Kingdom Securities Limited

Pre-Auction Fixed Income Note – February 2023

Total Issue KE 50.00Bn

FXD1/2017/010Yr - Term – 4.5Years – Coupon – 12.966%

FXD1/2023/010Yr - Term – 10Years - Market Determined

February 6, 2023

Research Analyst:
Willis Nalwenge, CFA
Office: +254 711 049 183

Research Analyst:
Shadrack Manyinsa
Office: +254 711 049 956

Bond Dealer
Ashley Odundo
+254 711 049 195

Bond Dealer
Asena Moffat
+254 711 049 663

Primary Bond Issue: February 2023 – FXD1/2017/10 and FXD1/2023/10

The government issued a KES 50.00Bn offer in the February bond primary market by reopening FXD1/2017/010, which has a remaining tenure of 4.5 year and a new 10-year bond FXD1/2023/10Year. The short-term bond is meant to attract members as the market continues to play on the short end while the 10-year bond is seen a price seeker as the yield curve continue with an upward shift.

The market has struggled to fill the precious bond issues with the government opting to tap to meet their threshold.

Below is our bidding guidance.

Bond	FXD1/2017/10	FXD1/2023/10
Tenure	4.5 - Years	10.0 - Years
Coupon	12.966%	MDA
Period of Sale	17-Jan-2023 to 07-Feb-2023	
Auction Date	08-Feb-2023	
Value Date	13-Feb-2023	
Conservative	13.375% - 13.500%	13.95% - 14.10%
Aggressive	13.625% - 13.850%	14.20% - 14.45%

Both bonds look attractive. However, the market environment remains tight thus we expect <100.0% subscriptions levels. Focus will be on the short-term bond as investors continue to value liquidity, currently trading at discounted prices and offers better coupons compare to bonds with nearly similar tenures.

The 10-year bond will attract investors looking for new pricing with coupon expected at a higher level compared to longer tenure bonds issued in 2022.

Central Bank - Monetary Policy Committee

The Central Bank Monetary Policy Committee voted to retain the Central Bank Rate (CBR) at 8.75% citing a marginal drop in inflation and a strong macroeconomic environment.

The committee acknowledged the weak global growth outlook, decline in global commodity prices, easing inflationary pressures, geopolitical tensions, persistent uncertainties, and measures taken by authorities around the world in response to these developments.

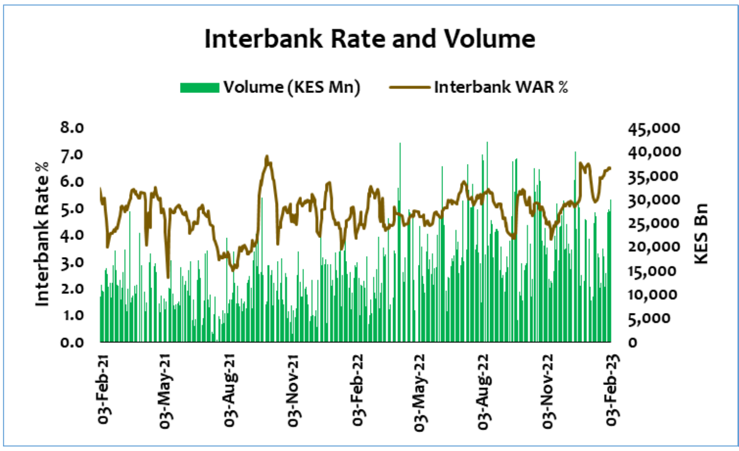
Growth in private sector credit was up 12.5% in 2022 compared to 8.6% in 2021 due to recoveries in manufacturing sector, transport and communication, trade, business services, and consumer durables.

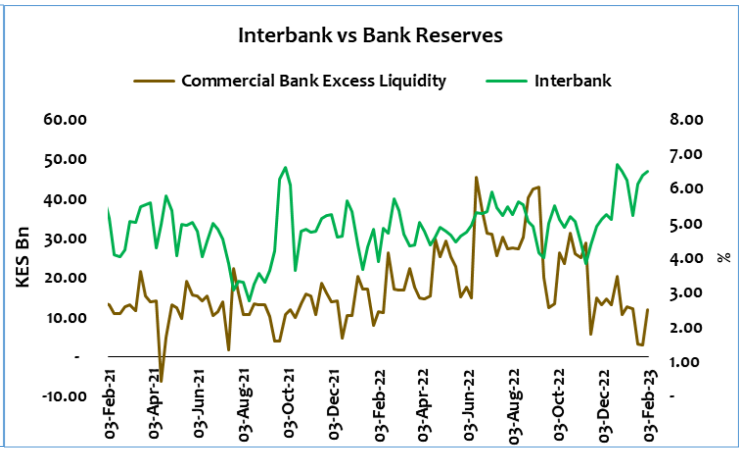
December non-performing loans eased to 13.3% in December from 13.8% in November 2022 with recoveries in the trade, tourism, restaurant and hotels, transport and communication and manufacturing sectors.

Global inflation has shown signs of easing in developed countries. Euro Zone January inflation was down to 8.5% from 9.2% in December. However, their central banks voted to hike rate hikes with US fed reserve rate adding 25bps from 4.50% to 4.75%, England 50bps to 4.0% from 3.5% and Euro Zone 3.0% from 2.5%.

Interbank Rate

Market liquidity was tight in the month January as the interbank rate closed the month at 6.4932%, 5bps lower from that of 6.4866% by close of December 2022. The commercial bank reserves closed at a low of KES 6,967Mn. The rate was affected by heavy demand in January with commercial entities paying taxes.



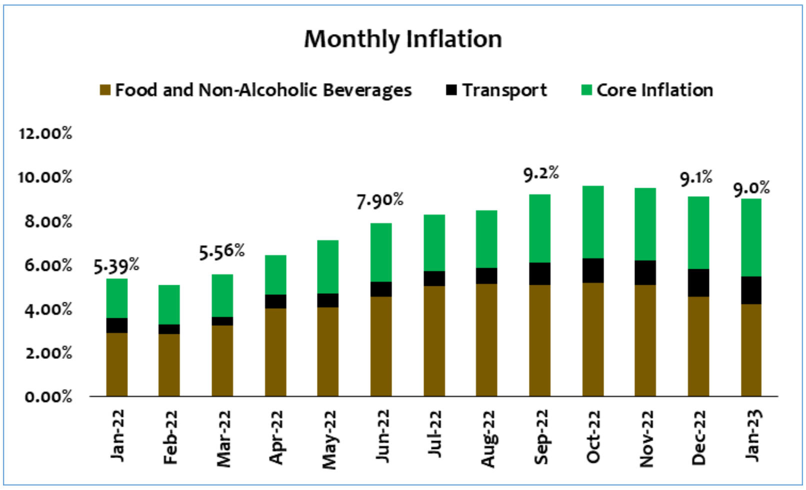


We forecast the rate to post 5.75% in the month of February as we expect a maturity of KES 126.56Bn in T-Bills and coupon payment of KES 42.74Bn which will be fully absorbed through reinvestment in the various government papers with an expectation of KES 96.00Bn in T-Bills and KES 50.00Bn in bonds.

Inflation

Inflation stood at 9.0% in January, a 10bps drop from 9.1% in December 2022. The rate was 361bps higher compared to January 2022. The rate saw the food prices ease to 12.8% from 13.5% while transport inflation edged upwards to 13.1% due to increase in cost of transport post-holiday and schools reporting.

Core inflation was up to 3.52% from 3.3% in December.



In the month of February, we forecast an inflation of 8.97% - 9.18% with the upper end affected by food inflation as the dry season pushes on. Changes in the cost of communication and cost of mobile money will impact consumer income while the excise duties that were to be effective in January will continue to trickle into the larger economy.

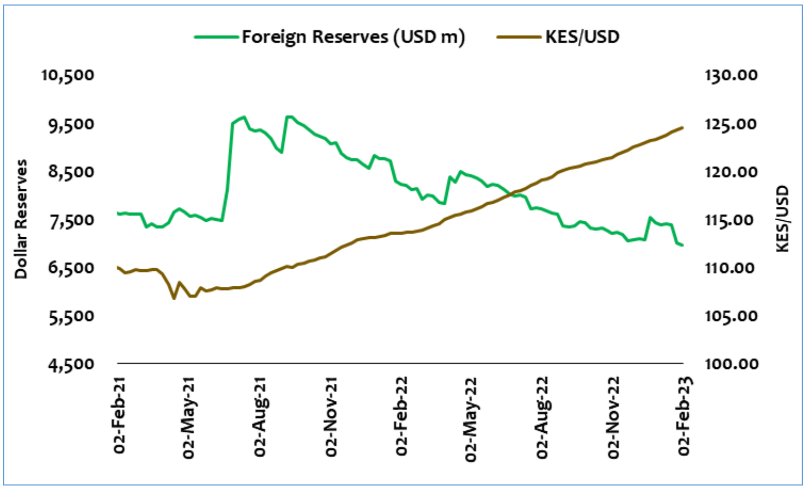
Relief will come from the recently announced allowance to import duty free sugar and maize which is expected to ease food price pressure helping to contain inflation.

Currency

The local currency continues to weaken against the world major currencies shedding 0.9%, 3.0%, 3.6% and 1.7% on the US dollar, British Pound, EURO and Japanese yen since the start of the year.

Forex reserves declined to breach the USD 7,000M closing the month at USD 6,967Mn or 3.9 months of import cover which is below the 4 months of import cover target by the CBK and 4.5 months of import cover by the East African Community requirement after January debt repayments.

The dollar index dipped by 1.5% on a y-t-d basis as the federal reserves hiked fed rate by 25bps as expected and communicated further hikes in the horizon. The US labor market remained strong while the manufacturing sector was weak with a contraction on a third month running.



For the last five months, the shilling has been declining by a monthly average of 0.7%. We expect trend to continue with an average monthly depreciation of 0.75% as the dollar reserves continue to struggle to meet the CBK threshold.

At the same moment, we expect the foreign debt levels to balloon at the end of this month as coupon payment on the Eurobond 2028 and 2048 worth USD 77.50Mn are due end of February, as at the current levels, we expect the reserves to strain.

T-Bills

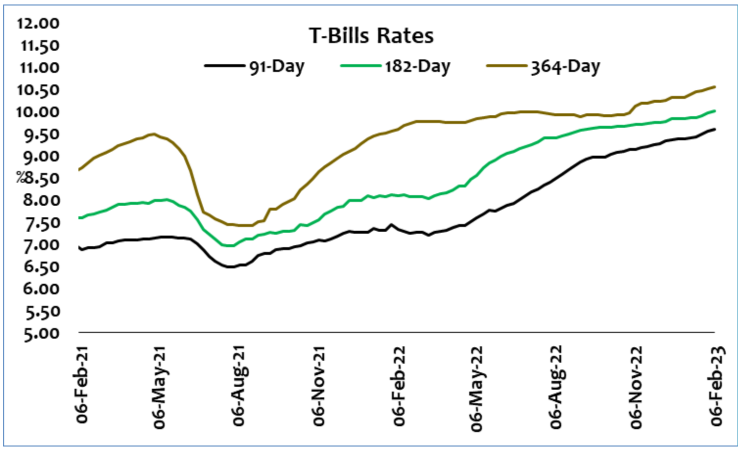
The month of January saw a subscription of KES 125.75Bn, a 104.8% on the KES 120.00 offer. Acceptance was KES 123.24BNn, 98.0% with the same levels of performance.

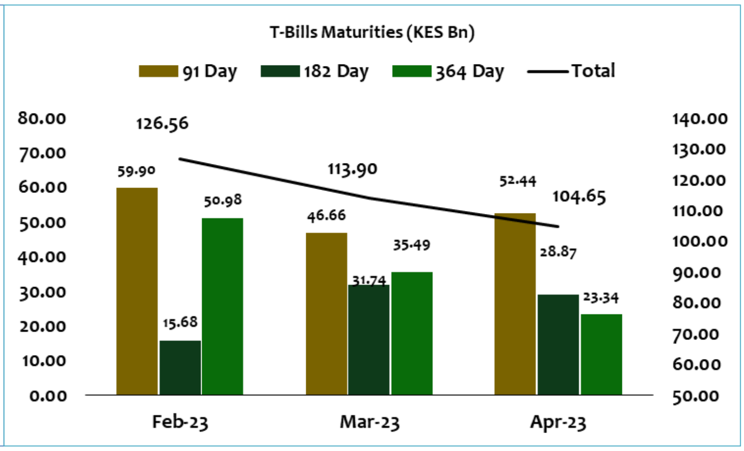
The market saw a heavy reinvestment with investors opting to switch from the 364-day paper to the 91-day papers whose rate closed at 9.538%, a 16.8bps higher month on month.

The acceptance on the 364-day paper saw rates up by 19.4bps to close the month at 10.504% to attract investors to the tenure.

The 181 day paper saw average subscriptions of 74.7% with a 99.7% acceptance with the returns up by 11.9bps to 9.954%.

The February offer stands at KES 96.6Bn with maturities standing at KES 126.56Bn of which KES 50.98Bn is on the 364-day which we expect to be moved to the shorter tenure of 91-day.



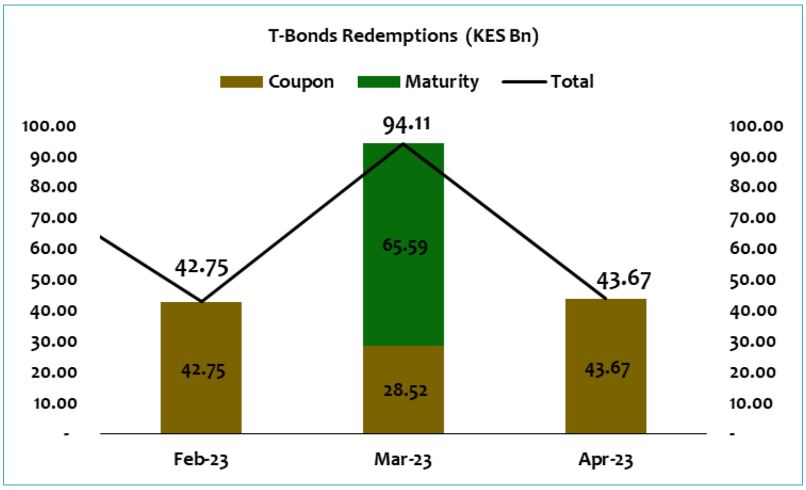


Tight government liquidity demand will continue to ensure high acceptance levels which will push the rates upwards. We advise investors to focus on the short tenure as the market liquidity remains tight with heavy reinvestments driving auctions. Despite an upwards expectation in rate hike, acceptance will drive containment of the yields with a projected average upward move of 20bps across for the month of February.

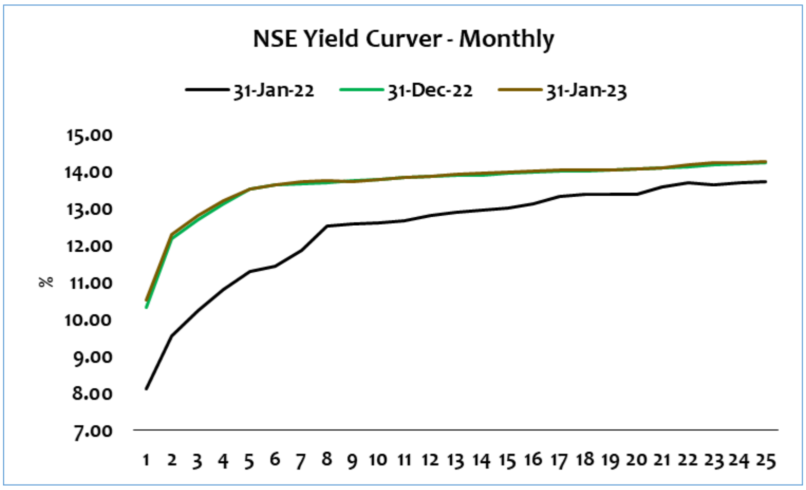
T-Bonds

Bond subscription have remained low with the government offering taps to hit their required targets. The month of January saw a subscription of KES 41.63Bn on an offer of KES 50.00Bn, a 83.3% subscription and an acceptance of 75.7%. The issue was tapped for a KES 10.00Bn receiving 18.02Bn for 180.2% performance and acceptance of 97.8%. Overall subscription stood at 119.3% at an acceptance of 82.4%.

There remains demand for short papers, less than three years, driven by tight liquidity and demand for the papers in the secondary market after investors opted to move a large portion of their investment to the held to maturity book.



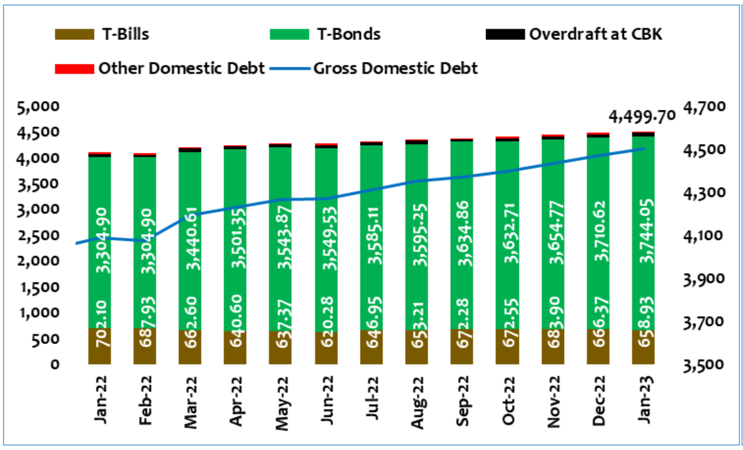
Yield Curve continues to show shift on the short end on liquidity concentration. The new issue will continue to leverage the short tenures which will see a continuous marginal upward shift on the short end of the curve

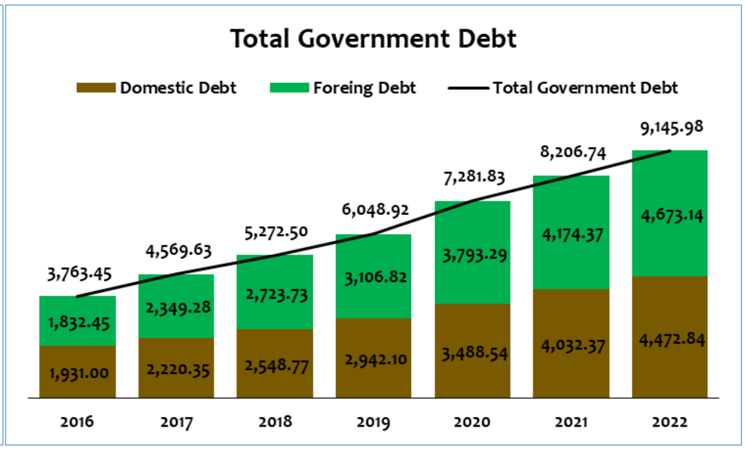


Government Debt

Net domestic debt increased by 10.2% y-y as at end of January with T-Bonds growing by 13.3% y-y while T-Bills were down 6.1%. The reduction in T-Bills was caused by switch to short term papers with government opting to issue 2-year papers.

Total government debt stood at KES 9,145.98Bn, a 11.4% y-y growth. During the period, domestic debt increased by 10.9% to KES 4,472.84 while foreign debt was up 11.9% to KES 4,673.14 due to borrowing from concessionary partners for budgetary support and foreign exchange stabilization.





Research Analyst Certification:

The research analyst(s) primarily responsible for the preparation and content of all or any identified portion of this research report hereby certifies that all the views expressed herein accurately reflect their personal views. Each research analyst(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the view(s) expressed by that research analyst in this research report.

Terms of Use – Disclaimer:

This research report has been prepared by Kingdom Securities Limited and is for information purposes only. This research report should not be construed as an offer or solicitation to sell or buy any investment or product. Any opinions expressed herein reflect the analyst's judgment at the date of publication and neither Kingdom Securities Limited, nor any of its affiliates or employees accepts any responsibility in respect of the information or recommendations contained herein. Unless otherwise stated, the opinions contained in this material are as of the date indicated and are subject to change at any time without prior notice. Past performance is not a guarantee or indication of future results.

The information and opinions contained in this Material have been derived from sources believed to be reliable and in good faith or constitute Kingdom Securities' judgement as at the date of this research, but no warranty is made as to their accuracy and any opinions are subject to change and may be superseded without notice. In no circumstances will Kingdom Securities or its employees be liable to you for any errors or omissions in this report or for any losses you may incur in following any recommendations in the report. Kingdom Securities is a Subsidiary of Co-operative Bank of Kenya.

Kingdom Securities Ltd – A subsidiary of Co-operative Bank Limited.

Co-operative Bank House- 5th Floor, P.O Box 48231 - 00100 Nairobi, Kenya

Office: 0711049540/0711049956

Email: info@kingdomsecurities.co.ke

Research Department	
Willis Nalwenge, CFA	**+254 711 049 283**
Shadrack Manyinsa	**+254 711 049 956**
Sales Team	
Edgar Martim	**+254 711 049 534**
Wycliffe Wesonga	**+254 711 049 715**
Asena Moffat	**+254 711 049 663**
Ashley Odundo	**+254 711 049 195**
Gloria Ohito	**+254 711 049 993**
Client Service and Operations	
Joab Kiprono	**+254 711 049 888**
Purity Malombe	**+254 711 049 729**