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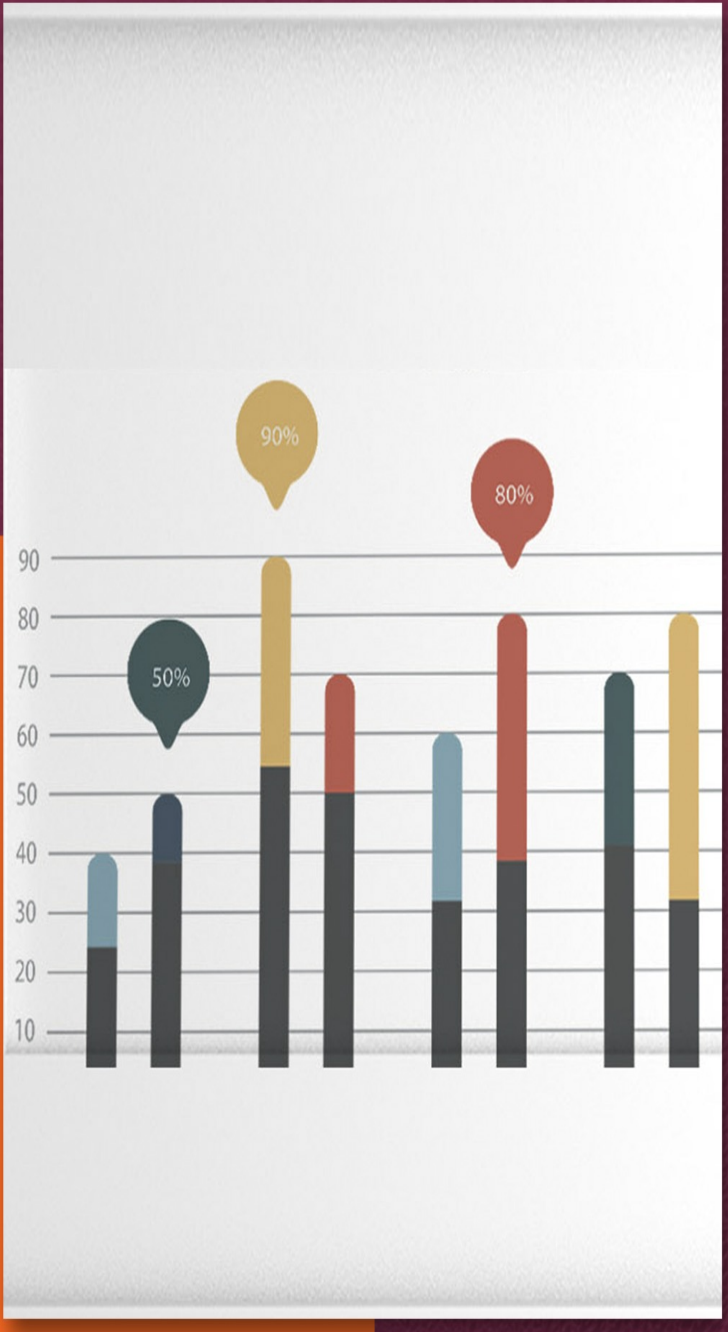

Primary Auction Guide

Primary Auction Guide – FXD1/2023/2 & FXD1/2016/10

The Central Bank of Kenya is in the market looking to raise KES 35.00Bn for budgetary support through the reopening of two previous issues (FXD1/2023/2) and (FXD1/2016/10). The coupon rate of FXD1/2023/2 will be 16.9723% while the coupon rate of FXD1/2016/10 will be 15.039%. The minimum investment is KES 50,000 with an effective tenor of 1.9 years for FXD1/2023/2 and 2.9 years for FXD1/2016/10.

We expect investors to prefer the 2-year paper, similar to recent auctions where investors have preferred shorted dated papers. We foresee this bond issue being oversubscribed driven by factors such as:

i. **Anticipated High Yields -** Yields currently being offered on government papers have been on the rise driven by deteriorating macroeconomic factors. Concerns about government debt sustainability, persistent inflationary pressures and depreciation of the shilling have led to investors seeking to preserve their actual return by demanding a greater premium on government papers. Yields are anticipated to keep rising higher resulting from the current macroeconomic outlook.

ii. **High Demand in the Secondary Market -** Holders of the bond have an exit option to cash out at a higher price in the secondary market making the papers attractive for secondary market trading. However, there may be restriction on early secondary market exits due to the possibility of a tap sale on the issue.

Investors are expected to place aggressive bids within the region of 100bps above the current trading levels for bonds with similar tenor. 2-year papers are currently trading at a yield of 17.0006% and we expect investors to bid higher in this issue. FXD1/2016/10 is currently trading at a yield of 18.00% and a coupon rate of 15.039%.

We foresee the government rejecting expensive bids to control higher yields and remain within the lower domestic borrowing target. The recent low acceptance levels suggest the government's need to control yields from rising further. Moderate bids could position investors within the acceptance zone with the expectation that the government is aiming to stabilize the yield curve upswings. We expect that the banking sector will heavily invest in this issue as they seek to capitalize on the rising yields in light of the challenging lending environment.

We opine that growing concerns about the government's debt sustainability particularly following the downgrading of the country's creditworthiness by rating agencies has prompted investors to seek a premium due to increased risk appetite.

Summary Bidding Guidance:

Issue No	Amount Offered	Next Coupon Payment	Coupon Rate	Bidding Range
FXD1/2023/2	KES 35.00Bn	19/02/2024	16.9723%	17.20%-17.49%
FXD1/2016/10		19/02/2024	15.0390%	17.69% -17.99%

11th September 2023

RECOMMENDATIONS:

FXD1/2023/2

Bid: 17.20% - 17.49%

FXD1/2016/10

Bid: 17.69% - 17.99%

Period of Sale: 01/09/2023 to 13/09/2023

Sovereign Credit Rating:

Moody's: B3 (Negative)

Fitch: B (Negative)

S&P: B (Negative)

August CPI: (2019=100): 134.02

August Inflation: 6.70%

Interbank Rate (8th August 2023): 12.39%

C.B.R (June '2023): 10.50%

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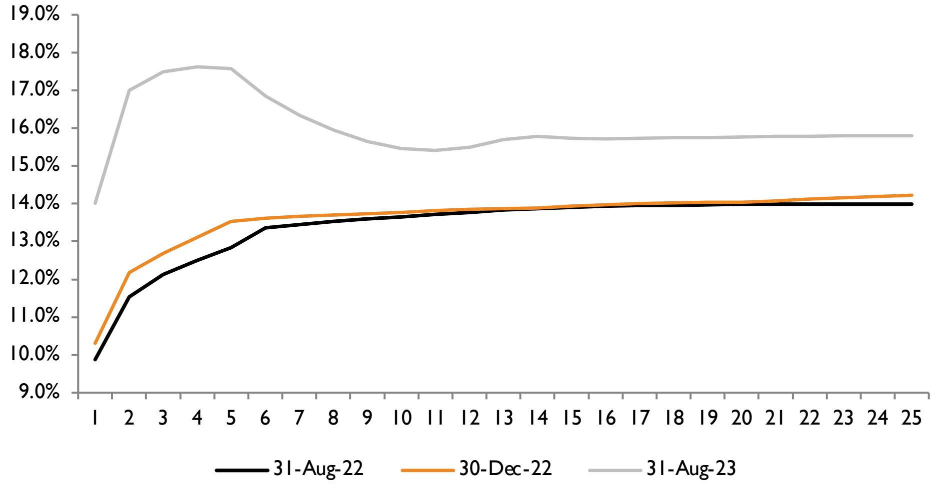
Liquidity

During the month of August, liquidity in the money markets continued to ease. Higher liquidity was partly attributable to government spending outpacing statutory deductions and tax remittances. Additionally, we opine the implementation of interbank pricing system has had a positive impact in the interbank trading. Mostly, interbank rates remained largely above 8.50% levels having recorded **12.40%** on 31st August reflecting a 415 bps decrease from **16.55%** recorded on 31st July 2023.

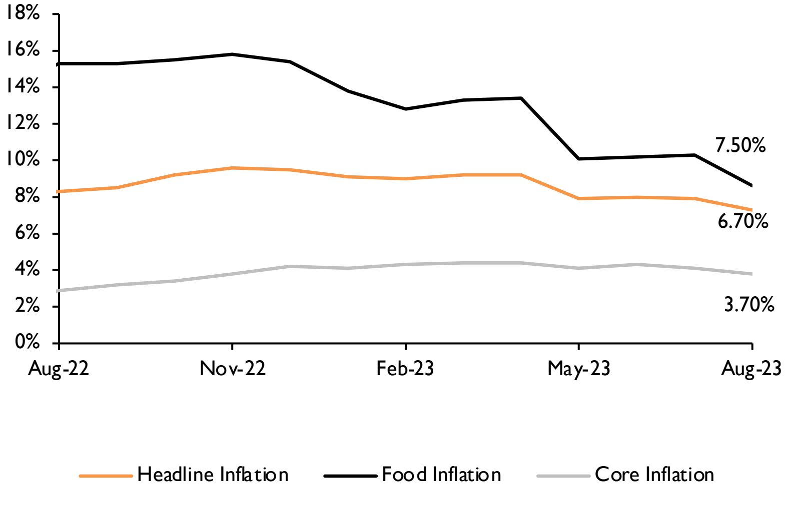
NSE Implied Yield Curve



In the month of August, there was an upward yield movement across the curve. We continued to see investors pricing risk on the short end with the 2-year papers increasing the most by 2.01x followed by the 6-year paper increasing 1.90x.

We expect the yield curve to experience upward pressure across all tenors with a concentration on the shorter end as compensation for prevailing market risks. The yields on the 91-day, 182-day, and 364-day papers closed August at 13.73% (+138bps), 13.49% (+110bps), and 14.01% (+129bps) respectively.

August Inflation



- The headline inflation decreased for the month of August to **6.70%** from **7.30%** in July. Inflation remains within CBK's target range of 2.50% -7.50%. The CPI decreased by 10bps to **134.02** in August from **134.15** in July 2023.
- Meanwhile, the food and non-alcoholic beverages index decreased by 110bps to **7.50%** y/y in August 2023 from **8.60%** recorded in July. Housing utilities decreased to 7.50% y/y while transport increased to 13.10% y/y.
- We expect headline inflation to remain under pressure but within CBK's upper target in the short-term. We foresee that the CPI will remain under pressure, at least until localized effects of the global oil price decrease, cost of electricity declines, and relief from expected rainfall increases food production.

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