
Systemic Risk and Bank Profitability: Unravelling the Global Banking Feedback Loop

Nikita Sharma*¹ and Sonali Jain¹

¹Indian Institute of Technology Delhi – India

Abstract

Reflecting the complex interplay between financial instability and banking institutions' profitability is crucial for effective risk management and regulation. This study examines the bi-directional link between bank profitability and two novel metrics of systemic risk: ΔCoVaR (contribution) and SRISK (exposure). Drawing on a panel of big global banks and employing GMM and PVAR techniques, the study reveals a self-reinforcing loop; higher systemic risk leads to lower profitability, and lower profitability amplifies systemic risk. In emerging economies, the study observes asymmetries in the relationship and a dampened reinforcement effect during 2015-2021, potentially reflecting structural and institutional differences relative to advanced economies. The study's findings underscore the need for incorporating forward-looking systemic risk metrics in the bank's internal control systems and aligning profitability objectives with long-term resilience. The study asserts the significance of context-specific regulatory intervention and proactive internal management practices in fostering banking growth and stability.

*Speaker