DETERMINANTS OF RISK-TO-DEFAULT IN EUROPEAN BANKING SECTOR

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ABSTRACT

The world wide financial crisis created a field of an interesting academic debate considering the risk-to-default in the banking sector. Unfortunately, to the detriment of both financial stability and economic growth, many of the financial crises seen in recent years in developed economies, can be attributed to fundamental weaknesses in risk management. The focus on risk-to-default is particularly acute in the banking sector. The literature on default risk modelling is huge and is growing very fast. However, much less attention has been paid to the determinants of risk-to-default. The main purpose of this paper is to present a comparative study of the evolution of risk-to-default for the European banking sector before and during the recent financial crisis. This paper empirically investigates both internal and external determinants of risk-to-default in a large dataset of the Central and Eastern European banking sectors during the period 2000 to 2009. Internal determinants encompass the management decisions made by each bank and are related to bank specific indicators and ownership status. External determinants capture factors beyond the bank's control, such as the legal environment and changes in bank supervision, the state of the economy in which a financial institution operates as well as banking market structure.

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