

Box 9 Financial conditions of 50 large euro area banks

This box provides an assessment of performances in the euro area banking sector during 2004 based on information provided in the published accounts of 50 large euro area banks. Historical data for these institutions also serve to complement the analysis in the main text. The 50 institutions were chosen because they represent a significant share of the assets of the domestic banking systems in individual euro area Member States.¹

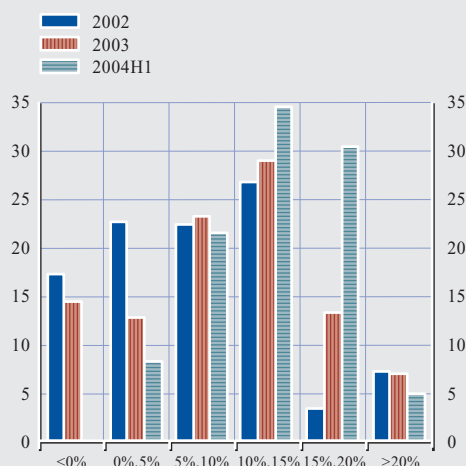
Overall, it appears that the condition of the 50 large banks in the euro area sample continued to improve in the first half of 2004, mainly driven by continued cost-cutting and reduced provisioning. However, income from traditional intermediation and trading activities weakened, clouding an otherwise positive outlook for large euro area financial institutions.

Profitability. While some of the banks in the group posted weaker profits in 2003 than in 2002, aggregate profitability increased, as measured by ROE after taxes and extraordinary items, to 6.7% in 2003 from about 6.1% in 2002.² There are also tentative indications that the

1 The banks were selected on the basis of their total assets and because they are generally active in more than one European country. The sample of banks remains the same over the reference period. Where the group owns substantial insurance operations, only the figures for the banking operation are taken into account. The comparability of banks' annual results could be affected by different accounting standards.

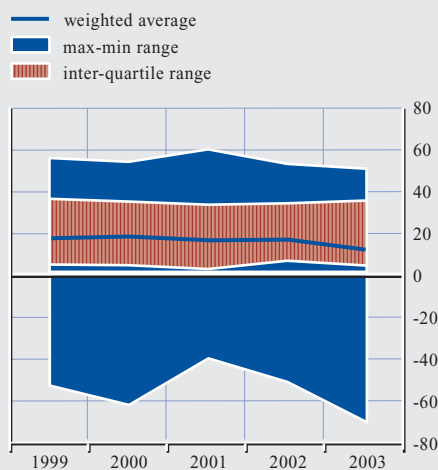
2 All figures in the text refer to weighted averages unless otherwise stated. The averages are weighted by each institution's total assets. The figures for the first half of 2004 (2004 H1) are based on non-audited interim reports. For 2004 H1 the sample covers approximately 40 euro area banks. Several institutions report an ROE only on a before-tax basis for 2004 H1 and are not included in the aggregate indicator, which calculates ROE after tax and extraordinary items.

Chart B9.1 Frequency distribution of ROE for large euro area banks



Source: ECB calculations based on published accounts.
Note: Data for 2004H1 are unaudited and are not based on the full sample.

Chart B9.2 Customer funding gap for large euro area banks



Source: ECB calculations based on the annual accounts of individual banks.
Note: The gap is calculated as the difference between customer loans and deposits expressed as a percentage of customer loans.

performances of these institutions improved in the first half of 2004 with an (annualised) ROE of 8.3%. Moreover, banks in the weakest performing quartile also managed to improve their ROE.

Income developments. Net interest income continued to decline from around 1.22% of total assets in 2002 to around 1.18% in 2003 and to 1.12% in the first half of 2004 (on an annualised basis). Even though loan volumes have grown over the past three years, this was insufficient to counteract the negative effects of a narrowing of interest rate margins on interest income. The narrowing of margins resulted from relatively low nominal interest rates and increased competition in some market segments. During the past years this narrowing has been further intensified by the need to use alternative (usually more expensive) sources of funding to cover the gap between the funding needs and availability of customer deposits (see Chart B9.2).³

Turning to non-interest income, interim financial statements (for banks that publish them) indicate that the exceptional trading profits made by many institutions in 2003 in an environment of buoyant stock markets are unlikely to be repeated in 2004 as a whole. On the other hand, a sizeable proportion of banks reported an increase in fee and commission income.

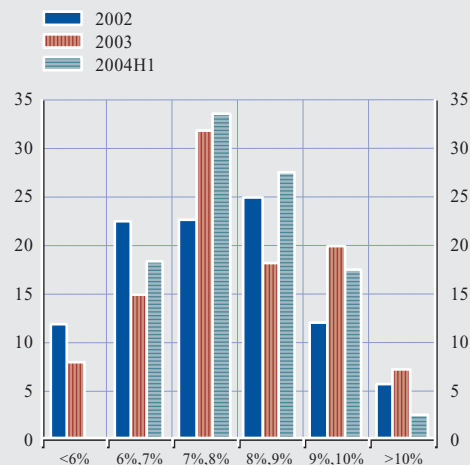
Provisions and costs. On average provisioning for loan losses fell from 0.32% of total assets in 2002 to 0.26% in 2003. The main factor behind this development, according to the published accounts of banks, was an improvement in credit risk related to the economic recovery. Indications from the financial results reported for the first half of 2004, as well as for the third quarter for some banks, are that they will fall again for 2004 as a whole, thus contributing to

³ Customer funding is defined as non-bank deposits. These include deposits from non-financial corporations, government and households. Customer loans are defined in a similar manner. Market funding includes issuance of debt securities such as medium-term notes, repos and unsecured interbank borrowing.

boosting profitability. The latest indications from the October 2004 ECB Bank Lending Survey tend to corroborate the perception of improved credit quality in 2004 (see Box 10).

Cost control has also been a priority for larger institutions in order to maintain profitability. The average cost-to-income ratio decreased from about 72% in 2002 to about 67% in 2003. Moreover, the degree of dispersion of this ratio between the quartiles continued to decrease up to the first half of 2004 (see Table S9). The main areas of cost-cutting were the rationalisation of branch networks and reductions in the number of staff. For some euro area institutions, it remains to be seen what further scope for cost reduction remains after the extensive cost-cutting measures already adopted.

Chart B9.3 Frequency distribution of Tier 1 capital for large euro area banks



Source: ECB calculations based on annual accounts and interim financial statements.
 Note: Data for 2004 H1 are preliminary and are not based on the full sample.

Solvency. The key regulatory solvency ratios improved between 2002 and 2003. The average Tier 1 ratio was 6.4% in 2003, up from 5.6% in 2002. Encouragingly, those banks with the weakest solvency ratios in 2002 managed to move their solvency ratios onto a more solid footing between 2003 and the first half of 2004 (see Chart B9.3). The improved shock absorption capacity of these banks that this implies should contribute positively to financial stability in the euro area.