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Prediction of Bank Failures Using Combined Micro and Macro Data

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Abstract: Despite increasing evidence that banking crises are brought about by changes in both micro factors and the macro environment. Few researchers have conducted empirical studies which systematically examine the concurrent contributions of these changes. This research combines micro and macro approaches, thus devising a modified early warning system it possible to monitor the individual banking distress of five severely crisis-hit Asian countries, namely, Indonesia, Malaysia, Thailand, Korea and the Philippines. Actual data on distressed banks are collected from existing literature, albeit little, and from web sites. Subsequently, the robust macro and micro prudential indicators as well as the fragile indicators are re-examined.

Since researchers have recently found that ownership is an important factor affecting business performance, the structure of ownership—divided into two variables-- is also considered. First, ownership structure is considered with state-owned banks being expected to have a higher tendency to default. Next, connected and independent banks are differentiated to identify the moral hazard.

Keywords: banking system, bank failure, ownership, CAMEL

1. Introduction

A well-known fact is that during the past two decades, many countries have experienced significant distress in the financial sector, but perhaps this phenomenon was highlighted by the unforeseen eruption of the Asian crisis in 1997.