CHAPTER 2

INTERNATIONAL BANKING AFTER THE CRISIS: INCREASINGLY LOCAL AND SAFER?

SUMMARY

Two developments stand out among the changes in international banking since the global financial crisis. First, direct cross-border lending as a share of total banking assets has declined, mostly because of the retrenchment of European banks. Second, the share of local lending by foreign bank affiliates has remained steady. Global banks in particular have refocused their activities on some key markets, leaving space for other banks to expand. As a result, intraregional financial linkages have deepened, especially in Asia.

Although the cutback in cross-border lending was triggered by the crisis, regulatory changes and weaknesses in bank balance sheets have contributed significantly to the subsequent retrenchment. Better-capitalized banks were more likely to maintain cross-border lending. Macroeconomic factors have also played a role.

The relative shift on the part of foreign banks away from cross-border lending and toward more local lending through affiliates has a positive effect on the financial stability of host countries. Cross-border lending compounds adverse domestic and global shocks. In contrast, foreign-owned subsidiaries, particularly those with better-capitalized parent banks, tend to behave less procyclically than domestic banks around domestic crises.

In principle, international banking has benefits that are not examined in this chapter. For example, global banks contribute to the allocation of global savings across countries, with positive effects on investment and growth. The reduction in cross-border lending may diminish some of those benefits.

Policymakers should therefore strive to maximize the benefits of international banking while mitigating risks. The findings of this chapter lend support to recent financial reforms that strengthen the resilience of global banks. They also emphasize the need for more international cooperation to deal with regional or global shocks.

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