Interest Rate and Bank Performance: Evidence from Sri Lanka

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Banking sector in any country plays an important economic role as the provider of financial intermediary role for the borrowers and lenders. It is evident in the empirical literature that effect of interest on profitability of banking industry shows mixed results. Banks profitability is identified through its ability to enhance the deposits from the savers. Higher the deposit greater the profitability as it is able to collect at lower rate of interest and lend at higher rate of interest. The purpose of this study is to examine the effect of interest rate on performance of banking industry in Sri Lanka. The study conducted to check and examine the effect of deposit interest rate and lending interest rate on banks' performance of licensed commercial banks in Sri Lanka. Lending interest rate and deposit interest rate were considered during the period over 2007 to 2018. Size of the bank, capital, liquidity, credit risk and operational efficiency were used as control variables. To analyse interest rate fluctuation and performance of bank industry in Sri Lanka, 11 licensed commercial banks in Sri Lanka were selected as the sample. Return on Assets (ROA) and Return on Equity (ROE) were taken as performance measurements of the banks. Regression analysis used to analyze data and the results show that there is a negative significant relationship between lending interest rates and financial performance of commercial banks in Sri Lanka. It is also found that there is a negative significant relationship between deposit interest rates and financial performance of commercial banks in Sri Lanka. Therefore the banks should prudently manage their interest rates to improve their financial performance.

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