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Column: BIZ INSIGHT: Concern over European banks, despite some improvements

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BIZ INSIGHT

SPECIAL TO THE NATION

THE BANKING industry was expected to be one of the most popular sectors this year, benefiting from higher bond yields, rising inflation, and improved economic growth. That outlook, however, was before oil prices plunged and Chinese economic growth slowed, which sapped investors' confidence worldwide.

European banks have been particularly affected by market volatility. Negative interest rates have diminished their profit, while there is uncertainty over credit default risk of energy-related debt. The prospects for European banks are quite cloudy. There is still concern over whether banks on average are able to recover their cost of equity, which has made them an unattractive long-term investment choice. Thus, during the first couple of months of this year, investors in this market quickly ran for the exit, spurred on by their panic over tumbling oil prices and signs of China's sluggish economic growth.

The European banking sector was worst hit early in the year. The negative interest rates set by the European Central Bank meant that banks in effect had to pay to have cash on their balance sheets, while at the same time they were getting squeezed on their net interest margins.

Nonetheless, every cloud has a silver lining. Several improvements have been made in the past month that ease the concerns over the banks' return to profitability. Euro zone inflation increased from negative-0.2 per cent in February to zero in March. The new TLTRO (targeted longer-term refinancing operations) lowers the refinancing rate for banks whose net lending exceeds the benchmark.

Meanwhile, Italian financial institutions and state lender Cassa Depositi e Prestiti agreed to set up a 5-billion-euro bailout fund for banks, to be called Atlante, in order to boost confidence. This announcement shored up European stocks, aided by a rally in Italian bank shares.

These are some examples of good news for the European banking sector. Nevertheless, there are many factors to monitor in such a volatile market.

Investors who are able to take the risks entailed in foreign stocks, but who do not have direct access to European equity or do not have expertise in stock selection and timing tactics, may approach professionally managed foreign-investment mutual funds (FIFs) with exposure in European stocks.

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