



Tuesday, 12 May 2020

Analysts:

Renaldo D'Souza

+254 (20) 2222651

Renaldo.DSouza@sterlingib.com

Susan Makena

+254 (20) 2222651

Susan.Makena@sterlingib.com

Elizabeth Njenga

+254 (20) 2222651

Elizabeth.Njenga@sterlingib.com

Justina Vuku

+254 (20) 2222651

Justina.Vuku@sterlingib.com

Fixed Income Note-2

May 2020

“CBK’s expected return”

For queries call: +254 (20) 315414; 2244077 or

Email: research@sterlingib.com

Website www.sterlingib.com

Bloomberg Code: SCLK <GO>

Table of Contents

Executive Summary	3
CBK's return to the market to raise KES.30Bn	4
Subscription rate for FXD1/2020/5 fell short of our expectations but this issue will not disappoint	4
Our weighted average and accepted bids averages.....	5
Investors to bid above current yield curve levels	5
National Treasury's KES.129Bn funding gap will be difficult to fill even with IMF support	6
Disclosures	7

Executive Summary

- Our second fixed income report in May 2020 titled “**CBK’s expected return**” is an analysis of the Central Bank of Kenya’s (CBK) re-opened 5-Year Treasury bond (FXD1/2020/5).
- We believe that the bond seeking to raise KES.30Bn was re-opened to plug in the huge budget deficit owing to the negative impact of the Covid-19 pandemic on tax revenues.
- With regards to investor demand, we expect the issue to be highly subscribed in contrast to the first issue on account of a longer period of sale and attractive tenor.
- Our investor and CBK accepted bid predictions are:

Weighted Average Rate (WAR) of bids: 11.85% - 11.95%

Weighted average rate of accepted bids: 11.80% - 11.90%

- Also taken into account in our yield predictions are the yields of similar tenored securities on the Nairobi Securities Exchange (NSE) yield curve.
- The final section of the report shows the country’s revised fiscal budget that exposes a KES.129.1Bn funding gap a portion of which will be covered by domestic borrowing and financial support from the International Monetary Fund (IMF).

CBK's return to the market to raise KES.30Bn

- Central Bank of Kenya (CBK) has invited bids for the re-opened 5-Year Treasury Bond (T-Bond) FXD1/2020/5 to raise KES.30Bn (Table.1).
- We expected a tap sale and not a re-opening of the bond based on the low subscription of 69.1% amounting to KES.34.5Bn against the KES.50Bn offered.
- A total of KES.20.8Bn of this was accepted with Weighted Average Rates (WAR) of market and accepted bids of 11.788% and 11.667% respectively.
- The WAR of accepted bids was 44bps above the yield curve as at 30th April 2020.
- We believe re-opening this bond is an indication of the huge deficit financing needs faced by the National Treasury particularly in the face of the negative impact of the Covid-19 pandemic on its receipts.

Table.1: FXD1/2020/5 Primary Bond Re-opening summary

Issue Number	FXD1/2020/5 (Re-opened)
Total Amount Offered	KES.30Bn
Tenor (Years)	5 Years
Coupon Rate (%)	11.667
Issue Price	Discounted/Premium/Par
Period of Sale	11 th May 2020 – 19 th May 2020
Auction Date	20 th May 2020
Value Date	25 th May 2020
Yield Curve (%) (Weighted Average tenor - 5 years) 08th May 2020	11.3528

Source: Central Bank of Kenya

Subscription rate for FXD1/2020/5 fell short of our expectations but this issue will not disappoint

- Subscription for the initial bond fell below our expectations and historical subscription trends.
- We attribute the low subscription to the short sale period and investor concerns of government proposals to defer interest payment on pension assets.
- The re-opened bond should be oversubscribed on the basis of its tenor and investors' flight to safety from the underperforming equity investments to the more predictable returns provided, risk free Government securities as well as more clarity on interest payments.

Re-opened bond likely to be oversubscribed

Our weighted average and accepted bids averages

- Our Weighted Average Rate (WAR) of investor and accepted bids are shown in Table 2.

Table.2: Auction bid predictions

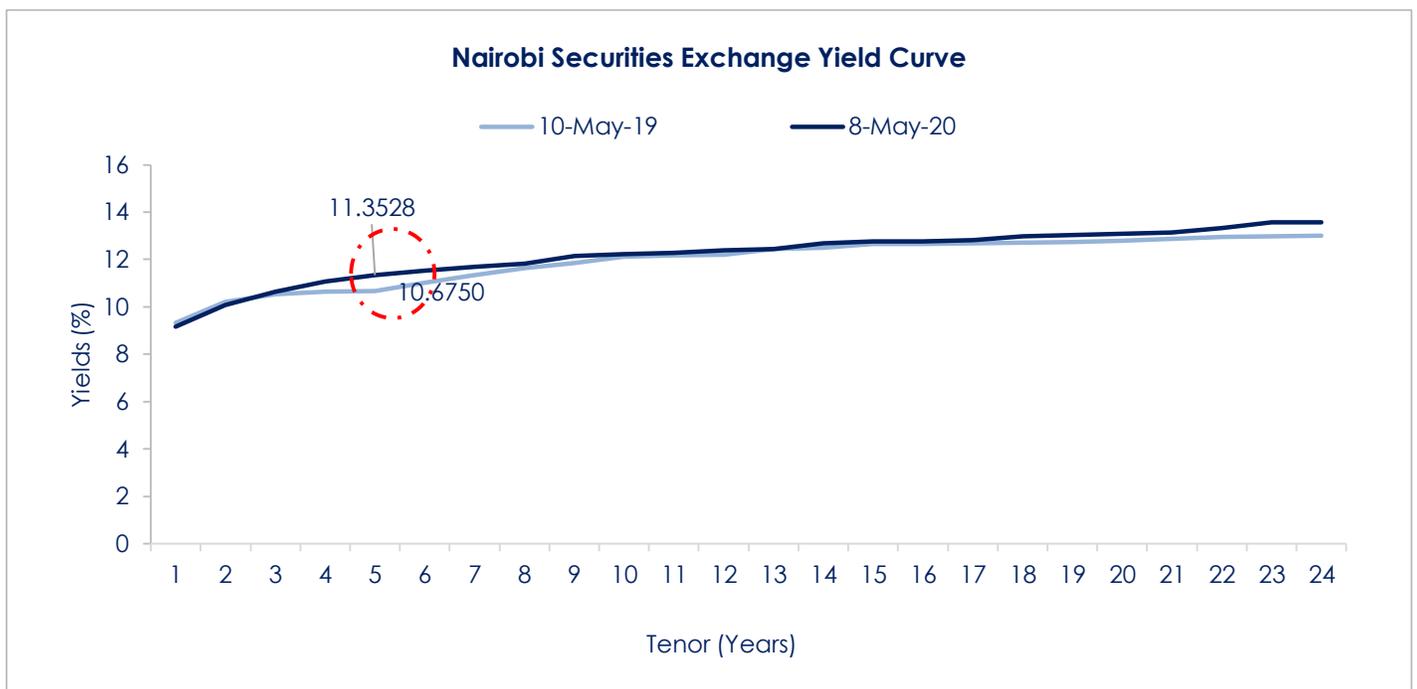
Rate	FXD1/2020/5
Market Weighted Average Rate (%)	11.85% - 11.95%
Weighted Average Rate of Accepted Bids (%)	11.80% - 11.90%

Source: Sterling Capital Research

Investors to bid above current yield curve levels

- A comparison of the NSE yield curve as at 8th May 2020 and the same period last year shows a 68bps rise in yields on 5 year tenored securities. (Fig.1)
- We once again expect investors to bid above the yield curve levels as was the case last week which saw WAR of investors bids at 11.788% 56 bps above the yield curve.
- The CBK re-opened this bond as opposed to a tap sale presumably as a signal that the 5-year bond rates should fall near 11.667%.
- However, the National Treasury's current financial position and dire needs for fiscal budget financing means that the CBK could accept aggressive investor bids.

Fig.1: Current yield for 5-year tenor is 11.3528%



Source: Nairobi Securities Exchange

National Treasury's KES.129Bn funding gap will be difficult to fill even with IMF support

Domestic borrowing and IMF credit support to partially meet fiscal deficit

- It is becoming increasingly apparent that the national Government is struggling to finance its revised budget with ordinary tax revenue as indicated in supplementary budget 2 falling 12.5% below printed estimates to KES.1.6Tn (Table. 3).
- CBK's heightened domestic funding efforts is evident from the KES.129.1Bn funding gap shown in the revised budget.
- The IMF announcement on 11th May 2020 that it had approved the disbursement of US\$739Mn to the National Treasury (KES.79Bn) under the rapid Credit Facility (RCF) "to allow them to maintain an adequate level of international reserves and help provide the budget financing needed to respond to the pandemic."
- This is a significant development with regards to deficit financing as we have been skeptical of the National Treasury's ability to meet the funding gap with slightly over a month left of the 2019/20 fiscal year.
- There is also a huge chance of the National Treasury missing its revised ordinary revenue target as the COVID-19 pandemic continues to disrupt economic activity and negatively impact tax revenues.

Table.3: Supplementary budget shows KES.129.1 fiscal budget deficit

Budgetary Item	Printed Estimates	Supplementary Estimates 1 (November 2019)	Supplementary Estimates 2 (April 2020)	Supplementary Estimates 2 change over printed estimates
Total Revenue	2,115.8	2,084.2	1,893.9	-10.5%
Ordinary Revenue	1,877.1	1,843.8	1,643.4	-12.5%
Expenditure	2,796.0	2,874.2	2,774.4	-0.8%
CFS (Interest Pensions etc.)	550.00	550.00	524.67	-4.6%
Recurrent Ministerial	1,224.6	1,224.3	1,248.62	2.0%
Development Ministerial	704.2	782.7	684.0	-2.9%
County Transfers	316.5	316.5	316.5	-
Net Lending	0.6	0.6	0.6	-
Equalization Fund	5.8	5.8	0	100%
Fiscal Balance	(680.2)	(789.9)	(880.5)	29.4%
Grants	38.8	41.8	44.6	14.9%
Fiscal Balance (Grants)	(641.4)	(748.1)	(835.9)	30.3%
Total Financing	641.3	657.4	706.8	10.2%
Foreign Financing	462.7	484.8	455.0	-1.7%
Debt Repayment	(131.4)	(131.4)	(121.5)	-7.5%
Net Domestic Financing	306.8	300.7	321.1	4.7%
Other Domestic Financing	3.2	3.2	152	4,650%
Provision for T-Bills Redemption	0	0	(100)	-
Financing Gap*	0.0	(90.7)	(129.1)	-

*During Supplementary 1 Cash Adjustment of KES.90Bn

Source: Parliamentary Budget Office

Disclosures

Ownership and material conflicts of interest:

The authors or a member of their household, of this report do not hold a financial interest in the securities of this company. The authors or a member of their household, of this report do not know of the existence of any conflicts of interest that might bias the content or publication of this report.

Position as an officer or director: The authors or a member of their household, do not serve as an officer, director or advisory board member of the subject company.

Research analyst certification:

The research analyst(s) primarily responsible for the preparation and content of all or any identified portion of this research report hereby certifies that all of the views expressed herein accurately reflect their personal views. Each research analyst (s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the view(s) expressed by that research analyst in this research report.

Additional Disclosures:

This research report is for distribution only under such circumstances as may be permitted by applicable law. This research report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient, even if sent only to a single recipient. This research report is not guaranteed to be a complete statement or summary of any securities, markets, reports or developments referred to in this research report. Neither SCL nor any of its directors, officers, employees or agents shall have any liability, however arising, for any error, inaccuracy or incompleteness of fact or opinion in this research report or lack of care in this research reports preparation or publication, or any losses or damages which may arise from the use of this research report.

Disclaimer:

This research report was prepared under the supervision of the Research Department of Sterling Capital Limited (SCL), a company authorized to engage in securities activities in Kenya, and with partnerships in Uganda, Rwanda, Zimbabwe, and Tanzania. Data used in this report was gathered from reliable sources, but the analyst(s) and the publishers of this report do not hold themselves responsible for the accuracy or completeness of data used. The report provides the opinions, analyses and conclusions of the Research division only and is provided without any warranties of any kind.

This report does not constitute an offer, or the solicitation of an offer, for the sale or purchase of any security. The reader should independently evaluate the investment risks and is solely responsible for their investment decisions. Whilst every care has been taken in preparing this report, no representation, warranty or undertaking (express or implied) is given and no responsibility or liability is accepted by SCL or any employee of SCL as to the accuracy, timeliness, completeness merchantability or fitness for any particular purpose of any such recommendation or information contained and opinions expressed herein. SCL do not accept any liability for any direct or remote loss or damage arising out of the use of all or any part of the information contained in this report.

This report is published for information purposes only and is not an offer to solicit, buy or sell any security of any kind. This report does not provide customized investment advice. It has been prepared without regard to the individual financial circumstances and risk and return objectives of individuals who receive it. The appropriateness of a particular investment will depend on an investor's individual circumstances, risk tolerance and return objectives. The investments securities referred to in this document may not be suitable for all or certain categories of investors. The Research Division and SCL have implemented Chinese walls procedures to prevent any conflict of interest. Other additional information may be available at SCL.

Further disclosure regarding SCL policy on potential conflicts of interest in the context of investment research and SCL policy on disclosure and conflicts in general are available on request. The opinions presented in this note may be changed without prior notice or cannot be depended upon if used in the place of the investor's independent judgment. The historical performance of a security is not representative of the security's future returns. Investment in securities can be highly risky as security prices may go down in value as well as up and you may not get back the full amount invested. Where an investment is denominated in a currency other than the local currency of the recipient of the research report, changes in the exchange rates may adversely affect the value, price or income of that investment. In case of illiquid investments for which there is no organized market it may be difficult for investors to exit investment positions or to obtain reliable information about its value or the extent of the risk to which it is exposed. The information contained in this report is confidential and is solely for use to those persons to whom it is addressed and may not be reproduced, further distributed to any other person or published, in whole or in part, for any purpose.