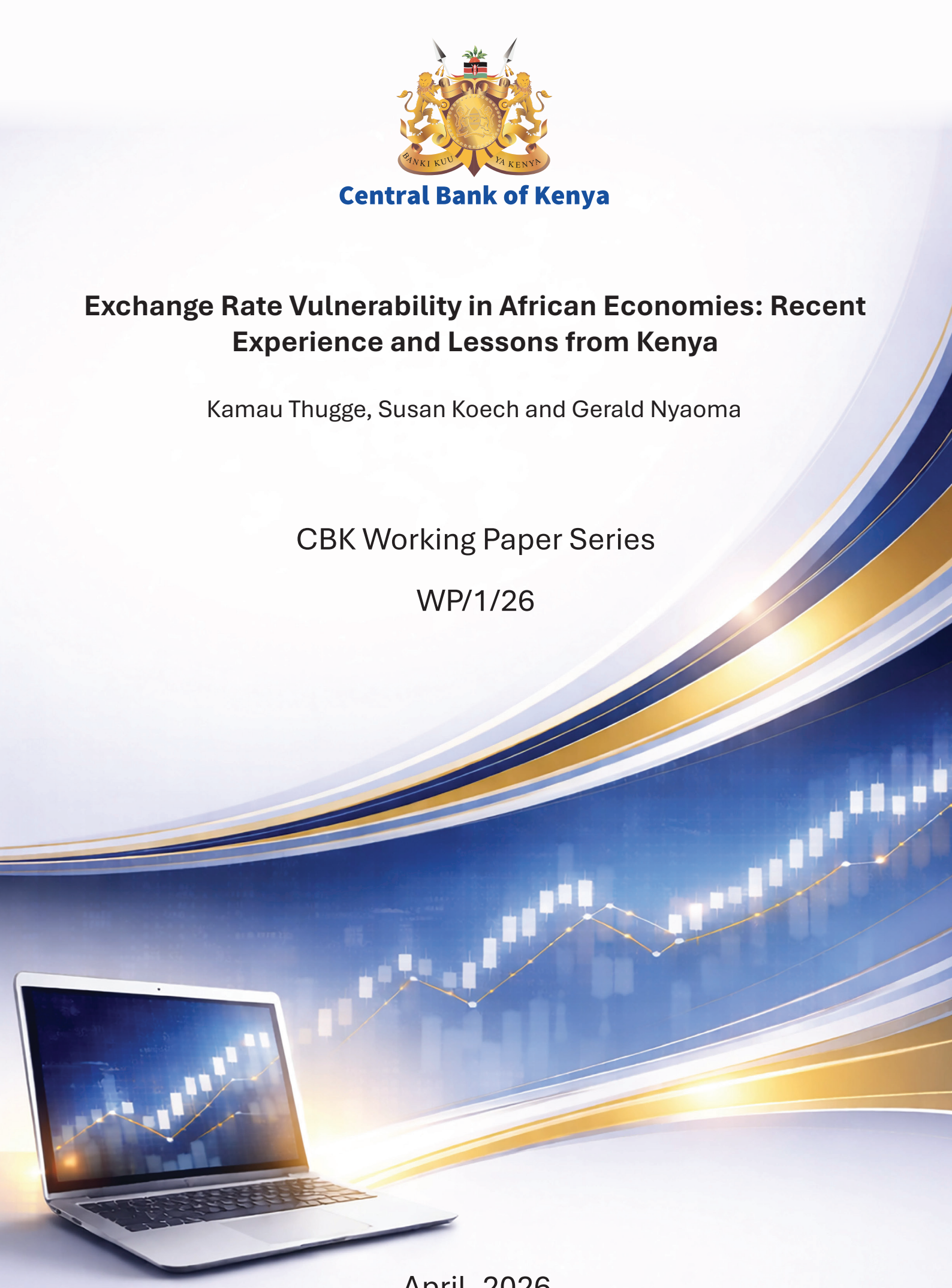
Central Bank of Kenya

Exchange Rate Vulnerability in African Economies: Recent Experience and Lessons from Kenya

Kamau Thugge, Susan Koech and Gerald Nyaoma

CBK Working Paper Series

WP/1/26



April, 2026

© Central Bank of Kenya

All rights reserved. No part of this publication may be reproduced in any form or by any means without fully acknowledging the author(s) and this Working Paper as the source.

The CBK Working Paper Series serves as a platform for disseminating research findings, analytical reflections, and policy insights from ongoing and completed work within and beyond the Central Bank of Kenya, to stimulate intellectual debate and promote exchange of ideas on critical economic and development issues.

Enquiries regarding the CBK Working Paper Series can be addressed to:

Director, Research Department
Central Bank of Kenya
P O Box 60000 - 00200 Nairobi, Kenya
Tel: +254 20 286 0000

Exchange Rate Vulnerability in African Economies: Recent Experience and Lessons from Kenya

Kamau Thugge*, Susan Koech** and Gerald Nyaoma**

April 2026

*Governor, Central Bank of Kenya

**Deputy Governor, Central Bank of Kenya

Abstract

African economies have become increasingly vulnerable to exchange rate volatility in the wake of global shocks. This paper examines Kenya's exchange rate experience with a particular focus on its evolution over the period 2022–2025, highlighting key drivers, policy responses, outcomes, and lessons. The sharp depreciation of the Kenya Shilling during 2022–2023 was driven by a combination of external shocks including higher global interest rates following aggressive monetary policy tightening, a strong U.S. dollar, commodity price fluctuations, and constrained access to international financial markets, as well as domestic factors such as foreign exchange market inefficiencies that compounded the demand–supply imbalances. The depreciation exerted significant inflationary pressures through exchange rate pass-through and increased the burden of external debt. In response, the Central Bank of Kenya implemented a coordinated policy mix of monetary tightening, reforms to strengthen policy transmission, and measures to enhance the efficiency and transparency of the interbank foreign exchange market, complemented by targeted fiscal interventions. These measures successfully stabilized the exchange rate, lowered inflation, restored investor confidence, and helped rebuild foreign exchange reserves, albeit initially at the cost of higher interest rates leading to a temporary contraction in private sector credit. The analysis underscores the importance of credible policy frameworks, effective monetary–fiscal coordination and structural reforms in managing exchange rate volatility. Notwithstanding the gains made, persistent risks from the global environment continue to pose challenges to macroeconomic stability, necessitating the need to continue enhancing the economy's resilience to shocks through export diversification and prudent economic and debt management.

Key words

Exchange rate, volatility, monetary policy, foreign exchange, Kenya

Acknowledgment

The authors are grateful for the valuable research assistance provided by Maureen Were, Maureen Odongo, Leonard Kipyegon, Anne Kamau, Roseline Misati, Anthony Gathogo, Edwin Maza, Joseph Wambua and Ruth Mwathi from the Research Department at CBK. They are also thankful to Prof. Victor Murinde and Mr. Jared Osoro for their insightful comments on earlier versions of the paper.

1.0 Background

The exchange rate is a key macroeconomic variable with significant implications for developing and small open economies. Its volatility has direct and indirect ramifications on macroeconomic stability, capital flows, trade, public debt, economic growth and societal welfare. Most African open economies are vulnerable to exchange rate volatility and speculative attacks on domestic currencies. The vulnerability is exacerbated by structural characteristics of these economies, such as shallow domestic capital markets, a narrow export base and reliance on primary commodity exports vis-à-vis high import-dependence. These characteristics render the economies to be highly susceptible to interest rate shocks, volatility in commodity prices and other shocks in the global economy. The negative impact of external shocks on exchange rates and capital flows is substantially greater in emerging and small open economies compared to advanced economies (Lim 2025). External shocks generate exchange rate fluctuations that largely deviate from uncovered interest rate parity and hence, they are a dominant driver of exchange-rate dynamics in small open economies (Cormun and De Leo 2026). Moreover, large swings in the exchange rate, especially large depreciations, can destabilize domestic prices, thereby undermining overall price stability (Brandão-Marques et al. 2023).

Most African economies have recently faced enormous challenges in maintaining stability of their domestic currencies, amid multiple shocks. Globally, the upsurge of inflation in advanced economies in 2022 and the subsequent interest rate hikes led to tightening of global financial conditions, strengthening of the United States (U.S.) dollar and capital outflows, all of which had significant repercussions on domestic currencies. The situation was compounded by public debt challenges that were particularly heightened by the high cost of debt service and inaccessibility to international financial markets due to the high global interest rates. Like the domestic currencies of its peers, the Kenya shilling (KSh) experienced immense pressure largely on account of these developments.

Kenya pursues a flexible exchange rate regime in which the value of the Kenyan shilling is market-determined.[1] This regime is consistent with the inflation targeting (IT) monetary policy framework that the Central Bank of Kenya (CBK) officially adopted in August 2023. Between January 2023 and January 2024, the shilling depreciated significantly by 29 percent against the U.S. dollar (USD), from a monthly average of KSh 123.9 to KSh 159.7 per dollar. Meanwhile, from June 2022 to June 2023, headline inflation remained elevated above the inflation target band of 5±2.5 percent, having peaked at 9.6 percent in October 2022. The adverse impact of external shocks played a key role in driving this macroeconomic instability.

Restoration of stability was achieved through a combination of monetary policy tightening and implementation of a raft of reforms to enhance efficiency of the interbank market, coupled with complementary fiscal measures. Consequently, the Kenya shilling reversed the sharp depreciation trajectory and appreciated by about 23.6 percent against the dollar to KSh 129.2 as at end of October 2024 and remained stable. Headline inflation decelerated to 2.7 percent in October 2024, before gradually rising towards the 5 percent mid-point of the target range, in line with the subsequent monetary policy easing cycle. The stability of the exchange rate and increased foreign exchange (forex) inflows enabled accumulation of reserves to record levels. By end of 2025, forex reserves had increased by 69 percent, from US$ 7,342 million in 2023 to US$ 12,394 million, an equivalent of about 5.3 months of import cover, thereby providing an ample buffer against short term shocks.

[1] *The Central Bank intervention in the foreign exchange market is restricted to minimizing excessive volatility where necessary.*

Notwithstanding the aforementioned gains, risks and heightened uncertainty in the global environment remain a major concern. The risks include potential adverse implications of the shifting trade and protectionist policies on global trade and growth, and the heightened geopolitical instability following the U.S.–Iran war that started on 28th February 2026, triggering a surge in international oil prices.

Against this background, this paper examines Kenya's experience regarding the recent exchange rate volatility, with the aim of highlighting key drivers and distilling the main successes, lessons and emerging challenges. The exploratory analysis largely focuses on the 2022-2025 period.

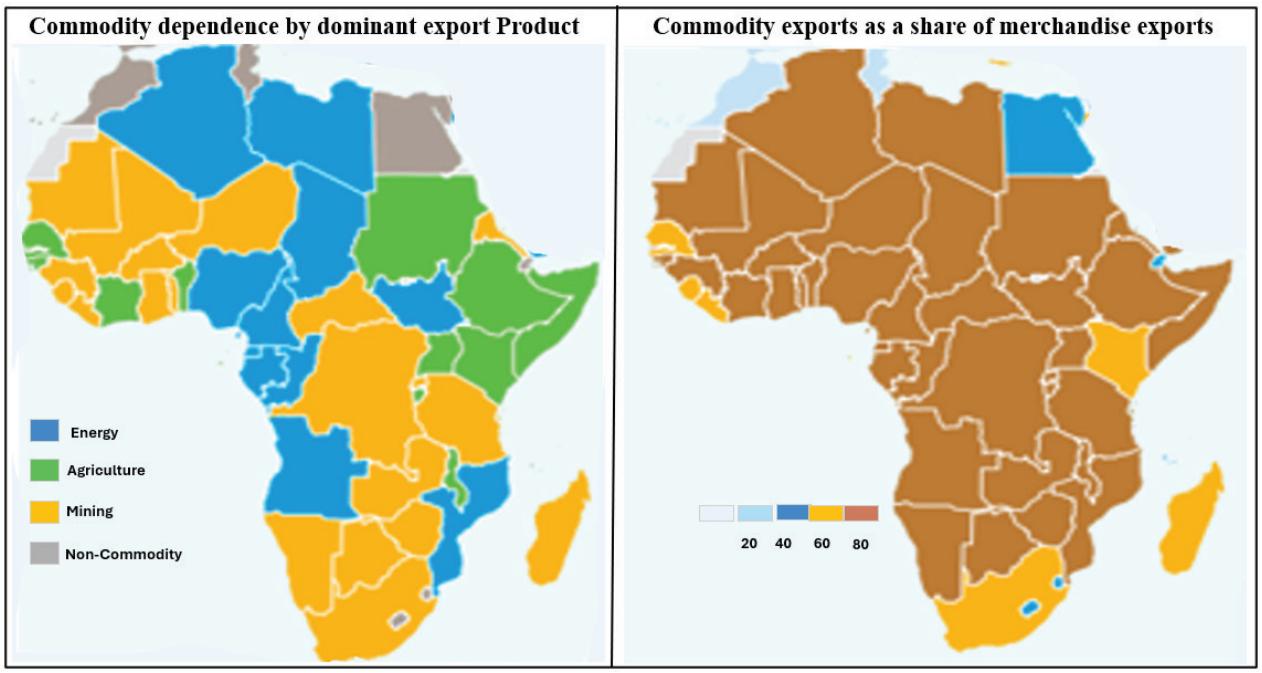
The rest of the paper is organized as follows. Section 2 provides an overview of key drivers of exchange rate vulnerability in African economies. Section 3 presents a trend analysis of nominal and real exchange rates. Section 4 describes the monetary policy responses and reforms implemented in the interbank market, while Section 5 provides an overview of the outcomes. Sections 6 and 7 highlight key policy lessons and conclusion, respectively.

2.0 Drivers of Exchange Rate Vulnerability in African Economies

There are several factors that influence exchange rate vulnerability in African economies. These include volatility in commodity prices, particularly for economies that are highly dependent on commodity exports (Ajao 2015; Goda and Priewe 2020; Okot 2022; Monterroso and Vilàn 2025). African economies remain heavily dependent on a narrow range of primary commodity exports such as agricultural products, mineral fuels, and metals **(Figure 1)**. These primary commodities are prone to global price fluctuations, which affect foreign exchange earnings and amplify exchange rate volatility. About 85 percent of African countries were classified as commodity dependent during the period 2021-2023, with exports of primary commodities accounting for over 60 percent of merchandise exports (UNCTAD 2025).

The high degree of export concentration makes African countries vulnerable to negative external shocks that affect the quantities and/or prices of the commodities exported, with implications on macroeconomic variables including exchange rates, terms of trade, current account balances, reserves and debt levels (UNDP 2016; Kohlscheen et al. 2016; Wanzala and Obokoh 2024). Periods of favourable commodity prices may temporarily boost export earnings and foreign exchange reserves. However, downturns in global commodity markets reverse these gains, exerting pressure on external balances, leading to exchange rate instability, and imposing fiscal constraints (IMF 2025a). Export market concentration has also become a key policy concern, especially in the context of U.S. tariff adjustments that have directly affected export earnings and foreign exchange inflows. For instance, the African countries that export under the African Growth Opportunity Act (AGOA) preferential duty-free access to the U.S. market are grappling with lower export revenues and uncertainty over the future of the programme, despite the recent temporary extension of the framework. Countries such as South Africa, Kenya, Madagascar, Lesotho, and Nigeria account for a notable share of AGOA exports to the U.S. market.

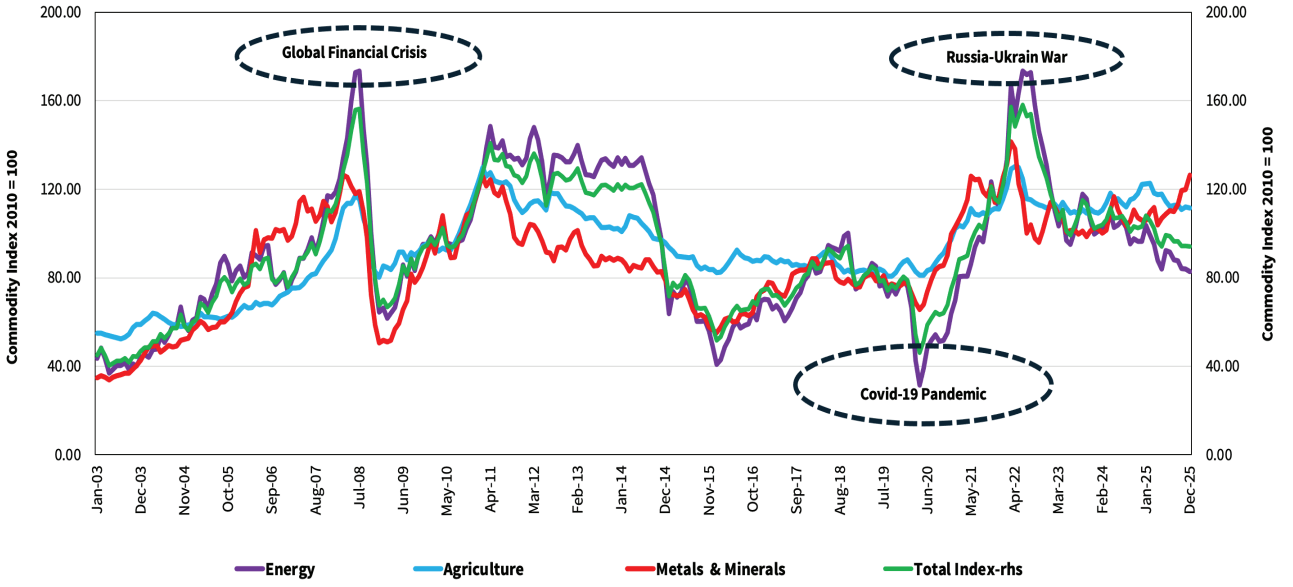
Figure 1: Commodity Dependence in Africa 2021-2023



Source: UNCTAD, State of Commodity Dependence 2025

Global commodity price movements have been erratic. They surged prior to the 2007 global financial crisis, collapsed during that period, and rebounded thereafter. They, however, plunged at the onset of the COVID-19 pandemic, followed by upswings in 2021 and 2022 **(Figure 2)**. Energy commodities comprising crude oil, coal, natural gas, and liquefied natural gas had the widest price variations during the period 2021- 2022. The energy price index increased from 31.6 in April 2020 to peak at 173.5 in June 2022, before slowing down gradually to 82.9 by December 2025. The increase was mainly attributed to Russia's invasion of Ukraine in February 2022. Additionally, prices of agricultural commodities, particularly wheat, maize and palm oil, also increased. Given Kenya's dependence on imports of these food items, the spike in international prices, driven by global supply chain disruption contributed to heightened domestic inflationary pressures in 2022.

Figure 2: Global Commodity Price Index, 2003-2025



Source: World Bank Commodity Price Database, Accessed February 2026

Swings in global commodity prices continue to pose challenges for macroeconomic management and sustainable long-term growth. Trade shocks associated with the upward and downward swings in commodity prices play a significant role in driving volatility in exchange rates, inflation, shifts in current and fiscal accounts balances, and external reserves in Africa (Deaton 1999; Kose and Riezman 2001). Additionally, commodity price shocks impact a country's capacity to honor debt service payments (Eberhardt and Presbitero 2021). They also act as a key transmission channel through which global financial shocks influence credit cycles in developing economies (Bationo et al. 2025).

The global shift towards low-carbon and clean energy technologies has significantly increased demand for a range of critical minerals and metals, including cobalt, lithium, copper, manganese, platinum group metals, and graphite. As countries accelerate efforts to decarbonize their economies and expand renewable energy capacity, the demand for these minerals has grown rapidly, placing resource-rich countries at the centre of the evolving global energy landscape. Although several African economies such as Democratic Republic of Congo, Zimbabwe and South Africa possess substantial reserves of strategic minerals with significant potential to transform their foreign exchange earnings[2], Africa's minerals are often exported in raw or minimally processed forms. This limits the share of value added domestically and reduces the potential foreign exchange gains that could arise from downstream processing and manufacturing. Without broader export diversification and stronger domestic value addition, the benefits of rising demand for critical minerals remain uneven, leaving mineral-exporting economies exposed to vulnerabilities in the global commodity markets and the associated exchange rate pressures.

Foreign Direct Investment (FDI) and capital flows also play a role in determining exchange rate vulnerability. Capital flows in developing economies tend to be highly sensitive to global financial conditions and investor sentiments, exhibiting sudden reversals, which worsen exchange rate vulnerability and weaken domestic financial conditions (Forbes and Warnock 2012; Kilicarslan 2018; Okot 2022). Significant interest rate differentials particularly relative to advanced economies and global risk aversion have been found to be important determinants of private capital inflows to developing and emerging markets (Ahmed and Zlate 2014; Hannan 2018; Abdi et al. 2020). Furthermore, inflows into commodity-dependent countries that are more closely integrated into international capital markets are often influenced by commodity price dynamics (Reinhart et al., 2016) and the evolution of international financial conditions (Cuddington and Jerrett, 2008; Fernandez et al. 2020).

Empirical evidence shows that external shocks such as U.S. monetary tightening and geopolitical risks have a greater negative impact on the exchange rates and capital flows in emerging and small open economies compared to advanced economies (Brandão-Marques et al.2023; Lim 2025; Cormun and De Leo 2026). Lim (2025) found that effects of external shocks on the forex market were more pronounced in economies with high sovereign debt ratios, high external debt ratios or commodity-exporting ones. Economies with highly diversified exports were more likely to alleviate the negative spillovers of the shocks.

The multiple global shocks, including the COVID-19 pandemic, Russia-Ukraine war, climate change shocks and interest rate hikes in advanced economies heightened public debt and exchange rate vulnerabilities. The public debt burden and the fiscal positions of most African economies worsened significantly after the pandemic, leading to widening of fiscal deficits, with little or no buffers to cushion the economies from increased vulnerability. By 2021, over three-quarters of Sub-Saharan Africa (SSA) countries had public debt to Gross Domestic Product (GDP) ratio of above 50 percent (Were 2024). Moreover, the upsurge in global inflation in 2022[3] and subsequent aggressive monetary policy tightening not only contributed to a stronger U.S. dollar but also led to tighter financing conditions in international financial markets, which priced out African economies from the sovereign bond market until early 2024 **(Table 1)**. The higher borrowing costs made refinancing and servicing of debt much more difficult, thus amplifying the pressure on domestic currencies.

[2] *Based on the Kenya Critical Mineral Catalogue (2025) and related analyses, Kenya has reported occurrences of minerals such as lithium, graphite, manganese, and significant potential for Rare Earth Elements (REEs) and Niobium.*

[3] *Global inflation increased significantly to 8.7 percent in 2022, from historically low levels of less than 2% before the pandemic.*

Table 1: Sovereign International Bond Issuance by Region (US$ billions)

	Country	Region	2021	2022	2023	2024	2025
1.	China	Asia	-	-	-	4.9	1.6
2.	Kazakhstan	Asia	-	-	-	1.5	4.0
3.	Philippines	Asia	6.0	4.8	4.0	4.5	3.3
4.	Indonesia	Asia	12.2	8.2	5.7	11.0	12.2
5.	Bulgaria	Europe	-	2.2	4.0	4.8	8.1
6.	Chile	Latin America	18.9	7.0	11.2	7.8	4.8
7.	Hungary	Europe	5.3	5.2	7.0	4.3	6.5
8.	Poland	Europe	-	5.1	10.6	15.9	12.1
9.	Romania	Europe	8.2	8.5	9.7	18.4	17.7
10.	Turkey	Europe	-	-	-	12.8	13.1
11.	Brazil	Latin America	2.2	-	4.2	6.4	6.9
12.	Colombia	Latin America	6.1	1.3	4.3	5.0	8.6
13.	Peru	Latin America	10.0	-	2.5	4.8	5.7
14.	Uruguay	Latin America	1.8	1.0	1.7	3.4	3.5
15.	Mexico	Latin America	9.1	7.3	5.3	10.7	41.4
16.	Dominican Republic	Latin America	4.6	3.6	3.1	3.0	6.6
17.	Bahrain	Middle East	4.0	-	2.0	3.3	5.0
18.	Kuwait	Middle East	-	-	-	-	11.3
19.	Qatar	Middle East	-	-	-	2.5	3.0
20.	Saudi Arabia	Middle East	10.0	5.0	15.7	16.8	19.7
21.	United Arab Emirates	Middle East	10.9	4.2	3.2	8.9	4.8
22.	Egypt	North Africa	-	-	-	-	3.5
23.	Morocco	North Africa	-	-	2.5	-	2.1
24.	Angola	Sub-Saharan Africa	-	-	-	-	1.7
25.	Benin	Sub-Saharan Africa	-	-	-	0.7	0.5
26.	Congo	Sub-Saharan Africa	-	-	-	-	0.6
27.	Côte d'Ivoire	Sub-Saharan Africa	-	-	-	2.6	2.1
28.	Gabon	Sub-Saharan Africa	-	-	-	-	0.5
29.	Kenya	Sub-Saharan Africa	-	-	-	1.5	3.5
30.	Nigeria	Sub-Saharan Africa	-	-	-	-	2.3

Sources: Bloomberg Finance L.P; Refinitiv Eikon Datastream IBES;

Heightened risk of debt distress or eventual debt default exacerbates depreciation of the domestic currency, which in turn increases public debt in domestic currency, thereby potentially leading to a vicious cycle of indebtedness. External debt is typically denominated in foreign currency, especially the USD, thus exposing debtor countries to exchange rate risks. Moreover, increased debt vulnerabilities lead to lower credit ratings and loss of investor confidence, further aggravating the depreciation of the currency against major world currencies and exposure to speculative attacks. Several SSA countries, including Mozambique, Zambia, Ghana and Ethiopia defaulted on their external debt repayments. Meanwhile, the risk of debt distress for most SSA countries including Kenya remains high. **Table 2** shows wider variations in public-debt to GDP ratios during the 2020-2025 period, especially in oil and mineral exporting countries. The mounting public debt challenges amid multiple shocks and commodity price swings, coupled with limited fiscal space, contributed to the weakening of domestic currencies and affected countries' ability to service external debts (Afreximbank 2024; Were 2024).

Table 2: Government Debt to GDP of Selected African Countries

Government Debt for countries exporting oil and minerals									
	Government Debt to GDP						Percent Change		
Country	2020	2021	2022	2023	2024	2025	2023/22	2024/23	2025/24
Zambia	140	111	99.5	129.1	114.9	90.10	29.7	-11.0	-21.6
Egypt	86.2	89.9	88.5	95.9	90.9	86.6	8.4	-5.2	-4.7
South Africa	68.9	68.7	70.8	73.4	76.4	79.6	3.7	4.1	4.1
Gabon	83	72.9	65.6	70.6	73.4	79.2	7.6	4.0	8.0
Ghana	72.3	79.2	85.7	76.4	70.5	66.4	-10.9	-7.7	-5.8
Angola	119.1	74.3	56.1	71.4	62.5	64.5	27.3	-12.5	3.2
Algeria	46	55.1	48.1	47.7	46.2	57.8	-0.8	-3.1	25.1
Nigeria	35.6	36.8	40.4	48.7	52.9	52.5	20.5	8.6	-0.7
Tanzania	41.3	43.4	44.9	47.4	48.2	47.1	5.6	1.7	-2.3
Botswana	23.5	22.3	21	22.5	32.6	43.0	7.1	44.9	31.8
Cameroon	44.9	47.2	45.6	43.2	42.7	39.9	-5.3	-1.2	-6.6
Equatorial Guinea	49.4	42.3	29.8	36.3	36.2	35.1	21.8	-0.3	-3.1
Chad	41.1	41.6	32.2	32.6	33.8	33.9	1.2	3.7	0.2
DRC	24.9	24.7	22.6	25.1	19.3	16.3	11.1	-23.1	-15.5
Group Average	**62.6**	**57.8**	**53.6**	**58.6**	**57.2**	**56.6**	**9.3**	**-2.4**	**-1.1**

Government Debt for countries importing oil and minerals									
	Government Debt to GDP						Percent Change		
Country	2020	2021	2022	2023	2024	2025	2023/22	2024/23	2025/24
Senegal	81.6	89.4	94.6	107.4	113.7	111.4	13.5	5.9	-2.0
Mozambique	120	104.3	100.3	90.8	96.6	101.1	-9.5	6.4	4.6
Rwanda	68.7	67.3	60.9	63.4	67.2	77.6	4.1	6.0	15.5
Malawi	53.9	66.5	75.5	86.1	74.4	73.0	14.0	-13.6	-1.9
Kenya	68	68.2	67.8	73	65.6	68.3	7.7	-10.1	4.2
The Gambia	85.9	83.1	83.9	75.7	72.9	67.5	-9.8	-3.7	-7.4
Lesotho	54.7	58	64.6	61.5	59.8	59.7	-4.8	-2.8	-0.1
CAR	44.4	48.5	51	58.2	60.7	58.3	14.1	4.3	-4.0
Uganda	46.3	50.3	50.2	50.2	51.8	54.0	0.0	3.2	4.2
Madagascar	52.1	49.5	50	52.7	50.4	51.3	5.4	-4.4	1.7
Ethiopia	53.7	53.8	46.9	38.7	32.3	41.8	-17.5	-16.5	29.4
Eswatini	38.7	37	40.7	37.3	36.4	39.0	-8.4	-2.4	7.2
Burundi	65.9	66.5	68.3	47.2	43.2	35.3	-30.9	-8.5	-18.3
Comoros	24.3	26.3	28.2	28.7	30.8	32.5	1.8	7.3	5.6
Group Average	**61.3**	**62.1**	**63.1**	**62.2**	**61.1**	**62.2**	**-1.4**	**-1.7**	**1.8**

Source: IMF, World Economic Outlook, accessed February 2026

Both commodity-exporting and importing countries faced varying degrees of exchange rate pressure, reflecting different levels of exposure and vulnerability to external shocks **(Table 3)**. Over the period 2022-2023, domestic currencies of major commodity/oil exporting SSA countries faced immense pressure, particularly Ghana's cedi, Nigeria's naira and Angola's kwanza, which depreciated sharply by about 33.2 percent, 53.6 percent and 40.7 percent, respectively in 2023 **(Table 3)**. Oil-importing African countries were also affected, as evidenced by the notable depreciation of domestic currencies of countries such as Kenya, Zambia, Malawi and Burundi. The rising global energy prices increased import costs and heightened exchange-rate pressures, as demand for foreign currency increased, thus weakening the current account balances and reducing reserve buffers. The exchange rate pressures were reinforced by the relatively high domestic inflation, the high public debt burden, and reduced access to international capital markets, which limited the ability to stabilize the currencies (IMF 2023). Arguably, more diversified economies, such as Kenya and South Africa coped relatively better. Countries operating fixed or managed exchange rate regimes maintained relative stability, albeit with constrained policy autonomy and limited capacity to absorb external shocks.

Table 3: Exchange Rate Changes in Select African Countries (Percent)

Year	Commodity Exporting Countries (Domestic Currency/USD) Percent Change										
	Libya Dinar	Egypt Pound	Angola Kwanza	Mauritania Ouguiya	Nigeria Naira	South Africa Rand	Algeria Dinar	Gabon CFA	Equatorial Guinea CFA	Chad CFA	Ghana Cedi
2022	6.6	25.7	-27.1	2.5	5.4	10.6	4.8	12.6	12.6	12.6	42.5
2023	-0.2	56.2	40.7	-1.0	53.6	12.3	-4.3	-2.9	-2.9	-2.9	33.2
2024	0.5	48.0	25.1	8.6	132.0	-0.7	-1.1	0.3	0.3	0.3	22.0
2025	9.5	7.7	4.3	0.5	-0.1	-2.8	-2.0	-4.6	-4.6	-4.6	-15.3

Year	Oil Importing Countries (Domestic Currency/USD) Percent Change										
	Ethiopia Birr	Rwanda Franc	Botswana Pula	Burundi Franc	Malawi Kwacha	Tanzania Shilling	Zambia Kwacha	Kenya Shilling	Lesotho Loti	Uganda Shilling	Mauritius Rupee
2022	18.3	2.5	11.5	2.8	18.6	-1.9	-13.0	7.7	10.6	3.8	5.4
2023	5.5	12.3	7.8	27.0	21.4	4.0	20.3	19.0	12.3	0.8	1.5
2024	131.7	13.2	1.3	11.8	49.1	8.0	27.5	-3.5	-0.7	0.6	2.7
2025	22.0	8.7	3.3	2.4	0.5	0.1	-3.9	-4.1	-2.8	-4.1	-0.7

Source: Authors' Illustration based on IMF International Finance Statistics, Thomson Reuters Database, Accessed Feb 2026

By 2025, exchange-rate performance across African countries became more differentiated, reflecting the varied macroeconomic management, external financing conditions, and exposure to global commodity markets. Although commodity prices recovered in some cases, the recovery was uneven and highly volatile, exposing commodity-dependent economies to renewed external shocks (IMF 2025b). Countries that benefited from favorable commodity prices, such as Nigeria, Angola, Egypt, and South Africa, experienced notable currency recoveries, supported by tighter monetary policy and improved export earnings (Afreximbank 2024; IMF 2025b). Countries such as Ghana, Zambia and Malawi implemented strong macroeconomic reforms under the IMF supported debt restructuring measures, which helped restore market confidence and eased pressure on the depreciation of the currencies. Oil-importing countries such as Kenya undertook monetary reforms and fiscal policy measures that improved external balances and strengthened foreign exchange reserve positions.

Following the decline of headline inflation in advanced economies and easing of global financing conditions, most emerging market and developing economies, including SSA countries, have continued to participate in the capital markets, with international sovereign bond issuance reaching a record high of over US$ 50 billion, thereby somewhat relieving the debt servicing liquidity constraints (**Table 1**). As integration of markets in the East African Community (EAC) and across Africa deepens, the incentive to reduce public debt vulnerabilities and exchange volatility will be increasingly needed to support the rationale for a unified currency.

3.0 Trends in Kenya's Nominal and Real Exchange Rates

Like other emerging market economies, Kenya faced significant exchange rate pressures, owing to the impact of the multiple shocks and elevated global risks in 2022-2023 (**Table 4**). Based on the annual averages, the Kenya Shilling depreciated against USD by 19 percent in 2023, reaching a historic level of KSh 161.36 against the USD on January 23, 2024. The increase was much higher compared to the 7.5 percent depreciation in 2022. Moreover, the domestic currency also weakened significantly against other major currencies including Sterling Pound and the Euro **(Table 4).**

The heightened depreciation was driven by various factors. These include higher interest rates in the U.S. and other advanced economies following aggressive monetary policy tightening that triggered capital outflows from emerging markets including Kenya, the strengthening of the U.S. dollar, lower export growth[4], and heightened public debt sustainability challenges amplified by the constrained access to international financial markets. Increased speculation of Kenya defaulting on the repayment of the sovereign bond that was due to mature in June 2024 also fueled speculative attacks on the domestic currency. Domestically, the limited supply of foreign exchange created a persistent imbalance between demand and supply, as forex demand to pay for fuel, machinery, and other essential imports increased. Structural and operational inefficiencies in the forex interbank market and dollar hoarding also compounded the situation.

Table 4: Kenya Shilling Exchange Rates Against Major Currencies (Annual Average Percent Change)

Year	US Dollar	Sterling Pound	Euro	Japanese Yen	Chinese Yuan	Indian Rupee	South African Rand	Uganda Shilling	Tanzania Shilling	Rwanda Franc	Burundi Franc
2019	0.7	-3.8	-4.6	1.1	-3.6	-2.3	-8.4	1.3	-0.7	-3.8	-2.8
2020	4.4	5.0	6.4	7.5	4.4	-0.9	-7.9	3.9	4.0	-1.0	0.1
2021	3.0	10.4	6.8	0.2	9.8	3.2	14.1	6.8	3.0	-2.3	-0.2
2022	7.5	-3.3	-4.3	-9.8	3.4	1.2	-2.6	4.6	7.0	4.9	3.5
2023	18.6	19.5	21.9	10.4	12.6	12.8	4.9	16.8	13.6	7.1	-4.7
2024	-3.5	-1.1	-3.6	-10.3	-5.0	-4.8	-3.0	-4.3	-11.0	-16.1	-15.2
2025	-4.1	-1.1	0.1	-3.1	-4.0	-8.0	-1.6	0.5	-1.4	-11.2	-6.2

Source: Central Bank of Kenya

Trend analysis of the trade-weighted Nominal Effective Exchange Rate (NEER) shows that whereas the exchange rate remained relatively stable between 2015 and 2019, it depreciated notably between 2020 and 2023, consistent with the KSh/USD exchange rate[5] dynamics **(Figure 3**). On the contrary, the Real Effective Exchange Rate (REER) strengthened between 2012 and 2019, following a gradual rise in the relative price. However, both NEER and REER weakened in 2020-2023, with the peak occurring in 2023, consistent with the notable depreciation of the Kenya Shilling witnessed during the period. NEER and REER are computed as follows:

$$NEER = \sum_{i=1}^{n} (E_i \times w_i)$$

Where E_i = bilateral exchange rate of domestic currency against foreign currency, expressed as units of domestic currency per foreign currency.

[4] *Based on Economic Survey 2025, export of goods and services grew by 18 percent in 2023 compared to 36.5 percent and 28.6 percent in 2022 and 2021, respectively.*

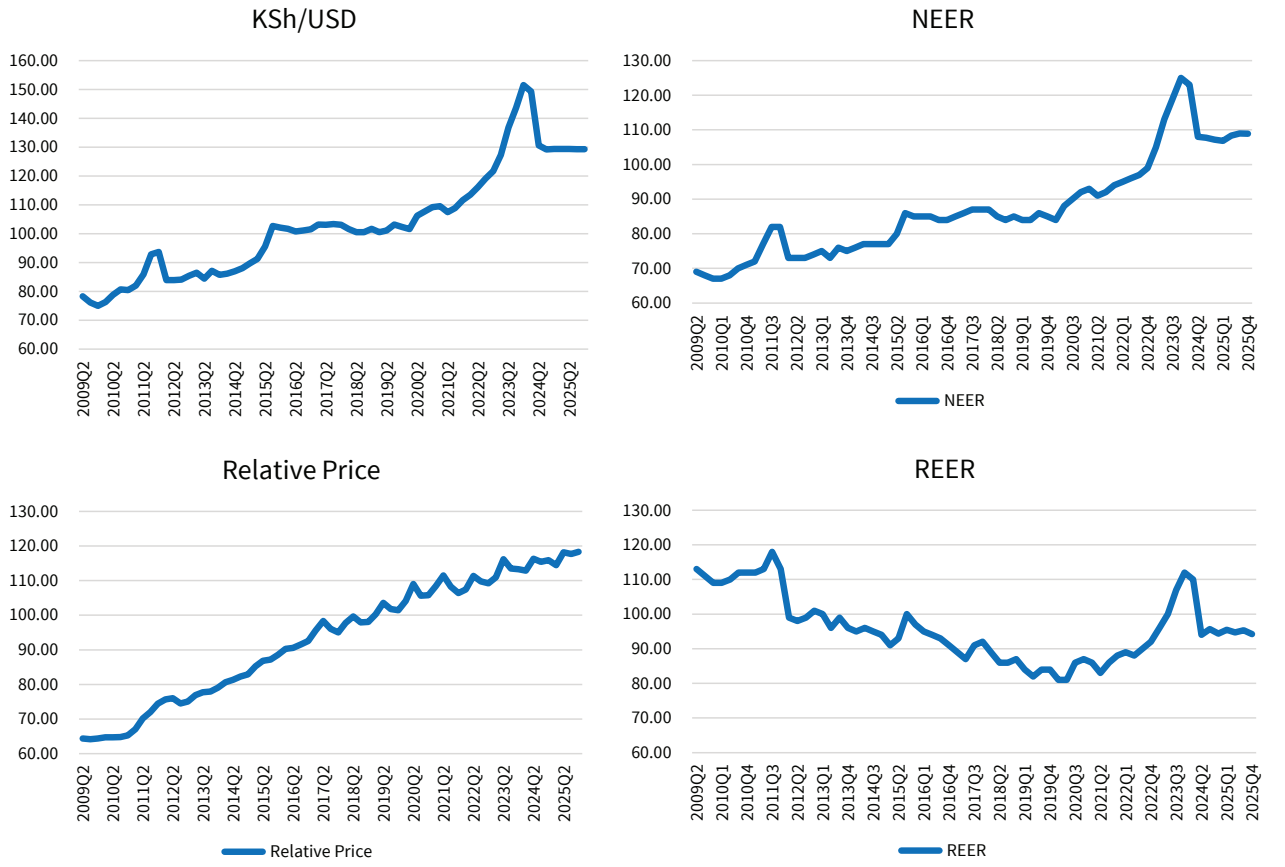
[5] *U.S. dollar is the main trading currency.*

w_i is trade weight of Kenya's main trading partner *i* and *n* is the number of countries/main trading partners.

$$REER = NEER \times \frac{P_i^{Foreign}}{P^{domestic}}$$

Where the relative price components $P^{foreign}$ and $P^{domestic}$ are trade-weighted foreign price and domestic price computed using Consumer Price Index (CPI).

Figure 3: Nominal and Real Effective Exchange Rates, 2009-2025



Source: Central Bank of Kenya

Owing to the significant movements in the exchange rates, particularly in the 2020-2025 period, an empirical assessment of possible exchange rate misalignment showed an episode of REER undervaluation in 2023 (Odongo et al. 2026)[6]. However, the undervaluation declined thereafter following the significant monetary policy tightening and appreciation of the exchange rate.

The steady depreciation of the domestic currency exerted significant upward pressure on domestic prices via increased costs of intermediate and final imported goods such as oil, edible oil and wheat, leading to pass-through effects on domestic inflation. Stabilizing inflation and the exchange rate needed well-coordinated policy and reform measures. These are discussed in the next section.

[6] *Exchange rate undervaluation implies the currency is weaker than it should be relative to the equilibrium value based on economic fundamentals.*

4.0 Monetary Policy Measures and Reforms in the Foreign Exchange Market

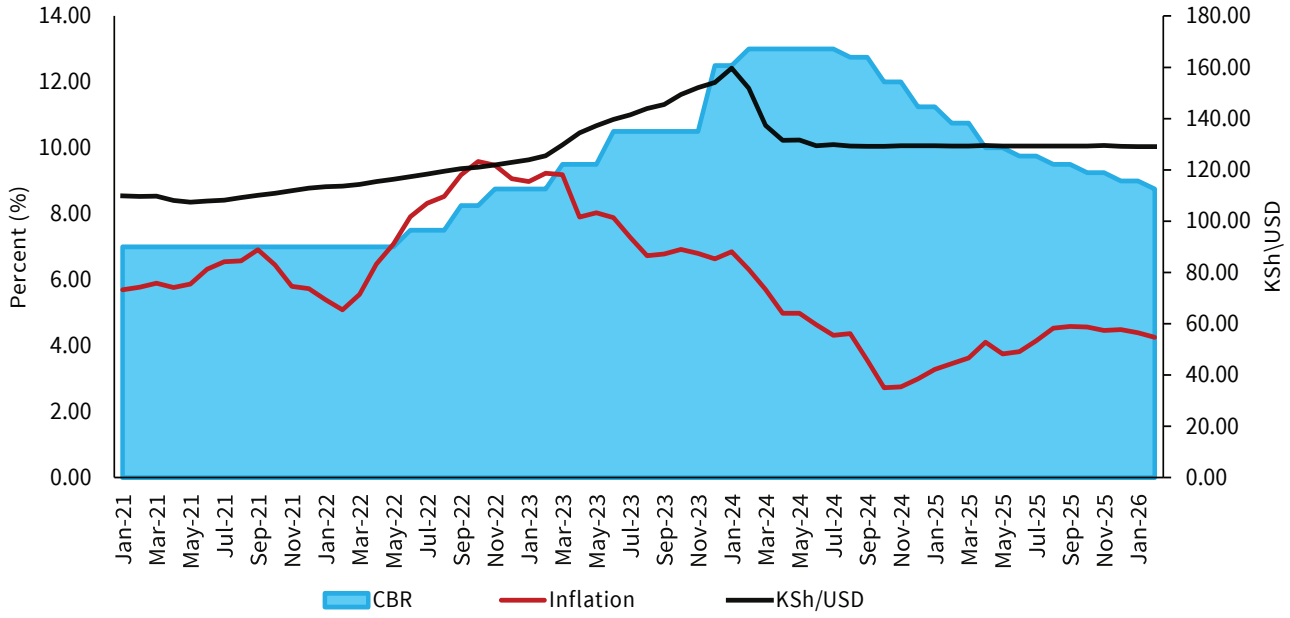
The monetary policy measures entailed policy tightening by raising the Central Bank Rate (CBR). This was accompanied by monetary policy implementation reforms to enhance the efficiency of the interbank market and transmission of monetary policy, as well as measures to improve the functioning of the forex market. These are briefly discussed below.

4.1 Monetary Policy Measures

The CBK tightened monetary policy by raising the CBR, cumulatively by 600 basis points to 13.0 percent between May 2022 and February 2024 (**Figure 4**). The bulk of the increments, 375 basis points, were effected in 2023, with the most decisive actions being 100 basis points and 200 basis points increases in June and December 2023, respectively. During the December 2023 meeting, the Monetary Policy Committee (MPC) noted the continued pressure on the shilling, leading to a steady depreciation against major foreign currencies, which in turn, exerted upward pressure on domestic prices, thereby increasing the cost of living. Although inflation had eased to 6.6 percent in December 2023 from 9.6 percent in October 2022, it remained above the 5.0 percent medium term target **(Figure 4)**. The MPC also noted the heightened public debt service distress, particularly owing to the US$ 2 billion Eurobond that was due for maturity in June 2024, amidst tight domestic fiscal constraints and global financing conditions that had priced out most developing economies including Kenya. The latter fueled speculations of potential default on Kenya's external debt, thereby exacerbating the steady depreciation of the shilling. Moreover, the continued weakening of the exchange rate was contributing to a significant increase in the Kenya shilling value of foreign currency denominated debt, thereby worsening the public debt vulnerabilities. Decisive action was needed to stabilize the shilling and curtail the vicious cycle. The further increase in the policy rate was mainly aimed at addressing the pressures on the exchange rate and mitigating second round inflationary effects from supply-side factors to ensure inflation expectations remained anchored towards the target.

The monetary policy tightening reduced the differential between domestic and foreign interest rates, thereby boosting capital inflows which, combined with reforms undertaken in the forex market, helped to stabilize the exchange rate. The stability of the shilling was also greatly supported by Kenya's successful issuance of US$ 1.5 billion Eurobond in February 2024, which helped to ease external debt financing liquidity constraints following the easing of financing conditions in the international financial markets. Consequently, investor confidence was restored and speculation on the domestic currency stopped.

Figure 4: Trends in Exchange Rate (KSh/USD), Inflation and CBR



Source: Central Bank of Kenya

On the back of the developments in the forex market, headline inflation remained elevated above the target range of 5±2.5 percent for 12 consecutive months between June 2022 and June 2023, following the adverse impact of multiple shocks including the supply-side disruptions occasioned by eruption of Russia-Ukraine war and prolonged drought on food prices **(Figure 4)**. Headline inflation increased to 9.6 percent in October 2022, mainly driven by higher food and energy prices. In particular, the aggregate food inflation increased substantially to 15.8 percent from 8.7 percent in February 2022. The tightening of monetary policy was complemented by implementation of fiscal measures aimed at moderating the prices of staple food commodities. These included zero rating of select food imports and boosting food production through subsidized fertilizer prices.

By the second half of 2024, inflation had declined and the stability of the exchange rate restored. Consequently, the MPC commenced easing of the tight monetary policy stance in August 2024 to boost private sector credit uptake and support economic growth. The CBR was lowered cumulatively by 425 basis points from 13.0 percent in August 2024 to 8.75 percent as of February 2026. Furthermore, Cash Reserve Ratio (CRR) was reduced by 100 basis points to 3.25 percent from 4.25 percent in February 2025, to complement the lowering of the CBR and facilitate reduction in lending rates. The CBK's actions were aimed at stimulating lending to the private sector by commercial banks, thereby supporting economic activity, while ensuring inflation expectations remain firmly anchored.

4.2 Monetary policy implementation reforms

Following the official adoption of IT monetary policy framework in August 2023, CBK introduced interest rate corridor around the CBR to enhance implementation of the framework and monetary policy transmission. On August 9, 2023, and in line with the reforms outlined in the CBK White Paper on *Modernisation of the Monetary Policy Framework and Operations*[7], the MPC approved a new monetary policy implementation framework aimed at ensuring the interbank rate as the operating target closely tracks the CBR as set by the MPC. In this regard, an interest rate corridor around the CBR was introduced and set at ± 250 basis points. Since then, the monetary policy operations are aimed at ensuring the interbank rate closely tracks the CBR. Additionally, to improve access to the Discount Window, the MPC reduced the Discount Window rate from 600 basis points above CBR to 400 basis points above CBR. Moreover, the width of the interest rate corridor around the CBR was further reviewed to ±150 basis points in June 2024 to better enhance the transmission of the MPC decisions to short-term interest rates. The interest rate on the Discount Window was also reviewed downwards to 300 basis points above CBR.

To further enhance the effectiveness of the monetary policy implementation framework, in April 2025, the interest rate corridor around the CBR was narrowed further from ±150 basis points to ±75 basis points, alongside the adjustment of the applicable interest rate on the Discount Window, from 300 basis points above CBR to 75 basis points (the upper bound of the interest rate corridor). In February 2026, the interest rate corridor was tightened further to ±50 basis points, and the applicable interest rate on the Discount Window adjusted to 50 basis points above CBR, which is the upper bound of the interest rate corridor. The gradual narrowing of the interest rate corridor was aimed at supporting the alignment of the CBR and the interbank bank rate, and enhancing monetary policy transmission and stability of the market.

Additionally, leveraging digital technology, the CBK developed the Dhow Central Securities Depository (DhowCSD) platform[8], which went live on July 31, 2023, to further improve the efficiency of the interbank market and investment in government securities. The DhowCSD is a versatile market infrastructure aimed at improving the functioning of the interbank market by facilitating collaterised lending among commercial banks, thereby reducing segmentation in the market. The platform has transformed Kenya's financial markets through enhanced operational efficiency, expansion of digital access, market deepening and improved monetary policy operations.

In August 2025, CBK issued a revised Risk-Based Credit Pricing Model (RBCPM), which is envisaged to strengthen transmission of monetary policy decisions to commercial banks' lending interest rates and increase transparency in the pricing of loans. The revised RBCPM is anchored on the overnight interbank average rate, which was renamed the *'Kenya Shilling Overnight Interbank Average (KESONIA),'* to align with the international best practices. KESONIA closely tracks the policy rate under the current monetary policy implementation framework. It was set as the common reference rate for all variable rate loans by banks, effective September 1, 2025. The computation of the lending rate = KESONIA + Premium ("K"), where the premium includes the costs related to lending, return to shareholders, and the risk profile of the borrower. The total cost of credit equals lending rate plus fees and charges[9].

[7] *https://www.centralbank.go.ke/wp-content/uploads/2021/07/Modernisation-of-the-Monetary-Policy-Framework-Operations.pdf*

[8] *The DhowCSD platform, which was officially launched in September 2023, enables individuals and corporates to invest in Government securities without going through an intermediary.*

[9] *Fees and charges include origination, processing, negotiation and commitment fees.*

4.3 Reforms in the interbank foreign exchange market

To invigorate the interbank forex market, CBK undertook various reforms to strengthen the price discovery mechanism and transparency, and boost market activity. By the end of 2022, the interbank forex market was experiencing several inefficiencies that hindered price discovery. These included low trading volumes, wide bid-ask spreads, high client margins charged by banks, a disconnect between interbank indicative rates and average market rates, elevated trading volatility, and banks opting to trade directly with their clients outside the interbank market.

To address these challenges, the CBK implemented the following reforms:

(i) Issued the Foreign Exchange Code (FX Code) for commercial banks in March 2023. In line with global best practice, the FX code sets out standards for commercial banks, with the aim of strengthening and promoting the integrity and effective functioning of the wholesale forex market in Kenya. It focuses on six leading principles to be adhered to by institutions:

- ***Ethics:*** Ethical and professional behaviour when operating in the forex market.
- ***Governance:*** Implementation of a sound and effective governance framework to oversee forex market activity.
- ***Execution:*** Exercising due care when negotiating and executing transactions.
- ***Information Sharing:*** Clarity and accuracy in communication.
- ***Risk Management and Compliance:*** Development and maintenance of a robust control and compliance framework.
- ***Confirmation and Settlement Processes:*** Ensuring predictable, smooth, and timely settlement of forex transactions.

(ii) Unified the parallel exchange rate and eliminated the quotation of different exchange rates by CBK and commercial banks. The exchange rate currently published by the CBK reflects the weighted average rate of the registered spot trades in the interbank forex market during the trading session.

(iii) Reviewed the limits on tenor for swaps and other local currency funding instruments with a view to boost market liquidity. Minimum tenor of forex borrowing from non-residents was reduced from one year to six months, while caps on the tenor of swaps between residents including EAC residents, were removed. Additionally, EAC residents were allowed to borrow in overnight forex swaps from local Kenyan banks.

(iv) Reduced the minimum amount tradable in the interbank forex market from US$ 500,000 to US$ 100,000 purposely to boost trading in the forex market, which had reduced significantly.

(v) Guidance to Money Remittance Providers (MRPs) - selling foreign exchange by MRPs to corporate customers was restricted to a maximum of US$ 100,000 per customer per day.

(vi) Lifted the suspension of the use of Electronic Brokerage Systems (EBS) in the forex market. The use of EBS in the forex market had been suspended in 2015 due to perceived weaknesses of the systems. However, market conditions have since changed, and given the advancement in technology, the use of EBS was deemed beneficial since they:

- Provide a transparent price discovery mechanism visible to all market participants
- Efficiently match demand and supply of foreign exchange in the market, thus avoiding lopsided transactions amongst interbank players
- Provide a mechanism through which the central bank can intervene in the market where necessary.
- Provide a tool through which the central bank can view activity in the interbank forex market.

(vii) Introduced Electronic Matching System (EMS) in August 2023 to promote a transparent and accountable price discovery mechanism and ensure visibility to all market participants. The EMS replaced the previous platform which used to provide only indicative exchange rates. The EMS facilitates efficient matching of demand and supply of foreign exchange in the market and is an effective tool for CBK to exercise the oversight role in the interbank forex market.

As a result of these reform measures, activity in the interbank forex market was enhanced with a transparent and accountable price discovery mechanism, and visibility to all market participants. In addition, there has been efficient matching of demand and supply of forex in the market, thereby enhancing stability, flexibility and market determination of the exchange rate.

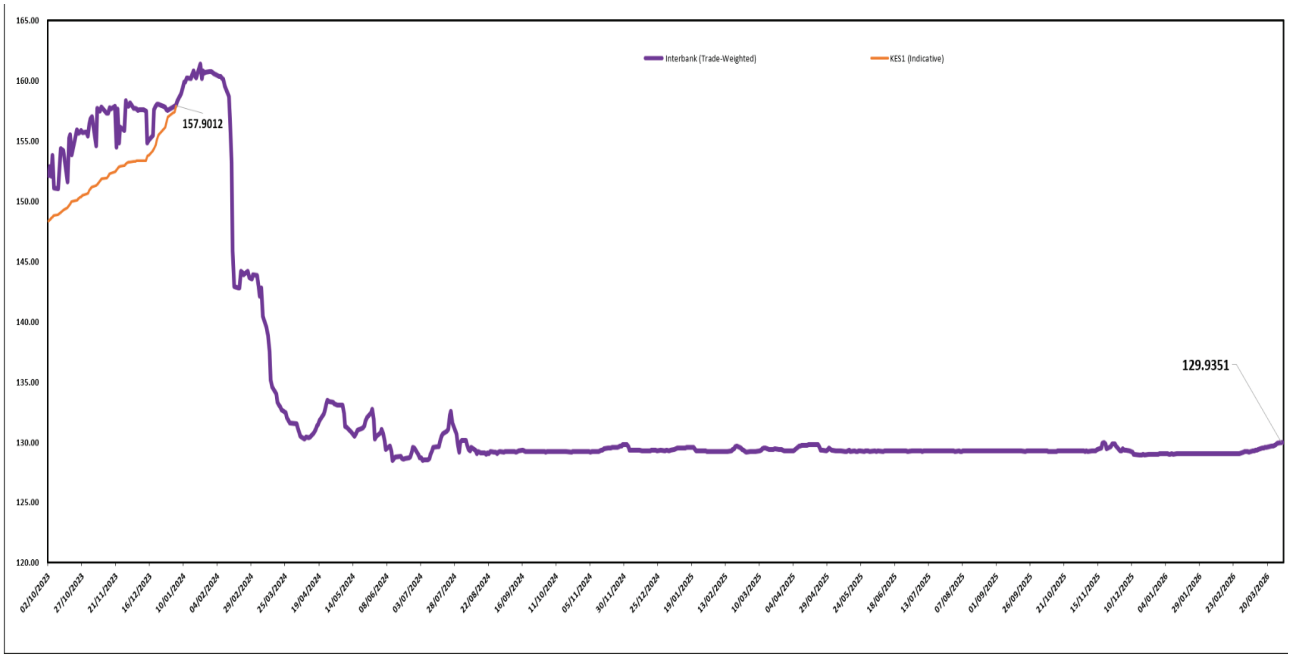
5.0 The Outcomes of Policy Measures and Reforms

The various policy measures and reforms undertaken helped to stabilize the exchange rate, lower inflation, anchor inflation expectations, strengthen the implementation of IT framework by streamlining KESONIA with the policy rate and build reserves.

5.1 Milestones on exchange rate stability

The Kenya shilling strengthened and remained stable (**Figure 5**). The shilling, which had significantly weakened to about KSh157 per US dollar at the beginning of 2024, had by end of August 2024, reversed the trend and appreciated by about 18 percent to KSh129.19 per USD, making it one of the best performing currencies globally, against major currencies (**Figure 6a** and **b**). The stability of the exchange rate helped to improve investor confidence and offshore investments. In addition, the enhanced transparency in the interbank forex market helped to restore market confidence, with clients being able to service their forex demands through formal channels, eliminating the speculative behavior earlier witnessed on the currency. Additionally, the revised current account deficit narrowed from 4.2 percent of GDP in 2022, to 2.5 percent of GDP in 2023 and further to 1.3 percent of GDP in 2024, supported by exports, lower growth in imports of goods, and strong remittance inflows. The exchange rate has since remained stable, supported by increased foreign exchange inflows, enhanced efficiency of the interbank forex market and improved public debt liquidity management.

Figure 5: Daily exchange rate of the Kenya Shilling against the USD



Source: Central Bank of Kenya

Figure 6a: Change in the exchange rates of select major global and regional currencies against the USD (between January 2 and November 8, 2024)

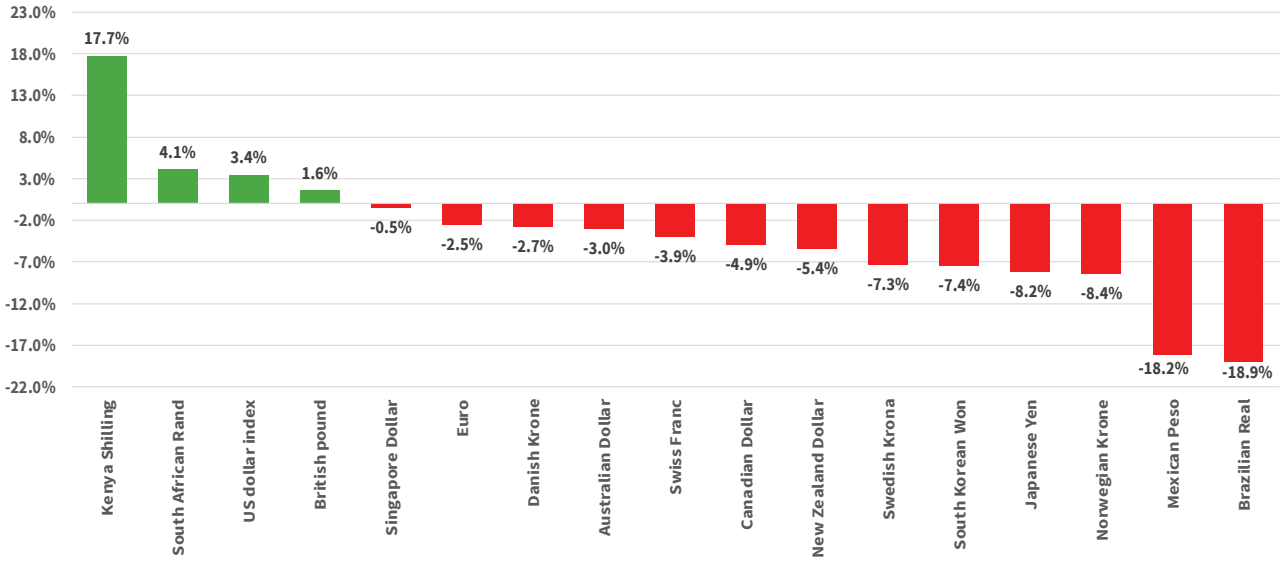
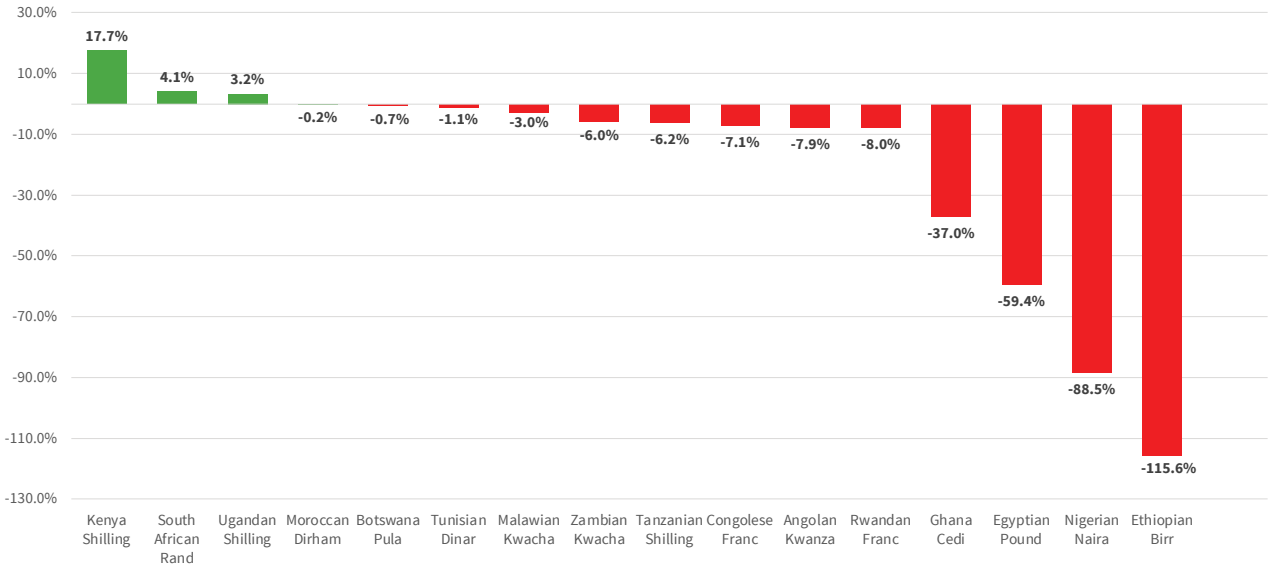


Figure 6b: Change in the exchange rates of select African currencies against the USD



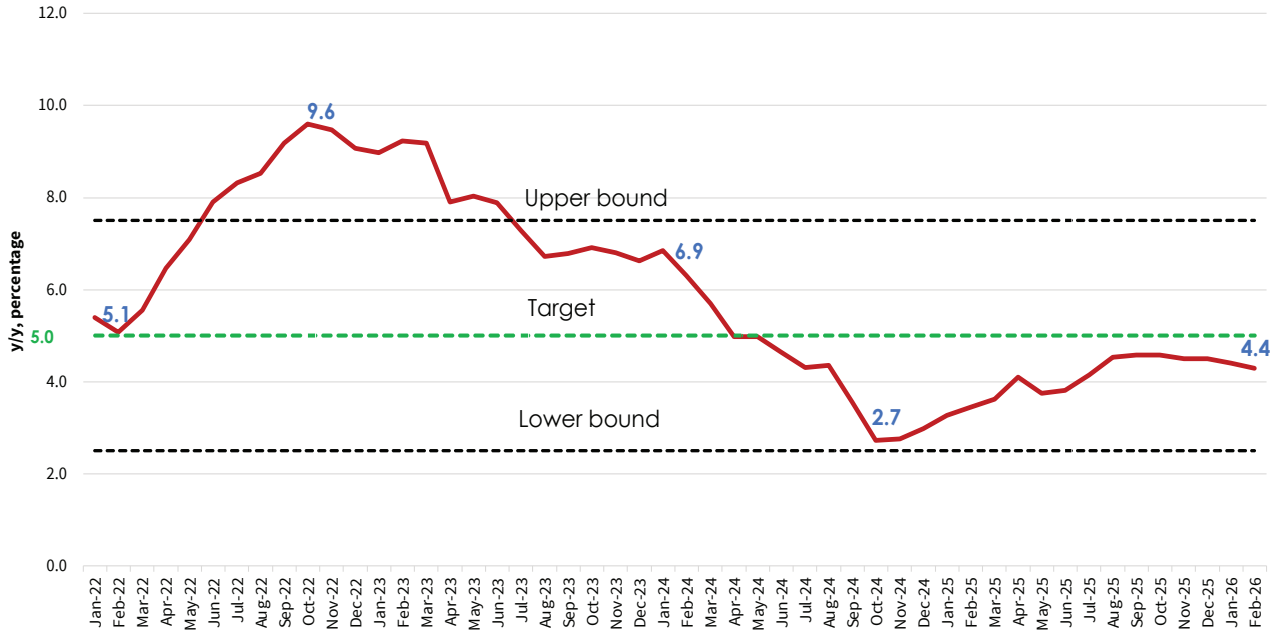
Source: Refinitiv. (Reuters)

5.2 Implications on price stability

The appreciation of the Kenya shilling reduced the impact of imported inflation and exchange rate pass-through effects to domestic inflation, thereby facilitating price stability. Headline inflation declined from 9.6 percent in October 2022 to as low as 2.7 percent in October 2024, before rising gradually in line with the monetary policy easing cycle (**Figure 7**). The significant decline in inflation reflects the impact of monetary policy measures, stability of the exchange rate and developments in domestic food and energy prices, which are largely driven by weather conditions and international oil prices, respectively.

In January 2025, the Kenya National Bureau of Statistics (KNBS) in collaboration with the CBK launched official measures of core and non-core inflation. Consequently, the CBK replaced the non-food non-fuel (NFNF) proxy used previously with the newly developed core inflation measure. Core CPI component accounts for 81.1 percent of the 330 items in the CPI basket, while non-core component accounts for 18.9 percent.[10] The computation was extended backwards to provide a longer time series of core and non-core inflation classification. In this regard, core inflation declined from 8.0 percent in October 2022 to 1.8 percent in October 2024, before gradually picking up. It stood at 2.2 percent and 2.1 percent in December 2025 and February 2026, respectively. Headline inflation picked up gradually to an average of 4.1 percent in 2025, and remained anchored within the target band, edging modestly towards the 5 percent medium term target in the recent past.

Figure 7: Headline inflation (y/y, percent)



Source: Kenya National Bureau of Statistics

5.2.1 Inflation scenarios analysis

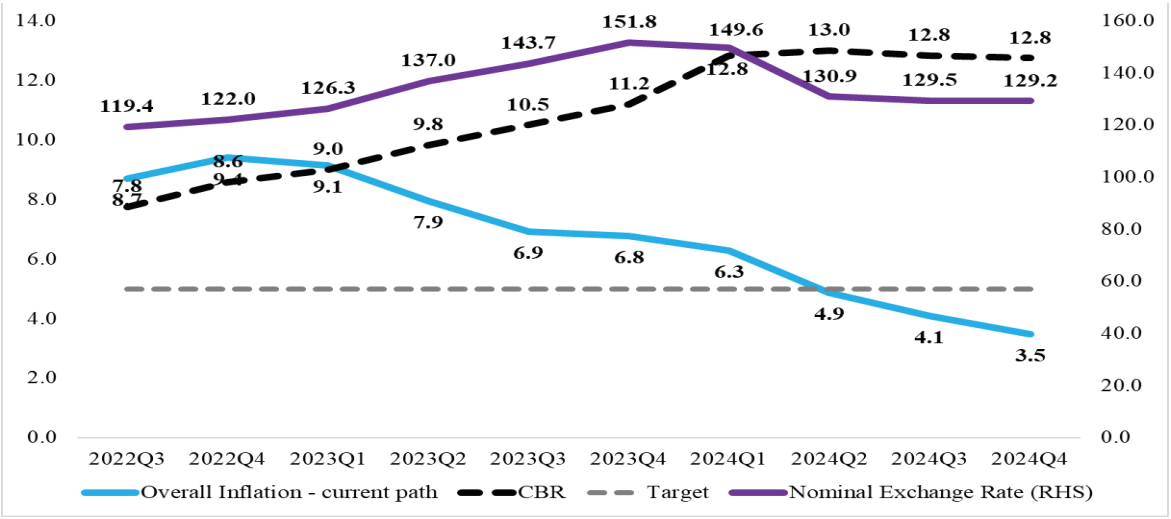
Different scenarios based on simulations from the CBK Quarterly Projection Model (QPM)[11] are used to illustrate how sustained depreciation would have impacted inflation/price stability **(Figure 8)**. The analysis shows that had the exchange rate (KSh /USD) remained depreciated at 151.8 - the highest quarterly average level reached in the fourth quarter of 2023, and with there being no further policy intervention, inflation would have taken longer to converge to the 5 percent mid-point of the target band (Scenario 1). Had the exchange rate continued to depreciate steadily to KSh 180 per USD level with no further policy intervention, inflation would have increased to above the 7.5 percent upper bound of the inflation target (Scenario 2).

[10] *For details on definitions and computation refer to Core and Non-Core Inflation Measures for Kenya report: https://www.knbs.or.ke/wp-content/uploads/2025/02/Core-and-Non-Core-Inflation-Measures-in-Kenya1.pdf*

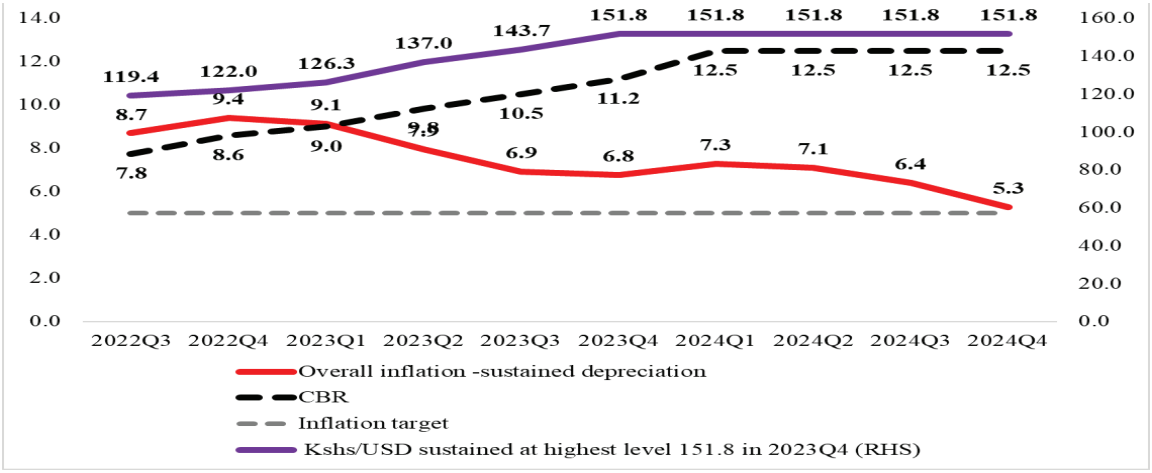
[11] *QPM is a forward-looking New Keynesian small open economy semi-structural gap model with core equations that link aggregate demand (output), inflation, policy rate and the exchange rate. Besides forecasting, it is particularly used by inflation targeting central banks in emerging and small open economies to analyse how external and domestic shocks impact domestic inflation and output.*

Figure 8: Inflation and Exchange Rate Scenarios

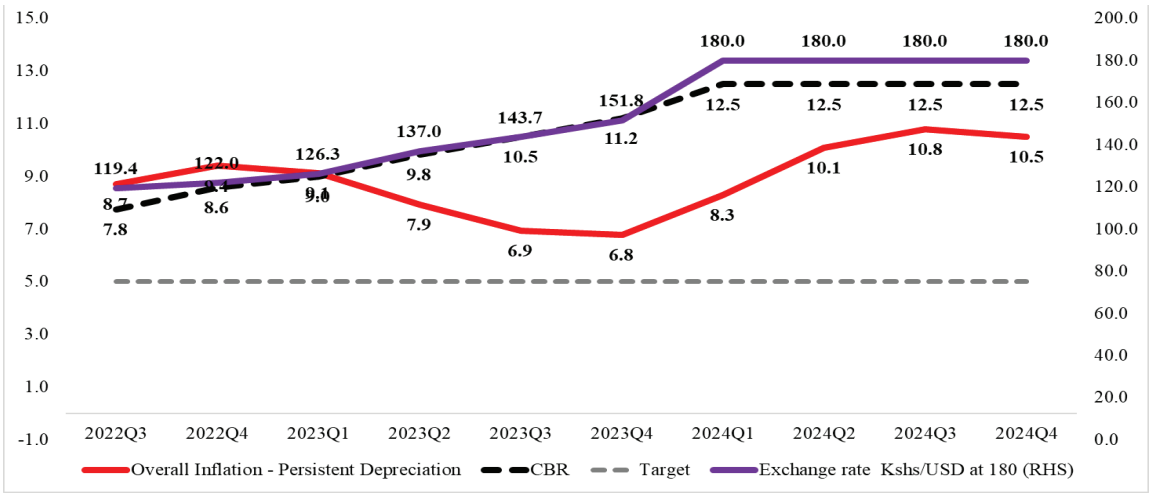
Baseline Scenario: Current Policy Stance and Exchange Rate Path



Scenario 1: Assumes KSh/USD at 151.8 and No Policy Intervention



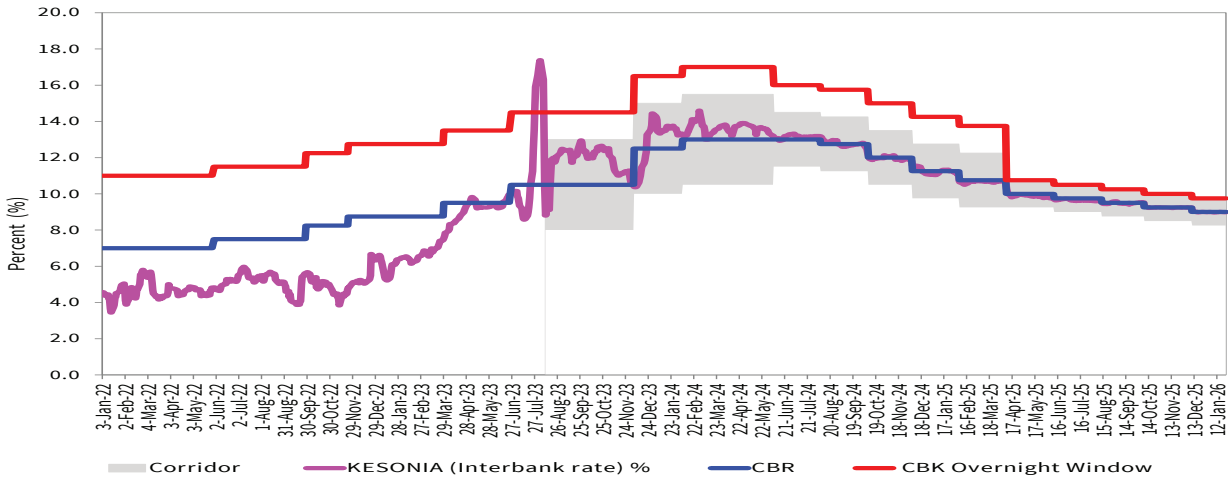
Scenario 2: Assumes KSh/USD at 180 and No Policy Intervention



5.3 Enhanced efficiency of interbank market and monetary policy implementation

Monetary policy operations have been strengthened since the introduction of the new monetary policy implementation framework, and ensured that the interbank rate as an operating target, closely tracks the CBR **(Figure 9)**. The interbank rate has remained within the corridor around the CBR and monetary policy transmission to short-term rates continues to be enhanced. Additionally, it has resulted in improved functioning of the interbank market, increased interbank activity and narrowed the interbank interest rates spread. Prior to the introduction of the interest rate corridor framework, the interbank rate was not aligned with the CBR and was relatively volatile, thus impairing monetary policy transmission **(Figure 9)**.

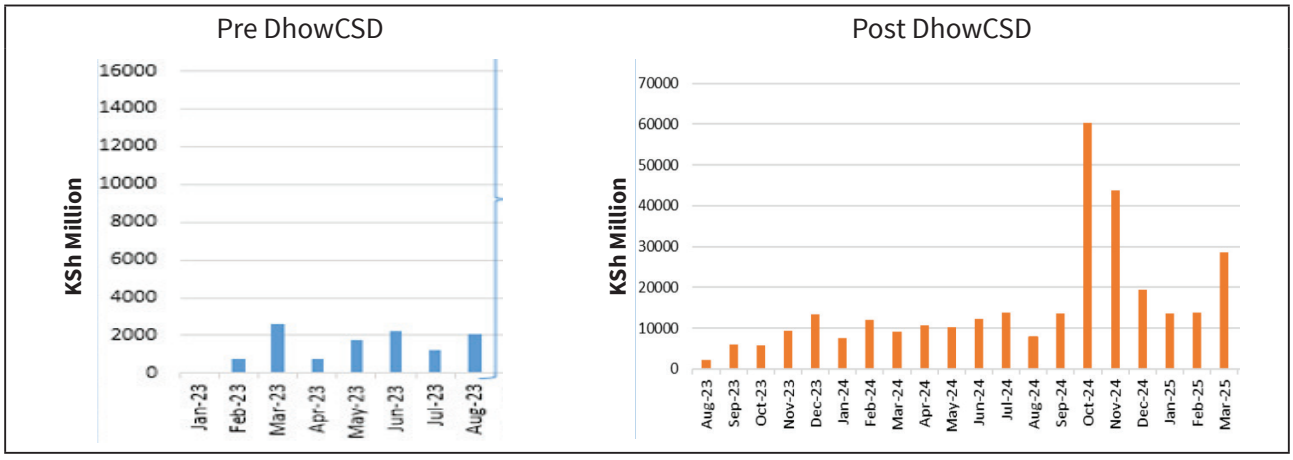
Figure 9: Monetary policy implementation framework: Interest rate corridor



Source: Central Bank of Kenya

Since the implementation of DhowCSD, there has been a notable increase in the horizontal repo market transactions under the collateralized market, with tenors ranging from overnight to 184 days, thus enabling banks to manage their liquidity needs (**Figure 10**).

Figure 10: Horizontal Repos Market Transactions (KSh Millions)

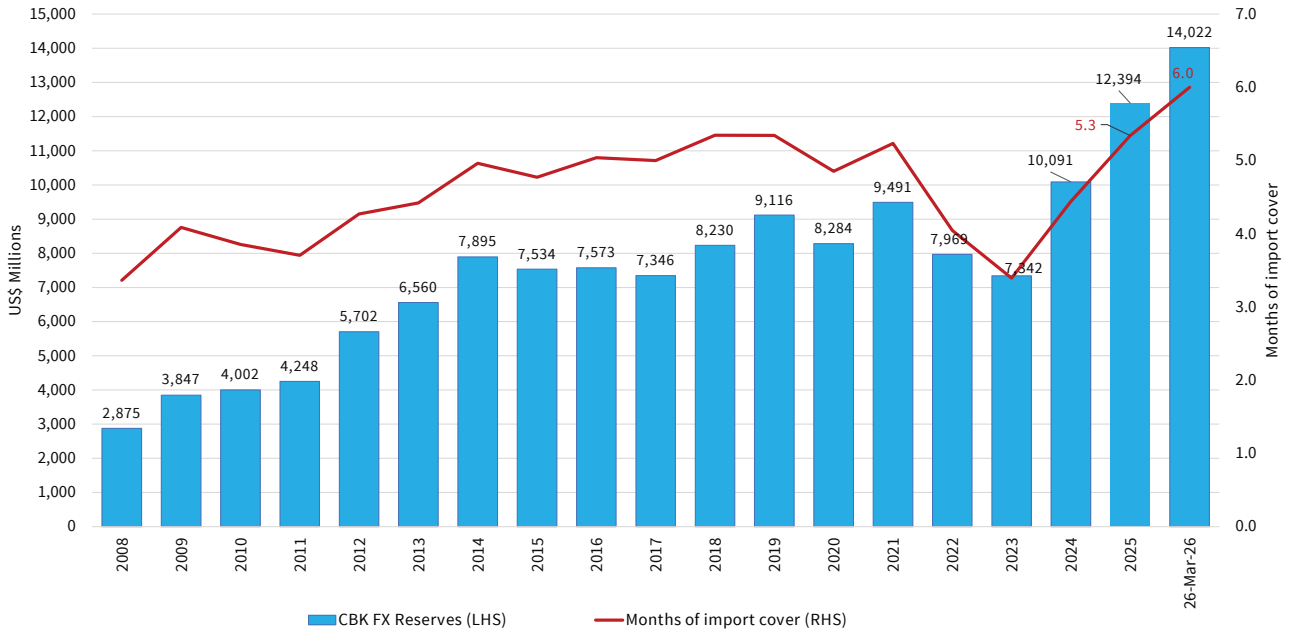


Source: Central Bank of Kenya

5.4 Forex reserves

The macroeconomic stability including the stable exchange rate helped improve investor confidence and promoted private external inflows into the local bond market, particularly government infrastructure bonds. This facilitated foreign exchange purchases to support build- up of reserves by the CBK. As a result, the foreign exchange reserves that had significantly declined, increased to record levels, thus providing a buffer against short-term shocks – they increased to US$ 12.4 billion, equivalent to about 5.3 months of import cover by end 2025 (**Figure 11**). As of March 26, 2026, the reserves had increased to US$ 14 billion, equivalent to 6 months of import cover.

Figure 11: CBK foreign exchange reserves (US$ Millions -end period)

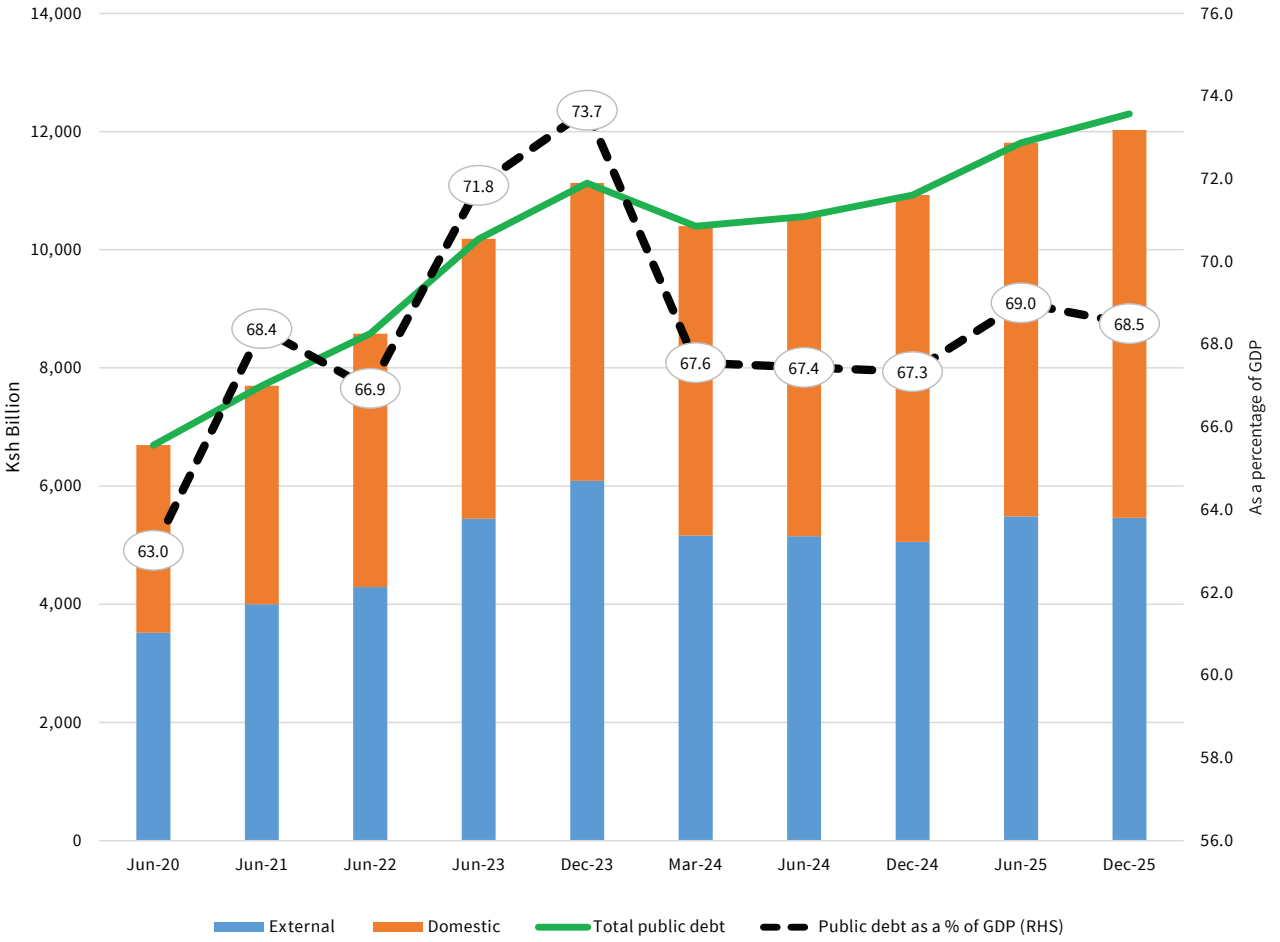


Source: Central Bank of Kenya

5.5 Implications on the public debt

The appreciation of the domestic currency against the dollar resulted in huge savings in debt service and reduced the total debt stock in Kenya shillings. Kenya's public debt moderated to KSh 10,925 billion (about 67.4 percent of GDP) at the end of December 2024, compared to KSh 11,129 billion (73.7 percent of GDP) at the end of December 2023, largely reflecting the impact of the Kenya shilling appreciation on the valuation of the external debt. The external debt declined from KSh 6,090 billion in 2023 to KSh 5,057 billion in 2024, and the savings in the external debt arising from the exchange rate appreciation was about KSh 1 trillion (**Figure 12**). That notwithstanding, the high public debt burden remains a challenge, given the heavy cost of debt servicing – total debt service accounted for 71.2 percent of ordinary revenue in the FY 2024/25 (Republic of Kenya 2025).

Figure 12: Public Debt (in KSh Billion and as percent of GDP)



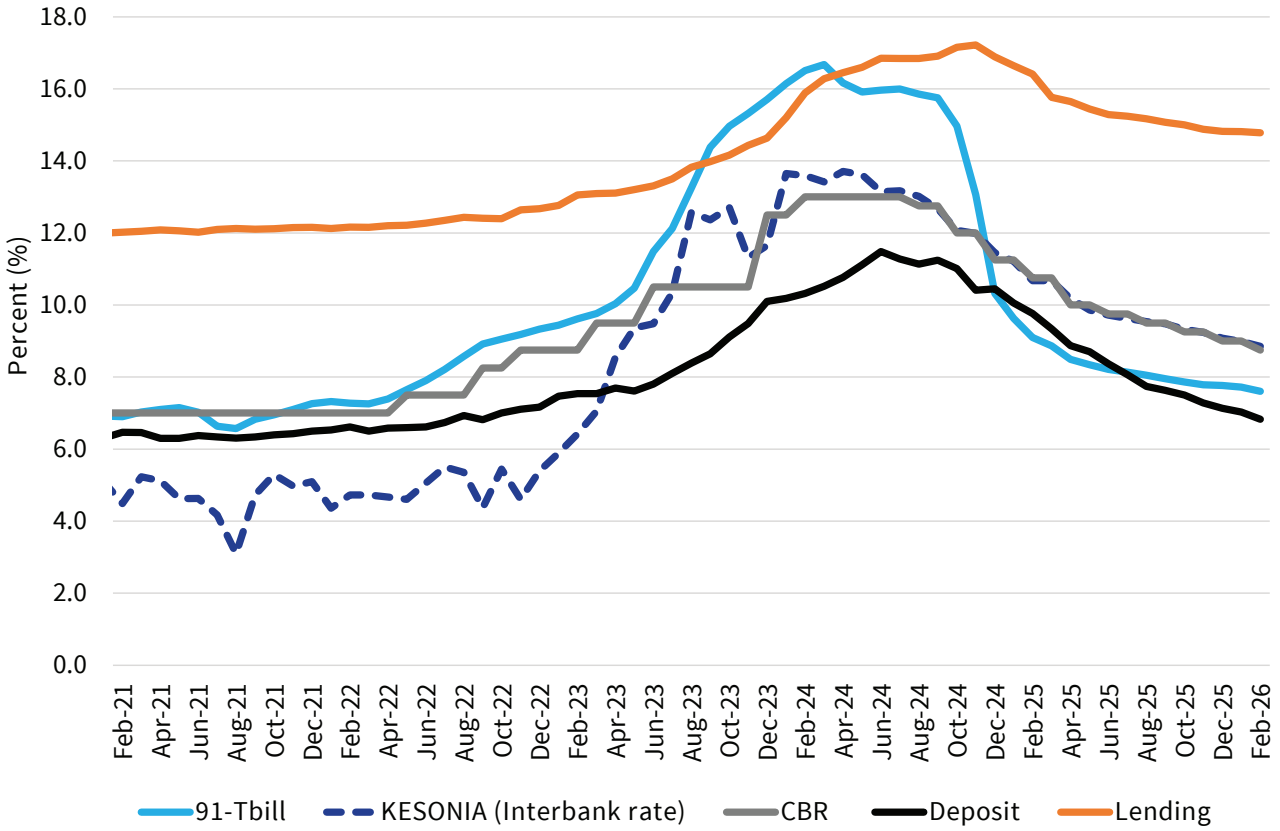
Source: The National Treasury and Central Bank of Kenya

5.6 Interest rates and private sector credit

While the monetary policy tightening helped to restore macroeconomic stability, borrowing costs increased leading to a contraction in credit to the private sector. In general, all the different interest rates increased. Commercial banks' average lending rate increased to 17.2 percent in November 2024 from 12.3 percent in June 2022, while the average deposit rate increased to 11.2 percent from 6.6 percent over the same period (**Figure 13**). Similarly, interest rates on government securities shot up during the period, with the average 91-day Treasury bill rate peaking at 16.0 percent in July 2024 compared to 7.9 percent in June 2022, thereby increasing the cost of borrowing from the domestic market.

However, the interest rates declined thereafter in line with the subsequent monetary easing. Commercial banks' average lending rate eased to 14.8 percent in December 2025 from 17.2 percent in November 2024, though the decline was less pronounced compared to the other rates (**Figure 13**). The average 91-day Treasury Bill rate declined to 7.8 percent as at December 2025.

Figure 13: Interest rates (percent)

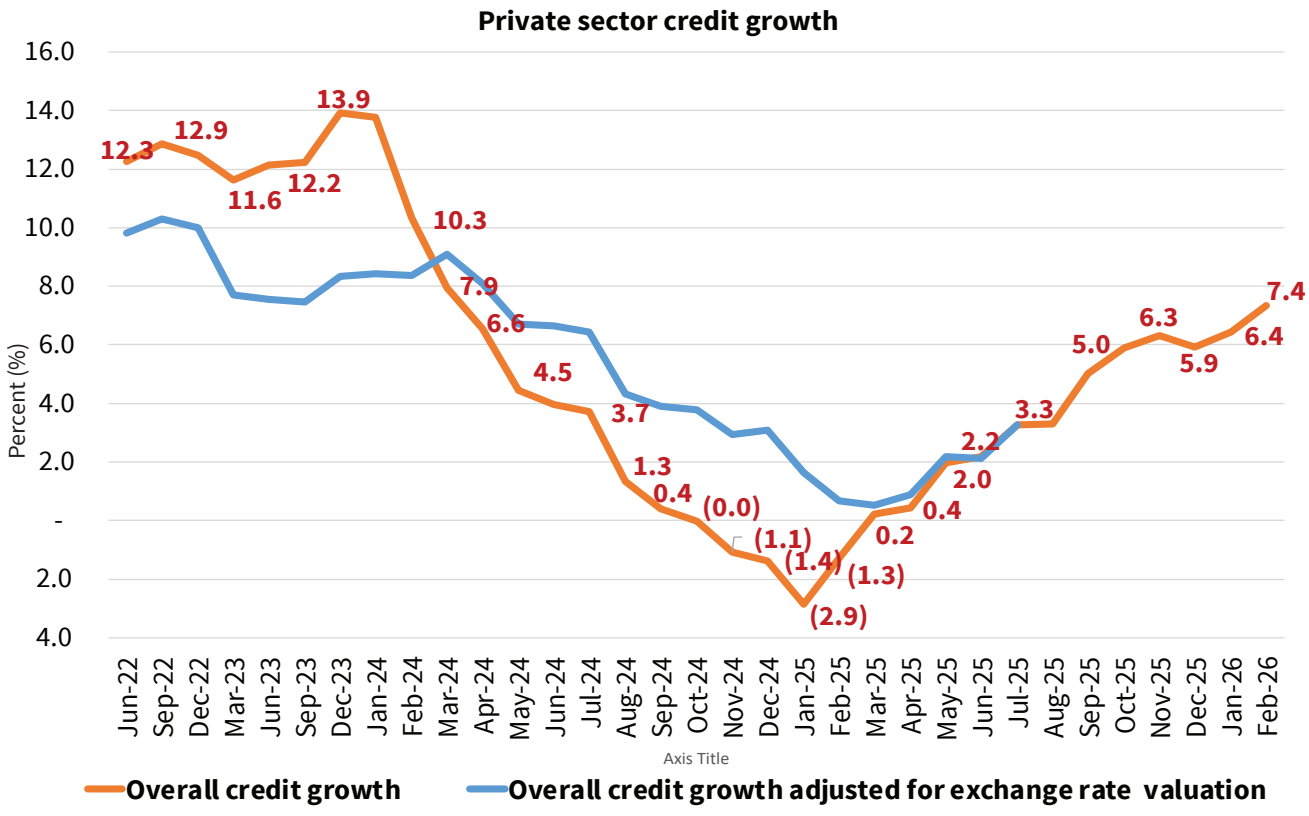


Source: Central Bank of Kenya

Private sector credit growth declined sharply in 2024, reflecting the impact of high interest rates and exchange rate valuation effects on forex loans. Growth in commercial bank lending to the private sector contracted by 1.4 percent in December 2024, down from robust growth of 13.9 percent in December 2023, partly reflecting exchange rate valuation effects on foreign currency denominated loans following the appreciation of the Kenya shilling, besides the impact of reduced demand for credit (**Figure 14**). Foreign currency denominated loans account for about 25 percent of total commercial banks' loans.

Private sector credit growth, however, continued to recover following sustained monetary policy easing since August 2024. Year-on-year growth increased to 5.9 percent in December 2025 and 7.4 percent in February 2026 from -2.9 percent in January 2025, reflecting improved demand for credit, supported by the decline in the lending interest rates and resilient economic activities. The recently launched RBCPM is expected to enhance transparency in pricing of loans by banks and transmission of monetary policy decisions from CBR to the lending interest rates.

Figure 14: Growth in credit to the private sector (y/y, percent)



Source: Central Bank of Kenya

6.0 Lessons and Emerging Risks

6.1 Lessons and Policy Insights

Several lessons and policy insights can be gleaned from Kenya's experience. These include the following:

(i) *The interest rate channel has a role to play in stabilizing nominal exchange rate volatility.* Monetary policy intervention to tame the drastic depreciation of the nominal exchange rate necessitated further increase in the policy rate in a bid to reduce the interest rate differentials and anchor expectations. However, there were trade-offs: whereas the exchange rate and price stability objectives were achieved, the resultant higher interest rates and subsequent appreciation of the shilling contributed to a steep decline in credit to the private sector, thereby partly constraining economic growth. This is one of the dilemmas policy makers often face, as an intricate balancing is required, especially in the context of developing economies like Kenya. For instance, Njuguna (2001) argues that it is appropriate to limit the use of interest rate intervention in the foreign exchange market and allow capital flows to be stabilized by movements in the exchange rate in the medium to long term.

(ii) *Maintaining macroeconomic stability especially in the wake of multiple shocks requires a holistic approach,* which could entail a blend of appropriate and timely policy interventions and structural reforms to strengthen the functioning of the market and enhance the effectiveness of policies. The monetary policy tightening was accompanied by various reforms and measures to enhance operations and efficiency in the domestic forex market. The reforms have helped to invigorate the interbank forex market and strengthen the price discovery mechanism and transparency. They have improved efficiency in the market, reduced uncertainty and facilitated market determination of foreign exchange rates. Moreover, the exchange rate stability helped to minimize the exchange rate pass-through effects to domestic inflation, thereby promoting price stability.

(iii) *Monetary and fiscal coordination is critical for policy effectiveness.* The importance of effective monetary–fiscal policy coordination as a critical determinant of macroeconomic stability is well acknowledged in the literature, although such interactions may at times give rise to policy conflicts or episodes of fiscal or monetary dominance (Sergent 1981; Leeper 1991 and Blanchard and Perotti 2002). Uncoordinated and inconsistent policy actions can generate macroeconomic disequilibria leading to persistent inflationary pressures, heightened output volatility, and/ or destabilizing exchange rate adjustments. These dynamics underscore the necessity of policy coordination (Yeboah 2023; Pastpipatkul and Ko 2025 and Salimi et al 2025). For instance, coordinated tightening through prudent public spending and enhanced revenue mobilisation, coupled with a credible monetary policy, anchors inflation expectations, stabilizes exchange rates and reduces the risk premium. When fiscal policy supports monetary restraint, central banks face less pressure to finance deficits, thereby strengthening policy credibility and improving investor confidence (IMF 2022). Although fiscal consolidation may have short-term costs, credible and well-sequenced adjustments can create fiscal space and lower debt vulnerabilities. Sound public finance management also allows governments to better respond to future shocks, while stable inflation protects real incomes and financial sector stability (World Bank 2022).

The gains from coordinated fiscal and monetary policy actions in Kenya are illustrated by the joint response to exchange rate and inflation pressures, and debt refinancing risks. For instance, CBK's monetary policy measures to tame inflationary pressures were complemented by fiscal policy measures such as zero-rating of key imported food items, which helped to moderate prices of staple

commodities commonly consumed by most households. Other government initiatives such as provision of subsidized fertilizer have continued to boost local production of staple foodstuff such as maize. The close coordination between the CBK and the National Treasury was also critical in facilitating successful issuance of the Eurobond in February 2024, whose proceeds were used in retiring the US$ 2 billion Eurobond that was due to mature in June 2024. This helped to calm the market and put an end to the speculative attacks on the shilling for fear that Kenya was bound to default. That notwithstanding, the high public debt burden amid limited revenues has greatly constrained the fiscal space, thus potentially putting pressure on domestic borrowing. The importance of effective public debt management cannot be underestimated owing to the challenges associated with high debt vulnerabilities.

Fiscal–monetary coordination is critical for effective debt management, as external borrowing can amplify exposure to currency swings and refinancing pressures, with implications on exchange rate stability. In many developing and emerging market economies, weak coordination and rapid accumulation of short-term commercial debt has amplified rollover risks, undermined policy credibility, and increased vulnerability to external shocks (Filardo et al. 2012).

(iv) *The exchange rate is a highly sensitive price prone to rapid fluctuations driven not only by underlying economic fundamentals but also by speculation and shifts in investor sentiments.* The heightened weakening of the shilling at the beginning of 2024 was partly driven by speculation and market sentiments that the government was likely to default the same way a few emerging African economies defaulted. This never materialized as the government was able to refinance the debt, which in itself was a sign of resilience and assurance that the international markets continued to view the economy positively. Prudent public debt liquidity management is, therefore, crucial to avoid undue pressure and speculative currency attacks.

(v) *The role of Central bank credibility is key.* A credible and trusted central bank enhances the ability to anchor market expectations and maintain macroeconomic stability. Conversely, perceived loss of credibility can potentially exacerbate volatility. Central bank credibility is reinforced by effective communication. The CBK has continued to strengthen its credibility and effectiveness of monetary policy by enhancing transparency through regular MPC statements, press briefings and engagements with key stakeholders, market participants and international investors. The credibility of central banks is increasingly being tested given increased exposure to external shocks.

(vi) *Commodity price volatility has significant implications for currency stability, underscoring the importance of economic diversification and multi-pronged strategies to support sustainable export growth.* This is a relatively more sustainable way of promoting foreign exchange earnings to meet the import demands, facilitate foreign debt servicing and provide continued support of domestic currency. Kenya's resilience in the wake of adverse shocks is partly supported by the diversification of the economy. While agriculture remains the largest sector of the economy, services sector has expanded and supported growth particularly given the high vulnerability of agricultural production to climate change shocks. That notwithstanding, the country's export value and growth are still below par, hence the need for higher-value added exports and continued diversification.

6.2 Emerging Risks

The global economy continues to grapple with heightened uncertainties particularly in the wake of shifts in U.S. trade and foreign policies, including increased protectionism and restrictive measures on immigration and foreign aid. For instance, the US administration imposed a 10 percent tariff on imports from all countries, with higher tariffs for select countries, which has implications on global trade. Additionally, the enforcement of stricter migration rules and tax on remittances could potentially impact remittance inflows, which is a key source of foreign exchange earnings, considering that the U.S. is the main source accounting for slightly over 50 percent of remittances to Kenya.

Furthermore, continued and emerging geopolitical conflicts worsened by the recent coordinated military strikes on Iran by the U.S. and Israel, and subsequent Iran's retaliation that rapidly escalated into a wider Middle East conflict leading to a surge in global oil prices pose significant risks. The war has significantly disrupted oil production and critical supply channels especially shipping through the Strait of Hormuz—approximately 20 percent of global oil and Liquified Natural Gas (LNG) is transported through the Strait. Given that Kenya is a net importer of refined petroleum products, the sharp increase in international oil prices to above US$ 100 per barrel is expected to exert upward pressure on domestic inflation through direct impact on pump prices, with potential ripple effects on the economy. Moreover, exports, remittances and international travel, which are Kenya's key sources of foreign exchange earnings, could be adversely affected particularly if the conflict is prolonged.

7.0 Conclusion

Exchange rates in emerging and developing open economies have become increasingly susceptible to volatility, partly driven by the vulnerability of these economies to shocks in the global economy. Kenya, like most of these economies, experienced enormous pressure on its domestic currency following the multiple global shocks especially in the period 2022-2024, leading to a sharp depreciation of the Kenya shilling against major world currencies, particularly the U.S. dollar. Notably, the Kenya shilling depreciated by 29 percent between January 2023 and January 2024. The paper examines Kenya's recent experience of exchange rate volatility, with a view to highlighting the key drivers, successes, lessons and emerging challenges.

The notable depreciation of the shilling against major currencies was driven by multiple factors. These include the aggressive interest rate hikes by advanced economies that led to widening of interest rate differentials and triggered capital outflows, sluggish export growth, and heightened public debt distress risk, which was exacerbated by the tight global financing conditions leading to speculative attack on domestic currency. Additionally, domestic inflation remained elevated, mainly driven by the adverse impact of Russia's invasion of Ukraine and prolonged drought on food prices.

The significant weakening of the domestic currency had implications on the economy. These include pass-through effects to domestic inflation, increased public debt and debt service, and reduced foreign exchange buffers, among others. Restoration of macroeconomic stability entailed a multi-pronged approach involving monetary policy tightening and various reforms aimed at enhancing monetary policy implementation and efficiency of the forex market. These were complemented by various fiscal measures.

Following policy interventions and the reform measures undertaken, both inflation and exchange rates stabilized. The shilling strengthened significantly to become one of the best performing currencies. The appreciation and subsequent stability of the exchange rate facilitated faster convergence of inflation towards the target, reduced debt service costs and the total debt stock in Kenya shillings and enabled accumulation of reserves. Stock of foreign exchange reserves increased by 69 percent from US$ 7342 million in 2023 to US$ 12,394 million by end of 2025. The flexible exchange rate regime and the buildup of forex reserve buffers provide the first line of defense against short-term shocks. Notwithstanding the gains made, the sustained monetary policy tightening that reached a peak of 13.0 percent led to higher interest rates and a temporary contraction in growth of private sector credit, which has since recovered.

Several lessons can be gleaned from Kenya's experience. These include the fundamental role of central bank in maintaining macroeconomic stability including exchange rate stability, the importance of policy coordination and a comprehensive approach in addressing macroeconomic challenges. While other emerging African economies were exposed to similar external shocks, Kenya demonstrated comparatively stronger resilience — supported by coordinated policy responses, fairly developed financial market and the diversified structure of the economy, which in itself underpins its resilience. Despite recent gains in macroeconomic stability, significant risks and uncertainty abound. These include the uncertainty in the global environment heightened by the protectionist U.S. trade policies and worsening of geopolitical conflicts following the recent U.S.-Israel attack on Iran.

References

Abdi, Z., W. Muturi., and T. Olweny (2020). 'Factors Affecting Exchange Rate Volatility in Kenya'. *International Journal of Economics, Commerce and Management*, 8(6): 355–379.

Afreximbank (2024). State of Play of Debt Burden in Africa 2024: Debt Dynamics and Mounting Vulnerability. Cairo: African Export-Import Bank (Afreximbank) Research.

Ahmed, S., and A. Zlate (2014). 'Capital Flows to Emerging Market Economies: A Brave New World?'. *Journal of International Money and Finance*, 48: 221–248.

Ajao, M.G. (2015). 'The Determinants of Real Exchange Rate Volatility in Nigeria'. *Ethiopian Journal of Economics*, 24(2): 43–62.

Bationo, F.d.B., V. Murinde., and I. Soumaré (2025). 'Cross-Border Banking and the Transmission of Global Shocks to Credit Cycles in Developing Economies: A Commodity Price Cycles Channel'. *International Review of Financial Analysis*, 106: 104515.

Blanchard, O.J., and R. Perotti (2002). 'An Empirical Characterization of the Dynamic Effects of Changes in Government Spending and Taxes on Output'. *The Quarterly Journal of Economics*, 117(4): 1329–1368.

Brandão-Marques, L., L. Górnicka., and G. Kamber (2023). 'Exchange Rate Fluctuations in Advanced and Emerging Economies: Same Shocks, Different Outcomes'. In Gelos, G. and R. Sahay. (eds), *Shocks and Capital Flows: Policy Responses in a Volatile World*. Washington, DC: International Monetary Fund.

Cormun, V., and P. De Leo (forthcoming). 'Shocks and Exchange Rates in Small Open Economies'. *American Economic Journal: Macroeconomics.*

Cuddington, J.T., and D. Jerrett (2008). 'Super Cycles in Real Metals Prices?'. *IMF Staff Papers*, 55(4): 541–565. Washington, DC: International Monetary Fund.

Deaton, A. (1999). 'Commodity Prices and Growth in Africa'. *Journal of Economic Perspectives*, 13(3): 23–40.

Eberhardt, M., and A.F. Presbitero (2021). 'Commodity Prices and Banking Crises'. *Journal of International Economics*, 131: 103474.

Fernandez-Perez, A., A.M. Fuertes., and J. Miffre (2021). 'On the Negative Pricing of WTI Crude Oil Futures'. *Global Commodities Applied Research Digest*, 6(1): 36–43.

Filardo, A., M. Mohanty., and R. Moreno (2012). 'Central Bank and Government Debt Management: Issues for Monetary Policy'. BIS Papers 67: 1–10, 51–71. Basel: Bank for International Settlements (BIS).

Forbes, K.J., and F.E. Warnock (2012). 'Capital Flow Waves: Surges, Stops, Flight, and Retrenchment'. *Journal of International Economics*, 88(2): 235–251.

Goda, T., and J. Priewe (2020). 'Determinants of Real Exchange Rate Movements in 15 Emerging Market Economies'. *Brazilian Journal of Political Economy*, 40: 214–237.

Hannan, S.A. (2018). Revisiting the Determinants of Capital Flows to Emerging Markets — A Survey of the Evolving Literature. IMF Working Paper WP/18/214. Washington, DC: International Monetary Fund.

IMF (2022). *Choice of Exchange Rate Arrangement*. Technical Assistance Handbook. Washington, DC. International Monetary Fund.

IMF (2023). *Managing Exchange Rate Pressures in Sub Saharan Africa: Adapting to New Realities.* Regional Economic Outlook: Sub Saharan Africa, Analytical Note. Washington, DC: International Monetary Fund (IMF).

IMF (2025a). *External Sector Report: Global Imbalances in a Shifting World.* Washington, DC: International Monetary Fund.

IMF (2025b). *Regional Economic Outlook: Sub-Saharan Africa: Recovery Interrupted*. Washington, DC: International Monetary Fund.

Kilicarslan, Z. (2018). 'Determinants of Exchange Rate Volatility: Empirical Evidence for Turkey'. *Journal of Economics, Finance and Accounting*, 5(2): 204–213.

Kohlscheen, E., F.H. Avalos., and A. Schrimpf (2016). 'When the Walk is Not Random: Commodity Prices and Exchange Rates'. Working Paper 551. Basel: Bank for International Settlements.

Kose, M.A., and R. Riezman (2001). 'Trade Shocks and Macroeconomic Fluctuations in Africa'. *Journal of Development Economics*, 65(1): 55–80.

Leeper, E.M. (1991). 'Equilibria Under Active and Passive Monetary and Fiscal Policies'. *Journal of Monetary Economics*, 27: 129–147.

Lim, H. (2025). 'Responses of Foreign Exchange Market to External Shocks'. *Open Economies Review*, 36: 981–999.

Monterroso, O., and D. Vilán (2025). Commodity Terms of Trade Uncertainty and Economic Activity in Emerging Economies. FED Notes. Washington, DC: Board of Governors of the Federal Reserve System. Available at: https://www.federalreserve.gov/econres/notes/feds-notes/commodity-terms-of-trade-uncertainty-and-economic-activity-in-emerging-economies-20250707.html

Ndung'u, N. (2001). Liberalization of the Foreign Exchange Market in Kenya. AERC Research Paper 109. Nairobi: African Economic Research Consortium (AERC).

Odongo, M., K. Ngoka., R. Misati., M. Kiptui., and A. Kamau (forthcoming 2026). Estimating Kenya's Equilibrium Exchange Rate. CBK Working Paper (forthcoming). Nairobi: Central Bank of Kenya.

Okot, A. (2022). Determinants of the Exchange Rate, Its Volatility and Currency Crash Risk in Africa's Low and Lower Middle-Income Countries. Working Paper 2022/12. Luxembourg: European Investment Bank.

Pastpipatkul, P., and H. Ko (2025). 'The Efficacy of Monetary and Fiscal Policies on Economic Growth: Evidence from Thailand'. *Economies 2025*, 13 (19): 1-17.

Reinhart, C.M., V. Reinhart., and C. Trebesch (2016). 'Global Cycles: Capital Flows, Commodities, and Sovereign Defaults'. *American Economic Review*, 106(5): 574–580.

Republic of Kenya (2025). *Annual Public Debt Management Report 2024/2025*. Nairobi: The National Treasury.

Salimi, S., E. Kazinczy., T. Tatay., and M. Amini (2025). 'Evaluating Fiscal and Monetary Policy Coordination Using a Nash Equilibrium: A Case Study of Hungary'. *Mathematics*, 13(9): 1427.

UNCTAD (2025). *The State of Commodity Dependence 2025.* New York: United Nations Conference on Trade and Development (UNCTAD).

UNDP (2016). *Primary Commodity Booms and Busts: Emerging lessons from Sub-Saharan Africa.* Regional Bureau for Africa, United Nations Development Programme (UNDP).

Wanzala, R.W., and L. Obokoh. (2024). 'The Effects of Working Capital Management on the Financial Performance of Commercial and Service Firms Listed on the Nairobi Securities Exchange in Kenya'. *Risks*, 12(8): 119.

Were, M. (2024). 'Emerging Public Debt Challenges in Sub-Saharan Africa'. WIDER Working Paper 2024/36 . Helsinki: United Nations University - World Institute for Development Economics Research (UNU-WIDER).

World Bank (2022). *Global Economic Prospects*. Washington, DC: World Bank.

Yeboah, S. (2023). 'A Systematic Review of the Association between Fiscal Policy and Monetary Policy: Interactions, Challenges, and Implications'. MPRA Paper No. 117530. Munich Personal RePEc Archive (MPRA).



Central Bank of Kenya

Haile Selassie Avenue P.O. Box 60000 - 00200 Nairobi | Tel: (+254) 20 - 286 0000 / 286 1000 / 286 3000