Bank stress tests: apples and oranges

Ana Rubio

The results of the European bank stress tests published a few days ago were passed by almost all of the banks considering that only one Italian bank and one Irish bank would have shown a capital shortfall compared to last year's minimum capital threshold. This is normal for various reasons: the situation faced by banks should have improved after the successive stress tests forced them to recapitalize in previous years, most of the national restructuring processes have been completed and the European economies seem to be on the path to recovery.

This year the much fewer banks were tested (50 compared to 140 in previous years) because authorities wanted to focus on large banks that are comparable. However, the results show that not even the large European banks are homogenous, as there are large differences on how they are impacted in adverse scenarios and their starting points. You cannot take any single approach to addressing problems faced by European Banks: recapitalizing them all, for example, as some analysts suggest.

One clear case is that of the Italian banks, as there are still over 600, which hold over 300 billion euros in impaired assets. However, the results of the five Italian banks that were tested were surprisingly good, with only one showing serious weakness. In any case, Monte dei Paschi's results were expected and, just half an hour before the test, it conveniently announced a plan to inject capital and sell impaired assets. We have to wait to see if they find any takers in order for this plan to be carried out. What should be done with the other Italian banks? Even though they have passed this test, they do not boast a comfortable capital position. If these banks can't access private capital, their bondholders will have to take the losses (as per EU regulations), and, subsequently, they will receive an injection of public capital and retail investors will be compensated if they were sold bonds with deceptive practices.

The negative surprises have also come from the traditionally more solid institutions, which are now facing some difficulties. Some German and English banks are showing relatively low capital ratios in the adverse scenario, so we cannot rule out some measures being announced to fix this situation.

The situation faced by Spanish banks is a lot rosier as they have ample capital. This reflects the efforts made in the past, the considerable restructuring of the system and the clean-up of their balance sheets. All that remains is for the markets to recognize this, and for other banks to no longer be penalized as much as other peripheral banks that face worse situations.

Although one might think that the international crisis has been left behind, these stress tests are of the utmost importance. First, it takes place at time when market sentiment towards banks is negative, as the equity markets have been punishing bank stocks since the beginning of the year. There are some whose doubts go beyond Italian banks to include all the peripheral countries. Furthermore, this is the first test conducted since the ECB became the single supervisor, so these results are important in so far as they show how the European authorities will ensure that their banks are healthy. And, lastly, for the first time these results will be integrated into the supervisory tests the ECB performs on banks every year, and will therefore help determine how much capital each one needs.

All Europeans should want their banks to be solvent. Given that we are on the path toward a banking union, it will only be possible to share risks if the burdens from the crisis have been dealt with. That's why it is so important to solve the Italian bank problem as soon as possible, but it is also crucial to abide by the rules we have all committed to. Only then will a solvent European banking system be able to help economies recover.