Standard Investment Bank

Regulated by the Capital Markets Authority

27TH JANUARY 2025

"Government Seeks KES 70bn via Two Reopened Infrastructure Bonds"

WEEKLY FIXED INCOME REPORT

Moody's Upgrades Kenya's Outlook: Anchored in Fiscal Reforms and Falling Interest Rates

MONEY MARKET ANALYSIS

Liquidity conditions in the money market demonstrated notable stability over the week, with the average lending rate holding steady at 11.31%, unchanged from the previous week. Meanwhile, interbank trading activity softened, with transaction volumes declining by 22.6% to KES 23.14 billion, down from KES 29.92 billion. This dip coincided with a 30.91% reduction in transaction count, reflecting moderated market activity.

The table below summarizes the market liquidity indicators:

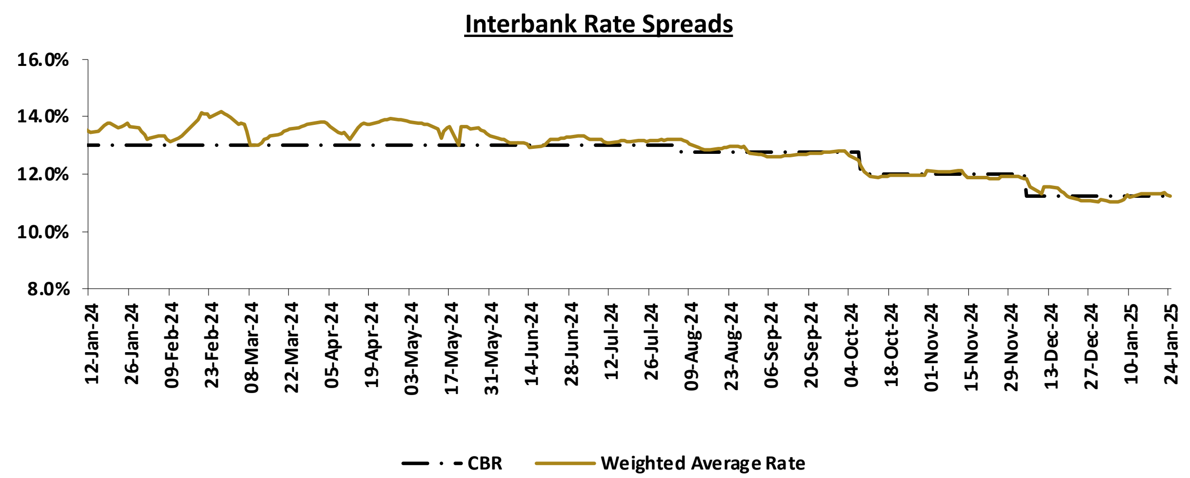
Average	Previous Week	Current Week	Change
Interbank Deals	55.00	38.00	(30.91%)
Inter- Bank volumes (KES bn)	29.92	23.14	(22.65%)
Inter – Bank Rates (bps)	11.3%	11.3%	(0.49)

Source: Central Bank of Kenya (CBK), Table: SIB

Conversely, the discount window remained inactive, while open market operations slowed during the week, with less than KES 10.0bn being injected into the market through reverse repos.

Notably, the weighted average interbank rate has stayed closely aligned with the Central Bank Rate (CBR). Interbank rate fluctuations remained well within the interest rate corridor, underscoring the stability and responsiveness of the monetary policy framework.

See the chart below;



Data: Bloomberg, Chart: SIB

GOVERNMENT SECURITIES MARKET

T-bills

This week, demand for Treasury bills rebounded, recording a subscription rate of 136.7% up from 78.6%, in the previous week. The 91-day paper garnered the highest interest, both in absolute and subscription terms, reflecting ongoing short-term liquidity management strategies. Total bids amounted to KES 32.82bn, with the fiscal agent accepting all submissions.

Yields on accepted bids trended slightly lower, settling at 9.53% (-3.95bps), 10.03% (-0.20bps), and 11.29% (-1.0bps) for the 91-day, 182-day, and 364-day papers, respectively. Notably, while investors continued favoring competitive bids for the 364-day paper, they placed lower bids compared to the previous week, signaling expectations of further rate declines. Meanwhile, the 91-day paper saw a preference for non-competitive bids, highlighting investors' general acceptance of the current market environment.

See the summary below;

KES bn

27-Jan-25	91-day 28-Apr-25	182-day 28-Jul-25	364-day 26-Jan-26	Totals
Amount offered	4.00	10.00	10.00	24.00
Bids received	16.79	3.82	12.20	32.82
Subscription rate (%)	419.8%	38.2%	122.0%	136.7%
Amount accepted	16.79	3.82	12.20	32.81
Acceptance rate (%)	100.0%	99.9%	100.0%	100.0%
Of which: Competitive Bids	0.22	2.14	8.09	10.45
Non-competitive bids	16.57	1.68	4.11	22.36
Rollover/Redemptions	19.97	1.71	2.99	24.67
New Borrowing/(Net Repayment)	(3.18)	2.11	9.21	8.14
Weighted Average Rate of Accepted Bids	**9.53%**	**10.03%**	**11.29%**	
Inflation	**3.0%**	**3.0%**	**3.0%**	
Real Return	6.5%	7.0%	8.3%	

Source: Central Bank of Kenya (CBK), Table: SIB

T-Bonds

In the primary bond market, the fiscal agent is seeking to raise KES 70 billion through two reopened infrastructure bonds: IFB1/2022/14 and IFB1/2023/17, with effective tenors of 11.8 and 15.1 years, respectively. It is worth noting that these instruments are amortized, and approximately half of the outstanding amounts will mature in about 6 years for the 2022 issuance and 8 years for the 2023 issuance.

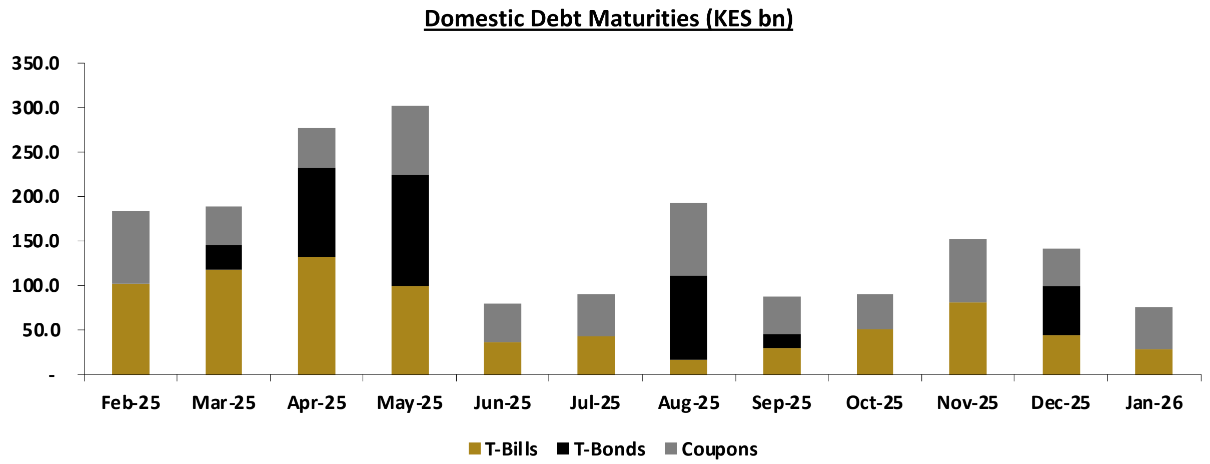
Recent trends suggest that investors are becoming more sensitive to tenor than returns – although this may change as the outlook improves. This indicates that the shorter-tenor 2022 issuance is likely to attract more interest compared to the 2023 issuance, although the coupon rates have only a marginal difference. Both are trading at a premium in the secondary market, with the longer-dated bond commanding a higher premium.

We will provide bidding guidance in the coming weeks. See a summary of the offer below;

Bond Auctioned	Maturity Date	Effective Tenor	Amount Offered	Coupon	Sale Period
IFB1/2022/14	27-Oct-36	11.8	70.0	13.94%	Up to 12th February 2025
IFB1/2023/17	20-Feb-40	15.1		14.40%	

Outstanding Debt Maturities (T-Bills and T-Bonds):

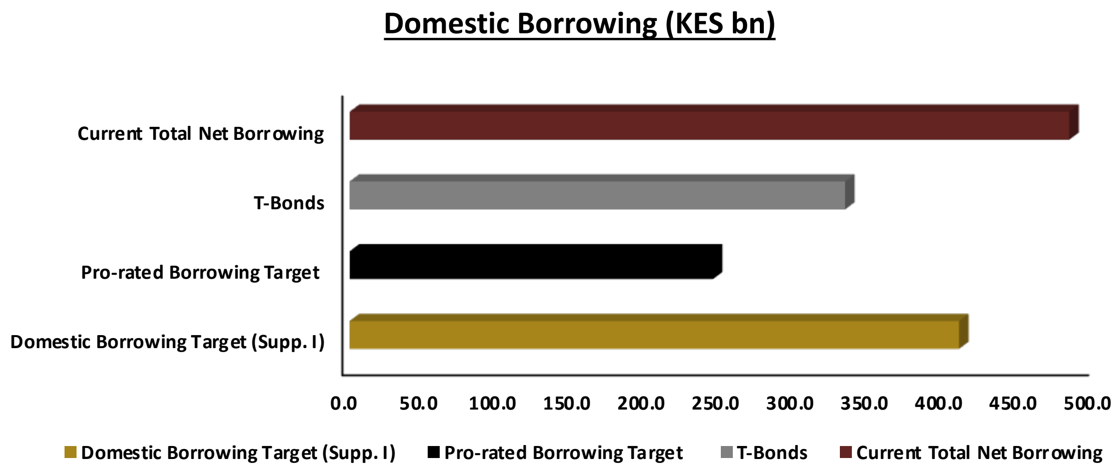
As of this week, the Government's outstanding T-Bill and T-Bond maturities for the next 12 months are valued at KES 786.58bn and KES 417.84bn, respectively. Including coupon payments, the total maturity profile is approximately KES 1.86tn, as outlined below;



Source: Central Bank of Kenya (CBK), Chart: SIB

The government is ahead of its domestic borrowing curve for FY24/25 by 18.1%, having raised KES 482.36bn against a target of KES 408.41bn. When Treasury bills are excluded, domestic borrowing exceeds the prorated target by 36.4% and currently stands at 81.3% of the overall target.

We anticipate that the government will continue to rely heavily on domestic borrowing to bridge revenue shortfalls and offset the challenges posed by expensive external borrowing. See the chart below;



Source: Central Bank of Kenya (CBK), Treasury, Chart: SIB

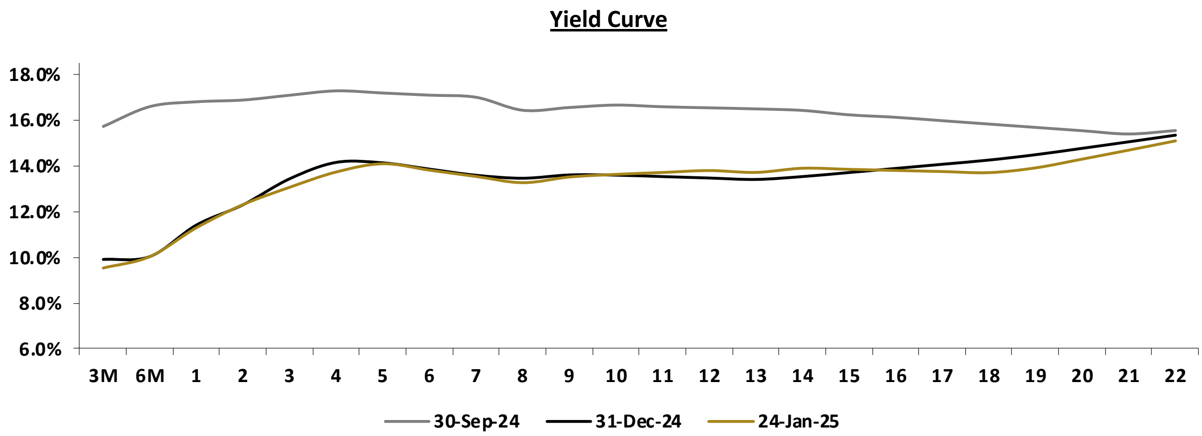
Additionally, if the government successfully meets its borrowing target with the February bond offers—which we believe is likely due to the tax-free nature of the bonds—it will have achieved nearly the entire targeted amount for the current fiscal year, with four months still remaining. However, we note that substantial bond maturities in April and May could significantly impact total net borrowing. This raises concerns that the government may ultimately fall short of its borrowing target or merely meet it at par unless a supplementary budget makes adjustments.

Yield Curve

The yield curve continues to reflect appropriately priced risks, with long-term yields surpassing those of short- and medium-term papers. While rates on long-term papers remain elevated compared to historical levels, we anticipate an overall downward shift, driven by government strategies and inflation dynamics.

Week-on-week, yields on government securities have generally trended downwards, with the exception of the 2-year papers. Overall, yields across all papers are on a downward trajectory, with the entire yield curve ranging between 9% and 15%.

Below is a visual representation;



Source: Nairobi Securities Exchange (NSE), Chart: SIB

The International Front

Kenyan Eurobonds

This week, Kenyan Eurobond yields experienced a moderate upward trajectory, reflecting stable international market conditions. Investors and key players are strategically positioning themselves for the year ahead, with a careful balancing act between risks and opportunities in the global financial landscape. Below is a summary of the performance;

Kenyan Eurobonds						
Issuance	KENINT 05/22/2027	KENINT 02/28/2028	KENINT 02/16/2031	KENINT 05/22/2032	KENINT 01/23/2034	KENINT 02/28/2048
Issue Date	May-27	Feb-28	Feb-31	May-32	Jun-34	Feb-48
Tenor to Maturity	2.3	3.1	6.1	7.3	9.4	23.1
31-Dec-24	8.5%	9.1%	10.1%	10.1%	10.1%	10.3%
16-Jan-25	8.2%	8.8%	9.8%	9.8%	9.8%	10.1%
20-Jan-25	8.3%	8.8%	9.8%	9.8%	9.9%	10.1%
21-Jan-25	8.2%	8.7%	9.7%	9.7%	9.8%	10.1%
22-Jan-25	8.3%	8.9%	9.9%	9.8%	9.9%	10.1%
23-Jan-25	8.3%	9.0%	10.0%	10.0%	10.0%	10.2%
Weekly Change	0.1%	0.2%	0.2%	0.2%	0.2%	0.1%
YTD Change	(0.1%)	(0.1%)	(0.2%)	(0.2%)	(0.1%)	(0.1%)

Source: Central Bank of Kenya (CBK), Table: SIB

Currency Performance

In the foreign exchange market, the Kenyan shilling displayed mixed performance across the currency pairs we track. The steepest depreciation was observed against the Euro, while the most notable gain came against the Japanese Yen, reversing last week's losses. The shilling appreciated by 0.2%, closing at a 7-week high against the US dollar, though still hovering at the KES 129-130 resistance level. This movement was in line with a 0.8% weakening of the USD Index.

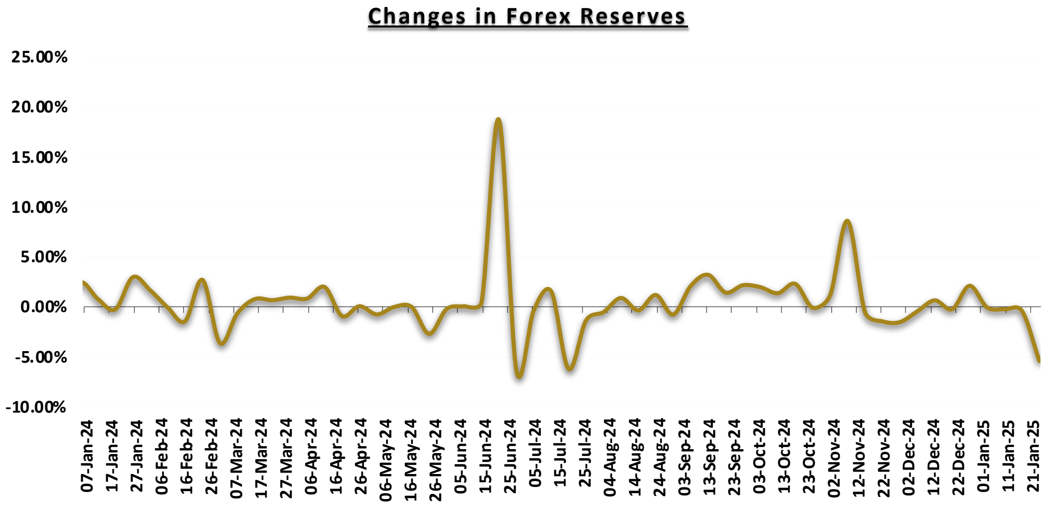
See the table below;

Currencies	29 Dec 2024	Previous Week	Current Week	w/w Change	YTD change
EUR/KES	134.3	133.3	134.4	(0.8%)	(0.1%)
GBP/KES	162.3	158.3	159.2	(0.6%)	1.9%
TZS/KES	19.0	19.5	19.5	(0.1%)	2.5%
KES/UGX	28.4	28.5	28.5	0.2%	0.4%
USD/KES	129.3	129.6	129.3	0.2%	0.0%
JPY/KES	82.1	83.3	82.7	0.7%	(0.7%)

Source: Central Bank of Kenya (CBK), Chart: SIB

Abb: GBP – British Pound, EUR – Euro, USD – US Dollar, UGX – Ugandan Shilling, TZS – Tanzanian Shilling, JPY – Japanese Yen I FX rate is determined by calculating the weighted average rate of recorded spot trades in the interbank market

Meanwhile, Kenya's foreign exchange reserves decreased by 5.4% to USD 8.65bn, which now provides 4.4 months of import cover, compared to USD 9.14bn (4.7 months of import cover) the previous week. This reduction is likely attributed to external loan interest payments, particularly to China, which are typically due in January and July. See below the changes overtime;



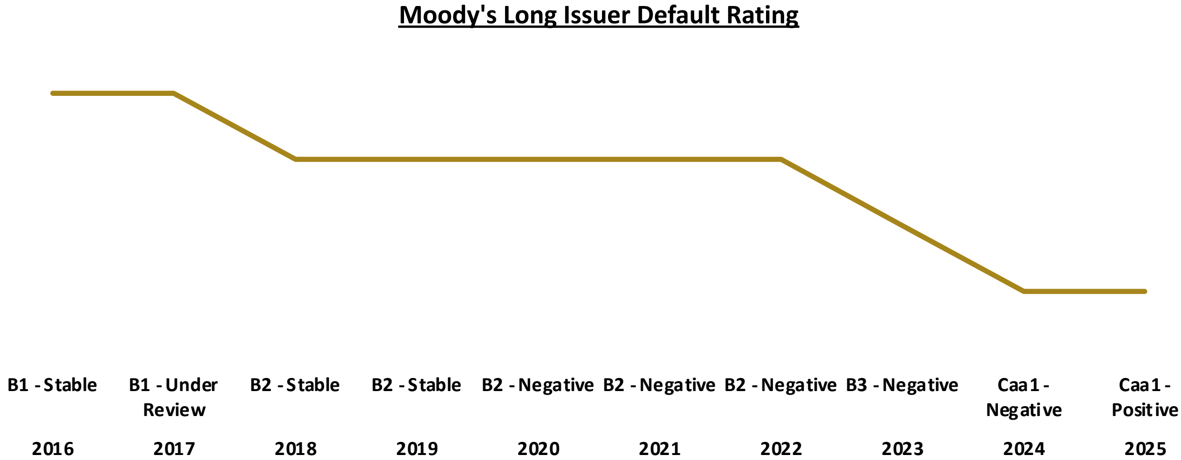
Source: Central Bank of Kenya (CBK), Chart: SIB

MARKET NEWS

Moody's Upgrades Kenya's Outlook: Anchored in Fiscal Reforms and Falling Interest Rates

In its January review, Moody's affirmed Kenya's local and foreign-currency long-term issuer ratings, as well as its foreign-currency senior unsecured debt ratings at Caa1. In a positive shift, Moody's upgraded its outlook from negative to positive. This stands in contrast to the other major rating agencies, which revised their outlooks to stable, although the prevailing market conditions at the time, particularly concerning borrowing costs may have warranted their stance somewhat. We expect to see further improvements in credit ratings over the year.

The evolution of Moody's ratings for Kenya is outlined below:



Source: Moody's Ratings, Chart: SIB

The Caa1 rating keeps Kenya within the speculative category, indicating substantial credit risk - this reflects concerns over weak debt affordability and high financing needs. Moody's highlights the challenges posed by weak institutions, policy unpredictability, and high levels of corruption, which limit the effectiveness of fiscal policy and revenue collection. Additionally, as noted in our previous reports, Moody's concurs that Kenya benefits from relatively developed domestic capital and credit markets, providing some resilience in the face of these challenges.

Rationale for positive outlook

This marks the first time since 2007 that the rating agency has assigned a positive outlook to Kenya, suggesting either a recovery from a very low or extremely unfavorable position, or indicating that structural monetary and fiscal adjustments are expected or have already been implemented.

However, this assessment offers a nuanced view of Kenya's creditworthiness, carefully weighing the risks posed by weak governance and high financing needs against the opportunities arising from stronger economic growth and ongoing fiscal reforms. Below are the key factors that led to the revision of the outlook to positive:

i. **Declining Borrowing Costs and Expectations of Further Decline** - This is linked to the reduction in government securities yields, attributed to the government's flexibility in rejecting expensive bids and declining inflation figures,
ii. **Fiscal Consolidation Goals** - These goals promise lower interest payments as a percentage of GDP, provided the government achieves modest primary surpluses by fiscal year 2026,
iii. **Potential Improved Access to External Funding** - This could result from successful fiscal consolidation, a condition tied to the IMF program with Kenya. However, we remain cautious about the sustainability of fiscal consolidation in the country, as expenditure continues to rise,
iv. **Availability of Reserves** - These reserves could help offset external debt obligations, providing a buffer for the country's finances.
v. **Expectations of a Revenue Boost** - The recent tax reforms, through the Tax Amendment Act, are expected to provide a much-needed revenue boost.

Factors that Could Lead to a Rating Downgrade:

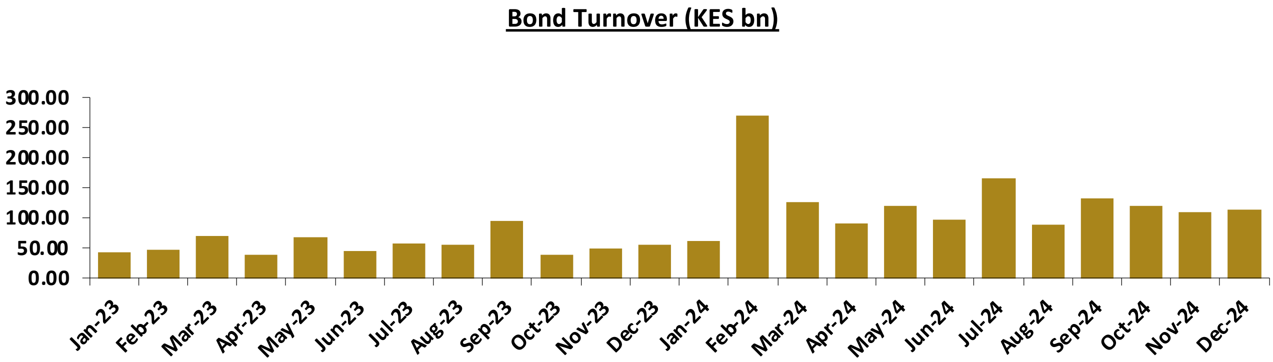
i. **Liquidity Risks** - If financing conditions reverse or fail to improve sufficiently, liquidity risks could rise, weakening fiscal metrics and debt affordability, potentially leading to a downgrade, and,
ii. **Fiscal Consolidation Failure** - Should the commitment to fiscal consolidation falter, worsening fiscal deficits would heighten the likelihood of a downgrade.

Factors that Could Lead to a Rating Upgrade:

i. **Domestic Financing Improvements** - Further improvements in domestic financing conditions and successful fiscal consolidation would enhance debt affordability and liquidity, potentially leading to an upgrade, and,
ii. **External Financing Strength** - Resilience in external buffers and access to diverse, affordable financing could also trigger an upgrade.

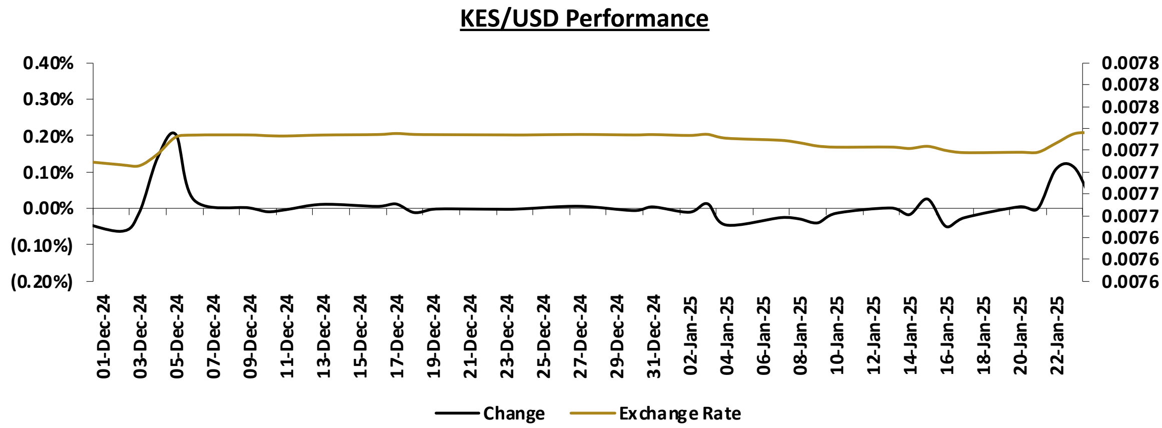
BACKGROUND CHARTS

Secondary Bond Turnover



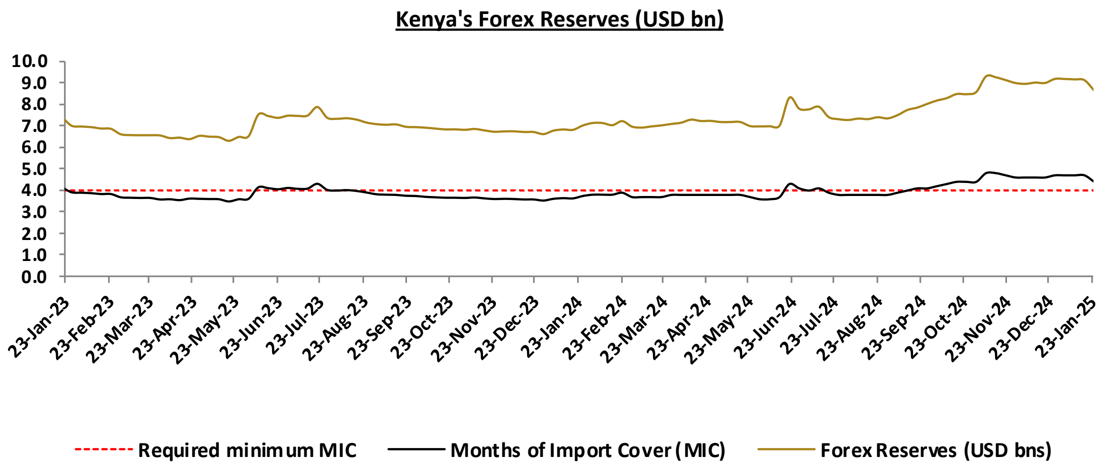
Source: Nairobi Securities Exchange (NSE)

KES/USD Performance



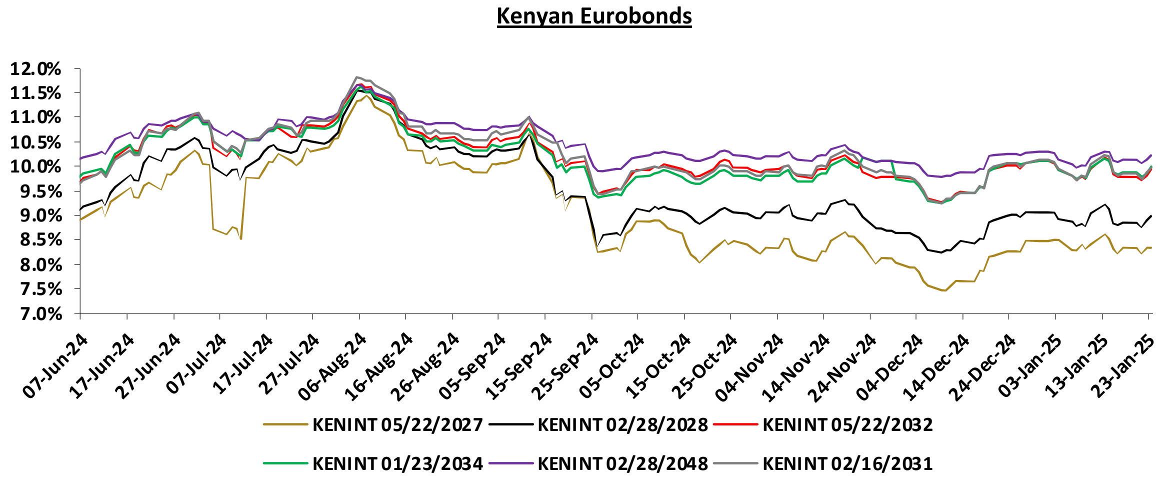
Source: Central Bank of Kenya (CBK)

Forex Reserves



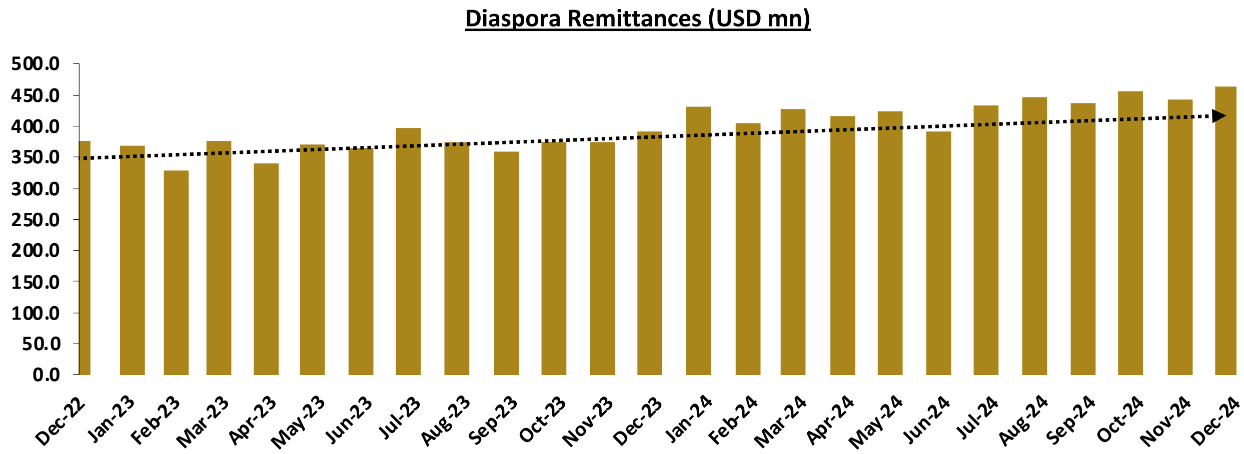
Source: Central Bank of Kenya (CBK)

Kenyan Eurobonds



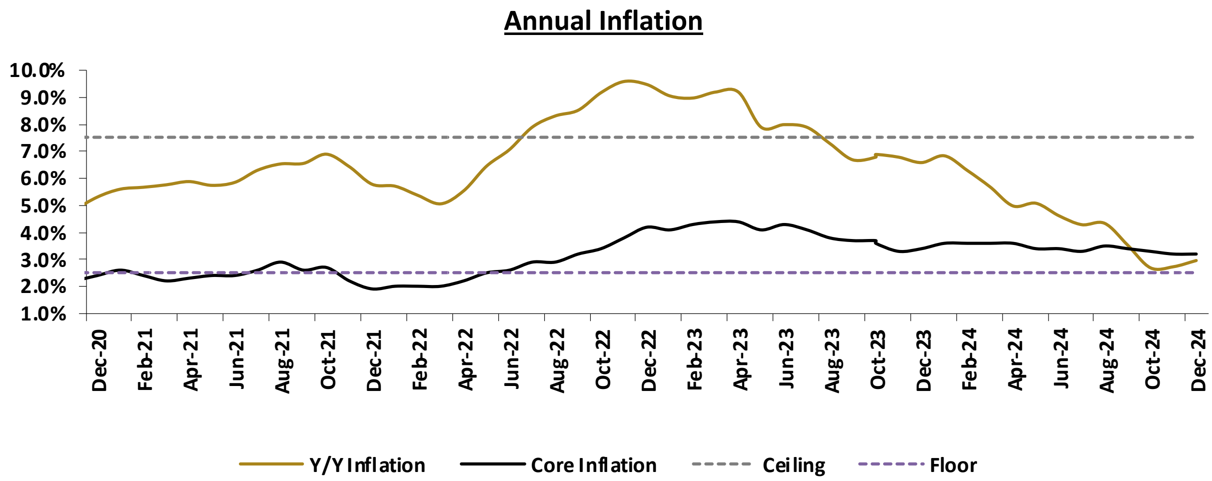
Source: Central Bank of Kenya (CBK)

Diaspora Remittances



Source: Central Bank of Kenya (CBK)

Consumer Prices



Source: Central Bank of Kenya (CBK)

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