KINGDOM SECURITIES

Fixed Income Pre-Auction Note September 2023

FXD1/2023/2

FXD1/2016/10

KES 35 Bn

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September Primary Auction – Reopen FXD1/2023/02 and FXD1/2016/10

The Central Bank of Kenya re-opened two bonds, FXD1/2023/02 – 1.9-years and FXD12016/10 – 2.9-years, targeting KES 35 billion for the month of September budgetary support. We forecast aggressive bidding on the two papers following tight liquidity in the market and a high appetite for funds by the government.

Below are our bidding recommendations based on the factors discussed hereafter:

Bond	FXD1/2023/002	FXD1/2016/10
Amount	KES 35 Billion	
Tenure	1.9-Yrs	2.9-Yrs
Coupon	16.9723%	15.0390%
Period of Sale	1st to 13th Sept. 2023	
Auction Date	13th Sept. 2023	
Value Date	18th Sept. 2023	
Conservative	17.30% - 17.60%	17.75% - 18.00%
Aggressive	17.61% - 17.90%	18.01% - 18.25%

The FXD1/2023/002 was first issued in August 2023, where the paper saw aggressive bidding, averaging at 17.5545% while the government accepted a coupon of 16.9723%. The paper received a subscription of KES 38.30Bn, a 95.8% performance at a 30.4% acceptance resulting to a tap sale. On tap-sale, the paper saw an 82.7% subscription with a 100% acceptance.

On its last auction in July 2023, the FXD1/2016/10 saw a market bidding average of 16.582% with CBK accepting those of 16.328% of amount KES 15.74Bn, a 69.5% performance against a target of KES 40.0Bn, leading to a tap-sale. July tap-sale of FXD1/2016/10 saw a subscription of 161.1% with 96.9% being taken.

Economic performance

High interest rates continue impacting investments across the globe even as economies emerge from the effects of Covid-19, Russia-Ukraine war and the recent drought that has seen African governments push for financing mechanisms to avert climate change.

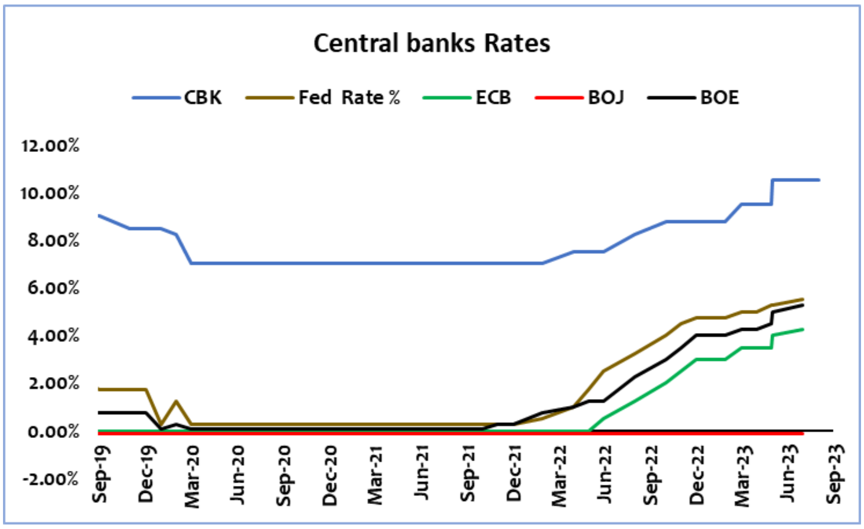
Locally, liquidity crunch saw the overnight interbank lending soar as high as 17.3% prompting the intervention of the Central Bank with a policy of the interbank to track the Central Bank Rate with margins of not more than 250bps. This has seen the interbank hover at an average of 11.43% with a high of 12.49%.

The Central Bank Monetary Policy Committee retained the CBR at 10.5% noting of the ongoing transmission of its impact and a further decline in inflation that is already within the government target on account increase in food supplies.

The banking sector remains stable with strong liquidity ratios and bettering profitability as evidenced by the H1-2023 financials. Banks' profit before tax went up 0.4% in H1-2023 to KES 120.20Bn.

Private sector credit remains strong with growths of 12.3% as of June 2023 mainly supported by credit growths in manufacturing, transport and communication and trade which grew by 18.0%, 19.9% and 12.2% respectively.

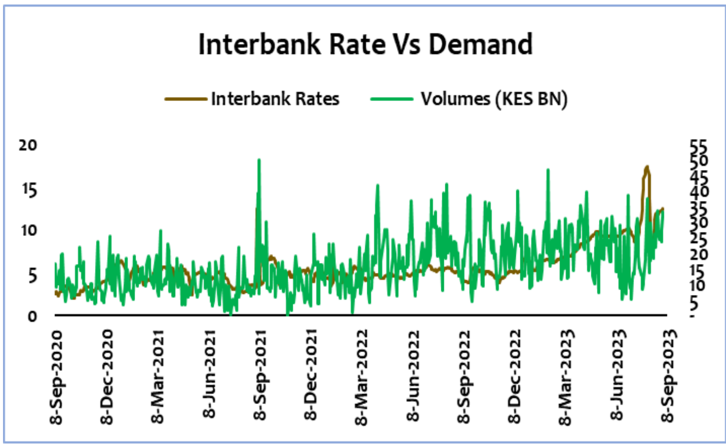
According to Stanbic's Purchasing Managers' Index (PMI) for August 2023, business conditions improved for the first time in seven months on mild growths in output orders as inflation cools down. The index hit the 50.6 points mark signaling of improvements in the business environment.

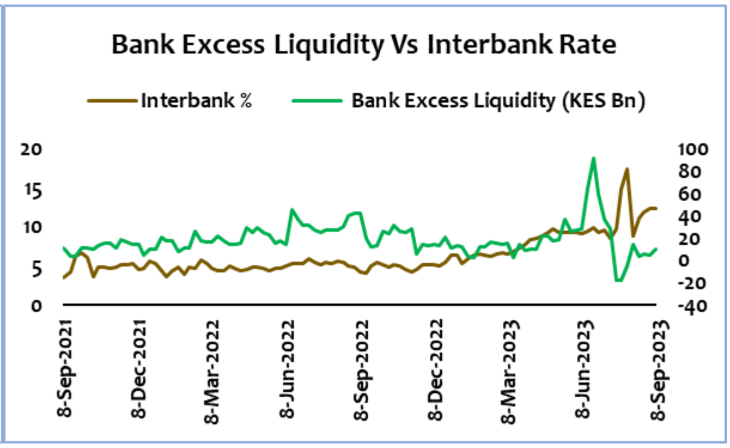


Interbank Rate

The interbank rate remains tight with an average of 12.42% in the first week of September while closing Bank Excess Liquidity remains strained, averaging at KES 4.8Bn in the month of August and KES 10.3Bn in the first week of September 2023 against a cash reserve requirement of 4.25%. In some weeks of July and August Bank excess reserves were at shortfalls of up to KES 18.2Bn.

With the high government appetite for funds, we revise our interbank forecast to the upper limit of the 250bps on the CBR rate within a range of 12.00% and 12.95% for the month of September. This on the heavy liquidity demand of KES 112.66Bn towards T-bill maturities and KES 41.49Bn T-bond coupon and maturity payouts for September 2023.



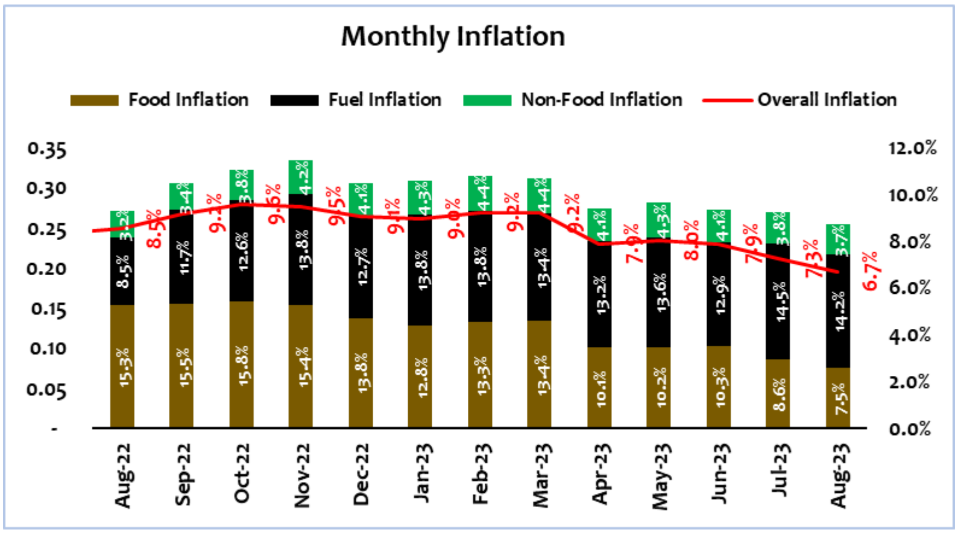


Inflation

Local inflation fell to 6.7% in August from 7.3% in July benefitting from the declining food inflation resulting from the long rains and the harvesting in western part of Kenya. Food inflation fell from 8.6% to 7.5% as that fuel also declined from 14.5% to 14.2%. Non-food inflation also fell marginally from 3.8% to 3.7% m-m.

Maize price declined 8.2% in August as supply from the harvesting western region went up pulling the prices down as that of potatoes and tomatoes went down 6.1% and 3.1% reaping off from the March-May rain season.

We forecast the food inflation to remain within a range of 6.0% and 7.0% on effect from declines in food inflation.



Currency

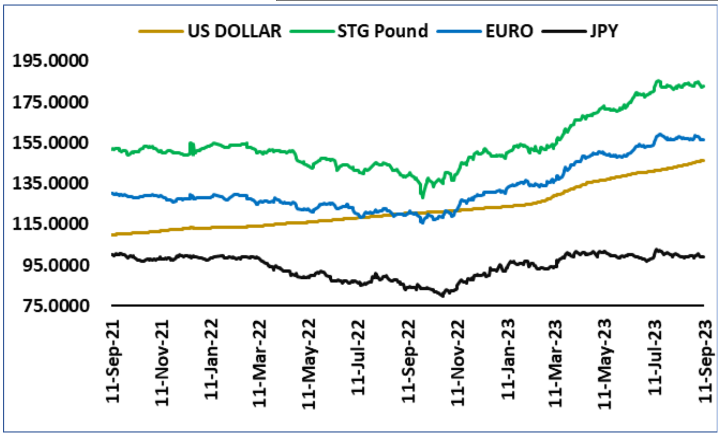
The local currency remains on the losing end against the US dollar weighed down by the heavy dollar demand both locally and in the global market. High demand to settle importation, debt payment and the recent political protests. The Shilling has shed 1.8% in the last one month from KES 143.58 to KES 146.22 per US dollar, representing acceleration from a previous month-on-month loss of 1.0%.

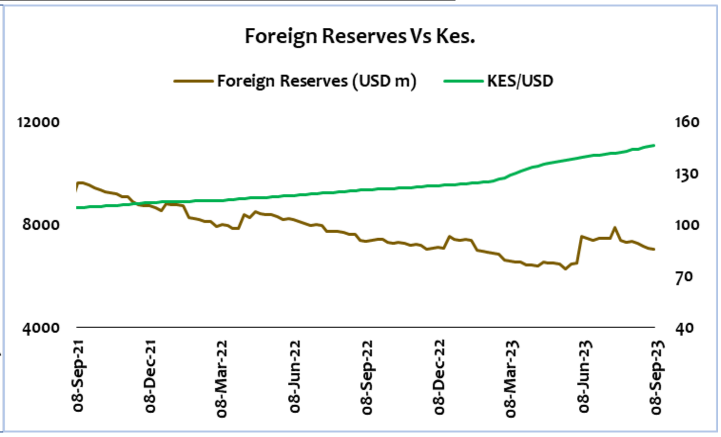
As the government-to-government oil importation payment comes due by end of August, we forecast the value erosion to remain to close the year at KES 150 the CBK rate. The US dollar gain has sustained a daily value gain of 0.1% against the Kenyan shilling in over the last one month.

Forex reserves stands at USD 7,051Mn, enough for 3.81 months of import cover, still below the 4-months import cover requirement for four weeks in arow.

We expect pressure on US dollar reserves to remain in the remaining of 2023 and 2024 on the upcoming USD 2.0Bn due in June 2024.

Currency	03-Jan-23	11-Aug-23	11-Sep-23	%Δ y-t-d	%Δ m-m
Dollar	123.42	143.58	146.22	-18.5%	-1.8%
STG Pound	148.73	183.25	182.60	-22.8%	0.4%
Euro	131.66	158.31	156.64	-19.0%	1.1%
JPY	95.24	99.56	99.16	-4.1%	0.4%
US Dollar Index	104.52	102.40	105.09	-0.5%	2.6%





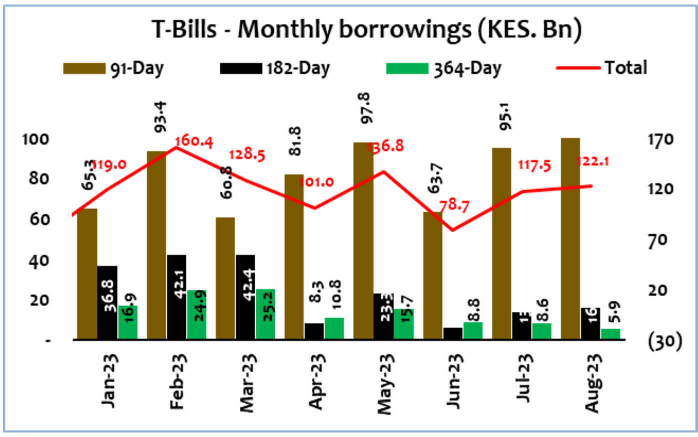
Treasury Bills

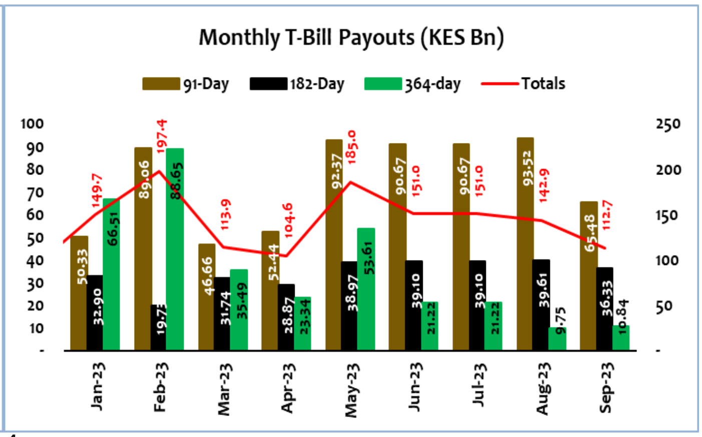
Investors continue preferring short-term papers as government demand for short-term cash remains elevated following heavy uptakes same period last year. This in return continues pushing returns across the papers higher with the 91-day paper touching a high of 14.2337% in the first auction of September.

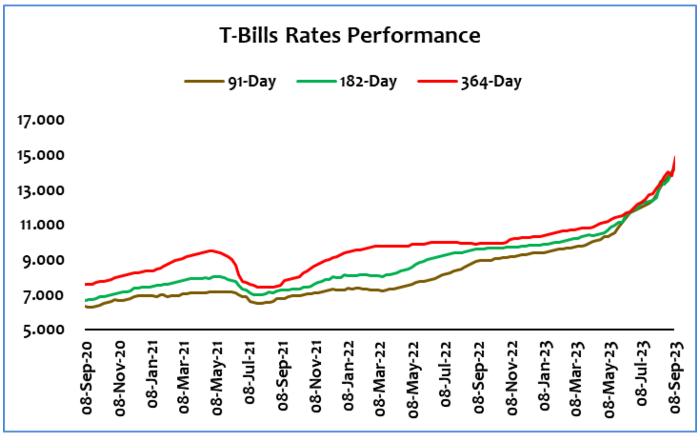
Investor preference remains on the 91-day paper with a subscription of 655.8% as its returns touched an 8-year high of 14.2337%, last witnessed in November 2015 where returns touched 19.47%.

The 364-day paper had the lowest subscription of 14.9% of KES as returns on the paper narrowed to 62.7bps from that oof the 91-day paper.

T-Bills Performance							
Tenure	Offer (KES Bn)	Subscription	Acceptance	Performance	Current WAR (%)	Previous WAR % 7/Aug/2023	w-w BPS y-t-d
364-Day	40,000	5,942	5,919	14.8%	14.860%	13.107%	175.3
182-Day	40,000	14,765	16,022	40.1%	14.369%	12.558%	181.1
91-Day	16,000	104,927	100,172	626.1%	14.234%	12.686%	154.8
Total	**96,000**	**125,634**	**122,113**	**127.2%**			







Bonds Market

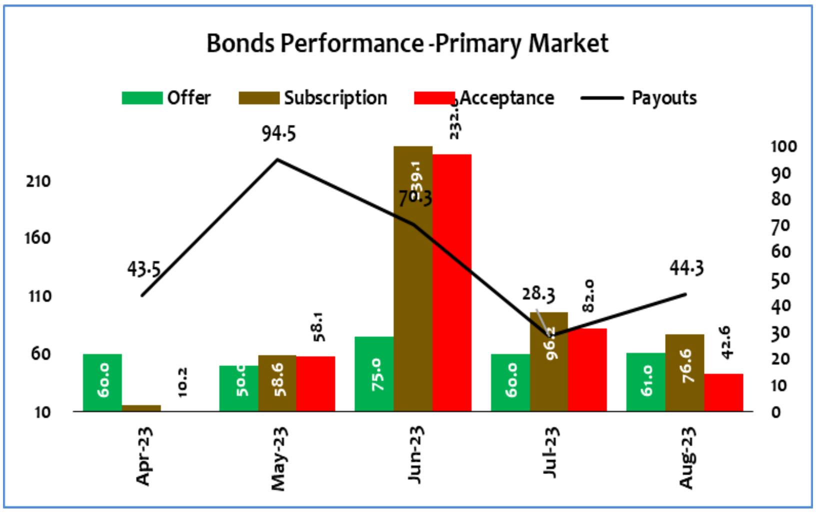
August saw a total of KES 53.31Bn being exchanged in the secondary market from a total of 2,329 deals in comparison to KES 74.88Bn traded in July and KES 68.39Bn of August 2022. The market activity were boosted by better returns in the on the run primary papers that helped activate the market.

The reopened FXD1/2016/10-Yr paper remains the most the most traded as investors start looking for better priced medium-term papers.

Top Bond Movers					
Bond	Value Traded (KES Mn)		Yirld Movement (%)		D Yields (bps)
	Jul-23	Aug-23	Jul-23	Aug-23	
FXD1/2016/10Yr	1,997.90	10,138.00	16.443	16.664	22.1
FXD1/2013/15Yr (Re-opened)	3,165.60	7,835.20	16.713	17.900	118.7
IFB1/2021/16Yr	461.90	4,342.10	14.957	15.331	37.4
IFB1/2023/7Yr	21,394.10	4,075.95	14.958	14.861	(9.7)
IFB1/2023/17Yr (Re-opened)	1,859.40	3,978.70	15.511	14.937	(57.4)
Total Mkt Value	**74.88**	**53.51**			

Investors continue preferring short-term paper government change its tactic to issuing short-term papers in a move to tap liquidity. The August auction saw the government receive a total of KES 76.71Bn at an acceptance of KES 42.61Bn on what we attribute to the aggressive bidding.

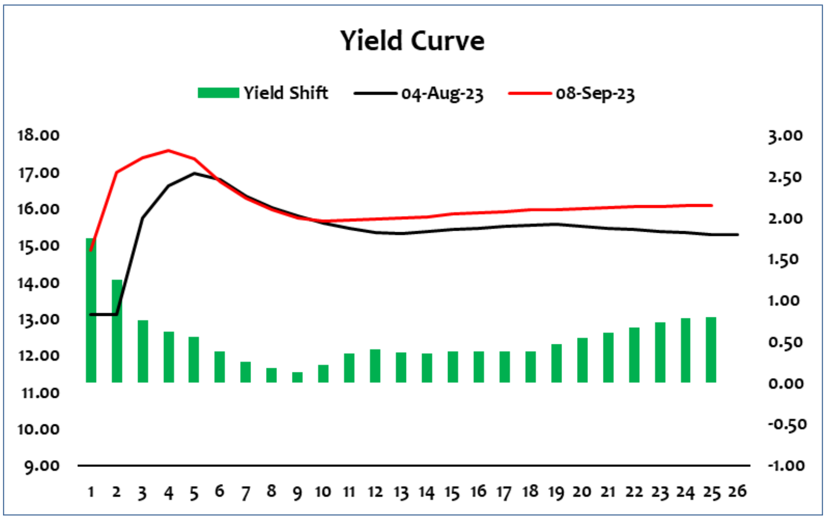
August 2023 Auction					
FXD2/2018/15	**offer (KES Mn)**	**Received**	**Acceptance**	**Market weighted rate**	**Coupon**
FXD1/2023/2	21,000	38,301.96	11,659.58	17.5545	16.972
FXD1/2023/5		14,704.44	7,456.28	18.1646	16.844
Tap Sale Auction – August					
FXD1/2023/2	21,000	17,375.70	17,373.51	16.9723	16.972
FXD1/2023/5		6,225.05	6,123.42	17.9538	16.844



Yield Curve

The short end of the yield curve continues widening on heavy demands for short-term papers even as the government opted to focus on the papers to tap liquidity. This is furthered by a tight liquidity environment that has left rates soaring.

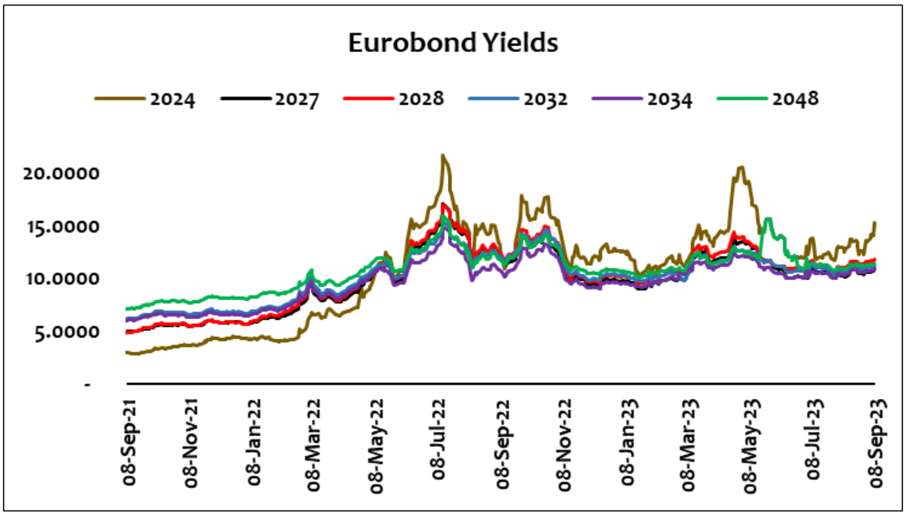
Yield Key Rates %	31-Aug-22	31-Jul-23	31-Aug-23	Δ bps y-y	Δ bps m-m
2-Yr	11.5443	14.9793	16.9935	544.92	201.42
5-Yr	12.8294	16.5656	17.5789	474.95	101.32
10-Yr	13.6441	14.7769	15.4545	181.04	67.76
15-Yr	13.9106	15.0007	15.7329	182.23	73.22
20-Yr	13.9753	15.2405	15.7640	178.87	52.35
23-Yr	13.9891	15.0500	15.8000	181.09	75.00



Public Debt

According to the government statistics for April 2023, public debt stands at KES 9,634.85Bn, representing a 13.7% year-on-year rise from KES8,470.42Bn same time 2022. Domestic debt stands at 47.1% or KES 4.54Trillion as the external debt contributes 52.9% of KES 5.09Tr as of April 2023.

We expect the external debt to remain higher, following the disbursement of USD 415.4Mn by the IMF approved on 17th July 2023. Domestic debt grew to KES 4.55Tr as of May 2023.

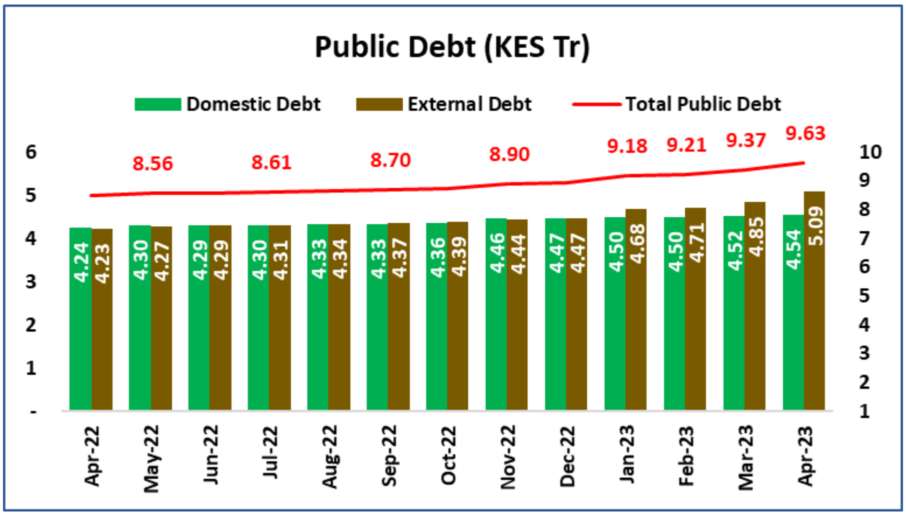


Eurobond

Yields on Kenya's international bonds remains on an up-hill just like the rest in the international market. In the last one-month yield in the June-2024 paper have gone 237,9bps higher immediately after the government confirmed shelved its buy back proposal that had reversed them downwards.

In our view the forex reserves remain enough for paying the maturing 2024 paper. This will further be supported by the IMF's extended fund and credit facilities for resilience and sustainability which is currently in the fifth review and disbursement.

Euro-bond Paper	03-Jan-23	08-Aug-23	08-Sep-23	Δ bps y-t-d	Δ bps w-w
Jun-2024	12.671	12.906	15.285	(261.40)	(237.90)
May-2027	9.724	10.279	10.984	(126.00)	(70.50)
Feb-2028	10.200	11.042	11.853	(165.30)	(81.10)
May-2032	10.314	10.734	11.208	(89.40)	(47.40)
Jan-2034	9.539	10.362	10.888	(134.90)	(52.60)
Feb-2048	10.708	10.933	11.405	(69.70)	(47.20)



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