

## Talking point

### European banks: Is growth finally returning?

December 5, 2014

**2014 is witnessing a remarkable reversal in some important European banking trends of the past few years, according to the 9-month results of the continent's largest banks. This is not solely a positive thing: apart from improvements in core revenues and a return to balance sheet expansion, expense levels are also rising again. Is deleveraging and shrinking over, then?**

Over the course of this year, some striking changes have taken place in the balance sheet and P&L developments of the 20 major European banks. Whereas at the beginning of 2014, net interest income seemed to be continuing its decline of the past three years, after nine months it is now slightly up yoy (2%). Similarly, fees and commissions have also seen a gradual improvement (3%). Total revenues (flat yoy) have been held down by a slump in trading income (-20%), but they might at least end their three-year decline in 2014 as a whole.

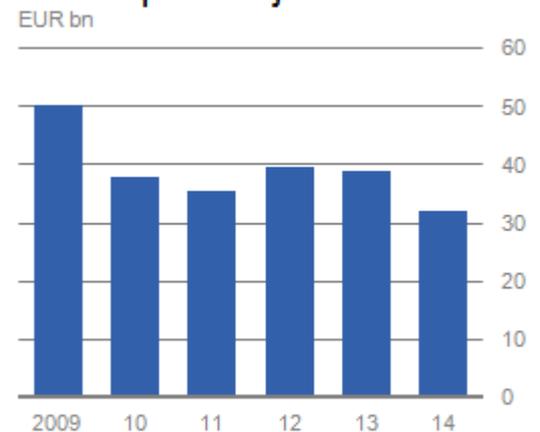
Further encouragement is coming from balance sheet figures: total equity is 4% higher than a year ago. Even more, banks have evidently recovered a bit of risk appetite. After a severe drop in 2013, total bank assets have grown nicely in the past nine months and are now modestly up yoy (1%). For risk-weighted assets, most of the 6% increase is due to the introduction of Basel III on January 1; however, RWAs have also edged up minimally since Q1 (0.5%). What are the drivers of change? For one thing, the contraction in corporate lending volumes is abating further. For another, banks' investments in government paper continue to rise – in the euro area, these bond holdings were EUR 1.84 tr at end-September, about EUR 150 bn more than at the beginning of the year.

But as much as the broad stabilisation in banks' business is welcome, pressure points remain. In particular, the industry as a whole seems to struggle with cost containment. Or at least, banks are not able to i) keep costs under control in areas where they have identified a need to invest and ii) reduce expenditures more meaningfully in those areas which are no longer at the core of their new business model. Overall, following moderate progress last year, 9M 2014 figures showed that operating expenses had climbed again by 2% yoy, with Q3 seeing a clear deterioration vs the first half of the year. Hence, given stagnating revenues, efficiency metrics are not getting better.

Banks can derive some support from the substantial fall in loan loss provisions on the back of a stabilising (most of the euro area) or recovering (Britain and much of the CEE region) economy. But a large chunk of the 17% decline in LLPs has been compensated for by the uptick in costs, hence operating performance has barely improved so far.

All in all, with litigation expenditures running high (again) this year, profitability took another hit – post-tax earnings in the first three quarters were down 19% yoy. Fortunately, at least one of the biggest headaches ever since the financial crisis, capital, may largely have been dealt with by now. The Basel III fully loaded Common Equity Tier 1 ratio continues to rise steadily and has now reached 11.8% on average, which is in most cases comfortably above regulatory requirements applicable in full from 2019 on. It is only logical, therefore, that the vast majority of the large European banks passed the recent ECB/EBA stress test quite easily.

#### 9M loan loss provisions of Europe's major banks\*



\* Excl. UK institutions

Sources: Company reports, Deutsche Bank Research



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