Journal of Economics

Effect of Financial Deepening on Economic Growth in Kenya: Evidence from ARDL Modelling Approach

Martha Moreka, Winrose Chepng'eno & Naftaly Mose

ISSN: 2617-5800

Stratford Peer Reviewed Journals and Book Publishing
Journal of Economics
Volume 9||Issue 1||Page 30-41||September |2025|
Email: info@stratfordjournals.org ISSN: 2617-5800

Effect of Financial Deepening on Economic Growth in Kenya: Evidence from ARDL Modelling Approach

[*1]Martha Moreka, [2]Winrose Chepng'eno & [3]Naftaly Mose

Department of Economics, University of Eldoret

***Email of the Corresponding Author: martha.moreka@gmail.com**

***How to cite this article*: Moreka, M., Chepng'eno, W. & Mose, N. (2025). Effect of Financial Deepening on Economic Growth in Kenya: Evidence from ARDL Modelling Approach. *Journal of Economics, 9(1),* 30–41. https://doi.org/10.53819/81018102t3142**

Abstract

Financial deepening has proven to enhance economic growth by mobilizing investments and boosting productivity in developing countries. However, the empirical literature regarding its relationship with economic growth in Kenya remains inconclusive. This study examines the long-run and short-run effects of financial deepening indicators on Kenya's economic growth from 1990 to 2023, utilizing the Autoregressive Distributed Lag (ARDL) technique applied to data from Kenya. The results indicate that, in the long run, all financial deepening variables have a positive influence on economic growth in Kenya. In the short run, findings show a positive relationship between private sector credit, stock market performance, bank deposits, money supply, and economic growth. At the same time, liquidity liabilities exhibit a negative relationship in Kenya. This underscores financial deepening as a key driver for economic growth by facilitating economic upgrading through capital accumulation. To stimulate economic growth in Kenya, policies should prioritize enhancing access to private sector credit and improving stock market regulations. Furthermore, increasing financial literacy and integrating financial technology would encourage savings and expand access to financial services.

Keywords: *Financial Deepening, Financial Services, Economic Growth, ARDL*

1.0 Introduction

Over the past few decades, particularly since the 1990s, the Kenyan financial system has undergone significant changes following the introduction of various reforms. During the 1990s, the economy was marked by heavy regulation, controlled interest rates, direct credit programs, a fragile banking structure, inadequate risk management systems, a lack of operational transparency, political instability among other challenges (Otieno et al., 2013; Hardi, 2025). These reforms aimed to liberalize the financial system, with the expectation that this would lead to increased savings and investments, ultimately driving the country's economic growth rate (Beck et al, 2023). Otieno et al. (2013) suggest that a well-developed financial system expands access to funding. In contrast, in an underdeveloped financial system, access to funds is restricted, forcing people to rely on their own limited resources or expensive informal sources like moneylenders. This limitation hinders economic activities that could drive growth (Appugol & Naik, 2025). In other words, an underdeveloped financial infrastructure constrains economic growth. Therefore, it is crucial to focus on developing the financial sector to support the real economy.

There has been a theoretical connection between financial deepening and economic growth. Financial sector deepening can alleviate poverty through two main channels. Firstly, financial development can indirectly benefit the poor by fostering economic growth, which improves conditions in the regions and sectors where they reside. This concept is often referred to as the trickle-down theory, where economic growth is believed to benefit the poor by creating jobs, housing and other economic opportunities (Mutai, 2025). This theory is supported by several studies, including those by Stiglitz (2017) and Skare and Druzeta (2016). Secondly, financial deepening can directly impact poverty by facilitating transactions and expanding access to financial services such as credit, savings, and insurance for the poor. This helps to reinforce their productive assets, increasing their productivity and economic potential (Coulibaly, 2020). Hassan (2019) noted that while the liberalization of bank interest rates and the entry of foreign banks have positively influenced technological progress and cost efficiency, prudential regulation may negatively impact bank cost performance.

This suggests that the relationship between financial deepening and economic growth remains an empirical question. In particular, as government intervention in the allocation of financial resources decreases, market competition conditions improve, leading to more efficient banking activities. Evidence from Zaman and Bhandari (2020) indicates that financial deregulation has positively impacted bank efficiency in India and Pakistan, while Martin et al. (2018) found that increased competition improved the cost efficiency of Spanish banks.

Kenya's financial system has undergone significant changes in recent decades. In Sessional Paper No. 1 of 1986, the government expressed its commitment to fostering the growth of the capital market, which led to the initiation of capital market reforms in the late 1980s, including institutional and policy changes. These reforms aimed to enhance the level of financial development in the country. Additionally, Kenya's Vision 2030 has identified financial deepening as a crucial sub-pillar within the broader economic pillar, intending to transform the nation into a middle-income economy. However, despite the development in financial deepening, studies on the role of financial deepening on economic growth point towards contrasting results. This study aims to address this gap by examining the effect of financial deepening on the growth of Kenya's economy and seeks to answer the question: What is the effect of financial deepening on Kenya's economic growth?

2.0 Literature Review

The Supply-Leading Hypothesis introduced by Schumpeter in 1911 and later supported by scholars like McKinnon, Shaw, and Bencivenga and Smith, asserts that well-developed financial markets lead to an increase in financial assets, subsequently boosting production in an economy. This theory argues that robust financial markets enhance economic efficiency, increase liquidity, mobilize savings, and facilitate the transfer of resources from rural areas to modern industries, thereby driving economic growth (Kapaya, 2020). In a frictionless economy, the need for financial intermediaries diminishes, and high transaction costs can hinder exchanges among economic agents, contributing to the emergence of financial institutions and markets.

The study employed the endogenous model to analyse the impact of financial deepening on economic growth. Developed by Lucas in the 1980s, this model asserts that human capital—including education, training, innovation, and knowledge—plays a crucial role in driving sustained growth through investment. It assumes non-decreasing returns to reproducible production factors (Mankiw et al., 1992) and highlights those endogenous factors, rather than exogenous ones, are key to determining economic growth. The flexibility of the endogenous growth model (Odhiambo, 2009; Momanyi, 2013) allows for the inclusion of various macroeconomic variables that influence per capita GDP growth, such as commercial bank deposits, domestic credit to the private sector, stock market capitalization, broad money, liquid liabilities, deposit interest rates, and inflation rates (Odhiambo, 2009). Several empirical studies have explored the relationship between financial deepening and economic growth. Ouma and Muriu (2014) found that real interest rates significantly influence financial deepening in Kenya, but did not examine their impact on growth. Similarly, Otieno et al. (2013) noted that developed financial systems enhance access to funds, while underdeveloped ones limit it, yet they overlooked the effect of financial access on the economy. Aduda and Kalunda (2012) suggested that measures of financial inclusion should consider both access and usage, emphasizing the role of informal services in developing countries, but did not assess their impact on growth rates. Odhiambo (2009) found that interest rate reforms and financial deepening affect economic growth, yet did not analyse financial deepening's specific impact on growth rates. Andele (2013) focused on the profitability of commercial banks, concluding that financial deepening positively influences it, but did not extend to the entire economy. Despite these findings, many recent developments in Kenya's financial sector remain unexamined about financial deepening and economic growth.

3.0 Methodology

This study employed an explanatory research design to investigate the influence of financial deepening measures on economic growth in Kenya, utilizing annual time series data from 1990 to 2023 to meet the requirement of over 30 observations for reliable econometric analysis, with this timeframe selected because the 1990s represented a significant period when Kenya's real GDP growth rate slowed from 4.3% in 1990 to nearly zero in 1992-1993 due to budgetary deficits and macroeconomic instabilities. Secondary data was collected from multiple sources including the Kenya National Bureau of Statistics (KNBS) for GDP per capita growth data, the Federal Reserve Bank of St. Louis for liquid liabilities and bank deposits data, and the World Bank's World Development Indicators for credit to private sector, stock market capitalization, money supply, interest rates, and inflation data, with variables measured as follows: credit to private sector (CPS) as domestic credit to private sector as share of GDP with expected positive relationship, stock market capitalization (MC) as stock market capitalization share of GDP with expected positive relationship, bank liquid liabilities (LL) as total liquid liabilities share of GDP with expected positive relationship, money supply (MS) as broad money share of GDP

with expected positive relationship, bank deposits (BD) as bank deposits share of GDP with expected positive relationship, interest rate (INT) as deposit interest rate with expected positive relationship, inflation rate (INF) as consumer price index with expected negative relationship, and economic growth (GDP) as GDP per capita growth serving as the dependent variable.

Following the endogenous growth model and similar studies by Babarinde (2020) and Ng'ang'a (2016), the functional relationship was specified as GDP=f(CPS, LL, MC, MS,BD, INF, INT) and econometrically modeled following Mukundi (2013) as $GDP_t=\beta_0+\beta_1CPS_t+\beta_2LL_t+\beta_3MC_t+\beta_4MS_t+\beta_5BD_t+\beta_6INT_t+\beta_7INF_t+\varepsilon_t$ where ε_t represents the error term, β_0 shows the constant term, and β_1 to β_7 are coefficients of each independent variable on GDP. The study employed the Autoregressive Distributed Lag (ARDL) regression model to analyze long and short-run relationships between time series variables because ARDL utilizes a singly reduced equation providing more detailed and comprehensive outcomes than traditional integration methods while accommodating different orders of co-integration for consistent and efficient results, with the relationship captured through the ARDL function $GDP_{(t-1)}=\beta_0+\beta_1CPS_{(t-1)}+\beta_2LL_{(t-1)}+\beta_3MC_{(t-1)}+\beta_4MS_{(t-1)}+\beta_5BD_{(t-1)}+\beta_6INT_{(t-1)}+\beta_7INF_{(t-1)}+\varepsilon_t$ where t-1 represents lags to capture dynamic relationships between dependent and independent variables over time. Before conducting the ARDL approach, the study performed Phillips-Perron (PP) unit root tests to determine whether time series variables were stationary or non-stationary and possessed unit roots, followed by ARDL bounds tests for cointegration to determine long-term relationships between variables integrated in different orders (I(0) or I(1)), with data subsequently subjected to comprehensive diagnostic tests including CUSUM test for structural stability based on recursive residuals, Jarque-Berra statistic test for normal distribution, Durbin-Watson, Breusch-Godfrey, and Ljung-Box tests for autocorrelation detection in regression residuals, and Breusch-Pagan and White tests for heteroscedasticity to ensure conformity with multiple regression model assumptions and validate results.

4.0 Data Analysis, Results and Discussion of Findings

4.1 Unit Root Procedure

The Phillips-Perron (1988) test is a statistical test used in time series analysis to determine if a time series is stationary or non-stationary. It's an extension of the Dickey-Fuller test and is used to detect the presence of a unit root in a time series. The PP test is an alternative to the ADF test but uses a non-parametric approach to address serial correlation and heteroscedasticity issues in the error terms. Table 1shows the stationarity test results.

Table 1: Philips-Perron unit root test results

Variable	Level		First difference		Order
	t-Statistics	P-Value	t-Statistics	P-Value	
GDP	2.660	1.000	-3.874	0.005	I(1)
CPS	-1.684	0.429	-6.489	0.000	I(1)
MC	-2.643	0.094	-6.532	0.000	I(1)
MS	-3.618	0.010	-	-	I(0)
BD	-2.567	0.109	-7.093	0.000	I(1)
LL	-0.849	0.791	-6.702	0.000	I(1)
INF	-2.937	0.051	-11.594	0.000	I(1)
INT	-1.740	0.402	-6.330	0.000	I(1)

Source: *Authors' work using E-views 12*

The PP test results confirm that economic growth, credit to the private sector, bank liquid liabilities, stock market capitalization, commercial bank deposits, deposit interest rate and inflation rate variables are non-stationary at their levels but become stationary after first differencing, reinforcing the conclusion that these variables are I (1). However, broad money was stationary at the level. The identification of the integration order of the variables has significant implications for the subsequent econometric analysis. For example, knowing that non-stationary variables justify using cointegration techniques to explore long-term equilibrium relationships among these variables. PP unit root tests and mixed integration have supported the application of the ARDL ECM approach in further model estimation. However, vector autoregression (VAR) was first performed to establish the autoregressive lag length. The study identified a lag length of two as optimal, with the Akaike information criterion (AIC) providing the minimum value at lag two (33.326). The choice of two lags is significant as it allows the VAR model to effectively capture the temporal dynamics without overfitting the data.

4.2 Cointegration Test Results

Cointegration analysis determines whether a long-term equilibrium relationship exists between the variables despite any short-term deviations. In this study, the F-bound test, based on the methodology of Narayan (2004), was used to assess the presence of cointegration among the variables. Table 2displays the F-bound cointegration test results from Narayan (2004) and Pesaran (2001).

Table 2: Bound test for cointegration

Narayan	**Value**	**Significance Level**	**Bounds Critical values**	
F-Statistics	5.33		I(0)	I(1)
		1%	3.31	4.63
K	7			
		5%	2.69	3.83
Note: Null hypothesis: No level relationship.				

Source: *Authors' work using E-views 12*

The results of the F-bound test showed telling the computed F-statistic of 5.33 exceeds the upper bound critical value of 3.83 at the 5% significance level. This finding strongly suggests the presence of a cointegrating relationship among the variables. The results suggest that the financial deepening indicators and economic growth are not just linked by short-term correlations but are bound by a long-term equilibrium. Any deviations from this equilibrium are expected to be temporary, with the variables adjusting over time to restore balance. For instance, if there is a short-term divergence where GDP grows faster than the financial deepening variables, the cointegration relationship implies that the financial sector will eventually catch up, or GDP will slow down to re-align with the long-term trend. The presence of cointegration is significant for policy formulation. It implies that efforts to deepen the financial sector, such as increasing bank deposits, broadening the money supply, and expanding credit to the private sector, will likely have enduring benefits for economic growth. These efforts do not just influence growth in the short run; they contribute to a sustainable economic development trajectory. Policymakers can, therefore, be more confident that initiatives aimed

at financial sector development will yield long-term economic gains. Furthermore, the cointegration finding justifies using an error correction model (ECM) in subsequent analysis. The ECM is designed to capture both the variables' short-term dynamics and the long-term equilibrium relationship.

4.3 Presentation of Regression Results

The study performed ARDL long-run analysis to determine the long-run and short-run relationship between dependent and explanatory variables. Table 3shows the short-run and long-run results of financial deepening and economic growth model analysis.

Table 3: Estimated ARDL model

Variable	Coefficient	Standard Error	t-Statistics	P-Value
Long run analysis				
BD	1.4195	0.3648	3.8909***	0.0037
CPS	0.4148	0.0285	14.5402***	0.0000
MS	1.5545	0.3454	4.5007***	0.0015
MC	0.0486	0.0185	2.6273**	0.0275
LL	0.0046	0.0004	9.3358***	0.0000
INT	0.0865	0.0057	14.9553***	0.0000
INF	-0.0839	0.0168	-4.9767***	0.0008
Short run analysis				
ΔBD	0.8480	0.1382	6.1354***	0.0002
ΔCPS	0.1503	0.0442	3.4011**	0.0192
ΔMS	0.3090	0.1101	2.8064**	0.0205
ΔMC	0.0226	0.0088	2.5500**	0.0312
ΔLL	-0.0004	0.0002	-1.5616	0.1528
ΔINT	0.0389	0.0083	4.6869***	0.0011
ΔINF	-0.0348	0.0046	-7.5174***	0.0000
ΔGDP	0.3453	0.1340	2.5774**	0.0298
ECT	-0.7396	0.0849	-8.7080***	0.0000
Cons	2.2200	0.2561	8.6663***	0.0000
		Tests	F-statistics	Probability
Durbin Watson 2.01		Breusch-Godfrey	2.7410	0.1046
R-Squared 0.99		Ramsey RESET	1.6708	0.2186
		Breusch-Pagan	1.3197	0.3046
		Jarque-Bera	1.1691	0.5573
*Note: indicates ** p < 0.05, *** p < 0.01 are significance levels at which the null hypothesis is rejected.*				

Source: *Authors' work using E-views 12*

From the results in Table 3, Bank Deposits (BD) emerge as a significant driver of economic growth, with a coefficient of 1.4195 and a p-value of 0.0037, indicating a strong and positive relationship. This means that an increase in commercial bank deposits will translate to an increase in financial deepening and an increase in economic growth in Kenya. Specifically, a one per cent increase in bank deposits increases economic growth in the long run by 1.41 per cent, other things being unchanged. This implies that an increase in bank deposits, as a percentage of GDP, contributes substantially to the country's economic growth. The logic behind this is that when individuals and businesses deposit more money in banks, it increases the available pool of funds that banks can lend to various sectors of the economy (Bairamli &

Kostoglou, 2010). These funds can be used for investments in infrastructure, business expansion, and other productive activities that drive growth (Odhiambo, 2009). These findings support similar results by Atmaja et al. (2022) in Nigeria and Ribaj and Mexhuani (2021) in Kosovo, which show that bank deposits have a significant positive effect on economic growth via increased investment. Therefore, policies that promote financial deepening and savings, such as offering attractive interest rates or ensuring the security of deposits, can have a long-term positive impact on economic growth. The short-run result is identical to the long-run findings. This finding suggests that an increase in bank deposits quickly translates into economic growth in the short term, just like in the long run. That highlights how commercial bank deposits help to increase production in the country through domestic sources.

Broad Money Supply (MS), another vital variable, had a coefficient of 1.5545 and a p-value of 0.0010. This means that a one per cent increase in broad money increases economic growth by 1.55 per cent, other things being unchanged. Broad money encompasses the total money supply within an economy, including cash, demand deposits, and other liquid assets. A higher level of broad money indicates greater liquidity, crucial for facilitating economic transactions and investment. The high money supply is important as it ultimately affects the business cycles and thereby affects the economy (OECD, 2014).The positive impact of broad money on GDP suggests that an adequately liquid economy supports business activities and investments, leading to sustained economic growth. This underscores the importance of monetary policies that ensure sufficient liquidity in the financial system to support ongoing economic activities. The impact of Broad Money (ΔBM) on economic growth is even more pronounced in the short run. This strong and positive relationship underscores the critical role of liquidity in the economy. An increase in broad money supply enhances the availability of funds for transactions, investments, and other economic activities, thereby driving short-term growth (OECD, 2014).

Stock Market Capitalization (MC) had a positive coefficient of 0.0486 and a p-value of 0.0275. This implies that a one per cent increase in stock market capitalization deposit increases GDP by 0.04 per cent, other things being constant. As captured by the endogenous growth model, stock market capitalization causes higher economic growth through its influence on the level of investment and productivity (Omoke, 2010). Stock market capitalization represents the total value of all listed companies on the stock market. A higher market capitalization reflects a robust and well-developed stock market, essential for providing firms with access to capital (Mishkin, 2004). When companies can raise funds through equity markets, they can invest in new projects, innovate, and expand their operations, contributing to economic growth. The significance of this variable highlights the need for policies that promote the development of the stock market, such as ensuring transparency, protecting investor rights, and encouraging more firms to list their shares. Findings agree with Moreka (2025), Mukundi (2013) and Levine and Zervos's (1998) empirical studies that established how stock markets and banks promote long-run economic growth. The short-run result mirrors the long-run result. This result highlights the importance of a well-functioning stock market for short-term economic performance.

Domestic Credit to the Private Sector (CPS) had a coefficient of 0.4148 and a p-value of 0.0000, implying that a one per cent increase in credit to the private sector increases GDP growth by 0.41 per cent, ceteris paribus. The positive relationship between CPS and GDP indicates that increased credit availability leads to higher economic growth. Access to credit is vital for businesses, as it allows them to finance operations, invest in new technologies, and expand their activities. Therefore, policies that enhance credit accessibility, such as reducing lending rates, improving credit information systems, and promoting financial inclusion, can significantly boost economic growth in the long run. The findings agree with Akpansung and

Babalola (2011) in Nigeria, Adamopoulos (2010) in Spain and Mukundi (2013) in Kenya's empirical results that an increase in domestic credit to the private sector will cause economic growth in the sample country. In contrast, Ayadi and Gadi (2013) show a negative relationship between private sector credit growth and GDP, attributed to high interest rates and inflation rates in sample countries. The long-run and short-run results are similar. In the short term, policies that improve access to credit, such as reducing borrowing costs, enhancing financial inclusion, and supporting small and medium-sized enterprises (SMEs), can lead to immediate gains in economic performance.

Bank Liquid Liabilities (LL), showing a minimal positive coefficient (0.0046) and statistically significant at a p-value of 0.0000. This means that a one per cent increase in liquidity liabilities increases economic growth by 0.0046 per cent, other things being unchanged, in Kenya. Empirical studies have shown that liquidity creation helps economies grow faster by fostering tangible investment (Beck et al, 2023). Liquid liabilities represent the liabilities of the financial sector that are easily convertible into cash. Although the positive sign aligns with theoretical expectations, the minimal coefficient value suggests that liquid liabilities may not fully drive long-term economic growth in Kenya. The higher the liquidity liabilities ratio, the larger the banking sector; that is, the size of the banking system is positively related to the provision of financial services, which leads to growth in financial deepening and growth (World Bank, 2021). Studies by Agu and Chukwu (2008), Aslam (2008) and Mukundi (2013) have confirmed that there exists a positive relationship between the liquidity liabilities ratio and economic growth, while Ng'ang'a (2016) reported a negative relationship. Interestingly, Liquid Liabilities (ΔLL) do not significantly impact economic growth in the short run. This result might indicate that other factors, such as the efficiency of financial intermediation or the financial system's stability, play a more crucial role in the short-term dynamics of economic growth. The result contradicts the long-run results that reported a positive and significant relationship.

On the other hand, Deposit Interest Rate (INT) had a positive and highly significant coefficient of 0.0865 and a p-value of 0.0000, indicating that an increase in deposit interest rate by one per cent will cause GDP to grow by 0.086 per cent. This suggests that higher deposit interest rates encourage savings, which leads to increased funds available for investment, ultimately driving economic growth (Thomi, 2021). An increase in deposit interest rate will cause the economy to grow in the long run, ceteris paribus. This finding highlights the importance of maintaining an interest rate environment that balances the need to encourage savings with borrowing costs. Policymakers should consider this balance when setting interest rates to ensure the economy benefits from increased savings and investment. The study result is similar to long-run estimates. Lastly, Inflation (INF) had a negative and significant impact on economic growth, as shown by the coefficient of -0.0839 and a p-value of 0.0008. Specifically, a one per cent increase in the inflation rate will translate to a 0.0839 per cent decline in economic growth. This result aligns with economic theory, which posits that high inflation erodes purchasing power, distorts price signals, and creates uncertainty, all of which can hinder economic growth (Odhiambo, 2009). The negative impact of inflation on GDP suggests that maintaining price stability should be a key objective for policymakers. Controlling inflation through appropriate monetary and fiscal policies can create a conducive environment for sustained economic growth. A study by Odhiambo (2009) on the effect of interest rates on economic growth in Kenya established that interest rates negatively affect economic growth by lowering the purchasing power of consumers. The study result is similar to long-run estimates.

The coefficient value of the error correction term (ECT) is -0.73 and statistically significant at a one per cent level of significance, implying a stable long-run relationship. The negative sign indicates that the model is convergent towards equilibrium, whereas the value shows that the adjustment towards equilibrium is about 73% in the current year. The error correction model

indicates how quickly variables converge to equilibrium in Kenya. Further, the regression function passed all diagnostic tests, namely the Breusch-Godfrey Lagrange Multiplier (LM)test, which shows that autocorrelation is not a problem in the regression model. Heteroscedasticity, which arises when the size of the error term varies across values of the explanatory variable, is absent according to the Breusch-Pagan test. Ramsey RESET test shows that the regression equation is well specified and the data were normally distributed, as shown by the value of the Jarque-Bera test.

5.0 Conclusion

This study embarked on a detailed exploration of the complex and multifaceted relationship between financial deepening and economic growth in Kenya, employing advanced econometric methodologies including Vector Autoregression (VAR) and Autoregressive Distributed Lag (ARDL) models to analyze interactions between crucial financial deepening indicators such as bank deposits, broad money supply (M2), liquidity liabilities, and stock market capitalization and Kenya's economic growth over an extended period. With an optimal lag length of two selected through robust model selection criteria like the Akaike Information Criterion (AIC), the study captured temporal dynamics and interdependencies between financial deepening indicators and economic growth, revealing both immediate effects and longer-term influences. The findings confirmed that financial deepening indicators examined exert substantial and positive influence on economic growth in Kenya, suggesting that as the financial sector grows more sophisticated and robust, it serves as a powerful engine for economic expansion, with cointegration analysis validating the existence of a long-term equilibrium relationship among variables, indicating that financial deepening and economic growth are bound together over time, moving in tandem as the economy evolves. These results provide compelling evidence that financial deepening, characterized by increased financial assets, greater credit availability, and a more dynamic capital market, is integral to economic prosperity and represents a fundamental driver that can propel the economy forward, ensuring robust and sustainable long-term growth rather than merely being a byproduct of economic development.

6.0 Recommendations

Building on the study findings, several key recommendations are proposed to enhance the role of financial deepening in promoting economic growth in Kenya. Policymakers should prioritize strategies that deepen the financial sector by improving accessibility, inclusiveness, and reach of financial services through expanding banking infrastructure in underserved and rural areas, promoting mobile banking platforms to bring more Kenyans into the formal financial system, and improving money supply through policies encouraging savings and investment while broadening available financial instruments, with financial institutions incentivized to innovate and offer attractive savings and investment products to mobilize public funds for productive investments. The financial sector's stability requires robust regulatory frameworks to ensure soundness and resilience of financial institutions against external shocks such as global economic downturns or domestic financial crises, maintaining investor confidence and effective system functioning during challenging economic environments. Additionally, enhancing financial literacy among the population through developed and promoted programs will improve public understanding of financial products and services, encouraging participation in the financial system and informed financial decision-making that contributes to economic growth through responsible saving, investing, and borrowing behaviours. Finally, efforts should focus on developing Kenya's capital markets to create a more vibrant and active stock market serving as an additional financial deepening channel, attracting domestic and foreign investment by creating conducive environments through strengthened investor

protections, improved market transparency, financial technology and encouraging more company listings on the stock exchange, while future research should incorporate more recent data capturing COVID-19 pandemic impacts on financial systems and economic growth for contemporary perspectives.

References

Aduda, J., & Kalunda, E. (2012). Financial inclusion and financial sector stability with reference to Kenya: A Review of literature. *Journal of Applied Finance & Banking, 2(6), 1-8.*

Agu, C., & Chukwu, O. (2008). Multivariate causality between financial depth and economic growth in Nigeria. *African Review of Money, Finance and Banking, 7(1), 7-21.*

Akpansung, O. & Babalola, J. (2011). Banking Sector Credit and Economic Growth in Nigeria: *An Empirical Investigation, CBN Journal of Applied Statistics, 2(2), 51-62*

Andele, O. (2013). Financial Deepening and Profitability of Commercial Banks in Kenya. A Project for the University of Nairobi.

Appugol, T. G., & Naik, B. M. (2025). Financial Inclusion and Economic Development: An Approach towards a Global Perspective. Asian Journal of Economics, Business and Accounting, 25(6), 67–74. https://doi.org/10.9734/ajeba/2025/v25i61835

Aslam, M. (2008). Financial development and economic growth: Evidence from South Asian countries. *The Pakistan Development Review, 47(4), 437-455.*

Atmaja, S., Fachrurazi, F., Abdullah, A., Fauziah, F., Zaroni, N., & Yusuf, M. (2022). Actualization of performance management models for the development of human resources quality, economic potential, and financial governance policy in the Indonesia Ministry of Education.

Ayadi, R & Gadi, S. (2013). Access by MSMEs to Finance in the Southern and Eastern Mediterranean: What role for credit guarantee schemes? CEPS Papers 8061, Centre for European Policy Studies.

Bairamli, N., & Kostoglou, V. (2010). The Role of Savings in the Economic Development of the Republic of Azerbaijan. *International Journal of Economic Sciences & Applied Research, 3(2).]*

Baskerville, R., & Pries-Heje, J. (2010). Explanatory design theory. Business & Information Systems Engineering, 2, 271-282.

Beck, T., Döttling, R., Lambert, T., & Van Dijk, M. (2023). Liquidity creation, investment, and growth. *Journal of Economic Growth, 28(2), 297-336.*

Bencivenga, R., & Smith, D. (1991). Financial intermediation and endogenous growth. The review of economic studies, 58(2), 195-209.

Coulibaly, A., & Yogo, T. (2020). The path to shared prosperity: Leveraging financial services outreach to create decent jobs in developing countries. *Economic Modelling, 87, 131-147.*

Hardi, I. (2025). Freedom and Prosperity: The Impact of Political Rights and Civil Liberties on Economic Complexity. Ekonomikalia Journal of Economics, 3(2), 78-92

Hassan, M. (2019). How do bank regulations impact efficiency and performance? Journal of Financial Economic Policy, 12(4), 545-575.

Kapaya, M. (2020). Stock market development and economic growth in Tanzania: an ARDL and bound testing approach. *Review of Economics & Political Science, 5(3), 187-206.*

Levine, R., & Zervos, S. (1998). Stock markets, banks, and economic growth. American Economic Review, 537-558.

Mankiw, G., Romer, D., & Weil, N. (1992). A contribution to the empirics of economic growth. The quarterly journal of economics, 107(2), 407-437.

Martín, E., Bachiller, A., & Bachiller, P. (2018). The Restructuring of the Spanish Banking System: Analysis of the Efficiency of Financial Entities. Management Decision, 56(2), 474-487.

McKinnon, I. (1973). Money and Capital in Economic Development. Washington, DC: The Brookings Institution.

Mishkin, S. (2004). Why the Federal Reserve should adopt inflation targeting? International Finance, 7(1), 117-127.

Momanyi, G., Odhiambo, O., & Aila, O. (2013). The relationship between fiscal deficits and economic growth in Kenya: An empirical investigation.

Moreka, K. M. (2025). Macroeconomic effect of financial deepening on economic growth in Kenya. *Unpublished master's thesis, University of Eldoret.*

Mukundi, A. (2013). The relationship between financial deepening and gross domestic product in Kenya: a case of NSE-listed financial Institutions (Doctoral dissertation, University of Nairobi).

Mutai, E. (2025). Macroeconomic Determinants of Housing Supply in Kenya. African Journal of Urbanism, Architecture, and Building, 1(1), 91-110.

Narayan, K. (2004). Fiji's tourism demand: the ARDL approach to cointegration. Tourism Economics, 10(2), 193-206.

Ng'ang'a, L. (2016). Relationship between financial deepening and economic growth in Kenya (Doctoral dissertation).

Odhiambo, M. (2009). Interest rate reforms, financial deepening and economic growth in Kenya: an empirical investigation. The Journal of Developing Areas, 295-313.

OECD. (2014). OECD Economic Outlook 2014. Organisation for Economic Co-operation and Development

Omoke, M. (2010). The relationship between capital market development and economic growth in Kenya (Doctoral dissertation, University of Nairobi, Kenya).

Otieno, S., Martin, L., Nyamao, R., Ojera, P. and Odondo,J. (2013). Effect of Provision of Micro-Finance on the Performance of Micro-Enterprises: A Study of Youth Micro-Enterprises under Kenya Rural Enterprise Program (K-REP), Kisii County, Kenya. Academic Journal, 5, 8290-8300

Ouma, N., & Muriu, P. (2014). The Impact of Macroeconomic Variables on Stock Market Returns in Kenya. *International Journal of Business and Commerce, 3, 1-31.*

Pesaran, H., Shin, Y., & Smith, J. (2001). Bounds testing approaches to the analysis of level relationships. *Journal of Applied Econometrics, 16(3), 289-326.*

Phillips, C., & Perron, P. (1988). Testing for a unit root in time series regression. biometrika, 75(2), 335-346.

Ribaj, A., & Mexhuani, F. (2021). The impact of savings on economic growth in a developing country (the case of Kosovo). *Journal of Innovation and Entrepreneurship, 10, 1-13.*

Schumpeter A (1911) The Theory of Economic Development. Harvard University Press.

Shaw, S. (1973). Financial Deepening in Economic Development. Oxford University Press. New York.

Škare, M., & Družeta, P. (2016). Poverty and economic growth: a review. Technological and Economic Development of Economy, 22(1), 156-175.

Stiglitz, E. (2017). The revolution of information economics: the past and the future (No. w23780). *National Bureau of Economic Research.*

Thomi, J. (2021). Financial Inclusion in East Africa: Does Economic Growth Matter? *Journal of Economics, Management and Trade, 27(2), 1-8.*

World Bank. (2021). Kenya economic update: Rising above the waves (Edition 23). World Bank Group.

Zaman, S., & Bhandari, K. (2020). Financial deregulation, competition and cost efficiency of Indian commercial banks: Is there any convergence? *Indian Economic Review, 55(2), 283-312.*