Title: ARE SYSTEMIC BANKING CRISES IN DEVELOPPED AND DEVELOPPING COUTRIES PREDICTABLE?

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ARE SYSTEMIC BANKING CRISES IN DEVELOPPED AND DEVELOPPING COUTRIES PREDICTABLE?

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Highlights

- An EWS for banking crisis addressing model uncertainty is proposed.
- Financial exposure is a good predictor of banking crisis.
- M-logit based on BMA selection technique performs well out of sample.

Abstract

This paper contributes to the improvement of the empirical literature on early warning system of banking crises using a new methodology accounting for model uncertainty. We enriched banking crisis literature by introducing new variables measuring exposure and connectivity of domestic banking sector to international financial markets. To do so, we show that a multinomial logit model based on Bayesian Model Averaging is favored to conventional multinomial and binary models highlighting what is called by Bussiere and Fratzsher (2006) "post-crisis bias". We show that the application of a multinomial logit model, which distinguishes between more than two states and using Bayesian Model Averaging, is a valid way to solve this problem and a substantial improvement in the ability to predict banking crises. The empirical results show that for a set of 49 developing and developed countries, the model would have correctly predicted the vast majority of crises.

Keywords: Banking crises; Bayesian Model Averaging, Early Warning System, Crisis prediction; Financial exposure, Developed and developing economies.

JEL classification: C2; C8 ; D5; D8 ; E6; F3; G2

1. Introduction

Recent decades have seen a large number of financial crises in emerging markets (EME) and in advanced economies (ADV), often with economic, social and political consequences. These financial

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