The Capital Markets Soundness Report

Volume XII

Quarter III. 2019

"Complementing Government's Role in financing Infrastructure development –The Latent Potential of a Sub-National Debt Market in Kenya?"

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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 the 12th edition of the Capital Markets Soundness Report (CMSR) for the quarter ended September 2019 (Q3.2019). The report has provided a platform for the Authority to share its thought focus on cross-cutting emerging policy issues that present a threat or provide opportunities towards the growth and development of the Kenyan Capital Markets industry and economy as a whole.

With the general global economic cycle undergoing depressed activity, policy makers, regulators, market participants and key stakeholders have had to engage the highest level of prudence and strategy in sustaining a favorable business environment. Industry performance has specifically been affected by a myriad of factors, with the persistent bear run becoming an increased concern globally. Kenya continues to witness a decline in the major share indices, now spanning five years, largely as a result of a mix of macro-economic, socio-political; as well as institutional challenges such as governance, uptake and financial literacy.

On the primary markets front, globally, Initial Public Offerings (IPOs)declined in activity in H1 of 2019 as the backlog of high-quality IPOs continued to grow with issuers awaiting more favourable market conditions for issuance. Statistically, only 256 IPOs came to the market in Q3 2019 with total proceeds of US$40.2billion, a decrease of 24% by volume and 22% by proceeds compared with Q3 2018.The first nine months of 2019 (YTD 2019) saw a decline of 26% by deal volume (768 IPOs) as well as a 25% drop in funds raised (US$114.1b) versus YTD 2018.

Further, the bond markets have equally experienced tough times as declining yields in the fixed income, partially driven by the increased demand for favorable returns by investors, have resulted in negative yields.

To avoid the negative effects of globalization on the domestic economy performance, focus should be redirected towards monitoring and stabilizing key country economic indicators using both fiscal and monetary policy interventions.

I hope that this report continues to inform your business strategies and decision making as you contribute towards the realization of Kenya's "Big 4" Agenda.

We are pleased to introduce stability indicators for exchange traded- financial derivatives in this issue and going forward, following commencement of trading of the Nairobi Securities Exchange NEXT platform during the period under review.

My sincere gratitude to you as a key player in the attainment of success within the Capital Markets in Kenya.

Enjoy the read.

Mr. Paul Murithi Muthaura, MBS
CHIEF EXECUTIVE

EDITORIAL

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

The 12th issue of the Capital Markets Soundness Report (CMSR) comes at a time when there is a global call for change in strategy, exploration of d innovative financing solutions in order to propel economic development, even as major economic superpowers face recession and capital markets performance continues to decline globally.

In this issue we have a special feature on how India leveraged sub-national debt with significant support from the Ministry of Finance, market intermediaries and other stakeholder to raise substantial capital to develop its Cities and Urban Areas using the capital markets.

This case study calls for concerted efforts in ensuring the potential of Counties, Cities and Urban Areas is nurtured to ensure the development of much needed infrastructure as populations continue to grow and informs the theme: ***"Complementing Government's Role in financing Infrastructure development –The Latent Potential of a Sub-National Debt Market in Kenya".***

This comes as debates between the National and County Governments continue to draw significant public interest, as confusion marred the process of approval of the Division of Revenue Bill in the financial year 2019/20, the basis upon which resources are forwarded to County Governments.

The clear message is that the country's resources continue to remain limited and great innovation is required in financing our ambitious Vision 2030 and the "Big 4' Agenda, as well as increased private sector participation and an enhanced role of the Capital Markets in intermediating the resource mobilization efforts. I hope the insights provided based on the Indian model in the development of a sub-national debt market provokes policy makers at the highest level into considering the vast opportunities abounding, even as we separately seek solutions to governance challenges and restore trust in management of funds at County Level..

We further explore pension reforms in Brazil and the lessons that Kenya can learn in implementing policies that will balance between injecting more contribution into pension schemes and addressing poverty and social welfare reduction through grants to ensure that pensions assets currently at Kshs 1.2 trillion continue to grow in order to comfortably support citizens post-retirement, while financing some of the key "Big 4' projects.

We additionally delve into how the China US trade war contagion is spreading to other bilateral trading partners, notably Japan and South Korea and how this surge in protectionist policies is threatening to exacerbate the eminent global recession.

Other areas of interest for policy makes that we cover in this issue include the emerging risks of unintended consequences of economies pushing for improved Global Competitiveness and Ease of Doing Business Rankings

Coming back home, the Kenyan corporate bond market was revitalized with the successful issuance of the country's first Green Bond by property developer Acorn Group and PE Fund Helios. The Bond attracted an 85 percent subscription rate, raising Sh4.3 billion out of the targeted Sh5 billion with a blend of investors including pension funds, commercial banks, development financial institutions (DFIs) and insurance firms onboarded.

As a core element of the Soundness Report, we also present an analysis of the health Kenyan Capital Markets stability indicatorssuch as: Market volatility, Liquidity, Market Concentration , Net foreign Equity Portfolio Flows and Settlement Guarantee Fund Coverage Ratio together with mitigation measures being undertaken

Overall, the significance and prominence of developing and leveraging on domestic Capital Markets in promoting economic development couldn't be emphasized further if sustainability is to be attained in the long run.

Happy reading!

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

1. Special Feature – Lessons from India's Sub-National Debt Market Reforms between 1994 and 2005

i. Introduction

In this Issue, we focus on the prospects presented for Kenya to develop a sub-national debt market to augment infrastructure funding and financing gaps for Kenyan Cities and Urban areas, referencing lessons learnt from India's Case Study on the development of a functioning Municipal bond market.

Globally, Municipal bonds are classified as revenue bonds or general obligation bonds. However, bonds issued by Urban Local Bodies (ULBs) in India were structured debt obligations, issued by pledging certain sources of revenue[1].

At the center of India's motivation to have a functioning sub-national debt market was the impact and effect of rapid urbanization that the country was undergoing since the 1990s. The pressures inflicted by growing urban populations meant constraints on the capacity of existing infrastructure framework – both physical and social towards servicing the demand of the growing population.

Like Kenya and in most decentralized Countries, the primary source of capital – both for recurrent and development expenditures are the equitable transfers from Central or National Government, supplemented with own source revenue collection sources.

While all efforts were on course to build efficiencies aligned towards revenue collection to finance development ventures – it was apparent that to achieve the magnitude of infrastructural investment at hand, alternative financing models needed to be considered in India, hence the Municipal bond market.

ii. The Inception of a Transformative Concept for Infrastructure Financing

India's discussions on the development of a Municipal bond market started in 1995, through a discussion initiated at a national workshop in Bangalore, sponsored by the FIRE(D) Project[2], on the potential and relevance of a Municipal bond system for India.

In the following year, The Rakesh Mohan Committee on Commercialization of Infrastructure Projects, established by the Ministry of Finance, issued recommendations for capital market development which included the development of a Municipal bond system in India. The task force set up to assist State Finance Commissions (SFC) also recognized the need to promote Municipal bonds.

Fast forward to 1997 and the Bangalore Municipal Corporation had raised INR125 crore, equivalent to USD 17.57 Million, through a private placement backed by the State Government. In 1998, the Ahmedabad Municipal Corporation (AMC) issued the first Municipal bond without a State Government guarantee having undertaken a significant number of reforms to facilitate successful issuance.

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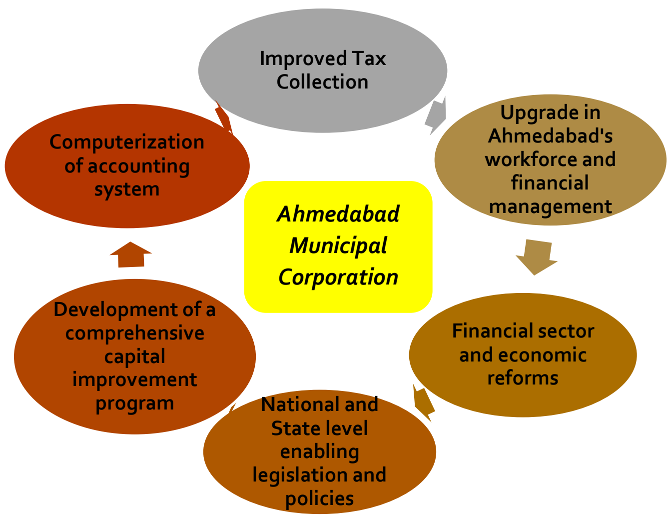
[1] https://pdfs.semanticscholar.org/54d5/08ae1b5fc7f708831f7ee3766ecbe23c3096.pdf

[2] FIRE-D was a three-phased, USAID–funded activity that ran from 1994 to 2011 and was implemented by TCG International. The activity worked in tandem with India's central, state, and city Governments to develop sustainable urban environmental services and to ensure the poor have access to those services. The activity's goals were tied to the following objectives:

i. Increasing the participation of cities, the private sector, and community organizations in the development and delivery of commercially viable and socially inclusive urban infrastructure services
ii. Improving the ability of city and state Governments, infrastructure agencies, and urban professionals to plan and manage urban growth, mobilize resources, and improve infrastructure services.
iii. Supporting development of an urban infrastructure finance system

The total cost of the project was estimated to be Rs 4,393 million in 1997. To partly finance the project, AMC issued Municipal bonds of Rs 1,000 million in early 1998. This was a remarkable achievement as it was the first Municipal bond issued in India without a state guarantee and represented the first step towards a market-based system of local Government finance.

Fig 1: Reforms Implemented for successful Issuance



Later in 2000 and early 2001, the Government of India gave tax exemption to interest income from certain Municipal bonds. Proceeds from the tax-free Municipal bonds were to be used for developing infrastructure for the supply of portable water, sewerage or sanitation, drainage, solid waste management, roads, bridges and flyovers, and urban transport.

Table 1: Sample Urban Local Bodies that successfully issued Municipal bonds post 1998

City	Amount (in Rs. Million)	Placement	Guarantee	Annual Interest	Escrow	Purpose	Rating
Bangalore (1997)	1,250	Private	State Govt.	13%	State Government grants and property tax	City roads/ street drains	A-(SO)
Ahmedabad (1998)	1,000	Public & Private	No	14%	Octroi tax from 10 octroi collection points	WS&S project	AA-(SO)
Ludhiana (1999)	100	Private	No	13.5% to 14%	Water & Sewerage taxes and charges	WS&S Project	LAA-(SO)
Nagpur (2001)	500	Private	No	13%	Property tax and water charges	WS project	LAA-(SO)
Nashik (1999)	1,000	Private	No	14.75%	Octroi tax from four collection points	WS&S project	AA-(SO)
Indore (2000)	100	Private	State Government	13.0%	Grants/property tax	Improvement of city roads	A (SO)
Madurai (2001)	300	Private	No	12.25 %	Toll tax collection	City road project	LA+(SO)
Visakhapatnam (2004)	200	Private	No	7.75%	Property tax	Water supply project	AA-(SO)
TOTAL	**4,450**						

Subsequently, the central Government amended the Income Tax Act (1961 vide the Finance Act 2000), whereby interest income from bonds issued by Local Authorities was exempted from Income Tax.

The Government of India further issued guidelines for issuance of tax-free Municipal bonds in February 2001. These guidelines stipulated eligible issuers, use of funds, essential pre-conditions, maturing period, buy-back, nature of issue and tax benefits, ceiling amount for a project, compulsory credit rating and external monitoring of the tax-free Municipal bond.

This incentive resulted in the issuance of the first tax-free Municipal bond in 2002 by the Ahmedabad Municipal Corporation to raise INR 100 crore, an equivalent of USD 14.06 Million, for water supply and sewerage. This was also India's first Municipal bond to be rated.

Fig 2: Steps undertaken by Ahmedabad Municipal Corporation in the issuance of the Bond

First rating by CRISIL	February 1996
IL&FS appointed as merchant bankers	April 1996
State government permission	June 1997
Second rating by CRISIL	August 1997
Draft prospectus approved by SEBI	December 1997
Public placement underwritten by the lead manager	December 1997
Application to NSE and ASE	December 1997
Press and brokers' conferences	December 1997
Public Issue	January 1998
Credit rating put on watch	August 1999
Utilisation of most of the proceeds	March 2000

Source: Ahmedabad Municipal Corporation.

It was assigned an A+ rating (indicating a credit risk profile in the adequate safety category) by CRISIL[3] . Ahmedabad issue was in reality a general obligation bond. In essence, bondholders were given the security of a dedicated revenue stream (beyond the control of the city) for debt service payments, as well as a full faith and credit pledge by the city.

Table 2: Tax-free Municipal Bonds Issued between 2002 - 2007

City Government	Year	Projects	Amount Raised (Rupees)
Ahmedabad Municipal Corporation	2002	Water supply and sewerage project	1,000
Hyderabad Municipal Corporation	2003	Road construction and widening	825
Nashik Municipal Corporation	2002	Underground sewerage scheme and stormwater drainage system	500
Visakhapatnam Municipal Corporation	2004	Water supply system	500
Hyderabad Metropolitan Water Supply and Sewerage Board	2003	Drinking water project	500
Ahmedabad Municipal Corporation	2004	Water supply project, stormwater drainage project, road project, bridges and flyovers	580
Chennai Metropolitan Water Supply & Sewerage Board	2003	Chennai water supply augmentation project	420
Chennai Metropolitan Water Supply & Sewerage Board	(2005)	Chennai water supply project	500
Chennai Municipal Corporation	(2005)	Roads	458
Ahmedabad Municipal Corporation	(2005)	Roads and water supply	1,000
Nagpur	(2007)	Nagpur water supply and sewerage project	212
TOTAL			**6,495**

iii. Pooled Financing Approach for Small Urban Local Bodies

Also taken into consideration was the fact that only financially strong, large Municipal corporations were in a position to directly access capital markets based on the established frameworks.

As a result, most small and medium ULB[4]s were not able to directly access capital markets on the strength of their own balance sheets. Further, the cost of the transaction was considered as an additional barrier. In the United States and elsewhere, small local bodies pool their resources and jointly access the capital markets. Based on this model, the Governments of Tamil Nadu and Karnataka issued Municipal bonds by pooling Municipalities.

[3] Credit Rating and Information Services of India Ltd

[4] ULB – Urban Local Boards

In 2003, the Tamil Nadu Urban Development Fund issued a bond by pooling 14 Municipalities for commercially viable water and sewerage infrastructure projects. A special purpose vehicle, the Water and Sanitation Pooled Fund (WSPF), was set up to issue the Municipal bond. The WSPF structured a Rs.304 million bond issue whose proceeds financed small water and sanitation projects in the 14 small ULBs.

The Trust vehicle enabled the local bodies to participate in the capital markets without increasing the contingent liabilities of the state and to channel private financial resources into infrastructure investments. This was the first Municipal pooled issue in India. It had a fifteen-year maturity and an annual interest rate of 9.20 percent. While the bonds were unsecured, a multi-layered credit enhancement mechanism was set up.

The ULBs agreed to set apart monthly payments equal to one-ninth of their annual payments into escrow accounts and transfer the same during the tenth month into the WSPF[5]'s escrow account.

Besides the strong escrow mechanism and Government intercept, a key to the bond's success was that all the pooled projects demonstrated strong collection of user charges and/or fixed upfront contribution from citizens.

USAID provided a backup guarantee of 50 percent of the bond's principal through the Development Credit Authority (DCA) mechanism[6].

iv. Kenya's Current Position in the financing of Cities and Urban Areas

In Kenya, the Urban Areas and Cities Act 2012 recognizes and establishes 5 cities namely – Nairobi, Mombasa, Nakuru, Kisumu and Eldoret.

Prior to devolution, Urban Areas and Municipalities were financed through the Local Authority Transfer Fund, facilitating the development and servicing of social services in the Municipalities.

However, post devolution and with equitable transfers as the primary funds through which devolved entities are financed, the monies were effectively channeled through County Governments, which are expansive in nature.

The resultant effect has been underfunded Cities and Urban Areas as they compete for limited resources with the geographically vast Counties that also cater for the needs of rural and marginalized areas.

Studies to quantify the financing gap post devolution have since been undertaken with various institutions including i. The State Department of Urban and Housing whose estimate of funding is Kshs 100 Bn, and ii. The Commission on Revenue Allocation in conjunction with the Kenya Cities Forum [7]estimated at Kshs 186 Bn, with the latter being an estimation based on the last six years of devolution. The cost of financing gap is projected to continue building gap if no intervention is made in the near future.

Noting Kenya's re-classification into a lower middle-income country, dependence on concessional loans, grants and aid in promoting the development of the country's economic

[5] WSPF - Water and Sanitation Pooled Fund

[6] Market-based financing for urban infrastructure in India – by Chetan Vaidya and Hitech Vaidya

[7] This is an association of the 5 Cities – Nairobi, Mombasa, Kisumu, Nakuru and Eldoret whose mandate is to promote the critical position of Cities as engines of economic transformation in Kenya.

transformation agenda, which includes infrastructure development is not sustainable.

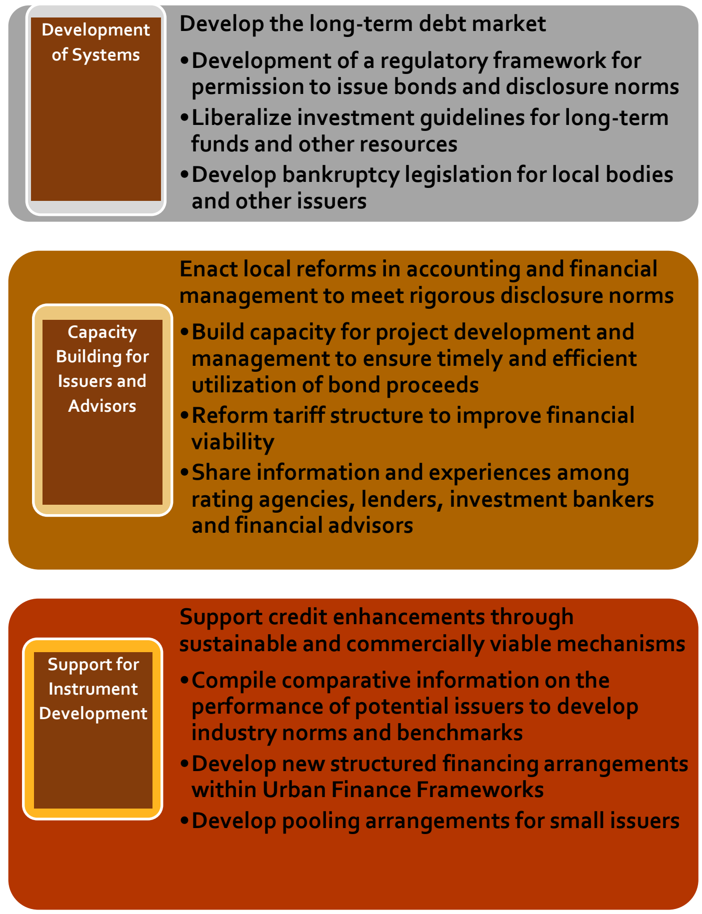
Sustainability requires building up of our domestic muscle in supporting the growth of our economy and there is no better way than to restructure the economy in a manner that the country's savings and investments are redirected to the most productive sectors of the economy through effective collaboration and increased participation by the private sector.

v. An Opportunity for the domestic Capital Markets to respond to demand through a Sub-National Debt Market?

Globally, the Capital Markets has been the platform through which savings and demand for funds is intercepted. With the growth in Assets Under Management (AUM) in the different financial sectors on an upward trend, opportunity abounds for the Capital Markets to facilitate the structuring of financial models to facilitate investment in new asset classes that support infrastructure development amongst the Kenyan Cities and urban areas.

Learning from India's nationalistic approach towards unlocking its subnational debt markets through the development of its Municipal bond market, some key interventions need to be put into consideration for success. These have been summarized in Fig 3 below for consideration by policy makers and devolved entities alike.

Fig 3: Summary of Key Reforms/Interventions for Success[8]



vi. The Cities Financing Dialogue and planned conference on November 25th – 27th 2019 at the Kenyatta International Convention Center, Nairobi

To explore this noble cause, an inter-agency technical team under the stewardship of the Ministry of Devolution was formed in March 2019.CFD[9], as commonly referenced, is a comprehensive, multi-level, interagency effort, to organize and mobilize all available forms of national resource, both public and private, in order to bridge the infrastructure gap in the Cities,

[8] "Emerging Innovations in Urban Infrastructure Finance: A Case of the Ahmedabad Municipal Corporation."

[9] Cities Financing Dialogue

Metropolitan and Urban Areas of Kenya, to achieve resilient, smart, sustainable cities for the 21st Century.

Noting the developments in India, Nepal, South Africa, the United States amongst others, there has been demonstrable success of the use of specific capital markets products to support subnational development projects The Authority therefore welcomes efforts by the Cities Financing Dialogue and other similar County initiatives, in engaging to determine the most feasible financial models, policy, regulatory, governance and infrastructure frameworks to establish Kenya's position and readiness in the development of a sub-national debt market.

We already note ongoing efforts to determine creditworthiness of Counties and their subsequent Rating by the Commission on Revenue Allocation through a pilot exercise targeting nine County Governments.

Learning from the huge success of Municipal bond issues in India, the support of the Government of Kenya is key in supporting similar issuances in Counties either as stand-alone or pooled, or in the form of Revenue Bonds and/ or General Obligations Bonds. Further the GoK[10] should emulate reforms taken by India such as exemption of such bonds from with-holding tax on interest income.

Counties on the other hand need to step up local reforms in accounting, financial management and taxation and to the extent possible set up a sinking fund and other credit enhancements to support bond issuances, while market intermediaries need to harness the opportunity for packaging the bonds and where possible act as underwriters to ensure success.

However, a number of factors need to be flagged for consideration by policy makers as they support the development of an active subnational market;

i. *There is need for development of a regulatory framework upon which investments within such devolved entities is anchored. Such regulation should establish the realm within which responsibilities of County Governments/entities are linked to the National Government's role especially with regard to incurring the burden of debt incurred;*
ii. *A successful subnational market in Kenya is dependent on the Governance framework being anchored away from the political leadership of the devolved entities. This will promote the sanctity of an issuance as investors will find safety if such issuances are managed by investment professionals;*
iii. *The success of subnational borrowing lies in the setting aside of income and revenue streams attached to an issuance to an escrow account or through the establishment of a sinking fund that solely guarantees a return to investors in spite operations within the devolved entities;*
iv. *Devolved entities also need to build capacity on the principles upon which market-based financing is anchored. This will enable them effect transparent financial management practices, maximization in own source revenue collections as well as understanding the principle of risk and return as the primary concern for investors;*
v. *Devolved entities should further be open to pursuing credit rating as a prerequisite to coming to market as a rating*

[10] GoK – Government of Kenya

acts as a barometer for investors in determining the financial soundness of an entity.

vi. *Crucially l, success of this proposed funding solution is anchored on the principle of trust. As a nation, we have a massive task ahead in breaking down the walls that hinder progress as a result of lack of trust at different levels; between National Government and County Governments; amongst market intermediaries; regulators and policy makers, and other stakeholders.*

2.0 Global Developments on Capital Markets

2.1 IPO backlog grows as global IPO market slows further in Q3.2019

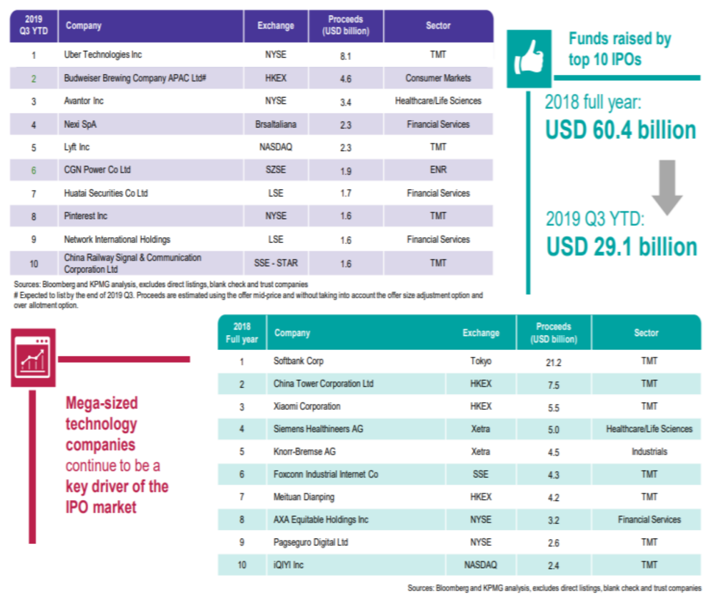
According to Ernst and Young Global IPO trends: Q3 2019 report, the backlog of high-quality IPOs continues to grow as issuers await more favorable market conditions, pushing IPO activity down across many markets in Q3 2019 compared with Q3 2018.

Overall, 256 IPOs came to the market in Q3 2019 with total proceeds of US$40.2b, a decrease of 24% by volume and 22% by proceeds compared with Q3 2018.The first nine months of 2019 (YTD 2019) saw a decline of 26% by deal volume (768 IPOs) and a 25% drop in funds raised (US$114.1b) versus YTD 2018.

Technology, health care and industrials had the largest share of IPOs in YTD 2019, together accounting for 407 IPOs (53% of global IPOs by deal volume) and raising a combined US$69.4b (61% of global proceeds).

Technology continued to be the strongest sector by deal numbers and proceeds in YTD 2019, representing 23% of global deal volume (179 IPOs) and 36% of proceeds (US$41.5b). In Q3 2019, technology was also the strongest sector by deal numbers and proceeds and saw 59 IPOs (23% of global IPOs by deal volume) which raised US$11.4b (28% of global proceeds[11])

Fig 4: Top 10 Largest Global IPOs – 2019 Vs 2018 [12]



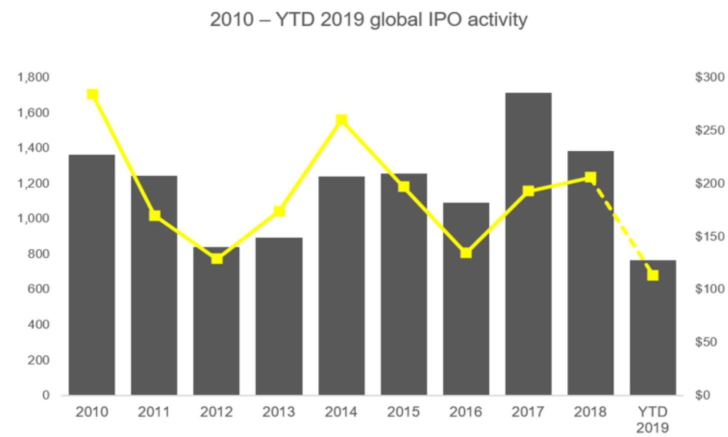
2019 Q3 YTD	Company	Exchange	Proceeds (USD billion)	Sector
1	Uber Technologies Inc	NYSE	8.1	TMT
2	Budweiser Brewing Company APAC Ltd#	HKEX	4.6	Consumer Markets
3	Avantor Inc	NYSE	3.4	Healthcare/Life Sciences
4	Nexi SpA	Brsaltaliana	2.3	Financial Services
5	Lyft Inc	NASDAQ	2.3	TMT
6	CGN Power Co Ltd	SZSE	1.9	ENR
7	Huatai Securities Co Ltd	LSE	1.7	Financial Services
8	Pinterest Inc	NYSE	1.6	TMT
9	Network International Holdings	LSE	1.6	Financial Services
10	China Railway Signal & Communication Corporation Ltd	SSE - STAR	1.6	TMT

Sources: Bloomberg and KPMG analysis, excludes direct listings, blank check and trust companies
Expected to list by the end of 2019 Q3. Proceeds are estimated using the offer mid-price and without taking into account the offer size adjustment option and over allotment option.

2018 Full year	Company	Exchange	Proceeds (USD billion)	Sector
1	Softbank Corp	Tokyo	21.2	TMT
2	China Tower Corporation Ltd	HKEX	7.5	TMT
3	Xiaomi Corporation	HKEX	5.5	TMT
4	Siemens Healthineers AG	Xetra	5.0	Healthcare/Life Sciences
5	Knorr-Bremse AG	Xetra	4.5	Industrials
6	Foxconn Industrial Internet Co	SSE	4.3	TMT
7	Meituan Dianping	HKEX	4.2	TMT
8	AXA Equitable Holdings Inc	NYSE	3.2	Financial Services
9	Pagseguro Digital Ltd	NYSE	2.6	TMT
10	iQIYI Inc	NASDAQ	2.4	TMT

Sources: Bloomberg and KPMG analysis, excludes direct listings, blank check and trust companies

Fig 5: Global IPO Activity – 2010 - Yield to Date 2019



Source: EnY

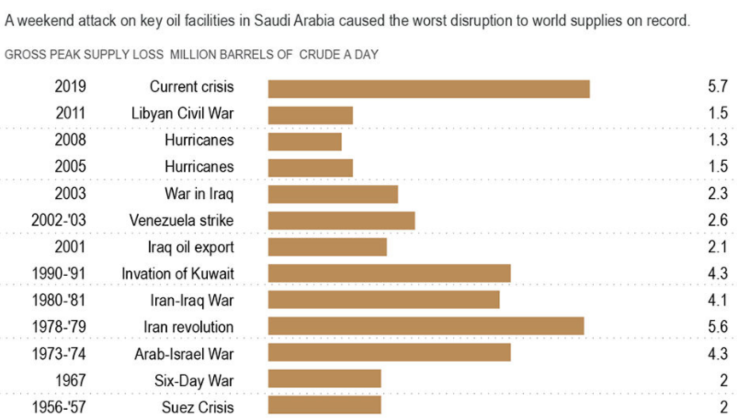
[11] https://www.ey.com/en_gl/news/2019/09/ipo-backlog-grows-as-global-ipo-market-slows-further-in-q3-2019

[12] KPMG - Mainland China and Hong Kong 2019 Q3 review: IPOs and other market trends

2.2 Attack on Saudi Arabia Oil Fields and effect on listing of Saudi Aramco

In the period under review, Yemen's Houthi rebels launched drone attacks on the world's largest oil processing facility in Saudi Arabia sparking huge fires and halting about half of the supplies from the world's largest exporter of oil.

Fig 6: World Disruption to world oil supplies on record



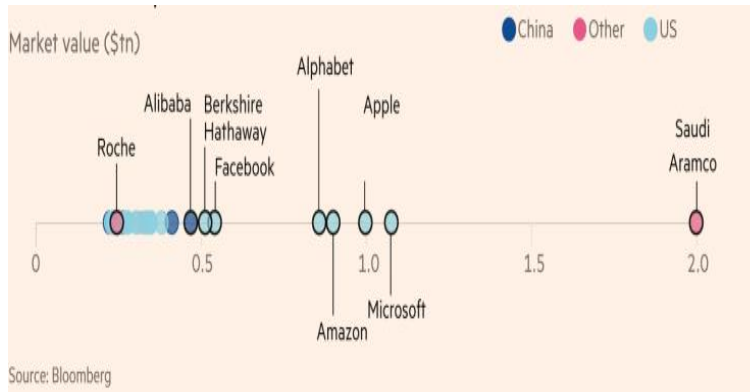
The fire is estimated to have led to the interruption of 5.7 million barrels in crude supplies. Saudi Arabia is the world's biggest exporter, shipping more than 7 million barrels of oil to global destinations every day, and for years has served as the supplier of last resort to markets.

Saudi Aramco Listing

Through the quarter under review, listing of Saudi Aramco, the official Saudi Arabian national petroleum and natural gas company based in Dhahran, Saudi Arabia, remained a key topic of discussion in the global capital markets.

The Aramco IPO is a pillar of an ambitious economic diversification drive by Crown Prince Mohammed bin Salman, who has put the firm's valuation at $2 Trillion. The domestic flotation is the first step towards a targeted five percent sale. Based on this valuation, a one-percent float would be worth $20bn and its subsequent listing would tower over the big tech groups.

Fig 7: Saudi Aramco Valuation Versus Other Big Tech Group IPOs in past



Analysts and bankers, however, have advised that a $1.5 trillion is a more achievable valuation for the world's biggest oil company, but rather than go straight for an initial public offering on an international stock market, the company is planning a gradual listing at home first, with plans list 1% on the Riyadh Stock Exchange before the end of 2019 and another 1% in 2020.

Following the attack on Saudi Oil fields, concerns were raised on the timing of the planned listing. However, post-attack reports indicate that Saudi Aramco oil facilities had no impact on Government revenues and that Authorities were gearing up to list the state-owned oil giant, signaling the Kingdom's resilience following the crippling drone strike on its oil industry.

The Government is also l considering a secondary listing overseas. Through the listing, the Government hopes will raise up to US$100 billion

The imminent listing of Aramco on Saudi Arabia's local exchange, despite calls to have the company listed on major global exchanges *such as the London Stock Exchange is a lesson for other jurisdictions in ensuring using strategic sectors and companies to profile their domestic economies.*

The Authority has over the years engaged its strategic partners and policy makers in order to expedite the privatization of strategic profitable companies in the country to attract the much needed domestic and foreign capital as well as enhanced profile, as part of capital raising and positioning the country as an investment decision of choice.

Such efforts should be sustained with the listing of the National Oil Corporation's Special Purpose Vehicle being a top priority, following Government's commitment to do so since 2018.

The sale of just 1% of Aramco further demonstrates that the GoK can still successfully divest a small percentage of State-owned Enterprises (SoEs) even if deemed strategic, depending on the size of IPO as long as this still results in increased number of shares available for secondary trading.

Further in the wake of a new era under its new prime minister, Dr. Abiy Ahmed Ali, Ethiopia is implementing reforms, notably proposed move to privatize state-owned enterprises.

The Ethiopian Government, for instance, has specifically launched the Privatization Program in accordance with Proclamation in 1994 thereof establishing the Ethiopian Privatization Agency whose objectives are; to promote the economic development of the country through encouraging the expansion of the private sector; generate revenue required for financing development activities undertaken by the Government; and to change the role and participation of the Government in the economy to enable it exert more effort on activities requiring its attention.

The target firms are Ethiopian Airline, Ethiopia telecom, Ethiopian Electric Corporation (EECO) and the Ethiopian Shipping and logistic enterprises. Management recommends that while making efforts to roll out big-ticket privatizations through the capital markets involving selected State Owned Enterprises locally, Kenya should cooperate with Ethiopia and other jurisdictions which do not have the necessary policy, regulatory and market infrastructure frameworks but have a robust privatization strategy for mutual benefit.

Noting Ethiopia's resolve and launch of a privatization program, an opportunity is presented for Kenya to provide Technical Assistance to the country in establishing the right framework towards establishment of an exchange in the long run. This has been done before for Rwanda and Burundi and can be replicated for the promising East African country. To leverage on this opportunity, the National Government should consider entering into a bilateral agreement with Ethiopia to facilitate such establishments working with financial sector players such as CMA, NSE and the CDSC.

In the medium term, cross-listing opportunities of the earmarked companies should be explored with the Nairobi Securities Exchange as the destination platform for listing

Other solutions being forwarded by the capital markets stakeholders include;

i. *The need to promote adherence to Corporate Governance requirements by State Owned Enterprises as guided by "Mwongozo Code of Governance" . As a solution, a minimum stake could be sold to strategic investors able to turn around the practice and image of such companies on matters Corporate Governance;*
ii. *Like devolved entities, SOEs should also be credit rated to determine their financial viability; and*

iii. *In the last two years, the privatization commission indicated on possible privatizations in the short term. However, the same has not be attained to date. To propel this agenda to realization, there is need for greater Political Will as well as Advocacy on the benefits that privatization presents to an economy;*

2.3 Brazil's Economy and Pension Sector Reforms

Brazil's economy is reported to be recovering at a slow pace as high unemployment puts a lid on growth. Private consumption is said to be growing but the challenging international environment and the lack of fiscal stimulus are dragging on the economy.

Between 2015 and 2016, Brazil's real GDP fell for eight straight quarters on a seasonally adjusted annualized basis before a rebound to start 2017. However, the recovery stalled after the first quarter of 2017, with GDP growth failing to break above 0.5 percent since then. Throughout this period, the Government put money aside to finance the pension system. However, with its relatively weak economic position, it cannot do that anymore as it is in a very fragile fiscal situation[13].

Retiring at 55, and thereafter earning 70 percent of their final salary for the rest of their lives has been the norm for Brazilians over decades. Pension costs accounts for about a third of all Government spending in Brazil and contributed to a record budget deficit in 2016. Brazil's debt levels have also surged to around 75 percent of GDP.

Analysts and politicians across the spectrum have long recognized that the pension system is unsustainable and a major factor in the country's continuing economic struggles. Brazil's retirement age for men who contributed into the country's pension system for 15 years is 65; for women, it is 60.

However, men can retire earlier if they pay into the system for 35 years, while for women it is 30 years. This has pushed down Brazil's average retirement age to the early-to-mid 50s, according to the Organization for Economic Cooperation and Development. Brazil is also one of the most generous countries in the world when it comes to pensions, with women getting53 percent of pre-retirement earnings. By comparison, workers in developed economies get full pensions averaging 53 percent of pre-retirement earnings at an average age of 65.5.

Fig 8: Brazil's Average Retirement Age in comparison to other developed economies

Proposal in the new Bill

Through the proposed bill that was given a nod by the Senate during the quarter, minimum retirement ages for men and women would be set and delay full pay out of pensions until 40 years of contributions. The measure would also implement a fixed retirement age for men and women at 65 and 62, respectively. The new rules would phase in over 12 to 14 years. It

[13] https://www.nytimes.com/2018/02/25/world/americas/brazil-pension-michel-temer.html

is equally reported that in future, the Senate would introduce a parallel bill to reform the pension system in states and Municipalities, which are not included in the original bill. If approved, it would generate an additional USD89 billion of savings[14].

The proposal aims to save the Government more than 1 trillion reals — or about $270 billion — over a 10-year period. This proposal is far more ambitious than former President Michel Temer's, which targeted 600 billion reals in savings.

While Kenya's pension obligations may not be at the same level with Brazil, there have been proposals from Government on the need to review the retirement age and benefits of employees in the recent past. Further there is a move towards adopting a five Pillar pension model ranging from: basic poverty alleviation state grant to all citizens above a certain age threshold-funded from tax revenue; Compulsory contributions; to a Defined Contribution National Social Security Pension Fund for all employers and employees with an opt out to prescribed occupational retirement benefits schemes; all the way to additional social assistance for elderly such as medical, discounted services, discounted transport, discounted holidays, low interest loans.

Capital markets stakeholder's welcome the intent of the GoK to phase out the existing Civil Service Scheme for Civil Servants and replace it with Defined Contribution effective April 2020. Noting that pension coverage in Kenya is only currently at 20%, this will be a significant reform measure that will ensure that that pension assets in Kenya currently at Kshs 1.2 trillion continue to grow in order to not only comfortably support citizens, post-retirement but to enhance the level of investible funds available to support National Development Goals .

The growth of the pension schemes will create opportunities in the capital markets as fund managers seek to diverse investments in order to optimize returns. Ministries , Departments and Agencies (MDAs) should engage with pension schemes on the scope of utilization of pension assets in the realization of the "Big 4" Agenda, especially in Public Private Partnerships (PPP) projects that are not perceived as high risk to ensure that pension industry in Kenya remains sustainable while deepening the capital markets. It however important for policy makers to note that while efforts are being made jointly by the Retirement Benefits Authority and the CMA to sensitize Trustees and Pension Administrators on other capital markets products, as long as Kenya Government Securities continue to offer superior real returns to Pension Schemes it is unlikely that there will be a shift towards investing in products that will support the "Big 4"Agenda projects

2.4 Hong Kong's leadership in Fintech leads to licensing of eight virtual banks

Hong Kong is paving the way with Government initiatives that promote innovation while protecting investors and consumers alike. Having developed three sandboxes, a dedicated Fintech Facilitation Office (FFO) of the Hong Kong Monetary Authority (HKMA), the Fintech Contact Point of the Securities and Futures Commission and the Insuretech Facilitation Team of the Insurance Authority, the Hong Kong Government has provided a solid foundation for Fintech growth and investment.

In the months leading to September 2019, Hong Kong Monetary Authority (HKMA) recently approved eight virtual banking license recipients, opening the door for Fintech companies to

[14] https://ihsmarkit.com/research-analysis/pension-reform-in-brazil.html

enter the banking industry. Some of the authorization criteria for becoming licensed as a virtual bank are in some ways less onerous than the criteria for becoming a conventional bank with physical branches.

The most obvious difference is that virtual banks are not required to maintain physical branches, although they must maintain a physical presence in Hong Kong, to interface with the HKMA and with customers, to deal with their enquiries or complaints.

The most significant feature of the new regime was that virtual banks were not required to be majority-owned by a regulated financial institution, meaning that non-financial institution companies, for example, technology and e-commerce companies, can become majority shareholders of virtual banks.

In contrast, the HKMA's policy in relation to conventional banks is that they should be majority-owned by a bank or other type of regulated financial institution.

The HKMA's Guideline on Authorization of Virtual Banks clearly sets out the HKMA's policy objectives for welcoming virtual banks in Hong Kong. The development of virtual banks is said to promote the application of financial technology and innovation in Hong Kong, to offer a new kind of customer experience, and to help promote financial inclusion, including the small and medium-sized enterprises. In China, five of the country's largest tech companies have already been operating virtual banks since 2014.

Kenya has already been able to witness the impact of digital disruption with the significant drop in agency banking services with the introduction of digital banking. The concept of virtual banks presents an opportunity that could be emulated in the capital markets industry as some Fintechs offering digital fund management services and crowdfunding are already undergoing tests in the CMA Regulatory Sandbox.

As alternative financial access and intermediation continues to gain traction both globally and domestically, conventional/traditional financial service providers need to adapt quickly to embrace Fintech.

In Kenya we see the growth of FinTechs as a further opportunity to position the Capital Markets through increasing the scope of its products and services and increasing efficiency.

Through its operational regulatory sandbox, a challenge is presented before the Authority to learn from the Hong Kong experience and perhaps work with the intermediaries in testing the applicability of the concept in the Kenyan Capital Markets space.

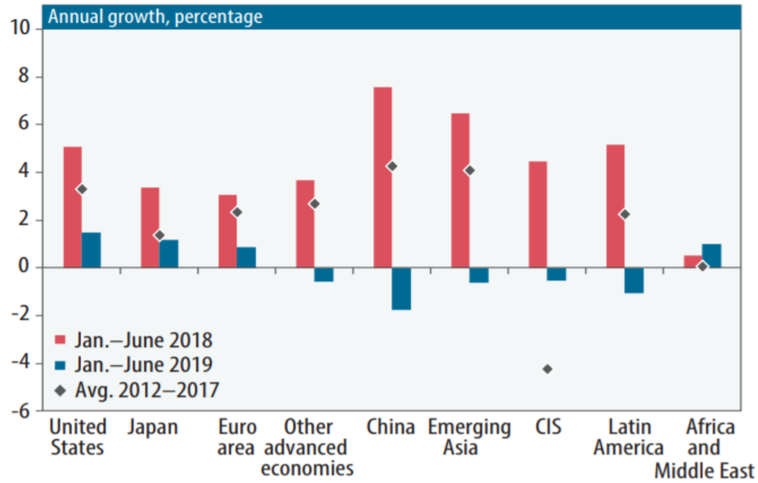
3.0 Key Global Economic and Financial Markets Stability issues

3.1 Deceleration in Global Economic Growth in 2019

Analysts continue to express concerns over a deteriorating global economic outlook mainly attributable to the Brexit-related uncertainty, downturn in Europe and new trade tensions, with the latter having a ripple effect on the manufacturing sectors of different economies as gains and losses are incurred.

Global growth has been declining, falling to an estimated 2.4 percent (yoy) in Q2.2019, down significantly from a peak of 3.5 percent in Q3.2017. As a result, trade growth continues to weaken for most developed and developing regions alike, attributable to globalization effects.

Fig 9: Merchandise import volume growth by region



Note: Emerging Asia includes China. Regional groupings are not strictly comparable to those in the World Economic Situation and Prospects but are illustrative of regional tendencies.
Source: UN DESA, based on data from CPB Netherlands Bureau for Economic Policy Analysis.

Fig 10: Forecasted Growth Rates [15]

(Percent change y/y, except quarterly data on industrial production, which are percent change q/q, annualized)

			2018		2019		2018					2019						
	2017	2018	Q3	Q4	Q1	Q2	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Industrial production, sa [1]																		
World	**4.2**	**3.7**	**2.8**	**1.8**	**1.6**	**0.4**	**3.5**	**3.5**	**3.8**	**2.3**	**1.9**	**2.2**	**1.9**	**2.7**	**1.6**	**2.0**	**1.3**	**1.3**
Advanced economies	2.8	2.2	1.7	0.5	-2.4	-0.8	2.4	2.3	2.4	0.7	0.2	1.2	0.5	0.0	-0.2	0.3	-0.9	-0.7
Emerging market and developing economies	5.5	5.2	3.9	3.1	5.5	1.5	4.7	4.6	5.2	3.9	3.5	3.2	3.2	5.2	3.4	3.6	3.5	3.2
Commodity-exporting EMDEs	2.5	2.9	5.6	1.7	0.0	-1.0	2.6	1.9	4.0	2.7	2.0	1.4	1.0	1.7	0.9	3.0	0.8	2.1
Other EMDEs	6.4	5.8	3.5	3.5	6.9	2.2	5.2	5.4	5.5	4.2	3.8	3.7	3.7	6.2	4.0	3.7	4.2	3.5
East Asia and Pacific	6.6	6.1	4.3	5.5	8.5	1.3	5.8	5.4	6.1	5.4	5.4	4.9	4.5	7.6	4.8	4.4	5.4	4.7
East Asia excl. China	7.1	5.0	9.1	5.0	-4.3	-5.3	3.7	3.1	7.3	4.9	3.7	2.9	-0.4	3.2	1.2	1.2	0.4	3.4
Europe and Central Asia	6.0	4.5	1.5	-2.7	4.4	0.9	3.8	3.3	3.0	1.8	0.0	0.5	1.9	2.3	1.7	0.6	0.7	1.6
Latin America and Caribbean	0.8	1.5	2.5	-3.5	-2.4	-0.1	1.9	1.2	1.2	0.4	-1.7	-1.2	-0.7	-1.8	-2.0	2.1	-2.6	-2.2
Middle East and North Africa	5.5	2.0	9.6	-6.2	-0.2	-	-3.4	5.7	-1.6	-0.9	1.6	0.4	0.5	2.6	4.2	2.6	-	-
South Asia	4.6	5.5	6.1	5.4	-2.5	5.5	2.7	6.3	8.6	1.5	2.4	2.1	1.3	2.5	2.7	4.8	3.2	4.1
Sub-Saharan Africa	0.0	1.5	8.1	3.6	-8.6	2.3	1.9	2.2	2.6	1.5	0.8	0.7	0.9	0.6	5.0	0.4	-1.8	-2.2
Inflation, sa [2]																		
World	**2.3**	**2.4**	**2.6**	**2.2**	**2.1**	**2.2**	**2.6**	**2.4**	**2.5**	**2.2**	**2.0**	**2.0**	**2.0**	**2.1**	**2.1**	**2.3**	**1.9**	**2.0**
Advanced economies	1.4	1.7	2.1	2.0	1.5	1.6	2.0	2.1	2.2	2.0	1.6	1.5	1.5	1.7	1.8	1.7	1.6	1.5
Emerging market and developing economies	3.2	3.0	3.1	2.5	2.5	2.6	3.1	3.0	3.0	2.5	2.2	2.2	2.4	2.7	2.8	2.7	2.4	2.6
Commodity-exporting EMDEs	3.4	2.9	3.0	2.7	2.6	2.5	3.0	2.9	2.7	2.8	2.3	2.5	2.5	2.5	2.5	2.6	2.3	2.4
Other EMDEs	2.9	3.1	3.1	2.5	2.4	2.9	3.3	3.3	3.4	2.4	2.0	2.2	2.4	2.7	3.0	3.1	2.7	2.7
East Asia and Pacific	2.9	3.4	4.1	2.8	2.3	2.7	3.6	3.5	3.2	2.5	1.8	1.7	1.8	2.3	2.4	2.7	2.6	2.6
Europe and Central Asia	2.4	2.6	2.8	2.1	2.5	3.2	3.0	2.4	2.2	1.9	1.8	2.1	2.4	2.9	3.3	3.4	2.9	2.8
Latin America and Caribbean	2.6	2.3	2.8	2.2	2.0	3.2	2.6	2.3	2.6	2.3	2.0	1.9	1.9	2.1	3.1	3.3	2.6	3.1
Middle East and North Africa	1.6	2.5	2.2	1.5	0.8	0.5	2.3	2.1	1.7	1.9	2.1	1.4	0.4	1.2	0.9	0.5	0.4	0.4
South Asia	3.9	4.0	4.1	3.4	4.3	4.8	4.0	3.9	4.1	3.3	3.7	4.6	4.3	4.2	4.4	5.3	4.4	5.6
Sub-Saharan Africa	5.4	3.7	3.4	3.9	3.5	2.3	3.5	3.7	3.8	4.1	3.5	3.6	3.4	3.1	2.3	1.9	2.1	2.1

Sources: Haver Analytics, IMF International Financial Statistics, World Bank.
[1] Industrial production is total production (may exclude construction). When data are unavailable, "industrial production, manufacturing" is used as a proxy.
[2] Median inflation rate for each grouping.

3.2 Japan and South Korea Trade Tension

In early July 2019, Japan restricted exports of materials critical to South Korea's semiconductor industry, citing national security concerns and a lack of trust in Korea. Further, South Korea is now bracing for Japan's decision to drop it from the list of countries that enjoy minimum trade restrictions as expressed by Seoul's Finance Minister[16]. Aside from the direct impacts coming from the export restrictions, some consumer-facing companies are beginning to feel the pressure of worsening relations between the two countries.

For instance, an apparent drop in tourism between the two nations, attributed to the political dispute, has led many major airlines to trim the number of flights or even terminate direct routes between major Japanese and Korean cities. Other major Korean companies that have cited operations being affected by the disagreement include tech giants Samsung and LG Electronics[17].

However, in the long term, the weaponization of trade is likely to come at the cost of efficiencies gained through decades of building supply chains across the Asia-Pacific and beyond, causing a drag on the overall global economic growth trajectory.

While we have previously observed that trade disputes between China and the United States (US) may create opportunities for Kenya to enhance existing bilateral trade agreements, an escalation of similar tensions between other key economic powerhouses' risks impacting the global economy negatively.

[15] http://pubdocs.worldbank.org/en/147371568918143953/Global-Monthly-Sep19.pdf

[16] https://www.cnbc.com/2019/07/31/japan-korea-trade-dispute-can-hurt-businesses-and-the-global-economy.html

[17]

Further the drop-in trading volumes between China and the US has resulted in a contraction of bilateral trade between each country and their trade partners in Europe and Asia, notably Japan and South Korea whose share of exports of electronic goods and services has dropped significantly.

Not only would current unresolved trade tensions prolong the weakness in global trade and demand, but they risk triggering a wider spread of protectionist measures by other countries, derailing global economic activity.

Kenya needs to advocate for robust and efficient dispute resolution mechanisms at global and regional levels to minimize the contagion of protectionist policies that are currently being adopted across the globe.

3.3 Volatility in Global Financial Markets

Following the trade announcement on imposition of import tariffs on more Chinese imports by the United States of America, the Dow Jones Industrial Average's recorded its worst performance of 2019. The Index dropped 800.49 points or 3.05% to 2, 5479.42, its worst percentage drop of the year and fourth-largest point drop of all time. The S&P 500 fell 85.72 points or 2.93% to 2,840.6, while Nasdaq Composite declined 3.02% to 7,773.94. The Dow gave up the entire rebound from a sell-off earlier in August and fell to a two-month low[18].

3.4 Decline in Repo Market Activity and Fed's Intervention

During the quarter, the US Federal Reserve injected hundreds of billions of Dollars into the market for repurchase[19], or repo, contracts. This is reported to have been necessitated by a shortage of funds in the market, leading the interest rate to soar, initially close to 10 percent. The Federal Reserve then intervened in order to fix the mismatch between supply and demand.

The shortage of funds is partially attributable to the fact that commercial banks have not showed keen interest in lending out their cash reserves, as they continue to earn interest from the Fed on these excess reserves. The result is that the size of the repo market has declined substantially in the last few years. At the same time, nonbanks such as hedge funds and securities brokers need cash to fund their purchases of corporate debt which have grown rapidly, explaining the imbalance in the market.

[18] https://www.cnbc.com/2019/08/14/stock-markets-wall-street-in-focus-amid-earnings-economic-data.html

[19] A **repurchase** agreement (**repo**) is a form of short-term borrowing for dealers in Government securities. In the case of a **repo**, a dealer sells Government securities to investors, usually on an overnight basis, and buys them back the following day.

The Fed's unwinding of quantitative easing has resulted in a decline in bank reserves, which partly explains why there is a reduction in the supply of short-term funds[20]. While this may have been a temporary intervention by the Fed, the stability of this market is reported to remain in limbo as consequences abound.

An analysis by Deloitte on this matter summarizes the possible outcomes into 3;

a. **First**, if the Fed winds up permanently participating in this market in order to avoid future imbalances, it could complicate the task of implementing monetary policy. It will boost the Fed's balance sheet at a time when it is intent on stabilizing it, and it will complicate the setting of interest rates;
b. **Second**, permanent Fed intervention could create an incentive for repo market participants to take excessive risks at a time when there might already be too much leverage in the corporate debt market;
c. **Finally**, the troubles in the repo market could alarm investors, leading to a seizing up of credit in short-term markets—as happened 10 years ago at the start of the global financial crisis. Clearly, conditions are not similar to what happened a decade ago. Still, economic troubles often begin when investors panic because of perceived shortages of funds. Thus, the Fed might have no choice but to continue intervening in order to avoid panic.

3.5 Monetary Policy Shifts by Central Banks

As global financial systems continue to respond to the uncertain operating environment, more jurisdictions have made monetary policy shifts to support the growth and development of their domestic economies. During the quarter, several policy measures were undertaken by different Central Banks.

a. **Bank of England Retains Rate:** At its meeting ending on 18th September 2019, the Monetary Policy Committee voted unanimously to maintain Bank Rate at 0.75%. It also voted unanimously to maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £10 billion. Additionally, they also voted unanimously to maintain the stock of UK Government bond purchases, financed by the issuance of central bank reserves, at £435 billion;

b. **European Central Bank (ECB) Cuts Rate:** The ECB cut its deposit rate to a record low -0.5% from -0.4% and will restart bond purchases of 20 billion euros a month from November 2019.With inflation falling, Germany skirting a recession and a global trade war sapping domestic confidence, the ECB had all but promised more support to the economy and the only question was how extensive stimulus would be. In addition, reports by the Governing Council expects (bond purchases) to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates .The ECB also eased the terms of its long term loans to banks and introduced a tiered deposit rate to help banks[21];

[20] https://www2.deloitte.com/us/en/insights/economy/global-economic-outlook/weekly-update.html

[21] https://www.reuters.com/article/us-ecb-policy-rates/ecb-cuts-key-rate-to-restart-bond-purchases-idUSKCN1VX1DB

c. **Reserve Bank of India Cuts Rate:** On 27th September 2019, the Reserve Bank of India equally cut interest rates for a fifth straight time as it steps up efforts to kick start economic growth that has been on the decline. The RBI maintained its "accommodative" stance, stating it would maintain this position "as long as it is necessary" to revive growth while ensuring inflation remains within target[22]. All six members of the monetary policy committee (MPC) voted to lower the repo rate, which is the rate at which the central bank lends to commercial banks, by 25 basis points (bps) to 5.15 percent. India's central bank has now cumulatively lowered interest rates by 135 bps this year. Further, to revive the faltering economy, the Government in September announced a steep cut in the corporate tax rate - to 22 percent from 30 percent - triggering the biggest intraday gain in Indian stocks in more than a decade.

d. **New Zealand Rate Cut:** During the quarter, New Zealand's Central Bank stunned markets on by cutting interest rates a steep 50 basis points and even flagged the risk of going nuclear by taking rates below zero, a radical shift that drove its currency to three-and-a-half year lows. The committee drove home its dovish message by predicting there was no chance of a hike until late 2021. Growth in New Zealand's near $200 billion economy has been running below-par in recent quarters as international trade frictions slowed global demand in a blow to factory activity and exports. Business and consumer confidence have also sunk, painting a gloomy outlook[23].

Kenya's Central Bank's Monetary Policy Committee has remained conservative over the years with respect to making changes to the Central Bank Rate which has only fell 1% since September 2016 when interest rate caps were introduced, to a consistent 9 percent over several months.

While there seems to be a global shift towards use of monetary policy as the solution towards correcting arising economic imbalances and instability, Kenya over the years has favored fiscal policy measures in stimulating economic activity and stability, with a current focus on Fiscal consolidation.

This could be attributed to the fact that Monetary policy interventions tend to be more complex in implementation and impact with respect to the stability of other economic indicators such as inflation, repo rates, cash reserve ratios and general credit positions of economies.

We however project that as Kenya reforms its Repo market and graduates into a middle-income country in the coming years with much more stable economic indicators, both fiscal and monetary policies can be used to maximize on the value/benefits earned from each, cognizant of the lag on effect presented by monetary policy interventions which may have a long-term outlook on the economy as opposed to fiscal policies, that are usually short-term in nature.

3.6 Japan: Economic growth decelerates

Although capital expenditure was firm during the first half of 2019, the Japanese economy is starting to feel the heat from US-

[22] https://www.aljazeera.com/ajimpact/row-india-central-bank-cuts-rates-191004062628768.html

[23] https://www.reuters.com/article/us-newzealand-economy-rbnz/new-zealands-central-bank-stuns-as-bold-50-basis-point-rate-cut-bowls-over-kiwi-dollar-idUSKCN1UX06A

China trade tensions. Sluggish exports and heightened uncertainty about international trade are likely to delay investments in the second half of the year, especially among manufacturers. Private consumption is also expected to lose some steam due to a scheduled VAT rate hike in October.

As the economy slows, the Government is expected to respond with a package of measures worth 1% of GDP in Q4 2019, but average growth in H2 2019 and 2020 will likely remain close to 0%. Analysts expect the Japanese economy to grow by 1.2% in 2019 and by 0.2% in 2020.

Regarding monetary policy, the BoJ may cut interest rates further, thus taking them into negative territory as a response to the global slowdown. Despite many years of aggressive easing by the BoJ, core CPI inflation has not picked up and is expected to decline from 0.8% in 2018 to 0.5% in 2019 and to 0.1% in 2020.

3.7 UK Brexit Developments

The British Government has proposed a new version of the Brexit deal which the EU is considering. Statements from both sides suggest agreement is unlikely, but discussions are still ongoing. In September 2019, MPs passed a new law - introduced by Labour's Hilary Benn - designed to stop Mr Johnson pushing through a no-deal Brexit on 31 October. Under the "Benn Act", Mr Johnson would be required to request a three-month Brexit delay unless he can pass a deal or get MPs to approve a no-deal exit by 19 October. Leaving without a deal (or withdrawal agreement) means the UK would immediately exit the customs union and single market - arrangements designed to make trade easier. Many politicians and businesses say this would damage the economy. Others say the risks are exaggerated.

3.8 Singapore edges out US as world's most competitive economy

Singapore has climbed one notch to become the world's most competitive economy, according to the 2019 World Economic Forum (WEF) report, overtaking the States. Singapore scored 84.8 out of a 100 on the WEF's scale, beating other countries especially in terms of infrastructure quality and the openness of its economy. The average global score was 60.7.

The report further states that in the US, uncertainty among business leaders, lower domestic competition and reduced trade openness were among the factors that set the country behind in 2019.

Led by Mauritius (52nd), sub-Saharan Africa is overall the least competitive region, with 25 of the 34 economies assessed this year scoring below 50. South Africa, the second most competitive in the region, improves to the 60th position, while Namibia (94th), Rwanda (100th), Uganda (115th) and Guinea (122nd) all improved significantly.

Fig 11: Top 15 - The Global Competitiveness Index 4.0 2019 [24]

Rank	Economy	Score[1]	Diff. from 2018[2] Rank	Diff. from 2018[2] Score
1	Singapore	84.8	+1	+1.3
2	United States	83.7	–1	-2.0
3	Hong Kong SAR	83.1	+4	+0.9
4	Netherlands	82.4	+2	—
5	Switzerland	82.3	–1	–0.3
6	Japan	82.3	–1	–0.2
7	Germany	81.8	–4	–1.0
8	Sweden	81.2	+1	–0.4
9	United Kingdom	81.2	–1	–0.8
10	Denmark	81.2	—	+0.6
11	Finland	80.2	—	—
12	Taiwan, China	80.2	+1	+1.0
13	Korea, Rep.	79.6	+2	+0.8
14	Canada	79.6	–2	–0.3
15	France	78.8	+2	+0.8

Among the other large economies in the region, Kenya (95th) and Nigeria (116th) also improved their performances, but lost some positions, overcome by faster climbers. On a positive note, of the 25 countries that have improved their Health pillar score by two points or more, 14 are from sub-Saharan Africa, making strides to close the gaps in healthy life expectancy.

Fig 12: Regional Performance by Pillar

Average score (0–100)

Region (alphabetical order)	Enabling Environment: Institutions	Infrastructure	ICT adoption	Macroeconomic stability	Human Capital: Health	Skills	Markets: Product market	Labour market	Financial system	Market size	Innovation Ecosystem: Business dynamism	Innovation capability
East Asia and the Pacific	61.6	74.8	70.3	89.6	83.8	67.3	62.2	66.6	74.3	67.9	66.1	54.0
Eurasia	53.8	67.7	59.5	74.9	71.3	66.1	56.1	63.5	52.0	50.3	61.9	35.5
Europe and North America	64.7	79.7	70.4	92.6	89.1	74.6	60.0	66.4	70.9	60.1	68.3	58.1
Latin America and the Caribbean	47.1	61.3	50.9	73.7	82.2	58.7	51.6	55.9	60.3	51.2	53.8	34.3
Middle East and North Africa	55.5	70.5	57.6	75.3	80.8	62.9	56.7	54.8	63.7	59.9	58.2	41.3
South Asia	50.0	59.2	35.1	74.7	68.4	50.1	45.8	51.5	60.0	67.7	57.8	36.3
Sub-Saharan Africa	46.9	45.0	34.3	69.4	50.8	44.3	49.3	54.6	50.8	40.4	51.8	29.4

Source: World Economic Forum analysis.
Note: See the At a Glance section on page xiii for regional classifications. Darker shades indicate better performance.

The Authority appreciate measures that Kenya is taking to improve its standing both in Ease of Doing Business and Global Competitive Index but is of the view that some parameters used in determining performance rankings may have far reaching unintentional consequences.

The recent amendment to the Companies Act that now lightens the threshold of takeover of firms by anchor investors to 50% has both pros and cons. The Regulations require that the offeror shall prepare a takeover offer document stating the terms of the offer and the offeree shall issue a shareholder's circular to all its shareholders together with an independent advisor's report with a similar offer being offered to all shareholders. This is in line with good Corporate Governance in protection of minority investors by ensuring that there is equitable treatment of all shareholders in a company by making it mandatory for minority investors also have access to any information relating to a takeover at the same time as controlling/majority investors. On the flip side, except for listed companies, protected by the Capital Markets Takeovers and Mergers Regulations, the amendments effectively mean that upon acquiring or unconditionally contracting to acquire 50% shares in a company, the acquirer can compulsorily buy out the remaining 50% of the shares. This could undermine the right of minority investors to decline the offer.

The Authority has engaged high-level policy makers on the implication of the amendment to section 611 and 615 of the Companies Act and further proposed to the Attorney General the urgency of developing Regulations under the Companies Act to further detail the takeover process envisaged under the Act for

[24] The index maps the competitiveness landscape of 141 economies through 103 indicators organized into 12 themes. Each indicator, using a scale from 0 to 100, shows how close an economy is to the ideal state or "frontier" of competitiveness. The pillars, which cover broad socio-economic elements are: institutions, infrastructure, ICT adoption, macroeconomic stability, health, skills, product market, labour market, the financial system, market size, and business dynamism and innovation capability.

unlisted companies. The key message however is that a proper balance should be made between improving Kenya's global rankings and exposing the economy to various shocks; and this may be achieved by increased tracking of the impact of reforms required to achieve the rankings as well as engagement with relevant stakeholders and the general public.

4.0 Domestic Economy

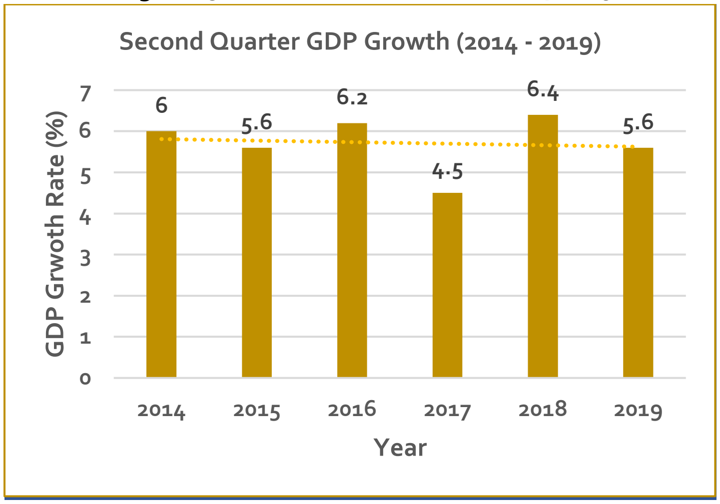
4.1 GDP - Kenya economy expands by 5.6 percent in Q2.2019

The recent release on GDP performance by the Kenya National Bureau of Statistics (KNBS) indicates that economic activity was notably subdued in the second quarter of 2019 relative to the performance recorded in the same quarter of 2018. The economy expanded by 5.6 per cent ibn Q2.2019 compared to 6.4 per cent in the corresponding quarter of 2018. The same growth rate of 5.6 per cent was recorded in Q1.2019.

A number of sectors posted impressive performances, but the overall growth was curtailed mostly by a slowdown in Agriculture, Manufacturing and Transportation.

Agriculture's performance as well as that of electricity and water supply were mostly hampered by a delay in the onset of the long rains. Transportation industry was negatively impacted on by rise in prices of fuel. On the other hand, accommodation and food services; information and communication; wholesale and retail trade; and construction industries maintained high growths and thereby supported the overall GDP growth

Figure 13: Q2 GDP Growth Trend (2014-2019)



Source: KNBS

4.2 Inflation

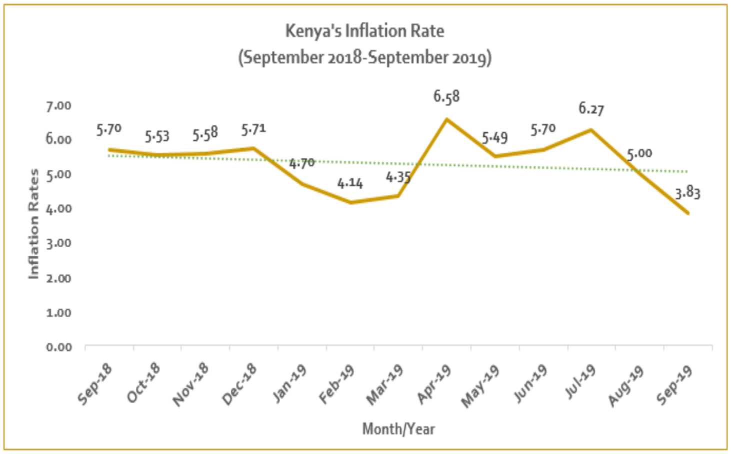
According to the most recent publication by Kenya National Bureau of Statistics on Consumer Price Indices (CPI) and Inflation Rates, overall year-on-year inflation stood at 3.83 % in September 2019. The CPI decreased by 0.11 per cent from 201.78 in August 2019 to 201.57 in September 2019.

Between August and September 2019, Food and Non-Alcoholic Drinks' Index decreased by 0.40 per cent due to decrease in prices of some foodstuffs outweighing increases recorded in others.

For instance, in September 2019 prices of carrots, cabbages and tomatoes decreased by 9.80, 6.32 and 4.14 per cent, respectively. The 'year on year' food inflation dropped from 7.13 per cent in August 2019 to 6.31 per cent in September 2019. During the same period, Housing, Water, Electricity, Gas and Other Fuels' Index, increased by 0.07 per cent mainly attributed to increase in house rent and cooking fuels.

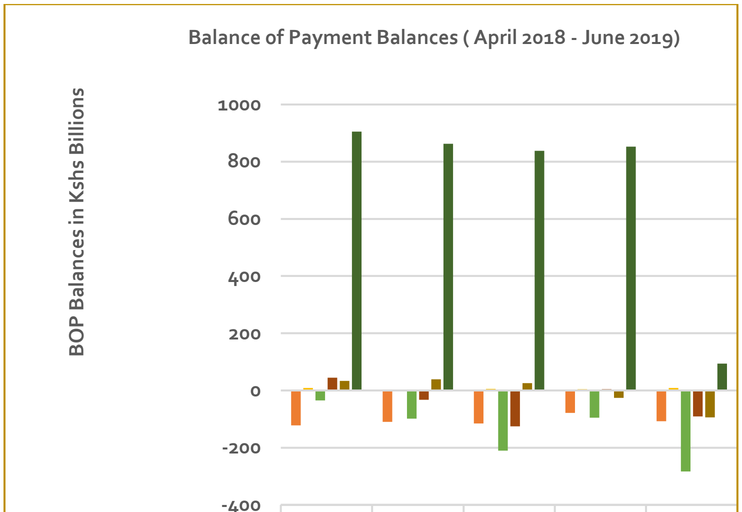
The Transport Index increased by 0.48 per cent mainly due to increase in pump prices of diesel and petrol.

Fig 14: Inflation Rates Trend for the year the period Sep. 2018 – Sep. 2019



Source: KNBS

Fig 15: Balance of Payment Components Balances (April 2018 - June. 2019)[25]



	Apr-June	July-Sep	Oct-Dec	Jan-Mar	Apr-June
Current Account	-122.03	-109.29	-115.38	-78.84	-107.62
Capital Account	9.37	3.58	5.24	4.26	8.68
Financial Account	-34.33	-98.46	-210.45	-95.7	-283.73
Net Errors and Omissions	44.74	-32	-125.88	4.42	-90.33
Overall Balance	33.59	39.24	25.57	-25.53	-94.46
Gross Official Reserves	904.84	862.68	838.23	853.13	94.46

BOP Component Accounts

Current Account
Capital Account
Financial Account
Net Errors and Omissions

Source: KNBS

4.3 Balance of Payment Position

The most recent Q2.2019 Balance of Payments report by the Kenya National Bureau of Statistics indicated that the overall balance of payments position improved to a surplus of KSh 94.5 billion in the second quarter of 2019 from a deficit of KSh 33.6 billion in the corresponding quarter of 2018.This, as a result of a sum total of;

i. Improvement in the Current Account deficit from Kshs. 122 Billion recorded in Q2.2018 to Kshs.107.6 Bn recorded in Q2.2019.

ii. Marginal decrease in the net inflows of international trade in services to a surplus of Kshs 38.3 Bn.

iii. Increase in diaspora remittances by 8.1 percent to Kshs. 80.8 Bn, boosting the secondary income account to a surplus of Kshs.149.2 Bn in Q2.2019.

iv. Surplus of Kshs 283.7 Bn in the financial account from Kshs 34.3 Bn recorded in Q2.2018, with the increase attributed to the proceeds from the issuance of the third sovereign bond during the review period.

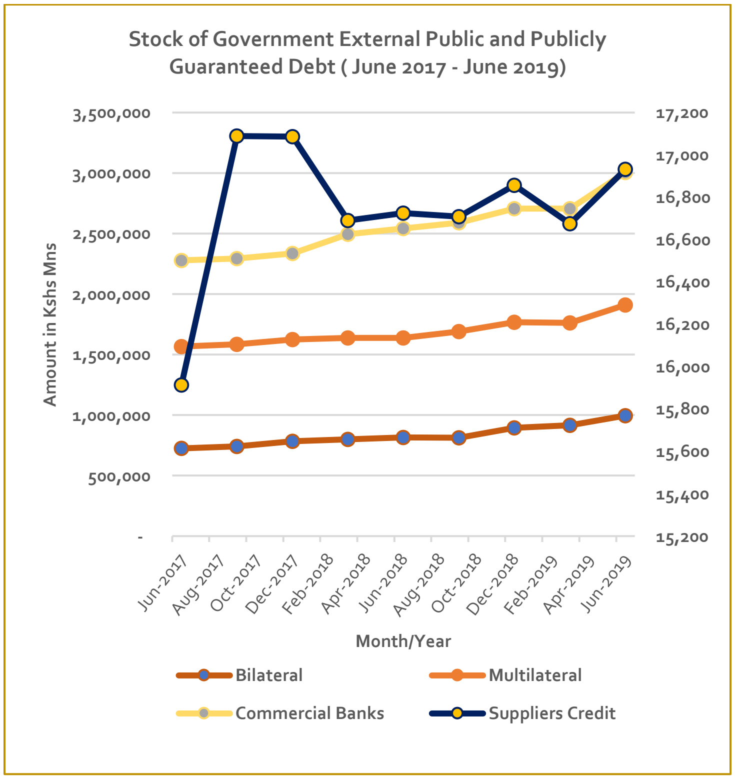
[25] BOP Statistics for quarter ended Sep 2019 were not available as at the time of this publication.

v. A 9.2 percent increase in the stock of gross official reserves, standing at Kshs 987.8 Bn in comparison to Kshs 904.8 Bn recorded in Q2.2018.

4.4 Stock of Public External Debt

The outstanding external public and publicly guaranteed debt from 2016/17 to 2018/19. The stock of public external debt increased by KSh 462.9 billion to KSh 3,023.1 billion as at end of June 2019. Stock of debt from commercial banks increased by 20.9 per cent to KSh 1,095.8 billion as at end of June 2019.

Figure 16: Stock of Government External Public and Publicly Guaranteed Debt



Source: KNBS

The Authority commends the National Treasury and Planning for its key step of developing a comprehensive Public Debt and Borrowing Framework. When finalized and implemented, we are confident that this policy document will guide high-quality and impactful decision making in public debt management and sustainability.

We further observe that the draft framework asserts TNT&P's intention to enhance the Public Debt Management Office (PDMO); prepare an annual borrowing program and auction calendar, which will be key in accelerating ongoing Bond market reforms in Kenya. We further hope that this policy document will be able to clearly outline the borrowing/capital raising arrangements for Counties, which has remained ambiguous.

5.0 Performance of Capital Markets

5.1 Equity Market Performance

In the secondary equities market;

i. Equity turnover for Q3. 2019 dropped to KSHs. **30.66** Billion from the turnover for Q2.2019 which stood at KShs **32.90** Billion; indicating a 6.8% decrease.

ii. End month market capitalization for Q3. 2019 was KSHs. **2189.98** Billion compared to KSHs. 2278.899 Billion recorded in the previous quarter, indicating a 3.90% decrease.

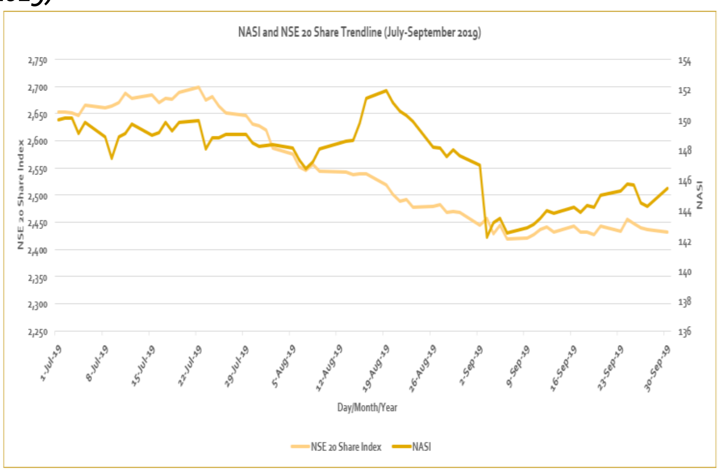
iii. Volume traded decreased over the period by 24.05% to **1060.81** million shares compared to **1396.67** Million in Q2. 2019.

iv. Other composite indicators such as the NSE All Share and NSE 20-Shares index similarly recorded decreases of **2.77%** and **7.65%** closing the quarter at **145.46** points and **2431.97** points respectively.

Table 4: Gross Securities Market Statistics – Q2. 2019 Vs Q3.2019

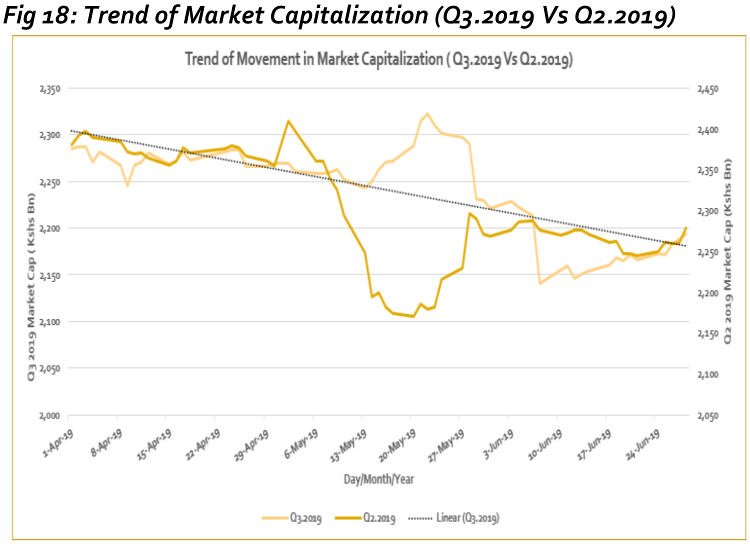
	Q1. 2019	Q2. 2019	Q3 2019	% change (Q3/Q2.2019)
NSE 20 Share Index	2846.35	2633.32	2431.97	7.65%
NASI	157.66	149.61	145.46	2.77%
Shares Volume traded	1673.55	1396.67	1060.81	24.05%
Equity Turnover (Kshs. Bn)	45.25	32.897	30.66	6.80%
Bonds Turnover (Kshs. Bn)	161.63	201.71	185.44	8.07%
End month market cap (Kshs. Bn)	2360.52	2278.899	2189.98	3.90%

Fig 17: Trend of the NASI and NSE 20 Share Index (July– September 2019)



Source: CMA

Fig 18: Trend of Market Capitalization (Q3.2019 Vs Q2.2019)



Source: CMA/NSE

5.2 Performance of Listed Companies

5.2.1 Price Gainers

During the quarter ended September 2019, the top price gainers during were HF Group, E.A. Cables Ltd, WPP Scan Group, KCB Group and Total Kenya as shown in the table below.

Table 5: Top 5 Price Gainers – Q3.2019

Counter	Q2. 2019	Q3. 2019	% change
HF Group Plc	4.01	7.04	75.56%
E.A. Cables Ltd	2.44	2.96	21.31%
WPP Scan Group	11.05	12.35	11.76%
KCB Group Plc	38.25	42	9.80%
Total Kenya	28.2	29.85	5.85%

Source: NSE

6.2.2 Price Losers

Counter	Q2. 2019	Q3. 2019	% change
Uchumi	0.51	0.28	45.10%
Kenya Airways	3.97	2.55	35.77%
Kplc	3.89	2.92	24.94%
Kenya-Re	3.76	2.89	23.14%
Trans-Century	4.05	3.16	21.98%

5.3 Bond Market Performance and Stability

5.3.1 Primary Treasury Bond Market

In the primary treasury bonds market, a quarterly analysis indicates that during Q3. 2019, five (5) Treasury bonds were issued. In issuing these bonds, the Government sought to raise KShs. 140 Billion but received subscriptions worth KShs. 186.74 Billion. In the end, however, it accepted to issue bonds worth KShs. 142.89 Billion, indicating a 76.52% acceptance rate.

In the secondary equities market, Equity turnover for Q3.2019 stood at KShs.30.66 Billion, compared to KShs. 32.89 Billion registered in Q2.2019; a 6.78% decrease confirming a decline in trading activity at the bourse during the quarter. End month market capitalization recorded a 3.90% decrease to KShs 2189.98 Billion registered in Q3. 2019 from KShs. 2,278.90 Billion in Q2. 2019. Volumes traded.

Table 5: Treasury bond Performance June - Sep 2019

Month /Year	Bond	Issued (Kshs Bn)	Amnt Received	Amnt Accptd	% AA/AI	% AR/AI
July	FXD3/2019/15	40	86.67	50.58	126.45	216.68
Aug	FXD 3/2019/10	50	52.77	45.01	119.36	134.88
	FXD 3/2019/20		14.67	14.67		
Sep	FXD 3/2018/15	50	15.256	15.26	65.25	65.25
	FXD 2/2019/15		17.368	17.37		

Source: CMA/NSE

5.3.2 Corporate Bond issues

In the quarter under review, the Kenyan corporate bond market was revitalized with the successful issuance of the country's first Green Bond by property developer Acorn Group and PE Fund Helios. The Bond attracted an 85 percent subscription rate, raising Sh4.3 billion out of the targeted Sh5 billion with a blend of investors including pension funds, commercial banks, development financial institutions (DFIs) and insurance firms.

5.3.3 Secondary bond market

Table 6: Summary of Bond Turnover (Jan – Sep) 2019

Month	Government Bond Turnover (KShs. Bn)	Corporate Bond Turnover (KShs. Bn)	Total Bond Turnover (KShs. Bn)
Jan.	50.98	0.05	50.98
Feb.	48.26	0.06	48.26
Mar.	62.38	0.07	62.37
Apr	70.456	0.05	70.461
May	57.35	0	57.35
June	73.61	0.112	73.72
July	89.56	2.102	91.67
Aug	43.89	0.34	44.22
Sep	49.52	0.03	49.55

In the secondary Bond Market, Kshs **185.44** Billion worth of bonds were traded in Q3. 2019 compared to Kshs 201.71 Billion traded in Q2. 2019, indicating an 8.07% decrease.

Further, KenGen, redeemed its 10-year, Kshs. 25 Billion infrastructure bonds, paying a fixed rate of 12.5% per annum, at no tax charge on the principal amount of the Bonds outstanding as at 11th October 2019.

6.0 New Capital Markets Developments – Q3.2019

6.1 Launch of Kenya's Derivatives Market and Subsequent Trading Statistics

The Nairobi Securities Exchange (NSE) with approval from the Capital Markets Authority launched the NEXT Derivatives Market on July 11, 2019 making it the second African Exchange to operate a derivatives market. The operationalization of the derivatives market is in line with the CMA's Capital Markets Master Plan which identified development of the derivatives markets as a key milestone.

Following the launch, the NSE now offers Index Futures and Single Stock Futures on selected indices and stocks respectively.

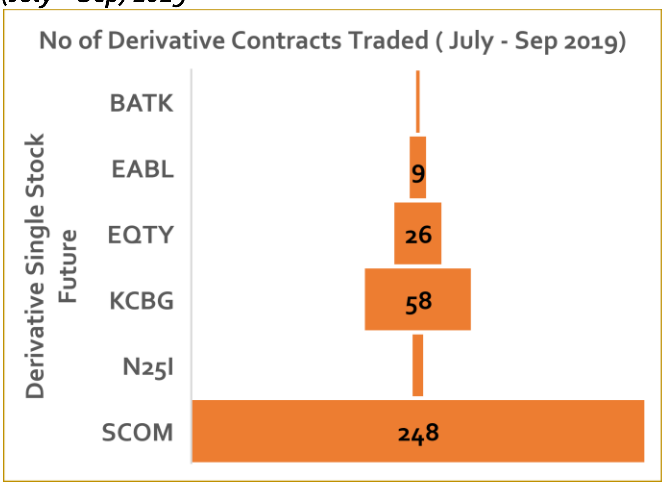
The Bourse offers index futures contracts on the NSE 25 Share Index and Single Stock Futures on Safaricom Plc, Kenya Commercial Bank Group Plc, Equity Group Holdings Plc, East African Breweries Ltd, and British American Tobacco Plc. Futures contracts listed on the NSE have quarterly expiry dates; these are the third Thursday of March, June, September and December of every year. All NEXT futures contracts will be initially cash settled.

349 contracts were traded between 4th July 2019 and 30th September 2019. As shown above, the majority of the liquidity

for the period was concentrated around Safaricom and the banking counters.

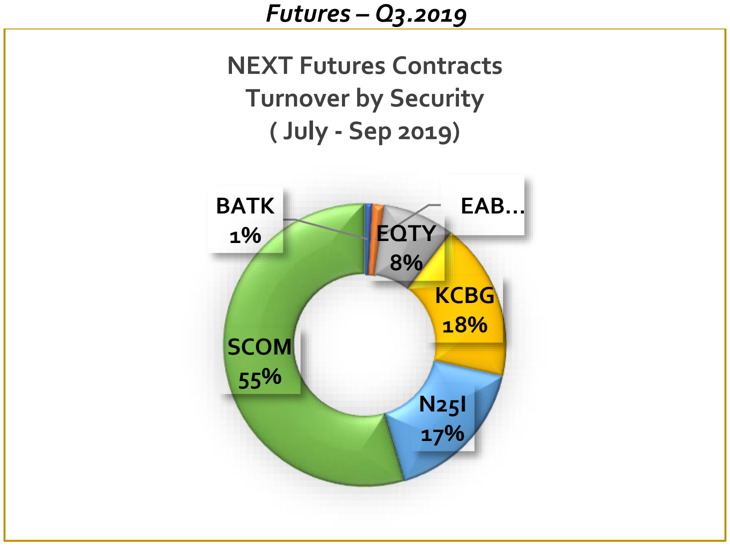
The market traded 248 Safaricom contracts representing a turnover of KES 6.9 million; banking contracts came in second with 58 KCB Group contracts traded at a total turnover of KES 2.3 million; and 26 Equity Bank contracts traded at KES 1.0 million. The NSE 25-Share index contract traded 12 contracts at a total turnover of 2.6M.

Fig 19: No of Derivative Contracts Traded at the NEXT (July – Sep) 2019



Source: CMA/NSE

Fig 20: Proportion of Turnover by Respective Listed Single Stock Futures – Q3.2019



Source: CMA/NSE

The NEXT Derivatives Market will provide new opportunities to investors enabling them to better diversify their portfolios, manage risk and deploy capital more efficiently. Futures contracts provide investors with risk management tools in the wake of unexpected volatility in asset prices.

NEXT Derivatives Market will also enable Kenya to consolidate its position as a leading financial services hub in Africa.

6.2 Three Firms Admitted to the CMA Regulatory Sandbox

Following the approval of the Regulatory Sandbox Policy Guidance Note (Regulatory Sandbox PGN) with effect from 26th March 2019, the Capital Markets Authority (CMA) has been receiving applications from fintech firms seeking to be admitted into the Regulatory Sandbox. As at July 2019, three applicants were admitted to live test innovative solutions with the capacity to deepen and enhance the efficiency of capital markets.

Innova Limited has been approved to test its cloud-based data analytics platform designed for use by Investors, Fund Managers, Custodian Banks, Actuaries, Pension Administrators and Regulators. The approval restricts the testing period to 12 months.

The second fintech, **Pezesha Africa Limited** has been approved to test an internet-based crowd-funding platform through which investors can provide loan facilities structured as loan notes (debentures) for Small and Medium Enterprises (SMEs). The approval restricts the testing period to 12 months.

The third fintech firm admitted has elected to remain anonymous during its three months test period, except to its closed group of test subjects, an option provided in the Regulatory Sandbox PGN.

All the admitted applicants shall be updating the Authority on the milestones achieved, challenges faced, and mitigation measures implemented in line with the test plans submitted to the CMA during the application process. The admission of the three firms is an important milestone noting that the Authority had set itself a target to admit five firms to the Regulatory Sandbox by 2023.

To enhance the Authority's investor protection mandate, Sandbox participants are required to comply with minimum regulatory requirements prescribed by the Regulatory Sandbox Policy Guidance Note such as submission of test plans, which outline key test objectives, testing metrics, performance indicators, and safeguard and remedial measures for test clients. The Regulatory Sandbox serves to continuously improve CMA's understanding of emerging technologies as well as the risks and opportunities that the innovations portend for investors, financial institutions and the regulator. The insights from the tests allow for a more evidence-based approach to regulation.

6.3 Abu Dhabi Global Market (ADGM) and the Capital Markets Authority (CMA) of Kenya Establish New Cooperation in Sustainable Finance

On 30th July 2019, the Financial Services Regulatory Authority (FSRA) of ADGM and the Capital Markets Authority (CMA) of Kenya entered into a Memorandum of Understanding (MOU) to enhance cooperation in sustainable finance in each other's markets.

This partnership was instituted following close discussions and continuous coordination between the two parties to scale up the development of sustainable finance in both jurisdictions and builds on an existing partnership to support financial technology. The MOU provides a framework for CMA and FSRA to exchange information pertinent to products, services and initiatives as well as to develop legislative, regulatory and institutional frameworks to enable the two sides to facilitate and support sustainable finance.

The strategic partnership between CMA (Kenya) and FSRA underscores the importance of sustainable finance and the intangible value drivers within Environmental, Social and Governance (ESG) perspectives and comes at an opportune time as sustainable finance is expected to play an important but niche role in driving the growth of Kenya's capital markets. Further, this is in line with the Marrakech Pledge which calls for an increase in the volume, flow and access to finance for climate projects, alongside improved capacity and technology from developed to developing countries"

The partnership and relationship between the two Regulators began in 2017 on FinTech where the Authorities shared mutual objectives of fostering innovation, financial inclusion and regulator cooperation. This initiative is also anticipated to foster responsible and sustainable methods that support the development and growth of the respective economies.

6.4 CMA approves Kenya's First Green Bond

As part of the Authority's commitment to sustainability, the CMA Board approved the Policy Guidance Note on Green Bonds in February 2019.

On 15th August 2019, Capital Markets Authority (CMA) approved the issuance of Kenya's first unlisted green bond, to be issued by Acorn Project (Two) Limited Liability Partnership following the launch of the Policy Guidance Note on Green Bonds in February 2019. The issuance sought to raise Kshs5 billion to finance sustainable and climate-resilient student accommodation and is structured as a restricted public offer for sophisticated investors. The issuer raised the funds from only targeted sophisticated investors being a restricted offer.

Given the existence of the legal instruments to facilitate Green Bond issuances, the issuance by Acorn is a critical step in advancing the development of an effective ecosystem to support the establishment of green capital markets in Kenya in line with the Marrakech Pledge 2016.

As per the issuer's Information Memorandum, Climate Bonds Initiative certifies the fixed-rate bond as a green bond. Sophisticated investors participating in the bond will benefit from a 50 percent guarantee from GuarantCo on principle and interest payments.

Going forward, the Authority would continue engaging with potential issuers in order to create a pipeline of green bond issuers to facilitate effective matching of demand and supply of green-centric capital and climate-resilient investing opportunities.

6.5 The Warehouse Receipt System Act, 2019

The development of the policy and legal framework for warehouse receipts has been on Kenya's legislative agenda for close to ten years. In June 2019, the President signed into law the Warehouse Receipt System Bill, 2018. The Act provides for the legal framework for the development and regulation of warehouse receipt system for agricultural commodities. The Act establishes the Warehouse Receipt System Council to regulate the issuance and negotiation of warehouse receipts while the county Governments have the mandate of licensing warehouse operators who will be issuing the warehouse receipts.

Further, the State Department for Crops Development (Ministry of Agriculture, Livestock, Fisheries and Irrigation), in consultation with the National Taskforce for Establishment of Commodities Exchange in Kenya, has developed Draft Warehouse Receipt Systems Regulations to support the operationalization of negotiable warehouse receipts in Kenya. These regulations provide for a regulatory framework for licensing and supervision of certified warehouses in Kenya.

This framework is aligned to the Authority's mandate of licensing and regulating commodities exchanges as provided for in the Capital Markets Act. The warehouse receipts for agricultural commodities once issued, will be eligible for trading at the commodities exchange. The draft Capital Market (Commodity Markets) Regulations, 2019, once finalized and gazetted will complement the warehouse receipt system through providing a regulatory framework for the trading of such receipts. The Warehouse Receipt System Regulations, 2019 are currently being finalized for Gazettement.

6.6 Draft Capital Markets (Commodity Markets) Regulations, 2019 and Draft Warehouse Receipts Systems Regulations, 2019

The Capital Markets Act was amended in 2016 to provide the legal framework for the regulation of commodity exchanges, with the Authority empowered to regulate such exchanges. In order to provide a comprehensive regulatory framework for commodity markets, the Capital Markets (Commodity Markets) Regulations, 2019 were drafted and are now undergoing public consultation process.

The draft regulations provide for the licensing of commodity exchanges and commodity brokers and the requirements for the conduct of commodity exchange business. Countrywide stakeholder consultations on the regulations were done in June 2019 followed by a joint consultative meeting with the stakeholders in September 2019

7.0 Capital Markets Stability Indicators (CMSIs)

Equity Market Depth	Quarter/ Year	Statistics				Assessment of Risk Level (High – Medium – Low)	Performance Brief for the Quarter	Ongoing Intervention Measures
NSE 20 Index Volatility **Base Year = 2010**	**Q3.2019**	**July**	**Aug**	**Sep**	**Q.Avg**	**Low** **(indicative - <10% high; >10% - low)**	• The NSE 20 Share Index volatility for the quarter ended Sep 2019 averaged at **0.44%**, compared to **0.45%** recorded in Q2.2019.	• The level of volatility of the market as evidenced by the NSE 20 Share and NASI index, has remained relatively low during the quarter. The commencement of trading of financial derivatives on NEXT and particularly Index futures is expected to further reduce volatility in the NSE Indices as investors take opposite trading positions.
		0.49%	0.31%	0.52%	0.44%			
	Q2. 2019	**April**	**May**	**June**	**Q. Avg**			
		0.64%	0.42%	0.31%	0.45%			
	Q1.2019	**Jan**	**Feb**	**March**	**Q. Avg**			
		0.49%	0.37%	0.41%	0.42%			
	Q4.2018	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		0.53%	0.28%	0.63%	0.48%			
NASI Volatility **Base Year = 2010**	**Q3.2019**	**July**	**Aug**	**Sep**	**Q. Avg**	**Low** **(indicative - <10% high; >10% - low)**		
		0.41%	0.36%	0.57%	**0.45%**			
	Q2.2019	**April**	**May**	**June**	**Q.Avg**			
		0.23%	0.80%	0.30%	**0.44%**			

	Q1.2019	**Jan**	**Feb**	**March**	**Q.Avg**			
		0.40%	0.41%	0.52%	**0.44%**			
	Q4.2018	**Oct**	**Nov**	**Dec**	**Q.Avg**			
		0.50%	0.57%	0.49%	**0.52%**			
Turnover Ratio	**Q3.2019**	**July**	**Aug**	**Sep**	**Q.Sum**	**Medium (indicative – annual: <8%-Low; >15% High)**	• A turnover ratio of **1.37%** was recorded in the quarter, compared to **1.39% and 1.85%** in Q2.2019 and Q1.2019 respectively. This indicates a reduction in trading	• The Authority has developed a regulatory framework to support securities lending and borrowing and is in the process of developing an operational framework. • The Authority will engage market stakeholders further on expediting market making arrangements and formalization of margin lending in the future
		0.50%	0.39%	0.48%	**1.37%**			
	Q2.2019	**April**	**May**	**June**	**Q.Sum**			
		0.42%	0.55%	0.42%	**1.39%**			
	Q1.2019	**Jan**	**Feb**	**March**	**Q. Sum**			
		0.67%	0.50%	0.67%	**1.85%**			
	Q4.2018	**Oct**	**Nov**	**Dec**	**Q.Sum**			
		0.79%	0.49%	0.37%	**1.69%**			

							activity at the bourse for two consecutive quarters – Q2. and Q3.2019.	
2.0	**Foreign Exposure Risk**							
Foreign Investor turnover as a % of total turnover	**Q3.2019**	**July**	**Aug**	**Sep**	**Q.Avg**	**Medium** **(indicative – annual: <40%-Low; >90% High)**	• Average Foreign investor participation for the months of July and August averaged at **64.95%,** a **6.18%** decrease from **71.13%**	As part of its market deepening and public awareness strategy, the Authority will be rolling out a plan to onboard more domestic institutional investors and High Net Worth Individuals (HNWIs) into the secondary market and/or Collective Investment Schemes (CIS)
		66.89%	62.31%	65.65%	**64.95%**			
	Q2.2019	**April**	**May**	**June**	**Q.Avg**			
		75.80%	63.43%	74.15%	**71.13%**			
	Q1.2019	**Jan**	**Feb**	**March**	**Q.Avg**			
		81.55%	72.38%	70.81%	**76.96%**			
	Q4.2018	**Oct**	**Nov**	**Dec**	**Q.Avg**			
		75.14%	76.54%	73.67%	**75.12%**			

							recorded in Q2.2019 and the lowest ratio for the last four quarters.	to reduce the dominance of foreign investors
Net Foreign Portfolio Flow **(In KES Millions)**	**Q3.2019**	**July**	**Aug**	**Sep**	**Q.Sum**	**High** **(indicative – annual: <Kshs (50million) -High (outflow; >KShs. 50 million High inflow)**	• Net Foreign Portfolio levels for July and Aug 2019 amounted to a total inflow of **Kshs 262 Mn,** compared to a total inflow of an **Kshs 1,359 Mn** in net foreign	
		(2,073)	1,509	827	**262**			
	Q2.2019	**April**	**May**	**June**	**Q.Sum**			
		93	2,166	(900)	**1,359**			
	Q1.2019	**Jan**	**Feb**	**March**	**Q.Sum**			
		(1,357)	216	1,742	**601**			
	Q4.2018	**Oct**	**Nov**	**Dec**	**Q.Sum**			
		(4,287)	(599)	(1,785)	**(6,671)**			

							inflows during the quarter compared to Q1.2019.	
Market Concentration **(Top 5 companies by market cap)**	**Q3.2019**	**July**	**Aug**	**Sep**	**Q.Avg**	**High** **(indicative – annual: >50% High concentration)**	• During the quarter, the top five companies by market capitalization accounted for **71.83%,** the highest in the last four quarters, confirming their dominance in the	• The Authority has been actively promoting market deepening (product development, innovation and uptake deepening, through diversification) , market diversification, as a way of addressing this challenge.
		70.85%	72.02%	72.61%	**71.83%**			
	Q2.2019	**April**	**May**	**June**	**Q. Avg**			
		70.17%	71.62%	70.62%	**70.80%**			
	Q1.2019	**Jan**	**Feb**	**March**	**Q. Avg**			
		65.34%	67.85%	69.56%	**67.58%**			
	Q4.2018	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		66.74%	64.76%	65.95%	**65.82%**			

<table>
<tr><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td>Kenyan securities market.
● The top five companies included SAFARICOM, EQUITY, EABL, KCB and CO-OP.</td><td colspan="2"></td></tr>
<tr><td>3.0</td><td colspan="9">Derivatives</td></tr>
<tr><td>Total Volume

(No. of contracts)</td><td colspan="5">
<table>
<tr><th></th><th>July</th><th>Aug</th><th>Sep</th><th>Q. Sum</th></tr>
<tr><td>25-Share Index</td><td>2</td><td>3</td><td>1</td><td>6</td></tr>
<tr><td>SCOM SSF</td><td>67</td><td>62</td><td>119</td><td>248</td></tr>
<tr><td>EQTY SSF</td><td>19</td><td>3</td><td>4</td><td>26</td></tr>
<tr><td>KCBG SSF</td><td>28</td><td>5</td><td>25</td><td>58</td></tr>
<tr><td>EABL SSF</td><td>4</td><td>1</td><td>4</td><td>9</td></tr>
<tr><td>BATK SSF</td><td>2</td><td>-</td><td>-</td><td>2</td></tr>
<tr><td>Total</td><td>122</td><td>74</td><td>153</td><td>349</td></tr>
</table>
</td><td colspan="2">Low</td><td>During the quarter, a total of 349 contracts were traded. Safaricom Sigle Stock Futures accounted</td><td>To diversify the derivative market, the NSE is considering increasing the number of Single Stock Futures traded.</td></tr>
</table>

<table>
<tr><td></td><td></td><td></td><td>for 71.06% of contracts traded.</td><td></td></tr>
<tr><td>Gross Notional Exposure (GNE)[26]

(Amount in Kshs Mn)</td><td>
<table>
<tr><th></th><th>July</th><th>Aug</th><th>Sep</th><th>Q. Avg</th></tr>
<tr><td>25-Share Index</td><td>0.72</td><td>1.07</td><td>0.35</td><td>**0.71**</td></tr>
<tr><td>SCOM SSF</td><td>1.88</td><td>1.73</td><td>3.21</td><td>**2.27**</td></tr>
<tr><td>EQTY SSF</td><td>0.77</td><td>0.12</td><td>0.15</td><td>**0.35**</td></tr>
<tr><td>KCBG SSF</td><td>1.09</td><td>0.20</td><td>1.00</td><td>**0.76**</td></tr>
<tr><td>EABL SSF</td><td>0.26</td><td>0.02</td><td>0.08</td><td>**0.12**</td></tr>
<tr><td>BATK SSF</td><td>0.10</td><td>-</td><td>-</td><td>**0.10**</td></tr>
<tr><td>**Total**</td><td>**4.82**</td><td>**3.14**</td><td>**4.79**</td><td>**12.75**</td></tr>
</table>
</td><td>**Low**</td><td>The total value (Gross Notional Exposure) of contracts traded during the quarter amounted to **Kshs 12.75 Mn**</td><td>The NSE are engaging institutional investors (foreign and domestic) to expand the scope of fund allocations to include derivative contracts.</td></tr>
<tr><td>Total Open Interest[27]</td><td>
<table>
<tr><th></th><th>July</th><th>Aug</th><th>Sep</th><th>Q. Avg</th></tr>
</table>
</td><td>**Low**</td><td>The total open interest</td><td></td></tr>
</table>

[26] Gross Notional Exposure = no. of Contracts * notional contract size * market price of underlying equity share or index. The GNE is the value amount. It is the exact conversion of the derivative into the market value of an equivalent position in the underlying asset of that derivative.
[27] Open interest is the total number of outstanding derivative contracts that have not been settled or closed. It is a measure of market interest.

<table>
<tr>
<td>(No. of Contracts)</td>
<td>
<table>
<tr><td>25-Share Index</td><td>-</td><td>1</td><td>-</td><td>1</td></tr>
<tr><td>SCOM SSF</td><td>36</td><td>55</td><td>42</td><td>44</td></tr>
<tr><td>EQTY SSF</td><td>6</td><td>4</td><td>-</td><td>5</td></tr>
<tr><td>KCBG SSF</td><td>20</td><td>20</td><td>-</td><td>20</td></tr>
<tr><td>EABL SSF</td><td>2</td><td>1</td><td>1</td><td>1</td></tr>
<tr><td>BATK SSF</td><td>-</td><td>-</td><td>-</td><td>-</td></tr>
<tr><td>Total</td><td>64</td><td>81</td><td>43</td><td>63</td></tr>
</table>
</td>
<td></td>
<td>during the quarter was 63. Safaricom was the most attractive contract with an average quarterly open interest of 44.</td>
<td></td>
</tr>
<tr>
<td>Settlement Guarantee Fund (SGF) Coverage[28] for Derivatives</td>
<td>
<table>
<tr><th></th><th>July</th><th>Aug</th><th>Sep</th></tr>
<tr><td>SGF</td><td>153,531,001</td><td>178,180,651</td><td>179,321,252</td></tr>
</table>
</td>
<td>Low</td>
<td>The SGF coverage ratio for the derivatives</td>
<td>To maximize value from the SGF fund balances, there</td>
</tr>
</table>

[28] An indicator of the level of coverage the SGF provides for the derivatives market. It is the total SGF amount divided by the average value of all positions in the derivatives market.

<table>
<tr>
<td></td>
<td>
<table>
<tr><td>Average Value</td><td>257,565</td><td>196,233</td><td>292,509</td></tr>
<tr><td>SGF Coverage</td><td>596 times</td><td>908 times</td><td>613 times</td></tr>
</table>
</td>
<td></td>
<td>market as at end Sep 2019 was 613 times reflecting high sufficiency of the Guarantee Fund to cover trading volumes in the market.</td>
<td rowspan="2">is deliberate effort by NSE to encourage increased activity by market intermediaries in this market for increased volumes of trade.</td>
</tr>
<tr>
<td>SGF Coverage of Clearing Member 1 and Clearing Member 2[29]</td>
<td>
<table>
<tr><th></th><th>July</th><th>Aug</th><th>Sep</th></tr>
<tr><td>SGF</td><td>153,531,001</td><td>178,180,651</td><td>179,321,252</td></tr>
<tr><td>Average Value CM1</td><td>116,937</td><td>103,570</td><td>159,516</td></tr>
</table>
</td>
<td>Low</td>
<td></td>
</tr>
</table>

[29] Total SGF Amount/Average value of the positions of CM1(Co-operative Bank) and CM2(Standard Bank).

Average Value CM2	140,628	92,663	132,993
SGF Coverage CM1	**1,313 times**	**1,720 times**	**1,124 times**
SGF Coverage CM2	**1,092 times**	**1,923 times**	**1,348 times**

4.0	**Government Bond Market Exposure**							
Treasury Bond market turnover Concentration	**Q3.2019**	**July**	**Aug**	**Sep**	**Q.Avg**	**High** **(indicative – annual: >50% High concentration)**	• During the quarter, Treasury bond turnover leveled at **98.68%** compared to **99.98%** in the previous quarter.	• The 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 was completed and some recommendations are already being implemented including the development of Public Debt and
		97.54%	98.55%	99.94%	**98.68%**			
	Q2.2019	**April**	**May**	**June**	**Q.Avg**			
		99.99%	100%	99.96%	**99.98%**			
	Q1.2019	**Jan**	**Feb**	**March**	**Q.Avg**			
		99.96%	99.84%	99.90%	**99.90%**			
	Q4. Avg	**Oct**	**Nov**	**Dec**	**Q.Avg**			
		99.96%	99.98%	99.96%	**99.97%**			

<table>
<tr>
<td>Corporate Bond Market ownership</td>
<td>
<table>
<tr><th>Category</th><th>No of Investors</th><th>Amount Outstanding (Mn)</th><th>% of total outstanding</th></tr>
<tr><td>Local Investors</td><td>4,721</td><td>67,539.04</td><td>99.06%</td></tr>
<tr><td>East African Investors</td><td>20</td><td>181.99</td><td>0.27%</td></tr>
<tr><td>Foreign Investors</td><td>111</td><td>457.17</td><td>0.67%</td></tr>
<tr><td colspan="4">Source: CDSC Data as at September 2018</td></tr>
</table>
</td>
<td>High
(indicative – annual: >50% High concentration</td>
<td>• Local Corporate bond investors were the leading investors in corporate bonds at 99.33% of amounts outstanding , while foreign bond investors held 0.67% of total corporate bond holdings.</td>
<td>Borrowing Framework Noting the the CS TNT&P pronounced in his Budget Speech that the Government will be undertaking Bond Market reforms the Authority will continue to engage with all relevant stakeholders to implement the other recommendations of the Consultancy.
• The recent establishment of the Kenya Mortgage Refinancing Company (KMRC) is further expected to deepen the bond marketafter it leverages on capital markets to raise funds through bonds for on-lending to banks and other</td>
</tr>
</table>

<table>
<tr><td></td><td></td><td></td><td></td><td>mortgage financing companies.</td></tr>
<tr><td>5.0</td><td colspan="4">Investor Profiles - Equity Market</td></tr>
<tr><td>Equity Market</td><td>

Type of Investor	**2015**	**2016**	**2017**	**2018**
E.A. Institutions (%)	65.68	66.38	68.36	68.61%
E.A. Individuals (%)	12.84	12.49	11.47	11.47%
Foreign Investors (%)	21.48	21.13	20.17	19.92%

Source: CMA- *Data as at August 2018</td><td>High

(indicative – annual: >50% High concentration)</td><td>● Local investors, a sum of East African institutional and individual investors accounted for 80.08% of shares held in the equity market with 19.92% being held by foreign investors.</td><td>● In order to address low uptake issue and attract local investors and issuers the Authority undertook a study aimed at determining the underlying reasons behind the low uptake of capital markets products and services.
● The Authority in consultation with the NSE, market intermediaries and other stakeholders is implementing a public education, awareness and market deepening strategy based on among other guides, the Investor</td></tr>
</table>

									Education Impact and Opportunities Analysis Study. Some of the key deliverables include the development of a National Consumer Financial Education Strategy as well as an Impact Assessment Measurement Index that the Authority can use to gauge the impact of its investor education program going forward. ● This will translate to more targeted engagements to onboard and drive increased market participation within the capital markets.
6.0	**Investor Compensation Coverage**								
	Q3.2019	**July**	**Aug**	**Sep**	**Q.Avg**				

Settlement Guarantee Fund (SGF) Coverage Ratio[30]		2.01	2.33	1.92	2.09	**Medium** **(indicative – annual: > 1 times, implies full coverage)**	• SGF Ratio for the quarter ended Sep 2019 averaged 2.09. This is an indication that the Guarantee Fund balances are sufficient to cover liabilities that would arise following	• Through Risk-based supervision, the Authority has been monitoring the SGF figures and the financial position of the firms to ensure that they are in good standing and that investors are protected. • The Authority is undertaking a joint assessment of the Capital Markets stability indicators and will be reviewing the sufficiency of the SGF in determining the sufficiency of the fund in the coming financial year.
	Q2.2019	**April**	**May**	**June**	**Q.Avg**			
		1.87	1.64	1.70	1.74			
	Q1.2019	**Jan**	**Feb**	**March**	**Q.Avg**			
		1.30	1.28	1.20	1.26			
	Q4.2018	**Oct**	**Nov**	**Dec**	**Q.Avg**			
		1.14	1.83	2.05	1.67			

30 ***Source: CDSC***

							default by securities brokers.	
7.0	**Asset Base of Fund Managers, Stockbrokers, Investment Banks**							
Assets Under Management	**As at 31st January 2019 (Amount in KShs Millions)**					**Medium** **(Indicative – the higher the figure, the more stable is the market)**	• The total Asset Base of Fund Managers, Stockbrokers, Investment Banks, Investment advisors and online forex brokers as at 31st July 2019 was	• The Authority continuously monitors asset levels of its licensees to ensure accurate reporting of assets and liabilities and monitoring sufficiency of liquid capital to monitor potential bankruptcy of licensees.
	CMA Licensee	**Total Assets**	**Total Liability**	**Net Assets**				
	Fund Managers	6,871.35	1,634.33	5,237.02				
	Stockbrokers	2,197.66	744.42	1,453.23				
	Investment Banks	11,277.87	2,893.15	8,384.71				
	Investment Advisors	1,454.94	94.20	1,360.74				

	Online Forex Broker (Non-Dealing)	310.34	211.92	98.43			**Kshs 5,237.02 Million, 1,453.23 Billion, Kshs.8,384.71 Million, Kshs 1,360.74 Million** and **Kshs 98.43 Million** respectively.	

8.0 References

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

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