2 October 2025

RESEARCH NOTE NO.80 – 2025 (RN/80/25)

There is Scope for a Further Cut in the Central Bank Rate

Highlights

The decision of the Monetary Policy Committee (MPC) of the Central Bank of Kenya at its meeting scheduled for **7th October 2025** is expected to be underpinned mainly by the following developments:

> ***"Given low inflation, there is scope for a further cut in the Policy Rate to support credit expansion and anchor stronger economic growth ..***

- **First**, overall inflation remains low and inflation expectations in the short to medium term are anchored within the target range;
- **Second**, while the domestic economy depicts resilience with a recorded growth of 5.0% in the second quarter of 2025, downside risks persisted in the third quarter primarily on weak demand;
- **Third**, private sector credit, despite the positive investor sentiment, remain under strain amidst elevated NPLs;
- **Fourth**, the Kenya Shilling remains stable, supported by strong foreign exchange reserves, resilient remittances, a stable current account deficit and ensuing favorable interest rate differentials with the recent Federal reserve rate cut.

In view of these developments, ***we opine that there is scope to cut the Central Bank Rate (CBR)*** *to provide impetus for a stronger private sector credit growth and anchor economic growth.*

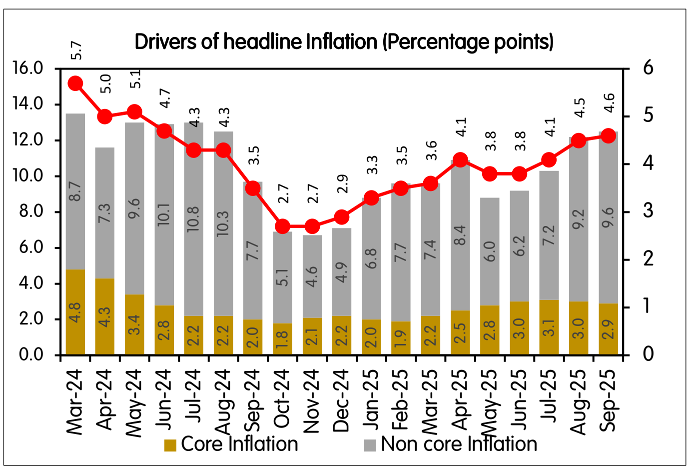
Background

At its meeting on **7th October 2025**, the Monetary Policy Committee (MPC) is expected to anchor its policy decision on four interlinked global and domestic developments.

First, overall inflation remains low and inflation expectations in the short to medium term are anchored within the target range. In September 2025, overall inflation continued on an upward trajectory, rising to 4.6%, largely due to seasonal food price hikes that pushed up non-core inflation from 9.2% in August 2025 to 9.6% in September 2025. However, core inflation, that reflects demand conditions in the economy, eased slightly to 2.9% in September from 3.0% in August **(Figure 1a).** Global oil prices edged up slightly in the period **(Figure 1b)**, reflecting recent OPEC+ policies affecting production and protracted geopolitical conflicts. Moreover, the spillover effects of the U.S. trade policies continue to weigh heavily on Kenya's inflation outlook. Other risks of higher inflation are associated with the sticky U.S. inflation **(Figure 1c)** that continue to exert pressure on import costs for Kenya. Going forward, S&P Global Market Intelligence forecasts Kenya's inflation to average 4.1% in 2025, 4.8% in 2026 and 4.3% in 2027 **(Figure 1d)**, remaining moderate but vulnerable to external shocks.

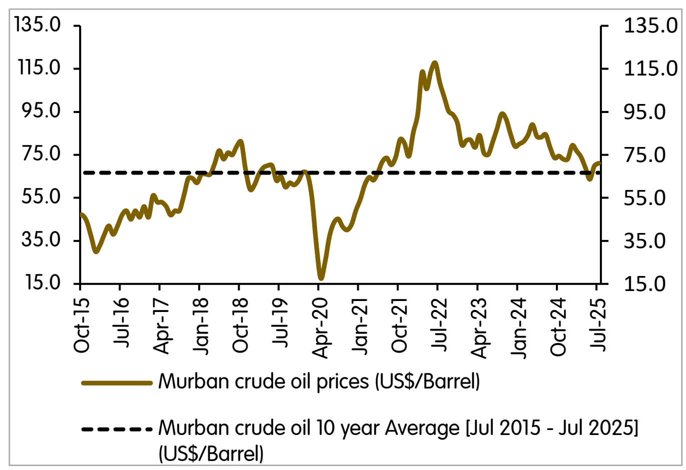
Figure 1: Inflation trends and components

1a: Headline inflation and its components



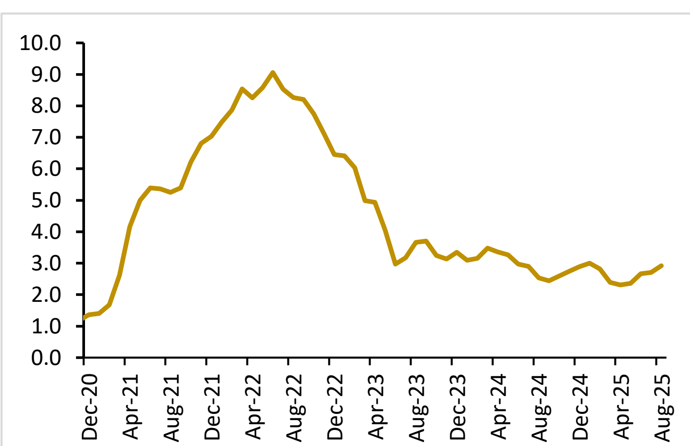
Source: *KNBS*

1b: Trends in Murban crude oil prices (US$/Barrel)



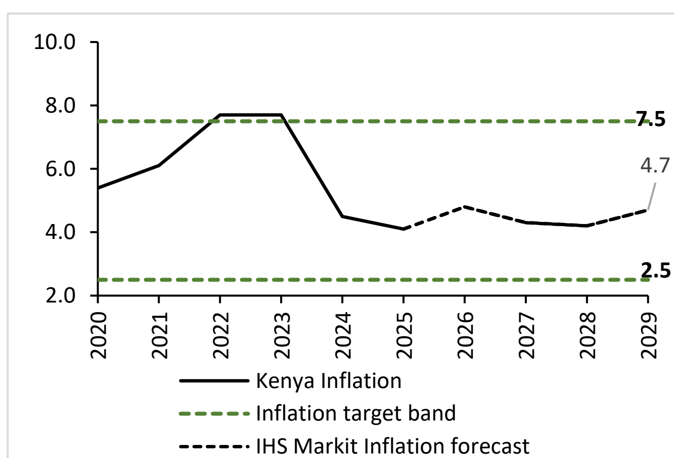
Source: *Oilprices.com*

1c: Trends in Overall Inflation in USA



Source: *U.S. Bureau of Labor Statistics (BLS)*

1d: Inflation forecast



Source: *IHS Markit*

Second, while the domestic economy depicts resilience with a recorded growth of 5.0% in the second quarter of 2025, downside risks persisted in the third quarter primarily on weak demand. The global economic growth, estimated at 2.8% in 2024 and projected at 2.6% for 2025 and 2.7% in 2026 and 2027 **(Table 2a)**, depicts fragility on rising protectionism, tighter financial conditions and persistent geopolitical tensions. Trade barriers, US tariffs amidst the expiry of AGOA in September 2025 and disruptions from Russia-Ukraine conflict and the Israel - Palestinian / Middle East tensions continue to weigh on trade and investment. Against this backdrop, Kenya's economy that recorded a strong growth of 5.0% in the second quarter of 2025 **(Figure 2b),** is expected to depict a moderation in growth in the remainder of 2025, if not stimulated with a faster growth in private sector credit.

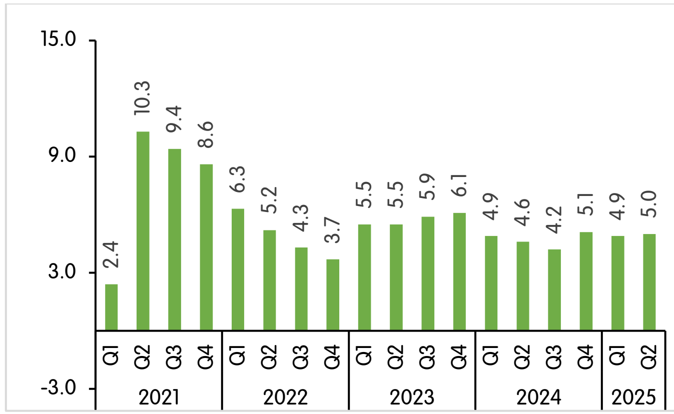
Figure 2: Economic growth and outlook

Table 2a: Global Economic Outlook for selected countries

	2024	2025	2026	2027
		Projections		
World Output	**2.8**	**2.6**	**2.7**	**2.7**
United States	2.8	1.9	2.3	1.8
Canada	1.6	1.1	1.4	2.0
Brazil	3.0	2.4	2.1	3.1
United Kingdom	1.1	1.3	1.1	1.5
Euro Zone	0.8	1.3	1.0	1.4
Russia	4.3	1.2	2.0	2.2
Mainland China	5.0	4.8	4.3	4.3
Japan	0.1	1.2	0.6	0.7
India*	6.5	6.2	6.3	6.5

** Fiscal year starting April 1, 2023.*

Figure 2b: Real GDP Growth rates



***Source**: S&P Global Market Intelligence*

Moreover, global business expectations for the next 12 months slipped to one of the lowest levels since the early months of the COVID-19 pandemic **(Figure 2c)**. According to the global PMI, companies cited geopolitical uncertainty and US trade policy as the most common causes of reduced confidence. In major developed economies, business expectations are the lowest relative to the long-run averages in the US and Canada, where sentiment worsened in August. Relatively weak and deteriorating sentiment was also recorded in the Eurozone. Sentiment picked up in Australia, Japan and the UK, albeit remaining below long-run averages. In the larger emerging economies, sentiment generally improved in August, but it remained weak in mainland China and Brazil.

In Kenya, however, the August 2025 PMI data signaled a softer decline in operating conditions, with the composite index rising to 49.2, from a low of 46.8 in July 2025 **(Table 2d).** The businesses showed a greater optimism towards future output, with August 2025 recording a high of 62.5. However, structural challenges remain, including weak aggregate demand, rising staff costs and input prices, which threaten medium-term growth momentum. Hence, going forward, Kenya's longer-term outlook hinges on expanding credit and investment, sustaining business confidence, and navigating external risks, particularly trade protectionism, to drive growth towards its long-term trajectory.

2c: Global PMI output expectations

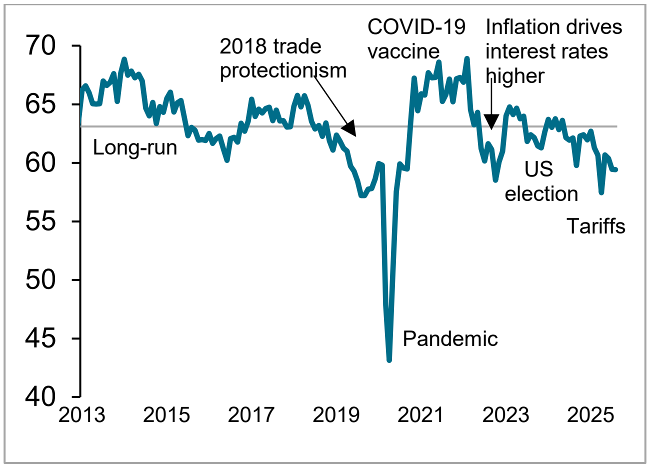


Figure 2d: Kenya PMI index and Sub-indices

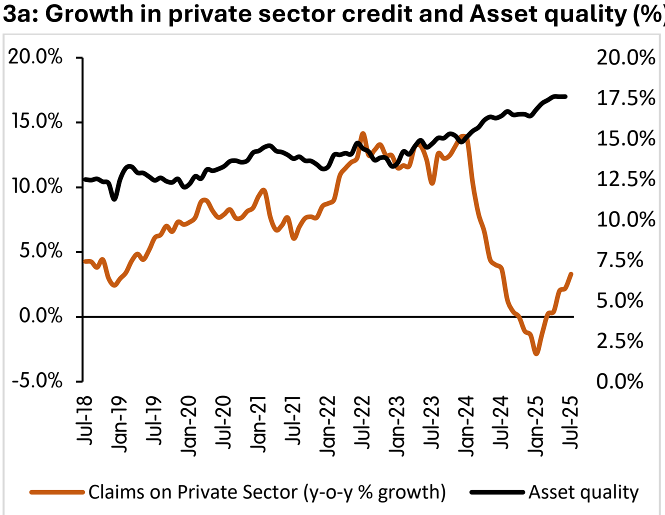
	2025		
	June	July	Aug
Composite PMI Index	**48.8**	**46.8**	**49.4**
Input prices	53.6	54.6	54.1
Output	51.3	52.6	50.4
New Orders	47.6	44.6	49.7
Employment	50.8	50.6	51.4
Suppliers Delivery Times	51.5	51.0	52.3
Stock of purchases	53.5	49.6	51.3

Source: IHS Markit

Third, private sector credit, despite the positive investor sentiment, remain under strain amidst elevated NPLs. Private-sector credit growth was up by 3.3% in August 2025, marking its seventh successive mild growth since its 2.9% contraction recorded in January 2025 **(Figure 3a)**. Despite this, asset quality remains a major concern, with the NPL ratio rising to 17.6% by June 2025. With declining money market interest rates, there is a notable recovery in the equity market with investor sentiment in Kenyan assets showing resilience, consistent with the recovery evident in the global equity markets, where global equities are now trading at (or above) levels observed at the start of 2025 **(Figure 3b)**. All the NSE indices posted gains in September 2025.

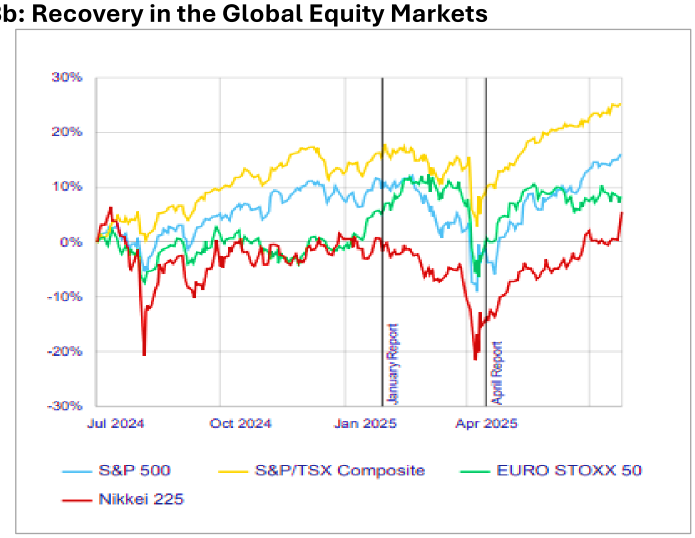
Figure 3: Credit Market Developments

3a: Growth in private sector credit and Asset quality (%)



Source: CBK

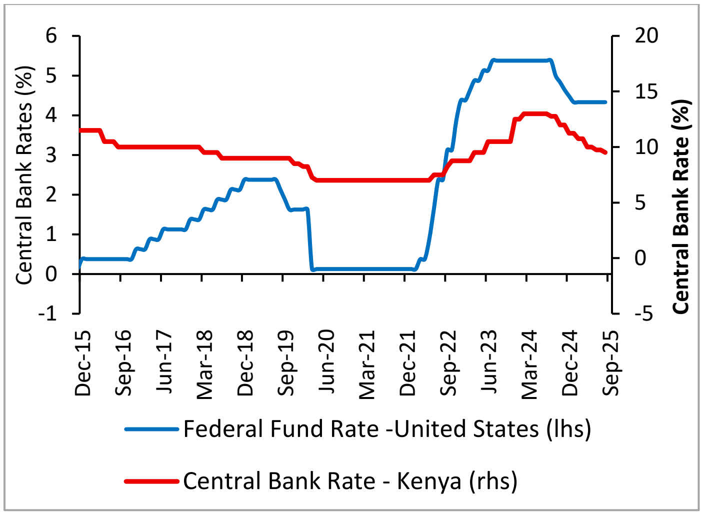
3b: Recovery in the Global Equity Markets



Source: Bloomberg

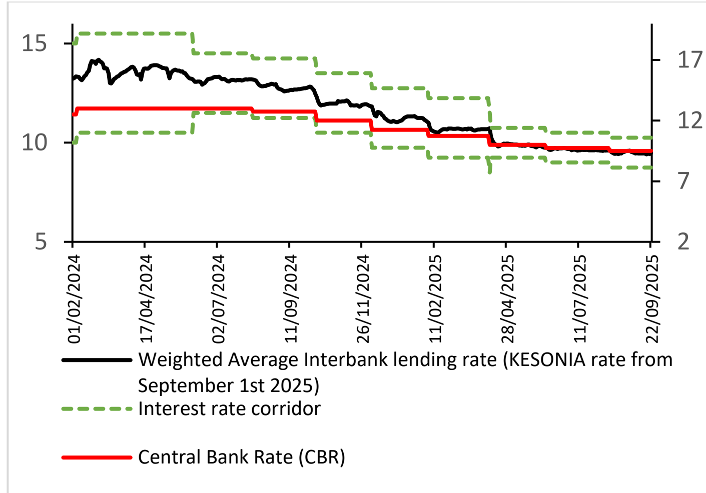
However, in September 2025, the U.S. Federal Reserve cut interest rates by 25 basis points, lowering the federal funds rate to 4.00% - 4.25% **(Figure 3c)**. The cut, widely anticipated by markets, saw the Dow Jones Industrial Average (Dow) edge higher, the S&P 500 remain flat, and the Russell 2000 outperform as smaller firms benefited from cheaper financing. For Kenyan investors, Fed policy shifts are expected to shape KES/USD movements, global bond yields, and rate-sensitive NSE sectors such as property, infrastructure and banking, thereby creating opportunities in small- and mid-capitalized equities, and global bonds. For Kenya, with stable core inflation and manageable risks on price stability, there is scope for a cautious easing of monetary policy, thereby signaling a further reduction in interest rates **(Figure 3d)** to support credit growth and stimulate stronger economic activity.

3c: Trends in Central Bank rates in selected major Markets



Source: Fed Reserve and CBK

3d: KESONIA rate within the interest rate corridor

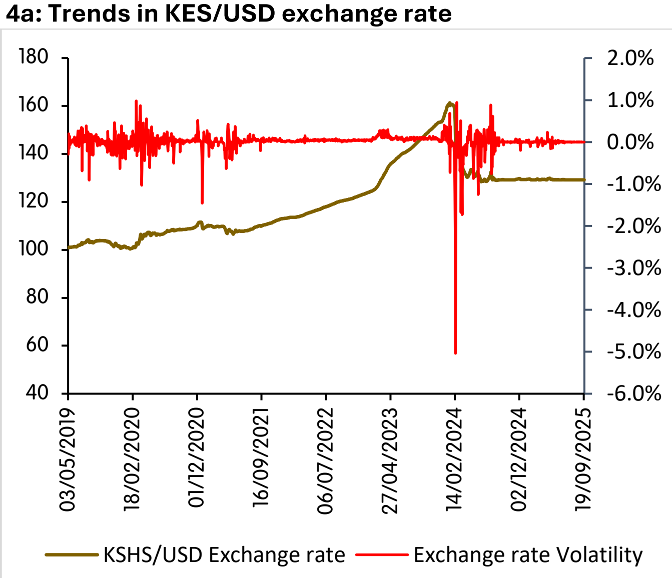


Source: CBK

Fourth, the Kenya Shilling remains stable, supported by strong foreign exchange reserves, resilient remittances, a stable current account deficit and ensuing favorable interest rate differentials with the recent Federal reserve rate cut. In September 2025, the Kenya Shilling held steady at around Ksh 129.24 - 129.26 per US dollar **(Figure 4a)**, reflecting some short-term stability. However, the medium-term outlook points to a gradual depreciation, with year-end projections at KSh 133.59 in 2025 and KSh 135.27 in 2026 **(Figure 4b)**, underscoring the economy's embedded structural external vulnerabilities.

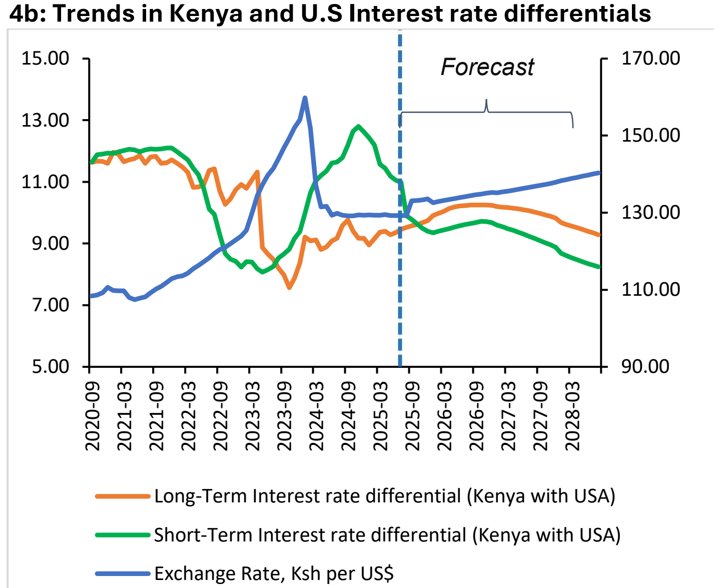
Figure 4: Exchange Rate movement and its drivers

4a: Trends in KES/USD exchange rate



Source: *CBK*

4b: Trends in Kenya and U.S Interest rate differentials



Source: *S&P Global Market Intelligence*

Even so, a positive interest rate differential between Kenya and the US **(Figure 4b)** has helped attract portfolio inflows, lending mild support to the Shilling, though reliance on short-term flows continues to expose the local currency to occasional volatility. As of 25 September 2025, foreign exchange reserves stood at USD 10.7 billion (equivalent to 4.7 months of import cover), providing a solid cushion. In addition, immigrant remittances, that grew by 3.91% in August 2025, remain a vital source of foreign exchange inflows.

Conclusion

In view of low inflation and well anchored inflation expectations, and stability in the exchange rate, the need to stimulate credit growth to support economic activity becomes paramount. In this regard, we view that there is scope to further ease monetary policy via a cut in the Central Bank Rate; but laced with caution watching the continuing external vulnerabilities.

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