

Macroeconomic environment and financial sector's performance: econometric evidence from three traditional approaches

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The stable macroeconomic conditions are the prerequisites for sound and healthy performance of the financial sector in the country. This fast changing in an open economy demands financial sector to be strongly integrated with the global village. In Pakistan, although, financial markets have been liberalized and witnessed positive growth as they are now operating on competitive basis but, still has to go a long way to achieve the required level of development. This study explores impact of macroeconomic environment on financial sector's performance in Pakistan. For the purpose of unit root estimation Ng-Person is employed. To test long-run association & robustness, Johansen, Augmented Engle-Granger and Co-integrating Durban Watson Co-integrating techniques is also applied. Finally, for capturing short run behavior of financial sector performance with a battery of other variables, Error Correction Method (ECM) is utilized.

Empirical findings of the present paper reveal that the previous policies of the government regarding financial institutions and economic growth have improved the level of financial development in Pakistan. Both the increase in government spending as well as foreign remittances pushes the performance of financial sector in the upward direction in the country. On the other hand, the efficiency of financial markets deteriorates on account of rising inflation due to its damaging impact while literacy rate is having negative influence on banking sector in Pakistan. Trade openness along with improved capital inflows opens new directions to improve the development of financial markets in the country. Furthermore, performance of financial sector is attached with qualified institutions. More qualified financial institutions means more development in financial sector. High savings rate declines the efficiency of banking sector and political instability retards the performance of financial markets.

Key words: Financial development, Macroeconomic environment, Co integration

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