Capital Requirements, Bank Behavior and Fair Value Accounting: Evidence from Japanese Commercial Banks

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Abstract

Using data from Japanese commercial banks during 2002-2012, we explore the relationship between banks' choice of capital buffers and prevailing macroeconomic conditions. We find a positive relationship between capital buffers and the phase of the business cycle, and further find that this positive relationship was weakened after the implementation of Basel II. We also examine whether the gap between desired and actual capital buffers, as well as the phase within the business cycle, affected banks' balance sheet management behavior and lending activities. We find that during periods of economic upturn, banks increased capital more than they increased lending. These results are consistent with the countercyclical capital management behavior exhibited by commercial banks. Moreover, we find that banks which adopting fair value accounting (FVA) intend to behave more counter cyclically in their capital management practice as compared to domestic banks.

JEL classification: G21; G28

Keywords: Capital buffers; Bank regulation; Procyclicality; Fair Value Accounting