KINGDOM SECURITIES

PRE AUCTION NOTE FOR FXD1/2019/5 AND FXD1/2019/10 - JANUARY 2020

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Executive Summary:

- We foresee January inflation remaining within the government range with the prediction of 5.56% - 5.88%.
- The shilling to oscillate in the levels of Kes 101.35-101.60/USD in the month of January.
- A Paradigm of shift to be experienced in the bonds markets with an increased activity in the short end and relative slowness in the long end.
- The yield curve is shifting upwards but with a relative flatness in short and medium end. Hence, we advise investors to go long in short and long end.
- Government payments, coupled with redemptions amounting to approximately kes 118.4Bn expected to improve liquidity within the month. This will consequently push the Interbank Rate to fall in the range of 4.20-4.60%.
- We anticipate the 364-day paper to post an above par performance rate within the year. We recommend investors to bid the 364-day paper at 9.80-9.90% within the quarter.
- The recent signing of phase I trade deal between the US and China consequently ending the trade standoff may lead to increase in export hence further enhancing the shilling stability.
- Primary Bond Auction
  - **FXD1/2019/**5Yr: We foresee a heavy subscription on the 5-year paper. We recommend conservative bidding in the levels of 11.15-11.25% and aggressive in the range of 11.30-11.50%.
  - **FXD1/2019/10Yr:** We anticipate an above-par subscription on this paper, although the investor appetite on the 5-year paper will be higher than the 10-year. We advise bidding in the conservative bidding at 11.90-12.10% and aggressively at 12.15-12.40%.

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Inflation Remains within the target; interbank rate dips…

Inflation in the month of December of spiked to 5.82% in comparison to 5.56% recorded in the previous month. The attributable reasons for this are:

- The Food and Non-alcoholic Drinks' Index up ticked by 1.41%. This was caused by the general rise of food prices that was experienced during the festive season.
- Inflationary pressure was also felt in the Transportation index, which spiked about 2.1% against the backdrop of increased travelling that is normally experienced within the month of December.
- Higher charcoal prices pushed the House, Water, electricity, Gas and Other Fuels' Index up by 0.88%.

With respect to the aforementioned, we opine the following regarding the month of January

- Food pressure will still be experienced within the month due to heavy rains that has been pounding the country consequently affecting the prices of spinach, tomatoes, onions and kales.
- Reopening of schools and after holiday commutations impacted pressure to the transportation index.

Overly, we foresee January inflation remaining within the government range with the prediction of 5.56% - 5.88%.

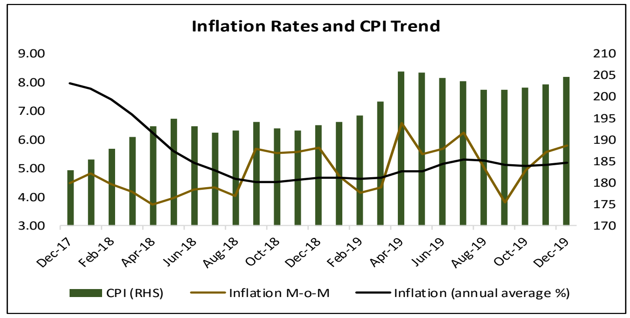

Figure 1: Inflation Rates and CPI Trend Source: KNBS, Kingdom Research

- The interbank rates spiked sharply from 4.30% experienced in November to 5.91% in December ensuing from a tight liquidity, which was faced within the month. The volumes traded rose by 25.21% from Kes 333.59Bn in November to Kes 417.69Bn in December.
- We anticipate the **Interbank Rate to fall in the range of 4.20-4.60% amidst the improving liquidity.** This is as a result of the government payments, coupled by maturing securities which stands approximately at Kes 118.4Bn for the month of January.

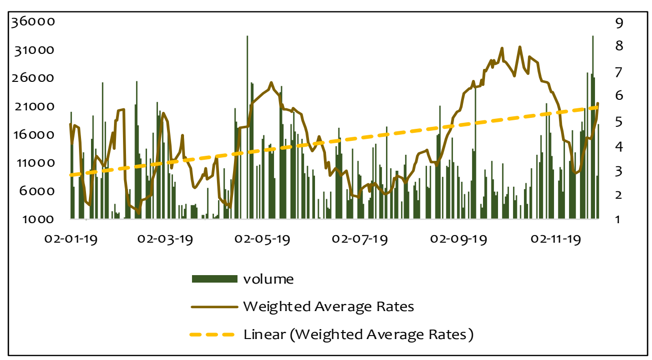

Figure 2: Interbank Rates and Volumes Source: CBK, Kingdom Research

A stable local unit…

- The Kenyan Shilling remained largely stable within the month of December against the three global benchmarks. It averagely traded at KES 101.34/USD, KES 113.37/EUR and KES 132.94/GBP.
- The recent signing of the Phase I trade deal between The US and China will cushion the shilling from some of the exogenous shocks since Kenya is a key trade partner to both Beijing and Washington DC.
- **We anticipate the shilling to oscillate in the levels of 101.35-101.60 against the dollar in the month of January**. We do not see a major shift as there is no external debt maturing within the month.

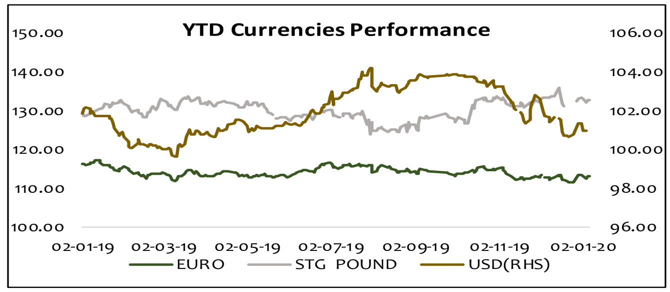

Figure 4: Currency Rates Source: CBK, Kingdom Research

	29-11-20	31-12-20	% Change
USD	102.81	101.34	1.45%
EURO	113.18	113.37	-0.17%
STG Pound	132.82	132.94	-0.09%

Higher Redemptions within the month to exert pressure on the Fiscal Agent…

The total redemptions falling within the months stand at approximately Kes 118.4Bn (Kes 103.3Bn on Tbills and Kes 15.1Bn on Tbonds) against Kes 146Bn which the treasury hopes to raise within the month (96Bn from Tbills and 50Bn from the two reopened papers). Hence, the fiscal agent will be left with approximately Kes 27.6Bn for budgetary support. With respect to the tenor of the two issued papers, coupled by the improving liquidity in the market, we are bullish that the central bank will raise enough money to offset the liabilities falling within the month.

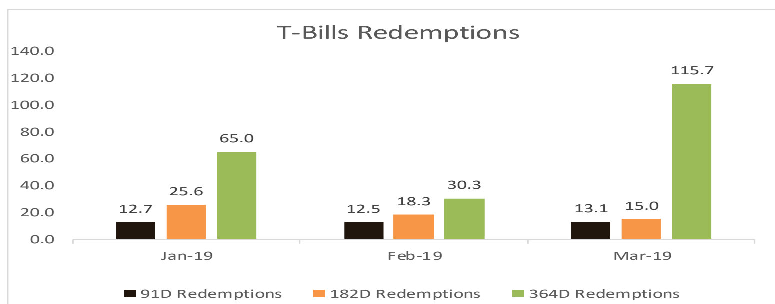

Figure 6: Tbills redemptions Source: Kingdom Research

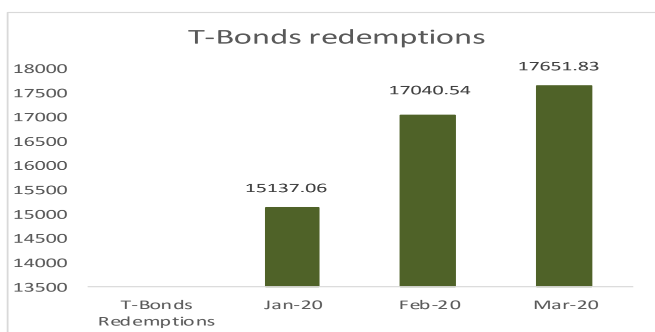

Figure 7: Tbonds Redemptions Source: Kingdom Research

The Yield Curve and Papers on issue…

The current yield curve is upward sloping with a concentrated activity on the short end, which subsides as we approach the long end.

A Paradigm of shift to be experienced in the bonds markets with an increased activity in the short end and relative slowness in the long end. This is attributable to the recent repel of interest rate capping, which will prompt most financial institutions who are key players in this market to divert cash to lending.

The yield curve is shifting upwards but with a relative flatness in short and medium end. Hence, we advise investors to go long in short and long end.

The treasury has reopened two papers FXD1/2019/5 and FXD1/2019/10. The papers, whose objective is to raise Kes 50Bn for budgetary support, are on sale on 15th – 21st January 2020. For the 5-year paper, we recommend conservative bidding in the levels of 11.15-11.25% while aggressive in the range of 11.30-11.50%. We recommend conservative bidding at 11.90-12.10 for the 10-year paper and aggressive bidding at 12.15-12.40%. Our projections are informed by Central bank's need of maintaining yield stability.

TBILLS…

As a result of repel of interest rate capping, we foresee relatively higher investor appetite on the 91, 182 and 364-day papers as most financial institutions shun the long end. We anticipate the 364-day paper to post an above par performance rate within the year. We recommend investors to bid the 364-day paper at 9.80-9.90% within the quarter.

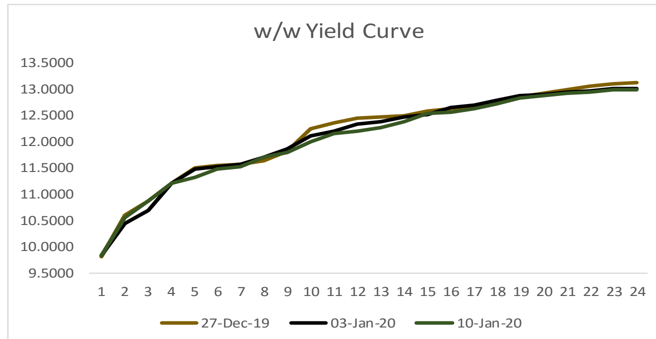

Figure 8; w/w Yield Curve

Source; NSE, Kingdom Research

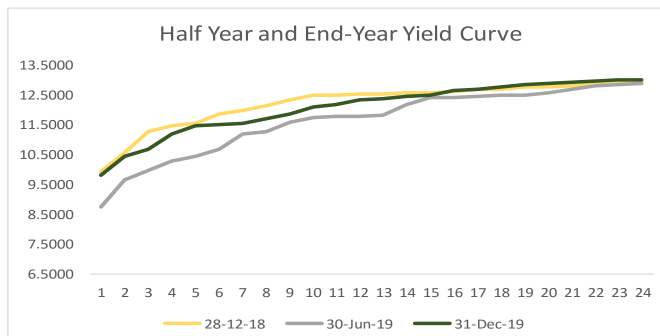

Figure 9; half Year and End-Year Yield curve   Source; NSE, Kingdom Research

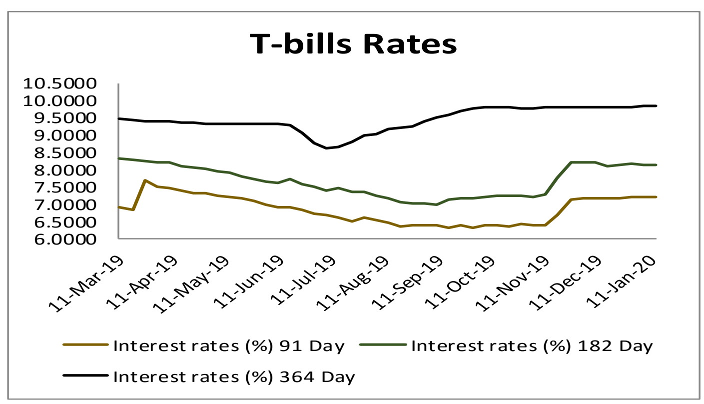

Figure 10; T-bills Rate   Source; CBK, Kingdom Research

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