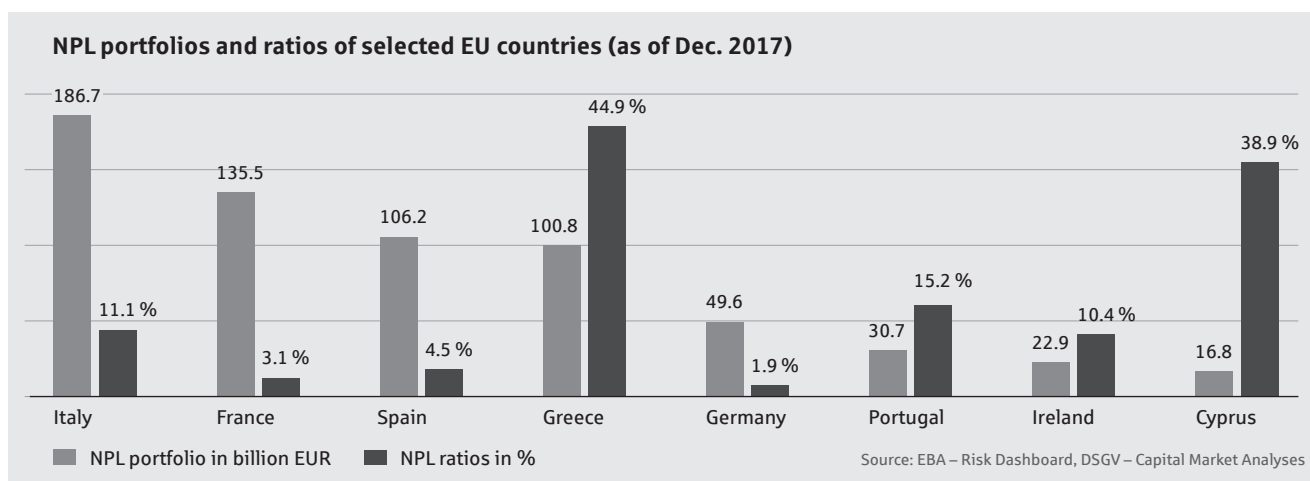


Problem loans in Europe: Sustainable risk mitigation will take years

- Problem loans are loans that are no longer properly serviced by their borrowers. They are also referred to as non-performing loans (NPLs). The EU's leading politicians now want to tackle this huge risk portfolio – approx. EUR 813 billion borrowed from the 150 largest banks.
- According to the Council of EU Finance Ministers (ECOFIN) in May and June 2018, this is the necessary precondition to further deepening the banking union.
- Most of the reductions of NPL portfolios achieved to date can be explained by one-off effects. However, sustainable risk mitigation will take years and will have to be maintained over multiple economic cycles.



Risks are unevenly distributed

Aside from examining the NPL ratios (black), it is worth taking a look at NPL volumes (grey): Italy accounts for 23 percent of the NPL volume in the euro area; if one adds Spain and Greece, 48.5 percent of the risks are concentrated in three countries. The EU-wide NPL ratio amounts to an average of 4 percent of all loans. However, the arithmetic mean is deceiving. The volumes are still above the level at which they were before the financial crisis, and they include risky concentrations.

Improvements achieved in ratios are one-off effects

The slight decline in the NPL ratio was explained by the European Banking Authority (EBA) mainly by changes in legal conditions, e.g. with regard to insolvency regimes or portfolio sales. The latest reductions of the portfolio of problem loans in Italy were achieved by loan sales, recapitalisation, and the closure of two banks.

DSGV statement:

The general quality of loans on the balance sheets of credit institutions does not improve as a result of one-off effects and changes in legal conditions. Genuine risk mitigation can only be achieved by a competitive overall structure. In the countries with high NPL concentrations, the portfolios will have to be reduced in a sustainable and ambitious manner. In the medium or long term, the NPL ratios in all the euro countries will have to be stabilised at a low level as, for instance, in France and Germany. In addition, a ratio reduction can only be designated as reasonable if ratios are kept at a comparably low level over a period of at least five years. Convergence that is sustainable for the euro area can therefore only be achieved within a period of several years.