Kingdom Securities Limited

Pre-Auction Fixed Income Note – June 2023

Total Issue KE 60.00Bn

IFB1/2023/007 – Coupon MDA - Tenure 7.0 years

June 12, 2023

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Primary Issue – June 2023 – Infrastructure Bond

The Central Bank of Kenya has offered the second infrastructure bond for the year with a 7-year IFB1/2023/007Year bond for KES 60.00Bn. The government changed tact on issuing long-term bonds as investors shied off the bonds market, preferring short-term bonds. This led to the offer of 7-year bonds compared to March 2023 offer of a 17-year bond.

In May 2023, Moody's Investors Service, a credit rating institution downgraded Kenya Sovereign credit to B3, a high credit rating risk from B2. One of the key reasons for downgrade was government liquidity due to low poor funding condition by domestic investors into government securities. This was due to a low subscription in April which led to cancellation of primary issue on FXD1/2019/15. However, the government switched to short term bonds with May 2023 3-year bond seeing an oversubscription on the initial offer and two subsequent taps. This eased the fear of market liquidity challenge that was perpetrated by the Moody's downgrade.

We expect strong subscription on the upcoming bonds with the government targeting to sweep KES 70.51Bn in June payments i.e., KES 31.27Bn and KES 39.25Bn in maturities. we see >100% subscription being a short-term infrastructure bond, with a potential tap.

Below is our bidding guidance.

Bond	IFB1/2023/007
Tenure	7.0 – Years
Offer	KES 60.00Bn
Coupon	MDA
Period of Sale	26th May 2023 to 13th June 2023
Auction Date	19th June 2023
Value Date	19th June 2023
Expected WAR	15.100% - 15.250%

Table 1: Bidding Guidance Source: KSL, CBK

Our bidding guidance is based on the government demand having borrowed a net of KES 264.44Bn as of April 2023 representing 55.0% to proportionate 9-months borrowing target or 45.9% to total domestic borrowing budget. To meet the borrowing target, the government is expected to borrow KES 256.15Bn in the last quarter, against a quarterly target of KES 130.15Bn. This will be a hard task as reflected in the missed target in 2021/22 at 89.0%.

The rate will come under pressure as the budgetary domestic borrowing target was adjusted upwards by 24.2% to KES 532.0Bn from KES 428.3Bn. The demand increases competition with the private sector which will push yields higher.

We forecast an aggressive upside bid of 15.900%.

CBK – Entry of a New Sheriff – Dr. Kamau Thugge

Central Bank of Kenya (CBK) Monetary Policy Committee (MPC) met on May 29th, 2023, to review the Central Bank Rate (CBR) where they ended up retaining the rate at 9.50%. The committee noted the following:

- May inflation was at 8.0%, which was below the first four-month average of 8.83%. food prices and fuel prices continue to exert pressure on inflation which is expected to remain above the government upper target of 5.0%±2.5%.
- Export growth was 6.6% y-y in April with strong receipts from tea and manufactured goods.
- Foreign exchange reserves remained at 3.63 months of import cover, which can sustain short-term economic shocks. The reserves have remained adequate with support from borrowing from IMF and World Bank.
- The banking sector remained resilient with private credit sector growth of 13.2% in April compared to 11.6% in March.
- Gross non-performing loans gross loans was at 14.6% in April compared to 14.0% in March with default in manufacturing, trade, real estate, and construction. These are the business lines that have been affected by delayed government payment.

Headwinds on economic growth emanates from

- Uncertain global economic growth on continues conflict in the Eastern European, high inflation, and policy tightening in developed economies. Commodity prices continue to ease, giving a light to future inflation direction.
- Weakening shilling- the shilling lost 1.9% m-m on May 9th, 2023. The local currency continues to be affected by local demand while global demand of the US dollar strengthens against the greenback leading to a ripple effect on the local economy.
- Slow revenue collection as April tax collection was at 89.5% of proportional target while total revenue collection was 77.3% of 9-month budget target.

The MPC will reconvene in July with a new CBK Governor, Dr. Kamau Thugge, who was approved by parliament in office as the current governor term ends on June 15th.

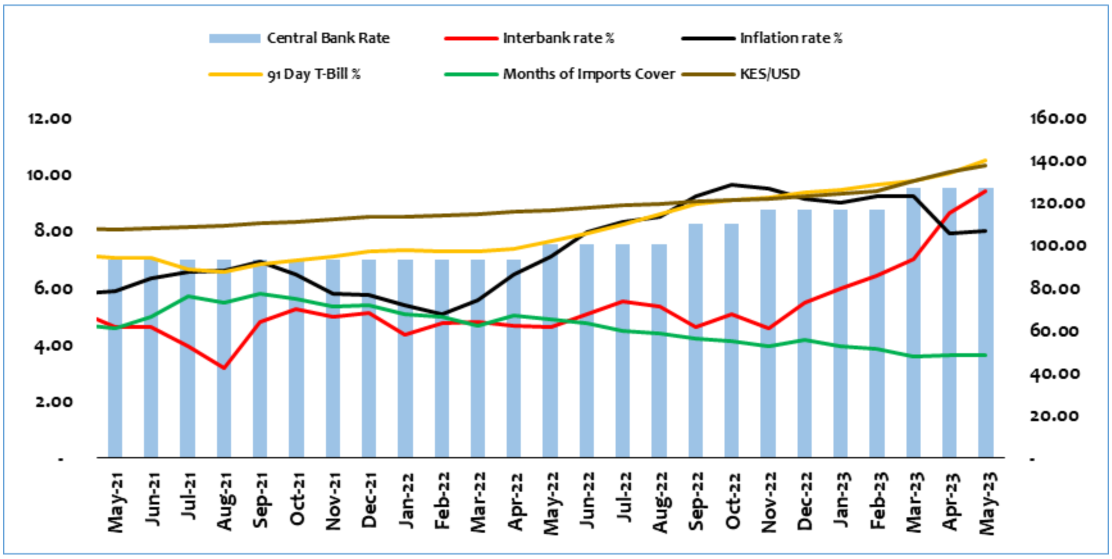

Figure 1: Bidding Guidance Source: KSL, CBK, KNBS

Inflation

The May 2023 inflation rate was at 8.0%, 10 bps higher than compared to 7.9% in April 2023 and 90bps to 7.1% in May 2022. Monthly inflation rate in May 2023 was 0.9%.

Core inflation eased to 3.57% from 3.63% in April 2023 but higher to 2.41% in May 2022. Food and Non-Alcoholic Beverages Index increased by 10.2% y-y due to increase in price of sugar and maize flour, Transport Index increased by 10.1% y-y after a 1.9% and 4.0% m-m increase in prices of petrol and diesel respectively, Housing, Water, Electricity, Gas and Other Fuels Index increased by 9.7% y-y due to a 10.4% m-m upward jump in price of paraffin.

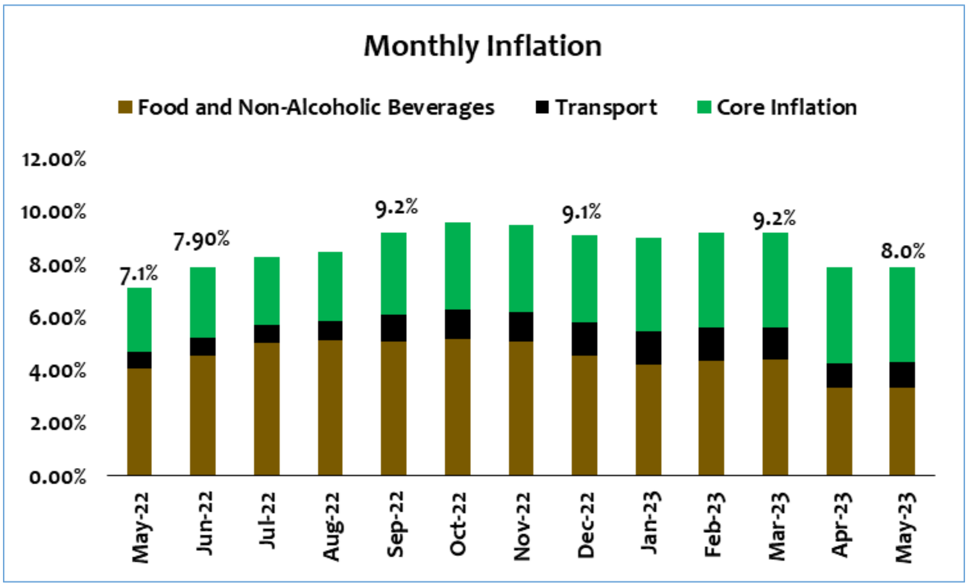

Figure 2: Bidding Guidance Source: KSL, KNBS

We expect the June inflation rate to range 7.61% -8.04% on downward farm food price despite pressure from manufactured products. We do not anticipate movement in petroleum pump prices unless due to the change in VAT from 8.0% to 16.0% presented in the Finance Bill 2023.

Interbank Rate

The interbank rate closed May 2023 at 9.3493%, nearly flat to 9.3676%. The rate touched a month high of 9.83% on high demand due to low government payment on a period of tax receipt payment on corporate taxes.

The monthly average was 9.39%, up 0.8bps while demand averaged KES 25.07Bn, 94.8% higher due to tight liquidity environment.

Commercial bank reserves closed the month at KES 26.10Bn above regulation requirement of 4.5%.

Interbank Rate - Monthly – 2023			
Period/Narration	Apr-23	May-23	%m-m
Closed Week at	9.37%	9.35%	-0.0
Average Rate	8.63%	9.39%	0.8
Closing Demand (KES BN)	12.87	25.07	94.8%
Average Demand (KES BN)	24.08	21.56	-10.4%
Bank Excess Liquidity (KES BN)	22.10	26.10	18.1%

Table 2: Interbank Rate, Commercial Bank Reserves Source: KSL, CBK

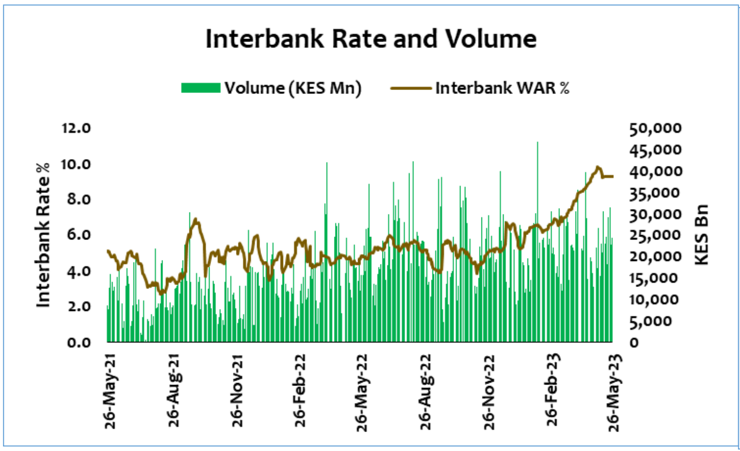

Figure 3: Interbank Rate, Value Source: KSL, CBK

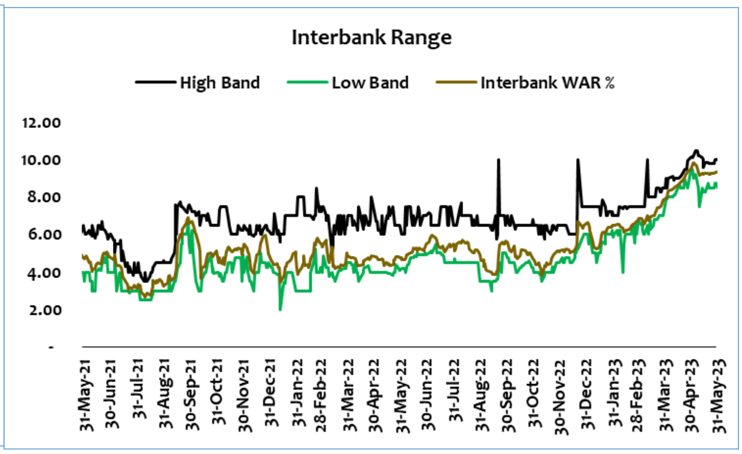

Figure 4: Interbank Rate Source: KSL, CBK

We expect the rate to ease marginally towards the end of the fiscal year with investors slowdown on demand while investment in government securities continue to rely on reinvestments than injection of new funds.

Currency

The shilling shed 1.9% m-m against the US dollar while losing 0.6% on the British pound but ended up gaining 0.8% and 1.2% m-m on Euro and Japanese yen prospectively. The currency continues to come under pressure due to demand and global strengthening of the dollar.

Commercial banks traded the currency on a premium of 2.8% - 3.1% range on the dollar. The monthly periodic depreciation has declined to below 2.0% which led us to adjust the annual level to range KES 157.97/USD - KES 159.08/USD on a 2.0% monthly depreciation for an annual depreciation of 28.0% - 29.2% compared to the current y-y 18.9% depreciation. The depreciation will be accelerated in the last quarter due to heavy import demand towards the holiday season, large debt obligation.

Forex reserves opened June at USD 6,512Mn or 3.62 months of import cover. The April remittance shrunk by 10.3% m-m and 9.8% y-y. The first four months saw remittance dip by 3.1% y-y due to a 4.6% and 5.1% y-y slowdown on remittance from North America and Europe respectively.

A receipt from IMF pushed reserves to a high of USD 7,532Mn or 4.15 months of import cover. The receipt came after the 5th review by the IMF Executive Board, giving Kenya access to USD 410Mn from the augmentation of access under the Extended Fund Facility (EFF) and Extended Credit Facility (ECF) arrangements. The review gave Kenya reprieve pushing the duration of the EFF/ECF arrangements by 10 months to April 2025 to allow Kenya to meet its objectives on economic revival.

KES	KES/USD	KES/GBP	KES/EUR	KES/JPY	Dollar Index
09-Jun-23	139.2235	173.8535	149.6303	99.9200	103.5330
W/W	0.4%	1.5%	1.1%	0.2%	-0.4%
M-t-D	0.4%	1.5%	1.1%	0.2%	-0.4%
M/M	1.9%	0.6%	-0.8%	-1.2%	2.1%
Y-t-D	12.8%	16.9%	13.7%	4.9%	-0.7%
Y/Y	18.9%	18.3%	19.4%	14.3%	-0.6%

Table 3: Currency Movement Source: KSL, CBK

Across the globe, the dollar gained 2.1% m-m as against the other major currencies as reflected by the dollar index. The gain came after an agreement was reached by Congress has approved a deal to lift the country's borrowing limit. The cap currently stands at roughly USD 31.4tn was surpassed in January 2023, but the Treasury Department used "extraordinary measures" to provide the government awaiting the agreement.

We view the currency will remain under pressure on import demand while coupon payment of USD 100.25Mn on Eurobond 2024 and 2032 is due on 23rd June.

Treasury Bills

T-Bills saw a subscription of 115.8% and an acceptance rate of 98.4% for a performance of 114.0%. the 91-day paper saw a subscription of 499.9% to dominate 71.9% or months subscription with yield edging up 22.3bps to close at 10.382%.

The 182-day paper saw a subscription of 46.6% and a 100.0% acceptance rate with rate edging up 63.6bps to 11.113%.

In June, the 91-day paper was more lucrative as the tenure closed on the 182-day paper with yields narrowing to a range of 13.4bps while standing 19.4bps against the 364-day. The range between the 364-day and 182-day stands at 0.6bps.

May-23							
Tenure	Offer (KES Bn)	Subscription	Acceptance	Performance	WAR % April 23	WAR % May 23	Δbps M-M
364-Day	50,000	31.4%	99.9%	31.4%	11.059%	11.457%	39.8
182-Day	50,000	46.6%	100.0%	46.6%	10.477%	11.113%	63.6
91-Day	20,000	499.9%	97.8%	488.9%	10.159%	10.382%	22.3
Total	120,000	115.8%	98.4%	114.0%			

Table 4: T-Bills Performance Source: KSL, CBK

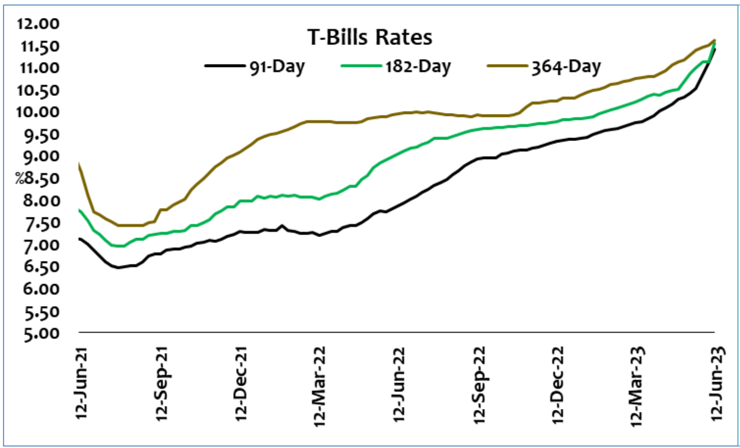

Figure 5: T-Bill Yields Source: KSL, CBK

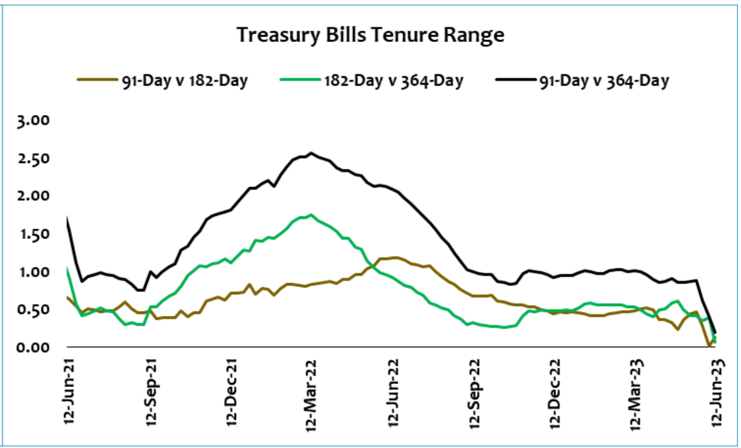

Figure 6: T-Bill Rane Source: KSL

We view the rates will retain upward pressure on demand while auctions will be fueled by oversubscriptions due to reinvestments as June payments stand at KES 90.84Bn against a target of KES 96.00Bn.

Preference on the 91-day paper will remain prevalent as we await the 364-day to breach the 12.00% mark.

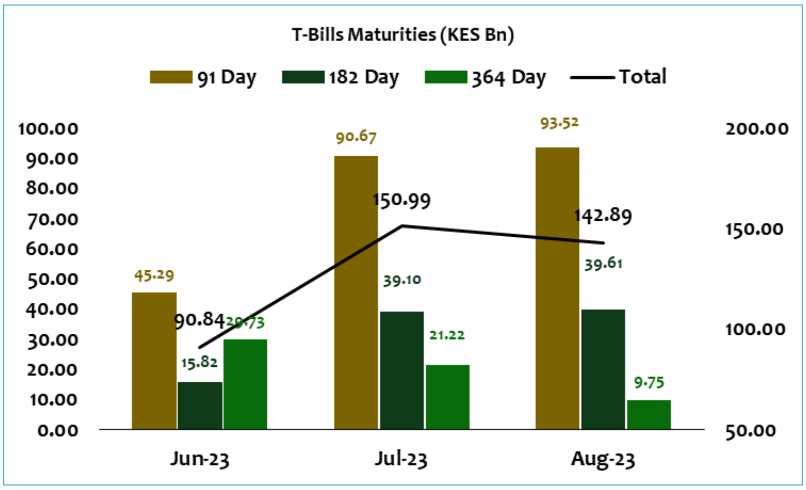

Figure 7: T-Bill Payment Source: KSL, CBK

Yield Curve

The monthly yield curve was dominated by price correction at the mid-of the curve after the May 2023 primary issue led to an upward shift on the short end. Long-end continue to suffer from decline in demand with few long issues due to low investors demand.

The month will see an upward shift on the mid tenure space on the June primary issue which will force the long end further up.

Yield Key Rates %	13-May-22	06-Jan-23	12-May-23	09-Jun-23	y-y bps Δ	y-t-d bps Δ	m-m bps Δ
2-Yr	11.6100	12.1960	13.5347	13.7346	212.5	153.9	20.0
5-Yr	12.2195	13.5472	13.7622	14.2580	203.9	71.1	49.6
10-Yr	13.6641	13.8562	14.1961	14.7536	108.9	89.7	55.7
15-Yr	13.8815	14.0073	14.3033	14.7595	87.8	75.2	45.6
20-Yr	13.9302	14.0586	14.5601	14.6494	71.9	59.1	8.9
24-Yr	13.9668	14.1760	14.5062	14.6132	64.6	43.7	10.7

Table 5: NSE Key Rates Yield Source: KSL, NSE

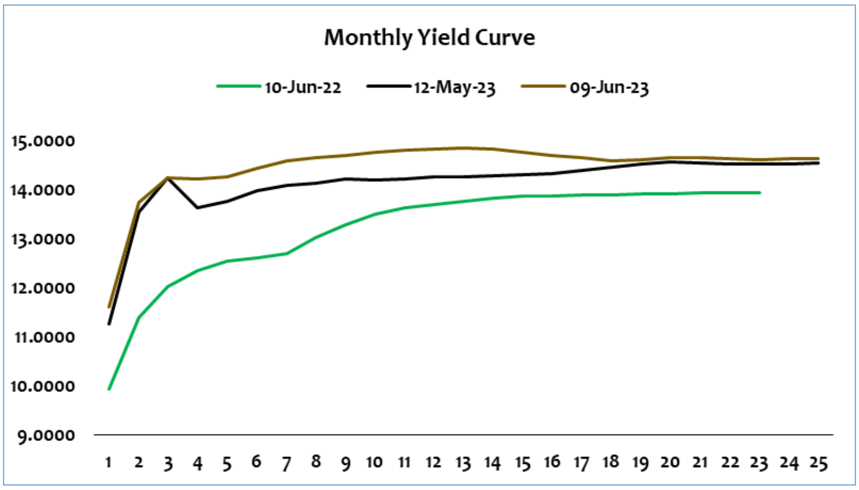

Figure 8: NSE Yields Source: KSL, NSE

Government Domestic Debt

Government domestic debt closed the month of May at a net of KES 4,531.25Bn, which was 0.2% m-m lower, 6.3% and 6.2% higher compared to May 2022 and June 2022 (close of fiscal year). The rate continues to see a shift on concentration with T-Bonds dominating 84.0% of debt after a 7.3% y-y increase in holding compared to 13.8% of T-Bill which saw a 1.5% y-y dip in holdings.

The debt levels opened the month of June 0.3% higher on net basis due to the tap on the FXD1/2023/003 bond which saw bonds concertation increase by 0.5%.

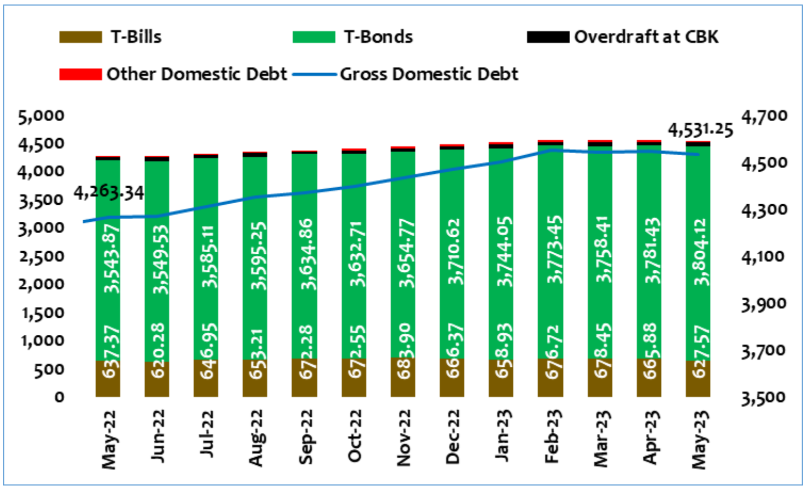

Figure 9: Government Domestic Debt Source: KSL, CBK

Debt levels are expected to increase on domestic borrowing budgetary target adjusted upwards by 24.2% to KES 532.0Bn from KES 428.3Bn.

Eurobond Yields

The month expects coupon payments of USD 100.25 on Eurobond 2024 and 2032 with holding of USD 2.00Bn and 1.00Bn at 6.725% and 6.30% is due on 23rd June. Rates have been on a downward edge with the 2024 bond shifting 470.2bps downwards a reflection of slowdown on the selloff by investors on the tenure.

Eurobond BPSΔ						
Bond Tenure	2024	2027	2028	2032	2034	2048
09-Jun-23	**14.096%**	**10.897%**	**11.457%**	**11.145%**	**10.453%**	**11.139%**
W-W	14.5	-19.3	-4.8	-11.2	-13.9	-15.3
M-T-D	-50.9	-43.1	-26.0	-29.3	-31.2	-30.4
M-M	-470.2	-241.9	-198.8	-146.1	-159.4	-129.9
Y-T-D	142.5	117.3	125.7	83.1	91.4	43.1
Y-Y	37.7	-103.9	-70.3	-48.9	-40.1	-85.4

Table 6: Eurobond Yields Source: KSL, Bloomberg

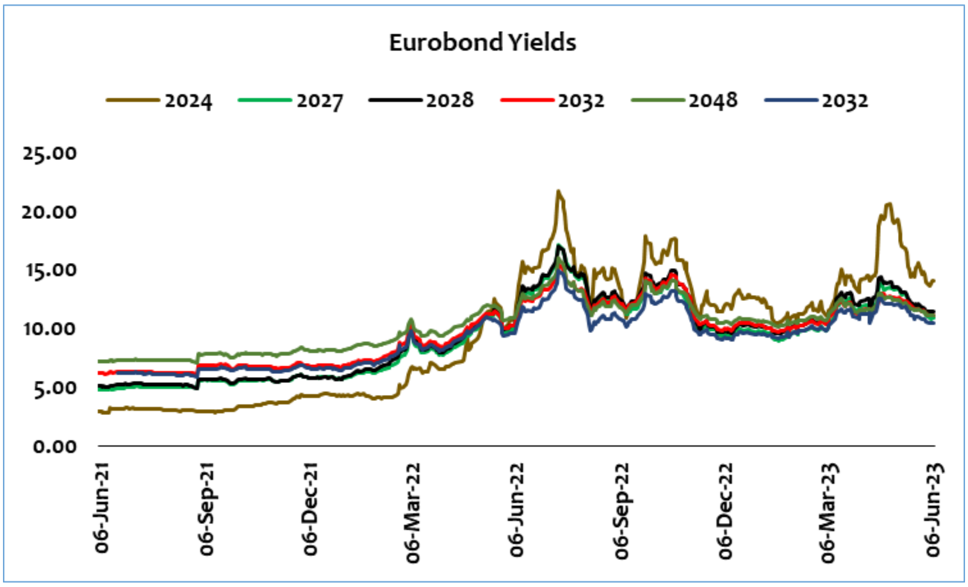

Figure 10: Eurobond Yields Source: KSL, Bloomberg

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