



# **IMPACT OF MACRO ECONOMIC FACTORS ON BANKING SECTOR DEVELOPMENT IN SRI LANKA**

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## ABSTRACT

Bank acts a vital role in the economic development of the country. It is necessary to motivate people to deposit their surplus funds with the banks. Several macroeconomic variables such as Interest rates, exchange rates, inflation, gross domestic production and money supply are examined to reveal the actual factors explaining the behavior of the development of the banking sector in Sri Lanka. The impact of macroeconomic factors on banking sector development for a particular group of countries recently affected by adverse economic and financial conditions. And this condition is applied for the Sri Lankan banking sector. Further Sri Lankan banking sector is still in an underdeveloped condition. The, researcher aims to fill this research gap within previous studies regarding Banking sector development and macro-economic variables, since there were contradictory ideas within literature. Gross Domestic Product, interest rate, inflation, money supply and exchange rate used as independent variables and Return on Equity, Net Interest Margin and Capital Adequacy Ratio as dependent variables. The research objectives are to investigate the status and reason trends of macroeconomic environment in Sri Lanka, Investigate the status and reason trends of Banking sector Development in Sri Lanka, Investigate the Impact of macro-economic factors on banking sector Development. The data of the research Apply 132 months from 2006 to 2016 for gather secondary data via Central Bank reports. Descriptive analysis, correlation coefficients and multiple regression analysis were used to evaluate findings in research study through spss software. The research findings reveal that, banking sector development (ROE, NIM, and CAR) has significant impact with macro-economic variables. Moreover, banking sector development has significantly positive relationship with Gross Domestic Product, significantly negative relationship with interest rate, and the money supply insignificant positive relationship with exchange rate and insignificantly negative relationship with inflation. Further, future researchers can investigate banking sector development using sector profitability indices, 'All Share price Index, liquidity and the efficiency and select more macro-economic variables such as oil prices, unemployment rate, tax rates, and reverse repo rates.

Key words: *Banking sector development, Macro-economic variables, Return on Equity, Net Interest Margin, Capital Adequacy Ratio*