Talking point

European bank performance in 2014: Not so bad

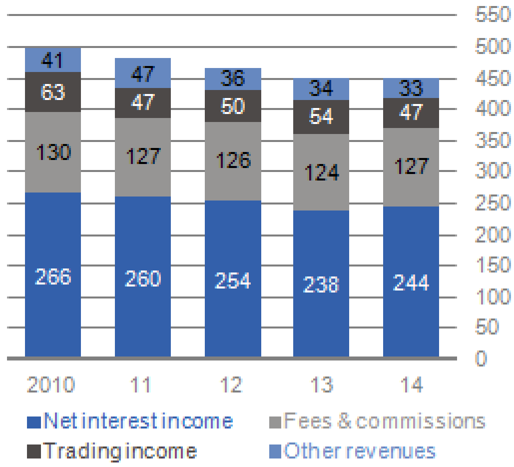
March 19, 2015

Core revenues are getting better, loan losses are falling substantially and capital ratios have climbed to sustainable levels – European banks seem to have turned the corner in 2014, finally. Profits have more than doubled, asset growth has also resumed and banks have regained a bit of risk appetite. The outlook for 2015 is thus brighter than in most of the past few years. The still-elevated expenditure levels remain a significant drag on performance, though.

2014 was a year of incremental progress for European banks, as shown by the results of the 20 major institutions. Following three years of decline, total revenues edged up marginally (0.3%) in 2014, driven not least by stabilisation in interest income. Net interest income rose 3% yoy, after suffering a double-digit decline from 2010 to 2013. The recent improvement in turn was partly attributable to better performance in private-sector lending, with corporate lending in the euro area stabilising over the course of the year (down only 1.6% yoy in December, compared with -4.2% 12 months before). Other revenue segments also showed relative strength – fee and commission income (the other core component) increased by 2%, whereas the fall in trading income (-12%) slowed towards the end of the year.

Share of core revenues on the rise

Revenue composition at Europe's largest banks, EUR bn



Sources: Company reports, Deutsche Bank Research

While revenues generally remained weak, a real boost came from a large fall in loan loss provisions. Having stayed elevated since the financial crisis, they now finally dropped by more than a third (-36%) to the lowest level since 2007, on the back of a strengthening European economy. This, together with lower one-off hits from litigation and goodwill write-offs, helped post-tax profit to more than double to EUR 43 bn. This is still substantially below 2010 (let alone pre-crisis) levels and the swing was primarily due to large-scale improvements at four (Italian and British) banks that were loss-making last year. Nevertheless, the fact that the majority of banks are actually moving in this direction is an encouraging sign that things may finally be getting better for the European banking industry.

Similarly, banks have started to expand their balance sheets again – total assets at the major banks rose 8%, which is more than for the EU market as a whole (2%). Risk-weighted assets were also up, both as a result of the shift towards Basel III in January and organically, with RWAs growing 1.1% in H2 alone. The apparent moderate increase in risk appetite notwithstanding, banks still managed to raise capital levels further. The Basel III fully loaded Common Equity Tier 1 ratio has reached 11.5% on average, a full percentage point more than at end-2013. Only two banks remain below the – at least symbolically important – 10% threshold. On the other hand, despite risk-weighted capital ratios now being less of an immediate concern, the leverage ratio still poses a challenge for some institutions.

Overall, while European banks are making visible progress, they still have a long way to go. International competitors are often significantly ahead, most strikingly in terms of profitability. This is reflected in European banks' generally weaker market capitalisation – there are only three European banks among the top 20 worldwide, but seven from the US (and five from Australia and Canada), despite the European banking sector being several times larger than its American counterpart. European banks also continue to struggle with controlling costs – operating expenses (+0.8%) once again rose faster than revenues in 2014. It will probably take a few more years before the industry is back on track and on par with its global peers.

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

...more information on **banking and financial markets**
Talking Point - Archive