

# INTRODUCTION

## 1.1 Origin of Bank

The origin of banking can be traceable from the early time of human history. In the ancient period especially in Greece and Rome, the practice of storing the precious metals and coins at safe place and loaning out money for public on interest was prevalent. In England, banking had its origin from London goldsmith who in the 7<sup>th</sup> century began to accept deposits from merchants and others for the safe keeping of the money and others valuable things. According to French writer Revilpot banks and bank notes were in existence in Baby loan in 600 B.C. But the term bank was used only after the establishment of bank of vanish in Italy in 1157 A.D.

There are various opinions about the origin of bank. The first opinions is that the term bank was originated from Italian word Benko which meant bench. The money exchangers at that time kept heap of money on the bench from which came that word Banko. In French and there after it started to be called bank by English. The second opinion is that in 1171 A.D. There was economic crisis in Italy, to save from crises Italian government took loan from general public at the rate of 5 %. It was difficult for government to take loan from public that was why in Italian term was called monte. It was also called Joint stock Fund. Later on in Germany it was called Bank. In Italian term Banko. French Banke and in English it was called Bank.

The banking system was prevalent in an unorganized way from ancient time; Crowther thus, has rightly remarked "The present day banker has three ancestor's. The merchant, the money lender and the goldsmith. Lending and borrowing are almost as old as money itself and the village money lender is found even in quite primitive communities". (As quoted by Vaish. 1998).

## 1.2 Meaning of Bank

In general, banks mean an institution that accept deposits in different accounts and provide loans of different types. A bank is an institution which deals with money and credit. It accepts deposits from the public and makes the fund available to those

people who needed money, and helps in the remittance of money from one place to another. In fact a modern bank performs such a variety of function that it is difficult to give a precise and general definition of it.

A bank is an institution which deals in money. Broadly speaking, banks draw surplus money from the people who are not using it at the time, and lend to those who are in a position to use it for productive purpose (Dewett.1987).

A banker is a dealer in debts. The banker's business is to take the debts of other people to offset his own in exchange and thereby to create money. A bank collects money from those who have it to spare or who are saving it out of their incomes, and it lends this money that require it (Ahuja.1992).

A bank is establishment which makes to individuals such advance of money as may be required and safely made and to which individuals entrust money when not required by them for use. According to the Indian companies Act, 1949, banking means " The accepting for the purpose of companies lending or investment of deposit of money from the public repayable on demand or otherwise, and withdrawable by cheque, draft or otherwise".

A bank is an institution that accepts deposits of money from the public withdrawal by cheque and used for lending Banks are said to be department stores of financial services to their customers. The range of these services differs from bank to bank, depending mainly on the size and type of banks (Gupta 1992). Commercial banks are mainly established to facilitate the development of trade and commercial sectors of the country. The first commercial bank in the world was bank of England established as a central bank of Britain.

We know that alternative word of bank is financial institution and which means financial market and its players and opening of all types of depository institution and other non-depository financial institution to the private sectors. There are so many institutions include in depository institutions, these are as commercial banks, development banks, finance companies, cooperative banks.

Non-Financial institution includes life and non life insurance companies, pension fund, provident and retirement funds, mutual funds, unit trust mortgage banks, money market mutual funds and so on.

### **1.3 History of Bank in Nepal**

The history of banking in a Nepal may be described as a component of the gradual and orderly evolution in the financial and economic Sphere of the Nepalese life. The banking business in Nepal began with the establishment of Nepal Bank Limited in 1937. At first the exchange of money was started by the Malla King of Kathmandu Valley. In 7<sup>th</sup> century the currency of money was used and exchanged by Amshuberma and Bishnu Gupta in 723 A.D. Gunakamdev collect the money as loan from the public and reconducted the Kantipur, city by that money. After some years Shankhadhar, who was the merchant and civilian of Kantipur, paid all the loan of public which was taken by the Malla King and started the Nepal Sambat. Since then the banking system was exercised in Nepal.

Before the established of Nepal Bank Limited, there was one semi banking institution, Tejarath Adda which was established in Nepal during the prim-minister ship of Ranodip Singh. But its activities were limited. It only provided loan and did not accept any kind of deposits. The commercial bank was established in 1937 A.D. Named as the Nepal Bank Limited which was in corporate as a semi-government organization with an authorized capital of Rs 10 million of which 51 percent share is owned by the government and rest by the private share holder. Now 41% share is owned by government, 5 % share is owned by staff and rest 54 percent share is owned by public. It started its business with collection of large amount (Rs 35829765) thousand from public deposits. Later the Nepal Rastra Bank was established as a central bank in 1955 A.D. Which helped to make banking system more dynamic with establishment of Nepal Rastra Bank the process of banking development started to gain movement, using Nepal Rastra Bank (RBB) Act 1955 another commercial bank was continuously opened in the country. The Rastriya Banijya Bank set up in 1966 A.D. Under the Rastriya Banijya Bank Act 1965. It is the full government owned bank and providing the banking facilities to the public. Similarly agricultural development bank established in 1969 A.D. Lender the Agricultural Development Bank Act 1967.

The bank inherited the assets and liabilities of the cooperative bank, which was established in 1963, in 1973 the land reform and saving corporation, it is the government and Nepal Rastra Bank being the major share holders.

Today Nepal can proudly speak in the remarkable growth and progress in the banking sector, Nepal had opened its door to foreign commercial bank NABL came into existence on 17 may 1984 under commercial bank Act 1974 as a joint venture bank. It has the authorized capitals Rs 30 million, 50 percent share is held by union bank of middle East Dubai 20 percent by Nepal industrial development corporation, National insurance corporation and securities marketing center and rest by the general public. Similarly in February 1986 Nepal Indosuez bank was established as a joint venture of Indosuez bank France and public share holders with an authorized capital of Rs 120 million. Nepal Grindlays bank then after established in December 1986, this is also another joint venture between the Grindlays bank of the U.K.

In Nepal there are massive entrances of foreign bank as the country followed economic liberalization. The Himalayan Bank and Nepal SBI Bank were established in 1993 as joint venture bank with Pakistan. Bank and Bank of India repetitively. Nepal Bangladesh bank and Everest bank were established in 1994 as a Joint venture with Bangladesh bank and Punjab National bank respectively. Bank of Kathmandu as a joint venture bank with Thailand bank establish in 1995. Similarly other joint venture bank in Nepal is bank of Ceylon as a joint venture with Srilanka Bank establish in 1995. These banks have been contributing in the expansion of banking industry of Nepal. In beginning most of the bank came into existence as a joint venture bank but at present situation some of the bank has converted into fully stated owned. Other banks like Lumbini Bank Ltd. Nepal industrial and commercial Bank Ltd. Kumari Bank Ltd. Laxmi Bank Ltd. Machhapuchhre Bank Ltd and Siddhartha Bank Ltd are established without Joint venture.

The entry of foreign commercial banks function led to rapid growth of banking system. The governments liberalization policy led to a dozen of commercial banks actively playing in the financial market of the coueter. Suggestion for the development of banking in the country on the basic of area approach is being made by the policy makers recently. The central idea behind this is that depending on their area of

operation and location commercial banks could be assigned particular areas where they act as pace setter in providing integrated banking facilities. The establishment of commercial and industrial bank in Biratnagar, Lumbini, bank in Narayangadh, Machhapuchhre bank in Pokhara are some of the example in the promotion of regional banking industry of the country. Similarly the introduction of Nepal development bank from private sector is exemplary in the history of banking in Nepal. Many of these banks have shown tremendous progress to the term of deposits, lending or in customer base within a short periods of time. In addition the government has also introduced five regional development banks, which have boost up the income of poor in rural areas.

Responding to the applications for the establishment of six banks namely, Janta bank, century bank, Mero bank, Sangrila bank, Civil bank Ltd. and state bank of Nepal, process (in different phase) are underway to issue licenses to banks. Following the decision of in April 2009, NMB bank with its Head office in Kathmandu metropolitan, is granted license to operate banking services of class 'A' in May 2009, similarly DCBL bank Ltd and Kist Merchant banking and finance Ltd are granted license in May 2009 for conducting "A" class banking services. Mega Bank just opening in July 2010, with it Head office in Kathmandu metroplitan, for conducting "A" class banking services.

The request letters received so far about the merger of 5 financial institutions namely Mahalaxmi finance Ltd. Butwal finance Ltd. Siddhartha finance Ltd, Birgunj Finance Ltd and Himchuli Development Bank, have been studied. Nepal Rastra Bank responded to applicants based on its circular of 5 September 2008 that it can be considered if application for such merger is received subsequent to raising the level of their capital fund.

During the review period, the number of "B" class banks reached 60 from 58 banks. Mean while, development credit bank Ltd (DCBL) of "B" class has been upgraded to "A" class whereas 3 new development banks have been established. Among the new banks, Jyoti development bank is located in Kathmandu, Purnima development bank Ltd. at Siddhartha Nagar Municipality and shine development and bank is located at

Butwal Municipality of Rupandehi district. Process in various phases is underway for 39 new banks planned for establishment.

Since no "C" class financial company was established in the review period their number is contained to the previous 78 by mid-March 2009. Out of these 53 financial companies are based in Kathmandu, whereas 25 are located outside valley, Mean while 8 more financial companies are in the different phases of their establishment process.

The number of "D" class micro finance companies has reached 13 against earlier 12 with one more micro finance development bank added during the review period. The new one, Shree Naya Nepal Micro-Finance development Bank is based at Dhulikhel of Kavre district.

There has been no change in the number of cooperatives with limited banking services registered under cooperative Act and limited to 16 ( as before ) by mid-March 2009. The number of non-government organizations working as intermediary agency, has limited to 45 by mid-March following the cancellation of licenses of Nepal Gramin Bikash Samaj Kendra Biratnagar, and Chhimek Samaj Sewa Sanstha, Kathmandu.

#### **1.4 Overview of the Nepal Bank Limited (NBL)**

Nepal Bank Limited (NBL) the first commercial bank was established in 1937(1994 karkit 30 Bs) under the NBL Act 1937. The establishment of Nepal Bank Limited is a great landmark in the history of modern banking in the country. This bank gave different service to the people and provides the various facilities for and borrowing money for commercial and Agricultural purpose. It solved to a great extent the problems of commercial banking in economy. It contributed significantly in creating banking habit among people, widening remote fisted area and helped the government and business community in various ways. The bank has also the objective to accumulate scattered capital and invest them towards best productive and profitable channels for the promotion of desired sector of the country for the various factors which are supposed to be four wheels of development vehicles. With the

establishment of commercial bank Act 2031, the bank has been operating its function under the Act 2031. According to commercial bank Act 2031 section 2(a) " accepts cooperative, agriculture, industry or banking with any other particular objectives a bank which exchanges money, accepts deposit grant loans and operates commercial transaction is called a commercial bank. "It is the bank with largest number of branches reaching every part of the rural and urban area of the country.

The bank started with the authorized capital of 10 million and paid up capital of Rs 84.2 million, out of which 51 percent of the shares were government and the remaining 49 percentage of the public. The head office of the bank is located in Kathmandu and 5 regional offices are located in Biratnagar, Birgunj, out of which 16 are located at rural region and remaining 79 at the urban region.

### **1.5 Overview of the Rastriya Banijya Bank (RBB)**

Rastriya Banijya Bank (RBB) is fully government owned and the largest commercial bank in Nepal. RBB was established on 23 January 1966 (2022 Magh 10 Bs) under the RBB Act. RBB provides various banking services to a wide range of customers including banks, insurance companies industrial trading houses, airlines hotels and many other sectors.

Rastriya Banijya Bank has Nepal's most extensive banking network with over 123 branches, through its branch network RBB has been contributing to Nepal's economic development by providing banking services throughout the country. RBB has many correspondent arrangements with major international banks all over the world that facilitate trade finance bank originated personal funds transfers and inter bank funds transfer via SWIFT. In a bid to promote remittance business, RBB works with western union and international money express, two leading person to person funds transfer network.

In addition RBB runs various programmes i.e. banking with the poor, Micro credit project for women etc. to exchange the living standard of people as per the govt. directives. As well RBB actively delivers various government programs to people living in remote parts of the country, these programs are intended to rise living

standards. The central office the bank is in Singhadurbar Palza Kathmandu main branch office of the bank is located in Bishal Bazar New Road Kathmandu and 5 regional office are located in Biratnagar, Birgunj, Kathmandu, Pokhara and Nepalgunja and 124 branches are divided under the 5 regional office which 27 branches are located in regional office Biratnagar, 15 branches are located in regional office Birgunj, 34 branches are located in regional office Kathmandu, 23 branches are located in regional office Pokhara and 25 branches are located in regional office Nepalgunja.

Commercial banks are the heart of our financial system. It is the four wheels of the development of economy. When the Nepal gets the membership of world trade organization (WTO) and adopts the liberalization. The joint venture commercial banks opened their branches in the country and used the new technology and provide service their customers with modern banking system. But full government shares bank and mid-government shares bank running with traditional values and services. They can not facing competition with joint venture banks. Now government owned commercial banks Nepal bank Limited (NBL) and Ratriya Banigya Bank (RBB) has many challengers. How to provide the good service for their customers not fully computerize system. But the joint venture banks had used the computer system and served the modern banking system. So the NBL and RBB have necessary to use full computerized system, modern banking system and quickly provide the service.

## **1.6 Concept of Interest Rate**

In common language interest is a payment made by a borrower to the lender for the use of money and is expressed as a rate percent per year. But in economics, interest is defined different by different economics. According to carver "Interest is the income which goes to the owner of capital "Marshall defines interest as "The price paid for the use for the capital in any market". For Wicksell interest is a "a payment made by the borrower of capital by virtue of its productivity as a rewards for this (the capitalized, abstains)" Keynes regards interest as a purely monetary phenomenon and defines it as the "Premium which has to be offered to include people to hold their wealth in some form other than hoarded money " (Chopra 1997).



The bank collected the scattered saving as deposits provide certain rates on various deposits. The collected deposits are again invested as various kinds of loans charging certain interest by the bank. The difference in lending and borrowing interest rate is called spread rate. Spread rate has been quoted by Nepal Rastra Bank i.e. 4% to 5 percentages. This spread rate is one of the pure profits of the bank.

In other view, the rate of interest is the cost or price of credit. The cost to the borrower is called required return. It reflects the level of expected returns. The different types of assets have different rates of interest for their use. However, rates of interest change together according to time. Hence it is enough to say that the rate of interest is high or low instead of saying the interest rate of particular financial assets. For example, if the corporate interest rate is higher usually the interest rate of the state or local bond is also higher.

### **1.7. Focus of the Study**

There is a reverse relation between lending and deposit in the case of interest rate, when the interest rate increases deposit will increase and when the interest rate decreases lending will increase and vice versa. Interest rates send price signals to borrowers, lenders, savers and investors. For example, higher interest rates generally bring forth a greater volume of saving and stimulate the lending of funds. Lower rates of interest on the other hand tend to dampen the flow of saving and reduce lending activity but increase the demand for loans. Higher rates tend to reduce the volume of borrowing and capital investment and lower rates stimulate borrowing and investment spending (Rose 1997, 124).

This study is basically focused on different interest rates of the selected period and to know their impact on the deposits of Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB). The interest rate provided by the bank is various according to the deposit and time. As profit-seeking banks, Nepal Bank Limited and Rastriya Banijya banks also provide loans to the people and take the high rate of interest than in deposits for which they have to pay. The performance of the Nepal Bank Limited and Rastriya Bank are evaluated along with the brief analysis of the state of the economy, which provides the opportunities as well as threats to the commercial bank.

## **1.8 Statement of the Problem**

Most of the banks are adopting new banking system they seen successful to achieve remarkable market share in Nepalese financial institution which has lead to throat cut competition among each other. It has threatened the entire banking system including two commercial bank like Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB). Commercial banks are expected to boost up the development pace of communities as well as the economy as a whole. Commercial banks are operated under the values, regulations, guidance and directive of the central bank. Government initiated many joint venture banks, government banks financial companies, rural banks and cooperate societies in Nepal.

Mobilizing of deposits towards best productive channels has been always the concern of the banks. But a proper effective efficient and economic media for canalizing the resources has not yet been devised. So the bank has to try its best to induce people to save and deposit saving in the banks and to utilize these deposit to the maximum possible extent.

During the last 72 years of the existence of Nepal Bank Limited and above the 43 years of the existence of Rastriya Banijya Bank these banks have been increasingly making efforts to extent activities and providing large amount of funds to trade. Industries and also rising along term capital form different resources. Bank seem to be ready to begrant much more loan advance and other facilities against clients insufficient deposit unsecured loan and investment may cause the liquidation of banks. If the funds are wrongly invested without thinking any financial risk, business risk and other related facts, these banks cannot obtain profitable return as well they should sometimes loose own principle though both banks faced the problem from bad loans. Besides these banks (Nepal Bank Limited and Rastriya Banijya Bank) are facing following problems;

- a. Fluctuation of interest rate is the main problem observed.
- b. Interest rate provided to the deposit also seems decline yearly.
- c. The NPA is not satisfying.

## **1.9 Research Questions**

This study seeks to answer the following questions.

- a. What is the trend at Impact of rate of interest on deposits?
- b. What is the trend and impact of rate of interest on lending of the banks?
- c. What are the reasons behind the fluctuation on deposit and lending of the banks?
- d. How do rate of interest and deposit relate each other?

## **1.10 Objective of the Study**

The general objective of the study is to analysis impact of interest rates on deposit mobilization and it long term effect on the profitability of the banks. The specific objectives are:

- a. To analyze the trend of interest rate on deposit and lending of NBL and RBB.
- b. To analyze the trend and causes of fluctuations deposit and lending amount of NBL and RBB.
- c. To analyze the impact of rate of interest on deposit and lending of NBL and RBB.

## **1.11 Significance of the Study**

The scope of interest rate policy is as broad as its definition. Many genuine research works have been done and many important theories are formed and even apply in the economic world. However, Nepal has yet to achieve a bit of what other foreign student and scholars have achieved. While in a process this is another effort to fulfill the gap that has been left by other researcher and continue their genuine work.

Bank are major part of the economy as their polices and movements are always under financial scrutiny old banks have obvious advantage over new banks in term of operational cost and expertise gained though past experiences. How ever, new banks have obvious advantages provided by the updated and software and technology which is definitely going to pay back in the long run. These banks got autonomy to maintain their own interest rate, it has to shoulder huge responsibility as they have to scrutiny every aspect of effect of increase or decrease in the interest level.

Any genuine study in this can solve problems set definite directions therefore there has always been encouragement to bring about new ideas and information. The study undertaken is deeply concentrated on the impact of interest rate on deposit

mobilization and profitability of the bank therefore it will be helpful to all directly or indirectly related to economic fields. The study will be well known to respective problems etc.

### **1.12 Limitation of the Study**

The research is limited to deposits included current saving and fixed deposits and its interest rate is provided by Nepal Bank limited (NBL) and Rastriya Banijya Bank (RBB). The major limitation being only impact of limitation being only impact of interest rate on deposit mobilization is considered deposit there are several factors which have higher influence. Besides this study is bounded by the following limitation.

- a. The study focus itself only on two commercial banks of Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB)
- b. Analysis is based on secondary data.
- c. In this study saving and fixed deposit only are included.
- d. This study covers only the period 2003 to 2009 AD.

## **CHAPTER- II**

### **REVIEW OF LITERATURE**

The develop concepts and ideas about the selected topic by reviewing all the relevant materials regarding the study. In fact, review of literature beings with each for a suitable topic and continues throughout the duration of the research work. It deals with a literature survey of the existing volumes of similar related subjects. Review of literature means reviewing research studies or other relevant propositions in the related area of the study so that all the past studies their conclusions and deficiencies may be known and further research can be conducted. It is an integral and mandatory process in research works. The main reason for a full review of research in past is to know the outcomes of those investigations in areas where similar concepts and methodologies had been used successfully.

#### **2.1 Conceptual Framework**

This chapter lays the foundation of my research work, it discuss briefly about the theoretical concepts of interest rate and it relation with other subjects. The banks sensitivity to changes on interest rates is another source of liquidity problems. When in interest rates full, some depositors will withdraw their funds in search of higher returns elsewhere. This trend will decrease the liquidity in the bank significantly. At the same time many loan customers may flow into banks for loan request or spend up their drawing on those credit lines that carry lower interest rates. When interest rates rise many depositors may rush into bank to deposit in their fund. Bank interest rate is very sensible. It means comparatively little difference in the interest rate on deposit can significantly increase or decrease the volume of bank deposit, because majority of bank customers are always looking for higher interest rate. At the same time, when interest rate rise, many loan customers may postpone new loan request or speed up their drawing on these credit lines that carry lower interest rates. "An important aspect of interest rate policy is the setting of an appropriate margin between the lending and deposit rate. If the margin is too high, banks will make excessive profit and this may lead to waste of saved resources is low, it will discourage intermediation and devitalize financial institution" (Schulz,1978).

The rate of interest is a purely monetary phenomenon, a rewards for parting with liquidity, which is determined in the money market by the demand and supply of money. In Keynes's monetary theory he has presented a proposition that the rate of interest influences the level of economic activity by first influencing the rate of real investment in the economy. According to him the real investment is in fixed capital or durable machines. Keynes (1936),

"An important aspect of interest rate policy is the setting of an appropriate margin between the lending and deposit rate, if the margin is too high banks will make excessive profits and this lead to waste of saved resources. If is too low it will discourage intermediate and devitalize financial institutions. At the same time the demand for credit goes on increasing being affected by the cheap loan rates. Hence it can be concluded that changes in interest rate structure produces either positive or negative impact upon the growth of developing economy such as ours. When such amendments are introduced without thinking seriously, there spread more negative effects than positive. There are different interest rates in the financial system. Even securities issued by the borrower often carry a variety of interest rates. Schulz (1989)

**Some common types of interest rate are as follows (Jhingan, 2000).**

#### **a. Risk Free Rate of Interest**

It is a component of all interest rates; pure interest rate is what remains with the lender after deducting the reward for risk taking from gross interest. The pure or risk free rate of interest exists only in theory, the closet real world approximation to this pure rate of return is the market interest rate on government bonds less inflation. It is a rate of return presenting little or no risk of financial loss to the investor. And it represents the opportunity cost of investing in government bonds with no risk and earns this minimum rate of return (Dictionary of Economics 2003).

#### **b. Gross Interest**

The payment, which the borrower makes to the lender excluding the principle, is gross interest.

### **c. Rewards for Risk Taking**

Interest also includes reward for risk taking. The lender exposes him to risk when he lends money. The greater the risk element the higher the rate of gross interest. Unsecured loans are more risky than secured loans and they carry a high premium rate.

### **d. Rewards for Inconvenience**

Interest also a reward for inconvenience. When a lender loans money he forgoes its use for the duration of the loan. His money is looked up and can not be used for more profitable purposes. Even if he needs this amount for his personal use, he will have to undergo the inconvenience of arranging it from some other source. So on fixing the rate of interest the lender includes in it the reward for such inconveniences.

Interest rates have diverse roles and functions in the economy. Its roles can be noticed as a reward to capital which is a factor of production a return to saving a cost of investment as an instrument of monetary policy for credit control, its functions are: It helps guarantee that current saving will flow into investment to promote economic growth. It rations the available supply of credit generally providing loan able funds to those investment projects with the highest expected returns. It brings the supply of money into balance with the public's demand for money.

## **2.2 Theories of Interest Rate**

Various interest rate theories have been propounded by various economists, which describe how interest rate is determined in various situations. Some well known theories of interest rates are as follows: ( Samuelson P,A, & Nordhus, William 2002 Economics)

### **2.2.1 The Classical Theory of Interest Rates**

One of the oldest theories concerning the determinants of the pure or risk free interest rate is the classical theory of interest rates, developed during 18<sup>th</sup> and 19<sup>th</sup> centuries by a number of British economists and elaborated by Fisher (1930) earlier in this century. The classical theory argues that the interest is determined by two forces: First is supply

of savings, derived mainly from households and second the demand for investment capital, coming mainly from the business sectors ( Rose, 2003).

### **Saving by Households**

Individuals and families carry out most of the saving in modern industrialized economics. For these households, saving is simply abstinence from consumption spending. Current saving therefore are equal to the difference between current income and current consumption expenditure. In making the decision on the timing and amount of saving to be done, households typically consider several factors: the size of the size of current and long term income, the desired saving target, and the desired proportion of income to be set aside in the form of saving (i.e. the propensity to save). Generally the volume of household saving rise with income. Higher income families and individuals tend to save more and consume less relative to their total income than families with lower incomes. Although income levels probably dominate saving decisions, interest rates also play an important role. Interest rates affect an individual's choice between current consumption and saving for saving future consumption. The classical theory of interest assumes that individuals have a definite time preference for current enjoyment of goods and services over future enjoyment. (Rose Peterson 2003)

### **Saving by Business Firm**

Not only households, but also business, save and direct a portion of their saving into the financial markets to purchase securities and make loans. Most business hold saving balance in the form of retained earnings. Infact, increase in retained earnings reported by business each year is a key measure of the volume of current business saving. And these retained earnings supply most of the capital for annual investment spending by business firms. Saving depends on two key factors: the levels of business profits and the dividend policies of corporations. These two factors are summarized in the retention rate, the ratio of retained earnings to net income after taxes. This ratio indicates the proportion of business profits retained in the business for investment purposes rather than paid out as dividends to the owners. Experience has shown that dividend policies of major corporations do not change very often. Many corporations prefers to keep their dividend payments level constant or increase them slightly each



year, regardless of their current earnings. Any shortfalls in earnings needed for dividend payments are made up through borrowing. (Rose Peterson 2003)

### **Saving by Government**

Government also saves though less frequently than households and business. In fact, most government receipts and unexpectedly exceeds actual amount of expenditures. Income flows in the economy out of which government tax revenues arise, and the pacing of government spending programs are the dominant factors affecting government saving. It increases the supply of funds. (Rose Peterson (2003) Money and capital markets.

### **2.2.2 The Liquidity Preference Theory of Interest**

The classical theory of interest has been called a long term explanation of interest rates because it focuses on public's thrift habits and productivity of capital factors that tend to change slowly. During the 1930. British economy Keynes (1936) developed a short term theory of the rate of interest that he argued was more relevant for policy makers and for explaining near term changes in interest rates. This theory is known as liquidity preference theory of interest. In this theory interest is the interplay of demand for liquidity and supply of money ( NRB, Economics Report, 2001)

### **2.2.3 The Fund Theory of Interest Rate**

A view that overcomes many of the limitations of earlier theory is the loanable funds theory of interest rates. This view argues that the risk free rate is determined by the interplay of two forces the demand for and supply of credit (loan able funds). The demand for loanable funds consists of credit demands from domestic business consumers and government and also borrowing in the domestic market by foreigners. The supply of loanable funds stems from four sources domestic saving, banking demand for money creation by the banking system and lending in the domestic market by foreign individuals and institutions (Ibid 2001:)

### **2.2.4 Rational Expectancy Theory**

In recent years, a fourth major theory about the forces determining interest rates has appeared and now appears to be gaining supporters. This is the rational expectations theory of interest rates (Ibid, 2001, p.132).

It builds on a growing body of research evidence that the money and capital market are highly efficient institutions on digesting new information affecting interest rates and security prices. The important assumptions and conclusions of the rational expectations theory are that the prices of securities and interest rates should reflect all available information and the market uses all of this information to establish a probability distribution of expected future prices and interest rates. Changes in rates and security price are correlated only with unanticipated information; the correlation between rates of return in successive time periods zero; expectations concerning future security prices and interest rates are formed efficiently. The rational expectations view argues that forecasting interest rates requires knowledge of the public's current set of expectations. It implies that policy makers cannot cause interest rates to move in any particular direction without knowing what the public already expects to happen and indeed, cannot change interest rates at all unless government officials can convince the public that a new set of expectations is warranted (Ibid, 2001).

### **2.3 Interest Rate and its Revision**

The former government of Nepal Rastra Bank Mr. Kul Shekhar Sharma remarks these things about interest rate changes (Sharma 1975).

- ) A high and positive rate of interest is necessary to attract the resources from the public in terms of rising prices.
- ) Cheap interest rates do not benefit proper section of the society for whom it was intended.
- ) A reform in the interest rate had become necessary to restore equilibrium because the commercial banks could not attract the general public by the existing interest rates.
- ) Interest rate should be changed from time to time in accordance with the condition of demand and supply of capital.
- ) The interest rates should not be fixed at an unrealistic level because its principal function is to guide investment opportunities which are needed in the economy.

## **2.4 Changes in Interest Rate and its Impact**

In Hamburger's view "monetary variables have a significant effect on consumers purchase of durable goods and the most appropriate measures of these variables are interest rates (Hamburgers 1967)".

This means to say that the consumption pattern of the individual can be changed by the interest rate. An individual can be attracted by a good avoid rate of interest and may divert his attention towards earning interest rather than consuming more durable goods. This shows the effects of interest upon the psychology of an individual. No doubt there exist positives relation between saving of the people and the interest rate of the banks.

## **2.5 Impact of Inflation on Interest Rate**

One of the most serious problems confronting economists around the globe in recent year is in inflation. The relationship between interest rate and expected inflation is often referred to as the fisher effect. Inflation is defined as a rise in the average level of prices for all goods and services. To explore the relationship between interest rate and inflation it is better to distinguish nominal and real interest rates. The nominal rate is the published or quoted interest rate on a security or loan. In contrast real interest rate is the return to the lender or investor measured in terms of its actual purchasing power. An increase in expected inflation automatically increases nominal interest rates. But expected real rate of return tends to be relatively stable over time because it depends on such long term factors as the productivity of capital is likely to influence only the nominal interest rate at least in the short run. (Rose 2003:165).

## **2.6 Impact of Deflation on Interest Rate**

For the past fifty year and more inflation a rising level of prices of goods and services has been a key economies and financial problem. However as the twentieth century began there was growing concern that deflation a fulfilling average level of price might soon replace inflation as one of the key problem. Indeed Japan for much of the past decade has experience falling prices to go along with rising unemployment and nominal interest's rates lowering close to zero. Deflation can lead to falling interest rates. We can think so because deflation can damage to production and peoples well

being. For one thing deflation tends to force real interest rates higher even as nominal rate drop downwards to zero. These elevated real interest rates tend to slow investment spending and decrease the development of new jobs. Real economic output will decline as factories come to produce less and business profits fall. At the same time lenders gain a tax expense of borrower because the formers purchasing power rise and business trying to borrow money have to struggle to raise the capital they require to grow and out people back to work (Ibid 2001 p 274).

## **2.7 Concept of Deposit**

Deposit is the main sources of funds. By providing the certain rate of interest commercial banks call for the deposits from the customers. Mainly three types of deposit are accepted by the bank that is the current deposit saving deposit, and fixed deposits are used for lending the money to different sector as agriculture, productive work. Trade, industry. The deposit will lead to increase the working capital of the bank. So in a developing country like Nepal, deposits have played a significant role fourth development of the Nepal.

### **2.7.1 Importance of Deposit**

Deposit arises from saving. An individual's income equal consumption plus saving he/she deposits the saved part of income in the bank and gets interest from it. Banks in turn lend this money and earn profit by charging high interest rates. And borrowers from banks, invests this fund in productive sectors yielding more return than the borrowed interest. This investment leads to create new employment opportunities in the economy, ultimately due to new employment the purchasing power of the economy increase and finally GDP and growth of the country occurs. it means that the deposit has very important role in the economy. There is a direct relationship between deposit of bank and the investment in the economy. If the volume of deposit is low, the investment in the economy also lags behind due to lack of resources. The deposit of bank is the accumulated capital which can directly be invested. There is a great need of such deposit in the developing countries. Deposit includes the idle money of the public, bond being the intermediate to accept this sort of money and help to channeled this in productive sector. So the importance of banks and financial intermediaries is larger in present context.

### **2.7.2 Deposits and Banks**

There is greater relationship between deposit and bank. Without deposit bank does not swing their wings. It means that deposit is the blood circulation of body of bank. So first of all banks performance to collect the more money as deposit. Money is deposited by the people in banks for some motives as.

- a. For high interest rate gain.
- b. Money for safe keeping
- c. Safe and transaction
- d. Those people who have no any idea how to utilize the money (as business, industry) so, they keep money for deposit in the bank.

As mentioned earlier people deposit money for safe keeping. It is intense that they can hardly control their conscience. So it banks does not exist it is certain that people save less money. It is necessary that three exist some institutions that mobilize their saving. So the importance of banks can not longer be exaggerated.

The large number of banks in the country suggests that the people of that country save more money. Unless people save more money the opening of new branches and the extensive of banking system will get no meaning. On the other hand the volume of deposit also depends upon the interest rates of the banks. Positive real interest rates attract more resources from the public.

### **2.8 Concept of Lending (Credit)**

Another importance function of commercial bank is to provide types of loans of credit. The word credit means trusting. In credit transaction the lender (or bank) must have confidence in the borrower that she/he will be able to repay the money. In credit transaction the creditor turned over to the debtor to repay and equivalent amount usually money in future plus as added sum called interest. In other words the commercial bank earns profit by lending the amount in terms of loan or credit and in return it gets interests. Banks loan are classified as: a) Loan and advances b) overdraft, c) cash credit d) Discounting of bills and so on. (Monohar 1998.225) But besides this the other forms of credit are: Bills of exchange cheque Draft, promissory Note, Letter of credit (LC). Travelers cheque, Treasury Bills (T. Bills ) credit etc.

### **2.8.1 Factors Affecting the Volume of Lending**

The volume of credit within a country upon different factors. For this study only the effect of interest rate is taken into consideration and other factors are not considered some of the factors affecting the volume of credit are as follows:

#### **a. Credit Lending Rate**

If the bank credit rate is very high then, the volume of credit expansion is less and vice-versa. It means that volume of credit and interest rate of credit has inverse relation. People invest very little in productive sectors when the interest rate is high in the market economy.

#### **b. Rate of Return**

If the rate of return is high people inclined to invest more. People earn more profit and they become able to afford higher rate of interest along with timely repayment of loan

#### **c. Investment Opportunity**

If the investment opportunity within the country is high, the volume of credit becomes high. The basic thing for investment stimulation is easy and cheap credit etc.

#### **d. Peace of Financial Development**

If there are enough banking facilities to provide loans in easy terms the volume of credit may be high. It is due to the lack of cheap money lenders that rural people are deprived of loan. If the banking facilities within the nations are expanded the volume of credit rises.

#### **e. Basic Infrastructure**

Like transportation, marketability, availability of raw materials also pays an important role in raising the volume of credit in the country

#### **f. Political Condition**

Political condition especially political instability, is also one of the major causes of low volume of credit. In such a case none would like to risk his capital in new ventures. The present condition of the country is the glaring example of this. In addition to aforementioned point, other factors like trade condition, currency conditioned are also the factors affecting the volume of credit.

## 2.9 Review of Related Studies

In the preparation of this thesis there are some research papers articles and thesis related to this study, which contributes some idea and the help in the presentation of this study regarding to this thesis, there are very few thesis and research papers articles submitted to the libraries Tribhuwan University and its wing colleges on the same topics. But besides this there are some other thesis which is related to this study to some extents. The review and the extract from them presented in this section.

**J.M Keynes (1936 p.136)** “The general theory of employed interest and money" in J.M Keynes book brought forwards his view about the rate of interest. Community's liquidity preferences and quantity of money and rate of interest are negatively correlated. At low rate of interest the liquidity preferences of community is high and it is low at high rate of interest.

According to the modern view interest rate determination deepens upon the investment, the marginal efficiency of capital is the rate of interest and investment is equal to the desire volume of saving.

Thus, the total investment total saving or  $I = S$  keynes said that the three divisions of liquidity preference are;

- i. The transactions motive i.e. the need of cash for the current transaction of personal and business exchanges.
- ii. The precautionary-motive i.e. the desire for security as to the future cash equivalent of a certain proportion of total resources; and.
- iii. The speculative-motive i.e. the object of securing profit from knowing better than the market what the future will bring forth.

**Maxwell (1974)**, Opines that the interest rate fixing authorities cause adverse effects on income distribution. The interest rates are beneficial especially for the small savers. According to him interest rate affects the saving and mobilization. A high interest rate diverts the resources from unproductive tangible assets into financial claims. For Nepalese people and Nepalese undeveloped money and capital market interest rate can be taken as an important weapons in mobilizing the interest resources, here interest rate plays as a market clearing device. Higher interest rate pushed people to some money and it allows people to invest into opportunities. Low

interest rate attracts the small borrowers. In Nepalese context investor are bound to take loan from unorganized sectors and have to pay high rate of interest. This high rate of interest affects on their return on investment. Interest rate risk exists in conditions in financial markets will later the balance between the supply and the demand for loanable funds.

"When funds are plentiful, market rate generally tends to decline banks seek loan move aggressively, and therefore lower their rates induce marginal borrower to come into the market. When funds are scarce banks raise their rates and coming of potential borrowers may differ the use of credit or seek it else where" (Crosse 1963).

**Samuelson (1989)**, Mentioned about the impact of changing rate of interest. Interest rate affects the interest earning and interest expenses. The spread changes according to the changes the interest rate. The changes in risk less rate of interest caused the whole spread some times, up and sometimes down.

## **2.10 Review of Papers and Articles**

When funds are plentiful market rate generally tends to decline banks seek loan more aggressively and therefore low their rates to include marginal borrower to come in to the market. When funds are scarce banks raise their rates and some potential borrowers may differ the use of credit or seek it else whereas (Crosse 1963).

Price level trends affect interest rates in two important ways. First the nominal interest rates the contract or stated, interest rate reflects expectations about future price level behavior. If prices are rising and expected to raise further the expected rate of inflation added to the interest rate that would have prevailed in the absence of inflation to adjust for the decline in purchasing power represent by price increases.

**Panta (1983)** mentioned that changing interest rates in deposits changes the saving held by the Nepalese individuals. High interest rate in deposit helped to raise the saving especially from rural areas. Lower rate loan showed huge increment in sale and purchase of land, building and vehicles in the recent years. In his book, interest



rate policy rate policy of Nepal has expressed the following view points about the rate interest.

The change in the interest rate will increase time deposit through the rout of balance payment but the magnitude of effect will depend in particular on the interest elasticity of money demand function. The real rate of interest has the expressed influence on money demand or the velocity of money. But the coefficient is too small to be statically significant on that an increase of 100 percent in real interest will lead to just seven percent increases in saving. The changes in interest rate in April 1975 by NRB have generated three effects.

- a. Time deposit increased at a relatively higher rate for a year or two and increased resources base of the commercial banks. The change in a deposit rate is expected to have diverted the resources from rural to urban area.
- b. Won traditional are but more importantly on the slow growth in demand for investment for the private sector.
- c. The profit position of commercial banks deteriorated sharply due to lack of any comprehensive credit plan to use the accumulated resources in the form of deposit liabilities.

**Kafle (2005)**, In her article entitled " Nepal Rastra Bank and its polices for monetary control" opines that liberalization, the effect on deposit seems to be positive in the letter period as it increased from 17.74 to 21.60 percent of nominal GDP and thus there was a positive effect on saving mobilization, however in the case of loan and advances commercial banks were founds to be underlet because the percentage of loans and advances to nominal GDP was only 10.6 and 11.9 in the two period respectively.

The existing of large unorganized money market. Lack of sensitivity of economic agents for monetary changes budgetary operation of the government highly mismatching for revenue and expenditure, lack of adequate securities markets, undeveloped money and capital markets. And so on are the main factors creating problems for the effectively use of monetary policy.

## 2.11 Review of Thesis

**Raj Bhandary (1978)** conducted a study on "the interest rate structure of commercial banks in Nepal". The objective of this study was to show the relation of interest rate with saving and fixed deposits; with loans and advances; and with net interest earning (i.e. interest received on loan minus interest paid on deposit). The study concluded that the time deposit are positively and significantly correlated with interest rates. There is significant correlation between the saving deposit and the rate of interest fixed deposit is more sensitive to the interest rate revision deposit and the interest rate particularly from 1977 is most significant. But the relation between the interest rates and the loan and advances is less significant. Among all the sectors, the private sector seems most sensitive to interest rate change. Most of the loans too are correlated positively if absolute cumulative figures are taken. But the growth rate of total loans and advances except investment on government securities is negatively correlated more with the weighted average rate of interest since 1973. The growth of loans to private sector is also negatively correlated with interest rate since 1971. Negative means that loans decrease at higher interest rate since 1971. Negative correlation between loans and interest rate means that loans decrease at higher interest rate and vice versa.

The net interest earning is developed upon interest coverage. The total interest received and the total interest paid significantly correlated in the case of both of the banks i.e. Nepal bank limited and Rastriya Banijya Bank the sample organizations of the study. He is in view that NRB can well monitor the credit flow and profits of the commercial banks in Nepal by manipulating the rates of interest. It can be also manipulate the demand for and supply of money.

**Pandey's (1979)**, Study on "Money level of prices and interest rate structure A case study" was conducted with the objective of studying the trend of money supply in Nepal and there by to find out the factors responsible for it same wise to analysis the interest rate of NRB. With this study we also have the relationship among money supply prices and interest rate structure of Nepal.

With the above mentioned objectives the study concluded that: the time deposit is positively and significantly correlated with the interest rate. There is significant correlation between the saving deposits and the rate of interest and between the fixed deposits and the rate of interest. Fixed deposit is more sensitive to the interest rate revisions. The correlation between the growth of fixed deposits and the rate of interest particularly is most significant. Among all sectors the private sector seems most sensitive to interest rate revision. The net interest earning depends upon interest coverage. The total interest received and the total interest paid is significantly correlated in the case of both the banks i.e. Nepal Bank Limited and Rastriya Banijya Bank. By manipulating the rates of interest Nepal Rastra Bank can will monitor the credit flow and profits of the commercial bank in Nepal. It can manipulate demand for and supply of funds by manipulating interest rates and by contracting or expanding money supply.

**Khatri (1980)**, Mentioned in this thesis that the overall performance of commercial banks in satisfactory and Nepal Rastra Bank has to play more active role to enhance the operation. The liquidity position of commercial bank is satisfaction co-efficient of correlation of deposit and lending and investment of commercial banks have better position. The co-efficient of interest rates and deposits of commercial banks do not have better position. He further found that the trend of deposit loan and advances and investment to deposits is in decreasing trend. He concluded his thesis mentioning that the interest rate has played important rate in deposit mobilization of the bank. So, the structure of interest rate should be changed according to the need of nation.

**Neupane (1997)**, Mentioned in his research work that interest rate various among nations. It depends upon their economics activities and existing policies. In every economy we find inverse relationship between investment and interest rate. Higher the interest rate, lower the investment and vice versa. Direct relationship may be found between interest rate and saving. With the lower interest rate the deposit also falls down so while determining the interest rate should always by equality in saving and investment. Appropriate interest rates scan direct investment in the proper filed. For resources, interest rate should be positive.

In Nepal interest rate can perform the following functions.

- The interest rates mobilized saving.

- The interest rates in an effective rationing device for the allocation of the scarce resources between alternative investments.
- The interest rate can provide a social discount rate for decision to save and invest.

Interest rate has the guideline for directing the investment into productive sector. The cheaper interest rate of the commercial banks diverted the capital into unproductive and speculative sectors.

**Bhandarie's (2005)**, Study on " A study impact of interest rate structure on investment portfolio of commercial banks of Nepal" a study was conducted with the objective to cast a glance at the historical background of interest rate structure of commercial banks policies, decisions and strategies regarding it and their impacts and to assess the impact of interest rate structure of commercial banks on their investment portfolio by analyzing their deposits loans advances, interest spread investment and bills purchases and discounted.

With these mentioned above objectives the major finding of the study are to be identified. Deposit rates and lending rates of the commercial banks have been changing time to time. It is found that the deposit rates and lending rates increased slightly immediately after the liberalization of interest rate on August 31, 1989. But therefore these rates started to decline. Lower rates of interest have helped in increasing the credit flow. Interest rate structure of the commercial banks greatly influences their profitability which depends on their interest spread, decrease in lending rates resulted in the increase of credit flow and interest spread which consequently increased the profits of commercial banks. Deposit rate is the most important determinant of the deposit collection of the commercial banks. According to the earlier analysis, it is found that though the mount of the deposit collection of the commercial banks is increasing the rate of increment is declining with the decline in the deposit rates. This means depositors are more interest conscious. They increase their deposit, if higher deposit rates are offered. The study shows that the increasing demands for credit can be met only by increasing deposit collection.

**Dangol's (2006)**, Study on "The impact of interest rate on financial performance of commercial banks of Nepal". A case study was conducted and following findings are

measured as most of the sample commercial banks contradict the general financial theory. The average data also is contradictory with the general financial theory. Thus, the whole banking sector represents an anomaly in the financial theory. The relation between deposit and interest rate must be positively correlated. But this is not so as indicated in the study. The analysis shows just the opposite picture. The study reveals that in our economy as whole deposits are increasing despite the decrease in the general level of interest. The economy of the country is stagnant at the present time. This has resulted in low consumer and business confidence. As a result of such psychological phenomenon. Business are reluctant invest in new ventures. The result such phenomenon is that there are fewer investment opportunities for the banking sector as well as the general investors. The relation between total amount of loan and the lending rate is negative and significant in all the cases. This thus is what is expected in an economy. This is one aspect where the general economic theory is applicable. The change in the total amounts of loan flow is not however proportionate with the change in the lending rate, this also caused by the current state of the economy. The general trend of the operating cost of the commercial banks is growing this is probably the result of inflation prevailing in the economy. The trend of the interest rates ate however just opposite. Thus, since the general trends of both the variables under consideration are opposite the correlation analysis is not able to clearly decipher the relation between the variables. The study also reveals the commercial banks are more or less similar in various aspects.

**(Dhungana: 2007)** in his study” Lending Practices of Finance Companies” concluded that lending plays key role for the success of every Finance Company. There should be effective loan policy and efficient implementation to get successful recovery. Loan policy and interest rate are interrelated, so fixing appropriate interest rate may lead the Finance Companies towards bright future. He further recommend that there is need to increase liquidity position of Finance Companies and they should be focused towards commission based transaction.

**Mr. Paudel (2008)** in his thesis study on "Impact of Interest rate on Deposit mobilization of Finance companies at Rupandehi" find out that Economic liberalization policy of the government has encouraged establishing and growing of FC's with is short span of time. In a situation when existing financial institution specially governments commercial banks were unable to mobilizing the deposit and to

cary capital market activities, finance companies have contribute a lot. Now there are 79 FC's up to mid January 2008 and all are operating smoothly. Due to the active roll of Nepal Rastra Bank overall performance of FC's is almost satisfactory.

## **2.12 Review of Policy Document**

The following Nepal Rastra Banks directions relating to interest rate issued for commercial banks effective from February 14, 2001.

- ) The commercial bank should in from Nepal Rastra bank in written from regularly and compulsorily, and publish in the news media within every three month and immediately in case change.
- ) The commercial banks could offer interest rate more than published interest by 50 basic points on the basic of negotiation with customers for the deposit of two hundred million and 100 basic points for the deposits more than Rs. two hundred million.
- ) Over the published lending rates for all types of loans, the bank could make the adjustment up to 50 basis point on the basis of negotiation with the customers.
- ) While publishing any deposits rate or any lending rates expect the provision on above (b) and (c) the commercial banks was not allowed to mention the term "could be determined on the basic of negotiations. "If interest rates are determined against this directive, penalty equivalent to an amount arising such increased or lowered rate of interest should be imposed (economic report 2000\2001)

The difference between the interest provided and interest charged (spread) should not be more than 5 percentage. The difference is calculated on the basis of the weighted interest provided and the weighted interest charged.

## **2.13 Nepal Rastra Bank's Domination on Interest Rates**

Nepal Rastra Banks playing a lending role in the economic and financial sector of the nation. As a result of interest rate on deregulation, commercial banks are allowed to determine their own interest rate on deposits and loans. The interest rate structure continues to be an important area concerned to born Nepal Rastra bank and commercial bank. The deregulation of interest rates has provided autonomy to

commercial banks to determine their own interest rate on deposits and loans but the disparity should not exceed more than 6 percent. After the establishment of Nepal Rastra bank, it held the authority of controlling commercial banks from and financial institutions. Nepal Rastra bank had actively formulating the monetary policies and fixing the interest rates.

The economic liberalization policy of the government also has encouraged the established and growth of commercial banks in the country within a short span of time. In a situation when existing financial institution, especially commercial bank are unable to supply credit is one of the important instruments of monetary policy. According to this policy Nepal Rastra Bank control over the commercial banks statutory reserve of liquid assets. Limitation and spread of interest rates over deposit and loans, ceiling on the flow of loan a priority sector etc. At past Nepal Rastra Bank (NRB). Sometimes controlled and sometimes provide facility in the determination of interest rates of commercial banks.

With a view to attract saving into the banking sector and to make rate structure in Nepal competitive with of India, the NRB issued their directives to interest rates effectives August 31<sup>st</sup> 1996. According minimum rate on saving deposit of 4 percentages per annum and on fixed deposit of year or more 6 percentage per annum. The commercial banks were also directed to increase by 1 percentage point in saving and by 2 percentage points in one year fixed deposit. (NRB directives, 1996)

For the subsequent development in the national economy, the NRB announced a new interest rate structure, effective April 14<sup>th</sup> 1971. The new lending rates of commercial banks ranged from the 7 percentage to 13 percentages as compared to the previous rates ranging from 7.5 percentages to 12.5 the new lending rates of the financial institutions in the agriculture sector ranged 3.45 for long term loans as compared to previous rates ranging from 5 percentages to 10 percentages. The new lending rate of Nepal industrial development cooperation had fixed the interest rate at 7.5 percentages. The corporation in an average interest rate fixed 8 percentages, 6 percentage and 5.5 percentages for short medium and long term respectively. (NRB directives, 1971)

From the very beginning of the FY 1971\1972, the rate of growth in fixed and saving deposits started to decline, whereas the demand for credit was rising steadily. One of the main causes of the fall in deposit growth was the non effective interest rate structure, turned negative due to spiraling prices, although the interest rate revisions of July 1974 had given some impacts to deposit growth for a few month the same could not continue for long. The exploding international price situation due to the and caused Nepalese price also to move upwards and the inflation rate was recorded at as high as 18 percentages during 1973\74 and 17 percentage during 1974 \75. This result is a negative real state of interest on saving discouraging deposit mobilization. To correct this, a historical upwards revision in interest rate structure was made in April 1975. (NRB directives, 1975)

In this interest rate revision, the rate on saving deposit was raised from 6.5 percentages to 8 percentages on three month fixed deposit from 3.55 to 4 percentages and on six months fixed deposit from the rate was fixed at 10 percentages. The rate of 1 year deposit was increased from 9.5 percentages to 15 percentages and 2 year deposits from 9.75 percentages to 16 percentages. With a view to make use of the expending sector in agricultural industry and export promotion, the NRB downwards revisions in the interest rate structure effective mid-July 1976. Accordingly, fixed deposit rates were cut down by 1 percentage fixing 1 year and 2 year deposit rates at 14 percentage and 15 percentages respectively. (NRB directives, 1976)

The interest rate revision aimed at controlling credit and was geared more towards mobilization of resources to enable commercial banks and financial institution to advance move credit. In order to provide additional impacts to resources mobilization and channeling the available resources to productive sectors effective June 15<sup>th</sup> 1982 increased the deposit rates marginally by 0.5 percentage and lending rates by 1.0 percentage. (NRB directives, 1982)

Effective November 16, 1984, the NRB granted autonomy to the commercial banks in offering the rate of interest on saving and time deposit to the extend of 1.5 percentage 1 percentage respectively above the minimum level. The NRB directed commercial banks and agricultural development bank to reduce the interest rate by 2 percentage



that the normal credit rate for agricultural and cottage industries in the 18 remote districts. (NRB directives, 1982)

Effective May 29, 1986 commercial banks and financial institutions were set free in fixing the maximum interest rate on deposits and lending rates above the minimum interest rate on deposit and maximum lending rates for productive and priority sectors. The minimum interest rates were 8.5 percentages on saving deposit and 12.5 percentages for one year fixed deposits. (NRB directives, 1986)

The banks were also instructed by the NRB regarding saving accounts operation authorized to fix ceiling on periodical withdrawals amount of minimum balance to be maintained by the saving account holders as well as the maximum balance that would be eligible for carrying interest etc, besides this, the NRB lifted the restriction on opening saving accounts by individuals only and institutions not motivated by profit consideration.

Regarding lending rates, the banks and financial institutions were allowed freedom in fixing the lending rate in all areas for credit to the priority sector. Effective interest rates of banks and financial institutions from 31 August 1989, were completely liberalized and granted autonomy in fixing their own deposit and lending rates. The ratio able for ending the administered interest rate structures, bring about flexibility in the mobilization of financial saving and make efficient allocation of available resources. (NRB directives, 1989)

Interest rate liberalization could not fully meet the objectives and the lending rates increased faster than the deposit rates. Interest rates structure could not treat uniformity in terms of interest rates. Thus, instead of competition in the market discrepancies were observed in the interest rate structure after August 22, 1992. The Nepal Rastra Bank issued the following directives to bank and other financial institutions. (NRB directives, 1992)

- a. Interest rates on deposit of at least up to one year to clearly spelt out.
- b. Range of interest rates on the credit of same type or purchase not to be more than one percent.
- c. Fixation of interest rate in flat basis to be stopped.

## **CHAPTER-III**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

Research methodology is the process of arriving at the solution of the problem through planned and systematic dealing with the collection, analysis and interpretation of fact and figures. When a particular research area has been identified, research problem defined and the related literature in the area have been reviewed; the next foremost step toward the objective is to set research methodology.

Research is a systematic and organized effort to investigate a specific problem that needs a solution (Sekaran1992). This process of investigation involves a series of well- through –out activities of gathering, recording analyzing and interpreting the data with the purpose of finding answer to the problem. Thus, the entire process by which we attempt to solve problems or search the answer to questions is called research.

The objective of this study is to examine deposit collected and interest rate provides by Nepal Bank limited (NBL) and Rastriya Banijya Bank (RBB) also tries to find out the relation between lending, deposit and interest rate. To achieve the objective, the study requires an appropriate research methodology. In methodology of data collection method of data processing techniques use in details for estimation and study design itself.

#### **3.2 Research Design**

"A research design in the arrangement of condition for the collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure" (Kothari, 1990).

Thus a research design in a plan for the collection and analysis of data. For research there exist different types of research design like historical research, descriptive research, case study, field study, analytical research, true experimental research and so on. This study mainly concerned with historical research. In this study generally to show the relationship of interest rate with deposit and lending amount, past historical

data are used. The relevant and needed data has been collected from various publications of commercial banks like Nepal Bank Limited, Rastriya Banijya Bank and Nepal Rastra Bank.

### **3.3 Population and Sample**

There are 26 commercial banks, 61 development banks 78 finance companies, 13 micro finance institutions 16 NRB licensed co-operatives (limited Banking transaction), 45 NRB licensed NGOs (Dealing in Micro Finance), in the country. Among the total population only some selected institution are taken as sample or random basis similarly due to unavailability of data from all the sector, only commercial banks are chosen for this study. So, precisely saying all 26 commercial banks are the population of this study and among them only two commercial banks are chosen as samples from total population from selecting the samples. These two banks are chosen deliberately NBL is the first bank of Nepal and is functioning in private sector, where, RBB is government owned bank. Thus these two banks are representative for monetary phenomenon of the country. At the same time different ownership of these two banks can clear rate on deposit and lending. The following are the population of the banks and their sample chosen there of.

Sample

1. Nepal Bank Limited
2. Rastriya Banijya Bank

### **3.4 Sources of Data**

Data may be obtained from several sources; it is easily to list them in detail. Each research project has its own data needs and data sources. However, the general classification of data sources has two dimensions: primary and secondary sources. Primary data are original data gathered by the researcher for the research project at hand. Thus, this data are collected for meeting the specific objectives of the study. Primary data are collected through interviews, questionnaires, observations or experiments. Secondary sources refer to those for already gathered by others. The sources of secondary data can be divided into two groups internal and external. The internal secondary data are found within the company. Sources of such data include sales information, accounting data and internally generated research reports. External

secondary data are collected from sources outside the company such sources may include books, periodicals, published reports, data services and computer data banks.

This study is conducted on the basis of secondary data. The data relating to the deposit, interest rate and other are directly obtained by the concerned banks. These data are based on the information provided by the officers of concerned department of Nepal Rastra Bank, Nepal Bank Limited and Rastriya Banijya Bank. During the personal interview with them. Another source of data can be collected from the publications of Nepal Rastra Bank which includes publications like annual economic report quarterly, economic bulletin banking and financial statistics, monthly Report, Nepal Rastra Bank Samachar, economic review, Mirmire, similarly various data and information collected from these related banks published and unpublished report, documents, bank Samachar, websites and economic survey of government of Nepal from various sources will also be used.

### **3.5 Methods of Analysis**

Collected data are comparatively analyzed in different ways according to its requirement. For that obtained data have been presented in various tables, graphs, diagrams ratio, average, and percentage with supporting interpretations.

### **3.6 Data Analysis Tool**

For the purpose of the study all collected primary as well as secondary data are arranged tabulated under various needs and then after disunities and statistical analysis have been carried out to enlighten the study.

In this way the tools used in this study can be classified in to two categories:

Financial Tools

Statistical Tools

#### **i. Financial Tools**

$$\text{Credit to Deposit Ratio} = \frac{\text{Total Credit Deposit}}{\text{Total Deposit}}$$

$$\text{Ratio} = \frac{\text{Deposit}}{\text{Total Deposit}} \times 100$$

$$\text{Total Deposit Growth} = \frac{\text{Growth Amount}}{\text{Total Deposit}}$$

Growth Amount = Current Year Amount – Last Year Amount

## ii. Statistical Tools

) Percentage

) Pie Chart

) Diagram

) Average Mean  $\bar{X} = \frac{\sum x}{n}$

When  $\bar{X}$  = Average Interest Rate

$x$  = Total Interest Rate

N = Number of Year Interest

) Graphical Trend Analysis

## 3.6 Limitation of the Methodology

As limitation of methodology is concerned with the study it is based only on Nepal Bank Limited (NBL), Rastriya Banijya Bank (RBB) and its seven years periods of analysis and comparative study. The data are based on the manual records of these banks.

## **CHAPTER –IV**

### **PRESENTATION AND ANALYSIS**

#### **4.1 Introduction**

The most important way to show the true position and the performance of organization is analysis of its past data. This is the one of the major chapter in this study because it includes detail analysis and interpretation of data from which concrete result of Nepalese market can be obtained with out this part the study becomes in complete. In this chapter the relevant data and information necessary for the study are presented and analyzed keeping the objectives set in mind. This chapter consist of various calculation made for the analysis of interest rate and it impact on deposit amount and lending amount for the sample banks to make our study effective and precise as well as easily understandable, this chapter is categorized in three part presentation analysis and interpretation section data are presented in terms of graph of figures, according to need.

#### **4.2 Expansion of Commercial Bank Branches.**

The number of commercial bank branches operating in the country increased to 752 in mid- July 2009 from 555 in Mid July 2008. Among the total bank branches; 50.39 percent bank branches are concentrated in the central region along. By the end of Mid-July 2009, total 379 branches are being operating in this region. However in the western, eastern, mid-western and far western region are 19.54 percent (147), 17.95 percent (135), 7.57 percent (57) and 4.52 percent (345) respectively.

**Table no. 4.1**  
**Branches of Commercial Bank**

S.N.	Name of Commercial Bank	Branches Mid-July 2009
1.	Nepal Bank Limited	100
2.	Rastriya Banijya Bank	123
3.	Nabil Bank Ltd.	32
4.	Nepal Investment Bank Ltd.	31
5.	Standard Chartered Bank Ltd.	13
6.	Himalayan Bank Ltd.	23
7.	Nepal SBI Bank Ltd.	33
8.	Nepal Bangladesh Bank Ltd.	17
9.	Everest Bank Limited	30
10.	Bank of Kathmandu Limited	30
11.	Nepal Credit & Commercial Bank Ltd.	17
12.	Nepal Industrial and Commercial Bank Ltd.	21
13.	Lumbini Bank Ltd.	5
14.	Machhapuchhre Bank Ltd.	31
15.	Kumari Bank Ltd.	15
16.	Laxmi Bank Ltd.	19
17.	Siddhartha Bank Ltd.	10
18.	Agricultural Development Bank Ltd.	86
19.	Global Bank Ltd.	16
20.	Citizen Bank Ltd.	10
21.	Prime Bank Ltd.	8
22.	Sunrise Bank Ltd.	21
23.	Bank of Asia Ltd.	21
24.	Development Credit Bank Ltd.	5
25.	NMB Bank Ltd.	9
26.	Kist Bank Ltd.	26
27.	Mega Bank Ltd. Just Opening this month	1
	<b>Grand Total</b>	<b>753</b>

*Source: Banking and financial statistic NRB*

**Table no. 4.2****Indicators of Financial Expansion and Deepening**

	Mid- April 2007	Mid- April 2008	Mid- April 2009 *
Commercial Bank Branches	546	591	617
Population per Branch	47120	44499	42832
Deposit in Commercial Bank (in Million) Rs.	325770.0	375590.0	481440.0
Per capita Deposit (Rs.)	12663	14282	18217
Loan and Advance of Com. Bank (in Milon Rs.)	324100	387050.0	47127
Per Capita loan (Rs.)	12598	14717	17833

*Source: Economic survey FY 2008/09 government of Nepal*

*\* Based on the data up to Mid-March 2009*

A fair degree of progress is observed while associating the number of commercial banks and their branches with the total population of the country. The earlier ratio of 44499 persons per branch by mid April 2008 has come down to 42832 persons per branch by mid-April 2009. In the mean time, per capita deposit of Rs. 14282 in April 2008 has increased notably to Rs. 18217 by April 2009. Likewise, per capita credit channeled through commercial banks has reached to Rs. 17833 by mid April 2009 against the earlier Rs. 14717. This data shows the steadily rising trend of bank credits.

#### **4.2.1 Deposit Mobilization and Credit Disbursement Situation of Commercial Banks**

During the first eight months of FY 2008/09 the total deposit mobilization of commercial banks has increased by 14.2 percent (Rs. 59.91 billion) amounting to Rs. 481.44 billion against the growth of 12.3 percent or Rs. 41.14 billion during the same



period of the previous fiscal year. In the review period saving deposits has increased by 14.1 percent and fixed deposit by 20.7 percent against the previous year's expansion of 12.2 percent and 14.5 percent respectively. The increased periodic deposit rate owes to the public issue of shares by the citizen Bank and the Bank of Asia with the collected amount deposited in commercial banks by the authorized banks and financial institutions.

The rate of credit flows of commercial banks to the private sector has declined during the review period. In the previous year, credit flow stood at 18.9 percent which grew only by 15.1 percent this year. Out of the credit circulated to the private sector in the last fiscal year 17.6 percent (1099 billion) was to the productive sector while it was 37.2 percent (7.35 billion) for construction sub-sector. The credit flow to the private sector on productive and construction – sub sector has increased by 10.7 percent (Rs. 9 billion) and 16 percent (Rs. 6.17 billion) respectively. There is a decline in metal-based production, machinery electric apparatus, wholesale and retail business and services whereas consumption credit has increased.

During the review period, the liquid fund of commercial banks rose by 14.9 percent against 7.2 percent rise last year. This higher deposit growth is attributed mainly to the promising inflow of remittances. The deposit with NRB one of the constituent factors of liquid fund has increased by 6.7 percent against the growth of 7.9 percent in the previous year. Likewise commercial banks stock in foreign banks has increased by 22 percent to Rs. 50.16 billion against the growth of 5.2 percent last fiscal year.

**Table no. 4.3****Interest Rate Structure on Deposit of Commercial Banks as on Mid- July**

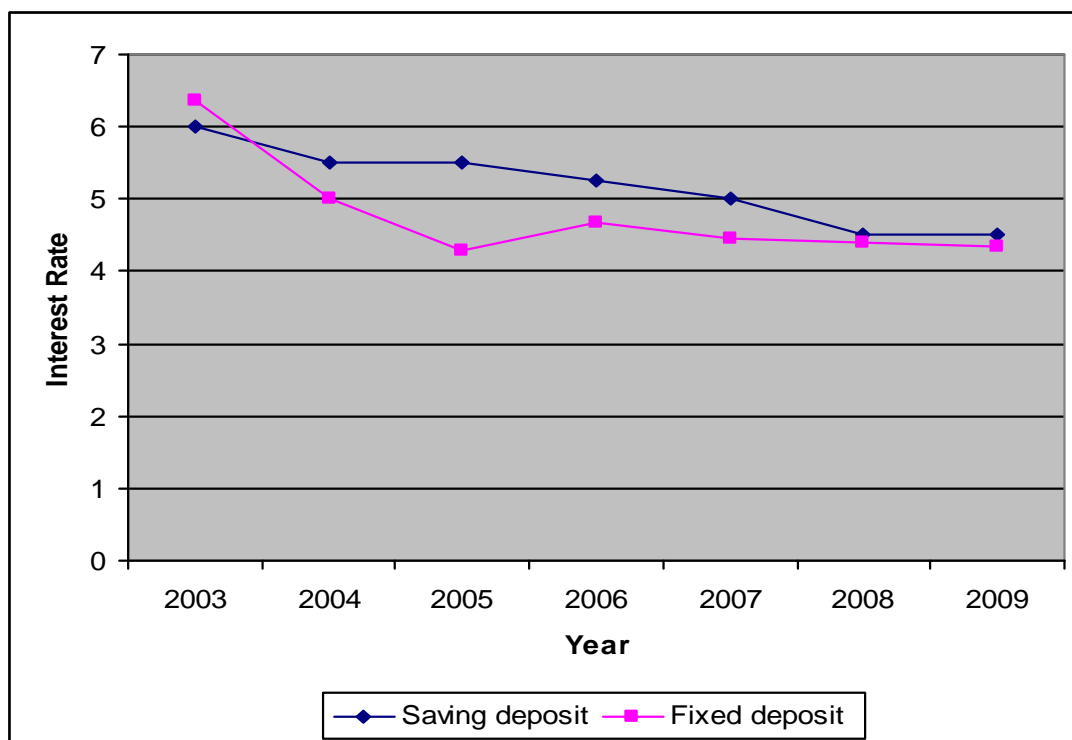
<b>Particular/ Year</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
Deposit rate %							
Saving deposit	6.00	5.50	5.50	5.25	5.00	4.50	4.50
Fixed Deposit							
1 months	0.00	3.50	3.25	3.50	3.00	3.00	3.00
3 month	5.00	4.75	4.50	4.00	4.25	4.00	3.75
6 month	6.00	5.00	4.75	4.50	4.50	4.25	4.00
1 year	7.00	5.75	5.00	5.00	5.00	5.00	5.00
2 year & above	7.50	6.00	6.50	6.40	5.50	6.00	6.00
<b>Whole Mean</b>	<b>6.3</b>	<b>5.08</b>	<b>4.91</b>	<b>4.77</b>	<b>4.54</b>	<b>4.45</b>	<b>4.37</b>
<b>Fixed deposit mean</b>	<b>6.37</b>	<b>5.00</b>	<b>4.80</b>	<b>4.68</b>	<b>4.45</b>	<b>4.40</b>	<b>4.35</b>

*Source: Nepal Rastra Bank:*

Table no. 4.3 shows the deposit interest rate of commercial Banks in 7 different FYs. For this study 2003 is taken as initial year and 2009 as final years. The data shows the decreasing tendency of interest rate. The interest on saving deposit in the beginning year was 6.00% and decreased to 4.50% in 2009. This is 25.00% reduction during the 7 years period. Similarly the interest rate of fixed deposit in the beginning year was (mean) 6.37 and decreased to 4.35% in 2009. This is 31.71% reduction during the 7 years period also fixed deposit rate was in decreasing trend during the 7 years period the decline percentage is 14.29% , 25.00, 33.33%, 28.57% and 20.00% respectively for 1 month, 3 month, 6 month, 1 year and 2 year & above. If the mean is taken of all (both saving and fixed) then average interest on deposit was 6.3% for 2003, 5.08% for 2004, 4.91% for 2005, 4.77% for 2006, 4.54% for 2007, 4.45% for 2008 and 4.37 for 2009. Similarly, if average of fixed deposits of different period is taken then the result is almost similar with "whole average", It means the average interest rate for fixed deposit only was 6.37%, 5.00%, 4.80%, 4.68%, 4.45%, 4.40% and 4.35% respectively for the year 2003, 2004, 2005, 2006, 2007, 2008 and 2009. All the above described matters can be shown on figure 4.1 as follows:

Fig. No. 4.1

**Interest Rate of Commercial Banks on Saving and Fixed Deposit.**



**Table no. 4.4**

**Relationship Between Interest Rate and Deposit Amount of Commercial Banks**

(Rate in percentage/Rs. In million)

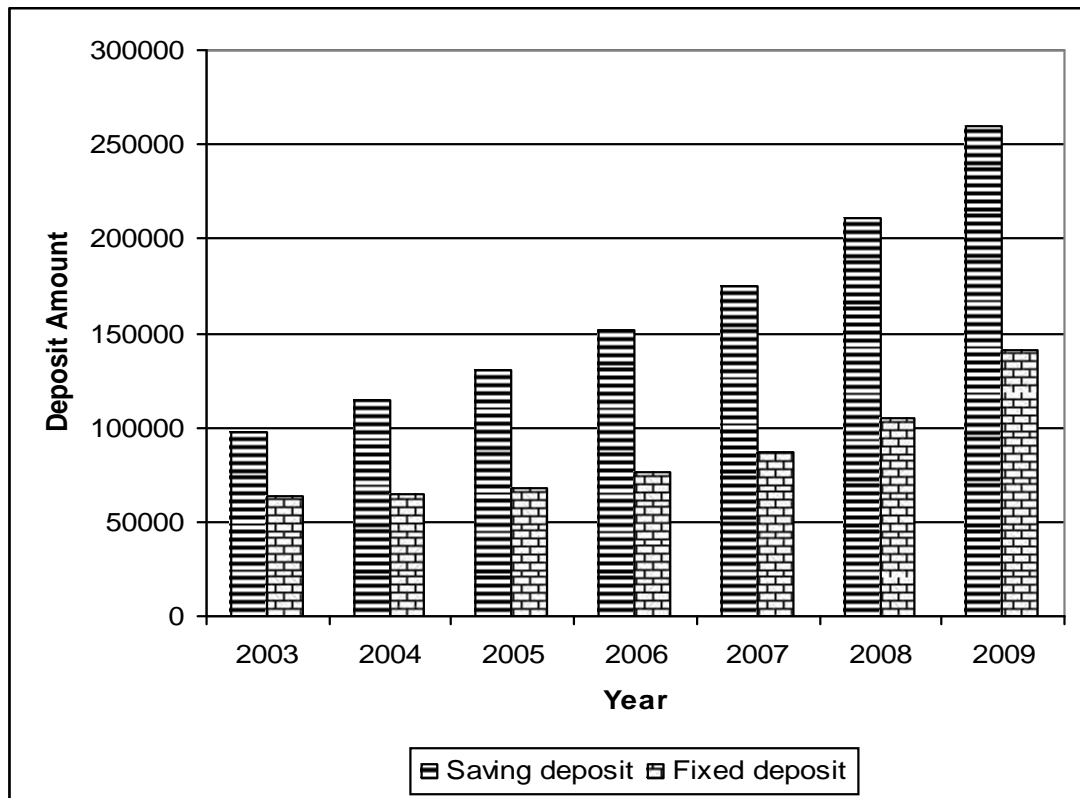
Year	Saving deposit interest rate	Saving deposits amounts	Fixed deposit interest rate	Fixed deposit amount
2003	6.00	97238.90	6.37	63287.60
2004	5.50	114137.20	5.00	65130.90
2005	5.50	129995.00	4.80	67318.20
2006	5.25	151639.40	4.68	76572.80
2007	5.00	174732.50	4.45	87212.60
2008	4.50	211452.00	4.40	104775.50
2009	4.50	259925.40	4.35	141259.40

Sources: Nepal Rastra Bank

The table 4.4 shows the amount of saving deposit and its interest rate as well as amount of fixed deposit and its interest rate for 7 fiscal year 2003 to 2009. The table indicates that, in one hand deposit rates are declining where as in other hand deposit amount is increasing in each fiscal year. This suggests that interest rate and deposit amount may have negative relationship. The interest rate on saving deposit in the beginning year 2003 was 6.00% and saving deposit amount was 97238.90 million and decreased is 25.00% and saving deposit amount increased 162686.5 million during the 7 years period and other hand the interest rate of fixed in the beginning year 2003 was 6.37% decreased to 4.35% in 2009. The interest rate fixed deposit reduction 31.71% and fixed deposit amount reduction during the 7 years 77971.8 million. This can also be shown in figure 4.2

Fig. no. 4.2

**Deposit Amount of Commercial Banks During Different FYs**



The above figure saving amount was 97238.90 million for 2003, 114137.20 for 2004, 12995.00 for 2005, 151639.40 for 2006, 174732.50 for 2007, 211452.00 for 2008 and 259925.40 million for 2009. Similarly fixed deposit amount was 63287.60 for 2003,

61130.90 for 2004, 67318.20 for 2005 76572.80 for 2006, 87212.60 for 2007, 104775.50 for 2008 and 141259.40 million for 2009.

**Table no. 4.5**  
**Deposit Ratio of Commercial Banks During Different F/Y**

(Rs. In Million)

Fiscal Year	Saving deposit	Fixed Deposit	Current Deposit	Other deposit	Total Deposit
2003	97238.90	63287.60	28862.50	14490.30	203879.30
2004	114137.20	65130.90	33729.90	20813.20	233811.20
2005	129995.00	67318.20	34646.40	20450.20	252409.80
2006	151639.40	76572.80	37386.50	25646.80	291245.50
2007	174732.50	87212.60	45031.20	30520.90	337497.20
2008	211452.00	104772.50	56089.30	53766.50	426080.30
2009	259925.40	141259.40	71651.00	90768.60	563604.40

*Source: Nepal Rastra Bank*

$$\text{Ratio} = \frac{\text{Deposit}}{\text{Total Deposit}} \times 100\%$$

(In %)

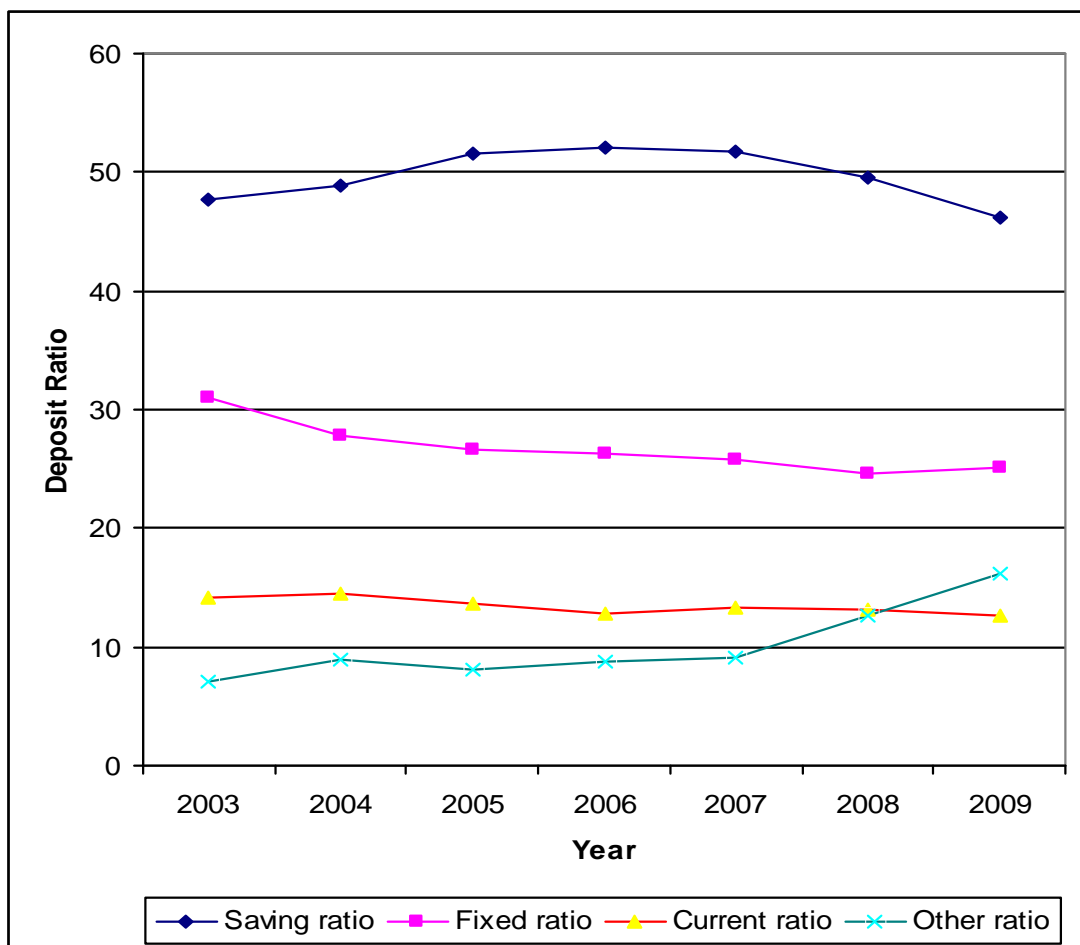
Fiscal Year	Saving ratio	Fixed ratio	Current ratio	Other ratio	Total Deposit growth
2003	47.69	31.04	14.16	7.11	10.12
2004	48.82	27.85	14.43	8.90	14.68
2005	51.50	26.67	13.73	8.10	7.95
2006	52.06	26.29	12.84	8.81	9.60
2007	51.77	25.84	13.35	9.04	15.88
2008	49.63	24.59	13.16	12.62	26.25
2009	46.12	25.06	12.71	16.11	32.28

From the above table the ration of saving to total deposit is higher than the other deposit. The highest amount was deposited in saving deposit second highest was fixed

deposit amount and the current and others deposit amount was the least compare to fixed and saving accounts. The deposit ratio of commercial banks in 7 different FYs. For this study 2003 is taken as initial year and 2009 as final years. The data shows the ratio of saving to total deposit is higher and increasing tendency of deposit amount ratio. The deposit ratio on saving deposit amount in the beginning year was 47.69% for 2003, 48.82% for 2004, 51.50% for 2005, 52.06% for 2006, 51.77% for 2007, 49.63% for 2008 and 46.12% for 2009 and second higher fixed deposit amount ratio was 31.04% for 2003, 27.85% for 2004, 26.67% for 2005, 26.29% for 2006, 25.84% for 2007, 24.59% for 2008 and 25.06% for 2009. The saving deposit comprises the major share in total deposit followed by fixed deposit and current deposit. As of Mid-July 2009 the proportion of saving fixed and current deposit are 46.12 percent 25.06 percent and 12.71 percent respectively in the last year 2008. The respective share of saving fixed and current deposit was 49.63 percent, 24.59 percent and 13.16 percent. This deposit ration is shown in the figure as in figure 4.3

Fig. No. 4.3

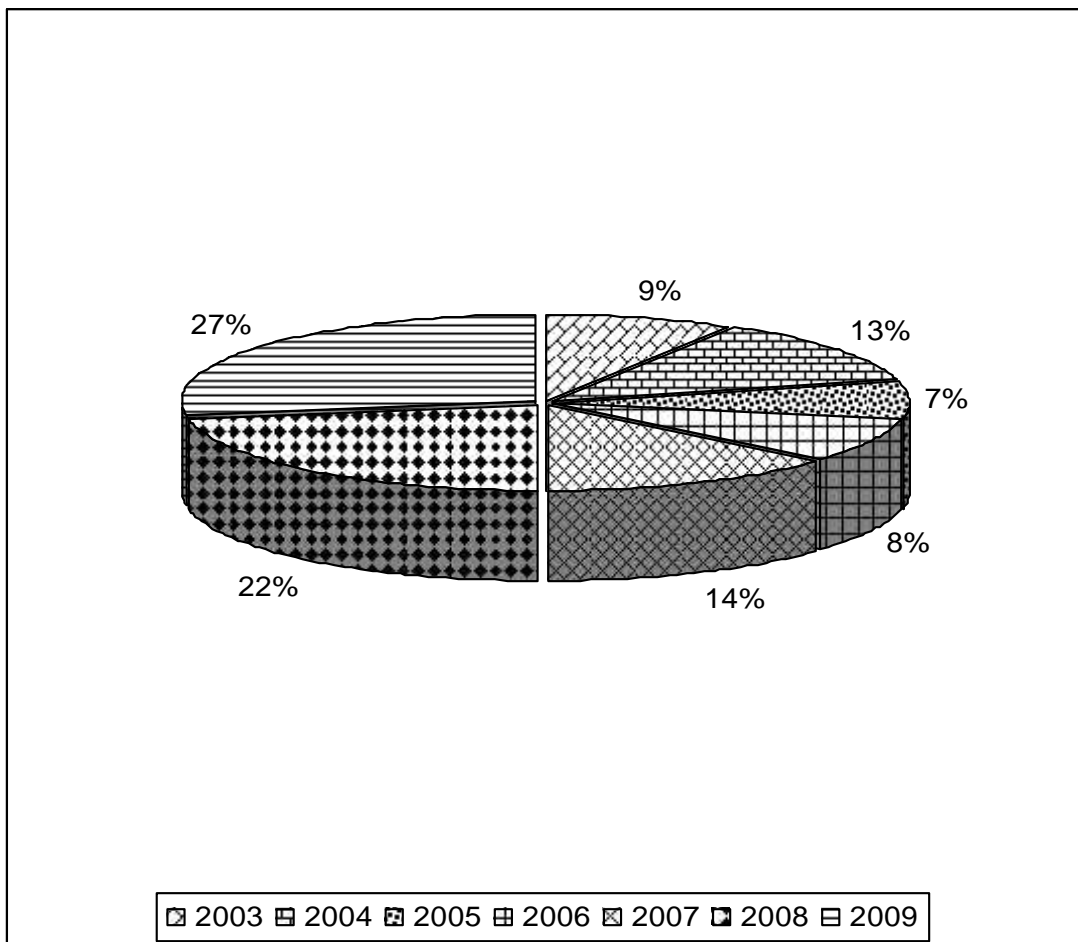
**Deposit Ratio of Commercial Banks During Different FYs.**



The table 4.5 show the increased of deposit amount and increased the growth rate of deposit percent the beginning year. The total deposit amount was 203879.30 and its growth rate was 10.12 percent for 2003, similarly total deposit amount was 233811.20 and its growth rate was 14.68 percent for 2004, total deposit amount was 252409.80 million growth rate 7.95, amount 291245.50 growth rate 9.60, amount 337497.20 growth rate 15.88 percent amount 426080.30 growth rate 26.25 and amount 563604.40 growth rate 32.28 percent was F/Y 2005, 2006, 2007, 2008 and 2009. The mid-July 2009 total deposit of commercial banks increased by 32.28 percent compare to 26.25 percent in the Mid- July 2008. As a mid- July 2009 it reached to Rs. 563604.40 million from Rs. 426080.30 in the mid-July 2008. All the above data can be shown on figure 4.4 as follows.

**Fig. No. 4.4**

**Total Deposit Growth Percentage of Commercial Banks During Different FYs.**



**Table no. 4.6****Lending Rate on Commercial Bank on Different Sector During Seven F/Ys**

Sector/ Year	2003	2004	2005	2006	2007	2008	2009
Industrial	14.00	13.50	13.50	13.50	13.00	13.00	13.00
Agricultural	14.50	12.50	13.50	13.00	13.00	12.00	12.00
Export Bills	13.00	12.00	12.00	11.50	11.50	11.00	11.00
Commercial loan	16.00	15.00	14.50	14.50	14.00	13.50	13.00
Overdraft	17.00	15.50	15.00	15.00	14.50	14.00	13.50
<b>Average Interest Rate</b>	<b>14.90</b>	<b>13.70</b>	<b>13.70</b>	<b>13.50</b>	<b>13.20</b>	<b>12.70</b>	<b>12.50</b>
<b>Lending Amount</b>	<b>1245 22.40</b>	<b>140031. 40</b>	<b>163718 .80</b>	<b>176820. 30</b>	<b>231829. 50</b>	<b>302913 .40</b>	<b>398143 .00</b>
<b>Lending growth (%)</b>	<b>10.03</b>	<b>12.45</b>	<b>16.92</b>	<b>8.00</b>	<b>31.11</b>	<b>30.66</b>	<b>31.44</b>

*Source: Nepal Rastra Bank*

The table 4.6 shows the interest rate of commercial Banks on lending on seven fiscal years granted in different sectors. From table it is clear that the interest rate on lending of commercial Banks is in falling stage. The average interest rate for F/Y 2003, 2004, 2005, 2006, 2007, 2008 and 2009 are 14.90%, 13.70%, 13.70%, 13.50%, 13.20%, 12.70% and 12.50% respectively. The average interest rate shows that the interest jump by high percentage gap and later on fill with little gap. In this interest of productive sector loan. In same manner for lending amount of commercial bank increased each year. During the last F/Y the lending amount rises by more than 3 times. The lending amount for 2003, 2004, 2005, 2006, 2007, 2008 and 2009 are 124522.40 million, 140031.40 million, 163718.80 million 176820.30 million, 231829.50 million, 302913.40 million and 398149.00 million. Similarly lending amount growth rate for 2003, 2004, 2005, 2006, 2007, 2008 and 2009 are 10.03%, 12.45%, 16.92%, 8.00%, 31.11, 30.66% and 31.44%. This shows that the lending



amount and interest rate have negative relationship. The figure for changing trend of interest rate and lending amount, lending growth rate is given on figure no 4.5, 4.6 and 4.7.

Fig. No. 4.5

**Average Lending Rate of Commercial Banks During Different FYs.**

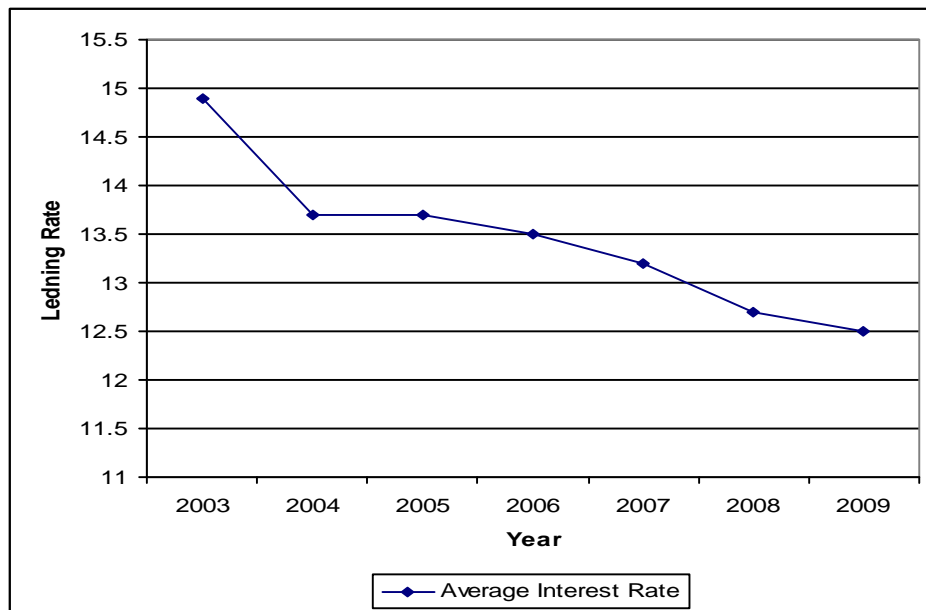


Fig. No. 4.6

**Lending Amount of Commercial Banks During Different FYs.**

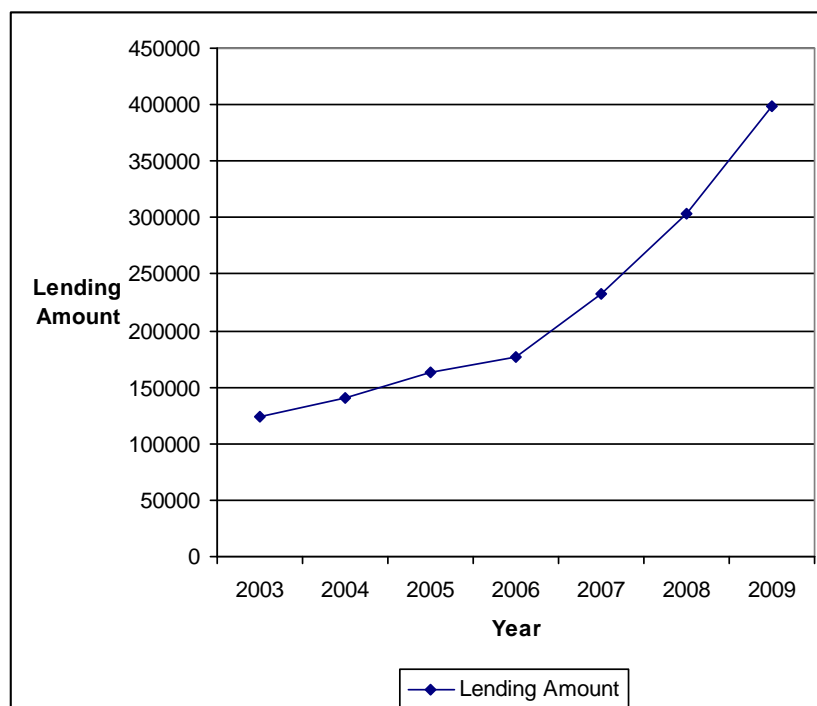
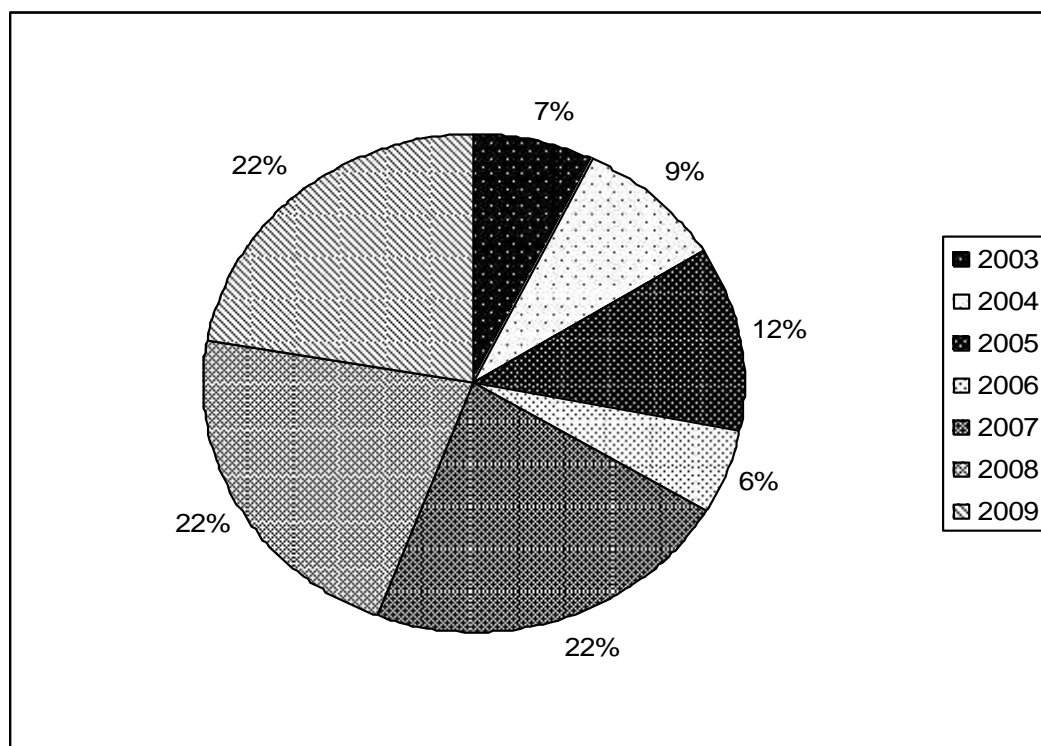


Fig. No. 4.7

**Lending Growth Rate (%) of Commercial Banks During Different FYs.**



**Table no. 4.7**

**Credit to Deposit Ratio of Commercial Banks During Different (F/Y)**

(Rs. In million)

Year/ Particulars	Amount of Total Deposit	Amount of Total Lending	Credit to Deposit Ratio (%)
2003	203879.30	124522.40	61.08
2004	233811.20	140031.40	59.89
2005	252409.80	163718.80	64.86
2006	291245.50	176820.30	60.71
2007	337497.20	231829.50	68.69
2008	426080.30	302913.40	71.09
2009	563604.40	398149.00	70.64

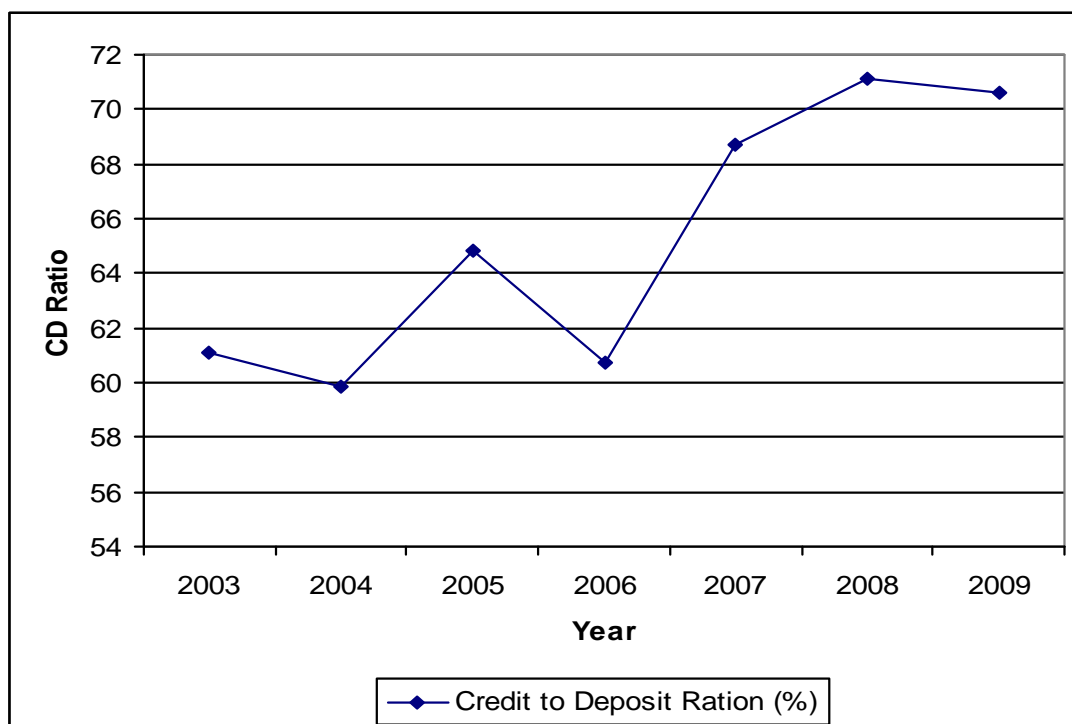
Source: Table no. 4.3 and 4.6

Above the table 4.7 shows the ratio of credit to deposit of commercial Banks from F/Y 2003 to 2009. The ratio of credit to deposit was 61.08% for 2003, 59.89% for 2004, 64.86% for 2005, 60.71% for 2006, 68.69% for 2007, for 71.09% for 2008 and

70.64% for 2009. Credit deposit ratio is main indicator of commercial Bank its international norms is under the 80.00%. So the above table's data presented to positive the commercial Banks are normal position about the deposit collection and lending ratio. We also can see following diagram figure no 4.8.

Fig. No. 4.8

**Credit to Deposit Ratio of Commercial Banks During Different FYs.**



### 4.3 Branches of NBL and RBB in Mid- July 2009

The number of Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB) branches operating in the country 100 and 123 in Mid-July 2009. Among the total bank branches of Nepal Bank Limited 41.00 percent branches are concentrated in the central region alone. By the end of Mid- July 2009, total 41 branches are being operating in this region. However in the eastern, western, Mid-western and Far-western region are 26 percent (26), 17.00 percent (17) 12.00 percent (12) and 4.00 percent (4) respectively. Similarly, among the total bank branches of Rastriya Banijya Bank (RBB) 37.40 percent branches are concentrated in the central region alone. By the Mid-July 2009, total 46 branches are being operating in this region. However in the eastern, western, Mid-western and Far-western region are 23.58 percent (29),

19.50 percent (24), 9.76 percent (12) and 9.76 percent (12). The branches of these banks in the country we can see the following table 4.8.

**Table no. 4.8**  
**Branches of NBL and RBB in Mid- July 2009**

Development region	Zone	District	NBL Branches	RBB Branches
		Jhapa	6	3
		Ilam	1	2
		Panchthar	1	0
		Taplejung	1	0
<b>Mechi Total</b>			<b>9</b>	<b>5</b>
		Sunsari	4	3
		Morang	4	6
		Dhankuta	0	1
		Terhathum	1	0
		Sankhuwasawa	1	2
		Bjopor	1	1
<b>Koshi Total</b>			<b>11</b>	<b>13</b>
		Saptari	2	1
		Udayapur	1	2
		Siraha	3	3
		Khotang	0	1
		Okhaldhunga	0	1
		Solukhumbu	0	3
<b>Sagarmatha Total</b>			<b>6</b>	<b>11</b>
<b>Eastern Total</b>			<b>26</b>	<b>29</b>
		Sarlahi	1	1
		Dhanusa	2	3
		Mahottari	0	1
		Dolakha	1	1
		Ramechhap	0	2
		Sindhuli	0	1

<b>Janakpur Total</b>			<b>4</b>	<b>9</b>
		Bara	1	2
		Rautahat	2	2
		Parsa	4	2
		Chitwan	3	2
		Makawanpur	2	1
<b>Narayani Total</b>			<b>12</b>	<b>9</b>
		Kathmandu	13	16
		Bhaktapur	2	3
		Lalitpur	5	2
		Rasuwa	1	0
		Dhading	0	3
		Sindhupalchok	1	0
		Kabhre	2	2
		Nuwakot	1	2
<b>Bagmati Total</b>			<b>25</b>	<b>28</b>
<b>Central Total</b>			<b>41</b>	<b>46</b>
		Lamjung	1	1
		Tanahu	2	1
		Gorkha	0	3
		Syangja	2	1
		Kaski	3	3
<b>Gandaki Total</b>			<b>9</b>	<b>9</b>
		Gulmi	0	1
		Nawalparasi	0	4
		Palpa	1	1
		Arghakhanchi	0	1
		Rupandehi	2	4
		Kapilvastu	1	1
<b>Lumbini Total</b>			<b>4</b>	<b>12</b>
		Baglung	1	1
		Parwat	1	1

		Mustang	1	0
		Myagdi	1	1
<b>Dhaulagiri Total</b>			<b>4</b>	<b>3</b>
<b>Western Total</b>			<b>17</b>	<b>24</b>
		Rolpa	1	0
		Dang	1	2
		Rukum	1	0
		Salyan	1	0
		Pyuthan	1	1
<b>Rapti Total</b>			<b>5</b>	<b>3</b>
		Jumla	0	1
		Mugu	0	1
		Humla	0	1
		Kalikot	0	1
		Dolpa	1	0
<b>Karnali Total</b>			<b>1</b>	<b>4</b>
		Dailekh	0	1
		Surkhet	1	1
		Jajarkot	1	0
		Bardiya	2	1
		Banke	2	2
<b>Bheri Total</b>			<b>6</b>	<b>5</b>
<b>Mid-Western Total</b>			<b>12</b>	<b>12</b>
		Bajhang	0	1
		Doti	0	2
		Bajura	0	1
		Kailali	2	3
		Achham	0	1
<b>Seti Total</b>			<b>2</b>	<b>8</b>
		Darchula	0	1
		Biatadi	0	1
		Dadeldhura	1	1

	Kanchanpur	1	1
<b>Mahakali Total</b>		2	4
<b>Far-Western Total</b>		4	12
<b>Total Braches in Country</b>		<b>100</b>	<b>123</b>

*Source: Banking and Financial Statistic NRB*

#### **4.4 Financial Sector Reform Program**

The financial sector reform program (FSRP) is considered an important constituent factor for the wide-ranging reform of the financial sector as a whole. Following the financial sector reform strategy paper 2000 AD, the government of Nepal introduced this program with clear cut guidelines through an announcement made in October of the same year. NRB is assigned with the responsibility of executing this program.

The main target of this reform program is to help financial sector become healthy competitive efficient and professional by enabling it for sufficient contributions in the country's economic growth. The World Bank department for international development (DFID) of UK government and loans and grants from government of Nepal are assisting the programe. The main activities under the programe include.

- Re-engineering of Nepal Rastra Bank (NRB)
- Restructuring of Nepal Bank Ltd. (NBL) and Rastriya Banijya Bank (RBB) in addition to capacity enhancement of the financial sector as a whole.

#### **4.5 Structural Reform of Nepal Bank Limited and Rastriya Banijya Bank**

Nepal Rastra Bank (NRB) has taken over the control of Nepal Bank Limited (NBL). Until Mid-March 2002 in accordance with the section 86 (c) of NRB Act 2002. A three member team from NRB succeeded the management since the expiry of the contract with the consultant of the Bank of Scotland (Ireland) on 21 July 2007. The team of experts has been appointed at the recommendation of the CEO to work under his direct supervision. Meanwhile NRB has taken the initiative to request the World Bank for further grant assistance for the remuneration of the newly recruited management team.

The re-structuring of Rastriya Banijya Bank (RRB) is being carried out by a management committee composed of the Chief Executive Office (CEO) and Chief Information Technology Officer (CITO). In order to continue the restructuring of the Bank, the contract of the present management team has been extended (with World Bank's consent) until 15 January 2010.

Both of the banks undergoing reform programs have been generating net profit since FY 2003/04. They have not only formulated and implemented internationally accepted practices to maintain sustainability but also have reduced the negative capital fund. Needless to mention both of these banks still need more reforms to advance and make progress.

**Table No. 4.9**

**Status of Nepal Bank Limited and Rastriya Banijya Bank**

Description	Mid- July 2002/03	Mid- July 2007/08	Mid- January 2009
<b>Nepal Bank Ltd.</b>			
Net Profit (in million Rs.)	(252.0)	529.0	450.0
Capital Fund (in Million Rs.) ( ) Negative	(98.3)	(57.2)	(55.6)
Non- Performing Loan (%)	60.47	13.49	8.98
No. of Staff	5250	2885	2852
<b>Rastriya Banijya Bank</b>			
Net Profit (in million Rs.)	(48.5)	1770.0	110
Capital Fund (in Million Rs.) ( ) Negative	(22390.0)	(155.0)	(14490.0)
Non- Performing Loan (%)	60.15	27.65	18.72
No. of Staff	5402	3002	2939

*Source: Economic survey FY 2008/09 Gov. of Nepal*



There has been some progress in Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB) after the introduction of the Restructuring Program. NBL which was continuously at loss of billion of rupees since 1999 has constantly reduced such losses limiting at Rs. 250 million by FY 2002/03. The net loss during Fiscal Year of 2003/04, 2004/05, 2005/06, 2006/07 and 2007,08 has made net profit worth Rs. 710 million, 1.73 billion, 1.21 billion, 230 million and 530 million respectively. Similarly, the bank has made a net profit of Rs. 450 million by January 2009.

The net loss of Rastriya Banijya Bank (RBB) which was Rs. 7.07 billion in FY 2001/02 and Rs. 4.84 billion in 2002/03 was turned into net profits of Rs. 1.04 billion in FY 2003/04 Rs, 1.32 billion in FY 2004/05, Rs. 1.62 billion in FY 2005/06 Rs. 1.68 billion in FY 2006/07 and Rs. 1.77 billion in FY 2007/08. Meanwhile the targeted profit of Rs. 940 million by January 2009 has reached to Rs. 1.11 billion showing a promise.

**Table No. 4.10**  
**Negative Net Worth**

(In billion Rs.)

Mid-July	Nepal Bank Limited	Rastriya Banijya Bank
2003/04	9.80	22.39
2004/05	8.90	21.00
2005/06	7.16	20.00
2006/07	6.30	18.59
2007/08	6.25	17.21
2008/09	5.72	15.50
Mid-Jan 2009	5.56	14.49

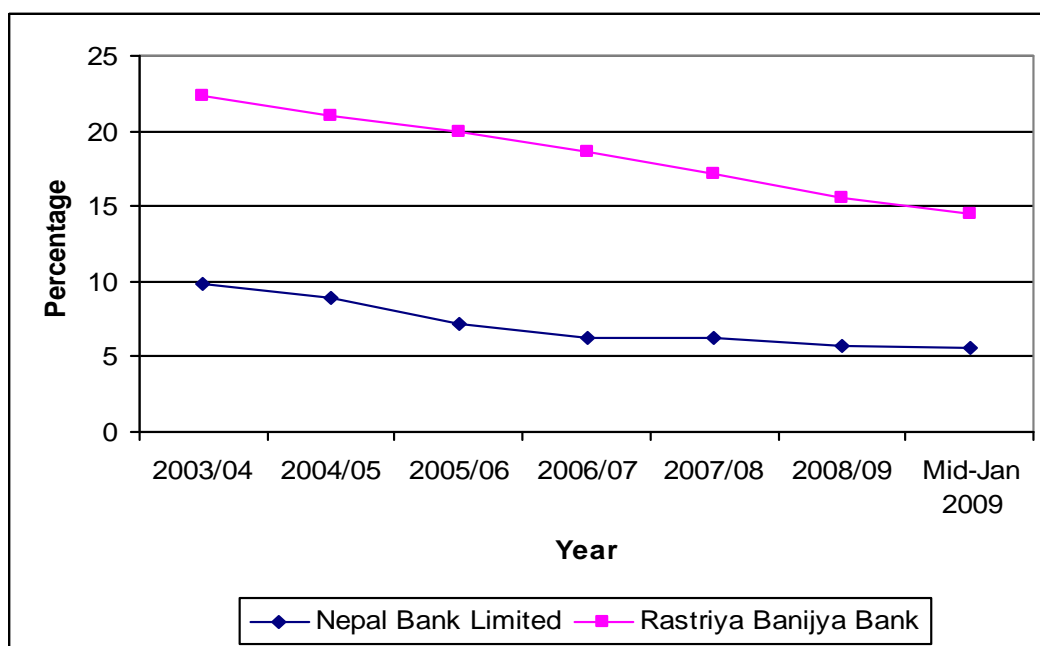
*Source: Economic survey FY 2008/09 Gov. of Nepal*

There seems a gradual progress in taking both banks NBL and RBB away from their negative net worth status in the past. After undergoing restructuring program, the negative net worth of NBL, Rs. 9.80 billion in June 2004, gradually decreased to Rs. 8.90 billion in 2005, Rs. 7.16 billion in 2006 Rs. 6.30 billion in 2007, Rs. 6.25 billion in 2008 and Rs. 5.72 billion by January 2009, similarly RBB's capital fund which was negative by Rs. 22.39 billion in 2004, has marginally improved to Rs. 21 billion in

2005, Rs. 20 billion in 2006, Rs. 18.59 billion in 2007, Rs. 17.21 billion in 2008 and Rs. 15.50 by June 2008 that shows the reversing trend of negative net worth. Likewise, the target to limit the negative net worth at Rs. 14.57 billion during the first 6 month of FY 2009 has marginally crossed having Rs. 14.49 billion negative net worth by January 2009. Never the less, rapid and substantial progress in this direction is imperative.

Fig. No. 4.9

**Negative Net Worth of NBL and RBB**



**Table No. 4.11**

**Overdue Loan in Total Loan and Advance**

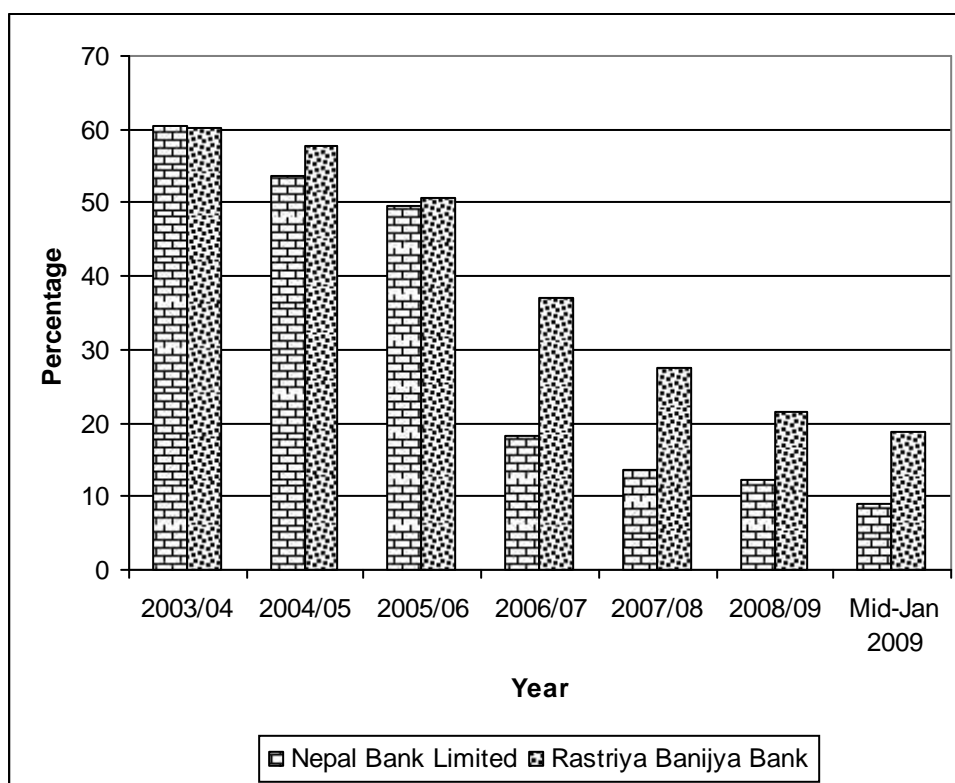
Mid-July	Nepal Bank Limited	Rastriya Banijya Bank
2003/04	60.47	60.15
2004/05	53.74	57.64
2005/06	49.64	50.70
2006/07	18.18	37.00
2007/08	13.50	27.60
2008/09	12.38	21.65
Mid-Jan 2009	8.98	18.72

*Source: Economic survey FY 2008/09 Gov. of Nepal*

Out of the total credit of NBL, Non-performing Assets (NPA) till Mid-July 2004 stood at 60.47 percent which gradually decreased in the subsequent years. The NPA between by mid-July of 2004, 2005, 2006, 2007 and 2008 gradually came down to 53.64 percent, 49.64 percent, 18.18 percent, 13.49 percent and 12.38 percent respectively. Eventually, it has come down to 8.9 percent by mid-January 2009. The sliding down of NPA since 2005/06 onwards is due to writing off of bad loans, which has again showed the trend of reviving back. The recovery of the written-off loan is a challenge in itself for the banks. Similarly, RBB'S non-performing asset as such has not decreased in quantitative term as desired, its level, however, is decreasing. The non performing loan of RBB by June 2003/04 was 60.15 percent of the total credit which has been limited to 57.64 percent in 2004/05, 50.70 percent in 2005/06, 37 percent in 2006/07, 27.60 percent in 2007/08 and 21.65 percent in 2008/09. During the first 6 months of the current fiscal year, out of the total credit of RBB the ratio of non-performing asset has remained at 18.72 percent.

Fig. No. 4.10

**Overdue Loan of NBL and RBB**



The obligatory auditing of both banks that were overdue for the last several years were resumed in case of NBL since 1999/2000 covering up to the period of 2007/08. In addition to updating of the audit, financial statements on activities are regularly being published on quarterly basis. The external audit of RBB, that remained pending for some years, has been resumed after the new management took over. By far the external audit of FY 2007/08 has been completed while the preliminary audit report for FY 2008/09 has been submitted to NRB. Meanwhile, all the details concerned with the recent external audit are updated and internal audit has been completed as well.

Both NBL and RBB have developed and put into practice their Management plan, HRD plan and Skill Enhancement plan for necessary human resource and right-sizing of institutions. Staff Needs Assessment has been completed and both banks have submitted their respective capital plan and successor plan to NRB.

The volunteer Retirement scheme as an attempt of right sizing in NBL has been successful to reduce the total number of staff of 6300 in June 2001 to 2885 by January 2009. Similarly, HR information system, HRD plan etc. are exercised for developing human resource and rightsizing it. HR Need Assessment has been completed and performance based Rewarding system is implemented. To right size the employees call for volunteer retirement scheme has implemented for the 5<sup>th</sup> time. The RBB has also succeeded in reducing the size of its staff slowly. The 5583 employees in 2002 were brought down to 3417 by June 2005; 3301 by next June 2006, 3127 in June 2007 and 3002 by June 2008 and 2939 by January 2009.

The management team of NBL has formulated and adopted various plans policies and directives for making banking system more robust and competent, especially by improving the credit management, credit policy and directives Assets and Liability Management (ALM) Guidelines designed and applied and Asset Liability Committee (ALCO) formed especially for better credit management. Besides strategic policies like New Audit Manual, Internal Audit Manual and classification of Accounts heads, HR plan Skill Enhancement Plan, portfolio status and plan, Budget plan, strategic plan etc. are designed and applied NBL has prepared and implemented a number of Manuals and Guidelines such as-the credit write off Regulations Antimony

Laundering policy, Investment and Treasury Operation Manual, Review of Internal Audit Manual, Trade Finance Manual as well as credit policy and Directives in addition to the application of credit write off.

To provide prompt efficient and well-managed banking services, computerization of 44 branches of NBL is completed and additional 38 branches are identified where computerized system are going to be applied. NBL has recently introduced. Any Branch Banking System (ABBS) in 27 of its branches. The total deposit and credit of the bank have undergone computerized system with 79 and 89 percent respectively. As in the case of RBB computerized system for efficient, prompt and manageable services, information Technology policy has been formed and accordingly, Pumory plus (Banking software) is in operation among the 40 branches of RBB. Pumory plus is also applied in two departments under the Head office while in other 37 branches outside Kathmandu Rastriya Banijya Bank System (RBBS) is in operation. Integrated banking Information System (IBIS) are already in full implementation. About 86 and 96 percent of deposit and credit of RBB has undergone computerized system by January 2009. Under restructuring of NBL and RBB processes to appoint a new Chief Executive Officer through open competition has already been started.

**Table No. 4.12**

**NPA as Percent of Total Gross Loan of Commercial Banks**

Mid-July	Nepal Bank Limited	Rastriya Bajijya Bank	Industry Average
2003	60.47	60.15	28.80
2004	53.74	57.64	22.80
2005	49.64	50.7	18.94
2006	18.18	34.83	14.22
2007	13.49	27.65	9.65
2008	8.95	21.65	6.08

*Source: Economic survey FY 2008/09 Gov. of Nepal*

The level of NPA's which are the outstanding loan and advances of the banks and financial institution classified under categories other than 'pass or good' loan. While it is suggested that there was significant levels of NPA in the end part of second phase

B, it was only in 2003 that it was identified that NBL and RBB each had more than sixty percent NPA level that had pulled total NPA level of domestic commercial banks at 28.8 percent. It has decreased significantly from the above mentioned level of 6.08 percent in mid-July 2008, although there is still scope to reduce this amount to the international level of below 5 percent.

The NPA level of commercial banks as a whole is due to progress made by NBL and RBB; there is significant level of shares of write-off of bad loans in these two banks. The share of NBL and RBB, both banks had about 60 percent NPA in 2003 and both showed similar progress till 2005. However after 2005, NBL managed to lower NPA level from 49.64 percent in 2005 to 18.18 percent in 2006 whereas RBB was just able to lower from 50 to 37 percent. The existing 14 percent and 27 percent NPA OF NBL and RBB is still the source of problem since these two banks combined together occupy about 25 percent of total deposit and 15 percent of total credit facilities of commercial banks and their branches cover all 75 districts of the country.

Review of the restructuring process of both banks shows that there has been an increase in net profit since FY2003/04, the negative net worth of both banks gradually reduced, various plans, policies and directive of international standard has been designed and implemented to ensure stability of banks, likewise, internationally accepted management practice and rightsizing models are introduced. Hence the progress made so far seems positive. Despite this repayment of non-performing loans is not satisfactory.

#### **4.6 Analysis of Lending and Interest Rate**

In this section, detail study is made about deposit amount lending amount and interest rate of simple banks. For this study only saving and fixed deposits are considered because current deposit doesn't earn any interest. Lending is second are of the analysis where mainly the relationship between lending interest rate and its effect upon lending amount is measured. Generally, when there is higher interest rate (esp. lending or credit rate) in the economy, people normally borrow lesser amount than the period when lending interest rate in low. According to theory, when there is low lending rate, then there should be higher amount of borrowing. Higher amount of borrowing

indicates higher investment in the country or higher transaction in trade. This is necessary for the growth of the economy.

#### 4.7 Interest Rate and its Impact of Deposit on RBB

Prior to entering into the main topics it is preferable to take a glance on the interest rate structure on different types of deposits. This is essential because the interest rates are generally different in magnitude for both sample banks. These differences are due to the numerous factors like maturity period, policy of banks, and goodwill of organization and so on. In real world government owned bank and banks with high reputation and goodwill have lower deposit rates. Similarly finance companies, co-operative and development bank quotes high interest rate on deposits than commercial banks do.

**Table No. 4.13**  
**Interest Rate Structure on Deposit of RBB as on Mid- July.**

Particular/ Year	2003	2004	2005	2006	2007	2008	2009
<b>1. Deposit Rate%</b>							
Saving Deposit	6.50%	6.00%	5.00%	4.75%	2.25%	2.00%	2.00%
<b>Fixed Deposit</b>							
7 days	0	0	0	0	0	0	0
14 days	0	0	0	0	0	0	0
1 months	0	0	0	0	0	0	0
3 months	5.00	4.50	4.00	3.75	3.00	2.25	2.25
6 month	5.50	5.50	4.75	4.25	3.50	2.50	2.50
1 year	7.00	7.00	6.00	5.75	3.75	3.50	3.00
Above 2 year	7.50	7.25	6.25	6.00	0	0	0
<b>Whole mean</b>	<b>6.30</b>	<b>6.05</b>	<b>5.20</b>	<b>4.90</b>	<b>3.12</b>	<b>2.56</b>	<b>2.44</b>
<b>Fixed Deposit Mean</b>	<b>6.25</b>	<b>6.06</b>	<b>5.25</b>	<b>4.94</b>	<b>3.42</b>	<b>2.75</b>	<b>2.58</b>

*Sources: Banking and Financial statistic NRB*

Table no. 4.13 shows the deposit interest rate of RBB in 7 different FY. For the study 2003 is taken as initial year and 2009 as final years. The table portrays the interest

rate that were prevailed in the Nepalese financial markets during last past 7 FYs. The data shows the decreasing tendency of interest rate. The interest on saving deposit in the beginning year was 6.50% and decreased to 2.00% in 2009. This is 69.23% reduction during the 7 years period. In same manner, the bank used to quote the interest rate of fixed deposit in different short term period like 7 days, 14 days, 1 month, 2 month, 3 month and so on. For the graph purpose, in this study the average of 7 days to 3 month is taken to make the figure clearer. For other period also the fixed deposit rate was in decreasing trend. During the 7 years period the decline percentage is 54.55%, 57.14% and 20.00% respectively for 6 month, 1 year and 2 years period. The decreasing tendency is high for longer period interest rate. If the mean is taken of all (both fixed and saving) then average interest rate on deposit was 6.30% for 2003, 6.05% for 2004, 5.20% for 2005, 4.90% for 2006, 3.12% for 2007, 2.56 for 2008 and 2.44% for 2009. Similarly, if average of fixed deposits of different period is taken, then the result is almost similar with "whole average". It means the average interest rate for fixed deposit only was 6.25%, 6.06%, 5.25%, 4.94%, 3.42%, 2.75% and 2.58% respectively for the year 2003, 2004, 2005, 2006, 2007, 2008 and 2009. The average figure also shows the decreasing tendency in interest rate except in the year 2004. At the period, the interest rate was slightly higher than year 2003 but ultimately fell to the 6.06% in 2004. All the above described matters can be shown on following table and figure.

**Table No. 4.14**  
**Relationship Between Interest Rate and Deposit Amount of RBB**

Rate in percentage/ Rs. In million

Year	Saving deposit interest rate	Saving deposit amounts	Fixed deposit interest rate	Fixed deposit amount
2003	6.50	20861.5	6.25	13579.2
2004	6.00	23288.9	6.06	11572.8
2005	5.00	26848.2	5.25	9001.5
2006	4.75	29494.9	4.94	8103.8
2007	2.25	32909.4	3.42	6997.5
2008	2.00	40213.0	2.75	4479.8
2009	2.00	46102.8	2.58	3207.8

*Source: Banking and Financial statistics NRB*



The table 4.14 shows the total amount of fixed deposit and saving deposits and the interest rates offered on such deposits by RBB on seven fiscal years starting from FY 2003 to FY 2009. The table portrays that the both interest rate has been decreased by greater magnitude. Deposit amount has been increased by more than 2.21 times during the study period. It means they move in opposite direction i.e. decrease in interest rate increases the amount of deposit and vice versa. Therefore they should have negative relationship. The relationship can also be shown in graph as shown in figures 4.11 and 4.12

Fig. No. 4.11

**Deposit Amount of RBB During 7 Year**

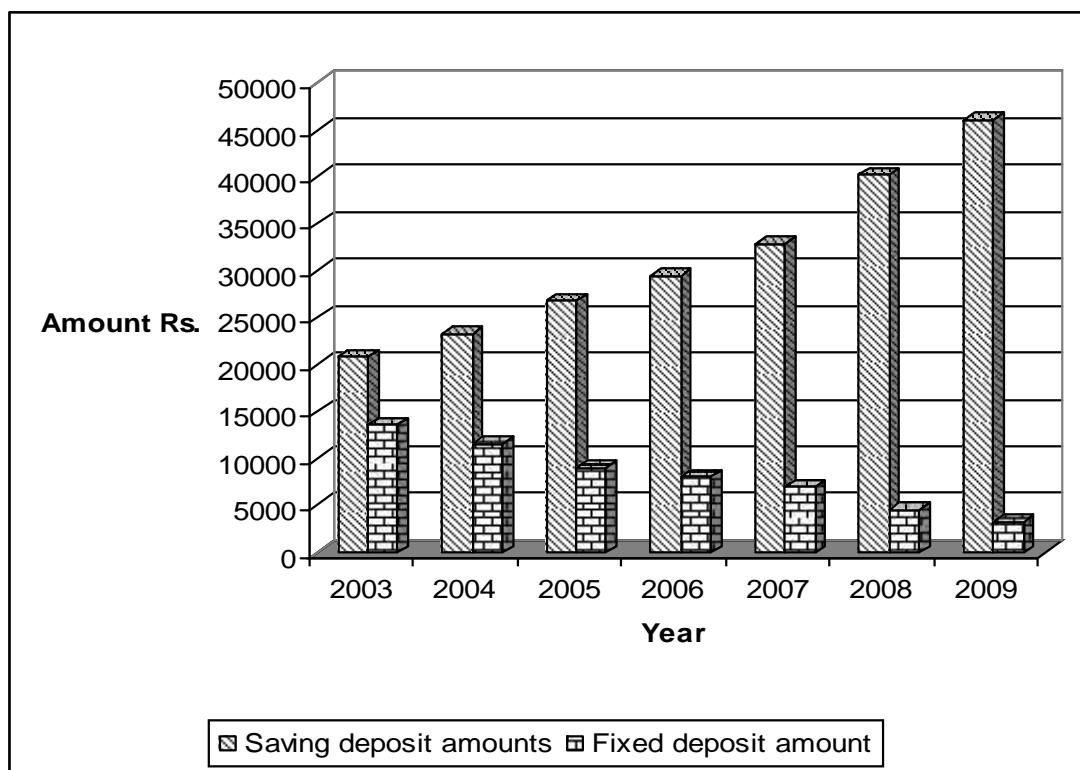
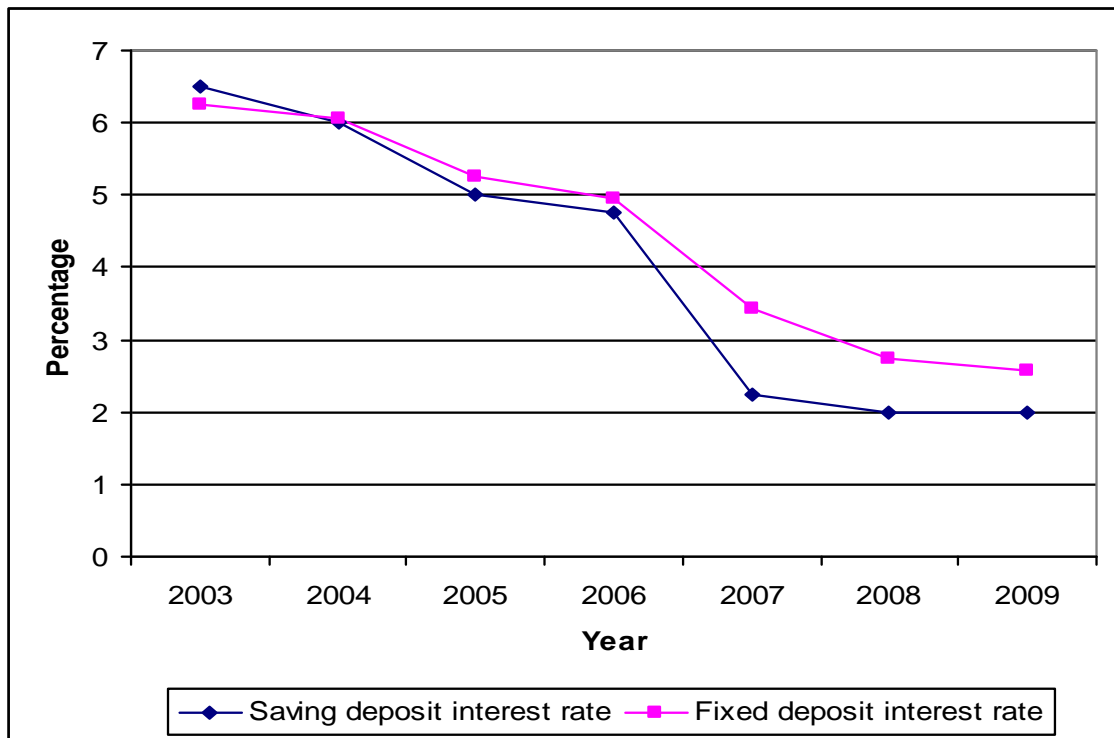


Fig. No. 4.12

**Interest Rate of RBB on Saving and Fixed Deposit**



According to table no. 4.14 the interest rate on saving deposit has been decreased from 6.50% to 2.00% during 7 FYs. The declining tendency is little. In same period the deposit amount was Rs.20861.5 millions but this amount increases to Rs. 46102.8 millions. It means interest rates fell by 69.23%, where as deposit amount rises by 120.99% within the period of seven years.

Similarly, for fixed deposit the table 4.14 shows that total amount of fixed deposit and interest rate on fixed deposit offered by RBB on seven consequent FY started from 2003 to FY 2009. The table reveals that average fixed interest rate has been decreased drastically during the seven FYs. At the FY 2003 the average interest rate was 6.25% on fixed deposit but later on every year this interest rate started to decrease by 1% per annum and at 2009. On effect of this decline, the amount of fixed deposit declined, the amount of fixed deposit also started to decrease in some respect. The table shows that up to the FY 2003, there is no effect on fixed deposit amount by the declination of interest rate but after the FY 2003; decrease in interest rate also decreases the fixed deposit amount. In this regards, the substitution effect holds true in the case of fixed deposit.

**Table No. 4.15****Deposit Growth rate of RBB During Different FY**

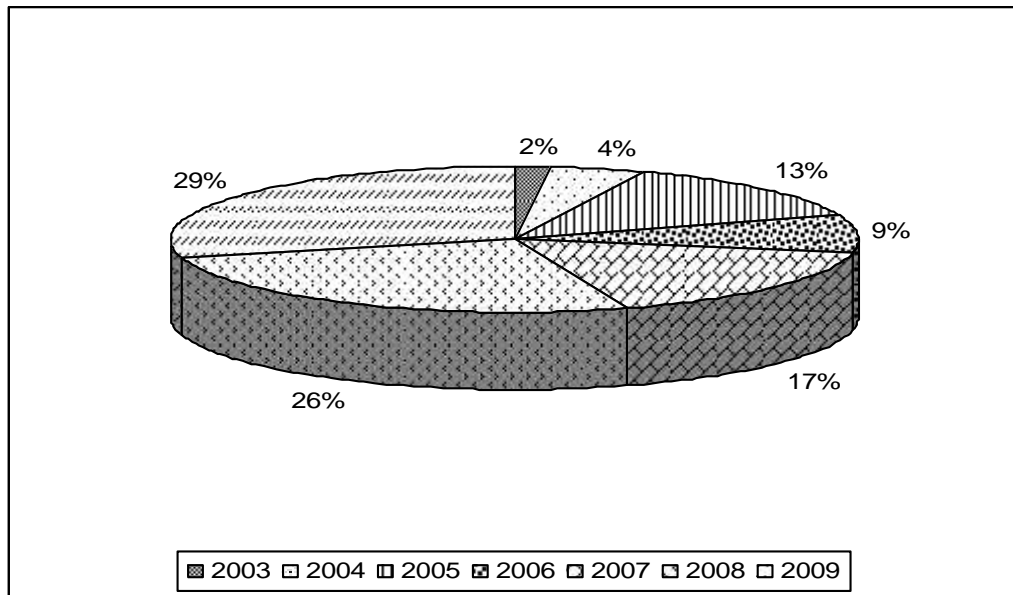
Fiscal year	Saving Deposit	Fixed Deposit	Current Deposit	Other Deposit	Total Deposit	Deposit Growth %
2003	20861.5	13579.2	4687.9	180.0	39308.6	1.0
2004	23288.9	11572.8	5227.5	224.4	40313.6	2.56
2005	26848.2	9001.5	6419.8	1219.7	43489.2	7.88
2006	29494.9	8103.8	7891.2	210.8	45700.7	5.09
2007	32909.4	6997.5	10084.7	201.0	50192.6	9.83
2008	40213.0	4479.8	12853.0	445.0	57990.8	15.54
2009	46102.8	3207.8	17642.1	1023.6	67976.3	17.22

*Sources: Nepal Rastra Bank*

The table on 4.15 shows the amount of saving deposit, fixed deposit, current deposit, other deposit and total deposit amount of RBB on different fiscal year. Similarly it table presented total deposit growth percents on different FY. The table shows the increased of deposit amount and increased the growth rate of deposit. The beginning year the total deposit amount and was 39308.6 million and growth rate was 1.0 percent fro 2003. Similarly the total deposit amount growth rate was 40313.6 million, growth rate 2.56 percent, amount 43489.20 million, growth rate 7.88% amount 45700.7 million growth rate 5.09%, amount 50192.6 million, growth rate 9.83% amount 57990.8 million, growth rate 15.54% and amount 67976.3 million, growth rate 17.22% in FY 2004, 2005, 2006, 2007, 2008 and 2009. The mid July 2009 total deposit of RBB increased by 17.22 percent compare to 1.00% in the Mid-July 2003. As a Mid-July 2009 it reached to Rs.67976.3 million from Rs. 39308.6 in the Mid-July 2003. All the above data can be shown on figure 4.13 as follows.

Fig. No. 4.13

**Total Deposit Growth Rate of RBB During Different FYs**



**Table No. 4.16**

**Deposit Ratio of RBB During Different FY (in %)**

Fiscal Year	Saving Ratio	Fixed Ratio	Current Ratio	Other Ratio
2003	53.07	34.55	11.92	0.46
2004	57.77	28.71	12.97	0.55
2005	61.74	20.70	14.76	2.80
2006	64.54	17.73	17.27	0.46
2007	65.57	13.94	20.09	0.40
2008	69.34	7.73	22.16	0.77
2009	67.82	4.72	25.95	1.51
Average ratio	62.84	18.30	17.87	0.99

Source: Table no. 4.15

The table no. 4.16 reveals the deposit ratio of RBB in different years. The deposit amount ratio increasing year by year. The ratio of saving to total deposit is higher than other deposit. The higher amount was deposited in saving deposit. Second highest was fixed deposit amount other deposit amount was the least compare to saving and fixed accounts. The deposit ratio of RBB in 7 different FYs. For this study is taken 2003 as initial year and 2009 as final years. The data shows the ratio of saving to total deposit

is higher and increasing tendency of deposit amount ratio. The deposit ratio on saving deposit amount percents was 53.07%, 57.77%, 61.74%, 64.54%, 65.57%, 69.34% and 67.82% in FY 2004, 2005, 2006, 2007, 2008 and 2009. The saving deposit compares the major share in total deposit followed by fixed deposit and current deposit. As of Mid- July 2009 the proportion of saving fixed and current deposit are 67.82%, 4.72 and 25.95%. The respective share of saving, fixed and current deposit were 69.34%, 7.73% and 22.16% respectively in Mid July 2003 the share of saving deposit fixed deposit and current deposit was 53.07 percent, 34.55 percent and 11.92 percent. This deposit ratio is shown in the figure as in figure 4.14

Fig. No.4. 14

**Deposit Ratio of RBB During Different FYs**

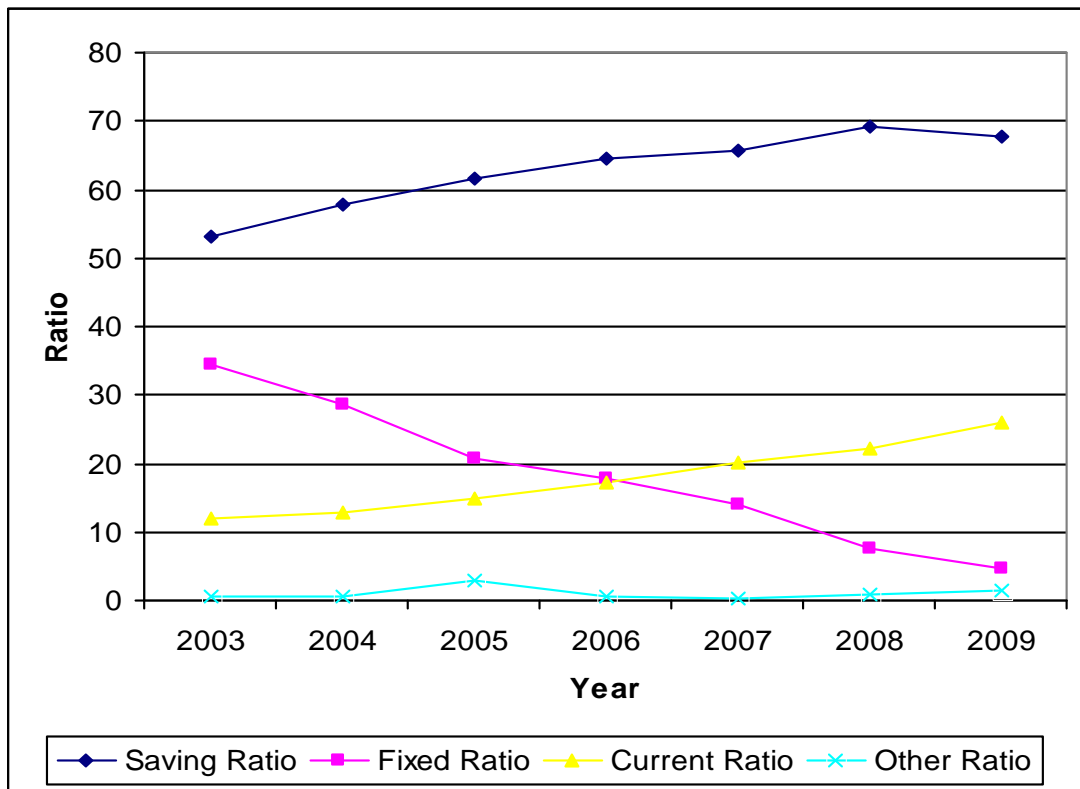
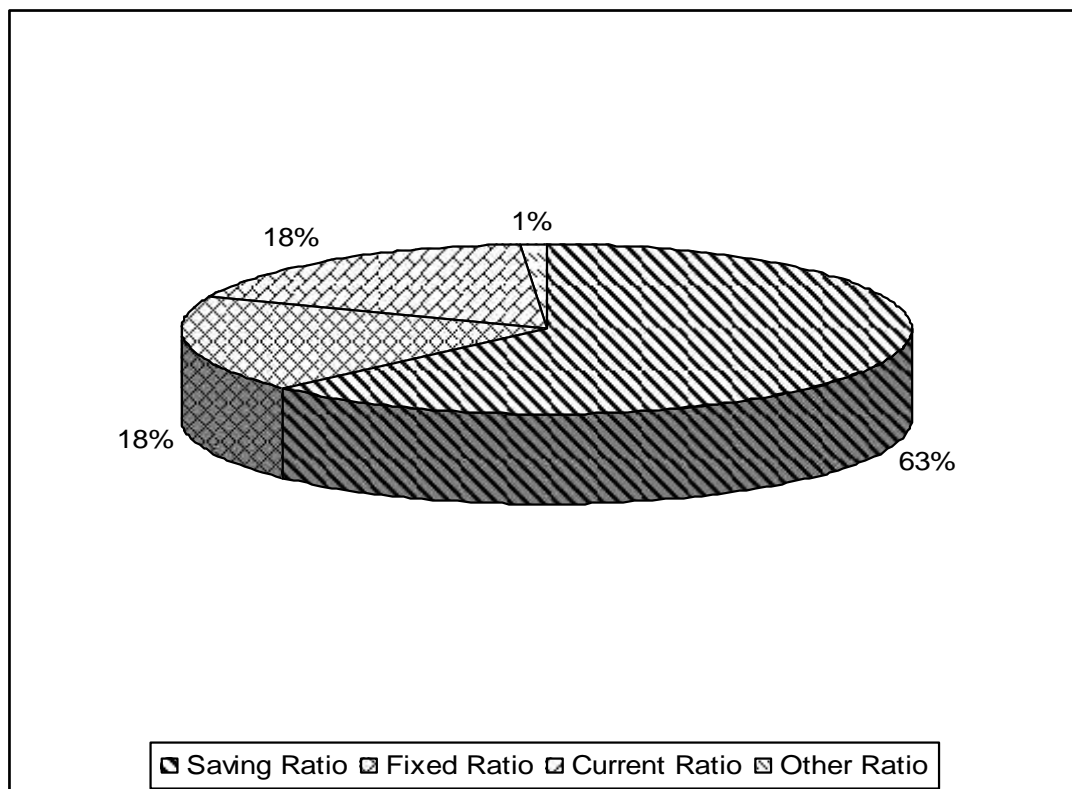


Fig. No.4.15

### Average Deposit Ratio of RBB



The above table no. 4.16 reveals that the total deposits position in different trend. It shows the deposit ratio of RBB in 7 different FY. From 2003 to 2009 in comparison of saving deposit ratio, fixed deposit ratio, current deposit ratio and other deposit ratio by mean value. The higher amount was deposited in saving deposit it was 62.84% second highest was fixed deposit it was 18.30%. Third position deposit was current it was 17.87% and lowest was other deposit it was only 0.99% is shown in the figure as in above figure no 4.15

### 4.8 Interest Rate and its Effect of Lending on RBB

The sector where RBB grant its credit during last seven FYs and there corresponding interest rate, average interest rate are presented in the table 4.17 below.

**Table No. 4. 17**  
**Lending Rate of RBB on Different Sectors During Seven FYs**

Sector Year	2003	2004	2005	2006	2007	2008	2009
Overdraft	16.50	13.50	11.75	11.25	12.20	11.00	11.00
Export Credit	15.00	12.00	11.50	10.00	9.50	8.00	8.00
Import L.C.	12.00	13.00	12.00	10.00	10.00	00	7.50
Govt. Bond	11.00	14.00	10.50	10.00	7.00	7.00	6.50
BG/CG	0	10.50	10.00	9.25	9.25	7.00	6.50
Other Guarantee	15.00	10.50	0	0	0	0	0
Industrial Loan	15.50	15.00	14.50	11.75	12.00	0	0
Commerci al Loan	16.50	15.50	15.00	0	0	0	0
Priority sector Loan	14.00	14.00	13.00	12.00	12.00	11.50	11.00
Working Capital	14.00	14.50	13.75	12.50	11.00	0	0
Hire Purchase	16.00	14.00	13.50	12.00	12.00	9.00	10.00
Others	16.50	15.50	15.00	12.00	12.00	11.50	11.00
<b>Average Interest Rate</b>	<b>14.73</b>	<b>13.50</b>	<b>12.78</b>	<b>11.08</b>	<b>10.70</b>	<b>9.29</b>	<b>8.94</b>
<b>Lending Amount</b>	<b>28258.9 0</b>	<b>26781.7 0</b>	<b>28919.8 0</b>	<b>27164.9 0</b>	<b>25422.3 0</b>	<b>27494.6 0</b>	<b>31607.9 0</b>

*Source: Banking and Financial Statistic NRB*

Lending activity of commercial banks can be diversified into different sectors. But according to the publication of Nepal Rastra Bank- Banking and Financial Statistics. The loan of commercial banks is classified in different sub-sectors like overdraft, export credit; import L.C., Commercial Loan and so on. Besides this there are other section (area) when bank provides loan and these areas are placed in the topic of "others". For this study lending area are categorized as classified by NRB.

According to table 4.17 it shows that interest rate on lending on different area are in declining stage. The table shows that the maximum interest rate is 16.50% in FY 2003 and minimum rate is 6.50% on FY 2009. This shows that the interest rate was decline drastically during the seven FYs previous. Generally the productive sector loan rate (like Commercial loan, industrial loan, priority sector loan, working capital rate and so on) decline less in magnitude than non productive sector loan like overdraft, loan against government bond, BG/CG rate and so on. For example during the last seven FYs declination of BG/CG rate was by 4.00%. In same manner the declining magnitudes were 5.50%, 5.50 and 6.00% for overdraft, other and hire purchase. The declining percentage for productive sector were 1.50%, 3.00%, .300% and 3.50% in commercial loan working capital, priority sector loan and industrial loan rate respectively. According to theory, in order to induce the investment in the country or expansion of trade the investment in the country or expansion of trade, the productive sector loan should be available at cheaper rate. But the table shows that these sectors loan were somewhat costlier than other non-productive loan. If the average of each fiscal year is taken, then it shows average lending interest rate was 14.73% (2003), 13.50% (2004), 12.78% (2005), 11.08% (2006), 10.70% (2007), 9.29% (2008) and 8.94% (2009), which shows the average rate is decreasing trend. The decreasing tendency was not smooth. It means the rate declined each year with different rate. In preceding year the declination was quite fast where as the declining tendency was little in latter year. This concludes that interest rate on lending is also in decreasing tendency for past few years. With harmony to interest rate the lending amount of RBB is also seen to be in decreasing some year but with some fluctuation. This can also be present in figure 4.16 and 4.17



Fig. No.4.16

**Average Lending Rate of RBB During Different FYs**

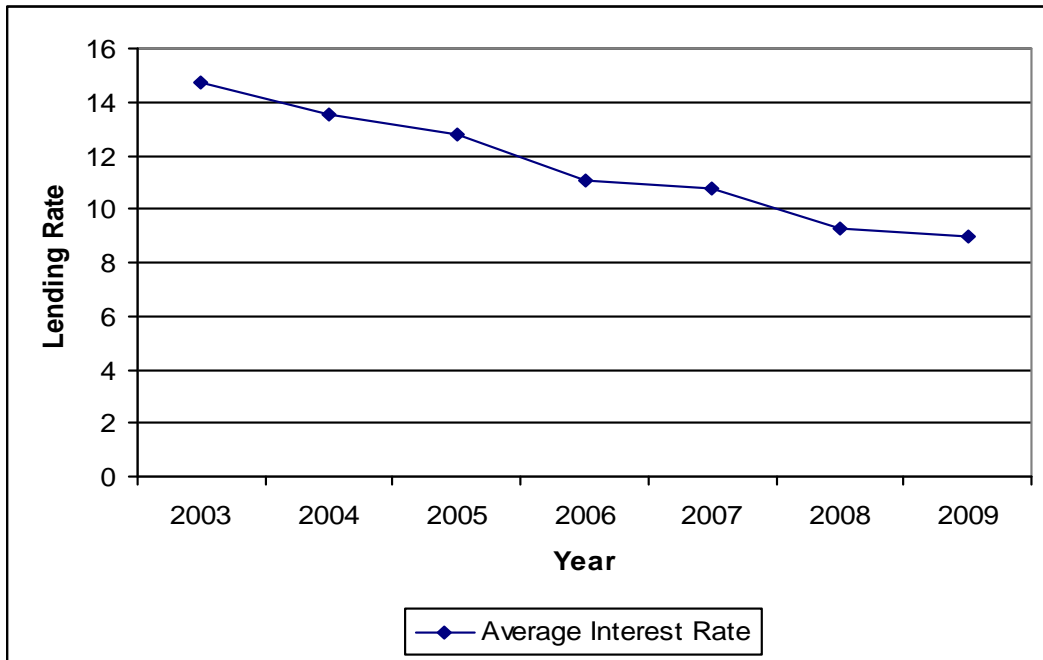
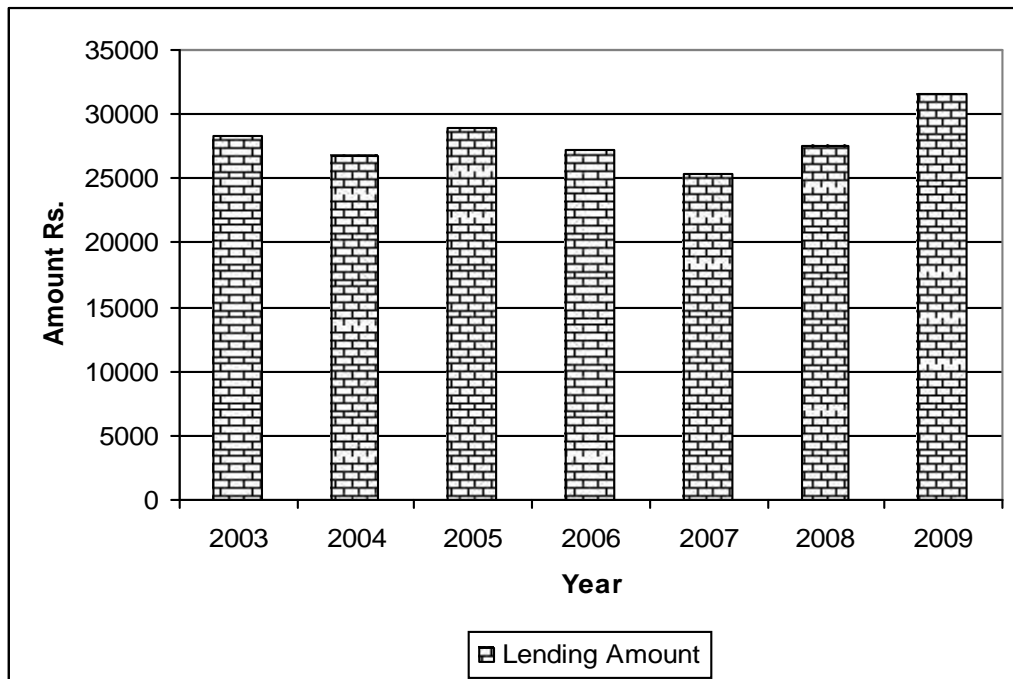


Fig. No.4.17

**Lending Amount of RBB During Different FYs**



**Table No. 4.18**

**Credit to Deposit Ratio of RBB During Different FY**

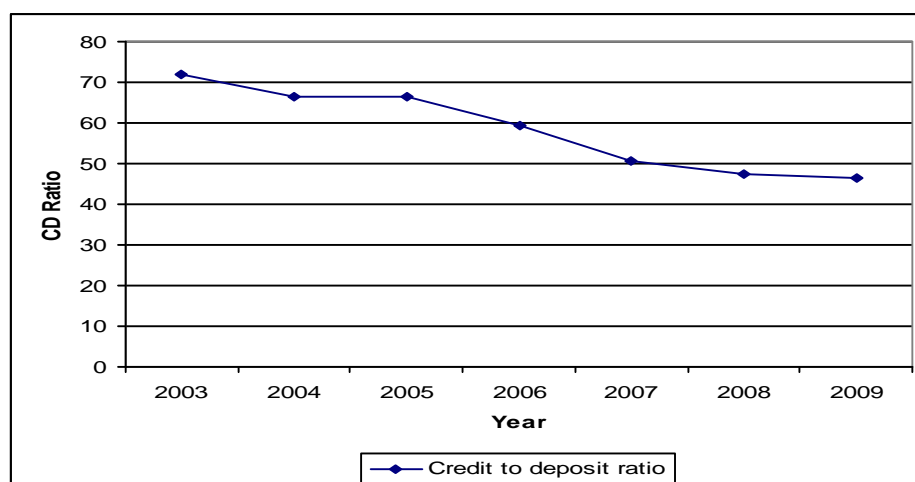
Year	Amount of total deposit	Amount of total lending	Credit to deposit ratio
2003	39308.6	28258.9	71.89
2004	40313.6	26781.7	66.43
2005	43489.2	28919.8	66.50
2006	45700.7	27164.9	59.44
2007	50192.6	25422.3	50.65
2008	57990.8	27494.6	47.41
2009	67976.3	31607.9	46.50

*Source: Table no. 4.14 and 4.17*

From table 4.18, it is clear that the credit to deposit ratio of RBB also in decreasing trend. During the first period out of seven FYs, the declining ratio of credit to deposit is fast, but after 2007 the declining speed is slow. The credit to deposit ratio of RBB during last seven was 71.89%, 66.43%, 66.50%, 59.44%, 50.65%, 47.41% and 46.50% in FY 2003, 2004, 2005, 2006, 2007, 2008 and 2009. In Mid –July 2009 the credit to deposit ratio of RBB remained to 46.50 percent it was 71.89 percent in Mid-July 2003. We also can see following figure no. 4.18 . this downwards slopping curve deficits the falling rate of interest on per unit of Rs.

**Fig. No.4.18**

**Credit to Deposit Ratio of RBB During Different FYs**



## 4.9 Interest Rate and its Impact of Deposit on NBL

The general structure of deposit interest rate of Nepal Bank Limited (NBL) is shown below on table no. 4.19 the table shows the interest rate of NBL during the last seven FYs. The trend of interest rate shows that it is decreasing trend. It is similar with that of RBB. The interest rate on saving deposit of NBL shows that it was 5.50% during the period of 2003 and decreases by 1% on average every year up 2004. But after the 2004 AD there was some stagnancy in interest rate because it was fell by only 0.5% up to 2006, i.e. interest rate decreased to 4.75%. But at 2007 there was sharp fall on interest rate of 2006 (4.75%) fall to 2.5% when it passes one year (2007) fall to 2.00% in 2008 and it constant from 2008 to 2009. Similarly interest rate on fixed deposit also fell during the seven fiscal years by almost half. The interest rate fell by large spread in first few years but on later years, the falling spread was little as compared to the previous years.

**Table No. 4.19**  
**Interest Rate Structure on Deposit of NBL on Mid-July**

Year	2003	2004	2005	2006	2007	2008	2009
<b>Deposit Rate</b>							
Saving deposit	5.50%	5.50%	5.00%	4.75%	2.5%	2.00%	2.00%
<b>Fixed Deposit</b>							
7 days	2.00	2.00	2.00	2.00	-	-	-
14 days	2.50	2.50	-	-	-	-	-
1 month	3.50	3.50	3.50	3.25	2.50	2.00	2.00
2 month	-	-	-	3.50	2.75	-	-
3 month	4.00	4.00	4.00	3.75	3.00	2.25	2.25
6 month	5.00	5.00	4.50	4.25	3.50	2.50	2.50
1 year	6.75	6.75	6.00	5.75	4.00	3.50	3.00
Above 2 years	7.00	7.00	6.25	6.00	-	-	-
<b>Whole mean</b>	<b>4.54</b>	<b>4.54</b>	<b>4.46</b>	<b>4.16</b>	<b>3.05</b>	<b>2.45</b>	<b>2.35</b>
<b>Fixed deposit mean</b>	<b>4.39</b>	<b>4.39</b>	<b>4.38</b>	<b>4.07</b>	<b>3.15</b>	<b>2.56</b>	<b>2.44</b>

Source: Banking and financial statistics NRB

It is also clear that the falling gap for long term fixed deposit is large where as for short term deposit the falling gap is little. In other words, both long term and short term interest rate's falling rate is similar in later year but in previous year the falling rate is fast for long term fixed deposit where as falling rate was slow for short term fixed deposit. These tendencies can also be shown in table 4.20 as follows.

**Table No. 4.20**  
**Relationship Between Interest Rate and Deposit Amount of NBL**

Rate in percentage / Rs. in million

Year	Saving deposit interest rate	Saving deposit amounts	Fixed deposit interest rate	Fixed deposit amount
2003	5.50%	21534.5	4.39%	8396.9
2004	5.50%	22063.0	4.39%	7481.0
2005	5.00%	22671.8	4.38%	6269.2
2006	4.75%	23547.9	4.07%	5790.9
2007	2.50%	26425.4	3.15%	5393.2
2008	2.00%	28545.1	2.56%	4757.9
2009	2.00%	31079.7	2.44%	3579.4

*Source: Banking and financial statistics NRB*

In table no. 4.20 saving amount and deposit rate are arranged in systematic order. The outlook of the table shows that the interest has been falling since 2004 on both saving and fixed deposits. But the amount of saving deposit has not been in decreasing trend. It is increasing every year. This indicates that the condition for NBL is opposite to the substitution theory. But the picture for fixed deposit is somewhat different. Up to 2003 the deposit amount had been increased with little amount. But after 2003 this deposit amount has been in decreasing trend. It indicates that with decrease in interest rate, fixed deposit amount also decreases. But the declining speed of interest rate is quite higher than that of declining speed of deposit amount. This suggests that they have positive relationship but to determine the magnitude of relation. Saving deposit interest rate was decreasing trend in the beginning year 2003 it 5.50%, 5.50% for 2004, 5.00% for 2005, 4.75% for 2006, 2.50% for 2007, 2.00% for 2008 and 2.00% for last year 2009. Similarly the saving deposit amount was increasing trend it was

21534.5 million for 2003, 22063.0 million for 2004, 22671.8 million for 2005, 23547.9 million for 2006, 26425.4 million for 2007, 28545.1 million for 2008 and 31079.7 million for 2009. But fixed deposit interest rate was decreasing trend and its deposit amount also decreasing trend fixed deposit interest rate was 4.39% and deposit amount was 8396.90 million for 2003, 4.39% (7481.0 million) for 2004, 4.38% (6269.2 million) for 2005, 4.07% (5790.9 million) for 2006, 3.15% (5393.20 million) for 2007, 2.56% (4757.9 million) for 2008 and 2.44% (Rs.3579.4 million) for 2009. The data on the table 4.20 are present on the following figure no. 4.19, 4.20 as follows.

**Fig. No. 4.19**

**Interest Rate of NBL on Saving and Fixed Deposit**

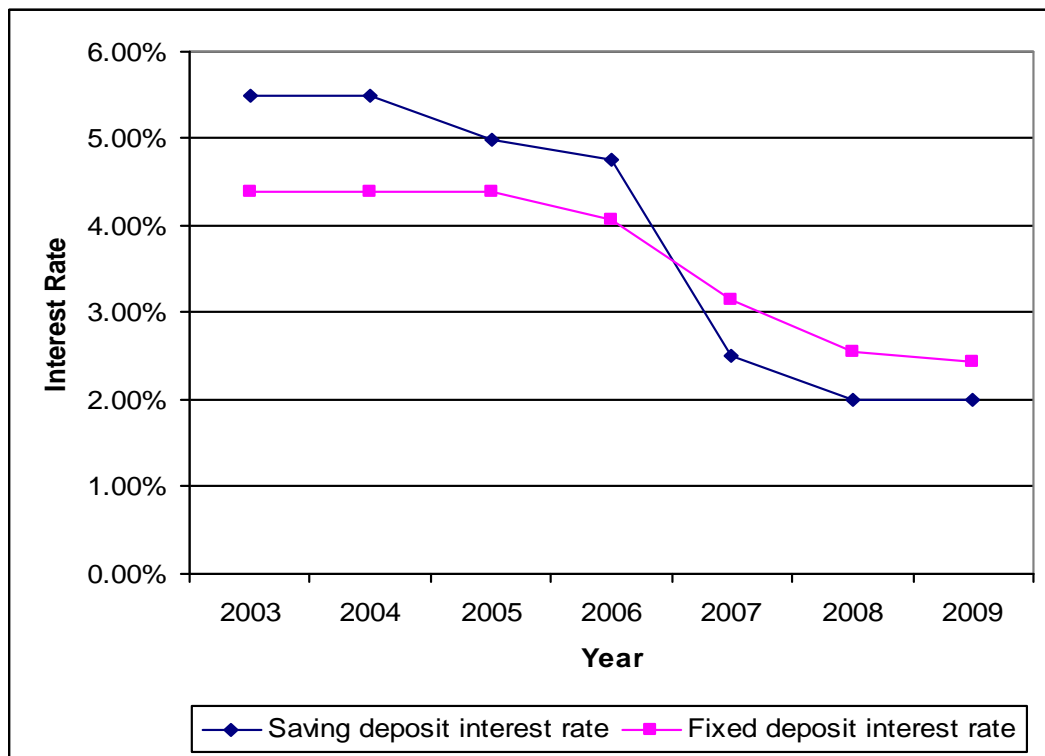
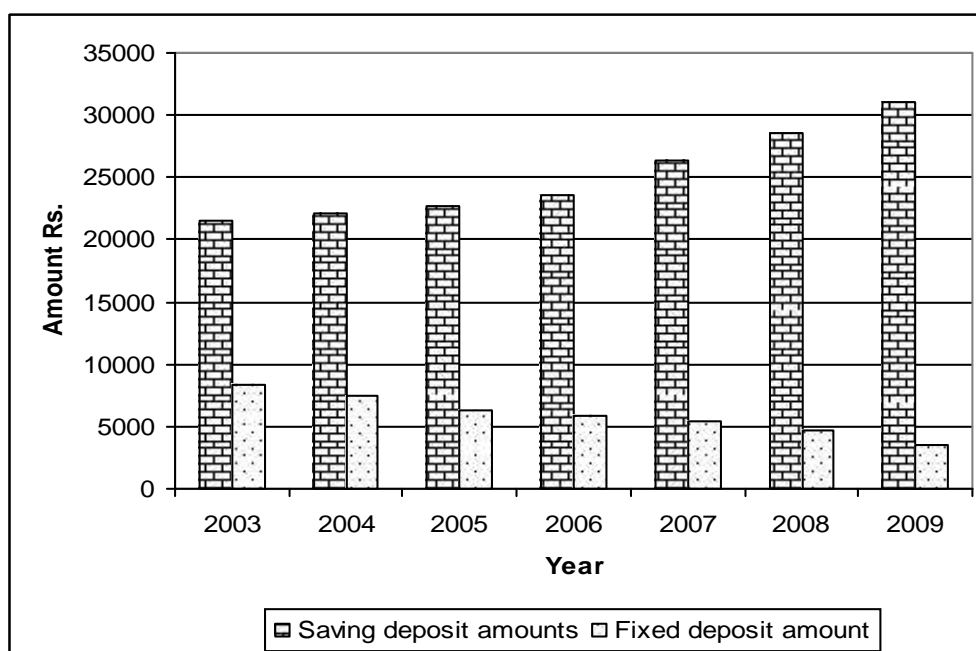


Fig. No.4.20

**Deposit Amount of NBL During Different FYs**



**Table No. 4. 21**

**Deposit Growth Rate of NBL During Different FYs**

Fiscal year	Saving deposit amount	Fixed deposit amount	Current deposit amount	Other deposit amount	Total deposit amount	Deposit growth %
2003	21534.5	8396.9	4689.5	116.5	34737.4	1.99
2004	22063.0	7481.0	6100.0	644.5	36288.5	4.47
2005	22671.8	6269.2	5514.4	288.8	34744.2	4.26
2006	23547.9	5790.9	5730.5	375.6	35444.9	2.02
2007	26425.4	5393.2	6561.5	335.1	38715.2	9.23
2008	28545.1	4757.9	7599.1	549.6	41451.7	7.07
2009	31079.7	3579.4	9072.0	615.0	44346.1	6.98

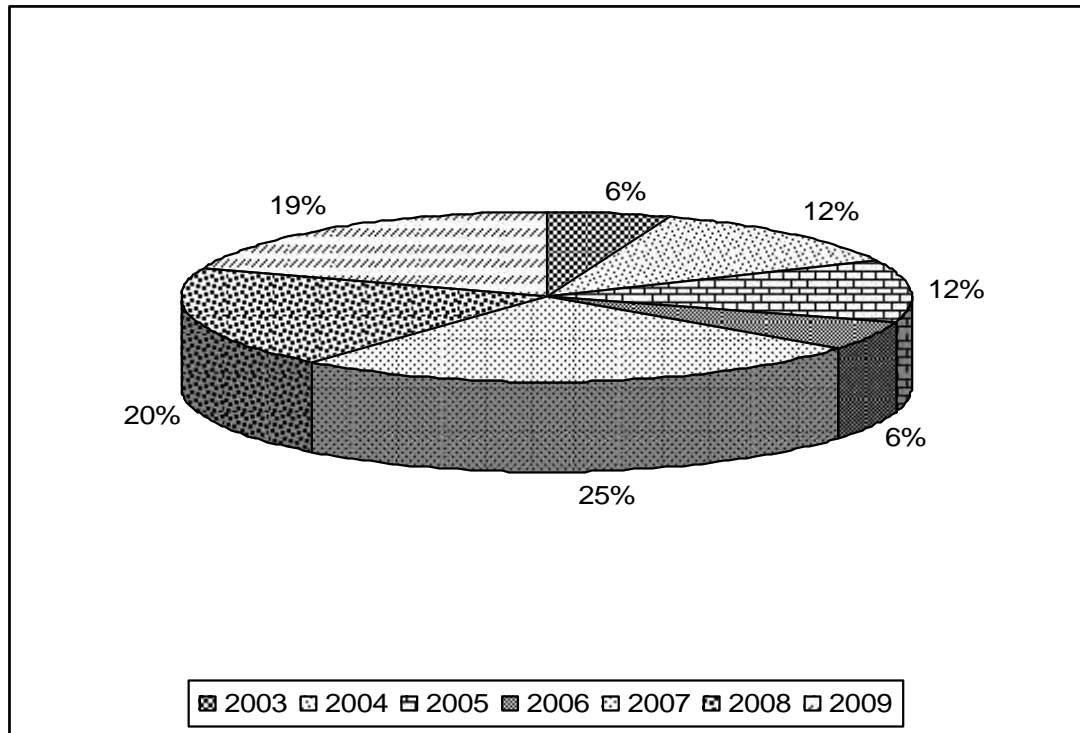
*Source: Banking and financial statistics NRB*

Above the table no. 4.21 show the increased the deposit amount growth rate. The total deposit growth rate of NBL in different fiscal years from 2003 to 2009. The data shows the growth rate of deposit amount is increasing tendency, it was 1.99 percent for beginning year 2003, 4.47% for 2004, in 2005 it was decreased 4.26% after FYs

2006 its trend up to increasing 2.02% for 2006 9.23% for 2007, 7.07% for 2008 and 6.98% for 2009. In mid-July 2009 the total deposit growth rate of NBL remained to 6.98% it was 1.99% in Mid-July 2003. This growth trend we can see following figure no. 4.21

Fig. No.4.21

**Total Deposit Growth Rate of NBL During Different FYs**



**Table No. 4.22**

**Deposit ratio of NBL during different FY**

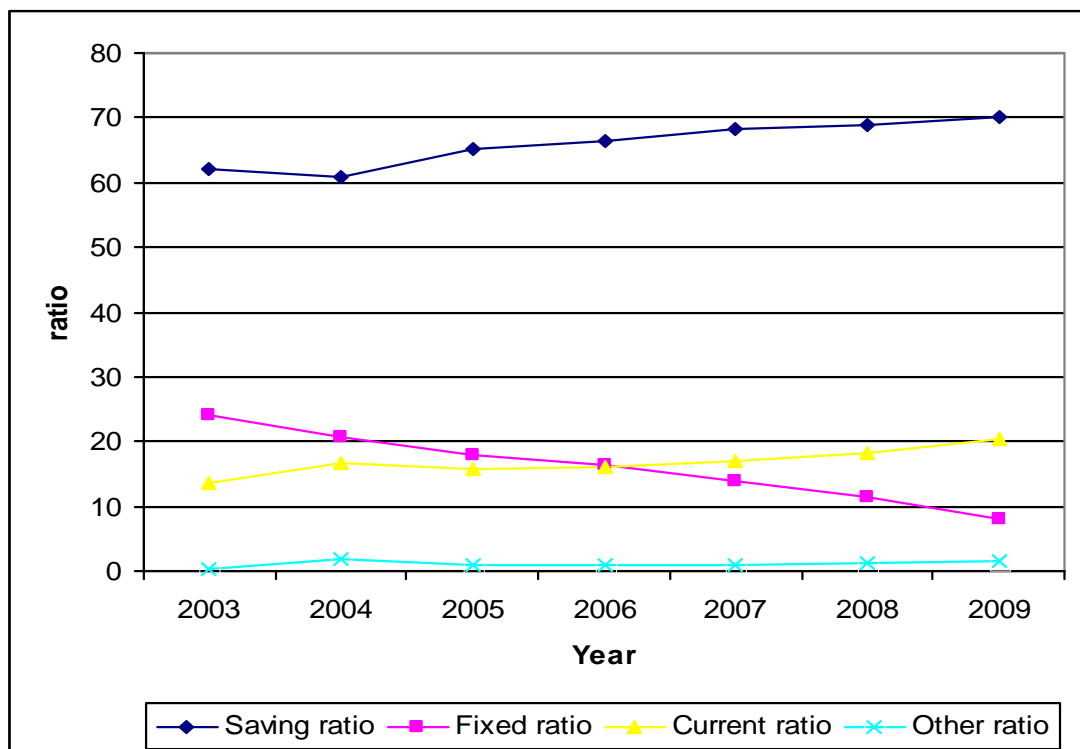
Fiscal year	Saving ratio	Fixed ratio	Current ratio	Other ratio
2003	61.99	24.17	13.50	0.34
2004	60.80	20.62	16.81	1.77
2005	65.25	18.05	15.87	0.83
2006	66.44	16.34	16.17	1.05
2007	68.25	13.93	16.95	0.87
2008	68.86	11.48	18.33	1.33
2009	70.08	8.07	20.45	1.40
Average ratio	65.95	16.10	16.87	1.08

Sources: Table no. 4.21

From the above table no. 4.22 shows the deposits ratio under seven years study period. The ratio of saving to total deposit is higher than the other deposit. The highest amount was deposited in saving deposit. Its deposit ratio is increasing trend. The deposit ratio of saving was 61.99%, 60.80%, 65.25%, 66.44%, 68.25%, 68.86% and 70.08% in fiscal year 2003, 2004, 2005, 2006, 2007, 2008 and 2009. Similarly second highest deposit is current deposit its deposit ratio also increasing trend it was 13.50%, 16.81%, 15.87%, 16.17%, 16.95%, 18.33% and 20.45% in FY 2003, 2004, 2005, 2006, 2007, 2008 and 2009. But third highest deposit amount is fixed deposit it's deposit ratio is decreasing trend it was 24.17%, 20.62%, 18.05%, 16.34%, 13.93%, 11.48% and 8.07% in FY 2003, 2004, 2005, 2006, 2007, 2008 and 2009. Other deposit ratio is least compare to saving fixed and current accounts. The saving deposit comprises the major share in total deposit. As of Mid-July 2009 the proportion of saving, fixed and current deposit are 70.08%, 8.07% , 20.45%, 61.99%, 24.17% and 13.50% saving, fixed current deposit were in Mid-July 2003. This deposit ratio is shown in the figure as in figure no. 4.22

Fig. No.4.22

**Deposit Ratio of NBL During Different FYs**

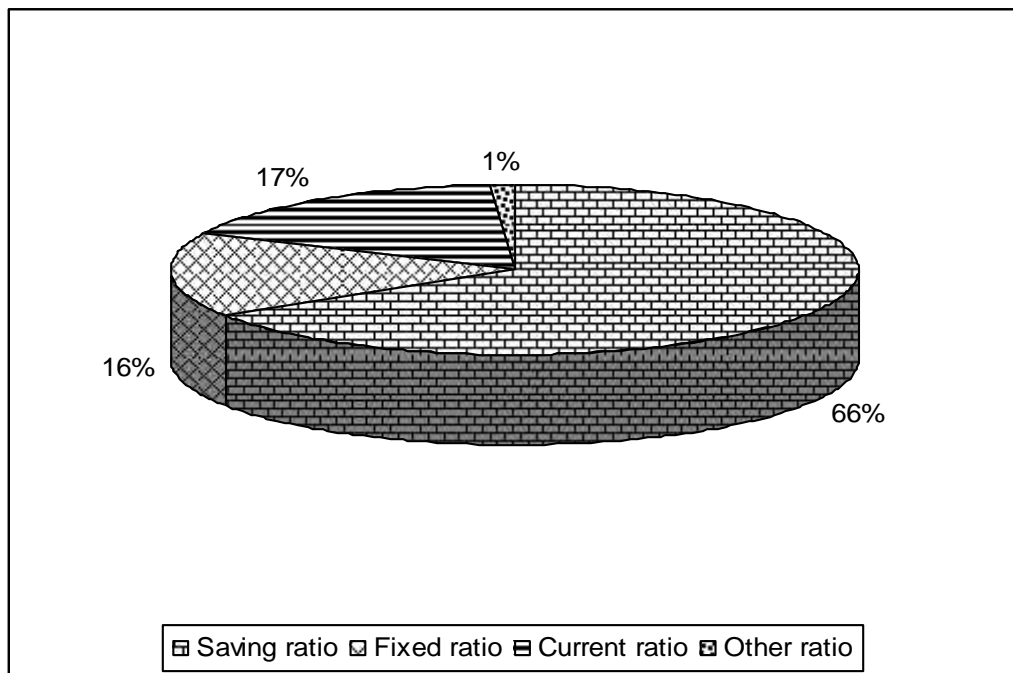




Above table no.4.22.Revels that the total deposits position. It show the deposit ratio of NBL in different FY and it's average deposit ratio of saving deposit, fixed deposit, current deposit and other deposit also presented. The higher amount of deposited in saving deposit it is 65.95% second higher is current deposit it is 16.87% nearest of second higher is fixed deposit it is 16.10% and lowest is other deposit it is 1.40% it is shown in the following figure no 4.23

Fig.No.4.23

**Average Deposit Ratio of NBL**



#### **4.10 Interest Rate and its Effects of Lending on NBL**

The sector where NBL grant its credit during last seven FYs and their corresponding interest rate, average interest rate and lending amount are presented in the table 4.13 below.

**Table No. 4 . 23****Lending Rate of NBL on Different Sectors During Seven FYs**

<b>Sector Year</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
Overdraft	15.00	15.00	14.00	10.0	10.00	10.00	10.00
Export credit	11.00	11.00	11.00	8.50	8.50	8.00	8.00
Import L.C.	11.00	11.00	11.00	8.50	-	-	-
Govt. Bond	8.00	8.00	7.00	7.00	7.00	6.50	6.50
BG/CG	10.00	10.00	10.00	8.75	8.75	7.00	6.50
Industrial loan	14.00	14.00	13.00	13.00	-	-	-
Commerci al loan	14.50	14.50	13.50	13.50	-	-	-
Priority sector loan	14.00	14.00	13.50	10.50	10.50	10.00	10.00
Poorer sector loan	10.50	10.50	10.00	8.00	8.00	7.50	7.50
Working capital	14.00	14.00	13.00	10.00	10.00	10.00	10.00
Hire purchase	14.00	14.00	14.00	11.00	11.00	9.00	9.00
Others	16.00	16.00	14.00	11.00	12.00	11.00	10.00
<b>Average interest rate</b>	<b>12.67</b>	<b>12.67</b>	<b>12.00</b>	<b>9.98</b>	<b>9.53</b>	<b>8.78</b>	<b>8.61</b>
<b>Lending amount</b>	<b>19266.1 0</b>	<b>19141.7 0</b>	<b>18530.6 0</b>	<b>12791.1 0</b>	<b>13750.6 0</b>	<b>15770.7 0</b>	<b>19482.2 0</b>

*Source: Banking and financial statistics, interest rate NRB*

According to the table 4.23 it is clear that all the lending interest rate fell by 1.00% to 6.00% within the seven FYs. During the FY 2004 the average interest rate declined quite rapidly, with greater magnitude but in middle of the FY in remained stagnant. Again after middle year the momentum of speed rises up. During the period especially hire purchase rate, against government bond rate, BG/CG rate. Import LC rate and overdraft lending rate fell drastically. The fell by 5.00%, 1.50%, 3.50% 2.5%, 5.00%. Where as other sector lending rate of NBL also fell but their magnitude was less. It means that commercial sector loan rate, industrial loan rate were not decreased by large percentage. So it can be said that only non-productive sector loan rates were reduce drastically during the seven FYs as compare to productive sector loan. The case is similar with the RBB. With rhythm to lending interest rate, the study of lending amount shows that it is also in decreasing trend. The trend shows that it is fluctuating. In other words, up to the FY 2006, the lending amount was in decreasing tendency but after 2006 the lending amount to be increasing. The average lending rate of each FY and their corresponding lending rate can be exhibited in the figure 4.24 and 4.25 as follows.

Fig. No. 4.24

**Average Lending Rate of NBL During Different FYs**

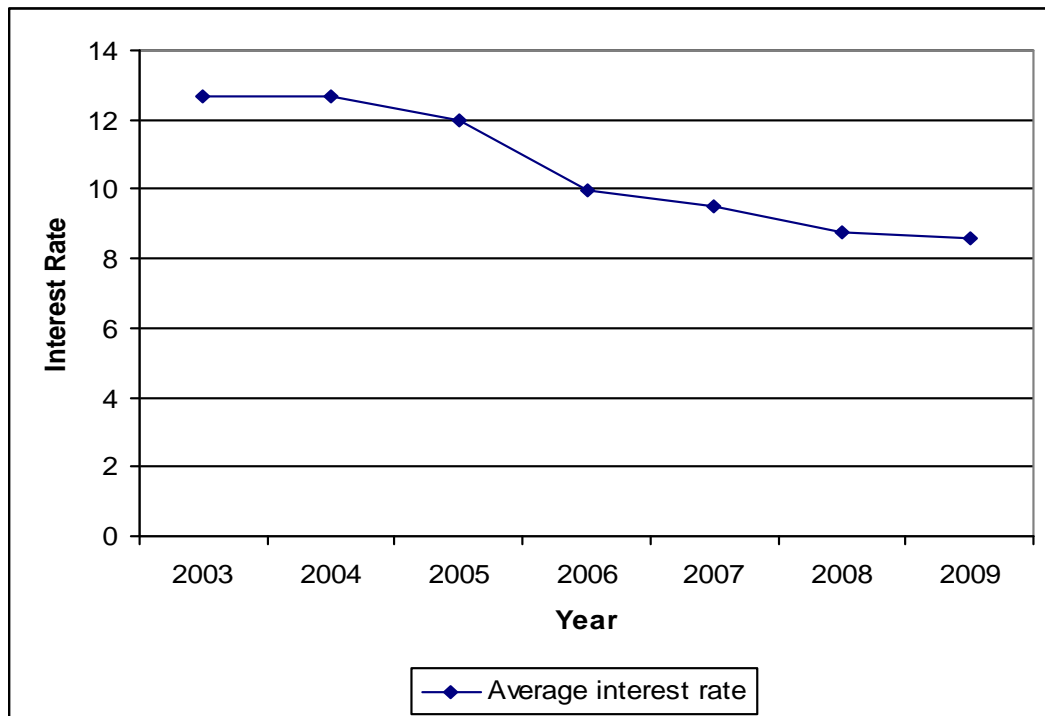
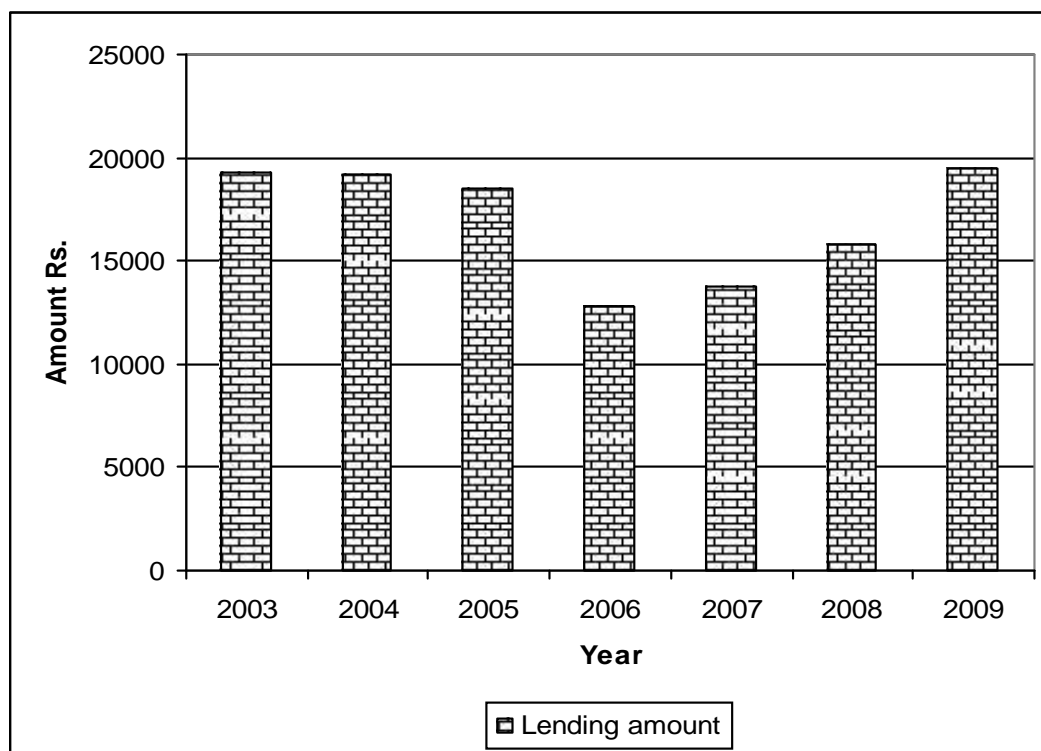


Fig. No.4.25

**Lending Amount of NBL During Different FYs**



**Table No. 4 .24**

**Credit to Deposit Ratio of NBL During Different FY**

Year	Amount of total deposit	Amount of total lending	Credit to deposit ratio
2003	34737.4	19266.1	55.46
2004	36288.5	19141.7	52.75
2005	34744.2	18530.6	53.33
2006	35444.9	12791.1	36.09
2007	38715.2	13750.6	35.52
2008	41451.7	15770.7	38.05
2009	44346.1	19482.2	43.93

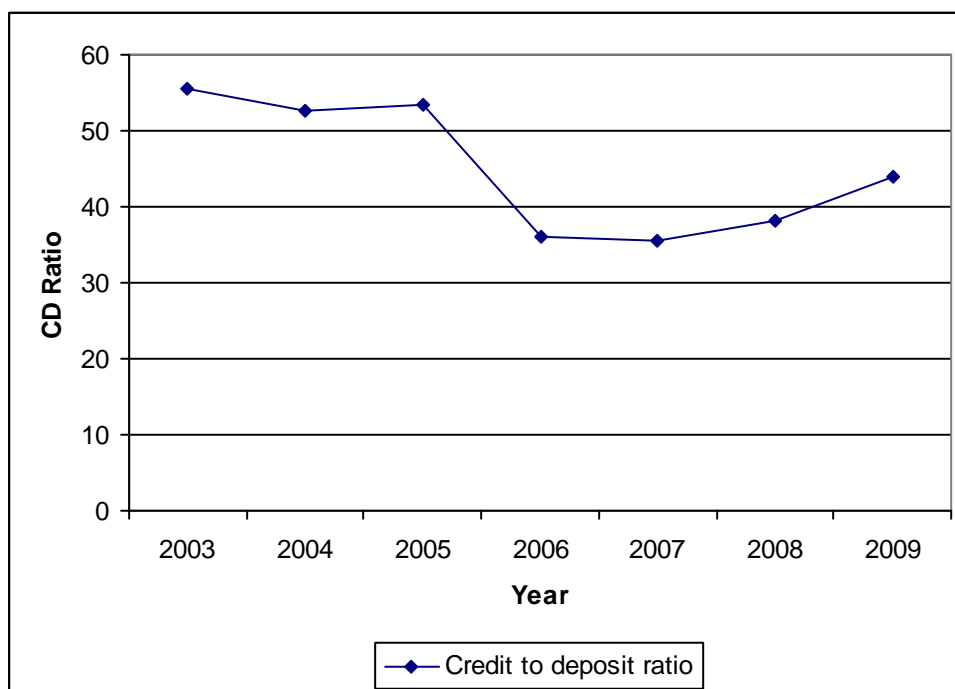
Source: Table no. 4.21 and 4.23

The table no. 4.24 shows the credit to deposit ratio of NBL during on seven FY. The table presented the ratio of credit to deposit is decreasing trend it was for FY 2003, 2004, 2005, 2006, 2007, 2008 and 2009 are 55.46%, 52.75% 53.33%, 36.09%,

35.52%, 38.05% and 43.93%. From the table it is clear that the total deposit amount of NBL is increasing trend and total lending amount of NBL is decreasing trend. So the credit to deposit ratio is also decreasing trend for seven fiscal years. In Mid-July 2009 it was 43.93% and it was 55.46% in Mid-July 2003. It is shown in the figure as in figure 4.26

Fig. No. 4.26

**Credit to Deposit Ratio of NBL During Different FYs**



**4.11 Major Finding of the Study**

1. The Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB), both banks deposit interest rate seems decreasing year by year.
2. As the interest rate has been decrease by greater magnitude the saving deposit interest rate of NBL from 5.50% to 2.00% and RBB from 6.50% to 2.00%. Similarly fixed deposit interest rate of NBL from 4.39% to 2.44% and RBB from 6.25% to 2.58% during the study period.
3. The deposit amount of saving of these banks have increasing trend. But the fixed deposit amount has been decreasing trend.
4. The NBL saving deposit amount has been increased by more than 1.44 times from Rs.21534.5 to 31079.7 million and RBB saving deposit amount has been increased by more than 2.21 times from Rs.20861.5 to 46102.8 million.

Similarly, the fixed deposit amount of NBL decreased from Rs.8396.9 to 3579.4 million and RBB from Rs.13579.2 to 3207.8 million in the study period.

5. This indicates that the saving interest rate and deposit amount condition for these banks is opposite. But the fixed deposit interest rate and deposit amount have positive relationship.
6. Both banks the ratio of saving to total deposit is higher than the other deposit NBL of its ratio is 65.95% and RBB of its ratio is 62.84% in Mid- July 2009.
7. Growth ratio of total deposit of these banks reveals that NBL and RBB having huge deposit showed 6.98% and 17.22% growth rate in total deposit. NBL and RBB total deposit reached respectively Rs.44346.1 and 67976.3 million in Mid- July 2009.
8. The interest rate on lending on different area of these banks is in declining stage.
9. The average interest rate on lending of NBL and RBB both banks are in falling stage NBL is from 12.67% to 8.61%. Similarly RBB is from 14.73% to 8.94% in the seven FYs period.
10. The lending amount of these banks are also seen to be in decreasing some year with some fluctuation. Lending amount of NBL and RBB increased during the last year. NBL was for starting year Rs.19266.10 million it reached Rs.19482.20 million in last year its rise by Rs.216.10 million. Similarly RBB lending amount was Rs.28258.90 million in starting year its reached 31607.90 million in last year, its rise by Rs.3349.0 million in Mid- July 2009. This shows that the lending amount and interest rate have negative relationship.
11. The credit to deposit ratio of these banks are in declining stage. In Mid- July 2009, the credit to deposit ration of the NBL and RBB remained to 43.93% and 46.50% it was 55.46 and 71.89% in Mid-July 2003.
12. Out of the total credit of NBL and RBB non- performing assets (NPA) till Mid-July 2004 stood at 60.47% and 60.15% which gradually decreased in the subsequent years. It was come down to 8.98% and 18.72% by mid-January 2009.
13. Review of the restructuring process of both banks shows that there has been an increase in net profit in Mid- January 2009 the net profit of NBL and RBB remained 450.0 and 110.0 it was (252.00) and (48.5) in Mid –July 2003.

14. From our above calculation we found that deposit interest rate plays a significant role in deposit collection as well as lending interest rate plays a significant role in loan disbursements and its long term effect on the profitability of the banks.

## **CHAPTER-V**

### **SUMMARY, CONCLUSION AND RECOMMENDATION**

#### **5.1 Summary**

Nepal Bank Limited (NBL), the first commercial bank established in country, before 72 years and Rastriya Banijya Bank (RBB), the fully government owned commercial bank established before 43 years. They have helped a lot to develop the banking habit of the general people within the country. Both banks since establishment have been functioning only with the main objective of making profit but also giving main priority to the well being of the nation. Thus there is no doubt that both banks have contributed a lot to the betterment of the country's economy. In the past overall performance of these banks, were quite remarkable. They were successful and helped the government to develop the economic infrastructure of the country. Recently they felt that in spite of success in collecting scattered saving in the form of deposits, they have not yet been able to utilize the most productively thus the proper utilization of the mobilized resources has been become a current and prevalent issue for the banks. Therefore, this study was undertaken with the objective of analyzing and evaluating the lending, deposit collected and its interest rate of NBL and RBB in order to trace out gaps and drawbacks in its performance. A period of seven years starting form FY 2003 to 2009 had been selected for the study.

Economic liberalization policy of the government has encouraged to establish and growth of commercial banks in the country within short period of time. In situation when the existing financial institutions, especially governments commercial were unable to supply credit in time and carry capital market activities whereas commercial banks have contributed a lot. Financial institutions are spread and functioning in the different parts of the country. Financial intermediaries transfer saving to the nearby investor which helps to utilization of funds among various productive sectors. This helps to the economic development and the rise of living standard of the people. Deposit is the main source of commercial banks for lending to needy people. Higher the deposit higher the bank has the ability to lending. The basic policy for the financial institution is to charge the higher interest in lending and lower interest for deposit funds. As a result, various of these type of organization are lure for investment



in order to gain maximum profit from the deposit and lending. Usually interest rates have greater impact on the lending and collection of the deposit. The higher interest rates attract more deposits and lower interest rate on loan and vice versa. However, in Nepal due to existence of some uncommon practices interest rates do not seem to have such impacts on deposits and credit. Both deposit and lending rates are continuously decreasing over the years decreasing the interest spread. Though it is quite obvious for increasing demand for loan but deposit too are increasing. This has proved that the customers in Nepal do not care much about when one is depositing but lower lending rate attract more customers to take loan. So, the relationship between deposit, lending and interests are directly or inversely proportional to each other.

The sample banks NBL and RBB both banks deposit interest rate has been decreasing trend. The saving deposit interest rate of NBL from 5.5% to 2.00% and RBB from 6.50% to 2.0%. Similarly fixed deposit interest rate of NBL from 4.39% to 2.44% and RBB from 6.25% to 2.58%. The deposit amount of saving of these banks have increasing trend. But the fixed deposit amount has been decreasing trend. The NBL saving deposit amount from Rs. 21534.5 to 31079.7 million and RBB saving deposit amount from Rs. 20861.5 to 46102.8 million. Similarly, fixed deposit amount of NBL decreased from Rs. 8396.9 to 3579.4 and RBB from Rs. 13579.2 to 3207.8 million in the study period. This is indicate that the saving interest rate and deposit amount condition for these banks is opposite to the substitution theory. But the fixed interest rate and deposit amount have positive relationship.

The average interest rate on lending of these banks are in falling stage NBL from 12.67% to 8.61% and RBB from 14.73% to 8.94%. The lending amount of these banks are also seem to be in decreasing some year with some fluctuation. But lending amount of these banks have increased in last year from starting year. NBL lending amount from Rs. 19266.10 to 19482.20 million and RBB from Rs. 28258.90 to 31607.90 million in the study period. This shows that the lending interest rate and amount have negative relationship.

## **5.2 Conclusion**

Interest rate has been the dominating factor for collection and mobilization of deposits and it is still continuous to be the important one for much longer time. People prefer

to deposit when the deposit interest rate is high and like to take loan when lending rate is low but what rate is high and low is determined by the market force and position of the bank in the market. Big banks in the present market situation are giving lower interest rate on deposit and expect higher interest in return. On the country to the small and new banks are offering comparatively higher interest rates on deposits and disburses loan at interest rate similar to well established bank. The total deposit collected seems unsatisfactory and the deposits should be encouraged to deposit in the NBL and RBB banks. The depositors being attracted to other banks as some joint venture banks, some new commercial banks and finance companies nowadays provide facilities to depositors. The interest rate seems decreasing year by year. It is fact because these banks have not able to motive and facilities to their client's except to change in rate of interest. Banks could not mobilize and utilize the accumulated deposit in productive sector. So it decreases its interest rate.

There is positive relation between interest rate and fixed deposit. Although, when the interest decreases deposit has gone down. But the relation between interest rate and saving deposit is high. In spite of low interest rates in the deposit collection is high. But the fact is something different, when liberalization was induced in Nepal as a means of development of the country, many joint venture bank, financial institutions were established, saving was now safe with banks than in home from securities point of view. Irrespective of rate of interest; deposit collection seemed to increase so lending amount also increase. Being an oldest and government owned commercial banks in Nepal people are appreciating and trusting these banks more than any banks.

To conclude, followings are some of the important impact of changing interest rate t that are emerged from the study.

- Changing interest rate structure can create a competitive environment among commercial banks.
- The wider spread interest rate helps the commercial bank to manage the higher liquidity position and good profitability.
- A high interest in deposit and low in lending is important to attract customers to the bank but the other facilities offered by the banks also plays an important role for the success of the banks.

- An appropriate and realistic interest rate on lending can help in optimum utilization of available resources.

Interest rate does play a vital role in Nepalese market, however there are other factors governing influence in deposit of commercial banks. So the interest rate plays a significant role in economic development. Any banks willing to increase the business should always present its interest rate structure in such a way that the impact of it should be positive of all. Currently banks in the market are able to structure its interest accordingly which is the reason of increasing profits year after year.

### **5.3 Recommendation**

NBL was the first organized banking institution being joint venture of government and private individuals and RBB was the fully government owned commercial bank both established with different objectives. One of the major objectives is to run the branches in the rural communities, to improve their living standard by providing banking securities in order to promote the economic situation of the problem and financial problem. Although NBL has 100 branches. As RBB could successfully operate 123 branches in different areas. In order to be the instrument of development, bank is required making better profit and better profit is possible only through better performance.

Then following are the suggestions to NBL and RBB for better performance.

1. Nowadays other commercial banks, joint venture banks and financial companies are giving various facilities to the customer providing new schemes and attractive interest rates. Hence both banks try to bring such schemes to attract new customers in this competitive business world.
2. Proper marketing strategy should be conducted so that new customer could be attracted as well we the bank can face a head with other competitor banks.
3. Most of the bank lack of modern technologies like computerized banking service, ATM service ABBS service and other banking facilities. Nowadays any joint venture and finance companies adopt these technologies lack of this technology the work of the bank is being tedious in the modern world of computer. Hence both banks must also try to modernize itself.
4. Financial statements should be published regularly.

5. To get success in competitive banking environment; depositors money must be utilize as loan and advances. Negligence in administering this asset could be the main cause of liquidity crises in the bank and one of the main reasons of a bank failure. To overcome this situation securities against which loan is going to provide should be valued fairly and properly.
6. The loan and advances department and the loan recovery department should also be target oriented, that is after advancing loan, there should be regular supervision and follow up for the proper utilization.
7. Banks should also include the rate of inflation while determining rate of interest of deposit.
8. In order to developed the economy, banks have to collect more volume of the capital, so, banks are suggested to quote higher deposit interest rate. This situation may lead to the reduction of the profit opportunity but it will enhance the economic condition of the country.
9. There is a higher spread between lending interest rate and deposit interest rate at present. So, higher spread increase the profit figure of the banks, but it reduces the deposit collection and investment in the country. Therefore banks should be conscious for the unusual spread of interest and suggestion is made to narrow down the difference between these two interest rates.
10. Banks are suggested to invest new but productive areas and they should introduce competitive customer oriented schemes. It will help in solving liquidity problems.

## APPENDIX – I

### Interest Rate Structure on Deposit of Commercial Banks as on Mid- July

Particular/ Year	2003	2004	2005	2006	2007	2008	2009
Deposit rate %							
Saving deposit	6.00	5.50	5.50	5.25	5.00	4.50	4.50
Fixed Deposit							
1 months	0.00	3.50	3.25	3.50	3.00	3.00	3.00
3 month	5.00	4.75	4.50	4.00	4.25	4.00	3.75
6 month	6.00	5.00	4.75	4.50	4.50	4.25	4.00
1 year	7.00	5.75	5.00	5.00	5.00	5.00	5.00
2 year & above	7.50	6.00	6.50	6.40	5.50	6.00	6.00

$$\text{Mean } \bar{X} = \frac{X}{N}$$

## APPENDIX – II

### Lending Rate on Commercial Bank on Different Sector During Seven F/Ys

Sector/ Year	2003	2004	2005	2006	2007	2008	2009
Industrial	14.00	13.50	13.50	13.50	13.00	13.00	13.00
Agricultural	14.50	12.50	13.50	13.00	13.00	12.00	12.00
Export Bills	13.00	12.00	12.00	11.50	11.50	11.00	11.00
Commercial loan	16.00	15.00	14.50	14.50	14.00	13.50	13.00
Overdraft	17.00	15.50	15.00	15.00	14.50	14.00	13.50

$$\text{Mean } \bar{X} = \frac{X}{N}$$

## APPENDIX – III

### Interest Rate Structure on Deposit of RBB as on Mid- July.

Particular/ Year	2003	2004	2005	2006	2007	2008	2009
<b>1. Deposit Rate%</b>							
Saving Deposit	6.50%	6.00%	5.00%	4.75%	2.25%	2.00%	2.00%
<b>Fixed Deposit</b>							
7 days	0	0	0	0	0	0	0
14 days	0	0	0	0	0	0	0
1 months	0	0	0	0	0	0	0
3 months	5.00	4.50	4.00	3.75	3.00	2.25	2.25
6 month	5.50	5.50	4.75	4.25	3.50	2.50	2.50
1 year	7.00	7.00	6.00	5.75	3.75	3.50	3.00
Above 2 year	7.50	7.25	6.25	6.00	0	0	0

$$\text{Mean } \bar{X} = \frac{X}{N}$$

## APPENDIX IV

### Lending Rate of RBB on Different Sectors During Seven FYs

Sector Year	2003	2004	2005	2006	2007	2008	2009
Overdraft	16.50	13.50	11.75	11.25	12.20	11.00	11.00
Export Credit	15.00	12.00	11.50	10.00	9.50	8.00	8.00
Import L.C.	12.00	13.00	12.00	10.00	10.00	00	7.50
Govt. Bond	11.00	14.00	10.50	10.00	7.00	7.00	6.50
BG/CG	0	10.50	10.00	9.25	9.25	7.00	6.50
Other Guarantee	15.00	10.50	0	0	0	0	0
Industrial Loan	15.50	15.00	14.50	11.75	12.00	0	0
Commercial Loan	16.50	15.50	15.00	0	0	0	0
Priority sector Loan	14.00	14.00	13.00	12.00	12.00	11.50	11.00
Working Capital	14.00	14.50	13.75	12.50	11.00	0	0
Hire Purchase	16.00	14.00	13.50	12.00	12.00	9.00	10.00
Others	16.50	15.50	15.00	12.00	12.00	11.50	11.00

$$\text{Mean } \bar{X} = \frac{X}{N}$$



## APPENDIX V

### Interest Rate Structure on Deposit of NBL on Mid-July

Year	2003	2004	2005	2006	2007	2008	2009
<b>Deposit Rate</b>							
Saving deposit	5.50%	5.50%	5.00%	4.75%	2.5%	2.00%	2.00%
<b>Fixed Deposit</b>							
7 days	2.00	2.00	2.00	2.00	-	-	-
14 days	2.50	2.50	-	-	-	-	-
1 month	3.50	3.50	3.50	3.25	2.50	2.00	2.00
2 month	-	-	-	3.50	2.75	-	-
3 month	4.00	4.00	4.00	3.75	3.00	2.25	2.25
6 month	5.00	5.00	4.50	4.25	3.50	2.50	2.50
1 year	6.75	6.75	6.00	5.75	4.00	3.50	3.00
Above 2 years	7.00	7.00	6.25	6.00	-	-	-

$$\text{Mean } \bar{X} = \frac{X}{N}$$

## APPENDIX- VI

### Lending Rate of NBL on Different Sectors During Seven FYs

Sector Year	2003	2004	2005	2006	2007	2008	2009
Overdraft	15.00	15.00	14.00	10.0	10.00	10.00	10.00
Export credit	11.00	11.00	11.00	8.50	8.50	8.00	8.00
Import L.C.	11.00	11.00	11.00	8.50	-	-	-
Govt. Bond	8.00	8.00	7.00	7.00	7.00	6.50	6.50
BG/CG	10.00	10.00	10.00	8.75	8.75	7.00	6.50
Industrial loan	14.00	14.00	13.00	13.00	-	-	-
Commercial loan	14.50	14.50	13.50	13.50	-	-	-
Priority sector loan	14.00	14.00	13.50	10.50	10.50	10.00	10.00
Poorer sector loan	10.50	10.50	10.00	8.00	8.00	7.50	7.50
Working capital	14.00	14.00	13.00	10.00	10.00	10.00	10.00
Hire purchase	14.00	14.00	14.00	11.00	11.00	9.00	9.00
Others	16.00	16.00	14.00	11.00	12.00	11.00	10.00

$$\text{Mean } \bar{X} = \frac{X}{N}$$

# Curriculum Vitae

## PERSONAL DETAILS

**Name** : Laxman Upadhyaya  
**Date of Birth** : 2036/07/24  
**Father's Name** : Mr. Bal Krishna Upadhyaya (Poudyal)  
**Permanent Address** : Kharjyang VDC-3, Maindanda, Gulmi  
**Temporary** : Butwal-8, Rupandehi,  
**Ph. No.** : 9847046613  
**Gender** : Male  
**Marital Status** : Married  
**Nationality** : Nepali  
**Language** : Nepali, English & Hindi  
**Religion** : Hindu

## Academic Qualifications:

Level	University/ Board	Year	Major Subject
MBS	T.U. (Lumbini Baniija Campus)	Thesis Submitted	Account
BBS	T.U. (Tribhuvan Multiple Campus, Palpa)	2062	Account & Finance
I.Com	T.U. (Tribhuvan Multiple Campus, Palpa)	2058	Math & Account
S.L.C.	HMG (Adarsh M.V. Digam Kot, Gulmi)	2054	History & Geography

## Training

- One month General Banking Training.
- 4 days Basic Accountancy Training.

## Skill

- Typing both Nepal and English.
- Computer Proficiency: MS- Word, Excel, Power Point and Tally.

## References:

Dr. Ishwor Gautam (Campus Chief of Lumbini Baniija Campus, Ph. No. 9857025020)

Mr. Tara Prasad Upadhyaya (Lecturer of L.B.C. , Ph. No. 9857028361)

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