KINGDOM SECURITIES

PRE AUCTION BOND NOTE- JULY 2019

FISCAL AGENT ISSUES A 15Yr PAPER; FXD 3/2019/15

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Key Bond Features for the Treasury Paper – FXD3/2019/15Yr

Treasury Bond	15-Year Paper
Issue No.	FXD3/2019/15
Tenors	15Yrs
Coupon	Market Determined
Opening Date	2nd July 2019
Closing Date	23rd July 2019
Minimum Amount (KES)	KES 50,000
Taxation	10%
Auction Date	24th July 2019
Secondary Trading	30th July 2019

Bidding Guide…

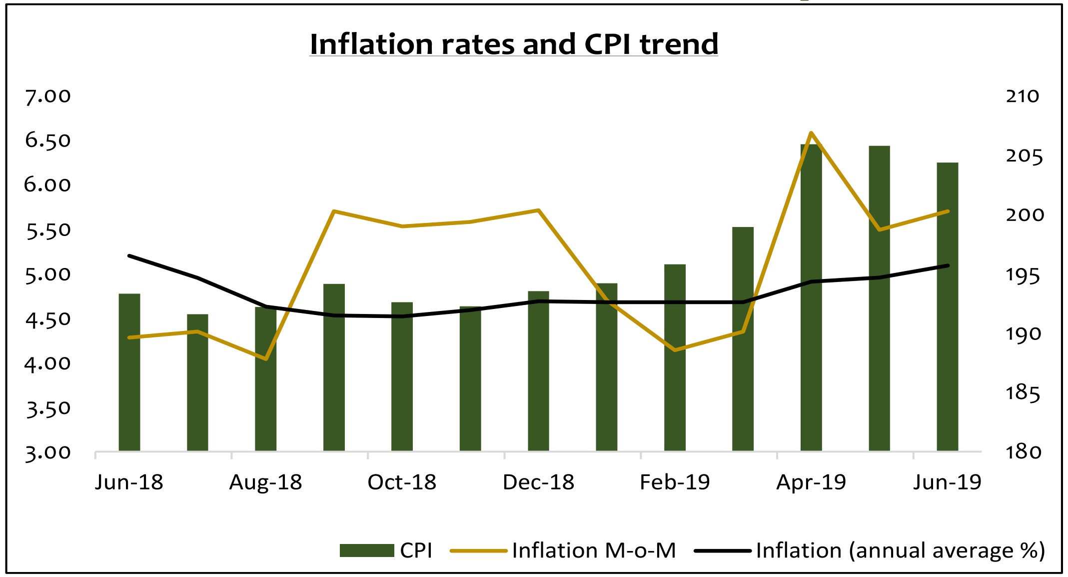
Investor	Bidding Levels
Aggressive	12.30 - 12.45
conservative	12.00 - 12.20

Our projected rates are informed by the Central Bank's need of maintaining yield stability which has been on the downward trend; a scenario that has been prompted by the liquid market.

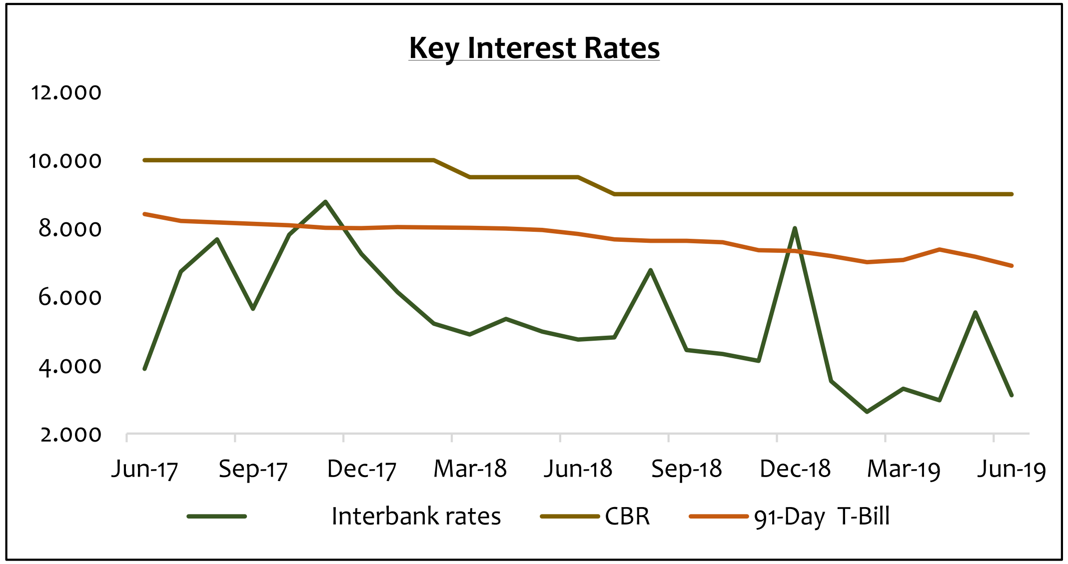
Overview:

- The treasury has issued a treasury paper FXD 3/2019/15Yr whose target is to raise Kes 40Bn for budgetary support. Bidding opened on 2nd July 2019 and it set to close on 23rd July 2019. Set for secondary trading from 30th July 2019, the paper's coupon will be market determined.
- The market has been characterized by increased activity on the medium and long end of the curve with medium term papers depicting concentrated activity which subsides as the curve approaches the long end. There has been a significant scarcity of supply on the short end which has consequently increased demand on the 364 -day paper.
- Courtesy of demonetization which has partly contributed to increased liquidity in the market, we opine a significantly high subscription on this paper; a move that will lock out the expensive bids.
- Interest rate uncertainty continue to favor the market with financial institutions actively participating in the bonds market. This has consequently contributed to the shaping of the yield curve. Any change on the interest rate environment could eventually lead to an inverted curve.

Inflation Rate spikes to 5.70%, Interbank Rates Dip to 3.12%…



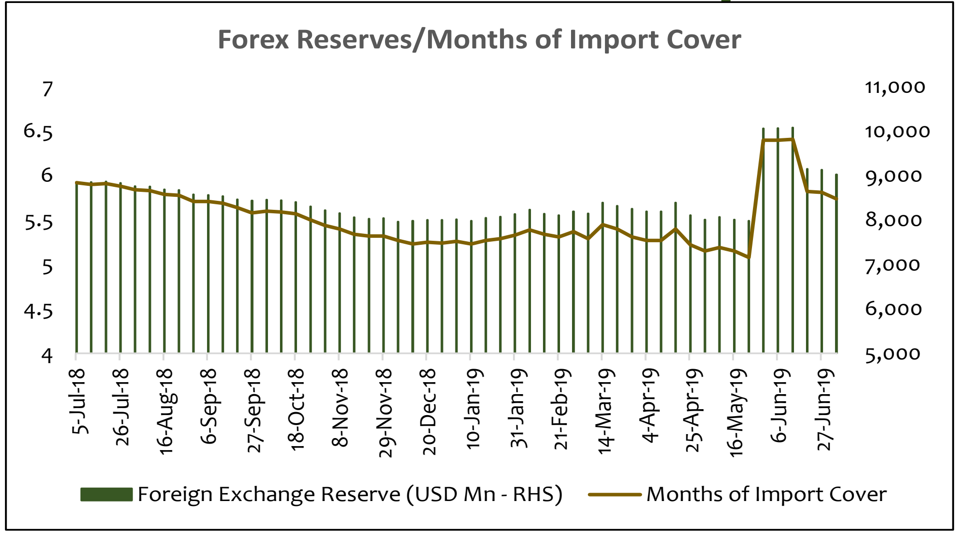
Source: KNBS, Kingdom Research



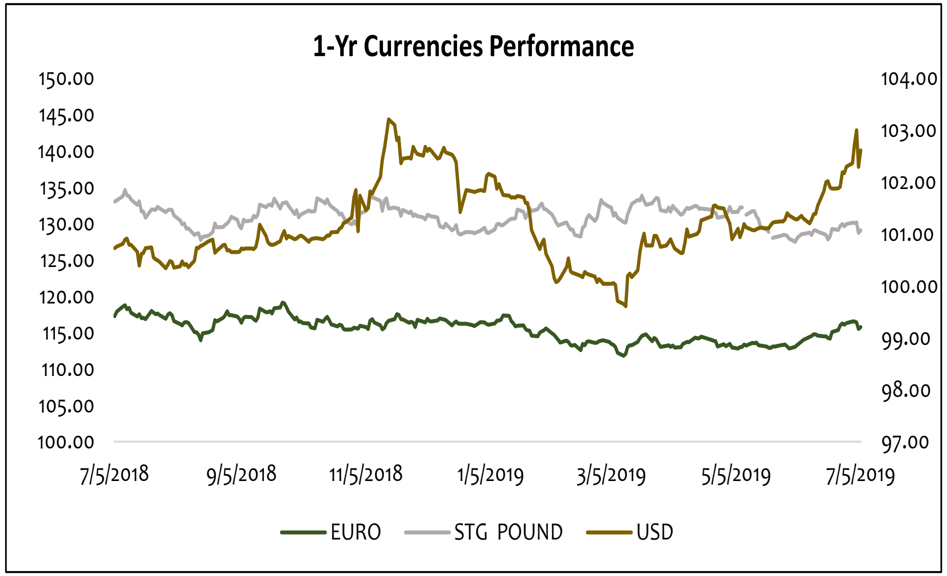
Source: CBK, Kingdom Research

- Inflation for the month of June spiked by 21bps to close the month at 5.70%; up from 5.49% recorded in the month of May. Alcoholic beverages, Tobacco and narcotics recorded the highest spike whereby it appreciated by 54bps to close at 2.06% . Food and non-alcoholic drinks index declined by 160bps in comparison to 37bps dip recorded in the previous month .This is attributed to the favorable weather which consequently favored the food prices. We anticipate the headline inflation to oscillate between 5.0-6.5% for the year.
- The interbank rates dipped to 3.12% in the month of June from a high of 5.57% in May largely attributed to the liquid market. The interbank volumes dipped by 53.70% to close the month at Kes 152.68Bn from a high from Kes 329.74Bn in May. Both the demonetization process and interest rate trends have improved cash deposits and free reserves for tier 1 and 2 banks while tier 3 banks have been left scuttled in the interbank market.
- We anticipate the interest rate to remain unchanged for the remaining period of this year. However, the increasing discussions regarding the same could lead to an eventual amendment in the subsequent year.

Adequate Forex Reserves, Stable Shilling…



Source: CBK, Kingdom Research



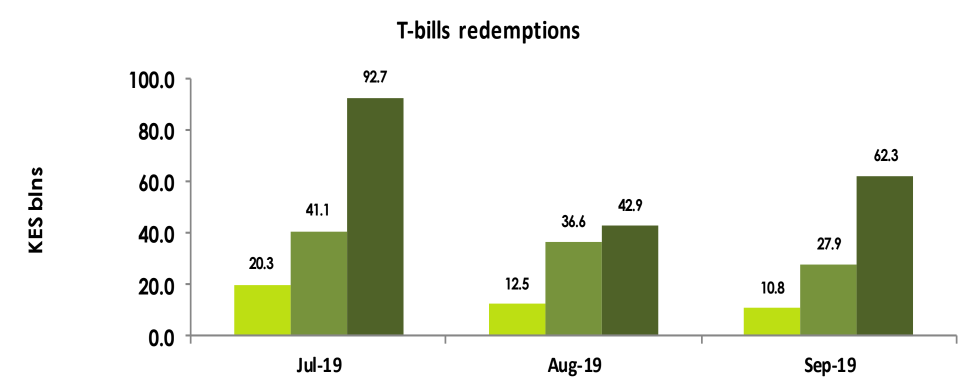
Source: CBK , Kingdom Research

- Official data from the CBK indicates that foreign reserves stood at USD 9.02Bn as at 4th July 2019. This is equivalent to 5.74 months of import cover. There is a significant decrease of 10.65% in comparison to 10.07Bn (6.40 months of import cover) recorded the previous month; prompted by the repayments of Eurobond 1 and the syndicated loans. Over the previous month, foreign reserves were significantly high because of the Eurobond at the LSE hence the 10.65% dip this month.

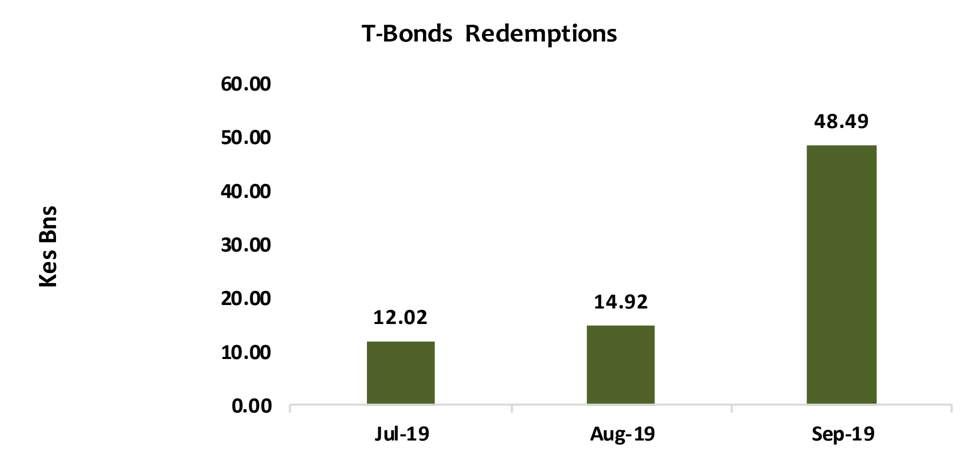
- The Shilling was significantly stable as at end of June against the three global currency benchmarks; The USD, Euro and STG Pound ; whereby it closed at 101.69, 114.71 and 128.82 respectively. Over the month, the shilling had weakened marginally against the Dollar and Euro by 53bps and 137bps respectively while it dipped against the STG Pound by 96bps. Brexit dynamics that eventually led to resignation of Britain's premier will still remain a contributory factor to Kes/STG pound for the foreseeable future. US and China reconciliatory remarks and the consequential holding off the imposed trade tariffs has caused an immediate impact on the global market. It is our anticipation that the shilling will revolve around 101-103 for the rest of the year ; courtesy of diaspora remittances and the exponentially growing tourism earnings.

- We are of the opinion that the strong foreign reserves will act as a buffer for any volatilities on the shilling.

Higher Redemptions from Maturities of 364-day Papers Suggest Pressure for Fiscal Agent

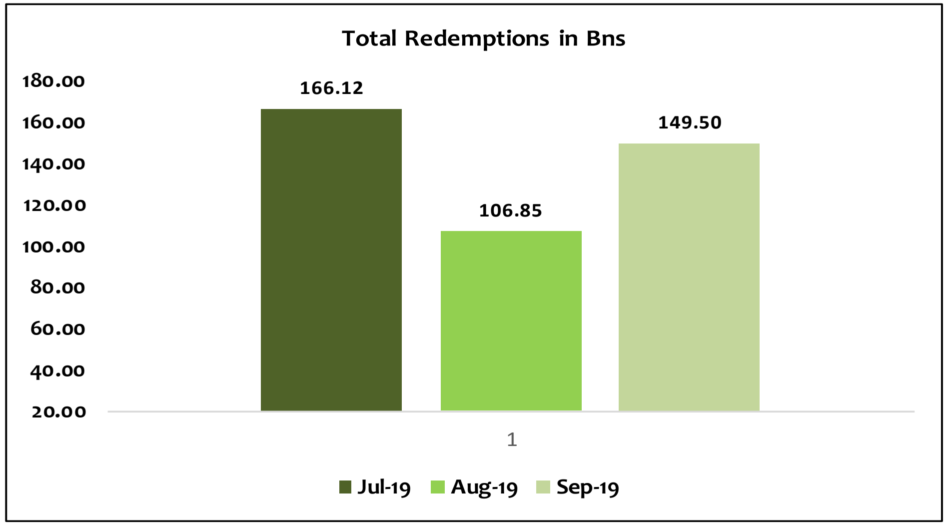


	Jul-19	Aug-19	Sep-19
91D Redemptions	20.3	12.5	10.8
182D Redemptions	41.1	36.6	27.9
364D Redemptions	92.7	42.9	62.3

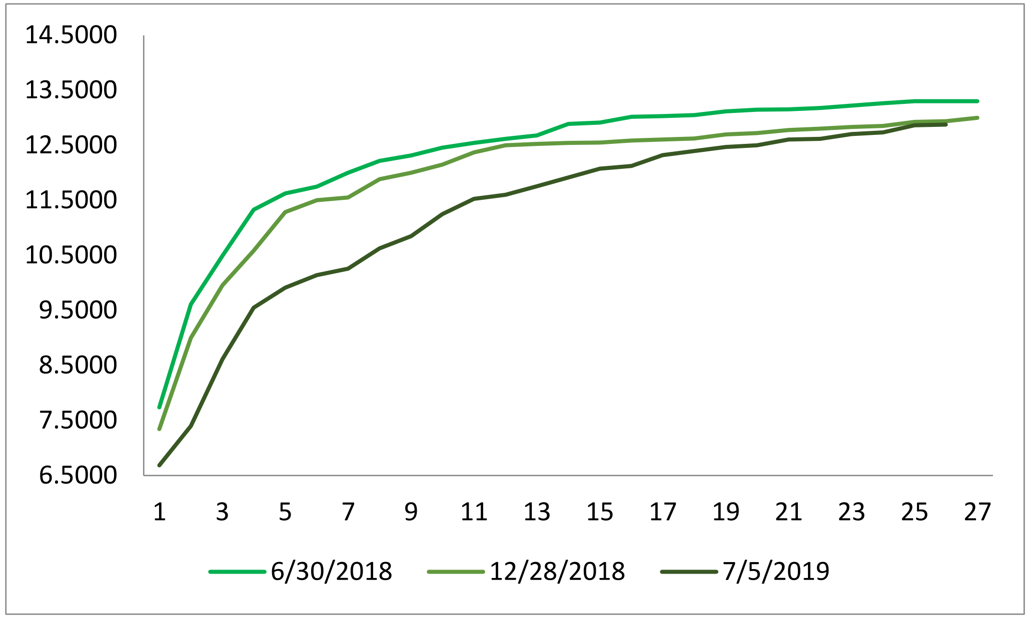


	Jul-19	Aug-19	Sep-19
T-Bonds Redemptions	12.02	14.92	48.49

- Estimated redemptions in the month of July-2019 for both T-bonds and T-bills sum up to KES 166.12Bn vs. the targeted issues worth KES 160Bn in both T-Bills and bonds. So far the fiscal agent has been able to raise Kes 105.35Bn which is slightly above the pro-rated target. Amounts equal to the redemptions (KES 166.12Bn) will be used to repay the principal & interest amounts of papers maturing within the month, thus being rolled over. We are optimistic that CBK will raise more than the required amount to offset all the obligations falling due this month due to the high liquidity in the market. It is likely that CBK will have the ability to plug some of the raised cash from domestic debt market into budgetary support as we expect CBK to raise more funds from the targeted issues due to high liquidity and great appetite for short term papers. 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/higher performance rates leading the CBK to acquire lower/ higher amounts than the target.



Evolution of the Yield Curve



Source: CBK, Kingdom Research

- The current yield curve depicts an upward slope with a downward shift on the short and medium term and a maintained flattening on the long end. From the illustration alongside, it is evident that the yield curve has been taking a gradual downward shift; a scenario buoyed by the high liquidity environment. This has consequently pushed the rates downwards.

- With the improving liquidity and high appetite for domestic debt we anticipate the gradual downward shift of the yield curve to remain apparent; which will in turn favor investors who will go long on the short end.

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