EUROPEAN CENTRAL BANK
EUROSYSTEM

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Summary of Banking Industry Dialogue on 10 July 2019 in Frankfurt am Main

Participants

- Members of the Governing Council of the ECB or their alternates.
- Representatives of ABN Amro, Allied Irish Banks, Bankia, Bank of Cyprus, Bank of Valletta, Belfius Banque, CaixaBank, Caixa Geral de Depósitos, Credit Suisse, Groupe BPCE, Intesa Sanpaolo, Landesbank Baden-Württemberg, Landesbank Hessen-Thüringen Girozentrale, Lloyds Bank, Nova Kreditna Banka Maribor, and Société Générale.
- Senior ECB officials from the Directorate General Macroprudential Policy and Financial Stability, Directorate General Monetary Policy, Directorate General Communications, Directorate General Secretariat, and the ECB's Chief Compliance and Governance Officer.

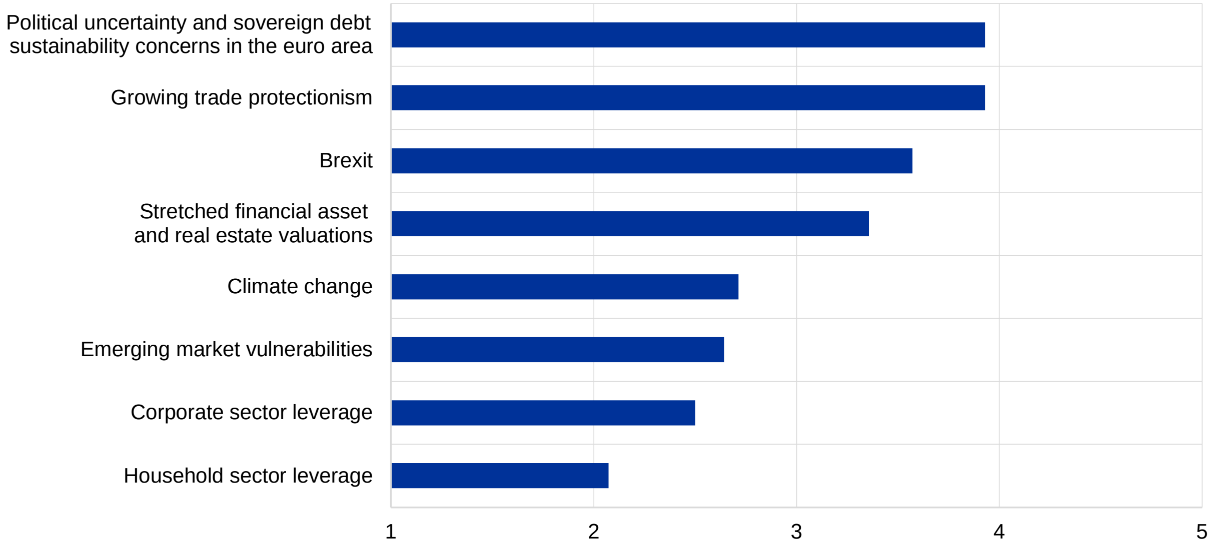
Financial stability challenges in the macro-financial environment and the banking sector

Participants from the banking industry highlighted that a confluence of factors constitute challenges to the environment in which they operate (see Chart 1). Several of the challenges stem from the macro-financial outlook. Geopolitical risks, tensions in global trade and risks emanating from Brexit-related uncertainties weigh on investor sentiment, with spill-overs to the banking sector. With regard to equity markets and asset prices, banks were not seen to be particularly at risk from possible market corrections, but the potential for systemic contagion arising from such developments, including via non-banks, could not be ruled out. Climate risk has come into sharper focus, with concerns raised over the risks associated with the costs of transition towards low carbon economies and the potential for climate-related events to affect asset prices.

Chart 1

Key current challenges in the global macro-financial environment according to bank participants

(1 = low concern; 5 = high concern)



Source: ECB survey with bank participants to the Banking Industry Dialogue.

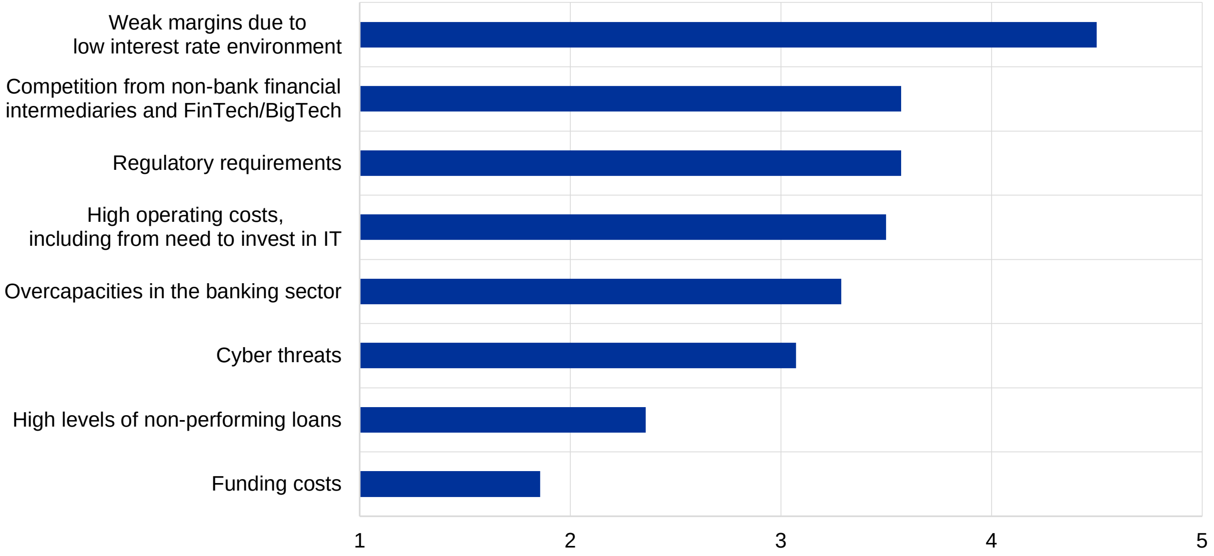
It was acknowledged that the euro area banking sector has made progress in building resilience in recent years but that challenges remain (see Chart 2). It was noted that the sector had ample levels of capital and liquidity, but faced challenges in deploying their resources profitably. The profitability outlook for the sector is concerning, in the context of: the low interest rate environment; the costs banks face as they strive to down-size, with a view to improving cost-income ratios; and the need to invest in IT infrastructure, not least in the context of FinTech developments.

With respect to credit risk, concerns were raised about the potential for weakening credit standards, in a search-for-yield environment. Potential vulnerabilities in leveraged lending were cited, in particular the rise of the share of covenant-lite lending, which had the potential to increase future losses, should the environment deteriorate. A need to understand the distribution of risks and the potential for contagion was highlighted.

Chart 2

Main challenges within the banking sector according to bank participants

(1 = low concern; 5 = high concern)



Source: ECB survey with bank participants to the Banking Industry Dialogue.

Overcapacities in the banking sector

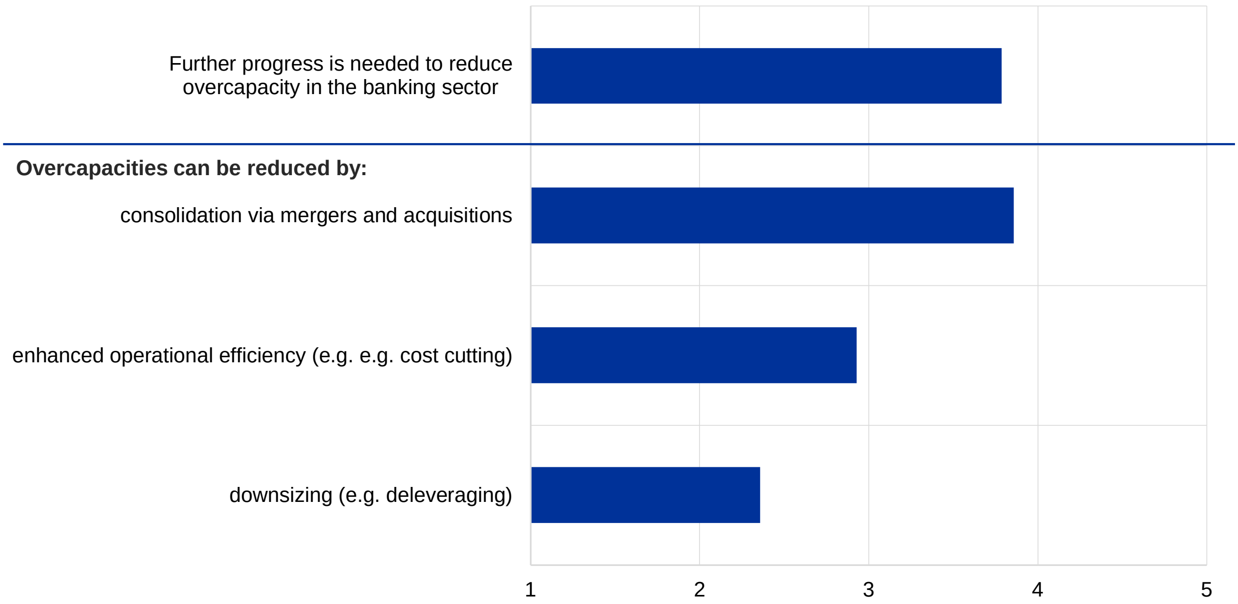
Overcapacity was recognised as a challenge facing the euro area banking sector (see Chart 3). Competition in the sector was mentioned as a factor, in an environment of low interest rates and margins, which drove a search for volume and scale in products to compensate. This phenomenon exacerbated overcapacities in the banking sector. Success in reducing capacity has been mixed across euro area countries, with employment protection laws cited as an impediment to effective downsizing, along with the overall costs.

While many bank participants agreed that consolidation in the banking sector was necessary, a number of impediments were discussed (see Chart 4). In the context of low returns on equity, high cost of equity and low price-to-book ratios, the costs of consolidation were highlighted as a constraint: in a low profitability environment and with banks unable to generate sufficient organic capital, the regulatory and business transformation costs associated with consolidation were cited. These costs could depend on the nature of the merging entities.

Moreover, in relation to overcapacities it was highlighted that domestic consolidation may be more feasible than cross-border mergers, not least as a result of the typically-higher IT investment costs of the latter. Additionally, cross-border consolidation was deemed unlikely until Banking Union is complete. Digitalisation was also important to drive efficiency and reduce costs, but challenges here include labour rigidities and the need to maintain physical infrastructure in order to avoid financial exclusion.

Chart 3
Ways to reduce overcapacity in the banking sector according to bank participants

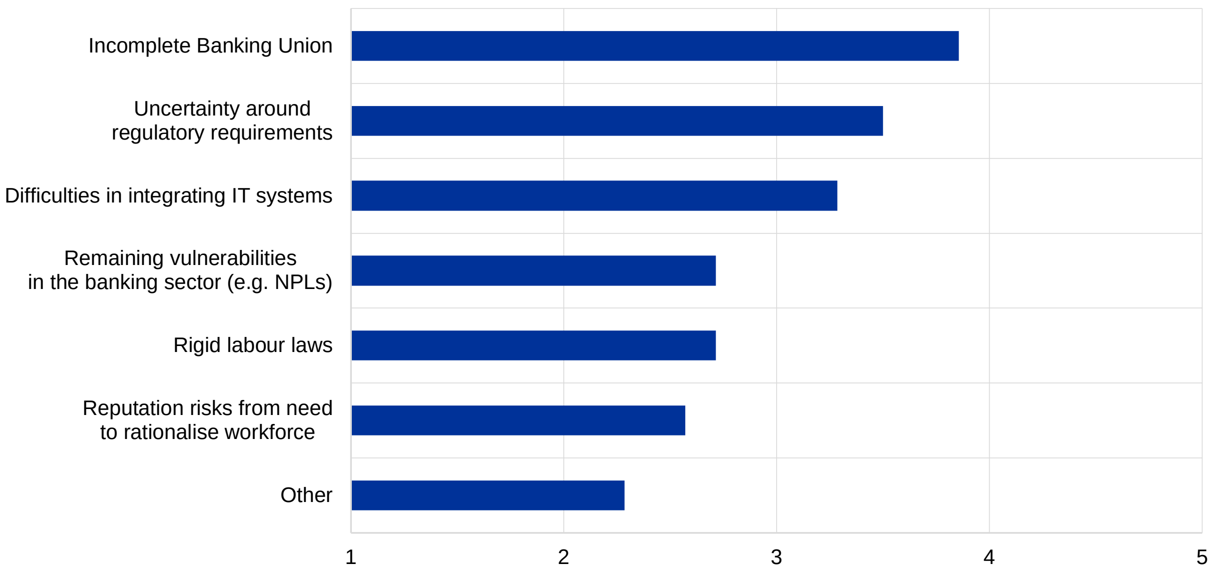
(1 = strongly disagree; 5 = strongly agree)



Source: ECB survey with bank participants to the Banking Industry Dialogue.

Chart 4
Impediments to bank consolidation in the euro area according to bank participants

(1 = small impediment; 5 = large impediment)



Source: ECB survey with bank participants to the Banking Industry Dialogue.