

## **Risk, Capital Buffers, and Bank Lending: The Adjustment of Euro Area Banks**

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**Abstract :** This paper estimates euro area banks' internal target capital ratios and investigates whether banks' adjustment to the targets have an impact on credit supply and holding of securities during the financial crisis in 2005-2011. Using data on listed banks and country-specific macro-variables a partial adjustment model is estimated in a panel context. The results indicate, firstly, that an increase in the riskiness of banks' balance sheets influences positively on the target capital ratios. Secondly, the adjustment towards higher equilibrium capital ratios has a significant impact on banks' assets. The impact is found to be more size-able on security holdings than on loans, thereby suggesting a pecking order.

**Keywords :** Euro area, capital ratios, credit supply, partial adjustment model

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