

# Research Brief



## Deglobalisation shocks, cross-border lending and positive effects of internal capital markets using the Brexit referendum as a case in point

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*The outcome of the Brexit referendum in June 2016 brought about an abrupt increase in political and economic uncertainty. In a new study, we show that German banks reduced lending to firms in the United Kingdom (UK) following the referendum. These firms reduced employment and investment as a result of the credit supply shock. Multinational corporations in the UK were able to mitigate this decline in external financing by making greater use of internal capital markets operated within their international corporate structures. Our study shows that the outcome of the Brexit referendum put pressure on the UK economy via indirect channels as well. Moreover, it highlights the role of multinational corporations, which were better able to mitigate the impact.*



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The pace of globalisation slowed since the global financial crisis of 2007 to 2009. Protectionist tendencies and geopolitical tensions have gained ground in recent years (Caldara and Iacoviello, 2022). Events such as Brexit and the trade conflict between the United States and China during Donald Trump's first presidency contributed to higher uncertainty with the potential for greater market fragmentation. Deglobalisation shocks, such as the outcome of the Brexit referendum, raise new questions about economic resilience. This is particularly relevant as external financial markets and internal capital markets may amplify or mitigate such shocks. These questions are all the more pressing given the new US Administration's trade policy stance, the worldwide measures and countermeasures taken in connection with this, and the turmoil this has caused.

## **Effects of the Brexit referendum shock on bank lending to UK firms**

In a new study (Imbierowicz, Nagengast, Prieto and Vogel, 2025), we show that German banks reduced their lending to UK firms by an average of 20 % following the Brexit referendum. This effect could be observed immediately after the referendum (and thus before the UK actually exited the EU). The findings are based on a difference-in-differences approach using unique Bundesbank microdata on cross-border bank lending and internal group financing. In our analyses, we focus on the credit supply and interpret the estimated decline in lending as the result of a negative credit supply shock. Further analyses show that well-capitalised and sound banks reduced their UK firm lending even more. This behaviour likely reflects prudence and stable risk management practices. Furthermore, less profitable firms were hit especially hard as they received fewer new loans and were able to less frequently extend existing credit lines.

## **Internal capital markets stabilise firms in times of crisis**

In further analyses, we assess the importance of multinational corporations' internal capital markets. Our findings show that non-UK subsidiaries played a key role for the overall reduction in lending to UK firms: non-UK subsidiaries secured more external financing and routed these funds internally to support UK affiliates within the multinational corporation. Presumably these firms had a greater interest in protecting their investments in the UK than external investors, such as banks, do. Internal capital markets thus offer financial flexibility and stability in times of crises. This is also evident when examining the outcome of the bank credit supply shock on the real economy. UK firms belonging to larger and regionally diversified groups were able to almost fully offset the decline in external financing as they kept their investment and employment levels stable following the Brexit referendum. By contrast, firms of smaller groups found it difficult to mitigate external financing constraints. Our findings show that internal capital markets are an important buffer against the real economic damage caused by external financing constraints.

## **Following a deglobalisation shock, banks adjust their lending and prefer familiar borrowers**

In addition, our study shows that the Brexit referendum shock did not just affect firms in the UK. It also influenced overall lending behaviour. German banks that were more exposed to UK borrowers also reduced their lending to non-UK firms more following the Brexit referendum. However, this was less pronounced for borrowers that were part of German groups. This shows that banks value familiarity in times of uncertainty and adjust their lending accordingly. Although UK firms' probability of default did not increase significantly after the referendum, banks tended to end lending relationships with UK firms more frequently. Moreover, the loans they issued after the Brexit referendum were generally smaller in both size and number. These findings suggest that adjustments to lending were not driven by specific risks but rather by heightened uncertainty about future developments in the UK and firms' future viability.

## **Conclusion**

On balance, we find that deglobalisation shocks have a significant impact on cross-border lending. The Brexit referendum led to an immediate credit crunch for firms in the UK. Multinational groups in the UK, however, could mitigate the effects of reduced bank lending by tapping internal capital markets. Note that our analysis focuses on the short-term effects following the Brexit referendum and does not examine the long-

term consequences of actual Brexit. The findings illustrate that international integration can amplify the negative effects of deglobalisation caused by supply-side international financial frictions. Greater international integration, however, can also mitigate the negative effects as multinational corporations may utilize firm-internal capital markets to mitigate the potential adverse consequences of deglobalisation. Thus, greater real economic integration has positive effects and can build resilience. At the same time, our findings show that uncertainty about future developments plays a key role in the adjustments made by banks and firms.

## References

Caldara, D. and M. Iacoviello (2022). Measuring Geopolitical Risk. *American Economic Review* 112: 1194-1225.

Imbierowicz, B., A. Nagengast, E. Prieto and U. Vogel (2025). Bank lending and firm internal capital markets following a deglobalization shock. Deutsche Bundesbank Discussion Paper No 05/2025.

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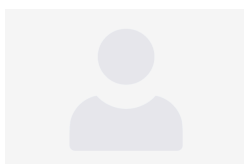
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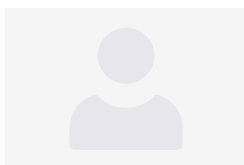
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