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Presentation to Banca d'Italia

European banks:

Coming out of the dark times

Alastair Ryan >>

Research Analyst

MLI (UK)

alastair.ryan@bofa.com

+44 20 7996 4806

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# Three themes

## The sources of risk have changed

- Yes, it's taken a long time to clean the banks
- Bank profitability the problem, not balance sheets
- Shadow banks

## We think the banks will grow

- A mortgage boom ahead
- The ruinous dividend ban is behind us

## Big choices ahead

- Digital euro
- Big Tech
- Climate stress – why no climate reward?

The sources of risk have changed

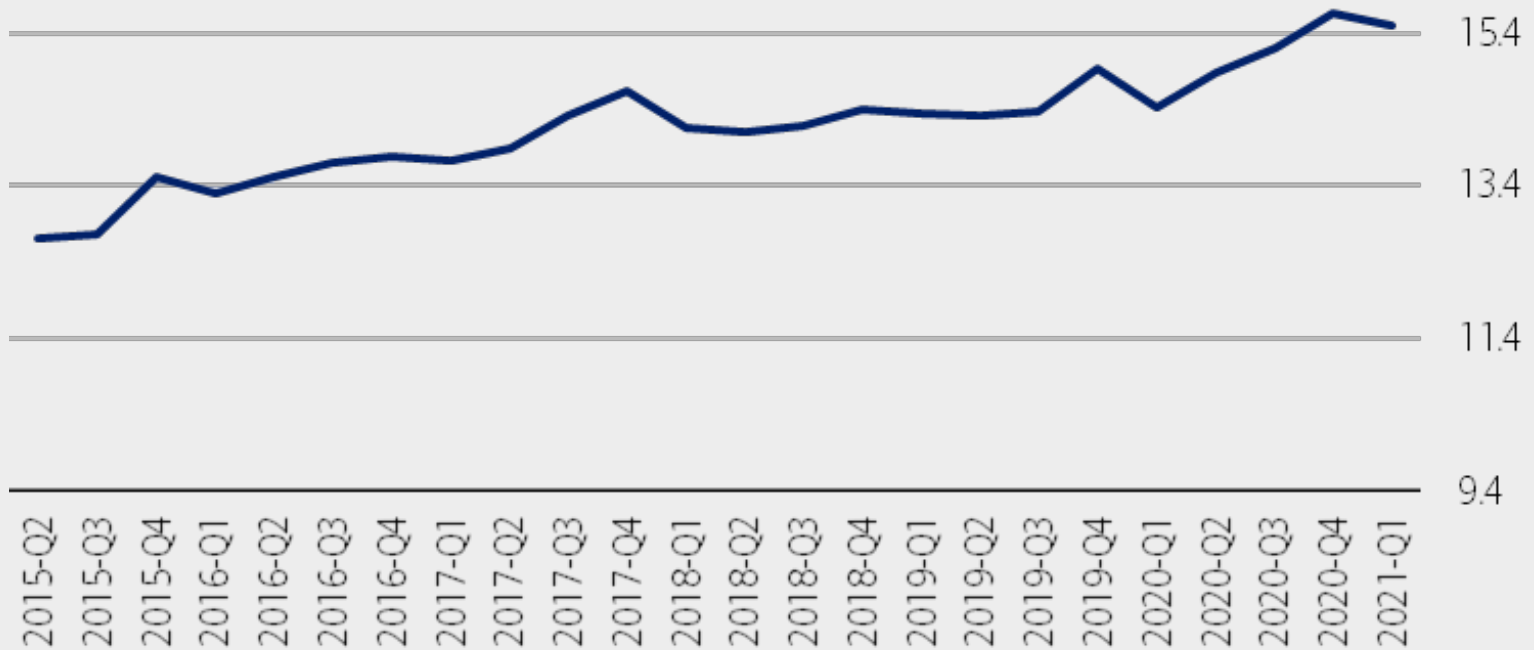




# I shouldn't be worried

## euro area Common Equity Tier 1 ratio (%) compared with SREP floor (%) 2015-21

The cushion to SREP demands has doubled over six years. It rose through the Covid shock



Source: ECB

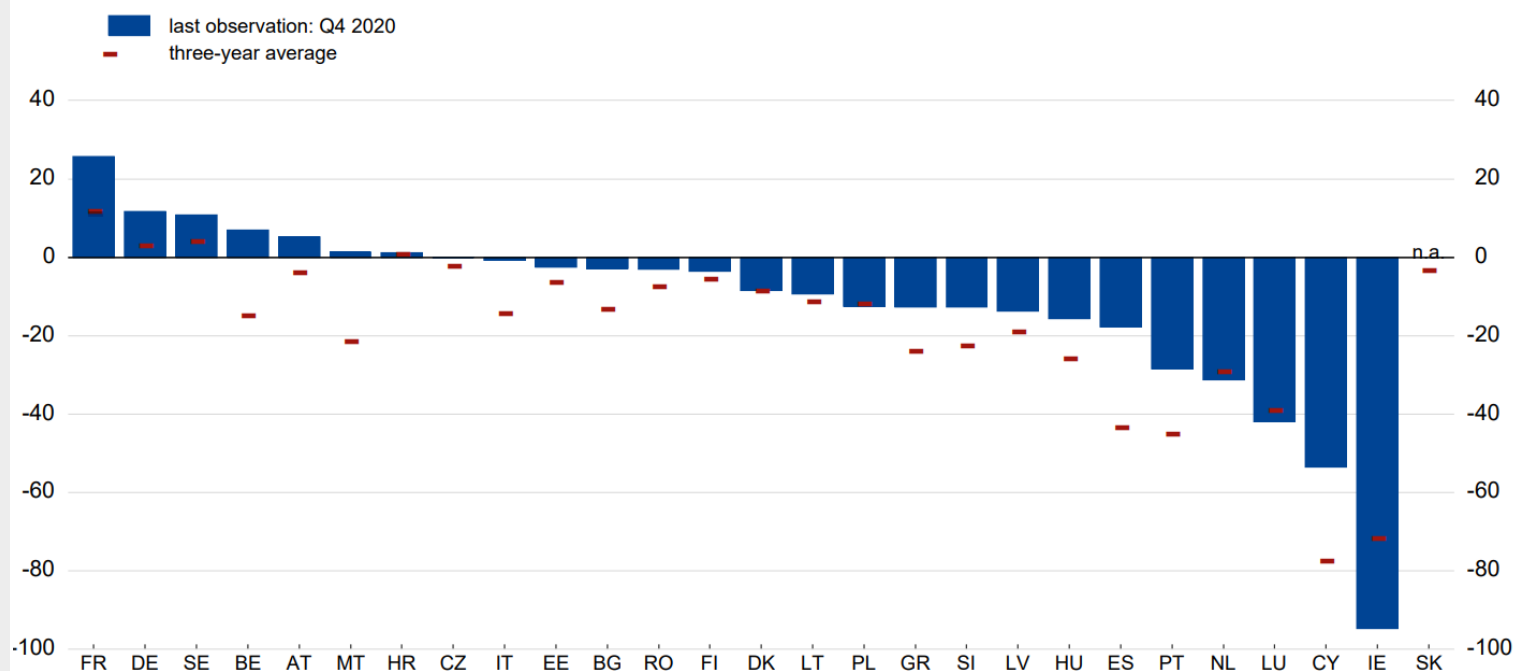
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# A bit of discipline: the credit/GDP gap



## Credit to GDP gap (%) 4Q 20

Only France was materially above long-term averages on this balance sheet measure, at a depressed moment in GDP. Strong 2021E GDP recovery will likely bring even France down towards trend



Source: ESRB

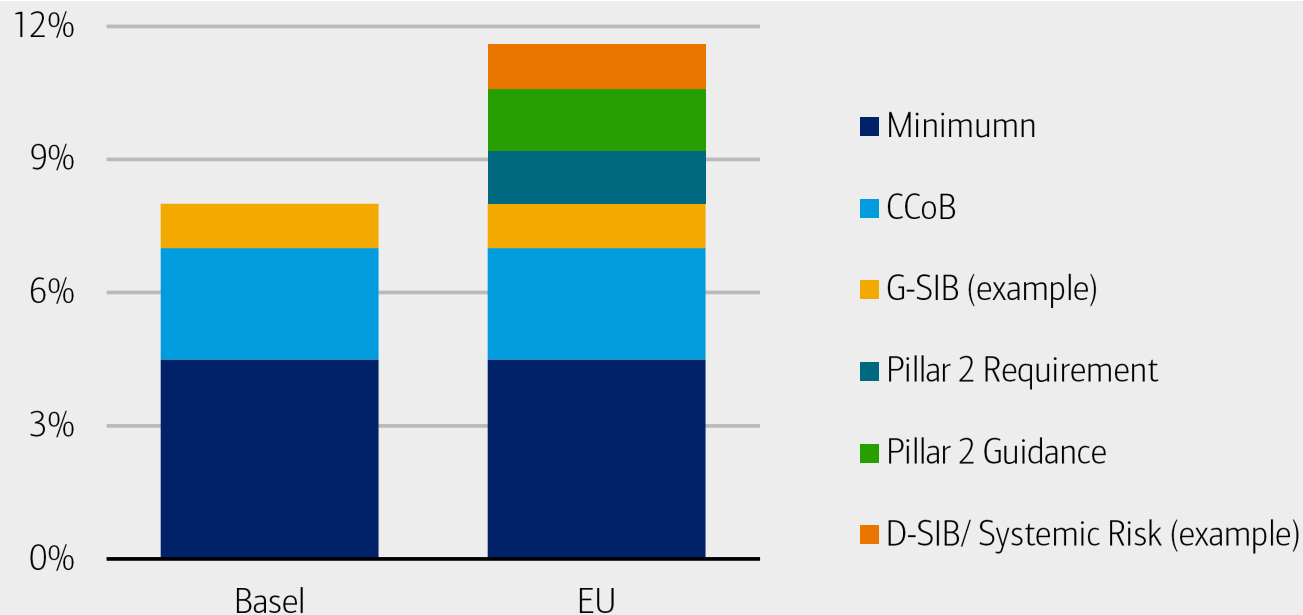
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# Europe gold plated Basel, big time - €200bn

## Common Equity Tier 1 requirements (% RWA): comparing Basel with European expectations

Pillar 2 is a European feature that raises capital requirements by €200bn. Domestic or systemic risk buffers also frequently raise requirements



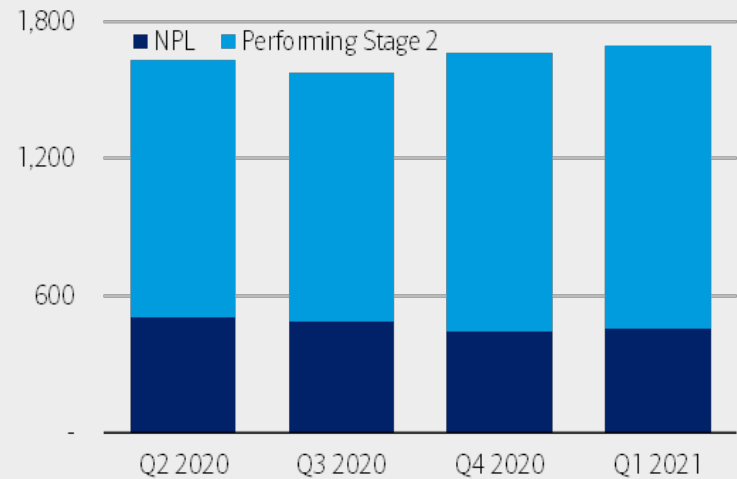
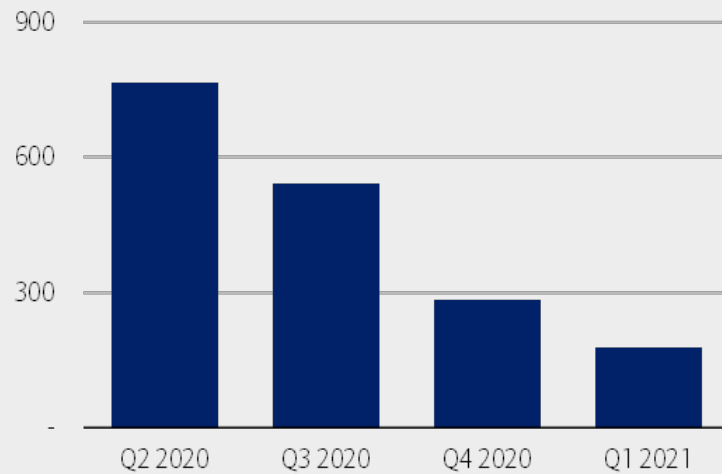
Source: BofA Global Research, Basel Committee

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# The bad debts? Erm...

Moratoria loans in the euro area (€ bn), left chart. NPLs and stage 2 loans (€ bn), right chart  
Moratoria expired and didn't turn into Stage 2 or NPL



Source: ECB

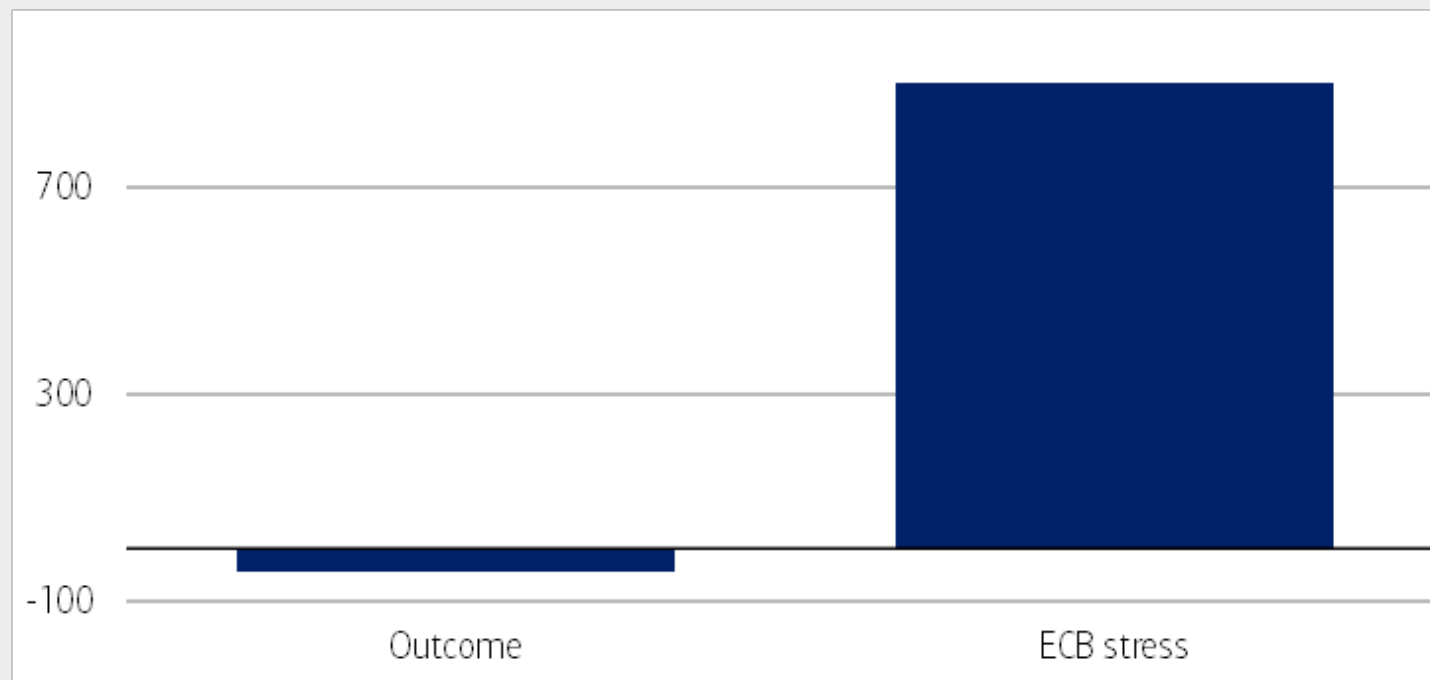
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# In the prior crisis, it was bank models that went awry. This time...



Change in Non Performing Loans, euro area (€ bn) 2020-21

Stress test was directionally wrong



Source: BofA Global Research, ECB

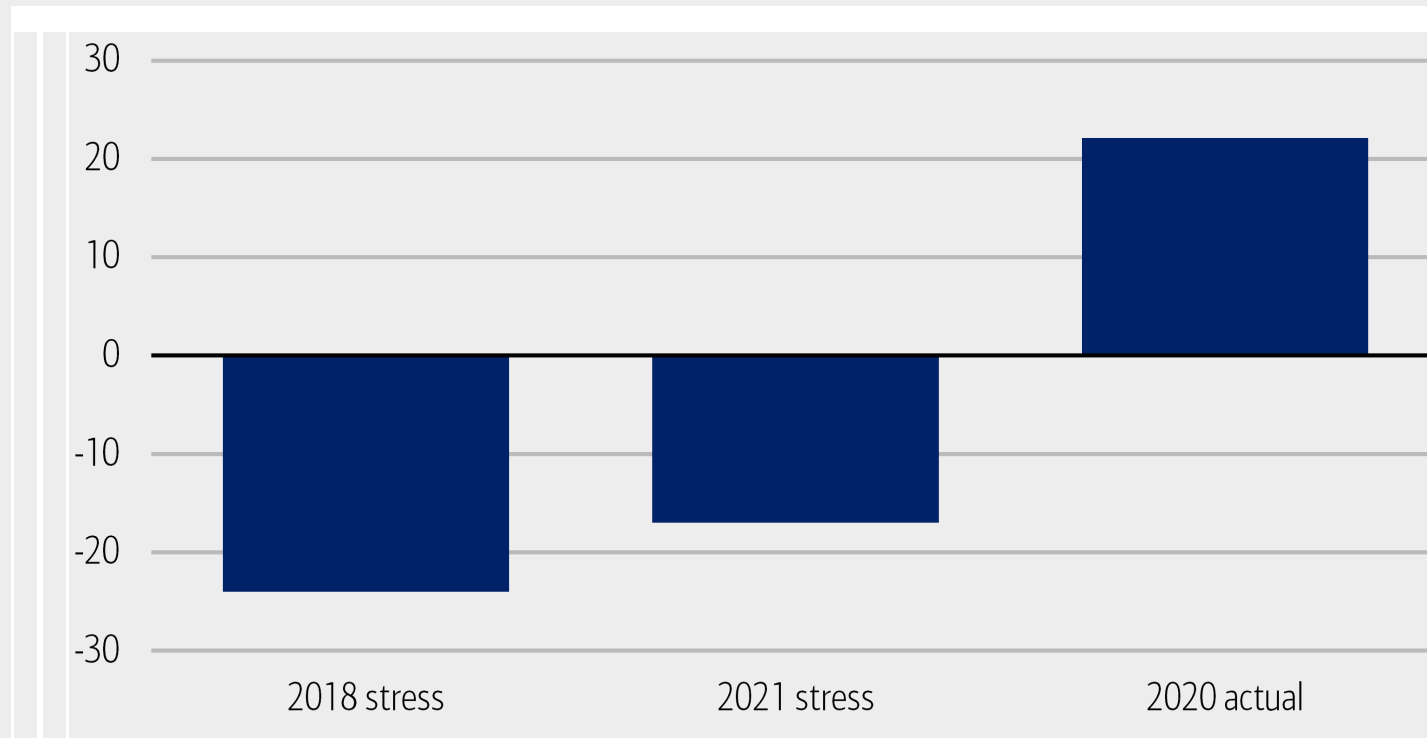
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# Trading also turned out fine. Better than fine

Trading results: EBA stress tests and 2020 actual (€ bn)  
€45bn better outcome than stressed for across the euro area



Source: EBA, ECB

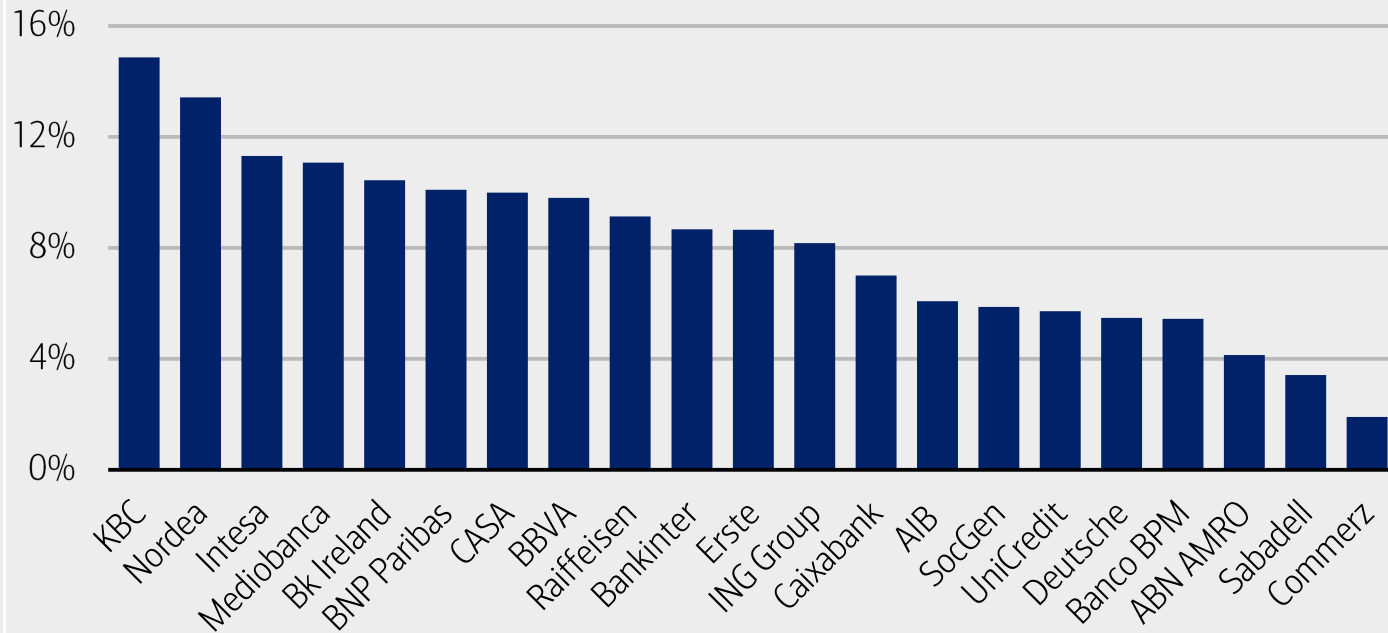
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# Returns are an essential truth. 10% is the floor

## Return on Common Equity Tier 1 (%) 2022E

A long tail of low ROE banks in the euro area. Restructuring choices now clear



Source: BofA Global Research

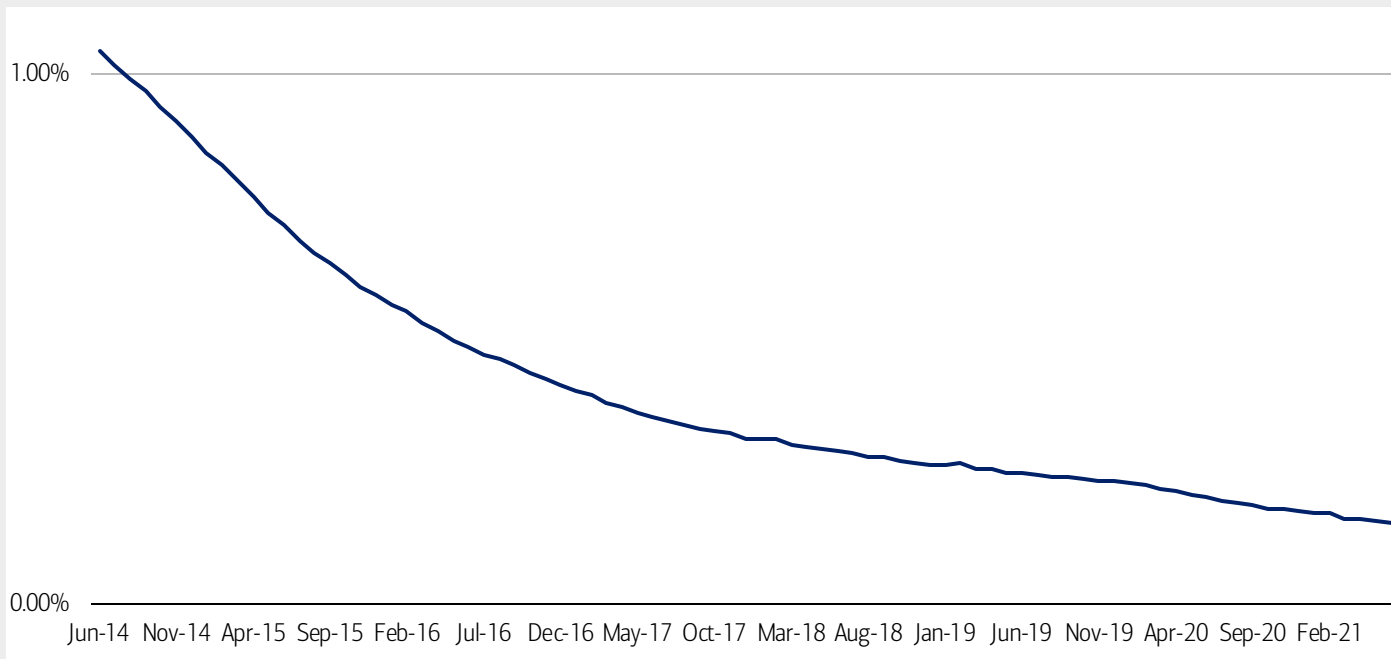
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# Challenges: negative rates are awful



Household deposit rate paid, euro area (%)

Trending to zero, not -50bp



Source: BofA Global Research, ECB

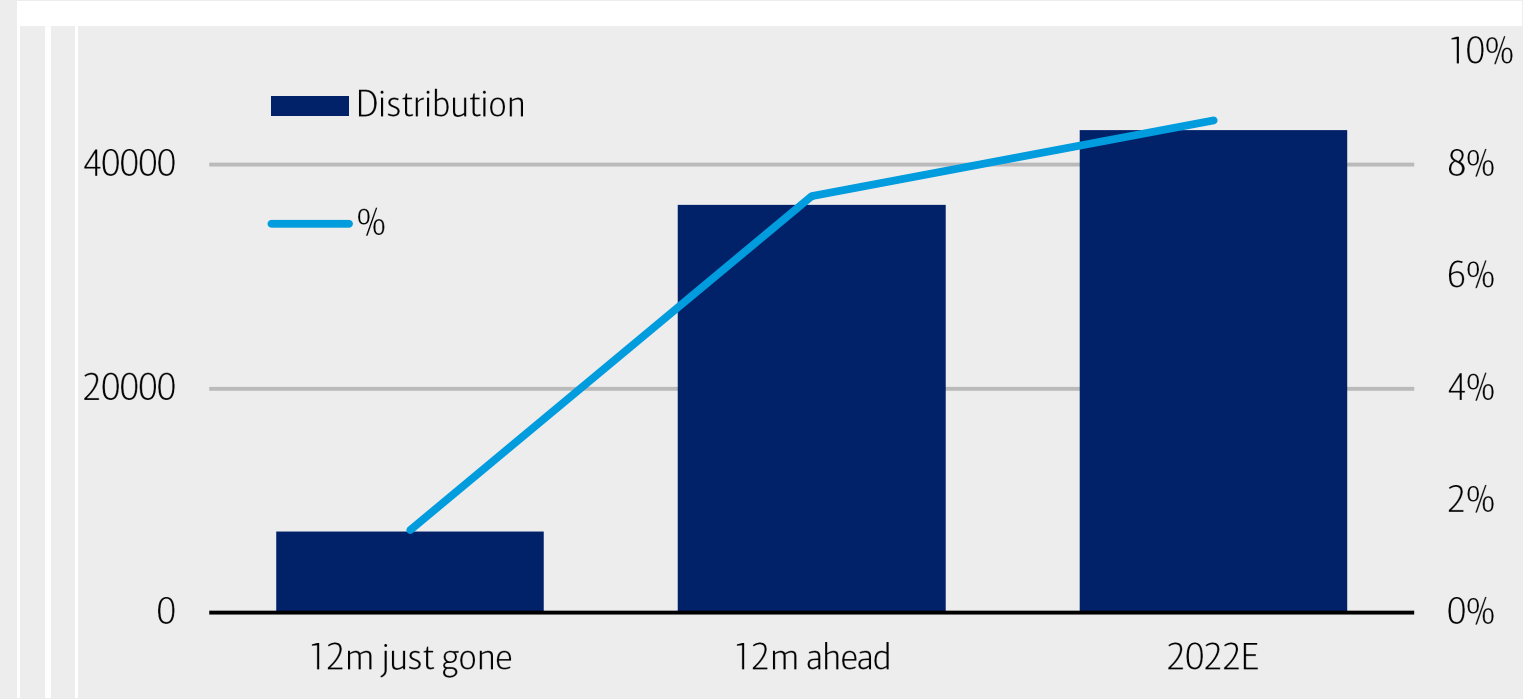
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# Banks are all about dividends



## euro area bank sector distributions (€ mn)

Industry set to distribute 7% of market cap in the coming 12 months, up fivefold



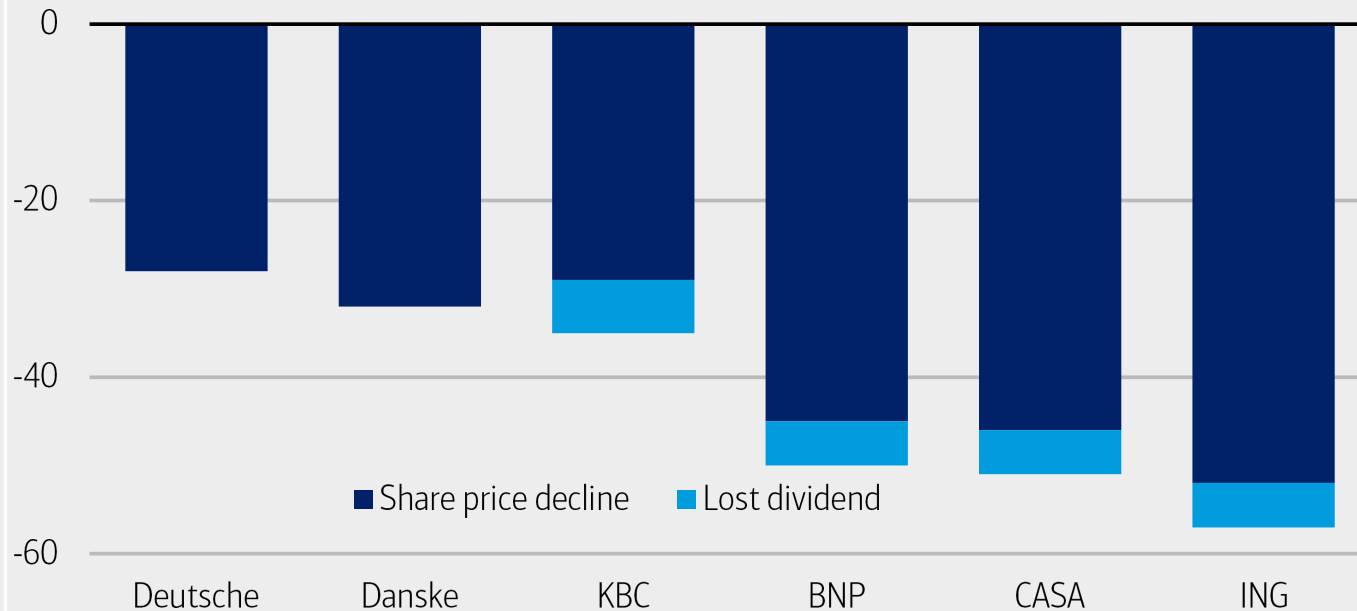
Source: BofA Global Research



# Don't do dividend bans

share price performance (%) 10 Feb-30 April 2020, plus dividends taken back following supervisory "preference"

Banks with higher returns and higher payouts fell by more through the dividend ban



Source: BofA Global Research, Bloomberg

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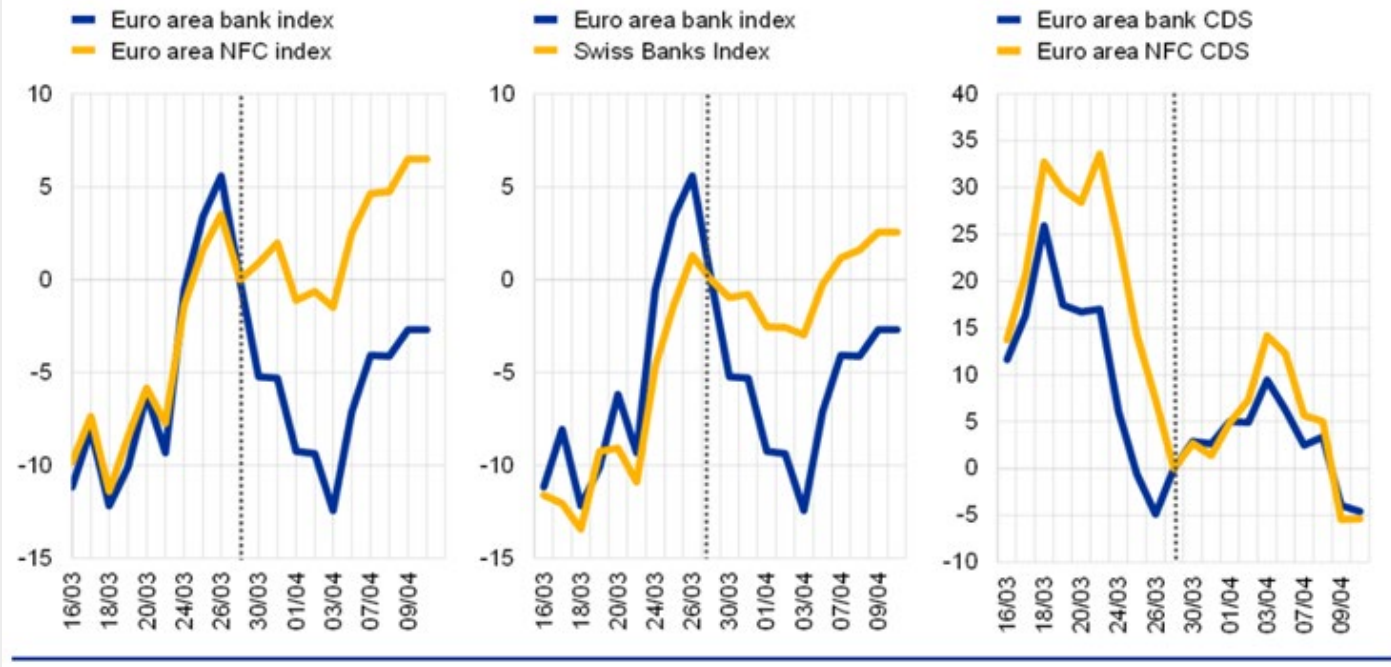


# Don't do dividend bans (2)

ECB work shows the dividend ban made share prices fall, but did not tighten Credit Default Swap spreads  
A poor mix of outcomes

## Cumulative returns, normalised at zero on the announcement date

(percentages)



Source: ECB Macroprudential bulletin

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We think the banks will grow

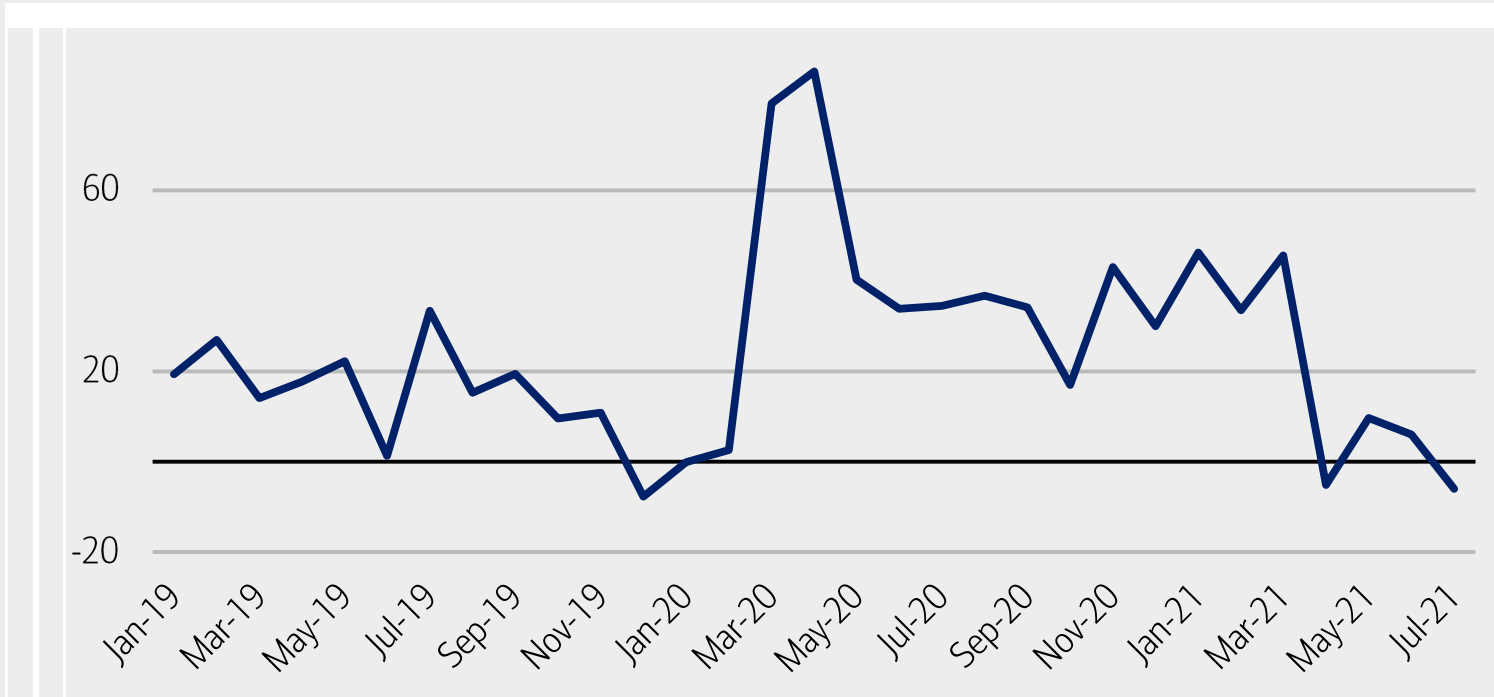


# Dry powder



## Europe: household deposit growth less household borrowing (€ bn) 2019-21

The consumer was just beginning to gear up pre-Covid. €300bn in excess savings later, growth at hand



Source: BofA Global Research, ECB

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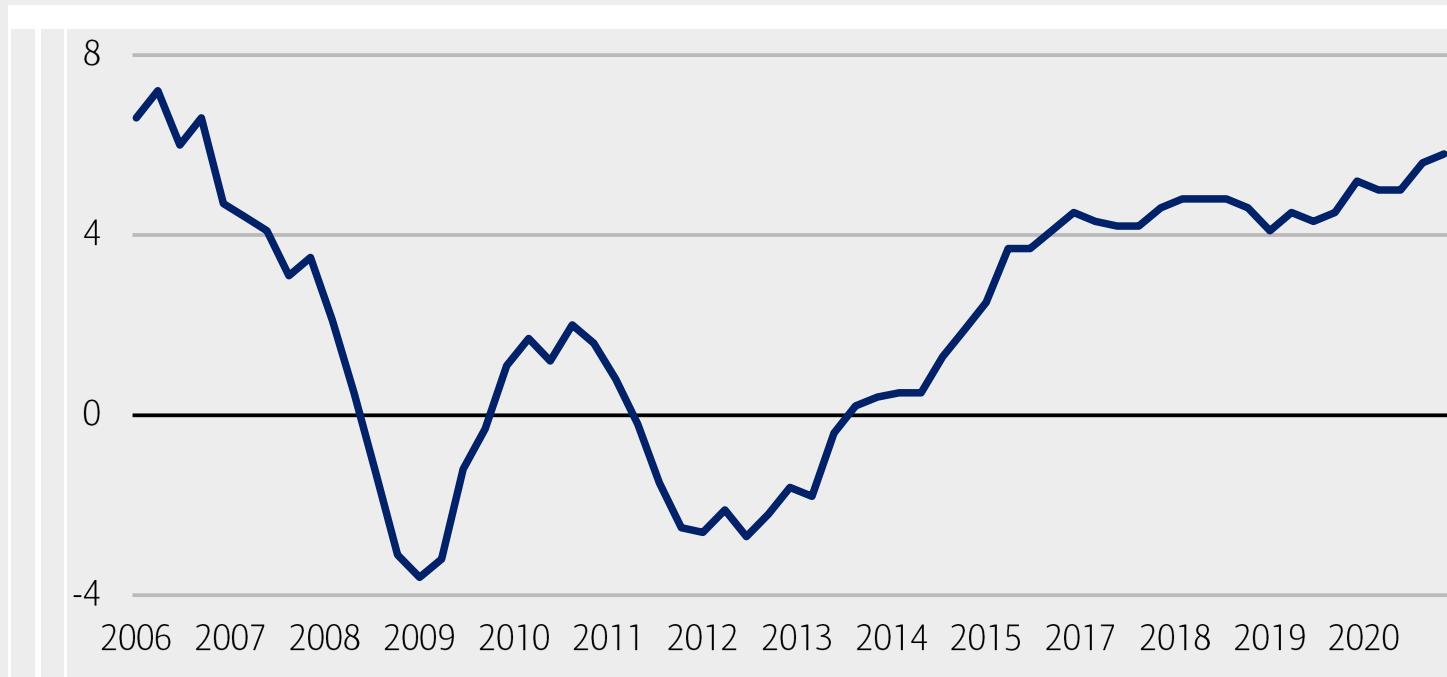




# House prices didn't boom

eurostat house price index (% growth y/y) 2006-2021

Modest growth pre-Covid



Source: Bloomberg

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# 30% less spent on mortgages....

mortgage affordability in the euro area, (€ mn)  
Monthly payment down 30% relative to wages

	<b>Balance</b>	<b>Rate</b>	<b>Monthly</b>	<b>Wage (hour)</b>	<b>Wages indexed</b>	<b>payment indexed to 07</b>
<b>Jul-07</b>	3,349,355	4.89%	1,776	11.7	100%	1,776
<b>Jul-21</b>	4,846,872	1.70%	1,720	15.4	131%	1,310
<b>New business</b>	4,846,872	1.30%	1,627	15.4	131%	1,239

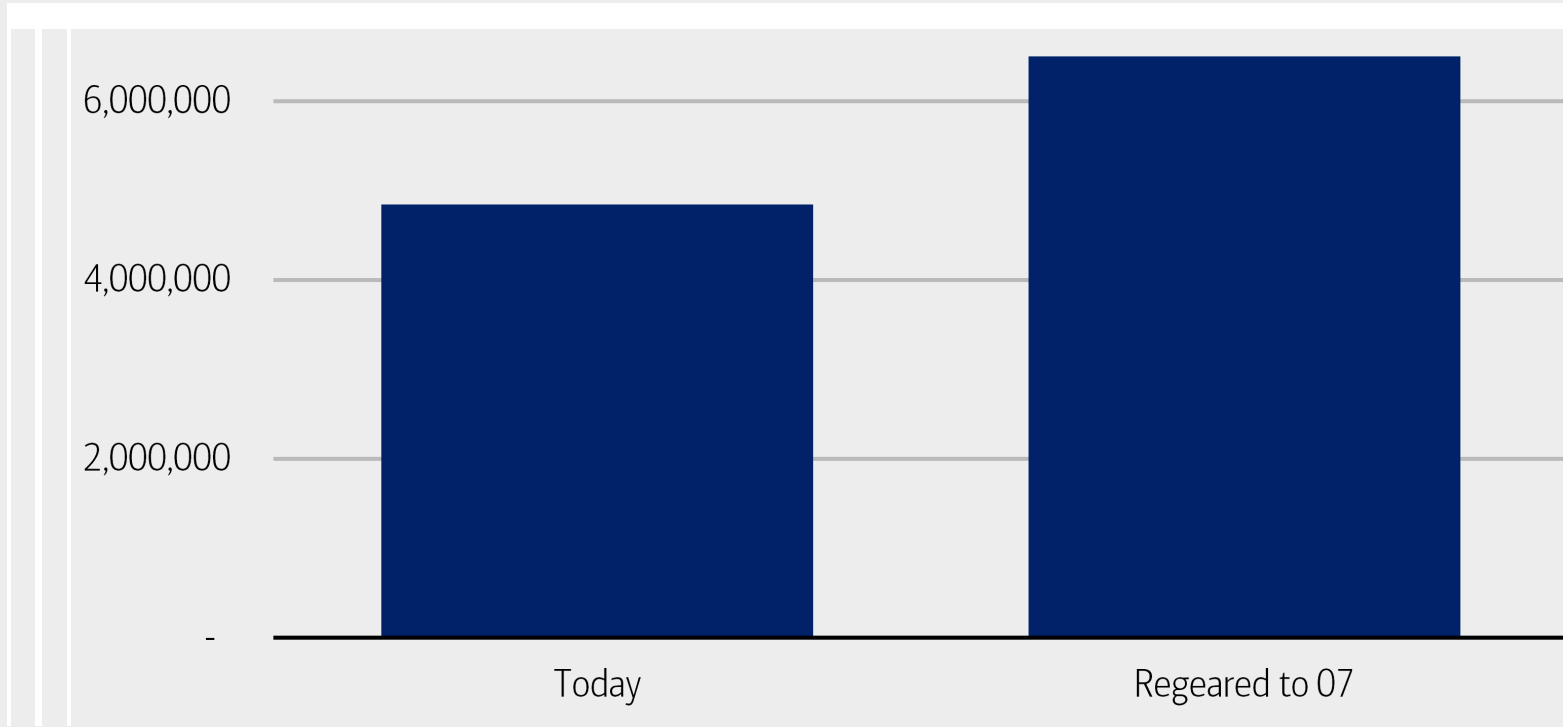
Source: BofA Global Research, Eurostat, ECB

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# ...which supports €2.1 trillion more mortgage lending



euro area mortgage market regeared to 2007 monthly payment (€ mn)  
43% upside, or €2.1 trillion just to get back to 07



Source: BofA Global Research

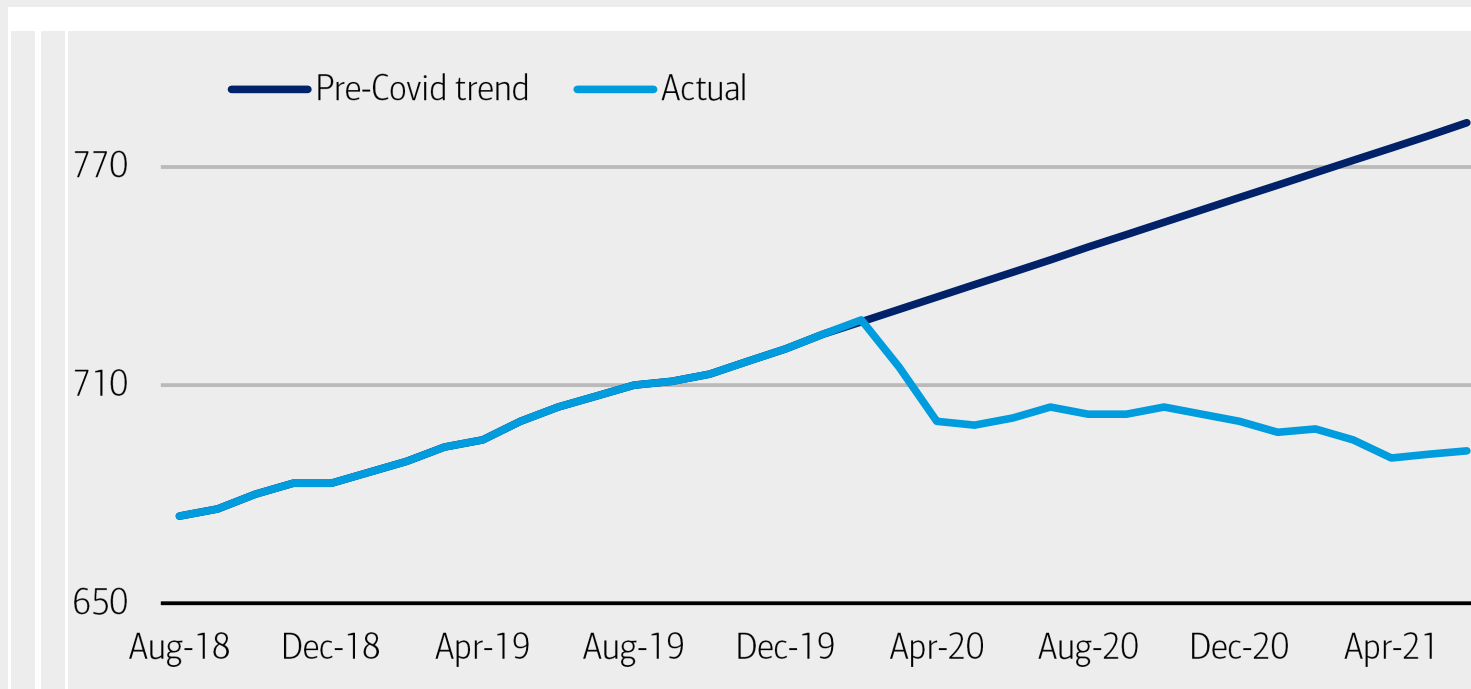
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# Consumer growth is back



consumer loans outstanding in the euro area (€ bn) 2018-21

Almost a €100bn shortfall based on pre-Covid trends



Source: BofA Global Research, ECB

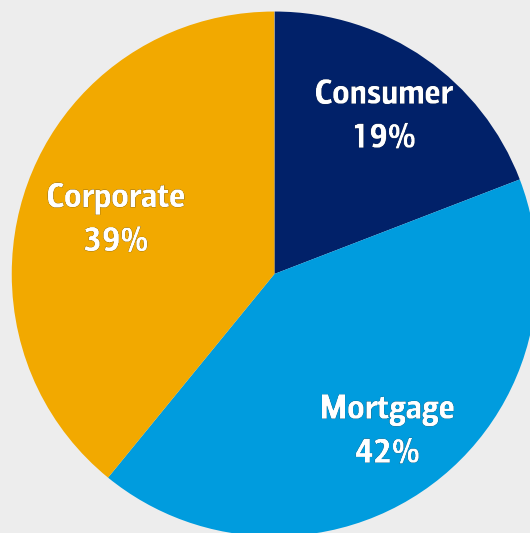
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# Consumer really matters



## Loan income, February 2020 (€ mn) by source

Consumer loans small by balances at 7%, but contributed 19% of income



Source: BofA Global Research

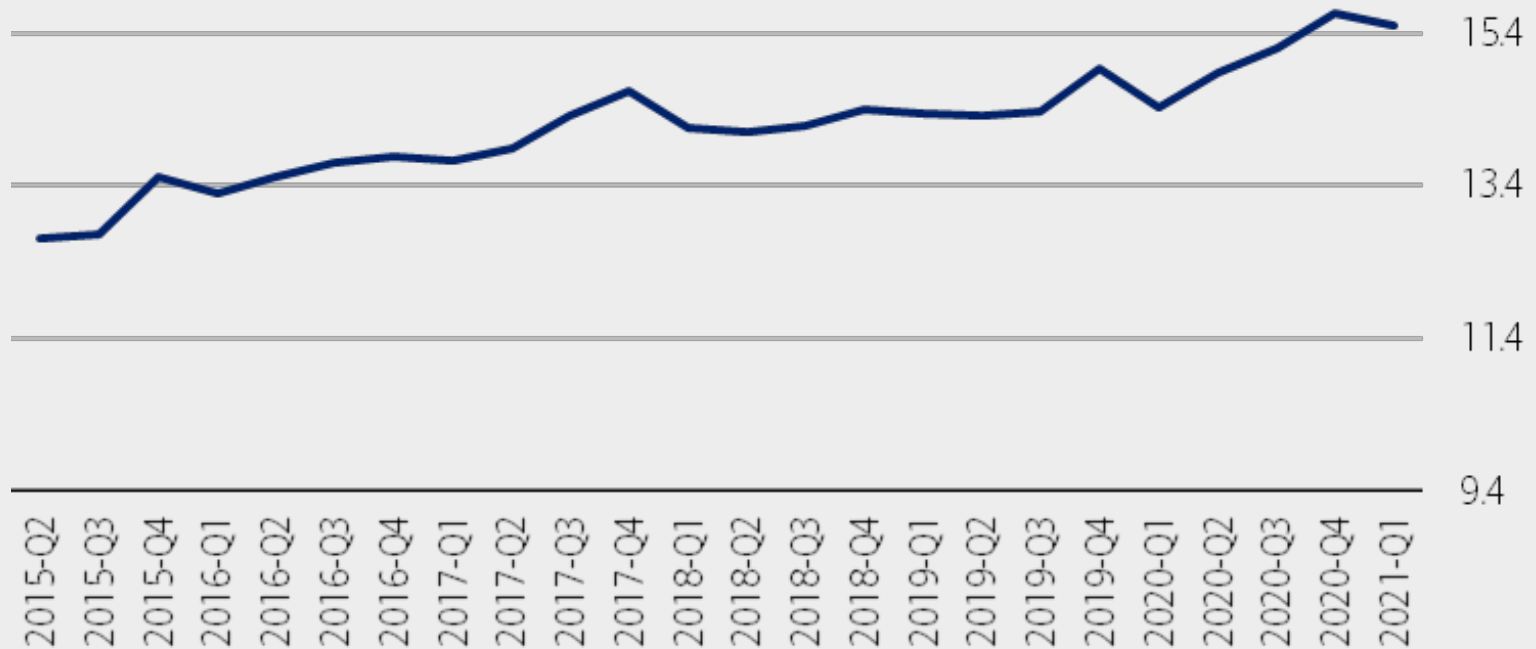
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# This was €60bn a year. Now that's there to grow

## euro area Common Equity Tier 1 ratio (%) compared with SREP floor (%) 2015-21

The cushion to SREP demands has doubled over six years. It rose through the Covid shock



Source: ECB

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# Growth is not a challenge vs payouts

Marginal costing means loan growth preferred to distributions (% RWA), illustrative  
Banks have the capital to do both as long as Return on Equity > loan growth

	Mortgage	Corporate
Revenue	1.30%	1.57%
Marginal cost	25%	25%
Expected loss	0.10%	0.20%
Pre-tax margin	0.88%	0.98%
Risk Weight	14%	46%
CET1%	13%	13%
Pre-tax ROE	48%	16%
Tax	25%	25%
After tax ROE	36%	12%

Source: BofA Global Research

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# The real risks

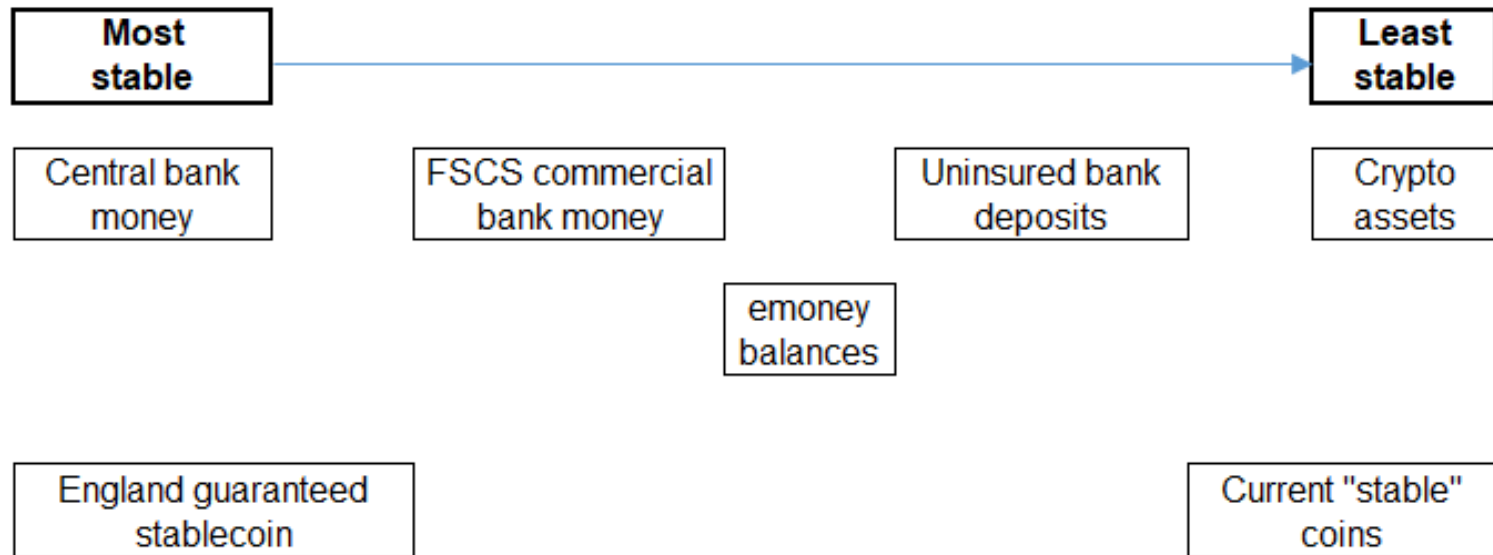




# Crypto, crypto, crypto



A hierarchy of UK money  
Stablecoins and “stable” coins



Source: BofA Global Research

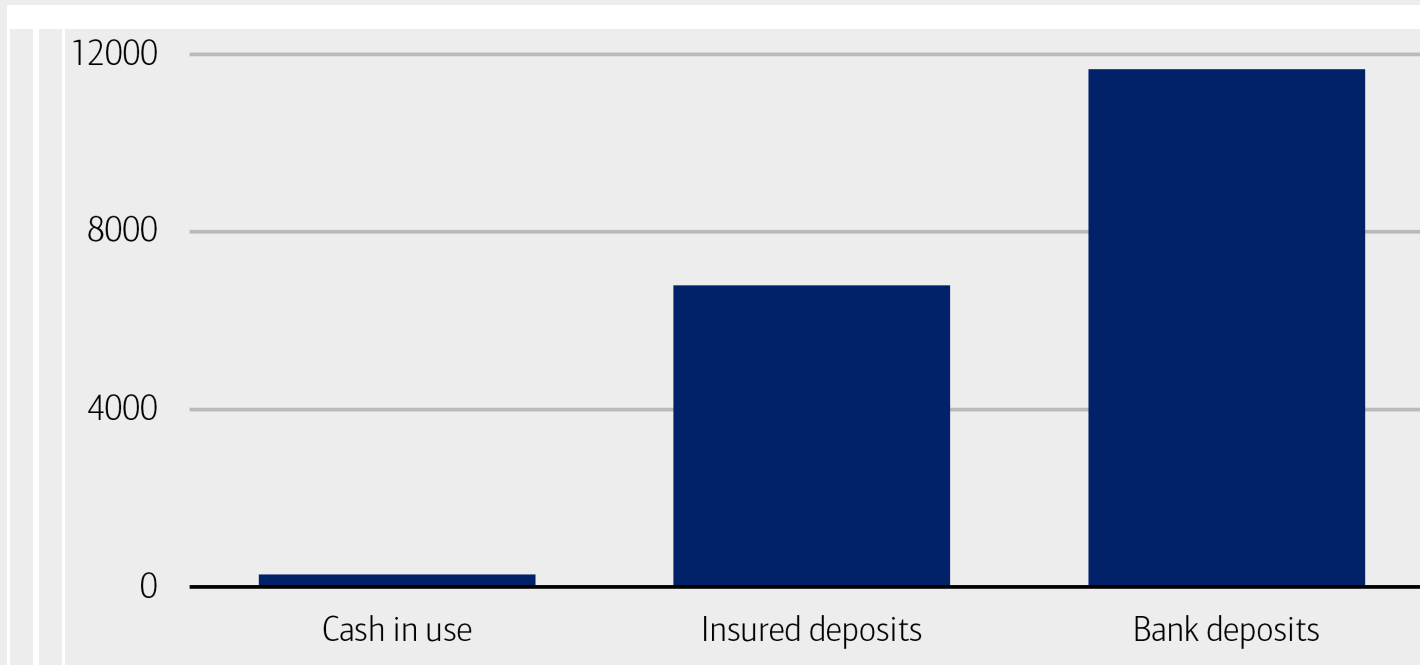
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# A digital euro would strip deposits, not replace cash



euro area: cash in use and bank deposits (€ bn), latest figures

ECB states €280bn cash in use, equal to 4% of insured bank deposits



Source: BofA Global Research, Single Resolution Board

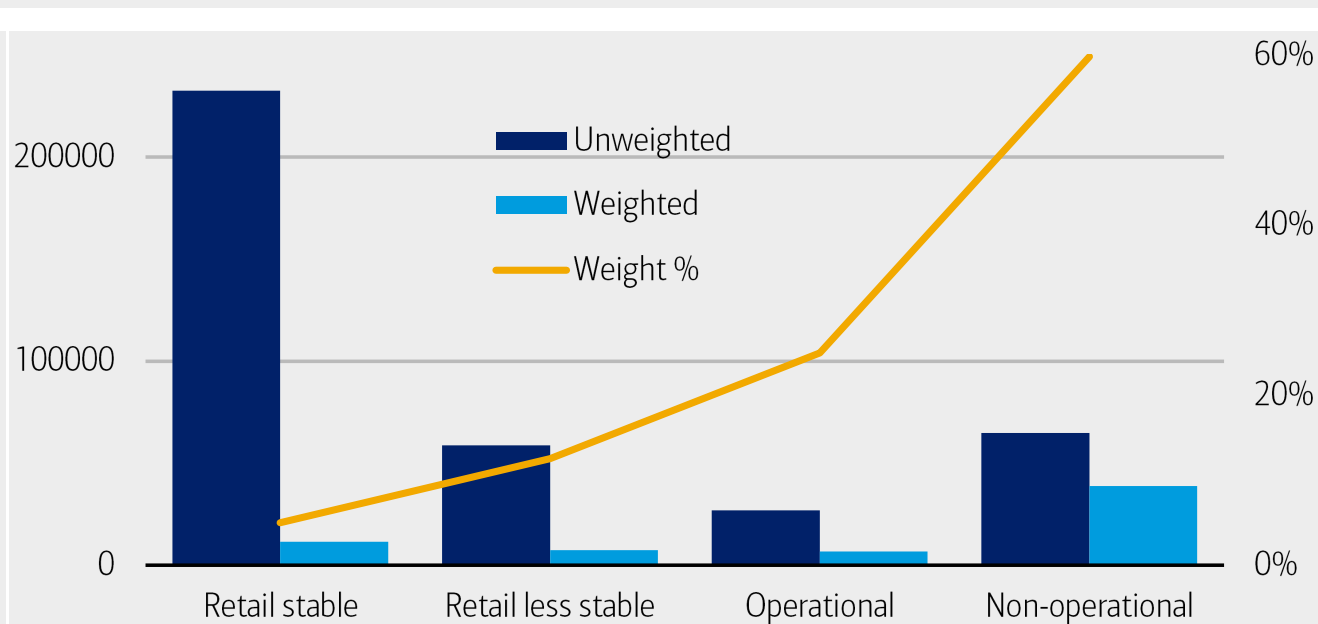
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# Salary accounts are everything



## Lloyds liquidity coverage ratio disclosures 2020 (£ mn)

£12bn weighted outflow against £232b stable deposits; £53bn outflow against £150b other deposits



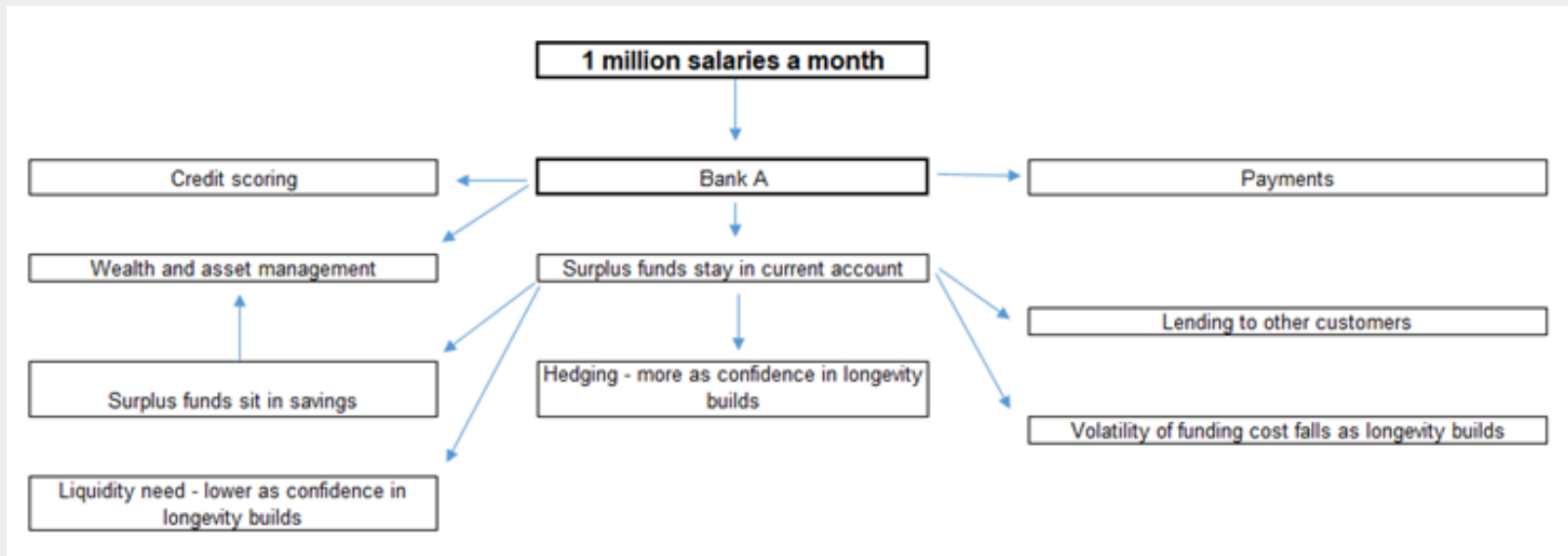
Source: Lloyds

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# Banks at the heart of today's financial world

Current business model: bank centrality  
Relationships enable cross-selling



Source: BofA Global Research

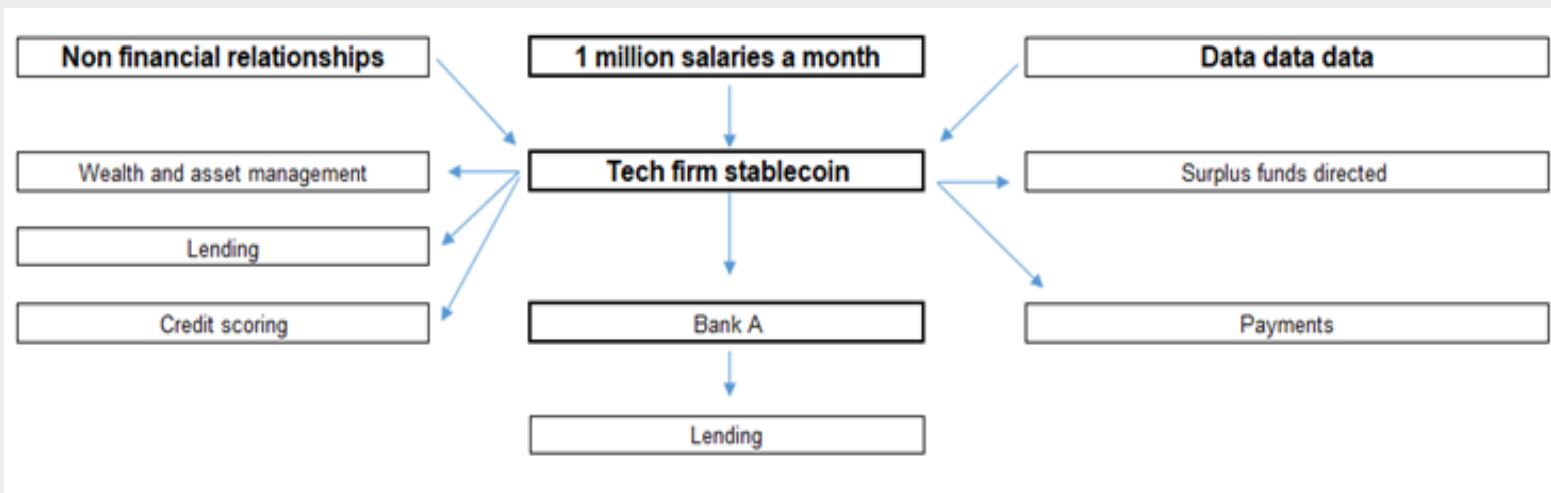
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# The whooshing sound of money leaving the regulated system



## Potential future bigtech stablecoin model

Bank becomes merely a lender



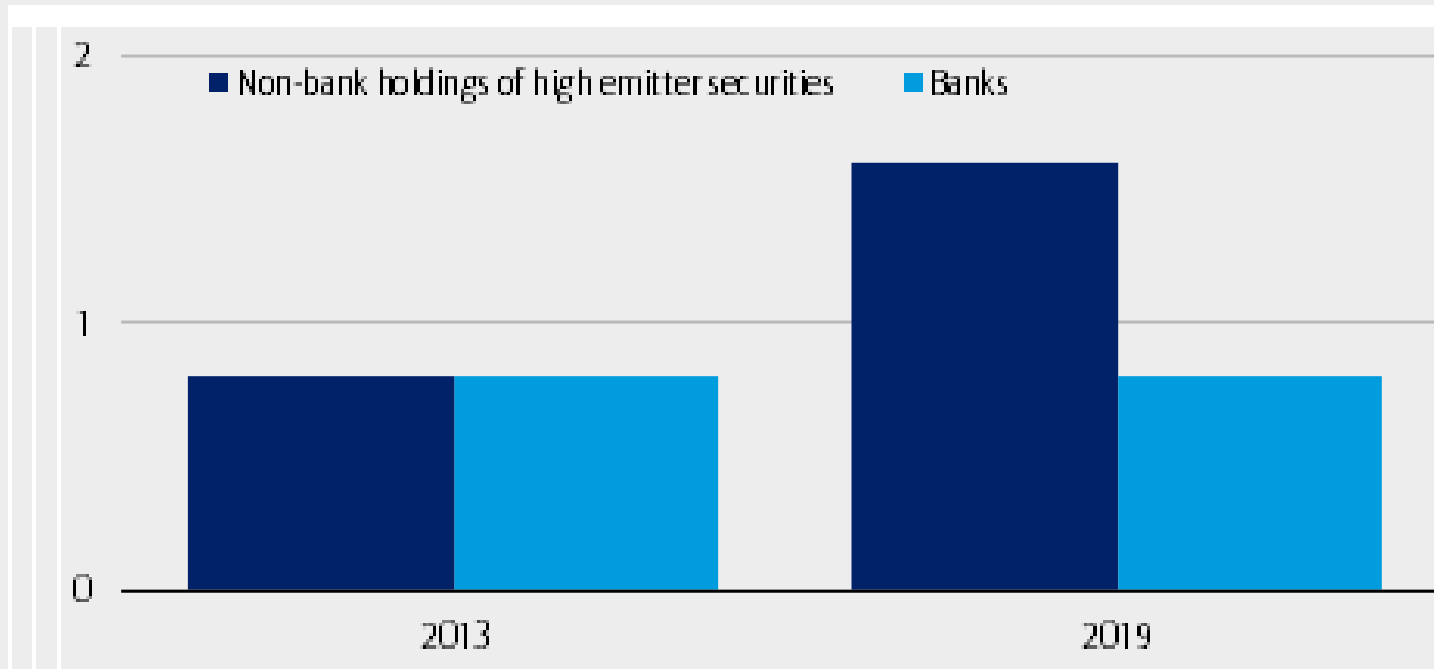
Source: BofA Global Research

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# You are aiming at the banks as a proxy for finance. They aren't



High emitter credit exposures (€ trillion), euro area  
Non-banks now twice as big as banks



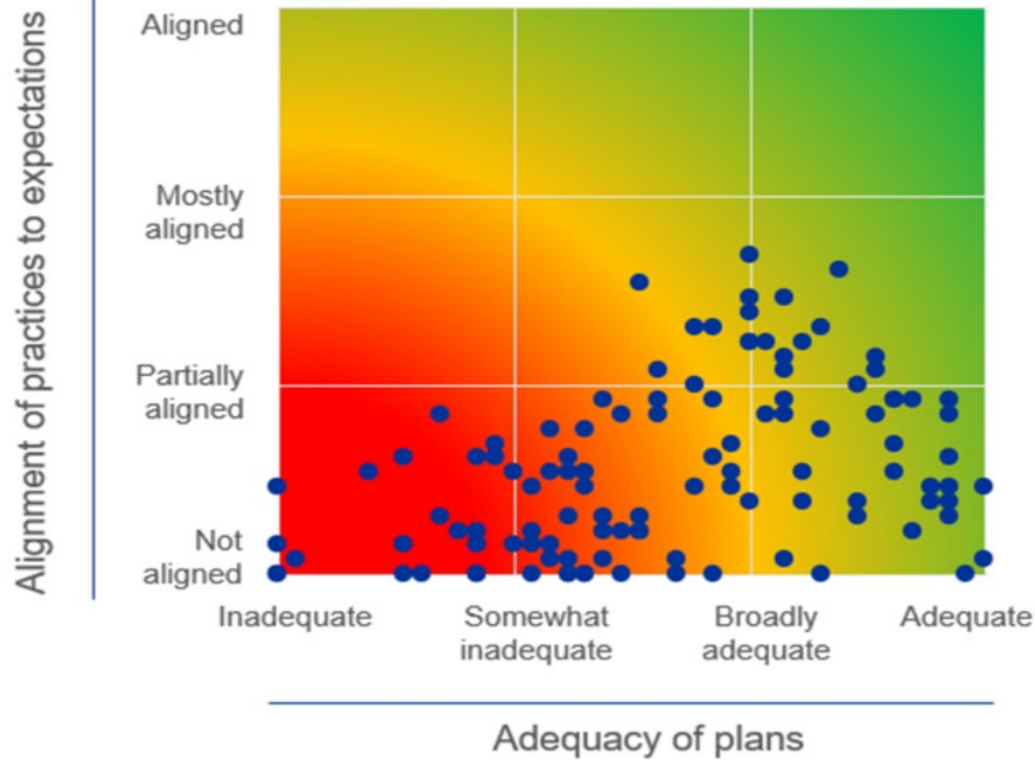
Source: BofA Global Researchy, ECB macroprudential review

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# It's not all plain sailing



The energy transition: how banks' practices align with the expectations mapped against the adequacy of their plans to advance those practices  
A tail of banks in the red



Source: ECB

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