The impact of short- term interest rates on bank funding costs

Files

nomsobo_impact_2018.pdf(636.06 KB)

Date

2019

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Publisher

International Foundation for Research and Development

Abstract

This study examines the impact of short- term interest rates on bank funding costs in South Africa. Literature suggests that rising short- term interest rates may cause similar financial crises experienced in 2007/08 (Bonner & Eijffinger, 2013; Turner, 2013; SaraÃ§ & Karagoz, 2016). It is vital to study short- term interest rates and bank funding costs in order to achieve financial stability. The study uses quarterly time series data for the period 2000 to 2014. To estimate the regression, the study uses the Vector Autoregressive model (VAR) and the data is found stationary at first difference. The 3 months Johannesburg Interbank Agreed Rate (JIBAR) is used as a proxy for bank funding costs whilst the prime overdraft rate, 10 -year government bonds and capital ratio are used as proxies for short- term, long- term interest rates and bank capital, respectively. The results show a positive and significant long- term relationship between the variables. The results for prime overdraft rate, 10 -year government bonds and capital ratio conform to the apriori expectations. For GDP growth the results show a positive relationship which does not conform to apriori expectations. Using the variance decomposition, the study illustrates fluctuations in JIBAR was due to changes in its value and fluctuations in the prime rate are also due to JIBAR. The study presents policy options whereby regulatory efforts need to strengthen the capital buffers of banks to reduce bank funding costs and therefore reduce short- term interest rates imposed on borrowers.

Description

CITATION: Nomsobo, A. N. & Van Wyk, R. B. 2018. The impact of short- term interest rates on bank funding costs. Journal of Economics and Behavioral Studies, 10(3):141-148, doi:10.22610/jebs.v10i3.2323.
The original publication is available at https://ojs.amhinternational.com

Keywords

Banks and banking, Bank loans -- Costs, Interest rates -- Effect of inflation on

Citation

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URI

http://hdl.handle.net/10019.1/106585

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