

The International Transmission of Shocks: Foreign Bank Branches in Hong Kong during Crises

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Summary

The international transmission of shocks in the global financial system has always been an important issue for policy makers. Different types of foreign shocks have different effects and policy implications. In this paper, we examine the effects of the recent U.S. financial crisis and the European sovereign debt crisis on foreign bank branches in Hong Kong. Unlike the literature on global banking that studies a global bank's foreign operations from a home country perspective, our analysis uses foreign bank branches in Hong Kong and has a distinct host country perspective, which would seem more relevant to the host country policy makers. We find that global banks use their foreign branches in Hong Kong as a funding source during a liquidity crunch in the home country, suggesting that global banks manage their liquidity risk globally. After central banks in the home country introduced liquidity facilities to relieve funding pressures, this effect disappeared. We also find strong evidence that foreign branches originated from crisis countries lend significantly less in Hong Kong relative to their controls, suggesting the presence of a lending channel in the transmission of shocks from the home country to the host country.