# MONETARY POLICY IMPLICATIONS ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS LISTED IN THE NAIROBI SECURITIES EXCHANGE, KENYA

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*Abstract:* **Commercial banks are regarded as very important players in the financial sector and the economy of a country at large. The study utilized causal research design and utilized panel data for Eleven (11) years from 2007 to 2017 using panel regression analysis. The target population constituted of all the eleven (11) listed commercial banks in Kenya and therefore this implied that a census was adopted. Data was sourced from the audited financial statements of commercial banks from the respective commercial bank's official websites and CBK statistical bulletins from the CBK's official website. Data obtained was regressed using the random effect model and the results of the analysis tabulated the results of the study established that that Central Bank Rate and inflation are insignificant to performance while money supply was significant. The study also indicated that capital adequacy had an insignificant moderating effect on the relationship between Central Bank Rate and money supply but significant moderating effect on the relationship between Inflation. Moreover, the study concluded that in absence of prudential regulation, Central Bank Rate and Inflation have insignificant effect on financial performance while Money Supply significantly affects performance. In presence of prudential regulations that dictates the capital buffer, Central Bank Rate, Money Supply have an insignificant moderating effect on the relationship with performance of listed banks while inflation has a significant effect. The results indicated that the CBK should ensure Money Supply is regulated as it affects performance of commercial banks. In the case of capital adequacy banks should engage other profitable ventures as opposed to putting so much capital buffer. This is because in periods of inflation such buffers become depleted and as such lowers the financial performance of commercial banks.**

*Keywords:* **Central Bank Rate, Money Supply, Inflation, Capital adequacy, Financial Performance.**

## 1. INTRODUCTION

### 1.1. Background of the Study

All over the world, the banking system constitutes a vital component of the financial sector of a country. Commercial banks play significant roles in a country's economy these roles include channeling of funds from various economic units that have excess funds to those units that have deficit funds, financial intermediation, monetizing the economy and provide seed capital (Al-Qudah, 2013). This therefore implies that the well-being of a country's economy rests on the soundness of its banking system and financial system at large. Ndugbu and Okere (2015) emphasize that a highly developed banking sector and financial system is linked to its economic growth and development of countries. Importantly, commercial banks serve as a heart in a country's economic structure where the capital it provides serves as

the blood in it and therefore, as long as blood is in circulation the organs will remain sound and healthy (MacCarthy, 2016). In the absence of capital financing to firms in the various sectors of the economy, there will be stagnant growth in such economies (Meshak, 2016).

Monetary policy involves the use of monetary policy instruments as a stabilization policy, to normalize and control the availability, cost, direction and the volume of money and loans in an economy to achieve some specific macroeconomic policy goals. Monetary Policy is a deliberate attempt by the monetary authority of a country to control the money supply and credit condition in the economy so as to achieve certain economic objective. In the Kenya the monetary authority is the Central Bank of Kenya (CBK). Some of the macroeconomic objectives include price stability, full employment, sustainable economic growth, balance of payment equilibrium and controlling money supply in the economy (Onouorah, 2013).

Economic activities are not directly affected by monetary policy instruments but they work through their effects on the financial markets. Monetary Policy affects economic activities through its effects on available resources in the banking sector. For instance, when the economy experiences inflationary pressure, the monetary authority can use contractionary monetary policy to stabilize the price level. This may be done by increasing the reserve ratio whose effect will be to reduce the amount available to commercial banks for the purpose of credit facility. Commercial banks will be reluctant to lend to businesses and consumers in an economy thereby reducing the money in circulation in the economy. This will eventually reduce the pressure on prices in the economy through a reduction in the volume of money in circulation. On the other hand, if the objective is to increase the aggregate demand in the economy, the reserve ratio may be reduced and therefore increasing the amount available to the commercial banks for lending to businesses and consumers (Akomolafe, 2015).

## 1.2. Problem Statement

The financial sector is among the sectors that is expected to facilitate the realization of vision 2030, by ensuring that there is provision of efficient financial services and investment opportunities that will create a vibrant and global competitive financial services in Kenya (GOK, 2007). It is evident that a majority of banks have undergone financial performance fluctuations, liquidated or gone under statutory management; however, others are yet to go through financial distress. The main and common factors that contribute to poor performance on the banking sector as identified by various studies reviewed include; liquidity, leverage, operational efficiency, asset quality and capital adequacy. However, the commercial banking sector has been branded by poor financial performance as indicated in their Net Interest Margin (NIM). The NIM of banks in Kenya went on a decline in 2017 to 7.5% from the previous 8.8% in 2016. This has been attributed to the capping of interest rates in 2016. Alongside the compressed margins of the current regulatory framework, they have impacted negatively on commercial banks.

Past studies on monetary policy and financial performance were largely centered on other countries such as Jordan, Nepal, China and Nigeria. Therefore, findings from such studies may not apply to Kenyan banks because each country is unique as it is characterized by varying economic conditions such as economic size and market concentration. Similarly, studies carried out in the Kenyan context were largely based on multiple regression and did not incorporate regulation and its moderating role that exists on the relationship between monetary policy and performance. The study sought to assess the influence of monetary policy on financial performance of commercial banks listed in the NSE and the moderating effect regulation has on the relationship between monetary policy and financial performance of listed commercial banks in Kenya. The study utilized panel data, therefore, the analysis of the study was carried out using panel regression analysis.

## 1.3. Objectives of the Study

i) To evaluate the effect of Central Bank Rate on financial performance of Commercial Banks listed in the Nairobi Securities Exchange, Kenya.

ii) To examine the effect of money supply on financial performance of Commercial Banks listed in the Nairobi Securities Exchange, Kenya.

iii) To establish the effect of inflation on financial performance of Commercial Banks listed in the Nairobi Securities Exchange, Kenya

iv) To investigate the moderating effect of prudential regulation on the relationship between monetary policy and financial performance of Commercial Banks listed in the Nairobi Securities Exchange, Kenya.

## 2. THEORETICAL REVIEW

Interest rate parity theory was developed by Bleaney and Fielding in the year 1937. This theory indicates that the interest rate differential between two countries is identical to the differential between the forward and spot exchange rates. Interest rate parity connects spot and forward exchange rates and interest rates, thus its importance in the international currency market, (Radha, 2011). The amount charged on loans granted to customers is regarded as interest rates. Usually, banks are guided by rules when extending loans to customers and also on the amount to be charged as interest on such loans (Mirzaei, Liu & Moore, 2013). Short term loans (such as overdraft facility) and long-term loans (mortgages, debentures or bank loans) are characterized by different rates of interest.

The quantity theory of money (QTM) was formulated by Fisher and Friedman (1929). This is a theory on demand for which is reflected by money supply in an economy. The Quantity Theory of Money is based on the notion that the quantity of money available (money supply) increases at the same degree as the level of prices in the long run. When the rates of interest charged decreases and there is less restriction to access to money, consumers will become less sensitive to changes in prices and subsequently a higher propensity to consume (MacCarthy, 2016). Consequently, the aggregate demand curve will move to the right, thereby shifting the equilibrium price level up. A key pillar of this theory is the notion that a unit change in the growth of money levels is accompanied by a corresponding increase in price levels which is in equal measures. The quantity theory of money is a test about the main cause of changes in the value of purchasing power of money. According to the theory the changes in the value of purchasing power of money are caused mainly by the quantity of money in circulation.

Deflation theory was introduced by Irving Fisher (1933). This theory advocated that the diminishing price levels would lead to a decline in the net worth of businesses, decreased level of profits and subsequently bringing about poor performance of firms. According to Fisher, lending cycles can only come to an end when the borrowers and lenders have burned their fingers and later learn from their mistakes. This cycle would repeat its self and caution omitted by the creditors and debtors. The cycle repeats itself in the long run resulting to a debt cycle. There may be a stable equilibrium however after departure from the equilibrium beyond certain limits, instability comes in just as at first, a stick may bend under strain, ready all the time to bend back, until a certain point is reached, when it breaks.

### 2.1 Empirical Review

Ekpung, Udude and Uwalaka (2015) researched on the influence of monetary policy on the banking segment in Nigeria. The research aimed at establishing factors study tried to ascertain the factors impacting on performance of the banking sector using deposits obligations as a substitute to banks performance. The findings of the study show that CBR has a positive and significant impact on banks performance in Nigeria. Importantly, the study focused on Nigerian banks whereas the current study focused on Kenyan banks. Due to the different contextual characteristics of the banking sectors of various countries, the research findings of such study cannot be applied in Kenya.

Mulwa (2015) carried out an analysis on monetary policy and impacts on the financial performance of commercial banks in Kenya. The study concentrated on the period between 2010 and 2014. Monetary policy was represented by open market operations, Central Bank Rate (CBR), and Reserve Ratio Requirement while financial performance of Commercial Banks was measured in terms of Net Interest Margin. The findings of the study show that Central Bank Rate has an insignificant impact on the performance of commercial banks in Kenya. However, Mulwa (2015) focused on just NIM as a measure of financial performance while the current study focused on ROE.

Al-Qudah and Jaradat (2013) carried out an empirical analysis on the impact of macroeconomic variables and bank specifics on profitability of Jordanian Islamic Banks. Profitability was measured in terms of Return on Assets and Return on Equity. The findings of the study show that the growth in money supply (GM2), significantly and positively influences ROA while it impacts on ROE insignificantly. This can be attributed to the notion that increases in money supply implies more money circulating in the economy and thus impacting on the financial performance of commercial banks.

Otalu, Aladesanmi and Olufayo (2014) did an empirical study on monetary policy and performance of Nigerian banks while focusing on the credit creation role. Variables of the study were money supply; cash reserve ratio, liquidity ratio and interest rate where total bank credit was used as a proxy for commercial bank performance. The results of the study show that cash reserve ratio and liquidity ratio have significant and insignificant negative effect on performance of commercial banks respectively. In respect to money supply, the findings show a positive and significant impact of money supply performance of banks in Nigeria. The current study was based on banks in Kenya.

Ajayi and Atanda (2012) conducted an analysis on the influence of monetary policy tools on performance of banks in the Nigerian context. The time scope of the study was the period 1978 to 2008. Co-integration approach was used where bank performance was regressed in terms of monetary policy tools. The findings of the study reveal that inflation rate has a negative effect on banks total credit. Notably, the research by Ajayi and Atanda focused on commercial banks in Nigeria. Due to varying contextual characteristics, the findings of such study cannot be generalized for commercial banks in Kenya.

## 3. RESEARCH DESIGN

In carrying out the study, causal research design was adopted in order to identify the extent and nature of cause-and-effect relationships (Cooper & Schindler, 2009). Causal research is utilized when assessing the impacts of specific changes in variables in a research, that is dependent and independent variables. Causal studies focus on an analysis of a situation or a specific problem to explain the patterns of relationships between variables. Casual research design was appropriate for this study as it sought to examine the effect of monetary policy on financial performance of commercial banks listed at the NSE, Kenya.

## 4. TARGET POPULATION

The target population constituted of the Eleven (11) listed commercial banks in the NSE, Kenya, which also made up the unit of analysis of the study.

The data collected was for the duration of eleven (11) years from 2007 to 2017. This period was chosen because it was characterized by changes in the operating environment of banks which include the introduction of the interest rate capping of 2016 and prudential strategies that were dispensed by the Central Bank of Kenya (CBK) in 2013 needing banks to sustain capital conservation buffer of 2.5% above the capital adequacy ratios.

### 4.1 Diagnostic Tests

Prior to carrying out a panel regression analysis, diagnostic tests were carried out to determine whether the variables used are appropriate for the study. This included, multicollinearity which was carried out using the correlation matrix, stationarity which was performed using the Augmented Dickey Fuller (ADF) test and the test for fixed effects and random effects performed using the Hausman test.

### 4.1.1 Multicollinearity Test

In carrying out panel regression analysis, the data is required to be independent and not be highly correlated to each other. High level of multicollinearity in the data leads to drawing of similar inferences and conclusions in the variables. The level of multicollinearity was assessed using the correlation test that indicates how strongly a pair of variable is associated. Specifically, Pearson Correlation was used to test whether there is a connection between the strength of relationship amid the listed commercial financial performance in the Nairobi Securities Exchange Kenya, which was measured by Central Bank Rate (CBR), Money Supply (M3), Inflation and Capital Adequacy and results tabulated in table 4.1.

**Table 4.1: Correlation Test**

|  | CBR | Money Supply | Inflation | Capital Adequacy |
|---|---|---|---|---|
| CBR | 1.0000 |  |  |  |
| Money Supply | '0.2843*<br>(0.0016) | 1.0000 |  |  |
| Inflation | '0.4876*<br>(0.0000) | -0.1439<br>(0.1153) | 1.0000 |  |
| Capital Adequacy | -0.1840*<br>(0.0433) | -0.7472*<br>(0.0000) | 0.0507<br>(0.5810) | 1.0000 |
| *.Correlation is significant at the 0.05 level (2-tailed). |  |  |  |  |

*Source (Research data, 2019)*

Table 4.1 tabulates the results of the Pearson correlation test. Test results show that inflation and money supply had a negative and insignificant correlation with a coefficient of correlation (r) of -0.143 and a p-value of 0.115. CBR and Money Supply are positively and significantly correlated with a coefficient of correlation of 0.284 and p-value of 0.001. Capital adequacy and Money Supply had a coefficient of correlation of -0.747 and a p-value of 0.000 which suggests that the pair is strongly correlated. Additionally, CBR and inflation were found to be positively and significantly correlated with a coefficient of correlation of 0.487 and p-value of 0.000, capital adequacy and inflation had a positive and insignificant correlation with a coefficient of correlation of 0.050 and p-value of 0.581. Lastly, capital adequacy and CBR had a coefficient of correlation of -0.184 and p-value of 0.043 which implies a positive and significant correlation. Greene (2008) established that a correlation coefficient (r) above 0.8 or coefficient of determination ($r^2$) above 64 implies the existence of high level of multicollinearity. In line with this, the study concluded that high level of multicollinearity does not exist among the predictor variables of the study since the correlation coefficient (r) values fall below 0.8.

### 4.1.2 Stationarity Test

In carrying out panel regression analysis, the data is required to be constant over time and thus stationary. Non-stationary data leads to drawing of wrong inferences and conclusions at large. The test for stationarity is carried out due to the time series aspect of panel data. The stationarity test was conducted through the use of Augmented Dickey Fuller (ADF) and findings presented below

**Table 4.2: Summary of the Test for Stationarity**

| Variable | Test statistic | P-value |
|---|---|---|
| ROE | -7.894 | 0.0000 |
| CBR | -5.213 | 0.0000 |
| Money Supply | -12.691 | 0.0000 |
| Inflation | -7.646 | 0.0000 |
| Capital Adequacy | -9.153 | 0.0000 |

*Source (Research findings, 2019)*

A panel data is said to be stationary if it's mean, variance or pattern does not exhibit an upward and downward trend. The null hypothesis is that the series is non-stationary while the alternative hypothesis is that the series is stationary which is based on a 0.05 significance level. The ADF statistics reveal ROE to have a test statistic of -7.894 and p-value of 0.000, Money Supply had a test statistics of -12.691 and a p-value of 0.000, inflation had a test statistics of -7.646 and a p-value of 0.000, CBR had a test statistics of -5.213 and a p-value of 0.000 and lastly, capital adequacy had a test statistic of -9.153 and a p-value of 0.000. Notably, the p-values of all the research variables were less than the threshold of 0.05 significance level and therefore, we reject the null hypothesis, which is an indication that the study data is stationary.

### 4.1.3 Tests for Fixed Effects and Random Effects

In carrying out panel regression analysis, the most appropriate model is required to be considered. The choice of the model is done by carrying out the test for fixed and random effects performed by the Hausman Test. A Hausman test is carried out to determine the best model to be used in carrying out a panel regression output. The choice of the appropriate model depends on whether we accept or reject the null hypothesis. If a p value of less than 0.05 is obtained, it implies that the null hypothesis should be rejected and therefore the fixed effect model is adopted and where a p value of more that 0.05 is obtained the null hypothesis is not rejected therefore the random effect model is used. For the cross section random effect result, we perform the Hausman Test to determine the viability of the model. If the null hypothesis is rejected and a random effect model is used then it implies that it will produce biased estimators, so a fixed effect model is preferred (Chmelarova, 2007).

**Table 4.3: Hausman Test**

| Test statistic Chi(4) | P-value |
|---|---|
| 0.00 | 1.0000 |

*Source (Research data)*

From the output of the Hausman test, the p-value is 1.0000 which is higher than the threshold of 0.05 this implies that we fail to reject the null hypothesis and therefore the preferred model for this study is the random effect model thus, in line with this, the random effect model was utilized in the research study.

### 4.2  Panel Regression analysis

The panel regression analysis is based on two models which are the direct random effect model and the random effect model.

### 4.2.1 Panel Regression Model without Moderating Variable.

The direct effect model is the first model, in this model ROE is presented as a function of money supply, inflation and Central Bank Rate (CBR). The model entails running the regression analysis without the inclusion of the moderating variable as exhibited in Table 4.4.

**Table 4.4: Random Model**

| Dependent  Variable | ROE |
|---|---|
| Explanatory Variable | Coefficient |
| CBR | 0.0121052 |
| MSupply | -1.070509* |
| Inflation | -0.0046451 |
| Constant | 7.393738* |
| **Post Estimation Diagnostics** | |
| R square: Within | 0.0000 |
| Between | 0.0000 |
| Overall | 0.2924 |
| Rho | 0.2089 |
| Wald chi2 (7) | 60.34 |
| Prob>chi2 | 0.0000 |
| Number of Observations | 121 |
| *.Correlation is significant at the 0.05 level (2-tailed) P-value <0.05 | |

*Source (Research data)*

The panel model thus becomes;

$ROE_{it} = 7.394 + 0.012CBR_{it} - 1.071Msupply_{it} - 0.005Inflation_{it} + \varepsilon t_{it}$

From the panel regression model, the constant stands at 7.393 which is significant as indicated by a p-value of 0.000. The regression output shows that the overall model is significant as shown by a p-value of 0.0000. A unit increase in the Central Bank Rate brings about an insignificant increase in ROE of banks by 0.012. A unit increase in money supply decreases financial performance of commercial Banks listed at the NSE, Kenya by 1.070 as indicated by return on equity (ROE) which is significant based on a threshold of 0.05 significant level. Lastly, a unit increase in inflation leads to a 0.005 decrease in ROE of banks, this is however insignificant.

### 4.2.2 Panel Regression Model with Moderating Variable

The moderating effect model is the second model, in this model ROE is presented as a function of money supply, inflation and Central Bank Rate (CBR) each interacted individually using capital adequacy. The model entails running the regression analysis with the inclusion of the moderating variable as tabulated in Table 4.5.

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**Table 4.5: Random Effect Model with Moderating Variable**

| Dependent Variable | ROE |
|---|---|
| Explanatory Variable | Coefficient |
| CBR | 0.0326636 |
| MSupply | -0.4444798* |
| Inflation | 0.0538832 |
| CBR*CAR | -0.3574986 |
| MSupply*CAR | 0.3459396 |
| Inflation*CAR | -0.1863302* |
| Constant | 2.4996261 |
| **Post Estimation Diagnostics** | |
| R square: Within | 0.4959 |
| Between | 0.4932 |
| Overall | 0.4512 |
| Rho | 0.1796 |
| Wald chi2 (7) | 104.53 |
| Prob>chi2 | 0.0000 |
| Number of Observations | 121 |
| *.Correlation is significant at the 0.05 level (2-tailed). P-value <0.05 | |

*Source (Research data, 2019)*

Table 4.5 presents the moderating effect model where capital adequacy was interacted individually with money supply, inflation and Central Bank Rate. Holding other factors constant a unit increase in Central Bank Rate increases banks' ROE by 0.033 which is insignificant at 0.05 level of significance. A unit increase in money supply decreases ROE of banks significantly by 0.444. The study additional demonstrates that a unit increase in inflation increases Return on Equity (ROE) of banks holding other factors constant, by 0.054 which is significant at 0.05 significant level.

The regression analysis reveal that a unit increase in the interaction between capital adequacy and Central Bank Rate brings about a 0.357 decrease in ROE which is insignificant at 0.05 significance level. A unit interaction between capital adequacy and money supply leads to a 0.346 decreases ROE of commercial banks which is significant at 0.05 significance level of. Lastly, a unit increase in the interaction between capital adequacy and inflation leads to 0.186 decrease in ROE of commercial banks which is significant at 0.05 significance level.

## 4.4 Hypotheses Testing

This is a statistical test that is used as an assumption which is tested to determine the relationship between two data sets. The first null hypothesis of the research states that Central Bank Rate has no significant influence on financial performance of listed commercial banks at the Nairobi Securities Exchange (NSE), Kenya. The results from the panel regression analysis indicated that Central Bank Rate has an insignificant effect on financial performance of listed commercial banks at the Nairobi Securities Exchange (NSE), Kenya.

The findings of the study with regards to the consequence of Central Bank Rate on commercial banks financial performance are in agreement with that of Ekpung *et al*., (2015) who found that Central Bank Rate has a positive and insignificant impact on bank performance in Nigeria.

Mulwa (2015) carried out an analysis on monetary policy and impacts on Kenya commercial banks financial performance. The study focused on the period 2010 to 2014. The findings of the study show that Central Bank Rate has an insignificant effect on the Kenyan commercial bank's financial performance.

The second null hypothesis of the study stated that money supply has no significant effect on financial performance of listed commercial banks at the NSE, Kenya. The specific objective for this hypothesis was to investigate the effect of money supply on financial performance of listed commercial banks at the NSE, Kenya. The regression output gave evidence of a negative and significant effect of money supply on financial performance of listed commercial banks at the NSE, Kenya and therefore we reject the null hypothesis.

Al-Qudah and Jaradat (2013) in an empirical analysis on the impact of macroeconomic variables and bank specifics on profitability of Jordanian Islamic Banks considered profitability in terms of both the return on assets and return on equity. The study findings show that the growth in money supply (GM2) significantly influences ROA while it impacts on ROE insignificantly. Similarly, Otalu *et al*. (2014) did an empirical study on monetary policy and performance of Nigerian banks while focusing on the Credit Creation Role. The results of the study show that cash reserve ratio and liquidity ratio have significant and insignificant negative effect on performance of commercial banks respectively. In respect to money supply, the findings show a positive and significant impact of money supply performance of banks in Nigeria.

The third research hypothesis states that inflation has no significant effect on financial performance of listed commercial banks at the NSE, Kenya. The specific objective in line with this hypothesis was to assess the effect of inflation on financial performance of listed commercial banks at the NSE, Kenya. The results from the regression analysis indicated that there is an insignificant effect of inflation on Kenyan listed commercial banks' at the NSE. The null was therefore not rejected at 0.05 percent significance level.

The findings of the study regarding the effect of inflation on financial performance of listed commercial banks in Kenya is in agreement with those of Ajayi and Atanda (2012) and Macharia (2013), who conducted an analysis on the influence of monetary policy tools on performance of banks in the Nigerian context for the period between 1978 and 2008. Co-integration approach was used where bank performance was regressed in terms of monetary policy tools. The findings of the study reveal that inflation rate has a negative effect on banks total credit. Macharia (2013) carried out a research on the effect of external factors on financial performance of commercial banks offering mortgage finance in Kenya. The study found a negative relationship between inflation and financial performance of commercial banks offering mortgage finance in Kenya. The negative effect of inflation on the financial performance of banks can be attributed to the notion that inflation erodes the real money value thereby reducing its purchasing power.

The fourth null hypothesis of the study was that capital adequacy has no significant moderating influence on the association between monetary policy and listed commercial banks' financial performance. The hypothesis was therefore broken down into three sub hypotheses. First was that capital adequacy has no significant moderating effect on the association between central Banks Rate and listed commercial banks' financial performance. The second hypothesis was that the capital adequacy has no significant moderating influence on the relationship between money supply and listed commercial banks' financial performance. Thirdly, the hypothesis stated that capital adequacy has no significant moderating effect on the association between inflation and listed commercial banks' financial performance. The specific objective was similarly broken down into three as per the sub hypotheses. The output from regression analysis revealed that capital adequacy has a negative and insignificant moderating effect on the relationship between Central Bank Rate and financial performance of Commercial Banks Listed at the NSE, Kenya. The study therefore, the study failed to reject the sub null hypothesis. The study findings further indicated that capital adequacy has a positive but insignificant moderating effect on the relationship between money supply and financial performance of Listed Commercial Banks at the NSE, Kenya. In line with this result, the null hypothesis was not rejected. Lastly, the study findings revealed that capital adequacy has a negative and significant effect on the relationship between inflation and financial performance of Listed Commercial Banks at the NSE, Kenya. The null hypothesis was therefore rejected at 0.05 level of significance.

## 5. CONCLUSIONS AND RECOMMENDATION

The policy recommendations of the research are informed by the variables which significantly predict the performance of commercial banks listed at the Nairobi Securities Exchange, Kenya. The study findings indicated that Money Supply negatively and significantly predicts the financial performance of listed commercial banks at the Nairobi Securities Exchange, Kenya. In line with this finding, the study is of the recommendation that Money Supply should be regulated or monitored by the Central Bank of Kenya, in that when there is too much money in circulation, number of borrowers seeking loans may decrease which can be detrimental to the performance of commercial banks. Therefore, the increase and decrease of money supply by the Central Bank of Kenya should be determined by market conditions.

The study also indicated that Capital Adequacy has a negative and significant effect on the relationship between inflation and financial performance of listed commercial banks at the Nairobi Securities Exchange, Kenya. In regards to this finding, the study recommends that after the attainment of the minimum capital requirements, banks should engage other profitable ventures as against put so much capital buffer. This is because in periods of inflation such buffers become depleted and as such lowers the financial performance of commercial banks.

Further studies can focus on the entire scope of the commercial banks in Kenya and test the moderating effect of prudential regulation on the relationship between monetary policy and financial performance of all commercial banks in Kenya, rather than the listed banks as they can give a wide range scope for comparison purposes.

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