EBA confirms progress in banks’ balance-sheet repair but points to a bleak outlook for their profitability

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**The European Banking Authority (EBA) published today its annual Report on risks and vulnerabilities in the EU banking sector. The Report is accompanied by the publication of the 2019 EU-wide transparency exercise, which provides detailed information, in a comparable and accessible format, for 131 banks across the EU. Overall, EU banks’ solvency ratios remained stable, while the NPL ratio further contracted. Amidst low profitability, a proactive management of operating expenses is essential.**

**Overview of key figures**

|  | **CET1 ratio (transitional)** | **CET1 ratio (fully loaded)** | **NPL ratio** | **Coverage ratio** | **RoE** | **Leverage ratio (fully phased-in)** |
| --- | --- | --- | --- | --- | --- | --- |
| Q2 2019 | 14.6% | 14.4% | 3.0% | 44.9% | 7.0% | 5.2% |
| Q2 2018 | 14.5% | 14.3% | 3.6% | 46.0% | 7.2% | 5.1% |

**EU banks assets rose by 3 % between June 2018 and June 2019.** Since 2014, commercial real estate, small and medium-sized enterprise (SME) and consumer credit exposures have been the segments with the highest growth rates. This focus on riskier segments shows banks’ search for yield in an environment of low interest rates and shrinking margins.

**Asset quality has continued to improve, although at a slower pace.** The NPL ratio declined from 3.6 % in June 2018 to 3 % in 2019. However, the focus on riskier exposures over the past few years combined with a weakening macroeconomic outlook might change this trend. Responses to the EBA’s Risk Assessment Questionnaire (RAQ) also show that an increasing share of banks expect a deterioration of asset quality for most of the loan segments. These include portfolios, which they also aim to expand, like SME and consumer credit financing.

**Funding conditions have improved, supported by benign financial markets.** Banks should take advantage of the current low interest rate environment to build up their MREL buffers. With an increasing number of banks charging or planning to charge negative interest rates to corporate and household deposits, the effects of such measures on the deposit base remain to be seen.

**After material progress over the past few years, capital ratios remained broadly unchanged year on year (YoY).** As of June 2019, the CET1 ratio stood at 14.4 % (14.3 % in June 2018) on a fully loaded basis. A parallel increase in risk-weighted assets (RWAs) (2.5 % YoY) and CET1 (3 % YoY) was observed in the last year. Credit risk, which makes up 80 % of total RWA, has increased by roughly 2.5 %, which is lower than the growth in total assets (3 %) and total loans (3.5 %). Such developments indicate that credit RWAs are driven not only by trends in banks’ assets, but also by changes in the composition of banks’ exposures and risk parameters.

**Profitability remains at low levels.** The RoE for EU banks decreased slightly from 7.2 % to 7 % in 2019. The deteriorating macroeconomic environment along with low interest rates and intense competition not only from banks, but also from financial technology (FinTech) firms and other financial players, is expected to add further pressure to bank profitability. In this challenging environment, the streamlining of operating expenses is presumably the main area to improve profitability.

**Technology risks and increasing money laundering/terrorist financing (ML/TF) cases maintain operational risk high.** Cyberattacks and data breaches represent major concerns for banks. In addition, the occurrence of ML/TF scandals may imply corresponding legal and reputational costs.