EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Banking sector resilience – the post-pandemic outlook

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Resilient capital position of banks

Q2-2021:

- CET1 ratio 15.6%, near all-time high since banking union start
- Leverage ratio 5.9%, on an increasing trend

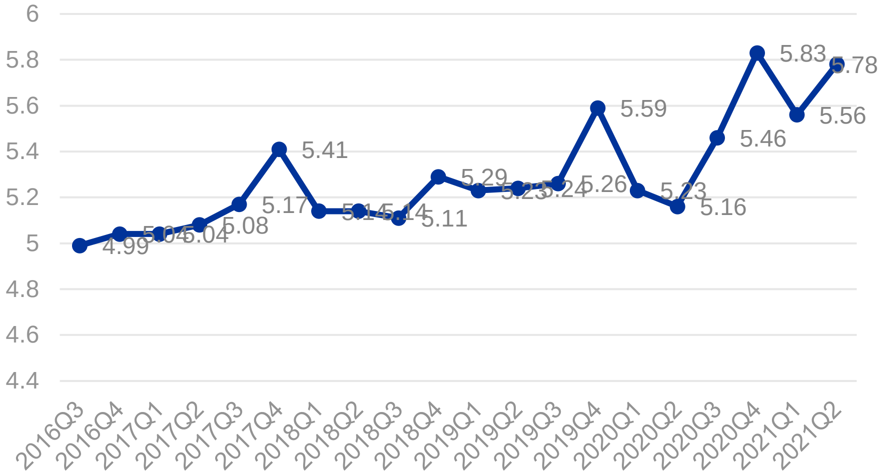
Chart 1
CET1 ratio

(percentages)

Source: Supervisory reporting.

Chart 2
Leverage ratio

(percentages)



Ample liquidity adds to resilience

Q2-2021:

- Liquidity coverage ratio 173.8%
- Net stable funding ratio 129.1%

Chart 3
Liquidity coverage ratio
(percentages)

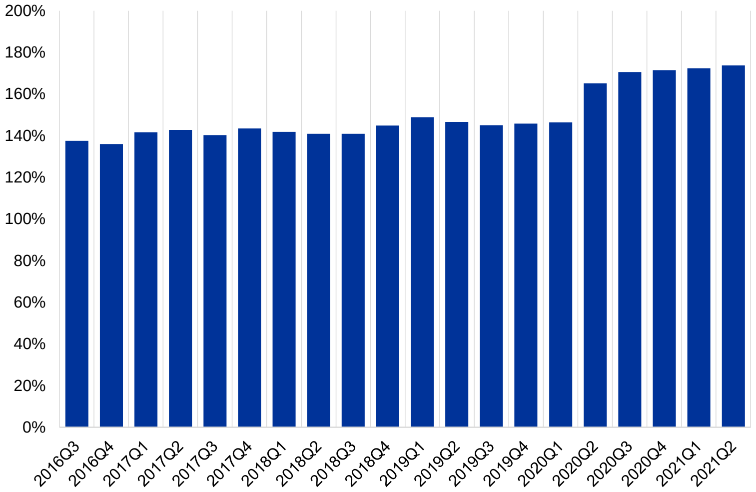
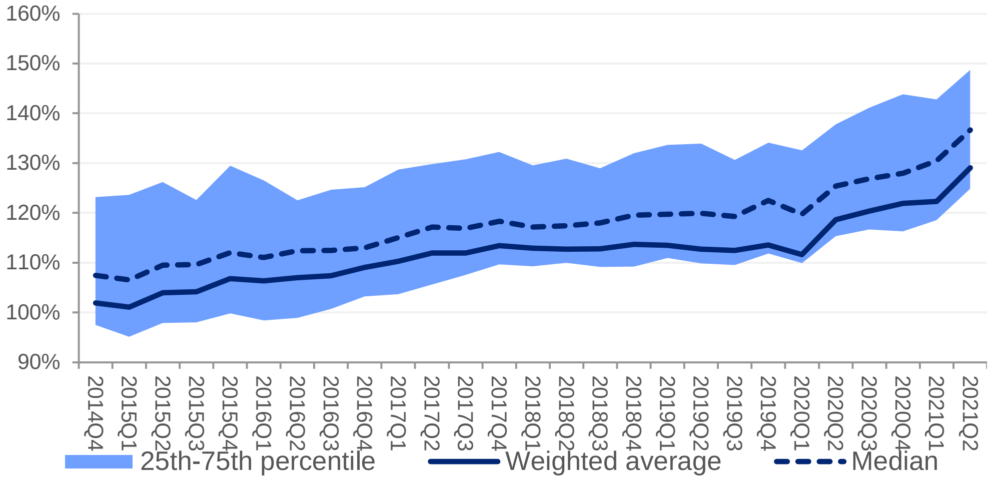


Chart 4
Net stable funding ratio
(percentages)



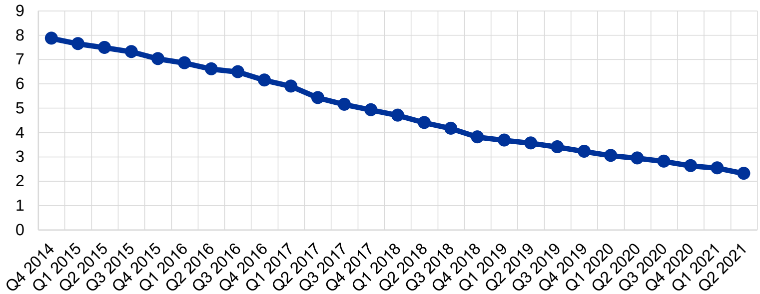
Source: Supervisory reporting.

Non-performing loans ratio continues to decrease, but early indicators show signs of deterioration

Q2-2021: NPL ratio 2.3% (from 2.5% in Q1)

- However, liquidity gathered via support measures might still obscure full impact of the pandemic.
- Early indicators such as forbearance rates are showing signs of deterioration. Historically, default rates for forborne loans are higher than for non-forborne loans.
- Cautious optimism is warranted, but we have to remain vigilant as support measure are being phased out.

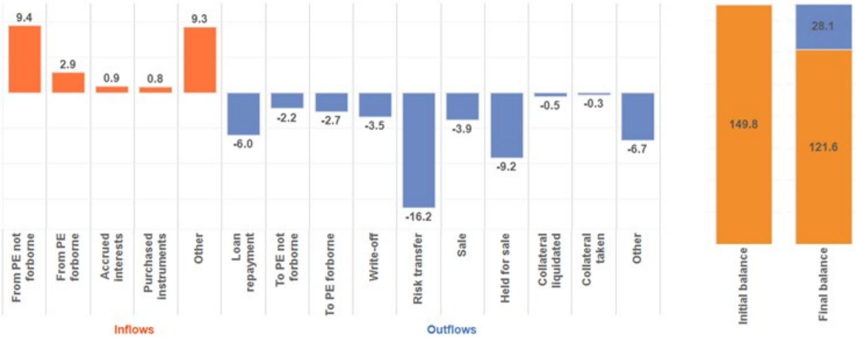
Chart 5
Non-performing loans ratio



Source: ECB statistics

Note: Changing sample.

Chart 6
NPL flows for high-NPL banks in H1 2021



Lessons learned from the pandemic

- **The post-GFC regulatory reforms worked as intended**

- **Higher capital and macro/micro buffers allowed banks to act as shock absorbers, not amplifiers as in GFC. This time lending increased after the shock of the pandemic.**

- **Public support still playing a key role**

- **Focus now on implementation of the finalised Basel III, stability of the framework is needed**

Potential room for improvement:

- **balance between structural/cyclical buffers**
- **heterogeneous approach of national macroprudential authorities**
- **triggers of AT1 coupons, which make banks reluctant to dip into capital conservation buffer**

Structural challenges

- Euro area banks, on average, do not earn their cost of equity
- Cost efficiency is sticky
- **However, some restructuring and cost optimisation is taking place: one-off costs and lagged benefits delay the evidence of change in P&L**

Chart 7
Cost on equity and return of equity

(percentages)

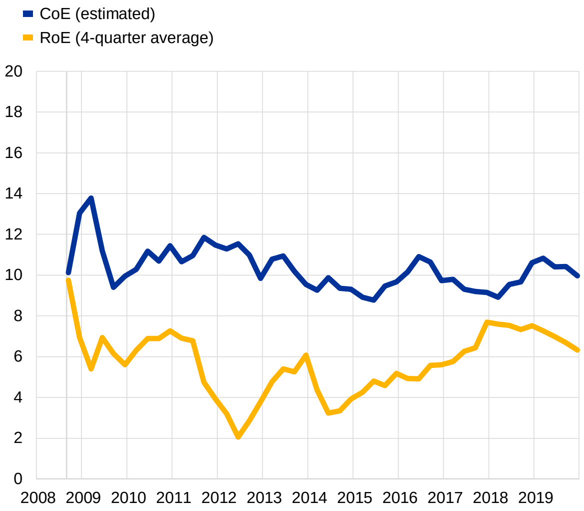
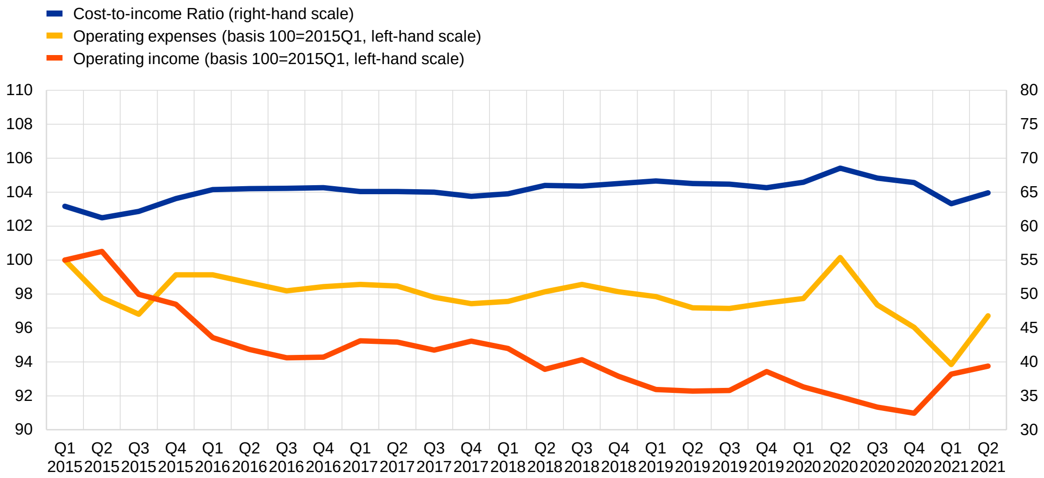


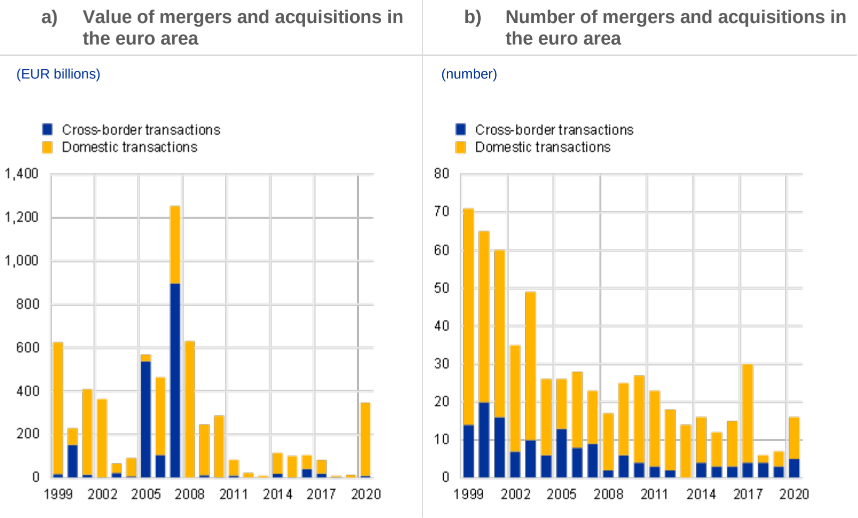
Chart 8
Cost-to-income and components



Bank M&As: encouraging signs of a rebound in bank consolidation in Europe

- Volume of transactions highest since 2008, with transactions worth more than €300 billion
- Targeted consolidations of business lines, also across borders: asset management, custody or securities services as well as payment technologies sector
- Similar to restructuring programmes, M&As entail upfront costs, so benefits can be expected to emerge with a lag

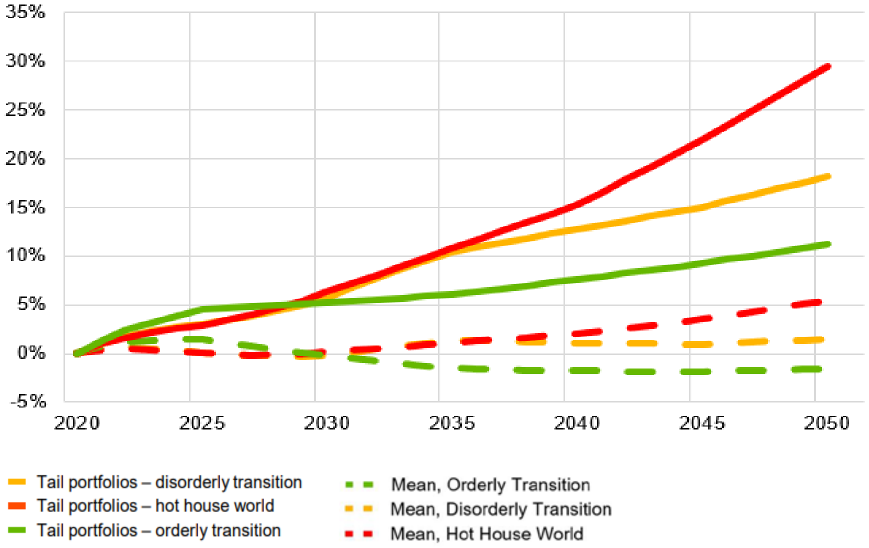
Chart 9
Mergers and acquisitions



Sources: ECB calculations based on Dealogic and Orbis BankFocus
Notes: Transactions associated with the resolution of banks and distressed mergers were removed fromthe sample. Transactions are reported by the year of the announcement. Total assets are the target’s total assets

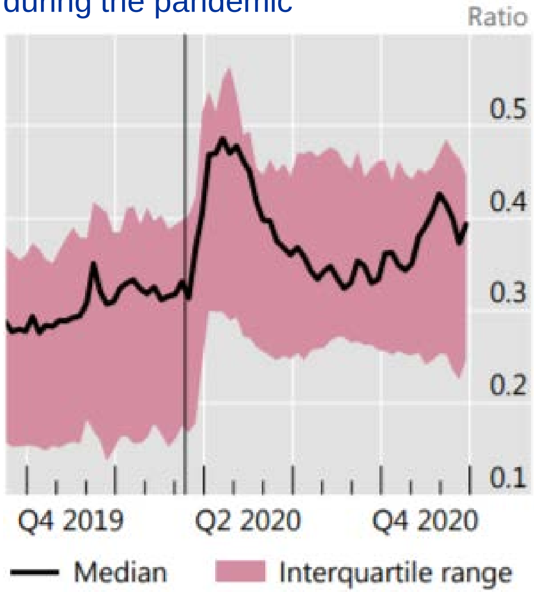
Digitalisation and green finance will drive business model transformation

Chart 10
Evolution of banks' credit portfolio probabilities of default between 2020 and 2050: physical risks increasing over time, while transition even brings benefits in long-run



Source: ECB economy-wide climate stress test

Chart 11
Increase in remote digital payments during the pandemic

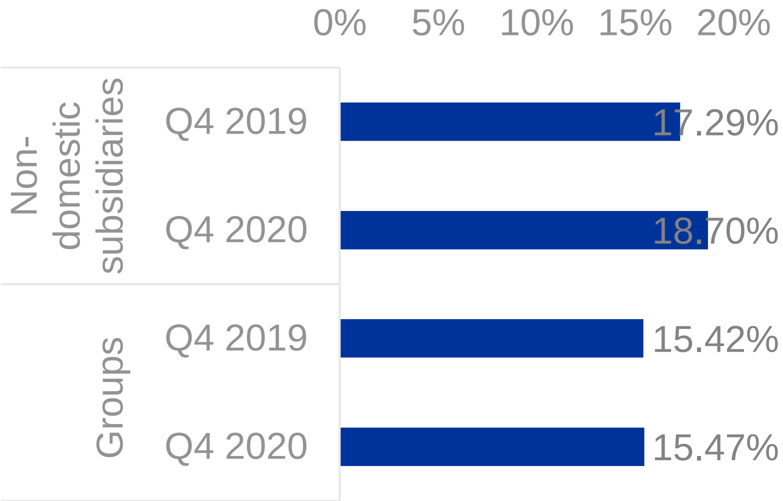


Source: BIS

Sample: The sample comprises AR, AU, BR, CA, CH, DE, ES, GB, HK, IN, IT, JP, NL, RU, SE, SG, US and ZA. The black vertical line in the centre panel indicates 11 March 2020

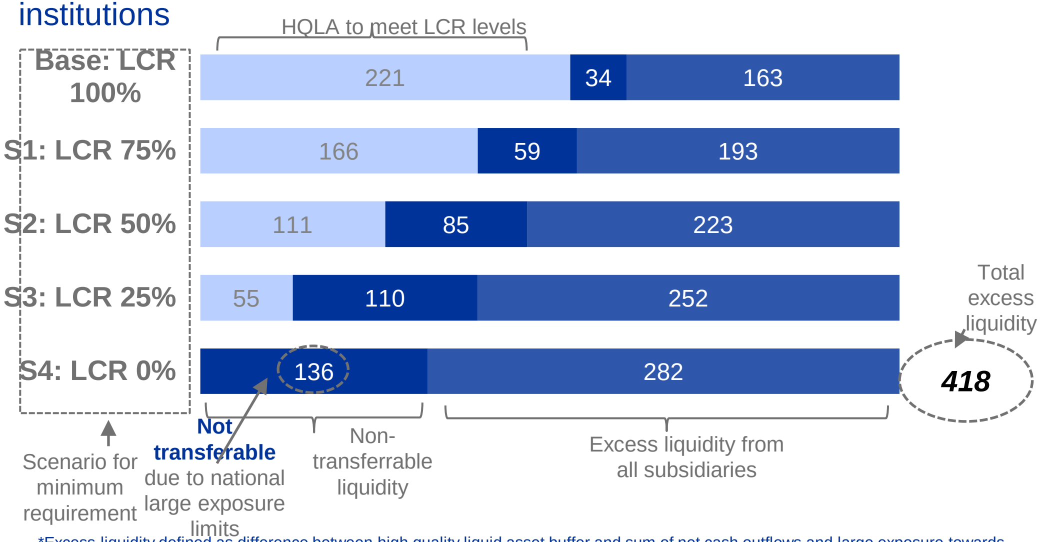
Further integration should be pursued, within the current setting and progressing with the Banking Union

CET1 ratios of parent entities and cross-border subsidiaries



Source: Supervisory data. Weighted average CET1 ratio of 117 non-domestic subsidiaries located in the SSM and their consolidated groups.

Excess liquidity held in the euro area by non-domestic subsidiaries of SSM significant institutions



*Excess liquidity defined as difference between high quality liquid asset buffer and sum of net cash outflows and large exposure towards ultimate parent.

- **Cross-border liquidity waivers could be coupled with intragroup financial support agreements embedded in recovery planning**
- **Branchification within the EA would allow to benefit from the one-legal-entity structure without changes of the the supervisory attitude**

The new normal of banking supervision is gradually taking shape

- **On-site work remains key.** This guarantees the full intrusiveness of our supervisory approach as it is originally conceived. We are also drawing lessons from the off-site investigations and keen to have the feedback from these first missions restarting on-site.

- **We need to work towards a true “one team” culture in JSTs and further increase collaboration between ECB and NCAs.** JSTs have reported that remote working has facilitated the free and equal flow of information between the ECB and NCAs. It will be important to carry forward these efficiency gains from remote working to the new normal.

- **Digitalisation is not just for banks, but for supervisors as well.** Supervisory technologies can help us to get the most from the large amounts of data available, and it can allow us to focus our time on the aspects of our work that will have the biggest impact.