

## **ABSTRACT**

Safeguarding economy and banking system from macroeconomic shocks has been the focus for supervisors and policymakers. It is important for regulators and banks to understand to what extent banks are affected by lending cycles given their level of capital and liquidity in order to maintain sound macroeconomic and financial stability. This paper investigates the issue of pro-cyclical nature of bank's supply of loans and advances using a dataset of Indian commercial banking sector over the period 2001-2015. By estimating random effect model we investigate whether capital and liquidity levels maintained by banks are significant determinants of loan supply and its pro-cyclical nature. Moreover this paper examines whether regulatory a change in terms of stricter capital standards and higher liquidity levels through compliance of Basel III norms reduces loan supply pro-cyclical nature. The estimated relations are studied across different ownership of banks of Indian banks to assess the impact of macroeconomic shocks. We find that supply of loans and advances .by banks are largely influenced by banks capital and liquidity, also banks appear to be more pro-cyclical with increasing capital and liquidity levels. Public banks and private banks continue to pursue pro-cyclical behavior however, foreign banks reveal mixed results.

Keywords: pro-cyclical, Basel III, capital, liquidity, lending cycle