Impact of Home Remittance and Debt Financing on Economic Growth of Pakistan 2005-2012

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ABSTRACT:

Pakistan has a semi-industrialized economy, which mainly encompasses textiles, chemicals, food processing, agriculture and other industries.This study is aimed to check the impact of Debt Financing from banks and home remittances on economy of Pakistan in the time span of 2005-2012.In order to achieve this aim Debt financing,Kibor rates, Profitability of Banks, Home Remittances and Trade Deficits are taken as variables. By using different statistical tests data are examined and on the basis of results conclusion and recommendations are drawn.
Keywords: KIBOR, Debt Financing, Home Remittances

Introduction:

Pakistan came into being on 14th August 1947, since its formation many reforms are placed and had different impacts on economy. The economy of Pakistan is the 47th largest in the world in nominal terms and 27th largest in the world in terms of purchasing power parity (PPP). Pakistan has a semi-industrialized economy, which mainly encompasses textiles, chemicals, food processing, agriculture and other industries.

Economy at a Glance in 2012:

The path of economic growth for any country depends on a number of factors including structural changes in the economy, natural calamities, political instabilities, global recessionary trends, self-feeding business cycles, etc., and the combined effect of all these factors is most commonly represented in the country's Gross Domestic Product. In statistical terms, however, the annual data series of GDP can be considered a combination of three processes; a long-run trend, business cycles, and short-run shocks to the economy, which can be separated from each other by using statistical techniques.

Fiscal and monetary policies are the tools of determining growth of any country. Monetary policy includes money supply and interest rate which is determined by the central bank of any country while the fiscal policy includes government revenues and expenditures which are done by the government of country. They both have interaction with one another if one is adopting tight policy then other one will adopt expansionary policy to balance the economy which gives direct impact on economic indicators such as GDP,Inflation etc.

Gross Domestic Product, the unemployment rate, the inflation rate, the interest rate and the exchange rate give a summary of the macro economy. The supply of money, the condition of credit and the price level influence the performance of the stock market over the short, medium and long run period.

Economy of Pakistan is facing a challenging situation. At start Pakistani currency appreciated but with the passage of time it started depreciated as compared to US Dollar and now US Dollar hit the highest rate of decade in Pakistan. Due to depressing economic condition govt of Pakistan and state bank of Pakistan are doing adjustment to make the economic condition favorable for growth but still there are some factors which are creating exchange rate exposure for investors.

Economic Highlights:

➢ GDP	211.092 bn $
➢ Inflation Rate	6.90%
➢ Trade Deficit	16095 mn $
➢ Budget	3.767 trillion PKR
➢ Bank Borrowing	303524 mn PKR
➢ Exchange Rate in $	97.0026
➢ Total debt	130 bn $
➢ Fiscal Year	1 July-30 June

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Sources of Inflows in Pakistan:

- Home Remittance
- Foreign Direct Investment
- Exports
- Foreign Aid

Home Remittance Country wise:

According to World Bank estimates the remittances flows to developing countries in 2011increased by 8.0 percent from $ 325 billion in 2010and is forecast to grow at 7 to 8 percent annually till 2014.Compared to the 10.1 percent growth in South Asia, remittances to Pakistan witnessed a strong growth of 25.8 percent in 2011 over previous year. Pakistan has become the fifth largest remittances recipient developing country in 2011. The general upward trend in remittances during the period under review was composed of a per annum average growth from U.A.E of 32.2 percent followed by U.K. (30.1 percent), Saudi Arabia(27.3 percent), EU countries (25.3 percent), Other GCC Countries (15.1 percent) and USA (9.5percent) during the period 2007-08 to 2010-11.

Budgetary Composition of Pakistan:

Reformer: Ministry of Finance

- Revenue
- Expenditure
- Fiscal Balance
- Financing of Fiscal Balance

Central Bank's Contribution in Economic health:

State Bank of Pakistan is the central bank of Pakistan, reformer of monetary policy, adjustment of KIBOR rate, decision maker regarding every sector's monetary policies, control M2 and interact with Fiscal policy of country.

Contribution of Banking Sector in Economy:

The role of the banks in the growth and development of sound and healthy economy of the country is briefly discussed as under:

1. Saving mobilization

2. Financing development project.

3. Facilitating trade activities.

4. Creating climate for capital formation.

5. Helping SBP in achieving monetary policies

6. Making capital available for investment

7. Export promotion cell

Scope of Study:

The scope of study will be very beneficial for:

- State Bank of Pakistan to identify relationship between KIBOR rates and Debt Financing which is affecting whole banking industry of Pakistan
- Ministry of Finance to identify the sources of finance without affecting economic health of Pakistan.
- Government of Pakistan to stabilize and alter those factors which are acting as economic indicator and help to boost the economy of Pakistan.
- Investors and Bankers to take decisions regarding investment opportunities in less threats.

Purpose of Study:

This study is conduct to determine the following:

- ➢ Impact of debt financing from banks and its impact on Kibor rates of State bank of Pakistan.
- ➢ Role of Kibor rates for profitability of banks which signalize growth of banks and attraction of investment in banking sector.

- Impact of home remittance on balance of payment.

Literature Review:

In order to understand relationship among variables or factors, following literatures are reviewed:

1)In 2007,Mr.Muneer Khan published in Sarhad J. Agric. Vol. 23, No. 4, 2007 regarding home remittance, he stated that home remittance is a function of import and there is positive relationship between income and imports.

2) In 2008,Mr.Abid Hameed and Hammad Ashraf published in International Research Journal of economics and Finance regarding external debt and its impact on economic growth in Pakistan, They stated that there is a long run and short term relation between debt service and its impact on Economic and business growth of Pakistan.

3)In 2008,Mr.Abdul Qayyum Khan published in Sarhad J. Agric. Vol.24, No.4, 2008 regarding budget deficits and its resources and stated that there is a relationship in budget deficits and foreign borrowings.

He further explained that"[3] foreign borrowings are the outcome of budget deficit and domestic bank borrowing, rather than budget deficit and domestic bank borrowing being a consequence of foreign borrowing. The outcome of the study suggests that Pakistan's fiscal policies are more susceptible to innovations or shocks than monetary policy. On the other side, monetary policy takes longer time to become effective. But still both policies are interdependent. As is the case of other economies, the country economic manager's harmonized the use of fiscal policies and monetary policy for sustainable budget deficit.

4) In April 2011, Mr.Parvez Hashmi published regarding KIBOR rates that KIBOR rate protected banks from liquidity crunch 2008.

He further explained that"[4] Cunningham (1993) who argues that the effect of debt Burden affects on the productivity of capital and labor is similar to that of exports on the productivity of non-export sector in the Feder's (1982) model. The model used relates the economic growth to debt burden, labor and capital in the form of a neo-classical production function. In, as much as, a nation has significant debt burden, the need to

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service its debt will affect how labor and capital will be employed in the production function. More specifically, if the gains of the productivity increase are transferred to foreign creditors and not to domestic agents, little incentive will be left to increase the productivity of capital or labor. This, in turn, means that increase in debt burden will decrease economic growth.

5)In April 2011,Mr.Parvez Hashmi published regarding KIBOR rates that KIBOR rate protected banks from liquidity crunch 2008.

6)In August 2011,Mr. Udo Kock and Yan Sun published in IMF working paper regarding home remittance in Pakistan and stated that remittance is contributing In GDP and internal growth of Pakistan.

7)In July 2011 published in CGFS Papers No 43 The impact of sovereign credit risk on bank funding conditions, it is extracted that"[5] Sovereign tensions may cause a rise in investors' risk aversion, which in turn may increase the premia demanded on banks' securities and reduce banks' funding availability. It may also cause a generalized decline in asset prices, which can trigger losses for banks. In principle, Heightened risk aversion influences investors in financial and non-financial companies alike, but the effects could be larger for banks, as they are more leveraged than non-financial firms.

8) In March 2012, Chialia Angelino published in Bruegel working paper regarding affects of government debt on banks and stated that the holding of government debt is not the determinant of bank's performance.

9)In 2012,Mr.Muhammad Azam and Sana Siddiqui published in International Journal of Economics and Financial Issues Vol. 2, No. 1, 2012, pp.33-40 regarding Foreign and Domestic Bank's profitability, and stated that Foreign banks are not affected by home market conditions and not adjusted by home market conditions that's why they are less profitable than commercial banks.

Methodology:

Data Collection Technique:

As there are two methods of collecting data Primary and Secondary, but this study is totally based on Secondary data.

Sources of Secondary Data:

- Debt policy Statements

[5] In July 2011 published in CGFS Papers No 43

- Articles, Journals and Publications
- State bank of Pakistan's annual records of trade and payments
- Financial market data from State Bank of Pakistan
- Fiscal policy Statements

Sample Size:

Time period from 2005-2012 is taken as a sample period because in this era major state reforms are done, in this era there is also an increment in inflows and outflows are recorded which adversely affected economy.

Variables:

Dependent Variables:

- **KIBOR Rates by SBP:** It is Karachi Inter Bank Offer Rate (KIBOR), given by specialized institution on daily, weekly, monthly and on 1, 2 and 3 yearly basis to all the commercial banks of Pakistan so that they charge interest to their customers on that basis. This rate is inflation adjusted rate and then banks by adding 2 or 3% in KIBOR rate charge their customers for their profit. But in this study KIBOR rate is taken annually to keep balance in figures with other variables.
- **Trade Deficits:** Trade deficit is occurred when country's outflows are greater than its inflows.
- **Profitability of Banks:** Profitability of banking sector is an attractive opportunity of investment but it is highly affected by state rules, policies and regulations such as interest rate, tax rate reserve requirements etc.

Independent Variables:

- **Government Debt Financing from bank:** Government of Pakistan is raising its debt to finance its fiscal deficit which is financed by the banks which indirectly create hurdles by increasing rate of KIBOR which acts negatively for financing rate of other customers.
- **KIBOR rates by SBP:** It is Karachi Inter Bank Offer Rate (KIBOR), given by specialized institution on daily, weekly, monthly and on 1, 2 and 3 yearly basis to all the commercial banks of Pakistan so that they charge interest to their customers on that basis. This rate is inflation adjusted rate and then banks by adding 2 or 3% in KIBOR rate charge their customers for their profit.But in this study KIBOR rate is taken annually to keep balance in figures with other variables.

- **Home remittance:** It is a source of inflows of any country and having high contribution to maintain balance of payment.

Hypothesis:

$H_{1:}$ Government Debt Financing from bank has relationship with KIBOR rates of SBP.

$H_{o1:}$ Government Debt Financing from bank does not have relationship with KIBOR rates of SBP.

$H_{2:}$ KIBOR rate gives impact on profitability of banking sector.

$H_{o2:}$ KIBOR rate does not give impact on profitability of banking sector.

$H_{3:\,:}$ Home Remittance has negative relationship with trade deficit.

$H_{o3:}$ Home Remittance bank does not have negative relationship with trade deficit.

Statistical Tests:

To analyze data following Statistical tools are used:

- Mean
- Standard Deviation
- Correlation
- T-test(probability)

Modeling Framework:

Following models are drawn to fulfill the purpose of this research:

Model No.1:

Kibor rates=α+β (debt financing from banks)

Model No.2:

Banks Profitability=α+β (kibor rates)

Model No.3:

Trade deficit=α+β (Home Remittances)

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Descriptive Statistics

	Mean	Std. Deviation	N
kibor rate	11.91	2.275	8
debt financing	231.74	190.704	8

<u>RESULT ANALYSIS:</u>
MODEL: 1

Correlations

According to statistical data Debt Financing has a mean of (231.74). Kibor has a mean of (11.91).

The standard deviation of statistical data of “Kibor rate” has the value of (2.275) which is quite minor. This indicates that there is a highest involvement between Kibor rates and Debt financing.

		kibor rate	debt financing
Pearson Correlation	kibor rate	1.000	.294
	debt financing	.294	1.000
Sig. (1-tailed) probability	kibor rate		0.00201043
	debt financing	0.00201043	
N	kibor rate	8	8
	debt financing	8	8

Descriptive Statistics

	Mean	Std. Deviation	N
Profitability	73.14	21.504	8

Dependent Variable:kibor rates

The data has analyzed through Statistical software by using correlation and t-test . The correlation test indicates the relationship between the variables. The correlation values show that there is a positive correlation of Debt Financing with Kibor rates. The dependent variable" Kibor rate" has the moderate correlation with Debt Financing(.294).Probability less than 0.05 shows significance of model.

MODEL: 2

kibor rate	11.91	2.275	8

According to statistical data Profitability has a mean of (73.14). Kibor rate has a mean of (11.91).

The standard deviation of statistical data of "profitability" has the value of (21.504).This indicates that there is a moderate involvement between Profitability and Kibor rate.

Correlations

		Profitability	kibor rate
Pearson Correlation	profitability	1.000	-.481
	kibor rate	-.481	1.000
Sig. (1-tailed) (probability)	profitability		0.0000000768572
	kibor rate	0.0000000768572	
N	profitability	8	8
	kibor rate	8	8

Dependent variable: Profitability of banks

The correlation test indicates the relationship between the variables. The correlation values show that there is strong negative correlation of Profitability with Kibor rates. The dependent variable "Profitability" has the strong negative correlation with Kibor rate (-.481). Probability less than 0.05 shows significance of model.

MODEL: 3

Descriptive Statistics

	Mean	Std. Deviation	N
trade deficit	14633.50	4273.019	8
home remittance	7295.96	2537.354	8

According to statistical data trade deficit has a mean of (14633.5).Home remittance has a mean of (7295.96).

The standard deviation of statistical data of “Trade deficit” has the value of (4273.019).This indicates that there is a moderate involvement between trade deficit and home remittance.

Correlations

		trade deficit	home remittance
Pearson Correlation	trade deficit	1.000	.522
	home remittance	.522	1.000
Sig. (1-tailed) (Probability)	trade deficit		0.00046643
	home remittance	0.00046643	
N	trade deficit	8	8
	home remittance	8	8

Dependent variable: trade deficit

The correlation test indicates the relationship between the variables. The correlation values show that there is a positive correlation of trade deficit with Home remittance.

The dependent variable" trade deficit" has the strong positive correlation with Home remittance (.522). Probability less than 0.05 shows significance of model.

Results:

On the basis of above analysis the following are the findings:

- There is a moderate relationship between Debt Financing and Kibor rates
- There is negative relationship between Kibor and profitability.
- There is strong positive relationship between Home remittance and Trade deficits.

Hypothesis (Accepted or Rejected):

$H_{1:}$ Accepted

$H_{o1:}$ Rejected

$H_{2:}$ Accepted

$H_{o2:}$ Rejected

$H_{3:}$ Rejected

$H_{o3:}$ Accepted

Conclusion:

This study highlights two different sectors of economy of Pakistan. In one direction impact of debt financing from banks on kibor rates and banks profitability by replacing variables has been discussed while the other direction is trade deficit and home remittances in Pakistan. Statistical tests show that debt financing is affecting kibor rates directly while banks profitability is indirectly affected by debt financing and directly from kibor rates. On the other hand home remittances and trade deficit have found positive relationship with one another.

Recommendations:

- SBP should allow tight monetary and credit policy for borrowings of Govt,and let it also strictly implemented.
- Home remittance is positive for economic growth but it is getting negative due to low quality of domestic products which causes increment in imports and create trade deficits, so Govt should take decisions regarding local products, high quality and low prices.
- As banking industry is a contributor of economic health of a country, but due to rules and regulation its profitability is getting low, so to compensate risk Govt should cut corporate tax rates and SBP should increase cash reserve requirement to control supply of money.

APPENDIX:

Year	Debt financing(in Pkr billion)	Kibor rates
2005	71	9.3
2006	102	10.1
2007	69.9	10.4
2008	81	14.5
2009	306	14.7
2010	305	14.12

2011	615	12.34
2012	304(B)	9.84

Year	Profitability in PKR(Billion)	Kibor rates
2005	63.3	9.3
2006	84	10.1
2007	73.1	10.4
2008	43.3	14.5
2009	54.4	14.7
2010	65	14.12
2011	110	12.34
2012	92	9.84

Year	Home remittance(in US $)	Trade Deficit(in US $)
2005	4168.79	6207
2006	4600.12	12130
2007	5493.65	13564
2008	6451.24	20914
2009	7811.43	17134
2010	8905.95	15420

2011	11200.97	15604
2012	9735.56	16095

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