

THE EFFECT OF INTEREST RATES CHARGES ON ECONOMIC GROWTH IN TANZANIA, A CASE OF ILALA MUNICIPAL

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Abstract

Globally, interest rates have fallen to extreme lows in advanced economies and are expected to remain low. At the same time, market concentration, corporate profits and profit markups are constantly increasing. Additionally, the productivity gap between leaders and followers within the same industry has widened. The study aimed to investigate the effect of interest rates charges on economic growth in Tanzania. The study adopted case study research design with quantitative approach. The study adopted probability sampling procedure. The study used Slovenes formula to obtain sample size of 378 from target population of 6893 respondents. The study used questionnaire to obtain data needed. The finding of the study indicates that interest rate led to increase price of commodities in the market indicates that, Changes in interest rates can also affect the broader economy, influencing consumer behavior and demand for commodities. Higher rates can slow economic growth, leading to reduced demand for certain commodities. Also, interest rates affect currency values. Higher rates can lead to a stronger domestic currency... The study concluded that higher interest rates can drive up commodity prices and influence consumer behavior, potentially slowing economic growth and reducing demand for certain goods. This demonstrates that fluctuations in interest rates have broader implications for the economy. Also, increased interest rates can strengthen the domestic currency, but this appreciation may make commodities more expensive for foreign buyers, further complicating demand dynamics.

Keywords: Interest Rates, Economic Development, Ilala Municipal

1. Introduction

Globally, Interest rates have fallen to extreme lows in advanced economies and are expected to remain low. At the same time, market concentration, corporate profits and profit markups are constantly increasing. The increase in concentration was accompanied by a significant decline in productivity growth; additionally, the productivity gap between leaders and followers within the same industry has widened (Zakhidov, 2024).

The central bank regulates the key interest rate aiming to stabilize and reduce inflation. As a result, business activity is restrained. Excessive restrictions can lead to a decline in economic growth and public revenues. Fiscal authorities involve some additional government borrowing; consequently, public debt rises. The above situation forms a systemic risk to price stability under limited access to external credit resources and insufficient domestic government borrowing market's development. Thus, to prevent debt instability, fiscal stimuli should be coordinated with monetary policy (Surya, 2014).

The economic environment's variability, the budget planning system's imperfection, and the existing intentions to increase social spending led to frequent changes in the main budgetary parameters. That fact complicates the interaction between fiscal and monetary

institutions. It is expedient to expand the central and local budgets' planning horizon and to impose restrictions on the main budget indicators. Inflation targeting involves a medium-term perspective. Extensive coordination between fiscal and monetary policies makes it advisable to adopt the three-year budget planning. Public expenditures are divided into short-term and long-term (Chugunov et al., 2021).

Countries with higher rates of savings have had a faster economic growth than those with lower saving rates. Capital accumulation creates greater opportunities for production and the productivity of a country by providing an additional income stream for countries. In that regard, the United Nations Conference on Trade and Development "Development and Globalization emphasizes that the main factor in increasing in-country capital is the increase of savings and that, in that regard, developing countries should prioritize programs that promote domestic savings, in order for capital to be invested towards the most productive practices (Stoica et al., 2020).

Development policies that are oriented towards regional economic growth supported by the use of technology will accelerate and encourage increased productivity in economic enterprises developed in the community. Community economic development through entrepreneurship training has an impact on economic growth, and efforts to increase community productivity will require technological innovation. The dynamics of the global economy have a significant impact on the economic structure of the region, including the SME development (Stoica et al., 2020).

According to the Bank of Tanzania Act of 1995, the main goal was to create and carry out monetary policy that was geared toward the economic goal of monetary price stability and supportive of sustainable and balanced economic growth (Moh'd, 2020). The Bank of Tanzania had to ensure the following in order to meet the goals: a) a reasonable and consistent rate of increase in the money supply; b) a suitable rate of expansion in domestic bank credit that will not put undue pressure on production resources and must be consistent with money supply objectives; c) realistic interest rates determined by the market; d) a sufficient amount of foreign reserves to allow the Bank of Tanzania to occasionally intervene in the foreign exchange market to smooth out reversible short-term fluctuations of the Tanzania shilling exchange rate in order to meet import requirements; e) a relatively stable exchange rate for the national currency; f) financial stability, which includes the growth and protection of sound and well-managed banking institutions; and g) an efficient and well-functioning financial market, including an efficient payment system (Mbarara, 2020). There is strong support for financial liberalization in order to achieve the intended outcomes, which include economic expansion brought about by an increase in investments. The Bank of Tanzania (BoT) enforced allocative controls on interest rates prior to interest rate liberalization. Additionally, it specified that small businesses would receive preferential lending (Mbarara, 2020).

With much enthusiasm for financial liberalization to produce the desired benefits which is the growth of the economy as a result of increase in investments. Prior to interest rate liberalization, the Bank of Tanzania (BoT) imposed allocative controls on interest rates. It also stipulated the preferential lending for small-scale enterprises. The impact of interest rate control was negative in terms of financial repression as it accelerated inflation and this was more severe in the 1980s where the inflation was frequently in excess of 30% per annum. The allocation of bank credit was predominantly determined by Sectoral credit guidelines and directives by the government as issued by BoT. This resulted into commercial banks acting as an adjunct of the Treasury rather than the financial

intermediaries channeling funds from depositors and increasingly in the 1980s (where bank deposits in real terms declined) from BoT to the government, loss-making corporations (Moh'd,2020).

Worldwide, Economic policies handle trade-offs and foster synergy between various objectives are what decision-makers and stakeholders should ideally develop by reducing poverty and promoting economic growth are two Goals that may have short-term tradeoffs with climate change mitigation and adaptation efforts, but these actions will likely have long-term positive effects on many SDGs (Altunyan and Colligues,2020).

Tanzanians Central Bank (BOT) is one of the most important pillars influencing the development path of countries by implementing monetary policies including controlling the interest rate, inflation rate, money supply, and exchange rate. Considering the goals and effects of the central bank's monetary policies that affect private household income, consumption levels, producer behavior, capital asset prices, etc. But still price of the goods within the country increases, decreases of investments and consumption of goods and services decreases even savings to individual's decreases. This led to the questions: "What are effects of interest rates on stimulating economic development in Tanzania?" "Therefore, this study needs to explore the effect of interest rates on stimulates economic growth within the country as well as in Ilala Minicipal.

2. Theoretical Background

Rushchyshyn, et al. (2021) found that the effective functioning of the banking sector has a key impact on the stability of economic growth. The results obtained confirmed the large discrepancy in the development of Ukraine's banking sector with some European Union countries (the highest lag values were observed with the Czech Republic and Poland). Among other things, the causality analysis revealed a strong favorable relationship between the level of development of the banking sector in Ukraine and GDP per capita. It shows that there is a significant relationship between commercial banking development and economic growth for Eastern Europe. They added that, more specifically, policies that liberalise banking to include more branches and Automatic Teller Machines, thus creating greater access, could spur greater growth in emerging economies like those of Eastern Europe.

Mbowe and Collogues (2020) did the study on determinants of bank lending interest rates in Tanzania. They revealed prudent consolidation of small banks could as well help cut on operating costs, improve efficiency, and enhance liquidity levels. Measures need to be taken to reduce non-performing loans including through enhancing borrowers screening mechanisms enabled by credit risk management frameworks at bank level and mandatory use of credit reference system to reduce credit risk. Strengthening of the regulatory and supervisory role is important mostly targeting to ensure adequate liquidity in the banking system for daily needs.

Said (2023) did the study on analysis of the role of commercial banks on economic growth of Tanzania. He revealed that the fluctuations in liquidity reserve and interest rate had a long-run significant implications on Tanzania economic growth, in a way that, with increases in liquidity reserve and interest rate, the GDP will decline in the long-run. Therefore, heavy reliance on liquidity reserve and interest rate are not a long-term sustainable approach for economic growth of Tanzania. The study concluded the government should have a regular system for monitoring liquidity reserve and interest for economic growth. Also, bank credits on economic growth. This noted that bank credit is

more important driver of economic growth. Private sectors should be provided with credits to explore different investment opportunities.

3. Methods

The study adopted a case study research design. A case study is an in-depth investigation of a specific research problem (Kothari, 2012). Due to the nature of the research problem, a case study research design was used to collect data at a single point at a time. Target population were 6893 investments that comprises small, medium and large investments operating within Ilala municipal. The study adopted probability sampling techniques. The study used Slovenes formula to obtain sample size of 378 investments. The study used questionnaire and questionnaire had closed ended question generated from objective of the study and literature review. In additional to that, the study used documentary review to obtain data needed.

4. Results and Discussion

4.1 Determination of the Effect of Interest Rates on Stimulating Economic Development in Tanzania. A Case of Ilala Municipal

Five-point Likert scale used to measure study variables found in questionnaires, ranging from: 1 to 1.80 (very low mean) (strongly disagree). From 1.81 to 2.60 (low mean) means (disagree). The range from 2.61 to 3.40 (Medium) represents (Neutral), from 3.41 to 4.20 (High Mean) represents (Strongly Agree), and from 4.21 to 5.00 represents (very high). From the responses, descriptive measures of central variability: mean and standard deviation were used to facilitate interpretation and generalization of the results.

4.1.1 To investigate the effect of interest rates charges on economic growth in Tanzania
 The study tries to investigate the effect of interest rates charges on economic growth in Tanzania. Table 4.1 shows the summary.

Table 1. The effect of interest rates charges on economic growth in Tanzania (N=378)

S/N Variables	Strongly agree		Agree		Undecided		Disagree		Strongly disagree		Mean	Std. Deviation
	F	%	F	%	F	%	F	%	F	%		
Interest rate led to increase price of commodities in the market	87	23.	162	42.9	0	0	72	19.0	57	15.1	2.6032	1.41091
Interest rates charges led to collapse of the business.	140	37	132	34.9	0	0	50	13.2	56	14.8	2.6878	1.28567
Interest rates charges led to decrease business transaction within the market.	88	23.3	130	34.4	0	0	89	23.5	71	18.8	2.3386	1.45731
Interest rates charges led to decrease savings of the people.	169	44.7	80	21.2	0	0	47	12.4	82	21.7	2.8016	1.49279
Interest rates charges led to reduction in bank lending.	46	12.2	203	53.7	0	0	81	21.4	48	12.7	2.4524	1.64296
Average											2.57672	1.457928

Source: Field Data (2024)

Table 1 shows the effect of interest rates charges on economic growth in Tanzania. The findings obtained through questionnaire on interest rate led to increase price of commodities in the market indicates that, 162(42.9%) agreed, 87(23%) strongly agreed, 72(19%) disagreed and 57(15.1%) strongly disagreed. Respondents agreed with high

mean value of 2.6032 and Standard deviation of 1.41091 respectively. This finding indicates that, Changes in interest rates can also affect the broader economy, influencing consumer behavior and demand for commodities. Higher rates can slow economic growth, leading to reduced demand for certain commodities. Also, interest rates affect currency values. This finding aligns to those of Mehtiyev and colleagues, (2021) that higher rates can lead to a stronger domestic currency. If a currency appreciates, it can make commodities more expensive for foreign buyers, potentially reducing demand and impacting prices.

Other findings obtained through questionnaire on Interest rates charges led to collapse of the business. Whereby 140(37%) strongly agreed, 56(14.8%) strongly disagreed and 132(34.9%) agreed. Respondents agreed with high mean value of 2.6878 and Standard deviation of 1.28567 respectively. This finding indicates that interest rates rise, the cost of borrowing increases. Businesses often rely on loans for expansion, operations, or managing cash flow. Higher interest payments can strain their finances, especially for those with significant debt. This increased cost can reduce profitability, making it difficult for businesses to invest in growth or even maintain operations. This finding aligns to those of Schwert, (2020) that interplay between rising interest rates and business viability is complex, with multiple factors contributing to potential collapse. Understanding these dynamics is crucial for business leaders, policymakers, and investors to mitigate risks associated with fluctuating interest rates and ensure economic stability. Effective financial management, strategic planning, and adaptability can help businesses navigate these challenges, but in extreme cases, the burden of rising interest rates can lead to unavoidable failures.

Also, the finding obtained through questionnaire on interest rates charges led to decrease business transaction within the market shows that, 130(34.4%) agreed, 88(23.3%) strongly agreed, 89(23.5%) disagreed and 71(18.8%) strongly disagreed. Respondents agreed with high mean value of 2.3386 and Standard deviation of 1.45731 respectively. This finding indicates that, rising interest rates can decrease business transactions through higher borrowing costs, reduced consumer spending, lowered investment confidence, and overall market uncertainty. These factors create a challenging environment for businesses, leading to a potential slowdown in economic activity. These dynamics is crucial for policymakers and business leaders as they navigate changing economic landscapes. This finding aligns to those of Li & Zhu (2024) that interest rates rise, the cost of borrowing increases. Businesses often rely on loans to finance operations, expand, or invest in new projects. Higher interest rates mean that the cost of servicing debt rises, which can discourage companies from taking out loans. As a result, they may delay or scale back investment decisions, leading to fewer business transactions.

The findings obtained through questionnaire on interest rates charges led to decrease savings of the people shows that, 169(44.7%) strongly agreed, 80(21.2%) agreed, 82(21.7%) strongly disagreed and 47(12.4%) disagreed. Respondents agreed with high mean value of 2.8016 and standard deviation of 1.49279 respectively. This finding indicates that, rising interest rates can lead to decreased personal savings through a combination of increased living costs, changes in consumer behavior, economic uncertainty, and psychological factors. This finding aligns to those of Vogel (2021) that the higher interest rates often correlate with rising costs for loans, including mortgages, auto loans, and credit cards. As people face increased monthly payments and higher overall debt servicing costs, they may have less disposable income available for savings.

Instead of saving, individuals might prioritize meeting their immediate financial obligations, leading to a decrease in savings rates.

The findings obtained through questionnaire on interest rates charges led to reduction in bank lending shows that, 203(53.7%) agreed, 46(12.2%) strongly agreed, 81(21.4%) disagreed and 48(12.7%) strongly disagreed. The respondents agreed with high mean value of 2.4524 and standard deviation of 1.64296 respectively. This finding indicates that, interest rates increase, the cost of borrowing rises for both individuals and businesses. This means that loans become more expensive to service, leading to higher monthly payments for borrowers. This finding aligns to those of Eggertsson, et al., (2024) that potential borrowers may decide to postpone or forgo taking out loans, leading to a decrease in overall lending activity. This rising interest rates can lead to a reduction in bank lending through higher borrowing costs, decreased demand for loans, tightened lending standards, and changes in economic outlook. These factors create a complex environment where both consumers and businesses may be less inclined to borrow, impacting overall economic activity.

4.1.2 Determination Relationship between Interest Rates on Stimulating Economic Development in Tanzania

Determination relationship between interest rates on business transaction in economic development, Pearson correlation coefficient was used to compute the correlation between the dependent variable (Economic development) and the independent variables interest rates (interest rates charges on economic growth) in order to determine the strength of the relationship at 1% significance level. A correlation of $r > +0.7$ implies that the variable is strongly related positively. Correlation coefficient ranges from -1.0 (perfect negative correlation) to +1.0 (perfect positive relationship). And the relationship between the dependent variable and independent variable was established by correlation coefficient (Kothari, 2013).

Table 2. Correlations Analysis

S/No Specific Objective		1	2.	3.
Economic development	Pearson Correlation	1		.
	Sig. (2-tailed)			.
	N	378		
Interest rates charges on economic growth	Pearson Correlation	.851**	1	
	Sig. (2-tailed)	.000		.
	N	378	378	
**. Correlation is significant at the 0.01 level (2-tailed).				

Source: Field Data (2024)

Person correlation was used to determine the relationship interest rate variable (interest rates charges on economic growth and interest rates charges on personal savings) were found to have positive significant correlation on economic development at 0.01 level of significance. There was a strong positive significant correlation between Interest rates charges on economic development ($r=0.851$, $P<0.01$).

In general, these findings indicates that interest rate variable (interest rates charges on economic growth) was found to have positive significant effects to the economic growth in Tanzania. This the findings underscore the importance of interest rates in shaping the economic landscape in Tanzania. By facilitating access to capital and encouraging

personal savings, appropriate interest rate policies can significantly enhance business transactions and contribute to broader economic growth.

4.2 The objective was to investigate the effect of interest rates charges on economic growth in Tanzania

The study finding indicates that respondents agreed with high mean value of 2.57672 and Standard deviation of 1.457928 that interest rate led to increase price of commodities in the market indicates that, Changes in interest rates can also affect the broader economy, influencing consumer behavior and demand for commodities. Higher rates can slow economic growth, leading to reduced demand for certain commodities. Also, interest rates affect currency values. Higher rates can lead to a stronger domestic currency. If a currency appreciates, it can make commodities more expensive for foreign buyers, potentially reducing demand and impacting prices. Thus, changes in rates can influence consumer behavior, business investment, and overall economic growth. While higher interest rates may initially lead to increased prices for certain commodities due to inflationary pressures, the longer-term effects often include reduced demand and potential price stabilization or decline.

4.3 Determination Relationship between Interest Rates on Stimulating Economic growth in Tanzania

The findings indicates that interest rate variable (interest rates charges on economic growth) was found to have positive significant effects to the economic development in Tanzania. This the findings underscore the importance of interest rates in shaping the economic landscape in Tanzania. By facilitating access to capital and encouraging personal savings, appropriate interest rate policies can significantly enhance business transactions and contribute to broader economic development.

5. Conclusion

From above summary the study concluded that, higher interest rates can drive up commodity prices and influence consumer behavior, potentially slowing economic growth and reducing demand for certain goods. This demonstrates that fluctuations in interest rates have broader implications for the economy. Also, increased interest rates can strengthen the domestic currency, but this appreciation may make commodities more expensive for foreign buyers, further complicating demand dynamics. Conversely, lower interest rates can lead to currency depreciation, impacting international trade. Thus, the higher interest rates appear to facilitate business activities, indicating their role as a crucial factor in promoting economic growth.

The study recommended that, policymakers should carefully consider the implications of interest rate adjustments on economic growth, currency stability, consumer behavior, and business transactions to foster a balanced and sustainable economic environment in Tanzania. Tanzanian government should implement strategies to stabilize the domestic currency, such as enhancing foreign exchange reserves and promoting export diversification. This can help mitigate the adverse effects of currency appreciation on commodity prices for foreign buyers.

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