Fixed Income Note:

Primary Auction- Oct-18

Friday, October 12, 2018

AIB Capital Ltd.
Your Vision… Our Mission

Recommendation:
Bid 12.750% or At Par for FXD2/2018/10Yr

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

CPI: (2009=100)
194.14

September Inflation:
5.70%

Interbank rate (11th Oct 2018):
3.3884%

C.B.R (As set on 25th Sep 18):
9.00%

91-Day T-Bill (6th Sep 18):
7.600%

182-Day T-Bill (6th Sep 18):
8.590%

364-Day T-Bill (6th Sep 18):
9.638%

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October Fixed Income Note:-

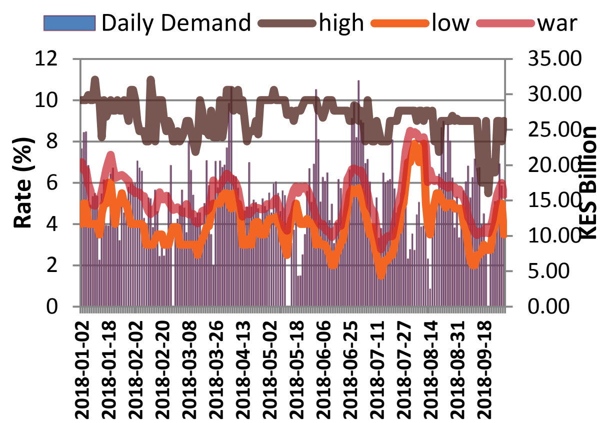
The Government plans issues a 15 Year Fixed Coupon Bond

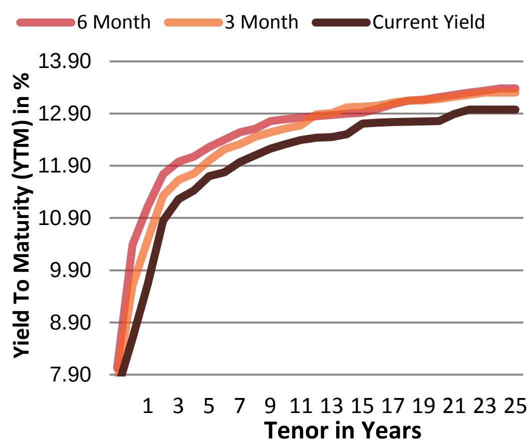
This month the CBK will be looking to raise **KES 40Bn (USD 396.55Mn)** for budgetary support by issuing a single fixed coupon Treasury bond. The government plans to issue of a **15.00**-year (**FXD2/2018/15)** with a **12.750%** coupon. We expect a moderate to luke warm subscription. We recommend investors to place their bid **12.75%** or **At Par** for the **15.0-**year fixed coupon bond (or **FXD2/2018/15**).

A total of **KES 31.92Bn (USD 316.52Mn)** (in coupons and maturities) will be redeemed in October of 2018. Redemptions for the months of November and December will be **KES 66.52Bn (659.65Mn)** and **KES 63.12Bn (625.91Mn)** respectively.

Secondary Market: The Secondary bond market in September managed only a muted performance, with turnover shrinking by **3.6%** to a total bond turnover of **KES 38.09Bn (USD 377.61Mn)** from a turnover of **KES 39.49Bn (USD 391.54Mn)** recorded in August. The slowdown of the bond turnover in the secondary market is likely to continue encouraged on by the general market reduced appetite for primary bond issues.

Interbank: The interbank rates in early October, is currently on an upward trend driven by deteriorating liquidity. The tight liquidity was driven by increased demand of funds to facilitate tax remittances. 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, (**05/10/2018**), continued to exhibit a downward shift in the short and long-term key rates. Investors should consider going long on a bonds with longer duration papers to benefit from an increased portfolio sensitivity to the possible flattening of the yield curve. The bond yields could continue flattening as a consequence of Kenya's monetary policy shift, with a possible upward pressure from government borrowing. Active managers should consider increasing their bond portflio duration by investing mainly in long term bonds to outperform.

October Inflation: We see inflation in October to further escalate from the current September inflation of **5.7%** to fall within the range of **5.5%** to **6.5%.** The headline inflation will come under upward pressure from the persistent rise in the **Housing, Water, Electricity, Gas and other Fuels Index** and the related **Transport index.** Global pump prices still remain key drivers for headline inflation in the short term, with US sanctions on Iran having the potential to keep driving the price of crude oil higher and as a consequence push pump prices upwards.

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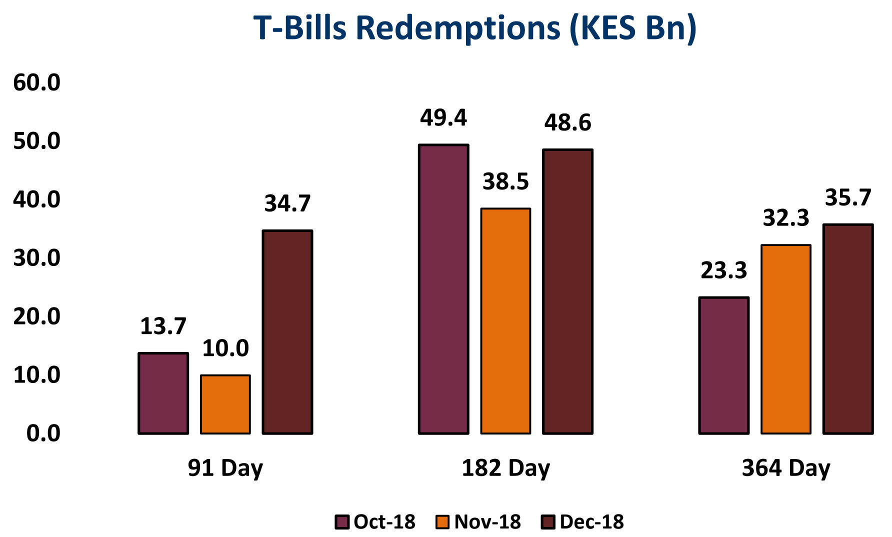


T-Bills: Subscriptions levels for the last four auctions stood at **133.81%** or an equivalent **KES 32.38Bn** (**USD 323.75Mn)** per auction**.** The average acceptance rate in the last four auctions, however, softened to **86.03%** from the **90.45%** acceptance rate recorded in the same period previously.

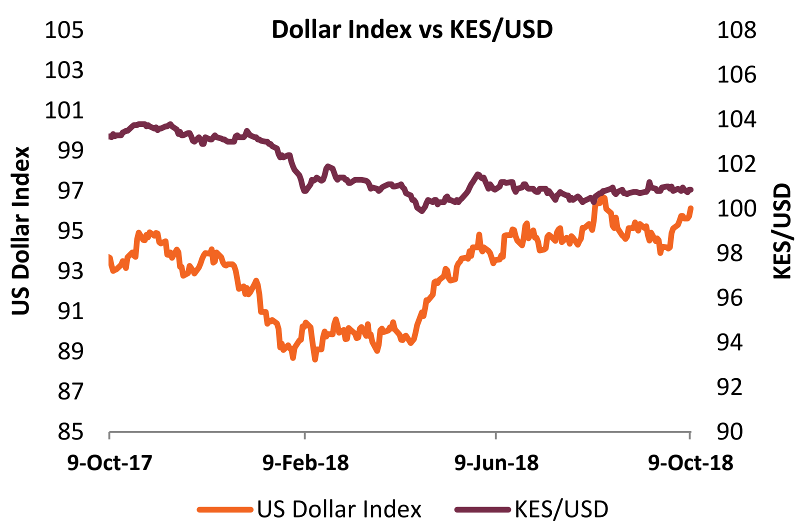
Investors continue to focus towards the **364-day** and **132-day** paper with the rates falling in the last six months by **145.6bp** and **173.9bp** respectively to yield **9.670%** and **8.646%** in the last auction**.** The **364-day** and **182-day** performance rate in the last 4-weeks improved from a 4-week average bid to offer ratio of **153.59%** and **69.34%** respectively recorded in August to **157.09%** and **114.88%** in September

We advise our clients to maintain investment on the 364 day paper at 9.670%, to achieve the best balance between yield enhancement and downside protection.

Forex: The Kenya Shilling opened on the second week of October at a **KES 100.8500/USD, 1.8 basis points (bps)** flat from the September average of **KES 100.8317/USD.** The early October performance, however, is in contrast with the Kenyan shilling last three months performance. The shilling in the last three month, has so far also remained flat from **KES 100.8861/USD** recorded on the 2nd of July to stand at **KES 100.8500/USD** by the 8th of October**.** On a Year To Date (**YTD**) basis, the Kenya shilling has, however, appreciated against most major currencies: KES has strengthened by **2.37%** so far against the greenback (from **KES103.2944/USD** to **100.8500/USD**), appreciated by **6.12%** against the Euro (from **KES123.8564/EUR** to **KES116.2736/EUR**) and gained **5.63%** against the Sterling Pound (from **KES 139.6533/GBP** to **KES131.7886/GBP**).

Forex reserves stood as of the 6th of September stood at **USD 8,652 Mn** or **5.60 months** of import cover. The foreign reserves have declined by **3.44%** in the last six 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 continued to firm up against most major currencies in early October as the Italian budget drama during the week weighed on the Euro. The greenback, however, is still in danger of slipping down with the looming global trade war with the likes of China, Canada and the European Union. The Dollar index surged **1.03% on a** Month on Month (**MoM**), to **96.13 points** but on a Year on Year (**YoY**) basis it rose **2.63%** from **93.67 points** recorded on the 9th of October last year

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