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STERLING CAPITAL LIMITED

Fixed Income

Primary Auction Results Update Note

April 2022

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>

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April 2022 Treasury Bond primary auction results update

- The Central Bank of Kenya (CBK) opened two bonds in April 2022, **FXD1/2022/3** and **FXD1/2022/15** seeking to raise KES.40Bn and KES.30Bn for budgetary support;

    - **FXD1/2022/3** (3*),
    - **FXD1/2022/15** (15*).

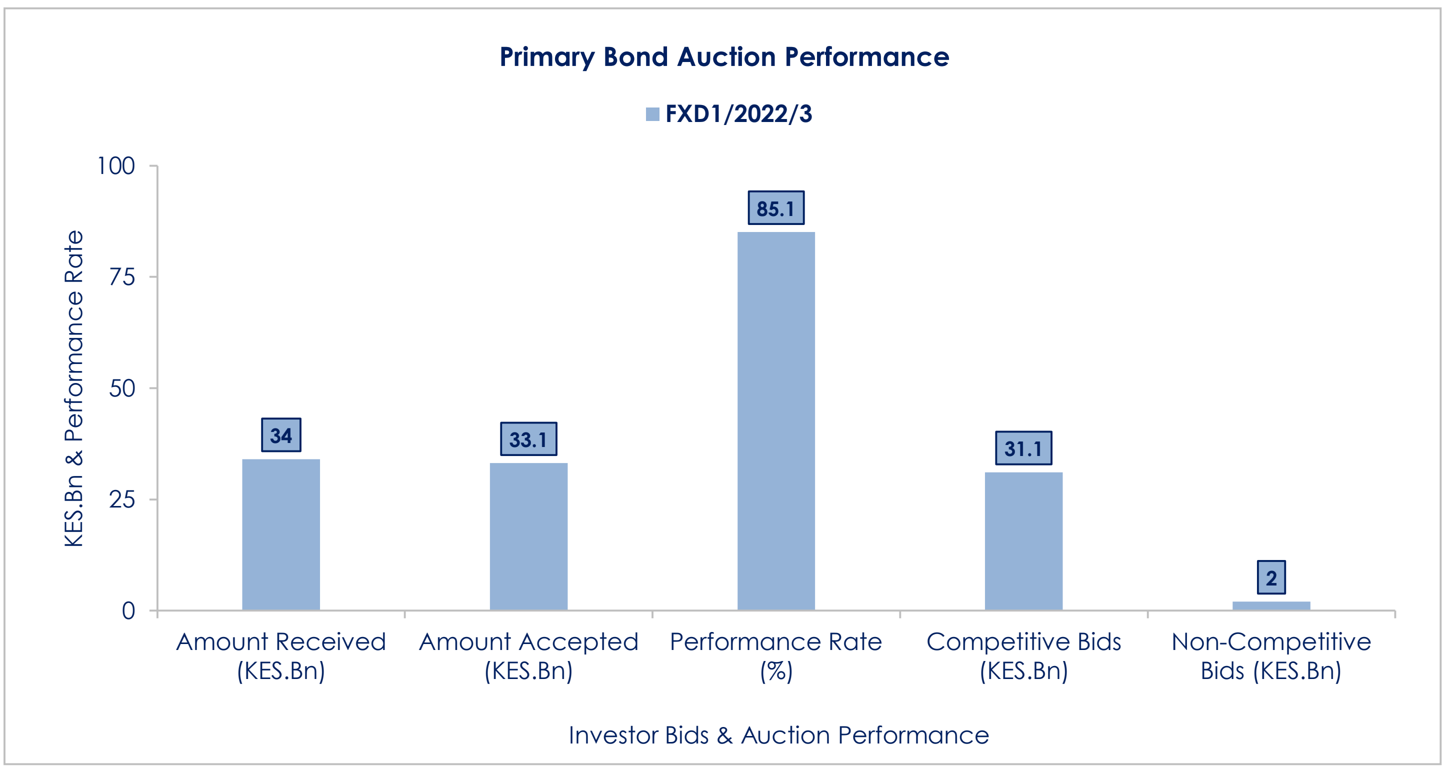
    ***Years to maturity**

- The bonds had different periods of sale with **FXD1/2022/3** (24th March - 5th April 2022) and **FXD1/2022/15**, 24th March - 19th April 2022.
- This results update will focus on **FXD1/2022/3** whose auction date was on the 6th of April 2022, results linked here.

Subscription Rates

- The debt issue was undersubscribed which was below our expectations of a full subscription as stated in our April fixed income report, "CBK's debt 3 year bond issue" given its short tenure.
- Total bids received were KES.34Bn against the KES.40Bn target equivalent to a 85.1% subscription rate (Figure.1).
- We attribute the undersubscription to a combination of tight market liquidity which the CBK has been trying to address via reverse repos over the past three months and expectations of interest rates rising.

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)
FXD1/2022/3	11.60 - 11.75	11.766	+9.1

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 indicative 3-year yield stood at 11.3193% as at 4th April 2022.

   To put this into context, the current yield levels for a 3-year debt isuse at 11.3193% is close to to the 5-year yield (11.9775% as at 4th April 2022).

   This means that on the back of the current rise in rates means, the CBK will have to issue more shorter dated papers such as the 5-year to normalize the yield curve.

   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%, 8.6% and 4.7% pointing to tight liquididty in the market.

   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 has continued to inject liquidity (KES.77Bn) through reverse repos in the month of March, adding to the KES.110Bn injected in January and February 2022.

3) **Investment Case** - Government remains a good investment option 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 do not expect high trading activity on **FXD1/2022/3** given that majority of the bids offered to the CBK were accepted and the fact that we expect buyers of this bond to hold to maturity.

   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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