Primary Auction Note - July 2019

In July, the CBK is offering a **15-year** treasury bonds for auction with a market determined coupon. The Central Bank of Kenya is planning to auction the **15-year** Treasury bond in a bid to raise **KES 40 Bn** (**$ 389.11 Mn**) from investors. The bond on offer attracts a withholding tax of **10%**.

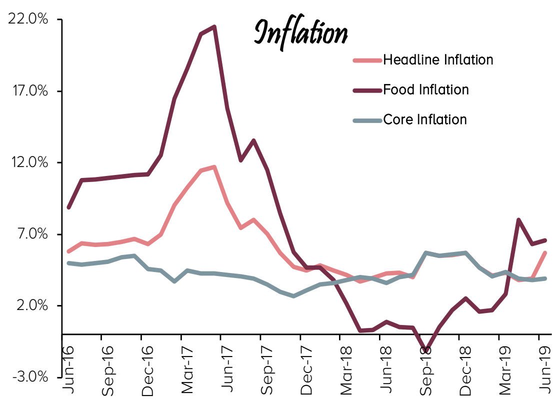
» **Investor focus remains along the short end of the yield curve**. In the current market fraught with easy liquidity and interest rate uncertainty, investors may be forced to continue focusing their efforts towards the shorter end of the yield curve to manage their risks. The **15-year** market-determined coupon bond, **FXD3/2019/15**, is likely to attract a medium to low subscriptions at auction due to its unattractively long tenor.

» **We advise investors to bid aggressively for the 15-year treasury bond.** We prescribe investors to demand a premium for taking the offer during this period of low demand. We prescribe our investors to bid within the range of **12.25%** to **12.35%** for the **15-year** or **FXD3/2019/15**, due to our expectation of medium to low subscription from investors for the bond.

» **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 July the secondary market activity was flat from its June levels. Turnover so far this month, increased by only **1.3%** to **KES 56.74Bn**(**$ 549.44Mn**) from **KES 56.02Bn** (**$ 542.47Mn**) witnessed over the same period in June.



Source: CBK, KNBS, AIB Capital

June Inflation:

CPI remained mute in June driven by a slight increase in food prices. Inflation in June rose to **5.70%** from **5.49%** recorded in May. The flat growth of CPI, on a Year on Year basis, was driven by favourable weather that improved agricultural production pushing food inflation lower. We expect that with enhanced rainfall expected in the June-July-August season we expect inflation to continue falling in the coming months.

July 22, 2019

Recommendation:
15-Year:
Bid **12.25%** *to* **12.35%** *for the:*
FXD 3/2019/15

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

CPI: (2009=100):
204.34

June Inflation:
5.70%

Interbank rate (10th Jun 19):
2.0192%

C.B.R (As set in May-19):
9.000%

91-Day T-Bill (Latest):
6.498%

182-Day T-Bill (Latest):
7.358%

364-Day T-Bill (Latest):
8.785%

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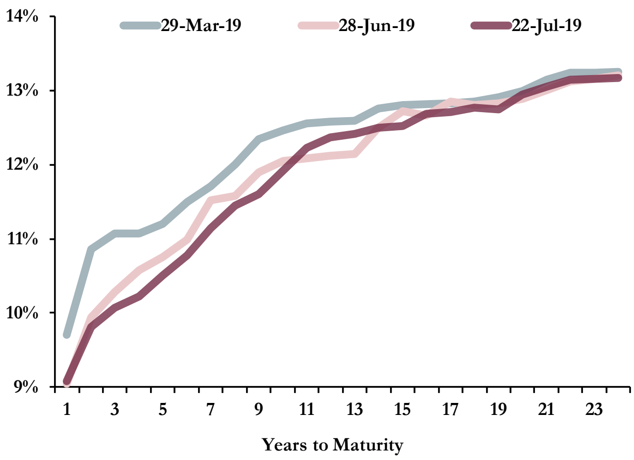
Interbank:

Liquidity remains slightly elevated in July as government payments offset tax remittances. The interbank remains at low single digits at **2.0192%.** The **2.0192%** interbank level is comparable to the **1.9444%** that the interbank closed at the end of June.

T-Bills:

During the month of July, T-bill auctions subscription increased slightly, with the average subscription rate of **153%** registered in June firming up to an average subscription rate of **169%** in July. The Investor's need to manage uncertainty but still maximize returns resulted in the **364-da**y T-bill remaining oversubscribed over the month of July, achieving an average subscription rate of **296.27%**. To manage uncertainty but maximize their yield, we advise our clients to continue buying the **364-day** paper.



Source: NSE, AIB Capital

NSE Yield Curve:

The current yield curve, (**22/7/2019**), 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.

Currency:

The Kenya Shilling continued to trend lower against the dollar, softening in value against the greenback since the start of the year. The greenback has gained **1.2%** against the Kenya shilling since the start of 2019. On the 19th of July, the Kenya shilling closed at a value of **KES 103.1028/$** from the **KES 101.8322/$** witnessed at the start of the year. The Euro, however, has lost ground against the KES. The Euro is down **0.6%** from levels witnessed at the start of the year to currently trade at **KES 115.6055/€**. The Sterling Pound's, in contrast to the greenback, fell slightly by **0.7%** to **KES 128.5947/£** by the 19th of July compared to **KES 129.4583/£** witnessed at the start of the year.

The CBK's usable foreign exchange reserves declined marginally over the month of July. The usable forex reserves at the CBK softened by **3.3%** to hit **USD 9,747 Mn** by the 18th July, down from **USD 10,083Mn**. 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 demonetization. The inflow of funds from debt issued by the government and extension loan tenors could also help shore up the reserves.

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