Deleveraging from Emerging Markets: the Case of Euro-area Banks

Alicia Garcia Herrero and Fielding Chen*

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Abstract

This paper shows stylized facts on the rather large retrenchment of cross-border lending by Euro-area banks into emerging markets. The clearest case is Asia where Euro-area banks have massively lost market share. The reason, however, is not only related to their retrenching but also to the surge in lending from others banks, especially from Emerging Asia. As a second step, we investigate empirically the determinants of cross-border bank flows with a gravity model and differentiate across Euro-area, US and Asian banks. We find a number of home factors behind the retrenchment in lending. Two are common to all home countries analyzed, namely *global risk aversion* and *trade* which, respectively, discourage and foster banks' overseas lending. Other factors, however, are specific of Euro-area banks, such as the *higher cost of funding* which is found to discourage lending while *poor economic growth* tends to foster it. The latter result would indicate that economic weakness of the last few years may have actually cushioned Euro-area banks' deleveraging from emerging markets. All in all, Euro-area banks' cross border lending appear to be more dependent on their cycle (both in terms of growth and external cost of funding) when compared with US and Asian banks.

Keywords: cross-border bank lending, emerging markets, Euro area, deleveraging

JEL: F34, G01, O57, C23

* Alicia Garcia Herrero (corresponding author) is Chief Economist for Emerging Markets at Banco Bilbao Vizcaya Argentaria (BBVA); Fielding Chen is Senior Economist for Asia at Banco Bilbao Vizcaya Argentaria (BBVA). The authors thank Edward Wu (BBVA) for excellent research assistance. All errors and inaccuracies are solely our responsibility. Finally, the opinions expressed in this article are ours and not necessarily those of BBVA.