

Banks Outlook 2021: The delayed impact of Covid-19 will make itself felt

The pandemic brought banks a renewed sense of purpose in 2020: providing liquidity to the real economy. Helped along by accommodative monetary and government policies, banks have indeed played their part in the crisis response. Going into 2021, the delayed impact of the pandemic will make itself felt



☐ Loan demand: weak, weaker, weakest?

In 2021, the recessionary environment will weigh on **bank loan demand of corporates**, as investment projects are shelved and businesses are struggling to survive. Borrowing rates are supportive, but cannot fall much further, and bond markets are an attractive alternative for larger corporates in many eurozone countries. Businesses seeking alternative sources of liquidity, once government-supplied liquidity has dried up, may stimulate demand for bank loans, but only to a limited extent. With southern European economies on average hit more strongly by lockdowns, having a higher share of Small and Medium-Sized Enterprises and consumer credit portfolios in those countries, and taking into account pre-corona trends, we expect bank loan demand to weaken mostly in southern Europe. Find that section [here](#).

❑ Margins: under increasing pressure

The clouded outlook for loan volumes is complemented by an ever-increasing **pressure on margins**, as eurozone banks continue to suffer from the negative rates environment in 2021. The 10-year EUR swap rate is hovering around -25bp, painting a dark picture of the European rates outlook with markets expecting short rates to stay, on average, at negative levels for the next decade. What is more, the yield curve has flattened considerably in the past few years, detrimental to banks deriving part of their income from maturity transformation.

The particular vulnerability of banks to negative rates depends on their loan book composition, including duration and funding mix. Deposits are no longer the safe and efficient means to generate interest income on maturity transformation that they once were. In fact, given difficulties imposing negative rates on deposits, a strong dependence on deposit funding may be turning into a weakness rather than a strength. Find that [here](#).

❑ Non-performing loans: silence before the storm?

Helped by extensive government support measures and payment holidays, many businesses have been surviving in 2020. Default rates and NPL ratios have been deceptively quiet this year. Support measures are not forever though. **A sharp increase in non-performing loans is a question of 'when, not if'**, but will hit some countries more than others. Factors driving those differences include the sectoral composition of corporate loan books, the share of SMEs in those loan books, and the size of legacy NPL portfolios. Taken together, a worrying picture emerges. Covid-19 may deal another blow to those countries and banking sectors that are worst positioned to deal with it. Find that article [here](#).

❑ Consolidation: a change in tune

Weak demand and digesting losses may drive banks into each other's arms. But even before Covid-19, several banking markets were already overbanked. 2020 will likely mark a year of change for bank consolidation in Europe with another hit to bank profitability in the form of Covid-19 and a change in tone from supervisors. This is likely to result in **more consolidation**.

We think domestic deals will continue to take the lead and consider in-market transactions to be more likely in certain areas. Cross-border deals are more likely to involve large banks that target new markets. Motivation could include increasing economies of scale, synergies, geographical and product diversification, acquiring better digital capabilities, or improving the asset and liability match by merging with a complementing entity. An important consideration for cross border mergers will probably continue to be the hunt for greater size and customer base, especially since banks are facing ever tougher competition from big-tech platforms. Cross-border deals have been hindered partly by a reluctance of domestic authorities. The tone may be changing though, with the ECB now seemingly pushing harder towards bank consolidation. More on that [here](#).

❑ Bank bond supply: I'm good, thank you

Covid-19 has sharply reduced **bank bond issuance** this year. The fall in covered bond and preferred senior supply is a direct consequence of banks relying more on the ECB's TLTRO funding. Only subordinated supply has kept its head above water thanks to the ECB's measures and a rise in lending growth for some banks. With the global economy projected to recover from its severe growth relapse in 2021, bank supply is likely to follow a similar pace as we have seen this year.

More on that [here](#).

□ Regulation: where were we?

Regulators have responded strongly to the Covid-19 pandemic in an effort to mitigate the impact of the crisis on households, corporates and banks. All these measures have guided banks well through the first storms of the Covid-19 crisis. To what extent banks will be able to rely on these **temporary provisions in 2021**, pretty much depends on how the coronavirus situation evolves. If renewed lockdowns and economic pressures are indeed the direction we are heading, governments and central banks will likely continue to do their utmost to navigate the crisis. That may include extending measures that were put in place temporarily to optimise the conditions for banks to deal with the Covid-19 crisis and the postponement of important measures such as the Basel-III reforms. Read more [here](#).

□ Sustainability: next steps towards climate neutrality

The Covid-19 pandemic is underscoring and reinforcing the importance of **sustainability**. Bank sustainable bond issuance held its ground in 2020, quite an achievement given the general reduction in bank bond issuance. Sustainability is likely to remain a key topic in 2021 for banks in many different ways, ranging from disclosure requirements to the impact of the taxonomy regulation in the field of green loan and bond market developments, just to name a few. The follow-up developments in light of the European Green Deal will keep financial market participants engaged and so should the ECB's monetary policy review, which could include a pivot towards green lending. Bond markets will remain a vital reflection of this. Click [here](#) for more on that.

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