

ECONOMICS AND RESEARCH **PRE MPC NOTE**

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With No Reason to Delay Until December for a Hike, We Expect the MPC to Raise CBR to 9.00%

The Monetary Policy Committee (MPC) convenes on 7th October for the penultimate policy meeting of 2026. The committee faces a more difficult policy trade-off than at its August meeting.

The combination of slightly stronger than expected core CPI in September, at 4.0% from 3.4% in the prior month and the renewed rise in energy prices is likely just enough to push consensus toward hiking the policy rate.

The interest rate increase is likely to be presented as a step to anchor inflationary expectations as well as the currency and not the start of a cycle of policy hikes given its current absolute level.

When the committee met in August, it assumed a gradual de-escalation of the war in the Middle East, which has now appeared to deteriorate. Therefore, the external risk is likely to persist for longer and not reverse in the near-term. As a result, second-round effects across various sectors of the economy are likely to manifest further into the remainder of the year.

Moreover, in the same meeting, the committee held the view that major central banks would remain cautious and hold their policy rates. However, weakening global outlook has already seen the European Central Bank (ECB) and US Federal Open Market Committee (FOMC) tighten further.

Thus, our view is that there is a material change in the committee's expectations in August regarding the external environment, inflation outlook and exchange rate- with the currency already losing 40 cents since August.

On the domestic economic growth front, resilient economic data has somewhat eased the urgency for further accommodation. Illustratively, The NCBA Consumer Activity Index

which is a high frequency measure of the general consumer pulse is up 6% YTD. Additionally, private-sector credit growth has returned to double-digit levels, while the headline PMI—a proxy for activity level on the production side remains broadly flat year over year, indicating moderate growth rather than a significant downturn.

Concerningly, the global backdrop warrants greater policy caution. Brent price remains elevated trading around USD102 per barrel. Importantly, markets do not foresee a quick reversal of the supply-demand deficits, while refined oil products are still in the red following reduced processing in Russia and Asia and the now low probability of a ceasefire agreement. For policy makers underlying inflation will prove persistent.

Consequently, global financial conditions have tightened considerably, with the US 10-year Treasury yield rising to around 5.30%. Therefore, the interest rate differential appears to narrow relative to August. To this end, real policy rate and the 2 year-bond differentials for Kenya and the US is down to 1.4% and 1.7%, respectively from 2% and 3.5%, respectively in August. Thus, presenting a policy need to anchor exchange rate stability at a time when Emerging and Frontier economies face higher external financing costs and greater vulnerability to capital flows. Choosing to manage the currency volatility through market intervention alone may prove costly despite the healthy official FX reserves, now equivalent to 6.1 months of import cover.

Overall, there is a case for a policy rate hike this quarter and we do not see any reason for the MPC to wait until the December meeting. Therefore, we expect the committee to increase the Central Bank Rate to 9.00% this week.