Financials. Sovereign debt

Rome woes heighten fears on Europe 'doom loop'

Italian lenders are vulnerable, but so are a number of other eurozone banks and insurers

MARTIN ARNOLD AND JUDITH EVANS

A clear lesson from last week's sharp sell-off in Italian bond markets: the "doom loop" that creates a direct link between eurozone countries and their banking systems is still a powerful force.

Within hours of Sergio Mattarella, the president, causing political palpitations in Rome by blocking the appointment of a Eurosceptic economy minister, investors were scurrying to check which banks were most exposed to Italian sovereign bonds. On Friday, Mr Mattarella approved a government, after the Five Star movement and the League proposed a slate that included a different economy minister.

The reaction was based on experience. Investors have been burnt before, most recently when Greece flirted with leaving the eurozone in 2015, hobbling its own banking system and inflicting losses on the many foreign banks holding Greek sovereign debt.

"The doom loop still exists," said Filippo Alloatti, a senior credit analyst at Hermes Investment Management. "The longer there is volatility and a widening of Italian bond market spreads, the more likely there will be a mark-to-market impact on banks. It is almost a given."

The idea that Italy could vote in a referendum to leave the eurozone and bring back the lira still sounds far-fetched to most investors. But the faintest chance of such an outcome for anyone holding Italian sovereign bonds was enough to prompt Moody's to put the ratings of 12 Italian banks on review for downgrade last week.

> The fear of contagion is fed by memories of the Lehman bankruptcy and Greek debt crisis

The country has one of the highest debt levels, at more than 130 per cent of GDP. Its banks are heavily exposed, with Italian sovereign bonds accounting for almost 10 per cent of assets at the country's lenders at the end of last year, according to the Bank of Italy. This is a higher proportion than most other European countries, even though it has come down as Italy's big banks have started to diversify bond portfolios.

It follows that Italy's biggest lenders have the highest exposure to the country's sovereign debt: Intesa Sanpaolo had €76bn at the end of 2017, and UniCredit had €54.5bn. In both cases, their exposure exceeded the size of their capital buffers. Banca Monte dei Paschi di Siena's exposure to its government made up more than 90 per cent of the €21.7bn of sovereign debt held by the bailed-out bank at the end of June 2017, according to the European Banking Authority. This explains why shares in Italy's three biggest banks have all fallen by about a fifth in the past fortnight.

However, the potential impact is wider than the Italian banks. Spanish, Belgian, German and French lenders are also exposed to Italian sovereign debt. Belgium's Dexia had €22bn of such exposure at the end of last year, reflecting the state-owned bank's legacy business of public sector finance. Germany's Commerzbank had €9bn. In Spain, Banco Sabadell had €10.5bn in June 2017, while BBVA had €9.6bn and Banco Santander €8.8bn. France's BNP Paribas had €9.8bn of Italian sovereign debt at the end of last year, a legacy of its acquisition of Italy's BNL more than a decade ago. Its French rivals BPCE and Crédit Agricole, which have both invested in Italy, had €8.5bn and €7.6bn of exposure respectively.

European insurers are also on the hook. Italy's Generali has by far the most exposure to Italian government bonds, according to Citi: shareholder exposure is 92 per cent of tangible book value, compared with between 10 and 13 per cent for Axa, Allianz and Zurich, while Prudential has no exposure.

Despite the extent of Generali's holdings, a report from Moody's said the group "has been improving its resilience to a hypothetical scenario of stress on Italian assets in recent years", in part by diversifying outside Italy. Moody's noted, however, that Allianz's Italian division held about 35 per cent of its investment portfolio in Italian sovereigns, placing the division under review for a potential downgrade. It underlines how last week's sell-off in bank shares was a Europe-wide phenomenon. Equally, the cost of insuring against default by European banks shot up, as the iTraxx senior financials index produced by Markit rose more than 50 per cent to its highest for more than a year.

The fear of contagion is fed by memories of how the Lehman bankruptcy and Greek debt crisis exposed deep links between banks, which fund each other via the interbank wholesale loan market as well as "repo" funding, credit default swaps and derivatives.

There are other ways the Italian bond shock has hurt the wider bank sector. As well as increasing funding costs for banks, it has thrown cold water on hopes that the ECB might soon raise rates from negative levels, which has been squeezing bank profit margins.

Italian banks will benefit in the short term from higher yields on sovereign bonds, in which they invest much of their cash from depositors. But the political crisis is mostly negative for the banks, particularly as it is likely to stymie the progress they have been making in selling non-performing loans.

> It has thrown cold water on hopes that the ECB might soon raise rates from negative levels

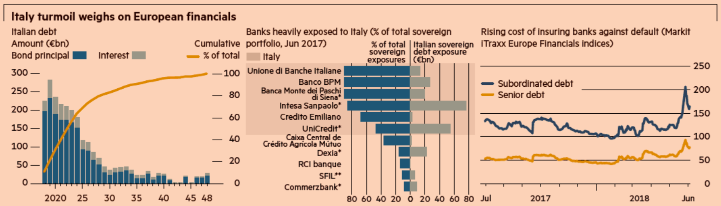
It costs almost €1.40 to insure €100 of five-year senior bonds from UniCredit and Intesa against default — more than double a month ago. To put this in context, it is a fraction of the €10-plus cost of insuring €100 of UniCredit senior debt when the last eurozone crisis peaked in late 2011. While investors are worried, they are yet to reach the level of panic seen in June 2012 when Mario Draghi, ECB head, promised to do "whatever it takes to preserve the euro".

Bankers across Europe will be hoping his resolve is not seriously tested again.

Feeling exposed

Monte dei Paschi's exposure to Italy's government made up more than 90% of the €21.7bn of sovereign debt it held at the end of June 2017 — Alessia Pierdomenico/Bloomberg

Italy turmoil weighs on European financials



Sources: Bloomberg; EBA; Markit iTraxx * Q4 2017 ** Société de Financement Local

10% Rome bonds as a proportion of assets at Italian banks	**€76bn** Exposure to Italian sovereign debt at Intesa Sanpaolo

Technology

Alibaba and Tencent flex muscle by ordering their bankers to pick sides

LOUISE LUCAS AND DON WEINLAND
HONG KONG

Tencent and Alibaba's rivalry has extended into investment banking, with China's dominant tech pair demanding that bankers working for them avoid doing so for their rival.

This had in effect split investment banks into two camps, said several people with knowledge of the matter, highlighting the companies' clout in virtually every sphere of China's economy, as well as their prolific dealmaking.

Ant Financial, the Alibaba payments affiliate that is closing a $10bn funding round, made a number of banks sign "very restrictive non-compete" agreements preventing them from working for Tencent entities, said one banker.

"This isn't unprecedented in the US," he said. "In the US you bank Coke, you cannot bank Pepsi. That was always the way of the world. But companies need to be prolific in paying fees — when you've got small IPOs not wanting you to do business, it gets more problematic."

Alibaba declined to comment.

Another person close to the issue said the tech groups "value loyalty" and did not want to hire bankers who were "going to be a service provider to competitors that will work against you when you do [a request for proposal] for the next deal".

He added that there were also issues of confidentiality. Both companies are dominant participants in areas spanning ecommerce, the cloud and payments, giving rise to possible conflicts of interest should a third party working for both see data and strategy details.

Tencent and Alibaba have large teams of in-house bankers, many from Goldman Sachs, whose alumni also furnish top management, which restricts the business meted out to external banks. Fees on IPOs have also dropped sharply.

The two have backed a large proportion of China's billion-dollar privately held "unicorns" and are behind most of the country's big forthcoming listings.

Banks have been made to sign 'very restrictive non-compete' agreements

Tencent is behind Tencent Music Entertainment, which is being spun out in an IPO later this year, as well as Meituan-Dianping, the food delivery company that is also shooting to list this year. Tencent did not immediately respond to a request for comment.

Meanwhile, Alibaba is behind Ant, valued at $150bn and expected to list next year. Didi Chuxing, the ride-hailing app that bested Uber in China, is unusually backed by both Alibaba and Tencent, the result of a merger between two competing apps in 2015.

While Goldman worked on Alibaba's IPO in 2014, it was not involved in the Ant fundraising, said a person close to the deal. Goldman did not comment.

Alibaba has been the driving force in creating the division among global banks, said a person who has worked on deals for the company. In the months before its September 2014 IPO, it requested its banks sign a strict engagement letter that specified its bankers would not work on JD.com or Tencent deals without its consent. The agreement lasted until the end of 2015.

The conditions were relaxed when the agreement lapsed but the guidelines have persisted, especially when it comes to JD.com transactions because of its direct competition in ecommerce with Alibaba, the person said.

"There's no hard agreement now but there tends to be an Ali camp vs a Tencent camp," the person said.