UNIVERSITI TEKNOLOGI MARA

FACTORS INFLUENCING NON-PERFORMING LOANS FOR COMMERCIAL BANKS IN MALAYSIA

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ABSTRACT

The credit risk is the major risk that a bank may encounter in the lending channel and this risk can be assessed through non-performing loans of the banks. Poor credit risk management can affect the banking performance as it can diminish asset quality, raise loan losses and might harm commercial banks' profitability. The goal of this study is to look at the factors that influence non-performing loans for Malaysian commercial banks with a focus onmacroeconomic factors include the Exchange Rate, Interest Rate, and Gross Domestic Product. This study examines annual data from five Malaysian commercial banks selected over 18 yearsfrom 2003 to 2020. Overall, the findings of the study revealed that the exchange rate have negative and significant influence on non-performing loans and interest rate have positive and significant impact on non-performing loans. Nevertheless, GDP growth, unfortunately, showsan insignificant influence on non-performing loans with a positive correlation. Thus, this research is necessary because the findings may assist bank management in managing their lending policies and credit risk assessments to avoid a massive bad debt crisis in the banking sector.

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CHAPTER ONE: INTRODUCTION

1.1 INTRODUCTION

Commercial banks' duties in emerging countries will be better comprehended if the features of developing countries are fully established, as banks are the dominant sources of credit to the economy. The roles of the banking sector are undeniably critical for emerging countries (Dao & Nguyen, 2020). Commercial banks are responsible for accepting deposits and lending for consumption or investment objectives. Commercial banks currently provide a wide range of financial goods and services to the market, by prioritizing lending as the main source of revenue (Morina, 2020). Based on Bank Negara Malaysia (BNM) updated, 27 lists of commercial banks are available in Malaysia as of 2021.

The major risk that a bank may confront in the lending channel is the ex-post credit risk, which manifests itself in the form of non-performing loans (NPLs) (Hajja, 2020). Credit risk can be determined when an economic loss is incurred and this will affect the company's inability to satisfy its contractual obligations (Norlida et. al, 2015). According to Bhattarai (2016), non-performing loans have become a major concern among banking organizations andexperts since they might have an adverse impact on commercial banks' profitability.

International Monetary Fund (IMF) has stated that non-performing loan exits when the debtor has an outstanding balance for more than 90 days; or when the interest has been renegotiated, delayed, or promoted for more than 90 days; or when installments are less than 90 days past due but are never again forecasted (Klein, 2013). The non-performing loan (NPL) depicts how banks mitigate their credit risk by measuring the value of loan losses in relation tothe total loan amount. In this context, a surge in NPLs' in banks' loan portfolios depreciates thebanks' assets and capital. This may pose a larger threat to the banks' liquidity and profitability as well as can hamper the performance of the banking sector (Hajja, 2020).

Thus, this study was conducted to evaluate the factors that give a significant influence to the non-performing loans which may have a bad impact on the performance of commercial banks. In this paper, we solely focus on the factors influencing non-