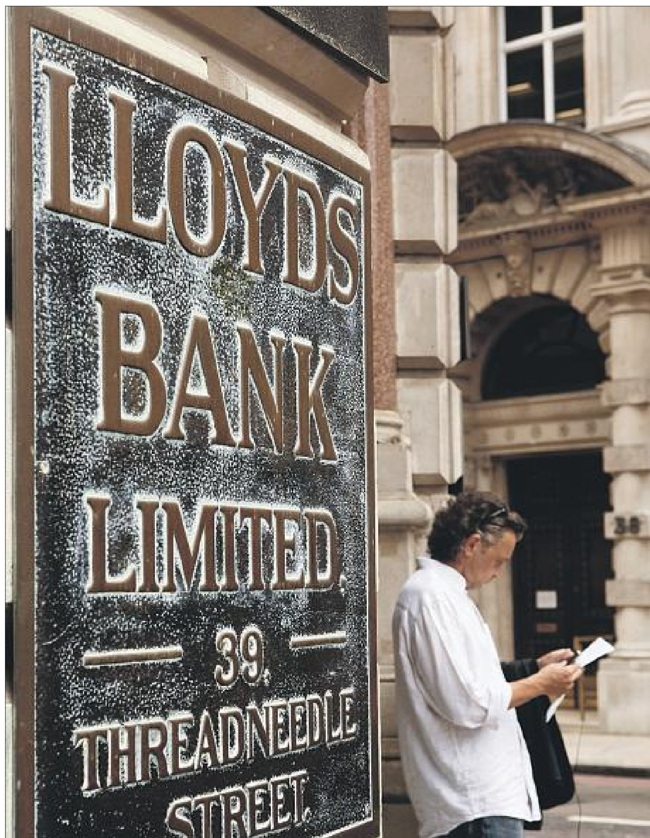
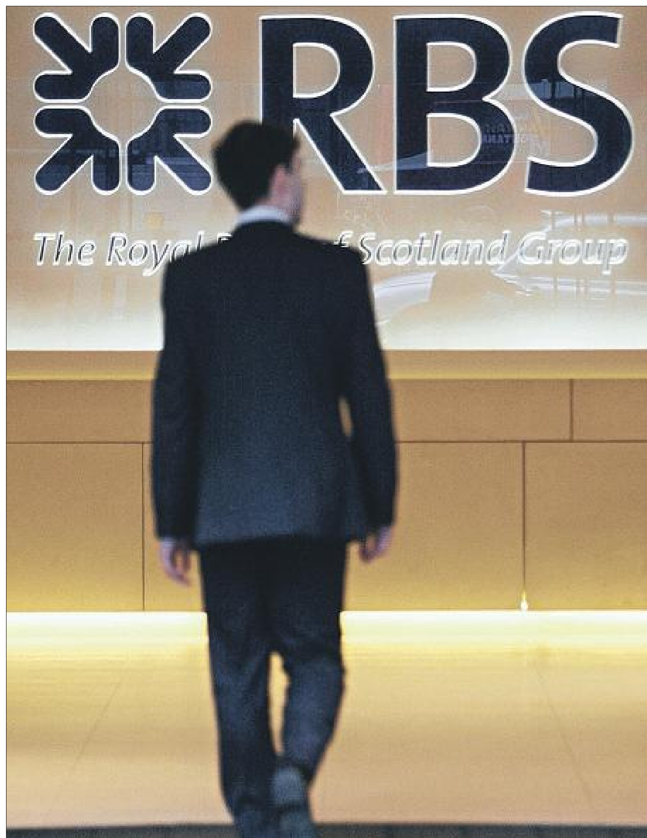


Lloyds – now owner of HBOS – and fellow Scottish banking icon RBS remain deep in troubled territory. They may have returned to profit but their share prices have signally failed to bounce back after the ravages of 2008



Troubled banks are far from out of the woods despite recovery talk

Banking

JEFF SALWAY

TWO years after the banking crisis that culminated in Scotland's biggest banks being bailed out by the UK government, the sector has gone a long way towards regaining the confidence of investors.

Yet while there has been some recovery, experts warn that the UK's biggest banks are far from out of the woods, with lingering concerns over the impact on the sector of the sluggish economy and potentially onerous new capital obligations.

It was two years ago this month that Royal Bank of Scotland had to be rescued by the government in the face of near-collapse. Edinburgh's other big bank, HBOS, was sold to Lloyds – a decision that continues to come under legal scrutiny – before the enlarged group followed RBS into the hands of the taxpayer.

Both banks remain government supported – 83 per cent in the case of RBS – and, while both have returned to profit in the past year, their share prices remain a long way short of the level prior to the crisis. Lloyds ended yesterday at 71.85p, compared with 111.5p on 22 October 2008 and 352.9p on the same date the year before. RBS shares were priced at 46.18p last night, down from 68.3p on the same date in 2008 and 502p in October 2007.

According to researchers H2O Markets, someone who invested £5,000 in Lloyds at the start of 2007 would now be left with just £432. The same stake in RBS would now be worth just £340.

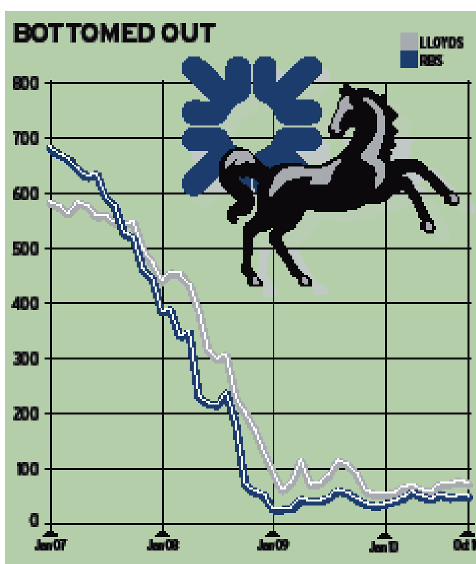
The difference is less marked among other UK banks, such as Barclays and HSBC. But despite last year's rebound, bank shares remain below pre-crisis levels and investors have been given fresh cause in recent weeks to retain their cautious outlook.

For instance, Standard Chartered – a UK bank despite its Asia focus – last week announced it was looking to raise more capital, sparking new speculation that other banks could also go to the market for more cash.

That is one of the implications of European rules announced last month aimed at preventing banks from returning to the lending practices that helped cause the credit crunch.

The new Basel III rules require banks to increase the cash they set aside to cover losses from 2 to 7 per cent, with total capital of at least 10.5 per cent, although some believe the UK's Financial Services Authority will enforce a minimum of 15 per cent.

They have seven years in which to meet the Basel requirements, but experts say the pressure is on for the banks to take significant steps sooner rather than later. Clem Chambers, chief executive of stocks and shares website ADVFN.com, said: "Banks are key to the plans of Europe and the US to escape the recession. Credit provision is vital to the process. Sadly the same governments are saddling the banks with onerous terms, and strangling the very process they need to save their economies."



Jeffrey Deans, managing director of Save & Invest in Edinburgh, said the rules could also result in lower dividends and pointed out that new capital raising issues could impact on capital returns for current shareholders.

Of course the banks most strongly associated with the 2008 crisis are RBS and Lloyds Banking Group, created from the merger of Lloyds and HBOS.

Chambers said: "Both are worth double their current price, on the face of it, but the yoke of politics means they trade at a big discount. As such, a brave investor can hunker down with their shares and wait for the inevitable, whether it takes one year or three to occur."

But David Thomson, chief investment officer at VWM Investment Management in Glasgow, pointed to other threats for investors in Lloyds and RBS to bear in mind.

"There is even a possibility that the government will sell its shares at the first available opportunity. Secondly, we keep hearing that UK banks are not lending but with the economic outlook so uncertain perhaps it is business that does not want to borrow," said Thomson.

"Thirdly, the government cannot be comfortable in the long term with such large banks and they may be broken up to stimulate competition and get them down to a size where they might not be 'too large to fail'."

And the broader outlook is still a concern, with the implications of a potential double-dip recession to consider.

Philip Gibbs – who runs the £1 billion Jupiter Financial Opportunities fund – has reduced his exposure to western banks in favour of those in the emerging markets. Last month Gibbs said he was unconvinced that western economies, with their high debt levels, would be able to avoid a double-dip recession. And although Gibbs said financials were currently attractively valued, that pricing is based on a recovery that would not necessarily materialise in the near future.

Thomson agreed that if UK banks are facing strong headwinds then overseas banks could be a better option, or at least those doing a lot of business in the emerging markets, such as HSBC and Standard Chartered.

"These banks have certainly outperformed their UK peers in the past couple of years with Standard Chartered returning 75 per cent since the bailout two years ago, helped in no small measure by the significantly high levels of economic growth in the Far East," said Thomson.

The other issue for many investors is understanding exactly where individual banks stand financially. As was made clear in the credit crunch, few people are able to unravel the workings of the typical bank balance sheet.

Deans said: "The complexities of the products that banks sell to companies and other institutions have, in many people's opinion, been the root cause of the financial crisis and are concerned that to date nothing much seems to have happened to properly reform the situation."