

## Eurozone Watch

By Jocelyn Paquet

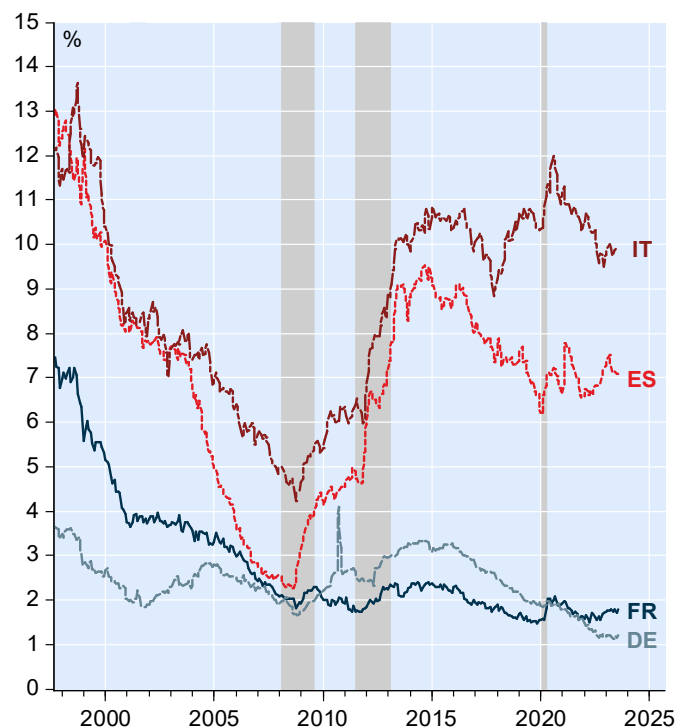
The past few weeks have seen one of the most violent recalibrations of the global bond market in recent years, with long-term interest rates reaching their highest levels since the mid-2000s in many jurisdictions. Apart from the economic implications of this repricing – which will certainly be significant given the sensitivity of economic activity to rising long-term rates – many are also beginning to question the capacity of the financial system to absorb such large losses in the bond market. The last breakout in yields did, after all, result in the bankruptcy of several U.S. regional banks, raising fears of a similar scenario this time around. Fortunately, U.S. banks can still count on help from the Fed, whose subsidized lending program (Bank Term Funding Program) will continue to limit losses in financial institutions' bond portfolios. European banks are not so fortunate, and therefore appear more at risk in the current environment. Italian institutions seem particularly vulnerable, given their exposure to domestic sovereign debt. As today's Hot Chart shows, bonds issued by the Italian government account for around 10% of the total assets of the country's chartered banks, a much higher percentage than in Germany or France. Given the substantial decline in the value of these securities – around 22% across the entire universe – it goes without saying that Italian banks have seen their unrealized losses increase in recent times. This doesn't mean that a banking crisis is just around the corner, but at the very least, the situation is likely to make banks much more cautious when it comes to lending practices, and this will have the effect of slowing growth further. Already, data published for the eurozone as a whole show a stagnation in lending to households and businesses. We don't expect the situation to improve much over the next few months, and therefore maintain our forecast that the eurozone will enter recession at the turn of 2024.

### Eurozone: Italian banks exposed to rising interest rates

Ishares Italy government bonds ETF



Domestic sovereign debt as percentage of total assets held by banks



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