The Role of Foreign Banks in Monetary Policy Transmission: Evidence from Asia during the Crisis of 2008-9

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Summary

Since the 1997-8 Asian financial crisis, the level of foreign bank penetration has increased steadily in Asian banking markets. This paper examines the impact of foreign banks on the monetary policy transmission mechanism in emerging Asian economies during the period from 2000 to 2009, with a specific focus on the global financial crisis of 2008-9. This paper presents consistent evidence that there exist heterogeneous responses on loan growth and loan interest rates between domestic banks and foreign-owned banks in response to changes in monetary policy in the host emerging Asian economies during the recent global financial crisis of 2008-9.

We present consistent evidence that, on the whole, an increase in foreign bank penetration weakened the effectiveness of the monetary policy transmission mechanism in the host emerging Asian countries during crisis periods. The empirical results are robust to various alternative measures, different sample countries and periods, incorporating demand factors in the estimations, and considering changes in monetary policy in home countries.

In addition, we present empirical evidence that the buffering effects of foreign banks in the Asian banking markets on the efficiency of monetary policy transmission during crisis periods become more conspicuous, (1) when an expansionary monetary policy, instead of a contractionary monetary policy, is conducted in the host countries; (2) for foreign banks whose parent banks in home countries are more adversely affected; (3) for foreign banks whose parent banks are more dependent on non-deposits, wholesale markets funding; (4) for global foreign banks more than Asia-regional foreign banks; and (5) for foreign banks which entered the host banking markets via a greenfield entry mode rather than an M&A entry mode.

Our findings suggest an important policy implication for both policy makers and banking regulators that, when monetary authorities in host countries conduct monetary policies—expansionary or contractionary—during crisis periods to bail them out from the credit crunch and spillover effects of financial shocks from abroad, they must take into account the buffering or hampering effects of foreign banks on the effectiveness of the monetary policy transmission mechanism in the host countries.