

Bank Lending, Risk Taking and the Transmission of Regulatory Policy: An Evidence from India

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Abstract

We study the transmission mechanism of macroprudential regulation through banks in India, using annual banks' balance sheet data for the period 1996–2014. The system generalised method of moments (GMMs) approach has been adopted due to the perceived endogeneity between some of the variables in our specified model while controlling for bank specific characteristics, industry and country characteristics. We obtain results which are consistent with the basic postulates of the risk-taking channel literature. The study finds a positive relationship between a minimum capital ratio and the net interest margin. The result suggests that a high minimum capital requirement would widen the spread between the lending and saving rates. The study further finds that banks excess capital above the minimum required drive credit growth in the banking sector in India. However, high excess capital increases risk-taking activities of the banks, as is found to be associated with high NPA ratios.

JEL classification: E5; E52; E59; G21

Keywords: Regulatory policy transmission; Bank lending channel; Risk taking channel

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