Abstract

The banking sector of Sri Lanka, principally it contains licensed commercial banks (LCBs) and licensed specialised banks (LSBs) which are essentially instituted in the finance industry of the country which based on the market share values. Despite, the both LCBs and LSBs perform extremely distinct functions in the finance industry of Sri Lanka while they are principally involved in the provision of liquidity to the complete economic system and distribution of uncertainties amongst their assets. Aside from the above, state banks are also engaged in the provision of most of the financial services that are similar to global transaction models while facilitating all the economic entities of the country. However, the state of the banking sector is one of the most vital areas due to the precise value of the finance industry that depends on the size of the state bank while considering the finance market of the country, it largely insists on credit and capital markets that come subsequently under both money and capital markets. Nevertheless, when considering the functions of state banks and financial markets, they are mainly restricting certain frameworks in short – and medium-term objectives. Anyhow, due to the more backward state policies as per the economic system of Sri Lanka, the greatest amount of state banks has not been able to implement long – term policies since the last few decades. Despite, state banks essentially line up with the ordinances of the Central Bank of Sri Lanka which is a mandatory requirement. Apart from the basic functions of the state banks of Sri Lanka, they are extremely engaged in the significant economic activities of the country while assisting to enhance the market price stability under the monetary policy framework of Sri Lanka. Hence, state banks are being highly considered the government policy instruments while understanding the operating objectives, indicative intermediate variables such as the extensive money supply of the state and ultimate objective which are based on profitability and highest service to the nation. This research has used Average Weighted Deposit Rate and Average Weighted Prime Rate as interest rates and Return on Assets (ROA) and Return on Equity (ROE) as profitability indicators in order to find the relationship between interest rate volatility and profitability of the State Banks, as the bank's profitability is likely to be highly dependent on the interest rate volatility. By assessing the relationship between interest rate volatility and the profitability of the state banks will help the stakeholders to change the course of decision making and arrive with new strategies to overcome possible interest rate risks and take proactive measures to divert risky investments into a far more rewarding pathway.