
Abdulkadir Abdulrashid Rafindadi and Zarinah Yusof

Department of Economics, Faculty of Economics and Administration, University of Malaya, Kuala Lumpur, Malaysia

Submitted: Nov 12, 2013; Accepted: Dec 17, 2013; Published: Dec 20, 2013

Abstract: The recent global financial crisis has plunged the Kenyan economy into massive currency depreciation, falling international demand, as well as the stagnation in its tourism industry. It is in reference to these episodes that this study aims to investigate whether the long-run financial development and economic growth prospects of the Kenyan economy have been affected. To achieve this, we measure the short-run and long-run impact of financial development on economic growth using time series data from 1980 to 2011. The ARDL bounds-testing approach to cointegration was applied and the U test methodologies. The finding of the study established that financial development has no contributory effects on Kenyan GDP in both the short-run and the long-run and this is immaterial to the course of the financial crisis. Trade openness was persistently discovered to be the most impeding factor to the growth of the Kenyan economy in both the short-run and the long-run. The study also discovered that the relationship between financial development and GDP is monotonic, meaning, there is no excessive monetary dilation in the Kenyan economy. The most startling empirical finding of this study is that the GDP of continents with evidence of the demand-following hypothesis, (as in the case of Kenya) has the fastest readjustment possibilities despite the crisis and other prevailing macroeconomic vices. The question of why and how opens up another area of empirical research.

JEL Codes: N27, O16, O47, G29

Key words: U-test • ARDL bounds-test • Economic growth • Financial crisis

INTRODUCTION

The Kenyan economy, which is driven by agriculture, financial intermediation, tourism and construction, experienced a drastic currency depreciation and rapid inflation in recent times, particularly during the 2007-2008 financial crisis. The crisis suppressed the economic activities of the country. The strong decline in global demand affected Kenyan horticultural exports to European markets and also caused stagnation in the tourism, manufacturing and construction sectors that constitute the mainstay of the Kenyan economy. It is now believed that Kenyan economic growth will not reach previously anticipated growth levels. An African Development Bank (AFDB) report [1] estimated that the Kenyan real GDP growth rate in 2012 was 3.4%, compared to an annual real GDP growth rate of 4.4% in 2011 and 5.8% in 2010. The 3.2% figure was attributable to a slowdown in most economic sectors. While real GDP growth is expected by some to increase to 4.5% in 2013 and to 5.2% in 2014, to date, there have not been any indications that these targets will be achieved. Studies have attempted to identify reasons for volatile economic growth among countries. A seminal work is Moreno and Trehan [2], which argued that the dichotomies in economic growth tend to arise due largely from internal and external factors. Internal factors include the level of macroeconomic stability in a country; natural resource endowments; levels of applicable innovation and creativity (which relate to educational systems and how education is used to exploit technology and science); institutional development; levels of capital accumulation;