DETERMINANTS OF THE LENDING RATE OF PHILIPPINE COMMERCIAL BANKS: AN ERROR CORRECTION MODEL

A Thesis
Submitted to the Faculty of the
College of Business Administration
De La Salle University-Dasmariñas
City of Dasmariñas

In Partial Fulfillment
of the Requirements for the Degree of
Bachelor of Science in Business Administration
(Major in Economics)

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March 2012

ABSTRACT

Gungon, M, S., Determinants of the Lending Rate of Philippine Commercial Banks: An Error Correction Model. Bachelor of Science in Business Administration (Major in Economics), De La Salle University-Dasmariñas, City of Dasmariñas, March 2012. Adviser: Mr. Benjamin A. Usigan.

This study investigated the determinants of lending rate of commercial banks in the Philippines using the error correction model. Specifically, it aimed to (a) describe the trend of lending rate, inflation, and peso per U.S. dollar, rediscount rate, and Treasury bill rate in the Philippines; and (b) estimate the effects of selected variables on the lending rate of commercial banks in the Philippines in the short and long run. The study covered the period 1987 to 2009 on a quarterly basis.

The study employed regression analysis using the data of Bangko Sentral ng Pilipinas. Specifically, it utilized actual rate of each variables. Results showed that Treasury bill rate, inflation rate, and rediscount rate were significant while foreign exchange was insignificant. Results also indicated that lending rate of commercial banks was inversely affected by peso per U.S dollar rate. Likewise, results also showed the significant effect of each of the variables with respect to the lending rate in the short run property.

Results of the cointegrating regression showed that inflation, rediscount rate, Treasury bill rate, and foreign exchange were found to be significant by affecting the lending rate. Results of error correction models showed that out of the four

determinants, two were significant in the movement of lending rate, T-bill, and rediscount rate, while foreign exchange and inflation rate were insignificant.

The speed of adjustment implies how fast the independent variable changes to achieve the long run equilibrium with respect to lending rate. Results showed that out of four independent variables, only T-bill rate was found to be fast in achieving the equilibrium level, by having 55 percent speed of adjustment, demonstrating that lending rate changes faster along with the change in T-bill rate in the short run. The remaining three independent variables showed slow speed of change in the short run with respect to lending rate. In addition, the adjustments took effect for the first three indicators for more than 10 periods while T- bill took effect for only five periods.

The results of error correction showed that out of the four indicators, only the T-bill rate achieved the long-run equilibrium for only 12 periods. On the other hand, the remaining indicators took more than 22 periods to achieve the long-run equilibrium. The results of test implies that the Philippine commercial banks are very sensitive in a sense that the government is selling securities rather than the immediate change in inflation rate and foreign exchange rate. In addition, the rediscount rate is not very effective in the determination of interest rates. One possible reason is that it is implemented on an annual basis.

Several indicators may thoroughly be used in determining the interest rates in the Philippines. Supply and demand for loans must be investigated to prove that the theory of loans can be used in determining the interest rate in the Philippines.