Capital Markets Soundness Report

Volume II

"Leading global market access and positive digital disruption through Financial Technology (FinTech) innovations"

A Quarterly publication of the Capital Markets Authority

JANUARY – MARCH 2017

In this issue…

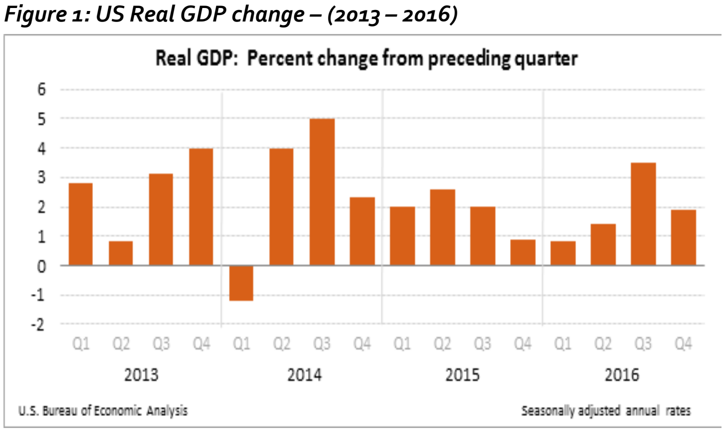
Overview – International Markets

Global Economy; improved growth driven by infrastructure development priorities – *The Global Interim Economic Outlook* of March 2017 reports that the global GDP growth is projected to increase to 3.3% in 2017 and around 3.5% in 2018. The anticipated moderate increase in 2017/18 is reflective of the aftermath of the various ongoing and envisaged fiscal policies in the United States, China, the Euro-area and other crucial initiatives in other economies such as Canada[1].

Infrastructure development remains top in the national agenda for the major global economic powers. Further to US President Donald Trump's pledge to close the US$1 trillion infrastructure gap, the United Kingdom is further championing infrastructure investments to mitigate the uncertainties caused by Brexit, while the Eurozone's €315 billion three-year Juncker Plan is already ahead of the curve. China's President Xi Jinping's New Silk Road plan to connect China with Central Asia, the Middle East and Europe through road, rail and port construction is well underway as a further testimony to growing priority of infrastructure as a key tool is fiscal stimulus

United States economy; robust but volatile – In the period immediately after election, Donald Trump's pro-growth message spurred a post-election U.S. equity rally, with domestic stocks gains outperforming most foreign markets, as the strong U.S. dollar suppressed overseas returns.

Figure 1: US Real GDP change – (2013 – 2016)



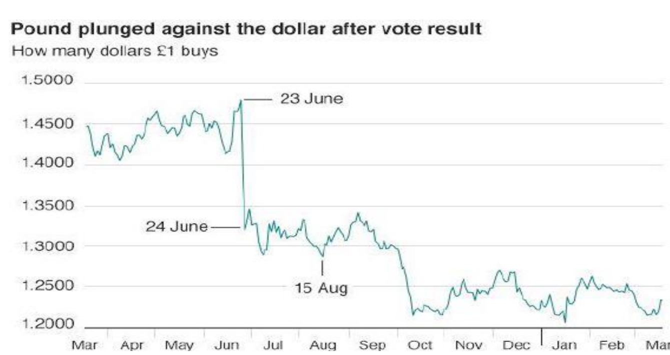
US Quarterly GDP Growth – (2013 – 2016)
Source: US Bureau of Economic Statistics

The risk of a recession has since reduced but, volatility spurred by decision-making uncertainty cannot be ruled out[1]. Although there are expectations of a modest acceleration in GDP growth, the stronger dollar and higher interest rates will be the likely factors that would determine US GDP growth in 2017.

Given the now improved yields in the US market, substantial international capital flows remain likely to find their way to the U.S. market. It is also worth noting that President Trump has promised to spend $1 trillion on improving U.S. infrastructure. In the interim, key stakeholders have been asked to identify new projects, find existing projects that need to be completed, identify policy, regulatory and statutory issues that would need to be addressed and come up with a funding proposal.

Brexit Impact to be determined in the long-term – Following the Brexit vote, it is important to note that the UK has not actually left the EU yet - the real change may only happen once it does. This explains why consumer confidence has not significantly suffered. In the quarter, Britain triggered Article 50 of the EU Treaty that allows a member state to notify the EU of its withdrawal and obliges the EU to try to negotiate a 'withdrawal agreement' with that state[2]. Against the foregoing background, the UK's Office for Budget Responsibility (OBR) recently revised up its growth forecast for 2017 from 1.4% to 2%. However, it expects growth to then slow to 1.6% next year. In terms of foreign exchange, the pound fell dramatically after the Brexit vote last year, and since then has been trading around 15% lower compared to the dollar and 12% lower compared to the euro than it was before the referendum.

Figure 2: British Pound vs US Dollar Exchange rate – Q1.2017



http://www.stats.gov.cn/english/
http://www.chinadaily.com.cn/business/2017-03/18/content_28601299.htm

1 *Atlantic Trust*
2 http://www.bbc.com/news/business-36956418

Britain has expressed its desire to strengthen its relations with Commonwealth countries, including Kenya. In his recent visit to Kenya, the United Kingdom Foreign Secretary Boris Johnson indicated that Kenya-UK trade relations will continue to blossom despite Britain's intended exit from the European Union (EU). To sustain and improve these historical relations, the Authority shall continue to participate in initiatives aimed at improving economic relations through portfolio capital flows.

Marginal growth to continue in the EU – According to preliminary estimates published by Eurostat, the statistical office of the European Union, seasonally adjusted GDP rose by 0.5% in the euro area (EA19) and by 0.6% in the EU28 during the fourth quarter of 2016, compared with the previous quarter. In the third quarter of 2016, GDP had grown by 0.4% in the euro area and by 0.5% in the EU28. In terms of Kenya's economic relations with EU, in September 2016, as members of the EAC, Kenya and Rwanda signed their part of the Economic Partnership Agreement (EPA) with EU. The EU-EAC EPA provisions, however, require that all EAC members sign and ratify it, for it to be in force. Should the other EAC countries (Tanzania, Burundi and Uganda) further postpone EPA signature, no country could enjoy its benefits. Under the EPA, the EU will keep its market open for the region in exchange for gradual liberalization of 82.6 per cent of the signatories' market over a period of 25 years[3]. Being the only developing country in EAC (the rest are classified as Least Developed Countries that enjoy duty-free trade with EU without reciprocating), Kenya has had to lobby its partners to endorse EPA because of the shared customs territory. Consultations are still on-going on EPA's signing.

China's Economic Performance expected to improve in Q1 2017 – The most recent update on China's economy is positive, with the world's second largest economy realizing an improved GDP growth rate of 6.9% on a year-to year- basis (1.3% quarter-on-quarter) in the first quarter of 2017, the highest since June 2015 with infrastructure being the main driver.

In March 2017, China's manufacturing purchasing managers index (PMI) was 51.8 percent, rising for two consecutive months, an increase of 0.2 percentage points over February 2017, with the manufacturing industry continuing to keep a steady and positive trend. It has been an increasingly important strategic and economic partner to Kenya.

Given the country's active role in Kenya's infrastructure, its economic performance has a bearing on Kenya's infrastructural prospects. From a policy standpoint, in line with the Capital Markets Masterplan, the Authority will proactively avail information on the potential of Kenya's capital markets to mobilize funds to finance Vision 2030 projects. There is already strong support by market stakeholders for the Government to brand its infrastructure plan as outlined in Kenya Vision 2030. The market further supports the setting up of an infrastructure fund, with seed capital from capital markets participants and/or existing national development funds to support a national integrated infrastructure strategy.[4] From a domestic policy perspective, the growing priorities of Kenya's major partners in respect of their own infrastructure development is likely to reduce their support to other emerging and frontier economies, Kenya inclusive- and there remains a strong case for the smaller economies to leverage global and domestic capital markets financing to support similar domestic priorities.

Kenya has greatly benefitted from policy and regulatory support by its Government and is working steadily towards issuing its first Sukuk and other conventional sovereign debt issuances, buoyed by its consistent sovereign rating, the most recent being Standard & Poor's affirmation of the country's short and long term foreign and local currency sovereign credit ratings at "B+/B" with a stable outlook on strong external position and monetary policy flexibility. This is complemented by the tax neutrality measures pronounced during the 2017/2018 budget delivery in March 2017 by the Cabinet Secretary for the National Treasury, designed to support the introduction of Islamic finance products, Asset Backed Securities (ABS) and Real Estate Investment Trusts (REITs).

[3] *https://www.standardmedia.co.ke/business*

[4] *The Authority held a round table policy discussion with market players on this publication on 27th April 2017 whose contributions are herein captured.*

It is noteworthy that Kenya's current estimated infrastructure funding gap is US$2-3 billion per year over the next 10 years, re-emphasizing the need to fully leverage market based financing. While international capital may flow more easily into the US and other large economies for various reasons outlined above, Kenya's capital markets is still likely to attract foreign funds, especially in bonds space, due to the relatively higher yields averaging 10 percent. Further, Kenya's capital markets were recently opened fully to foreign participation and, international investors may be attracted to listed companies with growth horizons, considering that most listed stocks are currently undervalued. The Authority is engaging with market stakeholders to ensure that foreign investors onboarding, client due diligence and that trading and settlement cycles are globally competitive. A survey to further understand the unique needs of foreign investors is also planned for the coming quarter.[5]

Growth in Sub-Sahara Africa – IMF projects economic growth for the SSA region at 3 percent in 2017, lower than the 3.3 percent in 2016. The institution attributes this decline mainly to lower commodity prices, a slowdown in inflows from major trading partners, and tightening borrowing conditions.

Table 1: Likely Top African Economic performers - 2017

Country	**GDP Growth rate (%)**
Ivory Coast	8.0
Ethiopia	7.5
Ghana	7.4
Tanzania	7.2
Senegal	6.8
Kenya	6.1
Rwanda	6.0

Source: IMF Regional Economic Outlook

The IMF sees most of the non–resource-intensive countries continuing to perform well, as they benefit from lower oil import prices, an improved business environment and strong infrastructure investment. In contrast, commodity exporters are expected to be under economic strains, including the region's three largest countries, Angola, Nigeria, and South Africa.

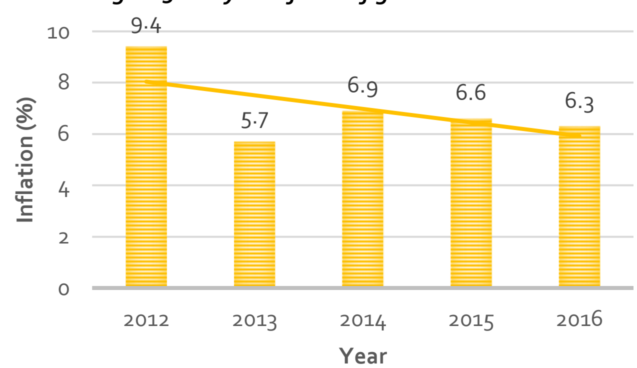
In terms of capital markets, the Authority has actively been supporting cross and dual listings as one of the approaches to increase capital markets participation in the region.

Overview – Domestic Markets' Stability

Kenya's GDP in 2016 - Latest figures[6] show Kenya's Gross Domestic Product (GDP) to have expanded by 5.8 per cent in 2016, compared to a revised growth of 5.7 per cent in 2015. Year-on-year, accommodation, food services, information and communication, real estate among others recorded improved growth, compared to a contraction of 1.3 per cent in 2015. On the other hand, among others, construction, mining and quarrying decelerated in 2016.

Annual Inflation – Figures reported by the Kenya National Bureau of Statistics show annual average inflation to have eased to 6.3 per cent in 2016 compared to an average of 6.6 per cent in 2015. This was mainly due to decline in prices of transportation; housing and utilities; and communication.

Figure 3: Kenya's Inflation figures



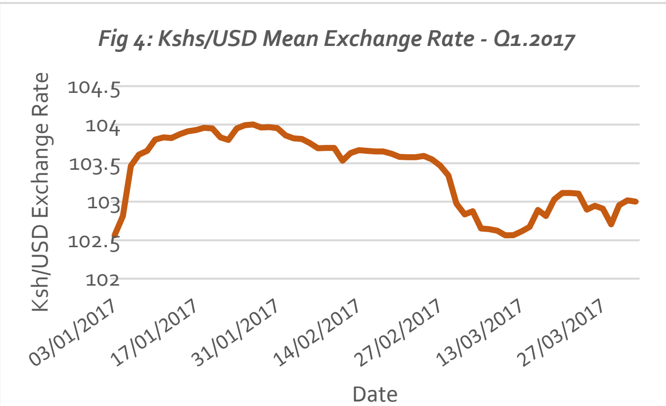
Source: KNBS

In quarterly terms Kenya's March 2017 inflation rose to 10.28 percent from 9.04 percent in February 2017, against Government's target range of between 2.5 per cent and 7.5 per cent. This was the highest inflation rate since May of 2012 mainly driven by the increased prices of food items caused by drought.

[5] Proposal to conduct survey was incorporated by the Authority following recommendation by Group 3 during the round table policy discussion hosted by the Authority on 27th April 2017.

[6] Kenya National Bureau of Statistics (KNBS)

Exchange Rate fluctuation – The Kenya Shilling has remained stable since 2016, supported by a narrower current account deficit and foreign currency inflows and was trading at between 102.6 and 104 to the U.S. dollar during quarter 1, 2017.



Source: CBK

Reaction of Secondary Market performance was mixed – Equity turnover for the first quarter of 2017 stood at KES 37.11 billion compared to KES 36.34 billion in the corresponding period in 2016, representing a 2.12% increase.

Bond turnover for the quarter declined marginally to KES105.3 billion, compared to KES113.4 billion registered in a similar period in 2016.

Capital Market Stability implications and outlook

Thus far, domestic markets have remained resilient, against a backdrop of increased inflationary pressure and an anticipated reduced momentum of GDP growth, owing to an extended drought period in the country. The August 2017 General Elections and the impact of the capping of interest rates at defined bands are also expected to create uncertainty over sustained positive performance of the economy.

Although they are expected to remain under pressure for most of 2017, capital markets are anticipated to largely remain resilient.

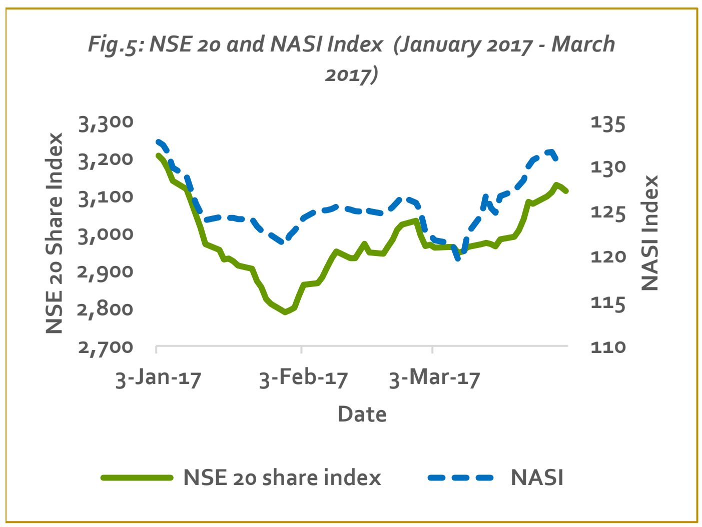
From a policy standpoint, together with relevant stakeholders, the Authority has been and shall continue to proactively engage the market to highlight the windows of opportunity available to, not just young firms with high growth potential, but established issuers and investors.

This is in recognition that the performance of exchanges is often taken as a barometer for countries' economic performance. As part of implementing this stance, the Authority recently hosted the 'Business Incubator and accelerator forum on the Listing experience' on 30-31 March 2017.

Kenya's Capital Market Performance & Stability

Equity Markets Performance

The highlight of the quarter was the listing of 400,000 Gold Bullion Debentures of NewGold Issuer (RF) Limited – a company incorporated in South Africa, on the Nairobi Securities Exchange. The ETF will track the price of gold. This further adds to new listed products on the Kenyan secondary market following the listing of Fahari-Real Estate Investment Trusts (REITs) in 2015.



Source: CMA

The NSE 20 and NASI indices were on an increase following positive annual performance and corporate action announcements by key listed companies, as well as market excitement following positive developments such as the listing of the ETF and M-Akiba and favorable outcomes for the Kenyan capital markets in the 2017 Budget Statement and Finance Bill 2017.

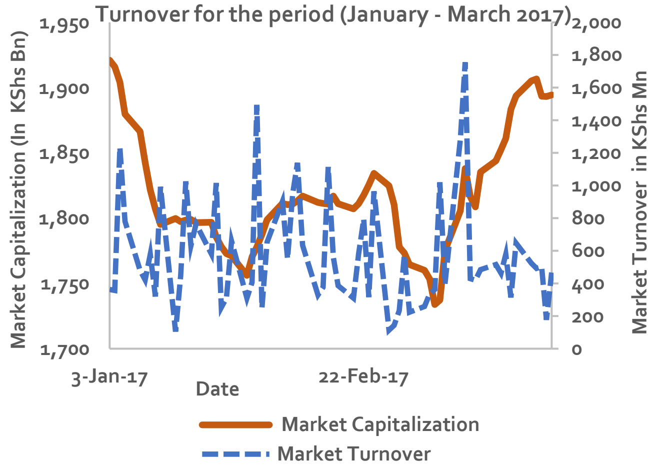
Table 2: Secondary Equity Market Performance; Q1.2017/16

Month	Equity Turnover (KES Bn)	Share Volume (Mn)	End Period NSE 20-Share Index	Market Cap (KES Bn)
Q1.2016				
January	12.99	397.09	3,773.17	1,926.47
February	9.93	299.83	3,862.24	2,000.21
March	13.42	534.51	3,982.09	2,078.28
End-period	**36.34**	**1,231.43**	**3,982.09**	**2,078.28**
				Q1.2017
January	12.05	572.99	2,794.00	1,827.27
February	12.60	651.15	2,962.00	1,812.45
March	12.46	636.67	3,112.52	1,894.34
End-period	**37.11**	**1,860.11**	**3,112.52**	**1,894.34**
Q1.2017/16 %Δ	**2.12%**	**51.11%**	**-21.84%**	**-8.85%**

Source: NSE

However, a decrease of 8.85% was recorded in end-period market capitalization in which KES 2.07 trillion was recorded in Q1.2016 compared to KES 1.89 trillion in Q1.2017.

Fig.6 Trend of Market Capitalization and Market Turnover for the period (January - March 2017)



Source: CMA

The extreme spikes in turnover recorded in February and March could be attributed to material disclosures of corporate actions which could have been interpreted differently by investors. A good example is the first week of February IFC announced its intention to acquire a significant stake in Britam Holdings significantly boosting its turnover. There was also increased turnover in the banking sector during the week as banks prepared to announce results.

In terms of listed company performance, overall, the top 5 companies' market cap accounted for an average of 64.85%, 64.96% and 63.70% of the total market capitalization in the months of January, February and March 2017 respectively.
This further confirms the dominance of blue chip companies like Safaricom, East African Breweries, Kenya Commercial Bank, Equity Bank and British-American Tobacco in the performance of the Kenyan market.

Safaricom had the highest market concentration accounting for 38.07% of total market cap as at March 31st 2017. Out of the 67 listings at the Nairobi Securities Exchange, 17 companies have a market cap share ranging between 1 percent and 10 percent, with the remaining 49 accounting for less than 1 percent of total market cap.

Price gainers

Sasini: During the quarter, Sasini was the top gainer with its share price appreciating by 35.42% to KShs.26.00 in March 2017 from KES 19.20 in December 2016.

Table 3: Top 10 Price gainers as at March 2017

Counter	VWAP as at 30th Dec.2016	VWAP as at 31st Mar.2017	% Change
SASINI	19.20	26.00	35.42%
UMEME	13.50	16.95	25.56%
KCB	28.75	34.75	20.87%
TOTAL	17.00	20.50	20.59%
STANDARD GRP	16.50	19.50	18.18%
TPSEA	20.50	24.00	17.07%
STANCHART	189.00	215.00	13.76%
KENGEN	5.80	6.55	12.93%
EQUITY	30.00	33.00	10.00%
B.O.C	82.00	89.50	9.15%

Source: NSE

CAPITAL MARKETS AUTHORITY

The appreciation in the company's share price could be attributed to the recent announcement of the Group's plans to invest more than Kshs. 600 million in new projects in a bid to diversify its sources of income in the next three years. Through the Permanent Secretary for the State Department of Agriculture, the national government announced that it will partner with Sasini to sell Macadamia seedlings at a subsidized price of KShs. 200 from 2018.

Umeme: In the previous market soundness report, it was reported that the company had announced a 19.5% reduction in its Profit after Tax. The report also noted that one of the company's major shareholders - Umeme Holdings Limited, a subsidiary of Actis Infrastructure 2 LP exited, leading to a price decrease during that quarter. As shown in *table 3*, in Q1.2017, The company's price recovered during the quarter under review, suggesting a change in investor sentiment in terms of the company's potential to turn-around and meet the Ugandan market's electricity demand, in line with the Ugandan Government's commitment to double access to electricity in the country among commercial and industrial users by 2040, from which Umeme will benefit.

Price losers

Table 4: Top ten price losers as at March 2017

Counter	VWAP as at 30st Dec.2016	VWAP as at 31st Mar.2017	% Change
UCHUMI	3.95	2.35	40.51%
C&G	27.00	18.00	33.33%
DEACONS	6.05	4.20	30.58%
HFCK	14.00	9.75	30.36%
MUMIAS	1.30	0.95	26.92%
ARM	25.50	19.95	21.76%
KPLC	8.15	6.45	20.86%
EAAGADS	27.25	22.00	19.27%
KENOLKOBIL	14.90	12.30	17.45%
HAFRIC	1.20	1.00	16.67%

Source: NSE

Uchumi: During the quarter, Uchumi share price depreciated by 40.51% to KES. 2.35 in March 2017 from KES 3.95 in December 2016.

The Company's share price has been on a persistent downward trend following challenges in reversing historical corporate governance issues that the company has been facing, with no clear turnaround strategy presented to investors.

Listed Banking entities performance brief

Q1.2017 registered significant improvement in the listed banks' shares trading. The industry recorded a 51.68% increase in share trading volume as compared to the preceding quarter. The improved performance was mainly due to increased foreign investor participation in some of the banking stocks, but can also be attributed positive market sentiments, following H.E The President's confirmation during his State of the Nation address on 15th March 2017 that the interest rate caps had resulted in some adverse unintended consequences and his commitment that the Government would try to address the challenges.

Table 5: Banking Sector performance Q1. 2017

Variable	Q4. 2016 (Amounts in Kshs. Millions)	Q1. 2017 (Amounts in Kshs. Million)	% Change
Total Value	416,880	37,107	91.10%
Sector – Volume Traded	289	438	51.68%
Sector – Value Traded	7,886	10,058	27.54%
Sector - % Total of Volume Traded	1.76%	23.54%	1237.34%
Sector - % of Total Value Traded	1.89%	27.10%	1332.87%
Sector Cap (Millions)	498,647	530,464	6.38%
Sector - %Total Market Cap	25.42%	27.97%	10.03%

Source: NSE

A survey was commissioned by the Kenya Bankers Association during the quarter under review that loan approvals turn-around times had slowed down to between 1 week and 1 month as banks continued to restrict lending to smaller and riskier businesses.

Interest Rate Capping

It is important to note that prior to the interest rate capping, private sector lending was already in a decline, due to among other factors inflationary pressures

According to the March 2017/18 Budget policy pronouncements, the National Treasury , Kenya Bankers Association and the CBK will be undertaking a comprehensive assessment on the impact of the interest rate capping law, to assess its impact on credit expansion to the private sector which has slowed down and the perceived impact on economic growth. The assessment will inform any intervention measures to be taken to ensure credit availability to consumers. The Government also anticipates to progressively reduce the interest rate spread. The assessment is expected to determine if capping worsened the existing problem of reduced lending.

However, market stakeholders believe that the existing fiscal deficit and subsequent pressure to the Government to borrow more, having fallen short of meeting its revenue collection targets in the first half of 2016/2017, could still push up interest rates in the near future, although not to the levels experienced pre-capping. A key emerging risk following the preferential lending policy by commercial banks arising from capping is the rise of an unregulated system of lending and borrowing as fewer people now have access to banking lending services.

Interest rate capping has equally had some positive impact in the industry. For example, repayment of amounts for customers who took loans in the post capping period have reduced. Additionally, the banking industry in February 2017 launched 'pesalink,' a solution that enables banks to share technology infrastructure and create new channels for providing a state of the art money transfer service to customers. Pesalink[7] is an initiative of the Kenya Bankers Association and the idea was conceived in 2012 when banks realized that they were losing about KES 2.3 billion ($23 million) to telcos through mobile money transfer services.

The platform is the first of its kind offering the first ever 24/7 real time interbank transaction framework with 24 participating banks as at the time of this publication.

Bond Markets Performance

East African Breweries (EABL) issued a 14.71%, 5-year corporate bond which received a 141 per cent subscription rate. Investors offered KES8.45 billion shillings, well above the KES6 billion it sought. The raised funds shall be used to restructure the company's balance sheet. The bond is the second tranche of an issue that was first offered to the market in 2015.

In the primary Treasury bonds market, during Q1.2017, Four (4) new Treasury bonds were issued (one was cancelled) together with two tap sales of the March Bond Offers, as the Government sought to raise KES90 billion. A total of KES99.28 billion worth of bond applications were received, with the government accepting applications worth KES 46.34 billion, indicating a 46.68% acceptance rate. In a similar quarter in 2016, the Government had sought to raise KES 85 billion, received KES 119.03 billion and accepted KES 71.54 billion worth of Treasury bonds.

M-Akiba - Following sustained efforts towards introduction of the mobile phone based bond issuance, during the quarter, after two years of testing, the National Treasury launched the M-Akiba bond on March 23rd 2017. The bond was offered as a Special Limited Offer (SLO). This coincided with the 10th anniversary of the globally renowned M-Pesa innovation.

The key but highly understated objective of M-Akiba is to democratize access to Government debt issuance allowing access to savings and investment opportunities for all ordinary Kenyans, through an affordable minimum subscription of Ksh. 3,000/-, by fully leveraging our market leading mobile phone penetration rate of 88%. The initial offer that was to run until 10th April or until Sh150 million was hugely successful, albeit with a few teething hitches during this pilot phase. The Government intends to issue an additional Kshs 4.85 billion in June 2017 and it will be crucial to ensure broader access by *Wanjiku* across the country through a longer offer period, aggressive sensitization campaigns, smoother onboarding process and seamless clearing and settlement mechanism. Market stakeholders will continue to review and improve measures in readiness of the upcoming additional issuance.

[7] *https://ipsl.co.ke/about-us/*

Table 6: Primary Treasury Bond Performance; Q1.2017/16

		Amt. Issued KES bn.	Amt. Received KES bn.	Amt. Accepted KESbn.
Jan.2016	FXD 1/2016/2	35	30.39	20.16
	FXD1/2013/10		5.94	3.99
Feb.2016	FXD 1/2015/5	25	29.69	12.81
	FXD1/2012/10		26.83	17.48
Mar.2016	FXD1/2013/10	25	13.71	9.07
	FXD2/2013/15		12.47	8.03
Total		**85**	**119.03**	**71.54**
Jan.2017	FXD 2/2007/15	30	-	-
Feb.2017	IFB 1/2017/12	30	35.03	6
Mar. 2017	FXD2/2014/5	30	31.33	12.96
	FXD3/2013/5		32.92	11.9
Mar. 2017 Tap sales	FXD2/2014/5			7.65
	FXD3/2013/5			7.83
Total		**90**	**99.28**	**46.34**

Source: CBK

In the secondary bonds market, KES 105.2 billion worth of bonds were traded during the quarter to March 2017, compared to KES113.4 billion worth of bonds traded in the quarter to March 2016.

This is a 7.2 percent decrease. Being an election year however, it is anticipated that mild fluctuations shall be experienced, reflecting investor sentiment in a period of increased political activity.

Table 7: Secondary Bond market Performance; Q1.2017/16

Month	Government Bond Turnover (KES Bn)	Corporate Bond Turnover (KES Bn)	Total Bond Turnover (KES Bn)
Q1.2016			
January	21.56	0.06	21.62
February	24.19	0.22	24.41
March	67.24	0.14	67.38
TOTAL	**112.99**	**0.42**	**113.41**
Q1.2017			
January	31.07	0.17	31.24
February	20.33	0.10	20.43
March	53.20	0.40	53.60
TOTAL	**104.6**	**0.67**	**105.27**
Q1.2017/16 %Δ	**-7.43%**	**59.52%**	**-7.18%**

Source: CBK

Outstanding amounts for Corporate Bonds

As at December 31, 2016, the total amount of outstanding corporate bonds was Kshs 83.1 Billion.

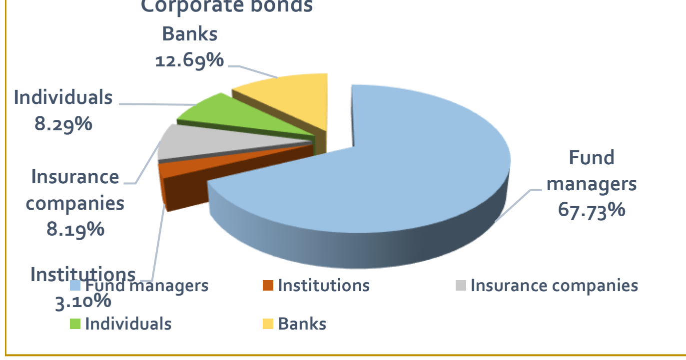


Fig.7: Major investment groups holding outstanding Corporate bonds

Source: CMA

Frontclear[8] project to support repo markets

One of the key impediments to successful implementation of the various liquidity enhancing mechanisms in bond markets has been the lack of clear carve-outs within the relevant laws to protect lenders in the event of default or insolvency and to address settlement finality.

[8] *Frontclear is a financial markets development company focused on catalyzing stable and inclusive interbank markets in emerging and frontier markets. In addition to the provision of guarantees to enable bilateral over-the-counter transactions, Frontclear provides risk capital to Financial Infrastructure Providers in emerging and frontier markets. Also, through its technical assistance program, Frontclear supports capacity development and the establishment of financial infrastructure in our countries of operations.*

In Kenya, there has been a compelling need for a comprehensive review of all laws affecting SLB, REPOs and other collateralized lending including but not limited to Insolvency Act, Companies Act, Capital Markets Act, Central Depositories Act, Kenya Deposit Insurance Act, among other laws that may affect effective roll-out of the different liquidity enhancing mechanisms. To address this challenge, through the Bond Market Steering Committee, CMA has received technical assistance from Frontclear[4] for a robust and legal review of the relevant clauses of the Kenyan law to facilitate effective insolvency netting and set-off for securities transactions in Kenya.

Capital Markets Stability Indicators (CMSIs)

1.0 Stock Market Volatility								
Equity Market Depth	**Quarter/Year**	**Statistics**				**Assessment of Risk Level** (High – Medium – Low)	**Performance Brief for the Quarter**	**Ongoing Intervention Measures**
NSE 20 Index Volatility	**Q1.2017**	**Jan**	**Feb**	**Mar**	**Q. Avg**	Low	• As of Quarter ended March 2017, the NSE 20 share index reflected an average standard deviation was 0.0035 compared to an average standard deviation of 0.0037 recorded in Q4.2016. • There has however been improvement in NSE index volatility from what was recorded in the preceding quarters. The low volatility recorded in the quarter ended March is an indication that the value of securities listed at the bourse does not fluctuate dramatically.	• The recent introduction and listing of Exchange Traded Funds at the Exchange is expected to increase overall market turnover and reduce volatility in the markets.
		0.0033	0.0038	0.0033	**0.0035**			
	Q4.2016	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		0.0050	0.0028	0.0032	**0.0037**			
	Q3.2016	**July**	**Aug**	**Sep**	**Q. Avg**			
		0.0041	0.0073	0.019	**0.0101**			
	Q2.2016	**April**	**May**	**June**	**Q. Avg**			
		0.0042	0.0046	0.0047	**0.0045**			
NASI Volatility	**Q1.2017**	**Jan**	**Feb**	**Mar**	**Q. Avg**	Low		
		0.0036	0.0019	0.0055	**0.0037**			
	Q4.2016	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		0.0093	0.0041	0.0032	**0.0055**			
	Q3.2016	**July**	**Aug**	**Sep**				
		0.0038	0.0082	0.0046	**0.0055**			
	Q2.2016	**April**	**May**	**June**				
		0.0034	0.0028	0.0031	**0.0031**			
Quarterly Turnover Ratio	**Q1.2017**	**Jan**	**Feb**	**Mar**	**Quarterly Tnvr Ratio**	Medium	• Q1.2017 recorded an average quarterly turnover ratio of 0.677%; an increase of 0.248% from the previous quarter. This could be attributed to increased activity at the bourse as the market gets more resilient.	• The Authority is additionally spearheading the introduction of new products such as Global Depositary Receipts and Global Depositary Notes as well as initiatives such as Direct Market Access and Securities Lending
		0.680%	0.694 %	0.657 %	**0.677%**			
	Q4.2016	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		0.395%	**0.523 %**	**0.368 %**	**0.429 %**			
	Q3.2016	**July**	**Aug**	**Sep**	**Q. Avg**			

		0.664%	0.908 %	0.856 %	0.809 %			and Borrowing to further enhance liquidity.
	Q2.2016	April	May	June	Q. Avg			
		0.494%	0.479 %	0.864 %	0.612%			
2.0 Foreign Exposure Risk								
Overall Foreign Investor Participation to Equity Turnover	Q1.2017	Jan	Feb	Mar	Avg	High	• Foreign investor participation in the quarter increased by 8.39% compared to Q4 2016.	• In line with the industry Capital Markets Master Plan, the Authority plans to provide multiple gateways for foreign investors to enter the market through new tailored products (Derivatives, ETFs etc.). • Foreign investors are now able to hold a 100% stake in most of the listed companies on the NSE.
		79.81%	73.37%	76.87 %	76.68 %			
	Q4. 2016	Oct	Nov	Dec	Avg			
		67.07%	63.69 %	74.10 %	68.29 %			
	Q3.2016	July	Aug	Sep	Avg			
		78.59%	69.85 %	83.18 %	77.21%			
	Q2.2016	April	May	June	Avg			
		65.86%	66.59 %	56.41 %	62.95 %			
Net Foreign Portfolio Flow **(In KES Millions)**	Q1.2017	Jan	Feb	Mar	Q. Sum	High	• Net Foreign Portfolio levels increased significantly by 109.48% in Q1.2017 compared to Q4.2016.	• Although foreign turnover accounted for an average of 78.68% of holdings, 100% foreign shareholding in any company has not occurred and where foreign holdings are highest, it is a case of those investors dealing with Kenya branches of multinationals with a large parent company (anchor shareholding).
		1,608	435	(55)	1,988			
	Q4.2016	Oct	Nov	Dec	Q. Sum			
		(125)	459	615	949			
	Q3.201	July	Aug	Sep	Q. Sum			
		974	3,703	1,343	6,020			
	Q2.2016	April	May	June	Q. Sum			
		80	196	6,707	6,983			

								• In addition, in 2015, the Ministry of Foreign Affairs launched the Kenya National Diaspora Policy whose main objective is to mainstream and empower Kenyans aboard to effectively make significant contributions to the development of the country. The Authority aims to work with the Ministry to ensure implementation of key aspects in the policy that will attract more participation by Kenyans abroad in the capital markets.
Market Concentration **(Top 5 companies by market cap)**	**Q1. 2017**	**Jan**	**Feb**	**Mar**	**Q. Avg**	High	• The top five companies by market capitalization at the bourse accounted for 64.50% of the market, with Safaricom accounting for the largest share, thus exposing the market to concentration risks.	• The Authority recently conducted a business incubator and accelerator forum on the listing experience to sensitize SMEs and family businesses to consider listing on the exchange through the GEMS segment. The initiative is aligned with the Capital Markets Master Plan target to increase listings on the Growth Enterprise Market Segment (GEMS) of NSE by 3-4 companies annually. The Authority will further continue to advocate for privatization of State Corporations through the Nairobi Securities Exchange
		64.85%	64.9%	63.7%	**64.5%**			
	Q4. 2016	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		65.44%	65.37%	64.6%	**65.15%**			
	Q3.2016	**July**	**Aug**	**Sep**	**Q.Avg**			
		62.82%	65.14%	65.3%	**64.4%**			
	Q2.2016	**April**	**May**	**June**	**Q.Avg**			
		61.96%	62.6%	62.9%	**62.50%**			
3.0 Government Bond Market Exposure								
	Q1. 2017	**Jan**	**Feb**	**Mar**	**Q. Avg**		• The Treasury bond market remains dominant in the Kenyan bond markets,	• The Authority is actively pursuing a raft of reforms in the hybrid bond

<table>
<tr>
<td>Bond market turnover Concentration</td>
<td>
<table>
<tr><td></td><td>98.43%</td><td>98.99 %</td><td>99.75 %</td><td>99.06 %</td></tr>
<tr><td>Q4. 2016</td><td>Oct</td><td>Nov</td><td>Dec</td><td>Q. Avg</td></tr>
<tr><td></td><td>99.52%</td><td>98.34 %</td><td>99.13 %</td><td>98.71 %</td></tr>
<tr><td>Q3.2016</td><td>July</td><td>Aug</td><td>Sep</td><td></td></tr>
<tr><td></td><td>99.73%</td><td>97.97%</td><td>98.28 %</td><td>98.66 %</td></tr>
<tr><td>Q2.2016</td><td>April</td><td>May</td><td>June</td><td></td></tr>
<tr><td></td><td>99.93%</td><td>98.66 %</td><td>99.89 %</td><td>99.49 %</td></tr>
</table>
</td>
<td>High</td>
<td>accounting for 99.06% during Q1.2017; a slight increase of 0.35% compared to the preceding quarter.</td>
<td>market through the Bond Market Steering Committee that aims at expanding the bond market in the middle to long term while stimulating liquidity in the short term.</td>
</tr>
<tr>
<td colspan="5">4.0 Investor Profiles (Equity & Bond Market)</td>
</tr>
<tr>
<td>Equity Market</td>
<td>
<table>
<tr><th>Category</th><th>No of Investors</th><th>Share Quantity Outstanding (mn)</th><th>% of total outstanding</th></tr>
<tr><td>EC</td><td>258</td><td>711.3</td><td>0.82%</td></tr>
<tr><td>EI</td><td>7,492</td><td>220.5</td><td>0.25%</td></tr>
<tr><td>FC</td><td>677</td><td>17,956.1</td><td>20.70%</td></tr>
<tr><td>FI</td><td>8,076</td><td>890.4</td><td>1.03%</td></tr>
<tr><td>LC</td><td>41,491</td><td>24,351,.7</td><td>28.08%</td></tr>
<tr><td>LI</td><td>1,197,264</td><td>42,593.9</td><td>49.11%</td></tr>
</table>
Source: CDSC
EC- East African Company; EI-East African individual; FC-foreign Company; FI-foreign individual; LI-local individual; LC-local Company
</td>
<td>High</td>
<td>• Local investors accounted for 78.12% of shares held in the equity market with 21.88% being held by foreigners.</td>
<td>• The Authority continues to effect mechanisms of marketing capital markets products to local investors across the region.
• Additionally, the Authority is working closely with other financial services sector regulators to introduce retail products that will attract more savings from local investors.</td>
</tr>
<tr>
<td>Corporate Bond Market</td>
<td>
<table>
<tr><th>Category</th><th>No of Investors</th><th>Amount Outstanding (mn)</th><th>% of total outstanding</th></tr>
<tr><td>EC</td><td>11</td><td>180.6</td><td>0.23%</td></tr>
<tr><td>EI</td><td>11</td><td>39.9</td><td>0.05%</td></tr>
<tr><td>FC</td><td>4</td><td>527.7</td><td>0.66%</td></tr>
<tr><td>FI</td><td>111</td><td>521.4</td><td>0.65%</td></tr>
<tr><td>LC</td><td>1,104</td><td>74,274.4</td><td>93.23%</td></tr>
<tr><td>LI</td><td>3,627</td><td>4,127.5</td><td>5.18%</td></tr>
</table>
Source: CDSC
</td>
<td>High</td>
<td>• Local bond investors were the leading investors in corporate bonds at 98.69% of amounts outstanding, while foreign bond investors held 1.31% of total corporate bond holdings. Foreign investors have been relatively more active in the Treasury bond market. This signals investor confidence in the local corporate bond market; an indicator of willingness by local investors to</td>
<td>• Together with the other members of the Bond Market Steering Committee, the Authority has been spearheading reforms in the Sector to improve liquidity. There already is in place a consultancy under the Frontclear Project to reform the market and ultimately improve its performance.</td>
</tr>
</table>

Indicator	Quarter	Month 1	Month 2	Month 3	Q.Avg	Risk Level	Comments	Mitigation
	EC- East African Company; EI-East African individual; FC-foreign Company; FI-foreign individual; LI-local individual; LC-local Company						participate in building locally owned companies.	
5.0 Investor Compensation Coverage								
Investor Compensation Fund Coverage Ratio	**Q1. 2017**	**Jan**	**Feb**	**Mar**	**Q.Avg**	Low	• Q1.2017 recorded a 26.55% decrease in the ICF coverage ratio. The decrease could be partially attributed to an increase in turnover from the previous quarter; a key component in the computation of the ratio. Nevertheless, the ratio confirms that the ICF balances are more than 2 times sufficient to cover any potential losses that result due to failure by market intermediaries to meet investor obligations.	• There are stringent measures put in place by the Authority to ensure that market intermediaries and licensed entities contribute their shares into the fund as per the required deadlines.
		2.80	2.58	3.18	2.85			
	Q4.2016	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		4.02	3.36	4.28	3.88			
	Q3.2016	**July**	**Aug**	**Sep**	**Q. Avg**			
		2.24	2.01	1.94	2.06			
	Q2.2016	**April**	**May**	**June**	**Q. Avg**			
		3.01	3.22	1.83	2.69			
Settlement Guarantee Fund Coverage Ratio	**Q1. 2017**	**Jan**	**Feb**	**Mar**	**Q. Avg**	Medium	• SGF Ratio for the quarter averaged at 1.36 indicating the sufficiency of the fund to address any liability or loss to investors that is likely to result following default by securities dealers.	• The Authority has continuously been monitoring the guarantee fund balances held by the CDSC to ensure that at any given time the fund's value supersedes overall value of market activity. • In addition, through its inspections of market intermediaries, the Authority has been monitoring the financial position of the firms to ensure that they are in good standing and that investors are protected.
		1.36	1.25	1.46	1.36			
	Q4.2016	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		1.95	1.63	2.08	1.89			
	Q3.2016	**July**	**Aug**	**Sep**	**Q. Avg**			
		1.10	0.99	0.94	1.01			
	Q2.2016	**April**	**May**	**June**	**Q. Avg**			
		1.45	1.60	0.91	1.32			
6.0 Asset Base of Fund Managers, Stockbrokers, Investment Banks								
	As at 30th December 2016 (Amount in KES Millions)							• The Authority continues to ensure that its licensees are in compliance with statutory net asset

<table>
<tr>
<td></td>
<td>
<table>
<tr><th>CMA Licensee</th><th>Total Assets KShs. bn</th><th>Total Liability KShs.bn</th><th>Net Assets KShs.bn</th></tr>
<tr><td>Fund Managers</td><td>5.24</td><td>2.96</td><td>2.29</td></tr>
<tr><td>Stockbrokers</td><td>4.17</td><td>1.42</td><td>2.75</td></tr>
<tr><td>Investment Banks</td><td>9.12</td><td>2.05</td><td>7.07</td></tr>
<tr><td>Investment Advisers</td><td>0.68</td><td>0.041</td><td>0.63</td></tr>
</table>
</td>
<td>Medium</td>
<td>• The total Asset Base of Fund Managers, Investment Banks and Stockbrokers as at 30th Dec. 2016 was Kshs 5.24Billion, Kshs.12 Billion and Kshs 4.17 Billion respectively.</td>
<td>requirements to demonstrate their financial soundness. The Authority has adopted a Risk-based system of supervising its licensees which means inspections are based on the size of the firms, systems in place, number of clients and capital.</td>
</tr>
</table>

Source: CMA/NSE

Market Infrastructure, New Products and Systems Stability

Market Infrastructure updates

Operationalization of the Derivatives Exchange

The Authority through its Derivatives Unit held round-table discussions with key industry stakeholders (mainly represented by NSE and CBK) on 23rd and 24th February 2017. Several pertinent issues were discussed during the two-day forum including: Margin requirements of the Derivatives contracts; management fees; and the insolvency protections available to the Derivatives Market among others. Consequently, CMA, CBK and NSE shall constitute a technical working group that would regularly engage and advice the three organizations on the various product and market structure aspects arising from Derivatives Market.

One of the key items that was highlighted by the participants during the forum was the development and publishing of a benchmark deposit rate curve to be used for mark- to- market valuation. The Authority has also had extensive discussions with Nairobi Securities Exchange Consultants focusing on the preparation of the Exchange for the inception of the derivative market. Additionally, to manage the risk that the fees applicable to derivative transactions may affect the level of uptake of derivative instruments in the market, the Authority placed the proposed fees under statutory public exposure from 20th January 2017 to 20th February 2017.

In addition, a robust enforcement manual for the Nairobi Securities Exchange to operate as an SRO for the derivatives markets is currently under development to ensure market integrity and build a culture of fair trading and compliance.

The key risk remains the opportunity cost of delayed launch by the market organizer, particularly for intermediaries who have invested substantial time and resources preparing to participate in this market. Investors have suffered a delayed opportunity to hedge their investments and products against price volatility. The Authority continues to engage market stakeholders, particularly the Central Bank of Kenya, whose licensees will be key players in the derivatives market.

It is also worth noting that, the Nairobi Securities Exchange (NSE) has supervisory powers over the upcoming derivatives market after it received formal recognition as a self- regulatory organization (SRO) from the Authority in July 2016. The recognition was given after the NSE successfully separated the management structures for its commercial and regulatory functions in line with the Capital Markets (Demutualization of the Nairobi Securities Exchange Limited) Regulations of 2012. The Authority will still be setting the fees to be paid by investors participating in the market.

Licensing and Approvals

During the quarter, CMA approved one license - Waugh MacDonald Limited as an Investment Advisor bringing the total number of Investment Advisers to fourteen (14). The following corporate actions were also approved by the Authority during the quarter; approval of Britam's Shareholders' Circular on acquisition of a 10.37% stake in Britam by IFC Group Limited and approval of KenGen Shareholders' Circular on acquisition of the untaken rights (from the 2016 rights issue) by Public Investment Corporation (PIC) South Africa. The Board of the Authority also granted consent for the registration of Watu Capital Collective Investment Scheme and approved the Issue and Listing of New Gold Limited Exchange Traded Fund.

Other Capital Market Updates

The quarter witnessed a number of new major developments:

ETF Markets launched – As a result of coordinated efforts between the Authority, the Nairobi Securities Exchange, Central Depository and Settlement Corporation, the issuer and vast stakeholder input in developing the policy guidance notes, the first Exchange Traded Fund (ETF) in the region was launched. To improve the understanding of this product, the Authority together with the NSE hosted an ETFs stakeholder education forum on 12th April 2017 targeting market intermediaries and key capital markets stakeholders.

This event brought to Kenya one of the foremost global authorities on ETF's Ms. Deborah Fuhr of EFTGI. Introduction of Exchange Traded funds in the capital markets is expected to increase overall market turnover and reduce volatility in the markets.

Budget delivered, major implication for Capital markets – The National budget for FY2017/18 was read. The C.S. National Treasury made major pronouncements, giving the go-ahead for amendments to relevant Acts in the financial sector to allow for the recognition and tax neutral treatment of Islamic finance products and services and tax neutral treatment of Real Estate Investment Trusts (REITs) and Asset Banked Securities. These policies are aimed at attracting greater investor participation in the sector and drawing more foreign investments.

Financial Technology (FinTech) and Regulatory Sandbox Policy Framework under development – Kenya is renowned as the global pace setter in FinTech innovations and will in the next quarter issue a consultative paper on the policy and guiding framework to support and nurture Fintech innovations under a "regulatory sandbox" model to market stakeholders.

Already, the Authority has proactively engaged other regulators and players in the Fintech space by seeking co-operation and liaison with organizations and/or regulators with experience in Fintech to benchmark on their strategy and approach. The ultimate aim is to support FinTech and foster innovation and participation in capital markets.

Capital Markets Role in Infrastructure Financing

Kenya's economic blueprint, the Vision 2030 identifies key infrastructural projects that Kenya seeks to develop by the year 2030 such as the SGR, LAPSSET, expansion of JKIA and modernization, dredging of the Mombasa Port, development of Dongo Kundu Freeport, expansion of the Kisumu Airport amongst others.

With devolved governance, county governments have equally developed their own development plans that seek to improve the status of infrastructural facilities.

Over the years both the National and county governments have gone to great lengths to secure financing for such projects; a clear indication of demand for infrastructural finance in the country.

In many devolved countries such as Nigeria, Brazil, Philippines, South Africa amongst others, the capital markets has played a key role in financing infrastructure development through municipal bonds and other structured debt financing mechanisms.

The Authority remains committed to ensure that capital markets raising instruments tailor made for the two levels of governments are developed in conjunction with stakeholders in line with its Capital Markets Master Plan (2014-2023). The Authority will be making proposals to the Government following stakeholders support for a national integrated infrastructure plan that will act as a repository for all infrastructure projects being pursued by both national and county governments.

The centralized repository can then be shared with prospective capital markets infrastructure who have an appetite for investing in government debt facilities.

CAPITAL
MARKETS AUTHORITY

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