

Adjustment and liberalization in Kenya: the financial and foreign exchange markets

Abstract:

The paper analyses the impact of liberalization on two key and interrelated markets in Kenya, the financial and the foreign exchange markets. It is shown that the inflation profile changes with exchange rate policy, interest rates have not been market determined even after liberalization, interest rate spreads have increased with liberalization, a reflection of inefficiency in the financial market, while foreign and domestic interest rate differential and short-term speculative capital inflows affect the real exchange rate. The policy conflict of targeting a competitive exchange rate and low inflation with interest rate as the only instrument is shown to lead to a policy dilemma and to complicate macroeconomic management in the 1990s in an environment where fiscal adjustment has not taken place