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**The Effect of Monetary Policy on Financial
Performance of the Commercial Banks Listed on The
Nairobi Securities Exchange**

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The Effect of Monetary Policy on Financial Performance of the Commercial Banks Listed on the Nairobi Securities Exchange

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Abstract

Purpose: The purpose of this study was to establish the effect of monetary policy on the financial performance of commercial banks listed in the Nairobi securities Exchange in Kenya

Methodology: The study adopted a descriptive survey of the commercial banks listed on the NSE. The total population consisted of all 11 commercial banks listed on the NSE as at 30 June 2015. Since the population of the study was small, the study used secondary data which was readily available from both the Central Bank of Kenya and the Nairobi Securities Exchange. All the listed commercial banks were included hence a census study.

Results: The findings from the study confirmed that monetary policy tools such as CBR, CRR and OMO had varying degrees of relationship with the financial performance of the commercial banks listed on the NSE. The study also revealed that OMO rates positively influenced returns of the listed commercial banks at the NSE. This study also established that OMO rates were positively correlated with the financial performance of the commercial banks listed on the NSE while the Central bank rate and the CRR rate negatively influenced the financial performance of commercial banks listed on the NSE.

Unique contribution to theory, practice and policy: This study therefore recommended that the Country should handle its macroeconomic policies appropriately as the changes in the macroeconomics like CBR, CRR and OMO bring about devaluation of the currency and affect the performance of the commercial banks listed in NSE.

Key words: *Monetary policy, financial Performance, commercial banks*

1.0 INTRODUCTION

1.1 Background of the Study

Monetary policy is the process by which the government, central bank, or monetary authority of a country controls the supply, availability and cost of money or rate of interest to attain a set of objectives oriented towards the growth and stability of the economy. Monetary policy rests on the relationship between the rates of interest in an economy, that is the price at which money can be borrowed, and the total supply of money (Saunders & Schumacher, 2000).

The 1971–1973 collapse of the Bretton Woods system created, for the first time in history, a situation in which the world's leading central banks were responsible for conducting monetary policies. Previously, central banks had normally operated under the constraint of some metallic standard like gold or silver standard (Kydlan & Prescott, 1980)

Developing countries have problems establishing an effective operating monetary policy. The primary difficulty is that few developing countries have deep markets in government debt. This is further complicated by the difficulties in forecasting money demand and fiscal pressure to levy the inflation tax by expanding the monetary base rapidly. In general, the central banks in many developing countries have poor records in managing monetary policy. This is often because the monetary authority is not independent of government. Recent attempts at liberalizing and reforming financial markets are gradually providing the latitude required to implement monetary policy frameworks by the relevant central banks Angbazo(1997).The proposed study sought to find out whether the monetary policy adopted by the central Bank of Kenya does have any effect on the financial performance of banks listed on the Nairobi Securities Exchange.

Monetary policy can be an effective tool in providing stability to the economy, stability to prices and keep inflation within set targets over the medium term The European Central Bank(2015).Monetary policy is concerned with changing supply of money stock and rate of interest for the purpose of stabilizing the economy at full –employment or potential output level by influencing the level of aggregate demand .More specifically, at times of recession monetary policy involves the adoption of monetary tools which tend to increase the money supply and lower the interest rates .It may however be noted that in developing countries,in addition to achieving equilibrium at full employment or potential output levels, monetary policy also promotes and encourages economic growth both in the industrial and agricultural sectors of the economy (Supriya & Guru, 2015)

In the recent past monetary policy has become a very important tool in helping stabilize a weakening shilling. A weakening shilling has concerned investors and other economic policy makers. A Weak home currency shillings creates costly import, raises the level of inflation consequently creates economic deterioration. The Central Bank of Kenya is responsible for the conduct of a Nation's monetary policy Mishkin(2004).Over the severally past years it has stepped through monetary policy instruments to promote sound macroeconomic conditions. Notably, in 2011 The Central Bank of Kenya increased interest rates from 5.75 percent to 18 percent over a relatively short period to reign in on a weakening shilling (Central Bank of Kenya, 2011).A further decline of the shilling was averted and stable macroeconomic conditions were restored. The rate was then reduced to 8.5 percent for some time until when again due to a weakening shilling, The Central Bank of Kenya increased the rate from 8.5 percent to in the month of May to 10 percent in June and then to 11.5% in July 2015.However, this has not the desired effect as the shilling continues to weaken further against the US Dollar (Central Bank of Kenya, 2015)

1.2 Research Problem

The type of monetary policy that a country adopts is a major determinant on the financial operations of most financial institutions operating in that country's economy. Monetary policy has the potential to trigger or inhibit investment activities through provision of affordable and denying access to credit respectively. Commercial banks are usually considered around the globe as the most appropriate avenues through which monetary policy is implemented by most Central Banks in many countries. This leaves the commercial banks in a vulnerable situation that's likely to affect their financial performance due to changes occurring in the macroeconomic environment.

Globally several studies on the link between monetary policy instruments and commercial banks activities have been done. (Gertler and Gilchrist, 1994) conducted a study that specifically looked at how bank business lending responds to monetary policy tightening in the United States America. Their study reveals that business lending does not decline when policy is tightened. They concluded that the entire decline in total lending comes from a reduction in consumer and real estate loans. In contrast to (Gertler and Gilchrist, 1994) study, (Kashyap and Stein, 1995) in their study of Monetary commercial banks financial performance in The United States of America found evidence that financial performance by commercial banks is affected by to a tightening of monetary policy. (Gambacorta and Iannotti, 2005) studied the velocity and asymmetry in response of bank interest rates (lending, deposit, and inter-bank) and financial performance to monetary policy shocks (changes) in Italy from 1985-2002 using an Asymmetric Vector Correction Model. They found out that banks adjust their loan (deposit) rate faster during periods of monetary tightening. This is due to the effects brought about by the changes on financial performance. These studies majorly show a positive effect of monetary policy on financial performance of commercial banks.

Kenya has experienced unstable macro environment in the last few years which led to Changes in monetary policy. These changes in monetary policy forced most of the commercial banks to shift the effects to their customers. Other Studies on monetary policy and bank performance indicate different results on the existing relationship. Ongore and Kusa (2013) also carried out a study on the determinants of financial performance of commercial banks in Kenya. The study established that the performance of commercial banks is mainly driven by board decisions. Ngendo (2012) conducted a study on the relationship between non interest income and financial performance of commercial banks in Kenya. The study revealed that noninterest income has partial significant positive impact on financial performance.

1.3 Research objectives

To determine the effect of Monetary Policy on the financial performance of banks listed in the Nairobi Securities Exchange in Kenya.

2.0 LITERATURE REVIEW

2.1 Theoretical Review

2.1.1 Keynesian Theory

This theory was proposed by Keynes (1930). It holds that some microeconomic level actions if taken collectively by a large proportion of individuals and firms can lead to inefficient aggregate macroeconomic outcomes, where the economy operates below its potential output and growth rate. The supply of money is determined by the monetary authority (the central bank), by the lending of commercial banks and by the public preference for holding cash (Were, Kamau, Sichei, Kiptui, 2013). Current interest rates reflect expected inflation rates,

income (GDP) and expected money supply changes (Were et al., 2013). Therefore to stabilize the economy combination of two approaches: a reduction in interest rates and government investment in infrastructure. Investment by government injects income, which results in more spending in the general economy, which in turn stimulates more production and investment involving still more income and spending. The initial stimulation starts a cascade of events, whose total increase in economic activity is a multiple of the original investment. In the 'neoclassical synthesis', which combines Keynesian macro concepts with a micro foundation, the conditions of general equilibrium allow for price adjustment to eventually achieve this goal. More broadly, monetary policy transmission through the interest rate channel is based on the traditional Keynesian interpretation of the role of money for real interest rate movements. A change in interest rates affects firm's investment spending, consumer spending on housing and personal consumption of durable goods Mishkin (1995). (Bernanke and Gertler, 1995). Mishkin (1995) spells out the differences in the manifestation of the credit channel. A monetary contraction leads to a reduction in bank lending due to a drop in bank deposits, and due to a deterioration of borrowing firms 'balance sheets and a decline in collateral value. A decline in aggregate credit reduces output. A reduction in firms 'cash flow and a drop in equity prices following periods of tight money monetary policy as puts a downward pressure on aggregate lending Mishkin (1995). Consumers would rather hold more liquid assets after a drop in the stock market following a monetary contraction, thus decreasing spending on illiquid assets such as real estate and on durable goods Mishkin (1995). This indicates that that monetary policy does have a positive relationship with the financial performance of banks in Kenya.

2.1.2 Loanable funds Theory

This theory holds that, the rate of interest is calculated on the basis of demand and supply of loanable funds present in the capital market Bibow (2000). The loanable funds theory of interest further holds that that both savings and investments are responsible for the determination of the rates of interest in the long run while short-term interest rates are calculated on the basis of the financial conditions prevailing in an economy. Interest rates are key in influencing credit appetite for borrowers from commercial banks. A tightening of the monetary policy leads to an increase in interest rates. This affects the demand for loans Bernake (2000). The Loanable Funds Theory of the Rate of Interest has similarity with the Liquidity-Preference Theory of Interest in the sense that both of them identify the significance of the cash balance preferences and the role played by the banking sector to ensure security of the investment funds. The rate of interest is not purely a monetary phenomenon Wray (1992). According to this theory loanable funds affects the rate of interest which is equally affected by the monetary policy.

2.1.3 Credit Market Theory

A model of the neoclassical credit market postulates that the terms of credits clear the market. If collateral and other restrictions (covenants) remain constant, the interest rate is the only price mechanism. With an increasing demand for credit and a given customer supply, the interest rate rises, and vice versa. It is thus believed that the higher the failure risks of the borrower, the higher the interest premium (Ewert et al, 2000). The increase in demand for credit brought about by low interest rates eventually may lead to depreciation of currency. Central bank therefore must adjust the interest rate to increase the cost of borrowing. Commercial banks in their turn must increase their rates and as a result lending is lowered as credit becomes expensive.

2.1.4 Macroeconomic Theory

This theory was proposed by Friedman (1963). The theory views interest rates as always and everywhere a monetary phenomenon. Further, macroeconomic theory assumes that growing the money supply in excess of real growth causes interest rates to rise. This is also the result from the Harberger (1963) model, which assumes that prices adjust to excess money supply in the money market. It is on the basis of this assumption that it is possible to invert the real money demand and control interest rates. Interest rates volatility in open economies results from different disequilibria in many markets specifically, the domestic money market, external/foreign markets and the labour market. Thus increase in interest rates emanates from three main sources that include excess money supply, foreign prices and cost push factors (Were et al., 2013).

The theory is related to Keynesian liquidity preference theory but recognizes additional sources of interest rates not only demand for money but also foreign prices and cost push factors. Critics of this theory base their argument on the grounds that governments would in practice be unlikely to implement theoretically optimal policies. According to them, the implicit assumption underlying the macroeconomic revolution was that economic policy would be made by wise men, acting without regard to political pressures or opportunities, and guided by disinterested economic technocrats. They argued that this was an unrealistic assumption about political, bureaucratic and electoral behaviour. In relevance to the study, macroeconomic theory views growing money supply in excess of real growth as the cause of interest rates to rise. Interest rate volatility is seen by the theory as emanating from three main sources that include excess money supply, foreign prices and cost push factors. Interest rates volatility will also results from different equilibria in many markets specifically, the domestic money market, external/foreign markets and the labour market. Hence controlling interest rates volatility will involve dealing with disequilibrium in the markets.

2.2 Determinants of financial performance

Financial performance is generally considered to be a reflector of the performance of a firm or a bank. A number of factors have been found to explain the correlation between how interest rate affect the financial performance of a commercial bank. According to (Fernando, 2006), since these rates can be justified by high transaction costs and risks associated with micro lending, it is often difficult to differentiate between sustainability, profitability and greed. This section therefore explains some of the determinants of financial performance.

2.2.1 Interest rates

Interest Rates Interest rates instability generally has been associated with poor financial performance of commercial Banks. Without interest rates stability, domestic and foreign investors will stay away and resources will be diverted elsewhere. In fact, econometric evidence of investment behavior indicates that in addition to conventional factors (past growth of economic activity, real interest rates, and private sector credit), private investment is significantly and negatively influenced by uncertainty and macroeconomic instability Sayedi (2013). Although it is difficult to prove the direction of the relationship between interest rates and profitability, studies confirm that interest rates instability affects commercial banks financial performance with studies giving contradicting findings Gilchris(2013).

2.2.2 Deposits

Deposits Banks are said to be heavily dependent on the funds mainly provided by the public as deposits to finance the loans being offered to the customers. There is a general notion that

deposits are the cheapest sources of funds for banks and so to this extent deposits have positive impact on banks profitability if the demand for bank loans is very high. That is, the more deposits commercial bank is able to accumulate the greater is its capacity to offer more loans and make profits. However, one should be aware that if demands for banks loans are low, having more deposits could decrease earnings and may result in low profit for the banks. This is because deposits like Fixed, Time or Term deposits attract high interest from the banks to the depositors Buyinza(2010).

2.2.3 Bank size

Bank Size Bank size affects the firm's market share which affects profitability. The bigger the firms market share, the more the sales; so in the case commercial banks are able for example to offer more loans then they stand a greater chance of increasing interest income as well as profits. Market share or size of banks is normally used to capture potential economies or diseconomies of scale in the banking sector. Secondly, the size of banks as a variable control for cost differences and product and risk diversification Rachdi (2013).

2.3 Empirical Studies

Buyinza (2010) investigated samples of 23 commercial banks profitability from 1999 to 2006 in Sub Sahara Africa countries. The study utilized panel data and the regression results revealed that capital, efficient expenses management, bank size, credit risk, diversified earning ability of the banks, per capital GDP, growth rate and inflation have significant and positive impact on banks' profitability. (Pinter, Ali, Akhtar, and Ahmed ,2011) examined the bank specific and macroeconomic indicators of 22 public and private sector commercial banks profitability from 2006 to 2009 in Pakistan. The research made use of multiple regression models and panel data estimation. The study found that bank size, operating efficiency, asset management and GDP had positive effect on banks' profitability. However, capital and credit risk had negative effect on banks profitability in Pakistan.

Saidu and Tumin (2011) investigated the performance and financial ratios on samples of four Malaysian and nine Chinese commercial banks from 2001 to 2007. The research made use of panel data and the regression results show that credit, capital and operating ratios have influence on the performance of banks in China which is not true for Malaysia. The study found that liquidity and size of the banks do not influence the performance of the banks in both countries. (Khrawish, and Siam, 2011) investigated the determinants on samples of three Jordan Islamic banks profitability from 2005 and 2009. The multiple linear regression results show capital, bank size, financial risk, GDP growth rate, inflation, and exchange rate.

(Ekpung, Udude & Uwalaka, 2015) examined the impact of monetary policy on the banking sector in Nigeria. The study tried to ascertain the factors that influence the banking sector performance using bank's deposit liabilities as proxy for bank performance. They tested the null hypothesis of no significant relationship between bank deposit liabilities and chosen indices of banking performance, namely Exchange Rate (EXR), Deposit Rate (DR) and Minimum Discount Rate (MDR Results showed that overall; monetary policy had a significant effect on the banks deposit liabilities. meanwhile, on individual basis, they discovered that Deposit Rate (DR) and Minimum Discount Rate (MDR) had a negative influence on the banks deposit liabilities , whereas Exchange Rate (EXR) had a positive and significant influence on the banks deposit liabilities in Nigeria. Their conclusion therefore was that monetary policy plays a vital role in determining the volume of bank's deposit liabilities in Nigeria.

Macharia (2013) studied the effects of global financial crisis on the financial performance of commercial banks offering mortgage finance in Kenya. The study found a negative relationship between inflation, interest rates as a result of global financial crisis and financial performance of commercial banks offering mortgage finance in Kenya. A unit increase in inflation and interest rates led to a 0.543 and 0.425 decrease respectively in the scores of financial performance of commercial banks offering mortgage finance in Kenya. The study further found that exchange rates as a result of global financial crisis had positive effect on financial performance of commercial banks offering mortgage finance in Kenya. A unit increase in foreign exchange rates led to a 0.652 increase in the scores of financial performance of commercial banks offering mortgage finance in Kenya.

Otuori (2013) investigated the determinant factors of exchange rates and their effects on the performance of commercial banks in Kenya. The study found that exports and imports Interest rates, inflation and exchange rates were all highly correlated. By manipulating interest rates, central banks could exert influence over both inflation and exchange rates, and changing interest rates impact inflation and currency values. Higher interest rates offered lenders in an economy a higher return relative to other countries which attract foreign capital and cause the exchange rate to rise.

Capozza and Israelsen (2009) find how quickly equity prices converge to intrinsic value. They focus on markets where information costs, transactions costs and the economic impact of information can vary widely. They find that 15-30% of the difference between the stock price and the estimated intrinsic value is removed in a year. Moreover, levels of predictability vary with firm characteristics like leverage, size and number of analysts. While momentum is stronger for larger firms with more analysts, reversion to the intrinsic value is greater for smaller firms with more analysts. They reach that the value of information is the net payoff from trading on the information. Information is less costly to acquire for some securities, especially large firms and widely followed firms. Net revenue from information is higher for more levered firms and more liquid firms. Private information is more valuable than public information so that corporate insiders have an information advantage. Barriers to entry increase the value of information, for example market makers and specialists.

3.0 METHODOLOGY

The study adopted a descriptive survey of the commercial banks listed on the NSE. The total population consisted of all 11 commercial banks listed on the NSE as at 30 June 2015. Since the population of the study was small, the study used secondary data which was readily available from both the Central Bank of Kenya and the Nairobi Securities Exchange. All the listed commercial banks were included hence a census study.

4.0 RESULTS AND FINDINGS

4.1 Introduction

This chapter presents the analysis of data as stipulated in the research methodology and the findings of the study as set out in the research objective. The study sought to investigate the effects of monetary policy on the financial of commercial banks listed at the Nairobi Securities Exchange. The independent variables were the Central bank rate, the cash reserve ratio and the open market operations. The dependent variable is the financial performance of commercial banks listed in the NSE which was measured by the Return on Assets.

Table 4.1 Descriptive statistics

Descriptive Statistics

	N	Minimum	Maximum	Sum	Mean	Std. Deviation	Variance
CRR	11	4.5000	6.0000	58.8300	5.348182	.5667066	.321
CBR	11	6.4800	15.7500	1.012022	9.200000	2.3359837	5.457
OMO	11	.0000	11.5700	68.1200	6.192727	3.1163700	9.712
ROA	11	.0312	.3840	2.4592	.223564	.1470026	.022
Valid (listwise)	N 11						

For the independent variables in table 4.2 above, CBR has a mean of 1.0120 and a standard deviation of 2.3359837 CRR has a mean of 5.348182 and a standard deviation of 5667066, OMO has a mean of 6.192727 and a standard deviation of 0.49429 and Inflation Rate has a mean of 14.1117 and a standard deviation of 3.163700. A reasonable level of consistency is observed between the mean and standard deviation for all variables. For the dependent variable, financial performance has a mean of 0.223564 and a standard deviation of 0.147002

4.2 Regression Analysis

In addition to descriptive analysis, the study conducted a cross-sectional OLS multiple regression on several firm characteristics over the period 2005–2015.

Table 4.2: Model Summary

Model Summary

Model	R	R Square	Adjusted Square	R Std. Error of the Estimate
1	.909 ^a	.827	.753	.0730618

The correlation and the coefficient of determination of the dependent variables (Returns of listed commercial banks when all the three independent variables CBR, CRR and OMO combined was measured and tested. From the findings 82.7% of returns at the NSE were attributed to the independent variables investigated in this study.

Table 4.3: ANOVA

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.179	3	.060	11.161	.005 ^a
	Residual	.037	7			
	Total	.216	10			

a. Predictors: (Constant), omo, crr, cbr

b. Dependent Variable: Roa

Source: Research Findings

From the data findings in table 4.4 above, the sum of squares due to regression is 0.179 while the mean sum of squares is 0.060 with 3 degrees of freedom. The sum of squares due to residual is 0.037 while the mean sum of squares due to regression is 0.005 with 7 degrees of freedom. The value of F calculated is 11.161 and the significance value is 0.005. The p value is 0.005. Since the p value is less than 0.05 implies that the relationship is significant at 95% level of significance, the model is therefore is significant for the study and prediction.

4.3 Correlation analysis of study variables

Pearson correlation was used to examine if there was correlation or degree of association between the financial performance of the commercial banks listed on the NSE measured by the Return on Assets (ROA) and the independent variables CBR, CRR and OMO. The results are shown in the table 4.3 below.

Table 4.3 Correlation analysis

	ROA	CRR	CBR	OMO
ROA	1			
CRR	0.55877	1		
CBR	0.528554	-0.32188	1	
OMO	-0.15514	0.229668	0.182807	1

*Correlation is significant at the 0.05 level (2-tailed)

The findings shows positive correlation between Return on Assets ROA and Cash reserve ratio CRR risk with a correlation coefficient of 0.55877. This implies that CRR affects the financial performance of commercial banks listed in the NSE in Kenya. The findings also show a positive correlation between Central bank rate, CBR with Return on Assets ,ROA with a correlation of 0.528554. This implies that if The Central bank reduces the CBR rate then it can significantly affect the financial performance of commercial banks listed in the NSE in Kenya .

However the study shows a negative a correlation between Open market operations, OMO with the financial performance of commercial banks listed in the NSE with correlation of 0.15514. This implies that increasing the Open market operations rates can significantly decrease reduce the financial performance of commercial banks in Kenya. These findings illustrate the results obtained from correlation analysis for the population of commercial for the period of study at 0.05 percent level of significance.

Table 4.4: Coefficients of Determination

		B	Std. Error	Beta		
1	(Constant)	1.995	.421		4.737	.002
	CRR	-.344	.070	-1.326	-4.936	.002
	CBR	-.026	.023	-.410	-1.138	.293
	OMO	.049	.021	1.045	2.335	.052

a. Dependent Variable: ROA

Source: Research Findings

According to the model the CRR variable was significant as its significance value was less than 0.05. The other variables (CRR and OMO) were negatively correlated. The open market operations were positively correlated with financial performance while CRR and Central bank rate were negatively correlated with financial performance. From the model, taking all factors (CBR, CRR, and OMO) constant at zero, returns had an autonomous value of 1.995. The data findings analyzed also showed that taking all other independent variables at zero, a unit increase in CRR will lead to a 0.344 decrease in financial performance. A unit increase in CBR will lead to a 0.026 decrease in returns. A unit increase in OMO will lead to a 0.051 increase in financial performance. This infers that central bank rate and CRR had a negative effect to the financial performance of the listed commercial banks at the NSE while the Open Market Operations had a positive contribution on the financial performance of commercial banks listed on the NSE. The coefficient table above was used in coming up with the model below:

$$\text{Financial performance} = 1.965 - 0.344X_1 - 0.026X_2 + 0.049X_3 + 0.421$$

4.4 Interpretation of Findings and discussions

The study found that the regression equations for the period 2005 to 2015 related financial performance of the commercial banks listed at the NSE to their CBR, CRR, REPO and OMO. From the findings of the model summary from 2005 to 2015, 82.7.2% of returns at the NSE were explained by the independent variables (CBR, CRR and OMO) investigated in the study while other factors not studied in this research contributed 17.3%. The value of the F calculated from the regression table was 5.908 while the value of critical F was 4.72. Since calculated F was greater than the critical F, the model was significant for the study.

From the coefficient table of 2005 to 2010, taking all factors (CBR, CRR and OMO REPO) constant at zero, Returns will be 1.961. The data findings analyzed also showed that taking all other independent variables at zero, a unit increase in CBR will lead to a 21.516 increase in returns. A unit increase in CRR will lead to a 0.333 decrease in financial performance. A unit increase in CBR will lead to a 0.029 decrease in financial performance while a unit increase in OMO will lead to a 0.051 Increase in financial performance.

From the summary of findings, it is clearly evident that the Open Market Operations had an effect on the financial performance of commercial banks as indicated by the coefficients of determination of year 2005 to 2015. The study found that the three independent variables in the study (CBR Rate, CRR and OMO) influenced the financial performance for the period under study. CBR and CRR negatively influenced share financial performance for the period of study.

These findings are in line with that of Fatade (2004) who in studying the effect of monetary policy on performance of banks in Nigeria established that various monetary policy measures instituted in the country over the years have directly and indirectly affected performance of the banking sector in a number of ways while includes Banks profitability, Deposit/Savings mobilization Loans & Advances and so on. He further confirmed that the effectiveness of bank's performances depends on the instruments used in macroeconomic policies and the prevailing economic conditions and the deregulation of monetary policy on performance of banks in Nigeria established that various monetary policy measures instituted in the country over the years have directly and indirectly affected performance of the banking sector in a number of ways while includes Banks profitability, Deposit/Savings mobilization Loans & Advances and so on. He further confirmed that the effectiveness of bank's performances

depends on the instruments used in macroeconomic policies and the prevailing economic conditions and the deregulation of the sector has led to a number of improvements.

These findings agree with the position held by Ahumada and Rodrigo (2004) who established that monetary policy largely affects that market interest rates thus forcing banks to change their investment decisions. They further indicated that when banks change their investment decisions their financial performance is also likely to change or be affected due to the changes in monetary policy. Their study concluded that regulatory distortions have an important effect on the efficiency and profitability of the Banking industry.

5.0 CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusion

From the analysis, it can be noted that the three independent variables (CBR, TBR, REPO, and Inflation) had varying degrees. The study concludes that central bank rate influences the returns of commercial banks listed at the NSE negatively. The study also deduced that CRR negatively influenced the financial performance of commercial banks listed at the NSE. The results are similar to the work of Friedman (1963) who stated that CRR is always a monetary phenomenon, which suggests a relationship between money growth and Open CRR. Monetary policy affects macroeconomic variables largely through its impact on interest rate. Lee (1992) suggested that central bank uses monetary policy tools to manipulate the money supply and interest rates, which influence indicators like output, exchange rates, and unemployment rate which consequently affect inflation and the overall economy.

The study also revealed that Open Market Operations positively influences financial performance of the listed commercial banks at the NSE. These findings are consistent with the works of Hördahl and King (2008) who stated that Open Market Operations are useful to central banks both as a monetary policy instrument and as a source of information on market expectations. Hördahl and King (2008) further stated that Open Market Operations are attractive as a monetary policy instrument because they carry a low credit risk while serving as a flexible instrument for liquidity management.

5.2 Recommendations for the study

This study established that Central bank rate; CRR and Open Market Operations play a key role on the financial performance of the commercial banks listed at the NSE. This study therefore recommends that the Country handles its macroeconomic appropriates as the changes in the macroeconomics like Open Market Operations rates and Central bank rate bring about devaluation of the currency and affect the performance of the commercial banks listed at the Nairobi Securities Exchange. This will ensure stability at the NSE which promotes fair trade.

This study also established that Open Market Operations were positively correlated with the financial performance of the commercial banks listed at the NSE while Central bank rate and CRR rate negatively influenced financial performance. This study therefore recommends that commercial banks balance off their borrowing and deposit rates since these rates of set by the the country's central bank are the rates affect the financial performance of these commercial banks.

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