June Primary Auction Note

In June, the CBK is offering two fixed coupon treasury bonds for auction. The Central Bank of Kenya is planning to auction an **8.42-year fixed** coupon bond (paying a coupon of **11.000% p.a**) and the **13.92-year fixed** coupon bond (paying a coupon of **12.650% p.a**) in a bid to raise **KES 40 Bn ($ 394.60 Mn)** from investors. The eight-year bond and the fourteen-year bond will both attract a withholding tax of **10%** respectively.

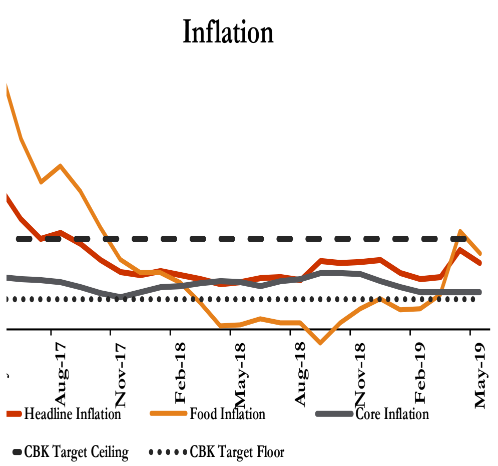
» **Investor focus remains along the short end of the yield curve**. In the current easy liquidity and interest rate uncertainty, investors may continue to focus their efforts towards the shorter bonds. The **8.42-year** fixed coupon bond, **FXD1/2012/15**, is likely to attract a medium to high subscriptions at auction due to its suitably short tenor. The longer term, the **13.92-year** bond, **FXD1/2018/15** will potentially attract lukewarm reception at auction, with low to medium subscriptions the most likely outcome.

» **We advise investors to bid lower for the in demand 8.42-year but bid aggressively for the longer term 13.92-year.** We prescribe investors to bid within the **11.52**% to **11.72**% range for the **8.42-year** or **FXD1/2012/15**, due to our expectation of medium to high subscription from investors for the bond. The longer-term bond, the **13.42-year** or **FXD1/2018/15** will likely witness medium to low subscriptions, so we advise our clients to bid within the **12.40%** to **12.55**% range.

» **Interest rates continue to succumb to the pressure of liquidity in the money markets.** Increased institutional investment into fixed income universe has driven the market yields to fall especially on the shorter end of the yield curve. Investors should note that the government's persistent expansionary fiscal stance heightens the possibility of the possible rise of interest rates in the medium term.

Secondary Bond Market:

In May, activity in the secondary market weakened from its April levels. Turnover last month declined by **18.2%** to **KES 54.61 Bn** (**$ 538.7 Mn**) from **KES 66.75 Bn** (**$ 658.4 Mn**) witnessed in April.



Source: CBK, KNBS, AIB Capital

May Inflation:

CPI weakened slightly in May driven by an abatement in food prices. Inflation in April fell to **5.49%** from **6.58%** recorded in April. The decline of CPI, on a Year on Year basis, was reported driven by the decline of prices of certain foodstuffs such as Spinach, tomatoes and Kales. We expect that with normalization of rainfall this year that inflation could continue to fall in the coming months.

June 7, 2019

Recommendation:
8-Year:
Bid **11.52%** *to* **11.72%%** *for the:*
FXD1/2012/15

14-Year:
Bid **12.40%** *to* **12.55%** *for the :*
FXD1/2018/15

Sovereign Credit Rating :
Moody's: B2 (stable)
Fitch: B+ (stable)
S&P: B+ (stable)

CPI: (2009=100):
205.77

May Inflation:
5.49%

Interbank rate (29th Apr 19):
3.8945%

C.B.R (As set in May-19):
9.00%

91-Day T-Bill (Latest):
6.995%

182-Day T-Bill (Latest):
7.651%

364-Day T-Bill (Latest):
9.311%

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Interbank:

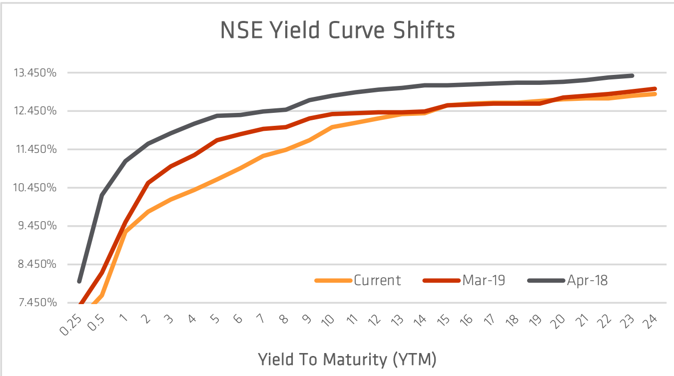
Liquidity eased off at the beginning of June as government payments offset tax remittances. The high liquidity at the end of May and beginning of June drove the interbank lower to hit **3.8945%** as at the 4th of June, compared to the **6.0834%** registered on the 3rd of May. Liquidity is likely to return to easy conditions as the banking sector lending remains suppressed and as government securities continue to mature over June.

T-Bills:

During the month of May, T-bill auctions subscription weakened, with the average subscription rate of **168%** registered in April declining to an average subscription rate of **103%** in May. The Investor's T-Bill need to manage uncertainty but still maximize returns resulted in the **364-da**y T-bill remaining oversubscribed over the month of May at an average subscription rate of **222.1%**. To manage uncertainty but maximize their yield, we advise our clients to continue buying the **364-day** paper.

NSE Yield Curve:

The current yield curve, (**31/5/2019**), continues to be shaped by the easy liquidity in the Fixed Income markets and exhibits a downward shift in the short-term key rates. We continue to iterate to Investors to consider going long on bonds with shorter duration papers to benefit from the possible continued steepening of the yield curve. The bond yields could continue to steepen as a consequence of increased demand and elevated liquidity on the short end of the yield curve. Active managers should consider decreasing their bond portfolio duration by investing mainly in short term bonds to outperform.



Source: NSE, AIB Capital

Currency:

The Kenya Shilling continued to trend lower against the dollar, softening in value against the greenback over the month of May. The greenback gained a minor **0.06%** against the Kenya shilling over May, . At the end of May, the Kenya shilling closed at a value of **KES 101.2806/$** from the **KES 101.1972/$** witnessed at the start of May. The Euro and the Sterling Pound, however, lost ground against the KES in May. The Sterling Pound's, in contrast to the greenback, fell by **3.03%** to **KES 128.0203/£** at the end of May compared to **KES 132.3100/£** witnessed at the start of the month of May.

The CBK's usable foreign exchange reserves rose significantly over the month of May following the successful issue of **USD 2.1Bn** Eurobond at the LSE. The usable forex reserves at the CBK firmed by **26.1%** to hit **USD 10,062Mn** by the end of May, up from the **USD 8,010Mn** recorded at the start of May. The reserves could be boosted by foreign remittances, and increased export earnings this year.

The stability of the shilling in the medium term, we reiterate will be determined by the government's ability to refinance existing debt. The inflow of funds such as the **USD 2.1Bn** issued by the government and extension loan tenors could also help shore up the reserves.

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