FACTORS AFFECTING NON PERFORMING LOANS IN SELECTED SOUTH EAST ASIAN COUNTRIES

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ABSTRACT

Non-performing loans are loans that borrowers are no longer making payment on. Loans are considered as non-perform when borrowers has not make repayment over than 90 days from the date of agreement. Non-performing loans will be categorised as default and the loss will be absorbed by the banks. However, the loans will be categorised as re-performing if the borrowers start making payment after 90 days has passed. This is also might be one of risk that has to bear by the banks because once borrowers have stopped making payment, they will do it again after that. This paper will be focused on investigate the non-performing loans in selected South East Asian countries by testing the relationship of non-performing loans with factors such as unemployment rate, inflation rate, gross domestic product (GDP) and lending interest rate. Three countries from South East Asian region will be selected for this study which are Brunei Darussalam, Thailand and Indonesia. In addition, this study will chose 75 observations on quarterly basis for seven years period starting from 2010 to 2016. The sample data will be gathered from DataStream consists of three selected countries. Panel data regression analysis will be practised to analyse determinants of non-performing loans based on the secondary data gathered and E-views 9 software will be used in analysing the data. The expected findings for this study are unemployment rate, inflation rate and lending interest rate will have significant relationship with non-performing loans while gross domestic product has no significant relationship with non-performing loans.

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INTRODUCTION

1.1 Introduction

In finance, a loan is the lending of money from one individual, organization or entity to another individual, organization or entity which acts as a surplus unit. A loan is a debt provided by surplus units to deficit units at an interest rate, and evidenced by a promissory note with the principal amount of money borrowed, the interest rate charged and date of repayment. In a loan, the borrower initially receives or borrows an amount of money, called the principal, from the lender, and is obligated to pay back an equal amount of money to the lender in future.

Acting as a provider of loans is one of the principal tasks for financial institutions such as banks and credit card companies. For other institutions, issuing of debt contracts such as bonds is a typical source of funding. The leading activities may lead to gain profit or also can suffer loss. It is very important to the bank because once a loan is made, it is considered as an asset to the bank. This is because it is a compulsion to the borrower to repay to the bank along with interest. However, if the borrower stop paying back, the value of the asset will decrease because it will cause a loss to the bank. These are categorized as non-performing loans.

Many loans become non-performing after being in default for 90 days or depend on the contract term. According to International Monetary Fund (2005), a loan will be categorized as non-perform or bad when interest and principal are deferred exceeding 90 days or more. Once a loan is nonperforming, the odds that it will be repaid in full are considered to be substantially lower.

Other than that, if the non-performing loans reach three percent of its loan holdings, it means that the bank started to have a problem with their loan portfolio. It becomes increasingly dangerous when level of non-performing loans reach five percent up to ten percent especially when the capital reserves are at minimum level.

To avoid further losses, banks will start to bind or reduce the amount of provision for loan given to borrower as a precautionary measure to side-step from becomes bankrupt in future because of higher non-performing loans level. This will