The Market Impact of the Countercyclical Capital Buffer

Dorian HENRICOT

Abstract:
Designed to allow regulators to adjust capital requirements through the cycle, the countercyclical capital buffer [CCyB] in Europe features a novel institutional setup which allows for a unique identification strategy of the impact of bank capital requirements: (1) specific announcement days by national authorities; (2) cross-sectional impact on all European banks proportional to their exposure to the country of activation. We show that announcements of CCyB hikes translate in a small drop in CDS spreads, indicating that markets perceive the shocks as reducing bank probability of default. On the other hand, bank valuations do not react. This suggests that on average, markets believe these announcements will translate in higher but costless bank capital.