Chart in focus

European banks' results in H1 2008: Back to the old days and old ways?

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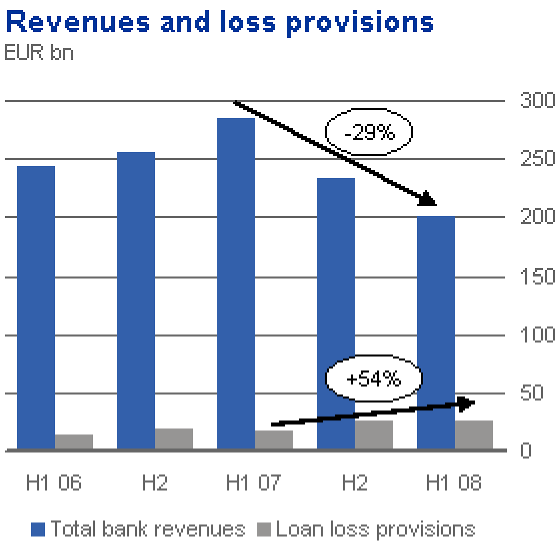

Europe's 25 largest banks reported weak results for the first half of the year which were, however, by and large in line with expectations. Net interest income (+12% year-on-year) was more or less the only profit driver and remained strong on the back of stronger growth of interest revenues than expenses – though this aggregate result masks a wide range of individual results. Fees and commissions suffered (-11%) from lower transaction volumes and valuations, and trading income was, in aggregate, completely wiped out due to significant markdowns at several banks. All in all, revenues fell by 29% from the record level reached in H1 2007. Loan loss provisions soared by 54%.

At first glance, the results seem to indicate a return to the past: interest income, mainly deriving from modest-growing retail banking, has regained its position as by far the largest share of banks' revenues, while trading income fell back from the extraordinary benign years 2005-07. Similarly, loan losses had reached very low levels in 2005/06, so their recent steep increase is, at least so far, hardly more than a cyclical shift back to average levels. But the adjustment goes beyond the profit and loss account: there are also signs of a beginning deleveraging process, as growth of banks' total assets slowed from 15% to only 4% year-on-year (in fact, balance sheets as well as risk-weighted assets shrank compared with Q1). Total equity increased slightly year-on-year due to capital measures at a few large banks following substantial subprime losses. At the bottom line, net profits and average return on equity (6.9% in H1 2008) went down by about two-thirds from a record level in the prior-year period, as lower staff compensation could not offset the decline in revenues. However, not too much should be read into the results: they primarily reflect the current market environment and are, in our view, not a reflection of a strategic re-orientation or a return to the old business model of banks.

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