

CHALLENGES OF THE BANKING SECTOR

Fernando Restoy

Deputy Governor, Banco de España

ANNUAL EUROPEAN FINANCIALS CONFERENCE

GOLDMAN SACHS

Paris, 8 June 2016

OUTLINE



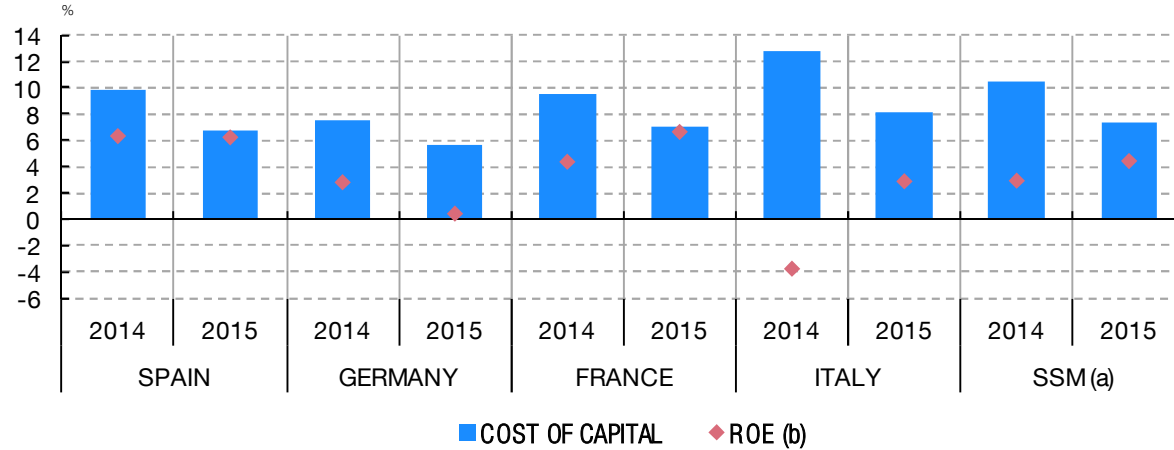
- 1** Recent developments
- 2** Challenges
 1. Low interest rates
 2. Non-productive assets
 3. Regulation
- 3** Expected reaction by the industry
 1. Efficiency
 2. Fees on services
 3. Corporate operations

1. RECENT DEVELOPMENTS



Improvements in terms of capital and profitability **but still low returns** (below cost of equity)...

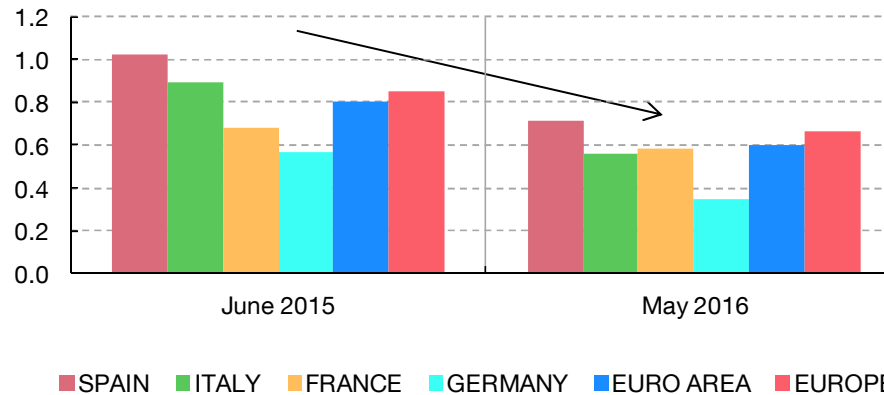
ROE AND COST OF CAPITAL IN DEC 2014 AND DEC 2015



Sources: SNL, Datastream, Consensus Economics and BdE.
 a. SSM cost of capital proxied by euro area cost of capital.
 b. ROE calculated using public data (SNL) for 114 SSM significant institutions.

...and **low expected** future profitability

PRICE-TO-BOOK-VALUE RATIO OF THE BANKING SECTOR



Source: Datastream.

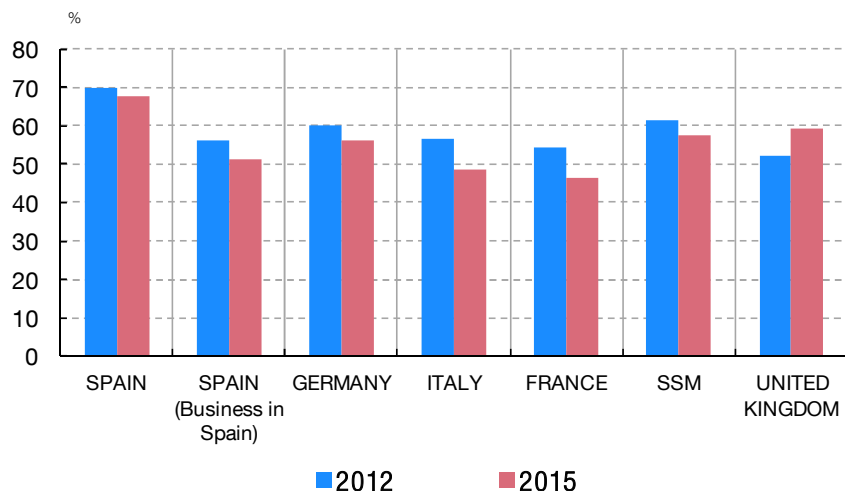
2. CHALLENGES



2.1. Low interest rates

- Strong **pressure on margins...** with **non-linearities** (the lower the interest rate, the higher the impact)

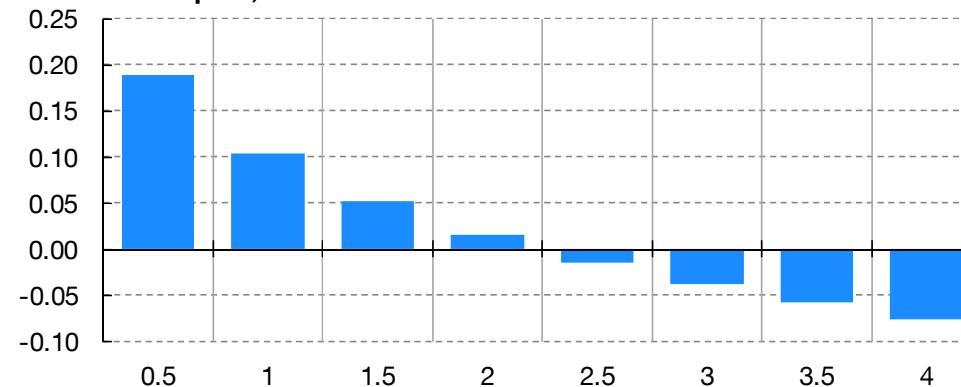
NET INTEREST INCOME TO TOTAL OPERATING INCOME



SOURCES: SNL and Banco de España.
(Significant institutions)

SEMI-ELASTICITY OF NET INTEREST INCOME TO 12-MONTH EURIBOR (a)

Business in Spain, ID



SOURCE: Financial Stability Report, May 2016, Banco de España.

a. The y-axis shows the semi-elasticity of net interest income to different levels of the 12-month EURIBOR in the range of 0.5-4, which are depicted on the x-axis. Semi-elasticity is defined as the rate of relative change in net interest income to a 100bp change in the 12-month EURIBOR.

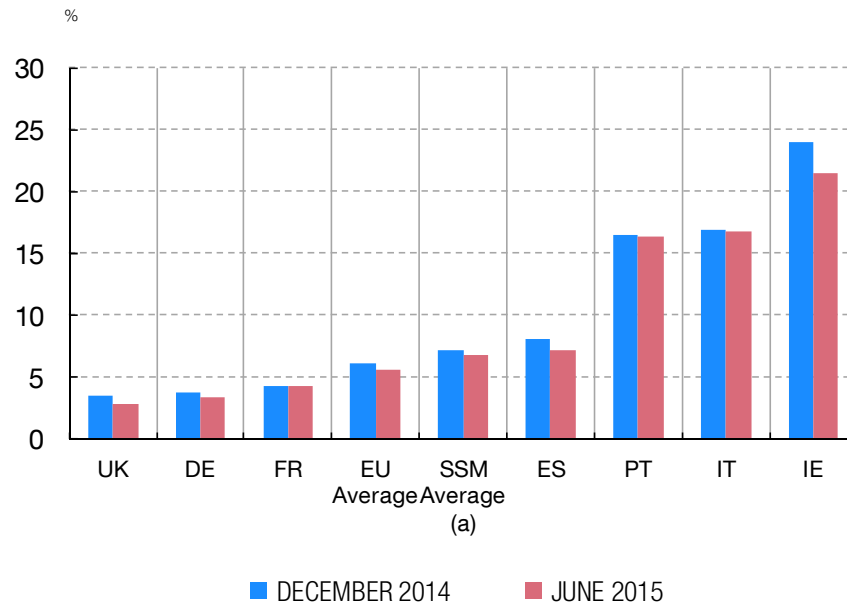
2. CHALLENGES



2.2. Non-productive assets

- NPLs are still high in some countries.
- Although NPLs are imperfect indicators, since they ignore provisions and collateral.

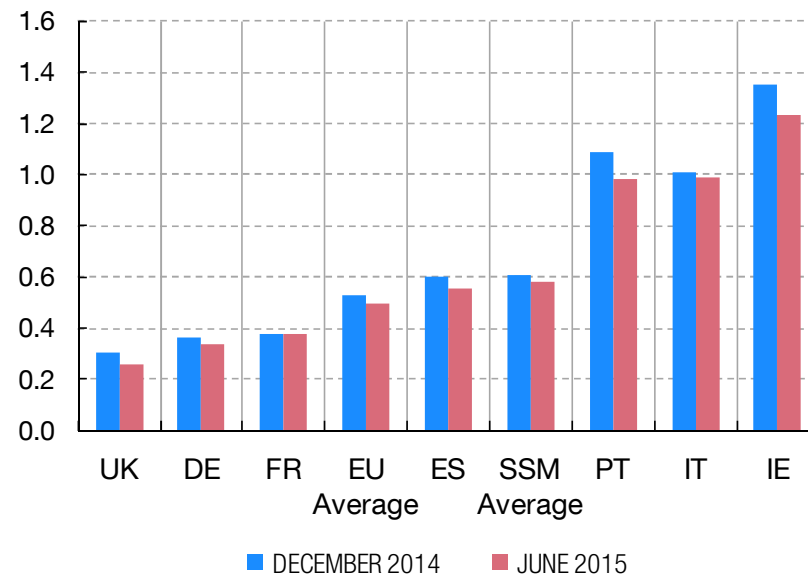
NPL RATIO



SOURCE: European Banking Authority.

a. SSM countries include data for 15 out of 19 countries in the euro area. There is no data for Greece, Slovakia, Estonia and Lithuania.

TEXAS RATIO PROXY (a)



SOURCE: European Banking Authority.

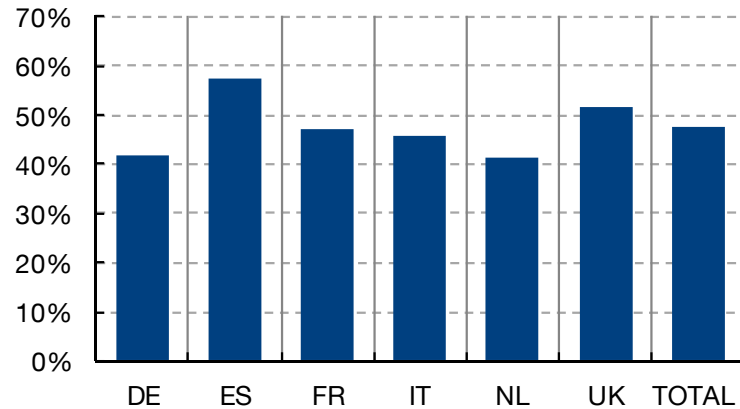
a. To calculate this proxy, NPL were divided by the sum of provisions and capital (including equity instruments eligible as CET1 and reserves).

2. CHALLENGES

2.3. Regulation

i) The **Basel agenda**: challenge of making all the required adjustments without significantly increasing capital requirements

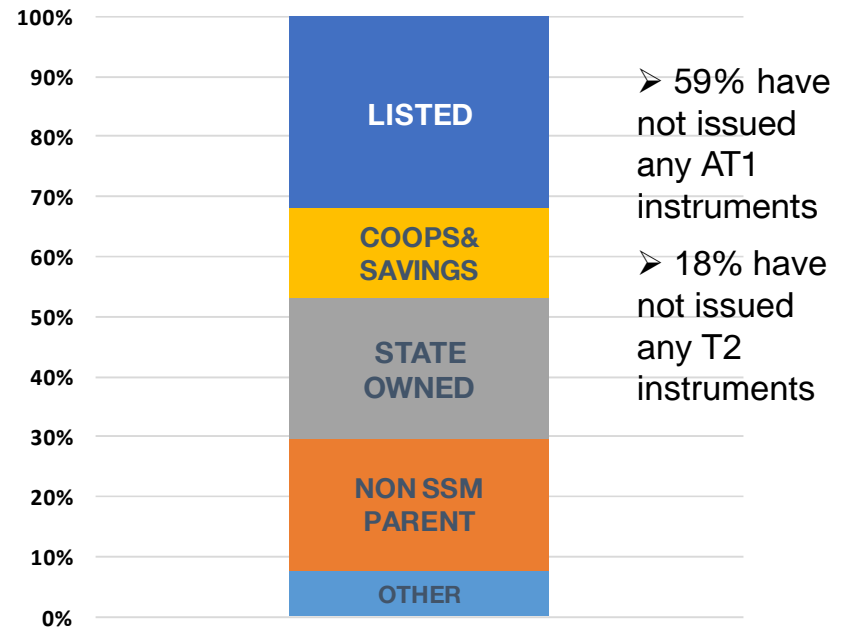
CORPORATE PORTFOLIO SUBJECT TO IRB. RWA DENSITY
June 2015



SOURCE: Financial Stability Report, May 2016, Banco de España.

ii) **MREL**: likely to be a binding constraint for medium-size non-listed financial institutions

SSM SIGNIFICANT INSTITUTIONS BY OWNERSHIP STRUCTURE

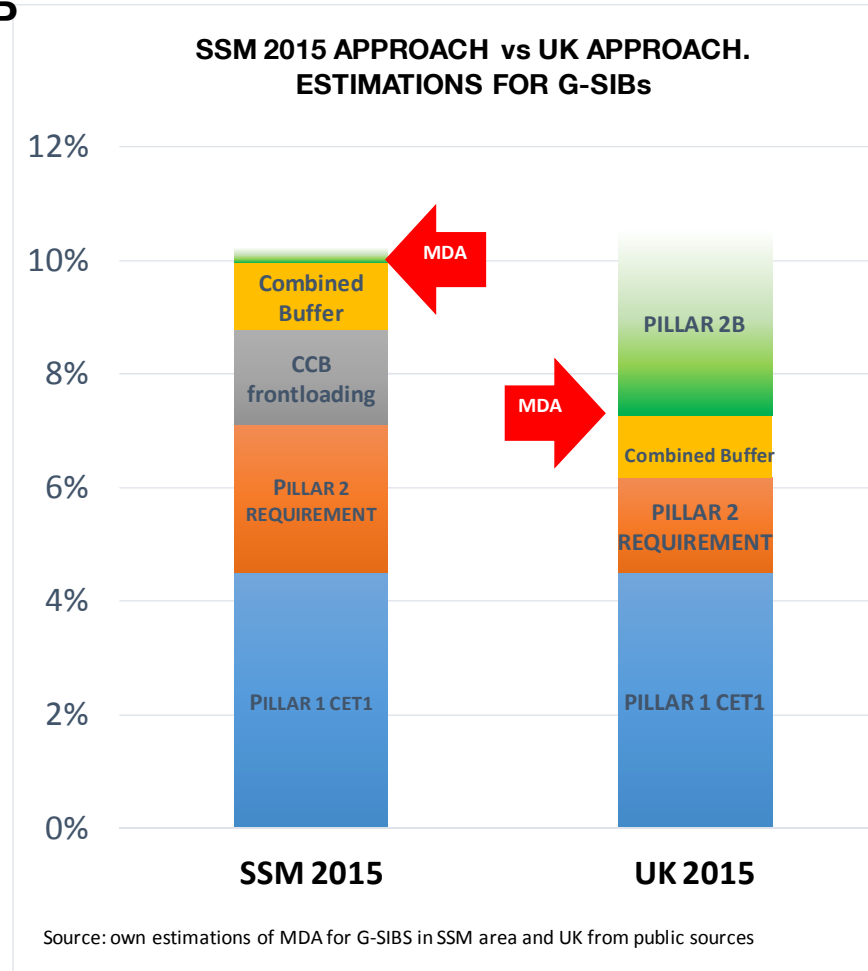


Source: Banco de España

2. CHALLENGES

2.3. Regulation

iii) MDA/SREP



SSM approach for 2016 may evolve towards requirements plus capital guidance:

- Requirements (relevant for the calculation of the MDA)
- Guidance (to be used when processing the impact of hypothetical scenarios)

No change in requested capital, just divided differently between requirements and guidance.

3. EXPECTED REACTION BY THE INDUSTRY

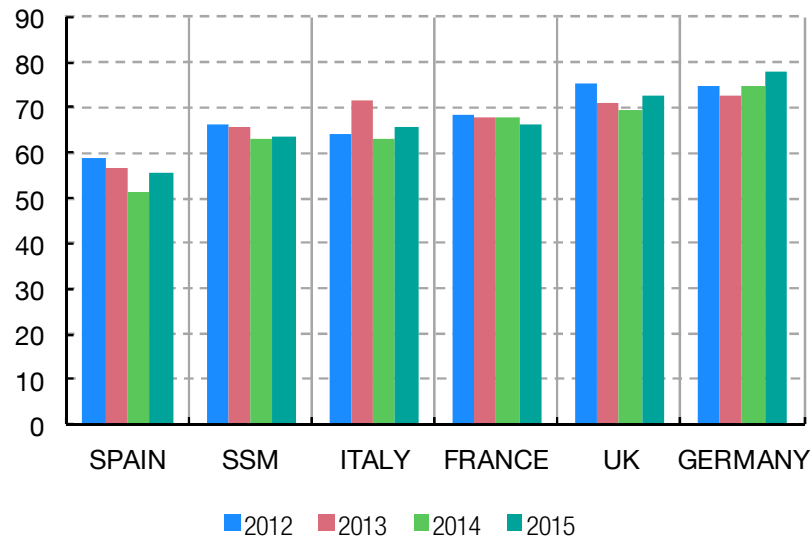


3.1. Efficiency

- With low profitability, **excess capacity** needs to be corrected

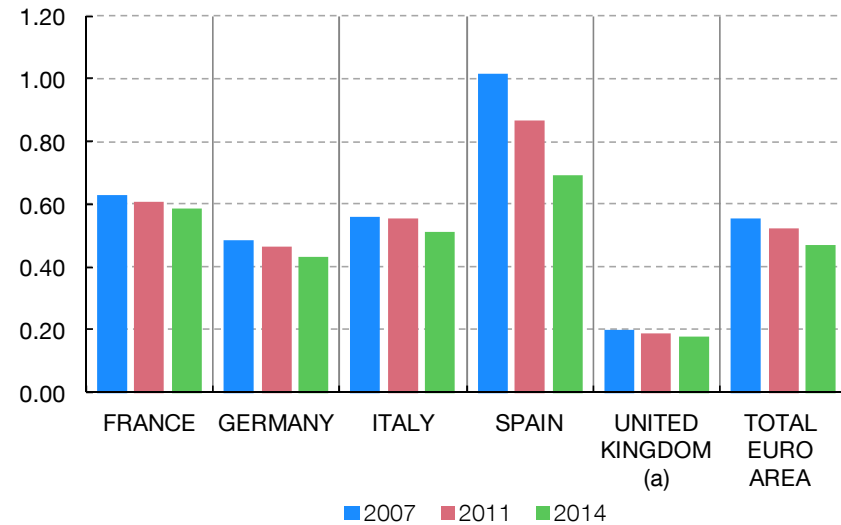
- Taking **advantage of new technologies**. Proximity of banks depends less on physical proximity

COST-TO-INCOME



SOURCE: SNL.

NUMBER OF OFFICES PER ONE THOUSAND INHABITANTS



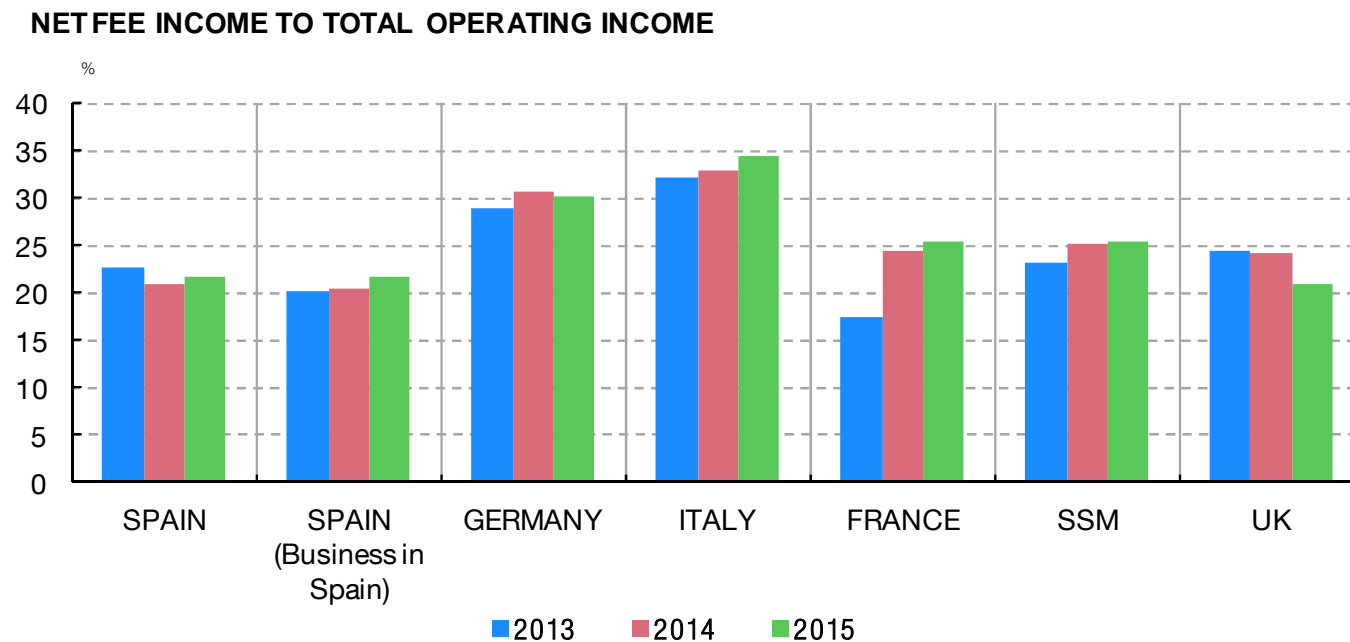
SOURCE: ECB and World Bank.
a. Data refer to 2013.

3. EXPECTED REACTION BY THE INDUSTRY



3.2. Fees on services

- End of **cross-subsidiarisation** of banking services. **Fin-tech** is a challenge but also an opportunity for banks



SOURCES: SNL and Banco de España.

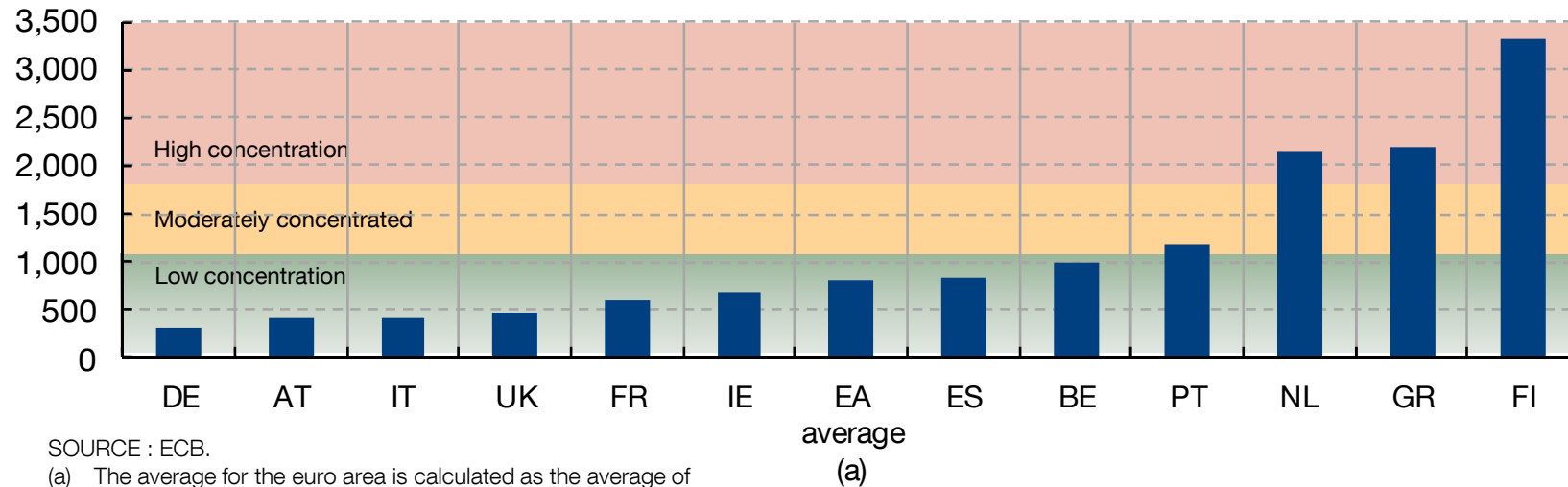
3. EXPECTED REACTION BY THE INDUSTRY



3.3. Corporate operations

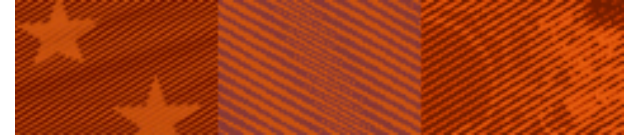
- **Consolidation** may be requested for an orderly correction of overcapacity.
- Ideally this is to be achieved at **European level**: it looks essential to have more pan-European banks to develop a fully effective risk-sharing mechanism.
- ... but in the **short term**, the need to cut costs will likely promote **within-border mergers** taking advantage of possible economies of scale.

HERFINDAHL-HIRSCHMAN INDEX
December 2014



SOURCE : ECB.

(a) The average for the euro area is calculated as the average of the HHI of each of the euro area countries, weighted by total assets.



THANK YOU FOR YOUR ATTENTION