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DO CAPITAL REQUIREMENTS AFFECT COST OF INTERMEDIATION? EVIDENCE FROM A PANEL OF SOUTH AFRICAN BANKS

Abstract:

Since the 2007 sub-prime financial crisis, world bank capital ratios have increased. Depending on systemic risk and bank`s idiosyncratic risk assessments, banks in South Africa may be required to maintain capital adequacy ratios above stipulated international minimum levels. In this paper, we investigate the impact of increased bank capital requirements introduced under the Basel Accord framework on the costs of intermediation. We attempt to answer this central question by running panel regressions using 2001 – 2012 annual bank-level data for ten banks constituting inter alia the four largest South African banks. We conclude that high capital requirements are associated with increased costs of intermediation. Our fixed effects estimations show that a one percent increase in capital requirements lead on average to a range of 12 – 14 basis points increase in the cost of intermediation during our period of analysis. We also find evidence that the Basel II capital requirements effected from 1 January 2008 contributed to increased cost of intermediation by an average 7 basis points for the period 2008 – 2012. We therefore caution that while maintaining adequate capital levels is crucial for obvious reasons, there is need for supervisory authorities to ensure that such regulation is effective and well-balanced to guarantee safety and stability of the sector without endangering the ability of the banks to service the economy.

Keywords:

Bank performance, Bank capital, Basel accord, Capital adequacy ratio, Financial regulation, Intermediation costs.

JEL Classification: C33, G21, G28