

The role, opportunities and challenges of the banking sector after the pandemic crisis

*Boštjan Vasle**

T

The recovery of our economies after a slowdown during the second and third waves of the COVID-19 pandemic has been faster than expected. More than two thirds of EU countries, including Slovenia, have already reached the pre-pandemic levels of GDP or will reach them later this year. However, uncertainty is still high and a surge in COVID-19 infections with increasing pressure on hospitals, further disruptions in global supply chains and aggravated labour shortages in some sectors have begun to stifle growth momentum and exert upward pressure on prices. Nevertheless, a significant part of the population has been vaccinated, so measures to contain the spread of COVID-19 infections can this time around be less restrictive, and businesses and consumers have adapted well to the new circumstances. Moreover, policy makers across several fields seem to agree in general that the unwinding of still abundant economic policy support should be gradual and well thought through, following the improvements in both health and economic situations.

With strong and coherent support from monetary, prudential, fiscal and other policies and a significantly better starting position than before the previous financial crisis, the banking system in Slovenia and the EU in general has remained resilient. In addition to bank recapitalisations and the resolution of non-performing loans (NPLs) after the previous crisis, the strengthening of banking regulation and super-

vision, which are now much more uniform across Europe, played a particularly important role.

All of this has enabled banks to continue lending to the real economy and avoid the credit crunch we have witnessed in the previous financial crisis. While banks have increased the share of forborne loans in this crisis, the NPL ratio has fallen further at the level of the system. In addition, this year most Slovenian and to a lesser extent some other European banks have begun to make impairment releases, which provided a short-term boost to their profitability. Nevertheless, banks should be vigilant and prudent, as all the consequences of the crisis are not yet visible and the increased credit and some other risks might be realized with a lag, which will probably be longer than usual given the unprecedented policy support.

Although the pandemic crisis is still at the forefront of our deliberations and policy actions, we are already focusing our attention on structural challenges that will become more apparent again when the crisis is over. Like many European banks their Slovenian counterparts are about to confront subdued profitability, which in the years before the crisis and this year was masked by one-off revenues and the release of impairments and provisions. The prolonged period of low interest rates and the rise of non-bank financial intermediation are particularly challenging for banks that are more reliant on traditional banking activities, including Slovenian banks and many others in

* Boštjan Vasle, Governor, Banka Slovenije

the CEE region. As a source of strengthening and attracting capital, bank profitability will be playing important role in light of the expected implementation of the renewed Basel III standards, more systematic consideration of climate risks and increased needs for modernisation of technology amidst growing competition from fintech and other “non-banks”. Better-capitalised banks generally lend more, as confirmed in the current crisis for the euro banks. Quite the opposite holds true for corporate lending by Slovenian banks, whose capital position is otherwise solid. With the relatively weak corporate demand for loans, more than a decade-long trend of lower corporate lending than in the euro area thus continues.

In the need for a strong and resilient European banking system, which will be able to contribute to financing the recovery, accelerated digitisation and greening of our economies, it is important that at the EU level we continue

with banking reforms initiated after the previous financial crisis, which have shown good results during this crisis. Pan-European efforts to improve the efficiency of capital allocation, to unify the European financial services market and create a capital market union are likely to gradually diversify the economy’s funding instruments and sources. This brings new opportunities and challenges for banks, which will be easier to seize and manage as the banking sector continues to consolidate.

In addition, future challenges for maintaining the economic role and stability of Slovenian banks - which have undergone significant structural changes in the last 15 years - are related to sustainability of their business models, including reducing income risk and developing new banking products, further digitisation and efficiency gains, and addressing the large maturity gap between bank assets and liabilities.