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The Effect of Interest Rate Changes on the Performance of the Loan Portfolio: A Case Study of Stanbic Bank Uganda Limited

Interest rate changes have been in existence since time immemorial, however, in recent times there has been increased volatility in interest rate changes especially the period from July, 2011 to date. It has also been noted that in recent times, banks have experienced increase in loan defaults as well as stated by (Hoque 2004, World Bank 1993 and Calomiris and Himmelberg, 1993). There has been hardly any bank or Development Financial Institution (DFI) in developing countries which has not experienced persistent loan default. This is evidenced by the under-capitalisation and illiquidity of 160 DFIs in 33 developing countries. The loanable funds theory (Black and David, 1998), Classical theory of interest rates, and the liquidity preference theory of interest rates (Keynes, 1936)-all the three theories agree that interest rates are as a result of forces of demand and supply. This study aimed at establishing the effect of interest rate changes on the performance of the loan portfolio taking a case study of Stanbic Bank Uganda Limit. The objectives of the study were used as a guide to the study and the research questions and conceptual framework was developed to answer the research objectives and research questions. The review of existing literature on the subject was done and a case study research design was used to carry out the research. Questionnaires were developed and used to collect data from 57 respondents out of a population of 72 staff of the credit department. The research established that inflation, high demand for funds, costs of operation, profit motive, and the monetary policy are all determinants of interest rate changes. It was also established that interest rate changes are a major determinant of loan demand and loan repayment. It was further established that there is a strong positive relationship between inflation, interest rates, demand for loans and loan repayments. It was concluded that interest rate changes have a very big effect on the performance of a loan portfolio, both positively and negatively. It was recommended that, therefore, there is need to invest into research to find a solution on how to deal with volatility of interest rates.

Key words: Interest, Portfolio, Rate, Loan, Performance, Bank