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NONPERFORMING LOANS IN BANKING AND FINANCIAL SECTOR

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SUBMITTED TO THE FACULTY OF ECONOMICS AND ADMINISTRATION, UNIVERSITY OF MALAYA, IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE DEGREE OF MASTER OF ECONOMICS

OCTOBER 2000

ACKNOWLEDGEMENTS

I would like to express my sincere appreciation to my supervisor, Professor Dr. Lee Hock Lock, for his patience, intellectual guidance, invaluable advice, and constructive comments in the development and completion of this research paper. His constant encouragement that drove me through this research is very much appreciated.

I feel a deep sense of gratitude to all my friends who have helped me in more than one way. I wish to extend my heartfelt appreciation to them for their moral support, inspiration and companionship throughout my entire study.

Last but not least, I am deeply indebted to my parents and my siblings for their undying love, care, concern, understanding, and unwavering support throughout the duration of the course. Without them, I would not have made this far. This piece of work is especially dedicated to them.

ABSTRACT

It is crucially important to understand the connection between banking sector fragility and the nonperforming loans (NPLs) problem. The problem of mounting NPLs gained much prominence during the recession that hit particularly all countries over the world in 1980s. It is again become prominent following the financial crisis that recently hit the Asian countries.

This study examines various factors contributing to the NPL problem, where some endogenous as well as exogenous factors are identified. Poor management and poor lending policies, fraud and embezzlement, moral hazard incentives, heavy government intervention and weaknesses in prudential regulation and supervision are among the factors highlighted in this paper.

The consequences of NPLs have been identified at individual bank level and at banking system level. The NPLs are financial tapeworms: when they are greater than anticipated, they eat up capital. They reduced banks' profitability and finally caused banking sector distress.

Finding the right policies and strategies for dealing with the NPLs problem can be an arduous task. As the NPL problems in the emerging economies have multiple causes, there is therefore no single solution. However, a resolution of the NPLs problem requires effective institutions to drive bank restructuring efforts, an effective legal system for loan recovery and also the political will to make many tough decisions. Resolving NPLs problem is crucial to restore investors' confidence and help revive the economy onto a sustainable growth path.

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