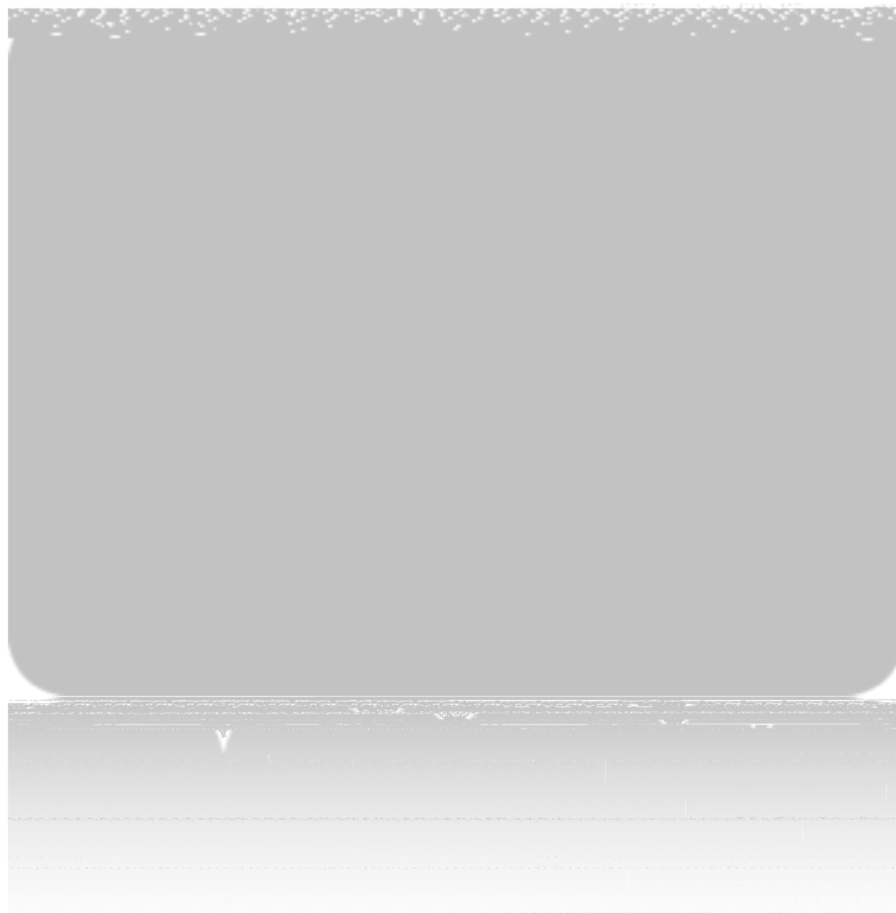

In ________________________, we use the construct of “expected loss” from loan loss provisions to examine banks’ expectations and uncover the presence of overreaction. If times are bad, banks tend to believe the future will be worse, and if times are good, they believe the future will be better. As a result of this kind of thinking, banks neglect risks when times are good and underperform in the future. We measure banks' unjustified belief (or sentiment) and show that an improvement in belief is associated with a rise in credit