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STERLING CAPITAL LIMITED

Fixed Income

Primary Auction Results Update Note II (FXD1/2022/15)

April 2022

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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;

  1) **FXD1/2022/3 (3*)**
  2) **FXD1/2022/15 (15*)**

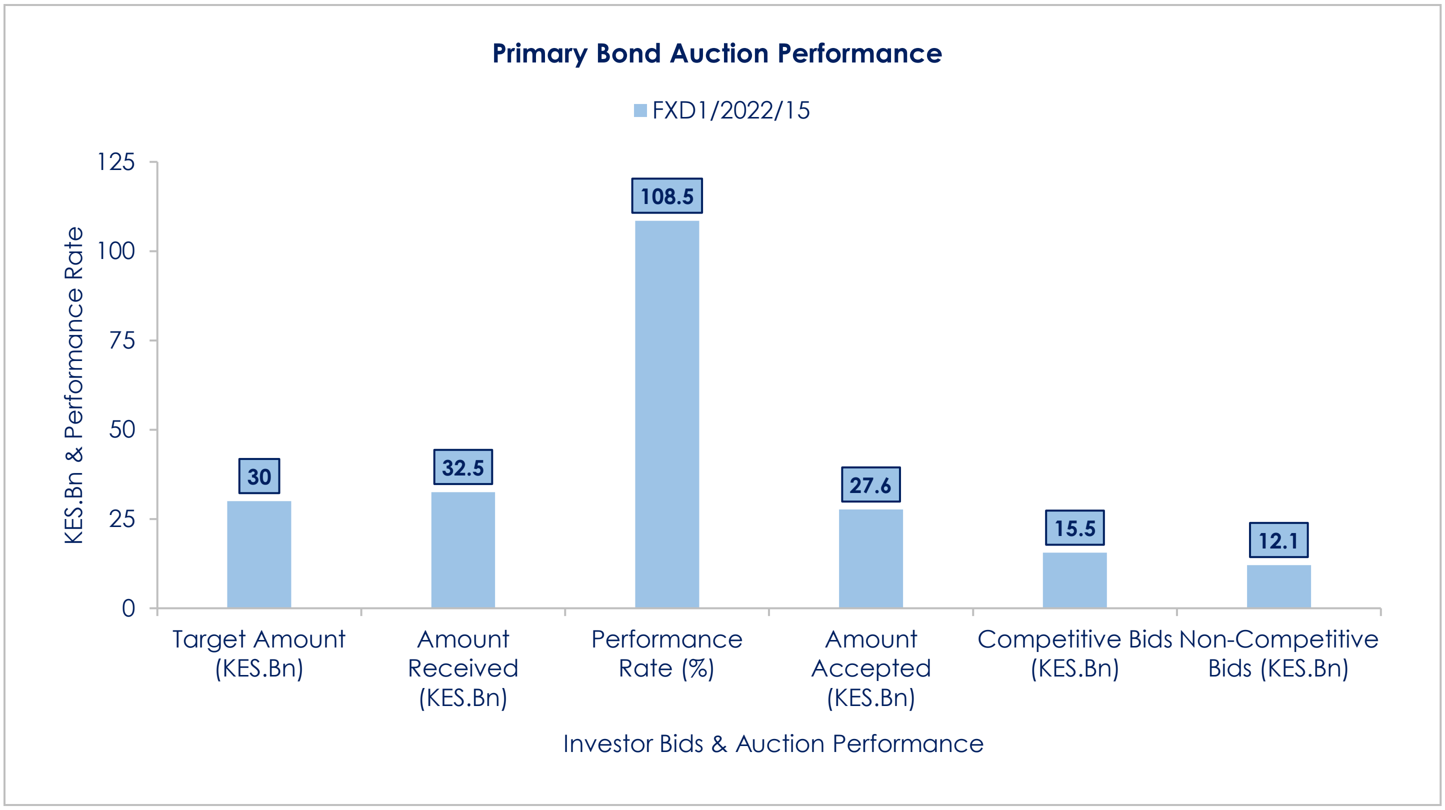
  *Years to maturity

- 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.
- Auction results for **FXD1/2022/3** whose auction date was on the 6th of April 2022 click here.
- The debt issue surprised us with an undersubscription with total bids received amounting to KES.34Bn against the KES.40Bn target equivalent to a 85.1% subscription rate.
- We attributed this to a combination of tight market liquidity which the CBK had been trying to address via reverse repos over the past three months and expectations of interest rates rising.
- This results update will however focus on **FXD1/2022/15** whose auction date was on the 20th of April 2022 click here.

Subscription Rates

- The debt issue was slightly oversubscribed which was above our expectations of a partial subscription as stated in our April fixed income report, "CBK's debt 3 year bond issue" given the prevailing tight market liquidity.
- Total bids received were KES.32.5Bn against the KES.30Bn target equivalent to a 108.5% subscription rate (Figure.1).
- We attribute the oversubscription to substantial demand from local institutional buyers as some look for stable long-term returns while few others chase interest income despite 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

- The CBK's accepted Weighted Average Rates (WAR) was withing our predicted rates range (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)
FXD1/2022/15	13.85 - 13.95	13.942	+4.2

Source: Central Bank of Kenya

Our view

1) **NSE yield curve** - The auction results once again support our view of an imminent upward shift in the yield curve given that the indicative 15-year yield stood at 13.6370% as at 14th April 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 financing pressure in light of Government expenditure, rising inflationary pressure and now imminent CBK's approval of the risk based loan pricing models (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 13th April 2022 were 4.9%, 8.8% and 4.3% pointing to tight market liquididty.

   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 continues to inject liquidity (KES.55Bn) through reverse repos in the month of April (as at 20th April 2022), adding to the KES.292Bn injected in January, February and March 2022.

3) **Investment Case** - Kenya Governemnt bonds are a good investment option for risk averse investors especially considering the bear equity market, rising inflation and limited high yielding, low risk investment options.

   They are also attractive to both passive ("Buy and hold") and active bond traders giving attractive predictable returns and capital gains opportunities respectively.

4) **Secondary market trading** - We do not expect high trading activity on **FXD1/2022/15** given that a bulk of investor bids (84.9%) were accepted and the fact that we expect some buyers of this bond to hold to maturity while few others chase interest income.

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

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