RESEARCH

Geopolitical Risk and Global Banking

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Summary

- Rises in geopolitical risk affect US banks’ domestic lending through their exposure to foreign assets

- Exposed banks tighten lending standards and reduce credit at home

- Structure of foreign operations matters: banks cut cross-border lending but maintain branch/subsidiary exposure $\longrightarrow$ different effect on domestic credit

General Comments

- Very well written and executed paper. Highly recommended

- Interesting and little-explored topic. Great dataset. Convincing evidence

- It could delve a bit more on transmission mechanism

- It could discuss policy implications in greater depth

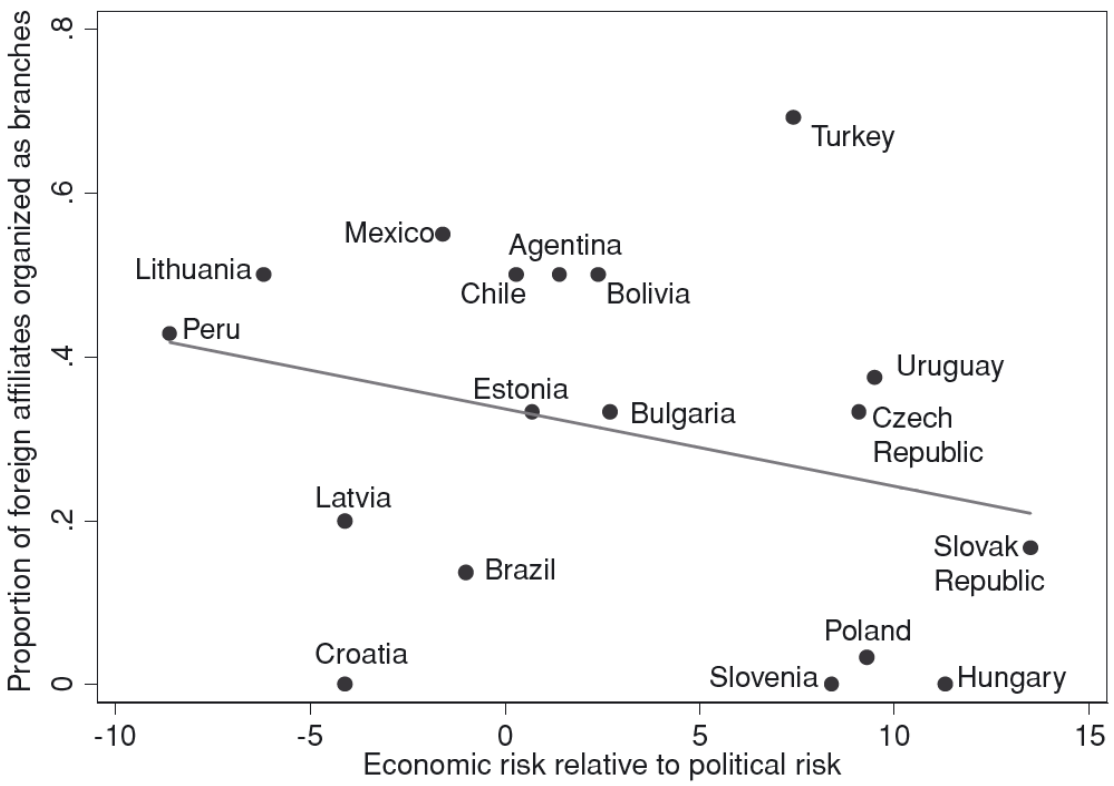
Channels of transmission of Geopolitical Risk to Credit

- Macro:
  - Indirect impact through domestic sentiment
  - Direct impact on firms trading with country in question
- Bank-level:
  - Exposure through cross border lending
  - Exposure through lending by foreign affiliates

Branches vs Subsidiaries

- Consolidated balance sheet vs individually capitalized affiliates
- Branches: more integrated internal capital market, greater protection from political risk
- Subsidiaries: greater protection from economic risk through limited liability
- Regulators may blur the lines
- Suggestion: explore whether form of incorporation of affiliates matters

Risk and the Corporate Structure of Banks

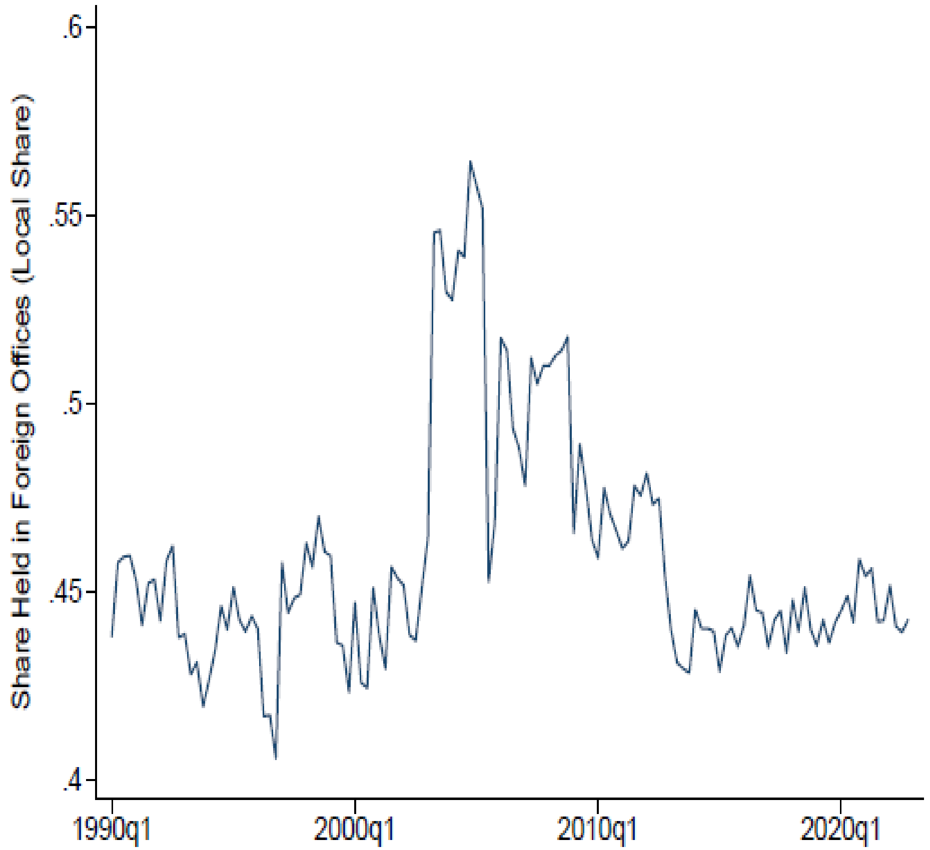


Dell'Ariccia and Marquez JF 2010; Cerutti et al. JBF 2007

Cross-border Lending vs Local Affiliates

- Apparent shift in lending patterns around GFC
- What happened?
- Did post GFC reforms alter benefits of branches vs subsidiaries?
- Or relative to direct cross-border lending?

Local Exposures as a Share of Foreign Exposures



Economic vs Political Risk

- Role of geopolitical fragmentation vs economic outcomes:
  - Israel-Gaza Episode?
  - Compare to sharp GDP contraction episodes?
- Role of regulators: SPE vs MPE resolution strategies; Potential differences across host countries
- Should we favor cross-border lending vs branches/subsidiaries?

Comments on Specifications

- No time FE in lending standard regression?
- Focus on exposure relative to assets
- “Weird” finding on country level geopolitical risk and credit risk
- Separate lending through branches and subsidiaries