Asymmetric effects of geopolitical shocks in international banking - a matter of trust?*

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Abstract

We examine asymmetries in the effects of geopolitical shocks on international bank positions, contrasting negative events, such as Russia's invasion of Ukraine, with positive events like the fall of the Berlin Wall. By utilizing granular bilateral data from the BIS international banking statistics, we analyze cross-border credit across up to 12,000 country pairs from 1977 to 2024. Our findings indicate that negative shocks substantially reduce credit between geopolitical blocs by 10-20% more than within blocs; by contrast, positive shocks have no commensurate effect on finance, even when boosting trade flows. We attribute these asymmetries to the greater need for trust in cross-border credit compared to trade in goods, which is shorter-term and collateralized. Narrative evidence from contemporary sources supports this mechanism.

JEL: F2, F3, D74, H56, N40

Keywords: geoeconomics, geopolitics, international finance, global banking, asymmetric shocks

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Introduction

Russia's invasion of Ukraine has sparked a surge in studies examining the impact of geopolitical fragmentation on international trade and finance. While this body of research is compelling, its focus is largely on 2022, offering limited insights into the broader applicability of these findings across different regions and historical contexts. This limitation is significant at a time when the strength of the transatlantic alliance is under scrutiny, and fissures within the Western bloc begin to appear. Moreover, research has largely addressed the effects of *negative* geopolitical shocks—such as unexpected escalations in geopolitical tensions—while overlooking the potential effects of *positive* geopolitical developments, such as reductions in tensions. Finally, economic research on global fragmentation has predominantly concentrated on international trade and foreign direct investment, less on finance. In line with this, a recent survey of the literature on geoeconomics noted that "more work is needed on the role of geopolitics ... in the international financial system" (Mohr and Trebesch, 2024).

This paper seeks to address these gaps by exploring the impact of major geopolitical shocks, both negative and positive, on international bank positions in a dataset spanning close to five decades. We analyze Russia's full-scale invasion of Ukraine in 2022, and compare this event with other negative shocks – notably the annexation of Crimea in 2014, and the Soviet invasion of Afghanistan in 1979 that marked the end of the détente between the West and Soviet blocs – and contrast them with a positive shock, the fall of the Berlin Wall in 1989. We use these events as a laboratory for analyzing the confidential bilateral banking statistics from the BIS, which record bilateral cross-border credit for up to 12,000 country pairs at a quarterly frequency from 1977 to 2024 in what is perhaps the richest macro-financial dataset available over such an extensive historical period.

We obtain gravity model estimates of the effect of geopolitical blocs on cross-border positions between pairs of countries, to discern the differential consequences for credit between and within these blocs. Following the methodology of Gopinath et al. (2025), the specification accounts for all time-invariant factors and country-level shocks that govern bank-related credit between country pairs. This leaves only the time variation in bilateral positions, the part most indicative of changing geopolitical allegiances between pairs of countries.

Our primary finding reveals a remarkable asymmetry in the effects of geopolitical shocks on international bank positions. Negative geopolitical shocks, such as Russia's recent invasion of Ukraine, have a pronounced negative impact, resulting in a substantial decline in cross-border credit *between* geopolitical blocs, typically 10 to 20% greater than credit *within* blocs. This effect is comparable in magnitude to the impact on trade documented in previous studies. On the other hand, the major positive geopolitical shock we examined—the fall of the Berlin Wall—did not have a commensurate expansionary effect on international bank positions. This is in sharp contrast with international trade, which saw a broad-based positive response to the same geopolitical event.

We conjecture that the economic mechanism underlying our findings reflect the fact that financial transactions are predicated on trust. Credit, especially when long-term and unsecured,

is inherently more trust-dependent than goods trade (Kiyotaki and Moore, 2001, 2002). Financial decisions involve intertemporal considerations, trade-offs between the present and the future, and commitment devices. Financial liabilities are mere promises – often over several years – whereas trading physical goods involves the short-term exchange of value against real collateral (goods in transit). When trust is eroded by geopolitical tensions, or when it needs to be (re)established between distant geopolitical blocs, it is more challenging to build the trust required for financial transactions than for goods trade. As a result, when geopolitical tensions ease, financial flows between geopolitical blocs do not resume as swiftly as trade flows. The response of finance to geopolitical shocks can therefore be asymmetric, failing to expand in the wake of positive geopolitical events that boost trade at the same time. Narrative evidence from contemporary reports by institutions (e.g. EBRD (1998), EBRD (1999), Fidrmuc and Schardax (1999)) and scholars Calvo et al. (1995) supports this mechanism.

Our paper contributes to several strands of literature. First, it builds on existing research on trade and financial fragmentation. For instance, Kempf et al. (2023) find that ideological distance between countries affects the size and direction of capital flows; Aiyar et al. (2024) and Gopinath et al. (2025) show that FDI and portfolio flows increasingly correlate with geopolitical tensions since Russia's invasion, while Catalan et al. (2024) provide evidence that investment funds allocate smaller shares of their portfolios to recipient countries that are geopolitically more distant to their country of origin. We extend this literature by exploring a mechanism through which the effects of geopolitical shocks manifest, using the unique perspective of international banking throughout history. Pradhan et al. (2025) find that geopolitical tensions dampen cross-border bank lending, but the longer time-span covered by the data in our paper enables us to provide a historical perspective and explore potential asymmetries in response to positive and negative geopolitical events. We also provide more nuance on how geopolitical blocs can be defined and grounded in countries' voting in the UN General Assembly than previous papers.

Second, the paper provides empirical backing to the rapidly expanding field of geoeconomics, including Clayton et al. (2023), Mohr and Trebesch (2024), Broner et al. (2024), and Clayton et al. (2025), by examining financial fragmentation over the longer term. In so doing, it adds to the body of work on international banking—e.g. Avdjiev et al. (2018), McCauley et al. (2019) and Broner et al. (2023) — by incorporating a focus on geopolitical factors. Finally, our paper provides a novel angle on the literature on the complementarities between trade and finance, such as Aviat and Coeurdacier (2007), Lane and Milesi-Ferretti (2008), Antras and Caballero (2009), Taylor and Wilson (2011), Manova et al. (2015) and Brei and Von Peter (2018). In highlighting how positive and negative shocks affect their interaction, our findings underscore that banking and trade need not go hand in hand.

The rest of the paper proceeds as follows. Section 1 presents the data, while Section 2 provides descriptive statistics. Section 3 discusses the methodology and our basic results, after which Section 4 examines the economic mechanism underlying our findings. Section 5 concludes and draws implications for policy.

1 Data

1.1 Historical episodes

Our starting point for examining the impact of geopolitical shocks on global bank positions is Russia's large-scale invasion of Ukraine in February 2022, similar to Gopinath et al. (2025). The invasion escalated geopolitical tensions by provoking widespread condemnation and sanctions from Western countries. NATO's increased support for Ukraine has heightened fears of a broader conflict, deepening divides between Russia and the West. The invasion also strained global diplomatic relations, especially with China and neighboring nations.

To broaden the scope, we also consider two other salient events that led to surges in geopolitical tensions. One is Russia's annexation of Crimea in February 2014, which predates the full-scale invasion of February 2022. The annexation was seen as a formative event challenging the post-Cold War European order. It led to the suspension of Russia's participation in the Group of Eight (G8) leading powers—reduced it to a Group of Seven (G7). The West, led by the US and the EU, responded with economic, financial and other sanctions against Russia, while NATO increased its presence in Eastern Europe. The conflict resumed as a frozen conflict with periods of escalations until the full-scale invasion. Another event we examine is the end of the "détente" between the Western and Eastern blocs—the period in the 1960s and 1970s marked by improved relations and nuclear arms control agreements between the two blocs. The Soviet invasion of Afghanistan in December 1979 led to a re-intensification of the Cold War. The Soviet union supported the Afghan communist movement, while the United States supported the Afghan anti-Soviet insurgents. The military involvement in Afghanistan exacerbated the arms buildups of the two superpowers well into the 1980s, even as the Soviet Union faced increasing economic strains.[1]

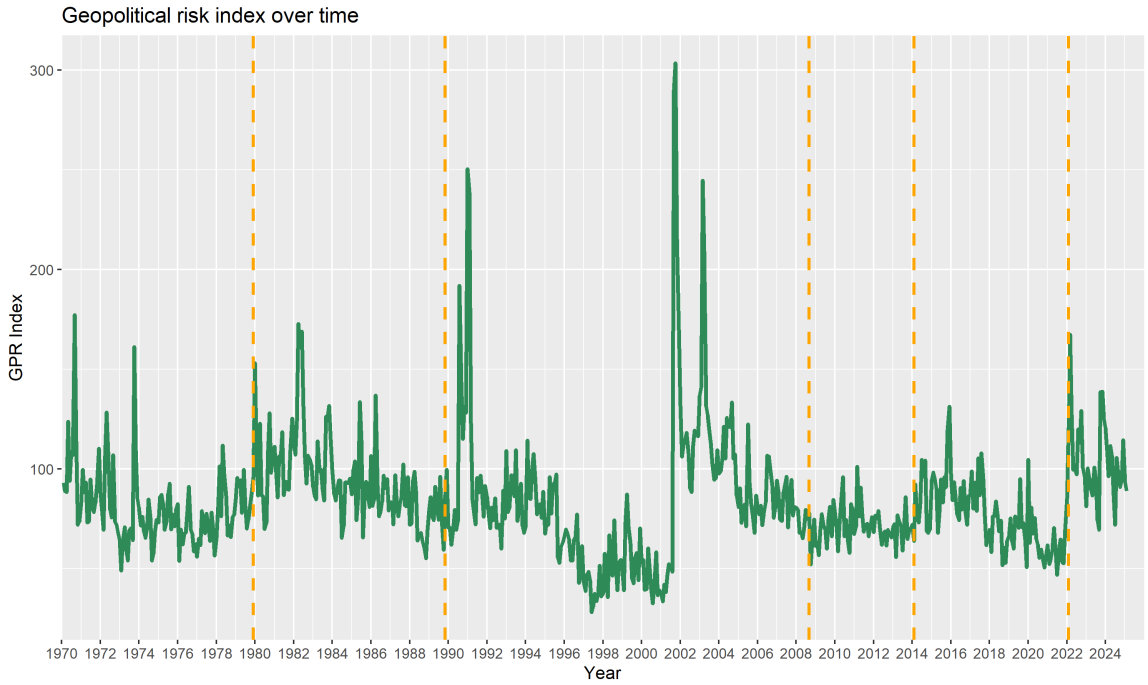
The major episode of reduction in geopolitical tensions we consider is the fall of the Berlin Wall in November 1989, which marks the beginning of the end of Cold War. The weakening of Soviet influence in Eastern Europe and Mikhail Gorbachev's reforms in the mid-1980s promoting openness and restructuring (also known as *glasnost* and *perestroika*) led to a reconfiguration of Russia's political ties with the West and Russia's neighbouring states, many of which were ex-Soviet states. A series of important events followed from the fall of the Berlin Wall and contributed to end the Cold War, including the German Reunification in October 1990, the dissolution of the Soviet Union in December 1991, and the founding of the European Union by the Maastricht Treaty's entry into force in November 1993.

To what extent can these events be considered as shocks for the purposes of identification? Figure 1 provides supportive evidence, showing the evolution since 1970 of the index of geopolitical risk of Caldara and Iacoviello (2022). The index is constructed from news articles and text analysis that allows to count the frequency of keywords related to geopolitical tensions.

[1]For instance, under President Reagan, the US increased defense spending and adopted a more aggressive stance with initiatives like the Strategic Defense Initiative, in defense of potential nuclear attacks from the Soviet Union

The dashed orange lines indicate the dates of each historical episode we consider. It is apparent that each is followed by a noticeable increase in the index of geopolitical tensions. Moreover, we validate our identification strategy further by considering the effect on global banking positions of a major shock unrelated to geopolitics—the Global Financial Crisis of 2008-09. As Figure 1 makes clear, this is an appealing placebo test, as stability in the index of geopolitical tensions in 2008-09 suggests.[2]

Figure 1: **Historical episodes used for identification and geopolitical risk**



Source: Caldara and Iacoviello (2022) and authors' compilation.

1.2 Geopolitical blocs

We analyze geopolitical blocs using countries' voting patterns in the UN General Assembly (UNGA). The use of UNGA voting for measuring foreign policy preferences has a long tradition in political science. Bailey et al. (2017) proposed a dynamic spatial model to estimate *ideal points* on a single dimension that reflects state positions toward the US-led liberal order. Their estimates yield a country panel of annual ideal points, centered on 0 with the US taking the top position in the ordinal ranking most of the time. These estimates naturally lend themselves to measuring geopolitical distance between country pairs. Bailey et al. (2017) transform ideal

[2]This does not mean that there were no geopolitical tensions in this period. For example, the collapse of Lehman Brothers in September 2008 was preceded by the Russia-Georgia War of August 2008. But the conflict did not lead to an escalation of global geopolitical tensions to an extent similar as the other events we consider, as the index suggests.

points into bilateral measures by taking the absolute distance between the ideal points of two countries, defining the *ideal point distance* as

$$IPD_{ijt} = |IP_{it} – IP_{jt}|. \tag{1}$$

These ideal point distances (IPDs) can be used to form geopolitical blocs. Gopinath et al. (2025) divide the world into three groups based on 2021 IPDs: a US-leaning bloc comprising countries in the top quartile in their political proximity to the US ("West"), a China-leaning bloc comprising the quartile of countries with the smallest IPDs to China ("East"), and all others taken as "non-aligned". We confirmed that this leads to a similar partition in 2021 as assigning the 25% members *furthest* from the US IP as East.

While the use of IPD is grounded in the international relations literature, forming geopolitical blocs from IPD differences this way is open to at least two criticisms. First, the use of quartiles is arbitrary: it divides the world into equal-sized blocs, each comprising 48 UN voting members, with the remaining UN membership (and other jurisdictions and territories) treated as non-aligned. This artificial bloc size is devoid of any meaningful link to the geopolitical stance of UN voting members. Second, IPDs in any given year are based on dozens of UNGA votes that cover a broad range of topics not necessarily related to geopolitical flash points.

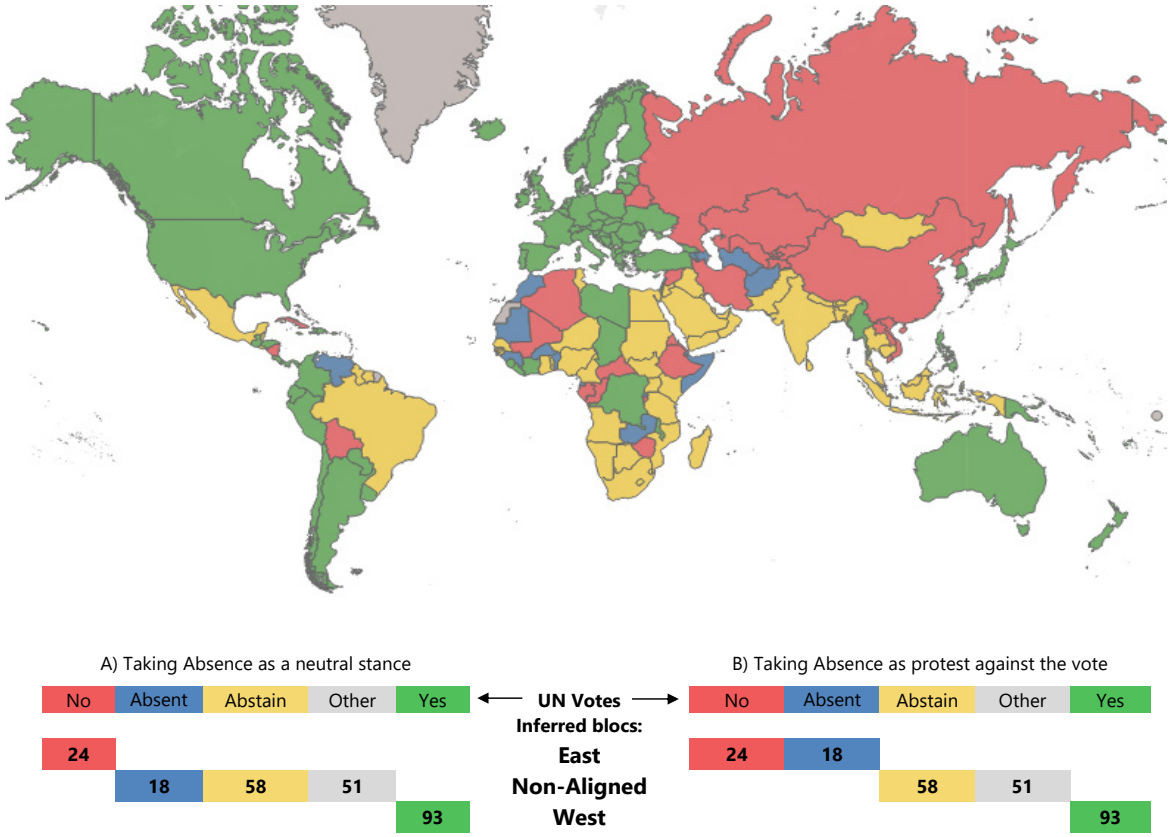
We thus propose an alternative bloc definition based on the single most divisive UNGA vote following Russia's invasion of Ukraine. The *Eleventh Emergency Special Session (ES-11)* comprised six GA votes between March 2022 and March 2023. Some of these resolutions can be read as symbolic expressions of support for peace in Ukraine. By contrast, the vote on 7 April 2022 directly sanctioned Russia, leading to its suspension from the UN's Human Rights Council – a singular event, especially for a Permanent UN Security Council member. Before the vote, Russia's campaign forced countries to take sides.[3] This led to the largest number of "No" votes (24) in any of the six ES-11 Resolutions. Hence, this was the single most informative UNGA vote on geopolitical allegiances following the invasion in our view.

Figure 2 maps the voting record and shows how we translate five possible states into three geopolitical blocs (East, West and non-aligned). UNGA voting allows for three explicit options: "Yes" (approve), "No" (disapprove), and Abstain (present, not voting); UN members can also be absent from a vote. In addition, many economies in our data are not UN voting members (eg Hong Kong SAR, offshore financial centres, dependent territories, etc). For the vote on suspending Russia's HRC membership, we take "No" as siding with Russia (East), "Yes" as West, and abstentions as "Non-aligned", since this is the only way to express a neutral stance in a vote. Non-UN members are treated as non-aligned as they cannot take a position in the UNGA. The treatment of Absences of UN members is open to different interpretations (Versions A and B).

Our definition of geopolitical blocs leads to a smaller East (24 countries) and larger West (93) than the statistical partition of IPDs by quartiles (48 each) in Gopinath et al. (2025). In

[3]Official letters sent to a large number of states warned that countries would be considered "unfriendly states" should they fail to vote against the Resolution (Boeglin, 2022).

Figure 2: **Geopolitical blocs inferred from the April 2022 UN vote suspending Russia from the Human Rights Council**



Version A, we include absent UN members with the non-aligned.[4] However, given the divisive nature of the HRC vote – as reflected in high numbers of No votes, Abstentions and Absences – it is plausible that some members use Absence as strategic choice, to side with Russia without going on the record. Thus, Version B of our geopolitical blocs combines Absences with No votes, enlarging the East to 42 countries (Figure 2).

In our empirical work on the main event (the 2022 invasion), we use the equal-sized blocs as a baseline, and versions A and B of our geopolitical blocs as a robustness exercise. For earlier events, we adapt the approach of defining equal-sized blocs based on IPDs, ensuring that Russia (or the Soviet Union) is indeed assigned to East.[5] For the end of the Cold War and the Soviet invasion of Afghanistan events, we follow Gopinath et al. (2025) in using the West–East divide as in Gokmen (2017) and Huntington (1997). Studying the associated patterns in international finance over several decades requires statistics with sufficient scope.

1.3 International banking statistics

To analyze geopolitical fault lines in international finance, a natural approach is to examine capital flows and stocks between pairs of countries, from source (lender) to destination (borrower). We focus on cross-border stocks and flows intermediated by banks, complementing the work on portfolio investment and FDI in Gopinath et al. (2025).

The global banking dataset in this paper is built from the BIS Locational Banking Statistics (LBS), the most comprehensive source of information on international banking, available at quarterly frequency since 1977. The data are reported by more than 6,000 banks (including subsidiaries and branches) in 48 reporting countries, comprising advanced economies, emerging markets and the major offshore centers.[6] The LBS include banks' cross-border claims and liabilities vis-à-vis more than 200 counterparty countries and jurisdictions. The bulk of claims represents credit; for simplicity, we use claims and credit interchangeably.[7]

The LBS are collected in the "banks-to-country" format, from which we construct a "country-to-country" network in two steps. First, we reconcile interbank positions. Denote banks' interbank assets (and liabilities) by IBA (and IBL). When a bank lends from a source country s to another bank located in destination country d, in principle $IBA_{sd} = IBL_{ds}$, since one bank's interbank asset is the other's liability. The reported amounts may differ, notably when the coverage

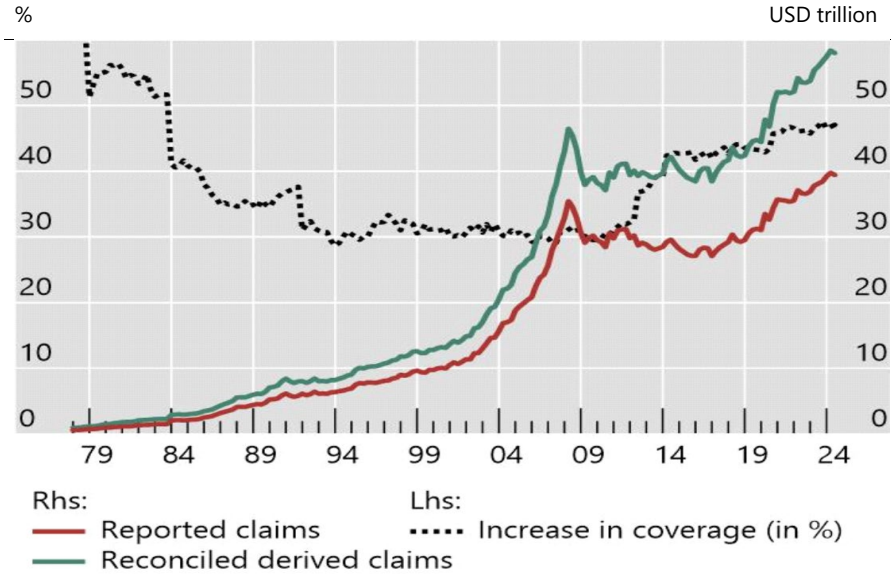
[4]Bailey et al. (2017) argue that absences typically do not reflect a country's views but are often due to the temporary lack of government or a crisis preventing attendance.

[5]Based on the 2013 IPDs vis-à-vis the US, Russia would not be part of the East, even as it annexed Crimea in 2014. The official geopolitical stance of Russia prior to the annexation suggests that the annexation was relatively unexpected.

[6]The statistics are reported on a residence basis, in line with the balance of payments. They include banks' intragroup positions with subsidiaries and other legal entities of the same banking group, as well as inter-office positions with their branches abroad (BIS, 2019). For example, the United Kingdom reports for domestic and foreign banks operating in the UK vis-à-vis their positions with counterparties anywhere.

[7]In the LBS, claims comprise (i) loans and deposits, (ii) holdings of debt securities and (iii) derivatives with a positive market value and other residual instruments (combined). Credit is the sum of (i) and (ii).

Figure 3: **Reported versus derived reconciled cross-border bank credit**



[1] Excluding claims unallocated by country

Sources: BIS locational banking statistics; authors' calculations

of institutions or classification of counterparties differ between reporting countries.[8] We reconcile interbank positions by taking the maximum between them, $IB_{sd} = max\{IBA_{sd}, IBL_{ds}\}$. Second, we include all positions with non-banks, comprising firms, households and the official sector. Banks in s extend credit to non-banks in d, denoted by NBA_{sd}. In addition, non-banks in s may be placing deposits with banks in d, reported by banks in d as liabilities to non-banks in s, NBL_{ds}. Combining all cross-border claims of country s on d yields total cross-border positions,

$$XB_{sd} = IB_{sd} + NBA_{sd} + NBL_{ds}. \tag{2}$$

The procedure of reconciliation and mirroring returns a network that contains all reported positions intermediated via banks between origin and destination countries, and maximises coverage in the process.[9] The resulting dataset covers between 3,000 and 12,000 bilateral bank positions between pairs of countries every quarter, amounting to more than 1 million observations over the decades. The empirics below use (log) levels of quarterly positions in millions of US dollars; where growth rates are used, they are based on quarterly changes adjusted for breaks in series and exchange rate fluctuations.

[8] There are various reasons why two reported legs may differ, see (Pradhan and Silva, 2019).

[9] See Pradhan and Silva (2019) and Brei and Von Peter (2018). The enhanced data means that the aggregate value of cross-border credit captured by our dataset increases substantially, from around $40 trillion in the reported "banks-to-country" format, to almost $60 trillion in the enhanced "country-to-country" in 2024 Q2 (Figure 3).The network only leaves out direct positions between non-banks, which are captured in other international datasets, eg the IMF's CPIS and CDIS.

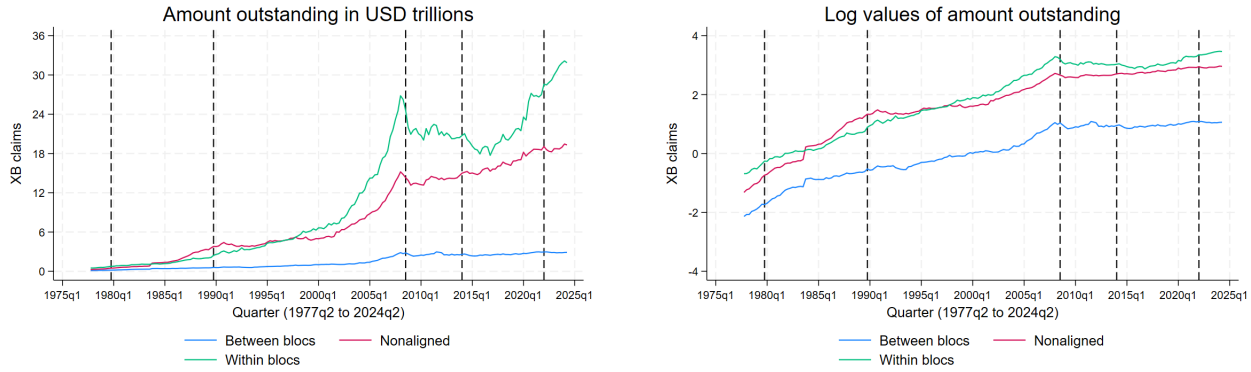
2 Descriptive statistics

The total value of reconciled cross-border bank credit has increased from around USD 1.0 trillion in 1977, at the start of our data, to around around USD 58 trillion by mid-2024. The left panel of Figure 4 shows the total value of cross-border credit over time, divided into categories based on whether the source and destination countries are within the same geopolitical bloc (within blocs, green), in different blocs (between blocs, blue), or whether the source *or* destination country is in the non-aligned group (Non-aligned, red).[10] For illustrative purposes, the geopolitical blocs in the chart are computed based on countries' ideal point distances in 2021 and are held constant over time, although geopolitical alignment has varied considerably over these decades.

Even as cross-border bank credit has grown dramatically over our sample period, the bulk remained concentrated in positions within blocs and with non-aligned countries. In part, this reflects the fact that finance is concentrated on major economies and financial centers associated with the West. Credit between blocs still only accounted for 5% of total credit in 2024 Q2. The historical episodes which we examine in the empirical section are shown as dashed vertical lines.

The right panel of Figure 4 displays the same times series but with the values expressed in natural logs, as in our preferred regression specification. Once again, the key events are shown as dashed vertical lines. Focusing on the most recent event, it is perceptible that while the between-bloc cross-border credit had been rising prior to the Russian invasion of Ukraine, it has declined somewhat since, while credit within blocs has continued to increase.

Figure 4: **Aggregate cross-border credit, by geopolitical bloc**



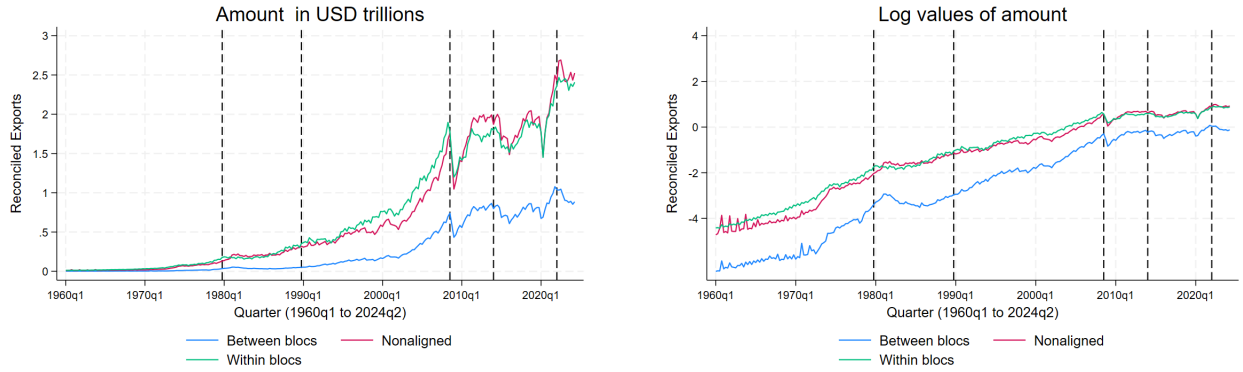
Sources: BIS Locational Banking Statistics, authors' calculations.

To facilitate a comparison of developments in cross-border banking to those in international trade over the same period, Figure 5 displays similar information but based on data on international trade in goods. The figures illustrate that international trade is less concentrated on

[10]Following Gopinath et al. (2025), East and West are treated as blocs, while the non-aligned group is not; hence, "between blocs" only refers to credit from East to West and West to East (see also Section 1.2).

flows within blocs than cross-border credit. Yet, as in the case of cross border credit, there has been an observable decline in trade between countries in different geopolitical blocs relative to trade within blocs since the Russian invasion of Ukraine.

Figure 5: **Aggregate trade in goods, by geopolitical bloc**



Sources: IMF Direction of Trade Statistics, authors calculations.

These patterns are illustrated more starkly in Figure 6. The top panels compare cross-border bank credit averaged over a window prior to the Russian invasion of Ukraine (2017q1 to 2021q4) to the period after the invasion (2022q1 to 2024q2), while the lower panel display the same but using data on international trade. The average bilateral outstanding amounts of credit among countries within the same blocs increased from around USD 13 billion to USD 18 billion, an increase of almost 40% compared to credit between blocs which increased from USD 1.5 billion to USD 1.7 billion, and increase of 8%. The same pattern is apparent when the data are expressed in logs in the centre panels, to aid comparison with the regressions presented below. There is also a clear difference in the growth rate of cross-border bank credit between countries different geopolitical blocs and those within the same bloc after the Russian invasion of Ukraine (Figure 6, right panel). Before the Russian invasion of Ukraine, the average bilateral growth rate of cross-border bank credit between countries in different geopolitical blocs was 3.2%, comparable to the 3.9% growth observer within blocs. After the Russian invasion of Ukraine, this declined to 1.6% for countries in different geopolitical blocs, whereas it accelerated to 7.3% for countries within the same bloc.

3 Empirical Analysis

Following (Gopinath et al., 2025) we estimate the following gravity model equation:

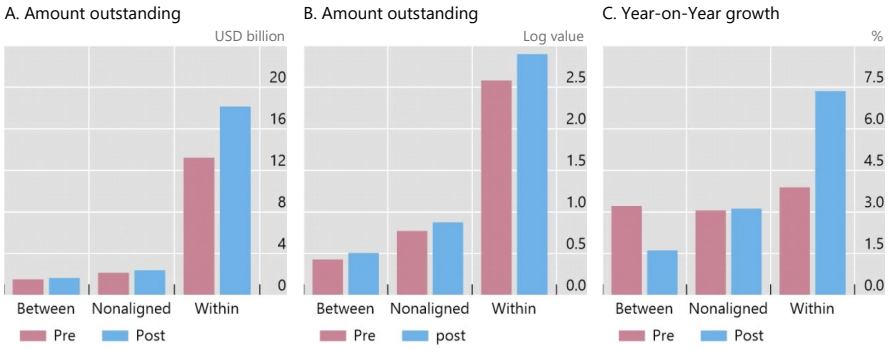
$$y_{sdt} = \beta_1\{BetweenBloc_{sd} \times Post_t\} + \beta_2\{Nonaligned_{sd} \times Post_t\} + \delta_{sd} + \tau_{st} + \phi_{dt} + \varepsilon_{sdt} \quad (3)$$

where the dependent variable is the log of cross-border credit from source country s to destination country d at time t. $BetweenBloc_{sd}$ is a dummy for country pairs in which the two

Figure 6: **Comparison of average cross-border bank credit and trade across geopolitical blocs before and after the Russian invasion of Ukraine**

Cross-border claims of BIS reporting banks, pre- and post- invasion of Ukraine

Mean values



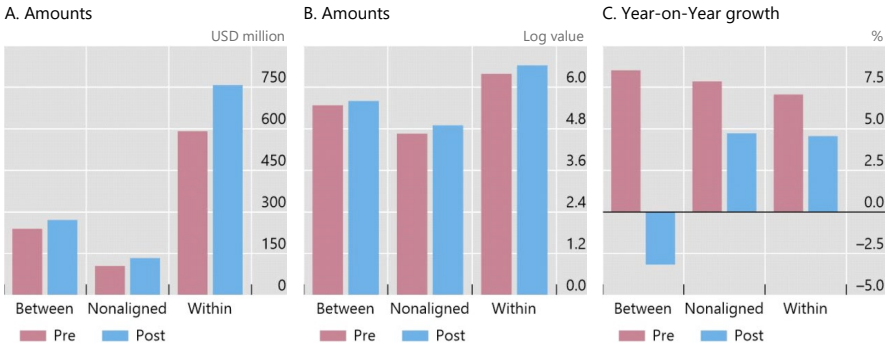
Pre-period: 2017 Q1 to 2021Q4; **post-period:** 2022Q1 to 2024Q2

The bars represent mean values across all pairs of lenders and borrowers during pre- and post- periods, respectively. Year-on-year growth are derived from aggregate of all pairs of lenders and borrowers in respective groups.

Sources: IMF; BIS; authors' calculations

Exports worldwide, pre- and post- invasion of Ukraine

Mean values



Pre-period: 2017 Q1 to 2021Q4; **post-period:** 2022Q1 to 2024Q2

The bars represent mean values across all pairs of trading partner countries during pre- and post- periods, respectively. Year-on-year growth are derived from aggregate of all pairs of partner countries in respective groups.

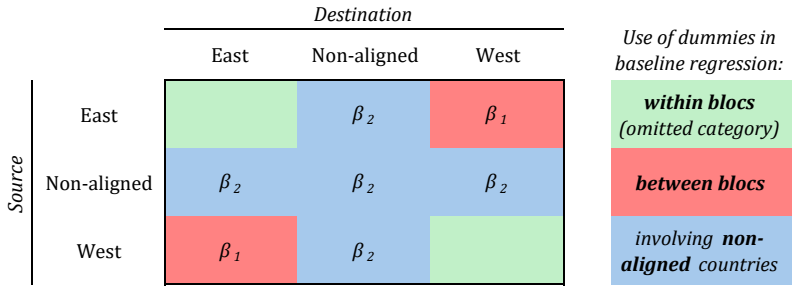
Sources: IMF; authors' calculations

countries belong to different blocs, while $Nonaligned_{sd}$ is a dummy for country pairs in which at least one country is nonaligned, as illustrated in Figure 7. This leaves country pairs in which both the source and destination country are in the same bloc as the omitted, reference category. These bloc variables are then interacted with a dummy variable $Post_t$ that equals 0 prior to Russia's invasion of Ukraine, and 1 from 2022Q1 onwards.

Our preferred specification is fully saturated with fixed effects at the country-pair (δ_{sd}), source×quarter (τ_{st}) and destination×quarter (ϕ_{dt}) level, estimated using the Poisson pseudo-maximum likelihood (PPML) estimator (Silva and Tenreyro, 2006).[11] Together, these account for all the time-invariant, country-pair determinants of cross-border bank credit, as well as all time-varying source- and destination-specific factors. In particular, the δ_{sd} fixed effects capture time-invariant variables typically found in the gravity literature such as physical distance, common language, common border, trade agreements, common colonial history, etc.

The coefficients of interest capture the variation in bilateral cross-border credit across different blocs over time. More concretely, the coefficient β_1 captures the difference in average bilateral cross-border credit between countries belonging to different geopolitical blocs before and after a geopolitical event (such as the Russian invasion of Ukraine) compared to the difference for country-pairs belonging to the same geopolitical bloc (Figure 7). When the credit relationship involves a Non-aligned country on either side (including when both counterparties are Non-aligned), it is assigned to the Non-aligned group. The coefficient β_2 measures the difference in cross-border credit involving non-aligned countries relative to that within geopolitical blocs. Finally, ε_{sdt} are robust standard errors, clustered at the country-pair level.

Figure 7: **Illustrating the use of blocs in the empirical specification**



Ukraine 2022 (Table 1)

The results show estimates of the main coefficient of interest β_1 estimated under alternative specifications. We use different estimators, two measures for the dependent variable, exclude Russia from the sample, and different definitions of geopolitical blocs. The estimates in all specifications suggest that there was a decline in cross-border credit between blocs (relative to credit within blocs) after the invasion of Ukraine. Columns (1)-(2) report coefficients estimated by

[11] The PPML estimator has a number of advantages particularly in contexts where there are a sizable number of observations with a value of zero, and is robust to heteroskedasticity, providing consistent estimates even if the variance of the error term is not constant (Silva and Tenreyro, 2006).

OLS, with cross-border credit in log-levels (column (1)) and in year-on-year percentage changes (column (2)) as the dependent variable, respectively. Column (3) is our preferred baseline specification, with the dependent variable in levels and using PPML estimation. Column (4) reports the result excluding Russia, confirming that the relative drop in credit between East and West was not limited to credit involving Russia.

The results are somewhat stronger when using our definition of geopolitical blocs based on the April 2022 vote in the UN General Assembly (as described in Section 1.2). Columns (5) and (6) report the results using the two alternatives shown in Figure 2, which differ in that Absence can be interpreted as a neutral stance (Version A, in column (5)) or as a sign of protest (Version B, in column (6)). The coefficient in the preferred specification was -0.1, which implies a decline in credit between blocs of around 10% compared to within blocs, after the Russian invasion of Ukraine. Using our geopolitical blocs, the drop in credit is estimated to be 15% larger between blocs than within blocs.[12] By contrast, the coefficient on the $Nonaligned \times Post$ dummy is significant only in column (1). Thus the results do not provide robust evidence that cross-border credit involving non-aligned countries evolved differently than credit within geopolitical blocs after the invasion.

Earlier adverse events (Table 2)

Table 2 reports the results of similar regressions for two earlier adverse geopolitical events, the 2014 Russian annexation of Crimea in 2014 (columns 1-3), and the Soviet invasion of Afghanistan in 1979 (columns 4-6). The β_1 coefficient on $Between \times Post$ suggest that both events dampened cross-border credit between geopolitical blocs compared to within bloc. Even though the annexation appears to have been a lesser event judging by the geopolitical risk index of (Caldara and Iacoviello, 2022), the magnitude of the coefficients is somewhat larger than for the Russian invasion of Ukraine. The annexation certainly reduced credit to Russia, but the effect on cross-border credit was felt more broadly since the econometric results are robust to the exclusion of Russia (column (3)).

The results also suggest that, in contrast to Ukraine 2022, cross-border credit involving non-aligned countries also declined compared to within geopolitical blocs after the annexation of Crimea. However, the coefficients on the $Nonaligned \times Post$ the somewhat smaller than $Between \times Post$, suggesting that the effect on credit to non-aligned countries was less pronounced.

The Soviet invasion of Afghanistan represented an unexpected and sizable escalation of the Cold War and resulted in increased Western defense spending and a renewed focus on countering Communism. In this respect, it may be considered as virtually comparable to the resurgence of geopolitical concerns since the Russian invasion of Ukraine. Data availability is more limited for this earlier episode, meaning that there are substantially fewer observations in the regressions. Despite this, the sign and significance of the coefficients of interest reported in columns (5) and (6) of Table 2 are similar to those of the more recent episodes, suggesting that the Soviet invasion of Afghanistan also had a notable effect on cross-border bank credit.

[12]Given the functional form of the PPML estimator, the decline in credit between blocs relative to that within blocs following the event can be computed as (exp(-0.16)-1) x 100 = -14.8%.

Counter-experiments (Table 3)

The next empirical exercise examines the end of the Cold War in 1989 as a positive geopolitical shock, in order to test whether the effects of geopolitical shocks are symmetric (Columns (1) using OLS and (2) using PPML). Using either estimator, the coefficient on the key variable of interest, the $Between \times Post$ interaction, is not significantly different from zero. This suggests that credit provision across geopolitical blocs did not differ substantially following the end of the Cold War, relative to that within blocs.[13] This stands in stark contrast with the results showing differential effect of adverse geopolitical shocks on cross-border bank credit.

To address possible concerns about the validity and robustness of the results, we also implement a placebo test using the 2008 Global Financial Crises as the treatment event. This crisis is well know to have had a dramatic effect on cross-border credit, but arose due to fragility intrinsic to the financial system rather than being geopolitical in nature (Cetorelli and Goldberg, 2011; McCauley et al., 2019; Emter et al., 2019). With this in mind, the results reported in columns (2) and (3) of Table 3 are reassuring as they show that the coefficient on the of variables interest, $Between \times Post$ and $Non-aligned \times Post$, are not statistically significantly different from zero. Although cross-border credit declined dramatically in the wake of the global financial crisis, this contraction did not occur across geopolitical lines.

Banking vs Trade (Table 4)

Overall, the results of the empirical analysis point to an important asymmetry. Adverse geopolitical shocks are found to dampen cross-border bank credit between countries in different geopolitical blocs, but positive geopolitical events do not appear to deliver the opposite effect. To explore this further, Table 4 tests whether the same asymmetry arises in international trade. Columns (1) to (5) report the results for the Russian invasion of Ukraine event using a variety of specifications.[14] In line with our results on banking, the coefficient on $Between \times Post$ is significantly negative. This confirms the findings of Gopinath et al. (2025), that trade flows declined substantially between countries in geopolitically distant blocs after the invasion of Ukraine, relative to flows between countries within the same bloc. [15]

However, the effects of geopolitical shocks on trade appear to be more symmetric than those on credit. The results reported in Table 4, columns (6) to (8) are for the end of the Cold War.[16] In contrast with the results for banking, this positive geopolitical shock appears to have given rise to a sizable increase in trade flows across previously opposing geopolitical blocs, relative to trade within blocs or involving non-aligned countries. Interestingly, the magnitude of the effect (around 60% or 70%) is close in size to the negative effect estimated by Gopinath et al. (2025)

[13]The coefficients on the $Non-Aligned \times Post$ variable are not statistically significant either.

[14]Column (1) shows the specification using an OLS estimator, column (2) uses PPML, column (3) and (4) use different geopolitical bloc definitions based on a specific UN vote on the war in Ukraine, column (5) excludes Russia.

[15]Similarly, the estimated effect on cross-border bank credit to or from non-aligned countries is more limited, as the coefficients are substantially smaller and are only statistically significant in 3 of the 5 specifications.

[16]Column (6) shows the specification using an OLS estimator, column (7) uses PPML, column (8) excludes the Soviet Union/Russia.

after the onset of the Cold War. Overall, this suggests that positive and negative geopolitical shocks have a broadly symmetric effect on international trade.

4 Economic mechanism and narrative evidence

Why are there asymmetries in the effects of geopolitical shocks? What explains our findings that negative shocks substantially reduce banking positions between geopolitical blocs, whereas positive shocks have no significant impact on finance, in spite of boosting trade? We conjecture that the underlying mechanism involves trust: financial transactions depend on trust to a greater extent than trade in goods, which is typically shorter-term and collateralized. Financial liabilities are promises over several years, whereas trade involves exchange against real collateral, namely goods in transit for a few months at most.

(Kiyotaki and Moore, 2001, 2002) stress that a classic challenge in the exchange of goods is finding a "double coincidence of wants", where both parties have exactly what the other desires. To overcome this, people use money as a medium of exchange. While the lack of coincidence of wants typically concerns the types of goods being exchanged, a more complex issue arises with intertemporal trade, which involves transactions, such as the exchange of money, occurring at different points in time. This introduces the crucial issue of trust, especially in unsecured long-term lending where the challenge shifts from the nature of goods to the timing of transactions. Time introduces a significant complication: if someone borrows today and later fails to repay, the initial loan cannot be reversed since time is irreversible. Hence trust becomes a critical factor in economic relationships.[17]

This distinction suggests that rebuilding trust for financial transactions is more difficult than for trade in goods when it is eroded by negative geopolitical shocks.[18] Consequently, when geopolitical tensions subside, financial flows between formerly distant blocs recover more slowly than trade flows. This explains why geopolitical events do not affect finance symmetrically when positive or negative, and why positive shocks fuel trade more than finance.

Narrative evidence from contemporaries corroborates this mechanism. For example, early publications by the European Bank for Reconstruction and Development (EBRD), established in 1991 to assist Central and Eastern European countries in transitioning from centrally planned to market-oriented economies after the Cold War and the collapse of the Soviet Union, observed that private finance took time to enter Eastern Europe in the years following the fall of the Berlin Wall. In contrast, trade reallocation to the West occurred much more rapidly. Regarding financial flows, EBRD (1999) (p. 61) emphasizes that:

[17] Kiyotaki and Moore suggest that money exists precisely because trust is limited. In an ideal world where everyone is perfectly honest, trade could occur using promises of future payment. However, because some individuals break promises ("evil"), trust alone is insufficient for intertemporal trade. This necessitates the use of money—an asset universally accepted regardless of trust. Money (or collateral) ensures that transactions can occur even when future promises are uncertain. Therefore, rather than being the root of evil, it is actually dishonesty and default risk that make money essential for borrowing, lending, and trade over time.

[18] A well-known proverb states that "Trust takes years to build, seconds to break, and forever to repair."

"Transition economies gained significant access to capital markets only after macroeconomic stabilisation had begun to take hold. Prior to 1994, significant capital flows occurred in only a few CEE countries, notably Hungary and the Czech Republic."

This stands in stark contrast with the observations made on trade flows (p. 90):

"The liberalisation of external trade in the early 1990s led to fast and sizeable change in the geographic composition of trade. Most of this adjustment consisted of a reallocation of trade flows away from the CMEA [Council for Mutual Economic Assistance, also known as Comecon] towards the European Union. Trade with the rest of the world also increased, but by much less. Not only did geographical trade patterns change, but also the composition of trade changed to reflect more closely the specific resources and comparative advantages of the transition countries... Although the biggest change to the geographical composition of trade flows happened early in transition and has changed little since then, the sectoral composition of trade has been changing more gradually and this process is likely to continue for many years to come."

This reorientation of trade from CMEA toward the European Union has boosted trade between blocs at the expense of trade within the East, in line with the results in Table 4 (columns (6)-(8)). More evidence that the trust-intensive nature of finance is essential to explain asymmetries in the effects of geopolitical shocks is found in EBRD (1998) (p. 79):

"Capital flows from 1989 to 1993 were shaped by Western governments' determination to make the transition "stick", coupled with a wait-and-see approach by private sources of funds. In the early years of transition, central economic coordination was lost, with markets only gradually taking its place... Reflecting these developments, capital flows into the region have followed a distinct sequence: official funding, FDI, nonguaranteed bank loans, dedicated equity funds, and lastly international bond issues and direct local stock and money-market investments."

Similar observations were made by scholars in this earlier era. For instance, Calvo et al. (1995) note that:

"In contrast with the previous decade, capital has flown in abundance from industrial to developing countries in the 1990s, most prominently in Latin America and Asia, and with a lag in Central and Eastern Europe.... This was likely triggered by the collapse of the Communist regimes in these... years".[19]

Overall, this narrative evidence supports the view that the trust factor is crucial in explaining why the response of finance to geopolitical shocks can be asymmetric, failing to expand in the wake of positive geopolitical events that boost trade.

[19]Moreover, Fidrmuc and Schardax (1999) (p. 29) similarly noted that *"...inflows of foreign direct investment had been small at the beginning of transition... Moreover, other forms of capital flows (portfolio investment) have started to develop dynamically in recent years. However, the capital inflows are heavily concentrated on a few countries in the region."*

5 Conclusion

In this paper, we have examined asymmetries in the effects of geopolitical shocks on international bank positions using granular bilateral data spanning almost five decades. Our findings reveal an intriguing asymmetry: negative geopolitical shocks significantly reduce cross-border credit between blocs by 10-20% more than within blocs, while positive shocks show no statistically significant effect on banking, even when they boost trade. We take this asymmetry as indicative of finance relying on trust to a greater extent than trade does. Narrative evidence from the experience of transition economies in the 1990s supports this mechanism.

These findings have implications for policy. A possible decline in geopolitical tensions created by Russia's invasion, could result in a quicker resumption of trade compared to finance between the Western bloc and Russia. By the same token, the findings suggest that fissures within the Western alliance could spell a substantial decline in cross-border banking across the Atlantic. This would have material implications for the global economy, given that the West is the bedrock of the global financial system.

6 Tables

Table 1: Cross-border bank loans—Large scale Russian invasion of Ukraine of 2022

	(1)	(2)	(3)	(4)	(5)	(6)
	Log level	YoY growth	Level	Level	Level	Level
Between X Post	-0.26***	-5.52*	-0.10**	-0.11***	-0.17**	-0.16**
	(0.04)	(2.82)	(0.04)	(0.04)	(0.07)	(0.07)
Non-aligned X Post	-0.21***	-4.64	-0.04	-0.03	0.01	0.01
	(0.05)	(3.12)	(0.05)	(0.05)	(0.04)	(0.04)
Observations	342,401	326,565	412,796	402,179	412,796	412,796
Event quarter	2022q1	2022q1	2022q1	2022q1	2022q1	2022q1
Sample period	2017q1-24q2	2017q1-24q2	2017q1-24q2	2017q1-24q2	2017q1-24q2	2017q1-24q2
Estimated by	OLS	OLS	PPML	PPML	PPML	PPML
Source	All	All	All	ex. RU	All	All
Destination	All	All	All	ex. RU	All	All
UN bloc					Neutral	Protest

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 2: Cross-border bank loans—Russian annexation of Crimea of 2014 and Soviet invasion of Afghanistan of 1979/End of détente

	(1)	(2)	(3)	(4)	(5)	(6)
	Log level	Level	Level	Log level	Level	Level
Between X Post	-0.23***	-0.35***	-0.31***	-0.15	-0.46***	-0.45***
	(0.05)	(0.07)	(0.07)	(0.10)	(0.12)	(0.12)
Non-aligned X Post	-0.15***	-0.28**	-0.28**	-0.05	-0.82***	-0.82***
	(0.05)	(0.12)	(0.12)	(0.07)	(0.12)	(0.12)
Observations	405,454	553,720	539,595	98,111	160,468	158,983
Event period	2014q1	2014q1	2014q1	1979q4	1979q4	1979q4
Sample period	2010q1-19q4	2010q1-19q4	2010q1-19q4	1977q4-85q4	1977q4-85q4	1977q4-85q4
Estimated by	OLS	PPML	PPML	OLS	PPML	PPML
Source	All	All	ex. RU	All	All	ex. SU
Destination	All	All	ex. RU	All	All	ex. SU

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 3: Cross-border bank loans—Fall of Berlin Wall of 1989/End of Cold War and Global Financial Crisis of 2008

	(1)	(2)	(3)	(4)
	Log level	Level	Log level	Level
Between X Post	0.14	-0.16	-0.00	0.09
	(0.11)	(0.16)	(0.05)	(0.06)
Non-aligned X Post	-0.09	-0.00	-0.04	0.01
	(0.06)	(0.09)	(0.05)	(0.06)
Observations	282,210	407,246	213,806	299,945
Event period	1989q4	1989q4	2008q3	2008q3
Sample period	1985q4-00q4	1985q4-00q4	2003q3-10q4	2003q3-10q4
Estimated by	OLS	PPML	OLS	PPML
Source	All	All	All	All
Destination	All	All	All	All

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 4: Trade in goods—Large scale Russian invasion of Ukraine of 2022 and Fall of Berlin Wall of 1989/End of Cold War

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Log level	Level	Level	Level	Level	Log level	Level	Level
Between X Post	-0.10***	-0.20***	-0.24***	-0.23***	-0.09***	0.71***	0.55***	0.62***
	(0.02)	(0.03)	(0.04)	(0.04)	(0.03)	(0.06)	(0.06)	(0.08)
Non-aligned X Post	-0.06***	-0.06*	-0.05	-0.05	-0.03	0.02	-0.03	-0.02
	(0.02)	(0.04)	(0.04)	(0.04)	(0.03)	(0.04)	(0.04)	(0.04)
Observations	637,144	893,310	893,310	893,310	881,730	757,262	1,273,613	1,252,149
Event quarter	2022q1	2022q1	2022q1	2022q1	2022q1	1989q4	1989q4	1989q4
Sample period	2017q1-24q2	2017q1-24q2	2017q1-24q2	2017q1-24q2	2017q1-24q2	1985q4-00q4	1985q4-00q4	1985q4-00q4
Estimated by	OLS	PPML	PPML	PPML	PPML	OLS	PPML	PPML
Source	All	All	All	All	Ex. RU	All	All	Ex. SU/RU
Destination	All	All	All	All	Ex. RU	All	All	Ex. SU/RU
UN bloc			Neutral	Protest				

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

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