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STERLING CAPITAL LIMITED

Fixed Income

Primary Auction Results Update Note

May 2022

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May 2022 Treasury Bond primary auction results update

- The Central Bank of Kenya (CBK) issued two bonds in May 2022, **FXD1/2022/10** and **FXD1/2021/25** seeking to raise KES.60Bn for budgetary support;

    - **FXD1/2022/10** (10*),
    - **FXD1/2021/25** (23.9*).

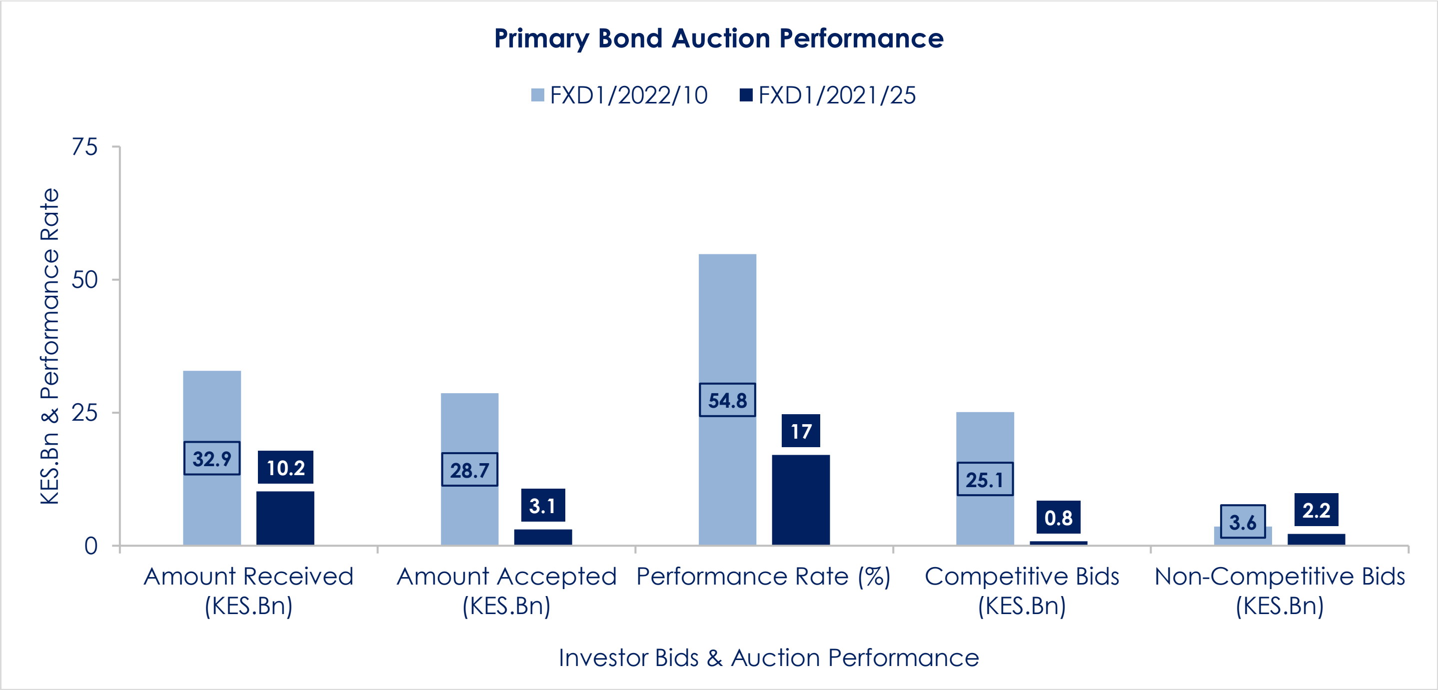
    Years to maturity

- The period of sale for both bonds was between 28th April - 10th May 2022 with auction date on 11th May 2022, results linked here.

Subscription Rates

- We had stated in our May fixed income report "CBK's last lap" that market liquidity would be a major determinant of subscription levels for the bond and this came to play in this auction.
- We also felt that the CBK would want to keep interest rates on Governement debt at below the 14% phychological barrier and would therefore reject aggressive investor bids on the longer dated issue.
- This too was the case as illustrated in the bond auction results.
- Aanother of our expectations was the 10 year receiving the bulk of investor bids in line with historical patterns and this was the case with 76.3% of total bids received directed to the issue.
- Total bids received amounted to KES.43.1Bn against the KES.60Bn target equivalent to a 71.9% subscription rate (Figure.1).

Figure.1: Primary Bond auction performance



Source: Central Bank of Kenya

Weighted Average Rates

- Our predicted Weighted Average Rates (WAR) ranges for FXD1/2022/10 fell slightly below the CBK's accepted weighted average rate while rate for FXD1/2021/25 fell well within estimated 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)
FXD1/2022/10	13.29 - 13.44	13.490	+12.5
FXD1/2021/25	13.99 - 14.14	13.976	-8.9

Source: Central Bank of Kenya

Our view

1) **NSE yield curve** - The auction results are consistent with our view of an upward shift in middle of the curve with the yield curve rising from 13.0412% as at 6th May 2022 to 13.490% as per this auction.

   While the new yield for the FXD1/2021/25 (23.9 years) is higher at 13.976% compared to 13.8839% as at 6th May 2022, we observe a flattening of the curve with minimal differentials for tenors of 15 years and beyond.

   This means that investors would prefer to bid or purchase bonds of shoter term to maturities on a risk versus return basis.

   This could mean that if the CBK intends to maintain its strategy of lengethening the Average Term to maturity of public debt, it will face pressure to begin accepting investor bids above 14%.

   Alternatively, the CBK could issue new or re-open bonds with tenors till maturity of between 10 and 15 years.

   The general trend in the yield curve movement will remain upwards at least in the short-term driven by rising inflatonary pressure and increased budget financing pressure.

   Our estimated average yields for 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 11th May 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.25Bn) through reverse repos in the month of May, adding to the KES.192Bn injected in March and April 2022.

3) **Investment Case** - Government debt remains an attractive investment option for both "Buy and hold" or active bond trading strategies considering current bear equity market, rising inflationary pressure and limited low risk high yielding investment options available in the market.

4) **Secondary market trading** - We do not expect a significant change in secondary market trading activity in May as the acution results showed subdued demand for both bonds.

   In addition, with a high supply of bonds of similar tenors available in the market we do not see high trading of these bonds.

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

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