Beyond the Balance Sheet:

The Role of Social Sentiment in Financial Contagion

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[1] The views expressed in this presentation are solely those of the author and do not necessarily reflect the views of the ECB.

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Research Background

This research was conducted as part of my Master's thesis in the Erasmus Mundus QEM Program – Models and Methods of Quantitative Economics.

Program Institutions:

- Université Paris 1 Panthéon-Sorbonne (France)
- Università Ca' Foscari Venezia (Italy)
- Universitat Autònoma de Barcelona (Spain)

Academic Advisors:

- Hugo Rodriguez
- Gabriel Perez-Quiros

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  - Defining Financial Networks: direct vs indirect methods
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  - The role of Social Media as a Bank Run catalyst
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  - Financial Contagion
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Introduction

- Systemic Risk
- Externalities created by the failure or distress of one bank can have significant spillover effects on other banks, potentially leading to a broader systemic crisis (2008, SVB, etc)
- Therefore, it is crucial for policymakers and financial institutions to monitor and address systemic risk to maintain financial stability
- The Basel III introduces Systemically Important Financial Institutions
- Emerge Network analysis (Jackson & Pernoud, 2021)

Introduction

- Financial Contagion
  Most papers focus on the effects of contagion in the **interbank market** on the system (Allen & Gale, 2000; Upper & Worms, 2004; Upper, 2010; Mistrulli, 2011; Battiston et al., 2012a and 2012b; Anand et al., 2015; Cerchiello et al.; 2017)
- I aim to examine **additional potential effects such as bank runs**
  - potential implications for systemic risk when incorporating indirect methods into networks derived from sentiment analysis rather than solely the deterioration of banks' fundamentals.
- I use unstructured big data gathered from X (formerly twitter) to measure sentiment based on the judgment of the financial institutions
  - captures also non-fundamentals info

Introduction

Can the analysis of unstructured big data contribute to the measurement of financial contagions and enhance the understanding of the dynamics between fundamental and non-fundamental factors in bank runs?

- contributions to the existing literature and for regulators
  - expand the existing literature on Financial Contagion by incorporating the potential impact of bank runs as an **amplification mechanism**
  - macro-prudential and targeted supervision framework: stress test simulation (measure impact and identify SIFIs)
- Initial step towards further exploration of the dynamics of financial contagion and bank runs

Literature Review: Financial Networks

Vertices: banks (weighted by Balance Sheet)
Edges: directed in the flow of the money (weighted by debt size)
Complex Networks: Scale-free, small words, core-periphery, etc

- What is special about Financial Networks?
  - **Elliott et al., 2014**:
    non-monotonicity ("too interconnected to fail", "robust yet fragile"), complexity (hard to identify/comprehend dynamics and vulnerabilities), highly dynamic (constant evolution and adaptation to changes)
- Defining Financial Networks: direct vs indirect methods
  - **Fan et al. (2021)**: direct, reduced-form, and emotional methods. **Rönnqvist & Sarlin (2016)** and **Bricco & Xu (2019)**

Literature Review: Financial Networks

- Financial Contagion and its applications in the literature
  Allen & Gale (2000)
  - Centrality measures
    Jackson & Pernoud (2021): traditional and financial centrality
    Depend on network topology rather then on a specific shock
  - Applications in the literature
    Allen & Gale (2000), Upper & Worms (2004), Mistrulli (2011), Battiston et al. (2012a and 2012b), Anand et al. (2015)
- The role of Social Media as a Bank Run catalyst
  - Cookson et al. (2023), Nopp & Hanbury (2015), Nyman et al. (2021), Calomiris Mason (1997), Iyer Puri (2012), Huang et al. (2009), Billio et al. (2012), Acharya et al. (2017), Shiller (2019), Fan et al. (2021), and Cerchiello et al. (2017)

Methodology and Data

- Data
- Direct Financial Network: interbank connections
  Minimum density **(Anand et al, 2015)**
- Financial Contagion
  Battiston et al. (2012a) and Mistrulli (2011)
- Sentiment Network: unstructured big data from Twitter
  Graphical Gaussian Models (GGM)
  Fan et al. (2021), Cerchiello et al. (2017), Lauritzen (1996)
- Financial Contagion with Bank Runs effects
- An illustration

Data

50 largest banks in Europe based on their assets (-2 RU and -1 TR)

- Balance Sheet
  individually financial reports in December/22

Table 1: Balance Sheet Europe's largest 50 banks

Rank	Institution Name	Ticker	HQ	Total Assets	Total Liabilities	Equity	IB Assets	IB Liabilities	CET1
1	HSBC Holdings plc	HSBA	UK	2805.44	2620.05	185.38	6.90	63.10	112.81
2	BNP Paribas SA	BNP	FR	2666.38	2539.82	126.56	32.62	124.72	91.83
3	Crédit Agricole Group	AGRI	FR	2167.62	2094.14	73.48	567.64	284.17	40.62
4	Banco Santander, S.A.	SAN	ES	1734.66	1637.07	97.59	63.69	80.34	73.39
5	Barclays PLC	BARC	UK	1717.29	1638.72	78.58	11.36	22.67	53.18

  - ★ 14 countries (British, French, German (6), Norway (1))
    Total amount of assets: 33,145.22 billion Euros
    Largest: HSBA (HSBC Holdings) has 2,805.44 (8.5%)
    Smallest: NORD has 109.33 b Euros (0.32%)
    Ranking IB liabilities: AGRI (3rd), DZ (20th), and BPCE (6th).

Data: Tweets gathered from Twitter

```
# Examples:
## 1st try: with keywords, just in English, and with engagement
(bank OR @name_in_twitter OR $ticker) AND (commissions OR "labour costs" OR deposits OR
interbank OR management OR "interest margin" OR subsidiaries OR capital OR "loan losses"
OR loans) since:2022-01-01 until:2022-12-31 lang:en filter:has_engagement

## 2nd try: keywords also in the language of the bank
## Example 13: ING Groep N.V. - ENGLISH/DUTCH
(@ing_news OR "ing bank" OR "ing groep" OR $INGA.AS OR $NYSE:ING) AND
(commissions OR commissies OR "labour costs" OR "arbeidskosten" OR deposits OR
bankstortingen OR interbank OR interbancair OR management OR  "interest margin" OR
renteverschil OR subsidiaries OR dochterondernemingen OR capital OR kapitaal OR
"loan losses" OR "verliezen op leningen" OR loans OR leningen)
since:2022-01-01 until:2022-12-31 filter:has_engagement

## 3rd try: no keywords but more engagement
## Example: 31: Skandinaviska Enskilda Banken AB (publ)
(@sebgroup OR "seb group" OR "skandinaviska enskilda banken" OR $SEB.A)
since:2022-01-01 until:2022-12-31 filter:has_engagement (min_retweets:10 OR min_faves:10)
```

Over 50k tweets in the period between 01/01/2022 to 31/12/2022.

Direct Financial Network: Minimum Density (MD)

Anand et al. (2015): banks do not spread their borrowing and lending across the entire system, since the costs in terms of information processing, risk management and creditworthiness checks would be prohibitive for all but the largest banks

- c is the fixed cost of establishing a link, A_i and L_i are assets and liabilities. MD approach can be formulated as a constrained optimization problem for the matrix Z which contains IB exposures:

$$\min_z = c \sum_{i=1}^{N} \sum_{j=1}^{N} 1_{[Z_{ij}>0]} \qquad s.t.$$

$$\sum_{j=1}^{N} Z_{ij} = A_i \qquad \forall i = 1, 2, ..., N$$

$$\sum_{i=1}^{N} Z_{ij} = L_j \qquad \forall j = 1, 2, ..., N$$

$$Z_{ij} \geq 0 \qquad \forall i, j$$

$$AD_i = \left(A_i - \sum_j Z_{ij} \right),$$

$$LD_i = \left(L_i - \sum_j Z_{ji} \right)$$

Direct Financial Network: Minimum Density (MD)

- Substituting into objective function one gets the value function for the optimization program:

$$V(Z) = -c \sum_{i=1}^{N} \sum_{j=1}^{N} 1_{[Z_{ij>0}]} - \sum_{i=1}^{N} [\alpha_i AD_i^2 + \gamma_i LD_i^2]$$

Financial Contagion: Interbank

Battiston et al. (2012a) and Mistrulli (2011): all banks raising funds in the IB market are allowed to fail one at a time.
Next, calculate the losses incurred by banks that have provided loans to the failed bank (if > Tier1; fail)
Simulation proceeds checking if the banks that failed 1st iteration lead to the failure of other banks.
The simulation continues until at least one bank defaults.

- B represent the set of banks and $c_i > 0$ the initial Tier 1 of bank i. $z \in B$ denote the 1st bank that defaults. $D_z^n \subseteq B$ and $S_z^n \subseteq B$ are the set of banks that default and survive, respectively, at the nth step of the contagion path initiated by bank z, as follows:

$$D_z^n = \{k \in B : c_{k,z}^n \leq 0 | c_{k,z}^{n-1} > 0\}$$
$$S_z^n = \{k \in B : c_{k,z}^n > 0\} \qquad \forall n \geq 1$$

Financial Contagion: Interbank

Where:

$$c_{k,z}^{n} = c_{k,z}^{n-1} - \alpha \sum_{j \in D_z^{n-1}} X_{kj}, \qquad \forall n \geq 1 \text{ and } \forall k \neq z \tag{1}$$

The contagion path is represented by the following:

Failed banks

$$D_Z^0 = \{Z\}$$
$$D_Z^1 = \{k \in S_Z^0 : c_{k,z}^1 = (c_k - \alpha X_{kz}) \leq 0\}$$
$$D_Z^2 = \{k \in S_Z^1 : c_{k,z}^2 = (c_{k,z}^1 - \alpha \sum_{j \in D_z^1} X_{kj}) \leq 0\}$$
$$\ldots$$
$$D_Z^n = \{k \in S_Z^{n-1} : c_{k,z}^n = (c_{k,z}^{n-1} - \alpha \sum_{j \in D_z^{n-1}} X_{kj}) \leq 0\}$$
$$\ldots$$
$$D_Z^N = \{\emptyset\}$$

Surviving banks

$$S_Z^0 = \{k \in B \backslash \{Z\}\}$$
$$S_Z^1 = \{k \in S_Z^0 : c_{k,z}^1 = (c_k - \alpha X_{kz}) > 0\}$$
$$S_Z^2 = \{k \in S_Z^1 : c_{k,z}^2 = (c_{k,z}^1 - \alpha \sum_{j \in D_z^1} X_{kj}) > 0\}$$
$$\ldots$$
$$S_Z^n = \{k \in S_Z^{n-1} : c_{k,z}^n = (c_{k,z}^{n-1} - \alpha \sum_{j \in D_z^{n-1}} X_{kj}) > 0\}$$
$$\ldots$$
$$S_Z^N = \{k \in S_Z^{N-1} : c_{k,z}^N = (c_{k,z}^{N-1} - \alpha \sum_{j \in D_z^{N-1}} X_{kj}) > 0\}$$

and the process stops after N iterations when no additional default occurs.

Financial Contagion: Interbank

- Main assumptions:
  - $\alpha = 1$
    stress test in a worst-case scenario
  - I assume that the occurrence of bank failure triggering contagion is unexpected, which implies that the pattern of interbank lending remains constant throughout the entire contagion process (no time for structural adjustments)
- these works focuses on a specific channel for contagion (IB).
  My contribution: incorporating the possibility of bank runs as an amplification mechanism in financial contagion

Sentiment Network

- Measuring the sentiment
  Each tweet has been classified into a sentiment class measure. The higher the measure, the more positive the sentiment (or value) that the tweet assigns to the bank under analysis.
  - Sentiment classification: NRC Emotion Lexicon (14k words/terms) - extend multi-language version
  - Google's Compact Language Detector
  - openNLP sentence tokenizer
  - Loop to analyze each bank/tweet and the correct language
  - Finally, I computed the average daily sentiment for each bank
- Construct the Sentimental Network to connect the banks
  - Graphical Gaussian Models (GGM) - are well suited Network Inference between a large set of financial institutions
    Fan et al. (2021), Cerchiello et al. (2017), Lauritzen (1996).

Sentiment Network

- Graphical Gaussian Model (GGM)
  estimate relationship among banks through their **partial correlation**
- Let $G = (V, E)$ be an undirected graph and edge set $E = VxV$, a binary matrix, with elements e_{ij} describe whether pairs of vertices are linked ($e_{ij} = 1$) or not ($e_{ij} = 0$).
- pairwise Markov property determined by G states that:

$$e_{ij} = 0 \Leftrightarrow X_i \perp X_j | X_{V \setminus \{i,j\}}$$

Sentiment Network

- Whittaker (1990) proved that this independence corresponds to a partial correlation of zero i.e.:

$$X_i \perp X_j | X_{V \setminus \{i,j\}} \Leftrightarrow \rho_{ijV} = 0$$

  Therefore, ρ_{ij} expresses the direct influence of a financial institution on another, which can be used to measure the relationships between institutions.
- So the structural learning of the GGM can be transformed into the problem of calculate partial correlations (precision matrix Θ)

Sentiment Network

- The maximum likelihood estimation problem of Θ is:

$$\max_{\Theta>0} log|\Theta| - tr(S\Theta)$$

- The resulting model is too complex to be interpreted in reality. Following Fan et al. (2021) and Banulescu Dumitrescu (2015) a Lasso approach can be used by applying L_1-norm penalty to:

$$\hat{\Theta} = arg \max_{\Theta>0} log|\Theta| - tr(S\Theta) - \lambda||\Theta||_1$$

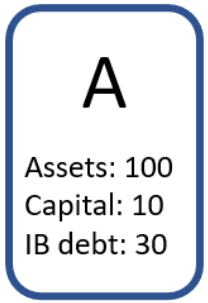
Since the L_1-norm penalty is used, the solution of $\hat{\Theta}$ will be **sparse**

Financial Contagion with Bank Runs effects

- for each bank, analyze the other banks sentiment connected
- let banks sentiment connect to default
- check the IB connections
- check if there are no duplicate cases (already fail IB)
- compute the number of additional banks that would fail
- compute the additional total assets from these banks
- compute the difference from this simulation from the simulation of only interbank contagion

An Illustration

SIMULATION – IF a bank defaults
(interbank contagion)



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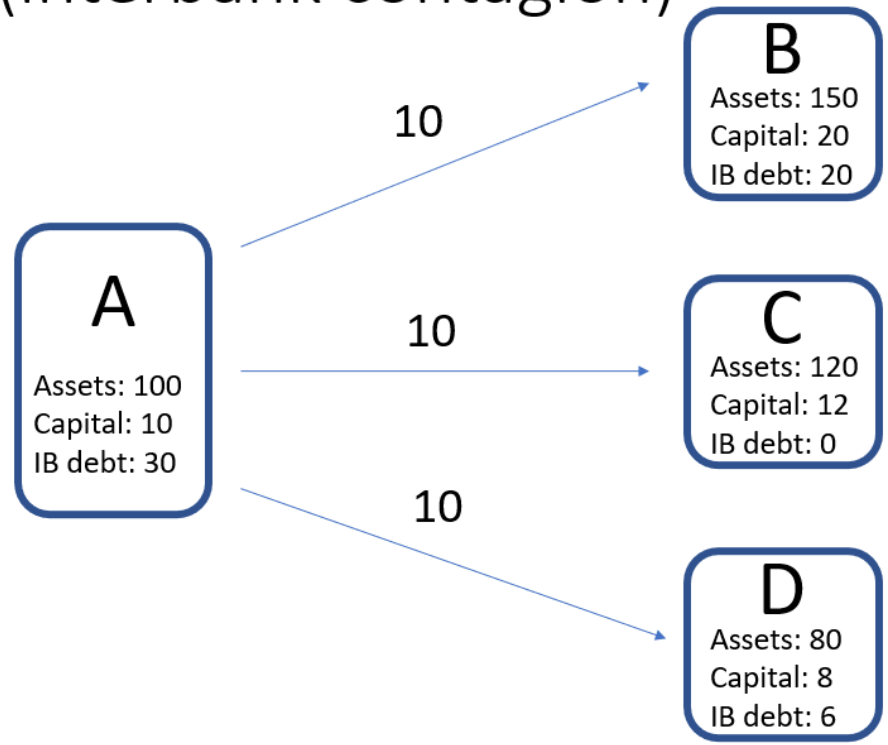

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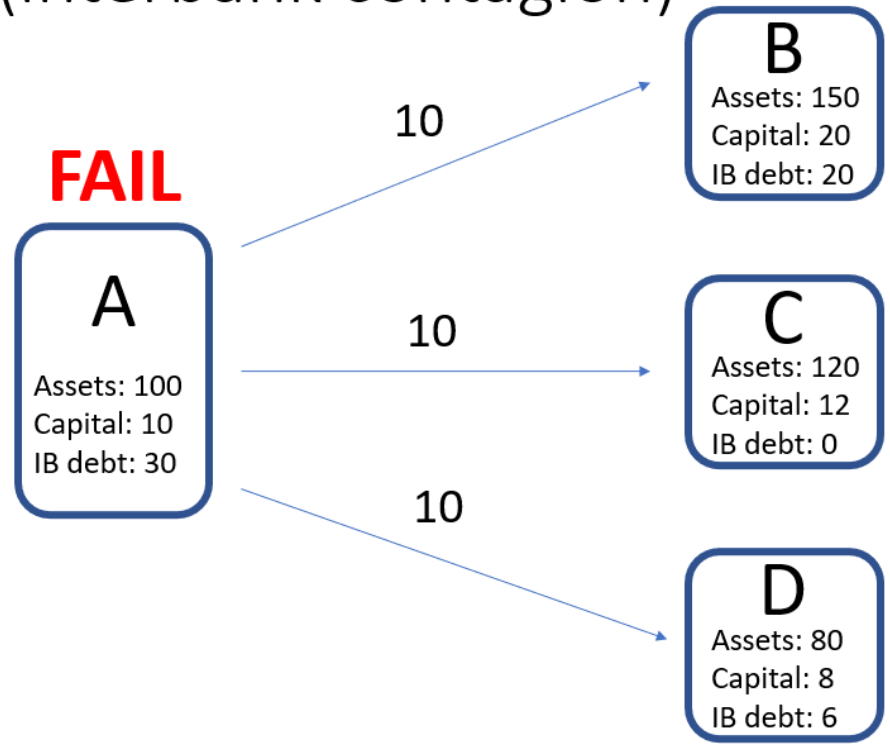

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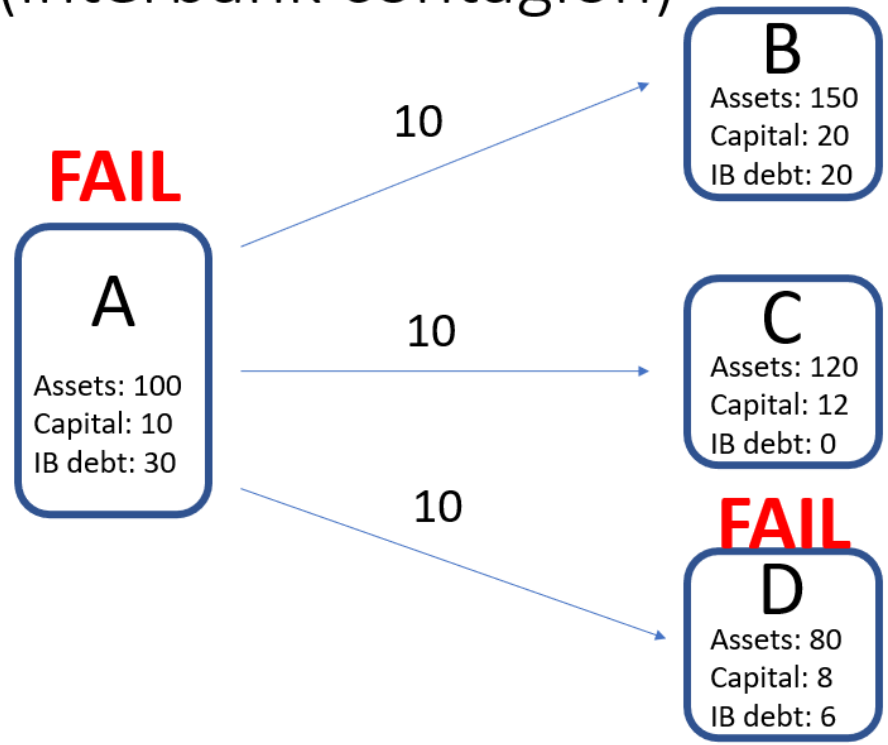

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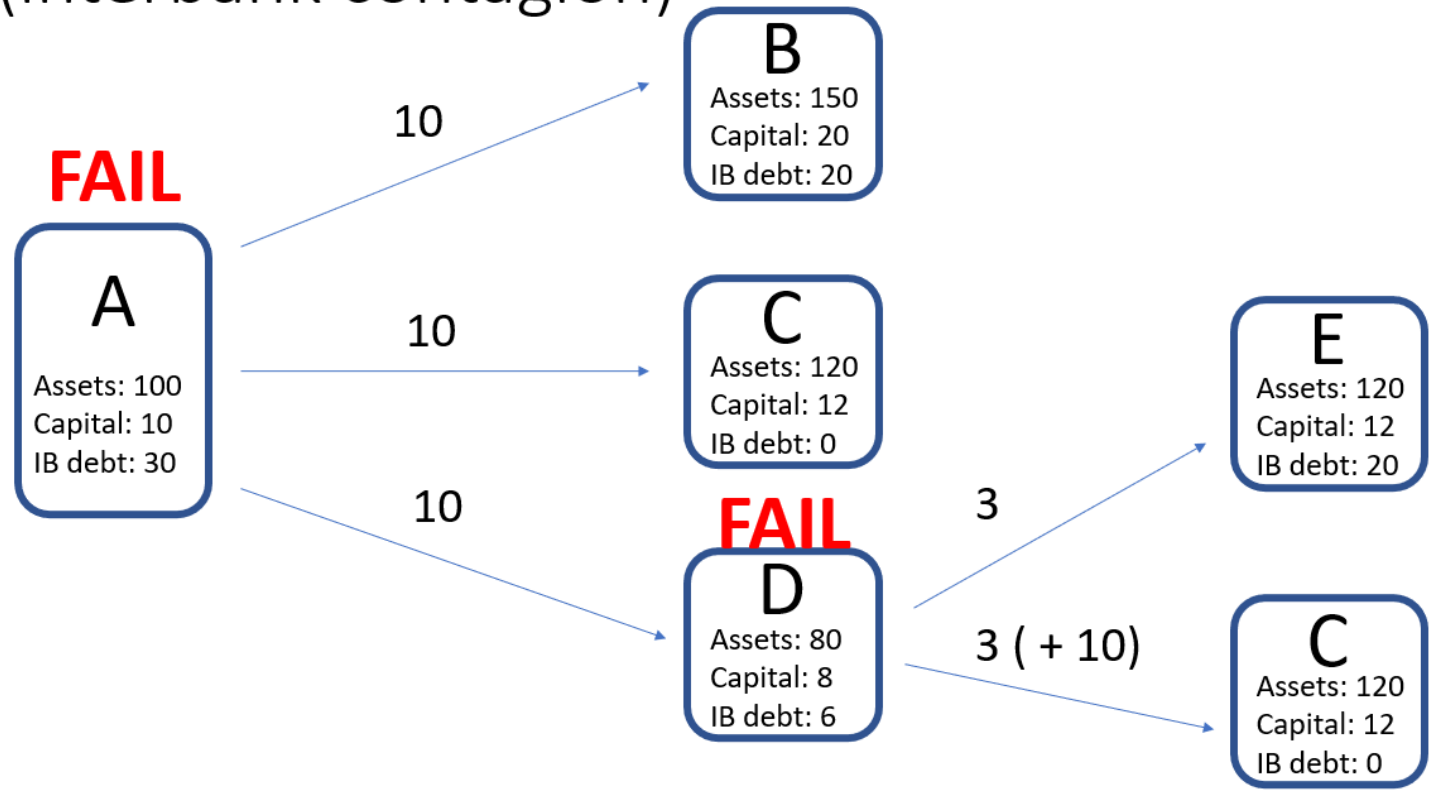

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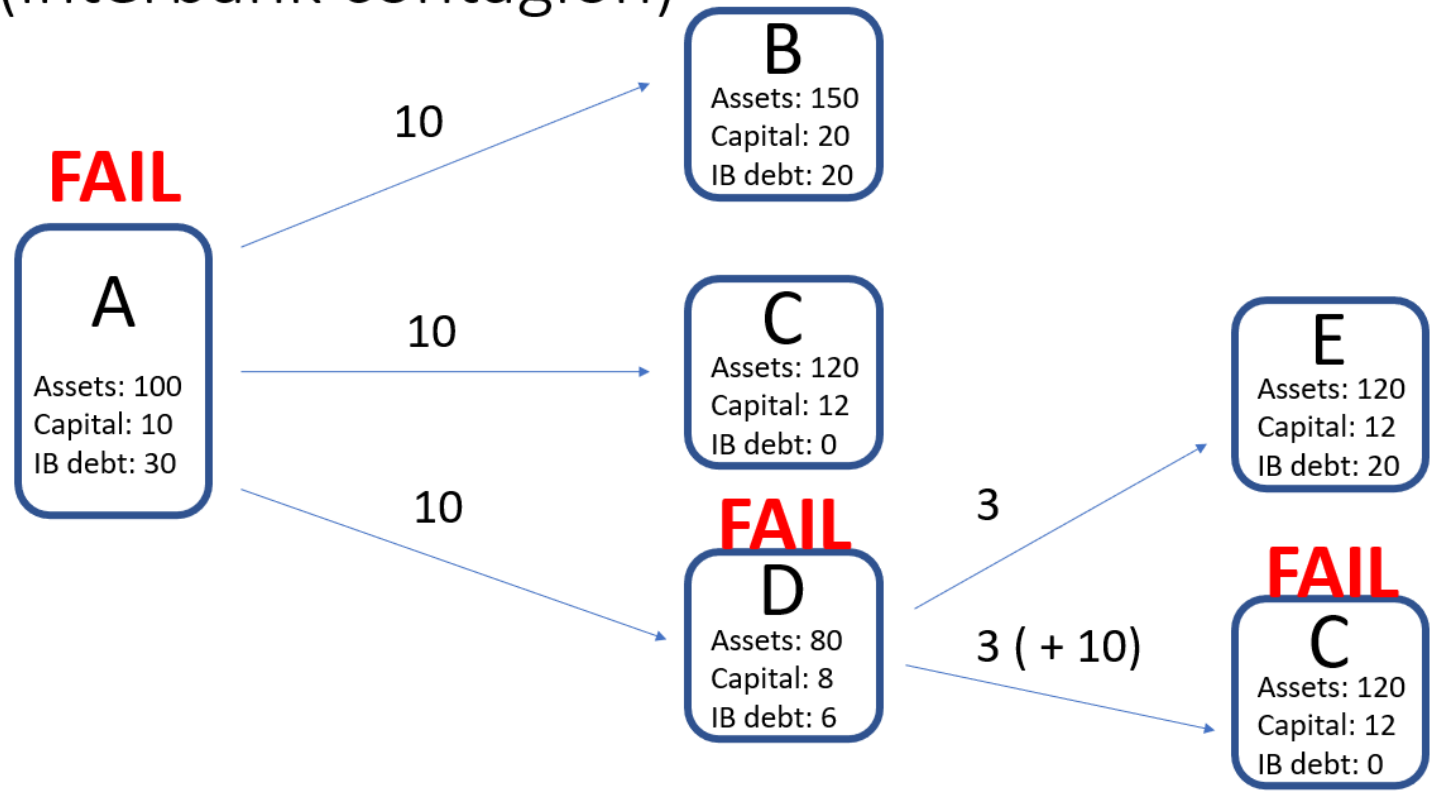
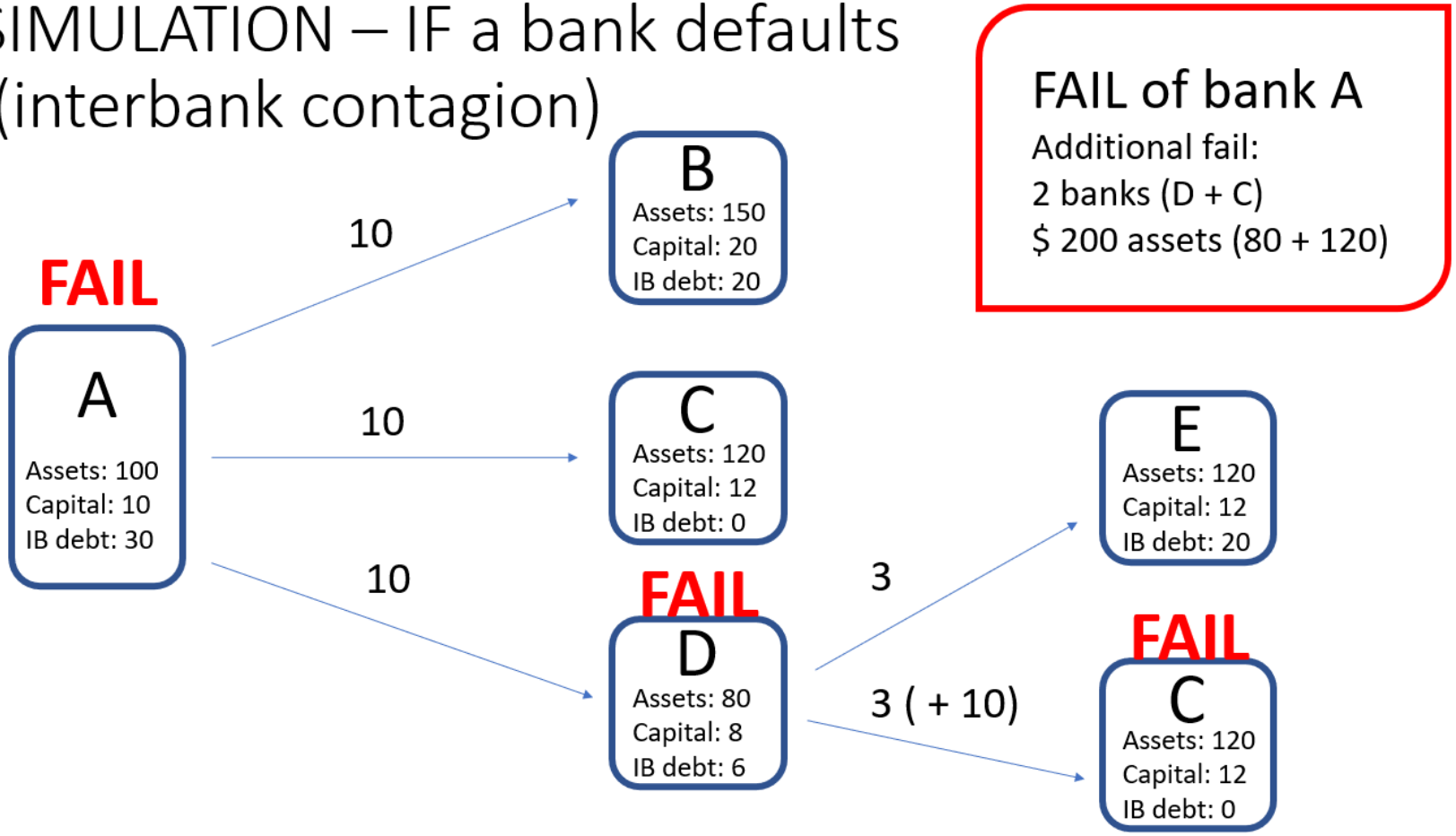


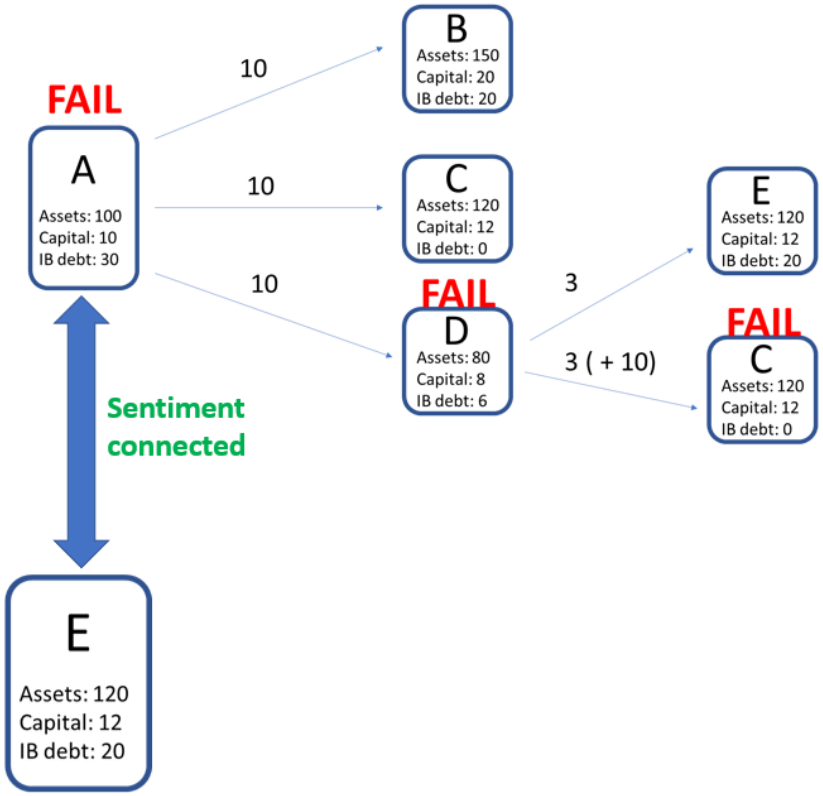
An Illustration

SIMULATION – IF a bank defaults (interbank contagion)



An Illustration

SIMULATION – IF bank runs occurs
(sentiment connection + interbank contagion)



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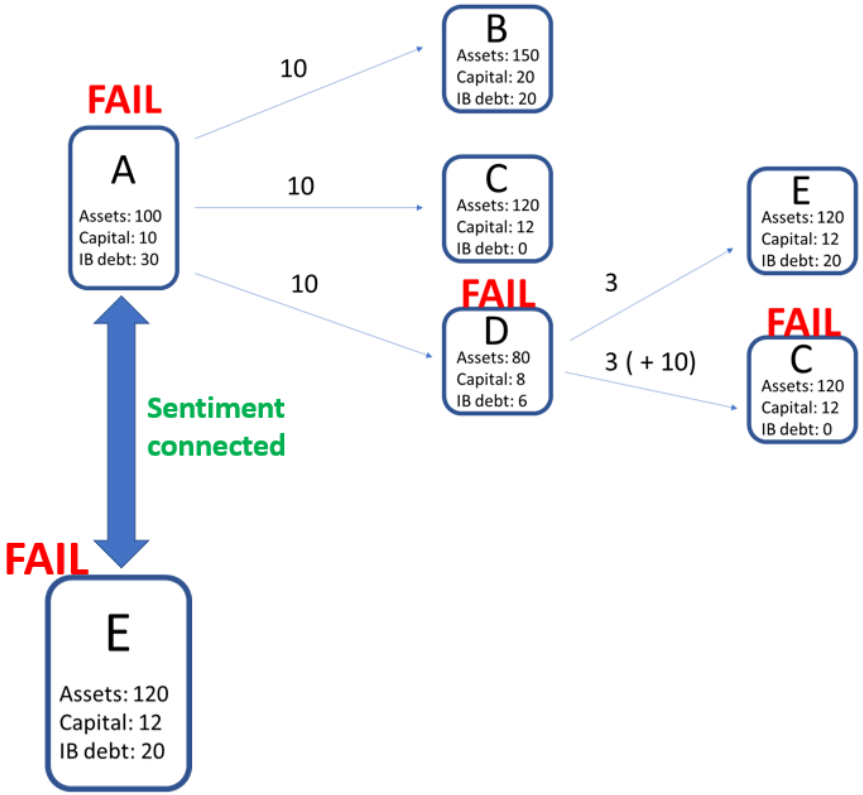

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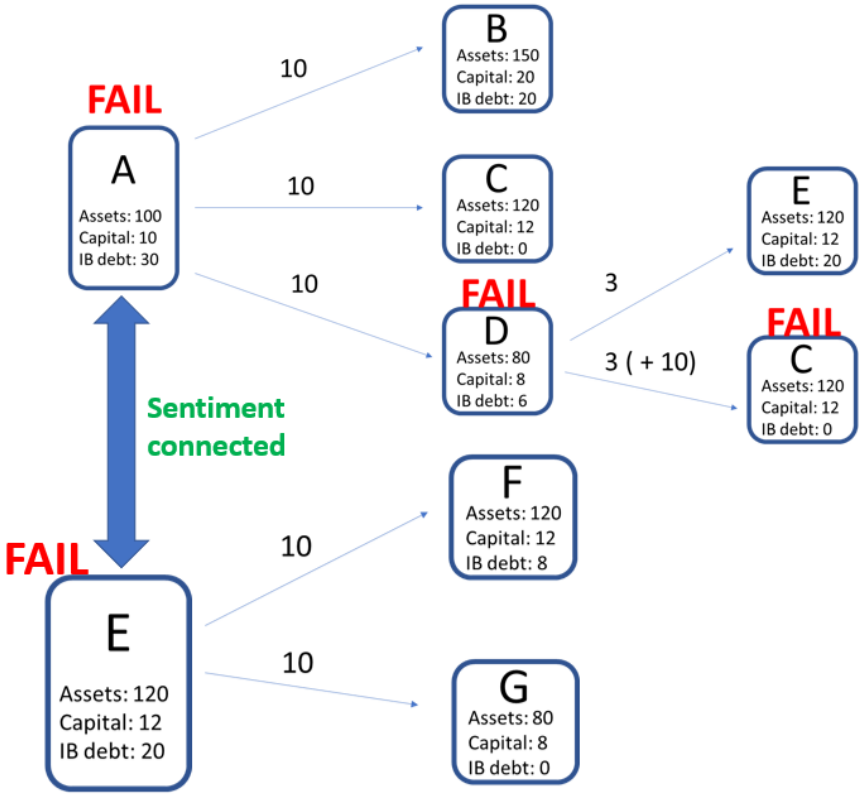

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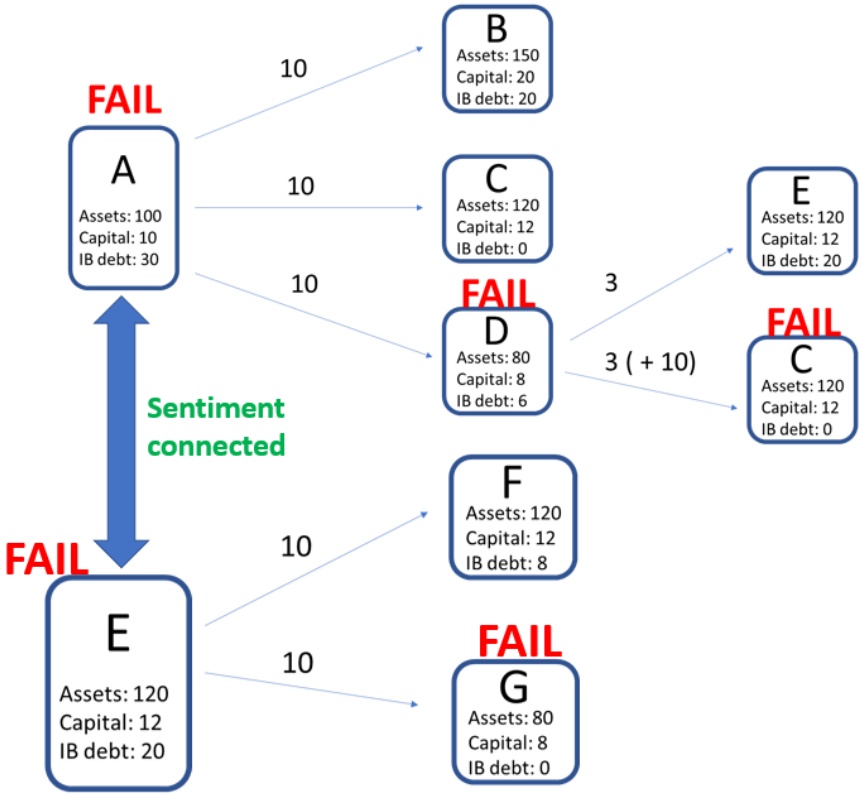

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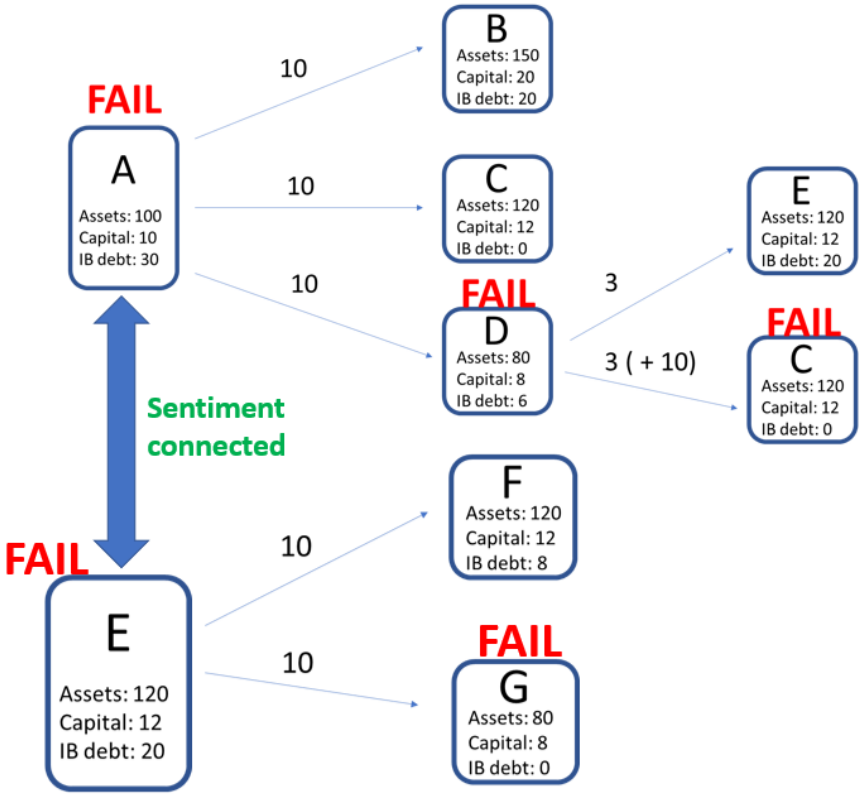


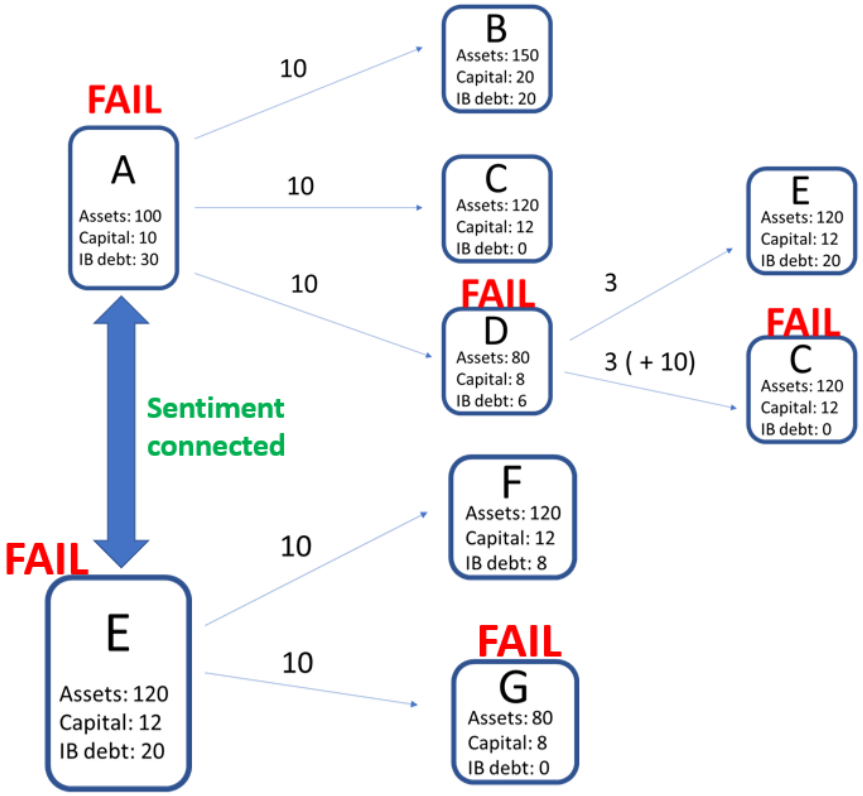
BEFORE:

FAIL of bank A

Additional fail:
2 banks (D + C)
$ 200 assets (80 + 120)

An Illustration

SIMULATION – IF bank runs occurs
(sentiment connection + interbank contagion)



BEFORE:

FAIL of bank A

Additional fail:
2 banks (D + C)
$ 200 assets (80 + 120)

NOW:

FAIL of bank A

Additional fail:
4 banks (D + C + E + G)
$ 400 assets (80 + 120 + 120 + 80)

An Illustration

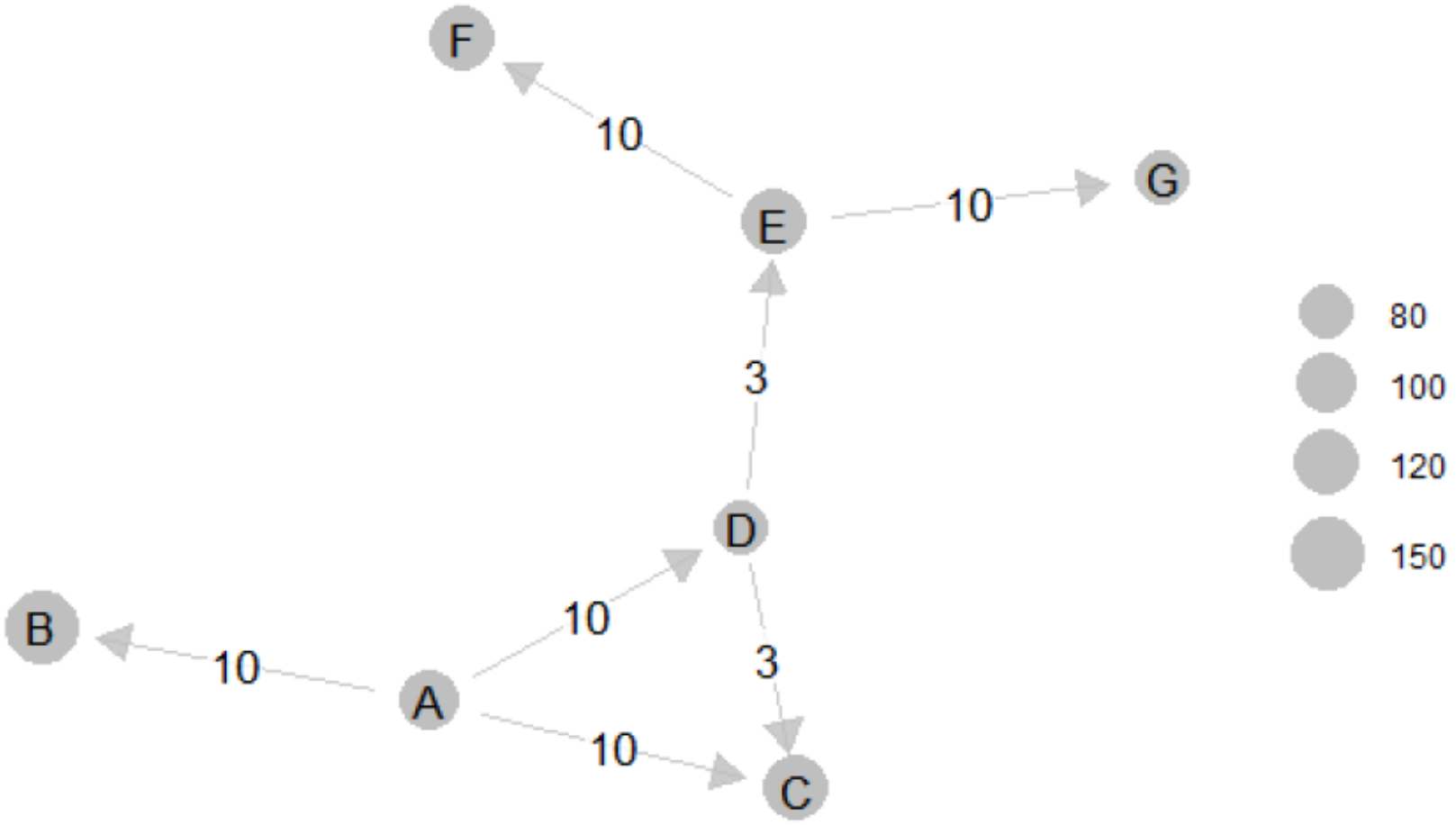


Figure 2: Interbank network with the illustration data

Results

- Financial Networks
- Financial Contagion

Results: Financial Networks

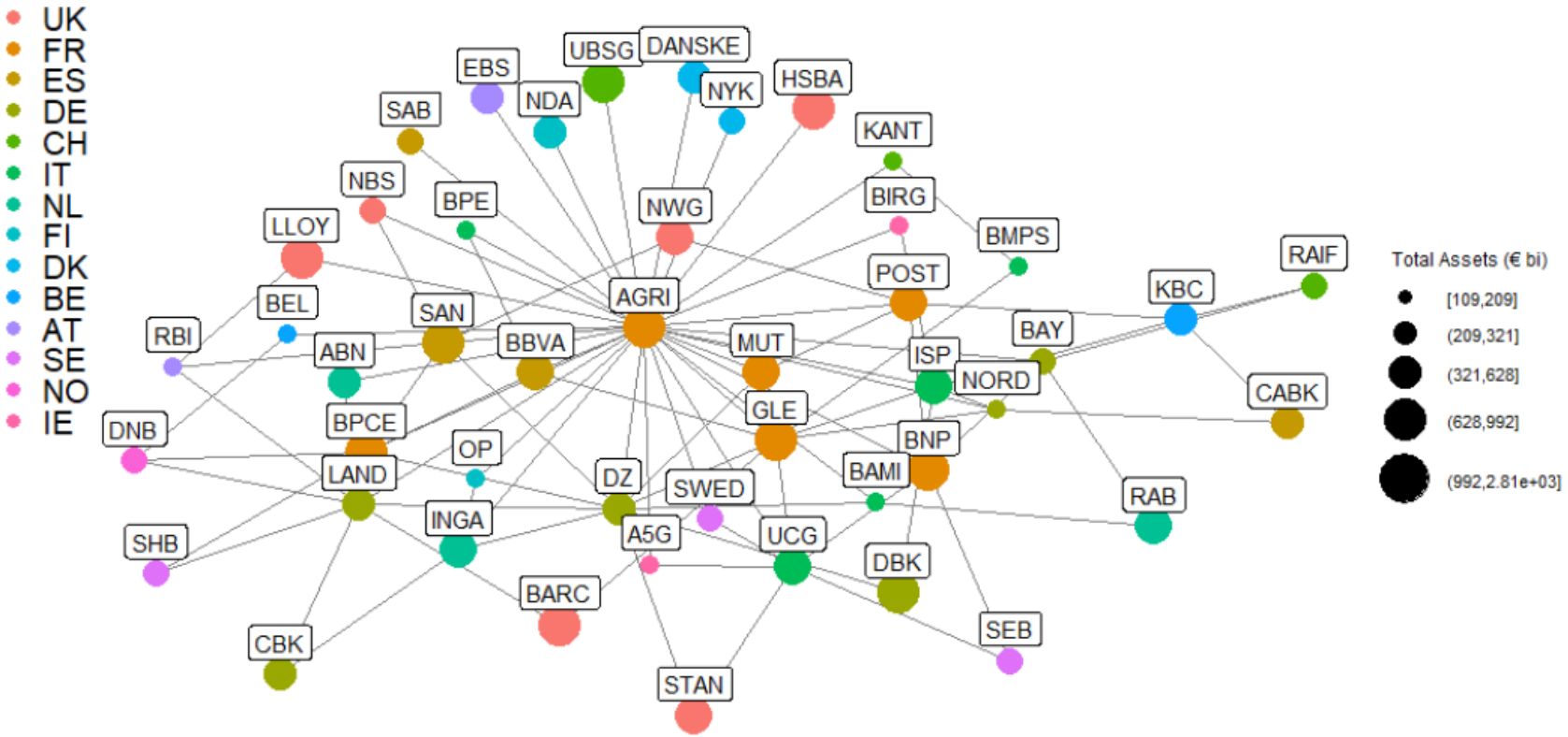


Figure 4: Financial Networks using Balance Sheet data

Results: Financial Networks

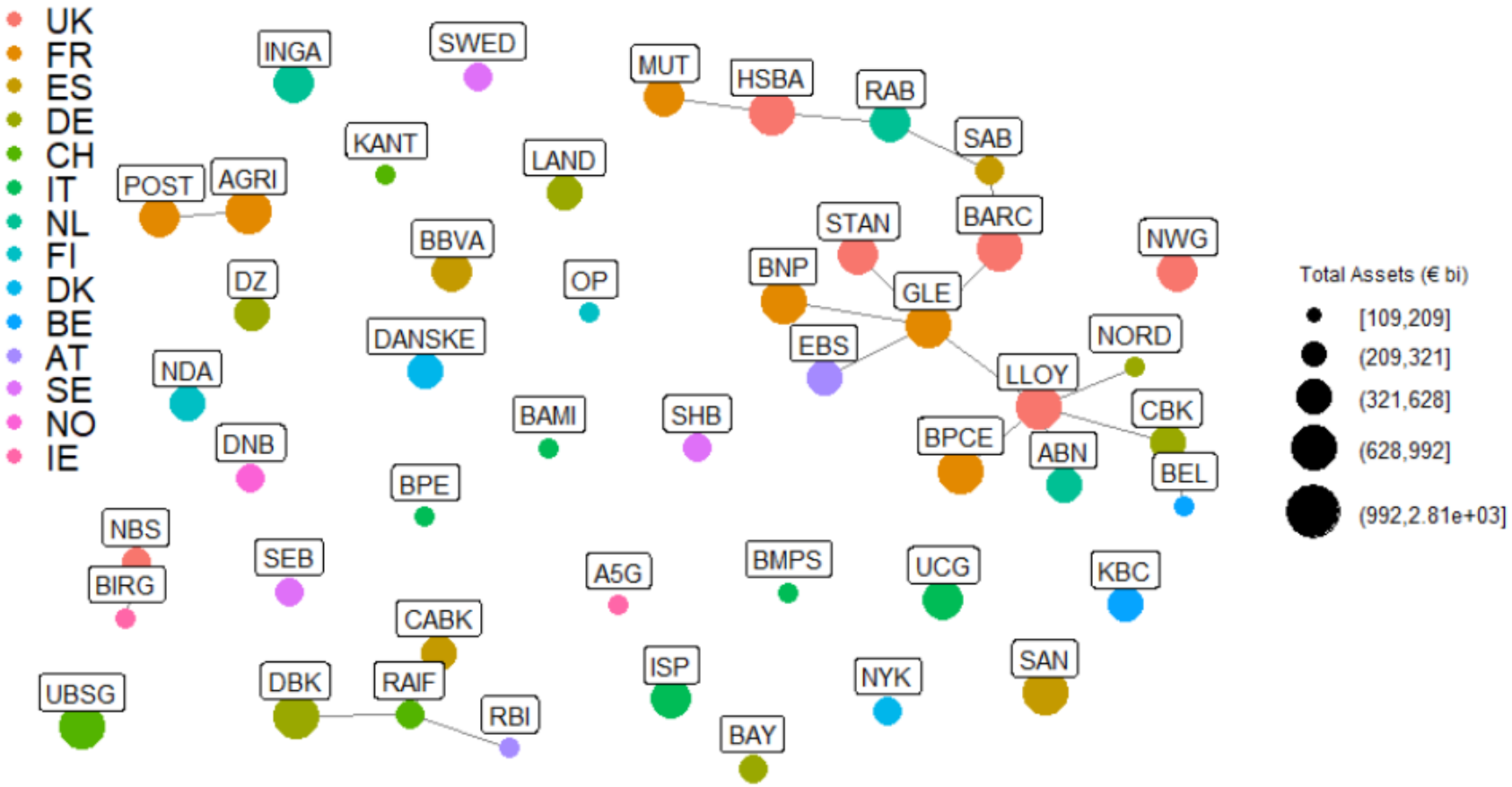


Figure 5: Sentiment Network using unstructured big data from Twitter

Results: Financial Contagion

Rank of IB Financial Contagion (by add assets default)

Bank	Institution Name	Rank	Total Assets	Add Banks Default	Add Assets Default	% Total
BNP	BNP Paribas SA	2	2666.38	17	14008.75	42.26
UCG	UniCredit S.p.A.	14	857.77	16	13150.98	39.68
GLE	Société Générale	7	1486.82	17	11924.81	35.98
LAND	Landesbank Baden-Württemberg	28	324.17	12	10627.17	32.06
HSBA	HSBC Holdings plc	1	2805.44	12	10073.31	30.39

NOTES: 1) assets are in Billions of Euros. 2) For the banks not listed in Stock Market, the column "Bank" present an acronym, otherwise it is the Ticker.

Results: Financial Contagion

Rank of Financial Contagion with Bank Run Effects (by add assets default)

Bank	Institution Name	Rank	Total Assets	Sentiment Connected	Add Banks Default	Add Assets Default	% Total
GLE	Société Générale	7	1486.82	BNP , BARC, LLOY, STAN, EBS	22	18749.63	56.57
BARC	Barclays PLC	5	1717.29	GLE, SAB	20	14856.88	44.82
LLOY	Lloyds Banking Group	10	995.90	BPCE, GLE, CBK, ABN, NORD	21	14458.33	43.62
BNP	BNP Paribas SA	2	2666.38	GLE	17	14008.75	42.26
STAN	Standard Chartered	16	770.12	GLE	18	13411.63	40.46

NOTES: 1) assets are in Billions of Euros. 2) For the banks not listed in Stock Market, the column "Bank" present an acronym, otherwise it is the Ticker.

Total amount of assets

IB connections: 127,604 billion euros

IB + Bank Runs: 239,351 billion euros (+ 87.57 %)

Results: Financial Contagion

Table 4: Comparison Financial Contagion with IB and with Bank Run Effects + IB (by total assets add)

Bank	Defaults IB	Assets IB	Defaults IB+BR	Assets IB+BR	Add Banks	Add Assets
LLOY	0	0.00	21	14458.33	21	14458.33
EBS	0	0.00	18	13411.63	18	13411.63
STAN	0	0.00	18	13411.63	18	13411.63
RAB	1	259.30	14	13138.04	13	12878.74
POST	0	0.00	15	11708.25	15	11708.25
SAB	0	0.00	13	11425.05	13	11425.05
RAIF	0	0.00	14	11065.35	14	11065.35
GLE	17	11924.81	22	18749.63	5	6824.82
BARC	10	8819.94	20	14856.88	10	6036.94
MUT	11	9188.22	13	12878.74	2	3690.53
CBK	0	0.00	2	1175.36	2	1175.36
ABN	0	0.00	1	995.90	1	995.90
NORD	0	0.00	1	995.90	1	995.90
BPCE	10	7974.96	11	8970.85	1	995.90
HSBA	12	10073.31	14	10961.12	2	887.81

NOTES: 1) assets are in Billions of Euros. 2) For the banks not listed in Stock Market, the column "Bank" present an acronym, otherwise it is the Ticker.

Results

- Outcomes lean towards a pessimistic perspective
  - stress test in a worst-case scenario approach, offering insights into the potential vulnerabilities of the financial system
- Not be interpreted too literally or used as the sole determinant of a financial institution's systemic importance
  - The additional stress indicator, represented by the bank runs amplification, can serve as another measure of systemic importance
- Distinction fundamental and non-fundamental networks is noteworthy
  - it provides valuable information that would otherwise be overlooked
  - considering both types of networks can contribute to a more comprehensive understanding of the dynamics and potential risks within the financial system.

Conclusion

- The results obtained from the analysis provide valuable insights into the potential effects of bank runs and sentiment-driven contagion in the financial system.
- The sentiment network provides additional information that complements the interbank network and contributes to a more holistic understanding of contagion dynamics.
- Contributions
  - expand the existing literature on Financial Contagion
  - regulators (e.g. banks that were not highly central in the network before now exhibit increased centrality)

Conclusion

- Interpret these results with caution and not view them as definitive determinants of a bank's systemic importance
  - stress test scenario and provide insights into potential vulnerabilities rather than precise predictions
- Main limitations
  - The sentiment analysis based on Twitter data may not capture the entire spectrum of market sentiment, and the sentiment expressed on social media platforms may no always align with market realities.
  - The estimation of the interbank network relies on the availability and quality of data, which may have limitations.
- Further research
  - Further research and analysis are necessary to validate and refine the findings
  - explore the applicability of the suggested methodology in real-world cases of distress for result comparison

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THANK YOU!

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Beyond the Balance Sheet: The Role of Social Sentiment in Financial Contagion

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Abstract

Recent financial crises underscore the importance of understanding financial network dynamics to assess systemic risk effectively. This study explores the potential impact of sentiment-driven bank runs on systemic risk, using sentiment analysis from X (formerly Twitter) data to integrate non-fundamental factors into traditional financial contagion simulations. The analysis utilizes balance sheet data of Europe's 50 largest banks and unstructured Twitter data, employing interbank network estimation, sentiment analysis, and financial contagion simulations. Interbank connections are estimated using the Minimum Density approach, while sentiment scores from tweets form a sentiment network using Graphical Gaussian Models with a Lasso penalty. The study reveals an expected core-periphery structure in the interbank network, highlighting banks like Crédit Agricole with high centrality due to interbank exposures. However, the sentiment network captures non-fundamental connections, altering the contagion landscape. Simulations show that sentiment-driven bank runs significantly affect systemic risk, with other banks becoming pivotal in the contagion scenarios. Notably, banks with previously lower centrality now exhibit increased importance in the network, a crucial finding for regulators. By incorporating sentiment-driven contagion into the analysis, this study offers a more comprehensive framework for assessing systemic risk and understanding the interplay between fundamental and non-fundamental factors to identify early warning signals. Additionally, the dynamic nature of sentiment analysis enables near real-time risk evaluation, facilitating the rapid reconstruction of the networks and offering valuable insights for regulators and policymakers to mitigate systemic risk through proactive monitoring and intervention strategies.

KEYWORDS: Systemic Risk; Financial Networks; Sentiment Analysis; Financial Contagion.

JEL codes: G01; G21; D85.

1 Introduction

Systemic risk is a critical concern in today's world, as externalities created by failures or distress in one bank can generate spillover effects, potentially leading to broader systemic crises. The interconnectedness and complexity of financial institutions and markets make identifying and mitigating systemic risk challenging.

Numerous studies have examined the structure and dynamics of financial networks to understand how shocks and contagion propagate through the system, potentially leading to systemic risk (Allen & Gale, 2000; Upper & Worms, 2004; Upper, 2010; Mistrulli, 2011; Battiston et al., 2012; Anand et al., 2015; Cerchiello et al., 2017). However, most of this literature focuses on contagion effects in the interbank market.

My approach is different: I plan to examine additional sentiment-driven effects, such as bank runs as in the self-fulfilling prophecy outlined by Diamond and Dybvig (1983). My research will explore the potential im-

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plications for systemic risk when incorporating sentiment analysis into network models, rather than focusing solely on the deterioration of banks' fundamentals.

Furthermore, existing approaches often rely on structured data, which may overlook critical insights from unstructured sources. Advances in Artificial Intelligence, specifically in natural language processing (NLP) and large language models (LLMs), now enable the processing and extraction of meaningful information from large volumes of unstructured text. This research seeks to bridge that gap by integrating these technologies into the network analysis of financial systems.

Specifically, my research will address the following questions:

- How do sentiment-driven effects, such as bank runs, impact the propagation of financial contagion in the interbank market?
- Can sentiment analysis of unstructured big data improve the measurement and understanding of the dynamics between fundamental and non-fundamental factors in bank runs?
- How does the inclusion of unstructured big data aid in identifying systemically important banks and early warning indicators for financial contagion?

By exploring the impacts of sentiment-driven effects on Europe's largest banks, my research aims to provide valuable insights for regulatory agencies concerning macroprudential and targeted supervision. It offers a comprehensive framework for assessing bank interconnectedness and conducting stress test simulations to measure the potential impacts of events such as bank runs. Additionally, it aims to identify systemically important banks and provide early warnings to signal financial vulnerabilities, enabling timely policy interventions.

2 Literature review: Financial Networks

Allen and Gale's (2000) seminal work has been instrumental in understanding financial contagion arising from credit interlinkages among banks. They demonstrate that the propagation of an unforeseen liquidity shock and its systemic implications are heavily influenced by the pattern of interconnectedness among banks.

In this sense, network analysis is a valuable tool for understanding and analyzing systemic risk. Jackson and Pernoud (2021) highlight that measuring the contribution of banks to systemic risk involves identifying central, significant, or systemic nodes using financial centrality concepts. However, traditional centrality measures often do not apply to Financial Networks.

To measure a bank's systemic importance, one effective approach is to utilize financial contagion simulations (Battiston et al., 2012; Mistrulli, 2011). However, a common issue in such analyses is the lack of specific interbank connection data, necessitating the estimation of these networks for contagion simulations. This study will follow Anand et al. (2015) in estimating interbank connections using the Minimum Density (MD) method. In this approach, banks avoid spreading their borrowing and lending across the entire system due to the prohibitive costs associated with information processing, risk management, and creditworthiness checks, which are manageable only for the largest banks.

Additionally, I aim to incorporate sentiment-driven effects as an amplification channel within conventional interbank financial contagion simulations. Using both direct measures (interbank exposures and balance sheet information) and indirect measures (non-fundamental aspects), this approach will provide a holistic understanding of systemic risk. For this, sentiment analysis from social media will be employed.

Social media has emerged as a significant factor in bank runs, rapidly spreading information and opinions that can fuel panic and lead to deposit withdrawals. Shiller (2019) emphasizes the role of shared narratives and group sentiments in driving economic events. Data from Twitter (Cerchiello et al., 2017; Cookson et al., 2023), the Bank of England, Reuters, broker reports (Nyman et al., 2021), and Eastmoney Net

(Fan et al., 2021) has been used to underscore the importance of sentiment analysis in understanding bank interconnections and risk contagion.

Traditional approaches often rely on limited structured data. This study will leverage advances in NLP and LLMs to process unstructured text and extract meaningful information, thereby bridging the gap in network analysis of financial systems.

3 Methodology and data

The objective of this section is to provide an overview of the methodology and data set utilized in this paper. Firstly, the dataset employed in the study is presented, followed by an outline of the methodologies employed. Lastly, an illustrative example is presented to showcase the practical application and effectiveness of the proposed approach.

I used mostly the software R version 4.2.2 with R-Studio 2023.03.1.

3.1 Data

In this study, I collected data on the 50 largest banks in Europe based on their assets. However, three banks were excluded from the analysis: two from Russia and one from Turkey. The decision to exclude these banks was primarily based on the limitation of the sentiment analysis algorithm used, which does not support these languages.

The dataset is divided into two main groups: the first group comprises balance sheet data for the banks, while the second group consists of tweets gathered from Twitter for sentiment analysis.

Regarding the first group, I analyzed individually all the financial reports of each bank in the last period of 2022 (December/22). From these financial reports I collected the following data:

- Ticker (in case of banks listed)
- Headquarter (HQ)
- Total Assets and Total Liabilities
- Total Equity
- Tier 1 Equity (CET1)
- Interbank Assets and Interbank Liabilities

This data can be seen in **Table 1**:

Table 1: Balance Sheet Europe's largest 50 banks

Rank	Institution Name	Ticker	HQ	Total Assets	Total Liabilities	Equity	IB Assets	IB Liabilities	CET1
1	HSBC Holdings	HSBA	UK	2805.44	2620.05	185.38	6.90	63.10	112.81
2	BNP Paribas	BNP	FR	2666.38	2539.82	126.56	32.62	124.72	91.83
3	Crédit Agricole	AGRI	FR	2167.62	2094.14	73.48	567.64	284.17	40.62
4	Banco Santander	SAN	ES	1734.66	1637.07	97.59	63.69	80.34	73.39
5	Barclays	BARC	UK	1717.29	1638.72	78.58	11.36	22.67	53.18
6	Groupe BPCE	BPCE	FR	1531.13	1448.58	82.56	97.69	139.12	69.67
7	Société Générale	GLE	FR	1486.82	1414.04	72.78	66.90	132.99	48.64
8	Deutsche Bank Aktiengesellschaft	DBK	DE	1336.79	1264.46	72.33	14.39	7.20	48.10
9	UBS Group AG	UBSG	CH	1044.39	990.28	54.11	13.99	10.97	42.99
10	Lloyds Banking	LLOY	UK	995.90	941.98	53.91	12.06	8.24	36.15

Rank	Institution Name	Ticker	HQ	Total Assets	Total Liabilities	Equity	IB Assets	IB Liabilities	CET1
11	Intesa Sanpaolo	ISP	IT	975.68	921.60	54.09	32.88	137.48	40.77
12	ING Groep N.V.	INGA	NL	967.82	917.40	50.41	35.10	56.63	41.97
13	Crédit Mutuel	MUT	FR	885.09	828.34	56.75	57.97	63.22	50.89
14	UniCredit	UCG	IT	857.77	796.12	61.65	57.80	131.34	51.44
15	NatWest	NWG	UK	816.90	775.50	41.41	8.10	23.19	28.35
16	Standard Chartered	STAN	UK	770.12	723.14	46.98	36.11	26.30	32.30
17	La Banque Postale	POST	FR	745.64	705.28	40.37	67.10	26.44	13.61
18	Banco Bilbao Vizcaya Argentaria	BBVA	ES	713.14	662.53	50.61	25.23	28.92	42.49
19	Coöperatieve Rabobank	RAB	NL	628.51	582.16	46.36	11.12	31.26	38.37
20	DZ BANK AG	DZ	DE	627.04	558.92	68.12	123.44	186.79	18.76
21	Nordea Bank Abp	NDA	FI	594.84	563.44	31.40	4.57	32.87	20.28
22	CaixaBank	CABK	ES	592.23	557.97	34.26	12.19	12.77	27.49
24	Danske Bank	DANSKE	DK	505.52	483.98	21.54	8.17	18.64	15.47
25	Commerzbank AG	CBK	DE	477.44	388.73	88.71	15.14	41.40	23.90
26	ABN AMRO Bank N.V.	ABN	NL	379.58	356.77	22.81	2.98	17.51	19.51
27	KBC Group NV	KBC	BE	355.87	335.06	20.81	29.42	35.67	16.82
28	Landesbank Baden-Württemberg	LAND	DE	324.17	278.62	45.55	81.28	84.08	13.53
29	Erste Group Bank	EBS	AT	323.86	298.56	25.30	18.44	28.82	20.44
30	Skandinaviska Enskilda Banken AB	SEB	SE	319.47	300.97	18.50	6.98	4.59	14.74
31	Svenska Handelsbanken	SHB	SE	312.31	294.59	17.73	0.85	7.39	14.34
33	Nationwide Building Society	NBS	UK	308.46	289.28	19.18	3.24	28.43	15.58
34	DNB Bank ASA	DNB	NO	295.09	271.47	23.62	1.87	16.17	17.70
35	Raiffeisen Gruppe	RAIF	CH	282.61	261.84	20.77	2.21	14.09	20.72
36	Bayerische Landesbank	BAY	DE	259.30	230.88	28.42	61.44	60.96	11.36
37	Swedbank AB	SWED	SE	258.16	242.24	15.92	5.12	6.59	13.03
38	Banco de Sabadell	SAB	ES	251.38	238.16	13.22	4.70	11.37	9.99
39	Nykredit	NYK	DK	214.96	201.95	13.01	1.56	3.74	11.83
40	Raiffeisen Bank International AG	RBI	AT	207.06	188.29	18.76	15.60	33.61	15.64
41	Zürcher Kantonalbank	KANT	CH	201.20	187.81	13.39	2.96	39.33	12.88
42	Banco BPM	BAMI	IT	189.69	176.29	13.39	5.49	32.64	8.62
43	Belfius Bank	BEL	BE	179.47	167.85	11.62	4.14	1.87	10.72
44	OP Financial Group	OP	FI	175.52	161.18	14.34	0.80	12.30	12.57
45	BPER Banca	BPE	IT	152.30	144.42	7.88	9.48	22.00	6.61
46	Bank of Ireland Group	BIRG	IE	151.32	139.39	11.93	3.18	3.68	7.54
47	AIB Group plc	A5G	IE	129.75	117.49	12.26	1.50	0.23	9.00
49	Banca Monte dei Paschi di Siena	BMPS	IT	120.17	112.14	8.03	3.26	21.38	7.60
50	Norddeutsche Landesbank Girozentrale	NORD	DE	109.33	103.03	6.30	13.11	28.66	5.68

NOTES: 1) all values are in Billions of Euros. 2) Sberbank of Russia, VTB Bank from Russia, and Türkiye Cumhuriyeti Ziraat Bankasi A.S. from Turkey are removed due to the different alphabet used in their mother language which is not supported by the sentimental analysys algorithm used. These banks would be the 23rd, 32th, and 48th in the rank, respectively. 3) For the banks not listed in Stock Market, the column "Ticker" present an acronym. 4) Deutsche Bank Aktiengesellschaft does not specify the amount of interbank assets

and liabilities, just the balance. Therefore, I assumed this value as liabilities and twice it as assets (to match the balance, since it was positive value in the assets). 5) Danske Bank A/S does not inform his CET1, just total equity. Therefore, I used the average ratio CET1/Equity (71.81%) of the other banks to estimate it.

Regarding the descriptive statistics of this data, there are banks representing 14 different countries, with the majority of them being British (6), French (6), or German (6). In the other hand, Norway only has one bank among the largest 50.

It is important to emphasize that the total amount of assets, which sums up for all 47 banks, is 33,145.22 billion Euros. The largest bank, HSBA (HSBC Holdings), has 2,805.44 billion Euros, accounting for 8.5% of the total. On the other hand, the smallest bank, NORD (Norddeutsch Landesbank Girozentrale), has 109.33 billion Euros, representing 0.32% of the total.

Another significant point to highlight is the interbank liabilities, which are used later to establish the interconnections among banks. The ranking of the largest banks based on interbank liabilities would be quite different from their ranking based on assets. The top three banks in terms of interbank liabilities would be AGRI (Crédit Agricole), DZ (DZ Bank), and BPCE (Groupe BPCE). Their rankings based on assets were 3rd, 20th, and 6th, respectively.

With respect to the Twitter data, I constructed a query in order to collect the relevant tweets for each one of the banks. I retrieved the tweets that commented the name of bank (or how it is know for in Twitter) or yet the Ticker for those banks listed.

Together with that, I filter for tweets containing a word belonging to a financial taxonomy that was developed by Cerchiello et al. (2017). This financial taxonomy was developed by the authors based on their knowledge of which balance sheet information may affect financial risk.

To ensure comprehensive coverage, this financial taxonomy was translaed to the local language of each bank's headquarters. Therefore, I conducted searches for tweets in both English and the local language of each bank's headquarters. This allowed for a broader range of tweets to be included.

Finally, whenever possible, I prioritized tweets with engagement, such as likes, retweets, or comments, as they indicate a higher level of interaction with the content.

In total I collected over 50 thousand tweets in the period between 01/01/2022 to 31/12/2022.

In the sequence, I detail the methodologies used in this work.

3.2 Direct Financial Network: interbank connections trough Balance Sheet

Typically, we have information on the assets and liabilities of each bank in the interbank market, but not on the specific interconnections between banks. In such cases, estimating the interbank network is necessary when performing contagion simulations or evaluating other risk metrics.

To estimate the interbank connections among the financial institutions, I followed the methodology proposed by Anand et al. (2015). The authors state that establishing network linkages represent a costs for banks. Contrary to the Maximum Entropy approach (ME) proposed by Upper and Worms (2004), in this methodology banks do not spread their borrowing and lending across the entire system, since the costs in terms of information processing, risk management and creditworthiness checks would be prohibitive for all but the largest banks. For this reason, the authors propose a Minimum Density (MD) approach to create interbank networks.

Minimizing the total number of linkages necessary for allocating interbank positions results to be consistent with total lending and borrowing observed for each bank (Mistrulli, 2011). Formally, let c represent the fixed cost of establishing a link, A_i the assets of bank i and L_i the liabilities. Then the MD approach can be formulated as a constrained optimization problem for the matrix Z which contains the interbank assets and liabilities of the n banks. As follows:

$$
\begin{aligned}
\min_z = c\sum_{i=1}^{N}\sum_{j=1}^{N} 1_{[Z_{ij}>0]} \qquad s.t. \\
\sum_{j=1}^{N} Z_{ij} = A_i \qquad \forall i = 1,2,...,N \\
\sum_{i=1}^{N} Z_{ij} = L_j \qquad \forall j = 1,2,...,N \\
Z_{ij} \geq 0 \qquad \forall i,j
\end{aligned} \tag{1}
$$

where the indicator function 1 equals one only if bank i lends to bank j. The constraints can be softened by assigning penalties for deviations from the marginals (i.e., A_i and L_j) as follows:

$$
\begin{aligned}
AD_i = \left(A_i - \sum_j Z_{ij}\right), \\
LD_i = \left(L_i - \sum_j Z_{ji}\right)
\end{aligned} \tag{2}
$$

where LD_i measures bank i's current deficit; i.e. how much its bilateral borrowing falls short of the total amount it needs to raise, L_i, which is also the amount to be matched by the solution being constructed, Z. Substituting into objective function one gets the value function for the optimization program:

$$
V(Z) = -c\sum_{i=1}^{N}\sum_{j=1}^{N} 1_{[Z_{ij}>0]} - \sum_{i=1}^{N}[\alpha_i AD_i^2 + \gamma_i LD_i^2] \tag{3}
$$

3.3 Financial Contagion

For simulating the interbank contagion, I will follow the works of Battiston et al. (2012a) and Mistrulli (2011). In the simulation of interbank financial contagion in Mistrulli (2011) all banks raising funds in the interbank market are allowed to fail one at a time.

The next step involves calculating the losses incurred by banks that have provided loans to the failed bank. If these losses exceed the lenders' tier-1 capital, which includes capital and reserves, the lenders would also experience a default. The simulation then proceeds by checking if the banks that failed in the initial iteration lead to the failure of other banks. In each subsequent iteration, the banks that failed in the previous iteration are removed from the set of banks that could be affected by contagion. The simulation continues until at least one bank defaults.

Formally, let B represent the set of banks and X_{ij} the funds that bank $j \in B$ borrows from bank $i \in B$, where $X_{ij} \geq 0 \quad \forall (i,j) \in BxB$ and $X_{ii} = 0 \quad \forall i \in B$. Additionally, let $c_i > 0$ represent the initial Tier 1 capital endowment of bank i, and $\alpha \in [0,1]$ the rate of loss (i.e. the incidence of losses due to contagion in the interbank exposure). Finally, let $z \in B$ denote the first bank that defaults because of some idiosyncratic shock, and define $D_z^n \subseteq B$ and $S_z^n \subseteq B$ as the set of banks that default and survive, respectively, at the nth step of the contagion path initiated by bank z, as follows:

$$
\begin{aligned}
D_z^n = \{k \in B : c_{k,z}^n \leq 0 | c_{k,z}^{n-1} > 0\} \\
S_z^n = \{k \in B : c_{k,z}^n > 0\} \qquad \forall n \geq 1
\end{aligned} \tag{4}
$$

Where $c^n_{k,z}$, which is the capital of bank k at the nth step of the contagion initiated by bank z, is equal to:

$$c^n_{k,z} = c^{n-1}_{k,z} - \alpha \sum_{j \in D^{n-1}_z} X_{kj}, \qquad \forall n \geq 1 \; and \; \forall k \neq z \tag{5}$$

The contagion path is represented by the following:

$$\begin{aligned}
&\textit{Failed banks} \\
&D^0_Z = \{Z\} \\
&D^1_Z = \{k \in S^0_Z : c^1_{k,z} = (c_k - \alpha X_{kz}) \leq 0\} \\
&D^2_Z = \{k \in S^1_Z : c^2_{k,z} = (c^1_{k,z} - \alpha \sum_{j \in D^1_z} X_{kj}) \leq 0\} \\
&\ldots \\
&D^n_Z = \{k \in S^{n-1}_Z : c^n_{k,z} = (c^{n-1}_{k,z} - \alpha \sum_{j \in D^{n-1}_z} X_{kj}) \leq 0\} \\
&\ldots \\
&D^N_Z = \{\emptyset\}
\end{aligned}
\qquad
\begin{aligned}
&\textit{Surviving banks} \\
&S^0_Z = \{k \in B \backslash \{Z\}\} \\
&S^1_Z = \{k \in S^0_Z : c^1_{k,z} = (c_k - \alpha X_{kz}) > 0\} \\
&S^2_Z = \{k \in S^1_Z : c^2_{k,z} = (c^1_{k,z} - \alpha \sum_{j \in D^1_z} X_{kj}) > 0\} \\
&\ldots \\
&S^n_Z = \{k \in S^{n-1}_Z : c^n_{k,z} = (c^{n-1}_{k,z} - \alpha \sum_{j \in D^{n-1}_z} X_{kj}) > 0\} \\
&\ldots \\
&S^N_Z = \{k \in S^{N-1}_Z : c^N_{k,z} = (c^{N-1}_{k,z} - \alpha \sum_{j \in D^{N-1}_z} X_{kj}) > 0\}
\end{aligned} \tag{6}$$

and the process stops after N iterations when no additional default occurs.

Based on the literature in Financial Contagion, I have made some important assumptions. Firstly, in line with Battiston et al. (2012a) I have adopted their rationale which assumes that agents are unable to recover during the duration of the cascade. Consequently, I will assume that the rate of loss (α) is equal to one. This choice is motivated by the fact that I am conducting a stress test and aiming to measure a worst-case scenario situation.

Also based on Battiston (2012a), another assumption I will make is that agents lack certainty regarding the robustness level of their counterparties, represented by the Tier 1 capital. Consequently, they are unable to anticipate whether a significant default cascade will occur or not.

Finally, one crucial assumption emphasized in numerous papers that conducted financial contagion simulations, such as Battiston et al. (2012a), Upper and Worms (2004), and Mistrulli (2015), pertains to the structure of banks once the simulations commence. Accordingly, I assume that the occurrence of bank failure triggering contagion is unexpected, which implies that the pattern of interbank lending remains constant throughout the entire contagion process. While this assumption may initially appear strict, it acknowledges the fact that domino effects may take place over a very short period of time, where banks have minimal opportunities for adjustments or strategic maneuvers.

Lastly, as highlighted by Mistrulli (2011), the contagion mechanism used in these works focuses on a specific channel for contagion while disregarding other potential sources that may interact with the propagation of contagion within the interbank market. This precise aspect forms the crux of my research. By incorporating the possibility of bank runs as an amplification mechanism in financial contagion, I aim to make a contribution to the existing literature.

3.4 Sentiment Network: unstructured big data from Twitter

In order to construct the Sentiment Network, I initially performed sentiment analysis on each of the retrieved tweets. Subsequently, I utilized the sentiment scores assigned to the banks to build the Sentiment Network.

3.4.1 Measuring the sentiment

Once the tweets were collected as stated in the "Data" section, each obtained tweet has been classified into a sentiment class measure. The higher the measure, the more positive the sentiment (or value) that the tweet assigns to the bank under analysis.

The sentiment classification has been carried out employing the NRC Emotion Lexicon. The NRC (National Research Council) lexicon consists of approximately 14,000 words or terms and is a popular resource used in sentiment analysis tasks. It is a sentiment lexicon that consists of a list of words and their associated sentiment scores. Each word in the lexicon is tagged with one or more emotions or sentiment categories, such as joy, sadness, anger, fear, trust, anticipation, surprise, and disgust.

Additionally, for this work I have used the extend multi-language version of the vocabulary as I need to measure the sentiment in the local language of each bank.

The procedure for measuring the sentiment of each tweet involves several steps. Firstly, I utilized Google's Compact Language Detector to determine the language used in each tweet. Although Twitter has its own language detection algorithm, I observed a significant number of mismatches, which were notably reduced by employing Google's algorithm.

After language identification, the next step involves using the openNLP sentence tokenizer for tokenization. Tokenization plays a crucial role in sentiment analysis as it breaks down a sentence into individual tokens. This process enables a more detailed analysis and understanding of sentiment by taking into account factors such as negation, sentiment modifiers, context, and noise removal.

For instance, in the sentence "I do not trust this bank," tokenization ensures the accurate interpretation of the negative sentiment by recognizing the presence of "not." Similarly, in the sentence "Its reserves are extremely fragile," tokenization identifies the sentiment modifier "extremely," which intensifies the negative sentiment expressed. Furthermore, tokenization helps eliminate noise such as punctuation marks, allowing the focus to be on meaningful words.

In the sequence, I implemented a loop to analyze each bank and its corresponding Twitter data. For each tweet, the language used was identified and then provided as input to the NRC Emotion Lexicon algorithm. This step ensured that the sentiment analysis was conducted in the appropriate language, taking into account the specific linguistic nuances and context.

Finally, I computed the average sentiment for each bank by aggregating the sentiment measurements on a daily basis. This approach allowed me to obtain a consolidated sentiment value for each bank, which will be used in estimating the sentiment network.

3.4.2 Construct the Sentimental Network to connect the banks

Accordingly to Fan et al. (2021), Cerchiello et al. (2017) and Cerchiello and Giudici (2016), Graphical Gaussian Models (GGM) are well suited to estimate interconnections between a large set of financial institutions.

In Cerchiello et al. (2017) the authors use GGM to estimate the relationships between banks. To do so they begin by estimating the relationship among banks through their partial correlation following the work of Lauritzen (1996). Partial correlations can be estimated assuming that the observations follow a GGM, in which the covariance matrix (Σ) is constrained by the conditional independences described by a graph.

More formally, let $X = (X_1, ..., X_N) \in R^N$ be a N-dimensional random vector distributed according to a multivariate normal distribution $\mathcal{N}(\mu, \sigma)$ and, assuming stationarity, $\mu = 0$. In addition, the authors assume throughout that the covariance matrix Σ is not singular.

Let $G = (V, E)$ be an undirected graph, with vertex set $V = 1, ..., N$, and edge set $E = VxV$, a binary matrix, with elements e_{ij}, that describe whether pairs of vertices are (symmetrically) linked between each other ($e_{ij} = 1$), or not ($e_{ij} = 0$).

If the vertices V of this graph are put in correspondence with the random variables $X_1, ..., X_N$, the edge set E induces conditional independence on X through the Markov properties as stated by Lauritzen (1996). In particular, the pairwise Markov property determined by G states that, for all $1 \leq i < j \leq N$:

$$e_{ij} = 0 \Leftrightarrow X_i \perp X_j | X_{V \setminus \{i,j\}} \tag{7}$$

that is, the absence of an edge between vertices i and j is equivalent to independence between the random variables X_i and X_j, conditionally on all other variables $x_{v \setminus \{i,j\}}$.

Whittaker (1990) proved that this independence corresponds to a partial correlation of zero i.e.:

$$X_i \perp X_j | X_{V \setminus \{i,j\}} \Leftrightarrow \rho_{ijV} = 0 \tag{8}$$

where

$$\rho_{ijV} = \frac{-\theta^{ij}}{\sqrt{\theta^{ii}\theta^{jj}}} \tag{9}$$

denotes the ijth partial correlation, i.e., the correlation between X_i and X_j conditionally on the remaining variables $X_{v \setminus \{i,j\}}$.

Therefore, ρ_{ij} expresses the direct influence of a financial institution on another, which can be used to measure the relationships between institutions.

If the value of θ_{ij} is zero (not zero), an edge does not exist (does exist) between vertex i and vertex j, and X_i and X_j are (are not) conditional independent.

Accordingly to Fan et al. (2021) constructing a visual connectedness network of financial institutions can be enhanced by considering partial correlations. When measuring the correlation of network nodes, it is important to differentiate between direct and indirect correlations. Simple correlation coefficients fail to capture this distinction, while partial correlation coefficients excel at quantifying direct correlations. By excluding the influence of other variables, the partial correlation coefficient specifically analyzes the correlation between two variables, providing a more accurate measure of direct correlation.

Therefore the GGM can be defined as the family of all N-variate normal distributions that satisfies the constraints induced by the graph $G = (V, E)$ on the partial correlation, as follows:

$$e_{ij} = 0 \Leftrightarrow \rho_{ijV} = 0, \qquad \forall \quad 1 \leq i < j \leq N \tag{10}$$

Moreover, let Θ be the inverse of the variance-covariance matrix Σ, i.e., Σ^{-1}. Θ is also referred to as a precision matrix and θ_{ij} are its elements.

According to the above analysis, the precision matrix contains the structural information of the graph model, so the structural learning of the Graphical Gaussian model can be transformed into the problem of calculate the precision matrix.

Let S be the covariance matrix of samples, that is, $S = \Sigma_{n=1}^{N} X^{(n)} X^{(n)T}/N$. The maximum likelihood estimation problem of the precision matrix can be expressed as:

$$\max_{\Theta > 0} log|\Theta| - tr(S\Theta) \tag{11}$$

where $\Theta > 0$ denotes that all the elements of the matrix Θ are positive; $tr(\cdot)$ indicate trace of the matrix; and $|\Theta|$ denotes determinant of Θ.

However, the resulting model is too complex to be interpreted in reality. This occurs because the maximum likelihood estimation method cannot generate sparse solutions. In order to solve this problem, following

Fan et al. (2021) and Banulescu & Dumitrescu (2015) a Lasso approach can be used by applying L_1-norm penalty to:

$$\hat{\Theta} = arg \max_{\Theta > 0} log|\Theta| - tr(S\Theta) - \lambda||\Theta||_1 \tag{12}$$

where $\lambda \geq 0$; Θ is a positive definite matrix; $||\Theta||_1 = \sum_{j=1} \sum_{i=1} |\Theta_{ij}|$ is L_1-norm penalty for Θ. Since the L_1-norm penalty is used, the solution of Eq. (12), i.e., $\hat{\Theta}$, will be sparse. In another words, the proportion of zero elements in the precision matrix $\hat{\Theta}$ is larger. These zero elements represent the conditional independence between X_i and X_j and the absence of an edge between vertices i and j.

The remaining issue pertains to determining the optimal value for λ since different values can yield varying partial correlations and, consequently, different connections in the Sentiment Network. While some authors, such as Cerchiello et al. (2017), argue that the choice of λ is arbitrary, the literature does provide some methods for obtaining the best value for λ.

Cross-validation is a widely used technique for model selection and hyperparameter tuning. In the case of Lasso, cross-validation can help determine the optimal λ value by assessing the model's performance on different subsets of the data.

The process involves dividing the available data into multiple subsets or folds. The model is trained on a combination of these folds and evaluated on the remaining fold. This process is repeated several times, with different fold combinations, and the performance metric (such as mean squared error or accuracy) is averaged across all iterations. By testing various λ values and selecting the one that results in the best performance metric, the cross-validation approach helps identify the optimal λ for the Lasso method, which is the approach I used in this work.

In summary, two or more banks will be connected when users exhibit similar sentiment towards these banks. In other words, the network connections are formed based on the similarity of sentiment expressed by users regarding the banks.

The main assumption underlying this approach is that if bank runs occur, they are more likely to spread among banks that have established connections in the sentiment expressed by social media users. This assumption suggests that the spread of a bank run is not random but rather influenced by the interconnected sentiment dynamics among banks.

3.5 Financial Contagion with Bank Runs effects

To incorporate the effect of bank runs in the interbank financial contagion approach, I propose a methodology that can be summarized in the following steps:

- for each bank, analyze the other banks that are sentiment connected to it
- check if the banks sentiment connected were not already contagioned by the interbank simulation. In case negative, allow these banks also to fail due to the bank run effect
- check the interbank connections from these new banks that are assumed to fail
- check if there are no duplicate cases (banks that have already been considered fail due to the interbank contagion)
- compute the number of additional banks that would fail in this approach
- compute the additional total assets from these banks
- compute the difference from this simulation from the simulation of only interbank contagion

Therefore, following these steps on simulations for each bank, I can compute the additional effects of considering bank runs in the simulation, both in number of banks and in total assets lost.

3.6 An illustration

In this section I provide a simple example to helps illustrate the model and the methodologies proposed. Consider **Figure 1**, where five stylized banks are represented. In this picture it is showed banks A, B, C, D, and E and theirs respective assets, capital (tier 1 capital) and interbank liabilities. This values are (100,10,30), (150,20,20), (120,12,0), (80,8,6), and (120,12,20) respectively.

To simplify the example, let's assume that bank A's interbank liabilities are evenly distributed among banks B, C, and D. It's important to note that this simplified scenario does not precisely reflect the behavior of the MD method. Instead, it is more similar to the ME method. However, for the purpose of this illustration, treating it in a similar manner would yield comparable results and make the analysis easier.

To consider the simulation of financial contagion in this approach, I first simulate that Bank A fails. In this case, I will consider that this bank will not pay the whole liabilities to the banks B, C, and D. What we have in this case is that Banks B and C, for having more financial robustness (they have capital of 20 and 12 respectively) could absorb this default of bank A and will not fail. However, bank D which has only 8 of capital would fail.

After that, the approach is to go for a second round where I need to check the impacts of the interbank liabilities of bank D, which has fail in the first round. Again for simplicity I will consider that bank D also split its interbank liabilities equally among banks E and C. Bank E, as it happened to banks B and C in the first round, has enough capital to absorb this loss and will not fail. However, now when we look to bank C, this bank would also fail considering that it is necessary to keep track of the defaults in the previous round. Therefore, bank C would be short of 13 (10 from default of Bank A in the first round plus 3 in the default of Bank D in the second round) and would also fail.

The simulation continues for another round with the analyse of the interbank liabilities of bank C now. However, since this bank has 0 of interbank liabilities the simulation would stop here.

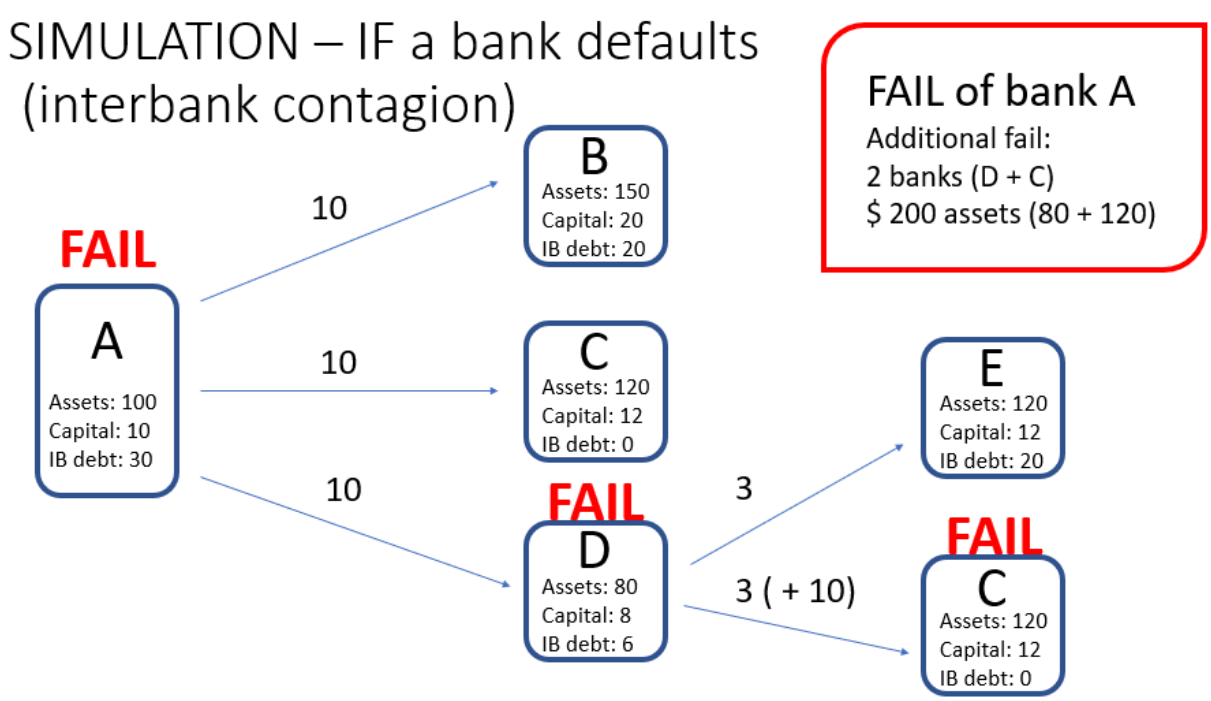

Figure 1: Simulation interbank contagion

In this case, the default of Bank A would cause the additional default of other 2 banks (D and C) and the additional amount of assets lost in this simulation would be 200 (80 from bank D and 120 from bank C).

This examples follows closely the works of Acenad et al. (2015) and Battiston et al. (2012a).

In **Figure 2** it is possible observe the representation of the network connecting the illustrated banks.

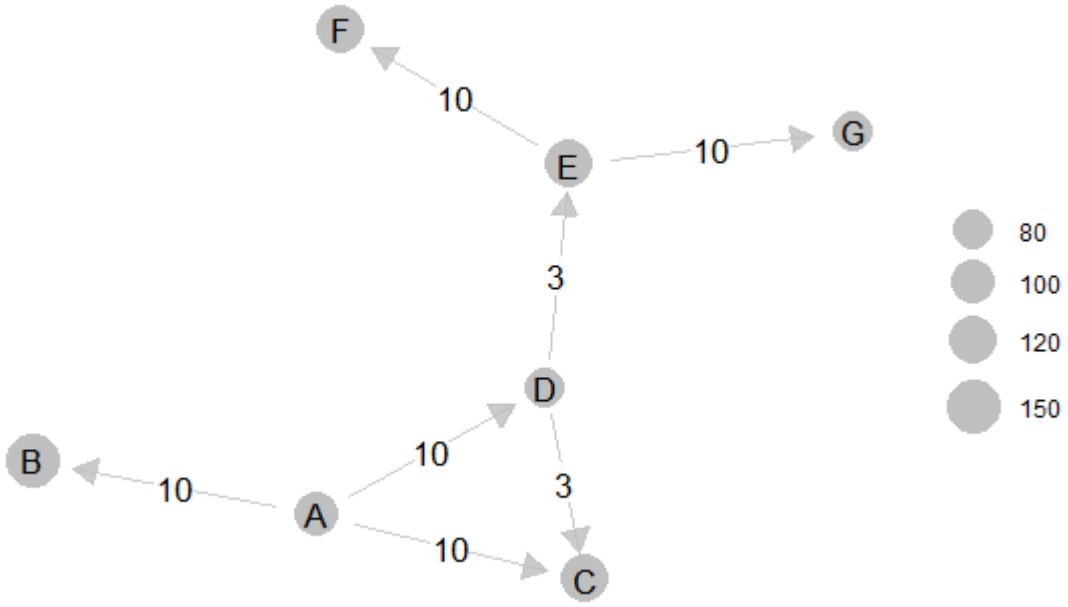

Figure 2: Interbank network with the illustration data

Now in my expansion, I will add the effects of a bank run in the simulation.

Consider **Figure 3**. Initially, it presents the same example as depicted in **Figure 1**, illustrating the interbank market contagion. However, in this scenario, I introduce the additional effects of bank run contagion.

In this case, Bank A is "sentiment connected" to Bank E. Therefore, when simulating the default of Bank A, I will also consider that, in addition to the interbank contagion effects explained earlier, Bank E would also fail due to a bank run contagion originating from Bank A. This is because in a simulation where Bank A experiences a bank run event and fails, it is likely that Bank E would also be affected by a bank run due to their sentiment connection.

Finally, in this case, I have also to analyze for the effects of interbank connections of bank E. Considering that, Bank G would also fail once it would not receive 10 from Bank E and its capital is only 8.

Therefore, now it is possible to analyze the effects of the default simulation of Bank A and compare the results in both cases, i.e., considering just the contagion in the interbank market and considering also the additional effect of bank runs.

As before we had that the simulation of the default in Bank A would cause the additional defaults of other 2 banks and 200 in assets. Now, considering the effects of a bank run, the effect of a simulated default in Bank A would cause the additional default of 4 banks (D, C, E, and F) and the additional loss of 400 in assets.

With this methodology it is possible to quantify the additional impacts that a bank run could cause in the system as well as access which banks would spread more default in the system (more central and systemically important).

Finally, it is crucial to emphasize that Sentiment Analysis is a highly dynamic process. As a matter of fact, these metrics could be computed in virtually real-time basis, providing a significant advantage over certain conventional indicators.

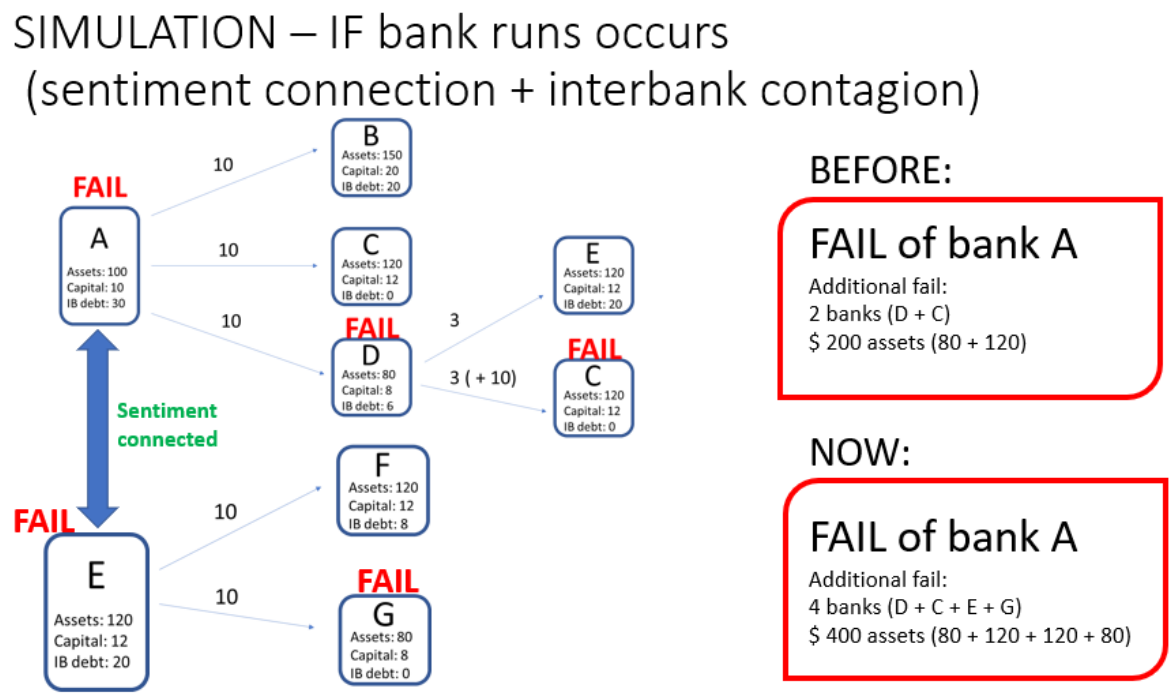

Figure 3: Simulation interbank contagion with bank run effects

Let's consider an example: suppose that today Bank Z experiences a bank run (for any given reason). Using this methodology, it would be possible to reconstruct the sentiment network connections within a few days, or even hours, and analyze the potential contagion effects. Moreover, it enables us to identify other banks that are more likely to be affected by the bank run through sentiment analysis.

This scenario becomes highly plausible when we have concrete information confirming that Bank Z indeed encountered a bank run. In such cases, if users who extensively comment on the bank run of Bank Z also display a similar pattern of behavior towards another bank, let's say Bank X, it is reasonable to assume that Bank X is susceptible to experiencing a bank run alongside Bank Z.

4 Results

In this section I start by showing the results of the estimated Financial Network created for the simulation on the interbank connections within the financial institutions' data. After that, I present the Sentiment Network constructed using the unstructured big data retrieved from Twitter.

In the sequence, I show the results of the simulations and how the contagious effect affect the institutions. Finally, I compare the effects considering only interbank connections with those of my method that includes bank run effects.

Therefore, this section provide two main approaches to analyzing the financial contagion and possible bank runs effect: visually and quantitatively.

4.1 Financial Networks

Figure 4 illustrates the estimated interbank network, employing the minimum density estimation method proposed by Anand et al. (2015). In this figure, nodes are weighted based on the total assets of each bank, and the colors indicate the countries where the banks are headquartered.

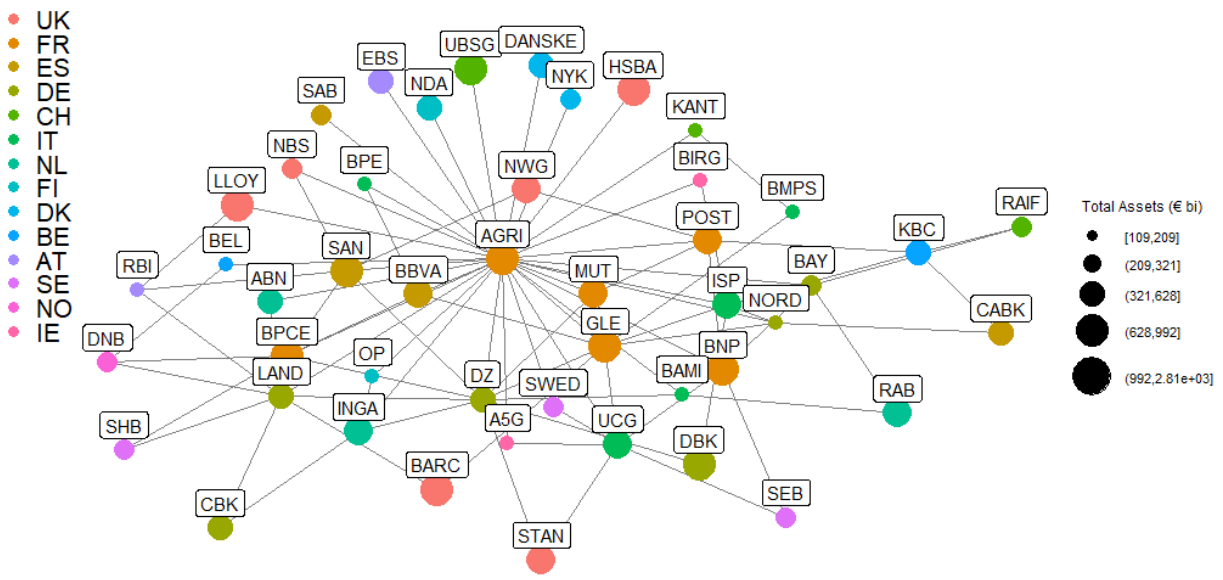

Figure 4: Financial Networks using Balance Sheet data

The resulting network demonstrates sparsity and disassortativity. Sparsity refers to a network with relatively few connections compared to the total possible connections, resulting in few edges between nodes. Disassortativity, or disassortative mixing, describes a network where nodes tend to connect to nodes with different attributes or characteristics. Highly connected nodes are more likely to be connected to less connected nodes.

These characteristics are typical of a core-periphery network, which is commonly observed in interbank financial networks. In a core-periphery network, a densely connected core of nodes interacts strongly among themselves, while the periphery consists of nodes with fewer connections.

In fact, observing the network, it becomes apparent that AGRI appears to be the most central bank, which aligns with its high interbank asset value. Despite not being the largest in terms of total assets, AGRI's significant interbank assets contribute to its centrality within the network. On the other hand, banks such as NIK, BEL, SEB, and BIRG, with low interbank liabilities, occupy the "periphery" of the network. These banks have only a few connections, reflecting their relatively small debts, which are primarily directed towards larger banks like AGRI and BNP. These observations align with the assumptions of the ME methodology.

Moving forward, in the sequence I present the Sentiment Network constructed using the unstructured big data retrieved from Twitter.

This Network can be seen in **Figure 5**.

As in the previous figure, here nodes are weighted based on the total assets of each bank, and the colors indicate the countries where the banks are headquartered.

First of all, it is possible to noticed that the connections among banks in this case differ significantly from the interbank connections in the previous case. This was expected, as stated by Cerchiello et al. (2017), considering that the two networks aim to capture distinct information. The interbank network focuses on the connections between banks, while this network is constructed based on the sentiment expressed by social media users towards those banks.

This distinction is beneficial because if both networks captured similar issues, the simulation considering both would duplicate these connections, leading to an overestimate of contagion. Furthermore, it would not align with the overall objective of this work.

It is important to note that is is expected from the sentiment network to also capture non-fundamental factors related to social media users' sentiment, which are not included in the first network. Additionally,

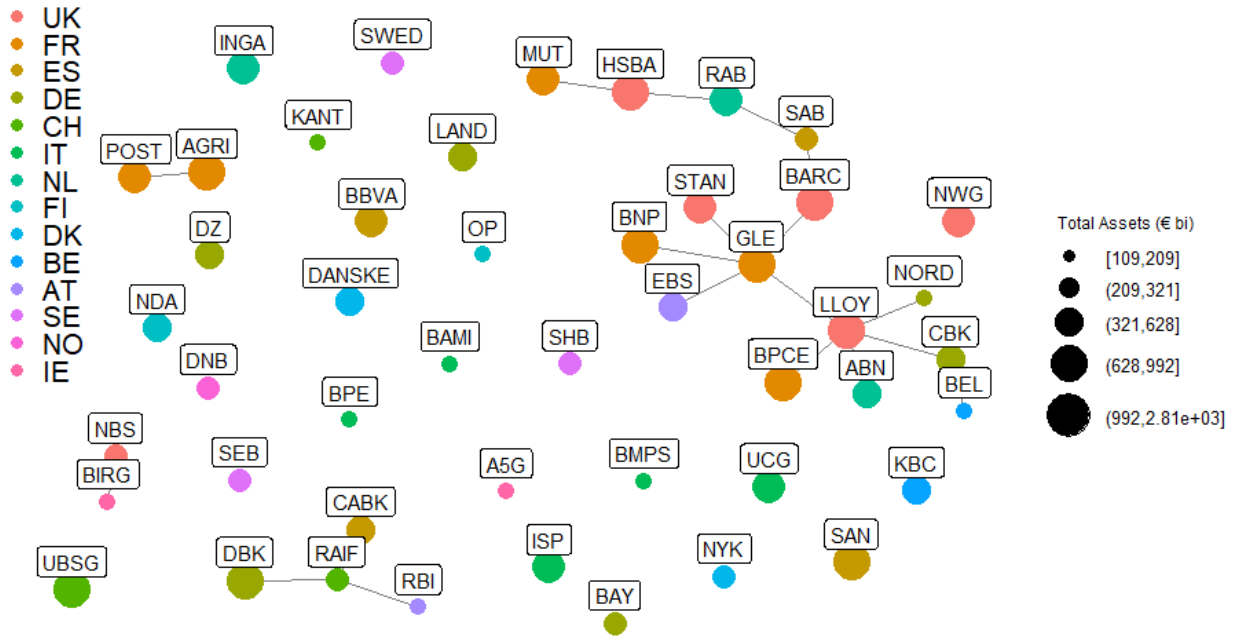

Figure 5: Sentiment Network using unstructured big data from Twitter

the comments in tweets cannot contain information about interbank connections since these connections are often unknown, even to central banks and regulators, as stated by Anand et al. (2015).

With that in mind, let's analyze the connections in **Figure 5**. We can observe certain connections that are to be expected, such as those between French banks POST and AGRI, and GLE and BNP. Similarly, the British BNS is connected to the Irish BIRG, and the German DBK is connected to the Swiss RAIF and the Austrian RBI.

However, it is important to note that connections are not necessarily limited to banks from the same country or language. These connections reflect the sentiment towards the institutions, regardless of language. Therefore, the presence of other connections is completely normal and somewhat expected.

The crucial aspect to emphasize is the dynamic nature of Sentiment Analysis. This process enables the computation of metrics in near real-time, as emphasized in the illustration chapter, enabling the identification of new connections as sentiments towards banks evolve.

By applying this methodology, it becomes feasible to reconstruct sentiment network connections within a short timeframe, ranging from a few days to mere hours. Such rapid analysis facilitates the examination of potential contagion effects in a turmoil situation.

4.2 Financial Contagion

After examining the visual aspects of the methodology's results, this section delves into the quantitative findings.

To begin with, the outcomes of the financial contagion simulations considering solely interbank connections are presented. **Table 2** displays the top 10 banks ranked by the potential contagion effect, measured by the total assets that would be impacted in the event of their failure.

Table 2: Rank of top 10 IB Financial Contagion (by assets default)

Bank	Institution Name	Rank	Add Banks Default	N	Add Assets Default	% Total
BNP	BNP Paribas	2	AGRI, BPCE, GLE, ISP, MUT, UCG, STAN, POST, DZ, KBC, LAND, EBS, BAY	13	11310.13	34.12
UCG	UniCredit	14	AGRI, BPCE, GLE, ISP, MUT, STAN, POST, DZ, KBC, LAND, EBS, BAY	12	10452.36	31.54
GLE	Société Générale	7	AGRI, BPCE, ISP, MUT, STAN, POST, DZ, KBC, LAND, EBS, BAY	11	8965.54	27.05
ISP	Intesa Sanpaolo	11	AGRI, BPCE, MUT, STAN, POST, DZ, KBC, LAND, EBS, BAY	10	7989.86	24.11
HSBA	HSBC Holdings	1	AGRI, BPCE, MUT, STAN, POST, DZ, LAND, EBS	8	7374.69	22.25
INGA	ING Groep N.V.	12	AGRI, BPCE, MUT, STAN, POST, DZ, LAND, EBS	8	7374.69	22.25
MUT	Crédit Mutuel	13	AGRI, BPCE, STAN, POST, DZ, LAND, EBS	7	6489.60	19.58
BPCE	Groupe BPCE	6	AGRI, MUT, STAN, POST, DZ, LAND, EBS	7	5843.55	17.63
AGRI	Crédit Agricole	3	BPCE, MUT, STAN, POST, DZ, LAND, EBS	7	5207.07	15.71
SAN	Banco Santander	4	STAN, DZ, LAND, RBI	4	1928.39	5.82

NOTES: 1) assets are in Billions of Euros. 2) For the banks not listed in Stock Market, the column "Bank" present an acronym, otherwise it is the Ticker.

The table highlights that BNP would have the most significant impact on the financial system if it were to fail. Its failure would lead to the failure of 13 other banks, resulting in a combined impact of 11,310 billion Euros. This amount represents over 34% of the total assets of all banks in the system.

Following BNP, the banks UCG, GLE, ISP, HSBA, and INGA are listed, and their failures would account for impacts ranging from around 30% to 20% of the system's total assets.

Interestingly, the spread of systemic contagion does not necessarily require banks to be extremely large in terms of total assets. A case in point is bank UCG, which ranks only 14th in terms of total assets. This effect may occur because banks can have significant interbank connections, leading to a domino effect. Furthermore, these banks may have substantial interbank liabilities despite their size. In fact, bank UCG would rank 6th if consider interbank liabilities.

Now turning to the results that incorporate the effects of bank runs in the simulations, I will analyze **Table 3**, which presents the top 10 banks also ranked by their total assets.

Table 3: Rank of top 10 Financial Contagion with Bank Run Effects (by add assets default)

Bank	Institution Name	Rank	Sentiment Connected	Add Banks Default	Add Assets Default	% Total
GLE	Société Générale	7	BNP, BARC, LLOY, STAN, EBS	15	15202.88	45.87
LLOY	Lloyds Banking	10	BPCE, GLE, CBK, ABN, NORD	16	12386.52	37.37
BNP	BNP Paribas	2	GLE	13	11310.13	34.12
BARC	Barclays	5	GLE, SAB	13	10703.74	32.29

Bank	Institution Name	Rank	Sentiment Connected	Add Banks Default	Add Assets Default	% Total
RAB	Coöperatieve Rabobank	19	HSBA, SAB	11	10690.81	32.25
UCG	UniCredit	14		12	10452.36	31.54
EBS	Erste Group Bank	29	GLE	11	10128.50	30.56
SAB	Banco de Sabadell	38	BARC, RAB	11	9979.79	30.11
STAN	Standard Chartered	16	GLE	11	9682.24	29.21
RAIF	Raiffeisen Gruppe	35	DBK, CABK, RBI	12	9620.09	29.02

NOTES: 1) assets are in Billions of Euros. 2) For the banks not listed in Stock Market, the column "Bank" present an acronym, otherwise it is the Ticker.

In this scenario, it is possible to observe a significant change in the top-ranked banks that would cause the most substantial systemic contagion in the event of their failure.

While GLE and BNP maintain their positions in the top ranks, banks such as LLOY, BARC, and RAB now emerge as contributors to significant systemic contagion.

Additionally, the total amount lost in this scenario is larger, with GLE potentially accounting for up to 45% of total assets. The other banks, up to RAB, would fall within the range of up to 32% impact on total assets.

The change in rankings is primarily attributed to the fact that these banks are sentiment connected to other banks that would experience significant contagion in case of distress. As a result, the contagion effect is considerably amplified.

To gain a clearer understanding of this comparison, let's refer to **Table 4**, which provides a comprehensive overview of all the banks in both scenarios: counting only interbank connections and accounting for the amplification mechanism through bank runs.

Table 4: Comparison Financial Contagion with IB and with Bank Run Effects + IB (by total assets add)

Bank	Defaults IB	Assets IB	Defaults IB+BR	Assets IB+BR	Add Banks	Add Assets
LLOY	0	0.00	16	12386.52	16	12386.52
RAB	1	259.30	11	10690.81	10	10431.51
EBS	0	0.00	11	10128.50	11	10128.50
SAB	0	0.00	11	9979.79	11	9979.79
STAN	0	0.00	11	9682.24	11	9682.24
RAIF	0	0.00	12	9620.09	12	9620.09
BARC	3	1721.34	13	10703.74	10	8982.40
POST	0	0.00	7	6629.04	7	6629.04
GLE	11	8965.54	15	15202.88	4	6237.34
MUT	7	6489.60	8	9295.04	1	2805.44
CBK	0	0.00	2	1175.36	2	1175.36
ABN	0	0.00	1	995.90	1	995.90
NORD	0	0.00	1	995.90	1	995.90
BPCE	7	5843.55	8	6839.45	1	995.90
HSBA	8	7374.69	10	8262.50	2	887.81
BEL	0	0.00	1	477.44	1	477.44
BIRG	0	0.00	1	308.46	1	308.46
DBK	0	0.00	1	282.61	1	282.61
CABK	1	109.33	2	391.94	1	282.61
RBI	3	1721.34	4	2003.95	1	282.61

Bank	Defaults IB	Assets IB	Defaults IB+BR	Assets IB+BR	Add Banks	Add Assets
NBS	0	0.00	1	151.32	1	151.32
BNP	13	11310.13	13	11310.13	0	0.00
AGRI	7	5207.07	7	5207.07	0	0.00
SAN	4	1928.39	4	1928.39	0	0.00
UBSG	0	0.00	0	0.00	0	0.00
ISP	10	7989.86	10	7989.86	0	0.00
INGA	8	7374.69	8	7374.69	0	0.00
UCG	12	10452.36	12	10452.36	0	0.00
NWG	1	745.64	1	745.64	0	0.00
BBVA	1	152.30	1	152.30	0	0.00
DZ	1	770.12	1	770.12	0	0.00
NDA	0	0.00	0	0.00	0	0.00
DANSKE	0	0.00	0	0.00	0	0.00
KBC	1	745.64	1	745.64	0	0.00
LAND	2	1397.16	2	1397.16	0	0.00
SEB	0	0.00	0	0.00	0	0.00
SHB	0	0.00	0	0.00	0	0.00
DNB	0	0.00	0	0.00	0	0.00
BAY	0	0.00	0	0.00	0	0.00
SWED	0	0.00	0	0.00	0	0.00
NYK	0	0.00	0	0.00	0	0.00
KANT	0	0.00	0	0.00	0	0.00
BAMI	0	0.00	0	0.00	0	0.00
OP	0	0.00	0	0.00	0	0.00
BPE	0	0.00	0	0.00	0	0.00
A5G	0	0.00	0	0.00	0	0.00
BMPS	0	0.00	0	0.00	0	0.00

NOTES: 1) assets are in Billions of Euros. 2) For the banks not listed in Stock Market, the column "Bank" present an acronym, otherwise it is the Ticker.

This table is ranked based on the total assets that are added to the contagion when bank runs are included in the simulations, compared to considering only interbank contagion. In other words, it represents the difference between the contagion effects when just interbank contagion are considering and when both bank runs and interbank connections are taken into account.

In this table, it is evident that bank LLOY contributes the most to the system's defaults after considering the amplification caused by bank runs. The significance of bank LLOY's contribution stems from the fact that, initially, it would not cause any defaults based solely on interbank contagion. The same holds true for the other seven banks at the top of the table (excluding banks RAB and BARC, which would cause 1 and 3 defaults through interbank connections, respectively).

The total amount of assets that would be lost, considering only interbank connections, sums up to 80,558 billion euros. Comparing when bank runs are taken into consideration, this number increases to 174,276 billion euros, representing an 116.34% increase (over twice as much). Nevertheless, it's important to note that this measure purely holds for a hypothetical comparison among the simulation, as the simulation should be considered only individually for each bank.

Although there may be convergence in results for certain banks, such as bank GLE, it is important to emphasize that the inclusion of the proposed amplification mechanism leads to significant changes in the results. This observation highlights the criticality of integrating different measures, as it allows for a more comprehensive understanding. By combining multiple measures of systemic importance, one can obtain a more accurate and holistic perspective of the potential risks that financial contagion poses to the stability of the financial system.

In light of the results obtained, it is evident that banks that were not highly central in the network before now exhibit increased centrality. This finding is of particular importance and should attract the attention of regulators. To mitigate these risks, a "sentiment buffer" policy could be considered. Such a buffer might involve targeted capital requirements or liquidity provisions that increase during periods of high negative sentiment, helping banks better withstand sentiment-driven liquidity demands. By proactively addressing sentiment contagion risks, regulators could potentially reduce the impact of panic-driven behavior on financial stability.

Finally, it is crucial to emphasize that the outcomes of this study lean towards a pessimistic perspective. However, it is essential to view these results as a stress test in a worst-case scenario approach, offering insights into the potential vulnerabilities of the financial system. In other words, these results should not be interpreted too literally or used as the sole determinant of a financial institution's systemic importance. The additional stress indicator, represented by the bank runs amplification, can serve as another measure of systemic importance. Therefore, it should be considered alongside other factors such as the institution's size, interconnectedness, and criticality to the overall functioning of the financial system.

5 Conclusion

Results obtained from this analysis provide valuable insights into the potential effects of bank runs and sentiment-driven contagion in the financial system. The combination of interbank connections and sentiment networks allows for a more comprehensive understanding of systemic risk and its propagation through the system.

The estimated interbank network demonstrates a core-periphery structure, where a densely connected core of banks interacts strongly among themselves, while the periphery consists of banks with fewer connections. This finding aligns with previous studies on interbank networks and reflects the hierarchical nature of the financial system. The centrality of certain banks, such as AGRI, highlights their importance in the network due to their high interbank assets. On the other hand, banks with low interbank liabilities occupy the periphery of the network, indicating their relatively smaller debts directed towards larger banks.

Sentiment network constructed from Twitter data provides a different perspective on the connections between banks. It captures non-fundamental factors, reflecting users' sentiments towards banks regardless of their country or language. This network is dynamic in nature and allows for near real-time analysis, enabling the identification of new connections as sentiments evolve. The sentiment network provides additional information that complements the interbank network and contributes to a more holistic understanding of contagion dynamics.

Simulation results highlight the potential impact of bank failures on the financial system. In the case of interbank contagion without considering bank runs, BNP emerges as the bank with the most significant potential contagion effect, followed by UCG, GLE, ISP, and HSBA. However, when bank runs are included in the simulations, the ranking of banks experiencing significant contagion changes. Banks like LLOY, BARC, and RAB emerge as contributors to systemic contagion due to their sentiment connections with other banks.

The comparison between interbank contagion and contagion with bank runs amplification shows a substantial increase in the potential losses and defaults in the system when bank runs are considered. Banks that initially would not cause any defaults based solely on interbank contagion can become significant contributors to systemic risk when sentiment-driven bank runs are taken into account. The inclusion of the amplification mechanism through bank runs provides a more comprehensive perspective on systemic importance and potential vulnerabilities.

These results emphasize the importance of integrating multiple measures of systemic risk to gain a more accurate understanding. By considering both interbank connections and sentiment-driven bank runs, regulators can identify systemically important banks that may not be apparent solely based on traditional measures. In this sense, a sentiment-buffering mechanism could serve as a proactive policy to help mitigate contagion risk driven by shifts in public sentiment.

While these findings highlight specific vulnerabilities within financial networks, they should be interpreted cautiously, as the simulations reflect stress-test scenarios rather than precise predictions. Additional research will be necessary to validate and enhance these findings. The sentiment analysis, for instance, relies on social media data that may not fully represent market sentiment. Similarly, the interbank network estimations are constrained by data quality and availability, and the simplified contagion model proposed does not capture all complexities of real-world events. Moreover, the sentiment analysis tool used is based on general vocabulary rather than finance-specific language.

Looking ahead, this research opens several avenues for further exploration. Advances in Artificial Intelligence, particularly NLP and LLMs, provide promising tools for enhancing sentiment analysis in financial contexts. Future work will involve developing a finance-specific language model to better capture nuanced sentiment dynamics. Additionally, further refinement of the contagion mechanism proposed in this study — to better integrate interbank and sentiment networks — could improve the accuracy of contagion predictions. Finally, real-world applications of this network methodology will also be explored by comparing network structures immediately before and after market distress events, allowing for validation under actual conditions.

Through these efforts, this study aims to offer a more comprehensive measurement framework for assessing systemic risk and understanding the interplay between fundamental and non-fundamental factors. By advancing these methodologies, this research can provide insights for regulators to enhance risk management and supervision practices, enriching both theoretical knowledge and practical applications in financial stability and risk management.

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