Kingdom Securities Limited

Pre-Auction Fixed Income Note – August 2020

The Hunt for the Elusive Recovery

New IFB1/2020/11Yr

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The CBK offered KES 70Bn on a 11-year infrastructure bond. We expect positive response from investors with high expectation from foreign investors. With favorable liquidity levels and need for well-priced investment vehicle, we forecast >150% subscription with over 85% acceptance levers. We advise our clients to bid as below

Bond	IFB1/2020/11Yr
Tenure	11 - Year
Coupon	10.90%
Conservative Bid	**10.60% - 10.85%**
Aggressive Bid	**10.90% - 11.30%**

Table 1: Bond Bidding Guide Source: CBK, KSL

- The Kenyan Economy continues to open up as it grapples with the effects of COVID-19 pandemic effect as the numbers of infections continue to rise touching 30,000 cases with increased testing across the country. Africa COVID-19 infection have been on the rise with low death rates and high recovery rates. As of August 15th, 2020, there were 1.1Mn infections, 25,129 deaths and 0.81Mn recoveries. This is a 2.3% death rate and 74.0% recovery rate compared to 3.6% death rate and 66.4% worldwide.
- The president sent all Cabinet Secretaries, Permanent Secretaries and Cabinet Administrative Secretaries and Attorney General on 14 day working leave as the next cabinet meeting is scheduled for September 3rd.

Macroeconomy

- CBK MPC retained the CBR at 7.0% for the fourth month running as it monitors monetary policies initiated for economic recovery.
- Banking sector liquidity remains strong. June Private credit growth slowed to 7.6% compared to 8.1% in May. June Gross NPLs at 13.1% vs 13.0% in May heavily skewed towards manufacturing and trade.
- The shilling has lost 0.5% against the dollar since the beginning of August with heavy demand from importers as the local economy continues to open up.
- The decline of the reserves shows the effort of the regulator's participation in the market to contain the slip of the shilling as the forex reserves easing 0.6% m-m.
- The next MPC meeting will be held on Tuesday, September 29th, 2020.
- Global economic environment remains unpredictable with major economies recovering after reopening.
- Business confidence indicators, PMIs and Job market data in US (PMI 50.9), Europe (PMI 51.8) and china (PMI 52.8), overshot analyst projections. America July retail sales figures were up 1.9% while Chinese retail sales figures dipped by 1.1%.
- Global Pandemic seems to be past peak in North Asia, Europe with America showing a slowdown in infection and falling mortality across the globe, positive news from vaccine research with Russia production phase despite safety concerns,
- Oil prices to inch higher as demand increases with slow reopening of economies. According to Saudi Aramco MD, China demand has grown to close pre-covid levels and expected to increase even further. Air travel on five months high increasing demand.
- The challenge globally remains on the ongoing America China fueled trade conflict, with President Trump banning the use of Tiktok and WeChat if they are not sold by their Chinese owned parent companies.

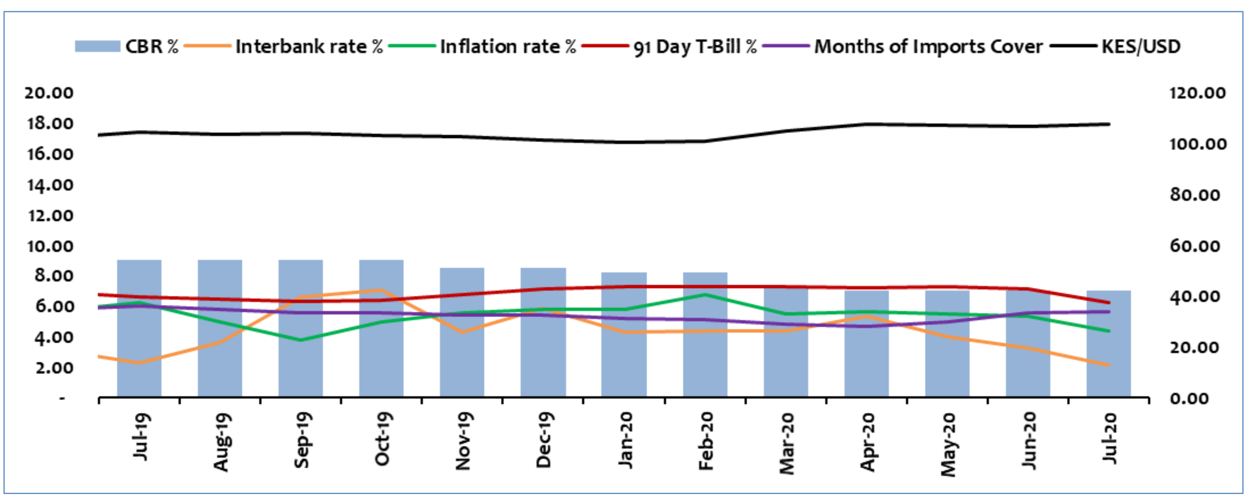

Figure 1: Key Macroeconomic Indicators Source: CBK, KNBS, KSL

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Local News

- County Allocation Revenue Bill 2020: Senate failed to resolve the stalemate on county revenue sharing formulae as senators continue to block national government effort in release county funds. Senators have rejected the Third Base formula proposed in the County Allocation of Revenue Bill 2020 citing loss of revenue by counties getting the largest allocation.
- The current formula used by Commission on Revenue Allocation puts emphasis on population factor (45%), equal share factor (26%), poverty factor (18%), land area factor (8%), fiscal effort (2%) and development factor (1%).
- CRA proposed the third Basis for revenue sharing formula - Health 17%, Agriculture 10%, Other County Services 18%, Public Administration 20%, Infrastructure 26%, Urban services 5%, Revenue Collection 2%, Prudent Use of County Resources 2%.
- Budget allocation on the fiscal budget stands at KES 316.5Bn for equitable distribution and a conditional grant of KES53.4Bn with an additional allocation of KES 5.24Bn for the purpose of development.
- The President sent all Cabinet Secretaries, Permanent Secretaries and Cabinet Administrative Secretaries and Attorney General on 14 day working leave as the next cabinet meeting is scheduled for September 3rd.

Macroeconomy

- CBK MPC committee retained the CBR at 7.0% for the fourth month running as it monitors monetary policies initiated for economic recovery.
- Banking sector liquidity remains strong. June Private credit growth slowed to 7.6% compared to 8.1% in May. June Gross NPLs at 13.1% vs 13.0% in May heavily skewed towards manufacturing and trade. By end of June, the industry had restructured a total of KES 844.4Bn in loans, 29.1% of total loan book, with c.72.0% in business loans.
- The lowering of the commercial bank cash reserve ratio (CRR) released KES 35.2Bn intended to support lending has not fully intended has seen a different effect with most commercial banks opting to grow investment in government securities to mitigating credit risk by growing loan book at a slower rate.
- The stimulus has headed to the financial market through government securities and not the real economy as intended by the CBK. There is need to continue coordinating of the fiscal policy and monetary policy to ensure the stimulus reaches the MSME which in the main drive of the economy.

Currency and Reserves: The reopening of the Kenyan economy has seen the shilling come under pressure from merchandise and oil importers demand.

- The shilling has lost 0.5% against the dollar since the beginning of August with heavy demand from importers as the local economy continues to open up. The shilling has shed 6.9% y-t-d basis.
- Figure 2 shows movement of the dollar reserves and shilling. The decline of the reserves shows the effort of the regulator's participation in the market to contain the slip of the shilling as the forex reserves easing 0.6% m-m.
- It continues to remain weak against major currencies shedding 1.1% and 1.2% m-t-d against the GBP and EUR respectively while gaining 1.1% against the JPY.
- Dollar index lost 0.4% m-t-d with sales figures underperforming expectations.
- In addition to the importers demand pressure, August will see a further decline in forex reserves on 7.25% and 8.25% coupon payment for USD 1Bn 2028 and USD 1Bn on 2048 maturities respectively.

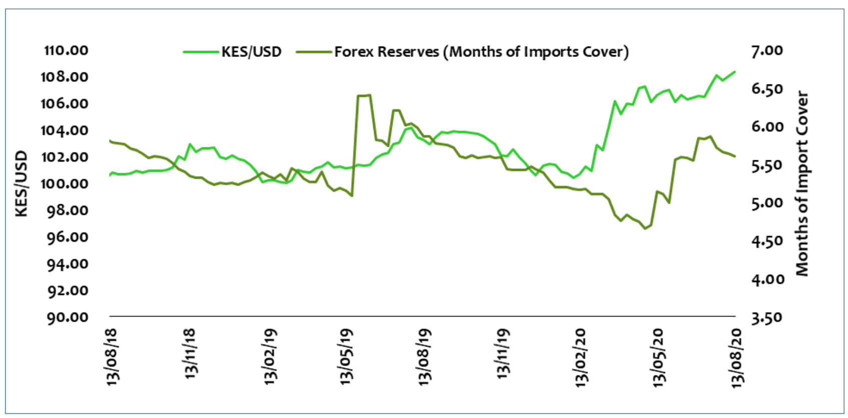

Figure 2: Forex Reserves vs KESUSD — Source: CBK. KSL

14-Aug-20	KES/USD	KES/GBP	KES/EUR	KES/JPY	Dollar Index
W/W	0.3%	0.3%	0.1%	1.0%	0.3%
M-t-D	0.5%	1.1%	1.2%	1.1%	0.4%
M/M	1.1%	4.9%	5.6%	1.4%	3.2%
Y-t-D	6.9%	6.3%	12.9%	8.6%	3.9%
Y/Y	4.9%	13.7%	11.0%	3.9%	5.1%

Table 2: Major Currencies — Source: CBK, KSL

- July PMI shot to 54.2 from 46.6 in June on rebound of business, recovering of consumer demand locally and for export.
- Local economy was boosted by removal of inter county restriction leading to quicker movement of finished products while reopening of the Kenyan skies will boost the levels better with H1-2020 exports growing by 1.7%.
- Low consumption will continue to pose a challenge to the economic recovery as the pandemic continues to pose a threat to MSME.
- With global tourism declining by 80%, Kenya tourism sector remains directly affected with low forex revenues expected from the sector.

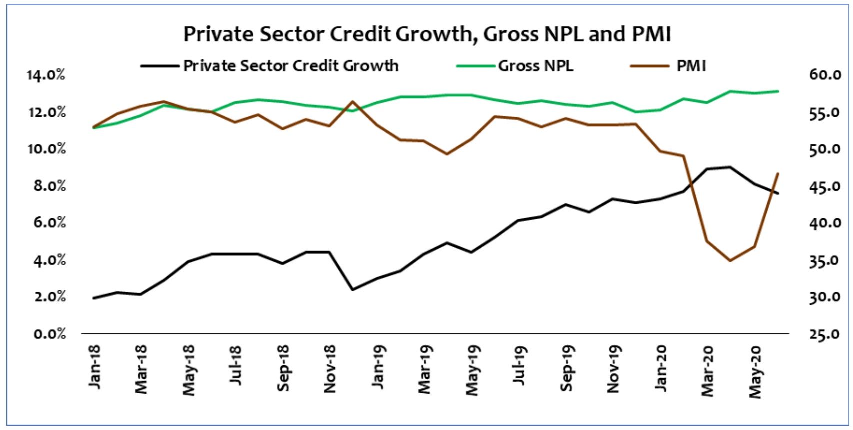

Figure 3: Private Sector Credit Growth, Gross NPLs and PMI Source: CBK, KSL

- July inflation was 4.36%, which was 23bps lower compared to 4.59% in June boosted by declining food prices. We project inflation to continue being anchored on the lower range of government target of 2.5%-5.0% on low food prices benefiting from favorable weather and stable international petroleum prices.
- As we enter the main maize harvest period, we forecast August inflation at 4.25% - 4.50%, we expect food prices to remain subdued.

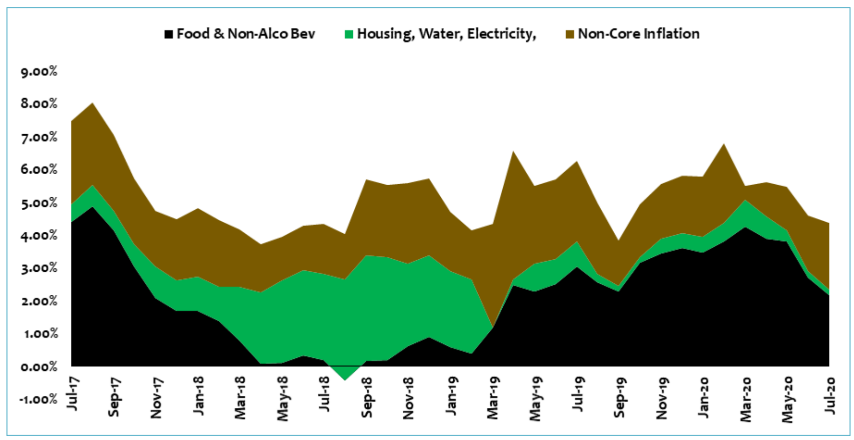

Figure 4: CPI and inflation Source: KNBS, KSL

Money Market

- **Liquidity –** liquidity in the market remained adequate with weeks interbank average rate at 1.95% from 2.49% with demand remaining flat at an average of KES 12.27Bn against an average of 12.44Bn previous week despite it being the close of CRR reporting.
- **T-Bills** Auction subscriptions stood at a four-week average of 124% on high liquidity in the market. Government thirst remains deep with an average acceptance levels of 90.1% in the last four auctions.
- There is a shift on subscriptions levels from the 364-day paper to the 91-day paper forcing a shift on redemption from the 364-day tenor to 91-day tenor. We expect subscription on the 91-day to remain high with investors strategy entail managing short-term liquidity.
- The market has seen an increase in government appetite leading to the reversal on the T-Bill rates trend with the 91-day, 182-day and 364 -day papers regain 18.9bps, 33.6nbps and 45.7bps respectively in the last three auctions.
- The tactical shift in investment from private credit lending to government securities, in particular short-term investments, has led to private credit lending growth declining to 7.6% in June compared to 8.1% in May.

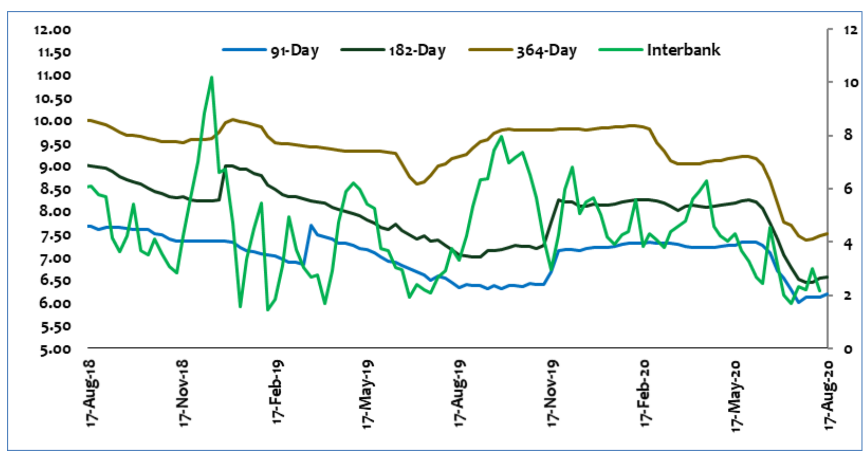

Figure 5: Money Market Rates Source: CBK, KSL

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- We do not anticipate the rates to continue an upwards trend for long as the increase is at a very slow pace compared to the earlier loss in value.
- **On liquidity management, we retain our recommendation on 91-day paper with a bid of 6.20% - 6.35%.**
- **T-Bill redemptions** for the month of August stands c.KES 123.87Bn. September and October redemptions stands at KES 72.48Bn and KES 119.43Bn respectively.
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Bonds Redemptions: Month of August expects interest payment of KES 21.08Bn.

- September interest payment will be KES 17.74Bn while October payment is KES 60.65Bn with bond redemption of KES 33.39Bn and interest payment of KES 27.26Bn.
- Bond Yield Curve has current yield curve lying just on top of the yield curve registered a year ago. The short end has seen the 2-year key rate shift down by 50.6bps while the long end shifting downward by a marginal 13.1bps y-y.
- Compared to last year where liquidity in the secondary market was constrained by the drama preceding the repeal of the interest rate capping, this year liquidity remains high with further dependency on the release of County funds by the National government.
- Week on week saw the 2-year key rate shift downward by the largest rate of 28.1bps. with activities concentrated on the most current issues, we are bound to witness a further marginal downward shift on the short end with flat shift no the mid to long end of the curve.

Primary Bond Issue: CBK offered KES 60.0Bn in the month of July. They received KES 181181.77Bn and accepted KES 80.85Bn.

Offered KES 40.0Bn on a tap sale on FXD2/2018/20yr with a coupon of 13.20%. They received KES 40.26Bn on face value and accepted KES 41.00Bn at cost with a weighted average rate of 12.931%

IFB1/2020/11Yr:

- For the month of August, they have offered KES 70.0Bn on IFB1/2020/11year with a coupon of 10.9%.
- With favorable liquidity levels in the market and limited investment options on well-priced investment vehicle, we forecast >150% subscription with over 85% acceptance levers.
- We advise our clients to bid as follows:

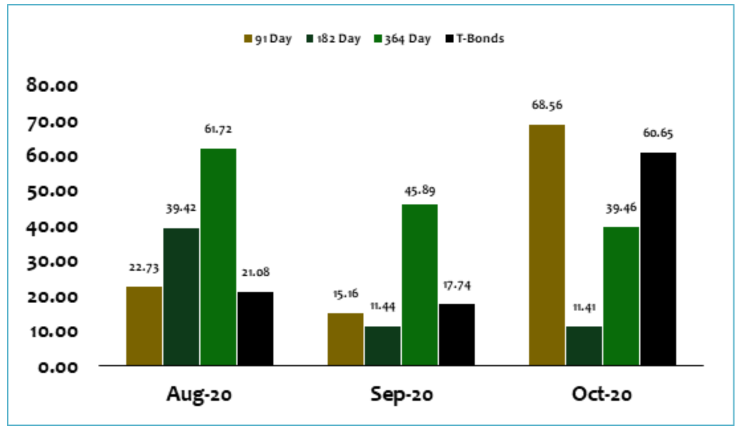

Figure 6: T-Bills and T-Bonds Redemptions Source: CBK, KSL

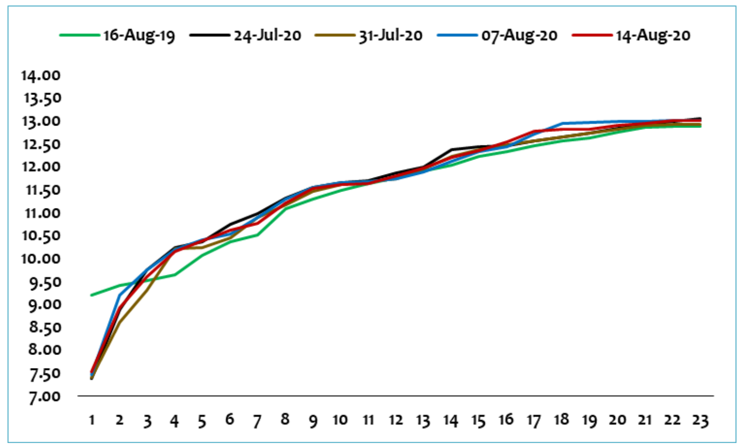

Figure 6: NSE Yield Curve Source: NSE, KSL

YTM Key Rates %	03-Jan-20	07-Aug-20	14-Aug-20	(YTD) bps	W/W bps
2 Year	10.4458	9.1888	8.9083	1.54	0.28
5 Year	11.4867	10.3998	10.3831	1.10	0.02
10 Year	12.1035	11.6436	11.5955	0.51	0.05
15 Year	12.5211	12.3220	12.3500	0.17	0.03
20 Year	12.9125	12.9770	12.9000	0.01	0.08
23 Year	13.0125	12.9967	13.0063	0.01	0.01

Table 3: Key Yield Rates Source: NSE. KSL

Bond	IFB1/2020/11Yr
Tenure	11 Years
Coupon	10.9%
Conservative Bid	**10.60% - 10.85%**
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