SEP 13

Will Paige

European banks warned to prepare for worst as energy crisis looms

Article

The news: As a continent-wide energy crisis looms, **the European Central Bank is reportedly urging lenders to prepare for the worst** amid fears that Russia could cut off gas supplies, according to Bloomberg.

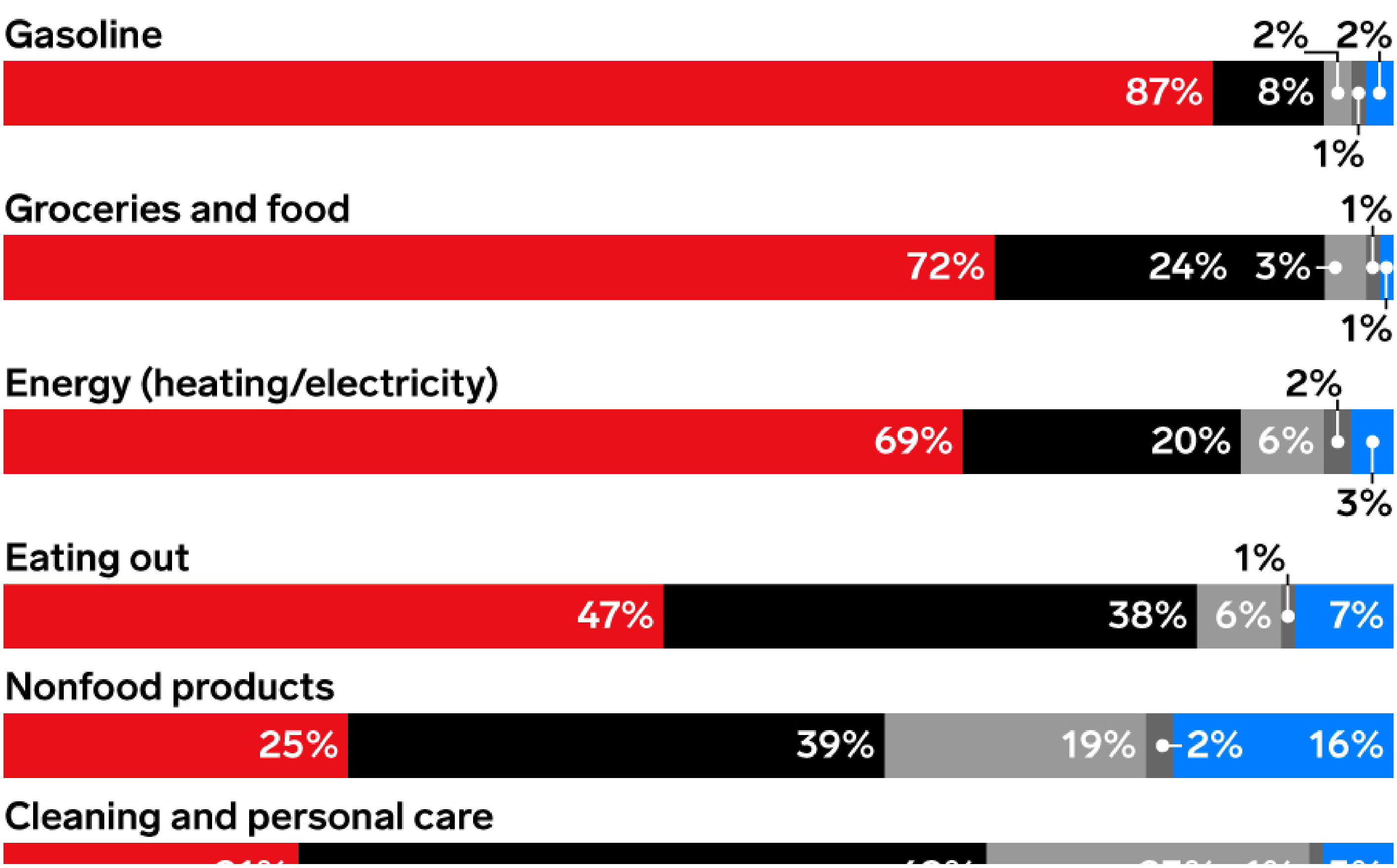
ECB's warning: The central bank privately wrote to banks last month, urging them to scrutinize the impact of a gas stoppage, including the heightened risk of companies defaulting, according to Bloomberg, which cited people familiar with the matter.

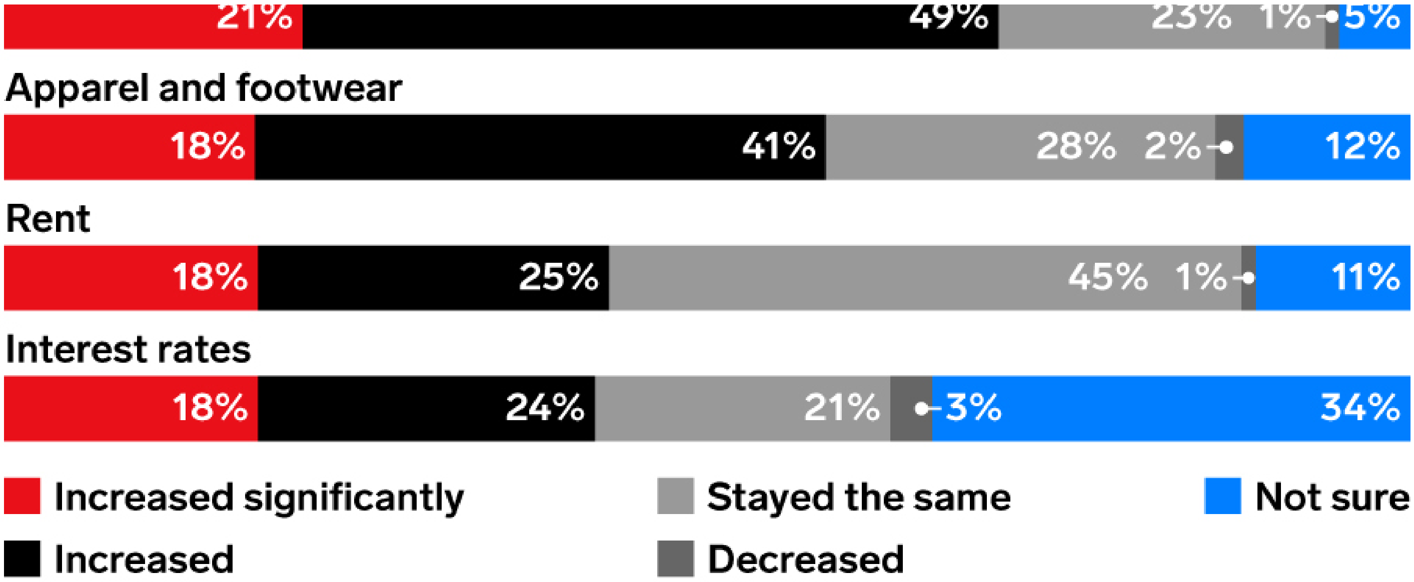
- **Responses are due in mid-September**, and the ECB will carry out follow-up conversations with bank executives by the end of the month.
- Separately, ECB President Christine Lagarde said the central bank is **"ready to provide liquidity to banks, not to energy utility firms."**

The bigger picture: European energy prices have soared in recent months after Russia began limiting the supply of natural gas through its Nord Stream 1 pipeline in response to sanctions. In the UK, energy bills are expected to jump **80% this winter**, per the country's energy regulator Ofgem. If energy companies fold in the wake of a crisis, the banks that lend to them could be hurt.

Product Categories in Which Adults in Germany Have Observed Price Changes, June 2022

% of respondents





Note: ages 18+; in the last 3 months; numbers may not add up to 100% due to rounding
Source: McKinsey & Company, "Europe Consumer Pulse Survey" as cited in company blog, July 14, 2022

277192 eMarketer | InsiderIntelligence.com

How prepared are banks? The banking sector's resilience during the Covid pandemic shows that lenders can weather crises and are much better prepared than they were in 2008.

- Regulations imposed following 2008 will help the banking system weather a possible energy meltdown. They include tougher liquidity rules and mechanisms allowing authorities to put failing banks into an orderly wind-down.
- But data shows that some banks may be too complacent about a possible energy crisis. Lenders **set aside about 30% less for doubtful loans in Q2, compared to the previous quarter**, per Bloomberg Intelligence. This is worrisome, given soaring inflation and the higher risk of defaults among energy businesses.
- Part of the problem is that generous relief packages during the pandemic and state bailouts after 2008 may have left banks overly optimistic about government interventions. Deutsche Bank CEO Christian Sewing said recently that **"from the experience in the past... [governments] would step in."**

The banking system is undeniably better prepared for an energy crisis than in 2008, which saw the collapse of **Lehman Brothers** and governments bailing out several banks. But the very different challenges that banks now face, compared to previous market slumps, mean they can't afford to be too casual in planning for another possible crisis. The ensuing public outcry at the bailouts makes state intervention to protect banks unlikely to be as extensive as in 2008. Lenders should draw up plans in the event of bank loan defaults en masse and heed ECB warnings that gas supplies could be cut.