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Cyclicality of SME lending and government involvement in banks*

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Abstract

Recent regulatory efforts aim at lowering the cyclicality of bank lending because of its potentially detrimental effects on financial stability and the real economy. We investigate the cyclicality of SME lending of local banks with versus without a public mandate, controlling for location, size, loan maturity, capitalization, funding structure, liquidity, profitability, and credit demand-side factors. The public mandate is set by local governments and stipulates a sustainable provision of financial services to local customers and a deviation from strict profit maximization. We find that banks with a public mandate are 25 percent less cyclical than other local banks. The result is credit supply-side driven and especially strong for public mandate banks with high liquidity and stable deposit funding. Our findings have implications for the bank structure, financial stability and the finance-growth nexus in a local context.

Keywords: Banks, Loan growth, SME finance, Business cycles, Financial stability

JEL classification: G21, O16, R11

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