

Cross-Border Banking and Global Liquidity*

Valentina Bruno
American University

Hyun Song Shin
Bank for International Settlements

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Abstract

We investigate global factors associated with bank capital flows. We formulate a model of the international banking system where global banks interact with local banks. The solution highlights the bank leverage cycle as the determinant of the transmission of financial conditions across borders through banking sector capital flows. A distinctive prediction of the model is that local currency appreciation is associated with higher leverage of the banking sector, thereby providing a conceptual bridge between exchange rates and financial stability. In a panel study of 46 countries, we find support for the key predictions of our model.

JEL codes: F32, F33, F34

Keywords: Cross-border banking flows, Bank leverage, Global banks

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