

DATA DISPATCH EMEA

Regulators leave eurozone banks' bond addiction untouched

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Global regulators have postponed tackling the overexposure of banks to their home government bonds in a regulatory overhaul, but European authorities hope that moves to bulk up their bailout fund will make them better able to deal with a spiraling debt sell-off of the sort that almost broke the single currency during the eurozone debt crisis.

The so-called doom loop linking prices of sovereign bonds to bank stability was at the heart of the eurozone debt crisis, prompting bailouts for Greece, Cyprus, Portugal and Ireland, as well as for Spain's banking system, and leading some at the time to question the continued existence of the single currency.

Influential voices including Germany's Bundesbank subsequently called for an end to rules assigning zero risk weights to even the riskiest sovereign debt, arguing that allowing banks to buy bonds without holding any capital against them encouraged a dangerous interdependency in fiscally weaker countries, ensuring that any doubts over the solvency of either government or financial system quickly infected the other.

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Domestic sovereign debt holdings at select banks in European periphery

EBA 2017 EU-wide transparency exercise

Company	Total sovereign debt holdings (€B)		Domestic sovereign debt holdings (€B)		Domestic sovereign debt holdings/total sovereign debt holdings (%)		
	2016	H1'17	2016	H1'17	2016	H1'17	H1'17 vs. 2016 (bps)
Cyprus							
Bank of Cyprus Holdings Plc	0.59	0.80	0.26	0.49	43.84	61.63	1,779
Hellenic Bank Public Co. Ltd.	0.89	0.86	0.64	0.66	71.74	77.38	564
Greece							
Alpha Bank AE	6.61	6.40	3.42	3.55	51.69	55.46	377
Eurobank Ergasias SA	11.77	10.58	3.26	3.59	27.68	33.92	624
National Bank of Greece SA	12.49	9.08	2.97	2.93	23.75	32.23	848
Piraeus Bank SA	15.85	11.24	2.08	2.22	13.15	19.72	657
Ireland							
Allied Irish Banks Plc	13.48	12.04	8.61	8.40	63.85	69.80	595
Citibank Holdings Ireland Ltd.	3.11	3.33	0.00	0.00	0.00	0.00	0
DEPFA BANK Plc	3.99	3.81	0.00	0.00	0.00	0.00	0
Permanent TSB Group Holdings Plc	2.67	2.59	2.67	2.59	100.00	100.00	0
The Governor and Co. of the Bank of Ireland	7.88	9.18	4.21	4.92	53.44	53.59	15
Italy							
BPER Banca SpA	NA	6.46	NA	5.55	NA	85.82	NA
Banca Popolare di Sondrio	6.75	10.21	5.92	8.39	87.61	82.17	-544
Credito Emiliano Holding SpA	4.78	3.58	3.13	2.34	65.33	65.35	2
Intesa Sanpaolo SpA	75.09	76.00	38.71	38.67	51.55	50.88	-67
Mediobanca - Banca di Credito Finanziario SpA	8.27	7.59	5.81	4.65	70.26	61.25	-901
UniCredit SpA	138.21	127.77	61.76	59.17	44.69	46.31	162
Portugal							
Banco Comercial Português SA	7.73	9.90	4.12	5.09	53.31	51.42	-189
Caixa Central de Crédito Agrícola Mútuo CRL	4.67	5.44	2.23	2.88	47.83	52.85	502
Caixa Geral de Depósitos SA	14.05	17.60	9.48	11.80	67.48	67.06	-42
Novo Banco	4.80	4.92	2.27	3.00	47.25	60.92	1,367
Spain							
Banco Bilbao Vizcaya Argentaria SA	83.25	80.25	30.82	28.03	37.02	34.93	-209
Banco de Sabadell SA	22.88	26.37	10.08	9.44	44.06	35.79	-827
Banco Santander SA	128.22	145.17	36.24	48.46	28.26	33.38	512

Data compiled Dec. 6, 2017.

Sample consists of banks with headquarters in the European periphery that participated in the EBA's transparency exercise and reported country level sovereign exposure breakdown.

NA = not available

Sources: S&P Global Market Intelligence; European Banking Authority

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further toward tackling the underlying problem of the great differences between the fiscal positions and creditworthiness of different eurozone states, so a bulked-up ESM will be necessary to cope with the fallout if markets again turn on the bloc's weaker links.

But countries in the eurozone's periphery lobbied hard against such changes, and the Basel Committee on Banking Supervision seems to have shunted the issue into the too-hard basket for now. When it announced a landmark deal Dec. 7, completing the post-crisis Basel III framework with new rules limiting the use of internal risk modeling, the issue of sovereign risk on bank balance sheets was postponed indefinitely.

Days later, European leaders agreed to work toward completion of banking union and to turn their permanent bailout fund, the European Stability Mechanism, into a European version of the IMF. This latter move, they calculate, will mean that if the doom loop does strike again, markets will not doubt their capacity to respond quickly, as well as to force losses on private bondholders.

Other, more ambitious proposals, including the creation of a joint eurozone finance ministry, ran into opposition from Northern European states and were rejected, as the idea of issuing joint eurozone debt had been previously. These would have gone some way

Aggregate domestic sovereign debt holdings

EBA 2017 EU-wide transparency exercise

Headquarters	Total sovereign exposures* (€B)	Domestic sovereign debt holdings (€B)		Domestic sovereign debt holdings/ total sovereign debt holdings (%)		
	H1'17	2016	H1'17	2016	H1'17	H1'17 vs. 2016 (bps)
Austria	55.54	9.89	8.84	23.55	21.90	-165
Belgium	175.75	24.01	20.30	21.47	19.17	-230
Bulgaria	0.40	0.21	0.20	50.17	50.99	82
Cyprus	1.76	0.90	1.16	60.68	69.77	909
Denmark	31.16	1.77	2.10	9.32	9.82	50
Estonia	0.03	0.00	0.00	0.00	0.00	NA
Finland	16.29	1.45	1.45	20.91	24.47	356
France	728.78	110.66	124.57	28.71	28.73	2
Germany	475.99	108.13	97.91	36.43	35.03	-140
Greece	44.06	11.73	12.28	25.10	32.92	782
Hungary	10.70	7.07	7.91	87.52	79.65	-787
Ireland	33.63	15.49	15.92	49.75	51.43	168
Italy	266.13	115.33	113.22	49.47	50.29	82
Latvia	0.86	0.24	0.20	22.71	22.91	20
Luxembourg	7.40	0.49	0.42	6.38	6.11	-27
Malta	1.66	0.70	0.78	43.21	48.00	479
Netherlands	189.10	38.97	34.61	26.23	25.14	-109
Norway	7.40	5.10	3.93	71.24	67.52	-372
Portugal	43.67	18.11	22.77	57.93	60.13	220
Slovenia	4.77	2.66	2.21	63.36	55.15	-821
Spain	329.52	77.14	85.93	32.92	34.13	121
Sweden	70.85	8.26	11.58	21.15	26.10	495
U.K.	559.48	144.63	125.08	25.80	23.75	-205

Data compiled Dec. 6, 2017.

Aggregates represent exposures of banks headquartered in respective countries that participated in the European Banking Authority's 2017 transparency exercise and reported data for both periods. Excludes banks that did not report detailed country level sovereign exposure breakdown.

* Represents the gross carrying amounts of sovereign loans and advances and sovereign debt holdings.

NA = not available

Sources: S&P Global Market Intelligence; European Banking Authority

This is especially so given that peripheral banks' addiction to their own countries' debt shows little sign of disappearing. Lenders in Greece, Ireland, Italy, Spain, Portugal and Cyprus all increased the concentration of local bonds within their total sovereign holdings in the first half of 2017. More than 60% of Portuguese banks' bonds were issued by their own government, while the equivalent proportion was almost 70% for Cyprus and about 50% for both Italy and Ireland, data compiled by S&P Global Market Intelligence shows.

Post-crisis monetary policy, which has provided the financial system with access to very cheap central bank funds, has also encouraged many banks to stock up on bonds, as they make an immediate profit on the yield with very little risk and no cost in capital. The bond carry trade helped frustrate European Central Bank efforts to persuade banks to lend to the real economy, although lending is now picking up.

Such behavior by banks is likely to continue for so long as wealthier eurozone nations maintain their reluctance to pool risk with the periphery, said Marcello Minenna, head of quantitative analysis at Italian finance regulator Consob, pointing to Germany's opposition to a joint eurozone bank deposit guarantee, as well as its refusal to countenance joint eurozone bonds.

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Domestic sovereign exposures at select European banks

EBA 2017 EU-wide transparency exercise

Company	Headquarters	Total sovereign exposures* (€B)		Domestic sovereign exposures* (€B)		Domestic sovereign exposures/total sovereign exposures (%)		
		2016	H1'17	2016	H1'17	2016	H1'17	H1'17 vs. 2016 (bps)
HSBC Holdings Plc	U.K.	299.98	257.44	36.23	21.61	12.08	8.40	-368
BNP Paribas SA	France	217.16	222.06	45.50	46.34	20.95	20.87	-8
Groupe BPCE	France	184.94	189.51	151.82	152.67	82.09	80.56	-153
Banco Santander SA	Spain	159.15	179.62	50.36	66.35	31.64	36.94	530
UniCredit SpA	Italy	160.93	151.38	66.98	65.76	41.62	43.44	182
Groupe Cr�dit Agricole	France	125.24	128.74	80.86	79.47	64.57	61.73	-284
Banco Bilbao Vizcaya Argentaria SA	Spain	118.07	114.37	51.53	48.40	43.64	42.32	-132
Deutsche Bank AG	Germany	113.30	113.25	19.87	18.01	17.53	15.91	-162
La Banque Postale^	France	106.24	104.36	NA	NA	>90	>90	NA
Soci�t� G�n�rale SA	France	51.55	93.14	14.75	26.73	28.61	28.69	8
Intesa Sanpaolo SpA	Italy	92.72	92.38	53.81	52.63	58.04	56.96	-108
Barclays Plc	U.K.	90.95	89.96	32.64	27.74	35.89	30.83	-506
The Royal Bank of Scotland Group Plc	U.K.	76.74	86.86	25.19	30.54	32.83	35.16	233
Dexia NV	Belgium	84.89	78.59	1.19	1.14	1.40	1.45	5
ING Groep NV	Netherlands	80.33	77.15	12.61	12.15	15.70	15.75	5
Lloyds Banking Group Plc	U.K.	72.32	67.07	62.43	57.72	86.33	86.06	-27
Standard Chartered Plc	U.K.	56.75	58.15	2.20	0.48	3.87	0.82	-305
SFIL (Soci�t� de Financement Local)	France	58.12	57.87	48.09	48.64	82.75	84.05	130
Commerzbank AG	Germany	65.12	57.11	22.07	17.93	33.89	31.39	-250
Deutsche Zentral-Genossenschaftsbank AG	Germany	60.39	55.54	46.01	42.65	76.19	76.79	60
NRW Bank	Germany	59.31	52.90	41.28	37.21	69.59	70.32	73
KBC Group NV	Belgium	49.65	48.78	20.38	18.14	41.05	37.19	-386
Bayerische Landesbank	Germany	42.65	42.10	33.98	34.53	79.66	82.02	236
NV Bank Nederlandse Gemeenten	Netherlands	42.83	41.30	35.01	33.64	81.74	81.45	-29
Erste Group Bank AG	Austria	39.53	37.93	10.34	9.59	26.14	25.30	-84
ABN AMRO Group NV	Netherlands	37.95	37.86	8.08	8.49	21.28	22.42	114
Criteria Caixa SAU^	Spain	34.83	37.85	NA	NA	>90	>90	NA
Cr�dit Mutuel Group	France	34.75	36.64	23.04	23.37	66.28	63.80	-248
Banco de Sabadell SA	Spain	32.63	35.52	19.69	18.55	60.33	52.22	-811
BFA Tenedora de Acciones SAU^	Spain	37.78	34.69	NA	NA	>90	>90	NA
Norddeutsche Landesbank Girozentrale	Germany	39.43	34.19	31.03	27.03	78.70	79.06	36
Nordea Bank	Sweden	28.14	31.45	4.74	5.74	16.86	18.25	139
Belfius Banque SA	Belgium	31.13	31.23	25.26	25.63	81.15	82.07	92
Banco BPM SpA^~	Italy	NA	30.21	NA	NA	NA	>90	NA
Danske Bank	Denmark	29.13	29.30	5.37	5.63	18.42	19.23	81
Landesbank Hessen-Th�ringen Girozentrale	Germany	29.76	28.59	27.39	25.72	92.05	89.97	-208
Co�peratieve Rabobank UA	Netherlands	32.30	27.84	20.95	17.72	64.88	63.64	-124
Landesbank Baden-W�rttemberg	Germany	30.65	25.03	23.68	20.94	77.25	83.68	643
Banca Monte dei Paschi di Siena SpA^	Italy	22.75	21.70	NA	NA	>90	>90	NA
Caixa Geral de Dep�sitos SA	Portugal	17.78	21.05	11.99	14.05	67.42	66.76	-66
Deutsche Pfandbriefbank AG	Germany	20.13	19.09	6.52	5.60	32.40	29.32	-308
Raiffeisen Bank International AG~	Austria	NA	17.38	NA	2.61	NA	15.02	NA
Kommuninvest	Sweden	13.93	16.55	13.43	16.13	96.46	97.48	102
National Bank of Greece SA	Greece	19.16	15.47	9.56	9.25	49.88	59.79	991
Unione di Banche Italiane SCpA^	Italy	16.45	15.11	NA	NA	>90	>90	NA
Unicaja Banco SA^	Spain	15.69	14.48	NA	NA	>90	>90	NA
Bpifrance (Banque Publique d'Investissement)^	France	13.80	14.47	NA	NA	>90	>90	NA
Allied Irish Banks Plc	Ireland	13.87	12.42	8.82	8.60	63.59	69.25	566
Skandinaviska Enskilda Banken	Sweden	10.83	12.19	1.95	3.24	18.01	26.59	858
HSH Beteiligungs Management GmbH	Germany	13.55	11.94	11.34	10.30	83.64	86.26	262

Data compiled Dec. 6, 2017.

Sample consists of the 50 largest banks by total sovereign exposures as of June 30, 2017, that participated in the European Banking Authority's transparency exercise.

"Since 2011 the trend has been towards risk

segregation ... the EU had taken a series of measures that pushed members to nationalize risks. This is not the best way to reinforce the eurozone. Hedge funds no longer bet on convergence of spread, they bet on divergence and wait for extraordinary interventions [i.e. bailouts],"

Minenna said. "It will eventually lead to the breakup of the eurozone." Minenna thinks the ESM should be recast as a treasury with powers to invest, buy securities and collect payments from national governments in exchange for guaranteeing as much as 70% of national debt in the bloc, at a price decided by the market. This credit default swap-type

* Represents the gross carrying amounts of sovereign loans and advances and sovereign debt holdings.

^ The domestic exposures were assumed to be over 90% of the total sovereign exposures, based on EBA's proposed reporting requirement, since the bank did not report detailed country level breakdown of sovereign exposures.

~ Data for 2016 was not reported.

NA = not available

Sources: S&P Global Market Intelligence; European Banking Authority

mechanism would cause yields across the eurozone to converge, he argued, adding that all main

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political parties in Italy are considering adopting his idea as policy.

But, despite a call for a United States of Europe by Germany's Social Democrats — now engaged in coalition talks with Angela Merkel's Christian Democratic Union — any such sweeping schemes are unlikely soon, said Agnieszka Smoleńska, a research associate at the Florence School of Banking and Finance.

"I would say there is little appetite for this kind of grand scheme solution," she said, although she added that some sort of centralized EU fiscal power is a matter of time.

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