Box 4

DELEVERAGING VIA A DECLINE IN INTERNATIONAL BANK LENDING DURING THE GLOBAL TURMOIL

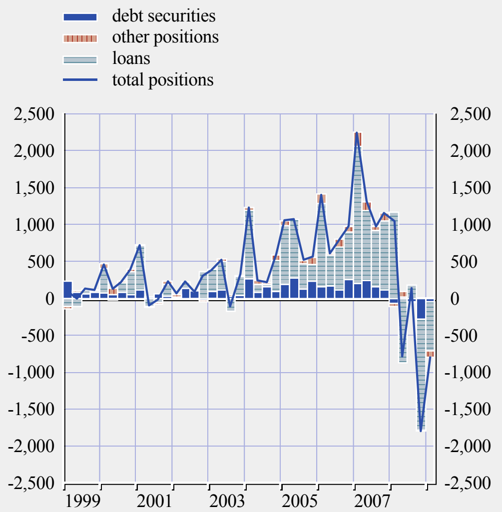
Financial globalisation has been an important feature of the world economy over the past decade. International financial claims showed a strong upward trend, rising from approximately USD 10 trillion in the first quarter of 1999 to USD 35 trillion in the second quarter of 2008. As the recent financial turmoil took hold of the world economy, financial institutions responded to capital shortages by cutting their lending and selling other assets to reduce the size of their balance sheet, a process known as deleveraging. Equally important was a home-bias effect in an environment of high uncertainty regarding the credit quality of banks on a global scale.

This box examines the international dimension of this process, i.e. how the banking sector reduced its international financial claims vis-à-vis banks and other borrowers by unprecedented amounts during the most severe phases of the global turmoil. International financial claims fell particularly significantly in the fourth quarter of 2008, namely by USD 1.8 trillion at constant exchange rates (see Chart A), and then declined at a more moderate pace in the first quarter of 2009. In terms of composition, banks delevered primarily international loans, while the impact was smaller on their holdings of debt securities and on their other positions.

The impact of the deleveraging process of international banks affected all world regions. Foreign claims of BIS reporting countries vis-à-vis the United States and the United Kingdom were reduced by USD 1 trillion and USD 940 billion respectively between March 2008 and March 2009 (see Chart B). A sizeable reduction was also observed vis-à-vis several euro area countries, partly reflecting a fall in intra-euro area financial claims. International banks also reduced their exposure to emerging market countries by half a trillion dollars (more than USD 200 billion of this retrenchment stemmed from euro area banks). There is evidence, however, of a considerable degree of stabilisation across all major destinations in the first quarter of 2009 and, according to provisional data, in the second quarter of 2009, suggesting that major tensions in the banking sector are gradually easing.

Chart A International financial claims by type of instrument

(Q1 1999 – 2009 Q1; USD billions at constant exchange rates)



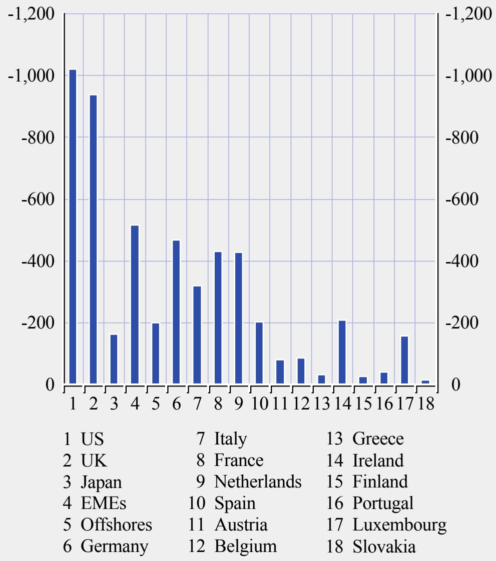
Sources: BIS and ECB calculations.
Note: Locational data, based on the resident principle.

The global economy is, however, unlikely to witness soon a return to pre-crisis rates of expansion in cross-border activity.

The process of bank deleveraging that was witnessed at the end of 2008, followed by a phase of stabilisation in the first half of 2009, could be viewed as a necessary adjustment of loan-to-deposit ratios, after several years of excessive expansion in global liquidity. However, a prolonged period of subdued cross-border activity could also signal a phase of generalised weakness in the banking sector for two reasons: first, its resilience could be reduced through lower international fragmentation and, consequently, deleveraging may limit the banking sector's ability to facilitate international risk sharing. Until such time as their capital position is sufficiently strengthened, this may have some impact on the banks' willingness to lend, and thus on the pace of the global recovery.

Chart B Change in foreign claims of BIS reporting countries vis-à-vis major counterparties

(Mar. 2008 – Mar. 2009; USD billions and ultimate risk basis)



Sources: BIS and ECB calculations.
Note: Consolidated data, based on headquarter principle.