

# DISCUSSION PAPER SERIES

DP11934  
(v. 2)

## **BANK CAPITAL REDUX: SOLVENCY, LIQUIDITY, AND CRISIS**

Alan M. Taylor, Òscar Jordà, Björn Richter and  
Moritz Schularick

**ECONOMIC HISTORY**

**FINANCIAL ECONOMICS**

**MONETARY ECONOMICS AND FLUCTUATIONS**



# **BANK CAPITAL REDUX: SOLVENCY, LIQUIDITY, AND CRISIS**

*Alan M. Taylor, Òscar Jordà, Björn Richter and Moritz Schularick*

Discussion Paper DP11934  
First Published 23 March 2017  
This Revision 15 July 2020

Centre for Economic Policy Research  
33 Great Sutton Street, London EC1V 0DX, UK  
Tel: +44 (0)20 7183 8801  
[www.cepr.org](http://www.cepr.org)

This Discussion Paper is issued under the auspices of the Centre's research programmes:

- Economic History
- Financial Economics
- Monetary Economics and Fluctuations

Any opinions expressed here are those of the author(s) and not those of the Centre for Economic Policy Research. Research disseminated by CEPR may include views on policy, but the Centre itself takes no institutional policy positions.

The Centre for Economic Policy Research was established in 1983 as an educational charity, to promote independent analysis and public discussion of open economies and the relations among them. It is pluralist and non-partisan, bringing economic research to bear on the analysis of medium- and long-run policy questions.

These Discussion Papers often represent preliminary or incomplete work, circulated to encourage discussion and comment. Citation and use of such a paper should take account of its provisional character.

Copyright: Alan M. Taylor, Òscar Jordà, Björn Richter and Moritz Schularick

# BANK CAPITAL REDUX: SOLVENCY, LIQUIDITY, AND CRISIS

## Abstract

What is the relationship between bank capital, the risk of a financial crisis, and its severity? This paper introduces the first comprehensive analysis of the long-run evolution of the capital structure of modern banking using newly constructed data for banks' balance sheets in 17 countries since 1870. In addition to establishing stylized facts on the changing funding mix of banks, we study the nexus between capital structure and financial instability. We find no association between higher capital and lower risk of banking crisis. However, economies with better capitalized banking systems recover faster from financial crises as credit begins to flow back more readily.

JEL Classification: E44, G01, G21, N20

Keywords: financial crises, Risk Taking, crisis prediction, local projections, bank liabilities, capital ratio, macroprudential regulation

Alan M. Taylor - amtaylor@ucdavis.edu  
*University of California, Davis and CEPR*

Òscar Jordà - ojorda@ucdavis.edu  
*Federal Reserve Bank of San Francisco*

Björn Richter - brichter@uni-bonn.de  
*University of Bonn*

Moritz Schularick - moritz.schularick@uni-bonn.de  
*University of Bonn and CEPR*

## Acknowledgements

This work is part of a larger project kindly supported by research grants from the Bundesministerium für Bildung und Forschung (BMBF) and the Institute for New Economic Thinking. Schularick acknowledges support from the Deutsche Forschungsgemeinschaft (DFG) under Germany's Excellence Strategy – EXC 2126/1 – 39083886, as well as a Fellowship from the Initiative on Global Markets at the University of Chicago. We are indebted to a large number of researchers who helped with data on individual countries. Matthew Baron and Malik Mazbouri kindly shared data with us. We are particularly thankful to Joao Azevedo and Marco Wyszietzki for outstanding research assistance. We benefited from helpful comments by conference and workshop participants attending the 2017 CESifo Area Conference on Macro, Money, and International Finance, the 5th Empirical Macroeconomics Workshop at Ghent University, the Fifth CEPR Economic History Symposium, the 6th Workshop in Financial Economics at the University of Bonn, the ECB, the NBER DAE Program Meeting, the EHA 2017 Annual Meeting, the IDB/Banco Central de Chile 2019 Workshop, and seminar participants at Bank of Finland, Bocconi University, Imperial College, SAFE Frankfurt, and UC Davis. All errors are our own. The views expressed herein are solely the responsibility of the authors and should not be interpreted as reflecting the views of the Federal Reserve Bank of New York or San Francisco or the Board of Governors of the Federal Reserve System.

# Bank Capital Redux: Solvency, Liquidity, and Crisis<sup>\*</sup>

Òscar Jordà<sup>†</sup> Björn Richter<sup>‡</sup> Moritz Schularick<sup>§</sup> Alan M. Taylor<sup>¶</sup>

July 2020

## Abstract

What is the relationship between bank capital, the risk of a financial crisis, and its severity? This paper introduces the first comprehensive analysis of the long-run evolution of the capital structure of modern banking using newly constructed data for banks' balance sheets in 17 countries since 1870. In addition to establishing stylized facts on the changing funding mix of banks, we study the nexus between capital structure and financial instability. We find no association between higher capital and lower risk of banking crisis. However, economies with better capitalized banking systems recover faster from financial crises as credit begins to flow back more readily.

*Keywords:* financial crises, risk taking, crisis prediction, local projections, bank liabilities, capital ratio, macroprudential regulation.

*JEL classification codes:* E44, G01, G21, N20.

---

<sup>\*</sup>This work is part of a larger project kindly supported by research grants from the Bundesministerium für Bildung und Forschung (BMBF) and the Institute for New Economic Thinking. Schularick acknowledges support from the Deutsche Forschungsgemeinschaft (DFG) under Germany's Excellence Strategy – EXC 2126/1– 39083886, as well as a Fellowship from the Initiative on Global Markets at the University of Chicago. We are indebted to a large number of researchers who helped with data on individual countries. Matthew Baron and Malik Mazbouri kindly shared data with us. We are particularly thankful to João Azevedo and Marco Wysietzki for outstanding research assistance. We benefited from helpful comments by conference and workshop participants attending the 2017 CESifo Area Conference on Macro, Money, and International Finance, the 5th Empirical Macroeconomics Workshop at Ghent University, the Fifth CEPR Economic History Symposium, the 6th Workshop in Financial Economics at the University of Bonn, the ECB, the NBER DAE Program Meeting, the EHA 2017 Annual Meeting, the IDB/Banco Central de Chile 2019 Workshop, and seminar participants at Bank of Finland, Bocconi University, Imperial College, SAFE Frankfurt, and UC Davis. All errors are our own. The views expressed herein are solely the responsibility of the authors and should not be interpreted as reflecting the views of the Federal Reserve Bank of New York or San Francisco or the Board of Governors of the Federal Reserve System.

<sup>†</sup>Federal Reserve Bank of San Francisco; and Department of Economics, University of California, Davis ([oscar.jorda@sf.frb.org](mailto:oscar.jorda@sf.frb.org); [ojorda@ucdavis.edu](mailto:ojorda@ucdavis.edu)).

<sup>‡</sup>Department of Economics and Business, Universitat Pompeu Fabra; and Barcelona Graduate School of Economics ([bjorn.richter@upf.edu](mailto:bjorn.richter@upf.edu)).

<sup>§</sup>Department of Economics, University of Bonn; and CEPR ([schularick@uni-bonn.de](mailto:schularick@uni-bonn.de)).

<sup>¶</sup>Department of Economics and Graduate School of Management, University of California, Davis; NBER; and CEPR ([amtaylor@ucdavis.edu](mailto:amtaylor@ucdavis.edu)).



## 1. INTRODUCTION

Systemic banking crises are a recurring phenomenon in modern economic history. Recent macro-finance research points to a general pattern where buoyant conditions in credit markets, measured by increases in the quantity of credit (Jordà, Schularick, and Taylor, 2013; Mian, Sufi, and Verner, 2017; Schularick and Taylor, 2012), or by low expected returns on credit assets (Krishnamurthy and Muir, 2016), presage banking crises and severe downturns. A key question for macroprudential regulators is whether higher capital ratios are associated with lower crisis risks, or at least will alleviate their economic fallout. Their instinct is to increase the loss-absorption capacity of banks, at least in recent years. However as we will show, financial crises have overwhelmed even the highest of defenses.

Bankers have an incentive to take excessive risks if the payouts from their bets are asymmetric and creditors do not monitor banks closely (Merton, 1977). A remedy might be to increase equity capital: more *skin in the game* should induce more prudent behavior and thereby reduce the probability that financial institutions will face large losses that put their existence at risk (Holmstrom and Tirole, 1997; Mehran and Thakor, 2011). But this view has not gone unchallenged. Rajan (2018) raised fundamental doubts whether equity governance is able to discipline banks *ex ante*. The regulatory response to the global financial crisis has, by and large, embraced higher capital buffers and regulation of bank leverage. This is not the first time that capital ratios have been raised in response to a systemic banking crisis, as Grossman (2010) reports. But despite all regulatory efforts, crises have not gone away.

A competing explanation for why financial crises happen starts from the observation that when credit booms are underway, neither financial markets nor the bankers themselves are necessarily aware that the risks on the balance sheets are rising. Recent research by Baron and Xiong (2017), Fahlenbrach et al. (2017), as well as Cheng et al. (2014) documents evidence of overoptimism by insiders and market-wide neglect of crash risk during credit booms. These findings mesh well with the older insights of Kindleberger (1978), Minsky (1977, 1986), and Shiller (2000) where, time and again, financial markets have become overly exuberant only to be disappointed later. They also echo the ideas proposed in recent theoretical work by Bordalo et al. (2018), Simsek (2013), as well as Greenwood et al. (2018). In line with the empirical evidence on overoptimism and neglected crash risk, in these models excessive credit booms are the product of behavioral biases—such as extrapolative belief formation—and not due to incentive problems of rational agents. In this context, higher capital will do little to moderate such overoptimism during the buildup of risks, although it may still act as a buffer for losses once optimism wanes.

How then is capital structure related to banking crisis risk and severity? Ultimately this is

an empirical question, and we answer it by turning to 150 years of modern financial history across 17 advanced economies. Our paper belongs to a growing literature in macrofinance that relies on long-run and cross-country perspectives to produce new knowledge about rare crisis events and the role of financial factors in the business cycle (Jordà, Schularick, and Taylor, 2013; Krishnamurthy and Muir, 2016; Reinhart and Rogoff, 2009; Romer and Romer, 2017; Schularick and Taylor, 2012).

The backbone of our study is a newly constructed aggregate data set for the advanced economies over the 1870–2015 period which covers three core categories of the funding mix of financial intermediaries: capital, deposits, and other (non-deposit) debt instruments. The new panel data complement prior work on the asset side of banking systems, and bank credit in particular (see Jordà et al., 2017). Looking ahead, we expect that the new data we release here will become an important resource for future research, over and above their contribution to this study.

We make three main contributions, corresponding to three parts of the paper. First, we establish new stylized facts on the long-run evolution of the capital structure of banking systems in advanced economies. Importantly, we correct the widely held view that capital ratios decreased substantially in the decades preceding the 2007–08 crisis. On the contrary, even unweighted (i.e., not risk-adjusted) capital ratios have remained remarkably stable over the entire post-WW2 period. Capital-to-asset ratios fell from around 30% in the late 19th century to about 5%–10% in 1950 (see Figure 1 below). Since then they have remained in a tight range across all the countries in our sample.

Such stability in capital ratios is quite striking compared to the “hockey stick pattern” seen in many other financial variables in advanced economies, such as aggregate balance sheets and mortgage lending (Jordà, Schularick, and Taylor, 2017). Instead, the most notable long-run change in banks’ funding structures occurred in the composition of debt liabilities. For example, in 1950, bank debt funding consisted almost entirely of deposits. The share of non-deposit debt liabilities increased rapidly starting in the 1970s. On the eve of the 2007–08 crisis, the deposit share of debt funding had shrunk to 50% of total debt liabilities. In short, the important development in the capital structure of banks was not a decline in equity capital, but rather the banks’ increasing reliance on non-deposit and potentially “runnable” debt funding.

In the second part of the paper, we study the relationship between the capital structure of banks and *systemic* banking crises. We establish stylized correlations by comparing the predictive ability of capital ratios, as a measure of “skin in the game”, to that of credit expansions and the two liquidity measures: the loans-to-deposits ratio and the share of non-deposit liabilities to debt. In line with the recent literature, we identify systemic

banking crises narratively as periods when significant parts of the banking system fail or have to be rescued by government intervention (Jordà, Schularick, and Taylor, 2017; Laeven and Valencia, 2012; Schularick and Taylor, 2012). Our results are robust to other chronologies, as we will show.

We find scant evidence that bank capital ratios are predictive of systemic banking crises *ex ante*. This is true whether we focus on the long-term variation in the levels of capital ratios, or whether we focus on short-term variation by looking at 5-year changes in capitalization. Lower capital ratios do not predict elevated crisis probabilities in either our full sample, or focusing on the post-WW2 period. This is true even after controlling for a wide range of macroeconomic indicators as well as indicators of asset risk and the equity market's perception of bank riskiness. The substantial variation of capital in our data allows us to show that, historically, banking systems have been overwhelmed by financial crises even with the highest of capital buffers.

We also show that bank capital, when viewed as a proxy of the “skin in the game” hypothesis, does not predict future bank stock returns. Instead, quantity-based measures—credit expansions in particular—perform much better, in line with the results on overoptimism during the boom in Baron and Xiong (2017).

In the third and last part of the paper, we examine the shock absorbing role of bank equity. We ask how bank capital affects the intensity of banking crises and their economic costs *ex post*. Seminal contributions on banking distress in the Great Depression (Bernanke, 1983), the role of financial intermediary health in Japan's 1990s downturn and the Great Recession (Jordà, Schularick, and Taylor, 2013; Khwaja and Mian, 2008; Peek and Rosengren, 2000), and recent work in macro-finance (Adrian, Mönch, and Shin, 2014; Brunnermeier and Sannikov, 2014; Geanakoplos, 2010; He and Krishnamurthy, 2013; Kiyotaki and Moore, 1997; Muir, 2017) all emphasize that financial intermediary balance sheets and leverage drive macroeconomic dynamics and asset prices. If intermediary health plays such an important role for economic outcomes, it is natural to suspect that equity capital likely affects post-crisis economic outcomes.

This is precisely what we find: bank capital limits the economic fallout of financial crises. A more weakly capitalized financial sector going into the crisis is associated with a deeper recession and a slower recovery. The differences in social costs are economically sizable. We also find that in better capitalized banking systems, credit grows much faster in the recovery, a potential channel that might explain this difference in outcomes.

Overall, the central finding is that our current regulatory system is built on an indicator that is unrelated to the incidence of systemic banking crises across modern economic history. Our results on the predictability of crises and returns do not prove, but are consistent with



the view that the causes of financial crises are rooted in collective failures to understand and adequately price risks. In this view, crises occur when overly exuberant expectations are adjusted and the prices of leveraged assets fall rapidly, thus putting lenders' solvency in doubt (Baron and Xiong, 2017; Bordalo, Gennaioli, and Shleifer, 2018; Krishnamurthy and Muir, 2016).<sup>1</sup> This view also implies that capital requirements have little bite during the buildup of risks in a boom.

Once the crisis materializes, capital buffers play a role in limiting damage to the economy; but substantial losses are baked in, and this is only partial mitigation. The case for bank capital regulation is intact. At the same time, these findings caution against being lulled into a false sense of security by rising capital ratios. Higher capital ratios are no shortcut to evaluate and achieve financial stability. Instead, reducing crisis risk may depend on quite different actions, e.g. targeting credit growth and maturity mismatch more directly.<sup>2</sup>

## 2. NEW DATA

The new dataset introduced here includes balance sheet liabilities of financial institutions on an annual basis from 1870 to 2015 for 17 advanced economies. Moreover, we disaggregate bank liabilities into capital, deposits, and other (non-core) liabilities. Schularick and Taylor (2012), and the updates in Jordà et al. (2017), focused on the asset side of bank balance sheets (and on macroeconomic aggregates). The new data cover the liability side of the bank balance sheets, thus completing the picture.

Table 1 describes the coverage of the new data. Except for a few countries, we were able to locate data for the entire period. The data come from a variety of sources, such as journal articles, central bank publications, historical yearbooks from statistical offices, as well as archived annual reports from individual banks. In most cases there is no source that covers the entire sample period and hence we had to link various sources to construct a continuous time series.

We take *book values* from banking sector balance sheets and we aggregate the capital structure into three broad categories: capital, deposits, and other debt liabilities. Table 2 displays, in simplified form, the typical structure of aggregate banking-sector balance sheets, displaying data for 1929 and 2007 for the United States as an example. The table already reveals a big change in the funding mix of banks over time, as we will show: non-core liabilities have become a much more important source of funding, rising here from under

---

<sup>1</sup>Baron and Xiong (2017) show that higher crash risk of bank equity during a credit boom is not adequately priced. Krishnamurthy and Muir (2016) find that credit spreads are too low prior to financial crises. Bordalo et al. (2018) show that these empirical findings are consistent with extrapolative expectations, where agents over-weigh incoming information when building expectations about the future.

<sup>2</sup>A similar concern has recently been voiced by Sarin and Summers (2016).

**Table 1:** Coverage of the new bank liabilities dataset

	Total	Capital	Deposits	Other (non-core)
Australia	1870–1945	1870–1945	1870–1945	1870–1945
	1950–2015	1951–2015	1950–2015	1951–2015
Belgium	1920–2015	1920–2015	1920–2015	1920–2015
Canada	1870–2015	1870–2015	1870–2015	1870–2015
Denmark	1870–2015	1870–2015	1870–2015	1870–2015
Finland	1873–2015	1873–2015	1873–2015	1873–2015
France	1890–2015	1890–2015	1946–2015	1946–2015
Germany	1870–1920	1870–1920	1870–1920	1870–1920
	1924–1940	1924–1940	1924–1940	1924–1940
	1950–2015	1950–2015	1950–2015	1950–2015
Great Britain	1880–2015	1880–2015	1880–2015	1946–2015
Italy	1870–2015	1870–2015	1870–2015	1870–2015
Japan	1893–2015	1893–2015	1893–2015	1893–2015
Netherlands	1900–2015	1900–2015	1900–2015	1900–2015
Norway	1870–2015	1870–2015	1870–2015	1870–2015
Portugal	1920–2015	1920–2015	1920–2015	1920–2015
Spain	1874–1935	1874–1935	1874–1935	1874–1935
	1942–2015	1942–2015	1942–2015	1942–2015
Sweden	1870–2015	1870–2015	1871–2015	1871–2015
Switzerland	1870–2015	1870–2015	1870–2015	1870–2015
United States	1870–2015	1870–2015	1870–2015	1870–2015

one-tenth to almost one-third of liabilities even as capital has remained largely unchanged.

## 2.1. Capital

Bank *capital* corresponds to the Basel III definition of Common Equity Tier 1 capital, i.e., shareholders' funds that allow banks to absorb losses on an ongoing basis. These are normally common stock (paid-up capital), reserves, and retained earnings.<sup>3</sup> Dividing the resulting measure of capital by total assets yields an unweighted capital ratio akin to the "leverage ratio" in Basel III (Basel Committee on Banking Supervision, 2014). Our definition of total assets differs from the definition of total exposure used in the Basel III framework as we observe only balance sheet data on total assets without being able to adjust assets for

<sup>3</sup>As defined in Basel III (Basel Committee on Banking Supervision, 2011, paragraph 52), Common Equity Tier 1 capital consists of the sum of the following elements: (1) common shares issued by the bank that meet the criteria for classification as common shares for regulatory purposes (or the equivalent for non-joint stock companies); (2) stock surplus (share premium) resulting from the issue of instruments included in Common Equity Tier 1; (3) retained earnings; and (4) accumulated other comprehensive income and other disclosed reserves. Additionally, the Basel definition includes "common shares issued by consolidated subsidiaries of the bank and held by third parties (i.e., minority interest) that meet the criteria for inclusion in Common Equity Tier 1 capital" and "regulatory adjustments applied in the calculation of Common Equity Tier 1."

**Table 2:** *Snapshots of a banking system balance sheet: United States in 1929 and 2007*

(a) End of year 1929			
Cash/liquid	17 %	Deposits	79 %
Loans	56 %	Non-core	9 %
Securities	22 %		
Other	5 %	Capital	11 %
Total assets	100 %	Total liabilities and capital	100 %
(b) End of year 2007			
Cash/liquid	4 %	Deposits	65 %
Loans	59 %	Non-core	27 %
Securities	14 %		
Other	22 %	Capital	8 %
Total assets	100 %	Total liabilities and capital	100 %

Sources: Federal Deposit Insurance Corporation (2007), chain linked with Historical Statistics of the United States (1929).

off-balance sheet exposures.<sup>4</sup>

Paid-up capital, retained earnings, and reserves have been reported in almost all cases throughout the entire period. We chose this specific definition of a capital ratio, as other measures based on risk-weighted assets are often prone to changes in the underlying assessment of risk attributed to certain asset classes and suffer from various problems discussed in [Admati et al. \(2013\)](#). Furthermore, in contrast to capital measures based on current market values, such as market capitalization, our book value measure is not affected by short-term fluctuations in asset prices. We will, however, verify our results later with market measures of bank capital as a robustness check.

## 2.2. Deposits and debt instruments

We include in *deposits* both term and sight deposits, and both checking and savings accounts by residents. Whenever possible we exclude interbank deposits and deposits by foreigners, as we aim to calculate total domestic deposits by non-financial resident entities. Yet in some instances this was not possible as different types of deposits were not reported separately. Interbank deposits as well as wholesale funding through interbank loans are included in the third category, *other liabilities*. Balance sheet items picked up by this category have changed over the course of time, but they mainly consist of bonds, repos, and interbank

<sup>4</sup>Basel Committee on Banking Supervision (2011) outlines how to adjust total assets in order to arrive at the total exposure measure.

loans. By convention, we will also refer to other liabilities as *non-core liabilities*.

### 2.3. Balance sheet ratios

Several key balance-sheet ratios of financial intermediaries are central to the analysis, starting with the *capital ratio* defined like today's Basel III "leverage ratio," that is, the ratio of capital over total assets given by

$$\text{Capital ratio} = \frac{\text{Capital}}{\text{Total assets}}. \quad (1)$$

Next we compute the ratio of *loans to deposits*, which is often considered a measure of banking sector illiquidity or vulnerability (Cecchetti, King, and Yetman, 2011). This ratio is defined as

$$\text{LtD ratio} = \frac{\text{Loans}}{\text{Deposits}}. \quad (2)$$

Finally, we compute the share of other liabilities in total debt liabilities (excluding capital). In order to avoid confusion, we will refer to this measure as the *non-core ratio*, defined as

$$\text{Non-core ratio} = \frac{\text{Other liabilities}}{\text{Deposits} + \text{Other liabilities}}. \quad (3)$$

The non-core ratio has taken on renewed significance since 2007. Recent studies have argued that large inflows of non-core funds can destabilize the banking system (Hahm, Shin, and Shin, 2013).

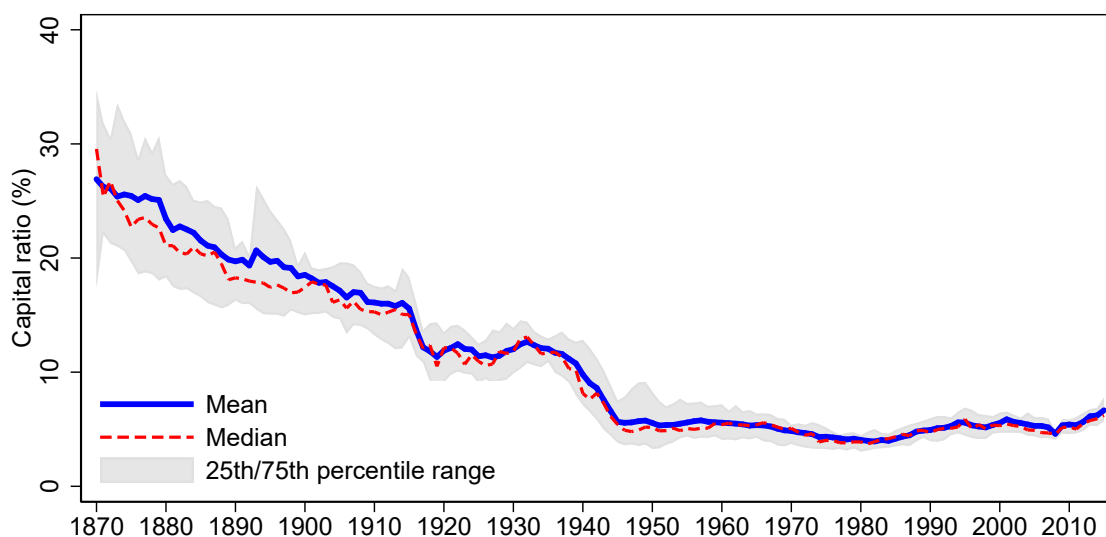
## 3. KEY TRENDS

In most countries, capital ratios decreased substantially from 1870 up to WW2 and have remained relatively stable thereafter. Loan-to-deposit ratios show a pronounced V-shape over the full sample period, with the lowest values during WW2 and, conversely, high levels at the beginning and the end of the full sample period. Non-core liabilities increasingly replaced deposits in the last quarter of the 20th century and remained at high levels until the 2007 crisis. We provide further details on these trends below.

### 3.1. Capital ratio

Bank leverage rose dramatically from 1870 until the mid-20th century, as shown in Figure 1. The cross-country average aggregate capital ratio *decreased* steadily from around 30% to less than 10% right after WW2, before fluctuating in the range 5%–10% over subsequent

**Figure 1:** Capital ratio, averages by year for 17 countries, full sample.



Notes: The blue line plots the mean of capital ratios in the sample countries between 1870 and 2015. The red line refers to the median of the sample countries. The grey area is the interquartile range for the 17 countries in our sample.

decades up to the present. A similar picture emerges at the country level as we show in Figures A.1 and A.2 in the Online Appendix. This is consistent with the work of [Saunders and Wilson \(1999\)](#), who studied the decline of capital ratios in Canada, the US, and the UK. It also dovetails with [Grossman \(2010\)](#), who documented a decreasing capital ratio between 1840 and 1940 for a subsample of our countries; it also mirrors developments discussed by banking historians for many smaller sub-periods at the individual country level. Our new data show that similar patterns hold across a broader set of advanced economies.

Since scaling issues can make it difficult to track developments after 1945, we separately present these trends in [Figure A.2](#). In the years preceding the financial crisis, capital ratios increased slightly in some countries although they are generally stable over this sample. [Table 3](#), shows for each country in our sample the year with the lowest capital ratio until the year before the recent crisis. These dates are spread out over the 60 years between the end of WW2 and the financial crisis of 2007–08.

### 3.2. Debt structure

In [Figure 2](#) we plot the share of capital, deposits, and non-core liabilities. While deposits make up the largest share of funding at all times, the patterns change substantially over time. Until about 1950, the share of deposits in total funding increased as the capital ratio decreased. There was little change in the share of non-core liabilities. Deposits made up

**Table 3:** *Lowest sample capital ratio by country*

Country	Year	Capital ratio in %	Country	Year	Capital ratio in %
Australia	1976	2.8	UK	1984	3.9
Belgium	1984	1.9	Italy	1952	1.4
Canada	1980	2.4	Japan	1952	2.0
Switzerland	1998	4.1	Netherlands	1981	3.7
Germany	1951	3.0	Norway	1991	2.6
Denmark	1993	5.5	Portugal	1983	1.8
Spain	1962	4.0	Sweden	1981	3.4
Finland	1981	3.2	USA	1974	3.9
France	1951	2.3			

*Notes:* This table displays the country-year observation with the lowest capital ratio between 1870 and 2006 for each country, excluding war years and 5 year windows around wars.

80% of all liabilities in the immediate post-WW2 period.

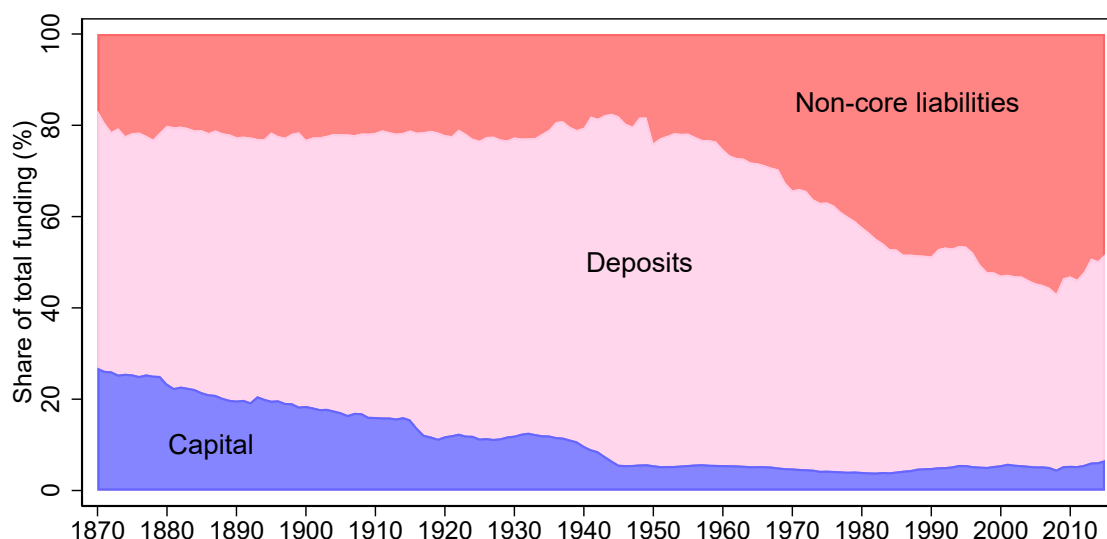
By the early 2000s, the share of deposits had fallen to around 50%. This illustrates the increasing importance in recent decades of non-core (e.g., wholesale) funding sources, which is central to the growing separation of money and credit in the post-WW2 period discussed by [Schularick and Taylor \(2012\)](#) as well as [Jordà et al. \(2013\)](#). The debt funding mix between non-core liabilities and deposits changed from being almost exclusively deposit-based in 1950 to a high non-core share in the early 2000s. [Figure A.3](#) shows the evolution of the non-core funding share for each country in the post-WW2 period. It is striking that a rising trend is seen in virtually all countries. It is also evident that the non-core ratio typically declines after financial crises, as in the Scandinavian crises of the late 1980s and early 1990s, and after the global financial crisis of 2007–08.

### 3.3. Liquidity

Banks intermediate funds between borrowers and savers. This intermediation model entails a maturity transformation since banks borrow short and lend long. In our data on balance sheets, this mechanism is reflected by deposits, callable on short notice on the liability side; and loans, with longer maturities, on the asset side. The LtD ratio is a common metric of bank illiquidity since a higher level means that banks would typically find it more difficult to withstand large deposit outflows. Table 1 in [Cecchetti et al. \(2011\)](#) shows large heterogeneity in this ratio across banking systems in the world today.

[Figure 3](#) shows the mean LtD ratio for all 17 countries in the full sample. There is a V-shape pattern, with a low near 50% at the end of WW2 when banks held a large share of their assets in government securities, a side-effect of war-time government finance policies rather than a market outcome. Hand in hand with the increase of deposits as a source of

**Figure 2:** *Composition of liabilities, averages by year for 17 countries, full sample.*



Notes: Averages over 17 sample countries. This figure plots the shares of capital (blue), deposits (pink) and non-core (red) in total funding. Categories add up to one (100%).

funds, the average LtD ratio declined from above 100% in 1870 until 1945. It then increased, from 75% in the 1950s to more than 100% before the global financial crisis. After the crisis, the LtD ratio has decreased as banks have deleveraged and reduced non-core funding. [Figure A.4](#) shows long-term LtD ratios at the country level. The trends appear very similar again. In most countries, the LtD ratio reaches a trough in WW2 and rises thereafter.

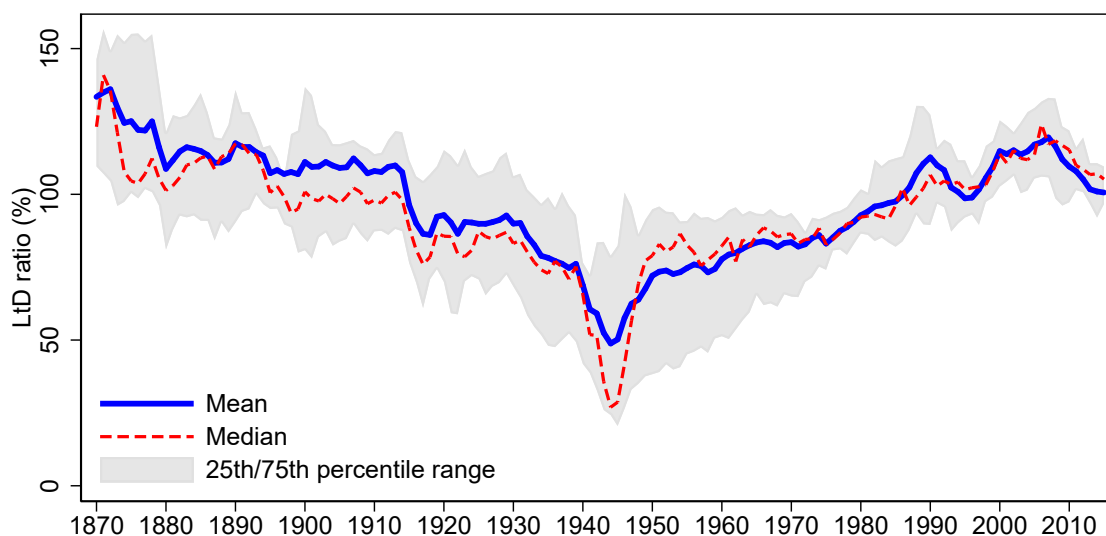
### 3.4. Bank capital structure around financial crises

We conclude our exposition of key trends by describing the dynamics of banking sector balance sheet ratios around financial crises. Crises are identified narratively as periods when significant parts of the banking system fail or have to be rescued by government intervention ([Jordà, Schularick, and Taylor, 2017](#); [Laeven and Valencia, 2012](#); [Schularick and Taylor, 2012](#)). The exact crisis dates are listed in the Online Appendix.

Consider the first two panels in [Figure 4](#), which examine the LtD and capital ratios around financial crises. These ratios are shown relative to their value in the year of the crisis, year 0, which is normalized to 1. The solid blue line corresponds to the median of the corresponding ratio across all financial crises, and the grey area marks the interquartile range. We also split the data into a high- and a low-bank capital regimes. The dashed/dotted green/red lines plot the behavior of the median for financial crises when the lagged level of the capital ratio was above/below the median.

The left panel of [Figure 4](#) shows that the LtD ratio increases prior to financial crises

**Figure 3:** *LtD ratio, averages by year for 17 countries, full sample.*



*Notes:* The blue line plots the mean of LtD ratios in the sample countries between 1870 and 2015. The red line refers to the median of the sample countries. The grey area is the interquartile range for the 17 countries in our sample.

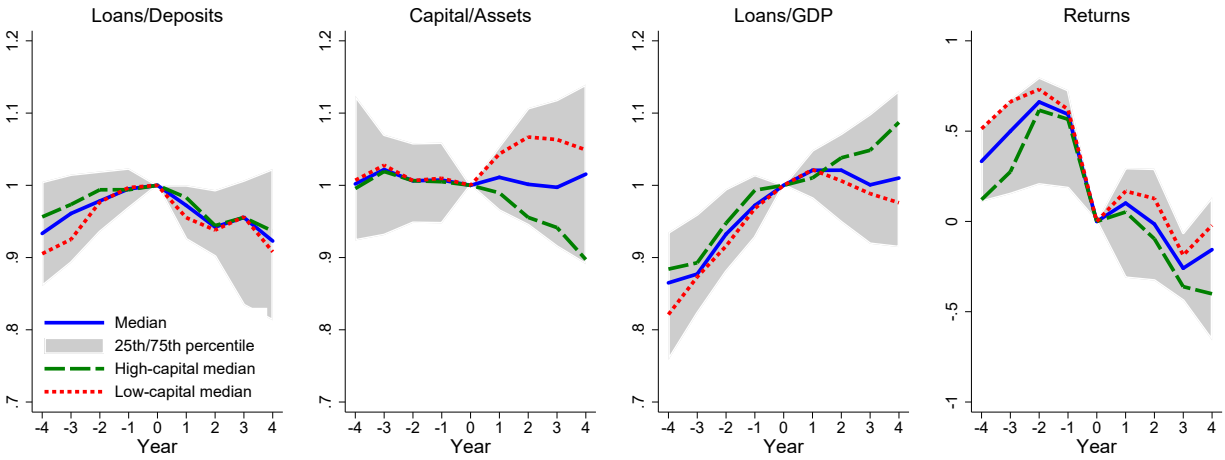
and decreases afterwards. The patterns are less clear for the equity capital ratio, shown in the second panel of [Figure 4](#). Before a financial crisis, book capital ratios do not change meaningfully. This is true at both high (dashed, green) and low (dotted, red) levels of capitalization. However, following a financial crisis the trajectory of capital ratios differs substantially depending on the initial level of capitalization. When capital is relatively low before the crisis, banks will tend to increase capital following the crisis. One possible explanation is that creditors probably penalize banks with low levels of capital. Moreover, changes in the regulatory environment following the crisis likely target banks whose capital buffers were deemed inadequate. When capital buffers are initially on the high side, they provide loss absorption capacity for banks following the crisis. As a result equity falls.

Another way to look at the data from the first two panels in [Figure 4](#) is provided in [Figure 5](#). These bin-scatter plots show that large credit expansions, often before a crisis, are typically financed with a surge in non-deposit funding (the upward sloping cloud of points). These non-deposit funds then dry up after the crisis, at a time when credit growth is low or negative. In contrast, capital ratios remain stable (the flat cloud of points) during credit expansions, so that loss-absorption capacity does not appear to buildup concurrently, matching the patterns we described in [Figure 4](#).

These two pieces of evidence speak of a weak connection between bank capital and crisis risk, a finding that is further corroborated in [Figure 6](#). The graph shows the frequency of banking crises in five equal-sized bins, where observations are sorted into the bins according to 5-year averages of changes in capital ratios. Banking crisis risks appear unrelated to

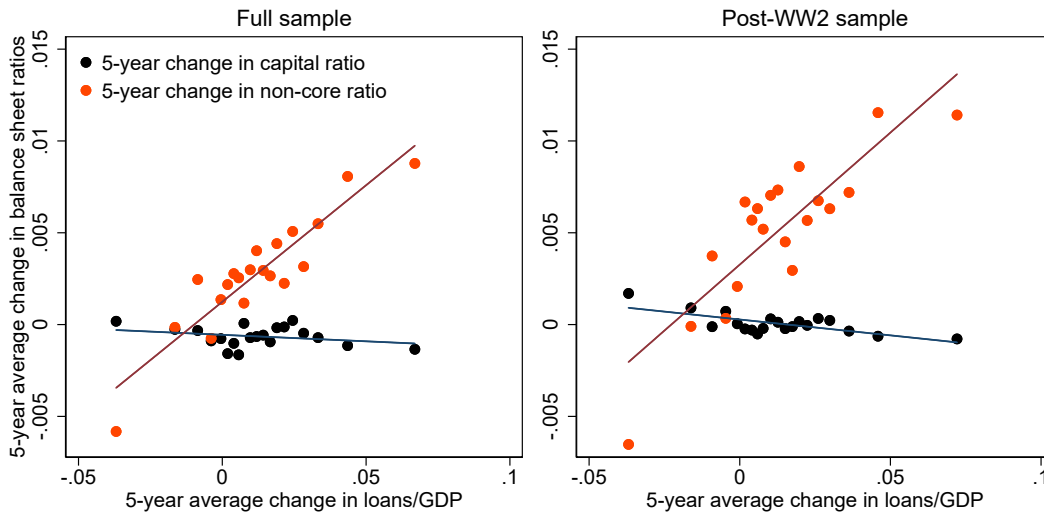


**Figure 4:** Event study of key variables centered on the crisis year.



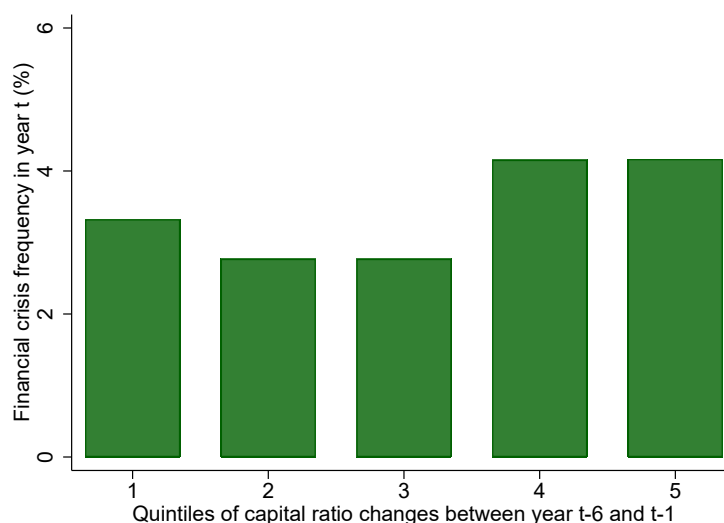
Notes: This figure presents the path of key variables around financial crises. Year 0 corresponds to a systemic financial crisis. The values of the respective ratio are scaled to equal 1 in year 0 in the first three panels. The fourth panel shows cumulative log excess returns on the bank index relative to year 0 (set to 0). The solid blue line corresponds to the median over all financial crises and the grey bands to the interquartile range. The dotted red/dashed green line shows the median for financial crises when the lagged level of the capital ratio was below/above the median of all financial crisis observations.

**Figure 5:** Booms and liability composition.



Notes: The graph shows binned scatterplots for the relationship between 5-year average changes in loans/GDP and 5-year average changes in liability composition.

**Figure 6:** *Capital ratio changes and crisis frequency*



*Notes:* The figure shows the relationship between changes in capital ratios and financial crisis frequencies. Observations are sorted into five equal-sized bins according to the change in the capital ratio over the years  $t - 6$  to  $t - 1$  from 1 (lowest change in capital ratio) to 5 (highest change in capital ratio). Vertical bars indicate the frequency of financial crises in year  $t$  for each of the bins.

capital ratio changes since the frequency of crises is almost the same in the lowest and highest bins of average 5-year capital ratio changes.<sup>5</sup>

Turning from asset and liability composition to the growth of balance sheets, the third panel of Figure 4 presents the well-known result that crises are preceded by a credit boom, which is clearly visible in the event windows. This pattern does not depend on the capitalization of the banking sector, the red dotted and the green dashed lines are essentially on top of each other. However, capitalization seems to play a role in the aftermath of financial crises, a pattern we explore in more detail later.

Finally, the fourth panel of Figure 4 shows cumulative log excess returns of bank shareholders relative to year 0. Returns are high during the boom, but shareholders make significant losses in the year of the crisis, mirroring the pattern reported in Baron and Xiong (2017). Even when bank capital ratios are above the median (the green dashed line), returns do increase prior to systemic banking crises, only for shareholders to be systematically disappointed in the following years. As argued by Baron and Xiong (2017) bank equity rallies during credit booms and before crisis events suggest that bank shareholders are not aware of the impending crisis. The right panel in Figure 4 suggests that bank equity prices do not seem to reflect risks more accurately when bank capital is above the median.

<sup>5</sup>Tables A.4 and A.5 report lagged levels and 5-year average changes of the capital ratio for crisis and no-crisis subsamples to get a sense of the variation of bank capital measures prior to financial crises.

#### 4. CAPITAL STRUCTURE AND CRISIS RISK

How is capital structure related to bank risk-taking and the likelihood of financial crises? The previous section provided some suggestive evidence that we explore more formally in this section. Before that, it is useful to review what competing theories tell us about the role of capital. An influential view argues that “more skin in the game” would reduce bankers’ risk-taking incentives. Bankers have an incentive to take risks since the payouts from their bets are asymmetric (Merton, 1977). Thus, more skin in the game could lead to more prudent behavior, improve screening and monitoring incentives for banks, and thereby reduce the probability that financial institutions face large and life-threatening losses (Holmstrom and Tirole, 1997; Mehran and Thakor, 2011). Incentives to engage in risk shifting or asset substitution arise because of limited liability (Jensen and Meckling, 1976) or to exploit mispriced deposit insurance (Merton, 1977). In this view, higher capital ratios serve as a remedy for agency frictions at the heart of financial crisis dynamics.<sup>6</sup>

Another view puts overoptimism and neglect of tail risk at the center of the credit boom–crisis nexus. In recent credit cycle models (Bordalo, Gennaioli, and Shleifer, 2018; Greenwood, Hanson, and Jin, 2018) positive news during good times are extrapolated into the future and create overoptimism. Non-rational expectations of market participants allow financial crisis risks to remain largely unnoticed, until beliefs are suddenly corrected during a predictable reversal. In this view, bank capital is orthogonal to the buildup of crisis risks and only plays a buffer role once the reversal occurs.

In sum, theory offers no clear guidance whether higher capital is associated with lower crisis risk, and better empirical evidence is needed. Some studies have used contemporary data to study the performance of a leverage ratio as a crisis predictor and found no clear evidence.<sup>7</sup> Our long-run dataset on the liability composition of the banking sector allows us to study the relationship between capital, risk-taking, and crises systematically, exploiting

---

<sup>6</sup>Empirically, some studies report evidence consistent with the risk-shifting hypothesis (e.g., Esty, 1997; Gan, 2004; Landier et al., 2011) while others have found little empirical support (e.g., Gropp et al., 2011 for banks and Gilje, 2016 for non-financial firms). The disciplining role of equity capital has also been challenged theoretically. One strand of the literature argues that leverage can be beneficial because uninsured short-term creditors monitor and discipline bankers more effectively (Calomiris and Kahn, 1991; Diamond and Rajan, 2001) than equity holders. Other studies argue that imposing higher capital requirements may perversely increase bank risk (Blum, 1999; Gale, 2010; Kim and Santomero, 1988; Rochet, 1992). This will be especially the case, when banks have to meet profitability targets. Adrian et al. (2015) show that return-on-equity targeting is indeed a widespread industry practice. Berger and Bouwman (2013) present empirical evidence that capital protects especially small banks individually against default, but Jiménez et al. (2017) find evidence that higher regulatory capital buffers even increased risk-taking among Spanish banks during the boom in the early 2000’s.

<sup>7</sup>Cihak and Schaeck (2010) and Detken et al. (2014) find no relationship between capital ratios and crisis risks, while Behn et al. (2013) find a link between low capitalization and crisis risks. Barth et al. (2006) find no relationship between bank capital regulation and crisis risks.

the within country variation in capital ratios over time.

We now turn to a formal econometric model to investigate financial crises and the predictive ability of our three key balance sheet measures, namely the capital ratio, the LtD ratio, and the non-core ratio. We will estimate probit regressions and assume, as is standard in the literature, that the probability of a crisis conditional on observables  $\mathbf{X}_{i,t}$  can be represented in terms of the normal cumulative distribution function,

$$Pr[S_{i,t} = 1 | \alpha_i, \mathbf{X}_{i,t}] = \Phi(\alpha_i + \beta \mathbf{X}_{i,t}), \quad (4)$$

for all years  $t$  and countries  $i$  in the sample, where  $S_{i,t}$  is an indicator variable for the start of a systemic financial crisis.

The vector  $\mathbf{X}_{i,t}$  includes the average annual change of the ratio of credit to GDP over the previous 5-year window (denoted  $\Delta_5$  Loans/GDP), following [Schularick and Taylor \(2012\)](#). We then evaluate the additional predictive power coming from the lagged level of each of the three balance-sheet ratios and 5-year average annual changes in capital ratios, one at a time. The coefficients reported in all the tables correspond to the marginal effect of the covariate evaluated at its sample mean. To soak up cross-country heterogeneity, we include a country fixed effect,  $\alpha_i$ . We exclude 5-year windows after the two world wars to avoid measuring the effects of wartime financing on banks' balance sheets. Pooled models and a variety of other robustness checks are reported in the Online Appendix.

To evaluate crisis predictive ability, we focus on the *AUC* statistic, the area under the ROC curve. This standard classification statistic measures the ability of a model to correctly sort the data into crisis and no-crisis bins. The *AUC* uses the variation of true and false positive rates as a function of the entire range of probability cutoffs. The *AUC* is close to 0.5 for models that have little ability to sort observations correctly, and it approaches 1 for models that perfectly sort the data.

The central question we address is whether capital ratios improve crisis prediction. We use as a benchmark null a model that only includes country-fixed effects. This benchmark has an *AUC* = 0.61 in the full sample, and an *AUC* = 0.60 in the post-WW2 sample. Since some countries are more prone to financial crises than others, fixed-effects already have the ability to sort the data somewhat. We use this as our benchmark null that observables add no additional information rather than the more customary 0.5 level.

[Table 4](#) shows the full and post-WW2 sample results for the specifications with covariates. As in [Schularick and Taylor \(2012\)](#), the credit variable is positively related to a higher probability of a crisis in all specifications. The model with 5-year annual average changes in credit/GDP as a single predictor variable (not reported) has an *AUC* = 0.71 in the full sample, and an *AUC* = 0.74 in the post-WW2 sample, statistically different from the fixed

**Table 4:** *Multivariate probit models for systemic financial crises.*

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Full	Post	Full	Post	Full	Post	Full	Post
$\Delta_5$ Loans/GDP	0.82*** (0.11)	0.62*** (0.07)	0.81*** (0.10)	0.64*** (0.07)	0.57*** (0.12)	0.26*** (0.09)	0.80*** (0.12)	0.17* (0.10)
Capital ratio	0.17*** (0.03)	0.06 (0.23)						
$\Delta_5$ Capital ratio			-0.04 (1.21)	1.29 (1.90)				
LtD ratio					0.04** (0.02)	0.05*** (0.01)		
Non-core ratio							-0.00 (0.02)	0.09*** (0.01)
AUC	0.75 (0.03)	0.74 (0.05)	0.72 (0.03)	0.75 (0.05)	0.72 (0.03)	0.80 (0.04)	0.71 (0.03)	0.84 (0.03)
Observations	1735	1004	1721	998	1713	1004	1671	1004

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are lagged by one period. Coefficients are marginal effects. All models include country fixed effects. The null fixed-effects only model has an  $AUC = 0.61$  (0.03) in the full sample and an  $AUC = 0.60$  (0.06) in the post-WW2 sample. Clustered (by country) standard errors in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

effect null model (with  $AUC = 0.61$  or  $0.60$ ). In column (1), for example, the coefficient of 0.82 means that a 2 percentage point increase (about 1 standard deviation) in the average annual change in the loans to GDP ratio would increase the probability of a crisis by 1.6 percentage points, all else equal. Note that crises happen about 5% of the time in the full sample, so this is a considerable boost in crisis risk.

We see that models that include the unweighted capital ratio typically have the “wrong” sign. Higher capital is associated with *higher* crisis risk. The effects are economically small. A 2 percentage point boost to capital (an oft discussed figure for countercyclical buffers) is associated with a 0.34 percentage points higher crisis probability in the full sample, for the specification in column (1). The coefficient on the loan-to-deposits ratio in column (5) is more intuitive and statistically significant though economically small. A 10 percentage point increase in this ratio (about 1 standard deviation) boosts crisis risk by 0.4 percentage points. Lastly, the model based on the non-core ratio and displayed in column (7) has an  $AUC = 0.71$ , almost equivalent to the credit-only null model in the full sample.

The post-WW2 results have a similar flavor but with a few notable differences. The levels and changes of the capital ratio now both have a positive coefficient and add no meaningful predictive value. The coefficient on the loan-to-deposits ratio is highly significant and yields some improvement in predictive ability:  $AUC$  rises from 0.74 in the credit-only model, to

0.80 using the LtD ratio in column (6). For the post-WW2 sample, the non-core ratio also enters significantly, with the expected sign (more non-traditional funding predicts crisis risk), and with further improvement in predictive ability, as the *AUC* increases to 0.84 in column (8). These results reiterate that, in the post-WW2 era, it was credit expansion and the debt funding structure of banks, not capital ratios, that best predicted crisis risk.

#### 4.1. Additional controls, market-based capital, and subsamples

Why is there no visible association between bank capital and crisis risk? One explanation may be that the markets force banks to adjust capital endogenously if the riskiness of assets changes. Variations in the simple capital ratio might then not properly proxy for changes in the underlying risk-adjusted capital ratio. Controlling for asset and macroeconomic risks will thus be an important task, but not the only one. We also study the capital-crisis nexus replacing the book value of capital with a market-based measure and explore the stability of our core results across a variety of additional specifications described briefly here and in more detail in the Online Appendix.

However, all these checks reinforce the central message from [Table 4](#): there is very little evidence linking capital, as a measure of skin in the game, and subsequent crises. This is a statement about the absence of predictive ability of the capital ratio, but it has interesting implications on its own. It means that our current system of global banking regulation is based on a variable that is not correlated with the outcomes that we care the most about—namely, reducing the incidence of financial crises.

#### 4.2. Controlling for asset risk

[Table 5](#) includes controls for macroeconomic risks, asset prices, and the market's perception of the riskiness of banks' balance sheets. For the latter we use the bank equity risk premiums constructed by [Baron and Xiong \(2017\)](#).<sup>8</sup> In addition to risk premiums, we control for house price booms, proxied by 5-year average changes in real house prices, and the volatility of house price growth over the preceding 5-year window. Interest rate or inflation volatility, as well as other macroeconomic risks could also affect the riskiness of banks' balance sheets and are therefore included.

We first add macroeconomic controls to the respective baseline model using long- and short-run variation in capital ratios in the full and post-WW2 sample in [Table 5](#), in the odd-numbered columns. As for the asset price controls, the house price variables and bank

---

<sup>8</sup>When data on bank index excess returns is not available, we use excess returns on the broad stock market index from [Jordà et al. \(2019\)](#) instead.

**Table 5:** *Multivariate probit models for systemic financial crises, controlling for asset risk.*

	(1) Full	(2) Full	(3) Post	(4) Post	(5) Full	(6) Full	(7) Post	(8) Post
$\Delta_5$ Loans/GDP	0.90*** (0.10)	0.63*** (0.10)	0.40*** (0.13)	0.26* (0.14)	0.91*** (0.10)	0.63*** (0.11)	0.41*** (0.13)	0.27* (0.16)
Capital ratio	0.17*** (0.04)	0.16*** (0.05)	0.09 (0.18)	0.01 (0.19)				
$\Delta_5$ Capital ratio					0.39 (1.32)	0.81 (1.47)	0.72 (1.67)	1.07 (1.66)
Macrocontrols	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Asset prices	No	Yes	No	Yes	No	Yes	No	Yes
AUC	0.75 (0.03)	0.80 (0.04)	0.80 (0.05)	0.83 (0.04)	0.73 (0.03)	0.79 (0.03)	0.80 (0.04)	0.83 (0.04)
Observations	1582	1277	988	887	1570	1274	984	884

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and regressors are lagged by one period. All models include country fixed effects. Coefficients are marginal effects. Macrocontrols include volatilities of real GDP per capita, inflation, loans-to-GDP and short-term interest rates as well as averaged real GDP per capita growth, inflation, and short term interest rates over the previous five years. Asset risks include average changes of real house prices and the volatility of house price growth over the previous five years and three lags of log excess returns on the bank index if available, on the general index otherwise. See text. Clustered (by country) standard errors in parentheses. \* $p < 0.10$ , \*\* $p < 0.05$ , \*\*\* $p < 0.01$

equity risk premiums are only available for a subset of observations, so these regressors are added subsequently, in the even-numbered columns.

Summing up, all specifications in this table result in marginal effects nearly identical to those reported in [Table 4](#). The coefficient on bank capital always enters with the “wrong” sign: more capital predicts a higher, not lower risk of crisis.

### 4.3. Other robustness checks

The Online Appendix presents a large battery of additional robustness tests, briefly described here.

**Clustering** In [Table A.6](#) and [Table A.7](#) we repeat our two main specifications additionally clustering standard errors on the year dimension to deal with possible cross-sectional correlation, but the results remain unchanged.

**Deposit insurance** Deposit insurance could affect the link between capital and crisis risk. Hence, we explore the stability of our results, and in [Table A.8](#) we estimate our baseline specification separately for country-year observations with and without a deposit insurance scheme in place.

**Market value of capital** Haldane (2011) argues for using market-based capitalization indicators in addition to accounting data. Using data from Datastream, we included market-based capital ratios. Table A.9 shows that results do not materially change.

**Heterogeneity within banking systems** Aggregate capital ratios could mask substantial heterogeneity within banking systems. Risks could be concentrated in a few, systemically important institutions or in a subset of banks with very low capital ratios. We employ more granular data in Table A.10 and Table A.11. In both cases, capital ratios remain poor predictors of crisis risks.

**Booms split by level of capital** If more skin in the game induces prudent behavior by banks, we would expect to find in the data that credit booms at high levels of bank equity are less likely to end in a crisis than credit booms financed with less equity. In Table A.12, however, we find no difference between high and low capital booms.

**Split samples by period** In Tables A.13 and A.14 we present unconditional correlations from probit specifications including only fixed effects in the full and post-WW2 samples. Table A.15 shows that there is no systematic relationship between capital ratios and financial crises in a pre-1914 sample with little or no bank regulation in many countries.<sup>9</sup>

**Saturated model** Table A.16 shows results where we start from a full model including the change in credit-to-GDP, the capital ratio, and the non-core ratio. We then drop one variable at a time. The resulting decline in predictive accuracy from dropping the capital ratio is small relative to dropping the other variables. The capital ratio improves predictive accuracy only when the coefficient has the “wrong” positive sign in the full sample.

**Further subsamples and crisis chronologies** We then exclude the 2007–08 financial crisis (Table A.19), and repeat the analysis excluding the UK and the US (Table A.20) since these two countries have historically the largest share of shadow banking activities. Additionally, we test robustness to the inclusion of country-decade fixed effects into the probit specifications (Table A.22) to control for unobservable long-run changes across countries. Table A.23 employs a different crisis chronology that is based on crashes in the bank equity index (Baron, Verner, and Xiong, 2020), but capital ratios are also unrelated to these crashes.

---

<sup>9</sup>For completeness, Tables A.17 and A.18 repeat the estimates of Tables A.13 and A.14, but without fixed effects to account for the possibility that the fixed effects capture cross-country differences in capital ratios and their effects on crisis risks.



**IV estimate** Many results here, and in the Online Appendix, show that higher capital is weakly, but positively associated with higher crisis risk. As discussed above, one explanation could be that bank capital is endogenously determined, and our controls for asset risk may not entirely pick up the reality (or perception) that a bank with risky positions may hold or be forced to hold more capital. How much could endogeneity bias still matter here?

Ideally, an instrumental variable would be needed to capture exogenous variation in capital—a tall order. Given data availability, the best we can devise is past return on assets, a common source of voluntary capital expansions (Appendix I.14). The first stage shows this candidate IV is strong, but as always the exclusion restriction cannot be formally evaluated. Assuming that, and controlling for credit growth and risk premiums, changes in return on assets are otherwise unrelated to crisis risk, and it can serve as an instrument for bank capital. Subject to these caveats, Table A.24 shows Conditional IV estimates. Here, capital ratios are still not associated with crisis risk: the point estimate is negative, but is economically (and statistically) very weak. This exercise goes to show that the purported strong negative association between capital and crisis risk is hard to find in the data.

The results of all these tests confirm our findings: credit growth, the LtD ratio and the non-core ratio are significant predictors of financial crisis, but the capital ratio exhibits a “wrong”-signed, weak, or non-existent predictive relationship with crisis risk.

## 5. CAPITAL RATIOS AND BANK STOCK RETURNS

A different approach to analyzing the role of bank capital is by examining its relation to the returns on bank stocks. In recent work, Baron and Xiong (2017) show that loan growth predicts lower subsequent returns to bank equity—there is little evidence that investors ask for compensation for rising risks during credit booms. In line with behavioral theories of credit cycles, the equity market does not appear to price the risks stemming from rapid credit expansions. Does the capital ratio help predict stock returns going forward and signal rising risks in the way that asset-side quantities do?

**Predicted bank stock returns** To test this, we ask whether balance sheet ratios are correlated with future returns on bank stocks. This is a useful check of whether capital ratios contain valuable information for regulators. We follow Baron and Xiong (2017) and regress bank index excess returns on bank balance sheet ratios using credit growth and equity index dividends as controls using the following specification:

$$r_{i,t+h}^{bank} - r_{i,t+h}^f = \alpha_{h,i} + \beta \mathbf{X}_{i,t} + \epsilon_{i,h}, \quad (5)$$

**Table 6:** Balance sheet measures and mean returns on the bank equity index.

	(1)	(2)	(3)	(4)	(5)	(6)
Cumulative returns	1-year	2-year	3-year	1-year	2-year	3-year
Panel A	RHS: $\Delta_3$ Loans/GDP			RHS: $\Delta_3$ Assets/GDP		
See column header	-0.042*** (0.005)	-0.083*** (0.011)	-0.108*** (0.017)	-0.006 (0.008)	-0.007 (0.015)	-0.021 (0.026)
$R^2$	0.034	0.049	0.060	0.035	0.050	0.062
Observations	885	859	832	885	859	832
Panel B	RHS: Capital ratio			RHS: $\Delta_3$ Capital ratio		
See column header	-0.050 (0.047)	-0.101 (0.083)	-0.145 (0.116)	-0.032 (0.022)	-0.036 (0.043)	-0.007 (0.064)
$R^2$	0.037	0.054	0.066	0.037	0.051	0.060
Observations	885	859	832	885	859	832
Panel C	RHS: $\Delta_3$ LtD ratio			RHS: $\Delta_3$ Non-core ratio		
See column header	-0.013* (0.008)	-0.024 (0.015)	-0.022 (0.021)	0.005 (0.007)	0.009 (0.011)	-0.004 (0.015)
$R^2$	0.034	0.049	0.058	0.033	0.047	0.057
Observations	873	847	820	859	833	806

Notes: The dependent variable is the log excess return on the bank equity index from [Baron and Xiong \(2017\)](#) cumulated over  $h$  years, where  $h$  is specified in the column header. All specifications include  $\Delta_3$  Loans/GDP and bank equity index dividend yield as control variables (with the exception of  $\Delta_3$  Loans/GDP in the first three columns of Panel A these results are not reported). All RHS variables are standardized at the country level using past data to avoid look-ahead bias. All specifications include country fixed effects. Standard errors in parentheses are computed using the Driscoll-Kraay method accounting for autocorrelation of up to 17 lags (the mean of results using the automatic bandwidth selection in individual country time series regressions). \*, \*\*, \*\*\* indicate significance at the 0.1, 0.05, 0.01 level, respectively.

where  $r_{i,t+h}^{bank}$  is the horizon- $h$  cumulative log-return on bank equity, and  $r_{i,t+h}^f$  the corresponding log-return using the safe rate.

Table 6 reports the estimates of this regression for each balance sheet variable of interest. Note that we standardize all explanatory variables at the country level and use only past observations to avoid any look-ahead bias. Table A.31 shows the results where controls are omitted for completeness. The results are very similar.

Columns (1)–(3) in Panel A in Table 6 are the baseline results with only  $\Delta_3$ Loans/GDP and bank equity index dividend yield as regressors. Columns (1)–(3) confirm the core result from [Baron and Xiong \(2017\)](#) showing that an increase in the credit-to-GDP ratio over a three-year window is associated with lower bank equity returns going forward.

Next, Panel B looks at the additional explanatory power of the capital ratio measured two ways: first, in levels (columns (1)–(3)); and, second, over a three-year period (columns

(4)–(6)). In both cases, higher capital ratios signal lower returns, but the standard errors are large and the fit is almost the same as the baseline regression in panel A.

Finally, Panel C examines the two liquidity ratios we discussed earlier. We find that increasing loan-to-deposit ratios (columns (1)–(3)) are somewhat informative and are associated with lower returns to bank shareholders, but the effect is very mild (the effects are larger in the univariate analysis reported in [Table A.31](#) not surprisingly).

Unlike quantity measures of asset growth, and insofar as one can interpret the capital ratio as a proxy for incentive-driven risk taking, we find that the capital ratio is *not* associated with future banking sector risks. In sum, the evidence on return predictability is also consistent with the view that risk-taking in credit booms is not closely linked to “skin in the game” explanations based on capital.

**Discussion** The evidence presented above does not suggest that capital ratios play an important role in signaling imminent crisis risk or future declines in bank stock returns. Rather, the evidence suggests that the disciplining effects of bank capital are absent when they presumably matter most: during credit booms ([Jiménez et al., 2017](#)). This finding is consistent with work that points to the overoptimism of insiders and market-wide neglect of crash risk during credit booms ([Bordalo, Gennaioli, and Shleifer, 2018](#); [Kindleberger, 1978](#); [Minsky, 1986](#); [Shiller, 2000](#)).

Capital ratios typically do not change much during the credit boom run-up to banking crises. Moreover, the market value of equity capital is endogenous and often surges during the boom. [He and Krishnamurthy \(2013\)](#) therefore argue that intermediary leverage is counter-cyclical. From a historical perspective, given our new data, this seems quite plausible.

However, liquidity matters. Rising loan-to-deposit ratios and non-deposit funding presage banking crises. Growing maturity mismatch and exposure to uninsured short-term debt pose a measurable threat to financial stability, in line with the seminal insights offered by [Diamond and Dybvig \(1983\)](#).

## 6. BANK CAPITAL AND THE SEVERITY OF FINANCIAL CRISIS RECESSIONS

Although modern financial history provides little evidence that higher levels of bank capital are associated with safer financial systems, could they facilitate the recovery from a crisis? This is the question we investigate in this section. Higher capital ratios are indeed associated with milder recessions and swifter recoveries from financial crises. This finding echoes recent empirical work by [Cecchetti et al. \(2011\)](#) and [Berkmen et al. \(2012\)](#) on the 2007–08 financial crisis and adds nuance to the characterization of financial crisis recoveries reported

**Table 7:** Normal versus financial recessions, real GDP per capita by capital ratio, with controls, full sample.Dependent variable: change in  $100 \times \log$  real GDP per capita relative to Year 0

	(1)	(2)	(3)	(4)	(5)	(6)
	Year 1	Year 2	Year 3	Year 4	Year 5	Sum
Recession	-1.81*** (0.14)	-0.24 (0.29)	2.13*** (0.27)	3.81*** (0.38)	5.28*** (0.30)	9.17*** (1.21)
Financial recession, high capital ratio	-1.36 (0.79)	-3.01** (1.10)	-3.69*** (1.03)	-2.60* (1.42)	-3.09** (1.26)	-13.75*** (4.33)
Financial recession, low capital ratio	-1.22* (0.61)	-4.80*** (1.14)	-7.63*** (1.58)	-9.42*** (1.83)	-9.46*** (1.49)	-32.52*** (6.08)
Macroeconomic controls	Yes	Yes	Yes	Yes	Yes	Yes
$R^2$	0.558	0.327	0.339	0.330	0.397	0.331
$H_0$ : financial high = low, $p$ -value	0.85	0.15	0.08	0.01	0.01	0.03
Observations	210	210	210	210	210	210

Notes: Standard errors (clustered by country) in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . The dependent variable is the cumulative change in real GDP per capita from the start of the recession. Financial recessions are binned depending on whether the lagged capital ratio of the banking sector at the peak was above or below the historical mean. See text.

by [Jordà et al. \(2013\)](#). The results are consistent with recent models of macroeconomic amplification through the balance sheets of levered financial intermediaries (e.g., [Adrian and Boyarchenko, 2012](#)). Furthermore, they add an aggregate dimension to empirical results on the real effects of shocks to financial intermediaries (e.g., [Jiménez et al., 2017](#); [Khwaja and Mian, 2008](#); [Peek and Rosengren, 2000](#)). These results also show that the variation in leverage ratios that we measure do capture fluctuations in the risk exposure of banks, linking the first and the second part of the paper.

The experiments that we conduct are straightforward. We take bank capital at its pre-treatment level. Crises, by virtue of being largely unpredictable with respect to capital, act as a quasi-random assignment mechanism that permits us a direct comparison of their aftermath for different levels of capital. We use local projections to conduct this type of experiment ([Jordà, 2005](#)) to allow for appropriate control.

In particular, we focus on recession episodes and split these into *financial* recessions (recessions associated with a financial crisis in a  $\pm 2$  year window), and *normal* recessions (all others), as in [Jordà et al. \(2013\)](#). We further split financial recessions into two bins depending on whether the one-period lagged capital ratio of the banking sector at the onset of the recession is above or below the historical average.

The dependent variable is defined as the difference in 100 times the log of real GDP per capita from the year when the recession starts  $t(p)$ , to  $h$  years later  $t(p) + h$ , and written as

$\Delta_h y_{i,t(p)}$ . The notation  $t(p)$  refers to the calendar time period  $t$  where the business cycle peak  $p$  takes place. We use the [Bry and Boschan \(1971\)](#) algorithm to determine  $t(p)$ . At yearly frequency, this algorithm exactly matches the NBER peak dating for the US. The definition of the dependent variable can be interpreted as the cumulative growth of real GDP per capita between the business cycle peak and  $h$  years later. The specification includes country fixed effects.

We define an indicator variable,  $d_{i,t(p)}$ , which is used to distinguish normal from financial crisis recessions and is therefore 1 if the recession is a financial recession and zero otherwise. We define an indicator variable,  $\delta_{i,t(p)}$ , that is one if the one-period lagged capital ratio of the banking sector in country  $i$  at the start of the financial recession  $t(p)$  is higher than the mean of one-period lagged capital ratios over all financial recessions.

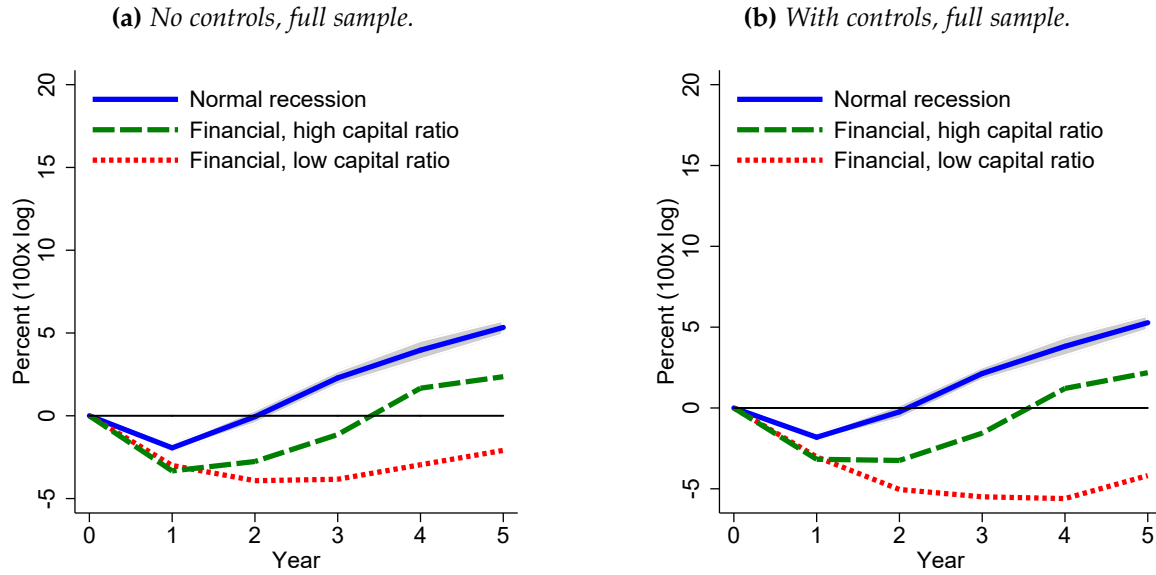
We also consider a vector of control variables,  $\mathbf{X}_{i,t(p)}$ , which include: the value at peak and the first lag of the growth rates of real GDP per capita, real investment per capita, CPI inflation, short and long term interest rates, and the current account to GDP ratio. Thus, the specification of the local projections is:

$$\begin{aligned} \Delta_h y_{i,t(p)} = & \sum_{i=1}^{I-1} \alpha_{i,h} D_{i,t(p)} + \mu_h + \gamma_h^{HI} d_{i,t(p)} \times \delta_{i,t(p)} + \gamma_h^{LO} d_{i,t(p)} \times (1 - \delta_{i,t(p)}) \\ & + \Phi \mathbf{X}_{i,t(p)} + \epsilon_{i,t(p)}, \end{aligned} \quad (6)$$

for  $h = 1, \dots, 5$ . The coefficients  $\gamma_h^{HI}$  (above-average capital) and  $\gamma_h^{LO}$  (below-average capital), modulate how the economy behaves after a financial crisis recession as a function of the level of the bank capital ratio at the start of the recession, as explained. With this setup, the average path of output per capita after a financial recession with a below- (or, above-) average capitalized banking sector is given by  $\mu_h + \gamma_h^{LO}$  (or,  $\mu_h + \gamma_h^{HI}$ ), which can then be compared to  $\mu_h$  for a normal recession. We will also be interested in characterizing the average path of the economy after a normal recession, that is,  $\mu_h$ .

The estimates of this augmented model appear in [Table 7](#). The coefficients for the two crisis recession bins separated by the level of banking sector capitalization are statistically not distinguishable in years 1 and 2, but capitalization begins to matter from year 3 onwards. The paths are shown in the right panel of [Figure 7](#). The average effect after a financial recession with an above- (or, below-) average capitalized banking sector is given by  $\mu_h + \gamma_h^{LO}$  (or,  $\mu_h + \gamma_h^{HI}$ ), compared to  $\mu_h$  for a normal recession. These outcomes are shown by the green dashed, red dotted, and blue solid lines, respectively. The grey area is the 90% confidence region for the normal recession path. As a reference, we provide local projection estimates without controls on the lefthand side panel. These estimates are reported in [Table A.25](#). The similarities between the two panels are clear. Indeed, the path differences

**Figure 7:** Normal versus financial recessions, real GDP per capita by capital ratio



Notes: This figure displays the coefficients reported in Table A.25 (left) and Table 7 (right). Full sample results: 1870-2013, excluding world wars and 5-year windows around them.

seem, if anything, even starker after controls are added.

Financial recessions are worse than normal recessions regardless of the bank capital ratio. However, while an economy with a well capitalized banking sector (green dashed line) recovers after year 2, and thereafter grows at a speed similar to that of a normal recession, an economy with poorly capitalized banking sector (red dotted line) sees a more protracted slump and recovers more slowly. Figure A.9 in the Online Appendix shows very similar patterns when we sort financial crisis recessions into four quartiles according to lagged capital ratios.

## 6.1. Capital ratios as a continuous treatment

So far we have split financial recessions into two bins according to the capitalization of the banking sector. We will now pursue a more ambitious specification to exploit the information in our measure of bank capital ratios. Instead of splitting the sample at the mean, we can now use a continuous measure of bank capital. In doing so, we will include the interaction of the type of recession  $d_{i,t(p)}$  with the lagged level of the capital ratio  $w_{i,t(p)}$  at the respective peak, demeaned at the country  $i$  and bin  $(F, N)$  level, that is,  $(w_{i,t(p)} - \bar{w}_{i,N})$  and  $(w_{i,t(p)} - \bar{w}_{i,F})$ , where  $\bar{w}_{i,N}$  refers to the mean capital ratio in country  $i$  in normal recessions and  $\bar{w}_{i,F}$  to the mean in financial recessions.

We compare the economic outcomes within a given country and type of recession, based on the capital ratio. We also include the six control variables from our baseline control

specification above. We then estimate the following set of local projections

$$\begin{aligned} \Delta_h y_{i,t(p)} = & \sum_{i=1}^{I-1} \alpha_{i,h} D_{i,t(p)} + \mu_h + \gamma_h d_{i,t(p)} + \beta_h^N (1 - d_{i,t(p)}) (w_{i,t(p)} - \bar{w}_{i,N}) \\ & + \beta_h^F d_{i,t(p)} (w_{i,t(p)} - \bar{w}_{i,F}) + \Phi \mathbf{X}_{i,t(p)} + \epsilon_{i,t(p)}, \end{aligned} \quad (7)$$

for  $h = 1, \dots, 5$ . Here,  $\mu_h$  is the average path after a recession peak,  $\mu_h + \gamma_h$  is the average path after a financial peak, and  $\beta_h^F$  and  $\beta_h^N$  are the marginal effects of the capital ratio at the begin of the recession. Again, all control variables are demeaned within each bin.

The results are presented in [Table 8](#). The coefficient in the first row is the average path of real GDP per capita for a normal recession, and in the second row is the average difference from that path for a financial crisis recession. As we have seen before, financial recessions are deeper and more protracted. Furthermore, we also see in the fourth row that the interaction of the capital ratio with financial recessions has a significantly positive effect on the path of real GDP per capita: a higher capital ratio is associated with a higher path of real GDP per capita after the crisis. That is, financial recessions are less severe in their output costs after the crisis, the higher is the capital ratio of the banking sector at the onset. We see that the capitalization of the banking sector seems to matter even more the longer the horizon we analyze. Putting numbers to these impacts, a bank capital ratio 10 percentage points higher than the country-specific mean at the start of financial recessions is associated with a cumulative real GDP per capita that is higher in year 5 by 3.1% (and cumulatively higher by 8.6% over 5 years).

In contrast to this finding, bank capital ratios do not seem to matter for the recovery path after normal recessions as shown by the insignificant coefficient in the third row. We present  $p$ -values for two tests: First, we see that the coefficients for the average coefficients of financial and normal recessions differ significantly after year 2. Furthermore, we present the  $p$ -value of a test for equality of the coefficients of the capital ratio in normal and financial recessions. We see that the hypothesis of these two coefficients being equal is rejected for the cumulative effect in years 4 and 5. This distinction is consistent with models of amplification by leverage in which an initial shock to the banking sector propagates through highly leveraged banks.

## 6.2. Accounting for long-run changes in capital ratios

Could our results be biased by the inclusion in our sample of the recent financial crisis and its aftermath? We saw that banking sectors had significantly higher leverage in the post-WW2 period and economic recovery after the recent crisis is slow relative to other recessions.

**Table 8:** Normal versus financial recessions, real GDP per capita with continuous capital ratios, with controls, full sample.

Dependent variable: change in $100 \times \log$ real GDP per capita relative to Year 0	(1)	(2)	(3)	(4)	(5)	(6)
	Year 1	Year 2	Year 3	Year 4	Year 5	Sum
Recession	-1.79*** (0.14)	-0.24 (0.27)	2.04*** (0.22)	3.74*** (0.32)	5.21*** (0.26)	8.97*** (1.01)
Financial recession	-1.28** (0.58)	-4.04*** (0.95)	-5.95*** (0.82)	-6.52*** (1.20)	-6.76*** (0.90)	-24.55*** (3.78)
Normal recession $\times$ capital ratio	-0.03 (0.03)	-0.05 (0.05)	0.06 (0.08)	-0.03 (0.10)	-0.05 (0.11)	-0.10 (0.33)
Financial recession $\times$ capital ratio	-0.06 (0.04)	0.12* (0.06)	0.21* (0.11)	0.28** (0.12)	0.31** (0.12)	0.86* (0.42)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
$R^2$	0.563	0.333	0.334	0.308	0.388	0.318
$H_0$ : normal = financial, $p$ -value	0.49	0.01	0.00	0.00	0.00	0.00
$H_0$ : normal $\times$ capital = financial $\times$ capital, $p$ -value	0.54	0.02	0.28	0.04	0.02	0.05
Observations	210	210	210	210	210	210

Notes: Standard errors (clustered by country) in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . The dependent variable is the cumulative change in real GDP per capita from the peak. Financial recession refers to the average path after financial recessions relative to normal recessions. Interaction terms refer to marginal effects of capital ratios after normal and financial recessions relative to the historical mean. Capital ratios have been multiplied by 100. See text.

A simple way to rule out that our results are driven only by the global financial crisis is to exclude those observations. The sample then falls to  $N = 193$  recession observations (Table A.28). However, the findings are unchanged and a higher capital ratio at the onset of a financial recession is still associated with a faster economic recovery.

It is also possible that the speed of economic recovery after recessions changed over our long-run sample. In Table 9 we add more fixed effects to account for decade specific variations in the speed of economic recovery.<sup>10</sup> The results, displayed in Table 9 are reassuring. A high capital ratio predicts a speedier recovery from a financial crisis recession, with the average path being close to the path in normal recessions. Low capital ratios are associated with slower recovery and lower output several years after the crisis.

Both approaches, excluding the recent crisis and including decade fixed effects, are depicted in Figure 8. The left panel shows average path estimates when we exclude the recent crisis from our data. The right panel shows the estimates when we include decadal

<sup>10</sup>These are defined in the same way as the country fixed effects. In order to estimate a constant average path, decade fixed effects add up to one and we omit the first decade of the twenty-first century.



**Table 9:** Normal versus financial recessions, real GDP per capita binned by capital ratio, with controls, full sample including decade fixed effects.

Dependent variable: change in  $100 \times \log$  real GDP per capita relative to Year 0

	(1)	(2)	(3)	(4)	(5)	(6)
	Year 1	Year 2	Year 3	Year 4	Year 5	Sum
Recession	-1.86*** (0.15)	0.20 (0.30)	2.84*** (0.23)	4.51*** (0.56)	6.17*** (0.57)	11.87*** (1.54)
Financial recession, high capital ratio	-0.99 (0.75)	-2.19* (1.04)	-2.95* (1.40)	-0.61 (2.03)	-1.02 (2.12)	-7.76 (5.94)
Financial recession, low capital ratio	-1.32 (0.91)	-4.22*** (1.39)	-6.43*** (1.85)	-7.65*** (2.13)	-7.11*** (1.73)	-26.72*** (7.35)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
$R^2$	0.598	0.413	0.447	0.464	0.514	0.466
$H_0$ : financial high = low, $p$ -value	0.78	0.21	0.14	0.03	0.06	0.06
Observations	210	210	210	210	210	210

Notes: Standard errors (clustered by country) in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . The dependent variable is the cumulative change in real GDP per capita from the start of the recession. Financial recessions are binned depending on whether the lagged capital ratio of the banking sector at the peak was above or below the historical mean. See text.

fixed effects. In both cases, it is easy to see that economic recovery takes longer if the banking sector had less loss absorption capacity at the beginning of a financial crisis recession.

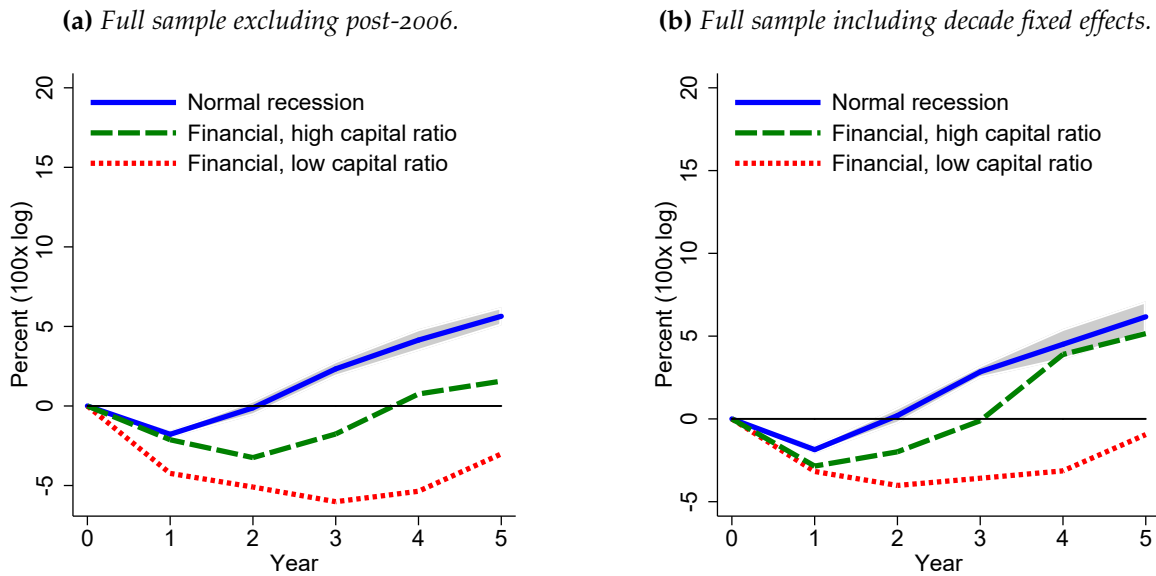
### 6.3. Inspecting the mechanism: the credit channel

Previous sections have shown that pre-recession capital ratios and economic recovery following the crisis are strongly related. It could be that highly levered intermediaries cannot extend credit after an initial shock to their balance sheets in line with recent research (Chodorow-Reich, 2014; Khwaja and Mian, 2008; Peek and Rosengren, 2000).

We test this proposition by estimating local projections with cumulative changes in real private credit per capita as the dependent variable, and by allowing for differences in capital ratios before the financial peak. We use real private credit instead of normalizing credit by GDP to avoid measuring the relationship of bank capital with GDP examined in previous subsections. Hence,  $\Delta_h y_{i,t(p)}$  now refers to the cumulative change in real private credit per capita extended by financial intermediaries.

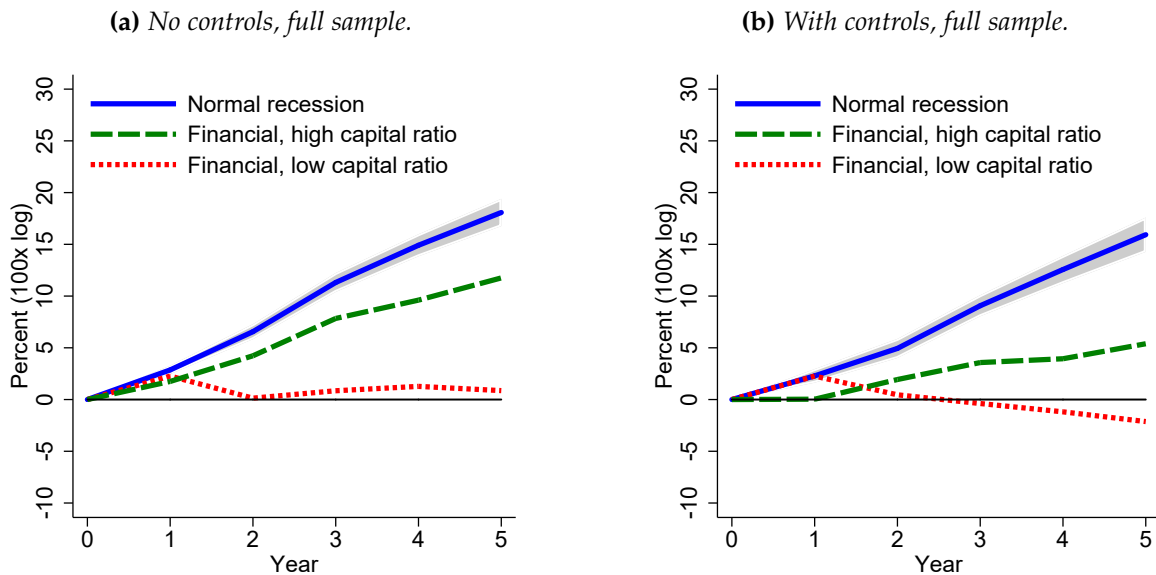
In Figure 9 we show results of this specification (estimates are reported in Table A.29 and Table A.30). We compare the path of real private credit per capita after normal and financial peaks and bin financial recessions by capital ratios. As in previous exercises, the

**Figure 8:** Normal versus financial recessions, real GDP per capita binned by bank capital, controls included, alternative estimates.



Notes: This figure displays the coefficient estimates on a sample excluding the global financial crisis, i.e., 1870–2006 (left) and on the full sample including decade fixed effects (right, Table 9). The solid blue line reports the average path after normal recessions. The grey area corresponds to the 90% confidence region around the recession path. The green dashed line corresponds to the sum of the coefficients of the average recession path and the financial recession coefficient when the pre-crisis capital ratio was high. The dotted red line corresponds to the sum of the average recession coefficient and the financial recession coefficient when the pre-crisis capital ratio was low.

**Figure 9:** Normal versus financial recessions, real private credit per capita binned by bank capital.



Notes: This figure displays the coefficients for estimating Equation 9 and Equation 6 with real private credit as the dependent variable. The solid blue line reports the average path after normal recessions. The grey area corresponds to the 90% confidence region around the recession path. The green dashed line corresponds to the sum of the coefficients of the average recession path and the financial recession coefficient when the pre-crisis capital ratio was high. The dotted red line corresponds to the sum of the average recession coefficient and the financial recession coefficient when the pre-crisis capital ratio was low.

solid blue line refers to the path after normal recessions, while the dotted red and dashed green lines reflect financial recessions when banks were above (dashed) and below (dotted) the mean capital ratio of all such recessions.

We see first that, after a peak, credit growth in a typical financial crisis recession is on average lower than in a normal recession. Furthermore, capital matters. Similar to the dynamics of output, below-average capitalized banking systems extend much less credit for several years in a financial crisis recession. These results therefore complement recent micro-evidence on the role of capital for lending (Carlson, Shan, and Warusawitharana, 2013; Gambacorta and Marques-Ibanez, 2011; Jiménez, Ongena, Peydró, and Saurina, 2017; Peek and Rosengren, 2000) and they are consistent with the idea that impairments to credit creation could be an important vector from low bank capital ratios to the slow pace of post-crisis economic recovery.

## 7. CONCLUSIONS

We present several hitherto unknown trends and stylized facts on the financial structure of banking systems by introducing a new dataset covering the composition of banking sector liabilities from 1870 to 2015 for a sample of 17 advanced economies. In most countries, banking sector capital ratios declined rapidly before WW2, but have remained low and stable since; yet other funding measures associated with banking fragility, like loan-to-deposit ratios and non-core ratios, have risen markedly.

Over this long time span, our first main finding is that, perhaps counterintuitively, there is no association between capital ratios and the likelihood of a systemic financial crisis. This non-finding is robust to subsample changes, to adding macroeconomic and risk controls and to replacing book capital with market valuations. Capital might protect banks individually against idiosyncratic shocks, but not collectively against systemic events.

However, we do find that loan-to-deposit ratios are a strong predictor of vulnerability, as some theories predict. And non-core liabilities have emerged in recent decades as a risk factor in a departure from the preceding century of modern finance. All that said, the evidence shows that the best crisis predictor for macroprudential regulators to monitor is still aggregate credit growth. This conclusion is supported by return predictability exercises that confirm a more important role for quantity-based measures as compared to balance sheet ratios.

Nonetheless our second main finding suggests that, even if capital ratios are not predictive of crisis incidence, well capitalized banking systems allow the economy to recover faster following a financial crisis and thus result in significantly shallower recessions. One

reason appears to be that the recovery of credit is greatly facilitated by boosting the loss absorption capacity of lenders as a whole rather than individually—higher capital ratios in banking systems can bring about more resilience.

Of course, the key caveat is that such resilience is incomplete, in the sense that even with high capital, financial crisis recessions are still much more painful than normal recessions, and high capital is not associated with a lower risk of ending up in a financial crisis event. For that, other policy measures focusing on asset growth and liquidity may be needed.

Overall, history lends support to a more nuanced perspective on bank capital. It plays its main role not so much in reducing the risks of systemic financial crises, but rather in somewhat mitigating their social and economic costs—a distinct but still important benefit.

## REFERENCES

- Admati, Anat R., Peter M. DeMarzo, Martin Hellwig, and Paul Pfleiderer. 2013. Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is Not Socially Expensive. Rock Center for Corporate Governance, Stanford GSB, Working Paper Series 161.
- Adrian, Tobias, and Nina Boyarchenko. 2012. Intermediary Leverage Cycles and Financial Stability. FRBNY Staff Report 567.
- Adrian, Tobias, Evan Friedman, and Tyler Muir. 2015. The Cost of Capital of the Financial Sector. FRBNY Staff Report 755.
- Adrian, Tobias, Emanuel Mönch, and Hyun S. Shin. 2014. Dynamic Leverage Asset Pricing. FRBNY Staff Report 625.
- Baron, Matthew, Emil Verner, and Wei Xiong. 2020. Banking Crises without Panics. NBER Working Paper 26908.
- Baron, Matthew, and Wei Xiong. 2017. Credit Expansion and Neglected Crash Risk. *Quarterly Journal of Economics* 132(2): 713–764.
- Barth, James, Gerard Caprio, and Ross Levine. 2006. *Rethinking Bank Regulation: Till Angels Govern*. Cambridge: Cambridge University Press.
- Basel Committee on Banking Supervision. 2011. *Basel III: A Global Regulatory Framework for more Resilient Banks and Banking Systems—Revised Version June 2011*. Basel: Bank for International Settlements.
- Basel Committee on Banking Supervision. 2014. *Basel III Leverage Ratio Framework and Disclosure Requirements*. Basel: Bank for International Settlements.
- Behn, Markus, Carsten Detken, Tuomas A. Peltonen, and Willem Schudel. 2013. Setting Countercyclical Capital Buffers Based on Early Warning Models: Would it Work? Working Paper Series 1604, European Central Bank.
- Berger, Allen N., and Christa H. S. Bouwman. 2013. How Does Capital Affect Bank Performance During Financial Crises? *Journal of Financial Economics* 109: 146–176.
- Berkmen, Pelin S., Gaston Gelos, Robert Rennhack, and James P. Walsh. 2012. The Global Financial Crisis: Explaining Cross-Country Differences in the Output Impact. *Journal of International Money and Finance* 31(1): 42–59.
- Bernanke, Ben S. 1983. Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression. *American Economic Review* 73(3): 257–276.
- Blum, Jürg. 1999. Do Capital Adequacy Requirements Reduce Risks in Banking? *Journal of Banking and Finance* 23(5): 755–771.
- Bordalo, Pedro, Nicola Gennaioli, and Andrei Shleifer. 2018. Diagnostic Expectations and Credit Cycles. *Journal of Finance* 73(1): 199–227.
- Brunnermeier, Markus K., and Yuliy Sannikov. 2014. A Macroeconomic Model with a Financial Sector. *American Economic Review* 104(2): 379–421.
- Bry, Gerhard, and Charlotte Boschan. 1971. *Cyclical Analysis of Times Series: Selected Procedures and Computer Programs*. New York: National Bureau of Economic Research.
- Calomiris, Charles W., and Charles M. Kahn. 1991. The Role of Demandable Debt in Structuring Optimal Banking Arrangements. *American Economic Review* 81(3): 497–513.
- Carlson, Mark, Hui Shan, and Missaka Warusawitharana. 2013. Capital Ratios and Bank Lending: A Matched Bank Approach. *Journal of Financial Intermediation* 22(4): 663–687.

- Cecchetti, Stephen G., Michael R. King, and James Yetman. 2011. Weathering the Financial Crisis: Good Policy or Good Luck? BIS Working Paper 351.
- Cheng, Ing-Haw, Sahil Raina, and Wei Xiong. 2014. Wall Street and the Housing Bubble. *American Economic Review* 104(9): 2797–2829.
- Chodorow-Reich, Gabriel. 2014. The Employment Effects of Credit Market Disruptions: Firm-level Evidence from the 2008-09 Financial Crisis. *Quarterly Journal of Economics* 129(1): 1–59.
- Cihak, Martin, and Klaus Schaeck. 2010. How well do Aggregate Prudential Ratios Identify Banking System Problems? *Journal of Financial Stability* 6(3): 130–144.
- Detken, Carsten, Olaf Weeken, Lucia Alessi, Diana Bonfim, Miguel M. Boucinha, Christian Castro, Sebastian Frontczak, Gaston Giordana, Julia Giese, Nadya Jahn, Jan Kakes, Benjamin Klaus, Jan Hannes Lang, Natalia Puzanova, and Peter Welz. 2014. Operationalising the Countercyclical Capital Buffer: Indicator Selection, Threshold Identification and Calibration Options. ESRB Occasional Paper Series 05, European Systemic Risk Board.
- Diamond, Douglas W., and Philip H. Dybvig. 1983. Bank Runs, Deposit Insurance, and Liquidity. *Journal of Political Economy* 91(3): 401–419.
- Diamond, Douglas W., and Raghuram G. Rajan. 2001. Liquidity Risk, Liquidity Creation, and Financial Fragility: a Theory of Banking. *Journal of Political Economy* 109(2): 287–327.
- Esty, Benjamin C. 1997. Organizational Form and Risk Taking in the Savings and Loan Industry. *Journal of Financial Economics* 44(1): 25–55.
- Fahlenbrach, Rüdiger, Robert Prilmeier, and René M. Stulz. 2017. Why Does Fast Loan Growth Predict Poor Performance for Banks? *The Review of Financial Studies* 31(3): 1014–1063.
- Flannery, Mark J., and Kasturi P. Rangan. 2008. What Caused the Bank Capital Build-up of the 1990s? *Review of Finance* 12(2): 391–429.
- Gale, Douglas. 2010. Capital Regulation and Risk Sharing. *International Journal of Central Banking* 187–204.
- Gambacorta, Leonardo, and David Marques-Ibanez. 2011. The Bank Lending Channel: Lessons from the Crisis. *Economic Policy* 26(66): 135–182.
- Gan, Jie. 2004. Banking Market Structure and Financial Stability: Evidence from the Texas Real Estate Crisis in the 1980s. *Journal of Financial Economics* 73(3): 567–601.
- Geanakoplos, John. 2010. The Leverage Cycle. *NBER Macroeconomics Annual 2009* 24: 1–65.
- Gilje, Erik P. 2016. Do Firms Engage in Risk-Shifting? Empirical Evidence. *Review of Financial Studies* 29(11): 2925–2954.
- Greenwood, Robin Marc, Samuel Gregory Hanson, and Lawrence J. Jin. 2018. Reflexivity in Credit Markets. NBER Working Paper 25747.
- Gropp, Reint, Hendrik Hakenes, and Isabel Schnabel. 2011. Competition, Risk-shifting, and Public Bail-out Policies. *The Review of Financial Studies* 24(6): 2084–2120.
- Grossman, Richard S. 2010. *Unsettled Account: The Evolution of Banking in the Industrialized World Since 1800*. Princeton, N.J.: Princeton University Press.
- Hahm, Joon-Ho, Hyun S. Shin, and Kwanho Shin. 2013. Non-Core Bank Liabilities and Financial Vulnerability. *Journal of Money, Credit, and Banking* 45(1): 3–36.
- Haldane, Andrew G. 2011. Capital Discipline. Remarks Based on a Speech Given at the American Economic Association, Denver, Colorado. January 9. ([www.bis.org/review/r110325a.pdf](http://www.bis.org/review/r110325a.pdf)).
- He, Zhiguo, and Arvind Krishnamurthy. 2013. Intermediary Asset Pricing. *American Economic Review* 103(2): 732–770.

- Holmstrom, Bengt, and Jean Tirole. 1997. Financing as a Supply Chain: The Capital Structure of Banks and Borrowers. *The Quarterly Journal of Economics* 112(3): 663–691.
- Jensen, Michael C., and William H. Meckling. 1976. Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics* 3(4): 305–360.
- Jiménez, Gabriel, Steven Ongena, José-Luis Peydró, and Jesús Saurina. 2017. Macroprudential Policy, Countercyclical Bank Capital Buffers, and Credit Supply: Evidence from the Spanish Dynamic Provisioning Experiments. *Journal of Political Economy* 125(6): 2126–2177.
- Jordà, Òscar. 2005. Estimation and Inference of Impulse Responses by Local Projections. *American Economic Review* 95(1): 161–182.
- Jordà, Òscar, Katharina Knoll, Dmitry Kuvshinov, Moritz Schularick, and Alan M. Taylor. 2019. The Rate of Return on Everything, 1870–2015. *The Quarterly Journal of Economics* 134(3): 1225–1298.
- Jordà, Òscar, Moritz Schularick, and Alan M. Taylor. 2013. When Credit Bites Back. *Journal of Money, Credit and Banking* 45(2).
- Jordà, Òscar, Moritz Schularick, and Alan M. Taylor. 2017. Macrofinancial History and the New Business Cycle Facts. *NBER Macroeconomics Annual* 2016. 31: 213–263.
- Khwaja, Asim Ijaz, and Atif Mian. 2008. Tracing the Impact of Bank Liquidity Shocks: Evidence from an Emerging Market. *American Economic Review* 98(4): 1413–1442.
- Kim, Daesik, and Anthony M. Santomero. 1988. Risk in Banking and Capital Regulation. *Journal of Finance* 43(5): 1219–1233.
- Kindleberger, Charles P. 1978. *Manias, Panics, and Crashes: A History of Financial Crises*. New York: Basic Books.
- Kiyotaki, Nobuhiro, and John Moore. 1997. Credit Cycles. *Journal of Political Economy* 105(2): 211–248.
- Krishnamurthy, Arvind, and Tyler Muir. 2016. How Credit Cycles Across a Financial Crisis. NBER Working Paper 23850.
- Laeven, Luc, and Fabian Valencia. 2012. Systemic Banking Crises Database; An Update. IMF Working Papers 12/163, International Monetary Fund.
- Landier, Augustin, David Sraer, and David Thesmar. 2011. The Risk-Shifting Hypothesis: Evidence from Subprime Originations. Unpublished.
- Mehran, Hamid, and Anjan Thakor. 2011. Bank Capital and Value in the Cross-Section. *The Review of Financial Studies* 24(4): 1019–1067.
- Merton, Robert C. 1977. An Analytic Derivation of the Cost of Deposit Insurance and Loan Guarantees: An Application of Modern Option Pricing Theory. *Journal of Banking and Finance* 1: 3–11.
- Mian, Atif, Amir Sufi, and Emil Verner. 2017. Household Debt and Business Cycles Worldwide. *Quarterly Journal of Economics* 132(4): 1755–1817.
- Minsky, Hyman P. 1977. The Financial Instability Hypothesis: An Interpretation of Keynes and an Alternative to “Standard” Theory. *Challenge* 20(1): 20–27.
- Minsky, Hyman P. 1986. *Stabilizing an Unstable Economy*. New Haven, Conn.: Yale University Press.
- Muir, Tyler. 2017. Financial Crises and Risk Premia. *Quarterly Journal of Economics* 132(2): 765–809.
- Peek, Joe, and Eric S. Rosengren. 2000. Collateral Damage: Effects of the Japanese Bank Crisis on Real Activity in the United States. *American Economic Review* 90(1): 30–45.
- Rajan, Raghuram G. 2018. Liquidity and Leverage. Speech at the AEA/AFA Joint Luncheon, January 5. Unpublished.

- Reinhart, Carmen M., and Kenneth S. Rogoff. 2009. *This Time is Different: Eight Centuries of Financial Folly*. Princeton University Press, Princeton, N.J.
- Rochet, Jean-Charles. 1992. Capital Requirements and the Behaviour of Commercial Banks. *European Economic Review* 36(5): 1137–1170.
- Romer, Christina D., and David H. Romer. 2017. New Evidence on the Aftermath of Financial Crises in Advanced Countries. *American Economic Review* 107(10): 3072–3118.
- Sarin, Natasha, and Lawrence H. Summers. 2016. Understanding Bank Risk through Market Measures. *Brookings Papers on Economic Activity* 57–109.
- Saunders, Anthony, and Berry Wilson. 1999. The Impact of Consolidation and Safety-Net Support on Canadian, US and UK Banks: 1893–1992. *Journal of Banking and Finance* 23(2): 537–571.
- Schularick, Moritz, and Alan M. Taylor. 2012. Credit Booms Gone Bust: Monetary Policy, Leverage Cycles, and Financial Crises, 1870–2008. *American Economic Review* 102(2): 1029–61.
- Shiller, Robert J. 2000. *Irrational Exuberance*. Princeton, N.J.: Princeton University Press.
- Simsek, Alp. 2013. Belief Disagreements and Collateral Constraints. *Econometrica* 81(1): 1–53.



## **Online Appendix**

### **Bank Capital Redux: Solvency, Liquidity, and Crisis**

## A. Deposit insurance timing

The dating of deposit insurance is based on the variable “Date of inception of explicit DGS” in [Demirgüç-Kunt et al. \(2014\)](#). The dates for our sample are shown in the table below.

AUS:	2008	GBR:	1982
BEL:	1974	ITA:	1987
CAN:	1967	JPN:	1971
CHE:	1984	NLD:	1978
DEU:	1998	NOR:	1961
DNK:	1987	PRT:	1992
ESP:	1977	SWE:	1996
FIN:	1969	USA:	1933
FRA:	1980		

## B. Systemic banking crisis timing

The crisis prediction classification models in the paper employ data on all systemic financial crises from 1870 to 2008. Dates of systemic financial crises are based on [Jordà et al. \(2017\)](#).

AUS:	1893, 1989.
BEL:	1870, 1876, 1885, 1925, 1931, 1934, 1939, 2008.
CAN:	1907.
CHE:	1870, 1910, 1931, 1991, 2008.
DEU:	1873, 1891, 1901, 1931, 2008.
DNK:	1877, 1885, 1908, 1921, 1987, 2008.
ESP:	1883, 1890, 1913, 1920, 1924, 1931, 1977, 2008.
FIN:	1877, 1900, 1921, 1931, 1991.
FRA:	1882, 1889, 1930, 2008.
GBR:	1890, 1974, 1991, 2007.
ITA:	1873, 1887, 1893, 1907, 1921, 1930, 1935, 1990, 2008.
JPN:	1871, 1890, 1901, 1907, 1920, 1927, 1997.
NLD:	1921, 2008.
NOR:	1899, 1922, 1931, 1988.
PRT:	1890, 1920, 1923, 1931, 2008.
SWE:	1878, 1907, 1922, 1931, 1991, 2008.
USA:	1873, 1893, 1907, 1930, 1984, 2007.

## C. Business cycle peak timing

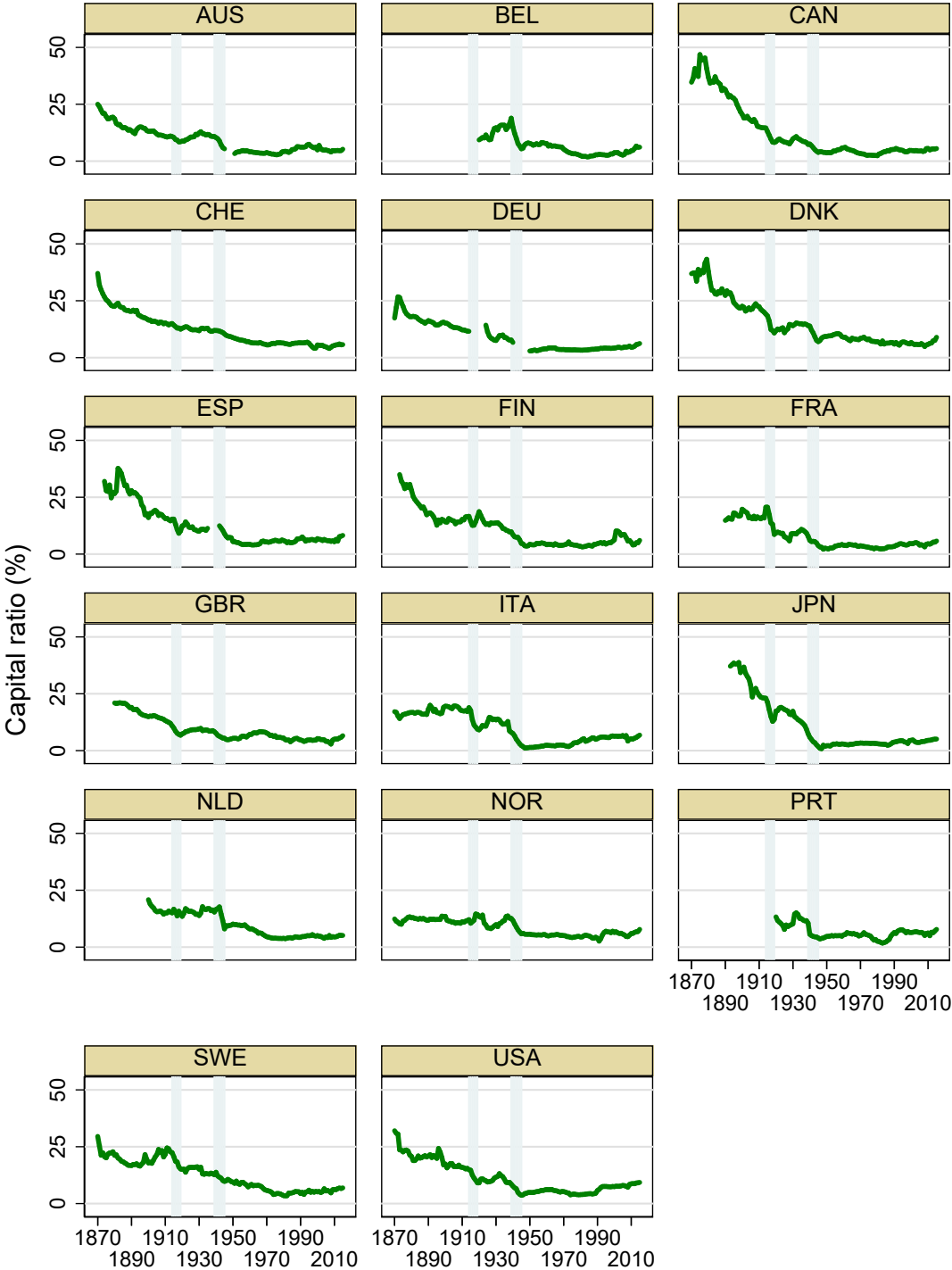
The local projections empirical analysis in the paper employs business cycle peaks from 1870 to 2008, excluding windows around the two world wars, with projections out to five years ahead, with the annual panel sample data. Peak dates and their classification are as shown in the table below, where “N” denotes a normal business cycle peak, and “F” denotes a peak associated with a systemic financial crisis (a crisis within  $\pm 2$  years of the peak). The dating method uses the [Bry and Boschan \(1971\)](#) algorithm. In the early sample period, with short business cycles, there can be more than one peak within the window. In these cases we classify according to historical narratives.

**Table A.1:** *Dates of normal (N) and financial crisis (F) recession peaks*

AUS	N	1875 1910 2008	1878 1913	1881 1926	1883 1938	1885 1943	1887 1951	1889 1956	1896 1961	1898 1973	1900 1976	1904 1981
	F	1891	1894	1989								
BEL	N	1872 1992	1887 2011	1890	1900	1913	1916	1942	1951	1957	1974	1980
	F	1870	1874	1883	1926	1930	1937	2007				
CAN	N	1871 1928	1874 1944	1877 1947	1882 1953	1884 1956	1888 1981	1891 1989	1894 2007	1903	1913	1917
	F	1907										
CHE	N	1875 1939	1880 1947	1886 1951	1890 1957	1893 1974	1899 1981	1902 1994	1906 2001	1916 2011	1920	1933
	F	1871	1912	1929	1990	2008						
DEU	N	1879 2001	1898	1905	1908	1913	1922	1943	1966	1974	1980	1992
	F	1875	1890	1928	2008							
DNK	N	1870 1950	1872 1962	1880 1973	1887 1979	1911 1992	1914	1916	1923	1931	1939	1944
	F	1876	1883	1920	1987	2007						
ESP	N	1873 1944	1877 1947	1892 1952	1894 1958	1901 1980	1909 1992	1911	1916	1927	1932	1935
	F	1884	1888	1913	1925	1929	2007					
FIN	N	1870 1957	1883 1975	1890 2008	1898 2011	1907	1913	1916	1938	1941	1943	1952
	F	1876	1900	1929	1989							
FRA	N	1872 1920	1874 1926	1892 1933	1894 1937	1896 1939	1900 1942	1905 1974	1907 1992	1909 2011	1912	1916
	F	1882	1929	2007								
GBR	N	1871 1929	1873 1938	1875 1943	1877 1951	1883 1957	1896 1979	1899	1902	1907	1918	1925
	F	1889	1973	1990	2007							
ITA	N	1870	1883	1897	1918	1925	1932	1939	1974	2002	2011	
	F	1874	1887	1891	1923	1929	1992	2007				
JPN	N	1875 1929	1877 1933	1880 1940	1882 1973	1887 2001	1892 2007	1895	1898	1903	1913	1921
	F	1890	1901	1907	1919	1925	1997					
NLD	N	1870 1937	1873 1939	1877 1957	1889 1974	1892 1980	1894 2001	1899 2011	1902	1906	1913	1929
	F	2008										
NOR	N	1876 2007	1881 2012	1885	1893	1902	1916	1923	1939	1941	1957	1981
	F	1897	1920	1930	1987							
PRT	N	1870 1925 1992	1873 1927 2002	1877 1934 2010	1888 1937	1893 1939	1900 1941	1904 1944	1907 1947	1912 1951	1914 1973	1916 1982
	F	1890	1923	1929	2008							
SWE	N	1873 1916	1876 1924	1881 1939	1883 1976	1885 1980	1888 2011	1890	1899	1901	1904	1913
	F	1879	1907	1920	1930	1990	2007					
USA	N	1875 1937	1882 1944	1887 1948	1889 1953	1895 1957	1901 1969	1909 1973	1913 1979	1916 1981	1918 1990	1926 2000
	F	1873	1892	1906	1929	2007						

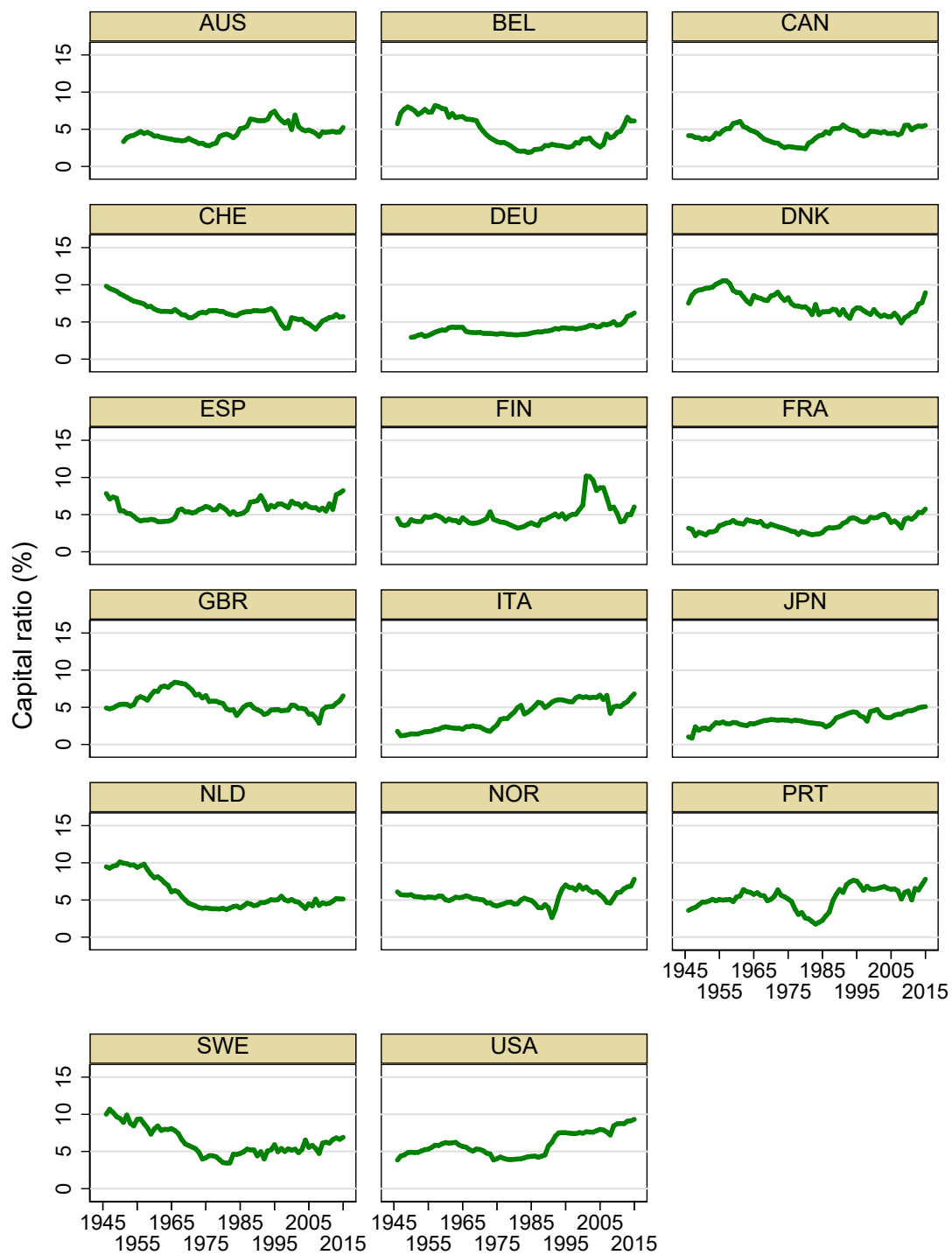
### D. Capital ratio series by country

Figure A.1: Capital ratio by country, full sample.



Notes: This figure plots the capital ratio for all 17 sample countries from 1870 to 2015. Years of world wars are shown in shading.

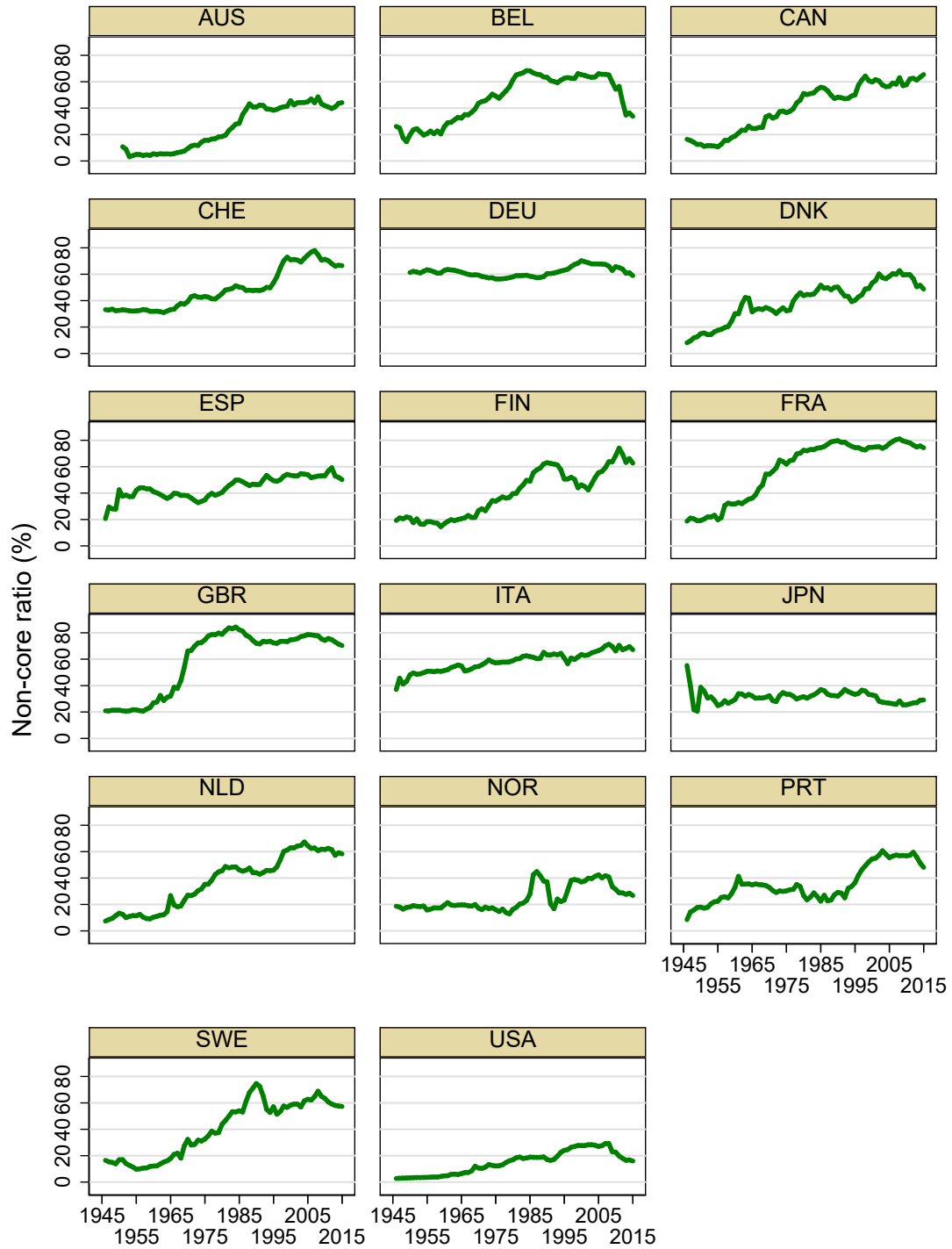
Figure A.2: Capital ratio, 17 countries, post-WW2 sample.



Notes: This figure plots the capital ratio for all sample countries for the period between 1945 and 2015.

## E. Non-core ratio series by country

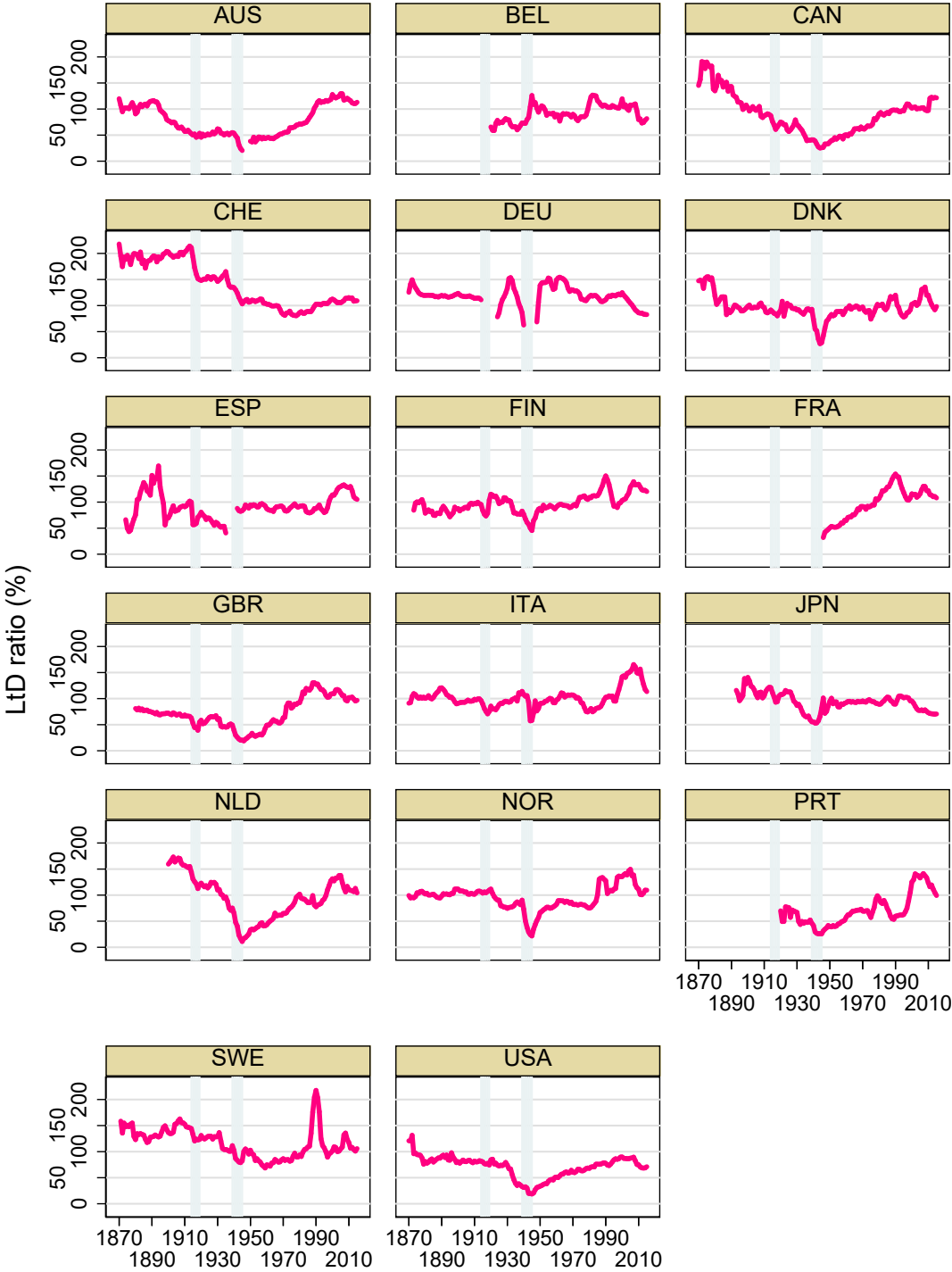
**Figure A.3:** Non-core ratio by country, averages by year for 17 countries, post-WW2 sample.



Notes: This figure plots the non-core ratio for all countries from 1945 to 2015.

## F. Loan-to-deposits ratio by country

Figure A.4: LtD ratio by country, averages by year for 17 countries, full sample.



Notes: Years of World Wars are shown in shading.

## G. Summary statistics

**Table A.2:** *Full sample: summary statistics*

	Mean	Min.	Max.	S.D.	Obs.
Capital ratio (%)	10.34	0.85	46.86	7.76	2018
$\Delta_5$ Capital ratio (%)	-0.07	-3.05	2.44	0.42	1773
LtD ratio (%)	97.83	18.44	218.16	31.50	1978
Non-core ratio (%)	35.84	2.35	84.37	20.14	1923

**Table A.3:** *Post-WW2 sample: summary statistics*

	Mean	Min.	Max.	S.D.	Obs.
Capital ratio (%)	5.11	0.85	10.68	1.76	1149
$\Delta_5$ Capital ratio (%)	0.01	-0.92	1.08	0.21	1064
LtD ratio (%)	93.14	18.44	217.52	27.14	1152
Non-core ratio (%)	41.68	2.91	84.37	19.98	1149

**Table A.4:** *Capital ratio summary statistics split by crises, full sample*

	No crisis observations					Crisis observations (one-period lagged)				
	Mean	Min.	Max.	S.D.	Obs.	Mean	Min.	Max.	S.D.	Obs.
Capital ratio (%)	10.22	0.85	46.86	7.71	1942	13.54	3.81	38.29	8.32	76
$\Delta_5$ Capital ratio (%)	-0.07	-2.41	2.44	0.41	1712	-0.07	-3.05	1.46	0.69	61

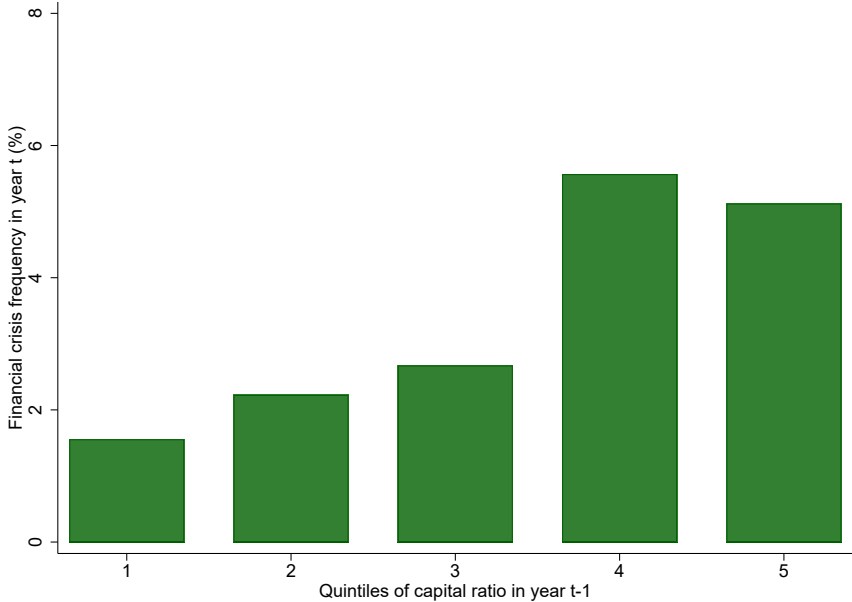
**Table A.5:** *Capital ratio summary statistics, post-WW2 sample*

	No crisis observations					Crisis observations (one-period lagged)				
	Mean	Min.	Max.	S.D.	Obs.	Mean	Min.	Max.	S.D.	Obs.
Capital ratio (%)	5.11	0.85	10.68	1.77	1125	5.27	3.81	7.89	1.14	24
$\Delta_5$ Capital ratio (%)	0.01	-0.92	1.08	0.21	1040	-0.00	-0.29	0.50	0.17	24



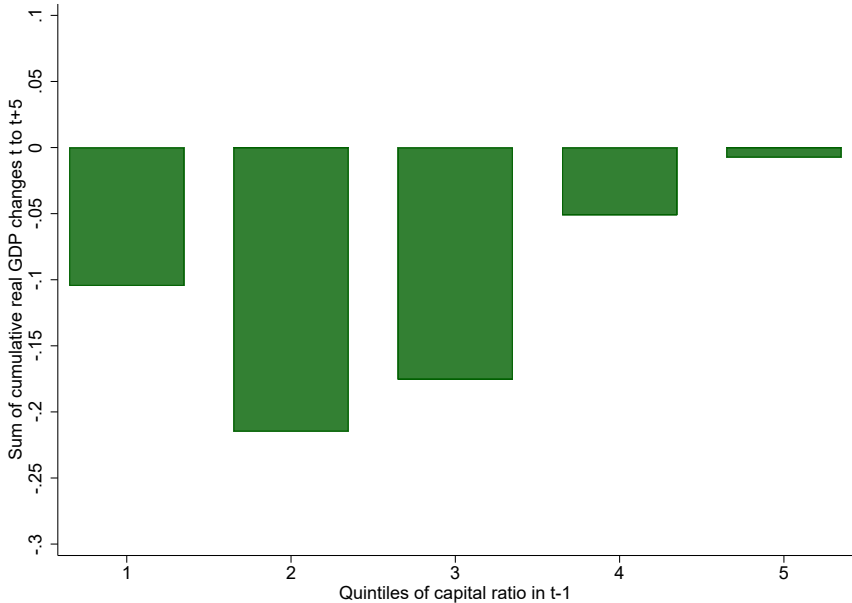
H. Binned barcharts

Figure A.5: Capital ratio levels and crisis frequency



Notes: This figure shows the relationship between levels in capital ratios and financial crisis frequencies. Observations are sorted into five equal-sized bins according to the capital ratio in  $t - 1$  sorted from 1 (lowest capital) to 5 (highest capital). Vertical bars indicate the frequency of financial crises in year  $t$  for each of the bins.

Figure A.6: Capital ratio levels and crisis outcomes



This figure shows the sum of cumulative growth in real GDP over the 5 years following a financial recession peak for different quintiles of the capital ratio sorted from 1 (lowest capital) to 5 (highest capital).

## I. Capital structure and crisis risk: Robustness checks

### I.1 Crisis prediction with standard errors clustered on country and year

**Table A.6:** *Multivariate probit models for systemic financial crises, standard errors clustered by country and year.*

	(1) Full	(2) Full	(3) Post	(4) Post	(5) Full	(6) Full	(7) Post	(8) Post
$\Delta_5$ Loans/GDP	14.42*** (2.55)	15.37*** (3.41)	13.12*** (2.28)	15.70*** (3.48)	9.47*** (1.73)	7.80*** (1.84)	12.81*** (2.03)	9.51** (3.70)
Capital ratio	3.02*** (0.99)	1.49 (3.23)						
$\Delta_5$ Capital ratio			-0.67 (15.68)	31.77 (41.65)				
LtD ratio					0.60** (0.30)	1.47*** (0.36)		
Non-core ratio							-0.05 (0.69)	4.82** (2.10)
Observations	1735	1004	1721	998	1713	1004	1671	1004

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are lagged by one period. All models include country fixed effects. The table corresponds to results in Table 4 in the main text. Here, we do not show marginal effects, but standard errors are clustered by country and year. \* $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

**Table A.7:** Multivariate probit models for systemic financial crises, controlling for asset risk, standard errors clustered by country and year.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Full	Full	Post	Post	Full	Full	Post	Post
$\Delta_5$ Loans/GDP	15.42*** (2.37)	14.45*** (3.45)	13.78*** (4.71)	8.84* (4.81)	15.21*** (2.24)	13.95*** (3.20)	13.99*** (4.59)	9.54* (4.94)
Capital ratio	2.96** (1.26)	3.77** (1.78)	3.19 (3.67)	0.24 (4.76)				
$\Delta_5$ Capital ratio					6.55 (18.78)	17.82 (31.18)	24.28 (47.18)	37.36 (47.53)
Macrocontrols	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Asset risk	No	Yes	No	Yes	No	Yes	No	Yes
Observations	1582	1277	988	887	1570	1274	984	884

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are lagged by one period. All models include country fixed effects. Macrocontrols include volatilities of real GDP per capita, inflation, loans-to-GDP and short-term interest rates as well as averaged real GDP per capita growth, inflation, and short term interest rates over the previous five years. Asset risks include average changes of real house prices and the volatility of house price growth over the previous five years and three lags of log excess returns on the bank index if available, on the general index otherwise. The table corresponds to results in Table 5 in the main text (no marginal effects here). Standard errors are clustered by country and year. \* $p < 0.10$ , \*\* $p < 0.05$ , \*\*\* $p < 0.01$

## I.2 Deposit insurance

The presence or absence of deposit insurance could affect the link between capital structure and crisis risk. Without deposit insurance, short-term debtors have incentives to monitor banks and force them to endogenously increase capital when they take more risk. When deposit insurance is in place, debtor control is weakened and risk-shifting incentives emerge more strongly. In Table A.8 we repeat the analysis from Table 5, but split the sample depending on whether a deposit insurance scheme is in place or not. We estimate separate models for the two subsamples consisting of observations with deposit insurance (DI), and without (No-DI). Unsurprisingly, the number of observations is higher in the No-DI sample, as deposit insurance was introduced in the mid to late 20th century in most countries. We include changes in credit/GDP, plus country fixed effects, along with risk and macroeconomic controls. With deposit insurance, capital ratios are no longer positively correlated with crisis risk. The coefficient estimate turns negative, but remains statistically weak. A similar pattern emerges for 5-year average annual changes in capital ratios. Once more, we find little evidence that lower capital predicts excessive risk taking by banks. Interestingly, it is only after the introduction of deposit insurance, that the non-core ratio—representing the remaining runnable debt on bank balance sheets—begins to play an important role (see column (8)).

**Table A.8:** *Multivariate probit models for systemic financial crises, samples split by existence of deposit insurance scheme.*

	(1) No-DI	(2) DI	(3) No-DI	(4) DI	(5) No-DI	(6) DI	(7) No-DI	(8) DI
$\Delta_5$ Loans/GDP	0.56*** (0.15)	0.22** (0.11)	0.79*** (0.17)	0.21* (0.13)	0.33** (0.15)	0.11 (0.11)	0.64*** (0.17)	0.13** (0.06)
Capital ratio	0.21*** (0.03)	-0.22 (0.18)						
$\Delta_5$ Capital ratio			0.73 (1.46)	-0.87 (1.13)				
LtD ratio					0.04*** (0.01)	0.03* (0.02)		
Non-core ratio							-0.02 (0.04)	0.08* (0.05)
Macrocontrols	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Asset Risk	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
AUC	0.88 (0.03)	0.86 (0.03)	0.84 (0.04)	0.86 (0.03)	0.86 (0.03)	0.86 (0.04)	0.84 (0.03)	0.88 (0.03)
Observations	675	536	672	536	627	536	604	536

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are lagged by one period. Samples are split by the existence of a deposit insurance scheme (DI). All models include country fixed effects. Coefficients are marginal effects. Macrocontrols includes volatilities of real GDP per capita, inflation and short-term interest rates as well as averaged real GDP per capita growth, inflation, and short term interest rates over the previous five years. Asset risks include average changes of real house prices and the volatility of house price growth over the previous five years and three lags of log excess returns on the bank index if available, on the general index otherwise. Clustered (by country) standard errors in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

### I.3 Market value of capital

We use data from Datastream on the price-to-book ratios for country level bank indices to compute this measure. Including this data causes our sample size to change substantially as the price-to-book ratio is only available for 14 of our 17 sample countries starting in 1973 or later.<sup>11</sup>

**Table A.9:** *Multivariate probit models for systemic financial crises, market-based capital ratio, controlling for asset risk.*

	(1)	(2)	(3)	(4)
$\Delta_5$ Loans/GDP	0.85*** (0.23)	0.14 (0.21)	0.98*** (0.29)	0.11 (0.19)
Market-based capital ratio	0.03 (0.12)	-0.16 (0.12)		
$\Delta_5$ Market-based capital ratio			0.62 (0.88)	0.24 (0.53)
Macrocontrols	No	Yes	No	Yes
House Price Changes	No	Yes	No	Yes
AUC	0.68 (0.07)	0.77 (0.06)	0.68 (0.07)	0.83 (0.04)
Observations	413	410	348	348

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and regressors are lagged by one period. All models include country fixed effects. Coefficients are marginal effects. Macrocontrols include volatilities of real GDP per capita, inflation, loans-to-GDP and short-term interest rates as well as averaged real GDP per capita growth, inflation, and short term interest rates over the previous five years. House price variables include average growth of real house prices and the volatility of house price growth over the previous five years. Clustered (by country) standard errors in parentheses. \* $p < 0.10$ , \*\* $p < 0.05$ , \*\*\* $p < 0.01$

Based on the price-to-book ratio and our balance sheet data, we compute market leverage as:<sup>12</sup>

$$\text{Market Leverage} \equiv \frac{\text{Market Value of Equity}}{\text{Book Value of Assets}} = \text{Price-to-book Ratio} \times \text{Capital Ratio}. \quad (8)$$

Column (1) of Table A.9 shows that, even with this measure, there is still no systematic relationship between bank capital and banking crises. Moreover, measured by the AUC, the market capital measure does not add any predictive power. In column (2) we additionally control for macroeconomic risks and house price changes and their volatility. We do not include bank risk premiums here, as bank equity risk premiums are closely related to changes in market capitalization. The coefficient on capital turns negative (the “right” sign), but remains insignificant, in just this one specification. Columns (3) and (4) confirm that short-run variation in this measure is unrelated to crisis risk. In short, the results are in line with our previous findings.

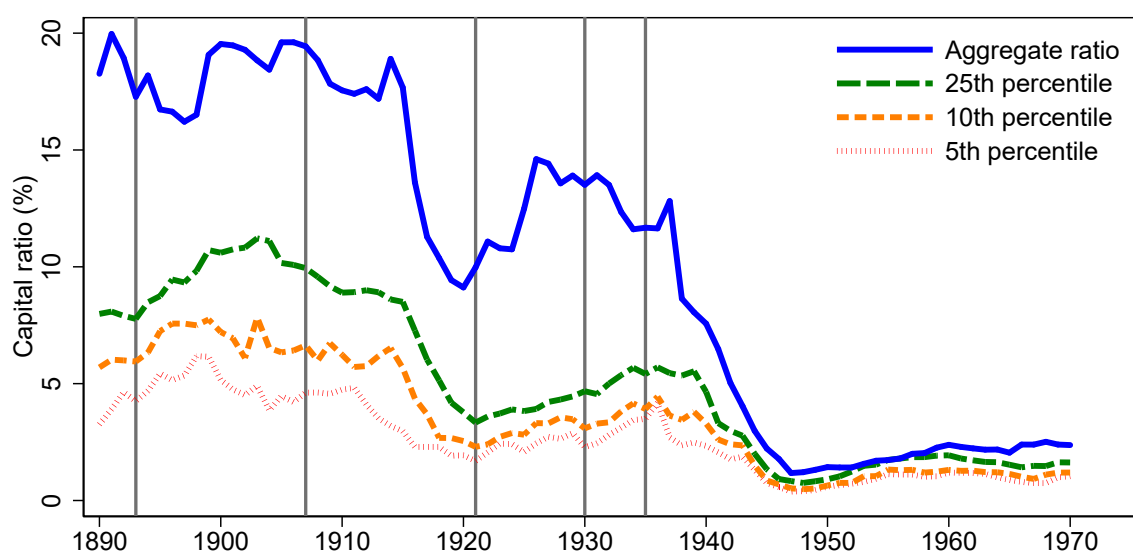
<sup>11</sup>There is insufficient data on price-to-book ratios for bank indices in Finland, Norway and Sweden.

<sup>12</sup>Note that the price-to-book ratio is market value divided by book value of equity and our capital ratio was defined as book value of capital divided by total assets. The price-to-book measure is only available for listed banks contained in the bank index. Hence, we have to assume that this ratio is representative for the entire banking sector.

## I.4 Concentration of risk

Aggregate capital ratios could mask substantial heterogeneity within banking systems and risks could be highly concentrated in a few, systemically important institutions or in a subset of banks with very low capital ratios. Our data do not have sufficient granularity for each country to subject these mechanisms to empirical tests. However, we can analyze these mechanisms based on available data for various subsamples. We turn to this now. First, we study whether capital ratios at the most highly levered banks helps predict a financial crisis. Here we rely on evidence from Italy, where the Historical Archive of Credit (Natoli, Piselli, Triglia, and Vercelli, 2016) contains micro-level balance sheet data for the near-universe of banks over more than 80 years, from 1890 to 1973. In a second step, we focus on the capital at the biggest banks, where we have data for a few countries.

**Figure A.7:** *Capital ratio dispersion of banks in Italy.*



Notes: Percentiles of capital ratio in Italy, 1890–1973: the 5th percentile (red dot), the 10th percentile (orange dash), the 25th percentile (green long dash) and the aggregate ratio (blue solid). Vertical lines correspond to systemic financial crises. See text.

**Table A.10:** *Probit models for systemic financial crises in Italy, sample 1890–1973.*

	5th pctl	10th pctl	25th pctl	Aggregate
Capital Ratio	1.93 (1.41)	1.21 (0.99)	0.79 (0.70)	0.65* (0.37)
AUC	0.64 (0.08)	0.64 (0.08)	0.64 (0.09)	0.67 (0.12)
Observations	66	66	66	66

Notes: The table shows probit classification models where the dependent variable is the financial crisis dummy. Coefficients are marginal effects. Regressors are in one-period lagged levels. Robust standard errors in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

During the period for which we have data, Italy experienced five systemic banking crises: 1893, 1907, 1921, 1930, and 1935. For our analysis, we use all observations on joint-stock banks and savings banks that are present at least 5 years in the sample and have a market share larger than 0.1% in the

respective year. We exclude cooperative banks as these were sampled only every 5 years. For all the remaining banks we observe the capital ratio yearly.

In [Figure A.7](#) we present the evolution of different percentiles of the capital ratio distribution per year. The paths of the 5th (red dot), the 10th (orange dash), and the 25th percentiles (green long dash) of the distribution of capital ratios across banks display a similar time series pattern as the aggregate ratio (blue solid) used in our macro-level analysis. In addition, the distribution becomes less dispersed over time. Unlike today, it does not seem to be the case that the largest banks have the lowest capital ratios. The banks contained in the 10th percentile for example fluctuate between 6% and 10% of market share, measured by total assets, between 1890 and 1973.

[Table A.10](#) confirms this impression. We again estimate a probit model with the crisis dummy as the dependent variable and the lagged capital ratio as an explanatory variable, excluding war years from the sample. Yet instead of only using the aggregate capital ratio, we also use various percentiles of the capital ratio distribution.

The results reported are consistent with our previous findings. The lagged level of the capital ratio is positively associated with financial instability. The coefficients are insignificant, but similar to the one for the aggregate measure in the same sample. The aggregate measure has the highest AUC, but AUC differences across columns are insignificant. These findings were also confirmed when we re-estimated the specifications using the 5-year changes in capital ratios instead of lagged levels.

## I.5 Capitalization of the largest banks

The capitalization of the largest and systemically important banks could be key to understanding financial crisis risks. In fact, current regulations often contain capital surcharges for large and inter-connected institutions. Hence, we test whether low or falling capital ratios of the largest banks signal growing financial fragility.

The analysis in this section builds on micro-data collected and kindly shared by [Mazbouri et al. \(2017\)](#) for a subset of the largest banks in Belgium, France, Germany, Italy, Switzerland, and the UK for the period 1890 to 1970. We extended the coverage using data for the same set of banks in France, Germany, Switzerland, and the UK. We also added recent data from statistics for large commercial banks from the OECD Banking Statistics. In addition, we collected additional data from Denmark, Italy, the Netherlands, Norway, Sweden, and the US. The capital ratio measure used here is now an asset-weighted capital ratio of the largest banks.

The core results are presented in [Table A.11](#). Column (1) shows the baseline regression including the lagged capital ratio of the largest banks for the full sample. Column (2) includes our control variables. Columns (3) and (4) repeat these these specifications in post-WW2 data. The results are similar to our previous findings. As in the aggregated data, the coefficient estimates are positive in the full sample. They turn negative, but insignificant, when estimated on a post-WW2 sample. In columns (5) to (8) we look at short-run variation and use 5-year changes instead of the capital ratio levels. The coefficients are negative, but insignificant and without adding predictive power as measured by the AUCs.

**Table A.11:** *Probit models for systemic financial crises. Largest banks.*

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Full	Full	Post	Post	Full	Full	Post	Post
$\Delta_5$ Loans/GDP	1.17*** (0.19)	0.92*** (0.23)	0.82** (0.37)	0.10 (0.13)	1.29*** (0.22)	1.01*** (0.31)	0.98*** (0.37)	0.00 (0.19)
Capital ratio large banks	0.06 (0.05)	0.10 (0.08)	-0.28 (0.49)	-0.30 (0.19)				
$\Delta_5$ Capital ratio large banks					0.10 (1.28)	0.07 (1.30)	-2.91 (5.33)	-1.55 (1.57)
Macro controls	No	Yes	No	Yes	No	Yes	No	Yes
House price changes	No	Yes	No	Yes	No	Yes	No	Yes
Excess stock returns	No	Yes	No	Yes	No	Yes	No	Yes
AUC	0.72 (0.05)	0.78 (0.05)	0.72 (0.07)	0.86 (0.04)	0.74 (0.05)	0.80 (0.04)	0.73 (0.08)	0.88 (0.04)
Observations	855	673	432	398	771	611	382	352

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are one-period lagged. Data on capital ratios is from the largest banks in a country only (see text). All models include country fixed effects. Coefficients shown are marginal effects. Macrocontrols includes volatilities of real GDP per capita, inflation and short-term interest rates as well as averaged real GDP per capita growth, inflation, and short term interest rates over the previous five years. Asset risks include average changes of real house prices and the volatility of house price growth over the previous five years and three lags of log excess returns on the bank index if available, on the general index otherwise. Clustered (by country) standard errors in parentheses. \* $p < 0.10$ , \*\* $p < 0.05$ , \*\*\* $p < 0.01$



## I.6 Credit boom and capital ratio interactions

**Table A.12:** *Probit models for systemic financial crises, credit interacted with high capital ratio indicator.*

	(1)	(2)	(3)	(4)	(5)	(6)
	Full	Full	Post	Post	Post	Post
$\Delta_5$ Loans/GDP	0.85*** (0.17)	0.53*** (0.17)	0.45 (0.29)	0.10 (0.24)	0.56 (0.41)	-0.04 (0.29)
High capital	0.02*** (0.01)	0.01 (0.01)	-0.01 (0.01)	-0.01 (0.01)		
High capital (market-based)					-0.00 (0.02)	-0.01 (0.02)
$\Delta_5$ Loans/GDP x High capital	-0.02 (0.30)	0.28 (0.24)	0.26 (0.36)	0.23 (0.24)	0.48 (0.59)	0.31 (0.44)
Macro controls	No	Yes	No	Yes	No	Yes
House price changes	No	Yes	No	Yes	No	Yes
Excess stock returns	No	Yes	No	Yes	No	Yes
AUC	0.75 (0.03)	0.80 (0.03)	0.76 (0.05)	0.84 (0.04)	0.67 (0.06)	0.79 (0.05)
Observations	1735	1277	1004	887	410	410

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy. All models include country fixed effects. Coefficients are marginal effects. Interactions are between lagged 5-year average annual changes in loans-to-GDP and dummies indicating whether the lagged capital ratio is above (high) or below (low) the respective sample median. Macrocontrols includes volatilities of real GDP per capita, inflation and short-term interest rates as well as averaged real GDP per capita growth, inflation, and short term interest rates over the previous five years. Asset risks include average changes of real house prices and the volatility of house price growth over the previous five years and three lags of log excess returns on the bank index if available, on the general index otherwise. See text. Clustered (by country) standard errors in parentheses. \* $p < 0.10$ , \*\* $p < 0.05$ , \*\*\* $p < 0.01$

Rapid balance sheet expansions—that is, credit booms—lie at the heart of financial crisis dynamics. If more skin in the game induces prudent behavior by banks, we would expect to find in the data that credit booms occurring at high levels of bank equity are considerably less likely to end in a crisis than credit booms financed with less equity. Hence we define an indicator variable for high levels of capital, specifically when the lagged capital ratio of the banking sector is above the median in the respective sample.

We then test the proposition using interaction terms in our original model. [Table A.12](#) provides no support for the view that higher capital has disciplining effects. The interaction coefficients for 5-year average annual credit expansion and the indicator for a high capital ratio are typically positive, for the full sample and the post-WW2 period. This holds both for book values of capital (columns 1 to 4) and market values of capital (columns 5 and 6). The inclusion of controls for asset risk and macroeconomic risk predictors lowers the coefficients, but does not change the overall picture. Credit booms financed with more capital are as dangerous as credit booms financed with more debt.

## I.7 Baseline probit model results without changes in credit/GDP

**Table A.13:** *probit models for systemic financial crises, full sample.*

	(1)	(2)	(3)	(4)	(5)	(6)
Capital ratio	0.17*** (0.03)					
$\Delta_5$ Capital ratio		0.01 (1.07)				
LtD ratio			0.06*** (0.01)			
$\Delta_5$ LtD				0.43*** (0.07)		
Non-core ratio					0.02 (0.03)	
$\Delta_5$ Non-core ratio						0.68*** (0.22)
AUC	0.67 (0.03)	0.62 (0.03)	0.68 (0.03)	0.69 (0.04)	0.63 (0.03)	0.65 (0.03)
Observations	2018	1773	1978	1743	1923	1698

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are in lagged 5-year average annual changes ( $\Delta_5$ ) or in one-period lagged levels. Coefficients are shown as marginal effects. All models include country fixed effects. Clustered (by country) standard errors in parentheses. \* $p < 0.10$ , \*\* $p < 0.05$ , \*\*\* $p < 0.01$

**Table A.14:** *Probit models for systemic financial crises, post-WW2 sample.*

	(1)	(2)	(3)	(4)	(5)	(6)
Capital ratio	-0.12 (0.31)					
$\Delta_5$ Capital ratio		-0.09 (2.20)				
LtD ratio			0.06*** (0.00)			
$\Delta_5$ LtD				0.40*** (0.08)		
Non-core ratio					0.09*** (0.02)	
$\Delta_5$ Non-core ratio						0.65** (0.27)
AUC	0.59 (0.06)	0.60 (0.06)	0.80 (0.04)	0.73 (0.06)	0.83 (0.03)	0.65 (0.05)
Observations	1081	1001	1084	1004	1081	1001

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are in lagged 5-year average annual changes ( $\Delta_5$ ) or in one-period lagged levels. Coefficients are shown as marginal effects. All models include country fixed effects. Clustered (by country) standard errors in parentheses. \* $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

**Table A.15:** Probit models for systemic financial crises, pre-1914 sample.

	(1)	(2)	(3)	(4)	(5)	(6)
Capital ratio	0.08 (0.15)					
$\Delta_5$ Capital ratio		0.87 (1.30)				
LtD ratio			0.12** (0.05)			
$\Delta_5$ LtD				0.69*** (0.27)		
Non-core ratio					0.17 (0.12)	
$\Delta_5$ Non-core ratio						1.66*** (0.61)
AUC	0.65 (0.06)	0.67 (0.05)	0.72 (0.05)	0.71 (0.05)	0.66 (0.05)	0.70 (0.05)
Observations	519	454	518	453	485	425

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are in lagged 5-year average annual changes ( $\Delta_5$ ) or in one-period lagged levels. Coefficients are marginal effects. All models include country fixed effects. Clustered (by country) standard errors in parentheses. \* $p < 0.10$ , \*\* $p < 0.05$ , \*\*\* $p < 0.01$

## I.8 Comparing predictive accuracy across probit models

**Table A.16:** AUCs from multivariate probit models for systemic financial crises.

	(1) Full model	(2) Excl. credit growth	(3) Excl. capital ratio	(4) Excl. non-core ratio
<b>Full sample</b>				
AUC	0.759	0.704	0.713	0.753
$H_0 : AUC = AUC^{Full},$ p-value		0.022	0.009	0.387
<i>N</i>	1671	1671	1671	1671
<b>Pre-WW1 sample</b>				
AUC	0.727	0.672	0.729	0.703
$H_0 : AUC = AUC^{Full},$ p-value		0.043	0.849	0.467
<i>N</i>	397	397	397	397
<b>Post-WW2 sample</b>				
AUC	0.843	0.821	0.840	0.740
$H_0 : AUC = AUC^{Full},$ p-value		0.217	0.644	0.007
<i>N</i>	1004	1004	1004	1004

*Notes:* This table reports the AUC for different probit classification models. The full model includes lagged values of the smoothed 5-year change in loans-to-GDP, the capital ratio, and non-core ratio as regressors. In columns (2)-(4) we drop one regressor at the time. For these specifications we report the AUC and the p-value of a test of equality of the AUC with the AUC of the full model.

## I.9 Probit models without country fixed effects

**Table A.17:** Probit models for systemic financial crises, full sample, no fixed effects.

	(1)	(2)	(3)	(4)	(5)	(6)
Capital ratio	0.17*** (0.04)					
$\Delta_5$ Capital ratio		0.09 (1.15)				
LtD ratio			0.04*** (0.02)			
$\Delta_5$ LtD				0.46*** (0.09)		
Non-core ratio					0.01 (0.02)	
$\Delta_5$ Non-core ratio						0.65*** (0.24)
AUC	0.64 (0.03)	0.54 (0.04)	0.63 (0.03)	0.63 (0.04)	0.52 (0.04)	0.55 (0.04)
Observations	2018	1773	1978	1743	1923	1698

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are in lagged 5-year average annual changes ( $\Delta_5$ ) or in one-period lagged levels. Coefficients are marginal effects. Robust standard errors in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

**Table A.18:** *Probit models for systemic financial crises, post-WW2 sample, no fixed effects.*

	(1)	(2)	(3)	(4)	(5)	(6)
Capital ratio	0.11 (0.17)					
$\Delta_5$ Capital ratio		-0.34 (2.06)				
LtD ratio			0.05*** (0.01)			
$\Delta_5$ LtD				0.37*** (0.08)		
Non-core ratio					0.07*** (0.01)	
$\Delta_5$ Non-core ratio						0.61*** (0.23)
AUC	0.55 (0.05)	0.51 (0.05)	0.74 (0.05)	0.68 (0.06)	0.74 (0.05)	0.57 (0.06)
Observations	1149	1064	1152	1067	1149	1064

Notes: The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are in lagged 5-year average annual changes ( $\Delta_5$ ) or in one-period lagged levels. Coefficients are marginal effects. Robust standard errors in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

## I.10 Probit models excluding the global financial crisis

**Table A.19:** Multivariate probit models for systemic financial crises, full sample excluding the global financial crisis.

	(1)	(2)	(3)	(4)	(5)	(6)
Capital ratio	0.19*** (0.02)					
$\Delta_5$ Capital ratio		0.12 (1.08)				
LtD ratio			0.06*** (0.02)			
$\Delta_5$ LtD				0.44*** (0.07)		
Non-core ratio					-0.02 (0.03)	
$\Delta_5$ Non-core ratio						0.71*** (0.26)
AUC	0.71 (0.03)	0.63 (0.04)	0.68 (0.03)	0.68 (0.04)	0.63 (0.03)	0.64 (0.04)
Observations	1865	1544	1766	1460	1711	1415

Notes: The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are in lagged 5-year average annual changes ( $\Delta_5$ ) or in one-period lagged levels. Coefficients are marginal effects. All specifications include a country fixed effect. Clustered (by country) standard errors in parentheses. \* $p < 0.10$ , \*\* $p < 0.05$ , \*\*\* $p < 0.01$



## I.11 Probit models excluding the US and the UK

**Table A.20:** *Multivariate probit models for systemic financial crises, full sample excluding the US and the UK.*

	(1)	(2)	(3)	(4)	(5)	(6)
Capital ratio	0.17*** (0.03)					
$\Delta_5$ Capital ratio		0.00 (1.10)				
LtD ratio			0.05*** (0.02)			
$\Delta_5$ LtD				0.40*** (0.07)		
Non-core ratio					0.00 (0.03)	
$\Delta_5$ Non-core ratio						0.67*** (0.26)
AUC	0.68 (0.03)	0.63 (0.04)	0.68 (0.03)	0.69 (0.04)	0.63 (0.03)	0.66 (0.04)
Observations	1768	1553	1728	1523	1725	1520

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are in lagged 5-year annual average changes ( $\Delta_5$ ) or in one-period lagged levels. Coefficients are marginal effects. All models include country fixed effects. Clustered (by country) standard errors in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

**Table A.21:** *Multivariate probit models for systemic financial crises, post-WW2 sample excluding the US and the UK.*

	(1)	(2)	(3)	(4)	(5)	(6)
Capital ratio	-0.09 (0.34)					
$\Delta_5$ Capital ratio		1.24 (2.01)				
LtD ratio			0.06*** (0.00)			
$\Delta_5$ LtD				0.36*** (0.07)		
Non-core ratio					0.07** (0.03)	
$\Delta_5$ Non-core ratio						0.73** (0.32)
AUC	0.57 (0.07)	0.60 (0.07)	0.80 (0.05)	0.74 (0.07)	0.85 (0.04)	0.66 (0.06)
Observations	945	875	948	878	945	875

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and the regressors are in lagged 5-year annual average changes ( $\Delta_5$ ) or in one-period lagged levels. Coefficients are marginal effects. All models include country fixed effects. Clustered (by country) standard errors in parentheses. \* $p < 0.10$ , \*\* $p < 0.05$ , \*\*\* $p < 0.01$

## I.12 Country-decade fixed effects

**Table A.22:** *Multivariate probit models for systemic financial crises, full sample including country-decade fixed effects.*

	(1)	(2)	(3)	(4)	(5)	(6)
$\Delta_5$ Loans/GDP	3.89*** (0.81)	2.12** (0.96)	3.26*** (0.79)	2.61*** (0.84)	1.12 (0.91)	1.87* (0.96)
Capital ratio	-0.43 (0.94)			1.46 (1.09)		
LtD ratio		0.51*** (0.17)			0.35*** (0.13)	
Non-core ratio			0.92*** (0.25)			0.78*** (0.26)
Macro controls	No	No	No	Yes	Yes	Yes
Asset risk	No	No	No	Yes	Yes	Yes
AUC	0.72 (0.03)	0.75 (0.03)	0.73 (0.03)	0.83 (0.03)	0.83 (0.03)	0.83 (0.03)
Observations	521	512	502	393	384	384

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy and regressors are lagged by one period. Coefficients are marginal effects. All models include country-decade fixed effects. Clustered (by country) standard errors in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

### I.13 Crisis chronology: robustness

**Table A.23:** Multivariate probit models for systemic financial crises, using *Baron et al. (2020)* crisis chronology, controlling for asset risk.

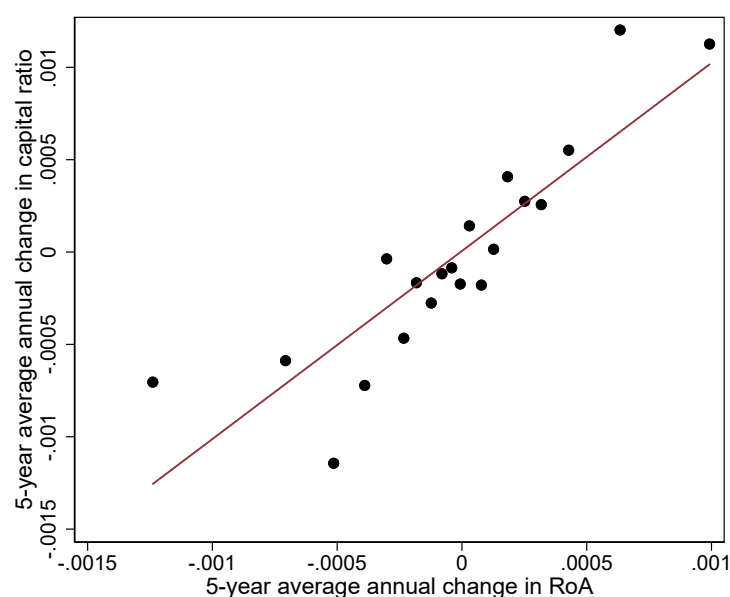
	(1) Full	(2) Full	(3) Post	(4) Post	(5) Full	(6) Full	(7) Post	(8) Post
$\Delta_5$ Loans/GDP	1.02*** (0.11)	0.80*** (0.15)	0.84*** (0.10)	0.31** (0.14)	1.00*** (0.11)	0.80*** (0.16)	0.87*** (0.10)	0.33** (0.15)
Capital ratio	0.13*** (0.04)	0.10 (0.09)	0.09 (0.33)	-0.17 (0.24)				
$\Delta_5$ Capital ratio					-0.29 (1.16)	-0.16 (1.28)	2.62 (2.26)	0.67 (1.59)
Macrocontrols	No	Yes	No	Yes	No	Yes	No	Yes
Asset prices	No	Yes	No	Yes	No	Yes	No	Yes
AUC	0.74 (0.03)	0.81 (0.03)	0.75 (0.05)	0.87 (0.03)	0.72 (0.03)	0.81 (0.03)	0.75 (0.05)	0.87 (0.03)
Observations	1735	1329	1067	939	1721	1326	1061	936

*Notes:* The table shows probit classification models where the dependent variable is a financial crisis dummy based on *Baron et al. (2020)* and regressors are lagged by one period. All models include country fixed effects. Coefficients are marginal effects. Macrocontrols include volatilities of real GDP per capita, inflation and short-term interest rates as well as averaged real GDP per capita growth, inflation, and short term interest rates over the previous five years. Asset risks include average changes of real house prices and the volatility of house price growth over the previous five years and three lags of log excess returns on the bank index if available, on the general index otherwise. Clustered (by country) standard errors in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

## I.14 Instrumenting changes in capital ratios

The surprising finding that more capital increases the likelihood of a crisis (albeit by a very small amount indistinguishable from zero statistically) runs counter to intuition. Thus, our strategy of controlling for observable factors that simultaneously explain crisis risk and are correlated with capital may have been insufficient. Regulators, market participants, or both could force banks to increase capital buffers when crisis risk is perceived to be high. This type of simultaneity bias could be masking the true relationship. Here, we will use an instrumental variable approach to address potential endogeneity. The instrument relies on variation in the wiggle room that banks have to adjust capital buffers by retaining profits. [Cohen and Scatigna \(2016\)](#) show that retained earnings have been the most important source of bank capital increases in advanced economies after the financial crisis and that banks also retained a significant fraction of earnings in earlier periods.

**Figure A.8:** *RoA as an instrument for capital ratio changes*



*Notes:* The figure shows binned scatterplots for 5-year average changes in capital ratios and 5-year average changes in RoA. Observations are collapsed into 20 equal sized bins according to 5-year average annual changes in RoA. Each point represents the group specific means of 5-year average annual changes in capital ratios and 5-year average annual changes in RoA. A fitted regression line is shown in red.

This behavior is also reflected in balance sheet data. As of 2018Q3, undivided profits account for 37.8% of total bank equity capital of commercial and savings banks in the US, which is slightly below the average share for the post-1984 period.<sup>13</sup> The higher profits are relative to total assets, the more banks can increase capital ratios by retaining these profits in the bank. Hence, retained earnings are a natural instrument for variation in capital ratios that can be justifiably be considered independent of perceptions of impending financial fragility.

We will exploit this relationship using data for banking sector profit and loss accounts from [Richter and Zimmermann \(2018\)](#) and instrument changes in capital ratios with changes in return on assets (RoA), the ratio of net income after tax to book assets. We define the 5-year change in this variable as  $\Delta_5 RoA_{i,t} = RoA_{i,t} - RoA_{i,t-5}$ . Including controls for asset growth and bank risk premia ensures that we capture only variation in capital ratios that is driven by changes in RoA that are unrelated to risk taking, following [Meiselman et al. \(2018\)](#). For the instrument to be relevant, a positive first-stage association between changes in RoA and changes in the capital ratio is required.

<sup>13</sup>Numbers are based on data from the "FDIC - Quarterly Banking Profile Time Series Spreadsheets".

Figure A.8 presents evidence of such a strong relationship between 5-year average changes in RoA and 5-year average changes in capital ratios.

There is no formal way to evaluate the validity of the instrument with just identification, as it is the case here. However, the economic justification seems clear. In good times, returns on assets increase. Banks will then retain some of the higher profits earned. Controlling for asset growth and bank risk, banks acquire more “skin in the game,” which in turn allows us to evaluate whether it reduces future crisis risk. It turns out that even as we are able to obtain a more intuitive link between capital and crisis risk, this link is tenuous economically and statistically, as we will see next.

Table A.24 presents the instrumental variable probit results for the post-WW2 sample and starts from a simple benchmark model including only changes in the loans-to-GDP ratio over the previous five years, as shown in the first column; this model has an AUC of 0.75. In the second column, we now add changes in the capital ratio over the last five years. The change in the capital ratio is insignificant—just as in our previous exercises—and it does not add any predictive accuracy to the benchmark model; the AUC is still 0.75. In column (3), the IV model now instruments changes in the capital ratio with changes in RoA. The first-stage regression (unreported) confirms the relevance of the instrument and has an  $F$ -statistic of 45.05. The coefficient for changes in capital ratios instrumented with RoA turns negative. But the coefficient of the capital ratio remains insignificant and does not add any predictive accuracy in comparison to previous models. Thus, if our IV strategy purges the estimates of endogeneity, it does not alter our main finding. Columns (4) to (6) follow the same strategy, but also include macrocontrols and asset risks as in our previous exercises. The message of the table is clear: changes in capital ratios are unrelated to financial crisis risks, even when we account for endogeneity. The results are statistically and economically small.

**Table A.24:** *Instrumental variable regression.*

	(1) No Cap	(2) Cap	(3) IV	(4) No Cap	(5) Cap	(6) IV
$\Delta_5$ Loans/GDP	0.72*** (0.09)	0.72*** (0.09)	0.73** (0.31)	0.26* (0.15)	0.27 (0.17)	0.27 (0.25)
$\Delta_5$ Capital ratio		0.16 (2.02)	-0.23 (7.83)		0.27 (1.50)	-0.10 (4.35)
Asset risks	No	No	No	Yes	Yes	Yes
Macrocontrols	No	No	No	Yes	Yes	Yes
AUC	0.75 (0.06)	0.75 (0.06)	0.72 (0.06)	0.85 (0.05)	0.85 (0.05)	0.83 (0.04)
Observations	844	844	844	749	749	749

*Notes:* The table shows probit classification models where the dependent variable is the financial crisis dummy. Column (1) includes lagged 5-year average annual changes in loans-to-GDP. Column (2) additionally includes lagged 5-year average annual changes in capital ratios. In column (3) 5-year average annual changes in capital ratios are instrumented with 5-year average annual changes in RoA. The  $F$ -statistic of the first stage regression for this model is 45.05. Columns (4), (5) and (6) additionally include macrocontrols and asset risks. Macrocontrols includes volatilities of real GDP per capita, inflation and short-term interest rates as well as averaged real GDP per capita growth, inflation, and short term interest rates over the previous five years. Asset risks include average changes of real house prices and the volatility of house price growth over the previous five years and three lags of log excess returns on the bank index if available, on the general index otherwise. Coefficients shown are marginal effects. All models include country fixed effects. Clustered (by country) standard errors in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

## J. Local projections robustness checks

### J.1 Local projections without controls

An estimate using panel local projections without covariates can be obtained from,

$$\Delta_h y_{i,t(p)} = \sum_{i=1}^{I-1} \alpha_{i,h} D_{i,t(p)} + \mu_h + \gamma_h^{HI} d_{i,t(p)} \times \delta_{i,t(p)} + \gamma_h^{LO} d_{i,t(p)} \times (1 - \delta_{i,t(p)}) + \epsilon_{i,t(p)}, \quad (9)$$

**Table A.25:** Normal versus financial recessions, real GDP per capita by capital ratio, no controls, full sample.

Dependent variable: change in  $100 \times \log$  real GDP per capita relative to Year 0

	(1)	(2)	(3)	(4)	(5)	(6)
	Year 1	Year 2	Year 3	Year 4	Year 5	Sum
Recession	-1.94*** (0.14)	-0.06 (0.27)	2.29*** (0.28)	3.96*** (0.38)	5.34*** (0.29)	9.60*** (1.20)
Financial recession, high capital ratio	-1.39* (0.76)	-2.71** (1.01)	-3.42*** (1.02)	-2.29 (1.52)	-2.97* (1.43)	-12.79** (4.48)
Financial recession, low capital ratio	-1.06* (0.52)	-3.87*** (1.18)	-6.12*** (1.54)	-6.92*** (1.87)	-7.43*** (1.40)	-25.40*** (6.00)
$R^2$	0.531	0.187	0.179	0.195	0.257	0.177
$H_0$ : financial high = low, $p$ -value	0.65	0.28	0.16	0.05	0.04	0.08
Observations	248	248	248	248	248	248

Notes: Standard errors (clustered by country) in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . The dependent variable is the cumulative change in real GDP per capita from the start of the recession. Financial recessions are binned depending on whether the lagged capital ratio of the banking sector at the peak was above or below the historical mean.

Estimates in Table A.25 are for the full sample of  $N = 248$  recessions. On average, financial recessions are worse than normal recessions, as shown by the negative coefficients in the second and third rows. However, though the path is still much worse than normal, the economy recovers faster from a financial recession with a well-capitalized banking sector. After 5 years, output per capita is more than four percentage points lower relative to a normal recession when the banking sector is poorly capitalized (-7.43%) than otherwise (-2.97%).

Table A.25 reports the  $p$ -value of a test of the null that the coefficients for low and high bank capital ratios at the start of the crisis are equal. The tests show that the coefficients are generally statistically different from each other (with  $p$ -values below 0.10 after year 3). However, economically speaking, higher bank capital at the onset of a financial crisis coincides with a considerably faster economic recovery. Over the 5-year period considered, the relative cumulative GDP costs of a financial crisis with a below-average capitalized banking sector amount, on average, to a loss of more than 12 percentage points of cumulative GDP as reported in column (6) of the table (compare -25.40% with -12.79%).

## J.2 Local projections with standard errors clustered on country and year

**Table A.26:** Normal versus financial recessions, real GDP per capita by capital ratio, with controls, full sample, standard errors clustered by country and year.

Dependent variable: change in  $100 \times \log$  real GDP per capita relative to Year 0

	(1) Year 1	(2) Year 2	(3) Year 3	(4) Year 4	(5) Year 5	(6) Sum
Recession	-1.81*** (0.13)	-0.24 (0.29)	2.13*** (0.34)	3.81*** (0.45)	5.28*** (0.41)	9.17*** (1.39)
Financial recession, high capital ratio	-1.36 (0.85)	-3.01*** (1.07)	-3.69*** (0.95)	-2.60** (1.15)	-3.09*** (0.86)	-13.75*** (3.82)
Financial recession, low capital ratio	-1.22* (0.65)	-4.80*** (1.14)	-7.63*** (1.58)	-9.42*** (1.63)	-9.46*** (1.05)	-32.52*** (5.35)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
$R^2$	0.558	0.327	0.339	0.330	0.397	0.331
$H_0$ : financial high = low, $p$ -value	0.88	0.17	0.06	0.00	0.00	0.00
Observations	210	210	210	210	210	210

Notes: Standard errors (clustered by country and year) in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . The dependent variable is the cumulative change in real GDP per capita from the start of the recession. Financial recessions are binned depending on whether the lagged capital ratio of the banking sector at the peak was above or below the historical mean. Corresponds to Table 7 in the main text.



### J.3 Local projections with continuous measure and standard errors clustered on country and year

**Table A.27:** Normal versus financial recessions, real GDP per capita with continuous capital ratios, with controls, full sample, standard errors clustered by country and year.

Dependent variable: change in  $100 \times \log$  real GDP per capita relative to Year 0

	(1) Year 1	(2) Year 2	(3) Year 3	(4) Year 4	(5) Year 5	(6) Sum
Recession	-1.79*** (0.13)	-0.24 (0.30)	2.04*** (0.34)	3.74*** (0.44)	5.21*** (0.41)	8.97*** (1.36)
Financial recession	-1.28** (0.56)	-4.04*** (0.88)	-5.95*** (0.83)	-6.52*** (1.08)	-6.76*** (0.62)	-24.55*** (3.38)
Normal recession × capital ratio	-0.03 (0.03)	-0.05 (0.05)	0.06 (0.08)	-0.03 (0.09)	-0.05 (0.09)	-0.10 (0.31)
Financial recession × capital ratio	-0.06 (0.04)	0.12** (0.05)	0.21** (0.10)	0.28*** (0.10)	0.31*** (0.08)	0.86** (0.34)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
$R^2$	0.563	0.333	0.334	0.308	0.388	0.318
$H_0$ : normal = financial $p$ -value	0.44	0.00	0.00	0.00	0.00	0.00
$H_0$ : normal × capital = financial × capital, $p$ -value	0.44	0.00	0.19	0.01	0.00	0.01
Observations	210	210	210	210	210	210

Notes: Standard errors (clustered by country and year) in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . The dependent variable is the cumulative change in real GDP per capita from the peak. Financial refers to the average path after financial recessions relative to the average recession. Interaction terms refer to marginal effects of capital ratios after normal and financial recessions relative to the historical mean. Capital ratios have been multiplied by 100. Corresponds to Table 8 in the main text.

## J.4 Local projections using pre-2006 sample

**Table A.28:** Normal vs. financial recessions, capital ratio bins above and below historical average, controls included, pre-2006 sample.

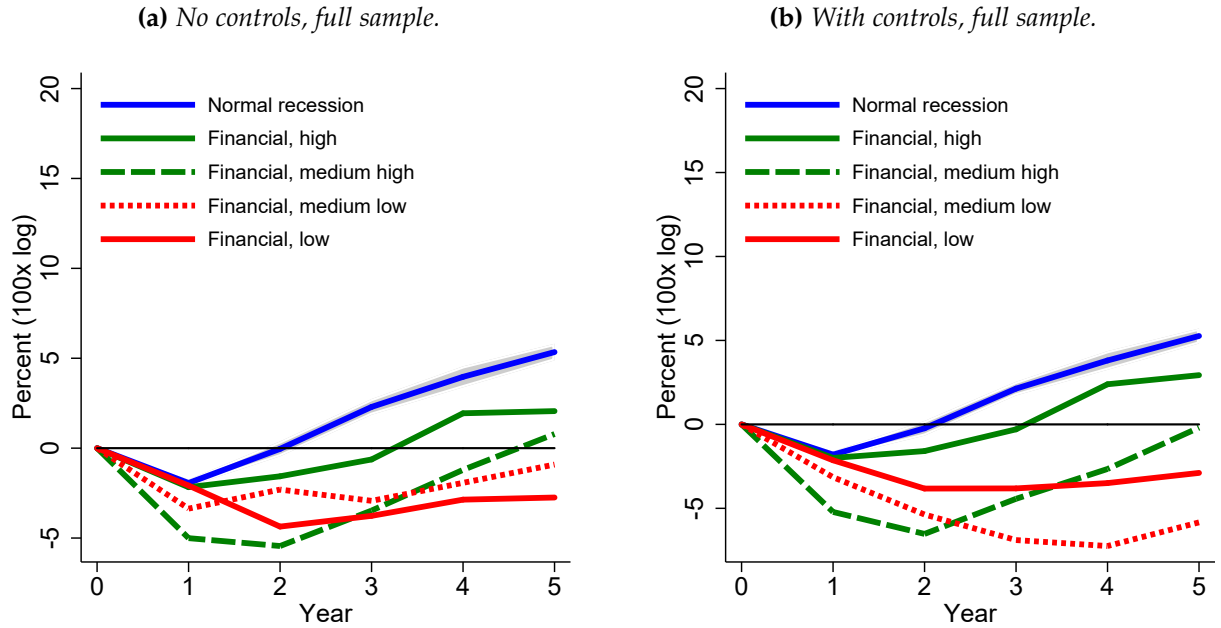
$100 \times \log$  real GDP per capita

	(1)	(2)	(3)	(4)	(5)	(6)
	Year 1	Year 2	Year 3	Year 4	Year 5	Sum
Recession	-1.78*** (0.13)	-0.12 (0.28)	2.33*** (0.30)	4.14*** (0.42)	5.64*** (0.35)	10.22*** (1.30)
Financial recession, high capital ratio	-0.34 (0.46)	-3.13** (1.17)	-4.09*** (1.13)	-3.39* (1.72)	-4.08* (1.93)	-15.03*** (5.14)
Financial recession, low capital ratio	-2.46** (0.88)	-4.98*** (1.37)	-8.35*** (2.13)	-9.50*** (2.39)	-8.65*** (2.13)	-33.94*** (7.95)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
$R^2$	0.603	0.307	0.366	0.343	0.410	0.349
$H_0$ : financial high = low, $p$ -value	0.01	0.16	0.15	0.05	0.17	0.07
Observations	193	193	193	193	193	193

Notes: Standard errors (clustered by country) in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . The dependent variable is the cumulative change in real GDP per capita from the start of the recession. Financial recessions are binned depending on whether lagged capital ratios at the beginning of the recession are below or above the historical average.

## J.5 Local projections based on capital ratio quartiles

**Figure A.9:** Normal versus financial recessions binned by pre-crisis capital ratio, real GDP per capita by capital ratio



Notes: This figure displays the average path of real GDP per capita after financial recessions depending on the capitalization of the banking sector in the year prior to the peak. The specification follows Equation 9 and interacts the financial recession dummy with a dummy  $q_{j,i,t(p)}$  that is 1 if the lagged banking sector capital ratio at the peak is in the  $j$ -th quartile of all financial recessions, and zero else.

$$\Delta_h y_{i,t(p)} = \sum_{i=1}^{I-1} \alpha_{i,h} D_{i,t(p)} + \mu_h + \sum_{j=1}^4 \gamma_h^j d_{i,t(p)} \times q_{j,i,t(p)} + \epsilon_{i,t(p)}.$$

The grey area is the 90% confidence region for the normal recession path. Full sample results: 1870-2015, excluding world wars and 5-year windows around them.

## J.6 Local projections with real private credit per capita as dependent variable

**Table A.29:** Normal versus financial recessions, real private credit per capita binned by capital ratio, no controls, full sample.

Dependent variable: change in  $100 \times \log$  real private credit per capita relative to Year 0

	(1) Year 1	(2) Year 2	(3) Year 3	(4) Year 4	(5) Year 5
Recession	2.86*** (0.25)	6.56*** (0.44)	11.31*** (0.56)	14.91*** (0.65)	18.08*** (0.80)
Financial recession, high capital ratio	-1.11 (1.40)	-2.33 (1.81)	-3.48 (2.57)	-5.30 (3.40)	-6.32 (4.93)
Financial recession, low capital ratio	-0.59 (1.06)	-6.43*** (2.14)	-10.46*** (2.72)	-13.64*** (3.29)	-17.22*** (4.00)
$R^2$	0.159	0.240	0.340	0.364	0.390
$H_0$ : financial high = low, $p$ -value	0.75	0.12	0.06	0.10	0.12
Observations	237	237	237	237	237

Notes: Standard errors (clustered by country) in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . The dependent variable is the cumulative change in real private credit per capita from the peak. Financial recessions are binned depending on whether lagged capital ratios at the beginning of the recession are below or above the historical average.

**Table A.30:** Normal versus financial recessions, real private credit per capita binned by capital ratio, controls included, full sample.

Dependent variable: change in  $100 \times \log$  real private credit per capita relative to Year 0

	(1) Year 1	(2) Year 2	(3) Year 3	(4) Year 4	(5) Year 5
Recession	2.29*** (0.40)	4.94*** (0.56)	9.07*** (0.62)	12.57*** (0.80)	15.93*** (1.01)
Financial recession, high capital ratio	-2.25 (1.44)	-3.00 (2.25)	-5.49* (2.75)	-8.62** (3.77)	-10.54* (5.37)
Financial recession, low capital ratio	-0.02 (1.04)	-4.48* (2.12)	-9.45*** (2.85)	-13.75*** (3.65)	-18.06*** (4.52)
Controls	Yes	Yes	Yes	Yes	Yes
$R^2$	0.252	0.325	0.428	0.434	0.438
$H_0$ : financial high = low, $p$ -value	0.17	0.58	0.32	0.35	0.31
Observations	199	199	199	199	199

Notes: Standard errors (clustered by country) in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . The dependent variable is the cumulative change in real private credit per capita from the peak. Financial recessions are binned depending on whether lagged capital ratios at the beginning of the recession are below or above the historical average.

## K. Return predictability: univariate results

**Table A.31:** Balance sheet measures and mean returns on the bank equity index.

	(1)	(2)	(3)	(4)	(5)	(6)
Cumulative returns	1-year	2-year	3-year	1-year	2-year	3-year
<b>Panel A</b>						
	RHS: $\Delta_3$ Loans/GDP			RHS: $\Delta_3$ Assets/GDP		
See column header	-0.041*** (0.005)	-0.082*** (0.011)	-0.113*** (0.018)	-0.021*** (0.007)	-0.037*** (0.010)	-0.061*** (0.015)
$R^2$	0.022	0.045	0.062	0.009	0.014	0.027
Observations	914	883	854	914	883	854
<b>Panel B</b>						
	RHS: Capital ratio			RHS: $\Delta_3$ Capital ratio		
See column header	-0.061 (0.049)	-0.105 (0.094)	-0.117 (0.131)	-0.017 (0.017)	-0.007 (0.030)	0.040 (0.041)
$R^2$	0.004	0.005	0.005	0.001	0.000	0.001
Observations	914	883	854	914	883	854
<b>Panel C</b>						
	RHS: $\Delta_3$ LtD ratio			RHS: $\Delta_3$ Non-core ratio		
See column header	-0.027*** (0.008)	-0.058*** (0.021)	-0.083** (0.032)	-0.001 (0.006)	-0.007 (0.015)	-0.035* (0.021)
$R^2$	0.008	0.019	0.027	0.000	0.000	0.005
Observations	901	870	841	886	855	826

Notes: The dependent variable is the log excess return on the bank equity index from [Baron and Xiong \(2017\)](#) cumulated over h years, where h is specified in the column header. RHS variables are standardized at the country level using past data to avoid look-ahead bias. All specifications include country fixed effects. Standard errors in parentheses are computed using the Driscoll-Kraay method accounting for autocorrelation of up to 17 lags. \*, \*\*, \*\*\* indicates significance at the 0.1, 0.05, 0.01 level, respectively.

## REFERENCES

- Baron, Matthew, Emil Verner, and Wei Xiong. 2020. Banking Crises without Panics. NBER Working Paper 26908.
- Baron, Matthew, and Wei Xiong. 2017. Credit Expansion and Neglected Crash Risk. *Quarterly Journal of Economics* 132(2): 713–764.
- Bry, Gerhard, and Charlotte Boschan. 1971. *Cyclical Analysis of Times Series: Selected Procedures and Computer Programs*. New York: National Bureau of Economic Research.
- Cohen, Benjamin, and Michela Scatigna. 2016. Banks and Capital Requirements: Channels of Adjustment. *Journal of Banking and Finance* 69(S1): S56–S69.
- Demirgüç-Kunt, Asli, Edward Kane, and Luc Laeven. 2014. Deposit Insurance Database. World Bank Policy Research Working Paper 6934.
- Jordà, Òscar, Moritz Schularick, and Alan M. Taylor. 2017. Macrofinancial History and the New Business Cycle Facts. *NBER Macroeconomics Annual* 2016. 31: 213–263.
- Mazbouri, Malik, Sebastian Guex, and Rodrigo Lopez. 2017. Swiss Data Bank of International Bank Data (1890–1970). University of Lausanne. (<http://www.unil.ch/hist/placefinanciere>).
- Meiselman, Ben, Amiyatosh Purnanandam, and Stefan Nagel. 2018. Judging Bank Risk by the Profits They Report. Unpublished.
- Natoli, Sandra, Paolo Piselli, Ivan Triglia, and Francesco Vercelli. 2016. Historical Archive of Credit in Italy. Bank of Italy Economic History Working Papers 36.
- Richter, Björn, and Kaspar Zimmermann. 2018. The Profit-Credit Cycle. Unpublished.