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Effect of Interest Rate on the Performance of Deposit Money Bank in Nigeria

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Abstract: *This study investigated the effect of interest rate on the performance of deposit money banks in Nigeria, using data for the period of 1981-2022.The objective of the study was to: investigate the effect of lending rate, monetary policy rate and interbank rate on the performance of deposit money banks in Nigeria. Ordinary Least Squared (OLS) method of data analysis was adopted because of its Best Linear Unbiased Estimators (BLUE) properties. The data for the variables used was sourced from Central Bank of Nigeria Statistical Bulletin. The variables used were lending rate, monetary policy rate and interbank as the independent variables, while return on equity is the dependent variable. The study adopted the unit root test, co-integration approach, as well as Error Correction Mechanism to analyze the corrected data. E-View software was used for the analysis. The study found that lending rate has no significant effect on performance of deposit bank in Nigeria. Monetary policy rate has significant effect on performance of deposit bank in Nigeria. Interbank rate has significant effect on performance of deposit bank in Nigeria. The study recommends that A floating rate system can help the Central Bank of Nigeria respond to lending rate more effectively and maintain price stability. The*

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Central Bank should closely monitor and adjust monetary policy rates as needed to maintain price stability and support economic growth. The Central Bank can encourage savings and investment by offering stable interbank rate and other financial instruments.

Keywords*:* lending rate, monetary policy, rate, interbank rate, return on asset, interest rate

INTRODUCTION

Nigeria's economic growth is still largely driven by the banking industry, whose performance is mostly dictated by monetary policy decisions, especially those pertaining to benchmark interest rates. More specifically, achieving improved performance and promoting the expansion of the banking sector depend on choosing an appropriate interest rate (Jibrin, Okorie, Okoro, Dada, Chiemeke, & Owolabi, 2015).An organization's performance can be defined as the assessment of its functional components that aims to determine how well a business can use efficiency and effectiveness to reach its desired goals (Okeke, 2021). Organizational managers' methods of measuring and controlling performance translate into improved management evaluation, increased value creation for customers, improved measurement of the organization's knowledge, and the ability to monitor the effectiveness and efficiency of performance metrics (Okeke, 2021; Young-Harry, Oparanma & Ejo-Orusa, 2018). High interest rates make borrowing more expensive, which in turn hinders economic growth, lowers aggregate demand, increases unemployment, and slows down domestic investment. Regarding the available financing and investment options, it presents important questions for policymakers. Conversely, lowering interest rates boosts export competitiveness, corporate confidence, employment, production, investments, and aggregate demand (Precious & Palesa, 2014). The benchmark policy rate set by the monetary authority has a significant impact on the interest rate that banks and other financial institutions charge their clients. Despite this, a mix of explicit and implicit costs influence the fees that banks charge to economic participants. The opportunity cost associated with using the banks' own resources is regarded as the implicit cost, whilst the costs associated with obtaining deposits are regarded as the explicit costs (Olayemi & Michael, 2016).There was no stock exchange, no capital markets, no development banking institutions, and a conspicuous lack of development banking practices (Balogun, 2008). For both the public and private sectors, this tendency resulted in the loss of any effective apparatus for funding industrial growth, which prompted the establishment of the Central Bank of Nigeria (Emecheta & Ibe, 2014).

A key component of a capitalistic society, the interest rate is the cost a borrower pays for using money borrowed from a lender or financial institution, as well as the charge paid on loaned assets (Irungu, 2013). It is typically expressed as a percentage rate over a one-year period (Sayedi, 2013), and the interest rate charged affects both the banks and the consumers involved because their adoption affects them all (Ferrari, Masetti & Ren, 2018).Low interest rates can inflate asset prices, leading to bubbles in housing, stocks or other asset classes, when these

bubbles burst, it can result in financial instability and economic downturns. Often, mal-investment occurs, where resources are allocated to unproductive or inefficient projects because the cost of borrowing is so cheap, and this can result in a misallocation of capital and potentially reduce long term economic growth. Low interest rates can also discourage savings as the returns on savings accounts and conservative investments are minimal. It's not just consumer purchases that interest rates can impact. When interest rates rise it's also more expensive for businesses to borrow money. This often means less growth and lower profit expectations. In theory, this should lower the share price of a company. What this means for the stock market is slower growth or in other words, a drop in the stock market.

Objectives of the Study

The broad objective of the study is toexamine the effect of interest rate on the performance of deposit money bank in Nigeria.The following are the specific objectives:

i. To investigate the effect of lending rate on the performance of deposit money bank in Nigeria
ii. To investigate the effect of monetary policy rate on the performance of deposit money bank in Nigeria
iii. To investigate the effect of interbank rate on the performance of deposit money bank in Nigeria

REVIEW OF RELATED LITERATURE

Conceptual Review

1nterest Rates

According to Kimani (2018), the interest rate is a charge that refers to current demands onresources in comparison to future claims on resources. It is the cost a borrower pays to beable to utilize resources right now. This indicates that the interest rate is the fee that acreditor pays to create present consumption to profit from future resource use. Pricechanges are expected in the actual world, and this expectation is a component of the processthat decides interest rates (Keynes, 2018). According to Maimbo and Gallagos (2014), theuse of interest rate models is majorly motivated by economic and political interestsespecially in many areas facing different money challenges. Financial power and moneycontrol are imperative in maintaining the balance. As a result, the interest rates promotemechanisms of short-term credit among consumers or borrowers in the economy (Miller,2013). Other scholars such as Kiseu (2014) suggested that interest rates indicate the borrowingcosts of capital over a specific period. Because loans are a substantial form of financing formany firms, current interest rates are of great importance to many firms because of interestrate caching in some financing arrangements; interest rates continue to influence a firm forthe entire period that the borrowing structure is exemplary (Keynes, 2018). With effectiveinterest rates, consumers can access credit at various rates, thus

promoting competition in the market (Nganga, 2017). This is why it has been argued that the set rates are vital to thestability of financial markets and work towards a severe reduction in the margin betweenthe level of the money borrowed and the money received from different customers, hencethe interest rate caps are a form of interest rate derivative in which the purchaser collectspayments at the end of any cycle in which the interest rate reaches the negotiated strikeprice (Miller 2013).

Lending Rate

The lending rate is the rate of interest that you have to pay when you are repaying a loan (CBN, 2007). Maximum lending rate refers to the rate charged by Deposit Money Banks for lending to customers with low credit rating. Price Lending Rate refers to the average prevailing lending rate charged by most deposit money banks in Nigeria to some of their more favoured customers. Lending rate is normally differentiated according to the credit worthiness of borrowers and objectives of financing.

Monetary Policy Rate (MPR)

The MPR is a policy interest rate that the monetary authority (CBN) sets in order to influence the evolution of the main monetary variables in the economy e.g. consumer prices, exchange rate, interest rate so as to achieve a desired macroeconomic objective. The CBN introduced the MPR in 2006 to replace the minimum rediscount rate MRR due to the relative ineffectiveness of the MRR (Taylor & Williams, 2008). In Nigeria, the Monetary Policy Committee of the CBN adjusts the MPR as a policy instrument in order to maintain monetary and price stability in a way that encourages macroeconomic stability in the light of experience and reason. The MPR is thus the anchor rate on which banks derive their lending rates. The effectiveness of this instrument has been challenged in the sense that the MPR hardly reflects in the movement of short-run and long-run interest rates in the economy (Efanga, Ihemeje, Yamta, & Biradawa, 2020). The CBN has raised the MPR for the seventh time since April 2022 to 18.75% representing 25 basis points increase from the previous level of 18.50% MPR influences the following variables; cost and availability of credit to deposit money banks, interest rate and economic activity.

Interbank rate

The interbank rate is the rate of interest charged on short-term loans from other banks. Banks may borrow money from other banks to ensure that they have enough liquidity for their immediate needs, or lend money when they have excess cash on hand. The interbank lending system is short-term, typically overnight, and rarely more than a week (Etini, Nwude, and Nwude, 2022). The term interbank rate also refers to the interest rate charged when banks conduct wholesale transactions in foreign currencies with banks in other nations. The interbank market is a market for redistributing the fixed amount of reserves held within the banking system. Banks may face uncertainty regarding their need for liquid assets; the interbank market

enable banks faced with distributional shocks to redistribute liquid assets among themselves (Aziakpono Wilson and Manuel 2017).

Theoretical Framework

Waiting Theory of Interest Rate

This theory of interest is associated with the name of Senior. According to the theory, interest is areward for abstinence. When a person saves money from his income and lends it to somebody else,he in fact makes sacrifice. Sacrifice in the sense that he abstains from consuming the whole of hisincome which he could have easily spent. As abstaining from consumption is disagreeable andpainful, so the lender must be rewarded for this. Thus, according to. Senior, interest is the rewardfor abstinence from the use. This theory is rejected on the ground that saving does not necessarilyinvolve discomfort or sacrifice. A millionaire may save and lend a major part of his income withoutundergoing any hardship or suffering (Idowu, 2005).

Marshall, realizing this flaw in Senior's definition, substituted the term waiting for abstinence. According to Marshall, interest is the reward for waiting. When a man saves a part of his income, he simply postpones his present consumption to some future date. During a period when money isloaned, he himself might stand in need of money. But he cannot get it back from the borrower asthe period of loan is fixed. He has to wait for the return of loan. In order to encourage the spirit ofwaiting amongst the lenders, some inducement is necessary and this inducement according toMarshall is interest.

Empirical Studies

Ogoke and Amadi (2024) examined the effect of Nigerian interest rates on the profitability of quoted commercialbanks using panel from 2014-2023. Timeseries data were sourced from Central Bank of Nigeria Statistical Bulletin while panel data weresourced from Nigeria Exchange Group fact book and financial statement of the quoted commercialbanks. Multiple regressions with econometrics view statistical package were used as data analysistechniques. From model 1, the study found that 48 percent of the variation in return on equity ofthe quoted commercial banks was explained by variation in the interest rate variables in theequation. That maximum lending rate have negative and no significant effect such that a unitincrease led to 0.08 percent decrease in return on equity of the quoted commercial banks, primelending rate and 6months money market rate have positive effect on return on equity of the quotedcommercial banks such that a unit increase in the variables led to 0.27 and 3.3 percent increasein return on equity. 12months and 3 =months negatively affected return on equity of the quotedcommercial banks that reduces return on equity by 1.2 and 2.7 percent. From model 2, theestimated model found that interest rates as formulated in the model explained 78.3 percentvariation in earnings per share of the quoted commercial banks. The independent variables provedthat maximum lending rate have negative and no significant effect such that a unit increase led to0.23 percent

decrease in earnings per share of the quoted commercial banks, prime lending rateand 6months money market rate have positive effect on earnings per share of the quotedcommercial banks such that a unit increase in the variables led to 0.25 and 4.7 percent increasein earnings per share. 12months and 3months negatively affected earnings per share of the quotedcommercial banks that reduces return on equity by 1.5 and 3.9 percent.

Ali- Momoh and Fajuyagbe,(2022) examined a relationship between interest rates and the financial performance of listeddeposit money banks in Nigeria. Specifically, the study investigated how the growth of domestic moneysupply affect financial performance; how the maximum bank lending rate affect financial performance; how the monetary policy rate influences the financial performance of Nigerian deposit money banks; and how therate of inflation affects the financial performance of Nigerian deposit money banks. The study made use ofsecondary data. The study's design comprised both descriptive and ex-post facto analyses. The analysis wascarried out using panel data. The statistical analysis revealed that there are positive and statistically significantrelationships between domestic money supply and financial performance; maximum lending rate has apositive relationship with financial performance; the relationship between the two is statistically significant; monetary policy rate has a positive and statistically significant effect on financial performance; and inflationhas a negative and statistically significant effect on financial performance.

Al-Slehat, (2022) determined the effect of interest rate risk on financial performance through the banking security degree as a mediating variable. The study population includes 13 Jordanian commercial banks from 2011 to2018. To achieve the current study objectives, a descriptive and analytical approach were used. Furthermore, Baron andKenny's test (1986) were adopted to examine the current study hypotheses. The results found that the banking security degree partially affects the relationship between interest rate risk and financial performance. Accordingly, this study providesa set of recommendations. Among them, we encourage policymakers and bank owners, and managers to develop efficientinterest rate risk policies continuously in addition to strengthening the monetary and financial policies of the banking sector. They should strive to achieve a balance between each of the risks of interest rate, performance, and banking security degree.

Ozigbo, (2020) investigated the impact ofinterest rate dynamics on performance of manufacturing- sub sector in Nigeria. Theresearch covers the period between 1980 and 2019.This period is important since it includes the pre-structural adjustment programme (SAP) era where interest rate was not liberalizedand the structural adjustment programme period where interest rate is liberalized. Theco-integration technique with its implied error correction mechanism was used for the study. The result shows that the high interest rate in Nigeria has hindered the performance of themanufacturing sub sector. The GARCH and ARCH results indicates that interest ratedynamics has influenced the performance of the manufacturing sub-

sector. The result alsoconfirms a long run relationship among the variables. It was therefore recommendedamongst others, that there should be a drastic reduction in the interest rate coupled withthe adoption of liberalized interest rate regime with some caution; this will increase theperformance of the manufacturing sub- sector in Nigeria.

Pam,et. al. (2021) evaluated the effect of interest rates onperformance of manufacturing firms in Nigeria,from 1981 to 2018. The objective of the study is toassess the relationship between interest rates andperformance of manufacturing firms in Nigeria for 38 years.Three indicators such as manufacturing sector output,manufacturing capacity utilization and manufacturingvalue added where employed as proxies of manufacturingfirm's performance. The data were analyzed using ordinaryleast square regression (OLS) on manufacturing output andauto regressive distributed lag (ARDL) on manufacturingcapacity utilization and manufacturing value added. A pre-diagnostic test such as unit root test and co-integration testwere carried out on the variables. The co-integration testshowed a relationship between manufacturing sectoroutput and interest rates and no co-integration of interestrates with manufacturing capacity utilization and valueadded. The data analyzed indicated interest rates has noeffect on manufacturing sector output, result also showedthat interest rates has no significant effect on capacityutilization and interest rates has significant impact onmanufacturing value added in Nigeria.

Okeke, Anetoh, Obiezekwem, Anetoh, Okafor, Ebomah, &Ikpo (2020), examined the effect of economic indicators on the performance of small and medium scale enterprise in Nigeria with a particular reference to south-eastern geographical area. The study investigated the effects of inflation rate, interest rate and exchange rate on the performance of small and medium scale enterprises. The research work was anchored on resource-based theory. The study adopted a cross-sectional survey research design. The population of the study was 1560 while the sample size was296. Multiple regression analysis statistical technique was used to test the hypotheses formulated to guide the study. The study found that inflation has a significant negative effect on the performance of SMES in South-East, Nigeria. Interest rate has a significant negative effect on the performance of SMES in South-East, Nigeria. Also, the study discovered that exchange rate has a significant negative effect on the performance of SMES in South-East, Nigeria. The study recommended that there is a need for efficient management of inflation rate in such a way to stimulate the economic growth. Government and policy makers should try more in regulating the interest rates and other credit facilities, making sure that they are accessible and affordable to all SMES in Nigeria. Also, federal government should come up with economic policy and regulatory framework that will maintain fixed exchange rate in Nigeria

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METHODOLOGY

Research Design

The type of research design for this study is Ex-post facto research. This is because the data are already collected, obtaining permission to conduct the study is less involved than enrolling participants, and less time is involved in conducting the study than by creating new data. Kerlinger,. (1986).

Nature and Sources of Data

Data for the study are obtained from secondary sources notably from publications of the Central Bank of Nigeria (CBN), Statistical Bulletin, between 1981 and 2022. The following data were sourced: Return on equity, Lending rate, monetary policy rate and Interbank rate

Model Specification

ROE= f (LDR, MPR, IBR) ---------- (2)

ROE = Return on equity
LDR= Lending rate
MPR=Monetary policy rate
IBR = Interbank rate
F= functional notation.
The above equation can be put in an econometric form as;
$ROE=b_0 + b_1 LDR + b_2 MPR + b_3 IBR + \mu$ ---------- (4)
Where;
β_0 and μ are the constant and error terms respectively while β_1, β_2, ,and $\beta_3$are the coefficients of Return on equity, Lending rate,Monetary policy rate and Interbank raterespectively, μ= error term

Method of Data Analysis

The study will use multiple regression technique to analyse the effect of the variables in each of the six models. The steps involved in the data analyses process are three. It includes the unit root test, test of stationarity of the time series variables and error correction model test.

PRESENTATION AND ANALYSIS OF DATA

Unit Root Test

The first stage of co-integration and Error Correction Model is to test for unit root, the whole analysis then proceed from it. Konya (2004) maintains that there exists unit root in most macroeconomics time series. Therefore, it is necessary to analyze whether the series are

stationary or not whenever time series data are involved. The presence of unit root implies that the time series under investigation is non-stationary, the absence of a unit roots shows that stochastic process is stationary. The augmented Dickey-Fuller (ADF) test would be employed in this test

Tables 4.1 Unit Root Result

Variable	ADF	Integration	Significance
ROE	-9.268304	I (1)	1%
LDR	-6.547556	I (1)	1%
MPR	-8.933550	1 (1)	1%
IBR	-7.144776	I (1)	1%

Source: Author's computation using e-view version 10

Following the result of ADF test above it is observed that none of the variables are stationary at level, but the entire variables become stationary at 1st difference.

Co-integration analysis

The aim of co-integration analysis is to determine the long-run equilibrium relationship between the variables. Co-integration exists among the variables if they are integrated of the same order. The implication of this analysis is that deviation or drift may occur between the variables but this is temporary as equilibrium hold in the long run for them. In this study we used the Johansen co integration approach to examine the existence of long-run relationship between the variables of interest. Below is the summary of co integration results

Table 4.2 co-integration result test
Unrestricted Co-Integration Rank Test (Trace)

Hypothesized No of CE(s)	**Trace static**	**0.05 critical value**	**Eigen value**	**0.05 critical value**
None *	69.08855	63.87610	36.97487	32.11832
At most 1*	32.11367	42.91525	15.63714	25.82321
At most 2*	16.47654	25.87211	12.31549	19.38704
At most 3*	4.161046	12.51798	4.161046	12.51798
At most 4*	69.08855	63.87610	36.97487	32.11832

Source: Author's computation using e-view version 10

Trace test indicates 1 co-integrating equ(s) as the 0.05 level* denotes rejection of the hypothesis at the 0.05 level ** Mackinnon-Haug-Michelis (1999) p–value. This suggests a long run equilibrium relationship among the variables. Co-integration is a pre-requisite for error correction mechanism following the result of co-integration, there is a long-run equilibrium relationship among the variables, hence, we can move over to error correction mechanism.

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Presentation of Regression Result

Table 4.3 Error Correction Model Result

Dependent Variable: ROE
Method: Least Squares
Date: 12/14/24 Time: 09:42
Sample (adjusted): 1982 2022
Included observations: 41 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.757797	0.331024	2.289252	0.0280
LDR	-0.013450	0.019835	-0.678095	0.5020
MPR	0.129866	0.033246	3.906194	0.0004
IBR	-0.078490	0.017867	-4.392888	0.0001
ECM(-1)	-0.356046	0.162202	-2.195081	0.0347

R-squared	0.563101	Mean dependent var	0.771220
Adjusted R-squared	0.514557	S.D. dependent var	0.696323
S.E. of regression	0.485155	Akaike info criterion	1.505151
Sum squared resid	8.473499	Schwarz criterion	1.714123
Log likelihood	25.85560	Hannan-Quinn criter.	1.581247
F-statistic	11.59972	Durbin-Watson stat	2.011257
Prob(F-statistic)	0.000004		

Source: Author's computation using e-view version 10

Interpretation of the Regression Result

The value of the R-square and the adjusted R-square in table 4.3 show that the explanatory variables are robust in explaining variation in the dependent variables return on equity, given their values as 0.563101 and 0.514557 respectively.

The F-statistics measures the overall significance of the explanatory parameter. From the result report in table 4.3 above, our computed value of f-statistics is11.59972, while its probability is 0.0004, given this value we reject the null hypothesis and accept the alternative hypothesis which state that there is a significant relationship between the variance of estimated regression model.

A' priori criteria was used to determine the existing economic theories and indicates the sign of the economic parameter under consideration. From the estimated regression model it was obtained from the coefficient Column that lending rate and interbank rate conform to a'priori expectation while monetary policy rate did not have expected negative sign. This further suggests that decrease in lending rate and interbank rate variables increase the return on

equity while an increase in monetary policy rate would lead to aincrease in return on equity all at a given percentage respectively.

T-statistics, this is the measure used to determine the individual statistical significance of the variables in the model. From the model it was obtained that the lending rate has no significant effect on return on equity. However, the monetary policies contribute significantly to return on equity in deposit money bank at 5% level of significant. Interbank rate has a negative significant effect on return on equity in deposit money bank at 5% level of significant

The Durbin-Watson statistics is used to test for the presence or otherwise of autocorrelation in our model. When the value of Durbin-Watson is closer or a little bit above 2, it means the absence of autocorrelation amongst the explanatory parameter (Koutsoyannis 1997) from the table 4.3 above, it was obtained that our Durbin-Watson result is (2), this satisfy the above stated condition. This means the absence of autocorrelation among the explanatory variables. The error correction model term ECM (-1) of about -0.35% is significant with the expected negative sign. A significant error term with the right sign indicates strong feedback effect of deviation of return on equity from its long-run growth path. The coefficient of the error term is -0.356046 this shows that about 35% of the discrepancies between the actual and the equilibrium value of the return on equity is corrected in each period (annually)

Hypothesis Testing

The researcher in this study formulated hypotheses and this has to be verifying in order to find out the validity of otherwise of such proposition. The research hypothesis is based on relevant statistics from the regression result. We use the null hypothesis for this analysis

Hypothesis One

Ho: Lending rate hasno significant effect on performance of deposit bank in Nigeria

From the regression result we discovered that in the t-statistics for lending rate is -0.678095 while its probability is 0.5020. Since its probability is greater than 0.05 desired level of significance, we reject the alternative hypothesis and accept the null hypothesis, we therefore conclude in favor of null hypothesis which states that lending rate has no significant effect on performance of deposit bank in Nigeria

Hypothesis Two

Ho: Monetary policy rate has no significant effect on performance of deposit bank in Nigeria

From the regression result we discovered that in the t-statistics for monetary policy rateis 3.906194 while its probability is 0.0004 Since its probability is less than 0.05 desired level of significance, we reject the null hypothesis and accept the alternative hypothesis, we therefore

conclude in favour of alternative hypothesis which states that monetary policy rate has significant effect on performance of deposit bank in Nigeria

Hypothesis Three

Ho: interbank rate has no significant effect on performance of deposit bank in Nigeria

From the regression result we discovered that in the t-statistics for interbank rate is -4.392888 is while its probability is 0.0001 Since its probability is less than 0.05 desired level of significance, we reject the null hypothesis and accept the alternative hypothesis, we therefore conclude in favor of alternative hypothesis which states that interbank rate has significant effect on performance of deposit bank in Nigeria

CONCLUSION AND RECOMMENDATIONS

Conclusion

Interest rates in Nigeria are a complex and important aspect of the country's economy, affecting a wide range of sectors and stakeholders. The impact of interest rates is far-reaching, affecting everything from consumer spending and borrowing to corporate investment and government policy. The Central Bank of Nigeria plays a critical role in managing interest rates, seeking to balance the needs of different groups and sectors while promoting economic growth and stability. Overall, interest rates in Nigeria will continue to be an important topic for policymakers, businesses, and individuals alike, as they shape the direction of the economy and the financial wellbeing of the country. In conclusion, interest rates have a significant impact on the performance of banks in Nigeria. Low interest rates can encourage lending and economic growth, but can also lead to decreased profitability for banks. On the other hand, high interest rates can increase profitability for banks, but may discourage borrowing and investment.The Central Bank of Nigeria plays a critical role in setting and managing interest rates, as well as overseeing the performance of banks in the country. It is important for the Central Bank to strike a balance between promoting economic growth and maintaining financial stability, while also ensuring that banks are operating safely and effectively. The study recommend that A floating rate system can help the Central Bank of Nigeria respond to lending rate more effectively and maintain price stability. The Central Bank should closely monitor and adjust monetary policy rates as needed to maintain price stability and support economic growth. The Central Bank can encourage savings and investment by offering stable interbank rate and other financial instruments.

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