Abstract

Private investment remains an important sector in the growth of the economy and sustainable development in Kenya. It is envisioned to create job opportunities, distribute income and alleviate poverty. The growth rate of private investments witnessed in the past years in Kenya is below the expected growth rate of 24%. Since 1980, the highest growth has been achieved at 15.2% in 2014. It then declined to 12.96% in 2021, 13.34% and 13.40% in 2022 and 2023 respectively, which are much below the projected growth rate. Existing studies in Kenya lack substantial inquiry on the relationship between financial deepening and private investment and have dealt with them separately without linking the two in a dynamic framework. Additionally, most of those studies tend to rely on a limited set of indicators of financial deepening, while employing different methods for analysis that may not be appropriate for unbiased results. The current study intended to determine the effect of financial deepening on private investment. A disaggregated analysis of three aspects of financial deepening was done: private sector credit, broad money and bank deposits. Data was obtained from KNBS and World Development Indicators (WDI) websites for the period between 1980-2021. STATA software was used in the analysis of the collected data. ARDL model was employed and the ECM was estimated since there was cointegration. The regression results indicated that Private sector credit, Broad money and Bank deposits were statistically significant at a 1% level in the short run. An increase in 1 percent of private sector credit, Broad money and Bank deposits cause private investment to increase by 0.32, 0.39 and 0.49 percent respectively. The findings show that financial deepening has a positive effect, while broad money and bank deposits have negative effect on private investment in the long run. The three models were good predictors of private investment as shown by R-squared values of 0.96, 0.94 and 0.94 respectively. The study concluded that financial deepening is important for growth of private investment in Kenya. Therefore, Financial intermediation theory is applicable in Kenya. The study recommends policymakers to conceptualize the policies that aim at facilitating financial access and inclusion for the marginalized groups in remote and rural areas. Further, the government needs to support financial sector through enhancing the growth of microfinance institutions. This will facilitate provision of credit and savings services to individuals earning low-income and owning small businesses.