KINGDOM SECURITIES

Fixed Income Pre-Auction Note

August 2023

FXD1/2023/2

FXD1/2023/05

KES 40 Bn

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

The Central Bank of Kenya issued two bonds, a new FXD1/2022/2 and a reopen FXD1/2023/5, seeking KES 40 Billion from the public for the August 2023 budgetary support. We forecast that the papers will be oversubscribed based on their expected appetizing returns on investment and the duration of the papers.

We anticipate that the rates on the FXD1/2022/2 will be priced highly based on the current prevailing economic conditions that has seen the 91-day treasury bill paper record a high of 13.144% as of the last auction of Thursday, 10th August 2023. This follows the tight liquidity the market that has drawn the intervention of the Central Bank . In the recent auction of July, the FXD1/2023/5 record market weighted average rate of 17.026% while the government accepting a return of 16.844%.

Below are our recommended bidding rates based on the factors discussed here after:

Bond	FXD1/2023/2	FXD1/2023/5
Amount	KES 40.00 Billion	
Tenure	2-Yrs	4.9-Yrs
Coupon	Market Determined	16.844%
Period of Sale	31st July – 16th August, 2023	
Auction Date	Wednesday 16th August	
Value Date	Monday, 21st August	
Conservative	17.00% - 17.25%	17.60% - 17.80%
Aggressive	17.30% - 17.49%	17.90% - 18.10%

CBK

On its recent monetary policy committee meeting of 9th August, the MPC retained the Central Bank Rate (CBR) at 10.5% while approving a new monetary policy framework aimed at ensuring that the interbank rate closely follows the CBR rate.

In the first week of August, the interbank had surpassed the CBR by 688.3bps before receding down to the current rate of 10.44% as of Friday, 11th August 2023. This continue to negatively impact tier two and three banks which are prone to low cheap customer deposits.

Tight liquidity in the market continue affecting the banks excess liquidity that has been in shortfall for three consecutive weeks against a cash reserve requirement of 4.25% of banks' deposits. This is despite the resilient growth of the private sector credit growth of 13.2% and 12.2% recorded in May and June respectively.

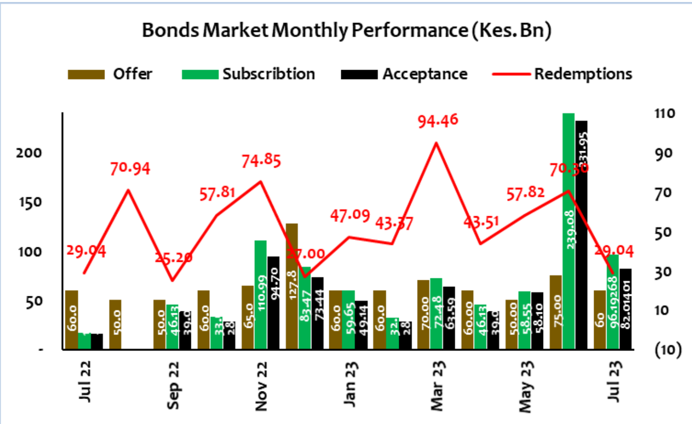
The Banking Sector remains stable with strong liquidity ratios. The ratio of gross non-performing loans fell from 14.9% in May to 14.5% in June supported improved loan repayments in transport and communication, agriculture, manufacturing and in the personal and household sectors.

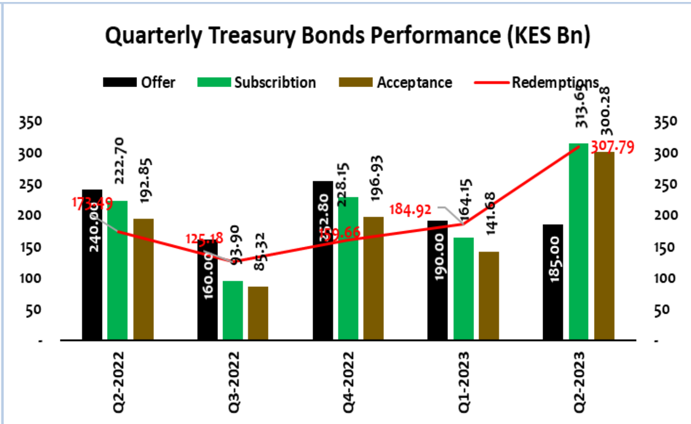
Government Borrowings

Government shift to heavy domestic financing resulted to the issuance of short-term papers after a very low subscriptions witnessed in long-term papers issued in the first four months of 2023. This has seen heavy demand for funds locally pushing the interest rate high.

The expected reduction in borrowings in the 2023/24 government financial year from 5.8% of gross domestic product (GDP) to 4.8% will ease pressure on borrowing rates once effected by the government. The MPC welcomed the efforts of the National Treasury of souring external funding to cover the recommended reduction in the domestic borrowing of KES 270.5Bn from KES 586.5Bn to KES 316.0Bn.

Domestic borrowings from treasury bonds rose in the last quarter of the fiscal year 2022-23 from KES 141.68Bn in Q1-2023 to KES 300.28Bn in Q2-2023 and compared to KES 192.85Bn borrowed same period in 2022. This follows the assumption of new government in office that indicated a shift to domestic borrowing.

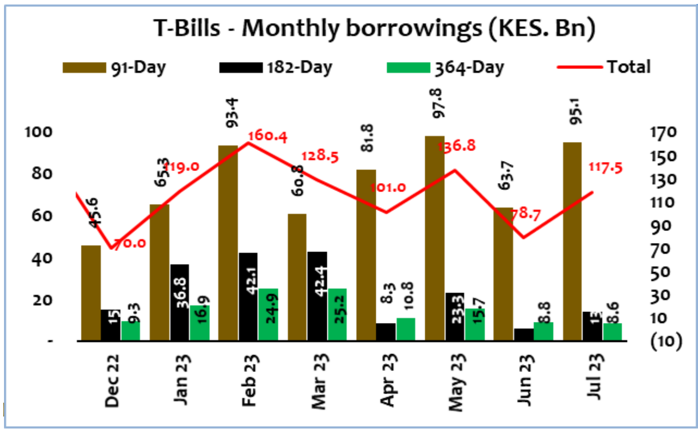


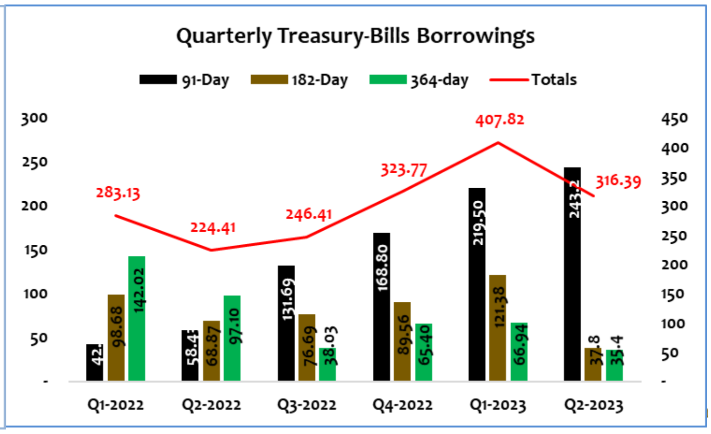


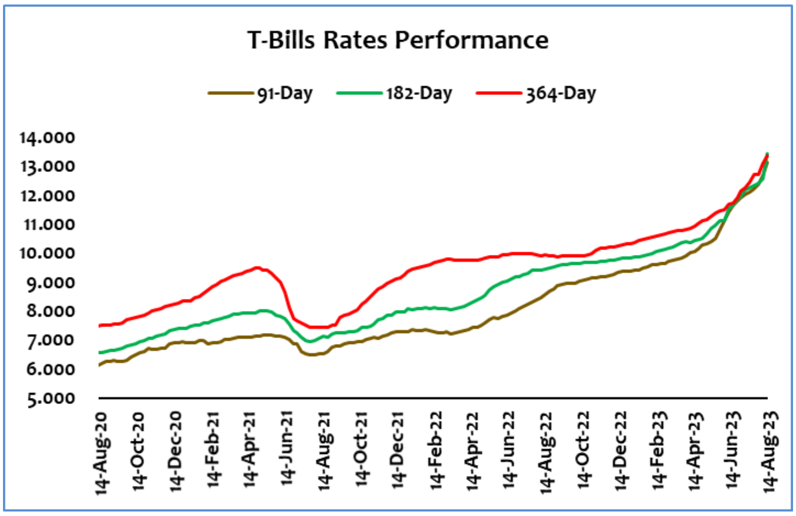
Treasury bills borrowings in the same period declined from KES 407.82Bn to KES 316.39Bn on a shift to the above short-term treasury bonds as their returns bettered and thus impacting performance.

Return on investment from T-Bills flourished held up by a tight liquid environment. Rates on the 91-day paper touched a new high of 13.114% in the auction of 10th August, a level last witnessed in November 2015.

Returns on the 182 and 364-day paper touched their 7-year highs of 13.438% and 13.340% respectively with the return on the 182-day surpassing that of the 364-day paper by 9.79bps. Rise in returns will continue attracting investors even as more compensation is sought in the market.





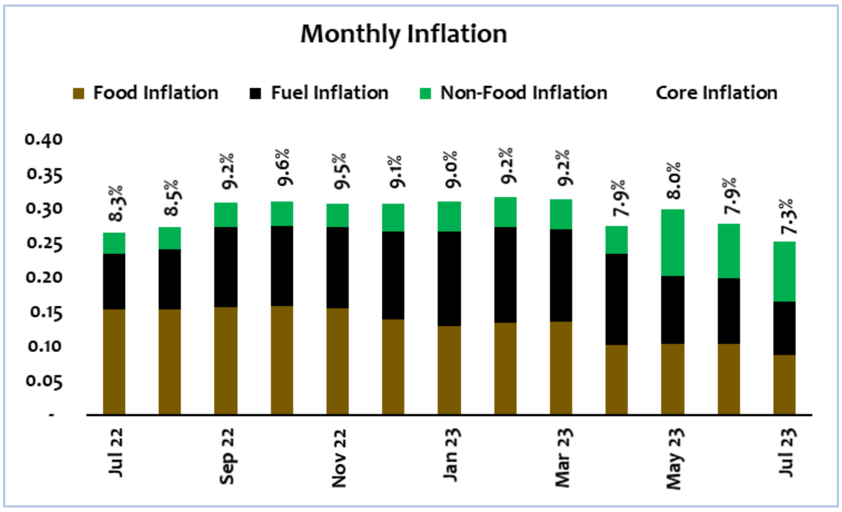


Inflation

Kenyan inflation declined in July to the government target of below 7.5% at 7.3% in July from 7.9% in June, brought down by food inflation that fell from 10.3% to 8.6% in the period. This followed an increased supply of key vegetable food items supported by the long rains of March-May 2023. Sugar and onions prices remained elevated on a supply constraint in the two.

Fuel inflation went up to 14.5% in July from 12.9% in June elevated by the implementation of the 16.0% value added tax (VAT) and the upward review of electricity charges. Fuel inflation was however moderated by the zero VAT on liquified petroleum Gas (LPG) tax.

We forecast the inflation to decline to the levels of about 7.0% flat. This is based on the expected rise in maize supply especially from the western part whose harvesting season starts in August. The anticipated increase in sugar supply upon the government approval of sugar importation which will further help in cooling the rate.

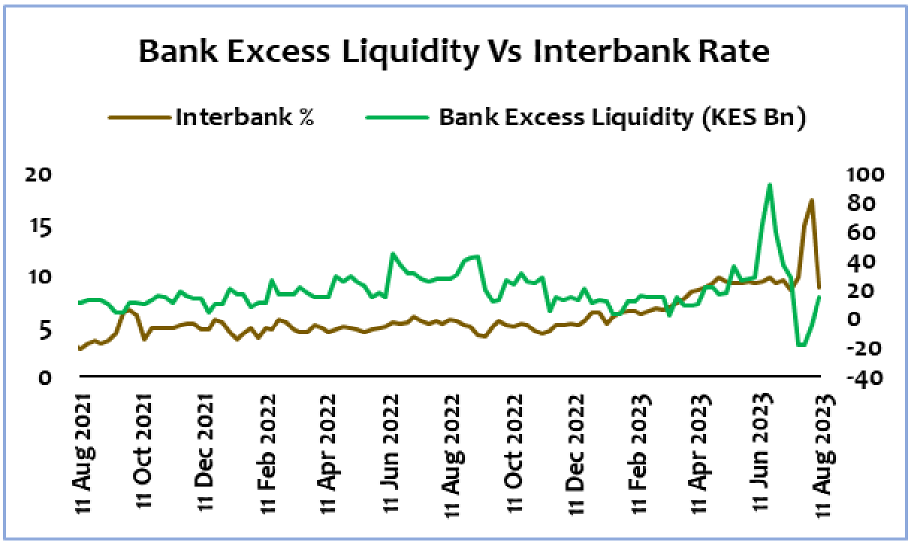


Interbank

The interbank rate fell sharply in the second week of August from 17.00% at the start August to the current rate of 8.80% on 10th August 2023 on what we view as CBK intervention on the rate. We attribute the drop to have been informed by the above approval of a new policy of enhancing CBK's monetary policy transmission.

Month-on-month (m-m) the interbank edged down 40.2bps to 9.05% from 9.20% on 10th July but remained higher year-on-year(y-y) compare to 5.60% witnessed same time last year.

Bank excess reserves remained at a shortfall since mid-July reflecting of liquidity constraints in the market.



Key Rates	11 Aug 22	11 Jul 23	11 Aug 23
Central Bank Rate	7.00%	10.50%	10.50%
Inter-Bank Rate	5.35%	8.82%	9.0%
Cash Reserve Requirement (CRR)	5.60%	4.25%	4.25%
Inflation	8.32%	7.9%	7.28%
91-Day T-Bill	8.565%	12.109%	13.114%
182-Day T-Bill	9.433%	12.271%	13.438%
364-Day T-Bill	9.922%	12.452%	13.340%
Bank Excess Liquidity (KES Bn)	27.20	18.20	(4.70)
Forex Reserves (USD Mn)	7,682	7,481	7,330
Months of Import Cover	4.43	4.09	4.00

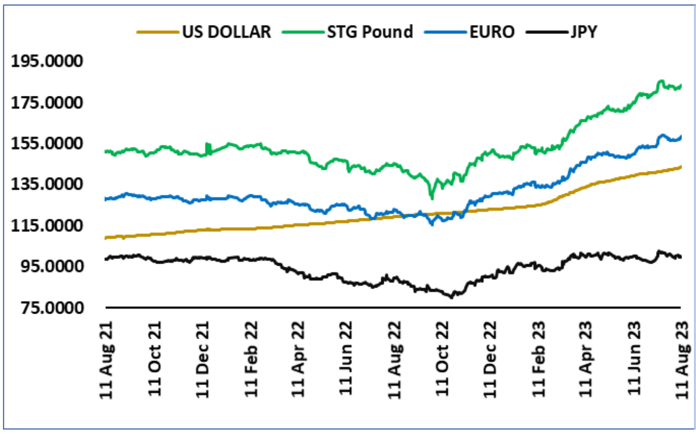
Currency

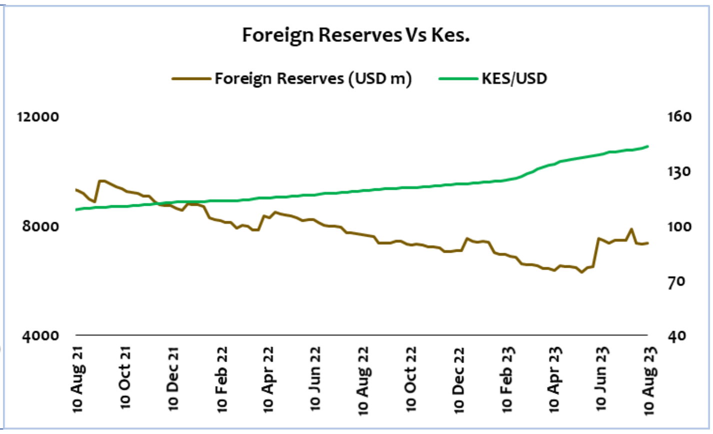
The Kenyan shilling remains on the losing end against some major currencies especially the US dollar, British pound and the euro. Against the dollar the shilling lost 1.8% m-m from KES 141.58 to KE 143.58 per dollar, noting of a faster deceleration on the shilling compared to same time last month.

Forex reserves remain under pressure especially on the Eurobond coupon payments that happened in June and July for three bonds even as one maturity of USD 2.0Bn comes due in June 2024.

The US dollar index continue strengthening on a strong US economy gaining 1.0% against a basket of currencies.

Currency	03 Jan 23	11 Jul 23	11 Aug 23	%Δ y-t-d	%Δ m-m
Dollar	123.42	141.06	143.58	-16.3%	-1.8%
STG Pound	148.73	180.50	183.25	-23.2%	-1.5%
Euro	131.66	154.69	158.31	-20.2%	-2.3%
JPY	95.24	99.51	99.56	-4.5%	0.0%
US Dollar Index	104.52	101.40	102.40	2.0%	1.0%

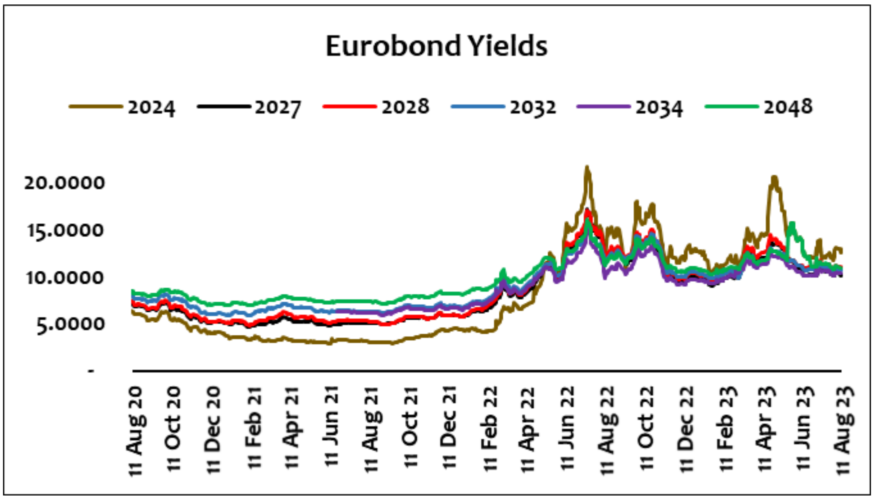




Eurobond

Kenya's euro-bond continue gaining value following the global retreat of rates as inflation rates edge down evinced by a reduced interest rate hike. Yields on the June 2024 paper has gained 27.7bps even as the Kenyan government reiterated on its commitment to its obligation.

Euro-bond Paper	03 Jan 23	11 Jul 23	11 Aug 23	Δ bps y-t-d	Δ bps w-w
Jun-2024	12.671	13.143	12.866	(19.50)	27.70
May-2027	9.724	10.810	10.142	(41.80)	66.80
Feb-2028	10.200	11.541	11.037	(83.70)	50.40
May-2032	10.314	11.187	10.694	(38.00)	49.30
Jan-2034	9.539	10.639	10.359	(82.00)	28.00
Feb-2048	10.708	11.446	10.896	(18.80)	55.00


Eurobond Yields
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