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Research Paper

The Impact of Banking Stability on Liquidity and Credit Risks in Iranian Banks: A Panel Smooth Transition Regression Approach[1]

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Purpose

Banks and the volume of their financial transactions have a positive effect on the income of companies and the country's economy, so paying attention to their stability conditions can lead to better performance of these institutions and create overall stability in the country's economy. The relationship between different risks in the banking industry is an important issue due to the nature of their function, the effect of these risks on banks' instability, and the possibility of a crisis that this relationship can ignite. This interdependence is one of the most important topics that are considered by the banking industry during the financial crises in the world. Investigating the relationship between liquidity risk and credit risk with bank stability is undeniable in managers' decision-making, and in fact, paying attention to this relationship can be beneficial in solving many problems that banks faced. In that case, the main goal of this study is to investigate the impact of banking stability on liquidity and credit risks in Iranian banks.

Methodology

To investigate the relationship between credit risk and liquidity indicators with the financial stability index of the banking system, the panel data method was used with a non-linear approach. Specifically, the soft panel regression method is used to check the

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proposed hypotheses. Also, the financial information of 15 selected banks admitted to the Tehran Stock Exchange between 2012 and 2020 was used.

Results

The results indicate that there was a non-linear relationship between credit risk and liquidity with financial stability in the banking system. In addition, it was observed that the bank's risk tolerance variable has acted as a transition variable. Also, the results showed that an increase in credit risk and liquidity leads to lower financial stability.

Findings

The findings show that liquidity and credit risk have significantly increased banking stability at first, and then after passing the first regime and entering the second regime, they have caused a decrease in banking stability. But in total, the effects of these two risks on Bank stability have been decreasing and significant. According to the research results, bank managers and owners are suggested to act more carefully and sensitively in granting facilities to customers. Because more facilities granting, increases liquidity risk. Also, failure to return the facility on time increases the credit risk and thus causes banking instability.

Keywords: Banking Stability, Liquidity Risk, Credit Risk, Banking System, Panel Smooth Transition Regression.
JEL Classification: E63, G32, G21, C23.