

ABSTRACT

This study examines the Effect of Exchange Rate fluctuations on Gross Domestic Product in Kenya from 2008 to 2012. Two theoretical views have been put forward; first view states that, a real appreciation of domestic currency lowers the cost of imported raw materials leading to an expansion of output while the traditional view states that a real appreciation lowers international competitiveness, which, in turn, causes net exports to fall and hence a reduction in the aggregate demand.

The model of this study did decompose GDP as a function of exchange rate, inflation, exports, imports and government expenditure. Regression was conducted to test the impact of the variables on GDP and showed that government expenditure impacted highly on GDP.

Findings indicated that, exchange rate fluctuations has significant adverse effects on GDP, contracting the growth of real output and the demand for investment and exports, while raising inflation. Monetary policies should be put in place to ensure inflation persistence are minimized and to ensure stability of exchange rates in Kenya.