EUROPEAN CENTRAL BANK
EUROSYSTEM

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Summary of Banking Industry Dialogue on 7 November 2018 in Frankfurt am Main

Participants

- Members of the Governing Council of the ECB or their alternates.
- Representatives of ABN AMRO, Banco Sabadell, Banque Degroof, BBVA, BNP Paribas, CaixaBank, Crédit Mutuel, DZ Bank, Eurobank Ergasias, Groupe BPCE, Hellenic Bank, LBBW, Nordea, Raiffeisen Bank Int., UBS and UniCredit.
- Senior ECB officials from the Directorate General Macroprudential Policy and Financial Stability, Directorate General Communications and Directorate General Secretariat, and the ECB's Chief Compliance and Governance Officer.

Key challenges in the global macro-financial environment

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 outside the euro area. The growing trade protectionism and the potential adverse impact on global confidence and economic growth were mentioned by several participants. Some participants underlined that renewed stress in emerging markets with potential adverse spillovers could unearth financial instability.

Bank participants noted that valuations in some asset classes are high. In particular, leveraged loan markets in advanced economies continue to show signs of stretched valuations as spreads remain compressed. Across regions, US corporates account for the bulk of the total volume of the outstanding amount of global leveraged loans. The importance of having a good understanding of exposures to leveraged loans by different sectors and entities was highlighted. Apart from the leveraged loan markets, participants viewed valuations as rich in US stock markets. Standard valuation metrics such as the cyclically adjusted price/earnings (CAPE) ratio continue to hover at levels significantly above its norm. It was also highlighted that correlations across asset classes has increased in recent years and that therefore a risk that any correction in financial markets would be widespread across segments.

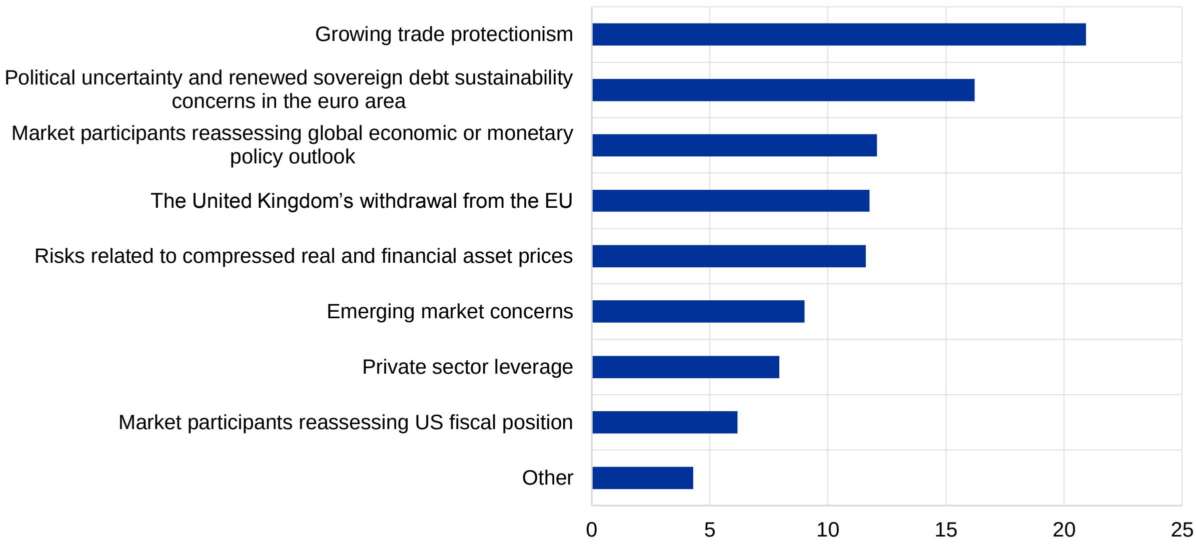
Within Europe, political uncertainty and potential debt sustainability concerns were noted as important vulnerabilities. On this topic, the discussion focused on developments in Italy. Participants agreed that solid economic growth and regaining foreign investor's trust are key factors to avoid future debt sustainability concerns in Italy and elsewhere across the euro area. Developments around the United Kingdom's withdrawal from the EU were also discussed.

Chart 1

A confluence of factors constitute challenges to the macro-financial environment according to bank participants

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

(Percentages; challenges ranked by allocating a total of 100 points across the different risks)



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

Challenges within the banking sector

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). The challenges are in many cases bank- or country-specific so there is no panacea for banks to address the issues that confront them.

The reasons for weak profitability in parts of the European banking sector were discussed. Bank participants mentioned the low interest rate environment and high stocks of non-performing loans as factors negatively impacting bank profitability. Low and negative interest rates were seen as dampening bank profitability via lower margins, due to impediments from banks in passing on negative interest rates to retail customer. It was however noted that low funding costs, including from the Eurosystem's targeted longer-term refinancing operations (TLTROs), as well as improved borrowers' conditions are mitigating the negative effects from the low interest rate environment. Regarding the high stocks of NPLs, bank participants noted the progress that has been made but acknowledged that further actions are needed.

Participating banks acknowledged that cost reductions were needed in several areas in order to improve profitability. One way to reduce costs could be via consolidation. Bank participants argued that impediments to consolidation, especially across borders, remain large. It was, however, noted that investments were also needed, for example in the areas of digitalisation and financial innovation, in order for banks to remain competitive and to be able to offer products that meet customer demand. With these changes it was noted that non-financial risks (e.g. cyber risks) are becoming more important for banks and that also supervisors need to be agile when supervising banks through the ongoing digital transformation.

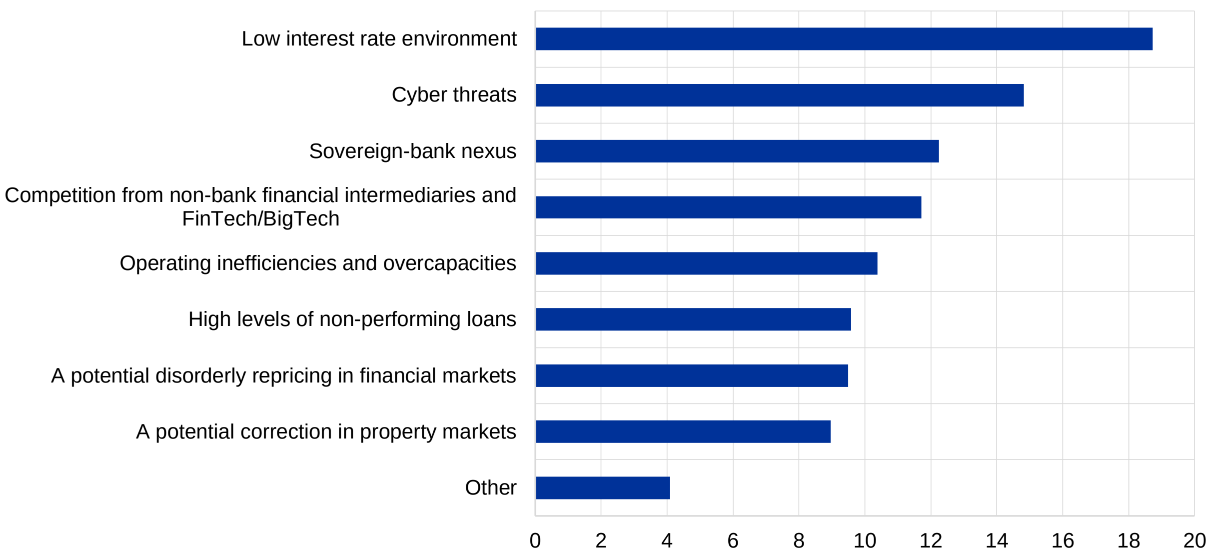
Regarding more structural challenges, the possibility that big technology companies incorporate financial services into their platforms was seen as a potential competition challenge for the banking sector. From another vantage point, Fintech was also noted as an opportunity, as banks can take advantage of technological advancements or partner with Fintech companies to develop efficient solutions. In this context it was mentioned that banks need to make further efforts in using the wealth of data they possess in developing and enhancing their businesses. However, bank participants highlighted that there is a need for regulators to ensure that regulation of banking activities is comparable regardless if the activities are performed by banks or non-bank intermediaries to ensure a level playing field.

Chart 2

Main challenges within the banking sector

Main challenges within the banking sector

(Percentages; challenges ranked by allocating a total of 100 points across the different risks)



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