



# **BUILDING BLOCKS FOR LIQUID PRIMARY AND SECONDARY MARKETS – CASE OF KENYAN MARKET**

## **7<sup>th</sup> OECD Forum on Africa Public Debt Management**

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# Outline

- 1. Evolution of Kenyan Public Debt Market**
- 2. Snapshot of Kenyan Bond Market Today**
- 3. Building Blocks for Market Liquidity**
- 4. Going Forward**

# **Evolution of Kenya's Public Debt Market**

# Evolution of Kenya's Public Debt Market

Prior  
to  
2000

- Only Treasury bills were available at primary market
- Virtually no bond market existed.
- Issuance of securities not auction based.
- No market development initiatives

From  
2001

- **Composition of debt portfolio:**
  - Treasury bills to bonds ratio at 76:24.
- **Maturity:**
  - Key objective was to lengthen maturity of securities to minimize refinancing risk
  - Average maturity of debt was at 8 months, mainly short term securities were in issue.
- **Issuance method**
  - Auction based issuance adopted – to promote price discovery and development of a yield curve.
- **Consultations with the Market**
  - The Market Leaders Forum (MLF) was formed – to support development of the bond market in Kenya.

2013

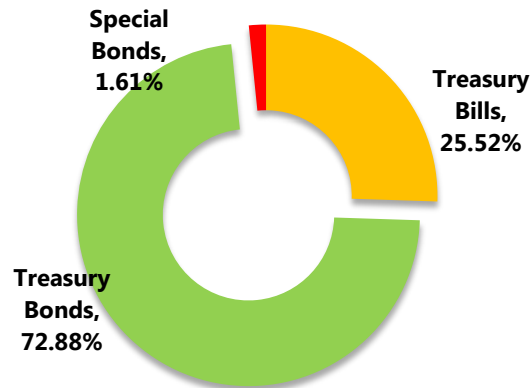
- **Composition of debt portfolio:**
  - Treasury bill to bonds ratio reversed to 16:74.
- **Maturity:**
  - Average maturity of all securities at about 7 years while bonds maturity alone is 5 years
  - Longest bond in the market is 30-year, issued in 2011. a 20-yr first issued in 2008, then 25-yr in 2010.
- **Issuance Method:**
  - Multi price auction method has increased bond market activity- providing initial pricing for trading.
- **Consultations with the Market:**
  - CBK and MLF have been very effective in implementing practical initiatives for market development.

# **Snapshot of Kenya's Bond Market**

# Snapshot of Kenyan Bond Market

## Composition of Government securities

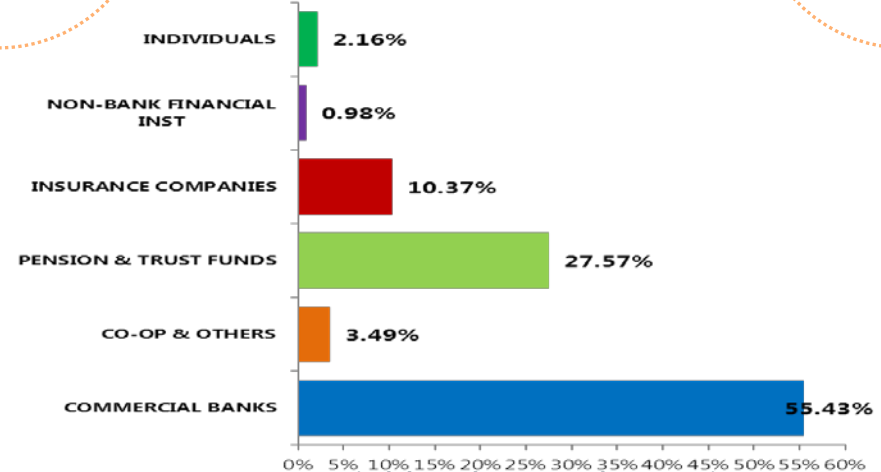
Stock of Government Securities as at 30/04/2013



- Bonds make up 73% of the portfolio.
- 59 Bonds worth \$8.9bn outstanding.
- 56 are fixed coupon tradable bonds categorized as conventional Treasury bonds, Infrastructure bonds and one savings development bond.
- All 56 trade at Nairobi Securities Exchange (NSE).

## Holders of Government securities

GoK Securities Holders By End April 2013



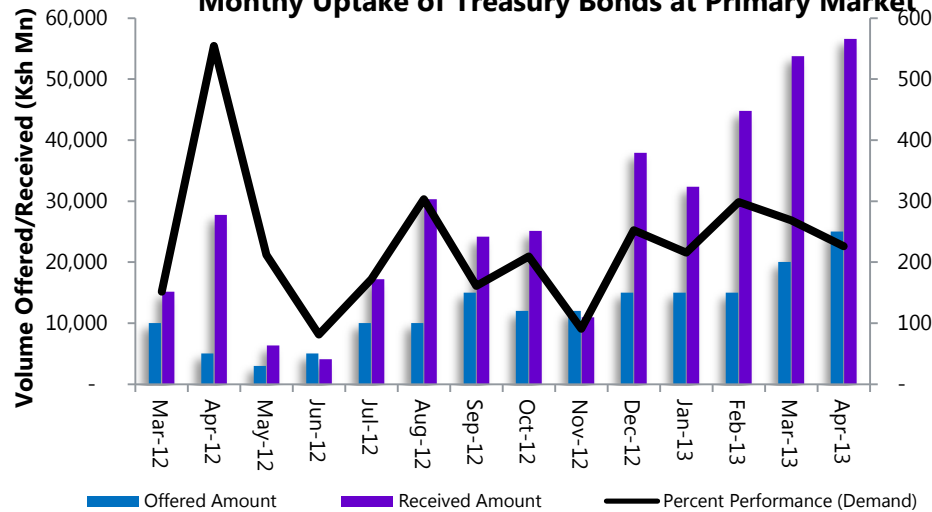
- Commercial banks are the main holders of government bonds
- Pension sector has grown impressively, about 28% of the primary market with insurance at 10.4%.
- Other non-bank institutions make up about 15%
- Retail sector small in volume size though large in numbers

Corporate bonds valued about \$520 million trade relatively slow.

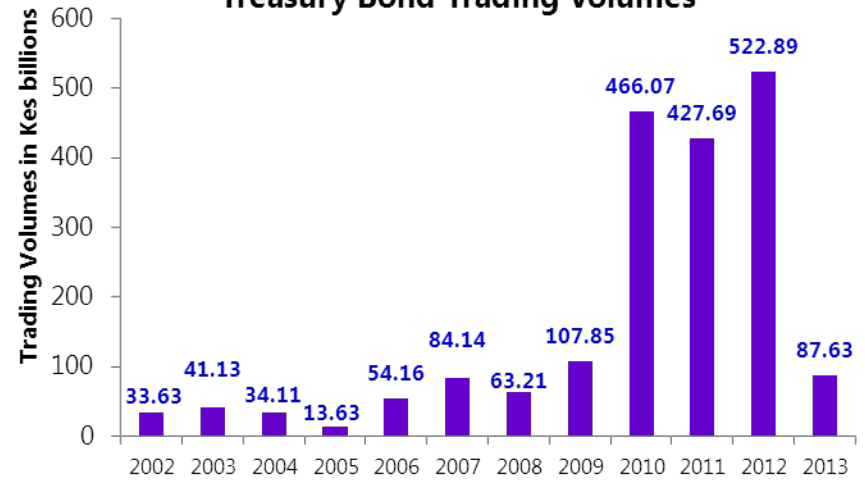


# .....Snapshot of Kenyan Bond Market

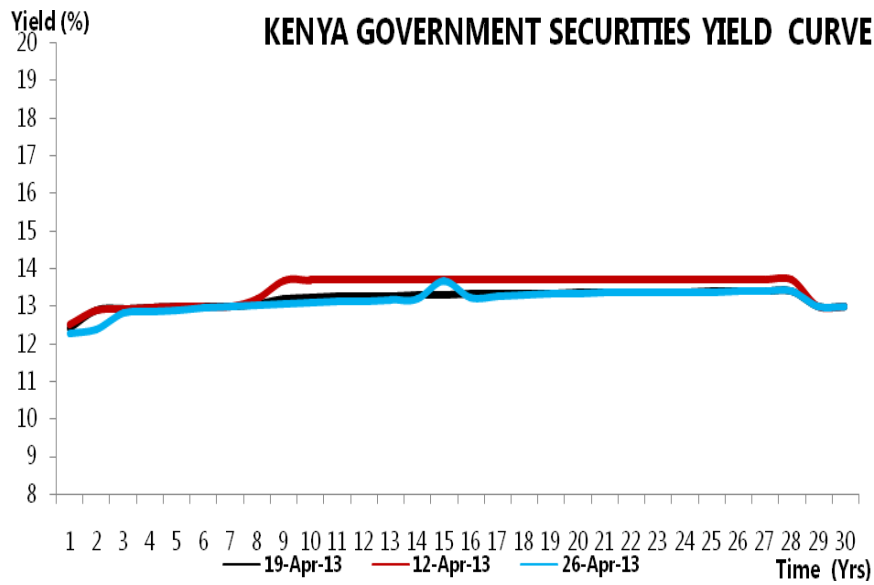
**Monthly Uptake of Treasury Bonds at Primary Market**



**Treasury Bond Trading Volumes**



**KENYA GOVERNMENT SECURITIES YIELD CURVE**



Uptake of Government bonds has been impressive

Average subscription beyond 150%

- Bonds trading has improved significantly over time.
- \$6.08bn traded in 2012 compared to \$5bn in 2011.
- The yield curve is relatively flat.

# **Building Blocks for Market Liquidity**





## Product Diversification

- Range of products include conventional Treasury bills and bonds (benchmark tenors), infrastructure bonds (IFBs) with special features, retail products and horizontal repo among others.
- Infrastructure bonds program has been very successful in Kenya both at the primary and secondary market level . Bond market liquidity has improved significantly due to high turnover traded on these bonds.
- IFBs are not included in the derivation of the yield curve because of their special features.
- Horizontal repo facility has enabled banks to access liquidity from the market using T-bills/bonds as collateral.



# Building Blocks for Market Liquidity

## **Stakeholder consultations**

**(Market Leaders Forum - MLF)**

- **Lengthening the maturity of bonds has enhanced market liquidity.**
- **Improved liquidity through other various initiatives e.g. bonds coupon determined by market.**
- **Channel for disseminating new information to the market.**

## Benchmark Bonds Program

- Program aimed at eliminating bond fragmentation at the secondary market and development of a firm reliable yield curve.
- Only specified bond maturities of 2,5,10,15,20 and 25 are issued.
- Strategies include: Reopening, Tap issuance, Consolidation – bond switches, buy-back and conversion.
- Issuance of large size bonds has enhanced liquidity through increased trading at the secondary market.

## Market Structure

- **Liberalization of pension sector in 2003 and reforms in the insurance sector, created demand for long term bonds.**
- **Improvement of primary market pricing through competitive auctions has increased secondary bond market activity.**
- **Initiatives to deepen investor base include financial literacy programs, proposed Treasury Mobile Direct (TMD) platform to allow easier access to Government securities by retail market.**

# Building Blocks for Market Liquidity

**Market  
Infrastructure**

- **Enhanced trading system (ATS) has improved efficiency of the market and increased liquidity.**
- **The envisaged market makers framework and the OTC platform will enhance bond market liquidity.**

**Integration  
of CSD  
systems**

- **Currently, there are two depositories , one for Government bonds and another for other securities.**
- **Plans to consolidate the two will improve market performance.**

# Building Blocks for Market Liquidity

## Market Legal Framework

Legal Framework  
(Under the  
2010 Kenya  
Constitution)

- Public Financial Management (PFM) Act 2012 consolidated all prior laws under this area and is expected to redefine public finance management in Kenya.
- PFM Act 2012 to support further development of bond market.

Legal review in  
1997

- Allowed dematerialization of Government securities register to promote and easy trading of Government bonds.
- Significantly enhanced bond market activity.



# Building Blocks for Market Liquidity

## Market Regulation Framework

- Capital markets in Kenya are regulated by the Capital Market Authority (CMA).
- Legal framework- Capital Markets Act and the CMA Regulations.

- CMA is responsible for licensing, regulation and supervision of all capital markets participants.
- CMA also promotes the development of an orderly, fair and efficient capital market in Kenya

## Market Regulation Framework

Institutions regulated by CMA include the NSE, fund managers, Central Depository Systems, custodians, investment banks, collective investment schemes, investment advisers, stock brokers, securities dealers, listed companies, credit rating agencies and venture capital firms.

- Two depositories:
  - CDSC for stocks and corporate bonds and CBK-CDS for Government securities.
  - CDSC operations governed by the CDSC Act 2000.
- Government and corporate bonds trade at the NSE.
- NSE operations bound by CMA Act but NSE is a *Self Regulating Organization* with regard to its members.



**Going Forward**



# Current and Future Initiatives

## Market Makers

Rollout of Market Makers platform will enhance bond market liquidity and efficiency due to commitment by market makers to make the market as well as from requirement to report firm two-way quotes.

## Over-the-Counter (OTC) Platform

Hybrid trading system comprising OTC alongside the exchange-traded platform will enhance bond market activity. Treasury bills will also trade OTC.

## Primary Market Structure

- CBK to adopt online bidding for Government bonds by institutional investors as a first phase then retail segment later.
- Treasury Mobile Direct: distribution of Government securities to the retail market through mobile phones -ensure efficiency, accuracy, safety and affordability of investment process. Also promote savings culture and efficiency of the market.

-Thank You-

Questions and Comments

