Capital Markets Soundness Report

Volume III

" Improving responsiveness to emerging capital market risks and opportunities."

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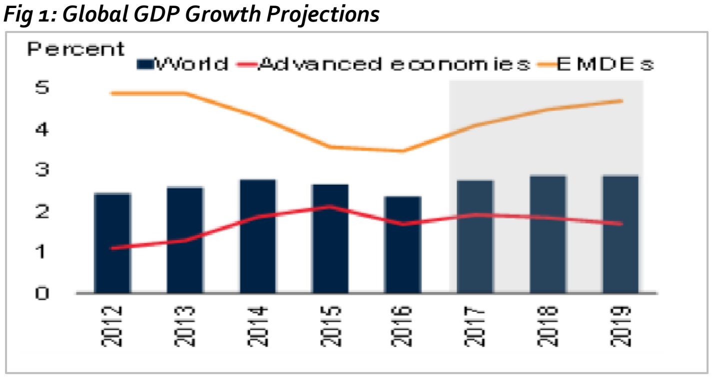
Stability Overview – International Markets

Global Economy 2017 - improved growth anticipated

A June 2017 publication by the World Bank titled 'Global Economic Prospects' projects the global economy to strengthen to 2.7 percent in 2017, supported by a pickup in manufacturing and trade, rising confidence, favorable global financing conditions and stabilizing commodity prices. Growth in advanced economies is expected to accelerate to 1.9 percent in 2017, while that in emerging markets and developing economies will recover too, registering a 4.1 percent growth this year, as obstacles to activity diminish in commodity-exporting countries.

Fig 1: Global GDP Growth Projections



EMDE – Emerging Markets and Developing Economies
Shaded area indicates forecasts
Aggregate growth rates calculated using constant 2010 US$ weights
Source: World Bank

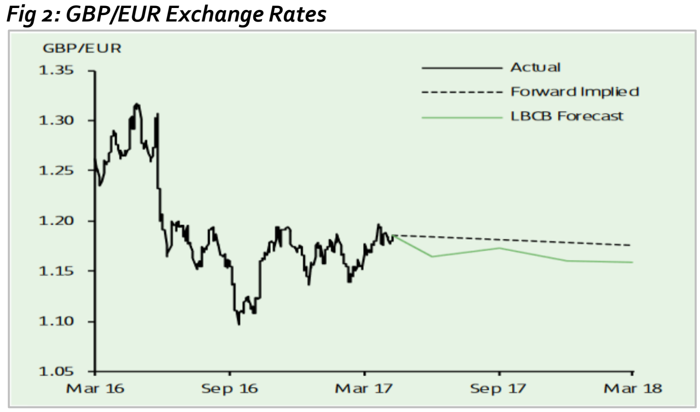
Global economic activity has therefore generally been on an upward trend in the first six months of 2017, with Europe's renewed momentum and China's steady growth compensating for challenges in some emerging markets. In terms of risks, Brexit negotiations are underway, and the British economy is facing challenges as a result of continued uncertainty on the scale and scope of the exit's modalities. The U.S. Congress is debating tax policy with a debt ceiling deadline looming. Oil prices are in retreat challenging the finances of many producers and China will be holding a key Communist Party meeting in late October 2017 that will set an important tone for global economic policy.

Global Economy Half-Year 2017 – Key risks

Brexit: Brexit could have a short to long-term impact on emerging economies, mainly through global volatility and increased political risk aversion to emerging and developing markets. Countries with deep UK relations, such as South Africa, Nigeria and Kenya, could see a more significant impact. Dependent on the economic ramifications, Brexit could also have a knock-on impact on the UK's development assistance commitments in sub-Saharan Africa. It is however worth noting that, the prospect of the need to compensate for EU trade losses following Brexit has pushed sub-Saharan Africa into the UK and European policy agenda[1].

Bank of England (BoE's) position on Brexit – Through its Governor, the Bank of England opines that Brexit will make Britain worse off than otherwise. The Bank further notes that a weaker real income growth is likely as the UK transitions to new trading arrangements with the EU.
In its latest official forecasts, BoE indicates that the level of UK GDP in 2019 relative to its pre-June 2016 referendum forecasts could be lower by about 1.5 per cent, or £30bn at current prices.

Fig 2: GBP/EUR Exchange Rates



Source: www.poundsterlinglive.com

The Pound Sterling has slumped since the June 2017 vote, with the Governor indicating that without a post-2019 transition process for the UK, which would retain single market and customs union membership for the UK for a period, the situation could deteriorate further and cause some firms to move operations out of Britain.

Further, the Bank of England's (BoE) Monetary Policy Committee (MPC) has been under pressure to increase the cost of borrowing by 0.25% above the current 0.25% in response to growing consumer debt and rising inflation.

1 https://www.controlrisks.com/en/our-thinking/analysis/the-global-implications-of-brexit

Three out of eight MPC Board members voted for the rise while five voted for a retention of the 0.25% rate. All members however agreed that any increases in Bank Rate would be at a gradual pace and to a limited extent. Should it be implemented, this may increase its national debt now standing at £1.75 trillion, which is currently at 87 percent of its GDP, to a record high.

At its June 2017, monthly meeting, the MPC noted that inflation has been pushed above the 2% target by the impact of the 2016 sterling depreciation reaching a high of 2.9% and could rise to 3% by October 2017.

US Debt ceiling – According to the Congressional Budget Office (CBO), the US Congress has until mid-October 2017 to raise the statutory borrowing limit or the United States will risk defaulting on its debt obligations[2]. Debate has continued on whether to have a "clean" increase or to attach other policy priorities or spending cuts to legislation that lifts the limit. The U.S. Treasury is attempting to avoid breaching the debt ceiling, a matter made more urgent due to declining tax revenues. Weaker than expected tax collection is seen to be possibly related to expectations by taxpayers of tax cuts in late 2017 translating to the larger than expected budget deficit in 2017. The implications of a default on US Treasuries pricing as well as on the dollar would give rise to significant transmission risks across the global economy.

Fig 3: Economic Outlook Projections for OECD Countries

Real GDP growth
Year-on-year, %

	2015	2016	2017	2018
World[1]	3.1	3.0	3.5	3.6
United States	2.6	1.6	2.1	2.4
Euro area[1]	1.5	1.7	1.8	1.8
Germany	1.5	1.8	2.0	2.0
France	1.2	1.1	1.3	1.5
Italy	0.7	1.0	1.0	0.8
Japan	1.1	1.0	1.4	1.0
Canada	0.9	1.4	2.8	2.3
United Kingdom	2.2	1.8	1.6	1.0
China	6.9	6.7	6.6	6.4
India[2]	7.9	7.1	7.3	7.7
Brazil	-3.8	-3.6	0.7	1.6

Note: Difference in percentage points based on rounded figures.
1. With growth in Ireland in 2015 computed using gross value added at constant prices excluding foreign-owned multinational enterprise dominated sectors.
2. Fiscal years starting in April.

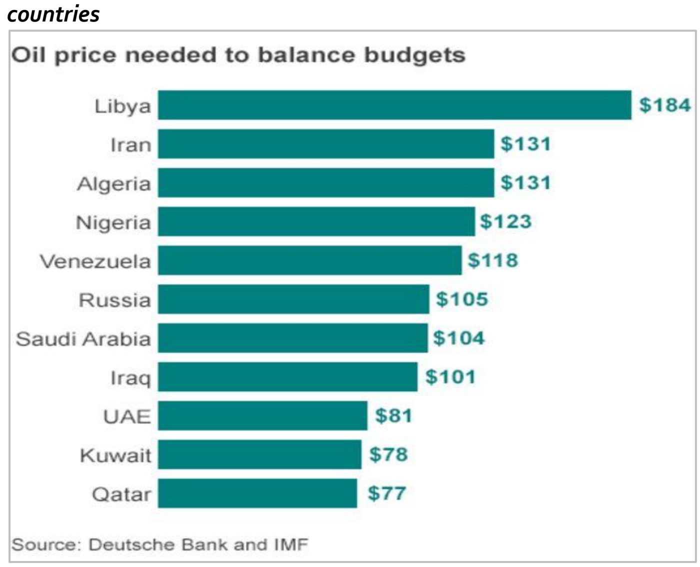
Source: OECD Economic Outlook, June 2017

Noting that the interest rate on Treasuries provides a benchmark for rates on other loans, borrowing would become costlier for consumers and businesses, and result in likely lower performance in stock markets in the U.S. and around the world, thus escalating uncertainty in the global economy.

US Tax policy and other reform – In April 2017, the US Administration released "core principles" of its tax plan, affirming its desire to enact comprehensive corporate and individual tax reform. The changes could affect investment and hiring decisions by companies, as well as capital and remittance flows to emerging market and developing economies.

Retreating Oil prices - Increases and decreases in global oil prices have diverse impacts on individual jurisdictions within emerging markets, but sharp variations in either direction have been responsible for volatility in the currencies of oil dependent and oil exporting nations. The transmission mechanisms for oil price variations to local economies and currencies include transportation, raw materials costs, current account balances and inflation. The price of oil fell dramatically three years ago, and has stayed low since, thanks to a significant global oversupply. From a high of $112 per barrel in 2014, oil tumbled to just $30 a barrel in February 2016.

Fig 4: Per Barrel Oil price needed to balance budgets for Selected countries

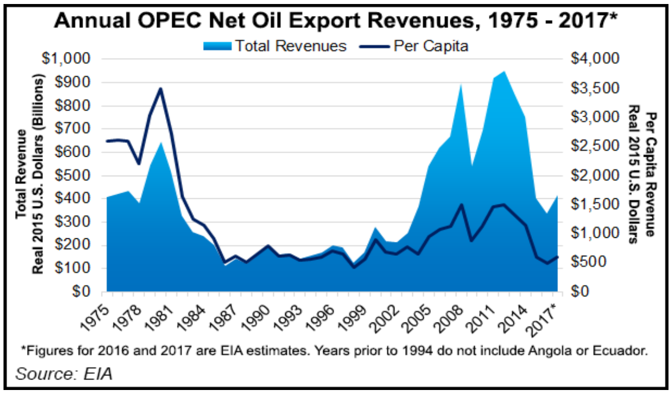


Since then, despite efforts by OPEC nations and Russia to limit production, prices have fluctuated around the $45-$50 per barrel mark to date, in part due to US production which has increased to fill the gap. In July 2017, BP CEO Bob Dudley suggested prices would not significantly recover until 2020[3]

2 *http://www.cbsnews.com/news/debt-ceiling-understanding-whats-at-stake/*

3 *http://www.reuters.com/article/us-bp-ceo-idUSKBN19614U*

Fig 5: Annual Net Oil Export Revenues (1975-2017)*



China party meeting – China remains the world's major growth engine. Every one-percentage-point decline in Chinese GDP growth knocks close to 0.2 percentage points directly off world GDP; and including the spillover effects of foreign trade, the total global growth impact would be around 0.3 percentage points[4]. This explains why political developments in China attract keen attention.

China's political cycle turns every five years. The event that marks this turning is the Communist Party of China's (CPC) Party Congress. The upcoming meeting of CPC is to be held from October 24 to 27 2017. The event is significant in that even though the top leadership will stay on for their second term, a number of senior leaders – five of seven Politburo Standing Committee (PSC) members – will probably retire[4]. Further, China is at a critical juncture in its economic transition, confronting internal challenges (such as slowing growth and structural imbalances) and external pressure from rising populism and protectionism globally. How any political reshuffle will transpire and what strategies the Chinese leaders will adopt to tackle these challenges will be important for the market and the future of the global economy. More than 15% of exports from Sub-Saharan Africa go to China, compared to virtually none at the beginning of the 2000s.

Global economy risks and mitigation – conclusion

Despite the positive growth thus far, the global economy still faces major risks as identified on global oil price, Brexit, US tax reform and political events in China which will need to be watched and mitigation strategies developed.

4 https://www.weforum.org/agenda/2016/09/why-china-is-central-to-global-growth

Stability Overview – Sub Saharan Africa

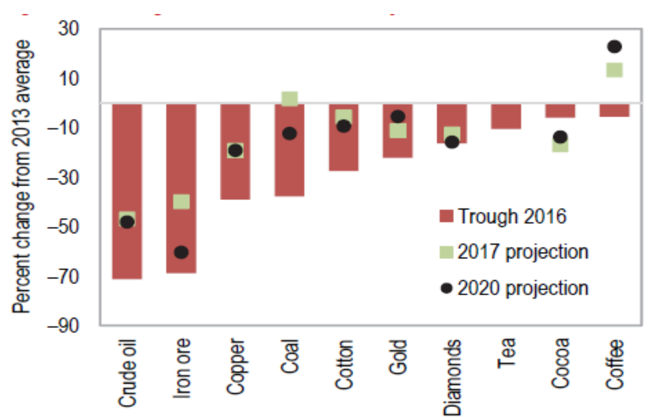
Sub-Saharan Africa in 2017 - improved growth anticipated

A World Bank Report titled "Africa's Pulse" projects Economic growth in sub-Saharan Africa to rise between 2017 and 2019, supported by better commodity prices and improved global conditions. According to the Report, SSA economies shall expand by 2.6 percent in 2017, 3.2 percent in 2018 and a further 3.5 percent in 2019. The region's growth was estimated at 1.3 percent in 2016. In the Report, the Bank observes that the 2016 growth was the worst for the region in more than two decades, adversely affected by poor economic performance in Nigeria, South Africa and Angola.

Sub-Saharan Africa in 2017 – key risks

Low Commodity price and high price volatility – SSA countries depend mainly on primary commodities (Agricultural commodities, Oil and Metals) for export foreign exchange. These countries have been severely affected by the significant drop in commodity prices since the end of the super cycle, adversely affecting economic growth over the past few years.

Fig 6: Africa's Export Commodity price changes (2012 – 2016)



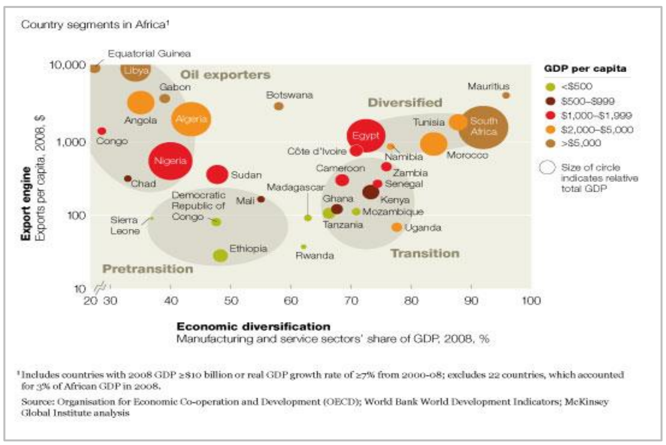
Sources: IMF, Commodity Price System; and IMF Global Assumptions.

Although these prices slightly recovered in 2016, there are no guarantees that they will go to their previous highs anytime soon. Low-income countries have especially been vulnerable to commodity price volatility. For Africa, the top low-income countries that may be at risk, are Equatorial Guinea, Mauritania, Sierra Leone and Chad. In 2014, their commodity exports as a percentage of their GDP were 78%, 48%, 39%, 33% and 30% respectively[5].

5 https://www.howwemadeitinafrica.com/2017-outlook-africa-threats-opportunities/

Low Export diversification - Most African countries today fall into one of four broad clusters: diversified economies, oil exporters, transition economies, or pretransition economies. Although the countries within each segment differ in many ways, their economic structures share broad similarities. Further Africa's oil and gas exporters have the continent's highest GDP per capita but also the least diversified economies. This group comprises of Algeria, Angola, Chad, Congo, Equatorial Guinea, Gabon, Libya, and Nigeria[6].

Fig 7: Africa's Level of Export Diversification



Four of the continent's more advanced economies—Egypt, Morocco, South Africa, and Tunisia are already broadly diversified. Manufacturing and services together accounts for 83 percent of their combined GDP. The main risks that most transition (Cameroon, Ghana, Kenya, Mozambique, Senegal, Tanzania, Uganda, and Zambia) and pretransition (Democratic Republic of the Congo, Mali, and Sierra Leone) countries face include the fact that they have unit labor costs that are higher than those in China and India thus making them less competitive, while for oil exporters, economic growth in them remains closely linked to oil and gas prices. The political instability risk and low regional trade is the other risk that needs to be mitigated.

Protectionism – African countries have been focusing more on national considerations to the detriment of trade between them. In the meantime, other regions have concluded trade deals with individual African countries.

A decision will therefore need to be made, to strike a balance between sovereignty and economic integration in order to unlock the continent's economic potential. In 2014 for instance, intra-African trade accounted for only 16 per cent, yet trade within Asia averaged 61 per cent; within Europe, it stood at 69 per cent, and 56 per cent within North America. Despite instruments like the Tripartite Free Trade Area (TFTA) and the proposed Continental Free Trade Area these are yet to yield tangible results[7].

Debt risk – Improved access to international financial markets by SSA (excluding South Africa) has led to a rise in the volume of indebtedness from USD 1.5 billion in 2011, with the volume of international sovereign bond issuance having increased nearly five-fold, to USD 7billion in 2014 and 2015[7]. In non-resource rich-intensive countries, such as Côte d'Ivoire, Kenya, and Senegal, fiscal deficits have remained high for a number of years, as Governments sought to address social and infrastructure gaps. While growth remains robust, vulnerabilities are starting to emerge—public debt is on the rise even as borrowing costs rise. In this context, history has shown that where comparator jurisdictions experience default or substantial liquidity challenges, there tends to be significant contagion risk for other countries in the region, who have been performing stably, introducing exposures well beyond the control of national authorities.

African economies' risks and mitigation – conclusion

To mitigate against the risks affecting Africa, export diversification, increased intra-regional trade, improved capacity in negotiations, pre-export value addition to have more say in determination of commodity prices and debt exposure monitoring vis-à-vis capacity to service the debt among others, could ensure that the continent's economies increasingly become competitive.

Stability Overview –Domestic Markets

Macroeconomic risks

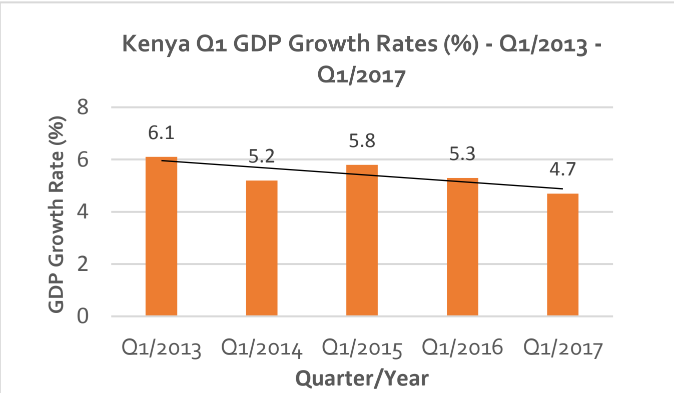
i. GDP Growth challenges

According to Kenya National Bureau of Statistics (KNBS), Kenya's economy expanded by 4.7 percent in the first quarter of 2017, down from 5.3 percent in the same period of 2016.

6 http://www.mckinsey.com/global-themes/middle-east-and-africa/whats-driving-africas-growth

7 http://economic-research.bnpparibas.com/Views/DisplayPublication.aspx?type=document&IdPdf=29012

Figure 8: Kenya's Q1 GDP Growth rates



Source: KNBS

A major challenge on GDP revolves around reconciling Kenya Vision 2030's target 10% year-on-year (y-o-y) from 2012 and sustaining this until 2030, as against the average annual GDP growth rate of below 6 percent over the past 9 years. The risk associated with this growth rate is that as time passes, if the suboptimal rate is sustained, the chances of achieving the Vision become more remote. However there is a strong likelihood that with the commencement of commercial production of oil and minerals in Kenya, the high growth levels that have been achieved by some oil rich countries in the continent, some way above 10%, may be attained in the medium term. This may bridge the current gap. Angola, for example, recorded a GDP growth of 23.20% in 20117

ii. Inflation risk

High inflation erodes the purchasing power of savers and investors. Kenya's target inflation rate is at 5±2.5 percent. In June 2017, the country's inflation rate fell to 9.21 percent year-on-year, from 11.70 percent a month earlier. The fall was partly attributed to a drop-in food prices.

iii. Budget Deficit and Public Debt risk

Kenya plans to target a fiscal deficit of 7.0 per cent of GDP in the 2017/18 fiscal year, down from 9.6 per cent of GDP in the 2016/17 fiscal year. The Government projects the deficit at Sh582.5 billion, down from an estimated Sh716.9 billion in 2016/17 fiscal. The deficit would be covered by Sh206.0 billion in net external borrowing while Sh376.5 billion will come from domestic borrowing.

The level of fiscal deficit presents a potential debt sustainability risk that may be mitigated through adoption of appropriate debt structures to balance commercial and concessional borrowing as well as local and foreign currency components. The Public Debt Management Office established by the National Treasury is expected to be at the forefront of optimizing these structures. Distinct from the sustainability issues however remain the realities of private sector crowding out risk which from the Government remaining aggressively active in the domestic debt markets.

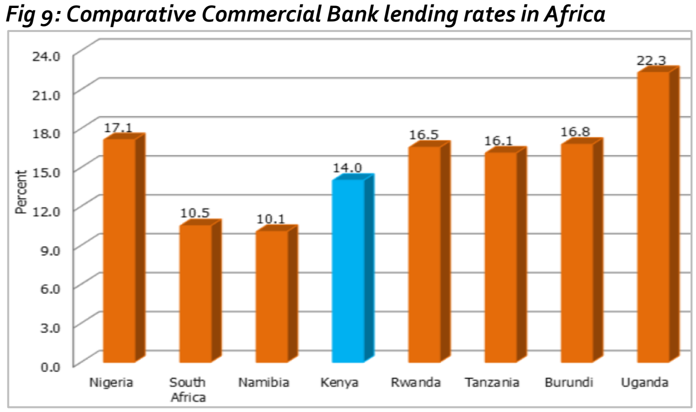
iii. Balance of Payments (BOP) position

Latest figures released by Central Bank of Kenya (CBK) indicate that the 12-month current account deficit widened to 6.2 percent of GDP in May 2017 from 6 percent in March. The deficit was estimated at 5.8 percent in the year to February 2017 compared to 5.5 percent in the year to February 2016.The bigger gap in May 2017 was attributed to short-term imports of cereals, sugar, and SGR-related transport equipment. Although there are expectations for the deficit to narrow in part due to resilient tea and horticulture exports, stronger diaspora remittances, and continued recovery in tourism, a sustained gap presents a risk to the economy.

iv. Interest rate risk

Since August 2016, the CBK's MPC has retained the Central Bank Rate (CBR) at 10 per cent when was cut from 10.5 per cent in July 2016.

Fig 9: Comparative Commercial Bank lending rates in Africa



Source: Quarterly Budgetary and Economic Review, TNT

Furthermore, CBK is expected to conclude a study on the law capping interest rates and its impact on the economy in the month of August 2017. There have been discussions on the likely risks (lower economic activity, reduced bank profits and shifts to investment in fixed income securities among others) presented by the slow growth of credit following implementation of the legislation capping bank lending rates at four percentage points above the Central Bank Rate from September 2016.

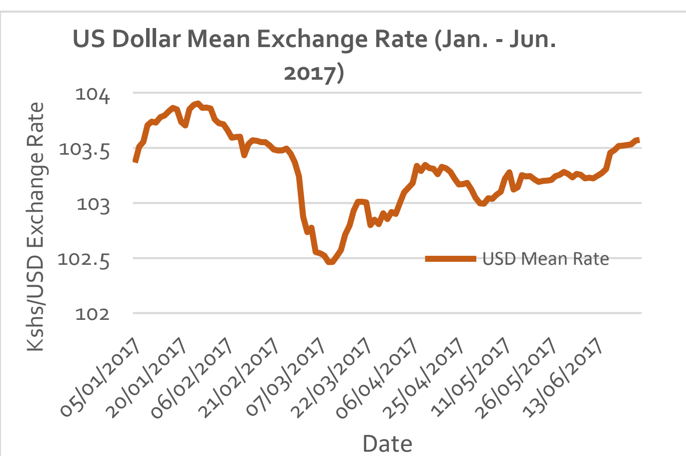
vi. Exchange Reserves position

Latest figures indicate that foreign exchange reserves currently stand at USD7,802.7 million (5.2 months of import cover), falling from recent record levels of USD8,276.5 million at end-May 2017. In addition to the Precautionary Arrangements with the International Monetary Fund (IMF) equivalent to USD1.5 billion, the forex reserves continue to provide a buffer against short-term shocks. Countries hold foreign exchange reserves partly to protect themselves against high sovereign risk exposure. A common rule of thumb is to have reserves that can cover three months' worth of imports.

vii. Exchange rate risk

Generally, a weaker currency could stimulate exports and make imports more expensive, thereby reducing a nation's trade deficit (or increasing its surplus) over time. Conversely, a significantly stronger currency could reduce export competitiveness and make imports cheaper, causing the trade deficit to widen further, eventually weakening the currency in a self-adjusting mechanism.

Fig 10: Kenya Shilling volatility



Source: CBK

Since early January 2017, the lowest mean rate to the US Dollar was in March, when the Shilling exchanged at Kshs.102.7 to the USD, while the highest rate was in early January, when the mean rate was at Kshs.103.9 to the USD. The Kenya Shilling's fluctuations have largely been reflecting seasonal trends and are expected to move in tandem with fluctuations in foreign exchange reserves.

Political risks

Political risk is the probability that an investment's expected return could be adversely affected by political decisions, events or conditions. Investors may take precautionary actions in anticipation of political risks to shield their investments from adverse returns and loss of capital[8]. These actions may lead to economic downturn, upturn or stagnation depending on the level of risk anticipated. Since 1992, Kenya has held regular democratic elections although there have been several bouts of election related tensions.

With the implementation of the Constitution 2010 and the Political Pillar of the Vision 2030, many of the institutions needed to deliver "credible" 2017 election results have largely been strengthened[9]. Conditions are in place for an electoral process that can be conducted peacefully with campaigns based more on issues.

Economic growth has consistently been lower in election years as a consequence of caution over political risk. Elections will take place in Kenya for all levels of government in August 2017 and investor sentiments around political risk shall be a driver of the speed of any post-election economic rebound or deceleration.

8 https://www.kenyabrief.com/political-risk-clouds-kenya-2017-economic-outlook/
9 https://www.gov.uk/government/publications/overseas-business-risk-kenya/overseas-business-risk-kenya

CAPITAL MARKETS AUTHORITY

Domestic Capital Markets Soundness

Secondary Market

Equity Markets

i. Market Concentration risk

As at June 2017, the top 10 listed companies in terms of market capitalization accounted for 80.5 percent of the total market capitalization.

Table 1: Equity Market Concentration for listed Co.s in Kenya

Listed Company	Apr.2017	May.2017	June.2017
Top 10 Co.'s Total Mkt Cap	1,538.89	1,739.16	1,787.50
End Month Market Cap	1,935.28	2,155.36	2,221.29
Mkt. Concentration	79.52%	80.69%	80.47%

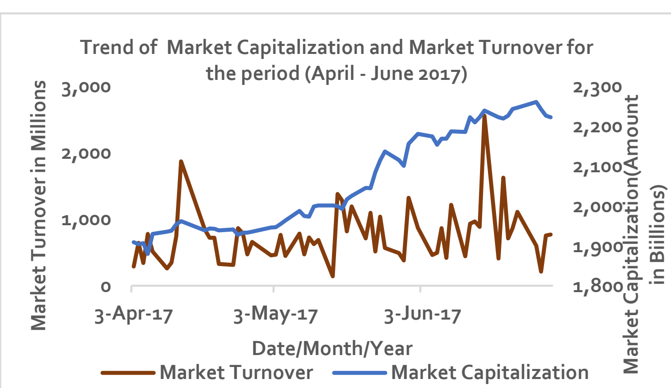
Source: NSE

This presents a market concentration risk that needs to be mitigated by more listings of large cap entities or significant numbers of smaller and medium cap companies. The Authority is therefore taking bold steps in conjunction with industry to broaden the market in order to reduce this risk.

ii. Market performance

Capital market performance has been a function of internal (listed companies' performance, sectoral factors, market infrastructure and frequency of adverse news among others) and external (economy performance, political climate, global economy dynamics and competition from other products like real estate) factors among others. Market performance significantly impacts on allocation of resources among competing financial sector products.

Fig 11: Equity Market Turnover and Market Cap (Apr. – Jun. 2017)



Source: NSE/CMA

At Kshs 2.2 trillion as of June 2017, market cap has rebounded, compared to the Kshs 1.9 trillion in April 2017 and is generally expected to remain resilient albeit, with a level of fluctuation as the country heads to the August 2017 election.

iii. Listed Company performance

In the year to June 2017, Safaricom (40.99%) , EABL (9.21%), EQUITY (6.41%), KCB (5.21%) and BAT-Kenya (3.81%) were the top five companies in terms of market capitalization; cumulatively 65.61%, confirming the dominance of the blue-chip companies on the Nairobi Securities Exchange. The remaining 34.39% was shared across the remaining 61 listed entities. Of the 61, eleven (11) companies had their market cap share ranging between 3.73% and 1.10% with the remaining companies' market cap remaining below 1%.

Price Gainers

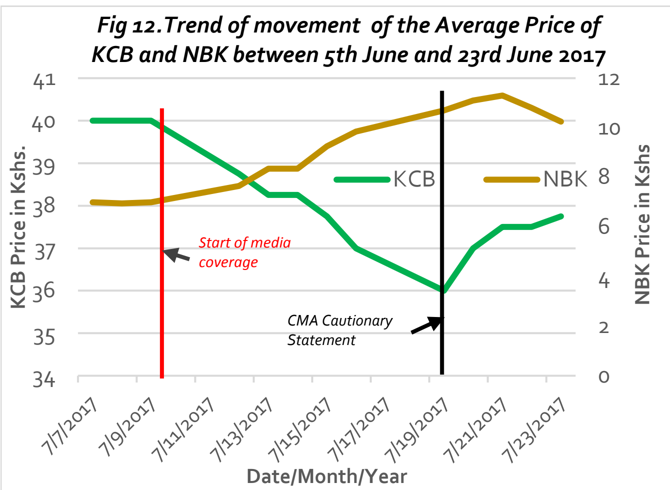
Table 2: Top 10 Price gainers as at 30th June 2017

Counter	VWAP as at 31st March 2017	VWAP as at 30th June 2017	% Change
STANDARD GROUP	19.50	39.25	101.28%
CROWN	44.25	72.50	63.84%
NBK	6.45	8.90	37.98%
DTB	116.00	160.00	37.93%
NSE	13.20	16.70	26.52%
NIC	26.50	33.50	26.42%
SAFARICOM	18.00	22.75	26.39%
BARCLAYS	7.95	9.95	25.16%
KPLC	6.45	7.95	23.26%
BRITAM	10.30	12.65	22.82%

Source: NSE

Crown Paints: During the quarter, Crown Paints held its AGM in June 2017. At the AGM, shareholders approved a share buy-back plan by the company, in line with the Companies Act 2015, authorizing the company to purchase a maximum of 10,677,150 ordinary shares, representing up to 15 percent of the company's current issued share capital as quoted on the Nairobi Securities Exchange over the period ending December 2018.

National Bank of Kenya: Media reports of discussions on KCB acquiring NBK came to the market in Q2.2017 though no formal application has been made to date by KCB on the matter. The Media reports further indicated that under the proposed acquisition plan, NBK shareholders would be given shares in KCB, but only after due diligence getting finalized to determine the fair value of the targeted lender. This elicited speculation from the market hence the observed price changes.



Source: CMA

As at the close of business on 12th June 2017, NBK shares had risen to Sh7.65 per share partly helped by news of a Sh2.9 billion fresh cash injection by the National Social Security Fund (NSSF), one of the bank's shareholders. Additionally, NBK held its AGM in May 2017 where shareholders approved a bonus share offer.

Price losers

Table 3: Top ten price losers as at March 2017

Counter	VWAP as at 31st March 2017	VWAP as at 30th June 2017	% Change
SAMEER	3.00	2.50	16.67%
KQ	6.00	5.05	15.83%
JUBILEE(H)	489.00	440.00	10.02%
E.A CABLES	6.15	5.60	8.94%
UCHUMI	2.35	2.15	8.51%
TPS (EA)	24.00	22.25	7.29%
EVEREADY	2.50	2.35	6.00%
HOME AFRIKA	1.00	0.95	5.00%
STANCHART	215.00	208.00	3.26%
BAT(K)	849.00	847.00	0.24%

Source: NSE

Sameer: Sameer closed down its Nairobi plant in September 2016 citing increased competition from cheaper Chinese imports. The implication of this has now translated to the tyre manufacturing company laying off 277 employees as there was a significant reduction in the number of staff required to run its operations.

iv. Listed Banks' performance

Table 4: Banking Sector performance Q2. 2017 as at May 2017

Variable	Q1. 2017 (Amounts in Kshs. Million)	Q2. 2017 (Amounts in Kshs. Millions)
Total Turnover	37,107	27,758
Sector – Value Traded	10,058	9,507
Sector – Volume Traded	438	293.97
Sector - % Total of Volume Traded	23.54%	25.70%
Sector - % of Total Value Traded	27.10%	34.25%
Sector Cap (Millions)	530,464	593,014
Sector - %Total Market Cap	29.58%	27.57%

Source: NSE Note: Q2.2017 statistics are as at May 2017

The capital market performance of listed banks decreased between Q1 and Q2 of 2017, with the proportion of the sector's market cap as a percentage of total market cap decreasing from 29 percent to 27 percent. In the same period, to improve cost of credit transparency, during the quarter, the Central Bank of Kenya (CBK) and the Kenya Bankers Association (KBA) officially launched a Cost of Credit website. The website is expected to be used by banking sector clients seeking loans.

v. Market Liquidity challenges

Calculated by taking the quarterly turnover figures as a percentage of total market cap, in the quarter to June 2017, average equity market liquidity stood at 2.02 percent, compared to 2.07 percent registered in the quarter to March 2017.

Table 5: Equity Turnover concentration as at June 2017

Period	Turnover (KShs. Bn)	Market Capitalization (KShs. Bn)	Turnover Ratio
Q2 2017	44.90	2,224.06	2.02%
Q1 2017	37.11	1,793.36	2.07%
Q4 2016	25.39	1,961.92	1.29%
Q3 2016	48.14	1,971.83	2.44%

Source: CMA

Although the equity market liquidity figure (compares well with the rest of the EAC members with Tanzania at 0.6 percent and Uganda at 0.24 percent, because liquidity levels measure the depth of the market, this ratio is relatively low, when compared with selected MSCI member jurisdictions.

Table 6: Equity Market Liquidity for Selected MSCI Countries - 2016

	Turnover/Liquidity Ratio (%)
Brazil	79.5
Chile	11.2
China	273.2
Colombia	13.5
India	26.4

Source: World Bank

To address the Kenya equity market liquidity challenges, through the on-going implementation of the Capital Markets Masterplan, a number of initiatives have been commenced. These include improvement of market infrastructure (CDSC/NSE systems, automation and adoption of online trading, Direct Market Access and use of SWIFT messaging for clearing and settlement, among others), market deepening through Block trading, Securities Lending and Borrowing (SLB), Automated Trading/Fintech, County Financing, GEMs and new listings etc.) and market Broadening (GDRs/Ns, Islamic Finance, REITs, ETFs etc.). The emerging challenge in all these efforts is uncertainty as to the uptake level of these new instruments aimed at improving market liquidity.

vi. Foreign Investor Exposure

Foreign Equity Turnover

Table 8: Equity Market Foreign Investor Exposure by Turnover as at June 2017

Quarter	Month/ Year	Foreign Investor Purchases KShs Millions	Foreign Investor Sales KShs Millions	Equity Turnover KShs Millions	Participation of Foreign Investors %
Q1 2017	Jan.	10,424	8,816	12,054	79.81%
	Feb.	9,447	9,012	12,579	73.37%
	Mar.	9,550	9,605	12,460	76.87%
Q2 2017	Apr.	8,478	8,045	11,409	72.41%
	May.	9,420	11,308	16,347	63.40%
	Jun.	9,526	10,339	17,144	57.94%

Source: NSE

As at June 2017, foreign investors accounted for 57.9 percent of the total market turnover, compared to 76.9 percent in March 2017. In the year to June 2017, in respect of daily participation therefore, foreign investor exposure significantly dropped. This should however not be misconstrued to mean increased aggregate foreign equity ownership exposure which stood at 20.85 percent as at June 2017. It therefore implies that the country is not significantly exposed to 'hot money' which factor, may therefore be relatively less significant compared to other jurisdictions with a higher aggregate foreign shareholding in listed companies in the event of capital flight or political uncertainty.

Table 7: Equity Market Foreign Investor Exposure by Holdings as at June 2017

Type of Investor	2014	2015	2016	2017*
E.A. Institutions (%)	64.16	65.68	66.38	66.75
E.A. Individuals (%)	14.58	12.84	12.49	12.40
Foreign Investors (%)	21.26	21.48	21.13	20.85

Data as at June 2017*

Source: CMA

Foreign investors have been active players in the NSE. As at June 2017, foreign investors held 20.8 percent of the total holdings at the exchange, compared to 21.1 percent in 2016. When analyzing market participation in the past 3 quarters, it is instructive that local institutions have increased their holdings by 1.49 percent, offsetting the international slow-down which has in turn resulted in the witnessed market recovery trends.

Table 9: Quarterly changes in Equity holdings at the NSE

	Dec 2016	Mar 2017	Jun 2017
E.A. Institutions (%)	65.26	65.87	66.75
E.A. Individuals (%)	12.29	12.43	12.40
Foreign Investors (%)	20.77	21.70	20.85

Source: CMA

Bond Markets

i. Issuance risk

Bond issuance in the Treasury bond market continues to be robust. However, in the corporate bonds market, activity has been low, with only one issuance (EABL) happening in 2017.The active Government participation in the bond market has effectively resulted in crowding out access to domestic funds by the private sector.

This is not only through reduced corporate bond issuance, but also through limiting the potential opportunities in the corporate debt market for companies facing access to credit challenges arising from interest rate caps. Noting the comparatively high interest rates available on risk free government debt in an environment where bank lending rates have been capped has created a disincentive on banks to make available private sector credit, resulting in significant amounts of bank liquidity being parked in government debt.

ii. Market Liquidity challenges

In the 5-month period to May 2017, bond market liquidity was at 16.75 percent, compared to 32.55 percent annual liquidity for 2016. It is instructive that bond market liquidity is by far higher than the equity market liquidity in Kenya.

Table 10: Bond Market Liquidity as at May 2017

	2015	2016	2017*
Total Turnover	305.10	433.12	236.64
Total Amount Outstanding	1,159.08	1,330.46	1,412.39
Turnover Ratio	26.32%	32.55%	16.75%

****as at May 2017***
Source: CMA

iii. Private Offers and Commercial Paper market

Although the private offerings market promises significant potential, reporting of the level of activity in the market has been limited. Similarly, in the Commercial Paper (CP) space muted market activity has been registered, providing limited alternatives to the private sector to access to finance. Overall, in terms of risk exposure, as at June 2017, corporate bonds and commercial papers accounted for approximately 8.02 percent of the total Unit Trust portfolio in Kenya.

Going forward, to help understand the level of activity in the private offers market, the Authority shall enforce provisions in section 30c of the Act which require that it be notified through information notices by issuers raising funds through private offers (both in Commercial Paper and Equity). To this end, the Authority is in the process of developing a framework for ensuring that all private offer transactions are made known to the Authority. As at June 2017, there was an estimated eleven (11) Kshs. 26.35 billion worth of outstanding Commercial Paper in the Kenyan market, with the 364-days paper dominating the market. The highest denomination in the CP market was Kshs. 6 Billion, while the lowest amount was Kshs. 250 million.

Market Infrastructure, New Products and Systems Stability – Recent Developments

The Authority holds its first consultation forum on Fintech and Regulatory Sandbox in Nairobi

Discussions around cryptocurrencies, blockchain technologies, and cybercrime among others continue to draw the attention of different regulators and the Authority acknowledges that technological developments are bound to transform the landscape of service offerings in the capital markets industry. To set a stage for these discussions with market players and the fintech industry, the Authority held its first consultative forum on Fintech and Regulatory Sandbox in Nairobi on Friday, 30th June 2017 aimed at enhancing a policy framework for the establishment of a regulatory sandbox in the country. Through the forum, insightful recommendations were made and in consultation with the relevant stakeholders, the Authority will chart a way forward in collaboration with market players. The report can be found on the CMA website (www.cma.or.ke)

Additionally, the Authority signed a co-operation agreement with the Financial Services Regulatory Authority (FSRA) of the Abu Dhabi Global Market on 18th June 2017, to provide a framework for co-operation and referrals between the Innovation Functions of the two Authorities. The agreement was based on the mutual desire by the Authorities to promote innovation in financial services in their respective markets.
The co-operation between the Authorities is expected to facilitate realization of this objective. Essentially the Agreement's scope will be based on three facets including;

i. Referral mechanism where the Authorities through their Innovation Functions will refer to each other, Innovator Businesses that they would like to operate in the other's jurisdiction.

ii. Potential joint innovation projects. The Authorities may consider participating in joint innovation projects on the application of key technologies such as digital and mobile payments, blockchain and distributed ledgers, big data, flexible platforms (API), and other areas of new technology.

iii. Information sharing. The Authorities, subject to applicable domestic laws and regulations, may share information about innovations in financial services in their respective markets, where applicable.

The FSRA launched the Regulatory Laboratory ("Reglab") in November 2016 to provide a controlled environment for Innovator Businesses to develop and test innovative solutions that promote efficiency and consumer choices in the financial sector, and to support it in the development of risk-appropriate and effective regulations for such innovations. The Authority is also working towards having a co-operation agreement with the Monetary Authority of Singapore which launched its guidelines on fintech Regulatory Sandbox in November 2016.

Licensing and Approvals

During the quarter, the Authority Licensed Longhorn Employee Stock Ownership Plan (ESOP) and Watu Capital Money Market Fund.

Operationalization of a Derivatives exchange

The Derivatives Unit on-boarded a Resident consultant in May 2017 to provide technical assistance ahead of the Derivatives market Launch. The consultant has been on-boarded under the World Bank Financial Sector Support Project (FSSP).
The objective of the consultancy is to enhance technical and other resource capacity in the Authority's derivatives unit, mentor staff and prepare them to take leadership in supervising operations of the derivatives market.

Mr. White is an expert with specialties in Derivatives, Risk Management, Credit, Regulation, Market Infrastructure undertaking assignments for the World Bank, the International Finance Corporation (IFC), Department for Financial Development (DFID), Asia Development Bank (ADB) in diverse countries (Asia, Sub-Continent, Middle East, East and West Africa, Australia) relating to market regulation and market infrastructure. In the past, he has provided expert consultancy services to diverse investment banks and commercial banks (Merrill Lynch, Barings, CS, CLSA, RHB Malaysia) as well as market issue cases in Australia, Hong Kong, Malaysia, Singapore and UK.

Funding appetite unmet by public markets due to risk aversion

According a publication by KPMG and EAVCA titled, "Private Equity Sector survey of East Africa for the period 2015 to 2016," funds raised for East Africa through private equity deals has significantly increased. In 2015 and 2016, an estimated USD 1.1billion was raised for private equity investment in East Africa compared to USD 1.6billion raised in the period between 2007 and 2014, indicating a significant 41 percent growth in funds looking at East Africa over the past two years with key sources of financing being development finance institutions, fund managers, Europe and North America.

The volume of deals in Kenya increased significantly to 23 in 2016, after reaching a low of 5 in 2012. The lull is partially, attributable to the political environment at that time. The Financial Services sector in Kenya also witnessed the most deals at 42, followed by the Energy and Natural Resources at 16 and FMCG at 12 sectors. The first half of 2017 has witnessed a substantial increase in the total value of deals, largely due to the Vodacom Group Limited and Safaricom Limited deal reported at USD 2.6 billion. Looking forward, Kenya remains an attractive destination for private equity investments. On this strength, the Authority is pursuing discussions with private equity firms with a view of encouraging them to realize their investments through exits on the Nairobi Securities Exchange. This has dual benefits as the public is granted and opportunity to participate in the growth of Kenya's financial markets through saving and investing in promising listed companies.

Fig. 13: Top 10 PE Deals in Kenya per Sector

Top 10 Deals by Sector in Kenya (USD million)

Target Company	Acquirer Name	Deal Value	Sector	Period
Safaricom Ltd	Vodacom Group Ltd	2,600	TMT	H1 2017
Africa Oil Corp-Blocks 4	Maersk Oil and Gas A/S	845	ENR	2015
I&M Bank Ltd	City Trust Ltd	335	Financial Services	2011
Ardan Risk & Support Services Ltd	Africa Oilfield Logistics Ltd	329	Transport & Logistics	2013
Kenya Breweries Ltd	East African Breweries Ltd	224	FMCG	2011
UAP Holdings Ltd	Old Mutual PLC	155	Financial Services	2015
ARM Cement Ltd	CDC Group PLC	140	Mining	2016
Wananchi Group Kenya Ltd	Investor Group	130	TMT	2014
CMC Holdings Ltd	Al-Futtaim Group	127	Retail	2013
Essar Telecom Kenya Ltd	Investor Group	120	TMT	2014

Source: Bloomberg, Reuters, NKC Research.

Funds under management in Banks under Statutory Management

As at June 2017, a total outstanding amount of KShs. 6.82 Billion in corporate bonds was held by Imperial Bank and Chase Bank. Further, the Kshs. 4.95Billion worth of deposits were held in Imperial Bank. This amount has remained unchanged since December 2016.

As part of the investor protection initiatives with regards to the funds held in custody accounts of the Banks still under statutory management, the Authority, issued a circular to licensees affected by the Banks placed under statutory management to make provisions in their books equivalent to 100% of the funds held in these Banks in line with IAS 37. The Authority wrote specific letters to licensees requiring them to make provisions for the exposure in the two Banks under statutory management. The CMA licensees were required to make at least 50% provisioning for firms with investments and deposits in Imperial Bank for the financial year ended December 2016. There was no requirement to make provisions for funds held in Chase bank. However, all interest accrued after the Banks were placed under receivership was to be fully impaired and no new interest was to be booked, effective October 13th 2015, the date of commencement of statutory management.

The Authority is also putting in place initiatives to avert similar occurrences in the market in future. In this regard, the Authority, working with support from Frontclear, onboarded legal consultants to review the insolvency legal framework affecting the capital markets with a view to identifying necessary amendments to provide for insolvency netting and settlement finality within the financial markets in Kenya. The review is covering the Insolvency Act, Companies Act, Capital Markets Act, Central Depositories Act and Kenya Deposit Insurance Act, among other laws with the aim of making relevant policy and legislative recommendations to provide for insolvency netting and explicit settlement finality for securities transactions in accordance with international best practice. These recommendations will then be implemented with a view to securing a clean opinion from International Swaps and Derivatives Association (ISDA) and International Capital Market Association (ICMA) for collateralized lending and derivatives transactions in Kenya.

Policy Guidance Note on Asset Backed Securities - April 2017

In line with the 10-year Capital Market Master Plan, the Authority published a Policy Guidance Note (PGN) to facilitate the issuance of Asset-Backed Securities (ABS) in May 2017. The PGN, which was approved by the Authority's Board in April 2017, was taken through extensive stakeholder consultation and engagement prior to publication, to ensure that the final product had the input of industry stakeholders, including a 30-day public exposure period in August to September 2016.

The ABS Policy Guidance Note was developed in line with the powers of the Authority under Sections 12A and 30Z of the Capital Markets Act. Section 12A empowers the Authority to issue guidelines to regulate capital market activities and products, while Section 30Z further empowers the Authority to issue guidelines in relation to the form or structure of a special purpose vehicle and documentation requirements for Asset Backed Securities.

Capital Markets Role in Infrastructure Financing

With support from the World Bank under the patronage of the National Treasury, through the Financial Sector Support Project (FSSP), the Authority on-boarded a consultant responsible for conducting a six-month consultancy on the assessment of funding gaps at the National and County Governments to inform the development of capital markets products and services.

The consultant made his maiden visit to the Authority between 12th and 19th May 2017 and met key stakeholders for an introductory session of the consultancy as he prepares for the actual work. The objective of the consultancy entails undertaking an in-depth analysis of the funding gap at the national and county level, both in government and in state owned enterprises levels.

The objective of the consultancy entails undertaking an in-depth analysis of the funding gap at the national and county level, both in government and in state owned enterprises levels as well as making policy recommendations aimed at enhancing the uptake of capital market products and services that can be leveraged towards bridging the identified gaps. The consultancy is supported by the World Bank's Financial Services Sector Project (FSSP) through the National Treasury, Kenya.

The consultancy will also make policy recommendations aimed at enhancing the uptake of capital market products and services that can be leveraged towards bridging the identified gaps. Prior to his visit, in a pro-active move, through the Capital Markets Week held in the month of May 2017, the Authority convened a roundtable discussion with company CEOs on their thoughts on the use of capital markets to raise revenue for county Governments in the coming years, given the lapse of the three-year moratorium issued to county Governments upon coming into office in 2013.

Some of the key aspects captured during the discussions included;

i. The need to focus on project financing rather than financing of county Governments. This takes into consideration the fact that most county Governments are yet to meet the required levels of corporate governance hence detaching economically viable projects from a county Government as an institution would enable financiers to invest purely based on project quality, expected return on investments and the general economic impact of the same;
ii. Consideration of use a pilot approach towards testing this phenomenon in the market. This will give all players involved significant one on one experience in identifying fundamental requirements upon which future pursuits can be based;
iii. The need to consider a multi-product approach in financing of county projects given the long-term nature of most of the projects;
iv. Consideration for a National conference bringing together players from all key stakeholders; development partners, county Governments and the private sector to act as a platform to seek convergence on best approach; and
v. The need to develop a clear matrix of the risks related to county project financing with clear mitigation measures in conjunction with relevant institutions.

The Authority has taken all the proposals into consideration and will be assessing the viability of each as a build up to the consultancy underway. It should be noted that South Africa financed its sports' stadia during the 2010 World Cup through issuing Municipal Bonds with Guarantees from Development Partners.

Securities Lending and Borrowing (SLB) submitted for approval

The Authority's management will be submitting the draft regulations on Securities Lending and Borrowing to its board for approval, upon which, the regulations will be forwarded to the National Treasury for approval and ratification. The Authority remains optimistic that this will be done in the next quarter. SLB is a temporary loan of securities by a lender or borrower where[10]:

i. The Lender may recall securities at any time, allowing securities to be returned within the normal market settlement cycle notwithstanding an agreed maturity date; and
ii. The Borrower may return securities at any time.

Ownership over the lent securities passes on from the lender to borrower. The borrower has certain rights, (for instance, the right to sell or lend to another borrower and attend AGMs). The borrower is entitled to economic benefits (like dividends), but the SLB agreement with the lender will oblige the borrower to make (or "manufacture") equivalent payments back to the lender. A lender of securities no longer owns them and has no entitlement to vote. Lenders reserve the right to recall securities from the borrower and must exercise this option if they wish to vote.

Benefits of SLB

- It promotes market efficiency and liquidity and reduces market volatility by reducing bid/offer spread and increasing bid/offer depth.
- It allows price discovery and the arbitrage of pricing inefficiencies.
- It supports the development of the capital markets by facilitating various investment strategies is used for fail coverage to ensure smooth settlement cycles and provides the lender incremental return to a portfolio.

Through SLB of key capital market securities specifically government debt, the Authority believes that Kenya's overall market liquidity will improve and hence increase market trading activity.

10 http://www.dfm.ae/products/slb

Bond Market reforms for a more vibrant OTC Debt Market

In line with the National Treasury's priorities for development of an efficient primary and secondary market for Government bonds, the Government through the National Treasury developed a 7-point plan that is currently under implementation. The plan's progress is as outlined below:

i. Finalize and post the issuance calendar on the National Treasury (NT) and Central Bank of Kenya (CBK) websites in order to promote efficiency and transparent communication between NT and the Financial market as concerns Government securities issuance: The process is largely on course;
ii. Separate retail segment from wholesale investors to improve efficiency in Government securities auction cycle: The roll out of Treasury Money Direct has already commenced to help retail investors access government securities 24/7 and allow automation of primary auction;
iii. Launch of Over The Counter (OTC) for Treasury bills to improve liquidity and market depth for government securities: Treasury Bills are already trading OTC in T24 system. The initiation of a two-way quote system is however yet to be effected;
iv. Launch of Over The Counter (OTC) for Treasury bonds to improve liquidity and market depth for government securities: This is an on-going process, with plans to determine the appropriate trade reporting system at an advanced stage;
v. Formalization of monthly stakeholders meeting and feedback to facilitate domestic Government Securities market development: This has been going on regularly;
vi. Introduction of electronic platforms for Primary and Secondary market to improve efficiency in Government securities market by automating the processes in both Primary and Secondary market for Government securities: The process of simultaneous roll-out of TMD, Internet banking and bids submission through Bloomberg will complete the first loop of automation. Additionally, auctions rules will be re-written. To this end, CBK has requested for a communication consultant support from FSSP;
vii. Launch of the Repo-market and short selling for government securities to enhance liquidity distribution among financial market players and promote use of government securities in the money market: The process is on course, with the development of key documentation in progress.

The Authority is actively implementing key strategies to establish a transparent and efficient OTC debt market in coordination with the Bond Market Steering Committee (BMSC) which brings together policy makers and industry players.

CMA signs MOU with the ACCA to undertake joint financial literacy initiatives

In the quarter to June 2017, the Authority signed a Memorandum of Understanding (MoU) with the Association of Chartered Certified Accounts (ACCA) to undertake joint financial literacy initiatives for an additional period of two years. The partnership aims to enhance financial literacy in Kenya through programmes targeting various stakeholders and builds on the previous joint initiatives under an earlier MoU.

It is expected that the joint financial literacy initiatives shall promote excellence in financial reporting by the media, recognizing the pivotal role that media plays in deepening financial literacy in Kenya. The partnership will also work with investment clubs, youth groups and will be involved in packaging joint publications and conducting research on financial markets.

Further, the partnership would leverage technology through joint web based media outreach on financial initiatives through platforms such as Facebook, Blogs and Twitter.

The MoU signing is part of the joint commitment to an all-inclusive approach involving working closely with all stakeholders, the government and other market players to promote the growth, efficiency and fairness of the financial sector in general.

The Authority launches Resource Center Portal

In the quarter, the Authority launched its resource center portal. The portal was developed based on modern information communication technologies to facilitate online access to the rich information that the Authority possesses. The Portal which was implemented through a pilot roll out in September 2016 is geared towards making more information content available online and to remove geographical barriers in accessing basic capital market information. The portal can be accessed through the link; http://www.cmarcp.or.ke

Industry demand for foreign currency denominated securities domestically

In some markets, investors (local and foreign) often include multi-currency denominated securities in their portfolios to not only take advantage of higher interest rates or yields but also diversify their holdings. When investments are made using a country's domestic currency, it means that the higher return expected from investing in domestic securities may be tapered by the effects of currency fluctuations. Currency volatility can therefore have a significant impact on securities' returns. If implemented in Kenya, domestic issuance of multi-currency securities could, not only reduce foreign exchange exposure on local infrastructure projects, but also support international Foreign Direct Investment (FDI) pipeline. Supra-nationals like International Finance Cooperation (IFC), African Development Bank (AfDB) and AfriExim Bank have already shown appetite to raise capital in Kenya to fund their pipeline using multi-currency instruments. There however are outstanding policy issue on the effect of such issuances on the stability of the Kenya Shilling and ultimately, the country's foreign reserve base. The prompt resolution of these concerns has the potential to unlock substantial appetite for local capital raisings in foreign currency and foreign exchange volatility hedging tools like forex futures.

CAPITAL MARKETS AUTHORITY

Promoting the Integrity and Growth of the Capital Markets

Table 11: Capital Markets Stability Indicators (CMSIs)

1.0 Stock Market Volatility								
Equity Market Depth	**Quarter/Year**	**Statistics**				**Assessment of Risk Level** (High – Medium – Low)	**Performance Brief for the Quarter**	**Ongoing Intervention Measures**
NSE 20 Index Volatility	**Q2. 2017**	**April**	**May**	**June**	**Q.Avg**	Low	• As of Quarter ended June 2017, the NSE 20 share index reflected an average volatility of 2.49%, a 0.06% decrease from the previous quarter. • A review of the preceding quarters indicates an improvement in the index volatility. for instance, in Q3.2016, the index volatility was as high as an average of 8.12%.	• To support the market and control the levels of volatility, the Authority is pursuing measures aimed at increasing market liquidity such as the introduction of securities lending and borrowing, Direct Market Access and reforms in the bond markets.
		2.45%	3.08%	1.95%	**2.49%**			
	Q1.2017	**Jan**	**Feb**	**Mar**	**Q. Avg**			
		2.34%	2.82%	2.50%	**2.55%**			
	Q4.2016	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		2.67%	1.58%	2.63%	**2.30%**			
	Q3.2016	**July**	**Aug**	**Sep**	**Q. Avg**			
		2.54%	6.57%	15.24%	**8.12%**			
NASI Volatility	**Q2. 2017**	**April**	**May**	**June**	**Q.Avg**	Low		
		3.39%	4.21%	3.20%	**3.60%**			
	Q1.2017	**Jan**	**Feb**	**Mar**	**Q. Avg**			
		2.39%	1.78%	4.80%	**2.99%**			
	Q4.2016	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		6.67%	2.94%	2.53%	**4.05%**			
	Q3.2016	**July**	**Aug**	**Sep**	**Q. Avg**			
		2.49%	6.93%	3.80%	**4.41%**			
Quarterly Turnover Ratio	**Q2. 2017**	**April**	**May**	**June**	**QTR**	Medium	• Q1.2017 recorded a quarterly turnover ratio of 2.02%; a marginal decrease of 0.05% from the previous quarter. • Comparative to the region, Kenya fared better in terms of quarterly liquidity. However,	• The Authority is spearheading the introduction of new products such as Global Depositary Receipts and Global Depositary Notes as well as initiatives such as Direct Market Access. Direct Market Access
		0.59%	0.61%	0.77%	**2.02%**			
	Q1.2017	**Jan**	**Feb**	Mar	**QTR**			
		0.68%	0.69%	0.66%	**2.07%**			
	Q4.2016	**Oct**	**Nov**	**Dec**	**QTR**			
		0.39%	0.52%	0.37%	**1.29%**			
	Q3.2016	**July**	**Aug**	**Sep**	**Q. A**			

		.66%	0.91%	0.86%	**2.44%**		the ratio is still relatively low when considered against global performance.	enables market participants to access the market through alternative channels, including directly, thus providing faster and more convenient link to the market hence enabling them to exercise freedom of choice. This increases turnover and subsequent liquidity in the markets.
2.0 Foreign Exposure Risk								
Overall Foreign Investor Participation to Equity Turnover	**Q2. 2017**	**April**	**May**	**June**	**Q.Avg**	Medium	• Average Foreign investor participation in Q2.2017 reduced by 8.69% compared to the immediate preceding quarter. • This could be an indication of reduced foreign participation in anticipation of the general elections.	• Renewed recent Domestic institutional interest has resulted in lower aggregate foreign shareholding in listed equity companies thus mitigating risk of overall exposure. The enhanced participation of the Domestic investors following their increased shareholding is partly the reason for this decline and is a positive development • In line with the industry Capital Markets Master Plan, the Authority plans to provide multiple gateways for foreign investors to enter the market through new tailored products (Derivatives, ETFs, and GDR/Ns etc
		72.41%	63.40%	57.94%	**67.91%**			
	Q1.2017	**Jan**	**Feb**	**Mar**	**Avg**			
		79.81%	73.37%	76.87%	**76.6%**			
		Oct	**Nov**	**Dec**	**Avg**			
		67.07%	63.69%	74.1%	**68.2%**			
	Q3.2016	**July**	**Aug**	**Sep**	**Avg**			
		78.59%	69.85%	83.1%	**77.21%**			
Net Foreign Portfolio Flow **(In KES Millions)**	**Q2. 2017**	**April**	**May**	**June**	**Q.Avg**	High	• Net Foreign Portfolio levels decreased in the quarter by a 173.19% decrease in net foreign portfolio inflows into the country when compared to the preceding quarter.	
		433	(1,888)		**(1,455)**			
	Q1.2017	**Jan**	**Feb**	**Mar**	**Q. Sum**			
		1,608	**435**	**(55)**	1,988			
		Oct	**Nov**	**Dec**	**Q. Sum**			
		(125)	**459**	**615**	**949**			
	Q3.201	**July**	**Aug**	**Sep**	**Q. Sum**			
		974	**3,703**	**1,343**	**6,020**			

								• As a policy incentive, foreign investors are now able to hold a 100% stake in listed companies at the NSE. This has increased foreign interest in the Kenyan market as more foreign entities seek to establish their presence in the country while other firms are opening their subsidiaries in the country. • In addition, in 2015, the Ministry of Foreign Affairs launched the Kenya National Diaspora Policy whose main objective is to mainstream and empower Kenyans aboard to effectively make significant contributions to the development of the country. The Authority aims to work with the Ministry to ensure implementation of key aspects in the policy that will attract more participation by Kenyans abroad in the capital markets.
Market Concentration **(Top 5 companies by market cap)**	**Q2. 2017**	**April**	**May**	**June**	**Q.Avg**	High	• The top five companies by market capitalization at the bourse accounted for 65.86% of the market, with Safaricom, BAT, EABL, KCB, and EQUITY as the predominant companies.	• To increase the number of listings on the exchange, the Authority in conjunction with the NSE introduced the GEMS market segment that targets Small and Medium Companies and thus has much more relaxed capital requirements.
		66.04%	65.49%	66.04%	**65.86%**			
	Q1. 2017	**Jan**	**Feb**	**Mar**	**Q. Avg**			
		64.8%	64.9%	63.7%	**64.5%**			
	Q4. 2016	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		65.4%	65.37%	64.6%	**65.15%**			
	Q3.2016	**July**	**Aug**	**Sep**	**Q.Avg**			
		62.8%	65.14%	65.3%	**64.4%**			

								• Additionally, the Authority is pursuing a business incubator and accelerator approach to sensitize SMEs and family businesses to consider listing on the exchange through the GEMS segment. • The initiative is aligned with the Capital Markets Master Plan target to increase listings on the Growth Enterprise Market Segment (GEMS) of NSE by 3-4 companies annually. The Authority will further continue to advocate for privatization of State Corporations through the Nairobi Securities Exchange
3.0 Government Bond Market Exposure								
Bond market turnover Concentration	**Q2. 2017**	**April**	**May**	**June**	**Q.Avg**	High	• The Treasury bond market remains dominant in the Kenyan bond markets, accounting for 98.75% during Q2.2017; a slight decrease of 1.75% compared to the preceding quarter.	• The Authority is actively pursuing a raft of reforms to implement a hybrid bond market through the Bond Market Steering Committee that aims at expanding the bond market in the middle to long term while stimulating liquidity in the short term.
		98.84%	98.40%	99.01%	**98.75%**			
	Q1. 2017	**Jan**	**Feb**	**Mar**	**Q. Avg**			
		98.4%	98.99%	99.7%	**99.0%**			
	Q4. 2016	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		99.5%	98.34%	99.1%	**98.7%**			
	Q3.2016	**July**	**Aug**	**Sep**				
		99.73%	97.97%	98.2%	**98.6%**			
4.0 Investor Profiles (Equity & Bond Market)								
Equity Market	**Type of Investor**	**2014**	**2015**	**2016**	**2017***	High	• Local investors accounted for 79.15% of shares held in the equity market with 20.85% being held by foreign investors.	• The Authority continues to effect mechanisms of marketing capital markets products to investors across the region.
	E.A. Institutions (%)	64.16	65.68	66.38	66.75			
	E.A. Individuals (%)	14.58	12.84	12.49	12.40			
	Foreign Investors (%)	21.26	21.48	21.13	20.85			

<table>
<tr><td></td><td>*as at June 2017
Source: CMA</td><td></td><td></td><td></td></tr>
<tr><td>Corporate Bond Market</td><td><table>
<tr><th>Category</th><th>No of Investors</th><th>Amount Outstanding (mn)</th><th>% of total outstanding</th></tr>
<tr><td>Local Investors</td><td>4,786.00</td><td>82,293.40</td><td>98.62%</td></tr>
<tr><td>East African Investors</td><td>22</td><td>219.68</td><td>0.27%</td></tr>
<tr><td>Foreign Investors</td><td>116</td><td>930.67</td><td>1.11%</td></tr>
</table>
Source: CDSC</td><td>High</td><td>• Local Corporate bond investors were the leading investors in corporate bonds at 98.89% of amounts outstanding, while foreign bond investors held 1.11% of total corporate bond holdings. This signals investor confidence in the local corporate bond market; an indicator of willingness by local investors to participate in building locally owned companies.</td><td>• Together with the other members of the Bond Market Steering Committee, the Authority has been spearheading reforms in the Sector to improve liquidity. There already is in place a consultancy under the Frontclear Project to reform the market and ultimately improve its performance.</td></tr>
<tr><td colspan="5">5.0 Investor Compensation Coverage</td></tr>
<tr><td>Investor Compensation Fund (ICF) Coverage Ratio</td><td><table>
<tr><th>Q2. 2017</th><th>April</th><th>May</th><th>June</th><th>Q.Avg</th></tr>
<tr><td></td><td>2.73</td><td>2.86</td><td>2.20</td><td>2.60</td></tr>
<tr><td>Q1. 2017</td><td>Jan</td><td>Feb</td><td>Mar</td><td>Q.Avg</td></tr>
<tr><td></td><td>2.80</td><td>2.58</td><td>3.18</td><td>2.85</td></tr>
<tr><td>Q4.2016</td><td>Oct</td><td>Nov</td><td>Dec</td><td>Q. Avg</td></tr>
<tr><td></td><td>4.02</td><td>3.36</td><td>4.28</td><td>3.88</td></tr>
<tr><td>Q3.2016</td><td>July</td><td>Aug</td><td>Sep</td><td>Q. Avg</td></tr>
<tr><td></td><td>2.24</td><td>2.01</td><td>1.94</td><td>2.06</td></tr>
</table></td><td>Low</td><td>• The ICF coverage ratio during the quarter averaged at 2.60%; a marginal decrease of 0.25% when compared to the previous quarter.
• However, this confirms that the ICF balances are more than 2 times sufficient to cover any potential losses that result due to failure by market intermediaries to meet investor obligations.</td><td>• There are stringent measures put in place by the Authority to ensure that market intermediaries and licensed entities contribute their shares into the fund as per the required deadlines.</td></tr>
<tr><td></td><td><table><tr><th>Q2. 2017</th><th>April</th><th>May</th><th>June</th><th>Q.Avg</th></tr></table></td><td></td><td></td><td></td></tr>
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<table>
<tr>
<td>Settlement Guarantee Fund (SGF) Coverage Ratio</td>
<td>
<table>
<tr><td>-</td><td>-</td><td>-</td><td>-</td><td>-</td></tr>
<tr><td>Q1. 2017</td><td>Jan</td><td>Feb</td><td>Mar</td><td>Q. Avg</td></tr>
<tr><td></td><td>1.36</td><td>1.25</td><td>1.46</td><td>1.36</td></tr>
<tr><td>Q4.2016</td><td>Oct</td><td>Nov</td><td>Dec</td><td>Q. Avg</td></tr>
<tr><td></td><td>1.95</td><td>1.63</td><td>2.08</td><td>1.89</td></tr>
<tr><td>Q3.2016</td><td>July</td><td>Aug</td><td>Sep</td><td>Q. Avg</td></tr>
<tr><td></td><td>1.10</td><td>0.99</td><td>0.94</td><td>1.01</td></tr>
</table>
</td>
<td>Medium</td>
<td>
SGF Ratio for the quarter to March 2017 averaged at 1.36 indicating the sufficiency of the fund to address any liability or loss to investors that is likely to result following default by securities dealers.
</td>
<td>

The Authority has continuously been monitoring the guarantee fund balances held by the CDSC to ensure that at any given time the fund's value supersedes overall value of market activity.
In addition, through its inspections of market intermediaries, the Authority has been monitoring the financial position of the firms to ensure that they are in good standing and that investors are protected.

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<tr>
<td colspan="5">6.0 Asset Base of Fund Managers, Stockbrokers, Investment Banks</td>
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<tr>
<td></td>
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<table>
<tr><td colspan="4">As at 30th March 2017 (Amount in KES Millions)</td></tr>
<tr><td>CMA Licensee</td><td>Total Assets KShs. bn</td><td>Total Liability KShs.bn</td><td>Net Assets KShs.bn</td></tr>
<tr><td>Fund Managers</td><td>5.24</td><td>2.96</td><td>2.29</td></tr>
<tr><td>Stockbrokers</td><td>4.17</td><td>1.42</td><td>2.75</td></tr>
<tr><td>Investment Banks</td><td>9.12</td><td>2.05</td><td>7.07</td></tr>
<tr><td>Investment Advisers</td><td>0.68</td><td>0.041</td><td>0.63</td></tr>
</table>
</td>
<td>Medium</td>
<td>
The total Asset Base of Fund Managers, Investment Banks and Stockbrokers as at 30th Dec. 2016 was Kshs 5.24Billion, Kshs.12 Billion and Kshs 4.17 Billion respectively.
</td>
<td>
The Authority continues to ensure that its licensees are in compliance with statutory net asset requirements to demonstrate their financial soundness. The Authority has adopted a Risk-based system of supervising its licensees which means inspections are based on the size of the firms, systems in place, number of clients and capital.
</td>
</tr>
</table>

QTR – Quarterly Turnover Ratio; Source: CMA/NSE

References

1. World Economic and Financial Surveys – Regional Economic Outlook; "Sub-Saharan Africa Restarting the Growth Engine."
2. Nairobi Securities Exchange Monthly Bulletins
3. Kenyan WallStreet
4. Focus Economics
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6. IMF Reports
7. Statutory reports/submissions (to CMA)

Contact Us:
Capital Markets Authority (Kenya)
3rd Floor, Embankment Plaza, Upper Hill
P.O BOX – 74800 00200, Nairobi
Tel – 254 – 20 – 2264900/2221910/2226225
Email – corporate@cma.or.ke
Website – www.cma.or.ke