Accepted Manuscript

Title: Do Credit Commitments Compromise Credit Quality?

Authors: Laivi Laidroo, Kadri Männasoo

PII: S0275-5319(16)30461-5
DOI: http://dx.doi.org/doi:10.1016/j.ribaf.2017.04.010
Reference: RIBAF 626

To appear in: *Research in International Business and Finance*

Received date: 5-12-2016
Revised date: 18-12-2016
Accepted date: 4-4-2017

Do Credit Commitments Compromise Credit Quality?

Laivi Laidroo [a], Kadri Männasoo [b]

[a] *Tallinn University of Technology, Akadeemia tee 3, Tallinn 12618, Estonia.*
Phone: +372 620 4065, Fax: +372 620 4073, laivi.laidroo@ttu.ee , corresponding author
[b] *Tallinn University of Technology, Akadeemia tee 3, Tallinn 12618, Estonia.*
Phone: +372620 4051, Fax: +372 620 4073, kadri.mannasoo@ttu.ee

Highlights

- Credit Commitments predict deteriorating credit quality two years ahead
- Credit Commitments enable to capture credit over-supply effect
- The credit over-supply effect stems from the credit boom-bust context
- The economic impact of credit commitments on credit quality is sizable
- Surveillance of credit commitments improves recognition of credit risk accumulation

Abstract

This paper focuses on banks' risk-taking arising from potentially excessive growth of loans and off-balance sheet credit commitments. Credit quality is investigated both in macro and micro context, using a panel of 28 European countries over 2004-2014 and a panel of 478 European banks over 2004-2013. The dynamic panel data estimation results confirm that an increase in the ratio of credit commitments to total assets is a two year ahead warning indicator of growth in the ratio of non-performing loans and loan loss reserves. Simultaneous equation estimation exemplifies that the adverse effect of credit commitments on credit quality stems from the credit boom-bust context. As the economic impact of credit commitments to credit quality is significant compared to that of traditional credit quality determinants (real GDP growth and real growth in loans), the consideration of a credit commitments measure may improve timely recognition of credit risk accumulation episodes.

Keywords: banks; risk-taking; credit quality; credit growth; credit commitments
JEL classification: G21