



Hot Spot

EU stress tests: a positive but limited impact

Overview

On July 23rd, the Central European Banking Supervisors (CEBS) published the results of the EU bank stress tests. These tests cover 91 EU banks, and have been conducted for the purposes of ascertaining the soundness of the banking system, to restore confidence in markets, and to instigate action to shore up weaknesses in the banking sector.

Results of the test are as follows:

- In aggregate terms, European banks could face EUR 566 bn of potential losses (EUR 67bn linked to a shock on sovereign bonds) if the European economy follows the worst-case scenario of the tests. The aggregate Tier 1 ratio would decrease from 10.3% in 2009 to only 9.2% by the end of 2011
- Only 7 out of 91 banks failed the test, including Germany's Hypo Real Estate, Greece's ATE, and 5 unlisted Spanish banks
- 17 banks are in a "danger zone" of 6-7% Tier 1 Capital Ratio, barely passing the test
- Largest banks appear to be in a good state of stability

Despite these positive results, there are concerns as regard worst case macroeconomic scenario for being too soft (at the level of unemployment rate and housing prices) and as regard hypothesis of haircuts on government bonds. 6 German banks have not furnished the full detail of their exposure to sovereign risk. Moreover the tests don't tackle the issue of short-term and long-term funding, an important source of fragility for European banks.

All these elements make the validity and transparency of the tests questionable despite their comprehensiveness. It is unlikely that they will have a significant impact on aversion of the market and its resulting volatility. However, the process of the stress tests has already encouraged governments and banks to take measures to improve their stability and has improved the overall transparency of the European banking system. Above all, the European authorities show one more time their capacity to coordinate their action to tackle the effects of the crisis. With the European Financial Stability Facility, the unconventional monetary policy of ECB, and the currently discussed financial reform, they represent another tool permitting to attenuate progressively the level of risk of the European financial system and the doubts of the market on the European economic model.

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	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

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