Impact of Banking Distress on Financial Stability: Evidence from Iran's Private Banking Sector

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Abstract.

A sound banking system should efficiently utilize its capital base to avoid crises and their costly economic impacts. As a result of this importance, the assessment of banking stability has drawn wide research attention in recent decades, particularly during and after financial crises. This paper assesses the impact of the banking distress index on the financial stability of private banks in Iran. Whereas banking distress was measured by 22 constructs developed from the CAMELS[1] framework in 2013, financial stability was assessed based on 9 constructs developed from two models of Imbierowicz and Rauch (2014) and Mari et al. (2017). The sample in this research was all the banks listed in the Tehran Stock Exchange; the data collected covered 78 bank-years from 2017 to 2022. The method adopted for this research is a correlational and causal-ex post facto design, correlation, and regression analyses to test the hypotheses. The result of testing the hypotheses showed that a higher banking distress index significantly associates with reduced financial stability among banks.
In this respect, financial distress is one of the crucial factors for bank stability and the aspect worthy of constant concern both from bank managers and regulatory authorities. Provided specific indicators of financial distress find reflection in some strategic models, bank resistance and stability of the whole banking sector could be increased.

Keywords: Banking Crises; Banking Stability; Banking Distress Index; Banking Risks; CAMELS Rating

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