Foreign banks and financial stability in emerging markets: evidence from the global financial crisis
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Discussion by
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Summary

• Question:
  Does a higher share of foreign ownership of EME and DC banking sector assets stabilize cross-border capital flows and domestic credit in times of financial distress?

• Several empirical studies on banking have pointed out advantages of foreign banks presence especially in emerging markets (e.g. Ongena/Gianetti; de Haas; Demirguec-Kunt)

• Sample periods of these studies comprise domestic banking crises, but no crises in host countries of foreign banks

• Effect of foreign banks on stability of domestic banking markets during a global financial crisis is unknown
Merits

• Very important research question
• Current crises constitutes a very nice exogenous event for most emerging markets that can be used to explore the effects of foreign banks
• Especially Eastern Europe is a great laboratory (since foreign banks have a high market share)
• Interesting illustration of global (and regional) cross-border capital growth and credit growth
Comments

Motivation

• What do foreign banks do to stabilize a financial system under distress?
  – Is this really a policy proposition? Based on which findings?
  – Why should foreign bank presence isolate domestic credit from international shocks? (e.g. Peek & Rosengren AER; Stiglitz)
  – Your motivation ignores the risks associated with foreign banking

• What is the expected relationship between capital flows and share of foreign banks?
  – Foreign investors can either invest in other countries by establishing banks or use capital flows – foreign share and capital flows should be substitutes
Comments

Identification

• Quote: “As the Lehman event marks a clear-cut beginning of the crisis,...”

• Define dependent variables as the difference (2008Q4-2009Q1)-(2007Q3-2008Q2)

• Your graph on credit growth shows significant drop in 2007!

Euro LIBOR-OIS Spreads

(taken from Schwarz, 2009)
Comments

Identification

\[ \text{FALL}(i) = a \ \text{FBAS}(i) + b \ \text{SURGE}(i) + \text{controls} + \text{epsilon} \]

- Dependent variable is absolute (!) change in cross-border flows before/after Lehman collapse (kind of volatility measure)
- Dependent is change in growth rate before/after Lehman event
- Positive shocks should be zero at worst
- It is unclear what these dependent variables really measure – especially since the pre-event period was also a crises period
- Why not simply taking level or volatility of credit growth?
Comments

Results

- Evidence of columns 1-3 consistent with substitution story
- Economic activity growth is insignificant
Comments

Results

• Causality (Omitted variable bias): Share of foreign banks is likely to proxy for many institutional variables, since foreign banks are not willing to work under uncertainty

• Quality of the financial system is likely to be related to stability

• Even the authors control for many of these institutional variables, the presented cross-country specification is difficult to rule out alternative stories

• Focus on within country variation
Suggestions

• Important research question – keep focus
• Combining emerging and developed economies
  – for developed economies shock was not clearly exogenous
  – Foreign banks role is likely to differ between foreign and domestic banks
• Use micro data on foreign banks’ lending and focus on one region