

The Impact of Country Risk on Financial Fragility

*Habib Ansari Saman**

*Hadis Dalvandi***

*Asma Shiri****

DOI: <https://doi.org/10.22096/esp.2024.2001692.1715>

Received Date: 06/05/2023 - Accepted Date: 23/10/2023

Abstract

Financial crises can rapidly affect the real sector of the economy, causing significant damage. The existing literature highlights the crucial role of a country's vulnerability in undermining the stability of the financial sector. This study investigates the effect of country risk on financial fragility in selected countries in the Middle East and North Africa (MENA) from 2000 to 2021 using the vector autoregression (VAR) method for panel data. The findings reveal that economic growth, economic structure, and economic freedom negatively impact financial fragility, whereas inflation rates, real interest rates, and country risk positively impact it. Country risk generates uncertainty, diminishes the security of the political, economic, and financial environment, and consequently reduces investment, leading to decreased economic growth and increased financial fragility. Despite its significance, the effect of country risk on financial fragility remains largely understudied. The results of this study have important implications: policymakers should focus on reducing country risk to foster a more stable political, economic, and financial environment.

Keywords: Financial fragility; country risk; economic growth; PVAR model.

JEL Classification: G01, G15, G18.

* Associate Professor, Faculty of Economics, Management and Accounting, Yazd University, Yazd, Iran. (Corresponding Author)
Email: ha.ansarisa@gmail.com

** Master's degree in Economics, Faculty of Economic and Social Sciences, Bu-Ali Sina University, Hamadan, Iran.
Email: hdalvandi1@gmail.com

*** Master's degree in Energy Economics, Faculty of Economic and Social Sciences, Bu-Ali Sina University, Hamadan, Iran.
Email: shiri.asma12@gmail.com



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