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 Contents

Abstract

The present article examines the relationship between economic growth and profitability of Malaysian banks. Specifically working on the period 2000-04, the empirical results show that during the period 2000-04, the empirical results show that economic growth and a higher loan concentration exhibit lower profitability level. On the other hand, banks that have a higher level of capitalization, a higher proportion of income from non-interest sources, and high operational expenses tend to exhibit higher profitability level. The results suggest that economic growth has a negative effect on Malaysian banks' profitability, while a higher inflation rate has a positive impact on Malaysian banks' profitability.

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1. The figure is as at end-2003, prior to the consolidation of finance companies into their respective commercial banking parents.
2. A guess would be that such relationship is observed in developed banking systems, which hire high quality and therefore, high cost staff. Hence, providing that the high quality staff is sufficiently productive, such banks will not be disadvantaged from a relative point of view.
3. In a contestable market, active firms are vulnerable to "hit and run" entry. For its existence, sunk costs must be largely absent. In the banking industry, some argue that most of the costs are fixed but not sunk, making it contestable (Whalen, 1988).

4. We would like to thank the anonymous referee for this suggestion.

5. We would like to thank the anonymous referee for this suggestion. For brevity purposes, we do not present the results here, but are available from the author upon request.

6. See Berger and Mester (1997) for a detailed discussion of this point.

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