Stressed Assets in Indian Banks - Do Monetary and Global Shocks Matter?

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ABSTRACT

What factors determine bank lending behaviour and subsequent loan repayments? This paper documents transmission effects of external sector shocks and foreign monetary policy on probability of loan defaults in Indian banks. The objective is to analyze shock transmission in build-up of stress in bank assets. Global shocks like movements in capital flows and asset prices impact bank risk either directly or indirectly, even while share of direct foreign ownership in India is low. Further, while transmission effects of domestic monetary policy are well understood, this paper extends to explore - lacking to date - spillover effects of U.S. monetary policy on portfolio of banks in India. This paper investigates these issues in a panel of balance sheet information of 46 scheduled commercial banks, capturing persistence effects in loan defaults. Findings reveal that degree of prudential regulation, leverage ratio and ownership of banks directly impact loan defaults, while size and liquidity of banks are not as effective. Higher capital adequacy ratios serve to smoothen bank's default risk exposure to external sector shocks. Banks exhibit a moral hazard tendency as higher leverage in banks reduces quality of loan advancement and subsequent repayments, although these results are mixed across bank groups. Default probabilities are also found to be ownership-specific, and more concentrated in public sector banks (PSBs). On the contrary, probability of non-repayment of loans does not depend on bank size or liquidity.

(This paper is a work in progress)

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