STERLING CAPITAL LIMITED

Fixed Income

Primary Auction Results Update Note

March 2022

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Analysts:

Renaldo D'Souza
Renaldo.DSouza@sterlingib.com

Davis Gathinji
Davis.Gathinji@sterlingib.com

Isabel Chakairu
Isabel.Chakairu@sterlingib.com

Email: research@sterlingib.com

Bond Dealing: +254 (20) 2213914/0723 153 219

Email: invest@sterlingib.com

Office Address: Delta Corner Annex, 5th Floor, Ring Road Westlands.

Website www.sterlingib.com

Bloomberg Code: SCLK <GO>

Table of Contents

March 2022 Treasury Bond primary auction results update

- The Central Bank of Kenya (CBK) re-opened three bonds in March 2022, **FXD1/2021/5**, **FXD1/2020/15** and **FXD1/2021/25** seeking to raise KES.50Bn for budgetary support;

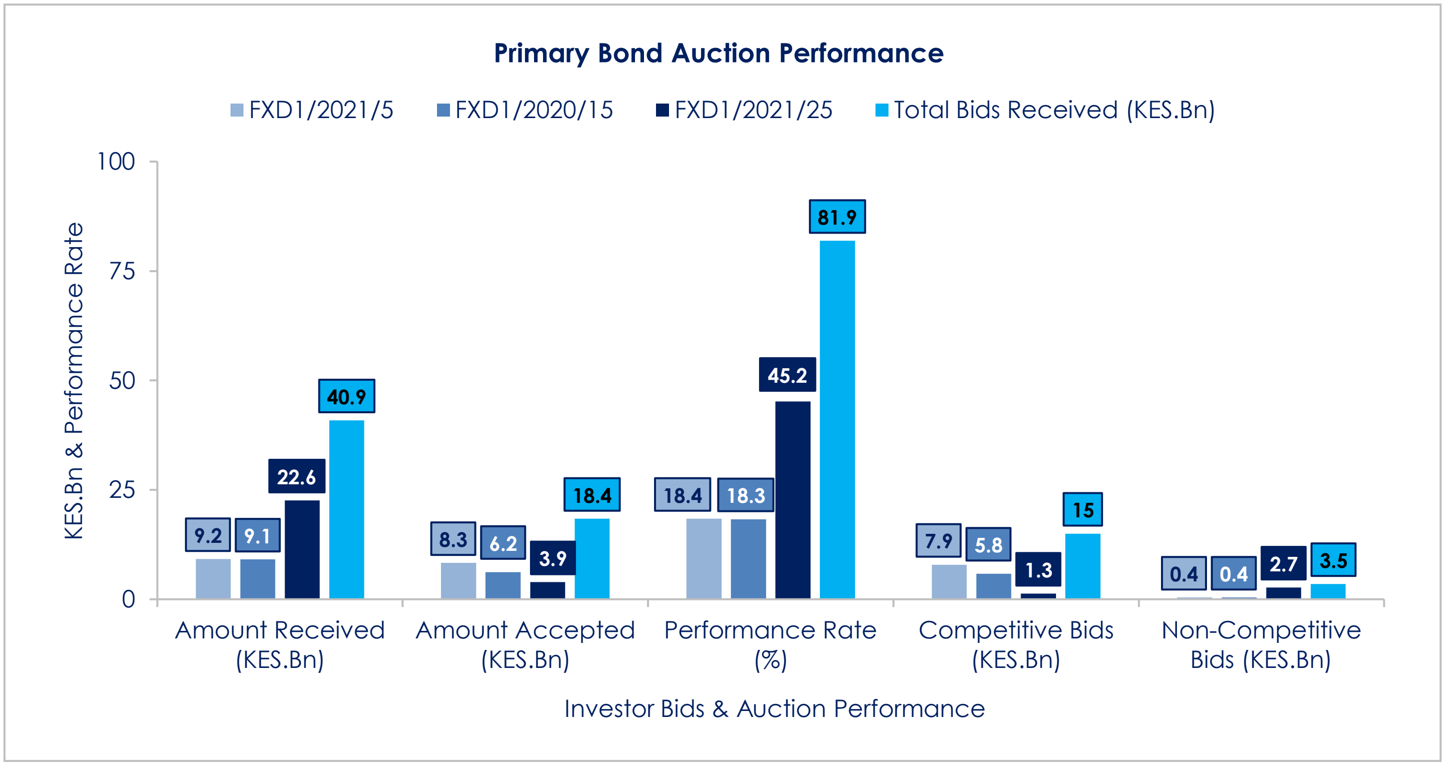
    - **FXD1/2021/5** (4.7*),
    - **FXD1/2020/15** (12.9*),
    - **FXD1/2021/25** (24.2*).

    Years to maturity

Subscription Rates

- The debt issue was undersubscribed which was slightly below our expectations of a subscription of KES.50Bn - KES.60Bn as stated in our March fixed income report , "Three bonds for the third month."
- Total bids received amounted to KES.40.9Bn against the KES.50Bn target equivalent to a 81.9% subscription rate (Figure.1).
- We attribute the undersubscription to a combination of tight market liquidity (especially after the IFB1/2022/19 issue which had a 176.3% subscription rate) and the presence of several debt issues of similar tenors currently trading in the market.
- Further, investor expectations of a rise in interest rates and an upward shift in the yield curve resulted in aggressive bidding above the CBK cut off.

Figure.1: Primary Bond auction performance



Source: Central Bank of Kenya

Weighted Average Rates

- Our predicted Weighted Average Rates (WAR) ranges were slightly below the CBK's accepted weighted average rates (Table.1).

Table.1: Predicted and actual Weighted Average Rates (WAR)

Domestic Debt Issue	SCL Accepted Bids WAR Prediction (%)	CBK Accepted Bids WAR (%)	CBK Accepted Bids WAR vs SCL Predicted WAR Range Average (Bps)
FXD1/2021/5	11.75 - 11.85	12.00	+20
FXD1/2020/15	13.15 - 13.25	13.73	+53
FXD1/2021/25	13.85 - 13.95	13.97	+7

Source: Central Bank of Kenya

Our view

1) **NSE yield curve** - The auction results once again support our view of an upward shift in the yield curve given that the 5, 15 and 25 year yields were lower than the auction averages of 11.80%, 13.30% and 13.65% respectively as at 4th March 2022.

   Overall, the yield curve has been shifting upwards since the second quarter of 2021 with average yields expected to continue on an upward trend in 2022.

   This will be on the back of increased budget finacing pressure in light of Government expenditure, rising inflationary pressure and now imminent CBK's approval of the credit pricing formulae (Equity Group has already received approval of the same and will offer loans between the range of **13% - 18.5%**).

   This would create competition between Government and private sector for bank capital.

   We estimate that average yields for the year 2022 on the short end (91 days - 2 years) will increase by 10 - 20 basis points (bps) while for medium (3 - 9 years) and long tenors (10 years and above) will increase by 20 and 30 bps.

2) **Market Liquidity** - The repo, reverse repo and inter-bank rates as of 9th March 2022 were 4.9%, 8.4% and 5.1% pointing to tightening liquididty in the market especially with the rising interbank rates from 4.4% Month on month.

   We expected liquidity to decline in the near term after the issue of **IFB1/2022/19** which has resulted in a further increase in inter-bank rates to +5% as indicated in our Fixed Income - Primary Bond Auction - Results Update - February 2022.

   The CBK had injected liquidity (KES.110Bn) through reverse repos in the months of January and February 2022 in what we saw as a bid to inject liquidity to support subscription for the IFB.

3) **Investment Case** - Government debt continues to present a compelling investment case for both "Buy and hold" or active bond trading strategies considering subdued equity prices, rising inflationary pressure and limited low risk high yielding investment options available.

4) **Secondary market trading** - We expect **FXD1/2021/5** to have activity in the secondary market driven by investors looking for capital gain opportunities while **FXD1/2020/15** and **FXD1/2021/25** by investors looking to cash in on interest income.

   We identify **IFB1/2022/19 and IFB1/2021/21** as attractive investment options for long-term investors because of their attractive yields (tax exemption), capital appreciation potential and high liquidity.

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