Global Banks and International Shock Transmission: Evidence from The Crisis

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Abstract

As banking has become more globalized, the consequences of shocks originating in home and host markets have likewise evolved. Global banks played a significant role in the transmission of the 2007 to 2009 crisis to emerging market economies. We examine the relationships between adverse liquidity shocks on main developed-country banking systems to emerging markets across Europe, Asia, and Latin America, isolating lending supply from lending demand shocks. Lending supply in emerging markets was affected through three separate channels: a contraction in direct, cross-border lending by foreign banks; a contraction in local lending by foreign banks' affiliates in emerging markets; and a contraction in lending supply by domestic banks as well, as a result of the funding shock to their balance sheet induced by the decline in interbank, cross-border lending. There is no evidence, however, that openness to international banking flows per se caused the propagation of the financial crisis.