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Fixed Income

Primary Auction Results Update Note

August 2022

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August 2022 Treasury Bond primary auction results update

- The Central Bank of Kenya (CBK) re-opened three bonds in August 2022, **FXD1/2022/03**, **FXD2/2019/10** and **FXD1/2021/20** seeking to raise KES.50Bn for budgetary support;

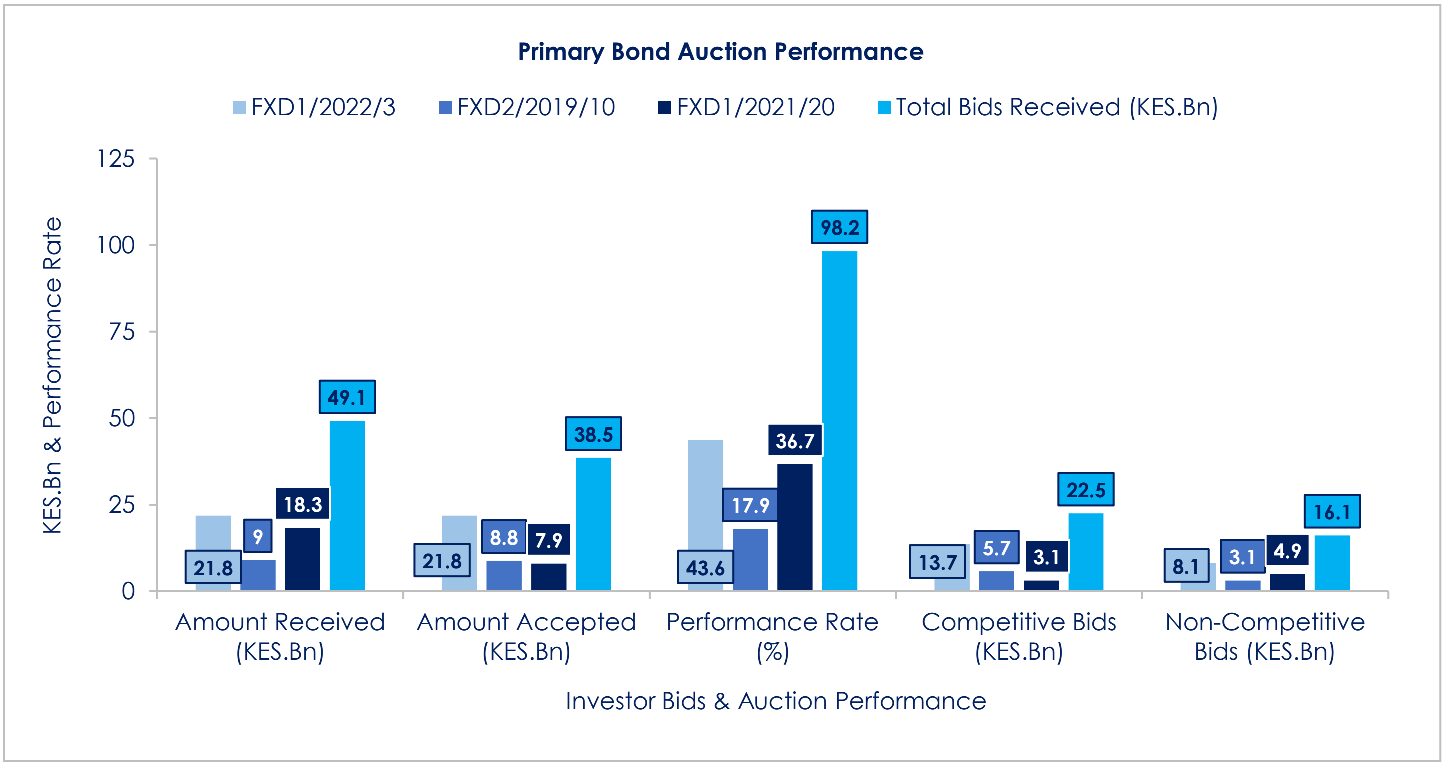
  - **FXD1/2022/03** (2.7*),
  - **FXD2/2019/10** (6.7*),
  - **FXD1/2021/20** (19.1*).

  ***Years to maturity**

Subscription Rates

- The debt issues were undersubscribed which was in line with our expectations as spelt out in our August fixed income report, "The National Treasury's missed targets".
- Total bids received amounted to KES.49.1Bn against the KES.50Bn target equivalent to a 98.3% subscription rate (Figure.1).
- We attribute the undersubscription to a continued focus on short term government paper such as the 91-day T-bill as investors strive to avoid mark-to-market losses brought about by holding longer-term debt issues as has become prevalent in the current rising interest rate environment.
- Contrary to our views, investor bids were not as aggressive as our expectations with only **FXD1/2021/20** exhibiting aggressive bidding above the 14% psychological level which were largely rejected by the CBK.

Figure.1: Primary Bond auction performance



Source: Central Bank of Kenya

Weighted Average Rates

- Two out of our three predicted Weighted Average Rates (WAR) ranges were above 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)
FXD1/2022/03	12.15 – 12.25	12.445	+24.5
FXD2/2019/10	13.90 – 14.00	13.884	-6.6
FXD1/2021/20	14.20 –14.35	13.963	-31.2

Source: Central Bank of Kenya

Our view

1) **NSE yield curve** - As has been the case for most of the year, these auction results support our view of an upward shift in the yield curve given that the 3, 10 and 20 year bond yields prior to the auction (12th August 2022) were 11.95%, 13.65% and 13.96% respectively, lower than the actual auction averages of 12.45%, 13.89% and 13.96% respectively.

   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 the near term.

   While the CBK managed to ward off aggressive investor bids as is evident by the significant deviation of the market weighted average rate of 14.23% against the acceptance rate of 13.96% on the 20 year paper, the flattening of the yield curve in the medium to long tenors will drive investors away from investing in longer dated debt. This may create a fiscal deficit challenge for the CBK in its continuous efforts to lengthen the maturity profile of public debt to reduce fiscal pressures.

   We see it fit to mention that if the CBK continues with its current efforts to keep interest rates below the 14% psychological level, we are likely to see an inversion of the yield curve. We however see this scenario as unlikely and expect interest rates on longger dated debt to bridge 14%.

   Our estimates remain unchanged with our expectation being that average yelds on the short end (91 days – 3 years) increasing by an estimated 80 – 100 basis points (Bps), while both medium term (4 – 9 years) and long term (10 years and above) increasing by 100 – 150 Bps in 2022.

2) **Market Liquidity** - The repo, reverse repo and inter-bank rates as of 17th August 2022 were 7.1%, 9.1% and 5.6% pointing to relatively tight liquididty in the market. Notably, the CBK has been initiating reverse repos since the 21st of July 2022 in a bid to raise market liquidity which has resulted in KES.74Bn being injected into the market via reverse repos.

3) **Investment Case** – We recommend a **BUY** on medium and long-term papers for interest earning purposes as buying for active trading in the secondary market is likely to leave investors susceptible to losses in an environment of rising interest rates.

   We advise active traders and investors with high risk tolerance to consider buying the US$ denominated Kenya Eurobonds to take advantage of current attractive yields.

   This however, is suitable to high net-worth investors (considering the high minimum amount of US$200,000) with US$ holdings or those willing to incur the cost of currency conversion.

4) **Secondary market trading** - We expect **FXD1/2022/03** to exhibit a relatively high degree of trading activity in the secondary market driven by investors looking for capital gain opportunities given its short term nature with some swaths of interest on the **FXD1/2021/20** by investors who missed out on it on the primary auction.

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