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THE ILLUSORY RESILIENCE OF ISLAMIC BANKS TO FINANCIAL CRISIS

Abstract:

A large amount of research has asserted the resilience of Islamic banks to the last financial crisis. The relative safety of these institutions is usually connected to the underlying risk-preventive principles of Islamic finance. Nevertheless, there is another set of economists who argue that those principles are double-edged, i.e. they are simultaneously risk dampening and risk boosting.

This paper tries to resolve these two viewpoints. Particularly, it aims to examine if there is any relationship between being an Islamic bank and the credit risk level. To fulfill our objective, first we followed a non-parametric approach, in which we compared the credit risk evolution of 71 Islamic and 205 conventional banks operating in 10 countries from 2005 to 2013. Then we followed a parametric approach to examine to what extent being Islamic does matter in determining a bank's credit risk level. Results reveal the following: (1) from 2005 to 2010, both sets of banks witnessed a sustained increase of credit risk, (2) also during this period there was no significant difference between Islamic and conventional banks' credit risk, (3) since 2011, in both sets of banks, the credit risk level began to diminish, but the credit risk in Islamic banks seem to be significantly higher than in conventional banks, and finally, (4) being Islamic does not seem to matter in determining a bank's credit risk. Rather the main credit risk determinants are GDP growth, competitive pressure, size, asset quality and gross financing.

Keywords:

the financial crisis, Islamic banks, conventional banks, bank credit risk determinants.

JEL Classification: A19