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Banks must deleverage to the tune of €3.4tn

BANKS

Europe lending to companies at risk

By Michael Stothard and Mary Watkins in London

European banks will need to shed as much as a further €3.4tn from their balance sheets over the coming years by reducing lending and selling assets, according to new data, adding to fears about a funding gap opening for European corporates.

Europe was already bracing itself for about €2.4bn of "non-core" asset disposals – more than 7 per cent of total banking assets – over the next seven years as banks are mandated to reduce the risk on their balance sheets.

But new figures from PwC, the consultancy, to be released today, suggest the problem of banks retreating from their traditional lending activities could be far worse than expected.

While in 2012 banks shed €600bn of assets to help comply with upcoming regulation, at the same time they admitted an extra €500bn of "non-core" assets on their books that was previously unaccounted for and would need to go as well.

Following this data, PwC is now predicting up to €1tn of fresh admissions in the coming years as banks look to meet Basel III regulatory requirements. Nearly 90 per cent of deleveraging last year was focused on reducing lending.

"European banks are becoming more transparent in relation to the size of their non-core portfolios," said Richard Thompson, chairman of PwC's portfolio advisory group.

"[But] given that identified non-core loan assets make up about 5 per cent of total banking assets, the deleveraging agenda could have a sizeable impact on economic growth," he added.

A decline in bank lending is a particular concern for small and medium-sized companies, which make up more than 99 per cent of European companies and employ 72 per cent of the workforce. Large companies are better able to borrow in the capital markets.

The latest data from the European Central Bank showed a 2.2 per cent fall in bank lending to businesses in December, which was the worst monthly figure in nearly three years. It was the eighth consecutive month when lending had fallen.

For some, bank deleveraging is an opportunity, particularly the distressed debt investors who have been keen to snap up entire loan portfolios from the banks at discount rates.

More than €200bn of loan portfolios are expected to be sold.

It is also a boon for those in markets hoping that Europe is moving towards a more US-style model of corporate financing.

A new white paper by Prime Collateralised Securities, which manages a labelling system for European asset-backed securities, predicts that at least €4tn will be required over the next five years to plug the hole in Europe left by banks withdrawing.

"Unless this funding gap can be bridged, European governments and businesses face the potential of an economic wasted decade: a long period of stagnation, similar to that experienced in Japan," PCS said.