

ABSTRACT

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The dissertation explores procyclicality in the banking sector across European Union (EU) countries, focusing on three core areas: loan supply, loan loss provisions (LLP), and capital buffers. The central hypothesis is that procyclicality varies significantly across countries due to diverse economic and institutional factors, challenging the assumption of uniformity in its effects. To test this, the study employs the Seemingly Unrelated Regression Equations (SURE) model, a novel econometric framework that captures cross-country variability and accounts for error correlations, offering a more nuanced understanding of procyclicality.

A comprehensive theoretical review highlights the evolution of economic cycle theories and their intersection with banking sector dynamics. It underscores the role of regulatory frameworks like Basel II and Basel III in shaping procyclicality while identifying gaps in the literature, particularly the neglect of cross-country heterogeneity.

The empirical analysis employs three methods: fixed-effects panel regression, independent regressions, and the SURE model. The findings demonstrate the SURE model's effectiveness in capturing cross-country differences. Loan supply is positively correlated with GDP growth and negatively with unemployment, with significant cross-country variability highlighted by the SURE model. Procyclicality in loan loss provisions (LLP) is evident, as LLPs decrease with GDP growth, while inflation and unemployment exhibit mixed effects. Additionally, bank-specific factors such as loans and profits play a crucial role in influencing LLPs. Similarly, capital buffers show a negative, procyclical relationship with GDP growth, but substantial regional and bank-specific variations emphasize the importance of accounting for diverse economic contexts when analysing these dynamics.

The study's contributions are twofold. First, it provides empirical evidence of significant cross-country heterogeneity in banking procyclicality, advocating for tailored regulatory frameworks. Second, it demonstrates the SURE model as a robust tool for analysing complex financial linkages. These insights offer valuable guidance for policymakers aiming to balance financial stability and economic growth in the EU's interconnected economies.