

**DETERMINANTS OF INTEREST RATE SPREAD AMONG
COMMERCIAL BANKS IN NEPAL**

**A dissertation submitted to the Office of the Dean, Faculty of Management in
partial fulfilment of the requirements for the Master's Degree**

By

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CERTIFICATION OF AUTHORSHIP

I hereby corroborate that I have researched and submitted the final draft of dissertation entitled “**Determinants of interest rate spread among commercial banks in Nepal**”. The work of this dissertation has not been submitted previously for the purpose of conferral of any degrees nor has it been proposed and presented as part of requirements for any other academic purposes. The assistance and cooperation that I have received during this research work has been acknowledged. In addition, I declare that all information sources and literature used are cited in the reference section of the dissertation.

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Report of Research Committee

Mrs. Kaushila kumari kathayat has defended research proposal entitled "**Determinants of interest rate spread among commercial banks in Nepal**" successfully. The research committee has registered the dissertation for further progress. It is recommended to carry out the work as per suggestions and guidance of supervisor Ass. Prof. Dr. Manoj Kumar Chaudhary and submit the thesis for evaluation and viva voce examination.

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ABBREVIATIONS

ANOVA	Analysis of variance
ARDL	Auto Regressive Distribution Lag
CBK	Central Bank of Kenya
CBN	Central Bank of Nepal
EPS	Earning Per Share
GDP	Gross Demotic Product
GDPPC	Gross Domestic Product per Capital
IRS	Interest Rate Spread
LATA	Liquid Assets to Total Assets
NBBL	Nabil Bank Ltd
NBL	Nepal Bank Ltd
NCBS	Nepal Central Bureau of Statistics
NII	Net Interest Income
NIM	Net Interest Margin
NP	Nepal
NPL	Non-performing Loan
NPLR	Non- Performing Loan Ratio
ROA	Return on Assets
ROE	Return on Equity
SPSS	Statistical Package for Social Sciences
VAR	Vector Auto Regression

ABSTRACT

In Nepal, there is a widespread perception that interest rate spread is too wide. Banks, on the other hand, have justified the wide interest rate spread on the basis of some economic variables that affect the banks. This study was largely a quantitative research given that the study sought to examine the determinants of the bank interest rates among commercial banks in Nepal. This study focused on the licensed large commercial banks according to the CBN which include in Nepal bank, Agriculture development bank, Nabil bank, Nepal Bangladesh bank, Standard chartered bank and Himalayan bank limited. This study used secondary data available from the annual financial reports from year period between 2015 and 2020. The collected data was organized into SPSS and analyses using descriptive analysis, correlation analysis, and regression analysis.

This study found out that the model summary of multiple regression model, showed that all the three predictors (credit risk, operation cost and liquidity risk) explained 83.5 percent variation of interest spread considering the three study independent variables, there is a probability of predicting interest spread by 62.1% ($R^2 = 0.621$). The F statistic is equal to 63.391 and p value of $0.000 < 0.05$ level of significance implying that the joint contribution of credit risk levels, liquidity and operating cost significantly predict interest spread. Thus justifying the following estimation model:-

This study revealed that credit risk was positively and significantly associated with interest spread ($r = 0.3661$, $\rho < 0.01$) indicating 36.61% positive relationship with interest spread. The study further found that operation cost was positively and significantly correlated to interest spread ($r = 0.695$, $\rho < 0.01$) showing that operation cost has 69.5% positive relationship with interest spread. Finally, the study found that liquidity risk was positively correlated with interest spread ($r = 0.778$, $\rho < 0.01$) an indication of 77.8% positive relationship with interest spread credit risk had a weak negative effect on interest rate spread ($\beta = -.001$, $p = 0.997$).

Consistent with some past literature on the factors that influence interest rate spreads, this study concludes that credit risk had a significant effect on interest spread with each unit increase in interest spread for each unit increase in credit risk. This study also concluded that each unit increase in operation cost, there was -0.0215 units decrease in interest spread. This study concluded that liquidity risk has significant effect on interest

spread for each unit increase in liquidity risk, there was up to 0.757 units increase in interest spread. This study also recommends that the Government, through the Central Bank of Nepal should be instrumental in developing policies and regulations to guide commercial banks in setting up of optimal interest rate spreads in order to promote loan uptake as well as improve performance of these commercial banks.