Vítor Constâncio
ECB Vice-President

Challenges for the European banking industry

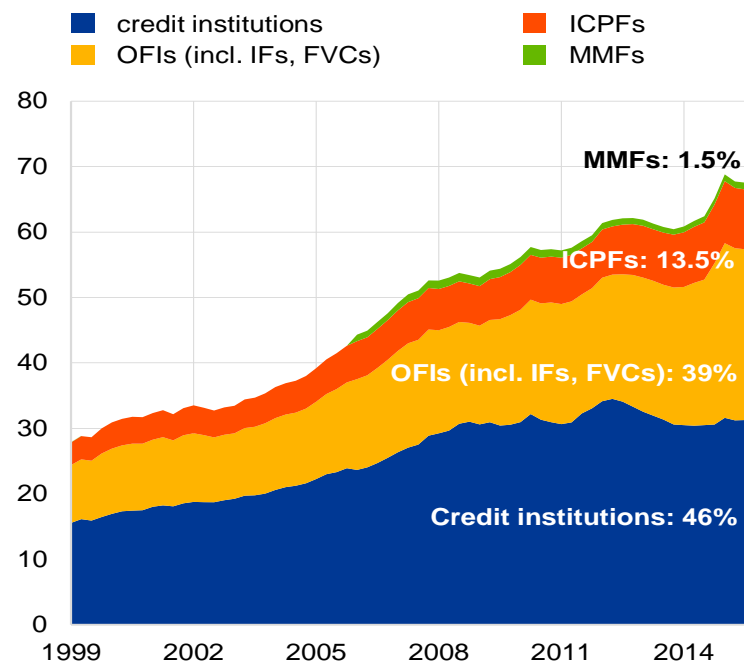Conference "European Banking

Industry: what's next?"

University of Navarra, 7 July 2016

Outline

» **Introduction**

» **Banks under siege: general challenges**

  » *FinTech* **threat of unbundling banks**

  » **Uncertainty in the finalisation of the regulatory agenda**

  » **Low interest rate environment**

  » **Regulation of shadow banking and the boundary problem**

» **The "***Alchemy of banks***", the financial crises and structural reform proposals**

» **European banking sector: facts and challenges**

  » **Low profitability**

  » **Non-performing loans**

  » **Overcapacity in the banking sector**

  » **Prospects for bank consolidation**

» **Response by the banks**

» **Conclusion**

Euro area total financial sector assets

(Q1 1999 - Q4 2015; EUR trillions)

External financing of euro area non-financial corporations

(Q1 2000 – Q1 2016; EUR billions; four-quarter moving flows)

Sources: ECB and ECB calculations.

Note: MMFs refer to Money Market Funds. ICPFs refer to Insurance Corporations and Pension Funds. Other financial institutions (OFIs) refers to non-monetary financial corporations excluding ICPFs. Non-money market investment funds (non-MMF IFs) and financial vehicle corporations (FVCs) are included in the OFI sector.
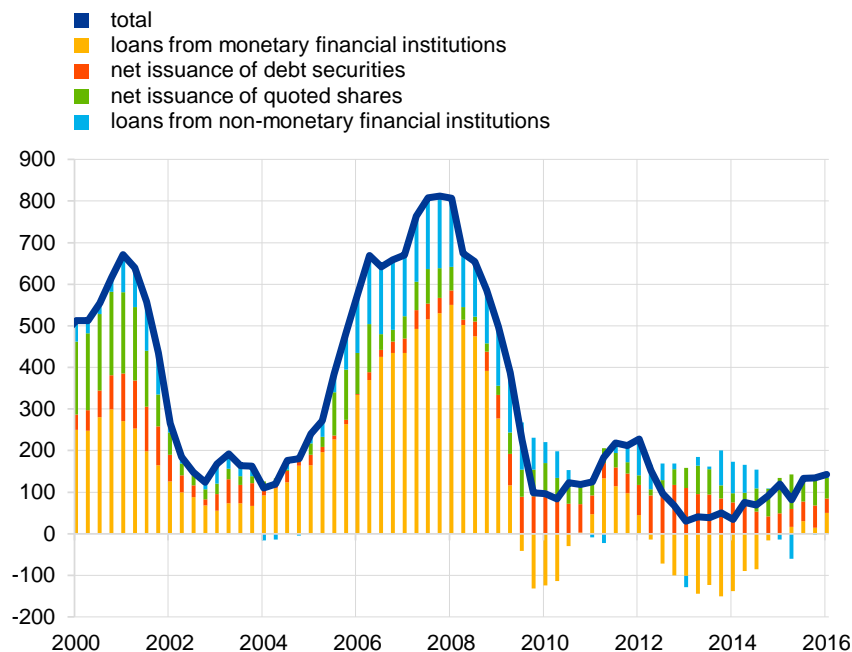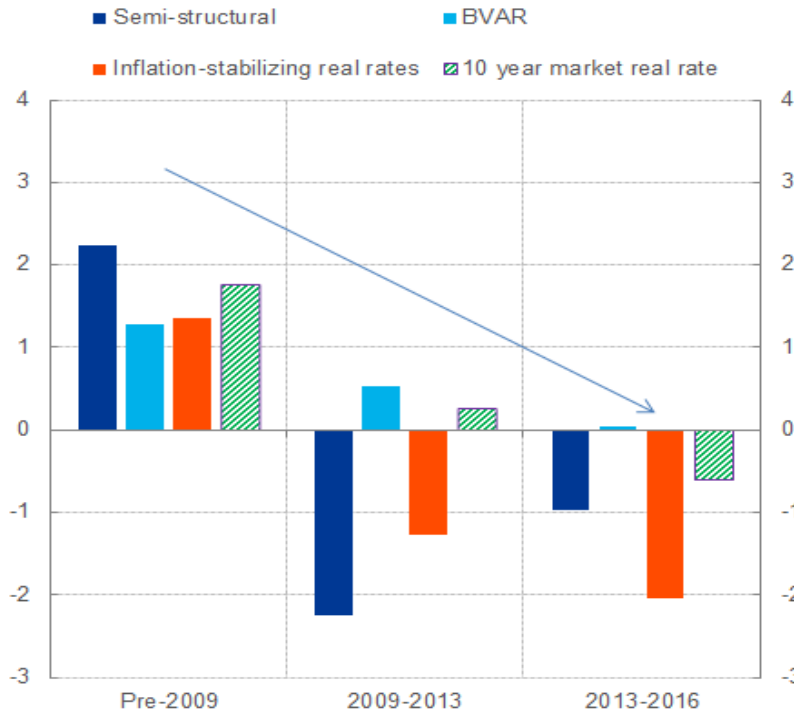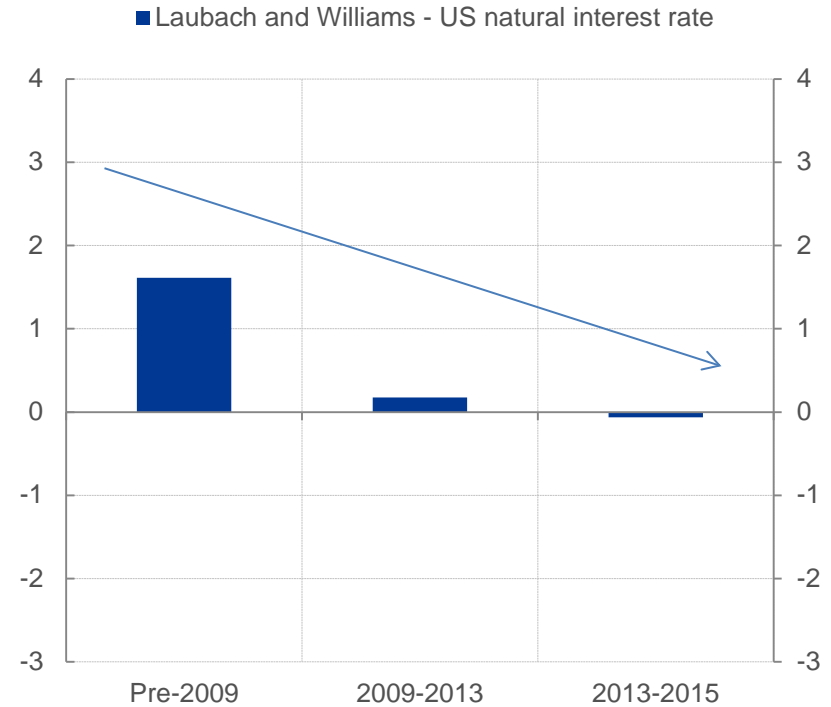
Sources: Eurostat, ECB, Dealogic and ECB calculations.

Note: Loans from monetary financial institutions to non-financial corporations are corrected for loan sales and securitisations, while loans from non-monetary financial institutions exclude loan securitisations.

Chart 2: Estimates of the equilibrium real rate compared to the market real rate


Source: ECB calculations, and San Francisco FED.
Notes: The semi-structural model is very much aligned with the approach of Messonnier and Renne (2007). The BVAR is a bayesian vector auto regression with minimal restriction that forecasts a five-year ahead forecast of the short-term real interest rate. The inflation-stabilizing real rate is the real interest rate that would be required to stabilise inflation in the euro area at below but close to 2% over the medium-term. It is based on the model by Christiano, Motto and Rostagno (2014). For the US, the natural real rate is based on the publically available data series from the model by Laubach and Williams (2003).
Latest observation: 2016 Q1 for the euro are estimates and 2015Q4 for the US.

Euro area banks' return on equity

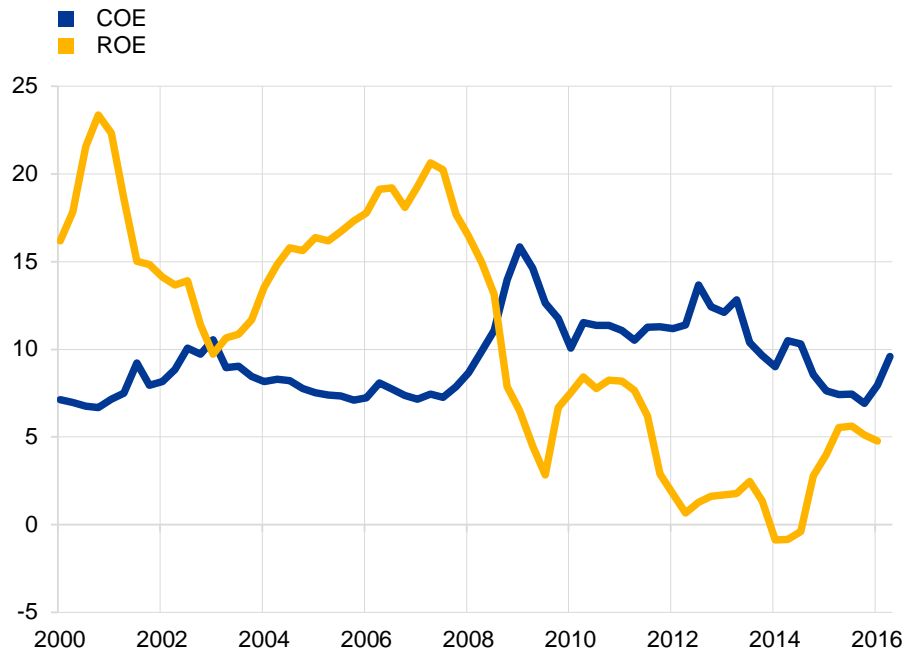(2009-Q1 2016; percentages; 10th and 90th percentiles, interquartile range and median)
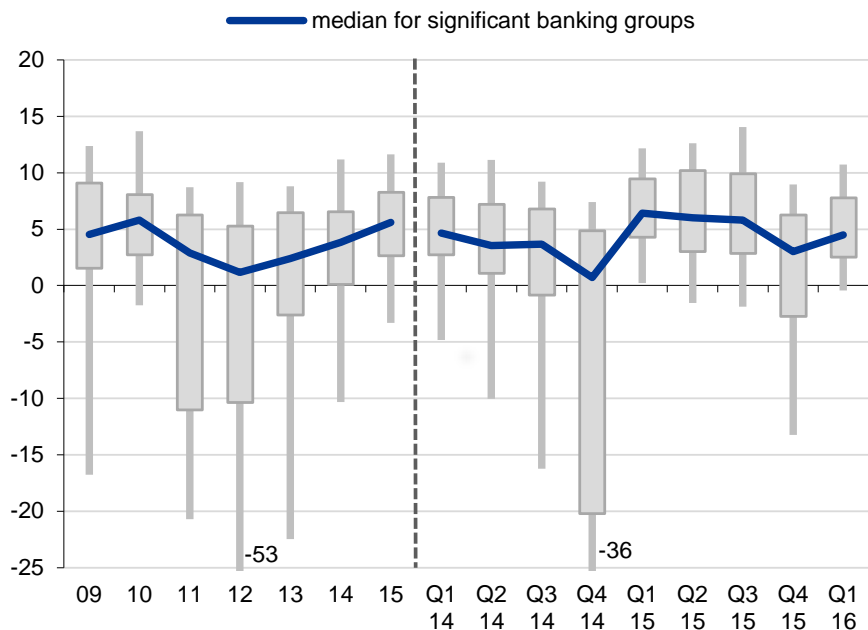
Source: SNL Financial.

Notes: Based on publicly available data on significant banking groups. Annual and quarterly data are based on a sample of 81 and 49 SBGs respectively.

Return on equity and cost of equity and for listed euro area banks
(Q1 2000 – Q2 2016; percentages)

Sources: Bloomberg, Datastream, Consensus Economics, ECB calculations.

Notes: COE is the expected return on the EuroSTOXX Banks index, estimated by applying the CAPM to the EuroSTOXX market index with one-year rolling betas. Estimates of the equity premium are based on I/B/E/S earnings forecasts and Consensus estimates of long term real GDP growth. Return on equity (ROE) is the trailing weighted average (by mkt cap) of individual ROEs. Latest observations are for Q1 2016 (ROE) and Q2 2016 (COE).

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Chart 4: Deterioration in market sentiment largely reflected a re-evaluation of banks' profitability prospects
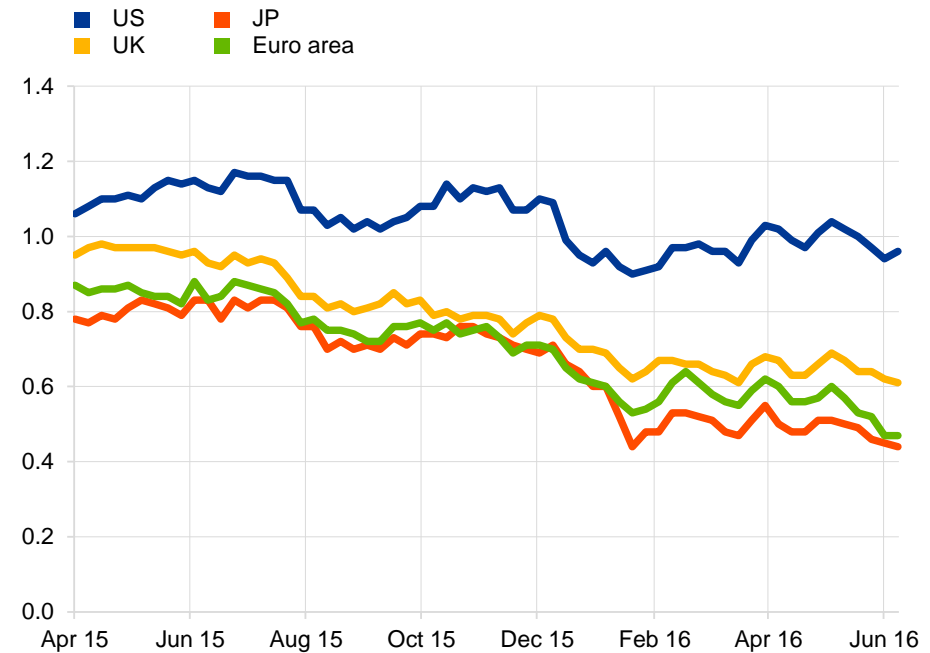
Bank equity indices for key regions

(1 Jun. 2015 - 5 Jul. 2016, daily data)

Legend:
- S&P500 Banks
- FTSE 350 Banks
- Nikkei 500 Banks
- Eurostoxx Banks
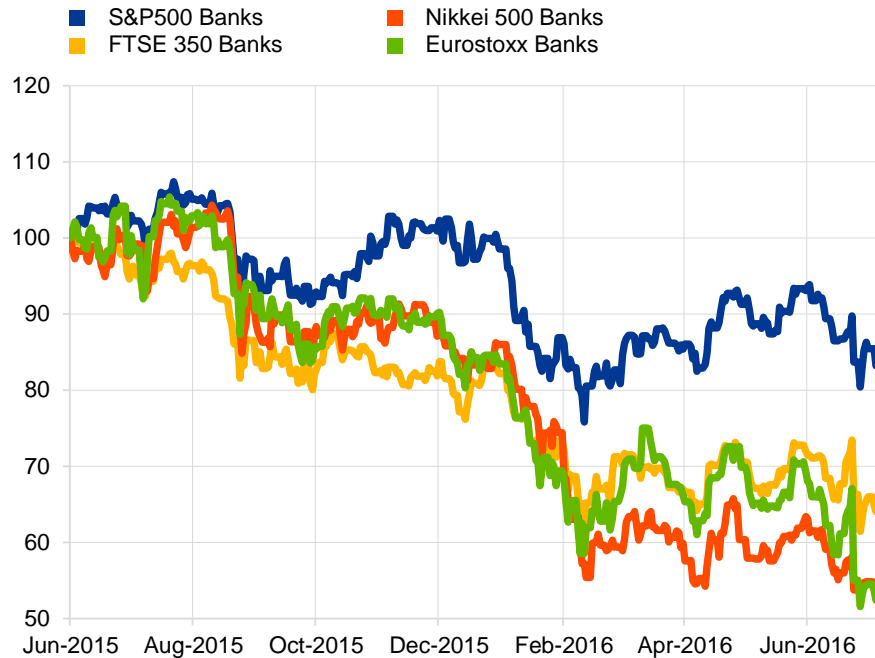
Sources: Bloomberg and ECB.

Banks' price-to-book ratios in key regions

(1 Jan. 2015 - 1 Jul. 2016, weekly data)


Legend:
- US
- UK
- JP
- Euro area

Sources: Bloomberg, Datastream and ECB.

Chart 5: Scope for efficiency gains in the banking sector

- Branch network rationalisation and headcount reductions brought efficiency gains in some, but not most, euro area banking sectors
- Low market concentration and higher cost inefficiency suggest there is scope for efficiency gains from consolidation

Change in the number of bank branches/employees versus the change in cost-to-income ratio in euro area countries
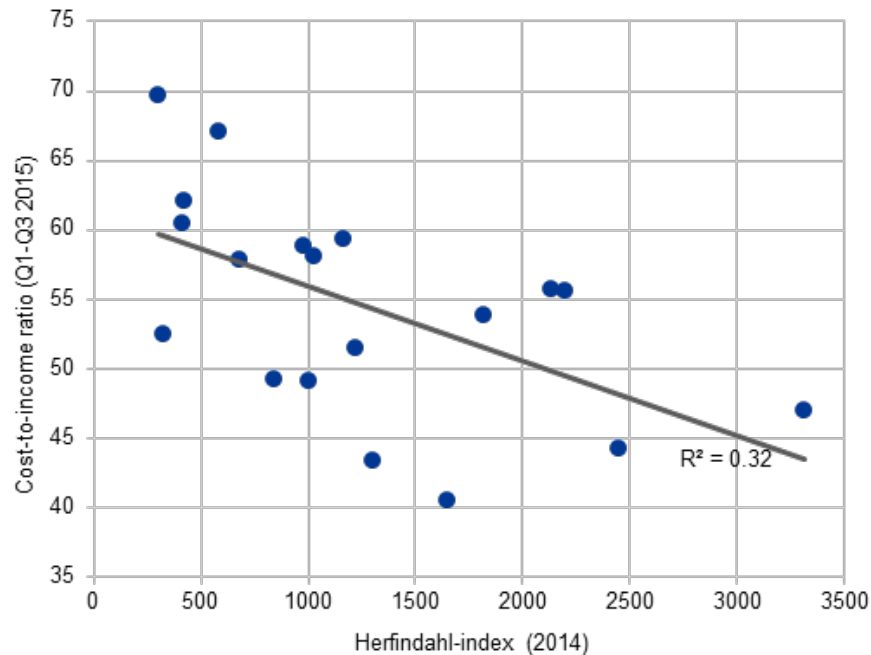2009-2014; percentage changes (x-axis); percentage point changes y-axis
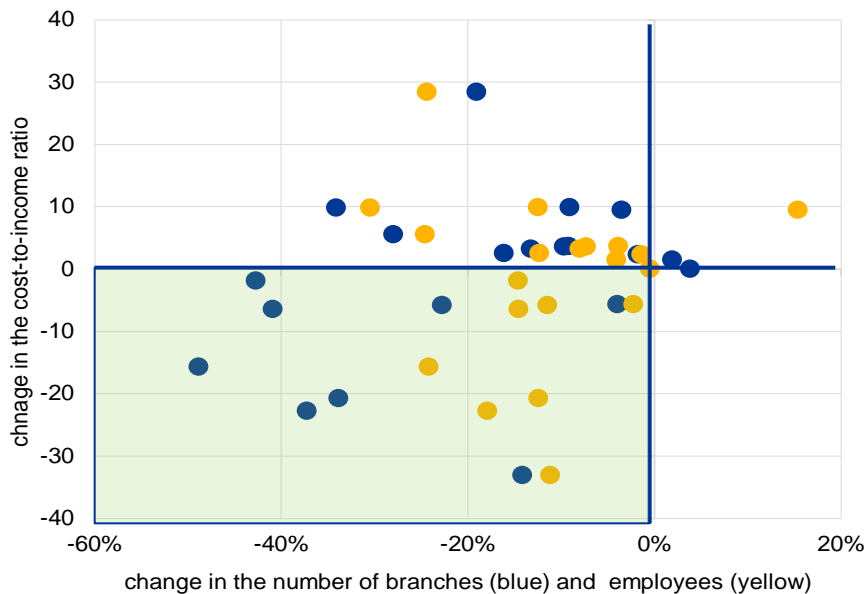
Market concentration and efficiency ratio in euro area countries
x-axis: Herfindhal index; y-axis: cost-to-income ratio

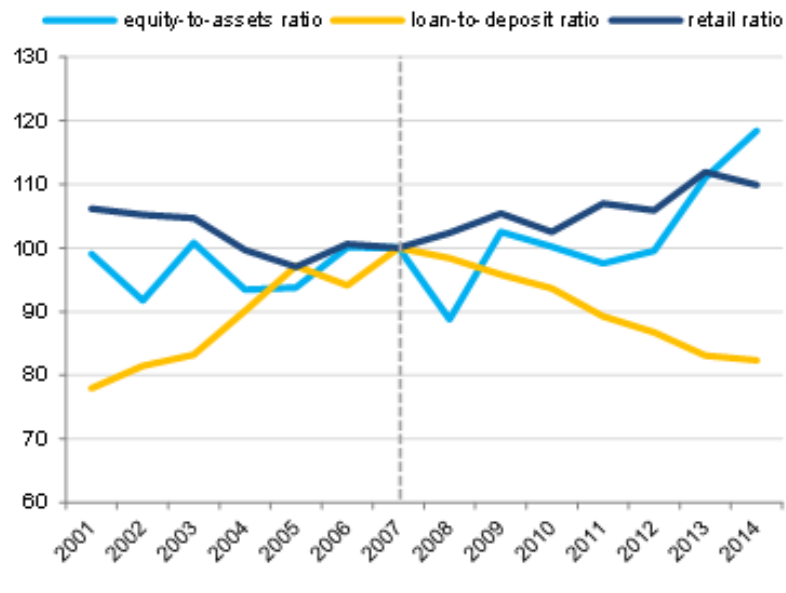Sources: ECB and ECB calculations.

Source: ECB.

Shift in EU banks' business models since the crisis to lower leverage, reduced reliance on wholesale funding and higher reliance on retail activities¶

Changes in EU significant banking groups' key business model characteristics after the crisis¶
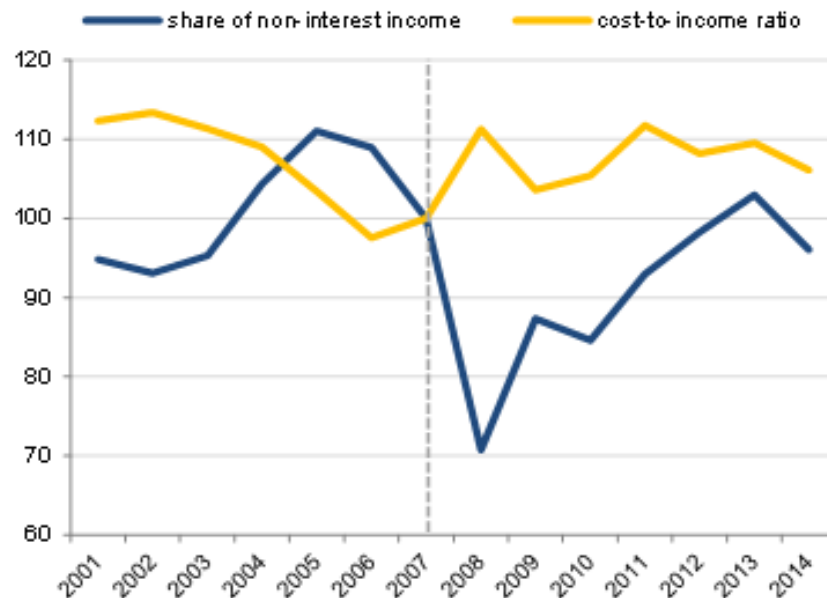
(2001-2014; index 2007=100)¶

Sources: Bloomberg, SNL and ECB calculations.¶
Notes: The index is based on the median value for each indicator. The retail ratio is calculated as the ratio of customer deposits plus (net) customer loans over total assets.¶

Income diversification gradually increased compared with crisis lows, while cost efficiency did not show any improvement in the post-crisis period¶

Changes in EU significant banking groups' non-interest income share and cost-to-income ratio after the crisis ¶
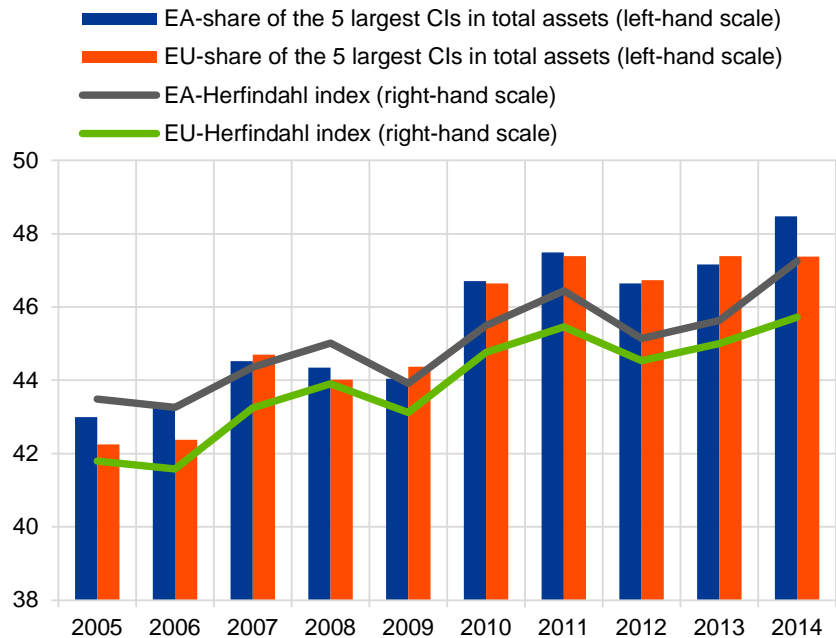
(2001-2014; index 2007=100)¶

Sources: Bloomberg, SNL and ECB calculations.¶
Note: The index is based on the median value for each indicator. ¶

Market concentration in the euro area/EU banking system

(2005-2014; share of 5 largest CIs; Herfindahl index)

Market concentration in euro area countries

(2008-2014; Herfindahl index)

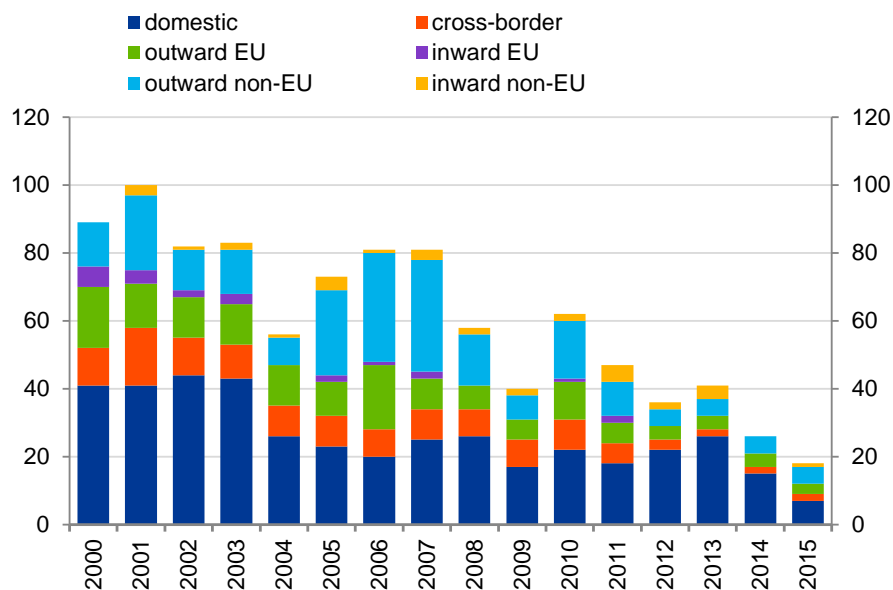Source: EU structural financial indicators.
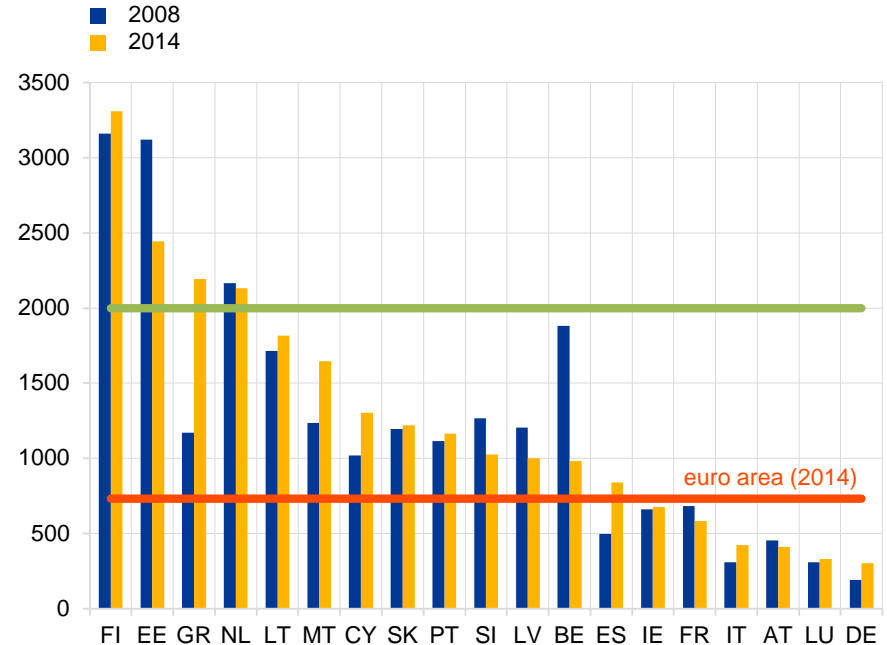
Source: EU structural financial indicators.

Note: Horizontal line represents market concentration in the euro area in 2014.

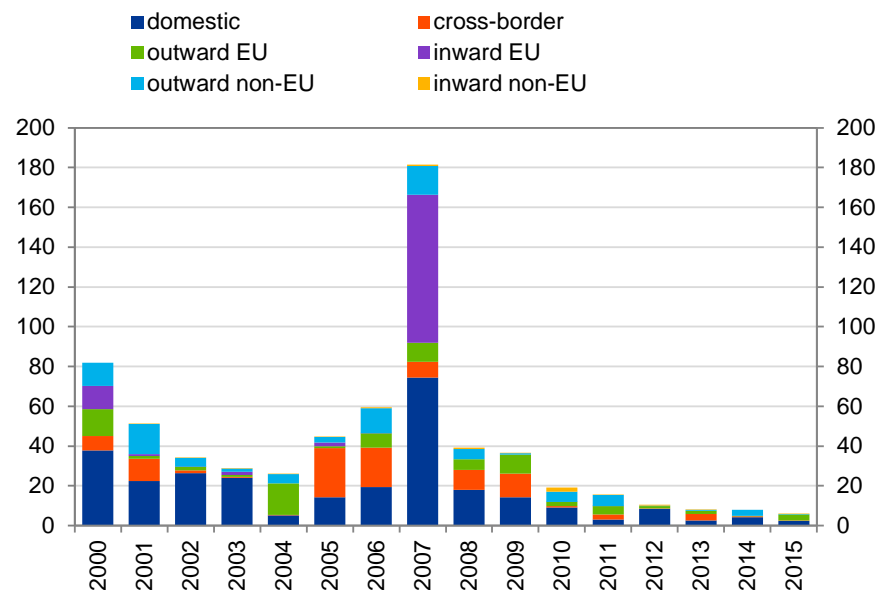## Bank M&As – number of transactions

(2000 - 2015)

- ■ domestic
- ■ cross-border
- ■ outward EU
- ■ inward EU
- ■ outward non-EU
- ■ inward non-EU

Bank M&As – value of transactions

(2000 - 2015; EUR billions)

- ■ domestic
- ■ cross-border
- ■ outward EU
- ■ inward EU
- ■ outward non-EU
- ■ inward non-EU

Source: Dealogic M&A Analytics.

Notes: M&As include both controlling and minority stakes. The value of some of the transactions is not reported. "Cross-border" M&As refer to intra-euro area transactions involving a non-domestic acquirer. "Inward" refers to M&As by non-EU or non-euro area EU banks in the euro area and "outward" indicates M&As carried out by euro area banks outside the euro area.