Kingdom Securities Limited

Pre-Auction Fixed Income Note – March 2023

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Primary Issue – March 2023 – The First of the Year

The government issued the first infrastructure bond for the year, seeking KES 50.00Bn on a 17-year IFB1/2023/017 bond. The economy is struggling with liquidity with investors opting for short end papers while foreign investors, who are the main drivers of US dollars through infrastructure bonds, have continued to shun the local market due to better returns and stronger dollar in the developed economies.

The regulator has opted to issue a lower amount compared to KES 75.00Bn in February and June and KES 60.00Bn in November 2022. December conversion if KES 87.80Bn in maturities.

Bond	IFB1/2023/017
Tenure	17 – Years
Coupon	Market Determined
Period of Sale	15-February to 07-March-2023
Auction Date	13-March-2023
Value Date	13-March-2023
Conservative	13.950% - 14.15%
Aggressive	14.220% - 14.370%

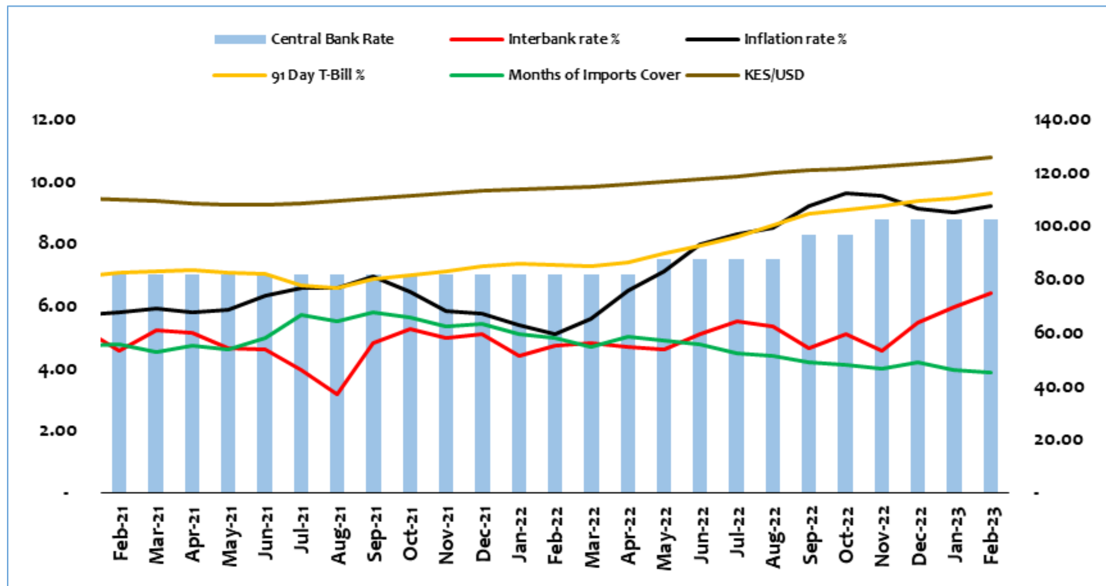
We foresee near 100% subscription mostly from local investors as the recent downgrade by S&P, the second sovereign credit valuer to downgrade Kenya, will keep foreign investors at bay.

The January exchequer items show that net domestic borrowing stood at 29.2% of the annual target. This is an indication of need for aggressive domestic borrowing which will push rates high especially for new issues.

On the other hand, commercial banks liquidity has been on the decline with December 2022 CBK figures showing liquidity stood at 50.8%, down from 56.2% in December 2021. Banks holdings of government securities has reduced to 46.7% at the beginning of Mach compared to 49.3% same period in 2022. This shows less demand of government papers by local banking sector which has been the main takers of the securities.

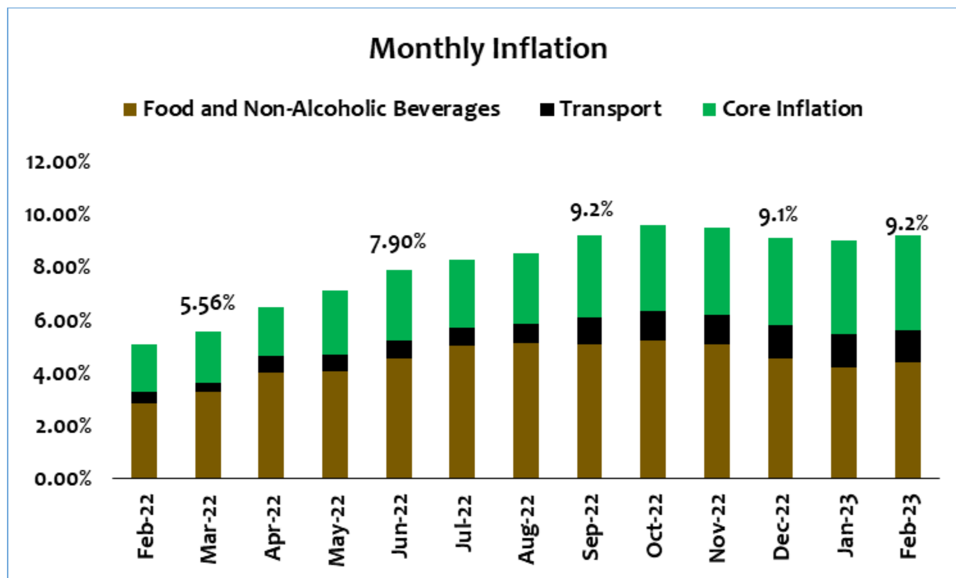
Compounded with tight liquidity environment and need by the government for funds especially investment in USD, we foresee aggressive bidding and a high acceptance levels.

Key Monthly Rates - Summary



Inflation

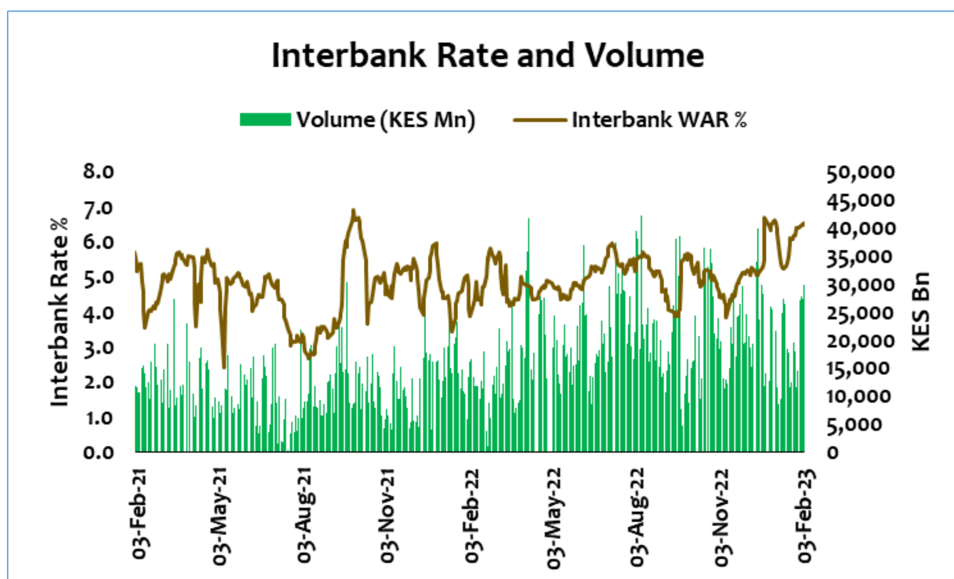
Inflation in the month of February stood at 9.2%, higher compared to 9.0% in January. The rate was affected by individual items in the food and non-beverage items as the index increased to 13.3% from 12.8%. Core inflation was at 3.58%, higher than 3.52% in January.



We forecast the march inflation to moderately decline to 8.8% - 9.1% on lower food prices, stable transport and fuel prices, the most impact coming from lower base. The impact of excise duty adjustment that were to take effect on 1st of march will have a huge impact on food and non-alcoholic index.

Interbank

The interbank rate has been on a high level with demand remaining stable as the CBK has been in the market with repos and reverse repos. The rate opened the month of march at 6.6935% against 6.4808% at the beginning of February and remained elevated above the 6.5% levels.



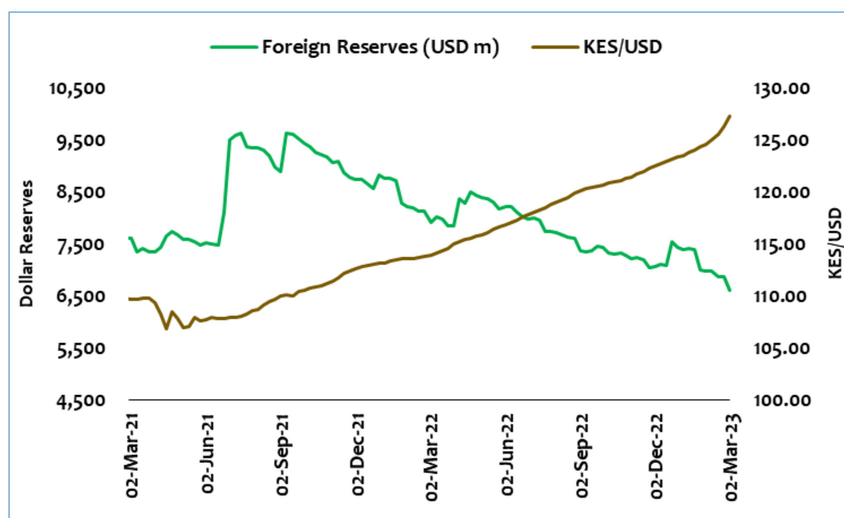
We foresee the rate to remain at the 6.25% to 6.75% with demand remaining above KES 20.00Bn range. CBK will continue to play a key role through repos and reverse repos.

Currency

The local currency touched a new CBK high of 127.00 on scarcity of dollar in the local market. The currency shed on 2.4% m-m basis while depreciating by 3.3% and 12.0% y-t-d and y-y respectively. This has been due to debt management by the government, high demand by local traders and thinning reserves.

Commercial banks traded the currency at 137.81 maintaining a 7.7% premium on the CBK rate.

Forex reserves stood at USD 6,605Mn or 3.65 months of import cover. The reserves have declined by an average of 5.1% for the last three months on heavy debt repayment. We expect a further dip in reserves as drive to dollar harvesting through infrastructure bond will not bear heavy fruits like previous issues.



Global currency space will see expectation on rate hike as main drivers of currency direction. The US market track a tough Q1-23 with focus on inflation taming as global performance improves with an expectation of slowdown on rate hikes in Q3-23.

There remains a red flag on the rate of depreciation of the shilling against the us dollar. Previously, it had been shedding by 0.8% - 0.9% rate monthly. On March 2nd, the currency depreciated by 2.2% on a m-m basis, an accelerated level compared to the previous periods. If the shilling continues weaking by 2.0% per month, then it will close the year at KES 152.13 against the dollar. If it scales down to the previous 0.9%, then it will close the year at 137.98.

Treasury Bills

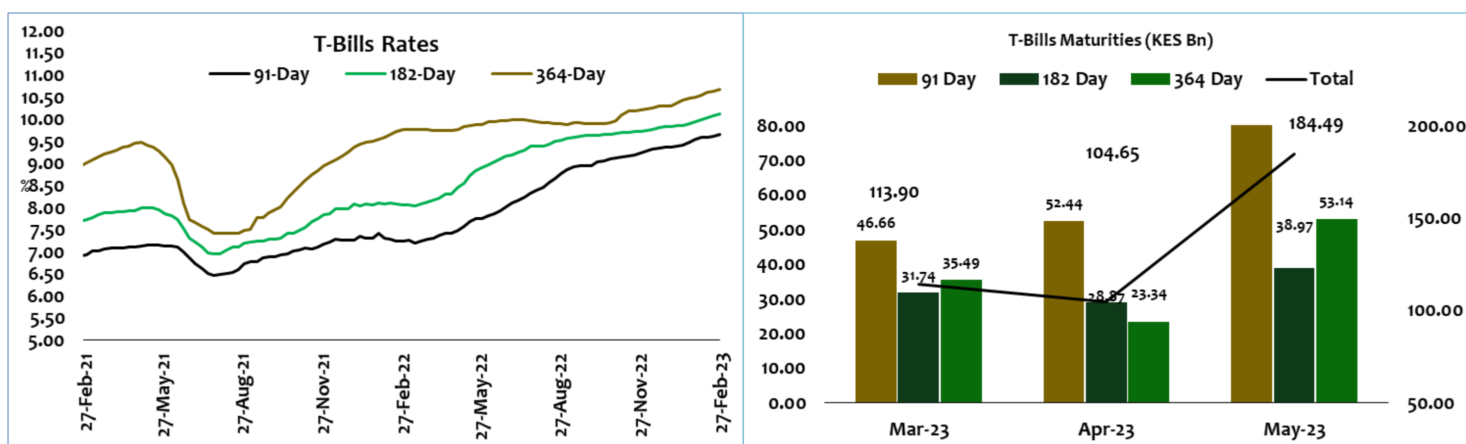
Investors continue to prefer short-term papers with February subscription at 167.1% with KES 160.37Bn against a demand of KES 96.00Bn. Acceptance was at 85.2% with KES 136.63Bn while performance was at 142.3%.

February-23							
Tenure	Offer (KES Bn)	Subscription	Acceptance	Performance	WAR % January 23	WAR % February 23	Δbps M-M
364-Day	**40,000**	62.2%	99.9%	62.2%	16.3bp%	10.656%	15.2
182-Day	**40,000**	105.3%	89.6%	94.3%	9.954%	10.117%	16.3
91-Day	**16,000**	583.7%	79.3%	462.8%	9.538%	9.655%	11.7
Total	**96,000**	167.1%	85.2%	142.3%			

Demand on the 91-day saw a 583.7% subscription. CBK accepted 79.3% with yields edging upwards by 11.7bps m-m to 9.538%. The paper continues to be a cash management front.

The 364-day paper had the lowest subscription of 62.2% and an acceptance of 99.9% while yields increased by 15.2bps m-m to 10.656. The paper has seen accelerated rate hike as the range between the 364-day and 91-day paper widens as government continues to attract players on that space.

The 182-day paper had the highest hike in rates of 16.3bps to 10.117%. The market has seen a shift in preference compared to the 364-day paper.

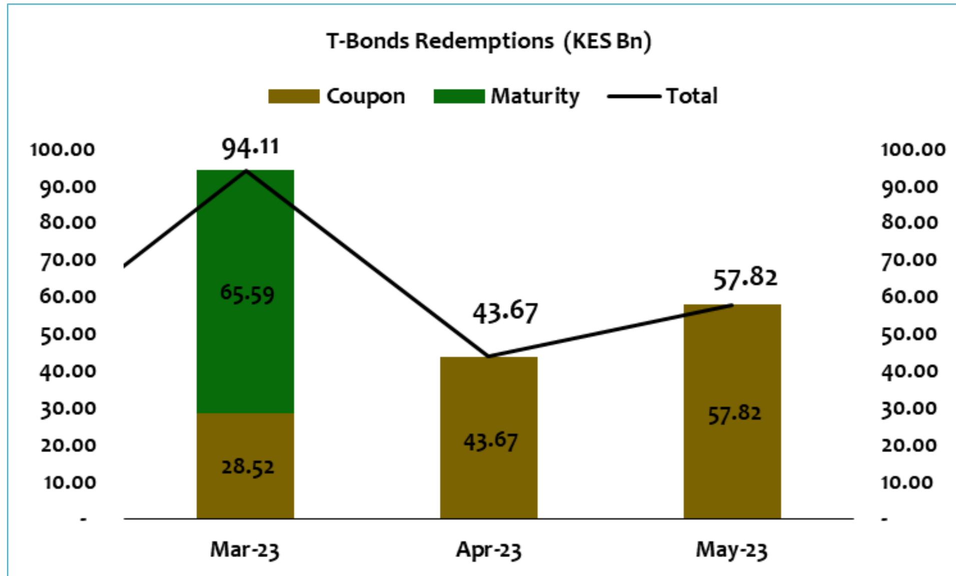


A total of KES 113.90Bn is expected in maturities with a prospect of heavy reinvestment as the rates continue an upward trend. Focus will remain on the 91-day paper while government preference will remain on the 364-day paper.

Treasury Bonds

T-Bonds have seen undersubscription due to tight liquidity with dependency of tap sale to meet monthly demand. Investors preference to liquidity and tradable bonds will see the government change tact from the long papers to 10-year papers.

Yields have edged up with the short end up 188.7bps y-y while the long end was up 52.2bps. We will continue to see an upward shift on the short end while the mid curve will be controlled by primary issue. Long end will remain stagnant as investors continue to say away.

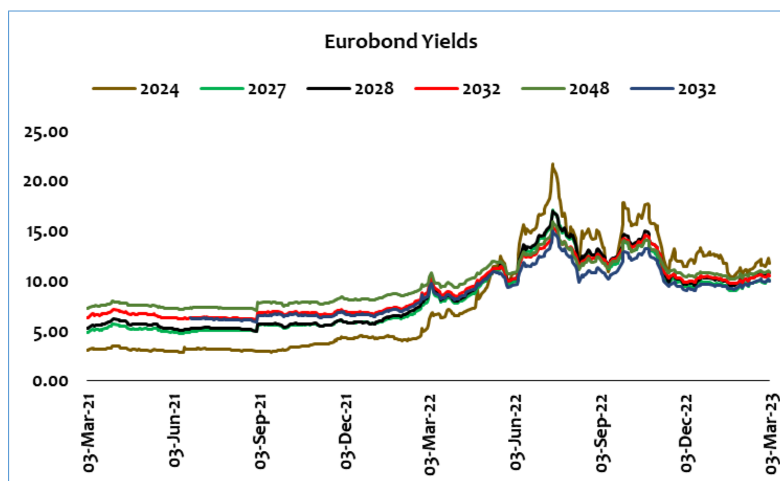


A total of KES 94.11Bn payout is expected in March with a maturity of KES 65.59Bn and KES 28.52Bn in coupons. Investor expectation on rising yields will keep them off long term bonds as there remains a strong sentiment on yield reversal post current economic situation that will render long term bonds invaluable.

Eurobond

Yields on the Eurobond marginally edged up on a m-m basis. The 2024 bond has seen a 85.7bps downward shift in yields on year to date. The 2032 bond saw a 23.9bps upward shift.

The yields remain affected by the global economic situation while slow performance of the local economy leaves the yields high.



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