

**IMPACT OF MACROECONOMIC VARIABLES ON FINANCIAL
PERFORMANCE IN BANKING AND FINANCE INDUSTRY IN
SRI LANKA**



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ABSTRACT

The distinctive prominence of the banking and finance industry in the financial system of Sri Lankan economy has encouraged inquiring into the external determinants of financial performance of banking and finance industry. Thus, the objective of the study is to examine the impact of Macroeconomic variables on financial performance of banking and finance industry in Sri Lanka. In this study, panel data sets of Sri Lankan banking and finance industry were used to investigate the macroeconomic determinants of financial performance of banking and finance industry using the Random Effects model. Random effects model has selected by using the results of Hausman Test. For the purpose of this study, 195 observations of 39 banks and financial institutions over the period 2012 – 2016 were included. Return on Assets and Return on Equity were considered as proxies for financial performance. GDP growth rate, Inflation rate, Interest rate, Money Supply and Exchange rate are considered as macroeconomic variables.

The findings indicated that GDP growth rate, Inflation rate and Interest rate have a significant positive relationship with financial performance while Exchange rate has an insignificant relationship with financial performance. Money supply has a negative significant relationship with only ROA. The study findings also indicated that Interest rate is the only factor that determines ROA of banking and finance industry in Sri Lanka. However, financial performance of banking and finance industry do not appear to have a strong dependent on selected macroeconomic variables except interest rate. This recommends that banks and financial institutions should be aware of interest rate to enhance their financial performance. These findings hold practical implications for policy makers, bank managers, investors, depositors, regulators and government.

Keywords: financial performance, macroeconomic variables, return on equity, return on assets

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