Primary Auction Note - Sep 2019

In September, the Central Bank of Kenya **(CBK)** is reopening two fifteen-year fixed coupon treasury bonds for auction. The double reopens includes the issues numbered **FXD 1/2018/15** and **FXD 2/2019/15**. The auction of the reopened twin **15-year** fixed coupon treasury bonds will be hoping to raise **KES 50Bn** (**$ 482.28Mn**) for budgetary support. The tenors for the **FXD 1/2018/15** & **FXD 2/2019/15** fixed-coupon treasury bond are **13.67 years** and **14.63 years** respectively. It is worth noting that a withholding tax of **10%** applies to both bonds.

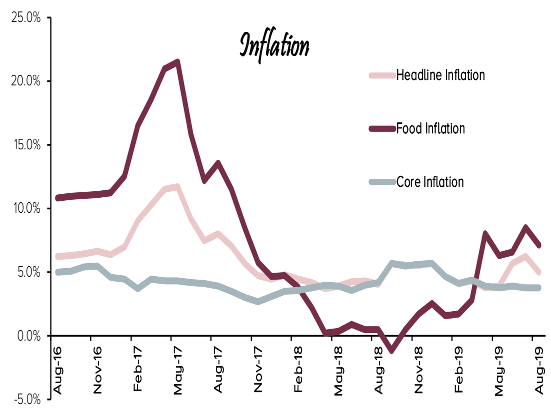
» **Investor focus remains along the short end of the yield curve.**

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 two reopened **15-year** fixed-coupon treasury bonds, **FXD 1/2018/15** & **FXD 2/2019/15 ,** is likely to attract a low to medium subscription at auction, due to their relatively long tenor.

» We advise investors to bid aggressively for the two re-opened **15-year** treasury bond. We currently are advocating for a range between **12.15%** and **12.35%** for the **FXD 1/2018/15** due to our expectation of a low to medium subscription for the **13.67-year** tenor bond. For the latter re-opened bond, **FXD 2/2019/15,** we are advice clients to be aggressive within the range of **12.40%** and **12.60%.** Our recommendation for **FXD 2/2019/15** is informed by our expectation of a low to medium subscription for the **14.63-year** tenor bond.

Secondary Bond Market:

In August, the secondary market activity weakened from July levels. Turnover last month, decreased by **51.3%** to **KES 41.20Bn** (**$ 397.41Mn**) from **KES 84.67Bn**(**$ 816.69Mn**) witnessed over the same period in July.



Source: CBK, KNBS, AIB Capital

August Inflation:

Headline Inflation decelerated over the month of August mainly driven by the decline of food inflation. Inflation in July fell to **5.00%** from **6.27%** recorded in July. We expect that with adequate rainfall expected in the October-November-December season we expect inflation to continue falling in the coming months.

September 16, 2019

Recommendation:

15-Year:
Bid **12.15%** *to* **12.35%** *for the:*
FXD 1/2018/15

15-Year:
Bid **12.40%** *to* **12.60%** *for the:*
FXD 2/2019/15

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

CPI: (2009=100):
201.78

August Inflation:
5.00%

Interbank rate (13th Sep 19):
6.3356%

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

91-Day T-Bill (Latest):
6.315%

182-Day T-Bill (Latest):
7.143%

364-Day T-Bill (Latest):
9.582%

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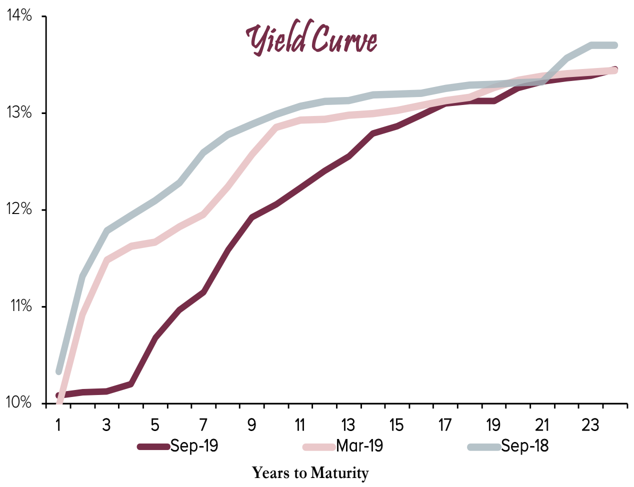
Interbank:

The easy liquidity that was present in July and August has dissipated. As at 12th September the interbank had hit a four month high of **6.5710%**. The interbank elevation over September is likely driven by Central Bank's mopping up of liquidity to manage the demonetization process. The Liquidity is likely to continue tightening as CBK continues to mop up excess liquidity. The tightening of liquidity in turn will keep the interbank rate at the **5.5%** to **6.5%** range.

T-Bills:

During the month of August, T-bill auctions subscription let-off slightly. The average subscription rate of **162.5%** registered in July weakened up to an average subscription rate of **104.7%** in August. 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 **129.7%.** 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, (**06/9/2019**), continues to be shaped by the easy liquidity in the Fixed Income markets and exhibits a downward shift in the short-term and medium-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 **1.91%** against the Kenya shilling since the start of 2019. On the 13th of September, the Kenya shilling closed at a value of **KES 103.7889/$** from the **KES 101.8322/$** witnessed at the start of the year. The Euro, however, has lost ground against the KES. The Euro is down **2.06%** from levels witnessed at the start of the year to currently trade at **KES 114.0436/€**. The Sterling Pound's, in contrast to the greenback, has also fallen on a year to date basis. The Sterling pound is now down by **0.87%** currently at **KES 127.8994/£** 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 **5.6%** to hit **USD 9,218 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.

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