

Executive Summary

This paper studies the internal and external determinants of bank profitability in Macau during the 1993-2002 period. By adopting a panel data regression technique, a set of bank specific characteristics, macroeconomic and financial structure variables are used to explain interest margins and return on assets. The empirical results show that larger loan to total asset ratio, with lower loan loss provisions, leads to more interest margins and profitability. Capital adequacy and scale economies, as measured by higher capital to total asset ratio and logarithm of total deposits, contribute to higher return on asset. Meanwhile, operating expense management and business diversification, as measured by non-interest expense ratio and non-interest income ratio respectively, are important determinants of bank interest margin. With regard to the macroeconomic variables, inflation affects banks return on asset and interest margin positively, whereas the real interest rate shows a positive impact on bank interest margin only. The result also suggests that the financial structure variables are relevant factors in explaining the banking performance in Macau.