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STERLING CAPITAL LIMITED

Fixed Income

Primary Issue Update Note

January 2021

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2021 off to a start with a short-term debt issue

- The Central Bank of Kenya (CBK) has invited bids for a 2-Year bond - **FXD1/2021/2**, seeking to raise KES.25Bn.
- The bond opened on Monday, 21st December, 2020 and closes on Tuesday, 5th January, 2021 with auction date and value dates of 6th and 11th January, 2021 respectively.
- This issue coincides with the opening of a 16-year amortized Infrastructure Bond (IFB1/202116) to raise KES.50Bn that closes on 19th January 2021.
- Our weighted average bid predictions are as follows:

Weighted Average Rate (WAR) of bids: 9.60% - 9.70%
Weighted average rate of accepted bids: 9.50% - 9.60%

- The Nairobi Securities Exchange (NSE) yield curve for the week ending 31st December puts the 2 Year yield at 9.3187% below the "Sterling Yield Curve's" 9.50%.
- We expect the issue to be oversubscribed due to the bond's short tenure and the banks' interest in the short-end of the yield curve as they are currently focused on short term liquidity needs.
- Our forecasted subscription for this issue is KES.30Bn-45Bn equivalent to a subscription rate of 120%-160%.
- We expect the high subscription rate to work in the CBK's favour giving it the leeway to reject high investor bids
- Market liquidity tightened in December 2020 with the average inter-bank rate rising to 5.1% from 3.2% in November.
- Commercial bank liquidity levels remained stable in 2020 as indicated by the decline in the average interbank rate to 3.7% from 4.3% in 2019.
- During the month CBK mopped excess commercial bank liquidity through the repo market in a bid to maintain stability of the Kenya Shilling.
- The repo rate increased to 6.6% as at 17th December from 2.6% on 12th October as a result of lower liquidity.
- With regards to the country's main macro economic variables, inflation edged upwards in December 2020 to 5.6% compared to 5.3% in November. New taxes re-introduced in January 2021 might extert further pressure on prices of food and fuel as well as other essential commodities.
- On the currency front, the KES came under pressure in 2020 from increased dollar demand depreciating 7.7% against the United States Dollar (US$) to close at KES.109.2 compared to the 0.5% appreciation in 2019, with this largely attributed to lower receipts from key exports and tourism.
- With regards to national accounts, we see an increase in the Government's financing needs for the month of January 2021 with total domestic debt service at KES.175Bn (KES.74Bn in December 2020) made up of KES.160Bn in debt redemptions and KES.15Bn in coupon payments.
- We believe that the increase in financing needs coupled with continuous shortfalls in revenue collections will have a huge borrowing in the National Treasury's borrowing strategy not only this month but also for the remainder of the 2020/21 fiscal year.
- It is still too soon to make a call on the impact of the reinstatement of the old income and Value Added Tax (VAT) re-introduced on 1st January 2021 on national accounts (new tax measures introduced in April 2020 to mitigate the impact of Covid-19 on businesses and households).
- The National Treasury expects this move to help reduce the fiscal budget deficit and Government's borrowing needs.
- We see this move as having a positive but lower than expected impact on account of subdued economic activity and loss of employment income.

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