

ABSTRACT

Volatility in lending interest rates represents one of the key forms of financial risk faced by commercial banks in Kenya. The aim of this research project was to identify and assess the effect that the determinants of lending interest rate volatility have on the profit levels realized by commercial banks in Kenya for the period 2010-2015. This study used profitability measured by Net Interest Margin as the dependent variable, while the independent variables were Borrowers' Default Rate, Central Bank of Kenya Liquidity Ratio, Central Bank Kenya Cash Reserve Ratio, Inflation Rate and Maturity Mismatch. The study population was the total 42 commercial banks that were in operation as at the end of 2015, with a sample size of 20 banks. The study used secondary data collected from individual commercial banks, among them audited financial statements, published bank supervision reports by Central Bank of Kenya, data on inflation was obtained from Kenya National Bureau of Statistics. Data analysis involved both descriptive and inferential statistics; with descriptive statistics involving the use of mean, standard deviation, minimum and maximum values of data collected, while the inferential statistics comprising the use of regression coefficients to test the hypotheses with values generated using the Statistical Package for Social Sciences software. The findings of the study revealed that Borrower's Default Rate, Inflation Rate and Maturity Mismatch Risk would impact negatively on the profitability of banks, whereas Cash Reserve Ratio and Liquidity Ratio would impact positively on the profitability of commercial banks in Kenya. The study therefore concluded that commercial banks should work in tandem with Central Bank of Kenya in order to constantly monitor the Cash Reserve Ratio and Liquidity levels to avoid cases of instability; the Inflation Rate should be watched as well in order to know and study the borrowing culture of the various bank clientele, and that both Maturity Mismatch and Borrowers Default Rate levels should be contained to avoid growth in Non-Performing Loans and to keep the banks' loan book open and in constant flow.

Key words: interest rate fluctuation, Default Rate, Liquidity Ratio, Cash Reserve Ratio