

# KINGDOM SECURITIES

Quarter 2

## MARKET REVIEW

Macro Economics | Fixed Income



## 2Q2026 Highlights

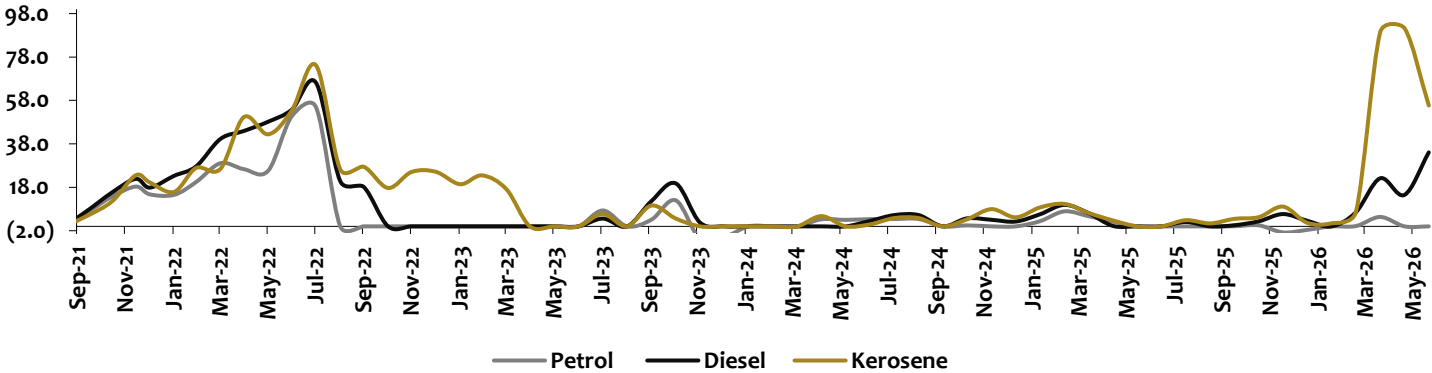
As highlighted in our Q1 2026 report, the second quarter of the year began amid renewed geopolitical tensions that threatened to reshape the economic outlook both locally and globally. The greatest concern was that fresh supply disruptions, particularly in the fuel market, would trigger another wave of inflationary pressures. Fortunately, the worst-case scenario did not materialize during Q1 2026, although there were casualties, with the business environment emerging as one of the most affected areas.

The period under review has increasingly become a sensitive quarter, given the recent tendency for fiscal issues to trigger public protests. In 2026, the trigger was fuel prices. In May 2026, petrol and diesel prices reached record highs, with diesel prices surpassing petrol prices for the first time in a long period. Petrol and diesel prices increased by 8.4% and 23.5% month-on-month, and by 22.7% and 47.4% year-on-year, respectively. The sharp increase triggered a strike by public service vehicle operators, who demanded a reduction in fuel prices. This resulted in a KES 10/litre reduction in diesel prices, while kerosene prices increased by KES 38.60/litre. The divergence was largely driven by the fixed subsidy amount applied across fuel products and the varying consumption levels of each fuel type.

During the period under review, the government allocated KES 21.20 billion towards fuel price stabilization. Additionally, the VAT applicable to fuel products was reduced from 16% to 8%, reverting to the pre-2023 rate. These interventions helped contain inflationary pressures, which, had they persisted, would have had broader implications for economic activity and financial markets. While fuel subsidies continue to represent a fiscal burden, their economic impact remains more manageable compared to the potential consequences of sustained fuel price shocks.

Kerosene has received the greatest level of support over time, largely due to its importance as a household fuel. Consequently, the subsidy per litre allocated to kerosene has consistently been higher, with recent levels exceeding those observed during the 2022 fuel crisis. See the chart below:

**Fuel Price Stabilization Amounts (KES/Litre)**



Source: EPRA | Chart: KSL

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Below, we look at the economy in numbers:

Period	Inflation	Benchmark Rate	PMI	FX Reserves (\$ Bn)	USD/KES	Domestic Debt (Kes Tn)	Petrol (Kes/Litre)	Diesel (Kes/Litre)	Kerosene (Kes/Litre)
1H25	3.68%	10.42%	50.50	9.80	129.32	6.33	176.05	165.63	149.84
1Q26	4.35%	8.83%	50.00	13.07	129.16	7.15	179.69	167.85	153.11
2Q26	6.23%	8.75%	48.67	13.30	129.42	7.30	208.63	217.45	178.51
1H26	5.29%	8.79%	49.33	13.19	129.29	7.30	194.16	192.65	165.81
Y/Y Change	1.61 p.p	-1.62%	-2.31%	34.51%	-0.02%	15.35%	10.28%	16.31%	10.66%
Q/Q Change	1.88 p.p	-0.08%	-2.67%	1.73%	0.21%	2.06%	16.10%	29.55%	16.59%

Source: CBK, KNBS, Stanbic Bank Kenya | Table: KSL \*Debt figures represent values at the close of the period

The economy recorded a mixed performance during the quarter, although the balance of indicators tilted slightly towards improvement. Three out of six tracked indicators recorded positive developments, compared to two that weakened, while one remained within range. This suggests that economic conditions improved marginally, but the gains were moderated by continued pressures in some segments of the economy. See the commentary below:

Indicator	Commentary	Status
<b>Inflation</b>	<p>In 2Q26, headline inflation averaged 6.23%, a 1.88 percentage point increase from 4.35% recorded in 1Q26. The performance raised the half-year average inflation rate to 5.29%, compared to 3.68% in 1H25. This was largely driven by a surge in fuel inflation, which translated into higher transport and logistics costs. Transport inflation averaged 14.2% in 2Q26, up from 4.2% recorded in 1Q26, while food inflation increased to 8.9% from 7.4% over the same period.</p> <p>However, despite the acceleration, inflation remained below the CBK's upper bound of 7.5%, largely supported by government interventions in the fuel market, which helped cushion the broader economy from further price pressures.</p>	Neutral
<b>Benchmark Rate</b>	<p>The benchmark rate continued a downward trajectory, averaging 8.79% in 1H26 compared to 10.42% in 1H25, reflecting a more accommodative monetary policy stance. The Monetary Policy Committee met twice during the second quarter and retained the benchmark rate at 8.75%, as the Central Bank balanced the need to support economic activity against emerging inflationary pressures.</p> <p>In our view, retaining the rate at 8.75% was the most appropriate action as created stability across several parameters. Y/y, the decline in borrowing costs provided some support to credit conditions and private sector activity, although the benefits were partly constrained by elevated operating costs.</p>	Positive
<b>Purchasing Managers' Index</b>	The private sector business environment weakened in 1H26, with PMI	Negative

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	<p>averaging 49.33 compared to 50.50 in 1H25, indicating a shift from expansion into contraction territory. The deterioration was more pronounced in 2Q26, when PMI declined to 48.67 from 50.00 in 1Q26. The slowdown reflected the impact of higher input costs, particularly fuel-related expenses, as well as softer demand conditions that affected business activity during the quarter.</p> <p>Looking ahead, the continued easing in global oil prices should gradually alleviate input cost pressures and support business activity. However, given the lagged transmission of lower energy costs through the economy, a more meaningful improvement in operating conditions is likely to emerge in September, all factors constant.</p>	
<b>Forex Reserves</b>	<p>The external sector remained resilient during the period, with foreign exchange reserves averaging USD 13.19 billion in 1H26, a 34.51% increase from USD 9.80 billion recorded in 1H25. Reserves improved further in 2Q26 to USD 13.30 billion from USD 13.07 billion in 1Q26, providing stronger buffers against external shocks and supporting exchange rate stability.</p>	<b>Positive</b>
<b>Currency</b>	<p>The Kenyan shilling remained largely stable against the US dollar during 1H26, averaging KES 129.29 compared to KES 129.32 in 1H25, representing a marginal 0.02% appreciation year-on-year. However, the currency recorded a slight depreciation in 2Q26, averaging KES 129.42 compared to KES 129.16 in 1Q26. The stability was supported by improved foreign exchange reserve buffers, proactive external debt management and historical currency related frameworks.</p>	<b>Positive</b>
<b>Domestic Debt</b>	<p>Domestic debt continued to increase during the period, rising to KES 7.30 trillion in 1H26 from KES 6.33 trillion in 1H25, representing a 15.35% year-on-year increase. The growth reflects continued reliance on domestic borrowing to bridge financing gaps amid elevated fiscal needs. On a quarterly basis, domestic debt increased by 2.06% in 2Q26, highlighting the continued pressure on government financing requirements even as the interest rates nudged upwards.</p>	<b>Negative</b>

And in case you missed it, please read our budget report [here](#).

## The Fixed Income Market

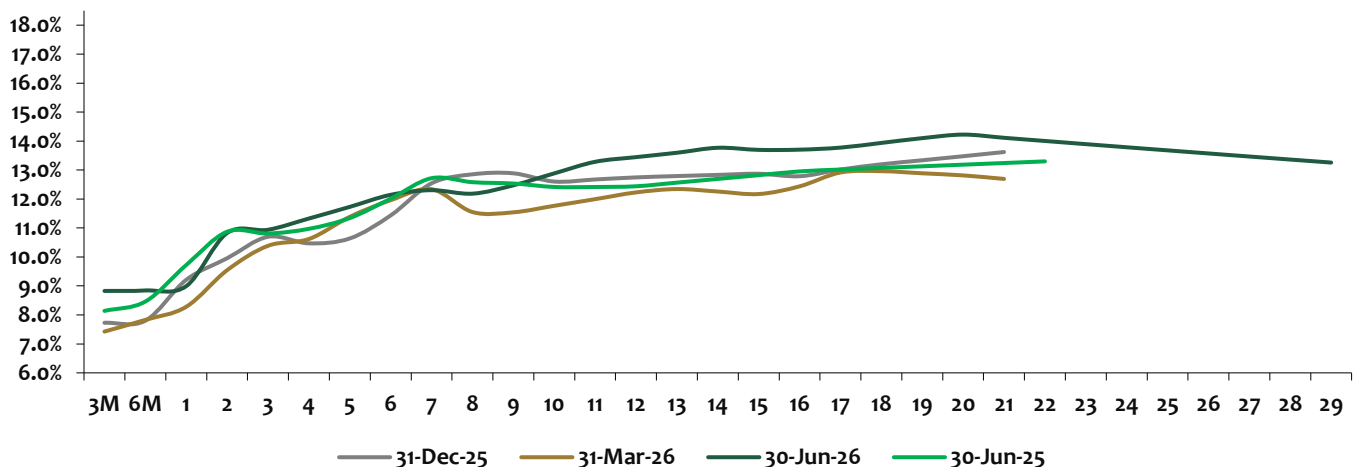
In the fixed income space, treasury bills remained oversubscribed in 2Q26, although demand moderated compared to the previous periods. Total bids received amounted to KES 361.28 billion against KES 312.00 billion offered, translating to a subscription rate of 115.8%. This was lower than the 172.9% recorded in 2Q25 and 196.1% in 1Q25, reflecting reduced investor appetite amid changing market conditions.

Similarly, demand for treasury bonds remained strong in 2Q26, with bids received amounting to KES 418.19 billion against KES 325.00 billion offered, representing a subscription rate of 128.7%. This was lower than the 236.9% recorded in 1Q25 and 141.8% in 2Q25, partly reflecting the larger issuance size during the quarter. The government accepted KES 325.53 billion, translating to an acceptance rate of 77.8%, higher than the 55.2% recorded in 1Q25 but below the 83.8% recorded in 2Q25. The relatively high subscription rate despite increased borrowing needs suggests that investor demand for government securities remained resilient, supported by attractive yields and increased liquidity within the financial system. See below a summary of the numbers:

Period	Amounts Offered	Bids Received	Bids Accepted	Subscription Rate	Acceptance Rate
<b>T-Bills</b>					
2Q25	312.00	539.43	456.40	172.9%	84.6%
1Q25	312.00	611.79	445.32	196.1%	72.8%
2Q26	312.00	361.28	326.53	115.8%	90.4%
<b>T-Bonds</b>					
2Q25	210.00	297.81	249.53	141.8%	83.8%
1Q25	170.00	402.71	222.11	236.9%	55.2%
2Q26	325.00	418.19	325.53	128.7%	77.8%

Given the heightened uncertainties and rising inflationary pressures during the period, interest rates experienced upward pressure, with the long end of the yield curve bearing the greatest impact. Investors demanded higher risk premiums, particularly for longer-dated securities, as concerns around inflation persistence, fiscal financing needs, and market uncertainty increased.

### NSE Yield Curve

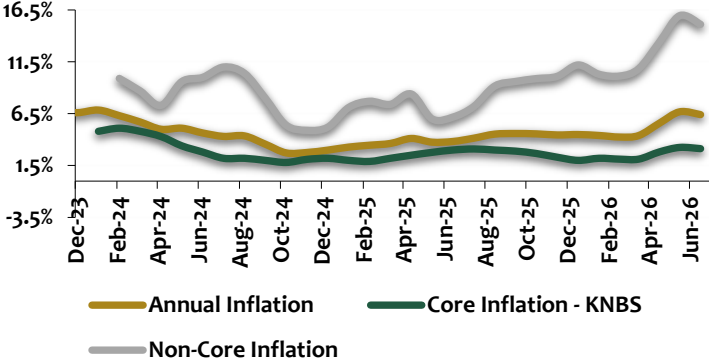


Source: EPRA | Chart: KSL

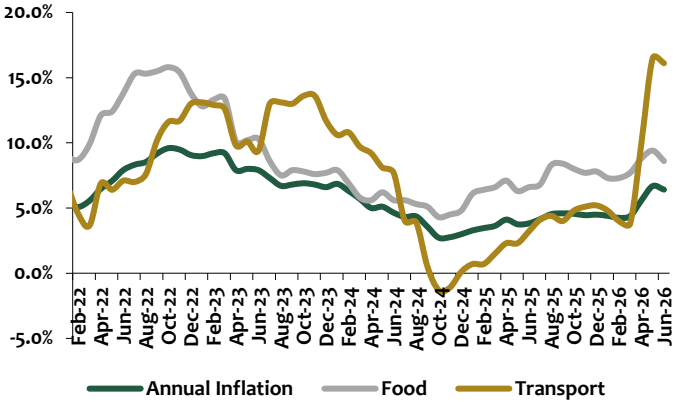
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## Background Charts

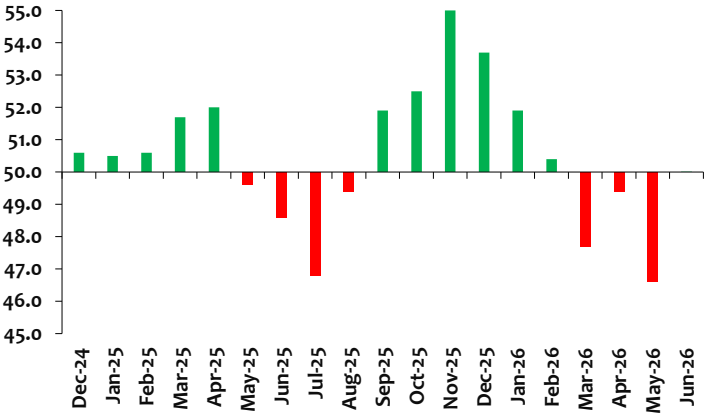
### Headline Figures



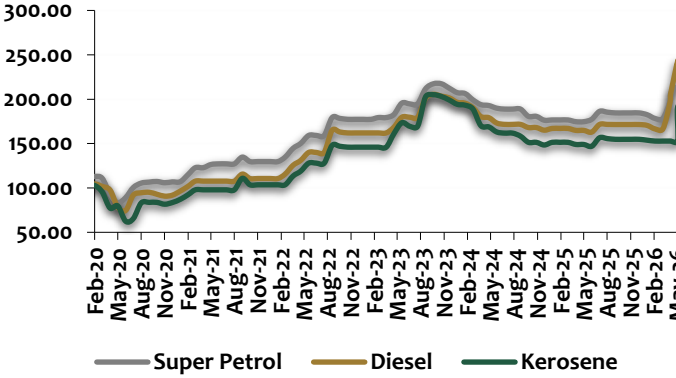
### Core Consumption Drivers vs Headline Inflation



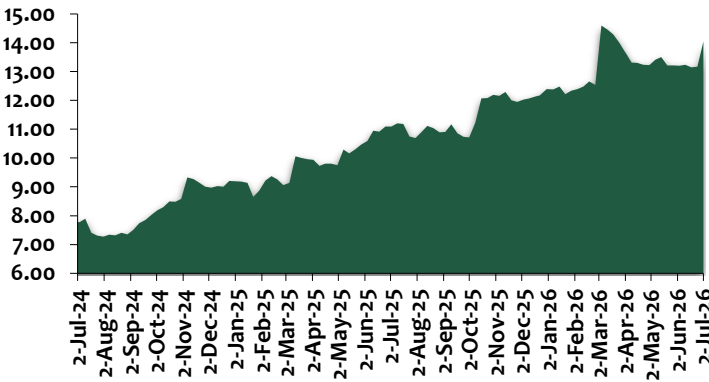
### Purchasing Managers' Index



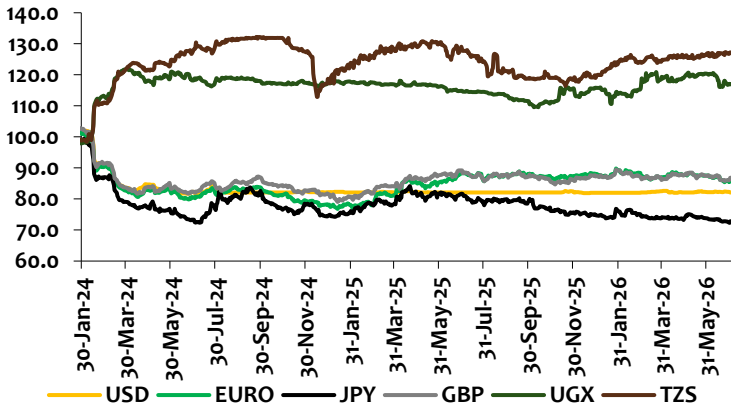
### Fuel Prices (KES/Litre)



### Kenya's Forex Reserves (USD BN)

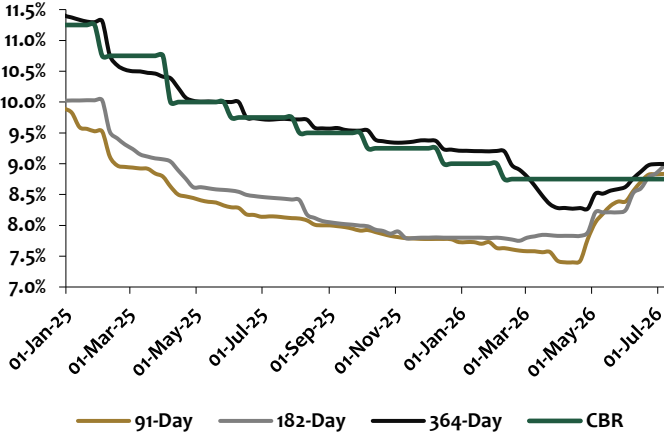


### KES MOVEMENT AGAINST SELECT CURRENCIES

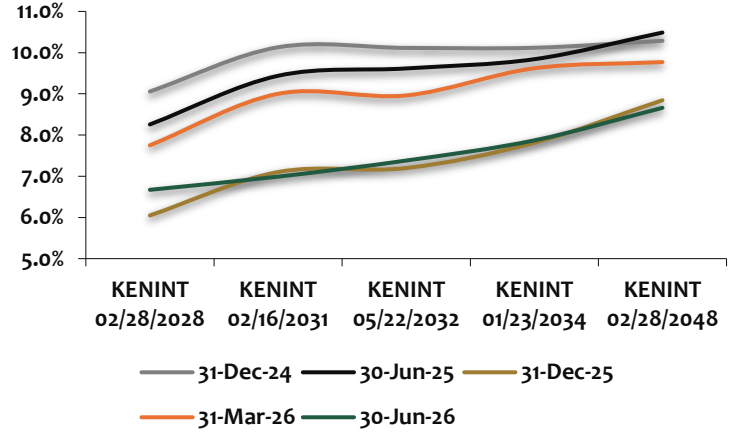


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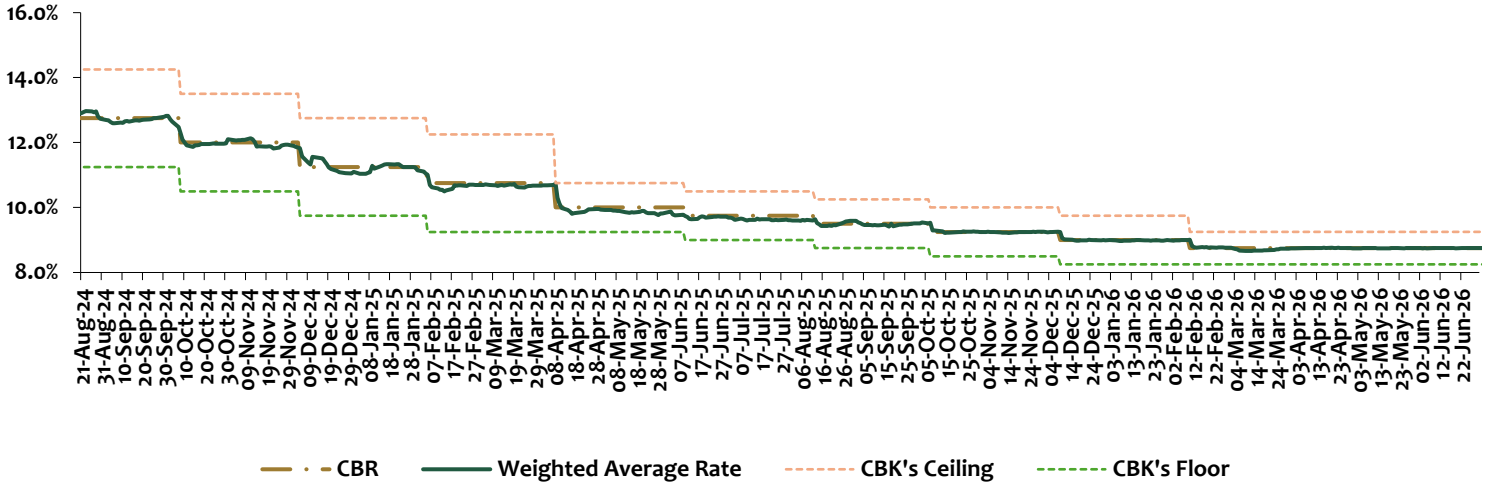
**WAR of Accepted Bids (Yields)**



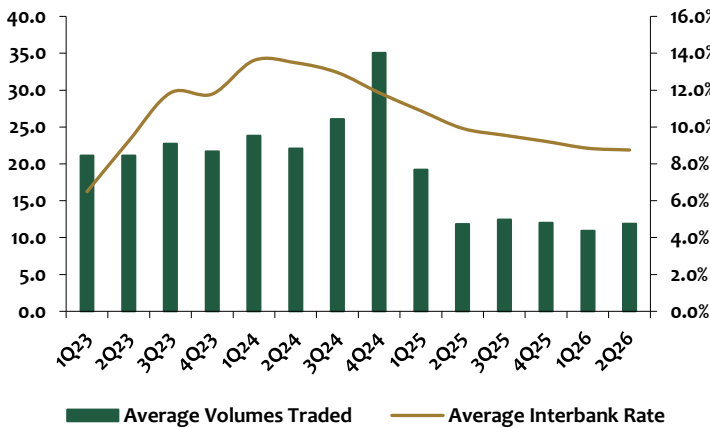
**Kenyan Eurobond Yields**



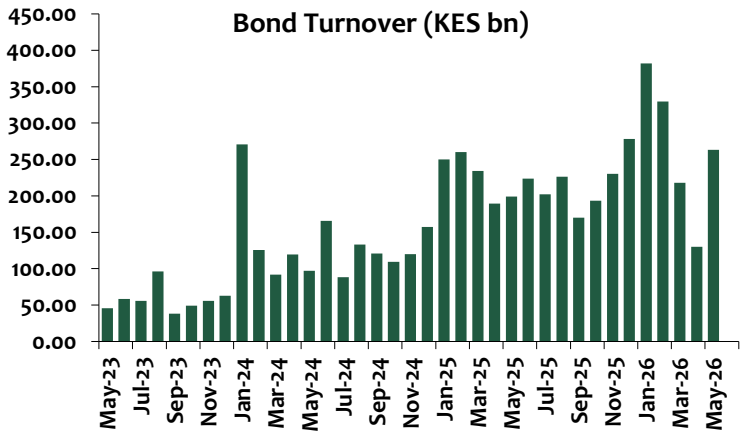
**Interbank Rate Spreads**



**Liquidity Indicators**



**Bond Turnover (KES bn)**



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