Reopening of 15 & 20 year bonds - November 2016

The government is looking to raise 30 billion through the reopening of a 15 year bond with a coupon of 12.5% and a 20 year bond with a coupon of 13.75%. The two papers have maturities of 5.96 years and 11.56 years respectively. The two papers are subject to a 10% withholding tax. Bond Issues with maturities of above 10 years are subject to a lower withholding tax of 10%.

Interest rates reverse trend

After yield declines in September and most part of October, yields shifted upwards in November in response to the revision of government domestic borrowing target (see discussion below). An uptick in inflation numbers may have further supported the rise in yields upwards. Inflation for the month of October stood at 6.5% up from 6.3% in September. It is further expected that inflation will rise further due to price pressure on food.

	24-Oct	31-Oct	7-Nov	14-Nov
Interbank	4.40%	3.87%	4.63%	4.98%
91 Day	7.70%	8.03%	8.11%	8.20%
182 Day	10.28%	10.27%	10.30%	10.30%
364 Day	10.41%	10.57%	10.61%	10.70%
5 year	12.44%	12.47%	12.55%	12.65%
10 year	12.85%	12.90%	13.03%	13.10%
20 year	13.87%	13.85%	13.95%	13.96%

Increased appetite for Local Debt

Treasury in its latest Budget Review and Outlook Paper revised its local borrowing target to KES 294.60 Bn up from the initial target of KES 234.00 Bn. Government seems to have shelved its initial plan of financing the fiscal deficit through external credit.

So far (July to date) the government has borrowed KES 74 bn representing 25% of the new target borrowing.

Treasury has shown significant demand for funds having accepted KES 74Bn against the target of KES 64Bn in the last 4 T-bill auctions. The 15 year IFB that was issued Last month had a subscription of 117% and they accepted Kes. 30 Bn at 13.1% against a target of KES 30 Bn. Treasury went ahead and issued a tap sale on the same paper raising KES 7 Bn against a target of KES 10 Bn.

The two issues are expected to be attractive to Banks.

At the current interest rates, government papers seem attractive on a risk adjusted basis compared to lending to private sector. Banking amendment act has forced banks to lend at no more than 400 basis points above the CBR. Looking at the five tiers 1 banks that have released their Q3 earnings results so far, banks seem to be shifting their asset allocation in favor of government securities. Tier 1 banks' liquidity is also significantly high relative to the 20%

minimum requirement. The Table below shows government securities as a % of assets for the five banks and how it has shifted between Sept last year to date.

	Q3 2016	Q3 2015	Liquidity
Equity	17.6%	7.2%	43%
KCB	15.6%	11.0%	38%
Coop	18.7%	12.7%	38%
Barclays	25.1%	20.2%	35%
DTB	23.6%	9.7%	49%

Composition of Government debt

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

- We expect robust demand on these two papers from local tier 1 banks.
- 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 6 year and 12 year papers are trading at 13.1% and 13.7% respectively.
- We recommend that investors bid at between 13.1% and 13.6% for the 15 year reopening and 13.8% to 14.3% for the 20 year reopening.

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