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WEEKLY FIXED INCOME NOTE

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Weekly Fixed Income Note

Week Ending: 25th August 2023

Key Highlights:

- T-bills were undersubscribed recording an overall decreased subscription rate of 95.80% from 186.16% recorded in the previous week. Investors continued to prefer the shorter-term 91-day paper with a 4.55x subscription rate. We attribute the performance to investors continuing to see short-term risks in the market. We expect continued preference toward the 91-day paper given the rising yields. We continue to observe the difference between the yields on the three papers shrinking to within 10bps increasing the possibility of a yield curve inversion on the short end. The Central Bank acceptance rate decreased to 88.67% of the **KES 22.99Bn** amounting to **KES 20.39Bn.** Yields on all the papers are now firmly above 13.00% with the 91, 182, and 364-day papers moving **25.78bps, 21.53bps,** and **26.81bps,** respectively.

- In the primary market, the tap sale of the newly issued FXD1/2023/2 and the reopened FXD1/2023/5 were oversubscribed recording a 111.89% subscription with the CBK accepting KES 23.40Bn.We attribute the overperformance to investors continuing to prefer higher risk adjusted returns.

- In the secondary market, the value of bonds traded decreased by 41.44% to **KES 7.67Bn** from **KES 13.10Bn** recorded a week prior. We attribute the decrease to investors interest in the primary auction tap sale. We observed a further steepening across the curve highlighting investors' demand for higher rates. As such, the 14-year paper gained the most by **304bps.** We continue to see a yield curve inversion in the short end section which is likely to spread across the curve depending on the maturity profile of upcoming primary issues.

- In the international market, yields on Kenya's Eurobonds decreased by an average of 40bps indicating improved investor sentiment on the long end. We observed the 2024 Eurobond paper declining by 121bps, highlighting the paper's sensitivity to market sentiments given that its maturity is less than 11 months away. We expect another week of lower yields on the 2024 paper that could point to improving investors sentiment.

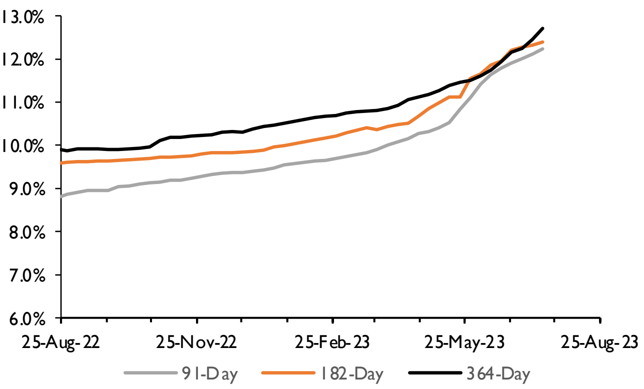
We expect activity in the secondary market to increase driven by investors who missed out on the primary market auction. We believe that the high frequency of tap sales is likely to continue having negative impact on the secondary market. Additionally, we expect marginal effects from the new Dhow CSD platform as investors are onboarded. In the coming T-Bond bidding sessions, we foresee investors testing CBK's resolve on accepting rates higher than 18.00% for short to mid tenor papers.

Key Indicators

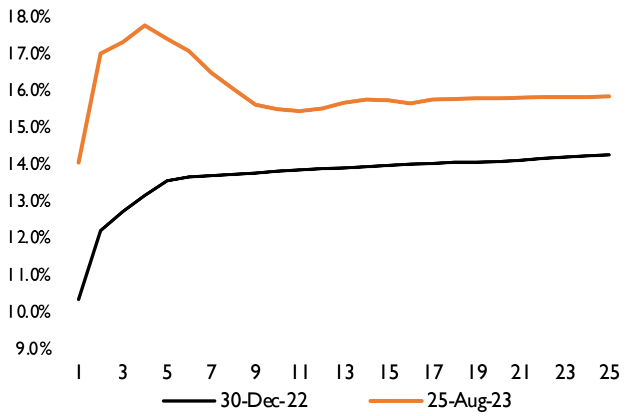
	Current	Previous	w/w bps Change	ytd bps Change
91- Day	13.73%	13.48%	25.78	436.32
182-Day	13.49%	13.28%	21.53	366.61
364-Day	14.01%	13.75%	26.81	370.40
SOFR	5.30%	5.30%	0.00	100.00
Interbank Rate	11.92%	10.32%	(160.57)	(551.55)

SOFR: Secured Overnight Financing Rate – Benchmark interest rate for dollar denominated securities.

T-Bill Rates



NSE Implied Yield Curve



MACROECONOMIC NEWS

Currency

The Kenya shilling further lost ground against the USD, depreciating **41bps** to **KES 144.87** from **KES 143.58** the previous week. On a YTD basis, the shilling has depreciated **16.99%** against the USD , depreciation exceeded the 9.04% depreciation recorded in 2022. The CBK's usable forex reserves decreased marginally remaining below the 4.00 months level to close last week at **USD 7,153Mn** (**3.91 Months** of Import Cover), a 192bps week-on-week decrease from **USD 7,290Mn** (**3.98 Months** of Import Cover), recorded last week. The current reserves is below the CBK's statutory requirement (4 Months) & below 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 market currencies.**

Liquidity

Liquidity in the money market tightened as shown by the interbank rate increasing 161bps to 11.92% from 10.32% recorded a week prior. We partly attribute the tightening to statutory deductions and tax remittances outpacing government spending. Additionally, we suspect the implementation of new CBK system has had marginal effects in the interbank trading coupled with CBK's absence from open market operations. **We expect the interbank rate to remain above 9.00% levels in the coming week, mainly driven by the monthly bank's Cash Reserve Requirements, delayed government payments and CBK's open market operations.**

Global Markets Overview

In the international front, the US dollar strengthened **0.61%** , against other major currencies during the week taking the YTD performance to **0.47%** strengthening. We attribute this to the Federal Reserve's aggressive monetary policy stance by raising interests to combat high inflation with anticipation that the Federal Reserve could hike the rates again during the year. The dollar has recovered some of its year-to-date losses as result of monetary policy tightening. The yield on the 2-year treasury paper climbed by 194bps to 5.04%. Global oil prices recorded mixed rends with Kenya's supplier UAE Murban increasing to close the week at USD87.07/barrel while Brent Crude oil decreasing to close the week at USD84.44/barrel.

During the week, the BRICS summit was held where it was announced that Argentina, Egypt, Ethiopia, Iran, Saudi Arabia and United Arab Emirates would join the economic bloc in 2024 in a move that will more than double the size of the bloc. The inclusion of these 6 countries is in line with the bloc's strategy to consolidate power and transform global governance into a system that priorities the voices of the global south. We expect that with members continued diversification of their foreign currency holdings away from the US dollar coupled with the anticipation of oil and gas prices to no longer be determined in US dollars, there will be a reduction in power of the greenback.

We expect the shilling to come under more pressure as the dollar gains strength which will lead to the widening of the current account deficit as import costs rise. We anticipate that the rise in interest rates in developed markets will accelerate the current withdrawal of foreign investors from developing countries like Kenya, which will keep the shilling under pressure.

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.

- **August Inflation Expectation -** We expect August inflation to come between 7.00%-7.50% largely driven by a drop in prices of CPI commodities and supported by stable household utilities index. We expect the maintenance of pump prices to have a positive base effect on the headline inflation.

	Macro event	Date
1.	Weekly T-Bill Auction	31st August 2023
2.	August Inflation Figures	31st August 2023

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