Pacific-Basin Finance Journal 29 (2014) 96–120

Contents lists available at ScienceDirect

Pacific-Basin Finance Journal

journal homepage: www.elsevier.com/locate/pacfin

The role of foreign banks in monetary policy transmission: Evidence from Asia during the crisis of 2008–9 ☆

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ARTICLE INFO

Article history:
Received 23 August 2012
Accepted 29 March 2014
Available online 23 April 2014

JEL classification:
E44
F43
G21

Keywords:
Foreign bank
Monetary policy transmission
Financial crisis
Asian banking

ABSTRACT

Since the 1997–8 Asian financial crisis, the level of foreign bank penetration has increased steadily in Asian banking markets. This paper examines the impact of foreign banks on the monetary policy transmission mechanism in emerging Asian economies during the period from 2000 to 2009, with a specific focus on the global financial crisis of 2008–9. We present consistent evidence that, on the whole, an increase in foreign bank penetration weakened the effectiveness of the monetary policy transmission mechanism in the host emerging Asian economies during crisis periods. We also investigate various conditions and environments, including the severity of shocks upon parent banks in the global crisis, the dependence of parent banks on the wholesale funding market, the country of origin of foreign banks, and entry modes, under which the effectiveness of monetary policy transmission is reduced more severely due to the increasing presence of foreign banks in the emerging Asian banking markets.

☆ Earlier versions of this paper were presented at the 2012 KDI–Korea America Economic Association (KAEA) meetings on Shared Growth and Sustainable Development, Seoul, Korea, and the 2012 Asian Finance Association Annual Meeting, Taipei, Taiwan. Revised versions of this paper have been presented at the Hong Kong Institute of Monetary Research, Seoul National University Institute for Research in Finance and Economics, Soongsil University, Hyundai Research Institute, Kyungnam University, Sogang University, and KAIST in Seoul, Korea. The authors are grateful to discussants and participants for their useful comments and suggestions.

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http://dx.doi.org/10.1016/j.pacfin.2014.03.005
0927-538X/

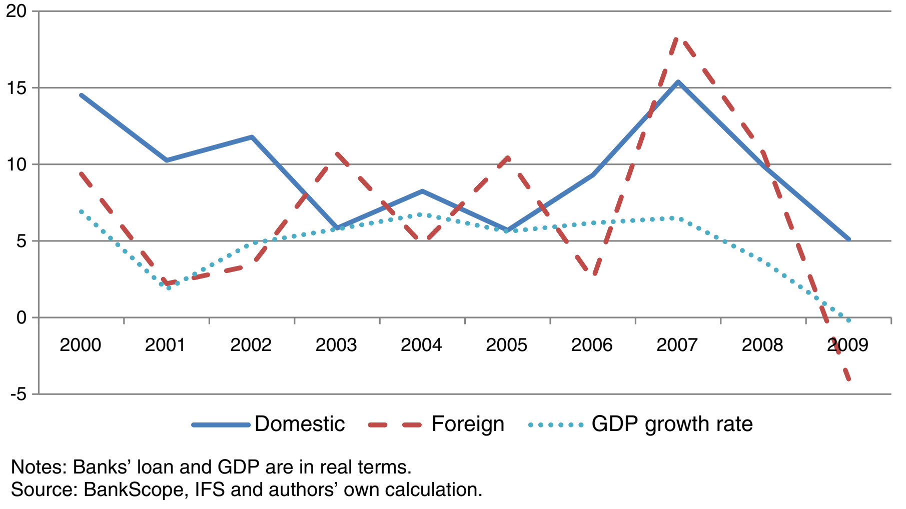

Fig. 1. Average loan growth rates of domestic and foreign banks (year-on-year, in %), 2000–2009. Notes: Banks' loan and GDP are in real terms. Source: BankScope, IFS and authors' own calculation.

1. Introduction

Since the 1997–8 Asian financial crisis, the banking system and domestic financial sectors in Asia have experienced significant structural changes and global integration. Domestic banks in Asia have become more consolidated, while facing more intensive competitive pressure from domestic and abroad. Through the efforts of opening up and international financial integration, with the policy recommendation from the International Monetary Fund, the presence of foreign banks has steadily increased. Between 1994 and 2009, emerging Asian banking markets have seen an increase in the level of foreign bank penetration from 17% to 25% when measured by the share of bank assets held by foreign banks, and from 26% to 43% when measured by the ratio of the number of foreign banks to the total number of banks in the host country.[1]

The recent global financial crisis of 2008–9 provides the first significant test for evaluating the stabilizing/destabilizing role of foreign banks in emerging Asia after experiencing a steady and substantial increase in foreign ownership in their banking sectors (Vogel and Winkler, 2011). Foreign banks are expected to enhance the financial stability of the host banking sector by providing an additional source of financing for lending. However, during the recent global financial crisis, it has been observed that many local subsidiaries of foreign banks in Asia reduced their credit by a larger extent than their domestic counterparts. The average growth rate of loans from foreign bank subsidiaries fell from 18.6% in 2007 to −4.0% in 2009, while domestic banks only from 15.4% to 5.1% (see Fig. 1).[2] Meanwhile, foreign banks' cross-border lending to Asian economies also decreased substantially during the 2008–9 crisis period (Fig. 2). Since the collapse of Lehman Brothers in September 2008, foreign banks' cross-border claims to Asian economies were reduced by 127 billion dollars in six months, among which the shrinkage of the funds to Asian banks amounted to 69 billion.[3]

This paper examines the impact of increased foreign bank penetration on the monetary policy transmission mechanism in emerging Asian economies during the period from 2000 to 2009, with a specific focus on the recent global financial crisis. We specifically focus on the bank lending channel as the monetary policy transmission mechanism in seven Asian economies, namely, Hong Kong SAR, Indonesia,

[1] These ratios of foreign bank penetration are obtained from *BankScope* for selected emerging Asian economies, which include Hong Kong SAR, Indonesia, Korea, Malaysia, Philippines, Singapore, and Thailand. See Appendix 1.

[2] The deeper reduction of foreign banks credit seems to be decoupled from the change in their deposits. In 2009, thanks to the expansionary monetary policy across Asian economies, foreign banks' deposits actually increased by 4.28% on average, although lower than domestic banks' average growth rate of 6.35%.

[3] For a description on how Asian banking markets were affected by the financial turmoil in 2007, see McCauley and Zukunft (2008).