Kingdom Securities Limited

Pre-Auction Fixed Income Note – April 2021

Second Take on Foreign Markets

IFB1/2021/18Yr

New IFB1/2021/18Yr – Market Determined Coupon

April 1, 2021

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CBK has offered a second Infrastructure Bond in Q1-21. The offer, IFB1/2021/18Years is for KES 60.00Bn with a market determinant coupon. With the target borrowing and building forex reserves, we expect aggressive bidding with >100% subscription shouldered by foreign investors interest. Below is our bidding guidance.

Bond	IFB1/2021/18Yr
Tenure	18 years
Coupon	MDA
Conservative Bid	**12.20% 12.40%**
Aggressive Bid	**12.50%- 12.80%**

CBK: MPC retain CBR at 7.0%...

- CBK's Monetary Policy Committee (MPC) retained the Central Bank Rate (CBR) at 7.0% stating stable macroeconomic environment. This included:
- Improved prospect on global recovery supported by aggressive vaccination and positive recovery policies
- Firm banking industry with adequate liquidity of 54.9% in January, gross NPLs of 14.5% with the industry restructuring KES 1.7Tr in loans or 57% of gross loan book.
- Steady shilling and adequate source of forex reserves of USD7,348 million (4.51months of import cover).
- Growing exports growing g by 1.2% y-y as of February with 2020 current account deficit in estimated at 4.8% of GDP.
- Private sector growth remains positive with private sector credit growing by 9.1% y-y in February while PMI was 50.9.

The current lockdown will create a new complication for business and economic projections especially with commercial banks remaining conservative on loan book growth. Borrowers will be hit hard as measures initiated by CBK including loan restructuring for a period of up to one of loans that were performing as at March 2, 2020, and the provision of regulatory flexibility to banks expiring on March 2, 2021.

February

- Gross NPL 14.5%
- PMI 50.9
- Private Credit Growth 9.7%

March

- CBR Retained at 7.0%

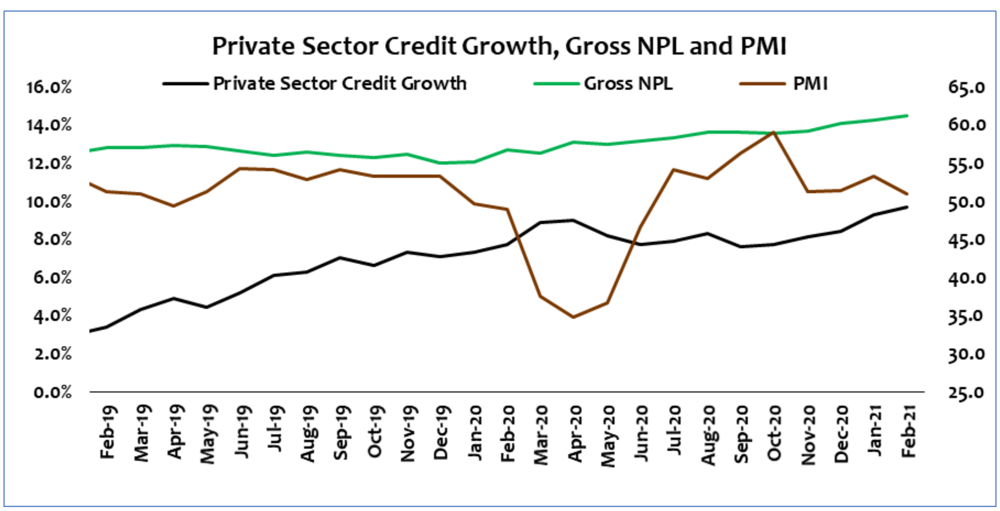

Figure 1: Private Sector, NPLs and PMI Source: CBK, KSL

US Ambitious Infrastructure Plan…

- International economies continue to put into place fiscal and monetary measures to stimulate economies. The US president initiated an ambitious plan to revive the economy through a USD 2Tn infrastructure spending which is intended to be financed through increase in corporate taxes from 21% to 28% and not dependent on national debt. The change in track on growing national debt will aid bond yields to stabilize or shift downwards from current levels

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Interbank Rate: The ups and downs…

- The market has seen the third wave of tight liquidity within the year. The monthly average interbank rate inched 69.5bps higher to 5.22% from 4.53% with average demand remaining flat at 13.02Bn from an average of KES 13.04Bn in March.
- The low demand was boosted by favorable liquidity levels from T-Bills maturities (KES 108.31Bn) and coupon payments (KES 20.83Bn).
- Commercial Bank reserves inched higher on the third week on delay on tax remittance. The levels later corrected with reserve dipping to close the month at KES 15.30Bn.
- **With the expected maturities, tight economic environment and high demand from treasury, we expect April to have tight liquidity with interbank rates to range on the 5.25% - 5.75% levels.**

March

- Inflation 5.9%

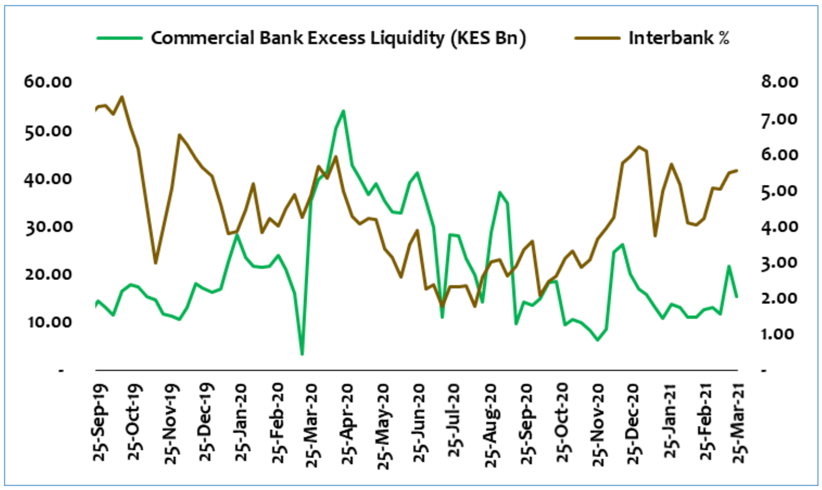

Figure 2: Interbank and Commercial Bank Excess Liquidity Source: CBK, KSL

Inflation: Food and Energy Pressure…

- At 5.9%, March inflation remained on the upper side of the government range of 5.0%±2.5% with pressure on from Food and Energy Index.

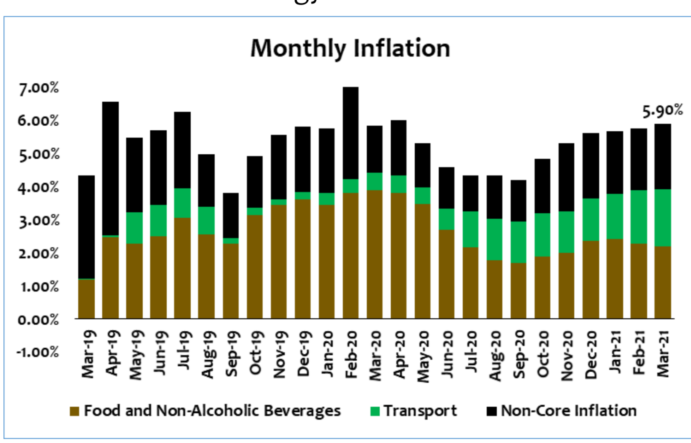

Figure 3: Inflation Source: KNBS, KSL

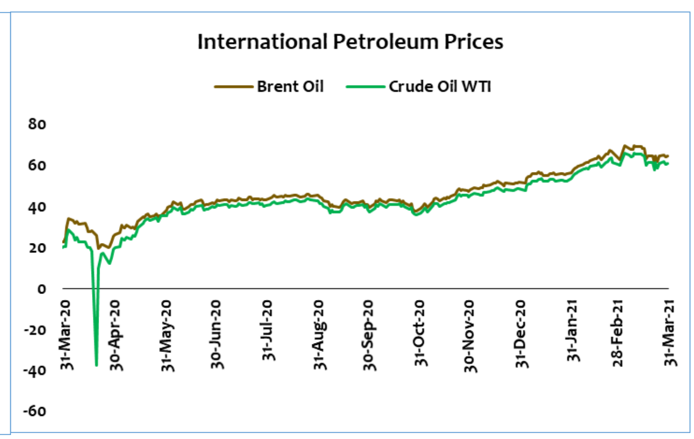

Figure 4: International Petroleum Prices Source: Bloomberg, KSL

- **We forecast a mild downward move on April inflation to 5.33% - 5.60% influenced by**
  i. Onset of long rains which will help ease food prices
  ii. Stable shilling against the dollar
  iii. Downward pressure on international petroleum prices. Brent trade at 5.6% average lower in March compared to February which had averaged 12.6% higher compared to January. Crude WTI saw March prices 5.6% higher compared to February which was 13.4% higher compared to January.

  On average, February-March prices averaged 8.9% and 9.3% higher on Brent and WTI respectively compared to an increase of 11.4% and 12.1% in January-February period which affected March pump prices.

Currency: Stability is Key…

- The local currency remained stable gaining 0.3% to close the month at KES 109.5118/USD. Against other majors, KES gained 2.7%, 3.9% and 4.1% on the GBP, EUR and JPY respectively.
- Internationally, the dollar eased its gain as bond yields shifted downwards but remained in demand as fiscal stimulus and aggressive vaccination rollout give light to a strong economic comeback.
- Attention on bonds remained high as the US plan USD 2Trn in infrastructure spending while will be finance through increase in corporate tax from 21% to 28% relieving the levels of National debt after the USD 1.9Tr stimulus package. The change in track on growing national debt will aid bond yields to stabilize or shift downwards from current levels.
- China's manufacturing PMI of March game in at 51.9, higher than February's 50.6reading. non-manufacturing PMI was 56.6 against 51.4 in February.

31-Mar-21	KES/USD	KES/GBP	KES/EUR	KES/JPY	Dollar Index
W/W	-0.3%	-0.8%	-1.6%	-1.9%	0.7%
M-t-D	-0.3%	-1.8%	-3.4%	-3.8%	2.3%
M/M	-0.3%	-2.7%	-3.9%	-4.1%	2.5%
Y-t-D	0.3%	1.1%	-4.2%	-6.3%	3.7%
Y/Y	4.6%	16.0%	11.5%	2.6%	-6.0%

Table1: Major Currencies Source: CBK, KSL

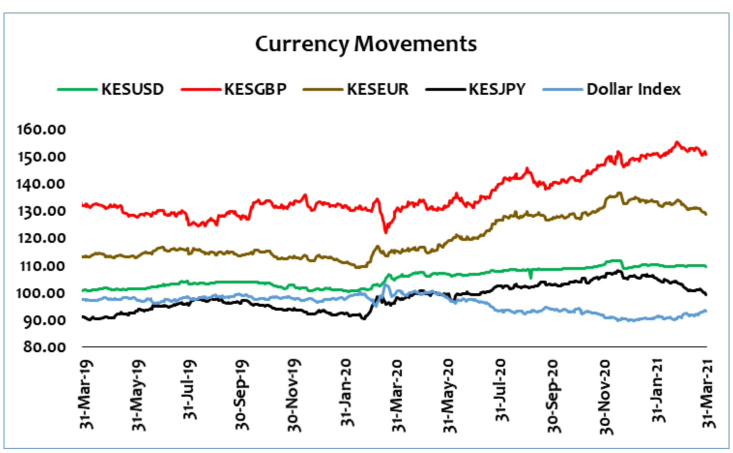

Figure 5: Major Currencies Source: CBK, KSL

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T-Bills: Liquidity reprieve enabled cost of funds…

- The month benefited from T-Bill maturities and coupon payments. This ensured March T-Bill auctions were oversubscribed by 116.4% compared to 87.9% in February.
- Increased demand saw acceptance rate remain high at 87.2% for March versus 93.4% in February. The market witnessed an upward trajectory on bids with 91-day,182-day and 364-day paper gaining 17.6bps, 20.6% and 32.8bps respective.
- There were rejections on aggressive bids on the 364-day paper with the aim of taming the rates.
- The maturities and low uptake helped treasury manage roll-over risk by reducing stock of treasury bills from 29.8% at end of March 2020 to 21.1% as per last auction.

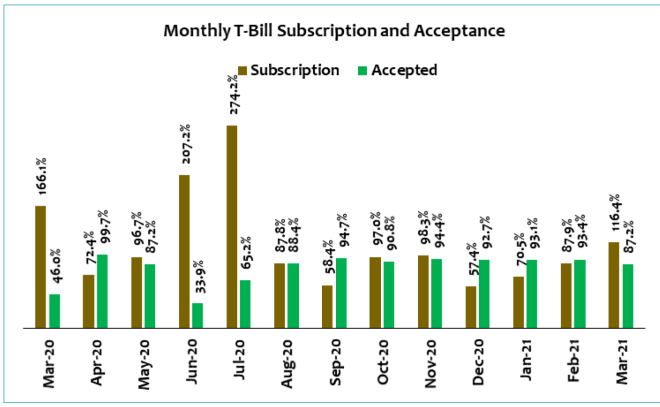

Figure 6: T-Bills Auction Performance Source: CBK, KSL

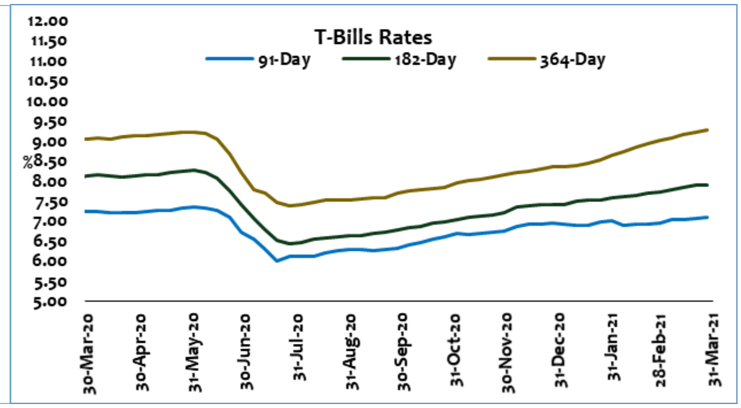

Figure 7: T-Bills Rates Source: CBK, KSL

- April will see a total of KES 181.5Bn in maturities against a target of KES 120.00Bn. First week will see a maturity of KES 25.65Bn which will help push liquidity. This is the liquidity treasury is moping with the IFB bond on issue.
- **We expect liquidity to remain fairly tight with auction undersubscription in April and May. Focus to remain on the 364-day paper. we foresee the rate on the paper to edge upwards to 9.635% - 9.660% in March.**

March Average T-Bill Rates

- 91-Day 7.027%
- 182-Day 7.819%
- 364-Day 9.140%

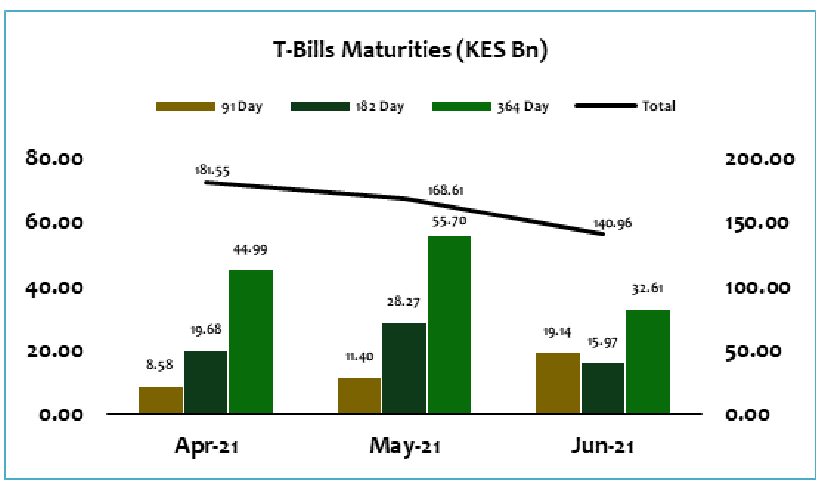

Figure 8: T-Bills Maturities Schedule Source: CBK, KSL

T-Bonds: Lengthening of the maturity profile of debt…

- Treasury continues with agenda for lengthening maturity profile by re-opening long-term papers with low coupon. This has contained the shape of the yield curve with only the short end shifting upwards with little or no shift on the long end.
- April payout stands at KES 19.54Bn in maturities and KES 27.28Bn in coupons. The payouts will concentrate on the third week with KES 31.95Bn expected during the period. This will give liquidity a cushion as company's schedule tax payments on 20th on the month.

April T-Bonds Payments

Coupon KES 27.28

Maturity 19.45

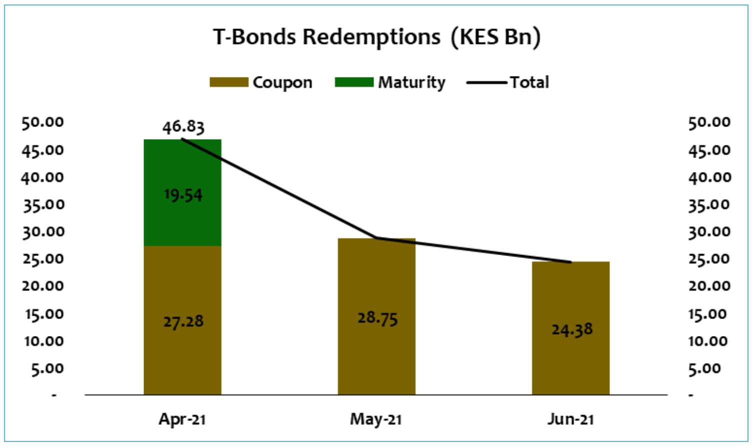

Figure 9: T-Bond Maturities Schedule Source: CBK, KSL

Yield Curve: Upward Shift on all Rates…

- Monthly yield curve saw an upward shift on all rates with the largest shift on the 2-year key rate. The curve showed a barbell within the horns likely to shift downwards.

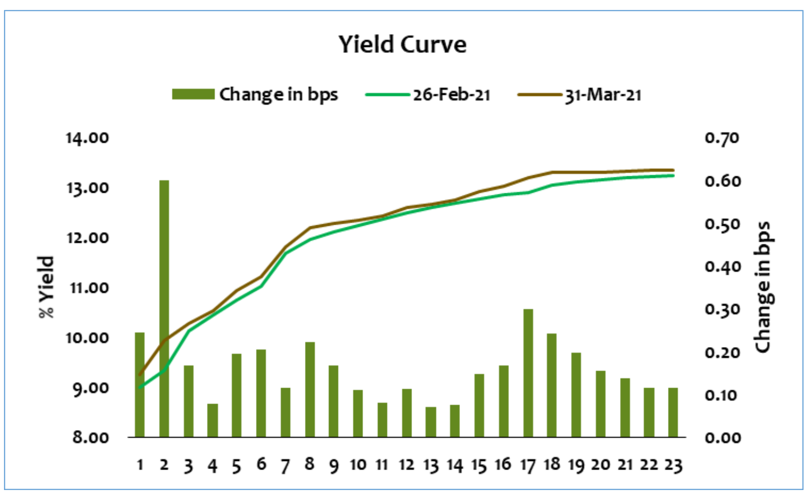

Figure 10: Monthly Yield Curve Source: NSE, KSL

- **We expect a sharp upward shift on the short end and a mild upward shift on the long end with investors focus remaining on the short end while trades will concentrate on the 8-year, 17-year and 18-year space.**

Government Debt: Rise and Rise in Government Debt…

- The debt maze continues to get complicated with parliament intending to reign in the run-away debt by ensuring treasury seeks approval of borrowing any amounts above KES 1.00Bn.
- As of end of January, reported government borrowing stood at KES 7352.26Bn with public and public guaranteed external loans at KES 3,819.70Bn or 52.0% and domestic det at KES 3,532.56Bn or 48%.
- With the treasury cutting revenues expectation by 2.3% while increasing expenditure by 3.2%, net borrowings, excluding grants, were adjusted upwards by 15.1% to KES 1,015.32Bn.
- Net domestic borrowing increased by 9.3% to KES 540.09Bn and total KES 802.04Bn. As of end of February, treasury had borrowed KES 524.43Bn or 74.7% of total need.
- Foreign debt was increased by 23.0% to KES 426.49Bn with heavy expectation to be filled by concessionary and Eurobond of USD 1.00Bn.
- **Treasury is seeking to float Eurobond of USD 1.0Bn to aid with debt payments. We project a hard sale with foreign investors requesting for higher returns compared to the last issue. This is due to**

i. Current tough economic status due to the Covid-19 pandemic effect will lead to a weak revenue base.

ii. Sovereign credit downgrade from B+ to B by S&P due to rising fiscal and external pressure caused by an increase in debt to GDP ratio to 65.1% in 2020 and weakening of the shilling by 7.7% over the period.

S&P Sovereign Downgrade

B+ to B

Debt to GDP 65.1%

January Public Debt

- Domestic KES 3,532.56Bn
- External and External Guaranteed KES 3,819.70Bn

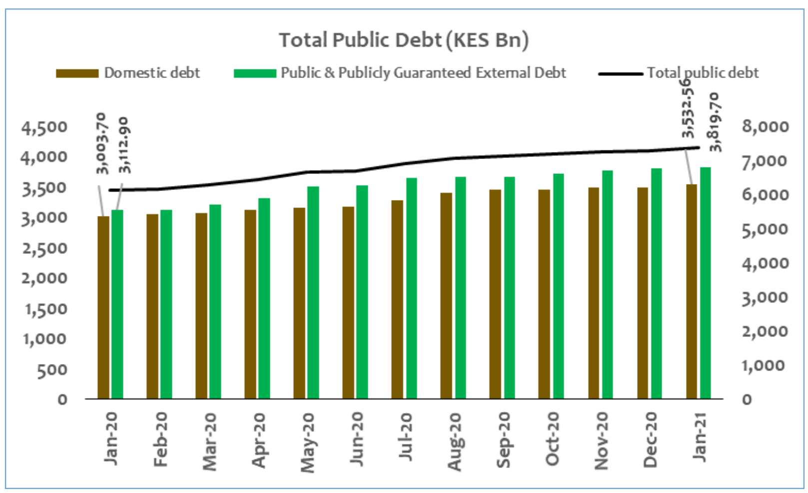

Figure 11: Public Debt

Source: CBK, KSL

Eurobond: Eurobond yields rise on Budget Review, Eurobond Proposal and Lockdown…

- Eurobond yields shifted upwards on:
  - i. Release of the February Policy Statement which increased foreign debt target by 23.0%,
  - ii. Proposal to issue USD 1.00Bn Eurobond,
  - iii. Downgrade of Kenya's sovereign rating from B+ to B by Standard and Poor Credit Rating Company,
  - iv. Presidential directive on regional lockdown which is expected to affect economic performance.
- **We forecast the yield to shift downward but remain under pressure in Q2-2021 as the economy continues to adjust in order to pull itself from the ream of the lockdown effects.**

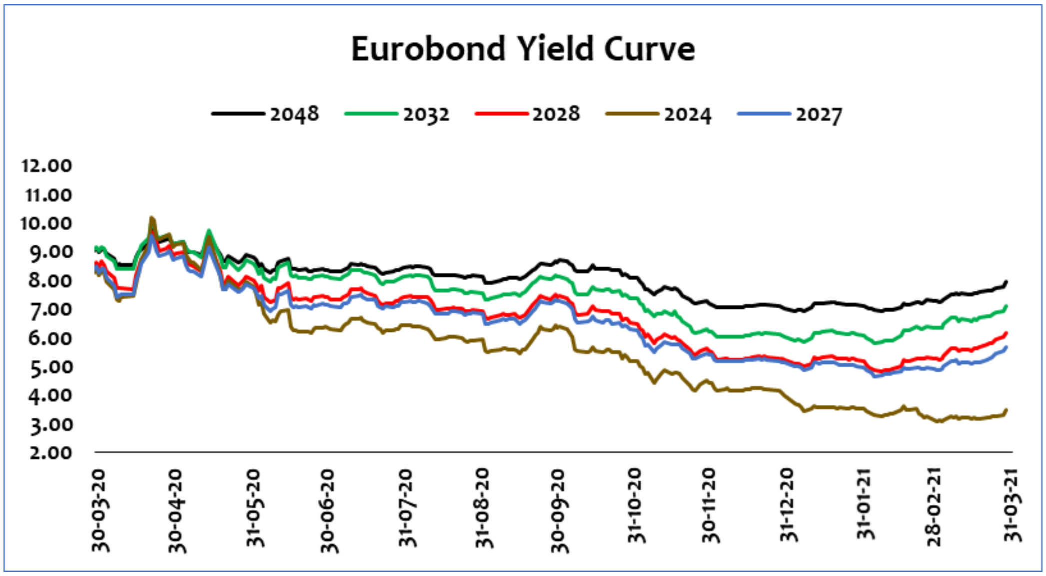

Figure 12: Eurobond Yields

Source: Bloomberg, KSL

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