A distinctive prediction of our model which sets it apart from existing macro models of capital flows is the comparative statics of exchange rate changes. When the local currency is expected to appreciate, ε declines. In effect, expected currency appreciation has the same impact as a decline in the credit risk associated with borrowers' projects. Since φ is a decreasing function of ε, exchange rate changes feed directly into the risk-taking of banks and their leverage decisions.

3 Empirical Analysis

3.1 Sample and Variable Definitions

Our sample for the panel investigation draws on data from 46 countries, encompassing both developed economies and emerging/developing economies, but excluding offshore financial centres. Since we wish to analyze the global banking channel, the criterion for inclusion is whether foreign banks play an economically significant role in the country's financial system. In addition to developed economies, we select countries with the largest foreign bank penetration, as measured by the number of foreign banks and by the share of domestic banking assets held by foreign-owned local institutions from the Claessens, van Horen, Gurcanlar and Mercado (2008) dataset.

The countries included in our sample are Argentina, Australia, Austria, Belgium, Brazil, Bulgaria, Canada, Chile, Cyprus, Czech Republic, Denmark, Egypt, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Indonesia, Ireland, Israel, Italy, Japan, Latvia, Lithuania, Malaysia, Malta, Mexico, Netherlands, Norway, Poland, Portugal, Romania, Russia, Slovakia, Slovenia, South Korea, Spain, Sweden, Switzerland, Thailand, Turkey, Ukraine, United Kingdom and Uruguay.

Our definition of banking flows ΔL is the growth (log difference) in cross-border loans of BIS-reporting banks on banking sector counterparties in a particular country, as measured by the difference between Table 7A (all borrowers) and Table 7B (non-bank borrowers) in the BIS Locational Statistics. Global banks account for most of these international exposures.[5] Since European banks have a pivotal role in the transmission of global liquidity (Shin, 2012)

[5] See, for instance, the E.16 statistics release (http://www.ffiec.gov/e16.htm)