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Transmission of Liquidity Shocks: Evidence on Cross-border Bank Ownership Linkages☆

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Abstract

This study examines whether a liquidity shock to a banking system could be transmitted to other economies through a network of bank ownership. Firstly we construct cross-border ownership networks for banks located in European countries. We then exploit the 2010 European debt crisis as a natural experiment. The analysis shows that subsidiary banks located outside of Greece, Ireland, Italy, Portugal and Spain (GIIPS) but with ownership linkages to these countries have a lower loan growth rate during the crisis period. This suggests that the liquidity shock experienced by GIIPS countries was indeed transmitted to those banks through ownership linkages. Larger subsidiary banks and those subsidiaries that were more profitable are found to be more resilient to the shock. We also find that the parent bank's characteristics affect the transmission of the shock, supporting the notion of an internal capital market operating within these banks.

Keywords: Foreign Banks; Liquidity Crisis; Crisis Transmission; Bank Lending.

JEL Classification: F3, G2, H63

1. Introduction

This study provides empirical evidence on whether foreign bank ownership linkages can transmit external liquidity shocks. The past two decades has witnessed extensive globalisation of the financial sector. Banks from one country to the next are increasingly connected by cross-border interbank lending relationships and ownership ties. Additionally, there has been a large increase in the presence of foreign-owned banks in a typical domestic banking system. The overall share of domestic banking assets held by foreign banks has increased from 15% in 1995 to 23% in 2005 (International Monetary Fund, 2007). As a result, the role of foreign banks

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