Primary Auction Note – March 2023

The Central Bank of Kenya is in the market looking to issue a new amortized bond, IFB1/2023/17 in an effort to raise KES 50.00 Billion for funding Infrastructure projects in the FY 2022/2023 budget estimates. The coupon rate of the newly issued infrastructure bond will be market determined with bidding closing on the 7th of March 2023. The minimum investment is KES 100,000 with an effective duration of 13.5 years.

We expect the issue to be oversubscribed due to the tax-free nature of IFB issues and the high yields currently being offered by government papers. However, the participation of international investors is likely to be constrained by the ongoing depreciation of the shilling.

We expect aggressive bidding driven by;

I. **Investors' increased preference for higher risk-adjusted returns** From the performance of recent FXD and T-Bills issues, investors' bidding trends have shown a risk vs duration mismatch. The recent 10-year paper successfully crossed the elusive 14.00% level and we also expect investors to test CBK's resolve in this issue.

II. **High inflation levels -** Given the risks associated with the current high levels of local and global inflation, we expect that investors will make aggressive bids on this paper trying to compensate for a higher real rate of return. Local inflation for the month of February increased to 9.20% after 3 months of consecutive decline.

Given the upcoming T-Bond maturities and coupon payments in the month of March totaling 178.61Bn coupled with budgetary needs, we foresee increased pressure on the government to accept expensive bids. The lack of transparency on the specific infrastructure projects to be financed by the IFB leads us to believe that some proceeds from the paper could be used for other budgetary needs.

Summary Bidding Guidance:

Issue No	Amount Offered	Next Coupon Payment	Coupon Rate	Bidding Range
IFB1/2023/17 (Amortized)	KES 50.00Bn	11/09/2023	Market Determined	14.19% – 14.49%

March 6th 2023

RECOMMENDATIONS:

IFB1/2023/17

Bid: 14.19% – 14.49%

Period of Sale: 15/02/2023 to 07/03/2023

Sovereign Credit Rating:

Moody's: B2 (negative)

Fitch: B (stable)

S&P: B+ (Negative)

February CPI: (2019=100): 130.13

February Inflation: 9.20%

Interbank Rate (28th February 2023): 6.64%

C.B.R (Feb '2023): 8.75%

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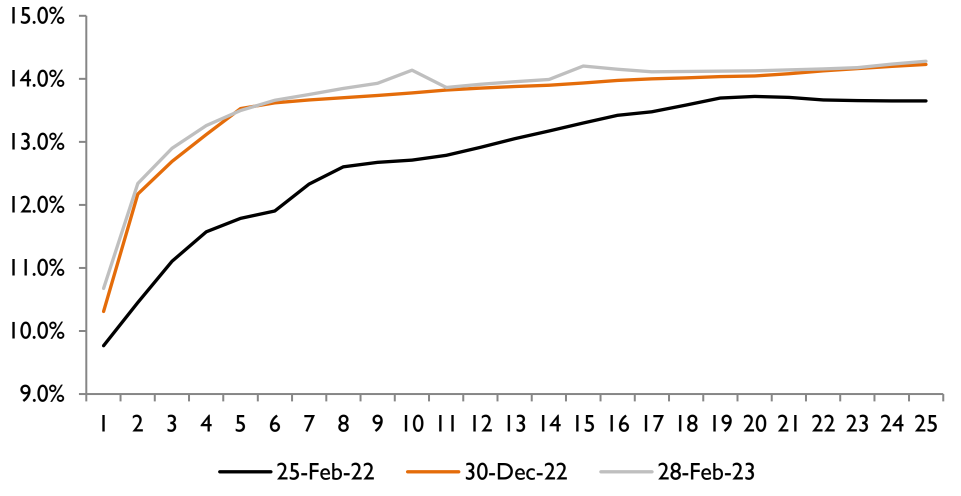
Liquidity

During the month of February, the money markets largely remained liquid supported by government payments which more than offset tax remittances. Mostly, interbank rates remained largely above 6.00% levels having recorded **6.64%** on 28th February 2023 reflecting a 21ps increase from **6.44%** recorded on 30th January 2023.

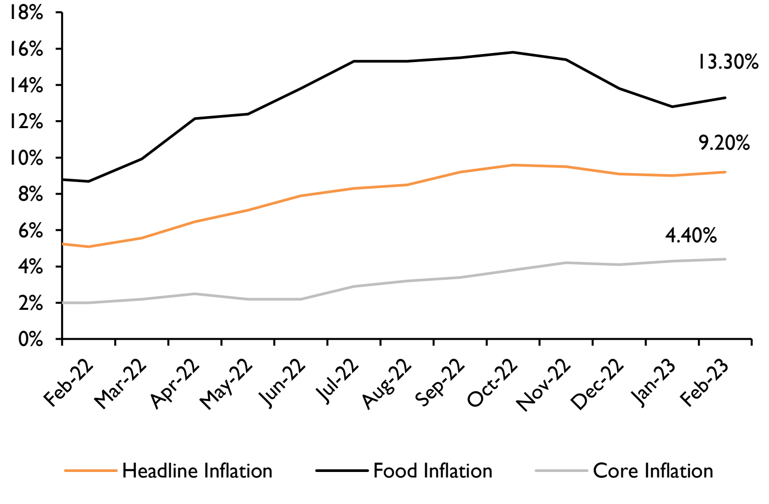
NSE Implied Yield Curve



In the month of February, yields increased across the curve. 10-year papers increased the most by 34bps while the 23-year papers were the largest decliners by 5bps. The 15 and 9-year papers increased by 22bps and 18bps m/m, respectively.

We expect the yield curve to experience upward pressure across medium and long-term tenors, with a slight easing in the short-term as investors seek higher premiums on prevailing high inflation. The average yields on the 91-day, 182-day, and 364-day papers closed in February at 9.62%, 10.06% and 10.62% respectively.

February Inflation



- The headline inflation increased to **9.20%** in February from **9.00%** recorded in January. The CPI increased 0.65% to **130.13** in February from **129.29** in January 2023.
- Meanwhile, the food and non-alcoholic beverages index increased 50bps to **13.30%** y/y February 2023 from **12.80%** recorded in January, and the housing utilities and the transport indices increased by **7.60%** and **12.90%,** respectively y/y.
- We expect headline inflation to continue to elevate above CBK's upper target of 7.50%. for the near term but decline towards CBK's target range in 2H'23. We anticipate continued pressure on the CPI, at least until localized effects of the global oil price slowdown, cost of electricity declines, and relief from expected rainfall increase food production.

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