

Effectiveness of early warning models: A critical review and new agenda for future directions

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Abstrak

This paper suggests a new agenda for constructing early warning models (EWMs) to enhance their effectiveness in predicting financial crises. The central argument of the new agenda aims to eradicate the weaknesses of existing EWMs, since their failure to predict the global financial crisis of 2007–2008 demonstrates the need to improve their efficiency. We document the history of EWMs and propose a new agenda as follows: 1) the accurate measurement of a financial crisis, 2) implementation of a fourth generation crisis model to capture the dynamic nature of the financial crisis, and 3) the inclusion of interconnectedness/contagion variables as explanatory variables for the financial crisis.