

Discussion on the lecture by Claudia Buch “Bank Profitability”

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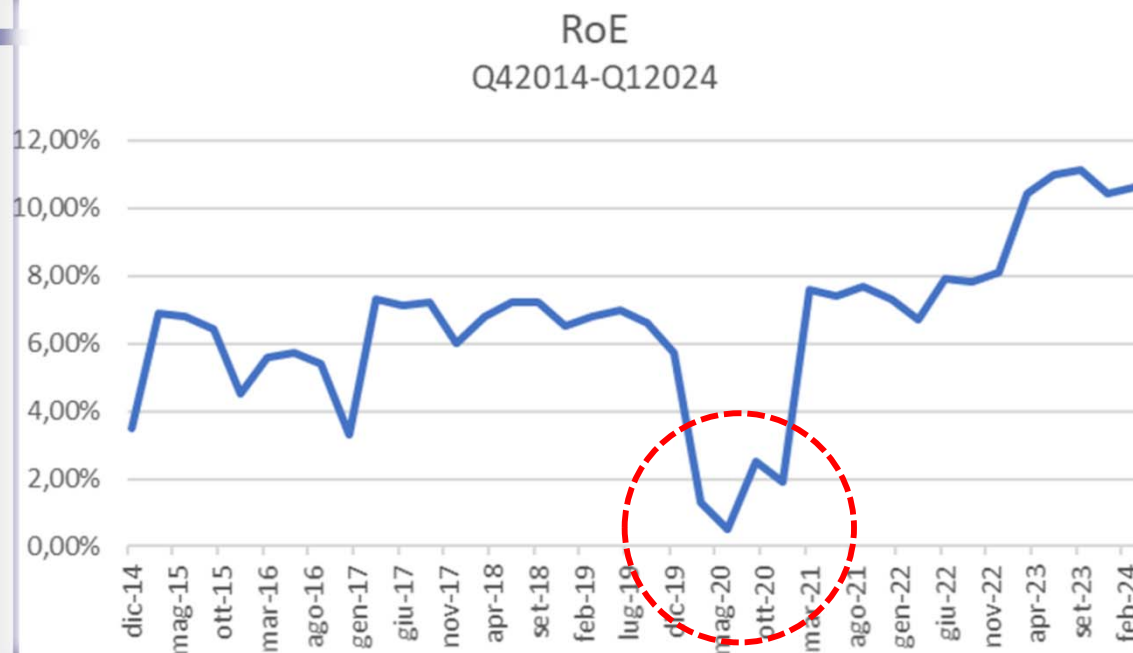
Bocconi University - 16 October 2024

Agenda

- Trend in European banks' profitability (RoE) and its components
- Is recent profitability sustainable?
- Financial integration and profitability at the 10th anniversary of the Banking Union

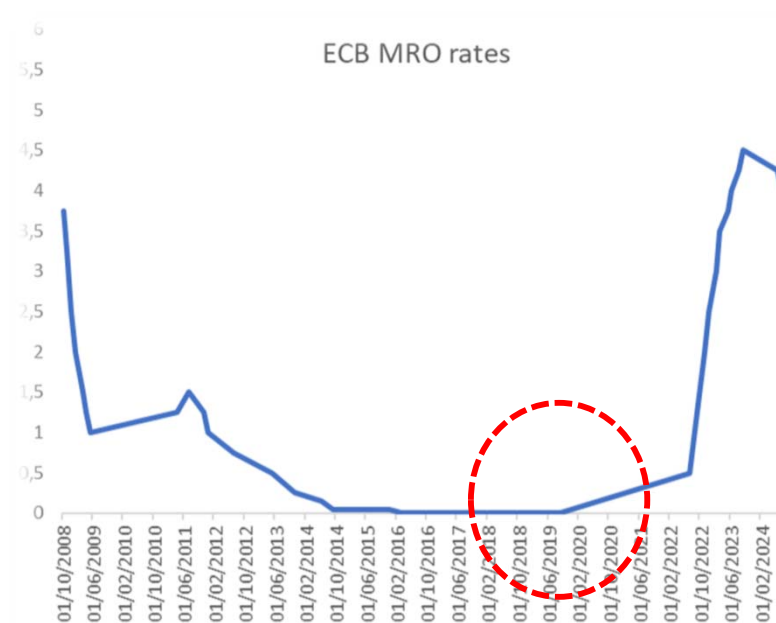
Trend in European banks' profitability

RoE



Source: EBA Risk Dashboard

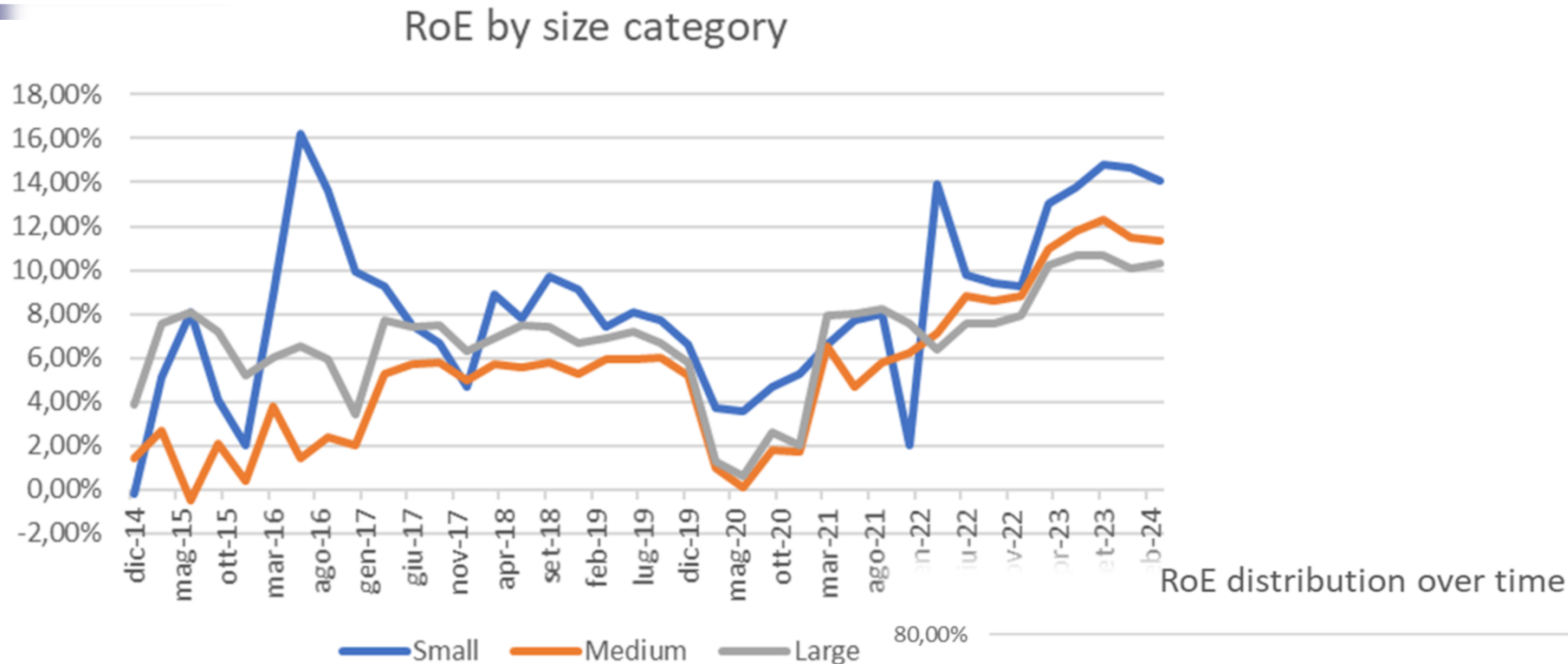
Banks have benefited from rising interest rates since the Covid years



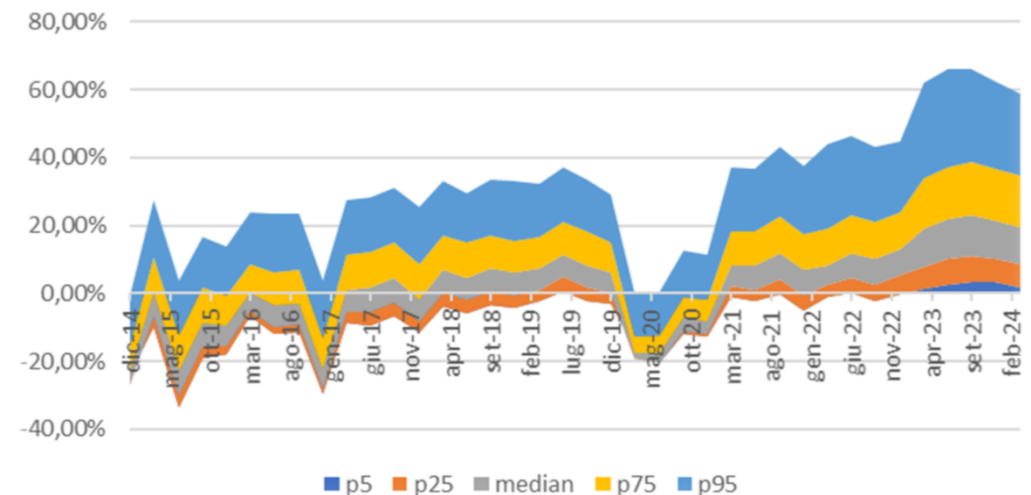
Source: ECB

Trend in European banks' profitability

RoE across the distribution and by bank size category



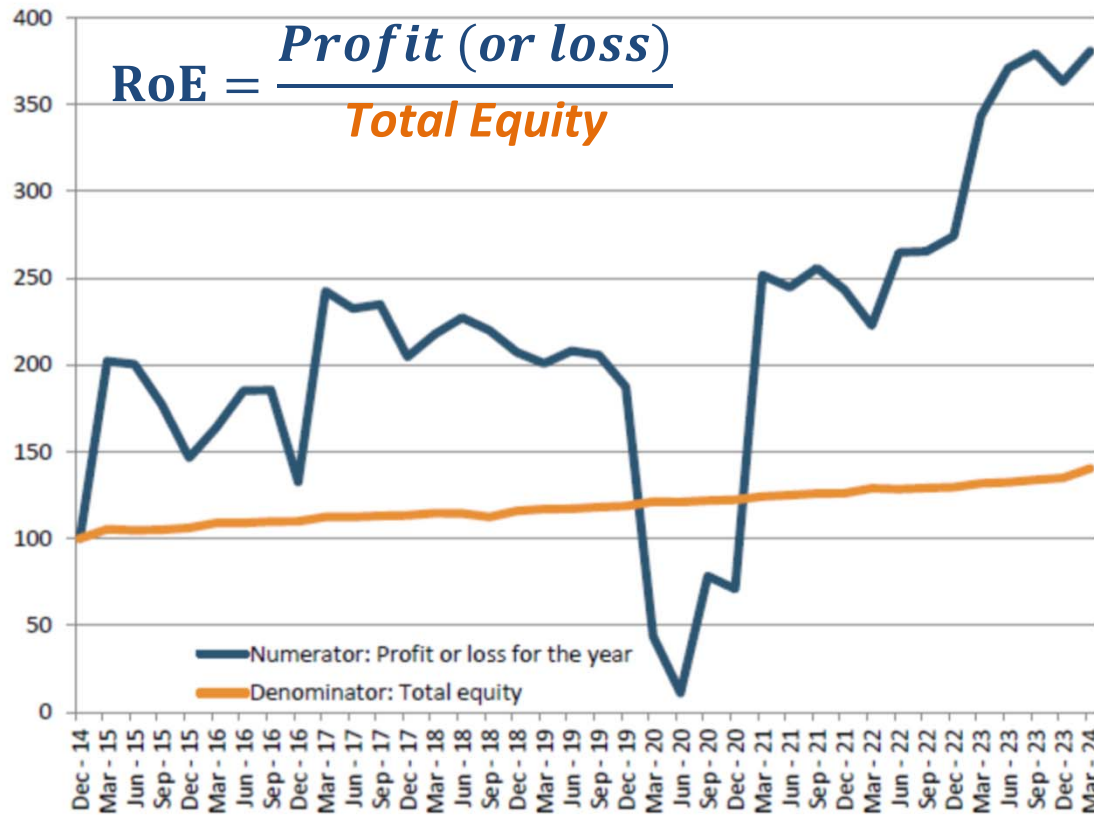
- Banks have all benefited from rising interest rates
- But there is wide dispersion



Trend in European banks' profitability

RoE and its components

Numerator and denominator: trends



Total numerator and denominator.
Dec 2014 =100.

- Banks's capital position (equity) has improved but profits have increased even more
- What have been the main drivers of higher bank returns?

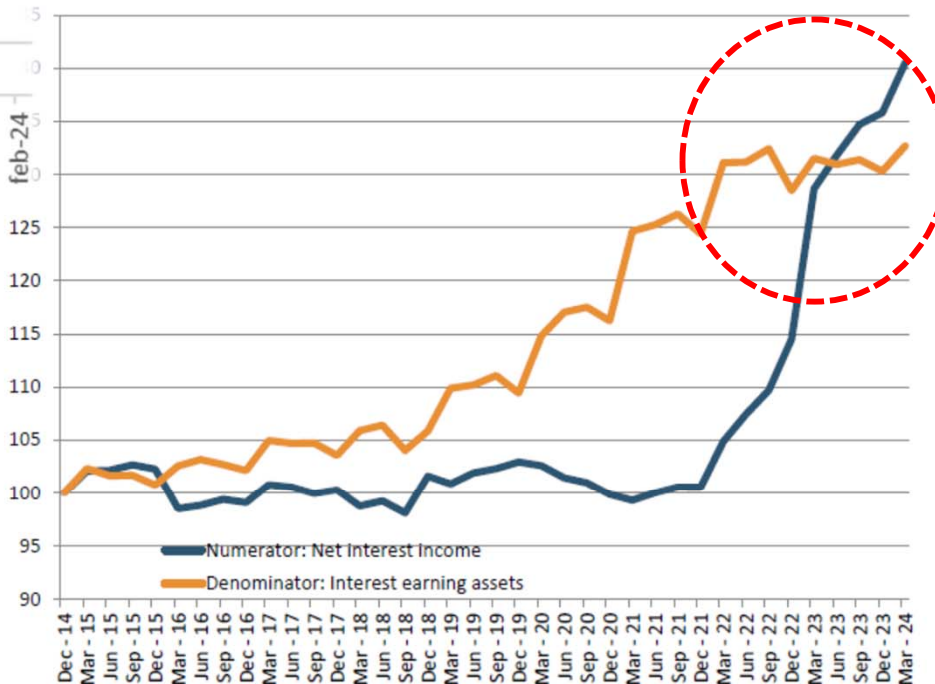
Trend in European banks' profitability

Driver 1: Net Interest Margin and its components



$$NIM = \frac{\text{Net Interest Income}}{\text{Interest Earning Assets}}$$

Numerator and denominator: trends

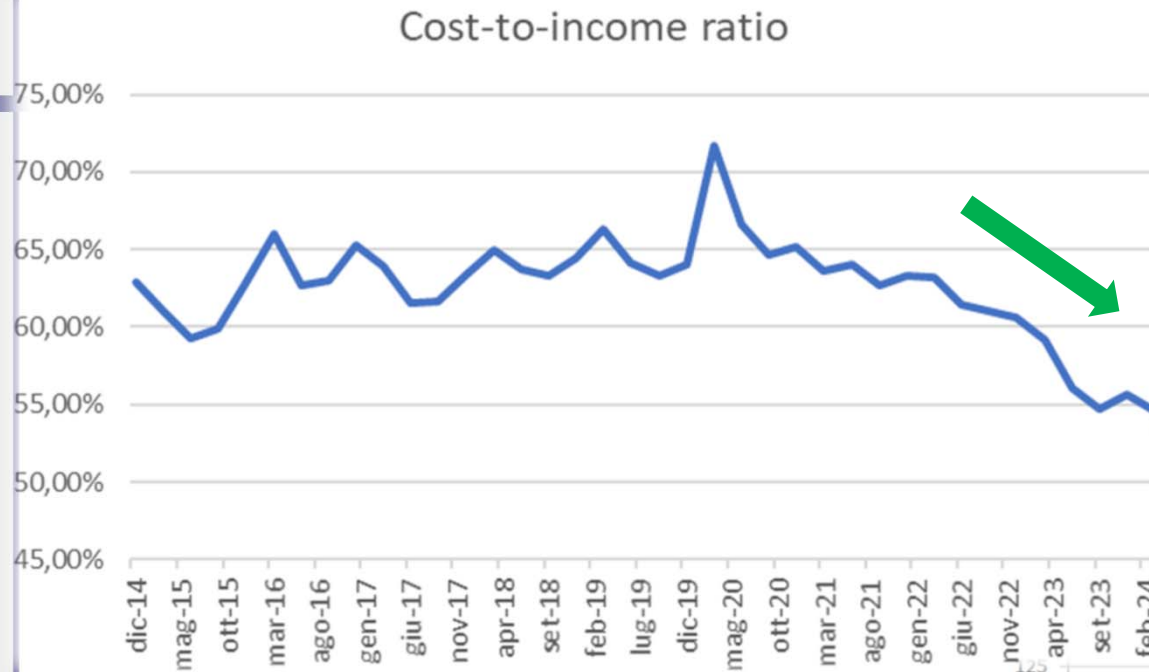


- NIM has increased...
- But the “spread effect” prevails over balance sheet effect

Total numerator and denominator.
Dec 2014 =100.

Trend in European banks' profitability

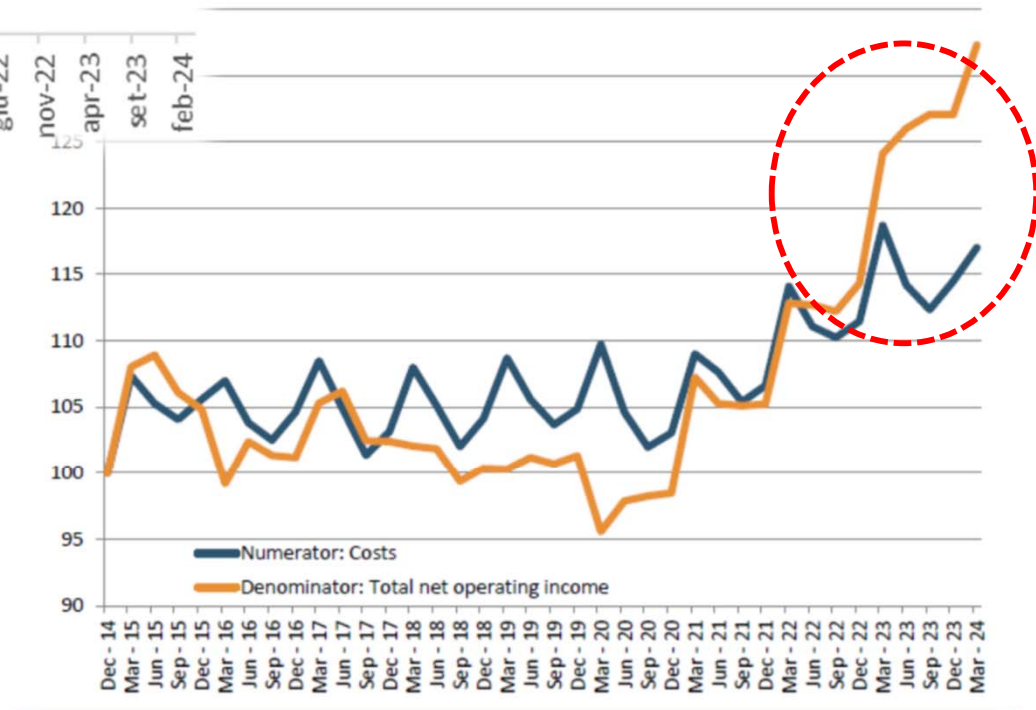
Driver 2: Cost-to-income ratio and its components



$$CTI = \frac{\text{Operating Costs}}{\text{Net Operating Income}}$$

Numerator and denominator: trends

- Cost-to-income has decreased...
- But the “denominator effect” prevails on the “numerator effect”



Total numerator and denominator.

Dec 2014 = 100.

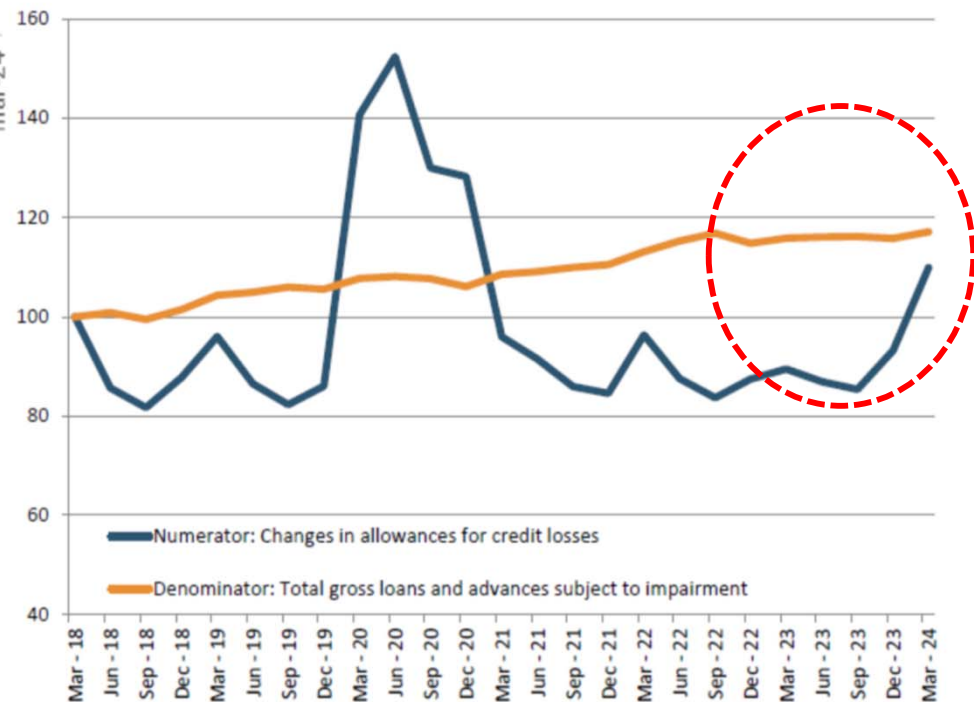
Trend in European banks' profitability

Driver 3: Cost of (credit) risk and its components



$$\text{Cost of Credit} = \frac{\text{Loan Loss Provisions}}{\text{Total Gross Loans}}$$

Numerator and denominator: trends



- Cost of risk has decreased...
- But there are symptoms of asset quality deterioration

Trend in European banks' profitability

Is it sustainable?

- Driven by the increasing interest rate margin due to the favorable interest rate scenario (spread effect).

Will this continue?

- Cost-to-income has improved

But mainly due to increase in the denominator that remarkable decrease in operating costs

- Cost of risk has improved

But there are signs of increased loan loss provisions. Concern about emerging risks and an uncertain macro-economic scenario?

- Discrepancies across banks in terms of RoE

Depending on the bank size and business models: There is no single, uniform level of sustainable profitability

Is this profitability trend sustainable?

Financial integration at the 10th anniversary of the Banking Union

What to expect from more integrated markets? (hints)

- Increased cross-border operations can lead to larger institutions, greater economies of scale, more investment in digitalization → Lower cost-to-income
- A more liquid and efficient secondary market for non-performing loans → Lower cost of credit

But also:

- Increased competition put pressure on margins, especially for smaller banks → Lower net interest margin

Is this profitability trend sustainable?

Financial integration at the 10th anniversary of the Banking Union

Open Questions for Banking Supervisors

- Is there a potential increase in risk associated with larger institutions?
- How to ensure biodiversity within the banking system? How will smaller banks react to greater financial integration?
 - There are now more than 1,000 fewer entities than at the inception of the SSM (from over 3,000 to less than 2,000 “less significant institutions”).

Happy Birthday SSM



Thank you
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