Early Warning detection of banking difficulty
Can commercial European banks fail?

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Abstract: The object of this contribution is predicting banking difficulties generated by the degradation of capital in order to justify the viability of a Prompt Corrective Action in Europe. We particularly examine the impact of safety net and the role of rating agencies trough their negative watches. In this respect, we use a binomial logit model for predicting the degradations of European commercial banking capital to test the contribution of institutional and reglementary factors in addition to the well-known balance sheet data. We also try to treat the question relative to the impact of concentration and the moral hazard generated by deposit insurance on banking stability. Our results are in line with the early literature and conclude a negative influence of institutional and regulatory factors on the probability of European banking difficulty and a significant role of rating agencies. The quality of national supervisions restrains considerably moral hazard and excessive risk taking of European commercial banks.

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