> Thursday, September 28th, 2023
14:00 – 16:00
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BASEL III JOINT REGULATORY CONSTRAINTS: INTERACTIONS AND IMPLICATIONS FOR THE FINANCING OF THE ECONOMY

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ABSTRACT

This paper examines the impact of multiple regulatory constraints on the financing of the economy in the context of Basel III regulation on capital and liquidity. We propose a simple theoretical model of bank lending decision to analyze interactions between these multiple regulatory requirements and the conditions under which some constraints bind while others do not. Building on the predictions of this model, we estimate the impact of these multiple regulatory requirements on lending growth, on a panel of 120 French banks since 2014. Our results indicate that two pairwise interactions have a significant effect on lending growth. We find a significant and partial level of substitutability between (i) the risk-based Tier 1 capital ratio and the leverage ratio as well as (ii) the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). We also note that the former interaction between the two liquidity ratios is even more pronounced in periods of financial stress.

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