## Free Economic weekly: European banks under ECB scrutiny

European banks that will be supervised by the ECB will face new reviews and tests that are likely to bring new questions about who is responsible for safeguarding the financial system. The deficit improved in the year up to September, and is currently below the troika limits.

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## European banks under ECB scrutiny

The ECB has announced this week that it will undertake a series of balance sheet review and stress tests of the banks that it will eventually come to supervise. The objective of these tests is to improve the overall confidence in the European banking sector, thereby supporting the normalisation of the money markets in Europe. However, this will only be achieved if the tests are transparent and are perceived to be difficult enough. In the past, stress tests done by the ECB have had a limited impact on confidence in the banking sector.

Referring to this review, ECB President Draghi has said that he expects some banks to fail these tests, and that he expects the European Governments to come up with recapitalization plans for those that do. This is likely to raise another fractious issue: who will finance it? Should national Governments' do it, it will increase the linkages between sovereign debt and the financial sector, which is the very thing that the ECB has tried to break in the past few years.

The alternative would be for the European Stabilisation Mechanism (ESM, has subscribed capital worth €700 bn provided by euro area Member States which provides a lending capacity for the ESM of €500 billion) to do it through borrowing on the financial markets as it has done recently for Spain (financial assistance to the banking sector) and for Cyprus. However, it is unclear that all euro area member states would approve using the lending capacity for that use.

## Portugal: deficit up to September below the troika limit

Preliminary Public accounts on a cash basis for the deficit was –€4.3bn in the year up to September, compared with a -€7.3bn troika limit. Comparing like-for-like, i.e., excluding one-off measures such as the sale of ANA, among others, the deficit improved by about €1.1bn between Jan-Sep 2012 and Jan-Sep 2013. According to the DGO that released these figures, the improvement was mostly due to rising revenues, given that spending also rose on the back of rising pension payments and the payment of the holiday pay that had been initially eliminated.

The data suggests that the deficit limit of 5.5% of GDP in 2013 is within reach, although the variability expected in Q4 due to the changes in the Christmas pay dates and to measures introduced in October may completely change the game. In any case, the Government has pencilled in a deficit of 5.9% for 2013, which at this moment appears conservative.

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