



Primary Auction Note – July 2022

The Central Bank is looking to raise a total of **KES 40.00Bn** for budgetary support for the current fiscal year through the issuance of the reopened **FXD2/2013/15** and **FXD2/2018/15** with a coupon rate of **12.00%** and **12.75%** respectively. Both bonds have a tenor of 15 years and an effective duration of 5.8 Years and 11.3 Years respectively.

We expect an undersubscription largely on account of tightening liquidity in the money markets. So far in 2022, the bid - to - cover ratio (value of bids received compared to the value of bids accepted) for issued papers has averaged at **1.39** lower than **1.63**, recorded over similar period in 2021. The lower ratio makes a case for reduced demand in 2022. We suspect that most banks have slowed on taking up government debt as it exposes them to fair value losses due to the rising yields and the private credit sector has shown signs of recovery.

Given that we are at the start of the new fiscal year coupled with no upcoming T-Bond maturities in July, we do not foresee additional pressure on the government to accept expensive bids. The acceptance rate has averaged at **98.70%** so far in 2022, which is higher than **77.85%** recorded over a similar period in 2021. However, the acceptance is likely to increase latter in the fiscal year as the new government will probably issue supplementary budgets as they adjust spending to suit their manifesto.

We foresee investors placing aggressive bids on both papers given the prevailing risks occasioned by;

- (i) **Upcoming General Elections** - There are fears of lack of a round one win, supreme court petition and a re-run which is likely to run up to May'23
- (ii) **Elevated Local and Global Inflation** – We foresee the current high inflation pushing investors to seek better real returns by placing aggressive bids as compensation for the rising inflation
- (iii) **Rising Eurobond YTM** - Government debt sustainability questions given the rising yields in the Eurobonds market which might see foreign investors sit out or go slow on this issue

Summary Bidding Guidance:

Issue No	Outstanding Amount	Next Coupon Payment	Coupon Rate	Current YTM	Bidding Range
FXD2/2013/15	KES 66.10 Bn	17/10/ 2022	12.00%	12.68%	13.00-13.39%
FXD2/2018/15	KES 29.06 Bn	17/10/ 2022	12.75%	13.67%	13.74 -13.99%

July 18th, 2022

RECOMMENDATIONS:

FXD2/2013/15

Bid: 13.00%– 13.39 %

FXD2/2018/15

Bid: 13.74%– 13.99%

Period of Sale: 23/06/2022 to 19/07/2022

Sovereign Credit Rating:

Moody's: B2 (negative)

Fitch: B+ (negative)

S&P: B (stable)

June CPI: (2019=100): 124.22

June Inflation: 7.90%

Interbank Rate (15th July 2022): 5.34%

C.B.R (May 2022): 7.50%

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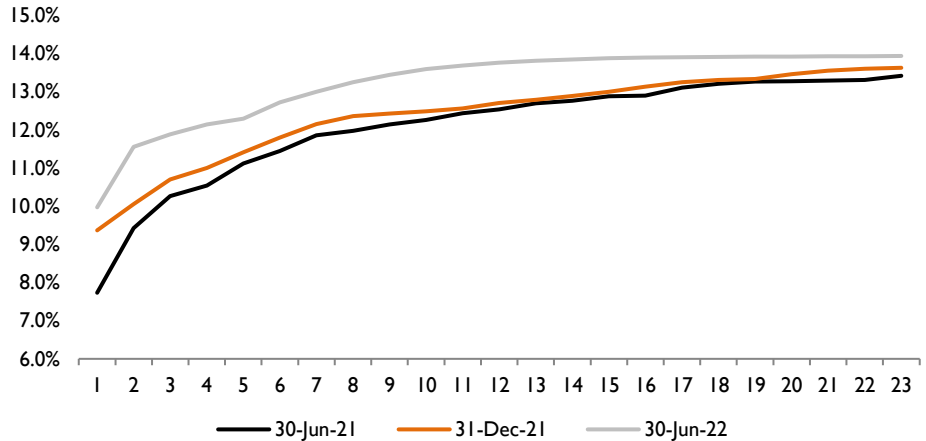
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Interbank

During June, liquidity in the money markets remained stable, supported by open market operations by CBK. The mostly interbank rates remained above 5.00% levels to close at **5.33%** on 30th June from **4.60%** recorded on 31st May.

CBK's Monetary Policy Committee (MPC) has raised the Central Bank rate to 7.50%, for the first time since March 2020, as it sought to tame soaring inflation in the wake of increased global and local risks. Inflation rose to 7.90%, above CBK's upper target of 7.50%. The committee will meet again on 30th June 2022.

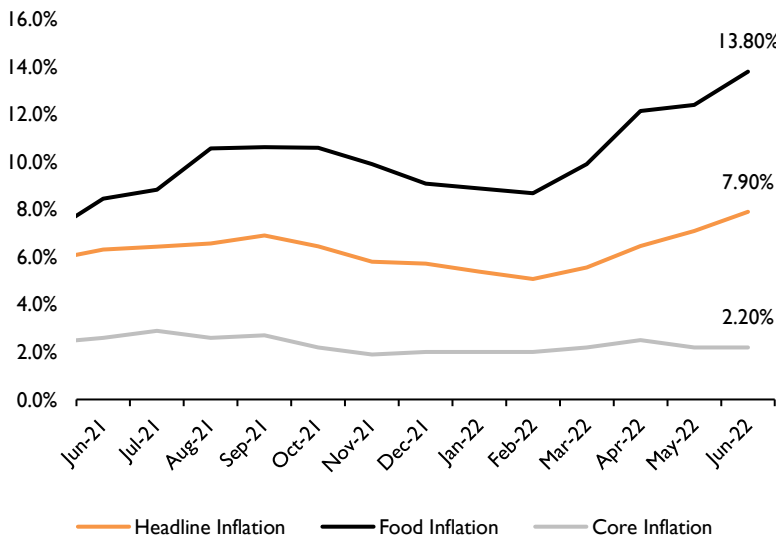
NSE Yield Curve



In the month of June, rates increased in the short to mid range of the across the yield curve. 6-year papers increased the most by 31.66 bps while the 23-year papers declined the most by 5.23%. 11 year papers increased 6.19 bps m/m.

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 political and pandemic related risks.

June Inflation:



- In June, headline inflation increased to **7.90%** from **7.10%** in May. CPI increased **0.90%** to 124.22 from 123.12 in May 2022.
- Food index increased by **13.80% y/y**. Additionally, the transport index increased by **7.10%** in the last year, indicating the continued effects of the supply chain constraints stemming from the Russia-Ukraine war.
- Rising fuel costs and anticipated shortages in the supply of farm inputs, maize and wheat are likely to exert pressure on transportation, energy and food prices. We expect the CBK to factor in the rising inflation in the next MPC meeting.

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