KINGDOM SECURITIES

PRE AUCTION BOND NOTE- JUNE 2019

FISCAL AGENT REOPENS 15YR PAPERS IN A MARKET STIRRED WITH SHORT TERM DEBT APPETITE

Senior Research Analyst:

Mercyline Gatebi - Kyalo

Office : +254711049540

Email address:

mgatebi@co-opbank.co.ke

Key Bond Features for the Treasury Papers – FXD1/2018/15Yr and FXD1/2012/15Yr

Treasury Bond	15-Year Paper	15-Year Paper
Issue No.	FXD1/2018/15	FXD1/2012/15
Tenors	13.94Yrs	8.42Yrs
Coupon	12.650%	11.000%
Opening Date	29th May 2019	29th May 2019
Closing Date	11th June 2019	11th June 2019
Minimum Amount (KES)	KES 50,000	KES 50,000
Taxation	10%	10%
Auction Date	12th June 2019	12th June 2019
Secondary Trading	18th June 2019	18th June 2019

Bidding Guide…

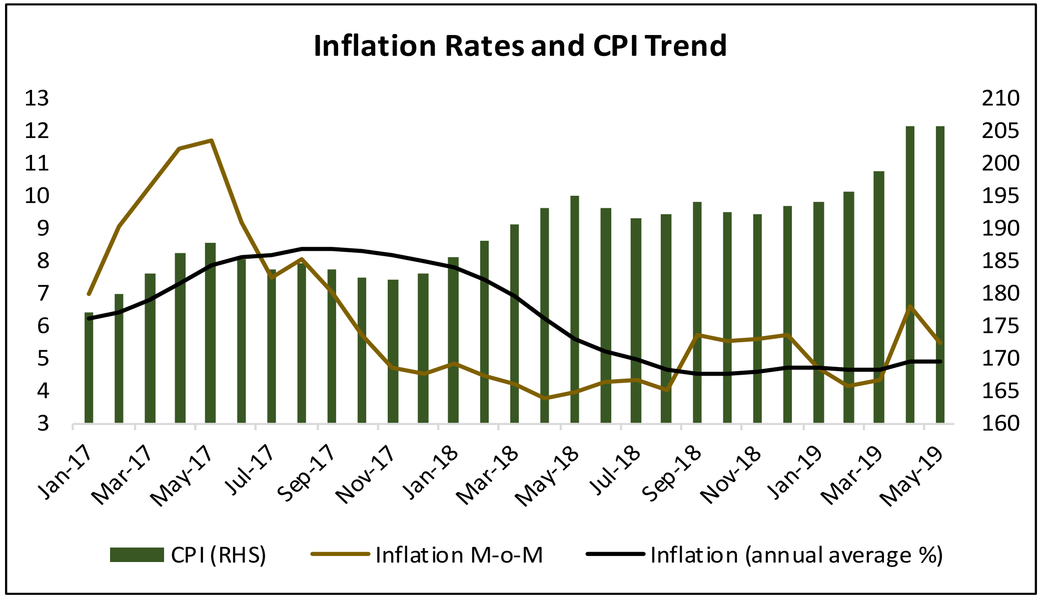
Paper	Bidding Levels
FXD1/2018/15	12.40 - 12.55
FXD1/2012/15	11.55 - 11.75

Our rates are backed by the need for CBK to maintain some form of yield stability and the improved liquidity in the market which has continued lowering the interest rates. **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).**

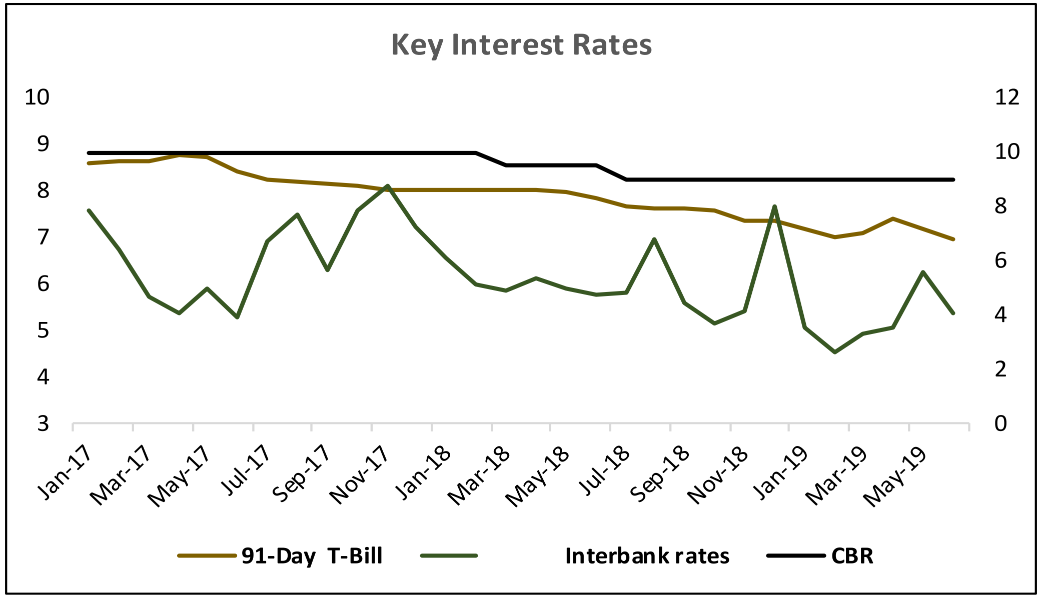
Overview:

- The treasury has issued two treasury papers – FXD 1/ 2018/15Yr (13.94Yrs) and FXD1/2012/15Yr (8.42Yrs) with a target of raising KES 40Bn for budgetary support. The paper's coupon rates are 12.65% and 11.00% respectively, and attracts 10% withholding tax respectively as allowed by the income tax Act.
- Currently, net domestic borrowing is on target at KES 298.8Bn whereas external financing has exceeded by KES 72.3Bn. In addition to the Eurobond 3 proceeds we don't expect significant borrowing pressure hence we recommend investors not to bid aggressively on this papers. This month will see the maturity of FXD 2/2014/5Yr paper with an outstanding amount of KES 37.1Bn.
- The market has witnessed active participation in the secondary market on both the medium and long end of the curve. In the current high liquidity and interest uncertainty environment, investors may continue focusing on the short dated bonds. We therefore expect the 8.42Yr tenor fixed coupon bond to attract a medium to high subscriptions and the 13.94Yr tenor to receive low to medium subscriptions.
- Last week; 15 , 20 and 25-year papers accounted for the bulk of the trades in the secondary market, buoyed by heavy interest from investors. Subscriptions will also be supported by high liquidity across the market .

Inflation Rate Declines to 5.49%, Interbank Rates Dip to 5.57%...



Source: KNBS, Kingdom Research



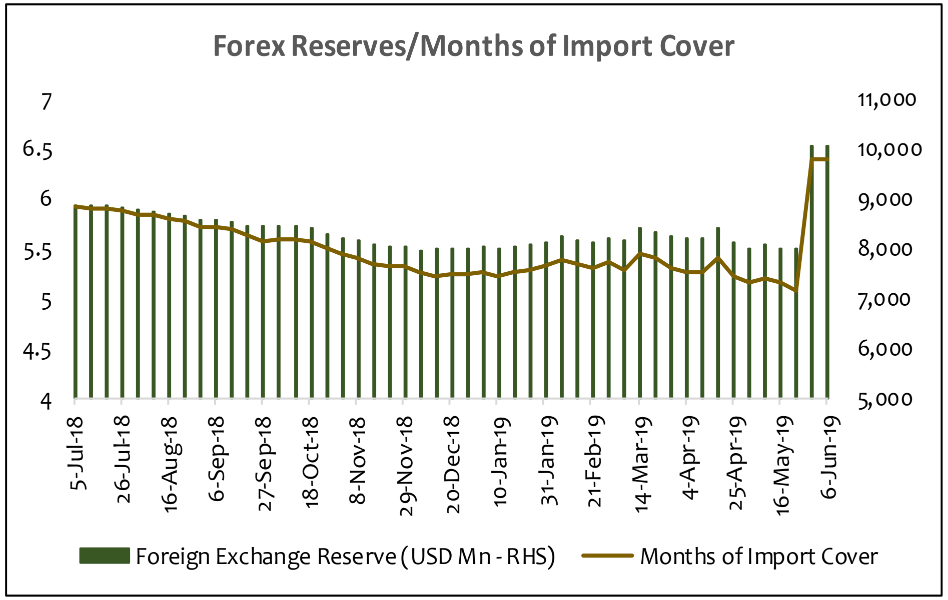
Source: CBK, Kingdom Research

- Inflation for the month of May declined to 5.49% compared to 6.58% recorded in April 2019. This was driven by a drop in food prices due to the improving weather conditions in the month of May. Food and Non-Alcoholic Drinks' Index decreased by 0.37% on account of lower prices for some food commodities. Housing, Water, Electricity, Gas and Other Fuels' Index, rose by 0.61% in May 2019 compared to April 2019 mainly due to higher cost of some house rents and cooking fuels. Transport index rose by 0.32% on account of rises in pump prices of petrol and diesel. Going forward, headline inflation is expected to remain within the target range (2.5% – 7.5%) in the near term mainly due to expected lower food prices as a result of the onset of long rains.

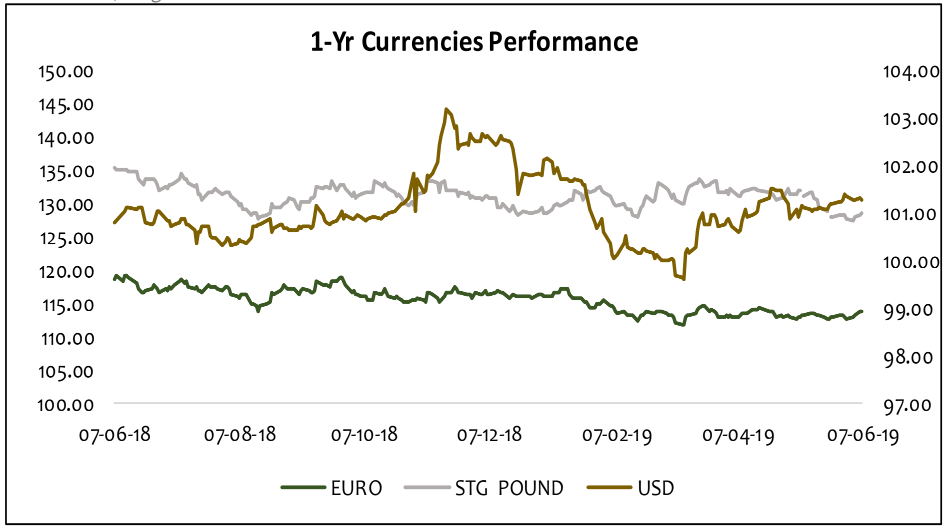
- The monetary policy committee met on 27th May 2019 and opted to retain the policy interest rate at 9.00%, supported by well anchored inflation expectations and a stable currency. Private sector credit grew by 4.9% in the 12 months to April 2019, compared to 4.3% in March.

- The interbank rate has come down from a high of 8.01% as at December 2018 to 5.57% as at May 2019, largely attributed to the high liquidity in the market. The total volumes traded in May rose to KES 329.74Bn from the total volumes of KES 243.55Bn in April. 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 continue filtering out any negative effects on the interbank rates.

Adequate Forex Reserves, Narrowing Current Account Deficit Offer Support to the Shilling …



Source: CBK, Kingdom Research



Source: CBK , Kingdom Research

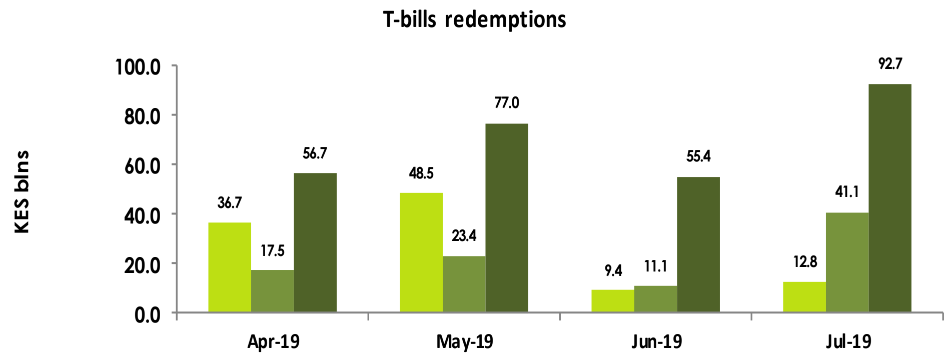
- Official data from the CBK indicates that foreign reserves stood at USD 10.065Bn as at 06th June 2019, equivalent to 6.40 months of import cover (minimum-4 months, a significant rise from last month). This was boosted by the successful issue of USD 2.1Bn Eurobond at the LSE. The forex reserves have been supported by robust diaspora remittances (13% growth in 12 months to April) and increased exports earnings especially horticulture and slower growth of imports.

- The foreign exchange market has remained balanced supported by narrowing of the current account deficit to 4.5% of GDP in the 12 months to April 2019. As at the end of May, the KES had weakened significantly to 101.28 against the USD in the last couple of weeks but still trading within our target range. This may have been caused by the rising imports cost as a result of the surge in oil prices. We still expect the soft currency pressures to be maintained , hence continue trading range bound against the dollar between 100.00 – 102.00.

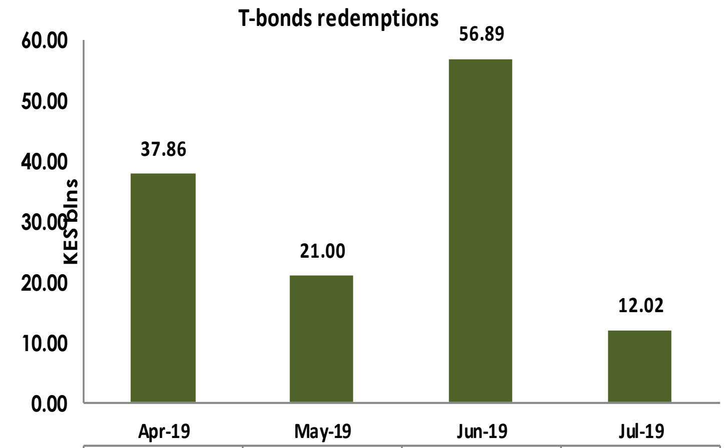
- The foreign reserves will continue to provide a buffer for the shilling against short-term shocks. We anticipate resilient tea and horticulture exports, stronger diaspora remittances and continued recovery in tourism to boost the forex reserves in the long-term.

- Stability of the local unit will mainly be determined by the government's ability to refinance existing external debt (a syndicate loan and a 5-year Eurobond) which is set to mature in 2019. The repayments are also anticipated to cut down CBK's forex reserves.

Higher Redemptions from Maturities and Coupon Payments Suggest Pressure for Fiscal Agent

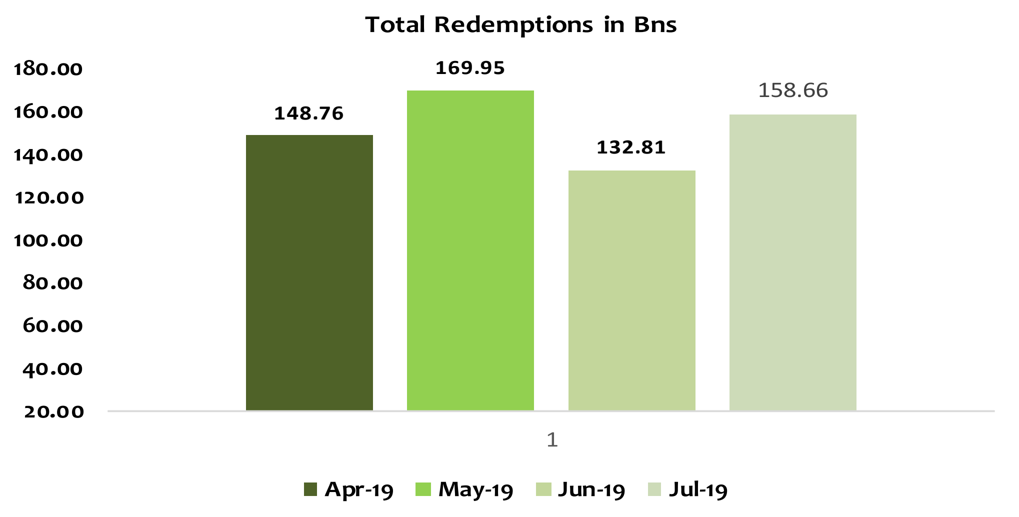


	Apr-19	May-19	Jun-19	Jul-19
91D Redemptions	36.7	48.5	9.4	12.8
182D Redemptions	17.5	23.4	11.1	41.1
364D Redemptions	56.7	77.0	55.4	92.7

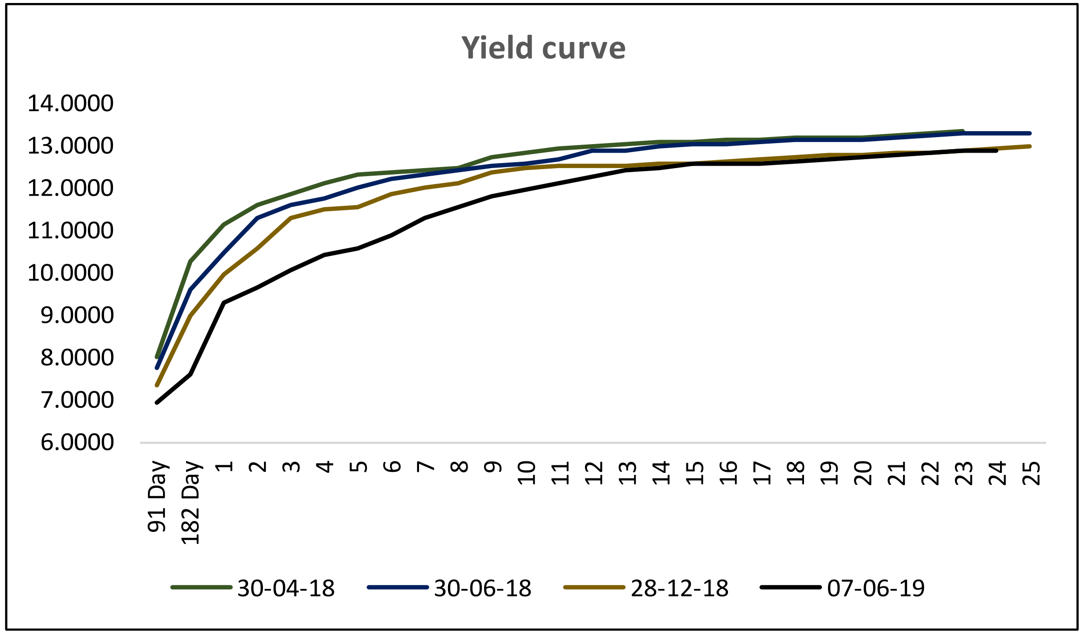


	Apr-19	May-19	Jun-19	Jul-19
T-bonds redemptions - KES b	37.86	21.00	56.89	12.02

- Estimated redemptions in the month of June-2019 for both T-bonds and T-bills sum up to KES 132.81Bn vs. the targeted issues worth KES 136Bn in both T-Bills and bonds. Amounts equal to the redemptions (KES 132.81Bn) 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 is upward sloping with a downward shift on the short end and flattening on the long end. This could be attributed to improving liquidity in the market which has resulted in high supply of these papers in the secondary market pushing rates downwards.
- 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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Co-operative Bank House- 5th Floor, P.O Box 48231 - 00100 Nairobi, Kenya

Office: 0711049540/0711049956

Email: kingdomresearch@co-opbank.co.ke/ mgatebi@co-opbank.co.ke/fmwireri@co-opbank.co.ke

Trading queries: Herine Ogutha : hogutha@co-opbank.co.ke

Joseph Ndungu **:** jndungu@co-opbank.co.ke