Kingdom Securities Limited

Pre-Auction Fixed Income Note – October 2020

October Primary Issue

Re-Opened: FXD1/201120/20 (10.6Yr) – Coupon 10.0%

Re-Opened: FXD1/2018/25 (22.7Yrs) – Coupon 13.4%

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Fixed Income Pre-Auction Note

October 2020

CBK reopened the FXD1/2011/2020 and FXD1/2018/25 for an offer of KES 50.0Bn for budgetary support. We expect an oversubscription on the offer with moderate performance on the FXD1/2011/20 due low coupon and poor demand in the secondary market year while focus will be on the FXD1/2018/25. The longer tenure bond was reopened in February and March 2020 with poor performance in its second stint due to tight liquidity in the market.

Bond	FXD1/2011/20Yr	FXD1/2018/25Yr
Tenure	10.6 Years	22.7 Years
Coupon	10.000%	13.451%
Conservative Bid	**11.70% - 11.85%**	**12.95% - 13.25%**
Aggressive Bid	**11.90% - 12.05%**	**13.35% - 13.50%**

Table 1: Bond Bidding Guide   Source: CBK, KSL

Local Update

- According to the IMF World Economic Outlook Report set to be released today, the review of cross-country relation between lockdown and economic performance reveals the countries that underwent stringent lockdown procedure are set to face a larger economic decline.
- Kenyan partial lockdown and low infection rate has seen economy resilience leading to IMF Country Representative indicating a revised growth from -0.3% forecast in June 2020.
- The government ease of lockdown in beginning of Q3-2020 led to improved demand helping push new orders destined for both local and foreign market. This led to an increase in manufacturing activities pushing to September PMI up 56.3 from 53.0 in August.
- CBK MPC retained the CRB 7.0% for the 6th month running. To retain the CBR, CBK stated:
   i. Leading economic indicators point to a strong economic performance in Q3-2020 from positive performance in key economic sectors on easing of economic restrictions. Private sector survey showed further optimism from the manufacturers which was confirmed by PMI f 56.3 in September compared to 53.0 in august.
   ii. A 0.8% increase in exports January to August 2020 compared to similar period in 2019. Receipts from tea exports increased y 17.1% over the same period.
   iii. Forex reserves stood at USD 8,457or 5.13 months of import cover compare to a target of4.0 Months of import cover.
   iv. Banking sector remained stable with strong liquidity. August Gross Non-Performing Loans stood at 13.6% against 13.1% in June.
   v. Private sector credit growth remained strong at 8.3% from 7.6% in June 2020.
   vi. September inflation was 4.2% remaining within government target of 5%±2.5%.
- With the President extending the Fiscal Policy and Monetary policy period to end of the year, we expect markets to remain liquid leading MPC retaining the CBR at 7% till the end of the year.

Global News

- Fear of second global wave in infection continues to cast a dark shadow on global growth which can lead to dire consequences to the local economy.
- Global Economy remains under uncertainty with second wave of the pandemic affecting the wider Europe and Asia.
- America stimulus package remains on a hang with the President and Speaker of the House of Representative talks grinding to a near halt. House Democrats passed a USD 2.2Tr bill while the President has proposed a USD 1.8Tr stimulus package.
- BREXIT completion by end December 31st, 2020 remained n the line with British Prime Minister blaming the EU of taking a hard stand on fisheries.

Money Market

Interbank: The start of the month saw liquidity improve (see figure 1) easing pressure on the interbank rate with interbank rate averaging 2.66% m-t-d compared to 15.2bps lower compared to 2.81% same period in September.

With anticipated improved liquidity from the upcoming maturities trickling into the market, we forecast interbank to remain at 2.5%-2.75% range for the remaining of October.

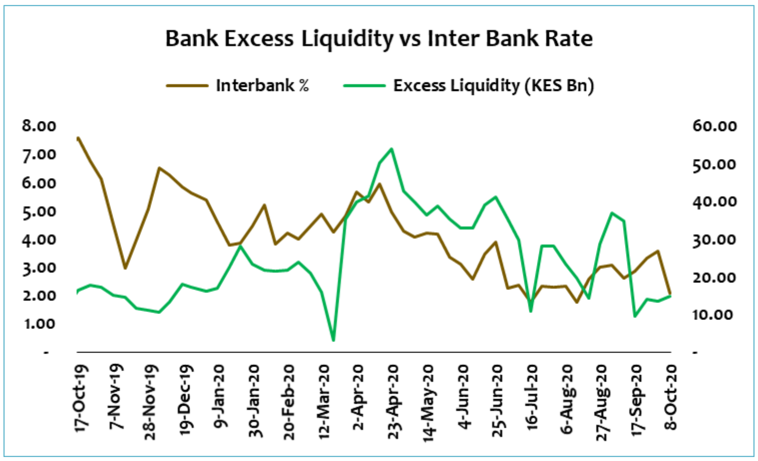

Figure 1: Liquidity and Interbank Rate — Source: CBK, KSL

Currency: Forex reserves dipped further to USD 8,457Mn or 5.13 months of import cover as of end week 41.

Our view is the decline comes from external loan repayments and regulators participation in the market order to stabilize the local currency. This saw the shilling remain flat at KES 108.5262/USD w/w at beginning of Week 42.

Shilling remained stable m-o-m losing 0.1% on the USD while gaining 0.2% and 0.5% on the GBP and EUR.

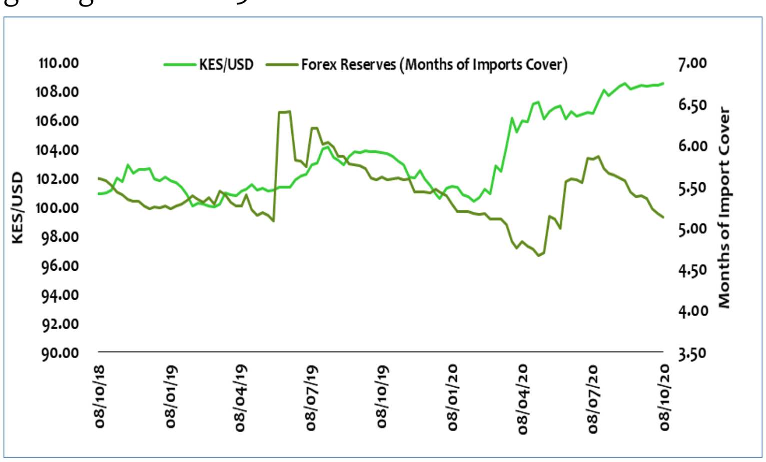

Figure 2: Forex Reserves and Currency — Source: CBK, KSL

Inflation: Low food prices continued to ease pressure on inflation with m-o-m Food and Non-Alcoholic drinks index up 15bps. September inflation stood at 4.2% (our forecast of 4.36% - 4.50%) from 4.36% in August as petroleum prices, which has been key pressure point on inflation dropped by 0.05% in September.

We forecast October inflation at 4.25% - 4.45% range as pressure emanated from higher food prices from change in weather from decreased rainfall and increase in petroleum pump prices after a 4.94% excise duty adjustment on inflation followed by increase in prices due to landing fees, weaker dollar despite a 1.4% decline in international prices.

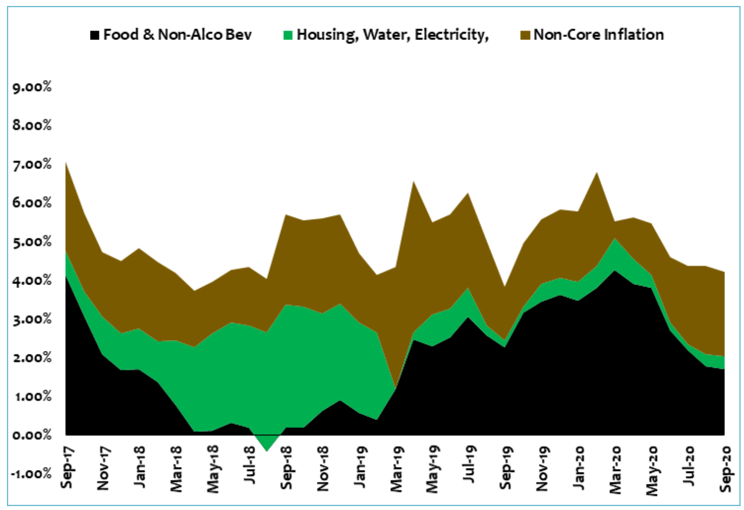

Figure 3: Inflation Levels — Source: KNBS, KSL

12-Oct-20	KES/USD	KES/GBP	KES/EUR	KES/JPY	Dollar Index
W/W	0.0%	0.0%	0.4%	0.6%	0.5%
M-t-D	0.1%	0.7%	0.6%	0.1%	0.8%
M/M	0.1%	0.2%	0.5%	0.3%	0.2%
Y-t-D	7.1%	5.3%	12.5%	9.8%	3.9%
Y/Y	4.6%	10.7%	12.2%	6.1%	5.3%

Table 2: Currencies — Source: CBK, KSL

Treasury Bills: Market saw an auction oversubscription after eight weeks of under subscriptions. Liquidity was driven by high redemptions.

Rates continues ticking upwards 20.1bps, 16.4bps and 19.8bps on the 91-day, 182-day and 364-day paper respectively.

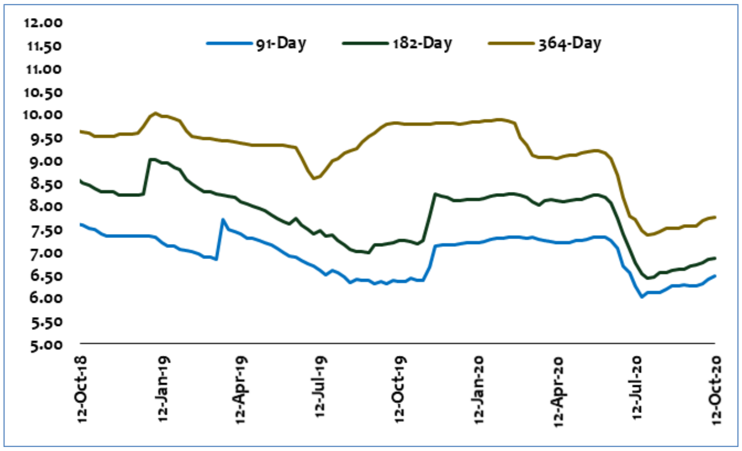

Figure 4: T-Bill Rate Source: CBK, KSL

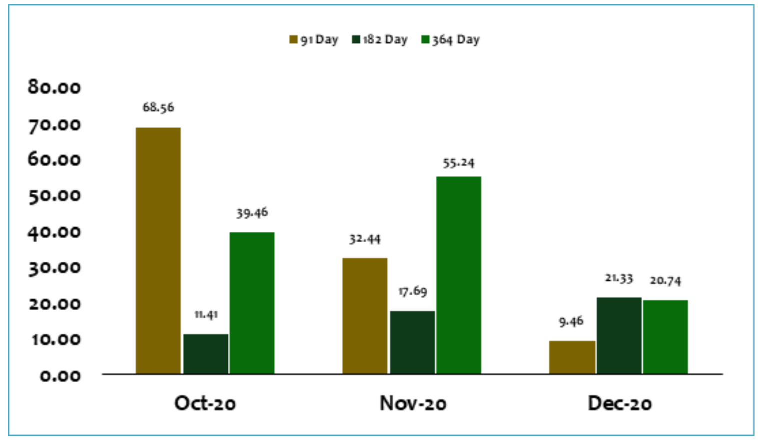

Figure 5: T-Bill Redemptions Source: CBK, KSL

Upcoming redemptions stand at KES 119.43Bn in October, 105.37Bn and KES 51.54Bn in November and December respectively.

We forecast the rates to continue with their upward trajectory with governments appetite for funds continues to grow.

We advise our clients to focus on the 91-day papers as it will enable them to reinvest at better rates on maturity as we forecast a rate range of 6.5% - 6.75% by end of the year.

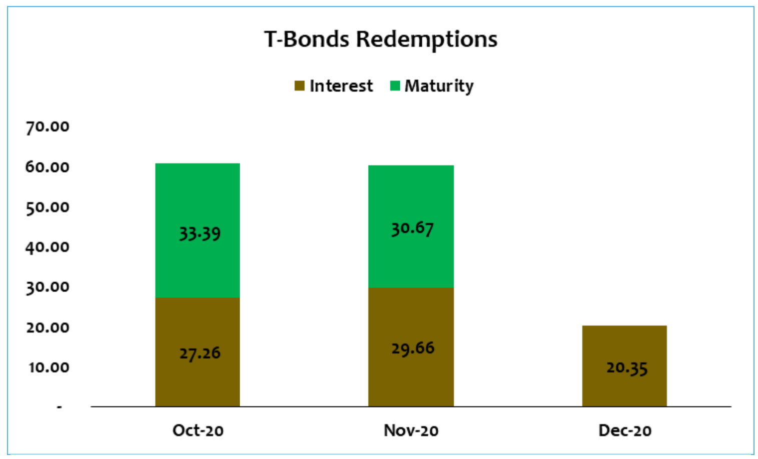

Figure 6: T-Bonds Redemptions Source: NSE, KSL

Treasury Bonds: September saw the government offered KES 50.0Bn on reopened FXD2/2010/15, FXD1/2020/15 and FXD12011/20. Subscription rate was 163.4% with an acceptance level of 78.6%.

October redemptions stand at KES 60.65Bn with KES 33.39 in maturities and KES 27.26Bn in coupons. November has KES 60.33Bn with KES 30.67Bn in maturities and KES 29.66Bn in coupons while December coupons stand at KES 20.35Bn.

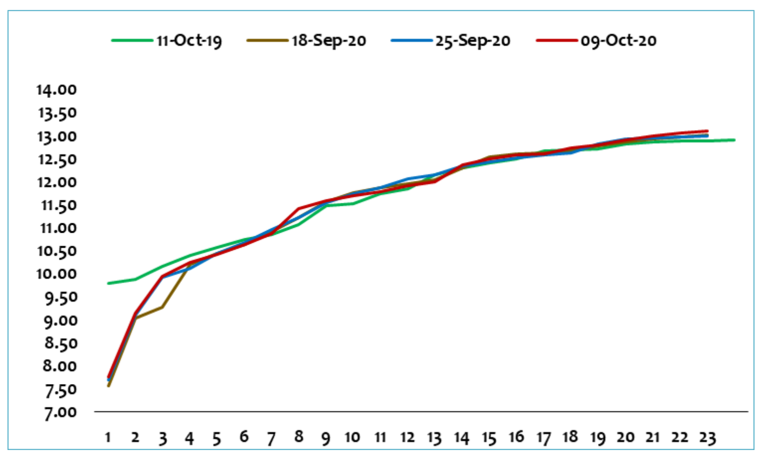

Figure 7: Yield Curve Source: NSE, KSL

NSE Yields: Domestic yield curve saw only the 2-Yr key rate inching down 12.1bps m-m as of October 9th, 2020, while 15-Yr key rate had the largest upward shift of 17.8bps.

Year on year basis saw the long end of the yield shift up by 7.4bps. the short end remains 130.4bps lower.

We forecast a further upward shift on mid-term key rates and a downward shift on the long end of the curve.

Table 3: Key Yield Rates Performance Source: NSE, KSL

YTM Key Rates %	03-Jan-20	11-Sep-20	09-Oct-20	(YTD) bps	M-M bps
2 Year	10.4458	9.2631	9.1421	-130.4	-12.1
5 Year	11.4867	10.3639	10.4217	-106.5	5.8
10 Year	12.1035	11.6248	11.6856	-41.8	6.1
15 Year	12.5211	12.3175	12.4955	-2.6	17.8
20 Year	12.9125	12.7964	12.8925	-2.0	9.6
23 Year	13.0125	12.9800	13.0868	7.4	10.7

Eurobond Yields: Eurobonds yields edged downward with the 2024 and 2027 Eurobonds rates edging 8.8bps and 6.7bps lower m-o-m while the long-term bond saw an upward shift of 24.8bps.

We forecast the rates to shift further downwards with the positive economic growth forecast.

Government Debt: Total net government debt stood at KES 7,067.93Bn at end of August, a 17.6% increase from KES 6,009.31Bn same period 2019.

The increase was due to heavy borrowing toward health and economic stimulation during since the onset of the pandemic.

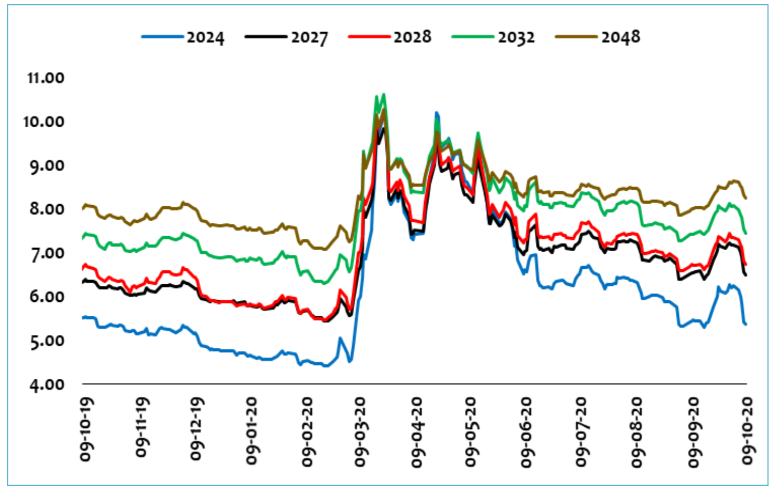

Figure 8: Eurobond Yields Source: Bloomberg, KSL

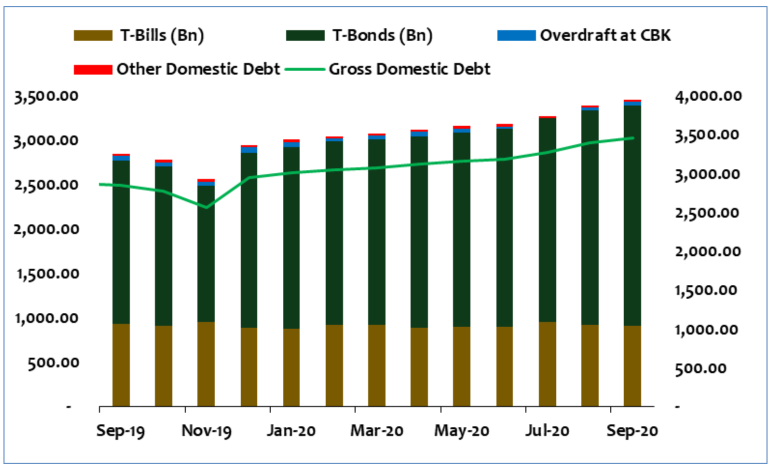

Figure 9: Government Domestic Debt Source: CBK, KSL

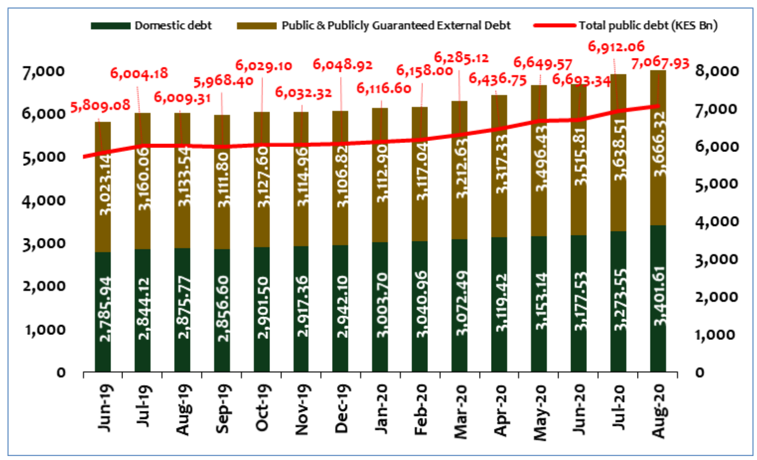

Figure 10: Total Government Debt Source: CBK, KSL

Period between March 2020 and august 2020 saw a net borrowing of KES 782.81Bn with a net of KES 329.12Bn and 453.69Bn in domestic and foreign debt respectively.

September BROP saw Fiscal deficit increase from 7.5% to 8.4%. External borrowing target were increased 14.4% to KES 397Bn from KES 347Bn. Domestic target

Bond Primary Issue

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