The Capital Markets Soundness Report

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"The Global Economic Cycle in Review, debate on a potential recession and counter strategies to reduce impact of evolving global risks."

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SPECIAL MESSAGE FROM THE CHIEF EXECUTIVE

Dear Reader,

Happy New Year 2019 and welcome to the ninth volume of the Capital Markets Soundness Report (CMSR). This publication continues to strengthen as an authoritative source of information on domestic capital markets performance, soundness and related activities taking note of global and regional developments whose impact and effects translate to our domestic economy. We therefore acknowledge and appreciate your active engagement in the development of this report in 2018 and look forward to an even better 2019.

In this issue, we explore a discussion that dominated the global space as we progressed through the second half of the year 2018 with economic analysts taking different positions on a looming recession. Key tipping indicators that have been of significant concern to analysts include trend of rising fed rates which have persisted over 2018; the resulting effect of increased inflation and an observed trend of record low unemployment rates in major economies.

Performance of emerging markets has been relatively impressive over recent years. However, the strengthening of the dollar, escalating trade wars and currency instability in key economies has had negative impact on most emerging market economies, including performance of major equity indices such as the MSCI Emerging markets.

Domestically, the Government of Kenya launched the Vision 2030 third medium term plan spanning 2018-2022, themed "***Transforming Lives: Advancing Socio-Economic Development through 'the Big Four*** 'during the quarter, key highlights of which are herein provided.

Finally, we provide a highlight of key activities undertaken by the Authority during the quarter in promoting its primary mandate of regulation and market development despite persistent slowdown of market activity in the year 2018.

Happy reading and a blessed 2019!

Mr. Paul M. Muthaura, MBS

CHIEF EXECUTIVE

EDITORIAL

Dear Reader,

Welcome to the ninth edition of the Capital Markets Soundness Report as you settle into the New Year. Economic indicators prompting the recession debate shows that the US recorded a 3.7 percent unemployment rate in September 2018, the lowest ever since 1969; Germany's seasonally adjusted harmonized unemployment rate edged down to 3.3 percent in October 2018, the lowest jobless rate since June 1980 whereas China's unemployment rate recorded a low of 3.82 percent in the third quarter of 2018; following a persistent 4.40 percent unemployment rate recorded between 2002 and 2018.

Further, we delve into the effects of an appreciating US dollar on emerging market economies and the resultant impact that has seen the growth projections of most of these economies reviewed downwards. This informs our special feature which details the benefits of raising debt denominated in local currency to reduce the debt burden experienced by emerging economies as most of their debt is held in US dollars.

Regionally, East Africa's economy has been acknowledged as the best performing in the continent, mainly attributed to the region's strong performance on economic diversification and investment driven growth with Ethiopia towering as the region's powerhouse, expected to achieve a GDP growth of 8.1% in 2019.

Domestically, the Kenya capital markets registered a marginal decline in the quarter under review. Market capitalization decreased from Kshs. 2,211 Billion recorded in Q3.2018 to Kshs 2,102 Billion in Q4.2018. The NSE 20 share index dipped by 1.46 percent in Q4.2018 compared to Q3.2018 to close the year at 2,834 points.

However, with 2018 behind us and the launch of the Third Medium Term Plan (MTPIII) with a primary focus on the implementation of the "Big 4" Agenda, the Authority is positioning itself and the capital markets as a source of funding for some of the infrastructural projects envisioned in this period, thus enhancing the overall development of Kenya's economy.

Enjoy your reading!

Mr. Luke Ombara

DIRECTOR REGULATORY, POLICY AND STRATEGY

SPECIAL FEATURE - Adoption of Local Currency Debt Financing in the face of increasing global risks

The amount of international funding channeled towards developing countries and emerging economies continues to grow, through both improved access to international financial markets and increased public spending financed through development assistance. In both cases, the funding is predominantly denominated in foreign currencies like the USD or EUR. However, foreign-currency denominated loans can introduce significant exchange-rate risks with developing countries often having limited options for market-based mitigation measures against exchange-rate risk. Exchange-rate risks are an inherent feature of international product and capital markets and are usually compensated through currency swaps or resold on the market in exchange for payment of a corresponding risk premium.

However, for poorer developing countries and the companies based there, these opportunities for risk mitigation are few and far between, either because their currencies are not readily marketable or because the risk premiums are so high that such payments are no longer "worthwhile" from the borrower's perspective.

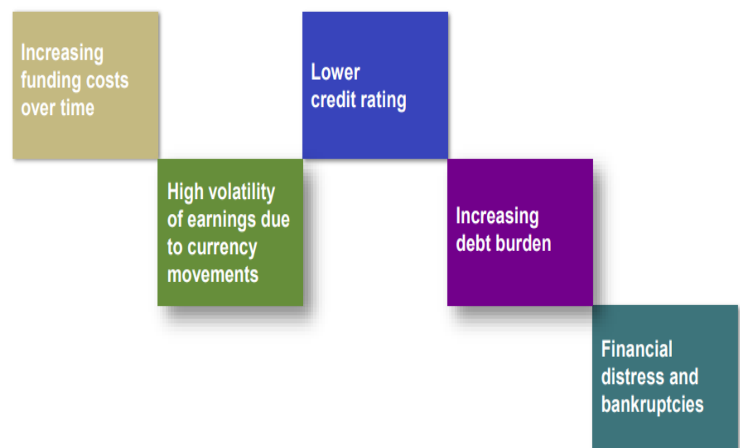
One "elegant" solution to this problem would be to acquire the necessary funds directly from local finance and international capital markets in the local currency.

Access to funds through international markets by African countries has been increasing over the years. Before 2006, across the African Continent, only Morocco, Tunisia and South Africa had issued sovereign bonds denominated in foreign currencies. However, by 2017, this number had grown to 14, Kenya included.

In 2018 alone, African countries sold $18.3bn-worth of euro and dollar-denominated debt, with the frequency of bond issuances also increasing. As a result, about 70 per cent of Africa's foreign debt is denominated in US dollars or euros. While some analysts link rising debt levels with lending by China, Chinese liabilities in fact account for less than 10 per cent of Africa's total external debt.[1]

In an environment of tightening financial conditions, a rising dollar and heightened global protectionism, foreign currency-denominated debt has a pernicious effect on the debt service burden as interest rates tend to rise.

Figure 1: Key Risks Local Currency Financing offers Protection from



Source: International Finance Corporation

The Ghanaian cedi and the Nigerian naira, for example, have been depreciating against the US dollar since 2008. This means that the current nominal values of the Eurobonds issued by both countries have increased significantly. In the case of Ghana, the nominal value of its

[1] https://www.ft.com/content/55f07042-ee65-11e8-89c8-d36339d835c0

$750m, 2007 Eurobond was $3.4bn in 2017. A similar trend is discernible in the case of Nigeria, which issued $500m-worth of Eurobonds in 2011. By 2017, their nominal value had risen to $966m[2].

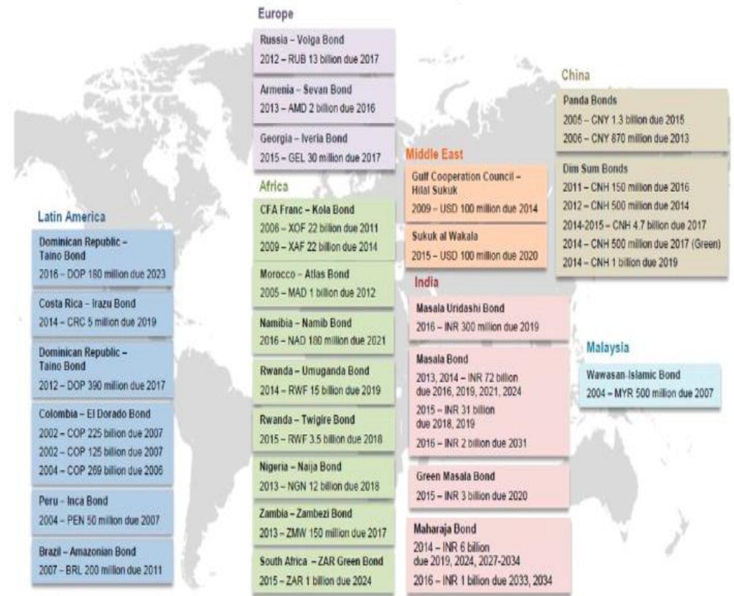
In the year 2018, we observed the effect of a strengthening US dollar against the economic output of emerging market countries with Turkey and Argentina attracting increased global attention due to the impact of depreciating currencies on other macroeconomic factors, including debt, the details of which are covered in this publication in subsequent sections.

As a result, many countries are increasingly moving to debt denominated in their local currency, thereby lowering exposure and exchange rate risks. The decision of India, for example, to borrow mostly in local currency for infrastructure financing through rupee-denon[illegible] "masala bonds" is a good example of this strategy.

Development Finance Institutions such as the International Finance Corporation have also become active participants in the local currency financing landscape. IFC sources local currency through swaps with market counterparts (usually highly rated international banks but also local swap counterparties).

For the sole purpose of funding local currency loans, IFC has extended the universe of eligible swap counterparties to include local central banks. Since 2002, IFC has issued bonds in 14 emerging market currencies around the world. Local currency financing through loans or swaps is made possible through the existence of a derivatives or swap market.

Figure 2 : IFC Local Currency Bond Issuances Landscape



Source: IFC

Fig 3: IFC Local Currency Issuance Case Study by the Dominican Republic – Taino Bond

Source: International Finance Corporation

[2] https://www.ft.com/content/55f07042-ee65-11e8-89c8-d36339d835c0

However, the growth of a local currency financing mechanism requires that the local finance and capital markets be sufficiently well-developed to generate and efficiently manage the necessary funds. Local banks must also have sufficient liquidity and be able to assess credit risks reliably. Further, by promoting equity markets (stock markets) and bond issues, e.g. through public anchor investments, institutional investors like pension funds and insurers can mobilize local capital to finance small and medium-sized enterprises (SMEs) and the partner [3]countries themselves, while risk-averse investors can be guided towards new investment classes on a sustainable basis. Guarantees for banks and investors can protect them from default risks from borrowers and bond issuers.

At the corporate level, companies with revenues in local currency should generally borrow in their local currency, instead of borrowing in a foreign currency which leads to currency mismatch risk. By matching the currency denomination of assets and liabilities, companies can concentrate on their core businesses rather than focus on exchange rate movements.

Implication and lessons drawn: *Noting increased foreign investor participation in Kenya's foreign denominated Eurobond issuances, placing the country in the global radar, Kenya should consider determining a balanced mix of both foreign denominated and local currency international debt issuances to minimize its risk of exposure to foreign exchange rate risks which result in increased costs of debt servicing. This should be considered for both its market based and concessional loans.*

Second, international financial institutions should be facilitated to implement hedging strategies for exchange risks using market-based products e.g. FX derivatives as they lend in local currency. The Authority's efforts to establish a derivatives market are well aligned with this objective and should be supported by key stakeholders including the National Treasury, Central Bank and other financial sector regulators.

Thirdly, the Adoption of an appropriate mix and balance of foreign currency denominated, and local currency debt will ultimately promote the development of local capital markets and better regulated financial markets, further positioning Kenya as the heart of the African capital markets in line with the aspirations of the Capital Markets Master Plan.

Fourthly, CMA to foster engagements with development partners on the issuance of a domestic local currency issuance.

1.0 The Global Economy

1.1 Global Economic Performance in Review

The International Monetary Fund has cut its global economic growth forecasts for both 2018 and 2019 to 3.7 percent, down from its July forecast of 3.9 percent growth for both years. Key factors cited for the drop include trade policy tensions and the imposition of import tariffs that have taken a toll on world trade, even as emerging markets struggle with tighter financial conditions and capital outflows. Other projections include an optimistic 3.8 percent global GDP growth by Reuters,

3 International Finance Corporation

Goldman Sachs and United Bank of Switzerland (UBS) Group and a pessimistic 3.5 percent by the Institute of International Finance.

Fig 4: Forecast Real GDP Growth of major economies

Real GDP Growth Percent Change yoy	2016	2017	2018 (f) GS	2018 (f) Cons*	2019 (f) GS	2019 (f) Cons*	2020 (f) GS	2020 (f) Cons*
US	1.6	2.2	2.9	2.9	2.5	2.6	1.6	1.9
Japan	1.0	1.7	0.9	1.1	1.0	1.1	0.6	0.6
Euro Area	1.9	2.5	1.9	2.0	1.6	1.7	1.6	1.5
Germany	2.2	2.5	1.7	1.8	1.9	1.7	1.6	1.5
France	1.1	2.3	1.6	1.6	1.7	1.7	1.6	1.6
Italy	1.0	1.6	1.0	1.1	0.4	1.0	1.1	0.9
Spain	3.3	3.0	2.5	2.6	2.3	2.3	2.1	1.9
UK	1.8	1.7	1.3	1.3	1.5	1.5	1.4	1.6
China	6.7	6.9	6.6	6.6	6.2	6.2	6.1	6.0
India**	7.9	6.3	7.5	7.4	7.3	7.5	7.9	-
Russia	-0.2	1.5	1.7	1.8	1.8	1.5	2.8	1.7
Brazil	-3.5	1.0	1.2	1.4	2.6	2.3	3.0	2.6
Developed Markets	1.7	2.4	2.4	2.4	2.1	2.1	1.7	1.7
Emerging Markets	4.5	5.1	5.1	5.1	4.7	4.9	5.3	5.1
World	3.1	3.8	3.8	3.9	3.5	3.6	3.6	3.6

* Bloomberg consensus forecasts as of November.
** Bloomberg consensus fiscal year basis

Source: Bloomberg, Goldman Sachs Global Investment Research

The downgrade reflects a confluence of factors, including the introduction of import tariffs between the United States and China, weaker performances by Eurozone countries, Japan and Britain, and rising U.S interest rates that are pressuring some emerging markets with capital outflows, notably Argentina, Brazil, Turkey and South Africa. [4]Despite the prolonged, trade war with China, US President Donald Trump and his Chinese counterpart Xi Jinping held a truce meeting on 2nd December 2018 where it was agreed that the US will halt new trade tariffs for a period of 90 days to allow for talks between the two states at a post-G20 summit meeting. The U.S has however stated that if at the end of this period, the parties are unable to reach an agreement, the 10 percent tariffs on Chinese goods will be raised to 25 percent.[5]

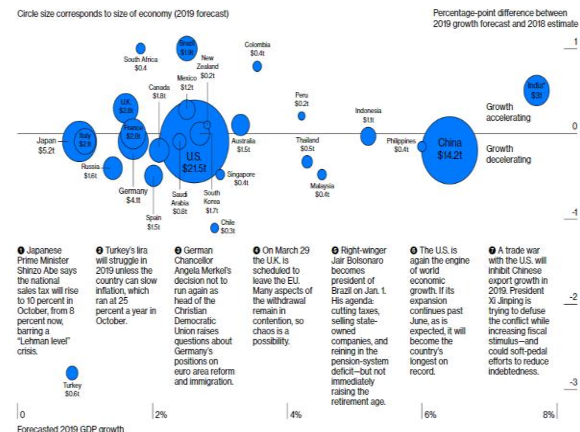
Further noted during the final half of 2018 is the declining trend of equities indices globally as indicated in Figure 2 below.

Fig 5: Trend of major equity indices in 2018

Source: Bank of England

Noting the current forecasts on global economic trends, the following are individual jurisdiction's policy and political developments to watch that may define the actual direction of world GDP growth.

Fig 6: Nations to Watch in 2019



[4] https://www.cbc.ca/news/world/imf-world-bank-growth-projections-1.4855024

[5] https://www.bbc.com/news/world-latin-america-46413196

India as a Country to watch

India's Economic Environment

According to a Boston Consulting Group (BCG) report; India is expected to be the third largest consumer economy globally as its consumption may triple to US$ 4 trillion by 2025, owing to shift in consumer behavior and expenditure pattern. It is estimated to surpass USA to become the second largest economy in terms of purchasing power parity (PPP) by the year 2040, according to a report by PricewaterhouseCoopers.
India is expected to witness strong economic growth rates in 2019, having emerged as the fastest growing major world economy this year amidst growing global vulnerabilities.

India's gross domestic product (GDP) is expected to reach US$ 6 trillion by FY27 and achieve upper-middle income status on the back of digitization, globalization, favorable demographics, and reforms.

India's revenue receipts are estimated to touch Rs 28-30 trillion (US$ 385-412 billion) by 2019, owing to Government of India's measures to strengthen infrastructure and reforms like demonetization and Goods and Services Tax (GST).

India is also focusing on renewable sources to generate energy. It is planning to achieve 40 per cent of its energy from non-fossil sources by 2030, which is currently 30 per cent, and also have plans to increase its renewable energy capacity from to 175 GW by 2022.

Figure 7: India Country Review and Country Forecast

	2015	2016	2017	2018	2019
Real Gross Domestic Product (LCU billions 2005 base)	113810.206168	121898.756033	130086.198820	139669.411141	150566.192578
Real GDP Growth Rate (%)	8.010212	7.107051	6.716592	7.366817	7.801838
Population, total (million)	1282.918000	1299.796000	1316.896000	1334.221000	1351.774000
Inflation, GDP Deflator (%)	1.785638	3.611771	3.177585	4.229757	4.347014
Official Exchange Rate (LCU/$US)	65.468450	67.072014	68.545974	70.490253	71.920516
Total Foreign Exchange Reserves ($US billions)	353.319058	361.694316	333.163466	365.697911	407.142610

Source: countrywatch.com

Reserve Bank of India

According to Economic Times[6], India appointed Shaktikanta Das as Central Bank Governor in December 2018. This move is anticipated to ensure continuity in monetary policymaking and regulatory measures even as the global economy is passing through uncertain times. Additionally, the financial markets will also significantly benefit given his rich prior experience in fiscal policies and trade. Further, it is expected that this new appointment will ensure a convergence of domestic and external policies.

According to CNBC, in November 2018, Prime Minister Narendra Modi's Government pressured the central bank to ease restrictions on how much capital India's troubled banks should hold. This is based on the fact that less stringent rules would allow banks to lend more, so that small and medium enterprises can obtain loans more easily.

[6] https://economictimes.indiatimes.com/industry/banking/finance/banking/shaktikanta-das-appointed-as-the-new-rbi-governor/articleshow/67045353.cms

That comes amid concerns struggling small businesses could hurt the government's prospects in the upcoming general elections.

According to Reuters[7], the Reserve Bank of India is not statutorily independent, as the governor is appointed by the government, but it has enjoyed broad autonomy in regulating the banking sector. It is also mandated to control inflation within a 2 to 6 percent range while keeping in mind India's economic growth objective.

Impact and Lessons Learnt

- *Worries about global trade, economic meltdowns in Argentina and Turkey, and tighter monetary policy in the United States have put pressure on emerging markets who are dependent on the flight of capital from other emerging markets and developed economies.*
- *The potential destabilization in the financial system as the banking system is weighed down by the bad loan resolution process while non-banking finance companies face restricted credit lending.*
- *The rift between the Government and Central Banks could create political and economic uncertainty. Investors want policy continuity from central banks and Governments to ensure inflation is kept in check and economic stability is maintained.*
- *Arguably, central bank independence is important for a country to keep its inflation rate low and stable. Countries where central banks are deemed not to be independent from political influence have seen a hit on their currencies — most recently in Turkey.*

1.2 Appreciation of the US Dollar against major currencies

Throughout the year 2018, the U.S Dollar has appreciated against major global currencies except for the Japanese Yen. The Yen is set to end the year as the biggest winner against the dollar among major currencies, the impact of which has been increased share of global reserves held in Japanese Yen by Central Banks to 5 percent in the third quarter of 2018, the highest in 16 years.

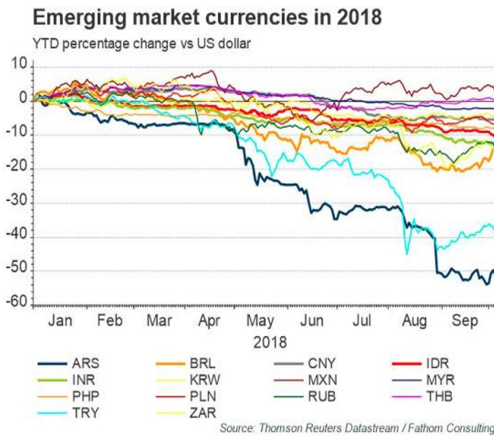
However, the same cannot be said on the real effective exchange rate performance of emerging market economies, especially those with weak fundamentals, experiencing a twin deficit position (sum of budget and current account balances), whose currencies have suffered large depreciations.

Fig 8: Performance of Major Currencies against the US Dollar in 2018

Sources: Bank of England, China Foreign Exchange Trade System (CFETS), ECB, Federal Reserve, JPMorgan and Bank calculations.;

[7] https://www.reuters.com/article/us-india-centralbank-government-explaine/why-indias-modi-wants-to-increase-control-over-the-central-bank-idUSKCN1N70A5

Fig 9: Trend of Emerging Market Currencies in 2018 between (Jan-Sep)



Source: Bloomberg [8]

Meanwhile, economies with favorable monetary policies such as Malaysia, South Korea and Thailand have weathered the storm better. The impact is that emerging market countries that have borrowed heavily in dollars and euros are now struggling with the burden of that foreign-currency debt, made much heavier by soaring inflation in their own currencies. This is particularly the case in Turkey and Argentina[9].

Implication and lessons drawn: *In October 2018, the IMF issued a cautionary statement on implied claims that the Kenyan shilling risks being reclassified from a floating currency to a managed currency following limited movements of the shilling relative to the US dollar contrary to the widely observed depreciation of currencies against the dollar globally. The Central Bank of Kenya has cited the claims as untrue backed by sufficient foreign reserves standing at $8.459 billion as at October 2018, equivalent to 5.6 months import cover, well above the required 4.5 months, despite the expiry of Kenya's standby arrangement with the IMF which expired in September 2018, removing the insurance it offered to the shilling in case of a shock to the economy. The Central Bank of Kenya needs to remain vigilant in ensuring the country's foreign reserves remain above minimum requirement.*

The Authority is however of the opinion that there are opportunities for Kenya to consider adopting alternative and complimentary measures that have generated interest from the governments in many emerging market economies; that is, raising capital in local currency, both in onshore markets where governments can tap local institutional investors and in offshore markets where they have greater access to a global investor base to curb a likely depreciation of the Kenya shilling.

Fundamental Changes in the European Union

a. EU 2019 budget approved

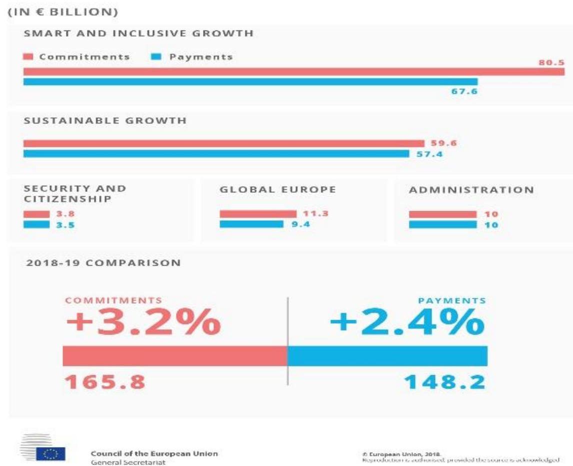
On 11th December 2018, the Council endorsed the agreement reached with the European Parliament on the EU budget for 2019. The total commitments are set at €165.8 billion, which is an increase of 3.2% compared with the 2018 budget as amended over the past months.

[8] **Key to Abbreviated Currencies:** ARS – Argentinian Peso; BRL – Brazilian Real; INR – Indian Rupee; PHP – Philippine Peso; TRY – Turkish Lira; KRW – South Korean Won; PLN – Polish Zloty; ZAR – SA Rand; CNY – Chinese Yuan; MXN – Mexican Peso; RUB – Russian Rubble; IDR – Indonesian Rupiah; MYR – Malaysian Ringgit; THB – Thailand Baht

[9] https://wolfstreet.com/2018/10/09/us-dollar-emerging-market-stocks-msci-em-gains-turn-to-losses/

Payments amount to €148.2 billion, 2.4% more than in 2018.The budget continues to focus largely on growth and the youth.

2019 EU Budget



b. Legislative changes in the EU – Proposed EU directives and anticipated impact

The Commission is proposing targeted changes to the EU's common rules on return. The proposed changes will improve the effectiveness of the existing rules, and ensure that they are applied consistently across the EU, in full respect of fundamental rights.

The proposed changes to the EU Return Directive include:

- **Accelerated border procedures:** Simplified return procedures will apply for persons whose asylum applications have been refused during border procedures to ensure return decisions can be quickly adopted and fully enforced at the EU's external borders, including in controlled centres.
- **Clearer and faster procedures for issuing return decisions**, in particular for rejected asylum seekers. A return decision will have to be issued immediately after a decision by a Member State terminating a legal stay.
- **Streamlined appeal procedures:** In cases where a return decision is the consequence of a rejected asylum application, appeals against the return decision will have to be lodged within five days and will be limited to only one level of judicial remedy. In addition, Member States will be able to restrict the suspensive effect of appeals against return decisions where there is no risk of breaching the principle of *non-refoulement.*
- A specific **obligation to cooperate** for persons subject to a return procedure throughout proceedings will be introduced. This will help Member States obtain information for verifying the identity of irregular migrants and acquiring travel documents necessary for the return.
- To make **voluntary returns** more efficient, Member States will have to set up dedicated programmes to assist persons willing to return, including with financial and practical support. At the same time, Member States will be able to shorten the period granted for voluntary departure, for example when there is a security risk or a risk of absconding.
- **Clear rules on detention:** This includes common criteria for determining the risk of absconding, the possibility to detain individuals posing a threat to public order or national security and a new minimum detention period of at least three months to give Member States sufficient time to successfully prepare, organise and carry out return operations.

- Member States will be able to impose an **entry ban** on a non-EU national exiting the EU when they find that the person had been staying irregularly in the EU. This will prevent future irregular migration and dissuade prolonged irregular stay.

c. 2019 European Parliament Elections Will Change the EU's Political Dynamics

According to Cargenie[10], over the last several decades, a broad alliance of big parties has called the shots in the EU. Politicians from the mainstream center-right and center-left parties have held a comfortable majority in the EU's principal institutions, including the European Parliament (EP), European Council, and European Commission. However, this era could come to an end with the next EP elections in May 2019, following waning support for mainstream parties, rising populists on both the radical right and left, and emerging new political players.

If the existing power balance changes, a complex constellation of forces could develop with more ad hoc coalitions across traditional party divides. While this might detract from the parliament's legislative efficiency, a more open decision making process might have a positive effect on public interest in democracy at the EU level. However, if the populist parties gain enough power to block crucial decisions, all the other parties will have to pull together to keep the EU functioning. If they don't, member governments will start bypassing parliament by doing intergovernmental deals.

Evidently, since the financial and economic crisis began in October 2008, national governments, the European Central Bank (ECB) and the Commission have been working together to:

- restore financial stability and create the right conditions for growth and job creation – coordinating supervision and intervention and supporting banks;
- protect savings – by increasing national guarantees for bank accounts to a minimum of €100,000 per customer, per bank;
- maintain a flow of affordable credit for businesses and households;
- put in place a better EU system of economic and financial governance.

1.3 Concerns on a potential recession in 2019 onwards

1.3.1 The Case of the United States of America

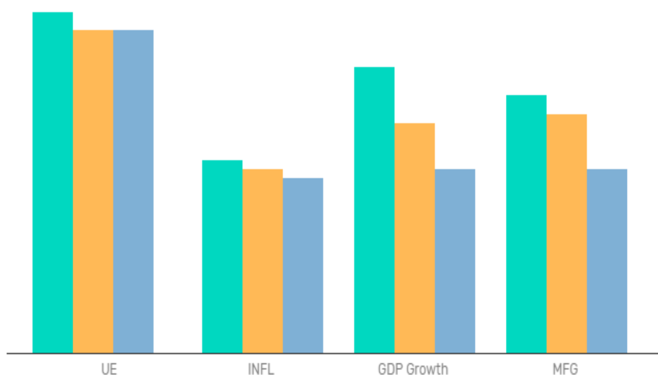
According to an October 2018 report by Fortune 500, two-thirds of business economists in the U.S. expect a recession to begin by the end of 2020, while a plurality of respondents say trade policy is the greatest risk to the expansion, according to a new survey. About 10 percent reported to see the next contraction starting in 2019; 56 percent saying 2020; and 33 percent pushing it to 2021 or later according

[10] Carnegie's Democracy, Conflict, and Governance Program and Carnegie Europe.

to a poll, issued by the National Association for Business Economics between August and September 2018.[11]

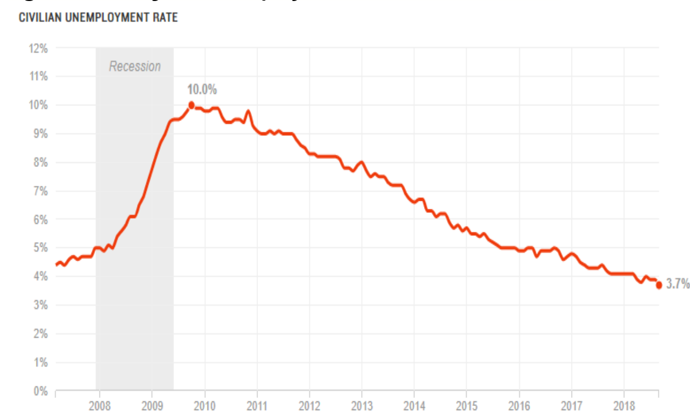
This has sparked great debate on a looming recession in the U.S in the near future. While divergence persists from different schools of thought on the possibility of a recession, the risk remains alive as more and more developed market economies move beyond full employment coupled with other factors[12].Some observers are concerned that, away from a recession it may be a sign that the economy is overheating[13], fanning fears of inflation.

Fig 9: U.S Inflation and Fed Rate Trends; 2018 – 2020



In the United States, unemployment rate has been falling in recent years with a record low of 3.7 percent recorded in September 2018; a level touched only once since 1969 just as the stock market peaked before a 30-month-long bear market and the economy fell into a recession[14].

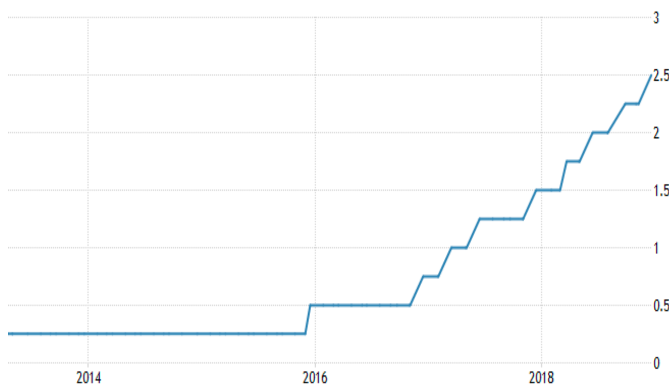
Fig 10: Trend of US Unemployment Rates (2008 – 2018)



Source: Federal Reserve

Further, as markets had expected, on December 19, 2018, the Federal Open Market Committee raised the current fed funds rate to 2.5 percent, up from a previous 2.25 percent. It expects to increase this interest rate to 3 percent in 2019.

Fig 11: U.S Fed Rate Trends; 2014 - 2018



[11] https://nabe.com/NABE/Surveys/Outlook_Surveys/October_2018_Outlook_Survey_Summary.aspx

[12] http://fortune.com/2018/10/02/the-next-recession-economists/

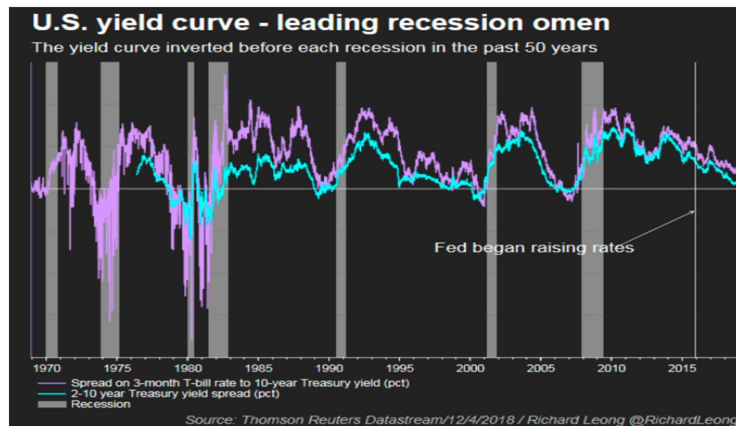
[13] ***An overheated economy*** is one that is expanding at a rate that is unsustainable, usually arrived at after a prolonged period of good economic growth and activity that has led to high levels of inflation (from increased consumer wealth). Rising rates of inflation are typically one of the first signs that an economy is overheating. As a result, Governments and Central Banks will usually raise interest rates in an attempt to lower the amount of spending and borrowing Unfortunately, these inefficiencies and inflation will eventually hinder the economy's growth and can often be a precursor to a recession.

[14] https://www.forbes.com/sites/raulelizalde/2018/06/02/why-a-recession-in-2019-is-possible-despite-unemployment-at-the-lowest-levels-in-50-years/#6776dc4456ca

Source: Federal Reserve

The move marked the fourth increase in 2018 and the ninth since it began normalizing rates in December 2015. It further projects two rate hikes in 2019.[15]The fed funds rate controls short-term interest rates. These include banks' prime rate, the Libor, most adjustable-rate loans, and credit card rates.[16]Whereas the central bank's rate hikes help control inflation, they also make loans costlier for consumers and businesses and for countries that borrow in U.S. dollars, the hikes make debts harder to bear. Argentina, for one, has slid into recession as its cost of repaying its debt has surged. Further, concerns over the inversion of the global yield curve [17]have spurred, noting that the last time this happened was in 2007 which, was before the global recession. Yield curve inversions - when shorter-dated securities yield more than longer maturities - have preceded every U.S. recession in recent memory by anywhere from 15 months to around two years[18].

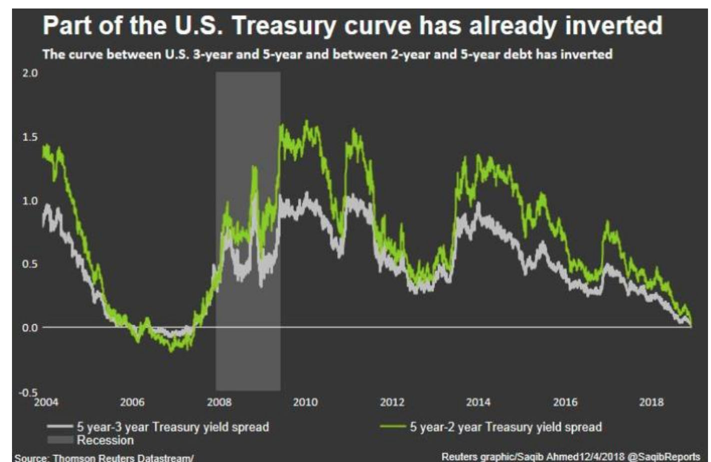
Fig 12: Historical Yield Inversion trend and recession occurrence



The yield on the 5-year Treasury note is reported to have fallen below the yield on the 3-year note, meaning that investors were being paid more to hold U.S. Government debt maturing in three years than comparable bonds maturing in five years.

An inverted yield curve is a sign that investors think the Government is less likely to pay back debt it owes in two years than what it owes in a decade — or in this case, the Government is less likely to pay in three years, than it is in five[19].

Fig 13: Current trend of the U.S Treasury Yield Curve



Despite the fact that this is not the major curve inversion that investors watch for, analysts predict that the same is likely to be replicated in the 2-year note holding a higher yield than the 10-year note, which has preceded every U.S. recession since World War II. The yield curve inverted between the 2- and 10-year yield before the recessions of 1981, 1991, 2000 and 2008. It has preceded all nine U.S.

[15] https://www.cnbc.com/2018/12/19/fed-hikes-rates-by-a-quarter-point-.html
[16] https://www.thebalance.com/us-economic-outlook-3305669
[17] The yield curve is a visual representation of how much it costs to borrow money for different periods of time; it shows interest rates on Treasury debt at different maturities at a given point in time.
18 https://www.reuters.com/article/us-usa-economy-yieldcurve-analysis/one-part-of-the-u-s-yield-curve-just-inverted-what-does-that-mean-idUSKBN1O50G1
19 https://finance.yahoo.com/news/treasury-yield-curve-just-inverted-sounding-alarm-recession-194921816.html

recessions since 1955, with a lag time ranging from six months to two years.

Fig 14: The Trend of the Slope of the U.S Treasury Yield Curve (10 Year – 2 Year Treasury Yield)

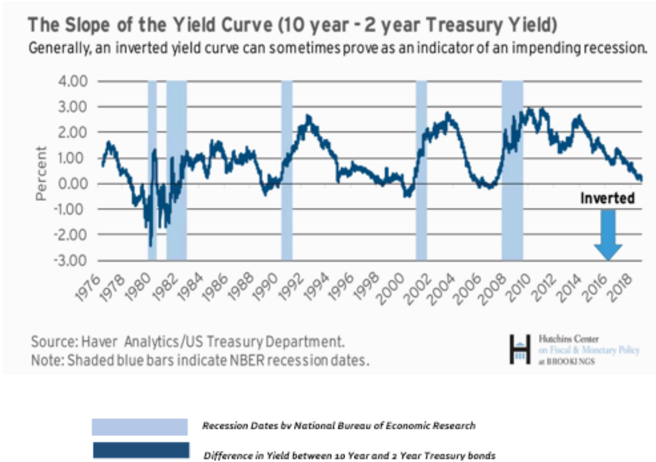
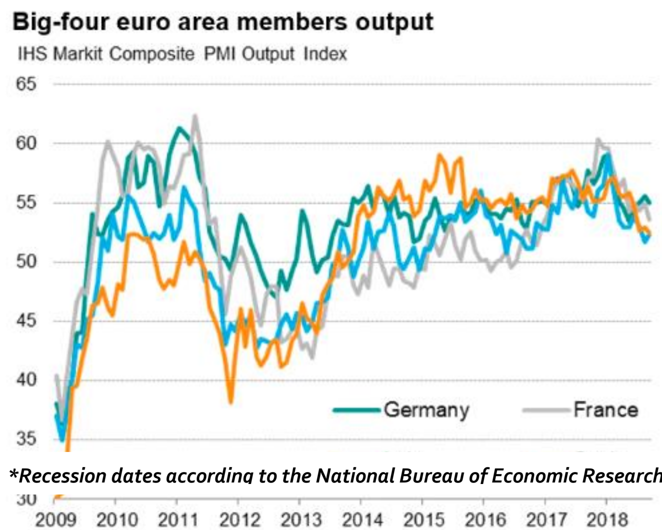


Fig 14 above show that whenever the rate between the 10 years and 2-year Treasury yield went to minus (that is yield curve inversion), a recession followed shortly (blue shaded bars).

1.3.2 Growth Slowdown in Eurozone and fears over Germany's risk of a recession

Growth in the Eurozone has slowed to its lowest level in over four years, as the region's recovery runs out of steam. Eurozone GDP only rose by 0.2% in July-September, down from 0.4% in April-June. Italy's growth rate fell to zero, in a blow its new government's plans to revitalize the economy.[20]

Fig 15: Trend of IHS Markit Composite PMI Output Index (2009 – 2018)



Source: IHS Markit

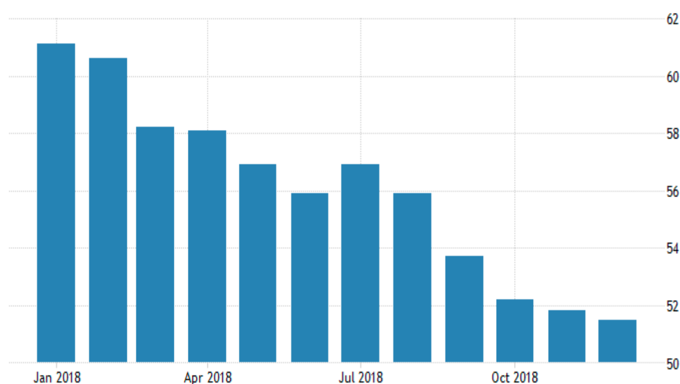
A dramatic plunge in German industrial activity in the last quarter of 2018 has raised the risk that Europe's largest economy will slip into recession with its gross domestic product (GDP) growing by 1.5 percent in 2018, compared with 2.2 percent in 2017, according to official statistics from the Federal Statistics Office (Destatis), pointing out to the weakest rate of growth in five years.

"Production fell for a third month in November 2018 and posted its worst year on year drop since the end of the financial crisis, with weakness in everything from consumer goods to energy," stated a Bloomberg article by Carolynn Look dated 8th January 2019.

20

Markit's Purchasing Managers' Index (PMI) for manufacturing, which accounts for about a fifth of Germany's economy, tumbled to a 33-month low of 51.5 in December 2018, down from 51.8 in November 2018, with the number inching closer to the 50.0 level which marks a contraction.[21]

Fig 16: Trend of Germany's Manufacturing PMI in 2018



Source: Trading Economics

This is reported to be the eleventh time in 2018 that the manufacturing index fell, resulting in a deterioration of the country's foreign trade position with exports falling and imports rising.

Further, Germany's seasonally adjusted harmonized unemployment rate edged down to 3.3 percent in October 2018 from 3.4 percent in the previous month, becoming the lowest jobless rate since June 1980.

In China, unemployment rate averaged 4.10 percent from 2002 until 2018, reaching an all-time high of 4.30 percent in the fourth quarter of 2003 and a record low of 3.82 percent in the third quarter of 2018.

Implication and lessons drawn: *The impact of the 2008 Global Financial Crisis was felt across the globe including Kenya more so the financial services sector as Kenya's markets are largely characterized and driven by foreign investors. Cumulatively the year 2018 as at end December 2018, realized an outflow of* ***Kshs 27,851*** *Mn at the Nairobi Securities Exchange, mainly attributed to the prolonged interest rate hikes observed in the U.S since December 2015 depressing performance at the bourse.*

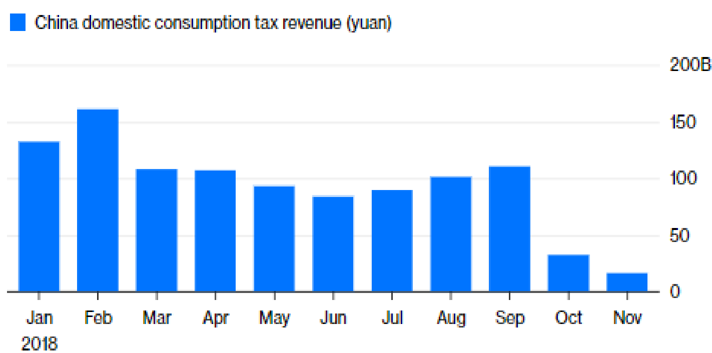
To avoid further losses, the Authority in conjunction with the Nairobi Securities Exchange will work to implement strategies aimed at attracting increased participation of local institutional and retail investors in the market to avoid over dependence on foreign capital to drive Kenya's ambitious economic growth plan. It is however important to note that Kenya's projected GDP growth rate is still high at over 5.5 percent in the medium term with a projection of 6 percent in 2020, as forwarded by the World Bank. Recession may lead to quantitative tightening by affected developed countries leading to a reversal of current capital flows back into frontier and emerging markets as investors search for yields. Kenya needs therefore to make its market attractive not only to domestic investors, but foreign investors and the Diaspora as well by stepping up product uptake strategies targeting various investor categories.

1.4 Expected Slump in Chinese Economy

[21] https://www.express.co.uk/finance/city/1069549/Germany-news-finance-recession-fears-industrial-output-economic-slowdown

China's economic growth is likely to slow to 6.2 percent in 2019 from an expected 6.5 percent this year. In October 2018, the International Monetary Fund cut its forecast on China's 2019 economic growth to 6.2 percent from 6.4 percent[22]. The economy started slowing in September 2018 and has dropped further since then. Aside from the trade wars with the US, China's consumption levels have equally dropped. Consumption tax revenue collapsed in the months leading to December 2018, recording declines of 62 percent and 71 percent from a year earlier. Value-added tax revenue has also turned negative within the last three months.

Fig 17: Trend of China's Domestic Consumption Tax Revenue (Jan – Nov 2018)



Domestically, China's economy is in a critical period of "great adjustment" where different industries and regions, business and finance, traditional finance and new finance are undergoing major differentiation and integration. Externally, uncertainties raised by multilateral trade friction, monetary policy shifts in developed economies and financial market turmoil in emerging economies will continue to put pressure on China, as well as the slowdown of the global economy[23].2019 marks the 70th anniversary of the founding of the People's Republic of China, hence pressure for the Government to ensure sound economic performance of the global giant. As tradition, China hosted its annual Central Economic Work Conference, a key Government committee led by President Xi Jinping that plans and sets the agenda for the broader economy between 19th and 21st December 2018, Policy issues discussed at the conference include:

- **Proactive Government fiscal policy citing tax cuts** - New tax brackets that raised the minimum threshold for personal income tax from 3,500 yuan to 5,000 yuan per month (an equivalent of between 510 USD and 730 USD) starting last October 1, is the latest by Chinese authorities to relieve the household tax burden in the hope of spurring growth. Under the new personal income law, taxpayers can claim deductions for expenses on children's education, continuing education, health treatment for serious diseases, housing loan interests, rent and elderly care. The deductible amount under each category ranges from 1,000 yuan per month to 2,000 yuan per month;
- Prospect of a **cut in benchmark interest rates** or the reserve requirement ratio in 2019;
- **Ease of rules on foreign business ownership;**
- **Commitment to make pre-emptive adjustments and fine-tune policies at the proper times** and ensure stable aggregate demand;

[22] https://www.cnbc.com/2018/12/20/world-bank-on-china-economy-expect-growth-to-slow-to-6point2percent-in-2019.html

[23] http://www.atimes.com/article/china-relaxes-duty-free-shopping-limits-for-hainan-island/

- Proportion of direct financing will be increased to make financing more accessible and affordable for the private sector and small businesses;
- **Priority to increase employment opportunities;**
- Reinforcement of structural adjustments with continued efforts to ***downsize glutted industries***, reduce all types of business burdens, and channel more energy into weak areas including infrastructure;
- Areas in abject poverty and special groups will receive more Government support;
- High-quality manufacturing development has been prioritized in the work agenda; and
- Small and Medium Enterprise (SMEs) will see greater support in innovation, and the ***protection and utilization of intellectual property rights will be enhanced.***
- ***Accelerated launch of a science and technology innovation board on the Shanghai Stock Exchange and experimentation of a registration system;***
- More investment to be channeled into pre-school education, early childhood education in poor rural areas, and vocational education.

Implication and lessons drawn: *China remains a key partner in the attainment of Kenya's infrastructural development agenda as well as trade promotion. In its December 2018 Central Economic Work Conference, China expressed its plan to embark on high quality manufacturing to expand the sector. The Government of Kenya has made commendable progress in strengthening bilateral ties with the Asian nation as evidenced by the recently signed MOU on Sanitary and Phytosanitary (SPS) measures between the Ministry of Agriculture with the General Administration of Customs of the People's Republic of China targeting export of produce such as fruits, nuts, avocados, mangoes legumes, flowers, vegetables, stevia, meat, leather and leather products. This presents an opportunity for Kenya's manufacturing sector to restructure and actively increase its production capacity from the current 9.2 percent contribution to GDP to the envisioned 15% by 2022. Noting access to capital as a key impediment to growth of the sector, the Authority is pursuing strategic partnerships with the Kenya Association of Manufacturers and the Kenya Private Sector Alliance with the overall goal of targeting potential manufacturing firms able to source funding through the capital markets.*

On the innovations front and in looking to have a more impactful Growth Enterprise Market Segment (GEMS), the NSE may need to introduce a technology segment that mirrors China's science and technology innovation board (due for launch) to provide a platform for entities that have successfully tested their FinTech solutions in the CMA Regulatory Sandbox, as well as established technology firms to list.

Management further, on the strength of national policies being taken by China to increase the disposable income of its citizens through high minimum wages thresholds, ease of doing business and general increase in social welfare, should consider adopting policies aimed at promoting employment to increase the disposal income of citizens, noting the constraints involved in meeting revenue targets by Government, making it difficult to offer tax cuts to the citizenry at the moment. A strategic direction on this has already been set by the Government through the Medium-

Term Plan III that aims to increase formal sector employment from 13% to 40% by 2022.

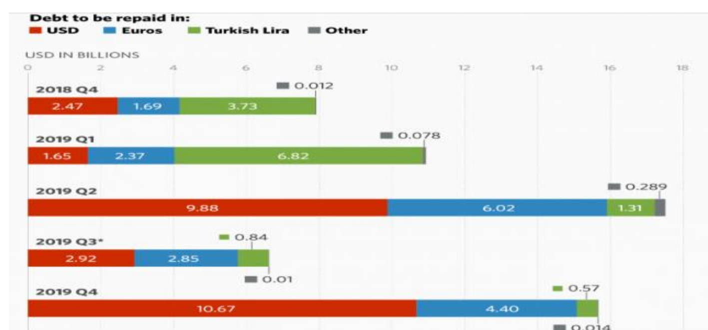
1.5 Currency Crisis in Turkey and Argentina and implication in 2019

Declines in the Lira and the Peso, two of this year's worst performers globally, are projected to translate into sharp economic contractions as growth decelerates across advanced and emerging markets as reported by the Moody's Investor Service.

1.5.1 Turkey's High Debt Burden and implications on growth

According to Moody's, Turkey's economy will probably contract through the first half of next year as the Lira's slump and rising borrowing costs take their toll. Moody's sees Turkey's economy growing 1.5 percent in 2018 and contracting 2 percent the following year. Turkey's corporate sector has acquired a remarkable amount of debt over the past 15 years and all these debts are coming to a head; meaning that the country's corporations will have to pay a bill estimated at $200 billion, or a quarter of Turkey's gross domestic product, come 2019.One important aspect of Turkey's dismal debt picture is the substantial number of bonds – most of which are denominated in U.S dollars or Euros, which it must repay next year.

Fig 18: Value of Turkish Bonds to be repaid in 2019



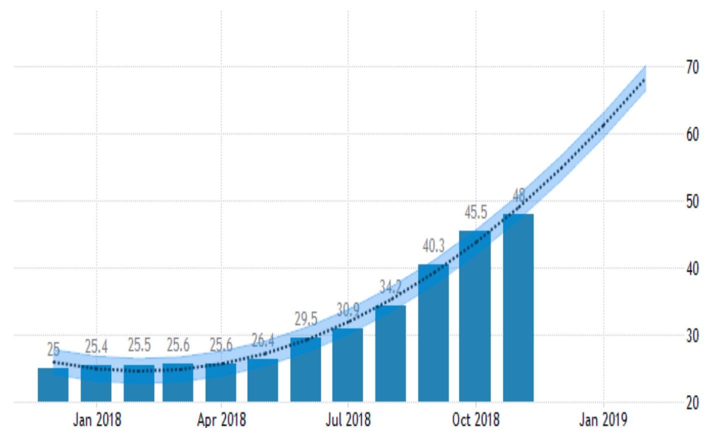
Source: Bloomberg, FINDEX

Most of the debt is denominated in dollars, making it more and more difficult for companies to continue paying back their debt the more the lira drops.

1.5.2 Argentina

GDP in Argentina on the other hand will not return to growth until 2020 as a result of the country's severe monetary and fiscal consolidation under an International Monetary Fund program. In Argentina, inflation expectations will continue to rise despite the central bank's very tight stance, as reported by Moody's, adding that it will take some time before the benefits of monetary policies fully materialize. It expects inflation to gradually fall to 20 percent by the end of 2020[24].

Fig 19: Argentina's Inflation Rate Trend in 2018 and 2019 Projections



Further, tighter global financial conditions, together with a domestic corruption scandal and persistent uncertainty over the success of the stabilization plan underlying the program with the IMF, have contributed to financial market volatility in Argentina. Despite a 2,000-basis-point hike in the short-term policy rate and several increases of reserve requirements, the Argentinean Peso depreciated by over

[24] https://www.bloomberg.com/news/articles/2018-11-08/moody-s-sees-sharp-contraction-in-turkey-economy-on-lira-turmoil

40 percent in real effective terms between February and mid-September 2018, equity valuations fell further, and sovereign spreads rose to above 700 basis points.

Implication and lessons drawn: *Kenya, like Argentina and Turkey has international debt obligations denominated in US dollars. To reduce exposure of its debt obligations, the Government of Kenya should consider financing its projects, particularly the Big 4 agenda through the domestic capital markets as well as equally pursue offshore local currency financing mechanisms.*

1.6 The US SEC asks for public comments on a wide range of its rules

On December 18th, 2018, the United States Securities Exchange Commission invited the public to comment on a host of its rules and whether they should be retained, removed or be amended. The exercise is a function of the Regulatory Flexibility Act (RFA), which means the agency has to consider the impact its rules are having on small businesses and potentially amend those that have been around for a decade.

The request for comment solicits public input on how the Commission can reduce burdens on reporting companies associated with quarterly reporting while maintaining, and in some cases enhancing, disclosure effectiveness and investor protections. In addition, the Commission is seeking comment on how the existing periodic reporting system, earnings releases, and earnings guidance, alone or in combination with other factors, may foster an overly short-term focus by managers and other market participants. Key focus areas include;

- Prospect of fewer companies being subject to external audit requirements;
- Rules covering executive pay, third party disclosures and annual proxy and shareholder proposals;
- Comments on how shareholders nominate directors and around rules for enhanced disclosures regarding board leadership and board oversight of risk;
- Rules are also being reviewed around short selling and naked short selling and pricing mechanisms for Initial Public Offers.

Implication and lessons drawn: *In the last quarter, the Authority conducted research aimed at identifying key impediments to the uptake of capital markets products and services. Stakeholders have flagged concerns over different regulatory requirements with some considered stringent and others costly to comply. To provide a facilitative environment, the Authority has set the review of regulations as a key activity in the life of its new strategic plan 2018-2023 and is willing to work with stakeholders to create a conducive environment for investment. Regulatory and tax incentive impact assessments are expected to be conducted periodically through the Financial Markets Law Review Panel (under establishment) and the relevant Capital Markets Master Plan Working Groups. The Authority has also introduced policy and regulatory framework advocacy and stakeholder engagement functions under its new organogram in line with its strategic influence objective.*

1.7 The 2019 Global Risk Landscape

2019 is projected to face a number of global risks that managers need to be cognizant of. According to a report by the Risk Management Monitor, a premier publication of analysis, insight and news for the risk management community, four key global risks are predicted for the coming year that are likely to impact risk managers well into the next decade:

1. **The nexus between populism and nationalism** will become more entrenched, implying that political figures such as Presidents Trump, Duterte and Erdogan may become the norm, rather than the exception in global politics. As a consequence, more of the global economy will depend on wily political decisions, rather than the traditionally agnostic economic forces that conformed to measurement. ***Implication:*** *This could mean a heightened propensity for expropriation, restrictions on currency convertibility and transfer, political violence, and breach of Government contracts;*
2. **Greater income inequality** leading to enhanced societal tension, strain on city, state, and national resources, and more pressure on governments to allocate greater funding for public services. ***Implication:*** *Despite growth in GDP, inequality in distribution will result in increased social unrest with potential tax evasion measures to increase disposable income. Governments should consider integrating development efforts across all spectrum of society even if it means investing more in social welfare to reduce cost of living on majority of citizens.*
3. **The race to achieve supremacy in the artificial intelligence arena will heat up**, not only between companies, but between a broader range of Governments. Those companies that have not yet joined the race will be under increasing pressure to get involved, particularly as competitors in their industries do the same.
   Implication: *Smaller Governments are now also starting to allocate resources to stake their claims. There is substantial risk that, in the rush to participate, many organizations will not first consider the risks associated with doing so or will only do so after the fact;*
4. **Economic double-jeopardy will begin to shape investment strategies in 2019 and beyond**. More and more sectors (in particular, large asset holders such as sovereign wealth funds, pension funds, hedge funds and insurers) are realizing that they are at once too big to fail and too big to hide.

1.8 Top 10 Future Trends to watch for in Capital Markets: 2019

A decade after the global financial recession that threw some too big to fail banks into freefall, the financial industry continues to bear scars. Banks, financial institutions, regulatory bodies and investors have taken multiple steps over the last decade to ensure that history is not repeated. Their actions aim to prevent another meltdown while ensuring that the industry giants stay competitive in the new age of technology-driven innovative

FinTechs [25] A recent report by Capgemini, a global leader in consulting, technology services and digital transformation identifies 10 key trends to watch for in the capital markets space.

Table 1: Technological Trends the Capital Markets needs to watch for in 2019

Key Drivers	Implication
Trend 01: Intelligent Automation Transforming Trade Functions ***Technology can help capital market firms deal with trade exceptions and mitigate risk without compromising returns.***	
Key Drivers	**Implication**
• Need to proactively manage trade risk and reduce operating expenses. • Automated processing reduces trade completion time and post-trade settlement errors.	• Machine Learning can quickly analyze large datasets to mitigate risk and drive higher returns for firms. • Artificial Intelligence can quickly identify failed trade transactions along with the exact reason for failure, allowing firms to implement remedies in seconds. • After identifying failed transactions, AI can propose solutions to fix process gaps, which leads to safer, faster and more profitable trades.
Trend 02: Robotic Process Automation(RPA) Enhances Business Process Effectiveness ***Capital market firms are developing applications for RPA across functions, driving efficiency and cost gains.***	
Key Drivers	**Implication**
• Persistent human involvement in repetitive tasks lowers productivity. • Human intervention focused on complex tasks add the most value to the organization. • Financial operations generate volumes of unstructured data that must be processed to produce useful and actionable insights.	• RPA will reduce operational costs significantly by driving processes without the need for human intervention as firms redirect more resources to work on strategic issues creating more value for the organization in the long run. • RPA can enable automatic parsing of huge datasets to generate intelligence at a faster rate compared to manual processes. This will enable firms to go to market faster compared to relying on traditional methods.
Trend 03: Cloud will drive operational efficiency and help with strategic decisions ***Increased adoption of cloud technology by capital market firms will improve real time strategic decision making and operational efficiency***	
Key Drivers	**Implication**
• The need to meet growing customer demand for real-time data insights. • Opportunity to improve organizational decision making by accessing real-time data and improving data sharing.	• Adoption of cloud services will drive down technology and infrastructure costs and free up funds for business processes and revenue generation. • By leveraging cloud infrastructure, firms can break data silos across various processes and pool utility data leading to improved decision making and cost efficiencies.

[25] Priyanka, Ayush, Mahapatra and Singh 2019

<table>
<tr><td>• Need to reduce upfront capital expenses to balance costs of regulatory and compliance requirements.
• Cloud adoption in other industries has driven tangible benefits and is spurring capital markets action.</td><td>• The cloud can enable firms to deploy analytics and business intelligence applications on their data pool to derive actionable business insights
• Capital market firms can leverage the cloud to move toward digital innovation and provide seamless service to customers</td></tr>
<tr><td colspan="2">Trend 04: Micro services Improves Firms' Agility and Workflow
Capital market firms are recognizing the capabilities of microservices architecture – improvements in technology deployment speed and service delivery</td></tr>
<tr><th>Key Drivers</th><th>Implication</th></tr>
<tr><td>• Companies cannot afford operational shutdowns or interruptions while systems are being upgraded or maintained.
• Frequent regulatory changes have given rise to the need for teams to develop technology applications that can quickly assimilate and implement changes.
• Firms are moving to reduce risks and costs associated with holding positions and data in monolithic systems.</td><td>• Large-scale disruption of overall systems caused by single failure points will be significantly reduced as microservices allow firms to decrease internal system dependencies.
• Overhead firm costs will be reduced as teams and systems are re-directed to execute similar functions across different divisions.
• Capital market firms will become more responsive to regulatory changes and technological trends and roll out dynamic changes to current systems without affecting normal workflows.</td></tr>
<tr><td colspan="2">Trend 05: Smart Contracts Boost Trade Settlement Efficiency
Smart Contracts are the next big wave of innovation in distributed ledger technology and have the potential to drastically alter the way trading is executed in capital markets</td></tr>
<tr><th>Key Drivers</th><th>Implication</th></tr>
<tr><td>• In trading, the increased focus on reducing the time taken to settle the trade has shifted focus from front office to middle and back offices; hence, firms are trying to identify opportunities in middle and back offices to improve processes.
• Implementations by cryptocurrencies such as Bitcoin and Ethereum have given a push to smart contracts for post-trade settlements.
• The potential benefits of smart contracts such as automatic enforcement and lower compliance costs make it economically viable to form smart contracts for numerous low-value transactions.
• Smart contracts will help regulators enhance transparency in transactions, which has been a major concern among investors</td><td>• The implementation of distributed ledgers with embedded smart contracts will lead to substantial improvements in compliance, cost-efficiency and accountability for capital market firms.
• Smart contracts will speed up processing of trade agreements on complex financial products, thereby increasing efficiency of transactions and reducing the cost burden on customers.
• Smart contracts will ensure zero errors as the contracts are executed as per the exact code provided by the parties involved.
• The encryption of documents makes them immune to theft thereby improving safety and trust as all parties have access to the documents on the shared ledger</td></tr>
<tr><td colspan="2">Trend 06: Platformification will generate new customers and revenue streams</td></tr>
</table>

The rise of platformification makes it imperative for capital market firms to move from build to buy side to meet customers' growing needs	
Key Drivers	**Implication**
• Capital market firms have limited capabilities to develop and support the varied nature of applications demanded in today's technology-driven world. • In-house development is time-consuming and adds additional cost when the firm is coping with costly issues such as legacy upgrades and regulatory compliance. • Legacy systems make it difficult for firms to offer new channels of delivery in response to customer demand. • Regulatory changes and the rise of open architecture have pushed capital market firms to connect with external systems and take advantage of new platforms to get access to new customers and new sources of income.	• Reduced firm overhead costs because clients will be able to access a variety of services via a plug-and-play model. • Consumers will not have to make duplicate data entries and pay multiple providers while getting access to a wider range of products and features. • Introduction of new revenue streams for capital market firms as more third parties get access to the bank's historical data. • Capital market firms will have shorter development and deployment cycles for newer technologies while ensuring their consumer data safety is not compromised.
Trend 07: Quantum Computing to revolutionize the Capital Markets Operating Model ***Quantum computing is poised to be the new gold standard of capital markets' technology, with applications ranging across risk management, portfolio optimization, fraud detection and asset pricing***	
Key Drivers	**Implication**
• The increase in machine learning techniques by quantum computers to detect recurring patterns in capital markets will drive adoption of quantum computing. • Many banks are interested in using quantum computing for risk management. Risk calculations entail large numbers in complex simulations, and if the algorithm has a self- learning module that can build on existing information, it can add new layers and abilities to manage risk better. • Quantum computers are equipped to solve algorithmic trading problems with speeds that are exponentially faster than traditional digital computers	• In stock markets, quantum computing can help find an effective frontier of portfolios with best possible returns for any given risk level – currently considered a non-deterministic polynomial time (NP) problem in today's market. • The data encryption technique used currently can become obsolete soon, owing to the power of quantum computing; this will enable capital market firms to reduce the database request times, improve financial forecasting and risk analysis in capital markets. • To achieve the same result, quantum algorithms require logarithmically fewer calculations than a classical computer, and capital market firms can leverage that capability by running complex financial models faster. • Quantum computers will provide deeper levels of insight and understanding, which investors and firms can use to help fight fraudulent activities previously thought inconceivable
Trend 08: Regtechs will boost compliance and risk mitigation capabilities ***Regtechs have the capability to endlessly monitor risk which can help firms reduce compliance obligations and enhance productivity and efficiency.***	

<table>
<tr><th>Key Drivers</th><th>Implication</th></tr>
<tr><td>

Capital market institutions are battling to comply with new regulations such as MiFiD II, General Data Protection Regulation (GDPR) and the revised Payment Service Directive (PSD2).
With the introduction of Fundamental Review of the Trading Book (FRTB), banks with trading books will need to enhance risk aggregation capabilities to survive market volatility.
Financial institutions currently do not possess the capabilities and resources to develop solutions to ensure compliance with the wide-ranging list of regulatory requirements.
With rapid growth in Big Data and the capability of the firms to acquire flexible infrastructure and cloud storage for data, disruptive technologies are being used in the operational aspects as well

</td><td>

RegTech will help firms create an integrated risk management system which will aid to evaluate risks in various functions of the organization and encompass regulations under a single umbrella.
By bringing all regulatory risks and business processes under a single umbrella, firms will be able to standardize compliance requirements, thus reducing the cost of regulatory compliance.
Firms will be better equipped and agile to scale their operations with standardized regulatory platform in a dynamic regulatory environment.

</td></tr>
<tr><td colspan="2">Trend 09: General Data Protection Regulation(GDPR) is prompting a deeper dive into Data Governance and Management
Since the introduction of the EU's General Data Protection Regulation, there is an increased focus on using data in a compliant way to scale up business</td></tr>
<tr><th>Key Drivers</th><th>Implication</th></tr>
<tr><td>

The volume and variety of data to be processed, managed, analyzed, and reported is increasing exponentially.
Specific guidelines under GDPR such as Article 30 require companies to keep an updated record of processing activities that use personal data. Non-compliance can result in heavy penalties and reputational loss.
Among GDPR rules, "ensuring the right of access, the right to data portability, and the right to erasure," are key drivers to maintaining a complete and secure data structure.
Firms must also identify overlaps with other regulations (such as FINCA record-keeping/data storage requirements) that push for better data structure and management frameworks.

</td><td>

GDPR will lead organizations towards a stronger and more advanced information governance system. This will help organizations understand their existing data, update the retention and disposition policies and adhere to those policies.
Firms should embrace the regulations as an opportunity to simplify and rationalize data structures and review internal processes.

</td></tr>
<tr><td colspan="2">Trend 10: AI and ML will play a major role in handling cyber-crime in the future</td></tr>
</table>

With increasing use of AI and ML, more sophisticated cybersecurity infrastructure can be implemented to protect firms and investors.	
Key Drivers	**Implication**
• Capital markets are extremely vulnerable to sophisticated cyberattacks adopted by cybercriminals globally. • Increasingly, valuable business data is stored online, thereby creating sizeable data-security risks. • Regulators face challenges in cases that require processing huge volume of data	• AI and ML help regulators and investigators scan through mountains of documents to identify relevant documents quickly. • As the technology attempts to learn from the information it processes, firms can identify and categorize similar red flags in related cases. • AI and ML will help institutions overcome several key challenges including detecting financial fraud[26]

Source: Capegmini

Implication and lessons drawn:

The Authority continuously monitors its risk profile to increase its responsiveness to arising global risks. Technological advancements and their impact within the capital markets continues to be a primary discussion point amongst regulators globally as businesses incorporate new technologies in running their operations to increase on efficiencies. Great progress has thus been made by the Authority towards actualizing the first regulatory sandbox environment test in the East African region as a platform to promote technological innovations aimed at impacting capital markets operations. A Policy Guidance Note on the operationalization of the regulatory sandbox has been developed with support from FSD-K and is up on public exposure effective 18th December 2018 to 20th January 2019. Platformication and Smart Contracts are feasible options for implementation within the Capital Markets in the short term. Smart Contracts are useful in dealing with fraud and addressing efficiency with how transactions are conducted within the capital markets while platformification potends a cost advantage as opposed to securing licenses for software. It is however crucial to encourage local development of platforms and solutions to facilitate flexibility and interoperability. Big Data can be leveraged to analyze key investors and client trends to draw patterns aimed at structuring suitable products and employing appropriate marketing techniques.

How Kenya can position itself to secure maximum gains from emerging Fintech trends.

a. ***CMA to concretize efforts to join the Global Financial Innovation Network*** a network of regulators to collaborate and share experience of innovation in respective markets, including emerging technologies and business models, and to provide accessible regulatory contact information for firms".
b. ***Robust Capacity Building to seal existent knowledge gaps****.* Regulators and market

[26] Top 10 Trends in Capital Markets: 2019 – What you Need to Know by Capgemini

participants to take lead roles in conducting capacity building and also to facilitate technology acceptance. Collaboration between Technology Hubs and Universities to promote technology awareness.

c. ***Data protection***- FastTrack the Draft data protection bill 2018-General Data Protection Regulation (GDPR) passed by the European Union and makes Kenya the second country in East Africa after Rwanda to have legislation dedicated to data protection.
d. More focus on embedding ICT and software development in current Education curricula.
e. CMA to consider on boarding technology initiatives in the current University Challenge programs.
f. Collaborative effort with innovation hubs to develop a Capital Markets Innovation Challenge.
g. Partnership with key stakeholders such as Technology Incubators and innovation Hubs, ICT Authority, Financial Sector regulators to enable successful implementation of technological innovations.
h. CMA to consider partnership with Association Of Startup and SME Enablers Kenya which is a suitable platform for developing strategies and policies/programs on software and solution development as well as providing a networking platform for startups and Fintech firms.

2.0 Outlook on Emerging Markets Economies in 2019

Under the weight of intensifying trade tensions, a strengthening US dollar, rising financing costs and less accommodative domestic policy settings, broad emerging markets growth similarly looks poised to slow more noticeably in 2019, to 4.5%.

While this remains a decent pace, risks are skewed to the downside amid the escalating trade spat between the US and China and potential missteps in that globally critical relationship. Moreover, the emerging markets recovery in 2017 had a very strong cyclical component, which has since dissipated, refocusing attention on fundamental challenges such as high debt levels and the lack of structural reforms. Brazil, Russia and India all struggled against headwinds in 2018, which do not appear to be dissipating in 2019.

Fig 20: 2019 GDP Growth Forecasts for Emerging Market Economies

Implication and lessons drawn: *As Kenya works towards becoming a middle-income country by the year 2030, there is need to monitor key emerging economies that continue to be preferred investment destinations thus shaping the global trade and investment*

environment. Key lessons should be drawn and implemented on relevant and applicable policies driving growth in these countries, particularly India that has been on a progressive economic trajectory in the last decade.

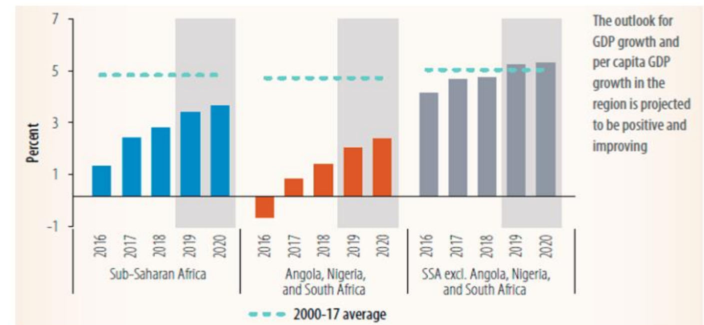
3.0 Sub Saharan Africa

3.1 Economic recovery in the region is set to continue but at a more gradual pace

Growth in the region is projected to increase from 2.7 percent in 2018 to 3.3 percent in 2019, rising to 3.6 percent in 2020, according to the World Bank forecasts. The recovery is set to continue amid a more challenging external environment, including moderating economic growth among the region's main trading partners, a stronger U.S. dollar, heightened trade policy uncertainty, and tightening global financial conditions.

Against this backdrop, growth may be supported by a modest uptick in oil prices, the easing of drought conditions that had depressed agricultural output, and a rise in domestic demand as policy uncertainty of the past year recedes and investment rises.[27]

Fig 21: Projected GDP Growth in the Sub Saharan Africa 2019 – 2020



Growth Forecast: GDP

Source: World Bank – Africa's Pulse

3.2 Zimbabwe Rising inflation and liquidity crisis leads to near-economic collapse and increased food insecurity

Zimbabwe has seen a significant spike in inflation and a liquidity crisis in 2018. By October inflation stood at 28.5%, the highest increase since 2009. One of Zimbabwe's biggest food processing companies closed its wheat mills as it could no longer afford agricultural imports. There have been ad hoc food shortages and temporary rationing in shops across the country. Any further deterioration of the economy is likely to result in hyperinflation, raising food prices even further and severely impacting market availability.

3.3 Nigeria Spike in farmer-herder violence in Nigeria's Middle Belt in anticipation of elections

Nigeria is scheduled to head for general elections in February 2019 which analysts have predicted to be a

[27] https://www.worldbank.org/en/region/afr/publication/africas-pulse-in-five-charts-boosting-productivity-in-sub-saharan-africa

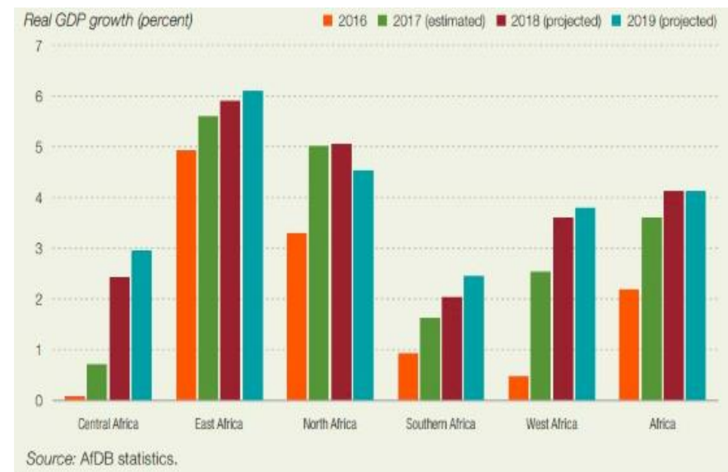
close race between President Buhari, primarily supported by Fulani herding communities and the opposition party's Atiku Abubakar, primarily supported by farming communities, further polarizing ethnic and religious tensions between the two groups. Farming communities in particular have been dissatisfied with the government's response to farmer-herder violence in 2018 and anti-grazing laws in two states have further exacerbated ethnic tensions and violence. The Middle Belt is typically a 'swing' region, which makes the risk of violence more likely. The increase in farmer-herder attacks and the fear of violence leading up to the elections are likely to lead to another spike in displacement.

Implication and lessons drawn: *The cases presented by Zimbabwe and Nigeria are not unique given Kenya suffered its own share of economic sabotage following the 2007/08 post-election that saw significant decline in economic growth and activity in the country. Politics is a key pre-requisite for stable and well performing markets. While Kenya's next election is scheduled for 2022, caution should be taken in political circles to avoid politicizing the economy as this affects market activity as observed in successive election years.*

4.0 Outlook on the East African Region

East Africa's economy has been acknowledged as best performing in the continent, according to a latest report by the Institute of Chartered Accountants in England and Wales (ICAEW) dubbed *Economic Insight: Africa.* ICAEW attributes the region's strong performance to economic diversification and investment-driven growth.

Fig 22: Projected GDP Growth across Regions in Africa



Ethiopia remains the region's powerhouse, with the country's GDP expected to grow at 8.1% owing to the recent reforms being implemented by new Prime Minister Abiy Ahmed. The report notes that Diaspora remittances are a key economic driver for most African countries. Growth in other regions is projected as; West and Central Africa's GDPs to grow at 2.9%, Franc Zone at 4.6%, Northern Africa at 1.8% and Southern Africa at 1.5%.

EAC Key Challenges

a. **Differing Tax rules and regimes**

EAC member countries have different tax rules, which has given rise to harmful tax competition, thereby attracting investments in some jurisdictions while hurting investors in others. Further, the region's different tax procedures interfere with free movement of goods, investment decisions and tax

administration eroding the gains of the Common Market.

b. **EAC has been faced with a low disposable income** status particularly with the emergence of a myriad of taxes.

Implication and lessons drawn: *Until recent years, Kenya always towered above other East African countries as the most promising economy. However, emergence of Ethiopia as a key competitor should be carefully monitored. Further, recent appointment of President Sahle-Work Zewde, in October 2018 as the first female president of Ethiopia, who has a wealth of experience in diplomacy having worked as UN's top official at the African Union has increased Ethiopia's profile as a key competitor in the global economy.*

Further, Kenya's tax regime is also higher than some of its biggest competitors for foreign direct investments such as South Africa (29.1 per cent), Ghana (32.4 per cent) and Nigeria (34.8 per cent).

Additionally, a widespread decrease in disposable income leads to decreases in stock investments and, therefore, decreases the overall value of the stock market.

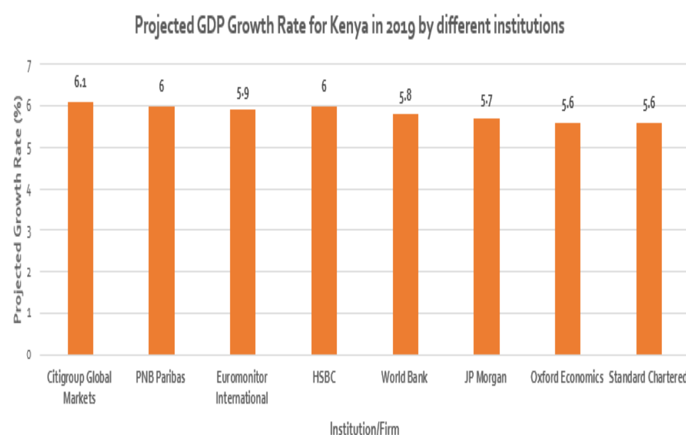
Diversification, private consumption and political stability will drive economic growth in EAC.

5.0 Domestic Environment

5.1 Outlook on Kenya's Economic Performance

The World Bank revised Kenya's 2018 economic growth from the 5.5 per cent figure it issued in April 2018 to 5.7 per cent. The change has been attributed to improved agricultural yields on account of good rains, better business environment and easing of political uncertainty. The growth is projected to remain robust over the medium term with GDP growth projected at 5.8 per cent in 2019 and 6.0 per cent in 2020.

Fig 23: Range of Projections by Different Institutions on Kenya's Growth Rate in 2019



Source: CMA

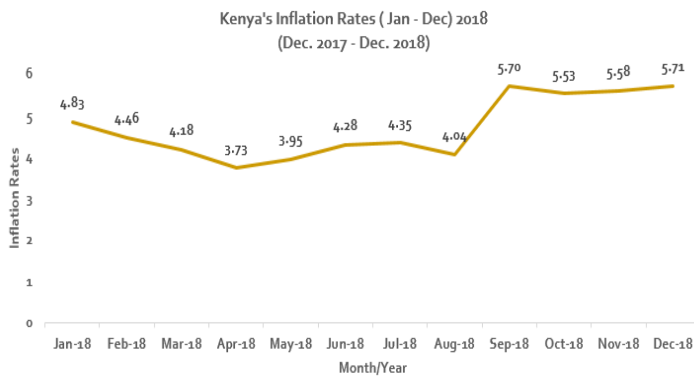
In addition, Kenya National Bureau of Statistics will be rebasing the National accounts figures from the base year of 2009 to 2016. This will provide a clearer picture of an economy's size and structure as well as allow the Government of Kenya to better evaluate its fiscal positions and potential revenue bases while providing investors with more accurate information on which to base their investment decisions.

5.2 Inflation Rates

During the year 2018, Kenya's inflation rate oscillated within the range of 3.73%, being the lowest rate recorded in April 2018 and 5.71%, being the highest rate recorded in December 2018. The steady rise in the

rate has been mainly attributed to a rise in the cost of food and nonalcoholic drinks as well as transport costs as a ripple effect of increased cost of oil in the country following the inclusion and implementation of an 8 percent VAT tax in the year.

Fig 24: Inflation Trends (Jan 2018 – Dec 2018)

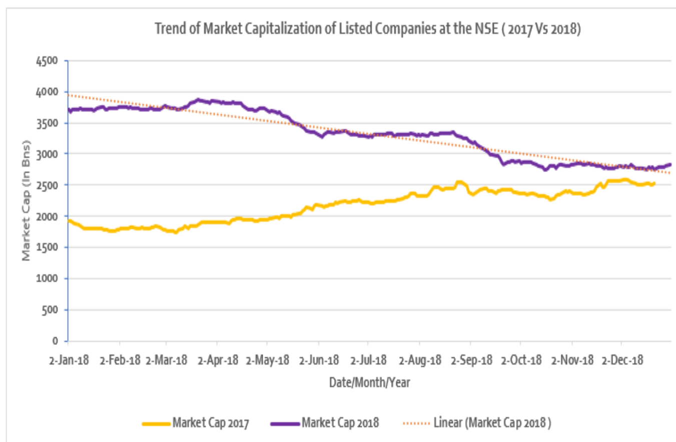


Source: KNBS

6.0 Capital Markets Industry Performance

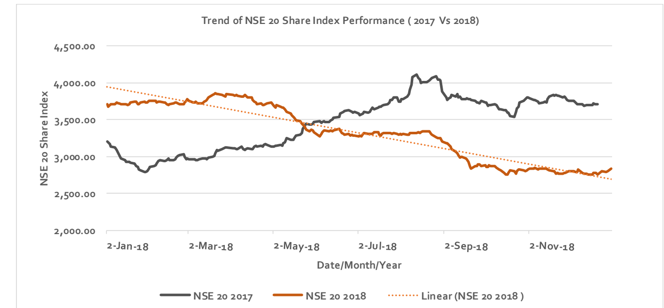
6.1 Equity Market Performance

Figure 25: Market Capitalization of Listed Companies (2017 Vs 2018)



Source: NSE/CMA

Fig 26: Trend of the NSE 20 Share Index (Jan – Dec 17/18)

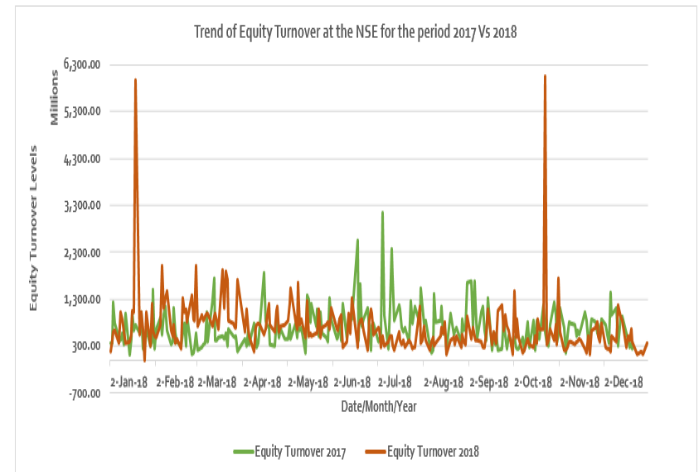


Source: CMA

Fig 25 and 26 above show a persistent decrease the market capitalization and NSE 20 share index registered throughout the year.

The lowest market capitalization level during the year 2018 was recorded on 21st December 2018 in Q4.2018, amounting to Kshs 2,079.81 Bn, compared to the highest cap value recorded on 5th April 2018 in Q2.2018, amounting to Kshs. 2,896.24.

Fig 27: Trend of the NSE 20 Share Index (Jan – Dec 17/18)



Source: CMA/NSE

Table 2: Summary of Equity Market Performance

Year	Month	Equity Turnover (KShs. Bn)	Share Volume (Mn)	NASI	NSE 20 Share Index	Market Cap (Kshs. Bn)
Q1.2018	Jan	20,340	862	181	3,737	2,660
	Feb	17,919	572	182	3,751	2,678
	March	22,890	704	191	3,845	2,817

	Total	61,149	2,138			
Q2.2018	April	15,076	449	180	3,735	2,645
	May	18,377	677	173	3,333	2,549
	June	13,688	453	174	3,286	2,576
	Total	47,141	1,579			
Q3.2018	July	9,736	323	170	3,297	2,519
	August	10,243	329	168	3,203	2,477
	September	11,950	392	150	2,876	2,211
	Total	31,929	1,044			
Q4.2018	October	16,890	843	144	2,810	2,133
	November	10,713	407	146	2,797	2,184
	December	7,830	320	140	2,834	2,102
	Total	35,433	1,570			

6.2 Bond Market Performance and Stability

6.2.1 Treasury Bond Market

In Q4.2018, there were four (4) treasury bonds on offer with one infrastructure bond IFB 1/2018/20 issued in November 2018. During this period the government sought to collect a sum total of Kshs 162 billion, Kshs 42 billion more than the usual Kshs.120 billion targeted in all the previous quarters of the year 2018 as the Government sought to fund its budgetary needs. This, even as the Kenya Revenue Authority missed its revenue targets of Kshs 92 billion and Kshs 60.46 billion in Q1 and Q2 of FY 2018/19.

The bids received for the bonds on offer amounted to Kshs 121.68 billion with the government accepting Kshs 82.86 billion. This translates to a cumulative acceptance rate of 68.10% for the quarter.

Further, there were two tap sales during the quarter seeking to raise Kshs 36.25 billion from the market. However, bids received amounted to Kshs 15.46 billion, with the government accepting Kshs 15.35 billion.

6.2.2 Corporate Bond issues

The Corporate bond market has been relatively dry. A resolution of the issues in the bonds market to address the issues of insolvency especially for bonds that have not been listed would go a long way in instilling confidence in corporate bond markets.

Table 3: Treasury bond Performance

	BOND	Amt Issued (Kshs. Bn)	Amt Received (Kshs. Bn)	Amt Accepted (Kshs. Bn)	% AA/AI	% AR/AI
Jan 2018	IFB 1/2018/15	40.00	55.76	5.04	12.60	139.40
	Tap Sale		-	36.21	-	-
Feb 2018	FXD1/2010/15	40.00	7.97	4.44	11.10	19.93
	Tap sale		-	3.17	-	-
	FXD2/2013/15		16.18	8.76	21.90	40.45
	Tap sale		-	35.01	-	-
Mar 2018	FXD1/2018/5	40.00	37.65	23.07	57.68	94.13
	Tap Sale		-	7.74	-	-
	FXD1/2018/20		13.74	8.49	21.23	34.35
	Tap Sale		-	7.77	-	-
Apr 2018	FXD1/2018/15	40.00	22.86	20.15	50.38	57.15
	FXD1/2018/20		9.90	6.79	16.98	24.75
May 2018	FXD 1/2018/15	40.00	20.22	12.86	32.15	50.55
June 2018	FXD 1/2018/25	40.00	10.13	5.17	12.93	25.33
July 2018	**FXD 2/2018/20**	40.00	13.86	10.51	26.28	34.65
Aug 2018	**FXD 1/2018/10**	40.00	29.83	19.36	48.4	74.6
Sep 2018	**FXD1/2018/10**	40.00	22.14	21.24	106.20	110.70
	FXD2/2018/20		10.33	5.31	26.55	51.65
Oct 2018	**FXD 2/ 2018/15**	40.00	27.05	7.85	19.63	67.63
Nov 2018	**FXD 2/2018/15**	32.00	25.38	21.26	66.44	79.31
	IFB 1/2018/20	50.00	40.39	27.59	55.18	80.78
	Tap Sale	22.41	8.84	8.73	38.96	39.45
Dec 2018	**FXD 2/2018/10**	40.00	28.86	26.16	65.40	72.15
	Tap Sale	13.84	6.62	6.62	47.83	47.83

Source: CMA/NSE

Table 4: Summary of Annual Treasury and Corporate Bond Turnover

	Treasury Bond Turnover (Kshs Bn)	Corporate Bond Turnover (Kshs Bn)	Total Bond Turnover (Kshs Bn)
2017	424.79	3.52	428.31
2018	528.06	4.20	532.26

Source: CMA/NSE

6.3 Performance of Listed Companies

Table 12: Price Gainers

Counter	28th Sep 2018	31st Dec 2018	% change
BAT KENYA	580.00	725.00	25.00%
KENOLKOBIL	15.95	19.05	19.44%
EXPRESS (K)	4.25	5.00	17.65%
NIC GROUP	24.50	27.80	13.47%
HOMAFRIKA	0.65	0.70	7.69%
STANLIB I-REIT	10.20	10.95	7.35%
NSE	13.60	14.55	6.99%
MUMIAS	0.55	0.58	5.45%
STANDARD GROUP	28.00	29.50	5.36%
KENGEN	6.70	7.02	4.78%

Source: NSE

NIC Group

During the quarter, the Commercial Bank of Africa (CBA) announced that it had opened talks with the NIC Group for a possible merger. If successful, the merger is expected to create the third-largest lender by assets, making it the biggest re-arrangement of Kenya's banking landscape in a decade, based on September 2018 statistics on asset base. When a company acquires another company, typically the stock price of the target company, in this case, NIC Group rises while the stock price of the acquiring company declines in the short-term. The target company's stock usually rises because the acquiring company has to pay a premium for the acquisition.

KENOLKOBIL

In October 2018, the late Biwott' s family sold its 24.99 percent stake in Kenol Kobil to Rubis for an estimated KShs. 5.6 Billion, laying grounds for a planned takeover by Rubis. The result was an increase in the price of the company as expectations of a takeover consolidate in the market. Rubis is reportedly expected to complete the takeover early in the year 2019, pending approval from various regulators including CMA, the Competition Authority of Kenya and the Energy Regulatory Commission. Further, in a public announcement dated 7th November 2018, the company announced its planned acquisition of 33 stations (23 in Uganda and 10 in Rwanda) from Delta Petroleum, with the deal expected to be concluded in March 2019. The acquisitions are reported to be in line with the Board's growth strategy through organic and inorganic network expansion. Subject to successful conclusion of the transaction, the total retail network of the KenolKobil group will rise to 433 stations, of which 200 stations will be in Kenya, 56 in Uganda and 61 in Rwanda[28].

BAT Kenya

Following announcements of a change in the Chief Executive Officer position effective 1 April 2019 in

[28] NSE Public Announcement by KenolKobil

Q3.2018 by the company, several other corporate actions have been undertaken by the company, a potential cause of the increase in its share price as investors show confidence in the new management team being put in place. Other changes included announcement of a new Regional Director, Americas and Sub-Saharan Africa, creation of two new management board roles including Director New Categories and Director, Digital and Information and the naming of the company as a top employer in Asia Pacific. Additionally, the company unveiled a new vaping technology namely Vype iswitch and Vype iiswitch Maxx as the company seeks to transform tobacco by offering adult smokers a range of potentially reduced-risk products, such as vapour, tobacco heating and oral tobacco and nicotine products.

Table 13: Price Losers

Counter	28th Sep 2018	31st Dec 2018	% change
NBV	1.60	1.15	28.13%
FLAME TREE(G)	3.25	2.50	23.08%
SAMEER	2.25	1.85	17.78%
OLYMPIA	2.50	2.10	16.00%
EQUITY	40.00	34.85	12.88%
KAPCHORUA	86.00	75.00	12.79%
KENYA POWER	4.65	4.07	12.47%
BAMBURI	150.00	132.50	11.67%
JUBILEE HOLDINGS	456.00	404.75	11.24%
UCHUMI	0.90	0.80	11.11%

Source: NSE

Nairobi Business Ventures

During the quarter, the Capital Markets Authority approved for Nairobi Business Ventures LTD to offer and list 15 million new shares on the securities exchange. This was after the company converted preference stock (convertible notes) into ordinary shares. Following the approval by NSE for the listing, the Board of the firm approved the allotment of 15,000,000 ordinary shares to rank in all respect with the existing shares.

Other Developments on Listed Companies

Deacons Placed Under Administration

On November 18th, 2018, fashion retailer Deacons announced its plans to be placed under administration, following a board resolution in a move aimed at helping it out of the financial distress it faces. The board appointed Peter Kahi and Atul Shah of PKF Consulting Limited as the firm's joint administrators, resulting to the suspension of the firm from trading at the NSE. Cash constraints facing the company have led to a decline in stock levels across most stores, leading to reduced margins. The board reported that the primary objective of placing the company under administration was to enable the administrators to explore the possibility of rescuing the company as a going concern or achieving a better outcome for the creditors than would likely be the case if the company were to be liquidated.

7.0 Major Policy Developments

7.1 National Treasury Launches Medium Term III Plan

During the quarter, the National Treasury launched the third Medium Term Plan 2018 -2022 on 23rd

November themed: ***"Transforming Lives: Advancing Socio-Economic Development through 'the Big Four*** ***'***at the Kenyatta International Convention Centre in Nairobi.

The plan targets to increase real GDP annual growth from 5.9 % in FY 2018/19 to 7% over the plan period, increase savings and investments as a percentage of GDP from 18.8% to 23.2% and 24.4% to 27.2% respectively by 2022 as well as increase the ratio of formal sector employment from 13% to 40% by 2022.

The plan prioritizes implementation of the "Big Four" initiatives that target to increase the manufacturing share of GDP from 9.2% to 15 % and agro-processing to at least 50 % of total agricultural output; provide affordable housing by building 500,000 affordable houses in five years across the country; enhance Food and Nutrition Security (FNS) through construction of large-scale multi-purpose and smaller dams for irrigation projects, construction of food storage facilities and implementation of high impact nutritional interventions and other FNS initiatives; and achieve 100% universal health coverage (State Department for Planning, National Treasury and Planning, Kenya).

To actualize the aspirations of the Medium-Term Plan III, significant infrastructural development is earmarked including rehabilitation of terminal 1-B, C and D at the Jomo Kenyatta International Airport, expansion of second container terminal at the Port of Mombasa, development of Dongo Kundu free trade port, development of 11-14 berths at the Lamu Port amongst others (MTP III, 2018-2022).

The plan is well aligned with the vision of the financial sector, more specifically the Capital Markets through the following;

i. **Retaining the Capital Markets Master Plan as a flagship project.**

The plan states continued implementation of the CMMP identifying key focus areas to include:

- Implementation of a new derivatives market;
- Issuance of regulation on online forex trading, securities lending and amendments to Collective Investment Scheme Regulations issued.
- Diversification of capital market products and increase in the number of companies listed on the GEMS.
- Strengthening capital markets infrastructure and institutions through development of a Single Central Depository to ensure efficient infrastructure.
- Establishment of a National Commodities Exchange, spearheaded by the Ministry of Industry, Trade and Co-operatives.
- Promoting cross border trade and supporting infrastructure financing by Counties and National Government through the capital markets.

ii. **Retaining the Nairobi International Financial Center Authority as a flagship project.**

The Plan aims to operationalise the established NIFCA, develop a strategy and developing strategic incentives aimed at attracting firms.

iii. **Establishment of the Financial Services Authority**

The aim is to enhance the effectiveness of the prudential oversight of the non-bank financial sub-sectors and improve the overall efficiency of the regulation structure. Key targeted initiatives include:

- Enactment of the new legislative framework;
- Operationalization of the new Financial Services Authority and merger of the regulatory agencies;
- Establishment of an integrated market conduct framework.

iv. **Promotion of digital finance**

MTP III aims to strengthen the use of digital finance through strengthening of the business registration services to provide an electronic KYC (e-KYC) to all financial services sector players and the development of policy, legal and institutional frameworks to support FinTech. Other programs across the financial sector include;

1. Development of an agricultural insurance programme to manage risks and losses amongst smallholder farmers and pastoralists.
2. Development of the architecture of financial sector which includes;
   a. Development of a strategy paper and developing regulations on the architecture of the financial sector covering macro-prudential framework; financial sector crisis management and resolution framework as well as regulatory sandboxes spearheaded by the Central Bank of Kenya and Communication Authority of Kenya.
   b. Revision and implementation of the National Insurance Policy.
   c. Design and implementation of a multi-tier health insurance model.
   d. Development of pensions/retirement benefits policy paper and bill.
   e. Development of a National SACCO strategy.
   f. Restructuring Government Owned Development Finance Institutions through development and implementation of AFC Transformation Strategy.
3. Modernization of financial sector supervision.
4. Development of a consumer protection framework through TNT, JFSRF and CAK.
5. Promotion of long term savings through increasing national savings rate to include;
   a. Development and implementation of pillar 0[29] pension policy
   b. Establishment of insurance innovation hubs.
   c. Developing individual savings products. E.g. expanding scope of M-Akiba bond and designing diaspora bonds.
   d. Implementation of the SACCO saving strategy.

[29] A pension pillar is one of five pension formats as outlined by the World Bank in 2005 and which has since been adopted by many economically reforming countries. Pillar 0 seeks to provide general social assistance designed to specifically deal with the poverty alleviation

e. Development and implementation of deposit protection strategy.
f. Development of Shariah compliant regulatory framework.

6. Under promotion of lending and investment environment to increase productive investment in small and medium enterprises;
   a. Enactment of legislation on credit information
   b. Development and implementation of collateral registry.
   c. Development of agriculture and affordable housing lending schemes.
7. On Government bonds, issuance of an Islamic bond, issuance of large benchmark bonds and issuance of longer term bonds.
8. Development of EAC Retirement Benefits Policy.
9. On climate Finance;
   a. Development of a National Climate Finance Strategy
   b. Establishment of a Climate Change Fund (CCF)
   c. Awareness Creation on green climate financing
10. Operationalization of Mineral Promotion and Investment and establishment of a Minerals and Metals Commodity Exchange.

Implication and lessons drawn: *The MTPIII presents a myriad of opportunities for the capital markets to actively participate, especially realization of the Big 4 agenda. The Authority has prioritized the universal healthcare and manufacturing agenda and is already actively engaging requisite institutions with the goal of availing capital markets products such as green bonds, real estate investment trusts, county bonds amongst others as alternative funding mechanisms to finance implementation of prioritized projects in the plan.*

To fully realize capital markets strategy inline the MTP III, it is imperative for the Authority to;

- *Promote the implementation of policies to support tax amnesty for those companies that are not fully tax-compliant;*
- *Strengthen capital markets infrastructure; and*
- *Promote cross border trade and support infrastructure financing by counties and National Government through the capital markets*

8.0 Ongoing Projects

8.1 Funding Gap Consultancy

The Authority hosted a half day workshop with senior leadership of key stakeholders in the funding gap consultancy on 6th December 2018 at the Kenya School of Government. The aim of the workshop was to highlight policy and regulatory barriers affecting access to market by Government entities, submitting proposed recommendations to unlock opportunities for Government entities to access funding through capital markets instruments and structures, determine general policy direction for improving access to capital markets funding by Government entities and to lock in the requisite buy in from the key institutions ahead of the National Validation

Workshop. A National Stakeholder Workshop is scheduled for Q1.2019 to ratify the findings of the funding gap report.

8.2 Islamic/Participatory Finance

The Authority on 15th November 2018 conducted Participatory/Islamic Finance stakeholder workshop at the Kenya School of Monetary Studies (KSMS) to discuss legal and policy issues cited in the respective financial services industry sectors White Papers including Capital Markets, Banking& Microfinance, Insurance, Retirement Benefits, SACCOs, Governance and Sukuk issuance. The main objective of the workshop was to set stage for the development of policies around Participatory/Shariah products across the financial services sector. A key focus was on the adoption of a more fit-for-purpose terminology to replace Islamic/Shariah Finance which would not denote a religion influenced product. Policy makers were presented with a number of challenges participants expected to be addressed in the policies under development. They included;

1. Inadequate legal and regulatory challenges for Shariah compliant banks and windows (such as liquidity requirements, reporting mechanisms, governance, operations);
2. Shortage of skilled personnel in provision of Shariah compliant services which cuts across, banking, capital markets, insurance and SACCOs;
3. Lack of a local framework on financial reporting guidelines on Participatory Finance/Shariah products e.g. classification of assets and liabilities, investment accounts etc;
4. Low uptake of Participatory/Shariah compliant banking services even amongst the Muslim community – as at 2016, 120,000 accounts were actively running; versus an approximate population of 4 million Muslims in the country;
5. Non-diversification / Scarcity of investment opportunities for Participatory Finance/ Shariah compliant products;
6. Shariah Corporate Governance issues such as;

- Conflicting opinions by Sheikhs from different schools of thought;
- Shariah audit – Internal versus external auditing mechanisms;
- Risk management frameworks; and
- Institutional specific Boards vs Group Shariah boards for windows and subsidiaries.
- The Authority has since submitted a policy advisory to the Cabinet Secretary to the National Treasury and Planning on the appropriate terminology and await a policy decision on the way forward.

8.3 Upgrade & Integration of the Capital Markets Authority's Market Surveillance System to the New Automated Trading System at the Exchange & the Central Depository System

The NSE is in the final stages of upgrading its Automated Trading System (ATS) after acquiring a modern version of the ATS while CDSC is in the

process of transitioning with a new vendor on board. The upgraded systems come with enhancements to support introduction of new products including securities lending and borrowing and short selling among others, in line with the Capital Markets Master plan 2014 - 2023.In parallel, the Authority, through the Financial Sector Support Program (FSSP) has initiated a project to ensure Integration of the Authority's surveillance system with the new ATS and CDS systems. This aims at ensuring that the Authority has connectivity once the systems are commissioned to improve on surveillance capacity of the Authority.

8.4 Information Repository, Financial Analysis System, E-Learning and Video Conferencing consultancy.

This consultancy was effected on 28th August 2017 with the aim of developing the information repository specifications that would have Advanced Financial Analysis, Business Intelligence System, E-Learning System, Video Conferencing and Communication/IT infrastructure capability for the Authority. The consultancy will enable the streamlining of the Authority's use of business intelligence through improved data collection and analysis and to strengthen internal capacity through e-learning. Following the approval of the same by the World Bank, the Project Implementation Unit (PIU) and the Permanent Secretary National Treasury, the tender for Supply, installation & commissioning of a Data Repository & Business Intelligence system was advertised on 24th September 2018 and closed on 23rd November 2018 after a two (2) week extension was granted to bidders. The tender for Supply, implementation, training and commissioning of a Learning Management & E-Learning system and Video Conferencing System was advertised on 25th October 2018 and closed on 6th December 2018.Technical evaluation of the bids is currently ongoing.

9.0 Legislative & Regulatory Developments

9.1 Capital Markets (Amendment) Act, 2018

The Capital Markets (Amendment) Bill, 2018 was published on June 19, 2018 and assented into law (Capital Markets (Amendment) Act, 2018) on December 31, 2018. The Amendment Act amended the Capital Markets Act to provide for penalties to persons involved in embezzlement activities and further ensure that administrative enforcement action set out is sufficiently explicit in application to key employees of listed companies. The Amendment Act further provides for payment of reward to any person who provides new and timely information leading to the recovery of sums payable to the Investor Compensation Fund.

In addition, the Act also provides that issuers of securities, licensed and approved persons should maintain a system of internal controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in conformity with the International Financial Reporting Standards.

Additional offences of front-running and obtaining gain by fraud have been incorporated into the Capital Markets Act.

9.2 Policy Guidance Note on Regulatory Sandbox

In 2013, the Capital Markets Act was amended to introduce Section 12A which gives power to the Authority to issue guidelines and notices for the regulation of capital market activities and products. This amendment introduced principle-based regulatory approach as contrasted with rule-based approach. The principle-based approach has contributed to the development of policy guidance notes to regulate capital market activities and products.

The Authority has developed a draft Regulatory Sandbox Policy Guidance Note to guide on the operation of regulatory sandboxes in the capital market. This was done in conjunction with support from FSD-K and CGAP consultants. The PGN provides a framework for the establishment of a regulatory sandbox to allow for the live testing of new products, services, and business models that have the potential to deepen the Kenyan capital markets. The salient features of the Policy Guidance Note include the:

(a) Eligibility, application and acceptance criteria;

(b) Testing plans;

(c) Records and reporting requirements;

(d) Regulatory relief and safeguards;

(e) Confidentiality; and

(f) Fees.

The Policy Guidance Note is currently undergoing public consultation effective from December 19 2018 to January 20, 2019. The PGN sets forth the eligibility, application, safeguard, and testing requirements for firms interested in live testing a new product, service, or business model with the Authority's Regulatory Sandbox Pilot Programme.

9.3 Green Bonds Issuance and Listing Framework

The Authority is developing a framework for the issuance of Green Bonds in Kenya. Green Bonds are financial instruments that are in line with national policies on the environment and climate action. The new framework will define Green Bonds, provide additional disclosure requirements to issuers, place requirement on the use of proceeds from a Green Bond issuance, provide for the appointment of eligible independent verifiers and related matters. The framework is currently under consideration by the Authority's Board with a view of receiving the necessary approvals by Quarter 1 2019.

9.4 State of Corporate Governance for Issuers of Securities to the Public, 2018

With the introduction of the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015 and its effective implementation in 2017, the Authority has continued to engage issuers and the market to ensure that the Code is seamlessly implemented and adopted by issuers. To ensure adoption, the Authority issued reporting templates for issuers to report annually on their application of the

Code. The Authority received the first set of duly filled reporting templates for the financial year 2017/2018.

Based on the reports from issues and the Authority's internal assessments, the Authority developed the State of Corporate Governance Report, 2018 and engaged issuers on the findings of the report in October 2018. The Report is now being finalized, with the findings being addressed to reinforce good governance and sustainability of issuers.

9.5 Financial Law Review Panel

The establishment of the Financial Law Review Panel is in accordance with recommendation 7.2.6 of the Capital Markets Masterplan (2014-2023) and under Section 14(1) of the Capital Markets Act Cap 485A, Laws of Kenya as an ad-hoc committee of the Authority's Board of Directors. The panel is envisioned to comprise of leading local and international market players who will act as a think-tank for early identification of potential legislative gaps or challenges that could affect the functioning of financial markets including ancillary legislation and propose regulatory reforms. The mandate of the Panel includes:

(a) To identify potential legislative or regulatory gaps or challenges that could affect the functioning of capital markets including ancillary legislation;

(b) To propose legal, regulatory and institutional changes to ensure that Kenya's capital market is competitive, functional, effective and efficient;

(c) To review legislative, regulatory and institutional proposals on reforms and provide advice to the Board of the Authority;

(d) To provide independent opinions and advice on the capital markets' legal, regulatory and institutional framework to the Board;

(e) To develop reports and consultation papers on the financial sector to inform the decisions of the Authority for sharing with relevant stakeholders at the option of the Authority; and

(f) To carry out any other duties delegated to it by the Board or incidental to its work.

The terms of reference for the appointment and operationalization of the Panel are currently being finalized and the Panel is expected to be appointed in due course.

10.0 Investor Education and Public Awareness Initiatives

10.1 Capital Markets University Challenge 2018

CMA continues to implement the National Capital Markets University Challenge 2018 that is scheduled to run to April 2019. The University Challenge specifically targets university students through various stages leveraging technology and presentations leading to a Grand Finale. The challenge comprises of five stages i.e. online examination questions with multiple choices as the elimination stage, online examination scavenger hunt

stage, presentation stage, semi-final stage and the grand finale.

During the period the Authority successfully executed the second stage of the Capital Markets University challenge 2018 which produced the top 10 students from all the 37 participating Universities. These 370 winners will compete for the top three position in the next three stages that will be conducted in the first quarter of 2019.

10.2 Partnerships

During the quarter, the Authority partnered with several stakeholders in awareness activities that included forums, exhibitions, the highlights of key partnerships during the period included.

(a) Sustainable Blue Economy Conference

The Authority Participated in the Conference on Sustainable Blue Economy held from November 26-28, 2018.The theme of the conference was Blue Economy and the 2030 Agenda for Sustainable Development, which focused on new technologies and innovation for oceans, seas, lakes and rivers as well as the challenges, potential opportunities, priorities and partnerships. The Authority participated in a panel discussion touching on Innovative Financing Models and Level government representatives and policy makers globally.

(b) East Africa Judges and Magistrates Conference

The Authority participated in the East African Judges and Magistrates Conference which brought together Legal fraternity across the East Africa was held from October 22-26, 2018.This was based on the a partnership with Judges, Prosecutors, Investigators and Lawyers on capacity building to educate them on the Capital Markets Authority and its role in the Kenyan economy.

(c) World Investor Week 2018

The Authority participated for the second time in the annual World Investor Week (WIW) 2018 from 1-7 October, 2018. The World Investor Week is a global campaign aimed at raising awareness about the importance of investor education and protection, with a highlight of various initiatives securities regulators undertake in these two critical areas. CMA identified key thematic areas touching on protection and listings that run across all our initiatives during the week. Below are some of the events undertaken during the world investor week:

i. ***WIW Official Launch*** - The official Launch of the WIW for Kenya was held on October 1, 2018 at an event that was attended by 77 participants comprising the intermediaries, stakeholders and CMA Board and management at the Authority's offices. The launch included media interviews, presentations as well as a press release of the WIW.
ii. ***Edutainment and Social Media Campaign*** – CMA leveraged technology by developing infographics, animations and short educational messages on opportunities, products and services within the

capital markets and investor protection techniques that were shared and boosted on Social Media. This created a platform for discussions on Social Media targeting the youth between 18 and 34 years old. In addition, CMA hosted two Facebook conferences specifically targeting the youth to specifically address avenues of investments from betting winnings. In addition, the use of influencers and bloggers were pertinent to communicating the messages.

iii. ***Resource Centre Portal Campaign*** from October 1-7, 2018 – Following the success of the scavenger hunt in 2017, CMA incorporated a themed topical scavenger hunt during the WIW where participants responded to questions by searching for the answers through our Resource Centre Portal and Website. CMA provided for several prizes that comprised of funds to purchase Government Bonds via mobile phones called M-Akiba Bonds. A total of 500 participated in the scavenger hunt that resulted in 35 entrants expected to receive the M-Akiba Bonds.

iv. ***National Radio Campaign*** – The Authority involved staff in visiting three vernacular radio stations during the campaign period providing various capital markets information on investing and protection. In addition, radio adverts and infomercials on the themed areas also run throughout the week. This was highly impactful as witnessed by the number of increased calls at 30% that the Authority directed at the participants received from the specific regions on capital markets matters.

v. ***Huduma Centre Initiative*** - Staff from CMA also set up desks at County Government offices called Huduma Centres in three counties namely: Trans-Nzoia, Kisii and Nakuru. The Vernacular radio campaigns were effectively utilized to mobilize investors who have questions or and issues on capital markets. A total of 478 investors visited the three centers during the 3 days.

vi. ***Support from Intermediaries*** – To complement the social media and other publicity campaigns that were undertaken, CMA sent a circular to intermediaries highlighting the event and encouraging them to participate by focusing their investor education and awareness programmes and marketing efforts during that week and to feature the WIW logo on their respective websites and in their promotion and marketing efforts. This initiative served as a prerequisite to the new strategy of empowering intermediaries to conduct more awareness programs with a view to increase uptake.

10.3 Kenya Institute of Planners International Conference

The Authority Sponsored and participated in the International Conference on Planning and the Big Four Agenda held from October 8-12, 2018 in Mombasa The Authority made a presentation on Capital Markets Solutions on Urban Developments during the conference.

10.4 National Defense College Training

The Authority hosted and educated twelve members of Senior military and government officials from the National defense college on Financial security matters hence increasing the Authority's profile standing and awareness of investment opportunities, and regulations and products.

10.5 Follow up Meetings on the Capital Markets Business Incubator and Accelerator on the Listing Experience

As a follow up to the Business Incubator and Accelerator on the Listings Experience held in 2017, the Authority developed a new strategy of conducting follow up meetings with key potential issuers on an appointment basis in partnership with the NSE and select intermediaries. CMA profiled various companies who attended the Business Incubator and Accelerator on the Listing Experience in 2016 and identified 33 potential issuers for follow up meetings with the heads of respective organizations in partnership with the Nairobi Securities Exchange as well as select intermediaries on a rotating basis. It is in this regard that following meetings were held;

i. A follow up meeting with the Management of Rift Valley Machinery Ltd in partnership with the NSE and Stanlib Capital aimed at demystifying the listing process and hand holding the firm until it is ready to list on the GEMS, which was held on December 4, 2018. The firm expressed interest to list within 2-3 years.

ii. A follow up meeting with the Management of Moad Capital Ltd in partnership with the NSE and Stanlib Kenya Ltd aimed at demystifying the listing process and hand holding the firm, which was held on December 11, 2018.The Company expressed interest to list within 2-5 years.

Other Investor Education Initiatives

10.6 More Targeted and Specific Approach towards Youth Leveraging Technology and Social Media, Mobile Phones, as Well as the Resource Centre Portal

With the youth being heavily influenced by social media, the Authority utilized this platform through boosts to communicate information about all the events pertaining to the youth. Key to this was the introduction of Facebook live conferences where participants were able to interact with CMA staff on various issues. The Social Media initiative was impactful as demonstrated by the discussions and questions on capital markets as well as the general increase in participation. From August to October 2018 alone the CMA Facebook page received 50,928 likes and 51,003 new followers.

This was largely demonstrated by the 118,167 daily organic impressions as a result of campaigns done for the Capital Markets University Challenge among other initiatives. In addition, there were 759 new followers on Tweeter with 200,000 new tweet impressions. The increased participants and followers are a testament to the interest created as a result of the engagements.

One of the key initiatives was also the creation of a Capital Markets Toolkit on the CMA website where the public can be directed to a lot of information to help investors begin or continue planning for a protected financial future. In September and October alone, there were 14, 276 visitors which is also a demonstration of impact given that there is traffic flow looking for capital markets information.

10.7 Leveraging Bloggers and Ambassadors and Mobile Phone Subscribers

The Authority used two key bloggers that have a high reach within the financial sector with the youth as a key target audience. CMA engaged Bankelele and Kenya Wall Street to disseminate information to their constituents. As an example, Kenya Wall Street had 9,427 views on the University Challenge article encouraging the youth to participate in the University Challenge. This was instrumental as witnessed by the increased participation in the University Challenge 2018.

In addition, the bloggers were able to create a buzz around capital markets information which was also witnessed by increase in queries directed to the Investor Education and Public Awareness Department. One of the key advantages is the Authority's storage of contact data that will be used to disseminate specific information as per the target groups.

11.0 Licenses and Approvals Granted during the Quarter

1. Granted an Investment Banking License to Salaam Investment Bank.
2. Granted a Money Manager License to Standard Investment Bank Limited.
3. Approved the offer documents for the take-over of KenolKobil Plc.
4. Approval of Listing by Introduction of a maximum of 896,759,222 ordinary shares of Bank of Kigali group Plc at the NSE.

12.0 Capital Markets Stability Soundness Indicators

	1.0 Stock Market Volatility							
Equity Market Depth	Quarter/ Year	Statistics				Assessment of Risk Level (High – Medium – Low)	Performance Brief for the Quarter	Ongoing Intervention Measures
NSE 20 Index Volatility Base Year = 2010	Q4.2018	Oct	Nov	Dec	Q. Avg	Low (indicative - <10% high; >10% - low)	• The NSE 20 Share Index volatility for the quarter ending December 2018 averaged **0.48%**, compared to **0.43%** recorded in Q3.2018.	• To maintain low volatility, the Authority is pursuing measures aimed at increasing market liquidity including introduction of market makers, Derivatives, Securities Lending and Borrowing, Direct Market Access among others.
		0.53%	0.28%	0.63%	0.48%			
	Q3. 2018	July	Aug	Sep	Q. Avg			
		0.35%	0.42%	0.52%	0.43%			
	Q2.2018	April	May	June	Q. Avg			
		0.28%	0.44%	0.51%	0.41%			
	Q1.2018	Jan	Feb	March	Q. Avg			
		0.37%	0.27%	0.29%	0.31%			
NASI Volatility Base Year = 2010	Q4.2018	Oct	Nov	Dec	Q. Avg	Low (indicative - <10% high; >10% - low)		
		0.50%	0.57%	0.49%	**0.52%**			
	Q3. 2018	July	Aug	Sep	Q. Avg			
		0.46%	0.54%	1.04%	**0.68%**			
	Q2.2018	April	May	June	Q. Avg			
		0.41%	0.74%	0.59%	**0.58%**			
	Q1.2018	Jan	Feb	March	Q. Avg			
		0.43%	0.58%	0.37%	**0.46%**			
Turnover Ratio	Q4.2018	Oct	Nov	Dec	Q.TR	Medium (indicative – annual: <8%-Low; >15% High)	• A turnover ratio of **1.69%** was recorded in the reporting period compared to **1.34%** in Q3.2018 indicating increased trading at the bourse, though skewed towards increased foreign sales than foreign purchases.	• The registered turnover ratios are relatively low compared to global peers. To increase trading at the bourse, the Authority has developed a regulatory framework to support securities lending and borrowing of select securities at the bourse. • Further, the Authority launched a pilot exercise of exchange traded derivatives contracts in
		0.79%	0.49%	0.37%	**1.69%**			
	Q3. 2018	July	Aug	Sep	Q. TR			
		0.39%	0.41%	0.54%	**1.34%**			
	Q2.2018	April	May	June	Q. TR			
		0.57%	0.72%	0.52%	**1.83%**			
	Q1.2018	Jan	Feb	March	Q. TR			
		0.76%	0.67%	0.81%	**2.24%**			

								June 2018 that has been successful. The full launch of the derivatives market is expected before the end of the FY 2018/19. • The Authority also issued a letter of no objection to the Nairobi Securities in December 2018 for the launch of the Exchange's Rapid Mass Visibilities Strategy aimed at increasing the visibility of a wider pool of Kenyan companies through an incubation and accelerator board with the eventual goal of attracting more listings at the bourse.
	2.0 Foreign Exposure Risk							
Foreign Investor turnover as a % of total turnover	**Q4.2018**	**Oct**	**Nov**	**Dec**	**Q. Avg**	**Medium (indicative – annual: <40%-Low; >90% High)**	• Average Foreign investor participation in the review period averaged at **75.84%**, an increase from **64.84%** recorded in Q3.2018	• To counter the increased outflow of foreign capital, largely driven by the increase in interest rates in developed nations, especially the US, the Authority is targeting initiatives aimed at increasing local investor participation at the bourse through strategic investor education initiatives focused on outcome. • Further, the Authority has expanded its scope of engagement with the
		75.14%	76.54%	-	**75.84%**			
	Q3. 2018	**July**	**Aug**	**Sep**	**Q. Avg**			
		67.69%	62.03%	64.80%	**64.84%**			
	Q2.2018	**April**	**May**	**June**	**Q. Avg**			
		63.55%	52.84%	68.77%	**61.72%**			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. Avg**			
		71.51%	49.63%	50.98%	**57.37%**			
Net Foreign Portfolio Flow (In KES Millions)	**Q4.2018**	**Oct**	**Nov**	**Dec**	**Q. Avg**	**High (indicative – annual: <Kshs (50million) -High (outflow; >KShs. 50 million High inflow)**	• Net Foreign Portfolio levels for the quarter ended December 2018 amounted to a total outflow of **Kshs 4,886 Mn** compared to an outflow of **Kshs 6,705 Mn** in the previous	
		(4,287)	(599)	-	**(4,886)**			
	Q3. 2018	**July**	**Aug**	**Sep**	**Q. Sum**			
		(2,111)	(1,565)	(3,029)	**(6,705)**			
	Q2.2018	**Apr**	**May**	**Jun**	**Q. Sum**			
		(1,815)	(4,022)	(2,339)	**(8,176)**			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. Sum**			
		(1,464)	(5,137)	(1,483)	**(8,084)**			

							quarter, culminating to a total outflow worth **Kshs 27,851 Mn** in the year 2018	diaspora community with the aim of promoting capital markets investments as an alternative home to increased diaspora remittances the country receives from Kenyans living abroad.
Market Concentration (Top 5 companies by market cap)	**Q4.2018**	**Oct**	**Nov**	**Dec**	**Q.Avg**	**High (indicative – annual: >50% High concentration)**	• During the quarter, the top five companies by market capitalization accounted for **65.82%** of the market value on average, confirming their market dominance. • The top five companies included SAFARICOM, EQUITY, EABL, KCB and CO-OP.	• The prospects of the revival of the privatization program which will be partly carried out through the capital markets and could stimulate the capital markets through new listings of State Owned Enterprises would have a multiplier effect on listing/issuance by private sector entities • This will help address issues around market concentration and drive market liquidity. • The Setting up of the National Credit Guarantee Fund will provide support to potential NSE Growth Enterprise Market Segment (GEMS) entities thus reducing market concentration risk.
		66.74%	64.76%	65.95%	**65.82%**			
	Q3. 2018	**July**	**Aug**	**Sep**	**Q. Avg**			
		68.45%	68.31%	67.40%	**68.05%**			
	Q2.2018	**Apr**	**May**	**Jun**	**Q. Avg**			
		67.21%	68.13%	68.83%	**68.06%**			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. Avg**			
		66.45%	66.69%	68.50%	**67.21%**			
	3.0 Government Bond Market Exposure							
	Q4. Avg	**Oct**	**Nov**	**Dec**	**Q.Avg**	**High**	• The Treasury bond market remains	• To counter the challenge of an illiquid corporate
		99.96%	99.98%	99.96%	**99.97%**			

<table>
<tr>
<td>Treasury Bond market turnover Concentration</td>
<td>
<table>
<tr><td>Q3. 2018</td><td>July</td><td>Aug</td><td>Sep</td><td>Q. Avg</td></tr>
<tr><td></td><td>99.78%</td><td>100.00%</td><td>100.00%</td><td>99.93%</td></tr>
<tr><td>Q2.2018</td><td>Apr</td><td>May</td><td>Jun</td><td>Q. Avg</td></tr>
<tr><td></td><td>99.93%</td><td>99.97%</td><td>99.75%</td><td>99.88%</td></tr>
<tr><td>Q1.2018</td><td>Jan</td><td>Feb</td><td>March</td><td>Q. Avg</td></tr>
<tr><td></td><td>99.91%</td><td>99.57%</td><td>99.66%</td><td>99.71%</td></tr>
</table>
</td>
<td>(indicative – annual: >50% High concentration)</td>
<td>dominant in the Kenyan bond market, accounting for an average of 99.97% during the review period.</td>
<td rowspan="2">bond market in Kenya, the Authority has procured a consultancy to support the introduction and the implementation of the hybrid bond market model that will allow trading of bonds both on and off the Exchange.
• The recent establishment of the Kenya Mortgage Refinancing Company (KMRC) will enable bond markets deepening as it is expected that it will leverage on capital markets to raise funds through bonds for on-lending to banks and other mortgage financing companies.</td>
</tr>
<tr>
<td>Corporate Bond Market ownership</td>
<td>
<table>
<tr><td>Category</td><td>No of Investors</td><td>Amount Outstanding (Mn)</td><td>% of total outstanding</td></tr>
<tr><td>Local Investors</td><td>4,721</td><td>67,539.04</td><td>99.06%</td></tr>
<tr><td>East African Investors</td><td>20</td><td>181.99</td><td>0.27%</td></tr>
<tr><td>Foreign Investors</td><td>111</td><td>457.17</td><td>0.67%</td></tr>
<tr><td colspan="4">Source: CDSC Data as at September 2018</td></tr>
</table>
</td>
<td>High
(indicative – annual: >50% High concentration</td>
<td>• Local Corporate bond investors were the leading investors in corporate bonds at 99.33% of amounts outstanding, while foreign bond investors held 0.67% of total corporate bond holdings.</td>
</tr>
<tr>
<td></td>
<td colspan="4">4.0 Investor Profiles - Equity Market</td>
</tr>
<tr>
<td>Equity Market</td>
<td>
<table>
<tr><td>Type of Investor</td><td>2015</td><td>2016</td><td>2017</td><td>2018</td></tr>
<tr><td>E.A. Institutions (%)</td><td>65.68</td><td>66.38</td><td>68.36</td><td>68.61%</td></tr>
<tr><td>E.A. Individuals (%)</td><td>12.84</td><td>12.49</td><td>11.47</td><td>11.47%</td></tr>
<tr><td>Foreign Investors (%)</td><td>21.48</td><td>21.13</td><td>20.17</td><td>19.92%</td></tr>
</table>
Source: CMA- *Data as at August 2018
</td>
<td>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 concluded an Investor Education Impact and Opportunities Analysis Study that will be instrumental in the</td>
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</table>

								development of a National Consumer Financial Education Strategy as well as development of an Impact Assessment Measurement Index that the Authority can use to gauge the impact of its investor education program going forward. • This will translate to more targeted engagements to onboard and drive increased market participation within the capital markets.
	5.0 Investor Compensation Coverage							
Settlement Guarantee Fund (SGF) Coverage Ratio[30]	**Q4.2018**	**Oct**	**Nov**	**Dec**	**Q.Avg**	**Medium (indicative – annual: > 1 times, implies full coverage)**	• SGF Ratio for the quarter to June 2018 averaged **1.75.** This is an indication that the Guarantee Fund balances are sufficient to cover liabilities that would arise following default by securities brokers.	• 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 recent Amendments to the Capital Markets Act will also ensure that the ICF is managed more efficiently by abolishing the ICF Board and vesting the management of the fund into the Authority.
		-	-	-	-			
	Q3. 2018	**July**	**Aug**	**Sep**	**Q. Avg**			
		1.96	1.83	1.46	1.75			
	Q2.2018	**Apr**	**May**	**Jun**	**Q. Avg**			
		1.11	1.01	1.17	1.10			
	Q2.2018	**Apr**	**May**	**Jun**	**Q. Avg**			
		1.11	1.01	1.17	1.10			

[30] ***Source: CDSC***

								Additional amendments are expected expected to address key capital markets malpractices including corporate governance, embezzlement of investor funds, front running, and provision of misleading information amongst others.
	6.0 Asset Base of Fund Managers, Stockbrokers, Investment Banks							
Assets Under Management	**As at 31st October 2018 (Amount in KShs Millions)**					**Medium (Indicative – the higher the figure, the more stable is the market)**	• The total Asset Base of Fund Managers, Stockbrokers, Investment Banks and Investment advisors as at October 31st 2018 was **Kshs 7,887.78 Million, 2,367.55 Billion, Kshs.12,107.35 Million** and **Kshs 1,335.09 Million** respectively.	• 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	7,887.78	1,366.67	6,521.10				
	Stockbrokers	2,367.55	822.80	1,544.75				
	Investment Banks	12,107.35	3,156.45	8,950.90				
	Investment Advisors	1,335.09	181.92	1,153.17				

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2. Nairobi Securities Exchange Monthly Bulletins
3. Kenyan Wall Street
4. Focus Economics
5. World Bank Reports
6. IMF Reports
7. Capital Markets Authority
8. Nairobi Securities Exchange
9. Central Bank
10. Statutory Reports/Submissions (to CMA)

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