EUROPEAN CENTRAL BANK

EUROSYSTEM

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Summary of Banking Industry Dialogue on 5 July 2017 in Frankfurt am Main

Participants

- Members of the Governing Council of the ECB
- Representatives of Allied Irish Banks, Alpha Bank, Banco Bilbao Vizcaya Argentaria, Bankia, Banque et Caisse d'Epargne de l'Etat Luxembourg, Belfius Banque, BNP Paribas, Commerzbank, Crédit Agricole, Deutsche Bank, DZ Bank, Erste Group Bank, Groupe BPCE, Intesa Sanpaolo, KBC, Landesbank Hessen-Thüringen, Landesbank Baden-Wuerttemberg, Rabobank Group, Société Générale, Swedbank, Unicredit
- Senior ECB officials from the Directorate General Macroprudential Policy and Financial Stability, Directorate General Communications and Directorate General Secretariat, and the ECB's Chief Compliance and Governance Officer

Risks for financial stability and macroprudential policy issues

Participants exchanged views on the: i) main financial stability risks; ii) outlook for banks active in the euro area; iii) revisions to capital requirements in CRD IV/CRR and; iv) potential impact of the introduction of IFRS9 and provisioning.

Participants agreed that repricing in global fixed-income and credit markets represents at the current juncture the key risk to financial stability in the EU. Reflation expectations in the US have led, over the past six months, to strong increases in bond yields and stock prices. Similar developments in bond and stock markets have been seen also in the euro area, despite some recent retrenchment. At the same time, long term bond yields were expected to remain at very low levels. In the euro area, the riskiest assets have benefited most from enhanced risk appetite. A sizeable repricing in euro area fixed-income markets, which may be triggered via spillovers of higher yields in other advanced economies, was seen as a potential source of substantial capital losses for banks and other investors with large exposures to fixed-income instruments.

Participants agreed that in recent years, banks' Return on Equity (ROE) has been well below the corresponding Cost of Equity (CoE) and lower than that expected by investors. While cyclical challenges are expected to gradually recede as the economy improves, structural challenges remain to be tackled.

These include the diversification of income sources, improvements in cost efficiency, NPL resolution and further consolidation. As demonstrated by relevant data, there is wide dispersion in performance and cost efficiency across euro area banks. Banking participants noted the challenges associated with low interest rates and the social impact that may arise from cost efficiency measures.

On regulatory issues, it was agreed that the EU Commission's proposals for the revision of capital requirements by amending CRD IV/CRR go, in general, in the right direction. Participants noted that there is, however, scope for improvement, including the harmonisation of prudential rules at EU level, as well as the provision of necessary powers and tools and sufficient flexibility for micro-prudential, macroprudential and resolution authorities to perform their tasks swiftly.

Regarding the finalisation of Basel III, participants stressed the need for a balanced and appropriate calibration to be agreed as soon as possible, in order to ensure a proper and stable framework for banks, while promoting a level playing field at international level. To this aim, the final rules should not lead to a significant overall increase in capital requirements but should provide the right incentives for banks to improve their risk management systems.

Participants also noted that it was of essence to maintain international cooperation and convergence of regulatory standards, in order to preserve a level playing field at the global level. In this respect, some concerns were expressed on recent developments in the debate on financial regulation in the US.

There was agreement that IFRS 9, which will replace IAS 39, constitutes an improvement from a financial stability perspective and, in general, is not expected to pose major challenges to banks' capital positions. At the same time, IFRS 9 implementation in the transitional phase must be closely monitored.

Economic and financial market conditions

Participants exchanged views on the: i) the economic outlook; ii) financial market developments and; iii) the functioning of the euro money market.

Participants agreed that the economic outlook in the euro area is improving and the recovery is gaining momentum, although not yet fully self-sustained, as still in need of monetary stimulus. The ongoing economic expansion, supported by domestic demand, was seen as increasingly resilient and has broadened across sectors and countries. Improvements in euro area labour markets were noted, while increased households' disposable incomes facilitate consumer spending. Housing markets are becoming buoyant, the business climate is improving and investment is gradually picking up. The current euro area economic expansion is expected to continue, supported by the ECB monetary policy measures, which are being passed through to the real economy.

Participants discussed recent financial market developments. Monetary policy was expected to remain supportive of the continuing recovery in the euro area which, more recently, has been reflected in risk-free interest rates. Even though the monetary policy stance in the US has tightened recently, financial conditions overall remain accommodative, supporting equity markets, which have remained buoyant. The continuing recovery has taken place in a context where volatility across asset classes has remained subdued.

Regarding interest rate benchmarks, banking participants and governors agreed on the importance of the Euribor reform owing to the fact that it is the benchmark for a large volume of contracts. Governors also noted that the Eurosystem stands ready to investigate the possible provision of an overnight benchmark in view of the potential financial stability repercussions and the impact on the transmission mechanism of monetary policy that could result from the absence of reliable benchmarks. All participants agreed that there was a need to take action and that there should be clarity about the respective roles of public authorities and the banking industry.

Banking participants noted the key role that the financial sector should continue to play in strengthening economic recovery and supporting the real economy. With technological innovation progressing, banks face great opportunities but also challenges. The future of the banking sector will depend on its adaptability in the face of new challenges, including innovation, new technology and digitalisation, diversification of activities and cost-cutting in traditional activities. It was remarked that substantial investments are required by banks for adapting to new technology requirements. EU banks were seen as exposed to competition with other non-EU banks and non-banks and therefore it is essential to promote a fair and competitive environment for all players. Banking participants also agreed that co-operation between banks and with non-banks may play an important role in meeting innovation challenges.

Banking representatives noted that Cyber and IT risks can be significant, and called for the European Commission and regulators to act accordingly. Participating Governors agreed and noted that those charged with market oversight and supervision are active in this regard and that the G7 is also expected to address cyber risk.