KINGDOM SECURITIES

PRE AUCTION BOND NOTE- MARCH 2019

25-Year Infrastructure Bond Issued Amidst Investors Higher Appetite for Short – term Papers

Senior Research Analyst:

Mercyline Gatebi - Kyalo

Office : +254711049540

Email address:

mgatebi@co-opbank.co.ke

Key Bond Features for the Infrastructure Paper– IFB1/2019/25Yr

Infrastructure Bond	25-Year Paper
Issue No.	IFB1/2019/25
Tenors	Twenty five-Year
Coupon	12.200%
Opening Date	01st March 2019
Closing Date	19th March 2019
Minimum Amount (KES)	KES 100,000
Taxation	Tax-exempt
Auction Date	20th March 2019
Secondary Trading	26th March 2019

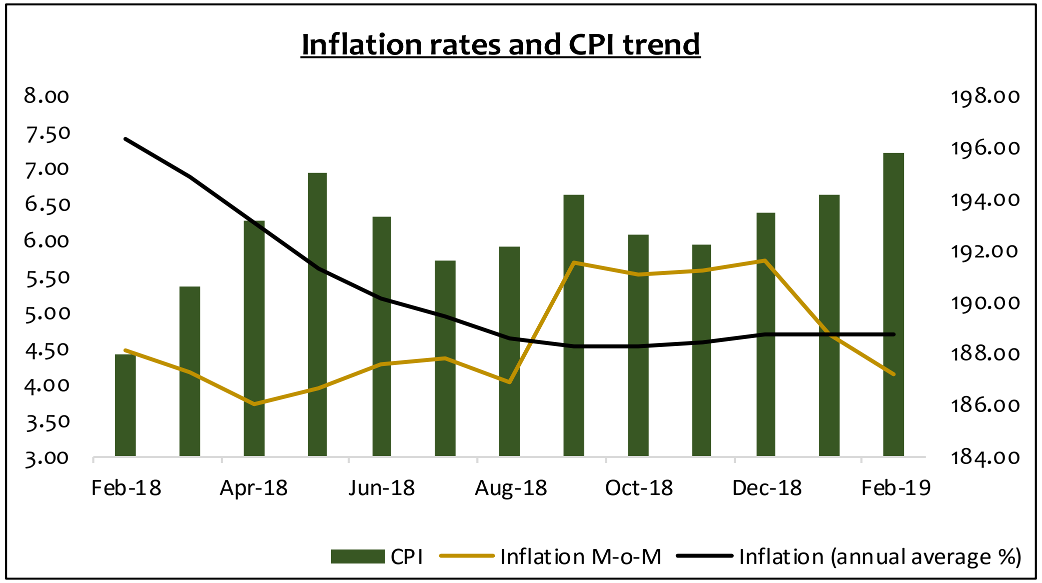
Bidding Expectations…

Aggressive investors are expected to bid between **12.50% – 12.80%** whilst the conservative investors may bid anywhere between **12.20% – 12.50%** for the 25-year paper. 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).**

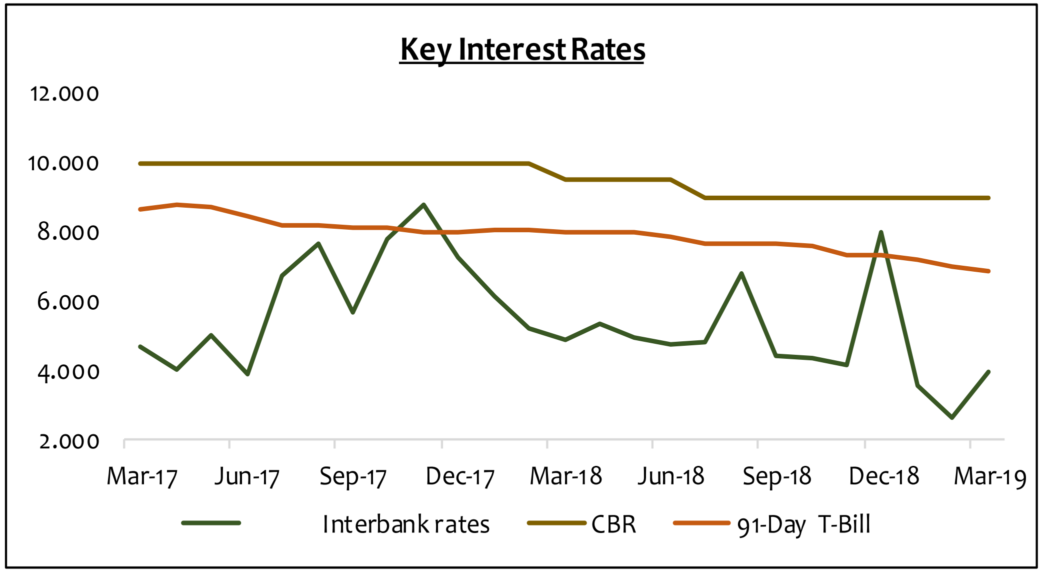
Overview:

- The treasury has issued an infrastructure bond -IFB 1/2019/25Yr with a target of raising KES 50Bn for partial funding of infrastructure projects in Transport, Water and Energy sectors. The paper's coupon rate is 12.20%, and attracts zero-tax as allowed by the income tax Act.
- The market has witnessed active participation in the secondary market on both the medium and long end of the curve. We anticipate a relatively moderate subscription on the 25-year due to the higher appetite for short term bonds and heavy liquidity in the market.
- Banks are usually attracted by short-dated papers due to their higher liquidity needs, thus much of the subscription is expected to come from other investors such as pension funds and insurance companies.
- Last week; 10 ,15 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 supported by improving liquidity across the market .

Inflation Dips to 4.14% in February, Interbank Rates Spikes to 3.96%…



Source: KNBS, Kingdom Research



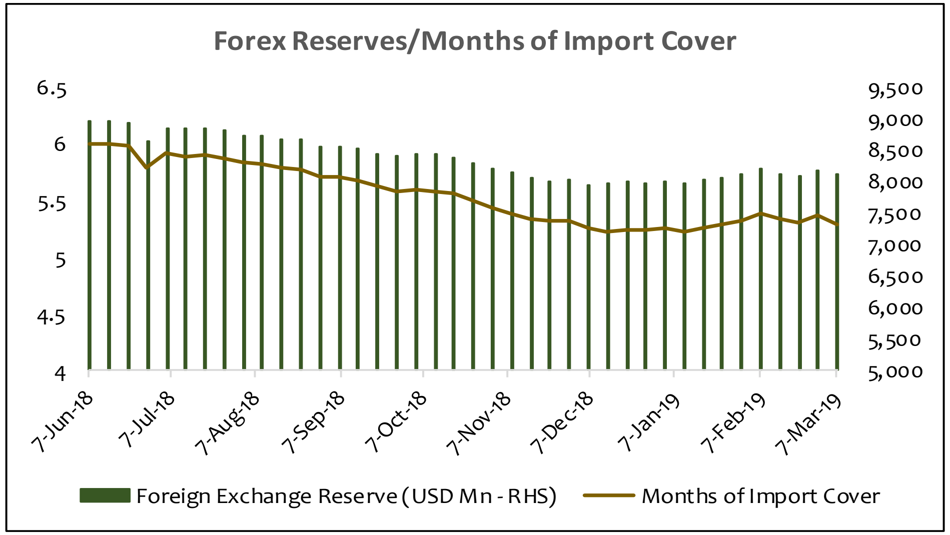
Source: CBK, Kingdom Research

- Inflation for the month of February plunged further to 4.14% compared to 4.70% recorded in January 2019. This was driven by a decline in food prices and transport index, Food and Non-Alcoholic Drinks' Index increased by 1.70% 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 0.12% in February 2019 compared to January 2019. Transport index decreased by 0.50% on account of decreases in pump prices of petrol and diesel. 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.

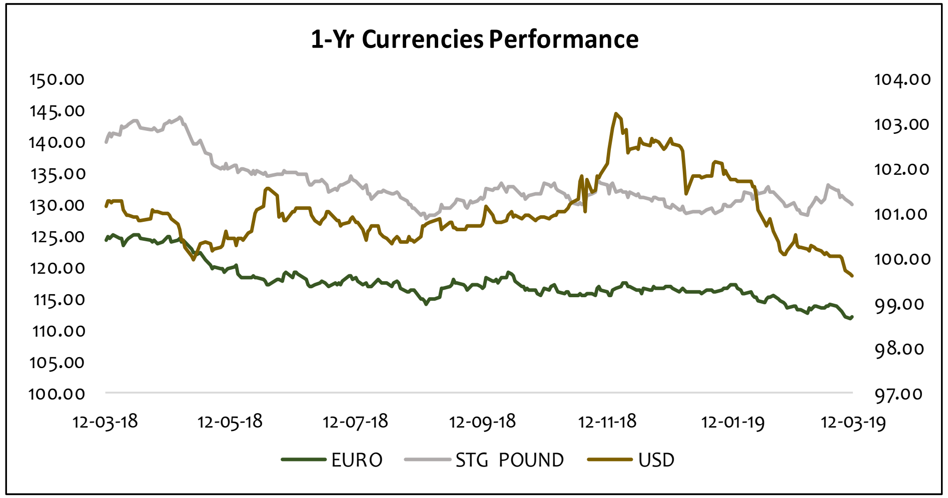
- The monetary policy committee is set to meet on 27th March 2019 and the committee may opt to retain the bench mark rate at 9.00%, supported by well anchored inflation expectations and a stable currency.

- In the first half of the month, the interbank rate rose to an average of 3.96%, an increase from February's average of 2.64%. The total volumes traded in February rose to KES 254.37Bn from the total volumes of KES 235.06Bn in January. 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 Offer Stability to the Shilling …



Source: CBK, Kingdom Research



Source: CBK , Kingdom Research

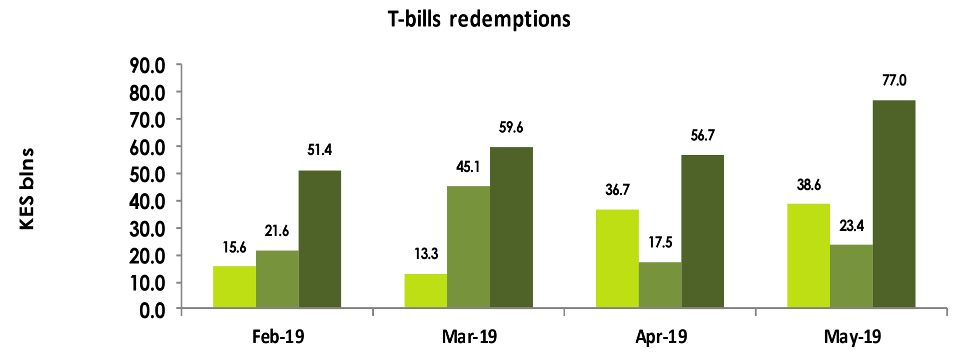
- Official data from the CBK indicates that foreign reserves stood at USD 8.15Bn as at 07th March 2019, equivalent to 5.29 months of import cover (minimum-4 months, a significant rise from last month). The reserves averaged USD 8.357Bn in 2018 with the months of import cover averaging 5.57, which was 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 narrowing of the current account deficit to 4.6%. The KES has strengthened significantly to 99.61 against the USD in the last couple of weeks and is expected to remain relatively stable trading range bound against the dollar between 100.00 – 102.00 This will be **largely** supported by a narrowing current account deficit, robust forex reserves and Central Bank of Kenya (CBK) interventions.

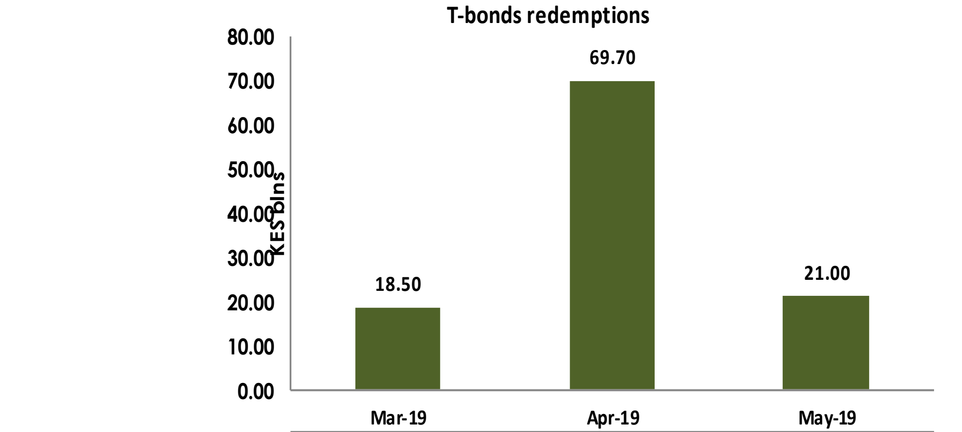
- The foreign reserves will continue to provide a buffer for the shilling against short-term shocks. We anticipate resilient tea and horticulture exports, stronger diaspora remittances and continued recovery in tourism to boost the forex reserves in the long-term.

- 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 although this could change if the government is successful in issuing another Eurobond which is already in talks.

Dearth of T-Bond Maturities in 1Q19 offers Apex Bank Some Reprieve…

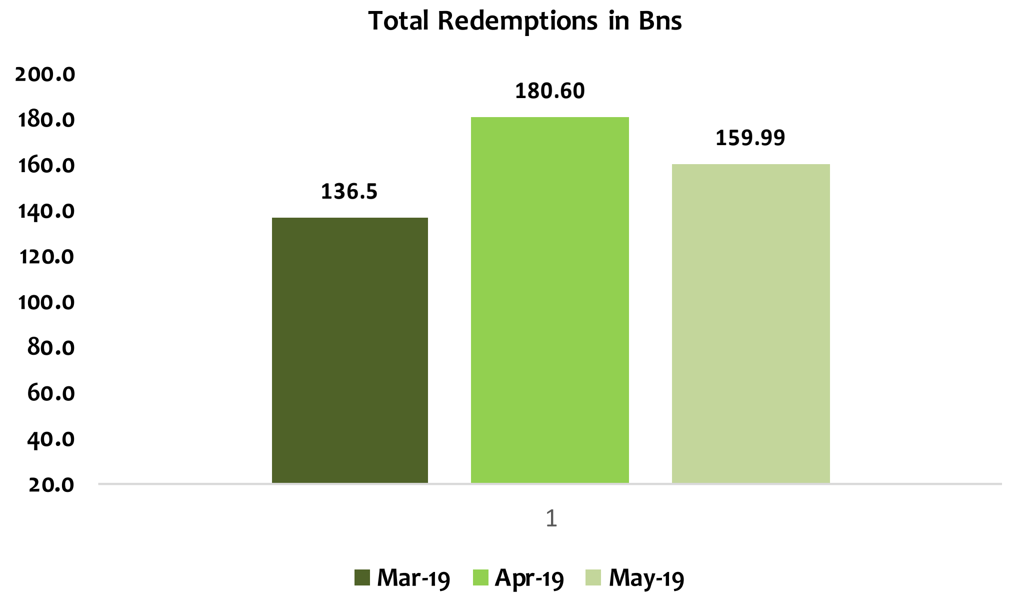


	Feb-19	Mar-19	Apr-19	May-19
91D Redemptions	15.6	13.3	36.7	38.6
182D Redemptions	21.6	45.1	17.5	23.4
364D Redemptions	51.4	59.6	56.7	77.0

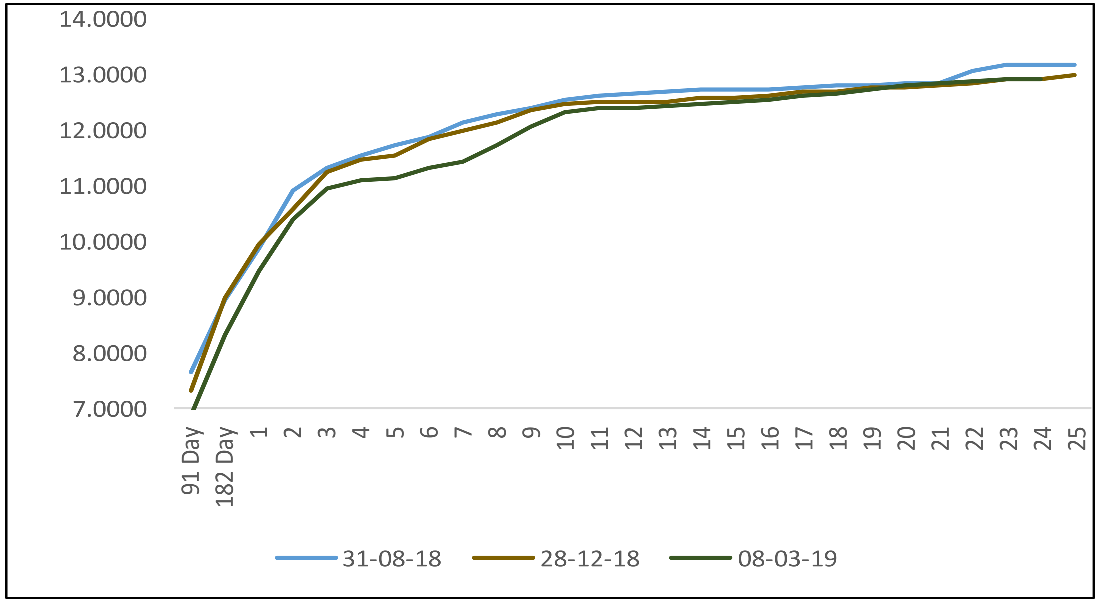


	Mar-19	Apr-19	May-19
T-bonds redemptions - KES b	18.50	69.70	21.00

- Estimated redemptions in the month of March -2019 for both T-bonds and T-bills sum up to KES 136.5Bn vs. the targeted issues worth KES 160Bn in both T-Bills and bonds. Amounts equal to the redemptions (KES 136.5Bn) 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 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/higher performance rates leading the CBK to acquire lower/ higher 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.
- 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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Research Department
Kingdom Securities Ltd – A subsidiary of Co-operative Bank Limited.
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