DETERMINANTS OF NON-PERFORMING LOANS IN UGANDA'S COMMERCIAL BANKING INDUSTRY 2002:1 – 2017:2

BY

SUNDAY NATHAN

BSC. EDUC (MATHS & ECON) MUK

DISSERTATION SUBMITTED TO THE DIRECTORATE OF RESEARCH AND GRADUATE TRAINING IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A MASTER OF ARTS DEGREE IN ECONOMICS OF MAKERERE UNIVERSITY

December 2018

ABSTRACT

Over the past decade, non-performing loans in Uganda's commercial banking industry have continued to show a positive trend. The continued increase in NPLs has not only affected credit growth, but has also resulted in the collapse and closure of some commercial banks such as Crane Bank (in 2017), Global Trust Bank (in 2014). It's against this background, that the study examined the determinants of NPLs in Uganda's commercial banking industry.

The study used secondary data on quarterly basis for the period 2002 quarter one to 2017 quarter two. Data on bank-specific factors was obtained from bank of Uganda while that for macroeconomic factors was obtained from IMF and World Development Indicators (World Bank) Secondary data Empirical analysis was carried out on both bank specific and macroeconomic factors using bounds test and ARDL technique. The findings of the study suggest that non-performing loans increase with increase in lending rates, real effective exchange rate and unemployment rate. Whereas increase in returns on assets and GDP growth are associated with a decreasing effect on non-performing loans.

Based on the findings, the study recommends that commercial banks should consider the international competitiveness of the domestic economy before extending loans so as to minimize the effect of real exchange rate appreciation. Efforts to lower lending rates (for example, by reducing operating costs of the banks and increasing liquidity of the banks) are of paramount importance in this regard. Furthermore, there is need to promote GDP growth for example, by creating a conducive business atmosphere and promoting high productivity industries. There is also need to reduce unemployment rate by developing labour market information system and supporting labour intensive industries. Promoting stock markets would also enable banks diversify their portfolio and therefore spread their risk.

 Key words; Determinants, Non-performing loans, cointegration, ARDL.