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WEEKLY FIXED INCOME NOTE

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Week Ending: 10th March 2023

Key Highlights:

- T-bills were oversubscribed for second consecutive week recording an increased overall subscription rate of 148.47% from 136.25% recorded in the previous week. Investors continued to prefer the shorter-term 91-day paper for the 10th straight month with a 5.01x subscription rate compared to the least preferred 364-day paper at 76.81%. We attribute the overperformance to investors continuing to see short term risks in the market. We expect an oversubscription in coming weeks as the yield on the 91-day paper is expected to get to the 10% barrier having recorded 9.74% in the recent auction. Additionally, CBK's announcement of easier access to opening treasury securities trading accounts for investors is likely to see increased investor interest. The Central Bank acceptance rate increased to 90.34% of the **KES 35.63Bn** amounting to **KES 32.19Bn.** Yields on all the papers are now firmly above 9.70% with the 91, 182, and 364-day papers gaining **4.40bps, 5.10bps,** and **5.70bps,** respectively.

- In the Primary market, March IFB issue results were in line with our expectations, recording an oversubscription of 119.54% (KES 59.77Bn) with the CBK accepting KES 50.88Bn being an 85.13% acceptance rate. We attribute the overperformance to the tax-free nature of IFB issues and the high yields currently being offered by government papers. We also believe that overperformance was driven by investor's increased preference for higher risk adjusted returns. The yield and coupon rate of the IFB1/2023/17 amortized infrastructure bond came in at 14.399%.

- In the secondary market, the value of bonds traded decreased by **14.76%** to **KES 9.08Bn** from **KES 10.65Bn** recorded a week prior. The yield curve recorded a mix of flattening and steepening across the curve. The 20-year paper gained the most by **10bps** while the 2-year paper lost the most by **1bps.**

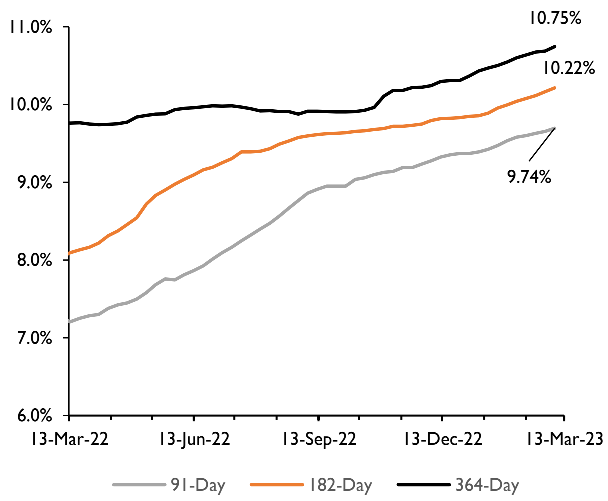
- In the international market, yields on Kenya's Eurobonds increased by an average of 0.67bps indicating decreased investor sentiment. We observed the 2024 Eurobond paper which increased by 60bps highlighting the paper's sensitivity to market sentiments given that its maturity is less than 18 months away.

We expect activity in the secondary market to be driven by IFB trading. Investors who missed out on the March IFB issue are likely to be looking for entry opportunities. In the coming T-Bill bidding sessions, we foresee investors testing CBK's resolve on accepting higher than 10.00% for a 91-day paper.

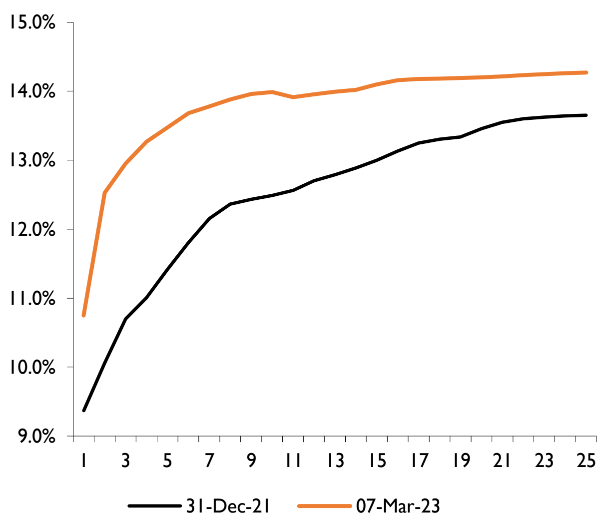
Key Indicators

	Current	Previous	w/w bps Change
91- Day	9.74%	9.70%	4.40
182-Day	10.22%	10.17%	5.10
364-Day	10.75%	10.69%	5.70
Interbank Rate	6.69%	6.71%	(1.59)

T-Bill Rates



NSE Implied Yield Curve



MACROECONOMIC NEWS

Currency

The Kenya shilling further lost ground against the USD, depreciating **105bps** to **KES 128.89** from **KES 127.54** the previous week. On a YTD basis, the shilling has depreciated 4.47% against the USD and if the same trend is maintained the depreciation is likely to exceed the 9.04% depreciation recorded in 2022. The CBK's usable forex reserves dropped even further in the week ended 10th March 2023 to close at **USD 6,566Mn** (**3.67 Months** of Import Cover), a 59bps week-on-week decrease from **USD 6,605Mn** (**3.69 Months** of Import Cover), recorded last week. The current reserves are well below the CBK's statutory requirement (4 Months) & EAC Convergence requirement (4.5 Months) of import cover. However, during the week, it was noted that Five local banks had been picked to issue letters of credit of up to KES 614.89Bn (USD 4.80Bn) for fuel that Kenya is set to import on credit from the United Arab Emirates over a nine-month period in an effort to reduce the dollar demand. **That said, we expect the local currency to continue coming under pressure due to the increased dollar demand from energy importers on the back of the prevailing high global oil 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 1.59bps to 6.69% from 6.71% recorded a week prior. We attribute the eased liquidity to government payments more than offsetting tax remittances. Open market operations also remained active within the week. During the week, the average number of interbank deals decreased to 28 from 29, while the average value traded decreased to KES 17.30Bn from KES 23.50Bn recorded in the previous week. **We expect the interbank rate to remain above 6.00% levels in the coming week, mainly driven by monthly bank Cash Reserve Requirements (CRR) cycle requirements. Additionally, we expect government payments to continue supporting inflows.**

Macro-economic News Roundup

During the week, the World Bank announced that it intended to upsize Kenya's budget support loan (Development Policy Operation (DPO) facility) set to be disbursed on June 30th 2023 from USD 750.00Mn (KES 96.75Bn) to USD 1.00Bn (KES 129.00Bn) albeit pending approval. This is expected to ease dollar demand in the country. The financing is now expected to focus particularly on climate change mitigation and adaptation, in contrast to the earlier plan. It comes against the backdrop of the Treasury having published the draft version of the National Green Fiscal Incentive Policy Framework.

In an effort to lower the cost of living in the country, the state received a KES 24.00Bn backing through issuance of a letter of credit from commercial lender KCB Group that's intended for the importation of cheaper goods on a duty-free basis. With the government acting as the de facto controller of the cost of essential commodities, the importation scheme aims to push other local manufacturers to cut the pricing of basic goods. The Consumer Price Index (CPI) which measures the cost of a basket of goods stood at KES 130.13 in February representing a 65bps increase from KES 129.29 recorded in January 2023. Inflation remained above CBK's upper target of 7.50% to close February at 9.20% from 9.00% recorded the previous month.

We expect that the economy will continue to be constrained by the prolonged high commodity prices and elevated inflation rates. Continued pressure of food inflation will continue to have a severe impact on household's food security. In the near term, we foresee business activity improving driven by better private sector credit growth, better agricultural production from the onset of short rains, and benefits from the ongoing monetary tightening. However, we foresee global challenges including inflationary pressure, recessionary fears and geopolitical events as likely to slow down economic growth and dampen the general business environment.

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.	March Pump Prices Review	14th March 2023
2.	Weekly T-Bill Auction	17th March 2023
3.	March MPC Meeting	29th March 2023
4.	March Inflation Figures	31st March 2023

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