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Capital Adequacy and Islamic Banks Behavior: Evidence from Middle East Countries

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Abstract : Using the simultaneous equations model, this paper examines the impact of capital requirements on bank risk-taking during the recent financial crisis. It also explores the relationship between capital and risk decisions and the impact of economic instability on this relationship. By analyzing the data of 20 Islamic commercial banks between 2004 and 2014 from four Middle East countries, the study concludes a positive effect of regulatory pressure on bank capital in Saudi Arabia and UAE and a negative effect in Jordan and Kuwait. Moreover, the results show a negative impact of regulatory pressure on bank risk taking in Saudi Arabia, Jordan and UAE. The findings reveal also that banks close to the minimum regulatory capital requirements improve their capital adequacy by increasing their capital and decreasing their risk taking. Furthermore, the results show that economic crisis negatively affects bank risk changes, suggesting that banks react to the impact of uncertainty by reducing their risk taking. Finally, the estimations show a negative correlation between banks profitability and capital adequacy ratio (CAR), implying that as more capital is set aside as a buffer for banks safety; it affects the performance of Islamic banks.

Keywords : bank capital, bank regulation, crisis, Islamic banks, risk taking
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