PRE AUCTION BOND NOTE- *MAY 2019*

CBK BALANCES OUT MARKET APPETITE WITH 5 &15 YR ISSUES

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Key Bond Features for the Treasury Papers – FXD2/2019/5Yr and FXD2/2019/15Yr

Treasury Bond	5-Year Paper	15-Year Paper
Issue No.	FXD2/2019/5	FXD2/2019/15
Tenors	5-Years	15-Years
Coupon	Market determined	Market determined
Opening Date	17th April 2019	17th April 2019
Closing Date	07th May 2019	07th May 2019
Minimum Amount (KES)	KES 50,000	KES 50,000
Taxation	15%	10%
Auction Date	08th May 2019	08th May 2019
Secondary Trading	14th May 2019	14th May 2019

Bidding Guide…

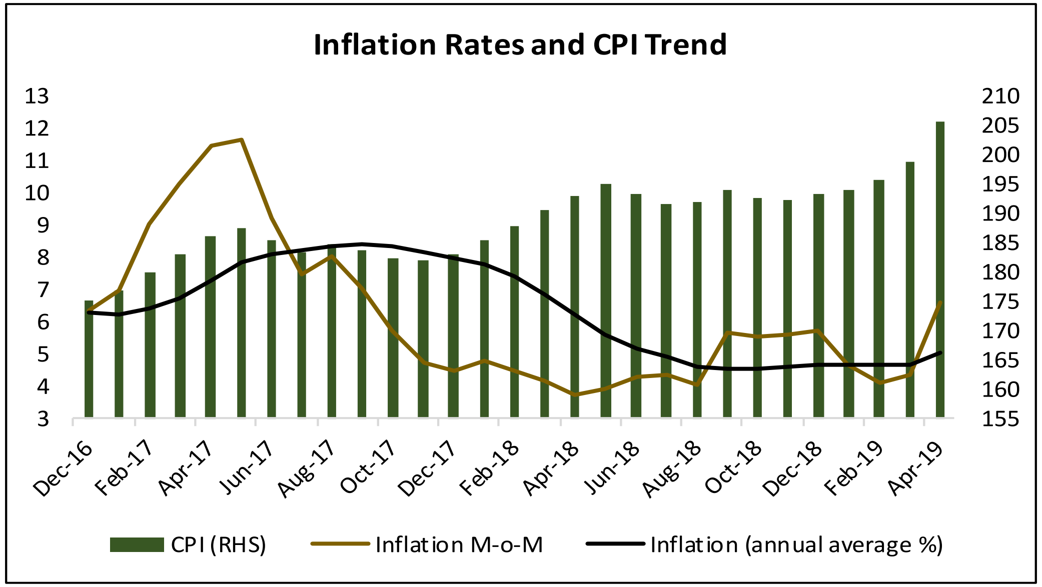
Paper	Conservative	Aggressive
FXD2/2019/5	10.60 - 10.70	10.70 - 10.90
FXD2/2019/15	12.45 - 12.55	12.55 - 12.70

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).**

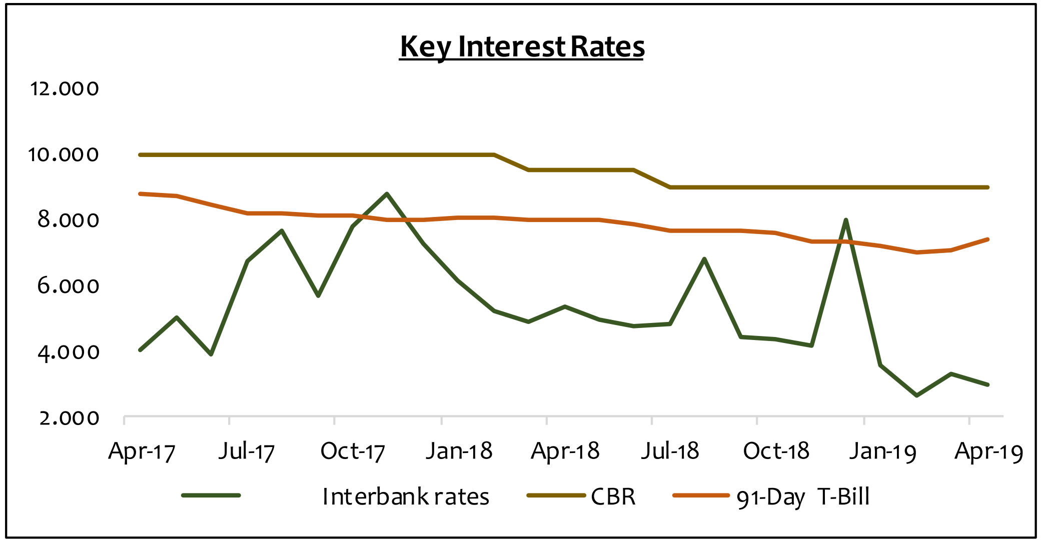
Overview:

- The treasury has issued two treasury papers – FXD 2/2019/5Yr and FXD2/2019/15Yr with a target of raising KES 50Bn for budgetary support. The paper's coupon rates will be market determined, and attracts 15% and 10% withholding tax respectively 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 15-year due to the higher appetite for short term papers and an oversubscription on the 5-year paper.
- Banks are usually attracted by short-dated papers due to their higher liquidity needs, thus much of the subscription is expected to come from them for the short-dated paper as other investors such as pension funds and insurance companies rush for the 15-year paper.
- 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 Edges Closer to the Upper Limit at 6.58%, Interbank Rates Dip to 2.98%…



Source: KNBS, Kingdom Research



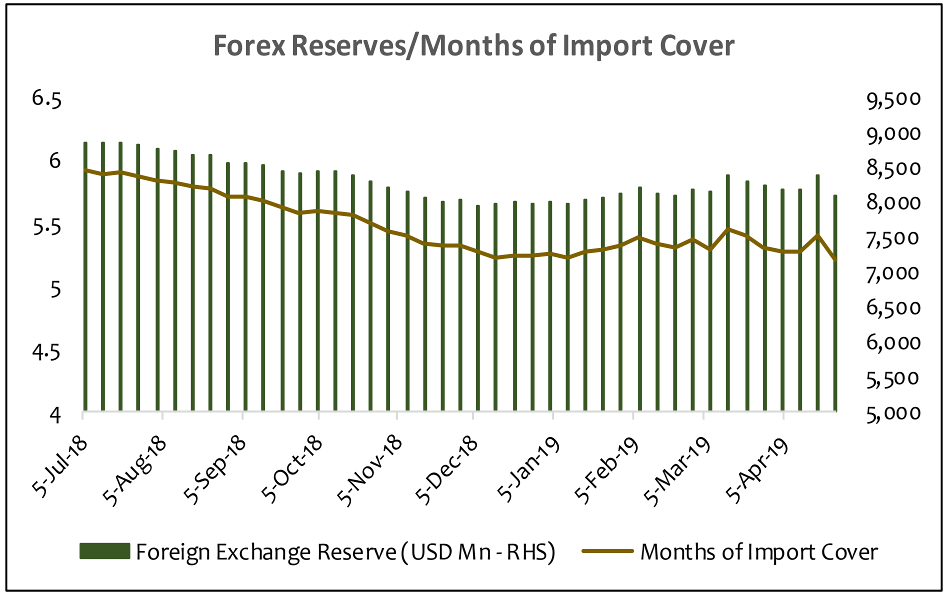
Source: CBK, Kingdom Research

- Inflation for the month of April ticked up to 6.58% compared to 4.35% recorded in March 2019. This was driven by a rise in food prices due to the prevailing drought conditions in the month of April. Food and Non-Alcoholic Drinks' Index increased by 6.86% on account of a rise in prices of some foodstuffs outweighing decreases recorded in others. Housing, Water, Electricity, Gas and Other Fuels' Index, rose by 0.93% in April 2019 compared to March 2019 mainly due to higher cost of some house rents and electricity. Transport index increased by 0.86% on account of rises 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 as a result of the onset of long rains.

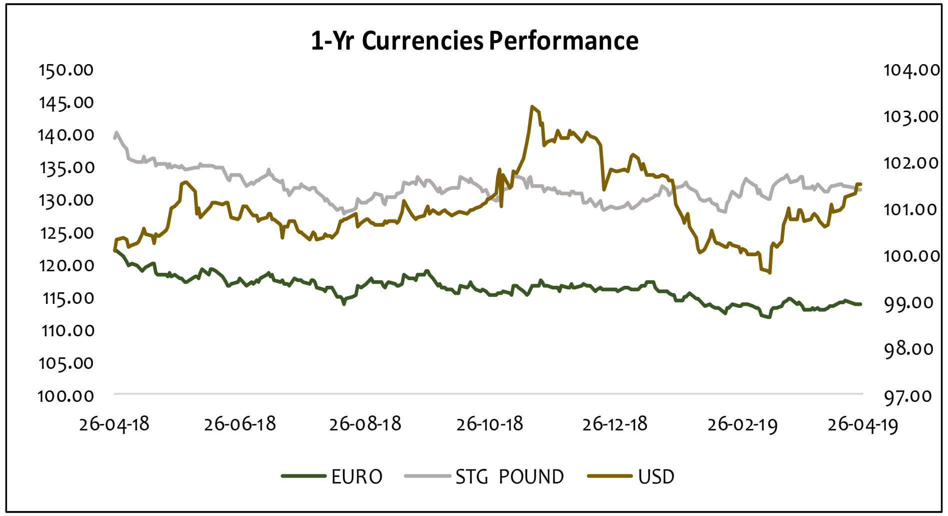
- The monetary policy committee met on 27th March 2019 and opted to retain the bench mark rate at 9.00%, supported by well anchored inflation expectations and a stable currency. Private sector credit grew by 3.4% in the 12 months to February 2019, compared to 3.0% in January.

- The interbank rate has come down from a high of 8.01% as at December 2018 to 2.98% as at April 2019, largely attributed to the high liquidity in the market. The total volumes traded in April rose to KES 172.14Bn from the total volumes of KES 108.09Bn in March. 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

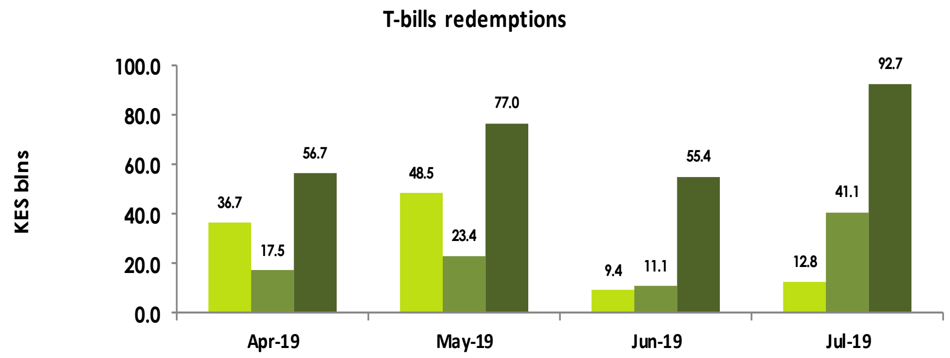
- ❖ Official data from the CBK indicates that foreign reserves stood at USD 8.12Bn as at 25th April 2019, equivalent to 5.22 months of import cover (minimum-4 months, a significant rise from last month). The reserves have averaged USD 8.174Bn in 2019 with the months of import cover averaging 5.32 compared to USD 8.357Bn /5.57months of import cover as at 2018. The forex reserves have been supported by robust diaspora remittances (30% growth in 12 months to Feb), strong growth of our exports especially horticulture (14% growth in 12 months to Feb) and slower growth of imports.

- ❖ The foreign exchange market has remained balanced supported by narrowing of the current account deficit to 4.7%. The KES has weakened significantly to 101.55 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 This will also be **largely** supported by a narrowing current account deficit, robust forex reserves and Central Bank of Kenya (CBK) interventions.

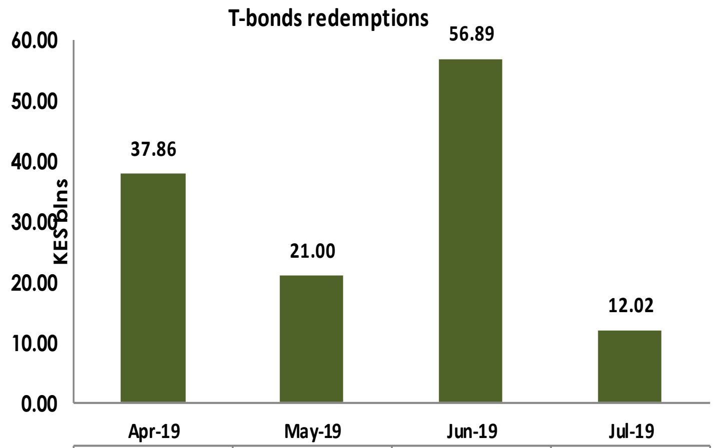
- ❖ The foreign reserves will continue to provide a buffer for the shilling against short-term shocks. We anticipate resilient tea and horticulture exports, stronger diaspora remittances and continued recovery in tourism to boost the forex reserves in the long-term.

- ❖ 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.

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

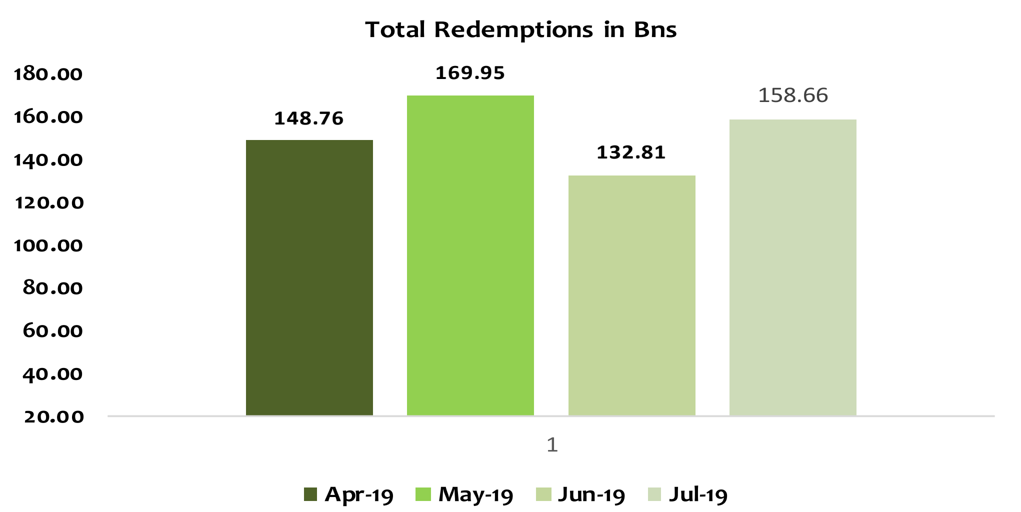


	Apr-19	May-19	Jun-19	Jul-19
91D Redemptions	36.7	48.5	9.4	12.8
182D Redemptions	17.5	23.4	11.1	41.1
364D Redemptions	56.7	77.0	55.4	92.7

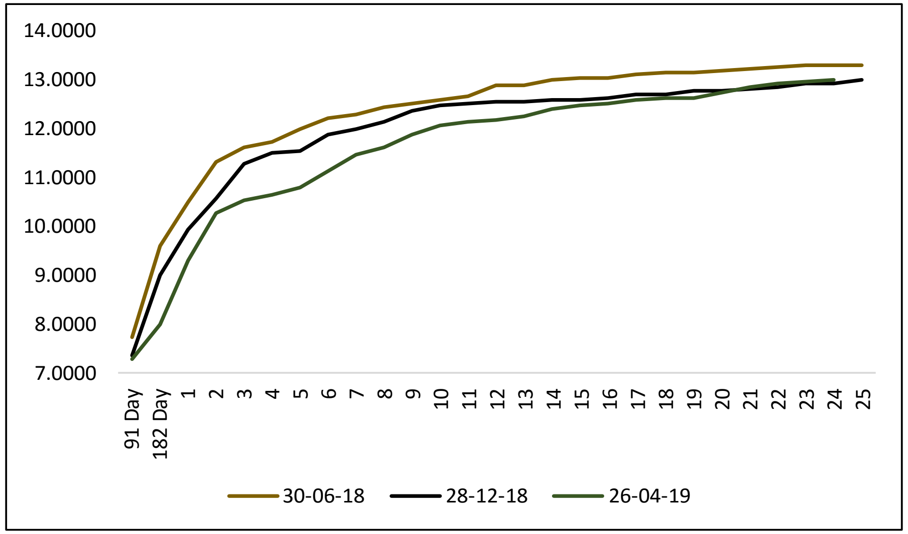


	Apr-19	May-19	Jun-19	Jul-19
T-bonds redemptions - KES b	37.86	21.00	56.89	12.02

- Estimated redemptions in the month of May-2019 for both T-bonds and T-bills sum up to KES 169.95Bn vs. the targeted issues worth KES 170Bn in both T-Bills and bonds. Amounts equal to the redemptions (KES 169.95Bn) 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 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 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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