

BANKING SECTOR DEVELOPMENT ON ECONOMIC GROWTH: STRUCTURAL EQUATION APPROACH

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of Science in Business Statistics

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ABSTRACT

Banking sector development on economic growth: structural equation approach

Banking sector is an important segment of an economy. Financial and regulatory authorities have been stressing the requirements to cope with the unforeseen consequences on financial systems, banks and economic growth globally. This study explores the determinants of the banking sector development (BSD) and direct and indirect effect of the BSD on economic growth of 18 countries for the period of 2006 to 2014. As per the objectives, Two-Step System-Generalized Method of Moment (GMM) estimation used to explore the determinants of the BSD. To explore the direct and indirect effect of the BSD on economic growth, Three Stage Least Square (3SLS) estimation is used. Four indicators of the BSD, (i) bank intermediation (IM) proxied by private credit by deposit money bank to GDP, (ii) bank broad access (BA) proxied by commercial bank branches per 100,000 adults, (iii) bank profitability (PF) proxied by banks return on assets and (iv) bank liquidity (LQ) proxied by banks liquid assets to deposit were identified. Study found that BSD was determined by economic growth (EG), interest rate (IR), trade liberalization (TL), financial liberalization (FL) and governance infrastructure (GVI) explored by the first principal component of the six governance indicators. Results of the direct effect on economic growth indicates that per capita commercial bank branches have significantly influenced to the economic growth. The indirect results showed that human capital development of the selected countries has significantly cared the economic growth effects of the IM and BA out of the four models. Since, improved bank intermediation and bank access have allowed flowing credits and reliable banking facilities to the entrepreneurs and individuals for the investment on skilled labour by way of trainings and higher education opportunities which have ultimately improved the economic growth endogenously. The study suggested that governments and monetary authorities must review the policies towards the hassle-free financial access and prioritize the productive investment ventures when providing bank facilities towards the economic growth.

Key Words: Banking Sector Development, Endogenous Growth, Financial Crisis, Generalized Method of Moment and Three Stage Least Square.

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LIST OF ABBREVIATIONS

Abbreviation	Description
2SLS	Two Stage Least Square
3SLS	Three Stage Least Square
ADRL	Autoregressive-distributed lag
AFR	Average Fertility Rate
AGRP	Annual Growth of the Population
ASTEP	Average working population with Secondary and Tertiary Education Level
ATM	Automated Teller Machine
BA	Broad Access
BCBS	Basel Committee on Banking Supervision
BLAD	Bank Liquid Assets to Deposit
BROA	Banks Return on Assets
BSD	Banking Sector Development
CAR	Capital Adequacy Ratio
CBB	Commercial Bank Branches per 100,000 Adults
CC	Control of Corruption
CGI	Composite Governance Index
DMI	Democracy Index
ECC	Error Correction Code
EG	Economic Growth
EIU	Economist Intelligence Unit
EU	European Union
FDI	Foreign Direct Investment

FE	Fixed Effect
FSI	Financial Soundness Indicators
FSI	Financial Stability Institute
GCE	Government Consumption Expenditure
GDP	Gross Domestic Product
GE	Government Effectiveness
GFCF	Gross Fixed Capital Formation
GFDD	Global Financial Development Database
GMM	Generalized Method of Moment
GI	Governance Infrastructure
HC	Human Capital
HHI	Herfindahl-Hirschman Index
IFC	International Financial Corporation
IFR	Inflation Rate
IM	Intermediation
IMF	International Monetary Fund
II	Initial Income
IV-GLS	Instrumental Variable-Generalized Least Squares
LQ	Liquidity
MEME	Manufacturing Export share on Merchandise Exports
MENA	Middle East and North America
MSME	Micro, Small and Medium Enterprises
NGVI	New Governance Indicator
NRR	Natural Resources Rent
OECD	Economic Co-operation and Development

OLS	Ordinary Least Square
PA	Political Stability and Absence of violence
PAG	Population Aging
PCA	Principal Component Analysis
PCDMB	Private Credit by Deposit Money Bank to GDP
PEE	Primary Education Enrolment in Population
PF	Profitability
PELF	Primary Education Level in Labour Force
PGDP	Per capita Gross Domestic Products
PI	Physical Investment
POLS	Pooled Ordinary Least Square
R&D	Research and Development
RE	Random Effect
RGDPG	Real Gross Domestic Product Growth
RI	Reform Index
RIR	Real Interest Rate
RL	Rule of Law
ROL	Rule of Law
RQ	Regulatory Quality
SEM	Structural Equation Method
SUR	Seemingly Unrelated Regression
TC	Technology
TFP	Total Factor Productivity
TO	Trade Openness
TOT	Trade of Terms

USD	United States Dollars
VA	Voice and Accountability
WB	World Bank
WBG	World Bank Group
WDI	World Bank Development Indicators
WGI	Worldwide Governance Indicators
WITS	World Integrated Trade Solution

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