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European Banks Prepared for a Crisis. But Not This One.
By Waleed Bin Arshad, LL.M Candidate 2020 | April 13, 2020

The European Banking Authority had planned to launch its fifth stress test this year. The results were supposed to be announced by July 31, 2020. However, before the Authority could start this practice drill, it was hit by the real and bigger economic shock—the financial impact of the novel COVID-19. The effect of COVID-19 has subsequently surpassed the Authority's worst-case scenario figures. The impending threat of bad loans, the freefall of the stock market, the standstill on production of goods, and the non-stop depreciation and amortization indicates that the European economy will decline by as much as 10%.

Some analysts believe the impact has been manageable thus far. Regulators, however, are questioning the ability of European banks to absorb this impact if it continues for a longer period of time. They are worried that this might result in a credit crunch and financial meltdown.

The European Central Bank had flooded the financial system with cash in order to avoid a bankruptcy or bail-out, but this might not be enough. The European banks did not fully recover from the last financial crisis, and some, like Deutsche Bank, are still suffering heavy losses. This is partly because the European economy depends on banks even more than the US economy. European companies get more than two-thirds of their credit from banks as compared to US companies, which only take one-third from banks and otherwise issue corporate bonds.

The European Central Bank plans to further tackle the COVID-19 blows by buying up to 1 trillion Euros of government and corporate bonds. This buying process, named the 'Pandemic Emergency Purchase Program' (PEPP), will help banks hold down interest rates while making it easier for them to extend loans to small and medium scale businesses and households. The Central Bank's regulatory arm has allowed banks to deploy capital they were required to set aside for only grave emergencies. Countries including Italy and Germany are providing credit guarantees so that struggling businesses can still get loans.

Beyond the traditional financial threats the banks are facing, they also face the risk of cyberattacks and data breaches for traders, loan officers, and tech specialists now that they are working from home. Data privacy remains a constant concern for financial institutions and will become increasingly important as countries remain under lockdown.