Kingdom Securities Limited

Fixed Income Pre-Auction Note July 2020

July Primary Issue

Re-Opened: FXD1/2020/5Year (4.90Yrs)

Re-Opened: FXD1/2018/10Year (8.49Yrs)

Re-Opened: FXD1/2019/15Year (13.61Yrs)

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Executive Summary

The treasury has re-opened three bond papers with the objective of raising Kes 60.0Bn which will aid in budgetary support. We advise our clients to bid as per below range.

- FXD1/2020/05: Aggressive Bid 10.40% - 10.65%. Conservative Bid 10.25% - 10.35%
- FXD2/2018/10: Aggressive Bid 11.50% - 11.70%. Conservative Bid 11.30% - 11.40%
- FXD 1/2019/15: Aggressive Bid 12.15% - 12.35%. Conservative Bid 12.0% - 12.1%

Our bidding guidance is informed by the current excess liquidity conditions coupled with the CBK's need of maintaining the yield stability.

We anticipate above par subscription on all the three papers, with greatest investor traction expected on the 5-year paper and high acceptance on the 10 year and 15-year papers.

CBK MPC is set to meet on Wednesday July 29th, 2020. We forecast the MPC to retain the CBR at 7.0% on the following basis:

- June inflation was 4.59%. We foresee July inflation in the 4.70% – 4.95% range on higher pump prices. We are optimistic Q3-2020 inflation to remain on 4.8% - 5.3% supported by lower food prices with the august harvesting season approaching.
- Due to the high liquidity environment, banking sector liquidity will remain way above regulators requirement of 10.0% and CRR of 4.25%.
- Private sector credit growing at a five-month average of 8.2%. June PMI inching up to 46.6 compared to 36.7 in May. Local producers remain optimistic due to supportive measures rolled out by the Government including the Economic Stimulus Programme and the commitment by the Government to pay pending bills.
- Adequate forex reserves of USD 9,669Mn or 5.87 months of import cover.
- Global financial sector has remained volatile with concern over global economy post-pandemic recovery with major economies posting increase in new cases of infection.

Inflation

Inflation for the month of June edged down by 74bps to 4.59% in comparison to 5.33% recorded in the previous month. This was buoyed by the following factors

- The diesel prices hinged down by 4.76%, courtesy of spiral down of the global oil demand. This too saw the cost of Kerosene surge by 21.33%.
- The Food and Non- Alcoholic Drinks' Index recorded an improvement of 1.27%.

We foresee July inflation in the 4.70% – 4.95% range on higher pump prices. We are optimistic Q3-2020 inflation to remain on 4.8% - 5.3% supported by lower food prices with the august harvesting season approaching.

The surge in pump prices was necessitated by the increasing May and June landing cost and a shift of VAT from 8.0% to 14.0%. The oil front has started experiencing price improvements; thanks to the gradual reopening of the major global economies. The Brent crude oil is currently trading at c.$43.00 per barrel as of 17th July 2020; down from sub $23.00 levels experienced in March.

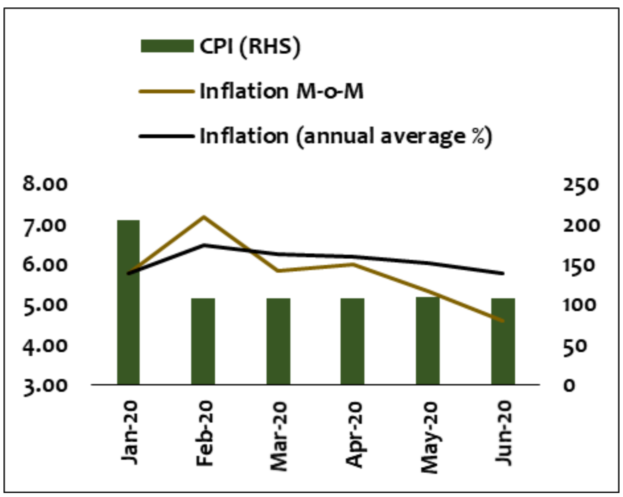

Figure 1; Inflation Source: KNBS, KSL

Currency and Forex Reserves

Months of Import Cover stood at USD 9268Mn or 5.87 month of import cover. This was a decline of 0.5% compared to USD 9,717Mn at the beginning of the month.

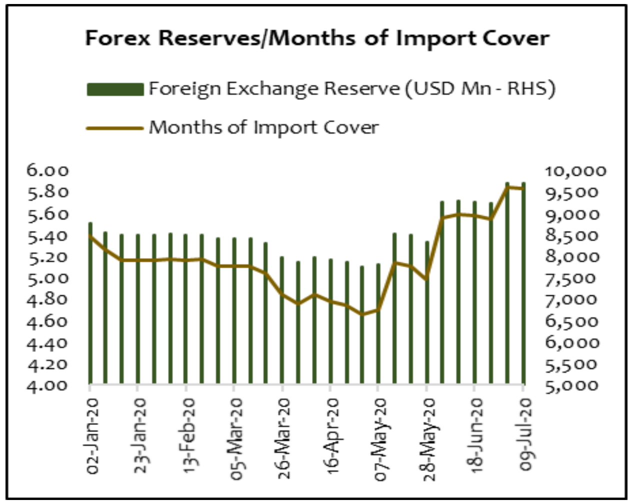

Figure 2: Forex Reserves Source: CBK, KSL

The shilling has oscillated at 106.91, 120.89 and 133.85 month-to-date against the USD, Euro and STG Pound respectively. The movement was highly affected by high manufacturing and energy import demand which necessitated mild intervention. We foresee the shilling stabilizing at 106.6 – 107.0.

17-7-20	USD	EUR	GBP
W/W	0.22%	0.73%	1.40%
M/M	0.44%	0.84%	0.39%
YTD	5.20%	6.27%	1.40%
Y/Y	5.33%	5.60%	4.77%

Table 1: Currencies Source: CBK, KSL

Inter-bank Rate

The money market remained highly liquid, a scenario that saw m-t-d interbank rate average at 2.12%; 106bps improvement from June's average rate of 3.18%. The excess reserves held by commercial bank's with CBK stood at Kes 29.8Bn with relation to 4.25% CRR.

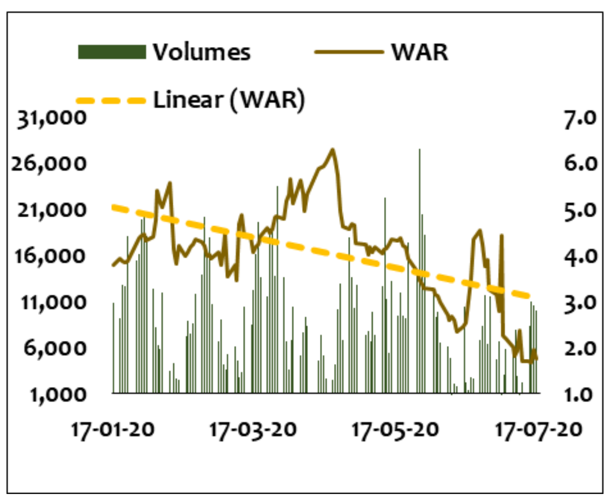

Figure 3: Interbank rates Source: CBK, KSL

T-Bills and T-Bonds Redemptions

The total redemptions for the month of July stands at Kes 124.20Bn (Kes 107.65Bn for the T-bills and Kes 16.55Bn for the coupon payments).

Within the quarter, the ex-chequer is expected to retire T-bonds worth Kes 77.80Bn (Inclusive of FXD3/2016/5 which will be maturing on September 20, 2020).

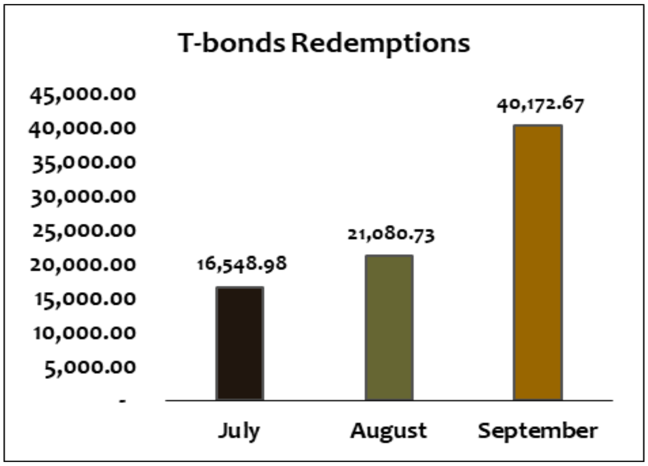

Figure 4: Quarterly Redemptions *Source: NSE,*

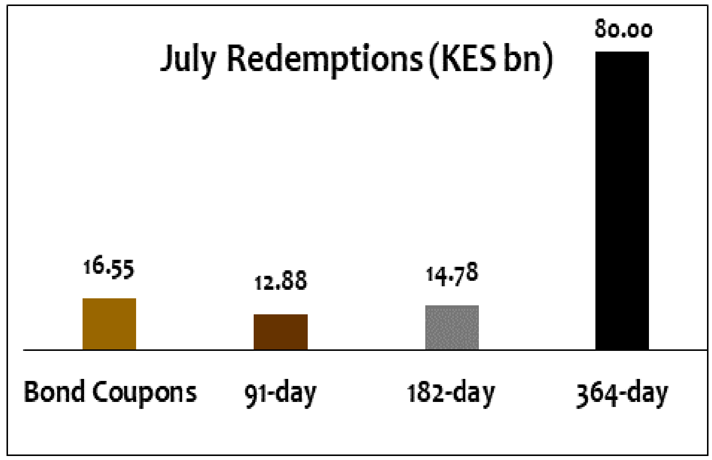

Figure 5: July Redemptions *Source: NSE, CBK, KSL*

Evolution of the Yield Curve

The current yield curve assumes a steep gradient in the short to medium but flattens as it approaches the long end.

Given the current liquid market conditions, we foresee the curve taking a further marginal downward shift in the next 2-3 auctions; subsequently stabilizing. The WAR on the one-year paper dipped by 132bps y/y to the current rate of 7.46%. The long end is characterized by resilience whereby the WAR on the 15 and 20-year papers grew y/y by 23.6bps and 14.9bps respectively.

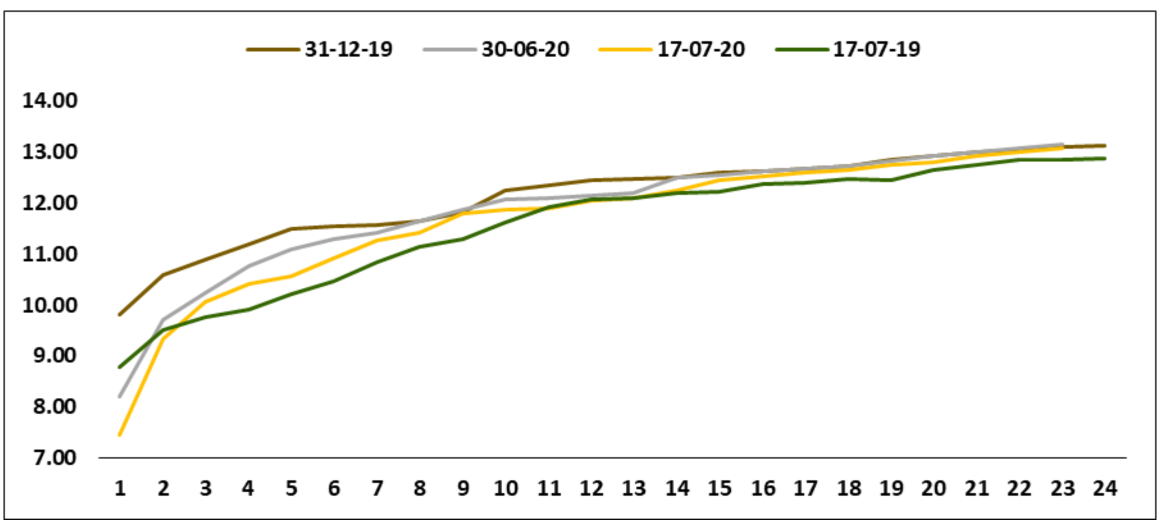

Figure 6: Yield curve *Source: NSE, KSL*

Primary Issue

The treasury has opened three papers with the objective of raising Kes 60.0Bn which will aid in budgetary support.

we anticipate above par subscription on all the three papers, with greatest investor traction expected on the 5-year paper.

Bidding Guidance

Issue	FXD1/2020/05	FXD2/2018/10	FXD1/2019/15
Tenor	4.90Yrs	8.49Yrs	13.61Yrs
Coupon	11.67%	12.50%	12.86%
Closing Date	21-07-20	21-07-20	21-07-20
Auction Date	22-07-20	22-07-20	s22-07-20
Conservative	10.25% - 10.35%	11.30%-11.40%	12.00%-12.10%
Aggressive	10.40%-10.65%	11.50%-11.70%	12.15%-12.35%

Table 2: Bond Features *Source: CBK, KSL*

Our bidding guidance is informed by the current excess liquidity conditions coupled with the CBK’s need of maintaining the yield stability.

We anticipate above par subscription on all the three papers, with greatest investor traction expected on the 5-year paper and high acceptance levels on the 10 year and 15-year papers.

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