Financial News

09 October 2018

Improving food prospects could partly dilute the impact of higher taxes and oil prices on overall inflation

The traditional link between inflation and interest rates in Kenya has weakened somewhat following the introduction of interest rate controls. While inflation expectations have increased over the last couple of weeks with actual headline reading rising from 4.0% to 5.7% in September, short term interest rates have maintained a downward bias largely on the back of sound liquidity conditions amid a dearth of higher yield investment options.

Even then, with price stability at the core of monetary policy, inflation remains a critical indicator of interest rate direction. To be sure, the MPC in September adopted a rather cautious tone, citing risks to inflation from the effects of recent tax increases and rising oil prices. While the direct effects on inflation may already be partially reflected in the recent inflation data, the second round effects should see inflation rise further in coming months.

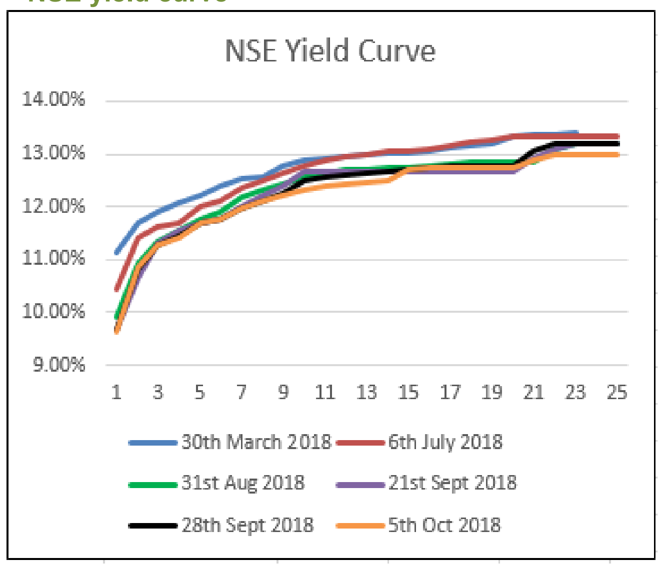
The question remains whether prices will rise considerably and sustainably to warrant a shift in the monetary stance. While oil and taxes may sustain the upward pressure on prices, prospects of lower food prices due to favorable weather could provide some respite. Food remains the largest constituent of the inflation basket, accounting for 35.0% of the basket's weighting.

The Kenya Meteorological Department has projected enhanced rainfall during the October-December short rain season. The rains are expected to be well distributed in both space and time. This could reduce pressure on cyclical food items especially vegetables and milk. Moreover, potential for increased hydro-electricity power production could reduce the overall cost of electricity. Even then, any upside from this weather conditions maybe lagged for at least a month.

Indicative Rates	Previous	Current	Change bps
Interbank rate	5.994%	3.676%	-231.80
91-Day T-bill	7.609	7.600%	-0.90
182-Day T-bill	8.646	8.590%	-5.60
364-Day T-bill	9.670	9.638%	-3.20
Inflation	4.040%	5.70%	166.00
USD/KES	100.900	100.850	-0.05%

Source: Central Bank of Kenya

NSE yield curve



Source: Nairobi Securities Exchange

Government maturities and coupon payments

Government Debt Maturities	KES (Bn)
15-Oct-2018	12.21
22-Oct-2018	25.13
29-Oct-2018	16.69
Oct-2018	54.03
Nov-2018	113.20
Dec-2018	141.53
New cumulative borrowing	148.81
Domestic Borrowing Target	**271.90**

Source: Bloomberg

On a more sanguine note, the favorable weather conditions should sustain the upbeat economic performance into the fourth quarter. GDP accelerated to 6.3% in the second quarter buttressed primarily by the solid agricultural performance. This could ease pressure on the MPC to provide further stimulation as the economy narrows the output gap.

Is the era of monetary accommodation over?

The Bank of Uganda (BoU) last week became the first central bank in Sub-Saharan Africa to shift into a tightening mode. In justifying its policy shift, the BoU cited rising inflation expectations on the back of positive output gap, growing domestic demand, weakening currency and rising global oil prices.

Kenya's situation is not very different from the Ugandan case. With rising cost-push inflation driven by recent tax measures and rising oil prices, scope for further accommodation is likely to be limited. Oil prices rose to a 4-year high of $85 last week on fears of supply constraints following new sanctions on Iran as well as supply disruption from Venezuela due to the ongoing political turmoil in the country. This is likely to invite considerable caution among central banks in oil importing countries.

The monetary authority will be expected to proactively step in to keep inflation below the 7.5% upper bound of the inflation target band. On a positive note, growth has accelerated considerably to 6.3% in the second quarter, reducing pressure for stimulation from the monetary authority.

However, it is worth noting that despite low credit growth, demand pressures have been building up. Core inflation accelerated to 4.7% from 4.2% in August. While it remains below the medium term target of 5.0%, sustained build-up could invite a tightening response from the Central Bank.

Weekly T-bill Auction Results

	91-Day	182-Day	364-Day
Yield	7.600%	8.590%	9.638%
Change (Bps)	-0.9	-5.6	-3.2
Amount Offered (Bn)	4.00	10.00	10.00
Bids Received (Bn)	3.94	6.54	18.53
Performance (%)	98.52	65.38	185.30
Amount Accepted	3.94	4.40	15.11
Bid-to-Cover Ratio	1.00	1.49	1.23
Redemption (Bn)	0.73	7.02	6.70
New borrowing (Bn)	3.21	2.62	8.41

Source: Central Bank of Kenya

Regional Equities Market

	28.09.2018	05.10.2018	WoW
NSE- 20	2875.51	2864.99	-0.37%
NASI	149.67	150.88	0.81%
NSE- 25	3819.15	3809.99	-0.24%
USE ASI	1824.81	1843.08	1.00%
DSEI	2106.26	2141.74	1.74%
TSI	3950.14	3950.19	0.00%
RSE ALSI	131.54	131.58	0.03%

Source: Regional Stock Exchanges

Stocks mixed but signal remains bearish.

The stock market extended its bearish run to its longest selloff since 2009. The rout has been attributed to general global risk aversion that has seen considerable capital reversals from emerging markets and weak fundamentals reflected in plateauing, if not declining, corporate profits across most sectors.

The third quarter of this year saw all the key benchmark indices record double digit declines. The NASI, NSE-20 and the NSE-25 shaved off 12.5%, 14.2% and 15.6% in the quarter ended 28th September 2018. On a week on week basis, the three indices moved by +0.81%, -0.37% and -0.24% respectively.

Regional Market

	UGANDA		TANZANIA		RWANDA	
Period to Maturity (2018)	Sept 12th	Sept 26th	Sept 19th	Oct 4th	Sept 27th	Oct 4th
91 Days T-Bill	10.112%	9.791%	2.990%	2.980%	5.023%	4.985%
182 Days T-Bill	11.800%	11.900%	5.030%	4.980%	6.225%	6.160%
364 Days T-Bill	12.802%	11.790%	7.900%	7.970%	6.706%	6.797%
Interbank O/N	9.000%	9.000%	1.750%	2.000%	5.300%	5.200%
CBR/CRR/ Key Repo Rate	9.000%	9.000%	8.000%	8.000%	5.500%	5.500%

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

Uganda:

Faced with risks of higher inflation due to persistent exchange rate volatility, rising oil prices and narrowing output gap, the Bank of Uganda (BoU) raised interest rates by 100bps to 10.00% to reign in these inflation expectations. The central bank revised its inflation projections to between 6.5-7.5% from the below 5% earlier in the year. The unexpected decision saw the currency gain 35 shillings to 3775/85 and is expected to remain within the 3770-3800 supported by higher yields.

Given the sensitivity of yield curve to monetary policy guidance, short-term interest rates adjusted upwards across the curve. Interbank rates rose to between 10 and 10.5%. To complement the policy move, the Central Bank mopped up about UGX 987Bn through repos across the week at a rate of 10%. Meanwhile, the twin bond auction of the 2-year and 5-year bonds was oversubscribed. The regulator accepted only UGX 240Bn out of the UGX 572.45Bn received for the papers. The average yield on the 2-year bond eased to 15.50%, down from 16.20%, while that on the 5-year bond rose to 16.9%, up from 14.65% in the previous auction.

Tanzania

Activity in the FX market remained subdued in the week. However, a mismatch in demand and supply saw the shilling give up 2 units to trade at 2282/92 against the US dollar. The shilling is expected to remain vulnerable to rising fuel prices and external debt repayment pressures but proactive intervention by the Bank of Tanzania should keep it below 2300 to the dollar.

Although liquidity conditions remain sound, distribution has been uneven. Flight to quality following the collapse of Bank M triggered some market segmentation, as big banks remain averse smaller players in the market. To stabilize the situation, the Central Bank continued to inject an average of TZS 30Bn through repos on a daily basis. Repo rates have averaged 4-5.5% considerably above the interbank rate at 2.0%.

Relatedly, appetite for government debt remained robust bolstered heavy liquidity and general risk aversion among banks. The 182-day bills oversubscribed at 191% (TZS 63.188Bn/33Bn) while 364-day paper was undersubscribed at 61.85% (TZS64.32Bn/104Bn). Yields barely changed at 2.980% (-1bps), 4.980%(-5bps) and 7.970% (+7bps) on the 91,182 and 364-day bills respectively.

Maturity	Issuer	Amount Outstanding	Principal	Interest
15-Oct-18	Treasury Bill	12.21	12.21	
22-Oct-18	Treasury Bill	25.13	25.13	
29-Oct-18	Treasury Bill	16.69	16.69	
	Treasury Bond-Coupon Payments			15.95
OCTOBER 2018		**54.03**	**54.03**	**15.95**
5-Nov-18	Treasury Bill	16.66	16.66	
12-Nov-18	Treasury Bill	34.69	34.69	
19-Nov-18	Treasury Bill	17.00	17.00	
19-Nov-18	FXD3/2013/5	26.85	26.85	
26-Nov-18	Treasury Bill	18.00	18.00	
	Treasury Bond-Coupon Payments			16.00
NOVEMBER 2018		**113.20**	**113.20**	**16.00**
3-Dec-18	Treasury Bill	34.51	34.51	
10-Dec-18	Treasury Bill	21.49	21.49	
17-Dec-18	FXD3/2016/2	25.54	25.54	
17-Dec-18	Treasury Bill	11.95	11.95	
24-Dec-18	Treasury Bill	32.42	32.42	
31-Dec-18	Treasury Bill	15.61	15.61	
	Treasury Bond-Coupon Payments			18.82
DECEMBER 2018		**141.53**	**141.53**	**18.82**
7-Jan-19	Treasury Bill	8.18	8.18	
14-Jan-19	Treasury Bill	20.16	20.16	
21-Jan-19	Treasury Bill	17.56	17.56	
28-Jan-19	Treasury Bill	16.03	16.03	
	Treasury Bond-Coupon Payments			9.80
JANUARY 2019		**61.93**	**61.93**	**9.80**
4-Feb-19	Treasury Bill	16.63	16.63	
11-Feb-19	Treasury Bill	19.16	19.16	
18-Feb-19	Treasury Bill	19.21	19.21	
25-Feb-19	Treasury Bill	18.00	18.00	
	Treasury Bond-Coupon Payments			11.72
FEBRUARY 2019		**73.01**	**73.01**	**11.72**