

## Bank Stability Analysis with Emphasis on the Role of Macroeconomic Shocks in Iran's Economy

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### Abstract

This study aimed to analyze bank stability with an emphasis on the role of macroeconomic shocks in Iran's economy. Employing the Factor Augmented Vector Autoregression (FAVAR) approach, the research was conducted annually on a relatively small scale over the period 1991–2022 to examine macroeconomic shocks and bank stability. Recent studies indicate growing attention towards models that incorporate a wide range of economic information in their framework. This has been facilitated by augmenting traditional Vector Autoregression (VAR) models with one or more unobserved factors. The effects of shocks to output, inflation, the exchange rate, oil revenues, and the money supply were investigated. Four indicators were used to estimate the latent variable of bank stability, including Return on Assets (ROA), liquidity risk, leverage, and the Z-score. According to the results, shocks to the money supply, inflation, output, oil revenues, and the exchange rate generate ripple effects within the banking sector, persisting for approximately 3 to 6 years. Furthermore, the impact of inflation, money supply, and the exchange rate on the banking sector is more prolonged and persistent than that of output and oil revenue shocks. The banking sector responds to inflation and exchange rate shocks more promptly than to other shocks. Notably, an increase in the money supply does not immediately translate into production and investment activities, suggesting a probable delayed transmission. Additionally, an inflation shock exerts a stronger impact on bank stability in the short term, with its effect diminishing over the long term.

**Keywords:** Macroeconomic Shocks; Bank Stability; Iran's Economy; FAVAR Model; Bank Liquidity Risk.

**JEL Classification:** O18, E50, E60.

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