Ownership, institutions and bank risk-taking in Central and Eastern European countries

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Abstract

In a recent line of research the low interest-rate environment of the early to mid 2000s is viewed as an element that triggered increased risk-taking appetite of banks in search for yield. This paper uses approximately 7,000 annual observations on banks of the CEE countries over the period 1997-2011 and presents strong empirical evidence that low interest rates indeed increase bank risk-taking substantially. This result is robust across a number of different specifications that account, *inter alia*, for the potential endogeneity of interest rates and/or the dynamics of bank risk. Furthermore, we take into consideration the presence of a significant number of foreign banks that operate in the 11 CEE countries. The new institutional and regulatory framework that has been implemented in these economies as the final stage of the modernization of the banking sector is shown to provide important implication in the conduct of monetary policy and the existence of a risk-channel. On average a relatively low level of risk assets leads to a higher risk-taking behaviour by banks over the period under examination. Finally, the distributional effects of interest rates on bank risk-taking due to individual bank characteristics reveal that the impact of interest rates on risk assets is diminished for banks with higher equity capital and is amplified for banks with higher off-balance sheet items.

Keywords: Interest rates; bank risk-taking; panel data; CEE banks

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