

The risk outlook for euro area banks

40th Board of Directors meeting of the European Savings and Retail Banking Group



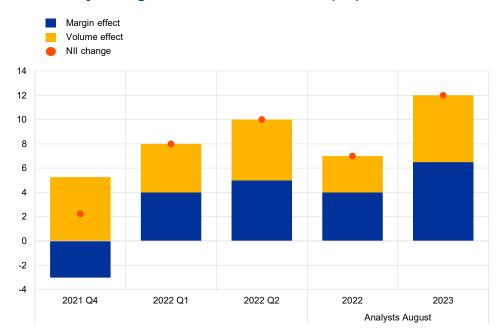
Andrea Enria Chair of the Supervisory Board

Sound balance sheets and net interest income on upward trend; analysts expect gains to continue

Q2 2022 prudential statistics

CET1 ratio	15.0%
LR	5.3%
LCR	164.4%
NSFR	127.0%
RoE	7.6%

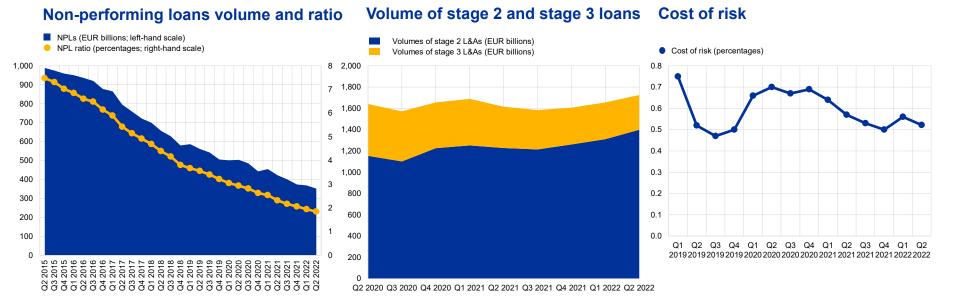
Quarterly change in net interest income (NII) for listed banks



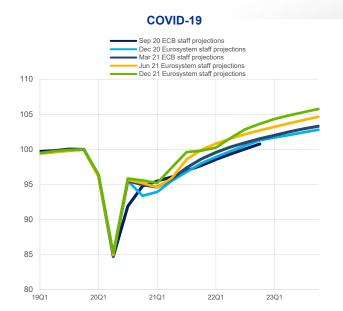
Source: Compiled from Refinitiv data.

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

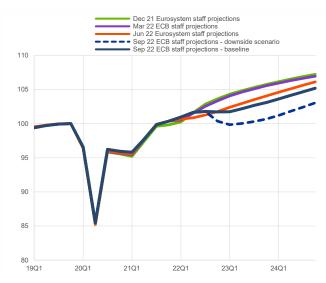


Source: ECB/Eurosystem staff macroeconomic projections.

Environment

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

Russian invasion of Ukraine



Source: ECB/Eurosystem staff macroeconomic projections.

Environment

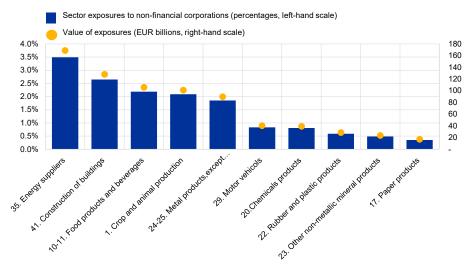
- Inflation rate persistently above target at record high levels
- Fast normalisation of policy and market interest rates

No two exogenous shocks are alike: banks' attitude towards the current crisis might be overoptimistic

- Banks seem to expect a new wave of public support measures, including government guarantees and moratoria, should the outlook deteriorate materially.
- II. Some governments are considering interventions to tax banks' profits on higher interest rates and/or limit the impact of higher interest rates on weaker borrowers.
- III. The recent past is not a good predictor of the future: banks' internal models are likely to project very low defaults when historical data from the pandemic period are used.

European Banking Supervision is scrutinising banks' energyrelated exposures

Exposures to vulnerable sectors in Q2 2022



Source: Anacredit

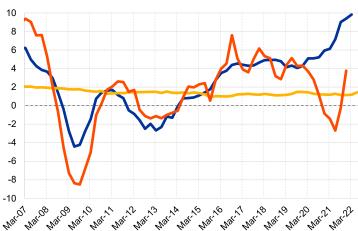
Note: The sample comprises credit institutions reporting the selected data points to AnaCredit as at June 2022.

- I. Credit exposures to energyintensive corporate borrowers
- II. Credit and counterparty credit exposures to commodity traders and energy utilities, who face increased demand for clearing margins due to heightened market volatility

European Banking Supervision is looking into banks' exposures that are more sensitive to interest rate and credit spread shocks

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

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



- I. Commercial and residential real estate exposures
- II. Consumer lending
- III. Leveraged finance
- IV. Interest rate and credit spread risk in the banking book

Sources: ECB and supervisory reporting.

European Banking Supervision to monitor funding and liquidity risk, as funding costs increase and TLTROs are withdrawn

Evolution of banks' funding spreads

(Option-adjusted spread; 2 January 2020 – 14 September 2022; left-hand scale: basis points)

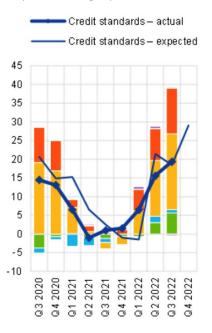


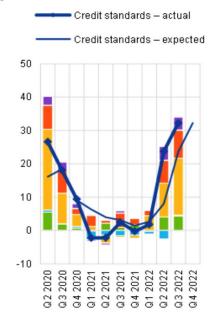
Specific business models and asset and liability management strategies (e.g. carry trade on sovereign exposures) may see income and economic value of equity eroded Tighter financial conditions for banks' counterparties on financial markets, particularly non-bank financial institutions, warrant close monitoring

- I. ECB has set out clear expectations for banks' prime brokerage businesses. The Archegos case highlighted the potential for losses in a highly leveraged and concentrated environment, and the turmoil stemming from liability-driven investments of British pension funds further confirms this.
- II. Counterparty credit risk is a supervisory priority, and in our Targeted Review of Internal Models, we have benchmarked banks' behaviours against good practices and are following up where necessary.

Supervisory focus on provisions

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





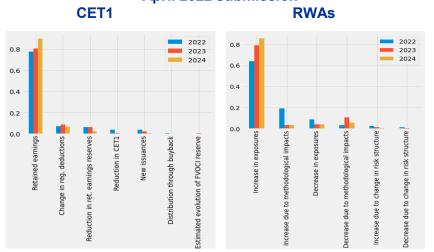
Despite rosy expectations, banks are tightening credit standards due to higher perceived risk and lower risk appetite

- ■Banks' risk tolerance
- Risk perceptions
- Competition
- Cost of funds and balance sheet constraints
- Other factors

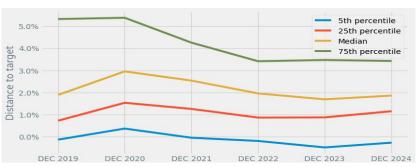
Supervisory focus on capital trajectories

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

Bank self-identified drivers for three-year projection in funding plans April 2022 submission



April 2022 capital trajectories: evolution of the distribution of banks' distance of their capital position versus own capital targets (2019-24)



<u>Capital target</u> 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: Supervisory reporting, COREP. Note: Balanced sample of 77 significant institutions.

EU banking package

- European Banking Authority estimates that the deviations from Basel III proposed by the European Commission reduce the expected increase in Tier 1 aggregate capital requirements stemming from the reforms by 3.2 percentage points. Pockets of risk would be left unaddressed and risks to financial stability could increase.
- The argument that deviations from international standards are necessary to reflect European specificities is misleading and does not recognise the significant results obtained in the Basel negotiations.
- If all deviations under discussion make it into the final legislative package, we cannot rule out the Basel Committee on Banking Supervision labelling the EU as "non-compliant" (the lowest possible grade).
- Reforms have already proved their worth during challenges brought on by COVID-19 and Russia's invasion of Ukraine. We risk undermining global cohesion and weakening the EU's standing in international negotiations if we do not keep our commitments. We need to faithfully implement all of Basel III to keep our banking system safe and sound.



Thank you for your attention!