Talking point

European bank performance: Bottoming out

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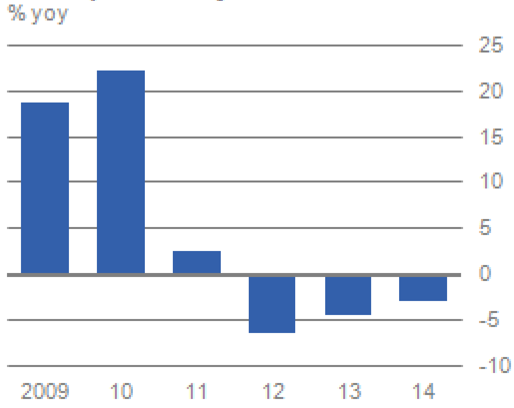
Current results are still very weak, with total revenues and profits both at the lowest level since 2009. But the largest European banks can justifiably draw hope from a stabilisation in interest income as well as fees and commissions, from declining loan loss provisions and shrinking expenses. The bottom line may have broadly bottomed out, though pressure from litigation charges and the ECB's balance sheet assessment remains high. New record capital levels abound.

The 20 largest European banks have reported Q1 results which at first sight again underline the numerous structural problems facing the industry. Net profit fell once more (-9% yoy), to its lowest Q1 figure since 2009, to a pale EUR 12 bn in what is usually the best quarter of the year. Total revenues also declined further, by 3%, driven by a slump in trading income (-36%) probably due to low volatility levels in financial markets as well as ever tighter regulation. At EUR 79 bn, revenues, too, were the weakest since 2009 and have now shrunk by more than 13% over the past three years.

Total Q1 revenues of Europe's major banks*



* Excl. UK institutions

Sources: Company reports, Deutsche Bank Research

This is only half of the story, though. Banks are indeed making progress in various other core areas. Net interest income, which has suffered a prolonged contraction, seems close to stabilising. It was down less than 2% yoy in Q1. Similarly, the other crucial source of income, fees and commissions, expanded slightly (1%) and, overall, revenues would in fact have increased were it not for the collapse in trading income. Loan loss provisions, though still elevated, receded by 16% yoy, and administrative expenses sank by 2.5%. Net income, similarly, decreased by "only" EUR 1.2 bn and may well rebound later this year. Finally, following a slashing of total assets in 2013, balance sheet totals moderately expanded at the start of this year (+2% since December).

All in all, banks may well see their fortunes gradually turn over the course of this year. Their operating performance is bottoming out, the economic recovery is accelerating and much of their internal restructuring is now implemented, so the outlook is moderately improving. However, there is still a sword of Damocles casting a shadow over the industry: obviously, potentially large litigation charges continue to be a burden for banks, and exact settlement costs are extremely difficult to anticipate. This is one main reason – the other being the ECB's current comprehensive balance sheet assessment and stress testing exercise – why banks remain eager to strengthen capital buffers. A number of (primarily smaller) banks have raised equity in recent months, while the fully-loaded Basel III Common Equity Tier 1 ratio has also climbed further at the largest European banks, but mostly in an organic way. For the latter it has now reached 11.2% on average, the highest capital level in decades. That the ECB's fresh measures to boost lending to the real economy will indeed succeed (i.e., that the banks will be willing to take on more risk) cannot be taken for granted in these circumstances.

Author: Jan Schildbach (+49) 69 910-31717

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