

Asset side

The growth of EU/EEA banks' assets has been affected by the weak economic growth, the persistent inflationary pressures – that are still above the central banks' target levels – and the relatively high interest rate levels. Banks have further lowered their cash balances, as they completed the repayments of the ECB's TLTRO, but they still hold relatively high levels of their assets in liquid assets. Expectations in the real estate markets have reduced the demand for housing loans, while geopolitical risks may have also encouraged borrowers to delay long-term investments. EU/EEA banks accordingly reported low loan growth since back in September 2022. This development was additionally affected by banks' limited willingness to take risks and grow their balance sheets, making their credit standards stricter. The effects of this slowdown could feed into an adverse loop of lower economic growth in the medium term and also affect directly (and indirectly) EU/EEA banks' performance. However, data on funding plans from EU/EEA banks shows an intention to gradually increase loan growth for both households and businesses. For the period from 2024 to 2026, banks expect cumulative lending growth of 12.4% for businesses and 7.1% for households.

The signs of worsening asset quality that banks, supervisors and market players anticipated in previous quarters began to appear, although slowly, during 2023. Rising living costs due to inflation and high interest rates have put some pressure on borrowers that have had to cope with lower debt repayment ability. The still strong labour markets may have partly offset the impact of weak economic growth on asset quality. In this context, the share of NPLs increased for all segments, and there was a slightly positive net NPL inflow in 2023. Despite banks' slight improvement in asset quality expectations, especially for households, the increased share of stage 2 loans and the ongoing macroeconomic instability do not permit any relaxation and require a thorough assessment of credit risk.

Assets: volume and composition

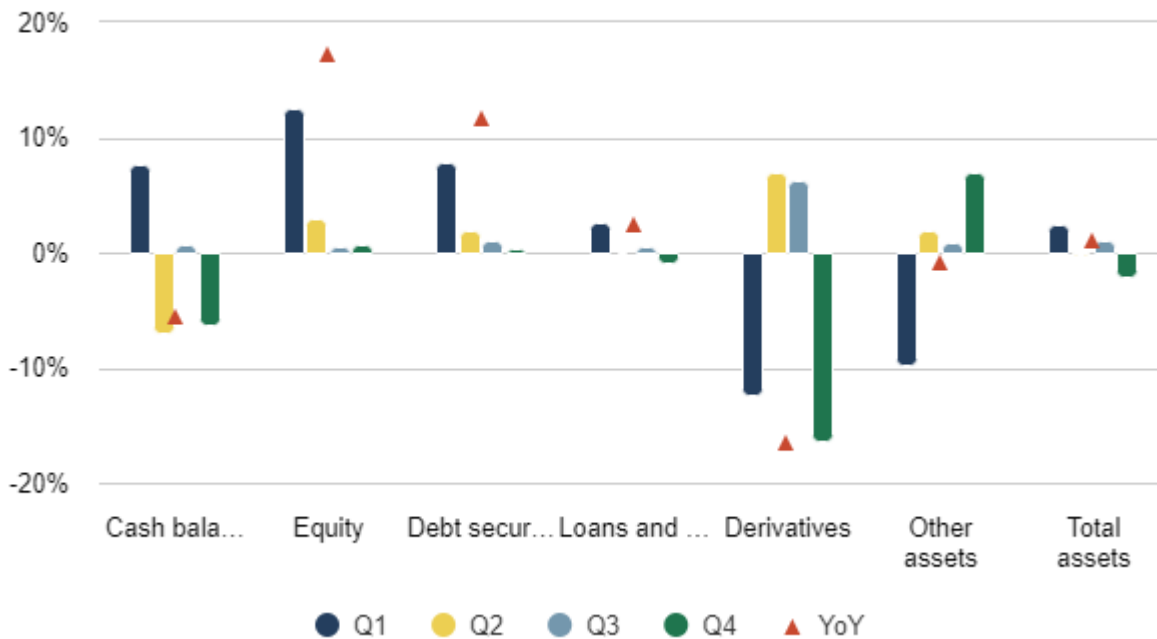
Cash balances and subdued loan growth limit asset expansion

The overall uncertainty in the macroeconomic environment remains elevated and this has impacted EU/EEA banks' risk appetite to further expand their balance sheets. As of Q4 2023, EU/EEA banks' total assets stood at EUR 27.3tn. This reflected an increase of +1.1% on a YoY basis.

The assets development in 2023 for the EU/EEA banking sector was mainly driven by the ongoing trend to reduce cash balances (-5.5% YoY), mainly due to the repayment of ECB's TLTRO facilities. It was also characterised by a lately emerging rise in debt securities (+11.6% YoY), including sovereign exposures. The latter could be explained by banks aim to lock-in higher yields for the medium to long-term, and might also explain partly the reluctance of the sector to expand their loan portfolio aggressively. Despite the higher exposures towards debt securities, the reported unrealised losses of EU/EEA banks' debt securities recognised at amortised cost were substantially lower.^[1] In December 2023, EU/EEA banks reported EUR 52bn of unrealised losses compared to more than EUR 99bn a year earlier. On average unrealised losses represent less than 3.5% of the EU/EEA banks' capital. Yet, for the smaller 50th percentile of banks, the unrealised losses amount to more than 6.5% of their capital, while for the 10 largest institutions the equivalent is less than 2%.

Loans and advances were only up by 2.4% YoY, significantly below the rise in 2022 (+5%). Total loans and advances accounted for EUR 17.1tn in December 2023 (+0.4tn YoY). Although during the first three quarters of 2023 EU/EEA banks consistently reported increased outstanding loans, in the last quarter of the year there was a significant drop (EUR -153bn) (Figure 5).

Figure 5: Quarterly and yearly growth rates in asset components, December 2022 to December 2023



Source: EBA supervisory reporting data

Growth in credit for consumption stands out as consumers keep up with inflationary pressures

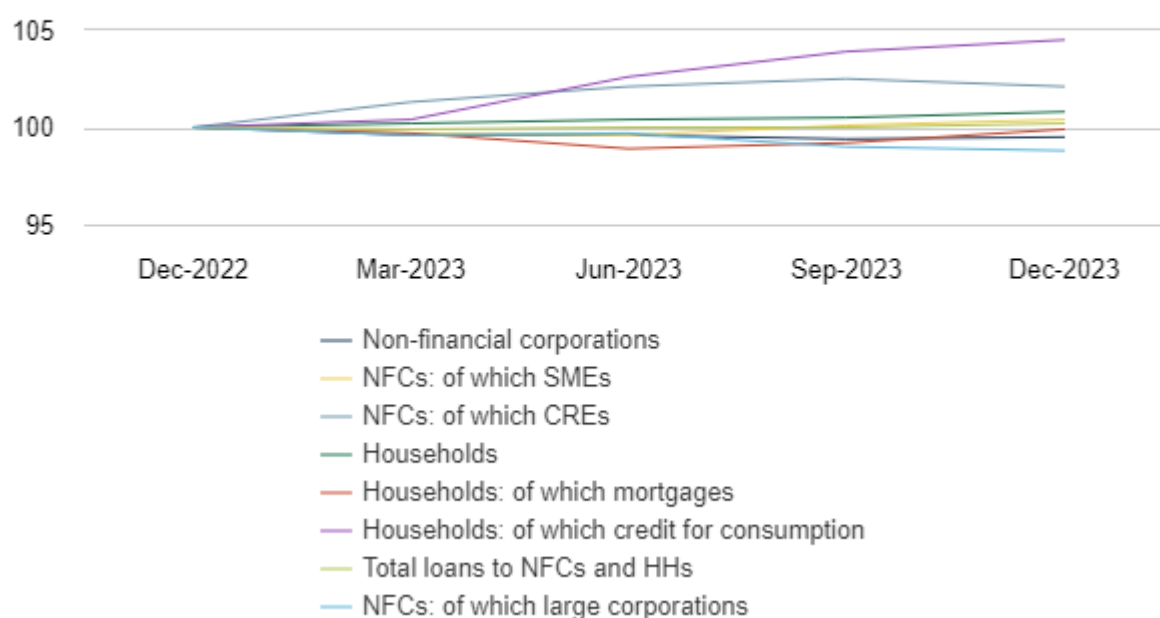
Over the course of 2023 outstanding loans towards NFCs and households remained stable at EUR 13.2tn despite the stabilisation of interest rates and increasing expectations for monetary easing. Elevated borrowing costs and economic uncertainty still adversely affected the demand for loans in the second half of 2023, while preeminent macroeconomic uncertainty still affected banks' risk-taking appetite. As of December 2023, EU/EEA banks reported exposures towards small and medium-sized enterprises (SMEs) of EUR 2.6tn (+0.4% YoY), while CRE loans stood at EUR 1.4tn (+2.1% YoY). Total loans towards NFCs accounted for EUR 6.3tn, down by 0.5% YoY. This was mainly driven by a decrease in loans towards non-SMEs (-1.2% YoY), as large enterprises scaled back their investments. Loans to these companies stood at EUR 3.7tn in December 2023. The subdued NFC loan growth in 2023 was not only due to low demand but also supply-driven. In the course of early 2024, the tightening of banks' credit standards seems to have slightly and slowly reversed. This

coincides with a reversal of banks' risk perceptions.

The overall decrease in NFC exposures was underpinned by a substantial setback in outstanding loans towards the manufacturing (-3.7% YoY) and mining and quarrying (-14.8% YoY) sectors. By contrast, NFC lending was supported by an increase in loans in the real estate activities (+2.2%) and information and communication (+5.7%) sectors, which saw the most positive impact across all sectors. EU/EEA banks' total loans towards households accounted for EUR 7.0tn (+0.8% YoY), of which EUR 4.5tn (-0.1% YoY) were loans collateralised by RRE and EUR 1tn (+4.5% YoY) was credit for consumption. Following a decline in the first half of the year, demand for house purchase revived slightly in the second half (+1% in outstanding mortgage loans), as stabilising lending rates helped demand which was also boosted by improving consumer confidence. The latter also facilitated demand for consumer credit, which has increased despite the simultaneous tightening of banks' credit standards. Higher wages and a solid job market offset the increase in living costs. As a result, outstanding credit for consumption increased by close to EUR 50bn in 2023 (+4.5% YoY). Despite related risks, CRE exposures rose by 2.1% in 2023 (Figure 6; on CRE exposures and related risks see Chapter 7).

Figure 6: Growth in loans and advances by segment, December 2022 to December 2023

December 2022 = 100



Source: EBA supervisory reporting data

EU/EEA banks further increase their sovereign exposures, tilting the maturity profile to the longer end

The substantial increase in EU/EEA banks' debt securities holdings was mostly driven by sovereign exposures. EU/EEA banks exposures of around EUR 3.4tn towards sovereign counterparties increased by 8% compared to December 2022 (EUR 3.1tn). Almost half of these exposures were towards domestically domiciled counterparties, while 27% were towards other EU/EEA countries. Sovereign exposures towards non-EU/EEA domiciled counterparties were slightly above EUR 810bn, around EUR 80bn more than a year before. Over the last few years, the maturity profile of the sovereign debt held by EU/EEA banks has tilted towards the long end. At least 48% of EU/EEA banks' sovereign exposures had a maturity of more than five years while 31% have a maturity of between one and five years.

Figure 7: EU/EEA banks' sovereign exposures maturity profile trend (year-end)

Source: EBA supervisory reporting data

This preference has been present for some years, as EU/EEA banks have been allocating a higher share of their investments to longer maturities. For example, in 2023 EU/EEA banks reported EUR 300bn more in sovereign exposures with long-term maturities than in 2018 (EUR 1.6tn vs EUR 1.3tn). Although this maturity profile may not offer a swift rollover to higher-rate investments, it allows locking in of higher rates for a long-term investment period and might serve as a hedging instrument. Yet, it exposes banks to heightened interest rate risk which banks need to manage prudently given the recent abrupt changes in the interest rate environment (Figure 7).

Banks' credit standards ease in some cases and demand partly resurges in the recent quarter

In 2023, macroeconomic uncertainty and monetary tightening concerns led to the adoption of stricter and more prudent lending standards for both loans and credit lines to enterprises and housing loans and consumer credit for households in most EA countries. This tightening, combined with a significant contraction in loan demand, accordingly weighed on loan growth.^[2] In the first quarter of 2024, EA banks still reported a slight net tightening of their credit standards for loans or credit lines to enterprises, while keeping

terms and conditions broadly unchanged. Meanwhile, credit standards and terms and conditions for housing loans eased for the first time since Q4 2021, while they tightened further for consumer credit and other lending to households. Alongside the overall net tightening of lending policies, higher interest rates, lower fixed investment of NFCs and low consumer confidence of households continued to exert negative pressure on loan demand, which declined further in almost all lending segments.^[3]

Outside the EA credit standards seemed to be loosening marginally, while demand is dependent on the country. Denmark's central bank lending survey, for example, reported a significant increase in corporate loan demand but a small decline in private loan demand by both existing and new customers in the first quarter of 2024, after extraordinarily high activity on the housing market at the end of 2023. In Denmark, credit conditions eased for lending to both households and corporates, due to lower risk perception and increased competition, especially in the corporate segment.^[4] In Norway, household credit demand fell slightly in the first quarter of 2024, with demand for residential mortgages declining for the third quarter in a row, while corporate demand remained broadly unchanged, as did credit standards overall.^[5]

By contrast, Polish banks tightened lending policy in most segments in Q1 2024, mainly due to a reduction in the quality of the loan portfolio and the worsening of the macroeconomic outlook. Changes in lending policy were accompanied by a significant decline in the demand for housing loans, but an increase in demand for consumer credit and loans to large enterprises.^[6] Hungarian banks' willingness to grant loans and credit lines to both households and enterprises is increasing, especially in the consumer credit segment, for which credit standards have remained broadly stable in the first quarter of 2024. Instead, a change in risk tolerance driven by CRE-specific problems and the fear of a real estate bubble has led to a tightening of credit standards for commercial real estate loans, following the deteriorating quality of the loan portfolio, which has been significant for the office segment.^[7]

Banks expect rising loan growth in the coming quarters

The bank lending surveys point to a similar conclusion to that of the EBA's RAQ. There is a wide divergence of loan growth dynamics depending on the region and the countries'

economic cycle. However, overall loan growth dynamics seem to have shifted in the last questionnaire, as more banks indicate their intention to increase their loan exposures. A larger share of banks in eastern and southern European countries respond affirmatively in this regard compared to the other regions. In addition, certain segment-specific dynamics have emerged. For example, there is a broad consensus for banks to increase their exposures towards the SME segment. Moreover, southern and eastern European banks report overwhelmingly their intention to expand their exposures in the consumer credit space. On the other hand, only 10% of the banks in the Nordics expect to increase their exposures in consumer credit (Figure 8).

Figure 8: Portfolios which banks, by region, expect to increase/decrease in volumes in the next 12 months *

Source: EBA Risk Assessment Questionnaire

Belgium, France, Germany, Ireland, Italy, Netherlands, Poland, Portugal, Slovakia, Spain, Sweden, Switzerland, Czechia, Denmark, Finland, Greece, Hungary, Bulgaria, Cyprus, Estonia, Latvia, Lithuania, Malta, Slovenia, Austria, Belgium, France, Germany, Ireland, Italy, Netherlands, Poland, Portugal, Slovakia, Spain, Sweden, Switzerland, Czechia, Denmark, Finland, Greece, Hungary, Bulgaria, Cyprus, Estonia, Latvia, Lithuania, Malta, Slovenia, Austria

Assets: outlook

Banks forecast recovery of loan growth in the coming years

Based on EU/EEA banks' three-year funding plans, total assets will this year grow by 1.6%, while this growth rate is expected to accelerate in the following two years (2.5% and 2.6% in 2025 and 2026, respectively). In this period, banks expect to reverse the sluggish growth rate in loans towards households and NFCs observed in 2023. These are predicted to grow at 1.5% and 4.3% respectively in 2024. The growth rate will further accelerate for households (2.6% and 3.3% in 2025 and 2026), while for NFC loans the annual growth rate will remain close to 4%. The cumulative growth rate over the three-year forecasted period is 7.4% for household and 12.1% for NFC lending. The reduction of cash and cash balances at central banks is set to continue at a rate of -8.1% this year, but then turn positive again. The growth of debt securities is expected to materially slow down (2.6% in 2024 and 2.4% in 2025 and well below 1% in 2026). Whereas the decline in cash balances can presumably be explained by the remaining TLTRO repayments, the lower growth rates in debt securities going forward might be explained by the expectations that interest rates have presumably reached their peak. This could disincentivise banks from continuing to increase their debt securities exposures in a declining rate environment (Figure 9; on rate expectations see

Chapter 1).

Figure 9: Growth expectations for selected asset classes *

Source: EBA supervisory reporting data (funding plan data)

* 'F' after the years refers to forecasts.

On a country level, banks forecast positive growth in their lending towards households in 2024 in nearly all countries, except for Ireland and Malta. At the same time, Italian, German and Dutch banks expect only marginal growth in 2024. All countries expect at least a 1% yearly growth rate for 2025 and at least 2% for 2026. Banks forecast a more aggressive growth rate for lending towards NFCs. Only Belgian and Italian banks expect a decrease in their NFC lending for 2024. In contrast to household lending, Irish banks expect a double-digit growth rate in 2024 (14%) for their NFC exposures, followed by Greek banks (12%) (Figure 10).

Figure 10a: Growth expectations for lending to households by country

Source: EBA supervisory reporting data (funding plan data)

Figure 10b: Growth expectations for lending to NFCs by country

Source: EBA supervisory reporting data (funding plan data)

For the years 2025 and 2026, banks do not expect significant changes to their overall asset composition. At the end of the forecast period (December 2026), the share of loans to households is set to remain close to 25% of total assets and that of loans to NFCs is expected to increase from 21.8% in 2023 to 22.9%. Banks forecast the share of total assets to debt securities and loans to financial corporates to remain constant, representing 12.4% and 6.2% respectively. Cash balances are expected to remain somewhat elevated at 10.6% of banks' total assets compared to pre-pandemic levels (7.6% in 2019), yet lower than their post-pandemic levels (11.7% in 2023) (Figure 11).

Figure 11: Actual and planned asset composition *

Source: EBA supervisory reporting data (funding plan data)

* 'A' after the years refers to actual numbers, 'F' after the years refers to forecasts.

Asset quality trends

Non-performing loans increase for first time in a decade

In 2023 EU/EEA banks reported an increase in the total NPLs by EUR 7bn (EUR 365bn in December 2023). NPLs were steadily increasing over the year and were +2.1% higher when compared to year-end (YE) 2022 (EUR 357bn in December 2022). The NPL ratio was 1.84% as of YE 2023, similarly increasing over the course of 2023 (+4 bps compared to YE 2022) (Figure 12).

Figure 12: Trend of EU/EEA NPL volumes and ratio, September 2022 to December 2023

Source: EBA supervisory reporting data

EU/EEA banks not only reported a higher inflow of NPLs in their balance sheets but also reported a lower outflow of NPLs. In 2023, EU/EEA banks reported a total NPL inflow of EUR 187bn (EUR 168bn in 2022) and a total NPL outflow of EUR 178bn (EUR 202bn in 2022). As a result, the net NPL inflow reached around EUR 10bn versus a net NPL outflow of close to EUR 35bn a year earlier (Figure 13).

Figure 13: NPL cumulative net flows by segment for 2022 and 2023

Source: EBA supervisory reporting data

The change in reported NPLs over the last year varied significantly across countries. Despite the overall increase in NPLs, around half of the countries reported lower NPL volumes compared to the previous year. For example, Italian and Greek banks still reported substantially lower NPLs compared to 2022. This is not least due to still ongoing NPL disposals and other measures to reduce their NPL stock. The higher volume of NPLs was therefore attributed to certain jurisdictions such as Austria, France, Germany and Spain. These countries reported a total increase in their NPLs of more than EUR 16bn during 2023. The highest NPL ratio was reported by Polish banks (4.3%) and was followed by Greek banks (3.3%). The biggest increase in the NPL ratio in 2023 was reported by Austrian banks (2.2% in December 2023 vs 1.8% in December 2022) (Figure 14).

At segment level, the biggest increase in NPL ratios was reported for loans collateralised by CREs (4.3% in December 2023 vs 3.9% in December 2022), while for other segments the increase was more moderate (around 10 bps; Figure 15). For example, for loans collateralised by RREs, banks reported only a marginal increase. The share of fixed-rate loans – at least in the biggest jurisdictions – for mortgage loans presumably acts as a safety

net for borrowers. At the same time, other borrowers are particularly challenged by rising interest payments due to their higher usage of variable-rate loans.

Figure 14: NPL ratio by country in December 2023 and p.p. change in NPL ratio QoQ and YoY

Source: EBA supervisory reporting data

Stage 2 allocation remained stable but at elevated levels

Banks also reported a similar increase in the allocation of loans to higher credit risk stages. Loans allocated to stages 2 and 3 increased by more than 3% in 2023. Stage 3 loans stood at EUR 340bn, like NPLs increasing by close to EUR 10bn in 2023. Stage 2 loans rose by more than EUR 50bn and stood at EUR 1.5tn as of December 2023. The share of stage 2 loans to total loans was at 9.6%, the highest level reported by EU/EEA banks, i.e. even higher than during the pandemic, when it had reached 9.1%.

The deterioration in the asset quality spanned across all segments of NFC and household lending, but was more profound in real-estate-related loans. Allocation to stage 2 for loans collateralised by CRE and RRE assets increased the most during 2023 compared to other segments. For CRE exposures stage 2 allocation reached 17.8% of total CRE loans (16.7% in December 2022), while for RRE exposures it increased to 7.8% (6.9% a year earlier). EU/EEA banks also reported material deterioration in SMEs, which have the second highest stage 2 ratio, reaching 15%, up from 14.5% a year ago (Figure 15). Anecdotal evidence suggests that in some cases the deterioration of SME exposures is also linked to ending state support measures that had been introduced in recent years.

Figure 15a: NPL ratios of loans (at amortised cost) by segment

Source: EBA supervisory reporting data

Figure 15b: Allocation of stage 2 loans (at amortised cost) by segment

Source: EBA supervisory reporting data

A large share of banks still expect asset quality to deteriorate in several key segments, even though the situation has improved compared to previous

expectations

According to the results of the spring 2024 RAQ, banks' expectations for asset quality seem to be stabilising and partially even improving from the subdued outlooks in previous questionnaires. Expectations for asset quality of household exposures have for instance improved significantly, probably supported by still strong labour markets and expectations of declining interest rates. However, for NFC exposures the majority of banks still expect a deterioration in asset quality (for SMEs and CREs), yet the share of banks has stabilised and has not been increasing further. This may indicate that downside risks may be limited (Figure 16). This is partially confirmed by data on funding plans. Banks anticipate that household NPLs will grow by about 3% by the end of 2024, while NFC NPLs will rise by 6%. Household NPLs are projected to keep going up in the coming years, but at a slower pace, while NFC NPLs are anticipated to level off.

Figure 16: Banks' expectations on possible deterioration in asset quality in the next 12 months by segment

Source: EBA Risk Assessment Questionnaire

[1] Financial assets held at amortised cost is an accounting classification, which is subject to certain conditions, such as for instance a bank's objective to hold the respective assets in order to collect contractual cash flows (see the [IFRS Foundation's overview of IFRS 9 Financial Instruments](#)). This makes it possible to reduce the sensitivity of the accounting profit and loss statement (P&L) to e.g. interest rate changes.

[2] See, for instance, the ECB's [EA bank lending survey \(europa.eu\)](#) editions from October 2023 and January 2024.

[3] See the ECB's [Euro area bank lending survey](#) from April 2024.

[4] See [Lending survey \(nationalbanken.dk\)](http://nationalbanken.dk).

[5] See [Norges Bank's Survey of Bank Lending \(norges-bank.no\)](http://norges-bank.no).

[6] See [Senior loan officer opinion survey \(NBP\)](http://nbp.hu).

[7] See [Lending survey \(mnbb.hu\)](http://mnbb.hu).