

MACRO STRESS TESTING AND RESILIENCE ASSESSMENT OF INDIAN BANKING

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Abstract

This study conducts policy-based macro stress testing of the Indian banking sector and also assesses its resilience towards compliance with BASEL norms with the aid of an empirical macro-financial model. It uses scenario analysis and quantitative techniques to capture the impact of macroeconomic stress on the stability of the Indian banks by evaluating financial soundness indicators (credit quality, quantity and quality of capital adequacy). The scenarios are generated through policy-based shocks vis-à-vis other external shocks. The results from the estimation of the model indicate a cointegrating relationship between credit quality and key macroeconomic variables including output growth rate, interest rate, money growth rate and exchange rate. The results of the scenario analysis reveal that the Indian banking sector remains largely sound in terms of total regulatory capital adequacy ratio as per current BASEL II and even BASEL III requirement. The results also show that expansionary monetary policy impacts credit quality and capital adequacy in a positive and significant manner via its effect on the economy's growth rate.

Keywords: Non-performing assets (NPA), Macro stress testing, Banking sector, Resilience assessment, Capital adequacy, Tier I capital, BASEL norms
JEL Classification Codes: C32, C58, E170, G21

1. Introduction

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