Abstract

This research study set out to examine whether a relationship between the Central Bank Rate and the Nairobi All Share Index exists. It used data collected over the period 2008 to 2013 which was collected from the Central Bank of Kenya and the Capital Markets Authority. The research was based on the simple regression analysis of secondary data with SPSS version 17 was used to undertake the analysis. This study is necessitated by the contradictory results from previous studies and the need to establish a relationship between the CBR and the NASI. Some of the previous studies done conclude that a positive relationship exists between the stock indices and the Central Bank Rate, which in some countries is referred to as the Federal Funds Rate, whereas others indicate that an inverse relationship exists. This research seeks to establish whether in Kenya a positive or negative (inverse) relationship prevails. The research reviews various relevant theories which were used to construct the theoretical foundation for the study. These theories also facilitated the development of an expected relationship between the Central Bank Rate and the Nairobi Securities Exchange All Share Index. The findings of this research establish that an inverse relationship between the Central Bank Rate and Nairobi Securities Exchange All Share Index exists. This study confirms the researcher’s priori argument that a negative relationship exists between the two variables, it however disagrees with a few previous studies and which had established a positive relationship. The study has developed various recommendations which may aid in the interactions between the central bank and the Nairobi Stock exchange. One such recommendation is that the MPC should avoid frequent adjustments of the CBR as this may result in a highly volatile market that may impact negatively on investments. Thus the MPC should subtly adjust the rates slowly over a period of time to allow the market to adjust to it otherwise sudden large changes in the rate may cause shock waves in the market.