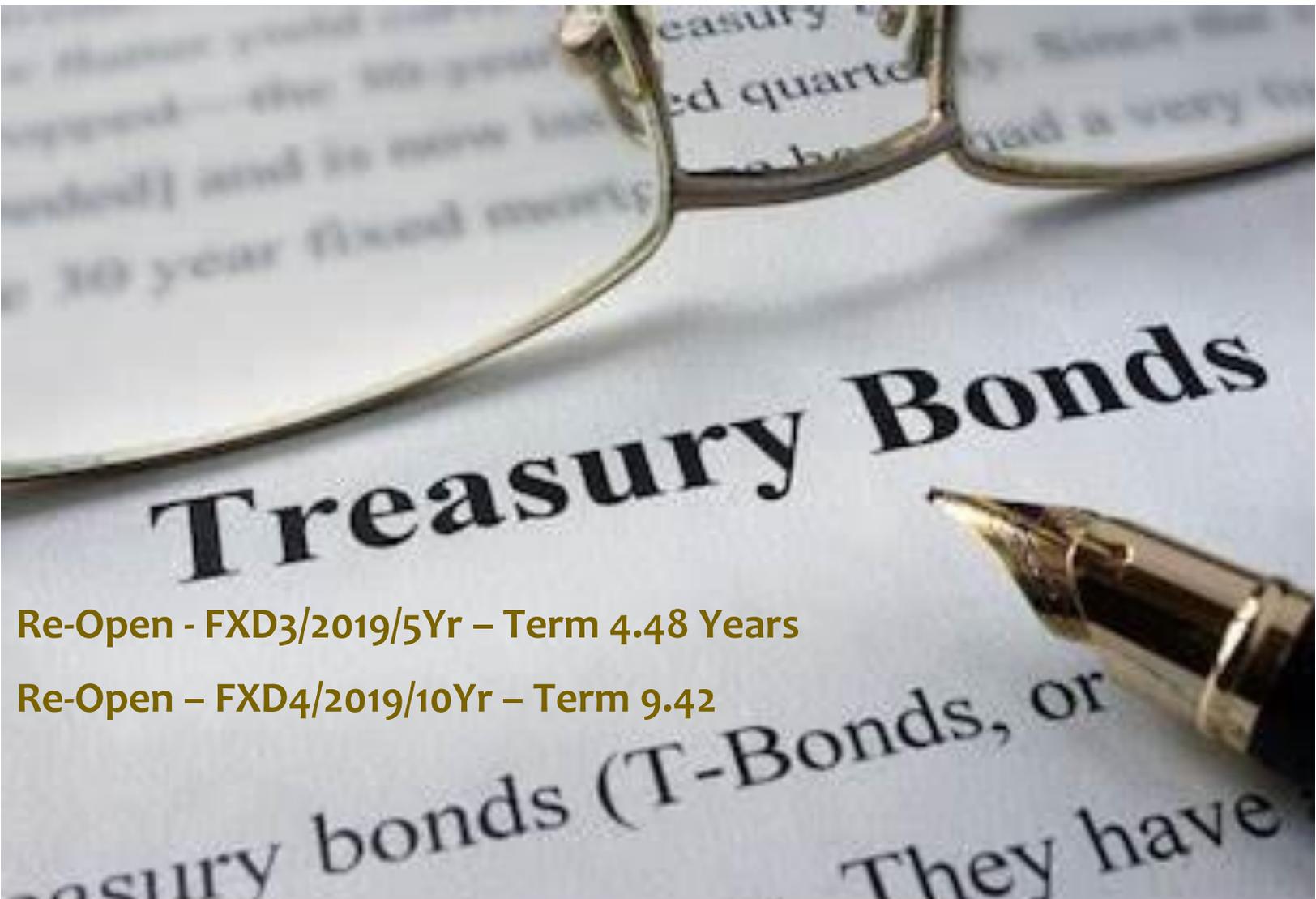


Kingdom Securities Limited

Pre-Auction Fixed Income Note – June 2020



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At the close of the 2019/2020 fiscal year, the CBK has re-opened FXD3/2019/5 (Coupon 11.492% - Term 4.48Years) and FXD4/2019/10 (Coupon 12.280% - Term 9.42Years) for a total of KES 40Bn to be used for Budgetary Support. We anticipate an over subscription on the 5-year bond and a preferred acceptance on the 10-year bond.

We advise our clients to bid as follows:

Bond	FXD3/2019/5Yr	FXD4/2019/10Yr
Tenure Year	4.48	9.42
Conservative Bid	11.35% - 11.55%	12.35% - 12.50%
Aggressive Bid	11.50% - 11.70%	12.45% - 12.60%

CBK's Monetary Policy Committee (MPC) will meet on Thursday, June 25, 2020. We opine that they will retain the MPR at 7.0% as the measures placed during the March and April MPC meetings continue to trickle into the economy.

Our opinion is based on:

- May inflation stand at 5.47%. June inflation to range 5.15% - 5.40%
- Liquidity Levels remaining high with interbank to remain in Sub 3% levels.
- Banking sector expected to remain stable with high regulatory levels.
- Stable shilling supported low import demand and foreign reserves 5.59 months of import cover.
- Private credit growth to remain positive focusing on manufacturing sector. This will boost PMI to better levels compared to 36.7 seen in May.
- Glimpse of re-opening of global economies with China and America consumption levels expected to rebound marginally in Q3 2020.

Inflation: May inflation stood at 5.47%, 11.1bps lower compared to 5.62%. The rate benefited from low food prices and decline in petroleum pump prices.

- We project June inflation to range 5.15%-5.40% with further food decline and much better diesel and paraffin prices.

Currency: The shilling remained on the backfoot against major currencies as countries continue to slowly re-open their markets with adjustment and work around with the COVID-19 pandemic.

12-Jun-20	KES/USD	KES/GBP	KES/EUR	KES/JPY	Dollar Index
W/W	0.4%	1.5%	1.6%	2.3%	0.4%
M-t-D	0.3%	2.2%	1.7%	0.3%	0.4%
M/M	0.3%	3.1%	5.4%	0.5%	2.6%
Y-t-D	5.1%	1.2%	6.5%	6.5%	0.5%
Y/Y	5.1%	4.6%	5.4%	6.3%	0.3%

Table 1: Currencies

Source: CBK, KSL

- The dollar touched y-t-d low of 107.2915 KES/USD in end of April with payment of KES 10.5Bn interest for loans owed to the Exim Bank of China and KES 17.8Bn interest payment on Eurobond 2019 in Mid-May at KES 107.0353/USD.
- On year to date basis, the shilling has lost 5.1%, 1.2% and 6.5% against USD, GBP and EUR.
- On the international level, the USD Index closed the week strong up by 0.4% w/w with May retail sales date expected on Tuesday with investors watching the signs of a mending economy after retail sales figures plunged 16.4% in April 2020.
- Stable shilling supported low import demand and foreign reserves 5.59 months of import cover.
- Financial assistance from multinational partners have boosted Forex Reserves to USD 9,302Mn or 5.59 Months of import cover. The reserves improved by 20.1% from USD 7,744Mn or 4.66 months of import cover.
 - World Bank – Contingency Emergency Response to the Ministry of Health – KES 6.8Bn
 - IMF Rapid Credit Facility – KES 78.3Bn
 - World Bank – Development policy operation for budgetary support and fight against COVID-19 – KES 108Bn
 - Africa Development Bank – Concessionary Loan – KES 22.5Bn
 - European Union – Grant Commitment – KES 7.5Bn

Interbank Rate: Money Market Interbank Rate averaged a low of 4.11% and an average demand of KES 12.70Bn in May from an average of 5.34% and KES 8.07Bn in April.

- Month to date, interbank rate has remained subdued at 2.88% and an average of KES 6.41Bn against an average of 4.11% and KES 10.53Bn same period last month.

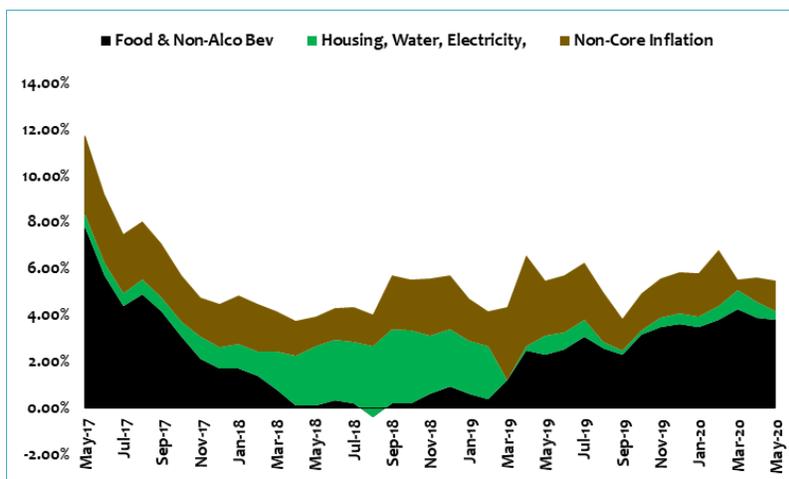


Figure 1: Inflation

Source: KNBS, KSL

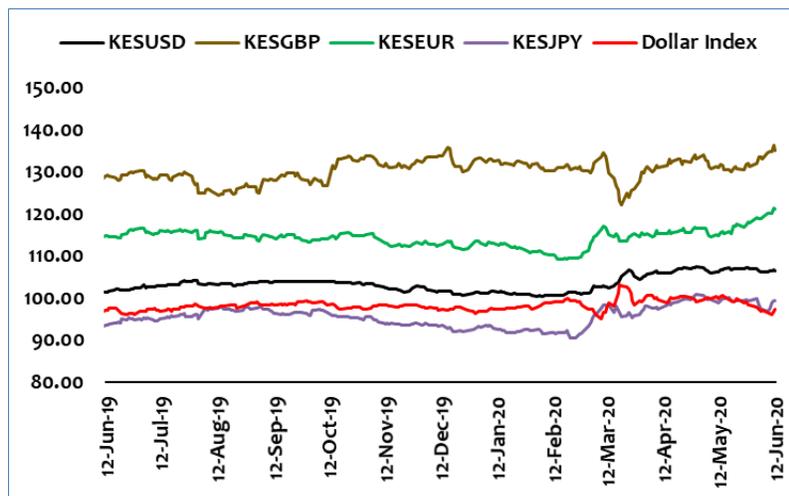


Figure 2: Currency and Dollar Index

Source: CBK, Bloomberg, KSL

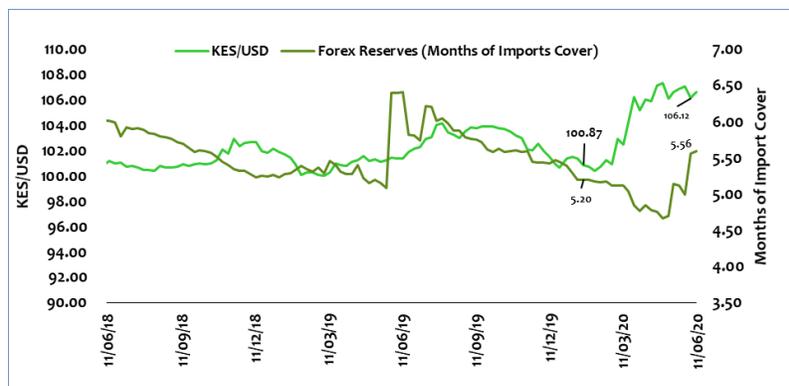


Figure 3: Foreign Reserves

Source: CBK, KSL

- With the high liquidity regime, we anticipate interbank rate to remain in sub 3.0% average as effects of 100bps cut in Commercial Bank's Cash Reserve Ratio and 125bps in CBR tickles to the market.

Government Domestic Debt: As at end of April, Domestic borrowing stood at KES 476.95Bn. As per the Supplementary Note 2 of 2020/2021, Domestic Debt was revised upwards to KES 560.97Bn from KES 429.34Bn in the 2019/202 Budget. The Domestic Debt is composed of KES 338.39Bn in Net Domestic Borrowing and KES 222.58Bn in Redemptions.

- We expect the Domestic debt levels to rise with the government set to borrow a net of KES 486.2Bn in the financial year 2020/2021. We anticipate the rate volatility to remain low as the government manages cost of financing especially for short tenure papers.

T-Bills: High liquidity levels in the market has seen T-Bill subscriptions on the rise to stand above 100% since May 17th auction to near triple levels in the second auction in June.

- Acceptance rates eased to <40% with rate of returns easing by 0.7bps, 13.4bps and 14.3bps for the 91-day, 182-day and 364-day respectively.
- T-Bill Redemptions: For the month of June, redemptions stood at KES 93.90Bn. This reduced by KES 19.28Bn with the conversion of T-Bill Issue No. 2236/364 to a six-year infrastructure bond.
- July and August redemptions stand at KES 107.65Bn and KES 123.87Bn against a need of KES 124Bn and KES 96Bn respectively.
- We expect subscriptions to remain high due to roll-over and increase liquidity due to the effects of the lowered Commercial Cash Reserve Ratios. We advise our clients to invest in the 364-day paper at 8.95%-9.0%.

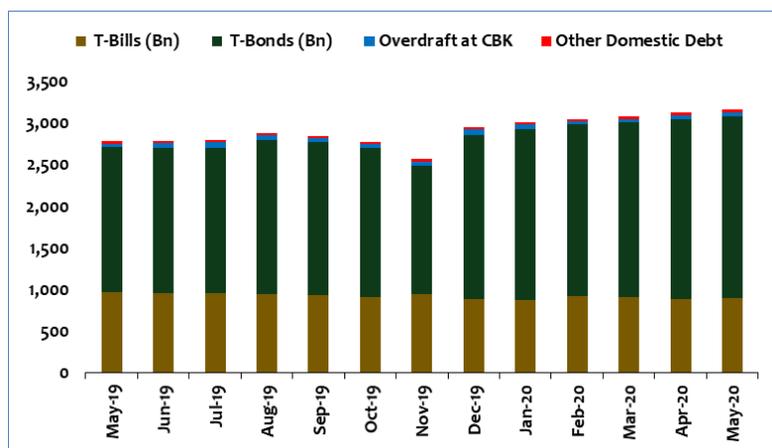


Figure 4: GoK Domestic Debt

Source: CBK, KSL

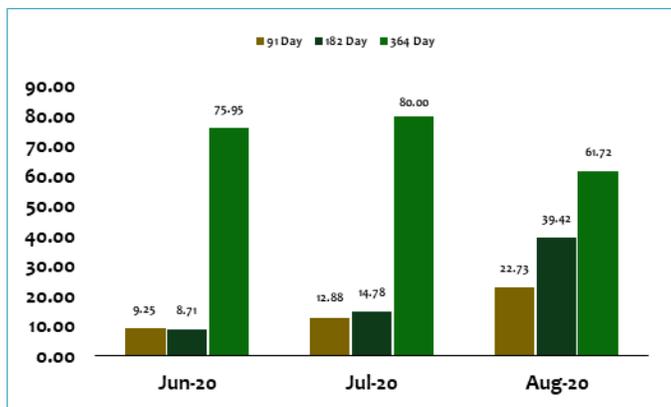


Figure 5: T-Bill Redemptions

Source: CBK, KSL

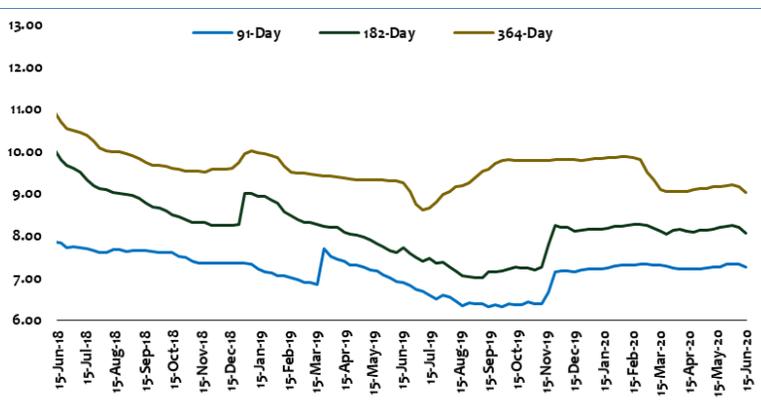


Figure 6: T-Bill Rates

Source: CBK, KSL

T-Bonds: In the month of May, the government issued a 5 Year Bond for KES 50Bn. It received KES 34.53BN (69.1%) and accepted 20.78Bn or 60.2% with a weighted average rate (WAR) of 11.67%.

- They issued the same bond with a KES 30Bn offer, receiving KES 20.58Bn (68.6%) accepting KES 8.95Bn at improve WAR of 11.75%.
- Treasury also opted to convert of T-Bill Issue No. 2236/364 to a six-year infrastructure bond worth KES 25.60Bn. Investors opted to convert KES 21.16Bn 82.7% while the government accepted 19.26Bn (91.1%) at WAR of 11.6%. The accepted WAR on the infrastructure bond was 229.9bps higher than the one year of 9.31%.

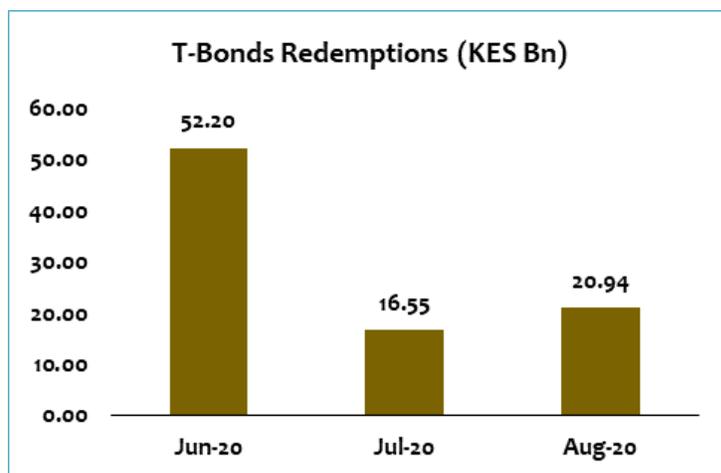


Figure 7: T-Bond Redemptions

Source: CBK, KSL

- T-Bonds Redemptions: in the month of June, we expect a total of KES 52.20Bn in payout composed of KES 30.96Bn in maturity and KES 21.25Bn in interest payout.
- July and August payment stand at KES 16.55Bn and KES 20.91Bn in interest.
- Weekly yields saw 2-Yr, 15-Yr and 20-Yr shift downward by 14bps, 7bps and 5bps respectively.
- The 5-Yr and 10-Yr key rates shifted up by 13bps and 10bps respectively.
- Liquidity levels in the market will continue to shift short end rates further down at a faster rate compared to the long end.
- At the end of May, the monthly yield curve saw a downward shift while remaining above the yield curve at the same period in 2019.

YTM Key Rates %	03-Jan-20	05-Jun-20	12-Jun-20	(YTD) bps	W/W bps
2 Year	10.4458	10.1408	10.0000	0.45	0.14
5 Year	11.4867	11.4251	11.5518	0.07	0.13
10 Year	12.1035	12.2309	12.3270	0.22	0.10
15 Year	12.5211	12.7294	12.6615	0.14	0.07
20 Year	12.9125	13.0438	12.9900	0.08	0.05

Table 2: Key Rates Changes

Source: NSE, KSL

Primary Issue: Treasury re-opened FXD3/2019/5Yr and FXD4/2019/10Yr.

We anticipate an over subscription on the 5-year bond and a preferred acceptance on the 10-year bond as the government continues to work on lengthening the tenure of the domestic debt.

Below find our bidding position.

Bond	FXD3/2019/5Yr	FXD4/2019/10Yr
Tenure (Year)	4.48	9.42
Coupon	11.49%	12.28%
Conservative Bid	11.35%-11.55%	12.35%-12.50%
Aggressive Bid	11.50%-11.70%	12.45%-12.60%

Table 3: Primary T-Bond Bid

Source: KSL

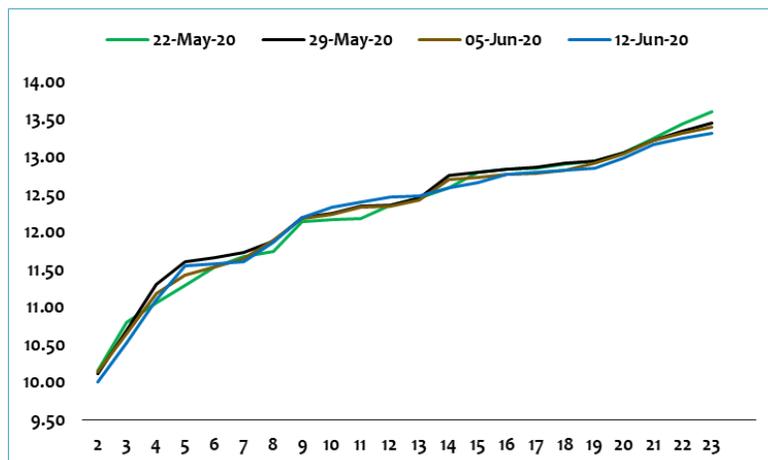


Figure 8: NSE Weekly Yield Curve

Source: NSE, KSL

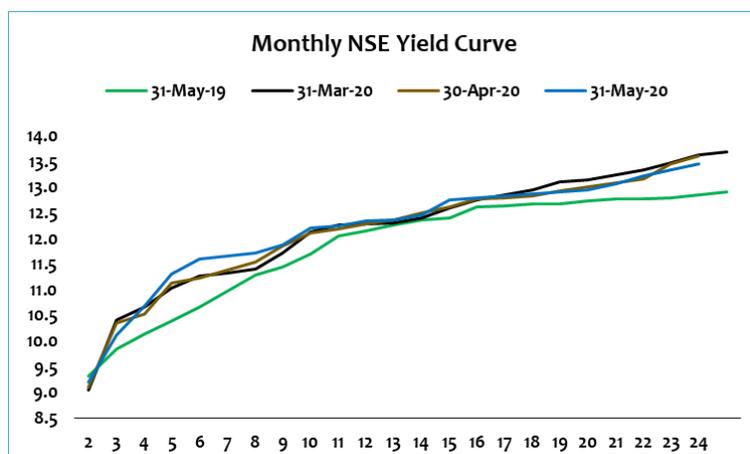


Figure 9: NSE Monthly Yield Curve

Source: NSE, KSL

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