

Box 7

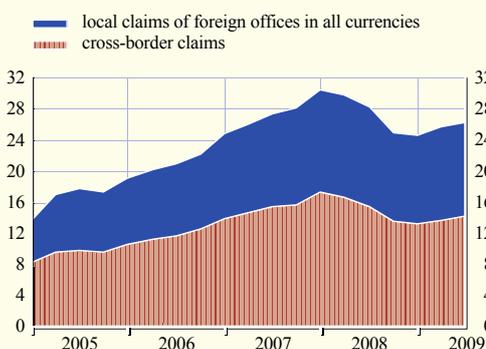
THE INTERNATIONAL DIMENSION OF BANK DELEVERAGING

An important channel through which the financial crisis has been propagated internationally has been the sizeable reduction of foreign claims by banks active in global financial markets. As the turmoil reached its climax, banks reporting to the BIS cut their global exposure sizeably, from USD 30.4 trillion in the first quarter of 2008 to USD 24.9 trillion in the fourth quarter of 2008 on a consolidated basis (see Chart A). Around 70% of this reduction was achieved by cutting cross-border claims, while the remaining 30% resulted from a reduction in the local claims of foreign subsidiaries. Having stabilised in the first quarter of 2009, foreign claims partially rebounded in the second and third quarters of the year, to USD 26.2 trillion. Although this may partly be explained by the weakness of the US currency, which propped up the dollar value of foreign claims, it could be seen as an indication that major tensions have been easing.

In line with the global nature of the financial turmoil, the deleveraging process and the

Chart A Foreign claims of BIS reporting countries (cross-border and local lending)

(total amount outstanding; USD trillions; ultimate risk basis)



Source: BIS.
Notes: Consolidated data. The last observation refers to the third quarter of 2009.

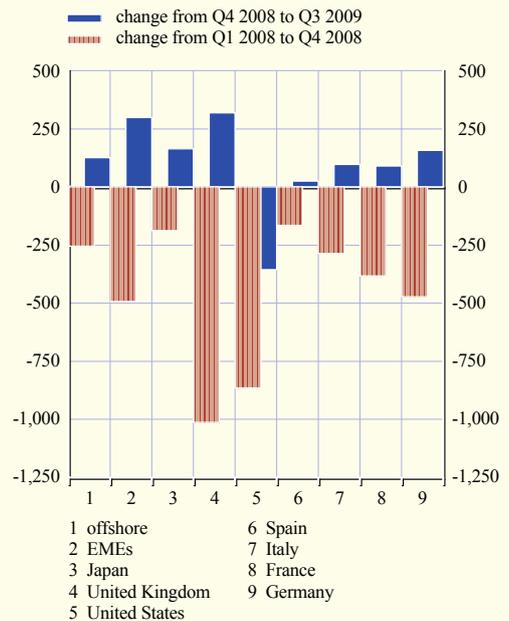
recent rebound in banks' foreign claims have been highly synchronised across countries, affecting almost all major developed and emerging economies. On a consolidated basis, foreign claims were reduced vis-à-vis the United States by USD 864 billion and vis-à-vis the United Kingdom by USD 1 trillion between the first and the final quarter of 2008 (see the red bars in Chart B). The reduction was also sizeable vis-à-vis euro area countries, partly reflecting a fall in intra-euro area financial claims. From a systemic point of view, the decline in banks' international exposure to emerging market economies was also particularly relevant, with BIS reporting banks withdrawing almost half a trillion dollars. This is significant, considering that in March 2008 the total exposure of banks reporting to the BIS towards these countries was approximately equal to USD 4 trillion. Since the fourth quarter of 2008, however, there has been a significant and broad-based rebound in foreign claims for many countries, except vis-à-vis the United States, where foreign claims continued to decline (see the blue bars in Chart B).

The nature of the international bank deleveraging process can also be assessed from a sectoral point of view. According to the latest figures, banks reporting to the BIS are mostly exposed to the non-bank private sector, with an outstanding amount of USD 14.9 trillion, while the exposure to other banks and the public sector is smaller (see Chart C). Between March 2008 and September 2009 banks decreased their international exposure mainly by reducing foreign claims vis-à-vis other banks (by USD 2.5 trillion) and the private sector (by USD 2.2 trillion). By contrast, they increased their exposure vis-à-vis the public sector (by USD 0.4 trillion), reflecting a "flight to safety" given the unfavourable market conditions.

Part of the process of global bank deleveraging can be viewed as a necessary adjustment of loan-to-deposit ratios after several years of rapid expansion in credit globally. The decline is also consistent with the sharp slowdown in economic activity observed at the global level. However, a prolonged period of subdued

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

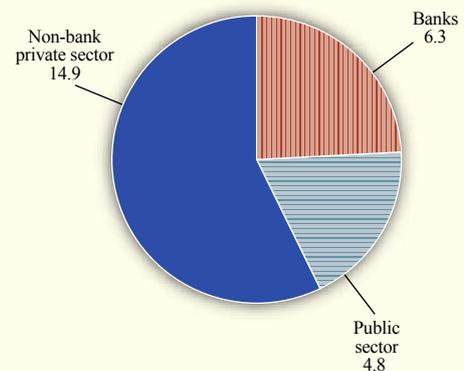
(USD billions; ultimate risk basis)



Source: BIS.
Note: Consolidated data. "EMEs" refers to emerging market economies.

Chart C Foreign claims of BIS reporting countries by sector

(total amount outstanding; USD trillions; September 2009)



Source: BIS.
Note: Consolidated data.

foreign lending activity could also signal a phase of generalised weakness in the banking sector, which may be similarly reflected in banks' willingness to lend domestically.

In summary, the global economy has witnessed a significant retrenchment of the banking sector from global markets, reflecting the severity of the financial turmoil, but also contributing to the spread of its impact internationally. There are, however, signs of an ongoing process of stabilisation, which could help to improve the prospects for the global recovery.