BENEFITTING FROM TAILWINDS

EUROPEAN BANKING SECTOR 2023

EURO GROUP CONSULTING

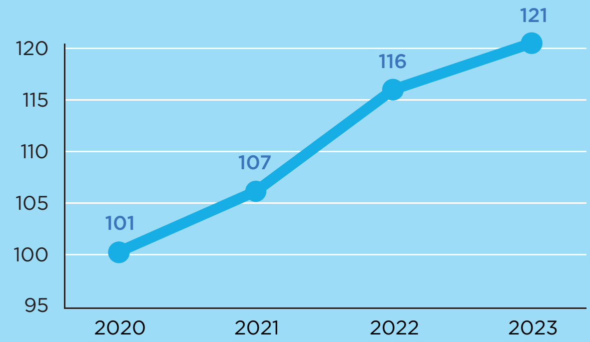
2023

EUROPEAN BANKING ANALYSIS

A comparative analysis of financial performance of major European banks in FY 2023[1]

2023 WAS SET UNDER THE BACKDROP OF RISING INFLATION AND INTEREST RATES

AVERAGE PRICE INDEX[2]



AVERAGE PRICES HAVE RISEN BY

+21%

SINCE 2020

INTEREST RATES HAVE BEEN AT THEIR HIGHEST[3] SINCE THE GFC

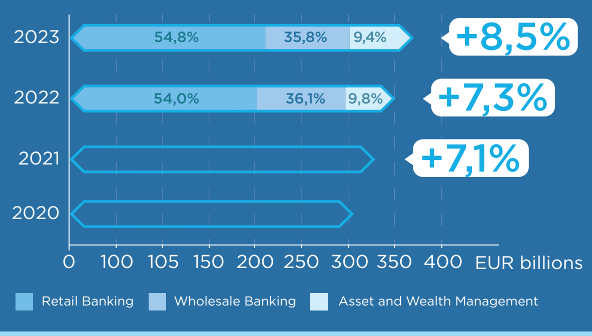
ECB: 4,50%
BoE: 5,25%

SINCE 2020, MARKET CAPITALISATION OF EUROPEAN BANKS HAS RISEN BY

+48pp

MORE THAN THE STOXX 600

AGGREGATED REVENUE FOR THE BANKS IN OUR PANEL CONTINUES TO GROW YoY[4]



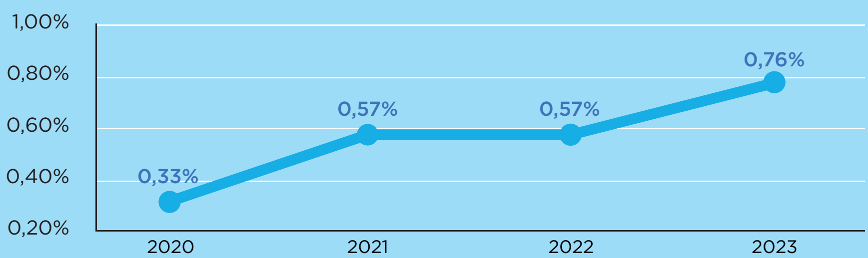
NET BANKING INCOME HAS GROWN FROM 2022 TO 2023 BY:

+29%

+3,70%

THE WEIGHTED JAWS RATIO FOR EUROPEAN BANKS IN OUR PANEL FOR 2023

WEIGHTED AVERAGE RoRWA HAS BEEN STEADILY INCREASING SINCE 2020



THE WEIGHTED RoRWA YoY HAS INCREASED BY

+0,19pp

SINCE 2022

(1) The panel of banks include the top 22 banks in Western and Southern Europe by AUM in 2023
(2) The average price index is calculated by the average consumer price index for the US, EU, and the UK
(3) As of March 2023. The rate from the ECB is the euro short-term repo rate. The rate from the BoE is the clearing banks base rate
(4) Revenue segmentation for the banks in the panel has been extrapolated based on a subset of banks

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Have banks managed to outperform the market?

There has never been a year where global events do not bring about unprecedented change. 2023 was no exception. The global banking sector faced a major reckoning early in the year when the US experienced its second largest bank failure in history. In Europe, Credit Suisse was taken over by UBS, in a deal brokered by the Swiss government and central bankers to prevent an impending continental and international banking crisis. Additionally, the ongoing geopolitical tension in the Middle East and Ukraine and mounting concern for the Chinese economy's ability to sustain global economic growth all contributed to an atmosphere of economic uncertainty in 2023.

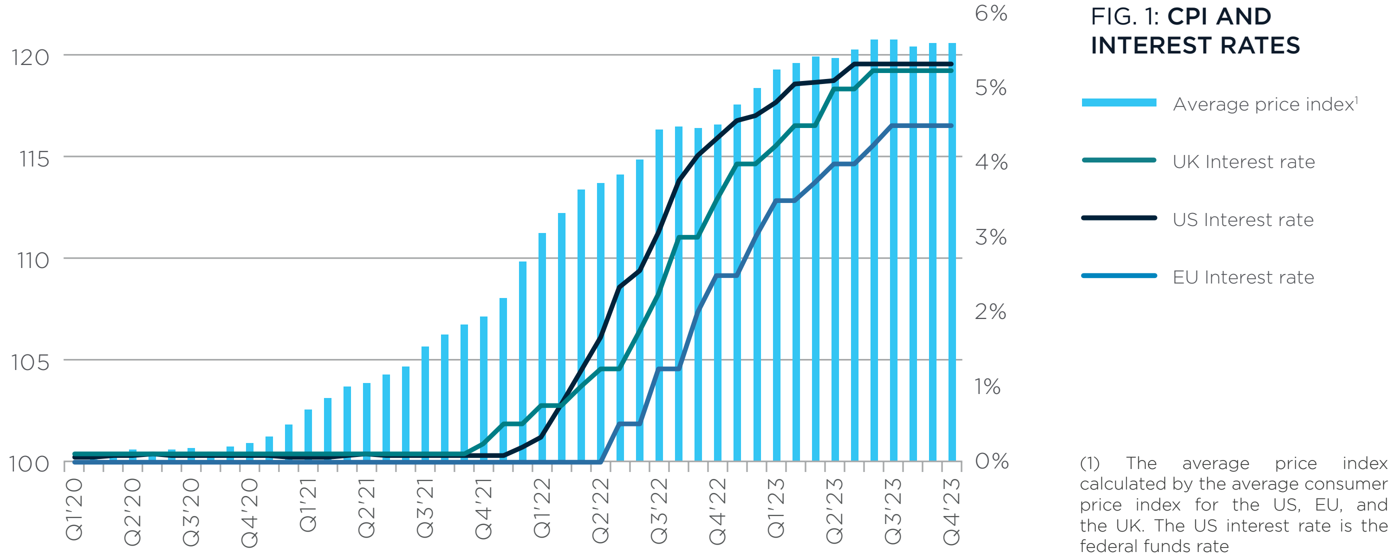


FIG. 1: **CPI AND INTEREST RATES**

(1) The average price index calculated by the average consumer price index for the US, EU, and the UK. The US interest rate is the federal funds rate

Source: ECB, BoE, Federal Reserve, Statista, Eurogroup anaysis

Closely related to macroeconomic uncertainty, inflationary pressures exacerbated by regional conflicts have compelled central banks to respond with contractionary monetary policies. Rising price indices have been matched by similar increases in interest rates, as seen in figure 1.

These rising interest rates have led to higher borrowing costs and a slowdown in economic activity, resulting in knock-on effects for the banking sector's top and bottom line.

In figure 2, rising rates have coincided with rising stock prices of the SX7P, a market index of the European banking sector, which has outperformed other sectors in terms of stock price growth over the past three years. The SX7P grew by 48pp more than the STOXX 600, a stock index encompassing a variety of sectors and industries in Europe.

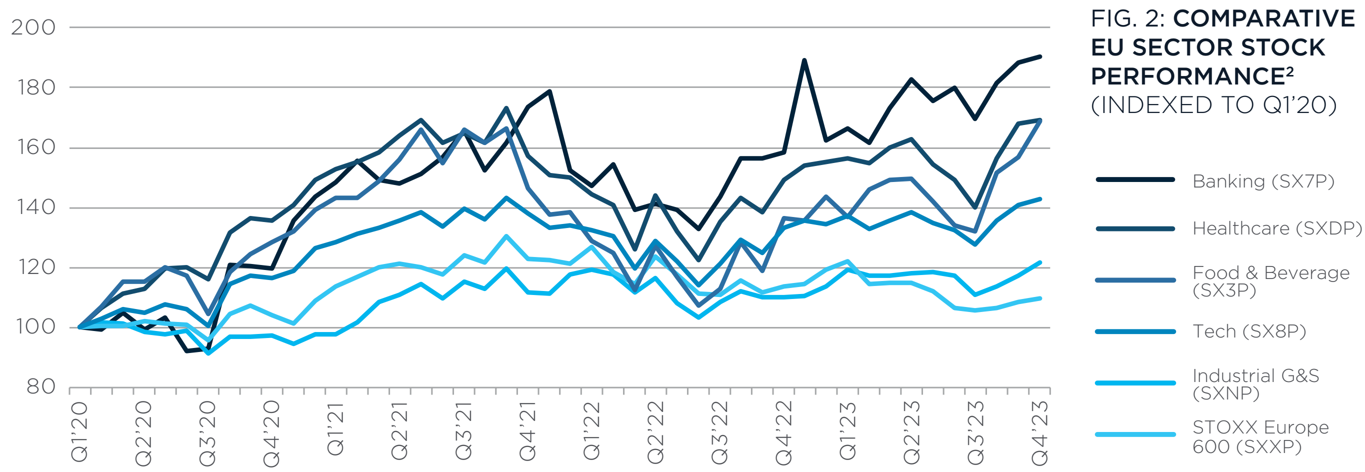


FIG. 2: **COMPARATIVE EU SECTOR STOCK PERFORMANCE[2]** (INDEXED TO Q1'20)

(2) Sector performance is derived from the STOXX series of market indices specific to various sectors taken at the end of each quarter

Source: Bloomberg, Eurogroup analysis

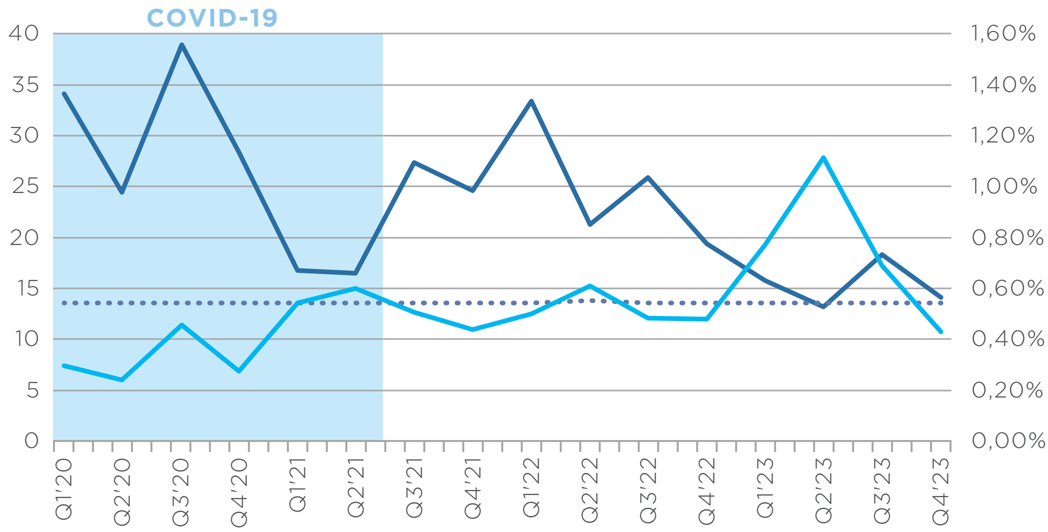


FIG. 3: AGGREGATED RoRWA[3] AND VIX[4,5]

(3) Calculated by taking the total panel NBI as a percentage of total RWA at the end of the year Expressed as a percentage

(4) A volatility index designed to represent market expectations of the relative strength of near-term price changes to the S&P 500 A higher value indicates greater market volatility

(5) Half-year reporters were omitted from this graph

Source: Bloomberg, Company reports, Eurogroup analysis

High interest rates are conducive to banking performance by allowing greater spreads and net interest margins. However, stock prices are arguably severed from bank performance, instead potentially being driven by "animal spirits"[6], which are more closely connected to consumer confidence.

By using the VIX to proxy for macroeconomic uncertainty, we can observe an inverse relationship between uncertainty and bank profitability. Similarly, we can observe the same relationship between the VIX and the stock prices for other sectors. The banking sector generally has the compounded effect of high interest rates to prop itself up while having a predominantly negative effect for other sectors.

Higher certainty can be linked with an uptake in business activity, investments, or deals, but is disconnected to interest rates, which are closely linked to inflation. Hence, the negative effects of high interest rates on businesses are sustained. At a sector level, banking revenues in Europe have risen consistently since Q1'20, with a sharp increase in Q1'23. Net banking income (NBI) has followed a similar trend. Despite growing by 22% from 2022 to 2023, the results from Q4 2023 suggests that NBI has recently stagnated, suggesting challenges surrounding the sector's cost base.

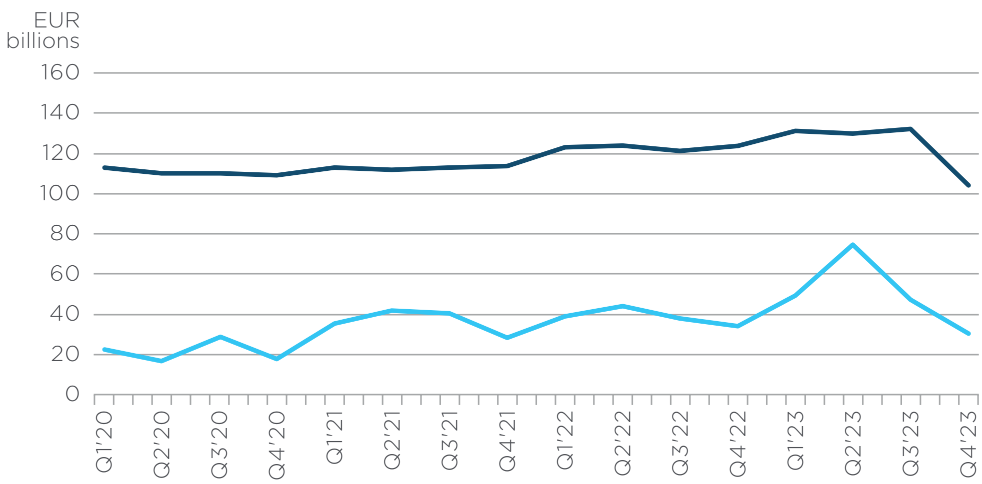


FIG. 4: AGGREGATED REVENUE[7] AND NBI[8,9]

(7) This figure is taken from the sum of quarterly revenue and net banking income for the 19 banks in our panel with quarterly reporting regimes

(8) Net banking income is the balance between bank operating revenues and expenses before tax obligations

(9) The sharp rise in NBI in Q2'23 can be attributed to the acquisition of Credit Suisse by UBS, inflating profit figures for the quarter

Source: Company reports, Eurogroup analysis

(6) Animal spirits is a term coined by John Maynard Keynes in 1936 that refers to the intrinsic human psychological and emotional characteristics that influence decision-making in uncertain situations

A focus on the three key banking segments[10]

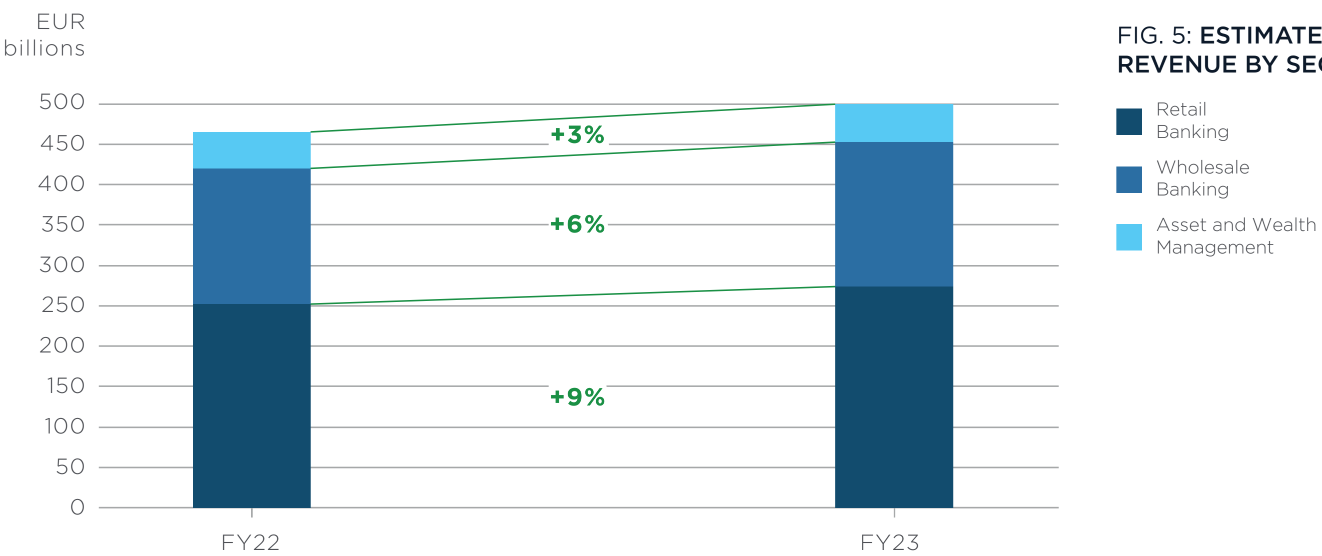


FIG. 5: **ESTIMATED REVENUE BY SEGMENT**

Source: Company reports, Eurogroup analysis

After disaggregating total revenue from the last two years along the three key business segments, namely retail banking, wholesale banking, and asset and wealth management, we observe that growth is largely driven by gains made in retail banking. Retail banking has grown at a faster rate than wholesale banking, with average QoQ growth higher by 1.1 pp. However, asset and wealth management has reported the highest compound quarterly growth rate among the bank segments.

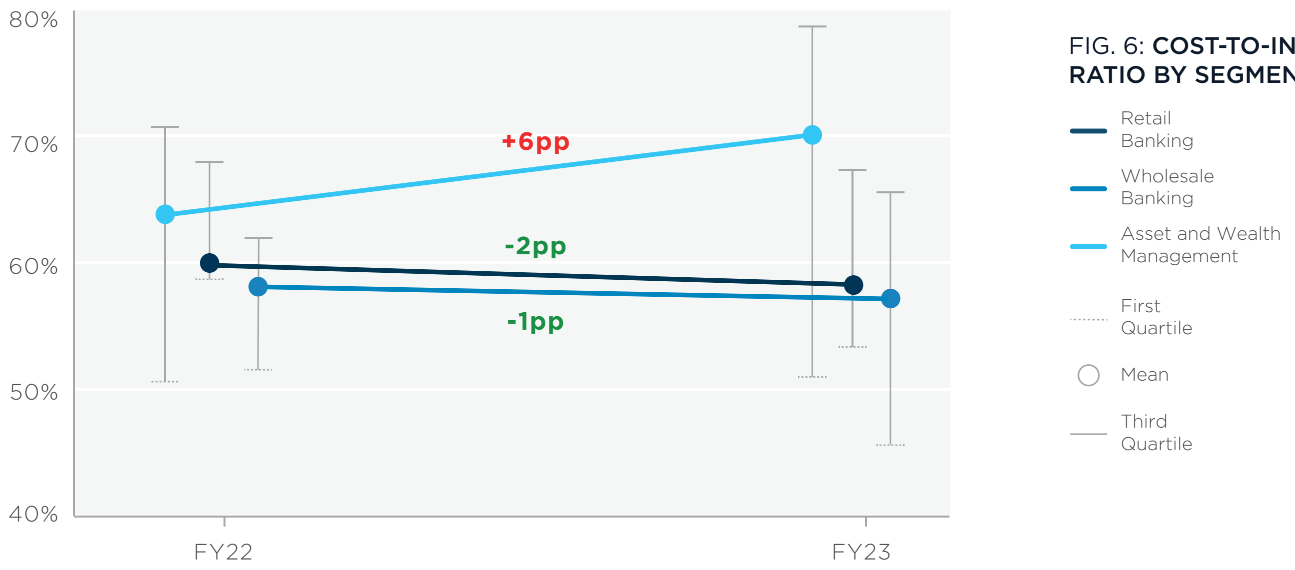


FIG. 6: **COST-TO-INCOME RATIO BY SEGMENT**

Source: Company reports, Eurogroup analysis

Based on our panel, the wholesale banking segment had the lowest cost to income (C/I) ratios across the two year time period. The latest improvement in wholesale banking's C/I ratio is largely revenue driven, with operating expenditure rising at a slower rate (+4%) than revenues (+6%) over the same period. The retail banking segment has seen a similar revenue-driven improvement, with revenue growth (+9%) outpacing expenditure growth (+5%). Asset and wealth management bank segments have reported a steady deterioration in their C/I ratio through 2023 that can be attributed to a growing cost-base (+11%). This cost growth was largely driven by the acquisition of Credit Suisse by UBS.

(10) The figures for the three banking segments are taken from a subset of 20 banks in the panel that have segmented their business operations by activity type. Retail banking refers to services focused on individuals, wholesale banking refers to services dedicated to corporates, and asset and wealth management refers to related advisory services

Relative performance of banks at group level

FIG. 7: **REVENUE GROWTH BY BANK AND YEAR**[11,12]

- Revenues above 30bn
- Revenues between 20 and 30bn
- Revenues below 20bn

(11) Reported figures have been converted to EUR using quarterly FX rates

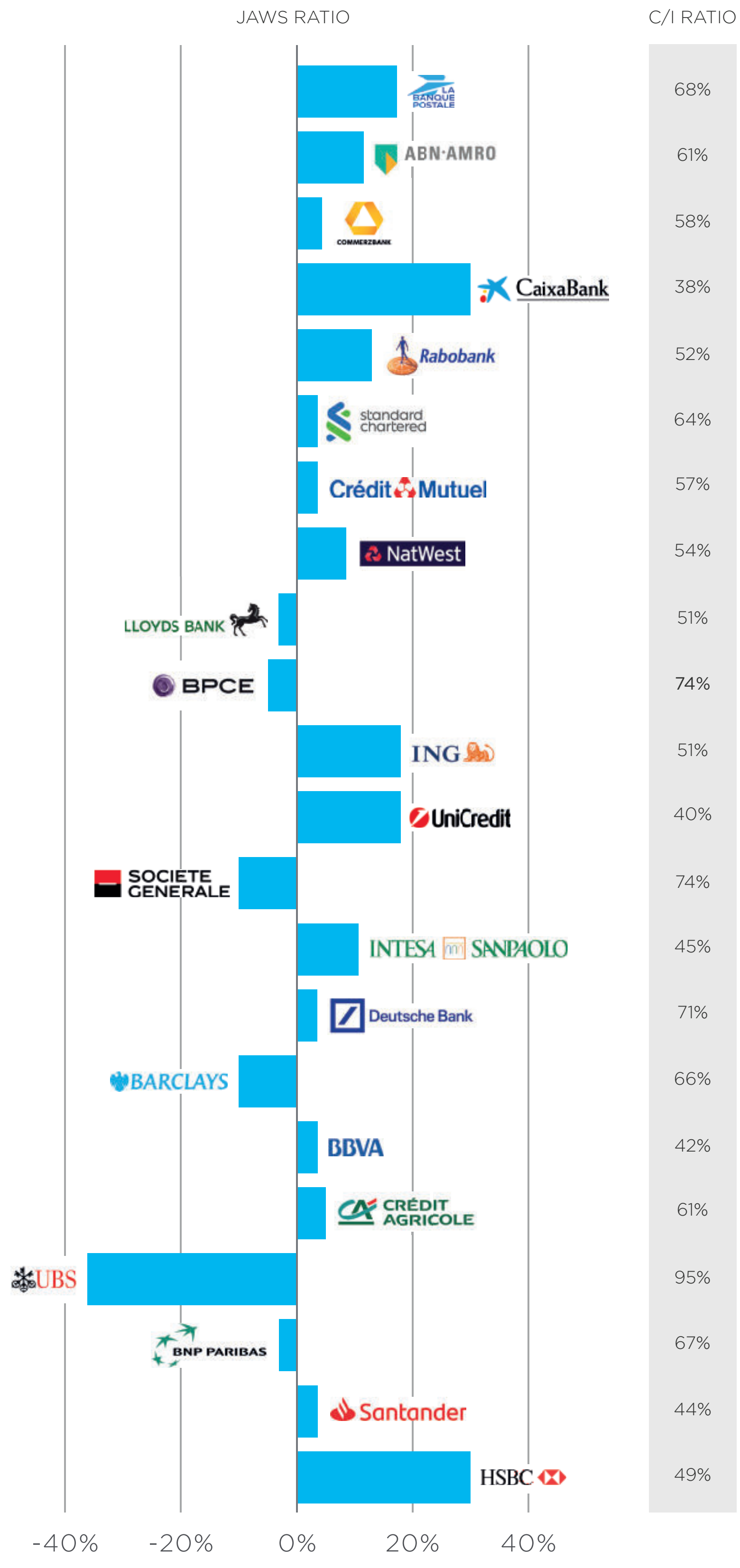
(12) Whenever possible, stated results were utilised

Source: Company reports, Eurogroup analysis

Revenue gains made across the panel are largely driven by a few banks who have experienced high revenue growth between 2021 and 2023 (HSBC: +43%, CXB: +43%, BBVA: +40%). On the other hand, there have been banks that have not been able to engender substantial top-line growth over the same time period (SG: -3%, BNPP: -1%, CA: 1%)

These gains have translated to a positive jaws ratio for most banks as seen in figure 8, suggesting that revenue growth has been stronger than cost growth over the past two years. The weighted jaws ratio across the panel of banks from 2021 to 2023 is 8.3%.

FIG. 8: **JAWS & C/I RATIOS BY BANK FROM FY22 TO FY23**



Source: Company reports, Eurogroup analysis

More than two thirds of the banks in the panel experienced positive jaws between 2022 and 2023. The positive growth is mostly top-line driven as banks experience increased revenue growth over the past year (+7.5%). Both retail and wholesale banking have delivered positive jaws over the last year, but retail banking had slightly higher jaws ratio (+1pp). A poor jaws ratio for the asset and wealth management segment (-9%) is mainly due to significance costs associated with the Credit Suisse acquisition by UBS.

The performance of the European banks on our panel have been favourable in 2023. Bank profitability (RoRWA) increased by 19 bps since 2022. Riding on high interest rates and the prospect of greater macroeconomic certainty, the European banking sector has been able to outperform other sectors in equity market indices. This strong performance and relatively minimal disparities in intra-sector performance[13] calls into question the significance of banks' business models in engendering positive economic performance. The largest banks seemingly benefit from the institutional set up of their financial ecosystem that balances segment focuses, financial product offerings, and risk exposure. While the banking sector has technically "beaten the market[14]", these banks benefited from high interest rates and employed a product and service mix that is fairly consistent across the sector, raising questions about how dependent banks are on market conditions to perform.

(13) There is only a 40pp disparity in the jaws ratio after excluding UBS
(14) Based on stock price growth of the SXXP and SX7P

CONTACTS

Marc SIBLINI
Partner
Tel. +33 6 46 47 77 50
marc.siblini@eurogroupconsulting.com

Matthieu PRIEURET
Partner
Tel. +44 7 453 285 421
matthieu.prieuret@eurogroupconsulting.com

Alexander HAN
Consultant
Tel. +44 7 539 754 091
alexander.han@eurogroupconsulting.com

eurogroupconsulting.com

@EurogroupFR

/eurogroup-consulting-france

/eurogroupconsulting