

Discussion on the  
lecture by Claudia Buch  
“Bank Profitability”

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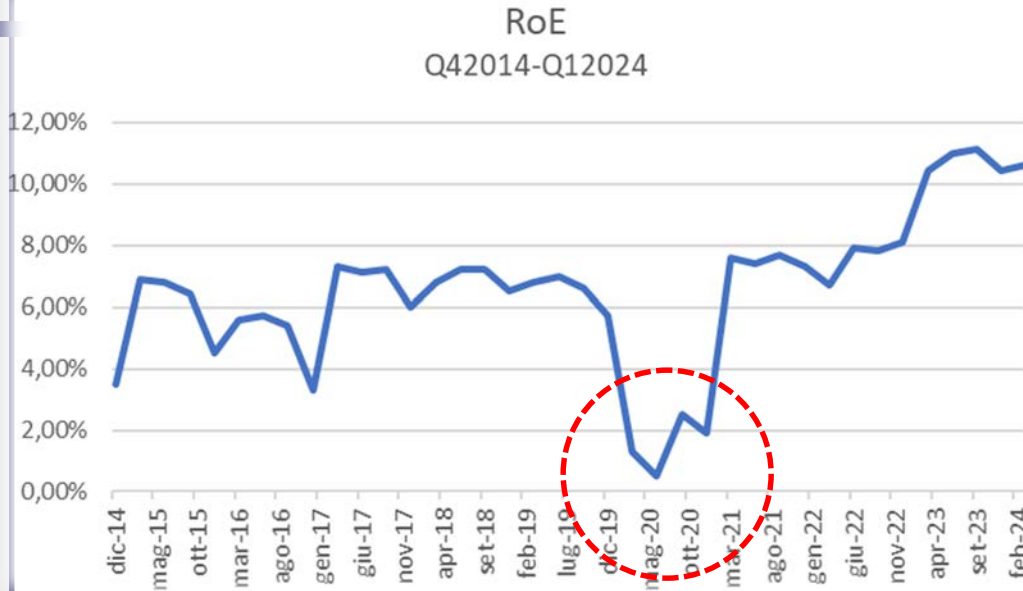
Bocconi University - 16 October 2024

# Agenda

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

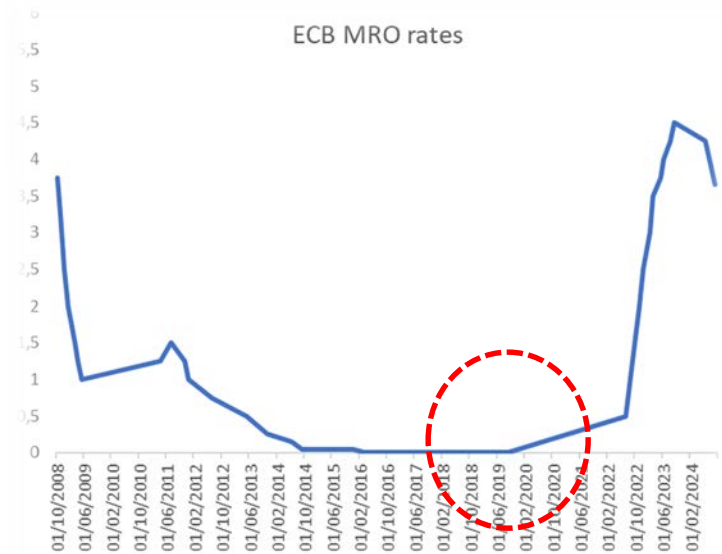
# Trend in European banks' profitability

## RoE



Source: EBA Risk Dashboard

Banks have benefited from rising interest rates since the Covid years

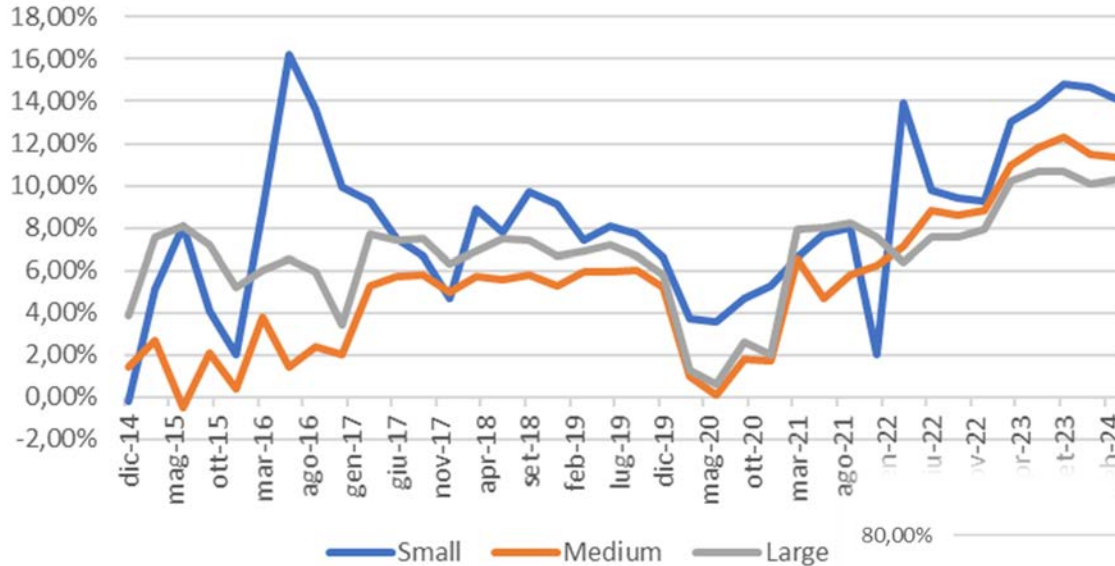


Source: ECB

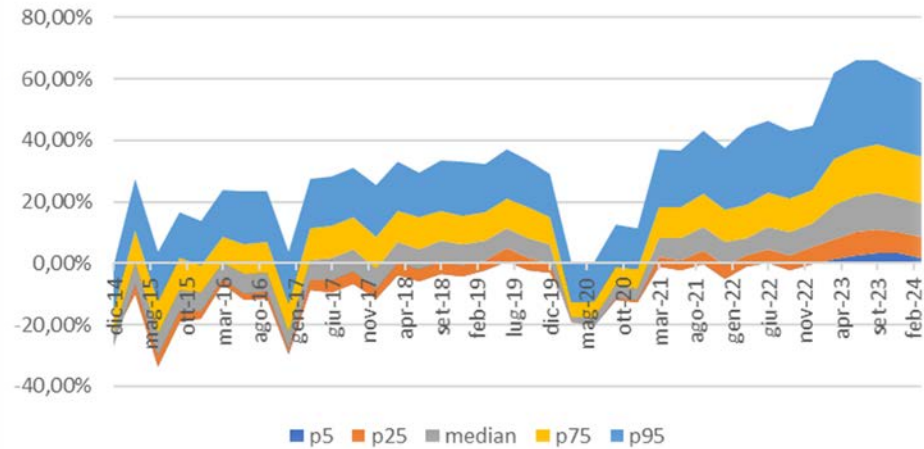
# Trend in European banks' profitability

## RoE across the distribution and by bank size category

RoE by size category



RoE distribution over time

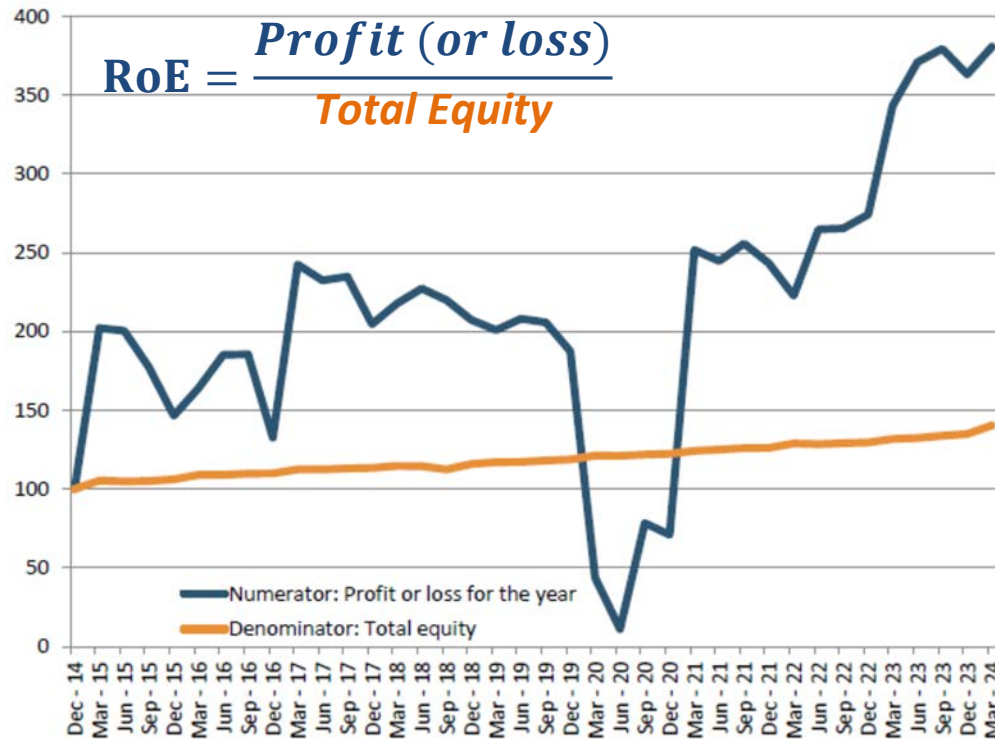


- Banks have all benefited from rising interest rates
- But there is wide dispersion

# Trend in European banks' profitability

## RoE and its components

### Numerator and denominator: trends



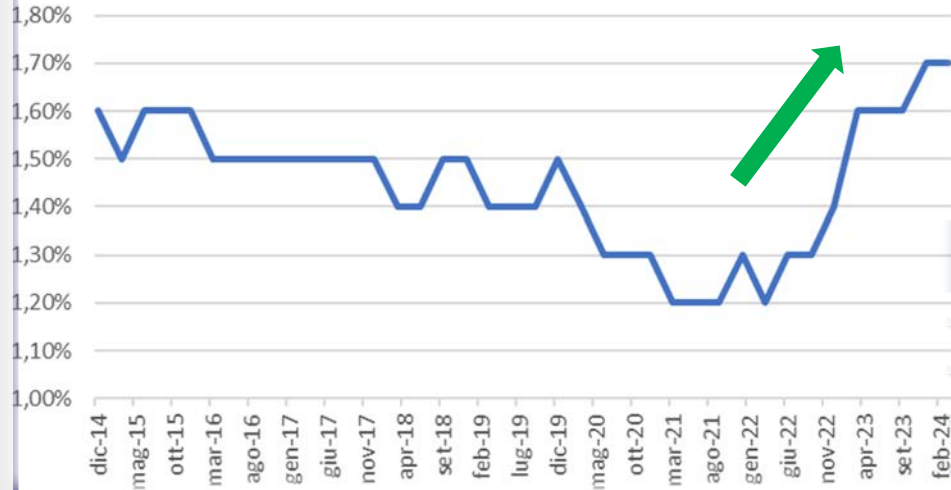
Total numerator and denominator.  
Dec 2014 =100.

- 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

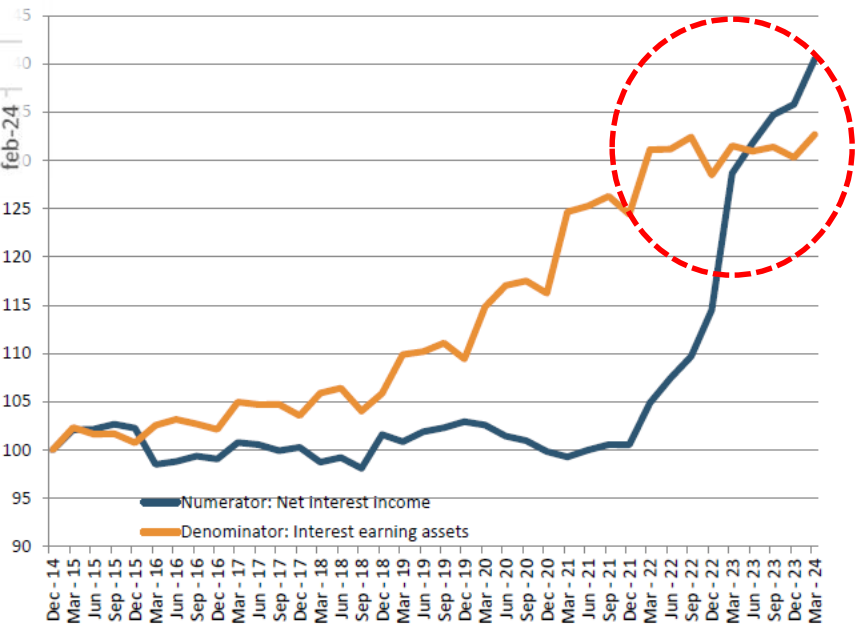
## Driver 1: Net Interest Margin and its components

Net Interest Margin



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

Numerator and denominator: trends

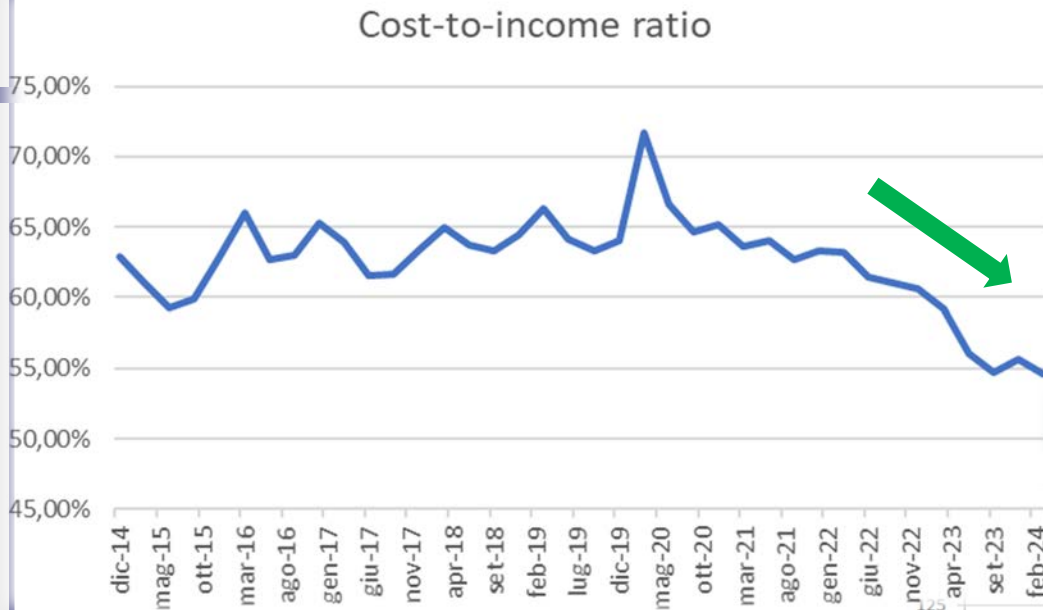


- NIM has increased...
- But the “spread effect” prevails over balance sheet effect

Total numerator and denominator.  
Dec 2014 =100.

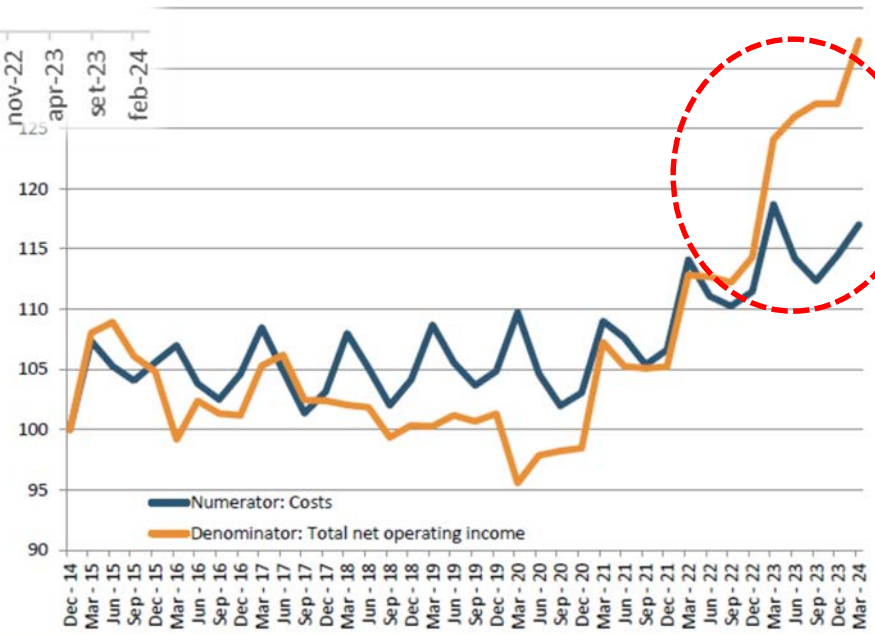
# Trend in European banks' profitability

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



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

Numerator and denominator: trends



Total numerator and denominator.  
Dec 2014 =100.

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

# Trend in European banks' profitability

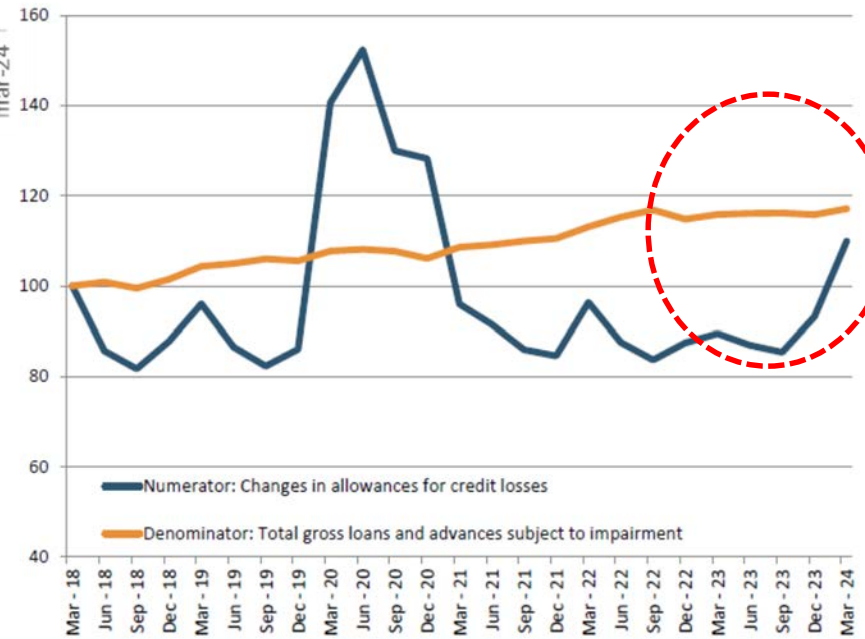
## Driver 3: Cost of (credit) risk and its components

Cost of risk



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

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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