EU banks set to disclose government bond holdings in test

Publié le 22 Juillet 2010

LONDON/FRANKFURT (Reuters) - European banks are expected to disclose holdings of doubtful government debt in stress test results to be released on Friday, although sources said there was some last-minute haggling among German banks over how much to reveal.

By Steve Slater and Philipp Halstrick

LONDON/FRANKFURT (Reuters) - European banks are expected to disclose holdings of doubtful government debt in stress test results to be released on Friday, although sources said there was some last-minute haggling among German banks over how much to reveal.

European bank supervisors are in the final stages of an exercise designed to convince markets that most of the continent's banking sector can withstand another economic downturn and losses on government debt, and that authorities can deal with those banks that need support.

Results of the test of 91 European lenders are eagerly awaited by markets whose skepticism about the sector has driven up funding costs and weighed on share prices since Greece's debt woes triggered fears the euro zone could unravel.

Bank stocks were up across the board on Thursday, a sign that investors are starting to hope the worst is behind an industry whose reluctance to lend and partial inability to borrow has been at the heart of the global crisis reaching back to 2008.

"This is a carefully choreographed piece of theater," said Nick Beecroft, senior markets consultant at Saxo Bank. "It is a necessary condition for the feeling of market security. Whether it is a sufficient condition, we have to wait and see."

The Committee of European Banking Supervisors (CEBS), the group presiding over the test, asked banks to provide all holdings of government bonds in a document obtained by Reuters, although it left publication up to banks and supervisors.

Disclosure could end uncertainty about the banks' exposure to sovereign debt from Greece, Spain and Portugal, the countries struggling most to convince lenders they can deal with high debt while economic growth remains weak.

"The regulators and the political leaders are effectively trying to bridge a gap of skepticism," said Gerard Fitzpatrick, global fixed income portfolio manager at Russell Investments.

German banks, which are among the biggest holders of Greek government debt, had been most reluctant to provide the data, were now leaning more toward succumbing to peer pressure, several sources close to the banks said.

"Currently, publication looks more likely than not," said one source. Another one said: "This is as 'voluntary' as the elections in the GDR (Communist East Germany) were."

PUSH FOR TRANSPARENCY, RECAPITALISATION

Weeks of confusion, which on Thursday culminated in uncertainty about the timing of publication of the test results, have cast doubts over the rigor of the tests amid signs of attempts to massage the results.

The "cacophony" of the European tests contrasts with a more disciplined U.S. precursor to the exercise, which was decisive last year in restoring confidence in America's banking sector.

"When the American stress test was released over a year ago it was done with military precision... It was a 'aye, aye sir'," said Christophe Nijdam at equity research house AlphaValue.

"Here in Europe, you have a huge cacophony, some leaks from each national regulator trying one way or another to protect its own banks and own reputation as regulator," he said.

The International Monetary Fund on Wednesday stressed the banking sector was one of the main risks to the euro zone's recovery and recommended highly transparent stress tests.

"A well-functioning financial system will be crucial to strengthening the moderate and uneven recovery," the IMF said. "To maximize confidence-building, the IMF report recommends full disclosure of the findings and effective follow up."

The lack of details about the terms of the test and earlier divisions among the 27 European Union members over how much information to divulge made investors concerned the assessments would not be tough or transparent enough.

The 91 banks participating have been asked to estimate if their Tier 1 capital will stay above 6 percent under two adverse scenarios assuming a double-dip recession in the first case and heavy losses on government bonds on top of that in the second.

In a flurry of statements by CEBS, the European Central Bank, the banks and national supervisors due to kick off at 1600 GMT on Friday, the banks that fall below that level are expected to say what they plan to address the shortfall.

If the shortfall detected in the system -- with German and Spanish public banks and Greek banks eyed most closely -- is not big enough compared to market estimates, and if recapitalization measures are not generous enough, the test may fail to convince.

"With too few banks likely to be identified as capital-deficient and too little additional capital being pumped into the banking system, it seems unlikely that current fears will dissipate," Macquarie analysts said on Wednesday.

Slovenia's Nova Ljubljanska Banka on Wednesday became the first bank to announce a capital increase linked to the stress test, even though it is expected to pass the test formally, showing that there might be capital raisings even for banks that do not drop below the 6 percent threshold.

(Additional reporting by Alexander Huebner, Reinhard Becker, Cecilia Valente and Boris Groendahl, writing by Boris Groendahl, editing by Mike Peacock, Patrick Graham, John Stonestreet)