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A macroprudential approach to address liquidity risk with the loan-to-deposit ratio

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Abstract

This paper maps the empirical features of the loan-to-deposit (LTD) ratio with an eye on using it in macroprudential policy to mitigate liquidity risk. We examine the LTD trends and cycles of 11 euro area countries by filtering methods and analyse the interaction between loans and deposits. We propose macroprudential policy to prevent an unsustainable level of the LTD ratio and policy measures to counter destabilizing cyclical developments.

Keywords:

financial stability | banks | liquidity | regulation

JEL Codes:

C15 | E44 | G21 | G32 | G28

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Notes

1. This outcome is based on F-tests for seasonality (X-12 seasonality adjustment method) and simple regression analysis with end-year dummies.

2. Adjustments for sales and securitization are not available for loans to non-financial companies and households in our time sample. The ECB Statistical Data Warehouse publishes growth rates of total loans to non-financial institutions excluding governments, adjusted for sales and securitization. We apply this correction factor (based on growth rates) to loans of companies and households.

3. The deposit ratio is defined as deposit holdings at banks over total financial assets (source: ECB).

4. For more details we refer to Love and Zicchino (2006), whose Stata code we gratefully used for the estimation.

5. The relative strength of the response of loans to a shock in deposits is underlined by simulations which include loans as the first variable in the panel VAR. Then the interaction effect running from deposits to loans remains significant, which is not the case anymore for the response of deposits to a shock in loans.