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TREASURY BONDS – PRIMARY MARKET ANALYSIS FEBRUARY 2023

+255 22 2124495 / +255 22 2112874
+255 714 269090 / +255 764 269090
research@solomon.co.tz
PSSSF House, Ground Floor
Samora Avenue / Morogoro Road
P. O. Box 77049, Dar es Salaam

INTRODUCTION

During the government financial year of 2023/24, the Central Bank released its Treasury Bonds and Bills issuance schedule for the forthcoming year. One notable aspect of the schedule was the Bank's reduction of longer-term bond auctions, particularly the 20-year and 25-year treasury bonds, from 12 planned auctions during the 2022/23 fiscal year to just six planned auctions in the 2023/24 fiscal year. This decrease was substituted with the increase in the issuance of short and medium-term debt instruments such as the 2-year, 5-year, and 10-year treasury bonds from a total of 11 planned auctions during the 2022/23 fiscal year to 16 planned auctions in the 2023/24 fiscal year, notably the 20-year and 25-year treasury bonds,

No of Auctions	2-Year	5-Year	7-Year	10-Year	15-Year	20-Year	25-Year	Total
2020/21	3	2	2	5	7	6	1	26
2021/22	3	3	3	3	4	5	5	26
2022/23	4	3	3	4	5	6	7	32
2023/24	5	5	0	6	5	3	3	27

% distribution of Treasury Bond Auctions	2-Year	5-Year	7-Year	10-Year	15-Year	20-Year	25-Year	Total
2020/21	11.54%	7.69%	7.69%	19.23%	26.92%	23.08%	3.85%	100.00%
2021/22	11.54%	11.54%	11.54%	11.54%	15.38%	19.23%	19.23%	100.00%
2022/23	12.50%	9.38%	9.38%	12.50%	15.63%	18.75%	21.88%	100.00%
2023/24	18.52%	18.52%	0.00%	22.22%	18.52%	11.11%	11.11%	100.00%

The rationale behind the changes above was to increase market participation and appetite for the short and medium-term treasury bonds as investor participation in the auctioning for these bonds was lower than that of the long-term treasury bonds since investors were mainly attracted to the higher coupon payments offered by the long term bonds. This is evident with the amount of bids received in the auctions for each treasury bond and the total amount tendered on the amount offered by each government bond.

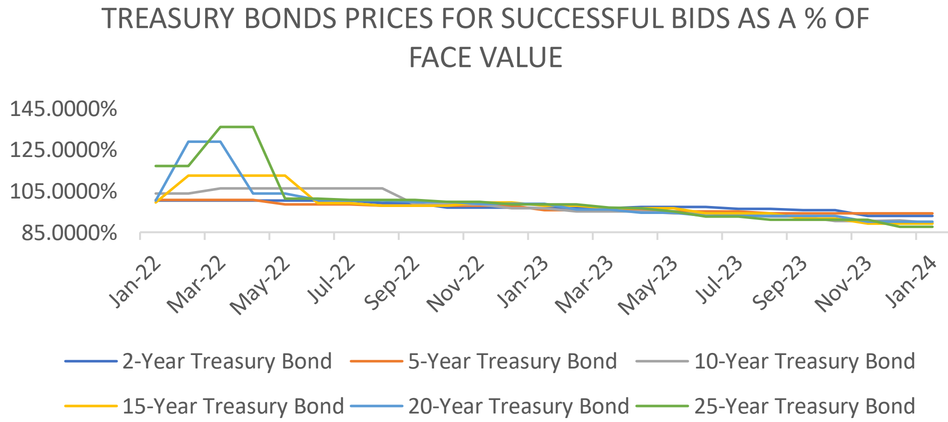
Number of Bids Received	2-Year	5-Year	7-Year	10-Year	15-Year	20-Year	25-Year	Total
2020/21	272	114	82	255	578	3,852	842	5995
2021/22	239	141	111	224	791	2,169	4,353	8028
2022/23	171	139	69	185	305	1,558	3,092	5519
Total	682	394	262	664	1,674	7,579	8,287	19,542

Tendered to Offered Amounts	2-Year	5-Year	7-Year	10-Year	15-Year	20-Year	25-Year
2020/21	160.84%	131.11%	155.08%	111.20%	114.39%	224.89%	378.67%
2021/22	147.36%	91.08%	58.14%	41.71%	141.60%	236.86%	347.24%
2022/23	99.37%	40.08%	29.04%	41.14%	60.28%	125.33%	184.24%

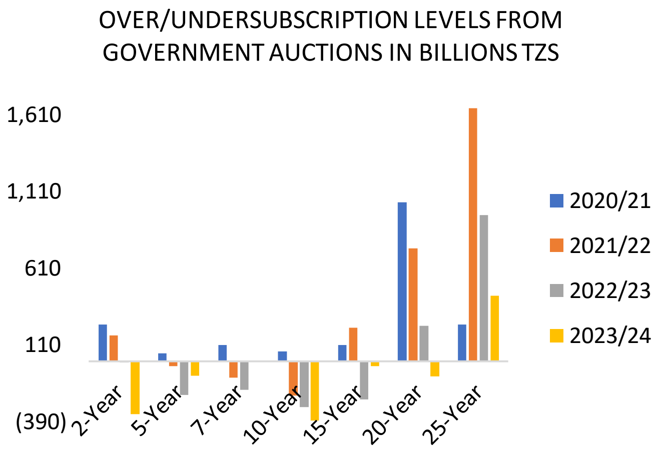
Increasing short and medium-term bond auctions at the expense of long-term bonds was intended to bring about greater price discovery for these debt instruments, a yield-to-maturity curve that would accurately reflect the returns available in the fixed-income market, and lower interest financing costs by the government.

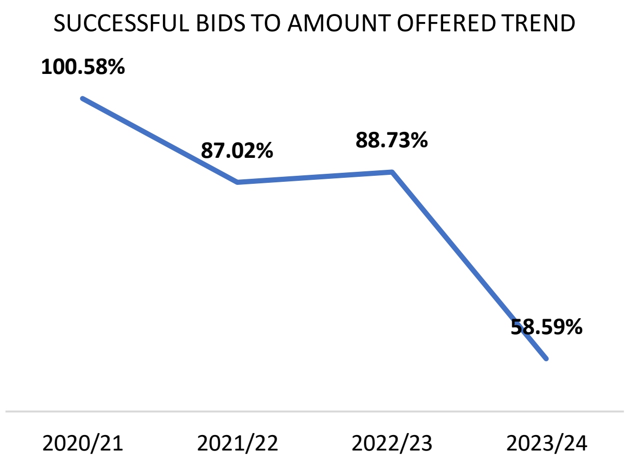
PRIMARY MARKET PERFORMANCE THUS FAR…

Primary Markets activities for Treasury Bonds had a rather interesting turn of events during the government fiscal year of 2023/24. For starters, the Central Bank discontinued the issuance of the 7-year Treasury Bond due to its consistent underperformance in terms of the amount of money it raised. Treasury bond prices continued to swing downwards as investors tried to maximize the returns they could get from treasury bonds, a trend that began to emerge when the Central Bank lowered its coupon rates as of April 2022.



This downward price trend is also attributed by the reduction in investor participation in the primary markets following the decrease in long-term treasury bonds for short- and medium-term bonds. This can be evidenced by the rise in under-subscription levels recorded by these Treasury Bonds and the reduction in the amount of money the government could collect as successful bids in comparison to the amount of capital they are targeting to raise.





During the 2023/24 government fiscal year between July 1st 2023 to 7th February 2024, the Central Bank targeted to collect over TZS 2.4 Trillion from government bond auctions, out of which the market bid TZS 1.88 Trillion or 78.36% of the intended target and the government was only able to raise TZS 1.41 Trillion or 58.59% of the intended target with under subscriptions of over TZS 519.21 Billion during the same period under subscriptions.

IMPLICATIONS & SOLUTIONS

The Implication:

During the 2023/24 fiscal year, the government intended to have an expenditure of over TZS 44.39 Trillion. One way on how the government intended to finance the budget is via borrowing TZS 5.44 Trillion from domestic sources. Over 65.07% or TZS 3.54 Trillion of the amount to be borrowed was to be utilized in rolling over maturing debt with the remainder designed for developmental and recurrent expenditure. However, with the government collecting TZS 1.41 Trillion out of its TZS 2.14 Trillion target throughout the first half of the government fiscal year until 7th February 2024. The government has a task of collecting TZS 730 Billion which it had failed to collect from the treasury bond auctions in addition to its pre-existing targets for the second half of the year in order to carry out its financing operations smoothly.

The Solution:

The Central Bank decided to re-open previously issued 20-year, 15-year, 20-year, and 25-year Treasury Bonds. Re-opening a bond is the act of raising additional amounts of money from a previously issued Bond rather than issuing a new bond. Re-opened bonds have the exact maturity dates and coupon rates as the originally issued bonds. raising additional amounts of money from a previously issued Bond rather than issuing a new one

Month	Auction Date	Effective Date	Maturity Date	Coupon Rate	Instrument Name	Bond Number
February	21-Feb-24	8-Jul-21	8-Jul-41	15.49%	20-Year	566
March	6-Mar-24	15-Oct-21	15-Oct-46	15.95%	25-Year	573
	20-Mar-24	28-Feb-19	28-Feb-39	15.49%	20-Year	498
April	3-Apr-24	5-Aug-21	5-Aug-46	15.95%	25-Year	568
	17-Apr-24	4-Feb-16	4-Feb-26	11.44%	10-Year	412
May	1-May-24	24-Sep-20	24-Sep-40	15.49%	20-Year	544
	15-May-24	21-Nov-19	21-Nov-29	11.44%	10-Year	521
	22-May-24	28-Mar-19	28-Mar-34	13.50%	15-Year	500
June	5-Jun-24	23-Apr-20	22-Apr-40	15.49%	20-Year	533
	19-Jun-24	22-Apr-21	22-Apr-46	15.95%	25-Year	561

From the schedule shared with the public thus far, there will be 10 government bond auctions remaining until 30th June 2024. Out of these, 7 auctions will be for the 20-year and 25-year Treasury Bond. This indicates that there has been a change in priorities as the Central Bank is trying to bank on investor appetite for longer-term high-coupon bond tenures to maximize the amount of money it can raise from the public over concerns on lower debt cost and increased participation for medium and short term bonds where attempts made to herd the market towards these objectives have failed thus far.10 government bond auctions will remain

IMPLICATIONS & SOLUTIONS

Successful bids	2-Year	5-Year	7-Year	10-Year	15-Year	20-Year	25-Year	Total
2020/21	355,805	138,274	205,640	324,972	588,020	1,280,578	132,626	3,025,915
2021/22	469,649	210,881	130,245	134,954	450,982	611,691	671,328	2,679,731
2022/23	401,684	128,104	53,151	190,554	298,460	1,036,754	1,616,932	3,725,639
2023/24	183,893	50,133	-	204,488	200,957	107,557	658,714	1,405,740

Successful Bids to Amount Offered	2-Year	5-Year	7-Year	10-Year	15-Year	20-Year	25-Year	Total
2020/21	89.90%	77.95%	106.74%	56.71%	78.19%	153.97%	154.22%	100.58%
2021/22	130.80%	60.27%	51.28%	35.54%	84.93%	113.67%	100.58%	87.02%
2022/23	98.61%	35.29%	20.43%	37.93%	48.34%	112.85%	143.08%	88.73%
2023/24	33.17%	35.06%	0.00%	33.55%	45.26%	49.74%	152.48%	58.59%

Historically, the 20-year and 25-year Treasury Bonds have been able to raise an average of over 55.08% of the total amounts raised from treasury bonds between the fiscal year 2020/21 and 2023/24 up until Feb 7th, 2024, with oversubscriptions primarily being recorded from these two bonds. By increasing the number of long-term bond auctions, the government anticipates higher investor activity and an opportunity to raise more money than they initially targeted as has been the case in preceding years, however, this time, this would be done to compensate for the underfinancing experienced during the 1st Half of the fiscal year 2023/24,

PRIMARY MARKET OUTLOOK

Following the announcement of the Treasury Bond re-openings, here is how we anticipate the markets to react**:**

1. Higher Yields

Following the re-opening schedule, we anticipate increased participation and competition in the forthcoming government bond auctions leading to higher bond prices for successful auctions. However, the re-opened bonds come with higher coupons that automatically inflate the bond yields. In addition we also don't expect investors to bid prices where yields would drop lower than the ones from the previously auctioned low-coupon bonds, as it was for those yields that caused investors to shy away from the primary markets in the first place. This is made more evident with the auction of the 15.49% 20-Year Treasury Bond which took place on Feb 21st where the weighted average price for successful bids was 99.9198% resulting to a yield of 15.8252% which is 231 basis points higher than the previous yield of 13.5125%

2. Reduced Activities in the Stock Market

Equities:

The re-auctioned Treasury Bonds could cause investors to re-balance their portfolios from equities in favor of more fixed-income instruments to compose their portfolio. By far, the most prominent local investors in the stock market are pension funds, insurance companies, and mutual funds, contributing to the most turnover recorded from the equities section of the stock exchange. The institutions above also have substantial investments in bonds, with pension funds registered as the 2nd largest subscriber to domestic debt, with about TZS 8.56 Trillion or 27.9% of the government's domestic debt portfolio. In comparison, insurance companies held about 5.8%, or TZS 1.76 trillion, of domestic government debt during December 2023. With re-openings of such lucrative treasury bonds continuing to take place or even the possibility of the Central Bank hiking coupons on the government bonds to boost participation remains uncertain going into the next fiscal year; hence, these institutions might utilize the limited opportunity to invest in these bonds and therefore potentially reducing the scale of equity investments during the 1st half of 2024

Treasury Bonds:

Treasury Bond prices for the low-coupon Treasury Bonds might plummet in the secondary market. Any buying investor would consider buying these bonds at a significant discount to match the yields offered by the soon-to-be-issued high-coupon Treasury Bonds. The Central Bank's bond issuance calendar indicates that a full year's long-term debt auctions will occur in 6 months. Most investors might be geared towards purchasing the bonds in the primary market as compared to before, where the duration between buying a long-term treasury bond and waiting for another auction might prompt an investor to consider buying the outstanding bond in the secondary market at a higher price, the waiting time may be significantly reduced, and the investor may be willing to invest in another successive auction something of which may reduce turnover activity in the secondary market. Lastly, as most institutions tend to hold a significant chunk of their debt portfolio to maturity rather than making it available for sale coupled with the uncertainty that the next fiscal year will also have re-openings or newly issued higher coupon paying treasury bonds, investors be encouraged to continue holding rather than selling these bonds.

PRIMARY MARKET OUTLOOK

2. Reduced Activities in the Stock Market (Cont.)

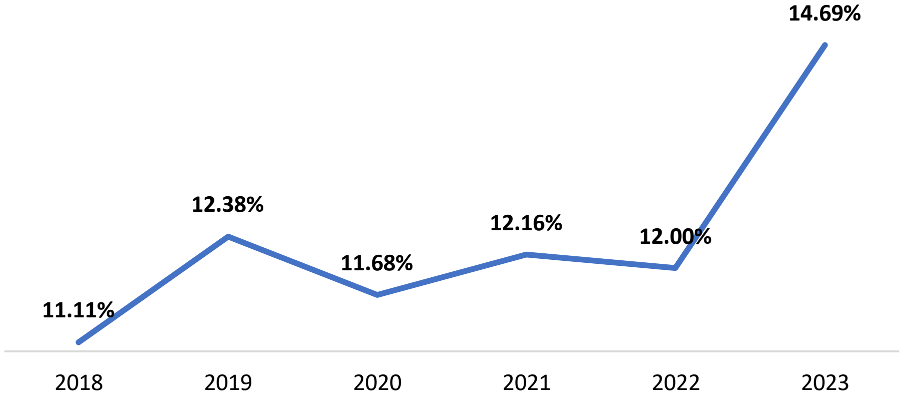
Corporate Bonds:

Successive bond tranches from the likes of NMB, NBC, CRDB, TMRC, and any other future corporate bond to be issued may be forced to issue higher coupons to reflect their higher risk profile compared to the central bank resulting in higher financing costs, whereas for the case of the banks mentioned earlier these costs, coupled with the high-interest environment from sourcing foreign debt may result to thinner interest margins or cause these banks to pass these costs to their customers in the form of higher interest rates.

3. Higher financing costs for the government

Re-opening the previously issued bonds which had higher coupon obligations compared to the new ones may increase the government's already increasing debt financing expenditure. During the 2023 calendar year the government spent over TZS 4.05 Trillion in financing its interest expenses out of which TZS 2.7 Trillion was interest payment on domestic debt according to government budgetary operations issued by the Central Bank. Despite the interest expense cost to make up about 14.69% of the total revenue collected by the government we anticipate the interest expense costs to rise going into 2024 partly due to these re-openings.

INTEREST EXPENSES AS A % OF TOTAL REVENUE



4. Higher returns from mutual funds

Mutual funds such as UTT AMIS, FAIDA Fund, NICOL and TICL with a high appetite for high-yielding debt instruments are likely to benefit from the higher-paying coupons which could result to higher interest income growth and ultimately a higher return distributed to their shareholders.

PRIMARY MARKET OUTLOOK

5. Revived Primary Market Activity

Following the re-opening of high coupon long-term treasury bonds, we anticipate a revival in investor activity in the primary markets, particularly from commercial banks. As of December 2023, commercial banks have been the biggest creditors of government domestic debt, holding over 28.7% or TZS 8.81 Trillion of the government's TZS 30.68 Trillion domestic debt, 75.5% of which is in the form of government bonds.

Our analysis of 31 commercial banks whose 4th Quarter Financial results were recently released showed that these banks had rebalanced their portfolios to accommodate for more liquidity. This was evident by the decline in their investments in government securities by 5.1% from TZS 8.87 Trillion as of the 3rd Quarter of 2023 to TZS 8.41 Trillion during the last quarter of 2023, shedding off over TZS 451.87 Billion worth of government securities which had been reallocated to cash and cash balances at the Central Bank where we had observed a 14.20% increase to TZS 4.99 Trillion during the last Quarter of 2023, an increase of about TZS 621.46 Billion.

The re-opening could see greater participation from banks as they would likely be after the improved yields that would come about as a result of the re-issued old coupon long-term bonds, which could offer yields ranging between 14% - 16% with the added advantage that these investments are perceived as risk-free. The increased yields would align and exceed the lending rates where overall lending rates stood at 15.34% as of December 2023, according to the 2024 January Monthly Economic Review released by the Bank of Tanzania.

We've already began observing the revival in activities as the 20-year re-opened bond auctioned on the 21st February with the amount received from investors amounting to TZS 319.72 Billion which is twice the amount that the central bank intended to raise at TZS 137 Billion which the amount the government successfully raised amounting to TZS 272.78 Billion which is 199% of the amount the government was planning to raise.

Analyst's Names and Contacts

Emmanuel Matunda, ACSI
Equity Research Analyst
Email: emmanuel@solomon.co.tz

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PSSSF House, Ground Floor
Samora Avenue / Morogoro Road
P.O. Box 77049
Dar es Salaam

+255 764 269090
+255 714 269090

research@solomon.co.tz

@sstockbrokers

#elimuYaUwekezajiHisa

www.solomon.co.tz

For further information please contact Us : 2124495 /2112874 /0764269090 /0714 269090

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