Banks and confidence

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Recovery from the global financial crisis and the role of banks are in the spotlight following recent events in Europe.

Eight years on from the GFC, Europe's banking sector is experiencing stress that could damage wider markets.

That stress is most evident at Germany's largest bank, Deutsche Bank.

Deutsche Bank's share price has halved this year. It is facing a multi-billion dollar fine for pre-GFC activity. Last week several global hedge funds reduced their positions with the bank.

Loss of confidence in Deutsche Bank is affecting stock market indices and bank values in other countries, and highlights hard choices facing Germany.

Germany has so far refused to help bail out faltering banks in other parts of Europe and would be conflicted if Deutsche Bank asked for help too.

If Germany agreed to support Deutsche Bank after refusing to support troubled Italian banks, it would not go down well in Italy. The coming Italian elections could lead to a vote to exit the EU.

On the other hand if Deutsche Bank's position worsened and it didn't get help, it could conceivably take other countries' banking systems down with it.

The IMF says Deutsche Bank is currently the greatest contributor to risk in the global banking system.

That risk is evident in Europe where negative interest rates are making it hard for banks to make profits. The balance sheets of many European banks are burdened with bad debts and loans that are unlikely to be repaid. Proposed new global regulations are bringing uncertainty to EU banks in particular, along with the potential for huge fines. Meanwhile EU banks like many others elsewhere are facing additional competition based on new technology, like crowdfunding, community shares and peer-to-peer lending.

All this is happening in a region where overall prospects are uncertain - a general trend away from European stocks, low GDP growth trends in larger EU states, and the failure of Eurozone quantitative easing to achieve the stimulus needed.

Watching Deutsche Bank and the European situation gives some perspective on the economic and banking environment here.

New Zealand has seen solid growth since the GFC, without the use of quantitative easing or other stimulus. Government debt is being steadily reduced. Currency independence makes New Zealand immune to sovereignty issues affecting Eurozone states. And New Zealand's banking system is stable, thanks to the Australian banks whose conservative management kept this region relatively free from the complex derivatives implicated in the GFC.

Four key factors are responsible for New Zealand's relatively healthy position - currency independence, a balanced budget approach, avoidance of stimulus and conservative banking.

Viewing difficulties in other regions where these factors are less evident, it's hard not to be thankful for good financial management and the relative economic strength it has delivered.

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