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Heterogeneous Market Structure and Systemic Risk: Evidence from Dual Banking Systems[☆]

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Abstract

This paper investigates how banking system stability is affected when we combine Islamic and conventional finance under the same roof. We compare systemic resilience of three types of banks in six GCC member countries with dual banking systems: fully-fledged Islamic banks (IB), purely conventional banks (CB) and conventional banks with Islamic windows (CBw). We employ market-based systemic risk measures such as MES, SRISK and CoVaR to identify which sector is more vulnerable to a systemic event. We also compute weighted average GES to determine which sector is most synchronised with the market. Moreover, we use graphical network models to determine the most interconnected banking sector that can more easily spread a systemic shock to the whole system. Using a sample of observations on 79 publicly traded banks operating over the 2005-2014 period, we find that CBw is the least resilient sector to a systemic event, it has the highest synchronicity with the market, and it is the most interconnected banking sector during crisis times.

JEL Classification: G21, C58.

Keywords: Graphical network models, Islamic banking, Partial correlations, Systemic risk measures.

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