

Kingdom Securities Limited

Pre-Auction Fixed Income Note – June 2022

Total Issue KES 70.00Bn

New – IFB1/2022/18Yr - Coupon – MDA - Term 18 Years

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June 2022 Bond Issue: IFB1/2022/18Year

The CBK issued an 18-year infrastructure bond, IFB1/2022/18Yr seeking KES 70.00Bn. This is the second infrastructure bond issued this calendar year. The issue is in line with the governments high need for dollars for upcoming Eurobond 2024 and 2034 coupon payment standing at USD 100.25Mn.

The green buck has seen a tight supply in the local market as dollar reserves stand at USD 8,177Mn or 4.86 Months of import cover compared to government target of 4.0 months of import cover and EAC of 4.5 Months.

Below is our bidding guide.

Bond	IFB1/2022/18Yr
Tenure	18.0-Yrs
Coupon	Market Determined
Period of Sale	23-May-22 - 07-Jun-22
Value Date	13-Jun-22
Conservative	13.10% - 13.40%
Aggressive	13.60% - 13.90%

Table 1: Bidding Guidance

Source: KSL, CBK

For our bidding guidance, we forecast an over subscription on the issue due to high investor interest on its tax-exemption and dominance of infrastructure bonds in the secondary market on available liquidity. We expect a >100.0% performance due to high government need for dollars.

The rate views market standings with the yield curve having shifted upward year-on-year (May 2022) by 91.4bps and 61.7bps on the 15-year and 20-year key rates respectively while moving year-to-date by 78.8bps and 33.3bps on the 15-year and 20-year key rates respectively.

CBK: CBR Adjustment

CBK MPC committee reviewed the Central Bank Rate (CBR) up by 50bps to 7.50% from 7.00% seen the last 25 months. The key issue raised by the committee was the surging inflation locally and globally with Kenya's May inflation standing at 7.1% from 6.47% in April.

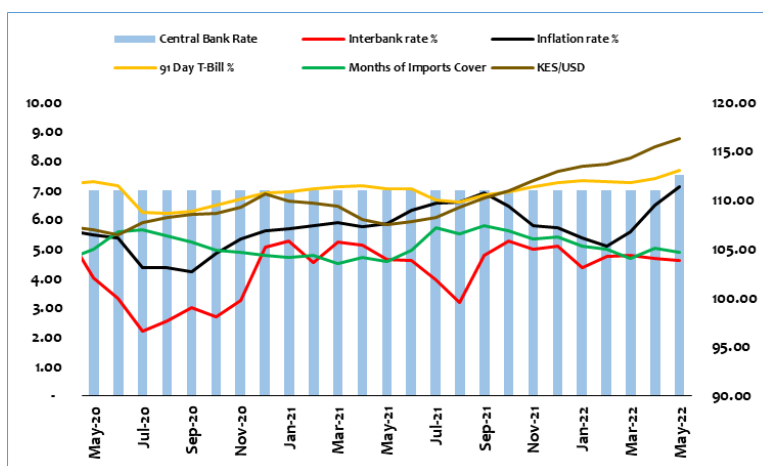


Figure 1: Key CBK Rates

Source: KSL, KNBS

Need for taming inflation has seen Central Banks in developed economies hike their key rates, USA Fed went for a second hike of 50bps pushing the fed rate to 1.0%, Bank of England hiked the rate by 0.25% during their last sitting to 1.0% as the April inflation of the two countries touching 8.3% and 9.0% respectively.

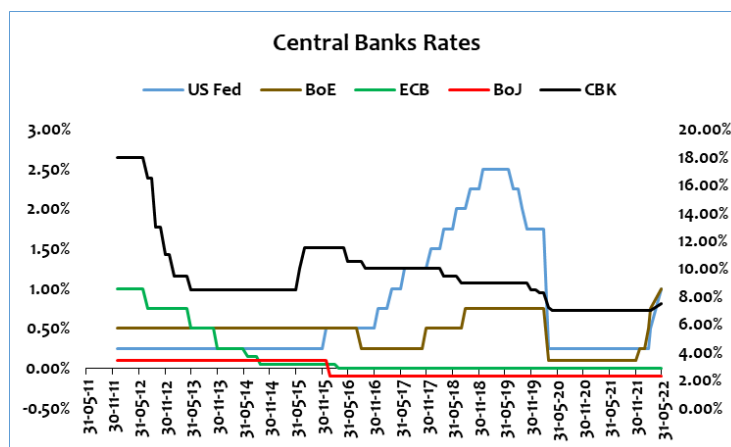


Figure 2: Central Bank Rates

Source: KSL, Bloomberg

Other parameters reviewed showed strong macroeconomic environment. They include

- Stable and resilient banking sector with strong liquidity and capital adequacy ratio. Non-performing loans stood at 14.1% in April against 14.0% in March, growth of private sector credit was 11.5% from 9.1% over the same period.

- Forex reserves was at 4.86 months of import cover against government target of 4.0 months of import cover.
- Export of goods grew by 11.1% y-y in April with receipts from tea and manufactured goods improving by 1.3% and 35.2% over the same period.

Risk from the ongoing geopolitical war in eastern Europe which has led to a rise in commodity prices remains a key factor to global growth which has already seen IMF cut April forecast on a Global growth forecast by 80.bps to 3.6% from January forecast of 4.4%.

Outlook on MPC

Upward pressure on the forward inflation will emanate from the ongoing geopolitical conflict in Eastern Europe. The invasion of Russia has led to further sanction by European Union on purchase of Russia petroleum, high international petroleum prices due to demand, reopening of China key main cities of Beijing and Shanghai which will lead to accelerated energy and raw materials demand to restart the manufacturing sector.

We expect further pressure on inflation, currently sitting 40bps below the upper government target of 7.5%, leading to need to manage inflation. This will be a key factor in the next MPC meeting set for Tuesday July 26th, 2022.

Inflation: A dawn of new reality

Inflation for the month of May 2022 was up to 7.1% compared to 6.47% in April 2022 and 5.87% in May 2021. This was due to an increase in prices of commodities as:

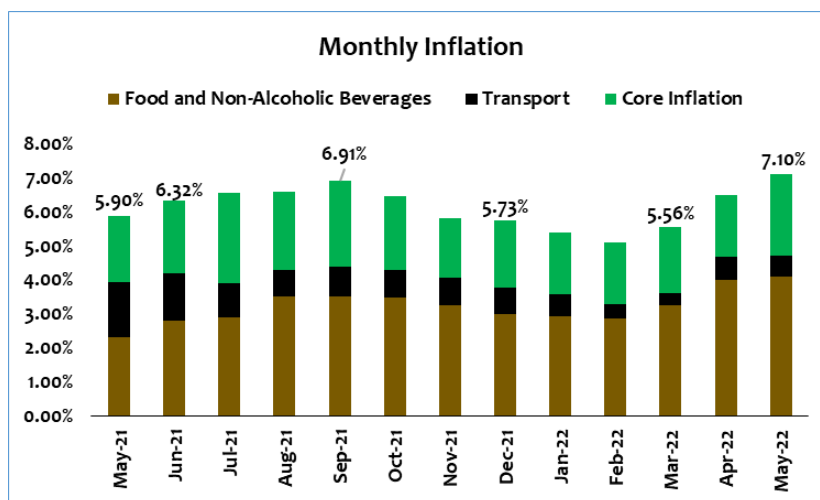


Figure 3: Inflation

Source: KSL, KNBS

- **Food and Non-Alcoholic index increased by 12.4% y-y (April 12.15%, Contribution to CPI 36.0%)** - Reprieve for the food index came from a dip on vegetable prices due to the ongoing rains while pressure came from price rise in milk and milk products.
- **Housing, Water, Electricity, Gas and Other Fuels Index increased by 6.0% y-y (April 5.47%, Contribution to CPI 18.3%)** – This was directly affected by an average KES 5.50 increase in pump prices. Pump prices remain heavily subsidized while landing rates were 1.5%, 6.4% and 31.1% up on super petrol, diesel, and kerosene respectively while the shilling depreciated by 1.0% while free on board (FOB) price of murban crude oil was up 10.4% m-m to USD 93.99 per barrel in April compared to USD 85.11 per barrel in March 2022. **See table at end of report**

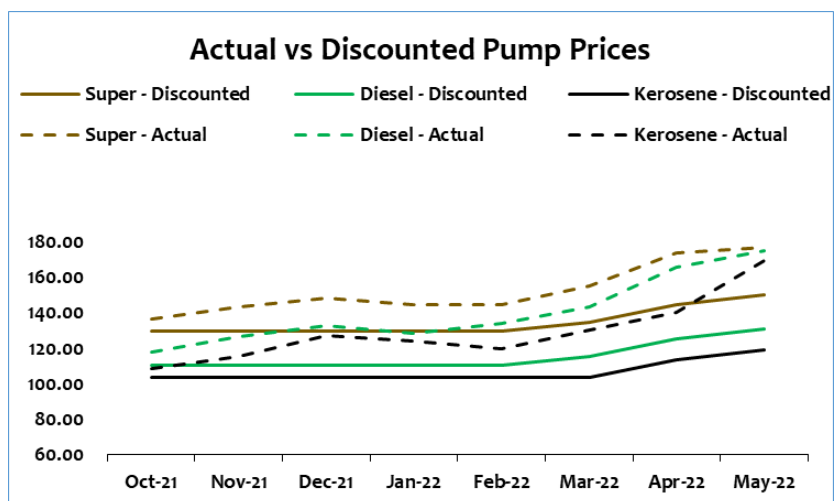


Figure 4: Inflation

Source: KSL, EPRA

- **Transport Index increased by 6.4% (April 6.88%, Contribution to CPI 8.7%)** – the rate edged downwards due to lower transport prices compared to April which saw price hikes during the back-to-school season and Easter Holiday travel rush.
- **Furnishings, Household Equipment and Routine Household Maintenance Index increased by 7.9% (April 7.15%, Contribution to CPI 6.2%)** - this is due to heavy imports and the weakening dollar. Prices continue to be affected by supply chain challenges as most of the products emanated from China whose two major cities, Beijing and Shanghai were on a lockdown to contain Covid-19 spread.

Outlook: Inflation

On rise in inflation, we do not expect the foot off the gas due to the ongoing geopolitical conflict in Eastern Europe which has led to additional sanctions on Russia with European Union countries proposing to cut amount of import from Russia by up to 90%. **We forecast June inflation at 7.30% - 7.55%.**

Interbank Rates: Regulatory Support

Interbank rate closed the month at 4.7569%, 13.1bps lower from 4.8876% with liquidity managed by regulatory injection to the market. Months average rate stood at 4.60%, 6.0bps lower against 4.66% in April. Average demand dipped by 28.2% from KES 16.15Bn from KES 22.51Bn seen in April.

Commercial bank reserves averaged KES 23.10Bn in May, 8.7% higher to an average of KES 21.25Bn in April. The levels have remained high due to liquidity injection through reverse repos.

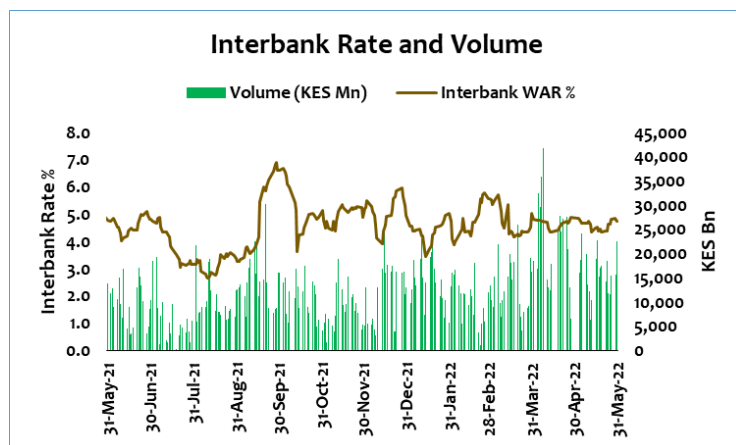


Figure 5: Interbank

Source: KSL, CBK

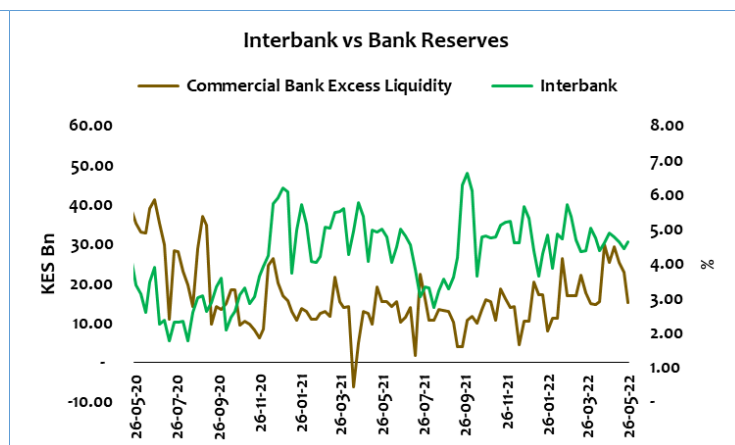


Figure 6: Interbank vs Commercial Bank Reserves

Source: KSL, CBK

We expect the regulator to continue propping liquidity levels while resistance will be felt from the 50bps increase in CBR rate. This will see the interbank range 4.75% - 5.25% in June.

Currency: Weaker and Weaker...

End of May 2022, the local shilling lost 0.8% m-m against the US dollar. The currency shed 0.9%, 2.3% and 2.6% on the British Pound, Euro, and Japanese yen respectively. The demand of the US dollar in the market is due to import demand, need for capital flight and dividend payment. This has been worsened by rate hikes and further hike talks by developed economies governors.

Forex reserves decline by 3.0% m-m from USD 8,427Mn at close of April to USD 8,177Mn at end of May. This was affected by debt payment and coupon payment of USD 79.50Mn which was due on May 22nd, 2022.

Dollar index gained 1.9% m-m against boosted by rising bond yields and positive data from manufacturing activities which picked in May.

KES	KES/USD	KES/GBP	KES/EUR	KES/JPY	Dollar Index
31-May-22	116.7382	147.4478	125.5976	91.4267	101.7660
W/W	0.2%	0.9%	0.8%	-0.1%	-0.3%
M-t-D	0.8%	0.2%	0.4%	1.8%	-0.5%
M/M	0.8%	0.9%	2.3%	2.6%	-1.9%
Y-t-D	3.2%	-3.2%	-1.9%	-6.8%	5.8%
Y/Y	8.5%	-3.2%	-4.0%	-6.5%	13.1%

Table 2: Currency Movements

Source: KSL, CBK

The Global currency market has been affected by commodity demand which has strengthened the dollar. Call by the European Union Central Bank governor to hike key rate has seen the euro strengthening against the dollar. Talks on further rate hike by Fed Reserve chair and governor of the Bank of England have led to excitement in the investment world with analyst anticipating the ECB meeting on June 6th, while the BoE and Fed Reserves meeting scheduled for June 16th.

According to Investing.Com, international petroleum opened the month with Brent and Crude Oil WTI trading 9.4% and 11.2% higher m-m after US Crude inventories fell more than expected amid demand for fuel and OPEC+ agreeing to boost crude output to cover for the Russian drop in production.

Prices were also supported by European Union six package of sanctions on Russia which were passed on Thursday and included to cut amount of import from Russia by up to 90%, immediate ban on insurance contracts for ships carrying Russian oil and six months phase-out of existing insurance contracts on the same.

International Petroleum Price		
Period	Brent	WTI
02-Jun-22	117.74	116.91
W-W	3.1%	2.5%
M-T-D	3.7%	1.4%
M-M	9.4%	11.2%
Y-T-D	49.1%	51.9%
Y-Y	65.0%	69.9%

Table 3: International Petroleum Prices

Source: KSL, Investing.Com

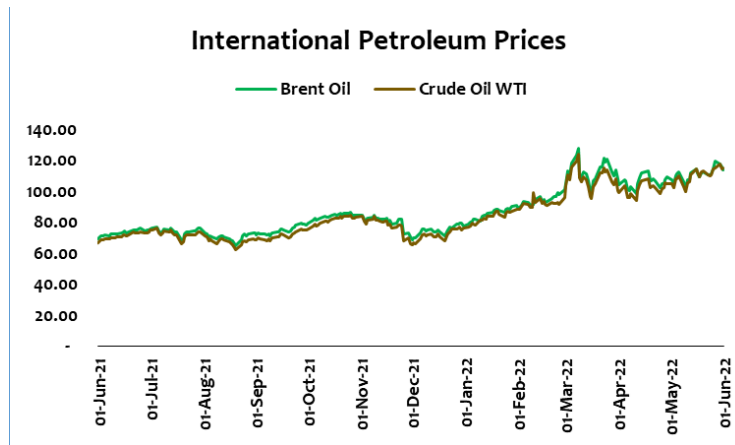


Figure 7: International Petroleum Prices

Source: KSL, Investing.Com

Treasury Bills: Rising Returns

May subscriptions improved to 92.2% from a low of 59.4% in April on better liquidity driven by maturities. Acceptance eased to 93.7% from a high of 99.7% with government opting to reject expensive bids especially on the 91-day paper which saw a subscription of 133.4% and an acceptance of 88.8%. Performance was at 86.3% which was higher compared to 59.2% seen in April.

Overall rates were up month on month with the 181-day leading by gaining 52.8bps to 8.901%. The 91-day paper was up 29.6bps to 7.744% while the 364-day was 12.6bps higher to 9.881%.

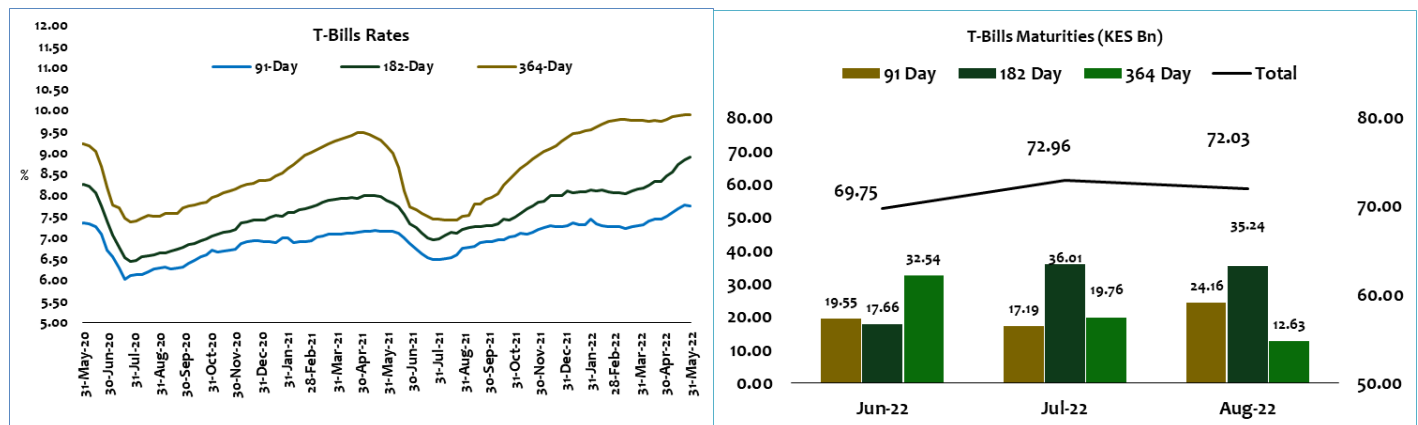


Figure 8: T-Bill Rates

Source: KSL, CBK

Figure 9: T-Bill Payouts

Source: KSL, CBK

May-2022							
Tenure	Offer (KES Bn)	Subscription	Acceptance	Performance	WAR % April 22	WAR % May 22	Δbps M-M
364-Day	50,000	100.9%	95.9%	96.8%	9.755%	9.881%	12.6
182-Day	50,000	66.9%	94.3%	63.0%	8.373%	8.901%	52.8
91-Day	20,000	133.4%	88.8%	118.5%	7.448%	7.744%	29.6
Total	120,000	92.2%	93.7%	86.3%			

Table 4: T-Bill Performance

Source: KSL, CBK

In the month of June, we expect a maturity of KES 69.75Bn against a demand of KES 120.00Bn. Heavy maturities are expected on the first week as the 364-day paper expecting a maturity of KES 32.54Bn during the month.

T-Bills Outlook

The CBR rate hike will lead to an upward push on the rates across all papers. This will necessitate a shift in short term investment strategy.

Treasury Bonds: Upward Shift of the Yield Curve

Primary bonds issue has seen value of issues increase by 4.0% in the first five months of 2022 to KES 315Bn compared to KES 303Bn over the same period in 2021. This is an indication of growing government appetite to funds especially on the offer of infrastructure bonds.

Subscriptions were 11.1% lower over the stated period with acceptance dipping by 9.4% due to rates. To defend the rates, the government rejections were heavy with an option of tapping which led to c.100% acceptance on the taps.

Primary Bond Issues						
Period	Issued KES Bn	Subscriptions KES BN	Accepted KES Bn	Subscription	Accepted Rate	Performance Rate
First five Months 2021	303.0	440.5	345.3	145.4%	78.4%	114.0%
First five Months 2022	315.0	391.6	312.8	124.3%	79.9%	99.3%
Δ%	4.0%	-11.1%	-9.4%			

Table 5: T-Bond Primary

Source: KSL, CBK

Bonds Market: Tough Secondary Market

Secondar market has seen a dip in value traded despite an increase in bonds. focus has been on foreign investors sell off of infrastructure bonds.

NSE Bonds Weekly Performance Week 18 2022			
Indicator	Apr-22	May-22	m-m
Deals	1,894	2,066	9.1%
Value (KES Bn)	68.74	53.52	-22.1%
proportion to bond issue	2.0%	1.5%	

Table 6: T-Bond Secondary Trade

Source: KSL, NSE

Upcoming payout stands at KES 92.80Bn with KES 24.84Bn in coupons and KES 67.96Bn.

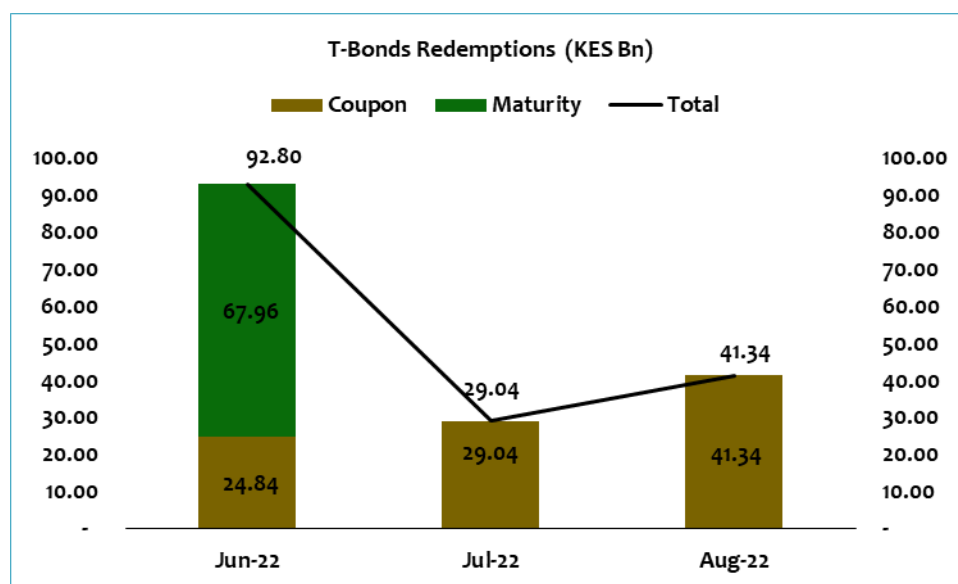


Figure 10: T-Bond Payouts

Source: KSL, NSE

Yield Curve: Shift or Jump:

Yield curve has seen a minimal shift on the short end and long end with an upward shift on the mid-curve due to the issued 10-year bond issued in April 2022.

The curve has shifted up by 104.9bps on the short end while mid-tier bonds continue to be affected by primary issues

Yield Key Rates %	31-May-21	31-Jan-22	30-Apr-22	31-May-22	y-t-d bps Δ	y-t-d bps Δ	m-m bps Δ
2-Yr	10.0133	10.2343	11.5620	11.2832	127.0	104.9	-27.9
5-Yr	10.9555	11.4261	12.2910	12.2397	128.4	81.4	-5.1
10-Yr	12.2979	12.6533	13.0240	13.5293	123.1	87.6	50.5
15-Yr	12.9869	13.1124	13.8878	13.9005	91.4	78.8	1.3
20-Yr	13.3003	13.5847	13.8919	13.9174	61.7	33.3	2.6
23-Yr	13.4360	13.6808	13.8937	13.9806	54.5	30.0	8.7

Table 7: Yield Curve Key Rates

Source: KSL, NSE

We expect an upward shift, especially on the short end, with the market pricing to cater for the 50bps addition on the CBR.

Eurobond: International Pressure

Eurobond yields saw the 2024 bond shift upwards by 160bps m-m higher as the global short-term yields edge up. The political scene continued to play a major role in pricing the country's Eurobond papers as indicated by the pricing of the short-term paper.

Additional sanctions on Russia led to the Eurobonds to shift up with the 2024 paper shifting upwards by 80bps as the ripple effects of the sanctions is not expected to spare the developing economies.

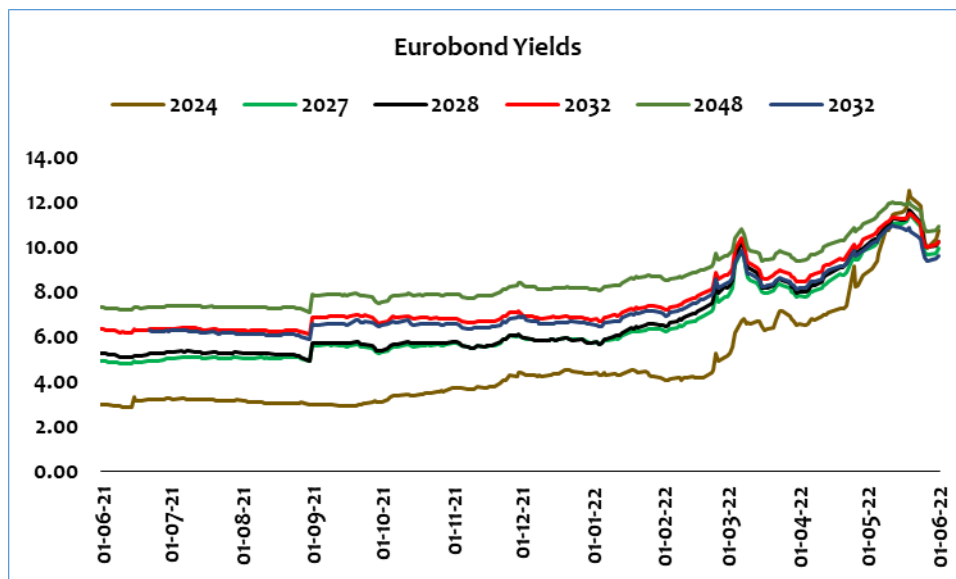


Figure 11: Euro Bond Yields

Source: KSL, Bloomberg

Period			Landing Rate			Discounted/Published Prices			Actual Prices			Discount		
	Crude Prices	Mean Exchange	Super	Diesel	Kerosene	Super	Diesel	Kerosene	Super	Diesel	Kerosene	Super	Diesel	Kerosene
Oct-21	69.73	111.10	606.06	561.06	522.06	129.72	110.60	103.54	136.34	118.01	108.54	5.1%	6.7%	4.8%
Nov-21	73.41	112.33	627.80	600.22	604.43	129.72	110.60	103.54	143.48	126.28	115.11	10.6%	14.2%	11.2%
Dec-21	82.73	113.14	601.97	565.92	574.85	129.72	110.60	103.54	148.04	132.49	127.07	14.1%	19.8%	22.7%
Jan-22	82.03	113.58	596.79	606.16	534.38	129.72	110.60	103.54	144.47	128.44	123.77	11.4%	16.1%	19.5%
Feb-22	74.36	113.79	676.40	677.31	619.57	129.72	110.60	103.54	144.25	133.89	119.42	11.2%	21.1%	15.3%
Mar-22	85.11	114.60	814.85	844.57	692.95	134.72	115.60	103.54	155.11	143.16	130.44	15.1%	23.8%	26.0%
Apr-22	93.99	115.74	826.77	899.36	908.66	144.62	125.50	113.44	173.70	165.74	139.89	20.1%	32.1%	23.3%
May-22						150.12	131.00	118.94	176.47	174.94	169.26	17.6%	33.5%	42.3%

Table 8: Kenya Petroleum Pump Prices

Source: KSL, EPRA

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