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Thursday, 02 April 2020

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Fixed Income Note

April 2020

"Kenya Government to the rescue"

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Executive Summary

- Our Fixed Income report this month titled "**Kenya Government to the rescue**" is aptly named due to the measures announced earlier this month to mitigate the economy against the negative impact of the COVID-19 pandemic.
- The Infrastructure Bond **IFB1/2020/9** on offer looking to raise KES.60Bn is the Central Bank of Kenya's (CBK) first and second in the current calendar and fiscal year (2019/20) respectively.
- This bond comes at a time of global economic certainty that have had significant negative impact on the performance of financial markets globally.
- Our note sets out our expectations of investor demand, their bids and CBK's accepted rates.
- Our investor and CBK accepted bid predictions are:

  Weighted Average Rate (WAR) of bids: 11.80%-12.30%
  Weighted average rate of accepted bids: 11.80%-12.00%

- The note also highlights high market liquidity resulting from recent monetary policy and CBK currency purchase activity, that is expected to have a significant impact on auction bids.

- It is expected that the increase in market liquidity will impact the secondary bond trading market activity which is defined in the report.
- We continue to give trading recommendations based on investors' preferred trading portfolios (income or trading) covered in the section on trading ideas.
- Also in the report is an analysis of the Government's debt service obligations (redemptions and coupon payments) for April and May.
- Public debt is discussed where we take note of the strain that the Covid-19 pandemic will have on public finances resulting in increased Government borrowing and public debt.
- We point out proposed Government support measures to support the economy in the uncertain economic environment.
- On the macro-economic front, we look at the new inflation rate guided by the rebased CPI give our forecasts for the month of April 2020.
- To conclude the report, we discuss the monetary measures evoked by the Monetary Policy Committee (MPC) in their March meeting giving our expectations of the impact of these measures on macro-economic variables.

CBK issues a medium term infrastructure bond IFB1/2020/9 to raise KES.60Bn

- Central Bank of Kenya(CBK) is seeking to raise KES.60Bn in this month's infrastructure bond **IFB1/2020/9**.
- The issue is a medium term bond and we expect it to receive a lot of market attention given that the equity markets has been plummeting, institutions opting to invest in safer securities such as the government bonds, tax-free status and the tenor of the bond.
- This is the first IFB in 2020, with a pre-determined coupon rate of 10.85%.
- Redemption will be in two tranches, the first tranche of 50% will be redeemed in April 2025 with the remaining 50% at expiry in April 2029.

Table.1: Primary Bond issue summary

Issue Number	IFB1/2020/9
Total Amount Offered	KES.60Bn
Tenor (Years)	9 Yrs.
Effective Tenor	7 Yrs.
Coupon Rate (%)	10.85
Issue Price	Discounted/Premium/Par
Period of Sale	26th Mar – 07th Apr 2020
Auction Date	08th Apr 2020
Value Date	13th Apr 2020
Yield Curve (%) (Weighted Average tenor - 7 years) 27th Mar 2020	11.7595

Source: Central Bank of Kenya

IFB1/2020/9 amortized redemption structure

- IFB1/2020/9 has an amortizing redemption structure making its effective tenor 7 years.

Table.2: Amortized redemption tenor is 7.0 years

Redemption Period	% of principal amount	Tenor Calculation	Weighted Tenor
5 years (Apr 2020- Apr 2025)	50%	50%*5 years	2.5 years
9 Years (Apr 2020- Apr 2029)	50%	50%*9 years	4.5 years
Effective tenor			2.5 + 4.5 = 7.0 years

Source: Central Bank of Kenya & Sterling Capital Research

Increase in US$ demand could affect market liquidity

- The mean exchange rate for the United States Dollar US$) TO Kenya Shilling (KES) was104.69 on 31st March 2020 compared to KES.101.16 on 1st March 2020 equivalent to a 3.5% depreciation.
- According to currency dealers, increased demand for US$ was triggered by CBK purchases from banks beginning March and set to end in June (US$100Mn monthly for 4 months) resulting in additional KES liquidity
- We expect high market liquidity the perceived safety of government securities coupled with the attractive tenor of the bond and its tax free status to shore up bond auction participation.
- Our expected subscription rate is **140% - 150% (KES.84Bn-KES.90Bn)** with a high acceptance rate due to the high financing needs of the Government worsened by expected decline in tax revenue collection.
- Our predicted Weighted Average Rates (WAR) of market and accepted bids are shown in Table 2.
- We expect the bids to be aggressive and above the yield curve level seeking a risk premium on account of uncertainty of the impact of Covid-19 on economy, rising inflation rate and currency risk for foreign investors.

Table.3: Auction bid predictions

Rate	IFB1/2020/9
Market Weighted Average Rate (%)	11.80% - 12.30%
Weighted Average Rate of Accepted Bids (%)	11.80% - 12.00%

Source: Sterling Capital Research

IFB's are popular with investors and often highly subscribed

Analysis shows that medium term IFB auctions historically had heavy demand.

- Medium term IFB's have traditionally received high subscription (Table.3).
- IFB1/2015/9 issued in 2015 to raise KES.30Bn went against the IFB demand craze with a 55.3% subscription rate (KES.16Bn) with KES.14Bn accepted.
- This was before the introduction of interest rate caps when banks were heavily skewed towards higher yielding private sector lending than investment in Government securities.
- Recent Monetary Policy Committee actions (see monetary policy) will result in an increase in market liquidity but are unlikely to have an impact on this auction.
- The "flight to safety" by equity investors to the more predictable fixed income securities during the uncertain times of COVID 19 pandemic will also supports our view on the subscription rate for this issue.

Table.4: Historical primary market auction performance

Issue	Offered (KES.Bn)	Bids Received (KES.Bn)	Amount Accepted (KES.Bn)	Performance Rate (%)	Coupon Rate (%)	Average Yield
IFB1/2014/12	15	38.8	15.8	258.5	11	11.30
IFB1/2015/12	25	51.7	25.7	206.6	11	11.60
IFB1/2015/12 (Tap)	25	51.7	24.0	97.53	11.00	11.56
IFB1/2015/9	30	16.6	14.0	55.3	11.00	14.75
IFB1/2016/15	30	35.1	30.6	117.0	12.0	13.28
IFB1/2017/12	30	35.0	6.0	116.8	12.50	13.05
IFB1/2017/12 (Tap)	-	8.0	7.6	-	12.50	13.56
IFB1/2017/7	30	45.9	42.0	153.0	12.50	12.28
IFB1/2018/15	40	55.8	5.0	139.4	12.50	13.03
IFB1/2018/15 (Tap)		-	36.3		12.50	12.51
IFB1/2018/20	50	40.4	27.6	80.8	11.95	12.29
IFB1/2018/20 (Tap)		-	8.73	-	11.95	12.16
IFB1/2019/25	50	29.4	16.3	58.75	12.20	12.89
IFB1/2019/16	60	86.9	68.5	144.9	11.75	12.18

Source: Central Bank of Kenya

- Implied yields of bonds of almost similar remaining terms to maturity from the Nairobi Securities Exchange (NSE) as at 27th March, 2020 were used to determine possible investor bids (Table.4).

Table.5: Benchmark issues to guide investor bids

Treasury Bond	Issue Date	Coupon Rate (%)	Maturity Date	Term to Maturity Years (Days)	Last traded Yield (%)	Yield Curve at time of issue
IFB1/2014/12	27th Oct 2014	11.00	12th Oct 2026	6.6 (2390)	10.40	12.4320
IFB1/2015/12	30th Mar 2015	11.00	15th Mar 2027	7.0 (2544)	10.62	12.8040
IFB1/2016/15	24th Oct 2016	12.00	6th Oct 2031	11.6 (4210)	11.11	13.6943
IFB1/2017/12	27th Feb 2017	12.50	12th Feb 2029	8.9 (3244)	11.11	13.7712

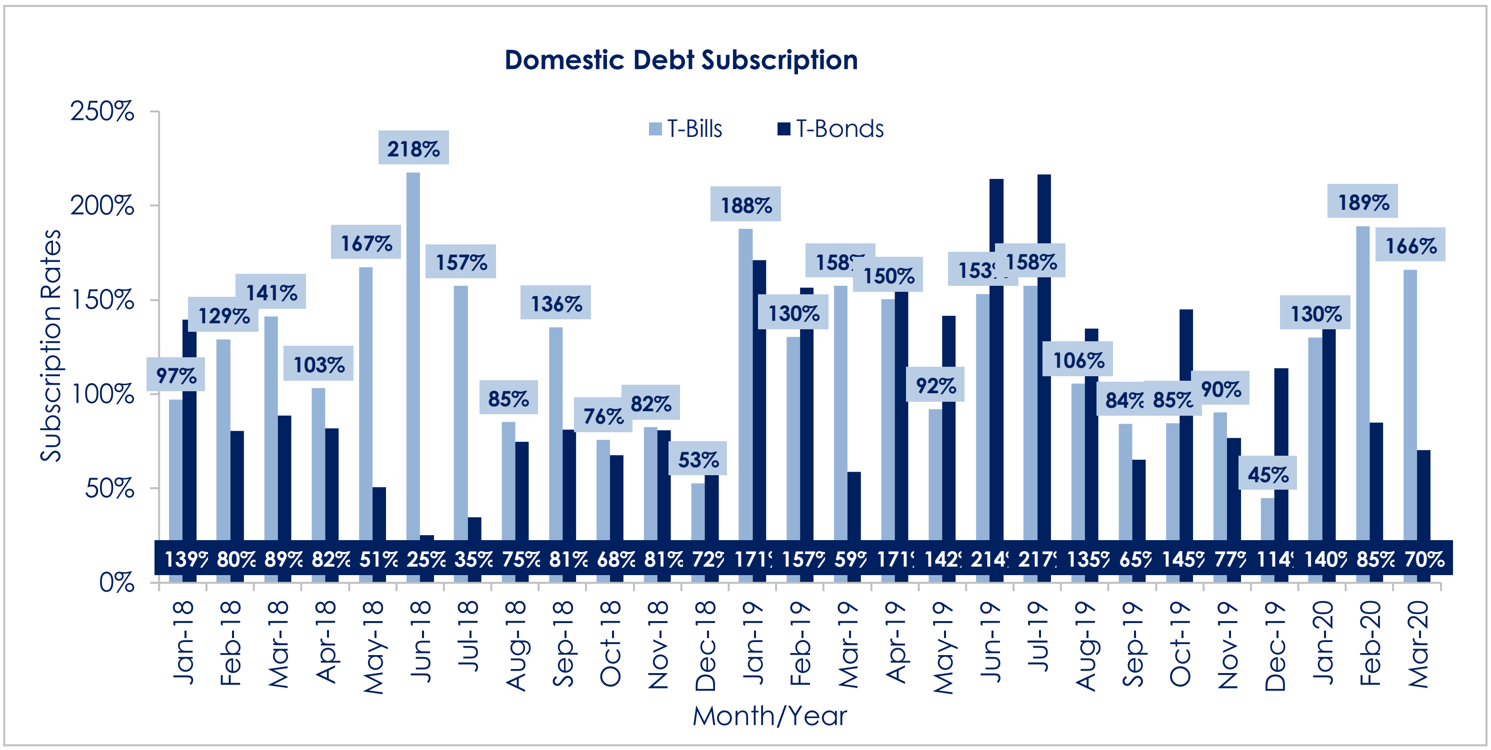
Source: Central Bank of Kenya

High domestic debt investor participation expected in April 2020

- CBK received bids worth KES.35.2Bn against KES.50Bn offered in T-Bonds for the month of March equivalent to a subscription rate of 70.3% attributable to the long tenor of the two bonds in issue.
- A total of KES.199.4Bn was received in T-Bill auctions against KES.120Bn on offer, representing a subscription rate of 166.1%.
- The 364, 91 day and 182 day papers received subscription rates of 141.6% 102.9% and 19.7% respectively.

- We observe a significant increase in the demand for the 91-day T-Bill in recent auctions which we believe is the preference of investors unwilling to tie capital in a period of high market volatility.
- High subscription for the 364-day paper continues from investors willing to take a comparatively longer investment view in the face of the ongoing global economic slowdown.
- Bids accepted by the CBK amounted KES. 22.9Bn for the bond issue and KES.91.8Bn in T-Bills.
- We anticipate high participation in the primary market by commercial banks as a result of high liquidity after the MPC reduced the cash reserve ratio (CRR) by 100bps from 5.25% to 4.25% thus freeing up an estimated KES.32.5Bn.
- Banks are also likely to invest heavily in government securities in a bid to reduce their credit risk and prevent further deterioration in asset quality.

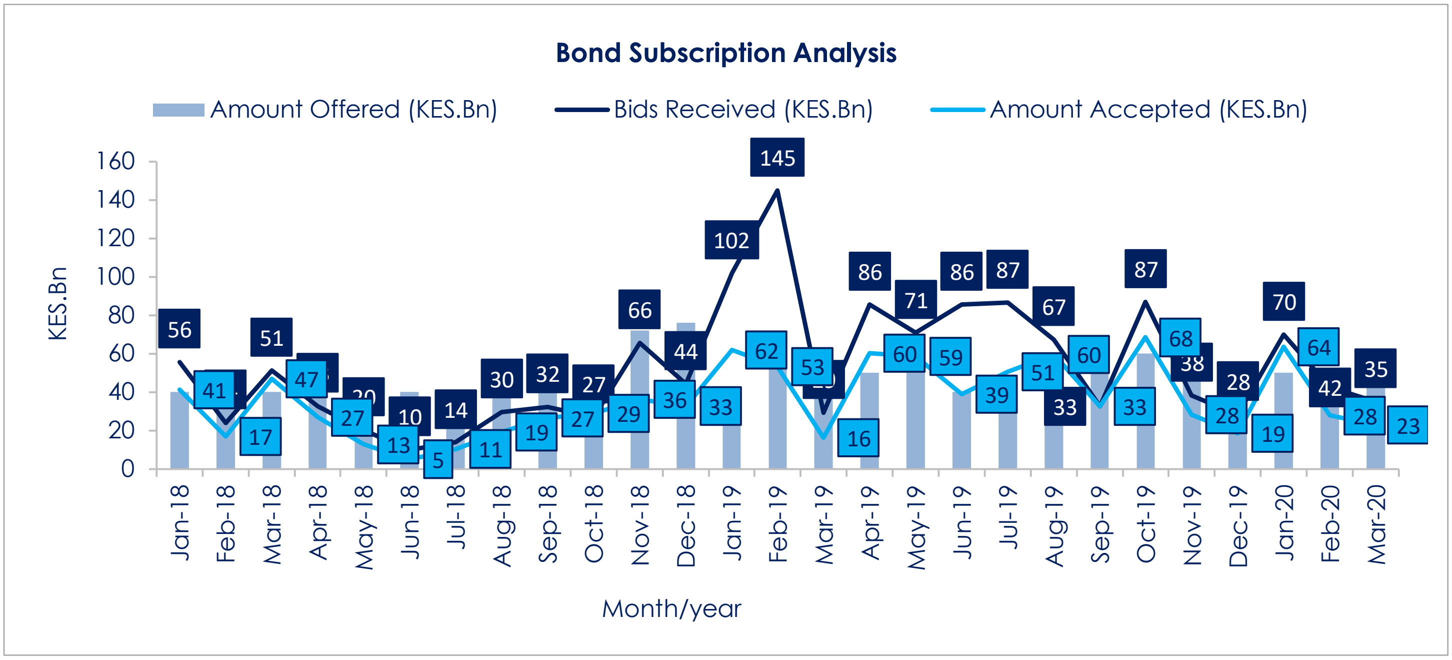
Fig.1: Treasury Bond subscription rate falls to 70% due to long tenor



Source: Central Bank of Kenya

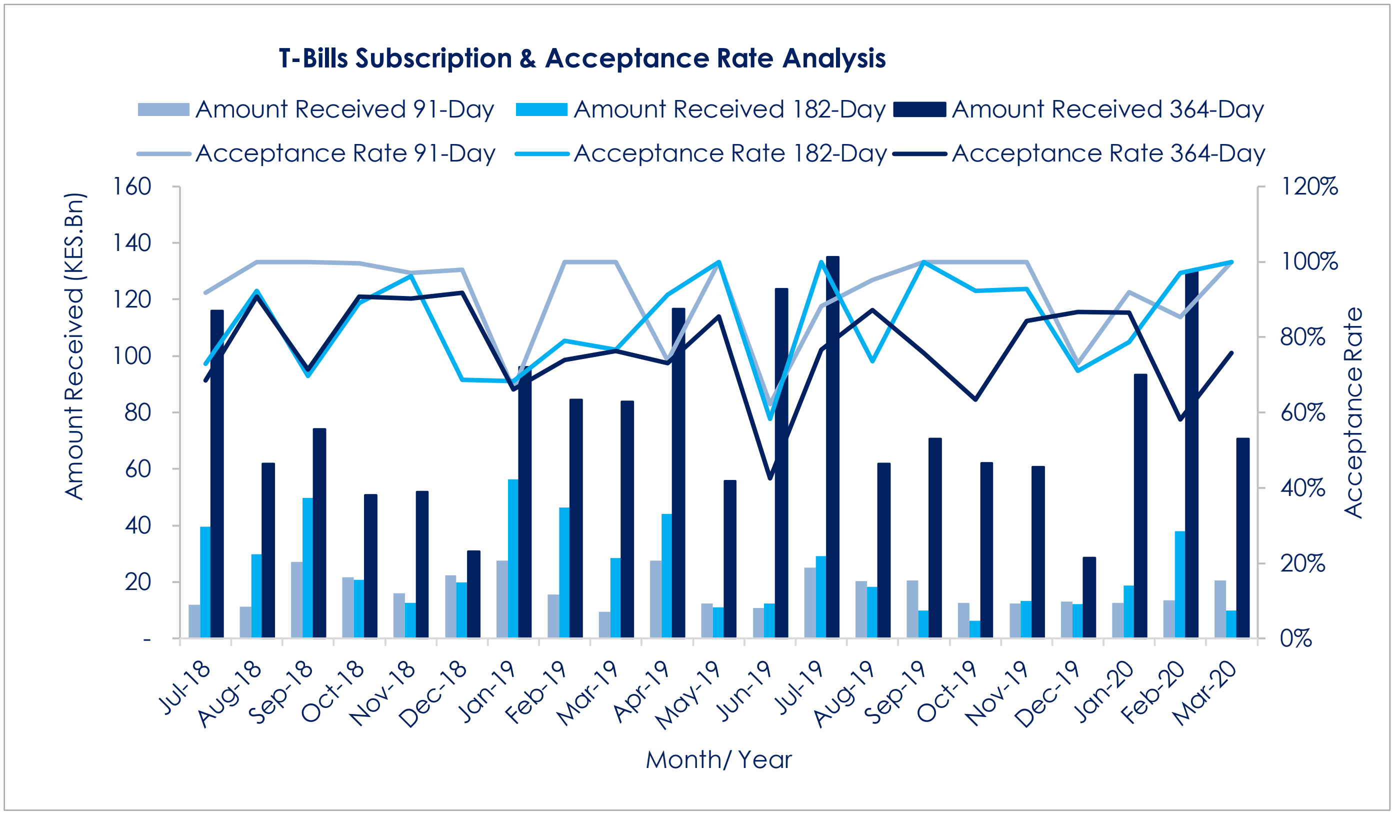
- FXD1/2018/20 (18.07 Years.) received a higher subscription (KES.19.8Bn) compared to the FXD1/2018/25 (23.32 Years) which received bids worth KES.15.3Bn.
- The 25-year bond had a higher acceptance rate (95.4%) compared to the 20-year bond (41.7%) with the CBK intent to lengthen the maturity profile of domestic debt (5.7 Months as at December 2019).

Fig.2: CBK accepts KES.35.2Bn in March Bonds issue



Source: Central Bank of Kenya

Fig.3: 364-day T-bill heavily over-subscribed in February but acceptance remains low

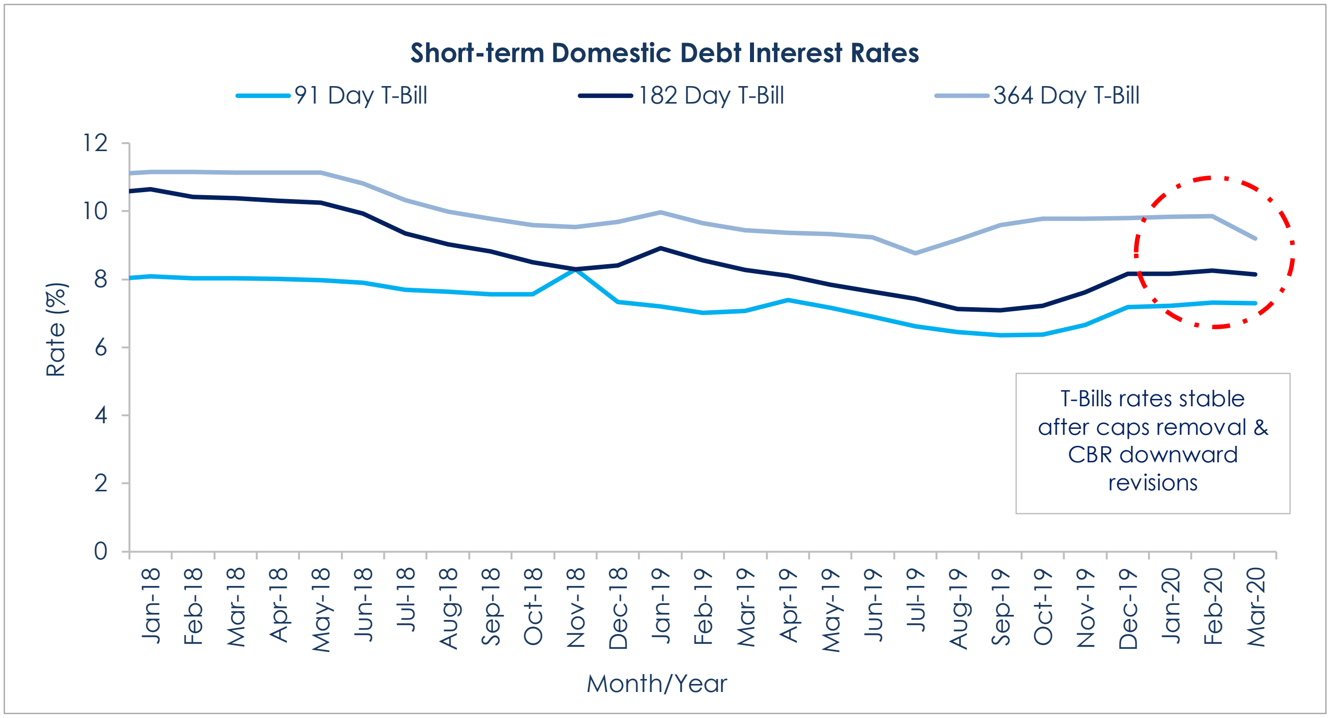


Source: Central Bank of Kenya

T-Bill yields on a gradual decline on high demand

- Average T-Bill yields declined marginally in March compared to February, 2bps, 11bps and 65bps to 7.3%, 8.1% and 9.2% for the 91, 182 and 364 day papers respectively. (Fig.4)
- We attribute the decline in yields to high investor demand in the face of an uncertain economic environment.
- We expect high liquidity and resulting high demand to result in a further decline in yields albeit minimal in the near term.
- Reduction of the Central Bank Rate (CBR) and the Cash Reserve Ratio (CRR) is expected to result in increased demand for government securities in the near to medium term.
- We expect slow growth in private sector credit the measures taken by government to mitigate the impact of the current economic crisis on both households and businesses.

Fig.4: T-Bill interest rates declining

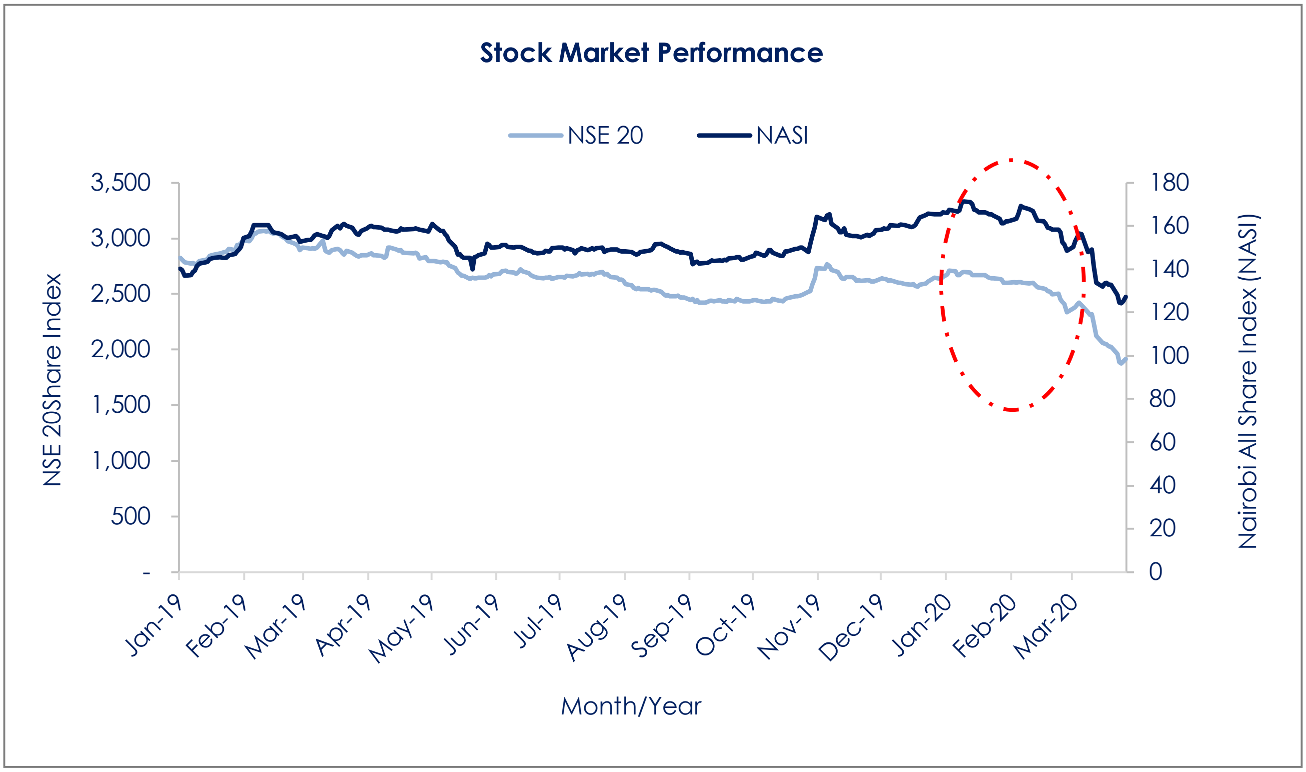


Source: Central Bank of Kenya

- The Nairobi Securities Exchange (NSE) has been on a decline since the beginning of the year as investors divest from equity investments due to the adverse impact of COVID-19 pandemic on global financial markets. (Fig.5)
- Primary fixed income auction and secondary market bond trading activity have however increased during the same the same period, evidence of asset reallocation towards "risk free" assets.

- Foreign investors have reduced their exposure to emerging and frontier markets Kenya included due to concerns over market and currency performance and have been net-sellers on the NSE.

Fig.5: The NSE on a free fall following heavy foreign sales activity

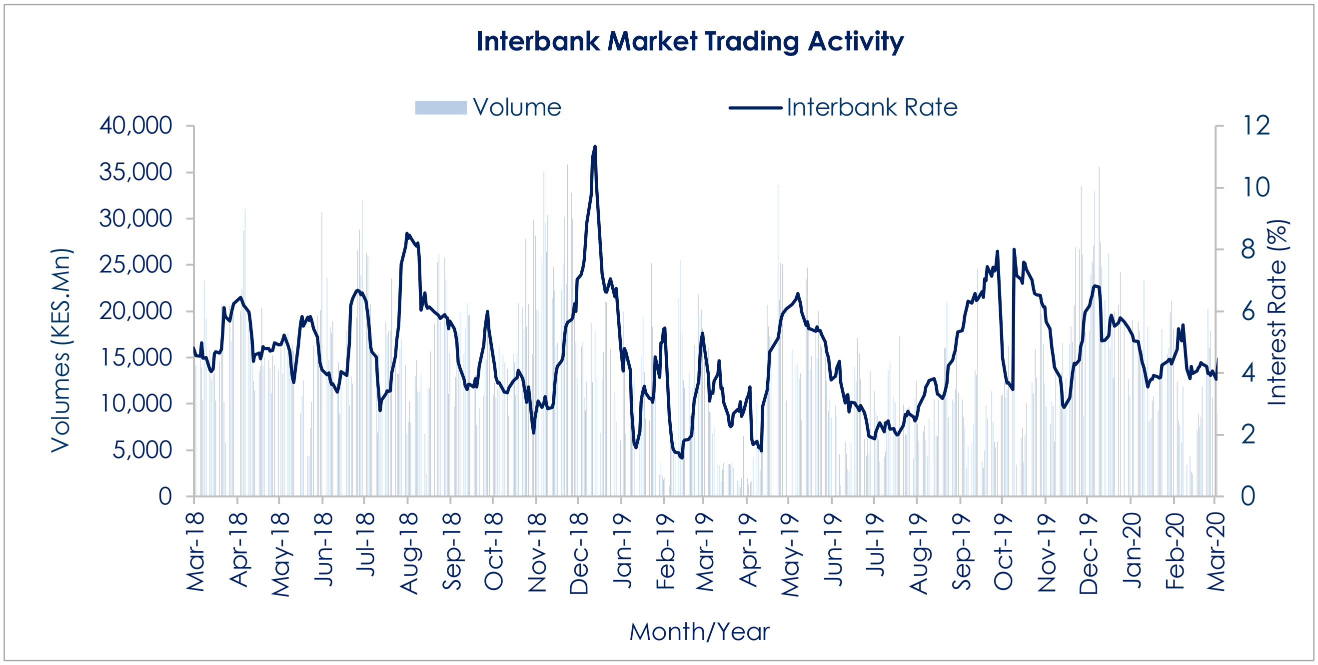


Source: Nairobi Securities Exchange

High market liquidity will keep inter-bank lending rates low in April 2020

- High market liquidity has resulted in a slight drop in inter-bank lending rates, averaging at 4.3% in March compared to 4.4% in February 2020.
- Total volumes exchanged during the month increased 24.5% from KES.181.5Bn in February to KES.225.9Bn.
- Daily inter-bank rates have however been on the rise following the announcement of US$ purchase by the CBK as well as the CBR and CRR downward revision contrary to market expectations that increased liquidity will result in a decline in the rates.
- A possible explanation for this trend is that CBK is mopping up excess market liquidity paying between 7-7.25%, way above recent inter-bank lending rates thus requiring banks experiencing liquidity challenges to pay higher rates to access liquidity.
- Therefore, as long as the CBK remains active in the REPO market mopping up exceed liquidity, we are likely see inter-bank rates edge upwards.
- Also note that the CRR revision is conditional as banks will only benefit if they can justify use of the additional liquidity preferably private sector lending.

Fig.6: Inter-bank rates remain low on high market liquidity, trend expected to continue in April 2020

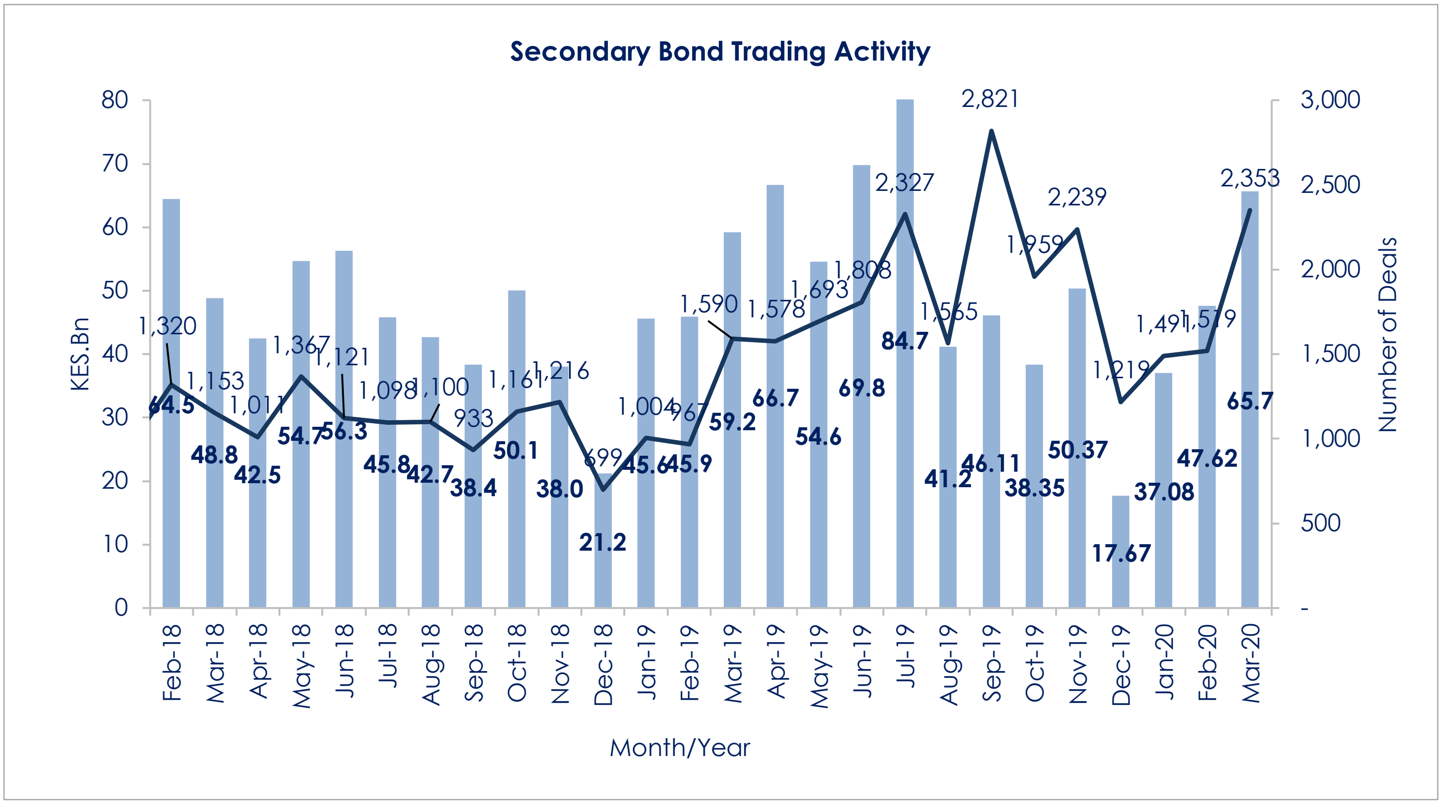


Source: Central Bank of Kenya

Secondary market trading activity up and up

- March 2020 bond trading turnover rose 38% compared to February to KES.65.7Bn with the number of deals up 54.9% to 2,353(Fig.6).
- The improved trading activity in the secondary market was partially attributable to the undersubscription for long dated bond issues with investors redirecting their extra liquidity to the secondary market.
- Secondary market trading activity is expected to continue rising in the near term following the lowering of the CBR and CRR rates as well as the flight of capital from the equity market.

Fig.7: Secondary market trading turnover on the rise



Source: Central Bank of Kenya

Trading ideas - Trading portfolio buy short, income portfolio go long

- Government securities are our preferred investment option during the ongoing global COVID-19 pandemic (Table 5).
- Investors with a trading portfolio should focus on the short end of the yield curve where most trading activity is concentrated.
- Market liquidity remains high but most investor interest in primary auctions and secondary trading activity is on the short and medium-term papers.
- Investors with income portfolio should consider investing in long term papers as yields are rising on the long end of the yield curve.

Table.6 - Trading ideas

Bond	Tenor (Years)	Coupon (%)	Modified Duration* (%)	Sterling Capital Yield to Maturity (%)	Current Yield** (%)	10-Year Historical Average Yield (Pre-Rate Cap)	Average Yield (Post-Rate Cap)
FXD1/2016/5	1.1	14.33	0.92	10.100	12.92	10.133	10.710
FXD1/2019/5	3.9	11.30	3.05	11.300	11.06	11.431	11.738
FXD2/2019/5	4.1	10.87	3.10	11.450	10.49	11.431	11.738
FXD3/2019/5	4.7	11.49	3.44	11.450	11.11	11.668	12.002
FXD1/2019/10	8.9	12.44	5.24	12.400	12.10	12.298	12.688

Source: Nairobi Securities Exchange & Sterling Research

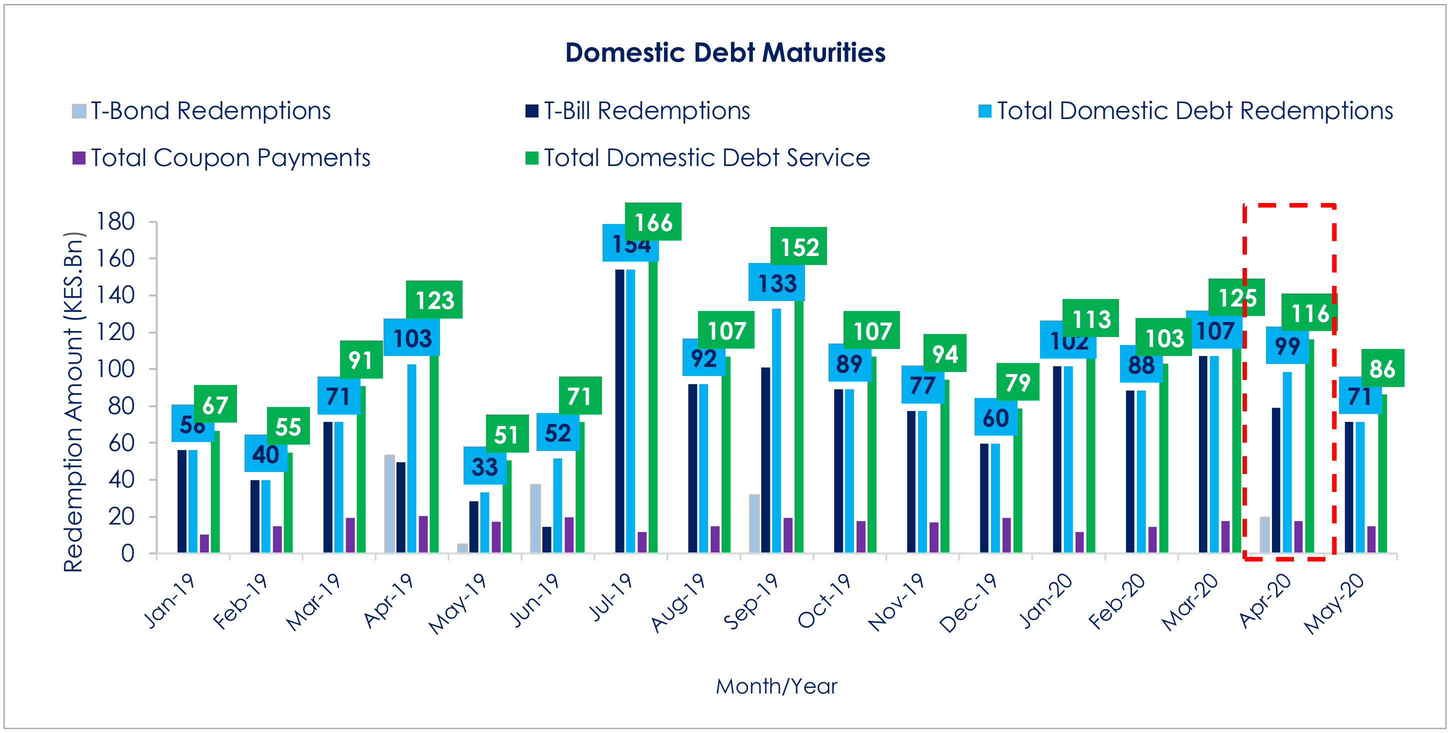
*Modified duration - Expresses the measurable change in the value of a security in response to a change in interest rates (for every 1% movement in interest rates, the bond would inversely move in price by the modified duration)
** Current Yield – Return on investment, for an investor holding a specific bond for 1 year

KES.116Bn in Total Domestic Debt Service for April 2020

Total domestic debt service in April 2020 – KES.116Bn inclusive of net redemptions and coupon payments

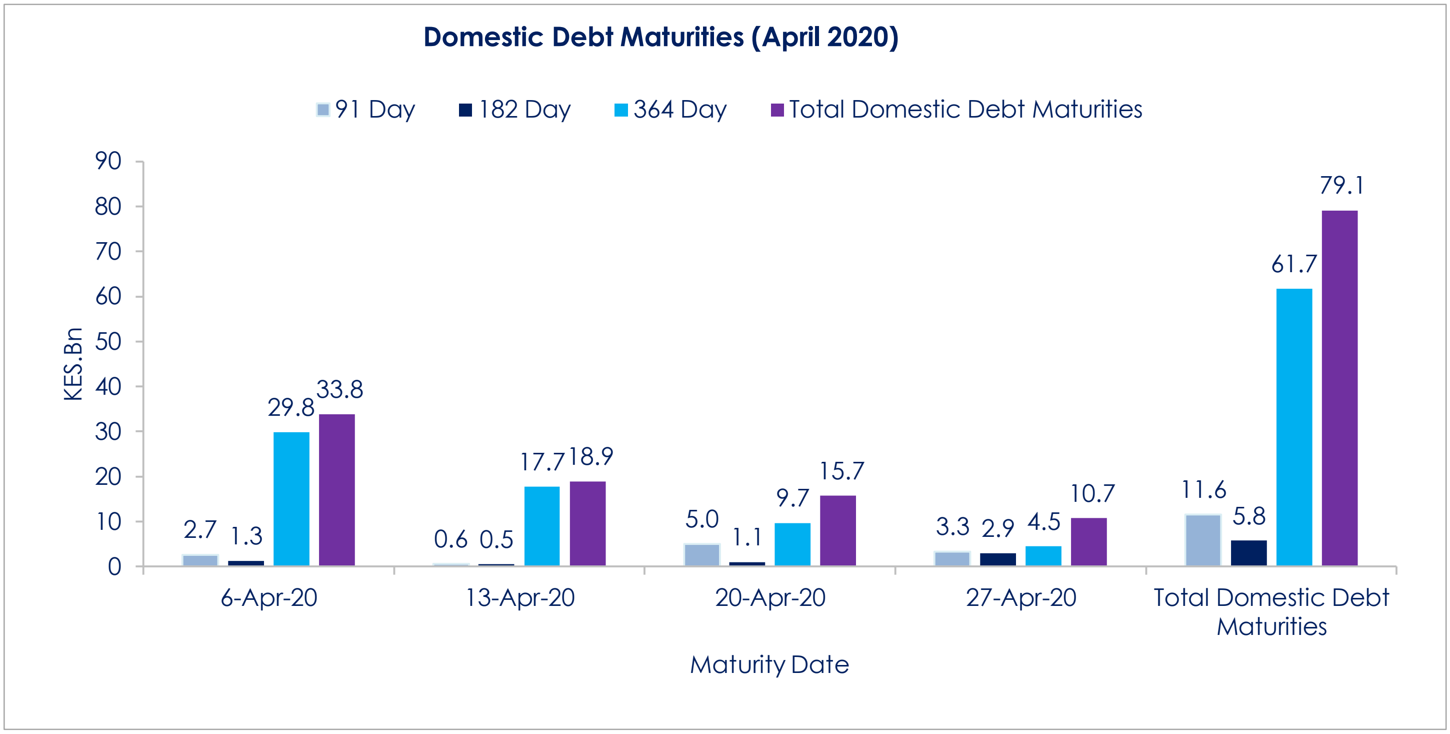
- Total domestic debt service for April KES.116Bn, a decline from KES.124.7Bn in March (Fig.8).
- This includes KES.98.6Bn in domestic debt redemptions (T-Bonds KES.19.5Bn and T-Bills KES.79.1Bn) and KES.17Bn in bond coupon payments on.
- The redemptions for the 91, 182 and 364 day T-Bills includes KES.11.6Bn, KES.5.8Bn and KES.61.7Bn respectively.
- Most redemptions (KES.33.8Bn) will be done in the first week of April (Fig.9).
- Domestic debt maturities will decline further in May to KES.71.4Bn (T-Bills only) implying a decrease in Government appetite for borrowing in the second quarter of 2020 to fund these redemptions.

Fig.8: KES.98.63Bn debt redemptions, KES.17Bn in coupon payments set for April 2020



Source: Central Bank of Kenya

Fig.9: Weekly debt maturities in April 2020

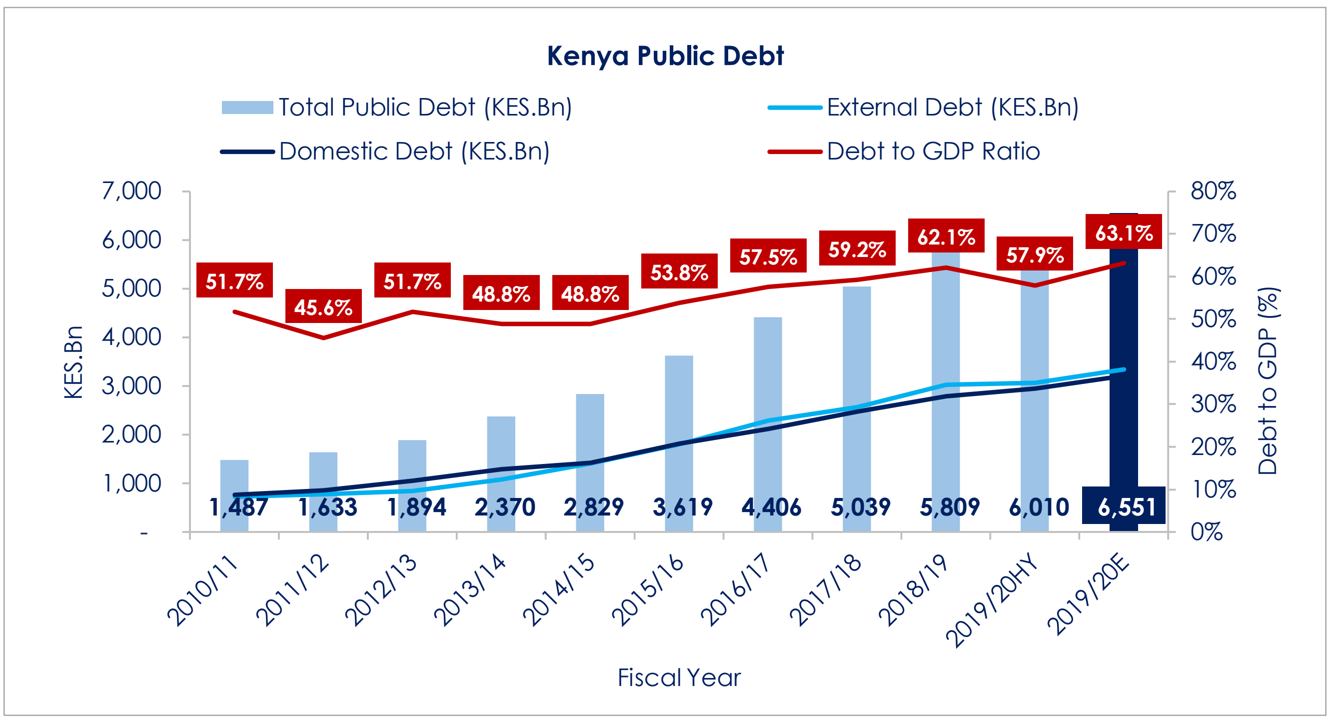


Source: Central Bank of Kenya

Kenya Public debt expected to rise on account of wider fiscal deficit

- Kenya's public debt at the end of the first half of the 2019/20 fiscal year (December 2019) stood at KES.6.01Tn and we estimate it at KES.6.55Tn at the end of the fiscal year (Fig.10).
- Domestic/External debt breakdown is 49:51 with commercial and sovereign debt issues in 2014/15 beginning the increase in the proportion of external debt.
- National Treasury in its Medium Term Debt Management Strategy 2020/21 estimates KES.441.5Bn and KES.150.9Bn in interest payments FY2019/20.
- We see rising external debt service cost risks on account of the depreciation of the KES against the US$ (5% depreciation between Jan and March 2020).
- In addition, the increase in Government expenditure and decline in tax revenue aimed at mitigating the impact of Covid-19 on the economy will result in an increase in the fiscal deficit and therefore Government borrowing and ultimately total public debt.

Fig.10: Kenya Public Debt 2019/20 estimate KES.6.6Tn, 63.1% of GDP



Source: National Treasury

Significant revision of 2020/21 budget estimates highly likely

- The draft budget policy statement for the 2020/21 fiscal year shows KES.2.13Tn, KES.1.86Tn, KES.2,874.2Tn and KES.569.4Bn in total revenue, ordinary revenue, total expenditure and net lending and financing estimates respectively (Table.6).
- We see significant revisions in these estimates as it has become evident that revenue collection will fall below and expenditures will exceed expectations due to the disruption in normal activity caused by the Covid-19 pandemic.
- The duration and economic impact of the disruption in economic activity is not known with certainty but the CBK estimates 2020 GDP growth at 3.4% against an initial estimate of 6.2%.
- The proposed tax and expenditure measures will push the financing gap inclusive of grants above KES.600Bn by our own estimates.
- We see an increase in both external and domestic financing with the International Monetary Fund (IMF) and World Bank looking as likely funding partners for budgetary support.

Table.7: Major revisions to 2020/21 fiscal budget estimates expected

Budgetary Item	2019/20 BROP*	2019/20 Supplementary Budget	2020/21 Estimate
Total Revenue	**2,090.5**	**2,084.2**	**2,133.5**
Ordinary Revenue	1,851.8	1,843.8	1,856.7
Ministerial Appropriation in Aid	238.7	240.4	276.8
Total Expenditure & Net Lending	**2,835.7**	**2,874.2**	**2,743.8**
Recurrent Expenditure	1,744.9	1.760.0	1,786.9
Development Expenditure	707.4	730.8	576.0
County Transfer	378.4	378.4	376.0
Contingency Fund	5	5	5
Balance Exclusive of Grants	(745.2)	(789.9)	(610.3)
Grants	38.8	41.8	40.9
Balance Inclusive of Grants	(706.4)	(748.1)	(569.4)
Adjustments to Cash	66.2	90.7	-
Balance Inclusive of Grants	(640.2)	(657.4)	(569.4)
Total Financing	**640.2**	**657.4**	**569.4**
Net Foreign Financing	331.3	353.5	247.3
Other Domestic Financing	3.2	3.2	3.2
Net Domestic Financing	**305.7**	**300.7**	**318.9**
Nominal GDP (Fiscal Year)	**10,355.4**	**10,355.4**	**11,633.4**

BROP - Budget Review and Outlook Paper

Source: National Treasury

Domestic borrowing ahead of 2019/20 fiscal target but upward revision expected

National Treasury has achieved 60.9% and 73.6% of its total revenue and domestic borrowing target

- Total Government revenue as 29th February 2019 stood at KES.1.6Tn equivalent to 60.9% of the total target for the 2019/20 fiscal year (KES.KES.2.65Tn) Table.7 and Fig.11.
- Actual receipts fall below our linear target run rate of 66.7% after 8 months of the fiscal year.
- The CBK however remains above the required run rate on domestic borrowing KES.378.4Bn (73.6%) as is the case with programme loan budget support and foreign Government and international organizations 588.5% and 72.5% respectively.
- Total tax target stood at (KES.995.4Bn) or 58.4% of the total target and we are certain that the National Treasury will be unable to meet its target especially in view of the adverse impact of the Covid-19 (Coronavirus) pandemic on the economy.
- We see a high likelihood of a revision of the Government's revenue target in the next few weeks due to the adverse impact of the pandemic on the following:

  1) Decline in economic activity due to disruption in normal business activity
  2) Increased redundancy as employers cut their workforce in response to reduced business income.
  3) Decline in investment and consumer spending due to increased economic uncertainty.
  4) Tax measures proposed by the Government and likely to be ratified by parliament aimed at mitigating the impact of the pandemic on the economy will result in a significant decline in tax collection
  5) Disruption in economic activity including export earnings resulting in an increase in current account deficit, depreciation of the Shilling and possibly inflationary pressure.

- In addition to the above, Government expenditure is expected to rise due to increased expenditure on public health and administration including on efforts aimed at containing the spread of the pandemic.
- An increase in expenditure and a decline revenue will result in a bigger budget deficit thus having a major implication on borrowing.

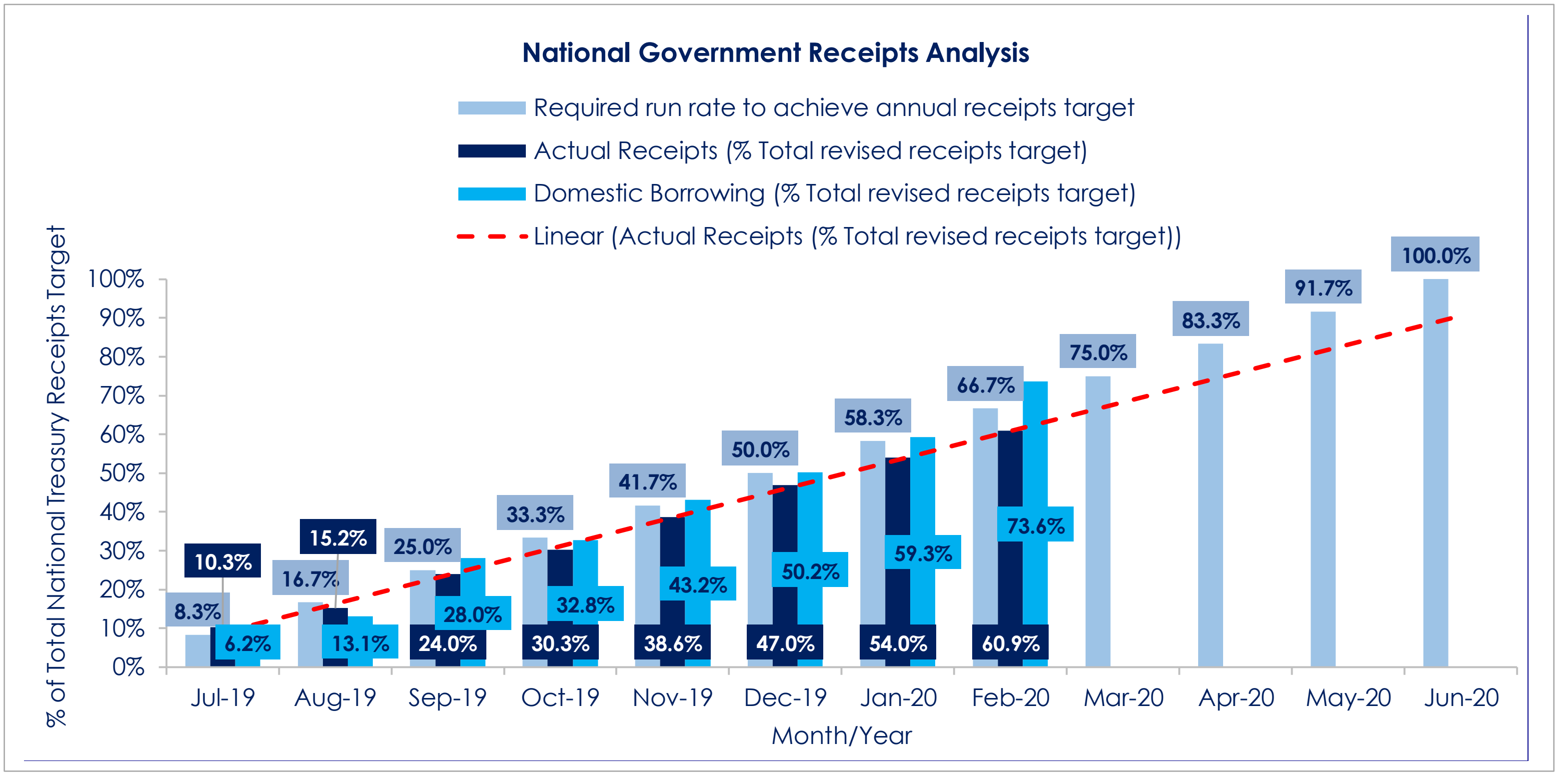
Table.8: CBK behind 2019/20 fiscal year total revenue target but on course with its domestic borrowing target

Receipts	2019/20 Original Estimates (KES.Bn)	2019/20 Revised Estimates (KES.Bn)	Actual Receipts (KES.Bn) 31st Jan 2020	Actual Receipts (KES.Bn) 29th Feb 2020	Proportion of Receipt Target Achieved 29th Feb 2020
Opening Balance (1st July 2019)			98.9	98.9	
Total Tax Income	1,807.6	1,705	897.7	995.4	58.4%
Total Non-Tax Income	69.5	138.9	81.7	89.7	64.6%
Domestic Borrowing*	429.4	514.0	304.8	378.4	73.6%
Loans -Foreign Gov't & International Org	65.2	66.1	17.3	21.4	32.3%
Programme Loan-Budget	2.0	2.0	11.8	11.8	588.5%
Domestic Lending & on-lending	4.3	4.3	1.6	2.2	49.8%
Grant -Foreign Gov't &	14.5	17.7	8.5	9.0	51.1%
Grants from AMISON	5.0	4.0	2.9	2.9	72.5%
Commercial Loan	200.0	200.0	0.0	0.0	0.0%
Unspent Balances (Recoveries)			5.7	5.7	-
Total Revenue	**2,598**	**2,651.9**	**1,430.9**	**1,615.3**	**60.9%**

* Note 1: Domestic Borrowing of KES. 514.6 = Net Domestic borrowing KES.391.4 & Internal debt redemptions (Roll-overs) KES.122.6.

Source: The Kenya Gazette Vol. CXXII - No.50 21st February 2020

Fig.11: CBK is below 2019/20 total receipts target but above the revised domestic borrowing target

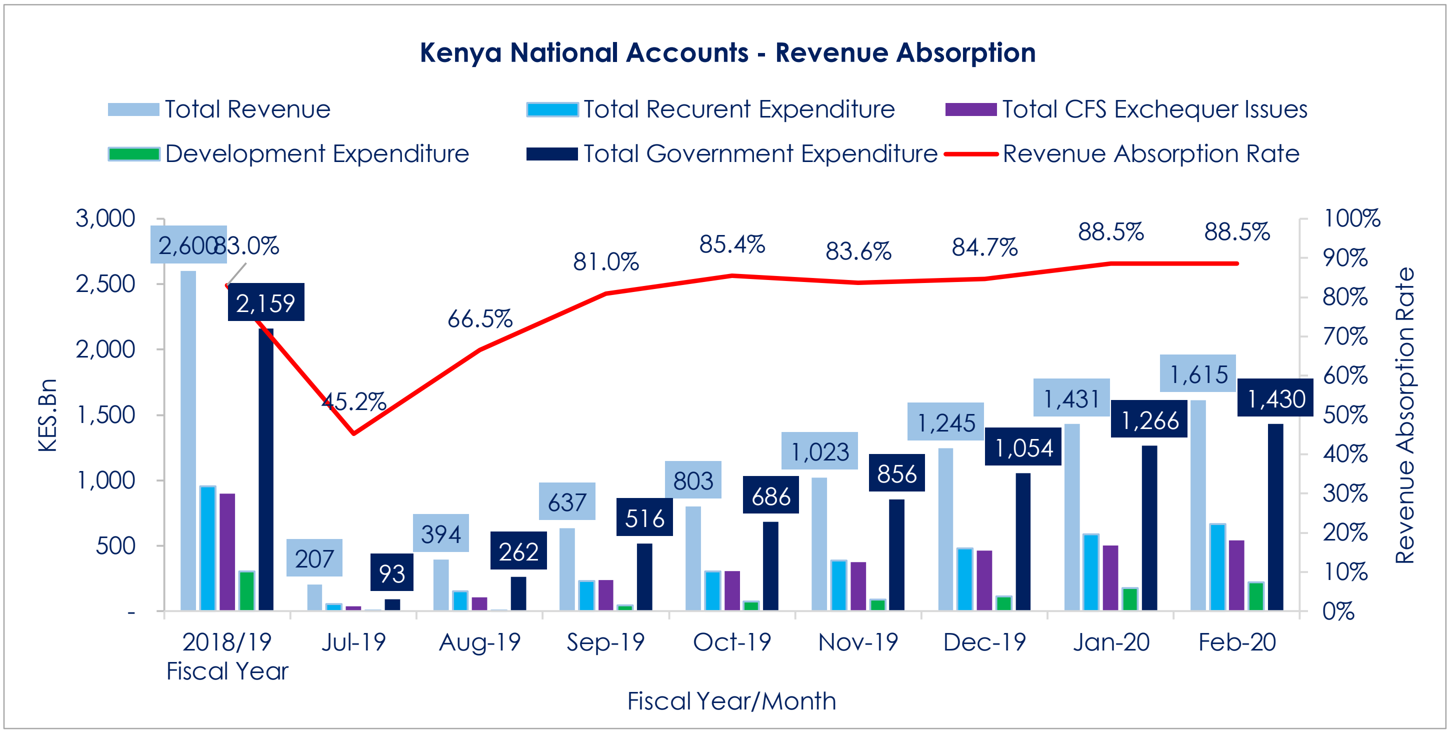


Source: The Kenya Gazette Vol. CXXII - No.50 21st February 2020

Government revenue absorption rates to remain high as financing needs rise

- "Revenue Absorption Rate" (RAA) the rate at which the National treasury uses its revenue to finance its expenditure remained unchanged in February as it was in January 2020 at 88.5% (Fig.12).
- The RAA will remain high over the next few months especially considering its high financing needs amid falling revenue.

Fig.12: Revenue absorption rate unchanged at 88.5%, expected to remain high in coming months



Source: The Kenya Gazette Vol. CXXII - No.50 20th February 2020

Proposed Government support measures to widen budget deficit

- On 25th March President Uhuru Kenyatta announced several measures to mitigate the impact of the epidemic on the businesses and the population in general.
- The tax and expenditure measures that will have a significant impact on the Government's financial position and necessitate major changes in new borrowing and existing debt service include the following:

Proposed tax and Government expenditures aimed at mitigating the impact of Covid-19 on the economy

1) **New Tax Measures**

- 100% tax relief for persons with monthly income of up to KES.24,000
- Reduction of income tax - Pay as You Earn (PAYE) and corporation tax from 30% to 25%.
- Reduction of the recently reintroduced turnover tax from 3% to 1% and Value Added Tax (VAT) from 16% to 14%.
- KES.10Bn verified tax refunds by the Kenya Revenue Authority (KRA) with a provision for offsetting of Withholding tax.

2) **New expenditure**

- Additional KES.10Bn to vulnerable members of the society to cushion them from the adverse economic effects of the pandemic.
- KES.13Bn payment by Government ministries and departments of verified pending bills.
- KES.1Bn from the universal health kitty used for recruitment of additional health workers to help in management of the epidemic.

▪ The proposed measures will require the approval of the National Assembly and will most likely result in an upward revision of the domestic borrowing target.
▪ Also likely is financial support from external financiers through international aid, grants and possibly The International Monetary Fund (IMF) and the World Bank.
▪ There is also the possibility of renegotiation of existing debt service to international financiers if the pandemic persists and effects on the economy last longer than initially expected.

Short end of the yield curve shows biggest shift on lower yields

Biggest decline in yields on the short-end of the yield curve

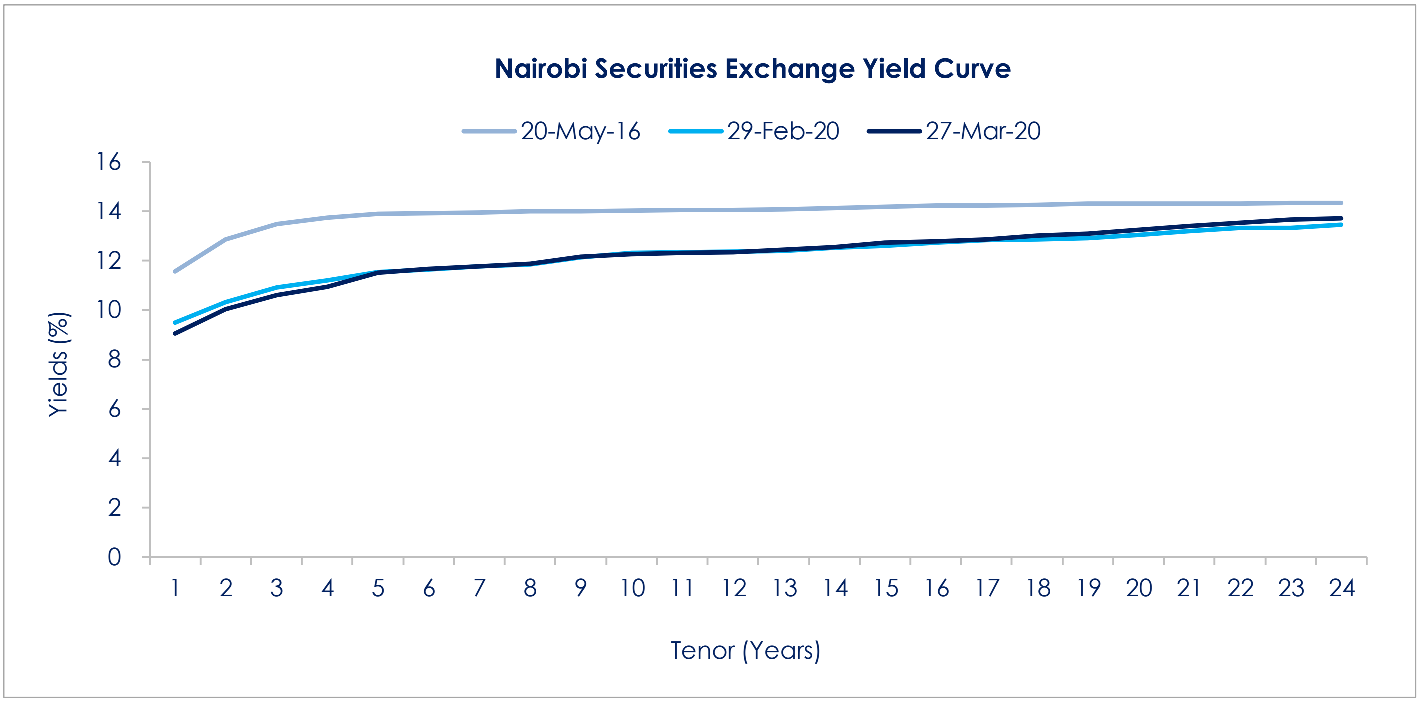
▪ A comparison of yields at 27th March 2020 and 20th May 2016 (time of issue of IFB1/2016/9) shows a big dip in short and medium term yields compared to long term issues (Table.6 and Fig.13).
▪ On month on month comparison, the latest NSE yield curve (27th March 2020) shows a rise in yields on the 15Yr and 20Yr papers respectively while the short and medium term yields declined.
▪ We expect the yield curve to shift downwards due to an increase in market liquidity resulting from the reasons mentioned earlier in the report.
▪ The yield curve is expected to normalize with short term yields declining and long term yields rise.
▪ **Our recommendation still stands; BUY short and medium term bonds and HOLD long term papers.**

Table.9: Short-term bond yields down while those on the long end rise

Tenor	Yield (20th May 2016)	Yield (29th Feb 2020)	Yield (27th Mar 2020)	Change May 2016 vs Mar 2020 (Bps)	Change Feb 2020 vs Mar 2020 (Bps)	Sterling Capital yield Curve(30th March 2020)
1	11.5700	9.5000	9.0450	↓252.5	↓45.5	9.45
2	12.8550	10.3307	10.0375	↓281.8	↓29.32	10.10
5	13.8929	11.5250	11.5001	↓239.3	↓2.49	11.45
10	14.0169	12.3167	12.2532	↓176.4	↓6.35	12.25
15	14.1867	12.6000	12.7196	↓146.7	↑11.96	12.75
20	14.3051	13.0521	13.2452	↓106.0	↑19.31	13.15

Source: Nairobi Securities Exchange

Fig.13: Decline in short end yields resulting in a normal yield curve



Source: Nairobi Securities Exchange

April 2020 inflation forecast 6-6.5%

- The Kenya National Bureau of statistics(KNBS) released three products: a rebased Consumer Price Index(CPI), a rebased Producer Price Index(PPI) and four quarterly labour reports to enhance quality statistics in measurement of inflation.

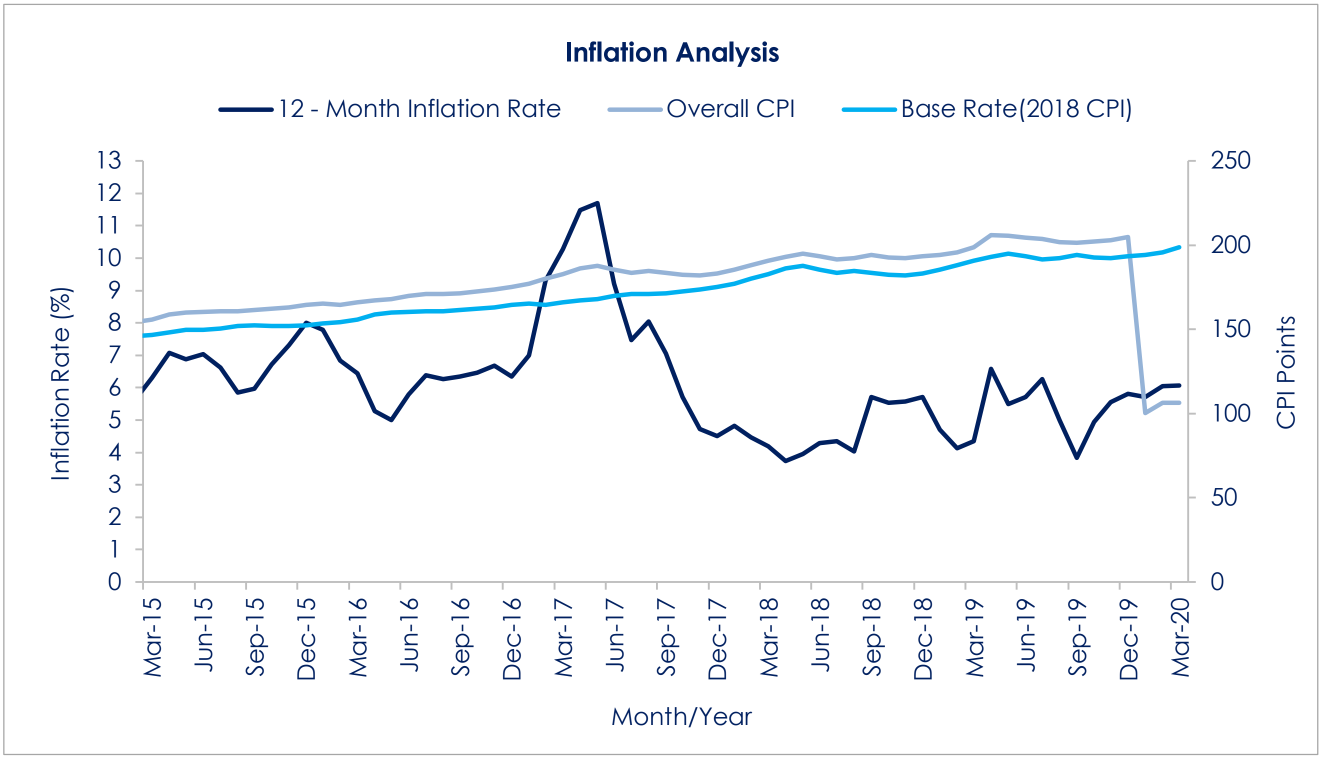
KNBS revises CPI and introduces quarterly labour reports

- The new basket includes 330 products up from 234, increase of data collection zones from 25 to 50 zones, separation of finance and insurance previous in miscellaneous category and Computer Aided Personal Interview(CAPI) has been adopted.
- Changes in new CPI include: mobile phone airtime which has highest expenditure with weighting up to 5.5% from 3.1%, while Television subscription, courier services, garbage collection, mobile money transfers and university boarding fees are the additions to the new CPI.
- Kerosene stove, radio/cassette/Player and video cassette have been scrapped off the new CPI to reflect lifestyle changes.
- We see the new CPI as a better measure of inflation as it takes into account lifestyle changes over time and includes expenditure items that take up a big proportion of household income.
- The overall year on year inflation for the month of March 2020 stood at 6.06% from 6.05% (rebased CPI) in the previous month (Fig.14).
- Food and Non-Alcoholic Drinks' Index increased by 0.6% month on month while the year on year food inflation in March, 2020 increased 11.9%.
- Transport Index declined by 0.1% per cent, mainly due to a 1.3% fall in petrol prices.
- Our April 2020 inflation forecast is 6.0% - 6.5% based on expectations of minimal deviations from the current CPI although food and non-alcoholic as well as the transport index could rise marginally due to disrupted supply chain resulting from the recently imposed partial curfew.
- Favourable weather conditions with the onset of the long rains will however limit the rise in food prices.
- We anticipate the prices of petrol, diesel, and kerosene to decline further following the sharp fall global crude oil prices - halved to U$23 per barrel In March compared to US$49.68 per barrel in
- February.

Inflation to remain in the upper band of the CBK target 5-7.5%

- We expect inflation to remain within the upper band of the target range 5%-7.5% in the short term due to the disruptive effect of the COVID-19 Pandemic on the economy.
- We do not expect the recent revision of the CBR and CRR to have a major impact on inflation in the near term as we see banks limiting credit to the private sector also noting that the revision of the CRR will be selective and not a blanket industrywide reduction.
- The proposed tax and Government spending measures are positive in the sense that they will increase market liquidity but this is likely to result in increased household savings rather than increased expenditure in these uncertain times.

Fig.14: April 2020 inflation forecast 6.0% - 6.5%



Source: Kenya National Bureau of Statistics

Monetary Policy Committee reviews CBR and CRR downwards in latest meeting

MPC lowers CBR to 7.25% to help mitigate the economic and financial impact of the corona virus pandemic

- The Monetary Policy Committee (MPC) in their bi monthly meeting held on 23rd March 2020 lowered the CBR by 100bps to 7.25% from 8.25%, exceeding our 25-50bps expectation.
- Revision of the CRR was a surprise to us but understandable in the current environment.
- Both measures are aimed at increasing market liquidity and therefore private sector credit thus mitigating the economic and financial impact of the COVID-19 pandemic.
- The MPC noted that the impact of the pandemic may be severe including giving an economic growth estimate for 2020 of 3.4% from the 6.2% estimate earlier in the year.
- The lower revision is based on expectations of reduced demand by Kenya's exports, supply chain and domestic production disruptions.
- The policy makers also mentioned their concerns over the health impact, job losses, and duration of the crisis.
- We do not think that the move by the MPC will increase private sector credit in the short term due to the high credit risk.
- Sector NPLs stood at 12.7% in February 2020 compared to 12% in December 2019) and banks are wary about lending to the private sector under the current economic environment even with additional liquidity from the CRR revision.

- In addition, the expected revision of lending rates makes it near impossible for pricing rising credit risk and banks.
- The most obvious move by banks would be to invest in Government debt and particularly short term debt, T-Bills and short term bonds.
- We also expect the KES to depreciate due to excess KES liquidity also taking into consideration that the CBK has been buying US$ from commercial banks (US$100 every month between March and June) to shore up its foreign exchange reserves.
- The overall impact of currency depreciation would be an increase in the cost of imports and a worsening current account deficit although this will be somewhat mitigated by the sharp fall in crude prices in recent weeks.
- It would also increase the cost of external debt service considering that the country has issued sovereign debt and accessed commercial debt.
- We wait keenly on the effectiveness of measures proposed by banks and the CBK to reduce the impact of the current health crisis on businesses and households.
- The next MPC meeting to review the impact of the above measures and set out new policy actions will be held in April 2020 (monthly meetings instead of bi-monthly meetings).

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