Financial integration and the Great Leveraging

Daniel Carvalho*

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Abstract

While previous studies have focused on the relationship between international capital flows and domestic credit growth, highlighting the importance of the equity/debt mix, this paper shows that there are also important implications of flows going to different domestic recipient sectors, especially concerning money dynamics. In particular, cross-border banking flows display a strong comovement with credit but none with broad money; in turn, flows of domestic non-banks display comovement with both credit and money. For this reason, banking flows correlate with the decoupling of these two variables – the Great Leveraging –, a stylised fact documented for several economies in the past decades and associated to the rapid expansion of banks non-monetary liabilities. These results thus shed light on the mechanisms through which the international banking activity might have consequences for the composition of the domestic bank balance sheet.

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*Banco de Portugal, Rua Francisco Ribeiro 2, 1150-165 Lisboa, Portugal, daniel.sousa.carvalho@bportugal.pt. I am grateful to Philip Lane for invaluable discussions and comments. I would also like to thank macro working group participants at Trinity College Dublin for comments. The opinions expressed in this paper represent the views of the author, they are not necessarily those of the Banco de Portugal, the European Central Bank, or the Eurosystem.