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## EU Banks Warn of Credit Drought Amid Push to Raise Capital

By Anne-Sylvaine Chassany and Simon Kennedy - Oct 25, 2011

A top lobbyist for France's largest bank says European lawmakers will have only themselves to blame if pressure to bolster capital too quickly results in more [Boeing Co.](#) planes at the expense of European rival [Airbus SAS](#).

"In the case of the French banks, activities where they were leaders like aircraft leasing or shipping financing will be partly taken over by U.S. or Chinese banks," [Dominique Graber](#), co-head of [BNP Paribas SA](#)'s public and prudential affairs, told the European parliament's [committee on economic and monetary affairs](#) in Brussels on Oct. 11. "One will also not be surprised if later on more Boeings than Airbuses get funded."

European banks say they have to cut assets to help satisfy a government push to boost capital faster than planned to insulate them against the sovereign debt crisis. That may trigger a credit crunch for companies and consumers throughout the 17-nation euro zone, helping to push its economy into recession, say Citigroup Inc. and Deutsche Bank AG analysts.

Leaders meet today in Brussels to approve a plan to increase lenders' capital by about 100 billion euros (\$139 billion). Banks say they will more likely achieve the new requirements by shrinking rather than raising cash from shareholders, a scenario they want to avoid partly because their share prices have fallen [30 percent](#) this year.

### Threats Are 'Pernicious'

"Threatening there will be fewer loans for Airbus aircraft is pernicious," said [Christophe Nijdam](#), an AlphaValue bank analyst in Paris. "Aircraft leasing isn't a big amount in BNP Paribas's balance sheet, but imagine the impact of such a comment on German or French lawmakers with an Airbus plant in their constituencies. Banks have other ways to boost capital than reduce lending to businesses. They could cut their trading books for example."

Banks are using the threat of lower lending to influence talks with regulators, just as demand for financing declines in a slower economy. Lenders reported a net decrease in loan applications by non-financial firms in the third quarter, the first drop in more than a year, according to the [European Central Bank](#).

“This whole tune sounds familiar, and it’s always been the case ahead of major recapitalization exercises that we see these statements of banks,” said [Christian Gattiker](#), head of research at Bank Julius Baer & Co. in Zurich.

## Europe Versus U.S.

Banks are more important to the European economy than they are in the U.S., according Bank of America Corp. economist [Laurence Boone](#). She calculates that loans to the private sector totaled 145 percent of gross domestic product in 2007, more than double that of the U.S., where companies rely more on stock and bond markets for capital.

[James Ferguson](#), head of strategy at Arbuthnot Securities Ltd. in London, draws parallels between Europe’s current situation and the credit crunches suffered in recent decades by Japan, the U.S. and the U.K.

“History shows that bank recapitalizations provide the catalyst for the credit crunch,” he said in an Oct. 20 note. “Japan learned this in 1998, and the U.S. and the U.K. in 2008. Continental Europe’s lesson starts now.”

Banks across Europe have announced they will trim more than 775 billion euros from their balance sheets in the next two years to reduce short-term funding needs and achieve the 9 percent in regulatory capital required by the [Basel Committee on Banking Supervision](#) ahead of schedule, according to data compiled by Bloomberg. They may be required by policy makers today to meet this ratio by the end of June, two people with knowledge of the talks said.

## ‘Incredibly Worrying’

So-called bank deleveraging could reach 5 trillion euros in the next three to five years, according to [Alberto Gallo](#), head of European credit strategy at Royal Bank of Scotland Group Plc in London.

“It is incredibly worrying that this wall of deleveraging will, in fact, continue to add additional pressure onto the European economies,” [John Moran](#), head of bank restructuring at Ireland’s Finance Ministry, said in a speech in Dublin Oct. 12. There is “an absolute necessity to avoid excessively speedy deleveraging across the system.”

The ECB reported on Oct. 6 that the toughening of credit standards by euro-zone banks “picked up significantly” in the third quarter. A net 16 percent of banks said they tightened loan terms to non-financial firms, compared with 2 percent in the previous three months and predicted more constraint in the current quarter. Eighteen percent said they had done the same for consumers buying homes, double that of the second quarter.

## Moving Toward Recession

The ECB's third-quarter data show the biggest restriction of credit since the third quarter of 2009 and that loan officers are signaling it will get worse in the first quarter of next year, according to an analysis by [Guillaume Menuet](#), a Citigroup economist.

Such constraint "will play a part" along with tighter fiscal policy in tipping the euro area into its second recession in three years, Menuet said. He estimates the economy will contract 0.3 percent in the current quarter before shrinking about 0.1 percent in each of the next three quarters. The economy expanded 0.2 percent in the second quarter from the previous three months, according to the most recent data.

"The recession has already started," [Eric Chaney](#), Axa SA's chief economist, said in an interview with Bloomberg Television in Paris on Oct. 14. "There is a credit crunch. Banks are not lending as much as companies would like, especially in peripheral countries."

## Rates Rising

In Spain, one in four companies were rejected for loans in 2010, compared with 10 percent in 2007, according to a survey by the country's national statistics institute published in May. The average interest rate on new company loans of as much as 1 million euros rose to 4.7 percent in July from 4.57 percent in June, and 3.88 percent in December, the Bank of Spain reported.

The EU proposals "will produce a contraction of credit since many institutions will opt to reduce their balances," Banco Santander SA Chairman [Emilio Botin](#) said in a speech on Oct. 18 at the bank's headquarters outside Madrid.

Santander expects lending at its Spanish branch network to drop 3 percent a year through 2013, it said in an analyst presentation in September.

In Ireland, 55 percent of loan applications by companies succeeded last year, compared with 95 percent in 2007, according to a [May survey](#) by the country's Central Statistics Office.

## France, Germany

Companies in countries at the heart of Europe, including France and Germany, are facing more selective banks demanding more expensive terms. A net 28 percent of French corporate treasurers judged it was "difficult" to get bank financing, according to an October survey by the [French Association of Corporate Treasurers](#). In July, a net 1.4 percent of the respondents said it was "easy."

"We're seeing a similar trend as in 2008 when things suddenly and massively deteriorated," [Richard Cordero](#), the association's head in Paris, said in an interview. "Banks are reducing their balance sheets, and it doesn't bode well in terms of getting access to credit."

[Airbus](#) said Sept. 19 it's concerned the European debt crisis may hurt airlines' ability to raise bank financing for aircraft purchases. Suppliers may also be hit, Airbus Chief Executive Officer [Thomas Enders](#) said at a conference last week.

"We see some troubling signs of lack of capital, especially with some of our smaller suppliers," Enders, 52, said in Toulouse, France, on Oct. 18. "They're the ones who get hit first when banks tighten up their capital."

## Financing Alternatives

French banks provide 15 percent to 20 percent of commercial aircraft financing, according to [Bertrand Grabowski](#), managing director of DVB Bank SE, which is among the biggest aircraft financiers in Europe. On Sept. 22, European Aeronautic, Defence & Space Co., Airbus's parent, sought to reassure investors that other lenders could fill the gap if European banks retrench.

"We have seen many new banks entering or re-entering the aviation market," EADS Chief Financial Officer [Hans Peter Ring](#) said in an e-mailed statement then.

Regulators created a framework that makes businesses such as aircraft leasing harder, BNP Paribas CEO [Baudouin Prot](#) said in a Sept. 22 interview with French newspaper Les Echos.

"All the banks will have to adapt, notably in the markets that are far from their base," Prot said. "We won't, however, abandon the expertise accumulated over decades in businesses that are useful to the real economy."

## Societe Generale

[Pascal Henisse](#), a spokesman for BNP Paribas in Paris, declined to comment further.

"We're going to continue to finance the French economy," Societe Generale CEO [Frederic Oudea](#), 48, said in an interview with French channel BFM TV on Oct. 24. He pointed out that the volume of loans provided by the French banks to companies and households grew 6 percent annually through August.

"If you give banks 18 months time to reach a certain capital quota, then they'll try to reach that through a reduction in business," Commerzbank AG CEO [Martin Blessing](#), 48, said in an interview with German newspaper Bild Zeitung on Oct. 21. "That would hamper lending to companies."

His comment echoed Deutsche Bank CEO [Josef Ackermann](#), 63, who said on Oct. 13 that banks may be forced to restrict lending "due to possible debt haircuts in the euro zone."

Regulators say the risk of reduced lending is worth taking in light of a bigger concern about the banks' ability to find short-term funding on the markets at a time when investors are questioning their sovereign debt holdings.

## 'Excessive Fear'

"It's a risk that exists," French Central Bank Governor [Christian Noyer](#) said in an interview on French channel TV5 Monde on Oct. 16. "But the risk that's more important today is that the banks are subject to excessive fear from investors making it hard for them to find funding."

The chances of a credit crunch would also shift "higher than 50 percent" if banks don't boost capital, Julius Baer's Gattiker told Bloomberg Television's "On the Move" with [Francine Lacqua](#) on Oct. 19.

Bank of America's Boone says the threat of a credit contraction similar to 2008 remains small. Her banking-analyst colleagues expect loan growth to decrease to 2.6 percent next year from 3.3 percent in 2011. If that comes to pass, then ECB studies suggest the effect of such a decline on economic growth would be to reduce it from Bank of America's 0.8 percent forecast next year to 0.77 percent or 0.63 percent, depending on the study, she said.

## Hiring Constrained

Small and medium-sized companies say they are particularly vulnerable because they lack the cash and ability to issue bonds that larger companies have, according to strategists at Credit Suisse Group AG's private-banking division.

Edward Hamilton, owner of Cheltenham, U.K.-based advertising agency [Artful Ltd.](#), said he can't hire more staff and is missing contracts because his bank is seeking to reduce his company's credit line. Hamilton, who employs half a dozen people, said his confidence in the future is at its lowest in 30 years of running the business.

"They are trying to reduce the overdraft facility so that they can stave off their losses on their loans to Greece," he said in a phone interview. "I am not going to put myself in a position where I am paying twice as much for a loan from a bank. I will find the money elsewhere."

More than 30 percent of small businesses say they have been missing opportunities because they were denied bank financing, [Andrew Cave](#), head of the U.K.'s [Federation of Small Businesses](#), said in an interview.

## 'Money in the System'

"Banks have the money to be able to carry on businesses in more lucrative investment banking," he said. "There's still money in the system. It's just a choice the banks make as to where they place that money."

Maurizio Guidi, co-owner of [EUSolar Srl](#), a builder of solar plants in northern Italy, said he has been losing contracts for three months because his clients, including farms and small companies, can't get bank loans.

“Last month we lost a contract with an agriculture business because the company didn't obtain a credit line to finance the plant,” Guidi said in an interview. “They were solvent and without particular problems, but the bank told them that they are not willing to lend money for more than 10 years. Banks only borrow money for short periods and at higher costs. I'm in the business since 2005, and I think that a new credit crunch period is around the corner.”

The banks' lending argument may backfire, pushing politicians to press lenders to raise cash from shareholders, an option they want to avert because it would be dilutive and, if they were to use government money, lead to policy makers having more say in their operations.

“The banks need to deleverage, but if they choose to deleverage by cutting assets not by raising equity then it will have negative consequences for the economy,” [Simon Maughan](#), head of sales at MF Global Holdings Ltd. in London. “It's much better to force a deleveraging through more equity even if that means it has to be forcibly injected in the banks.”

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