

Date of the event:

On Thursday 6th January 2011
From 01:00 PM to 2:00 PM

Location:

Luxembourg School of Finance
University of Luxembourg
4 Rue Albert Borschette
2nd Floor
Modigliani Miller Auditorium (E02-003)
L-1246 Luxembourg

Registrations:

- Free seminar (with lunch included)
- Registrations by email before January 3rd, 2011
- At the following address : lsf-events@uni.lu

Information:

Ms Caroline Herfroy
Tel : +352 46 66 44 6335

<http://www.lsf.lu/index.php/eng/Research/Seminars-and-Workshops>



The LSF is pleased to invite you to the following lunch seminar:

***The Good, the Bad and the Anxious:
How do Banks respond to the State
of the Economy?***

*By Prof. Georgios Kouretas
Athens University of Economics and Business*



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The Good, the Bad and the Anxious: How do Banks respond to the State of Economy?

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LSF Seminar

In a recent paper, John Geanakoplos and Ana Fostel (2008) suggest that financial markets operate under three conditions: the normal economy, when the liquidity wedge is small and leverage is high; the anxious economy, when the liquidity wedge is big, leverage is curtailed and the general public is anxiously selling risky assets to more confident natural buyers; and, finally, the crisis or panicked economy, when many formerly leveraged natural buyers are forced to liquidate or sell off their positions to a reluctant public, often going bankrupt in the process. How do banks perceive these three states of the economy and form their lending strategy? In this paper, we try to shed some light in the strategic behavior of banks concerning their lending behavior, by placing particular emphasis in the second state of affairs, i.e. at times where the economy is anxious. We use quarterly data on US banks over the period 1985-2010 and examine the response of bank lending to changes in (i) consumer confidence, (ii) the federal funds rate and (iii) CEO confidence. In line with expectations, initial results show that during the full sample banks expand their lending when consumer and CEO confidence rise and curtail their lending when monetary policy is contractionary. The findings become more unexpected when distinguishing between periods of anxiety and periods of distress. During periods of anxiety banks continue to expand their lending irrespective of whether anxiety is defined by consumer confidence, changes in monetary policy or CEO confidence. Banks seem to curtail their lending (and thus their risky assets) only in bad times and at the edge between anxious and bad times. These results provide new implications for the role of banks in exacerbating financial crises.

