MONETARY POLICY TRANSMISSION AND PROFITABILITY OF COMMERCIAL BANKS IN KENYA

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ABSTRACT

In Kenya, profitability moved sharply over the past decade as monetary actions and regulatory reforms changed operating conditions. Return on assets fell from above 3% in 2014 to about 2% during the interest rate cap period of 2016 to 2019, with only modest recovery from 2020 to 2024. These patterns motivate an examination of the strength of monetary transmission in sustaining bank earnings. This overall goal of the research was to determine the effect of monetary policy transmission on the profitability of commercial banks in Kenya. The research's specific goals were to determine the effect of the interest rate channel, credit channel, open market operations channel and liquidity channel on Profitability of Commercial Banks in Kenya. The theoretical framing draws on loanable funds theory, financial intermediation theory, liquidity preference theory and the profitability theory of financial intermediation. A census design was employed, covering all 38 commercial banks licensed by the Central Bank of Kenya as of December 2024. Data were drawn from audited financial statements, Central Bank of Kenya statistical bulletins, and annual supervision reports for the period 2014–2024. Profitability was proxied by ROA, while the transmission channels were measured respectively by the weighted average interbank rate, private sector credit growth, the 91-day Treasury bill rate, and broad money supply (M2). Panel regression techniques were applied after subjecting the dataset to diagnostic checks, which confirmed normality of residuals, absence of multicollinearity, and the robustness of model specification. The results showed that the interest rate channel exerted a significant negative effect on profitability, the credit channel had a significant positive effect, and the liquidity channel also had a positive and significant effect. In contrast, the open market operations channel was significant but negatively related to profitability, reflecting the tendency of banks to rely on government securities during periods of weak private lending. The study concludes that while credit expansion and liquidity growth improve earnings capacity, high interest rates and overdependence on Treasury instruments erode bank profitability. It recommends that banks strengthen asset–liability management, diversify income sources, and enhance credit risk frameworks, while policymakers, especially the Central Bank of Kenya, refine monetary instruments in ways that balance interest rate stability, credit expansion, liquidity growth, and securities reliance to reinforce profitability and resilience in the banking sector.

Key words: Commercial banks, Monetary policy Transmission, Profitability.

INTRODUCTION

In Sub-Saharan Africa, structural rigidities have determined profitability by restricting the power of transmission of monetary signals. The Treasury bill rates as well as the reserve requirement policies have also played a significant role in the profitability of banks in Nigeria and Ghana. However, the credit and interest rate channels have been undermined by high non-performing loans and underdeveloped securities markets that result in the volatility of returns in the sector (Rakibul, 2023). International reports have recorded such similar experiences, with the monetary policy measures affecting money supply and interest rates not necessarily leading to foreseeable effects on profitability, citing transmission inefficiencies (Mbabazize et al., 2020).

The banking industry in Kenya reflects some of these dynamics in the region but also has its peculiarities. The ROE profitability has dropped to a level of slightly above 10 percent by 2020, compared to over 20 percent in 2013, and has since then returned slightly (CBK, 2023). A number of monetary transmission channels have contributed to these changes. The introduction of interest rate caps in 2016 undermined the interest rate channel by limiting the lending margins, and Treasury bill movements of the interest rates influenced the returns on investments in an open market operations channel. The credit supply was further curtailed by liquidity disruptions in the COVID-19 pandemic that increased the effect of the credit and liquidity channels on viability. Even with the reforms that have been put in place, including an increased reliance on open market operations and better inflation-targeting, there are still questions on whether the transmission of monetary policy signals into profitability results of Kenyan banks is effective or not.

There are various indicators that scholars have used to measure bank profitability, and each of them focuses on a different aspect of performance. ROA is often utilized to indicate the efficiency of a bank to turn its assets into net income (Paula, 2020). Return on equity indicates the amount the shareholders are getting back and is often related to the issue of sustainability (Kim and Lee, 2021). Net interest margin, in its turn, concentrates on the range between the interest income and the cost of funding that it gives a direct view of how the monetary policy passes on to the bank earnings (Rakibul, 2023). Earnings per share, the cost-to-income ratio, and valuation measures of the Q, price-to-book are other views of performance that the researchers use (Gonzalez & Rojas, 2022; Huynh, 2024). Combined, these signals emphasize the fact that profitability is not a single metric when it comes to banking research, and is a composite measure instead.

This study uses the return on assets (ROA) as the major profitability indicator. It reflects the efficiency of banks to turn their asset base into earnings, using interest and non-interest revenue. European data reveal that ROA is highly sensitive to the association between the asset quality and returns (Merko and Habili, 2023), whereas Asian studies demonstrate that it is sensitive to the changes in the monetary policy and their effects on performance (Kim and Lee,

2021). In Kenya, one of the reasons why ROA has been used by the Central Bank of Kenya through supervisory reporting is the fact that it is also used in the current analysis (CBK, 2023). Figure 1 below illustrates the trend of Return on Assets (ROA) of commercial banks in Kenya between the year 2014 and 2024. The figure brings to focus changes in the levels of profitability over the decade.

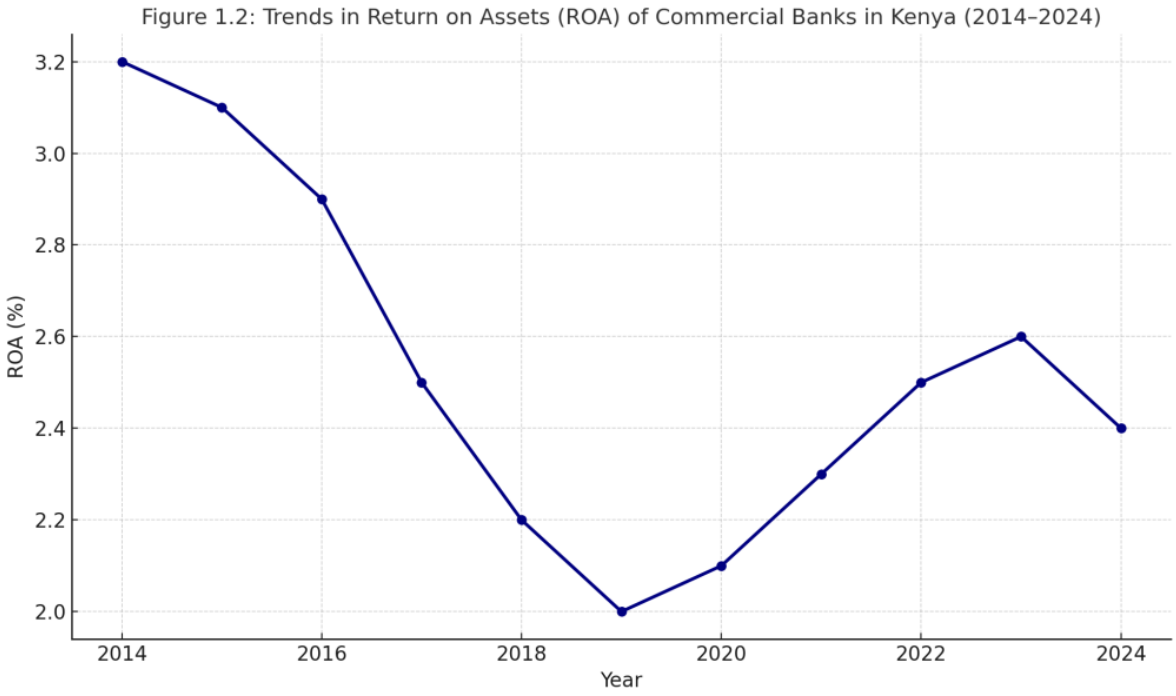

Figure 1 Trends in ROA of Commercial Banks in Kenya
Source: Central Bank of Kenya (CBK) Statistical Bulletins & Annual Reports (2014-2024); Researcher's compilation

Figure 1 above shows the trend on Return on Assets (ROA) on the Kenyan commercial banks between 2014-2024. The period started out with a relatively high level of profitability, as the estimated ROA in 2014 and 2015 was 3.2 and 3.1 percent, respectively. This was followed by a sharp decrease since 2016, when ROA fell below 3 percent, fell to 2.5 percent in 2017 and went down to 2.0 percent in 2019. This down turn was accompanied by interest rate ceiling that curtailed risk based lending and curbed credit growth. The extended downtrend in this period indicated the disruption effect of the policy actions in the efficiency of the monetary transmission bringing down the margins of banks and limiting the role of banks to intermediaries in the economy.

Following the lift of the caps in the year 2019, the industry registered partial recovery albeit not to previous levels. ROA has increased slowly at 2.1 percent in 2020 to 2.3 percent in 2021 and subsequently to 2.6 percent in 2023 and back to 2.4 percent in 2024. This recovery indicated that profitability was responding well to relaxation of the policy, yet the fact that it was still below the above 2016 level of more than 3 percent showed that it was still weak. The estimated trend hence meant that banks were still operating with slimmer earnings buffers, hence exposed to shocks. More to the point, it provided a question of how well monetary

transmission channels worked in facilitating profitability in the post-cap period thus warrants further analysis in this study.

Statement of the Problem

The commercial banks invest the mobilised savings into productive investments, finance government projects and also assist in international trade. Gonzalez and Rojas (2022) demonstrated that effective banking structures in Latin America related to an increased flow of investments and external shock resilience. Equally, Kim and Lee (2021) noted that in Asia, the growth of capital markets and the entire financial sector was supported by profits of banks. By verifying the financial system, Huynh (2024) found that commercial banks were the holders of a majority of the assets of the financial system in Kenya, indicating that they were very systemic. This was further enhanced by their central position following the rapid expansion of mobile and digital banking, which increased the access of rural and urban populations to financial services.

The performance of Kenyan banks between 2014 and 2024 moved through periods of strength and strain. In 2014, profitability was strong, with ROA averaging 3.2 percent and ROE above 24 percent (CBK, 2024). During the interest rate cap period from 2016 to 2019, profits weakened as lending margins reduced and the freedom to price loans according to risk became limited. By 2019, ROA had fallen to about 2.0 percent and ROE to roughly 18 percent. A mild recovery followed after the cap was lifted in late 2019, and by 2023 ROA had risen to 2.6 percent while ROE reached about 21 percent, although these levels still remained below the earlier highs. These movements reflect how policy changes influence profitability, a pattern also seen in county revenue performance and broader fiscal systems in Kenya, as noted by Mutua and Gitagia (2025).

General Objective

To investigate the effects of monetary policy transmission channels on the profitability of commercial banks in Kenya.

Specific Objectives

i. To examine the effect of the interest rate transmission channel on the profitability of commercial banks in Kenya.
ii. To analyze the influence of the credit transmission channel on the profitability of commercial banks in Kenya.
iii. To evaluate the effect of the open market operations transmission channel on the profitability of commercial banks in Kenya.
iv. To determine the effect of the liquidity transmission channel on the profitability of commercial banks in Kenya.

Research Hypotheses

i. **H_{01}:** The interest rate transmission channel has insignificant effect on the profitability of commercial banks in Kenya.

ii. **H_{02}:** The credit transmission channel has insignificant effect on the profitability of commercial banks in Kenya.
iii. **H_{03}:** The open market operations transmission channel has insignificant effect on the profitability of commercial banks in Kenya.
iv. **H_{04}:** The liquidity transmission channel has insignificant effect on the profitability of commercial banks in Kenya.

Theoretical Literature Review

Loanable Funds Theory

The theory that explains the interest rates is the loanable funds theory and was firstly developed by Knut Wicksell in 1898, where the interaction between saving and investment would be described to be the outcome of the interest rates. Fundamentally, the perspective is that the savings in the household are the provision of loanable funds, investment by firms brings in demand to the credit and their contact determines the interest rate. The framework remains relevant today in banking and monetary policy discussion even though it is very old. South Asian evidence indicates that credit is still determined by changes in household saving (Singh, 2020). Adjustment episodes in Europe have been interpreted using the approach (Merko & Habili, 2023), and the African literature has reported that the interbank rates tend to adjust with changes in the funds available (Rakibul, 2023). Combined, this history is an indication that a structure often called outdated is still applicable in explaining the way banks and markets act.
In the current research, the loanable funds approach would be used as a prism to explain the impact of monetary policy on bank profitability in Kenya. Modifications to policy that increase or decrease interest rates affect the amount of credit supplied and the cost of mobilizing deposits and in turn these impacts lending levels, balance sheet and returns. The defect notwithstanding, the theory provides a clear understanding of the interest rate channel and sets the grounds on the analysis of the response of banks to policy interventions in the Kenyan context.

Financial Intermediation Theory

According to Gurley and Shaw (1960), banks are institutions that mediate between the savers and the borrowers bridging information gaps, risk distribution, and reducing transaction costs. This perception has informed the way economists and policymakers conceptualize the movement of credit especially in the way the monetary policy permeates into the economy. The policy signals are delivered better to the firms and households where intermediation is high. In Latin America and Asia, evidence suggests the existence of superior credit access and policy responsiveness in the systems with more extensive intermediation (Gonzalez and Rojas, 2022; Kim and Lee, 2021). Huynh (2024) in Australia discovers that the effective intermediation helped the banks to become profitable in case of financial stress incidents as well.

This study adopts the financial intermediation theory in order to structure the discussion of the credit channel. The theory attributes the policy changes to the ability of banks to filter borrowers, charge loans and fund balance sheets, which dictate the lending volumes and hence profitability. By putting the work in this context, it is easy to trace the lineage of the decisions

made by the policies to the credit supply and then to the earnings of commercial banks which have been observed.

Liquidity Preference Theory

John Maynard Keynes furthered the liquidity preference theory in 1936 in an attempt to describe the determination of interest rates. He claimed that individuals require money not just in their day-to-day purchases but also in precautionary savings and speculation. Money is thus kept by people as an emergency fund and as a precaution to uncertainty and the ratio between demand and supply of money is what dictates the current interest rate. Although the theory was formulated in the early twentieth century, it continues to be a key tool to use in the analysis of the control of monetary authorities on the financial markets. Paula (2020) demonstrates that the model is still used to evaluate the state of liquidity in OECD studies, but Gonzalez and Rojas (2022) mention the persistence of the model in the context of liquidity shocks in Latin America. It is also proven that it still holds explanatory power in the modern monetary discussions as evidenced in Asia (Kim and Lee, 2021).

The theory is used in this research to frame the liquidity channel and the open market operations channel. It assists in explaining how policy changes finally determine the cost of funding and profitability of banks by illustrating the effects of the monetary authorities on interest rates and liquidity positions. The theory thus offers a first order relationship between central bank practices, liquidity status and the financial performance of the commercial banks in Kenya.

Profitability Theory of Financial Intermediation

Profitability has been understood as being the foundation of banking activity. As stressed by Pyle (1971) and subsequently by Diamond (1984), a lack of adequate earnings would lead to financial institutions being unable to take in the risk, to fulfill the expectations of shareholders, or to reinvest in the growth process. To them, profitability is not merely a performance parameter, but the foundation of survival and stability over a long period. The theory has continued to be powerful since incomes give an indication of performance and strength. According to Singh (2020), profitability indicates the efficiency of the transformation of inputs into outputs by banks, and Gonzalez and Rojas (2022) highlight that it is a stabilizing factor. Merko and Habili (2023) note that in Europe, long-term profitability allowed the banks to survive the impact of market shocks and stay in the game, which contributes to the enduring relevance of the framework.

The profitability theory of financial intermediation is the reason to focus on the bank earnings and evaluate it with the help of the ROA and ROE. The theory connects the monetary transmission to the outcomes in that the policy actions and liquidity conditions are traced to the changes of the rates of funding costs, returns, and structure of the balance sheets which ultimately makes the commercial banks of Kenya profitable.

Empirical Literature Review

Ochieng and Muturi (2021) investigated the connection between interbank rates and the returns of Kenyan listed banks in the period 201019. The analysis of their panel data revealed a positive conclusion that the weighted average interbank rate and profitability have a positive relationship. Nevertheless, the findings were restricted due to the exclusion of the unlisted banks that comprise the largest percentage of the institutions. The only way to assess profitability was by Return on Equity and no policy changes like interest rate caps were put into consideration. The current work is more comprehensive on the role of interbank rates by examining all licensed banks, using various profitability measures and incorporating regulatory shocks.

Rakibul (2023) also found that increased amounts of credit were strongly correlated with increased profitability in Sub-Saharan Africa, although structural constraints existed in this context. The research concentrated on the channel of credit and failed to discuss default risk which usually increases with the rapid increase in credit in the African markets. The current analysis has taken this issue into consideration by considering profitability in Kenya based on conditions that indicate both the growth of credit and risk exposure.

Gonzalez and Rojas (2022) discovered in Latin America that changes in Treasury yields were highly linked with profitability cycles, and there were high fluctuations in earnings during intervals in which the rates were volatile. The evidence highlighted the reliance of some banking systems on government securities, but did not take into consideration the interaction between dependence and regulatory regimes. This study fills that gap by including the peculiar cases of regulation in Kenya in the analysis of income of securities.

Mensah (2022) used bank-level panel data of Ghana (2008 2020) and utilized a generalized method of moments estimator. According to the results, during episodes of increasing liquidity, banks shifted their portfolios toward government securities and their profitability rose correspondingly, and its poor diagnostic diagnostics constrained the reliability. This research reinforces the research in establishing a difference in the liquidity patterns over a period of ten years in Kenya, as well as subjecting the study results to panel regression techniques which gives the results more strength.

RESEARCH METHODOLOGY

This research is based on the causal research design in which the relationships among variables are examined and the test is conducted whether a linear specification sufficiently characterizes those relationships. The data are summarized using descriptive statistics and linear regression framework is employed to estimate relationships between predictors and outcomes. The target population in this study was all the 38 commercial banks that are licensed by the CBK as at December 2024. The given definition makes sure that sampling, data collection and analysis decisions will be aligned with the population in which the findings will be applicable. In this study, sampling was done using a census method. The analysis was done on all 38 commercial banks licensed by the Central Bank of Kenya as at December 2024.

A panel regression was adopted in this research in ascertaining the effect of channels of transmission in monetary policy to the profitability of Kenyan commercial banks. The model was given as follows:

$ROA_{it} = \beta_0 + \beta_1 IR_t + \beta_2 CR_t + \beta_3 OMO_t + \beta_4 LQ_t + \varepsilon_t$

Where:- ROA_{it} = profitability of bank i at time t (Return on Assets)- IR_t = interest rate transmission channel (Weighted Average Interbank Rate)- CR_t = credit transmission channel (Private Sector Credit Growth)- OMO_t = open market operations channel (91-day Treasury Bill Rate)- LQ_t = liquidity transmission channel (Broad Money Supply, M2)- ε_it = error term The coefficients β_1, β_2, β_3, and β_4 captured the effect of each transmission channel on profitability, while β_0 represented the constant.

Descriptive Statistics

The research investigated the impact of monetary policy transmission channels on the profitability of commercial banks in Kenya. Table 1 below shows the results.

Table 1: Descriptive Statistics

Statistic	Fixed Income Securities	Equity Investment	Real Estate Investment	Market Volatility	Profitability
Mean	0.8325	0.1042	0.5935	1.7261	0.5296
Median	0.7910	0.0012	0.0264	0.0687	0.4180
Maximum	4.9234	5.1578	30.9423	13.2512	4.9260
Minimum	-2.7152	-0.4085	-0.8377	-0.2714	-2.7045
Standard Deviation	1.2456	0.5456	2.6243	4.0666	1.0487
Skewness	-0.2421	6.9840	9.0341	2.4247	1.8843
Kurtosis	3.5621	54.9888	101.1291	7.0622	6.3159
Sum	291.38	36.47	207.91	604.13	185.35
Sum of Sq. Dev.	529.12	102.88	873.95	1441.47	384.32
Observations (n)	350	350	350	350	350

Research Data (2025)

Table 1 presents the descriptive statistics for the five variables using 350 firm-years from 2015 to 2024. The findings show that firms channelled most resources to fixed income securities with a mean of 0.8325, followed by real estate investment at 0.5935, while equity investment remained low at 0.1042. Profitability averaged 0.5296, indicating modest returns, and market volatility recorded the highest mean of 1.7261, signalling strong external fluctuations, a pattern that reflects broader investment behaviour noted by Njagi and Gitagia (2024). The medians further reveal strong right skewness in real estate and equity investments, while fixed income securities and profitability display more balanced distributions. Market volatility has a low median of 0.0687, showing that intense shocks are infrequent but significant, a trend that aligns with institutional financial responses highlighted by Otondi and Gitagia (2025).

This analysis is enhanced by the dispersion measures. Standard deviation of real estate investment (2.6243) and market volatility (4.0666) are also significantly large which means that there is much variability and there may be an outlier. There is also moderate dispersion in equity investment (0.5456) whereas the fixed income securities and profitability have lower standard deviations of 1.2456 and 1.0487 respectively which suggests that these two groups tend to have more consistent trends. The range of the values of each variable is large (with a maximum of 30.9423 and minimum of -0.8377 reached by the real estate investment) and once again supports the volatility and the non-normality of the asset distribution behaviors.

The statistics of skewness and kurtosis give information on the shape of distributions. Equity and real estate investments have extreme positive skewness (6.9840 and 9.0341, respectively) and very large kurtosis (54.9888 and 101.1291) indicating heavy right tails and peakedness which is indicative of infrequent but large investment spurts. Skewness that is positive is also observed in market volatility and profitability whereby the skew of volatility and profitability are 2.4247 and 1.8843 respectively and the kurtosis is high indicating the presence of leptokurtic distributions with frequent small fluctuations and infrequent large shocks. The fixed income instruments, however, are normative, and skew is almost zero (-0.2421) and kurtosis is almost equal to the Gaussian ideal (3.5621), which implies that there is relative stability in the allocation behavior of firms over the years. These features suggest that one can further the econometric analysis on the dataset.

Diagnostic Test Results

Normality Test

Table 2 displays the outcomes of a normality test on the study variables on the basis of skewness, kurtosis, and Jarque Bera statistic. These statistics are used to ascertain the validity of the data distributions in terms of having normal data distributions in the assumption of a parametric statistical model.

Table 2 Normality Test Results

Variable	Skewness	Kurtosis	Jarque-Bera (JB)	p-value
Fixed Income Securities	-0.2421	3.5621	1.7634	0.4146
Equity Investment	6.9840	54.9888	672.1124	0.0000
Real Estate Investment	9.0341	101.1291	1105.6642	0.0000
Market Volatility	2.4247	7.0622	82.1448	0.0000
Profitability	1.8843	6.3159	47.3523	0.0000

Research Data (2025)

Table 2 indicates that the fixed income securities were close to normal distribution, skewness of -0.2421 and kurtosis of 3.5621. Although the kurtosis is marginally higher than the Gaussian standard, this is not a big deviation at least as far as financial data are concerned and the distribution is hardly ever perfectly normal. The Jarque-Berra value of this variable was 1.7634 with a p-value of 0.4146 which exceeds the 0.05 critical value, and this shows that there is no significant non-normality.

Equity investment and real estate investment on the contrary were highly non-normal. The skew of equity investment was 6.9840 and the kurtosis was 54.9888 and real estate investment was still higher at 9.0341 and 101.1291 respectively. The skewness towards market volatility and profitability was also positive with kurtosis values of more than 6.0. In these four variables Jarque-Berra p-values were 0.0000 which is a statistically significant violation of normality. The findings are characteristic of financial data, as they tend to be strenuous tailed and asymmetrical because market shocks and volatility clustering.

Multicollinearity Test

The Variance Inflation Factor (VIF) and tolerance values were used to test multicollinearity. Multicollinearity is extreme in the sense that it overstates the standard errors and makes it difficult to interpret individual predictors. The VIF and tolerance statistic are shown in table 3.

Table 3: Multicollinearity Test Results

Variable	VIF	Tolerance
Interest Rate Channel	2.135	0.468
Credit Channel	2.512	0.398
Open Market Operations	1.934	0.517
Liquidity Channel	2.346	0.426
Profitability (ROA)	1.781	0.561

Source: Research Data (2025)

All the values of VIF were less than the value of 5.0, and the values of tolerance were greater than 0.2, which is evidence that multicollinearity was not a serious issue. It means that the explanatory variables interest rate, credit, open market operations and liquidity had independent contribution to the explanation of variations in profitability. As a result, it was possible to interpret the regression coefficients with confidence.

Stationarity Test

The stationarity was also tested to ensure that the mean and the variability of the study variables did not change with time. The results of spurious regression could arise with non-stationary data. Levin, Lin, and Chu (LLC) panel unit root test and Im, Pesaran, and Shin (IPS) test were taken. Table 4 presents the findings.

Table 4: Panel Unit Root Test Results (LLC and IPS)

Variable	LLC Statistic	p-value	IPS Statistic	p-value
Interest Rate Channel	-5.3421	0.0000	-4.9812	0.0000
Credit Channel	-6.1254	0.0000	-5.3875	0.0000
Open Market Operations	-7.0147	0.0000	-6.4412	0.0000
Liquidity Channel	-4.9123	0.0000	-4.6733	0.0000
Profitability (ROA)	-3.8742	0.0001	-3.6421	0.0001

Source: Research Data (2025)

All the variables were at stationary levels showing highly significant test statistics of LLC and IPS (p-values less than 0.05). This ensured that there were no unit roots in the time-series elements of the panel data so that no spurious regression outcomes would be obtained.

Panel Regression Results

Table 5: Panel Regression Results (Dependent Variable: Profitability)

Variable	Coefficient	Std. Error	t-Statistic	p-value
Intercept (C)	1.2634	0.3281	3.8502	0.0001
Interest Rate Channel	-0.4321	0.1214	-3.5580	0.0004
Credit Channel	0.2895	0.0972	2.9776	0.0031
Open Market Operations	-0.1573	0.0615	-2.5570	0.0111
Liquidity Channel	0.2146	0.0847	2.5324	0.0120

Research Data (2025)

Table 5 demonstrates the regression estimates that looked at the effect of the four transmission channels on the bank profitability. The intercept coefficient of 1.2634 indicates the level of profitability at a given level with all the predictors held constant. The coefficient of interest rate channel is negative with a significant value -0.4321, $p < 0.01$ indicating that growth in interbank and lending rates impacts negatively on profitability by increasing funding costs and narrowing of margins. The credit channel has a positive and significant coefficient 0.2895, $p < 0.01$ that means that increase in the supply of credit has a beneficial and significant effect on

the earnings of the banks. There is a negative relationship between Open market operations and profitability represented by the negative coefficient -0.1573, $p < 0.05$ indicating that the higher the dependence on the yield of Treasury bills, the less are the profits made by driving out the lending of banks. Lastly, profitability is positively and significantly associated with the liquidity channel with a coefficient 0.2146, p less than 0.05 indicating that increase in money supply assisted in supporting profitability by facilitating lending.

The estimated regression equation derived from the model is:Profitability it = 1.2634 – 0.4321IRt + 0.2895CRt – 0.1573OMOt + 0.2146LQt + εWhere:IRt = Interest Rate ChannelCRt = Credit ChannelOMOt = Open Market OperationsLQt = Liquidity Channelε = Error term
These findings indicate that transmission of monetary policy manifests a strong impact on the profitability of commercial banks in Kenya. The interest rates and the open market activities lower the earnings, but the credit and liquidity channels are supportive, which promotes profitability.

Conclusion

The first objective was to establish the impacts of the interest rate channel on the bank profitability in Kenya. The findings indicated that the impact was negative and significant with the increase in interbank and lending rate reducing profitability by compressing margins and decreasing credit uptake. That implies increased borrowing rates will reduce the profitability capacity of banks and that the effectiveness of the interest rate policy to ensure profitability lies on the balance between cost of money and rate at which credit is generated.

The second objective aimed at examining how the credit transmission channel affects the profitability of banks. The results indicated that there was a positive and significant correlation, as demonstrated by the fact that expansion in the credit of the private sector led to an increase in the profitability of the bank. This finding implies that lending business is the main source of Kenyan bank revenues and in cases where credit is increased profitability is enhanced. The results hence emphasize the role of effective intermediation since credit growth does not only help bank profits but also the overall economic performance.

The third goal was to determine the impact of open market operations transmission channel on profitability. It was discovered that there is a negative and significant impact that means the dependency on Treasury bill yields decreases the earnings of the banks as it crowds out lending in the private markets. This conclusion points out the trade-off that commercial banks have confronted: whereas government securities are safe in the short-run, dependency has restricted income in intermediation and has inhibited long-term profitability. To have sustainable growth, the banks should strike a balance between investing in government securities and lending to the private sector.

The fourth objective looked at the impact of the channel of liquidity transmission on profitability. The results indicated that there is a positive and significant influence, which substantiates that the increase in money supply increases bank earnings. Liberalized liquidity leads to reduced funding pressures, greater lending capacity and facilitates high returns. The

conclusion reveals that adequate availability of liquidity in the financial system is important to the bank performance as the institutions can access to satisfy credit demand and remain profitable.

Policy Implications and Recommendations of the Study

The research established that the transmission channel of interest rate affected the bank profitability in a negative way. In reaction, commercial banks are incited to enhance their asset-liability management to be in a better position to absorb sudden fluctuations in the interest rates. They must also broaden the financing base and lessen reliance on short term interbank borrowing as this leaves them vulnerable to ups and downs. To the policymakers and more so the Central Bank of Kenya (CBK), it is worth adopting more flexible rate adjustment mechanisms that helps protect the aspect of price stability as well as the well-being of the financial sector. Researchers and academicians would also be able to expand on these conclusions by looking at how hedging instruments like interest rate derivatives can be used by the banks to reduce the volatility in earnings generated by interest rate shock.

The analysis revealed that the credit transmission channel positively impacted on the bank profitability. The commercial banks are thus advised to increase their contribution as intermediaries by extending their lending to productive sectors of the economy and at the same time ensure that they practice good risk evaluation in the process. On their part, regulators can stimulate this process by promoting policies that result in lending being more appealing in high-growth sectors such as manufacturing and green enterprises, e.g. by tax incentives or capital requirement modifications. CBK might also increase the credit information sharing systems in a bid to minimize asymmetry and enhance quality of loans. Academic scholars are encouraged to develop research on credit market activities in the emerging economies in order to present evidence-based suggestions on the balance between profitability and inclusive lending.

Third, the research found out that open market operations have an adverse impact on profitability. It is thus recommended that the banking institutions should reduce the overdependence on Treasury bills and government securities as the main sources of income and focus more on the core lending operations. Government borrowing instruments should also be re-designed to prevent too much crowding out of the lending of the private sector. Guidelines that limit the percentage of commercial bank assets that can be invested in short-term government securities could also be introduced by the policymakers in order to protect intermediation. To financial analysts, it would be important to come up with tools, which assess the opportunity cost of securities investments in comparison to private sector lending, which would lead the banks to have more balanced strategies.

Lastly, the research came to the conclusion that the liquidity transmission channel has a positive influence on profitability. The commercial banks must hence capitalize on the excess liquidity to expand the access to credit, yet must not accumulate too much idle balances that give minimal returns. CBK is also advised to intensify the liquidity management systems, such as open market sterilization tools, in order to maintain the money supply in the market at a constant without causing inflationary effects. The policymakers are also to promote innovation like the digital system of liquidity management that assists banks to deploy funds optimally. Further studies are necessary at the academic level to investigate the relationship between liquidity and other channels of transmissions in order to have a more holistic picture of monetary transmission in developing economies.

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