

THE STRESS TESTS

Do certain banks need more capital? We'll soon find out.



On April 24, 2009 the Federal Reserve revealed some of the details of the “stress tests” that will comprehensively analyze assets on the books of 19 notable U.S. banks. The results are expected to be released on Thursday, May 7 2009.¹ (The banks already know the results in private.)

What the Fed white paper had to say was hardly surprising. While mentioning that “most U.S. banking organizations currently have capital levels well in excess of the amounts required to be well capitalized”, it conceded that the recession and resulting market upheaval

“substantially reduced the capital of some banks.”¹ Which ones? We’ll find out the week of May 4, 2009.

Why is the government doing this? It wants to determine which banks might have the greatest risk of failure if the recession worsens. Can certain banks survive worst-case scenarios?

No banks will “fail” the test, but some could receive more TARP money as a result – which could mean a lot more money poured into TARP.²

How realistic are the stress test scenarios? Even if the government uses computer-generated models to make economic projections, how accurate will they prove to be? Some economists and analysts think things could get worse, but many feel the economy will improve in coming months. Others have questioned the testing criteria. Many wonder if releasing too much information might diminish public confidence.

The first scenario assumes a 2009:

- with -2.0% GDP
- unemployment hitting 8.4%
- home prices dropping 14%
- then in 2010, +2.1% GDP, 8.8% unemployment rate, and home prices down 4%

The second scenario is rougher:

- -3.3% GDP
- 8.9% unemployment
- and 22% lower home prices in 2009
- then +0.5% GDP, 10.3% joblessness and a 7% downturn in home prices in 2010.³

The White House View. The Obama administration says the tests are all about the goal of stabilization - a cautionary move that could help banks avoid any chance of nationalization. In fact, any banks directed to increase their “capital buffer” will have to turn to the private sector first before going to the government.¹

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Citations.

¹ abcnews.go.com/Business/Economy/story?id=7421449&page=1 [4/24/09]

² latimes.com/news/nationworld/world/la-fi-stress-tests19-2009apr19,0,655575.story [4/19/09]

³ forbes.com/feeds/afx/2009/04/24/afx6336215.html [4/24/09]