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Finance

BIS banking statistics amidst the financial turmoil

Geneva, 19 Nov (Andrew Cornford*) - According to the consolidated banking statistics for mid-2008 recently published by the Bank for International Settlements (BIS), there was a decline in banks' claims during the second quarter of the year reflecting the impact of the continuing credit crisis.

At an aggregate level, the statistics also point to other features of the crisis with a potential bearing on the access to and cost of international financing for emerging-market and other developing countries. However, the statistics now available do not cover the impact of the worsening of the crisis since the beginning of the autumn.

The statistics show the scale of short-term borrowing by emerging-market and other developing countries from banks which are part of the BIS reporting system. Much of this short-term borrowing will have to be rolled over in what are likely still to be unfavourable credit conditions. The statistics also show the importance of interbank borrowing by these countries.

Since 2005, the statistics have included off-balance-sheet positions in the form of contingent assets (over-the-counter or OTC derivatives and credit commitments) and contingent liabilities (guarantees).These off-balance-sheet positions are included in the risk weighted assets against which banks' regulatory capital requirements are set under Basel 2.

Moreover, the statistics can be used to indicate the increase in the scale of the operations (and thus the commercial presence) of foreign banks in emerging-market and developing countries.

The BIS consolidated banking statistics are collected on a worldwide basis for banks from a reporting group consisting mainly of industrial countries but also including a small number of emerging-market countries and territories (Brazil, Chile, Hong Kong SAR, India, Mexico, Panama, Singapore, Taiwan and Turkey). As a result of consolidation, the statistics cover the exposures of banks' foreign affiliates (subsidiaries and branches) but after the netting-out of inter-office transfers between entities within banking groups.

The data are collected on two different bases. The first basis, immediate-borrower, allocates claims to the country where the original risk is located. The second basis, ultimate-risk, allocates claims to the country where the ultimate risk lies in a manner consonant with banks' own systems of risk management.

The country of ultimate risk is that in which the guarantor of the financial claim resides or in which the head office of a legally dependent branch incurring the exposure is located (or the head office of a subsidiary in the case of exposures benefiting from explicit guarantees from their parent institutions). The instruments which result in the transfer of risk from the country of the immediate borrower to that of ultimate risk include not only guarantees but also collateral and credit derivatives providing protection against the credit risk of claims on the immediate borrower.

An example of the practical implications of the shift of a claim from the immediate-borrower to the ultimate-risk basis can be illustrated with the case of interbank lending by a German bank to the London branch of a bank with headquarters in the United States. On an immediate-borrower basis, the

claim would be reported as being on the banking sector of the United Kingdom. On an ultimate-risk basis, the claim would be reported as being on United States banks.

Allocating claims on an ultimate-risk basis can significantly clarify the true scale of the exposures of different countries' banking sectors. During the Asian financial crisis of 1997-1998, the exposure of the banking sectors of some countries affected which was held on the books of foreign affiliates was allocated to the countries in which the affiliates were located rather than to those of their head offices.

As part of the consolidated statistics on an ultimate-risk basis, the BIS publishes figures for guarantees and credit commitments extended by reporting banks as well as on most of their cross-border derivative contracts.

During the second quarter of 2008, for the first time since the onset of the credit crisis, there was a decline in the total foreign claims of reporting banks (i.e. their total cross-border claims and the local claims of their foreign affiliates in foreign and local currencies). For domestically-owned and foreign-owned banks in the reporting area, the decline on an immediate-borrower basis was from USD 36,897 billion at the end of the first quarter to USD 36,178 billion at the end of the second quarter, and for domestically-owned banks only on an ultimate-risk basis from USD 31,340 billion to USD 30,370 billion.

The decline in foreign claims on an ultimate-risk basis between the first and second quarters was concentrated in developed countries. The major developing regions all experienced increases in foreign claims: Africa and the Middle East from USD 508.7 billion to USD 536.8 billion; Asia and the Pacific from USD 1,248.2 billion to USD 1,262 billion; Europe from USD 1,553.2 billion to USD 1,624.4 billion; and Latin America and the Caribbean from USD 921 billion to USD 988.7 billion.

Data on maturity distributions in the consolidated statistics of the BIS are reported on an immediate-borrower basis only for the international claims of reporting banks (i.e. cross-border claims plus local claims of foreign affiliates only in non-local currencies). For all developing countries, the proportion of these claims maturing during a period of up to one year (short-term claims) at the end of the second quarter of 2008 was 48.4 per cent - up from 47.3 per cent at the end of the first quarter.

Short-term claims as a proportion of total international claims for Asia and the Pacific at 59.5 per cent were a higher proportion than for developing countries as a whole. These figures are consistent with those of another major source, the Institute of International Finance (an industry body), according to which the flow of short-term bank lending to Asian countries has been exceptionally large since the beginning of 2007 [Institute of International Finance, Capital Flows to Emerging Market Economies, 12 October 2008, pp.5-6]. This means that many Asian countries face heavy amortization payments, or alternatively large amounts of borrowing which must be rolled over, in 2009.

If these figures are viewed in historical perspective, the proportion of short-term borrowing in total international claims for Asian countries is considerably higher than that of 44.8 per cent at the end of December 2000 (when the worst of the 1997-1998 crisis was behind the region). However, the proportion is still lower than that of 62.2 per cent in mid-1997. when the countries' external assets in the form of foreign-exchange reserves were much lower.

However, despite the way in which apparently minor points of vulnerability have been unexpectedly and sometimes remarkably quickly transformed into sources of major problems during the current financial turmoil, less significance should be read into these figures than in 1997.

On the one hand, major Asian countries now have much larger foreign-exchange reserves which serve as protection against the possibility that an outflow of capital could become a full-fledged balance-of-payments crisis. On the other hand, international claims are now complemented by proportionally much larger local-currency positions for the BIS-reporting banks than in 1997 - positions which are part of the more inclusive aggregate, foreign claims (see above).

The maturity distribution of affiliates' positions in local currencies is not disclosed in the BIS statistics.

But outflows of foreign exchange purchased with monies accruing from withdrawal from local-currency lending by foreign banks are unlikely to serve as a trigger for a balance-of-payments crisis, although in the absence of controls such outflows might exacerbate a crisis already under way.

Since the current financial turmoil has been notable for especially unfavourable conditions in the market for interbank lending, particular interest also attaches to the share of interbank borrowing in the total international claims of BIS reporting banks on different regions. For Asia and the Pacific, the proportion is 40.3 per cent and for the transition economies of Eastern Europe and for Latin America and the Caribbean, much lower figures of 22.7 per cent and 21.6 per cent.

Since their inclusion in the consolidated statistics in 2005, the off-balance-sheet positions of BIS reporting banks vis-a-vis emerging-market and other developing countries have increased rapidly, though they remain only a small fraction of the total of such positions vis-a-vis all countries. The off-balance-sheet positions consist of OTC derivatives (other than certain credit derivatives which are treated separately as part of estimation of risk transfers for the consolidated statistics on an ultimate-risk basis), guarantees arising from irrevocable obligations to pay third-party beneficiaries when a client fails to perform a contractual obligation, and credit commitments which obligate a bank to extend credit at a customer's request.

Emerging-market and other developing countries accounted for 4.6 per cent of total global exposures of USD 4,872.3 billion in the form of OTC derivatives, 7.1 per cent of the total global exposures of USD 8,698 billion in the form of guarantees, and 14 per cent of the total global exposures of USD 4,854.5 billion in the form of credit commitments. Since 2005, exposure to Asia and the Pacific in the form of OTC derivatives has expanded faster than total foreign claims on the region, and now amounts to 48 per cent of total exposure to developing countries in this form. But the BIS statistics do not enable a breakdown of these derivatives by type of user or by purpose (hedging as opposed to trading or speculation).

The consolidated statistics on an immediate-borrower basis include separate figures for the local claims in local currencies of the affiliates of reporting banks. The long-term trend in such claims provides an indirect indication of the growing importance of the commercial presence and operations of foreign banks in emerging-market and other developing countries.

In 1990, claims in local currencies constituted less than 10 per cent of total foreign claims. By the second quarter of 2008, claims in local currencies constituted 44 per cent of foreign claims. For Latin America and the Caribbean, the proportion at 62 per cent was much higher than the figure for developing countries as a whole, while the proportions for Asia and the Pacific at 36 per cent and for the transition economies of Europe at 41 per cent were lower.

This upward trend in the share of claims in local currencies can be attributed to various factors. In the emerging-market countries of Europe, openness to the presence of foreign banks has been a major feature of their transition from socialism. Elsewhere, increased openness has been part of the restructuring of banking sectors in the aftermath of financial crises in various countries such as Mexico.

From the point of view of foreign banks, the incentives to increase their consolidated exposure in the form of local-currency lending by their affiliates are probably linked to the diversification of their activities in emerging-market and other developing countries. This diversification has involved a reduction in the relative importance of traditional lending as compared with involvement in fee-based business along lines similar to that also observed in industrial countries [P.D.Woolridge, D.Domanski, and A.Cobau, Changing links between mature and emerging financial markets, in BIS Quarterly Review, September 2003].Financing this broader range of activities with local currency borrowing results in lower foreign-exchange risk than would financing with cross-border lending.

A number of the trends indicated by the latest consolidated banking statistics of the BIS may be affected by the credit crisis. The overall growth in reporting banks' claims may take time to recover particularly if conditions in credit markets improve only gradually. A slowdown in the cross-border expansion of the commercial presence and operations in emerging-market and other developing

countries of major banks from industrial countries may prove to be one of the results of the restructuring and scaling-down of these institutions in response to losses incurred during the current financial turmoil.

Moreover, recent revelations concerning abusive use of derivatives may slow the expansion of off-balance-sheet positions of the BIS-reporting banks, though this will not necessarily have much effect on their still-limited exposure in this form to emerging-market and other developing countries.

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