# Daily Insight

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## Positive health check for European banks

**European Financials: A positive health check for European Banks** - The European Banking Authority (EBA) released on Friday their annual transparency exercise, assessing the balance sheets of 132 banks across the EU. On the whole, the results were broadly positive across the fundamental parts of the balance sheets. Solvency was the clear winner in the results, as CET1 on a fully-loaded basis strengthened intensely to 14% (was 13.1% last year). This is an all-time high and shows the huge strides that the banking sector has achieved over the last ten years. As a result, bank capital ratios are now at levels close to where regulators desire.

However, the asset quality figures were not so kind. Banks managed to reduce the NPL ratio to 4.5% from 5.4% a year earlier, but the EBA still found that ‘around one-third of EU jurisdictions have NPL ratios above 10%’. Moreover, the volume of NPLs (EUR 893bn) still remained at a very high historical level. We still expect an acceleration of the NPL reduction, predominately as authorities begin to wrestle more power. Also, all eyes will be on the reaction of the ECB to a recent NPL framework they wish to put forward to significantly reduce future NPLs staying on bank balance sheets.

The second negative takeaway was profitability. Profitability is still below the cost of equity, despite the return on equity increasing  to 7% from 5.7%. In particular, German banks continued to struggle with their return on equity, positioned fourth last in the results, a position only behind Greece, Portugal and Cyprus. Germany was also mentioned, along with two other countries, as a region where ‘operating expenses significantly affect banks’ ability to generate net income efficiently, in order to thrive in the future’. As solvency demands continue to take up more capital in Europe, the impact on profitability will continue and that should begin to weed out the weaker smaller banks in the industry.  (Tom Kinmonth)

**Global FX:  EUR/USD aiming at this year's high** - The more dovish than expected FOMC minutes that were published last week have resulted in lower US Treasury yields and some downward adjustment in the expectations about Fed rate hikes next year. This has weakened the dollar. In the near term EUR/USD will probably move towards 1.20. It will be interesting to see what investors will do at this level. Initially, they will likely try to push EUR/USD to this year's high of 1.2092. If they are not successful in approaching/breaching it, it is likely that they will take profit on euro-longs resulting in euro weakness, potentially pushing EUR/USD in the direction of 1.15.  (Georgette Boele).

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