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# January Primary Auction Note

**Date: 10 January 2019**

**Recommendation:**
Bid 12.60% to 12.75% for **FXD 1/2019/15**

Bid 10.65% to 10.75% for **FXD 1/2019/2**

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

CPI: (2009=100) 193.51

December Inflation: 5.71%

Interbank rate (7th Jan-19): 4.80%

C.B.R (As set in Nov-18): 9.00%

91-Day T-Bill (7th Jan-19): 7.32%

182-Day T-Bill (7th Jan-19): 9.00%

364-Day T-Bill (7th Jan-19):10.01%

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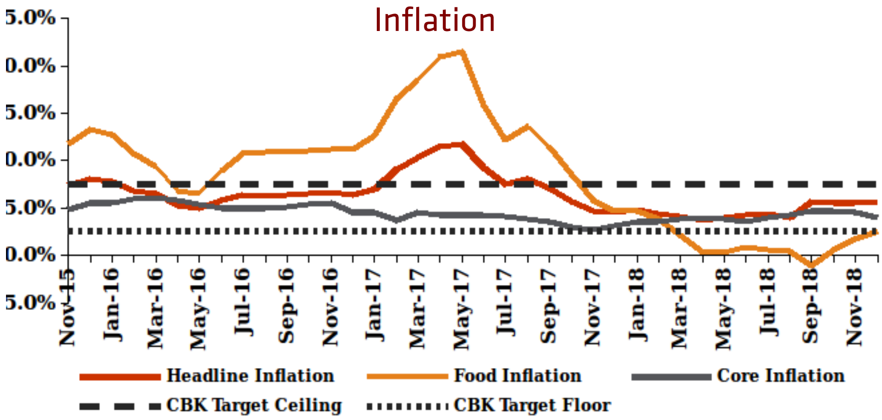
In January, the CBK is auctioning two market determined bonds: a **15-year bond (FXD 1/2019/15)** and a **2-year bond (FXD 1/2019/2)**, in a bid to raise a total of **KES 40 billion (USD 393.0 million)** for budgetary support. The coupon for both of the fixed coupon treasury bonds will be market determined. The short term paper is most likely to be the most attractive to the market. The reception for the **15-year** at the auction on the other hand may be lukewarm. We expect subscription rates to be high for the **2-year bond** thus we advise investors to bid within **10.65%** to **10.75%.** Those investors who find the 15-year bond suitable, we advise them to bid between **12.60%** to **12.75%.**

Interest rates have been on a downward trend supported by high money market liquidity. The government increased demand for domestic debt, the treasury raised its domestic borrowing target by **KES 100 billion**, could exert upward pressure on interest rates in 1H19. It should be noted that the government is currently almost **30%** off the pace of domestic borrowing targets.

This year CBK has been auctioning long term bonds thus a short term paper will be received well. Liquidity has been on the mend in January helped on by government payments and net redemptions over the month.

**Secondary Bond Market:** In December, activity in the secondary market in remained continued to be muted. Turnover during the month declined a further **44%** to **KES 21.23 Billion (USD 208.6 Million)** from **KES 38.0 Billion (USD 373.66 Million)** recorded in November.

Figure 1: January Inflation



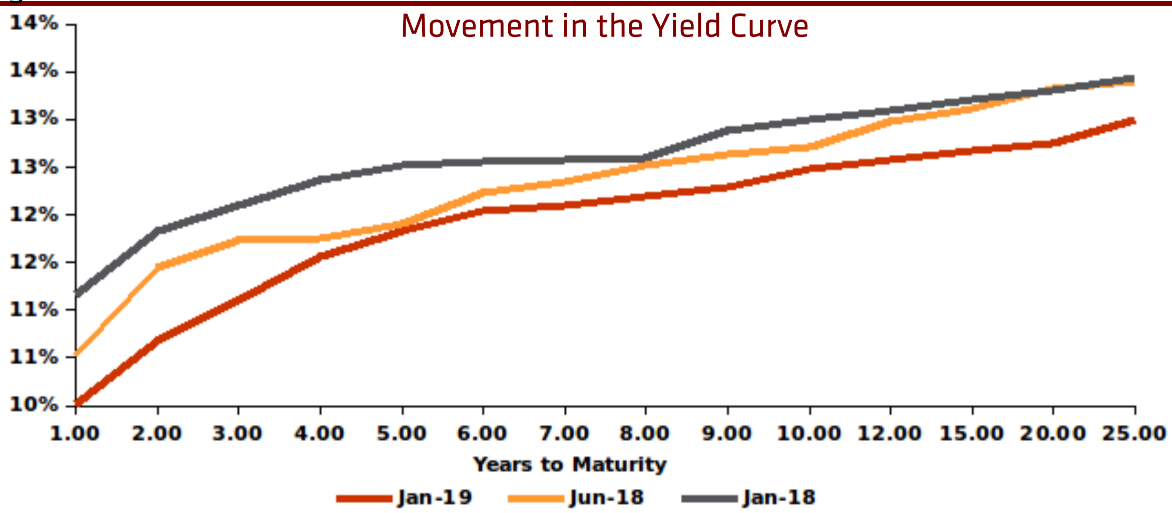

**January Inflation:** CPI accelerated in December driven by festivities inspired consumer spending. Inflation rose to **5.71%** from **5.58%** recorded previously. The slight increase in the CPI reported was driven be a firming up of transport prices, fuel costs and a price increase in alcoholic beverages. The Headline inflation in January should continue weakening helped by decline in transport costs, weakening petroleum prices and improved food production. Longer term outlook inflation remains positive with adequate rainfall expected this year and global prices of crude oil expected to be constrained by a global crude oil supply glut.

CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 3

**Interbank:** Money market liquidity improved in the first week of January helped on by government payments and net redemption of government securities. The interbank in January has fallen from a weighted average of 6.73% at the end of last year to 4.80% on 4th of January 2019.

**T-Bills:** During the month of December, T-bill auctions under subscription firmed up, with the average subscription rate of 84.1% registered in November falling lower in December to record an average subscription rate of 60.9%. Uncertainty continued to inspire a December average 91day T-bill subscription rates of 112.3%. To the manage the uncertainty surrounding interest rates, we advise our clients to buy the short-term papers as rates could increase in 1H19.

Figure 2: Movement in the Yield Curve




**NSE Yield Curve:** The current yield curve, (4/1/2018), continued to exhibit a downward shift in the short and long-term key rates. Investors should consider going long on bonds with shorter duration papers to benefit from the possible steepening of the yield curve. The bond yields could continue steepen as a consequence of increased demand 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 closed out the end of the year strong against major currencies. The KES managed to bounce back from downward pressure in the previous month to close out at KES 101.8461/USD at the end of December, a 0.68% appreciation from the KES 102.5444/USD it opened at the beginning of the month. The December strengthening of the Kenya Shilling was also evident against other major currencies namely: the Sterling Pound (appreciated by 0.8%), EURO (appreciated by 0.1%) and against the Rand (appreciated by 3.2%). The strength of the shilling was mostly driven by tight liquidity and lower dollar demand during the long festive season. Tailwinds such as a record two million arrivals and diaspora remittances may also have been a contributing factor.

CBK's continued intervention in the forex market led to a decrease in forex reserves which stood at USD 8.039 Billion at the end of November to currently stand at USD 7.969 Billion as at 3rd January. the current CBK usable Foreign Exchange Reserves represents 5.22 months of import cover.

The stability of the shilling in 2019 we reintegrate will be determined by the government's ability to refinance existing debt. A syndicated loan and a 5-year Eurobond are maturing in 2019. The repayment of this maturing debt, such as the maturing 5-year Eurobond and a maturing syndicated loan could decrease CBK's usable reserves. The inflow of funds and extension loan tenor could also help shore up the reserves.

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