KINGDOM SECURITIES

Fixed Income Pre-Auction Note November 2023

IFB1/2023/6.5 KES 50 Bn

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NOVEMBER 2023 PRIMARY AUCTION

An Amortized Infrastructure Bond

The Central Bank of Kenya issued a new infrastructure bond of 6.5-years targeting KES 50Bn from the market to fund infrastructure projects for the financial year 2023-24. This becomes the third infrastructure bond issued in 2023.

The new issue comes in a move to tap liquidity by the government, even as the overall market remains affected by low liquidity resulting to an upward shift in the yield rates. Re-opening of existing papers witnessed low subscriptions from investors on un-attractive returns considering the macro-economic condition.

This bond therefore presents good opportunity for better pricing even as the tax-free element remains attractive.

Below is our bidding rate guidance:

Bond	IFB1/2023/6.5
Amount	KES 50 Billion
Tenure	6.5-Years
Coupon	Market Determined
Period of Sale	20th Oct. to 8th Nov. 2023
Value Date	Monday, 13th November 2023
Conservative	17.50% - 17.75%
Aggressive	17.76% - 18.00%

We expect an oversubscription with low acceptance from the government trying to manage its cost of borrowing. This follows the expected aggressive/high bidding as investors push for better returns amid a tight liquid environment that have seen returns on bank savings attract as high as between 8.0% and 14.0% while that treasury bills touching above 15.0% per annum.

CBK

The general bonds market yields remain on an upward trend with the Central Bank of Kenya retaining the lending rate at 10.5% on its last meeting on 3rd October 2023. We forecast the CBR to remain flat at 10.5% in next two months due to:

- The inflation rate is expected to remain within the government range of 5%±2.5% supported by increased food supply especially from the Western food basket region. Constraints however are expected from pump prices if the Middle East wars escalate.
- The new interbank policy framework pegged on the CBR±250 basis points remain effective in reducing volatility. The interbank rate hover remains on the upper side of the CBR corridor above 12.0%.
- The banking sector remains stable with adequate liquidity ratios and capital ratios. Profit before Tax (PBT) for listed banks went up 5.9% from KES 122.78Bn in H1 2022 to KES 129.77Bn in the first half of 2023. Non-performing loans however pose a challenge with the ratio rising from 14.2% in August 2022 to 15.0% in August 2023, on delayed payments from manufacturing, building and construction, mining, and real estate.
- Growing economic output is expected to drive the current account deficit to 4.1% in FY 2023 from 5.1% in 2022 supported by expected rise in exports on the government campaign for product value addition through creation of industrial parks. As of August 2023, the current account deficit was at 3.7% of GDP.
- Pressure will continue piling on Kenya's forex reserves especially on the upcoming Eurobond coupon payments for the May-2032 and June 2024 papers. This is expected to extend to the mid of 2024 after

payment of the USD 2 billion is due for payment. Dividend payouts for FY 2023 financials especially add more pressure to the shilling.

Inflation

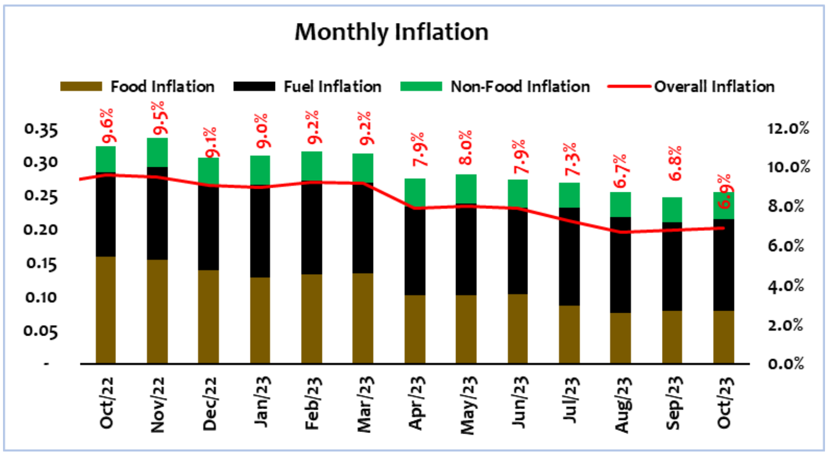
Inflation was 10bps m-m up from 6.7% in September to 6.9% in October 2023 on price rise in transport and some food items which outweighed declines of prices especially in Maize. Year on year inflation remained down compared to 9.6% of October 2022.

Food and non-alcoholic beverages inflation was up 7.8% m-m but lower in relation to 15.8% same time last year. Fortified and sifter maize flour was down 2.0% m-m and 2.7% y-y on increased maize supply from the harvesting western region of Kenya.

Transport inflation was up 13.6% from 13.1% the previous month being elevated by an upward review of pump prices that happened in mid-October 2023. Prices of petrol and diesel were 2.7% and 2.2% up to KES 217.97 and KES 206.21 per litre respectively.

We maintain our forecast on inflation to remain within a range of 6.8% and 7.5% in November and December 2023 held up by constraints from:

- High food demand for the festive season which will push prices up
- Continued oil supply cut by Saudi Arabia and Russia which will impact prices upwards
- expected high demand for oil from China, the world's top importer, to push prices higher globally.

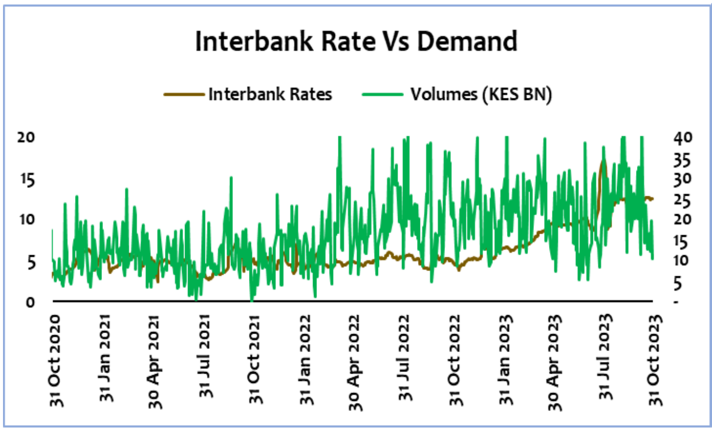


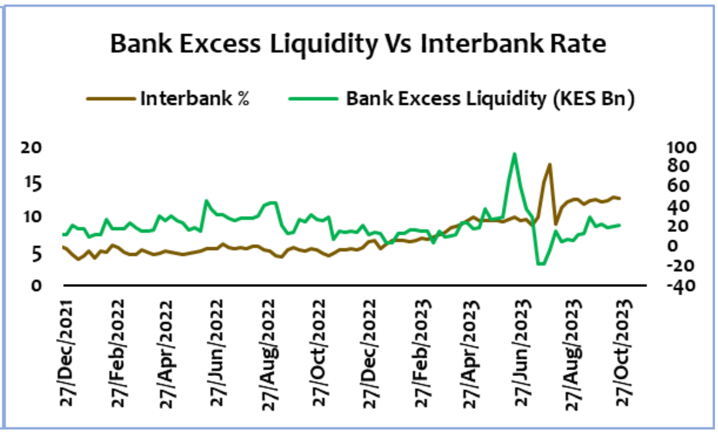
Interbank

Interbank rate closed the month of October at 12.52% with an average of 12.33% in relation to an average of 12.35% in September and 5.08% of October 2022.

We forecast the interbank rate to operate above the CBR rate within a range of 12.0% and 12.75% in November and December due to:

- Tight liquidity in the market and high demand for cash by the government for debt obligation and budget
- Heavy demand for liquidity by banks with some giving returns of as high as 14.0%
- National Treasury through CBK to drain liquidity from the market by issuing a tap sale on the IFB issue

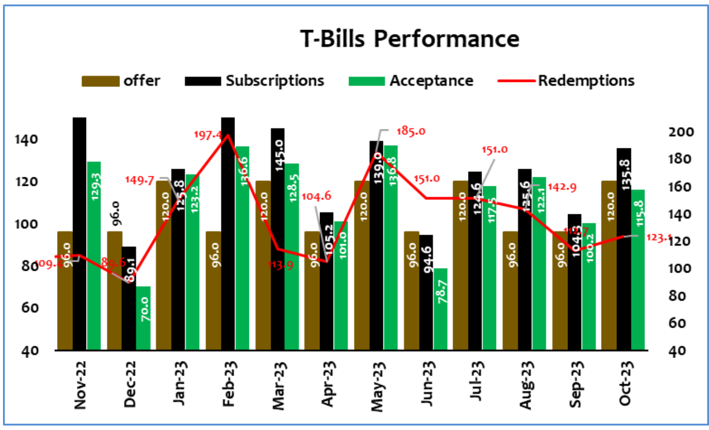


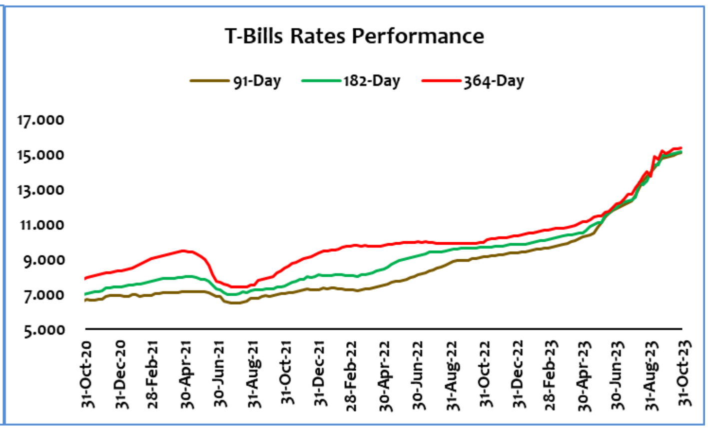


Treasury Bills

Appetite for cash by the government continues to drive rates on the Treasury Bills higher even as investors demand better compensation on low liquidity in the market. The 91-, 182 and 364-day papers touched new highs of 15.11%, 15.13% and 15.39% respectively in the last auction.

Reinvestments remains very key in the overall subscriptions.





Currency

Kenya shilling has lost 22.2% y-t-d and 24.3% y-y against the US dollar on a high dollar demand globally worsened aggravated by high external public debt, low forex inflows from exports in relation to imports especially import of oil.

We forecast the shilling to close the year at above KES 156.00 on the following:

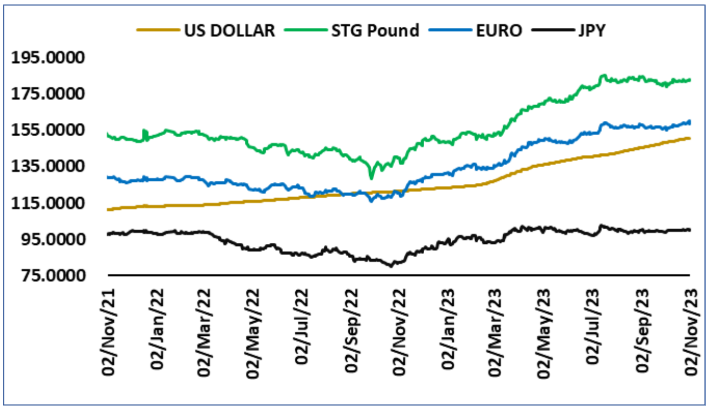
- Upcoming coupon payments for May 2027 and June 2024 are happening in November and December 2023 respectively.
- Settlement of government-to-government oil import deal
- Rising international oil prices globally.
- A strong US dollar on better US macroeconomic environment pushing the dollar up
- Low forex reserves currently standing at USD 6,836Mn (as of 26th Oct. 2023) enough for 3.67 months of import cover against a 4.0-month requirement.

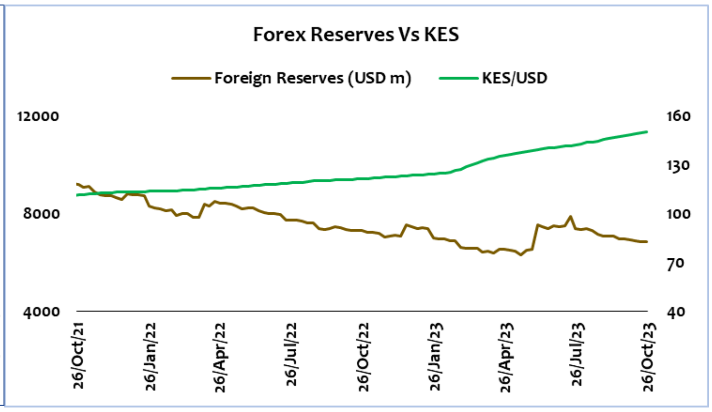
Relief is however expected from:

- Payment of the USD 2.0Bn due in June 2023
- Expected rise in exports supported by government initiative of value addition via industrial parks
- Growing domestic consumption which will aid the manufacturing sector
- Better agricultural production expected on resumption of rains after a long drought and government subsidy particularly on fertilizers and planting seeds
- Expected spike in forex remittance in the festive season.

This will aid the expected economic growth of 5.5% and reduction of the current account deficit, supporting the shilling on overall.

Currency	01-Nov-22	03-Jan-23	02-Nov-23	%Δ y-t-d	%Δ y-y
Dollar	121.38	123.42	150.86	-24.3%	-22.2%
STG Pound	139.79	148.73	182.73	-30.7%	-22.9%
Euro	120.34	131.66	158.88	-32.0%	-20.7%
JPY	81.60	95.24	100.28	-22.9%	-5.3%
US Dollar Index	111.48	104.52	106.37	-4.6%	1.8%





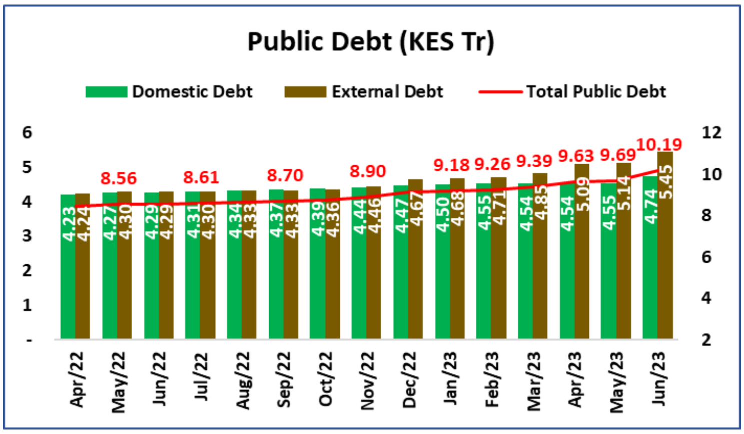
Public Debt

Statistics from Central Bank indicated a total public debt of KES 10.19 trillion as of June 2023, having grown 11.0% and 18.8% in the first six months of 2023 and 12-months ending June 2023.

External debt went up and stood at KES 5,452Bn representing 53.5% of the overall debt, with additions of KES 771.82Bn (16.5%) and KES 1,162.16Bn (18.8%) in first half and year ending June 2023.

The faster rise in external debt is largely attributed to the strengthening of the US dollar in which much of the loan is denominated.

Domestic debt was up 5.2% in the first half of 2023 and 10.5% year-on-year.

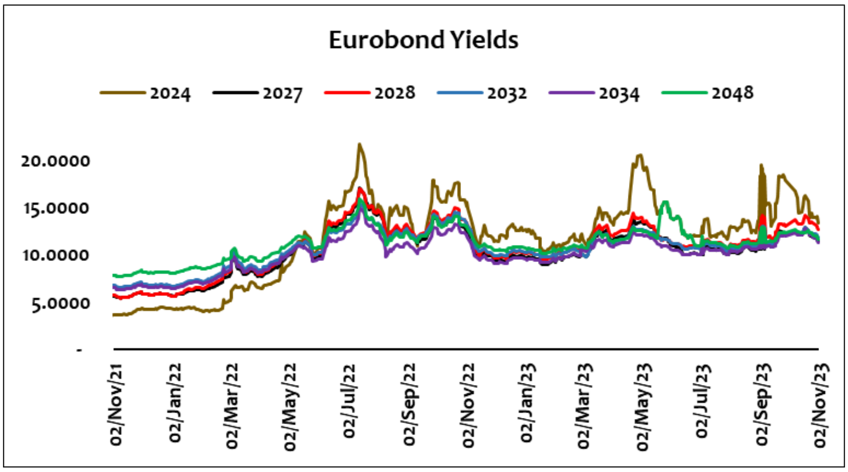


Eurobond

Yields on Kenya's international loans to continue relaxing following Kenya's plan to buy back up to USD 500Mn from the secondary market in an aim to address the debt liability. Until the transaction happens, investors will see the yield rates decline in a move to improve their bond values.

After the transaction, the yields will however make U-turn upwards on the weakening Kenyan shilling and the depressed forex reserves even as the government works on boosting the forex through more exports.

Euro-bond Paper	02/Nov/22	03/Jan/23	02/Nov/23	Δ bps y-t-d	Δ bps y-y
Jun-2024	15.088	12.671	13.415	(74.40)	167.30
May-2027	12.580	9.724	11.415	(169.10)	116.50
Feb-2028	13.398	10.200	12.699	(249.90)	69.90
May-2032	13.366	10.314	11.875	(156.10)	149.10
Jan-2034	12.076	9.539	11.338	(179.90)	73.80
Feb-2048	13.006	10.708	11.714	(100.60)	129.20



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