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Financial Crises and Economic Downturns of Commercial Banks in North Rift Region, Kenya

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Abstract

Purpose: General objective of the study was to explore the financial crises and economic downturn of commercial banks in North Rift Region in Kenya. The study specifically sought to establish the effects of interest rates crisis, currency crisis, corporate debt crisis and liquidity crisis on economic downturns of commercial banks in North Rift Region in Kenya. The study was anchored on Credit Crunch Theory, the Debt Overhang Theory, the Liquidity Preference Theory and the Credit cycle Theory.

Methodology: A descriptive survey design was adopted. The study population consisted of all the 44 commercial banks in the North rift region in Kenya and in each commercial bank, branch managers were also targeted who gave a clear overview of financial crises and how it affected the economic downturns of their respective banks. Purposive sampling was employed to select the 44 branch managers. The primary data was collected by using a questionnaire that was pretested for reliability and validity. The study also analyzed the data using both descriptive and inferential statistics. Descriptive statistics including percentages, frequencies, means and standard deviations were adopted in analyzing the data. Linear Regression analysis and correlation analysis as the inferential statistics were used to show the relationship that existed between the variables. The findings were then presented using tables.

Findings: The study findings indicated that interest rates crisis had a significant negative effect on the economic downturns of commercial banks ($p = 0.027$, <0.05). The findings also indicated that currency crisis had a significant negative effect on the economic downturns of commercial banks with $p = 0.033$, <0.05. corporate debt crisis had a significant negative effect on the economic downturns of commercial banks ($p = 0.015$, <0.05). Liquidity crisis had a significant negative effect on economic downturns of commercial banks where the regression model also indicated that $p = 0.002$, <0.05. The study concluded that interest rates crisis, currency crisis, corporate debt crisis and liquidity crisis had a negative effect on the economic downturns of commercial banks.

Unique contribution to theory, practice and policy: The study recommends that the commercial banks should develop products with flexible interest rates to cater to borrowers during periods of high interest rates. The management should consider offering fixed-rate loans for a limited term to provide some stability to businesses. The policy makers such as the Central Bank of Kenya should implement measures to stabilize the national currency and promote foreign investment during crises.

Key Words: *Interest Rates Crisis, Currency Crisis, Corporate Debt Crisis, Liquidity Crisis, and Economic Downturns*

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Background of the Study

Commercial banks contribute significantly to the economy of any country by acting as facilitators for resource allocation. They act as intermediaries, bringing together savers and borrowers. They collect deposits from investors and then lend that money to businesses and individuals who need it (Ongore, 2013). In addition to this, Ongore, (2013) adds that, to effectively fulfill this role, banks must be profitable. However, economic downturns and financial crisis have been one of the recurrent challenges in the global economic landscape, impacting nations and their financial institutions with profound consequences. Economic downturns, also known as recessions, are periods of negative economic growth and they are characterized by a decline in GDP, rising unemployment, and falling asset prices (Fosu, 2016). They can be caused by a variety of factors, including financial crises, natural disasters, and global economic shocks. The effects of economic downturns can be severe and widespread in commercial banks. The commercial banks may be forced to lay off workers, and consumers may cut back on spending (Furceri & Zdzienicka, 2012) and this can lead to a further decline in economic activity, creating a vicious cycle. Economic downturns can also have a negative impact in the banking sector, leading to reduced profitability in terms of ROA and ROE, increased credit losses, increase the number of non-performing loans, heightened deposit withdrawals and impaired management of risks. One of the factors that can also affect the economic downturn of a country is financial crises which have a devastating impact on the economy (Abbas, Pienkowski, and Rogoff 2019).

Kose, Nagle, Ohssorge and Sugawara (2019) state that financial crisis refers to the significant decrease in value of financial assets and instruments and therefore, businesses find it hard to meet their financial obligations, and financial institutions also have insufficient assets and cash to meet immediate needs of their customers. According to Blanchard (2019), economic downturns can cause investors to lose confidence in their assets value, while consumers find their incomes and assets shrinking making it harder for them to repay their debts.. Financial crises are often followed by economic downturns, characterized by negative economic growth, rising unemployment, and falling asset prices. The effects of financial crises on economic downturns of commercial banks are complex and have been the subject of much research. Economic shocks disrupt financial flows as investors pull back from risky investments, such as those in emerging markets (Massa, 2015). Therefore, financial crises can have a significant impact on economic downturns of commercial banks since when a financial crisis occurs, it can lead to a decline in profitability, credit availability, increased non-performing loans, liquidity concerns, a decline in asset prices, can make banks more vulnerable to risks and a decline in business confidence. These factors can all contribute to a decline in economic activity (Kose et al 2019).

Global Perspective of Financial Crises

Financial crises can vary in severity and impact different countries in unique ways. Resource-rich countries, like Kazakhstan, Ukraine and Russia were particularly affected during the 2008 Global

Financial Crisis. The Global Financial Crisis had a profound impact on commercial banks and financial institutions worldwide, many of which were forced to seek government bailouts or restructure (IMF, 2016). This crisis, largely caused by the issuing of risky subprime mortgages in the US and Europe, triggered a global chain reaction. As borrowers defaulted, financial institutions worldwide faced bad debt and a liquidity crisis. Investors lost confidence, asset values plummeted, and economies contracted. In general, the crisis led to a sudden loss of confidence in the financial system, leading to a decline in asset values, a liquidity crisis, and a rise in defaults, reduction in flow of capital, investments declined as well as remittances reduced (World Bank 2020). Wolf (2014) stated that the Global Financial Crisis in 2007-2008 was triggered by the collapse of the subprime mortgage market in the United States. The crisis led to a worldwide liquidity crisis, as banks and financial institutions were unable to borrow money at affordable rates. The crisis also caused a sharp decline in asset values, as the value of stocks, bonds, and real estate plummeted. Between 2002 and 2006, housing prices increased due to easy loan programs. This enticed people to take out risky mortgages, believing they could soon refinance with better rates. However, rising interest rates and falling housing prices in 2006-2007 made refinancing difficult, leading to an increase in loan defaults. This problem was not only confined to the US but it spread globally through complex financial instruments like collateralized debt obligations (CDOs). Countries like Russia and Ukraine saw a dramatic increase in non-performing loans by 2009, with a 300% and 250% respectively compared to the same period in 2008 (IMF, 2019).

The Great Depression (1929-1939) was the worst economic downturn since crisis led to widespread failures of banks, as depositors rushed to withdraw their funds, and borrowers were unable to repay their loans. The collapse of the banking system had a ripple effect throughout the economy, leading to unemployment, failure of businesses, and a decline in economic activities. The Asian Financial Crisis began in Thailand in 1997, when the country's currency, the baht, was forced to devalue. The crisis quickly spread to other countries in Southeast Asia, as investors lost confidence in the region's currencies and economies. The crisis had a severe impact on commercial banks and financial institutions in the region, many of which were forced to close or restructure (Krugman, 2009). The European Debt Crisis in 2009-2012 was triggered by the sovereign debt crisis in Greece. The crisis quickly spread to other countries in the eurozone, as investors lost confidence in the ability of these countries to repay their debts. The crisis put a strain on the financial systems of these countries, as banks were exposed to large amounts of sovereign debt (Wolf, 2020). According to a report by IMF (2022), the recent COVID-19 pandemic had a substantial negative effect on the global financial sector due to economic decline and rising defaults thus putting a strain on the financial health of commercial banks and other financial institutions.

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African Perspective of Financial crises

Commercial banks in Africa play a pivotal role in the continent's economic development, providing essential financial services such as credit, savings, and payment facilitation. However, the African financial landscape has been susceptible to periodic financial crises and economic downturns, which have had a profound impact on the stability and performance of commercial banks. In African continent, the financial crises on economic downturns vary depending on a number of factors, such as the severity of the crisis, the structure of the economy, and the policy response (Kose et al 2019). Reports from World Bank (2020) indicated that several financial crises have affected commercial banks across Africa in recent decades, highlighting the need for stronger regulatory frameworks, improved risk management practices, and enhanced resilience to external shocks (IMF, 2019). The 1990s Banking Crisis witnessed a wave of bank failures in several Sub-Saharan African countries, including Kenya, Nigeria, and Tanzania (ADB, 2011) and this also led to a rapid accrual of non-performing assets. The crisis was triggered by a combination of excessive lending, poor risk management practices, and the collapse of the East African Currency Board (IMF, 2020). In addition, in the 1990s financial institutions experienced a decline in profitability, distress in borrowing and non-performing assets hence affecting the profitability of the commercial banks (Ngugi, 2019). The ripple effects of the 2008 global financial crisis were felt across Africa, leading to a decline in economic activity, reduced capital flows, and increased risk aversion among investors. The crisis exposed the interconnectedness of global financial markets and the vulnerability of African commercial banks to external shocks. For instance, in Tanzania, the global financial crisis led to some financial institutions during the period experience an increase in their non-performing loans leading to a decline in their profitability. This included banks such as Stanbic Bank Tanzania and Standard Chartered, Exim Bank and Access Bank where they were able to get grants from African Development and India bank to help during the impact of the crisis by spreading special credit to other businesses, agriculture and value addition. The COVID-19 pandemic impact on African commercial banks has been mixed. While some banks have experienced profit declines due to the economic downturn, others have benefited from increased demand for digital banking services. The pandemic has emphasized the need for banks to adapt to operational risks and develop strategies for navigating future disruptions (IMF, 2020).

Kenyan Perspective of Financial Crises

In the context of Kenya, a country striving for sustained economic growth and development, the vulnerabilities of commercial banks to financial crises and economic downturns have become a subject of critical importance (Wanderi, 2019). Kenya, like many other developing countries, has been facing economic challenges for years. The current situation is worsened by the over-borrowing of the previous and current regimes, which has led to its inability to meet its recurrent bills due to significant strain on the Kenyan government's finances (CBK, 2018). The funds acquired through borrowing have been used on non-revenue-generating projects. Mismanagement

of funds has led to a decline in investor confidence and the weakening of the shilling against the dollar (Waweru, 2023). Kenya has experienced a number of financial crises over the years (IMF, 2023). For instance, the 1980s and 1990s banking crisis was caused by a number of factors, including poor lending practices by banks, high levels of government debt, and corruption. The crisis led to the collapse of several banks and a sharp decline in economic growth. The 2008 global financial crisis had a significant impact on Kenya, leading to a decline in exports, remittances, and investment. The crisis also led to a weakening of the Kenyan shilling and a rise in inflation. The 2008 global financial crisis led to a decline in economic growth of 1.7% in Kenya in 2008. (World Bank, 2020). The 2020 COVID-19 pandemic led to a sharp decline in economic activity in Kenya, as well as puting a strain on the Kenyan commercial banks in terms of increased of non-performing loans and low asset values (IMF, 2023).

Statement of the Problem

Financial crises have a significant impact on economic downturns of both developing and developed nations. This is because the economy is closely linked to the global economy, and is therefore vulnerable to external shocks such as financial crises. According to a report by World Bank (2021) and IMF (2019), the impact of financial crises on economic downturns in Kenya is transmitted through a number of channels such as decline in investments, exports and remittances, increased unemployment, increased inflation and reduced government revenue. For instance, the COVID-19 led to a decrease in economic growth of 0.3% in Kenya in 2020. The quality of assets were affected in commercial banks relating to an increase in credit crises which reduced the profits and some of banks declared their losses. Commercial banks have been susceptible to financial crises and economic downturns, which have had a detrimental impact on the financial performance of commercial banks and the regional economy. These crises are often characterized by a sudden loss of investor confidence, leading to a decline in asset values, a liquidity crisis, and a rise in defaults (CBK, 2020). According to the Central Bank of Kenya (CBK) supervision report (2022), the commercial banks in Kenya have experienced a significant increase in non-performing loans (NPLs) in recent years like other regions. NPLs have risen from 9.2% in 2016 to 14.5% in 2022, indicating a growing problem of loan defaults. Moreover, the region's economic growth has slowed down in recent years. The growth rate of the economy averaged 5.2% between 2010 and 2015, but it declined to 3.1% between 2016 and 2022. This slowdown is partly attributed to the financial crisis and economic downturns affecting commercial banks.

A 2022 report by the International Monetary Fund (IMF) highlighted the concerns about the financial health of commercial banks in the North Rift region. The report noted that the region's banks are exposed to a number of risks, including high levels of NPLs, weak corporate governance, and inadequate capital buffers. Additionally, a 2023 report by the World Bank warned that the commercial banks in Kenya is facing a heightened risk of financial crisis. A report by Kenya's Central Bank (CBK) showed a worsening loan situation in 2021. The percentage of bad loans

compared to total loans grew from 4.7% in December 2020 to 5.2% in December 2021. This rise in bad loans suggests a growing credit crisis and increased risks. The CBK attributed this situation to two factors: lingering effects of high interest rates set in early 2017 and a slowdown in economic activity due to the Kenyan general elections in August 2023. The CBK also monitored banks closely to identify those facing issues with loan quality. The report additionally highlighted a decline in the banking sector's capital adequacy ratio, which is a measure of its ability to absorb losses. This ratio dropped from 23% in December 2017 to 21% in December 2018. A number of different research studies have been carried out on financial crises and economic downturns in both developing and developed nations however, little research has been conducted on financial crises and economic downturns more especially in commercial banks in Kenya. For instance, Swinnen and Herk (2019) studied the global crisis' impact on Central Asia and Eastern Europe's agriculture, while Mackenthun (2019) focused on the external economies of 27 European countries. Kouki, Belhadj, and Chikhaoui (2017) analyzed financial crises on growth of GDP in various 28 emerging and developed nations between 1980-2011 and found banking crises have a deeper impact on economic growth compared to monetary crises. A combined twin crisis of both monetary and banking issues appears to be the most damaging scenario.

From the above reviewed previous studies, it was shown that there are research gaps of knowledge that need to be filled since most researchers have concentrated on financial crisis in general without clearly identifying how they influence the economic downturns and more especially in commercial banks in the North Rift region of Kenya. Some of the studies did not focus on any financial crisis and also failed to show their relationship to economic downturns. Therefore, this study clearly filled these contextual, conceptual, methodological gaps and investigated financial crisis and economic downturns with reference to commercial banks in the North Rift region in Kenya.

Objectives of the Study

i. To examine the effect of interest rates crisis on economic downturns of commercial banks in North Rift Region in Kenya.
ii. To establish the effect of currency crisis on economic downturns of commercial banks in North Rift Region in Kenya.
iii. To assess the effect of corporate debt crisis on economic downturns of commercial banks in North Rift Region in Kenya.
iv. To determine the effect of liquidity crisis on economic downturns of commercial banks in North Rift Region in Kenya.

Literature Review

The Credit Crunch Theory

The credit Crunch Theory was proposed by Minsky in 1992. In this theory, economic slowdowns trigger a decrease in bank lending. This happens because of a drop in both supply and demand for

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credit. Businesses borrow less as they become cautious during slowdowns. At the same time, banks tighten lending standards due to increased risk. This risk comes from borrowers with weaker credit quality and a decline in collateral values, leading to more loan defaults (Omotende, 2013). Banks respond by making it harder to get loans through stricter requirements (like collateral) and higher interest rates. This combination of reduced demand and stricter lending creates a credit crunch, slowing down money circulation in the economy. O'Brien and Brown (2013) add that past credit crunches and stricter regulations have caused banks to raise loan prices further, dampening demand even more. However, Saunders (2012) suggests that as economies recover and banks maintain stricter lending standards, the overall quality of bank loans improves, eventually making them more willing to lend again. The Credit crunch theory comes from the interest rates crisis facing commercial banks as well as borrowers. The theory is relevant to the study because it shows how interest rates crisis lead banks to tighten lending, limiting credit availability and hindering economic activity which in turn has an effect on the economic downturn of commercial banks. Therefore, this theory provides for a non-biased perspective on the relationship between interest rates crisis and economic downturn variables such as non-performing loans, profitability, asset adequacy and other measures related to commercial banks employed by the study. A interest crisis can arise due to various factors like bad loans, asset price bubbles, mismanagement, fluctuations in interest rates on borrowing costs, deposit levels and banking stability as well as external shocks. During a crisis, banks become wary of lending due to increased risk perception and potential financial problems. They tighten lending standards, raise interest rates, and become more selective in choosing borrowers. The stricter lending practices limit access to credit for businesses and individuals in the economy. This hinders investments, reduces consumption, and dampens overall economic activity.

The Credit Cycle Theory

The credit cycle theory was first proposed by economists Wicksell, Mises, and Hayek in the early 1900s. It was developed to explain the cyclical nature of economic growth and recessions. This theory argues that financial crises are caused by the cyclical nature of lending and borrowing. During the expansionary phase of the business cycle, banks are more willing to lend money and businesses and consumers are more willing to borrow money. This can lead to a buildup of debt, which can make the economy more vulnerable to shocks. During the recessionary phase of the business cycle, banks become more risk-averse and businesses and consumers become more reluctant to borrow money. This can lead to a credit crunch and a decline in economic activity. The credit cycle theory provides a thorough explanation and understanding on how currency crisis affects the economic downturns of commercial banks since financial crises such as currency crises are often caused by the credit cycle: The credit cycle theory argues that financial crises are caused by the cyclical nature of lending and borrowing. During the expansionary phase of the business cycle, banks are more willing to lend money and businesses and consumers are more willing to borrow money.

Debt Overhang Theory

The debt overhang theory was first proposed by economists Krugman, Sachs, and Cohen in (1980). It was developed to explain the slow economic growth in developing countries that were heavily indebted. This theory argues that high levels of debt can discourage investment and economic growth. This is because businesses may be hesitant to invest if they are already carrying a lot of debt, and consumers may be hesitant to spend if they are also carrying a lot of debt. The debt overhang theory suggests that countries with high levels of debt may struggle to repay it in the future. This creates a situation where a portion of any economic growth goes towards servicing the debt, leaving less for domestic investment (Claessens et al. 1996). As a result, both domestic and foreign investors become discouraged from investing in the country. The theory argues that reducing debt can improve a country's repayment capacity and encourage further investment, creating a virtuous cycle. The theory is related to the current study since the relationship between corporate debt crisis and the economic downturns is important because debt can have a significant impact on the commercial banks in terms of profitability, capital adequacy, operational efficiency and non-performing loans. If borrowers struggle to repay loans, banks face increased non-performing loans (NPLs), impacting their profitability and capital adequacy. This weakens the banking system and increases the risk of a crisis. Further, high debt levels can lead to higher interest rates, making borrowing more expensive and further hindering investments and economic activity. Therefore, commercial banks and policy makers need to be aware of the potential risks and benefits of debt when making decisions about fiscal policy.

The Liquidity Preference Theory

This theory was developed by John Maynard Keynes in (1930). It argues that investors demand liquidity because it gives them the flexibility to adjust their portfolios and meet unexpected needs. Keynes argued that the demand for liquidity is influenced by the interest rate and the level of uncertainty in the economy. The liquidity preference theory has a number of implications and applications for financial crises and economic downturns. One implication is that financial crises can be caused by a sudden increase in the demand for liquidity. This can happen, for example, if investors become more risk-averse and want to hold more liquid assets. When there is a sudden increase in the demand for liquidity, it can be difficult for financial institutions such commercial banks to meet the demand. This can lead to a liquidity crisis, which can have a negative impact on the economy. Another implication of the liquidity preference theory is that financial crises can lead to economic downturns. This is because financial crises can disrupt the banks' ability to offer credit to businesses and consumers. When businesses and consumers have difficulty getting loans, they may be less likely to invest and spend and this can lead to a decline in economic activity. The liquidity preference theory is an important concept for understanding financial crises such as liquidity crisis and economic downturns in commercial banks. It can help to explain why liquidity crisis can occur and why they can have such a negative impact on the economic downturns of

commercial banks. The analysis of this current study provided information that showed whether liquidity maintained by commercial banks affects the profitability, non-performing loans and operational efficiency of banks.

Conceptual Framework

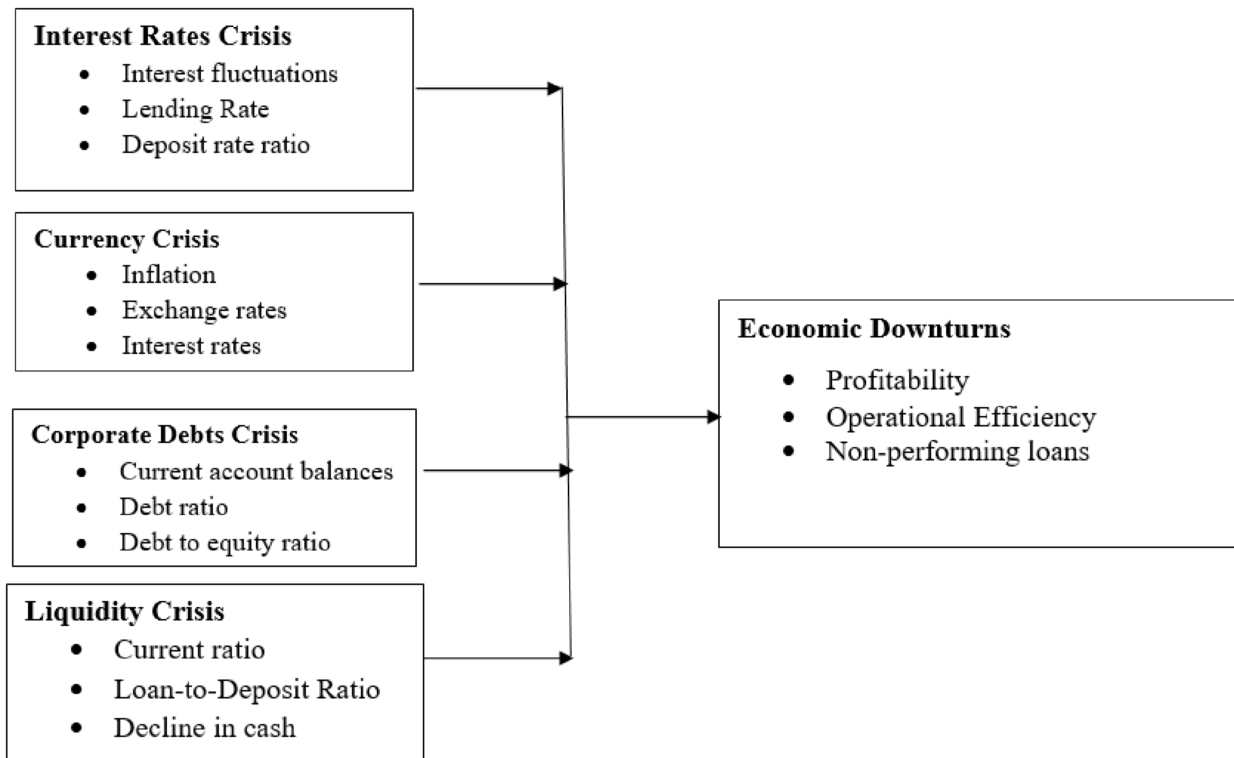

Figure 1: Conceptual Framework

Research Methodology

The study adopted a descriptive survey research design. The study targeted all the 44 commercial banks in the North rift region in Kenya which included both locally owned and those that are subsidiaries of foreign multinationals according to the CBK records of (2022). In each commercial bank, branch managers were also targeted who gave a clear overview of financial crises and how it affected the economic downturns of their respective banks. The study used purposive sampling to select the branch managers of all the 44 commercial banks in the North rift region. Primary data was collected through questionnaire and they were formulated using a likert scale of between 1-5. Secondary data is data that already exists and can be obtained from sources like organizational

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records, government sources, corporate fillings, print, and trade, business associations among other sources. The study used quantitative analysis in analyzing the data. The data from the questionnaires was coded using Statistical Package for Social Science (SPSS) Version 25.0 and the response on each item put into specific main themes. The study also analyzed the data using both descriptive and inferential statistics. Descriptive statistics such frequencies, percentages, means and standard deviations were used. Linear Regression analysis and correlation analysis as the inferential statistics were used to show the relationship that existed between the variables. This was presented using tables. The linear regression model was used to establish statistical relationships between specific financial crises and economic downturn indicators and had the following equation:

$$\mathbf{Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon}$$

Where: β_0 = Constant, β1, β2, β3, β4 = Partial regression coefficient, X_1 = Interest rates Crisis, X_2 = Corporate Debt Crisis, X_3 = Currency Crisis, X_4= Liquidity crisis and ε = Error term

Results

The researcher issued 44 research questionnaire and out of the samples all the 44 questionnaires were collected and returned. This represented a return rate of 100% and this was an acceptable questionnaire return rate given that it surpasses 50% for surveys involving small population and 70% recommended by Mugenda and Mugenda (2003).

Descriptive Analysis

Interest Rates Crisis and Economic Downturns

This first research question for this study was about the relationship between interest rates crisis and economic downturns of commercial banks. To answer this question the bank managers were required to indicate their opinion concerning the statements related to the effect interest rates crisis and economic downturns of commercial banks. The responses were presented in Table 1.

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Table 1: Interest Rates Crisis and Economic Downturns

Statements		SA	A	N	D	SD	Mean	Std.D
Changes in interest rates lead to a decrease in loan applications from businesses in the North Rift Region.	Freq	22	6	3	7	6	**3.70**	1.781
	%	50.0	13.6	6.8	15.9	13.6		
Fluctuations in interest rates make it difficult for commercial banks in the North Rift Region to plan for the future.	Freq	6	18	14	4	2	**3.50**	1.000
	%	13.6	40.9	31.8	9.1	4.5		
High interest rates lead to increase in non-performing loans from esteemed customers.	Freq	6	22	11	3	2	**3.61**	0.970
	%	13.6	50.0	25.0	6.8	4.5		
Unpredictable interest rates contribute to economic instability for commercial banks in the North Rift Region.	Freq	19	6	6	3	10	**3.48**	1.635
	%	43.2	13.6	13.6	6.8	22.7		
Interest rate fluctuations have a significant negative impact on the economic performance of commercial banks in the North Rift Region.	Freq	7	19	5	3	10	**3.23**	1.428
	%	15.9	43.2	11.4	6.8	22.7		
Average Mean							**3.50**	

n=44

According to table 1, a majority (63.6%) of respondents agreed (A) that changes in interest rates lead to a decrease in loan applications while 6.8% were not sure and 29.5% disagreed (Mean=3.70, SD=1.781). A significant portion (54.5%) agreed that interest rate fluctuations make planning difficult for banks, 31.8% were undecided and 13.6% disagreed as shown with a mean of 3.50 and SD of 1.000. Over half (63.6%) of respondents agreed on a rise in non-performing loans with high-interest rates, 25.0% were not certain and 11.3% disagreed with a mean value of 3.61 and Sd of 0.970. It was also established that (56.8%) agreed that unpredictable interest rates contribute to economic instability for banks, 13.6% were undecided and 29.5% disagreed (Mean=3.48, SD=1.635). A significant number (59.1) of respondents agreed that interest rate fluctuations significantly impact bank performance, 11.4% were not sure and 29.5% disagreed (Mean=3.23, SD=1.428. Overall, the above findings from the branch managers suggests that interest rate fluctuations are a concern for commercial banks in the North Rift Region as shown with an overall mean value of 3.50 meaning that the managers agreed to the statements connected to interest rates crisis and economic downturns in commercial banks. Interest rates play a significant role in the cost of borrowing and lending for commercial banks. Their effect aligns with existing findings, highlighting challenges in loan applications, planning, non-performing loans, economic instability, and negative economic performance. A crisis in interest rates, such as a sudden increase or decrease, can lead to reduced borrowing by businesses and individuals due to higher interest costs, leading to a decrease in loan demand for commercial banks. Lower profitability for commercial banks due to reduced interest income on loans and potential increase in non-performing loans as borrowers struggle to meet higher interest payments, leading to a deterioration of asset quality. The above findings support the work of World Bank (2018) who conducted a panel data analysis and found that interest rate changes can influence how much and to whom banks lend. High rates

might discourage lending, increase non-performing loans while low rates could lead to increased lending, potentially impacting risk exposure. Similarly, the findings of Hack and Nicholls (2021) in Sweden, Japan, Switzerland, Canada and United Kingdom found that in the short to medium run, low or negative interest rates appear to reduce bank profits only a little, after accounting for the positive effects of lower interest rates on loan losses and demand for credit. However, the negative effects on bank profits increase when interest rates remain very low for a prolonged period.

Currency Crisis and Economic Downturns

The second objective sought to establish the effect of currency crisis on economic downturns. The responses from the bank managers are as presented in Table 2.

Table 2: Currency Crisis and Economic Downturns

Statements		SA	A	N	D	SD	Mean	Std.D
Devaluation of the Kenyan currency leads to increased operational costs for commercial banks in the North Rift Region.	Freq	6	19	2	6	11	**3.07**	1.469
	%	13.6	43.2	4.5	13.6	25.0		
Currency fluctuations create uncertainty for foreign investors, impacting loan availability for businesses in the North Rift Region.	Freq	17	16	4	4	3	**3.91**	1.217
	%	38.6	36.4	9.1	9.1	6.8		
A weakened Kenyan currency discourages international trade, hindering economic activity for commercial banks in the North Rift Region.	Freq	14	5	9	10	6	**3.25**	1.465
	%	31.8	11.4	20.5	22.7	13.6		
Currency instability makes it difficult for commercial banks in the North Rift Region to manage their foreign exchange reserves effectively	Freq	9	18	3	2	12	**3.23**	1.538
	%	20.5	40.9	6.8	4.5	27.3		
Currency crisis is a major contributor to economic downturns for commercial banks in the north rift region.	Freq	5	21	3	2	13	**3.07**	1.485
	%	11.4	47.7	6.8	4.5	29.5		
Average Mean							**3.30**	

n=44

Table 2 shows that 56.8% of the managers agreed that devaluation of the Kenyan currency leads to increased operational costs for commercial banks (Mean=3.07, Sd=1.469). It was also clear that majority (75%) of the respondents agreed that currency fluctuations create uncertainty for foreign investors, impacting loan availability for businesses (Mean=3.91, Sd=1.217). further, 43.2% agreed that a weakened Kenyan currency discourages international trade, hindering economic activity for commercial banks as shown with a mean value of 3.25 and standard deviation of 1.465. A significant number 61.4% of the managers agreed that currency instability makes it difficult for commercial banks in the North Rift Region to manage their foreign exchange reserves effectively (Mean=3.23, Sd=1.538). It was established that 59.1% of the respondents also agreed that currency crisis is a major contributor to economic downturns for commercial banks with a mean

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value of 3.07 and SD of 1.485. The above findings were interpreted to mean that there are negative effects of currency crises on economic activity and the operational challenges they pose for commercial banks in the Northrift as shown with an overall average mean of 3.30. Most of the respondents indicated that Currency fluctuations create uncertainty for foreign investors, impacting loan availability for businesses and had the highest mean of 3.91. The findings are in agreement with Moyo and Turgut (2020) who examined how inflation and Exchange Rate impact on the financial Performance of Commercial Banks in South Africa. The findings illustrated that there is a significant inverse relationship between inflation and the return on equity and there is a weak relationship between exchange rate and the return on equity.

Corporate Debt Crisis and Economic Downturns

The third objective of the study measured the effect of corporate debt crisis on economic downturns. The findings are as presented in Table 3

Table 3 Corporate Debt Crisis and Economic Downturns

Statements		SA	A	N	D	SD	Mean	Std.D
An increase in bad debts puts a strain on the financial resources of commercial banks.	Freq	7	19	3	10	5	**3.30**	1.304
	%	15.9	43.2	6.8	22.7	11.4		
Companies struggling with debt repayment are less likely to secure new loans from commercial banks	Freq	12	8	11	4	9	**3.23**	1.476
	%	27.3	18.2	25.0	9.1	20.5		
The prevalence of corporate debt crises reduces the overall confidence of commercial banks in lending to customers	Freq	7	18	3	4	12	**3.09**	1.507
	%	15.9	40.9	6.8	9.1	27.3		
High levels of corporate debt in the region contribute to a decrease in loan applications	Freq	9	19	6	5	5	**3.50**	0.493
	%	20.5	43.2	13.6	11.4	11.4		
Corporate debt crises are a significant threat to the share price performance of commercial banks	Freq	17	11	5	8	3	**3.70**	1.34
	%	38.6	25.0	11.4	18.2	6.8		
Average Mean							**3.39**	

n=44

Table 3 indicates that the managers agreed that an increase in bad debts puts a strain on the financial resources of commercial banks (Mean=3.30,Sd=1.304), companies struggling with debt repayment are less likely to secure new loans from commercial banks (Mean=3.23,Sd=1.476), the prevalence of corporate debt crises reduces the overall confidence of commercial banks in lending to customers with a mean of 3.09 and SD of 1.507, high levels of corporate debt in the region contribute to a decrease in loan applications (Mean=3.50, Sd=0.493), corporate debt crises are a significant threat to the share price performance of commercial banks (Mean=3.70, Sd=1.34). The above findings were interpreted to mean that a crisis in corporate debt can pose significant risks to commercial banks, particularly if they have exposure to heavily indebted corporations. This is shown with an overall average mean value of 3.39. The majority of the bank managers indicated that corporate debt crises are a significant threat to the share price performance of commercial

banks with a mean value of 3.70. Increased default risk as corporate borrowers struggle to service their debt obligations, leading to potential losses for commercial banks. Decline in asset quality as non-performing loans rise, impacting profitability and capital adequacy ratios. Reduced lending activity by commercial banks as they become more cautious in extending credit to corporations with high debt levels, potentially constraining economic growth. The above findings do not concur with the findings of Muchugia (2014) where the findings show positive relationship between short term debt (SDA) and profitability since short-term debt tends to be less expensive and increasing it with a relatively low interest rate led to an increase in profit levels and hence performance. A negative association was established between long term debt (LDA) and profitability.

Liquidity Crisis and Economic Downturn

The last objective assessed the relationship between liquidity crisis and economic downturns of commercial banks. Descriptive analysis on liquidity crisis and economic downturns is presented in Table 4.

Table 4 Liquidity Crisis and Economic Downturn

Statements		SA	A	N	D	SD	Mean	Std.D
Some commercial banks struggle to maintain sufficient cash reserves to meet customer demands.	Freq	6	19	4	3	12	**3.09**	1.476
	%	13.6	43.2	9.1	6.8	27.3		
Limited liquidity makes it difficult for commercial banks to provide loans to businesses and individuals in the region.	Freq	15	9	4	3	13	**3.23**	1.683
	%	34.1	20.5	9.1	6.8	29.5		
A lack of readily available cash restricts the ability of commercial banks to invest in new opportunities and expand their services.	Freq	4	23	12	3	2	**3.55**	0.926
	%	9.1	52.3	27.3	6.8	4.5		
Liquidity issues are a major contributing factor to economic downturns for commercial banks	Freq	8	20	7	3	6	**3.48**	1.267
	%	18.2	45.5	15.9	6.8	13.6		
Improving liquidity is essential for ensuring low non-performing loans of commercial banks	Freq	9	18	12	3	2	**3.66**	1.033
	%	20.5	40.9	27.3	6.8	4.5		
Average Mean							**3.40**	

n=44

According to Table 4, it can be noted that the managers agreed that some commercial banks struggle to maintain sufficient cash reserves to meet customer demands (Mean=3.09, SD=1.476), limited liquidity makes it difficult for commercial banks to provide loans to businesses and individuals in the region as shown with a mean value of 3.23, SD of 1.683, a lack of readily available cash restricts the ability of commercial banks to invest in new opportunities and expand their services (Mean=3.55, Sd=0.926), liquidity issues are a major contributing factor to economic downturns for commercial banks (Mean=3.48, Sd=1.267), Improving liquidity is essential for ensuring low non-performing loans of commercial banks (Mean=3.66, SD=1.033). From the above findings, liquidity crises can severely impact the operations and stability of commercial banks and this is shown with a mean average value of 3.40. It was established that improving liquidity is

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essential for ensuring low non-performing loans of commercial banks as indicated by majority of the bank managers. The findings are in agreement with the findings of Chen, Chen and Huang (2020) who explored on Liquidity risk and bank performance during financial crises using US banks data from 1996 to 2013 and found that during the subprime crisis of 2007–2009, liquidity risk reduced a bank's survival probability, ROA, and net interest margin, and increased its loan-loss-provision expenses. This adverse effect was more severe for banks with lower capital ratios and higher credit risk. In contrast, there is no strong evidence that liquidity risk hurts bank performance in market crises. The results in this paper imply that liquidity risk is not merely a symptom of banks' insolvency problems; it has an independent effect on bank performance in banking crises.

Inferential Statistics

Regression Analysis

The study sought to determine the relationship the existed between financial crises and economic downturns in commercial banks. The critical value at 95% significance level was used to determine the relationship as shown in the following tables.

Table 5 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.425[a]	.381	.097	.58161	2.568

a. Predictors: (Constant), Interest Rates Crisis, Currency crisis, Corporate debt crisis, liquidity crisis

b. Dependent Variable: Economic Downturns

As illustrated in the Table 5, the predictor variables (Interest Rates Crisis, Currency crisis, Corporate debt crisis, liquidity crisis) explains 38.1% of the variation in economic downturns (R^2= .381). Thus, based on this coefficient, other factors that were not considered in this research contributed to 61.9% (1-0.381=0.619 expressed as percentage) of the variability in economic downturns of commercial banks in the Northrift region.

Table 6 ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	2.910	4	.727	22.150	.043[b]
	Residual	13.193	39	.338		
	Total	16.102	43			

a. Dependent Variable: Economic Downturns

b. Predictors: (Constant), Interest Rates Crisis, Currency crisis, Corporate debt crisis, liquidity crisis

As illustrated in the Table 6, the significance value in testing the reliability of the regression for the connection of Interest Rates Crisis, Currency crisis, Corporate debt crisis, liquidity crisis and economic downturns was obtained as 0.043 which is less than 0.05 (<0.05) the critical value at 95% significance level. Therefore, the regression is statistically significant in predicting the relationship between the dependent and independent variable of the study. The F value according to Table 6 is 22.150 indicating a significant regression for the relationship as given by the regression coefficients. This shows that the overall regression was statistically significant and reliable in explaining the effect of the predictor variables to economic downturns of commercial banks in Northrift Region, Kenya.

Table 7 Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	1.803	.755		2.387	.022		
	Interest Rates crisis	.634	.178	.444	2.024	.027	.691	1.447
	Currency Crisis	.311	.141	.358	2.206	.033	.797	1.255
	Corporate Debt Crisis	.830	.144	.733	3.207	.015	.831	1.204
	Liquidity Crisis	.765	.209	.539	4.787	.002	.674	1.483

a. Dependent Variable: Economic Downturns

The findings as shown in Table 7 indicate that all the predictor variables (Interest Rates Crisis, Currency crisis, corporate debt crisis, liquidity crisis) had a significant effect on economic downturns as shown by the coefficients. Interest rates crisis, $\beta 1 = 0.444$, $t = 2.024$, $p = 0.027$, <0.05. The B value for interest rates crisis was 0.634, implying that interest rates crisis contributed to 0.634 multiple changes in economic downturns of commercial banks. The findings have shown that interest rates crisis had a significant effect on economic downturns of commercial banks. Currency Crisis showed $\beta 1 = 0.358$, $t = 2.206$, $p = 0.033$, <0.05 and the B value was 0.311 showing that currency crisis contributed to 0.311 multiple changes in economic downturns of commercial banks. The findings have shown that currency crisis had a significant effect on economic downturns of commercial banks. Corporate debt crisis also showed that it had a significant effect on economic downturns of commercial banks where $\beta 1 = 0.733$, $t = 3.207$, $p = 0.015$, <0.05. The B value was 0.830 showing that corporate debt crisis contributed to 0.830 multiple changes in economic downturns of commercial banks. The findings also showed that liquidity had a significant effect on economic downturns of commercial banks ($\beta 1 = 0.539$, $t = 4.787$, $p = 0.002$, <0.05.). The B value was 0.765 showing that corporate debt crisis contributed to 0.765 multiple changes in economic downturns of commercial banks.

Thus, according to the formulae of the regression model;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

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Economic Downturns = 1.803+0.634Interest rates crisis+0.311Currency Crisis+0.830Corporate debt crisis+0.765Liquidity crisis +0.5861

The findings of the study are in line with the findings earlier posited by World Bank (2020) in their panel data analysis observed that banking crisis led to the collapse of several banks and a sharp decline in economic growth. The 2008 global financial crisis had a significant impact on Kenya, leading to a decline in exports, remittances, and investment. The crisis also led to a weakening of the Kenyan shilling and a rise in inflation. The 2008 global financial crisis led to a decline in economic growth of 1.7% in Kenya in 2008.

Pearson Correlation Analysis

The study sought to determine the correlation between the four financial crisis and economic downturns in commercial banks. The correlation test was conducted at the 95% (0.05) level of significance with a 2-tailed test.

Table 8 Pearson Correlation Analysis

		Economic downturns	Interest rates crisis	Currency crisis	Corporate debt crisis	Liquidity Crisis
Economic downturns	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	44				
Interest rates crisis	Pearson Correlation	.133	1			
	Sig. (2-tailed)	.038				
	N	44	44			
Currency crisis	Pearson Correlation	.402**	.165	1		
	Sig. (2-tailed)	.007	.284			
	N	44	44	44		
Corporate debt crisis	Pearson Correlation	.195	.046	.409**	1	
	Sig. (2-tailed)	.020	.765	.006		
	N	44	44	44	44	
Liquidity crisis	Pearson Correlation	.221	.553**	.225	.112	1
	Sig. (2-tailed)	.014	.000	.141	.469	
	N	44	44	44	44	44

**. Correlation is significant at the 0.01 level (2-tailed).
**. Correlation is significant at the 0.05 level (2-tailed).

The findings as shown in Table 8 indicate that Interest Rates Crisis, Currency crisis, Corporate debt crisis, liquidity crisis had a significant association with economic downturns of commercial

banks in the North rift region. Interest Rates Crisis, Currency crisis, Corporate debt crisis and liquidity crisis had a significant correlation with interest rates crisis having a Pearson's correlation coefficient of r=0.133 and a significant value of p=0.038, currency crisis r=0.402, p=0.007, corporate debt crisis r=0.195, p=0.020, liquidity crisis r=0.221, p=0.014 which is less than the critical value of 0.05 at 95% significance level.

Conclusion

The first objective was to examine the effect of interest rates crisis on economic downturns of commercial banks in North Rift Region in Kenya and according to the study it was established that interest rates crisis had a negative significant effect on economic downturns where the bank managers felt that changes in interest rates led to a decrease in loan applications from businesses in the North Rift Region. This is because, when interest rates rise sharply, borrowing becomes more expensive for businesses and individuals. This can lead to a decrease in loan demand, reducing a bank's income from interest on loans. When the economic downturn is severe, borrowers may struggle to repay their loans, leading to an increase in non-performing loans (NPLs) for banks. This reduces bank profitability and can threaten their solvency. These findings are supported by a study done by Ngure (2019) whose study findings established that interest rate instability can negatively impact bank profitability, especially in elastic loan markets (meaning borrowers are sensitive to interest rate changes). High rates can decrease loan demand, while low rates can squeeze profit margins. Rising interest rates or changes in interest rates lead to increased NPLs as borrowers struggle to repay loans, while falling rates might incentivize riskier lending practices, also contributing to NPLs.

The second objective was to establish the effect of currency crisis on economic downturns of commercial banks in North Rift Region in Kenya. The study indicated that currency crisis had a significant effect on the economic downturns of commercial banks as indicated by majority of the bank management that currency fluctuations create uncertainty for foreign investors, impacting loan availability for businesses in the North Rift Region. This suggests that when a currency crisis occurs, it adversely affects the economic performance of banks in the North Rift region. This is because during periods of currency crises, commercial banks often face challenges related to exchange rate volatility, capital outflows, and increased non-performing loans, all of which can contribute to economic downturns. Further, a weaker currency can make it more expensive for banks to service their foreign currency debt. Additionally, if a currency crisis leads to a broader economic downturn, it can negatively impact loan demand and fee income, further reducing profitability. The findings concurs with the findings of Njagi and Nzai (2022) who determined the effect of the risk associated with exchange rate volatility on the profitability of commercial banks in the East African Community and found that volatility exists as a risk to the profitability of commercial banks in the East African Community. Using the coefficient of variation, the study found that Uganda performed better than Tanzania. As a result, Tanzania and Kenya saw greater

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currency rate volatility than Uganda. Further, the results showed that the volatility influenced commercial banks' performance proxied by ROA for the period between 2000 to 2020. The relationship was however found to be weak and negative.

The third objective was to assess the effect of corporate debt crisis on economic downturns of commercial banks in North Rift Region in Kenya and the study revealed a positive correlation between corporate debt crises and economic downturns in commercial banks. The managers of the commercial banks also indicated that corporate debt crises are a significant threat to the share price performance of commercial banks. This suggests that when corporate entities experience financial distress due to excessive debt burdens, it negatively impacts the banking sector, leading to economic downturns. High levels of corporate debt can strain the financial health of businesses, leading to increased loan defaults, lower asset quality, and reduced profitability for commercial banks, which in turn can contribute to broader economic downturns. The findings are supported by a report written by CBK (2021) which indicated that during a corporate debt crisis, many businesses struggle to repay their loans. This can lead to a significant increase in NPLs for banks that have lent heavily to these corporations. Similarly, the findings are in agreement with Chechet and Olayiwola (2014) on the fact that there is negative effect of debt on return on assets, confirming that debt negatively affects profitability of commercial banks in Kenya. Therefore, other factors other than debt could also affect profitability of commercial Banks.

The final objective of the study was to determine the effect of liquidity crisis on economic downturns of commercial banks in North Rift Region in Kenya. The findings indicated that a negative correlation existed between liquidity crisis and economic downturns. This is supported by the bank managers who indicated that improving liquidity is essential for ensuring low non-performing loans of commercial banks. This revealed that during a liquidity crisis, banks face difficulty accessing funds to meet their short-term obligations. This can lead to a restriction of new loans, hindering economic activity and potentially contributing to an economic downturn in the North Rift region. The findings support the findings of Muriithi and Waweru (2017) who examined the effect of liquidity risk on financial performance of commercial banks in Kenya between 2005 and 2014 for all the 43 registered commercial banks in Kenya. Liquidity risk was measured by liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) while financial performance by return on equity (ROE). The findings indicated that NSFR is negatively associated with bank profitability both in long run and short run while LCR does not significantly influence the financial performance of commercial banks in Kenya both in long run and short run. However, the overall effect was that liquidity risk had a negative effect on financial performance.

Recommendations

i The commercial banks should develop products with flexible interest rates to cater to borrowers during periods of high interest rates. The management should consider offering fixed-rate loans for a limited term to provide some stability to businesses.

ii The policy makers such as the CBK should implement measures to stabilize the national currency and promote foreign investment during crises.

iii The commercial banks should strengthen credit risk assessment processes to evaluate the creditworthiness of corporate borrowers and identify early warning signs of potential debt crises. Further they should monitor debt levels and leverage ratios: Implement monitoring mechanisms to track corporate debt levels and leverage ratios, and take proactive measures to address excessive debt burdens before they escalate into crises.

iv Finally, banks should strengthen liquidity risk management frameworks to accurately assess liquidity needs, diversify funding sources, and maintain access to emergency liquidity facilities.

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