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Impact of Economic Indicators on Loan Default : Evidence from the Banking Industry In Srilanka

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Abstract

Purpose: The study intends to observe the impact of economic indicators on loan default in Sri Lanka.

Methodology: The study was influenced by the Arbitrage Pricing Theory (APT) and the Credit Portfolio View (CPV) model. A quantitative approach was carried out by taking the population as the banking industry in Sri Lanka. Secondary data for the period of 1998-2022 was collected from the Central Bank (CBSL) website.

Findings: Time series analysis revealed that the lending interest rate, inflation rate, and currency exchange rate have a positive impact on the default rate while a negative impact of economic growth on the default rate. However, higher lending interest rates significantly increase loan default.

Originality: The study recommends that the policymakers, including the CBSL as the main regulatory authority of the financial system to manage the interest rates in a way that benefits the Economy as the high cost of funding has significant shortcomings in the business environment and leading to high credit risk.

Keywords: Loan Default, Economic Indicators, Macro Economic Variables, Banking Industry, Sri Lanka.