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COVID-19 will expose many of European banks' strengths and opportunities

Beside its tragic human cost, the coronavirus' economic cost will very rapidly translate into substantially higher credit cost for European banks. And that is despite the substantial support provided by the authorities to households and corporates. But the capital and liquidity buffers built by banks over the past decade should, this time around, help banks be used as a conduit to support the authorities' monetary and economic policies to address the crisis. The flexibility granted by supervisors for banks to dip into these buffers will—as originally planned by the regulations—allow banks to contribute to minimise the depth of the crisis and build the foundations for a strong recovery.

That said, once the economic rebound takes hold, banks will not reap the financial benefits of their actions through the crisis. They will face customers that may be prone to deleverage, a cost of risk that will likely be well above pre-crisis levels, and the prospect of lower-for-even-longer rates. This will likely durably dent earnings that were already often feeble at the onset of the crisis.

One of the longer-term questions that will need to be addressed post-COVID-19 is the extent to which regulatory requirements will again be tightened, and how rapidly. The earnings recovery for banks is unlikely to be as sharp as the GDP rebound. Time, and clarity as to the regulatory path ahead, will be required for investor confidence to be preserved. The crisis will also reconfirm how useful it is for banks and supervisors to routinely carry out stress scenario analysis based on non-traditional risks. Climate-related stress-tests—put on hold during the pandemic—may be revisited with a new vigour.

Also, performance pressure and evolving customer needs (for instance around sustainable finance and fintech to name just two areas) may strengthen the argument for fewer banks with greater scale in terms of size, geographic reach, product offering and technological capabilities. This may reignite the debate around consolidation once the dust settles – the main question being whether it will still lead to predominantly domestic consolidation, or whether we will finally see more cross-border transactions within the European Union. The emergence of pan-European wholesale banks could be key to the success of the Capital Market Union. But it is unlikely to occur in the absence of clear support for this from the national and regional authorities.

Finally, another question will be around the image of banks post-COVID-19, and the perception of their role in the economy. The crisis may reveal the progress banks made after the last crisis in rebuilding their standalone strength. Their resilience through this severe and abrupt crisis would be testament to the substantial transformation they've undergone since the global financial crisis. Their willingness to use it to support customers in times of stress will be scrutinised by many. Therefore, after spending the previous decade strengthening their balance sheets, banks' ability to demonstrate this willingness to support the economy through the crisis and to explain it convincingly will be instrumental in also strengthening their image in the public opinion. ●