Infrastructure Bond Offer- October 2016

The government is looking to raise 30 billion through the issuance of a 15 year infrastructure bond (IFB) with a coupon of 12%. The paper will have partial redemptions as follows; 25% of outstanding principle to be redeemed after 5 years, 33% after 10 years and the rest after 15 years. As with other IFB's this issue will be tax free. The funds have been earmarked for infrastructure projects in Roads, Energy and Water.

Regional Fixed income markets

A look at the returns of fixed income instruments in peer economies, the East African markets stand out as having the most favorable real returns. With robust growth in their respective economies, and stable Macroeconomic environments, they have in the recent past rewarded investors with the best returns in real terms. Uganda for instance had the highest return among the countries we looked at with GDP growth remaining robust as currency performance remaining fairly stable compared to last year (see table below).

	GDP YoY	Interest rate	Inflation	Real return	YTD currency performance
Kenya	6.20%	10.00%	6.34%	3.66%	1.01%
Uganda	3.91%	14.00%	4.20%	9.80%	-1.48%
Tanzania	7.90%	12.00%	4.50%	7.50%	-1.28%
Rwanda	5.40%	6.50%	7.40%	-0.90%	-7.89%
Nigeria	-2.06%	14.00%	17.60%	-3.60%	-35.47%
Ghana	2.50%	26.00%	17.20%	8.80%	-4.37%
South Africa	0.60%	7.00%	5.90%	1.10%	8.05%

Source: *Bloomberg/CBK*

Liquidity-Kenya

The money markets have remained relatively liquid through the month of September and well into October. T-bill Subscriptions have remained high despite the declining interest rates. At an interest average of 8% (8.5% August), the 91 day T-bill has seen subscription rate of 124% in September. The 182 and 364 interest rates averaged at 10.9% and 11.0% and subscriptions of 144% and 194% respectively in September. Going forward we still expect liquidity in the markets to remain awash, on the bark of heavy upcoming maturities (see table below) and a sluggish private sector credit market.

Maturities	Oct-16	Nov-16	Dec-16
T-bond maturities	10,241,380	-	29,375,700
Upcoming coupon payments	11,936,650	14,123,410	17,601,950
T-Bill maturities	64,824,900	82,327,900	59,823,700
Total	**87,002,930**	**96,451,310**	**106,801,350**

Government Borrowing-Kenya

As at close of September 2016 government's domestic debt stood at KES 1.855 trillion compared to KES 1.798 trillion as at close of June 2016. This represents 57 bn in new borrowings. This represents 25% of their target borrowing of KES 225 billion for this year. Looking at the composition of government domestic debt the last 5 years (see table below), we see an interesting trend that suggests a bias towards government looking to lengthen the maturity of its debt. From 15% in 2011, T-Bill's contribution to GOK domestic debt has grown to 34% of government debt as at close of Sept 2016. GOK may be looking to turn this around this financial year, given the favorable interest rate regime.

GOK Domestic Debt composition.						
	2011	**2012**	**2013**	**2014**	**2015**	**2016**
T-Bills	15%	21.20%	28.20%	23.89%	26.68%	33.97%
T-Bonds	85%	78.80%	71.80%	76.19%	73.32%	66.03%

Bidding guide

- Given the good fixed income returns & relatively stable macroeconomic environment in East Africa, we expect foreign inflows into our debt markets to be high. For Kenya, despite the low fixed income return compared to the East African peers, the relatively robust secondary market for IFB's is expected to attract foreign flows for this paper.
- The current and expected high liquidity in the money markets serves as an indicator of expected oversubscription to this specific paper.
- Given that the government is currently slightly behind its borrowing timetable, and the decreasing maturity profile of its debt portfolio, we foresee a high acceptance rate to this paper.
- Current 15 year papers in the secondary market are trading at a yield of 13.6%. Given the tax exempt nature of this paper, the partial redemptions before maturity and the expected high liquidity, we expect the weighted average of the Yield to maturity to be between 12.6% & 13.1%.

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