

MACROECONOMIC AND BANK-SPECIFIC
DETERMINANTS OF MALAYSIAN BANK PROFITABILITY:
EVIDENCE DURING THE PERIOD OF 2008 GLOBAL
FINANCIAL CRISIS

NURUL HAZWANI BINTI RAMLI

MASTER OF SCIENCE (MSC) BANKING

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FINANCIAL CRISIS

By

NURUL HAZWANI BINTI RAMLI

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Abstract

This dissertation analyzes the determinants of commercial bank profitability in Malaysia for the period 2006-2012. This dissertation also examines whether 2008 global financial crisis affects bank profitability in Malaysia. Since the sample comprises foreign and local banks, this dissertation also tests whether there is significant difference between foreign and local banks in the aspect of profitability, as generally, foreign banks have larger capital than that of local banks. From the fixed effect estimation analysis, the findings suggest that Malaysian banks with a larger capital and higher credit quality exhibit high profitability level. The findings also demonstrate that bank size has a negative relationship with bank profitability, implying that bigger banks have lower profits than that of small banks. The results also do not support that foreign banks are more profitable than that of local banks in the period studied. In the aspect of macroeconomics determinants, the results suggest that GDP is not the main determinant of Malaysian bank profitability, while on the contrary, inflation rate significantly impact bank profitability in Malaysia. Interestingly, this dissertation does not find conclusive evidence to support that the 2008 global financial crisis affects bank profitability in Malaysia.

Keywords: *macroeconomic variables, bank-specific variables, domestic and foreign commercial banks, panel data, return on asset, Malaysian banking sector*

Abstrak

Tesis ini menganalisis penentu keuntungan bank perdagangan di Malaysia bagi tempoh 2006-2012. Tesis ini juga cuba meneliti sama ada krisis kewangan 2008 global memberi kesan kepada keuntungan bank di Malaysia. Sejak sampel terdiri daripada bank-bank asing dan tempatan, tesis ini juga menguji sama ada terdapat perbezaan yang signifikan di antara bank-bank asing dan tempatan dalam aspek keuntungan, sebagai amnya, bank-bank asing mempunyai modal yang lebih besar daripada banks. From tempatan kesan analisis anggaran tetap, penemuan menunjukkan bahawa bank Malaysia yang mempunyai modal yang lebih besar dan kualiti kredit yang lebih tinggi mempamerkan tahap keuntungan yang tinggi. Dapatan kajian juga menunjukkan bahawa saiz bank mempunyai hubungan yang negatif dengan keuntungan bank, menunjukkan bahawa bank-bank yang lebih besar mempunyai keuntungan yang lebih rendah daripada itu keputusan banks. The kecil juga tidak menyokong bank-bank asing adalah lebih menguntungkan daripada yang bank-bank tempatan dalam tempoh yang dikaji. dalam aspek makroekonomi penentu, keputusan menunjukkan bahawa KDNK tidak adalah penentu utama keuntungan bank Malaysia, manakala sebaliknya, kadar inflasi ketara memberi kesan keuntungan bank di Malaysia. Menariknya, disertasi ini tidak menemui bukti yang kukuh untuk menyokong bahawa krisis kewangan global 2008 memberi kesan kepada keuntungan bank di Malaysia.

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LIST OF ABBREVIATIONS

ROAA	Return on Average Assets
CAP	Capital Ratio
LSIZE	Logarithm of the Total Assets of Each Commercial Banks
LDEPOSITS	Logarithm of the Total Deposits of Each Commercial Banks
IR	Inflation Rate
GDP	Annual Percentage Changes of Malaysian Gross Domestic
LLP/TL	Loan Loss Provision to Total Loan
EQAS	Equity to Assets Ratio
NIM	Net Income Margin
NII/TA	Net interest income to total asset
LNTA	Logarithm of the Total Assets
RWA	Risk Weighted Average
GMM	Generalized method of moments
CHF	Swiss Franc
ETP	Economic Transformation Programme

CHAPTER ONE: INTRODUCTION

1.1 Background of study

Banking sector plays an important role in the economy. The Governor of Central Bank of Malaysia, Dr. Zeti Akhtar Aziz in year 2012 highlights that banking institutions are the most influential financial intermediaries that help to improve economic operations and hence, generating economic growth. Over the past few years, banking sector around the world experienced a rapid changing due to the changes in the financial structure environment and economic conditions (Naceur et. al, 2011).

Despite the increased trend toward bank disintermediation observed in many countries, the role of banks remains central in financing economic activity in general and different segments of the market in particular. A sound and profitable banking sector is better able to withstand negative shocks and contribute to the stability of the financial system. Therefore, the determinants of bank profitability have attracted the interest of academic research as well as of bank management, financial markets and bank supervisors.

In Malaysia, banks are regarded as dominant financial institution thus, their health condition is crucial as it will give effect to the general health of the economy (Sufian, 2009). As the asset of the bank is high, the bank profitability is also increased. Sufian (2009) stated Malaysian banks contribute more than 70 per cent of the total assets in the financial system. Commercial banks are considered as the leader of the Malaysian banking sector and main profitable banks (BNM Bulletin, 2013). This dissertation is solely focused on commercial banks due to its role as the country's largest and most significant fund provider in the Malaysian banking system. Until 2012, commercial banks

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Appendices

Table 6

Descriptive statistic

stats	roaa	cap	ln_ta	loanta	llp_loan	cpi	gdp	dum_0709	dum_fo~n
mean	.0321175	.081686	17.18239	.4835098	.004732	2.603725	4.770636	.4285714	.6
p50	.0320544	.0761316	17.55615	.568086	.0047574	2.027353	5.585031	0	1
min	.0056367	.0065035	13.94309	.0042582	-.0162491	.5833084	-1.513683	0	0
sd	.0111718	.0323199	1.591939	.2185283	.0068655	1.494732	2.693518	.4966486	.491657
max	.0785095	.1954159	19.65195	.7500752	.0441398	5.440782	7.425006	1	1

Table 7

Multicollinearity

. corr
(obs=135)

	code	year	roaa	cap	ln_ta	loanta	llp_loan	cpi	gdp	dum_0709	dum_fo~n
code	1.0000										
year	0.0620	1.0000									
roaa	-0.3186	-0.2797	1.0000								
cap	-0.1780	0.0395	0.1657	1.0000							
ln_ta	-0.2457	0.0383	0.2848	-0.1619	1.0000						
loanta	-0.1505	0.0391	0.2069	-0.2621	0.4797	1.0000					
llp_loan	-0.1477	-0.3252	0.2924	-0.2755	0.1640	0.3145	1.0000				
cpi	0.0087	-0.3511	0.1241	-0.0578	-0.0367	-0.0407	0.0137	1.0000			
gdp	0.0058	0.0268	0.0344	-0.0077	0.0076	-0.0355	-0.0607	0.3401	1.0000		
dum_0709	-0.0206	-0.4544	-0.0182	-0.0746	-0.0155	-0.0289	0.1489	0.0749	-0.5130	1.0000	
dum_foreign	0.4386	0.0314	-0.1906	0.0535	-0.6855	-0.3765	-0.2355	0.0048	0.0037	-0.0108	1.0000

Table 8

OLS regression

. (10 vars, 140 obs pasted into editor)
 - preserve
 reg roaa cap ln_ta loanta llp_loan cpi gdp dum_0709

Source	SS	df	MS			
Model	.004113131	7	.00058759	Number of obs =	135	
Residual	.012029812	127	.000094723	F(7, 127) =	6.20	
Total	.016142943	134	.00012047	Prob > F =	0.0000	
				R-squared =	0.2548	
				Adj R-squared =	0.2137	
				Root MSE =	.00973	

roaa	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
cap	.1081713	.0277149	3.90	0.000	.0533286	.163014
ln_ta	.0017774	.0006096	2.92	0.004	.0005712	.0029836
loanta	.0035719	.0046796	0.76	0.447	-.0056883	.012832
llp_loan	.5123356	.1331068	3.85	0.000	.2489412	.7757301
cpi	.0012154	.0006253	1.94	0.054	-.000022	.0024528
gdp	-.0001381	.0004088	-0.34	0.736	-.000947	.0006708
dum_0709	-.0014641	.0021099	-0.69	0.489	-.0056393	.0027111
_cons	-.0131653	.0104969	-1.25	0.212	-.0339368	.0076062

Table 9

Fixed effect estimation

Fixed-effects (within) regression
 Group variable: **code**
 R-sq: within = 0.3105
 between = 0.2174
 overall = 0.0360
 corr(u_i, xb) = -0.9300

Number of obs = 135
 Number of groups = 20
 Obs per group: min = 4
 avg = 6.8
 max = 7
 F(7,108) = 6.95
 Prob > F = 0.0000

roaa	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
cap	.0951038	.0537797	1.77	0.080	-.011497	.2017046
ln_ta	-.0129875	.0035385	-3.67	0.000	-.0200013	-.0059736
loanta	.0225087	.0136216	1.65	0.101	-.0044915	.049509
llp_loan	.2580037	.1314257	1.96	0.052	-.0025049	.5185122
cpi	.0007647	.000499	1.53	0.128	-.0002244	.0017537
gdp	.0000508	.0003235	0.16	0.875	-.0005903	.000692
dum_0709	-.0016822	.0017697	-0.95	0.344	-.00519	.0018257
_cons	.2342973	.0641275	3.65	0.000	.1071855	.3614091
sigma_u	.02366991					
sigma_e	.00755409					
rho	.90756249	(fraction of variance due to u_i)				

F test that all u_i=0: F(19, 108) = 5.41 Prob > F = 0.0000

Table 10**OLS regression for dummy foreign**

```

. (10 vars, 140 obs pasted into editor)
- preserve
- preserve
reg roaa cap ln_ta loanta llp_loan cpi gdp dum_foreign

```

Source	SS	df	MS	Number of obs =	135
Model	.004217337	7	.000602477	F(7, 127) =	6.42
Residual	.011925606	127	.000093902	Prob > F =	0.0000
				R-squared =	0.2612
				Adj R-squared =	0.2205
Total	.016142943	134	.00012047	Root MSE =	.00969

roaa	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
cap	.1142227	.0278085	4.11	0.000	.0591947	.1692508
ln_ta	.0023922	.0007822	3.06	0.003	.0008445	.0039399
loanta	.0042132	.0046404	0.91	0.366	-.0049694	.0133957
llp_loan	.5300393	.1334472	3.97	0.000	.2659713	.7941072
cpi	.001112	.000594	1.87	0.064	-.0000635	.0022875
gdp	.0000209	.0003331	0.06	0.950	-.0006383	.0006801
dum_foreign	.0030123	.0023848	1.26	0.209	-.0017069	.0077314
_cons	-.0275048	.0147112	-1.87	0.064	-.0566155	.001606