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STERLING CAPITAL LIMITED

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

January 2021

"Flurry of domestic debt issues continues"

Email: research@sterlingib.com

Bond Dealing: +254 (20) 2213914, 3315414; 2244077
+254 723153219, +254 734219146

Email: invest@sterlingib.com

Website www.sterlingib.com

Bloomberg Code: SCLK <GO>

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Executive Summary

- **"Flurry of domestic debt issues continues"** is the title of our third fixed income report in 2021 with the Central Bank of Kenya (CBK) re-opening two bonds with a KES.50Bn financing target.
- We anticipate an under subscription for the issue based on low liquidity in the market and relatively short period of sale.
- Our weighted average bid predictions are as follows:

  Weighted Average Rate (WAR) of investor bids

  - **FXD1/2013/15: 11.70% - 11.80%**
  - **FXD1/2012/20: 12.35% - 12.50%**

  WAR of accepted bids

  - **FXD1/2013/15: 11.65% - 11.70%**
  - **FXD1/2012/20: 12.30% - 12.40%**

- The report summarizes trends in subscriptions for both short- and long-term debt as well as giving an analysis of short-term debt interest rates.
- Also in the report is a short-term summary of commercial bank liquidity and secondary bond trading activity
- Kenya's financial position including debt service, revenue and expenditure at the mid-point of the 2020/21 fiscal year is also discussed in the report.
- We have also done a comparison of the Nairobi Securities (NSE) yield curve over the last one year to explain the decline in short- and medium-term domestic debt yields.
- The report concludes with our review of the Monetary Policy Committee (MPC) decision in January 2021.

CBK's re-opened medium tenor issues

- The Central Bank of Kenya (CBK) invites bids for two treasury bonds **FXD1/2013/15 and FXD1/2012/20 to raise** KES.50Bn (Table.1).
- The remaining term to maturity for **FXD1/2013/15 and FXD1/2012/20** is 7.1 and 11.8 years respectively.
- We anticipate an undersubscription for the issue -40%- 60% (KES.20Bn – KES.30Bn) on account of low liquidity in the market with most interest in the market on the short-term papers.

Table.1: Primary Bond issue summary

Issue Number	FXD1/2013/15	FXD1/2012/20
Total Amount Offered	KES.50Bn	
Tenor (Years)	15 Years	20 Years
Term to Maturity	7.1 Years	11.8 Years
Coupon Rate (%)	11.250	12.000
Price Quote	Discounted/Premium/Par	
Period of Sale	26th January 2021 to 2nd February 2021	
Auction Date	3rd February 2021	
Value Date	8th February 2021	
Yield Curve (%) (Weighted Average tenor - 22nd January 2021	**11.3689**	**12.1158**

Source: Central Bank of Kenya

Our weighted average and accepted bids averages

- We arrived at our market weighted investor and CBK accepted bids estimates using an analysis of yields of securities of similar tenors on the NSE as at 22nd January 2021 and discussions with fixed income traders (Table.3).

Table.2: Auction bid predictions

Rate	FXD1/2013/15	FXD1/2012/20
Market Weighted Average Rate	11.70 - 11.80	12.35 - 12.50
Weighted Average Rate of	11.65 - 11.70	12.30 - 12.40

Source: Sterling Capital Research

Historical debt issues provide guidance

- We implied yields of bonds of almost similar tenors to maturities on the Nairobi Securities Exchange (NSE) as at 22nd January 2020 to determine possible investor bids (Table.4).

Table.3: Benchmark issues to guide investor bids

Treasury Bond	Issue Date	Coupon Rate (%)	Maturity Date	Term to Maturity Years (Days)	Implied Yield to maturity (%)	Yield Curve at time of issue
15-Year						
FXD2/2013/15	29th April 2013	12.00	10th April 2028	7.2 (2,635)	11.3796	N/A
20-Year						
FXD1/2018/15	28th May 2018	12.65	09th May 2033	12.3 (4,490)	12.1894	N/A

Source: Central Bank of Kenya

Comparatively higher subscriptions for short- and medium-term tenors

- A historical review of primary auction results for 15- and 20-year issues show low investor demand due to the long term to maturity.
- As a result, we expect the auction to be undersubscribed with most investors left out in the 2-Yr and Infrastructure bond earlier in the month likely to direct their funds to the secondary market.

Table.4: Historical primary market auction performance

Issue	Offered (KES.Bn)	Bids Received (KES.Bn)	Amount Accepted (KES.Bn)	Performance Rate (%)	Coupon Rate (%)	Implied Yields (%)
15-Year						
FXD1/2018/15	40	20.2	12.9	50.5	12.65	11.9222
FXD2/2018/15	40	27.1	7.9	67.6	12.75	12.0153
FXD1/2019/15	40	25.1	14.7	62.7	12.86	12.0901
FXD2/2019/15	50	21.5	19.3	43.1	12.73	12.1669
FXD3/2019/15	40	86.7	50.6	216.7	12.34	12.2784
FXD1/2020/15	50	18.4	5.2	36.9	12.76	12.5664
20-Year						
FXD1/2018/20	40	13.7	8.5	34.4	13.20	12.7113
FXD2/2018/20	40	13.9	10.5	34.7	13.20	12.8087
FXD1/2019/20	40	25.1	14.7	62.7	12.86	12.8827

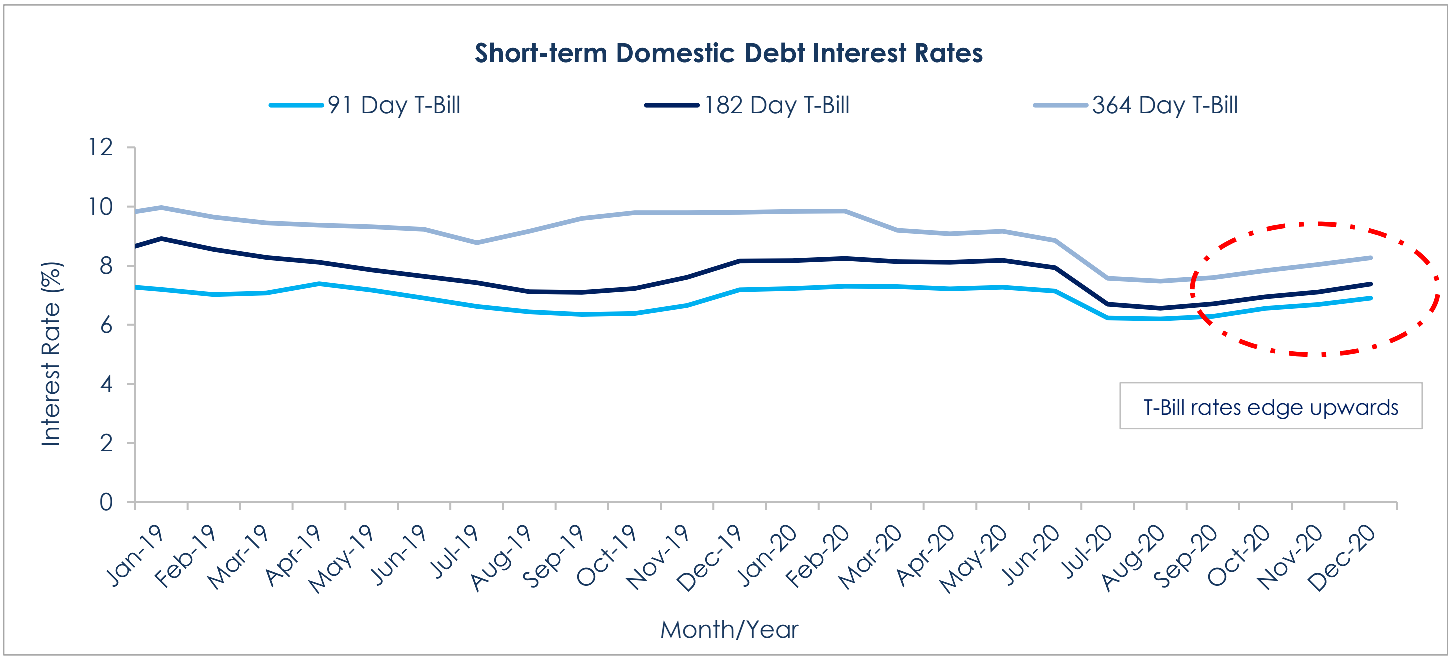
Source: Central Bank of Kenya

Average T-Bill rates have edged upwards in January 2021

Average T-Bill rates for the first three weeks of January 2021 higher than the those in December 2020.

- Interest rates on domestic debt have been rising gradually in recent months (Figure.1).
- Subscription as at the end of the first three weeks of January 2021 stood at 86.8% compared to 50.3% in December 2020.
- We attribute this to high market liquidity as well as marginal increases in T-bills' interest rates.
- The acceptance rate for the T-Bills during the period under review 91.4% compared to 93.5% in December 2020.
- Average interest rates for the 91, 182 and 364-day debt issues for the first three weeks of January stood at 7%, 7.5% and 8.5% respectively compared to the December 2020 averages of 6.9%, 7.4% and 8.4% respectively.
- We anticipate slight upward pressure on the short-end of the yield curve in upcoming auctions due to the high deficit financing demand by the National Treasury.

Figure.1: Interest rates on short-term debt securities edge upwards to 7%, 7.5% and 8.5% respectively



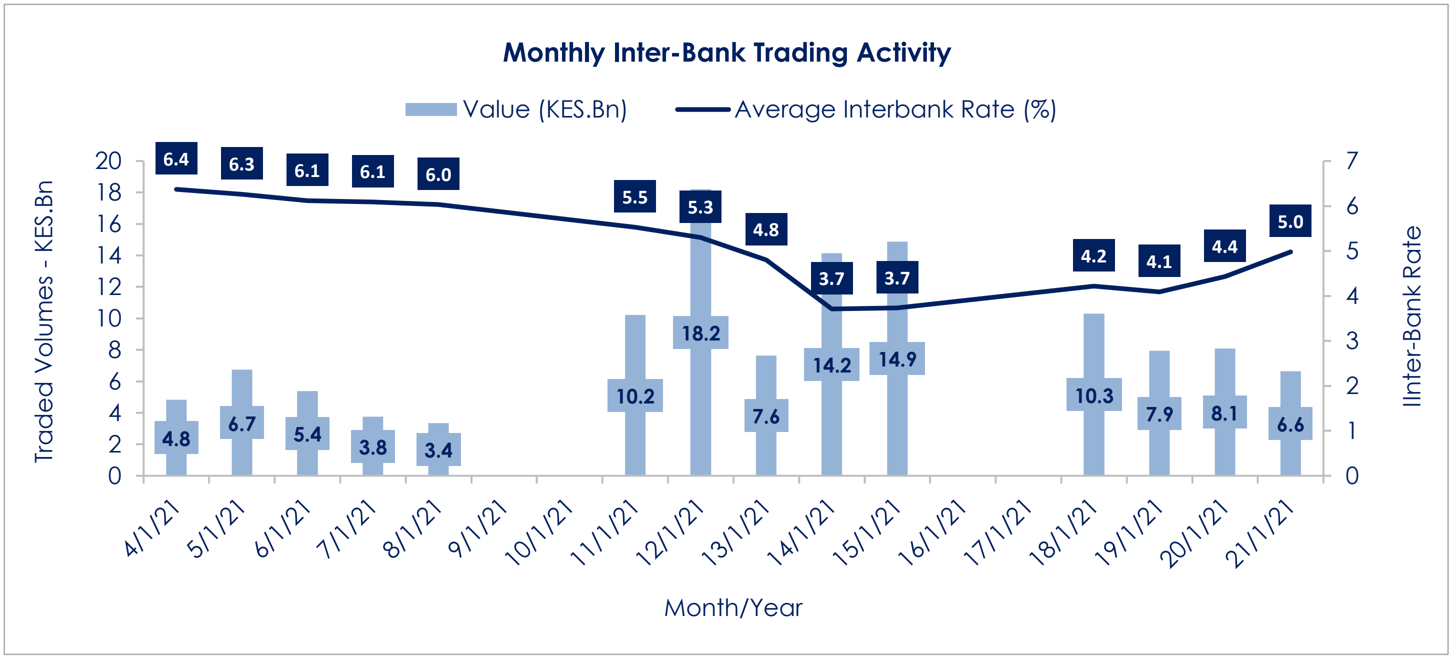
*Average T-Bill rates for January are up to the auction dated 25/01/2021
Source: Central Bank of Kenya

Inter-bank trading activity comparatively lower in January 2021

- The average inter-bank rate for the first three weeks ending 22nd January 2021 stood at 5.1% similar to that of the entire month of December 2020 (Figure.2).
- Total inter-bank trading volumes during the period stood at KES.128.7Bn compared to KES.259.2Bn for the entire month of December suggesting that total volumes for the month are likely to be lower than that in December.

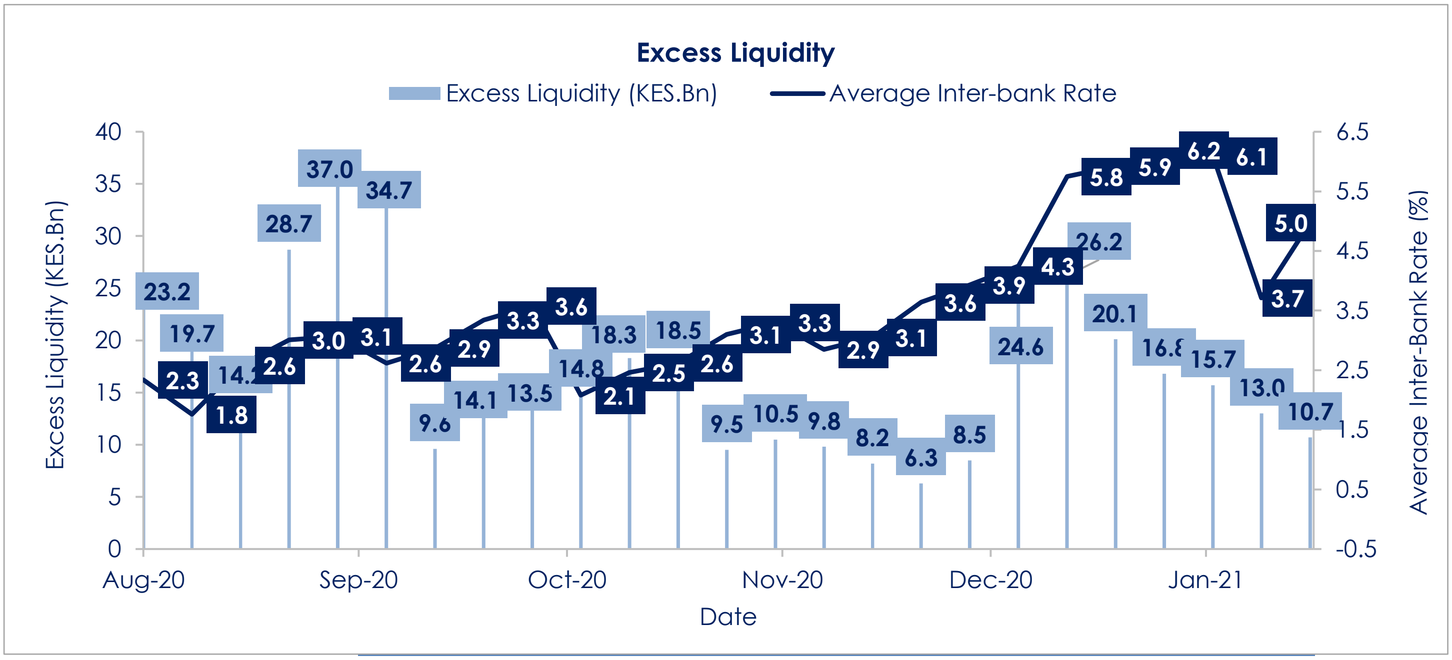
- Excess reserves (additional liquidity above the minimum 4.25% Cash Reserve Ratio (CRR)) over the same period stood at KES.39.4 compared to KES.96.2Bn attributable to the relatively high market liquidity, mainly supported by government payments that partly offset tax remittances (Figure.3).
- We forecast the average inter-bank rate for January 2021 in the range of 5% and 5.5%.

Figure.2: Inter-bank rates to range between 5.0% and 5.5% in January 2021



Source: Central Bank of Kenya

Figure.3: Commercial excess reserves declining in January

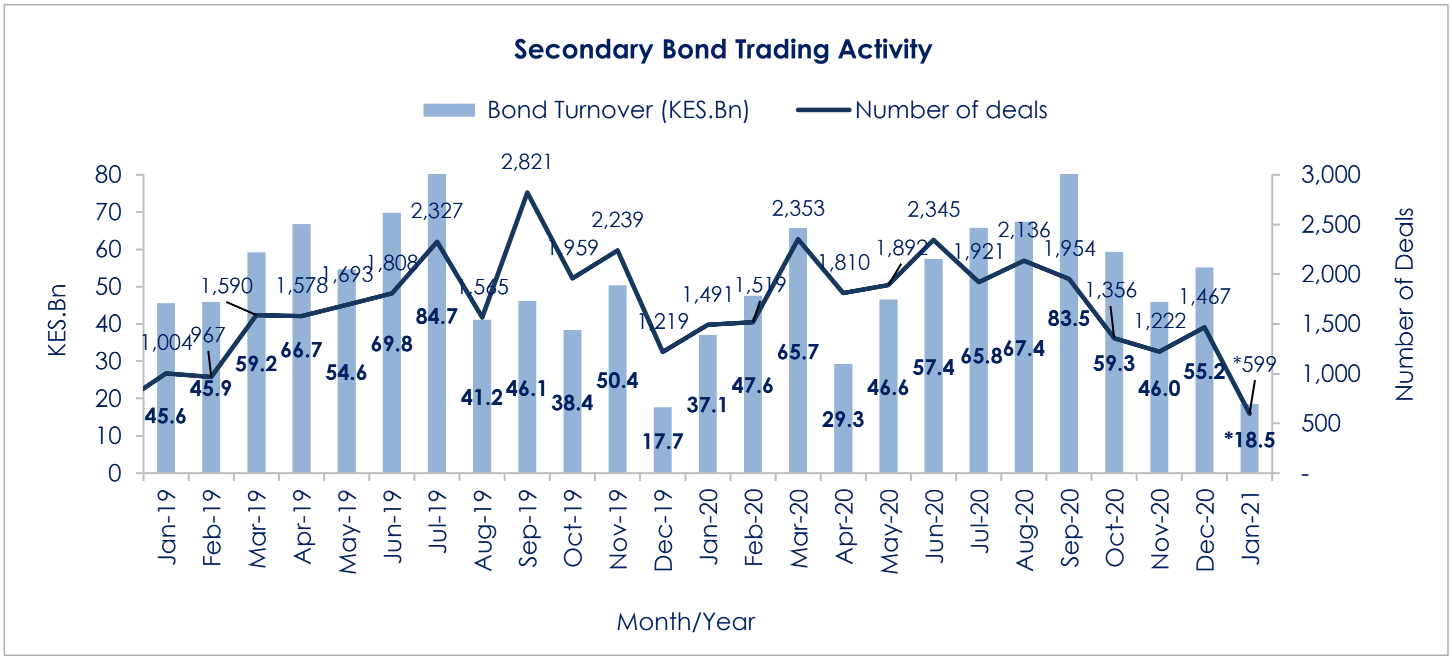


*Data is at 22nd January 2021

Source: Central Bank of Kenya

- Secondary trading up to the end of the third week of January (22nd) stood at KES.18.5Bn compared to KES.55.2Bn for the entire month of December while the number of deals stood at 599 compared to 1,467 in December (Figure.4).
- This suggests that we will see a decline in turnover for the month compared to the previous month contrary to our predictions at the beginning of the month.
- This decline in turnover can be explained by investors focus in the primary market where CBK issued two debt issues, FXD1/2021/2 and IFB1/2021/16 which were both oversubscribed at 244.6% (KES.61.1Bn) and 251% (KES.125.5Bn) respectively.

Figure.4: Secondary trading activity to decline in January 2021



*Data is up to 22nd January 2021

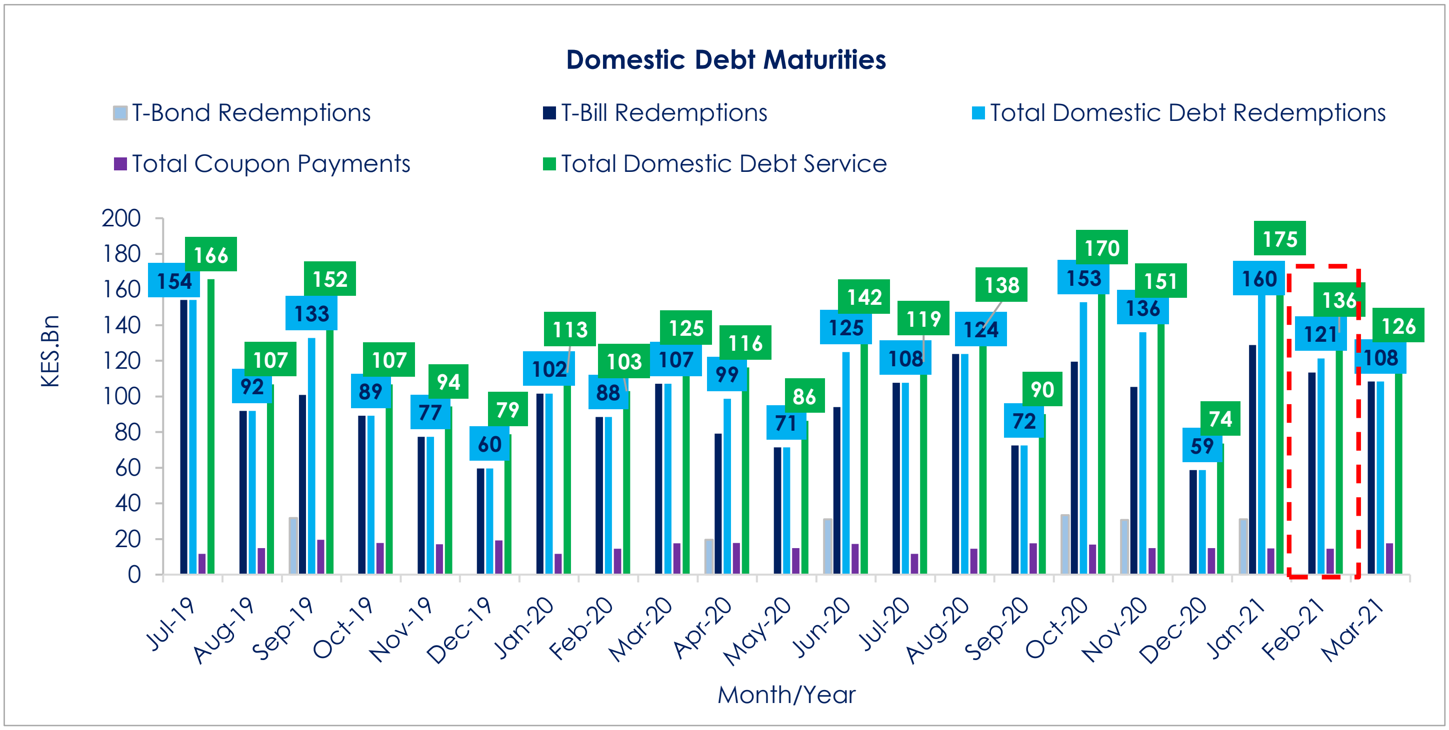
Source: Central Bank of Kenya

Domestic debt service to decline February 2021

KES.199.9Bn raised in January with KES.174.7Bn directed towards debt redemptions and KES.14.8Bn in coupon payments.

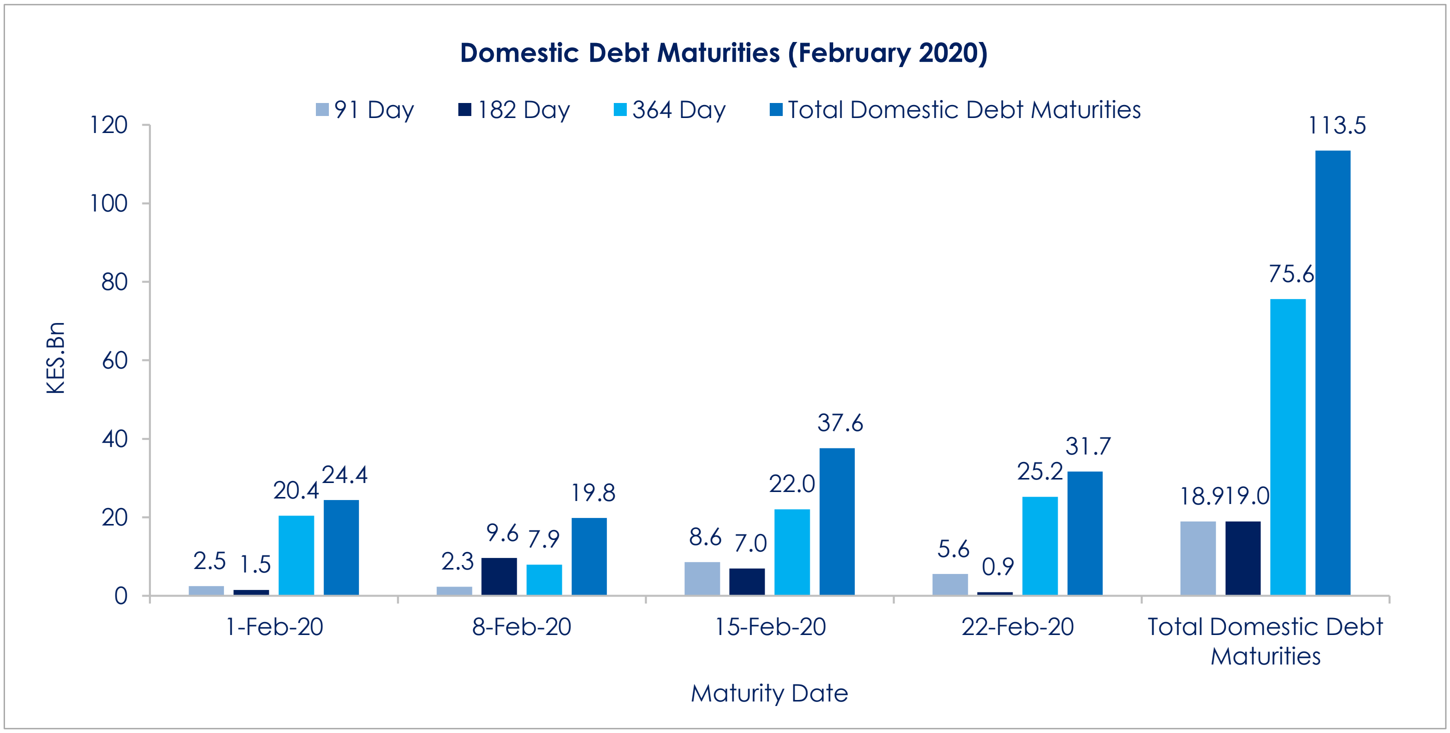
- Debt service for the month of January is KES.174.7Bn comprising of KES.128.8Bn in T-Bills, KES.31.1Bn in T-Bonds and KES.14.8Bn in coupon payments (Figure.4).
- Expected redemptions for the 91, 182 and 364-day T-Bills during the month are KES.24.5Bn, KES.29.1Bn and KES.75.2Bn respectively with the second week of the month expected to have the highest total redemptions at KES.51.4Bn (Figure.5)
- We observe that of the KES.199.9Bn raised in domestic debt auctions (KES.136.9Bn in T-Bonds and KES.63Bn in T-Bills), KES.180.1Bn has been used as new borrowing equivalent to 90.1% of total amount raised by the CBK.
- T-Bond and T-Bill redemptions are expected to fall to KES.7.9Bn and KES.113.5Bn respectively, while coupon payments decline to KES.14.5Bn, bringing the total debt service cost to KES.135.8Bn in February 2021.

Figure.4: February 2021 debt service to decline to KES.126Bn



Source: Central Bank of Kenya

Figure.5: February 2021 Weekly debt maturities



Source: Central Bank of Kenya

Revision of 2020/21 fiscal revenue, external and domestic debt targets likely

Tax receipts continue to fall short of revised target resulting in increased domestic borrowing.

- Data from the Kenya Gazette as at the end of December 2020, the mid-point of the 2020/21 fiscal year shows the Government is well below and just below annual revenue and domestic borrowing targets respectively, assuming a linear run-rate of 50% (Figure.6).
- KES.1,2Tn or 42.5% of the revised KES.2.8Tn had been raised as revenues while KES.385,8Bn of KES.786.6Bn had been borrowed from the domestic debt market in the during the period under review (Table.5 and Figure.6).
- We continue to expect major revisions in the fiscal budget including downward revisions to ordinary revenue and upward revisions to both domestic and external borrowing targets.
- A quick analysis of the draft 2021 Budget Policy Statement (BPS) shows Total revenue adjustment to KES.1.829Tn with Net Foreign and net domestic Financing revised to KES.428Bn and KES.573Bn respectively.

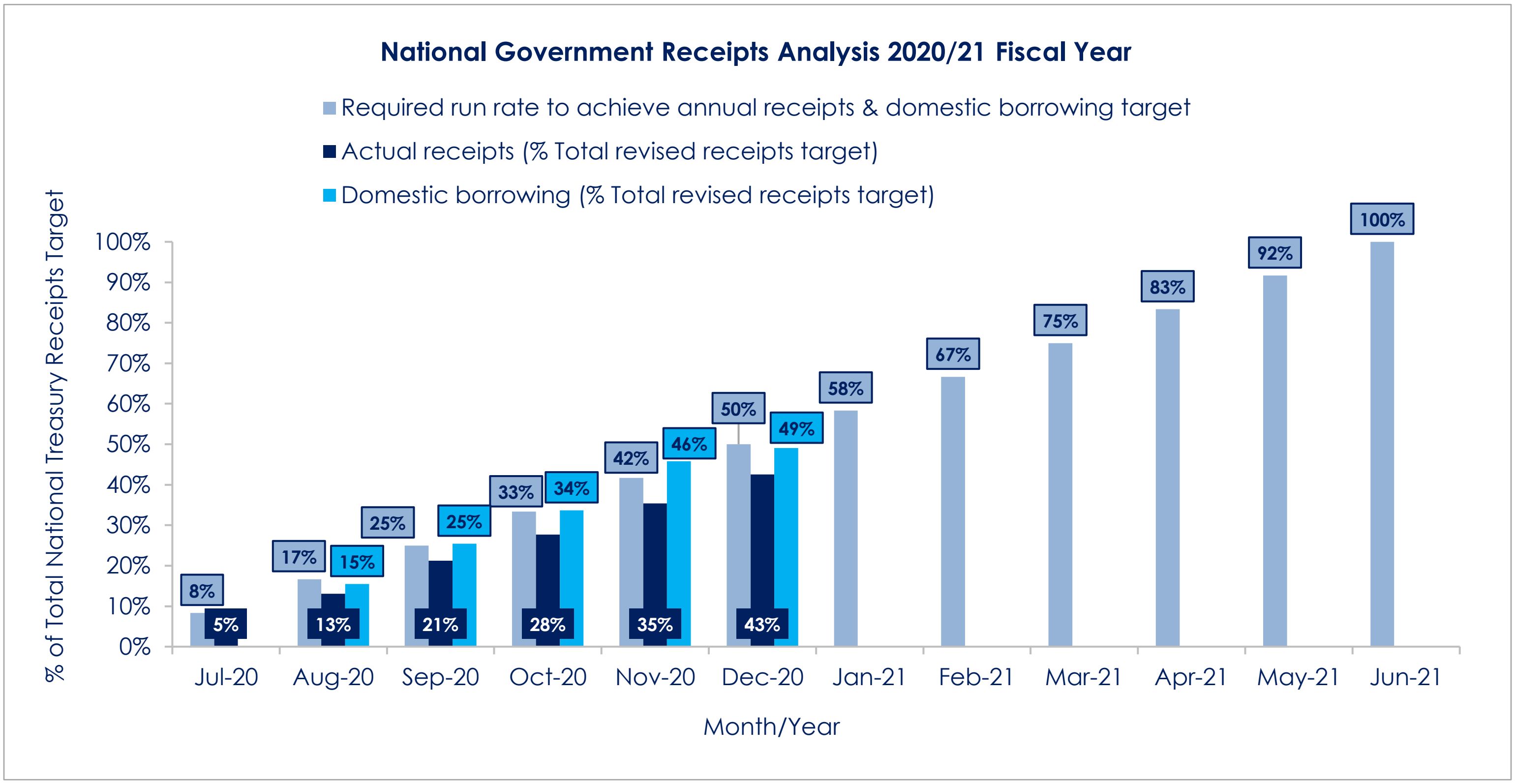
Table.5: Actual 2020/21 fiscal year revenues below half year target

Receipts	Original Estimates (KES)	Revised Estimates (KES) 31st August 2020	Actual Receipts (KES) 30th November 2020	Actual Receipts (KES) 31st December 2020	Proportion of Receipt Target (KES) 31st December 2020
Opening Balance (1st July 2020)			48.0	48.0	-
Tax Revenue	**1,567.6**	**1,567.6**	527.7	673.6	43%
Non-Tax Income	66.1	66.1	37.0	52.9	80%
Domestic Borrowing	756.9	786.6	360.6	385.8	49%
External Loans & Grants	373.2	373.2	26.2	39.8	10.7%
Other Domestic Financing	36.8	36.9	3.0	3.0	8.3
Total Revenue	**2,800.7**		**1,002.6**	**1,203.1**	**42.5%**

* Note 1: Domestic Borrowing of KES.786.6Bn = Net Domestic borrowing KES.524.7Bn & Internal Debt Redemptions (Roll-overs) KES.262

Source: The Kenya Gazette Vol. CXXII - No.17 22nd January 2021

Figure.6: Government remains below 2020/21 fiscal year revenue target



Source: The Kenya Gazette Vol. CXXII - No.17 22nd January 2021

Yield curve expected to shift upwards as a result of budgetary pressure

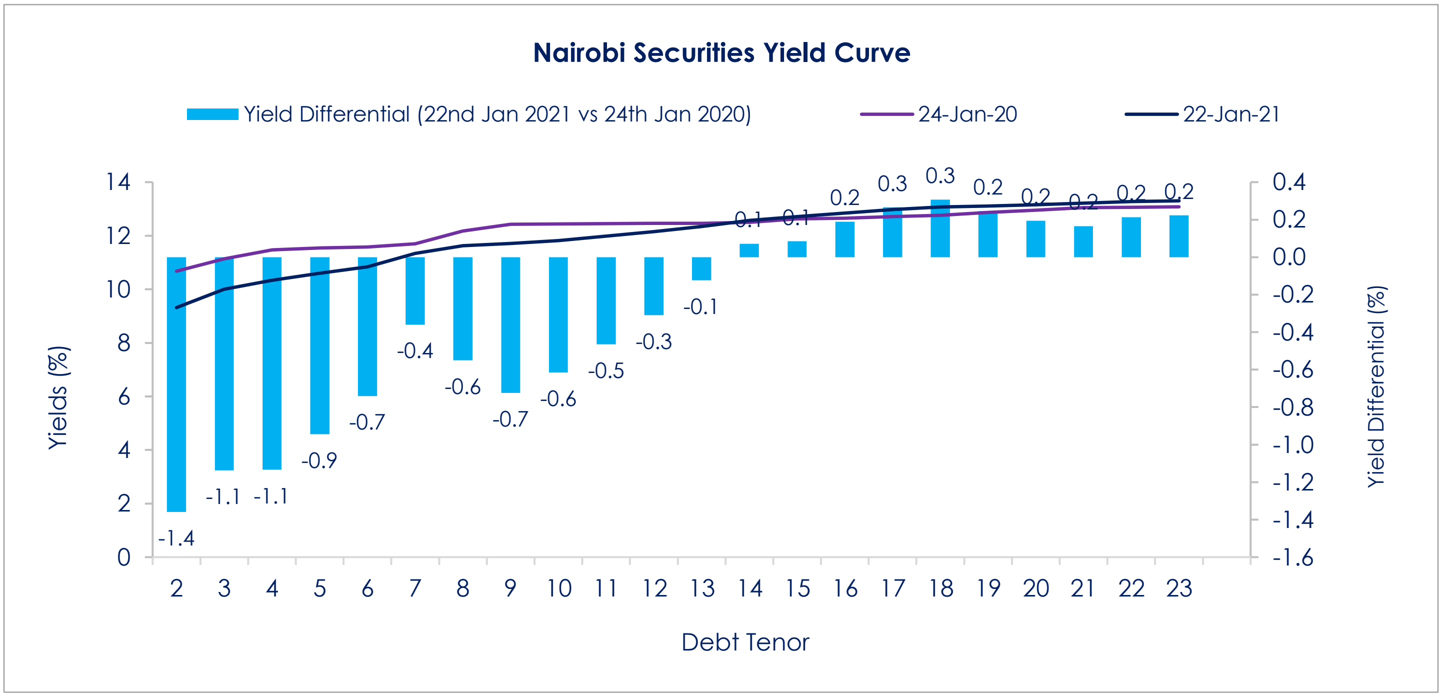
- A comparison of the NSE yield curve between 22nd January 2021 and 24th January 2020 (1 year) shows a significant decline in yields of short to medium tenor securities while those of long-term debt issues increased (Table.6 and Figure.7).
- We attribute this to Government's debt management strategy of issuing long-term debt issues in a bid to lengthen the maturity profile of public debt.
- Increased domestic debt financing in the 2020/21 fiscal year due to the growing fiscal deficit is likely to result in a gradual rise in yields.
- We maintain our recommendation of **BUY short and medium-term bonds and HOLD long term papers.**

Table.6: Yields on the short end and medium terms decline

Tenor	Yield (24th Jan 2020)	Yield (22nd Jan 2021)	YoY ∆ 22nd Jan 2021 vs 24th Jan 2020 (Bps)	Sterling Capital yield Curve (28th January 2021)
1	9.8590	8.5080	↓135.1	8.60
2	10.6757	9.3167	↓135.9	9.50
5	11.5446	10.600	↓94.5	10.65
10	12.4377	11.8223	↓61.5	11.90
15	12.6250	12.7091	↑8.4	12.60
20	12.9584	13.1529	↑19.5	12.95

Source: Nairobi Securities Exchange

Figure.7: Yields have risen in the long end of the yield curve compared to January 2020.



Source: Nairobi Securities Exchange

MPC retains CBR at 7% for sixth consecutive in January meeting

MPC retains CBR at 7% in January meeting.

- Monetary Policy Committee (MPC) retained the Central Bank Rate (CBR) at 7% in their most recent meeting on Wednesday, 27th January, 2021, in line with our expectations as stated in our January 2021 fixed income report titled "**2021 get set go!"**.
- Strong banking sector liquidity and capital adequacy ratios even with a relatively high Non-Performing Loans (NPL) ratio of 14.1%, a stable inflation rate and a relatively healthy foreign currency reserve position were quoted as some of the reasons for the decision
- We expect the resumption of most businesses that had stalled due to the pandemic, expectations of acquiring a Covid-19 vaccine and strong agricultural production to have a positive impact on the economic activity in 2021.
- The next MPC meeting will be in March 2021 where we once again expect a retention of the rate at 7%.

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