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Author: Caroline Roulet

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Basel III: Effects of Capital and Liquidity regulations on European Bank Lending

Caroline Roulet.

My affiliation is the Organisation of Economic and Cooperation Development (OECD).

" Corresponding author. Tel.: +33 1 45 24 87 77. E-mail address: caroline.roulet@oecd.org.

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Highlights

- Capital ratios have significant, negative impacts on the lending growth of large European banks.
- A buffer stock of liquid assets allows European banks to maintain commercial loan volume amid pressures to shrink assets.
- Extensive market activities help large European banks holding buffer stocks of liquid assets to reduce retail loans.
- The ratio of stable funding to total assets is not significant in determining European bank-lending-growth.

Abstract

Using data on commercial banks in Europe, this paper analyses the impact of the new Basel III capital and liquidity regulation on bank lending following the 2008 financial crisis. On the whole, capital ratios have significant and negative impacts on large European bank-retail-and-other-lending-growth in a context of deleveraging and "credit crunch" in Europe over the post-2008 financial crisis period. Additionally, liquidity indicators have positive but perverse effects on bank-lending-growth, which supports the need to consider heterogeneous banks' characteristics and behaviours when implementing new regulatory policies.