What Drives the Time-Series and Cross-Sectional Variations in Bank Capital Ratios

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This paper documents the time-series and cross-sectional variations in bank capital ratios and investigates their underlying driving forces by using listed Japanese commercial banks data from 1977 to 2009.　This paper presents an overall framework to analyze time-series and cross-sectional variations in bank capital ratios. In particular, the present-value model allows us to decompose the changes in capital ratios into three components: the variations in expected future discount rates, expected future profitability and expected leverage ratios.　We further employ the variance decomposition approach to show quantitatively how much these factors have contributed to the variation in bank capital ratios.　We find that the expected future discount rates dominate the time-series variation in bank capital ratios, while the expected future profitability has played an almost equally important role as the expected discount rates in the cross-sectional variation.