



Thursday, 09 March 2023

Analysts:

Renaldo D'Souza

+254 (20) 2222651

Renaldo.DSouza@sterlingib.com

Davis Gathinji

+254 (20) 2222651

Davis.Gathinji@sterlingib.com

Isabel Chakairu

+254 (20) 2222651

Isabel.Chakairu@sterlingib.com

Email: research@sterlingib.com

Bond Dealing: +254 (20) 2213914, 3315414; 2244077

+254 723153219, +254 734219146

Email: invest@sterlingib.com

Website www.sterlingib.com

Bloomberg Code: SCLK <GO>



Fixed Income

Primary Auction Update

IFB1/2023/17

March 2023

Table of Contents

March 2023 Treasury Bond Primary Auction Results Update	3
Subscription Rates.....	3
Weighted Average Rates	3
Our view	4
Disclosures	6

March 2023 Treasury Bond Primary Auction Results Update

- The Central Bank of Kenya (CBK) issued a new 17-year amortized Infrastructure Bond (**IFB1/2023/17**), with a market-determined coupon to raise KES.50Bn;

IFB1/2023/17 (17*)

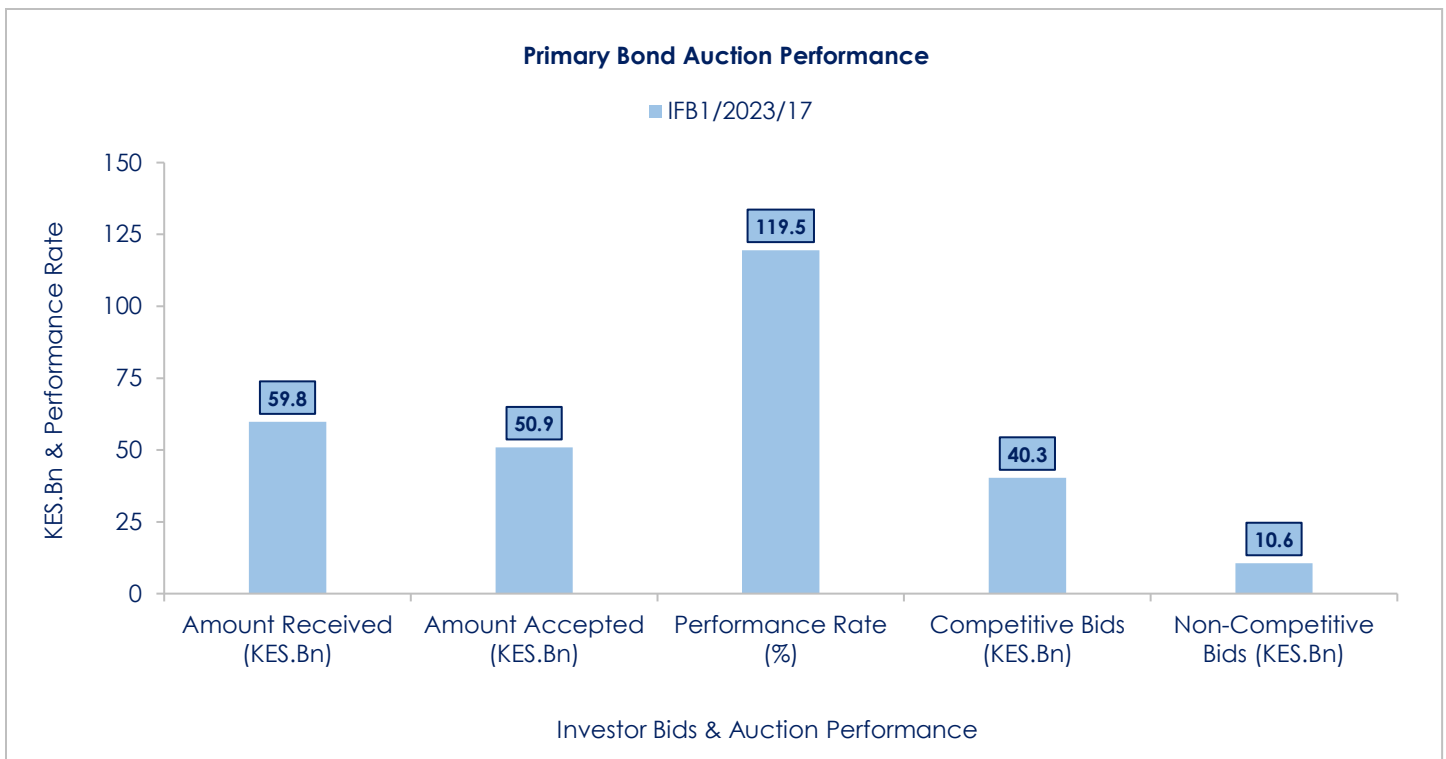
*Years to maturity

- The bond's period of sale was 15th February and 7th March 2023.

Subscription Rates

- As per our expectations [March 2023 fixed income report – CBK issues IFB in the face of low long-term debt demand](#), the issue was oversubscribed as is often the case with IFBs. (Figure.1).

Figure.1: Primary Bond Auction subscription



Source: Central Bank of Kenya

Weighted Average Rates

- An analysis of our predicted Weighted Average Rates (WAR) ranges as indicated in our March 2023 fixed income report compared to accepted WARs by the CBK are shown below. (Table.1).
- We observe aggressive investor bidding on account of evident fiscal financing pressure as well as prevailing and expected interest rates.

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)
IFB1/2023/17	14.09 - 14.19	14.399	+25.9

Source: Central Bank of Kenya

Our view

- 1) Nairobi Securities Exchange (NSE) yield curve** – There has been a significant upward shift in the yield curve over the last one year with the latest bonds' auction weighted average rates of accepted bids higher than the implied yields on similar tenured bonds.

The upward shift has resulted from the following:

- a) Upward revisions of the CBR from 7% to 8.75% between May and November 2022.
- b) Increased budgetary financing pressure resulting from modest growth in revenues with the CBK borrowing aggressively in the domestic debt market.
- c) CBK continues to accommodate more aggressive investor bids to encourage subscription for long-term debt instruments.
- d) Rising inflation with investors looking for positive real return on capital invested.

IFB1/2023/17 yield is higher than the implied yields as at 3rd March 2023 of even a 25-year tenor which currently stands at 14.2701%.

We also note that the yield curve is inverted on the 10 and 16-year tenors.

Data from the NSE indicates that the 10-year implied yield as at 3rd March 2023 stood at 14.0567% while the 11, 12, 13 and 14-year yields stood at 13.8789%, 13.9265%, 13.9607% and 13.9900% respectively.

Similarly, the 16-year implied yield came in at 14.1196% which surpassed all subsequent yields until the 22-year tenor which currently stands at 14.1449%.

This trend will continue to force the CBK to accept aggressive investor bids as they seek to normalize the curve and subsequently raise rates further.

- 2) Market Liquidity** - There has been no change in repo rate since our February results' update (7.1%). However, the reverse repo and inter-bank rates increased to 10.6% and 6.8% from 10.4% and 6.5% respectively signaling tight market liquidity.

A bulk of liquidity has been directed to the 91-day T-Bill as shown in the [latest auction](#) dated 6th March 2023.

3) Investment Case - We recommend the following investment strategies on account of rising interest rates:

Invest in T-Bills and short-term debt to avoid locking capital for longer periods in a rising interest environment as well as the higher yielding new Infrastructure Bonds (IFB).

Look out for bonds matching your maturity profile trading at huge discounts in the secondary market.

Avoid revaluation losses (selling bonds at lower prices than their purchase prices) by holding on to your existing bond investment portfolio.

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

4) Secondary market trading - We expect high secondary market trading activity on **IFB1/2023/17** driven by its high capital appreciation potential.

The recent trend in bond issuance is to have a tap sale soon after and this could also be the case for this debt issue for the following reasons:

- a) High March debt service (KES.199Bn) which is highest this year is an indication of high financing needs.
- b) The relatively low subscription (119.5%) and acceptance rates (101.8%) could be an indication that the CBK failed to meet its expected funding target.
- c) Relatively high weighted average of accepted bids (14.399%) which is even higher than a 25-year (14.2701% - as at 3rd March 2023) is an indication of the high fiscal deficit financing pressure.

Ownership and material conflicts of interest:

The authors or a member of their household, of this report do not hold a financial interest in the securities of this company. The authors or a member of their household, of this report do not know of the existence of any conflicts of interest that might bias the content or publication of this report.

Position as an officer or director: The authors or a member of their household, do not serve as an officer, director or advisory board member of the subject company.

Research analyst certification:

The research analyst(s) primarily responsible for the preparation and content of all or any identified portion of this research report hereby certifies that all of the views expressed herein accurately reflect their personal views. Each research analyst(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the view(s) expressed by that research analyst in this research report.

Additional Disclosures:

This research report is for distribution only under such circumstances as may be permitted by applicable law. This research report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient, even if sent only to a single recipient. This research report is not guaranteed to be a complete statement or summary of any securities, markets, reports or developments referred to in this research report. Neither SCL nor any of its directors, officers, employees or agents shall have any liability, however arising, for any error, inaccuracy or incompleteness of fact or opinion in this research report or lack of care in this research reports preparation or publication, or any losses or damages which may arise from the use of this research report.

Disclaimer:

This research report was prepared under the supervision of the Research Department of Sterling Capital Limited (SCL), a company authorized to engage in securities activities in Kenya, and with partnerships in Uganda, Rwanda, Zimbabwe, and Tanzania. Data used in this report was gathered from reliable sources, but the analyst(s) and the publishers of this report do not hold themselves responsible for the accuracy or completeness of data used. The report provides the opinions, analyses and conclusions of the Research division only and is provided without any warranties of any kind.

This report does not constitute an offer, or the solicitation of an offer, for the sale or purchase of any security. The reader should independently evaluate the investment risks and is solely responsible for their investment decisions. Whilst every care has been taken in preparing this report, no representation, warranty or undertaking (express or implied) is given and no responsibility or liability is accepted by SCL or any employee of SCL as to the accuracy, timeliness, completeness merchantability or fitness for any particular purpose of any such recommendation or information contained and opinions expressed herein. SCL do not accept any liability for any direct or remote loss or damage arising out of the use of all or any part of the information contained in this report.

This report is published for information purposes only and is not an offer to solicit, buy or sell any security of any kind. This report does not provide customized investment advice. It has been prepared without regard to the individual financial circumstances and risk and return objectives of individuals who receive it. The appropriateness of a particular investment will depend on an investor's individual circumstances, risk tolerance and return objectives. The investments securities referred to in this document may not be suitable for all or certain categories of investors. The Research Division and SCL have implemented Chinese walls procedures to prevent any conflict of interest. Other additional information may be available at SCL.

Further disclosure regarding SCL policy on potential conflicts of interest in the context of investment research and SCL policy on disclosure and conflicts in general are available on request. The opinions presented in this note may be changed without prior notice or cannot be depended upon if used in the place of the investor's independent judgment. The historical performance of a security is not representative of the security's future returns. Investment in securities can be highly risky as security prices may go down in value as well as up and you may not get back the full amount invested. Where an investment is denominated in a currency other than the local currency of the recipient of the research report, changes in the exchange rates may adversely affect the value, price or income of that investment. In case of illiquid investments for which there is no organized market it may be difficult for investors to exit investment positions or to obtain reliable information about its value or the extent of the risk to which it is exposed. The information contained in this report is confidential and is solely for use to those persons to whom it is addressed and may not be reproduced, further distributed to any other person or published, in whole or in part, for any purpose.