

ABSTRACT:

Banking systems experience shocks from spurt in default risk or currency volatility. The soundness of Indian banks is tested in a vector autoregressive (VAR) framework. The test is conducted firstly on banks classified according to their ownership, as public, old private banks, new private and foreign banks, secondly on all scheduled commercial banks in India. The net non-performing asset (NNPA) to loans ratio measures the deterioration in asset quality. VAR model is implemented with nominal interest rate, exchange rate, inflation rate and output gap as endogenous variables to NNPA. The stress is induced through the impulse response function in the framework by giving an endogenous shock to the GDP output gap. We find that the net non-performing assets to loans ratio increase post the shock, but the increase is not significant. Banks in India as a whole maintain sufficient reserves to withstand that shock from an adversity in output performance. The public sector and old private sector banks are found to be relatively more robust than new private sector and foreign banks.