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Cyclicality of Bank Liquidity Creation

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Abstract

This paper investigates the cyclicality of bank liquidity creation. Since liquidity creation is a major economic function of banks, their liquidity creation behavior may amplify business cycle fluctuations. Using the methodology of Berger and Bouwman (2009) to compute liquidity creation measures, we analyze the relation between GDP growth and liquidity creation of Russian banks from 2004 to 2015. Detailed quarterly data on a very large sample of banks and coexistence of different bank ownership types (state-owned, domestic private and foreign banks), makes Russia an ideal natural laboratory for study of cyclicality of liquidity creation for banks. We find that liquidity creation of banks is procyclical. We show that the liquidity creation behavior of state-owned banks and foreign-owned banks is similar to that of domestic private banks in terms of procyclicality. We further find that the magnitude of procyclicality is higher for liquidity creation than for lending. Thus, while ownership of banks does not influence the cyclicality of bank liquidity creation, liquidity creation behavior of banks can amplify business cycle fluctuations.

JEL Codes: G21.

Keywords: bank, liquidity creation, business cycles, state ownership.

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