The Capital Markets Soundness Report

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'Capital Markets and the Big Four Agenda – Unlocking the opportunities and overcoming the challenges'

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SPECIAL MESSAGE FROM THE CHIEF EXECUTIVE

Mr. Paul Murithi Muthaura, MBS
CEO, Capital Markets Authority, Kenya

Thank you for joining us for yet another quarterly edition of the Capital Markets Soundness Report (CMSR).

In this issue, we track the evolving impact of the economic decisions of major global players, regional economy developments and the domestic macroeconomic environment on our Capital Markets. Globally, we are seeing a sustained trend towards de-dollarization by a number of countries led by China and Russia. In Africa, countries like Sierra Leone and Nigeria have been at the forefront of non-U.S Dollar based international currency transactions. It is also worth noting that the Central Bank of Kenya (CBK) has already indicated that it is contemplating adopting the Chinese Yuan as one of its reserve currencies. In our analysis, we seek to draw lessons from countries that have started to de-dollarize to inform considerations in Kenya. Regionally, we see the performance of Sub-Saharan Africa's major economies namely: Nigeria, Angola, and South Africa disproportionately impacting the performance of the region in 2018, with the production and prices of Oil for Nigeria and Angola and household consumption for South Africa being the determining factors of SSA's growth. .

Domestically, in this issue, we conduct a deep-dive into the Big 4 Agenda and analyze its impact, while highlighting the areas in which capital markets could be leveraged to support the success of these key deliverables in the 2018 – 2022 period. Particular regard is also given to rising concerns on the performance of the domestic capital markets which have been under pressure since the start of 2018 and the acknowledgement that the necessary turn around will call for concerted stakeholder efforts to address the challenges.

We thank you our stakeholders once again, for your committed engagement with the Authority on the development of this Soundness Report as your insights ensure that its contents can better serve to identify the risks and opportunities emerging in our sector and the outlook for the markets as a whole.

As always, do not hesitate to engage us on your views on the contents herein and more so on matters you believe may require coverage in future editions.

Mr. Paul M. Muthaura, MBS
CHIEF EXECUTIVE

EDITORIAL

Mr. Luke Ombara
Director, Regulatory Policy and Strategy, CMA

Welcome to the Eighth Edition of the Capital Markets Soundness Report.

During the quarter, the trade stand-off between the U.S. and China escalated, with the list of products targeted by U.S. for. USD $200 billion in tariffs being released. On its part, China reacted by imposing USD $60 billion in tariffs. We see this trade tension extending well into the foreseeable future, given that no consensus has been reached on how to resolve the dispute. Related to this, is our key highlight on the concerted efforts by some countries led by China to reduce reliance on the U.S. Dollar in conducting international transactions.

In this issue, we also give an update on the Brexit negotiations, with a number of key outstanding issues anticipated to still remain unresolved as the deadline of 29th March 2019 nears. Regionally, East Africa's Gross Domestic Product (GDP) is anticipated to grow by an average 6.3% in 2018, significantly more than the continent's other regional economic communities[1]. West and Central Africa's GDPs are projected to grow at 2.9%, Franc Zone at 4.6%, Northern Africa at 1.8% and Southern Africa at 1.5%. Domestically, the Kenya capital markets registered a decline in performance during the quarter, with total market capitalization of KShs. 2,551.76 Billion at the beginning of the quarter compared to KShs. 2,211.33 Billion at the end of the quarter, a 13.3% contraction. As the tax measures effected in Finance Act 2018 take effect, we anticipate the market to remain relatively volatile before it settles.

Mr. Luke E. Ombara
DIRECTOR, REGULATORY POLICY & STRATEGY

[1] A report by the Institute of Chartered Accountants in England and Wales (ICAEW)

SPECIAL FEATURE - I

Performance of Capital Market Licensees as at June 2018

Market performance, specifically the market's equity trading activity was generally subdued, as exemplified by key market indicators. This could be attributed to the after-effects of last year's pro-longed electioneering period and uncertainties surrounding the country's interest rate and tax environment. Below is a summary of the performance of the market in the period to June 2018.

License Revocations

Two licensees (Investment Advisors) expressed their intention to voluntarily revoke their licenses.

Revenues

Stock Brokers were the only licensees that recorded a decline in revenues (by 3.79%) in the half year to June 30, 2018 compared to the half year to June 30, 2017. The industry experienced an 8.42% increase in revenues.

Table 1: Licensee Revenues as at June 2018

Category	Revenues June 30, 2018 (Kshs.bn)	Revenues June 30, 2017 (Kshs.bn)	% Change
Fund Managers	2.78	2.58	7.46
Investment Banks	1.17	1.14	2.92
Stock brokers	0.28	0.29	(3.79)
Investment Advisers	0.40	0.25	56.68
Total Industry Revenues	**4.62**	**4.26**	8.42

Source: CMA

Licensee profits/losses

The capital market industry's overall profitability slightly increased by 2.49% compared to the total net profit recorded in the period to June 30, 2017, from Kshs.592.1 million to Kshs. 606.8 million. Despite this overall improvement, the industry's total net profit for Stock Brokers significantly declined by 800.8%, while that of Investment Banks declined by 43%.

Table 2: Licensee Net profits/losses as at June 2018

Category	Net Profit/Loss June 30, 2018 (Kshs. M)	Net Profit/Loss June 30, 2017 (Kshs.m)	% Change
Fund Managers	352.05	266.76	31.97
Investment Banks	92.27	163.82	(43.68)
Stock brokers	-9.13	-1.01	(800.84)
Investment Advisers	171.58	162.48	5.60
Total Industry Profits	**606.77**	**592.05**	2.49

Source: CMA

Percentage of Licensees that reported losses

In the year to June 2018, out of a total 62 intermediaries, 23 of them or 37% reported losses.

Table 3: Percentage of Licensees that reported losses

Category	No. of firms with Losses	Total Firms	% of Total Licensees
Fund Managers	8	26	31%
Investment Advisers	4	12	33%
Investment Banks	4	14	29%
Stock Brokers	7	10	70%
Total	23	62	37%

Source: CMA

Licensee Net Assets/Shareholders' Funds

In the half year ended June 30, 2018, both investment banks and stock brokers experienced a decline in their total net assets compared to the full year ended December

31, 2017. However, the total industry net assets grew by 4.25% in the same period. Overall, the investment banks had the highest total net assets.

Table 4: Licensee Shareholder Funds

	Net Assets (Kshs. Bn)	Assets (Kshs.Bn)	
Category	**30-Jun-18**	**31-Dec-07**	**% Change**
Fund Managers	6.66	5.79	15.02
Investment Advisors	1.00	0.89	12.36
Investment Banks	8.18	8.36	(2.13)
Stock Brokers	2.20	2.27	(2.94)
Total	**18.06**	**17.32**	**4.25**

Source: CMA

Capital Market Performance – year-to-date

Profit warnings in 2017 / 2018 results

Already, in 2018, 3 listed companies have issued profit warnings. These are: Kenya Power (depressed economic environment, poor hydrological conditions in 2017 and the protracted electioneering period), Sanlam (due to a recent 100 per cent impairment of financial assets covering corporate bonds investments in the country) and Centum (following reduced real estate activity due to a less favorable environment and a reduced access to credit by the private sector).

In 2017, out of the 64 listed companies, 12 companies issued profit warnings[2], pointing to a decline in performance. These were Standard Chartered Bank, Standard Group, Britam Holdings, Bamburi, HF Group, Flame Tree, BOC Kenya, Deacons East Africa, Mumias Sugar, Nairobi Business Ventures and Unga Group.

Lower Equity Market Performance

As of September 2018, the equity market was registering lower performance results compared to a similar period in 2017.

Table 5: Snapshot of Annual Equity market performance

Year	Equity Turnover (KShs. Bn)	Share Volume (Mn)	NSE20 Share index	NSE All share index	Market Cap (Kshs. Bn)
2013	155.75	7,665.92	4,926.97	136.65	1,920.72
2014	215.73	8,133.67	5,112.65	162.89	2,316.00
2015	209.38	6,812.14	4,040.75	145.7	2,053.52
2016	147.18	5,813.49	3,186.21	133.34	1,931.61
2017	171.61	7,065.36	3,711.94	171.2	2,521.77
2018*	140.22	4,765.13	2,875.51	149.67	2,211.33
Q3.2017	53.57	2,020.0	3,751.46	162.21	2,376.69
Q3.2018	31.93	1044	2,875.51	149.67	2,211.33
% Q3/Q2Δ	24.6%	-100.0%	23.6%	-7.7%	-6.7%

****as at September***

Better Secondary Bond Market Performance is anticipated in 2018, when compared with 2017. Already, the bond market turnover for the period to September 2018 has surpassed the figure of 2017 by Kshs. 8.63 billion.

Table 6: A Snapshot of Annual Bond market performance

Year	Treasury Bond Turnover (KShs. Bn)	Corporate Bond Turnover (KShs. Bn	Total Bond Turnover (KShs. Bn
2013	451.58	0.88	452.46
2014	504.30	1.95	506.25
2015	302.14	2.96	305.10
2016	431.59	1.53	433.12
2017	432.81	3.08	435.89
2018*	**443.82**	**0.70**	**444.52**
Q3.2017	107.30	0.86	108.16
Q3.2018	133.68	0.00	133.68
% Q3/Q2Δ	24.59%	-100.00%	23.59%

****As at September 2018***

Source: CMA

[2] https://sokodirectory.com/2018/02/list-companies-issued-profit-warnings-2017-vs-2016/

Significant Net Foreign Portfolio Outflows

The year-to-date has registered a significant foreign portfolio outflows in 2018. These have been some of the highest levels of outflow registered in recent years.

Table 7: Portfolio flows in Kshs. millions

	2015	2016	2017	2018
January	(273)	(533)	1,608	(5,137)
February	201	281	435	(1,483)
March	(3,085)	(1,334)	(55)	(1,815)
April	(67)	80	433	(4,022)
May	(2,030)	196	(1,888)	(2,339)
June	(447)	100	(813)	(2,111)
July	(1,127)	974	(2,054)	(1,565)
August	1,183	3,703	(3,268)	(3,029)
September	6,500	1,343	(5,799)	
October	889	(125)	486	
November	(829)	459	(450)	
December	1	615	(218)	
NPF	**916**	**5,759**	**(11,583)**	**(22,965)**

NPF – Net Portfolio Flows

Source: CMA

Significant Foreign Investor activity

As a consequence of the high level of outflow, foreign investors on the sell side have dominated the domestic market accounting for about 65% of the total equity turnover in September 2018.

Table 8: Percentage Foreign Turnover (%)

Month-year	% Foreign Turnover
Jan-18	71.51%
Feb-18	49.63%
Mar-18	50.98%
Apr-18	63.55%
May-18	52.84%
Jun-18	68.77%
Jul-18	67.69%
Aug-18	62.03%
Sep-18	64.80%

Source: CMA/NSE

In conclusion, there is cause for concern on the direction of the markets, especially for the equities market, given recent performance indicators.

Main Driving Factors

i. Excise duty fees charged on money transfer services by cellular phone service providers from 10% to 12%.
ii. Improved market conditions in foreign source markets especially with the strengthening of the US economy.
iii. Potential increase in costs related to transfer of funds in relation to banking services arising from the implementation of the Finance Act 2018.
iv. Since the onset of dematerialization in 2012, there have been challenges of two distinct Central Security Depositories (CSDs) in the country, with distinct Know Your Client (KYC) requirements, meaning that a client has to open different accounts to trade different securities. This has greatly inconvenienced and curtailed foreign investor participation especially considering that in some competing jurisdictions Global custodians are able to transact and transfer various categories of securities using one Central Depository System (CDS) account, which is more efficient.

Lessons

1. Market performance is attributed to broad range of micro, macro-economic, social, cultural and political factors
2. Market intermediaries involved in value-addition services like professional management such as fund managers and investment advisors have performed better than those relying predominantly on agency services
3. Better and continuous financial sector collaboration between key stakeholders (National Treasury & Planning, Financial Sector Regulators, NSE, CBK, CDSC, KASIB, among others to have harmony and certainty in key tax and policy aspects on the financial sector would be necessary going forward to avoid their adverse unintended consequences.

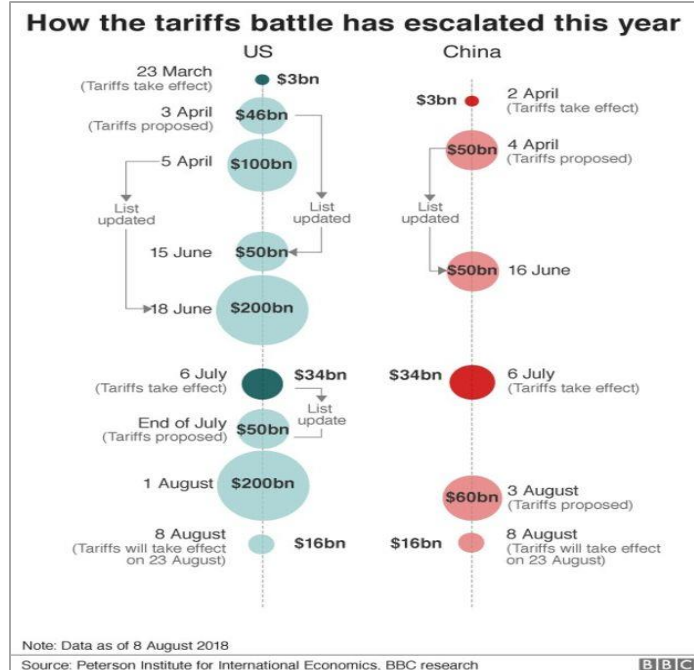
4. There is an urgent need to introduce a KYC mechanism that allows the use of one CDS Account for various categories of securities in the short term. In the long term it will be more efficient to have unified CSD to cover all transactions

SPECIAL FEATURE - II

Are recent de-Dollarization efforts likely to lead to a shift to other means of settling international financial obligations? What are the implications for Kenya?

In recent times, the U.S. has pursued a confrontational foreign trade policy, specifically targeting China (but not sparing other trade partners), by actively advocating for a review of the trade agreements and extending to levying tariffs which have triggered retaliation.

Fig 1: The U.S. – China Tariff Dispute timeline - 2018



This trade rift and other related disputes have now metamorphosed, culminating in deliberate efforts by China and a number of other countries to abandon the US Dollar as the preferred currency for settling international transactions.

After World War II, four main currencies have continued to be used as base currencies for settling international transactions. These are the US Dollar, European Euro, Japanese Yen and British Pound. It is noteworthy that there has been no formal criteria for choosing the base currency, however, to be used as a base currency, there are generally acceptable unwritten rules:

i. The base currency should be from a large and stable global economy.
ii. The economy whose currency is used as a base currency should have significant control over the global supply and demand of goods and services, making it easier for it to be naturally accepted as a means of payment.
iii. The country should have sufficient leverage such that it can ask other countries to pay in its currency instead of the other country's currency.

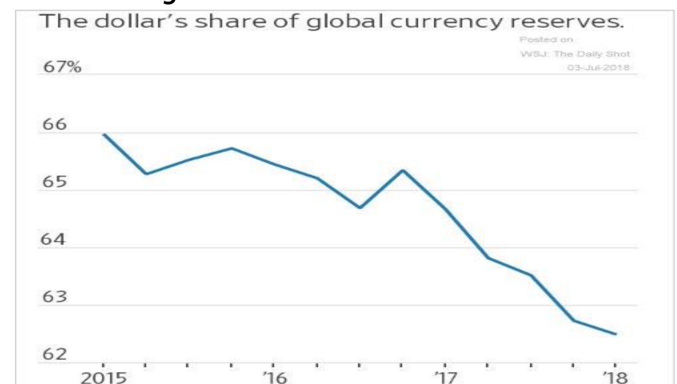
The U.S. Dollar came to be the preferred base currency following political power re-alignments in the post - World War II period, after it triumphed and took the global economic pole position.

De-Dollarization and its implications

Dollarization is the use of the US Dollar in addition to or instead of the domestic currency as legal tender. The countries that have the US Dollar as the only currency include; Ecuador, East Timor, El Salvador, Marshall Islands, Micronesia, Palau, Turks and Caicos, British Virgin Islands and Zimbabwe.

De-Dollarization is the deliberate action by a nation to cut down on the use of the U.S. Dollar.

Fig 2: The U.S. Dollar's Share of Global Currency Reserves 2015 - 2018



In the de-Dollarization process, a country switches to using domestic currency in settling international transactions, with the aim of positioning itself to be less affected by a hitherto widely used international currency. Latest statistics indicate that the US's GDP accounts for about 20% of the world's GDP, while 80% of international payments are made in U.S. dollars. This implies that the U.S. receives goods from abroad at comparatively lower prices, with the significant demand for its Dollars from the rest of the world allowing it to refinance its public debt at a comparatively low cost.

Evidence of De-Dollarization

China

China has actively been working on de-dollarizing its domestic markets. Below are some of the key pointers to this:

i. Effective October 1st 2016, the Chinese Yuan was admitted into the International Monetary Fund's Special Drawing Rights (SDRs) basket, effectively making it one of the top-tier international currencies, sharing SDR status with the U.S. dollar, Euro, British pound, and Japanese Yen.

ii. China has gradually been abandoning the international banking system based on the Society for Worldwide Interbank Financial Telecommunication (SWIFT) payment system, in favour of its own China International Payments System (CIPS) launched in October 2015.

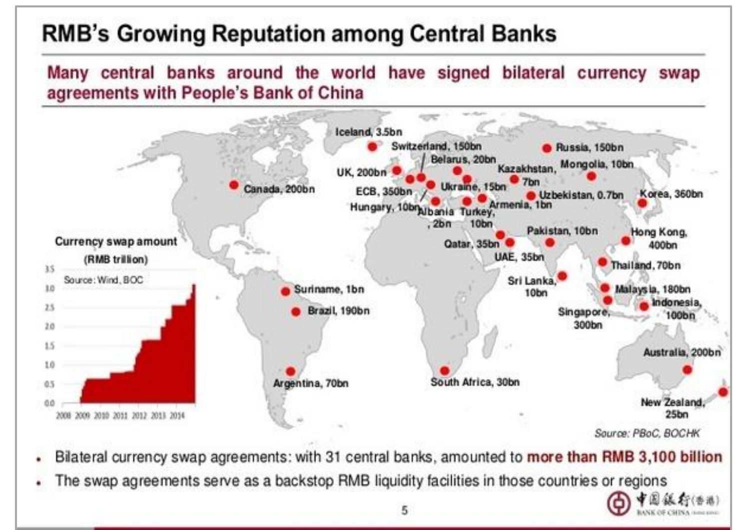
iii. China has been accumulating its stock of gold. As of June 2018, the country had a stock of 1,842.6 Tonnes of Gold, a significant increase from just over 600 Tonnes in 2013. In April 2016, the country announced that it would launch a yuan-denominated gold benchmark, effectively making it create its own yuan-based mechanism for fixing the price of gold that would compete with the dollar-based gold benchmark that has been based in London.

iv. The China Securities Regulatory Commission has already progressed a proposal to allow foreign individual investors to open accounts at domestic brokerages to trade yuan-denominated A-shares listed in Shanghai or Shenzhen.

v. Loans to developing countries are increasingly being denominated in Yuan.

vi. In the post-2008 financial crisis, China has been actively signing bilateral currency swaps with other select countries to avoid significant over-exposure to the U.S. Dollar.

Fig 3: China's growing bilateral Currency Swaps



Russia

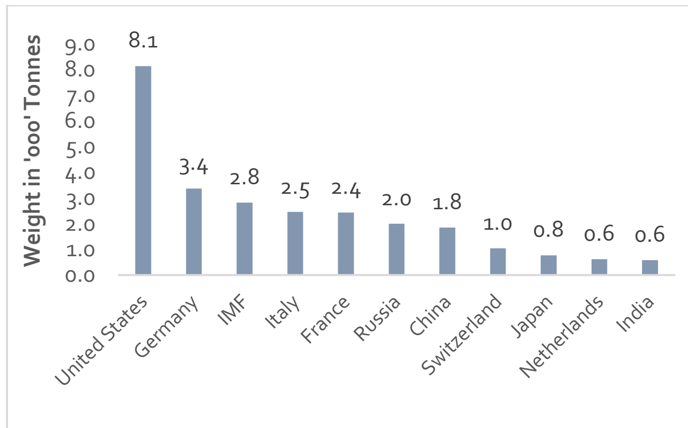
i. According to a U.S. Treasury report, Russia has been progressively reducing the amount it holds in U.S. Treasury bonds. As of the end of May 2018, Russia had bonds worth only U.S.$ 14.9 billion, in comparison with April 2018 (U.S.$ 48.7 billion), March 2018 (U.S. $96 billion) and end of 2017 (U.S. $102.2 billion).

ii. As of September 2018, total holdings were worth about $76 billion, coinciding with a significant 84% drop in ownership of U.S Treasuries between March and May 2018 to just $14.9 billion. By the end of the quarter to September 2018, U.S. Treasuries made up less than 17% of reserves at Russia's central bank.

The reduction in US Treasury holdings has been more pronounced than the build-up of stocks of Gold (from $96.1 billion in March 2018 to $48.7 billion in April 2018 and then to $14.9 billion in May 2018), however as of September 2018, Russia's total foreign exchange reserves were at $458 billion and their gold allocation had risen to 17% - equivalent to about USD78 billion, built over a longer period.

Excluding the IMF, Russia is currently the fifth-largest gold owner after the United States, Germany, Italy and France.

Fig 4: Top 10 Countries with highest Gold Reserves (2018)



Source: World Gold Council

iii. In 2014, the Russian National System of Payment Cards (NSPK) was established. The NSPK subsequently launched the Mir - a new card that introduced a new national payment system to rival Visa and MasterCard. Also, in March 2017 Russia implemented a system that would be an alternative to SWIFT (interacting with the Chinese one).

iv. In early 2017 Russia established a representative office of the Bank of Russia in Beijing, bringing the country closer to issuing Russia sovereign yuan-denominated bonds. Further, the Industrial and Commercial Bank of China is now officially acting as a renminbi clearing bank in Russia, thus easing settlement business between Russia and China in direct yuan-ruble trade. This was after Russia's 2015 inclusion of the renminbi as one of its official reserve currency.

De-dollarization in other selected countries[3]

Other countries have also been actively signing de-dollarization agreements

- Iran and Pakistan have already signed an agreement to re-establish a banking relationship, denominated in local currencies.
- Effective June 2016 Singapore included the Chinese Renminbi (RMB) financial investments as part of its Official Foreign Reserves (OFR).
- In June 2016 the Sierra Leone Government expressed a desire to de-dollarize the country's economy.
- In April 2016, China and Nigeria announced a currency swap agreement. The currency swap deal may be a mechanism to strengthen the Naira since Nigerian traders, can execute their transactions in the yuan instead of the dollar. From a Chinese perspective, this arrangement increases the demand for the yuan.
- In April 2016, Hungary became the first Eastern European country to issue a yuan-denominated sovereign bond.
- On June 21 2016, Poland became the first European nation to announce plans to issue yuan-denominated debt in China. Their Ministry of Finance signed a deal with the Bank of China to issue 3-billion yuan worth of panda bonds. Subsequently in August 2016 the 3-year bond was issued in China.
- The New Development Bank, formerly known as the BRICS development bank announced in July 2016 that it would issue 3 billion yuan worth of five-year "green bonds" denominated in the Renminbi to raise funds for clean energy and infrastructure projects.
- In November 2015 Iran approved the establishment of a bank together with Russia.

Lessons for Kenya

From the highlights, it is apparent that a number of countries have accelerated efforts to de-dollarize. The reasons for taking these steps include:

[3] https://www.thesiriusreport.com/geopolitics/de-dollarisation-continues-earnest/

- To reduce the impact of foreign exchange (U.S. Dollar) fluctuations on the local currency.
- To improve a country's international standing as a stable economy with sufficient reserves to be able to withstand any economic crises.

As a country, Kenya has a substantial portion of its debt obligations to China. As a way of addressing foreign exchange fluctuations, the country could sign bilateral currency swap relations with China.

Country Summary – Major developments

1. *United States*

United States signs trade Agreement with Mexico, Canada

The US, Canada and Mexico signed a deal to replace the North American Free Trade Agreement (NAFTA), with the United States-Mexico-Canada Agreement (USMCA), effectively creating the world's second-biggest economic bloc after the European Union. The deal signed indicates that among other things, from 2020, cars must have 75% of their parts manufactured in Canada, Mexico or the US to qualify for zero import tariffs – a substantial increase from the current 62.5% requirement. Further, at least 40% of a car made in North America must also be made by a worker earning at least $16 an hour, a provision likely to benefit the US and Canada most. Also, the deal stipulates that Mexican and Canadian cars will be exempt from any future US automotive tariffs up to certain import quotas. Further, in the deal, US farmers will get greater access to Canada's dairy market through an increased quota on foreign imports. The US tariffs on Canadian and Mexican steel and aluminium will however remain. The deal is pending approval by the US Congress which is however controlled by the Republican party of the President.

Lessons

i. Trade deals between countries usually have an adverse impact on those excluded from them. The revised import quotas specifically for farmers could affect those countries' investment in Kenya in the Agricultural sector, specifically, dairy products (cheese, cream, milk beverages, butter), corn (maize), poultry and egg products, refined sugar and sugar-containing products, among others, ultimately adversely affecting Kenyan companies that have invested in the Agricultural sector some of which may be listed.

ii. The Agreement on Car manufacturing and assembly could adversely affect the price of vehicle spare part imports in Kenya (or indeed other relevant manufacturing sector products imported from Central America), thus putting more pressure on Kenya's BoP position in the long term.

U.S. trade dispute with China escalates

The U.S. proceeded with plans to impose tariffs on an additional $200 billion in Chinese products and released a list of targeted items that included consumer products including clothing, television components and refrigerators and other high-tech items. In September 2018, the U.S. imposed 10 percent tariffs on $200 billion worth of Chinese goods which would take effect September 24, with the rate set to rise to 25 percent on Jan. 1, 2019. China responded with 10 percent and 5 percent tariffs on $60 billion worth of U.S. goods. In June 2018, both countries applied tariffs on $50 billion worth of imported goods from the other country. The U.S. and China have had a long running dispute on unfair trade practices and disputes on American intellectual property which escalated after the new administration took over the US Government.

U.S. Benchmark rate raised

On September 26th, 2018, the U.S. Federal Reserve raised its benchmark rate, signalling a steadily tightening monetary policy, as it forecast at least three more years of economic growth. The Fed's benchmark overnight lending rate was raised by 0.25 percent to between 2.00 percent to 2.25 percent. The Fed projects the economy to grow at 3.1 percent in 2018, expanding moderately for at least three more years, with sustained low unemployment and stable inflation close to its targeted 2 percent rate. This could benefit savers and retirees, who will likely earn a decent return on their investments. Conversely, it could set off wage inflation and over-leverage the U.S. economy, thus posing more risks to the U.S. financial system. Interest rate in the United States averaged 5.72 percent from 1971 until 2018, reaching an all-time high of 20 percent in March of 1980 and a record low of 0.25 percent in December of 2008.

Lessons for Kenya

For Kenya, as debate on the capping of interest rates continues, it is worth noting that a revision of the central bank rate may not be as effective in an interest rate cap regime as it would be in a floating interest rate environment.

2. United Kingdom

Brexit Negotiations still on, challenges abound

The UK voted to leave the EU through the Brexit referendum on 23rd June, 2016. In line with the laid down procedures, the U.K invoked Article 50 of the Lisbon Treaty which gives the two sides two years to agree the terms of the split, on 29 March, 2017. This implies that the UK is scheduled to leave EU at 11pm UK time, on Friday, 29th March 2019. This timeline may be extended if all 28 EU members agree. However all indications are that Brexit will happen on that date. Despite this, there are challenges that have been impeding progress of negotiations as highlighted below:

1. **Terms -** The Brexit or "Divorce' terms are still contentious. While the EU indicates the U.K. will have to pay about €55 billion to €60 billion to leave the bloc. U.K. is reluctant to agree.
2. **Written Guarantee** - Ireland (an independent country using the Euro), backed by the rest of the EU, has been advocating for a written guarantee from the UK that Northern Ireland (part of the UK that uses the Pound) will continue to follow EU rules.
3. **Rights of citizens** – pre-Brexit, EU Nationals living in the U.K. and the U.K. Nationals living in the EU enjoy the same rights. However, there will be differences on the rights that citizens of either side should enjoy post-Brexit.
4. **Level of market access** - the U.K. is keen on the widest possible access to the EU market. However, EU opines that U.K cannot enjoy the same benefits it has as a member after Brexit.
5. **Offering Financial Services** - Under current EU laws, banks in U.K can sell products to EU clients with minimal regulatory challenges. In EU's view, leaving the single market will likely mean losing all or at least some of those rights.

Lessons for Kenya

As the East African region and the larger continent seeks even closer integration, the challenges facing the UK-EU negotiations need to be noted. Further, the positioning of Nairobi as a Financial Centre is a crucial factor in ensuring that the country remains competitive. Worth noting too is the fact that Kenya is a key trading partner of the UK. Against the background of Friday, 29th March 2019, the on-going re-alignments including the recent engagements of senior Government officials of both the

UK and Kenya should be fully leveraged by Kenya's financial sector.

Bank of England leaves Benchmark rate unchanged

In the most recent meeting on September 13th 2018, the Bank of England voted unanimously to leave the Bank Rate unchanged at 0.75 percent, following a 25bps hike in the previous meeting. Interest rate in the United Kingdom averaged 7.57 percent from 1971 until 2018, reaching an all-time high of 17 percent in November of 1979 and a record low of 0.25 percent in August of 2016.

3. European Union

In its sitting on September 13th 2018, the European Central Bank (ECB) left its benchmark rate at zero percent. The central bank also indicated that it expects key interest rates to remain at record low levels at least through the third quarter of 2019. Interest Rate in the Euro Area averaged 1.99 percent from 1998 to 2018, reaching an all-time high of 4.75 percent in October of 2000 and a record low of 0 percent in March of 2016.

4. China

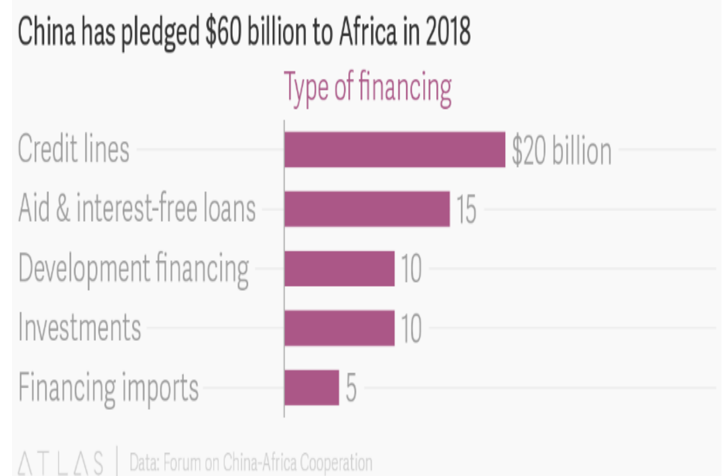
China on Course to becoming the World's Largest Economy in the World

China is on its way to becoming the largest economy in the world. This transition from rural poverty to an export powerhouse and then to a consumer giant has had the most impact on the country's economic standing. Worth noting is the country's major effort to build its own innovation economy. As of 2016, China's Venture Capital investment had caught up with U.S. levels. By the end of 2017, 3,418 Chinese VC funds were launched within the year, raising a combined $243 billion USD or 1.61 trillion RMB. Of the $154 billion worth of VC invested in 2017, 40 percent came from Asian (primarily Chinese) VCs. America's share is only 4 percentage points higher at 44 percent. Chinese VC firms are targeting three segments: robotics, driverless vehicles, and biotechnology. China Securities Regulatory Commission representatives recently indicated to a World Economic Forum panel, that there is little that U.S could do to significantly impact on the Chinese economy, indicating that an increase in tariff would only hit 0.7 percentage points of China's GDP growth[4].

China increasingly becoming a key economic partner to Africa as the U.S. follows suit

As China takes pole position in Africa's economy, its invitations to Africa's key leadership are receiving better response compared to other international engagements. Less African countries attended the 73rd session of the United Nations General Assembly (UNGA) in New York, than the Forum on China-Africa Cooperation (FOCAC) both held weeks apart.

Fig 5: A breakdown of recent financing to Africa by China



51 African leaders were in Beijing attending Forum on China-Africa Cooperation (FOCAC), compared with 27 in

[4] https://www.cnbc.com

New York. In the FOCAC held during the review period, China pledged a further USD 60 Billion financing to Africa.

Lessons for Kenya

i. Kenya could take advantage of China's global position to negotiate Double Tax Agreements (DTAs), sign bilateral currency swap relations with China and put in place measures to increase exports and negotiate project financing at concessionary rates, among others.
ii. Kenya could borrow a leaf from China's Venture Capitalism and innovation to help it become a significant regional capital markets player by focussing on FinTech Sandbox, Private Equity (PE) and VC enterprise.
iii. As a country Kenya should re-align its trading objectives to ensure maximum benefit by increasing public participation in matters of economic importance.
iv. There is need to actively advocate for Private-Public Partnerships (PPPs), specifically in major infrastructure projects instead of loans.
v. Active promotion of domestic entrepreneurship.
vi. Increase trade in agriculture and tourism where Kenya has a competitive advantage to improve the Balance of Payments position.
vii. Value addition of local products for export.
viii. Having other currency reserves rather than relying on 1 or 2 currencies.

U.S. Also actively fostering project agreements with Kenya

In so far as the U.S – Kenya trade relations are concerned, in late August 2018, the U.S. and Kenya agreed to be holding an annual high-level dialogue to accelerate their co-operation and create new opportunities. This followed the implementation of direct flights between Nairobi and New York City to strengthen business links and academic exchanges. During the period, the two countries concluded USD850 million in commercial deals and engagements with the public and private sector, to help increase the about USD1 billion annual bilateral trade.

Lessons for Kenya

i. There is likely to be more interest in Kenya as the world's major economies sign agreements with the country to fund infrastructure.
ii. With de-dollarization taking root, Kenya might become a ground for currency wars.

Natural disasters cause severe damage to economy, lives in Asia; Indonesia[5]

During the period, Natural disasters caused severe damage to economies and, lives in Asia and in Indonesia.

Earthquake, Tsunami — Sulawesi, Indonesia

The toll from the earthquake and tsunami that hit the port city of Palu and other communities in late September 2018 stood more 832. The extent of the damage was unknown as rescuers struggled to reach remote areas affected by the disaster.

Earthquake — Hokkaido, Japan

A magnitude 6.7 earthquake in Hokkaido on 6 September killed 41 people, most of them buried in a massive landslide. It wrecked roads and houses in the regional capital, Sapporo, and knocked out power for the island. Local media estimated the cost to public infrastructure, farming and forestry at 150 billion yen ($1.3 billion), not including losses to tourism and private businesses.

Typhoon Mangkhut — mostly Philippines, Hong Kong, China

[5] www.firstpost.com/

Typhoon Mangkhut, one of several powerful tropical storms to sweep through hit in mid-September. In the Philippines, the storms triggered landslides and flooding that killed at least 68 people. Latest Government estimates put the damage at more than 33.7 billion pesos ($622 million), just in the Philippines — and many millions more in Hong Kong and China.

Earthquake - Lombok, Indonesia

The earthquakes that struck Lombok in eastern Indonesia in August, the biggest with a magnitude of 6.9, did not generate a tsunami but nonetheless caused widespread damage on the island and on nearby Bali, killing more than 500 people. Damages are estimated at more than $500 million.

Dam Collapse, Lambok and Cambodia

On July 24th a dam in eastern Laos, along a tributary of the Mekong, killed at least 27 people and left more than 130 missing as flash floods wrecked roads and villages downstream as far as Cambodia and Vietnam. The Government has not released damage estimates.

Severe storms- Japan

Landslides and flooding in western Japan killed 229 people in early July and inflicted damage exceeding $2 billion. Those storms were followed in early September by Typhoon Jebi, the strongest storm to pound Japan in 25 years. It killed at least seven people and left thousands stranded at the Kansai International Airport when a tanker came unmoored and smashed into a bridge connecting the facility to the Japanese mainland.

Lessons for Kenya

The foregoing crises point to a need to put in place measures to mitigate natural disasters, the Authority's management is seized on consulting and implementing climate change initiatives through green bonds or other social development bonds to avoid man-made disasters.

FSB Decision on Monitoring of Crypto Currencies

According to the Recent Publication by the Global Risk Regulator September 2018, the Financial Stability Board noted that Crypto currencies such as bitcoin are not yet at the stage where they pose a systemic threat to the financial system but require a monitoring strategy to address the key risks they could pose.

The FSB further pointed out in the publication that crypto currencies are spreading quickly while data on their usage is quite scarce and coupled up with considerable regulatory uncertainty. Additionally, treatment of crypto assets in bank holdings could also become a key area of concern if they grow rapidly and become significant. Further, globally, crypto assets have become very volatile and also attracted a great deal of speculative interest.

Lessons for Kenya

Noting the growing interest in crypto currencies locally and regionally, the Authority will be is monitoring developments in the crypto segment.

Sub Saharan Africa Updates

During the quarter, World Bank cut sub-Saharan Africa's 2018 growth forecast to 2.7%, from an earlier forecast of 3.1 percent, attributing the revision to slower-than-expected growth in the continent's bigger economies - Nigeria, Angola, and South Africa. According to WB, the region had posted a fairly fast average growth rate in the years leading up to 2015, but suffered a loss of momentum in economic output after commodity prices crashed in

2015-16. The region had registered an average growth of 2.3 percent in 2017.

The main reasons for this predicament include lower oil production in Angola and Nigeria despite higher oil prices, and weak household consumption growth in South Africa, that was compounded by a contraction in Agricultural productivity. The rest of the countries in the region that do not depend on commodities, such as Ivory Coast, Kenya and Rwanda were reported to be registering robust growth in 2018.

Just as there is need to diversify economies within SSA, so is the need to diversify the product portfolio offered to capital market stakeholders. Efforts are being expended within the Authority to improve diversification, subject to feasibility studies establishing the need.

East Africa Region Update

A report by the Institute of Chartered Accountants in England and Wales (ICAEW)[6] dubbed Economic Insight: Africa released in September 2018 indicates that East Africa's economy is the best performing in the continent. ICAEW attributes the region's strong performance to economic diversification and investment-driven growth

Ethiopia remains the region's powerhouse, with the country's GDP expected to grow at 8.1% owing to the recent reforms. The report also notes that diaspora remittances are a key economic driver for most African countries.

Related

East Africa

East Africa's Gross Domestic Product (GDP) will grow by 6.3% in 2018, significantly more than the continent's other regional economic communities. West and Central Africa's GDPs will grow at 2.9%, the Franc Zone at 4.6%, Northern Africa at 1.8% and Southern Africa at 1.5%.

The Big 4 Agenda – What are the costs and benefits to Capital Markets?

During the Jamhuri Day celebrations of December 2017, the Government announced a new focus on four identified strategic areas or "Pillars" aimed at enabling the country to transform the standard of living of its citizens between 2017 and 2022, thus placing it on the path to becoming an upper middle income nation by 2030.

These pillars which are also known as the **Big Four** agenda items are **manufacturing, universal healthcare, affordable housing, and food security.**

Manufacturing

The manufacturing sector is one of the key contributors to the country's GDP. The sector comprises of about 3,700 manufacturing units. About two thirds of goods produced by the manufacturing sector in Kenya are consumed locally while the remaining third are exported. The manufacturing sector contributes about 9.2 percent to the country's GDP. Due to this importance, the sector was selected as one of the "Big 4" Agenda pillars that the Government will be focusing on to improve the country's competitiveness and ultimately its economic standing.

Under this Agenda item, the Government aims to raise the sector's contribution to the Gross Domestic Product (GDP)

[6] https://businesstoday.co.ke/east-africa-economy-best-performing-continent-report-reveals/

from 9.2 percent in 2016 to 15 percent by 2022. This is to be done through:

- Cutting the cost of off-peak power to heavy industry by half between 10:00pm and 6:00am.
- Improving the local skillset by reviewing the work permit regime so that expatriates whose skills support the Big Four are allowed into the country for knowledge transfer to Kenyans.
- Protecting intellectual property rights, promoting Buy Kenya and Build Kenya brand, and tackling illicit trade.
- Creating an additional 1,000 SMEs focused on manufacturing to accelerate growth in the sector; and providing them access to affordable capital, skills and markets.

In order to evaluate the level of success, the indicators that will gauge the success of this agenda include job creation, lower cost of living, lower income inequality and lower poverty levels.

Manufacturing and Capital Markets

In the 2018 – 2023 strategic plan, the Authority highlights the key areas in which the manufacturing sector and capital markets could collaborate in order to realize this big four agenda pillar. These areas include Initial Public Offers (IPOs), Project Bonds, Private Equity and Financial Technology (Fintech).

IPOs

An Initial public offering (IPO) (also known as a stock market launch) is a type of public share offering in which a privately held company is transformed into a public company selling its shares to investors to raise new equity capital to monetize investments of its private shareholders and to enable easy trading of existing holdings or for future capital raising. The country's over 3,700 manufacturing entities could take advantage of opportunities presented by capital markets to improve their bottom-line using funds raised from capital markets and in the process, enable the achievement of the big 4 agenda.

Project Bonds

A Project Bond is a bond used to finance (or re-finance) one or a portfolio of infrastructure assets. Infrastructure is increasingly starting to be viewed as an asset class of its own. In the post-global financial crisis period, stricter regulations have adversely affected bank lending policies, resulting in fewer bank borrowing opportunities to fund infrastructure projects. Project bonds offer an opportunity for investors to participate in infrastructure projects through listed, tradable securities.

Private Equity

Private-equity ("PE") firms are entities formed by investors keen on directly investing in other companies, rather than buying stock from a formal exchange. Investors in PE include companies, pension funds, limited partnerships and individual investors. PE firms that have invested in the manufacturing sector can use capital markets to monetize investments of their shareholders, enable easy trading of existing holdings or for future capital raising to expand.

Financial Technology

Fintech - a combination of the words "financial" and "technology," refers to any emerging technology that aims to help stakeholders in the financial services industry deliver financial services in newer, faster and often more convenient ways than hitherto has been available.

Entities in the manufacturing sector could use capital markets to raise funds. Through Fintech, stakeholders in the manufacturing sector have been empowered to leverage technology to use capital markets to raise capital, trade securities and view portfolio performance &

holdings among others, within a shorter time period and at their convenience.

Lessons

i. There is need to re-look at the factors behind low performance of manufacturing companies, such as cost of power.
ii. Manufacturing entities should take the opportunity to identify and implement alternative capital raising structures beyond full public offers by leveraging the flexibility of principle based approvals for new products and services under Section 12A, Capital Markets Act.
iii. Stakeholders should consider making arrangements for a formal OTC. This is because if well organized an OTC market could use the power of electronic trading and licensed dealers with strong networks and trading relationships with investors and other dealers to trade large securities volumes of smaller companies.
iv. Spur engagements with start-ups by having light regulatory obligations and differentiated offering mechanism to non-public investors in light of reduced regulatory burdens.
v. Encourage PEs and VCs to leverage the capital markets for exits as well as for refinancing their businesses. The PE industry should explore the opportunities to design fund of fund structures to raise public financing for deployment to PE funds for on investments to democratize access to high risk private equity returns.
vi. Consider limiting importation of foreign produced goods in various sectors.

Health

Universal health care (also called universal health coverage, universal coverage, universal care or socialized health care) avails health care and financial protection to all citizens of a particular country. Kenya aims to move from the current 36 per cent coverage in 2017 to 100 per cent universal health coverage by 2022. This shall be done by among others:

- Reconfiguring the National Hospital Insurance Fund through digitization and extending services through 37,000 bank agents.
- Increasing the CT scan capability in all counties.
- Reviewing the rules governing private insurers, to lower the cost of cover, protecting stakeholders from fraud and abuse and letting private insurers invest more in providing medical cover.
- Rolling-out the free maternity programme to missionary and private hospitals.
- Rolling-out the free maternity programme to missionary and private hospitals.

Health care and Capital Markets

Capital markets could be leveraged to achieve the targeted 100 percent affordable Health care by using Green Bonds & Sukuk, Social Impact Investing and Fintech.

Green Bonds & Sukuk,

Green bonds are bonds whose proceeds once raised, are earmarked for green projects that ultimately foster environmental/health and favourable climate sustainability. Green bonds finance projects usually aim at among others, improving energy efficiency, pollution prevention, clean transportation, sustainable water management and cultivation using environmentally friendly technologies.

Sukuk are the Islamic equivalent of bonds. Different from conventional bonds, which only confer ownership of a

debt, Sukuk grant an investor proportionate beneficial ownership in the underlying asset, along with the commensurate cash flows and risk. Sukuk securities adhere to Islamic principles, which among other things, prohibit the charging or payment of interest.

Taking advantage of the positive (socially impactful) marketing strategy and a potentially diversified investor base, the Health sector could leverage Green Bonds and Sukuk to raise funds whose proceeds may be used in the relevant compliant sectors to meet the targets of affordable Universal Health Care (UHC).

Social Impact Investing

This is investment made in companies, organizations or funds aimed at improving social services or social infrastructure. Funds are therefore raised to finance projects that would lead to an **achievement of an agreed social outcome** rather than the financial return on the investments made. In cases where investors are involved, full re-payment of the socially impactful invested funds is always expected and, potentially, a return on their investment although the expectation is this will be very patient capital allowing for long term investment to achieve targeted social objectives. Investment in UHC can be considered as one of the areas that if capital markets financing could be used to improve the level of health coverage, leading to a socially impactful outcome.

FinTech.

Because of its potential to improve efficiency and convenience, Fintech is increasingly being looked to for new solutions to improve health care coverage. Capital markets can be used to raise funds through platforms such as Crowdfunding, to among others, support the acquisition of new technologies for easy and more convenient payment channels, improve the speed of communication and feedback between Doctors and patients (e.g. through Apps) and facilitate the acquisition of new healthcare infrastructure. Given the track record of donation crowd funding in the region, repositioning products targeting support for health care initiatives (as has been seen with significant red cross fund drives on mobile money during disaster events) could unlock new funding flows.

Lessons

i. There is potential in listing big hospitals to enable them to raise further funds for expansion noting fairly strong revenue track record notwithstanding many are not for profit entities
ii. Promoting health tourism through specialized equipment and treatments.
iii. Other jurisdictions have excelled in Health Care through PPPs. Kenya can borrow a leaf.
iv. Potential Sectors for financing through Capital Markets
   - Infrastructure
   - Hospitality
   - Transport
   - Technology solutions financier

Affordable Housing

Kenya faces a real housing challenge. According to Bloomberg World Airbnb cost Index, in 2018, the average cost of a house accommodating two adults is $53 (Sh5,300) in Nairobi. Given this background, under the Big $ agenda, the Government of Kenya plans to build 500,000 affordable housing units over a five-year period (2017-2022) to deal with housing shortage in cities and urban centres.

This will be done by:

- reducing the cost of mortgages such that Kenyans will be able to own decent homes for the same amount of money they pay today as rent;
- cutting the cost of construction through the use of innovative technologies and materials;
- raising low cost funds from private and public sector for investment in large - scale housing construction and
- Setting-up a Kenya Mortgage Refinancing Company (KMRC) to manage low cost liquidity for mortgages.

Affordable Housing and Capital Markets

With appropriate infrastructural arrangements including competitive interest rates, Credit rating, appropriate professional advisory services and market liquidity, Capital markets can provide an ideal source of long-term financing for the housing sector. In Kenya, opportunities availed by capital markets have largely remained untapped. Investors in the housing sector could use instruments such as Housing Bonds, Asset-Backed Securities, Real Estate Investment Trusts, Mortgage Refinance Bonds and County Bonds.

Housing Bonds

Housing bonds are debt securities issued by the national or local Government to raise funds for affordable housing development. The bonds can either be short- or long-term issuances. The Kenya Government is keen on issuing such bonds through Kenya Mortgage Refinancing Company (KMRC).

Asset-Backed Securities

Asset-backed securities (ABSs) are bonds backed by financial assets. Typically these financial assets that back-up the bonds consist of receivables other than mortgage loan, including, credit card receivables and auto loans.

Real Estate Investment Trusts (REITS)

REITs are financial instruments mandated by law to distribute at least 80% of their profits to their investors. REITs are also subject to pass-through taxation, which means that REIT profits are not taxed at the institutional level, instead, investors account for REIT income alongside their other taxable income.

An Income REIT (I-REIT) is an entity that owns, operates or finances income-producing real estate, with REIT investors (usually referred to as unit holders) receiving stable cash inflows from the rental income generated from the real estate properties.

A Development REIT (D-REIT) is a real estate investment scheme where the proceeds of the REIT (raised off-plan) go towards real estate development and construction. The returns from D-REITs come from capital gains from sale of the project development and exits by either sale to the open market, or converts to an I-REIT.

Mortgage Refinance Bonds

Mortgage refinancing refers to the process of getting a new mortgage to replace an initial one, in order to allow a borrower to obtain a better interest term and rate. The first loan is paid off, allowing the second loan to be created. This process can be done through the issuance of mortgage refinance bonds as a mechanism for raising funds that can be used to retire older debt. This may mostly apply when interest rates are on the decline.

County Bonds.

These are debt obligations undertaken by County Governments using capital markets to raise financing, with repayment periods of longer than one fiscal year. The funds raised may be used improving access to public utilities such as transport, water supply and sewerage services, constructing public facilities such as schools, health centres and other educational or welfare facilities, among others. The structuring of the County bonds may

take the form of on-balance sheet as well as non-recourse SPV.

Lessons

i. There is need to address the interest rate environment and unfavorable macroeconomic conditions to be able to finance affordable housing, especially given the high rate (about 11%) on risk free assets. A conducive borrowing environment would be necessary to minimize the effects of Government crowding-out the private sector.
ii. Improving capital markets competiveness to make them attractive to investors.

Food Security

Kenya's food production is outpaced by food consumption. According to an Institute for Security Studies report[7], annual agricultural production will need to increase by an estimated 75% from 2015 levels to meet projected food consumption in 2030. Measures such as boosting Agricultural productivity, enhancing investment in climate change adaptation measures such as use of water pans and low-cost, small-scale irrigation projects, and in post-harvest technologies, could also improve yields and, in turn, contribute towards strengthening the food security situation in the country.

It is instructive therefore, that finding a lasting solution to the multiple and inter-related factors responsible for food insecurity and poor nutrition is a priority for the country. Under the Big 4 Agenda, the targeted initiatives include:

- Introducing targeted taxation to put idle arable land to use; encouraging and facilitating large-scale commercial agriculture through irrigation and other technologies.
- Protecting Kenya's water tower and, providing better extension services and market access for small-scale farmers.
- Re-designing subsidies to improve food yields and working with the private sector to deal with the challenges of distribution, waste, storage and value addition.
- The Ministries of Agriculture and Irrigation publishing terms and conditions for commercial farming to lease idle agricultural land, to raise production of strategic crops.
- Placement of an additional 700,000 Acres through Private – Public Partnership (PPP) (including idle arable land) under maize, potato, rice, cotton, aquaculture and feeds production.
- Formation of an Agriculture and Irrigation Sector Working Group (AISWAG) to provide coordination for irrigated Agriculture.
- Use of locally blended fertilizer on a 50/50 basis and implementing liming e.g. in maize.
- Availing incentives for post-harvest technologies to reduce postharvest losses from 20% to 15% e.g. by waiving duty on cereal drying equipment, hematic bags, grain cocoons/silos, fishing and aquaculture equipment and feed.

Food Security and Capital Markets

Kenya's Capital Markets have a fundamental role to play to improve the food security situation. This would mainly be done by using Spot Commodities and Derivatives Exchanges, Warehousing Receipt Systems, Social Impact

[7] https://reliefweb.int/report/kenya/food-security-under-threat-kenya

Investing, Private Equity Capital raising, Green Bonds and Central Clearing Counterparties.

Spot Commodities and Derivative Exchanges

A spot commodity trade or contract is a contract of buying or selling a commodity, security or currency for immediate payment and delivery on the spot date (normally within two business days after the trade date). A derivative exchange is a market where a financial instrument with a value that is reliant upon or derived from an underlying asset or group of assets is traded. Common underlying assets commodities, stocks, bonds, currencies, interest rates and market indices. Capital Markets can facilitate spot Agricultural commodities and derivative markets for Agricultural commodity derivatives.

Warehousing Receipt Systems

A warehouse receipt is a document guaranteeing the existence and availability of a given quantity and quality of a stored commodity. The receipt stipulates the quality, quantity, type of commodity, date deposited, and the date up to which storage costs have been paid. Once recognized as a negotiable document it may be used a document of title that can be used as a substitute for money when trading

Social Impact Investing using such instruments as Green Bonds

As an Impact investor, one can use capital markets to exploit opportunities in the Agricultural sector that are not only financially attractive but also address a social or environmental challenge like food security. Using diverse Capital structures like equity, debt, quasi equity, guarantees, etc. capital markets can be used to raise funds to improve the food security and market access for Agricultural products.

Central Clearing Counterparties

Central counterparties (CCPs) are structures that help facilitate the clearing and settlement process in financial markets[8]. These structures have in the past been utilized in the derivatives markets, more recently they have been adopted in cash securities markets and currently there is growing interest in further expanding their use including in commodity markets.

Lessons

i. Fast track the establishment of the commodity exchange and the warehouse receipt system.
ii. Use capital markets in Post-harvest wastage management through Warehouse receipting.

Lessons of the Big 4 for Kenya Capital Markets

Opportunities

i. In line with the Authority's 2018-2023 Strategic Plan, the Big 4 Agenda needs to be 'domesticated' through funding using Kenya's capital markets for rapid and sustainable growth.
ii. There is potential for capital markets to realize their strategic objectives by plugging into the big 4 agenda and actively seeking and pursuing specific opportunities for using capital market instruments for deeper and more diversified capital markets.

Risks

i. The Big 4 Agenda has not received buy-in from majority of Kenyan populace. It has not been clear what the role of the citizen is in ensuring the

[8] https://www.ecb.europa.eu/pub/pdf/other/rolecentralcounterparties200707en.pdf?2973e97f821d655058o8bd2a966256oe

achievement of the initiatives in the agenda. There is need for intense awareness creation to highlight the reasons for focusing on the Big 4.

ii. Recent taxation measures may impede the achievement of the target of improving the investment climate, thus affecting uptake.

iii. With the spread between the risk-free rate and the market rate being too narrow, risk averse investors would opt for the risk-free instruments thus crowding out the private sector from accessing credit.

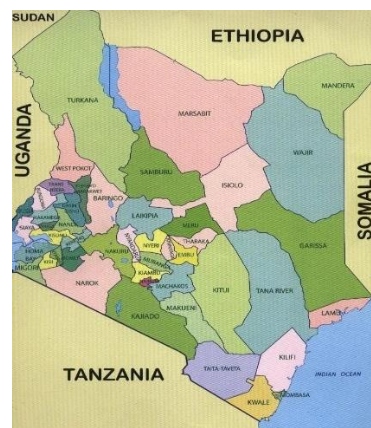
County Government readiness to participate in Capital markets – the outstanding challenges

The Kenya Constitution (2010) grants counties the freedom to generate revenue to implement their functions. The counties also receive funds from other sources to support their operations. These sources include revenue generated locally, revenue received from the national Government, and revenue sourced externally.

1. *Local Revenue*

Article 209 (3) of the Constitution (2010) empowers county Governments to impose two types of taxes and charges i.e. property rates and entertainment taxes. The county Governments can also impose charges for any services they provide in accordance with the stipulated laws.

Fig 6: Kenya's Counties



2. *Equitable Share*

These are funds that are equitably shared vertically between the national and the county Governments. The funds are from the revenue collected by the national Government. According to the constitution, the equitable share for the counties should **not be less than fifteen percent of all the revenue** raised by the national Government as per the most recent audited revenues by parliament. The equitable share is the biggest source of county revenue in Kenya.

The equitable share allocated to the counties is unconditional.

3. *Conditional Grants*

County Governments may receive additional allocations from the national Government's equitable share of revenue. In allocating these funds, the national Government imposes restrictions on how county Governments will spend them. The conditional grants include the Equalization Fund (Article 204) that currently benefits 14 counties that the Commission for Revenue Allocation (CRA) categorizes as marginalized. Other examples are money for Level Five hospitals and leasing of medical equipment.

4. *Donor Funding*

Donor funding is aid from international donors, usually in form of loans and grants. The donors may fund specific County projects directly as conditional grants or through the national Government Ministries, Departments and Agencies (MDAs).

5. *Loans*

Loans that could take various forms are another source of county Government revenue. These come from external sources or private lenders. The external sources may include **capital markets**, banks and international lenders. The accessed loans are usually repaid with interest. However, for the counties to access these loans, they **must** meet two conditions:

1. They can only access a loan if the **national Government guarantees** the loan.
2. The county assembly must approve any loans that the county Government intends to borrow.

Although the County Government has powers to raise funds through loans as per Article 212 (b) of the Constitution of Kenya and Section 140 of the PFMA, 2012, the challenge has been that there are no specific guidelines or criteria that should be observed to allow county Governments to borrow, pursuant to section 58 of the PFMA, 2012.

The Capital Markets and County Financing nexus

In collaboration with a Consultant, the Authority is in the process of concluding a funding gap study whose aim is to identify and analyse the funding gap at the national and county levels to inform capital markets products and services development has been conducted in two phases with phase one focusing on State Owned Enterprises and phase two targeting County Governments.

The consultant submitted a draft report to the Authority for review in September 2018. Working Group One of the Capital Markets Masterplan is currently reviewing the report and will share comments with the consultant for incorporation. The report will further be scrutinized by the Working Group One and the Implementation Committee of the Capital Markets Master Plan and comments incorporated before a technical workshop is organized to further review the report and adopt it before exposure of its findings and recommendations.

Lessons for Kenya Capital Markets

i. Until the guidelines/a criteria for national Government guarantee for county borrowings are drafted and adopted, the challenge of use of Capital Markets to raise capital are anticipated to persist. Alternatively, guarantees may also be provided through the use of non-recourse structures such as project SPVs rather than counties directly borrowing.
ii. The issue of sustainability of the country's debt levels in the long-term would need to be monitored. An alternative to this would an international issuance of debt denominated in local currency to reduce the burden of foreign exchange volatility.

Other Lessons

Kenya's readiness for County Financing

i. As a prerequisite, before borrowing, County Government must seek a National Government Guarantee as provided for by the Constitution. The Government
ii. Opportunities exist in the creation of SPVs by Government entities to facilitate access to capital markets. The SPV can be a 'ring-fenced' non-recourse alternative structure to raising funds.

iii. County Governments need to package their resources in a manner that is attractive to investors to consider investing in their development projects
iv. Risks that accrue based on factors such as Corporate Governance need to be addressed.
v. Economic viability of County Government projects needs to be carefully evaluated.
vi. Credit scoring – a decision should be made on whether to score the County Government or the actual project or assets backing the issuance of the product.
vii. Need for borrowing framework for County Governments
viii. Use of independent County Corporations as a starting point as Governance structures amongst Counties are addressed.
ix. Increased Capacity Building for County Governments is necessary.
x. There is a need for increased co-ordination on county efforts by different institutions including CMA, CRA, COG and other partners.
xi. There should be opportunity to focus on piloting Counties as a case study on potential of market access for others

Overview – Capital Markets Performance and Stability

Topical issue –performance of Capital Markets

Lately, the country's capital markets have come under heavy pressure, registering significantly lower performance. Below we highlight some of the possible reasons for this state of affairs.

1. Macro environment

The country's macro-economic challenges started in the post-August 2017 election period, with the country not fully stabilizing in the subsequent period. By the time the country was going for a presidential election re-run, there already had set in, a level of uncertainty in the investment landscape. In the post-Handshake era, the economy has stabilized somewhat, but appears to be trying to find a footing. Kenya' GDP seen expanding at 6% in 2018.

Projections by World Bank indicate that the country's economy will grow at 5.5 percent in 2018, compared to an estimated 4.8 percent in 2017. The improved growth is attributed to better weather and less political risk. WB's projections are slightly different from The National Treasury's which expects growth to rebound to about 6 percent in 2018 and 6.2 percent in 2019. Key challenges include pressure to curb the Government's fiscal deficit in the face of limited revenue expansion options.

2. Taxation

Taxation is one of the key challenges to investment. Recently, the Government effected taxes that will see excise duty charged for money transfer services by banks, money transfer agencies and other financial service providers increased to twenty percent of their excisable value and excise duty on fees charged for money transfer services by cellular phone service providers increased to twelve percent of the excisable value.

Table 9: Relevant taxes introduced in Finance Act 2018

Telephone and internet data services	10%	12%
Fees charged on money transfer services by banks, money transfer agencies and other financial providers	10%	20%
Other fees charged by financial institutions	10%	20%

Implication

- The new provision has now doubled the tax applicable on money transfers and other fees charged by financial institutions and increased the tax on telephone and internet services by 50%.
- This new doubled tax has a direct bearing on the cost of executing capital market transactions and ultimately, the level of participation in capital markets.
- The new taxes will have a negative impact on the growth of the mobile money services (including those of capital markets) which have been critical in growing financial inclusion.

VAT on petroleum products

The Finance Act, 2018 reduces the VAT rate on petroleum products from 16% which was introduced in the Value Added Tax Act, 2013 (VAT Act) but deferred for 5 years to 8%. The National Assembly had initially proposed that VAT on petroleum products be deferred for a period of two years to September 2020.

Implication

- The overhaul of the VAT legislation was to reduce the number of products that were classified as exempt or zero-rated as one way of increasing tax collections and reducing the cost of administering the VAT legislation. A significant part of the incremental Government tax collections for the 2018/2019 financial year were dependent on VAT collections from petroleum products which explains the Government's focus on implementing the tax.

3. Foreign Currency

According to CBK Exchange rate data, the Kenyan shilling closed the third quarter of 2018, at KES 100.96 to the U.S. Dollar. This is a slightly stronger position compared to 2017 at the same time where it traded at KES 103.25 on the dollar.

Table 10: East Africa Currencies Exchange Rate to KShs

Currency	29th Sep 2017	28th Sep 2018	% Change
KES / USHS	34.8678	37.8682	7.9%
KES / TSHS	21.744	22.6684	4.1%
KES / RWF	8.0656	8.6078	6.3%
KES / BIF	16.8626	17.7056	4.8%

Source: CBK

IMF stand-by loan arrangement expires

Kenya's stand-by loan agreement with the International Monetary Fund expired during the period, with the Government indicating that it will continue to consult with the Fund on the funding facilities it can access in future. The country had secured a six-month extension in March 2018, of the $989.8 million arrangement, agreed in 2016 to help cushion the economy in case of unforeseen external shocks that could upset the country's balance of payments position. It included a stand-by credit facility of $494.9 million that expired in March. It is worth noting that during the period that the Stand-by facility was available, no funds were ever drawn down. The IMF had set conditions for extending the stand-by arrangement, including the repeal of a cap on commercial lending rates which was imposed in 2016.

4. Interest Rates

Interest rate Cap review update

The law capping interest rate charged on loans was retained after the National Assembly's Finance Committee dropped proposals to amend the Finance Bill, 2018 to require banks to calculate interest based on the now-defunct Kenya Banks Reference Rates (KBRR). However, the committee successfully effected the removal of the cap on interest rate banks pay depositors, so that the banks and the customer are left to negotiate

the interest rate to be given on the savings. Given the cap is still in place negotiations will only likely to be in favour of the banks increasing their spread. This will likely increase the cost of borrowing, and the volume of loans.

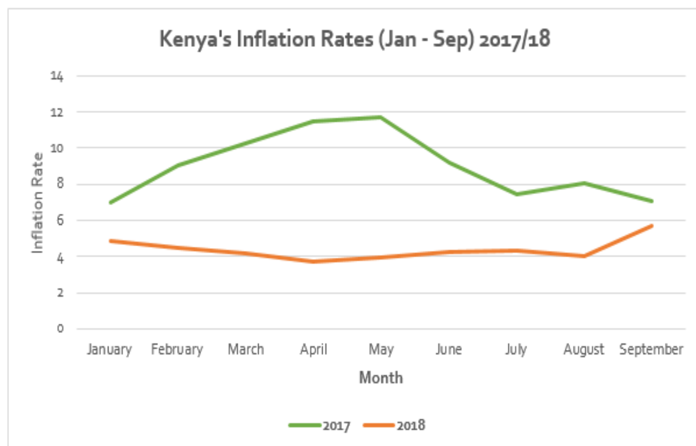
Bank lending rate drops to 13 percent after CBK revision

In July 2018, the Monetary Policy Committee (MPC) of the Central Bank revised the bank rate to 9.0 percent, four months after it had cut the same rate to 9.5 percent from 10 percent. The move will see Kenyans borrowing at an interest of 13 per cent from 13.5 per cent in line with the interest rate capping rule that limits lending rates to 4 percentage points above the CBR. The country's private sector credit growth is expected to remain below 5 per cent in 2018. According to Rating Agency Moody's, as of December 2017, it stood at just 2.4 per cent.

5. Inflation Rate

According to KNBS September 2018 statistics, the year on year inflation rate stood at 5.70 percent at the end of the third quarter of 2018, a 1.66 percent increase from 4.04 percent recorded in August 2018 and 1.36 percent decrease from 7.06 percent recorded in September 2017.

Fig 7: Comparable Inflation Rates (Jan – Sep) 2017/18

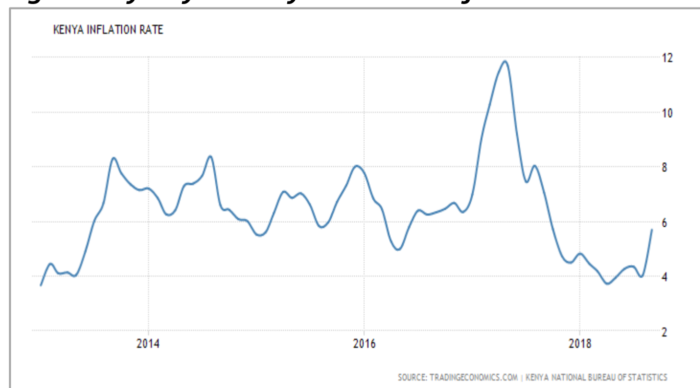


Source: KNBS

Comparatively, 2018 has witnessed lower levels of inflation than 2017 despite declining performance especially within the financial markets as characterised by the fall of the NSE 20 Share index that has since hit below the psychological 3000 mark with a low of 2,749.34 recorded on 16th October 2018 and a high of 3,862.27 recorded on 21st March 2018; the highest point since January 2018.

Kenya's annual inflation rate increased to 5.7 percent year-on-year in September 2018, from 4.04 percent in the previous month.

Fig 8: Kenya's year-on-year annual inflation rate



Source: KNBS/Trading Economics

The September 2018 inflation rate was the highest inflation rate since October 2017, mainly due to higher cost of transport and food & non-alcoholic beverages. The month coincided with the introduction of 8 percent tax on petroleum products. Inflation Rate in Kenya averaged 9.78 percent from 2005 until 2018, reaching an all-time high of 31.50 percent in May of 2008 and a record low of 3.18 percent in October of 2010.

6. Capital Markets Industry Performance

Listed Companies

In 2017, out of the 64 listed companies 12 listed companies issued profit warnings[9], pointing to a decline in performance. These were Standard Chartered Bank, Standard Group, Britam Holdings, Bamburi, HF Group and Flame, BOC Kenya, Deacons East Africa, Mumias Sugar, Nairobi Business Ventures and Unga Group.

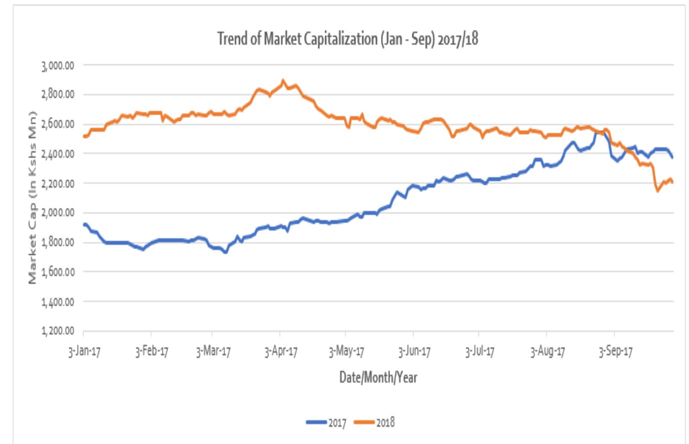
In the half-year to June 2018, 37% of the total number of licensed firms reported losses. Notably, 70% of the Stock Brokers reported net losses.

Review of Listed Companies Market Capitalisation

The Market capitalisation of public companies trading in the NSE registered a decline during the third quarter of the year. In the quarter, the total market capitalisation of NSE listed firms at the start of the quarter was as KES 2551.76 Billion compared to KES 2211.33 Billion at the end of the quarter[10]. This is a 13.3% contraction of the market capitalisation during the lapse of quarter 3, 2018.

A comparison between market capitalisation changes for the 3rd quarters of 2017 and 2018 are shown in the graph below.

Fig 9: Q3 2017 & 2018 Market Capitalisation



Source: NSE/CMA

Equity Market Performance

Table 11: Snapshot of Annual market performance

Year	Equity Turnover (KShs. Bn)	Share Volume (Mn)	NSE20 Share index	NSE All share index	Market Cap (Kshs. Bn)
2013	155.75	7,665.92	4,926.97	136.65	1,920.72
2014	215.73	8,133.67	5,112.65	162.89	2,316.00
2015	209.38	6,812.14	4,040.75	145.7	2,053.52
2016	147.18	5,813.49	3,186.21	133.34	1,931.61
2017	171.61	7,065.36	3,711.94	171.2	2,521.77
2018*	140.22	4,765.13	2,875.51	149.67	2,211.33

*As at September 2018

Performance of Listed Companies

Table 12: Price Gainers

Counter	29th June 2018	28th Sep. 2018	% change
ARM Cement	3.05	5.55	81.97%
Kapchorua Tea	68.00	86.00	26.47%
Longhorn Publishers	4.20	4.95	17.86%
Limuru Tea	500.00	540.00	8.00%
Standard Group	26.50	28.00	5.66%
Crown Paints	80.00	84.00	5.00%

[9] https://sokodirectory.com/2018/02/list-companies-issued-profit-warnings-2017-vs-2016/

[10] NSE data on equity price lists

Counter	29th June 2018	28th Sep. 2018	% change
Unga Group	39.25	41.00	4.46%
Umeme Ltd	8.40	8.60	2.38%
Scangroup Ltd	15.55	15.70	0.96%
Williamson Tea	139.00	140.00	0.72%

Source: NSE

ARM Cement

During the third quarter of 2018, the cement manufacturer had an increase in price of Kshs 2.50. This increase could be attributed to the news indicating International Finance Corporation (IFC) after the announcement of IFC's intent on July 11th 2018, to inject funds into the firm and resuscitate its operations. Effective August 18th, ARM cement was placed under administration by audit firm PWC.

Kapchorua Tea

In early August, Kapchorua Tea released its full year results in which it recorded a profit of Kshs. 166.4 million for the year ended 31st March 2018 compared to a loss of Kshs 51.8 million recorded in 2017. With the improved performance, the board recommended a final dividend of Kshs 10 per share.

Longhorn Publishers

Longhorn earned revenue of Kshs 1.696 Billion for the year ended 30th June 2018. This was a 17 percent increase from the previous year. Attributable to this is the company's product diversification and growth of its digital platform. The company also recommended a dividend of Kshs 0.42 per share

Table 13: Price Losers

Counter	29th June 2018	28th Sep. 2018	% change
Kenya Orchards	82.00	14.00	-82.93%
Deacons (E. Africa)	1.25	0.45	-64.00%
Uchumi	1.45	0.90	-37.93%
Eveready	1.50	1.00	-33.33%
Kenya Power	6.90	4.65	-32.61%
HF Group	8.50	5.80	-31.76%
NIC Group	35.50	24.50	-30.99%
Express Kenya	5.95	4.25	-28.57%
Britam	14.60	10.80	-26.03%
Home Afrika	0.85	0.65	-23.53%

Source: NSE

Kenya Orchards

By the end of September the share price of the counter had reduced by over 80% over the last 3 month period. NSE daily trading rules indicate that the daily price movement for any equity security in a single trading session shall not be more than 10% of the equity reference price. However, this does not apply for a security that has not traded for over three calendar months, as is the case for Kenya Orchards.

This volatility reinforces the need to introduce mechanisms to reduce impact of small trades on value of illiquid securities.

Deacons

The unaudited financial statements for the period ended 30th June 2018 indicate a sharp decrease in earnings. This was largely as a result of loss of revenue from discontinued operations of 'Mr Price' totalling Kshs 529 Million. The board also forecasted that the profits for the year ended December 2018 shall decline by at least 25% as compared to the previous reporting period.

Equity Market Liquidity risk

During the 3 month period of quarter 3 of 2018, the equities market recorded a liquidity percentage of 1.44%. This is a

reduction of 0.39% as compared to the second quarter of 2018 and a 0.81% reduction compared to the third quarter of 2018 which recorded a turnover ratio of 2.25%

Table 14: Market Liquidity Concentration in 2017/18

Period	Turnover (KShs Bn)	Market Cap (KShs Bn)	Turnover Ratio
Q3/2018	31.93	2,211.33	1.44%
Q2/2018	47.14	2,576.23	1.83%
Q1/2018	61.15	2,817.36	2.17%
Q4. 2017	36.02	2,521.77	1.43%
Q3 2017	53.57	2,376.69	2.25%
Q2 2017	44.90	2,224.06	2.02%

Source: NSE

Bond Market Performance & Stability

Primary Market Performance

In the third quarter of 2018, there were four (4) treasury bonds on offer namely three new issues and one re-opening. During this period the Government sought to collect a sum total of Kshs 120 billion. The bids received for these bonds amounted to Kshs 76.16 billion with the Government accepting Kshs 56.42 billion. This translates to a cumulative acceptance rate of 47.02% for the quarter. Comparatively, of the Kshs 90 billion total bond value issued in Quarter 3 of 2017, Kshs 86.04 billion was accepted. This translates to a higher acceptance rate of 95.6%.

Corporate Bond issues

Since the failure of two mid-tier banks that had issued bonds the corporate bond market has been relatively dry. A resolution of the issues in the bonds market relating the bank issuers to address the issues of insolvency and resolution especially for bonds that have not been listed would go a long way in instilling confidence in corporate bond markets. It is noteworthy that the challenges faced by Chase and Imperial Banks would not apply to an issuer that is not a deposit taking bank as was evidenced by the Bond issuance by EABL soon after the Imperial Bank collapse, which was very well received by the market. This notwithstanding, the negative sentiments relating to delayed bank resolutions has cast a shadow over the whole corporate bond market.

Secondary Bond Market Performance

The third quarter of 2018 saw a 23.78% increase in total bond turnover compared to a similar period in 2017. As was the case in both years, corporate bonds accounted for less than 1% of total turnover, attributed mainly to institution preference for Government bonds.

Table 15: Corporate Bond Performance

Month	Government Bond Turnover (KSHS. Bn)	Corporate Bond Turnover (KSHS. Bn)	Total Bond Turnover (KSHS. Bn)
Q3.2017			
Jul	35.77	0.01	35.78
Aug	33.43	0.81	34.24
Sep	38.10	0.04	38.14
TOTAL	**107.30**	**0.86**	**108.16**
Q3.2018			
Jul	48.65	0.00	48.65
Aug	44.80	0.00	44.80
Sep	40.23	0.00	40.23
TOTAL	**133.68**	**0.00**	**133.68**
Q3.2018/17 %Δ	**24.56%**	**100.00%**	**23.78%**

Source: NSE Monthly Reports

Table 16: Treasury Bond Performance

	Bond Issue	Offered (KShs. Bn)	Bids (KShs. Bn)	Accepted (KShs. Bn)	Performance Rate (%)
Q3.2017					
Jul-17	FXD 1/2017/10	30	19.04	5.19	63.48%
	Tap Sale		-	7.02	
	Aug.2017				

	Bond Issue	Offered (KShs. Bn)	Bids (KShs. Bn)	Accepted (KShs. Bn)	Performance Rate (%)
Aug-17	FXD 1/2017/5	30	18.72	12.11	88.90%
Sep-17	FXD 1/2017/2	30	34.41	20.69	147.72%
	Tap Sale		-	11.14	
	FXD 1/2017/10		9.91	6.29	
	Tap Sale		-	0.63	
	Q3.2018				
Jul-18	**FXD 2/2018/20**	40	13.86	10.51	34.65%
Aug-18	**FXD 1/2018/10**	40	29.83	19.36	74.60%
Sep-18	**FXD1/2018 /10**	40	22.14	21.24	110.70%
	FXD2/2018 /20		10.33	5.31	51.65%

Major Policy Developments

The Authority launches the Capital Markets Strategic Plan 2018-2023

Following the expiry of the 2013-17 Strategic Plan, the Authority developed a new Strategic Plan running from July 2018 to June 2023 to serve as a guide over the next five years. The major thrust of the five-year Strategic Plan is to create a regulatory framework that fosters growth, which is inclusive and sustainable, promotes innovation and financial technology and one that strengthens and builds a sound and resilient capital market.

The CMA Strategic Plan further serves as a blueprint for the Authority to steer the development of Kenya's capital markets to support national development objectives.

The 2018-23 CMA strategic plan has borrowed heavily from the outcomes anticipated in the Governments Big 4 Agenda to ensure the fruition of the Government objectives through the capital markets. The Capital Markets will be instrumental in supporting the delivery of the **Big 4 Pillars on development** targeting Food Security, Affordable Housing, Manufacturing and Universal Healthcare.

Derivatives Pilot Test

The Derivatives Pilot test commenced on July 2nd , 2018 and is scheduled to take place within the first half of the 2018/19 Financial Year. This rollout is restricted to select market participants and a select product category focused on an Equity Index and selected Single Stock Futures. The main aim of the pilot phase, is to test the functionality and process of end to end transactions in a live environment as well as inform stakeholders and regulators decisions on the official roll out of the Derivatives Market.

Implementation of Corporate Governance Code for Issuers of Securities to the Public

The Authority completed the assessment of all issuers for the financial year ended December 2017. The Authority shared its assessment findings with every issuer and is currently working on the first corporate governance scorecard/report which will be published once finalized. The Authority further intends to continue engaging with stakeholders to iron-out any challenges that they may be facing in order to enhance good corporate governance citizenry amongst the issuers.

Capital Markets University Challenge

CMA through the Investor Education and Public Awareness department rolled out the 2018 Capital Markets University Challenge Competition. It is an inter-university competition that will primarily focus on testing the participants' knowledge and understanding of capital markets and financial issues with an array of prizes and awards on offer to the top participants. The competition has a 5 stage testing process with the finale expected to be held in November 2018.

Table 17: Capital Market 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 **Base Year = 2010**	**Q3. 2018**	**July**	**Aug**	**Sep**	**Q. Avg**	**Low (indicative: < -10% or >10% : High)**	• The NSE 20 Share Index volatility for the quarter ending September 2018 averaged **0.43%**, compared to **0.41%** recorded in quarter 2 2018, a slight increase in the volatility of the NSE 20 share index.	• To maintain low volatility, the Authority is pursuing measures aimed at increasing market liquidity including introduction of market makers, Derivatives, Securities Lending and Borrowing, Direct Market Access among others.
		0.35%	0.42%	0.52%	0.43%			
	Q2.2018	**April**	**May**	**June**	**Q. Avg**			
		0.28%	0.44%	0.51%	0.41%			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. Avg**			
		0.37%	0.27%	0.29%	0.31%			
	Q4.2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		0.62%	0.36%	0.28%	0.42%			
NASI Volatility **Base Year = 2010**	**Q3. 2018**	**July**	**Aug**	**Sep**	**Q. Avg**	**Low (indicative: < -10% or >10% : High)**		
		0.46%	0.54%	1.04%	**0.68%**			
	Q2.2018	**April**	**May**	**June**	**Q. Avg**			
		0.41%	0.74%	0.59%	**0.58%**			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. Avg**			
		0.43%	0.58%	0.37%	**0.46%**			
	Q4.2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		0.39%	0.69%	0.42%	**0.50%**			
Turnover Ratio	**Q3. 2018**	**July**	**Aug**	**Sep**	**Q. TR**	**Low (Annual indicative: <8%-Low; >15% High)**	• A turnover ratio of **0.45%** was recorded in the reporting period compared to **1.83%** in quarter 2 2018 indicating 99.76% decrease in trading activity in the quarter.	• In Quarter 2 2018, the Authority concluded a study on factors underpinning low uptake of capital markets products and services and engaged stakeholders and industry participants on the findings of the paper.
		0.39%	0.41%	0.54%	**0.45%**			
	Q2.2018	**April**	**May**	**June**	**Q. TR**			
		0.57%	0.72%	0.52%	**1.83%**			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. TR**			
		0.76%	0.67%	0.81%	**2.24%**			
	Q4.2017	**Oct**	**Nov**	**Dec**	**QTR**			
		0.40%	0.58%	0.47%	**1.45%**			

								• The recommendations from the consultative workshop will be instrumental in addressing the low uptake challenge with the capital markets space, Reversing the perception that the capital market is expensive and removing identified obstacles to listings and improving other capital market products' uptake, increasing Listings at the NSE, addressing gaps in market issuance practice that have resulted to low listings in the equity and debt space as well as identifying potential ways of leveraging on the NSE/KASIB Rapid Mass Visibilities Strategy (RMVS) proposition to spur capital markets listings interest and ultimately develop the market.
	2.0 Foreign Exposure Risk							
Foreign Investor turnover as a % of total turnover	**Q3. 2018**	**July**	**Aug**	**Sep**	**Q. Avg**	**High (Annual indicative <30%; Low; >65% High)**	• Average Foreign investor participation in the review period averaged at **64.84%**, an increase of **5.06%** from **61.72%**	• The Proposed foreign income tax amnesty filing extension to 30th June 2019 as well as the extension of declaration period to allow
		67.69%	62.03%	64.80%	**64.84%**			
	Q2.2018	**April**	**May**	**June**	**Q. Avg**			
		63.55%	52.84%	68.77%	**61.72%**			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. Avg**			

		71.51%	49.63%	50.98%	**57.37%**		recorded in the preceding quarter.	individuals to repatriate income earned up to 31st December 2017 has the potential of attracting Diaspora inflows into the country, in which case some of the inflows will find their way into the capital markets;
	Q4.2017	Oct	Nov	Dec	Q. Avg			
		72.41%	56.69%	64.75%	**64.62%**			
Net Foreign Portfolio Flow (In KES Millions)	**Q3. 2018**	**July**	**Aug**	**Sep**	**Q. Sum**	**High (indicative – annual: <Kshs (50million) - High outflow; >KShs. 50 million High inflow)**	• Net Foreign Portfolio levels for the quarter ended September 2018 amounted to a total outflow of **Kshs 6,705 Mn** compared to an outflow of **Kshs 8,176 Mn** in the previous quarter.	
		(2,111)	(1,565)	(3,029)	**(6,705)**			
	Q2.2018	**Apr**	**May**	**Jun**	**Q. Sum**			
		(1,815)	(4,022)	(2,339)	**(8,176)**			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. Sum**			
		(1,464)	(5,137)	(1,483)	**(8,084)**			
	Q4.2017	**Oct**	**Nov**	**Dec**	**Q. Sum**			
		486	(450)	(218)	**36**			
Market Concentration (Top 5 companies by market cap)	**Q3. 2018**	**July**	**Aug**	**Sep**	**Q. Avg**	**High (indicative – annual: >50% High concentration)**	• During the quarter, the top five companies by market capitalization accounted for **68.05%** of the market value on average, confirming their market dominance. • The top five companies included SAFARICOM, EQUITY, EABL, KCB and CO-OP.	• The recent revival of the privatization program which will be partly carried out through the capital markets and could stimulate the capital markets through new listings of State Owned Enterprises and a multiplier effect of listing of private sector entities • This will help address issues around market concentration and drive market liquidity. • The Setting up of the National Credit Guarantee Fund will provide support to potential NSE Growth Enterprise Market Segment (GEMS) entities thus
		68.45%	68.31%	67.40%	**68.05%**			
	Q2.2018	**Apr**	**May**	**Jun**	**Q. Avg**			
		67.21%	68.13%	68.83%	**68.06%**			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. Avg**			
		66.45%	66.69%	68.50%	**67.21%**			
	Q4.2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		65.94%	65.89%	64.96%	**65.60%**			

<table>
<tr><td></td><td colspan="5"></td><td></td><td></td><td>reducing market concentration risk</td></tr>
<tr><td></td><td colspan="8">3.0 Government Bond Market Exposure</td></tr>
<tr><td rowspan="8">Treasury Bond market turnover Concentration</td><td>Q3. 2018</td><td>July</td><td>Aug</td><td>Sep</td><td>Q. Avg</td><td rowspan="8">High (indicative – annual: >50% High concentration)</td><td rowspan="8">• The Treasury bond market remains dominant in the Kenyan bond market, accounting for an average of 99.93% during the quarter; indicating an increase of 0.05% compared to the preceding quarter.</td><td rowspan="9">• To counter this challenge of an illiquid corporate bond market in Kenya, the Authority has procured a consultancy to support the introduction and implementation of the hybrid bond market model that will allow trading of bonds both on and off the Exchange.
• The recent establishment of the Kenya Mortgage Refinancing Company (KMRC) will enable bond markets deepening as it is expected that it will leverage on capital markets to raise funds through bonds for on-lending to banks and other mortgage financing companies.</td></tr>
<tr><td></td><td>99.78%</td><td>100.00%</td><td>100.00%</td><td>99.93%</td></tr>
<tr><td>Q2.2018</td><td>Apr</td><td>May</td><td>Jun</td><td>Q. Avg</td></tr>
<tr><td></td><td>99.93%</td><td>99.97%</td><td>99.75%</td><td>99.88%</td></tr>
<tr><td>Q1.2018</td><td>Jan</td><td>Feb</td><td>March</td><td>Q. Avg</td></tr>
<tr><td></td><td>99.91%</td><td>99.57%</td><td>99.66%</td><td>99.71%</td></tr>
<tr><td>Q4.2017</td><td>Oct</td><td>Nov</td><td>Dec</td><td>Q. Avg</td></tr>
<tr><td></td><td>98.39%</td><td>98.10%</td><td>99.95%</td><td>98.81%</td></tr>
<tr><td>Corporate Bond Market ownership</td><td colspan="5">
<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>4,721</td><td>67,539.04</td><td>99.06%</td></tr>
<tr><td>East African Investors</td><td>20</td><td>181.99</td><td>0.27%</td></tr>
<tr><td>Foreign Investors</td><td>111</td><td>457.17</td><td>0.67%</td></tr>
<tr><td colspan="4">Source: CDSC Data as at September 2018</td></tr>
</table>
</td><td>High (indicative – annual: >50% High concentration</td><td>• Local Corporate bond investors were the leading investors in corporate bonds at 99.33% of amounts outstanding, while foreign bond investors held 0.67% of total corporate bond holdings.</td></tr>
<tr><td></td><td colspan="8">4.0 Investor Profiles - Equity Market</td></tr>
<tr><td>Equity Market</td><td colspan="5">
<table>
<tr><th>Type of Investor</th><th>2015</th><th>2016</th><th>2017</th><th>2018</th></tr>
<tr><td>E.A. Institutions (%)</td><td>65.68</td><td>66.38</td><td>68.36</td><td>68.61%</td></tr>
<tr><td>E.A. Individuals (%)</td><td>12.84</td><td>12.49</td><td>11.47</td><td>11.47%</td></tr>
<tr><td>Foreign Investors (%)</td><td>21.48</td><td>21.13</td><td>20.17</td><td>19.92%</td></tr>
</table>
</td><td>High (indicative – annual: >50% High concentration)</td><td>• Local investors, a sum of East African institutional and individual investors accounted for 80.08%</td><td>• In order to address low uptake issue and attract local investors and issuers the Authority undertook a study aimed at determining</td></tr>
</table>

	Source: CMA- *Data as at August 2018					of shares held in the equity market with **19.92%** being held by foreign investors.	the underlying reasons behind the low uptake of capital markets products and services. • The Authority concluded an Investor Education Impact and Opportunities Analysis Study that will be instrumental in the development of a National Consumer Financial Education Strategy as well as development of an Impact Assessment Measurement Index that the Authority can use to gauge the impact of its investor education program going forward. • This will translate to more targeted engagements to onboard and drive increased market participation within the capital markets.
	5.0 Investor Compensation Coverage						
Settlement Guarantee Fund (SGF) Coverage Ratio[11]	**Q3. 2018**	**July**	**Aug**	**Sep**	**Q. Avg**	• SGF Ratio for the quarter to June 2018 averaged **1.75.** This is an indication that the	• Through Risk-based supervision, the Authority has been monitoring the SGF figures and the
		1.96	1.83	1.46	1.75		
	Q2.2018	**Apr**	**May**	**Jun**	**Q. Avg**		
		1.11	1.01	1.17	1.10		

[11] **Source: CDSC**

	Q2.2018	**Apr**	**May**	**Jun**	**Q. Avg**	**Medium (indicative – annual: > 1 times, implies full coverage)**	Guarantee Fund balances are sufficient to cover liabilities that would arise following default by securities brokers.	financial position of the firms to ensure that they are in good standing and that investors are protected. • The recent Amendments to the Capital Markets Act will also ensure that the ICF is managed more efficiently by abolishing the ICF Board and vesting the management of the fund into the Authority. This is expected to address key capital markets malpractices including corporate governance, embezzlement of investor funds, front running, and provision of misleading information amongst others.
		1.11	1.01	1.17	1.10			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. Avg**			
		0.87	0.91	0.76	0.84			
	6.0 Asset Base of Fund Managers, Stockbrokers, Investment Banks							
Assets Under Management	**As at July 2018 (Amount in KShs Millions)**					**Medium (Indicative – the higher the figure, the more stable is the market)**	• The total Asset Base of Fund Managers, Stockbrokers, Investment Banks and Investment advisors as at July 2018 was Kshs 8,170.20 Million, 1,148.64 Billion, Kshs.10, 816.84 Million	• The Authority continuously monitors asset levels of its licensees to ensure accurate reporting of assets and liabilities and monitoring sufficiency of liquid capital to monitor potential bankruptcy of licensees.
	CMA Licensee	**Total Assets**	**Total Liability**	**Net Assets**				
	Fund Managers	8,170.20	1,404.23	6,765.96				
	Stockbrokers	1,148.64	119.77	1,028.87				
	Investment Banks	10,816.84	2,650.70	8,166.13				

	Investment Advisors	3,048.77	855.67	2,193.10			and Kshs 3,048.77 Million respectively.	

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