

Press Release

IIMA Misra Centre for FME undertook[[1]](#footnote-1) a study: The Implications of Economic Uncertainty for Bank Loan Portfolios

**October 20, 2020 | Ahmedabad:**

**SUMMARY:**

A recent study by researchers from the Misra Centre of Financial Markets and Economy at IIMA analyzed the impact of economic uncertainty on the composition of bank credit across the household and firm loans using bank-level data from 40 developed and developing countries.

The study finds that higher economic uncertainty is associated with an increase in the relative share of household credit in the loan portfolio of banks. This change in the composition of credit likely results from banks’ efforts to reduce the overall riskiness of their loan portfolios, since corporate loans are generally viewed as riskier than household loans. This shift towards household loans is more pronounced for weakly-capitalized banks, which may face greater risks during economic shocks, and for larger banks, which may be riskier due to complex business models and more market-based activities. The findings suggest that these changes in bank credit composition are likely to be supply-driven.

The observed shift in bank lending portfolios contributes to a better understanding of the impact of changes in the macroeconomic environment on financing outcomes at the micro-level. The findings have implications from a macroprudential policy and regulatory perspective. Banking regulations across the world, usually based on the Basel norms for capital adequacy, require banks to have adequate risk-weighted capital as a proportion of their total loans. The finding that banks with higher capital ratios alter their credit composition to a lower extent during high uncertainty strengthens the argument for the importance of capital regulations for sustaining credit flows to the corporate sector.

The research is particularly important in light of the ongoing Covid-19 pandemic which has triggered extremely high economic uncertainty across the world. Although conducted using a cross-country framework, the findings of the study have significance in the Indian context. An implication for India is that with a projected increase in the volume of stressed assets and risk aversion in the banking system during these times of economic uncertainty, timely recapitalization of banks would help in ensuring adequate credit flows to the corporate sector and facilitate India’s economic recovery.

The full report can be accessed from https://www.iima.ac.in/c/document\_library/EPU\_BankLoanPortfolios.pdf

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1. The research was conducted by Prof. Sanket Mohapatra (Faculty in the Economics) and Siddharth M. Purohit (PhD student in Finance & Accounting) at IIM Ahmedabad. [↑](#footnote-ref-1)