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The spillovers, interactions, and (un)intended consequences of monetary and regulatory policies[☆]

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ABSTRACT

Have bank regulatory policies and unconventional monetary policies—and any possible interactions—been a factor behind the recent “deglobalisation” in cross-border bank lending? To test this hypothesis, we use bank-level data from the UK—a country at the heart of the global financial system. Our results suggest that increases in microprudential capital requirements tend to reduce international bank lending and some forms of unconventional monetary policy can amplify this effect. Specifically, the UK's Funding for Lending Scheme (FLS) significantly amplified the effects of increased capital requirements on cross-border lending. Quantitative easing did not appear to have a similar effect and countries with stronger prudential capital regulations were partially insulated against the effects of these changes in UK policy. We find that this interaction between microprudential regulations and the FLS can explain roughly 30% of the contraction in aggregate UK cross-border bank lending between mid-2012 and end-2013, corresponding to around 10% of the global contraction in cross-border lending. This suggests that unconventional monetary policy designed to support domestic lending can have the unintended consequence of reducing foreign lending.

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1. Introduction

Global financial intermediation has changed significantly since 2008. Cross-border capital flows have contracted sharply (Fig. 1), mainly due to a reduction in international bank lending. In contrast, FDI and international portfolio exposures have

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¹ His contribution to this paper was completed while employed by the Bank of England and does not represent the views of Barclays.

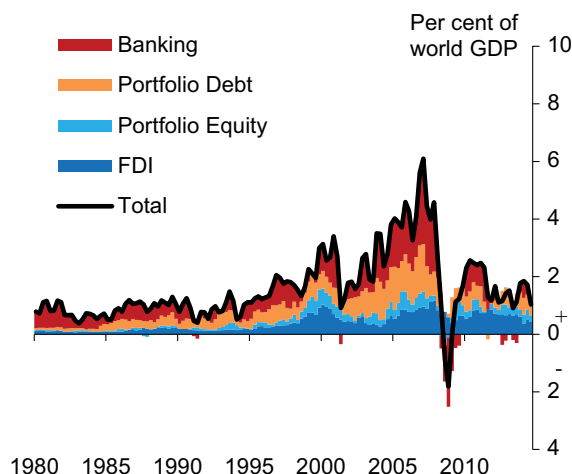


Fig. 1. Contraction in global capital flows. Sources: IMF International Financial Statistics and World Economic Outlook Database. Note: For each quarter, flows are summed over all available country data and then smoothed by averaging over the current and previous quarter.

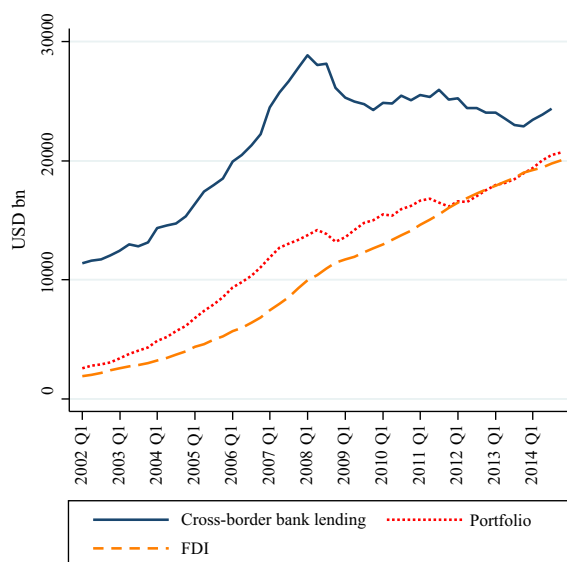


Fig. 2. The retrenchment in global banking contrasts to growth in other international financial exposures. Sources: IMF International Financial Statistics and BIS Banking statistics. Note: Gross lending in different types of assets is the cumulated (exchange-rate adjusted) USD bn flow in cross-border lending since 2002 Q1 summed across the BIS reporters for which data was available and then added to 2001 Q4 stocks.

not declined by nearly as much and have bounced back since the 2008 crisis (Fig. 2). This evolution in cross-border bank lending has been described as “financial deglobalisation” (Forbes, 2014) and “the great cross-border bank deleveraging” (Cerutti and Claessens, 2014). It can be divided into two stages: the sharp initial contraction that occurred during the crisis, and a more recent decline that began in 2012—what we refer to as the “second phase of banking deglobalisation”. This most recent decline in international lending stands in sharp contrast to the relative stability in domestic bank lending over the same period, in both the UK and the world (Fig. 3). Proposed explanations for the initial phase of banking deglobalisation include government intervention in the banking system (Rose and Wieladek, 2014), increased home bias (Giannetti and Laeven, 2012), reduced demand for loans, and reduced availability of wholesale funding for banks.² Although a substantial literature has analysed various effects of regulatory and unconventional monetary policy, no previous work has examined whether these policies could be an important factor behind this contraction in global banking.³ Also, no other work has studied the second phase of banking deglobalisation. This paper aims to fill these gaps.

² See Cerutti and Claessens (2014) and Forbes (2014) for more detailed discussion of various potential causes.

³ Most papers examining the impact of unconventional monetary policy focus on the effects on domestic and international financial market prices. Fratzscher (2013), Ahmed and Zlate (2013), and Koepke (2014) are some of the few examples of papers which instead assess the impact on global capital flows, especially to emerging markets.

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