The role of loan portfolio losses and bank capital for Asian financial system resilience

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Summary

This paper analyses the systemic risk in relation to bank lending for Asian economies. The methodology complements existing market-based systemic risk measures by providing measures based on accounting information that regulators typically collect. Loan loss provisions of banks are decomposed into (i) a prediction component that is based on observable bank characteristics, and (ii) two frailty components: a bank-specific systematic factor based on the assumption that a bank's asset portfolio is diversified and a systemic factor. Systemic risk is measured as the Value-at-Risk and Expected Shortfall of the financial system based on a simulation model that takes into account the current condition of banks in the financial system, the absolute size and the capitalisation of financial institutions, as well as the sensitivity to systematic and systemic frailty risk.