KCBIB 2025 Economic Review & 2026 Outlook

Kenya Enters 2026 with Improved Macro Stability, but Fiscal Discipline will Determine how Far the Recovery can Run

The short story:
2025 was about stabilization while 2026 is about controlled optimism, but with fiscal handcuffs on.

Globally, growth is holding up, but it's nothing to write home about. The world is growing slower, trade policy noise is still loud, and geopolitics remains the wild card. That said, inflation is cooling, rates are coming down, and financial conditions are easing, which is exactly the combination frontier markets like Kenya need.

For Kenya, the macro backdrop is meaningfully better than a year ago. Growth is recovering, inflation is well behaved, the shilling is stable, and monetary policy has flipped from brake to accelerator. Private sector credit is finally waking up, yields are easing, and the yield curve is behaving again, a sentence we couldn't say comfortably in 2024.

But let's be clear, fiscal risk hasn't gone anywhere. Debt is still high, the deficit is widening, and domestic borrowing remains heavy. This will limit how fast yields can fall and keep pressure on policy credibility. In short, Kenya is growing again, but on a tight leash.

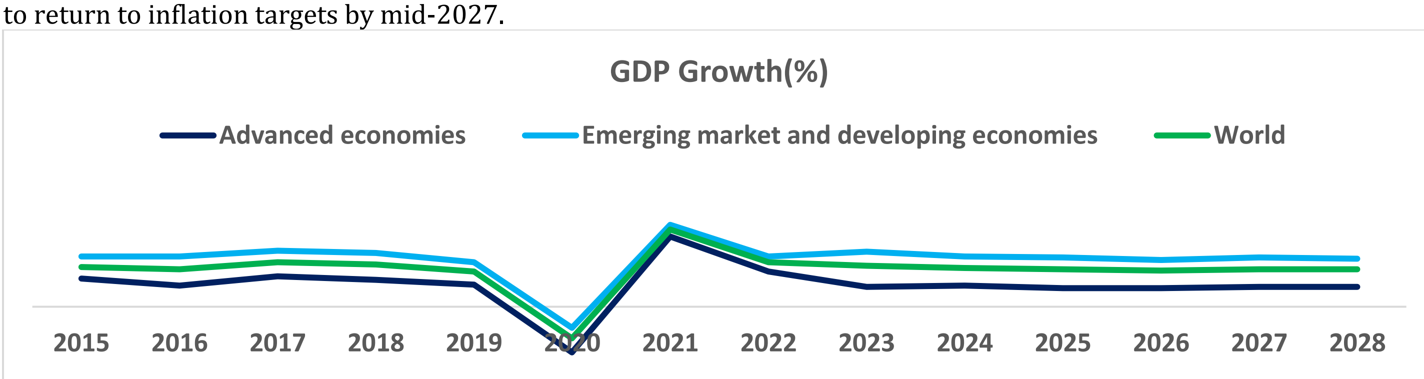
Global Macroeconomic Review (2025) & Outlook (2026)

Global Growth Dynamics

Global economic growth has remained resilient but subdued. The IMF projects global GDP growth of 3.1% in 2026, marginally lower than the 3.2% estimated for 2025. Growth continues to be constrained by geopolitical tensions, ongoing conflicts, and trade-related disruptions, including tariff wars that have heightened market volatility and policy uncertainty.

Looking ahead, the global outlook remains challenging in both the near and medium term, as frequent shifts in trade policy continue to distort supply chains and cloud growth forecasts. That said, several supportive factors are helping cushion the downside. These include accommodative macroeconomic policies, improving financial conditions, and growing optimism around technology-driven productivity gains which are supporting demand across major economies.

Into 2026, global conditions are expected to improve modestly. Policy interest rates are projected to ease further, while fiscal tightening is likely to remain limited in many countries despite rising budgetary pressures. Labor markets are softening, helping to ease wage pressures and support further disinflation. Inflation across the G20 is projected to moderate to 2.8% in 2026 and 2.5% in 2027, down from an estimated 3.4% in 2025, with most major economies expected to return to inflation targets by mid-2027.



Source: IMF, KCB IB

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U.S. growth is projected at 1.7% in 2026 (from 2.0% in 2025), supported by monetary and fiscal easing, although a cooling labor market is likely to weigh on momentum. In the European Union, growth is expected to slow to 1.2% in 2026, reflecting weaker export demand amid higher U.S. tariffs and persistent geopolitical risks.

In Sub-Saharan Africa (SSA), growth is forecast to improve to 4.4% in 2026, up from 4.1% in 2025, driven by domestic demand recovery and easing inflation. However, high public debt levels, geopolitical risks and climate-related shocks remain key risks.

Implications for Kenya

Growth: Kenya stands to benefit from firmer SSA growth and easing global financial conditions, supporting domestic demand and investment activity.

Capital Flows: Lower global interest rates should improve risk appetite for frontier markets, potentially supporting portfolio inflows into Kenyan equities and bonds.

Forex: A softer US dollar environment, combined with improved capital inflows, could ease pressure on the shilling, though trade and oil-price risks remain.

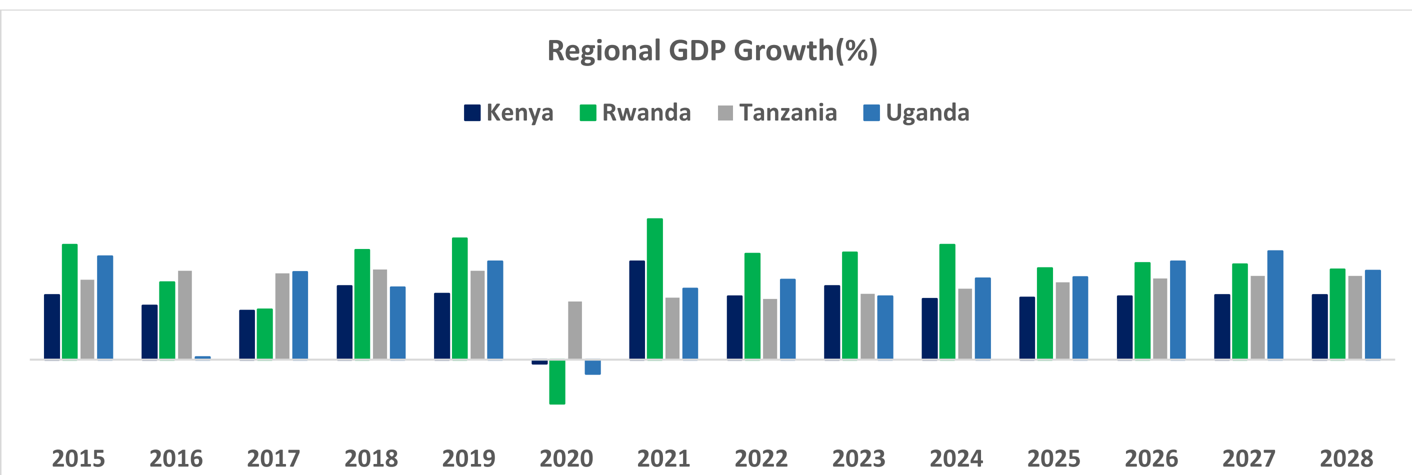
Yields: Global disinflation and easing monetary policy reinforce the case for lower domestic yields over the medium term, supporting bond prices and reducing government refinancing pressure.

Global headwinds persist but improving financial conditions and easing inflation create a more supportive external environment for Kenya's 2026 growth and market outlook.

A. 2025 Kenya Economic Review and 2026 Outlook

I. Kenya Economy in Summary; The Economy is Running while the Budget is Jogging Behind!

Kenya's economy is projected to grow at an average rate of 4.9% between 2025 and 2027, marking an upward revision from earlier estimates. Growth momentum has strengthened on the back of improving macroeconomic conditions, including contained inflation, a relatively stable exchange rate, and foreign exchange reserves at record highs.



Source: IMF, KCB IB

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Private sector credit is showing early signs of recovery, expanding by 5.0% y/y as of September 2025, supported by lower lending rates and a more accommodative monetary policy stance. Reflecting this improvement, GDP growth accelerated to 4.9%, 5.0% and 4.9% in Q1, Q2 and Q3 2025, respectively.

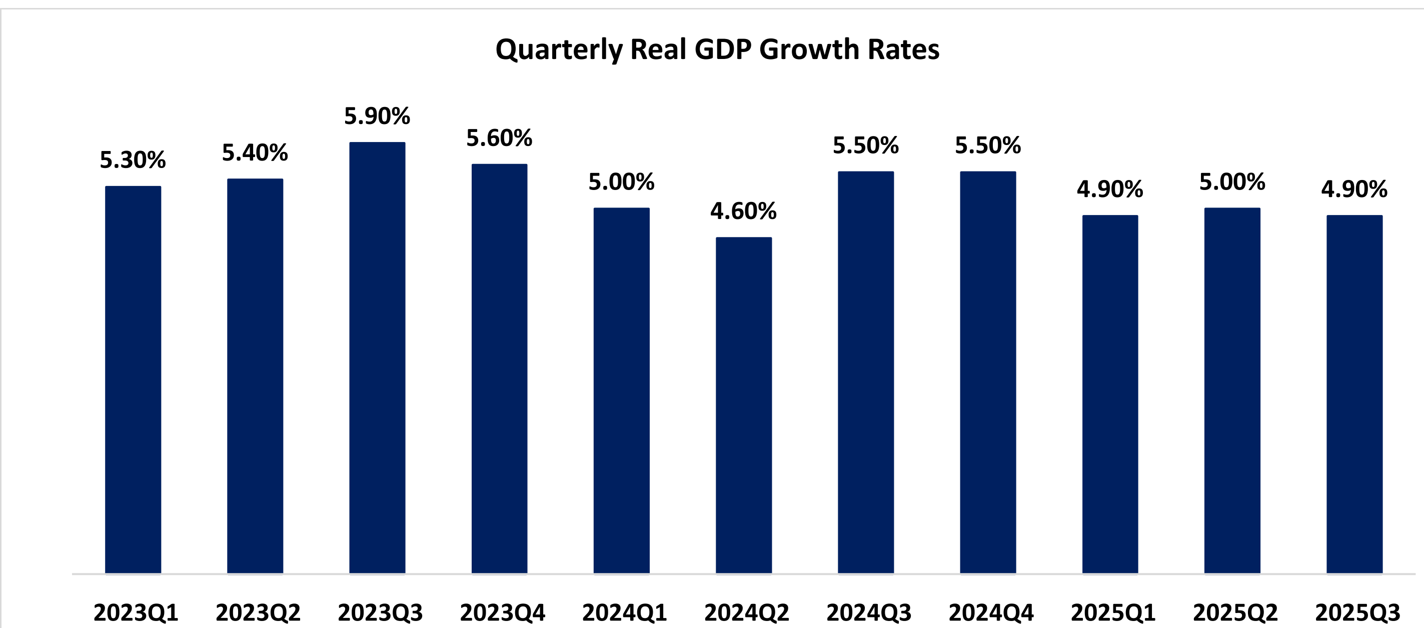
Despite the improvement in growth outlook, fiscal pressure remains elevated. The FY2025/26 fiscal deficit is projected at 4.8% of GDP, driven primarily by revenue underperformance and increasingly rigid expenditure structures, and is expected to widen further to 5.3% of GDP over the medium term.

Public debt has continued to rise, reaching 67.3% of GDP as of September 2025, keeping Kenya at high risk of debt distress and reinforcing the need for credible fiscal consolidation. Domestic borrowing has increased markedly, with a recent bias toward short-term T-bills, heightening rollover and refinancing risks. Encouragingly, issuance is now gradually shifting toward medium- to long-term domestic instruments, supported by the normalization of the yield curve.

Q3 2025 GDP Performance
Kenya's economy expanded by 4.9% in Q32025, up from 4.2% in Q32024, reflecting a broad-based sectoral recovery. Key growth drivers included:

- Agriculture, forestry and fishing
- Construction, which rebounded strongly
- Mining and quarrying, which grew by 16.6% following contraction in 2024

Additional support came from accommodation and food services, real estate, financial and insurance activities, transport and storage, and wholesale and retail trade. Overall performance was underpinned by macroeconomic stability, with inflation well contained and the shilling relatively stable.



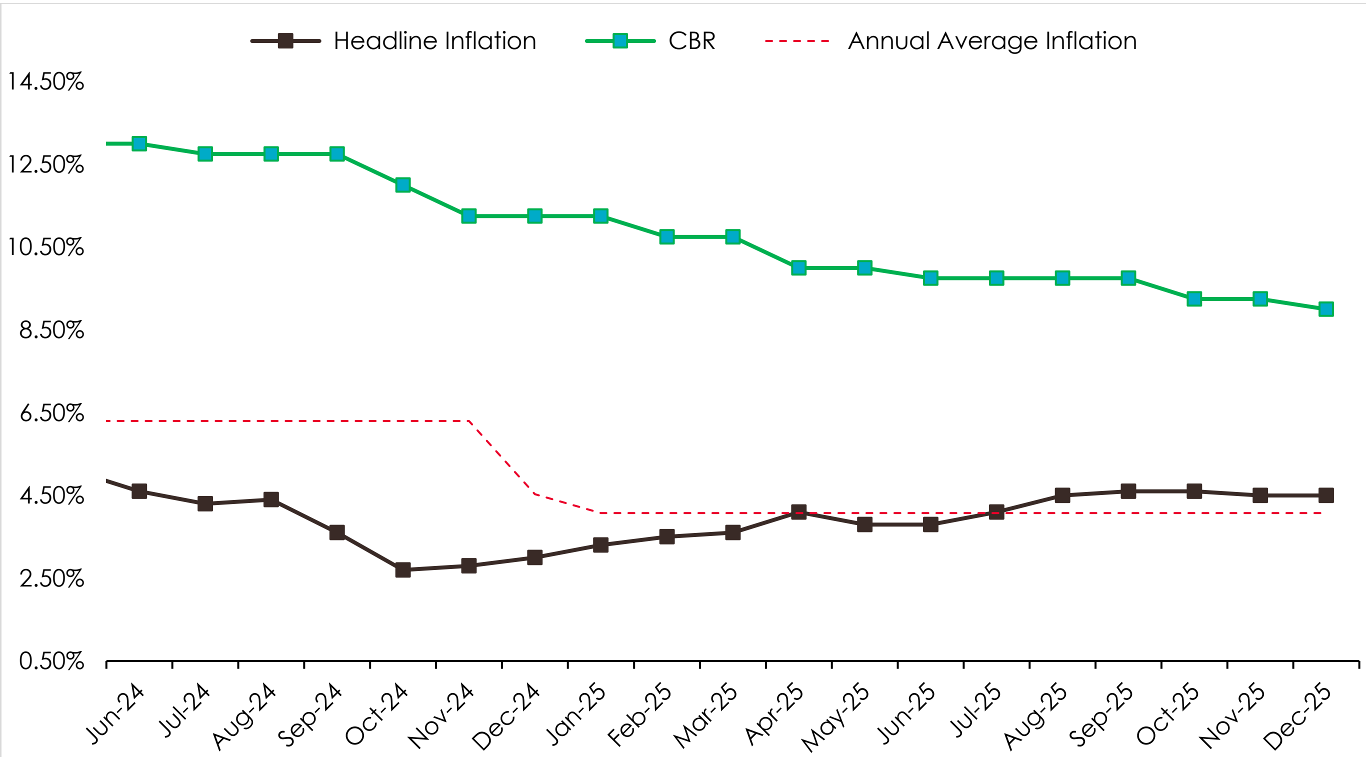
Source: KNBS, KCB IB

Outlook for 2026- We expect Kenya's economy to remain stable and resilient into 2026, supported by improving macro fundamentals, easing financial conditions, and a gradual recovery in private sector activity. However, the key risks are fiscal consolidation pressures, debt sustainability and cost of living pressures weighing on household consumption.

II. Inflation Remains Anchored as Policy Easing Takes Center Stage

With prices behaving, MPC finally gets breathing room.

Kenya's headline inflation has remained stable and firmly within the CBK target range of 5.0% ± 2.5% since June 2024. This stability has been supported by adequate food supplies due to favorable weather conditions and targeted government interventions, contained fuel inflation on the back of a stable exchange rate, and a decline in non-core inflation reflecting the lagged impact of earlier monetary policy tightening.



Source: KNBS, KCB IB

Headline inflation stood at 4.5% in December 2025, bringing the 2025 average to 4.1%. Core inflation eased to 2.0% in December 2025 and averaged 2.5% for the year, signaling subdued underlying demand pressures. In contrast, non-core inflation edged higher to 11.2% in December 2025, from 10.1% in November, largely driven by food and energy-related factors.

In response to the sustained disinflation trend, the Central Bank of Kenya has progressively eased monetary policy, cutting the policy rate from 13.0% in July 2024 to 9.0% by December 2025.

2026 Outlook: Looking ahead, we expect inflation to remain well anchored, averaging around 4.5% in 2026, slightly higher than the estimated 4.1% in 2025, as energy prices normalize while core inflation remains moderate.

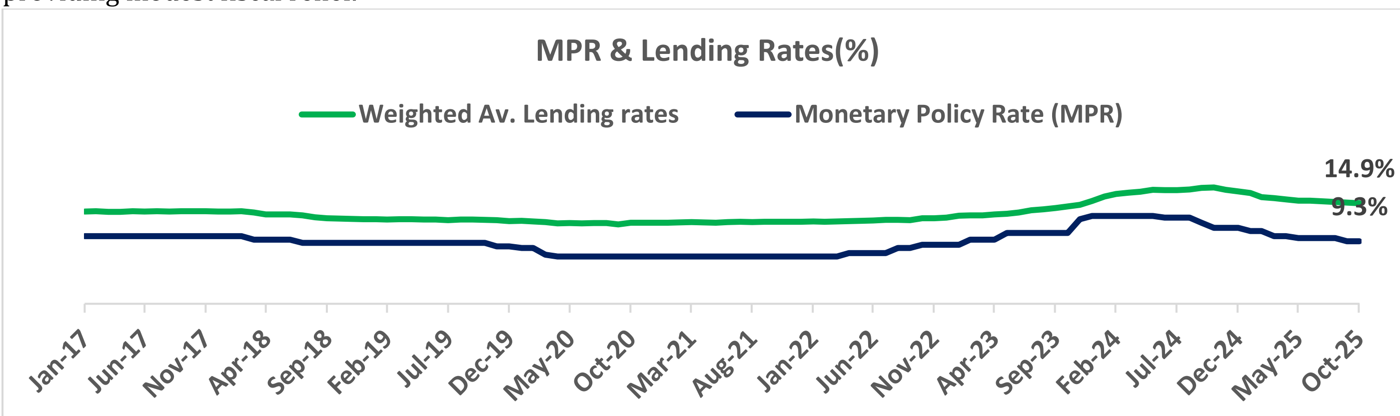
Inflation stability has created room for policy easing, supporting growth while keeping price pressures contained.

III. Monetary Policy Review: From Tightening to Growth Support

The Monetary Policy Committee (MPC) has progressively shifted to an accommodative stance, cutting the Central Bank Rate (CBR) from 13.0% in July 2024 to 9.0% in December 2025. The primary objective has been to stimulate private sector credit, support economic activity, and reinforce the growth recovery. This easing cycle has been underpinned by anchored inflation, which averaged 4.1% in 2025, and sustained currency stability.

Policy Transmission to the Economy: The impact of easing is increasingly evident across the economy. This is reflected in the declining yield curve and improved liquidity conditions. Transmission has been strengthened by the adoption of risk-based pricing, including the use of the Kenya Shilling Overnight Index Average (KESONIA) as a reference rate, leading to lower lending rates.

As a result, private sector credit growth rebounded to 5.0% y/y, while asset quality has improved, with the NPL ratio declining to 16.4% from 17.6%. Lower domestic borrowing costs have also eased government debt servicing pressures, providing modest fiscal relief.



Source: CBK, KCB IB

2026 and Medium-Term View

Looking into 2026, we expect monetary conditions to remain accommodative, broadly within current levels. This stance should continue to support the economic recovery, given that inflation remains contained, private sector credit is improving, and FX stability has been preserved.

Globally, the balance of risks remains skewed toward looser financial conditions but limited easing space, which could support capital flows, refinancing activity, and debt sustainability for emerging and developing economies.

Across SSA, monetary policy paths are likely to diverge, reflecting varying inflation trends, exchange rate dynamics, and fiscal positions. Countries with elevated debt burdens and large Eurobond maturities remain more vulnerable, particularly where fiscal buffers are weak.

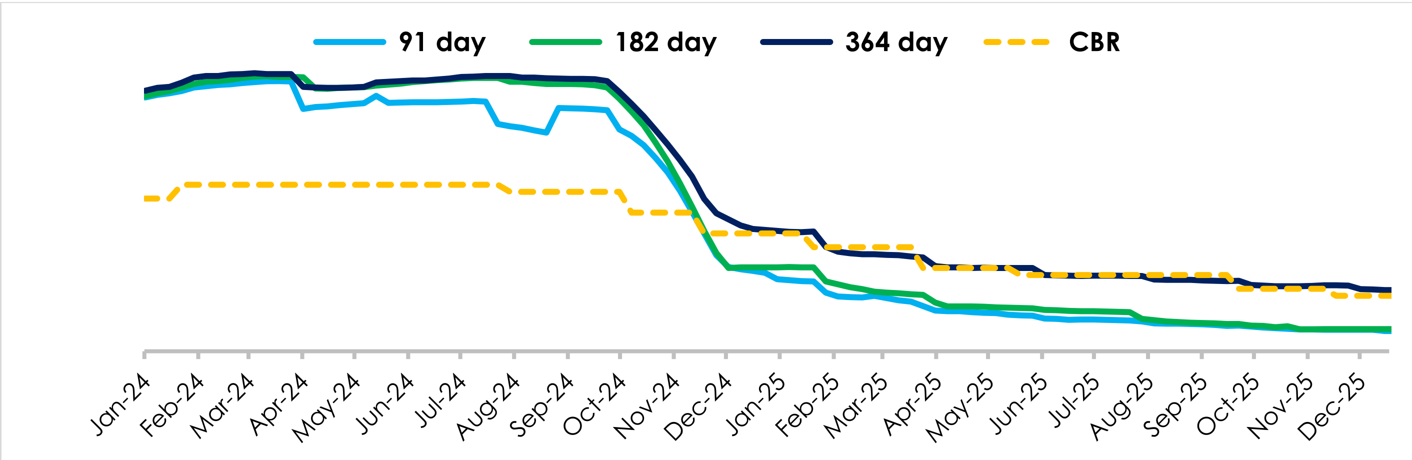
Monetary Policy Outlook – 2026

- **Expected MPC stance:** Neutral-to-accommodative
- **Policy bias:** Cautious easing, conditional on inflation and FX stability
- **Rate outlook:** Limited further cuts likely; focus shifts to policy transmission and credit growth

Monetary policy has turned supportive, with easing already feeding through to lower yields and improved credit conditions. The key risk lies in balancing growth support with fiscal and external stability.

IV. Interest Rates & Fixed Income: Rates are easing, the curve is behaving, but fiscal realities will keep yields from falling too fast!

Government securities yields have been on a clear downward trend since peaking in 2024, reflecting the ongoing monetary easing cycle and improved investor risk perception. Short-term T-bill yields have declined the most, mirroring the reduction in the policy rate and improved liquidity conditions.

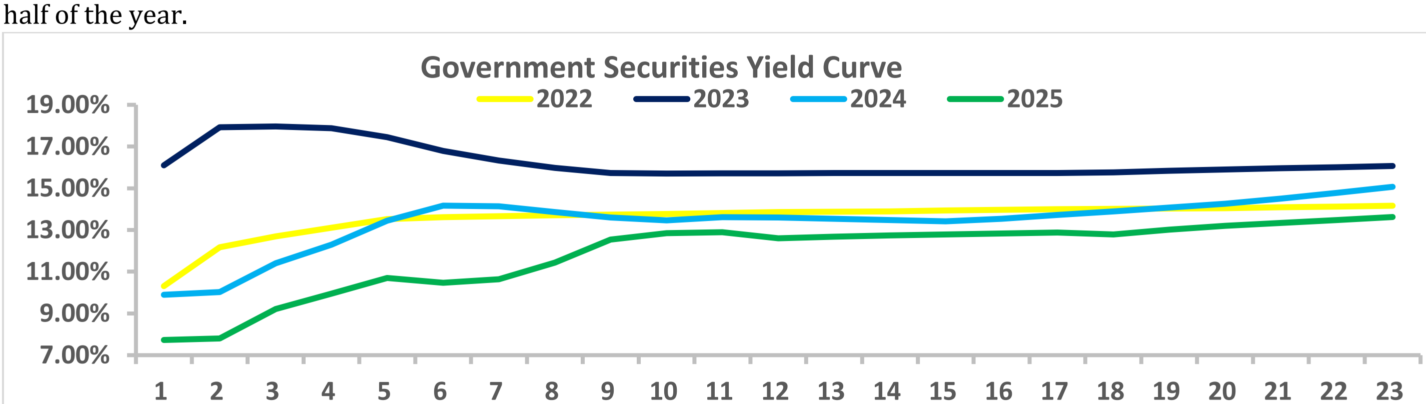


Source: CBK, KCB IB

Yield Curve Dynamics-The yield curve has normalized, supported by the Government's deliberate shift toward medium- to long-term issuance aimed at smoothing maturity profiles and reducing near-term refinancing pressures. This strategy has helped extend duration despite a lower-rate environment.

However, risks remain tilted to the upside for yields. The fiscal deficit is projected to widen to 5.3% of GDP in FY2026/27, sustaining a high domestic borrowing requirement. This is occurring even as the sovereign signals commitment to austerity measures.

With external concessional financing still constrained, pending progress with IMF and World Bank programs, domestic debt issuance is expected to rise. As a result, the pace of yield compression is likely to moderate, particularly in the second half of the year.



Source: NSE, KCB IB

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2026 Interest Rate Outlook; Easing, Not Free-Falling

We expect rates to oscillate around current levels in H12026, with a slower easing trajectory. Short-term rates are likely to trend lower, with the CBR expected to close 2026 in the 8.0%–8.5% range. Investor preference is expected to shift toward longer-dated instruments, which offer more attractive risk-adjusted returns and duration benefits.

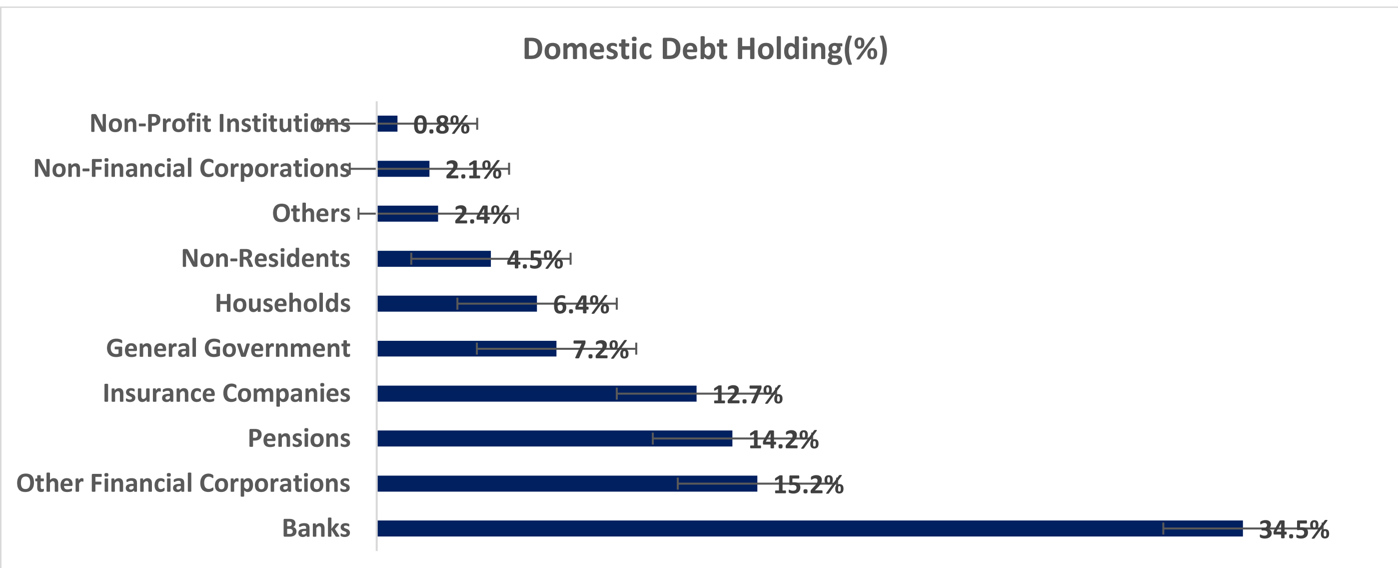
Implications for Fixed Income Investors

- **Extend duration selectively** to lock in yields ahead of further easing
- **Favor medium-to-long tenors** as curve normalization continues

Impact of Yield Curve on Domestic Debt Holding

Despite falling rates, domestic institutional demand remains strong, supported by ample system liquidity and limited alternative assets. Banks remain the dominant holders, increasing exposure by KES 43.5Bn, underscoring sustained appetite for government securities.

Pension funds and insurance companies added KES 17.9Bn and KES 12.0Bn, respectively, reinforcing long-term demand. Foreign participation edged higher, supported by attractive interest rate differentials and improved FX stability.



Source: CBK, KCB IB

V. Currency Outlook: The Shilling is no Longer Flashy, but Stability is the New Strength

Remittances and reserves anchor FX, but debt and commodities remain swing factors.

The Kenyan shilling remained broadly stable in 2025, appreciating by 0.6% in December to close the year at KES 129.01 against US dollar. On Y/Y basis, the shilling recorded a modest 0.2% appreciation, a sharp contrast to the 17.4% rally in 2024. The currency averaged KES 129.3/USD in 2025, compared to KES 134.8/USD in 2024, underscoring improved FX stability.

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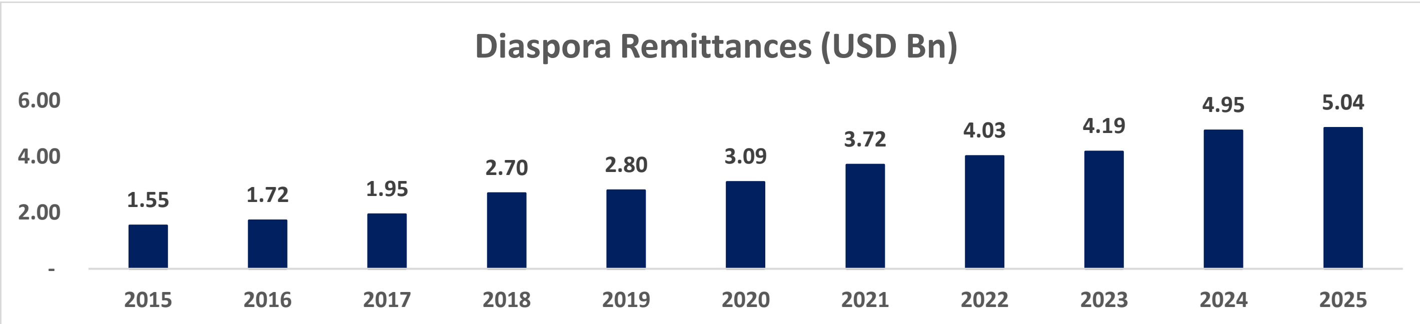
FX Inflows: Remittances Still Carry the Load

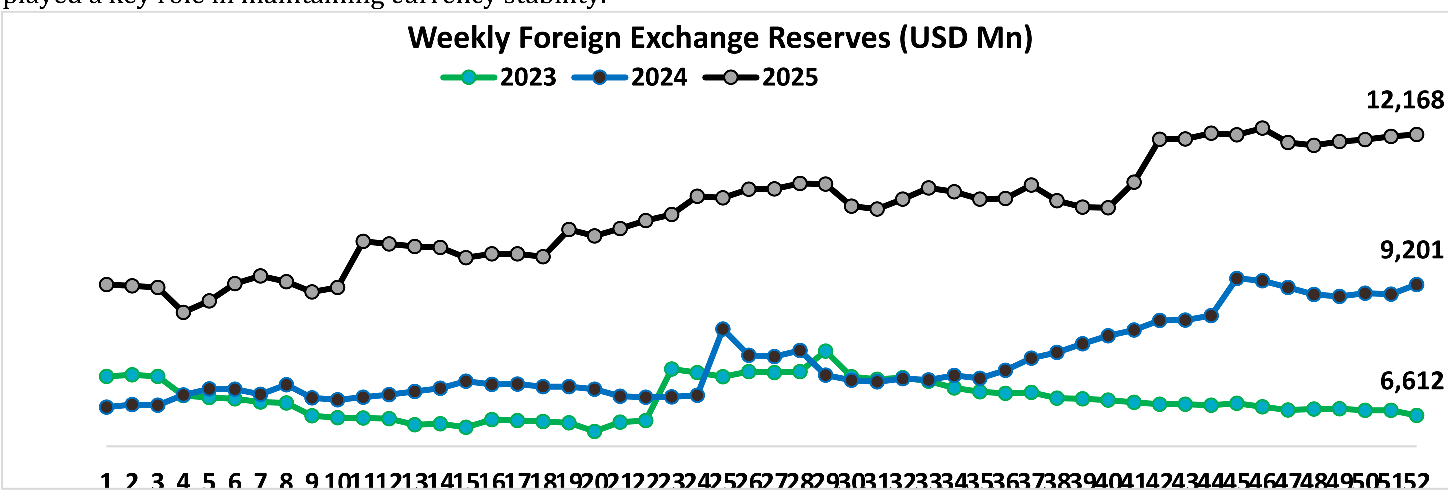
Diaspora remittance inflows amounted to USD 435.5Mn in December 2025, down 2.2% y/y from USD 445.4Mn in December 2024. However, on the 12-month cumulative basis, inflows rose by 1.9% to USD 5.04Bn as of December 2025, up from USD 4.95Bn in the comparable period in 2024. Remittance remains a critical source of foreign exchange, providing steady support to the balance of payments and helping anchor the currency.



Source: CBK, KCB IB

FX Buffers Remain Strong

Foreign exchange reserves remained comfortable at USD 12.39Bn, equivalent to 5.3 months of import cover as at December 2025, well above the statutory threshold. These reserves, together with active CBK market participation, have played a key role in maintaining currency stability.



Source: CBK, KCB IB

Outlook for 2026

The shilling is expected to remain largely stable into 2026, supported by:

- Continued diaspora remittance inflows
- Adequate FX reserve buffers
- Central Bank interventions to smooth volatility

However, upside risks to stability persist, including elevated debt servicing costs (public debt at 67% of GDP), a widening current account deficit, and vulnerability to global shocks, particularly from commodity prices and geopolitical developments.

VI. Fiscal Tightrope: Heavy Debt, Narrow Fiscal Space

Public Debt Outlook: Debt is high, deficits are sticky, and consolidation remains the main macro risk

Kenya's high public debt burden remains a key constraint to the country's growth outlook. As of September 2025, total public debt stood at KES 12.1Tr, equivalent to 67.3% of GDP, well above the government's medium-term target of 55%. Domestic debt accounts for 55.3% of the total stock, while external debt represents 44.7%, with US dollar-denominated loans comprising 56.7% of external obligations. Elevated debt servicing costs continue to strain the fiscal position, limiting budget flexibility and crowding out development spending, despite the government's stated commitment to austerity and fiscal consolidation.

According to the World Bank, Kenya remains at high risk of debt distress, reinforcing the urgency of credible fiscal adjustment. While debt servicing remains manageable, it comes at the expense of funding for development priorities and social expenditure.

Debt Management-On a more positive note, proactive debt management measures may help improve investor confidence. The Eurobond buyback and new issuance in early 2025 reduced refinancing risks and supported a decline in yields. Domestically, the CBK has increased issuance of medium- to long-term bonds and executed bond switches, helping smooth the maturity profile and reduce near-term repayment pressure.

Credit Ratings: Stability with Cautious Optimism

Kenya's sovereign credit profile remains weak but stable. Current ratings stand at:

- Moody's: Upgrade to B3 from *Caa1* (outlook Stable, affirmed January 27, 2026)
- Fitch Ratings: *B-* (stable outlook, affirmed January 26, 2026)
- S&P Global: *B-* (stable outlook, affirmed August 22, 2025)

Budget & Financing Strategy – FY2026/27; Borrowing Locally while Praying for Multilaterals Support

In the FY2026/27 Budget Policy Statement, the government signals a shift toward greater reliance on domestic financing, targeting higher local borrowing while moderating external issuance to reduce costly FX-linked debt servicing. While this strategy may lower external vulnerability, it raises the risk of crowding out private sector credit.

Kenya continues to rely heavily on concessional financing from the IMF and World Bank. However, disbursements have faced delays due to unmet fiscal and governance reform conditions. A key World Bank budget support facility remains frozen, with potential release pushed to mid-2026, while the IMF programme experienced review setbacks prompting the government to budget zero new IMF funding in FY2025/26, shifting reliance toward World Bank support contingent on reform progress.

Total expenditure in FY2026/27 is projected to rise to KES 4.7Tr, from KES 4.3Tr in the prior year. Total revenue is forecast at KES 3.5Tr, including KES 2.9Tr in ordinary revenue, supported by ongoing tax policy and administration reforms aimed at broadening the tax base and improving compliance.

Despite improved revenue mobilization, the fiscal deficit is projected to widen to KES 1.1Tr (5.3% of GDP), underscoring persistent financing pressures. Kenya's fiscal position remains fragile. While debt management and credit sentiment have improved at the margin, restoring fiscal sustainability will hinge on disciplined execution, concessional funding access, and sustained reform momentum.

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Summarily, Kenya enters 2026 with better macro stability, but fiscal discipline will determine how far the recovery can run.

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