Budget realities pressure South Africa to stop policy dithering

South Africa's government has spent months mostly talking about how to save the debt-stricken state power utility Eskom Holdings SOC Ltd, spur economic growth and get its shaky finances back on track. Financial realities may force an end to the dithering.

The government will have to make some decisions by October 30, when Finance Minister Tito Mboweni is due to deliver his mid-term budget policy statement and set out how massive bailouts for Eskom will be funded at a time when growth and tax revenue are falling short of target. That's two days before Moody's Investors Service is scheduled to make a call on the nation's only remaining investment-grade credit rating.

"We are really running out of time," Isaac Matshego, an economist at Nedbank Ltd, said by phone. "The number one priority for the government right now should be to stabilise the key state-owned enterprises, not only because they are failing operationally but also because they are a heavy burden

on the fiscus.”

President Cyril Ramaphosa’s ability to push through unpopular policies is constrained by his tenuous hold on the deeply divided ruling African National Congress and opposition from its labour union and communist allies, who oppose privatisation, fearing job losses. The slow pace of reform has frustrated investors, driven business confidence to the lowest level since 1985 and weighed on the rand — it’s slipped 23% against the dollar since Ramaphosa took office in February last year.

Progress has been particularly slow when it comes to fixing Eskom, which supplies about 95% of the nation’s power and is seen as the biggest risk to the economy. The utility has been without a permanent chief executive officer since Phakamani Hadebe quit in July, isn’t generating enough revenue to cover its costs and has been allocated 128bn rand ($8.4bn) in bailouts over three years to remain solvent.

The government signalled its intent to act decisively in August, as the Treasury asked departments to prepare budget proposals to cut their spending by an average 6% over the next three fiscal years — saving as much as 300bn rand. Eskom’s turnaround strategy is now due to be unveiled by the end of this month, as is its new CEO and the energy blueprint.

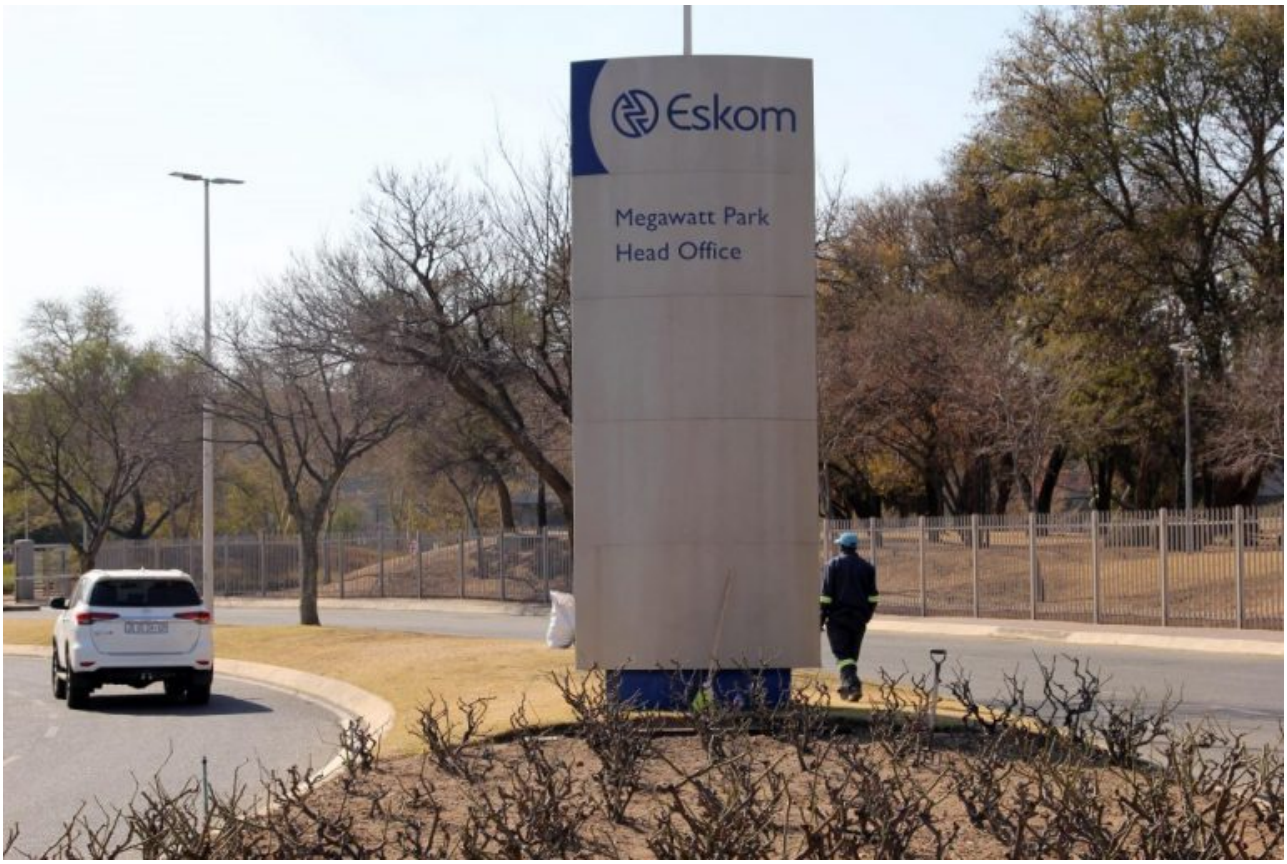
“Ramaphosa is now fully aware that he must be seen to be doing things and taking control and that the time for treading water is over,” Susan Booysen, director of research at the Mapungubwe Institute for Strategic Reflection, said by phone. “All those comments that he was a lame duck president and he was unable to control the factions in the ANC must have hit home.”

Even so, differences persist within the government and ruling party over how best to revive the economy.

While the Treasury suggested in August that Eskom could sell power plants to settle its 450bn rand of debt and that other assets be privatised, these proposals failed to win public endorsement from the ANC. The party has traditionally sought to build consensus among its widely divergent constituents,

which has all too often resulted in policy paralysis.
“The next steps will require political capital expenditure and that’s where things will get difficult,” said Peter Attard Montalto, head of capital markets research at research firm Intellidex. “Effecting major policy shifts will be both challenging and time-consuming.”

Eskom risk premium eases as Treasury off ers bailout conditions



Bloomberg/ Johannesburg

Credit default swaps for Eskom Holdings SOC Ltd, South Africa’s state-owned power company, are trading near the

cheapest level in almost three years relative to the sovereign risk after the Treasury published proposed conditions for funds to bail out the utility.

That suggests investors are comfortable a turnaround plan for the debt-ridden company, which President Cyril Ramaphosa says will be presented to cabinet shortly, will include a sustainable framework to deal with its $30bn of debt. The government has said it won't allow Eskom to fail or bondholders to take a haircut.

"It's about 10 years too late, but better than nothing," said Rashaad Tayob, a money manager at Abax Investments Ltd in Cape Town. "It's positive that there will be oversight on Eskom's capex, and a requirement that they must work to recover debtors in arrears. But nothing on energy and staff costs, so we must wait for the special paper/white paper to understand the long term plan to fix Eskom."

Eskom, which supplies about 95% of South Africa's electricity, has been granted 128bn rand of state bailouts over the next three years to help it remain solvent.

Amounts of 26bn rand and 33bn rand will be allocated in portions to Eskom in the 2020 and 2021 financial years on dates determined by the finance minister, the Treasury said in a presentation on its website Wednesday.

The conditions offered include that Eskom publish separate financial statements for its generation, distribution and transmission units. Treasury will also require daily liquidity position updates and for no incentive bonus payouts to be made to executives in the years where equity support is provided.

"The market is taking comfort from the fact that there is increased government oversight," said Bronwyn Blood, a fixed-interest portfolio manager at Granate Asset Management Ltd in Cape Town. "Conditions imposed on Eskom will ultimately allow for more certainty around repayment of debt, thus minimising the risk of default."

GLOBAL LNG-Asian prices hit three-week high; tanker rates rise

* CNOOC seeks to charter ships to replace COSCO-linked tankers

* Japan’s Tohoku buys November-delivery cargo – sources

* China’s LNG imports could slow due to terminal repairs

By Jessica Jaganathan

SINGAPORE, Oct 11 (Reuters) – Asian spot prices for liquefied natural gas (LNG) rose to a three-week high this week ahead of winter demand, while tanker rates nearly doubled on limited

availability of vessels.

Spot prices for November-delivery to Northeast Asia LNG-AS are estimated to be about $5.80 per million British thermal units (mmBtu), up by 25 cents from last week, said several sources who are market participants.

Prices for December delivery are estimated to be about $6.45 per mmBtu, they added.

Higher oil prices and shipping rates, which have nearly doubled in a week could boost spot LNG prices further, sources added.

LNG tanker rates rose after China National Offshore Oil and Gas Company (CNOOC) sought tankers to charter looking to replace ships it had previously hired that are linked to a Chinese company sanctioned by the United States for allegedly transporting Iranian oil, they added.

Several industry sources said CNOOC is seeking to replace some of six COSCO-linked LNG tankers – Dapeng Sun, Dapeng Moon, Dapeng Star, Min Rong, Min Lu and Shen Hai.

Still, apart from a few spot cargoes, demand from North Asia is yet to increase for winter, trade sources said.

In the spot cargo market, Japan's Tohoku Electric Power bought a cargo for November delivery from a trader at $5.80 per mmBtu, industry sources said, though this could not immediately be confirmed.

"Demand in Japan is low. I think it is only Tohoku who purchases spot cargoes constantly," a Japan-based trader said.

Essar Steel India is yet to award a tender seeking 12 cargoes for 2020 delivery, a company spokesman told Reuters.

China's LNG imports are expected to slow as repairs to the Rudong LNG import terminal is only likely to be done by mid-

November after an accident last month, two company sources said.

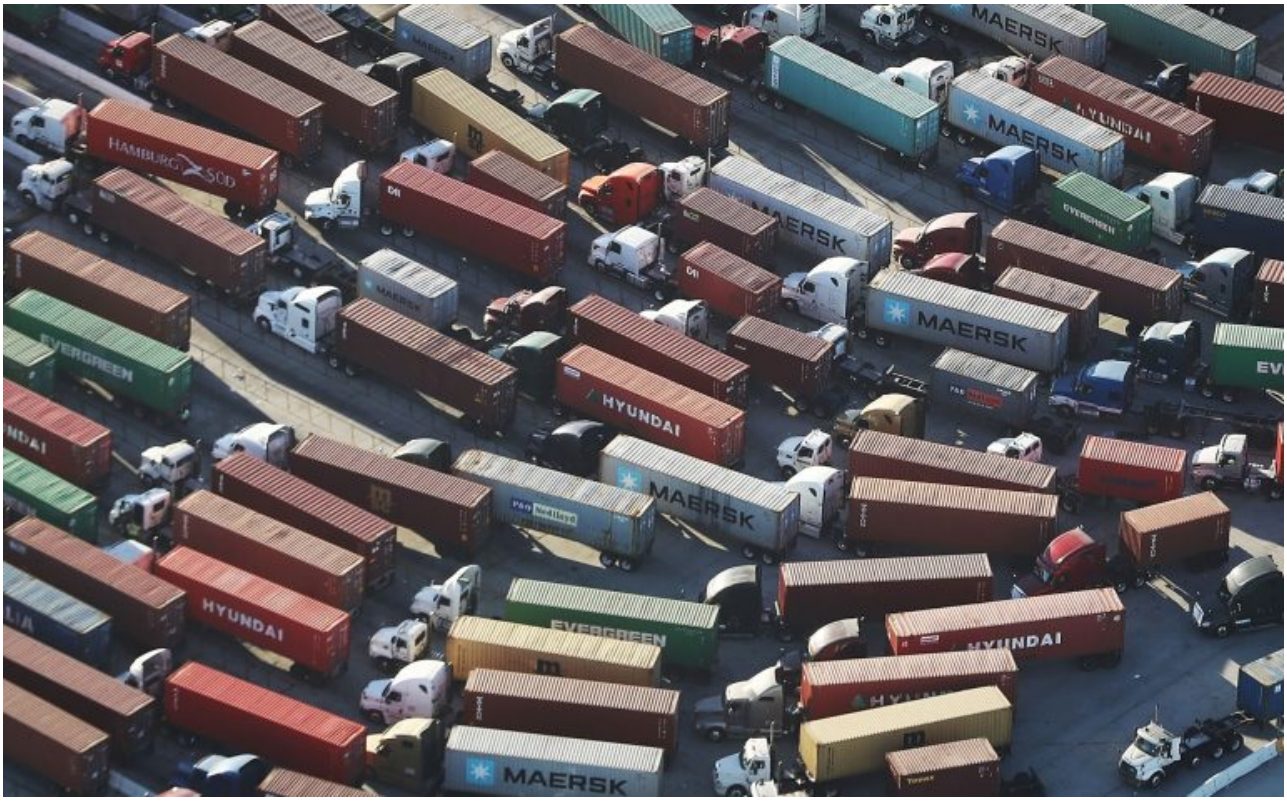
Kunlun Energy, which operates PetroChina's LNG receiving terminals, cut intake capacity at Rudong LNG terminal since Sept. 21 when a tanker collided into a bridge that connects the island where the terminal is located to the mainland during a typhoon.

PetroChina's trading unit Chinaoil is diverting some of the LNG meant for the Rudong terminal to its two other receiving terminals in Tangshan and Dalian, one of the company sources said. The company also offered spot cargoes earlier this week, traders said.

BHP Group has offered a cargo for loading in November from the North West Shelf plant in Australia while Angola LNG plant offered two cargoes for delivery in October and November.

Reporting by Jessica Jaganathan

Oil tanker rates spike is now bleeding into fuels trading



Record-high shipping costs are spilling over into the prices for refined fuels in Europe, Asia and the US. As freight rates rocket amid US sanctions and geopolitical risks, the prices of oil products such as gasoline and diesel are being forced to adapt in order to enable trade. Europe has long made excess gasoline, giving traders a lucrative opportunity to ship it to the US Now, the increase in tanker rates is hitting at a time when crude flows have also been disrupted by the same surge in shipping costs.

The cost of hauling freight on the route has soared to its highest since 2015, according to Baltic Exchange data. That helped make US gasoline the most expensive it’s been relative to Europe, on a seasonal basis, since 2016. “This is all because the explosion in dirty freight costs creates the risk that larger clean tankers switch to dirty service,” said Robert Campbell, head analyst for global oil products markets at Energy Aspects. Clean tankers refer to those carrying refined fuels; dirty tankers haul crude or fuel oil. The cost of shipping oil products such as diesel and jet fuel on a mid-sized tanker on the Middle East-to- northwest Europe route has surged as well. Earlier this week it reached $50 a tonne, the

highest since 2008. Rates from India to northwest Europe have also increased. While the seaborne trade of refined products is only about half that of crude oil, it’s still the market’s main way of balancing structural surpluses and shortages that routinely emerge in different parts of the world. As such, it performs a vital role in avoiding supply scarcity. The more expensive shipping gets, the higher a buyer has to bid and/ or the lower a seller has to offer in order to make the trade viable.

Since the spike in freight rates several weeks ago, the value of diesel relative to crude in Europe – a net diesel importer – has edged up to its high- est since 2018. Other factors, such as refinery maintenance and looming ship-fuel rules that are putting upward pressure on diesel prices, may also be playing into that number. At the same time, the price of diesel cargoes in the Middle East is generally falling, a trader said on Wednesday. Ripples are also being felt in the market for naphtha, a petroleum product used to make gasoline and as a feedstock for petrochemicals. Regularly shipped from Europe to East Asia, the cost of that voyage has surged to $3.97mn, the highest it’s been since at least 2016. How long the situation lasts is unclear.

The cost of hiring tankers that typically ship crude and fuel oil has retreated after spiking last week, with analysts saying the high costs weren’t sustainable. Rates initially rose in the wake of the US sanctioning units of China CO- SCO Shipping Corp, the world’s largest merchant vessel owner, as well as an attack on an Iranian ship. As shippers get their vessels ready for a sulphur ca- pon marine fuels, a number of tankers are also at repair yards, further tightening the freight market.

Opec faces serious 2020 challenge defending oil prices, says IEA

Opec faces a “serious challenge” if it wants to defend oil prices next year, as fuel-demand growth could slow further and rival supplies continue to grow, according to the International Energy Agency.

The IEA – which advises major economies – could lower its forecasts for demand growth again as the economic backdrop continues to weaken, Neil Atkinson, head of the agency’s oil industry and markets division, said in a Bloomberg television interview Wednesday. The agency lowered its projections in its monthly report last week.

At the same time, there is “a wave of new supply growth” from the US, Brazil and the North Sea, Atkinson said. As a result, it will be tough for the Organization of Petroleum Exporting Countries and its allies – who have cut production this year to prevent a surplus – to buoy prices in 2020, he said.

“There is a lot of supply coming into the market, and that suggests that the Opec countries and Russia, who is working

with them to manage the oil market, will face a serious challenge as we head into 2020 to keep prices at the level with which they feel comfortable," Atkinson said.

Brent crude futures traded below $59 a barrel in London on Wednesday, below the levels needed by most members of Opec to cover government spending.

The group and its partners will do "whatever it takes" to prevent another oil slump, Opec secretary-general, Mohammad Barkindo said in London last week.

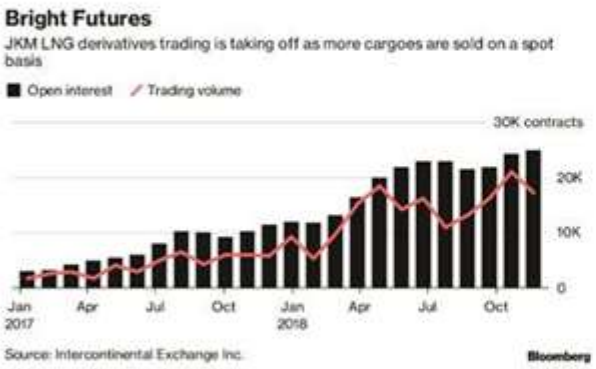
The IEA, which is based in Paris, trimmed its 2020 estimate for global oil-demand growth by 100,000 barrels a day to 1.2mn a day last week.

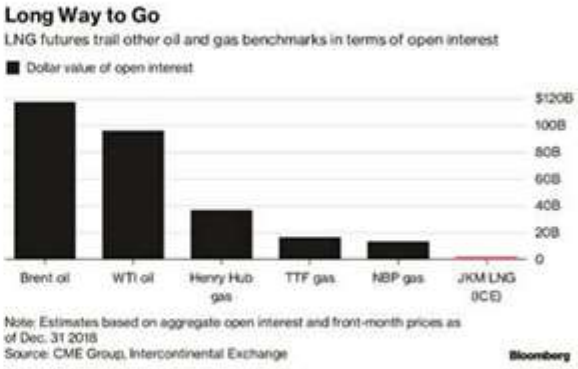
The IEA incorporates forecasts from the International Monetary Fund, which on Monday reduced its outlook for global economic growth next year to 3.4% from 3.5%. The IMF anticipates that this year's expansion will be the weakest in a decade.

"What the IMF numbers are doing is confirming a picture we have seen as 2019 has developed, and we are now looking at a possibility, no more than that, that the demand outlook could get weaker," Atkinson said.

Still, oil-demand data in recent months has been surprisingly strong, and so "the jury is still out as to whether we are definitively going to slash oil demand growth any further," he added.

Spikes in LNG shipping costs highlight need for hedging tools





A rally in the cost of chartering liquefied natural gas vessels on the spot market has highlighted the lack of tools available to traders to hedge against volatility.

The market for the fastest-growing fossil fuel is expanding quickly, with cargoes changing hands in increasingly short-term deals the way the crude oil trade matured two to three decades ago. But while physical trading is expanding rapidly, the paper market with derivatives and other financial instruments has lagged. That has made it difficult to hedge and offset potential losses both for the cargoes themselves and the freight cost of the ships that carry them.

The issue has come into high relief in the last week as the price to charter a tanker in the Pacific Ocean for December jumped more than 20% in the week to Tuesday, according to Spark Commodities Pte Ltd, which takes assessments from five LNG shipbrokers. That’s drawing attention to work to develop hedging tools, with Spark focusing on a paper market for vessels known as a forward freight agreement.

“The increased volatility continues to highlight the need for an LNG FFA to allow market players to manage freight exposure,” said Tim Mendelssohn, managing director of Spark, a venture between European Energy Exchange AG and cargo tracker Kpler. “We are attempting to provide a solution to a major

challenge facing the industry and drive liquidity as LNG develops."

The move by Spark would align the cost of existing deals with liquid cargo-related financial products. The forward freight costs for December, at $145,250 a day on Tuesday, threaten to reduce the potential profit of keeping a multimillion-dollar cargo on a boat to benefit from higher forward LNG prices.

The same is true for the LNG cargoes the ships are carrying. Of the almost 200mn tonnes of LNG traded in the last year, about a third was in the form of derivatives on the Japan Korea Marker, an industry benchmark, Pablo Galante Escobar, head of LNG at Vitol SA, said at the Oil & Money conference last week. Much more was hedged on liquid European gas hubs, he said.

"You can trade in a liquid way, but of course it is still developing," he said.

Developing the paper market is one of the key steps needed to make LNG a fully tradable commodity, according to Galante Escobar. Despite massive growth since 2016, JKM trading draws about 25% of annual production of the super-chilled fuel.

That is in sharp contrast to crude oil, where physical trading has become just 5% of the total market. Deeper paper markets bring in speculators and provide liquidity, giving producers and consumers greater confidence they can shift their physical cargoes when needed.

Other commodities have "far more paper market than physical market," Patrick Dugas, vice president for LNG trading at Total SA, said at the LNGgc conference in London last week. The so-called churn rate for the JKM market is near one, while the ratio needs to be closer to 10, he said.

Europe needs a serious nuclear-energy debate

Last month, the Akademik Lomonosov, Russia's first floating nuclear power plant, arrived in the remote town of Pevek in the country's Siberian Arctic region. Russian state-run nuclear energy company Rosatom sees this as a pilot project, and hopes eventually to deploy a fleet of such units in Russia and elsewhere – including in developing countries in Asia and Africa that urgently need affordable electricity.

The Lomonosov builds on a long tradition of nuclear-powered icebreakers in the Arctic Ocean. But, as I explain in my book on energy geopolitics, it also is a cutting-edge example of how small modular reactors can be deployed more easily, flexibly and cost-effectively than traditional nuclear facilities.

SMRs hold out the promise of clean energy production not only in remote areas, but also in developing countries that are not equipped to build bespoke nuclear power plants on land.

Floating SMR technologies also could potentially be used in commercial shipping in the thawing Arctic: nuclear-powered container ships would be far cleaner than those powered by heavy fuel oil, which produces emissions of sulfur and heavy metals. Furthermore, growing economic activity throughout the Arctic makes it increasingly important for remote areas like Pevek to have low-carbon energy sources.

Although the Lomonosov will be the world's smallest and most northerly nuclear plant when it comes online, it may soon have competition. Researchers in the United States, South Korea, Russia, France, China, Argentina, Japan and India are currently working on about 50 different SMR designs. Furthermore, the rapid changes in the Arctic, and the global push to replace fossil fuels with low-carbon energy sources, have led Chinese, French and American researchers to join their Russian counterparts in assessing the prospects for sea-based nuclear power.

Unfortunately, Western media have failed to recognize the importance of the Lomonosov. Instead, inflammatory and misleading language from Greenpeace and several other environmental groups has led to breathless reporting on the launch of a "nuclear Titanic" and "Chernobyl on ice."

Greenpeace, which has always opposed nuclear energy because of its supposed risks to the environment and humans, has highlighted the remote location of the Lomonosov and the unpredictable Arctic climate. As with many other nuclear projects in recent decades, the group has again succeeded in framing the terms of debate. But those with actual nuclear expertise have made it clear that Greenpeace's scare tactics have "no basis in science."

As industry experts have repeatedly pointed out, seaborne nuclear reactors are hardly a new concept.

The U.S. used an ex-World War II cargo ship equipped with a

nuclear reactor to generate power for the Panama Canal from 1968 to 1976, and Russia's fleet of nuclear-powered icebreakers uses the same type of reactor as the Lomonosov. These reactors already meet International Atomic Energy Agency requirements, with safety measures including double containment and passive reactor vessel cooldown systems.

In fact, offshore nuclear reactors could even be safer than those on land, because cold water facilitates the rapid cooling of the unit in case of emergencies.

Sadly, the primacy of anti-nuclear sentiment over empirical fact has been a consistent feature of Europe's nuclear-power debate since the '80s. In 1997, for example, France abandoned its own advanced Superphenix "breeder reactor" project because incoming Prime Minister Lionel Jospin required the support of the Green Party to form a government.

Two decades later, France still has not successfully developed the technology. And just last month, the country's Alternative Energies and Atomic Energy Commission decided to abandon the fourth-generation advanced sodium technological reactor for industrial demonstration (ASTRID) that had been launched in 2006 to replace Superphenix.

By succumbing to anti-nuclear pressure from groups such as Greenpeace, Western policymakers have failed to keep pace with Russia and China. Russia's Rosatom, for example, is already a global leader in marketing nuclear energy to emerging economies, and has over a hundred projects in countries including India, China and Belarus.

The alarmist rhetoric surrounding today's emerging nuclear technology is unfortunately par for the course. And it again highlights the contradictory and self-defeating approach of some Western policymakers to the world's largest and most reliable source of low-carbon energy.

According to the United Nations Intergovernmental Panel on

Climate Change, nuclear power generation is second only to onshore wind in terms of carbon neutrality, with median carbon dioxide emissions of just 12 grams per kilowatt hour of electricity generation. Those concerned about CO2 emissions should therefore prefer nuclear energy to fossil fuels such as coal (820 grams/kWh) and natural gas (490 grams/kWh).

Nuclear also outperforms biomass (230 grams/kWh), solar energy (48 grams/kWh), and hydropower (24 grams/kWh). In addition, nuclear power has none of the intermittency problems that plague wind and solar energy, causing ongoing price increases for consumers.

These differences come into sharp focus when we consider the effect of German Chancellor Angela Merkel's Energiewende policy, which aims to increase the country's renewable energy capacity while phasing out nuclear power. The Energiewende is often lauded as one of Europe's leading sustainability initiatives. Yet, in Germany's rush to move away from nuclear power following the 2011 nuclear accident in Fukushima, Japan, the country's energy sector has had to rely on coal for baseload power.

Pressure from German environmentalists helped drive this decision – but using nuclear energy instead of coal would have resulted in Germany releasing approximately 220 million fewer tons of CO2 per year. In fact, since 1990, Germany has managed to achieve only a slow, uneven decline in CO2 emissions, despite a manifold increase in renewable energy capacity.

While Germany continues to phase out its nuclear industry, the Akademik Lomonosov highlights the potential for nuclear-power generation in the Arctic. What Europe in particular needs now is a sensible nuclear-energy debate based on facts rather than fear.

Samuele Furfari is a professor of the geopolitics of energy at Universite libre de Bruxelles, and author of The Changing

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Germany to pick Schnabel for ECB board seat: source

BERLIN (Reuters) – Germany will nominate university professor Isabel Schnabel to the European Central Bank's executive board, a source familiar with the process told Reuters on Tuesday, giving Germany an expert voice on the bank's top decision-making body.

Schnabel, who rushed to the ECB's defense last month amid a fury of criticism over its most recent stimulus package, would become the second woman on the bank's 25-member Governing Council after incoming president Christine Lagarde.

A member of the German Council of Economic Experts, the

country’s “wise men”, Schnabel would replace Sabine Lautenschlaeger, another German, who resigned from the ECB board last month after having unsuccessfully opposed more ECB stimulus.

A German finance ministry spokesman declined to comment.

Although ECB board members are appointed by European leaders, Germany has a de-facto permanent seat on the ECB’s board, so its nominee is virtually assured approval.

While Lautenschlaeger was a top bank supervisor, she lacked the expertise in monetary policy and her critics said she was not a powerful enough voice to defend German interests against more stimulus.

Schnabel, considered a conservative economist and monetary policy expert, argued last month that the ECB’s most recent stimulus package was excessive it was within the mandate of the bank.

With Bundesbank chief Jens Weidmann openly criticizing the ECB decision, Schnabel also defended the bank, warning that too much criticism could undermine trust in the ECB.

“It’s dangerous that politicians, journalists and bankers reinforce the narrative that the ECB steals the money of German savers,” Schnabel told German newspaper Handelsblatt last month.

“The ECB, one of the most important European institutions, is constantly being made a scapegoat in Germany,” she added.

Lautenschlaeger will leave the ECB board on Oct 31 but European officials are unlikely to approve her replacement before December, indicating that Schnabel could take up her new role in late December or early January.

As Poland Exits Coal, a Billionaire Offers First Nuclear Plant

Poland’s second-richest man may beat the government in building the nation’s first nuclear power plant.

Michal Solowow’s Synthos SA, the second-largest European maker of synthetic rubber, signed a memorandum with GE Hitachi Nuclear Energy to build a small 300-megawatt reactor next to the company’s factory in southern Poland, which could be completed as early as 2027. That’s six years earlier than the government expects to build its first plant in a plan to construct at least 6 gigawatts of nuclear and cut the nation’s reliance on coal for electricity generation.

“Small modular reactors can play a significant role in addressing Poland’s energy challenges,” Sololow said Tuesday in a statement. They “will improve our chances to move away

from coal and have a positive impact on our industry and nation.”

Poland, which gets about 80% of its electricity from burning coal, is slowly coming to terms with the fact that it has no choice but to shed the dirty fuel to meet European Union climate goals. To do so, it’s energy policy is counting on gas, offshore wind, solar energy and nuclear, which it sees generating about 20% of its needs by 2040.

Solowow hopes that GE’s small modular reactor will be licensed in North America in 2024, which would would allow the company to build the unit in 2027, he said by telephone on Tuesday. Katherine Poseidon, a European policy analyst at BloombergNEF, said she doesn’t expect the first SMR to be online before 2026.

Solowow, whose energy-intensive businesses also produce ceramic tiles and wood flooring, seeks to produce cheaper and cleaner electricity than coal, which is becoming more expensive in power generation as the EU’s climate policy makes carbon-dioxide permits more expensive. The richest Pole, Zygmunt Solorz, earlier this year announced a push to promote green solutions.

The estimated costs of large nuclear projects in France, the U.K. and Finland have repeatedly been increased. Poland’s Energy Ministry in the 2040 policy published last year doubted that small reactors could be used any time soon and said investing in them would be “irrational.”

GE Hitachi says that small reactors are as much as 60% less expensive to build than regular ones and could compete with gas-fired plants and renewable energy.

“Small modular reactor technology is still a long way from commercialization,” BNEF’s Poseidon said. “It is definitely a big step for Poland – it shows they’re serious about developing zero-carbon power generating capacity.”

Italy’s biggest bank wants to become less Italian

MILAN (Reuters) – The chief executive of UniCredit (CRDI.MI) has a plan to revive his company’s ailing share price – make it less Italian.

Italy’s biggest bank is looking at whether it can distance itself from its home country’s stagnating economy and fractious politics by putting some of its most prized assets under one roof in Germany, people familiar with the matter said.

Jean Pierre Mustier will unveil on Dec. 3, as part of his new business plan, a scheme to set up a new sub-holding company in Germany to house the bank’s foreign operations, the sources said.

By keeping its assets in Germany, Austria, Eastern Europe and

Turkey away from Italy, UniCredit could reduce their Italian identity – and associated credit rating – making their funding cheaper, the sources said.

Mustier, a Frenchman appointed in July 2016 to reinvigorate the then weakly capitalized Milanese bank, has sold businesses, cut jobs and shut branches to strengthen UniCredit's balance sheet. Sources earlier this year said the bank had put on ice a possible bid for German rival Commerzbank (CBKG.DE).

But UniCredit, which describes itself as pan-European, operates in 14 countries and makes just over half of revenues outside Italy, is still essentially perceived by investors as a risky Italian institution.

The new plan is an indication of Mustier's belief that the Italian economy is holding back UniCredit's share price and risks pushing up the bank's funding even more if the economic outlook deteriorates.

"Who can say for sure that Italy's debt won't be downgraded to junk?" said one source, speaking on condition of anonymity and describing the corporate reorganization as an insurance policy if Italy's economy continues to perform poorly.

"The bank has to be ready for that kind of possibility," the person said, noting Moody's currently rates the euro zone's third biggest economy – burdened with the second highest debt to GDP ratio in the single currency bloc – just one notch above non-investment grade. Germany has a triple-A rating with all major credit ratings agencies.

SOVEREIGN DEBT PROXY

Italian banks – which are struggling with bad loans, a sluggish economy and political instability – have traditionally been seen as a proxy for the country's sovereign debt because they hold vast amounts of government bonds.

UniCredit trades at 0.5 times book value, among the lowest levels in the industry, despite having a better than average return on equity. Its share price has fallen 30% since April last year, wiping out much of the rally it had after Mustier took charge.

To place a $3 billion, five-year bond in November last year, when a sell-off in Italian assets sent borrowing costs for the country's banks soaring and shut all but the strongest names out of the funding market, UniCredit had to pay a steep 7.8% coupon.

"UniCredit is by size one of Europe's leading banking groups but, because of its Italian roots, investors associate it with the Italy risk to an extent which is in my opinion excessive given its geographical diversification," Stefano Caselli, banking and finance professor at Milan's Bocconi University.

"It's clear that UniCredit pays a price both in terms of regulatory capital and cost of funding for being Italian," he said. "So a diversification strategy aimed at allowing the bank to link its cost of funding to the countries where it is present makes total sense."

Some other Italian companies with big foreign operations, including car maker Fiat Chrysler (FCHA.MI) and broadcaster Mediaset (MS.MI), have moved or are in the process of moving their legal headquarters to the Netherlands as part of a pivot away from Italy.

he European Central Bank would have to approve the plan to set up the holding company in Germany – where UniCredit already owns lender HVB – potentially taking at least a year, meaning the shift would not happen for sometime.

CUTTING EXPOSURE

Mustier has repeatedly said that UniCredit will remain listed and headquartered in Milan and reiterated the bank's

commitment to its home country.

But since May he has steadily cut the bank's exposure to Italy, including by selling its stake in online broker FinecoBank (FBK.MI) and announcing it would reduce its 55 billion euros ($61.37 billion) portfolio of Italian government bonds.

The bank is also considering cutting 10,000 jobs, or around 10% of its workforce, as part of the new 2020-2023 plan, almost all of them in Italy, sources said in July.

UniCredit has said any workforce reduction will be handled through early retirement.

But the planned cuts, together with a wider management reshuffle earlier this year, have helped to create a perception among some employees and rivals that the bank is less focused on its Italian operations.

"You can tell that the Italian commercial business is not a priority for them, they are not aggressive, they are not chasing clients," said the chief executive of another Italian bank.

A UniCredit spokesperson said that figures from the bank's divisional database showed customer deposits for Italy's commercial banking operations rose by 4.3% in the second quarter of 2019 from a year earlier, while customer loans increased by 1.7% over the same period.