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EUROPEAN BANKS THAT ARE CUTTING BOND HOLDINGS THREATEN TO WORSEN CRISIS

While leading European lenders in a government-debt flight that threatens to exacerbate the region's crisis, BNP Paribas SA and Commerzbank (CBK) are unloading sovereign bonds at a loss. BNP Paribas, which is actually France's biggest bank, booked a big loss of 812 million euros (roughly around $1 billion) in the past four months from reducing its holdings of European sovereign debt, while the Commerzbank took losses as it cut all its Greek, Irish, Italian, Portuguese and Spanish bonds by 22 percent to 13 billion euros this year. As investors punish companies with large holdings and regulators demand higher reserves to shoulder possible losses, banks are selling debt of southern European nations. ''European regulators and leaders are shooting themselves in the foot because a big investor group for sovereign bonds has been taken out of the market,'' says Otto Dichtl, who is a London-based credit analyst for financial companies at Knight Capital Europe Ltd. ''The downward spiral will continue until policy makers find a back-up solution for the sovereigns.'' According to the most recent data from the Bank for International Settlements, European banks cut their foreign lending to the Greek public sector to $37 billion as of June 30 from $52 billion at the end of 2010. According to Basel, Switzerland-based BIS, European banks' lending to the Irish, Portuguese and Spanish public sectors also fell. As well as letting bonds mature, financial companies can reduce risk through write-downs, sales and hedges. Barclays Pic (BARC), who is the U.K.'s second-largest bank by assets, said on Oct. 31 that is cut their sovereign-debt holdings of Spain, Italy, Portugal, Ireland and Greece by at least 31 percent in the past three months. The Royal Bank of Scotland Group Pic (RBS), who is Britain's biggest state-controlled bank, said on Nov. 4 that it reduced central- and local-government debt of those countries to 1.1 billion pounds (which is roughly around $1.8 billion) from 4.6 billion pounds at year-end. Greek bonds have dropped a full 42 percent since July, the most among the 26 sovereign-debt markets tracked by Bloomberg/European Federation of Financial Analysts Societies indexes. The indexes shows that Italian debt declined 8 percent and Portuguese securities 5 percent. Yesterday Italian benchmark yields climbed to a euro-era record on concern that the region's third-largest economy will struggle to manage its debt as growth stagnates. To help tackle the debt crisis, European leaders are demanding that banks raise capital to increase their resilience after firms represented by the Institutes of International Finance agreed last month to accept a 50 percent loss on Greek sovereign holdings. The policy makers have also recently announced their plans to help boost the region's rescue fund to $1 trillion euros. ''The recapitalization of European banks is also turning out to be a damp squib,'' according to a note from CreditSights Inc. on Nov. 6. ''This does nothing to fix the main problem of restoring sovereigns' risk-free status.''