The Impact of Recent Financial Recession on the Banking sector of Pakistan

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Abstract:

The basic intent of this study is to examine the impact of recent financial crisis on the Pakistan commercial banking sector. This research paper will help to create the awareness about the risk factor which involves in Pakistan investment sector. The current worldwide financial crisis starts from large financial markets like US, UK and Candia. And this crisis becomes a cause of the fall down of well-known names in banking sector. Objective of this study, to establish the practical facts, that either the recant global financial crisis have or have not significant impact on Pakistan banks. The findings of this study will help to develop the assured recommendations which may help to formulate the policies regarding stabilization and crisis management in Pakistan banking sector.

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1. Introduction

The term "**financial crisis** is applied broadly to a variety of situations in which some financial institutions or assets suddenly lose a large part of their value".and this situation will lead to economic recession. As we know that characteristics Capitalist economic system in which the market forces have controlled the demand supply of goods and services and determine the price. In simple Capitalist economic system land, labor, production pricing and distribution are all determined by the market forces. We have to know the strong history of capitalism which is evident to extended period of massive growth in very short time of contraction.

The recent financial crisis started from 2003-04 to up till now. Basically it does begin from 20th century and since now it becomes severely bad. At the end of previous millennium, the real state sector prices in US, after a period of boom, suddenly the real state business and their prices came down to dead level and create greater shock to US economy. It have adverse impact on American economic system specially in credit, insurance and other financial institutions due to this down fall.

This financial crisis started in the middle of 2004 to 2007 when the stock markets of large economies show slowed trend, and many prominent banks and financial institutions are shrunken or been shut down. To come out from this horrific condition the governments of so many countries intervene to support their economic systems by introducing the rescue packages or bail out packages. We have empirical examples of US and UK. And many countries like China, Ireland and Portugal speak out their substantial infant of international institutions. After the UK, U.S, China, Ireland, Portugal, Spain and Italy economies are also adversely affected from this recent financial crisis. The current financial crises also affect South Asian Growth rate, BOP, TOT and also financial sector. As a part of south Asian region this crisis also showed its effects on Pakistan economy. We already know that Pakistan is already facing serious economic issues like inflation, BOP and trade deficits, Poverty, unemployment issues in Pakistan the domestic and foreign investment is very low because of the law and order situation caused by the engagement in war on terror, and because of this critical situation the only solution left for Pakistan government is to go toward the international financial institutes like IMF or world bank, because Sudi Arabia has refused to give Pakistan a financial concession on the oil trade, as well as we did not get any support from the forum like "Friends of Democratic Pakistan" as low as nothing. Now Government of Pakistan is receiving loan from IMF which imposed extremely tight terms and conditions which already started to show its effects in the economy as the hick inflation, poverty and unemployment is also increased because low purchasing power parity. A fragile Pakistan economy has been facing both economic and political crisis which predate the global financial crisis.

The global financial crises has started showing its effect on Pakistan's banking as profit rates on all accounts are likely to drop later this month. It wasn't long in the past when the news of Pakistani banks keeping their profit rates steady assured the investors and account holders that the global financial crisis has not affected Pakistan's banking.

Objectives of the present study are to find out the effect of financial crisis on the performance of commercial banks along with the policy guidance to enhance the performance of commercial banks.

2. Review Of Relevant Literature

The literature is not simply submissive consideration of the stated knowledge, but an active synthesis of that knowledge with the framework of the investigator's research. The importance of the re-examine of literature lies in the fact that it provides background knowledge to the problem under study. Some of the literature reviewed is given below.

Jeon and Miller (2002) "discussed Asian financial crisis spread and its effect across a number of countries. Korea faced serious issues in her financial and corporate sectors. His paper considers the performance of Korean countrywide banks before, during, and right away after the Asian financial crisis. Several factors acquire strong correlations with bank performance".

Firdausy (2002) talk about the "Indonesian financial predicament which turn into a great economic crisis, transformed the country from one of the world's fastest growing economies into one of its slowest growing economies. The economic crisis had a critically effects the Indonesian economic system, extensively the rise in unemployment".

Haung et al. (2003) discussed in his paper both "the beginning of the financial crisis in 1998 and the striking economic recovery afterwards in Russia and other Former Soviet Union (FSU) economies. Before the crisis banks do not lend to the real sector of the economy and firms use non-bank finance, including trade credits and barter trade, to finance production".

Chansarn (2005) gave the aims "to consider the efficiency in Thai financial sector after the financial crisis (1998 – 2004) by looking at the total factor productivity (TFP) growth in his paper. Furthermore, his study also scrutinizes the efficiency in commercial bank, finance, securities company sector and insurance company sector, and the efficiency in household and foreign financial companies".

Hayo (2005) gave an account in his research work of "the financial crisis that took place in Korea from the point of view of the Korean population using survey data collected in 1998 and 1999. Although both, interior and exterior factors were responsible as causes, domestic factors were considered to be of greater significance".

Feridun (2005) seek to find out in this article that "which macroeconomic variables played a role in the East Asian financial crisis of 1997 using a 'linear probability model' built for Malaysia, Indonesia, Thailand, Singapore, and Philippines".

Naghshineh- Pour (2008) "the present financial crisis and its impact on Iran economy discussed in this paper. The global financial crisis is set to depress oil producing economies. The crisis is pushing down oil prices in the world a firm response to the fall out of the crisis from governments and central banks".

Coulibaly and Millrar (2008) "found ambiguous results with the help of this study assesses the role of the Asian financial crisis of the late 1990s in the appearance and determination of the large current account surpluses across non-China emerging Asia, which has been a significant counterpart to the U.S. current account deficit".

Lungu and Daianu (2008) define the "combination of cyclical and structural factors have lead to a situation which could threaten financial stability worldwide they discussed in this paper. As the current financial turmoil is unfolding it becomes clearer that the effects of the initial sub-prime crisis, which originated in the US".

Schmidt (2009) "the worldwide financial crisis and its impact on china economy discussed in his paper. The recent financial effect China's Banks very badly. China's Banks see sharp turn down due to recent financial crisis. Financial sector the stock market break down that started in October 2008 has decreased more than two third of the market value."

Issues dissertation for conversation at the "Global Dialogue Forum at Geneva" on 24-25 February 2009 all ears on the impact of financial crisis on finance sector workers. The purpose of this paper is to in brief review the "background, causes, characteristics and path of the on going financial and economic issues".

3. Analytical Framework

Many studies have been made to asses the function commercial banks in economic development of a country. This study is carried out under these objectives to find out the effect of financial crises on the performance of commercial banks along with the policy control to enhance the performance of commercial bank.

To assess the impact of present financial crisis on the performance of Pakistani banking sector I use time series data of Albarka Islamic Bank, ABL, HBL, NBP, UBL, and MCB from 2000-2009 . The data is in non stationary form at level when apply "Dickey Fuller Test" is applied and correlogram of variables also shows that the data is non stationary at level. When apply correlogram and "Augmented Dickey Fuller Test" then they indicate that my model become cointegerate.

Trend analysis and regression analysis is carried out for this purpose. I use multiple regression models. To make the data stationary I take the difference of data at First difference it makes the data stationary.

3.1 Model

After taking the broad review of literature, the following model is specified to estimate the impact of recent financial crisis on the performance of Pakistan commercial banks

$$Y_t = f(X_1, X_2, X_3, X_4, X_5, X_6, X_7, X_8)$$

Y_t = A dependent variable denoting the profit on Banks from 2000-2009
X_1 = A variable denoting the Net Investments on Banks from 2000-2009.
X_2 = A variable denoting the Net Advances on Banks from 2000-2009.
X_3 = A variable denoting the Operating Fixed Assets on Banks from 2000-2009.
X_4 = A variable denotes Borrowing from Financial Institution on Banks from 2000-2009
X_5 = A variable denoting the Deposits and other Accounts on Banks from 2000-2009
X_6 = A variable denoting the Administrative Expenses on Banks from 2000-2009
X_7 = A variable denoting the Number of Employees on Banks from 2000-2009
X_{8i} = A dummy variable Financial crises effects on Banks from 2000-2009

Following multiple regression line has been regressed in this study.

$$Y_t = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_{8i} + \mu_i$$

The a priori expectations are as follows:

$$\beta_0, \beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6, \beta_7, \beta_8 > 0$$

The equation was estimated using a variety of analytical tools, including "Unit Root Tests, Co-Integration Tests and Error Correction Mechanism (ECM)". The results are discussed below. The data used for the

study covers the period 2000 and 2009. The study employed secondary data which are derived from "Hand Book of Statistics (State Bank of Pakistan) various issues of Albarka Islamic Bank, ABL, HBL, NBP, UBL, and MCB *Annual Report and Statement of Accounts*, ADB *Statistical Bulletin* and World Bank Reports".

4. Empirical Results

To estimate the relationship between net investments, net advances, operating fixed assets, borrowing from financial institution, deposits and other accounts, administrative expenses, profit and number of employees and also introduce a dummy variable of financial crises regress following regression model

$$Y_t = \beta_1 + \beta_2 X_{1t} + \beta_3 X_{2t} + \ldots + \beta_9 X_{8t} + \mu_i$$

The following regression equation is estimated

Profit=-252051.8+0.044718X_1+0.116281X_2+0.226987X_3-0.084707X_4-0.042850X_5 -0.725173X_6+36.60900X_7-104935

TABLE NO: 01 (Test Statistics of Multiple Regression Model)

	Coefficient	Standard Error	T-Stat
Intercept	-252051.8	847661.1	-0.297350
Net investments	0.044718	0.026103	1.713150
Net Advances	0.116281	0.022826	5.094286
Operating Fixed assets	0.226987	0.198192	1.145287
Borrowing from financial Institution	-0.084707	0.056666	-1.494848
Deposits and other accounts	-0.042850	0.020584	-2.081723
Administrative Expenses	-0.725173	0.282762	-2.564610
Number of Employees	36.60900	160.6250	0.227916
Financial Crisis	-1049353.	1669705.	-0.628466

Table Note: For Data analysis I have to use E-views (version 5.1) and find following results.

TABLE NO.02 (MODEL SUMMARY)

R-square	0.844189
Adjusted R-Squared	0.806416
S.E. of Regression	2532197
Durbin-Watson stat	1.474556
F-statistic	22.34933

The data is in non stationary form at level when apply dickey fuller test is applied and correlogram of variables also shows that the data is non stationary at level. When apply correlogram and Augmented Dickey Fuller Test then they indicate that my model become cointegerate. Above estimated regression shows that 1 unit change in net investments changes profit by 0.044718 units if other things remain constant. Through regression analysis it is observed that net investments positively affected by profit. The value of

T-statistic is 1.713150. The T-statistic shows the significant impact of profit. Also 1 unit change in net advances changes profit by 0.116281 units if other things remain constant. Through regression analysis it is observed that net advances positively affected by profit. Because banks gain earnings through advances. The value of T-statistic is 5.094286. The T-statistic shows the significant impact of profit.1 unit change in operating fixed assets changes profit by 0.2269873 units if other things remain constant. Through regression analysis it is observed that operating fixed assets positively affected by profit. The value of T-statistic is 1.145287. The T-statistic shows the insignificant impact of profit.1 unit change in borrowing from financial institution changes profit by 0.084707 if other things remain constant. Through regression analysis it is observed that borrowing from financial institution negatively affected by profit. The value of T-statistic is -1.494848. The T-statistic shows the insignificant impact of profit.1 unit change in deposits and other accounts changes profit by 0.042850 if other things remain constant. Through regression analysis it is observed that deposit and other accounts negatively affected by profit. The value of T-statistic is -2.081723. The T-statistic shows the insignificant impact of profit.1 unit change in administrative expenses changes profit by 0.725173 if other things remain constant. Through regression analysis it is observed that profit negatively affected administrative expenses negatively affected by profit. The value of T-statistic is -2.564610. The T-statistic shows the insignificant impact of profit.1 unit change in number of employee's changes profit by 36.60900 if other things remain constant. Through regression analysis it is observed that number of employees positively affected by profit. The value of T-statistic is 0.227916. The T-statistic shows the insignificant impact of profit. The last variable financial crisis put negative impact on profit but it is insignificant. R-squared and Adjusted R-squared is high. It reflects that 84% variations in profit due to other variables are explained by model.

The current financial crisis has shown that capital based regulations in ineffective regulations need to be based on Leverage instead. Regulation of credit is warranted. Particularly the sectoral contributions of bank loans. The exchange rate regime of pending local currency to the United State dollars has exchanged liquidity problem. Shifting to the policy of pegging local currency to an import weighted basket of currencies would therefore be a wise decision. Government has attempted to control financial crisis with the help of good regulatory system of financial sector. In this way impact of financial crisis on Pakistani banks may be controlled.

Time Series Trend of Variables

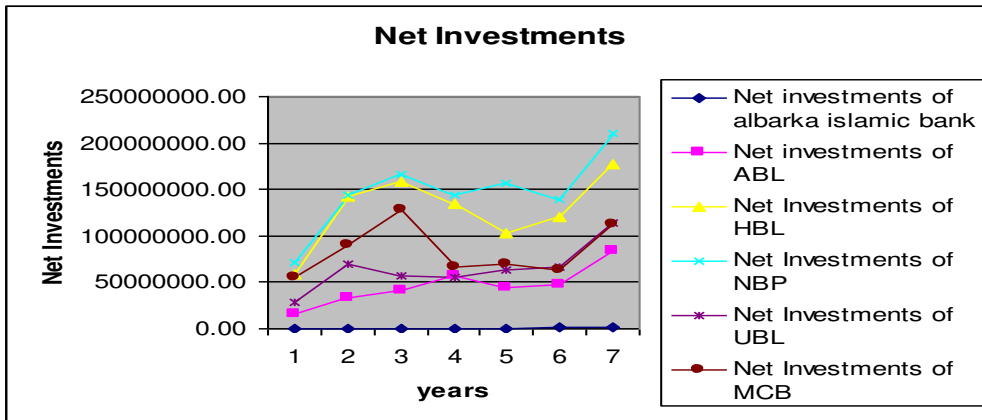**Figure: 01 Trend of Net Investments of Banks from 2000-2009**

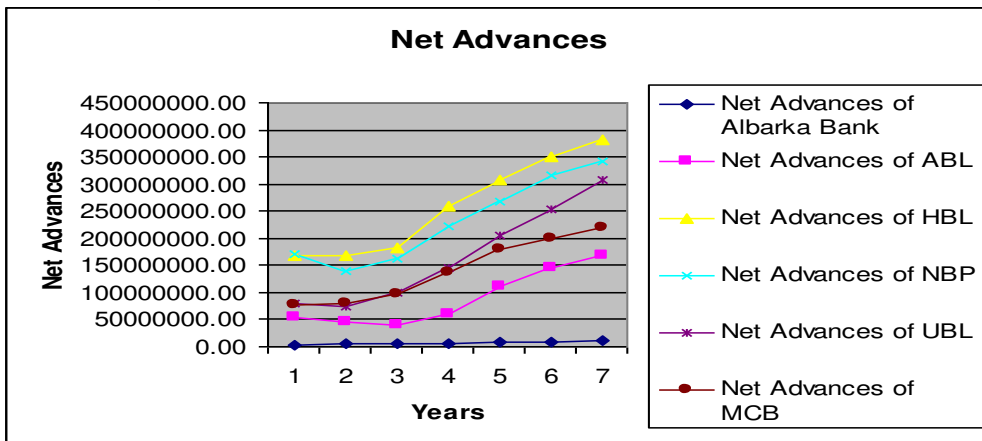**Figure: 02 Trend of Net Advances of Banks from 2000-2009**

Figure: 03 Trend of Operating Fixed Assets of Banks from 2002-2007
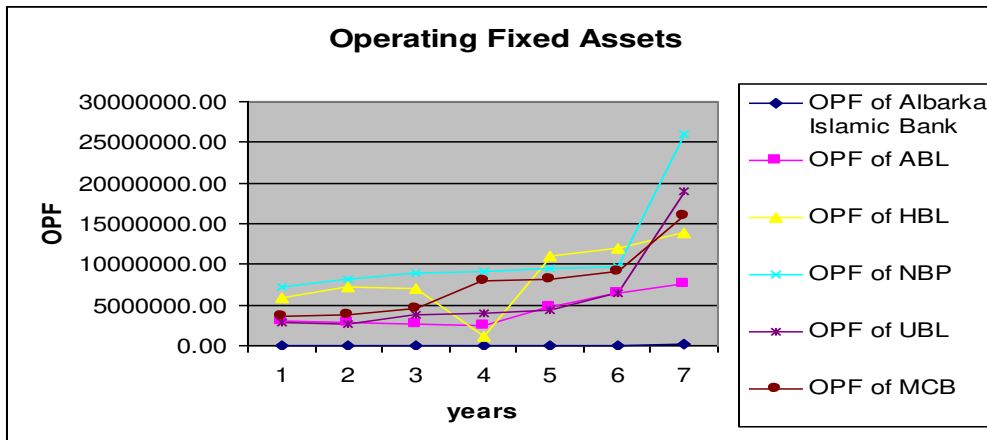
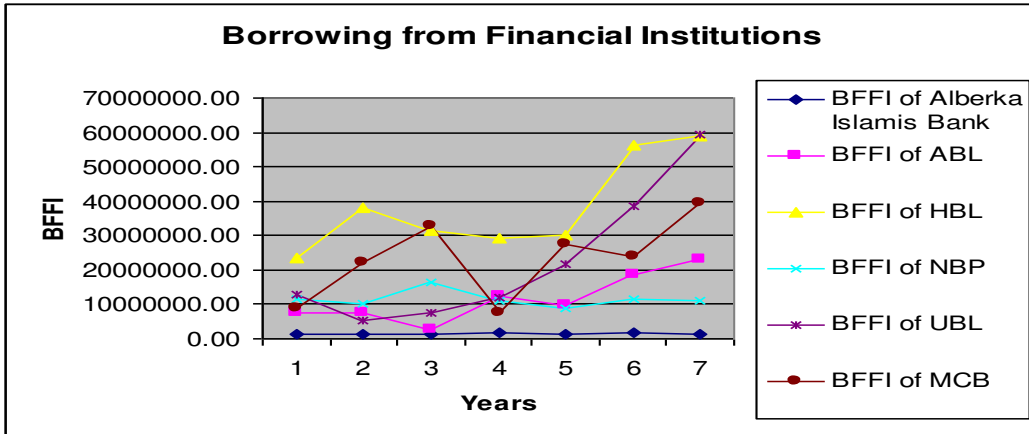**Figure: 04 Trend of Borrowing from Financial Institution of Banks from 2000-2009**

Figure: 05 Trend of Deposits and Other Accounts Of Banks from 2000-2009
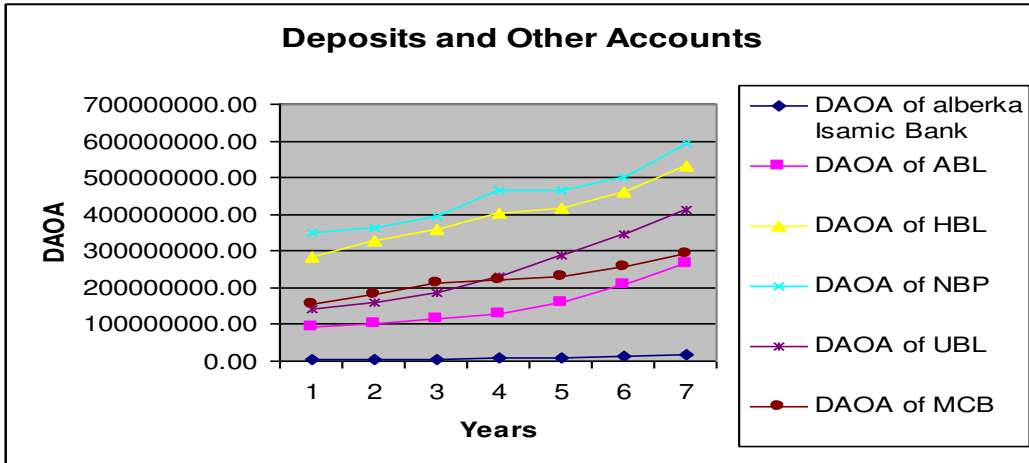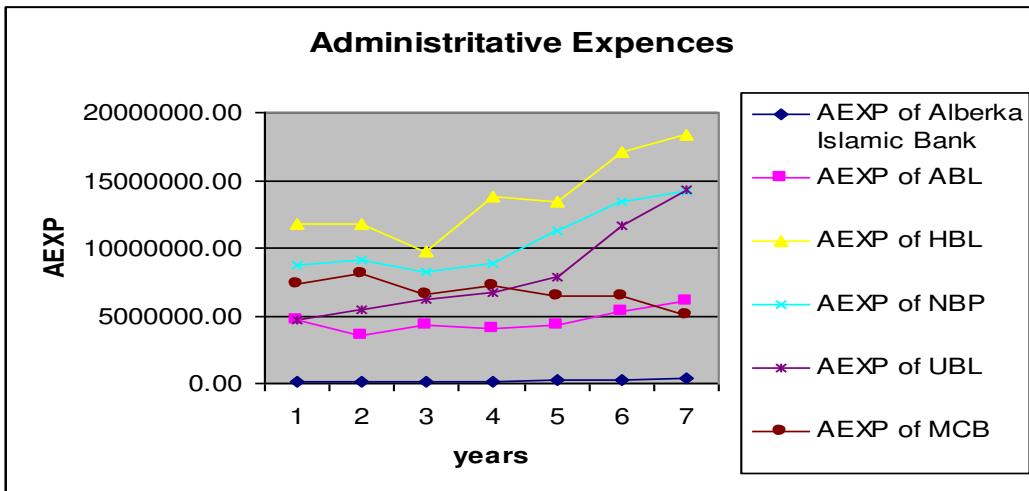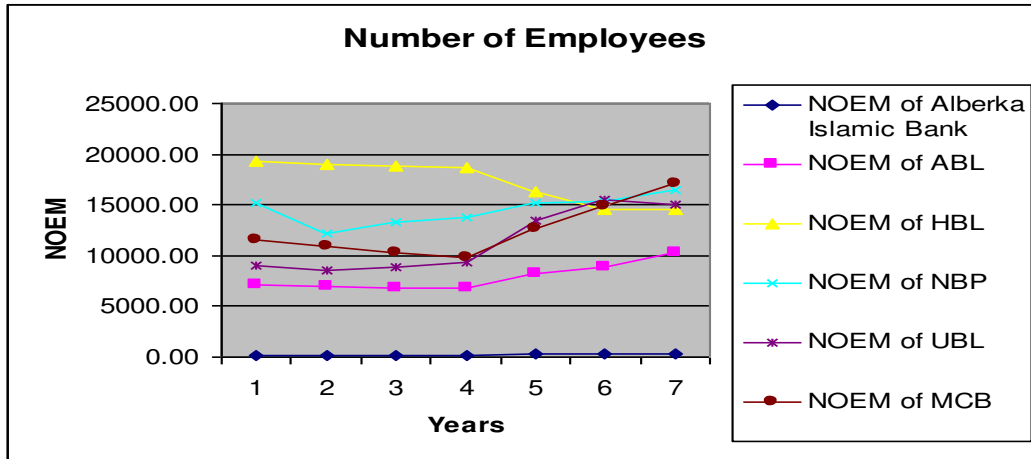

Figure: 06 Trend of Administrative Expenses of Banks from 2000-2009

Figure: 07 Trend of Number of Employees of Banks from 2000-2009

The above all graphs show that over all time series trend among the all variables and prominent commercial banks in Pakistan. Mostly variables show increasing trend and some are show decreasing trend.

5. Concluding Remarks

This study is carried out under these objectives to find out the effect of financial crises on the performance of commercial banks along with the policy guidance to enhance the performance of commercial bank. To assess the impact of current financial crisis on the performance of Pakistani banks I use time series data of Albarka Islamic Bank, ABL, HBL, NBP, UBL, and MCB from 2000-2009 . Trend analysis and regression analysis is carried out for this purpose. I use multiple regression models. To make the data stationary I take the difference of data. First difference makes the data stationary. Estimated regression equation shows that profit is influenced by net investment; net advances and operating fixed assets significantly. Borrowing from financial institution, deposits and other accounts, number of employees also influences profit but insignificantly. Current Financial crisis also put negative impact on profit but it is insignificant.

The government should introduce programs to recapitalize banks. Guarantee banks liabilities, and provide liquidity to banks by funding markets and in some case support troubled asset markets. Assets price inflation should be made under the control of monetary policy authorities by government. Responses to international disaster must be systematic, comprehensive, significant and organized. If the crisis will prolong for wide period, state government and local government may instigate to limit as they endeavor to shore up new financial transaction for operations.

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