

GLOBAL MARKETS

1. Global Growth Outlook

As the world awaits news on where tariffs are to settle once the 'Liberation Day' truce ends on 9th July, the widening of the conflict in the Middle East to a direct confrontation between Israel and Iran, and the US getting involved, added a new dimension of risk. The subsequent ceasefire calmed nerves in oil and gas prices.

There are upsides to the tariff situation becoming clear as the pause ends on July 9th and some positive traction in negotiations with major trade partners. Regardless, the average tariff rate is estimated to end up around 10-15%, still a stark increment from 2.5% at the end of 2024.

According to World Bank's Global Economic Prospects Report, heightened trade tensions and policy uncertainty has resulted in growth forecasts being cut in nearly 70% of all economies. Global growth is expected to slow to 2.3% in 2025, nearly half a percentage point lower than the rate that had been expected at the start of the year.

NATO's newly agreed 5%/GDP annual defense spending target is a marked step for European nations, adding to GDP in Germany. Growth is expected to slow in nearly 60% of all developing economies this year, averaging 3.8% in 2025. Investment growth has slowed, with debt climbing to record levels. Emerging-market and developing economies reaped the rewards of trade integration but now find themselves on the frontlines of a global trade conflict.

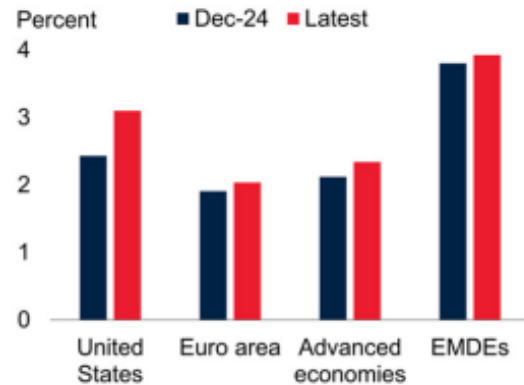
2. Global Inflation

Inflation expectations, particularly in the near term, have risen in 2025, mainly in some major economies. This is likely explained by the expected impact of tariff increases on consumer prices, even as trade tensions weigh on economic activity and commodity prices.

Persistent underlying inflationary pressures, coupled with the impact of rising tariffs and trade-protectionist measures, are anticipated to delay the normalization of global inflation to levels broadly consistent with inflation targets. On a GDP-weighted basis, global inflation is projected to average 2.9

percent in both 2025 and 2026, before easing to 2.5 percent in 2027—in line with the average inflation target. Inflation projections in 2025-26 have been revised slightly lower in Emerging and Developing Economies on account of weaker demand for traded goods, while being revised notably higher in advanced economies, primarily the United States.

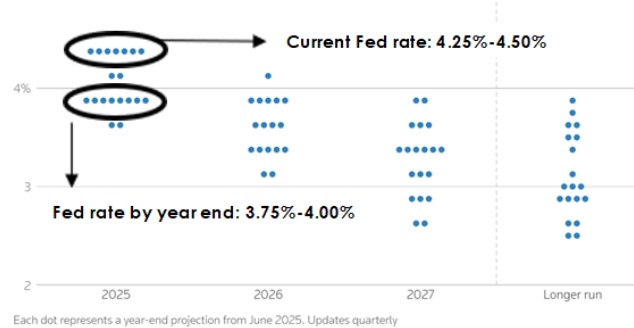
CPI Inflation Expectations for 2025



3. Global Monetary Policy

The Federal Reserve maintained its benchmark interest rate at 4.25%–4.50% during its June meeting, reflecting a cautious approach amid economic uncertainties. Into year-end, markets are expecting two quarter basis point rate cuts.

The Federal Reserve's outlook
Projections by members of the Federal Open Market Committee



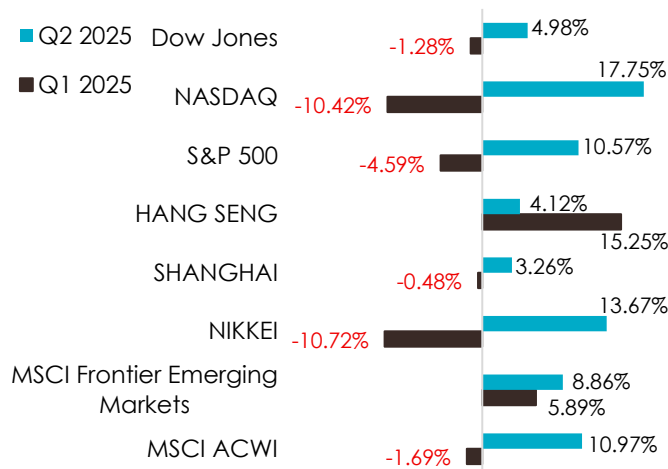
Despite President Trump's public criticism and calls for rate cuts, the Fed emphasized its commitment to data-driven policy decisions and independence. In addition, the Fed has to consider the "One Big Beautiful Bill", now Act, which is projected to add \$3.4 trillion to the \$36.2 trillion deficit, and the expected impact of deeper fiscal deficits and rising inflation risks.

The European Central Bank (ECB) implemented a 25-basis point rate cut in their latest meeting, lowering the deposit facility rate to 2.0%, signaling the possible end of its easing cycle for now. Concerns over weaker economic growth amid global trade tension and risks such as renewed energy shocks remain.

Despite volatile energy prices in the UK, the trend of disinflation is expected to prevail, supported by moderating pay growth. We expect two further cuts, leaving policy rate at 3.75% by year-end.

The People's Bank of China (PBOC) continued its monetary easing efforts, injecting 1.4 trillion yuan of liquidity, following the earlier rate cut in May to support the economy amid global trade challenges. The approach reflects a balanced easing strategy that supports growth, financial stability, and currency stability.

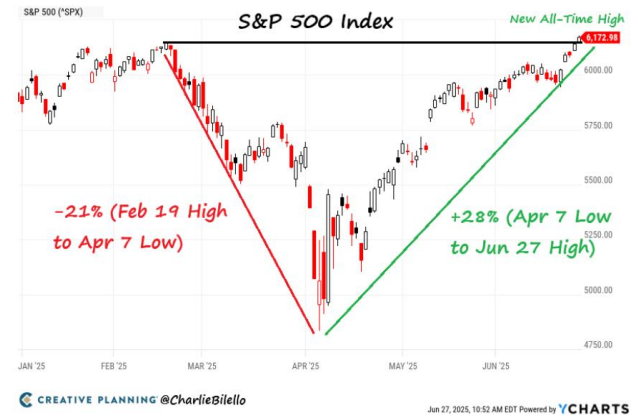
4. Equity Markets



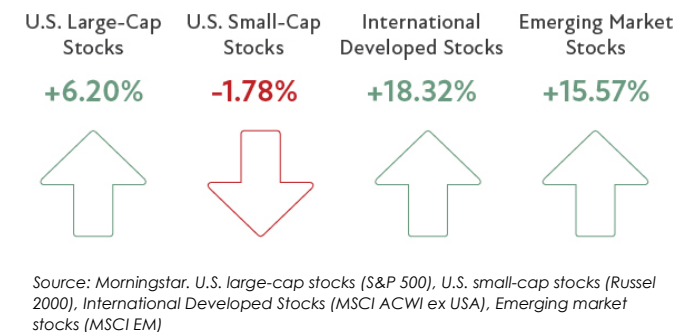
Looking at just the market returns from Q2 2025, one could easily assume that it was a decently quiet quarter that steadily trended upwards. After Q1 delivered the S&P 500's steepest loss in over three years, Q2 saw a remarkable, almost defiant surge. Markets plunged over 12% in the early days of April (Liberation day) amid tariff-induced uncertainty that threatened to push markets into bear market territory. Then Trump announced a "pause" on the most severe of the tariffs, causing a 9% reprieve. The rally continued in May and June, and by quarter-end, global stocks were hitting new all-time highs.

Part of the continued rally came from strong earnings, with ~78% of S&P 500 companies reporting

earnings well above forecasts. Also encouraging despite tariff uncertainty, was that companies continued to invest in expansion and growth.



International markets, as measured by the MSCI All Country World Index excluding U.S., is now outpacing the U.S. The shift has been catalyzed by a 10% drop in the dollar in the first half of the year.

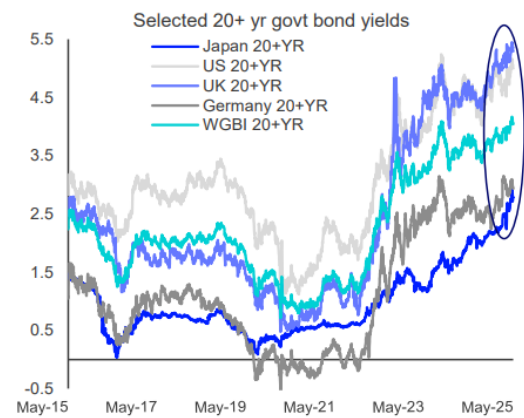


While the S&P 500 and Nasdaq soared, reclaiming ground above their 200-day moving averages, the story for smaller-cap and value stocks was less triumphant, hinting at a market driven by a select few giants rather than broad-based strength. The S&P 500's forward price-to-earnings (P/E) ratio now sits at a hefty 23 times, with an earnings yield barely matching the 10-year Treasury yields.

The volatile VIX, a barometer of market fear, experienced one of its most significant collapses on record from its April highs, signaling a widespread return of confidence. What is comforting though, is that markets are typically higher after these volatility declines and positive 100% of the time after three years. However, even in the midst of this bullish trend, the landscape bears complexities and contradictions.

assets. The 30-year yield closing at 4.77%, while touching 5% levels during the quarter.

Unlike short-term yields, which are more directly influenced by Fed policy, long-term U.S. Treasury yields reflect broader concerns — including inflation volatility, Moody’s recent credit rating downgrade, and rising government debt. These pressures have been amplified by Trump’s “Big Beautiful Bill,” which proposes deep tax cuts likely to widen the fiscal deficit. This would increase future bond supply, putting an upward pressure on long-term yields. Political interference with the Fed also adds to investor uncertainty, further contributing to elevated term premiums.

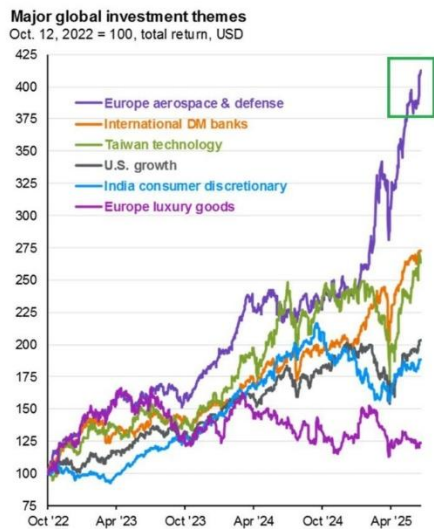


While market bets are 2 quarter-point rate cuts through the end of 2025, long-term rates continue to lift mortgage and loan costs, adding another layer of financial strain, and widening credit spreads.

Bond flows in the euro area suggest continued capital rotations to the region from both domestic and foreign investors. Germany’s new coalition government continues to push ahead with its ambition to increase defense spending, committing to the new NATO 5%/GDP target. This is expected to be financed by borrowing, with the increase likely to put upward pressure on bond yields.



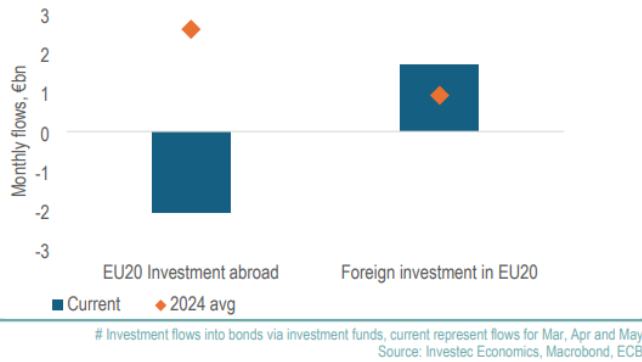
Seasonally, while July often brings positive returns, August and September have a historical reputation for being weaker months, adding another layer of caution. For investors navigating these uncertainties, it is key to explore major investment themes. Exploring non-U.S. or emerging markets could unlock significant value.



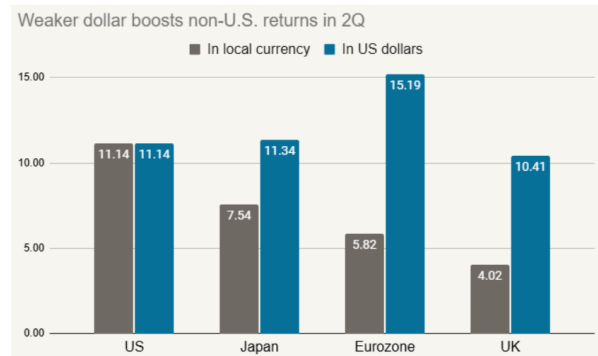
5. Fixed Income

Bond markets were also highly volatile, reacting to redirection of international capital flows, anticipation of Federal Reserve policy, and uncertainty about the U.S. piling debt, resulting in a sell-off. Shorter-term treasury bond yields declined as traders began to bet that the Fed would be cutting rates later this year. However, longer-term rates rose as term premiums adjusted higher and investors attached a higher risk premium on U.S.

Euro Area Cross-border Bond Investment Flows



Dollar weakness helped boost non-U.S. returns over the quarter, indicative in non-U.S. stocks outperforming for the second quarter in a row (entirely due to currency movements).



The euro closed the quarter at its highest level vs. the dollar since 2021. June was a strong month for EUR, which gained 4% against the USD, partly due to a shift in views of the EUR being seen as an alternative safe asset to the greenback. Higher foreign flows into the market could support the Euro into year-end.

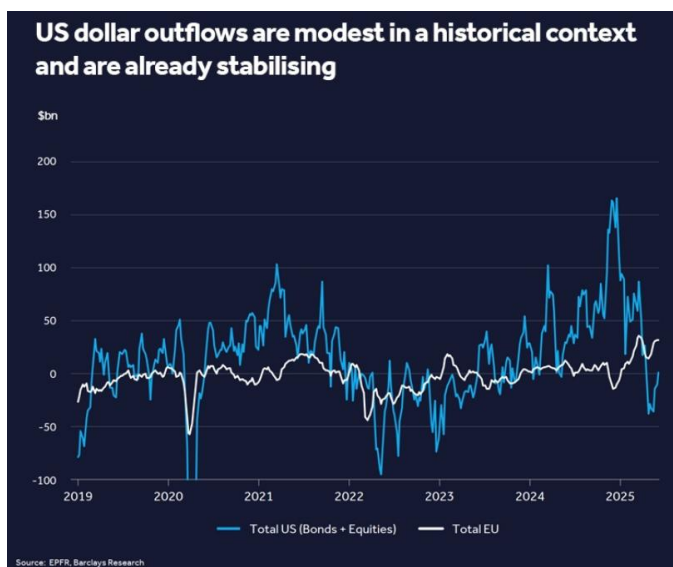
While downside risks remain evident, the key being the outcome of EU-U.S. tariff negotiations, and a subsequent holding policy pattern with ECB, we expect a stronger euro in the medium term.

In China, the government bond market remained anchored by subdued economic momentum and continued policy support. The 10-year government bond yield ended the quarter at 1.65%, only marginally lower than the start of the period. The muted yield environment reflects the market's continued pricing of structurally weaker growth expectations and limited inflation risk.

6. Currency

The U.S. dollar seems more battered over the second quarter than in Q1, driven mainly by ongoing trade tensions and the potential that U.S. economic weakness could lead to rate cuts by the Fed.

However, the fundamental advantages of the U.S. are still strong.

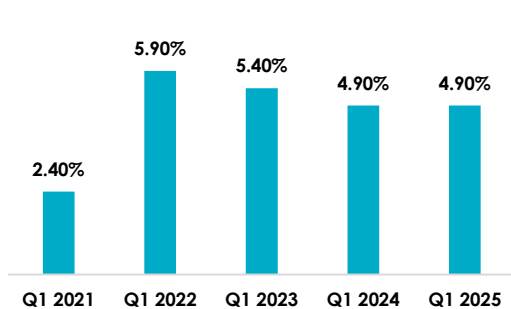


KENYAN MARKET

1. GDP

According to KNBS, GDP growth came in flat year-on-year at 4.9% in Q1 2025. All sectors of the economy recorded positive growth during the quarter led by Agriculture at 6%, driven by favorable weather conditions. Macroeconomic indicators—particularly the easing of inflation to an average of 3.45% in Q2 from 6.29% in Q1, driven largely by lower food prices—also supported performance.

GDP Growth



Growth was also occasioned by expansions in Information & Communication (5.8%), Trade sectors (5.4%), Real estate (5.3%), Financial & Insurance (5.1%), Public Administration (6.5%). Service activities slowed 4.1% in Q1 compared to a 38.1% growth in Q1 2024 on account of tepid tourism activity in the country.

Higher agricultural processing activities will boost further recovery in manufacturing, that expanded by 2.1%, up from 1.9% in 1Q2024. Growth in construction was similarly higher at 3.0% from 0.4%. The anticipated increase in private sector lending into H2 is expected to see a further upturn in the industrial sector growth.

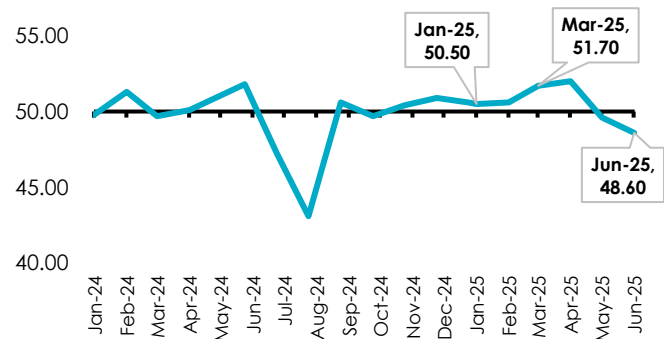
While leading economic indicators of economic activity reveal subdued momentum in the first half of 2025, there is potential for some upside in the second half of the year that could lead to a materialization of the 5.2% growth projection by year-end. The transmission effect from the MPC's policy signals will likely be dampened by the evident fiscal strain. This indicates slower transmission of lower interest rates into the market,

subduing credit growth and hurting Kenya's medium-term growth prospects.

2. Private Sector Conditions

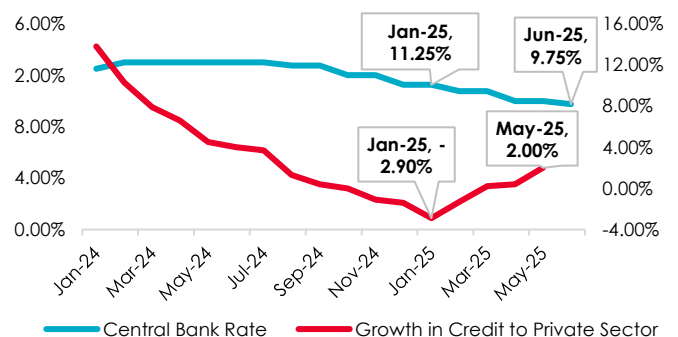
Kenya's private sector continues to face challenges into the end of the first half of 2025. Headline PMI averaged 50.07 in Q2 2025; a slowdown compared to an average 50.93 in Q1 2025. In June, the PMI fell the sharpest in 11 months on weaker conditions primarily driven by a contraction in business activity.

Purchasing Managers' Index (PMI)



Market participants attributed the decline to lower consumer spending, challenging economic conditions and operational disruptions from protests.

Growth in Credit to Private Sector vs CBR



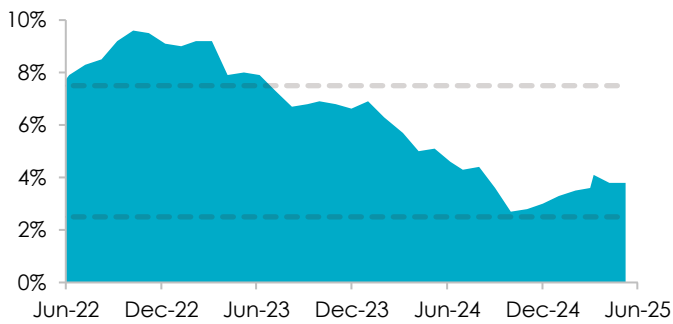
We remain cautiously optimistic that monetary policy easing will continue transmitting to private sector credit through year-end. This, coupled with increased optimism about future business activity backed by optimistic demand expectations and market expansion, is expected to improve conditions.

3. Inflation

Headline inflation averaged 3.9% over the second quarter and remained within the target range at 3.8% in June. Inflation numbers at this level will support cheaper food imports, capping upside pressures on food prices. The four-month consecutive increase in core prices to 3.0% as of June highlighted underlying demand pressures.

With this inflationary background, progress from previous policy actions aimed at stimulating lending by banks to the private sector and supporting economic activity, the MPC lowered rates further by 1% over the quarter.

Year-on-Year Inflation



With inflation expected to remain range-bound at current levels, the outlook is marred with the fragile domestic demand. This supports the case for further stimulation through monetary policy. We expect the MPC to remain cautious over the coming policy meetings amid reliance on external risk positioning, focus on fiscal dominance concerns in FY2025/26 and spurring private sector credit growth.

4. Fiscal Position

June saw quite some activity regarding the government's attempt at running a narrower fiscal deficit amid anticipated revenue shortfalls in FY2024/25. The situation resulted in a third Supplementary budget, whose tabling and approval came just twelve days to the end of the fiscal year, the same day Finance Bill 2025 was passed in Parliament.

The third estimate numbers saw a widening of the fiscal deficit from 5.1% (Supplementary Budget II) to 5.7%, and reallocations on state budgets, indicating an evident fiscal strain. Illustratively, the fiscal deficit

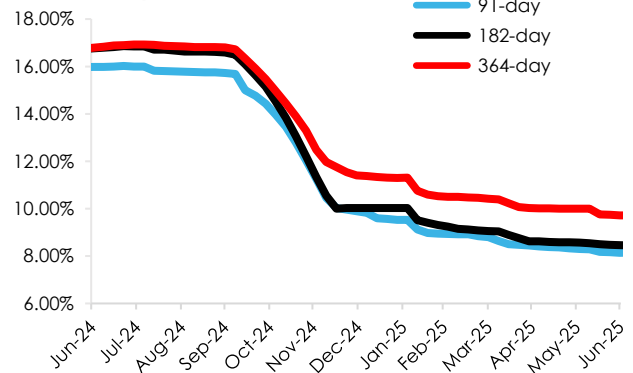
in 2024/25 closed at a whopping KES 997Bn and is expected to narrow marginally to KES 923Bn in 2025/26.

At a time when concessional sources of external funding are limited, the government is likely to rely predominantly on local deficit financing.

5. Interest Rates

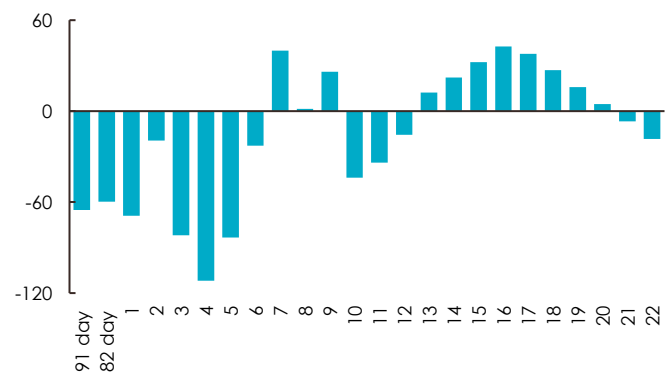
Treasury bill rates dipped further over the quarter, with yields on the 91-, 182-, and 364-day tenors falling by 65, 60 and 69 basis points to 8.14%, 8.46% and 9.72% respectively. The softening in short-term rates was underpinned by Central Bank's 100bps cut to CBR over the quarter. Strong demand on the 364-day paper ensured a positive net borrowing position across the tenors by close of quarter.

Treasury Bill Yields



The yield curve shifted downwards by 15 basis points on average over the quarter, with the short-end (between the 91-day and 5-year issues) seeing the most pronounced declines. In contrast, yields on long-dated papers have ticked upwards recently, steepening the curve, with the section between the 15-year and 19-year edging upwards.

Quarter on Quarter Changes in Yield Curve



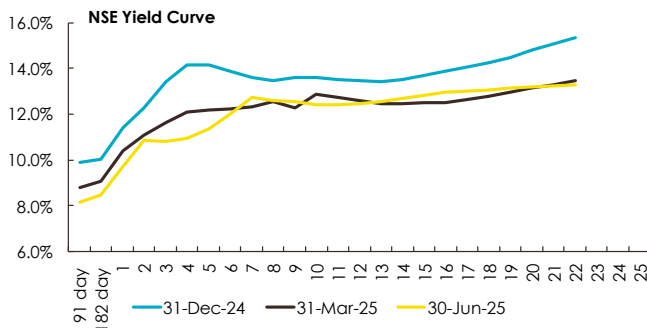
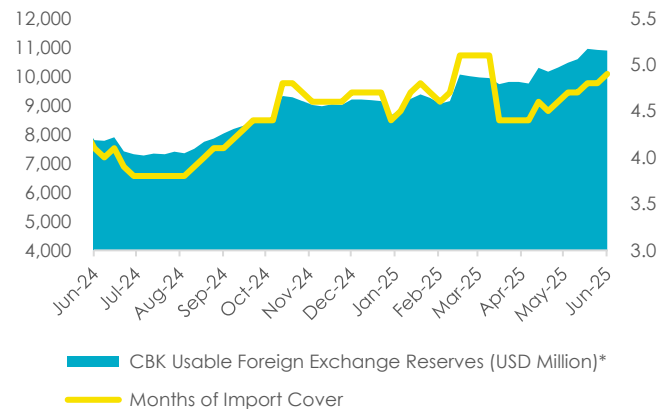
This is likely driven by the government's repeated reopening of long-dated bonds and investor positioning amid concerns over delays in external funding. Sentiment was further shaped by the government's signal to exclude IMF financing from the FY2025/26 budget and its commitment to meet World Bank conditions on curbing expenditure inefficiencies.

To bridge funding gaps, the government tapped \$500M from the UAE private debt facility, priced at 8.25% and maturing in 2032, with scope for an additional \$1B this fiscal year.

Investors' concerns around government debt, visibility of external financing and monetary policy easing have seen them price these and demand a premium for holding longer-dated bonds. High domestic liquidity and low credit expansion are expected to keep yields sticky into the end of 2025.

Into the third quarter, we expect the USDKES to hold within current ranges, supported by adequate forex reserves. However, there is potential for a mild adjustment owing to the risk from unstable diaspora flows due to stricter immigration laws in the U.S. and an increase in importer demand.

FX Reserves



6. Currency

The Kenya Shilling remains unfazed amidst a highly volatile environment. Underscoring this, demand from importers remains at bay while foreign currency inflows from diaspora, agricultural commodity exports and central bank intervention remain favorable.

