

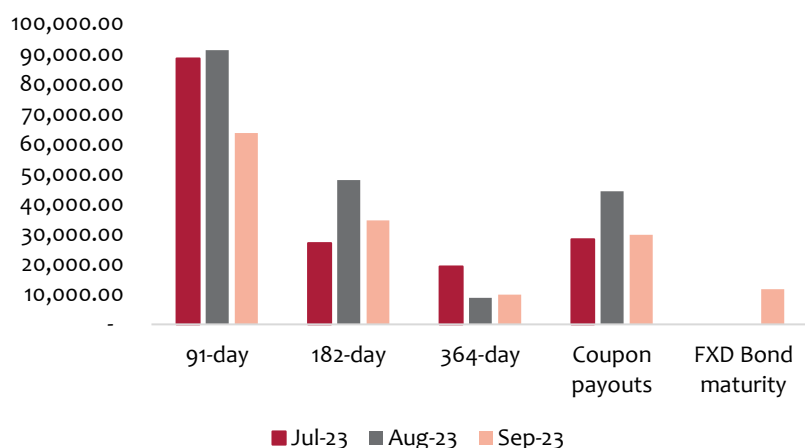
Primary Bond Auction Note

10th July 2023

In the **July 2023** Primary Bond Auction, the National Treasury is seeking to raise KES 40.0Bn through the issuance of a 5-year Fixed Coupon Treasury Bond (FXD), and a reopening of 3.2-year FXD1/2016/010 for budgetary support. The quantum sought in this month's auction is KES 20.0Bn lower than June's auction. The auction comes on the back of the FXD1/2023/003 tap sale. The government successfully raised KES 18.6Bn through the tap sale – bringing the total cash raised through the primary bond market in the month of June to KES 232.0Bn.

Currently, the weighted average tenor to maturity of the Fixed Coupon Treasury Bonds segment is c. 6.04 years. Regarding domestic borrowing maturities (visualized in **Chart 1**), the government has approximately KES 163.0Bn worth of T-Bills and coupon payments due in July 2023. We believe part of the proceeds from the auction will go towards refinancing the upcoming maturities.

Chart 1: 3Q2023 Maturities of Domestic Government Securities (KES 'Mn)



Source: Nairobi Securities Exchange, Genghis Capital

June 2023 Primary Bond Auction Review

The June 2023 bond auction featured the issuance of IFB1/2023/007. Of the KES 60.0Bn on offer, the government received bids worth KES 220.5Bn and accepted KES 213.4Bn. This represented a performance rate of 367.53%. The IFB1/2023/007 paper – with an effective tenor of 5.45 years – printed a market-weighted average rate of 15.857%. This was 149.6bps above the extrapolated yield curve to the effective tenor (by laws of congruence).

The weighted-average rate of accepted bids, which sets the paper's coupon, came in 20bps shy of the market-weighted average rate at 15.837%. Regarding participation levels, we believe the oversubscription was primarily driven by the paper's trifecta; namely the short tenure, the ability to lock in attractive coupons at premiums against the yield curve, and the tax incentive.

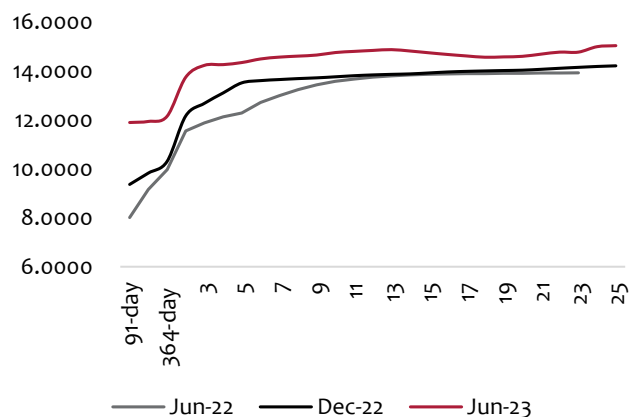
The government sought to raise an additional KES 15.0Bn in the bond markets through a tap sale of FXD1/2023/003. It successfully raised KES 18.6Bn – bringing the total cash raised in the primary bond markets in the month of June to KES 232.0Bn

FXD1/2023/005 & FXD1/2016/010

Issuer:	Republic of Kenya
Total Amount:	KES 40 Billion
Purpose:	Budgetary Support
Tenor:	FXD1/2023/005 – 5 yrs FXD1/2016/010 – 3.2 yrs
Coupon:	FXD1/2023/005 – Market Determined FXD1/2016/010 – 15.039%
Price Quote:	Discounted/Premium/Par
Period of sale:	28/06/2023 to 11/07/2023
Minimum Amount:	KES 50,000.00
Taxation:	FXD1/2023/005 – 15% withholding tax FXD1/2016/010 – 10% withholding tax
Redemption Dates:	FXD1/2023/005 – 10/07/2028 FXD1/2016/010 – 17/08/2026
Classification:	Both are benchmark bonds
Non-Competitive bids per CDS A/C:	Max. KES 20 Million per CDS A/C

Source: July 2023 Primary Bond Prospectus

Chart 2: Yield Curve movement (%)



Source: Nairobi Securities Exchange (NSE)

Analyst:

Wesley Manambo

wmanambo@genghis-capital.com

Direct Line: +254 709 145 000

Website: www.genghis-capital.com

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Secondary market activity declined in June 2023

Secondary bond market activity declined by 32.63% m/m, with volumes hitting KES 45.84Bn down from KES 68.05Bn in May 2023. Trades were skewed towards the infrastructure bonds (IFB segment). Notably, for trades above KES 50.0Mn, the IFB segment accounted for c. 45% of the activity. The most traded paper in the segment was the IFB1/2023/007 – which accounted for 41.8% of total trades in June.

Discount securities' performance declined in June 2023 with the average performance rate at c. 98.56% (vis-à-vis c. 115.82% in May 2023). We believe this was in part driven by the shift of investor attention to the bond markets. In line with the recent trends, activity was generally concentrated on the 91-Day T-Bills – accounting for c. 80.94% of the KES 78.65Bn T-Bills accepted in the period (vis-à-vis c. 71.49% of the KES 136.77Bn accepted in May 2023). We believe this is on the back of investors' preference for these papers as a hedge against duration risk.

We expect to see additional pressure on the T-Bill rates as the shorter end of the yield curve edges upwards. Indeed, the 91-day, 182-day, and 364-day T-Bills yields crossed the 12% mark in [last week's auction](#) and are expected to continue edging upwards.

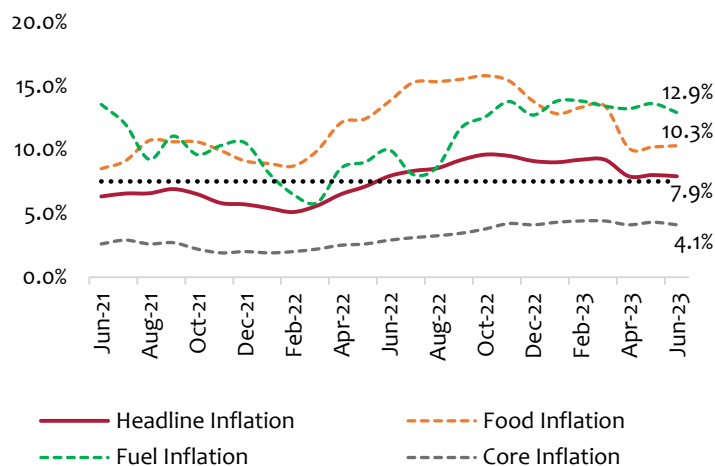
Headline inflation remained sticky downwards in June 2023

The year-on-year (y/y) headline inflation ([Chart 3](#)) for the month of [June 2023](#) was 7.9%. The y/y rise was partly due to the rise in prices of commodities under Food and Non-alcoholic Beverages (10.3%); and Housing, Water, Electricity, Gas, and other fuels (9.4%); and Transport (9.4%) between June 2022 and June 2023.

From a month-on-month (m/m) perspective, headline inflation remained sticky downwards – declining marginally by 10bps. Food inflation increased to 10.3% from 10.2% in May 2023. Fuel inflation declined to 12.9% from 13.6% in May 2023. Core inflation (non-food and non-fuel inflation) for the month of June printed at 4.1% from 4.3% in May 2023.

We note that headline inflation has remained above the National Treasury's upper bound threshold of 7.5% for a cumulative 13 months (from June 2022 to June 2023). From our vantage point, we expect to see core inflation remaining sticky downwards in the near term on account of the translation effect of externally driven cost-push inflation, coupled with the ripple effects of the rising pump prices on provisions of the finance bill 2023.

Chart 3: Inflation trends

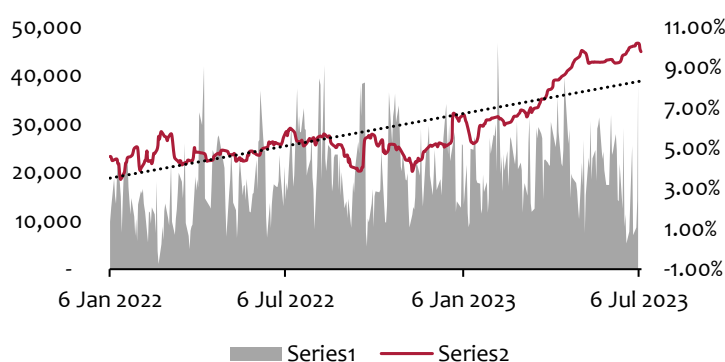


Source: Kenya National Bureau of Statistics (KNBS)

Tight market liquidity persisted in the period under review.

Rates in the overnight interbank market ([Chart 4](#)) edged upward in June 2023, with the average interbank rate coming in at 9.43% (+4bps m/m). In terms of Open Market Operations, the CBK injected KES c. 292.0Bn in June 2023 via reverse repos (vis-à-vis KES c. 179.2Bn injected in May 2023). We forecast that the tight liquidity will exacerbate aggressive biddings in July's auctions.

Chart 4: Interbank volume and rate



Source: Central Bank of Kenya (CBK)

The yield curve sustains an upward trajectory.

The yield curve ([Chart 2](#)) rose in June 2023, with yields rising an average of 143.7bps y/y (vis-à-vis 139.5bps y/y in May 2023). Yields at the belly of the curve continued edging upwards (with an average of c. 175.9bps y/y) while those at the longer end of the yield curve held relatively steady (on a 75.3bps y/y rise).

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Meanwhile, T-Bill yields rose by an average of 295.3bps y/y in June 2023. We believe the yield curve will continue facing upward pressure attributable to the evolving macro economical risks and rising yields in the primary markets.

Projection

We foresee aggressive bidding and high participation levels in the July 2023 auction. From our analysis of the macroeconomic environment, liquidity levels, and investor behavior in the past auctions – with regard to short-term papers, we recommend bid levels of 16.10% - 16.30% for FXD1/2023/005, and 15.90% - 16.20% for FXD1/2016/010, respectively.

Table 1: Yield Curve Spreads

Duration	1Q2023 Spreads	2Q2023 Spreads	YTD Spreads
91-day	54 bps	200 bps	254 bps
182-day	57 bps	155 bps	211 bps
1	49 bps	136 bps	185 bps
2	38 bps	120 bps	158 bps
3	32 bps	123 bps	155 bps
4	22 bps	94 bps	116 bps
5	bps	88 bps	83 bps
6	9 bps	80 bps	89 bps
7	20 bps	72 bps	92 bps
8	31 bps	61 bps	92 bps
9	39 bps	54 bps	93 bps
10	32 bps	67 bps	99 bps
11	19 bps	81 bps	100 bps
12	18 bps	82 bps	100 bps
13	18 bps	88 bps	101 bps
14	20 bps	74 bps	94 bps
15	29 bps	53 bps	83 bps
16	25 bps	46 bps	72 bps
17	17 bps	46 bps	63 bps
18	10 bps	46 bps	56 bps
19	3 bps	53 bps	56 bps
20	-3 bps	59 bps	57 bps
21	1 bps	61 bps	62 bps
22	6 bps	60 bps	66 bps
23	11 bps	51 bps	62 bps
24	12 bps	69 bps	81 bps
25	11 bps	72 bps	83 bps

Table 2: CBK OMO

2022	TADs	REPOs
JAN	35,600.00	93,618.00
FEB	-	100,632.00
MAR	-	107,928.00
APR	-	85,568.00
MAY	5,000.00	56,214.00
JUN	113,200.00	56,200.00
JUL	93,500.00	55,500.00
AUG	-	94,300.00
SEP	-	89,300.00
OCT	-	63,050.00
NOV	-	48,338.00
DEC	-	74,320.00
2023	TADs	REPOs
JAN	-	206,428.00
FEB	-	117,948.00
MAR	-	95,440.00
APR	-	88,549.00
MAY	-	179,157.00
JUN	-	292,000.00

Source: NSE, CBK, Bloomberg

Table 3: 2023 Primary Market Bond Auctions Granular View

	Offer (KES, Mn)	Paper(s)	Duration at the Time of Auction (yrs)	Total Bids Received	Total Bids Accepted	Performance Rate	Market Weighted Average Rate	Weighted Average Rate of Accepted Bids	Market-Weighted Premiums above the Yield Curve	Premiums accepted above the Yield Curve	Coupon Rate (%)
Jan-23	50,000.00	FXD1/2020/005 - Reopening	2.4	27,620.35	24,352.62	55.24%	12.917%	12.879%	0.197%	0.159%	11.667%
		FXD1/2022/015 - Reopening	14.3	14,011.92	7,160.39	28.02%	14.337%	14.186%	0.442%	0.291%	13.942%
				41,632.27	31,513.01	83.26%					
	10,000.00	FXD1/2020/005 - Tapsale	2.4	13,902.65	13,571.35	139.03%		12.879%			11.667%
Feb-23		FXD1/2022/015 - Tapsale	14.3	4,119.30	4,056.03	41.19%		14.186%			13.942%
				18,021.95	17,627.38	180.22%					
	50,000.00	FXD1/2017/010 - Reopening	4.5	8,030.13	7,469.52	16.06%	13.897%	13.875%	0.367%	0.345%	12.966%
		FXD1/2023/010 - New Issuance	10.0	11,514.95	9,279.28	23.03%	14.217%	14.151%	0.424%	0.358%	14.151%
Mar-23				19,545.08	16,748.80	39.09%					
	10,000.00	FXD1/2017/010 - Tapsale	4.5	8,855.70	8,593.57	88.56%		13.875%			12.966%
		FXD1/2023/010 - Tapsale	10.0	3,607.55	3,607.23	36.08%		14.151%			14.151%
				12,463.25	12,200.80	124.63%					
Apr-23	50,000.00	IFB1/2023/017 - New Issuance	17.0	59,772.04	50,877.20	119.544%	14.469%	14.399%	0.282%	0.212%	14.399%
				59,772.04	50,877.20	119.544%	14.469%	14.399%			14.399%
	20,000.00	IFB1/2023/017 - Tapsale	17.0	12,712.30	12,711.16	63.56%		14.399%			14.399%
				12,712.30	12,711.16	63.56%					
1Q2023	190,000.00			164,146.89	141,678.35	86.39%					
May-23	20,000.00	FXD2/2018/010 - Reopening	5.8	3,570.55	3,360.37	17.85%	14.393%	14.366%	0.668%	0.641%	12.502%
				3,570.55	3,360.37	17.85%					
		IFB1/2023/017 - Tapsale	17.0	5,119.00	5,117.00			14.399%			14.399%
	30,000.00	FXD1/2022/003 - Reopening	2.1	7,328.96	1,757.09	24.43%	13.839%	13.471%	1.030%	0.662%	11.766%
Jun-23		FXD1/2019/015 - Reopening	10.9	CANCELED		-	-	-	-	-	12.857%
				7,328.96	1,757.09	24.43%	13.839%	13.471%			
	20,000.00	FXD1/2023/003 - New Issuance	3.0	20,744.34	20,293.99	103.72%	14.259%	14.228%	0.923%	0.892%	14.228%
				20,744.34	20,293.99	103.72%					
Jul-23	10,000.00	FXD1/2023/003 - Tapsale	3.0	10,603.25	10,602.30						14.228%
	20,000.00	FXD1/2023/003 - Tapsale	3.0	27,206.35	27,201.72						14.228%
	60,000.00	IFB1/2023/007 - New Issuance	7.0	220,518.51	213,399.35	367.53%	15.857%	15.837%	1.496%	1.476%	15.857%
				220,518.51	213,399.35	367.53%					
2Q2023				18,560.05	18,552.07						
	15,000.00	FXD1/2023/003 - Tapsale	3.0								
1H2023	175,000.00			313,651.01	300,283.89	179.23%					
	365,000.00			477,797.90	441,962.24	130.90%					

Source: CBK

Key Contacts: Research

Wesley Manambo

wmanambo@genghis-capital.com

Ronny Chokaa

rchokaa@genghis-capital.com

Key Contacts: Dealing

Faith Mukeli

fmukeli@genghis-capital.com

Ian Waihenya

iwaihenya@genghis-capital.com

Wanjira Njaga

wnjaga@genghis-capital.com

CEO: Edward Wachira

Phone: +254 709 185 000

Website: www.genghis-capital.com

@GenghisCapital



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