

European Rates Watch

Have French banks turned off the taps?

Italian banks' net cross border bank borrowing stabilised...

In our [Year-Ahead](#), we showed that banks in Italy have accumulated enough reserves by July 2023 to fully repay their TLTROs when they come due. This was probably achieved by increased cross border borrowing from banks in France. We update the data and find that net cross border bank borrowing by banks in Italy stabilised since August 2023 (Exhibit 1).

... yet their reserves continued to grow...

Yet reserve holdings by banks in Italy continued to grow. Since August 2023, excess liquidity net of TLTROs of banks in Italy increased by c. €35bn (Exhibit 2). Such desire to hold more reserves does not come as a surprise to us, as banks in Italy, like all banks in the euro area, will want a certain amount of reserves for HQLA purposes.

... supported by asset sales and debt issuance...

What we would stress is that the reserve build-up by banks in Italy occurred while excess liquidity in the euro area continued to fall. Changes in the balance sheet of banks in Italy suggest their reserve growth since August 2023 may have been supported by 1) asset sales, including c. €15bn of government bonds and 2) debt issuance of c. € 13bn (Exhibit 3). Asset sales and debt issuance that supported the reserve growth for the Italian banking system must have been on a cross-border basis. TARGET2 data show that most net TARGET2 outflows came from France and the Netherlands, suggesting that residents in these two countries could have been end-buyers, but we stress other drivers including intra-euro area trade flows may have meaningful influence on TARGET2 flows (Exhibit 4). An increase in the "remaining liabilities" component may have also played a role in reserve growth of banks in Italy, but what that specifically entails is less clear as it is a catchall component.

... we stay positioned for growing euro funding pressures

Our concern with respect to euro funding pressures is when banks in cash-rich markets stop lending to banks in cash-scarce markets. We envision regulatory requirements, such as the LCR, would prompt even banks in cash-rich countries to hold back cross border lending. The stabilisation of net cross border bank borrowing by banks in Italy could be an early signal of growing reluctance among euro area banks to lend reserves. In our view, ongoing QT and TLTRO maturities in 2024, which will reduce reserves in the euro area banking system, will strengthen such reluctance (Exhibit 5). But the impact on Euribor fixings may only be evident when large euro area banks need to pay up meaningfully for funding: the Euribor panel comprise 19 large banks (Exhibit 6). We stay positioned for growing euro funding pressures via [ERM4-ERU4 vs €str steepeners](#) (current: 1.4bp, target: 5.5bp, stop: -1.6bp). Risk is a very large short-term shock that causes the Euribor futures-€str spread curve to invert.

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For a list of our open trades and trades closed over the last 12 months, please see [Global Rates Weekly](#)

€str: euro short-term rate

Euribor: euro interbank offered rate

HQLA: high quality liquid assets

LCR: liquidity coverage ratio

TLTRO: targeted longer-term refinancing operations

TARGET: trans-European automated real-time gross settlement express transfer system

QT: quantitative tightening

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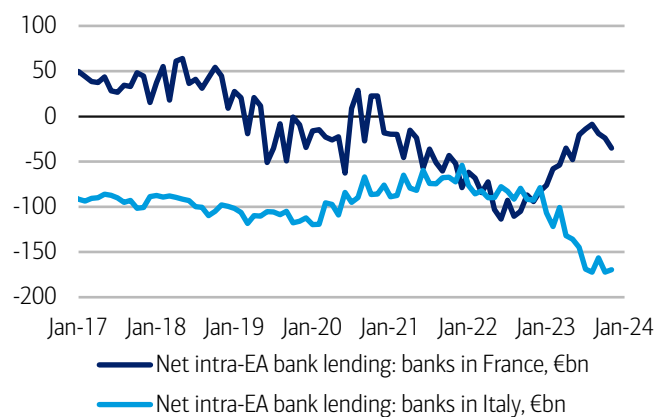
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Timestamp: 23 January 2024 12:00AM EST

Exhibit 1: Net cross border bank lending

Net cross border bank borrowing by banks in Italy have stabilised recently

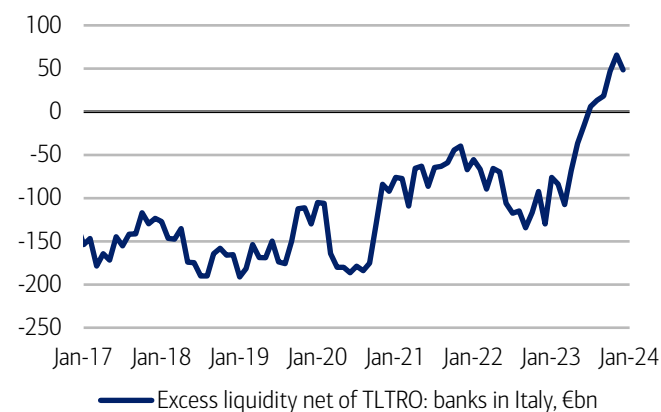


Source: BofA Global Research, ECB

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Exhibit 2: Excess liquidity net of TLTROs for banks in Italy

Banks in Italy increased reserves despite stabilised cross border borrowing

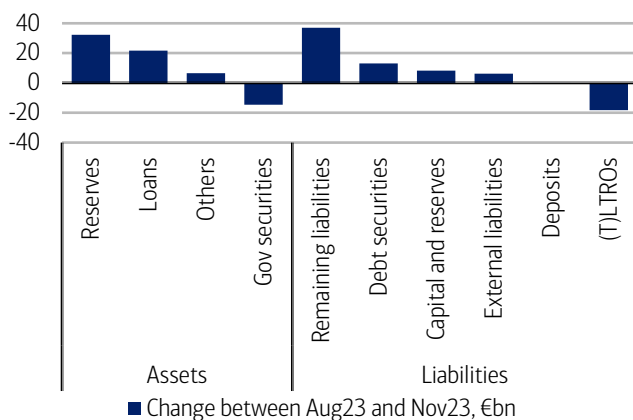


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Exhibit 3: Balance sheet change for banks in Italy

Recent reserve growth may be partly supported by gov sec. sales and debt

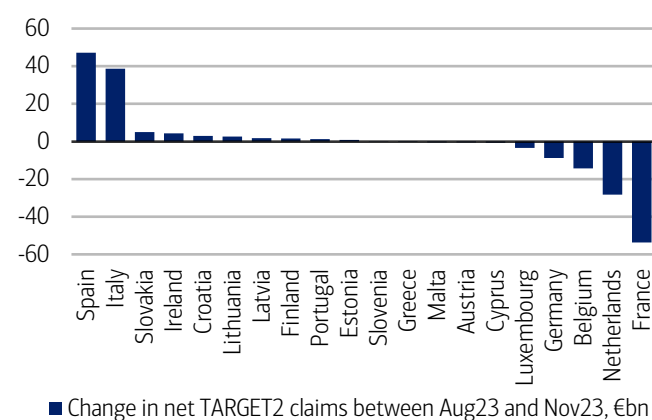


Source: BofA Global Research, ECB

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Exhibit 4: Net TARGET2 claims change

Net TARGET2 claims in France and Netherlands decreased most since Aug23

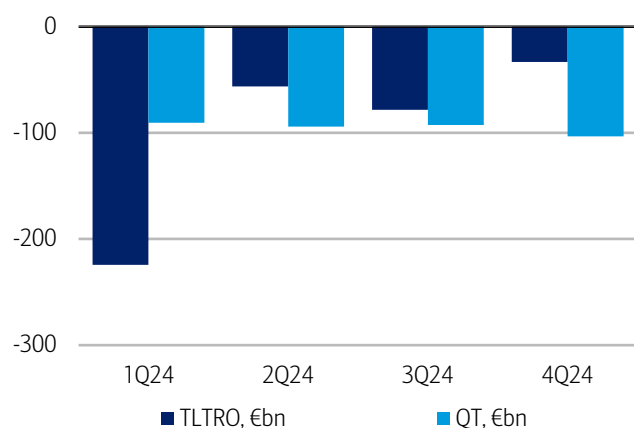


Source: BofA Global Research, ECB

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Exhibit 5: TLTRO and QT expectations

TLTRO maturity and QT to reduce reserves in euro area further in 2024

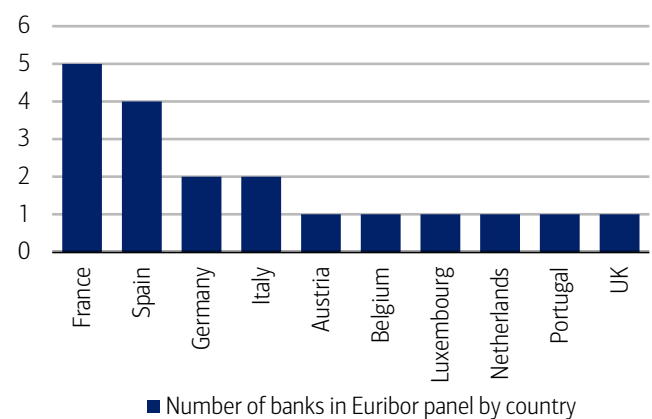


Source: BofA Global Research

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Exhibit 6: Number of Euribor panel banks by country

There are 19 panel banks in total for the Euribor fixing



Source: EMMI

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