ECONOMIC RESEARCH

The NewsLine

October 26, 2014

} MACROECONOMICS | FINANCIAL MARKETS | ECONOMIC POLICY | SECTORS

EURO AREA

Successful start, end unknown

Dr. Michael Heise
Tel. +49.89.3800-16143
michael.heise@allianz.com
Allianz SE
https://www.allianz.com/economic-research/en

The disclosure of the results of the comprehensive assessment of 130 banks and the forthcoming Single Supervisory Mechanism mark a watershed for the eurozone. The realization of the banking union for major and cross-border banks will strengthen the eurozone banking system and create the conditions to overcome the marked fragmentation of banking markets still prevailing six years after Lehman.

The focus of interest in the stress tests is on the number of failed banks and the capital shortfall established. Some critics will therefore doubtless find the results disappointing: In fact, taking into account fresh capital that has already been raised since end-2013, 13 banks failed the test, but mainly only minnows, and the shortfall in the European banking system is only EUR 9.5bn. However, this point of view misses two things: Since Lehman eurozone banks have already shored up their capital reserves by more than EUR 700bn; and bank balance sheets have shrunk by almost EUR 4,000bn in the last two years alone. Given current business volumes, European banks are on average not short of capital (and certainly not of liquidity). The IMF reaffirmed this in the latest Global Financial Stability Report: In sum, capital ratios in the eurozone are (at least) as high as on the other side of the pond. The problem lies elsewhere: many eurozone banks struggle to cover their capital costs.

The real significance of the ECB's bank review therefore lies in the preceding scrutiny of bank balance sheets (Asset Quality Review – AQR). For the first time comparable figures are now available for the eurozone, there is more transparency and clarity regarding the evaluation of asset positions. The AQR is a kind of sweeping due diligence examination for the most important banks in the eurozone – the results of which are now available to all. They therefore provide the perfect occasion for banks and investors to plug holes or adjust business models as necessary.

So the long-term impact of today's figures should by no means be underestimated. The exercise serves to create the conditions to build a more integrated European banking system and overcome the refragmentation of markets, reflected above all in a sharp decline in cross-border bank loans. The reactivation of European interbank markets – instead of the broad refinancing via the ECB with corresponding Target II balances - would be an important milestone in restoring the health of the banking system.

For the economy, by contrast, the results are relatively insignificant. Why should a bank which has successfully passed the test step up its lending now? Presumably it was aware of its adequate capital base beforehand. So hopes that the stress tests alone will boost lending are likely to be disappointed. And in the USA, the "inventor" of the stress tests, corporate lending fell for a further six quarters following the first successful test in May 2009. To get the economy back on its feet quickly, action needs to be taken elsewhere.

These assessments are, as always, subject to the disclaimer provided below.

ABOUT ALLIANZ

Together with its customers and sales partners, Allianz is one of the strongest financial communities. Over 83 million private and corporate customers insured by Allianz rely on its knowledge, global reach, capital strength and solidity to help them make the most of financial opportunities and to avoid and safeguard themselves against risks. In 2013, around 148,000 employees in over 70 countries achieved total revenues of 110.8 billion euros and an operating profit of 10.1 billion euros. Benefits for our customers reached 93.9 billion euros.
This business success with insurance, asset management and assistance services is based increasingly on customer demand for crisis-proof financial solutions for an aging society and the challenges of climate change. Transparency and integrity are key components of sustainable corporate governance at Allianz SE.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.
Such deviations may arise due to, without limitation, (i) changes of the general economic conditions and competitive situation, particularly in the Allianz Group's core business and core markets, (ii) performance of financial markets (particularly market volatility, liquidity and credit events) (iii) frequency and severity of insured loss events, including from natural catastrophes, and the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) particularly in the banking business, the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the Euro/U.S. Dollar exchange rate, (ix) changes in laws and regulations, including tax regulations, (x) the impact of acquisitions, including related integration issues, and reorganization measures, and (xi) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences.

NO DUTY TO UPDATE

The company assumes no obligation to update any information or forward-looking statement contained herein, save for any information required to be disclosed by law.