



Historic quarter for European banks at the onset of the corona crisis

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European banks have taken a substantial initial hit from the corona crisis in Q1, but so far digested it relatively well. Nevertheless, more pain is surely to come. While revenues and costs were both down only mildly, loan loss provisions shot up and almost wiped out industry profits. Capital levels dropped quarter-over-quarter, yet less than feared as banks cancelled 2019 dividends. Balance sheets expanded by a record-breaking 10% compared to year-end due to growth in corporate loans, higher liquidity reserves at central banks and increased derivatives volumes.

The 20 major European banks have been hit hard in Q1 by the coronavirus crisis and the recession triggered by it, but so far they have managed to contain the fallout. Total revenues were slightly down yoy (-1%) on the back of diverging trends. On the one hand, especially during the market turmoil in March, clients traded more stocks and bonds, which benefited fee and commission income (+9%). On the other hand, trading income (-26%) suffered from wider credit spreads and lower stock market valuations. Net interest income was flat, with margin compression and volume growth largely offsetting each other. The trend of falling operating expenses continued (-1%). Still, the average cost-income ratio edged up 2 pp to 66%.

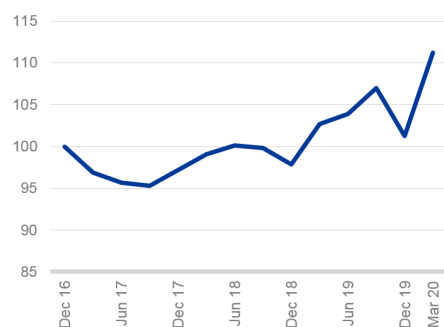
The biggest immediate P&L impact was a jump in loan loss provisions. They rose to 2½ times the prior-year level – which had been close to record lows, however. In addition, the provisions are modest compared to US peers where they surged to 4½ times the 2019 figure in Q1, although the recession may hit Europe more than the US. GDP is expected to slump by 12% in the euro area and 11.5% in the UK in 2020, compared to 7% in the US. This is an important yardstick for the economic shock though it does not translate one-to-one into loan losses thanks to structural differences and a host of varying government support measures which will have an effect on default probabilities. While policymakers have instructed European banks not to provision aggressively and use all available flexibility in the accounting framework, this risks a repeat of the precarious post-financial crisis experience. US banks' loan loss provisions were back at normal levels already in 2011/12, whereas it took their European counterparts much longer, until 2014/15. One of the reasons, apart from the second-round effect of the European sovereign debt crisis, were the considerably lower provisions in Europe and the bolder reaction of US banks during and immediately after the financial crisis in 2008-10. The prolonged burden on European banks enabled their US competitors to pull ahead and gain market share, especially in the capital markets business.



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Total assets of the largest European banks*

Dec 2016 = 100



* excl. UK institutions

Sources: Company reports, Deutsche Bank Research

Bottom line, net income was almost wiped out in the first quarter (-84% yoy) as more than a third of the European banks recorded a net loss (in contrast to their US peers which all stayed in the black). This followed softer net income last year already. 2018 had been the only full year since the financial crisis when all major European banks were profitable and it may remain so for the time being.

On the balance sheet, total assets jumped by 8% yoy and a staggering 10% in the last three months. A seasonal gain in Q1 is common, but this one is unprecedented and the strongest surge in a single quarter on record (which started in 2005). Not even during the tumultuous years of the financial crisis of 2007-09 or the European debt crisis did banks' balance sheets grow as massively. That was due to higher liquidity reserves at central banks and interbank claims, higher derivatives volumes, and a strong increase in (corporate) loans. This underscores banks' fundamentally different, more positive role in the current crisis: deficiencies in the banking system had been at the core of the financial crisis and the Global Recession, and weak banking sectors in countries such as Ireland, Spain and Italy aggravated the debt crisis of 2010-15. Now, by contrast, banks can contribute to mitigating the economic shock that has hit the world like a bolt out of the blue, by continuing to support clients and finance companies, households and governments even when their creditworthiness deteriorates and banks' capital levels are under pressure. In this sense, the corona crisis offers the banking industry "redemption", i.e. an opportunity to somewhat restore its reputation as a good corporate citizen.

Risk-weighted assets (RWA) climbed 2% both yoy and qoq in Q1, mainly because of asset growth, rating migration, regulatory inflation for securitisation positions and higher market risk due to the extreme financial market volatility. This more than offset some asset sales and positive FX effects, as emerging market currencies devalued against the euro.

The total equity base rose by a modest 1% yoy and qoq. At 13.5%, the average CET1 ratio slightly exceeded its level of 12 months ago (+0.2 pp), however, decreased materially since year-end 2019 (-0.4 pp). The release of (sometimes substantial) 2019 dividends which had already been accounted for, yet were scrapped or at least delayed following ECB guidance, was more than offset by the increase in RWA as well as net losses at some institutions, which contributed to lower capital ratios. Of course, they would have fallen more had loan loss provisions been higher. Similarly, the leverage ratio was flat yoy at 4.8% but contracted 0.3 pp qoq. Overall, capital positions remain robust for the time being. Most of the pain, though, is still to come as the recession only fully bites in the current quarter and will probably take until 2022 to be completely overcome. On the liquidity side, despite the turmoil, banks managed to keep the LCR broadly stable qoq at a solid 146% on average (down 5 pp yoy).

See also:

[Crisis impact on bank balance sheets in the euro area](#)

[Initial US bank performance in the corona crisis](#)

[European banks in the corona crisis](#)



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