KINGDOM SECURITIES

# Fixed Income Pre-Auction Note October 2023

# FXD1/2023/02

# FXD1/2023/05

# KES 55 Bn


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# Fixed Income Pre-Auction Note – October 2023

## Re-opening of FXD1/2023/02 and FXD1/2023/05

The National Treasury through the Central Bank of Kenya (CBK) is seeking Kes 55.0Bn for budgetary support by re-opening two bonds, FXD1/2023/02 - 1.9 years and FXD1/2023/05 - 4.8 years whose coupon rates are 16.9723% and 16.8440% respectively. We view the re-openings as a tactic to manage the cost of borrowing by the government that could otherwise be expensive if new papers were issued.

We expect investors to bid aggressively in a push for better discounts as the coupons are already set. This is further informed by tight liquidity in the market and other macro-economic conditions discussed hereafter.

Below is our bidding rate guidance:

| Bond | FXD1/2023/02 | FXD1/2023/05 |
|---|---|---|
| Amount | KES 55.00 Billion | |
| Tenure | 1.9-Yrs | 4.9-Yrs |
| Coupon | 16.9723% | 16.8440% |
| Period of Sale | 2nd to 11th October 2023 | |
| Auction Date | Wednesday 11th October 2023 | |
| Value Date | Monday, 21st August | |
| **Conservative** | **17.70% - 17.95%** | **18.20% - 18.45%** |
| **Aggressive** | **17.95% - 18.20%** | **18.45% - 18.60%** |

FXD1/2023/02 was first issued in August 2023 where the paper was undersubscribed at 95.8% of KES 38.30Bn at an acceptance of 30.4% or KES 11.66Bn. Later it was re-opened in September with 51.5% subscription and 83.3% acceptance against a target of KES 35.00Bn. With the high demand from the government, we expect the paper to be undersubscribed resulting to a tap-sale in this auction.

The FXD1/2023/05 was first issued in July 2023 with a subscription of 78.5% and an overall performance of 57.1% against a target of KES 40.00Bn. On its re-open, the paper attracted only KES 6.23Bn at a 98.4% acceptance.

In both papers and offers, the overall performance of both papers was supported by tap-sales after heavy rejections in the primary auction on aggressive bidding.

| FXD1/2023/02 | | |
|---|---|---|
| Last Issued on | August 2023 | Sept. 2023 |
| Mkt Average Rate | 17.5545% | 17. 5834% |
| Accepted Rate | 16.9723% | 17.4537% |
| Coupon | 16.9723% | 16.9723% |

| FXD1/2023/05 | | |
|---|---|---|
| Last Issued on | July 2023 | August 2023 |
| Mkt Average Rate | 17.0260% | 18.1646% |
| Accepted Rate | 16.8440% | 17.9538% |
| Coupon | 16.8440% | 16.8440% |

## Macro-economic conditions

The weakening local currency continues locking out foreign investments even as global interest rates hikes continue witnessing a recall cash from emerging markets especially from Africa. This leaves many African countries including Kenya depend on local financing, thereby pushing the rates even higher. The situation saw Kenya's new Eurobond muted since June 2022.

The Monetary Policy committee held on 3rd October retained the Central Bank rate (CBR) at 10.5% citing of its ongoing transmission in the economy and a relatively low inflation within a government target of between 5.0% and 7.5%. As of September, overall inflation stood at 6.8% elevated by the rise of pump prices.

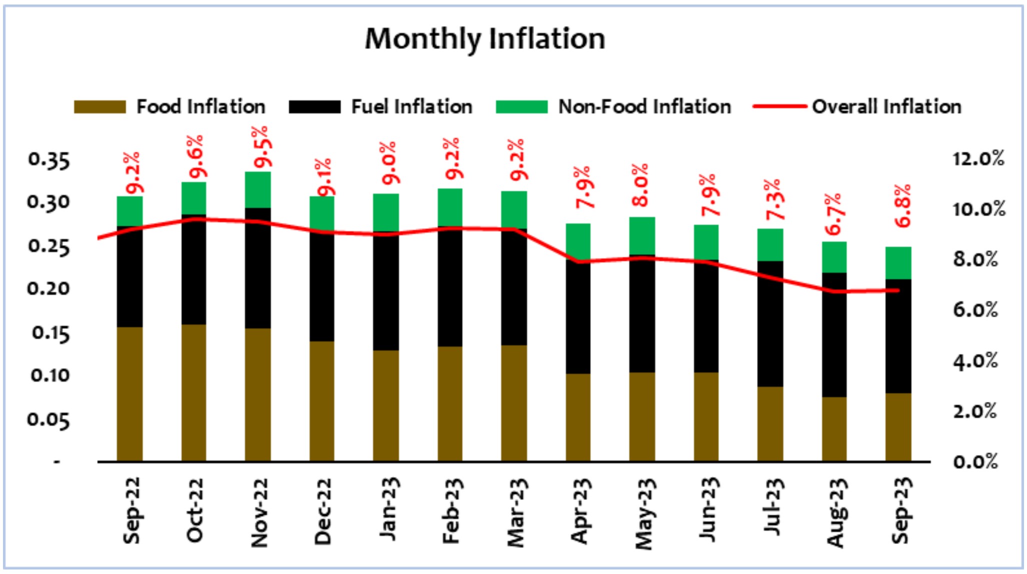
The current account deficit is estimated to improve from a deficit of 5.1% of GDP in 2022 to 4.1% of GDP in 2023 largely on what is estimated to be a faster growth in exports compared to imports. Currently the current account deficit stands at 3.7% of GDP as forex inflows spiked 3.2% up in the 12 months ending August 2023. Push for growth in manufacturing is expected to see its contribution to GDP rise to about 20% in 2030 from the current 7.2%.

The Purchasing Managers' Index (PMI) signals a weaker consumer demand on depressed consumer spending as a rise in cost of production is passed to the consumers. In Q3-2023, the PMI index averaged 48.0 points held down by a generally high inflation.

We expect the recent new taxation measures to stabilize the overall public debt and help in the development in the long run even as it impacts individual disposable income.

Overall, local economy remains steady on the recovery path, growing by 5.4% in GDP in Q2-2023 in relation to a growth of 5.2% same time last year. This was boosted by a 7.7% growth in agriculture supported by service sector, real estate and financial services.

| Revenues | | | | | |
|---|---|---|---|---|---|
| **Source** | **Original Estimate** | **Proportional** | **Actual receipt** | **% Receipt to Exchequer** | **% Receipt to Proportional** |
| Tax Revenues | 2,495.83 | 415.97 | 317.58 | 12.72% | 76.35% |
| **Total Revenues** | **4,132.74** | **688.79** | **502.38** | 12.16% | 72.94% |
| **Expenditure** | | | | | |
| **Expenditure** | **Original Estimate** | **Proportional** | **Actual receipt** | **% Receipt to Exchequer** | **% Receipt to Proportional** |
| Recurrent Exchequer Issues | 1,302.80 | 217.13 | 148.98 | 11.44% | 68.61% |
| Public Debt | 1,751.07 | 291.85 | 267.04 | 15.25% | 91.50% |
| CFS Exchequer | 212.62 | 35.44 | 32.98 | 15.51% | 93.05% |
| Development Exchequer Issue | 480.82 | 80.14 | 14.48 | 3.01% | 18.06% |
| Total Issues to National Gov'nt | 3,747.32 | 624.55 | 463.47 | 12.37% | 74.21% |
| Total Issues to County Gov'nts | 385.42 | 64.24 | 39.27 | 10.19% | 61.13% |



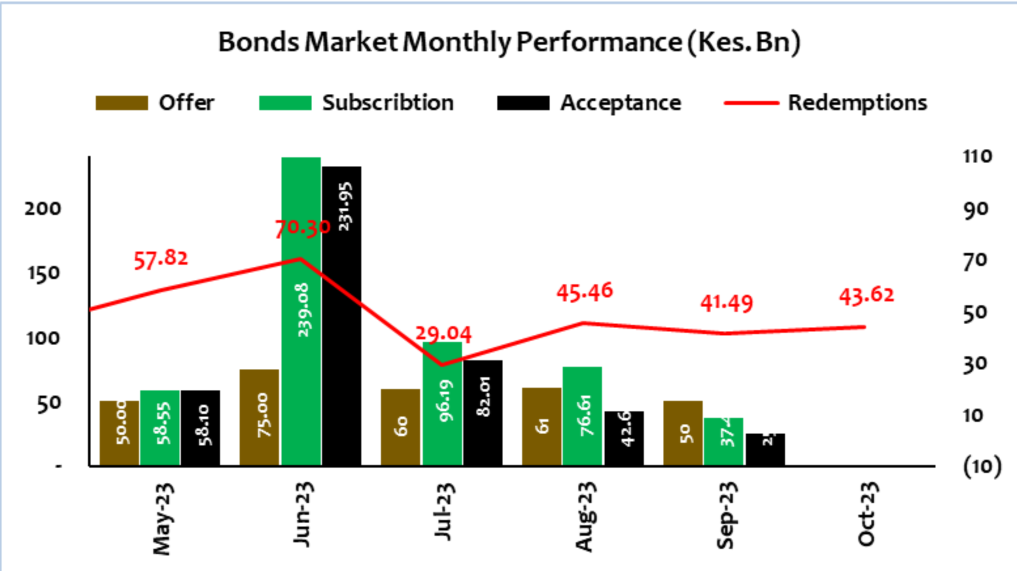
## Bonds Performance

High appetite for cash by the government and a tight liquid environment continue pushing rates higher. In October we expect a total of KES 43.62Bn payouts with KES 11.74Bn being maturities for IFB1/2011/012.

The short-term papers have been the most active in the secondary market, especially those entering the secondary market (on the run papers). This is caused by interest rate volatility in the market that continues attracting short-term papers even as the same is being witnessed in the primary market.

| September 2023 Auction | | | | | |
|---|---|---|---|---|---|
| FXD2/2018/15 | offer (KES Mn) | Received | Acceptance | Market weighted rate | Coupon |
| FXD1/2023/02 | 35,000 | 17.38 | 15.01 | 17.5834% | 16.9723% |
| FXD1/2016/10 | | 6.23 | 6.62 | 18.4865% | 15.0390% |

| Tap Sale - September 2023 Primary Auction | | | | |
|---|---|---|---|---|
| FXD2/2018/15 | offer (KES Mn) | Average Yield | Average Price Per KES 100 | Coupon |
| FXD1/2023/02 | 15,000 | 17.4537% | 101.1498 | 16.9723% |
| FXD1/2016/10 | | 17.9266% | 95.3871 | 15.0390% |

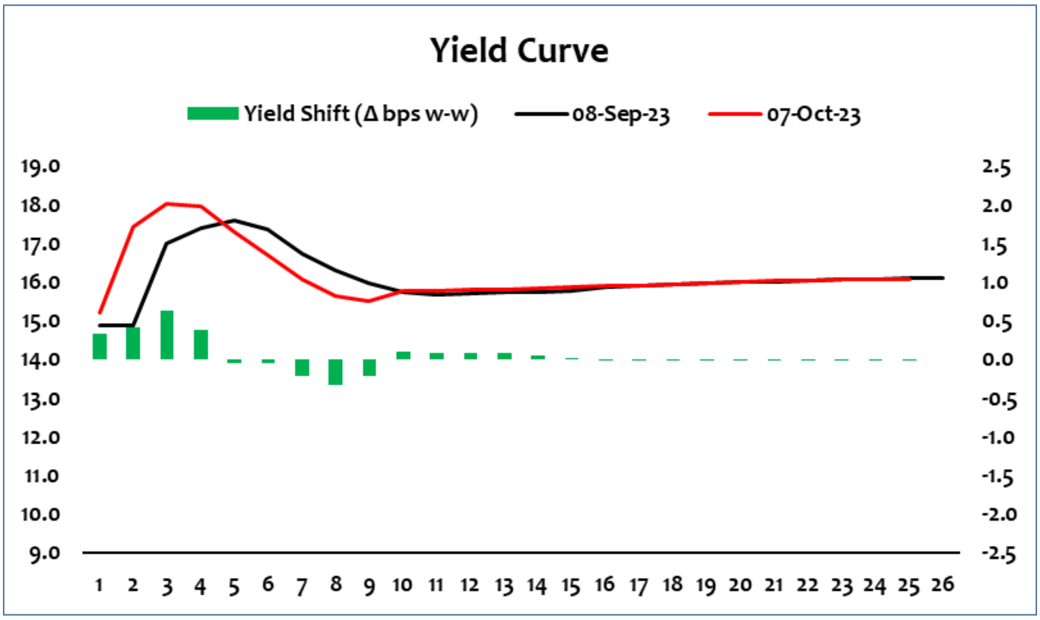



## Yield Curve

Heavy activity on the short end of the yield curve saw the short end shift upwards even as the gap widened further on high demand in the section. The middle to the long end relatively remained stable on little to zero activity in the section.

With the expected high demand for funds for the government and the tight market liquidity, we foresee a further widening of the short in the coming weeks till next year.

| Yield Key Rates % | 06-Jan-23 | 08-Sep-23 | 07-Oct-23 | (y-t-d) bps | (m-m) bps |
|---|---|---|---|---|---|
| 2-Yr | 12.1960 | 17.0006 | 17.4179 | -522.19 | -41.73 |
| 5-Yr | 13.5472 | 17.3511 | 17.2914 | -374.42 | 5.98 |
| 10-Yr | 13.7798 | 15.6668 | 15.7566 | -197.68 | -8.98 |
| 15-Yr | 13.9356 | 15.8527 | 15.8604 | -192.48 | -0.77 |
| 20-Yr | 14.0586 | 16.0057 | 15.9917 | -193.31 | 1.41 |
| 23-Yr | 14.2374 | 16.0843 | 16.0750 | -183.76 | 0.93 |

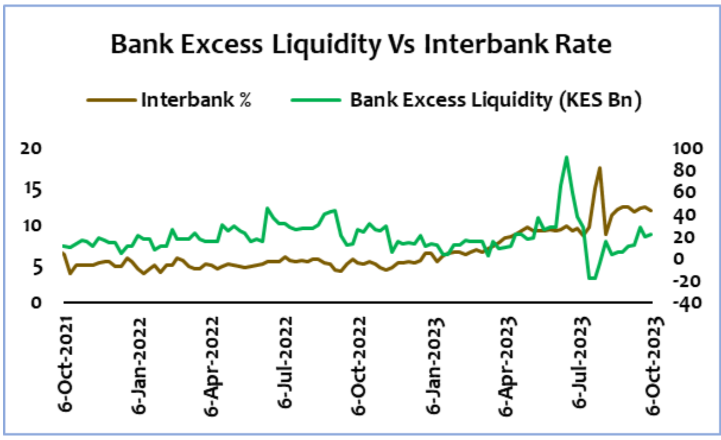


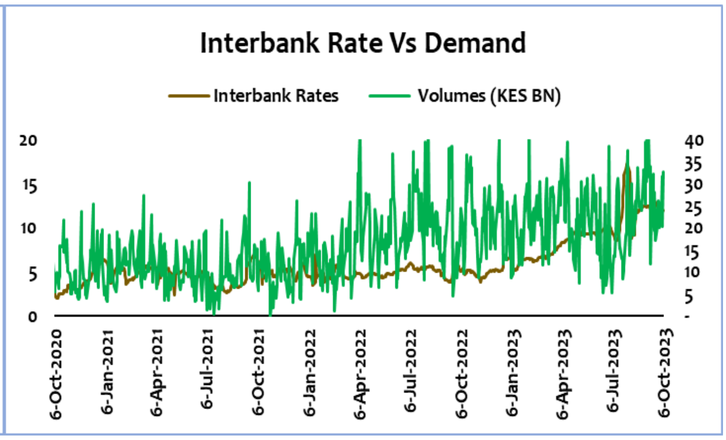

## Interbank

The current Interbank rate remains at the upper limit of the CBR rate, indicating tight liquidity in the market. In the last one-month, the average interbank rate stands at 12.27% as liquidity demand remained high at an average of KES 26.40Bn, same period.

Bank excess liquidity stands at an average of KES 7.1Bn, drained by high liquidity demand especially in the T-bill space whose rates have been very attractive.

We retain our forecast of the interbank to remain in the upper limit of the CBR within a range of 11.95% and 12.95%.

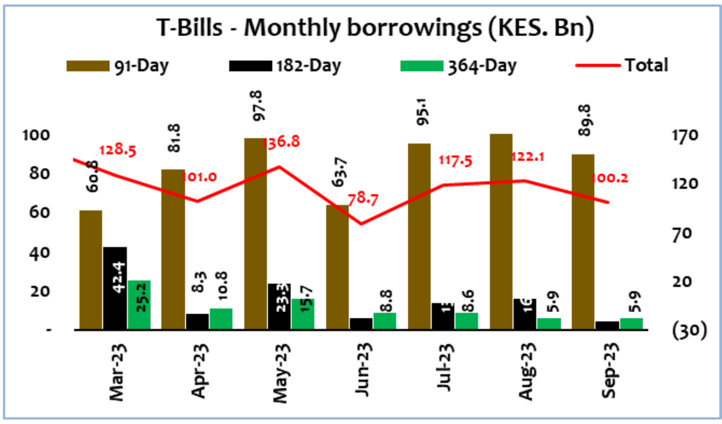


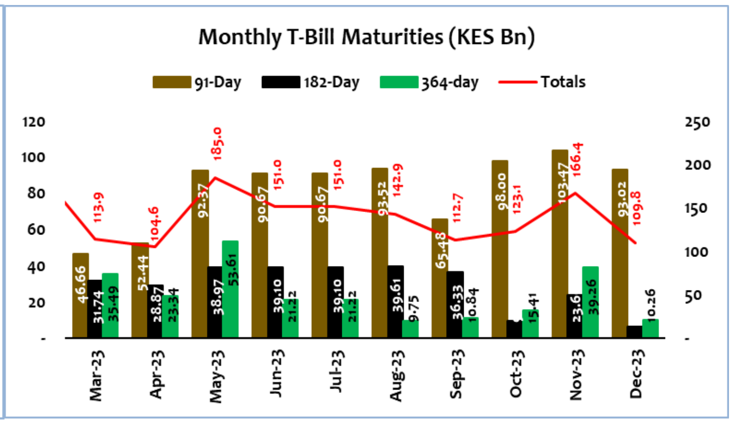



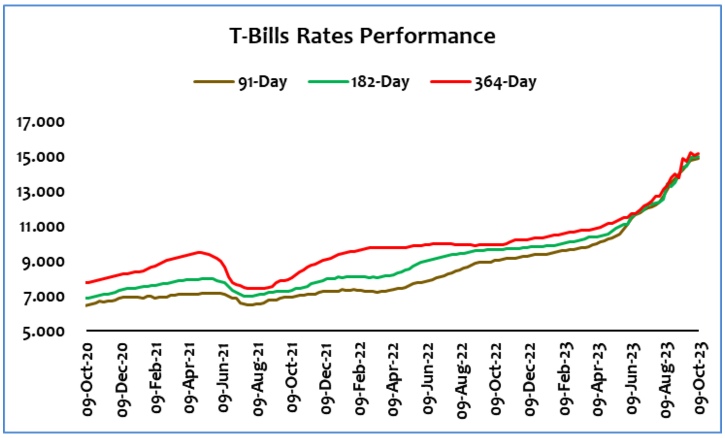

## Treasury Bills

Heavy demand for liquidity continues pushing returns on investment in Treasury bills higher. The 91-day paper hit an 8-year high at 14.87% in the last auction. The 182- and 364-day paper recorded a new high of 14.98% and 15.22% on 9th October and 25th September 2023 respectively.

With the 364-day paper operating above 15.00%, we expect this to impact the overall auction performance and push rates higher. We forecast heavy subscriptions to remain on the 91-day paper as the returns remain attractive



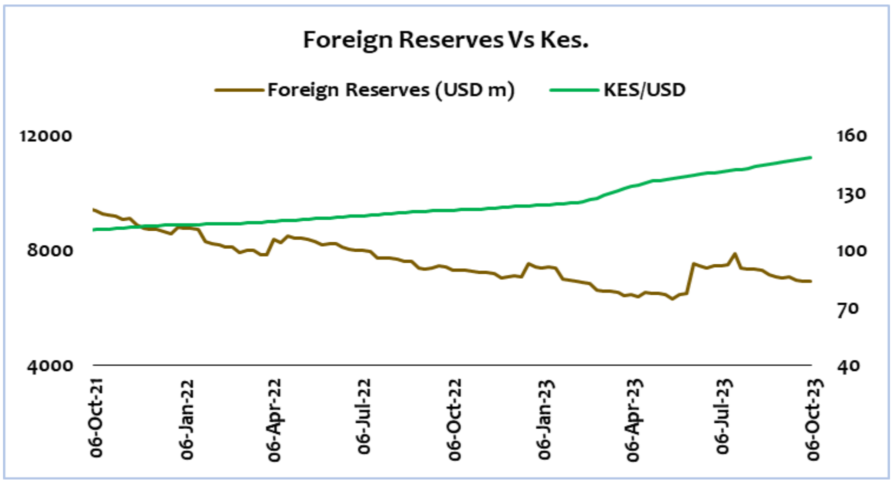




## Currency

The strengthening US dollar against the local currency continues worsening the external debt situation at an equivalent rate of appreciation. This further impacts the forex reserves ratios and overall impacts the balance of payments.

Currently exchanging at KES 148.69 per US dollar, CBK rate, the dollar is expected to trade at about KES 160.00 by the end of the year (2023) if the 0.1% daily value loss is not contained.

| Currency | 03-Jan-23 | 06-Sep-23 | 06-Oct-23 | %∆ y-t-d | %∆ w-w |
|---|---|---|---|---|---|
| Dollar | 123.42 | 145.91 | 148.69 | -20.5% | -1.9% |
| STG Pound | 148.73 | 183.28 | 180.47 | -21.3% | 1.5% |
| Euro | 131.66 | 156.63 | 156.37 | -18.8% | 0.2% |
| JPY | 95.24 | 99.02 | 99.90 | -4.9% | -0.9% |
| US Dollar Index | 104.52 | 104.86 | 106.04 | 1.5% | 1.1% |

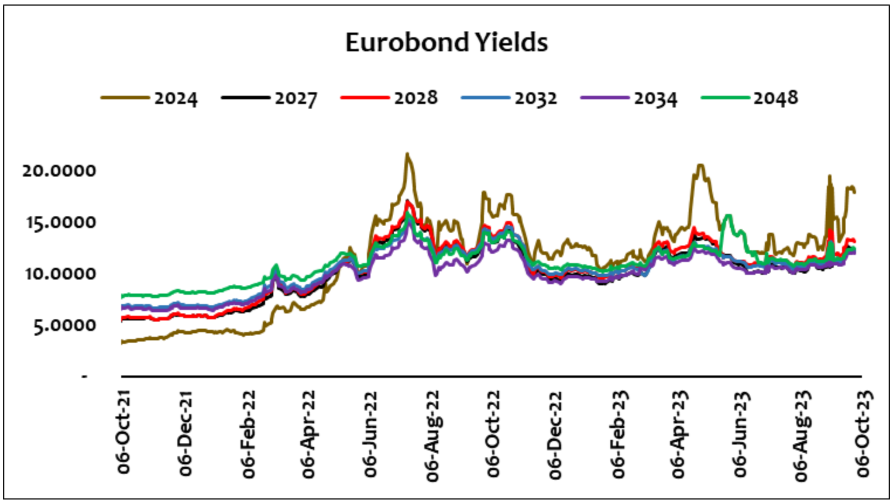



## Eurobond

Yields on international bonds continue remain high occasioned by the hiked interest rates globally. Locally, Kenya's Eurobond of USD 2.0Bn maturing in June 2023 is currently trading at 18.35%, a 417.50bps month-on-month value loss.

We expect the yields to remain elevated on the strengthening dollar and high demand for the same globally even as interest rates remain higher globally.

| Euro-bond Paper | 03-Jan-23 | 06-Sep-23 | 07-Sep-23 | Δ bps y-t-d | Δ bps w-w |
|---|---|---|---|---|---|
| Jun-2024 | 12.671 | 14.170 | 18.345 | (567.40) | (417.50) |
| May-2027 | 9.724 | 10.734 | 12.941 | (321.70) | (220.70) |
| Feb-2028 | 10.200 | 11.668 | 14.015 | (381.50) | (234.70) |
| May-2032 | 10.314 | 11.163 | 12.908 | (259.40) | (174.50) |
| Jan-2034 | 9.539 | 10.832 | 12.584 | (304.50) | (175.20) |
| Feb-2048 | 10.708 | 11.426 | 12.830 | (212.20) | (140.40) |



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