

FACTORS AFFECTING INTEREST RATES ON DEPOSITS

Mr. karim Khan*

Ms.fouzia nasir**

ABSTRACT:

The purpose of understanding this study is to see that saving deposits are not necessarily increased by positive change in real interest. There may be also other factors (like: economic & demographic factors; rise in per capita income; increase in remittances; high proportion of population is of working age; high inflation; and increase in certainty in business & political environment etc.) involve in this context. This report also suggests some positive ways for improving degree of deposits into bank

* Asst professor-D.A.SKBZ-COLLEGE

** Asst professor-D.A.COLLEGE FOR WOMEN

INTRODUCTION:

Background: Deposit is the life blood for a bank. Without its mobilization, banks can not function. Similarly it is the major expense item on Bank Books. Banks strive hard to mobilize cheap deposits, which helps them to reduce their expense and consequently increase their earnings. Thus the interest rates also play an important role while mobilizing deposits.

Problem Statement: The Statement of this research is to investigate the critical role of interest rate (rate of return) on deposits growth and other factors affecting on it.

Study Objectives: The purpose of conducting this study is to evaluate the nature of relationship between the growth of deposits and interest rate with the factors which influence over this relationship.

Significance of the Study: The study will help researchers, strategic level managers and organizational development consultants to understand the different factors, including interest and their impacts on the deposits mobilization into our country.

Research Methodology: This study is qualitative as well quantitative in nature and would be based on the information and data collected from primary and secondary sources.

Hypothesis: The theoretical assumption is that with the rise of interest rates the deposit should grow or vice versa.

H₀: Deposits are not necessarily increased by positive change in real interest. There may be also other factors involved in this prospect.

H_a: Deposits are only being increased when people will get positive

DETERMINANTS OF DEPOSITS:

Economic & Demographic Factors: In Pakistan, it is also found while estimating the saving function for micro data that average incomes and savings of an urban household are more than those of Rural. But on the other hand propensity to save for rural areas is more than those of urban.

Increase in Real Interest Rate: provides an incentive to private households to save more, induces corporate sector to generate its own savings due to high cost of borrowing, thus overall saving would increase

A Rise in Per Capita Income: may lead to higher savings in the developing countries. Therefore a rapid growth of income leads to a rapid growth of savings as people lead to save more out of transitory income.

Remittances: are also used as explanatory variables in deposits. If the foreign residents remit their earnings regularly in their home land and their particular percentage is deposited into banks as saving, consequently, it will lead to high deposits.

Age structure: of a country also effect saving rates. Higher proportion of the young and elderly in relations to persons of working age-dependency ration are associated with lower saving rates.

Transitory Improvement: in term of trade leads to higher savings rather than higher consumption.

Higher Inflation: Inflation can also increase savings through real balances effect, where holders of money balances and other financial assets try to restore the real value of their holdings after an increase in prices.

FACTORS AFFECTING INTEREST RATES ON DEPOSITS:

Rises in Inflation: After 9/11 the inflation rates especially in Pakistan has increased. The reason observed is that, there is no properly mention of employment, fixed investment and distributional concerns in our monetary policy statement or the annual or quarterly review of the State Bank. Monetary policy is not made with these concerns in mind and the impact of this policy on employment and the growth of distributional injustice is therefore not evaluated; even inflation targeting is crudely aggregative. Moreover naïve post monetarist advocates of consumption-fuelled growth are killing domestic savings. There is now an

effective inflation tax on non current accounts savings of about 2.7 % on average. Therefore, continues rise in inflation rate has adversely affected on the increase in number of saving accounts in our country, although the volume of savings has gradually increased every year.

Influences of State Bank Pakistan: A part of commercial banks deposits are injected with the State Bank at a very minimum rate of return rather than utilized in lending profitable businesses. Further SBP also restricts member banks not to pay interest rates higher than the nationalized banks or national saving centers, which is indeed a big barrier for these banks to catch savings from the market at maximum interest rates and hence their role for lending big amount to sound investors become weak and consequently their role for effective economic growth in the country also become weak.

Public Deposits and Investment Strategy: The investment and saving rates in Pakistan could not be achieved significant growth in past two to three decades and resulted in slow economic growth as comparison with the East Asian economies, which reveals clearly that Pakistan has long way to go. To be at the same level of growth with these fast growing economies, Pakistan needs to finance the desired investment through increase domestic savings without undue reliance on the foreign resources as these introduce an element of unsustainability. Further there is a need to boost up the public saving and investment strategies in the country through effective policies and management rules, giving due consideration to the effectiveness of the potential determinants.

Interest Rates & Economic Growth: It has also been noted that gradually increase in interest rates on deposits reveals the face of rising inflationary pressure and strong fiscal positive goes hand in hand with ability of central bank to prudently sustain low interest rates on deposits which also leads to strong growth in government revenues and containment of fiscal deficit.

Impact of Monetary Policy: State Bank of Pakistan uses targeting monetary aggregate for its monetary management functions. This impact of monetary policy remains successful in controlling interest rates and increasing deposits of public in saving accounts of commercial bank to an extent in last 10 to 15 years but as compare to other South Asian countries it is still

not very appreciable. The main cause is the decreasing in value of local currency day by day as compare to foreign currencies in a very high proportion than interest rates.

Environment Development: If the campaign reaches households that are already in financial system it will only induce household to switch between competing banks without creating social value. And if, however, it reaches households previously not connected to the system, it creates social returns by increasing financial depth. Thus, until unless a deposit created environment is not developed in the country at all level of income, the mobilization of savings through bank's deposits is not possible.

SBP Hikes Interest Rates: Although the SBP restricted all schedule banks to pay minimum profit rate of 5 % on all saving PLS accounts but the question arises, is this rate is sufficient to mobilize people towards more savings even the present inflation rate in our country is more than 10 %. Further to suppress the aggregate demand pressures and rising inflationary trends, it is imperative for real lending rates to increase.

Results of Financial Restructuring: Although the main purpose of restructuring financial sectors was to improving their efficiencies, their enrichment should be more to people for services rendering and giving a big hand in economic development projects. But, yet the impacts of these financial sector reforms are not positive in our country. For example deposits were paid negative real returns, thus discouraging savings in the country. Similarly, restrictions on interest rates led to financial disintermediation, as saver and investors sought alternative outlets out side the formal financial system. Consequently, financial deepening was hindered and financial resources were not directed into productive activities.

Working Age Dependency Ratio: In Pakistan a high proportion of the male population is involved in working age group and only a minor percentage of females are contributing their efforts in economic development of our country, because of Islamic Culture and stillworse thinking of our educated society that women should only look after children and home affairs. Consequently, higher proportion of the female young and elderly in relation to person of working age depend on their males and hence it adversely affects on the savings rate in our country. And in many families it is zero and their income & expenditures are hand to mouth.

Cash Remittances Facility: It is also observed that, much of the remittances are used for repayment of loans, in daily expenses such as food, clothing, child education and healthcare and basic subsistence needs. Funds are also spent on building or improving housing, buying cattle or land or durable, consumer goods such as washing machines and televisions etc....They are also utilizing remittances for financing migration of other family members, on social ceremonies and community development activities. Consequently, only a small percentage of remittances are used for savings

Determinants of Interest Spread: The high lending rate increases the cost of borrowing and hence discouraging investment. On other hand low deposit rate discourages the consumption and savings, resulting high debt/GDP, deterioration of bank balanced sheet, lowering economic growth and increase in poverty. Further more, the large spread also reflects perceived sovereign risk.

Islamic Banking & Deposit Mobilization: Although the concept of interest, has been replaced by Islamic Banks with the concept of equalize profit, profit-sharing, rental sharing, profit and loss sharing, commission service charges, etc. as it has been termed as Shariah complaint return by the Supreme Court of Pakistan in the Riba Judgment which has been remanded...But still a particular saving group is still not been convinced to motivate for deposits through these banks.

Interest Rates on Public Vs Private Bank Deposits: It has also been observed that the State Bank of Pakistan restricts the private commercial banks to pay profit to their deposit holders comparatively at low rate than the government's banks or we can say on national saving schemes. Due to which the trend of money savers is diversified more in government saving schemes as compare to private banks. Thus the major part of deposits goes in the hands of government who often lends these amounts to unproductive projects as compare to private banks.

Low Level of Per Capita Income: The per capita income of Pakistan is \$ 1,000 per year means about Rs 70,000/- , which is very low as compare to other Asian developing countries....As the expenditures are high, so the majority are passing their lives with hand to mouth and are not able to save money.

Lack of Knowledge Regarding Banking System: It has also been observed that the major population in Pakistan is illiterate or not knowing properly the functions and offered schemes of commercial banks for their deposit holders. Moreover if they are entered into the bank for know how regarding the saving process they are not treated properly because of very low propensity of savings and often they are ignored or discouraged for savings.

Extra Ordinary Documentations: One of the draw back which I found during my study regarding the failure of target savings by private commercial banks as compare to nationalized banks or saving centers in the country is the extra ordinary documentations done by them at the time of opening any saving deposit account. Further their documentation processes are very complicated and in more detailed as compare to government's banks.

Minimum Limits of Amounts: One of the major reasons of the declining bank's mobilization towards deposits is the minimum amount requirement for opening saving account in any ordinary bank. Which is from Rs. 1,000/- to Rs 2,000/- and the minimum level of keeping balance required in the banks are from Rs. 5000/- to 50,000/-. It is therefore, for the lower income class mobilization of savings is obsolete.

Certainty in Business Environment: If the business and political environment in the country are certain means stable than there is a great opportunity of local as well as foreign investments in the country. Consequently large income will be rose, which may lead towards high savings i.e. high deposits of cash into banks.

CONCLUSION:

It is concluded that Hypothesis was correct, means deposits are not necessarily increased by positive change in real interest. There may be also other factors like high inflation, transitory improvement in trade, high proportion of population of working class, remittances rise in per capita income, increase in uncertainty of stock market and economic & demographic factors etc. Further, it has also been proved that in last fifteen years although it was a fluctuating trend in number of opening saving deposit accounts but the degree of amount has

continuously increased which reveals the increase of money savers trust on banks and other financial institutes.

REFERENCES

Adams, D., 1988, "Mobilizing Household Savings through Rural Financial Market," Economic Development & Cultural Change, pp 547-560.

Khan and Muhammad Arshad, 2007, "Financial Sector Restructuring in Pakistan," Pakistan Institute of Development Economics Islamabad. <http://mpira.ub.uni-muenchen.de/4141/>

Nusrat Khurshedi, 2008, "Using Remittances for Economic Development," <http://DAWN.com>

"NSS & Scheduled Banks Deposits," 1992-2007, Statistics of NSS and Scheduled Banks. www.sbp.org.pk

Idrees Khawaja and Musleh-ud-Din., 2007, "Determents of Interest Spread in Pakistan," working papers, 2007: 22, Pakistan Institute of Development Economics, Islamabad

Amjad R., 1986, "Impact of Workers Remittances from Middle East on Pakistan's Economy: Some selected issues," Pakistan Development Review, vol.25,no.