Banking in Europe: EBF
Facts & Figures 2018

The data contained in this publication has been compiled from publicly available information released by the European Central Bank, European Commission, Eurostat, the European Banking Authority, national competent authorities and members of the European Banking Federation. Unless otherwise noted, all graphs and tables have been produced to illustrate the figures mentioned in the relevant chapters.

Due to rounding, figures presented in the charts throughout this document may not sum.

The projections presented in chapter one has been compiled from the EBF Spring 2018 Economic Outlook, a bi-annual report prepared by the European Banking Federation’s Chief Economists’ Group. European Commission data for previous years

Figures provided in the country-by-country overview may not match those presented in the statistical annex due to the sources used i.e. National Central Banks and European Central Bank.
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Chapter 1
The wider economy

Supported by the European Central Banks’ (ECB) accommodative monetary policy stance, a strong global economy and robust domestic demand, and despite political uncertainty and geopolitical tensions surrounding the world economy, the euro area grew by 2.4% in 2017.

This was a higher rate than international partners such as Japan (1.7%) and the UK (1.8%) and comparable to the US (2.3%), but lower than Canada (3%) and China (6.9%).

In 2018, the 19-country bloc will continue to benefit from supportive financial conditions, sustained global and domestic demand, and robust growth of global economy. While political uncertainty in Europe is less of a threat than in previous years, geopolitical tensions and the possible escalation of trade conflict remain downside risks. The euro area is expected to expand, above potential, by 2.4% in 2018. The growth is expected to slacken slightly in 2019, when GDP expansion of 2.1% is forecast. The Euro area however has a lower expected growth rate for 2018 and 2019 than the EU 28 and the US.

![GDP Growth, 2008-2018](image)

Domestic demand will remain the key driver for the expansion of the euro area economy, as it has been over the last few years, running on the two engines of private consumption and investment, and sustained by job creation, slow return of inflation and improved profitability.
Private consumption will maintain a healthy growth in 2018 benefitting from an improved labour market and favourable financing conditions. Fixed business investment will continue its recovery benefitting also from favourable financing conditions, after a period of significant decrease mainly due to a wide range of uncertainties and lower bank lending in a number of countries.

On the back of a sustained global recovery, world trade continued growing in 2017 boosting European exports by 5.1%. The global economy will continue, in 2018, to expand supporting external demand and boosting European exports despite the euro appreciation. Exports are expected to grow by 4.9% outpacing a 4.5% growth in imports.

Since the peak of the financial crisis, euro area member states have achieved significant progress in reducing public sector deficits. The fiscal policy stance is expected to remain broadly neutral over the forecast horizon. With the decrease of the deficit ratio, mainly due to the low interest rate environment and the economic upswing, the euro area fiscal deficit is to equal 0.9% of GDP in 2018. This, in combination with the economic recovery, will translate into a reduction of the debt to GDP ratio over the forecast horizon.

At the beginning of 2017, consumer prices increased at their fastest pace since 2013, driven by a surge in commodity prices. However, since then, the development has softened somewhat and with still significant slack in the labour market limiting upward pressures on wages and prices, gains in the forecast horizon will be modest. The overall rate of inflation is expected to remain stable with consumer prices increasing by 1.5% annually over the coming years after increasing by 0.2% in 2016.

Core inflation (excluding volatile items like commodities, energy and non-processed food) will increase in 2018 at a lower rate than overall inflation, 1.2%, due to weak labour market dynamics i.e. wage growth and lower import prices.
Labour market conditions remained favourable in 2017 stimulated by a combination of robust domestic demand, a relatively low increase in productivity growth and structural reforms, e.g. labour market reforms undertaken in some euro area countries. These labour market conditions are expected to remain favourable in 2018 driven by the economic upturn. With economic growth above potential, unemployment has been improving and is expected to continue this trend over the coming years. Unemployment in the euro area is expected to be 8.4% in 2018, with a further improvement to 7.9% in 2019, the lowest levels since 2008.

Solid growth of the world economy will permit the euro area to continue growing above potential making the 19-country bloc more resilient to external shocks. However, although the uncertainty related to the political events in Europe has diminished, geopolitical tensions have the potential to spark a period of instability disturbing buoyant global growth. Trade tensions could also trigger a trade battle that would harm the recovery of the global economy. The euro area, which is relatively highly exposed to external trade, would be severely hit by a trade war following the tariffs imposed by the US administration on European steel and aluminium exports.

The Chief Economists’ Group of the European Banking Federation in its Spring 2018 Outlook of the Euro Area Economies in 2018-2019 argues that the current economic outlook remains surrounded by a number of upside and downside risks with the risks to the growth outlook fairly well balanced.
Chapter 2
Structure and economic contribution of the banking sector

Number of banks
The downward trend in the number of EU-28 credit institutions, which started in 2009, continued in 2017, falling to 6,250. This marked a decline of 5% compared to the previous year and a reduction of 2,275 in total since contraction started. Most of the consolidation has occurred within credit institutions legally incorporated into the reporting country, where the stock has fallen by 31% since 2008. This trend includes factors such as mergers in the banking sector with a view to enhancing profitability.

The countries that experienced the largest contraction in absolute terms in 2017 were Germany (-70 units), Italy (-65), Hungary (-49) and Austria (-43), according to the ECB. Sweden (+3 units) and the UK (+15) were the only countries where the number of credit institutions increased. The number of credit institutions in the EFTA countries fell from 413 to 410 in 2017.
Branches and subsidiaries

The rationalisation taking place in the EU banking sector also involved bank branches as the number of bank branches continued to shrink, falling to about 183,000 by the end of 2017. Compared to the previous year, branches in the EU-28 decreased by 3.1%, or about 5,900 branches. This partly reflects the increasing use of digital banking by consumers as more than half of EU individuals used internet banking in 2017 up from 29% in 2008.

The number of branches has fallen by 21% since 2007, or by almost 50,000. Since 2007, the branch network contracted by more than 5,000 units in three countries: Spain (down by 18,020 units) Germany (down 8,769) and Italy (down 5,800).
The overall number of subsidiaries continued declining for the tenth consecutive year, falling by 4.4% to 566, the lowest level since 1997. The number of subsidiaries of credit institutions from other EU countries fell by 14 in 2017, the lowest level since 1998. The number of non-EU credit institutions’ subsidiaries dropped to 245, down from 288 in 2013.

Credit institution subsidiaries

Bank staff

By end-2017, EU-28 banks employed about 2.7 million people, about 40,000 fewer than in 2016 and the lowest level since the ECB’s data series began in 1997. The five largest EU economies continue to be the five countries with the largest number of employees in the banking sector employing some 67% of the total EU-28 staff employed. Including EFTA countries, the number of staff employed in the banking sector was about 2.9 million.
Also reflecting a contraction in the banking sector, the average number of inhabitants per bank staff in the EU Member States rose from 184 in 2016 to 187 in 2017. The average number has risen each year since 2008, when it was 154.
Economic contribution

Banking and related financial services activities make a significant contribution to the EU’s economy.

Despite the drop in bank employment in recent years, about one in every 100 jobs in the EU was a banking job in 2016.

In the past decade, between 3% and 4% of the value of compensation of employees and gross value added in the EU economy has come from financial services (excluding insurance and pension activities).
Chapter 3
Lending and deposits

General trends
The core banking activities of raising deposits from and providing credit to customers are crucial to Europe’s banks. Despite deleveraging by European consumers and businesses, bank deposits and loans grew in 2017.

Deposits
Domestic or euro area deposit liabilities in the EU rose by 3.1% to €23.6 trillion. This was the highest level recorded, with the previous peak at €23.1 trillion in 2012.

Deposits from other Monetary Financial Institutions (MFIs) rose for the first time since 2011 to €7.1 trillion.

Total deposits from non-MFIs, excluding central governments, grew by 2.5% in 2017 to €16.3 trillion in the EU at the end of 2017, with €12.1 trillion deposits coming from the euro area.

Growth has been driven by an increase in deposits from households (including non-profit institutions serving households), which rose by 2.9% year-on-year to €9.1 trillion and non-financial corporations (NFCs), up by 6.7% to €3.2 trillion.
Loans

The total value of loans outstanding from EU MFIs increased by 3.9% in 2017 to more than €24.5 trillion, surpassing the previous peak in 2011. The increase derived from growth in loans to other MFIs which rose by 9.8% year-on-year to €7.9 trillion.

Loans to EU households rose by 2.5% in 2017 to €7.8 trillion, rising slightly faster in the euro area. Loans to households in the euro area grew for the third successive year, adding almost €500 billion on loans outstanding since 2014.

NFC loans outstanding rose by 0.7% in 2017 to €5.2 trillion, the highest level since 2013.
Real estate activities, professional, scientific and technical activities and administrative and support service activities accounted for more than one third (35.3%) of loans outstanding at the end of 2017. Manufacturing and the wholesale and retail trades accounted for 14.3% and 13.2% respectively.
Bank Lending Survey

Results from the quarterly ECB’s Bank Lending Survey suggested a broadly stable environment in 2017 for small and medium-sized enterprises (SMEs) and large enterprises.

Despite some minor tightening of credit standards for SMEs in Q1 2017, results signaled a slight easing of credit standards i.e. banks’ internal guidelines or loan approval criteria, throughout the year for new loans to both SMEs and large enterprises reflecting the tendency seen in most quarters from the start of 2014.

After reaching an all-time high net weighted percentage of 27.9 in Q1 2016, the demand for loans among SMEs remained broadly stable during 2017 closing the year with a net weighted percentage of 13.3. Demand for loans to large enterprises stabilize towards the end of the year from fluctuations seen in the previous quarters.

The Role of Banks: lending and payments

Banks act as facilitators between those who have money and those who need money, while also providing the systems for funds to flow between payers and payees.
The primary role of banks is to take in money from those with cash in hand and to lend money to borrowers. Banks then receive loan repayments which can be used in new lending to other borrowers.

The traditional view of this process has been that banks “create” money by providing some of the money on deposit in the form of loans to borrowers, which returns to the banking system as deposits. This money can then be lent again and again, resulting in a multiplier effect. More recently, money creation has focussed on how lending creates bank deposits i.e. whenever a bank provides a loan to a customer, a deposit is created.

Banks cannot lend freely without limits. They have to be able to lend profitably in a competitive market, while also managing liquidity risks (i.e. that they have sufficient liquid assets to repay depositors or investors when required) and credit risks (that some borrowers may not repay their loans). These lending activities are regulated and safeguarded by global/international standards and EU regulations.

Just as money can be created, it can also be destroyed. For example, in the case of a mortgage being used to purchase a second-hand property, the purchaser could use the proceeds from the sale to pay an existing mortgage, effectively bringing the amount of money created back to zero.

Banks are also key players in national and international payment systems. Some 122 billion cashless payments were made by non-MFIs in 2016 at EU 28 level. More than half (60 billion) of those were card payments, while about a quarter were credit transfers (31 billion) or direct debits (25 billion).

The Single European Payments Area (SEPA) aims to harmonise and integrate payment markets across Europe, with one set of euro payment instruments: credit transfers, direct debits and payment card, common standards and practices and a harmonised legal basis. SEPA covers more than 520 million people in the 28 EU Member States and six non-EU countries (Iceland, Liechtenstein, Monaco, Norway, San Marino and Switzerland).
Chapter 4
Banking sector performance

Bank capital

European banks have continued building a solid capital position and strengthening their balance sheets. The recapitalisation effort that European banks have made following the 2008 financial crisis makes the European banking sector more resilient and robust. Capital has continued increasing, with the core equity Tier 1 ratio of EU banks on a fully loaded basis, which includes only capital of the highest quality, at 13.8% in June 2017, 100 basis points more than the previous year and double the same ratio in December 2011.

Banks in the European Union have reduced the original total capital shortfall by more than €500 billion from 2011 mainly by raising new capital and retaining earnings. Tier 1 and total capital also continue showing a positive trend, doubling the same ratio in 2011.

In 2017, for the first time, the shortfall of all categories of capital was practically zero. All banks met the liquidity coverage ratio above the minimum. Also, the leverage and NSFR shortfalls continued to decrease to €2 billion and €51 billion, respectively.

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Data and assumptions from EBA and EBF
*Including G-SIB surcharge **Overall shortfall group 1 and group 2 *** Assumption of weights: 80% G1; 20% G2

Bank funding

The share of deposit liabilities over total assets increased in 2017 from 51.3% to 53.4%, in line with the rising trend since 2007 (47.3%) that reveals the shift towards greater reliance on deposits as a source of funding.
The rise in the share of non-banks’ deposits to total assets has continued, rising from 36.8% in 2016 to 38.1% in 2017.

The country breakdown for total deposits shows that domestic deposits were equivalent to less than half of the assets in Denmark, Ireland, Sweden, Finland, the UK, Luxembourg, Malta and the Netherlands. The figures continue to reflect, in part, different banking models, for example the well-developed covered bond markets in Scandinavia. Meanwhile, countries with the largest shares of deposits financing the banking sector’s assets were Bulgaria, Slovenia, Slovakia, Lithuania, Romania and Portugal; all of which had deposits equivalent to 70% or more of assets.

![Deposits in EU banks as a share of total banking assets %](image)

**Assets**

The amount of total assets held by EU banks contracted for a third consecutive year in 2017. This time by approximately €300 billion from the previous year amounting to €42.89 trillion (€30.4 billion in euro area and €12.5 billion in non-euro area). While there was a modest gain in the total assets in the non-euro area (2.42%) this was offset by a drop (1.93%) of total assets held by banks in the euro area countries.

Considering the country breakdown, the country with the strongest boost in absolute terms was Czech Republic with €53.6 billion (23.9%). Among the four largest European countries only France registered a positive result in their stock of assets which increased by 1.5%, Germany, Italy, and Spain showed a reduction of 1.1%, 5.3% and 0.2% respectively. The countries with the most significant reductions in their stocks of assets were Greece (-14.3%) and Finland (-17.4%).
Bank profitability

With the ECB maintaining its ultra-low interest rates, profitability remains a key challenge facing European banks. The return on equity (ROE), a key indicator to assess the bank sector’s attractiveness for investors has been slowly recovering. The ROE of European banks was 5.6% in 2017 for EU 28, practically half of the 10.6% registered in the burst of the financial crisis, but the highest since 2007.

While most countries have a positive ROE, Denmark (10.8%), Sweden (10.9%), Romania (11.7%), Czech Republic (13.0%) and Hungary (14.5%) registered a double-digit ROE. Reflecting on the national breakdown, the average ROE of Cyprus, Greek and Portugal banks were the only three with negative results at -11.5%, -1.3% and -0.8% respectively. The difference between the highest (Hungary) and lowest (Cyprus) ROE was 26 percentage points in 2017, far from the 101.6 recorded in 2013 (11.4% in Czech Republic and -90.2% in Slovenia).

The ROE across EU countries diverged after 2007 signaling growing fragmentation particularly across the euro area. After reaching a peak in 2013 (25.8), the dispersion around the average ROE has substantially decreased falling to 8.3 in 2014, 7.4 in 2015, 5.7 in 2016 and further into 2017 to 5.1, the closest so far to the 4.5 seen in 2007 before deviation started.

In the largest EU economies, the ROE in 2017 was 8.8% in the Netherlands, 7.1% in Italy, 7.0% in Spain, 6.4% in France, 4.3% in the UK and 2.9% in Germany.
Chapter 5 – Special Chapter

Part 1: A closer look at European Non-performing loans (NPLs) stocks

The global financial crisis has seen a strong uptake in non-performing loans (NPLs) in banks’ balance sheets leaving policymakers worldwide concerned by this challenge. This trend has been exacerbated for some countries by the Euro Area crisis, particularly in Southern Europe, resulting in an EU-wide peak NPL ratio of 7.5% in 2012.

However, NPL ratio trajectories point to a significant decline across the European Union which can be attributed to enhanced loan selling activities of banks in recent years. In fact, as of 2017, the ratio for the EU stood just below the world average of 3.74%, at 3.7%, which suggests that NPLs are no longer a specific European problem.

Source: EBF, based on World Bank and IMF Data
European NPLs stock

The European Commission has identified three groups of countries within the European Union reflecting the differences in the intensity of the problem as follows:

- **Group 1**: low level of NPLs and no significant increase throughout the crisis
- **Group 2**: relatively low level, after a significant increase during the crisis
- **Group 3**: high level of NPLs

Cumulative NPLs levels reached a peak of more than €1 trillion in June 2016 across Europe stirring considerable scrutiny in the public sphere and placing pressure on policymakers to act. After 18 months, this amount has been reduced to reach around €800 billion, a nearly 25% reduction. However, a closer look to the composition of total NPLs reveals that only a fraction is really problematic.

At end-2017 the largest share of non-performing loans (€329 billion) is found in the category of Group 1 countries which includes major economies such as France, Germany and the UK. Although a large volume in aggregate numbers, the ratios are considered low and not uncharacteristic of the typical functioning of an economy. In Groups 2 and 3, nearly half of the NPL amount (€237 billion) is provisioned, meaning that a significant part has already been absorbed by banks.

Further an additional chunk of €266 billion contains either collateralized NPLs or non-covered NPLs accumulated in Group 2 and 3 countries. It is estimated that the real problem to tackle is a portion between €150 billion and €200 billion, which are those neither provisioned nor collateralized. In the end, the remaining amount is less than one fourth of the current NPLs stock.
European NPLs declining

![European Union non-performing loans and Euro Area non-performing loans](chart)

Source: Bloomberg based on ECB data. From September 2016, EBF based on EBA data.

On the whole, NPL stocks have decreased considerably in recent years due to fostered NPL disposals: Of the overall NPL disposals of €256 billion between end of 2015 and mid-2017, more than 60% can be attributed to countries of Groups 2 and 3. This has been made possible at growing rates due to several implemented reforms, notably in Group 3 countries where NPL accumulation was largely due to enforcement procedure length. Measures were taken to increase efficiency of insolvency procedures, an important step in the right direction although there still exists room for improvement, as well as to stimulate secondary markets which increased NPL outflow rates and reduced NPL growth.

With overall European NPL ratios being below the world average and in view of numerous recently initiated regulations on non-performing loans, including a new provisioning method in IFRS9, disclosure procedures and enhanced supervisory scrutiny in pillar 2, inevitably the question arises whether the objective of improving efficiency in NPL reduction processes can be met through additional burdensome regulations and transaction costs for banks.
Part 2: Financial technology

On a continuous basis, banks found new ways to create better customer experiences and streamline operational processes along many business lines. Banks have become both providers of technology as well as users, integrating advanced tools to improve the financial services offered to its clients, both in the corporate and retail business. According to Oliver Wyman, technology has grown to become 15–20% of the wholesale banking cost base¹. 62% of global banks expect to be digitally mature by 2020, compared with just 19% in 2018². Of the top 20 banks in Europe by assets, the average occurrence of the word “digital” in the annual reports was 55 times³. The number of recruitment adverts on IT and engineering roles at banks across the EU in the first quarter of 2018 was 11.4 times higher than in the same period in 2015⁴.

Across the financial industry there have emerged a wide range of innovative business models and startups that have enriched the sector while broadening the choice for the consumer; from payments to lending and from risk management to entire new financial ecosystems. According to Capgemini, in Europe more than 2,000 startups dedicate their business to financial technology, while globally more than 7,500 startups provide valuable solutions for the industry⁵. According to EY, fintech investments are surging, reaching €27 billion worldwide in 2017 alone, with €4.6 billion in Europe making this more than double the amount of a year before. More than half of this financing occurred in the business-to-business space⁶.

While technology adoption is providing many opportunities, new risks are also emerging. The physical appearance of banks might slowly be subject to change. Concrete examples of this include the way customers will be onboarded. Goode Intelligence states that by the end of 2020, some 1.9 billion bank customers around the world will be using biometrics and e-identification to access financial services. This will be facilitated by mobile bank adoption⁷.

Mobile banking and e-identification change the front of banking services, but the behind the scenes bank processes are transforming even more notably, in particular the way financial institutions are generating and managing digital data flows. Distribution of data and data exchange is changing radically boosted by EU regulations. Accenture states that 90% of bankers surveyed believe Open Banking will boost organic growth by up to 10%. In 2017 the number of banking APIs available for third parties to connect reached 1,500, up from only 17 APIs ten years ago⁸. Furthermore, the banking industry is leading the growth in big

Cybersecurity remains a top priority

Cyber threats are the single and most important risk to financial services today. Research indicated that enhancing cyber and data security is the number one priority for global banks. Increased interconnectedness between systems and new actors linking to the chain requires extra alertness on vulnerabilities. Fortunately, banks are not unfamiliar with protecting valuable assets. They did so for a long time. Artificial intelligence and advanced data analytics will be key in preventing cyber-attacks. The criminals behind the Carbanak and Cobalt malware managed to steal more than €1 billion from more than 100 financial institutions across 40 countries. Digital transactions in Europe were hit by 30% more cyber-attacks in the first three months of 2018 than in the first quarter of the previous year, according to Europol (2018) Mastermind Behind EUR 1 Billion Cyber Bank Robbery Arrested in Spain. Retrieved from: https://www.europol.europa.eu/newsroom/news/mastermind-behind-eur-1-billion-cyber-bank-robbery-arrested-in-spain

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AI is also expected to have widespread adoption in the banking sector. Some 67% of executives expect AI to result in a net gain in jobs within their bank in the next three years. Accenture states that between 2018 and 2022, financial services companies that invest in AI and human-machine collaboration could boost their revenue by an average of 32%. At the same time Accenture estimates that due to the adoption of new technology such as artificial intelligence, the need for human expertise to implement this will rise and potentially could increase employment levels of organisations by 10% between 2018 and 2022. Moreover, 77% of banks plan to use AI to automate tasks to a large or very large extent in the next three years.

More advanced technologies such as artificial intelligence and distributed ledgers are foreseen to have an impact in the near future. As of 2017, the financial services industry was spending about €1.5 billion per year on blockchain, according to Greenwich associates. IBM states that 91% of banks are investing in blockchain solutions. Moreover, banks are moving beyond the proof-of-concept stage and expect to roll out commercial distributed ledger technology products - 77% of financial services providers expect to adopt blockchain as part of an in-production system or process by 2020.

Cloud computing provides the means to make other digital solutions scalable and cost-efficient. Gartner predicts that by 2020, a corporate "no-cloud" policy will be as rare as a "no-internet" policy is today.

ActiveViam found in its research that banks’ IT budgets for public cloud projects will rise by 6-10% in the next two years. Simultaneously, 64% of banking respondents intend to migrate certain systems to public clouds in the next two years.

Data and business analytics solutions, in which revenues will surpass €180 billion by 2020. Banks are hiring data scientists and integrating tools running on artificial intelligence (AI), robo-advice and cloud computing. Such advancements are much needed considering the enormous amount of data generated each day. Cloud computing provides the means to make other digital solutions scalable and cost-efficient. Gartner predicts that by 2020, a corporate "no-cloud" policy will be as rare as a "no-internet" policy is today. ActiveViam found in its research that banks’ IT budgets for public cloud projects will rise by 6-10% in the next two years. Simultaneously, 64% of banking respondents intend to migrate certain systems to public clouds in the next two years.

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ThreatMetrix\textsuperscript{17}. Besides security governance, technology solutions education and awareness are crucial to prevent vulnerabilities of the financial system. BBVA indicated that 69% of European companies lack basic knowledge about their exposure to cyberattacks despite 80% of them having suffered some type of cyber-incident in the past year\textsuperscript{18}.


Chapter 6
Country-by-country overview

Austria

The Austrian economy has been in an upswing for several years now and has left the impact of the financial crisis behind. While in 2016 tax reductions stimulated private consumption, exports drove growth significantly in 2017. Moreover, the rising capacity utilization stipulates private investment. Gross domestic product (GDP) growth amounted to roughly 3% in 2017 and is expected to remain strong in 2018 and 2019.

The rising production has led to significantly higher employment. However, the unemployment rate will decrease only slightly and remains high compared to Austrian pre-crisis levels due to rising labour force participation of older people and women. Consumer price inflation is about 2% and therefore slightly higher than the average of the Euro area. The current account surplus will remain at approximately 2% of GDP.

The Maastricht deficit of the general government has been below 1% of GDP since 2017 and could switch to a surplus in 2019. Public debt, which had reached more than 80% of GDP following the great recession and restructuring measures of some banks, declined below this level in 2017. Due to the favourable economic conditions and the successful resolution of bad bank vehicles the public debt ratio will decline further in the coming years, but is expected to remain above the Maastricht-threshold for a longer period.

Austria has a highly developed banking sector. The Austrian banking network consists of nearly 600 banks (according to the Capital Requirements Regulation definition) with – besides the widely-used access to online banking – some 3,700 branches, making it one of the densest in Europe (2,400 inhabitants per branch). However, the trend towards self-service and online banking has induced a consolidation both of credit institutions and branches. Starting with the financial crisis, this development has accelerated since 2016. Since 2008 the number of employees decreased by 8.2% to 74,000 at year end 2017.

The Austrian banks’ geographical focus apart from their home market is Central Eastern and South Eastern Europe (CESEE).

The Austrian banking industry can be divided into seven sectors, namely joint stock banks and private banks, state mortgage banks, (originally rural) Raiffeisen credit cooperatives, savings banks, (originally commercial) Volksbanken credit cooperatives, building and loan associations and special purpose banks. The biggest sectors are the joint stock banks and private banks and the Raiffeisen sector. The joint stock banks, including the central institutions of the cooperative groups and savings banks, have Austrian as well as foreign shareholders. Only very few banks have a public entity as a shareholder.
Besides the dense network of branches, 90% of the population over 14 years old uses debit or credit cards. For some years the share of contactless debit cards, has continued to rise, and contactless mobile solutions which integrate the debit card into a smart phone have been rolled out. Notwithstanding, compared to a number of other European countries, significant parts of the population show a strong propensity to use cash, supported by the easy access via 8,700 ATMs free of charge.

In line with the global trend of deleveraging, the balance sheet total of the Austrian credit institutions has decreased since the outbreak of the financial crisis. At year end 2017 it was lower, by approximately one fourth, than in 2008, declining in 2017 by 2% to €815 billion. This reduction has been primarily caused by significantly shrinking interbank exposures and investments in securities. Deposits are the private households’ preferred way of holding financial assets in Austria. Insurance products are ranking second, albeit at significantly smaller volumes than deposits. They are followed by stocks and interest-bearing securities. Non-bank deposits have increased steadily over this period and amount to €403 billion in 2017. Loans to non-bank borrowers had remained more or less static in past years but have shown signs of an upturn recently. They amounted to €427 billion at year end 2017.

Low interest rates and the flat yield curve provide a very challenging environment to the Austrian banking industry. Despite shrinking net interest income, increasing commissions income and strict cost management provided better operating profits and profits after tax. The Common Equity Tier 1 (CET 1) ratio has grown steadily over recent years to approximately 15%, but this is still below the average of European peer banks. Therefore, a further consolidation, i.e. a continuing shift from branches to online and mobile banking as well as a reduction of employment, will take place.

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Belgium

According to the European Commission, after an increase of 1.7% in 2017, Belgian GDP is expected to grow by 1.7% and 1.6% respectively in 2018 and 2019. This is slightly more than in the previous three years (2014-2016), albeit somewhat lower than in the euro area as a whole. The policy to improve competitiveness, by reducing labour costs (including a major tax shift operation) supports exports and employment growth (employment grew by 1.4% in 2017, and the unemployment rate is expected to fall from 7.1% in 2017 to 6.3% in 2019). Investments are in a strong phase, in particular, equipment investments by companies. In a coordinated investment plan, the Belgian government is planning to pour investments worth several tens of billions of euros in the fields of energy, mobility, security, digitisation and health.

The Belgian banking community is characterised by a variety of players who are active in different market segments. BNP Paribas Fortis, KBC, Belfius and ING Belgium are the four leading banks (with a cumulated balance sheet on a non-consolidated basis of 62% of the sector total at the end of 2017) and offer an extensive range of services in the field of retail banking, private banking, corporate finance and payment services. In addition, a number of smaller institutions exist that are often active in a limited number of market segments.

A number of institutions have specialised in international niche activities, such as Euroclear (one of the world’s biggest players in clearing and settlement services) or The Bank of New York Mellon (custody). Of the 87 banks established in Belgium, 84% are branches or subsidiaries of foreign institutions, and only 16% have Belgian majority ownership. At the end of 2017, 13 credit institutions under Belgian law had 91 branches in 25 other countries.

At the end of 2017, the number of bank branches in Belgium amounted to 3,195. When adding the number of branches held by independent bank agents, this number reaches 5,896. The number of ATMs amounted to 13,732, including 8,235 cash dispensers. E-banking and mobile banking are on the rise: there were 12.1 million subscriptions for internet banking and 5.9 million subscriptions for mobile banking.

Banks in Belgium employ some 54,000 people, with 123,200 in the wider financial sector. The sector invests significantly in staff skills: almost 3% of total annual staff costs is spent on training.

At the end of 2017, the Belgian banks’ total assets (on a consolidated basis) amounted to €994 billion. Interbank claims account for approximately 20% of the total balance sheet. Loans to households also account for one-fifth of the total balance sheet, followed by investment in debt securities issued by financial and non-financial companies and public-sector entities (18%) and corporate lending to non-financial companies, taking up about 13% of the total assets. Some 66% of liabilities are client deposits (including debt evidenced by securities), mainly consisting of regulated savings deposits, sight deposits and term deposits.

The Belgian banking sector is essential for financing the economy and companies. In recent years, banks have relaxed their criteria for granting loans to companies. Credit demand of companies increased considerably as well. The volume of outstanding loans to non-financial companies rose to a record level in 2017. Medium and long-term loans, in particular, are on the rise. Companies want to make maximum use
of and fix the exceptionally low interest rates, driven by the ECB’s extremely accommodating stance. In addition, almost three-quarters of the loan volume taken out by companies is granted to SMEs.

Companies also use asset-based financial instruments, such as leasing, from independent leasing companies or the many banks that have leasing subsidiaries or provide lease financing themselves. Corporate financing in Belgium has become more diversified. The larger companies also rely directly on the financial markets (e.g. bond issues), with accompanying services provided by the banks.

A similar diversification of services occurs in the savings and investment segments. Belgian households had gross financial assets of €1,348 billion at the end of 2017, more than three times the value of Belgium's GDP. Belgian households, non-banking companies and public authorities together had around €525 billion in deposit accounts with Belgian banks at the end of 2017. Banks also offer a wide range of investment instruments and services, including asset management.

In the years following the 2008 banking crisis, the Belgian banking sector worked on its financial soundness, including through a phase of balance sheet deleveraging. The cost-to-income ratio fell from 72.1% in 2012 to 58.2% in 2017, indicating a significant improvement in cost efficiency. The return on average equity (ROE) has been around 10% in each of the past three years. The Liquidity Coverage Ratio and CET 1 ratio also remained robust in 2017, at 140.1% and 18.3% respectively. Finally, credit quality is solid, with an impaired claims percentage of 2.8% at the end of 2017.

The sector is aware of the major challenges ahead. The climate of continuing extremely low interest rates increases the banks’ focus on adjusting their business models, including in terms of distribution channels. At the same time, digital applications are picking up speed, a development that is being met with substantial investments. Emphasis is put on shifting services from the traditional branch network to digital banking via online channels and banking applications. FinTech has become an important issue, and the Belgian financial centre is taking many notable initiatives such as Start It@KBC, ING Fin Tech Valley, Co.Station and The Birdhouse among others.

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Bulgaria

Driven by private consumption, exports and business investments, in 2017 the Bulgarian GDP recorded real growth of 3.6% on an annual basis. The pace of growth was slower compared to the growth of 3.9% in 2016 but, nevertheless, it was above the average for the EU.

In 2017 the unemployment rate declined to 6.2%, remaining at its lowest level since 2008 when it was 5.6%. 2017 was the first year with inflation since 2012. The average annual change of the Harmonised Index of Consumer Prices (HICP) in Bulgaria was 1.2% compared to -1.3% in 2016.

In 2017 the banking system showed solid resilience, sound capital adequacy, high profitability and stable growth in the context of the rising credit portfolio and attracted deposit resources. This was supported by the favourable condition of the Bulgarian economy, the low level of unemployment and rising incomes, despite the effects of the low interest rates and the heavy regulatory environment in the banking system.

As of 31 December 2017, there were 27 banks operating in Bulgaria, five of which were foreign banks’ branches. The top five banks held approximately 55.9% of all assets in the banking system. At the end of 2017 the market share of domestic banks and those of the EU subsidiaries remained unchanged at 23.5% and 72.9%.

Changes in the ownership of some banks were observed in the last year and in the beginning of 2018. In 2017, the Belgian bank KBC, the sole shareholder in the second-tier bank CIBANK finalised a deal to acquire the National Bank of Greece’s Bulgarian subsidiary United Bulgarian Bank (UBB), which was in the first group of banks. The merger took place in February 2018 and the new bank ranked third in terms of assets.

The volume of cashless payments has been growing steadily. More specifically, between 2014 and 2016 the number of card payments increased by 44%, and the amount of card payments increased by 38%, while the amount of card payments initiated through virtual POS terminals grew by over 20%. In 2016, more than 50% of credit transfers were initiated electronically by users, which represents two thirds of the total value of all credit transfers. According to preliminary data from the Bulgarian National Bank (BNB – the Central bank of Bulgaria) for 2017, these trends have been maintained.

In 2017 banks’ total assets increased by 6.2% year-on-year to €50 billion (BGN 97.8 billion). The share of loans and advances increased to 61% compared to 60.7% at the end of December 2016. The share of cash rose to 19.9% from 19.7% and the share of securities decreased to 14.3% from 14.7%.

The loan portfolio of the banking system grew at a moderate pace due to the favorable economic environment and the low interest rates on loans. The BNB’s interest rate statistics for 2017 registered a continuing decline in the average interest rates on new loans in all sectors and currencies.

The total amount of loans outstanding to the non-government sector (non-financial corporations and households), increased by 3.3% on annual basis reaching €25.93 billion (BGN 50.71 billion) in comparison with the reported growth of 1% in 2016, according to the BNB monetary statistics.

In the last year the outstanding loans to non-financial corporations, including small and medium-sized enterprises (SMEs), representing 99.9% of all enterprises in the country, increased by 1.7%, reaching €15.9
billion (BGN 31.08 billion). By sectors, the highest amount of loans and deposits were in the trade, manufacturing and construction industries.

Deposits held by banks continued to grow, although with a slower pace. As of the end of December 2017 they reached €37 billion (BGN 72.383 billion), or 73.8% of GDP, despite the low interest rate levels. Approximately two-thirds of the deposits were held by the household sector (66.1%).

The active efforts of the banks for optimizing their portfolios led to a gradual decline in the share and the amount of non-performing loans (NPLs). As of 31 December 2017, the amount of NPLs (excluding Central Banks and credit institutions) declined to €2.89 billion (BGN 5.65 billion) in absolute terms, or to 10.07%.

Total operating expenses decreased by 0.7% on an annual basis to €914.7 million (BGN 1.789 billion). As of the end of 2017 the cost/income ratio increased to 46% from 43.2% a year earlier, remaining below the EU average.

Net interest income declined by 4.6% year-on-year to €1.37 billion (BGN 2.675 billion). Net income from fees and commissions grew by 8.1% to €509 million (BGN 995.7 million).

The net profit of the banking system increased by 9.1% in 2017 to €600.3 million (BGN 1.174 billion) compared with 2016 where there was a one-off effect arising from the deal between Visa Europe and Visa Inc. which affected the net profit for 2016.

As of the end of 2017 the total capital adequacy ratio increased from 20.88% to 22.08% on a system level. The CET 1 of the banking system remained unchanged at 20.41% compared to a year earlier. The liquid asset ratio accounted for 38.97%. The ROA and ROE were 1.2% and 9.32%, respectively.

In 2017 the banks paid €68.7 million (BGN 134.3 million) as a corporate tax, which represented 5.8% of all corporate tax revenue in 2017.

As of the end of 2017, 63,700 people were employed in the financial sector, as approximately half of them were in the banking sector.

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Croatia

Croatian GDP growth slowed in 2017 to 2.8%, versus 3.2% in 2016, in line with consensus expectations at the beginning of 2017. Despite financial issues related to Agrokor - a conglomerate, largely centered in agribusiness, with headquarters in Zagreb - the main drivers behind such a performance were a record tourism season, stronger private consumption, robust EU trade partners’ demand and favourable funding conditions. That said, private consumption rose by 3.6% driven by the tourist-related spending, strong wage growth, rising employment, lower savings rate and citizens’ re-leveraging.

Despite strong business optimism, higher firms’ profits, price competitiveness gains and cheap capital, investments surprised on the downside, reflecting halted capital expenditure (related to Agrokor and its economically intertwined companies), accompanied by some EU funding under performance. Net trade contributed negatively to the GDP growth against the background of stronger import-intensive domestic demand.

Croatia ended 2017 with a small budgetary surplus just above 0.5% of GDP due to cyclically stronger tax revenue, a positive impact from tax reform, general spending restraint and capital expenditure under-execution. Stronger HRK and faster nominal GDP growth combined with one of the strongest fiscal deficit reductions in two years in the CESEE and interest bill cuts have brought about further decline in public debt to 78% of GDP.

We expect the Croatian National Bank (CNB) to hold its easing policy, maintaining hefty Kuna liquidity and bringing down the Kuna yield curve as well as liquidity costs for banks. From a risk perspective, monetary easing is allowed by banks’ strong external positions, steady foreign exchange outlook and reduced fiscal risk.

Currently 25 banks and five housing savings banks operate in the market. The top six banks hold roughly 80% of market share by assets. Banks assets declined to 110% of GDP in 2017 (from 114% in 2016) on the back of strong government deleveraging and accelerated non-performing loan (NPL) sales. That said, the sales of NPLs intensified during the year amounting to HRK 8.4 billion of sold claims, resulting in NPL ratio decline by 2.4 percentage points to 11.4%.

Foreign ownership in the banks is prevailing with 90% of assets under the control of 15 foreign-owned banks, while only three banks are still state-owned (6% assets). The rest are locally owned private banks.

In terms of infrastructure, the numbers of ATMs, EFTPOS terminals and internet users are constantly growing while the brick outlets network continues to shrink slowly. There are 1.2 ATM and 28.8 EFTPOS terminals per 1,000 inhabitants and 0.27 brick outlets per 1,000 (1 per 3,710). There are two payment cards per inhabitant on average.

Gross loans decreased by 4.2% in 2017, with public sector (-21.4%) the main drag after state road companies’ bank debt was swapped with a much cheaper €1.25 billion Eurobond. Notwithstanding higher business optimism and easier SME credit standards, the corporate loan book fell 1.3%, largely due to NPL sales (HRK 6.2 billion) but also due to lower disbursements, as a result of Agrokor-related uncertainty along with a €530 million life-line to Agrokor in June that effectively lowered local demand for working capital loans. Retail re-leveraging (up 1.8%) due to a stronger labour market, consumer sentiment and in turn demand for non-purpose loans. Housing loans soared in the second half of the year thanks to state
subsidies. Private sector lending thus displayed only a modest 0.5% year-on-year growth under strong impact of NPL sales, while excluding this effect the actual private credit growth, i.e. performing portfolio, reached 4.7% year-on-year.

Deposit growth decelerated to 3.2% year-on-year (versus 4.7% in 2016). The strongest positive contribution came from corporate deposits (9.0% year-on-year) due to another record tourist season and stronger firms’ profits. Growth in household deposits was modest (1.2% year-on-year), reflecting low interest rates offered on savings.

Regarding profits, net interest income increased 1.4% year-on-year supported by a significant drop in funding costs (-32.6%) which managed to compensate for lower interest income. Agrokor financial restructuring forced higher provisioning costs (51.2% year-on-year), resulting in strong pre-tax profit deterioration (-29.2% year-on-year) and higher cost of risk (up 63 basis points year-on-year).

Bank capitalization remains among the highest in the EU, with the capital adequacy ratio consistently above the 20% threshold, most recently at 23.2%.

Key initiatives of the Croatian banks are related to further NPL resolution, in the context of still very high NPL level, especially in the corporate sector (22.3%). However, the banking system still lacks clear criteria for automatic NPL resolution. That said, the potential starting point could be to follow up on write-offs executed in 2017, in order to analyse the effects of temporary regulation and suggest modifications to the existing income tax legislation, with the aim to establish a permanent and efficient procedure for write-offs in terms of tax deductibility that would balance the interests of creditors and debtors.

Settling the disputes related to forced Swiss Franc loan conversion and deposit insurance reform, in order to bring it in line with the EU average, and cut the cost of regulation, remain high on the agenda. Furthermore, the Croatian banking sector has to bring a plethora of regulation into line with EU standards, on the other hand, and reduce the cost of regulation on the other.

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Cyprus

Two years after the successful conclusion of the economic adjustment programme, economic recovery has been concluded and the economy is in an increased growth phase. Real GDP growth reached 3.9% in 2017, up from 3.4% in 2016, exhibiting one of the best performances in Europe. Growth has been broad-based across nearly all economic sectors, while many leading indicators of economic activity (e.g. credit card use, economic sentiment, property transactions, a new record in tourist arrivals) point to a continuation of expansion at a solid pace (projected to be 3.6%) in 2018.

Unemployment in Cyprus, although still above the euro area average, has continued to decline to 11.1% in 2017, and fell below 10% in early 2018. In the first quarter of 2018 the number of registered unemployed has declined at a faster pace than in previous quarters, while the continuation of growth is expected to be reflected in further improvements in labour market conditions.

During this period, banks have contributed towards Cyprus’s successful performance after the conclusion of the economic adjustment programme, having managed to restore, gradually, credibility, restructure operations and procedures, and overcome challenges to finance new viable projects and investment opportunities. At the same time, banks have had to comply with an ever-increasing number of supervisory and regulatory requirements.

The banking sector in Cyprus comprises domestic banks and international banks with Cyprus-based subsidiaries or branches. Beyond the traditional deposit and lending services, banks in Cyprus operate under the universal banking model as they offer a diverse range of products and services. Deposits from customers have traditionally been the main source of funding for banks and that element remains stable for the local banking sector.

There are 36 authorised credit institutions in Cyprus, consisting of eight local authorized credit institutions, three subsidiaries of foreign banks from EU Member States, two subsidiaries of foreign banks from non-EU countries, six branches of banks from EU Member States, 15 branches of banks from non-EU Member States and two representative offices.

Within the framework of the European Banking Union, since November 2014, the Bank of Cyprus, Cyprus Cooperative Bank, Hellenic Bank and RCB Bank, were among the European credit institutions that came under the direct supervision of the ECB, as part of the Single Supervisory Mechanism (SSM) provisions, whereas the subsidiaries of Greek banks are supervised by the SSM as their parent banks are systemic in their home country.

All banks are adhering to the SEPA direct debits’ scheme, administered by JCC Payment Systems (a national card acquirer).

A law transposing the revised Payment Services Directive (PSD2) was enacted in April 2018. The banking sector, through the Association, has been undertaking preparations for the past two years in order to deal with payment innovations that will be brought by open Banking and instant payments as well as with the necessary increased payment safety.

As at the end of 2017, there were 458 branches in Cyprus (compared to 542 in 2016) and banks employed a total of 10,627 employees. Banks provide a widespread ATM network as well as mobile solutions,
contactless transactions and smart device applications to customers, while they continuously upgrade their online banking sites.

During 2017, aggregate bank deposits slightly increased by €400 million (a 0.8% increase), as confidence gradually returned. Bank deleveraging is continuing at a slower pace compared to previous years. Total outstanding loans were reduced by €4 billion throughout 2017 (a 7.2% decrease from the end of 2016). At the same time, the high level of NPLs remains the greatest challenge faced by the banking sector and towards this goal, great efforts are directed to restructure and clean up banks’ balance sheets.

The financial education programme “More than Money”, launched during 2016 in primary schools across Cyprus, was further expanded into more schools and students in the country in 2017. The project is run as an initiative of the Association and its member banks and is aimed at familiarising primary school pupils with concepts related to money management. The programme is implemented by the organization “Junior Achievement” (Cyprus) and is under the auspices of the Ministry of Education and Culture.

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The GDP growth, following a temporary slowdown in the previous year reached 4.6%, without posing any greater threat to macroeconomic or financial stability. The general government’s economic management in the election year – despite the planned budget deficit - ended with a surplus of about 0.06 % of GDP, the balance of payments current account also ended with a modest surplus at the year end, and unemployment in December 2017 fell to 2.4%, making it increasingly difficult for entrepreneurs to find workforce in the tight labour market.

The Czech banking sector has continued to deliver a high degree of stability despite all the challenges as has been repeatedly confirmed by the results of the demanding stress tests carried out by the Central Bank. Its aggregate capitalisation exceeds by almost 3 percentage points the regulatory capital requirements, and although the total capital ratio of banks slightly increased to 19.25% and is slightly below the EU average, almost 97% of the capital is made up of the highest quality Tier 1 capital – in that the Czech banks are above the EU average. The Czech Republic has a comparatively low share of non-performing loans (NPLs). According to the European Banking Authority (EBA), compared to the previous year the NPL ratio has dropped further to 1.6% and was thus the fifth lowest among EU Member States, while the coverage ratio of NPLs by allowances was 62%, the third highest.

By the end of 2017, there were 46 licensed banks. The structure of the banking sector consists of four large banks, five medium-sized banks, nine small banks, 23 branches of foreign banks and five building societies; 38 entities are under the control of foreign owners including 14 banks and 23 branches. Domestic owners control nine banks, two of which are banks with state participation.

Towards the end of 2017, the total value of the banking sector's assets amounted to CZK 7,009.6 billion, which is a year-on-year increase of 17.6 %. To match up the situation mechanically with the previous period, when the 2016/2015 year-on-year increase reached already a high 9%, would be misleading. A substantial part of the growth of banks' assets occurred during the first quarter of 2017 in a period of increasing expectations that the Central Bank of Czech Republic (CNB) would end its exchange rate commitment which had lasted for four years. The banking sector's assets thus represented almost 140% of GDP at the end of the year.

Compared to the previous year, net profit for the year 2017 slightly increased to approximately CZK 75.9 billion. Return on equity reached 15.6% and return on assets amounted to 1.09%.

The healthy banking sector managed to boost economic growth through the supply of loans also in 2017, under the tightening regulation and the increasing competition not only among banks, but also, to an increasing extent, of fintech companies.

By the end of 2017, the value of bank loans in the Czech economy grew by 4.6%, amounting to CZK 3,085.5 billion. At the end of the year, households had CZK 1,437 billion in loans, 8% more than a year earlier, and loans to the corporate sector amounted to CZK 1,022 billion, with a year-on-year increase of 4.7%.

2017 was a boom year for household lending. Households drew down new housing loans from banks and building societies worth CZK 346.4 billion in 2017, only 2% more than in 2016. Bank consumer loans grew even faster - households borrowed CZK 118.1 billion in 2017, 12.8% more than in 2016. The central bank’s stricter macroprudential recommendations for mortgages began to apply during 2017, requesting that the
average value of LTV in a lender’s portfolio should not exceed 80% and in individual cases it should not exceed 90%. The share of new mortgages with an LTV between 80% and 90% should not be higher than 15% of newly granted mortgages in a given quarter.

Enterprises drew down CZK 457.9 billion in new loans during 2017, 10.3% less than in 2016, which had already been a weak year. 2017 showed not only the tendency of enterprises to invest primarily from retained profits of the previous period, but also a tendency to wait for new EU grant calls to be made.

By the end of 2017, the value of deposits stood at CZK 4,169.1 billion and exceeded loans by approximately 35%. The excess of deposits compared to loans has been traditionally generated by the household sector, where households have deposited 65% more funds on deposits with domestic banks than they had drawn in loans. In the corporate sector, the value of deposits and loans is approximately balanced.

Although the excess of deposits, compared to loans, implies a relatively low dependency of banks on inter-bank financing, it also limits the efficiency of monetary policy. At the same time, it is also a challenge, so far ignored, for the synergic use of cohesion financial instruments in the form of guarantee schemes, which would be able to unlock up to CZK 10 in private loans per CZK 1 of public funds, thus contributing to at least a partial absorption of this excess.

By the end of 2017, households had deposited CZK 2,370.2 billion in banks, 7.3% more than last year. More than 75% of the total was in demand deposits. By contrast, the volume of fixed term deposits at the end of the year fell by 8%, to CZK 550.4 billion. With interest rates being still low, people preferred the immediate availability of deposited funds, among other things, for partial financing of investments into their own housing.

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Denmark

The Danish economy has been improving steadily during the last few years. The economy has entered an expansionary phase with mounting pressure on the labour market. The economy is well prepared for the expansion and is growing at a sound pace without any visible build-up of imbalances at the aggregate level.

The composition of Danish credit institutions has been evolving over the last decades. Primarily owing to the continuing consolidation of the Danish financial sector, the number of banks and mortgage institutions has declined from approximately 190 in 2000 to 74 in 2017, where 67 are banks and seven are mortgage banks.

In 2016, 37,155 people were domestically employed in the Danish banks compared to 40,907 at the end of 2000. The Danish banking sector is characterized by a few large international groups and many small institutions.

The Danish banks were managing assets of €512 billion at the end of 2017, while the Danish mortgage institutions manage assets of a similar amount; in 2017 these amounted to €529 billion. The total assets for the whole industry thus constituted €972 billion.

The special Danish mortgage system is a defining component of the financial sector in Denmark. Danish mortgage bonds are securities with high credit quality and very high liquidity.

Since the beginning of the financial crisis, the Danish banks have gradually recovered. They paid negative return on equity in 2008 (-2.6%) and in 2009 (-6.5%). The figure has since improved, and the return on equity was 14.2% in 2017 (excluding Nordea’s Danish banking activities and other foreign entities). The increase in earnings is primarily driven by lower costs, extraordinary income and lower levels of impairment, due to the fact that the economy has entered an expansionary phase.

Danish banks’ earnings are, however, challenged by low net interest income which is under pressure from subdued demand for new loans and the extraordinarily low level of interest rate. In the autumn of 2017 approximately 50% of deposits to businesses were on negative interest rates.

Overall, the Danish banking sector is robust, and banks have increased their capitalisation since the beginning of the financial crisis. The Danish banking sector had an overall solvency ratio of 23.8% in 2017, which was 10 percentage points higher than in 2008. In addition, the core capital ratio rose from 10.8% in 2008 to 21.3% in 2017. The Danish banking sector has also proved to be well-capitalised and resilient in the stress tests conducted by the EBA.

Banks and mortgage banks are not required until 2019, to meet a number of capital and liquidity requirements that have followed in the wake of the crisis. Nevertheless, many Danish banks and mortgage banks opted to fulfil the requirements already in 2014/2015. In doing so, the Danish financial sector has played an active role in making the financial system safer at a faster pace than was originally intended by the authorities.

The financial sector plays an important role in the digitisation of Denmark. Thus, in recent years, the Danish fintech community has been quite successful, and Copenhagen was ranked sixteenth in Deloitte’s global fintech hub review 2017, and seventh in Europe. The strong position was consolidated by the establishment
of the Copenhagen FinTech lab in the autumn of 2016. Denmark is recognized as a digital pioneer country in the financial sphere, a position that has in part been achieved through collaborations between the public and financial sectors.

Finance Denmark supports the EU’s transition towards a more sustainable economy. Already today, the Danish financial sector contributes actively to financing a sustainable transition in several areas. By international standards, Denmark has made great progress towards becoming a sustainable society, only Sweden ranks higher in the UN’s SDG Index, which shows how countries deliver on the 17 sustainable developments goals.

With Money Week, Finance Denmark and Danish banks put focus on personal finance in the municipal primary and lower secondary schools. The purpose of Money Week is to teach children and young people personal finance terms such as interest rates, loans and budgets and to prepare them to take responsibility for their own personal finances so that they avoid getting in financial trouble.

More than 16,000 pupils - or more than one in ten Danish pupils of the targeted age - participated in the Danish Money Week 2018. Sessions on financial literacy, how to budget and save and generally take care of personal finances were given by teachers and more than 700 guest lecturers.

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The Estonian banking sector consists of 16 banks of which eight are licensed credit institutions in Estonia and eight are operating as branches of foreign credit institutions. Banking sector assets constitute €25.2 billion equivalent to 110% of Estonian GDP. The Estonian banking sector is dominated by Scandinavian banking groups holding 90% of banking sector assets.

The market is chiefly divided between Swedbank, SEB Bank and Luminor Bank. LHV Bank, the largest bank based on local capital, holds 7% of banking sector assets. Banks serve 2.2 million customers through 74 bank branches. Estonian customers operate 1.8 active current accounts per inhabitant and 1.25 active internet bank accounts per inhabitant. Estonian banks have issued 1.4 bank cards per inhabitant, 80% of issued cards are debit cards, and 20% credit cards. 60% of retail payments are initiated by bank cards and more than 99% of payment orders have been initiated electronically since 2009. Only 4% of the population receives income entirely or partially in cash.

Banks hold €16.9 billion worth of deposits and operate loan portfolios to the value of €18.1 billion. Loan and lease portfolios of banks grew rapidly in 2017. The banking sector is mainly funded through the deposits of resident clients, though financing from Scandinavian parent companies plays an important role in the funding of some banks. A similar amount of profit was earned as in the previous year, and most banks continued to have high levels of own funds. Changes to income tax law encouraged the banks to pay out more in dividends, and so the capitalisation of the banks will fall in time as their assets increase.

Bank deposits continue to grow faster than debt liabilities - the bank deposits of households rose 10% in 2017. The rise in incomes and in employment has meant the saving rate of Estonian households has been quite high in recent years.

The average interest rates on new loans did not change substantially in 2017. The average rate for long-term corporate loans issued in December was 2%. The average interest rate for new housing loans was 2.3% by the end of the year.

The quality of the loan portfolio remained good. The value of loans overdue by more than 60 days was 0.3 percentage points lower than a year previously, when it was at 0.8% of the loan portfolio.

Housing loans account for about 40% of the loans to the non-financial sector, which is slightly above the average for the countries in the EU, but as a share of total assets, the volume of these loans is one of the largest in the EU. This reflects the universal banking model used by banks in Estonia, the concentration of the domestic market and the preference of households for home ownership over renting. It also indicates that the operations of banks in Estonia are less diversified than is the average for the EU. Credit growth continues to be supported by very low base interest rates and by the relatively strong competition in the corporate loan market, which has kept interest margins low.

The profitability of the Estonian banking sector has been among the strongest in the countries of the EU. The Estonian banking sector is relatively cost-efficient, which may be partly because the expenses of the local units of foreign banking groups can be reflected at group level rather than local level. Profitability is
also aided by smaller loan losses than in other countries and quite large spreads between interest income and interest expenses. Net profit earned in 2016 was €335 million. Profit was mainly aided by the growth in the loan portfolio, which raised interest income, and by the good quality of the portfolio.

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The Finnish economy grew at a rapid pace on a wide front. The GDP grew 3.2% in 2017 after a decade-long recovery from the financial crisis.

Exports are finally fuelling growth, while domestic demand also continues to be high. Companies are investing in machinery and equipment, in addition to construction. Consumer confidence improved to a record level which boosted consumer spending, supported by favourable employment development. Government target to reach 72% employment level is close to being achieved.

Strong economic conditions have also improved public finances. The general government deficit shrank to 1.1% of GDP in 2017 and the public debt/GDP ratio will continue to decrease and is expected to come down below 60% by next year. The better economic situation will not, however, resolve the longer-term problems with the ageing population.

Finnish banking market is dominated by four large groups, which together hold 81.0% of the market. These four groups are deemed as domestically significant institutions (O-SII) and are directly supervised by the ECB. Smaller domestic retail groups, like the Savings Banks group and POP Bank group and other small domestic banks, are under the supervision of the Finnish Supervisory Authority.

The biggest group is the OP Financial Group, with 35.5% market share. The group consist of 160 cooperative banks. The second largest group is Nordea with 26.4% market share. In January 2017, the Finnish subsidiary of Nordea merged into the Swedish parent bank and became a branch in Finland. By the end of 2018 Nordea will move its head office from Stockholm to Helsinki and will become the first globally significant institution (G-SIB) domiciled in Finland. Through Nordea’s decision, the Finnish banking sector will grow to over three times the size of its gross domestic product. However, the foreign ownership will drop significantly.

All the other credit institutions are privately owned except Municipality Finance which specialises in financing the Finnish public sector. Danske Bank and Municipality Finance are nearly equal in terms of their balance sheets and market shares, 9.5% and 9.6%, respectively. Danske Bank turned its Finnish subsidiary as a branch in Finland at the end of 2017.

According to the European Commission Digital Economy and Society Index (DESI), Finland ranks third after Denmark and Sweden. Already 96% of people aged 25-54 years pay bills online and especially younger people use mobile phones for payments.

Contactless payments are increasing rapidly. Almost every Finn (97%) has a payment card (debit and/or credit) and 64% of cards include contactless payment facility. In 2015 the share was 22%.

The housing market has been on an upswing. The value of new housing loans rose by 1.6% year-on-year. At the end of 2017, the total housing loan portfolio stood at €96.1 billion (43.0% of GDP), after growing by 2.2% during the same year. Demand growth is expected to accelerate in 2018 driven by, among other things, positive economic and employment prospects, strong consumer confidence and the low interest rate environment.

At the end of 2017, an average of two thirds of banking groups’ funding consisted of non-MFI deposits. However, the shares vary greatly between credit institutions: some fund their operations almost entirely
with deposits while some, especially mortgage credit institutions, only issue covered bonds. Around one third of mortgage loans are funded by covered bonds.

Lending to corporates increased by 4.3 % on an annual basis. The growth was mainly due to boom in construction sector, especially to housing corporations. Green bonds have been issued in Finland since 2016. While issuance remains low, sustainable finance is gaining momentum through market-led initiatives as well as strong political commitment to support low-carbon society.

The capital adequacy of the Finnish banking sector remained strong. At the end of 2017, the overall capital adequacy ratio was 23.4%. The Common Equity Tier 1 ratio (CET1) stood at 21.0%. The leverage ratio improved to 6.8%.

Operating profits slightly increased from the previous year. Net interest income continues to be the banking sector’s most substantial source of income, even though on average, its share of banks’ total returns has fallen in recent years. Banks have continued diversifying their business models and have received more income from asset management, trading activities and insurance services.

Operating costs continued to grow and were 9% higher than in 2016. Personnel expenses remained unchanged and the increase was due to other operating expenses such as development projects and IT costs. In recent years, banks have invested heavily in digitalisation and service development. In the long run, efficiency will increase and cost will decrease due to higher automation.

Non-performing loans have remained low and were 1.4% of total loans.

The banking sector’s short-term liquidity position was strong. Liquidity Coverage Ratio stood at 138% at the end of the year. The liquidity buffer totalled €40.6 billion and consisted mainly of central bank’s reserves (56%) and extremely high-quality covered bonds (17%).

The financial industry continued to be a significant taxpayer to the Finnish economy. Corporate tax contribution was €651 million, i.e. 11% of the total annual corporate tax revenue.

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France

The French economic situation is improving steadily. GDP growth recorded a marked acceleration of 2% in 2017, after 1.1% in 2016. Domestic demand has been the main growth driver in recent years, but signs of a pick-up in exports are appearing for 2018, supported by a stronger external demand and a more dynamic industrial activity in France. Investment (by both corporates and households) is dynamic and supported by improving activity and employment prospects in a context of low interest rates and ample credit supply, as well as economic policy measures (tax reforms have improved corporate margins). The structural reform agenda developed by the government covers a wide range of areas (labour law, education and employees’ training, pension and unemployment regimes, public expenditures and entities) and will contribute to a higher potential growth, as already shown by stronger business climate indicators. Government deficit and debt remain at a high level in 2018, forecasted by the French Government at -2.6% (below the 3% Eurozone threshold) and 96.8%, respectively.

The banking sector is one of France’s six main economic assets, according to the OECD. As of January 2018, the French banking industry numbered 347 banks. According to the European Banking Authority (EBA), three French banks are among the seven euro area Global Systemically Important Banks (G-SIBs). Financial activities account for 4.1% of total value added in France, of which approximately 60% for the banking industry. The banking industry employed more than 366,200 people at the end of 2017, representing 1.9% of the private workforce in France, and recruiting more than 42,200 in 2017, while overall banking employment decreases at a very moderate pace (-1.2% in 2017).

The results of the combined asset quality review and stress testing, conducted by the EBA and the European Central Bank, demonstrated the high level of capitalisation of French banks. The aggregate common equity Tier 1 capital (CET1) of French banks was 13.8% at the end of 2017.

The six largest French banking groups, which operate according to the universal banking diversified model, reported a strong financial performance in 2017. Total net banking income reached €146.4 billion (up 0.5% compared to 2016), of which retail banking accounted for 66%. Group net income was €23.9 billion (down 1.9%).

Banks finance business development, as well as individuals, very dynamically in France. Credit is one of the main drivers of growth. At the end of March 2018, outstanding loans to the economy stood at €2,314 billion, up 5.5% year-on-year.

Outstanding loans to businesses stood at €974 billion at the end of March 2018, up 5.4% year-on-year, while the euro area rose by 2.2% on average. Outstanding loans to investment were the most important segment, at €689 billion (up 6.4%).

Loans to SMEs accounted for 42% of total loans granted to businesses in March 2018 and rose by 3.5% year-on-year. Access to credit is high: 95% of SMEs investment loans and 85% of cash credits applications were accepted in the first quarter of 2018. Credit demand remains stable: only 23% of SMEs sought an investment loan and 7% requested cash credits.
French banks also actively finance French consumers. Outstanding household loans reached €1,170 billion at the end of March 2018, up 5.9% year-on-year. Most household loans were housing loans, representing €963 billion (up 5.7% year-on-year).

The French lending model is both dynamic and sound. The level of non-performing loans is very low (3.1% at the end of 2017) as is the cost of risk (€8.4 billion in 2017, down 18.0% year-on-year).

Diversification of corporate financing is developing very rapidly in France. Markets account for 39% of corporate financing, compared with 31% in 2009. French banks also have a large and efficient investment banking activity.

French banks’ investments, innovation and leading role in the fintech ecosystem make them the natural leaders of the digital financial movement in France. Banking applications for smartphones and tablets rank third among the most used by French people, after the weather forecasts and social networks, according to survey company Opinion Way. Some 1.2 billion contactless payments were made in 2017 (up 102.9% compared to 2016) for a total of €12.4 billion (up 98.6% compared to 2016).

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Germany

The German economy is facing the fifth consecutive upswing year. Although economic momentum slowed somewhat in the first quarter of 2018, overall economic output should nevertheless increase by a little by more than 2% on an annual average. Domestic demand remains robust. It is supported by continued employment growth and decent real wage increases. However, the increasing shortage of skilled workers, persistently high geopolitical uncertainties and concerns about escalating trade disputes are having a braking effect on the economy.

Germany’s banking system comprises three pillars — private commercial banks, public-sector banks, and cooperative banks — distinguished by the legal form and ownership structure.

The private commercial banks represent the largest segment by assets, accounting for 40% of total assets in the banking system. An important feature of the private banks is that they compete keenly not only with banks in other sectors of the industry, but also among themselves. The private banks play a key role for the German export economy, they are involved in 88% of German exports and maintain almost three quarters of the German banking industry’s foreign network.

The public banking sector, comprising savings banks (Sparkassen), Landesbanken and DekaBank, which acts as the central asset manager of the Savings Banks Finance Group, representing 26% of total banks’ assets. There are currently about 400 savings banks. They are normally organised as public-law corporations with local governments as their guarantors/owners. Their business is limited to the area controlled by their local government owners. Other than this regional focus, their business does not differ in any way from that of the private commercial banks. As a result of the so-called regional principle, savings banks do not compete with one another.

Landesbanken were originally designed to act as central banks for the savings banks. In recent years, however, they have been increasingly involved in wholesale funding, investment banking, and international business activities, thus directly competing with commercial banks. The eight Landesbanken at present are owned by the federal states and the regional associations of the savings banks.

In the past, savings banks and Landesbanken were backed by state guarantees (Gewährträgerhaftung and Anstaltslast). The state guarantees were of key importance to Landesbanken since they enabled them to obtain AAA ratings and lower their funding costs. These guarantees ended in 2015, however. Current German law does not allow privately owned banks to have stakes in publicly owned banks (like most savings banks). However, some Landesbanken and savings banks have bought private banks. The level of public involvement in the system therefore continues to be much higher than in other countries of the EU.

The cooperative sector consists of around 900 cooperative banks (Volks- und Raiffeisenbanken) and one central cooperative bank (DZ Bank AG). It accounts for 50% of institutions by number and 17% of total bank assets. The cooperative banks are owned by their members, who are usually their depositors and borrowers as well. By virtue of their legal form, cooperative banks have a mandate to support their members, who represent about half of their customers. But cooperative banks also provide banking services to the general public. Like the savings banks, cooperative banks have a regional focus and are subject to the regional principle.

The number of banks in Germany has dropped sharply in recent years, and by 52% since 1995. Consolidation to achieve economies of scale has taken place largely within the existing pillars. Most consolidation in the savings bank and cooperative sectors (contrary to mergers in the private sector) has been the result of stress rather than proactive business considerations. Pressure to further consolidate in the coming years stems from the low interest rate environment and banking regulation in recent years such
as Basel III which increased banks’ capital requirements substantially. German banks fear that real estate and corporate finance could be particularly affected and could seriously restrict banks’ lending capacity.

Nevertheless, accompanied by low interest rates and the overall extraordinarily favourable financing conditions, lending to companies and the self-employed increased to €886 billion in 2017, up by 3.7% on the previous year. Due to the German Energy Transition and the new EU Action Plan “Financing Sustainable Growth”, banks have launched many initiatives in recent years to promote sustainable financing.

The very low and partly negative interest rates at present decrease profit opportunities for banks and increase the risk of distortions and price bubbles as well as the danger of zombie banks and firms. For banks in the euro area the negative deposit rate of the European Central Bank is a special tax with monthly tax earnings of around €500 million. In order to limit the side effects of the negative deposit rate, the Association of German Banks proposes an amount of exemption for the excess liquidity holding at the ECB by commercial banks.

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Greece

After an eight-year period of deep and prolonged recession, with the brief interval of anemic growth in 2014, Greece’s economy started to grow confidently again in 2017. Greece’s real GDP grew by 1.4% in 2017 compared to 2016, driven mainly by a 6.8% rise of exports and a 9.6% increase in investment. In 2017, the general government primary balance is estimated to have registered a surplus – for the fourth time in five years– of 4% of GDP in ESA 2010 terms. The unemployment rate dropped further, at 20.8%, while employment increased by 2.2%. According to official estimates, real GDP forecast/outlook for 2018 ranges between 2% to 2.6%. Capital controls, albeit materially relaxed, still remain in place after almost three years. The preparatory work for the successful completion of the final fourth review of the last third Economic Adjustment Programme and the discussions over the post-programme relation of the country with its official creditors are already under way.

The number of domestic credit institutions was drastically reduced since 2009 from 35 to 17, of which eight are commercial and nine cooperative. Of the eight commercial banks only four are deemed “systemically significant”, according to the respective SSM definition and these control about 96% of the banking assets. Foreign banks have insignificant market share, since all but one of the foreign banks with retail customer service networks have divested from Greece. Branches of 21 foreign banks operate in Greece. Finally, the number of branches (2,168) has decreased by 46% since 2010 and similarly, the number of employees (41,707) and of ATMs (5,532) dropped by 34% and 22%, respectively.

Greek banks committed themselves to implementing restructuring plans following extensive use of State aid. Greek banks are already delivering on the commitments with significant divestments of banking subsidiaries in the SEE region, as well as from non-core assets in Greece (insurance, hotels and real estate investment trusts).

Following the implementation of capital controls in June 2015, businesses and consumers have adapted, to a considerable extent, to cashless payments. In particular, there has been a sharp rise in the use of payment cards. The number of point-of-sale (POS) terminals increased by 87% in 2017. The number and value of payment card transactions rose by 79% and 45%, respectively, to 555 million and €23 billion. The average card transaction value dropped by 19% year-on-year to €41, while the average electronic credit transfer transaction in 2015 was €1,990 (down 34% year-on-year).

In 2017, total domestic deposit inflows reached €5.7 billion, in parallel to an improvement in economic sentiment. The return of private sector deposits, the re-establishment of market funding and the elimination of Eurosystem dependency constitute the main challenges which the Greek banking sector still has to face in the period ahead.

Greek banks have contributed to economic recovery through, among other things, the funding of all large-scale infrastructure projects and ongoing funding of the tourism industry.

Greek banks have submitted to the Bank of Greece and the SSM operational targets for the management of non-performing exposures (NPEs) for the period up to the end of 2019. In 2017, a revision took place moving the end-target in 2019 lower by €2 billion versus the initial target to €64.6 billion (that is, a 40% reduction).
At end-December 2017, NPEs decreased by 10% compared to the end of December 2016, reaching 43.1% of total exposures. Significant amounts of write-offs, portfolio sales, restructuring, and enforcement recovery, resulted in the reduction of NPEs by €13 billion or 12% since March 2016.

Greek banks underwent four severe stress tests in the 2012-2015 period leading to three rounds of recapitalisation of €64 billion cumulatively. The capital raisings of 2015 led to strong capital ratios across all the significant credit institutions. The CET1 ratio of the four significant credit institutions stood at 16.8% in 2017 (2016: 17%). The European Banking Authority classifies Greek banks among the most adequately capitalised within the EU versus an EU average of around 14%.

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Hungary

The stability and performance of the Hungarian economy has improved significantly in recent years. In 2017 the country’s GDP growth was at 4%. Among production components of the GDP, the private service sectors and manufacturing industry were the major contributors but the construction industry also expanded quickly. Regarding the components of use, domestic consumption became the main driver, supported by wage and employment ratio increases. Capital formation also contributed much to the good performance and although domestic consumption strongly increases imports, net exports were still an important factor. The economy is close to full employment and a structural lack of skilled labour force, both in terms of specific industries and geographical areas, is an issue.

The inflation rate in Hungary mainly follows the European Union’s trend, the Philips’ curve is flat, meaning so far the wage increase did not cause inflation pressure. However, the stagnation of productivity is an issue that the economic administration is trying to address.

The surplus on balance of payments, the controlled central budget deficit, decreasing state debt, foreign exposures among state and private debts moderated further the financial vulnerability of the country, and in addition to the efficient use of EU structural funds, it opened up some room for the government for fiscal stimuli, such as providing extensive home creation allowances.

The penetration of banking had slightly decreased by the end of 2017. The sector’s total assets were 95.2% of the annual GDP of which 49.5% was kept by the top five banks.

The Hungarian banking sector consists of 69 institutions. Among them are 26 commercial banks, nine foreign bank branches, five mortgage banks, four building societies, three specialized banks and – as a result of massive consolidation - 22 credit or saving cooperatives.

At the end of 2017, 50.5% of the banking sector’s shareholding was kept by domestic entities with almost two-thirds of that in the hands of the state.

The banking sector has 2,420 branches and employs around 39,000 people (0.88% of the total employment in Hungary). For the country’s population of 9.8 million in 2017, there are 10.5 million bank accounts, 9.1 million payment cards (of which 72% are contactless), 5,100 ATMs and 136,400 POS terminals.

Electronic payments increased dynamically in 2017. The payment card accepting network grew significantly by 25% which also means that 83% of the POS terminals support contactless card acceptance. In 2017, two-thirds of retail payments were made by contactless cards. The rate of access to payment accounts by internet and mobile banking services increased by 2.5% which means that 82% of the payment accounts can be accessed by one of them.

The National Bank of Hungary has launched a project to implement a domestic (denominated in HUF) instant payment (IP) solution. The new payment system will be available to make payments between Hungarian payment accounts within seconds, on a 24/7/365 basis. It will also be possible for market participants to provide a range of additional services. The IP service will start on 1 July 2019. The new basic infrastructure supports innovative payment services.
One-third of the banking sector’s total loan portfolio is provided to non-financial corporates, one-third to households and organisations closely linked to households and one-sixth to the foreign sector (half of it to foreign corporate sector). In 2017, corporate lending grew at a rate unseen since the crisis, expanding by more than 13% in annual terms, while retail lending almost stagnated with an increase slightly over 1%.

The deposit value of the banking sector remarkably increased in 2017 (by 7.7%) in total, each major sector (local state, corporate and household as well as foreign) contributed positively.

The capital position of the Hungarian banking sector is stable. The Tier 1 capital adequacy ratio (CAR) is over 18%, while the total CAR is a bit over 20%.

In 2017 profits reached a new high in nominal terms, mainly due to extraordinary or external factors, before tax ROE remained over 14.5%. Major extra contributors to the unexpectedly good performances are the good profitability of local banks’ foreign affiliates and releasing impairments.

The banking sector has a relatively high contribution to the central budget in Hungary. It provides almost 4% of the total budget revenue (approximately 1.5% of the GDP), half of it coming from sectorial taxes.

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Iceland

Although the Icelandic banking sector was hit hard during the financial crisis of 2008 the transformation and restructuring of the banks laid solid foundations for the continuation of highly developed banking services. The commercial banking sector now consists of three universal banks, one investment bank, and four small savings banks that operate in the rural areas. Total assets amount to ISK 3,492 billion, the equivalent to a little less than 140% of GDP in 2017.

The banks are predominantly funded with domestic deposits that are around ISK 1,800 billion or almost 75% of GDP. Bond issuance has been increasing over the last few years: first and foremost, the issuance of contingent and covered bonds. Total loans in the banking sector amount to ISK 3,492 billion. The asset base is predominately domestic: total domestic assets are ISK 3,112 billion. Icelandic banks have also sold bonds on the international market in recent years. Total foreign liabilities are ISK 631,5 billion and total domestic liabilities are 2,256 billion.

All the major banks have been profitable over the last six years, but with irregular factors, such as the sale of assets and revaluation of loan books contributing to the return on equity. The average interest rate margin has risen from pre-crisis levels reflecting partly the increased share of retail deposits in bank funding. Capital adequacy ratios (CARs) have risen well above the 16% requirement by the regulator and are now generally in the 20-25% range of risk-weighted assets.

All the major banks have been increasing their funding in European bond markets and that trend has been strengthened with significant improvements in their credit ratings in 2016. In March 2017 authorities removed the last remaining hurdles of the capital controls that were introduced in 2008 to stabilise the currency during the financial crisis. The lifting of the capital controls on individuals, firms, and pension funds marks the completion of Iceland’s return to the international financial markets.

The Icelandic economy has been recording healthy GDP growth in recent years spurred on by a significant increase in tourism along with contributions from the export sector. GDP growth in 2017 was recorded at 3.6%. Robust growth has not increased inflation, which was steady at around 2% in 2017. Strong economic performance along with a healthy current account surplus has led to an appreciation of the Krona in recent years.

At the same time household and private sector debt has not increased. Total loan levels in the banking sector have remained stable although there has been an increase in loans to the tourism sector.

Since October 2015, the ownership of two of the three major banks has been primarily in the hands of the Icelandic government. The government has not introduced detailed plans on how its ownership of the banks will develop. Most shares in the third bank are in the hands of private international funds that had been in the creditors’ group of the estate of the predecessor. The owners are planning to list the bank at the stock exchanges in Reykjavík and Stockholm in the coming months. If those plans materialise it would be the first Icelandic bank to list its shares since 2008.

The banking sector in Iceland bears the largest burden of any sector of the economy when it comes to taxes and government fees. The financial sector paid almost ISK 40 billion in taxes in 2017. Icelandic financial
firms pay three sector specific taxes: bank tax, financial activity tax and a special addition to the financial activity tax. The banking sector currently has around 3,000 employees working in 87 branches around Iceland. Both employment and the number of branches have decreased in recent years because of ever-increasing digitalisation of the Icelandic financial sector.

The Icelandic banks are all involved in projects to increase public awareness on the importance of financial literacy. The Icelandic Financial Services Association also runs a joint project called Fjármálavit. The project is based on visits from employees from the Icelandic banks to grammar schools where they talk about money and savings. Fjármálavit participates in the European Money Week.

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Ireland

Gross domestic product rose by 7.8% year-on-year in volume terms. However, personal consumption and international trade were the key drivers as investment fell. Total domestic demand fell by 7.9% year-on-year in 2017 driven by a 23% growth in capital formation (mainly related to lower imports of intellectual property products [IPP]) and a 1.9% rise in personal consumption. Modified total domestic demand, which removes globalisation effects such as IPP imports, rose by 3.7%.

Ireland’s current account surplus more than quadrupled in 2017, driven mainly by a 14.3% rise in services’ exports. Ireland’s exports of financial services grew by 22.1% to €14.5 billion. Ireland was the world’s seventh largest exporter of financial and insurance services in 2016, according to UNCTAD.

Unemployment also continued to fall, with the rate dropping to 6.4% by Q4 2017. The gross saving ratio of households (saving as a percentage of total disposable income) increased from 6.8% in 2016 to 8.6% in 2017, partly reflecting continued deleveraging in the Irish economy.

There were 58 banks operating in Ireland at the end of 2017. These included 24 credit institutions authorised in Ireland (of which five were covered bond banks) and 34 branches of foreign banks operating in Ireland. While the number of banks has been relatively stable in recent years, the number of credit unions - not-for-profit, member-owned financial cooperatives funded primarily by member deposits – fell from 292 to 269 during 2017 as credit unions consolidated.

The Irish government has majority stakes in two banking groups (Allied Irish Banks and permanent tsb) and a minority stake in another (Bank of Ireland). The five main banks operate some 680 branches and 3,400 ATMs for cash withdrawal nationwide.

Card payments grew strongly in 2017, as consumers switched from cash to cards, especially debit cards on which volumes grew by 22% in 2017 to about 765 million. The expansion of contactless card payments has helped to reduce consumers’ dependence on cash. By the last quarter of 2017, contactless accounted for 28% of the volume and almost 7% of the value of card payments.

Some 71% of households used Internet banking in 2017, according to the Central Statistics Office. About one in three credit transfers in the second half of 2017 were initiated via digital banking (online or mobile banking).

Outstanding credit institution loan balances have declined in recent years as both businesses and consumers have deleveraged, but gross new lending grew in 2017: new residential mortgage lending rose by 29% year-on-year to €7.3 billion, of which €0.7 billion was re-mortgaging with a new lender or switching.

New lending to non-financial small and medium-sized enterprises (SMEs) rose by almost 10% year-on-year. Gross new drawdowns to core SMEs (excluding financial intermediation and property-related sectors) rose by 14% year-on-year to €3.7 billion during 2017. A further €1.35 billion in gross new lending was drawn down by SMEs in property-related sectors. The government-owned Strategic Banking Corporation of Ireland provides wholesale funding to banks and non-bank financial institutions for on-lending to SMEs. During 2017, it supported some €0.9 billion in lending. SBCI shared the lending risk with other lenders on €142 million of those loans.
Some €26.2 billion of the €42.8 billion loans outstanding to Irish resident private-sector enterprises (excluding financial intermediation) was outstanding to SMEs at the end of 2017. Housing loans of €74.8 billion were on the balance sheets of credit institutions, with a further €27.3 billion in securitised loans.

Non-mortgage consumer credit outstanding continued to recover in 2017, increasing to €13.5 billion by the year end, up from €12.8 billion a year earlier. The Central Bank of Ireland estimated that credit unions maintained a roughly one-third share of consumer credit.

Credit institution deposits also grew, with private household deposits at almost €94 billion at the end of 2017, up 3.1% year-on-year, and deposits of Irish resident private-sector enterprises (excluding financial intermediation) up by 8% to €55.9 billion.

An Post, the State-owned postal service operator, managed a further €20.4 billion in national savings schemes and post office savings accounts, up from €20.1 billion a year earlier.

Credit institutions in Ireland employed an estimated 26,300 people at the end of 2017. Banks and building societies paid some €2.4 billion in wages and salaries in 2017, of which banks, focussed on international markets, contributed €0.6 billion. They also paid some €0.5 billion in corporation tax. Since 2014, banks have also paid an annual levy of about €150 million. By 2021, banks will have paid €1.2 billion in such levies.

Gross value added (GVA) by the banking sector was estimated at €6 billion in 2015, according to the Central Statistics Office. Profit after interest and tax rose from €2.2 billion in 2016 to €3.3 billion in 2017.

Total balance sheet assets fell to €552 billion, their lowest level since the data series began in 2003, reflecting continued contraction in loans outstanding, although loans to the Irish resident private sector increased for the first time since 2007. In terms of liabilities, non-monetary financial institution deposits from Irish residents have become a key source of funding. They represented 35% of liabilities at the end of 2017, almost three times the ratio in 2008.

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Italy

The economic recovery in Italy is gaining pace, mainly supported by domestic demand. GDP growth increased in 2017, rising to 1.5% from 0.9% in 2016. It is expected to moderate in 2018 and 2019 but to remain positive and higher than 1%. The improved outlook is translating into higher consumption and investment, which will be beneficial for the whole economy and for the banks.

The ongoing economic recovery is helping Italian banks to strengthen their balance sheets and accounts. In 2017, with the precautionary recapitalisation of Banca Monte dei Paschi di Siena and the orderly liquidation of Banca Popolare di Vicenza and Veneto Banca, the headline risks have been removed and the perception of the market on the solidity and the positive perspective of the Italian banking sector has improved.

Lending to the private sector has been expanding again since the end of 2016. The figures of April 2018 show total loans to households and firms are growing at around 3% year-on-year.

In particular, lending to firms, which was slowed in part by firms’ abundant liquidity, is increasing again - currently at around 2.2% on an annual basis - in connection with the acceleration of investment underway since the second half of 2017. The economic recovery is supporting firms’ profitability, reducing their vulnerability.

Loans to households continued to increase at a robust pace, with an annual growth rate close to 3%, driven by loans for house purchase due to the recovery in real estate market transactions and the favourable credit conditions offered by banks.

Customer funding remains a strength for Italian banks. In particular, deposits continue to increase, at an annual growth rate of approximately 5%, while medium and long-term bond funding declines.

Credit risk is falling to pre-crisis levels. The flow of new non-performing loans (NPLs), which has been decreasing since 2014, stands at about 1.7% of total loans, below the pre-crisis average.

The stock of NPLs is also diminishing at a remarkable pace, also due to massive disposals of NPLs. In May 2018 (latest figures), net bad loans or “sofferenze nette” fell to about €49 billion (2.8% as a percentage of loans), 45% less than the peak touched in November 2015 and 43% less than the amount at year end 2016. The volume of total net NPLs amounted to around €110 billion.

The reduction of NPLs inflows combined with the increasing outflows indicate a strong improvement in the asset quality. The gross NPL ratio, which declined from over 18% in 2016 to 14.5% at December 2017 - or 13.4% following one major NPL disposal deal closed in the first half of 2018 - is expected to fall below 10% in 2019 and under 6.1% by year end 2021 according to the forecasts of the Italian Banking Association (ABI).

The coverage ratio for NPLs is above the EU average and grew from 50.4% at December 2016 to 52.7% at the end of 2017.

Capital adequacy has also increased and is well above the prudential minimum target. Common equity tier 1 ratio stood at around 13.3% at year end 2017 for the Italian Significant Institutions (up from 10.4% in 2016) and at around 13.8% for the whole banking sector.
The profitability of the Italian banks, even if still lower than the cost of capital, as for the majority of the other European banks, is improving. In 2017 the aggregated return of equity (ROE) rose to about 7% (from -6% in 2016), buoyed mainly by extraordinary components (net of these items, the ROE would have amounted to around 4%).

The restructuring of the Italian banking sector continues, partly induced by the changing regulatory environment and the digital revolution. This affects not only the banks' business mix and structure of costs, but also the composition of the sector itself and its consolidation.

Many Italian banks are facing a delicate transition from the traditional credit intermediation business model to a more diversified model, with lower exposure to credit risk, also reducing the number of branches - decreased by 20% between 2008 and 2017 - and increasingly relying on digital resources. With respect to the latter, the digitalisation of banking customers has shown a strong acceleration in the last five years. The use of online banking grew in 2017 and, by year end, 62% of customers have accessed their banking services online (43% in 2012).

The consolidation of the sector also continues, even if the sector is already less fragmented than often claimed: excluding foreign banks branches, the Italian banking sector consists of fewer than 120 independent banks - including banks’ holding groups, standalone banks not included in the any groups and three mutual bank groups which will soon emerge from the merger of the 289 mutual banks as a consequence of the recent national reform in the sector of mutual banks.

In 2017, the largest cooperative Italian banks were transformed into joint stock companies, as required by a law approved in 2015. Two of them consequently merged (Banco Popolare and Banca Popolare di Milano), creating Italy’s third largest banking group thus increasing further the degree of concentration in the sector.

Market appreciation of Italian banks’ progress is confirmed by the increasing presence of foreign institutional investors in banks’ capital: based on ABI calculation based on Thomson Reuters data, the share of the largest Italian banks’ capital held by foreign funds has increased by 12 percentage points between 2011 and 2017. At year end 2017, the share of capital held by foreign funds was around 32%.

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Latvia

The 2017 was a year of steady and strong economic growth in Latvia (4.5% GDP), more than double compared to 2016 and among the strongest in the European Union. It was marked by resolute continuation efforts started in 2016 to ensure the highest standards in countering money laundering and terrorist financing, to facilitate sustainable development of the Latvian banking sector and to embrace opportunities of new technologies.

In 2017 there were 21 banks operating in Latvia, including 16 credit institutions registered in Latvia, and five branches of banks registered elsewhere in the European Union. The Latvian banking sector is dominated by Nordic banking groups, holding 54% of shareholder capital while other OECD countries represent 34%. A major merger embarked on in 2016 and rolled out in 2017, of Nordea and DNB, combining their operations in Estonia, Latvia and Lithuania is not yet dully represented in 2017 data.

Banks served 2.16 million customers through digital channels (predominantly), as well as 239 bank branches and customer service centres. Banks have installed over 43,307 payment card terminals and issued 2.24 million payment cards while clients made 322.6 million purchases worth €10.6 billion during the year, an increase of 33%. Banks have embraced new technologies. Modernised their ATM networks and continued to foster use of on line payments. It was reflected by a slight drop in the total number of ATMs, providing 1,015 ATMs with withdrawal functions and 356 with cash deposit functions. The move to reduce usage of cash in daily transactions was ongoing as banks’ strategies recognise the growing role of digital payment services solutions. It was well reflected in the dynamics of bank and Fintech cooperation; as well as the “Open Digital Finance Framework” a position adopted by the Association to guide support development of digital ecosystem in Latvia and EU.

Increased new lending to businesses (4%) as well as continued progress (5%) in the household segment demonstrate recovery of investment that supported Latvia’s economic growth. Data however also reflects a continued effect of de-risking and a decrease of total assets of the banks by 3.7%, reaching in total €28.4 billion, equivalent to 106% of the Latvian GDP. During 2017 the amount of deposits at banks dropped by 5.1% (largely driven by reduced foreign client deposits), adding up to €20.3 billion, according to the Financial and Capital Market Commission (FCMC).

Nevertheless, the banking sector continued to demonstrate healthy profitability and reported a profit of €236 million in 2017. The Latvian banking industry’s return on assets and return on equity are at 0.9% and 7.61% (6.9%, EBA) respectively. The cost to income ratio 59% (FCMC) is strong, compared to EU average.

Latvian banks maintain high capitalisation levels and total capital adequacy ratio of the banking sector was 21%. Higher prudential requirements and relatively high returns have contributed to improvement of capital ratios providing high potential loss absorption capacity.

Overall the Latvian banking sector is stable, resilient, well capitalised and ready to support the expanding ambition of Latvian economy.

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Liechtenstein

Due to the customs and Swiss Franc currency union, Liechtenstein is strongly linked to the Swiss economy. Generally, Liechtenstein’s economy is on a moderate path to growth with optimistic outlook and Liechtenstein’s AAA-rating with stable outlook was confirmed by Standard & Poor’s in January 2018. With an increase of 4%, the direct exports of goods from Liechtenstein companies have recovered for the most part after the sharp decline in the past year, which was highly affected by the revaluation of the Swiss Franc in 2015. Employment grew by 3.6% in 2017. The average unemployment rate fell to 1.9%.

By the end of 2017, there were 14 fully licensed banks operating in Liechtenstein. Six of them are subsidiaries of Swiss, Austrian, Luxembourgish and Chinese institutions. A former Austrian-owned subsidiary was sold to a Hong Kong financial group. The others are Liechtenstein banks whereas the LGT Group is the largest private banking group owned by the princely family and the LLB Group listed on the Swiss Stock Exchange but majority-owned by the Liechtenstein government.

Owing to the very limited home market, the Liechtenstein banks are very internationally-oriented and have representations in more than 20 countries. Their activities traditionally focus on private banking and wealth management. They do not engage in investment banking and carry comparatively low risks. However, smaller banks, in particular, are engaging more in other business areas, such as Bank Frick which has built up a high level of competence in e-commerce/payment solutions over the last few years.

Liechtenstein is also affiliated to the Swiss payment systems and, together with Switzerland, will switch in 2018 to the new ISO 20022 payment transaction standard. Liechtenstein is also a SEPA participant.

Due to the narrow business model of the Liechtenstein banking sector, the lending business focuses on mortgages, which increased by 3% compared to the previous year, and Lombard loans. Total loans increased to CHF 30.0 billion and amounted to 45.5% of total assets, whereas the share of both loan types is more or less equal. Residential mortgages amount to 75% and are mainly secured by Liechtenstein or Swiss real estates. The average loan-to-value for residential mortgages is about 50%. Commercial loans do not have a significant share of the loan portfolio of Liechtenstein banks.

Deposits increased to CHF 42.7 billion and households account for nearly 30% of total deposits. Sustainability has always been at the core of the Liechtenstein financial centre’s values and culture and is a key pillar of its long-term strategy.

Sustainability has become an integral part of the corporate culture of banks in Liechtenstein. The LGT Group is one of the pioneers in this area, not just in Liechtenstein, but also worldwide. Consequently, the positive trend towards sustainable investments has continuously continued over the last years whereby the percentage of sustainable investments meanwhile have increased up to 10%. According to a study carried out in 2016 more than 50 equity funds domiciled in Liechtenstein received excellent environmental, social and governance (ESG) fund ratings, with 60% of the equity funds listed in the ESG Market Report, rating Liechtenstein “A” or higher.

A demanding environment encompassing negative interest rates, volatile financial markets and costly regulation continued to challenge the sector. But despite the uncertainties and the restraint shown by
investors, the banks attained substantially higher profit and growth in assets under management (AuM). To sum up, the banking sector can look back on a very successful year in 2017.

The AuM reached once again a new peak, both in Liechtenstein (up 23.5% to CHF 168.9 billion) and on a consolidated basis (up 25.3% to CHF 294.3 billion), i.e. including the banks’ activities abroad. Even more important is the fact that net new money could be raised from CHF 3.0 to CHF 17.6 billion (globally CHF 40.1 billion, two times higher than the previous year). Total balance sheet assets increased to CHF 65.8 billion (up 6.5%).

The result from normal business activity rose by 3.6% to CHF 331.9 million compared to the previous year. Liechtenstein banks are distinguished by their financial strength and stability. They have solid and high-quality equity capital resources with an average core capital (Tier 1 ratio) of more than 20%.

The national economic significance of the financial centre is disproportionately high, compared with other countries. It is one of the central pillars of Liechtenstein’s national economy. The financial sector contributes a total of 24% to Liechtenstein’s GDP and 16% to the workforce. With a stake of around 16% of total tax revenue, the outstanding importance of the financial sector would be even more highlighted.

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Lithuania

The Lithuanian economy has gathered momentum: real GDP grew 3.9% in 2017. Over several recent years, private investments of businesses were hampered by geopolitical tensions and caution on the businesses’ side. However, a pick-up in investment activities of enterprises in the beginning of 2017 was the main factor that stimulated stable growth in banks’ credit portfolio. Energy, transport and industrial companies were most pro-active in implementing investment projects.

Overall, the Lithuanian Statistics Department predicts 2.9% growth in GDP in 2018.

Six banks and eight foreign bank branches are operating in Lithuania. The Lithuanian banking sector is dominated by the subsidiaries of large Scandinavian banks. The three largest banks – SEB, Swedbank and Luminor – are fully owned by their parent legal structures in Sweden and Norway. The other three banks, AB Šiaulių bankas, UAB Medicinos bankas and AB “Citadele” bankas, are considerably smaller and are owned by groups of local and foreign investors. Among the foreign banks’ branches, Scandinavian capital also dominates. There are 68 credit unions united by the Lithuanian Central Credit Union. The Lithuanian government has no ownership stake in the banking sector.

Digital banking gathers pace. The year 2017 was when new or improved digital services were introduced for consumers to save their time and make it easier to manage their finances. The number of cashless payments rose by 11% in 2017.

The number of banks employees decreased by 11% in 2017.

Credit growth in Lithuania is picking up. Funding conditions remain very supportive, as final interest rates on loans for both non-financial enterprises and households remain among the lowest in the euro area. The favourable economic situation contributed to a rising credit portfolio. The annual increase in the loan portfolio was 3.2% in December 2017. The household loan portfolio consists predominantly of housing credits. The rise in housing affordability also supports the private sector’s lending.

Moreover, loan quality keeps improving, with non-performing debt dropping to 3.1% of the overall loan portfolio. Despite the low interest rate, the amount of customer deposits in banks increased by almost 7% in 2017. The capital adequacy ratios of Lithuanian banks exceeded the established rates and now they are one of the highest in the EU. The profitability indicators have also remained sustainable, enabling banks to function stably and fulfil their natural function - to finance the economy and stimulate economic growth.

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Luxembourg

The financial services industry, and more specifically the banking sector plays a key role in the Luxembourg economy. Contrary to conventional wisdom, the Luxembourg economy is well diversified; the financial services industry represents approximately 27% of total GDP.

In comparison with other countries, Luxembourg can boast an economic growth close to 3.5% in 2017 and forecasted to increase in 2018. Unemployment stood slightly lower than 6%. Both services and industries contribute to this positive trend.

The 140 banks based in Luxembourg are part of the financial services industry and conduct activities across multiple strategic pillars leading to a broad and sophisticated product offer as well as a diversified client base. Five of these are of Luxembourgish origin, the others coming from 30 different countries, meaning an internationalisation rate of 96.5%, the highest in Europe.

In the aftermath of the 2008 financial crisis, many financial groups had to reorganise and restructure their businesses internationally. These changes had an impact on the Luxembourg banking centre, where the number of banks has decreased, essentially due to mergers and acquisitions, resulting in fewer but larger entities.

However, in the last few years, new banks from third countries have established their European hubs in Luxembourg, including the seven largest Chinese banks, including Bank of China, ICBC, the world’s largest bank; Bank of Communications, Agricultural Bank of China, China Construction Bank, China Merchants Bank and China Everbright bank. In addition, many international banking groups are establishing competence centres in Luxembourg, either in private banking, fund administration, custodian services, in treasury management, or as booking centres for international loans.

Luxembourg has a long-standing experience in e-commerce and is the European home to headquarters of leading companies such as Skype, Amazon and PayPal. E-payment companies have mainly been attracted in large numbers to Luxembourg to support global e-commerce brands.

Credit institutions in Luxembourg enjoy a high level of capitalisation. On the credit side, the trend is, as in the previous years, on a positive path, recording an increase of 1.3% from February 2017 to February 2018: retail banking, corporate banking and private banking all contributed to this increase. During the same period, with regards to deposits, the evolution is stable. On a general basis, deposits are still higher than loans, ensuring a strong and robust stability in all credit institutions.

Luxembourg is the leading wealth management centre in the euro area. In line with the financial centre as a whole, local private banks, financial advisers and family offices specialise in handling international clients who often have complex business and family profiles stretching across several countries or even continents.

The Luxembourg financial centre is a major worldwide distribution platform for investment funds. Collective investment management has been developing since the mid-1980s. Luxembourg is the world’s second investment fund centre after the United States, and Europe’s first with around €4,187 billion assets under management end of January 2017. As demand for green finance is rising, Luxembourg financial centre is proud it can rely on the Luxembourg Green Exchange (LGX) launched in 2016 and already home
of 160 Green Bonds amounting to more than EUR 80 billion in 20 currencies from 30 international issuers. LGX has the highest number of listed Green Bonds worldwide. Furthermore, Luxembourg is the leading European centre domicile for impact funds. Since 2015, the Luxembourg government and Luxembourg’s financial services industry have been working together in a dedicated Climate Finance Task Force, implementing a coherent and fully integrated Climate Finance Strategy with the dual objective of contributing in a meaningful way to the international fight against climate change and cementing Luxembourg’s role as an international centre for climate finance.

Despite an unfavourable global environment, as well as very challenging low interest rates, credit institutions managed to increase their global net results slightly, allowing banks to control their costs and create growth in incomes efficiently. Banking employment recorded a slight decrease from 2016 to 2017, from 26,063 to 26,111 end of year 2017. Reserves expanded by 8% from 2016 to 2017.

Luxembourg aims to develop the financial centre by focusing on key areas including responsible investing and green finance, managing Renminbi business, be it through listing, issuing instruments, RQFII scheme, or trade finance, becoming a European hub for fintech and opening up to new market segments, including Islamic finance.

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Malta

In 2017, the Maltese economy grew by 6.6% in real terms, well above the euro area average. This growth was underpinned by an increase in exports of goods and services, and private consumption expenditure. Unemployment levels declined to an historic low of 4.1%, and labour productivity improved by a further 1.2%. The Maltese government sustained its efforts to improve public finances, with gross public debt falling to 53.4% of GDP by the end of 2017, and a budget surplus equal to 3.2% of GDP in 2017. Price pressures remained contained, with the inflation rate, based on the Harmonised Index of Consumer Prices, averaging 1.3%.

Over the past two decades, the banking sector in Malta has grown from four retail banks serving the local population to 25 licensed banks - as from the end of 2017 - only three of which are Maltese majority-owned. The other banks originate from various EU and non-EU jurisdictions, including Austria, Australia, Belgium, Greece, Kuwait, Turkey and the United Kingdom. As such, around 71% of the banking sector’s total assets of around €48 billion are foreign-owned.

The sector is very diverse in terms of inter-linkages with the domestic economy and can be split into three groups according to the extent of linkage with the Maltese economy: core domestic banks, non-core domestic banks and internationally-oriented banks.

Six core domestic banks had assets of around €23 billion representing 207% of Malta’s GDP, and which employed 83% of the sector’s workforce numbering around 4,900 employees. Two of these banks are the local market leaders, owning around 80% of this group’s assets, and operating 69 of the 106 core bank branches in the Maltese islands. The core banks exercise a conservative business model consisting mainly in the raising of deposits and the granting of loans to Maltese residents. Resident deposits and loans increased by 5.0% and 1.9% respectively in 2017.

These banks rely mainly on resident deposits for their funding and have a stable deposit base thanks to the high propensity of Maltese households to save. Their loan-to-deposit ratio is low at around 59%, and this insulated the banks from the volatility on the international wholesale markets during the financial crisis. On the asset side, over 98% of total loans are for Maltese residents, with the banks applying prudent lending norms and loan-to-value ratios, as well as a cautious valuation of collateral. Their investment portfolios are also widely diversified in well-rated securities. Overall, the core domestic banks are characterised by a sound capital base (Tier 1 capital adequacy ratio of around 15%), high liquidity and a healthy profitability.

Five non-core domestic banks had assets of €2.2 billion representing 20% of Malta’s GDP. These banks undertake some business with Maltese residents, but not as their core activity. As such, the linkages with the domestic economy are limited, with resident assets and resident liabilities each accounting for less than one-fifth of the banks’ balance sheet size. With a Tier 1 capital adequacy ratio of 13.3% these banks have good shock-absorbing capacity to cover a potential deterioration in asset quality. Considering also their limited exposure to the domestic economy, these banks are not deemed to pose a threat to domestic financial stability.

The 14 internationally-oriented banks are mainly subsidiaries and branches of large international institutions. These banks have almost no links to the domestic economy. Their combined assets, amounting
to around €23 billion, represented around 207% of Malta’s GDP. They fund themselves mainly through the wholesale market or through their parent banks, and deal mainly with intra-group activities. Overall, this group is also very well capitalised, has strong liquidity and is profitable. Here again, therefore, the very low level of business carried out with residents, and the fact that these banks have negligible contingent claims on the Deposit Guarantee Scheme, mitigates possible concerns regarding the size of their asset base in relation to GDP, or the threat which they might pose to domestic financial stability.

The Malta Financial Services Authority (MFSA) is the sole regulator for all banking, investment and insurance business carried out in or from the Maltese islands. The Central Bank of Malta is primarily responsible for maintaining price stability through the formulation and implementation of monetary policy. It is also responsible for the promotion of a sound financial system and orderly capital markets. To this end, a Joint Financial Stability Board, set up between the MFSA and the Central Bank of Malta, focuses on macro-prudential aspects of financial stability, extending its remit to the entire financial sector.

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The Netherlands

The performance of the Dutch economy remains strong. GDP growth of 3.2% is expected in 2018, primarily driven by domestic factors and helped by low interest rates and strong housing market performance. Consumption is soaring due to higher employment and the expansionary budgetary policy of the government. Favourable international economic developments drive up export growth.

The double dip recession has been overcome and the economy is growing since summer 2013. Growth is expected to continue in 2019 (up 2.7%). As a consequence, the Dutch labour market is tightening rapidly. Unemployment will decrease to 3.5% in 2019 and wage growth will pick up in the coming years. Despite expansionary budgetary policies, the government runs a budgetary surplus of 0.7% and 0.9% in 2018 and 2019 respectively. The total government debt will be far below the Maastricht criterion of 60%, with a projected debt level of 48% of GDP in 2019.

The Dutch banking sector is characterised by its relatively large size to GDP. Its assets accounted for 370% of GDP in 2017, down from 530% of GDP in 2007. The decline in balance size, combined with developments such as digitisation and cost reduction programmes, have led to net decline of employment. In 2017, about 70,000 people are employed in the Dutch banking sector (based on NVB members).

The Dutch banking market is relatively competitive. Entrance barriers are fairly low. Helped by the low interest rate, new non-bank entrants enter the market of mortgages increasingly. Large Dutch banks are internationally active to serve the open and export-oriented Dutch economy.

The five largest Dutch banks account for 85% of the balance total in 2017. However, with the European banking union phased in step by step, the relevant market gradually becomes a truly European market. The ownership structure of the three major banks is diverse. The largest bank is publicly listed; the second largest is a cooperative institution.

Card payments are increasing each year at the cost of cash payments. Since 2015, the total amount of card payments is larger than cash payments. This development is expected to continue in the future. Contactless payments by card are increasing. Among the young, payments between them are primarily initiated by mobile applications.

Banks play a vital role in the financing of Dutch companies, especially to SMEs. The total amount of outstanding loans has decreased in recent years due to a drop in demand, mainly as a result of improved company profitability, leading to increased use of internal financial resources and equity financing. The percentage of non-performing loans is low and the Netherlands ranks among the best in the EU among its peers. Flexible forms of finance such as leasing and factoring have become more popular, but in terms of volume compared to outstanding bank loans, the use of alternative forms of finance is limited. Banks increasingly combine different forms of finance.

With increasing utilisation rates, we expect a pickup of demand for external credit in the coming years. This is supported by the expectations in the ECB Bank Lending Survey. The total amount of outstanding debt to non-financial companies in the Netherlands equals approximately €260 billion, of which almost 50% is lent to SMEs. About 10% of the outstanding amount are loans of less than €250,000. Acceptance criteria have been eased over the last year; eight out of ten loan requests are currently accepted.
Dutch banks have committed to supporting and stimulating the transition to a sustainable economy. A group of banks and other financial institutions have developed a methodology to assess the carbon emissions related to the institutions’ core activities: financing and investment. Some banks have set quantitative targets to decrease their climate impact. Dutch banks are also working on fine-tuning their services to green businesses, thus supporting the development of a green economy. They have contributed to the development of a toolkit for businesses, helping them to increase the ability to finance green business models.

The Dutch supervisor stated in its annual report 2017 that the Dutch banking sector is in healthy shape. The capital position of Dutch banks has continuously improved in recent years. Core Equity Tier 1 capital has almost doubled since the financial crisis of 2008 from 9.6% to 18.4%. The IMF confirmed the strong capital position of the sector last year.

The banking sectors’ profitability has somewhat rebounded in comparison to previous years with a return on equity of 12.8%. Low interest rates are a main challenge, in combination with increased regulatory burdens and the need for investments in digitalisation and innovation. All in all, the gross value added to the economy is approximately 4.9% in 2016.

Culture and conduct are very important for the banking sector. The Dutch banking sector has made culture and conduct one of its priorities. The introduction of the bankers’ oath and disciplinary law in 2015 contribute to making culture and conduct a continuing discussion theme.

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Norway

Economic activity in the Norwegian economy picked up in 2017, after 2016 ended as the weakest year in terms of growth since the financial crisis. The improved outlook has continued in 2018 and reflects a more positive outlook after the downturn in the petroleum sector, which faced challenges after the oil-price drop in 2014. Unemployment has decreased to currently 3.7% according to the Labour Force Survey. Growth has been stimulated by the continuance of expansionary monetary and fiscal policy but as the economy continues to improve, the Central Bank of Norway has communicated that the key policy rate probably will increase from the current record low level of 0.5% in the second half of 2018.

The Norwegian banking sector is characterised by a few very large commercial banks, some regional based and several small savings banks. At the end of 2017 the Norwegian banking sector consisted of 122 banks. In addition, there were twelve branches and subsidiaries of foreign banks operating in Norway. The market share of the branches of foreign banks was 19% and 38% in the retail and domestic corporate market, respectively.

At year end 2017, the aggregate assets of the banking sector (including foreign entities) amounted to around €631 billion, corresponding to 190% of Norway’s total GDP. However, given the large presence of foreign banks, total assets relative to the size of the economy is noticeably lower when regarding Norwegian banks only. The financial intermediation sector contributes approximately 6% of GDP and employs around 2% (50,000 people) of the total labour force.

The Norwegian banks’ return on equity was on average 11.3% in 2017, while losses were 0.14% of gross lending. Losses decreased considerably compared to the previous year when some of the large banks experienced losses on oil-related exposures. Norwegian banks have strengthened their financial positions in recent years by retaining a larger share of their profits and by issuing new equity. The overall common equity tier 1 ratio for Norwegian banking groups was 16.3% by the end of 2017. The leverage ratio was on average 7.8%.

There were 943 branches by the end of 2017, and the average number of inhabitants per bank branch was about 5,600. As more and more people are using banking services online, the number of branches has decreased significantly over several years. Mobile payment solutions have been well received by Norwegian households and are becoming increasingly popular. More digital banking has given the banking sector large productivity gains and hence lower costs. In 2017, the cost-income ratio in Norwegian banks was on average 47.5%. The ratio increased somewhat in 2017, due to changes in the pension system and the introduction of a new tax on financial services.

When it comes to funding, the most important sources are deposits and covered bonds. Large banks have a considerably larger share of market-based, international funding than smaller banks, which base their operations largely on depository funding. Bank deposits are guaranteed by the Norwegian deposit guarantee scheme and have thus proven to be a stable source of funding, also during the financial crisis. The guarantee provided by the Banks’ Guarantee Fund covers up to NOK 2 million (approximately €210,000) per depositor per bank. This may be changed in the future to the equivalent of €100,000 to be aligned with the EU. The deposit-to-loan ratio (deposits as a share of gross loans to customers) for
Norwegian parent banks was 98% at year end 2017. The high level is due to the transfer of mortgages to separate credit institutions (with the purpose of issuing covered bonds). If these loans were included, the deposit-to-loan ratio would be 59%.

Domestic credit growth has in recent years been fluctuating around 5-6%. Household credit growth has in the same period been 6-7%. In recent months, credit demand from non-financial companies has increased significantly, reflecting the more positive outlook in the economy. This has led to an increase in the aggregate credit growth although growth among households has, to some extent, decreased lately.

Norwegian banks strongly support the progress in the stability and governance of the European financial sector, as well as the increasing harmonisation of regulation and supervision throughout Europe, to ensure a level-playing field and to improve the functioning of the market economy. Norway is not a member of the EU but participates in the EU’s internal market under the European Economic Area Agreement. According to this agreement Norway is obliged to implement all EU directives and regulations that relate to financial institutions and markets, such as the CRR/Crd IV, MiFID, Prospectus Directive, Solvency II etc. This ensures Norwegian financial institutions the same rights and obligations as institutions established within the EU.

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Poland

Poland is the largest economy in Central and Eastern Europe. According to Eurostat and the European Commission, its economy has been one of the fastest growing among the EU Member States (GDP in 2017 grew by 4.6%). This trend, with rising credit demand, makes Poland a potentially favourable destination for investment in the banking sector. It has a competitive landscape, focused on domestic business and plays an important role in financing private households, SMEs, big infrastructure projects, and project financing. Interest rates in Poland remain positive.

The Polish banking system has shown resilience and avoided serious problems during the financial crisis. The Polish Financial Supervision Authority (Komisja Nadzoru Finansowego [KNF]) is responsible for state supervision of the national financial market. The institution responsible both for operating the deposit guarantee scheme and resolution processes is the Bank Guarantee Fund (Bankowy Fundusz Gwarancyjny [BFG]). The authority responsible for macro-prudential supervision is the Financial Stability Committee (Komitet Stabilności Finansowej [KSF]), comprising the Polish National Central Bank (NBP), the Ministry of Finance, the KNF and the BFG.

At the end of 2017 the Polish financial landscape was made up of 35 commercial banks, 553 cooperative banks and 28 branches of credit institutions. In 2017, the ownership structure of the Polish banking sector changed. For the first time since 1999, the share of domestic investors in the sector's assets was higher than the share of foreign owners. At the end of 2017 it reached 54.5% (in comparison to 43.4% in 2016).

Cooperative banks are members of two associated banks. Despite the large number of these institutions, their market share is estimated at around 7.3% of the sector’s total assets. Due to preparations for the requirements of the CRD IV package, and taking into account national regulations, cooperative banks must make the final decision, in 2018, on their further business model: joining one of the two Institutional Protection Schemes, conducting business independently or functioning as part of cooperation within the newly established apex bank.

A banking tax act came into force in February 2016. It applies to selected financial institutions such as domestic banks and insurance companies, branches of foreign banks and insurance companies operating in Poland, and consumer lending institutions. The tax does not cover investment funds, pension funds and small local credit institutions (with total assets below PLN 4 billion). The tax base comprises the assets of financial institutions and only Polish treasury bonds in bank portfolio are excluded from taxation. The rate applied to the taxable base is 0.0366% per month (0.44% annually). This tax is not deductible for income tax calculation. This has imposed a substantial fiscal burden on Polish banks. In 2017 banks paid PLN 3.6 billion (€0.86 billion) as banking tax.

In 2017, the Polish banking sector’s assets totalled €427.17 billion. The value of the total balance sheet increased by 4.1% compared to the previous year. The size of the banking sector, relative to GDP, remains quite small in comparison to other EU economies (89.9% at the end of 2017).

The share of credit portfolio in total assets was 56.4% in 2017. After a longer period of stronger growth in retail banking, corporate banking has grown faster during the last three years. The problem of mortgages denominated in foreign currency is still under discussion but this portfolio is diminishing every year. The
prudent credit policy and relatively good results of the Polish economy have allowed banks to maintain the NPL ratio at a relatively low level (6.8%), lower than at the end of 2016.

The year 2017 was characterised by rapid growth of household deposits, which represent 71% of all non-financial sector deposits. The ratio of non-financial sector deposits to GDP was estimated at around 54%. However, the share of long-term deposits is limited and term mismatch on the credit and deposit side is significant.

Polish banks registered in 2017 return on equity (ROE) of 8.5% and return on assets (ROA) of 0.77%. However these results were lower than those of 2016 (ROE: 9.4%, ROA: 0.84%). The main reason for these results was the high fiscal and prudential burden imposed on banks.

The average total capital ratio in the domestic banking sector increased significantly. At the end of 2017 the ratio was 19%, and the Common Equity Tier 1 and Tier 1 capital ratios were estimated above 17%. Only 0.3% of the sector did not meet the KNF recommendations on the level of minimum capital requirements.

At the end of 2017, 35.5 million clients had access to online banking services, a 7% increase in comparison to the fourth quarter of 2016. Mobile payments are also increasing their share of transactions. In 2017, the number of transactions made with cards increased by 16% and their value grew by 11%. Since 2015, the BLIK system, which allows payments to be made by portable devices such as mobile phones and tablets, has been dynamically developing in Poland.

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Portugal

The Portuguese economy has strengthened its recovery, having grown 2.7% in 2017 (versus 1.6% in 2016). It benefited from a higher contribution from domestic demand, mainly due to an acceleration in investment, and from exports of goods and services (up 7.8%). According to the 2018-2022 Stability Programme, GDP is expected to increase by 2.3% in 2018. Throughout 2017, there were upgrades to Portugal’s credit rating, which had a positive impact on the country’s government bond yields and market sentiment.

Several key events had a significant impact on strengthening the Portuguese banking system in 2017: the completion of the sale of Novo Banco, the conclusion of state-owned CGD’s recapitalisation process, the completion of the tender offer for Banco BPI by its majority shareholder Caixa Bank (reaching a 84.51% stake), capital increases by Millennium BCP and Montepio, the repayment of the remaining contingent convertible bonds (CoCos) by Millennium BCP, the resolution and sale of Banco Popular to Santander in Spain (involving Banco Popular's Portuguese subsidiary) and the extension of the maturity of the loans granted by the State to the national Resolution Fund.

At the end of 2017, the Portuguese banking system comprised 152 institutions, 61 of which were banks (including 29 branches of foreign banks), 87 mutual agricultural credit banks and four savings banks. The five largest banks accounted for around 79% of total assets. The number of bank employees stood at around 1% of the total active workforce.

The Portuguese banks have been evolving towards more digitally-oriented business models, including the launch of innovative tools in their digital channels. In 2017, the number of ATMs decreased by around 3% to 14.5 thousand mainly as a result of the 8.3% year-on-year reduction in branches. On the other hand, the number of POS terminals grew by 6% to 319,900. The number of payment cards issued totalled 21.2 million (up 3% year-on-year), with 19.1 million debit cards and 8.3 million credit cards. In both types, some of these cards double as debit and credit cards. Retail payments, processed by the SICOI (Sistema de Compensação Interbancária) retail payment system managed by the central bank, totalled €417 billion (up 8% year-on-year), of which credit transfers accounted for €222 billion (up 10.9% year-on-year), the Multibanco interbank card network €115 billion (up 8.5% year-on-year), direct debits €24.5 billion (up 16% year-on-year) and cheques €55 billion (down 6% year-on-year). The amount of online purchases represented 5.9% of card purchases made in 2017, which compares to 5.2% in 2016.

Portugal is strongly committed to promoting a more efficient, sustainable and inclusive economy based on lower consumption of natural and energy resources. Tax incentives, regulatory measures and special lines of financing are some of the measures that have been implemented. Some of the most important financing initiatives already in place are Compete 2020 (Operational Competitiveness Programme), PO SEUR (Operational Programme for Sustainability and Efficient Use of Resources), PO Regionais (Regional Operational Programmes), IFRRU 2020 (Financial Instrument for Urban Rehabilitation and Revitalisation) and other lines of funding under Horizonte 2020 and LIFE (L’Instrument Financier pour l’Environment).

The downward trend in total outstanding loans (down 1.1%) slowed significantly against previous years, which may be an indication that deleveraging is nearing its end. As far as domestic activity is concerned,
loans to non-financial corporations fell 5.3% to €73 billion while loans to households fell 1% to €114.7 billion in the year. Loans to SMEs (80.9% of total corporate loans) decreased 4.7% year-on-year while credit to micro companies (39.6% of total SMEs loans) remained flat. One noteworthy fact was that SMEs' overdue credit dropped significantly (down 17.5%), with the corresponding ratio standing at 15.2% (versus 17.6% in 2016), mostly fuelled by the performance of micro companies.

Against the backdrop of a reduction in total loans, the non-performing loan (NPL) ratio decreased significantly from 17.2% in 2016 to 13.3% in 2017, a €9.3 billion drop. This improvement showed across all segments, particularly in the NFC segment (down €5.9 billion), reflected mostly the banks’ own active NPL reduction programmes supported by positive developments in the Portuguese economy. The NPL coverage ratio increased from 45.3% in 2016 to 49.4% in 2017.

In 2017, new credit production increased 4.8% over 2016, driven by the household segment (up 26.1% year-on-year).

Customer deposits rose by 1.7% and reinforced their position as the main source of bank funding (72.3% in 2017 versus 69% in 2016). As a result, the loan-to-deposit ratio decreased by 3.0 percentage points to 92.5%. This contrasts with the June 2010 peak of 158.8%. ECB funding continued to decline gradually, representing 6.3% of total assets by the end of 2017.

Capital was reinforced as a result of capital increase operations undertaken by several banks. Consequently, solvency levels increased, with the Common Equity Tier 1 ratio for the industry standing at 13.9% (11.4% in 2016) and the Total Capital ratio at 15.1% (12.3% in 2016).

The sector recorded pre-tax income of €1.2 billion (versus €2.3 billion in losses in 2016) largely explained by the increase in gross income and a substantial reduction in impairments. Operating costs remained broadly flat. The sector’s cost-to-income ratio dropped by 6.5 percentage points to 52.9%.

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Romania

In 2017, Romania had a high rate of economic growth at 7% due to consumption demand being boosted by pro-cyclical fiscal measures aimed at increasing revenues and cutting indirect taxation. We estimate gross domestic product (GDP) growth at over 6.1% in 2018 and 5.7% in 2019.

During 2017, the structural budget deficit and the trade deficit increased. The inflation rate on consumer prices rose to 1.3% in 2017.

The unemployment rate continued its downward trend and was close to historical lows at the end of 2017 at 3.9%. However, Romania’s labour market is vulnerable to high emigration which has reached a worrying level of 15% of the country’s population, or 25% of the active population.

Romania’s fiscal standing is sustainable, considering that the budget deficit was 2.9% of GDP, and that the country’s public debt was 60% of GDP. With 35% of GDP, the level of public debt is one of the lowest in the EU in 2017. During 2017, the balance of payments current account had a deficit of €6.464 billion, according to the National Bank of Romania data.

We expect a review of the macro-prudential framework in 2018. The asset quality review of 2018, the interest rates’ development, a review of the macro-prudential framework and the double-digit increase in new lending are the main concerns of the banking sector for 2018.

At the end of 2017, the Romanian banking sector included 35 credit institutions: two banks with full or majority Romanian state capital, four credit institutions with majority domestic, private capital, 22 banks with majority foreign capital and seven branches of foreign banks. About 77% of the Romanian banking sector assets were held by institutions with foreign capital in 2017, a downward trend compared to the 91.3% registered at the end of 2016. At the end of 2017 the banks with Austrian capital have a market share of 25%, followed by the banks with French and Dutch capital (13% market share each), Italian (10%) and those with Greek capital (9%). Banks have adjusted their employee number in the sector to around 55,000 persons, while the number of bank outlets shrank to 4,500 at the end of 2017.

Non-government credit is forecast to grow by 6.4% in 2018 in conformity with banks’ strategies, having grown by 5.6% in 2017 to about €50 billion.

The ratio of banking sector assets to GDP was about 50%.

The legislative initiatives e.g. the capping of interest rates, the limitation of the recoverable amount of assigned receivables, and the elimination of the writ of execution feature of credit contracts for individuals (draft laws are meant to be applicable to ongoing lending contracts) with retroactive application, have the tendency to affect the financial sector stability, which in turn affects investors’ predictability and perception.

Domestic saving went up by 60% between 2008 and 2017, increasing to €65 billion.

The Romanian banking sector maintained its structural stability in 2017 and the level of solvency and liquidity ratios were at an adequate level: 19.98% and 38%, respectively. The high capital reserves show a good capacity to absorb unexpected losses and the presence of resources to lend to the real sector.
Last year, we had very good results, and this positive trend makes us optimistic with regard to the fact that banks will be able to concentrate their efforts and resources on their main line of business: to finance the economy and, implicitly, the Romanians’ welfare. The development of the profitability ratio was brought about by the favourable macroeconomic context, the significant drop in the net expenses with adjustments for depreciation and the low level of funding costs. For the banking market, 2017 was the second year of real operational profitability which had been lost for a couple of years, contemplating the cut in risk costs. Return on assets reached 1.30% and return on equity stood at 12.51%.

The NPL rate shrank four times compared its maximum registered in 2014. The NPL rate shrank to 6.41% at the end of December 2017. For 2018, it is very likely that we will continue to witness the reduction of the NPL rate. The loan-to-deposit ratio reached 75.30%.

The banking sector’s assets, which were €91.8 billion, and which show the size of the funding granted to the economy, went up 30 times in the last two decades.

The banking industry from Romania intends to contribute in the future to the sustainable development of Romania and to the Romanian society in general. During 2012-2016, the banking sector had a total contribution of 4.2% to Romania's cumulated GDP. This goal could be achieved more quickly if there were a balanced and predictable legal framework and Romania’s convergence speed can be improved by the elimination of barriers at national level generated by the law-making process.

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Slovakia continues to enjoy strong economic growth. In 2017 the economy grew by 3.4%, which was one of the highest levels in the EU. The main drivers were private consumption and exports. Private consumption was supported by the improving labour market situation and strong household credit growth. Exports benefit mainly from the expansion in the automotive sector. Public debt remains low (50.9% of GDP) but is not far below domestic debt brake thresholds. Thanks to the strong economic environment, the unemployment rate fell for the fifth consecutive year to an historical low (7.6%). Real wages grew by 3.3% and the annual inflation rate continued to accelerate to 1.4%.

The Slovakian banking sector consists of 25 financial institutions with banking licences. Most of them are universal banks, focused on retail and corporate banking. Four of them are specialised banking institutions (three building societies and a state-owned development bank). Since privatisation (1999-2001) most of the banks in Slovakia are controlled by foreign entities, mainly banking groups from Austria, Italy and Belgium. Only four banks are now fully controlled by domestic investment groups (three banks) or government (one bank).

The Slovakian banking sector is concentrated within the hands of three major players (Slovenska sporitelna, VUB Banka and Tatra banka) who control more than 50% of the banking assets. Despite this concentration, the market share of small and medium-sized banks has slightly increased in recent years.

In comparison to the national GDP, the banking sector is one of the smallest in the EU. Funding of Slovakian banks is based primarily on the domestic clients’ deposits. The loan-to-deposit ratio has been growing for several years but is still one of the lowest in the EU. In 2017, deposits rose by 5%.

Retail loans have been dominating the domestic lending market and Slovakia has one of the highest growth rates in retail loans in the EU. The outstanding amount of consumer loans and housing loans rose in 2017 by 12% year-on-year. The main reasons are low interest rates, rising disposable incomes and growing competition.

According to the regulator, rapid growth in household indebtedness could be one of the principal risks to the stability of the Slovak financial sector. The household debt-to-income ratio in Slovakia is one of the highest among the central and eastern European region. In response, the central bank used macro-prudential measures to introduce tighter loan-to-value ratios and a systemic risk buffer and to prepare to introduce a new indicator: the debt-to-income ratio. The main objective of these measures is to reduce retail credit growth.

Strong economic growth and improving sentiment also provided a significant boost to firms’ demand for loans. The outstanding amount of corporate loans rose by 7% year-on-year.

Due to retail credit growth, most of the Slovak banks have remained profitable, but their outlook for the future is worsening. The environment of low interest rates has affected the interest rate margin and interest rate income. The special bank levy has also had a negative impact on banking sector profits.

In the last few years most of the net profits have supported the capital bases of Slovak banks. Total capital adequacy ratio increased on average to 18.81%, with the lowest individual level at 13.17%. Slovakia has
some of the most stable and soundest banks in the EU. According to the World Economic Forum’s Global Competitiveness Report 2017-2018, Slovakia has the third soundest banking sector in the euro area.

Profitability and stability enable banks in Slovakia to focus on innovation. Slovak banks are among the leaders in the use of new technologies in day-to-day banking e.g. contactless cards, contactless mobile payments and peer-to-peer payments. In 2017, banks, in cooperation with the Slovak banking association, prepared a common API (application programming interface) standard for communication between the banks and third-party providers based on PSD2 requirements.

Banks in Slovakia play an active role in financial education. There are many programmes supported by banks or the bank association. One of them is the educational programme “More than money” whose aim is to increase the financial literacy of elementary and high school pupils and teach them how to make financial plans for their future.

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Slovenia

With 5% real GDP growth rate Slovenian economy was the third-fastest growing economy of the euro area in 2017, next to Ireland and Malta. Growth was mostly driven by net exports, private consumption and private sector investment, while public investment contracted in comparison to 2016. The growth momentum is expected to continue in 2018 at 5.1% and 2019 at 3.8% with net exports and domestic demand being major factors. The contribution of net exports to growth is going to diminish from 1.3 percentage points in 2017 to 0.3 percentage points in 2019. Contribution of domestic demand is projected to remain relatively strong in 2018, 3.6% growth forecast in private consumption, 10% growth in investment. The unemployment rate is expected to fall further from 9.5% in 2017 to 7.2% in 2019. The fiscal position of the country has further improved with the general government deficit of 1.9% of GDP in 2016 projected to turn into a 0.5% surplus in 2018. At the same time, the general government debt to GDP ratio is expected to improve from 73.6% of GDP in 2017 to 69.3% in 2018.

As of the year end 2017 there were twelve commercial banks, three savings banks and three branches of foreign banks operating in the Slovenian banking sector. Total assets of the banking system increased by 2.4% in 2017 and reached €37.9 billion. This was equivalent to 87.7% of GDP, down from 93.2% in 2016, mostly due to GDP growth. Three out of five largest banks are government-owned: NLB with 25.6%, Abanka with 10.5% and SID (a development bank) with 7.1% market share as measured by total assets. NLB and Abanka are under the state aid restructuring programme and the government is committed to privatising them. The government has asked the European Commission for an extension of the deadline for the sales of NLB owing to the adverse effect of an ongoing lawsuit over Yugoslav-era deposits in Croatia unfavourably on pricing conditions. The new proposed deadline for NLB bank is set for the end of 2019.

In 2017, positive economic sentiment together with beneficial economic developments and persistently low interest rates stimulated borrowers’ demand for loans. However, loans to non-financial corporations (NFCs) grew by 2.2% year-on-year, while household loans increased by 6.8% in 2017. In the household sector, consumer loans increased by 12.9% while housing loans grew by 4.8%. Non-performing exposures (NPEs) declined to 6% of total loans in December 2017, while the NPE ratio for non-financial corporations remained at a relatively high level of 12.9%, despite its gradual improvement.

Non-bank deposits rose by 5.3% year-on-year in 2017, when the household deposits grew by 5.6% (in 2016 by 7%) and deposits by NFCs at 10.6% annually. Both household and NFC deposits together amounted to €23.9 billion or 63% of total banking sector liabilities. Roughly 70% of these were sight deposits, which contributed substantially to the liquidity and interest rate risk in the banking sector.

The capital position of banks remained strong both in terms of the amount and quality of bank capital, although capital adequacy differed among banks noticeably. At Q3 2017, the CET 1 capital ratio for the banking system, as a whole, was at 19.7%, while the same ratio for small domestic banks amounted to only 11.9% and, for the group of large domestic banks to a hefty 23.9%. Due to the strengthening credit activity of banks, regulatory capital requirements have been increased gradually and banks were mostly able to cope with increased requirements by optimising capital allocation and by retaining earnings coming from advantageous performance of the banking system in 2017.
The profitability of the banks in the Slovenian banking system increased substantially for the third consecutive year and stood at 9.54% as measured by return on equity at the end of 2017. The profitability of banks can be attributed to lower credit risk exposures and a net release of impairments and provisions. However, the banks’ gross income decreased in 2017 by 4.7% in comparison to 2016, which was a result of the decreasing level of net interest income (-2.7%) as well as net non-interest income (-7.3%). Banks are trying to enhance their income by increasing the volume of lending activity as the trend of declining net interest margins persists and the margin recorded at the level of the banking system was 1.7% at the end of 2017. Maintaining a satisfactory profitability for the future is going to be a challenging task as the room for cost efficiency improvements is rather limited, net interest margins remain depressed and banks, have to face a rather challenging and competitive environment.

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Spain

Spain continues to benefit from a reduction in macroeconomic imbalances underpinned by a strong, relatively broad-based economic recovery. For the third year in a row, the Spanish economy grew by more than 3% in 2017 and above the euro area average.

This dynamism has been favoured by a structural change in the Spanish growth model; a shift with several dimensions and anchored in competitive gains. Spain has registered a current account surplus during the last five years, allowing for a more balanced growth pattern. It is also showing a strong capacity to create jobs. Employment continues to increase at a pace of around half a million jobs per year. The unemployment rate decreased to 17% in 2017 and 16% in 2018. Additionally, the functioning of the financial sector has substantially improved while the deleveraging process undertaken by the private sector, since the peak of 2010, accounts so far, for a reduction of nearly 60 percentage points of GDP. Also, the general government deficit has continued its reduction, reaching a 3.1% of GDP target in 2017.

These trends are expected to give support to the positive momentum of the Spanish economy in the future. In 2018, GDP growth forecast is 2.9% and inflation is under control, with the main challenges remaining in the field of public debt, the labour market, further tensions in Catalonia that could continue to paralyse the political reform agenda, and the withdrawal of ECB stimulus, faster than anticipated.

The Spanish banking sector was composed, as of January 2018, of twelve banking groups (14 groups last year), representing more than 90% of the industry. These groups include 59 private banks, two saving banks and 63 cooperative banks.

The very limited variation of the banking structure reflects the stability of the sector. It should be noted that the merger between the two remaining public banks, BMN and Bankia, materialised in January 2018, under the lead of the Spanish Fund for Orderly Bank Restructuring (FROB).

On the other hand, in June 2017, the Single Resolution Board agreed the resolution of Banco Popular. This resolution was the first operation of this nature carried out in the euro area under the Bank Recovery and Resolution Directive (BRRD). The resolution tool chosen was sale of the business, and it was successfully completed after its acquisition in a public auction by Banco Santander. As provided for in the regulation, the resolution of the entity had no negative impact on financial stability and did not require public funds.

In general terms, the trends observed in 2016 were maintained in 2017: low interest rates and household and SME credit slowdown continued. However, Spanish banks have gone deeper in the cleaning-up of balance sheets and in the construction of a strong CET1 on a fully loaded basis.

In terms of capital, the equity-to-assets ratio was in December 2017, and on a solo basis, 10.6%, reaching a new high for the second year in a row. The consolidated regulatory capital ratio reached 11.37% fully loaded CET1 (10.90% as December 2016). Regarding profitability, and according to EBA data, Spanish ROE continued to increase, from 5.10% in December 2016 to 7.05% in December 2017, and above the European average (6.08%), with an efficiency ratio that remained constant. As mentioned before, the NPL ratio further decreased to 4.53% in 2017 (5.70% in 2016).
As far as the Spanish balance sheets are concerned, the total volume of credit continued to experience a small reduction although fresh credit, namely for SMEs and households, increased from €250 billion in 2016 to €272 billion in 2017. In terms of deposits, a tiny drop was observed in 2017 to €1,113 billion.

Banks in Spain are early adopters in the digitalisation process of financial services. Regarding payments, they have been frontrunners for instant in person-to-person (P2P) mobile payments. After the launch of BIZUM, which allows customers to make instant P2P payments using the payee’s telephone number, the Spanish banking community was among the first to adopt SEPA Instant Credit Transfer by November 2017, which opens the instant experience of payments to business through any remote channel at their disposal. Additionally, considering their obligations under PSD2, Spanish banks work to propose the best solution for opening accounts to third-party providers for payments’ initiation and account information services. They look for a common, resilient and standard dedicated interface to provide secured access to customers’ accounts.

Spanish banks are fully committed in the fight against climate change and the 2030 agenda of the United Nations through the 17 Sustainable Development Goals. They are active players in green bonds, sustainable loans and green finance with the objective of channelling capital aligned with environmental considerations. This commitment is easily identified in the leadership of Spanish entities in numerous international initiatives aimed at promoting this field of global concern.

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Sweden

The Swedish economy continued to strengthen in the fourth quarter of 2017, writes the National Institute of Economic Research (NIER). The NIER’s Economic Tendency Survey shows strong optimism in the business sector. Consumer confidence, on the other hand, has fallen considerably in recent months to more historically normal levels. This is probably a result of the recent downturn in the housing market with falling property prices. After a strong surge in the first quarter this year, employment growth will be more subdued for the remainder of 2018 and in 2019. The NIER writes that there are bigger labour shortages in both the business sector and the public sector. One reason for this is that the share of people with a weak attachment to the labour market has risen markedly over the past decade.

There are four main categories of banks on the Swedish market: Swedish commercial banks; foreign banks; savings banks and co-operative banks. In December 2017, Sweden had a total of 119 banks, of which 40 commercial banks, 30 foreign banks, 47 savings banks and two co-operative banks.

The number of commercial banks and foreign bank branches in Sweden has increased from 59 in 2007 to 70 in 2017, due to the rise in the number of Swedish commercial banks, including credit market companies that have become banks. The number of foreign banks and bank branches has been stable around 30 banks for the last ten years. The fifth largest bank in Sweden, in relation to the total balance sheet, is a foreign bank branch.

Cross-border activities have increased over the last several years and the major Swedish banks all have a large share of their business abroad. The banking market in the other Nordic countries is important for the major Swedish banks as well as the Baltic States and other countries in northern Europe.

The Swedish state owns one bank, which mainly offers mortgage loans. Since the State sold its share in another bank in 2013 the state has no other ownership in the banking sector.

The Swedish banks have 1,409 branch offices compared to 1,950 branch offices in 2007. Branch offices are still an important way to meet the customer for several banks, even though the number of branch offices has diminished slowly in the last ten years. The Swedish banks have around 40,000 employees compared to 90,000 in the whole financial sector.

The most common means of payment in Sweden are the various charge cards and electronic giro systems. Most payments are linked to bank transaction accounts, which register salary deposits, ATM withdrawals, credit and charge card purchases and automatic transfers. In Sweden there are 2,850 ATMs and 258,000 card payment terminals.

Paper-based payments such as giro forms, cheques and cash payments have been replaced by electronic payments of various types. As an example, the use of different kinds of cards has increased from 1,200 million transactions in 2006 to around 3,200 million transactions in 2016.

According to a survey by the Riksbank, the Swedish central bank, 93% of the Swedish citizens have used a debit card in the past month and 62% have used the Swish mobile payment service. Swish, which was introduced five years ago and offers real-time account-to-account transfers, has 6.3 million users, over 60% of the Swedish population.
The strong activity in the Swedish economy is mirrored in the growth of loans and deposits. In particular, the high demand in housing has increased house lending. Lending to the Swedish public increased by 7.4% in 2017 and deposits from the public increased by 6.6% in 2017.

In a survey among managers of local bank branch offices, business volumes indicate that lending to SMEs has increased since 2013. In the same survey the managers believe that lending will continue increasing in 2018. According to an OECD report, 37% of outstanding business loans in Sweden are loans to SMEs. In a survey by an organisation for SMEs it shows that bank loans are the most common form of financing by SMEs: 20% of the Swedish SMEs in the survey used bank loans to finance investments.

Sustainable finance has high priority in Sweden. Initiatives in the area have started or are planned by both banks and government.

Normal bank services are to a large extent performed through mobile phones, tablets and computers. Moreover, new ways to perform bank services are increasing rapidly, e.g. mobile payment services, Bank e-ID and e-invoices. According to the ECB, Swedes use non-cash payments, to a larger extent, than any other Europeans. For that reason, cash in circulation is declining rapidly.

Finansinspektionen (the Swedish Financial Supervisory Authority) and the Riksbank have the main responsibility of monitoring compliance with laws and regulations, and maintaining financial stability. Finansinspektionen has a direct responsibility to supervise the individual institutions in the financial market. The Riksbank has an overall responsibility to promote a stable functioning of the financial system. In addition, the Swedish National Debt Office has the main role of handling banks in crisis and of being responsible for the deposit insurance scheme.

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Switzerland

Switzerland’s economy is in shape with stable economic growth and a comparatively low unemployment rate. In 2017, real gross domestic product (GDP) grew by 1.0%. Growth was broad-based across the various business sectors, with manufacturing, construction and most service sectors, particularly financial services, providing momentum. The average unemployment rate in 2017 was 3.2%.

The financial sector, and particularly the banking sector, is one of the key elements of Switzerland’s economy. Around one in ten value-added francs in Switzerland is generated in the financial sector.

Banks contribute to Switzerland’s international top competitiveness rank by catalysing economic development, offering a large number of skilled jobs, paying above-average salaries and contributing a considerable share of public-sector funding in taxes.

Overall, banks in Switzerland continue to be significantly affected by the negative interest rate environment following the lifting of the 1.20 CHF/EUR floor in early 2015. Interest rates on banks’ sight deposits at the Swiss National Bank, which exceed a fixed exemption threshold, remain negative at -0.75%.

The challenges currently faced by banks in Switzerland, however, are in fact manifold: high regulatory costs; shrinking margins; price-sensitive customers; negative interest rates and rising competition from both financial and non-financial actors. Despite considerable headwinds, the Swiss banking sector is in moderately positive shape with the stability-related homework done.

Banks in Switzerland are primarily focussing on digital innovation and new business models while improving internal efficiency and cost structures as well as strictly following compliance and regulatory requirements.

As of year end 2017, there were 253 banks, 2,683 branches and 7,046 ATM in Switzerland. In addition, banks in Switzerland operate 230 branches abroad.

The 253 banks in Switzerland differ in size, business model, ownership structure and regional orientation. They include four major banks, 24 cantonal banks, 43 stock exchange banks, one Raiffeisenbank and 62 regional and savings banks. The rest are split between private banks, foreign controlled banks and foreign branches in Switzerland, among others.

In terms of trends in payment systems, some of the major banks in Switzerland have developed a digital platform for payment called Twint, which enables cashless payments and person-to-person money transfers via phone numbers in real time. Although the platform was introduced in 2015, it only became the new standard after merging with its major competitor Paymit in 2017.

The total credit utilisation in 2017 was CHF 1,332 billion (approximately €1,222 billion). Liabilities to banks have fallen by more than 50% to CHF 390 billion over the last ten years. Nearly half of the CHF 7,291 billion (approximately €6,689 billion) assets currently managed in Swiss banks originate from abroad. This is equivalent to a 24% market share in global cross-border wealth management business, making Switzerland a global leader in the field.

The banks’ lending business experienced no restrictions during the financial crisis and remains key for the economic development of Switzerland. The total outstanding domestic credit volume in 2017 rose moderately to CHF 1,134 billion of which CHF 974 billion was attributable to domestic mortgage lending.

Despite low interest rates, growth in mortgage loans of 2.7% in 2017 continues to be very moderate compared to previous years. Swiss SMEs employ around 68% of the labour force. SMEs that make use of external capital primarily rely on bank financing. Around 94% of the companies that applied for a bank loan
in 2017 received an approval. To date, banks have generally not passed these negative interest rates on to
their private customers and downward risks have eased.

Clients at banks and securities dealers that are authorised by the Swiss financial market authority FINMA,
are covered by a depositor protection scheme. If a bank or securities dealer is declared bankrupt, deposits
up to a maximum of CHF 100,000 per client are secured. This applies to all deposits, including those made
at foreign branches.

The aggregate balance sheet of all the banks in Switzerland rose by 4.8% to CHF 3,249 billion in 2017
(approximately €2,981 billion). In 2016, the economic contribution of banks remained high, since banks are
important consumers of goods and services. Alongside the CHF 32.0 billion generated by the Swiss banking
sector, the indirect effects create an additional CHF 14.0 billion of value added in other sectors, leading to
a total of 7.35% share of Switzerland’s gross value added.

In 2016, the financial centre paid CHF 19.8 billion in direct and indirect taxes. This represents about 14.6%
of all federal, cantonal and municipal tax receipts. CHF 14.5 billion, i.e. more than 10% of all tax receipts,
can be attributed to the banking sector alone.

In 2017, Swiss banks employed 110,413 people, of which 93,555 were employed in Switzerland. Most of
them are employed at one of the four large banks (28%), followed by cantonal banks (18%). The proportion
of women employed remained virtually unchanged at 39%.
Economic output in the UK slowed in 2017, to annual GDP growth of 1.8%, the lowest level since 2013, lagging behind the US (2.3%) and the Euro-area (2.3%), though slightly ahead of Japan (1.7%). The UK saw inflation rising through the year, real earnings remaining negative and productivity showing little improvement.

Consumer spending moderated in the year amid pressures from higher household costs. The annual rate of consumer price inflation peaked at 3.1% towards the end of 2017, mainly driven by higher import prices from the depreciation of sterling which, despite improvement, remained around 15% below its late 2015 peak. Real earnings failed to grow during the year, staying at an average negative rate of 0.3%. Consistent with that, the household savings ratio of 5.2% points to a rundown of deposits alongside subdued borrowing. Monetary policy indications from the central bank are for a gradual rise in interest rates over the next three years.

As household consumption moderated, economic growth rotated towards net trade, boosted by stronger exports as the business landscape was underpinned by consistent levels of confidence. Through the year, manufacturing growth picked up and services output remained steady, but activity in the construction sector slowed. Rising employment added to positive business sentiment, but confidence and activity did not translate into investment, which grew annually by just 1% as businesses became conditioned to the uncertainty surrounding the Brexit negotiations and broad macroeconomic consequences.

The latest available figures showed the total trade deficit widened to 2.2% of GDP in 2016. Trade in services surplus reached a record high, with a surplus of £92.4 billion. The expansion in services exports was primarily driven by increased financial services exports, rising from £52.2 billion in 2015 to £61.4 billion in 2016. This contributed to a financial services balance increasing by £8.4 billion, to a record high of £50.8 billion in 2016, a growth of 20% from 2015.

2017 saw growth in the number of entrants into the banking and payments sector, led by technology and innovation. Further market developments, such as the Payments Services Directive II and Open Banking (facilitating the sharing, with customer consent, of transactional account information with service aggregators to allow recommendations of alternative service providers, or to allow account-to-account payment without an intermediate card or payment service) will open the market further to increased competition. Payments volumes highlight the trends — nearly 40 billion payments were made in the UK in 2017, with consumers responsible for nine payments out of every ten, the majority of which are made spontaneously. Payment card usage continues to rise — virtually all the UK population hold a debit card and two-thirds a credit card. In 2017, debit cards overtook cash as the most frequently used payment method and are expected to grow more than any other payment method, as contactless payments become increasingly accepted by retailers and service providers. Over two-thirds of UK adults used online banking and four in ten used mobile banking via an app on smartphone or tablet in 2017. The increasing uptake of ‘banking on the move’ or remote banking services is leading to a natural consolidation of traditional branches, although through an industry arrangement with post offices, there are still some 20,000 physical locations where people can carry out banking transactions.

There are some 350 monetary financial institutions (MFIs) in the UK. Just under half the sector balance sheet (48%) is held in GBP, 20% in EUR and 32% in other currencies. By country of ownership, 51% of the
sector balance sheet reflects UK ownership, 17% reflects EU ownership and the remaining 32% reflects institutions owned in the rest of the world. Total balance sheet assets of £8 trillion represent the largest banking sector in the EU and the fourth largest worldwide. The regulatory capital ratio of the sector stood at 20.5% at end of 2017, with Core Equity Tier 1 capital of £432 billion, slightly lower than a year earlier but consistent with a reduction in risk-weighted assets.

MFI credit growth in the UK in 2017 was 3.7% for private non-financial businesses and 3.8% for the household sector. Within the latter, secured lending rose by 3.8%, credit card lending rose by 7.2% and other unsecured household credit (personal loans and overdrafts) rose by 5.5%. Growth in households’ deposits with MFIs slowed in 2017, expanding by only 2.7%, less than half the annual growth rate a year earlier, while businesses’ deposits grew by 7.7% over the year.

In terms of cross-border financial services, the UK banking sector generates a balance of payments trade surplus. In 2016, the latest available figures, the surplus was £22.4 billion, reflecting one quarter of the UK’s total trade surplus in services.

The total tax contribution of the banking sector to government finances was some £35.4 billion (UK-owned banks £18.1 billion, foreign owned banks £17.3 billion), representing 48% of banking sector profits and 5.4% of all government tax receipts in the 2016/17 tax year. The sector employs more than 400,000 – some 1.6% of the total UK workforce – generating employment tax receipts of £18.4 billion, contributing 4% of the UK’s gross-value added.

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Albania

Albania is one of the fastest growing economies in Europe, with GDP growth reaching 3.8% in 2017. The main growth driver was private domestic demand, with accelerating exports providing additional impetus over the past couple of years. Unemployment decreased, public debt is on a declining trend, economic sentiment improved, and average inflation stood at 2%. Inflation is projected to rise gradually towards the central bank target of 3% as domestic demand heats up and global commodity prices and inflation edge up.

In April 2017, Albania received a European Commission recommendation to open EU accession negotiations, reflecting the progress made so far in structural and institutional reform. Bold implementation of reforms are necessary, to put Albania on a faster, sustainable and inclusive income convergence path.

The Albanian financial system consists of 16 banks, 31 non-bank financial institutions and 13 saving and loans institutions. The ratio of financial system assets to GDP increased to 102.6%. This was due to the expansion of the assets of all component segments of the system, including non-bank financial institutions, insurance companies and investment funds. The structure of financial system assets is dominated by banks, whose assets account for about 93% of the total assets of the system. Over the period, the share of banks in the financial system has increased. Banks with foreign capital account for around 81.4% of the sector’s total assets.

During 2017, the banking sector expanded its activity with the main contribution from treasury and interbank transactions, as well as by the contraction of the credit risk provisioning fund. Bad debt write-offs from the banks’ balance sheets as well as the increase of loan repayment and reconstructing has led to lower non-performing loans (NPLs). Exposure to market risks is presented at limited levels, and but needs to be monitored on a continuous basis.

By the end of 2017, the share of banking sector assets to GDP was estimated at 92.5%. This share has increased during the period, driven by the expansion of interbank transactions and the contraction of provisioning funds. In terms of financial soundness indicators, the banking sector was characterised by higher levels of capitalisation, profitability and liquidity. The direct exposure of the banking sector in the non-banking sector is assessed to be low. Banking system was operating 494 bank branches and agencies as the end of 2017.

Commercial banks represent the biggest financial market segment in the country, holding roughly €8.3 billion worth of deposits and operating a loan portfolio of close to €5 billion. Around 85% of deposits are household deposits, 65% of which are time deposits.

Lending activity slowed down in the aftermath of the crisis. A moderate credit recovery is ongoing, following higher credit demand and better credit supply. The latter reflects determined action to reduce NPLs and improve the domestic credit environment. By the end of December 2017, the balance sheet of the banking sector recorded ALL 600 billion in outstanding loans (€ 4.76 billion). Credit to residents grew by 3.4% in
2017, broadly reflecting the pick-up in domestic currency lending. The gradual rebalancing towards Lek-denominated loans continues and the share of foreign currency loans in total credit declined to 53% in December 2017, down from 60% five years ago. Lending to households grew by 7% in 2017, with mortgage loans increasing by 5% and consumer loans by 13%. Lending to businesses grew by 1.4%; with construction and service sectors benefiting the most. Business loans represent 63% of the total loans. Notwithstanding the new lending dominated by loans to enterprises, the decline in their outstanding loans has been due to the decline in NPLs, as a result of write offs, loan repayment and loan restructuring.

Banking sector assets expanded by about 4%, to ALL 1.445 billion. The performance of assets was determined by the increase of the items “Treasury and interbank transactions” and “Customer transactions” as well as by the significant contraction of the provisioning funds for credit risks. The Albanian government’s debt securities represent around 22% of the total assets.

The banking sector closed 2017 with a profit of around ALL 22 billion, as per Bank of Albania reporting standards, significantly higher than the previous year. The main reason for the increase in profits is related to the significant decrease of credit risk provisions, while net interest income continued to contract. Return on assets and return on equity are estimated respectively at 1.6% and 15.7%. The fall of interest income brought a decrease in net interest margin to 3.9% from 4.2% in 2016.

The capitalisation of the banking sector is good. In December 2017, the capital adequacy ratio stood at 16.6%, up from 16% in 2016. This is determined by the increase of regulatory capital.

The Albanian banking sector is characterised by a low financial leverage ratio. As of December 2017, the financial leverage ratio (assets to equity ratio) was 9.8 times, from 10.3 times in the previous year.
Andorra

The Principality of Andorra is a European micro-State located in the Central Pyrenees between Spain and France with a population of around 80,000.

For Andorra’s economy, 2017 was a year of consolidation, with positive data in terms of jobs and wealth creation. GDP grew by almost 2%, inflation rose by 2.6% and consumer indicators continued their promising trend with increases in car registrations (up 18.2%) and imports (up 6.6%), and the number of people visiting the country, with over 8 million tourists. These data point to a favourable outlook both for Andorra and for the Andorran financial sector.

The financial sector is a cornerstone of the Andorran economy due to its significant contribution to the country’s GDP (together with the insurance sector, the financial sector accounts for approximately 21%, while employing 5% of the workforce), with its banking system at the core.

The financial system comprises five banking groups, one specialised credit institution, eight financial investment firms, four asset management firms and 34 insurance companies, 18 of which are branches of foreign insurance companies authorised to do business in the Principality.

The banking sector has over 85 years’ experience in the business with a presence in 14 countries and as of today comprises a total of five banks which together manage over €46 billion. Out of the five banks, three are Andorran-owned, one is a subsidiary of a Spanish bank and the other is owned by an American fund.

The banks offer a full range of banking services including loans and credit, asset management and financial consultancy, operations with liabilities, financial analysis and other services (credit cards, transfers, etc.). They also have specialised subsidiaries of financing, insurance and asset management firms.

One of the challenges for the Andorran banks is to continue improving client services, both through face-to-face and remote channels. In this context, one of the sector’s main bets has been the digital transformation. Furthermore, a high-profile reform that will come into force this year is around payment services. Andorra and the banking sector are also in the process of becoming SEPA participants.

Andorran banks enjoy a high level of capitalisation. Andorra’s financial institutions closed 2017 with a 1.5% increase of assets under management reaching an aggregate of over €46 billion. This growth shows the strength and stability of Andorra’s financial centre at a time of regulatory changes in terms of transparency and banking regulation.

The success of this international strategy is proven by the fact that around 50% of the assets under management are held outside of Andorra.

The allocated net profit was €131 million in line with the international context of persistent low interest rates and the substantial investment required by the new rules and regulations. Return on equity (ROE) in 2017 was 9.85%.

Andorran banks have also contributed to Andorra’s economic growth, last year they granted €5.98 million worth of loans and credit transactions, the latter representing 31% of the lending activity.
Customer deposits amounted to €10.16 million which represent 71.8% of total assets. The loan-to-deposit ratio is 57% in line with the characteristics of private banking.

The main characteristics of the Andorran banking sector are providing added value services, a sharp focus on services and strong internationalisation and sustainable and profitable growth. The assets managed by Andorran banks have grown significantly in recent years, rising by approximately 60% in the last ten years.

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Armenia

Armenia has a strong and stable financial system with banks dominating in the system. The system is well protected due to the strict and market-friendly supervision by the Central Bank of Armenia.

In recent years, the Armenian banking sector has benefitted from adjustments to its legislation and corporate governance, high liquidity of banking assets and favourable conditions for transferring investments to other markets. These are the sound bases for rapid development of the economy and healthy demand for financial products.

The banking system is the biggest part of the Armenian financial market. As of 31 December 2017, there were 17 commercial banks operating in the Republic of Armenia. They had 528 branches in Armenia, of which 237 were based in Yerevan. The total number of employees in the Armenian commercial bank sector was about 11,175. All the banks are listed in the range of first one thousand large taxpayers’ list.

In December 2014, the Central Bank of Armenia raised the minimum amount of total capital to AMD 30 billion from previous AMD 5 billion with effect from 1 January 2017. This was aimed at ensuring the stability, efficiency and transparency of the Armenian banking environment.

The banking system is privately owned with no government share. Moreover, three of the 17 Armenian banks are open joint stock companies and banks are expected to continue to strive to attract new shareholders.

Non-residents hold stakes in all Armenian banks. Moreover, in total 65% of shares belong to non-residents. In nine banks, 100% of the shares belong to non-residents and only in seven banks are the shareholdings of non-residents less than 50%. The shares of international organisations in Armenian banks are also significant. For example, EBRD has 5.04%-22.7% shares in three banks, IFC has a 4.26% share in one bank, while KFW also has a stake in one bank.

Foreign investments in the Armenian banking sector total $2.565 billion. Investments have been made by the World Bank, European Bank for Reconstruction and Development (EBRD) and Black Sea Trade and Development Bank in large scale. By August 2017, EBRD investments in Armenia reached $1,347 million in 162 projects, of which 42% was through the Armenian banks. The investments of Black Sea Trade and Development Bank make up $269 million, 56.8% through the Armenian banks. International Finance Corporation (IFC) and KFW investments totalled $480 million and $78 million respectively.

The return on assets (RoA) was 0.9% and the return on equity (RoE) was 5.6%. In the context of capitalisation ratios, the capital adequacy ratio was 18.6% in 2017.

Armenian banks actively participate in the development of each sector of the economy. The transfer volume through the banking system is also impressive. In 2017, transfers only into Armenia was $1,750 million, of which $1,064 million came from Russia and $183 million from the USA.

The major part (92.4%) of the total sum of the outstanding loans was provided to the residents of Armenia, of which 56.8% were companies (only 1.3% of this amount was provided to the state-owned companies), 35.6% to households, and only a small part to non-profit organisations and other financial organisations. Compared to the same period of the previous year the share of loans to households in the total amount of
outstanding loans fell by 1.3 percentage points and the share of companies dropped by 0.4 percentage points.

Households and other financial institutions are mainly provided with loans in AMD (67.3% and 75.9% of the total loans provided to them, respectively) in contrast to companies and non-for-profit organisations, which prefer loans in foreign currencies (81.3% and 60.6% of total loans provided to them, respectively).

Loans to consumer, industry and the trade sector traditionally account for the major part of the total loans of the banks: 21.5%, 18% and 17.7%, respectively, in 2017. The biggest growth in lending was in the construction sector (compared to 31 December 2016, the volume of loans grew by 39.8%).

As of 31 December 2017, the loans/deposits ratio was 1.04 compared with 1.10 a year earlier. The banking system’s total net provision expenses decreased by 10.3% and reached AMD 58.2 billion. Total liabilities grew by 6.8% year-on-year, to AMD 3,661.1 billion, of which 69.8% are deposits.

The ongoing globalisation and fierce competition made banks shift to a new business model – the digital bank model – enabling their clients to make transactions by using remote channels such as Internet and mobile devices.

The Armenian banks recently began to introduce various channels of remote services, particularly online and mobile banking.

However, banks have had little time to transform their activities to adapt to new realities and they face competition from other non-bank institutions, in particular, payment systems and telecommunication companies which have begun to provide financial services.

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Azerbaijan

Azerbaijan’s economy declined by 3.8% and the non-oil sector by 5.4% in 2016 as a result of the impact of oil price shock. The weak recovery of oil prices, the emergence of new growth opportunities for the tradable sectors through the impact of the declining national currency as well as the launch of economic reforms (liberalisation of the business environment, stimulation of exports, etc.) supporting the supply in the country have led to economic growth in 2017. In general the economic growth rate in 2017 was 0.1% and the non-oil economy increased by 2.7%.

Inflation was 12.4% in 2016, and 12.9% in 2017, as a result of increased import prices with devaluation shocks.

With a gradual increase in oil prices, proficite recovered in the current account balance in 2017 (USD 1.7 billion). The large volume financial accounts’ deficit observed in previous years ($9.1 billion in 2015 and $2.8 billion in 2016) declined to $0.1 billion. The main reasons for the improvement of the balance of payments, along with increased oil prices, were the increase in the surplus on tourism and portfolio investments. As a result, the country's foreign-exchange reserves increased by $2 billion.

Owing to the decrease in transfers from the State Oil Fund of the Republic of Azerbaijan to the state budget in 2017, declines were observed in the state budget revenues (-6%) and expenditure (-1%). Transfers from the State Oil Fund to the budget amounted to AZN 7.6 billion in 2016 and AZN 6.1 billion in 2017. However, in parallel, the Fund allocated AZN 4 billion to the Central Bank of Azerbaijan to ensure macroeconomic stability. With the gradual recovery of oil prices, the amount of assets of the State Oil Fund was close to $36 billion at the end of 2017.

Taking into account the gradual stabilisation of the exchange rate of manat, growth of the non-oil economy and double-digit inflation, the Central Bank of Azerbaijan (CBA) increased the monetary base by 8.7% in 2017 to meet the monetary demand and maintain the monetisation level.

The official exchange rate of the U.S. dollar as of 1 January 2018 amounted to 1.7001 AZN / USD and EUR 2.0431 / USD. Since the beginning of the year the reserves of the CBA have increased by $1.4 billion and amounted to $5.3 billion.

Owing to the abolition of the licenses of 11 banks in 2016 and two banks in 2017, 30 banks operate in the market in 2018, of which two are state-owned and 28 are private banks. The share of foreign capital in eight out of 15 foreign capital banks is over 50 percent. Two of these banks are local branches of foreign banks.

Following the annulment of the licence of two banks in 2017 and the suspension of activity of several branches of banks or continuation of their activity as departments within the framework of optimisation of expenses, the number of branches of banks dropped from 569 to 509 during the year and the number of departments increased from 131 to 142. The number of ATMs and POS terminals also declined in 2017: the number of ATMs dropped from 2,461 to 2,431, and the number of POS terminals dropped from 71,806 to 65,471.
With the impact of double devaluation in 2015, the value of bank assets decreased by 11.2% amounting to €13.8 billion, loan portfolio declined by 29% amounting to €5.6 billion, and non-performing loans rose from 6.9% to 14% in 2017.

Despite complex economic conditions, the banking sector continued to capitalise: the total capital of the sector increased by 52% in 2017 amounting to €1.8 billion (16% of banking sector liabilities).

Due to the decrease in bank deposits placed by the financial sector in 2017, about a 7% decrease was observed in the banking sector’s deposit base, but household savings and non-financial organisations deposits rose by 1.5% and 22% respectively.

With the gradual stabilisation of manat and relatively high deposit interest rates in AZN, the level of dollarization in deposit and savings dropped. In 2017 the dollarization level in deposits and household savings dropped by 3 percentage points and 13.1 percentage points respectively.

The generation of revenues in the banking sector was restored: interest income of the sector in 2017 amounted to €465.1 million, non-interest losses amounted to €20.6 million, net profit (after tax) amounted to €432.5 million.

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Bosnia and Herzegovina

In 2017, according to preliminary data, nominal GDP growth in Bosnia and Herzegovina accelerated to 1.05% compared to 2016 and was €15.9 billion (consumption-based GDP; the share of household consumption in total GDP is about 76%).

Supported primarily by consumption and to some extent by public investment, GDP increased by 2.8% in 2017; and the still favourable external environment is expected to support growth acceleration in 2018. The unemployment rate in 2017 was 39.5%, an improvement compared to 2016 (41.7%) with a tendency to further improvement. The population of Bosnia and Herzegovina is 3.5 million.

Public debt was 40.7% of GDP in 2017, whereas in 2016 it was 43.7%. Gross debt in 2017 declined vs 2016 year end by 6% or €400 million. Bosnia and Herzegovina (BiH) foreign debt in 2017 decreased in comparison to 2016 year end by 8% or €371 million. Inflation was 1.3% and increased compared to 2016 year end.

The BiH financial system is dominated by commercial banks. Currently 23 banks operate on the market.

As Bosnia and Herzegovina consists of two entities: Federation of BiH and Republic of Srpska. There are two supervising bodies for the banking sector: Banking Agency of Federation of BiH and Banking Agency of Republic of Srpska.

In 2017, the banking sector proved to be a generator of business in the BiH economy. Total bank assets amounted to €14.5 billion and grew by 8% compared to the previous year. Total deposits in BiH amounted to €10.8 billion and had increased by 12.2%. Deposits of legal entities increased by 21% and deposits of individuals by 5.8%.

The growth of loans was 7.1% compared to the previous year, whereas loans to legal entities grew by 7.5%, while loans to individuals grew by 6.6%. Total loans amounted to €9 billion, whereas loans to individuals amounted to €4.7 billion.

The increase in deposits and loans enabled the increase of economic activity throughout the country.

All banks ended 2017 with historically good results. The banking system of BiH ended the year with a net profit that was 51% higher than that end 2016 (after taxes). This is the best result achieved so far.

Such profitability positively influenced all the indicators: return on assets, return on equity, and most importantly for the capital adequacy ratio, which in all banks is considerably above the regulatory requirement. With its reorganisation which included a significant reduction in operating costs and a reduction in interest rates on loans up to 15%, banks have a significant impact on improving the overall economic situation in the country. Great attention is paid to reducing costs, through cost optimisation, business reorganisation, and investment in digitisation as a new opportunity to generate revenue.

As for the payment systems in BiH the number of transactions increased by 2.7% compared to the previous year whereas the value of these transactions is 8.8% higher than in 2016.

The ten largest BiH banks participated in 71% of payment transactions, an increase when compared to that of 2016 (70% in 2016). Their transaction volumes increased by 5.8%, while the total value of transactions increased by 17.7%. In 2017, a total value of interbank transactions was 8.8% higher than the previous year.
At the same time, intrabank transactions were worth 28% more than in the previous year.

The ratio between intrabank transactions and intra-banking transactions was:

- 45% of interbank transactions and
- 55% of intrabank transaction

The total number of active cards in 2017 was above two million. Card transactions on POS terminals increased by 8% on the previous year. The use of ATMs and POS terminals is as follows: POS 29%, ATM 71%.
Macedonia

In 2017, the Macedonian economy experienced economic stagnation, mainly due to the decline in investments as a result of the prolonged political crisis. However, there were positive developments towards the end of the year, as well as retained macroeconomic fundamentals and structural transformation in recent years, which together with the favourable external environment, provided a solid basis for rapidly reversing the path of the economic growth.

The trend of reducing the unemployment rate continued to fall in 2017, dropping to 22.4%.

Inflation increased in 2017, in line with the movement of the global prices of basic products, especially fuel. The average inflation rate was 1.4%.

On December 31, 2017, there are 17 deposit-taking institutions in the Republic of Macedonia, 15 banks and two savings houses. Six banks are mainly oriented to lending to non-financial companies, five banks are mostly crediting households, three banks equally finance the two sectors, while one bank, Macedonian Bank for Development Promotion places credits through the other banks (as the state-owned financial intermediary for approved credit lines from international financial institutions).

Most banks are owned by foreign shareholders. In 2017, eleven banks were owned by foreign shareholders, and there were six subsidiaries of foreign banks, unchanged from 2016.

Greek and Slovenian shareholders held 21.3% and 14%, respectively, of the banks’ share capital. In 2017, the share of capital originating from Germany increased by 0.8 percentage points.

Since the beginning of 2017, the National Bank of the Republic of Macedonia (NBRM) through the Macedonian Interbank Payment System has enabled the banks to make payments in euros (inflows and outflows) in the country and abroad through the payment system TARGET 2.

The number of ATMs with transfer functionality rose in 2017 by 9.4%. The number of accounts that could initiate electronic banking increased slightly and the number of contactless cards doubled. The total value of non-cash payments in the country in 2017 grew by 9.6%.

The banking network consists of 427 branches. In 2017, the number of employees in the banking system was 5,929.

Despite caution on the part of domestic non-financial entities and consumers, consequently, reduced demand for loans in the first half of 2017, banks maintained a satisfactory pace of lending activity. Thus, the total loans to non-financial entities in 2017 increased by 5.9%, which was faster than to the growth of total bank assets and deposits. The credit growth was mainly a result of the increased credit to households, which contributed to the total annual growth with almost three quarters of loans to non-financial entities.

The fall of banks' deposits in the first quarter of 2017 and their minimal growth in the second and third quarters of this year contributed to a slowdown in the growth rate of the total deposit potential of the banks in 2017, despite the solid growth of the deposits realised in the last quarter of the year. The deposit growth rate was 5.1%.
Deposits remained the main source of financing of banking activities (73.4% of total assets, which is almost unchanged compared to end 2016). Moreover, households are still the most significant depositor in the domestic banking system, with a share of 69.8% in the total deposits (68.5% in 2016).

In 2017, the ratio between the loans and deposits of non-financial entities registered a minimal increase mainly owing to the stronger credit growth (5.9%) compared to the deposit growth rate (5.1%).

At the end of 2017, this ratio was 87.7%, 0.7 percentage points higher than 2016.

In 2017, there were no significant changes in the level of credit risk in the banking system.

The most significant credit risk for the banks still derives from the corporate sector, where the rate of non-performing loans (NPLs) was 10%. The credit risk of households' placements is low, with the NPL rate falling to the historically lowest level of 2.4%. The share of NPLs in total loans in 2017 decreased by 0.3 percentage points and reached the lowest level of 6.3%.

Prudential regulation and supervision, as well as the careful approach of banks in measuring the credit risk, enable high coverage of NPLs with the allocated impairment and minimising the risks for the banks' solvency against possible full default of these loans.

During 2017 the banks worked in an unstable political situation in the country and reduced economic activity, especially in the first half of 2017, which gradually stabilised in the second half of the year. The unpredictable domestic environment certainly affected the modest annual growth of the total assets of the banking system by 3.9%.

In 2017 the banking system successfully maintained its solvency. The banks' capital positions experienced faster growth compared to the risk-weighted assets, mainly due to the reinvestment of some of the banks' profits and the issuance of new subordinated instruments. This enabled an increase in the solvency indicators, with the capital adequacy ratio at the end of the year, amounting to 15.7% or more than the 0.5 percentage point compared to the end of 2016.

One of the significant challenges the banks faced in 2017 was the compliance with the capital requirements of Basel III from March 2017. Banks now have to calculate and maintain a minimum level of capital adequacy ratio (8%), also the rate of core capital (6%) and the rate of regular core capital (4.5%). In addition, and apart from the internal capital requirements, all banks have an obligation to maintain a capital conservation buffer of 2.5% of the risk-weighted assets.

Moreover, seven banks, designated by the NBRM as systemically important banks, have an obligation to fulfill the protective layer of capital for systemically important banks.

Finally, in 2017, the banking system realised a profit, which was 3.6% higher compared to the profit realised in 2016.

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Moldova

The analysis of the economic indicators for the year 2017 shows that the economic situation in the Republic of Moldova continued an upward trend, and the Moldovan economy was showing signs of revival.

Economic growth is characterised by the growth of the Gross Domestic Product, which amounted to €7.4 billions, and increased by 4.5% compared to 2016. The initial projected increase of 6% did not materialise due to several factors, including the adverse weather conditions in the spring of 2017, which undermined agricultural production and business uncertainty, which stifled the relaunch of lending.

The volume of industrial production increased by 6.6% and the total agricultural production in households of all categories grew by 8.6% compared to 2016. Investment activity also increased (+2.4%).

The average inflation rate for the year 2017 amounted to 6.6% and remained within a relatively stable range.

As far as the development of foreign trade is concerned, in 2017, Moldova managed to increase exports by 18.6%. Thus, exports of goods made in 2017 amounted to $2.4 billion, $0.4 billion more than in 2016, and imports amounted to $4.8 billion, up by $0.8 billion.

Exports of Moldovan products to the EU market in 2017 totalled $1.59 billion, accounting for 66% of total Moldovan exports, up by 19.9% compared to the same period in 2016. At the same time imports from the European Union reached $2.39 billion, representing 49% of the total imports in the Republic of Moldova.

The monetary policy promoted by the National Bank of Moldova during 2017 was influenced by the rise in inflationary pressures generated largely by the changes in fiscal policy, adjusting regulated prices to the new market realities, and the major excess of liquidity in the economy.

The base rate set by the Moldovan National Bank dropped from 9% in the first half of 2017 to 6.5%. In this respect, the interest rate on newly granted loans decreased from 11.5% to 9.58%. The required reserves ratio of the attracted funds in national currency was increased to 40% and the reserve ratio in foreign currency was maintained at 14%.

As of December 31, 2017, eleven banks were licensed by the National Bank of Moldova (NBM) to operate in the Republic of Moldova, including four branches of banks and foreign financial groups.

In the registered capital of licensed banks in Moldova, the share of foreign investments is 81%, and the share of domestic investments is 19%. The state does not hold shares in the capital of the banks.

Among the foreign investors participating in the formation of the capital of the banks of the Republic of Moldova are the European Bank for Reconstruction and Development, banks from Italy, France and Romania, as well as corporate investors from Germany, Austria, the UK, Ukraine, Cyprus, Russia, the US, The Netherlands, Liechtenstein, Switzerland and the Czech Republic. Of the total number of banks, four banks have full foreign investment capital, two of which are branches of foreign banks, and seven banks have foreign and domestic capital.

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Monaco

Monaco's financial marketplace dates back to the end of the nineteenth century, when the first deposit banks opened in the Principality. Most of these banks were French. However, the financial industry did not really take off until the 1970s, when expansion was stimulated by an imaginative and active policy on the part of the public authorities and by the effect of a long period of economic growth and political and social stability.

Today, Monaco has a very extensive banking network, comprising around thirty full service banks and fifty portfolio or mutual fund management companies.

The banking and finance industry is now one of the strengths of the Principality’s economy. Total assets have doubled in the past 15 years. By the end of 2016, credit institutions held about €115 billion in deposits and securities.

- Monaco’s continued attraction as a financial centre is based on advantages that include high quality infrastructure and dedicated professionalism;
- a diversified economic base and an attractive tax regime.

All of the banks operating in Monaco belong to leading banking groups. Some 70% of the industry’s assets belong to non-resident clients from across Europe and sub-Saharan Africa, the Middle East, Latin America and Asia-Pacific.

Under various agreements between France and Monaco, Monegasque banks are supervised by the Prudential Supervisory Authority (Autorité de Contrôle Prudentiel [ACP]) and are therefore subject to the same prudential and regulatory rules as French banks. All supervisory activities are strictly regulated, which guarantees the confidentiality of transactions carried out by financial institutions in Monaco.

Asset management companies are approved and controlled by the Commission de Contrôle des Activités Financières (CCAF), which is supported at the highest level by the Autorité des Marchés Financiers (AMF), the French market regulator.

The industry provides a full range of private banking products and services, as well as a personalised approach to a highly demanding clientele. It also provides access to mutual fund management through a very broad array of investment funds covering every business sector and markets, including emerging markets. AMAF is an Associate Member of the European Banking Federation, the united voice of banks established in the European Union and European Free Trade Area.

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Montenegro

Since the restoration of its independence in 2006, Montenegro has made a serious step forward in its social and economic development, has strengthened the position of the most economically developed country in the Western Balkans, and has shown itself to be a safe, politically stable and economically sustainable country with the potential to grow rapidly. The security and prosperity of Montenegro have created preconditions for future integration into the European Union (EU). Accession negotiations began in June 2012.

Current developments in the Montenegrin economy point to the recovery of economic activity from the second quarter of 2016, underpinned by intensifying investment in large infrastructure projects as well as projects in tourism and energy. Under the conditions of the global economic crisis, the programmes of eliminating the barriers to the development of new investment projects and the creation of a more favourable business environment have become crucial. In this respect, the business environment in Montenegro has been significantly improved by adopting new laws aligned with the EU regulations and implementing institutional reforms in the fiscal system and the financial sector. The economic policy is focused on increasing the competitiveness of the economy, with the implementation of structural reforms and the development of infrastructure, with the aim of creating conditions for a greater inflow of domestic and foreign investments.

According to the 2016-2019 projections for Montenegro, real GDP growth is expected to reach 4.4% in 2017, 3.9% in 2018 and 1.8% in 2019. It is estimated that Montenegro’s economy will grow up until 2019 due to the growth of investment activities and the engagement of domestic resources, primarily in the construction and transport sector. The strong contribution of the construction sector will be boosted by domestic companies involved in road building, as well as the construction of new tourist and energy facilities. Positive contributions are also expected from the agricultural sector, as a factor of substitution for food imports and increased exports.

Owing to the economic growth, employment will gradually increase (on average 1 percentage point per annum), and the 2% growth in salaries, on average, is expected in the period 2017-2019. The unemployment rate is expected to fall from 19.4% in 2016 to 16.6% in 2019. Fifteen banks operate in Montenegro and the banking sector is stable and adequately capitalised. The stability of the sector is reflected in the growth of all key business indicators in the system during 2017. The balance sheet of banks grew by 10% in 2017, while the growth of total loans and deposits was 14.1% and 10.9%, respectively. The aggregate financial result of banks’ performances was positive and significantly higher than in the previous year.

With regard to capital adequacy, capital grew by 7.9% in 2017. The aggregate solvency ratio was 16.8%, which was above the statutory minimum of 10%.

The progress in improving the quality of the loan portfolio and reducing non-performing loans (NPLs) has been noticeable over a long period of time. Total NPLs, as well as their share in total loans, have been declining in recent years. The NPL ratio fell from 25.9% in August 2011, to 10.29% at the end of 2016. During 2017, the NPL ratio fell further to 7.0% by year-end.
The preservation of financial stability in an open economy, integrated into the international environment, is a continuous challenge for the banking system and regulators and applies to all segments of the financial system, financial infrastructure and their participants. Montenegrin economy and the banking sector are not isolated from the domestic risks, nor from the transfer and materialisation of international risks and uncertainties. Consequently, the policy is focused on a proactive approach and preventive action in communication and control of banks, as well as in the creation of a regulatory environment in accordance with the implementation of international standards and sound banking practice.

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Serbia

The banking sector of Serbia comprises 28 banks operating on the market pursuant to the licence of the National Bank of Serbia (NBS), as the banking regulator and supervisor. Seven of these banks are fully or partially state-owned. Most of the banking market capital is foreign (83%), predominantly coming from EU countries (Austria, Italy, Hungary, Greece and France). In recent years the Serbian banking sector followed the global trend of consolidation, resulting in several mergers and acquisitions on the market. These processes are leading towards further consolidation of the banking sector, achievement of better performances of banks and higher yields to shareholders.

At the end of 2017 the balance sheet size of the banking sector amounted to €28,425 million, and total capital of the banking sector, to €5,615 million. Lending activity of banks, after a medium-term period of stagnation and decline, recorded an upward trend in 2017, encouraged by the easing of the monetary policy of the NBS, accompanied by the effects of increased competition among banks, the growth of economic activity, the recovery of the labour market, and the decline in the country’s risk premium and low interest rates in the euro area. Total loan placements at the end of 2017 were nominally higher by 3% compared to the end of the previous year. Consequently, there was growth despite the write-offs of non-performing loans (NPLs), which exceeded those of the previous year.

Broken down by the sector structure, corporate loans (companies and public enterprises) experienced a nominal growth by 2.7%, at the end of 2017. Loans granted to entrepreneurs noted a nominal growth pf 3%, while retail loans were, in nominal terms, 10% higher at the end of 2017 than they were at the end of the previous year, the result of a considerable drop in the interest rates on loans linked to foreign currencies (FX). The gross carrying value of all approved loans granted to public enterprises, companies, entrepreneurs, households and the public sector amounted to €15.3 billion. Corporate loans experienced growth based on the increased lending to companies. Increase in retail lending continued, primarily in the segment of cash and refinancing loans.

The banking sector of Serbia ended 2017 with net profit before taxes to the amount of €580 million, which was 33.7% higher than in 2016. Return on assets in 2017 was 2.2%, which was higher by 1.5 percentage points than in the previous year, while return on equity (RoE) at the end of 2017 amounted to 11.1%, indicating growth by 7.7 percentage points. It should be noted, however, that after excluding the effects of solving NPLs, the RoE amounted to only 4.2%. Nevertheless, the quality indicators of the banking sector’s balance sheet structure at the end of 2017 remained satisfactory: the capital adequacy ratio was 22.6% (far above the regulatory minimum of 8%), the coverage of NPLs by loss provisions was 133.2% and the liquidity ratio was 2.0.

In 2017, inflation remained low and stable, moving within the allowed deviation from the NBS target (3% +/-1.5 percentage points). Bearing in mind that low inflation expectations and relatively stable foreign exchange rates have been present for a longer period, together with other signs of stability, especially fiscal consolidation, these measures will support further incentives to lending and overall economic activity. The FX rate of the dinar against the euro remained stable during 2017, thus confirming the trend of a relatively stable FX rate in the past five years. Such a trend of the FX dinar rate considerably contributed to the maintenance of low and stable inflation.
The NPL ratio at the banking sector’s level, as a percentage of the share of these loans in the portfolio of total approved loans at the end of 2017, amounted to 10%. This indicator experienced a significant drop in comparison to the end of 2016 (down by 7.2 percentage points, chiefly owing to the banks selling NPLs, thereby significantly clearing their portfolios from risk-bearing assets and boosting their liquidity. Broken down by sectors, the highest rate of NPLs was noted in corporate loans (around 11%), the same as in the loans granted to entrepreneurs, followed by public enterprises with 6.4% and households with 5.6%. All of the observed indicators decreased compared to the year before, due to the active measures of the NBS, the Serbian government, and the banks, the end goal being to solve, finally, the problem of NPLs as a limiting factor to the increased lending growth.

Overall, the results of the banking sector’s operations in 2017, together with the prospects of further improvement in 2018, show that the banking sector is highly secure, stable and liquid.

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Turkey

Despite the increase in external shocks stemming from global financial markets and geopolitical risks, Turkey's economy grew rapidly in 2017. The banking sector supported growth and increase in employment by financing economic activity through enlarged loan supply.

Compliance with international standards in banking regulations was further continued in 2017. The EU Council announced that Turkey was fully compliant with Basel regulations. During the transitional period to IFRS 9, following the completion of regulations, test work was carried out throughout the year.

As of 2017, 52 banks operated in the banking sector, of which 34 were deposit banks, and 13 were development and investment banks. Three of the deposit banks were state-owned banks, and nine were private banks. In addition, there were five participation (Islamic) banks.

As of the end of 2017, banks employed 208,000 people, while the number of bank employees decreased by 2,631 compared to the previous year. The number of branches declined by 158 to 11,582; the decline in number of branches resulted from deposit banks. The population per branch was 6,977.

The sector share of the largest five banks in total assets was 56%. The share of the first ten banks in total assets remained unchanged with 85%.

The share of assets of deposit banks in the banking sector was 90%, while the shares of development and investment banks and participation banks were 5% each.

Total assets increased by 19% to TL 3.3 trillion. Total assets increased by 11% to $864 billion on a dollar basis. The ratio of total assets to GDP was 105%.

Banking sector loans and liquid assets represented 65% and 15% of assets, respectively. The share of securities was 12%. The share of subsidiaries and fixed assets was 2%.

Deposits and non-deposit funds accounted for 53% and 28% of liabilities, respectively. The share of shareholders’ equity in total liabilities was at 11% level.

Loans increased by 21% in nominal terms, and by 19% in fixed exchange rates, amounting to TL 2,112 billion ($560 billion). The ratio of loans to GDP increased by 1 percentage point to 68% compared to the previous year. Loans to be provided with the Treasury-backed Credit Guarantee Fund (CGF) guarantees were a key factor in loan growth. The effective rate of guarantee by CGF backed loans was about 6%.

Some 51% of total loans was extended to large scale companies and project financing, 24% to SMEs and 25% to consumers.

The share of housing loans in retail loans was 36%, the share of consumer loans 39%, credit cards 23%, and that of automobile loans 2%.

The ratio of non-performing loans to total loans was 3%. This rate was around 2.8% in corporate loans and 3.5% in retail loans. Provisions set aside represented 79% of non-performing loans.
Total deposits grew by 18% in nominal terms and 11% in fixed exchange rates to TL 1.711 billon ($454 billion). The ratio of deposits to GDP was 56%. The loan-to-deposit ratio increased by 3 percentage points compared to the previous year to 123%.

Non-deposit funds amounting to 28% of total liabilities increased by 21% in nominal terms and 12% in fixed exchange rates to TL 903 billion ($239 billion).

Due to the inclusion of almost all net profit to shareholders’ equity, shareholders’ equity increased to TL 359 billion ($95 billion). Shareholders’ equity financed 11% of total assets. As a result of shareholders’ equity growth and regulatory framework compliant with international standards, capital adequacy increased by 100 basis points and reached 16.6%. Core capital adequacy ratio kept its high level with 13.9%, increasing by 70 basis points.

Profit volume increased by 31% to TL 49.1 billion ($13 billion) due to the rapid increase in loan volume. Return on average equity increased by 160 basis points to 14.9%. As of December 2017, average return on average assets with around 1.6% remained almost the same compared to the previous year.

Despite the market value of the banking sector’s stocks, traded on Borsa İstanbul, increasing from TL 175 billion to TL 233 billion, the ratio of market value of the banking sector’s stocks to total market value decreased to 27%. The ratio of market value to book value declined from 0.88 to 0.84.

As of December 2017, the number of active customers using digital banking transactions reached 35 million. Some 95% of the customers were individual, and 5% were corporate. In the last three quarters of 2017, the value of digital banking transactions was TL 2,960 billion, 121% of GDP in the same period.

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SHARE OF TOTAL NUMBER OF BANKS IN THE EU-28
TOTAL NUMBER OF BANKS: 6,250

- Germany 26.1%
- Other EU Member States 17.4%
- Poland 10.3%
- Austria 9.2%
- Italy 8.7%
- France 6.8%
- United Kingdom 5.9%
- Ireland 5.6%
- Finland 4.3%
- Spain 3.3%
- Sweden 2.5%
- Other EU Member States 17.4%

All figures as at 31 December 2017. Amounts in € millions.
SHARE OF TOTAL ASSETS HELD BY BANKS IN THE EU-28
TOTAL ASSETS: €42,888,568

United Kingdom, 21.0%
France, 19.7%
Germany, 18.0%
Italy, 8.7%
Spain, 6.3%
Netherlands, 5.5%
Sweden, 3.2%
Denmark, 2.5%
Luxembourg, 2.4%
Ireland, 2.5%
Other EU Member States, 10.2%
SHARE OF TOTAL CAPITAL AND RESERVES IN THE EU-28 BANKING SECTOR
TOTAL CAPITAL AND RESERVES: €3,576,308

- United Kingdom 19.9%
- France 17.0%
- Germany 16.3%
- Italy 12.2%
- Spain 8.2%
- Netherlands 3.9%
- Sweden 2.6%
- Ireland 2.3%
- Austria 2.1%
- Greece 2.0%
- Other EU Member States 13.3%
Country-by-country statistics – Euro area Member States

All figures as at 31 December 2017

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<th>Number of banks</th>
<th>Assets (€ million)</th>
<th>Loans (€ million)</th>
<th>Deposits (€ million)</th>
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Country-by-country statistics – Non-euro area EU Member States

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<th>Number of banks</th>
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<th>Loans (€ million)</th>
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<td>370</td>
<td>8,995,107</td>
<td>4,040,049</td>
<td>3,849,684</td>
<td>712,143</td>
</tr>
<tr>
<td>Non-Eurozone</td>
<td>1,481</td>
<td>12,510,007</td>
<td>6,297,345</td>
<td>5,341,416</td>
<td>1,010,928</td>
</tr>
<tr>
<td>EU-28</td>
<td>6,250</td>
<td>42,888,568</td>
<td>24,602,917</td>
<td>22,891,054</td>
<td>3,576,308</td>
</tr>
</tbody>
</table>

EU-28 2,737,889
The focus of this publication is on banks; however, the pure data on banks is not available from the ECB. This is why the EBF uses both of the notions of Credit Institutions (CI) and of Monetary Financial Institutions (MFI) depending on which type of data is available. Since banks represent around 75-80% of the entire financial system in the EU, the EBF deems it feasible to base the analysis of the banking sector on the ECB’s CI and MFI data. For your convenience, the ECB definitions of CI and MFI are presented below:

Credit Institution (CI) = Any institution that is either (i) an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credit for its own account, or (ii) an undertaking or any other legal person, other than those under (i), which issues means of payment in the form of electronic money.

Monetary Financial Institution (MFI) = Financial institutions which together form the money-issuing sector of the euro area. These include: the Eurosystem, resident credit institutions (as defined in EU law) and all other resident financial institutions whose business is to receive deposits and/or close substitutes for deposits from entities other than MFIs and, for their own account (at least in economic terms), to grant credit and/or invest in securities. The latter group consists predominantly of money market funds.