

ABSTRACT

Banks are interdependent because of payment systems and liquidity supports; at the same time, banks also compete with each other. Understanding the link between bank competition and stability is essential for the financial sector regulators. Literature does not have a consensus on the impact of competition on bank's liquidity and stability. The literature have discussed bank competition, liquidity and risk separately and the factors influencing these parameters in silos. However, in recent years, there have been a series of bank failures that were operating in an interconnected network caused by stiff competition and liquidity crises. Though competition has eased the lending rate and improved service quality, indiscriminate lending and cut-throat competition have increased the systemic risk of the banking system.

Despite significant reforms, many banks in India experienced loan defaults and increased stressed loans. Such defaults caused panic among depositors and raised concerns about stability of the banking system. The thesis, therefore, assessed the intensity of bank competition, level of bank liquidity and riskiness of the Indian banking system, identified their determinants and constructed competition, liquidity and risk networks to understand their interactions. The study analyses the interaction among bank competition, liquidity and risk networks through a Euclidean Distance, a Panel GMM VAR based Interactive Network Approach and machine learning models. The study also developed network indices and identified the bank-specific determinants of these network indices.

The empirical findings of the thesis advocates that while enhancing competition, the regulator should pay attention towards providing liquidity to the banking system without disturbing the solvency and stability of the banking system. Since a concentrated banking system threatens the financial stability, therefore, the banking system regulator should monitor the monopoly power of big-size banks and cautiously permit mergers and acquisitions in the banking system. The banking system regulator should maintain an appropriate balance between competition and stability while regulating the banking sector. The regulator should impose higher risk weight on loans to contain excessive loan creation during economic up-cycle. The regulator should ensure that through increasing higher-quality capital and liquidity provision, banks strengthen their resilience against adverse shocks due to fluctuations in the intensity of competition.

Keywords: Bank Competition, Bank Risk, Bank Liquidity, Economic Cycles, Interactive Network, Copula, LASSO VAR