



• LBBW Treasury Jan Misch

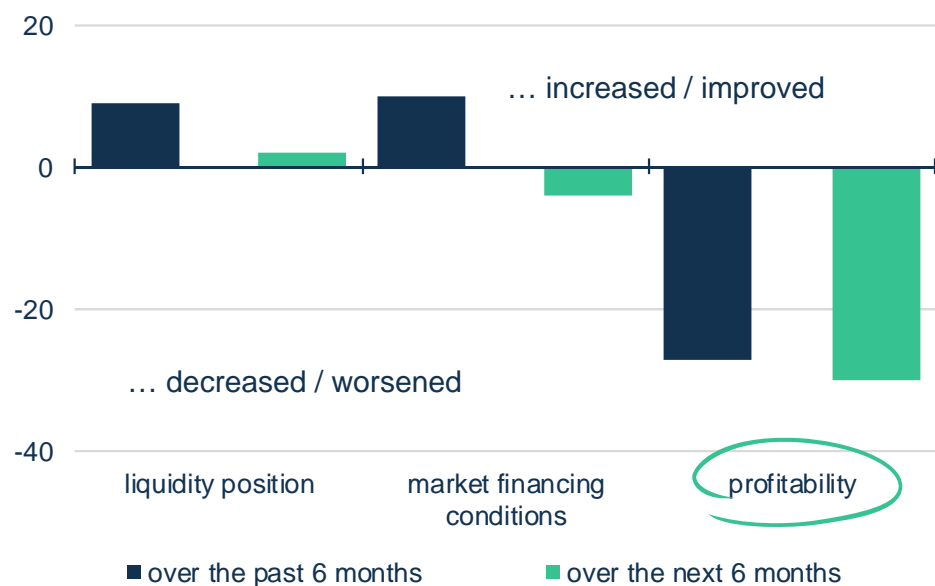
**LBBW**  
Breaking new ground

# ECB Money Markets Contact Group - profitability impacted through negative interest rates?

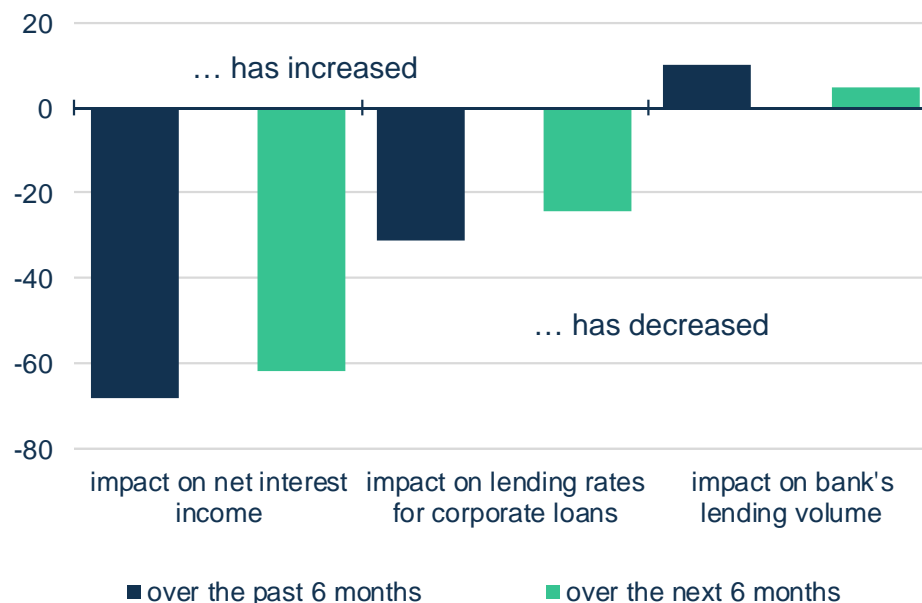
MMCG Meeting Amsterdam 25.06.19

# Side effects of unusual ECB policy is about to stay

## Impact of ECB buying programs on financial situation of banks

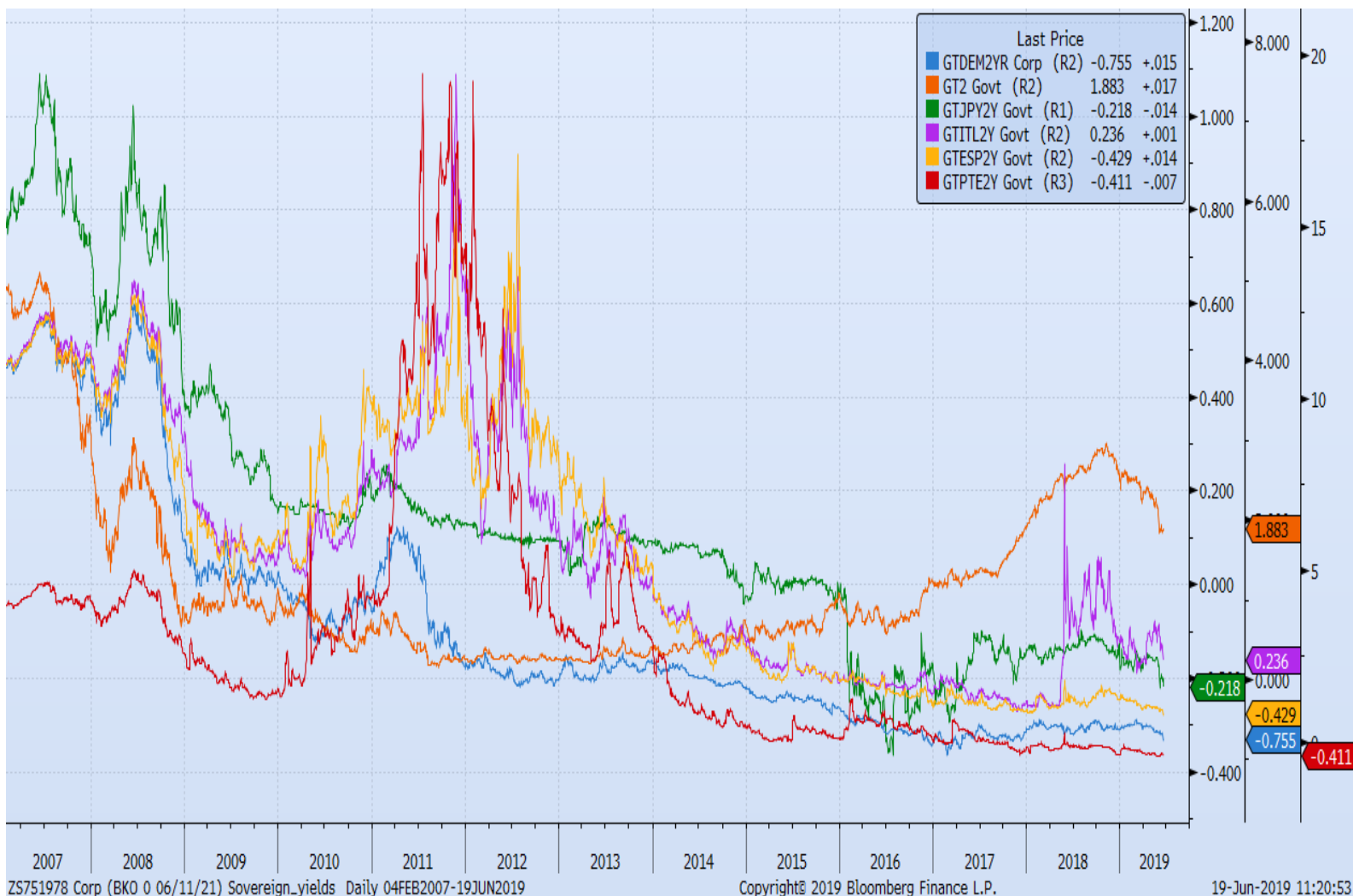


## Impact of negative deposit facility @ ECB on various points



Source: ECB Bank Lending Survey Oktober 2018, LBBW Research. Quarterly survey ECB Loan Business amongst 150 banks within the Eurozone. Graphs show in % the difference between answers „increase / improve" and „decrease / worsening".

# Sovereign yields 2 years USA, Japan, EURzone

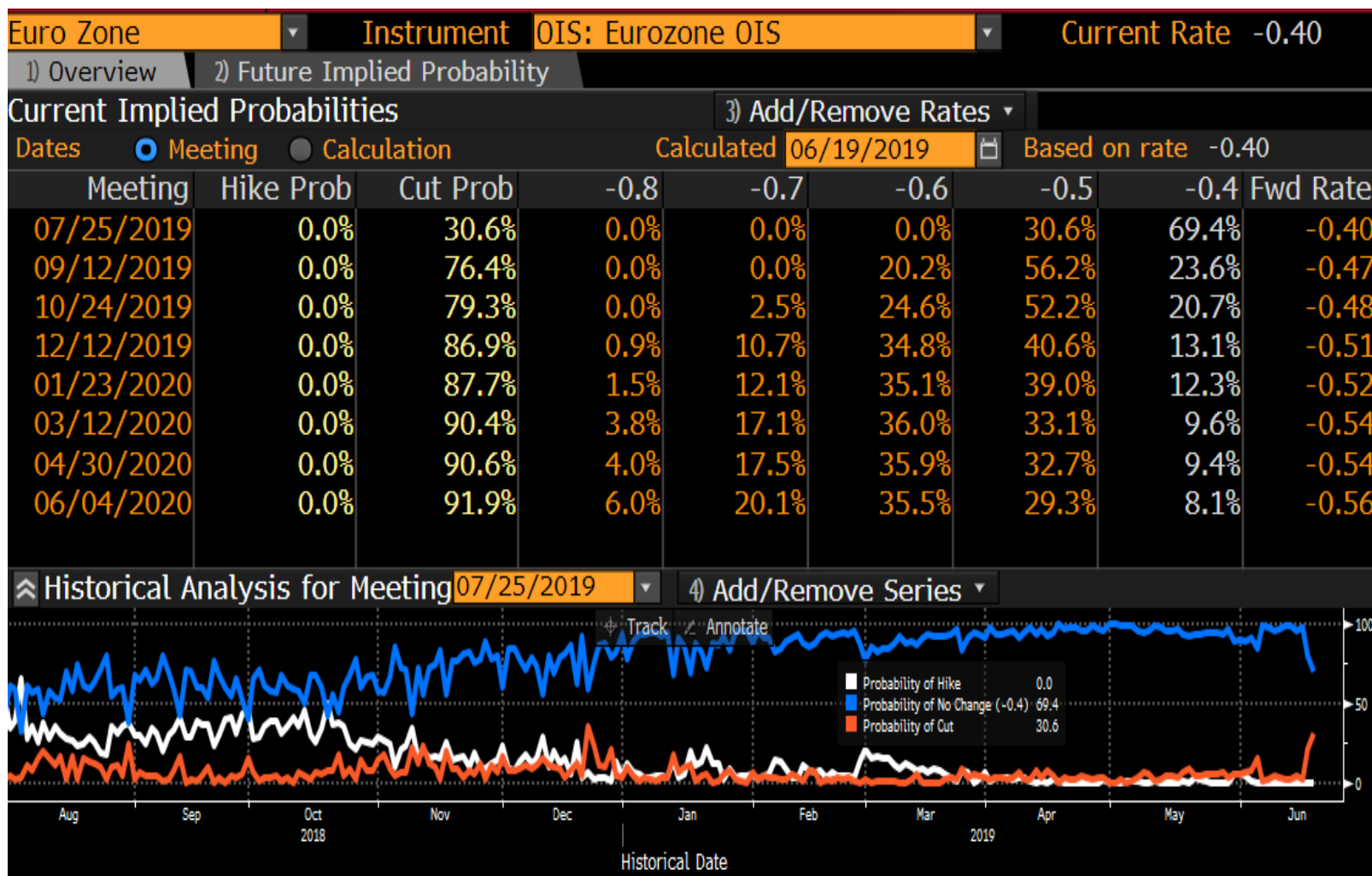


As the opportunities to ,risk free' invest surplus liquidity at different CB is extremely heterogeneous it is worth looking at short term sovereign yields as a proxy

Source: Bloomberg

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# Market expectation interest rate move EUR Zone

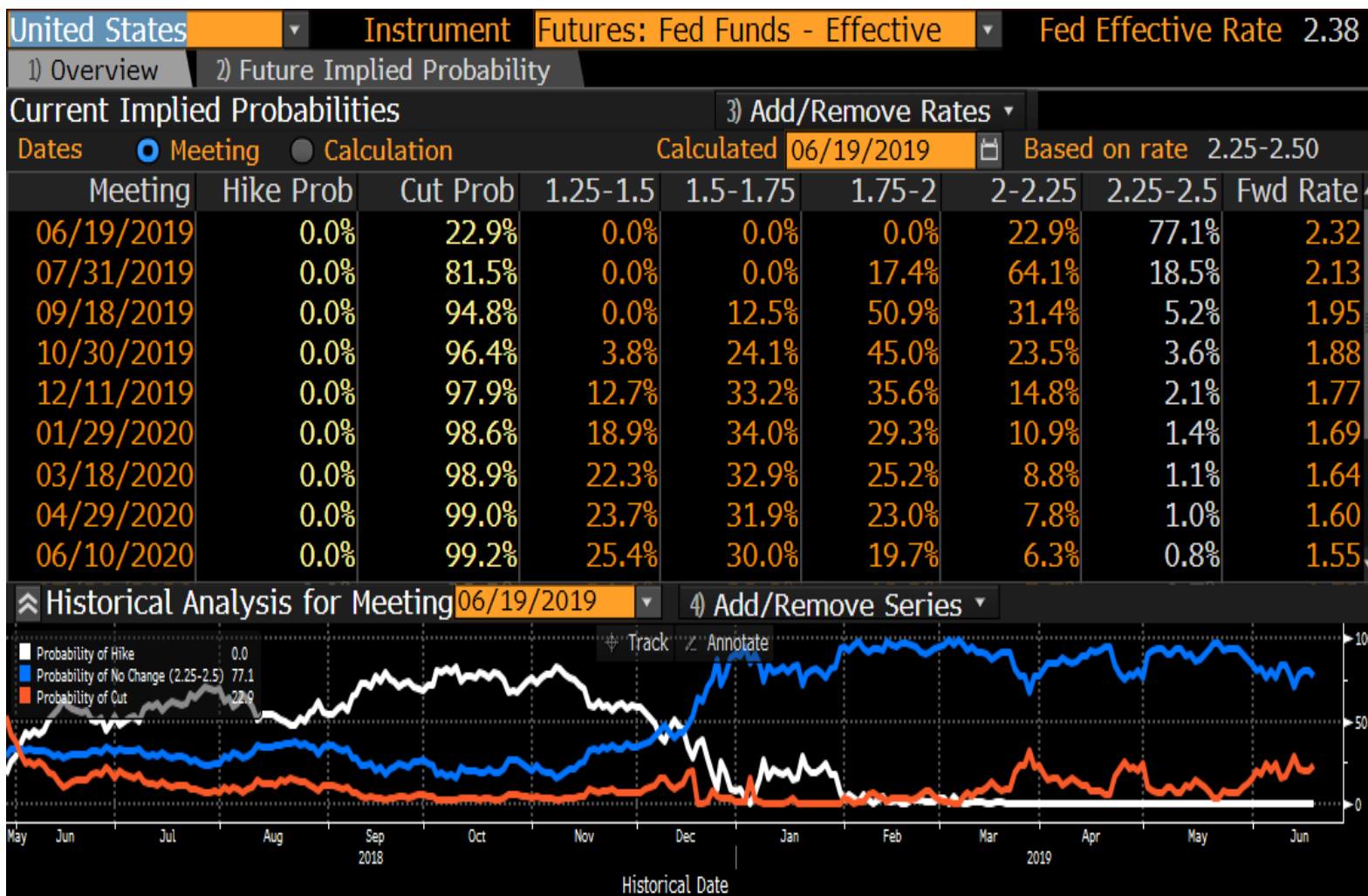


Market expects another cut by the ECB with a 2/3 probability until Dec 19

Source: Bloomberg

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# Market expectation interest rate move USA

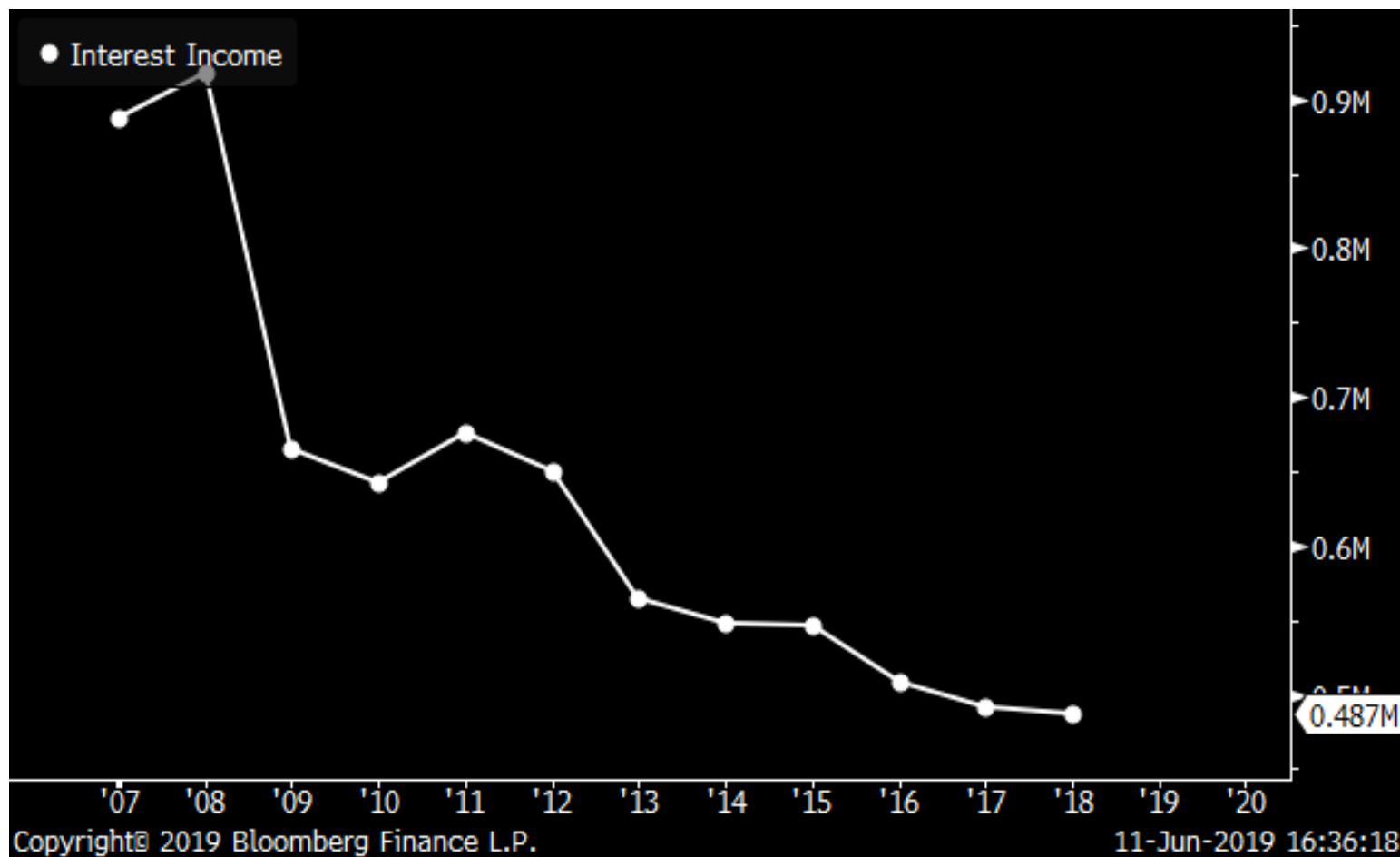


Market expects a FED cut In July with a more than 80% probability

Source: Bloomberg

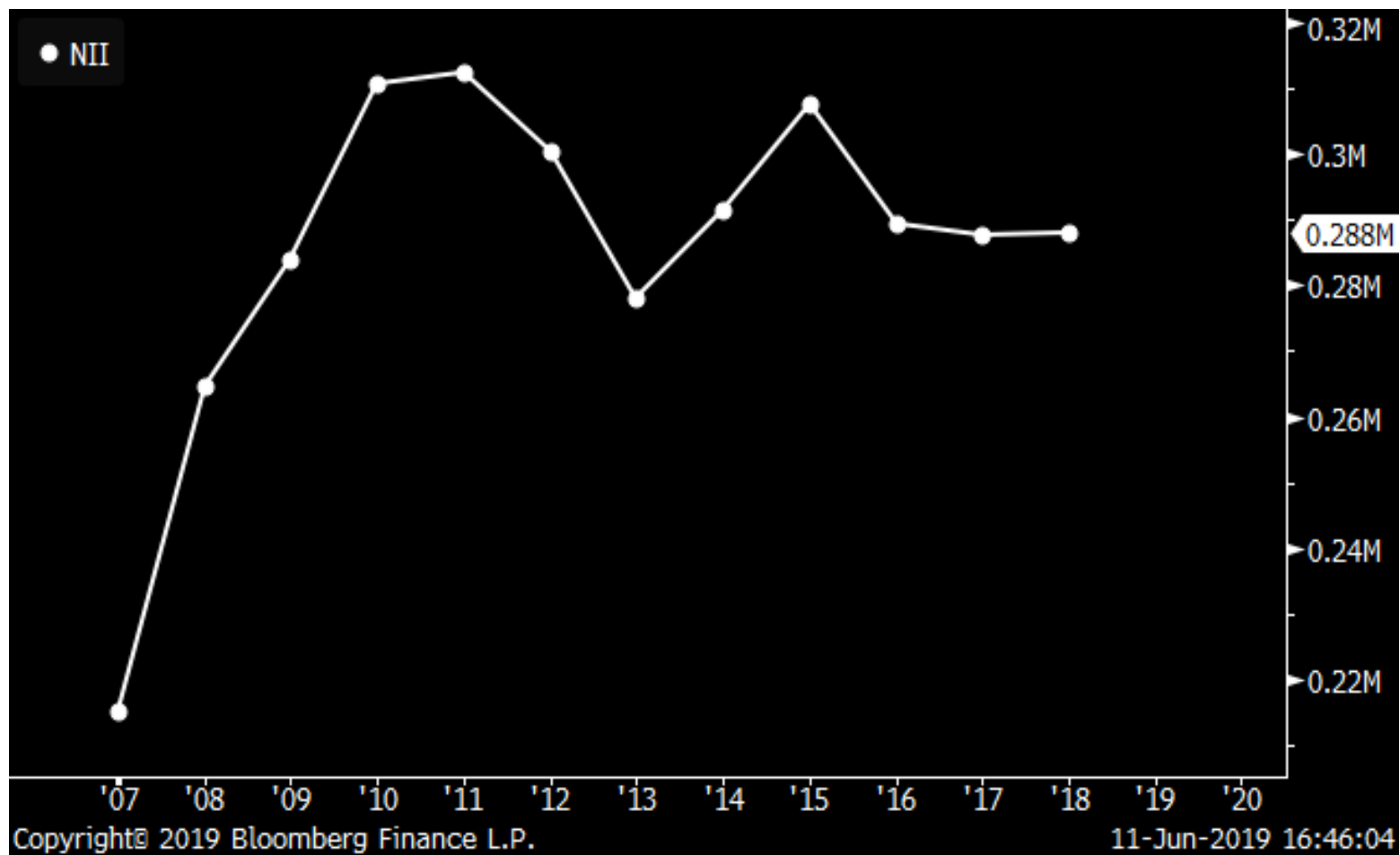
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## Interest Rate Income European Banks 2007 - 2019



At first glance European banks NII suffers from the current interest rate environment

## NII European Banks 2007 - 2019



However European banks NII seems currently untouched by the interest rate environment

# NIM European Banks 2007 - 2019



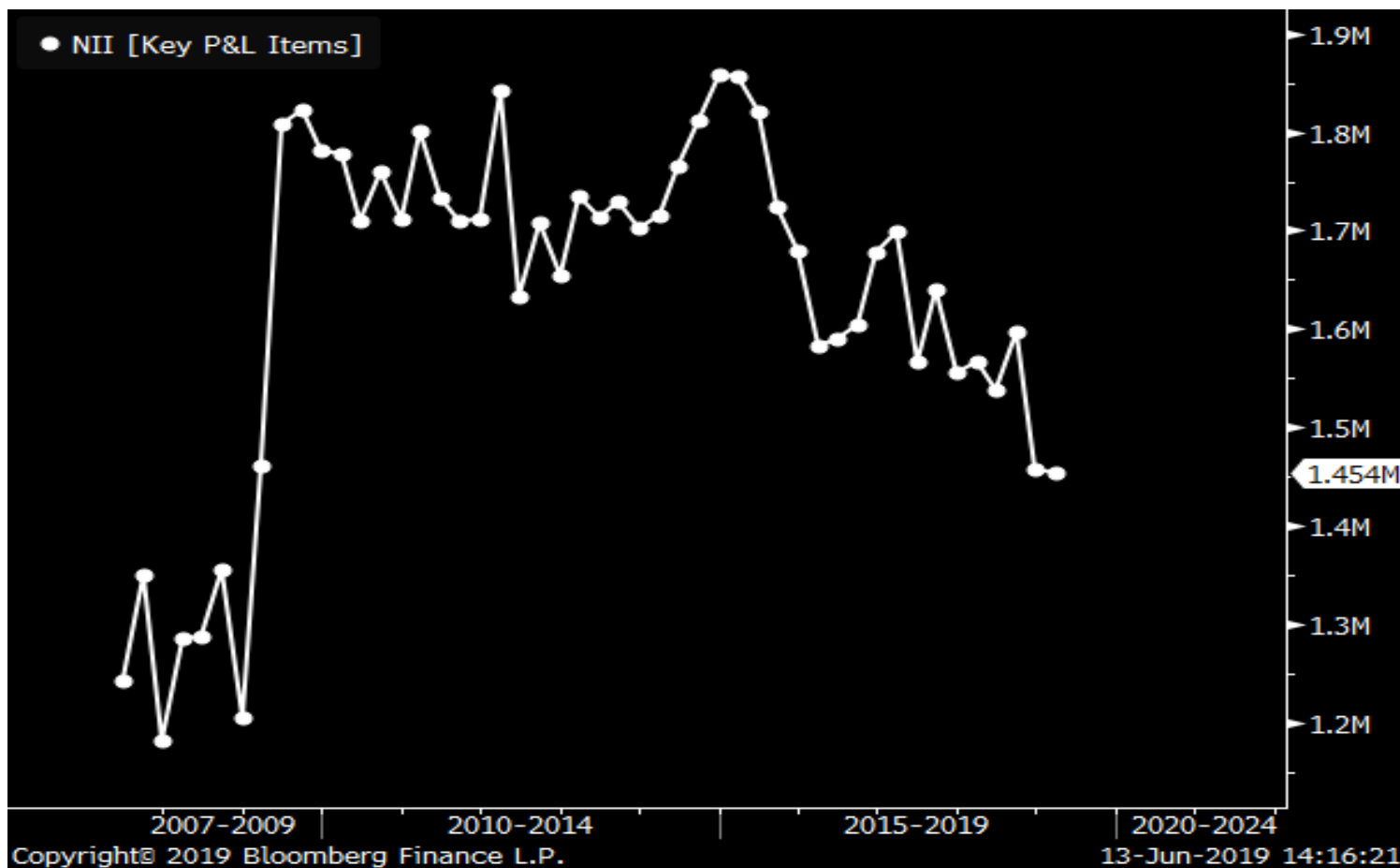
The current NIM for European banks is @ 1,57%

Source: Bloomberg

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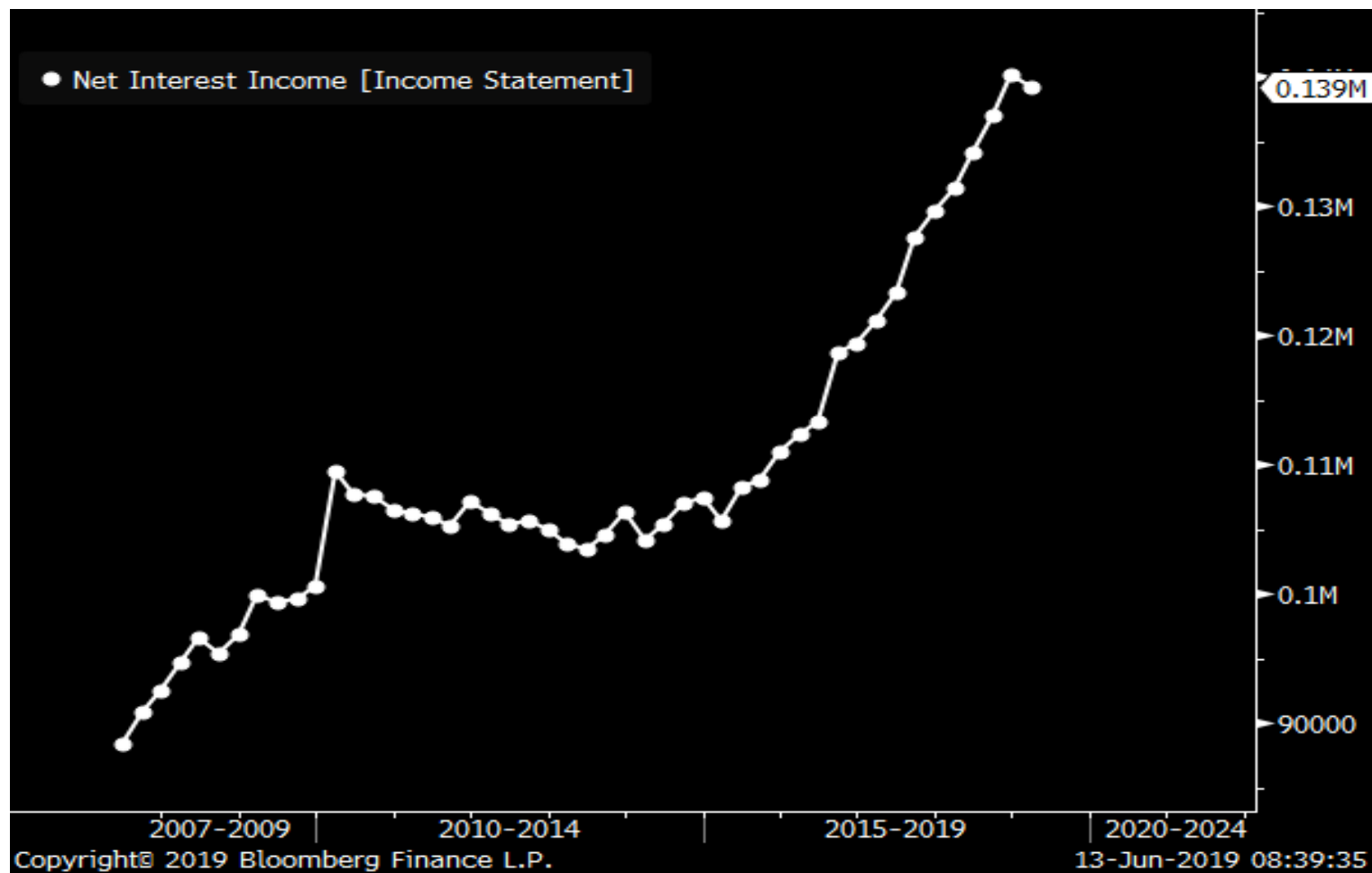


## NII Japanese Banks 2007 - 2019



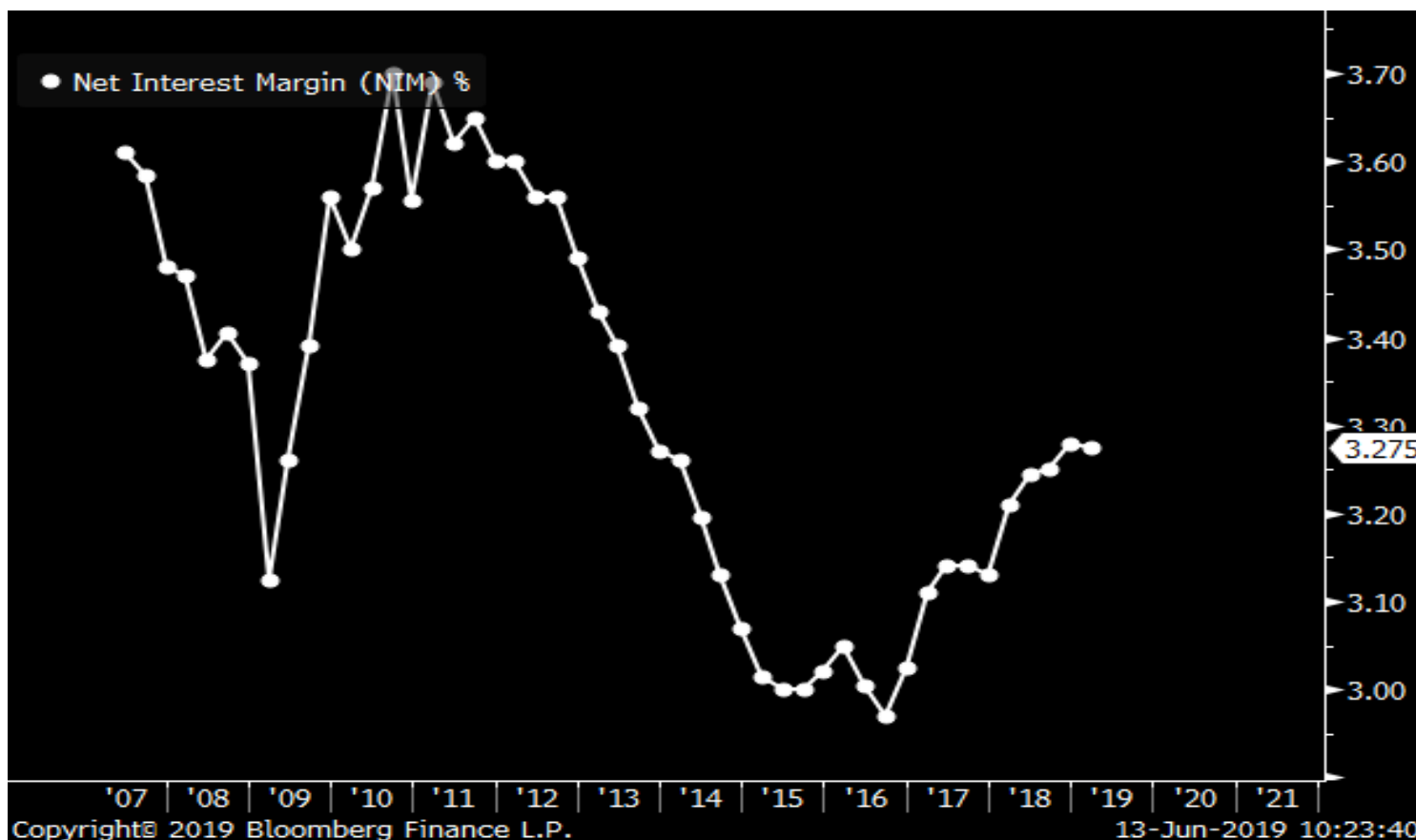
Japanese banks face an increasing velocity of declining NII

## NII US American Banks 2007 - 2019



US banks have constantly been able to increase NII eventhough the FED Fund Target is still lower since 2007

# NIM US American Banks 2007 - 2019



The current NIM for US banks is @ 3,275%

# ECB Money Markets Contact Group – profitability impacted through negative interest rates?

**David Tilson**

June 2019

Bank of Ireland 

Begin

# ECB research on negative rates

## Negative interest rates, excess liquidity and retail deposits: banks' reaction to unconventional monetary policy in the euro area

Working paper no 2283 / May 2019

- banks highly exposed to the policy tend to grant more loans, confirming studies that point to higher risk taking by banks as a reaction to negative rate
- contrasts some earlier research; difference is likely driven by the broader data
- banks most reliant on retail deposits have the strongest incentive to convert their EL, created by the APP, into loans

## Is there a zero lower bound? The effects of negative policy rates on banks and firms

Working paper no 2289 / June 2019

- sound banks can pass negative rates on to their corporate depositors without experiencing a contraction in funding ... these passthrough effects become stronger as policy rates move deeper into negative territory.
- Banks offering negative rates provide more credit than other banks suggesting that the transmission mechanism of monetary policy is not hampered.
- The negative interest rate policy (NIRP) provides further stimulus to the economy through asset rebalancing ... firms increase their investment in tangible and intangible assets and decrease their cash holdings

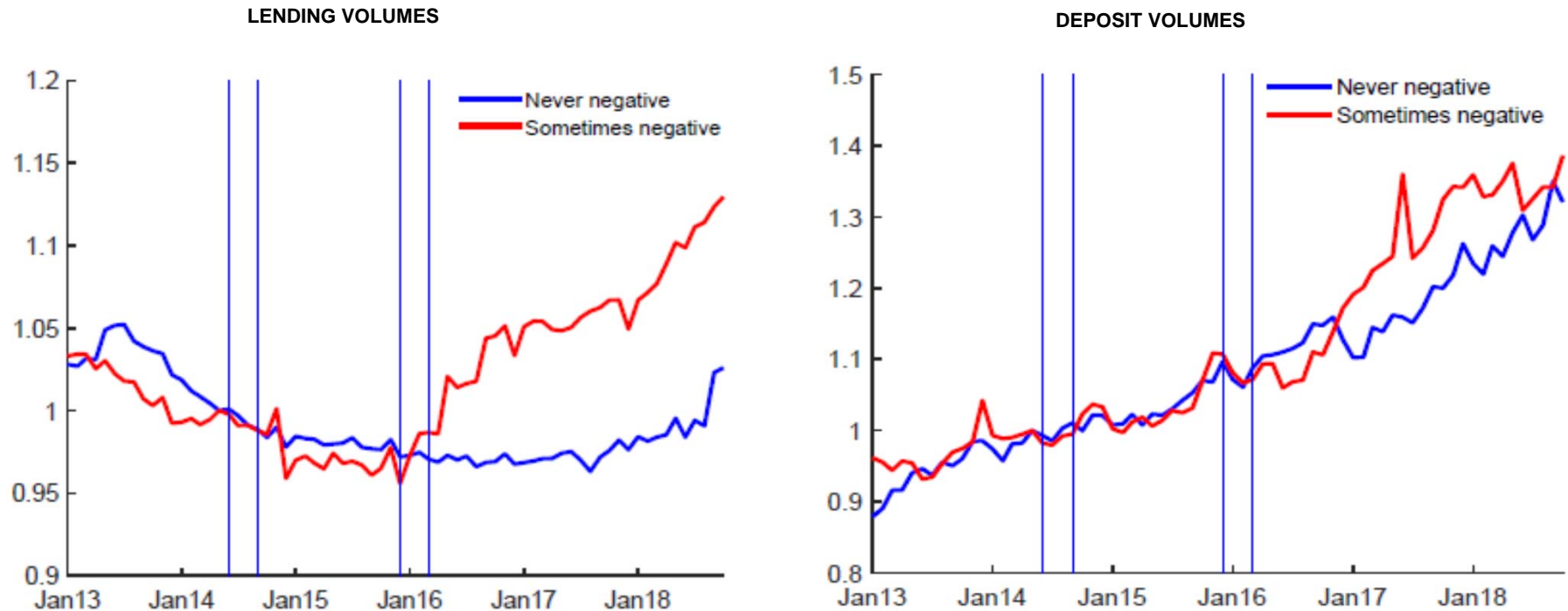
## Monetary policy, credit institutions and the bank lending channel in the euro area

Occasional paper no 222 / May 2019

- the transmission of standard policy interest rate cuts to firms and households was diminished during the crisis, in a context of financial market stress and weak bank balance sheets
- unconventional monetary policy measures have helped to restore monetary policy transmission and pass-through to interest rates ..... via eg reduced funding costs, improved capital ratios, and reduction in NPLs
- impact of recent monetary policy measures on bank profitability does not appear to be particularly strong when all the effects on the macroeconomy and asset quality are taken into account (ie credit quality improves, sovereign bond gains, etc)

# Lending and Deposit Volumes:

## Banks that never charge negative rates vs those that do



Total lending and total deposit volumes are normalised to May 2014. The blue vertical lines indicate the four times the ECB deposit rate was cut below zero.

Source : ECB working paper No 2289 June 2019 *Is there a zero lower bound? The effects of negative policy rates on banks and firms*

# Recent ECB Comments

'In the context of our regular assessment, we will also consider whether the preservation of the favourable implications of negative interest rates for the economy requires the mitigation of their possible side effects, if any, on bank intermediation'.

*Draghi, ECB meeting press conference, April 10<sup>th</sup>*

'..if the conclusion were that cutting rates is the best option, then we would have to consider the impact of negative rates on financial intermediation, especially for banks. We would have to consider whether a tiering system is needed. Today the prevailing view in the Governing Council is that it is not, but we also agree that it deserves further reflection'.

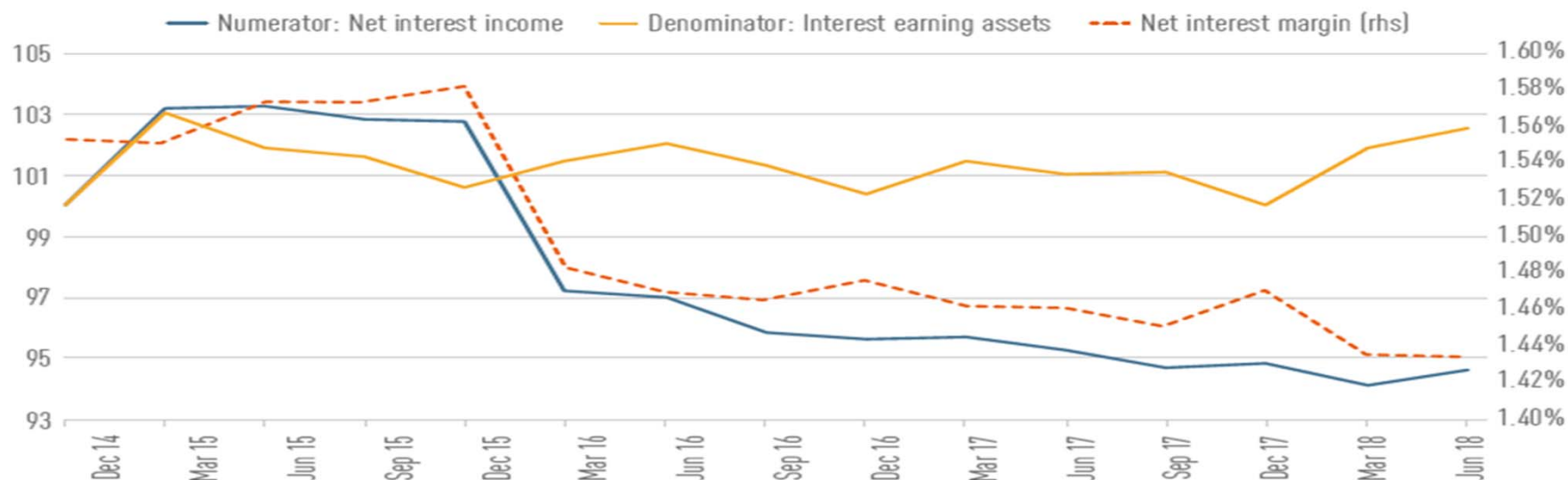
*Coeure, FT interview, June 17<sup>th</sup>*

'Just as our policy framework has evolved in the past to counter new challenges, so it can again. In the coming weeks, the Governing Council will deliberate how our instruments can be adapted commensurate to the severity of the risk to price stability..... Further cuts in policy interest rates and mitigating measures to contain any side effects remain part of our tools.

*Draghi, ECB forum on Central Banking, Sintra, June 18<sup>th</sup>*

# NIM dependency of banks

Figure 57: Net interest margin  
Source: EBA supervisory reporting data



NII was the most important source of revenues for banks. NII continued its decline in the first half of 2018 (almost -1% compared with the same period of 2017) and was about 3% below the 4-year average. As of June 2018, the net interest margin (calculated as net interest income divided by interest-earning assets) reached a new low, of 1.44% (Figure 57).

The main driver is the numerator, net interest income, which has declined by almost 0.7% since June 2017 and has not kept pace with the denominator, interest-earning assets, which have increased by almost 1.4% during the same period.

Source : EBA

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# 2% Cost of Negative rates?

## 1. European Banking Systems – Cost of Excess Reserves (Deposit Facility) and Minimum Reserves, Latest (€m)

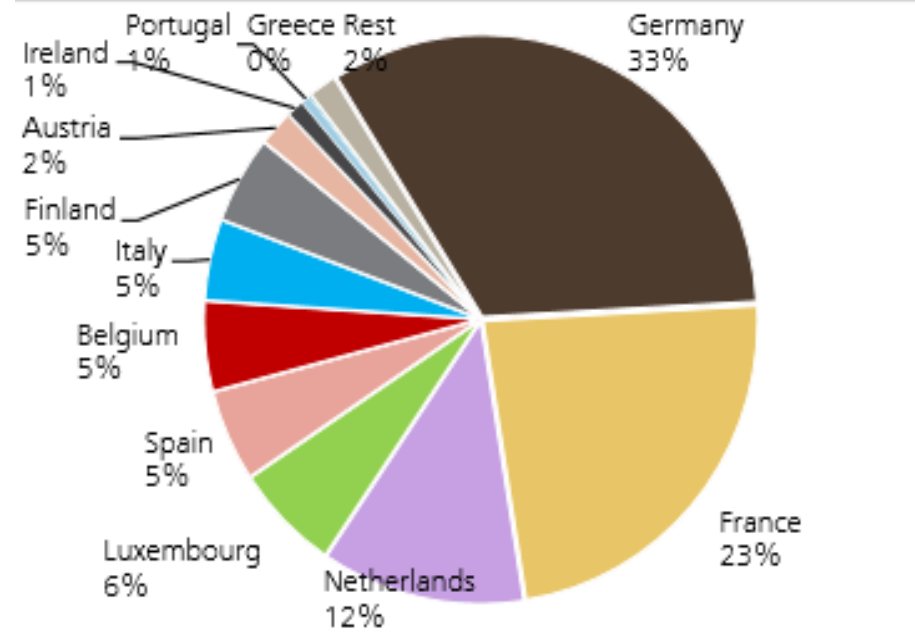
	Minimum reserves	Excess reserves (Deposits)	Total Reserves	Cost of min reserves	Cost of excess reserves (deposits)	Total Cost Pre-Tax	Total Cost Post-Tax	Total Cost % System Profit	Memo: Net Profit 2017
Luxembourg	66,640	57,955	124,595	0	-232	-232	-162	-20%	808
Finland	63,289	40,500	103,789	0	-162	-162	-113	-8%	1,353
Belgium	24,516	81,032	105,548	0	-324	-324	-227	-7%	3,207
Malta	928	3,824	4,752	0	-15	-15	-11	-6%	178
Germany	453,158	172,223	625,381	0	-689	-689	-482	-4%	12,192
France	246,123	264,646	510,769	0	-1,059	-1,059	-741	-3%	26,652
Ireland	13,676	7,315	20,991	0	-29	-29	-20	-1%	1,882
Austria	46,981	1,443	48,424	0	-6	-6	-4	0%	5,607
Cyprus	6,833	4,328	11,161	0	-17	-17	-12	0%	-624
Estonia	4,424	0	4,424	0	0	0	0	0%	54
Greece	1,390	2,130	3,520	0	-9	-9	-6	0%	-450
Italy	71,364	7,270	78,634	0	-29	-29	-20	0%	14,042
Latvia	4,632	0	4,632	0	0	0	0	0%	100
Lithuania	5,306	0	5,306	0	0	0	0	0%	1
Netherlands	211,654	9,283	220,937	0	-37	-37	-26	0%	12,635
Portugal	12,222	0	12,222	0	0	0	0	0%	-734
Slovakia	1,248	27	1,275	0	0	0	0	0%	91
Slovenia	3,163	0	3,163	0	0	0	0	0%	296
Spain	104,364	21,045	125,409	0	-84	-84	-59	0%	17,926
<b>Total Eurosystem</b>	<b>1,341,911</b>	<b>673,021</b>	<b>2,014,932</b>	<b>0</b>	<b>-2,692</b>	<b>-2,692</b>	<b>-1,884</b>	<b>-2%</b>	<b>87,217</b>

Source: Citi Research, ECB

1. European Banks - Earnings Impact of +25bps Rise in Interest Rates, by Bank

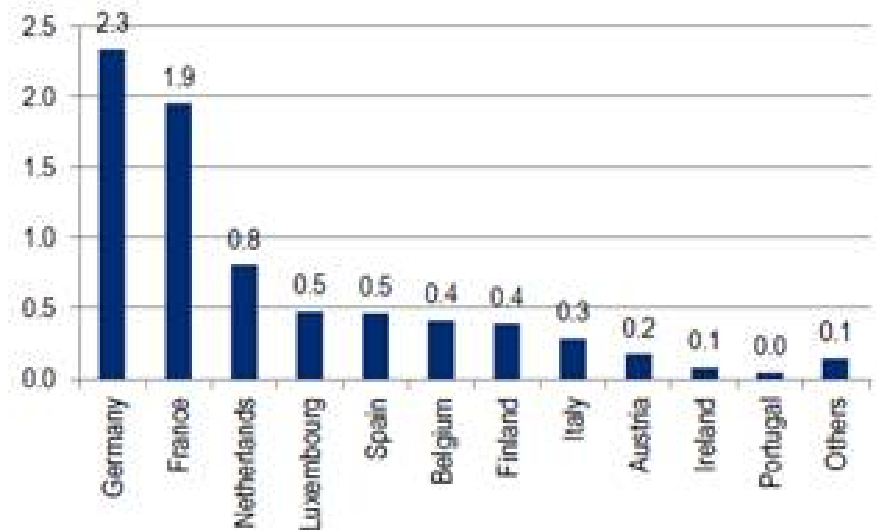
# Excess Liquidity Costs

Figure 9: Country shares of EZ excess liquidity (Jan 2019)



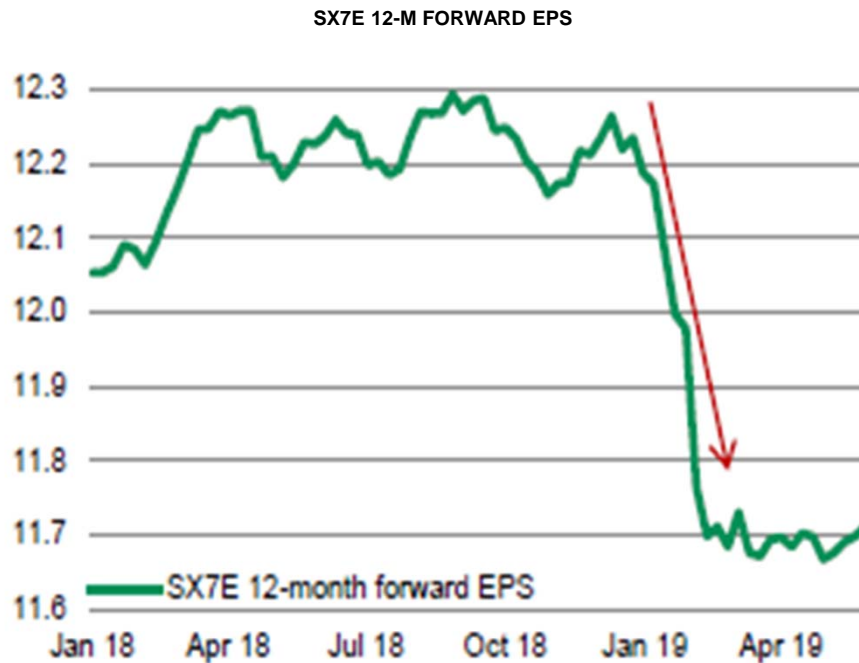
Source: Haver, UBS calculations

Figure 3. Current costs incurred by the negative deposit rate by banking system, €bn

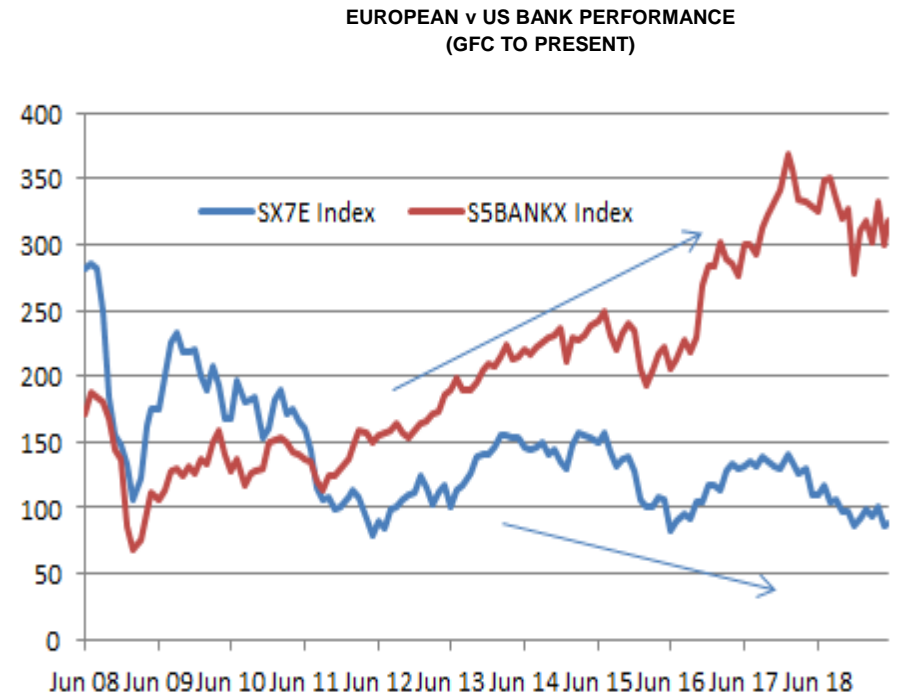


Source: Cit Research

# ECB nod to effect of negative rates – tiering to soften the expected blow?



Source : BNP 31.05.19 "Is tiering the trick up Draghi's Sleeve?":



Source : Bloomberg

# RoE – are Eurozone banks sustainable?

## EBA Transparency Exercise Dec'18 using June'18 Data:

June'18 weighted average RoE 7.2%, 1<sup>st</sup> quartile 4%, 3<sup>rd</sup> quartile 10.1% v

Mar'18 weighted average RoE 6.8%, 1<sup>st</sup> quartile 3.9%, 3<sup>rd</sup> quartile 10%

Only 20% of banks said their business models are sustainable <10% ROE.

Banks continue to struggle with costs as a sector... weighted average costs Jun'18 was 63.8% and has sat in 61-66% range since 2015

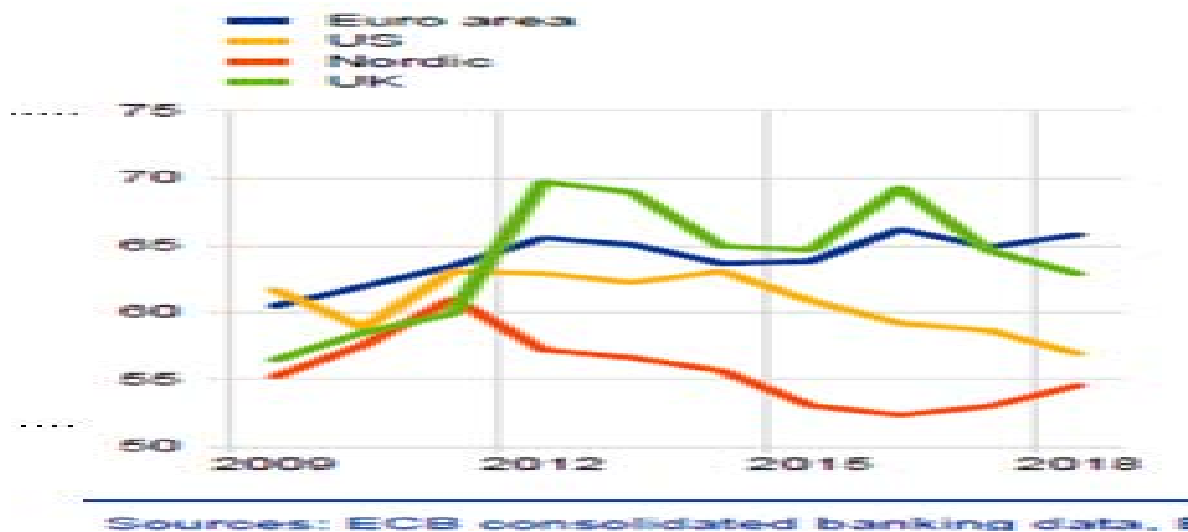
## ECB May 2019 Financial Stability Review

2018 RoE of around 6%, says deteriorating outlook will affect bank's ability to grow profits

ECB does not support idea negative rates as a key driver of European underperformance – more structural issues like overcapacity etc.

Euro area banks continue to materially underperform US & Swedish banks on costs and profits.

## COST/INCOME RATIOS



## Topics to discuss

- Is there a zero lower bound for all customers?
- When will the NIM / NII figures start to drop?
- Is the current discussion taking the asset duration into account?