Banking Sector Performance and Political Stability's Impact on Economic Growth in Pakistan

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Abstract *This paper empirically finds the link between the banking sector performance and political stability on Economic growth. Panel data was used encompassing the time frame from 2006 to 2016 for banks operating in Pakistan. This paper main purpose at discovering that the banking sector performance, political stability, and other bank-specific factors have a vital impact on enhancing the procedure of economic growth in Pakistan. "Predictable outcomes suggest that economic growth in Pakistan is in long-term stability relationship; banking sector and political stability have long-term significant impact on economic growth and subsequently, economic growth converge to their long-term stability levels by the means created by Investment. This supports the reality that political certainty or stability is capable of stimulating a country's development process". Therefore, revealed significant relationship between banking sector performance and political stability of Pakistan on economic growth.*

Introduction

The banking sector of the country influences the economy of the country and that is fair clear those countries that have an efficient and strong financial system the economy of the country always on boom position and the economic development is increasing with a high ratio (Kauffman et al., 1996). Central banks act as the regulatory authority in most countries. The central bank of the country modification of a controlling financial system. the financial zone has a dual effect they show central part in the economy to developing actions and second is they offer loan abilities to investor on minimum rate of interest which is set by the central bank.

In Pakistan, the main source of funds supply and financing to support the commercial investment and Islamic banking sector of the country. The banking sector of Pakistan has positive impact on economic growth. Some previous studies about the economic growth and Pakistan banking sector showing the negative picture also the reason are interest rate and the non-performing loan. The banking sector is more affected by the non-performing

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loans which are not recovered. These bad debts more influence bank lending activities and sufficient effectiveness. The new technological change has impact on the performance of the banking sector of Pakistan. According to Rehman (2011) identified in his research on financial improvements reflect in the type of inflation, saving and bank deposits. After this analysis the problem is incorrectly investigated with the performance standards of the banking sector specifically in investment profitability of the said sector.

However, the core factor has an impact on the performance of the banking sector i.e. political stability and economic growth. The political instability (PI) which have considerably high impact on economic growth. PI makes ambiguity in government strategies and also can disappoint current as well as new investment opportunities because of the instability every investor wants to invest their capital in some harmless environment where the investor has protection.

Statement of the Research Problem

The banking sector and political stability are playing energetic role in the development of the economic. Political uncertainty and the economic crises directly affect the baking sector of the country and banking sector facing high crises and difficulties due to which the financial efficiency of the banking sector is highly affected. The banking system is junction and its future economic growth majority depends on political stability (Kauffman, 1996). Political stability is requirement for confirming growth in the banking sector any location. Pakistan's economy suffering from 1998 to still due to political uncertainty and challenges. Economic growth and political stability are solid connections with each other, on the other hand the PI link with decrease investment and the pace of the economic growth and deprived economic act may lead to government failure and political conflict.

Research Objectives

The key objective of this study to investigate:
1. The impact of banking sector performance and the role of political stability on economic growth of Pakistan.
2. The performance of the banking sector, its importance, and political stability on economic development, socio-economic contribution of banking sector policy reforms in banking sector in line with economic growth.

Research Questions

The following research questions describe as follows.
1. To find out the impact of political stability in economic growth?
2. How can the role of the banking sector be measured in the economic growth of a country?

Significance of the Study

The banking sector and political stability playing the role of backbone on economic growth. The banking sector has strong base the banking sector will be performing in more strong and effective ways. If the banking sector working with efficient way the economic condition will be growing the employment opportunity will be on a high number and the FDI will invest their money without any fear and hesitation.

Literature Review

Kenway (2009) argued in his study about the banks' globalization and its impact on the banking sector and economic growth of Egypt. The researcher to know about the impact of globalization he collects date from the central bank of Egypt during this analysis the secondary data were used. The main variable of this study is globalization after the analysis the result showing a positive impact on the economic growth and competence of the economy.
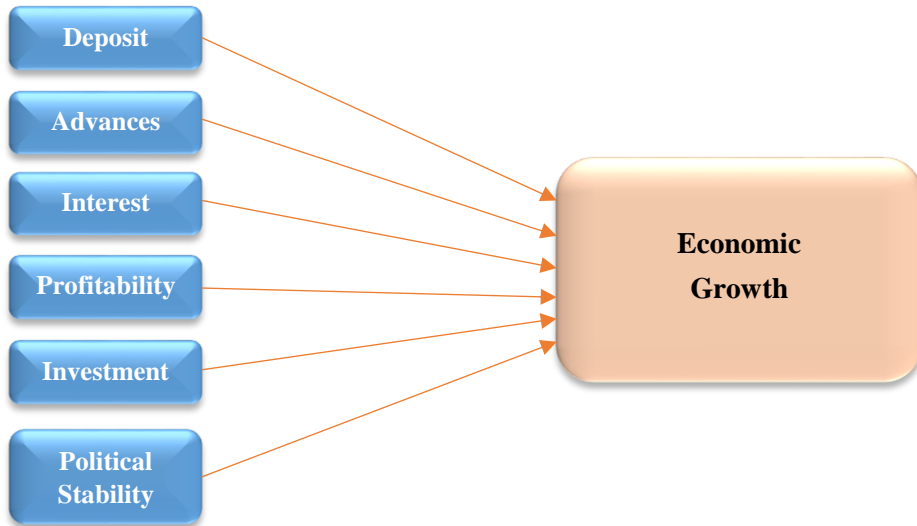
Levine and Zervos (2000) stated that they have many studies and research about the banking industry and the economic development. Due to facts, majority studies use the cross country data sets to know about the facts and the relation of banking sector and their contribution in economy throughout the world. They used variable of different factor which is playing a clear role in GDP growth after the analysis the result showing the indicator that the banking sector performance is base of political environment every country economy if a country have strong banking sector system their economic growth will be faster than other who have poor and lazy banking sector performance.

Lipstel (1960) stated in his study about the political stability and the economic growth. Political stability is play important part in the development of the economic situation of a country. The PI in a country cause of hamper economic growth. The author defines a stable country he says a country is is generous and reliable democracy or dictatorship for 25 years that country will be considered stable but the modern political and economic schools of thought have improved the ritual of the PI. The core idea is that the effectiveness of the country hangs on the reliability of strong political government. The author also investigates the connection among the PI and the economic growth in two prospective, first PI make hesitation and unpredictability which decrease investment and lending ratio which directly have negative impact of the economic development.

Alisena, Ozler and Swgel (1992) discuss in his study about the PI that which type of impact has on the economic growth. PI makes ambiguity in government strategies and also can disappoint current as well as new investment opportunity because of the instability every investor wants to invest their capital in some safe environment where the investor has a protection. Hann and Sierman (1996) also discussed the same point PI becomes the reason of the capital out flow and weak economic situation. The main point of this study explained the important relation between the PI and economic growth.

Ali, Hashmi and Hassan (2013) identify in his study and discussing both economic and political issues to expect the explanation of unstable economic development and the low ratio of investment in Pakistan. This research find and discuss the elements which effect the economic growth this factor also include non-economic elements like corruption, political stability, quick changes in Government, energy shortage, and the clashes between different political parties and departments has the main issue of the low economic growth and lower level of the investment. These issues make insecurity and made the country unsafe. Due to this issues and the instability the local investor transfer their investment to other countries because of the stable environment of business and also get high return. This investment transfer has become the main reason of the low economic growth in Pakistan.

Theoretical Frame Work

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Deposit ─────────────┐
Advances ────────────┤
Interest ────────────┤         ┌──────────────────┐
Profitability ───────┼────────▶│     Economic     │
Investment ──────────┤         │      Growth      │
Political ───────────┘         └──────────────────┘
Stability
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Research Methodology

Data

In this study we investigate how banking sector performance and political stability affect the economic development in Pakistan. The sample of data consider of 19 banks from the period of 2006 to 2016. The data collected from the banks yearly reports, state bank of Pakistan database and from World Bank data base. All those bank are not included in date which start or stopped there operation before and after 2006.

Methodology

The leading aim of this study is to find the impact of banking sector performance and political stability on economic growth. According state bank of Pakistan they have 27 bank register we take date sample of 19 banks out of 27.

Population

There are 27 commercial banks operating in Pakistan and listed at Pakistan stock exchange. We collect data from 19 banks from the year of 2006 to 2016.

Sample

We select 19 banks because of their data availability and reliability listed on the Pakistan stock exchange. Data is collected from those banks which operating during 2006 to 2016.

Variables Used

Based on the literature the mention variable was acknowledge as GDP proxies, the selected variables is define in given table 1.

Model

In this research model banks internal factors are used as the determinants of Economic growth.

GDPit = α + β1 DEPit + β2 INVit + β3 ADVit + β4 PRFit + β5 INEit + β6PSit+£

Where:

GDP is Gross domestic product   DEP is Deposits
INV is the level of Investments   ADV is the level of Advances
PRF shows Profitability   INE is the Interest
PS is political stability

Results and Data Analysis

Descriptive Statistics

Table 1.

Variables	Mean	Std. Dev.	Min	Max
GDP	3.872	1.453	1.6	6.20
DEP	11.776	1.687	5.25	15.031
INV	11.000	1.656	4.89	14.136
ADV	11.238	1.682	2.45	13.525
PRF	5.873	4.932	-9.8	11.269
INE	8.576	2.324	-2.6	11.429
PS	-2.526	.182	-2.81	-2.025

The following table shows that the descriptive statistics test uses to measure both dependent and independent variables. GDP shows the lowest value is 1.6 and the highest is 6.2, so the Std. Dev is 1.45. Deposit lowest value is 5.25 while heights is 15.031 and the std. Dev is 1.68 and mean is 11.77. Investment lowest value is 4.89 while heights are 14.13 and Std. Dev is 1.65 while mean for Investment is 11.00. An advance lowest value is 2.458 while highest value is 13.5257 while Std. Dev is 1.68 that is high while mean is 11.238. Profitability lowest value is -9.98 while highest value is 11.269, so Std. Dev is high that is 4.932 and mean is 5.81. Interest lowest value is 2.6 while highest value is 11.429, so the standard deviation is 2.32. The mean of Interest is 8.57. The political stability lowest value is -2.81 while highest value is -2.02, so the standard deviation .182.The mean for Political stability is -2.52.

Correlation Matrix

Table 2.

Variables	GDP	PS	INV	PRFT	INT	ADV	DEP
GDP	1.000						
PS	0.764	1.000					
Investment	0.028	-0.240	1.000				
Profitability	0.167	0.063	0.562	1.000			
Interest	0.109	-0.058	0.611	0.660	1.000		
Advances	-0.007	-0.115	0.716	0.537	0.598	1.000	
Deposit	0.031	-0.125	0.721	0.551	0.654	0.700	1.000

The table (on previous page) indicate both the independent and dependent variables and their connection with each other. As no two independent variables are above .80 level so we may have low multicollinearity issue (Gujarati, 2003).

Heteroscedasticity Statistics

Results of the test		
chi2(1)	=	9.50
Prob > chi2	=	0.081

The aim of the above analysis is to find the homogeneity in the data and we do not have any heterogeneity issue. The above results show that there is no issue of heteroskedasticity in our collected data as the result of 0.81 is clearly above the t level of significance that is possibility of 0.05.

Multicollinearity Statistics

Table 4.

Variables	VIP	1/VIF
Investment	2.89	0.345
Deposit	2.71	0.368
Advances	2.49	0.401
Interest	2.34	0.426
Profitability	2.03	0.492
Political stability	1.13	0.883

The above table shows that we have no issues of multicollinearity because all variables VIF values are less than 10 (Gujarati, 2003).

Regression Results

The regression results are given below.

Fixed Effect Panel Least Square

Table 5. Fixed Effect Results

Variables	Coefficients	St. errors	t-values	P-Value
Political Stability	6.524	.318	20.50	0.000
Investment	.390	.066	5.90	0.000
Profitability	.013	.019	0.72	0.472
Interest	.074	.048	1.54	0.065
Advances	.020	.069	0.29	0.769
Deposit	.069	.059	1.15	0.251
Cons	14.300	.973	14.68	0.000
R. square 0.6877				

Table 5 shows that GDP as a proxy for economic growth is regressed with the independent variables like PS, INV, PRFT, INT, ADV, and DEP of commercial banks. PS has positively related to GDP but this association is statistically insignificant. Similarly, Ari and Aisen (2011) find that relationships among political stability such as positive impact on economic growth. Hence, countries having stable political environment then investment opportunities and development also increasing and the foreign direct investment ration will be increasing.

INV has a positive relationship with GDP, it is insignificant at 5% level but significant at the 10% level. Aurangzeb (2012) fined in his study the link between the investment and the GDP he finds that investors have a positive & significant impact on GDP. PRFT is positively and significantly related to GDP. Interest and Investment are positively and significantly associated with GDP. ADV shows an insignificant relation at 5% level but significant at level 10%.

Aurangzeb (2012) found in his study relation between GDP and Deposit, Advances, Profitability and interest have a positive and significant relationship. It means that the following variables have positive impact on economic development. Ahmad, Hamza (2014) also find the impact of interest, advances, and profitability have positive and significant relation with GDP.

Random Effect Panel Least Square

Table 6

Variables	Coefficients	St. errors	t-value	p-value
Political stability	6.068	.326	18.60	0.000
Investment	.285	.062	4.58	0.000
Profitability	-.006	.017	-0.35	0.723
Interest	.0588	.039	1.47	0.063
Advances	-.014	.569	-0.54	0.011
Deposit	-.028	.059	-0.48	0.631
Cons	17.55639	.8632868	20.34	0.000

R. Square 0.647

Table 6 shows the impact of independent variables like PS, INV, PRFT, INT, ADV, and DEP on GDP using the Random Effect Model. PS and INV are positively and significantly related to GDP, however, PRFT negatively and significantly associated with GDP. INT and ADV show insignificant relationship with GDP. Moreover, DEP has negative and significant relation with GDP. Ahmad & Hamza (2014) also find during their research analysis that deposit has negative relation with GDP.

Hausman Test

Table 7. Hausman Results

	Coefficient			
Variables	Fixed	Random	Difference	S.E
Political Stability	6.524	6.068	.465	
Investment	.390	.285	.104	.021

Profitability	.0139	-.006	.020	.008
Interest	.0745	.058	0.157	.027
Advances	.0203	-.144	.164	.039
Deposit	.069	-.028	.975	.009

chi2 =50.09
Prob>chi2 =   0.0000

Hausman test is used to find the best suitable model for this analysis. Based on the Hausman test result Random effect model is select as a suitable model for this research.

Conclusion

This research identified a relationship between banking sector performance and political stability on economic growth in Pakistan. Using traditional OLS and techniques, it was shown that financial development has a direct and strong impact on the growth rate of real GDP. However, all research studies of Pakistan commercial banks' studies in this literature, the findings suggest that banking sector performance and political stability have positive relationship to economic growth. Although this conclusion may be puzzling upon first glance, it does fit rather well with the state of the Pakistan economy and banking sector during the year of 2006 to 2016.

During this duration, Pakistani banking sector is not able to mobilize and merging the domestic saving for the purpose to invest in some profitable project because of the PI. Aurangzeb (2012) find in his study relation between GDP and Deposit, Advances, Profitability, and interest have a positive and significant relationship. It means that the following variables have positive impact on economic development.

PI has an indirect relation to economic development. The outcomes additionally recommend that, counter to hypothesis if political toughness increments by one unit, government spending will increment. Anyway take note of that this negative impact that political strength has over government spending rates is more than made up for by the constructive outcome this variable has on risk rates.

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