Kingdom Securities Limited

Pre-Auction Fixed Income Note – April 2023

Total Issue KE 20.00Bn

FXD2/2018/010 – Coupon 12.502% - Tenure 5.8 years

April 3, 2023

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TWO PHASE ISSUE – FXD2/2018/10, FXD1/2022/03 AND FXD1/2019/15

In April, CBK has re-opened three bonds FXD2/2018/10, FXD1/2022/03 and FXD1/2019/15. The bond will be sold in two phases, target to raise KES 50.00Bn against a coupon of KES 43.67Bn.

In the first phase, FXD2/2018/010, has a remaining tenure of 5.8-year, lies on the actively sort after tenure space. The bond which was issued in December 2018, has been reopened twice in July 2020 and January 2022. Investors currently hold KES 60.21Bn which will pose a demand challenge with only KES 3.53Bn, representing 5.8% of value held transacting y-t-d.

We expect the issue to be lowly subscribed on the KES 20.00Bn on tight liquidity and heavy holding as CBK targets to raise cash adequate to cover the upcoming coupons worth KES 24.49Bn due April 10th.

Below is our bidding guidance on the first phase bond. We will issue another bidding guidance on the second phase.

Bond	FXD2/2018/010
Tenure	5.8 – Years
Offer	KES 20.00Bn
Coupon	12.502%
Period of Sale	16March 2023 to 04 April 2023
Auction Date	5th April 2023
Value Date	10th April 2023
Conservative	13.875% - 13.950%
Aggressive	14.000% - 14.200%

The second phase has FXD1/2022/03 and FXD1/2019/15 targets KES 30.00Bn. The two bonds have short-end and mid-curve tenure. The issue timing will aid to match coupon payment of KES 19.17Bn due in the second half of the month.

CBK – Monetary Policy Committee

The market continues to face macroeconomic challenges which can be heavily attributed to global changes rippling to the local economy. The CBK's monetary policy committee (MPC) voted to push the Central Bank Rate (CBR) up by 75bps to 9.5% from 8.75%, levels seen last in July 2018. The committee which has held the rate at 8.75% for 4-months matched the international rate hikes that seek to tame runaway inflation. The key outlines of the meeting were:

Global macroeconomic environment continues to trend on weak foundation and geopolitical tension. On the positive side, China has reopened production while inflation pressure has eased in major economies.

Macroeconomic Upside

- CEO Survey and Market Perceptions Survey showed tempered optimism on economic growth but showed concern on weakening shilling, rising inflation. CBK remained confident on the 5.6% GDP growth in 2023.
- Export growth increase by 11% y-y in February as Receipts from tea and manufactured goods exports increased by 13.4% and 27.2% respectively during the period.
- Private sector credit growth was up 11.7% in February compared to 11.5% in January.
- Easing global inflation in developed economies (see the inflation graph below) and reopening of Chinese economy to trade post covid-effects.

Macroeconomic Downside

- High inflation rates with March inflation remaining flat on February level of 9.2%. This is heavily influenced by high food inflation,
- Uncertainty in global economic outlook have increased, instability of the financial sector of advanced economies, continued tension on the ongoing Russia-Ukraine war and continued rate hike in developed economies.
- Foreign exchange reserves decline remains weak on providing any drastic short-term shock in the forex market.
- Weak tax revenue collection to cover the fiscal budget
- Gross NPL increased to 14.0% in February from 13.4% in January with impact from trade, personal and household, manufacturing, building and construction sectors.

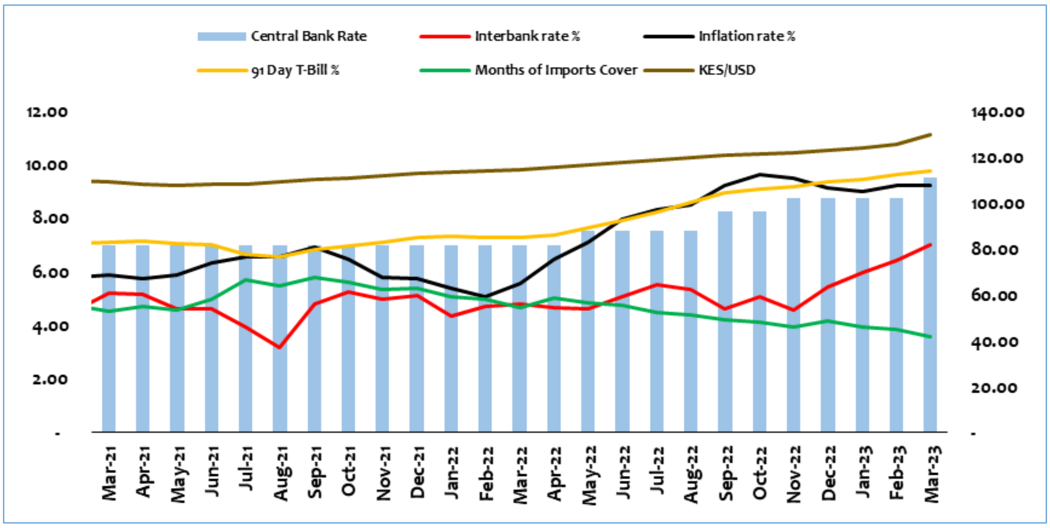

Figure 1: Key CBK Rates

Source: KSL, CBK, KNBS

Inflation – March 2023

Global inflation has seen a downward pressure in developed economies with USA, China and Eurozone inflation declining to 6.0%, 1.0% and 8.0% in February on improved food prices and decline in energy prices. Indian inflation remained flat at 6.4%.

United Kingdom saw inflation edge up to 10.4% due to higher food prices mainly vegetables due to bad weather in bad weather in southern Europe and Africa and higher energy prices.

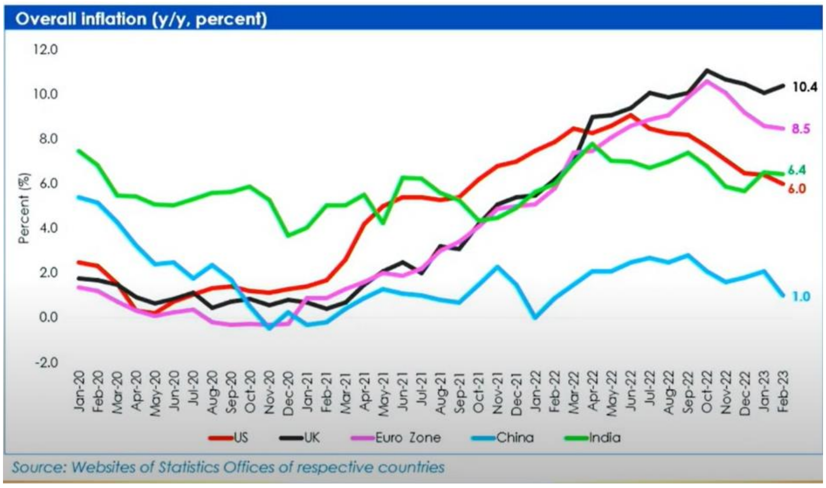

Figure 2: Global Inflation Source: KSL, CBK

Locally, March inflation stood at 9.2%, flat levels to February inflation. The levels were supported by flat movement on transport index while pressure emanated from Food and Non-Alcoholic Index which increased by 13.4% y-y.

The Housing, Water, Electricity, Gas and Other Fuels' Index, increased by 0.6% between February and March 2023 due to change in tariffs leading to prices of electricity edging upwards by 11.6% for 50 Kilowatts and 9.0% for 200 kilowatts.

Monthly inflation was affected by Food and Non-Alcoholic Beverages which was up 1.6% m-m as Transport Index increased by 0.3% m-m due to increase in petrol priced by KES 2.00 or 1.1% m-m.

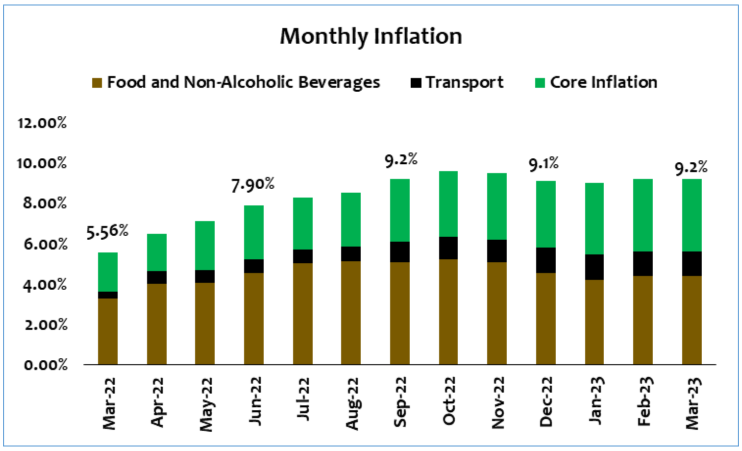

Figure 3: Kenya Inflation Source: KSL, KNBS

We forecast a dip in April inflation to 7.8% - 8.1% range due to improved food prices after the onset of the long rains, fair petroleum prices and low energy cost as the country switch to more hydro generated power. The rate will be further boosted by low base levels.

Interbank Rate

The month saw interbank rate close the month at a high of 7.8612%, 122.0bps compared to 6.6414% at close of February. The rate was affected by tight liquidity in the market despite a heavy presence by the CBK. Average monthly rate stood at 7.04%, 63.1bps higher to the February average of 6.41%. Monthly average demand was KES 21.35Bn, a 13.2% m-m lower to KES 24.58Bn in February.

Commercial bank reserves closed the month at KES 8.90Bn as payments remained higher than receipts with the month average KES 11.16Bn in reserves from KES 13.33Bn in February.

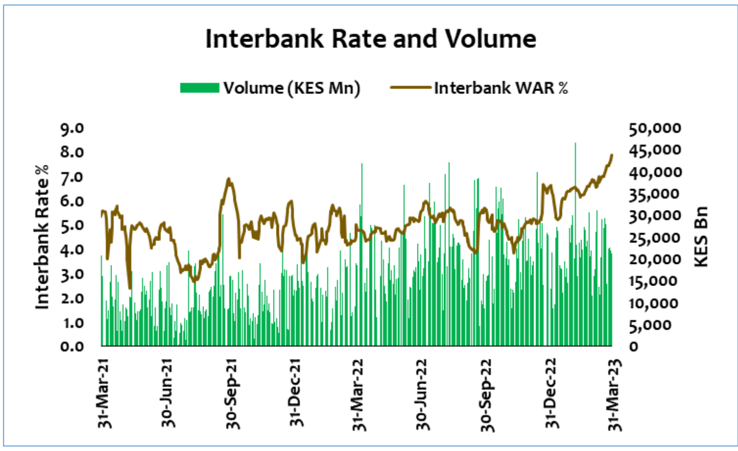

Figure 4: Interbank Rate, Demand Source: KSL, CBK

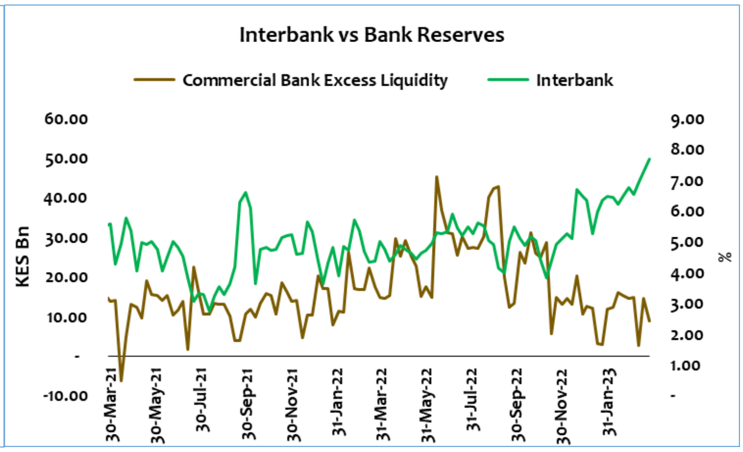

Figure 5: Excess Liquidity, Interbank Source: KSL, CBK

We expect interbank rate to remain elevated above 7.0% as liquidity remains a tight spot as payments continue to overshadow receipts especially in the short term. CBK will remain in the market to try and tame the runaway liquidity.

Currency

Negation between the CBK and commercial banks with regards to reviving interbank foreign exchange trading temporarily halted the slide of the shilling to see the shilling depreciate by 4.3% m-m against the US dollar. The rate seen to have accelerated than 2.0% and 0.83% m-m depreciation seen in February and January respectably. The agreement between the CBK and commercial banks was seen as a reversal of an earlier move by the regulator aimed of curing the same problem.

Commercial banks traded the local currency at KES 139.75/USD from a high of KES 142.00/USD before the CBK engaged them on the interbank foreign currency trade. The trade levels were 5.6% higher to the CBK indicative rate, down from 9.2% a on the day of the talks.

The local currency shed 7.8% m-m on the British Pound and Euro while losing 7.0% m-m on the Japanese yen with the currencies strengthening against the dollar.

KES	KES/USD	KES/GBP	KES/EUR	KES/JPY	Dollar Index
31-Mar-23	132.3324	163.6715	144.3688	99.6291	102.1860
W/W	0.8%	1.2%	1.0%	-0.5%	-0.6%
M-t-D	4.1%	6.5%	7.1%	7.2%	-2.2%
M/M	4.3%	7.8%	7.8%	7.0%	-2.5%
Y-t-D	7.2%	10.0%	9.7%	4.6%	-2.0%
Y/Y	15.1%	8.3%	13.0%	5.6%	3.9%

Table 1: Currency Source: KSL, CBK

Forex reserves declined by USD 434Mn to USD 6,426Mn or 3.56 months of import cover from USD 6,860Mn or 3.84 months of import cover as of end of February.

Commercial Banks forex reserves remained stable closing January at USD 3,922Mn with the economy sitting on a 4.2 months of import cover.

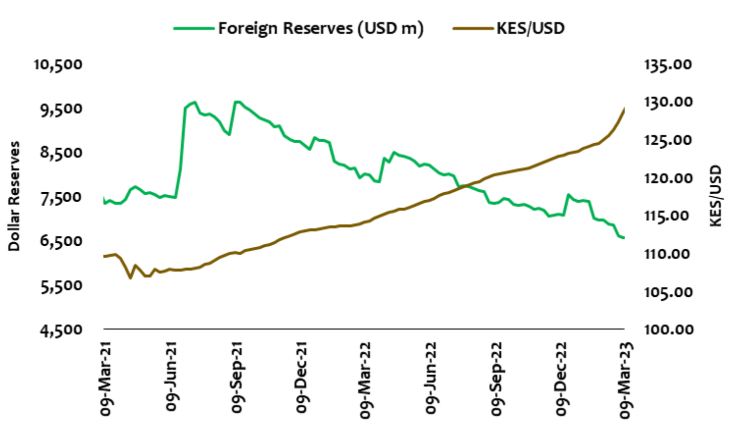

Figure 6: Forex Reserves, Currency Source: KSL, CBK

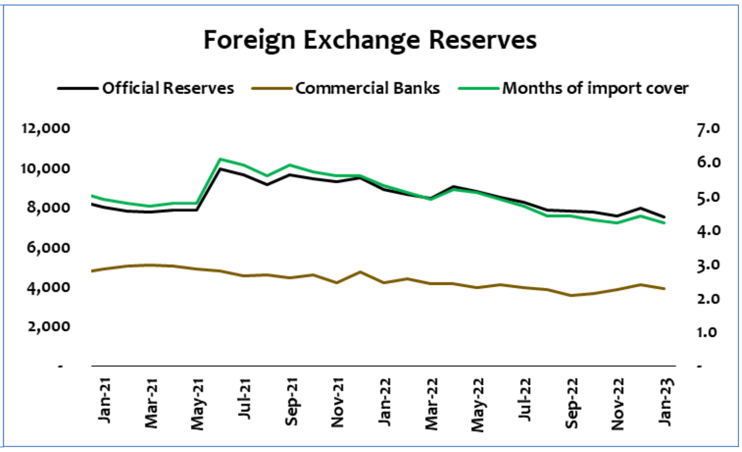

Figure 7: Foreign Exchange Reserves Source: KSL, CBK

On the global front, the US dollar lost against other world majors as the dollar index declined by 2.5% driven by policy divergence by the Fed Reserve and easing inflation in key markets. Developed markets continue to anticipate further policy tightening despite hints that they are near the end of their hiking cycles as inflation continue to ease.

We anticipate a further depreciation on the shilling as the forex reserves continues to dwindle while dollar demand remains strong especially on external debt repayment, manufacturing supply demand and energy importation as the government pushes on further opening of the economy.

Treasury Bill

March subscription on T-Bills stood at 113.8% with 88.1% acceptance and a performance of 100.3%.

The 91-day paper remained dominant with a subscription of 354.5% with the government accepting 78.0% to tame rate which increased by 17.4bps to close the month at 9.829%.

The 182-day paper had the best return move, an upward movement of 22.7bps to close at 10.344%. The tenure subscription was at 87.7% and an acceptance of 98.5%.

March-23							
Tenure	Offer (KES Bn)	Subscription	Acceptance	Performance	WAR % February 23	WAR % March 23	Δbps M-M
364-Day	40,000	43.7%	99.9%	43.7%	10.656%	10.787%	13.1
182-Day	40,000	87.7%	98.5%	86.4%	10.117%	10.344%	22.7
91-Day	16,000	354.5%	78.0%	276.3%	9.655%	9.829%	17.4
Total	96,000	113.8%	88.1%	100.3%			

Table 2: Monthly T-Bill Performance Source: KSL, CBK

Roll overs continue to fuel the market with a preference of 91-day paper while those seeking returns went for the 182-day. The market saw a slowdown of yield reward as all ranges eased downwards. A shift in strategy to the 182-day paper saw the yield cover ground on the 364-day paper while widening on the 91-day paper, an indication of better returns on the tenure as the 91-day paper remains favorite for liquidity management.

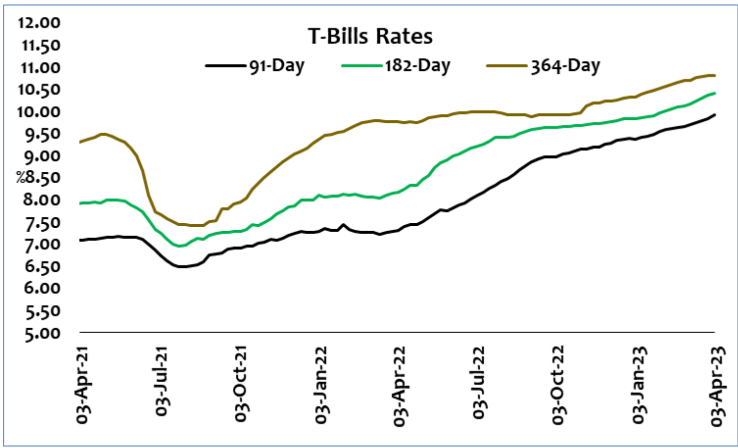

Figure 8: T-Bill Rates Source: KSL, CBK

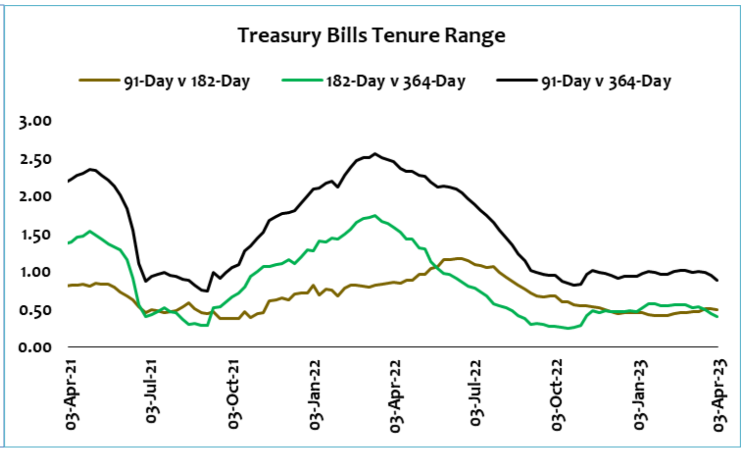

Figure 9: T-Bill Rates Range Source: KSL, CBK

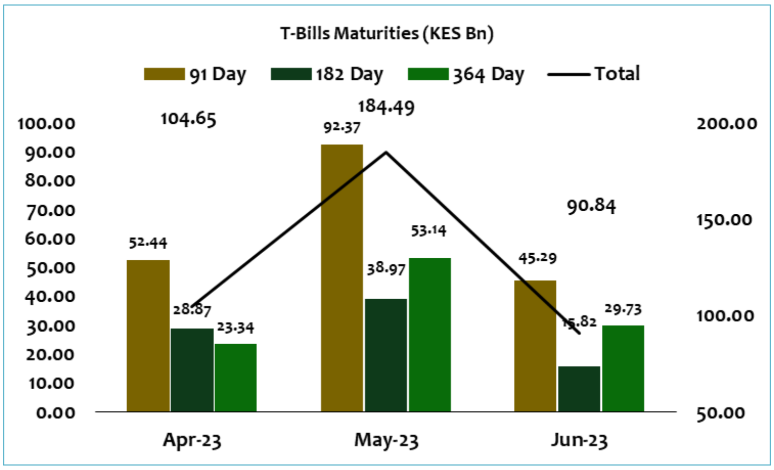

Figure 10: T-Bill Payout Source: KSL, CBK

April expects KES 104.65Bn in payment against a target of KES 96.00Bn an indication of oversubscription. Rates will continue an upward trajectory with the 182-day paper retaining attractiveness on return. The market will continue to shun the 364-day paper despite the government offering improved return.

The 91-day paper, which expects a payout of KES 54.44Bn in April, will continue to see low acceptance levels due to management of holdings while investors managing funds will not mind the slow upward movement of return as the rate approaches 10.0% levels. This will lead to CBK cutting back on the tenure as it becomes expensive compared to the other two tenures.

Treasury Bonds

March issue saw a total subscription of KES 72.48Bn achieved after a tap which netted KES 12.71Bn. amount accepted stood at KES 63.59Bn representing 87.7%. Recently, primary issue has depended on taps to raise the intended targets.

Secondary market saw KES 70.51Bn traded, a 51.3% improvement compared to KES 46.61Bn in February. The uptake was due to an infrastructure bond issue and maturities that excited the market. Yields continues to witness an upward shift in yields with short end seeing more action.

Yield Key Rates %	31-Mar-22	31-Jan-23	28-Feb-23	31-Mar-23	y-t-d bps Δ	y-t-d bps Δ	m-m bps Δ
2-Yr	11.0414	12.2988	12.3365	12.5541	151.3	25.5	21.8
5-Yr	11.9775	13.5286	13.4962	13.5328	155.5	0.4	3.7
10-Yr	12.8760	13.7789	14.1332	14.0953	121.9	31.6	-3.8
15-Yr	13.6180	13.9826	14.2030	14.2255	60.8	24.3	2.3
20-Yr	13.7388	14.0473	14.1241	14.0191	28.0	-2.8	-10.5
23-Yr	13.8615	14.2220	14.1740	14.2737	41.2	5.2	10.0

Table3: Yield Curve Source: KSL, NSE

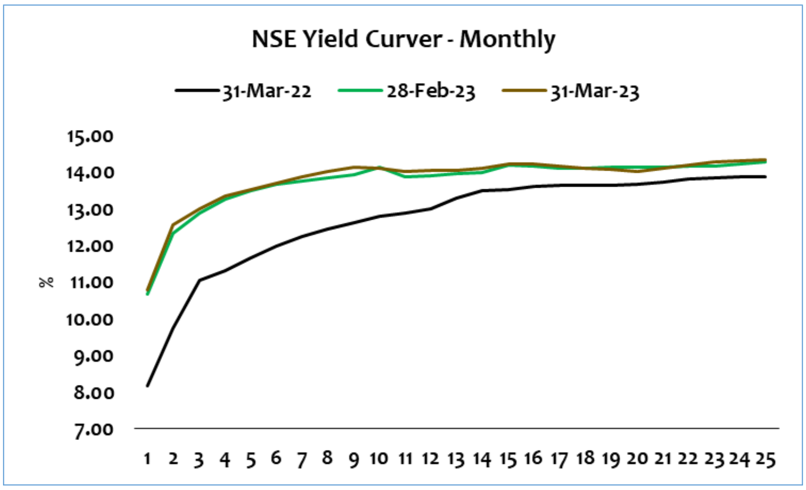

Figure 12: Yield Curve Source: KSL, NSE

Yields will continue an upward shift with mid-curve remaining a safe space. Liquidity will continue to influence activity in the short end while low demand will affect the long end of the curve.

Government Domestic Debt

Net domestic debt marginally dropped by 0.2% m-m while increasing by 8.3% y-y. The monthly dropped was due to a 0.4% dip in T-Bonds holdings. High subscription on 91-day paper saw T-Bills holdings increase by 0.3% m-m and 2.4% y-y to containing its contribution to domestic debt to 14.9% from 15.8% same period last year.

There has been a low interest on T-Bonds necessitating CBK to issue taps on the last 5 bond issues. April re-opening do not give any hope towards the government meeting it domestic borrowing demand with February Exchequer Items indicating that the government had achieved only 37.6% of its annual target or 56.4% on 8-month prorated levels on the revised target of KES 886.52Bn (a 14.8% cut from KES 1,040.46Bn initial budget)

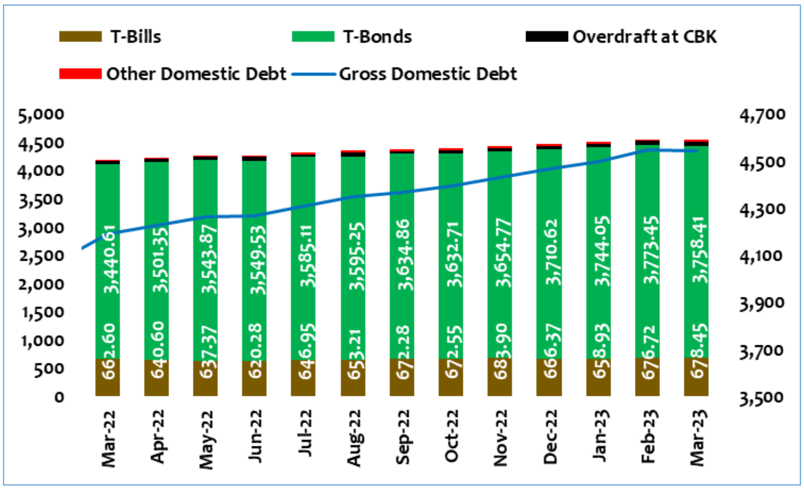

Figure 13: Government Domestic Debt Source: KSL, CBK

Eurobonds

Eurobonds yields were marginally elevated m-m affected by the two-week opposition demonstration and the strain by the international banking turmoil which had a ripple effect to the local economy.

Week on week, the rate edged downward after rate hikes by developed economies which was replicated in the domestic economy.

Eurobond BPSΔ						
Bond Tenure	**2024**	**2027**	**2028**	**2032**	**2034**	**2048**
31-Mar-23	**13.636%**	**11.637%**	**12.142%**	**11.329%**	**11.005%**	**11.500%**
W-W	-82.5	-82.3	-79.6	-82.5	-53.3	-56.7
M-T-D	167.5	166.1	142.8	80.6	95.2	55.2
M-M	2.0	1.7	1.6	0.9	1.0	0.6
Y-T-D	96.5	191.3	194.2	101.5	146.6	79.2
Y-Y	7.1	3.9	4.2	2.9	2.9	2.1

Table 4: Eurobond Yields Source: KSL, Bloomberg

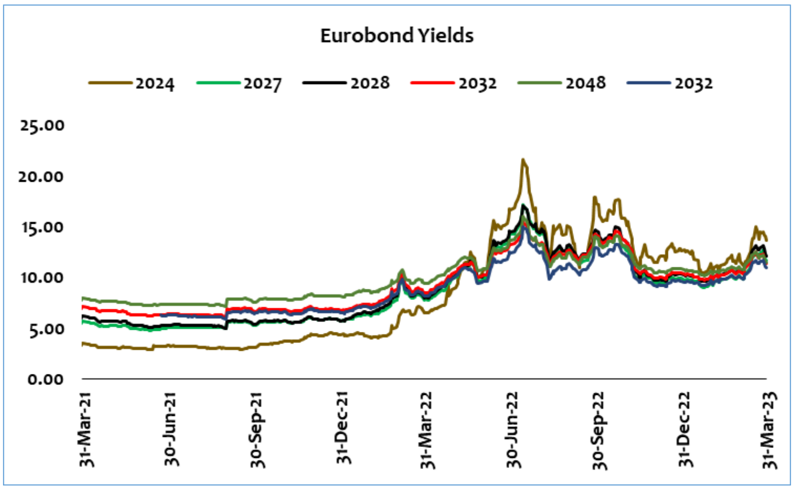

Figure 14: Eurobond Yields Source: KSL, Bloomberg

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