KINGDOM SECURITIES

# PRE AUCTION BOND NOTE- JANUARY2019

## *GO LONG ON SHORT-DATED BONDS!*


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# Key Bond Features for the Treasury Papers – FXD 1/2019/2Yr & FXD 1/2019/15Yr

| Treasury Bond | 2-Year Paper | 15-Year Paper |
|---|---|---|
| Issue No. | FXD1/2019/2 | FXD1/2019/15 |
| Tenors | 2yrs | 15yrs |
| Coupon | Market determined | Market determined |
| Opening Date | 02nd January 2019 | 02nd January 2019 |
| Closing Date | 22nd January 2019 | 22nd January 2019 |
| Minimum Amount (KES) | KES 50,000 | KES 50,000 |
| Taxation | 15% | 10% |
| Auction Date | 23rd January 2019 | 23rd January 2019 |
| Secondary Trading | 29th January 2019 | 29th January 2019 |

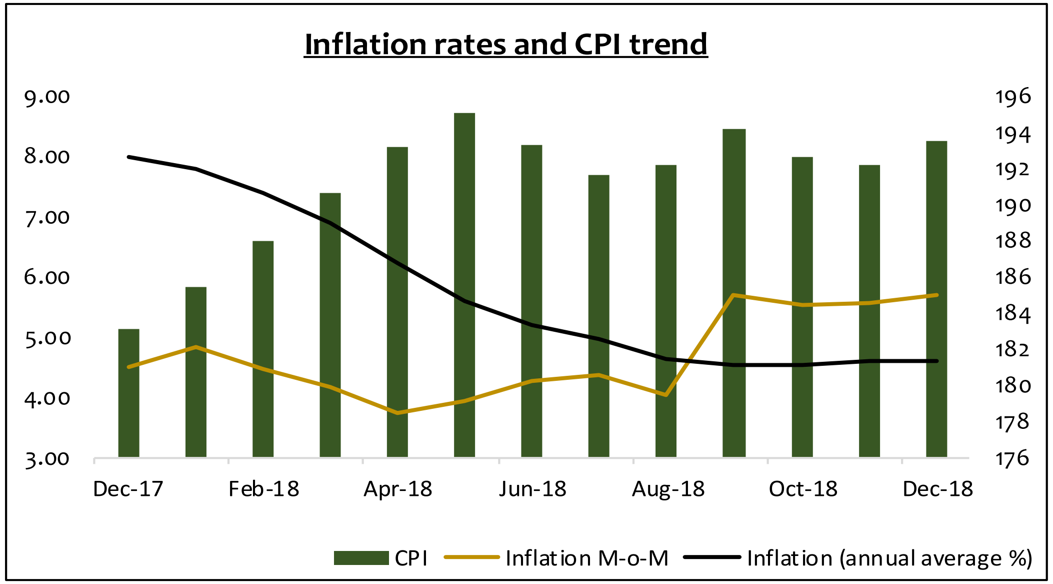
## Bidding Expectations…

Aggressive investors are expected to bid between **10.80% – 11.00%** whilst the conservative investors may bid anywhere between **10.60% – 10.80%** for the 2-year paper. On the other hand, aggressive investors interested with the 15-year paper can bid between **12.75% - 12.85%** while moderate investors could bid between **12.60% - 12.75%.** Our rates are backed by the need for CBK to maintain some form of yield stability and the current improving liquidity in the market.. **Aggressive bids risk rejection from CBK. Conservative bids are suitable for holding for longer periods until rates are ideal for trading or Holding to Maturity option (HTM).**

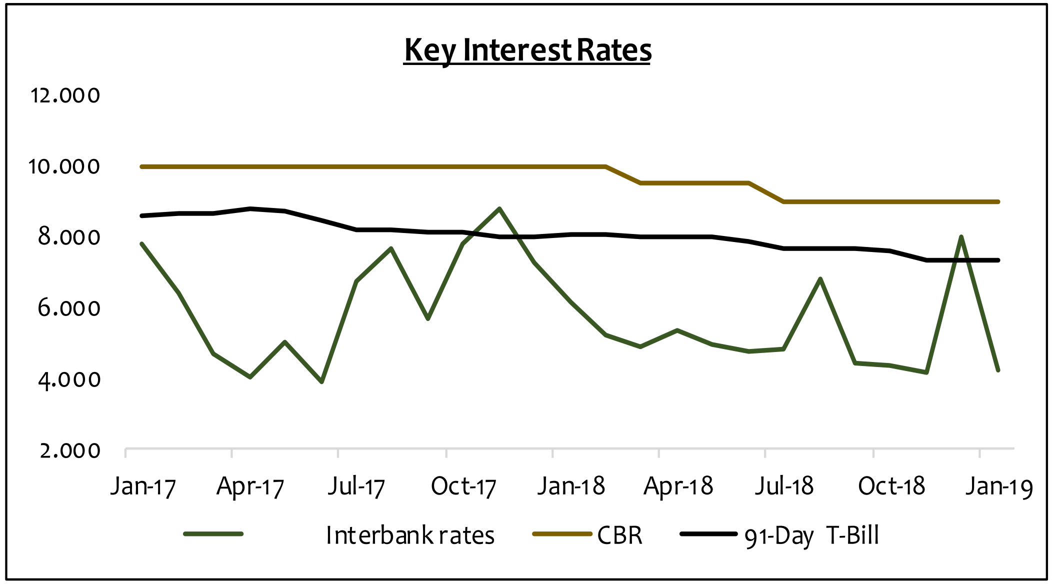
## Overview:

- The treasury has issued FXD1/2019/2Yr and FXD1/2019/15Yr bonds with a target of raising KES 40Bn towards budgetary support. The paper's coupon rate will be market determined, hence giving investors a chance to price the bond. The bonds attract a tax rate of 15% and 10% for the 2-year and 15-year respectively.
- The market has witnessed active participation in the secondary market on both the short and medium end of the curve. We anticipate a relatively moderate subscription on the 15-year paper and a healthy subscription on the 2-year paper due to the high appetite for short term bonds and heavy liquidity in the market.
- Pension funds and insurance companies are usually attracted by the long-dated papers due to their lesser liquidity needs, thus much of the subscription is expected to come from them for the 15-year paper while banks could plug in on the 2-year paper.
- Last week; 10 and 20-year papers accounted for the bulk of the trades in the secondary market, buoyed by heavy interest from investors. Subscriptions will also be buoyed by improving liquidity across the market .

# Inflation Rises to 5.71% in December, Interbank Rates Dips to 1.71%…



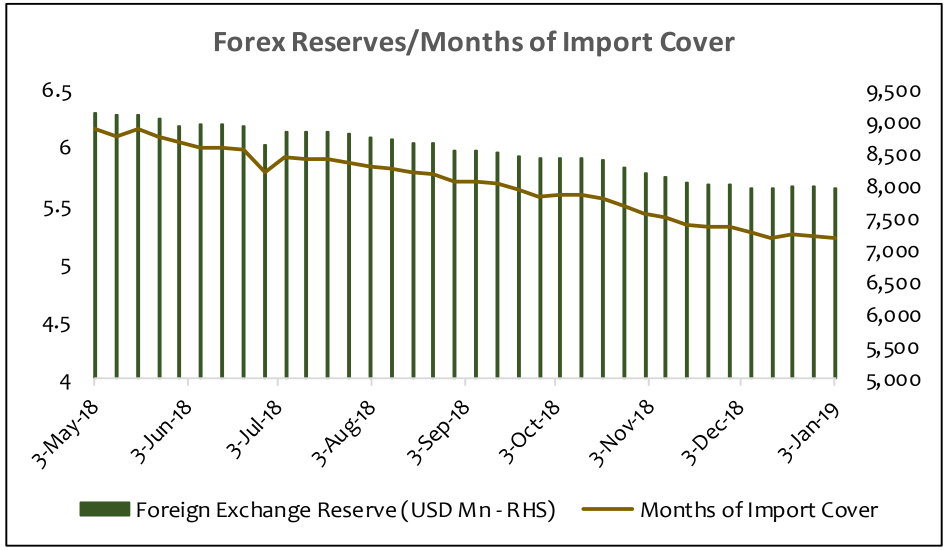

*Source: KNBS, Kingdom Research*



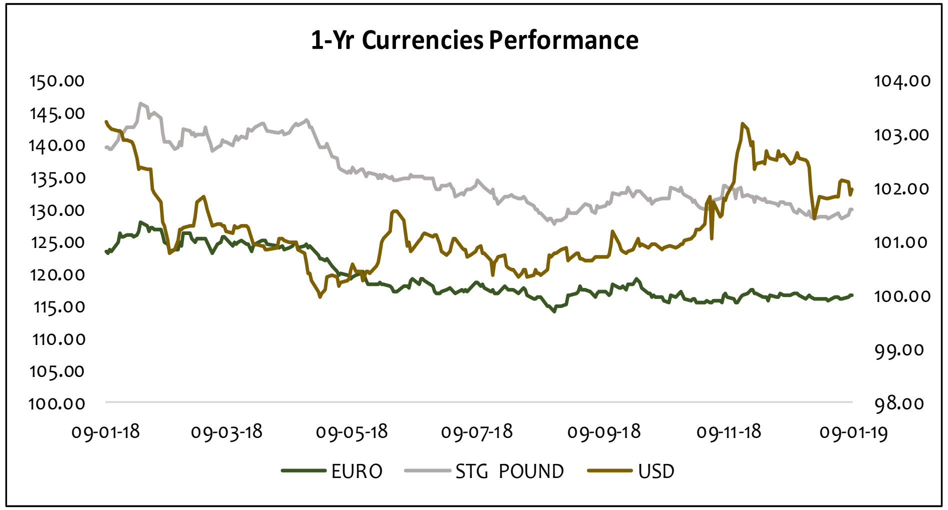

*Source: CBK, Kingdom Research*

- Inflation for the month of December rose slightly to 5.71% compared to 5.58% in November 2018. The year on year food inflation in December, 2018 was 2.54%. Food and Non-Alcoholic Drinks' Index increased by 1.05% on account of a rise in prices of some foodstuffs outweighing decreases recorded in others. Housing, Water, Electricity, Gas and Other Fuels' Index, increased by 0.07% in December 2018 compared to November 2018. Transport index also went up by 1.34% on account of increase in local and international flight charges due to higher demand. Going forward, headline inflation is expected to remain within the target range in the near term, mainly due to expected lower food prices reflecting favorable weather conditions, the decline in international oil prices, and the decline in transport costs.
- The monetary policy committee is set to meet on 28th January 2019 and the committee may opt to retain the bench mark rate at 9.00%, supported by well anchored inflation expectations and a stable currency.
- Interbank rates have significantly dipped by 314 bps to 1.71% as of 11thJanuary 2019 from 4.86% at the beginning of the year and an average of 8.01% in December 2018, as a result of improved liquidity in the money market. We expect the overnight rates to be kept at a low as there are no imminent shocks in the market and CBK interventions through the reverse repos will filter out any negative effects on the interbank rates.

# Adequate Forex Reserves Offer Stability to the Shilling …




*Source: CBK, Kingdom Research*




*Source: CBK , Kingdom Research*

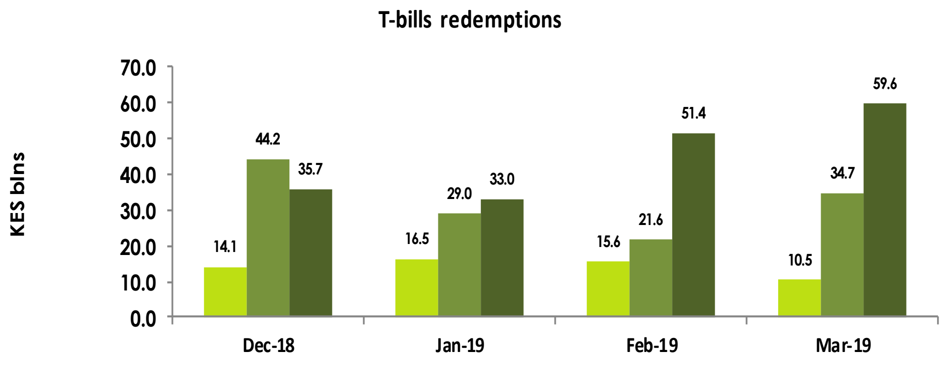
- Official data from the CBK indicates that foreign reserves stood at USD 7.98Bn as at 10th January 2019, equivalent to 5.23 months of import cover (minimum-4 months, a significant drop from last month). The reserves averaged USD 8.357Bn in 2018 with the months of import cover averaging 5.57, which was a better stand point than the previous year (Reserves- USD 7.498Bn, Months of import cover – 4.97). The forex reserves have been supported by robust diaspora remittances, strong growth of our exports and improved tourism receipts.

- The foreign exchange market has remained balanced supported by a narrowing of the current account deficit. The local unit has experienced some slight pressures in the recent past but is expected to remain relatively stable trading range bound against the dollar between 101.00 – 103.00 This will be **largely** supported by a narrowing current account deficit, robust forex reserves and Central Bank of Kenya (CBK) interventions.

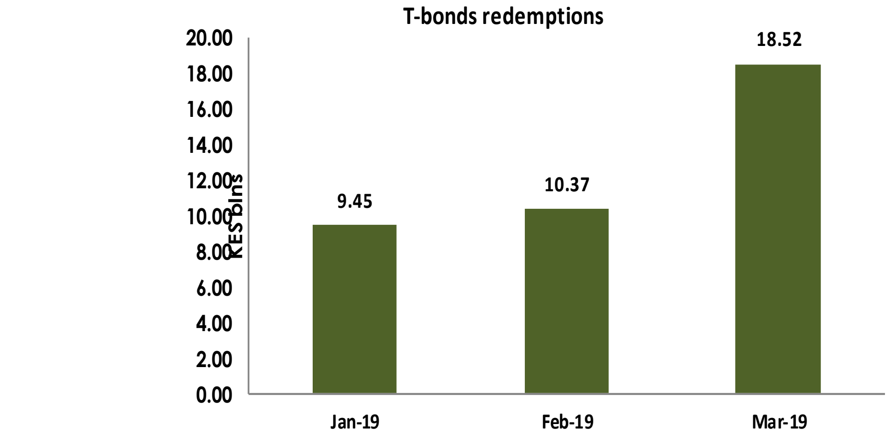
- The foreign reserves will continue to provide a buffer for the shilling against short-term shocks. We anticipate resilient tea and horticulture exports, stronger diaspora remittances and continued recovery in tourism to boost the forex reserves in the long-term.

- We expect the KES to remain relatively stable against the rest of the global currencies such as Euro, and Sterling pound for the rest of the month.

# Lower Gross Redemptions in the month of January 2019…



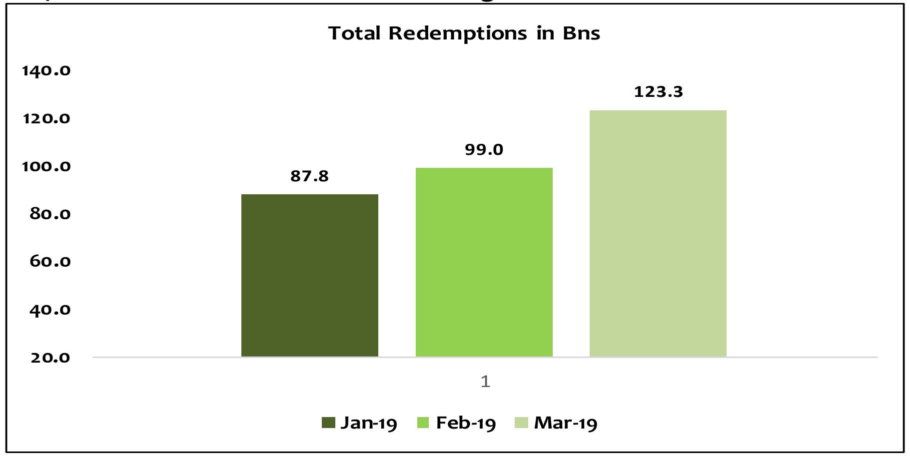

| | Dec-18 | Jan-19 | Feb-19 | Mar-19 |
|---|---|---|---|---|
| 91D Redemptions | 14.1 | 16.5 | 15.6 | 10.5 |
| 182D Redemptions | 44.2 | 29.0 | 21.6 | 34.7 |
| 364D Redemptions | 35.7 | 33.0 | 51.4 | 59.6 |



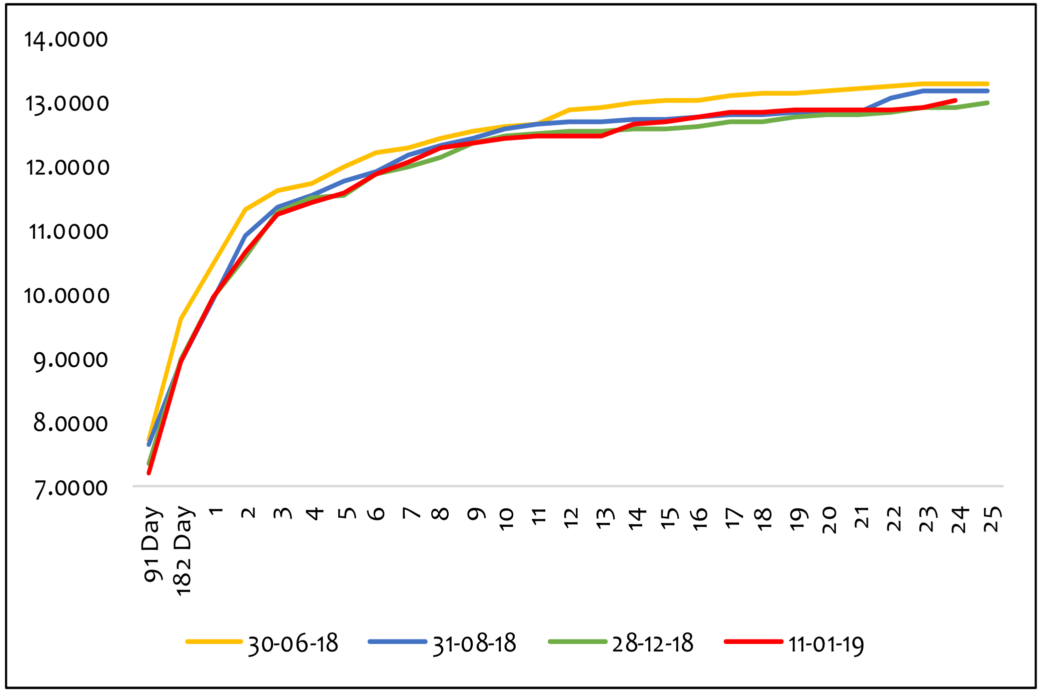

| | Jan-19 | Feb-19 | Mar-19 |
|---|---|---|---|
| T-bonds redemptions - KES b | 9.45 | 10.37 | 18.52 |

- Estimated redemptions in the month of January -2019 for both T-bonds and T-bills sum up to KES 87.8Bn vs. the targeted issues worth KES 160Bn in both T-Bills and bonds. So far CBK has accepted KES 65.35Bn against the KES 48Bn offered, a 136% acceptance rate. Amounts equal to the redemptions (KES 87.8Bn) will be used to repay the principal & interest amounts of papers maturing within this month, thus being rolled over. On a best case scenario, the remaining amount for redemptions (KES 22.45Bn) is expected to be raised within this issue and the remaining T-bill issues for the month hence we expect part of the amounts raised from this issue to also be spent on budgetary allocations.

- We are optimistic that CBK will raise required amount to offset all the obligations falling due this month and still plug a sizable amount into budgetary support. This is supported by the traction the T-bills are receiving, in addition to expected healthy subscription in this month's bonds. The figures stated could have some margin of error due to the following factors; (1) Some of the papers have posted a higher performance rate and (2) The papers on issue could record lower performance rates leading the CBK to acquire lower amounts than the target.



# Evolution of the Yield Curve




- ❖ The current yield curve is upward sloping with a slight downward shift on the short and medium term. This could be attributed to improving liquidity in the market which has resulted in high supply of these papers in the secondary market.
- ❖ Unmatched supply of long dated papers with demand has led to the papers trading at higher yields, hence the upward shift of the yield curve this month.
- ❖ Investors should consider going long on bonds with shorter duration to benefit from the increased appetite in the market which has been pushing the rates downwards and also benefit from the steepening of the yield curve.
- ❖ The bond yields could continue flattening as a consequence of Kenya's monetary policy stance, with a possible upward pressure from government borrowing.
- ❖ Active managers should consider reducing their bond portfolio duration by investing mainly in short term bonds to outperform and also reduce the maturity risk .

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