ABSTRACT

Financial liberalization refers to the removal of legal restrictions on the financial system mainly on interest rates. Financial liberalization paradigm in developing countries is perceived to promote savings prior to investment that will lead to economic growth.

Among other arguments, this study realizes that the increase in deposit rates resulting from financial liberalization encourage the flow of financial resources to the financial sector for lending to finance investment through loans. The increase in banking efficiency that includes the increase in the number of banks in the economy seems to increase the chance of investors to obtain loan and hence lead to high level of investment. The main approach used is the tests for Co integration were Engle and Granger (1987). This has been applied and tested by using Tanzania annual time-series data for the period from 1976 -2010 was used through the application of Regression analysis (OLS) to examine the impact, Augmented Dickey-Fuller technique and Phillip-Perron test in testing the unit root property of the series, Correlation coefficient and co-integration technique to establish the relationship between real deposit rate of interest, financial intermediation ratio, real income growth inflation and investment. Coefficient of elasticity to measure the degree of responsiveness to change in investment due to changes in the independent variables.

The econometric results shows that real deposit rate (RD) and financial intermediation ratio (FIR) variables in the model are statistically significance to explain private investment in the economy using z test where the probability of z test is 0.027 and 0.001 which is not above 0.05. ARIMA regression analysis reveals that only d1 is negatively related with investment while all other variable are positively related. This means that the real deposit rate and financial intermediation ratio have a positive influence on the level of investment while income growth (GDPg), inflation (INF), dummy one (D1) and dummy two (D2) are statistically insignificant to explain investment in the economy. The findings of this study show that financial conditions do matter in the behavior of investors. This implies that policies, which make intermediation costly or hinder the development of financial institutions, should be avoided. Government can improve intermediation by reducing taxation of the financial

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