

## Macroeconomic condition and banking industry performance in Indonesia

Mahjus Ekananda, author

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### Abstrak

The ratio of Non-Performing Loan (NPL) and Capital Adequacy Ratio (CAR) is still a measure of bank soundness in various countries including Indonesia. Interdependence across bank condition, diversity of the size, market structure within banking industry, and macroeconomic variables, may be very complex and dynamic. This paper utilizes the advantage of PVAR model on capturing this complexity to analyze the dynamic relationship between the macroeconomic variables and the soundness of the banks.

The result shows NPL of banks with small asset will increase rapidly when interest rate fluctuates. For banks with large asset, the increase in interest rates leads to a larger reduction on their CAR. On the other hand, the result shows banks with smaller capital are less able to adapt quickly to an increase in NPL due to exchange rate depreciation, therefore banks with smaller capital should be cautious about the exchange rate risk.