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The Impact of Basel III Regulations on Bank Lending

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Abstract

This study examines the effects of Basel III regulatory reforms—particularly enhanced capital and liquidity requirements—on the loan growth of U.S. commercial banks over the period 2010–2023, with the aim of understanding how post-crisis regulation influences bank lending, financial stability, and economic growth. Using an unbalanced panel of 1,141 U.S. commercial banks, the analysis investigates whether bank capital and liquidity ratios affect lending activity, and whether the implementation of Basel III altered banks' loan growth behavior. Bank-level data are obtained from BankFocus, while macroeconomic indicators are sourced from the Federal Reserve Bank of St. Louis. The study employs difference-in-differences (DiD) and two-stage least squares (2SLS) methodologies to identify policy effects and address potential endogeneity in capital and liquidity measures. The results indicate that both capital and liquidity ratios are positively associated with loan growth, suggesting that regulatory measures and policy interventions aimed at strengthening bank balance sheets can support lending. However, the direct effect of Basel III implementation on loan growth is negative but statistically insignificant. Further, 2SLS results show that higher capital ratios significantly promote lending, whereas liquidity ratios exhibit a negative, though insignificant, relationship with loan growth, highlighting the complex role of liquidity regulation. The analysis also reveals that bank size, profitability, and interest rate conditions significantly shape these relationships, with larger and more profitable banks displaying weaker lending responses. These findings underscore the conditional effectiveness of regulatory policy and the importance of macroeconomic context in regulatory design.

Keywords: Basel III; Bank Lending; Capital Requirements; Liquidity Requirements