Yet Another Greek Secret: The Case of Greece's Phantom Assets

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When banks are in distress, it is important to assess how easily the bank's capital cushion can absorb potential losses from troubled assets. To do this, I performed an analysis using Texas Ratios for Greece's four largest banks, which control 88% of total assets in the banking system.

We use a little known, but very useful formula to determine the health of the Big Four. It is called the Texas Ratio. It was used during the U.S. Savings and Loan Crisis, which was centered in Texas. The Texas Ratio is the book value of all non-performing assets divided by equity capital plus loan loss reserves. Only tangible equity capital is included in the denominator. Intangible capital — like goodwill — is excluded.

Despite the already worry-some numbers, the actual situation is far worse than even I had initially deduced. A deeper analysis of the numbers reveals that Greece's largest banks include deferred tax assets as part of total equity in their financial statements. Deferred tax assets are created when banks are allowed to declare their losses at a later time, thereby reducing tax liabilities. This is problematic because these deferred tax assets are really just "phantom assets" in the sense that these credits cannot be used (read: worthless) if the Greek banks continue to operate at a pretax loss.

Similar to its neighbors — Portugal, Spain and Italy —Greece provides significant state support to its banks by offering credit for loss deductions for taxable future profits. For the four largest banks, this type of support made up 38-61% of total equity (see accompanying chart).

Deferred Income Tax Assets as a Percentage of Total Equity		
Bank	Year	Percentage
National Bank of Greece	2014	**38.40%**
Piraeus Bank	2014	**54.90%**
Alpha Bank	2014	**47.90%**
Eurobank Ergasias	2014	**61.80%**
Source: Bloomberg. Calculations by Prof. Steve H. Hanke. The Johns Hopkins University		
Note: Deferred income tax assets are reported in the accumulated other comprehensive income component of capital equity.		

Adjusting the Texas Ratio to account for the phantom assets yields much higher ratios. These indicate significantly higher risk of bank failures, barring a capital injection (see the accompanying chart).

Adjusted Texas Ratios For the Largest Greek Banks			
Bank	*Year*	*Texas Ratio*	*Adjusted Texas Ratio*
National Bank of Greece	*2014*	***98.70%***	***122.00%***
Piraeus Bank	*2014*	***195.10%***	***265.5%***
Alpha Bank	*2014*	***129.40%***	***166.60%***
Eurobank Ergasias	2014	**124.70%**	**164.70%**
Source: Bloomberg. Calculations by Prof. Steve H. Hanke. The Johns Hopkins University			
Texas ratio formula: (Bank non-performing assets and loans) / (Total equity + Reserve for loan losses)			
Adjusted Texas ratio formula: (Bank non-performing assets and loans) / ((Total equity – Deferred income tax assets) + Reserve for loan losses)			

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