Primary Auction Note - Aug 2019

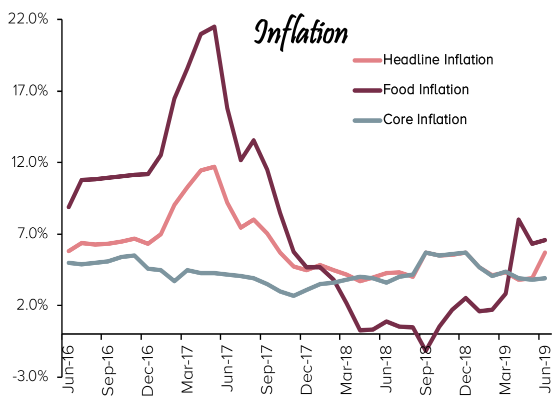
In August, the Central Bank of Kenya (**CBK)** is offering two treasury bonds for auction: a **10-year** (**FXD 3/2019/10**) and reopening a **20-year** (**FXD 1/2019/20**) treasury bond in a bid to raise **USD 50Bn** for budgetary support. The **10-year** fixed-coupon treasury bond (**FXD 3/2019/10**) will have a market determined coupon. On the other hand, the reopened **20-year** fixed-coupon treasury bond is offered with a coupon of **12.873%.** It is worth noting that a withholding tax of **10%** applies to both bonds.

» 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. The **10-year** market-determined fixed-coupon bond, **FXD3/2019/10,** is likely to attract a medium to high subscription at auction, due to its attractively short tenor. The **20-year** market-determined coupon bond, (**FXD1/2019/20**), in contrast is likely to attract a low to medium subscription at auction due to its long tenor.

» We advise investors to bid aggressively for the **10-year** treasury bond but be reserved when bidding for the reopened **20-year**. We advise investors to bid competitively for the in-demand **10-year,** we advocate for a range between **11.45%** and **11.70%**. We also prescribe investors to demand a premium for taking on the **20-year** FXD treasury bond offer during this period of low demand. We specify to our investors to consider bidding within our ideal range of **12.65%** and **12.85%,** for the **20-year** or **FXD1/2019/20**, due to our expectation of a medium to low subscription from investors for the bond.

Secondary Bond Market:

In July, the secondary market activity firmed up from its June levels. Turnover last month, increased by only **21.3%** to **KES 84.67Bn($ 819.47Mn)** from **KES 69.77Bn** (**$ 675.30Mn**) witnessed over the same period in June.



Source: CBK, KNBS, AIB Capital

July Inflation:

Headline Inflation accelerated over the month of July mainly driven by the low July 2018 base. Inflation in July rose to **6.27%** from **5.70%** recorded in June. We expect that with adequate rainfall expected in the June-July-August season we expect inflation to continue falling in the coming months.

August 8, 2019

Recommendation:

10-Year:
Bid **11.45%** *to* **11.70%** *for the:*
FXD 3/2019/10

20-Year:
Bid **12.65%** *to* **12.85%** *for the:*
FXD 1/2019/20

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

CPI: (2009=100):
203.61

June Inflation:
6.27%

Interbank rate (7th Aug 19):
3.3027%

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

91-Day T-Bill (Latest):
6.547%

182-Day T-Bill (Latest):
7.254%

364-Day T-Bill (Latest):
9.038%

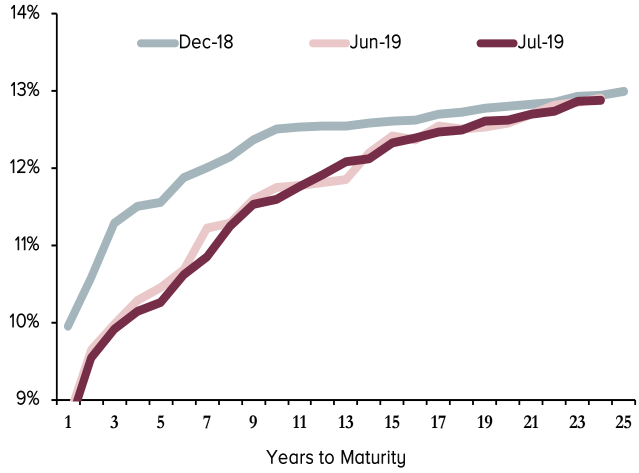
Analyst
Victor Koech
+254711047133
koechv@aibcapital.com

Interbank:

Liquidity remains slightly elevated driven by government payments. The interbank remains at low single digits at **3.3027%**. The **3.3027%** interbank level reported by the 7th August, 2019, is slightly higher than the **2.4461%** that the interbank closed at the end of July.

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 **138.4%** in July. The Investor's need to manage uncertainty but still maximize returns resulted in the **364-day** 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 **1.34%** against the Kenya shilling since the start of 2019. On the 6th of August, the Kenya shilling closed at a value of **KES 103.2014/$** from the **KES 101.8322/$** witnessed at the start of the year. The Euro, however, has lost ground against the KES. The Euro is down **0.86%** from levels witnessed at the start of the year to currently trade at **KES 115.4042/€**. The Sterling Pound's, in contrast to the greenback, fell slightly by **3.0%** to **KES 125.5544/£** by the 6th of August 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 **2.8%** to hit **USD 9,490 Mn** by the 1st August, down from a July high of **USD 9,765 Mn**. 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.

RESEARCH DISCLOSURE

Though utmost care has been taken in the preparation of this report, we do not guarantee the accuracy or completeness of the information contained herein nor will AIB Capital Ltd be held liable for the information contained herein.

The views expressed in this report are solely those of the Research Department and are subject to change without notice.

The information in this report is not an offer for the sale or purchase of any security. This document should only be considered a single factor used by investors in making their investment decisions.

This publication may not be distributed to the public media or quoted or used by the public media without prior and express written consent of AIB Capital Ltd.

NOTICE TO US INVESTORS

This report was prepared, approved, published and distributed by AIB Capital Limited Company located outside of the United States (a non-US Group Company"). This report is distributed in the U.S. by LXM LLP USA, a U.S. registered broker-dealer, on behalf of AIB Capital Limited only to major U.S. institutional investors (as defined in Rule 15a-6 under the U.S. Securities Exchange Act of 1934 (the "Exchange Act")) pursuant to the exemption in Rule 15a-6 and any transaction effected by a U.S. customer in the securities described in this report must be effected through LXM LLP USA.

Neither the report nor any analyst who prepared or approved the report is subject to U.S. legal requirements or the Financial Industry Regulatory Authority, Inc. ("FINRA") or other regulatory requirements pertaining to research reports or research analysts. No non-US Group Company is registered as a broker-dealer under the Exchange Act or is a member of the Financial Industry Regulatory Authority, Inc. or any other U.S. self-regulatory organization.

Analyst Certification. Each of the analysts identified in this report certifies, with respect to the companies or securities that the individual analyses, that (1) the views expressed in this report reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly dependent on the specific recommendations or views expressed in this report. Please bear in mind that (i) AIB Capital Limited is the employer of the research analysts responsible for the content of this report and (ii) research analysts preparing this report are resident outside the United States and are not associated persons of any US regulated broker-dealer and that therefore the analysts are not subject to supervision by a US broker-dealer, and are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with US rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

Important US Regulatory Disclosures on Subject Companies. This material was produced by Analysis AIB Capital Limited solely for information purposes and for the use of the recipient. It is not to be reproduced under any circumstances and is not to be copied or made available to any person other than the recipient. It is distributed in the United States of America by LXM LLP USA and elsewhere in the world by AIB Capital Limited or an authorized affiliate of AIB Capital Limited. This document does not constitute an offer of, or an invitation by or on behalf of AIB Capital or its affiliates or any other company to any person, to buy or sell any security. The information contained herein has been obtained from published information and other sources, which AIB Capital Limited or its Affiliates consider to be reliable. None of AIB Capital Limited accepts any liability or responsibility whatsoever for the accuracy or completeness of any such information.

All estimates, expressions of opinion and other subjective judgments contained herein are made as of the date of this document. Emerging securities markets may be subject to risks significantly higher than more established markets. In particular, the political and economic environment, company practices and market prices and volumes may be subject to significant variations. The ability to assess such risks may also be limited due to significantly lower information quantity and quality. By accepting this document, you agree to be bound by all the foregoing provisions.

LXM LLP USA assumes responsibility for the research reports content in regards to research distributed in the U.S. LXM LLP USA or its affiliates has not managed or co-managed a public offering of securities for the subject company in the past 12 months, has not received compensation for investment banking services from the subject company in the past 12 months, does not expect to receive and does not intend to seek compensation for investment banking services from the subject company in the next 3 months. LXM LLP USA has never owned any class of equity securities of the subject company. There are not any other actual, material conflicts of interest of LXM LLP USA at the time of the publication of this research report. As of the publication of this report LXM LLP USA, does not make a market in the subject securities.