SIB Standard Investment Bank

Regulated by the Capital Markets Authority

FIXED INCOME | ECONOMICS

“Secondary Bond Turnover Soars 45.4% y/y to Another Record High”

1Q25 PERFORMANCE REVIEW
KEY TAKEAWAYS & TRENDS

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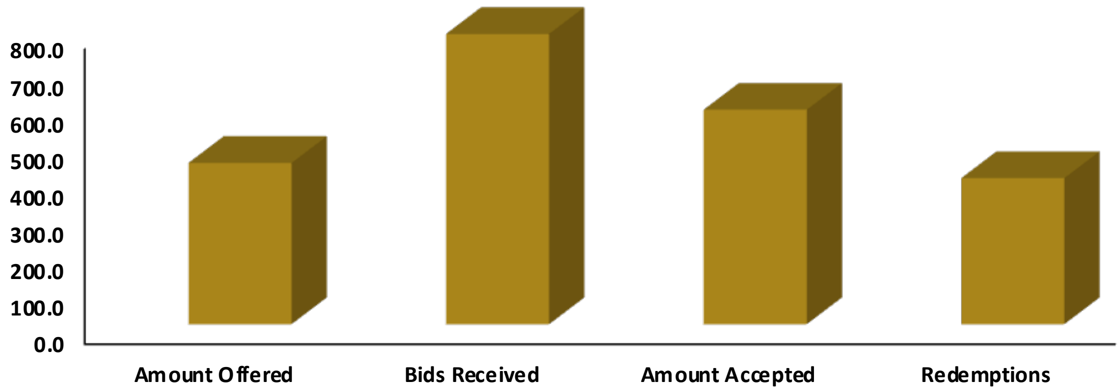
FIXED INCOME MARKETS: PRIMARY OFFERINGS RECEIVE 180% OVERALL SUBSCRIPTION RATE

In the primary market, demand for government securities remained strong, with the overall subscription rate standing at 180.1%. The fiscal agent offered KES 437.0bn, attracted bids amounting to KES 787.0bn, and accepted 73.9% of the total bids received. In total, KES 395.82bn was repaid, resulting in a net domestic borrowing of KES 185.53bn for 1Q25. See a summary of the offering below;

T-Bills & T-Bonds Perfomance 1Q25 (KES bn)



Source: CBK, Chart: SIB

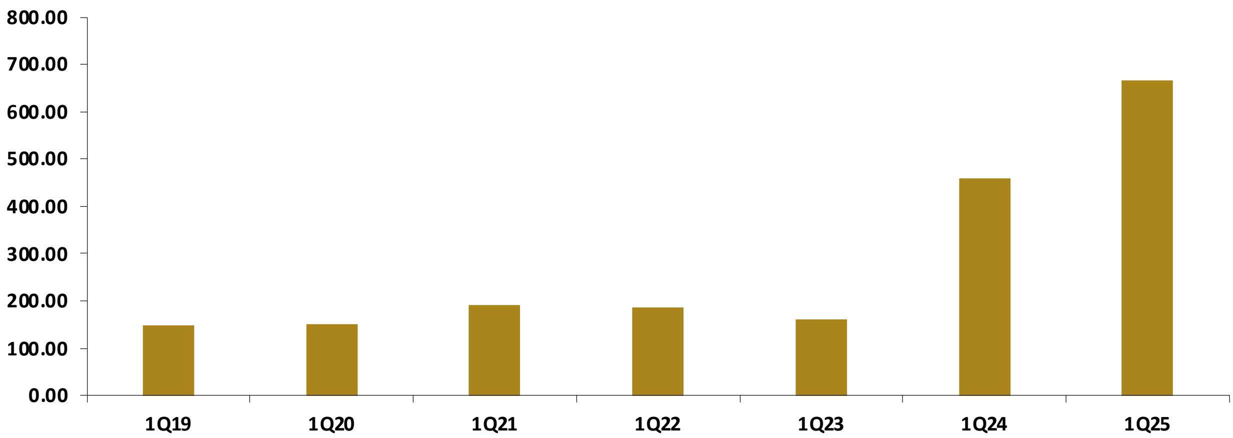
1Q25 also marked the execution of the first local bond buyback, which registered a fairly strong performance with a subscription rate of 112.2%. This initiative was seen as a strategic move aimed at alleviating the redemption pressure from maturities falling due in March, April, and May, while simultaneously enhancing liquidity in the money market.

Additionally, the average tenor of issuances in 1Q25 rose significantly to 15.03 years, up from 5.6 years in 1Q24, aligning with the government's borrowing strategy for FY24/25.

Bond Market Activity; Turnover Soars 45.4% y/y to Another Record High

In 1Q25, the secondary bond market recorded a 45.4% y/y increase to approximately KES 667.79bn, up from KES 459.30bn in 1Q24. This strong performance was largely buoyed by the February infrastructure bond, which attracted notable investor interest. See the chart below for details;

1ST Quarters Bond Turnover (KES bn)

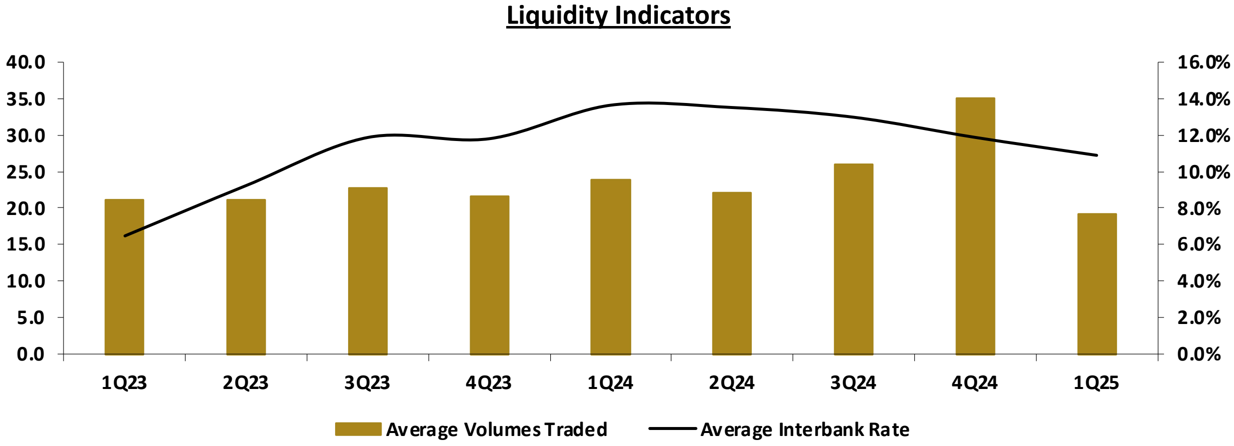


Source: CBK, Chart: SIB

Money Market; Navigating Policy Frameworks and Liquidity Management

In the interbank market, average traded volumes declined by 45.2% q/q and 19.4% y/y to KES 19.21bn, from KES 35.07bn and KES 23.4bn, respectively. Conversely, the average interbank lending rate eased to 10.88%, down from 11.86%, in line with the downward adjustment of the CBR.

See the chart below;

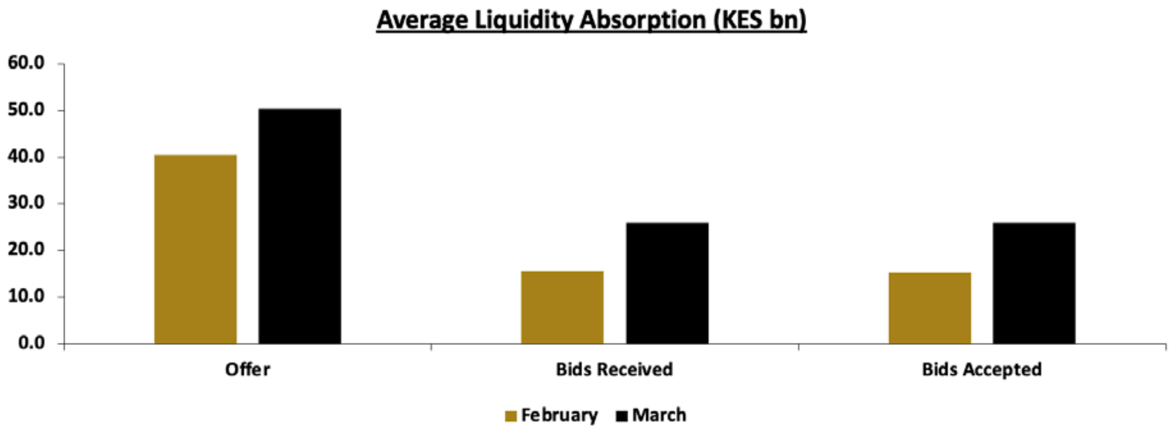


Source: CBK, Chart: SIB

Nonetheless, several indicators pointed to the presence of ample liquidity, reinforcing the view that the policy framework is functioning effectively. These factors include;

i. A notable decline in discount window activity, with cumulative lending to banking sector players falling to KES 7.0bn in 1Q25 compared to KES 54.46bn over the same period in 2024, and,

ii. Consistent open market operations throughout February and March, primarily geared towards liquidity absorption, as shown below;



Source: CBK, Chart: SIB

The month of January saw a continuation of the 2024 liquidity injection, which was subsequently followed by mop-up operations through repos in February and term auction deposits in March. Nonetheless, the CBK has maintained that these interventions align with policy frameworks designed to ensure the interbank rate closely tracks the CBR.

MACRO VIEW

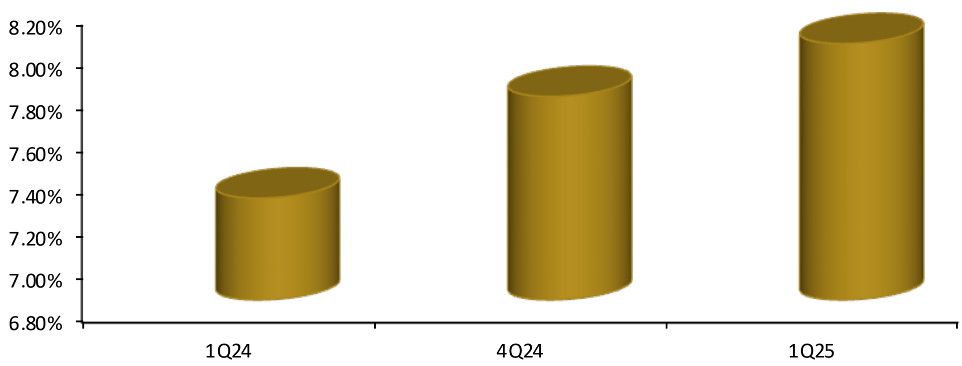
Eurobond Market in Full Swing: Second Buyback and Repeat Issuance

One year after the inaugural Kenya Eurobond buyback, the Treasury returned to the market in 1Q25 with another buyback, maintaining the same contingency requirements for a successful issuance. This approach appears to be part of the government's strategy to manage short- to medium-term maturities.

In this exercise, the National Treasury successfully raised USD 1.5bn at a 9.50% yield through an 11-year note, which was used to refinance part of the 2027 Eurobond. However, only 64.2% of the KENINT 2027 bond was repurchased, with investors offering USD 578.14m for the buyback, against a target of USD 900m. Unlike last year's buyback, this one had minimal impact on macroeconomic indicators, as the risk on the amortized 2027 issuance was relatively low, and the global market was in a 'risk-on' mode, leading investors to be generally inclined to hold the bond to maturity.

Kenya's Eurobond profile stood at USD 7.52bn, reflecting a 13.9% increase from the 2024 year-end figure of USD 6.60bn. Additionally, the average annual interest rate on all existing Eurobonds rose to 8.01%, up from 7.76% at the end of 2024, and 7.28% at the end of 1Q24, signalling that the country's cost of commercial debt continues to rise.

Average Return on Existing Eurobonds

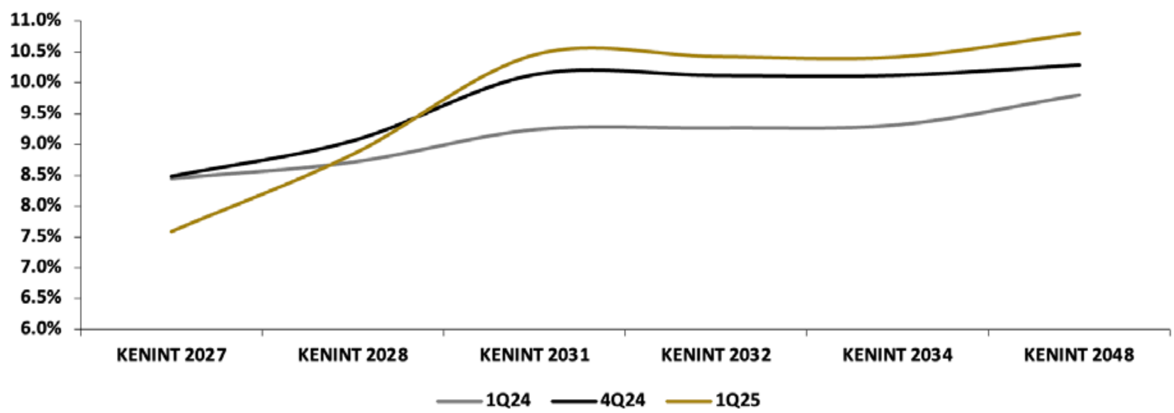


Source: Treasury, Chart: SIB

Despite the fluctuations in yields driven by evolving global developments, the new notes present an appealing investment opportunity. Furthermore, the amortization structure provides relief in terms of tenure, particularly for investors without the capacity to hold until maturity.

Specifically, yields on most Eurobonds increased both q/q and (y/y), with the exception of the 2027 maturity, which was partially bought back and now has the smallest outstanding amount. We attribute this rise in yields to heightened perceived risks on the global stage, particularly stemming from new developments in the United States. See below the performance of the Eurobonds;

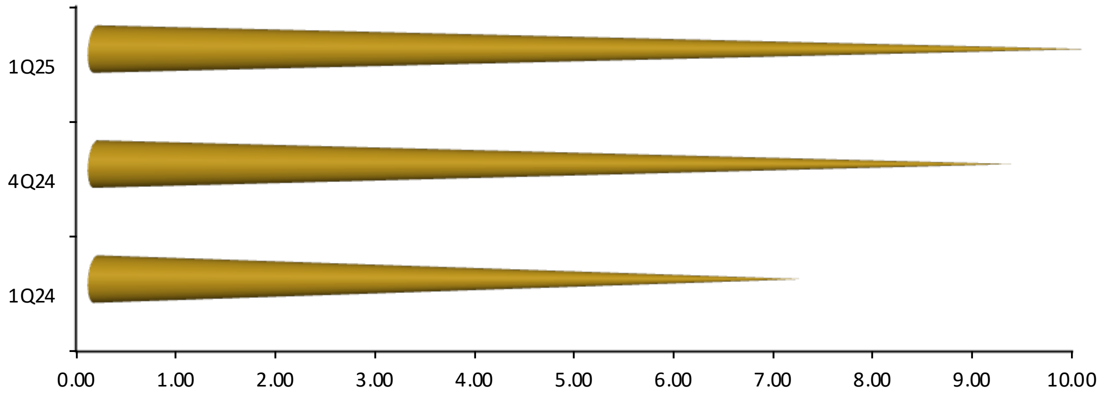
Kenyan Eurobond Yields



Source: CBK, Chart: SIB

One significant impact that cannot be overlooked is the boost to the country's reserves, which rose to a six-year high of USD 10.01 billion, providing 5.1 months of import cover.

Kenya's Forex Reserves (USD bn)



Source: Treasury, Chart: SIB

Kenya Abandons Latest Review, Seeks a New Program

In our **In the News** report titled '*Kenya Eurobond Buyback Offer 36.4% Below Target*', we expressed the view that the government's early redemption of the 2027 maturity—despite being manageable—indicated expectations of a short- to medium-term cash crunch or a potential delay in the IMF's final disbursement, especially in light of persistent revenue shortfalls. Shortly after, the Treasury and IMF announced that the final review of the IMF-Kenya program would not proceed. Instead, the Kenyan government requested a new program, the details of which have not yet been disclosed. Although the new issuance was more expensive, it served to bridge the gap left by the IMF's exit until the potential agreement of a new program, if one materializes.

Despite this, one might expect positive sentiment following the IMF's departure, as the program's objective was to stabilize debt and rejuvenate the economy post-COVID—its exit would indicate that these goals were achieved. However, the decision to abandon the IMF's final review—accompanied by unclear explanations and the evident deterioration of key evaluative factors—raised significant concerns. Notably, S&P Global expressed apprehension over the potential delay in other external loans, noting that IMF funding often acts as a catalyst for both private and official inflows. In our view, external lenders may now hold greater bargaining power, as disbursements that once bolstered foreign reserves and mitigated default risks are no longer guaranteed. This development coincides with stagnant revenue growth and an increasingly tax-averse population.

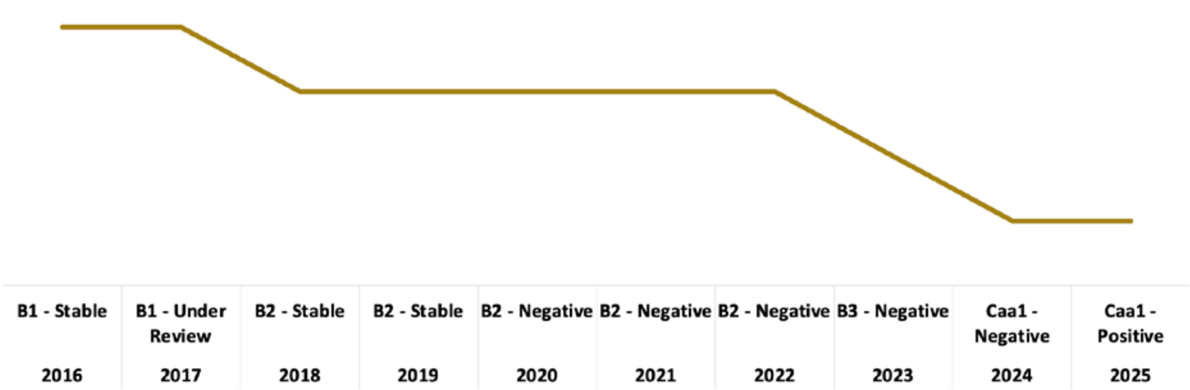
In the same quarter, credit rating agencies did revise the country's outlook positively.

Credit Rating: Kenya Earns First Positive Outlook from Moody's Since 2007 in 1Q25

As highlighted in our 2025 outlook report, the renewal of the IMF program, a more cautious approach to tax hikes to mitigate public discontent, and the smooth passage of the 2025 Finance Bill could pave the way for an upgrade in the country's credit rating—and potentially improve the overall outlook.

In 1Q25, Moody's revised the country's outlook to positive while maintaining the long-term rating at Caa1. In contrast, Fitch Ratings retained both the B- rating and a stable outlook. The key highlight was Moody's shift from a negative to a positive outlook, which stood in contrast to the other major rating agencies, all of which revised their outlooks to stable. However, the prevailing market conditions at the time—particularly with regard to borrowing costs—may have contributed to their more cautious stance.

Moody's Long Issuer Default Rating



Source: Moody's Rating Agency. Chart: SIB

Notably, the positive outlook from Moody's marked the first time since 2007 that the agency assigned a positive outlook to Kenya. This shift suggests either a recovery from a historically low or unfavorable position, or signals that structural monetary and fiscal adjustments are either anticipated or already underway.

Looking ahead, a potential upgrade largely hinges on fiscal performance as the country approaches the peak of the budget process and the availability of external funding. Domestically, we anticipate that sustained low interest rates will lower the cost of debt servicing, thereby supporting a more favorable rating. Furthermore, a stable currency is expected to enhance dollar inflows into the country, particularly as global interest rates decline.

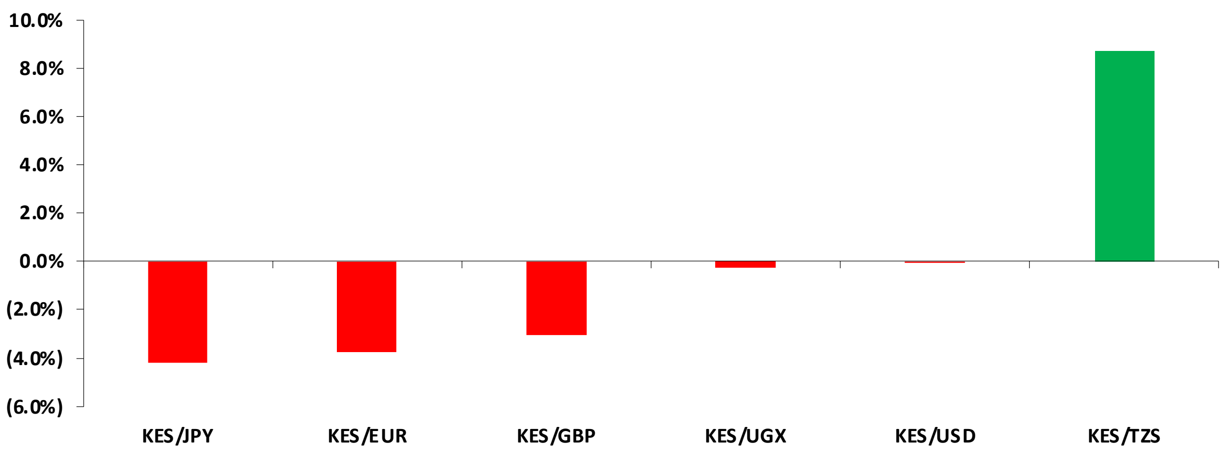
Exchange Rate – Shilling Remains Steady against most Currencies

In 1Q25, the shilling exhibited relative stability against most of the currencies we track, with only minor fluctuations. The most notable movement occurred with the TZS, which appreciated earlier in the year due to dollar inflows, but this gain was soon reversed, with KES regaining strength.

Specifically, the shilling closed the quarter on a mixed note, depreciating against the JPY, EUR, GBP, and UGX. However, it remained steady against the US dollar and appreciated against the TZS.

See the chart below for illustration;

Q/Q KES Performance



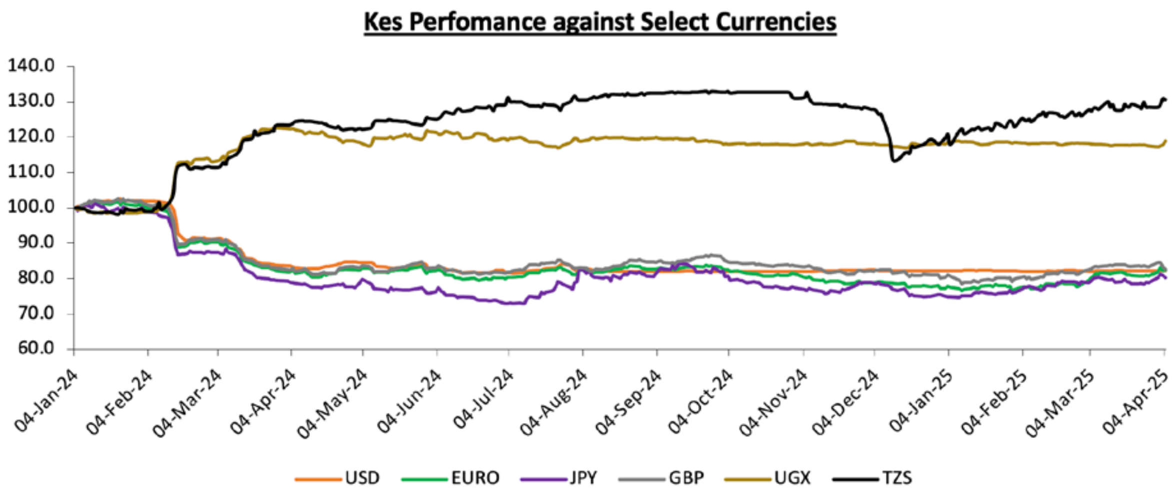
Source: CBK. Chart: SIB

Looking back, the CBK made a number of initiatives to regulate the forex market including;

i. Reviving the FX interbank market even though the status of its activity remains unclear,
ii. Removing the 20-cent maximum spread between indicative two-way quotes in the interbank foreign exchange market,
iii. Lowering the minimum tradable amount in Electronic Matching System to USD 100,000, from USD 500,000 with additional lot sizes of USD 50,000, and,
iv. Issuing an FX code.

A significant change implemented by the CBK, which we believe plays a crucial role in maintaining the stability of the shilling, was the shift in the reporting system from indicative rates to weighted average rates of registered spot trades in the interbank foreign exchange market. This adjustment means that large trades now have a greater influence on the rate, and as is well known, banks tend to offer more favorable rates for larger transactions.

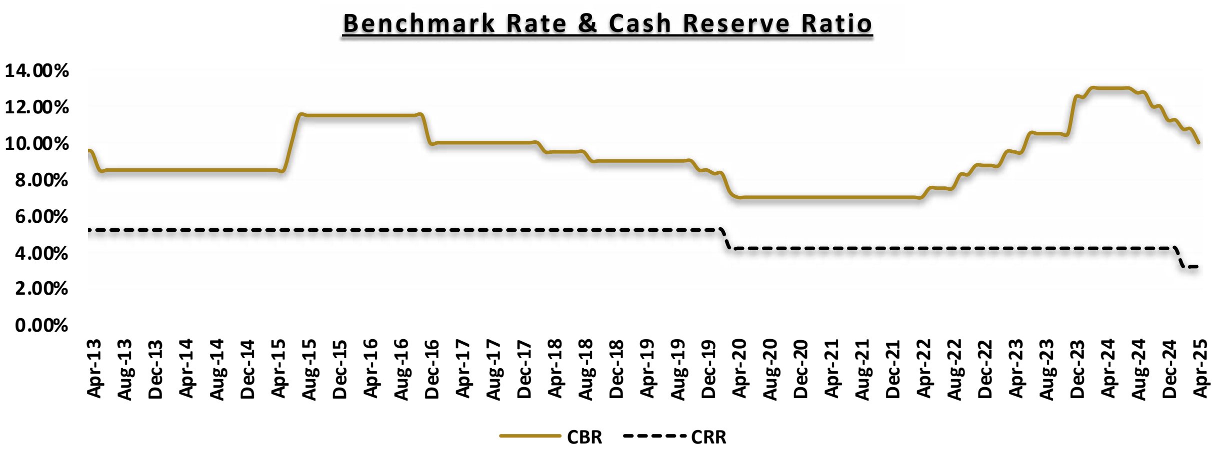
See the chart below;



Source: CBK, SIB Estimates, Chart: SIB

Benchmark Rate – The Bold Turn Comes Early, Steep Cut Exceeds Expectations

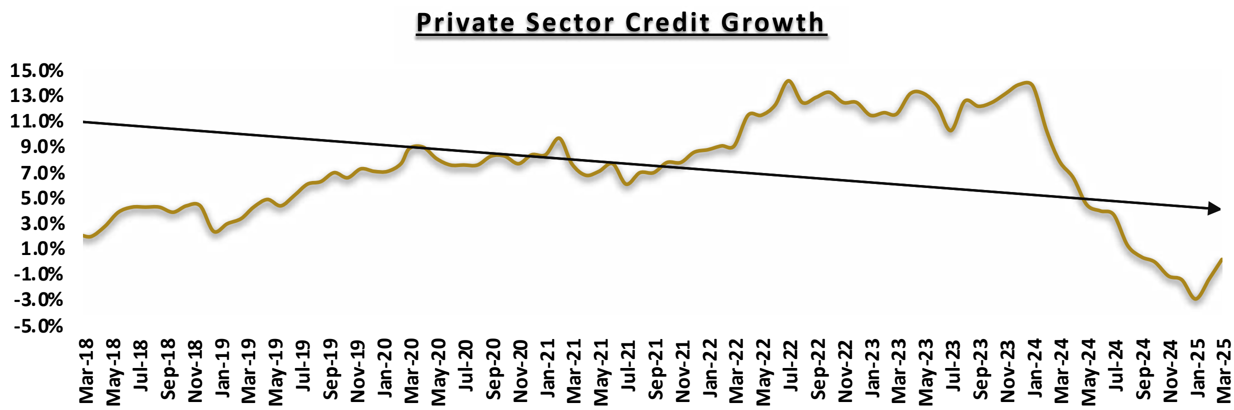
In 1Q25, the Central Bank's Monetary Policy Committee (MPC) met once, kicking off the year with a 50bps reduction in the Central Bank Rate (CBR), lowering it from 11.25% to 10.75%. The committee also reduced the Cash Reserve Ratio (CRR) to 3.25%, down from 4.25%, a level maintained since March 2020. In a subsequent development, the CBK further lowered the CBR by 75bps during their second meeting in April, bringing it to 10.0%. This move serves as an early validation of our projections and strengthens the assertions made in our outlook report that 2025 formed latitude for a bold turn ahead. See the chart below;



Source: CBK, Chart: SIB

The year began with headline inflation at 3.0%, credit growth in the contraction zone, and the Non-Performing Loans (NPL) ratio at 16.4%—still higher than the 14.1% recorded in 2Q22 when interest rates began to rise. Inflation closed the quarter at 3.6%, with an average of 3.5%, remaining below the CBK's mid-point target. Meanwhile, private sector credit growth stood at a modest 0.2% for the quarter, with an average contraction of 1.3%. The NPL ratio increased to 17.2% as of February 2025.

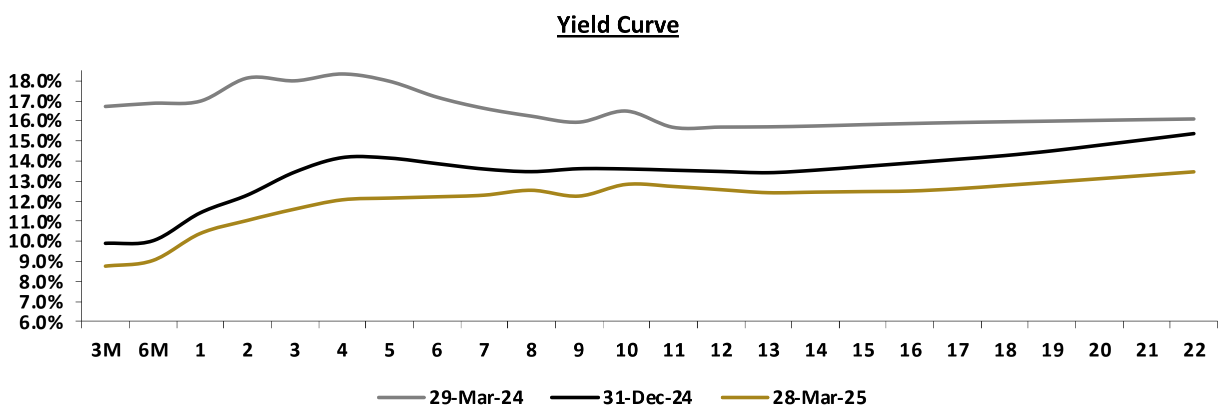
Regarding private sector credit, the impact of a stronger shilling cannot be overlooked. With the stability of the Kenyan shilling, credit growth is now anticipated to be more organic. However, caution is warranted, as several headwinds may impede faster credit expansion. These include government borrowing crowding out the private sector, unresolved pending bills, narrower margins, and more cautious lending behavior by banks. See a summary of the rates;



Source: CBK, Chart: SIB

The Tide of Fortune – Government's Cost of Borrowing continues to Ease as Rates Fall

As it turned out, yields on government securities have been on a downward trend since October 2024. Specifically, by the end of 1Q25, the yield curve had declined by 438.35bps y/y and 133.48bps q/q, as illustrated below;



Source: NSE, Chart: SIB

We maintain that the decline is largely influenced by;

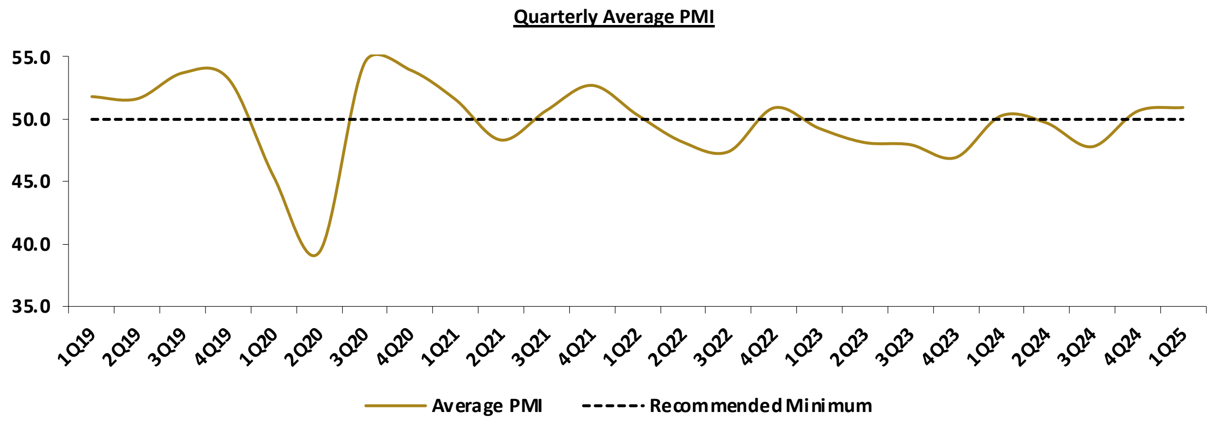
i. **Flexibility in Bid Management** - The government's ability to reject expensive bids, buoyed by access to external funding, provided room for strategic rate adjustments,

ii. **Lower Benchmark Rates** - The cumulative cuts in the Central Bank Rate (CBR) created a ripple effect across the yield spectrum, and,

iii. **Moral Suasion & Stability** - A relatively stable economic outlook in the short term encouraged market players to align with lower rates.

Business Indicators Suggest an Improving Business Environment

Private sector business conditions began the year on a relatively positive note, with the Purchasing Managers' Index (PMI) averaging 50.9 in 1Q25—slightly above the 50.6 and 50.3 recorded in 4Q24 and 1Q24, respectively. See the chart below illustrating PMI trends over the years;



Source: Stanbic, S&P Global, Chart: SIB

Despite the major challenges of input costs, we expect some improvement due to a combination of factors including lower cost of credit.

Disclosure and Disclaimer

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