August 6, 2026

RESEARCH NOTE NO.4 – 2026 (RN/4/26)

A call to hold the Central Bank Rate Unchanged to Support growth and price stability

Highlights

The decision of the Monetary Policy Committee (MPC) of the Central Bank of Kenya in its meeting scheduled for **11th August 2026** is likely to be underpinned by the following developments:

- **First, overall** inflation remains within the target range, with minimal threat of demand-driven inflationary pressures that continue to outweigh elevated supply-side pressures;

- **Second**, domestic economic growth remains resilient, supported by stronger industry and services, but facing headwinds from geopolitical tensions, weaker global demand and widening fiscal deficits;

- **Third**, easier financial conditions from previous policy rate cuts have been transmitted through lower lending rates and improved private sector credit growth; and

- **Fourth**, the Kenya shilling remains stable, supported by resilient external inflows and stronger foreign exchange reserves despite the widening of the current account deficit.

*"**With** Inflation within the target range, and exchange rate stability achieved, there is merit in sustaining the current stance of monetary policy, to support the recovery in private sector credit and economic activity………"*

With inflation currently anchored within the target range and minimal threats to its escalation in the near term, as well as sustained exchange rate stability, we view that maintaining the current stance of monetary policy in keeping the CBR unchanged at 8.75% would be appropriate to support private sector credit growth and strengthen economic activity.

Background

The MPC's decision on **11th August 2026** decision is likely to be shaped by four significant developments:

First, overall inflation remains within the target range, with minimal threat of demand-driven inflationary pressures that continue to outweigh elevated supply-side pressures. Headline inflation rose slightly to 6.5% in July 2026 from 6.4% in June 2026 and 6.7% in May 2026, remaining within the target band **(Figure 1a)**.

Core inflation, that represents demand pressure in the economy, remained broadly stable at 3.2% in July 2026, compared to 3.1% in June 2026 and 3.2% recorded in May 2026 **(Figure 1b)**. However, non-core inflation remained elevated compared to historical levels, underscoring the continued supply-side pressure on headline inflation.

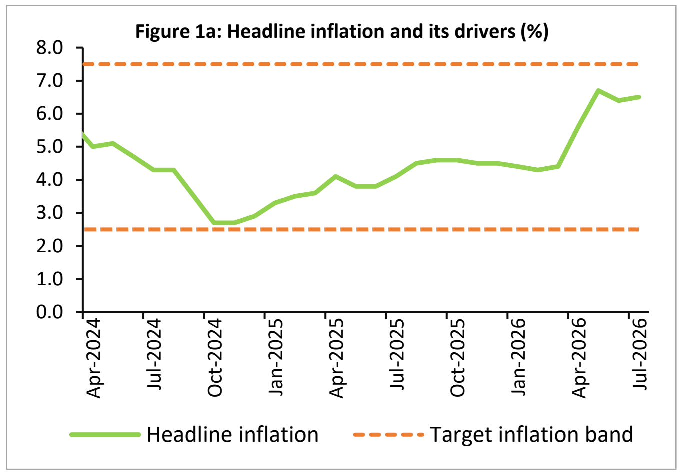
In particular, non-core inflation remained virtually unchanged at 15.0% in July 2026 compared to June, though lower than 16.0% in May 2026 **(Figure 1b)**. The elevated outturn was primarily driven by a sharp 9.0% annual increase in food and non-alcoholic beverage prices, specifically tomatoes and kales, alongside a 15.6% rise in transport costs occasioned by oil pump price increases.

Inflation outlook faces risks primarily from protracted geopolitical tensions and heightened volatility in global commodity markets. The escalation of the Middle East conflict has disrupted global energy and food supply chains, resulting in higher crude oil, natural gas and food prices, with the potential to transmit imported inflation through increased fuel, transport and production costs.

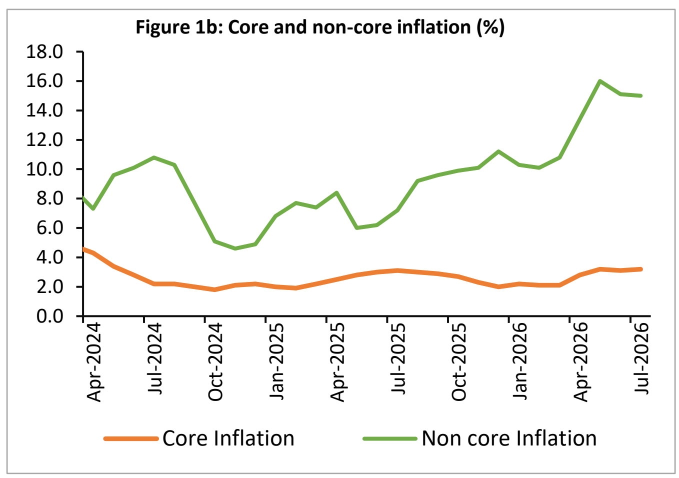
Although IMF projects that global inflation will moderate in 2027 **(Figure 1c)** as supply conditions improve and commodity prices gradually stabilize, uncertainty surrounding energy markets remains high, increasing the likelihood of renewed price pressures.

Accordingly, the focus for Kenyan economy going forward should be on preventing temporary cost-push shocks from becoming entrenched in inflation and inflationary expectations, and to safeguard short- to medium-term price stability through continued Government measures to minimize oil price increases.

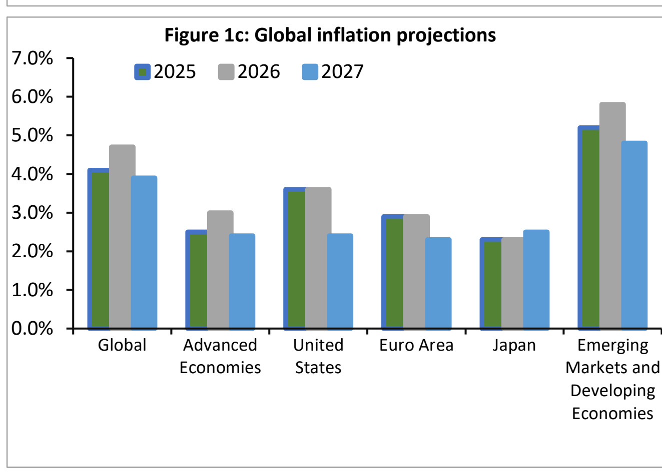
Figure 1: Inflation trends and drivers



Source: KNBS



Source: KNBS

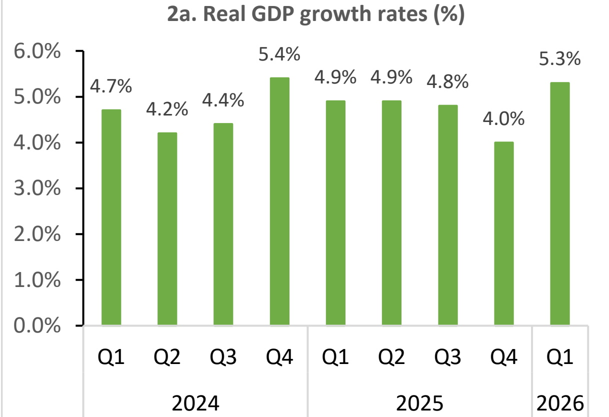


Source: IMF

Second, domestic economic growth remains resilient, supported by stronger industry and services, but facing headwinds from geopolitical tensions, weaker global demand and widening fiscal deficits. The domestic economy during the first quarter of 2026, grew by 5.3%, up from 4.9% in the first quarter of 2025 (**Figure 2a)**. This improvement was largely driven by strong industrial rebound and sustained expansion in the services sector **(Figure 2b)**. Industrial growth strengthened by 5.4% on account of increased production of sugar, soft drinks, assembled vehicles, cement and galvanized sheets. Mining, quarrying and construction sectors also contributed significantly to the stronger industrial performance. The services sector continued its steady growth trajectory, expanding by 5.5% in the first quarter of 2026, supported by robust growth in accommodation and food services as tourism and hospitality activities surged. In contrast, the agriculture sector moderated to 4.9% in the same quarter due to weaker coffee and fruit exports, despite improved tea, cane and milk production.

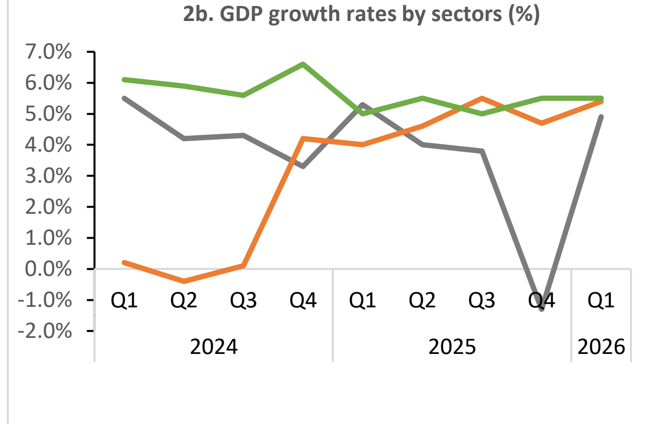
Business sentiment in June improved, with the Purchasing Managers' Index rising to the neutral 50 mark from 46.6 in May 2026 **(Figure 2c);** signalling stabilizing business conditions with modest growth in new orders, stronger business confidence, inventory restocking and notable employment gains. Nonetheless, persistent output weakness, supplier delays and elevated fuel-driven input cost pressures continue to prevail. Moreover, the outlook remains clouded by downside risks from the Middle East conflict, which has disrupted global trade, heightened energy market volatility and slowed global growth to a projected 3.0% in 2026 down from 3.5% in 2025 **(Table 2d)**.

Figure 2: Domestic and Global GDP growth outlook



2a. Real GDP growth rates (%)

Source: KNBS



2b. GDP growth rates by sectors (%)

Source: KNBS

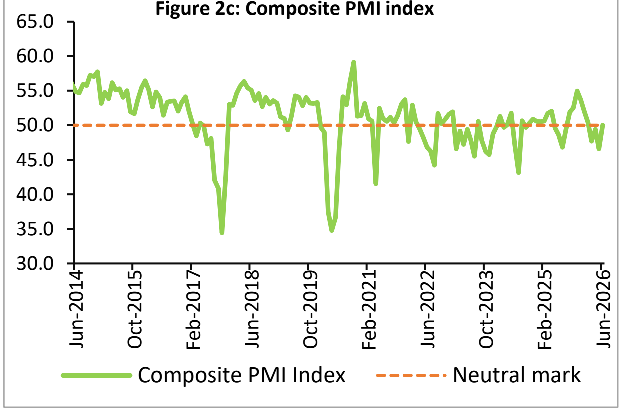


Figure 2c: Composite PMI index

Source: IHS Markit

Table 2d: Global Economy growth and projections

		Projections	
	2025	**2026**	**2027**
World Output	**3.5**	**3.0**	**3.4**
Advanced Economies	**1.9**	**1.7**	**1.8**
United States	2.1	2.3	2.2
Euro Area	1.4	0.9	1.2
Japan	1.1	0.6	0.7
Emerging and Developing Economies	**4.5**	**3.8**	**4.5**
China	5.0	4.6	4.1
India	7.7	6.4	7.1
Sub-Saharan Africa			
Nigeria	4.0	4.1	4.3
South Africa	1.1	1.1	1.3

Source: IMF

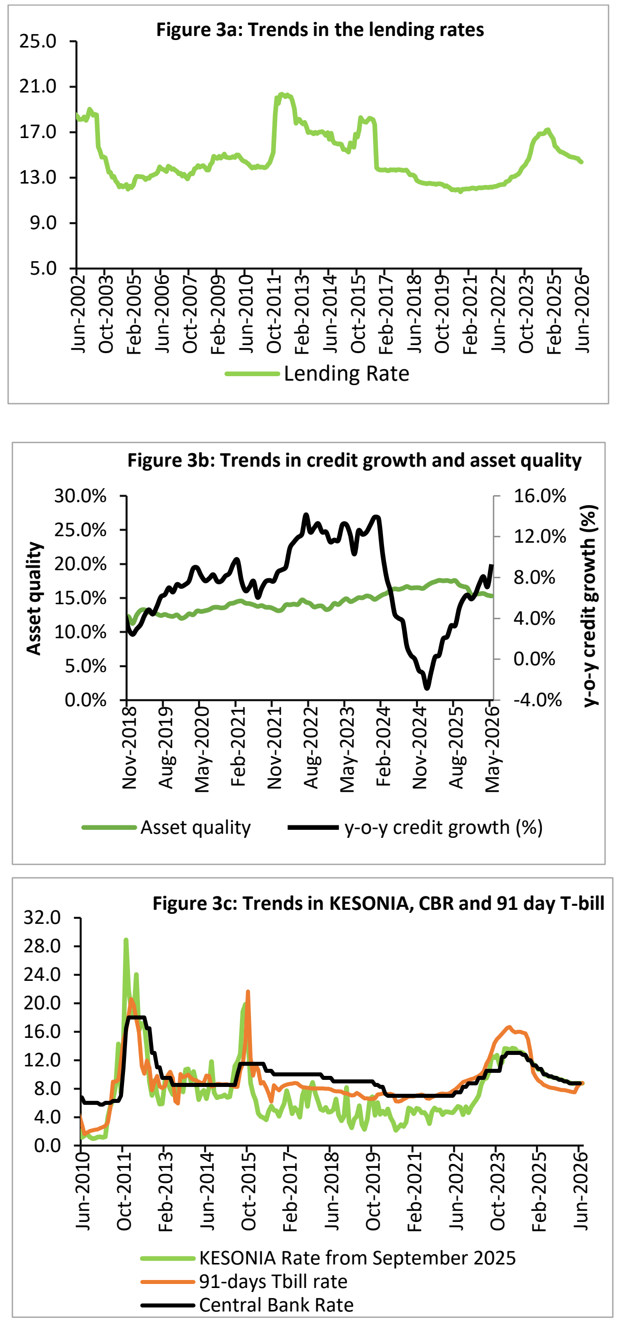
Going forward, the risks to growth in the domestic economy are two-pronged. First is the projected slowdown in global growth in 2026 on geopolitical tensions and conflict in the Middle East, rising inflation and remedial measures through tighter financial conditions. This portends weaker external demand for Kenyan exports. Second, is the widening domestic fiscal imbalance with overall fiscal deficit projected to widen from 5.3% of GDP in FY2023/24 to 6.5% of GDP in FY2025/26. Persistent government revenue shortfalls and rising financing needs have increased reliance on domestic borrowing, and raised financing costs, constrain fiscal space and dampen private investment, thereby moderating the pace of economic expansion.

Third, easier financial conditions from previous policy rate cuts have been transmitted through lower lending rates and improved private sector credit growth. Previous successive cuts in the Central Bank Rate (CBR) continue to be transmitted effectively through the banking system, with evident improved liquidity conditions, lower lending rates, and strengthening private sector credit growth.

In particular, the average lending rate declined steadily from 16.64% in January 2025 to 14.82% in December 2025 and further to 14.5% in May 2026 **(Figure 3a)**. Consequently, private sector credit growth rebounded significantly, rising from 7.4% in February 2026 to 9.3% in May 2026. As private sector credit grew, the industry NPL ratio improved from 15.61% in February 2026 to 15.41% in April 2026 and further to 15.3% in May 2026 **(Figure 3b)**. Short-term money market rates remained well anchored around the Central Bank Rate (CBR), while the 91-day Treasury bill rate that had eased from 7.62% in February to 7.5% in April 2026, edged up to 8.23% in May 2026 **(Figure 3c);** as the Government borrowing requirements increased towards the end of the fiscal year.

Going forward, the interest rate path is expected to remain broadly unchanged, on account of two key considerations. First, major central banks are expected to maintain a cautious monetary policy stance amid persistent geopolitical tensions, elevated energy prices and lingering inflationary pressures. Accordingly, the US Federal Reserve and the European Central Bank kept their policy rates unchanged at 3.625% and 2.25% in June and July 2026. Second, domestic monetary policy transmission continues to strengthen, with lower lending rates, improving liquidity and rising private sector credit supporting economic activity without catalyzing excessive demand-driven inflation.

Figure 3: Developments in the Credit Market

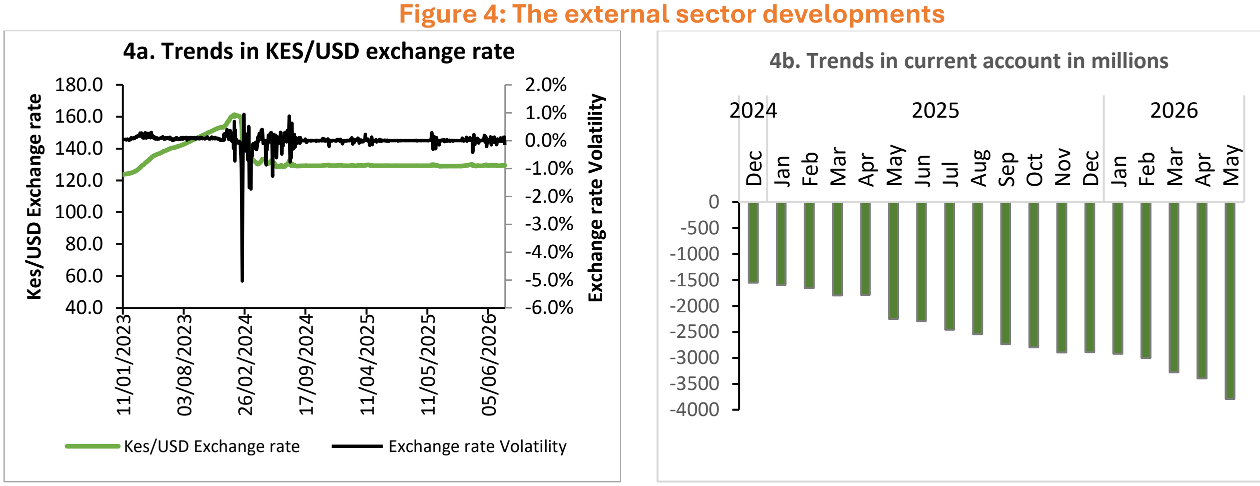


Source: CBK

Fourth, the Kenya shilling remains stable, supported by resilient external inflows and stronger foreign exchange reserves despite the widening of the current account deficit. The exchange rate has remained stable trading within narrow margins (**Figure 4a)**, supported by strong inflows and buildup in official foreign exchange reserves to USD 15.4 billion by 30th July 2026 (equivalent to 6.4 months of import cover, well above the statutory requirement of 4 months). Strong tourism receipts, transport services and resilient diaspora remittances of USD 7.49 billion continued to provide a reliable source of foreign exchange, while sustained foreign direct investment and portfolio inflows supported external financing. Despite the notable exchange rate stability, Kenya's external sector faces mounting pressure from a widening current account deficit, which increased from USD 2.25 billion in May 2025 to USD 3.79 billion in May 2026 **(Figure 4b)**, reflecting a stronger import bill on elevated global commodity prices.

Going forward, the strong level of official foreign exchange reserve buffers and resilient foreign exchange inflows are expected to provide a cushion against these external shocks, support exchange rate stability and preserve macroeconomic confidence. A notable downside risk to the external sector stems from the recent surge in global oil prices following heightened geopolitical tensions, which could increase Kenya's fuel import bill, further widen the current account deficit and exert depreciation pressures on the shilling.

Figure 4: The external sector developments



Source: CBK and KNBS

Conclusion

With inflation currently anchored within the target range and minimal threats to its escalation in the near term, as well as sustained exchange rate stability, we view that maintaining the current stance of monetary policy in keeping the CBR unchanged at 8.75% would be appropriate to support private sector credit growth and strengthen economic activity.