

8th International Conference On Opportunities
and Challenges In **MANAGEMENT,**
ECONOMICS and **ACCOUNTING**



19-21 November 2021

Paris, France

The Effect of Higher Capital Requirements on Bank Lending: The Capital Surplus Matters

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Abstract

This paper studies the impact of capital requirements on growth in loans to the private sector for banks in the Czech Republic. The analysis draws on a unique supervisory panel dataset and examines the relationship both at the aggregate level and the bank-specific level. The empirical results indicate that higher capital requirements have a negative effect on loan growth for banks with lower capital surpluses. The results confirm the importance of the capital surplus in the transmission of increasing capital requirements. In addition, we find that the relationship between the capital surplus and loan growth is positive and significant also at times of stable capital requirements.

Keywords: Bank lending, capital requirements, capital surplus