INTEREST RATE VOLATILITY AND THE PERFORMANCE OF ISLAMIC BANKS

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A thesis submitted in partial fulfillment of the requirements for the MS degree in Islamic Banking and Finance

University of Management

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Institute of

Islamic Banking

Lahore, Pakistan.

1436 AH / 2015 CE

TABLE OF CONTENTS

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The thesis entitled ***"Interest Rate Volatility and the Performance of Islamic Banks"*** by **Muhammad Nadeem Khalil** (ID # **13003130-005**) has been examined by the undersigned panel of examiners and has been accepted in partial fulfillment for the degree **of MS Islamic Banking and Finance**.

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DECLARATION

I hereby declare that no portion of the work that appears in this study has been used in support of an application for another degree in qualification to this or any other university or institution of higher learning.

This thesis is a presentation of my original research work. Wherever contributions of others are involved, every effort has been made to indicate this clearly, with due reference to the literature and acknowledgement of collaborative research and discussions.

The work was done under the guidance of Muhammad Mahmood Shah Khan, Director, Institute of Islamic Banking, University of Management and Technology, Lahore, Pakistan.

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In my capacity as supervisor of the candidate's thesis, I certify that the above statements are true to the best of my knowledge.

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Date: _________________________

STATEMENT OF COPYRIGHT

DEDICATION

I dedicate this humble and valuable effort to my parents, brothers, sister and all my family members whose hands always rise in prayers for my success.

ACKNOWLEDGEMENT

First of all I bow my head to Almighty ALLAH who gave me the power, courage, health, thoughts, wisdom, skills and knowledge and made me able to complete my thesis. I am also thankful to ALLAH for giving me spirit, patience and courage during the completion of my thesis.

I deem it my utmost pleasure to avail this opportunity to express my heartiest gratitude for my respected worthy supervisor, Mr. Muhammad Mahmood Shah Khan – Director, Institute of Islamic Banking for his keen interest, dexterous guidance, untiring help, encouraging attitude, valuable suggestions and enlightened supervision during my whole thesis work.

I am very thankful to Mr. Farrukh Ijaz and Ms. Anum Akmal for helping me in data analysis and understanding research methodologies used in my research thesis. Mr. FarrukhI Ijaz was very helpful in answering various thesis related queries and his role was very supportive in this regard.

Finally, I present a bouquet of thanks and wishes best of luck for all those people who helped me and remembered me in their prayers for my success in this world and hereafter.

Muhammad Nadeem Khalil

August, 2015

ABSTRACT

Market interest rates in an economy keep on changing. The objective of this research study was to analyze the impact of interest rate changes on the performance of Islamic Banks. For this purpose, four independent variables named, Discount Rate (DR), Karachi Interbank Offer Rate (KIBOR), Treasury bill (T.bill) rate, and Pakistan Investment Bond (PIB) rate were taken as a proxy for interest rates while the performance of Islamic Banks was measured using Return of Asset (ROA) and Return on Equity (ROE) ratios. Secondary data was used for this research study which was obtained from the State Bank of Pakistan's official website. Vector Auto Regression (VAR) model, Impulse Response Function (IRF) and Variance Decomposition Analysis (VDA) was used to see the impact of interest rate changes on the performance of Islamic Banks. The findings showed that there was not a significant impact of interest rate changes on the performance of Islamic Banks. The study also concluded that although Islamic Banks use KIBOR as benchmark rate, Islamic banks still able to effectively mitigating interest rate risks by using various interest mitigating techniques. The research also recommended that Islamic Banks, instead of using KIBOR as benchmark should adopt a business model which do not take into consideration the market interest rates and carry out their operation keeping in view the true principles of Islam. A complete new business model for Islamic Banks is proposed in this regard.

LIST OF TABLES

LIST OF FIGURES

LIST OF ANNEXURES