

ABSTRACT

Inflation has been a topical issue since the 1970s oil price instability which resurged in the 2000s with a rate of 3.6% for advanced economies and 10.2% for Africa. In Kenya, labour unrests have mainly been attributed to inflation that has persistently remained above the Central Bank's target of 5%. Studies on the determinants of inflation have reported mixed results, focused on aggregated fiscal, trade and monetary factors and analytical techniques inadequate in providing information on the direction of shock transmission between inflation and the factors. This makes the influence of fiscal, trade and monetary factors on inflation uncertain and inconclusive. This study therefore analyzed the influence of fiscal, trade and monetary factors on inflation in Kenya. The specific objectives included establishing; influence of fiscal factors, influence of trade factors and influence of monetary factors on inflation in Kenya. The study was modeled on the demand pull, cost push and monetary theories of inflation and applied correlation research design. Monthly time series data from Central Bank of Kenya spanning 132 months from 2005 to 2015 was used for analysis. Vector autoregressive techniques of Johansen cointegration, vector error correction, variance decomposition, impulse response and Granger causality were used to analyze the relationship between inflation and its influencing factors in Kenya. Results indicated that total government expenditure and total imports had a significant negative long run influence on inflation where a percentage increase in total government expenditure and total imports decreased inflation by 0.59% and 0.86% respectively. On the other hand, total tax, total exports and total money supply had a significant positive long run influence on inflation that was supported by impulse analysis where a percentage increase in total tax, total exports and total money supply increased inflation by 1.38%, 1.39% and 1.63% respectively. There was unidirectional causality from the fiscal, trade and monetary factors to inflation. The study concluded that fiscal, trade and monetary factors influence inflation in Kenya. However, they are highly influenced by recurrent expenditure, indirect taxes, domestic exports and extended broad money. This adds to literature on the determinants of inflation from the Kenyan perspective. In view of this, the study recommends adoption of diverse policies that encompass fiscal, trade and monetary policies that target reduction in taxation, exports, money supply and increase in government expenditure and imports that are likely to lower production costs and product shortages thus leading to a reduction in inflation in Kenya.