KINGDOM SECURITIES

Fixed Income Pre-Auction Note

February 2024

IFB1/2024/8.5

KES 70 Bn

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The First 2024 Infrastructure Bond – IFB1/2024/8.5

The National Treasury continues to show heavy demand for liquidity to settle heavy treasury bills and bond maturities that come due in February 2024. Total payouts of KES 281.27Bn maturities and coupon payouts will happen in the month thus the need for this infrastructure bond.

Bond maturities and coupon payouts stand at KES 118.16Bn with KES 65.36Bn being a redemption for FXD1/2019/005 as T-bills payouts stand at KES 163.11Bn in February 2024.

We expect the paper to attract heavy subscriptions even as the government manages its cost of borrowing. Below are our bidding rate recommendations:

Bond	IFB1/2024/8.5
Tenure	8.5 – Years
Amount	KES 70 billion
Coupon	Market Determined
Period of Sale	24th Jan. – 14th Feb. 2024
Auction Date	14th February 2023
Value/Payment Date	19th February 2023
Conservative	18.60% - 18.85%
Aggressive	18.86% - 19.10%

The IFB1/2024/8.5-year paper is amortized with three principal redemptions which is expected to attract investors especially retail investors:

Investments of KES 1 million and below, will be redeemed in full on 15th Feb 2027 – after 3 years. Amounts above KES 1.00Mn will be redeemed as follows:

a. 20% will be paid back on 15th Feb 2027
b. 30% of remaining principal on 11th Feb 2030 - after 6-years
c. 50% of principal cleared on 9th August 2032 (after 8.5-years). As is the case for infrastructure bond papers, the paper is tax free.

We forecast aggressive bidding in the paper on the elevated lending rates in the market worsened by the recent upward adjustment of Kenya's Central bank rate (CBR) from 12.5% to 13.0%, February 2024. The CBK will tend to accept conservative or lower rates in a way of managing its costs.

The CBK Monetary Stance

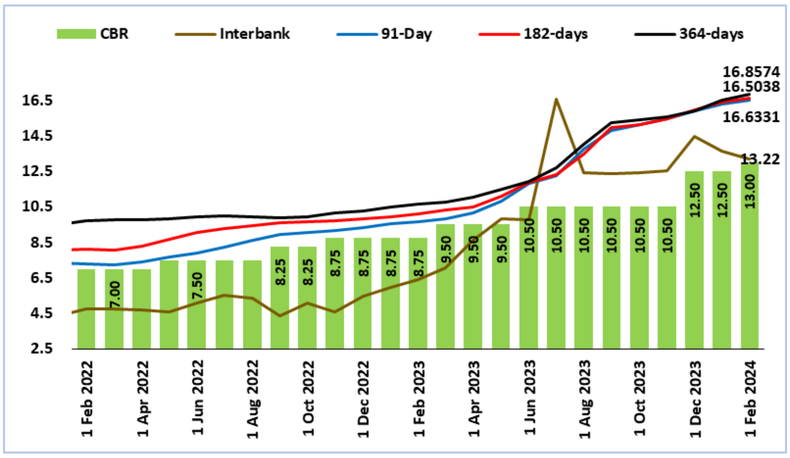
The MPC met on 6th February where the Central Bank Rate (CBR) was further raised by 50.0bps from 12.5% to 13.0% while re-affirming some of its recent policies and later giving direction of the looming USD 2.0Bn Eurobond maturity. The MPC signaled strong economic growth with the government revising new economic estimates for 2023and 2024 at 5.6% and 5.7% respectively.

- The MPC defended its rate hike to tame inflation and the local currency devaluation that had gone almost out of hand.
- January 2024 inflation of 6.85% is geared to edge down to levels of near 5.0%.
- Recent measures on the interbank forex market of new electronic matching of forex rates and publishing of an average of all interbank transactions instead of selected few has also contributed to the stability of the shilling in the last three weeks ending the first week of January 2024.

- Forex reserves stand at USD 7,101Mn, adequate for 3.81 months of import cover on inflows from the IMF and World bank expected for development.
- Issuance of new international bond for the buyback of the USD 2.0Bn maturing in June. The Buy back offer closes on 14th February 2024 while, the new Eurobond issued is expected to be priced on 12th February 2024.
- Government exiting the government-to-government (G-G) oil deal and leave market force/competition to take effect.
- Despite a tight credit environment, banks credit growths remain strong, growing at

Constraints facing the positive monetary stance:

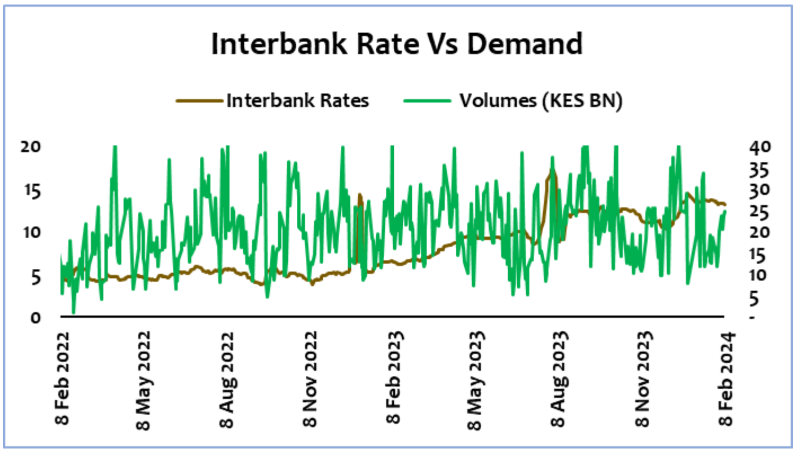
- Credit market risks marked by high non-performing loans in the banking sector have resulted to heavy loan loss provisions and strained capital ratios in some banks.
- Higher inflation was elevated by high imports, especially oil imports.
- Unfavorable and new tax measures that seem unattractive especially to foreigners.
- Low manufacturing activity strained by high cost of importation low consumptions.
- Tight liquidity levels in the market have seen the interbank rate operate above 13% since early December 2023.



Interbank rate

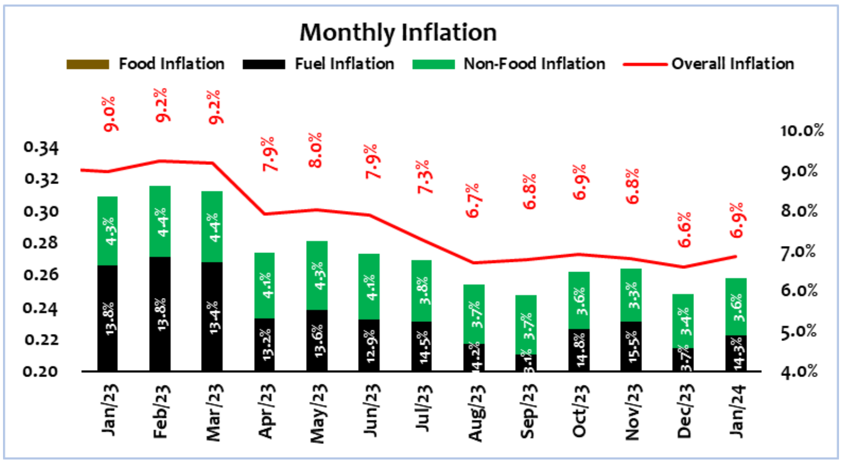
Poised by the previous review of the CBR and high demand for cash by banks, the interbank rate continues to average at above 13% as witnessed in the last one month.

We expect a slow transmission of the new CBR rate in the market even as liquidity is expected to improve in the near term on heavy upcoming maturities from domestic debt holdings. We forecast the interbank to remain almost touch levels of 13.0% in the next one month.



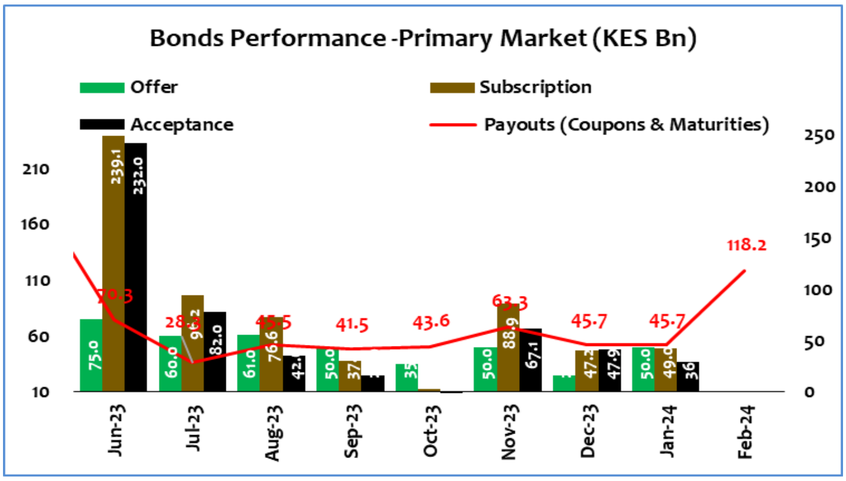
Inflation

- Kenyan inflation remains sticky averaging at 6.8 in the last six months, but still low compared to that of 9.0% witnessed same time last year.
- Food inflation remains the largest contributor to the 6.9% inflation of January at 3.01%, followed by fuel at 2.81% as non-food items contribute about 1.03% of the overall inflation. Rise in non-food inflation is attributed to the seasonal rise in education related costs.
- Fuel inflation is projected upwards upon review of the fuel levy on road maintenance that is proposed to rise from 18% to 23%. Electricity contribution to fuel inflation adjusted upwards at 4.7% on effect from the forex rate.



Primary Market Bonds Performance

Heavy government uptakes of November 2023, fall due in February 2024 which will continue putting the government under pressure if not spread in the medium term.



Eurobond Offering and Buyback

In a mover to alleviate fears of ability to pay the maturing USD 2 billion Eurobond, Government of Kenya opened a buyback offer for the USD 2.0Bn by way of issuing a new Eurobond. 'Funds from new debt security will be used to purchase the Eurobond maturing in June-2024, said the government.

The new Eurobond will be priced on 12th February 2024.

The buyback offer is priced at par with the accrued interest as at the date of the buyback and will close on 14th February 2024.

We expect an oversubscription in the Eurobond as informed by oversubscriptions in the recent two African countries' Eurobond issued. The offerings come after a 100bps decline in US's yield rates late January 2024 from 5% to 4%.

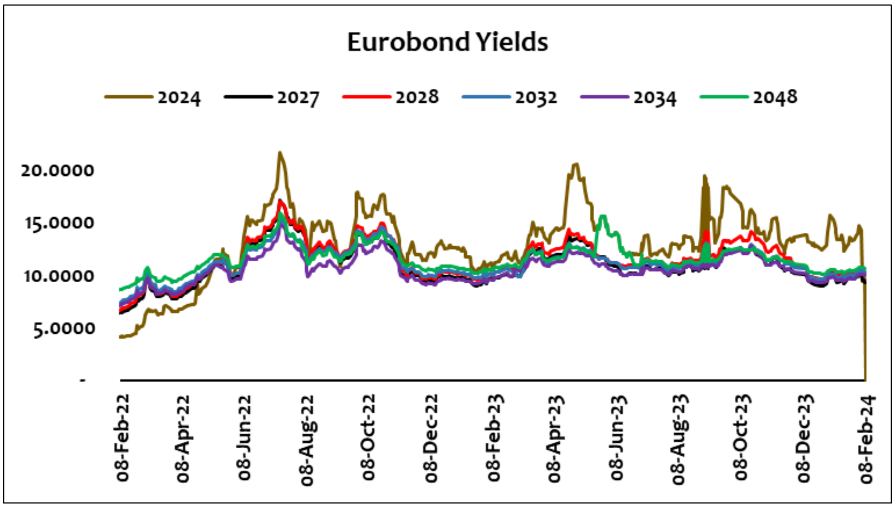
- Ivory Coast's two Eurobonds were oversubscribed at USD 8.0Bn with the authority accepting USD 2.6Bn. The interest rates for the paper were 6.30% and 6.85% for the 8- and 13-year paper respectively.
- In Benin, the country sold USD 750Mn in the first week of February 2024, and surprisingly witnessed a 566% oversubscription USD 5Bn at a pricing below 8.375%.

We anticipate a minimal impact from the Eurobond on the IFB1/2024/8.5 performance as the government appears to be very strategic on the move.

Upon the above announcement, yield rates on the June 2024 paper fell 486.8bps in a single day from 14.28% to 9.42%. Rates on the May-2027 and February 2028 also so their yield rates decline following the declaration.

However, the drop in yield to maturity rates do not have an impact on the buyback value since the bond is purchased back at par considering only the accrued interest.

Euro-bond Paper	08-Feb-23	08-Jan-24	08-Feb-24	Δ bps y-y	Δ bps m-m
Jun-2024	10.692	15.274	9.624	106.80	565.00
May-2027	9.567	9.860	9.350	21.70	51.00
Feb-2028	10.043	10.466	10.244	(20.10)	22.20
May-2032	10.042	10.135	10.300	(25.80)	(16.50)
Jan-2034	9.572	9.816	9.955	(38.30)	(13.90)
Feb-2048	10.528	10.503	10.615	(8.70)	(11.20)



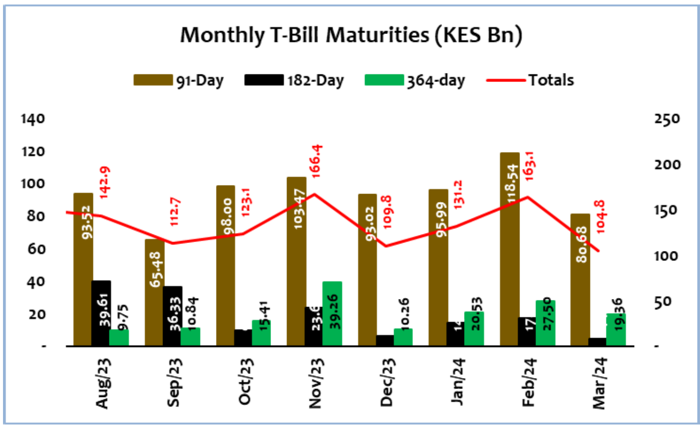
Treasury Bills

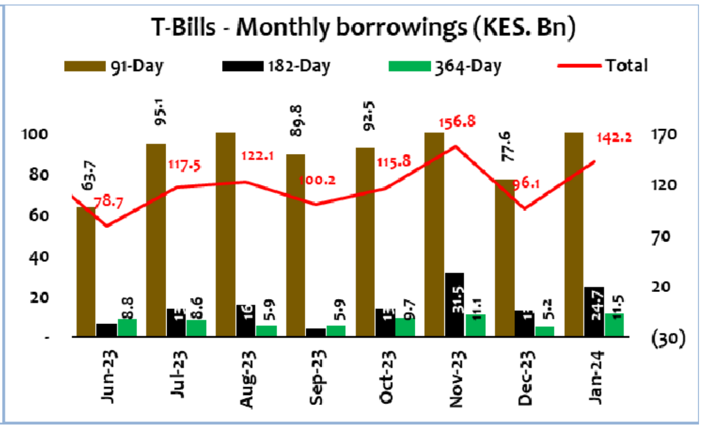
Heavy government uptakes of November 2023, fall due in February 2024 which will continue putting the government under pressure if not spread in the medium term.

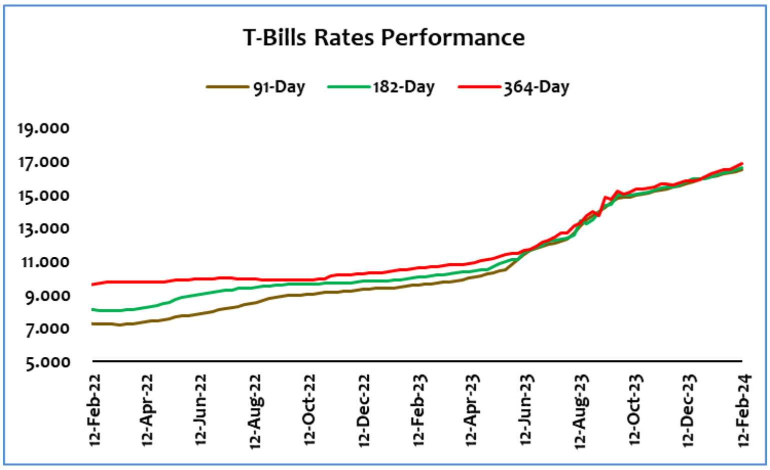
Total of maturities of KES 163.11Bn is due in February 2024, with the 91-day paper contributing 72.7% of the total at KES 118.54Bn.

We forecast the rates to further rise in the coming auctions till the Central Bank introduces rate cuts.

We advise our clients to be keen and take advantage of the better rates, especially in the amortized infrastructure bond papers as we project rates to rate cuts to take effect in the third quarter of 2024.







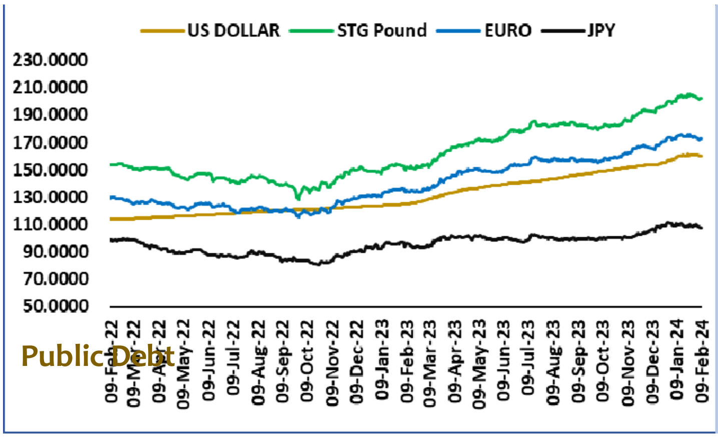
Currency

Developments in the interbank forex market by the monetary policy committee has seen early signs of the Kenyan shilling stabilizing, further supported by the government exiting the oil importation deal.

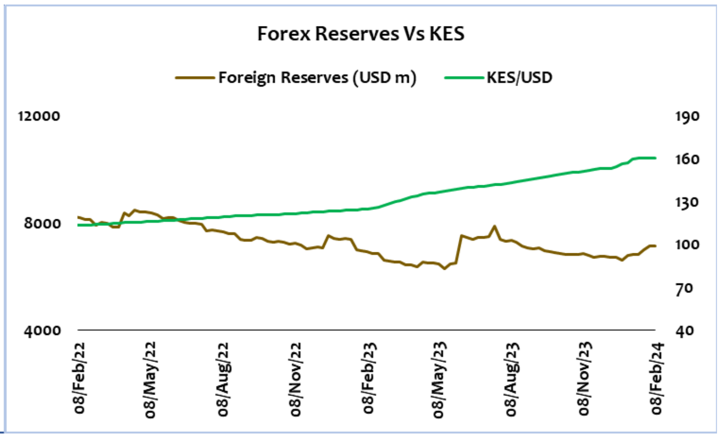
All these combined with better projections in the local economy is set to see the local currency remain stable and even gain in the coming days.

In the last one month, the shilling forex rate against the US dollar has stabilized at an average of KES 160.51 per dollar. See below rates against the four major currencies.

Currency	09-Feb-23	09-Jan-24	09-Feb-24	%∆ y-y	%∆ w-w
Dollar	124.98	158.88	160.09	-28.1%	-0.8%
STG Pound	150.94	202.46	202.00	-33.8%	0.2%
Euro	134.14	174.29	172.43	-28.5%	1.1%
JPY	95.26	110.33	107.16	-12.5%	2.9%
US Dollar Index	104.11	102.57	104.18	0.1%	1.6%



Public Debt

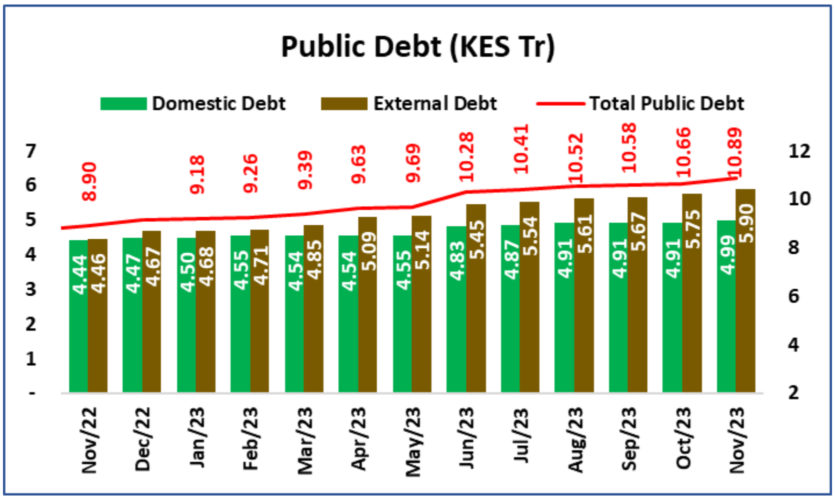


Public Debt

Official statistics indicate Kenya's total public debt at KES 10.89Trillion by end of November 2023, a 22.3% y-y rise from KES 8.90Tr in November 2022.

Domestic debt rose 12.5% y-y from KES 4,435.94Bn to KES 4,990.80Bn same period to contribute 45.8% of the total debt. Government Treasury bonds constitute 84.7% of domestic debt as T-Bills contribute 11.5%.

External debt rose faster at 32.1% y-y from KES 4,462.89Bn to KES 6,896.50Bn, largely attributed to a 25.1% depreciation in the local currency against the US dollar from KES 122.45 to KES 153.50 per dollar.



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