THE EFFECTS OF INTEREST RATES ON INVESTMENT IN KENYA

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ABSTRACT

This paper empirically analyzes the influence that interest rate changes have on investment in income in Kenya. Using the complete history of interest rates on savings and deposit rates for commercial banks over the 2001 to 2011 period. This paper uses the theoretical model of interest rate determination proposed by Edwards and Khan 1985 which was adopted to analyze the interest markets in Kenya.

It uses the technique to examine the directions of association between interest rates and investment in Kenya over the period 2001-2011. We examine the aggregate private saving rate and its interaction with investment and the association of the two with interest rates assuming that savings are equal to investment. That is the amount of income which the households put into savings is all used to invest.

The paper finds that the private saving rate has a direct as well as an indirect effect on investment. The indirect effect is through the private investment rate. Again we find out that the higher the rates of interest the low the investment rate hence there is a negative correlation with each unit increase of interest rates to investment. This result has important implications for monetary and fiscal policies.