The risk outlook for euro area banks

Cumberland Lodge
Financial Services Summit

4 November 2022

Andrea Enria
Chair of the Supervisory Board
Sound balance sheets and net interest income on upward trend; analysts expect gains to continue

**Q2-2022 prudential statistics**

<table>
<thead>
<tr>
<th>Metric</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>CET1 ratio</td>
<td>15.0%</td>
</tr>
<tr>
<td>LR</td>
<td>5.3%</td>
</tr>
<tr>
<td>LCR</td>
<td>164.4%</td>
</tr>
<tr>
<td>NSFR</td>
<td>127.0%</td>
</tr>
<tr>
<td>RoE</td>
<td>7.6%</td>
</tr>
</tbody>
</table>

**Quarterly change in net interest income for listed banks**

- **Margin effect**
- **Volume effect**
- **NII change**

<table>
<thead>
<tr>
<th>Year</th>
<th>Margin effect</th>
<th>Volume effect</th>
<th>NII change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2021 Q4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2022 Q1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2022 Q2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2022</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2023</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Compiled from Refinitiv data.

Note: The sample comprises 38 listed banks.
No asset quality deterioration yet, provisions on downward trend and expected to stay flat despite some latent risk.
A tale of two shocks: fast rebound after COVID-19, but gradual deterioration of outlook since Russian invasion

**COVID-19**

- Inflation rate well within target: gradual upward adjustment driven by supply chain bottlenecks

**Russian invasion of Ukraine**

- Inflation rate persistently above target at record high levels
- Fast normalisation of policy and market interest rates

Source: ECB/Eurosystem staff macroeconomic projections.
Euro area banks have considerable exposures to sectors vulnerable to the energy crisis

Exposures to vulnerable sectors in Q2 2022

- Sector % of exposures to non-financial corporations (percentages, left-hand scale)
- Value of exposures (EUR billions, right-hand scale)

Stage 2 evolution for vulnerable sectors

- Sector % of exposures to non-financial corporations – Q2 2022 (percentages, right-hand scale)
- Share of exposures in Stage 2 – Q2 2022 (percentages, left-hand scale)
- Share of exposures in Stage 2 – Q2 2021 (percentages, left-hand scale)

Source: Anacredit.
Note: The sample comprises credit institutions reporting the selected data points to AnaCredit as at June 2022.
Residential real estate market at risk of abrupt correction as inflation and interest rates threaten affordability

Year-on-year growth rates in real estate market (percentages)

- Residential property prices
- Rental prices
- Commercial property price indicator, transaction value

Residential real estate and commercial real estate performance in the second quarter of 2022

- Performing loans
- Non-performing loans
- Stage 2 loans
- Exposure (percentage of total loans and acquisitions)

Source: ECB and supervisory reporting.
Sustained origination of riskier leveraged loans over last few years despite 2017 supervisory guidance

Leveraged finance exposures of euro area banks (EUR billions, left-hand scale) and share relative to CET1 capital (percentages, right-hand scale) – aggregate levels

Origination volumes by leverage level (percentages)

Source: Euro area banks under ECB supervision reporting supervisory data via ECB Banking Supervision’s leveraged finance dashboard.
Note: Data as of the second quarter of 2022.
Companies hedging against gas price face high margin calls due to volatility: exposures to banks may increase.

**Gas price and margins**
- Title Transfer Facility Gas Futures price (left-hand scale)
- Initial Margin for Title Transfer Facility Gas Futures (right-hand scale)

Source: ICE Futures Europe and ICE Clear Europe.
As interest rates normalise and funding costs increase, some business models may see income and economic value of equity eroded.
Supervisory focus on provisions

Changes in credit standards applied to the approval of loans or credit lines to enterprises (LHS) and loans to households for house purchase (RHS), and contributing factors

Despite rosy expectations, banks tighten credit standards due to higher perceived risk and lower risk appetite.
Supervisory focus on capital trajectories

Capital trajectories submitted in April are outdated, banks have been requested to send new estimates factoring in the energy shock and a recessionary scenario.

**Bank self-identified drivers for 3-year projection in funding plans**

*April 2022 submission*

**CET1**

- Retained earnings
- Change in net earnings
- Reduction in CET1
- New issuances
- Distribution through buyback
- Estimated evolution of PD/CI
target

**RWAs**

- Increase in exposures
- Increase due to methodological impacts
- Decrease in exposures
- Decrease due to methodological impacts
- Increase due to change in risk structure
- Decrease due to change in risk structure

**April 2022 capital trajectories: evolution of the distribution of banks’ distance of their capital position vs own capital targets (2019-2024)**

*Source: HA on SI’s projections (DG-HOL/BCC), using STEs, COREP. Notes: Balanced sample of 77 SIs.*

**Capital target** can be defined as the strategic capital position the bank intends to converge to over the medium term, set sufficiently above all requirements, guidance and management buffer, while properly accounting for the risk appetite framework of the institution. Source: *HA on SI’s projections* (DG-HOL/BCC), using STEs, COREP. Notes: Balanced sample of 77 SIs.