Kingdom Securities Limited

Pre-Auction Fixed Income Note – March 2021

Re-opening the World

Re-opening Africa

Re-opening Kenya

Re-open FXD2/2018/20Yr – 13.20% Coupon - 17.4 Years

Re-open FXD1/2019/10Yr – 12.438% Coupon – 8.0 Years

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CBK reopened FXD1/2019/10 AND FXD2/2018/20 for total value of ES 50.00Bn to be used for budgetary support.

- **This is the fourth reopening on the FXD2/2018/20. The paper was first issued in July 2018 with poor reception of 34.7% subscription as this was the period CBK started issuing long term papers. It was re-opened in September of the same year with 25.8% subscription on tight liquidity with investors awaiting the review of Interest Rate Capping repeal. The third reopening was a tap sale in August 2020 where it received 100.7% subscription partially due t high liquidity during the period.**
- **FXD1/2019/10 was issued in February 2019 with a subscription of 72.7%. it was re-opened in January 2020 receiving 50.9% with clients preferring a shorter tenure bond in an active liquid market.**
- **In a moderate liquid environment, we expect an undersubscription with a bias on the longer-term paper FXD2/2018/20. Below is our bidding guidance.**

Bond	FXD2/2018/20Yr	FXD1/2019/10Yr
Tenure	17.4Yr	8.0Yr
Coupon	13.200%	12.438%
Conservative Bid	**13.25% - 13.40%**	**12.00% - 12.40%**
Aggressive Bid	**13.50% - 13.80%**	**12.50% - 12.80%**

Table 1: Budding Guidance Source: CBK, KSL

Central Bank Rate (CBR) - CBK MPC is set to meet on Monday, March 29, 2021. We forecast that they will retain the rate at 7.0% as key macroeconomic indicators remained stable.

- February inflation stood at 5.78% compared to 5.69% in January. The increase was driven by high food prices, increased in pump prices for paraffin and diesel. The onset of the rainy season will aid with easing food prices pressure leading to a downward movement on inflation.
- Stable banking industry with adequate liquidity and capitalization levels.
- Stable currency with the shilling which has weakened by 0.4% y-t-d against the dollar. This has been supported by forex reserves which have been shouldered by government financing support from IMF, strong diaspora remittance increasing by 7.3% compared to January 2020. Pressure remains from import demand especially energy importers.
- Positive economic sentiment with February 2021 PMI down to an eight-month low of 50.9, compared to 53.2 in Jan-21 but an improvement against 49.0 in February 2020. This was due to weak cashflow curtailing consumer spending.

Budget Policy Statement (BPS) – February-21 – BPS cut the Kenya's forecasted Nominal GDP by 1.0% with nominal GDP growth adjusted downward to 9.8% from an earlier estimation of 10.8%.

- revenues projections were reduced by 2.3% with ordinary revenues cut by 2.4% on expected missed target on tax revenues.
- Expenditures were increased by 3.2% with development expenditure and county transfers adjusted upwards by 8.3% and 8.4% respectively.
- Deficit exclusive grants increased by 15.1% pushing fiscal deficit up to 9.1% from an earlier estimate of 7.8%.
- Net foreign borrowing was increased by 23.0% while domestic borrowing was adjusted up by 9.3%.

The increase in domestic borrowing target will continue to put pressure on government to offer better returns. To counter this, the government with continue preferring reopening of 2018 and 2019 issues that were well priced in order to manage the cost of funds

External finance will focus on development partners with a continuous increase in chances of issuing Eurobond to aid in payment of dues that are expected after the break by the Paris Club and China comes to an end at the close of the current fiscal year.

Budget Policy Statement – Fiscal Framework			
Item (KES Mn)	**Budget Estimates**	**Revised Budget**	**%Δ**
Total Revenues	**1,892,647**	**1,849,213**	**-2.3%**
Ordinary Revenues	1,633,767	1,594,009	-2.4%
Total Exp and Net Lending	**2,774,711**	**2,864,529**	**3.2%**
Recurrent Exp	1,826,718	1,838,005	0.6%
Development Exp	589,705	638,520	8.3%
County Transfers	353,288	383,004	8.4%
Deficit Excluding Grants	**(882,064)**	**(1,015,316)**	**15.1%**
Net Foreign Financing	346,793	426,491	23.0%
Net Domestic Financing	494,350	540,088	9.3%
Nominal GDP	**11,275,797**	**11,168,511**	**-1.0%**
Deficit % to GDP	-7.8%	-9.1%	

Table 2: Budget Policy Statement Source: Treasury, KSL

Exchequer Issues: January exchequer issues indicated tax revenues performance stood at 50.1% of budget target while performing at 85.8% on proportioned 7 months estimates.

- Domestic borrowing closed the month at 64.1% on budget while remaining ahead of the curve at 109.9% on the seven-month borrowing target.
- Total expenditure stood at 50.9% of budget estimates while performing at 87.2% on prorated level.
- Development expenditure and county issues lagged proportional target by 71.2% and 70.5% limiting the performance of total expenditure.

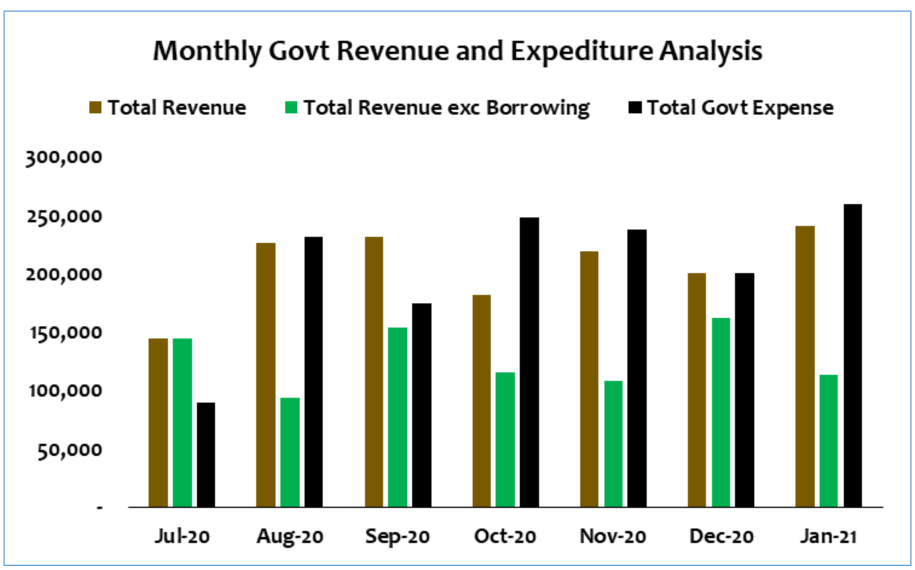

Figure 1: Exchequers Issues Source: Treasury, KSL

Interbank Rate: Fair liquidity has aided interbank to open the month on the lower end of 5.0% to average 4.87% on the first weed with an average demand of KES 11.52Bn compared to an average rate of 5.40% and a mean demand of 10.85Bn on first week of February.

- We expect the rate to range the 4.75% - 5.25% with government payments remaining weak compared to demand.

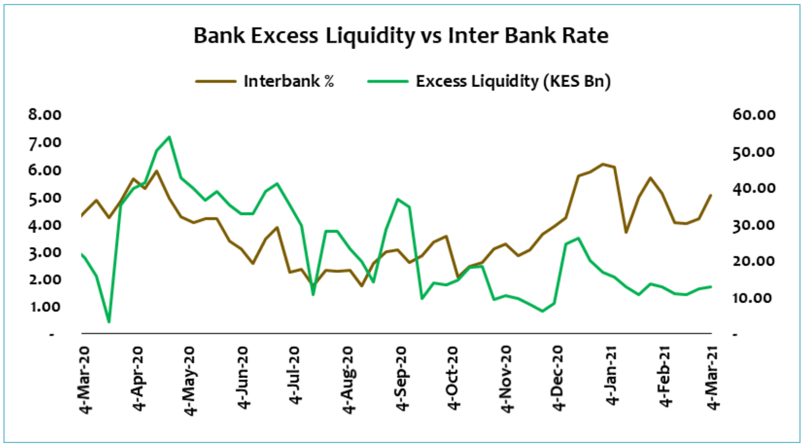

Figure 2: Interbank and Commercial Bank Liquidity Source: CBK, KSL

T-Bills: Heavy maturities in the second half of February supported T-Bills auction leading to oversubscriptions that tickled down into the first week of March. The month saw a subscription of 87.9% with an acceptance rate of 93.4%.

- In March, the government targets to borrow a total of KES 120.00Bn against an expected maturity of KES 108.31Bn in T-Bills.
- We expect subscriptions to remain high at the beginning of the month while it will slow down towards the end of the month on lower government payments.
- Client focus will remain on the 364-day paper boosted by roll-over (KES 68.42Bn) and favorable return on the tenure as returns increased by 35.5bps m-m as of March 8th, 2021. This is compared to 17.1bps and 14.8bps on the 182-day and 91-day papers respectively.

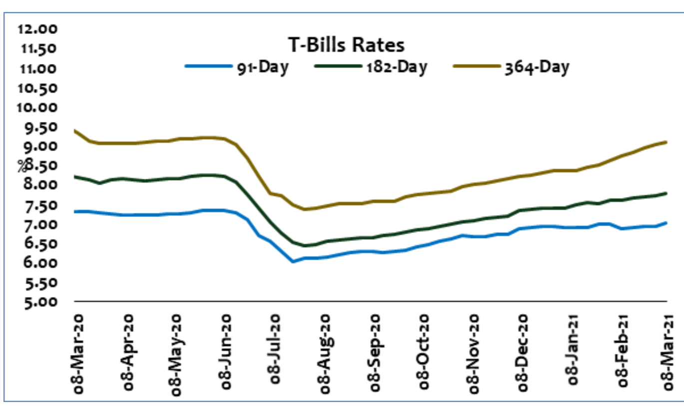

Figure 3: T-Bill Rates Source: CBK, KSL

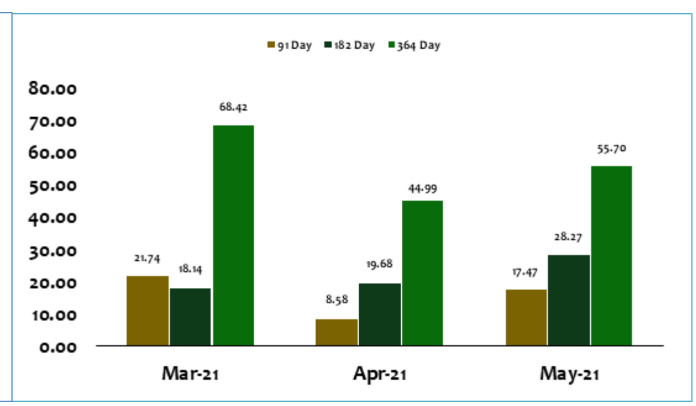

Figure 4: T-Bill Maturities Source: CBK, KSL

Yield Curve: Monthly yield curve saw an upward shift in the short term controlled by liquidity and demand. Heavy primary issues focusing on the mid of the curve saw a downward shift on the key rates on price rationalization while demand by insurance companies led to an upwards shift on the long end of the curve.

- We expect the trend continue as the economy reopens. Investors concentration will remain on the short end leading to an accelerated upward shift on the key rates and a lagged upward movement on the long end.

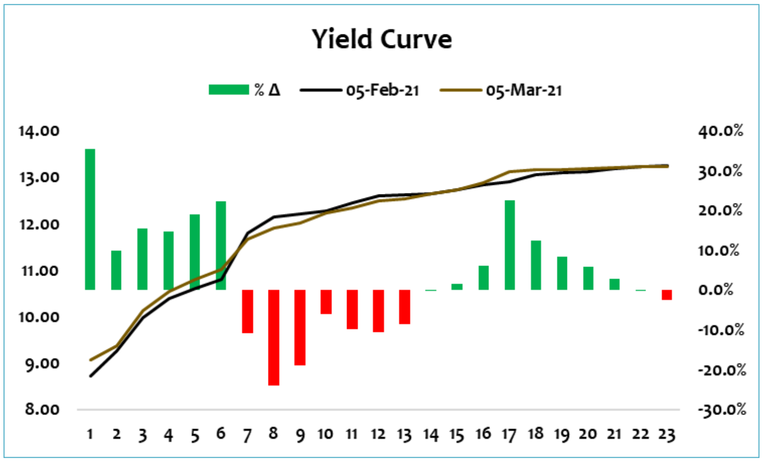

Figure 5: Yield Curve Source: NSE, KSL

T-Bonds: Government maintains its strategy of balancing liquidity fill while lengthening the yield to maturity.

- Secondary markets continue to see preference on IFB, which is more preferred by foreign investors, and short-term papers which aids in managing liquidity.
- March payments stand at KES 20.83Bn on coupon payment.

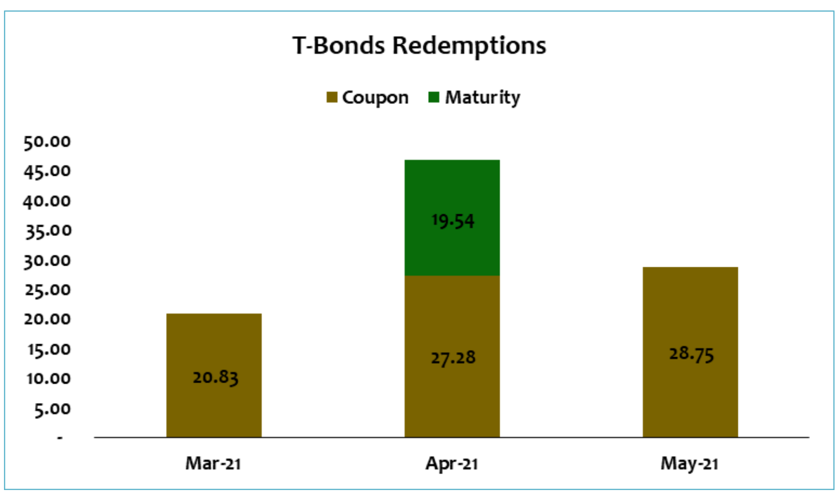

Figure 6: T-Bonds Payouts Source: NSE, KSL

Eurobond: Political tension in the country, the talk of BBI referendum and probability of the government going for another Eurobond has pushed the yields upwards.

- The range between the 2024 and 2048 bond widened to 423.8bps compared to 368.8bps same period in February

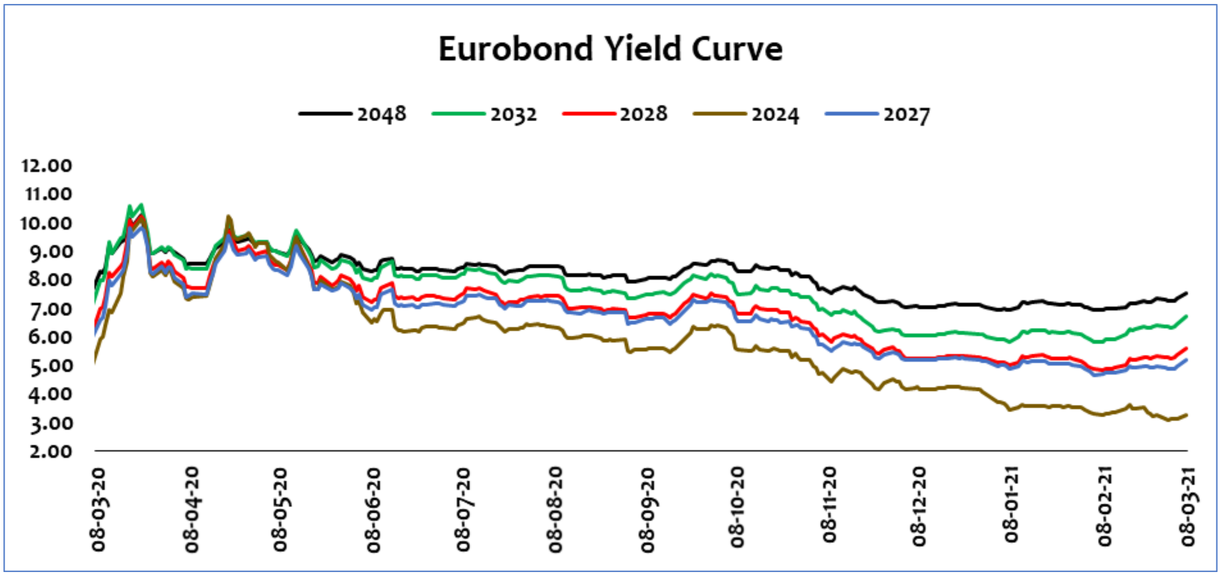

Figure 5: Eurobond Yield Curve

Source: Bloomberg, KSL

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March 2021

Research Analyst Certification:

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Fixed Income

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