



Playing the game

Short sellers must consider politics when it comes to European banks, says Andrew Shinn, vice president, SunGard's Astec Analytics

DATA PROFILE

The acute crisis is over, and Greek authorities announced this week that Greek banks are in decent shape to pass upcoming stress tests.

However, many European banks need additional support as they struggle with massive loan losses. Irish banks, having already been provided with €46 billion, were the latest to undergo a series of stress tests. At the conclusion of the tests, the Irish government declared that the remaining four largest Irish banks need an additional €24 billion of capital. Spanish banks, meanwhile, are supposed to raise an additional €15 billion to bolster their tier-one capital ratios.

If banks are not able to raise the additional capital themselves, governments will step in. But in Portugal, the government is having difficulty raising money. While investors are still purchasing new issues of Portuguese government debt, they're demanding much higher interest rates. In addition, even though Portugal successfully issued another round of sovereign debt, it's selling most of it to Portuguese banks. It's not sustainable to have governments bail out domestic banks and banks return the favor by purchasing sovereign debt, although it does keep the wheel turning another day so that banks can deal with their loan losses without frightening the market.

Japanese banks suffered from similar speculative investments in the 1990s, when they kept non-performing loans on their balance sheet and ignored them. Unfortunately, this didn't solve the problem, and the sickly banks were a drain on the Japanese economy for years. The moral is that it's better for a country's economy if banks are forced to be upfront about losses.

Admitting to losses, however, means that someone will have to pay. In the case of European banks, governments have been careful to protect senior bond holders. With the Lehman bankruptcy still fresh, European governments are fearful of pushing banks to the point of default. But equity investors have suffered significant losses; subordinated debt holders of Irish banks are set to lose up to €6 billion as Irish banks reshuffle the liability side of their balance sheets.

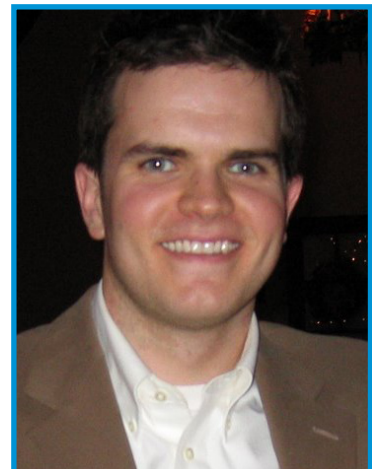
Some countries have targeted short selling, blaming it for declining market values. For example, Greece banned regular short selling of all Greek stocks several times over the past three years, and Italy took drastic measures and banned both naked and regular short selling for all stocks. To their credit, perhaps, Portugal and Spain only banned naked short selling of financial firms' stock in 2008 and 2009.

However, Ireland's experience shows the fallacy of this practice. Ireland banned short selling bank stocks in 2008 and 2009. However, in 2010, despite the continued ban, brokers began borrowing and shorting shares of the Bank of Ireland on US exchanges. Last autumn, brokers began borrowing shares of Allied Irish Bank as well. In addition, the Irish Stock Exchange sometimes halted trading in shares of AIB and Bank of Ireland. Despite these extraordinary measures to protect share prices, Irish banks have lost almost all their value.

In fact, regardless of whether regulators banned naked or regular short selling, shares in European banks have declined in every PIIGS country because of poor fundamentals. It's a good reminder that markets can decline even without any short selling activity whatsoever. Share prices eventually find their true value.

Regarding the European bank stocks that investors are shorting right now, below is a table of the most expensive Portuguese, Italian, Irish, Greek, and Spanish bank shares to borrow as of April 5. **SLT**

Name	Market Intrinsic Rate	Market Loan Volume
Bco de Valencia	8.19	13,149,430
Agricultural Bank of Greece	6.39	2,103,517
EFG Eurobank Ergasias SA	5.02	2,912,157
Banco Pastor sa la Coruna	4.49	1,234,793
Banco Comercial Portugues	4.46	193,293,558
Allied Irish Bks plc	4.08	8,663,052
Credito Bergamasco	4.00	2,053
Bankinter, SA Madrid	3.79	23,365,698
Alpha Bank A.E.	3.34	3,798,365
Piraeus Bank SA	3.30	4,330,044



Andrew Shinn
Vice president, sales and development
SunGard Astec Analytics