BROOKINGS

Up Front

Hutchins Roundup: Distressed banks, housing and black wealth, and more

Vivien Lee, Michael Ng, and Louise Sheiner Thursday, May 9, 2019

Studies in this week's Hutchins Roundup find that distressed banks didn't gamble for resurrection, black families paid more rent but had deteriorating home values early in the Great Migration, and more.

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Distressed banks didn't gamble for resurrection in the 1980s or 2000s

Itzhak Ben-David and René M. Stulz of The Ohio State University and Ajay A. Palvia of the Comptroller of the Currency find that financially distressed banks don't try to gamble their way out of trouble by making riskier loans or investments, but instead act to decrease their debt and raise additional equity. Using a panel dataset of over 23,000 banks, the authors study how banks responded to distress during two distinct periods: 1985-1994 and 2005-2014, both of which included financial crises (the savings and loan crisis of the late 1980s and the financial crisis of 2008). During both periods, banks facing financial trouble increased their equity capital ratios sharply and also cut dividends, lending, employment, and deposits. The authors note that despite large differences in regulation between periods, the extent of deleveraging was similar, suggesting that economic forces beyond formal regulation incentivize bank managers to deleverage when their banks are in distress. Their findings go against traditional narratives that to get out of financial distress, banks often double down by making riskier loans.