in 2014, if issued against a backdrop of rising interest rates in the US.

Indicative Rates	Previous	Current	Change bps
Avg Overnight	5.918%	4.926%	
91-Day T-bill	8.005%	8.045%	+4.00
182-Day T-bill	10.438%	10.424%	-1.40
364-Day T-bill	11.156%	11.159%	0.30
Inflation	4.50%	4.83%	33.00
USD/KES	101.74	101.10	-0.63%

Source: Central Bank of Kenya

NSE yield curve



Source: Nairobi Securities Exchange

Government maturities and coupon payments

Month	KES (Bn)
05-Feb-18	14.41
12-Feb-18	25.35
19-Feb-18	37.29
26-Feb-18	11.38
New Cumulative Borrowing	163.70

Source: Bloomberg

Investors and Treasury shift to the mid to long end of the curve as yield expectations moderate

Demand is increasingly shifting towards the longer end of the curve as yield expectations moderate. In addition to policy accommodation signals from the monetary authority, the low yield expectation has been under-pinned by prospects of increased external financing.

In hindsight, supply of shorter tenors has thinned leaving investors, especially the funds with little option but to take up any issue by the fiscal agent. Treasury through CBK is also riding this shift in sentiment to average down its overall cost of debt. This month, the CBK has reopened two 15 year papers; (FXD2/2013/15 and FXD1/2010/15 with 10.15 and 7.06 years to maturity) for a sum of KES 40.00Bn. The two papers carry coupon rates of 12.00% and 10.25% respectively and could sell near their current yields of 12.786% and 12.606% respectively.

Shilling maintains bullish run but upside is now limited

The shilling extended its bullish run to a 2 year high of 100.80/90 last week as supply persisted amid lethargic demand. While a reversal may be imminent, the upside for the shilling looks fairly limited in the immediate term. While improved economic sentiment, rising flows from tourism and agricultural exports, resilient diaspora remittance and prospective flows from the Eurobond may anchor the shilling, downside risks stem from the widen-ing interest rate differential between Kenya and the US as well as heavy shilling liquidity. Moreover, the current levels could evince some dollar buying interest from both corporates and the Central Bank.

This is welcome news as it could further strengthen the current account position by reducing the overall cost of imports. Export earnings may be somewhat diluted but the impact on current account should be offset by the saving on imports. Additionally, the impact on inflation could be soothing, bolstering consumer spending.

That said, the possibility of purchases by the CBK may increase liquidity in a market already awash with cash. Last week, foreign exchange reserves rose by $107Mn which translates to about KES 10.80Bn in fresh liquidity. This should sustain the current heavy liquidity predicate.

Weekly T-bill Auction Results

	91-Day	182-Day	364-Day
Yield	8.045%	10.424%	11.159%
Change (Bps)	4.00	-1.40	0.30
Amnt Offered (Bn)	4.00	10.00	10.00
Bids Received (Bn)	2.10	12.51	17.15
Performance (%)	52.41	125.1	171.53
Amount Accepted	2.05	12.51	17.11
Bid Cover	1.02	1.00	1.00
Redemption (Bn)	6.84	9.43	6.00
New borrowing (Bn)	4.79	3.08	11.11

Source: Central Bank of Kenya

Regional Equities Market

	02.02.18	09.02.18	WoW
NSE- 20	3,758.18	3,741.02	-0.46%
NASI	181.69	179.96	-0.95%
NSE- 25	4,544.76	4,509.07	-0.79%
USE ASI	2,057.84	2,078.04	0.98%
DSEI	2,409.91	2,336.14	-3.06%
TSI	3,964.11	3,868.88	-2.40%
RSE ALSI	133.25	133.02	-0.17%

Source: Regional Stock Exchanges

The market has been swamped with shillings with the overnight rate dropping to lows of 3.0% last week. The average overnight lending rate eased to 4.93% on Friday from 5.54% at the beginning of last week. This despite a withdrawal of KES 49.0Bn earlier in the week. Liquidity absorption from the interbank system has reduced markedly in the aftermath of interest rate controls which materially weakened credit supply.

	UGANDA		TANZANIA		RWANDA	
	Jan 19th	Feb 02nd	Jan 12th	Jan 26th	Jan 19th	Jan 26th
91 Days T-Bill	8.556%	8.658%	3.74%	3.74%	6.283%	6.236%
182 Days T-Bill	8.409%	8.833%	4.37%	4.20%	7.524%	7.562%
364 Days T-Bill	9.039%	9.271%	7.65%	7.31%	8.372%	8.329%
Interbank O/N	8.15%*	9.50%	2.96%	2.00%	5.50%	5.50%
CBR/CRR/ Key	9.50%	9.50%	8.00%	8.00%	6.00%	5.50%

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

Uganda

The Uganda shilling weakened slightly in the week following a mild pickup in demand from corporates. The local unit which was quoted at 3630/3640 at the week's opening on Monday eased to 3635/45 as at close of trading. The shilling is expected to hold steady this week buoyed by liquidity withdrawal for mid-month tax payments as well as reduced demand from the Bank of Uganda (BoU).

Meanwhile, markets remained fairly liquid with the overnight lending rate holding between 8.50-9.50%. The BoU is expected to intensify its liquidity sterilizing open market operations this week to keep liquidity balanced. Persistent surplus liquidity could potentially destabilize the currency.

Tanzania

After the admirable stability of the last two years, the shilling has in recent week exhibited increased vulnerability to the US dollar as demand for dollars pickup amid weakening dollar supply. The shilling depreciated to 2250/60 against the greenback from 2241/51 earlier in the week. Besides the aforementioned factors, shilling weakness may be stemming from the extremely low yields in the market due to high liquidity.

Dollar flows to the country has thinned following the ban on mineral exports and the general uncertainty around public policies which has undermined foreign investments in the country. The shilling is expected to remain on the back foot although any depreciation will be gradual.
Meanwhile, the overnight rate dropped further to 1.97% from 2.25% at the end of the previous week. BoT was in the market to mop up excess cash and absorbed TZS 11.0Bn at 1.00%, record low yield on the paper. The narrative is unlikely to shift until private sector credit picks up markedly.

Reflecting the sound liquidity standing was the heavy subscription for T-bills. For the TZS 169.00Bn worth of papers, the BoT received TZS 344.15Bn of which only TZS 169.00 Bn was accepted. Yields fell across the spectrum with the 35, 91, 182 and 364 day settling at 2.73% (-62.0bps), 3.50%(-25.0bps), 4.01%(-19.0bps) and 6.92%(-39.0 bps). Yields could fall further with the continued yield search. The shift towards the longer end of the curve underscores expectations of further decline in yields.

Kenya Government Debt Maturities (KES Bn)

Maturity	Issuer	Amount Outstanding	Principal	Interest
12-Feb-18	Treasury Bill	9.43	9.43	
12-Feb-18	**FXD1/2008/10**	2.90	2.90	
19-Feb-18	Treasury Bill	29.64	29.64	
19-Feb-18	**IFB1/2010/8**	7.29	7.29	
26-Feb-18	Treasury Bill	11.38	11.38	
	Treasury Bond-Coupon Payments			**10.03**
FEBRUARY 2018		**60.66**	**60.66**	**10.03**
5-Mar-18	Treasury Bill	23.85	23.85	
12-Mar-18	Treasury Bill	41.89	41.89	
19-Mar-18	Treasury Bill	27.29	27.29	
26-Mar-18	Treasury Bill	18.61	18.61	
	Treasury Bond-Coupon Payments			**15.10**
MARCH 2018		**111.64**	**111.64**	**15.10**
2-Apr-18	Treasury Bill	17.29	17.29	
9-Apr-18	Treasury Bill	17.70	17.70	
16-Apr-18	Treasury Bill	19.44	19.44	
23-Apr-18	Treasury Bill	25.51	25.51	
23-Apr-18	**FXD1/2013/5**	20.17	20.17	
30-Apr-18	Treasury Bill	13.33	13.33	
	Treasury Bond-Coupon Payments			**17.26**
APRIL 2018		**113.45**	**113.45**	**17.26**
7-May-18	Treasury Bill	18.81	18.81	
14-May-18	Treasury Bill	17.94	17.94	
21-May-18	Treasury Bill	23.91	23.91	
21-May-18	**FXD2/2016/2**	30.22	30.22	
28-May-18	Treasury Bill	16.68	16.68	
	Treasury Bond-Coupon Payments			**17.01**
MAY 2018		**107.55**	**107.55**	**17.01**
4-Jun-18	Treasury Bill	14.21	14.21	
11-Jun-18	Treasury Bill	13.84	13.84	
18-Jun-18	Treasury Bill	14.01	14.01	
25-Jun-18	Treasury Bill	17.28	17.28	
25-Jun-18	**FXD2/2013/5**	26.43	26.43	
	Treasury Bond-Coupon Payments			**19.96**
JUNE 2018		**85.77**	**85.77**	**19.96**

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