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## Working Paper Series<sup>1</sup>

# Determinants of Non-Performing Loans in a Multicurrency Environment: A Case of Zimbabwe

by

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<sup>1</sup> **Note:** The findings from this working paper does not in any way reflect the views of the Development Finance Centre (DEFIC). The views are only representative of the authors.





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# Determinants of Non-Performing Loans in a Multicurrency Environment: A Case of Zimbabwe

Collen Masunda, Joshua Abor and Nicholas Biekpe

## Abstract

Zimbabwe has been experiencing an unprecedented increase in Non-performing loans (NPLs), since the adoption of the multi-currency regime in 2009. The NPL ratio which stood at 15.92% as at 31 December 2013, has attracted much attention considering its impact on banking sector stability and its effect on the real sector. The banking sector has since reduced its risk appetite, adopting conservative lending strategies, in response to the scourge, in an environment where industry is in need of funding thus causing second round effects. There have been conflicting views in literature on factors influencing the rise in NPLs. Shareholders and bank management have placed the blame of the increase in NPLs on the macroeconomic environment, while regulatory authorities and policy makers have attributed the levels to corporate governance weaknesses. This study sets out to ascertain the factors that have been instrumental in driving the level of non-performing loans in Zimbabwe and the extent to which each of these factors has contributed to this trend. Using quarterly data on 21 banks from March 2009 to December 2013, the paper employs panel estimation techniques to examine the effect of both bank level and macroeconomic variables in explaining the variations in NPLs.

The findings indicate that all the macroeconomic factors were not statistically significantly related to the rising levels of NPLs. On the other hand, bank specific factors with the exception of loan tenure and lending rates, were found to be significantly related to the rise in NPLs. Lagged NPLs were found to be more influential implying that the country is blighted with credit indiscipline. Findings of this study, with the exception of size were found to be generally consistent with previous literature on determinants of NPLs. An interesting observation made was that bank size was found to be positively related to NPLs, contrary to literature, indicating that larger banks are not benefiting from diversification benefits. Based on the findings, the research recommends enhanced monitoring of banking institutions by the supervisory authority coupled with collaborative NPL resolution options. Banking institutions are encouraged to tighten their credit risk management systems and practices.

**Keywords:** Non-performing loans | Multicurrency | Banks | Zimbabwe |