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# INTEREST RATES AND LOAN REPAYMENT PERFORMANCE IN DEPOSIT MONEY BANKS IN NIGERIA

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**Abstract**
The study investigated the relationship between interest rates and loan repayment performance in deposit money banks (DMBs) in Nigeria from 2004 to 2023. The specific objectives were to find out whether interest rate (INTR), inflation rate (INFLR), loan duration (LDUR) and gross domestic products (GDP) significantly affected loan repayment performance (LRP) in DMBs in Nigeria overtime. The fully modified least squares (FMOLS) technique was utilised for data analysis and the results obtained revealed that, interest rate (INTR) and loan duration (LDUR) exert a weak positive relationship with loan repayment performance (LRP) of DMBs in Nigeria while inflation rate (INFLR) and gross domestic products (GDP) have a significant negative effect on loan repayment performance in DMBs in Nigeria. The study recommends among others that, the significant negative impact of inflation rate on loan repayment performance in DMBs suggests that monetary authority (CBN) should up their regulatory and monetary oversight in the management of inflation rate in the country. They must ensure that the right policy that will minimize the continuous rise in general price level. Inflation targeting measure should be proactively deployed to stabilize inflation level in the country as this will enable customers and indeed borrowers to be able repay any amount of money borrowed to do business from DMBs in Nigeria.

**Keywords:** Loan Repayment, Interest Rate, Inflation, Gross Domestic Product, Loan Duration

**JEL Classification**: E31, E43, E58, G21.

## Introduction

The relationship between interest rates and loan repayment in Nigeria's banking industry has attracted a lot of attention from financial experts, banking institutions, and policymakers in recent years. Due to its direct impact on loan affordability and borrower's repayment capacity,

interest rates are crucial factor in Deposit Money Banks' (DMBs') operations (Ebinum & Ehiedu, 2025). DMBs are essential to Nigeria's financial system since they serve as intermediaries mobilizing savings and extending loans to both individuals and firms. The Nigeria's financial system has experienced a number of interest rate policy adjustments, mostly as a result of economic reforms meant to stabilize the economy and encourage profitable investments. One essential strategy for curtailing inflation and stabilizing the value of the naira is the implementation of the monetary policy rate (MPR) by the Central Bank of Nigeria (CBN) which in turn influences lending rates throughout the banking industry (Awopegba, Afolabi, Adeoye, & Akpokodje, 2022). In response to growing inflation, which peaked at 23.71% in April 2025, the CBN set the MPR at 27.50% in February 2025 and kept it at 27.50% by May 2025 (CBN, 2025a, 2025b). Because rising interest rates translate into higher borrowing costs, this circumstance poses difficulties for borrowers. High and volatile interest rates often make it difficult to repay loans, which raise the proportion of non-performing loans (NPLs) and has an effect on financial institutions' general health. According to the World Bank (2024), Nigerian banks' non-performing loans (NPLs) rose by 0.06% to 5.1% of total loans in the first quarter of 2024 compared to the first quarter of 2023, which is slightly higher than the prudential benchmark of 5.00% that is deemed acceptable. This marginal increase is explained by the fact that, in an economy where inflation exceeds income growth, the cost of loan servicing increases when interest rates rise, placing a burden on borrowers' ability to repay their debts.

The DMBs base their lending rates on the Central Bank Interest Rate (CBIR), also referred to as the Monetary Policy Rate (MPR), which has a direct impact on borrowers' repayment commitments (CBN, 2017). The average maximum lending rate in Nigeria's banking industry, for instance, increased from 27.07% in January 2024 to 29.79% in January 2025. This is inspite of the CBN maintaining its MPR at 27.50% (CBN, 2025b). Furthermore, the ability of borrowers to fulfill their repayment commitments is greatly impacted by other macroeconomic factors including inflation rates and economic growth. Increased default rates can result from rising inflation, especially for businesses and people, as it reduces the real value of repayments (Lekupanai & Makori, 2024). Nigeria's headline inflation rate, for example, dropped from 24.23% in March 2025 to 23.71% in April 2025, as stated by the National Bureau of Statistics (NBS). The headline inflation rate for April 2025 was 0.52% lower than the headline inflation rate for March 2025, based on an analysis of the movement. The headline inflation rate was 9.99% lower on an annual basis (33.69%) than it was in April 2024 (NBS, 2025a). However, borrowers face serious difficulties as a result of these swings. Rates of economic growth have also fluctuated. When comparing the fourth quarter of 2024 to the same period the year before, Nigeria's GDP grew by 3.84% in real terms. This growth rate is higher than the 3.46% growth rates recorded in 2024's third and 2023's fourth quarters. In the first quarter of 2024, Nigeria's real GDP at basic prices grew by 2.98% year over year, a higher growth rate than the same quarter in 2023, when it increased by 2.31%. Q2 2024 growth remained positive at 3.19% compared to Q2 2023 growth of 2.51% (NBS, 2025b). Furthermore, the duration of loans might make repayment plans more difficult; longer-term loans usually have higher interest rates since lenders are taking on more risk, which can put further burden on borrowers' ability to repay (Ssekiziyivu, Bananuka, Nabeta, & Tumwebaze, 2018).

While many studies (including Olowofeso, Oyedele & Ayedun, 2024; Ademola & Adegoke, 2021; Ogundipe, Akintola, & Olaoye, 2020) have examined the individual effects of variables like interest rates, inflation, loan duration and economic growth on loan repayment performance, the majority have taken a fragmented approach by concentrating on each variable separately. For example, some research looked at the effect of interest rates on loan defaults,

while others concentrated on the role of loan tenure or inflation. But these factors are frequently linked together and can affect borrowers' ability to repay loans as a whole. Furthermore, the majority of current research uses single-method econometric models, ignoring multidimensional techniques that reflect how these elements interact dynamically over time. The peculiarities of Nigeria's economic climate, which include high lending rates, erratic growth, and fluctuating inflation rates, have also received little attention. Understanding loan repayment patterns in Nigerian DMBs is made more difficult by these circumstances. In order to close these gaps, this study combines interest rates, inflation, loan duration and economic growth into a single model and examines their combined effect on loan repayment performance.

In order to better understand how interest rates, along with inflation, loan duration, and economic growth affect loan repayment and contribute to the prevalence of non-performing loans, this study seeks to examine the relationship between interest rates and loan repayment performance in Nigerian DMBS. It takes a comprehensive and industry-specific approach, using cutting-edge econometric methods and current data to offer insightful analysis of the Nigerian banking industry. This study will shed light on the precise mechanisms via which interest rate variability impacts loan repayment by analyzing how these variables interact. The results will help develop targeted policies that improve repayment capacities and reduce default risks, supporting the stability of the financial sector and the overall economy. They will also help us gain a more thorough understanding of the factors influencing loan repayment outcomes in Nigeria.

## Literature Review

**Conceptual Review:** The interest rate, stated as a percentage of the principal amount, is the cost of borrowing or the benefit of saving. Interest rates have a direct influence on the lending environment of DMBs in Nigeria and are a key factor in determining the affordability of loans. Nonetheless, the Monetary Policy Rate (MPR), which is the standard by which all financial institutions determine lending and deposit rates, is used by the Central Bank of Nigeria (CBN) to control interest rates. Based on macroeconomic variables like inflation, exchange rates, and GDP growth, the MPR is reviewed on a regular basis (CBN, 2023). Lending rate changes brought about by variations in the MPR have a substantial impact on people's and enterprises' capacity to obtain credit and fulfill repayment commitments (CBN, 2025a). For borrowers, high interest rates have significant implications, especially in developing nations like Nigeria. They make borrowing more expensive, which limits people's access to credit, especially for low-income earners and businesses. Moreover, the danger of loan default is increased by high interest rates. When the cost of loan servicing exceeds income growth or company performance, borrowers may find it difficult to fulfill their repayment commitments. The real cost of borrowing increases during unstable economic conditions, such as severe inflation or currency depreciation, making this problem even more difficult (World Bank, 2024). Conversely, lower interest rates promote borrowing by lowering the cost of credit, which may stimulate the economy. But if borrowers take on more debt than they can afford to pay back, they may also result in excessive borrowing and a rise in non-performing loans (NPLs) (World Bank, 2024). Therefore, monetary authorities must strike a delicate balance while managing interest rates in order to promote economic growth and preserve financial stability. In summary, one of the primary factors influencing loan affordability and payback performance is interest rates. Their regulation by CBN through the MPR has a big impact on the Nigerian banking industry and how lenders and borrowers interact.

Therefore, it is essential to comprehend the complexities of interest rates in order to evaluate how they affect loan repayment in DMBs.

**Theoretical Framework**

The essence of this section is to highlight the theoretical relationship between interest rates and loan repayment in DMBs. A number of financial and economic theories describe how interest rates affect borrowing and repayment patterns. This section provides a theoretical foundation for the study by analyzing the loanable funds theory, credit rationing theory and liquidity preference theory.

**Loanable Funds Theory**

Bertil, Robertson, and Hawtrey (1937) developed the Loanable Funds Theory. According to this theory, the relationship between supply of savings and the demand for loans determines interest rates. By mobilizing savings from surplus units and distributing them as loans to deficit units, banks serve as intermediaries. Interest rates are adjusted to balance the demand for credit and the supply of savings. The theory is applicable to the Nigerian banking industry since it clarifies the dynamic interplay among interest rates, credit availability, and repayment performance. Borrowing costs are raised by high interest rates, which are frequently caused by strict monetary policies or inflationary pressures. This makes it difficult for people and companies to repay their loans, especially those in sensitive industries.

**Credit Rationing Theory**

According to the Credit Rationing Theory, which was first proposed by Stiglitz and Weiss (1981), banks frequently limit the amount of credit that borrowers can obtain instead of increasing interest rates in order to control credit risk. Adverse selection, which occurs when higher interest rates draw riskier borrowers, is the reason of this behaviour. Because they are more prone to default, risky borrowers are more likely to have non-performing loans. By enforcing more stringent lending standards or restricting the quantity dispensed, even to creditworthy customers, banks may choose to ration credit in order to reduce this risk (Stiglitz & Weiss, 1981). This idea sheds light on why getting credit is still so difficult in Nigeria, particularly for low-income individuals and businesses. Nigerian banks frequently restrict lending by imposing hefty fees, limiting loan amounts, or requesting substantial collateral. Because borrowers who obtain expensive loans find it difficult to repay them, this practice not only limits access to finance but also has an impact on loan repayment capacity.

**Liquidity Preference Theory**

Keynes (1936) developed the Liquidity Preference Theory, which holds that the demand and supply of money affect interest rates. Cash and other liquid assets are preferred by both individuals and businesses for speculative, transactional, and precautionary reasons. Interest rates rise when there is a greater desire for liquidity since there is less money available for lending. Consequently, this impacts loan repayment by increasing the cost of borrowing (Keynes, 1936). This hypothesis is especially pertinent to the explanation of how Nigerian credit markets are impacted by monetary policy. For example, people and firms may hoard cash during uncertain or inflationary times, which lowers the amount of loanable capital available. Interest rates increase as a result, raising the cost of lending and making repayment more difficult.

**Empirical Literature**

Several studies have been carried out to explore the link between interest rates and loan repayment performance of banks globally. Sangwa, Rasheed, and Bakar (2022) examined the effect of interest rates on loan repayment in 29 microfinance banks in Kuala Lumpur area of Malaysia. Descriptive and inferential statistics were employed to analyze secondary data. The results of correlation and regression show that interest rates are negatively and significantly connected with loan repayment. Changes in interest rates have a significant effect on loan repayment; if banks charge higher interest rates, the repayment will be lower, but some loans do not perform as expected because of low repayment rates, which results in non-performing loans. Ademola and Adegoke (2021) investigated the socio-economic factors affecting loan repayment rate among microfinance banks in South-West Nigeria. Twenty (20) credit officers and one hundred and twenty four (124) respondents were chosen using the purposive sample technique. Regression analysis and descriptive statistics were utilised to analyze primary data. The findings indicated that the respondents' average monthly income, age, and educational attainment all had a substantial effect on the loan repayment rate. Despite being positive, the household type and gender factors had no discernible impact on the loan payback rate. Additionally, the results showed that loan repayment performance is significantly impacted by loan amount, interest rates, repayment style, and time.

Negatu (2021) investigated how interest rates affected credit and loan repayment in Ethiopian credit cooperative unions. One hundred (100) cooperative members were chosen using simple random sampling procedure, and descriptive, quantitative, and qualitative techniques were utilised to analyze the data. The percentage of defaulters falls from the younger group to the older group, according to the results. Additionally, illiterates made up a larger share of the defaulting category, but non-defaulters' numbers rose as their educational attainment increased. The results also shows a substantial correlation between the dependent variables and all business types, education level, loan amount, loan diversion, training, time intervals from loan application to disbursement, and payback period. Additionally, the researchers discovered that defaulters differed significantly in terms of age, family size, number of dependents, company experience, recurrent borrowing, and supervision.

Ogundipe, Akintola and Olaoye (2020) examined the relationship between interest rates and loan repayment in Nigeria using data from three banks (United Bank for Africa, First Bank of Nigeria and Guaranty Trust Bank) and the Central Bank of Nigeria (CBN) statistical database. Descriptive, correlation and regression analyses were used to evaluate the data. From the results, interest rate and loan repayment, as determined by credit quality (non-performing loan ratio), are significantly correlated. This suggests that a rise in interest rates will probably result in a comparable rise or fall in the credit quality. It also demonstrated that non-performing loans will rise in response to even a little adjustment in the lending rate.

Wafula (2017) examined the relationship between interest rate, corporate membership and loan repayment in micro-financial institutions in Nakuru County of Kenya. Primary data was analysed utilizing correlation and multiple regression models. The study's outcomes indicate that interest rates did not influence loan repayment in Nakuru County's micro-financial institutions, leading to the conclusion that interest rates have no bearing on loan repayment. Additionally, the study discovered that corporate membership had no discernible impact on loan repayment in Nakuru County's microfinance institutions.

## Methodology

**Data:** This study focuses on the connection between interest rate and loan repayment performance in DMBs in Nigeria. The population of this study comprises the fourteen (14) DMBs listed on the Nigerian Exchange Limited (NGX) as at December 2023. The study employed a census sampling technique**,** selecting all fourteen (14) listed DMBs as the sample. This method is appropriate because these banks are regulated by the CBN and are required to publish financial reports, ensuring data availability and reliability. The selection of the DMBs is justified by their significant representation of the Nigerian banking sector in terms of asset size, market share, and financial activities. These banks account for a significant part of the loans granted within the economy, making them a critical subset for understanding the dynamics of loan repayment performance in response to interest rate changes. Additionally, this manageable sample size allows for in-depth analysis while maintaining the reliability and generalizability of the findings. The dataset spans 2004 to 2023, a twenty-year timeframe, giving room for a thorough analysis of trends and patterns in loan repayment performance against the backdrop of fluctuating interest rates. This period is particularly significant, as it reflects various economic conditions and interest rate policies that have impacted the banking sector. The data was extracted from the annual financial reports of the selected DMBs, Central Bank of Nigeria (CBN) Statistical Bulletin, National Bureau of Statistics (NBS) reports, and the World Bank.

### Model Specification

To analyze the impact of interest rates and other macroeconomic variables on loan repayment performance, the study adopts the following regression model. The functional form of the model is specified as:

$LRP=f(INTR,INFLR,LDUR,GDP)$.....(1)

The econometric form of the model is specified as:

$LRP_t=\beta_0+\beta_1 INTR_t+\beta_2 INFLR_t+\beta_3 LDUR_t+\beta_4 GDP_t+\epsilon_t$.....(2)

Where: $LRP_t$ = Loan Repayment Performance (measured by Non-Performing Loans (NPL) ratio); $INTR_t$ = Interest Rate (CBN benchmark rate and average lending rate); $INFLR_t$ = Inflation Rate (annual percentage change in CPI); $LDUR_t$ = Loan Duration (average tenure of loans issued by DMBs); $GDP_t$ = Economic Growth Rate (measured by annual GDP growth rate); $\beta_o$ = Intercept; $\beta_1$ - $\beta_4$ = Regression coefficients; $\varepsilon_t$ = Error term

The a priori expectation is: $\beta_1, \beta_3, \beta_4>0; \beta 2<0$

### Estimation Procedure

This study used the Fully Modified Ordinary Least Squares (FMOLS) technique. The unit root test was employed to evaluate the stationarity properties of the data in order to prevent spurious regression outcomes while cointegration test is used to ascertain whether there is a long-term relationship amongst the variables. We utilize the fully modified ordinary least squares (FMOLS) estimator, which is typically chosen over the OLS estimate due to its ability to handle endogeneity and small sample bias by using the leads and lags of the first-differenced regressors. Additionally, the FMOLS requires that the regressors themselves not be cointegrated and that all variables be integrated of the same order [i.e., I(1)].

## Results and Discussion

**Unit Root Analysis:** The unit roots are examined using the Augmented Dickey Fuller (ADF) test. Table 1 displays the results in terms of levels and first difference. Each variable's ADF test statistic is displayed in the second and fifth columns of the result, while the third and sixth columns, respectively, display the 95 percent critical ADF value. The result shows that all the variables are not stationary at levels, except INTR that was stationary. Nonetheless, after the first difference was taken, all the variables were now stationary. This suggests that the variables achieve stationarity after their first differences, indicating that they are in fact difference-stationary. Therefore, the hypothesis that the variables have unit roots would be accepted. In fact, the variables are integrated of order one (i.e., I[1]).

**Table 1: Unit Root Tests**

| Variables | At Levels | | | At First Difference | | |
|---|---|---|---|---|---|---|
| | ADF Test Statistic | 95% Critical ADF Value | Remark | ADF Test Statistic | 95% Critical ADF Value | Remark |
| LRP | -3. 022734 | -3. 459970 | Non-Stationary | -7.988271 | -3.052169 | Stationary |
| INTR | -5.233114 | -3.040391 | Stationary | -3.338778 | -3.052169 | Stationary |
| INFLR | -1.239817 | -3.02997 | Non-Stationary | -3.667638 | -3.040391 | Stationary |
| LDUR | 0.937817 | -3.02997 | Non-stationary | -4.24057 | -3.040391 | Stationary |
| GDP | -2.461832 | -3.02997 | Non-Stationary | -4.639605 | -3.052169 | Stationary |

**Source: Authors' Computation (2025)**

### Cointegration Test

We used the Johansen Cointegration Test to check for cointegration. The two primary test statistics that form the basis of the panel test are the eigenvalue test (λ-max) and the trace test statistics. There are around six (6) significant cointegrating vectors of interest rate and loan repayment performance of DMBs in Nigeria based on the trace test statistics, as shown in Table 2. This suggests that the variables have a long-term relationship. Therefore, Table 2 below provides a summary of the results of the cointegration test.

**Table 2: Johansen Cointegration Tests Results**

| | Trace Test | | | Maximum Eigenvalue Test | | |
|---|---|---|---|---|---|---|
| Null Hypothesis | Statistic | 0.05 Critical Value | Prob. Value | Statistic | 0.05 Critical Value | Prob. Value |
| r = 0* | 151.3342 | 69.81889 | 0.0000* | 72.33128 | 33.87687 | 0.0000* |
| r ≤ 1 | 79.00295 | 47.85613 | 0.0000* | 39.71953 | 27.58434 | 0.0009* |
| r ≤ 2 | 39.28342 | 29.79707 | 0.0030* | 28.59653 | 21.13162 | 0.0037* |
| r ≤ 3 | 10.68689 | 15.49471 | 0.2315 | 10.18762 | 14.26460 | 0.1999 |
| r ≤ 4 | 0.499276 | 3.841466 | 0.4798 | 0.499276 | 3.841466 | 0.4798 |

**Source: Authors' Compilations (2025).**

**The Fully Modified Ordinary Least Squares (FMOLS) Estimates**

Table 3 below shows the results of the fully modified ordinary least squares (FMOLS) estimation of the relationship between interest rates and DMBs loan repayment performance in Nigeria. The R squared value of 0.5 indicates that the model has demonstrated a good predictive ability. This indicates that changes in the explanatory variables account for more than half of the systematic fluctuations in loan repayment in DMBs. The model's R-squared value of 0.5 suggests that it has good predictive ability, and its adjusted R-squared value of 0.25 percent is modest.

**Table 3: Interest Rates and Loan Repayment Performance in DMBs in Nigeria (FMOLS)**

| Variables | Coefficient | T-Ratio | Prob. |
|---|---|---|---|
| INTR | 0.56886 | 1.6188 | 0.1314 |
| INFLR | -1.2132 | -2.5200 | 0.0269* |
| LDUR | 0.0006 | 0.6823 | 0.5080 |
| GDP | -1.3200 | -4.6197 | 0.0006** |
| C | 42.6903 | 4.1840 | 0.0013** |
| @TREND | 4.9206 | 2.6959 | 0.0195 |
| @TREND^2 | -0.2364 | -2.8632 | 0.0143 |
| $R^2$ = 0.50 $\bar{R}2$ = 0.25 | | | |

**Source: Authors' compilations (2025): Note: ** significant at 1% level; * significant at 5% level.**

With respect to the individual results obtained, we observed that the coefficient of interest rate (INTR) exerts a weak positive relationship with loan repayment performance (LRP) of DMBs in Nigeria. The variable failed the 5 percent significance level. By implication, the result suggests that the aggregate interest rate measured as bank's prime lending rate does not play any important role in loan repayment performance (LRP) of DMBs in Nigeria during the investigating period.

The coefficient of inflation rate (INFLR) exerts a statistically significant negative impact on loan repayment performance in DMBs in Nigeria and passes the 5 percent significance level. This implies that inflation rate in the country is a major determinant of loan repayment performance in DMBs. Indeed, as inflation rises, loan repayment performance in DMBs decreases by approximately -1.2132%. This means that high inflation rate is repugnant, and inhibitive to the ability of customers to repay loan promptly in DMBs in Nigeria overtime.

The coefficient of loan duration (LDUR) which represents the period of time in which loans taken by banks' customers are expected to lapse is seen not to exert any significant impact on the level of loan repayment performance of DMBs in Nigeria overtime. The variable indeed, failed the 5 percent significance level.

The coefficient of gross domestic product (GDP), a measure for economic growth is seen to have a significant negative relationship with loan repayment in DMBs in Nigeria. The variable passes the 1 percent significance level; suggesting that as the magnitude of general economic activities increases by the day, aggregate loan repayment performance in DMBs weakens or reduced by approximately -1.3200 percent. This finding however contradicts theoretical expectation of a positive and significant association between economic growth and loan repayment capacity of banks' customers. Probably this is due to the high level of inflation in Nigeria as rightly suggested by the high impact of inflation rate on loan repayment above.

**Conclusion and Policy Recommendations**

The role of interest rate in the loan repayment capacity of DMBs' borrowers cannot be over emphasized. Theoretically, interest rate is expected to be positively related to loan repayment performance in DMBs. However, where it is compromised, and excessively become high, it discourages customers, investment and indeed borrowers from taking loans for investment purpose because of the envisage difficulties in repaying the loans given a high inflation environment. Thus, in order to ascertain to the extent to which interest rates (INTR), inflation rate (INFLR), loan duration (LDUR) and gross domestic product (GDP) have affected loan repayment performance in DMBs in Nigeria over the period 2004 to 2023, this study was undertaken. The fully modified ordinary least squares (FMOLS) technique was utilised in analyzing the data and the outcomes generally revealed that, interest rate (INTR) and loan duration (LDUR) exert a weak positive connection with loan repayment performance (LRP) of DMBs in Nigeria. On the other hands, inflation rate (INFLR) and gross domestic products (GDP) have a significant negative impact on loan repayment performance in DMBs in Nigeria. The study therefore concluded that, in the determination of loan repayment performance in DMBs in Nigeria, interest rate (INTR) is not a relevant factor to be considered. Rather, it is inflation rate (INFLR) and gross domestic products (GDP) that are critical determining factors to be considered and which must not be disregarded by banks' management and regulatory authorities (CBN and NDIC) in this regard. From the findings of the study, the following specific recommendations for policy decisions are made:

i. The significant negative effect of inflation rate (INFLR) on loan repayment performance in DMBs suggests that the monetary authority (CBN) should up their regulatory and monetary oversight in the management of inflation rate in the country. They must put in place the right policy that will minimize the continuous rise in general price level. Inflation targeting measures should be proactively deployed to stabilize inflation level as this will enable customers and indeed borrowers to be able repay any amount of money borrowed to do business from the DMBs.
ii. The significant negative impact of GDP on loan repayment suggests that the monetary authority (CBN) should formulate appropriate policy that would minimize interest rate to make it more attractive to borrowers so that more productive investment can be embarked on in the real sector of the economy and in the general economy so that borrowers can make profits and in turn be able to promptly repay their loans on agreed terms.

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