Determinants of Non-Performing Loans: Evidence from Sri Lanka

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The increasing trend of non-performing loans (NPL) in Sri Lanka threatens the whole banking system. Also, it is doubtful whether the policymakers have the capacity and capability to identify NPL determinants because of the missing information. Therefore, this study attempts to identify the determinants of NPL in licensed commercial banks in Sri Lanka to fill the void in the finance research arena. This study is carried out with a sample of eight licensed commercial banks using macroeconomic factors and bank-specific factors: the real interest rate, annual GDP growth, and annual inflation rate, exchange rate, and unemployment rate, efficiency of the bank, bank size, lending rate, and ROA. Financial data were analyzed for the period 2008-2018 using panel data regression analysis. Results show that GDP growth rate, Exchange rate, Unemployment rate, and bank size have a significant effect on non-performing loans in the Sri Lankan banking industry at a 95% confidence interval. The inflation rate also has a significant impact, however, only at a 90% confidence level. However, bank efficiency and return on asset (ROA) do not show any significant relationship with NPLs. Among these relationships, only the exchange rate shows a positive relationship with the NPL, where all other variables show a negative relationship.

Keywords: *Exchange rate, Inflation, Non-performing loans, Unemployment rate*

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