Asynchronous Monetary Policies and International Dollar Credit

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Summary

This paper presents a theoretical model in which the supply of international US dollar credit by a global bank is responsive to unconventional monetary policies (UMPs) both in the US and its home country, the functioning of the FX swap market and the bank's default risk. The theoretical model is tested using two unique confidential datasets. The results suggest that the contractionary effect of US monetary normalisation on global liquidity would be partly offset by an expansionary effect of UMPs in Japan and the euro-area. The net impact, however, is critically dependent on whether the Fed's exit from UMP coincides with a switch to a risk-off regime and triggers financial market dislocation, particularly in the FX swap market.

Our stress testing analysis further shows that, even if we assume that monetary policy paths in the US, the euro-area and Japan follow broadly their existing plans up to the end of 2015, there remains a small risk that the supply of international US dollar credit declines especially if liquidity in the FX swap market decreases significantly as the US normalises monetary policy.

Finally, we find that global banks' risk-taking attitude, credit risk exposure, and the business model of their overseas branches are important factors affecting the extent to which UMPs are transmitted internationally. This finding supports the view that the financial and organisational structure of global banks plays a vital role in transmitting imbalances of cross-border funding flows and therefore requires careful regulatory attention.