KINGDOM SECURITIES

Fixed Income
Pre-Auction Note

October 2024

FXD1/2016/010

FXD1/2022/010

KES 30Billion

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PRIMARY PRE-AUCTION NOTE – OCTOBER 2024

The National Treasury re-opened two papers, FXD1/2016/010 and FXD1/2022/010, seeking KES 30 billion from the public for the month of October 2024 budgetary support.

The auction comes after the government payment of KES 31.95Bn for FXD1/2009/15 that matured on 7th October 2024, and payment of KES 24.13Bn coupon payouts also due on Monday, 7th October 2024. This lifts KES 56.08Bn demand out of a total of KES 75.59Bn government demand for October 2024 maturities and coupon payouts.

Further, the auction will take place immediately after the anticipated second interest rate cut anticipated for Tuesday, 8th October when the Monetary Policy committee (MPC) is scheduled to make a policy decision.

In the light of the above and the factors discussed herein, we recommend the following bidding rates:

Bond	FXD1/2016/010	FXD1/2022/010
Amount	KES 30 billion	
Tenure	1.8-Years	7.6-Years
Coupon	**15.039%**	**13.490%**
Period of Sale	25th Sept. to 9th October 2024	
Value Date	18th September 2024	
Conservative	**17.00% - 17.20%**	**17.50% - 17.75%**
Aggressive	**17.21% - 17.40%**	**17.51 – 18.00%**

On its last three secondary market trades of the first week of October, FXD1/2016/10's yield to maturity (YTM) averaged at 16.9025% with high and low yields of 17.400% and 16.4389% respectively. We do not expect wide deviations from this high yield traded and, therefore, we remain conservative on the paper.

FXD1/2016/10 was last re-opened in September 2023 where it performed below average while being aggressively priced at a market weighted average of 18.4865% at an acceptance of 17.9266%. The economic factors have so far changed, and we do not expect a replication of this.

We expect low activity on the FXD1/2022/010 on its low return on investment which has kept demand low in secondary trading. For instance, except the first quarter of 2024 where FXD1/2022/010 traded KES 1.5Bn in the secondary market, Q2-2024 and Q3-2024 saw the paper trade only odd lots of less that KES 50.00Mn in total.

We do not expect aggressive bidding in overall as already much of the months' demand has been alleviated with significant liquidity injected to the market well before the auction date. This is further supported by the anticipated interest rate cut, as all economic indicators point to this both globally and in the market.

Economic Condition

The local economic growth grew by 4.6% in the second quarter of 2024 compared to 5.6% of Q2-2023, slowed down by a general slowdown across all sectors. Contractions in the construction and quarrying and mining sectors further pulled the economy down even as notable growth remained in the hospitality sector at 26.6%, information and technology at 7.2% and some select service sectors. Agricultural economic growth dropped from 7.8% to a growth of 4.8% in the quarter.

The manufacturing sector continue gaining momentum accelerating up from 1.5% in Q2-2023 to 3.2% in Q2- 2024 driven by food manufacturing, especially soft drinks, sugar and milk. We expect the manufacturing sector to expand further supported by the ongoing government initiatives in the setting up industrial parks for value addition.

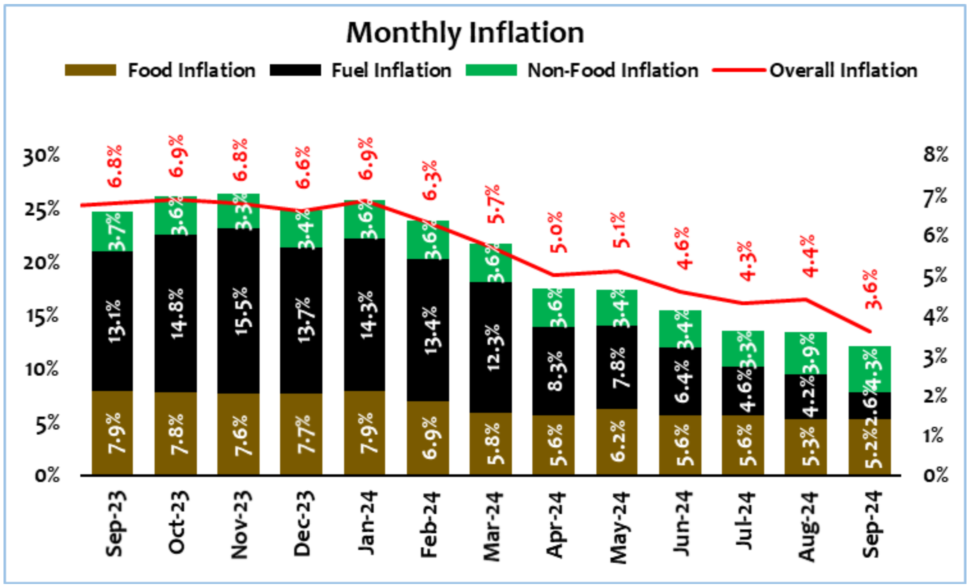
The services sector recorded a5.5% rise in the quarter compared to a growth 6.8% of Q2-2023 to contribute 3.1% of the total real GDP.

Overall economic growth for the first half of 2024 grew by 4.8% real compared to an average growth of 5.6% recorded in H1-2023.

CBK -MPC

In the next monetary policy meeting scheduled for Tuesday, 8th October 2024, we forecast a 75bps to 100bps reduction on the Central Bank Rate lending rate from 12.75% to 11.00% or below. We base our view on:

- Low inflation risks and overall easing of interest rate both in the local market and globally. Locally, inflation hit a decade low of 3.6% in September on reprieve from low fuel prices which benefitted heavily from the currency appreciation. This was further supported by continued rise in food production on ample rainfall.
  - ✓ In the last four months, inflation averaged at 4.2%, operating at the lower bound of the government mid-target range of 5% ±2.5%.
  - ✓ We expect inflation for the last quarter of 2024 to remain below 4.5% supported by an anticipated further decline in food inflation on the ongoing bumper harvesting in the food basket, Western region off Kenya.
- The strengthening of the local currency which has brought reprieve in import inflation especially in fuel inflation as Kenya remains a net importer for oil.
- Forex reserves remain adequate at USD 8,186Mn, adequate for 4.2-months of import cover in the first week of October against 4.0-months of import cover target.
- The banking sector remain stable with strong liquidity and capital adequacy even as non-performing loans ratio remain high at 26.3% as of May and June 2024. The rise in NPL ratios follows declines on overall bank loan book which shrunk by 1.0% between end of Q1-2024 and end of Q2-2024.

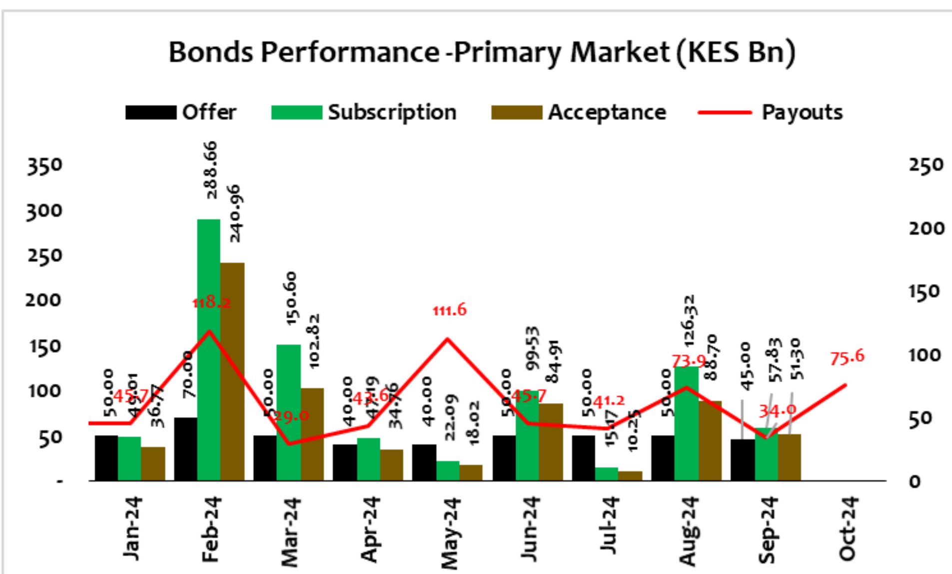


Bonds Performance

The last two primary auctions were largely supported by infrastructure bond papers re-opened and tapped in August and September 2024 respectively. Normal bonds underperformed despite one paper having a high return of up to 16.0% coupon rate.

This was even as the coupon payouts for August were relatively high at KES 73.92Bn while that of September went down to KES 33.95Bn.

We expect part of the coupon payouts for October of KES 56.08Bn due on Monday, 7th October to be channeled to the auction.

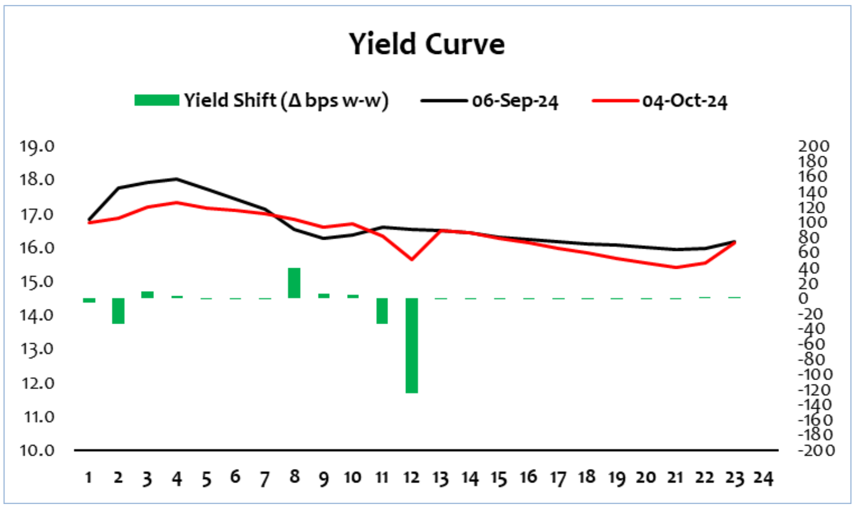


Yield Curve

The yield curve continues shifting down as rates narrow down on effect from the ongoing interest rate cuts. Over the past one month the yield curve shifted down with the short-end and long-end widening faster on heavy activities.

Except the 11th and 12-year papers which are being impacted by the issuance of a twelve-year paper in September 2024, the section low gradual downwards shifts on low liquidity demand in the respective papers.

Yield Key Rates %	05-Jan-24	06-Sep-24	04-Oct-24	y-t-d bps	w-w bps
2-Yr	17.9234	17.7545	16.8627	106.07	89.18
5-Yr	17.4396	17.7102	17.1638	27.58	54.64
10-Yr	15.7044	16.3645	16.6914	-98.70	-32.69
15-Yr	15.7253	16.2763	16.2668	-54.15	0.95
20-Yr	15.8983	15.9931	15.5274	37.09	46.57
23-Yr	16.0647	16.1470	16.1414	-7.67	0.56



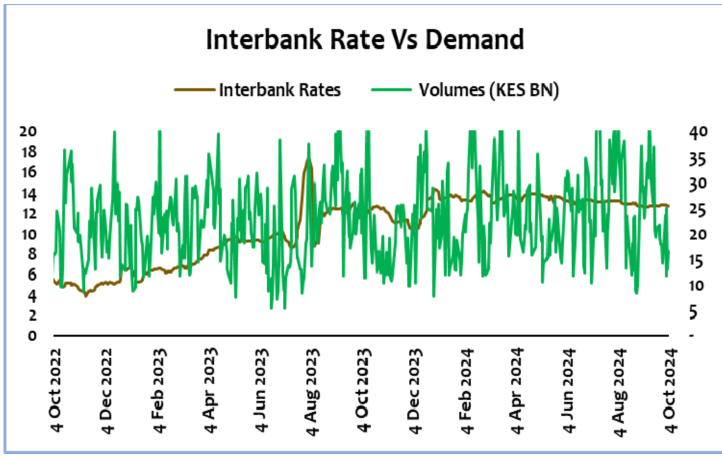
Interbank

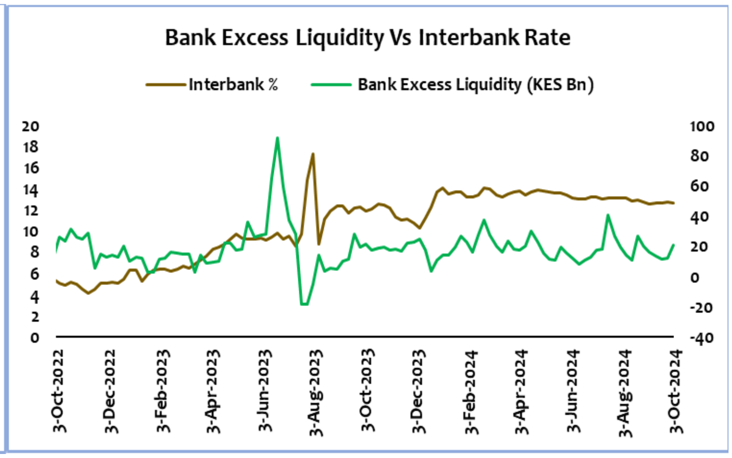
We expect the interbank rate to remain within the lower range of the target range of CBR ±250bps. The interbank rate averaged at 12.70% over the past one month from an average of ±he 12.91% in the earlier month ending 5th September 2024.

This despite the rate continuing to track the CBR, which declined by 25bps on 6th August on its effect transmission in the market.

By the year-end and if forecasted rate cuts comes into effect, we anticipate the interbank to drop to levels of below 12%.

Key Rates	04-oct-23	04-Sep-24	04-Sep-24
Central Bank Rate	10.50%	12.75%	12.75%
Inter-Bank Rate	12.05%	12.63%	12.64%
Cash Reserve Requirement (CRR)	4.25%	4.25%	4.25%
Inflation	6.8%	4.4%	3.6%
91-Day T-Bill	14.8206%	15.7844%	15.6855%
182-Day T-Bill	14.9499%	16.6327%	16.4990%
364-Day T-Bill	15.0544%	16.8592%	16.7291%
Bank Excess Liquidity (KES Bn)	21.5	16.4	21.0
Forex Reserves (USD Mn)	6,913	7,503	8,186
Months of Import Cover	3.71	3.9	4.2



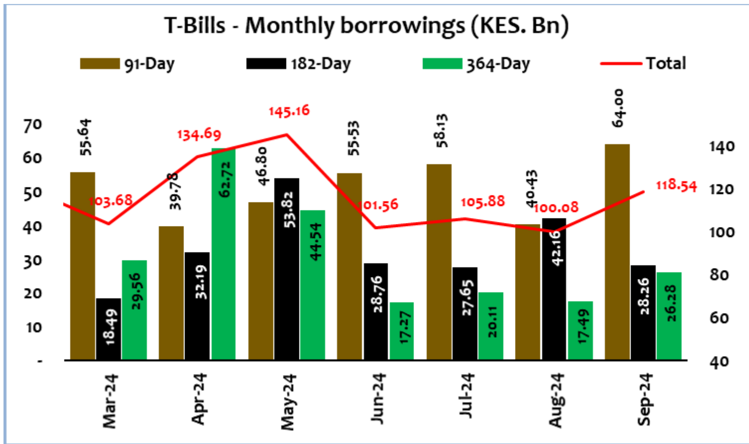


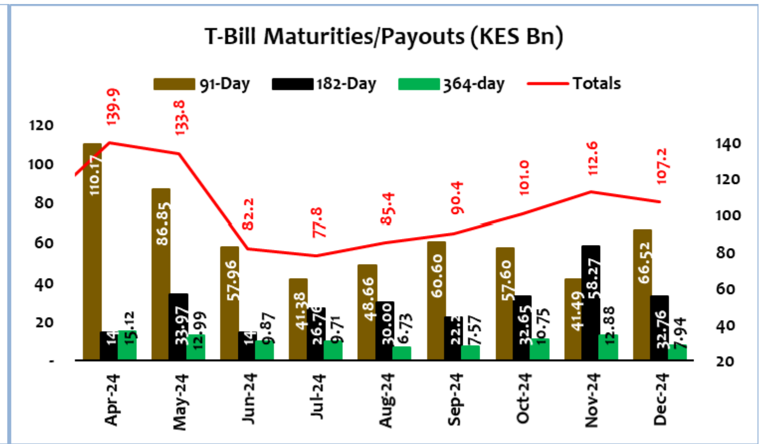
Treasury Bills

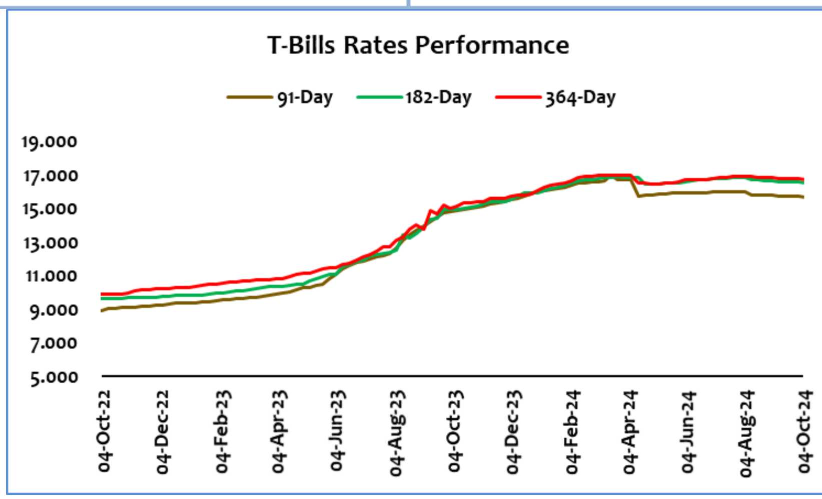
Despite low maturities witnessed in the Treasury bills market, auction performance remains relatively at par with the government demand on what we view to be investors taking advantage of the better returns before they erode. For instance, September T-bill maturities stood at KES 90.44Bn while the public oversubscribed a total of KES 135.80Bn while the government accepting KES 118.54Bn.

Return on investment across the three papers remain on a downtrend due to interest rate cuts. In the last one month, the 182-day paper lost the most at 13.3bps from 16.63% to 16.50% followed by 364-day paper at 11.3bps from 18.64% to 16.73%.

We anticipate a continued decline in treasury bills on the expected general erosion of interest rates.





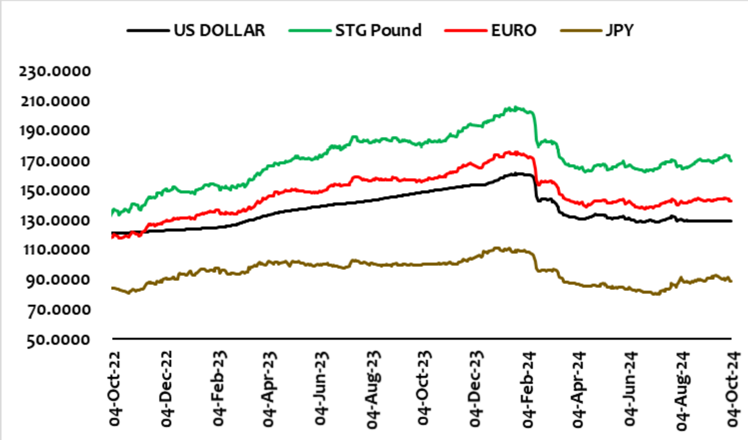


Currency

Trading at KES 129.17 per US dollar as of 4th October, the shilling continues remains strong while making investments more predictable in terms of returns. This raises investor confidence and thus more foreign direct investments that boost the forex reserves.

Foreign exchange reserves accelerated up 9.1% to USD 8,16Mn, enough for 4.2-months of import cover, as of the first week of October compared to USD 7,503Mn witnessed in the first week of September. Part of this gains is attributed to a stable currency and a perceived receipt of concessional development facilities.

DATE	04-Oct-23	02-Jan-24	04-Sep-24	04-Oct-24	% Δ y-y	%Δ y-t-d	%Δ q-q
US DOLLAR	148.45	156.99	129.19	129.18	13.0%	17.7%	0.0%
STG Pound	179.2079	199.85	169.42	169.66	5.3%	15.1%	-0.1%
EURO	155.4462	173.65	142.84	142.47	8.3%	18.0%	0.3%
JPY	99.4807	110.98	88.99	88.36	11.2%	20.4%	0.7%
US Dollar Index	106.8	102.20	101.27	102.52	4.0%	-0.3%	-1.2%


US DOLLAR
STG Pound
EURO
JPY
230.0000
210.0000
190.0000
170.0000
150.0000
130.0000
110.0000
90.0000
70.0000
50.0000
04-Oct-22
04-Dec-22
04-Feb-23
04-Apr-23
04-Jun-23
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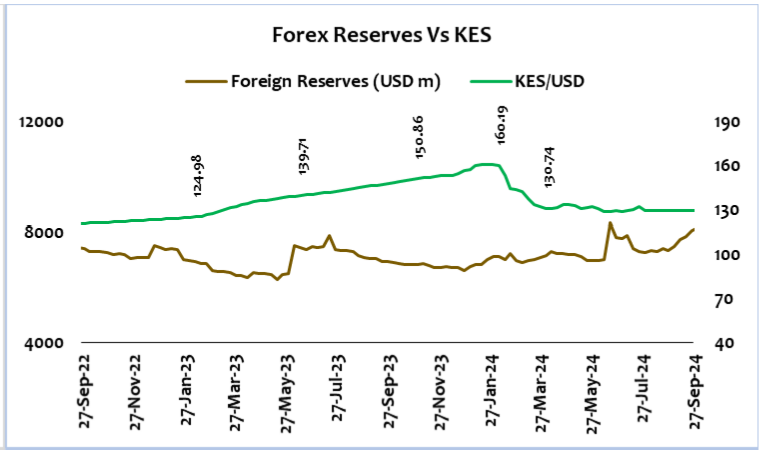
04-Aug-24
04-Oct-24


Forex Reserves Vs KES
Foreign Reserves (USD m)
KES/USD
12000
8000
4000
190
160
130
100
70
40
124.98
139.71
150.86
160.19
130.74
27-Sep-22
27-Nov-22
27-Jan-23
27-Mar-23
27-May-23
27-Jul-23
27-Sep-23
27-Nov-23
27-Jan-24
27-Mar-24
27-May-24
27-Jul-24
27-Sep-24

End

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