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Research Article

Analyzing The Effects of Interest Rate Adjustments As a Monetary Policy Tool on Financial Stability: Evidence from Absa Bank Customers in Zambia

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About Article

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ABSTRACT

This study took the end user customer assessment of the impact of changes in the monetary policy rate on Absa Bank's financial performance. The study used a quantitative approach with a 100 sample size. The study aimed at establishing if strategic changes in the monetary policy rate indeed affect bank customers decisions on demand for loans, willingness to incur costs that would make banks profitable and deposit volume decisions. Findings were that demand for loans was highly inelastic to changes in interest rates where 80% of customers reported that they would still apply for loans even after interest hike and 46% admitted that they do not consider bank interest rates when applying for loans. For deposits, response to interest rates changes varied with different customer type with retail and individual type of customers being highly responsive to changes in deposits rates (45%) followed by corporate clients (25%). Government agencies and funded groups were found to be non-responsive to deposit interest rate changes. This made interest rate deposit elastic for retail and individual clientele (Pearson chi-square test result χ^2 = 40. p = 0.000). The bank's profitability was dependent upon these adjustments (p = 0.001). The study concluded that changes in interest rates were highly inelastic on loans and fairly elastic on deposits, bank profit depends on the net effect of the two rates. The study recommends that to achieve financial stability both the bank and the regulator should set optimum interest rates clearly targeting the right side of the market.

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1. INTRODUCTION

1.1. Background to the study

Commercial banks stabilize and enhance business in poor economies like Zambia (Mwansa, 2020). They are not just mere service operators/ providers; he or she is a conduit through which Board of Zambia (BoZ) monetary policy decisions conveyed to the household level and firms. According to Chileshe and Phiri (2022), Absa Bank Zambia is one of the players that make changes possible. They play a key role in affecting access to credit and the behaviour of investment in reaction to policy changes. Over time, the BoZ has increasingly begun using the policy rate as an instrument for inflation management and exchange rate stability. Increasing or decreasing of this rate causes that banks to In Zambia, the Bank of Zambia (BoZ) has increasingly resorted to the policy rate to influence inflation and bring exchange rate stability compelling banks to change their lending portfolios, liquidity positions, and risk management (Musonda & Chanda, 2024). Absa Bank Zambia operates in Lusaka and shows how commercial banks respond to new policies, particularly the challenge of ensuring profitability while complying with regulations (Ngoma, 2019; Simpasa & Nandelenga, 2022). The monetary policy could be limited in its effectiveness due to structural issues such as shallow capital markets, fiscal deficits, and dependence on external commodity prices, which may limit the extent to which the changes in the policy rate are passed on to the real sector (IMF, 2023).

According to Simpasa *et al.* (2014), comparative evidence from African economies indicates that policy rates do not always pass through to lending rates. This is because Discussions have arisen on whether monetary policy alone can prevent financial stability in Zambia's case, in which domestic reforms are expected to be undermined often by fiscal pressure and global shocks (World Bank, 2022). For Absa, resilience means robust internal capabilities and strong competition within macroeconomic uncertainty and competitive challenges beyond BoZ policy signals (Chileshe & Phiri, 2023). Many scholars argue that for stability to be sustainable, regulatory oversight and fiscal discipline are needed.

This reason is particularly relevant for analysis, as Lusaka is the economic center of the country where most policy changes are disseminated through lending, liquidity and investment choice. By studying these dynamics, key policymakers and regulators can strengthen how Zambia's banking system adapts to changing economic conditions (UNCTAD, 2023).

1.2. Statement of the problem

Banks keep the economy afloat. But they are also deeply hurt by policies that ensure the economy works (Borio & Gambacorta, 2021; Phiri, 2021). Zambia uses interest rates to keep inflation low and the currency stable. But these changes were bad for banks as well. Their efforts must be rapid to avoid going hungry and into business (Bank of Zambia, 2022).

In particular, interest rate changes affect the banks, how depositors pay, and how much cash they have. This changes how money banks make and they eavesdrop on (Chileshe & Phiri, 2022; Mwape, 2022). Such changes for Absa mean that they must behave quickly and intelligently. Many banks have changed the way they make money and their balance sheets to avoid paying interest income (Kumar & Singh, 2023; Ozili, 2023). But these are only band-aids for what is wrong.

They don't fix what makes banks so easy to hit by policy changes. The learning There is little proof from the real world that Zambia banks feel the pain of changes in the policy rate and the credibility of central banks varies from one country to another (Kose & Sut, 2025). Although theory links interest rates to how well banks do, we have few local cases of how these issues work out in the long run (Aron & Muellbauer, 2023; Zhang *et al.*, 2023). This work looks at Absa Bank Zambia in Lusaka to fill this gap. It looks at how BoZ policy rate rules hit the bank's ability to make money, hold cash, and act without risks.

1.3. Objectives of the study

The objectives of the study were split between the general theme and the three focused specific objectives as explained in the subsections below.

1.3.1. General objective

To analyze the effects of interest rate adjustments as a monetary policy tool on the financial stability of Absa Bank in Lusaka.

1.3.2. Specific objectives

- i. To assess the impact of interest rate changes on the lending costs of Absa Bank.
- ii. To investigate the effect of interest rate adjustments on the profitability of Absa Bank.
- iii. To establish the influence of interest rate changes on the deposit volumes at Absa Bank.

1.4. Research questions

- i. How do interest rate changes affect the lending costs of Absa Bank?
- ii. What is the effect of interest rate adjustments on the profitability of Absa Bank?
- iii. What is the influence of interest rate changes on the deposit volumes at Absa Bank?

1.5. Conceptual framework

The conceptual framework in Figure 1 summarizes the relationship between the core variables. It proposes that changes in interest rates directly influence three fundamental variables: Lending Costs, Profitability, and Deposit Volumes. These three factors provide a collective influence that ultimately determines Financial Stability.

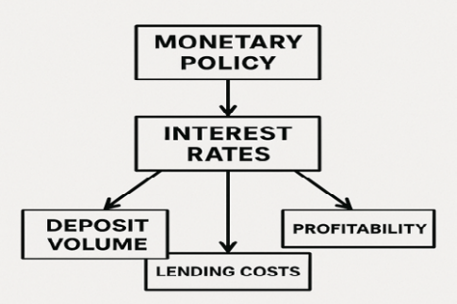

Figure 1. Conceptual framework

2. LITERATURE REVIEW

This chapter looks at previous work done on the effects of interest rate adjustment on stability. The text is divided into three main themes to be addressed in the studies focus areas: loan costs, profitability, and deposit volumes. It draws on journal articles, research papers, and concepts in the evidence of interest rate changes and commercial banks. Then it ends with a critical look at the literature and notes how the work needed to be done and how it is missing.

2.1. Effects of interest rate changes on lending costs.

In the case of interest rate policy one of the many ways monetary policies can affect the economy is through its role in economic regulation.

If the Bank of Zambia raises the policy rate, commercial banks will become less likely to borrow. This usually leads to higher lending rates for clients (Smith & Zhao, 2021; Rosenberg & Arman, 2022). It is also frequently influenced on the basis of how each bank's funding sources, risk policies, and internal pricing systems differ (Hermes & Meesters, 2022; Kumar & Singh, 2023). When rates are changed, but the level of competition in the banking sector also affects rate changes that affect borrowers. If markets are competitive, banks may decide to offer to absorb some of the additional costs to keep customers satisfied and market share (Moya, 2021).

This makes the spread of interest rates less expected. Economic conditions also disturb this process. When the market sees rate swings, banks have to tighten up on liquidity management so they don't run into cash flow problems. They tend to add other risk premiums to the price of loans to make up for the risk and to offset the effect of the instability, which raises the cost of lending even more (Schreiner & Gupta, 2023). Long stretches of tight monetary policy tend to make banks cautious and cut the amount of credit supplied to clients with higher risk (Khandker & Samad, 2021).

The ability of this transmission mechanism to work is different across economies. Developed financial systems tend to see the speed of rate adjustment and the degree of change be faster and more complete while in emerging economies such as Zambia weak financial markets and weak competition tend to slow this process down (Almeida *et al.*, 2022).

2.2. Effects of interest rate changes on bank profitability

The profitability of commercial banks is closely linked to interest rate movements through the net interest margin (NIM), which measures the difference between income from loans and expenses on deposits (Borio *et al.*, 2021). A rise in interest rates can temporarily improve NIMs when loan rates adjust faster than deposit rates (Demirgüç-Kunt & Huizinga, 2020; Beck & Keil, 2021). Studies in Sub-Saharan Africa show that the first phase of monetary tightening can increase lending spreads and short-term earnings (Kasekende *et al.*, 2022; IMF, 2022). These benefits are often temporary. Higher rates also increase repayment burdens for borrowers, which raises the risk of loan defaults and reduces profitability (Mwega, 2021; Chileshe & Phiri, 2022).

When tightening persists, banks are seeing new NPLs and the loans are growing, posing higher credit and liquidity risks (Ozili, 2023; Tembo & Simatele, 2022). This is another challenge as interest rates remain low for long periods. Although default risk declines, low margins also lower overall profitability (Claessens *et al.*, 2022; Adrian & Shin, 2020). This is particularly evident in developing countries, where banks rely on interest income, Mpofu 2022; Ngugi 2023. Nevertheless, many institutions now consider non-interest income such as service fees, commissions, and digital banking charges as a way to remedy the pressures.

These sources of revenue allow for less dependence on traditional lending income (Albertazzi & Gambacorta, 2020; Beck & Keil, 2021; World Bank, 2022). In Africa, banks are moving digital and agency banking channels in order to enhance income stability and protect profits from policy rate volatility (Kumar & Singh 2023; IMF 2023).

2.3. Effects of interest rate changes on deposit volumes

It is common for monetary policy to have a major effect on financial stability through deposit mobilization. High policy rates are likely to boost savings by increasing deposit yield (Bernanke & Blinder, 2023; Cecchetti & Schoenholtz, 2022). This is part of classical monetary theory (Mishkin, 2023). For example, in Southern Africa, commercial banks, such as Absa Zambia, have responded by offering higher deposit rates, which are used to convert savings and fixed-term accounts into savings and backed up accounts.

In practice, this relationship is often stronger in developing economies. Increased inflation and currency instability can deflect real deposit returns, making saving less attractive even when nominal interest rates increase (Demirgüç-Kunt *et al.*, 2023; IMF, 2023). In poorer financial markets, deposit volumes may have a lower response to rate changes (Molefhe, 2022; Chileshe & Phiri, 2022). Some financial uncertainties further change depositor behavior. As confidence in the economy decreases, people choose cash and security over interest income (IMF 2023).

In such circumstances, may not increase deposits, as a large proportion of savers prefer cash or converting it to (Ozili, 2023; Simatele, 2022). This makes deposit behaviour in Zambia more frequent and more sensitive to inflation and exchange rate trends.

2.4. Establishment of research gaps

While substantial research has been conducted on the relationship between monetary policy and financial stability, much of the existing literature has significant limitations that justify further study. Firstly, the majority of prior studies are conducted in developed economies such as the United States and the Eurozone, where financial systems are more sophisticated and policy transmission mechanisms are stronger (Bernanke & Gertler, 1995; Mishkin, 2019). These findings cannot be directly generalized to developing economies like Zambia, where structural and institutional differences affect how interest rate adjustments influence bank behaviour and stability.

Secondly, most previous studies adopt macroeconomic or cross-country perspectives, often relying on aggregate data that obscure variations between individual banks (Claessens & Kose, 2018; Gambacorta, 2009). Consequently, these studies overlook how individual commercial banks, such as ABSA,

respond uniquely to policy rate changes given their differing risk management practices, capital structures, and client profiles.

Thirdly, there is a heavy reliance on quantitative econometric models such as VAR and GARCH frameworks that, while robust, fail to capture behavioural and perceptual aspects of how monetary policy is transmitted through the banking system (Engle, 1982; Hamilton & Susmel, 1994). Qualitative insights, including managerial decision-making and customer reactions to rate changes, remain largely unexplored. This narrow methodological approach limits the holistic understanding of financial stability as both a quantitative and behavioural phenomenon.

There is a clear scarcity of empirical research focused on Zambian commercial banks and how they respond to interest rate changes within the broader monetary policy framework. While the Bank of Zambia periodically publishes policy statements and macroeconomic reports, there is limited academic research examining how these policies influence micro-level financial stability indicators such as liquidity, non-performing loans, and capital adequacy within individual institutions (Bank of Zambia, 2023).

3. METHODOLOGY

3.1. Research design

A descriptive survey format incorporating mixed methods for quantification of financial measures and contextual context information was adopted in this study with a mixed method of sampling (Dawadi, 2021). Quantitative data assessed the relationship between interest rates and key stability indicators while qualitative data provided deep insight on strategy responses and managerial experience, which was a triangulation and validation of results (Fetters & Molina-Azorín, 2021).

3.2. Target population and sampling

The research focused on Absa Bank clients and staff in Lusaka involved or affected by monetary policy transmission. Purposive sampling was used to select with relevant knowledge and experience to select, with a sample size of 100 respondents. These were chosen by bank managers and clients who would be interviewed for a lengthy interview.

3.3. Data collection

One hundred randomly selected respondents completed the structured questionnaires. The majority came from independent views of customers and only few members of staff were asked to give masked responses on sensitive data. The purpose of this research was to see how interest rate cascades down to end users, who are the customers. These instruments calculated lending costs, profitability, and deposit volumes.

3.4. Data analysis

The data were thoroughly examined using mixed methods analytical techniques. Statistical analyses of quantitative data were done using STATA software. The descriptive statistics summarized the data, followed by the chi-square relationship test. The qualitative interview data were translated and analysed thematically to identify patterns. But this was combined with the inclusion of numerical and narrative data to strengthen the conclusions of the study.

3.5. Ethical considerations

It adhered to the highest ethical standards throughout the research process. Several detailed briefings informed participants that consent was obtained. All respondents were provided confidentiality and anonymity assurance. The participants were free to participate and free to withdraw. The ethics committee formalized approval of data collection before the data was collected. The bank was not endangered on any of its financial position or any internal data publications. The majority of the respondents were the bank customers who submitted their views and very little was done from the bank side. Only 20% of the respondents were from the bank.

4. RESULTS AND DISCUSSION

The results have been presented on the basis of research objectives but the few indicators on the demographic.

4.1. Background information

Table 1. Gender

Gender	Percent
Male	50%
Female	50%
Total	100%

There are 40 respondents in each group, or 50% of the sample, who are equally split between male and female respondents. Thus, the balance of interest rate changes and financial stability yields is not only reliable but fair for both men and women, and mitigates gender bias in consumer perceptions. This balance strengthens the credibility and dependability of the analysis through its balance.

Figure 2 showing distribution by Age.

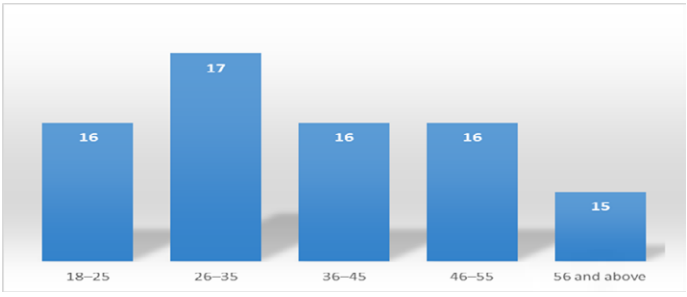

Figure 2. Age

It seems that respondents tend to be relatively balanced in age range, with the largest proportion (21.25%) being in 26-35 26-35 and 56 and above and the least (18.75%) being in 56 and above 26-35 and 56 and above. While the five groups are distributed evenly, opinions from younger, middle-aged, and older clients are remained consistent. This allows researchers to assess the impact of life stages, financial status and economic priorities on the perceptions of interest rate adjustments.

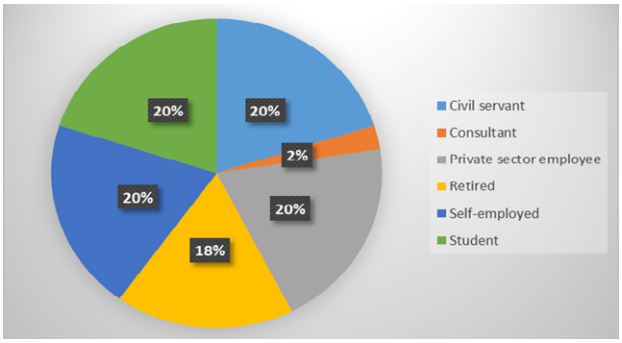

Figure 3. Occupation of customers

The proportions of occupational representation in the sample vary, but the majority of respondents in the sample were government servants, private sector workers, independent contractors and students, 17.5% retirees and 2.5% consultants. Similarly, this distribution represents both active earners and non-earners such as retirees and students. Thus, profession is often a factor in sensitivity to changes in interest rates as income stability fluctuates and access to financial products increases.

4.2. Impact of interest rates on lending demand – objective one

This assessment was to meet the first objective to show how the interest rate changes affects loan demand. The indicators are as depicted in the presentations below.

4.2.1. Perception of interest rate effect on affordability of loans

In a survey, 22.50% submitted that loan interest rates were affordable, only slightly above the tenth or 13.25% described them as high or very high (18.75%). To a striking shock, almost half of the respondents or 46.25% chose "N/A" to show that interest rate is not what they consider when applying for loans. The frequencies validate the fact that loan demand is very highly inelastic to changes in interest rates and while a number of them still give it a thought, the majority do not consider interest rates to be a thing to hinder them from getting or applying for a loan.

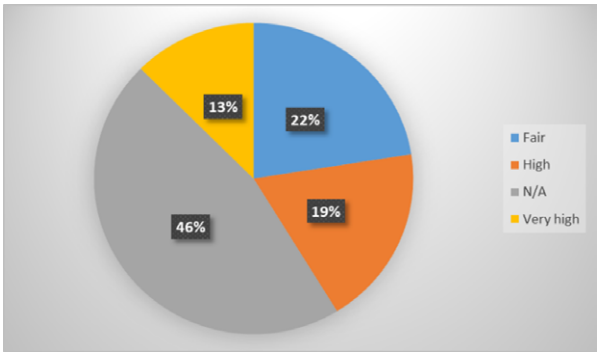

Figure 4. Perception of loan interest rate affordability

4.2.2. Effect of interest rates on the loan application

The effect of changes in interest rates on the volume of loan applications is as shown below. From the total customers, 80% submitted that they would apply for the loans even if the interest rate changes while only 20% reported that would not or can first reconsider when the interest rate increases or changes. This was another piece of evidence to show that demand for loans is very highly inelastic, and few customers would abandon the service when the interest is even increased. Refer to figure 5 below.

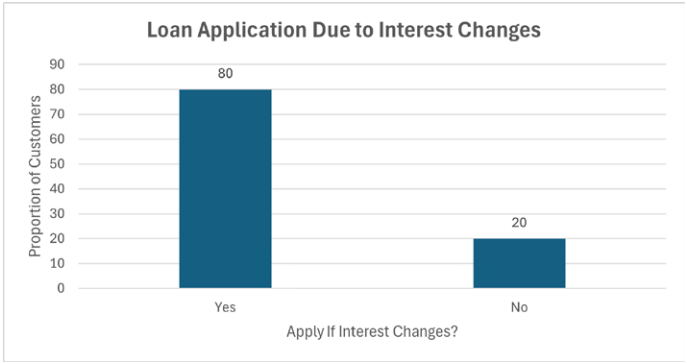

Figure 5. Loan applications

4.3. Impact of interest rates on profitability

This was a direct question on staff from the bank and without revealing the actual numbers, only proportions were submitted from 20 key members of staff while maintaining confidentiality. The masked results were run on a test to show is the interest rate income has no effect on the profitability of the bank, and the results are as shown in table 3 below. The test was revealing whether the profitability is statistically independent of the interest income realised from interest-based interest income from loans.

Therefore, we reject the null hypothesis that profitability influence and profitability from interest income are independent based on the chi-square test findings ($\chi^2 = 40.000$, $p = 0.000$) and a significance threshold of 0.05. A statistically significant correlation between these variables is shown by a p-value of less than 0.05. This indicates that interest rate changes and associated financial policies have a direct effect on ABSA Bank's earnings and overall financial performance as the factors affecting profitability are directly tied to the bank's profitability from interest income.

4.4. Interest rate influence on saving deposits

The indicators included here verifying whether interest rate adjustments arising from changes in monetary policy were of significance to the changes in the volume of deposits.

4.4.1. Interest influence on savings

Of all ABSA Bank clients engaged, 57.5% admitted that interest

Table 3. Profitability and interest rate income from interest fees from loans

Profitability Influence	Profitability from Interest Income				
	50-74%	75%+	Less th..	25-49%	Total
Slightly increased	8	0	0	2	10
	4.0	2.5	2.5	1.0	10.0
No effect	0	0	5	0	5
	2.0	1.3	11.3	0.5	15.0
Significantly incre..	0	5	0	0	5
	2.0	11.3	1.3	0.5	15.0
Total	8	5	5	2	20
	8.0	15.0	15.0	2.0	40.0
Pearson chi2 (6) = 40.0000			Pr = 0.000		

rates have an impact on their saving habits, whilst 42.5% said they do not attribute their saving habits to the interest rate pegged. The evidence thus shows that most consumers take interest rate changes into account when choosing how much to save, which demonstrates how interest rate policy relates to financial behavior. But large numbers of unaffected consumers acknowledge the impact of other factors, such as income levels, liquidity requirements and other investment opportunities, which affect the selection of savings choices. Refer to Figure 6 below.

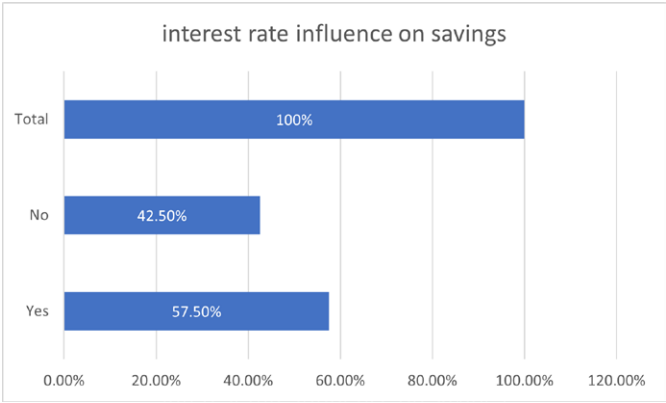

Figure 6. Interest rate influence on saving deposits

4.4.2. Customer willingness to deposit after interest rate change

Of those interviewed, 28.75% agreed, and another 28.75% strongly agree that they would increase deposits if interest rates swelled, of which 57.5%. But 23.75% were neither opposed nor disagreed, 18.75% disagreed. This results in a large percentage of consumers who are either unwilling or aggressive about saving more with a higher interest rate on their cards, even though more than half of them are encouraged to save more at higher interest rates. This suggests changes in interest rates can be beneficial to deposit mobilization at ABSA Bank, but that inconsistency in client preferences and behaviors may further inhibit efficiency. See summary in figure 7 below.

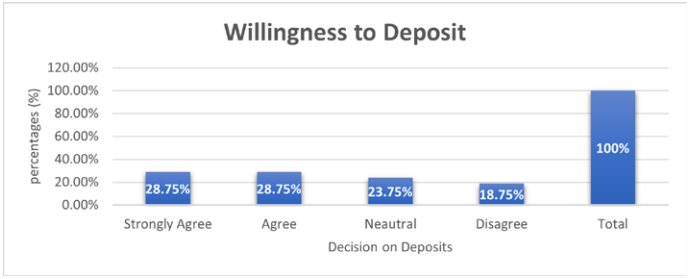

Figure 7. Willingness to deposit more if interest rates increase

4.4.3. Customer sensitivity to deposit interest rates

The study revealed that different groups have different deposit sensitivity levels to changes in interest rates. Referring to figure below, the NGOs scored 10%, government agencies 5%, and other donor-funded groups 10%. However, the most sensitive group of customers that pays adequate attention to interest rates paid on deposits were found to be individuals and retail customers. The individuals and retail customers scored the most sensitive depositors to interest rate adjustments (45%) and were followed by corporate clients (25%). This implies that corporate and retail customers are the most susceptible to changes in interest rates, actively modifying their deposit patterns in reaction. Targeted interest rate strategies may have different impacts on different depositor segments, as seen by the low response of other categories including government agencies and individual non-retail clients.

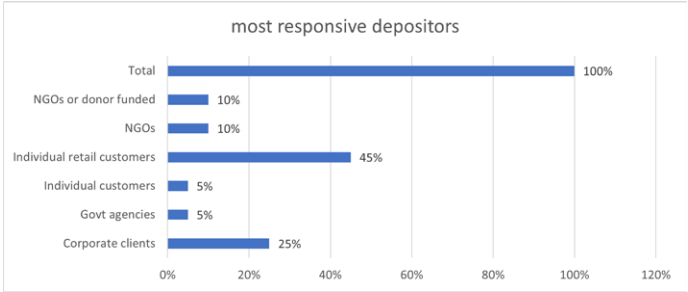

Figure 8. Analysis of most responsive depositors

4.4.4. Significant tests on impact of interest rates on deposit volumes

Considering chi-square test findings of 40.00, p = 0.000 and a significance threshold of 0.05, a null hypothesis that deposit volume change and deposit mobilization impact is independent is rejected. A statistically significant correlation between these variables is shown by a p-value of less than 0.05. This implies that variations in deposit volume are reliant on the bank's attempts to mobilize deposits, indicating that changes in interest rates and associated policies have a direct impact on consumer saving habits and ABSA Bank's overall liquidity management. However, this has different impact from different clientele.

Table 4. A Chi Square test on credit volume change and credit organization effect

Deposit Volume Change	Deposit Mobilization Effect Agree Neutral Strongl..			Total
Slight increase	8	0	0	8
	4.0	2.0	2.0	8.0
No effect	0	5	0	5
	2.5	11.3	1.3	15.0
Substantial increase	0	0	5	5
	2.5	1.3	11.3	15.0
Slight increase	2	0	0	2
	1.0	0.5	0.5	2.0
Total	10	5	5	20
	10.0	15.0	15.0	40.0

Pearson chi2(6) = 40.0000 Pr = 0.000

4.5. Discussion of findings

These results bolster the theoretical assumption that interest rates have an important role to play in the performance of the banking sector. It is obvious that rate changes affect lending costs, profitability and deposit volumes, and their statistically significant relationship to rates suggests the power of monetary policy to change bank-level stability.

The important role of lending costs and its effect on demand for loans in this context, as well as the influence that it has on lending demand, is considered in the literature on the credit channel of monetary policy. It illustrates how Absa Bank's credit availability is directly affected by BoZ policy, and its intermediation function.

A study of interest income is similar to international studies but highlights Absa Bank's vulnerability in a highly volatile environment. The bank's weight is significant. reliance on net interest margins makes its earnings susceptible to policy shifts, underscoring the need for income diversification.

In the literature, rates and deposit volumes are consistently well tied, but for a significant proportion of rate-insensitive savers the existence of nuance is a bit ambiguous. This suggests that Absa Bank deposit base is not exclusively rate-elastic, but that this may be somewhat stable but that aggressive rate competition for deposits may not work universally.

5. CONCLUSION

This study concludes that interest rate adjustments as a monetary policy instrument play a major and multifaceted role in financial stability at Absa Bank in Lusaka by directly impacting the costs and demand for credit, its assets portfolio, by influencing the net interest income channels, and are of large concern in the profitability and volatility of deposits. Evidence is presented that monetary policy is not a remote macroeconomic tool, but an essential component of business bank performance and resilience. The results have shown how the loan and deposits demand elasticity of changes in prices can affect different depositors and borrowers in the banks. This revelation helps to make decisions both at regulatory and bank operational levels that would help stabilise the banking sector using interest rate adjustment.

RECOMMENDATIONS

The sensitivity response to interest rate is a guide to Absa and other commercial banks when it comes to making decision on different customer groupings. The loans were found to be inelastic to changes in interests rates and customer desperation may accommodate higher interest rates. Hence it is recommended that the bank can leverage these interest rates and align them to the type of clientele.

On the deposits, the bank should pay attention to individual and retail customers who were found to be highly sensitive to the changes in deposits interest rates. This calls for the Absa Bank-Fortify interest rate risk management strategies to continue being blended and enhanced through clientele segmentation and stress tests on concentration single category deposit customer exposures.

To prevent excessive net interest income dependency, the bank should diversify revenue streams and work around client financial advisor services so clients can navigate rate changes while maintaining relationships and confidence.

- *For the Bank of Zambia (BoZ):* Improve predictability and transparency of monetary policy communication to avoid uncertainty for commercial banks. If policy rate adjustment can have an impact on bank stability, the odds of it helping banks function in meeting the macroeconomic goals, and bank health are important.
- *For Future Researchers:* Conduct longitudinal studies to identify long-run cumulative effects of interest rate cycles on bank capital and resilience. Comparing multiple banks to find the best practices to manage interest rate risk in Zambia.

Coordinating prudent bank-level risk management, clear and predictable monetary policy and focused research will help ensure greater financial stability for key institutions like Absa Bank, ensuring that Zambia's national economy has more support.

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