Fixed Income Note:

Primary Auction- Sep-18

Monday, September 17, 2018

AIB Capital Ltd.

Your Vision... Our Mission

Recommendation:

Bid 12.700% to **12.450%** range **FXD1/2018/10Yr (Reopen)**

Bid 13.000% to **12.800%** range **FXD1/2018/20Yr (Reopen)**

Sovereign Credit Rating (outlook):

Moody's: *B2 (stable)*

Fitch: *B+ (stable)*

S&P: *B+ (stable)*

CPI: (2009=100)

192.18

August Inflation:

4.04%

Interbank rate (5th Sep 2018):

5.27% (weighted average)

C.B.R (As set on 30th Jul 18):

9.00%

91-Day T-Bill (6th Sep 18):

7.649%

182-Day T-Bill (6th Sep 18):

8.876%

364-Day T-Bill (6th Sep 18):

9.825%

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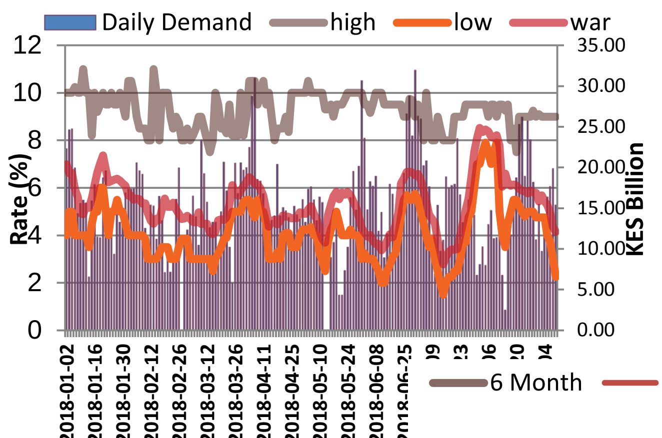
September Fixed Income Note:-

The Government plans to reopen a 10 Year and 20 Year Fixed Coupon Bond

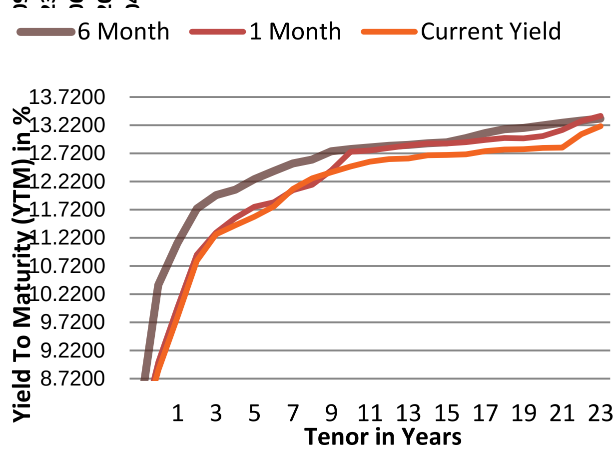
This month the CBK will be looking to raise **KES 40Bn (USD 398.28Mn)** for budgetary support by reopening two fixed coupon Treasury bonds. The government plans to reopen of a **9.99**-year (**FXD1/2018/10**) and a **19.92**-year bond (**FXD2/2018/20**) with a **12.686%** (**9.99yrs**) and **13.200%** (**19.92yrs**) in coupon respectively. We expect a moderate subscription with an expected tap sale. We recommend investors to place their bid between **12.700% to 12.450%,** for the **9.99**-year fixed coupon bond (or **FXD1/2018/10**) and bid between **13.000%** to **12.800%** for the 19.92-year fixed coupon bond (or **FXD2/2018/20)**.

A total of **KES 61.55Bn (USD 610.95Mn)** (in coupons and maturities) will be redeemed in September of 2018. Redemptions for the months of October and November will be **KES 31.90Bn (316.65Mn)** and **KES 21.07Bn (209.18Mn)** respectively.

Secondary Market: The Secondary bond market in August posted a muted performance, with turnover growing by **0.78%** to a total bond turnover of **KES 45.06Bn (USD 0.45Bn)** from a turnover of **KES 44.71Bn (USD 0.44Bn)** recorded in July. De-escalation in bond turnover is most likely to continue helped on by general market reduced appetite for primary bond issues. Expectations of a government policy change and uncertainty over future interest rate changes shifted forced market focus away from primary bonds issues to Treasury bill issues.



Interbank: The interbank rates in September are currently on a downward trend driven by improved liquidity. The weighted average monthly rate declining from **6.79%** recorded in August to a monthly average of **4.98%**. The average monthly interbank volume, however, in September increased to **KES 15.3Bn**, a **4.9%** increase from the average monthly interbank volume of **KES 14.59Bn** registered in May of this year.



NSE Yield Curve: The current yield curve, for the week ended on the 7th September 2018, continued to exhibit a downward shift in the short and long-term key rates. We advise our clients to consider going long on the short term papers to preserve their bond portfolio value from a possible flattening of the yield curve. We see the possibility of the bond yields flattening as a consequence of Kenya's monetary policy shift with a possible upward pressure coming from accelerated government borrowing.

September Inflation: We project inflation in September to fall within the range **4.0%** to **4.5%,** from the current **4.04%** due to the persistent rise in pump prices, a possible rise in electricity costs and the threat of an increase in transport costs will possibly put an upward pressure on headline inflation. We especially see the continuing escalation of charcoal and the continuing rise of pump prices as key drivers that will continue to push the Housing, Water, Electricity, Gas and Other Fuels' Index upwards to double-digit levels of inflation.

CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 3

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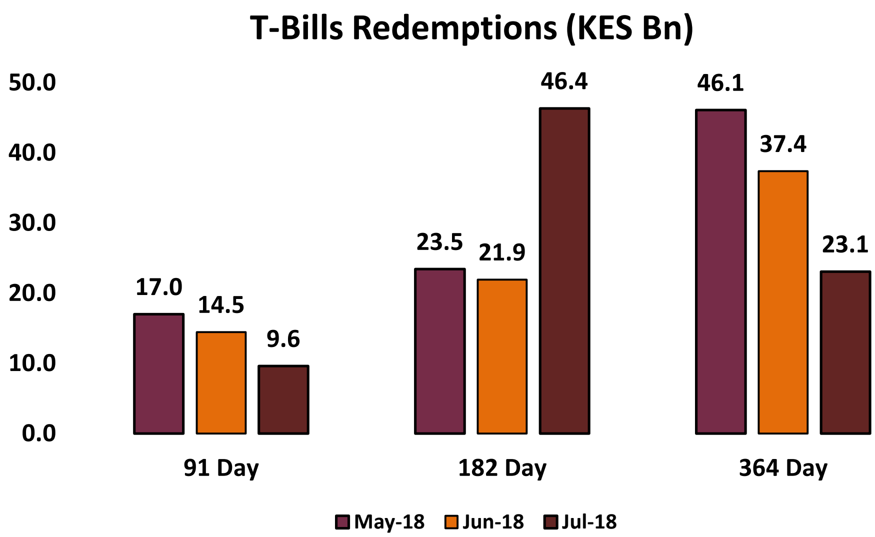


T-Bills: Subscriptions levels for the last four auctions stood at **137%** or an equivalent **KES 32.84Bn (USD 326.01Mn)** per auction**.** The acceptance rate, however, firmed to **82.4%.**

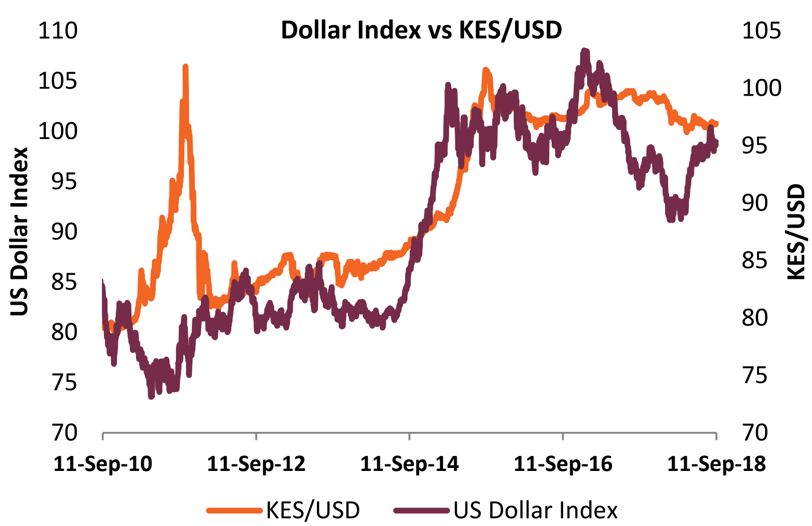
Investors continue to focus towards the 364-day paper with the rates falling to four week average of **9.926%.** The 91-day paper average four-week subscription also firmed up to **138.95%** and as rates at auction fell to **7.649%**in the last auction, from the **7.664%** recorded on the 20th of August**.**

We advise our clients to maintain investment on the 364 day paper at 9.80%, to achieve the best balance between yield enhancement and downside protection from interest rate risk.

Forex: The Kenya Shilling opened September at a **KES 100.6483/USD, 3.53 basis points (bps)** lower from the August average of **KES 100.6128/USD.** In congruence with its early September performance, the shilling remains relatively flat on a month on month basis, has so far depreciated by only **0.34%** from **KES 100.4639/USD** registered on the 10th of August to stand at **KES100.8083/USD** on the 11th of September**.** On a Year To Date (**YTD**) basis, the Kenya shilling has, however, appreciated against most major currencies: KES has strengthened by **2.12%** so far against the greenback (from **KES102.9944/USD** to **KES100.8083/USD**), appreciated by **5.77%** against the Euro (from **KES123.9786/EUR** to **KES116.8294/EUR**) and gained **4.23%** against the Sterling Pound (from **KES123.9786/GBP** to **KES116.8294/GBP**).

Forex reserves stood as of the 6th of September stood at **USD 8,565 Mn** or **5.71 months** of import cover. The foreign reserves have declined by 2.24% in the last five weeks from **USD 8,761 Mn** registered on the 02nd of August.

The shilling is bound to continue coming under pressure from importers demand for major foreign currency demand.



The dollar firmed up against most major currencies in September due to a stronger than expected increase in American wages in August. The greenback, however, is still in danger of slipping down further driven by the looming global trade war with the likes of China, Canada and the European Union. The Dollar index plunged **0.98% on a** Month on Month (**MoM**), to **95.28 points** but on a Year on Year (**YoY**) basis it rose **3.73%** from **91.85 points** recorded on the 11th of September last year**.**

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