Kingdom Securities Limited

Pre-Auction Fixed Income Note – February 2021

Rebuilding the Global Economy **Monday, February 1, 2021**

Re-open FXD1/2013/15Yr – 11.25% Coupon - 7.1 Years

Re-open FXD1/2012/20Yr – 12.00% Coupon - 11.8 Years

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Central Bank of Kenya reopened FXD1/2013/15Yr and FXD1/2012/20Yr for a total offer of KES 50.00Bn. The request comes at the background of lagging revenue performance, tight liquidity after heavy cash mopping through the recently closed infrastructure bond.

The early offer on the February primary issue has no payout aligned to it, with no heavy redemption coming up at the start of the month. Coupon payments are scheduled as follows; February 8th c.KES 0.49Bn, February 15th c.KES 6.65Bn and February 22nd c.KES21.14Bn.

Below is our bidding guidance. We forecast a fair performance on the bond to near full subscription. The timing and government demand will lead to an aggressive bidding.

Bond	FXD1/2013/15Yr	FXD1/2012/20Yr
Tenure	7.1 years	11.8 years
Coupon	11.25%	12.00%
Conservative Bid	**11.40% - 11.60%**	**12.20% 12.40%**
Aggressive Bid	**11.65% - 12.00%**	**12.60% - 12.90%**

Table1: Bidding Guidance Source: CBK, KSL

Central Bank Rate (CBR)- CBK's MPC retained the CBR at 7.0% on January 27th, 2021. With the need to revive the economy, CBK's monetary policy remains on a tight rope to balance growing investment needs through private sector credit and managing public domestic debt by offering good returns on government securities without crowding out the private sector. The review stated:

- At 5.62% in December 2020 (January 2021 - 5.69%), inflation remained anchored within government target of 5.0%±2.5%
- Strong economic leading indicators pointing to economic recovery in fourth quarter with strong performance in agriculture and construction with improved exports and manufacturing. Exports rebounded by growing by 3.3% in 2020 compared to 2019. The economic view was supported by PMI remaining above 50 (Q4-2020 average 53.9).
- Shilling remained stable against the major currencies with forex reserves at USD 7,663Mn or 4.71 months of import cover.
- Stable banking sector with adequate liquidity and capital ratios. Gross non-performing loans worsened to 14.1% in December from 13.7% in November. This was due to increase in restructured loans of KES 1.6Tr representing 54% of total loan book.
- Credit to private sector increased to 8.4% in December compared to 8.1% in November 2020 and 7.1% in December 2019.
- Positive global economic sentiment with a forecast growth of 5.5% in 2021 compared to a projected contraction of 3.5% in 2020.

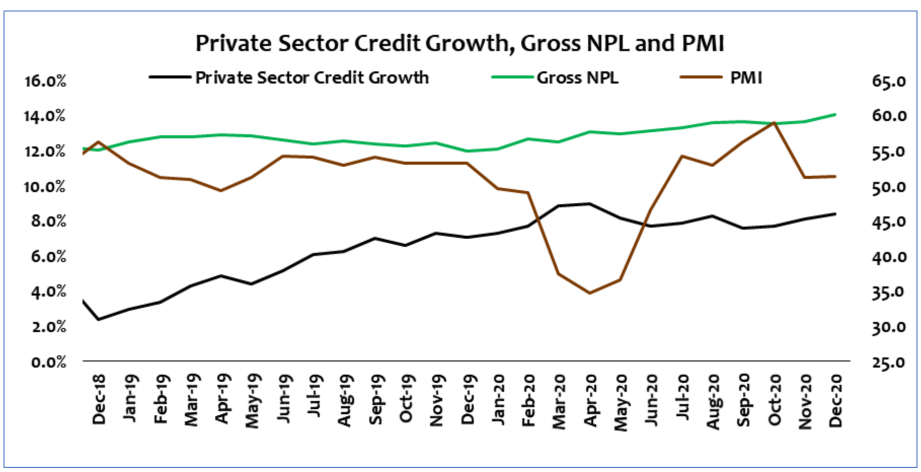

Figure 1: Private Credit, PMI and Gross NPL Source: CBK, KSL

Kenya GDP- Q3-2020- Kenya economy contracted by Q3-2020 1.1% compared to a contraction of 5.8% growth in Q3-2019. The economic growth in Q3-2020 bettered Q2-2020 which was a contraction of 5.7%.

- The recovery was boosted by 24.0% growth in agriculture due to favorable weather that stretched to October 2020, construction 24.8% which is driven by low cost housing in counties through the Big-4 Agenda, transport 6.1% was due to reopening of county lockdown and border movement, finance 3.3% and real estate 5.9%.
- On the contrary, the economy saw a shrinkage in manufacturing -1.5% and wholesale 0.9% which saw sector contribution to the GDP shrink to 6.9% 7.8% from 7.7% and 8.6% in Q3-2019 respectively.
- Reopening of the economy in the third quarter of 2020 saw manufacturing and wholesale improve from a low of 4.6% and 2.5% in Q2-2020 respectively. This contributed to the widening the current account deficit to 5.3% from 3.1% in Q2-2020 and 4.1% in Q3-2019. (Current Account deficit is calculated against GDP at market Price).

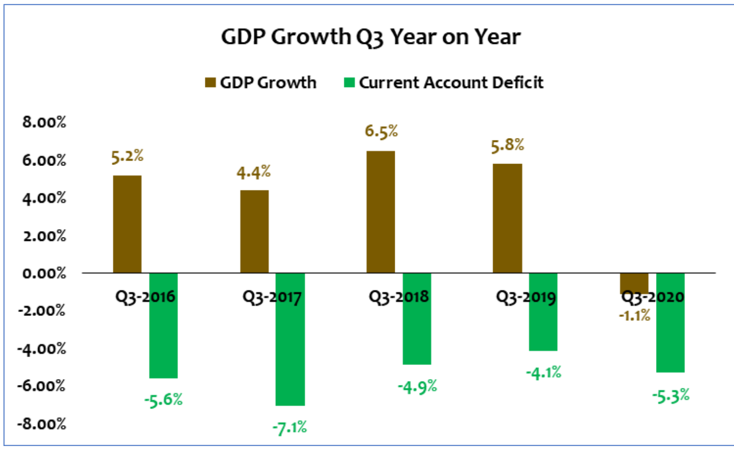

Figure 2: Year on Year GDP Growth Source: KNBS, KSL

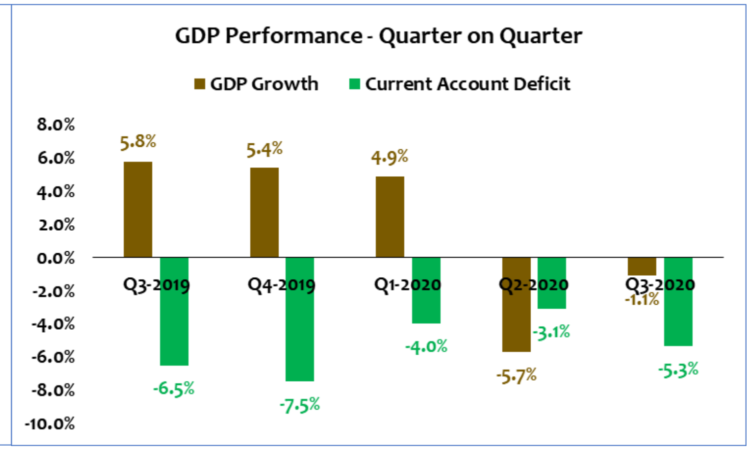

Figure 3: Quarterly GDP Growth Source: KNBS, KSL

Public Domestic Debt

- Net Public Domestic borrowing stood at KES 3,488.53Bn a 11.6% increase from the beginning of the fiscal year 2020-2021.
- As of December 2020, net domestic borrowing was KES 385.77Bn or 49.0% of the original target of KES 786.65Bn for year 2021-22.
- The draft Budget Policy Statement for fiscal year 2021-22, net domestic borrowing for 2020-21 fiscal year was revised upwards to KES 572.70Bn, a 9.2% increase from KES 524.69Bn.
- This will force the government to continue offering better rates to fulfil its funding needs.

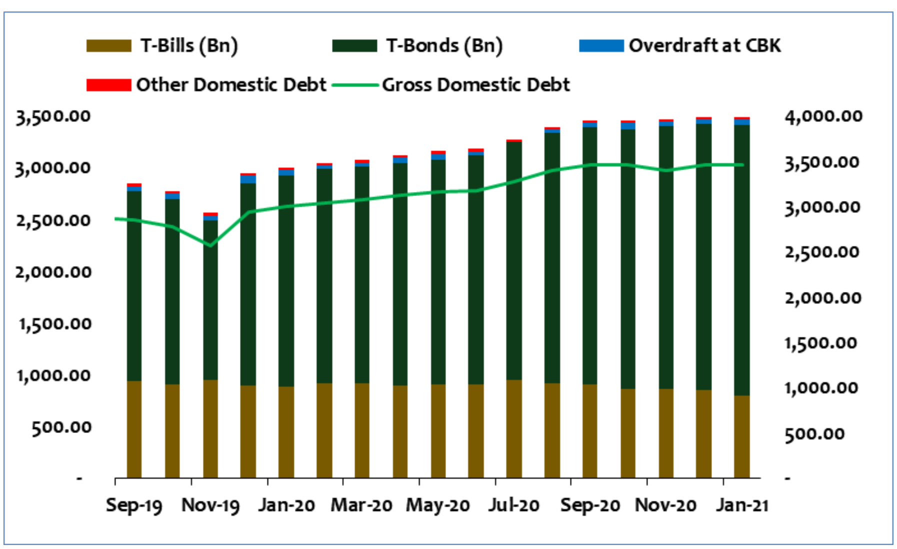

Figure 4: Public Domestic Debt Source: CBK, KSL

T-Bills- Net T-Bills borrowing has declined to KES 792.34Bn as at January 22nd, 2021 to a low of 22.8% of total domestic borrowing. This is a 12.6% decline since the beginning of the fiscal year 2020-21.

- The years subscriptions and acceptance eased towards the end of 2020 with investors opting to rollover rather than inject new funds.

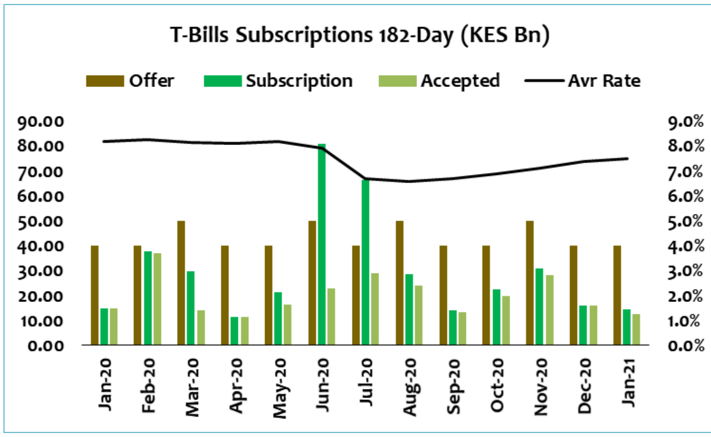

Figure 5: Monthly T-Bills Performance Source: CBK, KSL

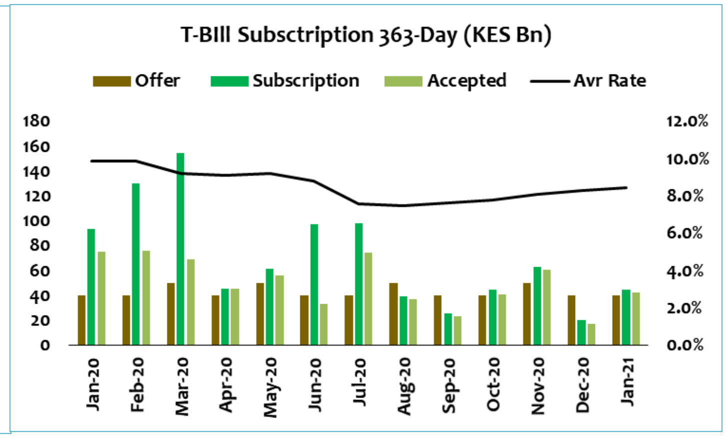

Figure 6: Monthly 91-Day T-Bills Performance Source: CBK, KSL

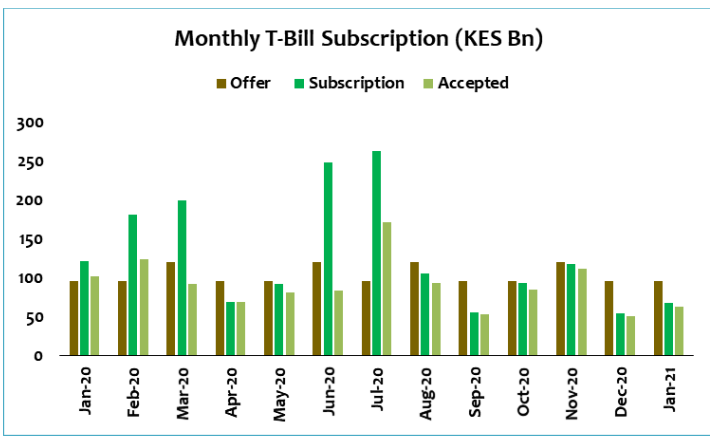

Figure 7: Monthly 182-Day T-Bills Performance Source: CBK, KSL

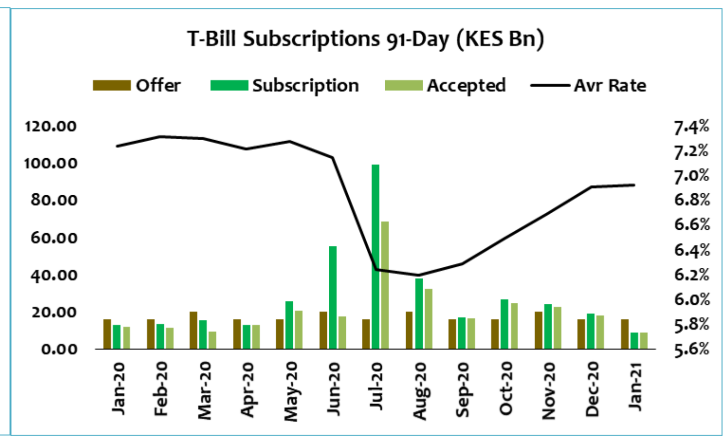

Figure 8: Monthly 364-Day T-Bills Performance Source: CBK, KSL

- We expect low growth on the T-Bills front as the government continues to reduce short papers holding preferring long-term papers.
- The high performance in June and July 2020 was due to the cut of the commercial bank cash reserve rates (CRR) from 5.25% to 4.25%. We do not expect the performance to recur in 2021.
- Although with CBK retain the CRR at 4.25%, we expect the maturity to be rolled over with the reinvestment skewed towards the 365-day paper.
- February redemptions stands at KES 113.47Bn with March and April standing at KES 108.31Bn and KES 73.24Bn respectively.

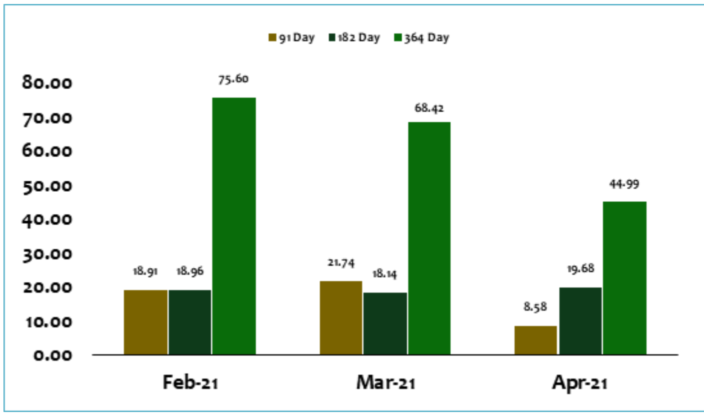

Figure 9: T-Bills Redemptions Source: CBK, KSL

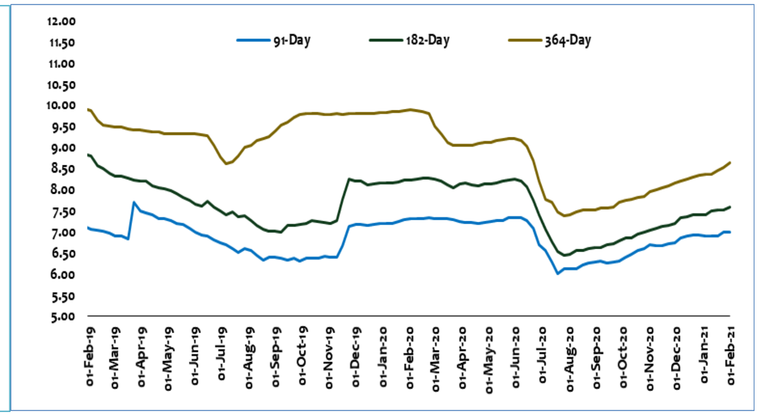

Figure 10: T-Bills Rates Source: CBK, KSL

- Investors will continue to opt to reinvest in the one-year paper that offers better results compared to the other short papers
- We advise our clients to continue bidding on the 364-Day. Below is our bidding range for the month of February

February T-Bill Offer		
Tenure	**Amount (KES Bn)**	**Rate**
91-Day	16.000	6.85% - 6.95%
182-Day	40.000	7.60% - 7.73%
364-Day	40.000	8.65% - 9.00%

Table: T-Bills Bidding Rates Source: CBK, KSL

T-Bonds- Government offered KES 75Bn in January 2021 on FXD1/2021/2Yr and IFB1/2021/16Yr. Total subscription stood at KES 186.62Bn or 248.8% with an acceptance of KES 136.91Bn or 73.4%.

- Bonds performance has seen different response. Key to note in the increase in offer from KES 40.00Bn to KES 50.00Bn. just like the performance of T-Bills, bonds had a heavy subscription in the months of June and July 2020 due to the reduction of CRR.

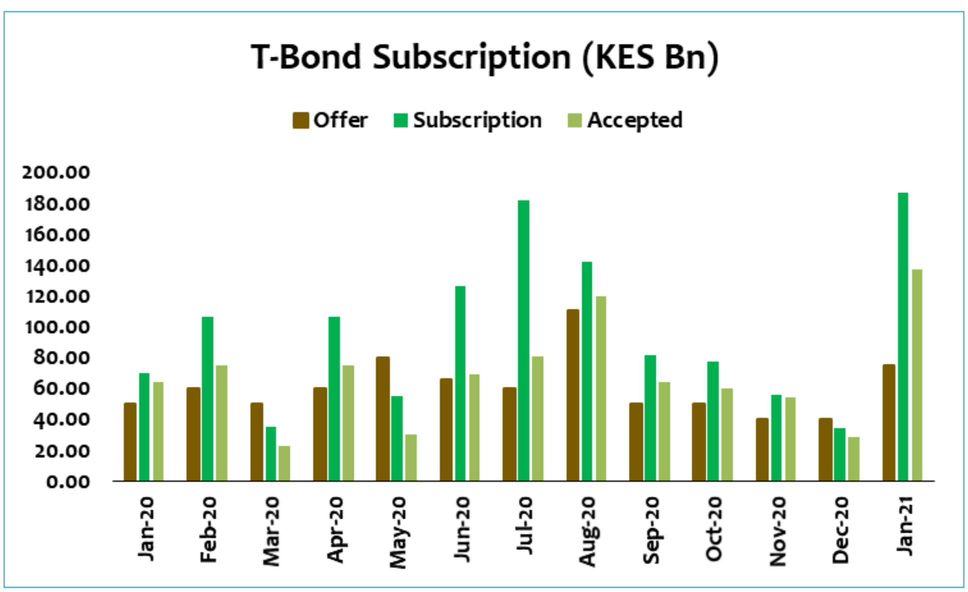

Figure 11: T-Bonds Subscriptions Source: CBK, KSL

- Coupon payouts for month of February stands at KES 24.00n. March will see coupons worth KES 20.83Bn while April has a redemption of KES 19.54Bn with coupon payment of KES 27.28Bn for a total payout of KES 46.83Bn

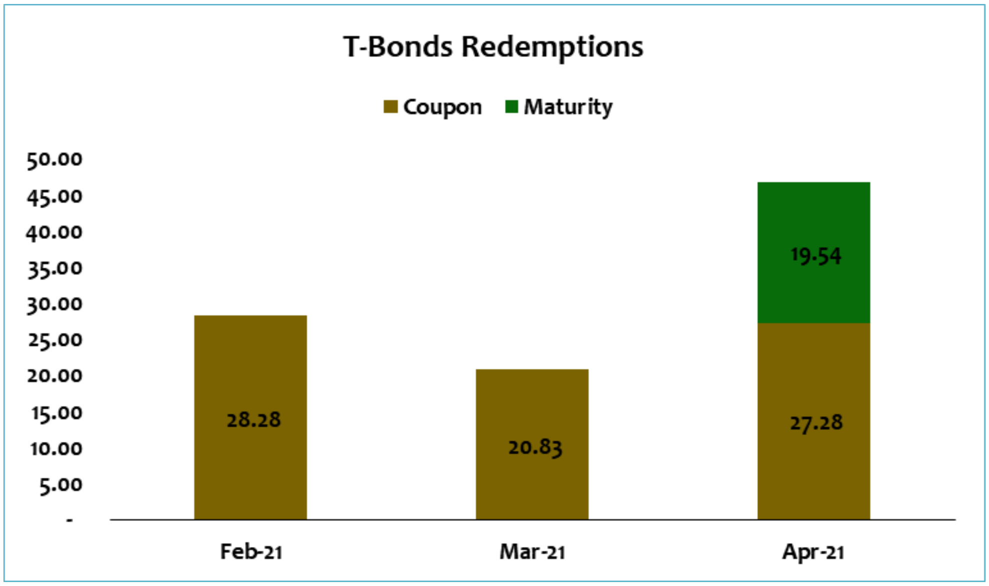

Figure 12: T-Bonds Redemptions Source: CBK, KSL

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