IMPACT OF BANKING SECTOR FINANCIAL PERFORMANCE ON ECONOMIC GROWTH IN SRI LANKA

The main objective of this study is to find out the impact of banking sector financial performance on Sri Lankan economic growth. In order to achieve this objective, the ARDL test is applied to evaluate the long-term relationship between the variables and the error correction model is applied to analyze the short-term relationships between the variables. Further, in this research, the Granger causality test is used to examine the causality relationship between the variables. The GDP, return on equity, credit to the private sector, money supply, trade balance, and FDI are the variables used in this research. The analysis was carried out on secondary data for the period from 1998 to 2019 and the software E-views 10 and MS Excel were used to analyze the data. The ARDL Bound test results indicate that there is a co-integrating relationship between the variables. According to this test, the banking sector's financial performance impacts on the economic growth of Sri Lanka in the long run. Further, this test suggests that banking sector financial performance variables such as return on equity, trade balance, and credit to the private sector have a positive significant impact on economic growth in the long run. The error correction model found that banking sector financial performance has a positive and significant impact on economic growth in the short run. At the same time, the Granger causality test indicates that there is a uni-directional causation between the banking sector and the economic growth of Sri Lanka. According to these results, this research emphasizes that the return on equity by banks should be increased to drive economic growth in Sri Lanka. Additionally, policymakers should encourage a competitive market environment in order to improve the banking sector's financial performance in Sri Lanka.

Keywords: Banking sector, Return on equity, Economic growth, FDI

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