Kingdom Securities Limited

Pre-Auction Fixed Income Note – September 2022

September 12, 2022

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Primary Bond Issue – KES 50.00Bn

The Central Bank issued a KES 50.00Bn offer on the September Primary by re-opening FXD1/2022/10Yr and FXD1/2022/15Yr papers. The amount of KES 50.00Bn seems to be the new minimum borrowing levels as demand creates unending appetite.

The re-opening of the two bonds is aligned with the market rate as they seem to be better priced compared to previously re-opened bonds. Low holding on the two bonds have left room for coupon payment containment even with additional issue.

The market has seen adequate subscription to cover the demand despite the election fever in the last three months. August auction was affected by the election activities including filing petition and Supreme Court feedback on the petition. This left the market with high liquidity and demand for short-term papers and short tenure bonds doing well in the secondary market.

Bond	FXD1/2022/10Yr	FXD1/2022/10Yr
Tenure	9.6 Years	14.5 Years
Coupon	13.490%	13.942%
Period of Sale	25/08/2022 to 13/09/2022	
Value Date	19/09/2022	
Conservative	13.400% - 13.550%	13.850% - 13.950%
Aggressive	13.650% - 13.900%	14.000% 14.300%

The secondary bonds market has seen improved activities despite yields remaining high. We anticipate another c.100.0% subscription performance as the market adjust itself to the new executive office, reserved liquidity upcoming coupon payments.

FXD1/2022/10Yr was opened in May 2022receiving 54.8% subscription, 87.2% acceptance and a that was not deployed during the election period and the KES 28.02Bn

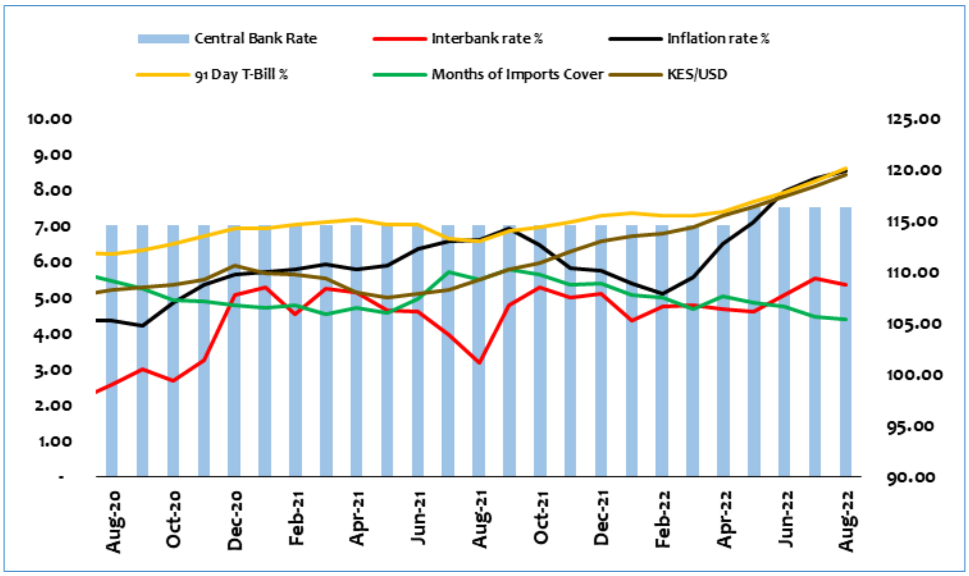
47.8% performance. We anticipate investor to concentrate their interest on this paper due to better tenure and coupon.

FXD1/2022/15Yr was opened in April 2022 as a second paper in the month's issue. The paper's subscription stood at 108.5%, acceptance at 84.9% and a performance 92.1%. The performance was due to high liquidity during the time. We fathom a near 70% performance on the paper benefitting from the upcoming coupons.

CBK CBR Rate

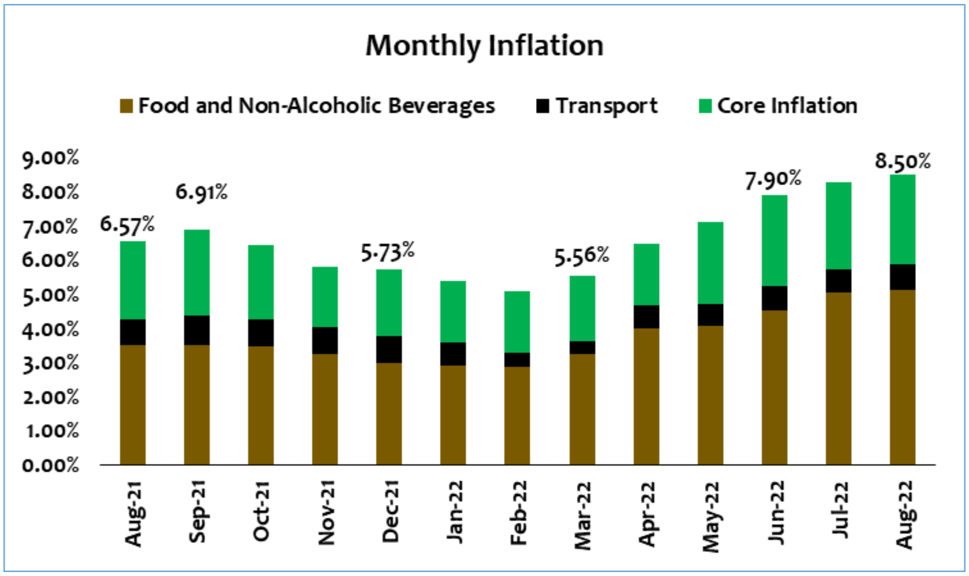
The CBK monetary policy committee (MPC) will be held on Thursday, September 29, 2022. All macroeconomic indicators point towards a retained rate of 7.5%. We shall release our MPC review report towards the meeting date.

The July 2022 current account deficit stood at 5.1% of GDP compared to 5.2% in July 2021. The rate remained near the government annual target of 5.0%. The rate was supported by improved diaspora remittance and export revenues. Export performance has supported the narrow deficit figures with strong figures from horticulture export to Europe and regional traded.



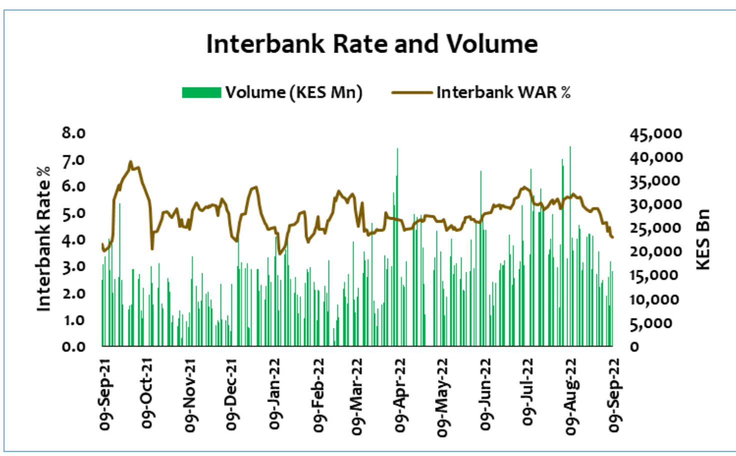
Inflation

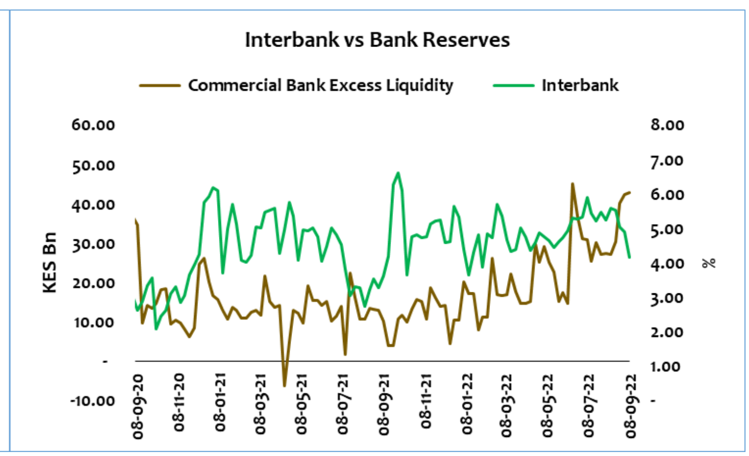
- Inflation stood at 8.5% in August, a 20bps increase from 8.3% in July and 193bps up from that of 6.6% in august 2021. The figure was affected by increase in manufactured food prices while it was contained by the non-movement in pump prices as government retained fuel subsidy. Core inflation edged to 2.63% 4bps from 2.59% in July 2022.
- Inflation remained constrained on pump prices which can be reflated by the inflation rates in the region Ethiopia 33.5% in July, Uganda 9.0% in August, Tanzania 4.6% in August, Rwanda at 20.4% in August, Nigeria 19.6% in July, Ghana 31.7% in July, and South Africa 7.8% in July.
- **We fathom inflation to rise to 8.65% - 8.75%. The rate is dependent on the governed retain the subsidy for another month as it has been lagging the price increase cheered by the declining international petroleum prices and the increase at a decreasing inflation rate in developed and regional economies. The rate prediction will be buoyed by lower farm produce prices with the short duration crops benefiting from the ongoing rains and rejuvenation of the manufacturing sector post-election.**



Interbank Rate

- The interbank rate eased at the beginning of September with the rate supported by undeployed liquidity with investors watching closely the election petition that had been launched at the Supreme Court.
- The rate had a four-week average of 5.05% as of September 9th compared to an average of 5.38% four weeks prior. The rate eased to a low of 4.0732%, 151.5bps lower form 5.5884% on August 8th, 2022.
- The rate eased as we see commercial bank reserves increased to KES 42.80Bn, surging from KES 27.20Bn a month prior.
- **We expect a deployment of the funds as the election issues are laid to rest which will erode the liquidity pushing the interbank rate back to the 5.0% levels seen between June and August.**

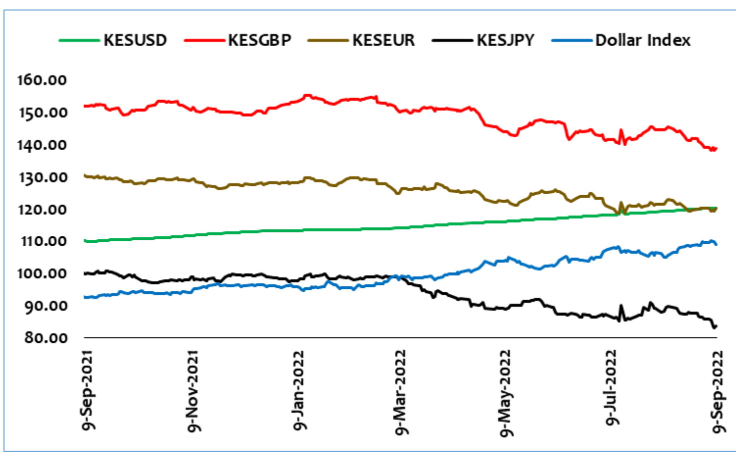


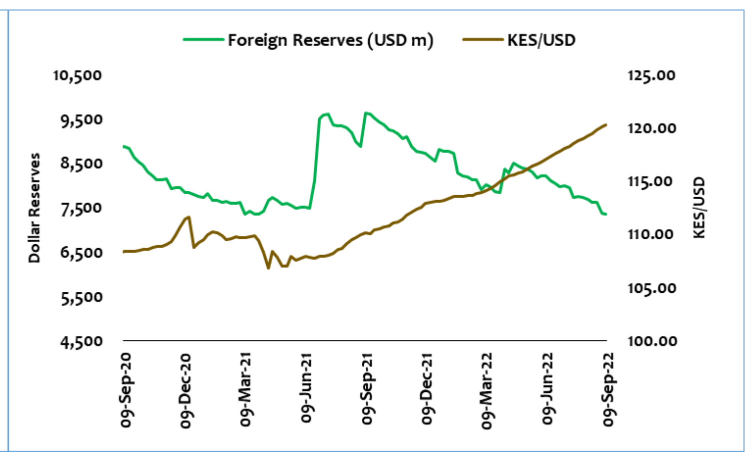


Currency

- Payment of august Eurobonds and Chinese debt eroded the central bank reserves which further pushed the local currency further to the red shedding 1.0% m-m against the US dollar. However, the shilling gained 3.9%, 1.2% and 4.8% month on month on the British Pound, Euro and Japanese Yen respectively.
- Banks trades on major currencies have an upside of 8.5%, 12.5% and 12.9% on the US Dollar, British Pound and Euro respectively.
- Foreign reserves declined USD 336.00Mn to stand at 4.19 months of import cover against government target of 4.0 months of cover. The change of administration left the country vulnerable to the shocks as the outgoing executive eased its footing from external borrowing especially concessionary borrowing from IMF and World Bank.
- **We expect the first financial port of call for the new administration to cushion the levels to above the 4.5 months of import covers required by the East Africa Community. However, the shilling has been shedding 1.0% per month in value for the last 4 months. If the trend continues, we forecast the shilling will be at 121.50 on the US dollar by 9th October 2022.**

KES	KES/USD	KES/GBP	KES/EUR	KES/JPY	Dollar Index
9-Sep-22	120.3059	138.7535	120.1029	83.8106	108.9970
W/W	0.2%	-0.2%	0.1%	-2.3%	-0.5%
M-t-D	0.2%	-0.8%	0.0%	-3.1%	-0.6%
M/M	1.0%	-3.9%	-1.2%	-4.8%	2.5%
Y-t-D	6.3%	-8.9%	-6.2%	-14.6%	13.3%
Y/Y	9.3%	-8.5%	-7.8%	-16.1%	17.9%



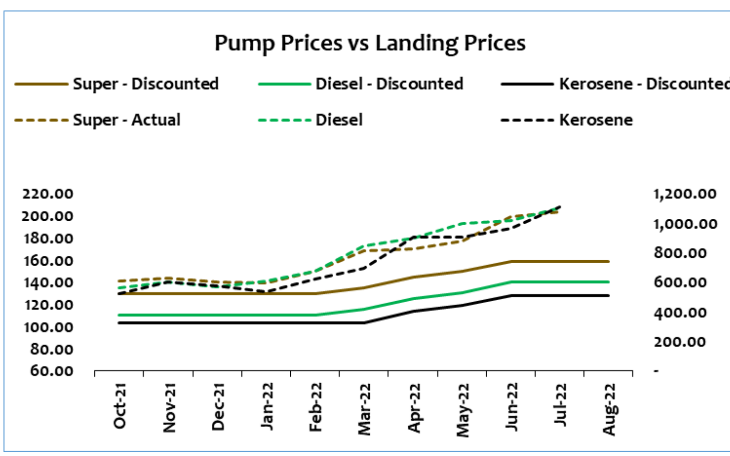


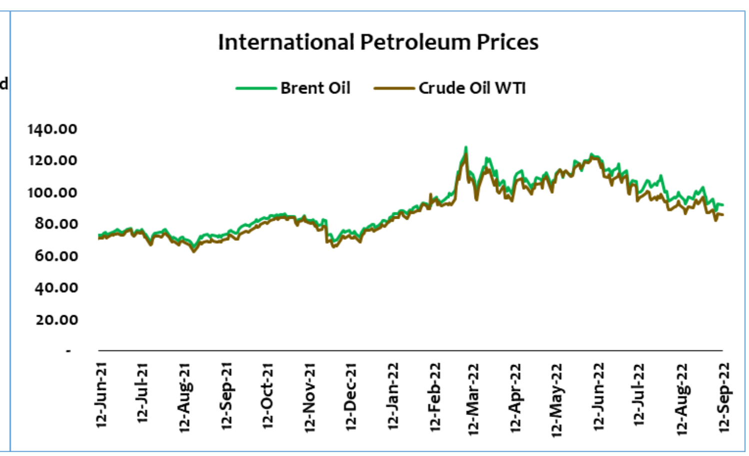
Global News

- Globally, the US dollar was up 2.5% as reflected by the dollar index. The gains seem to fade as the Fed President retained sentiments to push the Fed Rate even higher. The US economy awaits the Fed rate decision scheduled for September 16th while the inflation figures are set to be released on September 13th. Analyst, who have forecasted an 8.1% inflation rate, have indicated that the level of August inflation will determine the rate hike with majority voting for a 75bps hike.
- The EURO gained against the dollar after European Central Bank voted for a 75bps rate hike to 0.75%, the highest since July 2011. Core August inflation is forecasted to remain at 4.3% and CPI at 9.1% as not much news came out of the European Energy Ministers meeting which was to review the high energy prices and its effects to the upcoming winter.
- The Chinese inflation eased as the economy slowed. Inflation declined to 2.5% in August from 2.7% rate seen in July. The country's produces index increased by 2.3% on the year through august 2022.
- In Britain, the Bank of England MPC will meet on Thursday September 16th with analyst forecasting a rate hike. Britain's August inflation is set for anther headline levels with analyst forecasting 10.2% from 10.1% in July.

Petroleum prices

- Local petrol pump prices have remained stable for the third month running thanks to fuel subsidies. The pump prices are discounted at 34.5%, 47.3% and 58.0% on the super petrol, diesel, and kerosene prices respectively. This is contrary to the landing prices that have been up 29.9%, 22.6% and 22.3% up in the three-month super petrol, diesel, and kerosene prices respectively used to calculate prices while the dollar has weakened by 2.6% over the same period.
- The government is banking on declining international petroleum prices as the prices dipped by 6.7% and 7.3% m-m on the Brent and Crude Oil WTI. The prices have dipped 13.6% and 17.2% since May while falling 25.9% and 30.1% from high of USD 123.58 and USD 122.11 per barrel on the Brent and Crude Oil WTI. The international prices are trading near April prices which had prices at KES 144.62, KES 125.50 KES 113.44 while undiscounted price were KES 173.70, KES 165.74 and KES 139.89 super petrol, diesel, and kerosene prices respectively.
- **The executive will need to play its cards right to ensure they do not start on a wrong footing as it works on managing the electorate expectation. This will force an extension on the subsidy for another month or two which will aid in containing inflation levels.**





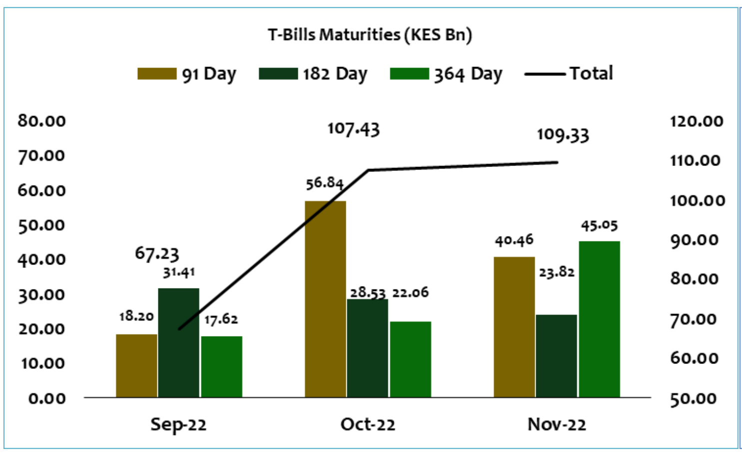
Treasury Bills

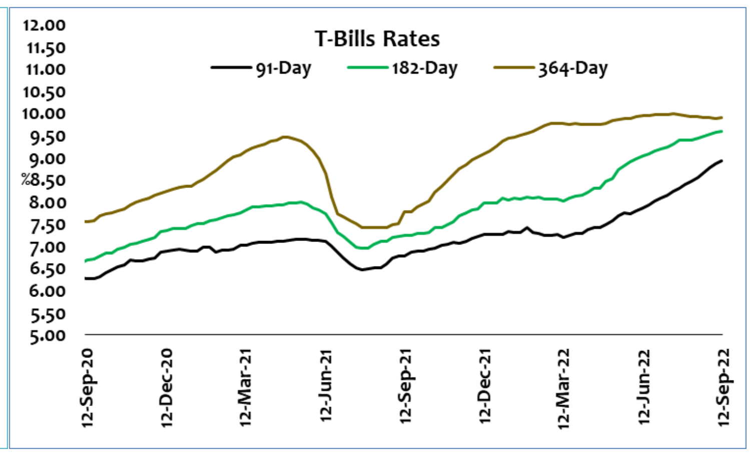
T-Bills have remained the beneficially of the liquidity tactic as during the election period. Investors opted to pack funds on the 91-day paper. The rate is fast heading towards the 9.0% levels which will counter the need to invest in the longer tenure papers. The 91-day paper rate levels are not sustainable which will lead to reversal of rates.

We forecast auction to remain undersubscribed in September with maturities standing at KES 67.23Bn against a target of KES 96.00Bn. Investors will be skewed to the 91-day- paper. However, with the rates rising fast, there will be need to tame the rate which will lead to heavy rejection forcing investors towards the 182-day paper.

The 364-day paper, on the other hand, has seen the rates benefiting from low subscription forcing the government towards 100% acceptance reversing the yield loss that was seen in early August.

August-2022							
Tenure	**Offer (KES Bn)**	**Subscription**	**Acceptance**	**Performance**	**WAR % July 22**	**WAR % August 22**	**Δbps M-M**
364-Day	**50,000**	22.9%	98.2%	98.2%	9.968%	9.910%	(5.8)
182-Day	**50,000**	40.4%	83.3%	83.3%	9.393%	9.532%	13.9
91-Day	**20,000**	280.6%	95.6%	95.6%	8.322%	8.767%	44.5
Total	**120,000**	73.2%	93.1%	93.1%			



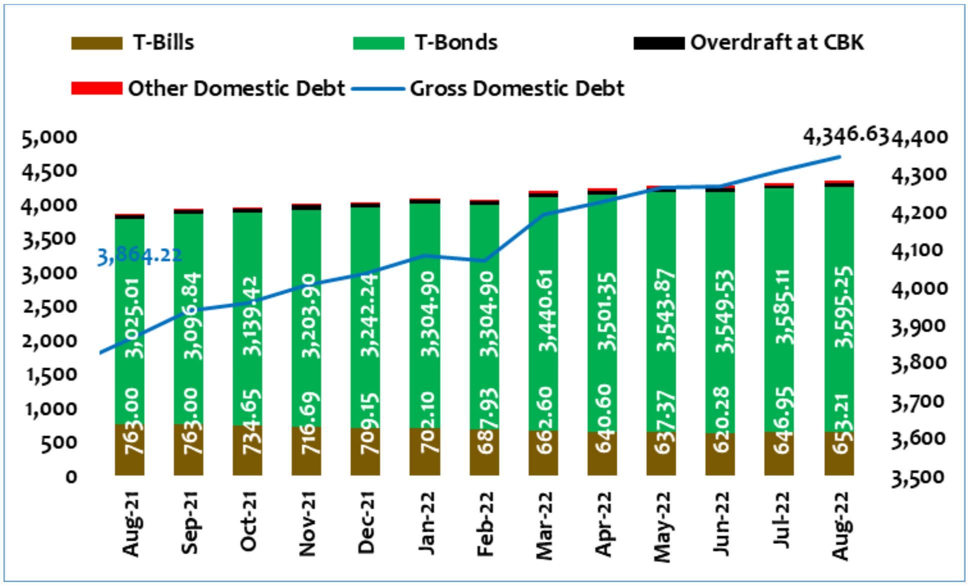


Government Domestic Debt

Government has been working on managing debt levels in line with the Mid Term Debt Strategy (MTDS). Domestic debt has increased on a decreasing speed as net domestic debt increased by 1.9% between the end of the 2021-2022 fiscal year and end august 2022. This was a lower rate compared to 4.5% growth between the end of the 2020-2021 fiscal year and end August 2021. Year on year, the growth increased by 12.5% y-y as of end of August 2022 compared to a 34.4% y-y as of end of August 2021.

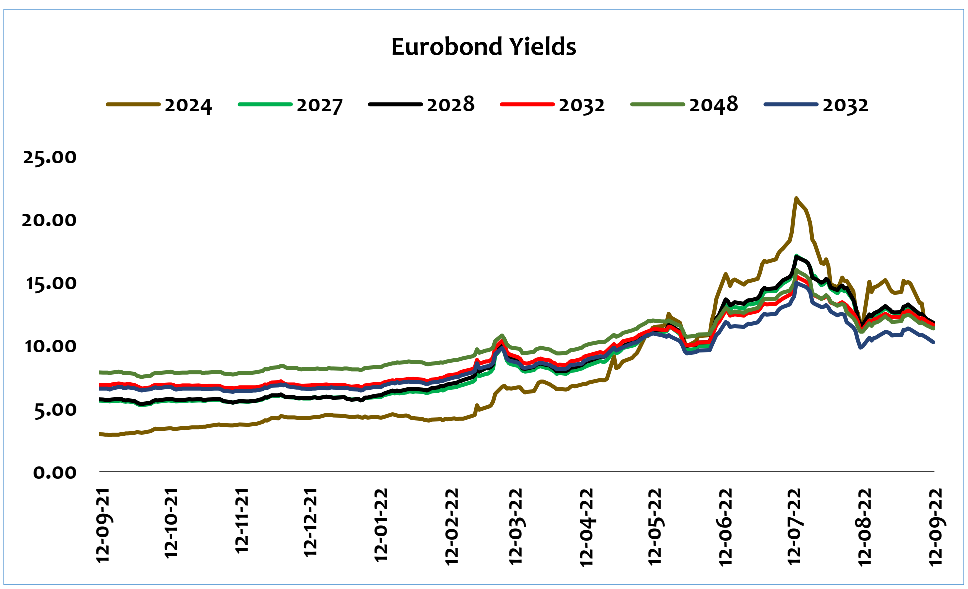
The slowdown in seen as a shift from borrowing from the domestic market to pay international debt with treasury opting for concessionary borrowing to deal with external loan payments. The shift also affected the short-term papers, with T-Bills holdings at 15.2% from a high of 30% in 2020, with a preference of long-term bonds between 15-20 years.

The shift has led to Treasury opting to increase its issue ticker from KES 40.00Bn.



Eurobond

Eurobond Yields continue with the downward shift to new m-m low. The 2024 paper currently at 6.1bps higher m-m but remains 874.9bps higher y-y. We opine the rates will continue a downward shift as the government takes shape and start taking steps towards economic performance, international relation, and political amendments.



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