Journal of Money, Credit and Banking / Volume 45, Issue 6 / pp. 1147-1164

SHORTER PAPERS, DISCUSSIONS, AND LETTER

Bank Capital: Lessons from the Financial Crisis

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First published: 15 August 2013

https://doi.org/10.1111/jmcb.12047

The views expressed in this paper are those of the authors, and should not be attributed to the World Bank, the International Monetary Fund, or the European Securities and Markets Authority. We thank Stijn Claessens, Martin Hellwig, Noel Sacasa, and seminar participants at Williams College, Chicago Federal Reserve Bank Structure Conference, and the IMF Institute for useful comments.

Abstract

Using a multicountry panel of banks, we study whether better capitalized banks experienced higher stock returns during the financial crisis. We differentiate among various types of capital ratios: the Basel risk-adjusted ratio, the leverage ratio, the Tier 1 and Tier 2 ratios, and the tangible equity ratio. We find several results: (i) before the crisis, differences in capital did not have much impact on stock returns; (ii) during the crisis, a stronger capital position was associated with better stock market performance, most markedly for larger banks; (iii) the relationship between stock returns and capital is stronger when capital is measured by the leverage ratio rather than the risk-adjusted capital ratio; (iv) higher quality forms of capital, such as Tier 1 capital and tangible common equity, were more relevant.

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