Kingdom Securities Limited

Pre-Auction Fixed Income Note – February 2022

February 2022: First Infrastructure Bond of 2022

NEW IFB1/2022/19Yr - Coupon - MDA - Term 19.0 Years

Amount: KES 75.00Bn

February 10, 2022

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KINGDOM SECURITIES

Fixed Income Pre-Auction Note

February 2022

Primary Bond Issue February 2020: first infrastructure bond of 2022…

In February, Treasury issued an infrastructure bond seeking KES 75.00Bn. The timing of the bond is seen crucial with only one infrastructure bond having been issued in the month and two infrastructure coupon payments during the month.

The move is seen to manage payments as bond liability for the month of February totals to KES 35.96Bn being KES 33.09Bn in coupons and a 20.0% redemption of IFB1/2017/12 which amounts to KES 2.87Bn. The expected forex receipts that accompany IFBs is set to aid in payment of USD 77.50Mn on 2028 and 2048 Eurobonds.

We expect heavy subscription of >100% driven by a liquid market and high acceptance of >80% with government demand for funds and forex will be key. Below is our bidding guidance

Bond	IFB1/2022/19
Tenure	19 year
Coupon	MDA
Issued	**Feb-22**
Conservative Bid	**12.40% - 12.60%**
Aggressive Bid	**12.70% - 12.95%**

Table 1: Bidding Guidance Source: KSL, CBK

CBK

CBK maintained the Central Bank Rate (CBR) at 7.0% for the 22 months citing:

- Lower inflation rate within government target of 5±2.5% with January inflation at 5.39% on lower food cost and stable transport prices due to stagnant local pump prices.
- Strong and recovering macroeconomic environment leading indicators confirm that the Kenyan economy rebounded strongly in 2021
- Stable banking industry with private credit growing at 7.8% in the month of December 2021 while non-performing loans at 13.1%.

Budget Review Outlook Paper: +126.28Bn…

- February 2022 Budget Review Outlook Paper (BROP), the government is set to widen the targeted Fiscal deficit to 9.1% from KES 1.39Tr to KES 1.51Tr as the overall budget edges 4.0% up from KES 3.19Tr to KES 3.32Tr.
- With the November 2021 BROP was presented in parliament without adjustments, the February 2022 BROP forwarded to parliament includes an additional KES 126.28Bn.
- The main beneficiaries are; Teachers Service Commission (TSC), State department of infrastructure, National Treasury, Ministry of interior and citizen services, Ministry of Health, Ministry of petroleum and mining, Independent Electoral and Boundary Commission (IEBC), Ministry of Defence. **Read the full on report on the Budget Review Outlook Paper here.**

International News: central bank rates and international conflicts to direct global economy…

- Bank of England hiked Bank Rate from 0.25% to 0.50%. Members of the committed opted to reduce stock of government bond purchases in effort to tame inflation which touched a 30-year high of 5.4% on increase in energy cost, resurgent demand and global shipping crisis. European Central Bank (ECB), retained key rate flat at 0.00%.
- International tension between US and Russia on Ukraine remain high with first US troops reinforcing NATO allies arrive in Romania.

Inflation: food index pressure on dry conditions in the month…

- January 2022 inflation stood at 5.39%, 34.0bps lower to 5.73% in December 2021 and 30.0bps compared to January 2021. The lower inflation was supported by 75.0bps drop in Housing, Water, Electricity, Gas and Other Fuels' Index due to decline in electricity prices and a 11.0bps drop in transport index.
- Core inflation declined to 1.80% from 1.96% in December 2021 and 1.89% in January 2021.
- **We view inflation will edge upwards to a range of 5.50% - 5.7% heavily influenced by higher food prices as the most parts of the country will experience generally sunny and dry conditions throughout the month.**

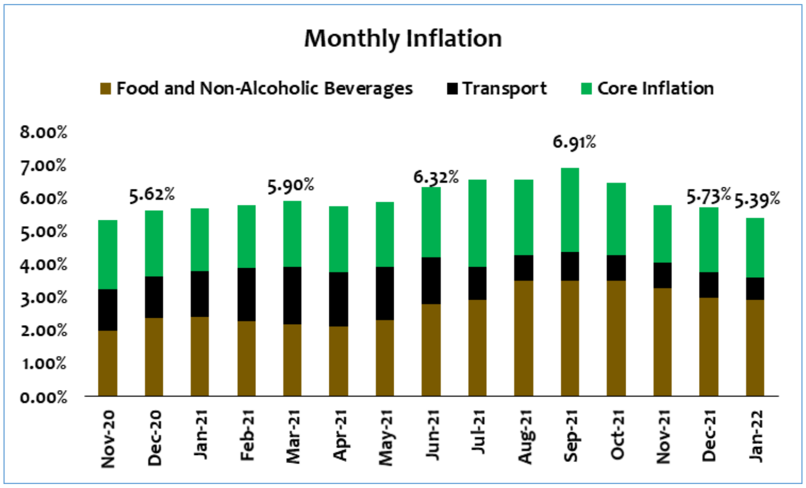

Figure 1: Inflation Source: KSL, KNBS

Interbank Rate: fair liquidity to limit upside…

- Interbank rate favored demand side with the rate standing at 4.3830% on February 8th, 2022, 23.3bps lower compared 4.4059% on January 7th, 2022.
- Month to date, the rate stands at an average of 4.23%, 2.29bps lower against an average m-t-d rate of 4.46% seen on the same period in January. The period has seen average demand up 4.0% to KES 14.49Bn against KES 13.93Bn.
- **Liquidity is bound to remain favorable the rest of the month with KES 115.04Bn expected maturities on T-Bill.**

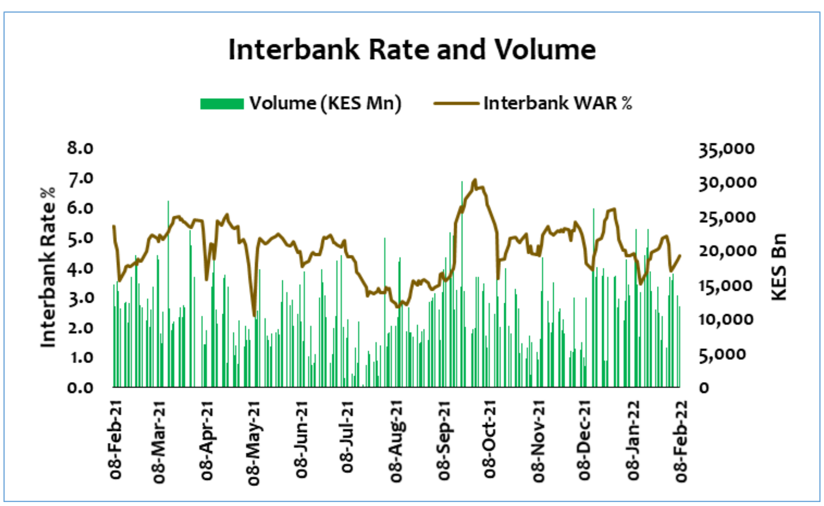

Figure 2: Interbank Rates Source: KSL, CBK

Currency: approaching Eurobond coupons and high demand on energy import…

- The shilling weakened by 0.3% m-m against the USD. The local currency also declined by 0.4%, 1.2% and 0.6% against the pound, euro and Japanese yen respectively.
- The dollar weakened against the other world majors as indicated by the 0.5% downward move on the dollar index The loss was necessitated by the positive sentiment on hiking interest rates in USA and Britain with Europe Central Bank opting to hike the bank rate by 0.25% to 0.5% with the aim of managing inflation. This was further coupled by weak employment data.

10-Feb-22	KES/USD	KES/GBP	KES/EUR	KES/JPY	Dollar Index
W/W	0.0%	0.4%	1.2%	0.8%	0.2%
M-t-D	0.0%	0.9%	1.9%	0.0%	0.9%
M/M	0.3%	0.4%	1.2%	0.6%	0.5%
Y-t-D	0.4%	1.0%	1.1%	0.3%	0.7%
Y/Y	3.7%	2.0%	-2.1%	-6.0%	5.7%

Table 2: Currency Rates — Source: KSL, CBK

- The developed countries central banks have opted to reduce on bonds purchase aimed at quantitative easing with the aim of reducing support to the overheating economies.
- The local currency will remain under pressure with approaching USD 77.50Mn coupon payment at the end of February and further pressure on high import bill especially energy demand with international petroleum prices seeing Brent up 16.3% y-t-d and 49.4% y-y while Crude Oil WTI up 16.9% y-t-d and 53.4% y-y.

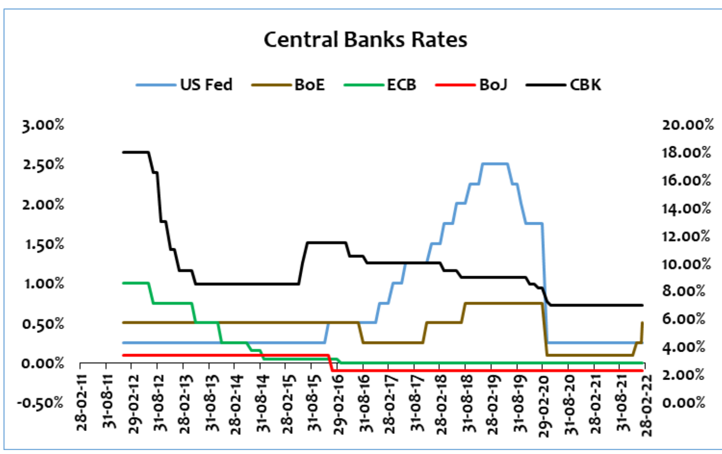

Figure 3: Central Bank Rates — Source: KSL, Bloomberg

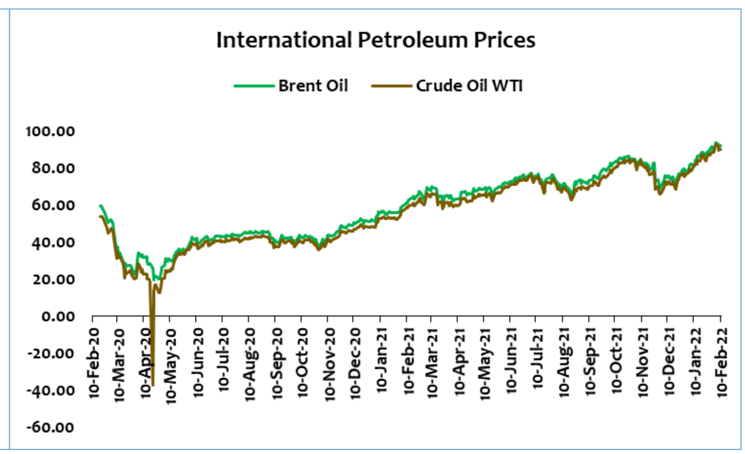

Figure 4: International Petroleum Prices — Source: KSL, Investing.com

Treasury Bills: saved by reinvestment…

- In January, high liquidity sustained T-Bill with subscription standing at KES 123.12Bn (102.6%). Treasure retained a high acceptance with KES 114.44Bn received or 93.0% acceptance.
- Redemptions are expected to continue to fuel T-Bill Auction with treasury forced to offer higher returns on reinvestments. Investors will continue to focus on the 364-day paper which has gained 22.7bps in the first week of February compared to the opening week of January 2022
- Treasury bill maturities for the month stands at KES 115.04Bn compared to an expected demand of KES 96.00Bn.

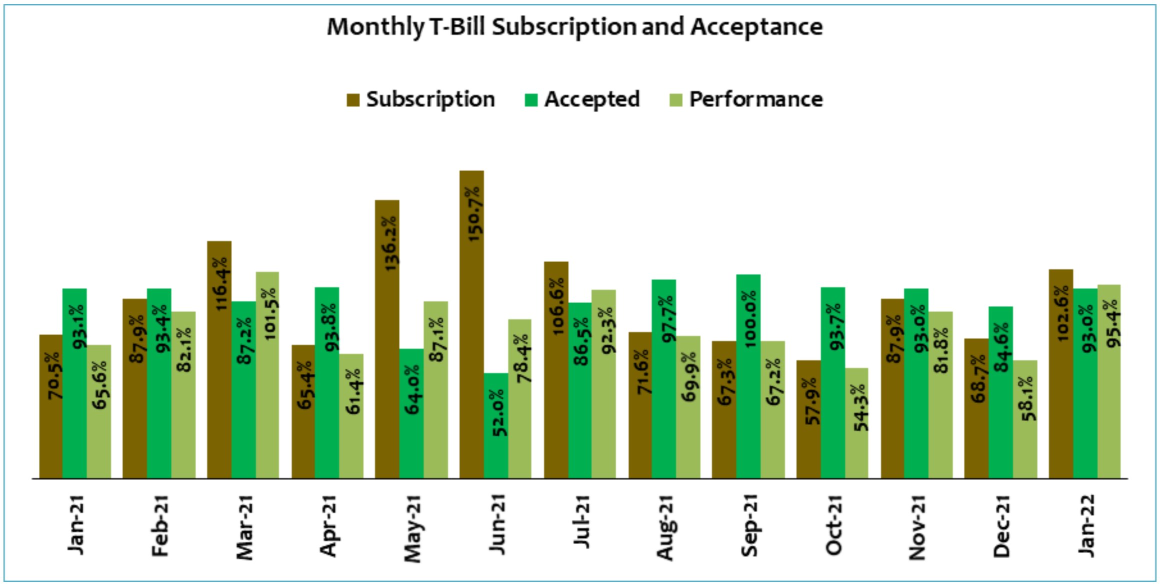

Figure 5: Monthly T-Bill performance Source: KSL, CBK

- With the upcoming maturities, we view the rates will mildly ease especially for the 91-day and 182-day paper due to the heavy maturities due. This will force investors to shift investments to the 364-day paper leading to government opting to shun expensive funds leading a downward movement on the 364-day paper.

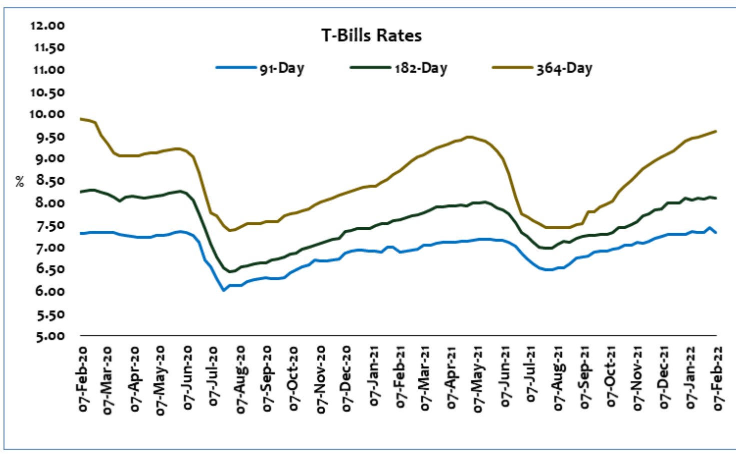

Figure 6: T-Bill Rates Source: KSL, CBK

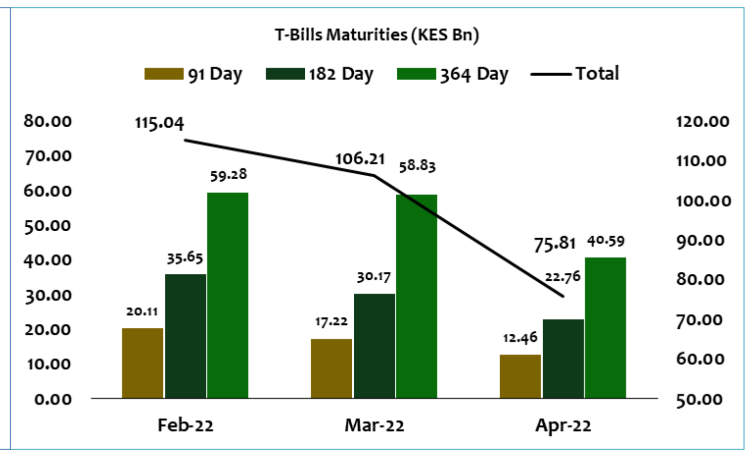

Figure 7: T-Bill Payouts Source: KSL, CBK

Treasury Bond: more and more…

- The plan of lengthening yield to maturity of public debt while managing cost of funds as laid out in the Mid Term Debt Strategy has led to heavy government demand which has seen offer amounts averaging KES 60.7Bn in 2021 compared to an average of KES 27.9Bn in 2016.
- This was matched with high subscriptions in 2021 due to liquidity environment favoring high acceptance while managing cost.

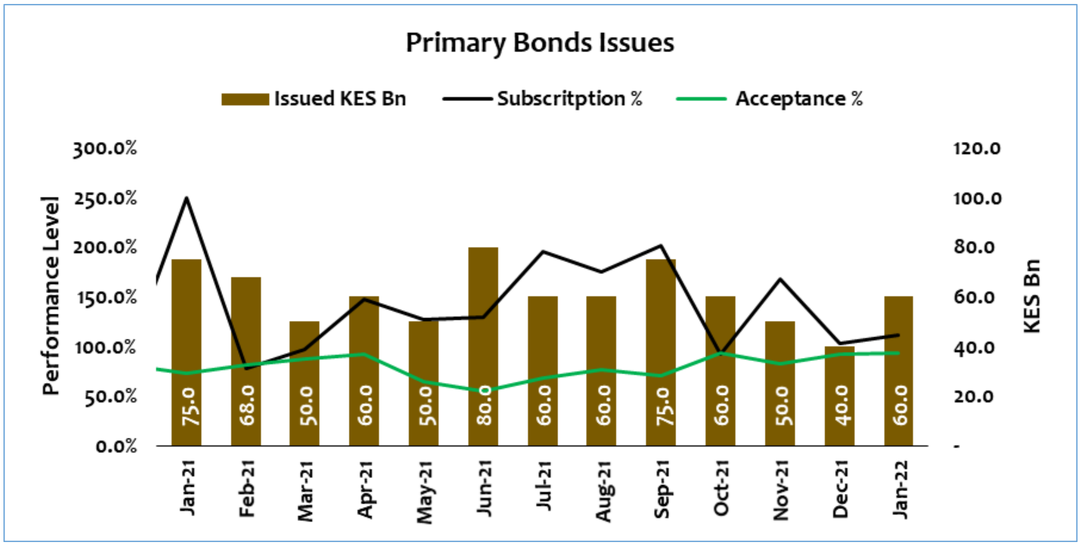

Figure 8: Monthly T-Bonds performance Source: KSL, CBK

- February 2022, the government has issued a KES 75.00Bn infrastructure bond. This is against a payout of KES 35.96Bn broken down as KES 33.09Bn in coupon payment and KES 2.87Bn in partial redemption of IFB1/2017/12.
- As per figure 10, the yield Curve reflects the effect of liquidity in the short end and the effect of on-the-run issues. In the secondary market. IFBs continue to be investors preference capturing 50.6% of the y-t-d trades while reopened bonds FXD1/2021/20Yr controlled 13.5%.

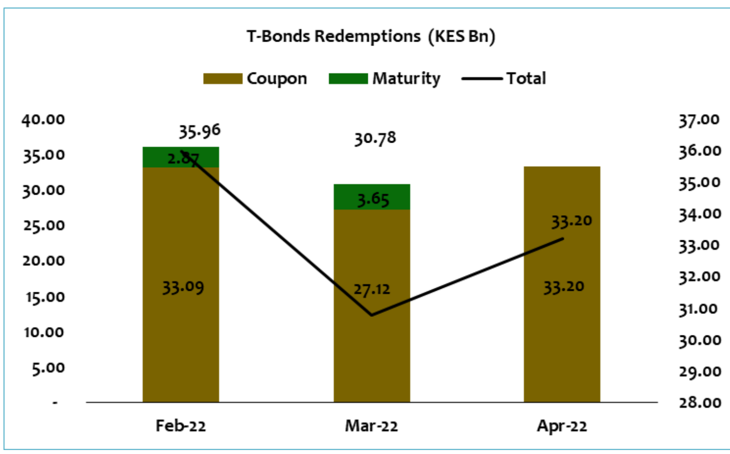

Figure 9: T-Bonds Source: KSL, CBK

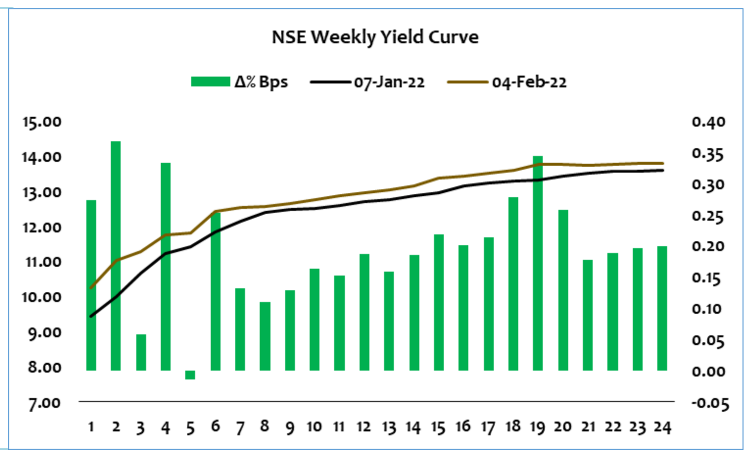

Figure 10: Yield Curve Source: KSL, NSE

Domestic Debt: deeper hole…

- Net domestic public debt close the month at KES 4,084.93Bn, 1.2% higher compared to KES 4034.61Bn in January but 10.5% higher against KES 3697.71Bn at the end of June-21.
- With the new issue, the domestic debt levels are expected to rise even further with a slowdown expected in May and June where we anticipate heavy payout on maturities. Pressure remains on government borrowing with expense need having increased by 126.28Bn as per the February Budget Review Outlook submitted to parliament.

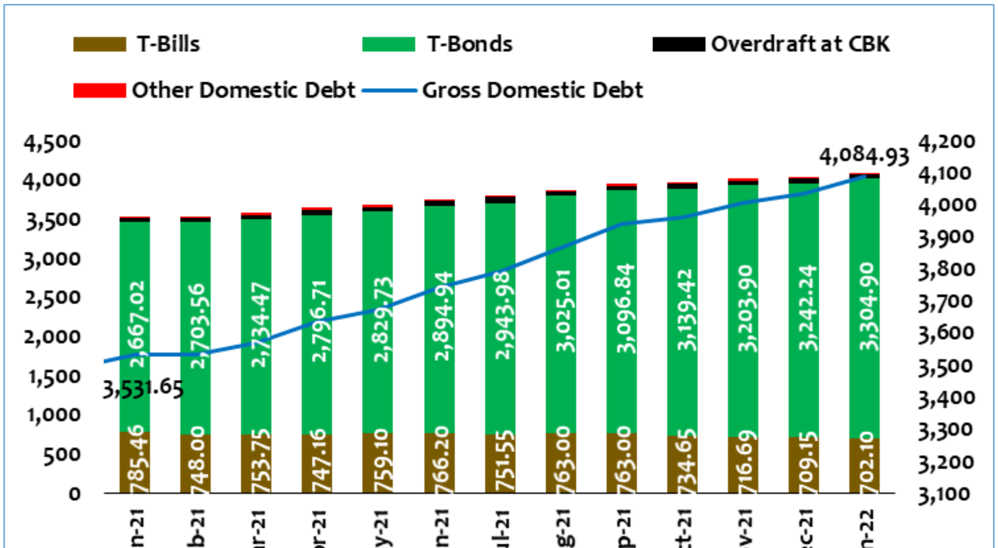

Figure 11: Public Domestic Debt Source: KSL, CBK

Eurobond

- Eurobond saw an upward shift on yields as political temperature continue to rise as part of the cabinet interested in political seats resigned on the set date of February 9th, 2022, six months to the gazette general election date of Tuesday August 9th, 2022.
- This was further coupled with the approach of USD 77.50Mn coupon payment on the 2028 and 2048 bonds scheduled for end of February
- The 2028 bond saw the highest shift of 74.1bps m-m to 6.745% while 2027 bond shifted up by 53.4bps to 6.438%.

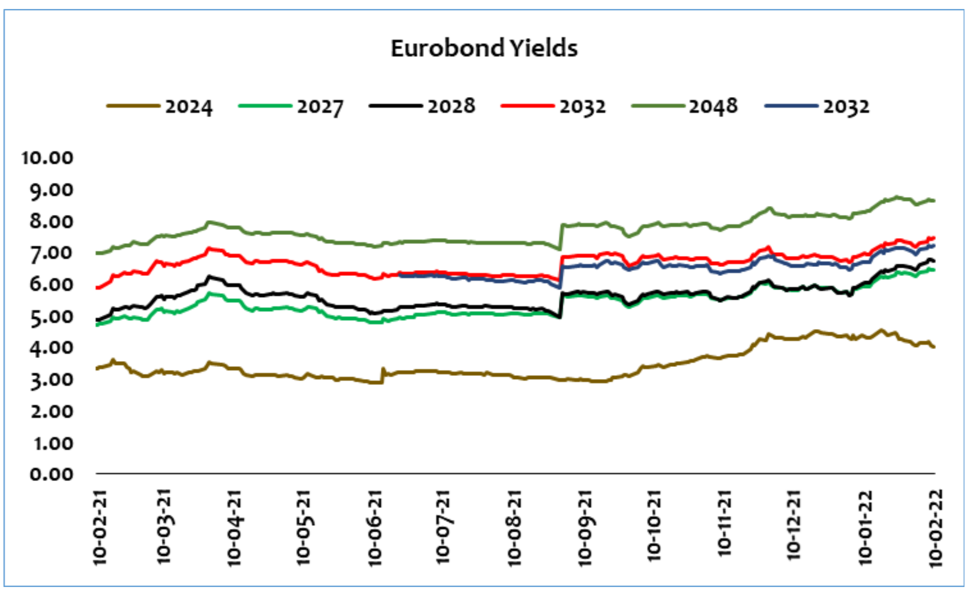

Figure 12: Eurobond Yields Curve Source: KSL, Bloomberg

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