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RESERVE BANK OF INDIA

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**RBI Working Paper Series 3:
Anaemic External Situation, High Inflation and Dwindling
Asset Prices caused Asset Quality Problems for Indian Banks**

The Reserve Bank of India today placed on its website a Working Paper titled [“Re-emerging Stress in the Asset Quality of Indian Banks: Macro-Financial Linkages”](#) under the Reserve Bank of India Working Paper Series*. The paper has been authored by Shri Shashidhar M. Lokare.

In a bank-based economy, sound health of the banking system is an imperative for efficient financial intermediation in the context of overall development and financial stability. The Indian banking sector has witnessed significant transformation over time and although it weathered the worst consequences of the global financial turmoil, it had to traverse through a challenging macroeconomic environment during the post-crisis period. The asset quality of Indian banks has come under intense pressure and growing scrutiny in the recent times. Against this backdrop, this paper undertakes a critical and empirical analysis to understand the macro-financial linkages and the micro-level sources underlying the asset quality deterioration. This analysis has been carried out using disaggregated time series quarterly data from 2001 to 2013.

The paper finds evidence of pro-cyclicality in the Indian context as reflected in past credit boom-bust episodes as well as economic and interest rate cycles. According to the paper, anaemic external macroeconomic situation that prevailed post-crisis, high inflation and dwindling asset prices have eroded the debt servicing capacity of the borrowers and have also contributed to the asset quality problems. Sectoral analysis across bank groups demonstrates rising incidence of loan defaults in infrastructure, particularly power, retail, SSIs and agriculture. Going forward, there is a likelihood of asset quality coming under greater strain, given the weakening economic backdrop and global headwinds, having important bearing on the soundness of banks and macro financial stability.

**The Reserve Bank of India introduced the RBI Working Papers series in March 2011. These papers present research in progress of the staff members of the Reserve Bank and are disseminated to elicit comments and further debate. The views expressed in these papers are those of authors and not of the Reserve Bank of India. Comments and observations may kindly be forwarded to authors. Citation and use of such papers should take into account its provisional character.*