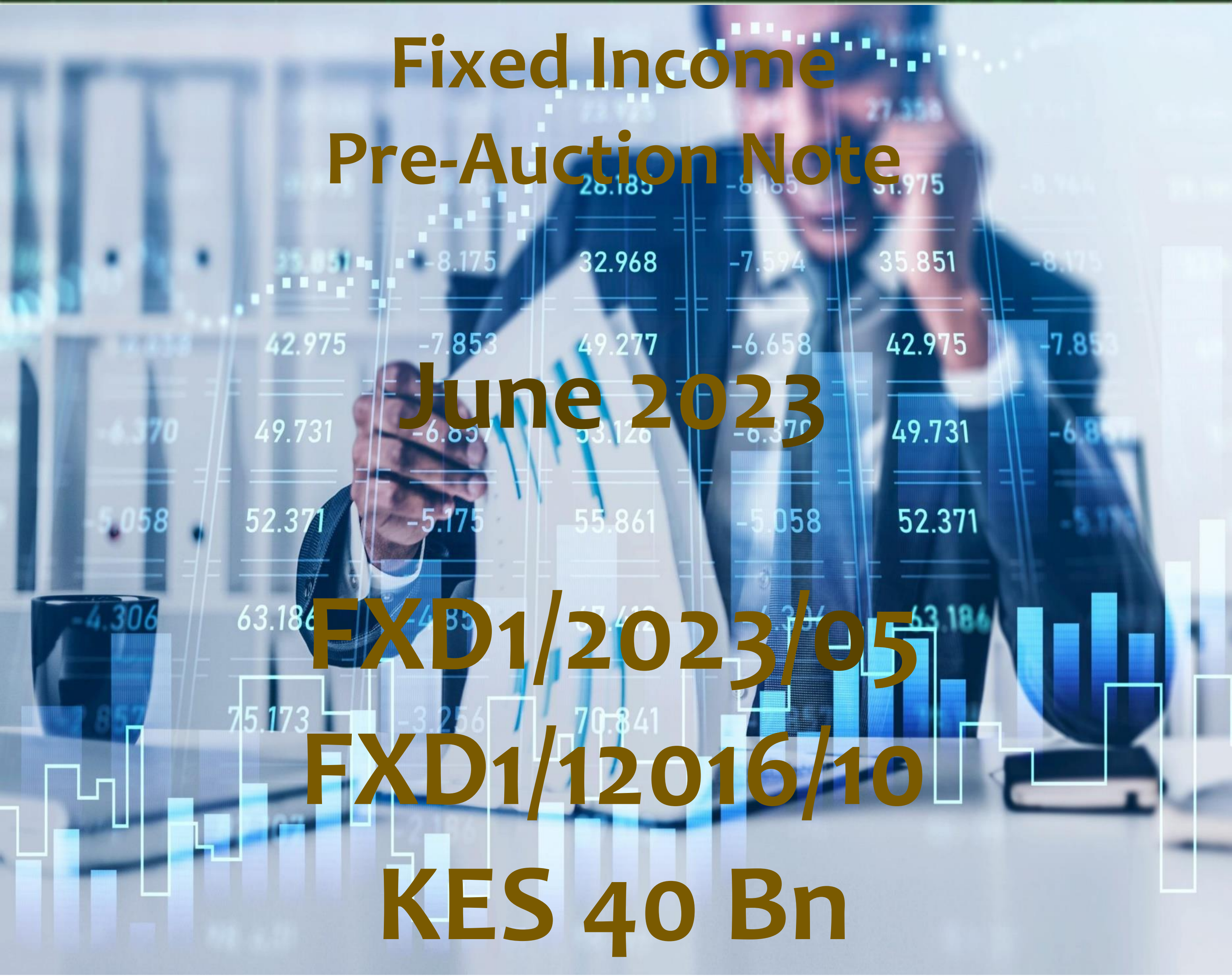
KINGDOM SECURITIES



Fixed Income Pre-Auction Note

June 2023

FXD1/2023/05
FXD1/12016/10
KES 40 Bn

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JULY PRIMARY AUCTION - FXD1/2023/5 AND FXD1/2016/10

The National Treasury issued two bonds in July, a new FXD1/2023/05 and a re-open FXD1/2016/10, seeking KES 40.00Bn from the market. To succeed on its monthly domestic borrowings, the government released the two short-term papers after witnessing low subscriptions upon issuance of long-term papers as witnessed in in the first five months of 2023. This follows a general investor preference on short-term papers necessitated by macro-economic uncertainties that has depressed major economic indicators as discussed hereafter.

Below are our bidding guidance rates:

Bond	FXD1/2023/05	FXD1/2016/10
Amount	KES 40.00 Billion	
Tenure	5-Yrs	3.2-Yrs
Coupon	Market Determined	15.039%
Period of Sale	28^{th} June – 11^{th} July 2023	
Auction Date	12^{th} July 2023	
Value Date	17^{th} July 2023	
Conservative	16.50% - 16.75%	15.95% - 16.25%
Aggressive	16.75% - 17.05%	16.25% - 16.60%

Our bidding is based on the current hiked Central Banks' lending rates from 9.5% to 10.5% as of June 2023, geared towards cooling high inflation rate, making investing in government securities more attractive to many investors.

We forecast heavy subscription on the new FXD1/2023/05-year paper on what we expect to be an aggressive bidding to compensate for the new Central Bank Rate of 10.5% and the restrictive business environment occasioned by the high inflation.

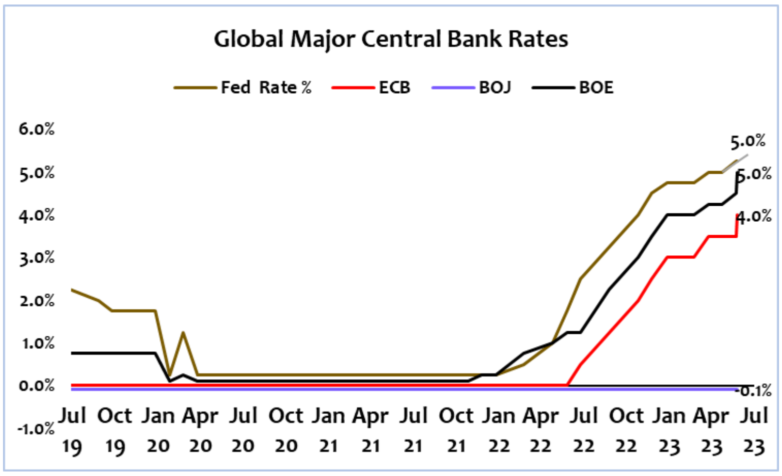
On overall, we forecast a total over-subscription on the auction on a general investors' shift to short-term bonds which has forced the government to change its tactic of long-term bonds in order to achieve on its domestic borrowing target. On its budget estimates, the government projects to borrow heavily from the domestic market KES 532.0Bn against an external estimate of KES 131.5Bn. We forecast that the heavy domestic borrowings will continue driving the lending rates even higher.

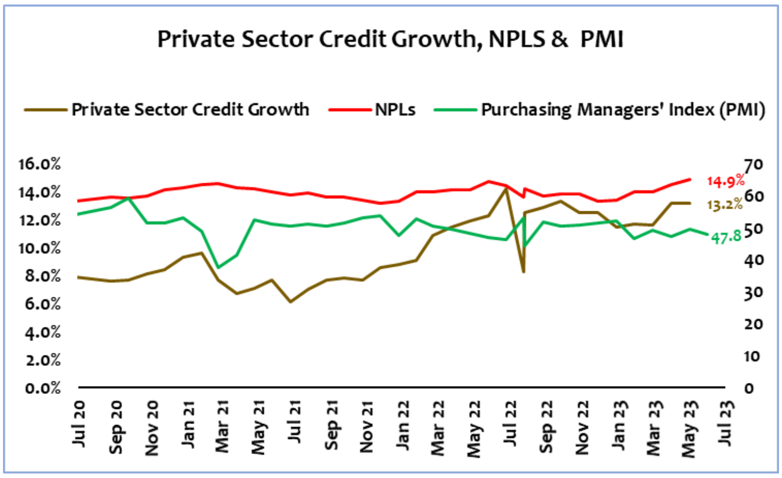
According to the Purchasing Managers' Index (PMI), Kenya's private sector performance contracted faster in June on a sharp decline in purchases on a weakened purchasing power eroded by inflationary pressures. The PMI index fell to 47.8 points in June from 49.4 points in May, remaining below the 50.0 neutral point for the 5th month in a row since February. Firms however remains optimistic on growth resulting to increased labor absorption in the private sector.

Private sector credit remains strong growing by 13.2% in May and April 2023 with transport and communication recording a faster growth of 22.0% on what we view as heavy transportation of raw materials by manufactures and rise in fuel prices. Manufacturing credit followed with a growth of 19.3% while trade and consumables followed with growths of 15.4% and 11.9% respectively.

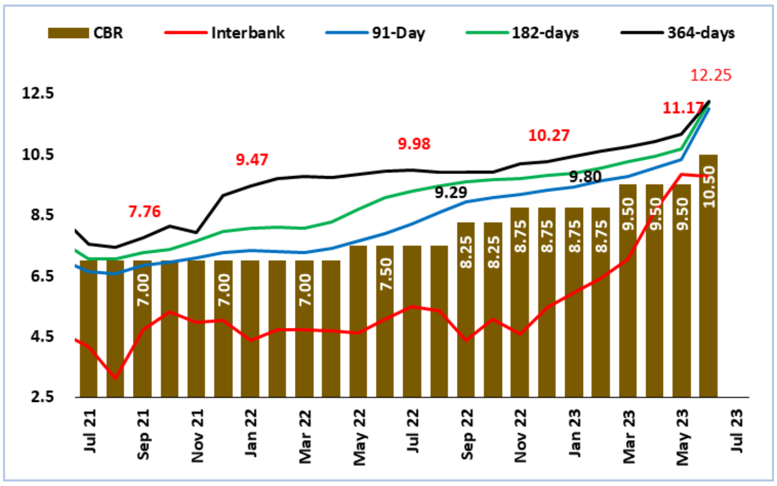
Bank gross non-performing loans (NPLs) rose 40.0bps month-on-month(m-m) to 14.9% in May from 14.5% in April and 14.0% in March. The NPLs were depressed especially on repayments from Manufacturing, trade, real estate and transport and communication sectors. This follows the above constraints in consumer spending emanating from high inflation.

	Jan-23	Mar-23	Jun-23
CBR	8.75%	9.50%	10.50%
PMI	52.0	49.2	47.8
Private Sector Credit (PSC)			
PSC	11.5%	11.6%	13.2%





The last treasury bill auction dated 10th July 2023 saw all market weighted averages (WAR) for all the three papers surpassed the 12.0% mark, with the government accepting 99.9% of the offered at the market rates, indicating of the government thirst for funds. Find more on the T-Bill section.



Current Money Market Rates

6th July 2023 auction

Interbank – 9.77%

91-Day paper – 12.014%

182-Day Paper – 12.199%

364-Day paper – 12.250%

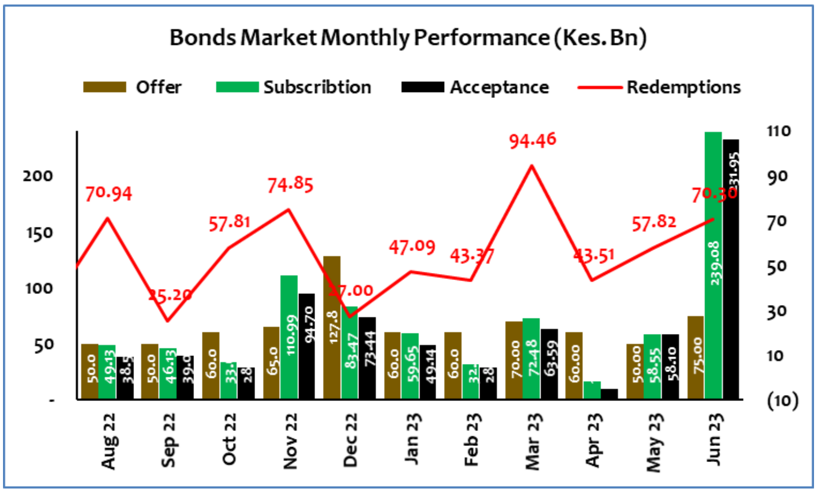
Primary Market Performance

Primary auctions continue witnessing heavy subscriptions on short-term papers after investors shunning long-term papers until the government changed its tactic to short-term papers to attract investors achieve its tactic of domestic borrowing. The new regime focus on domestic borrowing confirms as per the 2023/24 fiscal budget.

The short-term June infrastructure bond called the conserved funds amounting to KES 220.52Bn, that had been conserved by investors as per our earlier re-iterative reports on the same.

In our view, while the appetizing short-term papers seems to be attracting funds to the government, however, the cost of borrowing continue soaring higher.

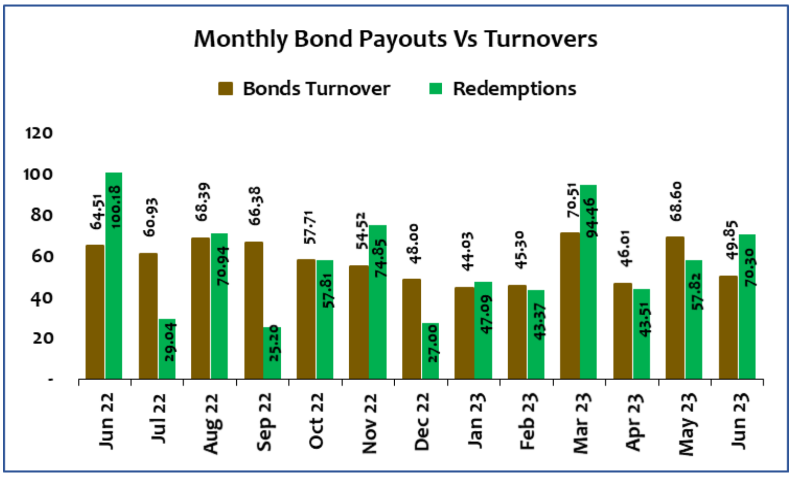
In July we expect KES 39.25Bn in bond maturities and KES 31.06Bn coupon payouts from the government.



Secondary Market Bonds Activity

The rising rates continue having a double effect on investors on account of uncertainty in controlling of inflations that has remained an elephant globally despite the minimal signs of easing out. This follows the capital loss on existing bonds forcing many to hold the papers till maturity.

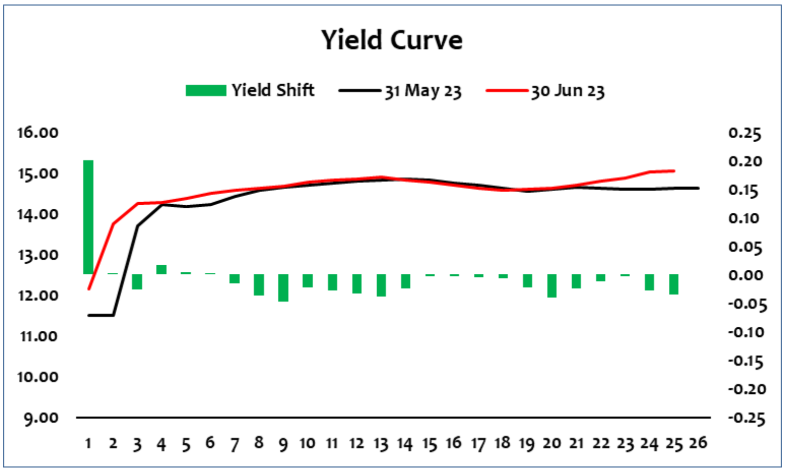
In view of this, the secondary market activity remains low with a total of KES 49.85Bn traded in June from 2,801 deals compared to KES 68.60Bn of 1,726 deals transacted in May 2023 and KES 64.51Bn traded same time in 2022 from 2,646 deals.



Yield Curve

The yield curve experienced mixed movements with the middle curve shifting down as demand for short-term papers pushed the short end down. We expect the demand on the short end to further widen the short end as rates remain on a rise.

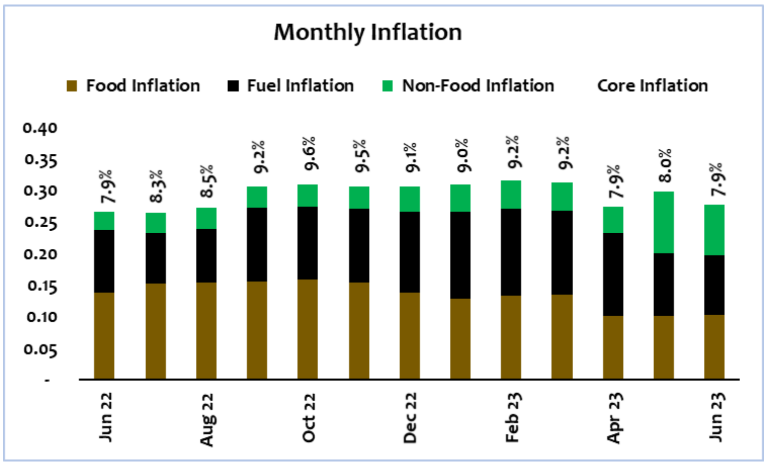
Yield Curve Key Rates %	06-Jan-23	31-May-23	30-Jun-23	(y-t-d) bps	(m-m) bps
2-Yr	12.1960	13.6930	13.7576	6.5	6.5
5-Yr	13.5472	14.2231	14.3588	13.6	13.6
10-Yr	13.7798	14.7444	14.7681	2.4	2.4
15-Yr	13.9356	14.7541	14.7582	0.4	0.4
20-Yr	14.0586	14.6447	14.6129	-3.2	-3.2
25-Yr	14.2374	14.2374	15.0500	81.3	81.3



Inflation

Local inflation fell to 7.9% on overall on a reduced growth in food prices especially vegetables following improved supply attributed to the long rainfall season of March May 2023. Food inflation went up 10.2% in June compared to 10.3% rise in May 2023.

We expect inflation to remain above the government target to levels of between 8.0% and 8.5% on effect from fuel inflation upon return of the 16% excise duty taxation following the passage of the 2023 finance bill by parliament.



Treasury Bills

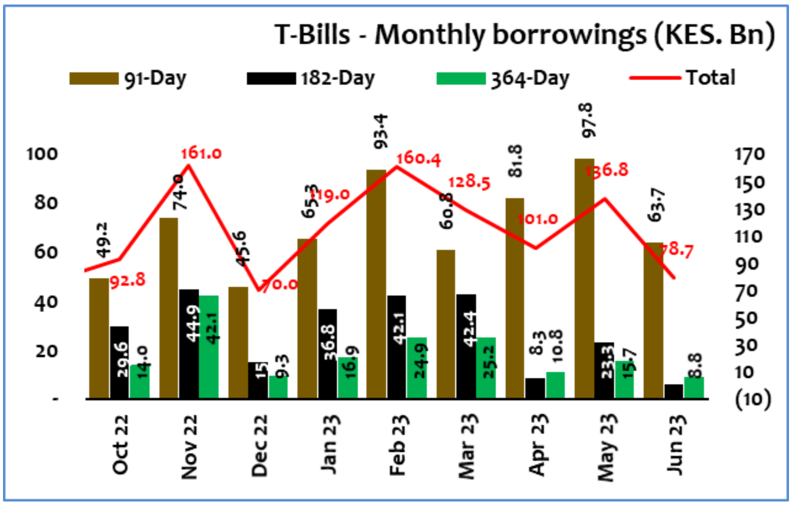
T-bills market has been very active in the first half of 2023, on a fund conservation by investors. In June a total of KES 94.49Bn was subscribed against an offer of KES 96.0Bn at an acceptance of KES 78.65Bn compared to a subscription of KES 138.98Bn and an acceptance of KES 136.77Bn.

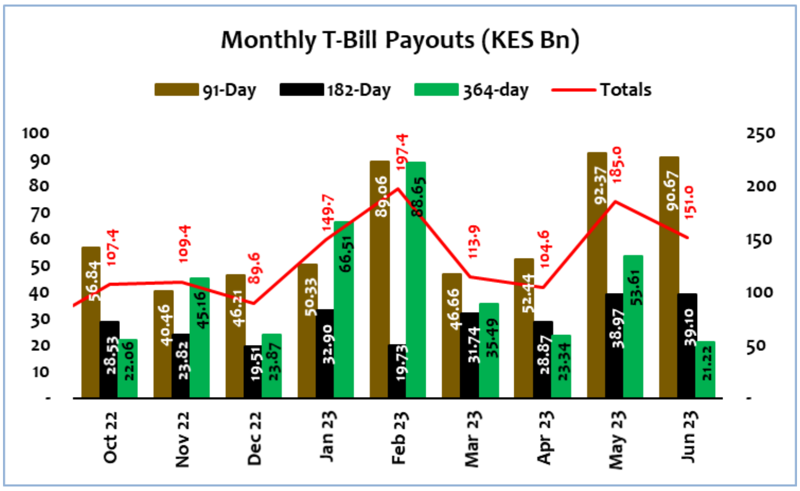
The June performance was affected by the June 2023 IFB1/2023/07 bond that was heavily subscribed.

On individual performance, the 91-day paper was the favorite paper on its high return touching the 12.014% mark in the first auction of July 2023. The paper contributed 80.9% or KES 63.66Bn of the overall accepted amount as the 182 and 364-day papers contributed a total of KES 14.99Bn.

In July, we high subscriptions in the treasury bills auctions as investors continue taking advantage on the better returns 91-day paper whose deviation from the 182- and 364-day papers stand at 18.5bps and 84.9bps respectively.

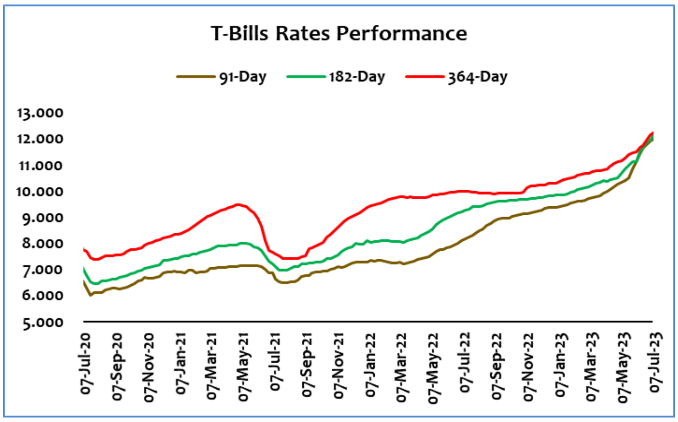
The July performance will be supported by heavy T-bill redemptions of KES 150.99Bn for July. We also expect the returns to remain on an uptrend as the range between the 91-day paper and the other two continue narrowing.





Subscriptions

Month	April	May-23	Jun-23
91-Day	85.49	99.97	78.68
182-Day	8.75	23.31	7.10
364-Day	10.93	15.70	8.8



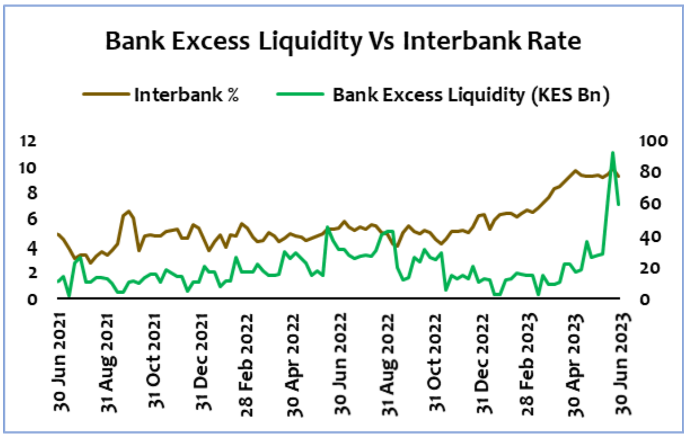
Interbank

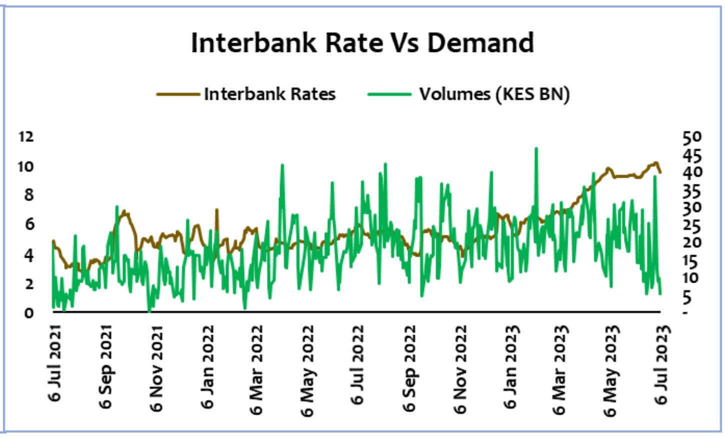
Review of CBR rate saw the interbank rate touch the 10.0% mark in June averaging at 9.58% and 9.83% month-to-date. Mopping up of liquidity from the market by CBK through bonds, treasury bills and rate hikes will continue adding pressure on the interbank.

Liquidity demand fell 15.6% to KES 18.21Bn majorly on high bank excess reserves from that of KES 21.56Bn in June and KES 24.04Bn.

Bank excess reserves was high averaged at KES 54.5Bn in June 2023, the highest ever in the last three years, in comparison to an average of KES 16.00Bn in May -2023 and KES 29.10Bn of June 2022.

We forecast the interbank rate to range between 9.35% and 9.75% in the month of July.





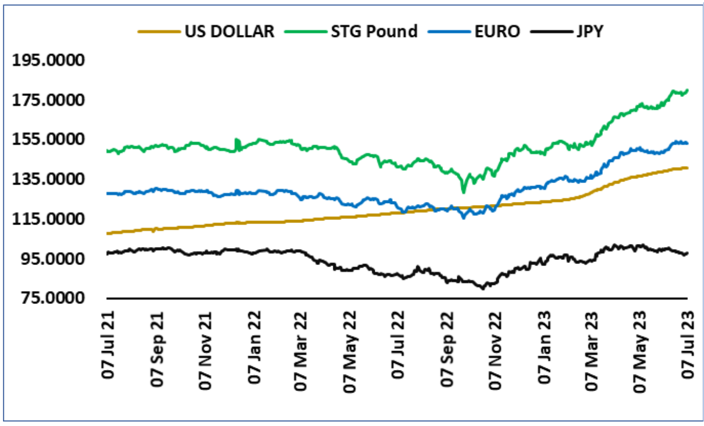
Currency

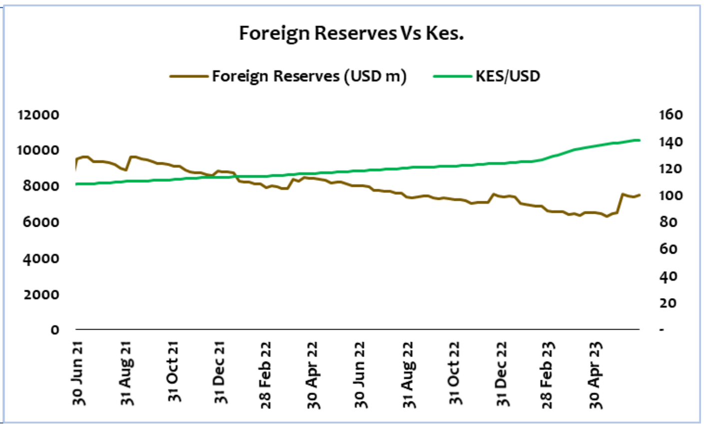
The shilling remains under pressure against the dollar touching KES 140.92 per dollar as of 7th June 2023, a 1.4% m-m depreciation from KES 138.97 to KES 140.92 per dollar. Year to date the shilling has lost 19.4% and 19.4% year-on-year implying that the depreciation accelerated in 2023 on high demand for the dollar both locally and globally.

Forex reserves improved in June to close the month at USD 7.476Mn enough for 4.12 months of import cover in relation to USD 6,479Mn of 3.6 months import cover recorded by end of May 2023.

The reserves were largely supported by the USD 1.0Bn World Bank facility on its Development Policy Operation (DPO) geared to budgetary supporting. The forex reserves are set to further gain from the expected USD 500Mn syndicated medium term loan facility from the Citibank, Rand Merchant Bank, the Standard Bank of South Africa, Standard Chartered Bank.

Currency	07 Jul 22	07 Jun 23	07 Jul 23	%Δ y-t-d	%Δ m-m
Dollar	118.0324	138.9676	140.9206	-19.4%	-1.4%
STG Pound	141.2174	172.425	179.7579	-27.3%	-4.3%
Euro	121.0612	148.4432	153.3124	-26.6%	-3.3%
JPY	87.3764	99.4793	97.9287	-12.1%	1.6%
US Dollar Index	107.13	104.10	104.10	2.8%	0.0%

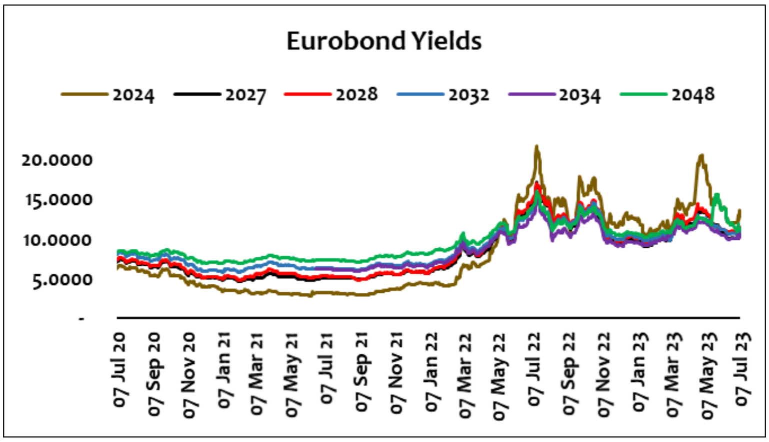




Eurobond

Kenya expects to clear its USD 2.0Bn Eurobond n June 2024 amid efforts to restructure the bond in vain. Yield rate on the June 2024 Euro-bond dropped by 27.4bps even as yields edge down globally.

Euro-bond Paper	03 Jan 23	07 Jun 23	07 Jul 23	Δ bps y-t-d	Δ bps w-w
Jun-2024	12.671	13.832	13.560	(88.90)	27.20
May-2027	9.724	10.841	10.705	(98.10)	13.60
Feb-2028	10.200	11.166	11.490	(129.00)	(32.40)
May-2032	10.314	11.157	11.133	(81.90)	2.40
Jan-2034	9.539	10.467	10.551	(101.20)	(8.40)
Feb-2048	10.708	13.832	11.373	(66.50)	245.90



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