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French Banks' Capital Gap Said to Have Shrunk in New Stress Test

By Fabio Benedetti-Valentini and Mark Deen - Dec 7, 2011

French lenders' capital shortfall shrank from the October estimate of 8.8 billion euros (\$11.8 billion), the European banking regulator's new test will show, a person with direct knowledge of the matter said.

The test will reveal that their capital situation improved thanks to profits in the third quarter, the person said, declining to be identified because the results, to be released later today, are not yet public. It will reflect efforts by BNP Paribas SA, Groupe Credit Agricole, [Societe Generale \(GLE\)](#) SA and Groupe BPCE, France's four biggest banks, to cut holdings in the region's sovereign debt and other capital-sapping assets.

The results may do less to alleviate concern that the banks still face funding constraints, which was among the reasons for a [Standard & Poor's](#) warning this week that France's AAA credit rating risks being downgraded, along with the debt of 14 other euro nations. S&P late yesterday placed ratings of BNP Paribas, BPCE, Societe Generale and [Credit Agricole SA \(ACA\)](#) on watch for a possible downgrade.

"French banks have published positive results, so their capital situation is bound to have improved," said Alex Koagne, an analyst at Natixis SA in Paris. "The real problem for French banks is liquidity rather than solvency."

[Europe's](#) leaders demanded that the region's banks bolster capital to withstand losses after financial firms agreed to write down Greek bonds. The European Banking Authority estimated in October that the region's financial institutions need 106 billion euros to reach a 9 percent core Tier 1 capital ratio by mid-2012, after marking their sovereign bonds to market.

'Fashionable' Criticism

BNP Paribas spokeswoman Carine Lauru reiterated that the bank has no need to raise new capital, adding that it has raised about a third of its 2012 medium-to-long-term funding needs. BPCE's spokesman Thierry Martinez declined to comment as did Stephanie Ozenne, a spokeswoman at Credit Agricole. Societe Generale spokeswoman Laetitia Maurel repeated the bank can meet the capital target "through its own means."

[France](#)'s four largest banks had cumulated net income of 2.43 billion euros in the third quarter, with all of them remaining profitable even after absorbing about 4.3 billion euros of pretax losses on their Greek sovereign-debt holdings.

“Questions about French banks' health have become fashionable in some financial centers,” Bank of France Governor [Christian Noyer](#) said Dec. 6. “As their supervisor, I can tell you that they're solid.”

Still, the banks' external debt amounts to about 104 percent of France's gross domestic product, with about 60 percent being short-term, “implying sizable external refinancing needs for the French banking sector in 2012,” S&P estimated Dec. 5.

Liquidity Concerns

“Liquidity concerns and the weakening asset quality of French banks' securities and loan portfolios could, in our view, increase the risk of the need for additional capital injections by the state or similar interventions,” S&P said.

Before today, BNP Paribas [has fallen \(BNP\)](#) 31 percent this year, Societe Generale 50 percent, Credit Agricole 49 percent and Natixis 37 percent. That compares with a 30 percent drop in the 46-company [Bloomberg Europe Banks and Financial Services Index. \(BEBANKS\)](#)

Eight European banks failed the official European Union stress tests in July. The exercise was criticized for failing to include writedowns on sovereign debt held to maturity.

In the latest round, European lenders were asked to raise money on their own and only seek aid from national and European authorities if their efforts fail. The updated figures take into account sovereign holdings through the end of September, rather than the estimates, which used June data.

Firms are trying to hit the 9 percent core capital target by adjusting risk-weightings, limiting dividends, retaining earnings, reducing loans and selling assets.

No Dividend

BNP Paribas, France's biggest bank, cut 8.3 billion euros of Italian government debt from its banking-book holdings between June and October, the bank said Nov. 3. It reduced its total banking-book sovereign debt portfolio by 23 percent to 81.5 billion euros in the period.

Societe Generale, France's second-largest bank, cut its banking-book sovereign holdings on [Greece](#), [Italy](#), Ireland, [Portugal](#) and [Spain](#) to 3.4 billion euros at the end of October from 5.6 billion euros in June, it said Nov. 8. The 147-year-old firm also last month scrapped its 2011 dividend, the first time it has done that since its 1987 privatization.

“The priority in these times of uncertainty is to enter 2012 with the maximum of force and muscles,” Chief Executive Officer [Frederic Oudea](#), 48, told reporters on Nov. 8.

The no-dividend policy will help Societe Generale cut its additional [capital requirements](#) to 2.1 billion euros from 3.3 billion euros estimated by the EBA in October, it said last month. BNP Paribas will have to bolster its finances by 2.1 billion euros, BPCE by 3.4 billion euros and [Credit Agricole](#) has no additional capital needs, the EBA's October estimates showed.

Shrinking Assets

“Their capital needs should have fallen because they've reduced their sovereign portfolios, and they've had retained earnings,” said Christophe Nijdam, an analyst at AlphaValue in Paris. “The challenge now is whether there will be a European accord to buy sovereign debt on the secondary market.”

BNP Paribas and Societe Generale are racing to shrink their balance sheets, with the two companies announcing in September steps to trim a combined 300 billion euros of assets by 2013.

“The deleveraging is a response linked more to their liquidity stress,” said [Pierre Flabbee](#), an analyst at Kepler Capital Markets.

Societe Generale cut the liquidity needs of its corporate- and investment-banking unit by 40 billion euros at the end of September, it said last month. Societe Generale plans to raise as much as 15 billion euros for its long-term funding next year or about 50 percent less than this year.

BNP Paribas said it trimmed \$20 billion of corporate- and investment-banking U.S. dollar needs in the third quarter, mostly through cuts in capital-markets businesses. It plans to reduce an additional \$20 billion in the current quarter from capital-markets and financing operations.

To contact the reporter on this story: Fabio Benedetti-Valentini in Paris at fabiov@bloomberg.net

To contact the editors responsible for this story: Frank Connelly at fconnelly@bloomberg.net; Edward Evans at eevans3@bloomberg.net