

MACROECONOMIC INDICATORS AS DETERMINANTS OF BANKING INDUSTRY'S NON-PERFORMING LOANS

BY

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I, hereby, declare that no portion of the work referred to in this thesis has been submitted in support of any application for another degree or qualification of this university or any other institution of learning.

Student's Signature: _____

Dedication

I dedicated my dissertation work to my parents and family members. A special feeling of gratitude to my caring parents who's always support and show words of encouragement & motivation that push me to fulfill my dreams.

I also dedicate this dissertation to my family member who have supported me throughout the process. I will appreciate all they have done specially to develop my research skill.

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Abstract

Purpose

The preliminary purpose of this research work and study is to recognize and assess the determinants of Non-Performing Loans in the Financial (Banking) industry of Pakistan and establish a correlation between these variables.

Methodology & Design

To work for this determination, historical data on Macro-economic variables have been collated and used to determine the relationship between these variables and Non-Performing loans statistically. Regression and Correlation based techniques have been used to establish the dependency

Findings

This in depth and empirical study of the macro – economic variables in explaining the variation in non – performing loans, revealed that collectively Inflation (CPI Index), GDP growth (LSM Index), Exchange Rate (ER), Discount Rate (DR), Imports, Exports, Private Sector Credit, PSX performance (KSE 100 Index), Oil prices, Money Supply (M2) and Infection Rate (Textile Sector), statistically are able to significantly explain the variation in the non – performing loans. Upon conducting detailed multi-variate regression analysis, it was deduced that regardless of underlying correlation of each macro - economic variable vis – a – vis non – performing loans, except for GDP Growth, PSX performance and Oil prices, all other variables are significant predictor of non – performing loans

Limitations

Given the time constraints and the limited scope of this study, different set variables (Macroeconomic) have been studied for their interdependence on non-performing loans. As assessed in the literature review part, defaulted portfolio is also dependent of bank specific variables, as a part of this study, such bank specific variables have been studied. Additionally, the direct impact of cyclicity of economic cycle has also not been accounted for as part of this study.

Recommendations

It is imperative for banks to be wary of impact of these macro-economic variables on their advances portfolio and with the issuance of recent directive by the State Bank of Pakistan regarding parallel implementation of reporting standard IFRS 9, which transitions Banks from the existing Incurred Loss model to Expected Loss model for booking of provisions; it is extremely crucial for banks to calculate client level probability of default in order to rationalize the additional provision.

Keywords

Non - Performing Loans, LSM, CPI, Exchange Rate, Default Rate, Probability of Default

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