Kingdom Securities Limited

Pre-Auction Fixed Income Note – October 2022

October 3, 2022

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Primary Issue – October 2022: Act of Balance and Need for Liquidity

The primary market bond issue for the month of October stands at an offer of KES 40.00Bn on reopened FXD1/2017/10Yr and FXD1/2020/10Yr and new bond FXD1/2022/25Yr. This cemented the strategy on liquidity and yield management.

The bond's issue is divided into two with the short-term bonds value date of 10th October while the new bond FXD1/2022/25 set for value date of October 24th, 2022. The issue is aligned to the coupon and maturity payments with coupons worth KES 22.07Bn scheduled for October 10th while a coupon payment of KES 15.02Bn and maturity of KES 20.71Bn is due on the tail end of the month.

Below is our bidding guidance.

Bond	FXD1/2017/10Yr	FXD1/2020/15Yr
Tenure	4.9 Years	12.6 Years
Coupon	12.966%	12.756%
Period of Sale	21st Sept 22 - 4th Oct 22	
Value Date	10th October 2022	
Conservative	12.650% - 12.800%	13.850% - 13.950%
Aggressive	12.900% - 13.050%	14.000% 14.250%

Table 1: Bidding Guidance Source: KSL, CBK

The increase in Central Bank Rate (CBR) by 75bps from 7.50% to 8.25% will shift the yield curve higher pushing current portfolios deeper underwater necessitating the need for portfolio restructure for return management creating liquidity in the secondary market.

The FXD1/2017/10Yr is meant to manage liquidity due to its short tenure and coupon levels. Its current holding is KES 35.17Bn, an indication that treasury will be comfortable paying the coupon on additional holding. The bond has seen a turnover of 15.2% y-t-d. The paper will generate the most interest in the market as investors will go for returns and tenure.

The FXD1/2020/15Yr paper aids in managing yield curve as the as the coupon is not as attractive as the FXD/12017/10Yr. The paper was first issued in February 2020 with very low reception. It was reopened in September 2020 where is saw a buildup on holdings due the high market liquidity. It was again reopened in March 2022 benefiting from a tap sale. Current holding on the paper is KES 72.07Bn an indication of saturation in the market.

We do not anticipate much interest on the paper as turnover in the market stands at 20.5% with heavy trades concentrated on the fist week of September. The attraction on the bond will be based on the discounted levels with yields at 13.8902%.

We shall advise on the FXD1/2022/25Yr as closing date approaches.

CBK-MPC

Central Bank Monetary Policy Committee (MPC) increased the Central Bank Rate (CBR) by 75bps to 8.25% from 7.50%. The committee opted to tighten the monetary policy citing inflationary pressure and global risk and their impact on the local economy.

Factors that were considered included:

- Inflation continues an upward surge to 9.2% in the month of September duet to transport and fuel pressure.
- The strengthening of the US dollar on the global currency scene has led to its continued domination on the local currency, rate hikes in developed economies with the aim of taming inflation.
- Inflation is driven mostly by energy prices and supply chain challenges despite a decline in commodity prices.
- The global economy outlooks remain wanting mirroring effects of tightening monetary policies, impact of the Russia-Ukraine war and effects of the Covid-19 pandemic on the China's economy leading to trade disruption.
- Local economic activity remained positive in second quarter with bank liquidity and capital requirements remaining stable. August NPLs were at 14.2% while private sector credit growth at 12.5% during the period.
- The manufacturing sector continues to reel out of election mood with august PMI at 44.2 from 46.3 seen in July. We expect the index to adjust upwards towards the 50.0 levels in Q4-22.
- Forex reserves remained adequate at 4.19 months of import cover while reserves of external asset at 4.64 months of import cover at end of September.
- August current account stood at 5.2%, same level as August 2021 while 10bps worse to 5.1% seen in July 2022.

The next MPC meeting will be held on November 29th, 2022.

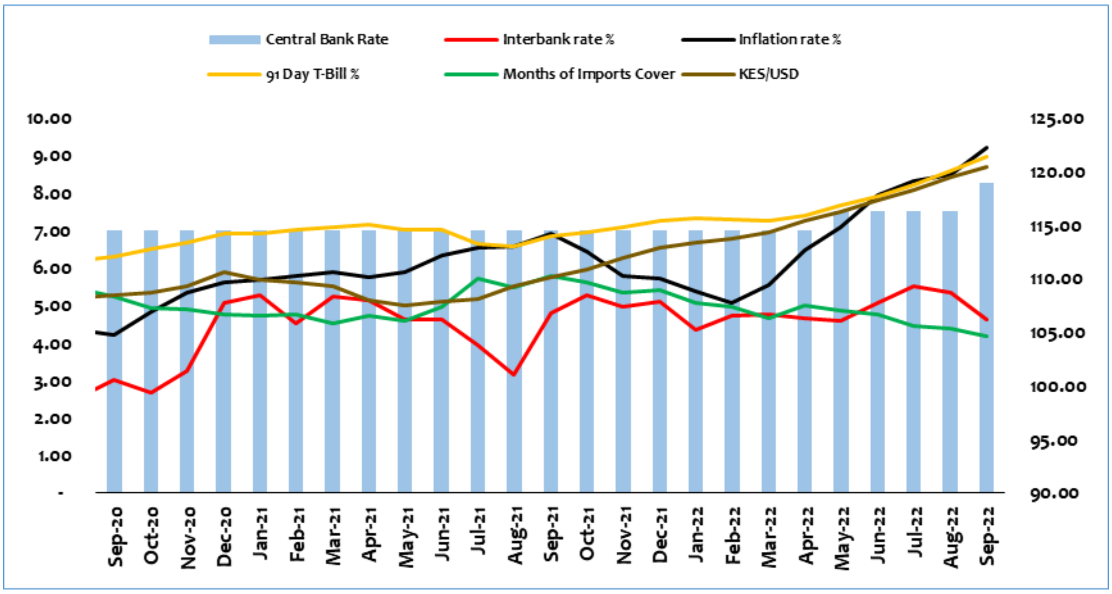


Figure 1: Key Rates Source: KSL, CBK, KNBS

Inflation

Kenyan inflation was up for the 8th month running to stand at 9.2% in September from 8.5% in august 2022 and 6.91% in September 2021. The rate overshot our revised inflation rate of 9.05%.

Core inflation increased to 3.11% from 2.63% in August 2022 pushed up by Housing, Water, Electricity, Gas and Other Fuels which increased by 7.3% y-y.

The increased was heavily influenced by transport index which increase by 10.2% y-y and 3.6% m-m driven by the increase in local petroleum pump prices which saw super petrol, diesel and kerosene prices increase by 12.7%, 17.9% and 15.6% respectively.

The October, November, and December weather forecast indicated a depressed (below average) rainfall that will be poorly distributed in both time and space. This will have an impact of short-term crops. Food prices will be cushioned by august harvest in the main breadbasket which will help manage food index.

Decline in international petroleum prices will see the country start benefiting by lower petroleum prices. However, the weakening shilling and high cost of international shipping prices will lead to high landing prices forcing higher pump prices in the month of October.

This will push cost of living higher. We forecast inflation range 9.10% - 9.38% driven mostly by the transport index and housing, water, electricity, gas, and other fuels index.

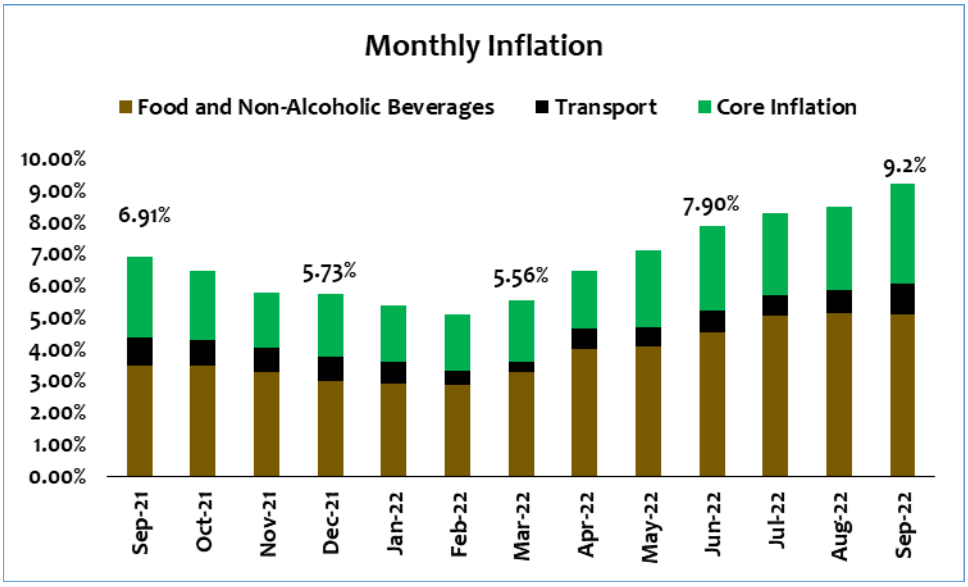


Figure 2: Inflation Source: KSL, KNBS

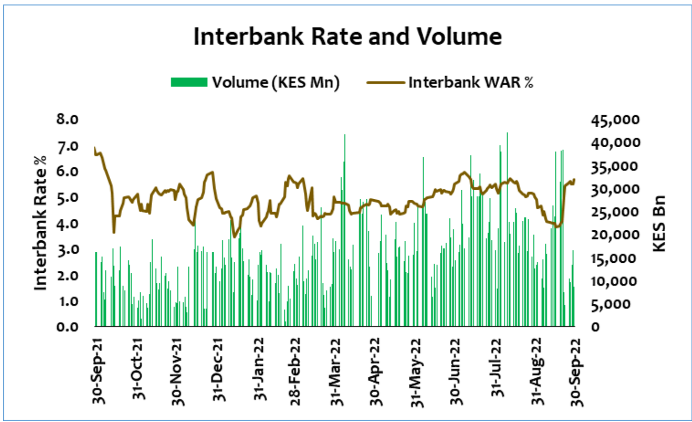
Interbank Rate

Interbank rate edged upwards to close the month at 5.6775%, 67.4bps higher compared to end of august 2022. This was driven by tight liquidity in the market after the market released investment funds that were held pre and post presidential election petition which saw the rate drop to a low of 3.8631% in mid-September.

Commercial bank reserve plunged to close the month at KES 13.40Bn from a high of 42.40Bn at end of August as investors priced low political risk. We forecast the levels to remain within this range.

During the month, the market expects an injection of KES 107.43Bn in T-Bills maturity and KES 76.60Bn in Bond maturities and coupons.

We anticipate the rate to remain on the 5.25% - 5.75% range as market liquidity remains tight with government targeting KES 96.00Bn in T-Bills and KES 40.00Bn bonds.



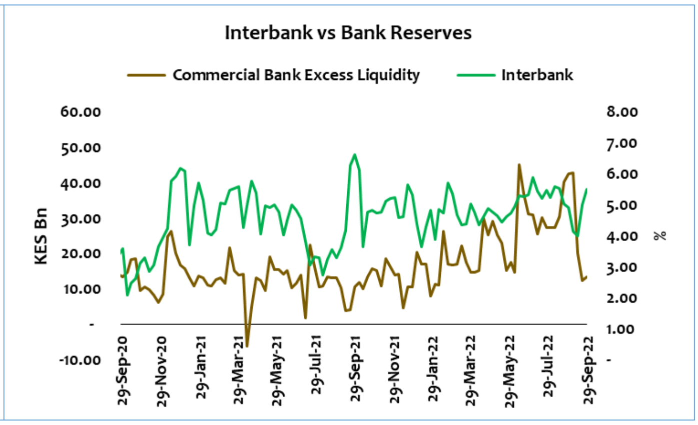


Figure 3: Interbank Source: KSL, CBK

Figure 4: Interbank vs Commercial Bank Reserves Source: KSL, CBK

Currency

The shilling shed 0.6% against the dollar in the month of September. It gained 6.6%, 3.5% and 2.5% against the British Pound, Japanese Yen, and Euro respectively.

The CBK remains adamant on available of adequate forex reserves at 4.19 months of import cover while reserves of external asset at 4.64 months of import cover at end of September against set requirement of 4.0 months of import cover and EAC requirement of 4.5 months of import cover.

Commercial banks priced retail currencies trades near 10.0% as forex bureau priced the exchange 5.0% above the CBK set mean.

Demand on the dollar remain high as need for raw material and energy continues to surge towards the holiday season while government debt payment remain key. This will lead to weakening further of the shilling against the dollar. November and December retain a high need due to the upcoming payments on euro bond coupons.

KES	KES/USD	KES/GBP	KES/EUR	KES/JPY	Dollar Index
30-Sep-22	**120.7324**	**130.6644**	**117.1341**	**83.4796**	**112.0840**
W-W	0.1%	4.3%	1.8%	2.7%	0.8%
M-t-D	0.6%	6.6%	2.5%	3.5%	2.2%
M-M	0.6%	7.2%	2.3%	3.6%	3.1%
Y-t-D	6.7%	14.2%	8.6%	14.9%	16.5%
Y-Y	9.3%	12.7%	9.2%	15.8%	18.9%

Table 2: Currency Movements Source: KSL, CBK

Global Summary

Rate hike in the US and worsening global economic growth kept the US dollar at a new high with the dollar index gaining 3.1% m-m against the world major currency. The demand for the greenback showed dominating on of the currency globally.

In the UK, policy direction by the new PM on tax cut with an underfunded mini-budget at the time the Bank of England issued a rate hike saw the pound shed 3.6% m-m against the dollar. It took BoE announcement of bonds buying to contain exits from the gilt market shoring up the erosion of the pound. The UK economy grew by 0.2$% in Q2-22, an improvement from an estimated fall of 0.1%.

Euro remained on a tight rope as the geopolitical conflict continues to fuel the regional energy crisis. The EU energy ministers met on Friday to discuss further sanctions on Russia as the Russian president announced the annexation of another four regions of Ukraine.

To contain the energy crisis, the member state ministers were to propose to key measure:

i. to reduce monthly electricity demand during the upcoming heating season by 10% compared to the corresponding period in the previous five years.
ii. electricity demand be reduced by 5% during peak times.

International petroleum prices were down with Brent losing 13.0% while Crude WTI shed 13.3% on m-m pricing. The forecast of global economic recession leading to anticipated low demand has been a key factor in price drop despite supply remaining largely unchanged.

The market has positioned itself for higher prices as winter heating demand approaches while it is anticipated that OPEC+ will cut supply in its upcoming meeting to contain weakening prices.

International Petroleum Price		
Period	Brent	WTI
30-Sep-22	85.14	79.49
W-W	0.1%	1.0%
M-T-D	-7.8%	-8.2%
M-M	-13.0%	-13.3%
Y-T-D	7.8%	3.2%
Y-Y	8.4%	5.9%

Table 3: Petroleum Prices Source: KSL, Investing.com

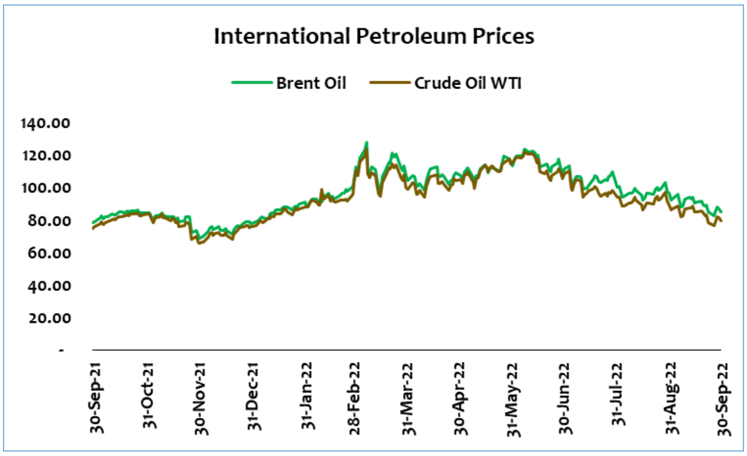


Figure 5: International Petroleum Prices Source: KSL, Investing.Com

Treasury Bills

September saw a subscription KES 102.08Bn, 106.3%, against a demand of KES 96.00Bn for the month. Acceptance stood at 62.2% with KES 76.55Bn and a performance of 79.7%.

Political environment saw investors pack investments on the 91-day paper with the receiving heavy subscription of 362.0%. Heavy rejections an acceptance of 62.8% with aim of taming yields which closed September at 8.951%, 18.4bps compared to end of August.

October will see a slowdown in subscription despite an expected maturity of KES 107.43Bn. Focus will remain on the 91-day paper, however with lower subscription levels. We forecast a slowdown on yields across all papers despite the increase in CBR as the CBK works on managing cost of financing.

Yields return versus the tenure reduces interest on the 364-day paper as the m-m yields were flat with a movement of -0.1bps. CBK will remain reluctant on raising the 182-day paper yields as yield range versus the 364-day paper stands at 28.4bps apart.

September-22							
Tenure	Offer (KES Bn)	Subscription	Acceptance	Performance	WAR % August 22	WAR % September 22	Δbps M-M
364-Day	**40,000**	11.3%	99.2%	99.2%	9.910%	9.909%	(0.1)
182-Day	**40,000**	30.5%	99.7%	99.7%	9.532%	9.625%	9.3
91-Day	**16,000**	128.2%	48.5%	48.5%	8.767%	8.951%	18.4
Total	**96,000**	106.3%	75.0%	90.2%			

Table 4: Treasury Bills Performance Source: KSL, CBK

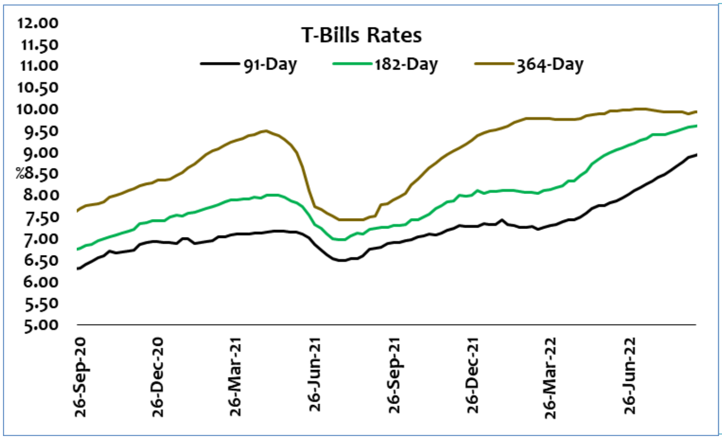


Figure 6: T-Bill Yields Source: KSL, CBK

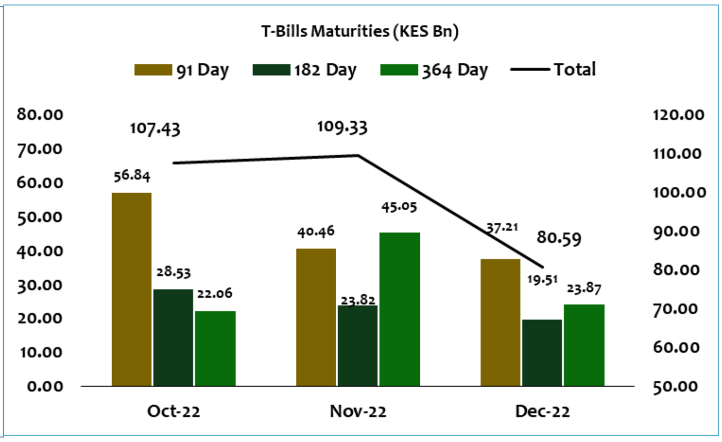


Figure 7: T-Bill Upcoming Maturities Source: KSL, CBK

Bonds Market

High yields suppressed secondary bonds trade with KES 66.38Bn traded in September a 2.9% drop compared to 68.39Bn in August 2022. Yield curve edged up with the 5-yr and 10-yr key rates rising by 10.9bps and 21.8bps higher. The shift was due to fewer trades on infrastructure bonds with IFB dominating 37.9% of September trades compared to 52.8% in June 2022.

October payouts include a maturity of KES 20.71Bn on FXD2/2017/5Yr and KES 37.08Bn in coupons.

We anticipate a further rise in yields on the increase of the CBR from 7.5% to 8.25%. This will lead to a starved market as investors hold on longer.

Yield Key Rates %	30-Sep-21	31-Jan-22	31-Aug-22	30-Sep-22	y-t-d bps Δ	y-t-d bps Δ	m-m bps Δ
2-Yr	9.4730	10.2343	11.5343	11.5772	**210.4**	**134.3**	**4.3**
5-Yr	10.9116	11.4261	12.8294	12.9382	**202.7**	**151.2**	**10.9**
10-Yr	12.3265	12.6533	13.6441	13.8625	**153.6**	**120.9**	**21.8**
15-Yr	12.8936	13.1124	13.9106	13.9206	**102.7**	**80.8**	**1.0**
20-Yr	13.3230	13.5847	13.9753	13.9970	**67.4**	**41.2**	**2.2**
23-Yr	13.4304	13.6808	13.9891	14.0106	**58.0**	**33.0**	**2.1**

Table 5: Key yields Source: KSL, CBK

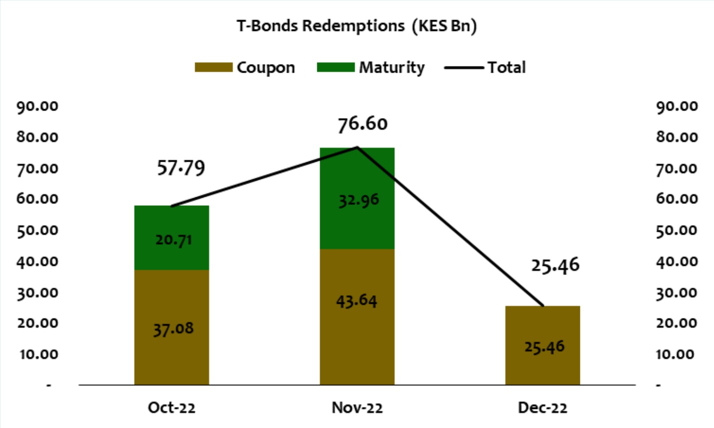


Figure 8: T-Bonds Payouts Source: KSL, CBK

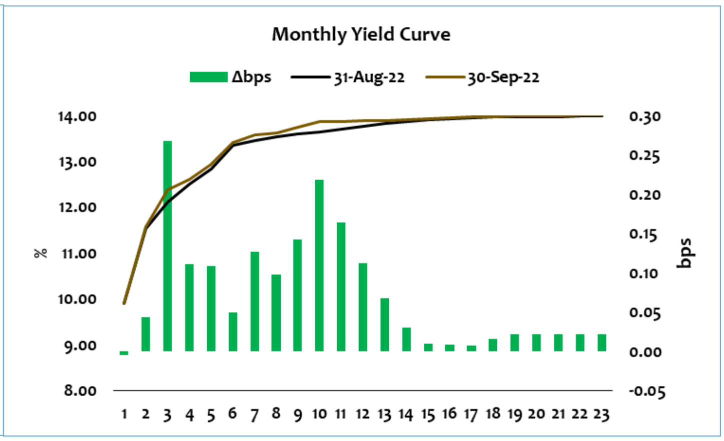


Figure 9: NSE Yield Curve Source: KSL, CBK

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