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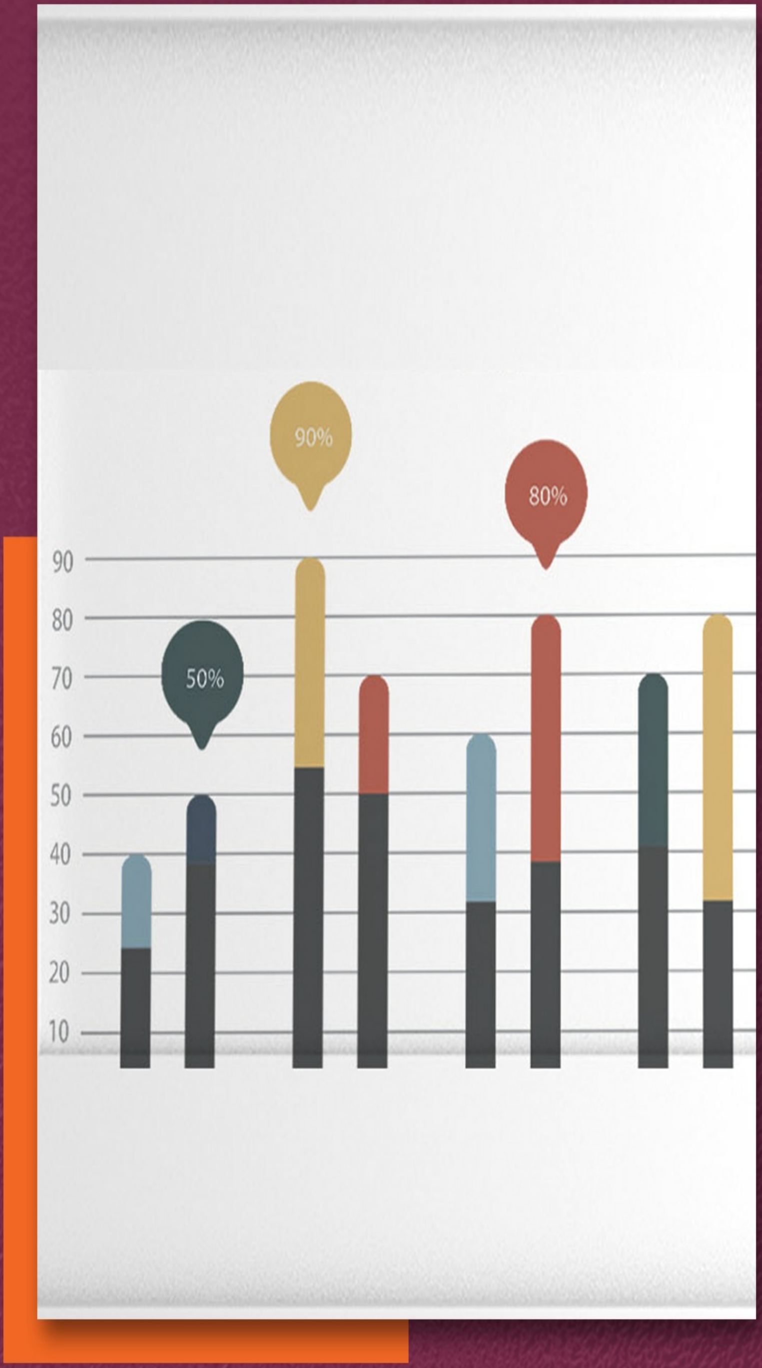

Primary Auction Guide

Primary Auction Note – FXD1/2023/003

The Central Bank of Kenya is in the market looking to raise KES 20.00Bn for budgetary support through issuance of a new bond, FXD1/2023/003. The coupon rate of the newly issued bond will be market determined with bidding closing on 09th May 2023. The minimum investment is KES 50,000 with an effective tenor of 3 years.

We expect this bond issue to be undersubscribed driven by factors such as;

i. **Tight Liquidity** – Liquidity in the interbank market has shrunk as evidenced by fluctuating T-Bill subscriptions and the interbank rate remaining above 8.00%. The CBK open market operations have also been active in the month of April, playing a part in mopping up liquidity.

ii. **Reduced Foreign Players Participation** – Driven by the declining local currency (2.70% depreciation in April), we expect foreign players to keep off this issue, and,

iii. **Reduced Participation From Banking Sector Players** – Driven by increased mark-to-market losses and better lending rates, we expect banks to continue tapering down their allocation to government securities

Recent low acceptance levels are an indication of the government's need to control yields from rising further. As such, mid-range bidding could place investors within the acceptance zone. Given no T-Bond maturities in May 2023, coupled with end of fiscal year budgetary needs, we foresee increased pressure on the government to accept expensive bids as investors seek to push the rates higher.

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 two-year paper, FXD1/2022/03, came in at the 13.47% level and we also expect investors to bid higher in this issue.

II. **Debt Sustainability Concerns-** Recent fiscal position concerns relating to Kenya's current debt burden (including the upcoming Eurobond 2024 maturity) and ability to meet budgetary needs has spooked talks of potential debt restructuring. As such, we expect investors awaken their risk feelers and demand a premium by placing aggressive bids.

Summary Bidding Guidance:

Issue No	Amount Offered	Next Coupon Payment	Coupon Rate	Bidding Range
FXD1/2023/003	KES 20.00Bn	13/11/2023	Market determined	13.75% -13.99%

05th May 2023

RECOMMENDATIONS:

FXD1/2023/003

Bid: 13.75%-13.99%

Period of Sale: 26/04/2023 to 09/05/2023

Sovereign Credit Rating:

Moody's: B2 (Negative)

Fitch: B (Stable)

S&P: B (Negative)

April CPI: (2019=100): 131.83

April Inflation: 7.90%

Interbank Rate (4th May 2023): 9.73%

C.B.R (April '2023): 9.50%

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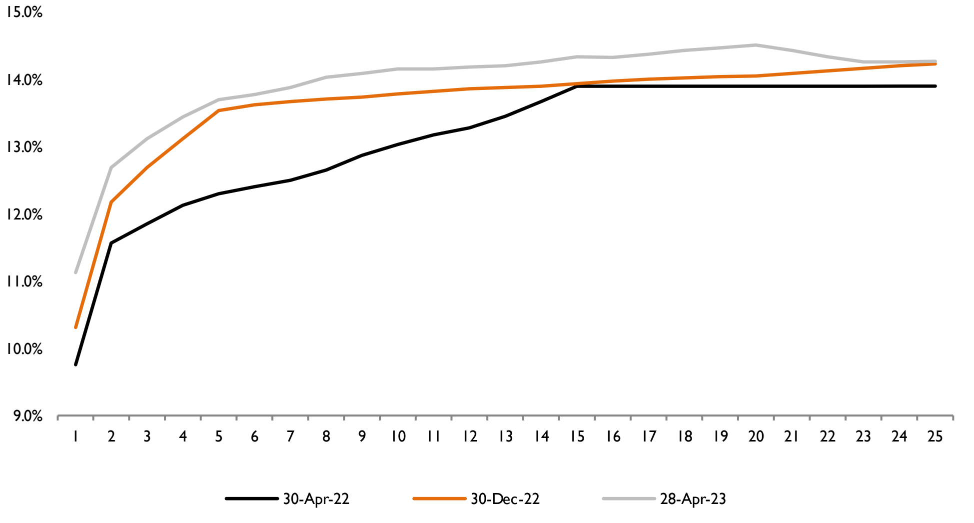
Liquidity

During the month of April, liquidity in the money markets tightened driven by CBK open market operations and tax remittances more than offsetting government payments. Mostly, interbank rates remained largely above 8.00% levels having recorded **9.37%** on 28th April 2023 reflecting a 151bps increase from **7.86** % recorded on 31st March 2023.

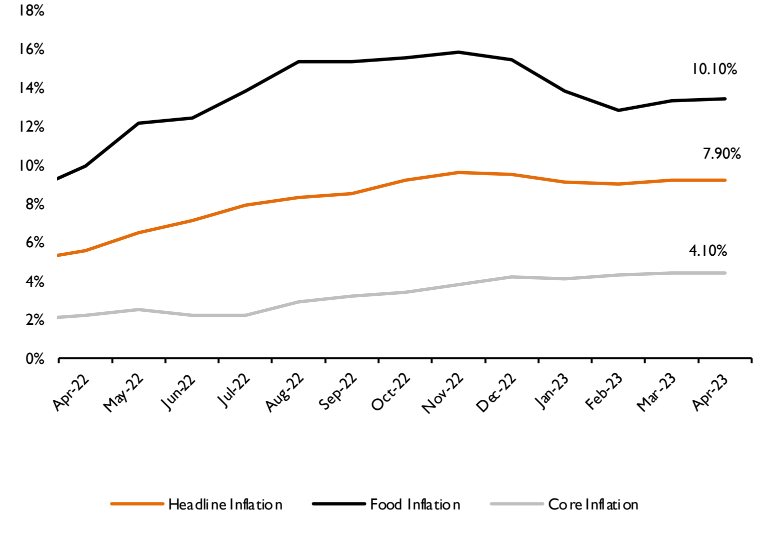
NSE Implied Yield Curve



In the month of April, yields increased across the curve. 20-year papers increased the most by 48bps while the 25-year papers were the largest decliners by 7bps. The 3-year papers increased by 10 bps.

We expect the yield curve to experience upward pressure across all tenors with a concentration on the short end as compensation for prevailing market risks. The average yields on the 91-day, 182-day, and 364-day papers closed April at 10.04%, 10.42% and 10.91% respectively.

April Inflation



- The headline inflation decreased for the month of April to **7.90%** from **9.20%** in March. The CPI increased 50 bps to **131.83** in April from **131.18** in March 2023.
- Meanwhile, the food and non-alcoholic beverages index decreased 330bps to **10.10 %** y/y April 2023 from **13.40%** recorded in March and the housing utilities and transport indices increased marginally to **9.60%** and **9.80%,** respectively y/y.
- We expect headline inflation to continue elevated above CBK's upper target of 7.50%. for the near term but decline towards CBKs 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 increases food production.

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