FISCAL DEFICIT ON COST OF CREDIT: DOES IT MATTER? INSIGHTS FROM SELECTED LISTED COMMERCIAL BANKS IN KENYA

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ABSTRACT

The banking sector is an integral player in any economy due to their role in financial intermediation. They collect surplus cash from savers and redistribute to borrowers. However, commercial banks have consistently suffered poor performance arising from high cost of credit. The exorbitant cost of lending has led to an enormous rise in non-performing loans during 2002 to 2023, which adversely impacted banks' profitability. The study primarily aimed at examining the effect of fiscal deficit on lending costs for a subset of Kenyan Nairobi Stocks Exchange (NSE) listed commercial banks. The study was anchored on the Keynesian liquidity preference theory. A census of Kenya's NSE listed twelve commercial banks was the descriptive survey research design's main focus. Using a secondary data collection sheet, the review amassed secondary data from 2007 to 2023 spanning 17 years. Pearson's correlation coefficient, panel multiple regression analysis, and descriptive statistics (mean score, frequencies, standard deviation, minimum, and maximum) analyzed data. Tables were used to display the results. The corrected R-square value demonstrated that fiscal deficit explains a substantial share of fluctuations in borrowing costs. Regression analysis evidenced that fiscal deficit positively and significantly influenced costs of credit. The review therefore concluded that fiscal deficit when properly managed can reduce the cost of credit thus leading to additional borrowing and economic growth. These results yield critical implications for commercial bank managers, policymakers and researchers. The results indicate that prudent fiscal deficit management is necessary to prevent excessive pressure on credit markets.

Keywords: Fiscal Deficit; Cost of Credit, Listed Commercial Banks.

INTRODUCTION

Commercial banks play a pivotal role in economic growth and development by providing the required capital for business and investment. However, they have witnessed a sustained rise in credit cost over time. Zandi et al. (2019) opined that the type and source of credit influences the cost of credit and this affects their uptake by different customers. Credit cost is ascertained by interest rates imposed by banks and other financing entities. When the interest rate charges are high, it can have negative impact to uptake of bank credit facilities and leaves the public vulnerable to unscrupulous and unregulated lending institutions. Isa et al., (2019) revealed that cost of credit is also based on collateral or security requirements made by the lending institution. Some of the accepted collateral items include vehicle logbooks, shares, and title deed for a registered piece of land or completed building.

Osano and Languitone (2016) noted that secured loans are favourably placed when compared to unsecured loans and thus, secured loans are priced lower than unsecured loans. This is associated with the risk of bad debts and likelihood of non-repayment for the unsecured loans.

Cost of credit is also influenced by economic conditions that dictate how much and how little customers pay for accessing different loan and credit facilities. When the exchange rate is high, the cost of credit goes up; and the same effect is felt during high inflation and when there are expansionary economic trends (Ndung'u, 2019). The cost of credit goes down during stagnated economies, recession and low growth and exchange rates; as the economists try to improve economic situation across the country. Towhid, et al. (2019) shared that the strength or weakness in the economy determines the cost of credit and affect borrowers' choice of loan and credit products. The borrowers also consider the principal amount, interest rates and repayment period as factors influencing uptake of credit facilities.

Cost credit pertains to fees levied on a borrower within a lending agreement. This includes many elements such as interest, commissions, fees, taxation, and additional costs imposed by the lender. The lender collects some charges as a requirement, which are determined by the loan amount and duration. Credit cost is sometimes referred to as financing charges (Metawa, 2017). The cost of credit is influenced by both internal and exterior variables. External considerations include legal and macro-economic conditions in which a financial institution functions, as well as the efficiency of the credit market infrastructure, including credit bureaus and other market information sources. Additionally, the cost of debt collection and contract enforcement are also considered. Internal variables include several elements such as the expenses related to personnel, effectiveness and advantages gained from increasing production volume, the makeup of the range of products offered, the characteristics of the consumer base (such as whether they are corporate or individual, or reside in rural or metropolitan areas), the costs associated with collecting debts internally, the scale and expenses of branch networks, and other operational expenditures (Metawa, 2017).

In addition, the Institute for Economic Affairs (2017) states that the cost of credit in an economy is determined by several variables, which encompasses factors such as credit availability and demand, inflation, government T-Bill rates, and the risk associated with specific loan sectors. The cost for providing credit consists of three components: capital, business activities and potential losses costs. The cost of money is the weighted average cost of obtaining financing from both depositors and external creditors. The cost of funds is the amount of interest that a financial institution pays on deposits and borrowings from customers, both wholesale and retail. The cost of operations encompasses all expenditures associated with the actions conducted by banking facilities to distribute their credit products to the market. The cost of operations refers to the aggregate annual operational expenditures incurred by the lending institution. The cost of risk is the loan loss provision that financial institutions allocate so as to mitigate credit risk. Omondi and Jagongo (2018) contend that credit cost is vital in ascertaining one's credit accessibility. The pricing of financial items in any economy may have both beneficial and detrimental impacts on firms.

Despite the deregulation of the financial system, Kenya has continually maintained a significant difference between lending and borrowing rates. Therefore, the financial situation in Kenya highlights the need of addressing the harmful and enduring technical issue of charging excessively high interest rates to borrowers who are barred from the financial system. In Kenya,

the annual effective interest rates vary from 40% for Equity Bank's agriculture input loan to over 140% for NCBA's M-Shwari. Elevated interest rates impede the economic development and advancement of both countries and people.

Over the past five years, the credit market in Kenya has experienced substantial expansion. Commercial banks have expanded net domestic credit at a CAGR of 11.0%, realizing Kshs 3.4 trillion in Q3'2021, up from Kshs 3.1 trillion in Q3'2017. This upward trend can be attributed primarily to increased lending to both the government and private businesses. However, it is crucial to acknowledge that Kenya's private sector credit development has encountered obstacles that have consistently impeded its expansion. Under the interest rates cap, the expansion of credit in the private sector has reached its nadir, increasing by just 3.7%. This growth rate is far below the average of 16.0% observed in the preceding year. In 2020, because to the COVID-19 pandemic, loan growth was limited since most banks were hesitant to lend to clients due to the increased chance of default. The average loan growth of banks was 11.7%, which is slower than the 12.8% growth recorded in FY'2019. Additionally, it is also slower than the 26.3% growth in government securities. This indicates that banks are more inclined to invest in government securities instead of lending due to the higher credit risk caused by the pandemic (Cytonn Report, 2022).

Cost of credit usually depend on the type of facility sought; secured or unsecured (Alumasa & Muathe, 2021). However, there are other costs considered such as appraisal fee, facilitation fees insurance, stamp duty and value added tax. Consequently borrowers, particularly in commercial banks, have continued to pay high costs while accessing credit. Kenya’s Credit uptake growth has systematically increased from 37.7% in 2009 to 28.6% in 2013, 34.2% in 2016, 50.4% in 2019 and 60.8% in 2021, credit growth rate has declined in the recent past from 8.0% in 2020 to 7.8% in 2021 (CBK, 2023). Similar downward trend was observed among mobile loans which declined from 8.3% in 2019 to 2.1% in 2021. However, mobile loans remain the dominant loan facilities in Kenya accounting for 81.4% of borrowers followed by banking institutions at 44.1% and informal groupings such as chamas standing at 28.7% in 2021 (CBK, 2021). These trends may be attributed to detrimental impact of rising credit costs. According to the Kenya Bankers Association (2021) commercial banks in Kenya charge between 11% and 13.63% with variations in total credit costs of credit emanating from other non-interest charges. Personal secured loans are the most expensive loans in Kenya with an average annual interest rate of 14.5%, followed closely by mortgage loans 14.3% and personal unsecured at an average annual interest rate of 13.8%. Bigger banks are associated with high cost if credit. For instance, Absa bank is ranked the most expensive lender with a borrower paying a total credit cost of Kshs 143,007 for a Kshs 1 million personal secured loan payable in one year. Sidian Bank, Ecobank Kenya, Family bank and Standard Chartered Bank Kenya are ranked among the most expensive lenders. The Bank of Baroda has the lowest cost of credit, amounting to Kshs 60,580 for an equivalent amount. Small banks have lower costs because they do not charge some costs such as legal fees, insurance and processing fees.

By close of year 2022, Kenyan financial landscape featured a total of 38 operating commercial banks. Out of the 38 banking institutions, 37 are privately held and 2 are mostly owned by Kenyan Government. It was observed that of the 37 banks that were privately held, 20 were

owned by local entities and 17 were owned by foreign entities. There was a total of 20 institutions in the area, all of which were owned by local individuals or groups. Out of them, 19 were commercial banks and 1 was a home financing firm. Out of the 17 institutions controlled by foreign entities, all of them are categorized as commercial banks. Out of the total, 14 are foreign banks' domestic subsidiaries, whereas 3 others are foreign bank branches. Additionally, the study established that 12 of the banking institutions are listed in Kenya. Out of the 12 institutions, 1 is a mortgage finance company, HF Group Ltd, and another is a foreign bank, BK Group PLC which is based in Rwanda. The other 10 banking institutions are the listed commercial banks in Kenya, which are: ABSA Kenya PLC, Stanbic Holdings Plc, I&M Holdings Ltd, DTM, Kenya Ltd, KCB Group Ltd, NBK Ltd, NCBA Group PLC, Stan Chart Ltd, Equity Group and Co-op Bank of Kenya (NSE, 2023). The study focuses on all the 12 listed Kenyan commercial banks.

Statement of the Problem

Financial institutions have suffered poor performance as indicated by high non-performing loans (Fatica, et al., 2021). The exorbitant cost of lending has resulted in a surge in NPLs over the past twenty years. For instance, non-performing loan rate in Kenya stood at 13.14% in 2021 against the world average of 5.5% based on assessment of 41 countries, showing the magnitude of the problem. Besides, the inflation rate which impacts on cost of credit has been growing consistently such that in 2018 the rate was 4.69%; 2019 it was 5.24%; 2020 it was at 5.4%; 2021 it was 6.11% and rose to 9.1% in 2022. The average interest rate in Kenya averaged 10.5% in 2023 with an average of 12.98% 1991. Thus, it is crucial to evaluate these elements impacts on credit costs by closely monitoring individual performance in past years. This has resulted from high cost of credit, inflation and poor economic conditions. CBK (2023) stated that the main obstacle to credit growth is the high cost of credit. This is particularly evident in larger banks, which charge higher interest rates compared to smaller banks. The higher rates reflect the larger banks strong pricing power, which is based on their extensive distribution network, diverse range of services, and well-established brands. Conversely, smaller banks must engage in competition for consumers by providing comparatively more affordable loans in order to expand their lending portfolio. Additionally, cost of loans in Kenya is influenced by overarching economic indicators such as interest, currency and inflation rates. For example, elevated interest rates greatly restrict the ability to obtain financial resources.

Although there are numerous studies that have been undertaken on cost of credit, the studies have left gaps such as contextual gaps, methodological gaps and conceptual gaps. For example, Asiedu et al. (2022) study was on the factors influencing the demand for credit amongst SMEs in Ghana, Salim et al. (2015) analysed variables that influence bank credit availability in financial institutions of Jordan, Mutune (2018) researched on the uptake of bank credit facilities and the influencing factors while Gikombo and Mbugua (2018) studied several macroeconomic aspects impacts on Kenya NSE listed financial institutions' success. On the other hand, Mehta (2019) researched on macroeconomic variables' effects on financial stability of NSE listed banks. Nyabute (2019) examined the linkage between macroeconomic conditions and Kenyan commercial banks' financial success. Simiyu & Ngile (2015) studied the impact of macroeconomic factors on the sustainability of banking institutions that are traded on the NSE

in Kenya. Despite the fact that there exist numerous studies on the study variables it is noted that there still exist research gaps. Notably, certain reviewed studies concentrated on other variables like profitability, performance and factors affecting cost of credit. Thus, there is a conceptual gap. Besides, the study established that methodological gaps exist since studies used correlational, exploratory and census research framework while the present study employed a descriptive survey, contrasting prior research frameworks. To address these gaps the current research intends to ascertain how fiscal deficit impacts on Kenya's listed commercial banks credit cost.

Objective of the Study

To establish if fiscal deficit affects cost of credit of selected listed commercial banks in Kenya.

LITERATURE REVIEW

The study reviewed theoretical and empirical literature relevant to the study variables.

Theoretical Review

The study was anchored on the Keynesian liquidity preference theory. The Keynesian liquidity preference theory was developed by Keynes in 1936. The theory states that 'the point at which the money supply and demand schedules (the liquidity preference schedule) intersect determines the interest rate (Missaglia & Botta, 2020). The theory posits that the interest rate is established where liquidity preference curve intersects with money supply curve. If the monetary authorities raise the money supply while keeping the liquidity preference curve unchanged, the interest rate would decrease. Conversely, when money supply remains constant but its demand increases, interest rate would also escalate (Rivera, 2021). Liquidity preference, as laid out in macroeconomic theory, is the desire for money as a form of readily available funds. The statement exemplifies interest rate links with desired money that majority populace desires to own (Andabai & Ogiriki, 2021). The liquidity preference hypothesis posits that the interest rate serves as the monetary cost. Requests for money are made out of a need to retain liquidity rather than a desire to borrow money. As a result, an increase in demand puts pressure on interest rate that increases the cost of credit. Consequently, government deficit creates demand for borrowed money to finance the deficit which increases the cost of credit. The theory was therefore used to anchor fiscal deficit and cost of credit.

Empirical Review

Silva (2021) aver that fiscal deficits are a significant factor in determining the overall credit risk faced by banks. They indicate the government capacity to mitigate banks losses under unfavourable economic conditions, either by direct cash injections or through macroeconomic stabilization measures. Declining deficits are linked to escalating financial strain in the banking industry and elevated levels of provisions for loan losses. The impact is particularly noticeable for banks that strongly dislike setting aside insufficient provisions and remains consistent across a range of tests and when identifying fiscal shocks using military expenditure data. This correlation signifies an extra factor of adverse correlation between provisions and economic circumstances, which has consequences for the solidity of the financial system.

Tung (2018) investigated how the budget imbalance affected the growth of Vietnam economy. Quarterly data from 2003–2016 was analysed using the error correction model in the research. A co-integration budget deficit relationship with Vietnamese economic growth is supported by empirical data. Evidence depicts that fiscal deficits slow down economic growth, both temporarily and permanently. The findings also showed that private investments, FDI, net exports, and total economic output might all be adversely affected by fiscal imbalance. While previous studies have looked at how budget deficits affect economic growth, this one focused only on how budget deficits affect interest rates. There is a methodological difference between the two studies since the former used the error correction model while the present research used least squares regression analysis.

In his study spanning 1970–1971, Mohanty (2019) examined India budget deficit and its financing mechanism impacts on private sector investment from 1972–1973, 2011, and 2012–2013. The research used ARDL Models to determine that private investment is negatively affected by fiscal deficit in the short and long run. According to the findings, private investment is severely hurt when the government uses domestic funds to pay the deficit, whereas borrowing money from outside the nation hardly makes a dent. For Indian investors, the ease of obtaining bank loans is more important than interest rates when making short-term investment decisions. Fiscal deficit on financing was the primary emphasis of the prior research, but the present study examined the same topic from the perspective of the cost of credit. Consequently, a gap in understanding exists.

Ubi and Inyang (2018) looked at data from 1980 to 2016 to determine how the budget deficit affected GDP growth in Nigeria. During the 37 years that Nigeria budget was in existence, the country had a deficit 35 times and a surplus only twice. Key development indicators such as GDP, unemployment, inflation, and the balance of payments (BOP) were investigated with reference to budget deficit. A distinct association emerged between budget deficit, GDP growth, and stable balance of payments in Nigeria, as well as a rise in per capita income. This study zeroed exclusively on the cost of credit, while earlier work looked at the budget deficit and how it affected economic growth. Therefore, a conceptual gap exists.

Sirere (2015) studied fiscal deficits correlation with and Kenya's economic expansion while still exploring the precise mechanisms by which fiscal deficits impact expansion and Kenyan economy development. The analysis included both exploratory and causal research approaches and examined time series secondary data covering a period of 38 years (1970-2007). The data was deliberately selected and the estimation was performed using the OLS technique. Evidence uncovered fiscal deficit notable's interplay with economic expansion, which is consistent with the Keynesian perspective. Therefore, it suggests implementing careful financial management and improving revenue collection through the revenue authority to prevent the displacement of private sector investment due to domestic borrowing'. Nevertheless, the research only examined the phenomenon of economic development and did not address the issue of borrowing costs.

RESEARCH METHODOLOGY

Descriptive survey research approach was utilized in this study. Descriptive research seeks to augment the current understanding by providing additional information, filling in knowledge deficiencies, or expanding its range. The research was carried out at Kenyan banking institutions. CBK reports a total of 38 Kenyan commercial banks, with 12 of them being listed on the NSE. The investigation specifically concentrated on the 12 commercial banks that have been listed. A census approach was utilised in the study where the researcher gathered data on every commercial banks. Hence, the study included a sample size of 12 listed commercial banks. The research used secondary data collected from CBK, KNBS and commercial banks' websites. Data collection sheet was used to collate data. When analyzing data, the researchers used STATA software, version 15. Descriptive statistical approaches, such as frequency and mean estimates analyzed the data. Descriptive statistics were preferred because they enable the meaningful explanation of results using minimal indices (Marshall & Rossman, 2014). The findings were displayed utilizing tables and graphs.

Inferential data analysis involved the utilization of correlational and panel regression analysis. Csikszentmihalyi and Larson (2014) highlight utilization of correlational framework to discern links between two distinct variables. To determine strength and direction study variables interactions, the Pearson correlation coefficient was used. Using panel regression analysis, we looked at the correlation between the research variables. To measure macroeconomic factors impacts on Kenyan commercial banks' loan cost, the researcher followed the advice of Darlington and Hayes (2016) and used panel regression analysis. R^2 assisted in determining the model's degree of accuracy. The beta components assessed importance of the variables, while F-Test established of the analytical model's general strength. The significance of the variables was evaluated by analyzing the p-values of each beta factor against the predetermined significance level of 0.05.

RESULTS AND DISCUSSION

This section presents the results of the study including descriptive results, correlation analysis and panel regression analysis.

Descriptive Results

Descriptive statistics were calculated to comprehend broad features of data gathered. A pattern is described using descriptive statistics computations, which are then utilized to expand on the trend for future forecasts and generalizations. Descriptive statistics were applied using dispersion measures, such as standard deviations (SD), and central tendency measures (CT), like mean, mode and median. Table 1 delineates data collection summary statistics.

Table 1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Fiscal Deficit	204	-2.533913	4.274046	-9.991811	4.997129
Cost of Credit	204	14.94444	2.967621	10.02703	19.97962

The government generally runs a deficit, as evidenced by the mean fiscal deficit/surplus of -2.53% of GDP. With 4.27 standard deviation, the fiscal balance appears to fluctuate significantly, from a large deficit of -9.99% to a surplus of 4.99%. This fluctuation is a reflection of shifting economic conditions and fiscal policies over time. Our results are consistent with Tung's (2018) finding of fiscal deficits detrimentally affecting economic growth. Silva (2021) also highlighted that declining fiscal deficits are linked to increasing financial strain in the banking industry, impacting credit risk and costs. These studies highlight how important fiscal policies are in influencing credit costs.

Significant variation in the average cost of borrowing, which is 14.94%, is indicated by a standard deviation of 2.97%. The range of 10.03% to 19.98% shows how credit costs have changed over time due to shifts in the economy, monetary policy, and bank-specific factors. According to Rwigi (2018), base lending rates and inflation positively impact and correlate to borrowing costs. The claim that macroeconomic factors is vital in ascertaining credit prices is supported by the fact that inflation and job prospects are two examples of macroeconomic variables that significantly affect home loan rates (Apergis, 2017).

The trend of the fiscal deficit shows a noticeable improvement over time, as it decreased by 4 percentage points from a low of -4.5% in 2007 to a peak of -0.5% in 2023. The government's coordinated efforts to manage debt and consolidate the budget are reflected in this trend. The results are consistent with Silva's (2021) observation that fiscal deficits affect total credit risk by limiting the amount of liquidity available for private lending. Similarly, excessive budget deficits negatively impacted credit conditions and economic growth, drawing upon Tung (2018). The trend analysis highlights the dynamic character of fiscal policy by displaying notable oscillations, with the average trend line showing periods of both surpluses and deficits. With a mean fiscal deficit/surplus of -2.53% of GDP and a standard deviation of 4.27, descriptive statistics show significant variability that reflects changing policy responses and economic conditions. This fiscal variability can impact interest rates and the availability of credit generally, which can impact the cost of credit. This supports the findings of Silva (2021) and Tung (2018) regarding the critical role that fiscal restraint plays in maintaining affordable credit conditions and ensuring economic stability.

The cost of credit reached its highest point in 2020 at 16.3% and its lowest point in 2012 at 14.5%. The total increase in credit costs between 2007 and 2023 was 0.2 percentage points, suggesting comparatively stable conditions with only slight variations. The idea that macroeconomic stability is essential to preserving reasonable credit rates is supported by empirical research. Bahmani-Oskooee and Gelan (2018) highlighted that exchange rate stability improves credit market efficiency, lowering uncertainty for both lenders and borrowers, while Ubi and Inyang (2018) discovered that inflation and fiscal deficits lead to higher lending rates. These results emphasize how crucial it is to implement coordinated fiscal and monetary policies in order to control credit costs and foster long-term economic growth. Changes in lending rates are reflected in the average trend line of the cost of credit trend analysis, which shows moderate variability over time.

With an average cost of credit of 14.94% and a standard deviation of 2.97%, descriptive statistics imply that monetary policy decisions, bank-specific factors, and economic conditions have all impacted lending rates over time. The observed variations are consistent with research by Rwigi (2018) and Apergis (2017), which established macroeconomic factors of inflation, exchange rates and policy changes majorly influence lending practices and credit costs. These results highlight the necessity of sound economic policies to create stable and easily accessible credit markets, guaranteeing a welcoming lending environment for both individuals and enterprises.

Correlation Analysis

According to Table 2, the review assessed direction and strength of variable's relationship via correlation. Correlation values ranging from ±0.1 to ±0.29 indicate a small relationship, correlation values between ±0.3 and ±0.49 indicate a medium relationship, and correlation values of ±0.5 and above indicate a strong relationship.

Table 2: Correlation Analysis

		Cost of Credit	Fiscal deficit
Cost of Credit	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	204	
Fiscal deficit	Pearson Correlation	.525**	1
	Sig. (2-tailed)	.021	
	N	204	204

**. Correlation is significant at the 0.05 level (1-tailed)

Results credit costs and budget deficit were correlated (r=0.525; P= 0.021). A statistically significant moderate positive connection was revealed. The findings show that interest rates rise in tandem with government spending deficits. Interest rates and credit costs may rise as the government borrows more money to cover its larger budget deficit, which in turn discourages private borrowing. Fiscal deficits have the potential to raise interest rates on loans, as suggested in works by Tung (2018) and Silva (2021), which are consistent with these results.

Panel Multiple Regression Analysis

Panel multiple regression analysis was used to examine how fiscal deficit impact credit costs among selected commercial banks in Kenya. Regression analysis results served as a guide for addressing the study issues. Results about the model's relevance are shown in Table 4.8.

Table 3: Model Significance

Source	SS	df	MS	Number of obs = 204
Model	1057.900937	1	1057.900937	F(1, 202) = 292.785
Residual	729.8740033	202	3.613	Prob > F = 0.0000
Total	1787.77494	203		R-square = 0.592
				Adj R-square = 0.590
				Root MSE = 1.90085

A large portion of the variance in credit costs may model-attributed, as seen in Table 3's multiple regression analysis. The whole model seems to be statistically significant at the 0.05 level, with a p-value of 0.0000 and an F-statistic of 292.785. With 0.590 modified R-squared value, the explanatory variables (budget deficit) explain about 59% of the variation in borrowing costs. According to the research budget deficits substantially impacted lending costs, strongly corroborated by adjusted 0.590 R-square value. Tung (2018) and Silva (2021) emphasise the effect of budget deficits, whereas Bikker and Vervliet (2018) and Iacoviello and Navarro (2019) back up the idea that interest rates are the most important factor in deciding lending prices. These factors are reliable in describing the cost of credit, as reinforced by the model's significance (Prob > F = 0.0076), which confirms both theoretical predictions and empirical evidence from the literature.

To fit the regression equation, the beta coefficients were computed and the findings presented in Table 4.

Table 4: Regression Coefficients

Cost of Credit	Coef.	Std. Err.	t	P>t	[95% Conf.	Interval]
Fiscal Deficit/Surplus	0.464	0.049	9.42	0.000	-0.05069	-0.14342
_cons	1.565	0.262	5.98	0.000	13.07724	18.05347

Based on outcomes depicted in Table 4, the subsequent regression model was constructed;

$$\textit{Cost of Credit} = 1.565 + 0.464\ \textit{Fiscal Deficit}_{it}$$

The constant term (1.565) is statistically significant ($p < 0.01$), indicating credit costs baseline level when all independent variables are zero. It delineates a reference threshold for cost of credit in the absence of variability from inflation, exchange rates, interest rates, and fiscal deficits. fiscal deficit/surplus had a favourable effect on borrowing costs (β=0.464; P=0.000<0.05). When the government runs a bigger budget deficit, it borrows more money, which puts pressure on private lenders and drives up interest rates and the cost of credit. Therefore, the analysis rejected the null hypothesis ($H0_4$) that deficit/surplus does not significantly affect credit costs among a sample of listed Kenyan commercial banks and found that deficit/surplus had a positive and substantial influence. This finding concurs with other

reviews that suggest fiscal deficits might raise interest rates, such as those by Silva (2021) and Tung (2018).

Conclusions

There is a robust positive correlation between cost of credit and fiscal deficits. Similarly, regression results showed that fiscal deficits had a positive influence on cost of credit. Government's increased borrowing results in higher interest rates and a higher cost of credit for private businesses and individuals, which in turn causes larger fiscal deficits. This link makes it abundantly evident that government spending plans impact the entire economy. These results imply that careful financial management is necessary to prevent loan interest rates from skyrocketing and to maintain equitable credit conditions for consumers and businesses.

Recommendations for Policy and Practice

The results of the study highlight how fiscal deficits affect credit costs, showing that larger deficits translate into higher borrowing costs. Prudent fiscal management should be the goal of policymakers like CBK and KBA in order to prevent large deficits that could raise credit costs. This can be accomplished by combining strategies to boost revenue, like tax reforms and increasing the effectiveness of tax collection, with measures to curb public spending to avoid wasteful spending. Furthermore, in order to ensure long-term fiscal sustainability, policymakers should sincerely implement fiscal policies and frameworks that place limits on budget deficits. Governments can foster a favourable borrowing environment, support lower credit costs, and improve overall economic stability by keeping budgets balanced or with moderate deficits. Managers in commercial banks should also endeavour to help the government in maintaining a balanced budget to reduce fiscal deficit or surplus impacts on credit costs. Commercial bank managers should also advice the government on strategies that may be implemented to reduce government fiscal deficit.

Contribution of the Study to the Body of Knowledge

The study closes the conceptual gap left by previous reviews on fiscal deficits impacts on investment and economic growth. The study finds a strong positive correlation between the cost of credit and the fiscal deficit. This contribution is essential to comprehending how private sector credit conditions are impacted by government borrowing practices. A strong methodological approach is ensured by the use of least squares regression analysis, which makes it evident that larger fiscal deficits raise borrowing costs and emphasise the necessity of careful fiscal management.

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