TOPIC: INTERNATIONAL BANKING AND CREDIT CREATION

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International Banking

International Banking is a process that involves banks dealing with money and credit between different countries across the political boundaries. It is also known as Foreign/Offshore Banking. In another words, International Banking involves banking activities that cross national frontiers.

It concerns the international movement of money and offering of financial services through off shore branching, correspondents banking, representative offices, branches and agencies, limited branches, subsidiary banking, acquisitions and mergers with other foreign banks.

All the basic tools and concepts of domestic bank management are relevant to international banking. However, special problems or constraints arise in international banking not normally experience when operating at home. In particular:

Business activities have to be transacted in foreign languages and under foreign laws and regulations.

1. Information on foreign countries needed by a particular bank wishing to operate internally may be difficult to obtain.
2. Control and communication systems are normally more complex for foreign than for domestic operations. Risk level may be higher in foreign markets.
3. Foreign currency transaction is necessary.
4. International bank managers require a broader range of management skills than managers who are concerned only with domestic problems.
5. It is more difficult to observe and monitor trends and activities in foreign countries.
6. Larger amounts of important work might have to be left to intermediaries, consultants and advisers.

International banking deals with all banking transactions-private and governmental- of two or more countries. Private Banks undertake such transactions for profit; governments may be for provision of various services.

Functions International Banking

International banking can provide the same services to its customers as domestic banks, but also provide additional services. International banks help financing trade through the use of letters of credit and export credit. They also provide exchange services, so that businesses can make payments in the local currency.

1. **Trade finance**

   International banks help finance trade through letters of credit and export credit.

2. **Foreign exchange**

   International banks arrange foreign exchange for import and export purposes.

3. **Investment banking**

   International banks offer investment banking services, such as underwriting shares and making financial decisions for investment.

4. **Treasury operations**

   International banks provide treasury operations across borders.

International banking has grown due to factors such as migration of enterprises, optimization of capital costs, and regulatory avoidance.

Control of international banks

The term international banking refers to the practice of providing financial services across international boundaries. Banks provide services such as accepting deposits, issuing loans, facilitating payments, and offering investment products to customers around the world.

1. **Domestic and foreign governments**

   These governments regulate international banking to protect customers from financial exploitation.

2. **Global financial organizations**

   The International Monetary Fund (IMF) and the World Bank are examples of global financial organizations that regulate international banking.

3. **The Basel Committee on Banking Supervision (BCBS)**

   This committee is a global standard setter for the prudential regulation of banks. The BCBS's 45 members are central banks and bank supervisors from 28 jurisdictions.

4. **The Office on the Comptroller of the Currency (OCC)**

   The OCC oversees international banking activities, including federal branches and agencies of foreign banking organizations.

Credit Creation

Credit creation is the process by which banks increase the money supply in an economy by lending money to borrowers. This process is a fundamental function of banking systems in modern economies.

Concepts of Credit Creation

- ***Bank as a*** business institution – Bank is a business institution which tries to maximize profits through loans and advances from the deposits.
- ***Bank Deposits*** – Bank deposits form the basis for credit creation and are of two types:
  - ***Primary Deposits*** – A bank accepts cash from the customer and opens a deposit in his name. This is a primary deposit. This does not mean credit creation. These deposits simply convert currency money into deposit money. However, these deposits form the basis for the creation of credit.
  - ***Secondary or Derivative Deposits*** – A bank grants loans and advances and instead of giving cash to the borrower, opens a deposit account in his name. This is the secondary or derivative deposit. Every loan crates a deposit. The creation of a derivative deposit means the creation of credit.
- ***Cash Reserve Ratio (CRR)*** – Banks know that all depositors will not withdraw all deposits at the same time. Therefore, they keep a fraction of the total deposits for meeting the cash demand of the depositors and lend the remaining excess deposits. CRR is the percentage of total deposits which the banks must hold in cash reserves for meeting the depositors' demand for cash.
- ***Excess Reserves*** – The reserves over and above the cash reserves are the excess reserves. These reserves are used for loans and credit creation.
- ***Credit Multiplier*** – Given a certain amount of cash, a bank can create multiple times credit. In the process of multiple credit creation, the total amount of derivative deposits that a bank creates is a multiple of the initial cash reserves.