Climate transition risks: Do interbank networks change banks’ vulnerability?

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Climate transition risks: Do interbank networks change banks’ vulnerability?

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Abstract

What can happen to a bank if many of its borrowers operate in sectors for which tighter climate policy becomes a serious burden? And can those losses also reach banks that are not directly connected to those borrowers, but have lent to the first bank?

This research note shows how far lending links between Armenian banks can change estimates of individual banks’ potential losses from climate transition risks. To this end, it applies network analysis, focusing on domestic interbank lending.

The results show that the network effect is limited at the system level: under the Perverse Disorderly scenario, aggregate losses rise from 10.09% to 10.54% of total banking-system capital. For individual banks, however, the increase in losses can be considerably larger, up to about 49%, and interbank linkages also change which banks are relatively more vulnerable.

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