

# A data-driven approach to financial institution soundness around the world

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## **Abstract**

We use a fully data-driven approach and information provided by the IMF's financial soundness indicators to measure the soundness of a country's financial system around the world. Given the nature of the measurement problem, we apply principal component analysis (PCA) to deal with the presence of strong cross-sectional dependence in the data due to unobserved common factors. Using this comprehensive sample and various statistical methods, we produce a data-driven measure of financial soundness that provides policy makers and financial institutions with a tool that is easy to implement and update.