The Capital Markets Soundness Report

Volume X

Quarter I. 2019

"Capital Markets Infrastructure (CMI) as an enabler of Efficiency and Market Liquidity – What does the future hold for Kenya?"

SPECIAL MESSAGE FROM THE CHIEF EXECUTIVE OFFICER

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

On behalf of the Authority, I am happy to welcome you to this 10th edition of the Capital Markets Soundness Report (CMSR) for the quarter ended March 2019 (Q1.2019). Since the inaugural report that was published in 2016, the CMSR has undergone continual improvement both in depth and scope, making it one of the most sought-after publications of the Authority, due to its evaluation of multiple aspects of capital market soundness and stability.

The Authority is committed to sustaining the growing level of interest in this publication by diverse local and international capital market industry players and will continuously improve the quality and content of publications to retain its place as a source document for information on capital markets operations and performance in Kenya. I am happy to note the very active participation by market stakeholders in forums held to input on the reports' content and observations before the final document is circulated to the public.

We therefore continue to welcome feedback on the report's key identified issues, lessons and proposed mitigations in order to enrich our capital markets policy framework to support market-based funding. I am further pleased to inform you that the policy interventions validated by stakeholders in previous publications have been shared with the National Treasury for progression.

I thank you all for your invaluable support thus far and look forward to achieving greater heights and more partnerships in 2019.

Enjoy the read.

Mr. Paul Murithi Muthaura, MBS
CHIEF EXECUTIVE OFFICER

EDITORIAL

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

I am delighted to welcome you to the 1st Quarter (Jan- March 2019) edition of the Capital Markets Soundness Report (CMSR).

This is the tenth volume of the Soundness Report and is themed ***"Capital Markets Infrastructure (CMI) as an enabler of Efficiency and Market Liquidity – What does the future hold for Kenya",*** inspired by global developments in Capital Markets Infrastructure, sparked by the rapidly changing technological landscape with a key focus on securities markets' IT systems. Fundamentally, the report features the current state of our local CMI and challenges, while prioritizing the fast-tracking of upgrades as the main solution for a more efficient and liquid local capital market.

Globally, the Authority continues to keep close tabs on latest developments in trade negotiations between U.S. and China, the overall state of the global economy, notably the recession in Turkey and Italy and general slackening of the world's economic growth. Within Africa we explore the implications of the impending coming into force of the Continental Free Trade Area (AfCFTA), following the expected depositing of ratification instruments by Gambia in April 2019 and the opportunity this portends, in addition to lessons learnt on integration as we count down to Brexit. Related to this, we also cover the latest challenges to the East African regional integration Agenda amidst recent tensions between some member states.

On the domestic front, the report examines the key soundness signals during the quarter, including the recent court ruling on the capping of interest rates, inflation trends and exchange rate volatility.

Happy reading!
Mr. Luke E. Ombara
DIRECTOR, REGULATORY POLICY & STRATEGY

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1 Special Feature

Capital Market Infrastructure advancement as a driver of market liquidity and efficiency – Is Kenya prepared for the future?

1.1 *Overview of Kenya's CMI Structure*

Capital Markets Infrastructure (CMI) is the combination of systems, institutions, resources, platforms that support the efficient operation of financial institutions, companies, Governments and investors in building businesses and contributing to growth of the wider economy. CMI therefore provides critical services that promote the clearing, settlement and recording of financial transactions, including the transfer of securities and funds between counterparties. By making transactions safer, cheaper, more robust and efficient, market infrastructure can significantly boost trading liquidity.

Trading of securities in Kenya has evolved over the years from the days of 'open outcry' system to the current electronic trading system that is currently supported by the Automated Trading System (ATS) at the Nairobi Securities Exchange. Electronic trading at the NSE started in 2006 with the primary goal being to ensure that buy and sell orders were matched automatically and executed on a first-come-first-served basis. It is worth noting however, the ATS has not been without challenges over its 12 years of operation.

Consequently, system upgrades and updates have been undertaken in the past. For instance, in 2014, the system was upgraded to enable faster settlement in the trading of bonds and shares as well as be able to accommodate trading of new products namely; Real Estate Investment Trusts (REITs), Exchange Traded Funds (ETFs), Futures and other Derivative instruments.

In 2011, under the ATS, the equity settlement cycle moved from the previous T+4 to a T+3.

Overall, the speed and capacity of automated trading systems has contributed to significant benefits including increase in trading volumes and improvement in transaction speed.

1.2 *History of System Failures by major Global Exchanges*

In September 2008, the London Stock Exchange suffered its worst systems failure in eight years, forcing the world's third largest share market to suspend trading for about seven hours. This was the longest outage suffered by the exchange since April 5, 2000, when problems with an older trading system led to an eight-hour suspension. The impact was also felt by the Johannesburg Stock Exchange, which uses the same trading platform *TradElect*, making it to also suspend trading[1]. More recently in 2018, multiple exchanges globally faced system failures including Vietnam, India, Toronto, New Zealand and Tokyo main exchanges.

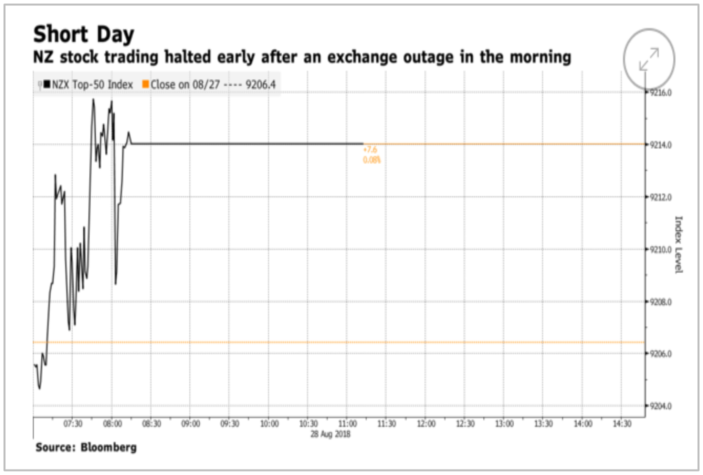
In January 2018, Vietnam's main stock exchange, home to the nation's benchmark VN Index remained shut for two days following a system malfunction, the longest halt in a span of ten years.

In April 2018, Canada's TMX group shut down its exchanges in Toronto and Montreal, attributed to hardware failure in a central storage appliance.

In August 2018, New Zealand halted trading due to a system fault at the country's national stock exchange. Live prices and indexes stopped updating for 5 hours. In a statement, the Exchange's Chief Executive attributed the incident to an internal operational challenge.

[1] https://www.reuters.com/article/us-lse/london-stock-exchange-crippled-by-system-outage-idUSL01084620080908

Fig 1: Stalled Trading Activity on the New Zealand Stock Market



In October 2018, the Tokyo Stock Exchange suffered a system failure that forced SMBC Nikko Securities and other Japanese brokerages to temporarily freeze some of their operations. In his response, the Japan Exchange Group Chief Information Officer attributed the system failure to an 'overwhelming amount of data received from one of its brokerage firms. In response to such system malfunctions, different mitigation measures have been adopted including implementation of single-stock circuit breakers, the ban on stub quotes, implementation of rules banning stub quotes and requiring pre-trade risk controls among others.

1.3 System Failures at the Nairobi Securities Exchange

More recently, the NSE ATS system experienced system hitches which impacted trading activity at the bourse.

On April 1st, 2019, the market trading infrastructure experienced a delay in opening due to unavailability of the Central Depository System, with trading commencing at 2.55 p.m. with 15 minutes pre-open and 2hrs 10 minutes of continuous trading to close 5:00 p.m., resulting in a turnover value of Kshs 369.7 Mn for the day, a decrease of 44.4. % from the previous trading day. However, on the subsequent day on 2nd April, 2019, equity turnover rebounded to Kshs. 1.22 Bn, indicating a 229 percent increase in trading following the technological challenges that the trading system had experienced earlier.

On October 1st, 2018, challenges were experienced by a dependent System of the ATS which led to an extended delay in trading hours by more than four hours. The Impact was a drop in equity turnover for the day which stood at Kshs 130.43 Mn, a 79.77% from the previous day's trading statistics of Kshs 644.74 Mn. However, once system operation resumed fully, a turnover of Kshs 1.48 Bn was recorded on the following day, 2nd October 2018.

Confronted with such realities on the impact of system infrastructure failures, there is an urgent call to action. There is a need therefore for industry players and key stakeholders mainly the Nairobi Securities Exchanges, the Central Depository Settlement Corporation and the Central Bank to fast-track system infrastructure upgrades and integration, for Kenya to reap from the advantages that come with being an attractive securities investment destination for investors.

1.4 Ongoing Initiatives in improving Kenya's CMI Landscape

Over the last 5 years, efforts have been channeled towards upgrading the Automated Trading System (ATS) at the Nairobi Securities Exchange (NSE), the Central Depository and Settlement Corporation (CDSC) IT system, merging of the CDSC and Central Bank of Kenya (CBK) Central Security Depositories (CSDs) as well as not only adhering to the EAC Common Market Council of Ministers Directive 2014/9/EAC, but also adopting a common securities trading and settlement infrastructure.

It is worth noting too, that there currently are concerted joint (NSE & CDSC) efforts to upgrade their IT infrastructure systems so that the challenges being experienced are fully addressed. NSE plans to have a new

IT infrastructure system by June 2019 whereas the CDSC is at an advanced stage of upgrading its systems. The launch has been postponed a number of times, with the indicative date remaining within the 2018/19 financial year. The institution currently handles between 15,000 and 30,000 transactions per day.

1.4.1 Settlement of Securities in Central Bank Money is already in place

Effective January 16th, 2015, with the facilitation of the Authority, the Central Depository and Settlement Corporation (CDSC) and the Central Bank of Kenya (CBK) developed a more robust cash settlement model for equities and corporate bonds. Consequently, the cash side of the settlement process for transactions is now coordinated through the Central Bank of Kenya's Real Time Gross Settlement (RTGS) system. Before then, the cash settlement for securities transactions was being affected through four commercial banks appointed as settlement banks by the CDSC. However, the securities leg of the settlement process, which entails the transfer of securities between the buyers and sellers was and still is carried out by CDSC.

1.4.2 The Case for consolidation of the Country's Central Securities Depositories (CSDs)

In an effort to further consolidate securities settlement and align the Kenyan market with the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) i.e. CPMI-IOSCO Standards for Financial Markets Infrastructures, in November 2016, the National Treasury commissioned a study to explore the possibility a horizontal merging of the Central Depository and Settlement Corporation (CDSC) and the Central Bank of Kenya Depository operations[2].

There still are on-going consultations to find a common position on the ideal CMI for Kenya, with CBK currently in the process of conducting a systems upgrade, with a possibility of systems plug-in once the upgrade is concluded.

1.4.2 EAC CMI Initiative and regional integration

There is an EAC CMI project that was initiated in 2011 by the EAC Secretariat, in collaboration with the World Bank. The integration of the region's capital markets is compliance with the provisions of the EAC Common Market Protocol, which provides for free movement of capital in the region. The project envisioned the acquisition and installation of an information technology platform that would facilitate the implementation of a Smart Order Routing System linking the trading systems, as well as a clearing and settlement interface for Central Securities Depositories (CSDs) of the EAC member states. The project was part of a wider World Bank-funded EAC Financial Sector Development and Regionalization Project (FSRDP) 1, which sought to support the establishment of a single financial market among the EAC member states.

In 2015, Kenya pulled out from the Project for technical and operational reasons.

A recent EAC Sectoral Council of Finance and Economic Affairs report (2019) called for hastening of the process[3].

1.5 Opportunities for improved Capital Markets Infrastructure in future

On the global landscape, capital markets infrastructure has significantly evolved with greater use of advanced technologies to improve speed, efficiency, integration of functions across the financial infrastructure ecosystem.

[2] https://www.nation.co.ke/business/Merger-of-two-securities-depositories-on-course-/996-3448504-u6h26pz/index.html

[3] https://www.pressreader.com/

As activity in the sector grows,a report by Mckinsey and Company titled "***Capital Markets Infrastructure: An Industry Re-investing itself***," has identified areas that present an opportunity for capital markets infrastructure service providers to offer solutions. These include;

- Renewed focus in providing solutions on new and fast-growing asset classes, such as corporate bonds.
- Capitalize on data and analytics to create new intellectual property.
- Provision of integrated compliance and risk management solutions, to help clients meet their regulatory obligations.
- Create industry utilities for processes that aren't differentiated, for example, client on-boarding.
- Expand service offerings for corporations in capital markets, for instance, pre-IPO advisory and investor relations services.
- Expand into new geographies through partnerships and new distribution networks
- .Establishment of e-commerce trading ecosystem

Fig 2: Current Global Capital Markets Industry Infrastructure value chain

Source: Mckinsey & Company

Lessons: With the rapid diversification and complexity of new capital markets products, increased transaction volumes, introduction of new trading platforms and in spite of timely assessment of the CMI for Kenya, the delays in implementation of key domestic and regional initiatives pose a key risk. Specifically, the following can be discerned from the multiple efforts that are already being made to improve Kenya's and the region's Capital Markets Infrastructure:

i. Capital markets Infrastructure is a crucial component for better efficiency and higher capital market liquidity: As they work towards addressing this component, EAC member countries will need to harmonize their approach to implementing a regional CMI so as to save cost and reap from the synergies that accompany a mutually agreed-upon approach to addressing regional integration challenges;

ii. Systems have a lifetime: As their lifespan shortens, they are bound to develop performance challenges. Continuous systems evaluation and upgrade is a key component of ensuring convenient, reliable and seamless execution of capital market transactions Stakeholders need to

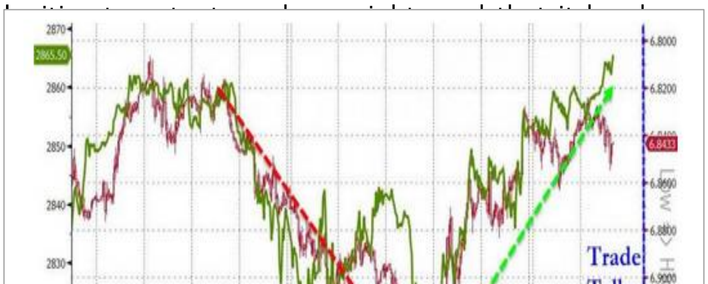
iv. Delays in linkages to the EAC CMI and especially the depository, clearing and settlement systems may result in lost opportunities of an integrated market such as economies of scale. However, each EAC Member state will need to put its house in order first.

Mitigation: On 13th March 2019, CDSC and NSE made a joint presentation to the Authority and detailed the planned systems upgrade and the expectations on CMI service delivery improvement. The Authority encouraged this joint approach and will continue to monitor both the CDSC and NSE based on their provided timelines and where necessary take enforcement actions. On the EAC CMI, the Authority continues to consult with the National Treasury and Planning to ensure that integrity in the process of acquisition of a system to link the region's exchanges and Central Securities Depositories is addressed.

2 Key Global Economic and Financial Markets Stability issues

2.1 Hope abounds for the resolution of the trade stand-off between U.S. and China

During the quarter under review, U.S. and China continued to hold negotiations to resolve a trade dispute that started in April 2018 when U.S. filed a request to the World Trade Organization (WTO) in regard to concerns that China was violating international intellectual property (IP) rights, specifically in innovations in robotics and electric cars. According to the U.S., China was doing this by forcing foreign companies to engage in joint ventures with Chinese companies, which then gave Chinese companies access to the use, improvement, copying or having unauthorized access the U.S's technologies. The U.S. has also raised concerns that China has failed to recognize



instituting various non-tariff barriers thus insulating most sectors of the Chinese economy from international competition.

Fig 3: The U.S. Trade Deficit with China

However, in response, China has indicated that it has strengthened its International Property Rights (IPR) protections, while contending that the U.S. has ignored World Trade Organization (WTO) rules and the calls for U.S's own industries to reduce tariffs, in order to discount a perception that U.S. has been pursuing a policy of "unilateralism" and "protectionism".

Global Capital Markets' Reaction

Following indications of a possible resolution of the trade dispute, in the course of the quarter, shares in Asia significantly gained in price. In the latest update on the negotiations, as of end of March 2019, Chinese officials are reported to have made offers regarding forced technology transfers and other major sticking points, raising hopes of a possible trade deal.

Fig.4: market optimism that the ongoing trade war between U.S. & China may be resolved

***Source: WSJ*[4]**

The trade standoff between the two major world economies has been closely watched by investors, due to concerns that if it is not amicably resolved, could lead to an economic slowdown globally, with Kenya feeling the knock-on effects of the persistence of such a standoff.

Trade activity between Kenya and China, U.S.

China - Kenya is a key trading partner with both China and the U.S. Kenya exports mainly goods such as hides, skins, coffee, tea, titanium ores and plastics. From China it imports mainly leather, rubber, machinery and transport equipment and chemicals. But much of the trade is "heavily skewed" in favour of China. In 2017, Kenya's exports to China were valued at $96.88 million, while it imported $3.79 billion in goods[5]. When exports and imports are added together, China was Kenya's largest trading partner in 2017. Overall, Kenya's trade with all other African nations combined is larger than with China, but this is with 54 countries.

U.S. - as of 2017, Kenya was U.S's 92nd largest goods trading partner with $1.0 billion in total (two way) goods trade during 2017. Goods exports totaled $454 million; goods imports totaled $572 million. The U.S. goods trade deficit with Kenya was $118 million in 2017[6]. U.S. exports to Kenya include agricultural products, aircraft parts, and machinery. U.S. imports from Kenya include apparel, coffee, and tea.

Implication: The trade balance position between Kenya and both China and the U.S. is skewed in favour of both countries. An escalation of trade differences between the two major global economic players could lead to an even wider trade deficit for Kenya, because lesser funds would be available to those countries to purchase Kenyan exports. There would also be lower production leading to less demand for relevant Kenyan raw materials.

Mitigation: The Authority will continue to monitor and report on any new developments on these trade negotiations. There is however room to negotiate existing bilateral trade partnerships with each of the two economic superpowers to fill in any voids arising from any measures that they take against one another.

2.2 Global economic update – are we staring at a recession?

A recession is commonly defined as an extended period (a minimum six months or two consecutive quarters) of negative economic growth, leading to a contraction of GDP. The period is dominated by high unemployment, stagnant wages and fall in consumption levels. Generally, a recession does not last longer than one year and is much milder than a depression.

According to the World Bank's Global Economic Prospects report released in January 2019, global growth will decline from 3% in 2018 to 2.9% in 2019 and 2.8% in 2020-21. Also, in its World Economic forecast, the IMF sees global growth falling to 3.5% in 2019, from 3.7% in 2018.

[4] Wall Street Journal

[5] https://africacheck.org/reports/yes-china-is-kenyas-biggest-trading-partner-but-its-not-a-balanced-trade/

[6] https://ustr.gov/countries-regions/africa/east-africa/kenya

Fig 5: Interim Economic Performance Projections of the Countries – 2018 – 2020

OECD Interim Economic Outlook Projections

Year-on-year, %. Arrows indicate the direction of revisions since November 2018.

	2018	2019	2020		2018	2019	2020
World	3.6	3.3 ↓	3.4 ↓	G20	3.8	3.5 ↓	3.7
Australia	2.9	2.7 ↓	2.5 ↓	Argentina	-2.5	-1.5 ↑	2.3
Canada	1.8	1.5 ↓	2.0 ↑	Brazil	1.1	1.9 ↓	2.4
Euro area	1.8	1.0 ↓	1.2 ↓	China	6.6	6.2 ↓	6.0
Germany	1.4	0.7 ↓	1.1 ↓	India[1]	7.0	7.2 ↓	7.3 ↓
France	1.5	1.3 ↓	1.3 ↓	Indonesia	5.2	5.2	5.1
Italy	0.8	-0.2 ↓	0.5 ↓	Mexico	2.1	2.0 ↓	2.3 ↓
Japan	0.7	0.8 ↓	0.7	Russia	2.3	1.4 ↓	1.5 ↓
Korea	2.7	2.6 ↓	2.6 ↓	Saudi Arabia	2.0	2.1 ↓	2.0 ↓
United Kingdom	1.4	0.8 ↓	0.9 ↓	South Africa	0.8	1.7 ↑	2.0 ↑
United States	2.9	2.6 ↓	2.2 ↑	Turkey	2.9	-1.8 ↓	3.2 ↑

1 – Financial year starts in April
Source: OECD

Among the countries that are already in recession are Turkey and Italy as highlighted below:

i. ***Turkey*** – According to the Turkish Statistical Institute, Turkey went into recession at the end of 2018 after its economy shrank by 2.4% in the fourth quarter of 2018, from the previous quarter. This decline followed a 1.6% drop the previous quarter, making two quarters of falling growth. A trade dispute with the US sparked a steep fall in Turkey's currency, making imports far more expensive.

ii. ***Italy*** – According to Italy's Statistics Agency, the Italian economy which is the Eurozone's third largest economy dropped by 0.2% between October and December 2018. This was after a 0.1% decline of the Italian economy's GDP in the three Months to September 2018, putting Italy in recession. This is the third time the country has fallen into recession in a decade[7].

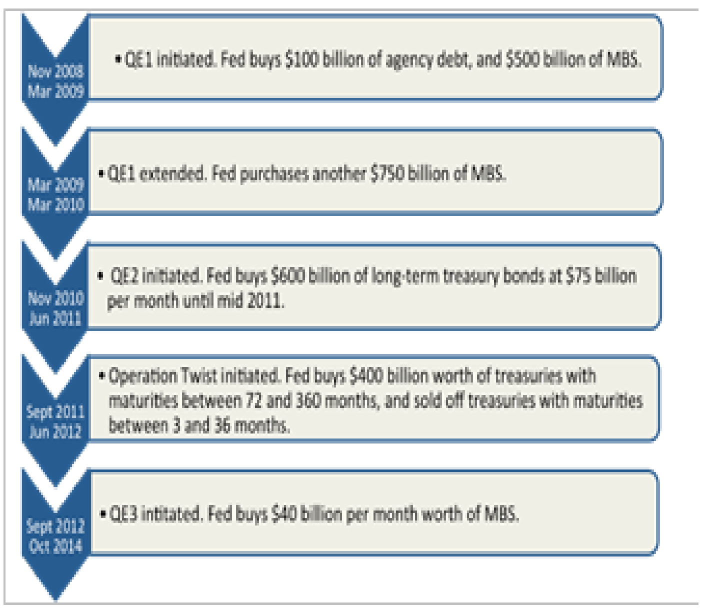
2.2.1 U.S. – is a Recession now more likely?

In the World Bank's Global Economic Prospects report, the US economy is predicted to slowdown from 2.7% in 2018, to 2.5% in 2019 and 1.8% in 2020. At about the same time (January 2019), the Chinese government announced that economic growth in 2019 will be 6.6%, well below the average growth rate of above 8% that has been witnessed in the past 15 years. GDP growth rates in Europe are also anticipated to decline from 1.8% in 2018, to 1.7% in 2019 and 1.6% in 2020.

Quantitative Easing (QE), Quantitative Tightening (QT) and Central Bank actions

The Federal Reserve's efforts to get the U.S. economy out of recession through Quantitative Easing (QE) were active in 2008 - 2014.QE is a policy stimulus in which money is printed then supplied to the economy through the purchase of Government paper or debt. This ultimately increases its supply in circulation while gradually pushing down the interest yield on those instruments and at the same time raising the price of Government securities, due to reduced supply.

Fig 6: U.S. Federal Reserve QE initiatives – 2008 - 2014

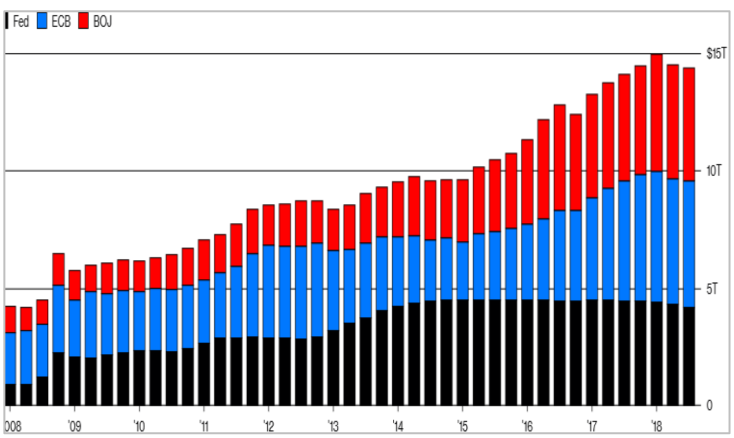


[7] https://www.theguardian.com/world/2019/jan/31/italy-slips-into-recession-for-third-time-in-a-decade-economy

As a response, because they have more liquidity, investors tend to buy investment-grade (higher yielding) corporate bonds instead of Government bonds. QE therefore ends up amplifying risk appetite, because investors have more funds to deploy in higher-yield securities in place of Government securities paying a relatively lower yield[8].

Quantitative Tightening (QT) is the opposite of QE. Instead of buying bonds, the Central Bank sells them. Its intended effect is the opposite of QE. In the wake of the Financial Crisis, the U.S. Federal Reserve took two actions to reinvigorate the U.S. economy, that is, by cutting interest rates to zero percent and providing more liquidity by printing money to buy U.S. securities. Due to the QE effort that commenced in 2008, the size of the Federal Reserve's balance sheet increased substantially, from about USD$ 1.5 trillion in 2008 to $4.5 trillion by 2014.

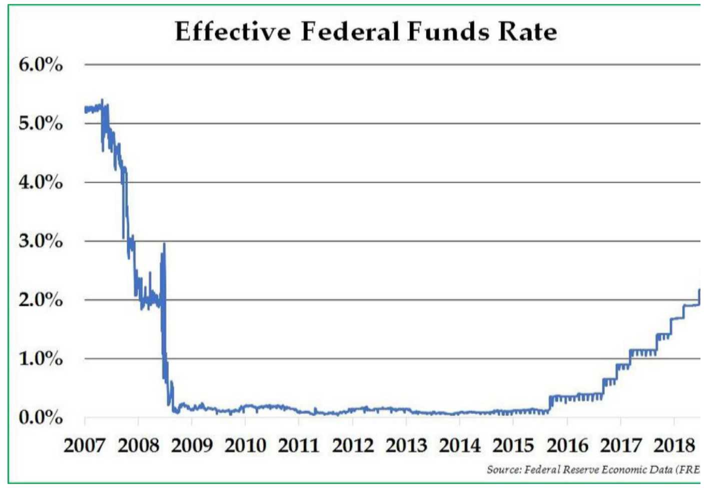
Fig 7: Assets held by the U.S. Federal Reserve, European Central Bank and Bank of Japan, quarterly



Source: Bloomberg[9]

By the end of 2015, the Federal Reserve had gradually begun to hike interest rates as a way of weaning world markets out of the QE stimulus, to normalize policy by aiming to reduce excess liquidity.

Fig 8: The effective Federal Funds rate (2007 – 2018)



Source: Forbes

in high-risk assets like corporate debt started to pull their funds out, driving down leveraged asset prices and increasing interest cost for corporations that had hitherto been issuing debt to buy back stock. This was exemplified ne significant negative reaction as evidenced by the ormance of the S&P 500 Index generating a total rn of -9.0% in December, which was the worst ember return since 1931 in the midst of the Great ression[10].

quarterly return of the S&P 500 Index was -13.5%, esenting the worst fourth-quarter return since 2008, h was in the midst of the Financial Crisis.

onding to the lower U.S. capital market performance numbers towards the end of 2018, on 20th March 2019, the Fed brought a three-year rate-hike cycle to an end,

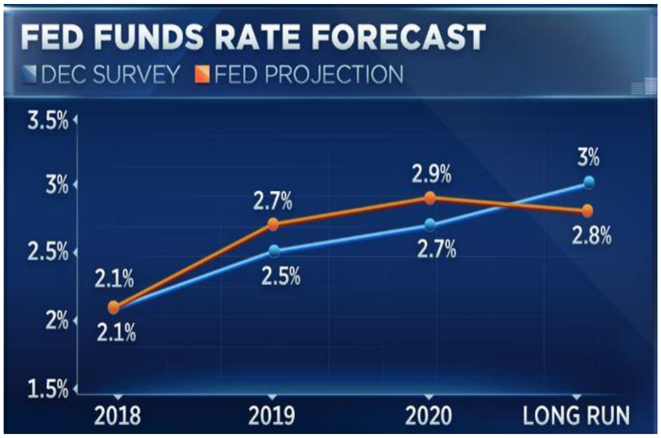
[8] https://moneyweek.com/502517/what-the-end-of-quantitative-tightening-means-for-markets/

[9] https://www.bloomberg.com/news/articles/2018-07-09/after-years-of-easing-meet-quantitative-tightening-quicktake

[10] https://www.forbes.com/sites/adamstrauss/2019/01/22/with-quantitative-tightening-asset-price-deflation-has-arrived-time-to-sell/#6074546469d0

abandoning projections for any further increases in borrowing costs in 2019, promising that it would stop shrinking its bond holdings in September 2019.

Fig 9: Fed Funds Rate Forecast – 2018 - 2020



Source: CNBC[11]

The Fed indicated that it expects the benchmark rate to stay near 2.4 percent by the end of 2019, slashing its forecast from 2 hikes for the year to zero. The Fed indicated that its benchmark rate will approach 2.6 percent in 2020 and remain at that level through 2021. In the longer run, the central bank expects rates to rise to 2.8 percent.

The reasoning behind the raising of interest rates by Central Banks after QE has been that raising rates in anticipation of the next recession provides Central Banks with an economic management tool in the form of the ability to cut rates when a recession eventually occurs after QE. If QE continues without tapering it with QT, in case the economy overheats in the middle of a QE stimulus, the economy can easily transition into crisis mode, with Central Banks having little control on the resultant spiral. As a further sign that the U.S economy is headed for a recession, in late March 2019, the yield on the U.S. 10-year Treasury note fell below the yield on the 3-month note. In a normal market environment, the yield is upward sloping, given that bond investors are likely to get higher rates in a longer-term market environment than in the short term.

This is due to the fact that perceived risk in a longer-term environment is higher. Occasionally, when investors are pessimistic about the longer term, this yield curve starts to get inverted, meaning longer-dated notes give lesser yields than shorter-dated notes- leading to the yield curve becoming inverted. The U.S. yield curve considered a barometer of economic sentiment in the U.S. got inverted for the first time on 22nd March 2019, since mid-2007.

Lessons:

i. Key indicators, chief among them, the inversion of the U.S. yield curve point to the U.S. economy having a slackening of GDP growth in the short-to-medium term;
ii. In the U.S a significant decline in the S&P 500 Index (like it happened in December 2018) would result in a policy reversal to turn-around the situation. Capital markets are therefore a key barometer that guides Central Bank's policy actions;
iii. Depending on the state of the economy, QE or QT are usually interchanged, to manage an economy that is usually at risk of falling into an economic crisis;
iv. QE/QT in some developed economies has an impact on Emerging markets -When borrowing becomes cheap, investors usually direct excess funds into high risk, high reward assets. This was the case when QE was effected, with some capital moving from the U.S. to 'riskier' emerging markets, leading to economically strengthened emerging market economies, and their currencies. However, when the Fed announced the QE taper, these funds started returning back

[11] https://www.cnbc.com/2017/12/11/fed-survey-tax-cuts-and-rate-hikes-on-the-way.html

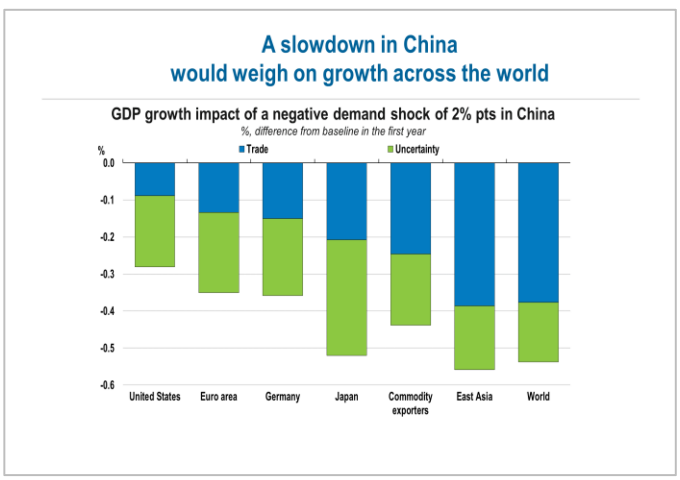
to the U.S., leaving many emerging economies with volatility.

Mitigation: Given that the performance of stock markets is usually a barometer of the state of the economy, the Authority recommends that CBK should regularly monitor and detect signals from capital markets early enough, to pursue a particular policy action to get the economy out of crisis. It also calls upon greater cooperation between the CMA and CBK in formulating policy interventions

2.3 China – GDP growth slows

China which has been generating about one-third of global growth in recent years registered slower GDP growth in the fourth quarter of 2018 at 6.4 per cent, its slowest pace since 1990, amid lower domestic performance and external headwinds instigated by a trade dispute with the U.S. The country's 2018 full-year growth was down to 6.6 percent, the slowest annual pace since 1990. China's GDP in 2017 grew by a revised 6.8 percent.

Fig 10: Impact of a 2 percent negative demand shock on World Trade

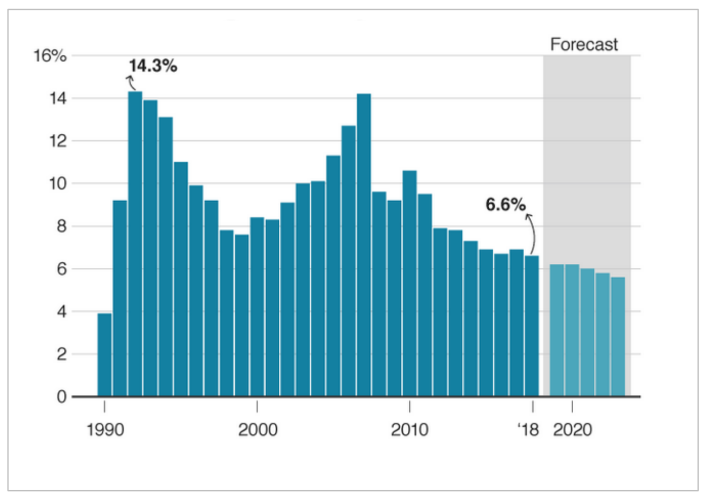


Source: OECD

In recent months, the country has introduced a range of monetary and liquidity measures to support growth. In January 2019, the People's Bank of China reduced bank reserve requirement ratios for the fifth time in a year. Earlier, it had also raised bank lending quotas, particularly with regard to lending to small and micro enterprises, in an effort to stimulate credit growth. In addition, restrictions on local government bond issuances were eased to boost infrastructure investment[12].

In the three months to December 2018, the Chinese economy grew by 6.4%, down from 6.5% in the preceding quarter. Given the country's significance to the global economy, China's rate of growth will continue to be an issue of major concern, given the likely knock-on effect that could be felt by the global economy, especially if the country's GDP continues to be on a declining trend as indicated in projections.

Fig 11: China's growth and projections (2018 – 2020)



ource: IMF

.essons: Even as China's GDP growth slows, increasingly Kenya's trade relations with China have been strengthening. Given China's influence in the global

12 https://www.un.org/development/desa/dpad/publication/world-economic-situation-and-prospects-march-2019-briefing-no-124/

economy therefore, Kenya needs to actively monitor and negotiate favorable trade relations with China.

2.4 Africa – major economies stabilizing

A key highlight for Africa is that the Africa-China economic ties appear to be strengthening. China is now Africa's single largest trading partner, importing 86% of the continent's oil, gas and minerals. The main countries supporting the continent's growth namely; Nigeria, South Africa and Angola appear to be stabilizing after a tumultuous 2018.

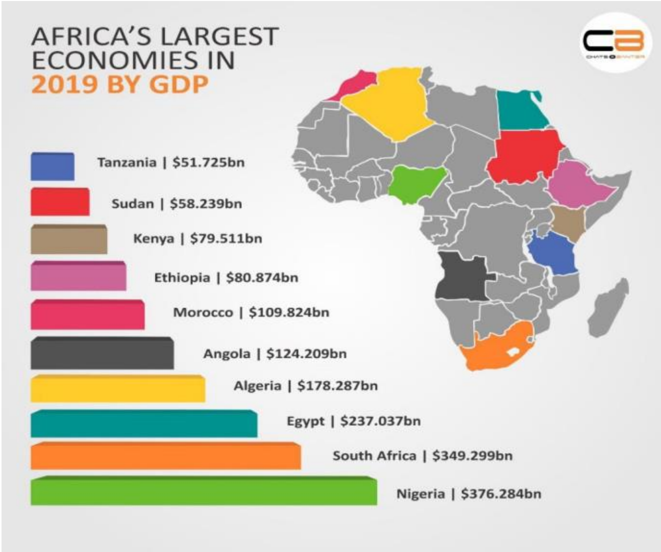
Table 1: Capital Markets in Performance in Africa

Selected Markets	Index Name	Index Level	Year-To-Date returns			
			Local (%)	USD (%)	EUR (%)	Date
Botswana	BSE DCI	7,885.57	+0.43	-0.06	+1.96	29-Mar
BRVM	BRVM-CI	174.50	+1.31	-0.87	+3.36	29-Mar
Egypt	EGX 30	14,665.81	+12.50	+16.29	+18.66	28-Mar
Ghana	GSE-CI	2,454.51	-4.58	-12.60	-10.90	29-Mar
Kenya	NSE ASI	157.66	+12.27	+13.44	+15.73	29-Mar
Malawi	MSE ASI	27,303.65	-5.80	+1.10	+3.29	29-Mar
Mauritius	SEM ASI	1,984.38	-2.08	-3.85	-1.93	29-Mar
Morocco	MASI	10,912.23	-3.98	-4.99	-3.09	29-Mar
Namibia	NSX OI	1,324.10	+1.33	-0.25	+1.76	29-Mar
Nigeria	NGSE ASI	31,041.42	-1.24	+0.13	+2.16	29-Mar
Rwanda	RSE ASI	124.81	-3.08	-6.04	-3.87	29-Mar
South Africa	JSE ASI	56,462.55	+7.06	+6.06	+8.27	29-Mar
Tanzania	DSE ASI	2,060.29	+0.93	+0.26	+2.28	29-Mar
Tunisia	TUNINDEX	6,861.49	-5.64	-8.01	-6.15	29-Mar
Uganda	USE ASI	1,754.81	+6.39	+6.29	+8.50	28-Mar
Zambia	LuSE ASI	5,599.94	+6.70	+4.72	+6.84	29-Mar
Zimbabwe	ZSE Ind.	405.57	-16.74	-16.74	-15.06	29-Mar

Source: https://www.african-markets.com/en/stock-markets

Nigeria's recovery is now gathering pace, with Angola in the process of exiting from a three-year recession. Also, there is modest growth in South Africa, supported by higher domestic capital spending and a favorable price outlook for energy exports.

Fig 12: Africa's Largest Economies



chatsandbanter.com

2.4.1 The African Continental Free Trade Area (AfCFTA) takes shape

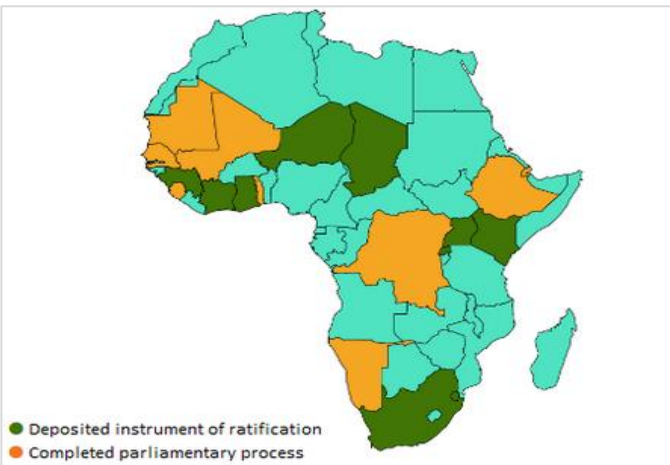
In its 18th Ordinary Session of the Assembly of Heads of State and Government of the African Union, held in Addis Ababa, Ethiopia in January 2012, the AU adopted a decision to establish a Continental Free Trade Area (CFTA) by an indicative date of 2017. The Summit also endorsed the Action Plan on Boosting Intra-Africa Trade (BIAT) which identifies seven priority action clusters: trade policy, trade facilitation, productive capacity, trade related infrastructure, trade finance, trade information, and factor market integration[13].

Between 17th and 21st March 2018, the AU Heads of State and Government held an Extraordinary Summit on

[13] https://www.tralac.org/resources/our-resources/6730-continental-free-trade-area-cfta.html

AfCFTA in Rwanda. At the summit, the agreement establishing the AfCFTA was presented for signature, along with the Kigali Declaration and the Protocol to the Treaty Establishing the African Economic Community relating to the Free Movement of Persons, Right to Residence and Right to Establishment. In sum, 44 out of the 55 AU member states signed the consolidated text of AfCFTA, 47 signed the Kigali Declaration and 30 signed the Protocol on Free Movement. As at end-March 2019, only three countries have yet to sign the consolidated text of the AfCFTA Agreement: Benin, Eritrea and Nigeria.

Fig 13: State of implementation of AfCFTA – February 2019



Source: Tutwa Consulting Group

AfCFTA's entry into force. This means that only 4 more countries have to deposit their instruments of ratification with the AU Chairperson to reach the 22-member threshold. Thirty (30) days after this threshold is reached, the AfCFTA will enter into force.

The 19 countries that have deposited their instruments of AfCFTA ratification with the AUC Chairperson are Ghana, Kenya, Rwanda, Niger, Chad, Congo Republic, Djibouti, Guinea, eSwatini (former Swaziland), Mali, Mauritania, Namibia, South Africa, Uganda, Ivory Coast (Côte d'Ivoire), Senegal, Togo, Egypt and Ethiopia. The three countries that have obtained parliamentary approval for ratification but still need to deposit their instruments of ratification with the depositary are Sierra Leone, Zimbabwe, and the Gambia.

Implications of AfCFTA

i. Creation of a single continental market for goods and services, will allow free movement of persons and investments and thus pave the way for accelerating the establishment of the Continental Customs Union and the African customs union.
ii. When fully implemented, AfCFTA will lead to expansion of intra-African trade through better harmonization and coordination of trade liberalization and facilitation regimes and instruments across Regional Economic Blocks and across Africa in general.
iii. Resolving the challenges of multiple and overlapping memberships and expediting the regional and continental integration processes would lead to closer integration.
iv. AfCFTA could lead to enhancement of competitiveness at the industry and enterprise level through exploiting opportunities for scale production, continental market access and better reallocation of resources.

Mitigation

i. Kenya may leverage on the Treaty to drive the achievement of the "Big 4" Agenda which could also widen its export market size for more rapid growth;
ii. The continental free trade area will provide Kenya with a greater negotiating power for Africa, thus assisting in better trading terms with the rest of the world.

2.4.2 *Ethiopia's rapid GDP growth – What are the contributing factors and what can Kenya learn?*

Ethiopia is the second most populous nation in Africa after Nigeria, with over 102 million people (2016) and the fastest growing economy in the Eastern Africa region. The country has an ambition of reaching lower-middle-income status by 2025. The latest International Monetary Fund (IMF) Economic Outlook for Africa, predicts that Ethiopia's economy is forecast to grow at 8.5% in the financial year to 7th July 2019.

The main sources of the country's economic performance are services and agriculture sectors. According to World Bank estimates, 50% of the 10.8% average annual growth recorded by Ethiopia between 2004 and 2014, came from services, specifically, hospitality and transportation. Agriculture, meanwhile, accounted for 3.6% of the growth during the period.

According to IMF projections, Ethiopia will have the highest GDP growth in 2019 though it will be slightly lower than its current GDP. In 2019, Ethiopia's GDP is expected to be at 8.3 percent, a slight dip from the current 8.5 percent[14].

Some of the key factors responsible for the country's rapid growth include:

i. A rising middle class;
ii. A vast population and cheap workforce;
iii. Shift from recurrent to capital expenditure that has

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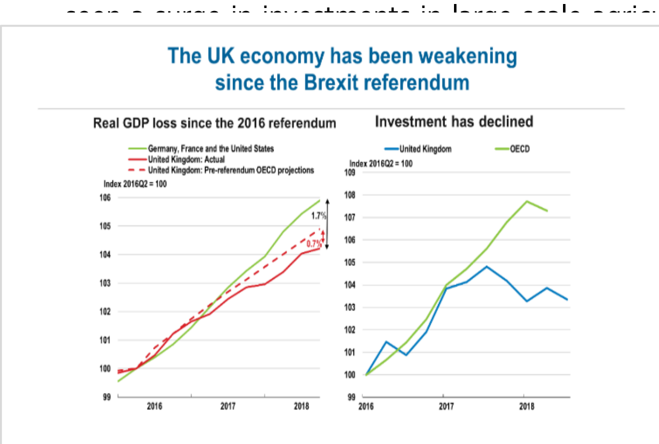
viii. An increasingly educated population; and
ix. Investments from China that have gone to productive sectors.

Lessons: As a way of facilitating faster growth, Kenya should target to increasingly apply a significant portion of collected revenues towards development. While we continue to vouch for Public Private Partnerships (PPP) the Government of Kenya should also play a key role in promoting economic development.

2.5 *Brexit – Is an inter-parties' consensus a possibility?*

The UK held referendum on Thursday 23rd June, 2016, to decide whether or not, it should leave or remain in the European Union (EU). The majority vote supported a Britain Exit (Brexit) by 51.9% against 48.1% who supported UK's EU membership. The referendum turnout was 71.8%, with more than 30 million people voting. Subsequently, as was the requirement, the UK invoked Article 50 of the Lisbon Treaty which gives the two sides two years to agree the terms of separation on 29 March, 2017. The UK was therefore scheduled to leave EU as a member at 11pm UK time on Friday, 29 March 2019. However, this did not happen. Instead, the UK requested and was granted more time to make a decision on the Brexit deal – a document that would define the future relationship between EU and UK.

Fig. 14: Status of the UK Economy since Brexit



Source: OECD

The deal is a legal text that lays out the management of the transition after the UK officially leaves the EU, how much the UK must pay the EU when it leaves, what happens to EU citizens living in the UK and vice versa and the so-called "Irish backstop" that prevents a hard border[15] between Northern Ireland (part of the UK) and the Republic of Ireland (an EU member state) after Brexit. Since the Brexit vote, the UK has lost about 0.7 percent of its GDP following the rejection in the past two attempts to pass the withdrawal deal, on request by the UK, the EU granted the UK an extension until 12th April 2019. It is however not clear if there can be a request for another extension request before April 12th, 2019.

The bone of contention

The main challenge currently facing Brexit is the British Parliament's inability to reach a consensus on the options of Brexit it wants to adopt. Out of all the options presented before it, no option won a clear majority. A plan for a second referendum, in which any Brexit deal approved by Parliament would go back to the public for a vote, received the most votes[16].

Table 2: Brexit Options and their Implications

	Option	Implications
1.	No-deal Brexit	Crashing out of the EU without any agreement or transition period in place. It is the default option on April 12 if no deal is approved. This option was defeated 160-400.
2.	Common market 2.0 (also known as 'Norway Plus')	UK and the EU to have very close economic ties. The model for this is Norway, which is not an EU member but has access to the EU single market (free movement of goods, capital, services, and people). The 'plus' is because this would also mean joining a customs union. This option was voted down, 188-283.
3.	Norway Option	The same as the plan above, but without the plus, which means no customs arrangement. This option was defeated 65-377.
4.	Customs Union	The UK would follow all the EU customs rules. This was the most popular option. 264 supported it while 272 did not.
5.	Labour Party Option	Customs union membership, but with the ability for the UK to make its own trade agreements while aligning itself with the single-market rules. Close cooperation in specific areas like security. The option was defeated 237 to 307.
6.	Revocation of Article 50	Stop Brexit if the UK does not have a deal two days before the deadline and if Parliament agrees it does not want to leave the EU without a deal. This option lost 184 to 293.
7.	Second Referendum	Any Brexit deal approved by Parliament to go for a vote. This option got the most "yes" votes. It was however defeated 268 to 295.
8.	A managed 'No Deal'	The option is similar to that already rejected by EU. It provides for UK leaving the EU without a deal. Despite the there being 'No Deal' there would still be a transition period to negotiate some free trade agreements. This option was defeated 139 to 422.

Source: Vox.com

[15] a border between countries that is strongly controlled and protected by officials, police, or soldiers, rather than one where people are allowed to pass through easily with few controls

[16] 019/3/28/18284470/brexit-parliament-indicative-votes-theresa-may-deal

A customs union arrangement, where the UK would follow the same customs rules as the EU, came in second. Overall, so far, it has not been clear how the UK would want to address the Brexit debacle, with the latest being a request to EU to delay the official day of Brexit.

Towards the end of the quarter, there were plans by British Prime Minister Theresa May to meet opposition leader Jeremy Corbyn in an attempt to break the impasse over Brexit. The objective would be to have cross-party talks so as to arrive at a mutually acceptable agreement on the UK's withdrawal from the European Union.

Key observations

i. Unless brought to an abrupt stop through cancellation, Brexit appears to be a long-running challenge that will possibly extend well into mid 2020s[17] even as the engagements to find the best option continue.

ii. Britain is losing many companies that had their headquarters in London[18]

   a) US banks Goldman Sachs, JPMorgan, Morgan Stanley, and Citigroup have moved 250 billion euros ($283 billion) of balance-sheet assets to Frankfurt because of Brexit;

   b) Bank of America is spending $400 million to move staff and operations in anticipation of Brexit, and is trying to persuade London staff to move to Paris;

   c) Barclays last week won permission to shift assets worth £166 billion ($216 billion) to its Irish division. Barclays is set to become Ireland's biggest bank;

   d) France's BNP Paribas, Credit Agricole, and Societe Generale have opted to transfer 500 staff out of London to Paris;

   e) UBS has chosen German financial center Frankfurt for its new EU headquarters;

   f) Swiss peer Credit Suisse is moving 250 jobs to Germany, Madrid, and Luxembourg among other EU 27 countries as well as $200 million from its market division to Germany. And in December Credit Suisse told its wealthiest clients to hurry and move their money out of the UK before Brexit;

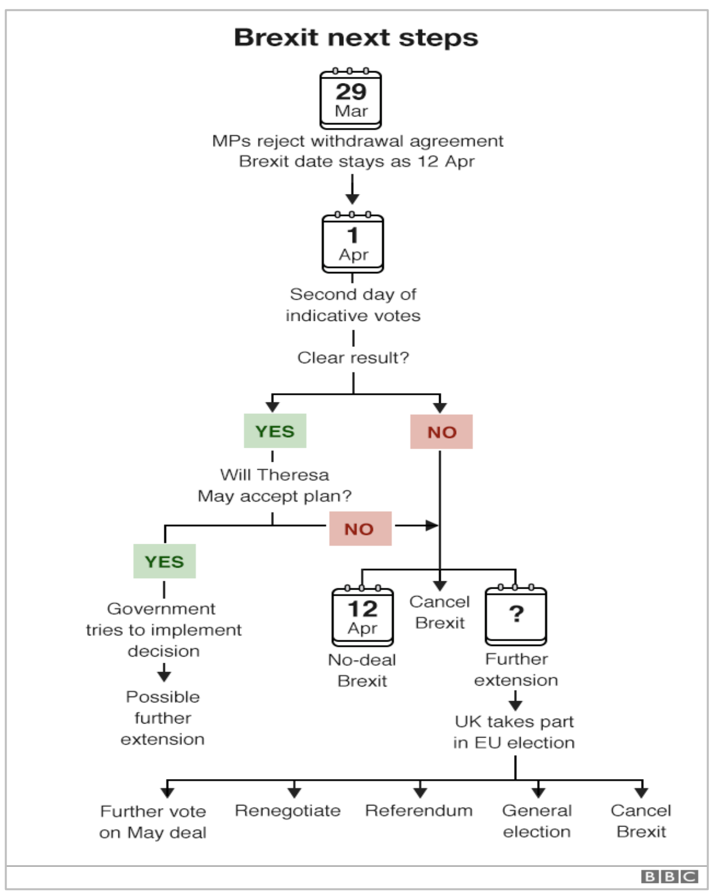
   g) HSBC, Europe's biggest bank, has shifted ownership of many of its European subsidiaries from its London-based entity to its French unit;

   h) Australia's largest bank by assets, Commonwealth Bank of Australia, has set in motion plans to base around 50 staff in Amsterdam, and has applied for a banking license in the country;

   i) Europe's biggest repo trading venue - BrokerTec, is being moved to Amsterdam from London, meaning a $240 billion a day repo business is leaving the UK; and

   j) More than 100 UK-based asset managers and funds have applied to the Irish central bank for authorization in Ireland.

Fig 15: Brexit – Summary of possible next steps



[17] https://www.ft.com/content/64e7f218-4ad4-11e7-919a-1e14ce4af89b

As a result of these actions, the UK Government's tax revenue will likely reduce resulting in less job opportunities, less international deals, thus shaving part of the shine in the City of London as an international financial centre and also ultimately adversely impacting on the UK's GDP figures.

Lessons: Irrespective of whether or not it will eventually leave the EU, the current uncertainty on Brexit will continue to adversely impact London's and by extension, UK's potential as an International Financial Centre (IFC). Uncertainty is therefore a significant risk that should be avoided for countries (including Kenya) aspiring to become financial hubs.

2.6 Global Capital Markets Performance

Table 3: Capital Markets Performance in the Americas

Name	Value	Net Change	% Change	1 Month	1 Year	Time (EDT)
DOW JONES IND. AVG.	25,928.68	+211.22	+0.82%	-0.38%	+7.57%	Mar.2019
S&P 500 INDEX	2,834.40	+18.96	+0.67%	+1.10%	+7.33%	Mar.2019
NASDAQ COMPOSITE INDEX	7,729.32	+60.16	+0.78%	+1.76%	+9.43%	Mar.2019
NYSE COMPOSITE INDEX	12,696.88	+64.30	+0.51%	-0.03%	+1.97%	Mar.2019
S&P/TSX COMPOSITE INDEX	16,102.09	-53.40	-0.33%	+0.21%	+4.78%	Mar.2019

Table 4: Capital Markets Performance in Europe & Middle East

Name	Value	Net Change	% Change	1 Month	1 Year	Time (EDT)
Euro Stoxx 50 Pr	3,351.71	+31.42	+0.95%	+1.20%	-0.29%	Mar.2019
FTSE 100 INDEX	7,279.19	+44.86	+0.62%	+2.43%	+3.15%	Mar.2019
DAX INDEX	11,526.04	+97.88	+0.86%	-0.65%	-4.72%	Mar.2019
CAC 40 INDEX	5,350.53	+53.99	+1.02%	+1.62%	+3.55%	Mar.2019
IBEX 35 INDEX	9,240.30	+65.60	+0.72%	-0.30%	-3.75%	Mar.2019

Table 5: Capital Markets in Perfomance in Asia Pacific

Name	Value	Net Change	% Change	1 Month	1 Year	Time (EDT)
NIKKEI 225	21,205.81	+172.05	+0.82%	-1.84%	-1.16%	Mar.2019
TOPIX INDEX (TOKYO)	1,591.64	+8.79	+0.56%	-1.49%	-7.26%	Mar.2019
HANG SENG INDEX	29,051.36	+276.15	+0.96%	+0.83%	-3.46%	Mar.2019
CSI 300 INDEX	3,872.34	+143.94	+3.86%	+3.27%	-0.67%	Mar.2019
S&P/ASX 200 INDEX	6,180.73	+4.65	+0.08%	-0.19%	+7.32%	Mar.2019
MSCI AC ASIA PACIFIC	159.81	+1.26	+0.79%	+0.46%	-7.50%	Mar.2019

Source: Bloomberg

3 EAC Regional Integration – are the challenges a significant threat?

Since it was revived on 30th November 1999 and came into force on 7th July 2000, the EAC has registered marked progress in improving trade within the member countries. However, recent political and trade disputes have stifled the implementation of the EAC protocol. Below is a highlight of the disputes.

3.1 The Rwanda - Uganda Stand-off – What does it mean for the EAC region?

The stand-off between Uganda and Rwanda who are East Africa Community (EAC) member states has been simmering for years but worsened in February 2019 when

Rwanda closed its border with Uganda, mainly the Gatuna border post, in reaction to alleged activities of the Ugandan Government. Publicly, Rwanda has indicated that:

i. Rwandans have been arrested, tortured, and harassed in Uganda, with some of them getting deported for unknown reasons;
ii. Uganda is involved in providing safe haven and significant support to armed dissidents opposed to the government of Rwanda, with an allegation that such groups have carried out criminal activity in Rwanda;
iii. There has been a challenge relating to the free movement of Rwandan goods across Ugandan territory.

These allegations have been denied by the Ugandan government; with Uganda expressing regret with regard to the third accusation, whilst committing to addressing any trade related issues.

3.2 Rwanda and Burundi political dispute

Since 2015, Rwanda and Burundi have been trading accusations bordering on security breaches. On June 19th 2018, relations between the two countries deteriorated further, after an attack in Rwanda's Southern Province, with Rwanda alleging that it was carried out by Burundian security agencies. Further, Rwanda has been complaining about Burundi's actions - which include a blockage of the movement of goods and passenger vehicles across the border, indicating that this is a violation of the Common Market Protocol. Burundi has already filed multiple reports to the EAC, the United Nations and the African Union, accusing Rwanda of supporting rebels opposed to the current Burundi government.

Burundi has also issued a ban on food exports to Rwanda and closed down the offices of bus companies operating between the two countries. In 2018, some Rwandan traders fled Burundi fearing for their safety while others were forced out in a purge[19]. The trade flow between the two countries has also suffered, with the Rwanda Institute of Statistics showing that neither country has imported or exported to the other since 2016.

3.3 The Coalition of the willing – is it still feasible?

In 2013, Kenya agreed with Uganda and Rwanda to form a 'coalition of the willing' (CoW) arrangement, leading to the initiation of infrastructure, telecommunication, defense and tourism-promotion projects in East Africa's Northern Corridor. The Northern Corridor links Kenya, Uganda and Rwanda and gives the two landlocked countries as well as the eastern Democratic Republic of Congo (DRC) and South Sudan access to the sea through the port city of Mombasa. Among the projects earmarked for implementation included;

i. A USD 13 billion high-speed standard gauge railway to connect the three nations in the shortest time possible.
ii. Uganda, to construct an oil pipeline through Kenya to Lamu Port at a cost of $5 billion. The plan seems to have been abandoned, with Uganda and Rwanda opting out of the oil pipeline and rail line respectively. However, recent developments indicate that Uganda is now supportive of the SGR project.

Key observations

i. Itself a member of the EAC states, Rwanda is now in a political standoff with two of its fellow EAC member countries. This implies that during the time the standoff will be persisting, the progressive implementation of the EAC protocol will be facing significant challenge;

[19] https://www.theeastafrican.co.ke/news/ea/No-end-to-Rwanda-Burundi-spat/4552908-4728838-huhf8w/index.html

ii. Given the importance of these EAC member states to it, Kenya has already expressed concern that a prolonged diplomatic row between the two could significantly hurt trade. Uganda controls about 73 per cent market share of transit cargo at the Mombasa facility, South Sudan accounts for about 10.6 per cent share, DR Congo (5.7%), Rwanda (3.3%) Tanzania (2.6%) and Burundi (1.1%)[20];

iii. Going by recent developments, Kenya is now too deep into the EAC integration especially through the Northern Corridor projects. Ken-Exit is therefore unlikely in the medium term. The optimal option would be for the country to lay strategies for utilizing the EAC protocol agreement to improve its Balance of Payments (BOP) position;

iv. Old regulations restricting movement of goods, capital, and people are still in the law books of some countries, while fresh restrictions are being brought in through legislation or administration, further impeding EAC regional integration[21].

Lessons: Any kind of standoff within a region takes away trust and goodwill within the region. Whether it is the Rwanda-Uganda standoff, the Rwanda- Burundi Tiff or the Brexit challenge. A prolonged standoff usually leads to realignments and complications in negotiating integration agreements.
All efforts should be made to prevent simple trade or political tiffs from escalating further because they may significantly harm regional harmony.

Mitigation: The Authority will continue to monitor and update stakeholders on the key developments in resolving these standoffs given the heavy portfolio of investments in Kenyan capital markets by the country's regional trading partners.

4 Domestic Economy

Key Economy Indicators

4.1 Gross Domestic Product (GDP)

According to the Kenya National Bureau's Statistics recently released Economic Survey2019, Kenya's Real Gross Domestic Product (GDP) is estimated to have expanded by 6.3 per cent in 2018 compared to 4.9 per cent in 2017.

The growth was attributable to increased agricultural production, accelerated manufacturing activities, sustained growth in transportation and vibrant service sector activities. Agricultural activities benefitted from sufficient rains that were well spread throughout the country. Other factors cited include increased precipitation which is reported to have significantly boosted electricity generation and consequently favorable to growth during the review period.

The Agriculture, Forestry and Fishing sector growth accelerated from a revised growth of 1.9 per cent in 2017 to 6.4 per cent in 2018. The manufacturing sector is reported to have expanded by 4.2 per cent compared to a revised growth of 0.5 per cent in 2017 mainly buoyed by increased agro-processing during the review period.

Other sectors reported to have grown notably in 2018 include Electricity Supply, Transportation and Storage, Information and Communication Technology, Accommodation and Food Services at 10.5, 8.8, 11.4, 16.6 per cent, respectively in 2018.

[20] https://www.trademarkea.com/news/kenya-news/why-kenya-is-threatened-by-uganda-rwanda-standoff/

[21] The East African Common Market Scorecard 2014

4.2 *Inflation*

According to the most recent publication on Consumer Price Indices and Inflation Rates for March 2019 by Kenya National Bureau of Statistics, the overall year-on-year inflation stood at 4.35 % in March 2019, a 0.56% decrease from 4.70% recorded in January. Between January and February 2019, Food and Non-Alcoholic Drinks' Index increased by 1.70 per cent.

Between February and March 2019, Food and Non-Alcoholic Drinks' Index increased by 3.30 per cent. The increase is mainly attributed to drought conditions causing the costs of some foodstuffs to be higher than in February 2019. However, prices of some food items were lower in March 2019 compared to March 2018. The Housing, Water, Electricity, Gas and Other Fuels' Index, decreased by 0.06 per cent in March compared to February 2019. This resulted from lower cost of electricity which outweighed increase in house rents and cooking fuels.

4.3 *Exchange Rate*

Table 6: KES Exchange Rate Performance

Currency	Mar-17	Mar-18	%Δ	Mar-18	Mar-19	%Δ
US DOLLAR	103.0	100.8	2.1%	100.8	100.7	0.1%
STG POUND	128.8	142.3	10.5%	142.3	131.8	7.3%
EURO	110.6	124.7	12.8%	124.7	113.1	9.4%
SA RAND	8.0	8.6	7.3%	8.6	6.9	20.0%
KES/USHS	35.1	36.5	4.1%	36.5	36.9	1.2%
KES/TSHS	21.7	22.4	3.3%	22.4	23.1	3.1%
KES / RWF	7.9	8.6	7.7%	8.6	8.9	4.3%
KES / BIF	16.6	17.5	**5.3%**	17.5	17.9	**2.7%**

Note: Red (Currency Depreciation); Green (Currency Appreciation)
Source: CBK

Fig 16: Exchange Rate fluctuation (KES vs USD)

4.4 *Interest Rates*

In the latest sitting of the Central Bank of Kenya's Monetary Policy Committee (MPC), the CBK held its benchmark interest rate unchanged at 9 percent, indicating that domestic macroeconomic stability, sustained optimism on the economic growth prospects were holding despite the delayed onset of the long rains in parts of the country, a gradual rise in international oil prices and the weakening of global growth. Interest Rate in Kenya averaged 13.80 percent from 1991 until 2019, reaching an all-time high of 84.67 percent in July of 1993 and a record low of 0.83 percent in September of 2003.

Also, in a ruling in March 2019, Kenyan courts determined that a section of the Banking Amendment Act 2016 that gives the Central Bank of Kenya authority to set interest rates disrupts the existing relationship between banks and their customers. The courts opined that Section 33(b)1 and 2 had been suspended for a period of 12 months to give National Assembly an opportunity to reconsider the existence of the provisions.

Further, to improve SMEs' access to credit, the Kenya Government recently announced plans to launch a Credit

Guarantee Scheme (CGS)[22]. The initiative is aimed at countering depressed credit advancing to SMEs in light of the interest rate capping regime.

Implications:

i. So long as the rates charged do not become overly prohibitive, once effected a review of the interest rate cap, will be a welcome move. It is worth noting though, that the Consumer Federation of Kenya (COFEK) has filed an appeal challenging the judgement of the High Court ruling;

ii. Once launched, if properly managed, a CGS will ease the burden on SMEs of having to meet stringent provisions to access credit.

Mitigation: The Authority will continue to monitor and update on developments in the interest rates field so as to highlight the risks and opportunities available to capital markets arising from upcoming policy decisions.

5 New Developments during the quarter

5.1 *Listed companies issue Profit Warnings*

15 publicly traded firms have already issued profit warnings in the period to December 2018, indicating that their earnings will fall by at least 25 percent over the previous financial year. The diminished earnings signal a possible worse performance in 2018 than in 2017.

Implication: Although it is projected that the economy will be growing at an average 6% during the year, the reported slowdown in performance of listed companies will likely affect the performance of capital markets in the Short to medium-term.

5.2 *The Authority penalizes some market players for Market misconduct*

The Authority (CMA) fined a former CBA Capital executive a total of Sh166.9 million for engaging in front running of clients in Treasury bonds between 2016 and 2017. The financial penalty levied was twice the amount of benefit that the former Commercial Bank of Africa Executive received from the irregular trading in the fixed income securities that CMA indicated amounted to Sh83.4 million.

Also, in an insider trading case, the Authority seized KES 458 million related to suspicious trades that were initiated through 14 accounts that were frozen in October 2018 when the buyout of KenolKobil was announced. The funds surrendered related to 90 percent of the quantum of suspicious trades identified. The recovered funds have been paid into the Investor Compensation Fund.

Implication: The Authority has sent a strong deterrence signal to those keen using publicly unavailable information or through abusing their privileged position to trade capital market securities.

5.3 *Another stab at M-Akiba attracts 79% subscription*

In February 2019, the Government opened a third offer of the M-Akiba bond, seeking to raise Kshs. 250 million. Following the expiry of the period of offer, the bond raised Kshs.197 million. This was a 79% subscription rate that attracted 82,829 new registrations.

The bond will be redeemed on September 7, 2020 and will have three interest payments dates; September 9, 2019, March 9, 2020 and September 7, 2020.So far, the government has paid out interest worth Ksh59.67 million, the Central Depository and Settlement Corporation (CDSC) which pays the interest on behalf of the state, said.

[22] A form of intervention to improve access to finance for SMEs by providing third-party credit risk mitigation to lenders by absorbing a portion of the losses on the loans made to SMEs in case of default, in return for a fee.

5.4 Kenya's capital expenditure requirements expected to rise

Kenya is currently weighing the possibility of returning to the international debt market for a planned $2.5 billion Eurobond, partially to help settle maturing debt obligations. Noting the aggregate costs of projects under the Medium Term Plan III and by extension the "Big 4 Agenda", together with County funding requirements, estimated at Kshs 13 trillion over the next 5 years as against Budget Policy Statement 2019/2020 Projections of 12.5 Trillion, there is likely to be a Kshs 0.5 trillion funding gap. Given that KRA has not been meeting its revenue collection targets and coupled with the fact that a sizeable portion of Government revenue is being used to service existing debts as mentioned above, we expect the actual gap to be wider. While there are various mechanisms for bridging this gap such as equity financing, Public Private Partnerships and debt financing, should the Government opt to borrow directly, Kenya's Debt levels could rise in the Medium Term.

6 Capital Markets performance

6.1 Equity Market Performance

In the secondary equities market;

i. Equity turnover for Q1.2019 stood at KShs. 45.25 Billion, compared to KShs. 35.43 Billion registered in the last quarter, Q4.2018, indicating a 27.72% increase.
ii. End month market capitalization for Q1.2019 was 2,360.52 Bn, compared to Kshs 2,102.02 Bn recorded in Q4.2018, indicating a 12.30% increase in the market cap from the past quarter.
iii. Volume traded also increased over the period by 6.59% to 1,673.55 Million in Q1. 2019 compared to 1,570.02 Million in Q4. 2018.
iv. Other composite indicators such as the NSE All Share and NSE 20-Shares index similarly recorded increases of 0.46% and 12.72% closing the quarter at 157.66 points and 2,846.99 points respectively.

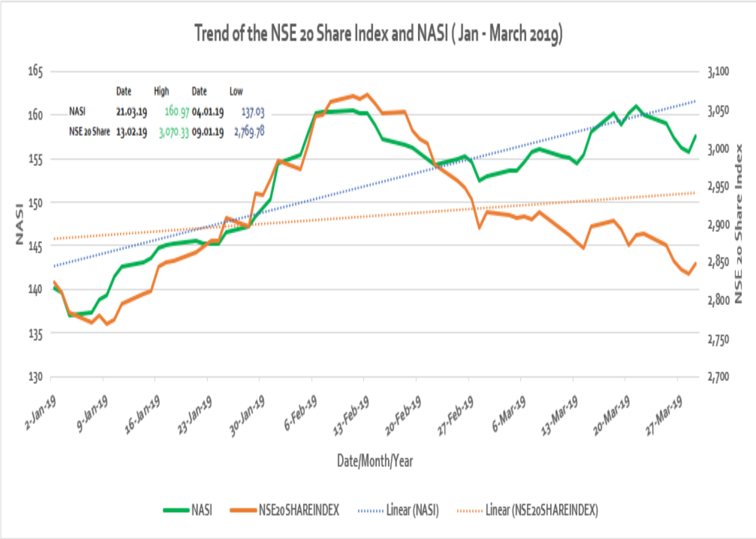
Table 7: Gross Securities Market Statistics – Q1.2019 and Q4.2018

	Q4.2018	Q1.2019	% Change
End Month NSE 20-Share Index	2,833.84	2,846.99	0.46%
NASI	140.43	157.66	12.27%
Shares Volume Traded (Mn)	1,570.02	1,673.55	6.59%
Equity Turnover (KShs. Bn)	35.43	45.25	27.72%
Bonds Turnover (KShs. Bn)	109.32	147.78	35.18%
End-Month Mkt. Cap (KShs. Bn)	2,102.02	2,360.52	12.30%

Source: CMA/NSE

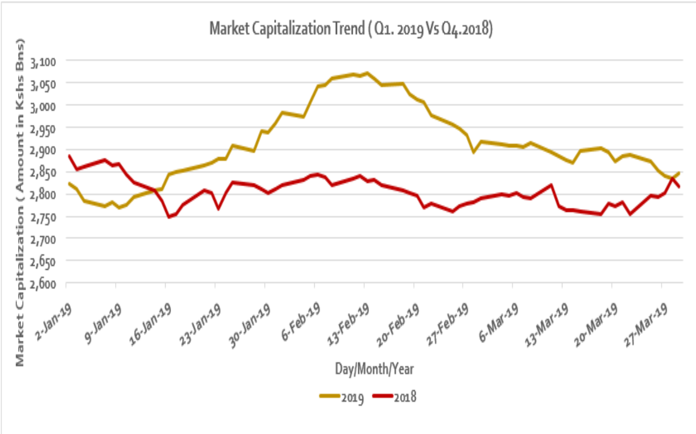
In the secondary Bond Market, Kshs 147.78 Billion worth of bonds were traded in Q1. 2019 compared to Kshs 109.32 Billion traded in Q4.2018, indicating a 47.82% increase.

Fig 17: Trend of the NSE 20 Share Index (Jan – Mar. 2019)



Source: CMA

Fig 18: Trend of Market Capitalization (Q1.2019 Vs Q4.2018)



Source: CMA/NSE

6.1.1 Performance of Listed Companies

Price Gainers

During the quarter ended March 2019, the top price gainers during were Express Kenya, Longhorn, I&M, NIC and Safaricom whose share prices appreciated by 50.00%, 37.53%, 33.53%, 30.76% and 24.10%.

Table 8: Price Gainers

Counter	31st Dec 2018	29th Jan 2019	% change
EXPRESS KENYA	5.00	7.50	50.00%
LONGHORN	4.61	6.34	37.53%
I&M BANK	85.00	113.50	33.53%
NIC GROUP	27.80	36.35	30.76%
SAFARICOM	22.20	27.55	24.10%
EQUITY	34.85	41.60	19.37%
OLYMPIA	2.10	2.50	19.05%
EABL	174.75	206.25	18.03%
KCB	37.45	44.05	17.62%
EAPC	16.00	18.70	16.88%

Source: NSE

Express Kenya

In December 2017, Express Kenya was a candidate of a takeover bid by its CEO who offered to purchase 38.36% of the issued shares. The takeover bid failed, forcing the company to seek an alternative way to resolving its cash requirements. In the half-year period to June 2018, the logistics firm's net loss narrowed by 15 per cent to Sh22.5 million against the backdrop of a recovery effort[23].

Longhorn

In the period to September 2018, Longhorn Publishers Plc recorded a 17% increase in turnover to close at Shs 1.69 Billion against the previous year turnover of Shs 1.45 Billion. Profit after tax for the year ended 30 June 2018 rose by 38% to Kshs 183 million up from Kshs 133 million from the previous year. The company's profit growth was attributed to the successful implementation of the company's 2015-2018 strategic plan which focused on product diversification, entry into new markets and growth of the digital offering. The performance was further boosted by savings achieved through improving the Group's operational efficiencies, which resulted in the growth of operating margin from 16% to 21%.

In its 2018-2021 strategic plan, the company has a focus on growing its digital products and expanding into new territories within Southern Africa and Francophone territories by offering innovative country-specific learning solutions[24].

I&M Bank

I&M Holdings reported an 18 percent growth in net profit for the nine months ended September to Sh5.85 billion driven by non-interest income. I&M Holdings, which made an after-tax profit of Sh4.94 billion in the corresponding period in 2017, recorded non-interest income growth of 38.6 percent to Sh5.56 billion on improved fees, commissions on loans and advances and foreign exchange trading earnings.

[23] https://kenyanwallstreet.com/express-kenya-shares-resume-trading-on-nse-after-3-month-suspension/

[24] https://longhornpublishers.com/longhorn-publishers-plc-records-a-37-growth-in-profit/

In terms of percentage increase in profit for the period, I&M was the sixth best performing bank in the sector ahead of Diamond Trust Bank which posted a 10 per cent growth in income[25]. I&M Holdings is also currently trading cum-bonus. The company announced a Bonus Issue of 1:1 on 27th March, 2019, with books closing on 10th May 2019.

Price Losers

The top price gainers during the quarter were KQ, Uchumi, BAT, Liberty and Kenya Re whose share prices depreciated by 44.83%, 30.00%, 24.97%, 21.15% and 19.66%.

Table 9: Price Losers

Counter	31st Dec 2018	29th Jan 2019	% change
KQ	8.90	4.91	**44.83%**
UCHUMI	0.80	0.56	**30.00%**
BAT	725.00	544.00	**24.97%**
LIBERTY	12.90	9.78	**24.19%**
KENYARE	13.95	11.00	**21.15%**
KENGEN	7.02	5.64	**19.66%**
SASINI	19.90	16.00	**19.60%**
HAFRIC	0.70	0.57	**18.57%**
SG	29.50	24.35	**17.46%**
DTB	156.50	130.00	**16.93%**

Source: NSE

KQ

A prognosis by Kenya Airways management contained in a report handed to National Assembly Transport Committee indicates that the carrier is facing significant challenges due to daily loses emanating from decisions made in the past. Among others, "very influential" trade unions, a bid to take up control of the Kenya Airport Authority (KAA) and a costly Aircraft leasing agreement have all adversely affected the carrier[26]. The Airline made a Sh4 billion half year loss in 2018.

Uchumi

In 2018, the board of Uchumi put in place a financial restructuring team to identify and advise on options available to settle debts owed to creditors or restructure the company's liabilities and present a proposal before creditors in a timely manner. Following litigation regarding its solvency and the lease agreement of its headquarters, the Supermarket chain delayed the release of its audited financial statements for the period that ended in June 2018.

BAT

BAT is now trading ex-dividend. The company announced a final dividend of Kshs 31.50 on 14th February, 2019. Books were closed on 14th March 2019, with payment scheduled for 10th May, 2019. The cigarette manufacturer posted a profit of Ksh4 billion for the year ended December 31, 2018.

6.2 Bond Market Performance and Stability

Primary Market

6.2.1 Treasury bond Market

A quarterly analysis of the primary market indicates that, during q1.2019, seven (7) Treasury bonds were issued with one infrastructure bond (IFB1/2019/25) issued in March 2019. In issuing these bonds, the government sought to raise Kshs. 152 billion but received subscriptions worth KShs. 276.22 billion. In the end, however, it accepted to issue bonds worth KShs. 131.62 billion, implying a 48.65% acceptance rate.

[25] https://www.nation.co.ke/business/I-M-banks-9month-profit-grows-18pc/996-4872268-r8ykayz/index.html

[26] https://www.standardmedia.co.ke/article/2001320894/kq-blames-woes-on-overpaid-pilots-and-bad-deal-with-jkia

Table 10 Treasury bond Performance Jan-March 2019

Month /Year	BOND	Amt Issued (Kshs. Bn)	Amt Received (Kshs. Bn)	Amt Accepted (Kshs. Bn)	% AA/AI	% AR/AI
Jan 2019	FXD 1/2019/2	40.00	76.90	23.77	59.43	192.25
	FXD 1/2019/15		25.07	14.72	36.80	62.68
Feb 2019	FXD 1/2019/5	50.00	41.93	20.59	107	157
	FXD 1/2019/10		36.33	32.81		
Mar 2019	IFB1/2019/25	50.00	29.38	16.30	32.60	58.76

Source: CMA/NSE

6.2.2 Corporate Bond issues

There has been limited activity within the corporate bond market space.

Secondary bond market

Table 11: Summary of Bond Turnover Q4. 2018-Q1.2019

Month	Government Bo Turnover (KShs. Bn)	Corporate Bo Turnover (KShs. B	Total Bo Turnover (KShs. Bn)
Oct.	53.73	0.02	53.73
Nov.	41.66	0.34	42.00
Dec.	22.41	0.01	22.42
Jan.	50.98	0.05	50.98
Feb.	48.26	0.06	48.26
Mar.	62.38	0.07	62.37

Source: CMA/NSE

7 New Developments and Key Updates

7.1 Green Bond framework launched in Kenya

As part of the strategy to provide a facilitative framework that would lead to diversification of the product portfolio in the Kenyan capital markets, under the oversight of the Authority, capital market stakeholders launched the framework for issuance of listed and unlisted green bonds on 20th February 2019. A green bond is a fixed income instrument whose proceeds are used to finance or refinance projects which generate climate or other environmental benefits that conform to green guidelines and standards.

Issuers of unlisted or listed green bonds in Kenya will be required to appoint an independent verifier to conduct a pre-issuance review and confirm to the investors, the Authority, and the NSE in the case of listed green bonds, that the issuance is eligible to be classified as a green bond in line with green guidelines and standards.

7.2 CMA Admitted to the Global Financial Innovation Network

On January 30th 2019, the Authority was admitted to the Global Financial Innovation Network, a positive development that is anticipated to support the transformation of capital markets in Kenya through nurturing innovation. The Global Financial Innovation Network (GFIN) is an international network of 29 financial services regulators and related organizations, committed to supporting financial innovation. The admission cements the Authority's efforts to support innovation in the capital markets, noting the important role of financial technology (Fintech) as a key enabler of performance excellence under the 10-year Kenya Capital Market Masterplan, 2014-2023.

7.3 The Authority's Regulatory Sandbox now Ready to Receive Applications

As a strategy aimed at leveraging on Financial Technology (FinTech) to drive the capital markets value chain, on 26th March 2019 the Authority's board approved the Policy Guidance Note to facilitate the implementation of a Regulatory Sandbox Framework that will allow firms to test innovative products, solutions and services that have the potential to deepen or broaden Kenya's capital markets in a live environment. Fintech firms and innovators can now apply for admission to the Regulatory Sandbox.

7.4 *Hybrid Bond Market Project Implementation*

The National Treasury has undertaken to introduce several reforms for the development of an efficient primary and secondary market for Government bonds by Among them; introducing an electronic auction system; separating retail and wholesale market; institutionalizing an issuance calendar; establishing an efficient and transparent OTC bond market; establishing an efficient horizontal REPO market as well as introducing securities lending and short selling for market participants. This is imperative for Kenya to achieve the Capital Markets Master Plan aspirations to transform the country into a financial hub.

7.5 *Derivatives Market launch underway*

Under the supervision of the Authority, the Nairobi Securities Exchange (NSE) successfully completed a six-month pilot test phase that was conducted over two cycles. The first involved the use of dummy cash and was aimed at conducting a full end-to-end test of the systems and technological infrastructure deployed by the Exchange in readiness for market go-live. The second cycle was a live trading environment involving the use of actual funds by the trading members and it was aimed at testing the clearing and settlement activities and the practicability of implementing the turnaround times contained in the rules and various service level agreements between the market participants.

In the meantime, to ensure adequate capacity, the Authority has been engaging the market through running a series of market awareness programs on Exchange Traded Derivatives, in preparation for a launch due within the financial 2018/19 financial year.

Legislative and Regulatory amendments

7.6 *Policy Guidance Note on Green Bonds approved*

The Authority's Board approved the Policy Guidance Note (PGN) on Issuance of Green Bonds and amendments to the NSE Listing Rules to facilitate issuance of green bonds in Kenya's capital markets. The PGN provides a framework to guide on the operational regulatory environment on Green Bonds in Kenya. The key features of the PGN include; procedure for issuance and listing of a green bond, eligibility of an independent verifier, Submission of the Information Memorandum, Disclosure and Continuous Reporting Obligations, Project Selection Process, Use and Management of Proceeds, Consequences for Breach of Green Requirements by an Issuer of Unlisted Green Bonds, Consequences for Breach of Green Requirements by an Issuer of a Listed Green Bond and Suspension of a Green Bond. Further, the amendments to the NSE Listing Rules will enable the Exchange to mobilize domestic resources and international capital flows earmarked exclusively for environmentally beneficial investments to support the country's transition to a sustainable economy.

7.7 *Policy Guidance Note on Regulatory Sandbox approved*

The Authority's Board approved the Regulatory Sandbox Policy Guidance Note on 26th March 2019, to guide on the operation of regulatory sandboxes in the capital market. The PGN provides a framework for the establishment of a regulatory sandbox to allow for the live testing of new products, services, and business models that have the potential to deepen the Kenyan capital markets. The salient features of the Policy Guidance Note include: Eligibility, application and acceptance criteria; testing plans; Records and reporting requirements; and Regulatory relief and safeguards.

7.8 *Draft Capital Markets (Commodity Markets) Regulations*

The Authority has been mandated to regulate spot commodity markets in Kenya through an amendment made to the Capital Markets Act Cap 485A in 2016. There was a workshop held from 11th March till 15th March 2019 organized by the Ministry of Industry, Trade and Cooperatives in Naivasha to discuss the draft Regulations. The Regulations cover the licensing and regulation of:

(a) Commodity exchanges;
(b) Commodity clearing houses;
(c) Commodity brokers;
(d) Trading and conduct of business;
(e) The commodity settlement guarantee fund;
(f) Record keeping, accounts and inspections; and
(g) Offences relating to the commodity markets.

There will be a public participation exercise through a nationwide roadshow on the draft Regulations organized by the ministry and scheduled in the month of April 2019.

Investigations and Enforcement

7.9 CMA concludes an investigation into suspicious trades in relation to the KenolKobil PLC take over transaction

Through its market surveillance, the Authority identified potentially irregular trading of the KenolKobil counter in the run up to the issue of the Notice of Intention by Rubis Énergie to take over KenolKobil. Upon conclusion of its investigations, the CMA secured the surrender of potentially illegal gains amounting to Ksh458 million from the investigations into insider trading on KenolKobil shares. The funds surrendered related to 90 percent of the quantum of suspicious trades identified through a total of 14 accounts that were frozen in October 2018 to facilitate investigations. The recovered funds were paid into the Investor Compensation Fund managed by the Authority.

7.10 CMA warns against Kenicoin initial coin offering and trading

In a bid to protect investors, the Authority (CMA) cautioned the public against participating in any initial coin offering or trading in any coin exchange offered by Wiseman Talent Ventures. The Authority launched investigations into the operations of Wiseman Talent Ventures owing to the nature and features of the Capital Raising and Coins Trading promoted by Wiseman Talent Ventures that took the form of regulated activities which have not yet been approved by the Authority.

Investor Education and Public Awareness

7.11 Capital Markets University Challenge 2018

The current University Challenge initiative has continued to be impactful in terms of participation and increased knowledge as witnessed by the 6015 participants who registered for Stage One with 3151 actually taking the exam. Stage Two witnessed a 68.6% participation rate with a total number of 2,615 who had qualified for the stage from which 1,794 sat the exam. The top 10 candidates from each of the 37 participating universities presented during the just concluded Stage 3.

Preparations are ongoing for Stage 4 where the top 2 students from each university will be subjected to structured questions within their respective topics with the overall objective of selecting the top 12 to present during the Grand Finale scheduled for May 17th, 2019. A key impact of the initiative going forward is the anticipated increase in knowledge and attitude towards the capital markets which will eventually translate to actual product uptake. The top candidates are also anticipated to be presented with internship opportunities within the capital markets with a view to further increase their interest and future opportunities. In addition, the candidates also serve as ambassadors in influencing peer perception of the capital markets.

Licenses and Approvals Granted during the Quarter

1. Registration of Credit Rating Agency Care Ratings Africa Limited;
2. Approval of a REIT Manager License to Cytonn Asset Managers Limited;
3. Approval of an Authorized Depository License to Gulf African Bank Limited;
4. Approval of a shareholder's circular in shareholder circular in respect to proposed cash offer by Rubis

Energies S.A.A to acquire all the ordinary shares of Kenol Kobil not already legally or beneficially owned by Rubis Energie; and

5. Approval of circular in relation to proposed merger between CBA & NIC by way of Exchange Offer where CBA ordinary shares are exchange for NIC shares

8 Capital Markets Stability Indicators (CMSIs)

	1.0 Stock Market Volatility							
Equity Market Depth	Quarter/ Year	Statistics				Assessment of Risk Level (High – Medium – Low)	Performance Brief for the Quarter	Ongoing Intervention Measures
NSE 20 Index Volatility Base Year 2010	Q1.2019	Jan	Feb	March	Q. Avg	Low (indicative - <10% high; >10% - low)	• The NSE 20 Share Index volatility for the quarter ending March 2019 averaged **0.42%**, compared to **0.48%** recorded in Q4.2018.	• To maintain market stability, the Authority continues to surveil the market to ensure that unless there is a corporate action, the daily price fluctuation threshold of +/-10% is observed. • When officially operationalized, Securities Lending and Borrowing (SLB) will facilitate implementation of hedging strategies, further assisting in stabilizing price movements and cushioning the market against drastic price changes in the capital markets.
		0.49%	0.37%	0.41%	0.42%			
	Q4.2018	Oct	Nov	Dec	Q. Avg			
		0.53%	0.28%	0.63%	0.48%			
	Q3. 2018	July	Aug	Sep	Q. Avg			
		0.35%	0.42%	0.52%	0.43%			
	Q2.2018	April	May	June	Q. Avg			
		0.28%	0.44%	0.51%	0.41%			
NASI Volatility Base Year = 2010	Q1.2019	Jan	Feb	March	Q. Avg	Low (indicative - <10% high; >10% - low)		
		0.40%	0.41%	0.52%	**0.44%**			
	Q4.2018	Oct	Nov	Dec	Q. Avg			
		0.50%	0.57%	0.49%	**0.52%**			
	Q3. 2018	July	Aug	Sep	Q. Avg			
		0.46%	0.54%	1.04%	**0.68%**			
	Q2.2018	April	May	June	Q. Avg			
		0.41%	0.74%	0.59%	**0.58%**			
Turnover Ratio	Q1.2019	Jan	Feb	March	Q. Sum	Medium (indicative – annual: <8%- Low; >15% High)	• A turnover ratio of **1.85%** was recorded in the reporting	• The quarter's turnover ratio translates to an annual figure of 7.4% which is less than the annual 8% threshold. This implies although
		0.67%	0.50%	0.67%	**1.85%**			
	Q4.2018	Oct	Nov	Dec	Q.TR			

		0.79%	0.49%	0.37%	**1.69%**		period compared to **1.69%** in Q4.2018 indicating a slight increase trading at the bourse, though skewed towards foreign sales.	the turnover ratio has improved relative to the previous quarter, the country's ratio is still relatively low compared to the minimum threshold ratio • New initiatives like SLB, the derivatives market, the Rapid Mass Visibility Strategy (RMVS) could improve market activity and therefore the turnover ratio.
	Q3. 2018	**July**	**Aug**	**Sep**	**Q. TR**			
		0.39%	0.41%	0.54%	**1.34%**			
	Q2.2018	**April**	**May**	**June**	**Q. TR**			
		0.57%	0.72%	0.52%	**1.83%**			
	2.0 Foreign Exposure Risk							
Foreign Investor turnover as a % of total turnover	**Q1.2019**	**Jan**	**Feb**	**March**	**Q.Avg**	**Medium (indicative – annual: <40%-Low; >90% High)**	• Average Foreign investor participation for the months of January and February 2019 averaged at **76.96%**, a 1.84% increase from **75.12%** recorded in Q4.2018	• The average foreign participation is still within the threshold of between 40% and 90%. Portfolio outflows appear to have decreased. • The Authority is on an intensive education and awareness campaign to improve domestic investor participation in capital markets.
		81.55%	72.38%	-	**76.96%**			
	Q4.2018	**Oct**	**Nov**	**Dec**	**Q.Avg**			
		75.14%	76.54%	73.67%	**75.12%**			
	Q3. 2018	**July**	**Aug**	**Sep**	**Q.Avg**			
		67.69%	62.03%	64.80%	**64.84%**			
	Q2.2018	**April**	**May**	**June**	**Q. Avg**			
		63.55%	52.84%	68.77%	**61.72%**			
Net Foreign Portfolio Flow (In KES Millions)	**Q1.2019**	**Jan**	**Feb**	**March**	**Q.Sum**	**High (indicative – annual: <Kshs (50million) -High (outflow; >KShs. 50 million High inflow)**	• Net Foreign Portfolio levels for Q1 2019 amounted to a total inflow of **Kshs 601 Mn.**	
		(1,357)	216	1,742	**601**			
	Q4.2018	**Oct**	**Nov**	**Dec**	**Q.Sum**			
		(4,287)	(599)	(1,785)	**(6,671)**			
	Q3. 2018	**July**	**Aug**	**Sep**	**Q. Sum**			
		(2,111)	(1,565)	(3,029)	**(6,705)**			
	Q2.2018	**Apr**	**May**	**Jun**	**Q. Sum**			
		(1,815)	(4,022)	(2,339)	**(8,176)**			

Market Concentration (Top 5 companies by market cap)	**Q1.2019**	**Jan**	**Feb**	**March**	**Q. Avg**	**High** **(indicative – annual: >50% High concentration)**	• During the quarter, the top five companies by market capitalization accounted for **67.58%** of the market value on average, confirming their market dominance. • The top five companies included SAFARICOM, EQUITY, EABL, KCB and CO-OP.	• The high market concentration risk continues to be an industry challenge that requires continuous collaboration among industry players to resolve. • With support of the Authority, NSE has already launched RMVS which in the long term might increase the No. of listings and reduce the high level of market concentration in the long run.
		65.34%	67.85%	69.56%	**67.58%**			
	Q4.2018	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		66.74%	64.76%	65.95%	**65.82%**			
	Q3. 2018	**July**	**Aug**	**Sep**	**Q. Avg**			
		68.45%	68.31%	67.40%	**68.05%**			
	Q2.2018	**Apr**	**May**	**Jun**	**Q. Avg**			
		67.21%	68.13%	68.83%	**68.06%**			
	3.0 Government Bond Market Exposure							
Treasury Bond market turnover Concentration	**Q1.2019**	**Jan**	**Feb**	**March**	**Q.Avg**	**High** **(indicative – annual: >50% High concentration)**	• The Treasury bond market remains dominant in the Kenyan bond market, accounting for an average of	• To counter the 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.
		99.96 %	99.84%	99.90%	**99.90%**			
	Q4. Avg	**Oct**	**Nov**	**Dec**	**Q.Avg**			
		99.96 %	99.98%	99.96%	**99.97%**			
	Q3. 2018	**July**	**Aug**	**Sep**	**Q. Avg**			

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<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>
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<td>99.90% during the review period.</td>
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The Authority expects some corporate bond issues to happen in the market in the near future through green bonds and other bond structures like ABSs.
In addition, engagements are on-going with key big 4 agenda stakeholder sectors to promote capital markets as viable capital raising alternative.

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<td>Corporate Bond Market ownership</td>
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<tr><td>Category</td><td>No of Investors</td><td>Amount Outstanding (Mn)</td><td>% of total outstanding</td></tr>
<tr><td>Local Investors</td><td>4,265</td><td>56,983.72</td><td>98.99%</td></tr>
<tr><td>East African Investors</td><td>11</td><td>51.23</td><td>0.09%</td></tr>
<tr><td>Foreign Investors</td><td>113</td><td>529.10</td><td>0.92%</td></tr>
<tr><td colspan="4">Source: CDSC Data as at March 2019</td></tr>
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<td>High (indicative – annual: >50% High concentration</td>
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Local investors were the leading investors in the bonds market at 98.99% of amounts outstanding, with local corporates accounting for 95.41% as at end of reporting period, with foreign and East African investors accounting for a meager 0.92% and 0.09% respectively.

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<td colspan="4">4.0 Investor Profiles - Equity Market</td>
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<td>Equity Market</td>
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<table>
<tr><td>Type of Investor</td><td>2015</td><td>2016</td><td>2017</td><td>2018</td></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>
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<td>High (indicative – annual: >50% High concentration)</td>
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Local investors, a sum of East African institutional and individual investors accounted for 80.08% of shares

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Following extensive engagements with stakeholders on reasons for low uptake of capital markets products in June 2018, the Authority has embarked on the implementation of some of the recommendations forwarded by

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<tr><td>Foreign Investors (%)</td><td>21.48</td><td>21.13</td><td>20.17</td><td>19.92 %</td></tr>
</table>
Source: CMA- *Data as at August 2018
</td>
<td></td>
<td>held in the equity market with 19.92% being held by foreign investors.</td>
<td>stakeholders namely pursuing collaborations with trade associations in the country eg KEPSA and consideration on review of regulations, with ongoing work on review of collective investment scheme regulations. 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 is expected to translate to more targeted engagements to onboard and drive increased market participation within the capital markets.</td>
</tr>
<tr>
<td></td>
<td colspan="4">5.0 Investor Compensation Coverage</td>
</tr>
<tr>
<td>Settlement Guarantee Fund (SGF) Coverage Ratio[27]</td>
<td>
<table>
<tr><td>Q1.2019</td><td>Jan</td><td>Feb</td><td>March</td><td>Q.Avg</td></tr>
<tr><td></td><td>1.30</td><td>1.28</td><td>1.20</td><td>1.26</td></tr>
<tr><td>Q4.2018</td><td>Oct</td><td>Nov</td><td>Dec</td><td>Q.Avg</td></tr>
<tr><td></td><td>1.14</td><td>1.83</td><td>2.05</td><td>1.67</td></tr>
<tr><td>Q3. 2018</td><td>July</td><td>Aug</td><td>Sep</td><td>Q. Avg</td></tr>
<tr><td></td><td>1.96</td><td>1.83</td><td>1.46</td><td>1.75</td></tr>
</table>
</td>
<td>Medium
(indicative – annual: > 1 times, implies full coverage)</td>
<td>• SGF Ratio for the quarter ended March 2019 averaged 1.26, showing a decrease in the ratio compared to the last</td>
<td>• Through Risk-based supervision, the Authority continuously monitors sufficiency of the settlement guarantee fund to ensure it is able to address any settlement failures that may arise from one of the parties to a transaction.</td>
</tr>
</table>

[27] *Source: CDSC*

<table>
<tr>
<td></td>
<td><table><tr><td>Q2.2018</td><td>Apr</td><td>May</td><td>Jun</td><td>Q. Avg</td></tr><tr><td></td><td>1.11</td><td>1.01</td><td>1.17</td><td>1.10</td></tr></table></td>
<td></td>
<td>two quarters. This is attributed to the increase in equity turnover levels in the first quarter of the year 2019. Despite the decrease, a ratio above 1.0 indicates sufficiency of the fund to cover liabilities that would arise following default by securities brokers.</td>
<td>• The Authority is also in the process of reviewing the formula used in the computation of the SGF ratio to ensure that it is an actual representation of market activity.</td>
</tr>
<tr>
<td></td>
<td colspan="4">6.0 Asset Base of Fund Managers, Stockbrokers, Investment Banks</td>
</tr>
<tr>
<td>Assets Under Management

As at 31st January 2019 (Amount in KShs Millions)</td>
<td><table><tr><td>CMA Licensee</td><td>Total Assets</td><td>Total Liability</td><td>CMA Licensee</td></tr><tr><td>Fund Managers</td><td>7,853.96</td><td>1,532.09</td><td>6,321.86</td></tr><tr><td>Stockbrokers</td><td>2,330.41</td><td>692.06</td><td>1,638.36</td></tr><tr><td>Investment Banks</td><td>11,885.78</td><td>2,995.46</td><td>8,890.32</td></tr><tr><td>Investment Advisors</td><td>1,464.78</td><td>161.95</td><td>1,302.83</td></tr></table></td>
<td>Medium
(Indicative – the higher the figure, the more stable is the market)</td>
<td>• The total Asset Base of Fund Managers, Stockbrokers, Investment Banks, Investment advisors and online forex brokers as at 31st January 2019 was Kshs 7,853.96</td>
<td>• The Authority continuously monitors asset levels of its licensees to ensure accurate reporting of assets and liabilities and monitoring sufficiency of liquid capital to flag potential liquidity challenges of licensees.</td>
</tr>
</table>

	Online Forex Broker (Non-Dealing)	202.58	200.21	2.4		**Million, 2,330.41 Billion, Kshs.11,885.78 Million, Kshs 1,464.78 Million** and **Kshs 202.58 Million** respectively.	

9 References

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

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