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The Global Crisis and Financial Intermediation in Emerging Market Economies

BIS Paper No. 54

411 Pages

Posted: 15 Nov 2011

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Date Written: December 1, 2010

Abstract


On 28-29 January 2010, senior central bank officials from emerging market economies (EMEs) met at the BIS in Basel to discuss how policymakers had responded to the effects of the international financial crisis on emerging market economies. Although hit hard, most EMEs displayed remarkable resilience. Four aspects were discussed:

Capital flows and cross-border lending. Policymakers could do little to counter the sharp declines in the supply of cross-border bank financing and more broadly of capital flows at the height of the crisis. But comparatively strong macroeconomic fundamentals meant the crisis was short-lived, and capital flows recovered.

Financial intermediation in EMEs during the crisis: home-owned versus foreign-owned banks. EME banks adjusted to the crisis in ways that stabilised their financial positions: they reduced (already limited) reliance on wholesale markets, curbed new lending, shifted towards less risky loans and increased holdings of government bonds, and shortened the maturity of their assets. While foreign bank affiliates and domestic banks often behaved in similar ways, it was noted that foreign banks: (i) did not always fully appreciate the risk posed by currency mismatches (eg in central and Eastern Europe); (ii) reduced their participation in domestic interbank or credit markets compared to domestic banks; (iii) sometimes provided financing to their parents during a period when funding markets in the advanced countries were experiencing stress. Foreign bank behaviour may have been influenced by the funding model, the financial condition of the parent and the strategic importance of the market. The experience has prompted a reassessment of the relative merits of foreign branches versus subsidiaries. There is now much greater emphasis on the responsibilities of host country supervisors.

The impact of the crisis on local money and debt markets. The crisis adversely affected financing in foreign exchange markets (eg the swap market), and to a lesser degree the domestic interbank market. There were significant effects on domestic bond markets in some cases.

Central bank instruments in response to the crisis. Central banks responded to the crisis by providing financing in foreign and domestic currencies. An important issue in the provision of foreign currency financing concerned the pros and cons of using foreign reserves as opposed to other sources, notably Federal Reserve swap facilities. The authorities changed their monetary operations or set up special facilities (eg to widen the range of securities purchased and lengthen their maturities) to support local currency funding. Policy rates and (in some cases) reserve requirements were also lowered countercyclically.

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