INTO AFRICA

A publication from Capital Markets in Africa

OCTOBER 2016

BANKING IN AFRICA: THE CURRENT STATUS

FEATURED ARTICLES

www.capitalmarketsinafrica.com

FMO

Entrepreneurial
Development
Bank

EMPOWERING PROGRESS

FMO IS THE DUTCH DEVELOPMENT BANK. FMO HAS INVESTED IN THE PRIVATE SECTOR IN EMERGING MARKETS FOR MORE THAN 45 YEARS.

Our mission is to empower entrepreneurs to build a better world. We offer our capital and knowledge to ambitious entrepreneurs, financial institutions and infrastructure and energy projects – so that today's emerging markets can become tomorrow's thriving ones.

Follow us:

www.fmo.nl
info@fmo.nl

CONTENTS

Cover Image : A windmill situated on the roadside between Johannesburg and Durban (South Africa). Image by Steven O'Sullivan.

Welcome to the October edition of **INTO AFRICA**, a publication with fresh insight into Africa's emerging capital markets. In this edition, we have a special focus on the Banking Sector in Africa, with an overview of the current trends and opportunities in the Sector.

The banking sectors in African countries have been on an upward path for nearly a decade posting record growth rates while at the same time undergoing radical restructuring and stabilisation. African banks lending activity tends to focus on the financing of large corporate clients and governments and therefore may alleviate downward pressure on the banks' credit profiles and vulnerability to macroeconomic headwinds. SMEs, low and middle-class individuals too often remain formally unbanked, so potentials for growth remain on an upward trajectory.

While Africa's fast-expanding banking sector has strong potential to continue its recent growth trend, boosted by robust economies and widening financial inclusion, the growth output is positive across the continent so the banking systems will likely develop unequally. These will depend on macroeconomic fundamentals and levels of capital markets development as well as mobile banking adaptation and penetration.

Having said that, the banking sector in Africa faces challenges which often contributes to the volatility and unpredictability of the operating environment. Such obstacles to growth include fiscal vulnerability, domestic security risks, corruption, high poverty rates and infrastructure bottlenecks. These could have a negative impact on banking sector growth and compromise their credit profile. In spite of these challenges, the banks' high capital buffers and strong earnings generating capacity support financial stability and provide room to support growth and loss-absorption.

In this edition, we bring you expert commentaries from **ANDRE BLAAUW** (Associate Director at PwC, South Africa); **AYOKUNLE OLUBUNMI** (Analyst at Agusto & Co. Nigeria); **EDWIN CHUI** (Analyst at Dyer & Blair Investment Bank), **BHAVIK DESAI** (Head of Research at AXYS Stockbroking, Mauritius) and **CAS COOVADIA** (Managing Director at South African Banking Association). The topics range from how the *Emerging Basel IV directive could provide an opportunity for African Banks* to tackling *Cybercrime in East Africa and the challenges* and *opportunities in the Mauritius Banking Sector*.

And we're not done yet! Other special guest contributors include **KEVIN COUSINS** (Equity Analyst at PSG Asset Management, South Africa); **CAYETANO GEA-CARRASCO** (Managing Director at Moody's Analytics) and **NIHIL PATEL** (Senior Director - Portfolio Research at Moody's Analytics) as well as **MARK BYRON** (Managing Director at Barton Heyman) with topics covering re-investing in growth, the challenges financial institutions face when implementing IFRS9 solutions, the technological impact of the FIX protocol and a summary of Monetary Policies from Africa's most active Central Banks!

Kind regards,

Michael Osu,
Associate Editor

Connect with The Editor on Linkedin. Follow us on twitter @capitaMKTafrica. To subscribe to INTO AFRICA, please send an email to *intoafrica@capitalmarketsinafrica.com.*

Please visit our website at *www.capitalmarketsinafrica.com* for the latest news, bespoke analysis, investment events and outlooks.

ENJOY!

EMERGING BASEL IV: AN OPPORTUNITY FOR AFRICAN BANKS?

By **Andre Blaauw,** Associate Director, PWC South Africa

Introduction

Whilst developed countries have been frantically adopting the string of new capital adequacy regulations released by the Basel Committee of Banking Supervision ("BCBS"), since the global financial crisis, the situation across the African continent has been very different. Apart from South Africa, which has been closely aligning with the BCBS developments, the picture on the rest of the continent is very mixed. Some countries on the continent still apply Basel I capital adequacy rules, some have partially adopted BII and some have partially adopted BIII. This trend in new banking capital adequacy regulation adoption is similar in other emerging continents around the world.

In general, developing countries have found the implementation of the BII/BIII rules very challenging - in particular the advanced approaches which rely on internal models for capital measurement. This can be attributed to compliance rules complexity, limited models expertise, lack of historical loss data, underdeveloped credit bureau integration and legal system shortcomings.

Due to the above reasons, developing country regulators have followed a cautious approach, adopting new rules slowly and, in general, only allowing standardized approaches for banks in their jurisdictions. The BII/BII standardized approaches are simple to implement, but lack in risk sensitivity and comparability with capital adequacy ratios of advanced approach banks. Unless a jurisdiction also allows advanced approaches for its banks, it is generally not being considered as being compliant with BII/BIII.

Emerging Basel IV

Apart from the new liquidity requirements, BIII has been targeting add-ons to the minimum capital adequacy ratio through new capital buffer rules (counter cyclical buffer, capital conservation buffer, etc.) However, the base for calculating capital requirements (i.e. risk weighted assets ("RWA")) was not materially changed with BIII. Since the release of BIII, the BCBS has been conducting a significant overhaul of the RWA measurement rules for all risk types - credit, market, operational, etc. through various consultations and impact studies. Rules on all the amendments are expected to be finalized by the end of 2016 for staggered implementation thereafter, through 2019 by developed countries.

The main aim of the revisions is to promote harmonization of capital requirements across jurisdictions by finding a balance between risk sensitivity, simplicity and comparability. This has been necessitated by the large differences in risk weights across advanced approach banks globally.

The revised standardized approaches

A key feature of BIV is a new set of standardized approaches for operational risk, trading and banking book credit risk and trading and banking book market risk. The aim of the new standardized approaches are to provide capital floors for banks using advanced approaches and to provide improved risk sensitivity and calibration to the current standardized rules. The new standardized approach rules are significantly more comprehensive and risk sensitive than the current BII/BIII 'broad brush' standardized rules. Unlike under the BII/III framework, jurisdictions will be considered compliant with the BIV framework if they allow the use of the standardized approaches only.

Although the new rules will be phased in and not implemented in a 'big bang' fashion, such as with BII, the amendments constitute such a significant change from the BII/BII approach that commentators now commonly refer to them as BIV, even though the regulators have not officially used this term.

BIV and internal models

BIV is a major departure from the reliance on internal models which was introduced with BII and continued under BIII with more stringent requirements in some areas (e.g. market risk). Under the new regime, the use of internal models for capital adequacy measurement is discontinued for some risks (e.g. operational risk and credit spread risk in the trading book). For other risks, e.g. market risk in the trading book, internal models are partially allowed. However, for all risk types internal model capital measures might be constrained by the equivalent standardized approach calculation, which will provide a minimum capital floor.

Advanced approach banks have made significant investments in internal models for capital adequacy measurement and is likely to continue doing so under BIV. However, for standardized approach banks, the cost vs benefit equation of investing in internal models for regulatory capital measurement have been significantly altered. Going forward, there could be less incentives for standardized approach banks to adopt internal model based advanced approaches.

BIV Capital Implications

The BCBS stated aim is not to increase capital requirements overall in the global banking system, but to achieve harmonization and reduced variability of risk weights across jurisdictions. Capital implications of the new rules could differ widely across jurisdictions. This will be due to the different stages of BII/BIII adoption in developing jurisdictions and differences in risk weights of BII/BIII advanced approach banks across developed jurisdictions being observed at present. The latter is one of the reasons for BIV and can be attributed to differences in rules interpretation (e.g. local vs international rating scale adoption) and different stress testing regimes for setting minimum capital floors across developed jurisdictions. Apart from differences in capital adequacy regimes across jurisdictions, the capital implications of the new rules will be influenced by business models, portfolio/product structures and risk mitigation practices which could impact individual banks in the same jurisdiction to a greater or lesser extent.

Typically, under BII/BIII the aggregate capital requirement under the advanced approaches could be around 30% less than the equivalent risk profile standardized requirement. Under BIV, the revised standardized approach floors could increase the capital requirement for low risk portfolios (e.g. investment grade corporates and residential mortgages) compared to internal rating model outputs. In general, one can expect the BIV capital implications for advanced approach banks to be more negative than for standardized approach banks in developed jurisdictions.

Capital implications of BIV for African banks will be a function of many factors, such as extent of capital adequacy reform, business models of banks and risk profiles of banks. Some African countries have set the minimum capital adequacy ratio at a large margin above the BCBS minimum requirement to compensate for the reduced risk sensitivity of the current standardized approaches. To avoid double counting, scope might exist in these jurisdictions to bring their minimum capital adequacy ratios in line with the BCBS requirements, when adopting the more risk sensitive BIV standardized approaches.

Compliance complexity

The Basel IV standardized approaches have much more granular calculation rules than the existing BII/BIII standardized approaches and will be more complex to implement. However, compared to the advanced approaches, it will be a relatively painless implementation that does not rely extensively on loss data availability, risk modelling expertise, re-training of bank staff to use model outputs in decisions, process changes, etc. Migration from the current BII/BIII to the BIV standardized approach should be achievable within 6-12 months for a large African bank compared to the multi-year transformation efforts typically associated with migrating from standardized to advanced approaches.

BIV and capital markets

Compared to the current BII/BIII standardized approaches for measuring market and credit risk capital requirements for banks' capital market activities, the new BIV standardized approaches are much more precise and risk sensitive in this area. Under the new standardized rules, banks will receive capital benefits for implementing counterparty pre-settlement collateral management risk mitigation practices (netting, margining, etc.). Counterparty capital requirements for trades cleared through central counterparties (exchanges) will also attract significantly less capital requirements than bi-laterally cleared OTC trades. This could provide incentives for African countries to adopt BIV and expedite implementation of derivatives exchanges.

BIV benefits for African banks

Basel IV offers a very attractive alternative for African banks and Regulators who have been contemplating adopting the BII/BIII advanced approaches or for those still on BI.

Through the standardized floors, BIV could reduce the competitive advantage that advanced approach banks might have had in developing markets through their internal models capability. It could level the playing field as subsidiaries of advance approach foreign controlled banks might not be able to hold substantially less capital for the same risk than a standardized approach local bank.

The increased risk sensitivity of the BIV standardized approaches and enhanced disclosure will increase credibility in the capital adequacy measures produced by these approaches. Comparability with capital ratio components of advanced approach banks in developed markets will further aid in understanding of risk profiles and capital adequacy position of African banks, once BIV has been adopted globally. This could lead to increased confidence in the banking systems of many African countries.

For the above reasons, one can expect that rating agencies and multi-lateral agencies are likely to place pressure on developing country jurisdictions to be early adopters of BIV.

Conclusion

Whilst new capital adequacy releases have typically posed threats to African banks and regulators, as it raised the compliance hurdle and increased the gap with developed jurisdictions, BIV offers a welcome change. It could provide a low cost opportunity for jurisdictions across the continent to expedite bank capital adequacy reform and align with the latest global capital adequacy standard. This could lead to increased confidence in their banking systems as the BCBS BIV aims of increased risk sensitivity, capital adequacy comparability and calculation simplicity are being realized.

Regulators across the continent should therefore take a pro-active approach to BIV by initiating industry impact studies, performing cost and benefit analysis for BIV adoption and design roadmaps for implementation.

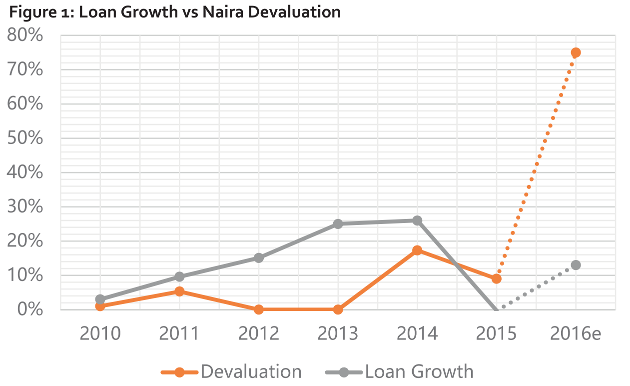
A WEAK MACROECONOMIC CLIMATE: A CLOG IN THE WHEEL OF THE NIGERIAN BANKING INDUSTRY?

By **Ayokunle Olubunmi,** Analyst, Agusto & Co. Nigeria

Over the last two years, the Nigerian economy has contended with severe pressures primarily on account of the plummeting price of crude oil. In addition to reducing federally collected revenue, the external reserves have also maintained a downward trajectory. The situation was further aggravated by a renewed militancy in the oil producing region, changes in political administration and the delays in the clear articulation of an economic direction by the new government. All this culminated in high inflation and low capital importation leading the country to slip into recession after negative GDP growth were recorded in the first two quarters of 2016. The Nigerian banking industry has been significantly affected by the downturn in the economy as well as the fiscal policies instituted to address the economic challenges. This is evident in the high level of non-performing loans, the creation of risk assets, stunted profitability and poor capital adequacy. The weaknesses in the risk management framework of Nigerian banks were also exposed by the prevailing economic challenges.

The gloomy economic climate has heightened credit risk in the Nigerian economy. As a result, the appetite of Nigerian banks for risk asset creation has waned considerably. In 2015, growth in the industry's net loans was muted despite the naira devaluation during the year which increased the value of foreign currency dominated loans. The efforts of the Central Bank of Nigeria (CBN) to stimulate lending by reducing the monetary policy rate (MPR), credit reserve ratio (CRR) and providing incentives to lending to some sectors during the year were also not successful. Although we expect the industry's loan portfolio to grow by 13% in 2016, this is premised primarily on the depreciation of the domestic currency and its impact on the foreign currency component of the loan book.

Figure 1: Loan Growth vs Naira Devaluation

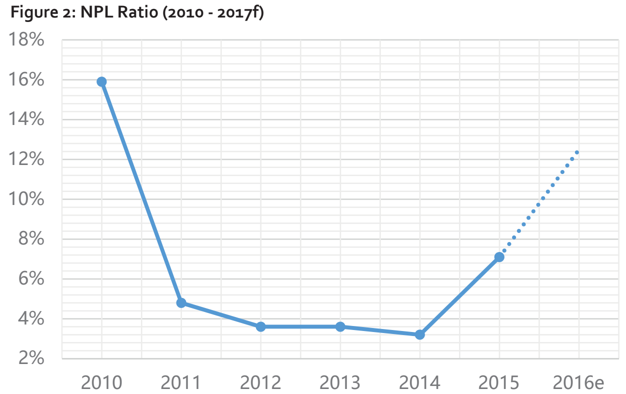


Source: Agusto & Co Research

Over the last five years, Nigerian banks leveraged the divestment of oil assets by the international oil companies to increase their exposure to oil and gas sector by lending to indigenous companies that acquired these assets. The Eurobonds raised by the banks funded these transactions that were usually denominated in US dollars. The assets were valued using high crude oil price as the commodity was trading above $100 per barrel during this period. As a result, the industry's exposure to oil & gas sector spiked to 22% of total loans as at 31 December 2015. Unfortunately the plummeting crude oil price significantly reduced the cash flows of oil companies with some unable to meet their loan obligations. Although the banks restructured most of their oil and gas loans, about 11% of the exposure to this sector were impaired as at 31 December 2015. This propelled a 127% spike in the industry's non-performing loans (NPLs) during the year to N875 billion as at FYE 2015, the highest in the last five years. This represented 7.7% NPL ratio (non-performing loans to gross loans), more than twice the 3.2% recorded in 2014.

The foreign currency demand management policies introduced by the CBN to reduce the depletion of the external reserves which affected the ability of corporates to source inputs in addition to declining consumer purchasing power contributed to the increase in impaired credits in the manufacturing and general commerce sectors. The inability of some state government to pay salaries as well as staff rationalisation also increased delinquency rate of personal loans. As at 31 December 2015, about nine banks recorded NPL ratio above the 5% regulatory maximum. Subsequent to year end, the industry's NPL ratio increased further to 10% in Q1 2016. We however note that the bulk of the Industry's impaired credits are concentrated in some banks with only one of the top five largest banks recording NPL ratio above the regulatory threshold. The deterioration in the loan book resulted in the loan loss expense more than doubling to N365 billion and accounted for 26% of net interest income.

Figure 2: NPL Ratio (2010 - 2017f)



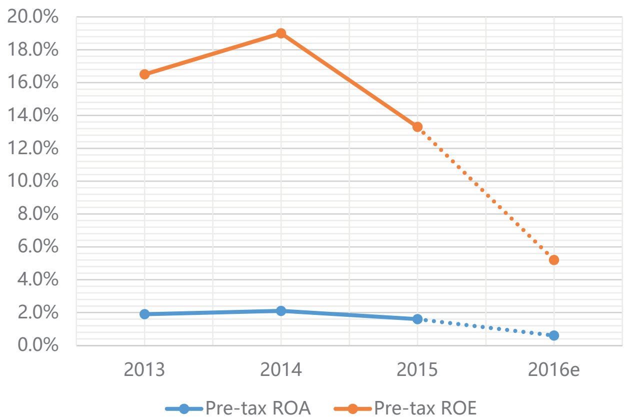
Source: Agusto & Co Research

In 2016, the story remains the same. The devaluation of the domestic currency coupled with non-abating economic pressures remain the most significant factors responsible for increases in the impairment levels in the industry. One bank recorded NPL ratio of 77% as at H1 2016 one bank had recorded an NPL of ratio of 77%." "In August 2016 the CBN responded to the high impairment levels in the industry by granting a one-off forbearance for banks to write-off fully provisioned loans without awaiting the mandatory one year period. As a result, we anticipate that the industry's NPL ratio will stand at 12.5% as at FYE 2016, despite the ravaging macroeconomic headwinds as Nigerian banks leverage this policy to reduce their level of impaired credits.

The macroeconomic pressures impacted the performance of Nigerian banks with pre-tax return on average equity dipping to 13.3% as at FYE 2015, the lowest in the last 5 years. Foreign exchange income plummeted by about 58% on account of the foreign currency regime of the CBN which significantly reduced the volume of trade transactions. This resulted in the Industry's non-interest income declining by 6% during the period under review. We however noticed increased push for electronic banking income. The number of POS terminals deployed in 2015 increased by 34% resulting in the volume of transaction consummated on the platform increasing by 74%. Most banks expanded their ATM network while one bank introduced a new payment channel.

In response to the economic pressures, most banks are adopting measures to reduce operating costs. Cost to income ratio remained elevated at 73% in 2015 relative to 68% recorded in 2014. Despite staff rationalisation as well as other cost containment measures adopted in 2016, we believe the inflationary pressure in the economy will increase operating expenses by at least 10%. Conversely, the low government spending on account of the late passage of the 2016 budget, difficulties in accessing anticipated borrowings and persistent challenges in the foreign exchange market will keep the income of the Nigerian banks low in 2016 in our view.
Based on these factors, we anticipate further decline in the profitability of the banking industry in 2016 with a single digit pre-tax return on equity.

Figure 3: Profitability Ratios

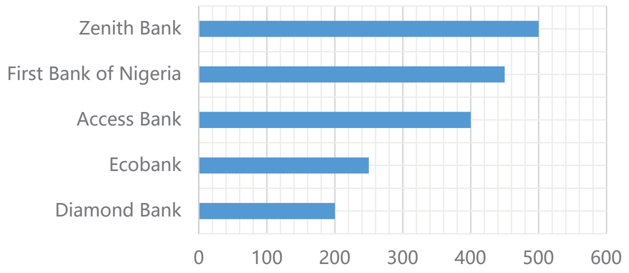


Source: Agusto & Co Research

Capital Adequacy remains resilient

The capital base of the industry will remain adequate despite the economic pressures. As at 31 December 2015, the industry had core capital of ₦3.7 trillion and each of the banks had capital base above the regulatory minimum. During FY 2015, two banks successfully conducted rights issue exercises to shore up their capital base. Secondary capital comprising long term borrowings also grew by 39% supported by the Eurobond raised by one bank and the devaluation of the domestic currency which increased the naira value of foreign currency borrowings. Nonetheless, the Basel II computed capital adequacy ratio (CAR) of some of the banks were impacted negatively by the ravaging macroeconomic headwinds. Two banks recorded CAR below the regulatory threshold while one other bank's Basel ratio was at the regulatory minimum as at 31 December 2015. As at the same date, the CAR of some banks were also below their internal benchmark. We expect the industry's capital base to remain resilient in 2016, although pressured due to the macroeconomic climate.

Figure 4: Eurobond Issue by Nigerian Banks (2014-2015)



Source: Agusto & Co Research

The macroeconomic pressures have exposed the weaknesses of the risk management practises in most Nigerian banks. Most banks that breached the CBN sectoral limit especially in the oil and gas sector suffered significant deterioration in their loan book. Banks with inadequate collateral coverage and poor quality collateral were also exposed. The non-adherence to the CBN policy on insider related credits was also revealed as some director related loans became impaired. Nigerian banks are using the prevailing challenges to fortify their risk management framework. Some banks have engaged independent consultants to review their risk management practises while some others have implemented reforms needed to mitigate prevailing risks. The remedial and recovery processes of most banks were also strengthened while most credit requests are now scrutinised more rigorously. We believe compliance is key to success here. Nigerian banks are operating under stressed market condition which has led to the banks transforming to a defensive mode. We expect the performance of banks to be subdued in the near term and outlook for the industry is negative.

THE BANKING BILL: A STATE OF TRANSITION FOR THE KENYAN BANKING SECTOR

By **Edwin Chui,** Analyst, Dyer & Blair Investment Bank

Interest rate cap: Our thoughts

A Banking (Amendment) Bill by Parliament to cap banks' lending rates at 400 bps above the Central Bank of Kenya's base rate and impose a deposit floor at 70% of the CBR was signed into law on 24th of August 2016. If the law is implemented immediately, banks will charge a maximum of 14.5% on loans while paying about 7.35% on deposits held in interesting earning deposits.

Impact on Banks

The true impact on Kenyan banks cannot be estimated until the Central Bank of Kenya announces the implementation timelines as well as the operational framework. Assuming an immediate implementation however, expect impacts on:

Yields from loans and advances: The average lending rate as per the Central Bank of Kenya currently stands at 17.96% with multiple reports indicating that the personal unsecured rate is at around 24.0%. A 14.5% would therefore result in at least 346 bps reduction in yields from loans and advances all else held constant.

Deposit rates: In FY15, the average deposit rate stood at 6.9%. A 7.35% deposit would thus raise the cost of deposits by about 45 bps. In an effort to maintain asset-liability mismatches while keeping cost of funds low, banks have relied on a tiered deposit account structure with some accounts such as term deposits attracting higher rates due to their characteristic long tenors and large opening balances. As banks will henceforth have to pay a minimum rate of 70% of the CBR on all interest earning deposits, we expect them to restrict interest earning deposit accounts to longer tenors and larger opening balances.

Net interest margins: The decline in yields from loans and the rise in the cost of funds will result in NIMs compression across the banking universe. Assuming yields from loans at a maximum of 14.5%, and cost of deposits at a minimum of 7.35%, NIMs from banks core business will stand at 7.15%. With the FY15 average lending and deposit rates at 17.96% and 6.9% respectively (NIMs at 11.06%) this will present a 391 bps reduction in NIMs. As we explain further in this report, such an analysis assumes no variation on the Central bank's base rate, banks complete acquiescence with the new regulations among other key issues.

Corporate deposits and loans: For some banks, especially those in the Tier I and II sectors, corporate deposits are critical as such banks are unable to leverage either international parentage or stronger relations with DFIs. Consequently, they tend to lend directly from their deposit base. Such banks have in the past focused on niche marketing in a bid to compete for wholesale corporate deposits in the market. A legally binding deposit floor rate will thus extend more leverage to corporates to negotiate even higher rates on their deposits which will effectively raise the cost of funds in these tiers.

Small and Medium Enterprises: With respect to the SME space, we see two likely scenarios. Firstly, to the

USED BANKS; FY15, 1Q16 AND 1H16 NIMS ANALYSIS

	YIELDS			COST OF FUNDS			NIMS		
BANK	FY15	1Q16	1H16	FY15	1Q16	1H16	FY15	1Q16	1H16
EQUITY	13.5	11.2	14.0	3.0	2.2	2.7	10.5	9.0	11.3
KCB	12.3	13.7	13.0	3.9	4.5	4.0	8.4	9.1	9.0
CO-OP	14.0	11.0	14.0	5.2	4.0	4.8	8.8	7.0	9.2
BBK	12.2	13.2	13.3	2.0	2.8	2.7	10.5	10.4	10.6
HF	13.34	11.2	15.0	7.45	6.5	8.2	5.89	4.7	6.8
DTB	11.0	13.1	12.7	4.7	6.0	5.6	6.4	7.1	7.1
I&M	13.0	13.1	12.6	6.4	6.0	5.7	6.7	7.1	6.9
NIC	11.3	14.0	12.8	5.3	6.3	5.5	6.0	7.7	7.3
STANCHART	10.9	13.4	12.7	2.8	3.1	3.0	8.2	10.4	9.8
Cap Average**	14.5	14.5	14.5	7.35	7.35	7.35	7.15	7.15	7.15

Source: Companies, DBIB Research

extent that there is a substantial number of viable SMEs that have been locked out of borrowing by high interest rates, banks should see an uptick in the number of loan applications by SMEs in the short term which may give them an opportunity to maximize on volumes to mitigate the effects of the rate cap. On the flip side, it is possible that banks will in the short term be unwilling to extend credit to the more risky SME sector without viable collateral which should effectively facilitate credit shortages.

Mortgages: Although demand for mortgages has been rising steadily y-o-y, the number of mortgage loans still remain subdued primarily because of pricing. According to the Central Bank of Kenya, mortgage loans in the market rose 11.1% y-o-y in FY15 to 24,458 due to increased demand from the expanding middle class. This represented a 23.0 % y-o-y rise in the value of mortgage loan assets outstanding to KES 164.0 BN. The interest rate charged in 2015 on mortgages on average was 17.1% and ranged between 11.9%- 23.0% as compared to 15.8% average with a range of 8.0%-21.3% in 2014. That rates were high can be inferred from the 8.3% y-o-y rise in the outstanding value of non-performing mortgages to KES 11.7 BN in FY15. Anecdotally, a 14.5% rate on Mortgage loans is still quite high to drive up mortgage uptake substantially. If banks are to compensate for the drop in direct lending by increasing their mortgage lending they will have to incentivize their clients by charging at a substantial discount from the cap.

Key Questions

Will the law be applied retroactively? As most of the lending is on flexible terms, a retroactive implementation will certainly cause a dent in FY16 bank's performance.
Does the rate apply to all loan classifications equally? Equal treatment of all segments will distort risk pricing in the market. Banks may also append various fees and commissions on lending that would effectively keep the cost of credit high. At the moment some banks have already suspended some of their loan products for instance personal unsecured lending.

Does the rate apply to all deposit classifications equally? Banks may raise the criteria for opening a savings account or attach more/higher processing and maintenance fees.

Mobile products: There is uncertainty on what will happen to lending through mobile platforms especially Mshwari and KCB Mpesa which are partnerships between Safaricom with Commercial Bank of Africa and KCB Group respectively. As margins are shared between each of the two companies, individual banks do not have discretion on the rates applied. In addition, that KCB and CBA classify margins from these products as fees, the interest rate cap (as written) maybe inapplicable in which case we can expect CBA and KCB to divert more funds into these products.

Banks FY15 income analysis: In FY15, circa 65.66% of banks' income arose from loans and advances either as interest or as fees with 14.9% arising from investments in government securities.

Banks' interest expenses: The banking sector expenses rose 16.3% to KES 322.8 BN in December 2015. Interest expenses accounted for 41.2% of the total banking sector expenses in 2015 compared to 24.8% in 2014. This increase was in line with the average rise in cost of deposits to 5.5% in FY15 as compared to 4.9% in FY14.
Assuming a total a customer deposit growth forecast of 8.5% y-o-y (as in FY15), a deposit rate of 7.35% (CBR at 10.5%), a loans and advances growth of 11.2% (as in FY15) and an interest rate of 14.5%, the consequent banking sector net-interest income would decline 1.3% y-o-y to circa KES 144.359 BN. Therefore, all else held constant and assuming a seamless implementation, a rate cap may not result in a huge income decline in the sector as a whole.

Sectoral distribution of gross loans: According to the Central Bank of Kenya, loan accounts in FY15 were distributed as follows:

FY15	Number of loans*	Gross value**	Non perfor -mance***
Personal/household	91.87%	25.45%	17.71%
Trade	4.64%	19.56%	30.06%
Agriculture	2.12%	4.04%	5.69%
Real estate	0.24%	13.58%	8.43%
Manufacturing	0.18%	12.30%	11.38%
Construction	0.12%	4.63%	11.02%

** Out of total number of loans | ** Out of total gross value | *** Out of total non-performance*

The relatively high weighting of the personal/household sector numbers does give credence to the argument that banks have focused their lending on the more risky but economically less productive sector of the economy. It is thus plausible that a smooth implementation of the

LOANS VS INVESTMENTS IN GOVERNMENT SECURITIES

	Loans and Advances			Government Securities		
Bank	FY15	1Q16	1H16	FY15	1Q16	1H16
Equity	63.0%	63.9%	60.5%	10.0%	14.5%	16.4%
KCB	62.0%	62.1%	62.0%	17.2%	18.8%	17.1%
Co-op	60.9%	60.9%	61.0%	19.0%	21.1%	22.4%
BBK	60.4%	63.1%	59.9%	19.0%	21.4%	21.4%
HF	74.0%	74.0%	75.0%	3.0%	5.8%	5.4%
DTB	65.4%	62.9%	59.1%	17.3%	21.7%	26.0%
I&M	65.9%	67.0%	64.4%	22.9%	20.8%	23.8%
NIC	70.0%	69.6%	66.3%	13.2%	15.9%	17.2%
Stanchart	55.2%	44.0%	44.6%	31.5%	29.6%	36.3%

NB: Proportion of loans/govt. securities relative to Total Assets interest cap may incentivize banks to lend more to the more-productive sectors of the economy which as per the data above do not yield as much non-performance.

NET-INTEREST INCOME RELIANCE			
Bank	FY15	1Q16	1H16
Equity	60.9%	66.7%	66.2%
KCB	62.7%	74.0%	68.4%
Co-op	63.8%	66.2%	67.9%
BBK	69.3%	67.8%	68.4%
HF	78.3%	80.5%	83.3%
DTB	76.3%	79.5%	79.2%
I&M	73.4%	75.1%	75.4%
NIC	70.7%	72.2%	73.8%
Stanchart	71.4%	67.4%	68.7%

CUSTOMER DEPOSIT MIX			
	Current	Savings	Term
Equity	35.6%	44.9%	19.5%
KCB	60.0%	10.0%	30.0%
Co-op	56.9%	6.8%	36.3%
Barclays*	77.0%	-	23.0%
HF**	-	-	-
DTB	29.8%	10.2%	59.3%
I&M**	-	-	-
NIC	36.0%	2.1%	60.7%
Stanchart	68.0%	7.4%	24.6%

***Barclays current % includes savings accounts*
*** Data unavailable on I&M/ HF customer deposit mixes*

Tier 1 Loans Split	
FY15	Barclays
Manufacturing	14.0%
Trade	11.0%
Transport and Comm.	5.0%
Agricultural	2.0%
Private individuals	57.0%
Other	11.0%

Tier 1 Loans Split	
FY15	Equity
Consumer	18.6%
Micro Enterprises	6.3%
Agriculture	2.6%
SMEs	45.7%
Large Enterprises	26.8%
Total	100.0%

Tier 1 Loans Split	
FY15	Co-op
Corporate	29.0%
SMEs	15.0%
Personal	47.0%
Sacco	9.0%

Tier 1 Loans Split	
FY15	KCB
P. Sector & Individuals	80.6%
G. & Parastatals	19.4%

FY15 WEIGHTED AVERAGE EFFECTIVE INTEREST RATES			
Effective rate on:	Deposits	Govt. Securities	Loans
Equity*	2.49%	9.72%	15.57%
KCB	4.00%	10.60%	17.50%
Co-op	5.05%	16.20%	12.10%
Barclays	2.60%	14.50%	9.40%
HF	7.01%	12.76%	13.90%
DTB*	5.42%	10.27%	13.55%
I&M	7.00%	10.67%	13.92%
NIC	5.19%	9.32%	11.72%
Stanchart	6.40%	12.40%	13.15%
Rate cap	7.35%		14.50%

Impact on NSE listed equities

Listed Banks: In the short term, we anticipate a panic-driven sell-off of listed bank equities in the Nairobi bourse due to uncertainty on the impact the cap will have on banks' profitability. Indeed, volume weighted prices of all bank stocks fell today one day after the decision. The market is also replete with sellers as buyers continue to wait and see if prices will drop further.

Other counters: If the law is retroactively implemented, companies with local debt such as Kenya Electricity Generating Company (KenGen), Kenya Power and Athi River Mining (ARM) will stand to benefit as their finance cost will be substantially reduced.

Impact on the fixed income market

Primary market: As banks are the dominant players in the treasury bills and bonds primary auctions, and in the continued absence of official primary market makers, we anticipate high bidding and oversubscriptions in the weekly and monthly auctions. This month, the Central Bank of Kenya offered a 10 year Treasury Bond for a total amount of up to KES 25.0 BN. The total number of bids received was 795 amounting to KES 26.31 BN. However, 105 bids were accepted amounting to KES 18.3 BN of which KES 13.2 BN was from competitive bids. The market weighted average rate was 15.267%.

With lending capped at 14.5%, we believe that Banks will shift a key portion of their assets to government securities. However, given that banks are the most dominant players in the fixed income market there is a chance for collusions in the bidding process in an attempt to lock in high coupon rates. In the absence of collusions, and assuming banks hold back on lending, then they will be stuck with huge cash balances that if redeployed to government securities should also push the yields down. In the long term therefore, government securities may offer no respite.

Secondary market: We anticipate that banks will scramble for any bond in the market with at least a 14.5% annual coupon rate. We also anticipate that banks may opt to hold such bonds and those acquired during primary auctions to maturity.

Impact on the macro-economic environment.

Portfolio outflows: As banking stocks are the most dominant in the Nairobi Securities Exchange in terms of daily turnover numbers, we are concerned that a sustained sell-off especially by foreign investors may trigger substantial short-term portfolio outflows from the Kenyan equities market.

Foreign exchange: Substantial portfolio outflows may lead to further depreciation of the Kenyan Shilling against major currencies which may lead to a rise in the cost of imports that may in turn trigger a rise in inflation.

Syndication prospects: An interest rate cap may boost prospects for syndicated lending by mitigating price differentials among banks. This may come in handy especially in the financing of infrastructural projects such as still in the works road annuity program.

Contributor's Profile

Edwin Chui joined Dyer & Blair Investment Bank in 2016 and is responsible for covering tier I banks. Dyer & Blair is renowned for topping investment bank rankings, having executed several landmark transactions including transaction advisor for the USD 840mn Safaricom IPO, Sole advisor to the USD 180mn acquisition of Equity Bank's 24.99% stake by Helios and USD 317.5mn capital restructuring programme by Kenya Power Company Limited. The brokerage division executes transactions across the equities and fixed income markets and provides access to the Kenya, Uganda, Tanzania and Rwanda markets for both retail and institutional investors. Prior to joining Dyer & Blair, Edwin worked at Bank of New York Mellon in the wealth management department.

Banker-Bashing Is a Dangerous Thing. Just Look at Kenya

The frontier market of Kenya isn't often on U.S. or European investors' radar. It should be. It offers a timely reminder of financial markets' complacency about the risk of populism; and the attractiveness of bashing banks to win votes.

East Africa's most advanced economy has introduced a law setting a cap on commercial lending rates and a floor on deposit payout rates, an instant squeeze on margins that sent shares of Kenyan banks to their lowest in years. Investors were clearly unprepared for a measure designed to make banks poorer — or less greedy, depending on your point of view — in the face of what Kenyan President Uhuru Kenyatta described as ordinary citizens' frustrations about the cost of credit and earnings from deposits.

There's no denying Kenyan banks make rich returns. The country's largest bank by assets, KCB, has a return on equity of 24.7 percent, according to Bloomberg data, while rivals Cooperative Bank and Equity Group are on 24.5 percent and 26.9 percent respectively. That's not just leagues ahead of the 5-7 percent ROE at Europe's biggest banks, it beats the 15-18 percent at South Africa's top lenders. Market concentration may have something to do with it: Kenya's seven biggest lenders (there are about 43 in total) hold 80 percent of the banking system's cash.

But capping interest rates risks damaging the Kenyan economy and stunting credit growth, a danger not lost on officials at the country's central bank and finance ministry, who opposed the measure. If banks stop catering to anyone but the safest credit risk, it may encourage shadow banks or dodgy lenders to step in. If smaller banks find it harder to make ends meet, they may get bought up, making those dominant banks even bigger. And the new loan cap, at 4 percentage points above the base central bank rate, sets a potentially "unreasonable" ceiling for Kenya's risk premium, according to investment firm Cytonn.

So why take such a chance? Well, next year's election and a bank-bashing law may be just the ticket to win votes. Some analysts reckon it's a purely populist move.

Yet the sell-off of Kenyan bank stocks over the past month suggests markets weren't adequately prepared for this risk, with the chorus of credible dissenting voices perhaps lulling investors. And while it's easy to dismiss this as the kind of problem specific to emerging markets, there are echoes of the anti-elite vibe in Europe and the U.S.

Championing the banks, in particular, isn't much of a vote winner. The U.S. election has put the restoration of Glass-Steagall back on the table, with Republicans calling for big banks to be broken up. British chancellor Philip Hammond is trying to put a protective arm around the City of London by exploring continued access to Europe's single market, but he's clashing with the crowd-pleasing instincts of the "three Brexiteers", Boris Johnson, Liam Fox and David Davis.

There's still hope that pragmatism will prevail. Calls for a restoration of Glass-Steagall look like posturing, while Moody's reckons that even if the U.K. quit the single market, its finance firms could probably still do plenty of business in the EU.

Yet the Kenya experience shows the potential for nasty surprises in a populist age, whether self-harming or not. Don't forget that Brexit itself caught investors on the hop.

Source: Bloomberg News

CYBERCRIME IN EAST AFRICA TARGETING LOCAL BUSINESS

Although the majority of East African institutions and businesses are investing in their security infrastructure, many are doing so in the wrong places.

A recent report by Control Risks has revealed that Government, followed by telecoms and financial services are at most risk in East Africa. Of note is that the report shows that attacks are not only carried out against multinationals operating in the region – a common misconception, but that East African businesses are also fast becoming the target.

“What we have seen is that the majority of East African businesses are not investing in the right areas for todays’ threats. With cybercrime costing Kenya alone two billion shillings, the battle has shifted and businesses need to seriously worry about highly motivated human adversaries,” says Mark Campbell, consulting engineer for sub-Saharan Africa at Arbor Networks, the company that helps secure the world’s largest enterprise and service provider networks from distributed denial-of-service (DDoS) attacks and advanced threats.

He explains that these modern day foes do things that can’t be stopped purely with technology. “For instance, modern adversaries do their reconnaissance in a ‘human’ way to build an understanding of their targets’ technologies, processes and people. They will use social media to understand the staff, affiliates and partners. They watch for press announcements about your technology upgrades. They will then rent the similar equipment, online or physically, to craft and test their attacks against,” he says.

Campbell adds that all of this points to a fundamental problem with “traditional” security infrastructure. That is, the attacks do not rely purely on malware anymore or the use of stolen credentials. “Threat actors will use business partners to get inside your environment or supply chains linked to your business. Traditional security infrastructure relies on a ‘detect and response’ strategy. It tries to sort events into priority lists, where incident responders (IR) will focus on high priority alerts first. The human adversary doesn’t work in a way that can stopped by a ‘detect and response’ strategy. Leading organisations have moved to a ‘seek and contain’ strategy,” he continues. “These invest in more forward leaning strategies, which involve threat hunting. This uses the human defence element, the incident responders’ brains instead of relying purely on technology.”

In addition, Campbell highlights that the real dangers posed by cybercrime to East African organisations are multifaceted. “For instance, the current trends are for attackers to use all weapons at their disposal to maximise chances of success,” he says. “They use combined arms, like in conventional warfare where a region is bombed before invasion, because this grants them much better chances of success. In cybercrime, it is similar, where attackers use DDoS attacks to disguise their ‘invasion’. So the dangers to the region’s organisations can be that of a total breach of their availability, confidentiality and integrity, on all fronts, like reputation, data and business fronts.”

Whether East African businesses have the skills to cope with increased security threats depends on how they use their key resources: their people, Campbell points out. He says that in the traditional security approach, businesses train or shape the skill set of their people to fit to technology they have in place, or are investing in. “They should rather look at their peoples’ skills and match that to the technology instead,” he highlights.

“The rise of mobile malware and the Internet of Things will also have an impact on security strategies within East African organisations.” Campbell believes that there will be greater focus and emphasis placed on network and traffic visibility.

“You cannot protect what you cannot see. Looking at mobile malware, you need to understand what the devices are that connect to your network, and what they are doing. The Arbor Worldwide Infrastructure Security Report (WISR) stated that 40 percent of our survey respondents had nothing in place to monitor BYOD. They have policies around BYOD but no way to monitor the activity of these devices. Security strategies need to do more in getting visibility into networks and the movement of data. For instance, understanding who gets access to the infrastructure and data and what are they doing with it.

About Arbor Networks

“Arbor Networks, is the security division of NETSCOUT. As organisations move data from their internal data centres into the cloud, Cloud Access Security Brokers (CASB), which act like reverse proxies, are involved in the Digital Rights Management (DRM) and control of who can see what data, who can download and view, or who can retain and read it offline, or if it can only be accessed while online,” concludes Campbell. “Modern security strategies need to define these granular policies: what is sensitive data, who accesses it and how can it be accessed. This is mostly driven now because of data moving to the cloud, but why did organisations not do this internally when data was kept internal to their networks?”.

MAURITIUS' BANKING SECTOR: OVERVIEW, CHALLENGES AND OPPORTUNITIES

By **Bhavik Desai,** Head of Research, AXYS Stockbroking, Mauritius

Banking Sector Overview

Over 20 banks operate in Mauritius and, in addition to traditional banking services, they offer a range of specialised services ranging from custodial services to cross border activities. Half of these banks offer retail banking services to residents - a space dominated by a couple of players - while the rest focus on specialised international banking services and also include a couple of purely private banks. In Mauritius the domestic operations are typically referred to as "Segment A" (SegA) while non-resident operations are referred to as "Segment B" (SegB). Mauritian owned banks with large SegA operations are very conservative in their approach which made them resistant to shocks from the Great Financial Crisis of 2008 (Great Crisis), while banks with large SegB operations have been highly focused on providing services to Global Business Companies (GBC) which has made them largely immune to the domestic economic environment whose landscape has been challenging.

The Backdrop

Mauritian GDP growth has slowed from above 5% prior to the Great Crisis to hover at ~3.6% in recent years until a further slowdown to 3.0% in 2015. In years surrounding the Great Crisis, the economy had been doped by public infrastructure and private constructions mostly funded by borrowed money. For the past five consecutive years, the construction industry has contracted but a resilient financial industry has been a key sector to keep the economy growing albeit at a tepid pace. 2014 was an electoral year in which investment slowed as economic players adopted a wait-and-see stance until after the General Elections.

The new government began its tenure with ambitious growth targets and reviewing existing policies. The most significant event of 2015 was the demise of the BAI Group - a conglomerate which operated a Life Insurer and a Bank in addition to a consumer goods and healthcare division. Swift actions helped stymie contagion; however business morale appeared to take a hit then improve in the wake of the latest National Budget 2016/17 was presented in late Jul-16. Earlier this year, the Financial sector - like textiles and sugar industries before it - was dealt a blow when the Indo-Mauritian Double Taxation Avoidance Agreement (DTA) was renegotiated giving India the rights to fully apply its tax on capital gains as from Apr-18. The Global Business sector has relied strongly on this DTA to fuel its growth and has been given just a few months to re-invent itself and/or diversify operations away from a heavy reliance on the treaty with India.

Segment A

Against an unfavourable backdrop, the banking sector has shown resilience averaging 6.8±0.1% of GDP since the Great Crisis and growing at 5.5±0.1% in recent times despite the recent shakeups. Lending has grown in-line with the economy having averaged 81±0.9% of GDP since 2012. A little over a quarter of all credit is geared towards the "Construction" sector which in addition of Property Developers also includes Personal Mortgages, followed by Tourism [15%] and Category 1 Global Business Companies [14%] (GBC1) and Traders [10%]. Credit quality has deteriorated with the ratio of Non-Performing Loans (NPLs) doubling to 8% between 2010 and 2015. With the average Tier 1 Capital Adequacy standing above the regulatory minimum of 10% at 12.1% for domestic banks, they are expected to withstand shocks. Nonetheless, the Bank of Mauritius (BoM) – the Central Bank – has identified the "Systemically Important Banks" and has required they hold an additional capital surcharge between 1-2.5%.

In essence the domestically focused banks who have traditionally adopted a conservative business model are deemed to be sound, resistant to shocks and able to absorb impairments incurred on their respective deteriorating loan books. Our primary concern is therefore not on the strength of banks but their ability to grow: Return on Assets (RoA) has more than halved from 3% in 2012 to under 1.5% in 2015. In fairness this was in part a consequence of a set of specific external loans going sour followed by impairments in the aftermath of the BAI Group's collapse.

The limited ability for banks to grow domestically is primarily related to the small nature of the Mauritian economy and slowing private investment amid an uncertain outlook. A renewed "Feel-Good" factor was apparent – with the benchmark index, ALEX 20, which regroups the 20 most liquid stocks surging 6% in under 3-Weeks and in the process breaking out of a "Bear" spell – following the National Budget. Reflecting this is the fact loan book growth for the large banks has ground to a halt in 2016. In addition to macro-factors, the increasing visibility of smaller players and their aggressiveness is nibbling away market share as exemplified by ABC Banking Corporation Ltd (ABCB) growing its loan-book by 30% YoY as at Jun-16. Another factor hurting loan book growth is the burgeoning corporate debt market – inexistent five years ago – of which some Rs13bn are listed and tradeable on the Stock Exchange of Mauritius

(SEM). Interest for this market segment by multi-nationals is dwindling: HSBC unsuccessfully attempted to sell is retail business a few years back while Barclays has announced that it intends to pull-out of Africa altogether.

Their inability to effectively redeploy growing deposits – which grew strongly in 2015 for the "safer" banks in the BAI aftermath – coupled with low-yields on government T-Bills, Notes and Bonds has pushed banks to increase fees especially for premium banking services. Banks are increasingly offering premium services and growing private banking/wealth management arms which are services specifically single-out by the Board of Investment (BoI) as areas where "opportunities exist". Further banks are being less conservative and increasingly investing in securities but the biggest potential for growth lies beyond the island in cross-border services.

The relatively small size of domestic banks – even the larger ones – means they are ill-positioned to on their own go against continental players. The oldest and largest Mauritian bank, The Mauritius Commercial Bank Ltd (MCB) – Baa3 rated by Moody's – has expanded its presence throughout the Indian Ocean (Seychelles, Maldives, Madagascar) and partnered with Société Générale (SocGen) in neighbouring Réunion island and Mozambique. MCB recently took a back-seat on Mozambique in-line with its strategy to be a "bank of banks" i.e. a banking services provider for continental peers rather than to take them head on. MCB has thus grown its overseas operations which now account for about a third of its profits. The part State-owned, State Bank (Mauritius) Ltd (SBM) – the 2nd largest bank – is also rated Baa3 by Moody's and had been looking to expand its continental presence in recent years but has yet to find the right fit. SBM has given a greater focus to its expansion in Asia, especially given its existing presence in India, by opening a representative office in Myanmar and most recently setting up shop in Seychelles.

Segment B

SegB banking operations in Mauritius are expected to take a substantial hit starting 2017 when the renegotiated Indo-Mauritian DTA comes into effect. Over 60% of lending to non-residents is geared toward Asia (mostly India) with non-resident banking assets roughly twice the size of domestic assets. Both the International Monetary Fund (IMF) in its Article IV consultation and Moody's a recent assessment have warned that banks could experience significant withdrawals resulting in liquidity constraints but more importantly in structural changes to the nature of the economy whose Current Account Deficit (CAD) overshadowed by a positive Balance of Payments (BoP) driven by flows relating to GBCs and luxury real-estate developments. Domestic banks have very limited exposure to Indo-Mauritian DTA specific funding and will likely not face any issues. Subsidiaries or branches of big-names are also unlikely to face issues given that they are expected to receive injections from the parent company in case of need. 2017 spells the end of an era for the GBC sector which in the short term will result in a shrinking of the sector leading to potential departures by select banks operating within this space today. The spill-over effects from these departures, subsequent loss of few but high paying jobs, are expected to have an adverse effect on credit quality of personal loans and lower consumption.

> *"The Mauritian entrepreneur has often forsaken short-term gains for long-term growth and it is with this mindset that we expect local players to take their business abroad or expand."*

Prospects

In conclusion, both SegA and SegB banking are each facing challenges for growth of a different nature. SegA growth is stalling due to the limited size of the Mauritian market and tepid economic growth, while SegB is expected to contract as a consequence of structural changes. The Mauritian entrepreneur has often forsaken[1] short-term gains for long-term growth and it is with this mindset that we expect local players to take their business abroad or expand their SegB operations right here from Mauritius. The gradual shift noted towards broader diversification of banking assets as well as introduction of custodial and premium banking services are a nod in this direction. With regards to international players, several have business models that do not rely at all on the Indo-Mauritian DTA but instead focus on cross-border services offered to clients investing in Africa or African clients investing internationally. We therefore expect to lose some players in the short term, others alter their business models, but in the medium-to-long term continue to grow given the level of investment required on the continent in the decades to come.

Contributor's Profile

Bhavik Desai leads the equity research and valuations department at AXYS Stockbroking which he joined in 2010. His primary foci are Mauritian equities and the burgeoning Mauritian fixed income market. Prior to joining AXYS, Bhavik worked on the implementation and monitoring of corporate strategies for the Office of the CEO at SAP Labs LLC in California. Bhavik holds a Double Bachelors in Arts in Physics and Astrophysics from the University of California, Berkeley.V

1 Most famously when the Sugar industry signed up for a long-term sugar contract at lower prices while world prices were soaring in the 70s

GOOD GROWTH HUNTING WITH LONG-TERM THINKING

By **Kevin Cousins,** Equity Analyst, PSG Asset Management

Companies that have the ability to re-invest capital for growth over long periods of time, while still generating great returns, are well worth the hunt. The incremental compounding of shareholders' wealth that results from effectively re-investing in growth can generate spectacular returns for long-term investors. However, growth alone is not enough; it needs to be 'good growth' that increases per share value for investors.

A fast growing company often needs to turn to financial markets to raise additional capital. How this process unfolds and is managed can provide excellent insight as to whether 'good growth' can be expected from the company in the future.

Looking at two recent capital raises helps demonstrate this point.

PPC rights issue – high cost to shareholders

PPC is in the process of raising R4 billion of capital through a rights issue. The company currently has five large projects to expand cement capacity. Two of them, in Zimbabwe and South Africa, can be regarded as relatively low risk. The other three, in Rwanda, the Democratic Republic of the Congo and Ethiopia, are new geographies for PPC, and in our view carry considerable in risk. The costs of the expansions are not currently impacting PPC's reported income, as interest and other expenses relating to the new projects are being capitalised pre-commissioning.

These expansions have until now been primarily funded by debt which, together with their Black Economic Empowerment (BEE) share scheme funding, put considerable stress on PPC's balance sheet. Unfortunately the capital raise was triggered not per a managerial plan, but by necessity following a debt rating downgrade to "junk" status by S&P which meant that debt PPC had only been obliged to repay many years in the future had to be settled immediately, creating a liquidity crisis.

Raising this capital via a rights issue to end the liquidity crisis has come at a very high cost to shareholders. Management estimated the total costs of navigating the liquidity crisis as R400m, or 10% of the capital raised. The rights issue was priced at greater than a 50% discount to market, and shares in issue will increase 2.6 times leading to a dilution of shares in issue of more than 60%. PPC's management and directors do not own significant equity in the business, and so they have suffered little, if any, personal economic cost.

Discovery rights issue – investing in 'good growth'

In April last year Discovery raised R5bn via a rights issue, primarily to fund a capital injection into their United Kingdom businesses, Vitality Health and Vitality Life, after the buyout of Prudential's 25% stake. Part of Firstrand's stake in DiscoveryCard would also be purchased, with Discovery owning 75% (up from 20%) thereafter.

Key members of management, as very substantial shareholders, invested more than R600m of their own capital to follow their rights and avoid dilution of their economic interest (they borrowed money to do this). This is valuable evidence that this was likely to be a 'good growth' opportunity.

The capital raising was planned for by management, with the new shares being issued at a roughly 30% discount to the prevailing market price. The total costs incurred in financing the capital raising were just 1.5% of the capital raised, and the shares in issue were diluted by less than 10%. It is also worth noting that Discovery expensed R823m relating to future projects in their year to June 2016, reducing reported earnings by 13%.

> *"Growth alone is not enough; it needs to be 'good growth' that increases per share value for investors."*

To successfully deliver 'good growth' companies need to have a strong focus on long-term thinking. They need to take and implement decisions that are in the best long-term interests of their shareholders. Discovery has demonstrated a willingness to incur the necessary upfront expenses despite the negative impact on current profits. This long-term thinking is epitomised by a robust growth culture and a well incentivised management team (through a large personal shareholding) to focus on long-term per share returns.

Contributor Profile

Kevin Cousins is an equity analyst at PSG Asset Management. He has over two decades of experience in investment management, including long stints at BoE Asset Management and Brait, as both an equity analyst and portfolio manager.

SOUTH AFRICA'S BANKS: EXAMINING THE CURRENT ENVIRONMENT, EXPLORING THE 10 YEAR OUTLOOK

By **Cas Coovadia,** Managing Director, The Banking Association South Africa

The 2015/16 Global Competitive Index, published by the World Economic Forum, rates the SA banking sector 6 out of 140 countries in availability of financial services and 8th in the soundness of banks. This is high praise for a banking sector that is small in global terms, but is globally connected and punches way above its weight globally.

The quarterly S A Reserve Bank Report details statistics that demonstrate the size of the banking sector in SA. The following is pertinent in this regard (as at 30 June 2016):

Total assets	R 4,841 trillion
Total deposits	R 3,395 trillion
Total loans & advances	R 2,891 trillion
Capital adequacy	
Tier 1	12.41%
Total	15.19%

The latest Price Waterhouse Cooper Banking Survey also demonstrates the state of SA banks. The following, as at 31 March 2016, is pertinent:

Combined headline earnings up 12.5%
Ave Return on Equity 17.9%
Bad debt expenses up to 10.8%
Total operating income up 6.69

The SA banking sector is clearly a sophisticated sector that is globally credible and respected. It is a developed country sector that can compete with any in the developed world, but it operates in a developing country with particular challenges. The rise in bad debt expenses, although still low in comparison to our peers, demonstrates the problem of indebtedness in our country and banks are using numerous mechanisms to address this, including debt restructuring, credit education and tougher criteria for lending. A critical challenge is to broaden access to banking services to as many people as possible. A particular complication in SA is that the majority of people that must be included in banking were systematically barred from banking under apartheid. This is thus a new market coming into a complex banking environment. We have, despite this, done very well for a developing country. The 2015 Finscope Survey shows 84% of SA adults have formal access to banking.

The legislation and regulations governing banks in SA is recognized to be at the cutting edge of global best practice, with a very proactive primary regulator in the SA Reserve Bank and a political department in National Treasury that develops appropriate and relevant policies keeping the sector at the cutting edge of global best practice, while enabling banks to respond positively to the particular circumstances in the SA market. The SA Reserve Bank is independent of government and we must, in the national interest, protect that independence. We apply cutting edge legislation to identify and stop money laundering and other such criminal activity through the Financial Intelligence Centre Act (FICA), amendments to which are to be signed off by the President. The banking sector has also established the SA Bank Risk Information Centre (SABRIC) to fight financial sector crime. SABRIC has established itself as the pre-eminent bank crime intelligence centre and works closely with relevant government departments to try and remain ahead of criminal activity in the sector.

The above details the current state of banking in SA. What then of the future? What are some of the critical issues and challenges for the banking sector in SA in the next ten years or so?

There is little doubt banking as we have known it will change substantially. The future of banking will be influenced by robotics, technology, customer expectations and demands, as well as social expectations. Some consultants working with banks are talking about "bionic banking" as the next phase of delivering optimal services to a customer base that is younger and used to instant services.

Ongoing development in the regulatory environment will also be a critical aspect of the future. The financial crisis in the USA and EU that started in 2008 is still have an impact, with increasing regulations that banks will be expected to follow. These regulations emanate in the EU, but impact on SA banks because of our global connectedness and keeping at the cutting edge of global best practice.

The ongoing problems in the major economies will also be a factor SA banks will be looking out for. China is expect to grow at 6.6% in 2016, which is still very good, but the pace of growth of the last decade is no longer there. Sub-Sahara Africa (SSA) is also facing the challenges of low commodity prices, exacerbated by economies too dependent on commodities instead of diversifying to reduce such dependency, Our country is expected, according to the SA Reserve Bank, to grow only at about 0.9%.

SA banks have a significant footprint in the rest of the continent and broader macroeconomic deficiencies will impact of business. It is thus important that SSA countries grow and diversify their economies.

We will also be watching political developments in SA and the rest of the continent, The ongoing policy and regulatory uncertainty in SA, the attacks on the Minister of Finance and National Treasury, the indication from some in government and civil society that they would want to dilute the regulatory environment in which banks operate and lack of progress in sorting out the State-Owned Enterprises are all political factors that need to be resolved to enable our economy to grow substantially. There are also political issues in the rest of the continent, with Zimbabwe on a powder keg and serious unrest in the Democratic Republic of Congo.

Banks in SA are stable and profitable. The banking sector is a critical asset and we must, as a country, ensure its continued growth, which must include it being relevant to the majority of our people.

What's on South Africa's Economic Space

Interest rate hiking cycle may be in sight says South Africa's Reserve Bank

The end of South Africa's interest rate hiking cycle may be in sight if inflation conditions remain consistent with latest forecasts, but the bar for loosening policy is high, the central bank said.

In its second and final monetary policy review for 2016, the South African Reserve Bank (SARB) said risks to the inflation forecasts were more evenly balanced since the previous review in April.

The bank kept its benchmark repo rate unchanged at 7 percent last month, with a weak economic growth outlook balancing out concerns about the inflation trajectory. It said the risks to the inflation outlook remained considerable, but it was now clearer than earlier in the year that the risks went both ways.

"Should conditions develop in line with the current forecasts, it may at some point become possible to conclude the policy tightening cycle," it said in the review.

South Africa foreign currency bonds oversubscribed despite low-growth
South Africa issued a pair of new dollar bonds worth $3 billion on Friday in a surprise show of confidence by investors in an economy that narrowly avoided recession and faces possible downgrades to junk in coming months.

The rand erased losses after the issuance was announced, and was 0.86 percent firmer against the dollar at 13.7600 by 1440 GMT, lapping up the positive sentiment as yield-hungry investors ignored the country's dismal growth prospects.

"There have been a lot of ratings downgrades across the globe this year, which really helps those countries which maintain their investment grade ratings," said managing director of ETM Analytics George Glynos.

"So South Africa is still benefiting from the fact that it has an investment grade rating."
Fitch and SP Global Ratings both score the country's debt at BBB-, the lowest rung on the investment ladder, with a negative outlook. The next round of reviews are due in December.

S&P Says Political Tension in South Africa 'Must Be Watched'

Political tension in South Africa is making economic reforms more challenging and must be watched, according to S&P Global Ratings.

"We clearly stated that there is a concern that political tension stifles the reform effort, so that must be watched," S&P Managing Director for sub-Saharan Africa Konrad Reuss said in an interview in Johannesburg on Thursday. "In the current climate of political tension and turmoil it's certainly more challenging now to achieve all the reforms than one would've thought six months ago."

S&P affirmed South Africa's credit rating at one level above junk, with a negative outlook, in June and said the government must take decisive steps to bolster growth, quell policy uncertainty and end political interference in institutions to avoid a future downgrade. Reports last month that Finance Minister Pravin Gordhan is being probed by police led to a slump in the rand and bonds.

While economic growth in South Africa rebounded to 3.3 percent in the second quarter following a 1.2 percent contraction in the previous three months, it's too early to say it is setting a new trend, given the political turmoil, Reuss said.

Moody's Sees One-Third Probability of South Africa Downgrade

The probability that South Africa's sovereign credit rating could be cut in November by Moody's Investors Service is about a third, the company's Vice President Zuzana Brixiova said.

"We expect the probability of a downgrade at less than 50 percent, its closer to around one third," Brixiova told reporters in Johannesburg on Tuesday. The country's growth path will be "very important," she said.

South Africa is struggling to revitalize the economy and contain public debt in the face of warnings by ratings companies of possible downgrades. While Moody's places Africa's most-industrialized country at the second-lowest investment-grade level, Fitch Ratings Ltd. and S&P Global Ratings assess the debt at one level above junk. A decline to non-investment grade could lead to capital outflows at a time when the economy is expanding at the slowest pace since 2009.

Source: Bloomberg News

DE-RISKING IN AFRICA IS ON THE RISE, ACCORDING TO LATEST SWIFT DATA

The latest SWIFT data shows that many countries in Africa have seen a reduction in the number of foreign counterparties, the overseas banks with which African banks transact. The data was part of a new report looking at the impact of global regulations on correspondent banking networks, called 'Addressing the unintended consequences of de-risking – Focus on Africa', which was released at the SWIFT Business Forum South Africa, in Johannesburg.

Correspondent banking enables banks to access products and services that might otherwise be unavailable, while enabling cross-border transactions and access to overseas products and markets. Increasingly, as banks globally respond to new regulatory requirements they are reviewing and rationalising their correspondent banking relationships in jurisdictions where they believe there is greater risk. This is known as de-risking.

Correspondent banking plays a critical role in the global payments landscape," said Hugo Smit, Head of Sub Sahara Africa, SWIFT. "The increase in de-risking in Africa could therefore have damaging consequences across the region. SWIFT's new report illustrates the extent of de-risking in Africa and elsewhere, and aims to support the industry in addressing this growing challenge."

The report shows that de-risking is on the rise in several African countries. South Africa lost more than 10% of its foreign counterparties between 2013 and 2015. In Angola the decline was even steeper, with the number of foreign counterparties dropping by 37% in two years. Mauritius has also seen a sharp decline of 18%.

The data shows that Nigeria's international banking network has experienced limited de-risking. However, local banks have at the same time been cutting their own relationships with other African banks and financial services providers perceived to be risky, such as bureau de change and money transmission companies.

The report looks at some of the potential consequences for the affected countries. These include a significant impact on cross-border trade if countries are cut off from the global financial system. This could lead to issues with the supply chain.

"De-risking creates problems along the supply chain, making it difficult to import and export goods.

This will have a direct impact on levels of poverty and unemployment," says Pattison Boleigha, Chief Conduct and Compliance Officer at Access Bank.

There could also be difficulty in accessing some products and services such as international wire transfers, cash management services and trade finance. If traditional banking channels are no longer available, transactions are likely to be forced into alternative channels, which may be less well regulated.

We could see serious funding gaps emerging, exacerbating an already fragile situation in most markets, says Bleming Nekati, Chief Trade Finance Officer at the African Development Bank. "This will negatively affect the viability of projects and have the effect of slowing down the development drive in Africa. In addition, the increased costs of funds will inevitably be passed on to the end borrowers."

Additionally, de-risking could have a negative impact on financial inclusion rates on a continent where huge proportions of the population are unbanked. Typically it is the smaller, local banks that are de-risked; those that are providing services to local communities. Therefore de-risking could adversely impact the services available to the poorest in society.

SWIFT's report aims to support the industry in overcoming the challenges of de-risking. Smit said: "Banks need to understand the circumstances that lead to de-risking if they want to prevent it from happening to them. Factors include the political and economic landscape in specific African countries, however, transparency over activities, business lines and behaviour is also critical. Data utilities such as SWIFT's KYC Registry for example can contribute to increasing transparency, reducing costs and sharing information in an efficient and standardised way."

Other steps that banks can take to improve the transparency and consistency of their information include:

- Creation of a specific individual or department to create a gold standard data set, the so-called 'golden copy'. This data set can then be sliced and diced before being shared with the market in different ways.
- Compliance controls such as transaction screening.
- Reduction in due diligence costs incurred by correspondents.
- Effective communications of strategies with correspondent banks.
- Greater levels of collaboration and information sharing between banks, regulators and law enforcement.

You can find the full report https://www.swift.com/node/3512.

About SWIFT

SWIFT is a global member-owned cooperative and the world's leading provider of secure financial messaging services. Visit us at www.swift.com.

IMPLEMENTING AN IFRS 9 SOLUTION: CHALLENGES FACED BY FINANCIAL INSTITUTIONS

By **Cayetano Gea-Carrasco**, and **Nihil Patel**, Moody's Analytics

Background

IFRS 9 is a new international standard set forth to address the weaknesses of IAS 39. This article provides an overview of the new standard and analyzes the major challenges financial institutions will face in ensuring compliance. While there is still uncertainty in terms of implementation approaches, we believe IFRS 9 adoption will lead to a more efficient and lower-risk financial system.

As part of the response to the last financial crisis, the International Accounting Standards Board (IASB) recently issued IFRS 9 to resolve the weakness of IAS 39. Under IAS 39, incurred loss resulted in credit loss recognition that was "too little, too late." Improvements under IFRS 9 include a logical model for the classification and measurement of financial instruments, a forward-looking expected credit loss impairment model, and a substantially reformed approach to hedge accounting. The new standard has a wide reach; it is required in more than 100 countries across Europe, the Middle East, Asia, Africa, the Americas, and Oceania. While all financial entities must adopt IFRS 9 by January 1, 2018, many organizations are targeting parallel runs and impact analyses of the end-to-end process (including staging and classification, impairment calculation, and reporting) by mid-2017. Quantitative Impact Studies (QiS), such as European Banking Authority's QiS in Europe, are also accelerating timelines of infrastructure and tactical short-term solutions for an early assessment of the impacts on provision levels.

Implications on financial institutions

IFRS 9 covers three areas with profound implications for financial institutions:

- ***Classification and Measurement:*** IFRS 9 introduces a logical approach for the classification of financial assets driven by cash flow characteristics and the organization's business model in which an asset is held. This principle-based approach replaces existing rule-based requirements which are complex and often difficult to apply.
- ***Impairment:*** Under IFRS 9, the expected credit loss (ECL) model will require more timely recognition of credit losses compared with the incurred loss model of IAS 39. The new standard requires entities to account for expected credit losses using forward-looking information and lowers the threshold for recognition of full lifetime expected losses.
- ***Hedge Accounting:*** IFRS 9 represents a substantial overhaul of hedge accounting that aligns the accounting treatment with risk management activities, enabling entities to better reflect these activities in their financial statements.

IFRS 9 will drive profit and loss, which will affect earnings. In addition, the standard will materially influence financial institutions' financial statements, with impairment calculations most affected. IFRS 9 will lead to changes including the following:

- It will no longer be necessary for a credit event to occur before credit losses are recognized.
- The measurement of allowance of credit loss will depend on the instrument's impairment stages.
- An entity will be required to base its assessment and measurement of expected credit losses on historical, current, and forecast information that is available without undue cost or effort.
- Measurement of financial assets will be aligned with a bank's business model, contractual cash flow of instruments, and future economic scenarios. The forward-looking provision framework will make financial institutions evaluate how economic and credit changes alter their capital and provision levels at each subsequent reporting date.
- An expected credit loss impairment model will also bring significant challenges for auditors given the move from a factual credit event as a driver of provision and toward quantitative credit forecasting approaches and staging classification. In turn, this will create significant risks due to the effect on profitability, capital ratios, fair value measures, and tax rates. Primarily for these reasons, auditors are actively monitoring the development of ECL models and the implementation of IFRS 9 solutions at financial institutions.

Design considerations

From a solution design perspective, ability to track data and manage overrides (for example, due to effect on earnings) will be critical. In addition, multiple processes including those in risk, finance, and accounting groups will need to be integrated for the IFRS 9 provision calculation. In terms of architecture design, an IFRS 9 solution requires multiple layers, including: risk and finance data aggregation layer, model risk management and workflow layer, ECL calculation engine, general ledger (GL) reconciliation layer, and reporting and variance analysis layer. For financial institutions transitioning to IFRS 9, the main architecture design questions involve the business, systems, and processes. Main challenges include the following:

- ***Systems, processes, and automation:*** Systems will need to change significantly in order to calculate and record changes required by IFRS 9 in a cost-effective, scalable way.
- ***ECL calculation engine:*** The calculation engine will need to be robust and flexible. It will need to incorporate facility-level and be adjusted by credit events. The ECL engine will need to support granular calculations and expected modeling challenges. It must have built-in data quality checks and reports, and must be able to define or choose ad hoc economic forecast and scenarios. It must be capable of modeling or importing PD, LGD, and EAD term structures and behavioural metrics affecting cash flows. It must be able to allocate, optimize, and value collateral and credit risk mitigants.
- ***Risk, finance, and accounting integration:*** Previously separate processes will need to integrate, especially from a data and process perspective.
- General ledgers reconciliation: Ledgers will need to reflect IFRS 9 calculations and new impairment metrics. Financial institutions usually have several general ledgers within a single legal entity.
- ***Computational and performance requirements:*** The IFRS 9 forward-looking impairment calculation will require higher volumes of data than the current IAS incurred loss model, Basel guidelines, or stress testing. Institutions will want to do facility-level analyses, and calculations leveraging scalable architecture, such as grid computing processes, will be imperative.
- ***Tax treatment:*** IFRS 9 may affect effective tax rates, as some institutions may leverage IFRS 9 as a tax optimization tool.
- ***Underwriting, risk-adjusted pricing, and limits systems:*** Financial institutions will have to estimate and book an upfront, forward-looking expected loss (either 12-month or lifetime) and monitor for ongoing deterioration of credit quality.
- ***Risk-adjusted pricing metrics:*** Pricing and performance metrics will need to be redesigned and/or expanded (e.g., IFRS 9 based risk-return metrics) in order to be aligned to IFRS 9 dimensions and capital impacts.
- Impairment calculation: Institutions must have the ability to calculate a probability-weighted impairment that incorporates past events, current conditions, and forecasts of future economic conditions. In addition, valuation analysis needs to consider scenario-specific cash flows.
- ***Collateral allocation and valuation:*** Institutions will need to determine how to incorporate collateral effects on the valuation and computation of cash flows for impairment calculation purposes.
- ***Hedge accounting:*** IFRS 9 will affect existing documentation, hedging models, and software systems.
- ***Reporting and financial statements:*** It will be necessary to reconcile with other regulatory rules, including Basel 3, the Dodd-Frank Act, and the Foreign Accounting Tax Compliance Act (FATCA). Institutions will need to reconcile risk and finance data where risk data will be used down to the legal reporting entity level. Additionally, impairment values and variance changes over reporting horizons will need to be included in FINREP reporting by European institutions.
- ***Operational risk:*** This type of risk will increase as a result of changes in systems, models, processes, and data.

Data requirements

Financial institutions will also face additional data requirements to meet IFRS 9-related calculations and ongoing monitoring. These requirements will lead to related challenges, including:

- ***Retrieval of old portfolio data:*** It will be necessary to save old data, which will be especially difficult for transactions originated many years ago.
- ***Classification of transactions at origination:*** There is the need to map products if they can be categorized prior to the calculation. An additional effort would be required to identify products that can be considered out of scope, such as short-term cash facilities and/or covenant-like facilities.
- ***Flexibility of implementation:*** Exact implementation procedures must be able to change depending on data according to the asset classes and model availability. For example, if a granular approach should be applied to a certain part of the portfolio (e.g., corporate) or if it should be aggregated (e.g., retail).
- ***Gather and store data:*** Very granular data must be gathered and stored for any new transactions. Given the IFRS 9 requirements in terms of classification, measurement, impairment calculation, and reporting, financial institutions should expect a need for significant changes to the way they do business, allocate capital, and manage the quality of loans and provisions at origination.

Financial Institutions will face modeling, data, reporting, and infrastructure challenges in terms of reassessing the granularity (e.g., facility level provisioning analysis) and/or credit loss impairment modeling approach, and maintaining consistency in the definition of risk metrics between Basel and IFRS 9 models. Institutions will also face challenges in enhancing their coordination across finance, risk, and business units. Furthermore, considerable uncertainty remains regarding the interpretation of the IFRS 9 standard and modeling approaches. These will likely be fine-tuned after QiS and parallel runs are performed by institutions and regulatory bodies.

Effectively addressing these challenges will enable boards and senior management to make better-informed decisions, proactively manage provisions and effects on capital plans, make forward-looking strategic decisions for risk mitigation in the event of actual stressed conditions, and help in understanding the evolving nature of risk. In the end, a thoughtful, repeatable, and consistent capital planning and impairment analysis should lead to a more sound, lower-risk financial system with more efficient institutions and better allocation of capital, thus enhancing returns for shareholders.

FIX TECHNOLOGY: THREE YEARS ON IN THE NIGERIAN CAPITAL MARKETS

By **Mark Byron**, Managing Director, Barton Heyman Limited

Any analysis of Frontier markets will, inevitably, underline the role of technology and best-in-class operational processes and establish them as key drivers to moving a market from “frontier” to an “emerging markets” classification. Enabling technology and transparent efficient processes are, therefore, essential ingredients for these markets to achieve their full potential; serving both a national need for developmental capital and wealth creation, as well as an international need for portfolio diversification and higher returns. Three years on from defining a roadmap for Technology as an enabler in the Nigerian Capital Markets ecosystem, a lot has been accomplished within in the Nigerian Capital Markets and Banking sectors. The Financial Information eXchange (FIX) protocol has become synonymous with Stock Exchanges, Brokers, Asset Managers, Investment Banks and Retail investors.

When the journey started few had the belief that the dream would turn into reality. Nigeria, now ranks, amongst leading financial markets in the world where Financial Information Exchange Protocol (FIX) has become the standard for pre-trade and trade communication messaging. Brokerage institutions in Nigeria are now happily receiving (Local & Global) orders; and sending trades (electronically) using the FIX protocol.

The Debut and the Aftermath

After two years of development and market readiness, the Trading technology (Nasdaq OMX with FIX Protocol) was launched in the capital markets arena. The next step led the Nigerian Stock Exchange (NSE) to seek engagement with the brokerage community to ensure full compliance with the FIX Protocol. So started the scramble for new trading platforms. The NSE had factored this in as part of the overall technology transformation strategy and as such the uptake of the protocol as a de facto standard led to waves of implementation by Broker firms.

In an interview with the Head of Transformation at the Nigerian Stock Exchange Mr. Olumide Lala, he confirmed that the journey to reach the final FIX destination was perceived back in 2008, when he had been educating the Capital Market players in Nigeria about the benefits of FIX protocol. By the time the Stock Exchange went live with FIX; the top ten brokerage institutions were ready to integrate their various trading applications to the Nasdaq OMX Matching engine.

Once the technology infrastructure had been laid, it was only a question of on-boarding and certification. This took less than a month for most of the brokers to complete and start trading and receiving Market data via the FIX protocol. To date, over 30 brokerage institutions now trade using the protocol. In addition, retail investors can also trade via their mobile apps and applications in real time. The following Case Study highlights the impact of FIX on Trading and Banking systems.

Case study: Top Brokerage institutions and the benefits of FIX

An extensive interview with the Head of Trading of a Major brokerage company in Nigeria reveals the true benefit of the protocol: “The use of FIX has led to tremendous growth across our trading desks (from Lagos to London to Cape town.) We have seen tremendous increase in order flows and revenue, which we can attribute to the FIX protocol. Chief among the benefits FIX has brought to our firm includes:

Economies of scale:
New products have been introduced into their framework (Care Orders; Semi-care orders and Direct Market Access orders);

Expanded trading possibilities:
Increase in number of institutional investors and retail investors and hence, increase in global trading possibilities;

Indirect Network effects:
We now receive orders across the globe from our institutional and retail investors. Prior to the introduction of FIX, we had to rely on Voice messaging and emails;

There is no doubt that FIX is seen as an enabler to business and technology needs and there are future plans for roadshows to encourage more clients to connect with the FIX protocol. There is every confidence that FIX will open up new business possibilities.

“Being among the first to offer an innovative solution with great potential of development in the field of pre-trade securities will help us win new customers. We count on a return of investment within approximately two years.

“In short, thanks to the NSE X-Gen Matching platform and FIX Protocol, straight-through-processing has become a reality for us and our clients.”

The next step

The considerable benefits of the Nasdaq OMX FIX platform to the Nigerian Stock Exchange in particular and the Nigerian Capital Markets in general can be recognized on a number of fronts. The FIX protocol increasingly provides the level playing field for its many market participants while encouraging exchange market differentiation across more value added service areas such as STP, latency, trading platforms and trading strategies and increased market data offerings.

FIX has furthermore been a key enabler for the Stock Exchange to take advantage of economies of scale and provide broader access as well as generate the additional revenues the business requires. The next series of projects revolving round FIX protocol includes: Fixed Income; Derivatives, ETDs and commodities.

Moving on to new frontiers in Africa with FIX

Frontier capital markets that are savvier in the selection, implementation and exploitation of trading technologies, and which underpin these with robust business processes, will not only achieve improved participation and liquidity in their markets, but will also create a basis for market growth. The NSE plans to take the success story of FIX to other markets in Africa, notably, the West African Capital Markets Integration Council (WACMIC.) WACMIC was established to harmonize a regulatory environment for the issuance and trading of securities across the West-African sub region. With the advent of FIX, the future is looking bright for inter-regional and cross-border dealing across the African continent.

In conclusion, astute investors (Retail and Institutional) cannot afford to ignore the critical wave of emerging frontier markets in their proprietary and client portfolios. Nigeria, for example, is the largest African economy, and by 2020 has been predicted to be one of the N11 economies in the world. It continues to grow at an enviable rate of over 6%, annually, in a world of struggling economies. Nigeria is a country with over 170 million people, of which 89 million are of working age. And we are keen believers in technology playing a key enabling role to boost the Capital Market. FIX will have a key role to play in increasing flow of liquidity and bringing new entrants into the market.

Given the current environment of FX instability, currency depression and lull in commodities trading there has never been a better time for the emergence of technology robustness in frontier markets. Investors locally, on the continent and globally can remain confident that as the growth cycle rebounds and the expansion in Retail Banking continues in Africa the technology to drive that growth and expansion provided by the FIX protocol will be well and truly embedded in the Capital Markets and Banking ecosystems.

Contributor's profile

Mark Byron is an Investment Director and co-founder of Barton Heyman Limited. Mark has undertaken several implementations of the FIX messaging protocol and Electronic Trading applications for Exchanges and Brokers. Prior to Barton Heyman, Mark worked at PLUS Markets Group and Fidelity Investments Ltd. He has an MBA from the University of Chicago Booth Graduate School of Business, holds the Investment Management Certificate (IMC) and is a Member of the Society of Investment Professionals. Mark is currently writing a book on Investing in Africa called *Africa Arrives*!

WHAT'S THE AFRICAN CENTRAL BANKS' DOING: KEEPS, SLASHES OR HIKES?

Angola's central bank leaves benchmark lending rate unchanged at 16 pct

The National Bank of Angola (Banco Nacional de Angola, BNA) left its benchmark lending rate unchanged at 16 percent during its latest monetary policy meeting. The Central Bank has raised the Basic Interest Rate three times since the beginning of the year in an effort to combat spiraling inflation; the previous hike was at the monthly meeting in June. Inflation has been soaring due to the successive reductions in fuel subsidies and the weakness of the Kwanza.

Egypt's central bank unexpectedly keeps rates unchanged

Egypt's central bank kept its key interest rates unchanged at a monetary policy meeting, confounding a unanimous forecast by analysts that it would hike borrowing costs to curb inflation. The central bank instead kept its overnight deposit rate at 11.75 percent and its overnight lending rate at 12.75 percent.

Moroccan central bank keeps rates unchanged, sees 4 pct growth in 2017

Morocco's central bank kept its benchmark interest rate unchanged at 2.25, saying the inflation forecast was consistent with its price stability objective. The bank, known as Bank al-Maghrib, said it expected inflation to remain around 1.6 percent in 2016 and fall to 1.2 percent in 2017. Expecting agricultural output to rebound in 2017 from the worst drought in decades to hit North Africa, the bank said growth would jump to 4 percent next year from an estimated 1.4 percent in 2016. It had previously expected the economy to grow by 1.2 percent in 2016

South Africa holds key rate, hints at end of tightening cycle

South Africa's central bank kept interest rates unchanged at 7 percent for a third consecutive time this year, with a weak economic growth outlook balancing out concerns about inflation. The Reserve Bank said the growth outlook remained constrained, but revised upwards its forecast for this year to 0.4 percent growth having previously said the economy would remain at a standstill.

Nigeria central bank keeps benchmark interest rate, cash reserve ratio

Nigeria's central bank left its main lending rate unchanged as it weighed supporting the currency and fighting inflation while propping up an ailing economy. The Monetary Policy Committee held the benchmark rate at 14 percent, Governor Godwin Emefiele stated. Loosening monetary policy now is not advisable as real interest rates are negative, pressure exists on the foreign-exchange market, while inflation is trending upwards, the Governor said. Borrowing at lower rates "will stimulate demand for goods without taking action to boost industrial production of goods. Too much money chasing too few goods will worsen the inflationary condition."

Kenya central bank cuts main lending rate to 10 pct

Kenya's central bank cut its benchmark lending rate by 50 basis points to 10 percent on Tuesday on concerns about sluggish credit growth, its Monetary Policy Committee (MPC) said. Demand pressures on inflation are moderate and inflation is expected to decline in the short term but the committee remains concerned about the persistent slowdown in private sector credit growth," the MPC said in a statement.

Bank of Ghana holds rates; cuts signalled with inflation view

Ghana's central bank kept its benchmark interest rate unchanged for a fifth consecutive meeting after inflation accelerated in August. The Bank of Ghana held the rate at 26 percent, Governor Abdul Nashiru Issahaku stated. Inflation expectations by businesses, consumers and the financial sector also eased on the back of continued stability in the local currency, according to the Governor. While price growth should slow to within target in the second quarter of next year "upside risks to the inflation outlook are the unanticipated shocks" like fuel and utility prices and their second-round effects, he said.

Rwandan central bank maintains its key repo rate at 6.5 percent

Rwanda's central bank on maintained its key repo rate at 6.5 percent, the central bank governor said. Governor John Rwangombwa said average inflation this year was expected to be between 5.7 and 6 percent, while growth was still on track to hit the target of 6 percent.

Tunisia's central bank holds key rate unchanged at 4.25 percent

Tunisia's central bank kept its key interest rate unchanged at 4.25 percent. The bank last cut its main interest rate in October 2015, from 4.75 percent, in a bid to boost economic growth as inflation fell. The inflation rate was 4.9 percent in 2015, down from 5.5 percent in 2014.

Congo Central bank hikes interest rate in bid to contain inflation

Democratic Republic of Congo's central bank has raised the main interest rate from 2 to 7 percent in a bid to contain quickening inflation, the bank said, as low commodity prices continue to batter the economy of Africa's top copper producer.

Botswana's central bank cuts rate 50 bps as inflation declines

Botswana's central bank cut its Bank Rate by 50 basis points to 5.50 percent, saying the current state of the economy and both the domestic and external economic outlook as well as the inflation forecast provides scope for easing monetary policy to support economic activity without undermining maintenance of inflation within the Bank's medium-term objective range of 3-6 percent. It is the first rate cut by the Bank of Botswana since August 2015.

HOW IS AFRICA NAVIGATING THE NEW REALITY: CONTRACTION OR EXPANSION?

African economic growth to dip to 1.6 pct this year
Economic growth in sub-Saharan Africa is likely to slip to 1.6 percent this year, from 3 percent in 2015, due to continuing woes in the continent's largest economies South Africa and Nigeria, a World Bank report stated. Growth will pick up slightly to 2.9 percent next year, according to "Africa's Pulse", the Bank's twice-yearly analysis of economic trends, analysis of economic trends.

Nigeria's economy enter recession in second quarter
Nigeria, Africa's biggest economy, officially slid into recession for the first time in more than 20 years as the statistics office announced a further contraction in the second quarter of the year. The Nigerian Bureau of Statistics (NBS) said that gross domestic product (GDP) contracted by 2.06 percent after shrinking 0.36 in the first quarter. It said the non-oil sector declined due to a weaker currency, while lower prices dragged the oil sector down.

South Africa's economy expands 3.3 percent in second quarter
South Africa's economy expanded by 3.3 percent in the second quarter of 2016 after shrinking by 1.2 percent in the three months to March, Statistics South Africa stated. Gross domestic product also expanded by 0.6 percent on an unadjusted year-on-year basis in the second quarter, compared with 0.1 percent contraction in the previous three months, the agency said.

Tunisia's economic growth slows sharply in second quarter
Tunisia's economic growth slowed sharply in the second quarter to 0.7 percent, the state statistics institute stated, after two major Islamist militant attacks targeting a museum and a beach hotel crippled its tourism industry. In the same period a year earlier, the economy grew 2 percent, and in the first quarter of 2015, it expanded by 1.7 percent.

Morocco GDP growth weakens to 0.5 percent in second quarter
Morocco's economic growth fell to 0.5 percent year-on-year in the second quarter of 2016, slowing from 4.2 percent in the same period last year, after a severe drought hit the agricultural sector, the planning agency said. It had said this year it also expects Moroccan gross domestic product growth to slow to 1.2 percent in the third quarter of the year.

Ghana's economic growth slows in second quarter
Ghana's economic growth slowed to 2.5 percent in the second quarter, compared with a year earlier, as oil production fell, provisional official revealed. The slowdown in the second quarter was mainly due to a halt in oil production caused by a technical fault at the country's main production vessel. In the second quarter of last year, the economy grew by a revised 3.8 percent from a year earlier, the statistics office said.

Kenyan economic expands at 6.2 percent in second quarter
Gross domestic product expanded 6.2 percent from a year earlier in the second quarter compared with 5.9 percent in the previous three months, the Kenya National Bureau of Statistics said. Farming activity, the biggest contributor to output, expanded by 5.5 percent from a revised 4 percent a year earlier and Tourist arrivals increased by 10 percent to 186,685 travellers in the three months.

Namibia's economy contracts 1.2 percent in Q2
Namibia's economy shrunk by 1.2 percent in the second quarter of 2016 compared with a revised 3.4 percent expansion in the first three months of the year, according to statistics agency's website. Construction, hospitality and mining sectors were the largest contributors to the decline, contracting 19.9 percent, 15.5 percent and 13.2 percent respectively in the quarter.

Tanzania's economy grew 7.9 percent in second quarter
Tanzania's economy grew 7.9 percent in the second quarter of 2016, compared to 5.8 percent during the same time last year, the state-run National Bureau of Statistics stated. The growth of GDP in the second quarter was driven by mining, manufacturing and energy sectors. The increased production of natural gas has significantly boosted electricity generation in the country. Tanzania's growth in the first quarter was 5.5 percent.

Ivory Coast projects GDP growth of 8.9 percent in 2017
Ivory Coast's government projected on Wednesday that its economy will grow by 8.9 percent in 2017 as it approved a 6.501 trillion CFA franc ($11.11 billion) budget for the coming year, a government spokesman said. The budget marks an increase of 12 percent over the current year, spokesman Bruno Kone told reporters at a news conference following a cabinet meeting in the commercial capital Abidjan.

Mauritius cuts 2016 growth forecast; agriculture, manufacturing seen slowing
Mauritius' economy is expected to grow by 3.7 percent this year, from a previous forecast of 3.9 percent in June, due to an expected slowdown in agriculture and manufacturing and no growth in construction, the statistics office said. The Indian Ocean island economy expanded by 3.0 percent in 2015, after the statistics agency in June changed its base year for compiling data to 2013 from 2007 used previously.

WHAT'S THE CONTINENT'S INFLATION RATE DOING: FALLING OR RISING?

Angola inflation rises to 38 percent year-on-year in August
Angola's inflation quickened to 38.18 percent year-on-year in August from 35.3 percent in July, data from the national statistics agency. Prices increased at a slower pace in August, to 3.3 percent month-on-month from 4.04 percent in July. Rwandan inflation fell to 6.4 percent year-on-year in August from 6.9 percent in July, the state-run statistics office said on Saturday.

Botswana inflation slows to 2.6 percent in August
Botswana's consumer inflation slowed to 2.6 percent year-on-year in August from 2.7 percent in July, data from the statistics office showed. On a month-on-month basis, prices rose 0.2 percent in August after a 0.1 percent increase the previous month, Statistics Botswana stated.

Egypt's inflation jumps to 15.5 percent in August
Egypt's annual urban consumer price inflation jumped to 15.5 percent in August from 14 percent in July, the official statistics agency CAPMAS said. Egypt's urban consumer price inflation figure had been rising since April but the figure was unchanged in July, raising hopes among some economists that the impact of currency devaluation earlier this year had begun to fade.

Ethiopia's inflation slows to 5.9 percent in August
Ethiopia's inflation slowed to 5.9 percent in August from 6.0 percent the previous month, thanks to a slower rise in non-food prices, official data released. The Central Statistics Agency said non-food inflation was 7.6 percent in August from 8.3 percent the previous month. Food inflation rose to 4.4 percent from 4.1 percent in July.

Ghana consumer inflation rises to 16.9 pct in August
Ghana's annual consumer price inflation rose to 16.9 percent in August from 16.7 percent in July, the statistics office said. The West African country is implementing a three-year aid programme with the International Monetary Fund to remedy fiscal problems that include inflation that for years has exceeded government targets.

Kenya's inflation falls to 6.26 percent in August
Kenya's inflation fell slightly to 6.26 percent year-on-year in August from 6.39 percent the previous month, the statistics office said. The Kenya National Bureau of Statistics said in a statement that on a month-on-month basis, inflation was at 0.08 percent.

Nigerian inflation rises to 17.6 percent in August
Annual inflation in Nigeria accelerated to 17.6 percent in August from 17.1 percent in July, the statistics office said on Friday. The Nigerian Bureau of Statistics (NBS) also said food inflation rose to 16.4 percent in August, from 15.8 percent in July.

Rwanda's inflation at 6.4 percent yr/yr in August
In August 2016, Rwanda's Consumer Price Index (CPI) increased by 6.4 percent year on year, thereby easing from 6.9 percent year on year recorded in July 2016. For the last three months, "Food prices" have been the main driver of the recent increase in CPI. The year on year inflation for "Food and non- alcoholic beverages" reached 12 percent in August 2016. Other main drivers were as usual "Transport" and "Housing, water, electricity, gas and other fuels" with a year on year inflation of 8.6 and 3 percent respectively.

Seychelles inflation at -1.6 percent yr/yr in August
Seychelles inflation was -1.6 percent year-on-year in August from -0.7 percent a month earlier, the statistics office said. Inflation was -0.6 percent month-on-month from 0.8 percent in July, the National Bureau of Statistics said in a statement.

South African annual inflation eases further in August
South African inflation inched down from 6.0% in July to 5.9% in August, thus hitting the lowest reading in eight months. This brings inflation just below the upper threshold of the Central Bank's target range of 3.0%–6.0%. Annual average inflation inched up from 5.7% in July to 5.8% in August.

Tanzania annual inflation slows to 4.9 percent in August
Tanzanian inflation edged down in August after food and fuel prices rose more slowly, the statistics office said. The state-run National Bureau of Statistics said inflation fell to 4.9 percent year-on-year last month from 5.1 percent in July. Month on month, the headline inflation rate was 0.2 percent in August.

Uganda annual inflation falls to 4.8 percent in August
Uganda's inflation fell to 4.8 percent year-on-year in August from 5.1 percent a month earlier, the statistics office said. Core inflation - which the central bank monitors for monetary policy purposes - also dropped to 4.9 percent from 5.6 percent in July.

Zambia's inflation slows to 19.6 percent in August
Zambia's inflation slowed to 19.6 percent year-on-year in August from 20.2 percent in July, due to a decrease in food prices, the central statistical office (CSO) stated. The monthly inflation rate inched up to 0.4 percent from 0.1 percent in July, the statistics agency said.

Zimbabwe annual consumer prices fall 1.43 percent in August
Zimbabwe's consumer prices declined 1.43 percent year-on-year in August, after contracting 1.60 percent in July, data from the national statistics agency. On a month-on-month basis, prices declined 0.13 percent after a 0.19 percent fall previously, Zimstats said.

AFRICAN EQUITY MARKET INDICATORS AS AT 30-SEPTEMBER-2016

Country Name	Index Name	Index at 30-Sept	1-month % Δ	YTD % Δ	1-Year % Δ	1-Year Low	1-Year High	30 Days Volatility %
Botswana	BSE DCI	9,797	2.52	-7.60	-7.79	9,504	10,655	2.710
BRVM	IC Comp	285	-1.62	-6.19	-4.34	281	321	11.473
Egypt	EGX 30	7,881	-3.39	12.49	7.48	5,526	8,481	12.861
Ghana	GSE ALSI	1,847	2.33	-7.39	-8.07	1,746	2,039	13.339
Kenya	FTSE NSE15	137	1.34	-6.14	-6.92	130	148	22.390
Malawi	MSE ALSI	13,744	4.32	-5.62	-13.15	12,478	15,825	5.771
Mauritius	SEMDEX	1,830	0.90	1.06	-4.20	1,738	1,920	3.194
Morocco	MORALSI	10,039	1.81	12.47	10.15	8,790	10,235	4.168
Namibia	Local	1,032	2.76	19.29	7.47	767	1,072	20.077
Nigeria	NIG ALSI	28,335	2.67	-1.07	-9.23	22,331	31,256	14.183
Rwanda	RSEASI	128	-0.26	-1.90	-5.41	128	138	1.823
South Africa	JSE ALSI	51,950	-1.49	2.48	3.72	45,976	54,761	15.752
Swaziland	SSX ALSI	368	0.00	12.52	19.42	308	368	0.000
Tanzania	DAR ALSI	2,478	4.38	6.19	-2.09	2,173	5,005	31.224
Tunisia	TUNIS	5,342	-1.55	5.94	1.27	4,812	5,563	3.906
Uganda	USE ALSI	1,536	8.05	-12.94	-20.19	1,419	1,927	25.611
Zambia	LuSE ALSI	4,321	-1.44	-24.66	-25.51	4,293	5,801	11.998
Zimbabwe	IDX (USD)	98.96	-0.30	-13.84	-24.99	93	132	8.489

SELECTED AFRICAN CURRENCY EXCHANGE Vs. US DOLLAR AS AT 30-SEPTEMBER-2016

Country Name	Currency Name	Index at 30-Sept	1-month % Δ	YTD % Δ	1-Year % Δ	1-Year Low	1-Year High	30 Days Volatility %
Algeria	Dinar	109.67	-0.08	-2.34	-3.16	103.80	111.32	2.897
Angola	Kwanza	166.95	1.36	-19.00	-18.93	133.90	169.43	16.641
Botswana	Pula	0.10	3.91	7.30	0.84	0.08	0.10	10.675
CFA Franc	CFA Franc	592.23	0.78	4.44	0.25	567.51	633.62	9.283
Egypt	Pounds	8.88	-1.11	-11.88	-11.92	7.77	8.96	5.497
Ethiopia	Birr	22.26	-0.56	-4.82	-5.26	20.36	22.33	4.401
Ghana	Cedi	3.98	-0.48	-4.40	-5.78	3.43	4.27	10.363
Kenya	Shillings	101.27	-0.02	1.02	3.50	100.18	105.56	1.267
Malawi	Kwacha	721.39	-0.05	-7.43	-23.02	544.80	757.03	1.428
Mauritius	Rupee	35.48	-0.79	1.04	-0.17	34.61	1,769.60	5.269
Morocco	Dirham	9.72	0.41	2.16	0.12	9.23	10.20	3.880
Mozambique	Metical	78.08	-6.86	-38.52	-45.57	42.29	78.78	16.740
Nigeria	Naira	315.00	-0.24	-36.73	-36.74	196.48	350.25	24.874
Rwanda	Franc	805.71	-0.46	-7.54	-6.73	708.50	828.00	0.676
South Africa	Rand	13.76	7.03	12.39	0.66	13.01	17.92	21.779
Tanzania	Shilling	2,181.00	0.23	-1.45	-0.50	2,117.49	2,220.00	1.047
Tunisia	Dinar	2.20	0.50	-7.08	-10.48	1.93	2.25	5.514
Uganda	Shilling	3,389.00	-0.41	-0.50	8.94	3,302.50	3,705.00	2.312
Zambia	Kwacha	10,025	-4.9377	9.7257	20.20	9,110	14,605	16.034

SELECTED AFRICAN GOVERNMENT INTERNATIONAL BONDS AS AT 30-SEPTEMBER-2016

Country Name	Maturity	Price at 30-Sept	Mid-Yield at 30-Sept	1-month Yield Chg (%)	YTD Price Change (%)	Price 1-Year Low	Price 1-Year High	Amount Outstanding (US$ M)
Angola	12-Nov-25	99.826	9.526	0.067	7.167	78.535	102.806	USD
Cameroon	19-Nov-25	111.195	7.762	-0.035	19.296	81.683	113.384	USD
Congo	30-Jun-29	69.324	10.145	-0.276	-12.099	66.397	84.096	USD
Cameroon	19-Nov-25	111.195	7.762	-0.035	19.296	81.683	113.384	USD
Egypt	30-Apr-40	96.665	7.170	0.040	17.755	79.322	100.290	USD
Ethiopia	11-Dec-24	99.156	6.759	-0.137	11.663	82.037	100.503	USD
Gabon	16-Jun-25	92.295	8.204	0.293	15.448	69.735	96.664	USD
Ghana	14-Oct-30	117.144	8.620	-0.428	15.076	87.092	117.640	USD
Kenya	24-Jun-22	98.528	7.124	-0.065	12.085	83.919	100.688	USD
Ivory Coast	31-Dec-32	98.739	5.935	0.117	10.643	83.659	101.499	USD
Morocco	11-Dec-42	114.768	4.531	0.173	18.605	92.194	118.426	USD
Namibia	29-Oct-25	105.953	4.445	0.062	13.224	88.524	108.052	USD
Nigeria	12-Jul-23	98.766	6.602	0.175	12.169	84.651	101.380	USD
Rwanda	02-May-23	101.433	6.354	0.149	5.800	92.349	102.978	USD
Senegal	30-Jul-24	103.758	5.648	-0.152	15.686	84.764	105.956	USD
South Africa	24-Jul-44	108.810	4.797	0.057	20.232	85.925	116.000	USD
Tanzania	09-Mar-20	104.745	5.726	-0.187	10.535	92.702	105.644	USD
Tunisia	19-Sep-27	98.436	8.787	0.019	23.463	66.194	101.494	USD
Zambia	30-Jul-27	98.965	9.119	-0.072	24.794	65.003	102.284	USD

Compiled by Capital Markets in Africa