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European banks after Covid – Challenges and opportunities for the years ahead

The COVID crisis saw a remarkable turnaround for Europe's banks. In 2008-9 they were part of the problem; through COVID, they were part of the solution, deploying much-strengthened balance sheets to maintain the flow of financing to the EU economy. Loans to companies are expanding at the strongest pace since the financial crisis (+5.5% yoy in December 2020), while retail lending also maintained its solid momentum (+3.2%).

A year into the crisis, Europe's banking sector has proven its resilience, with a total capital ratio above 16% and liquidity well above 100%. Banks are well placed to continue to play a vital role in Europe's recovery. Two priorities stand out. First, dealing effectively with insolvencies and other impacts of withdrawing government support; second, seizing and supporting opportunities to boost growth.

Regarding the first: the impacts so far have been contained. Non-performing loans have not risen appreciably as government measures are still in place. They are expected to rise in 2021-2022, although with important local differences as the economic impact and scope of government support both vary across different nations.

So far, flexibility on all sides has been key – for example, through moratoria or other forbearance measures. Going forward, this is vital; entire sectors will need restructuring to become viable. Working with clients to identify workout solutions has proven successful, and regulation needs to enable this to continue. Excessively onerous capital requirements on non-performing loans would have the opposite effect: forced asset sales, collateral enforcement and insolvencies, and thereby choke off the post-COVID recovery.

Regarding the second: a clear path to competitiveness, innovation and growth is vital for Europe. Digitalization and the transition to a low-carbon economy both offer significant opportunities; however, both require financing on a scale which goes beyond conventional balance sheet lending – still the dominant source of financing for most European companies. Here, too, Europe's banks can play a central role, but two factors will be decisive.

First: further progress on banking union and capital market union. This will spur consolidation in the banking sector and help Europe's leading banks close the 'scale gap' to their US and Asian peers. Enabling Europe to develop deeper capital markets helps finance economic growth and creates opportunities to boost returns for savers and investors.

Second: a regulatory level playing field. This is all-important as Europe completes implementation of Basel III. If we raise capital requirements for lending, Europe's businesses, particularly smaller companies, may find financing more expensive or less available at a critical time in our recovery. The high impact on large banks may translate into higher cost across all types of financing.

Europe's path ahead is clear. We will only make progress on that path by working together. Governments, regulators and banks came together and worked in partnership to steer Europe through the COVID crisis. Let's keep that partnership spirit as we set the course for recovery, competitiveness and growth.