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| Foreign banks and the global financial crisis: Investment and lending behaviour[Stijn Claessens](http://www.voxeu.org/index.php?q=node/2081) [Neeltje van Horen](http://www.voxeu.org/index.php?q=node/5434) 31 January 2012 *How did foreign banks adjust their investment and lending decisions during the global financial crisis? This column uses a new and comprehensive database to show that the crisis dramatically halted foreign direct investment in banking and that foreign banks often cut back on lending more than their domestic competitors. While exits have so far been limited, this is likely to change in the coming years.*  Foreign banks have in many countries become important sources of financial intermediation. Given this importance, understanding the impact of the financial crisis on foreign-bank behaviour is important. Questions being asked include:   * Did the financial crisis cause banks to adjust their foreign presence? * When does the presence of foreign banks help mitigate the effects of various shocks to the host countries’ banking systems and when not? * Do differences between types of foreign banks – country of origin, size, degree of international operations, distance between home and host countries, etc – and the relative presence of foreign banks affect their role as risk absorber or risk amplifier?   This column attempts to shed light on some of these questions by presenting results of a new working paper describing a data-collection effort ([Claessens and van Horen 2012a](http://www.imf.org/external/pubs/ft/wp/2012/wp1210.pdf)), which also provides new analysis on foreign-bank investment and the relation between foreign-bank presence, financial-sector development and stability (see our other Vox column based on this new dataset [Claessens and van Horen 2012b](http://www.voxeu.org/index.php?q=node/7570)). Investment and disinvestment during the financial crisis Figure 1 shows foreign-bank entries and exits from 1995 to 2009. In the years leading up to the crisis entry peaked, but with the start of the global financial crisis it slowed down markedly. While 2008 still saw entries at levels similar to 2005, in 2009 the number of entries was the lowest since the beginning of the period. This drop in entry is due to a combination of bank-specific and home- and host-country factors. Many banks suffered capital losses and other balance sheet impairments and, due to market forces or government interventions, were forced to consolidate. Many choose to retreat from cross-border banking in general, including through cutting back on new entry. At the same time, host countries affected by the crisis became less interesting as investment opportunities.  **Figure 1**. Number of entries and exits of foreign banks (1995–2009)  http://www.voxeu.org/sites/default/files/image/FromAug2011/Claessens_vanHorenFig1.gif  *Note:* As the database starts in 1995 the number of foreign banks that exited the market in that year cannot be determined.  While the crisis affected new entry, until 2009 it hardly had an impact on exits which remained at levels similar to earlier periods. Parent banks, apparently, did not (yet) feel the need to close or sell their foreign affiliates. This likely reflected that most affiliates were located in countries at the time only marginally affected by the crisis and/or with substantial long-term growth opportunities (with fixed costs involved in setting up a foreign affiliate, exits are in general not driven by short-run fluctuations but long-run opportunities).  However, the tide seems to be turning. With the pressure on to increase their capital ratios and with equity markets discounting banks, for many banks selling assets has become a cheaper way to raise capital than selling new stock. Therefore, pressure from regulators and markets to bolster banks’ capital ratios potentially has the (unintended) consequence of banks selling some of their profitable foreign subsidiaries perforce. Indeed, recently a number of European banks (including Santander, ING, and Banco Espirito Santo) have had to sell some of their fastest-growing foreign subsidiaries. Lending during a financial crisis The role of foreign banks in financial stability has been much debated, with studies finding ambiguous results. Some find that global banks support their foreign affiliates during times of financial stress through internal capital markets (De Haas and van Lelyveld 2011). Ongena *et al* (2011) find that, while foreign banks reduced lending more than local domestic banks did, they did not compared to domestic banks that financed their lending boom through borrowing from international capital markets. And De Haas and van Horen (2011) show that during the crisis foreign banks continued to lend to those countries geographically close and with whom they have established long-term lending relationships, suggesting that foreign banks do differentiate.  Earlier work had shown that (funding) shocks to parent banks can be transmitted to their foreign subsidiaries with negative consequences for their lending (Peek *et al* 1999). Since the crisis, more studies have pointed out the risks of foreign banking. Indeed, De Haas *et al* (2011) and Popov and Udell (2010) find for emerging European countries that foreign subsidiaries reduced their lending more compared to domestic banks. In a recent Vox column, [De Haas and van Lelyveld (2011)](file:///C:\Users\sreid\Desktop\Vox\Macintosh%20HD:\(http\--www.voxeu.org-index.php?q=node-7419)) report similar results when comparing loan growth of foreign subsidiaries of large multinational banking groups with large domestic banks. Other recent studies also have found that foreign banks created financial instability in their host countries during the crisis (Acharya and Schnabl 2010, Chava and Purnandam 2011, Cetorelli and Goldberg 2011). New results suggest the role of foreign banks differs bycircumstances For a sample of 3,615 banks, of which 1,198 are foreign-owned, in 118 countries, we test whether loan growth of foreign banks differs from that of domestic banks in 2008 and 2009. We do not find loan growth to differ between domestic and foreign banks in 2008, probably as the financial crisis only became truly global in 2009 and did not yet affect many foreign banks’ operations in 2008. But our results do show that in 2009 foreign banks reduced lending more compared to their domestic counterparts by around six percentage points (compared to mean credit growth in 2009 of 5%).  The impact of the crisis on foreign relative to domestic bank lending does, however, crucially depend on a number of host-country and bank characteristics.   * First, foreign banks in OECD countries already in 2008 reported lower loan growth compared to domestic banks. In 2009, however, as the crisis spread, foreign banks reduced lending compared to domestic banks in both OECD and non-OECD countries. * Second, while in countries with minority presence foreign banks reduced domestic credit during 2009 more than domestic banks did, the opposite is the case in countries dominated (in terms of numbers) by foreign banks. In fact, where they dominate, foreign banks had a 1% higher loan growth compared to domestic banks. * Third, having access to deposit funding during the crisis turns out to be especially important for foreign banks to maintain credit. While a one standard-deviation increase in the deposit-to-liability ratio increases credit growth of domestic banks by some three percentage points, it is seven percentage points for foreign banks.  Future prospects The crisis continues to affect global banking systems in many ways. Faced with large losses and capital shortfalls, many banks in advanced countries are undergoing major restructurings, either voluntary or as conditions of government support. Furthermore, banks need to comply with stricter regulations, such as Basel III and other measures triggered by the crisis. And all banks are responding to changing global economic patterns, including the economic slowdown in advanced countries and the increased economic importance of emerging markets.  Given these developments, the past patterns documented suggest some possible future paths. While many advanced country banks are less likely to be active investors in the near future, banks from emerging markets, being in much better financial positions, are likely to step into the void, increasing their relative importance as foreign investors, especially within their geographical regions. As such, the foreign-bank landscape is likely to change substantially in the future. 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