

The Effect of Tier 1 Capital Ratio on Banks' Excess Reserves

Takeshi Osada *

We empirically examine long-term panel data for commercial banks over the period 1991–2007 to determine the reasons for the excess reserves held by the Japanese banking sector from the end of the 1990s to mid-2000s. Since the end of the 1990s, the Japanese banking sector had been holding excess reserves as the Bank of Japan implemented easy monetary policies such as a zero interest-rate policy and quantitative easing. However, even after these policies were discontinued, the banks continued to hold excess reserves. We identify two factors that explain their demand for reserves: a low short-term interest rate (the call rate), and the soundness of banks (the Tier 1 capital adequacy ratio). The main contribution of this paper is that it explains how banks' excess reserves are affected by the Tier 1 capital ratio, which is the best indicator for capturing banks' precautionary demand for reserves.

Broad Track: Banking

JEL Codes: G21; G28; C23; E51

* Dr. Takeshi Osada, Assistant Professor
Faculty of Service Management, Bunri University of Hospitality,
311-1, Kashiwabara-shinden, Sayama, Saitama, 350-1336 Japan
Email : osada@bunri-c.ac.jp TEL : +81-42-954-7575 FAX : +81-42-954-7511
Banking and Finance