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WEEKLY FIXED INCOME NOTE

research@aib-axysafrica.com

Weekly Fixed Income Note

Week Ending: 12th May 2023

Key Highlights:

- T-bills were oversubscribed for the second week recording an increased overall subscription rate of 188.91% from 110.72% recorded in the previous week. Investors continued to prefer the shorter-term 91-day paper for the 12th month. We attribute the performance to investors continuing to see short-term risks in the market. We expect continued preference towards the 91-day paper given the rising yields which as expected have crossed the 10% level. Additionally, CBK's announcement of easier access to opening treasury securities trading accounts is likely to see increased retail and diaspora investors' interest. The Central Bank acceptance rate increased to 99.88% of the **KES 45.34Bn** amounting to **KES 45.29Bn.** Yields on all the papers are now firmly above 10.00% with the 91, 182, and 364-day papers moving **9.20bps, 17.50bps,** and **10.00bps,** respectively.

- In the primary market, FXD1/2023/03 was oversubscribed, against our expectations, by recording a 103.72% subscription rate. We believe that investors continue to see the market's short-term risks, hence the high appetite for shorter dated papers. Additionally, the yield and coupon rate came in at 14.23%, which points to the governments willingness to accommodate higher yields.

- In the secondary market, the value of bonds traded increased by 0.32% to **KES 13.93Bn** from **KES 13.88Bn** recorded a week prior. We observed a further yield curve steepening across the curve highlighting investors' demand for higher rates. As such, the 3-year paper gained the most by **88bps.** We continue to see a yield curve inversion in the mid section which is likely to spread towards the long end depending on the maturity profile of the upcoming primary issues.

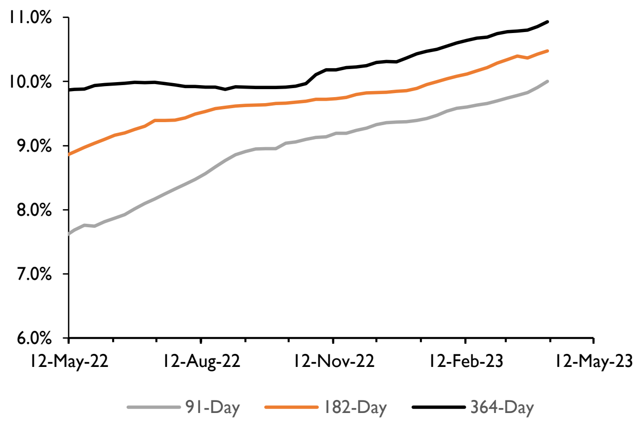
- In the international market, yields on Kenya's Eurobonds decreased by an average of 60bps indicating improved investor sentiment on the long end. We observed the 2024 Eurobond paper decreased by 218.9bps, highlighting the paper's sensitivity to market sentiments given that its maturity is less than 13 months away. We expect further declines in the 2024 paper following positive domestic subscriptions that could point to improved sentiments. However, the S & P ratings downgrade could sway yields upwards.

We expect activity in the secondary market to be driven by investors who missed out on the May T-Bond issue. We believe that the high frequency of tap sales is likely to have a negative impact on the secondary market especially for IFBs. Several transactions in the secondary market are driven by investors who missed out in the primary market. In the coming T-Bond bidding sessions, we foresee investors testing CBK's resolve on accepting rates higher than 14.50%.

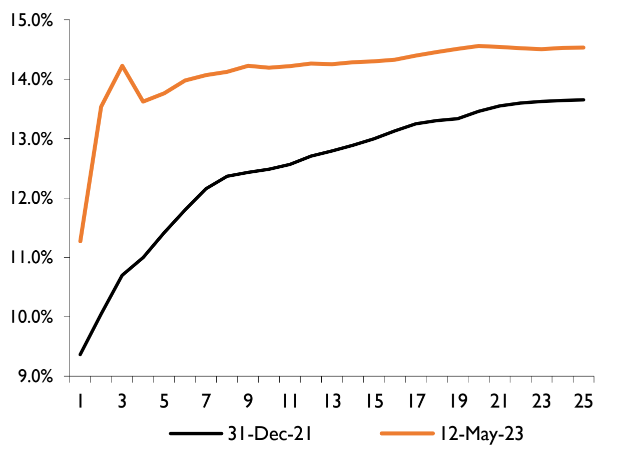
Key Indicators

	Current	Previous	w/w bps Change
91- Day	10.41%	10.32%	9.20
182-Day	10.85%	10.68%	17.50
364-Day	11.27%	11.17%	10.00
Interbank Rate	9.50%	9.66%	16.36

T-Bill Rates



NSE Implied Yield Curve



MACROECONOMIC NEWS

Currency

The Kenya shilling further lost ground against the USD, depreciating **35bps** to **KES 136.88** from **KES 136.40** the previous week. On a YTD basis, the shilling has depreciated **10.98%** against the USD ,depreciation exceeded the 9.04% depreciation recorded in 2022. The CBK's usable forex reserves declined marginally remaining below the 4.00 months level to close last week at **USD 6,468Mn** (**3.60 Months** of Import Cover), a 37bps week-on-week decrease from **USD 6,492Mn** (**3.61 Months** of Import Cover), recorded last week. The current reserves remain below the CBK's statutory requirement (4 Months) & EAC Convergence requirement (4.5 Months) of import cover. **We expect the local currency to continue coming under pressure due to the increased dollar demand from importers on the back of the prevailing high global commodities prices, and reduced dollar inflows from key export-earning sectors. Additionally, the depreciation is driven by the continued strengthening of the dollar against emerging and frontier markets currencies.**

Liquidity

Liquidity in the money market eased as shown by the average interbank rate decreasing 16bps to 9.50% from 9.66% recorded a week prior. We partly attribute the easing to government payments outpacing statutory deductions and tax remittances. **We expect the interbank rate to remain above 9.00% levels in the coming week, mainly driven by the remittance monthly obligations, delayed government payments and CBK's open market operations.**

Macro-economic News Roundup

The National treasury gazetted the statement of revenues and expenditures for the ten months of fiscal year 2022/23. The total revenues collected were KES 2,325.79Bn being 77.26% of prorated estimated collection of KES 3,010.27Bn. We observed an under collection in Tax revenues at KES 1,573.22Bn being 74.62% of the estimated collection of KES 2,108.33Bn and 89.54% of the prorated target of KES 1,756.94Bn. As per our estimates KRA collected KES 179.87Bn in taxes for the month of April 2023. Recurrent expenditure, KES 905.81Bn, was below prorated estimates of KES 1,054.97Bn. We remain concerned with the lower allocation absorption of the development expenditure which came in at KES 180.06Bn (a KES 5.30bn increase from March) being a 54.87% of the prorated estimate of KES 328.18Bn. However, the government remains below the prorated domestic borrowing target having borrowed KES 406.62Bn being 55.04% of the prorated estimates.

Moody's rating agency downgraded Kenya's rating to B3 from B2 driven by the increase in government liquidity risks indicating high credit risk. The worsening of domestic finance circumstances resulting from low net domestic issuance has led to funding shortages and delayed government expenditure. We expect the downgrade in Moody's rating, indicating the decrease in Kenya's creditworthiness, will affect access to financing from international markets.

EPRA increased the pump prices for all fuel categories for the next month following the full removal of the all fuel subsidies. Petrol will retail at KES 182.70/litre (+ KES 3.40), diesel will retail at KES 168.00/litre (+ KES 6.40), and kerosene will continue at KES 161.13 (+ KES 15.19). The increase was largely driven by an increase in the landing costs of all fuels, continued depreciation of the local currency and an 0.88% increase in FOB price of Murban crude oil. We maintain our earlier expectations that the G-to-G oil import model is likely not to bring additional pricing benefits to consumers. As per our observations, the oil import model was largely looking to ease the dollar shortage situation. of diesel and kerosene while petrol increased marginally.

Given the tax collection trend KRA is likely to miss the FY22/23 collection targets given the tough business environment. However, efforts by KRA to fix revenue loss avenues through the introduction of new generation ETR machines and daily tax collection from betting firms are likely to boost tax collections. The collection of installment tax is likely to improve the May-June tax collections. We expect the increase in the fuel prices to be reflected in the end of month inflation figures.

Weekly Fixed Income Calendar

- **Treasury issues -** This week, the Central Bank of Kenya, as the government's fiscal agent, is in the market for **KES 24.00Bn** in T-bills.

	Macro event	Date
1.	Weekly T-Bills Auction	18th May 2023
2.	May MPC Meeting	29th May 2023
3.	May Inflation Figures	31st May 2023

CONTACTS:

Research Desk
Solomon Kariuki
Research Analyst

Stacy Makau
Research Analyst

Email: research@aib-axysafrica.com

Equities Dealing

Nina Goswami

Bernard Kung'u

Benard Gichuru

Brian Tanui

Samuel Githinji

Sheema Shah

Samuel Wachira

Benson Ngugi

Email: trading@aib-axysafrica.com

Bond Dealing

Crispus Otieno

Titus Marenye

Aundrina Musyoka

Kenneth Minjire

Email: trading@aib-axysafrica.com

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