

ABSTRACT

In this thesis the applied aspects got emphasized of the new framework for banking directive in private banks of Pakistan as defined in Basel III and State Bank of Pakistan circular number BPRD 06 dated 15th August, 2013 regarding instructions for Basel III implementation in Pakistan. It examines the effect of the higher capital requirements on loan rates and bank loans presented under the Basel III framework. The Generalized Method of Moments (GMM) estimation procedure has been adopted for empirical estimation of data of 17 private banks of Pakistan during 2007 to 2013 period, which defines synchronized decision for banks on how much capital holding which is perceived as call option, loan rate setting and level of bank loans. The empirical results conclude that (i) one percent point increase in common equity ratio increases the loan rate in private banks of Pakistan by 108 basis points because higher capital requirements result in raising banks' marginal cost of funding (ii) an increase in bank loans by 0.186 percent against one percent increase in loan rate which is in contrast to the expectation but that is due to inflation factor which reduces the people purchasing power of developing country Pakistan and results in the increase in demand for loans to meet their expenses causing high loan rate which in turn increases the supply of loans. The data presented submits that majority of private banks of Pakistan are already maintaining high capital adequacy ratios against required level of capital requirements.

Key Words: Private Banks, capital requirements, GMM