



## IMPACT OF BANKING PERFORMANCE ON ECONOMIC GROWTH IN SRI LANKA

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### AUTHOR'S CONTRIBUTION

The sole author designed, analyzed, interpreted and prepared the manuscript.

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### ABSTRACT

The objective of this study is to analyze the impact of banking performance on economic growth in Sri Lanka. This study is conducted by using a panel data from 2010 to 2019 for 10 banks to examine the impact of banking performance on economic growth in Sri Lanka. The data was taken from selected banks annual reports. By using panel unit root test, found that at first difference variables are stationary. By using panel co-integration, shows that there is long run and short run co-integration among the variables. A stable banking sector is very important for the economic growth of a country. As policy implications, in order to stabilize economic growth and make the banking sector more resilient, policymakers and bank managers should aim to enhance total assets, return on assets among other things.

**Keywords:** Banking performance; banking sector; EGLS; economic growth; Sri Lanka.

### 1. INTRODUCTION

Economic growth is the increase in the aggregate production in an economy. The economic growth is measured by Gross Domestic Product. To increase this GDP value banking sector also playing a remarkable role. Various studies have looked at the relationship between a country's financial industry and its overall economic performance.

Ragonmal [1] found that the financial development has a positive and significant relationship (lagged by a two year period) with growth. Awdeh (2012); Hou and Cheng (2017) said that banking activity and economic performance are positively related. According to Salami (2018), the impact of interest rates on economic growth in Swaziland found a negative and significant relationship between the deposit interest rate and gross domestic product

(GDP). Cecchetti and Kharroubi [2] found a negative relationship between the rate of growth of the financial sector and the rate of growth of total factor productivity.

As this way, several studies have been undertaken on this issue, but each of these studies produced different results, raising several doubts about the banking sector's impact on economic development, for instance many studies indicated positive [1] and weak relationship. Whereas some shows negative [2] relationship between banking performances and economic growth. In Sri Lankan context also several studies have been done on banking sector. Kobika (2017) has also done a study to compare the financial performance of banking sector in Sri Lanka using six commercial banks using the CAMEL rating system. From all these studies it is clear that no any study has been done on the problem of impact of banking sector

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performance on economic growth using panel data in Sri Lanka.

Therefore, this study investigate the behavior of the banking sector in the development of the economy, keeping in mind the importance of doing such a study.

**2. OBJECTIVE**

The objective of this study is to analyze the impact of banking performance on economic growth in Sri Lanka.

**3. METHODOLOGY**

This study is conducted by using a panel data from 2010 to 2019 for 10 banks to examine the impact of banking performance on economic growth in Sri Lanka. The data was taken from selected banks annual reports. The panel analysis is carried out by using eviews 10 software. The following is the general equation for the relationship between banking performances and economic growth.

$$GDP_{i,t} = \beta_0 + \beta_1 OP_{i,t} + \beta_2 ROA_{i,t} + \beta_3 TA_{i,t} + \beta_4 IF_{i,t} + \beta_5 TO_{i,t} + u_{i,t} \tag{1}$$

Where, OP denoted Operational Profit, ROA denotes Return On Assets, TA denotes Total Assets, IF denotes inflation, TO denotes Trade Openness and GDP denotes Gross Domestic Product Growth Rate as a proxy for economic growth.

**3.1 Research Hypotheses**

H1: Banking sector performances has a positive impact on Economic Growth

Since this study has used panel estimated generalized least square method with panel unit root test, panel cointegration teat, and residual cross section dependence test to find the results on impact of banking performance indicators on economic growth.

**4. RESULTS**

Table 1 shows the results of the panel unit root test. The tests are LLC, IPS, ADF, PP, Hadri, Heteroscedasticity and Breitung. Each of these test have performed at level and first difference. At level many tests reject the null hypothesis but at first difference many tests accept null hypothesis. Therefore, we can say that at first difference all variables are stationary.

**Table 1. Unit root test**

	LLC	IPS	ADF-	PP-	Hadri	Heteroscedasti	Breitung
<b>At level</b>							
GDP	-3.01082 0.0013	0.99233 0.8395	8.31051 0.9896	5.42815 0.9995	5.37227 0*	5.37227 0*	-4.2048 0
TA	-7.4386 0	-0.76254 0.2229	31.5785 0.048	10.7673 0.952	3.79884 0.0001*	7.29038 0*	0.82963 0.7966
ROA	-2.94805 0.0016	0.50969 0.6949	15.6381 0.7388	35.6729 0.0168	6.3856 0*	15.1394 0*	0.88908 0.813
OP	-4.22848 0	0.21238 0.5841	22.5893 0.3094	22.0143 0.3397	8.15055 0*	16.3865 0*	1.26865 0.8977
TO	-2.40354 0.0081	-0.01784 0.4929	18.8453 0.5319	53.3449 0.0001	29.0102 0*	29.0102 0*	-2.72385 0.0032
IF	1.2321 0.891	1.19502 0.884	4.50168 0.9999	172.524 0	3.56786 0.0002*	3.56786 0.0002*	-1.3159 0.0941
<b>First diff</b>							
GDP	-13.319 0	-1.6447 0.05	49.4587 0.0003	121.969 0	32.7941 0*	32.7941 0*	-5.00395 0
TA	-9.86059 0	-0.57335 0.2832	32.825 0.0353	26.5896 0.1472	32.7888 0*	19.7265 0*	1.75366 0.9603
ROA	-25.0318 0	-2.03022 0.0212	41.7259 0.003	111.981 0	19.1442 0*	24.3283 0*	-1.73672 0.0412
OP	-2.75237 0.003	0.30878 0.6213	25.5941 0.1796	63.5268 0	32.7778 0*	22.9995 0*	0.5604 0.7124
TO	-2.51326 0.006	-1.7653 0.0388	51.3884 0.0001	184.207 0	32.7941 0*	32.7941 0*	-3.92777 0
IF	2.45075 0.9929	0.87542 0.8093	6.40438 0.9982	184.207 0	32.7941 0*	32.7941 0*	-0.44158 0.3294

\*Significant at 1% level, \*\*Significant at 5% level, \*\*\*Significant at 10% level

**Table 2. Co- integration test**

Test Statistics	Statistics	Prob.	Weighted	Prob.
Panel v-Statistic	-2.343235	0.9904	-3.135421	0.9991
Panel rho-Statistic	3.191152	0.9993	3.430574	0.9997
Panel PP-Statistic	-7.153329	0.0000*	-9.655706	0.0000*
Panel ADF-Statistic	-1.565498	0.0587***	-2.217541	0.0133**
Group rho-Statistic	4.682405	1.0000		
Group PP-Statistic	-12.48788	0.0000*		
Group ADF-Statistic	-2.132911	0.0165**		

\*Significant at 1% level, \*\*Significant at 5% level, \*\*\*Significant at 10% level

**Table 3. Cross sectional dependency test**

Test	Statistic	d.f.	Prob.
Breusch-Pagan LM	418.6961	45	0.0000*
Pesaran scaled LM	39.39103		0.0000*
Pesaran CD	20.41707		0.0000*

\*Significant at 1% level, \*\*Significant at 5% level, \*\*\*Significant at 10% level

**Table 4. Panel estimated generalized least square test**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
ROA	0.001273	0.000540	2.358493	0.0204**
OP	-1.52E-11	9.62E-12	-1.581259	0.1172
IF	0.287823	0.060650	4.745615	0.0000*
TA	3.97E-12	1.68E-12	2.361383	0.0203**
TO	0.475295	0.162708	2.921157	0.0044*
C	-20.71748	8.511527	-2.434050	0.0168

To investigate whether there is co-integration, Pedroni Residual Co-integration Test was used. The Table 2 shows, between dimensions and within dimensions outcomes of panel Co-integration test. This test conclude that there is co-integration among the variables because Panel PP-Statistic, Panel ADF-Statistic, Group PP-Statistic and Group ADF-Statistic are significant at 1%, 5% and 10% level of significance.

To investigate whether there is cross sectional dependency in the data residual cross sectional dependence test was conducted. According to Pesaran CD test, it shows that the probability value is 0.000 which reject the null hypothesis which is no cross section dependence (correlation) in residuals.

To overcome from this problem and to analyze the data panel estimated generalized least square method was conducted. It shows that return on assets, total assets, inflation and trade openness affect positively on economic growth in Sri Lanka.

## 5. DISCUSSION

Therefore, we can say that the objective of this study which is to analyze the impact of banking performance on economic growth in Sri Lanka is

satisfying since the banking sector performances namely return on assets, total assets, are positively impact on GDP which is the economic growth. The research objective which is the Banking sector performances has a positive impact on Economic Growth is also satisfying. Islam1 et al (2019) also found that Bank Size (BS) and Return on Equity (ROE) have positive impact on the Gross Domestic Product Growth Rate (GDPGR). Awdeh (2012); Hou and Cheng (2017) also found that Banking activity and economic performance are positively related. Therefore, these findings are also consisting with the results of this research.

## 6. CONCLUSION

Because one lesson learnt from the 2007-2009 financial crises is that banking sector performance and resilience are dependent on the macroeconomic environment, the bank sector performance and macroeconomic environment nexus analysis has lately returned in the economic and financial literature.

The present study is analyzing the impact of banking performance on economic growth in Sri Lanka. 10 banks were used for this study. By using panel unit root test, found that at first difference variables are stationary. By using panel co-integration, shows that

there is long run and short run co-integration among the variables. A stable banking sector is very important for the economic growth of a country. Since the banking performances are very important. By using panel estimated generalized least square test, shows that return on assets, total assets, trade openness and inflation positively and significantly affect the economic growth in Sri Lanka. Therefore, this study conclude that by increasing Return on Assets, Total Assets, Trade Openness and Inflation can enhance the economic growth in Sri Lanka.

As policy implications, in order to stabilize economic growth and make the banking sector more resilient, policymakers and bank managers should aim to enhance total assets, return on assets among other things.

### COMPETING INTERESTS

Author has declared that no competing interests exist.

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