ABSTRACT

The focus of the study is the credit risk and business cycle relationship in banking sector in India. This is done by examining the relationship at the aggregate bank level and at individual bank level, taking a representative of one each from public sector and new private sector banks. The business cycle is measured as variations in output gap and the variables indicating procyclicality and credit riskiness of banks analyzed using ordinary least squares method to find the major influencing factors and the extent of lag effect. At bank specific level the two aspects of focus were the default levels, provisions rate and the flow of credit with respect to each bank. The extent of influence by various macroeconomic and bank related credit risk variables is established. The lag effect is also looked into and by comparing the regression analysis results of the two banks, it is evident that the variations are significantly different between the two banks. While SBI shows procyclicality behavior, ICICI tends to follow a income smoothening approach.

There is an increasing trend of defaults in both the banks and is affected by the output gap in the previous years. The lag effect of loans advanced in previous years on the provision differs for the two banks. Credit risk management by effective recovery mechanism is evident in the case of ICICI Bank.