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New capital for Greek banks

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The imminent recapitalisation of Greek banks represents a vital stage of the third bailout plan because restoring the functionality of the banking sector and normalising payment transactions are key factors in improving the economic situation. This was originally scheduled to take place no later than 15 November but compliance with the stipulated timeframe has become uncertain, as the maximum available to financial institutions of EUR 25 billion will not be granted until the initial review has been completed. Time is, therefore, of the utmost importance.

New rules – undesirable consequences?

The new EU Bank Recovery and Resolution Directive (BRRD) will come into effect in 2016, after which government bail-outs will only be possible if shareholders and creditors had previously bailed in at least 8 % of total assets. The BRRD establishes a liability cascade intended to ensure that, after the numerous rescue measures since the financial market crisis, credit institutions are again liable for their own losses and subject to a greater degree of market discipline. Ideally, this should increase financial stability and reduce moral hazard in the long term. However, adhering to the new regulations could result in significant disadvantages in a specific crisis situation. In the case of Greece, the low volume of outstanding bank bonds means that non-guaranteed deposits of more than EUR 100,000 would likely be affected. Bail-in funds would come mainly from small and medium-size companies, which would adversely affect depositor confidence and growth. Great efforts are therefore being made to conclude the recapitalisation in 2015.

How much capital is needed?

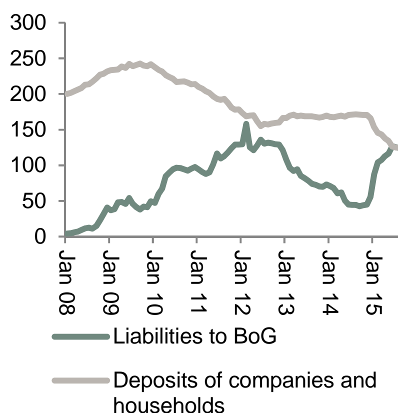
The ECB published the results of the asset quality review and stress test for the four dominant financial institutions on Saturday. The base scenario resulted in a capital requirement of EUR 4.4 billion and the adverse scenario resulted in a capital requirement of EUR 14.4 billion. The amounts required are thus lower than initially feared. However, when looked at more closely, the result is not all that surprising. After all, capitalisation and asset quality were last reviewed only a year ago. At that time, the institutions were able to fulfil their obligations when recapitalisation plans were taken into account. Tier 1 capital ratios of between 8.7 and 12.6 % at the end of the first quarter also indicate an acceptable starting level before the dramatic developments during the summer.

Sustainable stabilisation requires more than new capital

It is obvious that the Greek bank crisis will only end when depositors regain confidence (see Figure 1). Higher capital buffers are helping in this regard, partly because strengthening bank solvency is creating more leeway for central-bank financing. But other factors are playing an important role. The objective must be to largely insulate the banking system from Greek insolvency risk. Exposure from domestic government loans and bonds has a direct impact on this. A glance at Figure 2 shows that, at 6 % of total assets or EUR 23 billion, this is already comparatively low in Greece. This fact should attract attention when development of the currency union moves forward because it shows that new regulatory measures to reduce government debt on bank balance sheets may not suffice to prevent a massive loss of confidence.

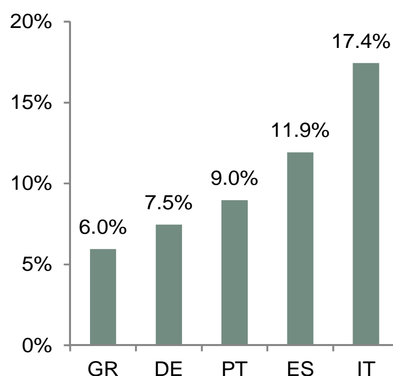
There is thus a good argument in favour of moving the banking union towards a single banking market in which cross-border institutions can flourish. Their ability to refinance would not hinge on the economic situation in one member state. In Greece, the privatisation of the four large banks pending in the medium term would be a good opportunity to take a step in this direction, through a sale to institutions from other member states. ■

Figure 1: Lack of confidence among depositors (in EUR billions)



Source: Bank of Greece.

Figure 2: MFI holdings of domestic government debt (in per cent of total assets)



Source: national central banks, ECB, own calculations.

Note: This paper contains the opinion of the authors and does not necessarily represent the position of KfW.