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February Primary Auction Note

Date: 13 March 2019

Recommendation:
Bid **12.50%** to **12.80%** for **IFB 1/2019/25**

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

CPI: (2009=100)
195.78

February Inflation:
4.14%

Interbank rate (12th Mar-19):
3.963%

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

91-Day T-Bill (11th Mar-19):
6.886%

182-Day T-Bill (11th Mar-19):
8.346%

364-Day T-Bill (11th Mar-19):
9.469%

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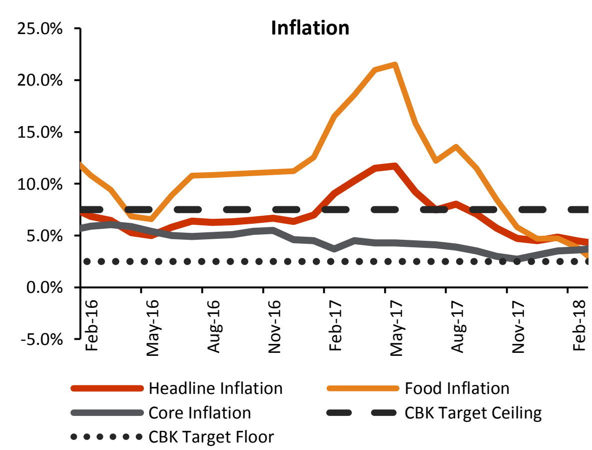
In March, the CBK is offering a 25-year amortized bond, worth **KES 50Bn**, to partially fund infrastructure projects in: water, energy and transport sectors. The **25-year** Infrastructure Bond (**IFB 1/2019/25**) offers a coupon of **12.20%.** This issued **IFB 1/2019/25** will attract no tax as is the nature of all Infrastructure Bonds.

In the current high market uncertainty and investor inclination towards the shorter end of the yield, the long term **IFB 1/2019/25** will potentially attract lukewarm reception at auction. With low subscriptions the most likely outcome, we prescribe investors to bid within the **12.50%** to **12.80%** range.

Interest rates continue to succumb to the downward pressure of liquidity in the money markets. High supply of investments into the fixed income universe has driven the market yields to fall especially on the shorter end of the yield curve. Upward risk for the rise of interest rates in the medium term, given the low probability of fiscal consolidation and high rollover risks present in the government's domestic debt portfolio. The government persistent expansionary fiscal stance also heightens the possibility of the possible rise of interest rates in the medium term.

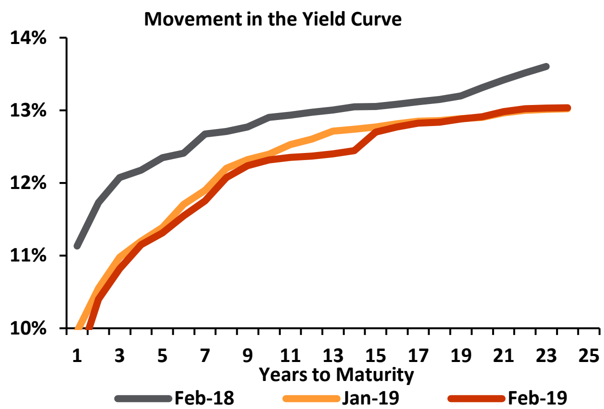
Secondary Bond Market: In February, activity in the secondary market in remained flat from its performance in January. Turnover during the month marginally grew by **0.62%** to **KES 45.86 Billion** (**USD 458.3 Million**) from **KES 45.58 Billion** (**USD 455.51 Million**) recorded in January.

February Inflation: CPI continued to decelerate in February driven by decline in food and transport inflation. Inflation fell to **4.14%** from **4.70%** recorded last month. The slight decline in the CPI reported was driven by the decline in the price of maize flour, spinach and tomatoes that drove food inflation lower. The decline in pump prices was also a contributing factor in the decline of headline inflation. The Headline inflation was suppressed by the **0.5%** decrease in the transport index. The transport sector in February enjoyed relief from the reduction of petrol and diesel prices over the month on February. Core inflation also weakened marginally over the month of February from **3.51%** to **3.08%**



Interbank: The high money market liquidity that was ever present in January moderated in February. Tax remittances at the end of February weakened the level of money market liquidity. The interbank in saw rise from a weighted average of **1.79%** on 7th February to hit **5.07%** by the end of February in direct response to the tightening of liquidity.

T-Bills: During the month of February, T-bill auctions subscription weakened, with the average subscription rate of **188%** registered in January falling lower in February to record an average subscription rate of **153%.** Investor's demand to manage uncertainty and their need to maximize returns inspired a February average 364-day T-bill oversubscription rates of **211.34**%. To the manage the uncertainty surrounding interest rates but maximize their yield, we advise our clients to buy the 364-day papers as rates could increase in the medium term.



NSE Yield Curve: The current yield curve, (**1/3/2018**), 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 continued steepening of the yield curve. The bond yields could continue 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 closed out the end of February stronger against major currencies. The greenback lost ground against the Kenya shilling in February again as the Kenya shilling appreciated by **0.8%** in February to **KES 100.0861/USD** at the end of February, from **KES 100.8900/USD** recorded at the end of January. The Euro also lost ground against the KES in February, the Euro's value fell by **1.23%** to trade at **KES 113.8861/€** down from the value of **KES 115.3006/€** that it traded against the Kenya shilling at the end of January. In February, however, saw the Kenya shilling lose value against the sterling pound. The sterling pound clawed back ground against the Kenyan Shilling by growing by **0.93%** to trade at **KES 133.2381/£** by the end of February from the value of **KES 132.0083/£** it registered at the end of January.

The CBK's usable foreign exchange reserves continued to see a rise over the month of February. The usable forex reserves at the CBK rose by **0.74%** to hit **USD 8,196Mn** by the end of February, up from the USD 8,136Mn recorded at the end of January. The reserves could continue to be boosted by foreign remittances, export earnings and the possible issue of a new Eurobond.

The stability of the shilling in 2019 we reiterate 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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Research Disclosure

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