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# The effects of capital on bank lending in large EU banks – the role of procyclicality, income smoothing, regulations and supervision.

This paper aims to find out what the impact is of bank capital ratios on loan supply in the EU and what factors explain the potential diversity of this impact. Applying the Blundell and Bond (1998) two step GMM estimator, we show that, in the EU context, the role of capital ratio for loan growth is stronger than previous literature has found for other countries. Our study sheds some light on whether procyclicality of loan loss provisions and income smoothing with loan loss provisions contribute to procyclical impact of capital ratio on loan growth. We document that loan growth of banks that have more procyclical loan loss provisions and that engage less in income smoothing is more sensitive to capital ratios. This sensitivity is slightly increased in this sample of banks during contractions. Moreover, more restrictive regulations and more stringent official supervision reduce the magnitude of the effect of capital ratio on bank lending. Taken together, our results suggest that capital ratios are an important determinant of lending in large EU banks.