THE MACROECONOMIC DETERMINANTS OF INTEREST RATE SPREAD: AN EMPIRICAL STUDY OF MALAYSIA

NUR ALIYA SYAHIRA BINTI KAMARUDIN

2016354069

BACHELOR OF BUSINESS ADMINISTRATION WITH HONORS (FINANCE)

FACULTY OF BUSINESS AND MANAGEMENT

UNIVERSITI TEKNOLOGI MARA CAWANGAN TERENGGANU

JUNE 2019

TABLE OF CONTENT

DECLARATION OF ORIGINAL WORK ..... **i**
LETTER OF SUBMISSION ..... **ii**
ACKNOWLEDGEMENT ..... **iii**
TABLE OF CONTENT ..... **iv**
LIST OF TABLES ..... **vii**
LIST OF FIGURES ..... **viii**
LIST OF ABBREVIATIONS ..... **ix**
ABSTRACT ..... **x**

CHAPTER 1 1
INTRODUCTION 1
1.0 INTRODUCTION 1
1.1 BACKGROUND OF THE STUDY 3
1.2 PROBLEM STATEMENT 5
1.3 RESEARCH QUESTION 7
1.4 RESEARCH OBJECTIVE 7
1.5 SCOPE OF THE STUDY 7
1.6 SIGNIFICANCE OF THE STUDY 8
1.7 LIMITATION OF THE STUDY 9
1.8 OPERATIONAL DEFINITION 10

CHAPTER 2 11
LITERATURE REVIEW 11
2.0 INTRODUCTION 11
2.1 DEFINITION AND THEORY OF INTEREST RATE SPREAD 11
2.2 THE RELATIONSHIP BETWEEN INFLATION AND INTEREST RATE SPREAD 13
2.3 THE RELATIONSHIP BETWEEN GROSS DOMESTIC PRODUCT AND INTEREST RATE SPREAD 16
2.4 THE RELATIONSHIP BETWEEN EXCHANGE RATE AND INTEREST RATE SPREAD 19
2.5 THE RELATIONSHIP BETWEEN DEPOSIT INTEREST RATE AND INTEREST RATE SPREAD 21

2.6 THE RELATIONSHIP BETWEEN RISK PREMIUM ON LENDING RATE AND INTEREST RATE SPREAD 22
2.7 SUMMARIZATION OF PRECEDENT STUDY 23

CHAPTER 3 33
RESEARCH METHODOLOGY 33
3.0 INTRODUCTION 33
3.1 FUNCTIONAL FORM 33
3.2 ESTIMATION MODEL 34
3.3 CONCEPTUAL FRAMEWORK 35
3.4 VARIABLE DESCRIPTION 36
3.5 EXPECTED SIGN 38
3.6 HYPOTHESIS 40
3.7 DATA COLLECTION METHOD 41
3.8 MEASURING DATA ANALYSIS 42

CHAPTER 4 45
DATA ANALYSIS AND INTERPRETATION 45
4.0 INTRODUCTION 45
4.1 DESCRIPTIVE STATISTIC 45
4.2 PEARSON CORRELATION 48
4.3 REGRESSION ANALYSIS 49
4.3.1 COEFFICIENT OF DETERMINATION – R-SQUARED ($\mathcal{R}2$) 51
4.3.2 T-STATISTIC (T-STAT) 52
4.3.3 F-STATISTIC (F-STAT) 53
4.3.4 DURBIN WATSON 53
4.3.5 MULTICOLLINEARITY TEST 54
4.4 RESULT ANALYSIS 55
4.5 HYPOTHESIS ANALYSIS 57

CHAPTER 5 59
CONCLUSION AND RECOMMENDATIONS 59
5.0 INTRODUCTION 59
5.1 OVERALL FINDINGS 59

ACKNOWLEDGEMENT

In the Name of Allah, the Most Gracious and the Most Merciful

First of all, be grateful to Allah S.W.T. for providing me with everything I am needed in completing this research project successfully. Besides, I would like to thank to the authorities of University Teknologi Mara (UiTM) Dungun, Terengganu for providing a good and satisfying facilities and study environment throughout the completion of this paper project.

In performing our assignment, I had to take the help and guideline of some respected persons who deserve my greatest gratitude. I would like to express my deepest appreciation and gratitude to Madam Fathiyah Binti Ismail as my advisor of (FIN 672) for giving me a good guideline for assignment throughout numerous consultations session. The attitude and substance of her genius, continually and convincingly conveyed a spirit of adventure in regards to this research and excitement in regard to teach me. Without her guidance and persistent help would not have been possible as a requirement for me to complete my final research paper.

I also would like to say a special thanks to my co-advisor Madam Salwani Binti Affandi in the same way help me in completing this research paper such as rechecked my research proposal and also provide me some recommendation to improve the accuracy and quality of my paper project for better understanding. I would like to give her credit for her patience in sharing a valuable knowledge.

In addition, nobody has been more important to me in finishing this paper project than my own family members. I would like to thank to my beloved parents who continuously supporting me in many aspect especially in terms of financial, love and guidance. They are the ultimate role model.

Finally, many people, especially my classmates that have made valuable comments and suggestions which gave me inspiration in improving this research paper. A big thank to all people for lending their hands to help me both directly and indirectly to accomplish my assignment.

ABSTRACT

This paper is done to examine affecting factors on spread rate and define a relevant model of spread rate in Malaysia. Spread rate can be defined as a difference between two linked interest rate which are lending and borrowing rates. In financial terms, spread rate is the difference between debts rate (specifically for deposit) and assets rate (specifically for loan). Interest rate spread has constantly been one of the most crucial and significant economic issues in various countries of the world. Hence, this paper is to analyse the factors influence the interest rate spread movement in Malaysia. Using annual time series data from year 1978 to 2017 periods that are consist of 40 observations which employ the Ordinary Least Square Method (OLS). The macroeconomic variables that have been used in this study is inflation (INF), gross domestic product (GDP), exchange rate (ER), deposit interest rate (DIR) and risk premium on lending interest rate (RPL). The data was collected by using secondary data from World Development Indicator. The finding shows that risk premium on lending rate is the most significant factor in influencing interest rate spread. Furthermore, while other variables such as inflation and exchange rate have a significant relationship while gross domestic product and deposit interest rate have insignificant relationship towards interest rate spread trends. The objectives of this research are obtainable.

Keywords: *interest rate spread, inflation, gross domestic product, exchange rate, deposit interest rate, risk premium on lending interest rate, ordinary least square method*