

Cross-border lending falls sharply

By Claire Jones in London

The intensification of the eurozone crisis in the second quarter of this year led to the second sharpest retrenchment in lending between international banks since early 2009, according to Bank for International Settlements data.

Cross-border lending slumped this spring as a worsening of economic and financial conditions in the euro area sparked a fall in activity in the interbank markets, where banks lend to one another, data in the BIS's latest quarterly bulletin, out yesterday, showed.

The data highlight the degree to which a worsening in the financial and economic health of Spain and Italy exacerbated fears among US lenders about the health of their European counterparts.

The pullback in interbank markets came mostly at the hands of banks in the US, who reined in lending to their German, Spanish and Dutch counterparts,

through both their US and UK operations.

"The sharp decline in cross-border claims in advanced economies was mainly the result of reduced inter-office positions, which contracted by the largest amount on record," the BIS said.

"Inter-office positions vis à vis banks headquartered in the United States and the euro area accounted for the major part of this fall."

The amount of interbank lending done in dollars fell by the sharpest amount since the fourth quarter of 2008, when Lehman Brothers, then the world's fifth largest investment bank, collapsed.

Cross-border claims fell by \$575bn – 1.9 per cent of the total amount – between the end of March and the end of June as interbank lending dried up. Cross-border interbank claims plunged by \$581bn, or 3.1 per cent of total interbank lending.

The BIS data also highlight that banks with headquarters in the euro area

cut their exposure to the government debt of peripheral sovereigns.

At the same time, banks in the currency bloc and beyond increased their exposure to German and French government debt.

The cost of borrowing for the Italian and Spanish governments rose sharply over the course of the spring as concerns grew that the eurozone's third- and fourth-largest economies would require bailouts.

Since then, the European Central Bank has promised to buy sovereign debt in potentially unlimited amounts in exchange for commitments from governments to go ahead with structural reforms to their economies. Yields on Span-

ish and Italian debt have fallen since Mario Draghi, ECB president, pledged to do "whatever it takes" to counter perceptions of a break-up of the currency bloc at the end of July.

However, Stephen Cecchetti, head of the monetary and economic department of the BIS, warned against complacency on the part of governments and markets following the actions of several large central banks in recent months.

Mr Cecchetti said on Friday: "The stimulus policy makers provide in the form of further balance sheet expansion surely has its limits. And, without structural adjustment, economies will not return to strong, sustainable and balanced growth paths. The time that the temporary relief central banks provide must be used wisely."

The retrenchment in cross-border lending followed a modest rise in cross-border claims in the first three months of 2012.

A worsening in the financial health of Spain and Italy exacerbated fears among US lenders

