Lloyd's List

Shipping bankers braced for red letter day

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Uncertainty prevails ahead of stress test results on October 26

Red letter day: Bankers will find out the results of the ECB stress test on October 26. Phatic-Photography/Shutterstock.com

SUNDAY lunch is traditionally an opportunity to spend some quality time with the family.

Unfortunately, the weekend after next is likely to see many European shipping bankers paying more attention to their emails than their food.

Spoiling the occasion for spouses and kids will be the results of the European banking asset quality review and stress testing, which are due for release around midday on October 26.

Presumably the date and time have been deliberately chosen because the markets are closed and everybody will have a few precious hours to think things through before they reach their desks the following day.

What happens next is impossible to predict, but there as far as shipping is concerned, there are grounds for pessimism.

At the time of writing, two important lenders to the shipping industry, HSH Nordbank and NordLB, had seen their deeply subordinated debt lose as many as six points in the last week alone, as markets factor in the possibility that they will come out among the failures.

Meanwhile, a rush to sell off weaker shipping loans is an entirely imaginable upshot, senior banking sources have told Lloyd's List.

Even for better credits, borrowing from banks experiencing higher capital costs is likely to become more expensive.

What of the potential upsides? Nobody we spoke to came up with any. Perhaps the best that can be said is that nobody knows for sure.

The European Central Bank, which has conducted the exercise, has so far managed to ensure that there have been no substantial leaks of exactly what is to come.

"If I had a good take on the outcome, I'd give it to you," insisted a highly cautious big name banker who admitted that his own shipping portfolio had been subjected to close examination.

"Only a few days before the ECB lifts the curtains, it is next to impossible to forecast the outcomes."

One of the first banker's peers pointed out that ECB has been dealt a difficult hand. While it has to reassure the public that it is doing something to prevent a recurrence of the 2008 financial crisis, it cannot regulate to the extent that materially hampers the banking sector from carrying out its functions.

"On the one hand the ECB will not want to cause too much concern in the banking market and run the risk of damaging confidence in the sector again," pointed out another European shipping banker. "On the other hand they cannot afford to pretend that everything is OK and risk losing their credibility."

At this stage, the betting is that the majority of the 130 eurozone institutions subject to scrutiny – including many important lenders to the industry – will be given a clean bill of health.

German banks

However, widespread expectations remain that several less diligent pupils will fail their term papers. In particular, media reports have highlighted some German entities as among the weaker brethren.

Those found wanting will be given two weeks to come up with plans to put things right.

After that, they will have six months to enact those proposals for any capital shortfalls discovered in the baseline stress test scenario, and nine months to cover any capital shortfalls from the adverse stress test scenario of a 7% drop in eurozone GDP.

So by somewhere around the middle of next year, investor confidence will be fully restored, while capital bases will be strengthened, enabling easier lending.

That way, everybody goes home happy. Well, that's the theory, anyway.

German banks in particular are known to have lent a lot of money to owners – both domestic and international – that are incapable of repaying either the principal or the interest.

Earlier in the crisis, the amount of troublesome shipping debt was assessed at around €100bn ($127.8bn), greater than the debt owed to German banks by all of peripheral Europe put together.

Since that time, notable efforts have been made to sell off debt, with US private equity and hedge funds scooping up an unknown amount of the overhang.

So the outstanding tally will likely be somewhat lower now, albeit surely sufficient to cause loss of sleep in some of the nicer dormitory suburbs of local financial centres.

For what it's worth, both Deutsche Bank and Commerzbank — which is in the protracted process of pulling out of shipping altogether — appear to be in a better shape than many commentators suggested when the AQR and stress tests were first announced.

Meanwhile, it is openly being reported in the German media that regionally owned landesbanks NordLB and HSH Nordbank — as well as Munich Hypo, which has little skin in the shipping game — are in for an enforced haircut.

Additionally, other German shipping bankers highlight the nature of the guarantees provided by the states of Hamburg and Schleswig-Holstein to HSH, and whether or not they will be treated as equity.

Given their public sector status, they cannot readily raise equity from public markets, and EU guidelines on state aid may mean that there is no choice but to shunt any shortfalls onto bondholders, or so the theory goes.

"My feeling is therefore that Commerzbank and NordLB will come out reasonably okay but that HSH will be deemed to have insufficient provisions on their loan portfolio and therefore too low a capital position," suggested another shipping banker.

"Probably at the same time they will announce that the states of Hamburg and Schleswig-Holstein will increase their guarantees from the current level to cover. Deutsche should be okay in view of the capital raising they undertook earlier in the year."

Severe consequences

The obvious further question is whether any drive to bolster weaker balance sheets will entail dumping bad shipping credits at fire sale prices. Some give this possibility credence.

The head of shipping at one eurozone bank, who asked not to be identified, said: “For those banks who have transferred toxic shipping assets to a bad bank or who have decided not to sell shipping loans, due to price, despite an overwhelming need to do so, the consequences could be very severe.”

Another immediate impact will probably be seen in the risk-weighted asset increases imposed on eurozone bank shipping divisions, resulting in a requirement to raise additional equity or get rid loans at whatever price, the same banker believes.

“This will impact several shipping banks in the sector, particularly those who have been nursing their portfolios for a while whilst in self-denial,” he added.

His prediction is that some hedge fund buyers are licking their lips in anticipation.

Veteran shipping bank watcher Ted Petropoulos of Athens-based consultancy Petrofin is another who maintains that it is difficult to make an early call on the subject.

“The trend, however, is for the ECB, via the local central banks in each country, to determine which loans require provisions, and which loans are viewed as non-performing loans,” he added.

“Presumably, once such determination shall be made, the banks shall need to take action to preserve their financial ratios, via increases of capital and disposal of non-performing loans.

“Coupled with the poor shipping markets, the outcome of the stress tests may well be highly significant for shipping.”

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