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How COVID and War Have Reshuffled the European Banking Sector

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Abstract

The stability of the European banking system has been recently tested by the COVID-19 pandemic in 2020 and then by the Russian aggression against Ukraine in 2022. Both events have forced the European Central Bank to implement many recovery measures. Despite having vastly different fundamentals, those events have led to the new economic reality with high interest rates and return on equity below the cost of equity for most European banks.

The paper aims to assess how pandemic and war impacted the banking sector and its stability. The analysis relies on data provided by public international authorities, global banking advisors, and open-access databases such as Eurostat. The overall, conclusion is that these neither events pushed the entire sector to the brink of collapse. The primary reason for this outcome was the implementation of measures established following the global financial crisis 2008.

Keywords: Banking system, stability, COVID, financial crisis, profitability, liquidity

JEL Classification: E58, G21, O52, H12, H56

Introduction

Chinese people are used to wishing each other “may you not live in interesting times”. The more interesting the times, the more disturbances. The more disturbances, the more uncertainty which generates additional risks. The past few years have provided us with as much turbulence as people used to experience over several decades. While the war in Ukraine had the greatest impact on the European market, the COVID-19 pandemic has spread practically on every continent, possibly changing our lives forever.

The purpose of this article is to shed light on the impact of the COVID-19 pandemic and the Russian invasion on Ukraine on the condition of the European banking system. Therefore, the article presents an analysis of the effects of these events divided into four chapters. The first part briefly describes the history of major global crises and their consequences for the financial sector. The second part focuses on the macroeconomic effects of the pandemic and the war against Ukraine on the European banking sector. In the third part, the author analyses the impact of these events on the profitability of the entire banking system. The fourth part evaluates the sector from the perspective of liquidity and system stability.

The research methods employed by the author include the analysis of data published by financial institutions such as, the European Banking Authority, the European Central Bank, the World Bank, as well as the analysis and synthesis of relevant literature. This study is not a closed investigation but serves as an introduction to a more in-depth analysis of the role of the COVID-19 pandemic and the Russian invasion Ukraine in relation to the stability of the European banking system. The article is based on current data, and the final outcomes of the described events are not yet fully known. Therefore, the author intends to conduct further investigation in the future to assess the complete impact and consequences based on the latest available data.

Understanding the financial crisis

Recession is often defined as periods of heightened changes in the financial market, which directly correlate with insufficient liquidity among its participants. Minsky's model distinguishes five basic stages: excitement, boom, euphoria, profit-taking, and panic. During the stage called excitement, investors overly focus their attention on a specific goal. This can be a particular promising company, an attractive financial product, or an alternative instrument, such as tulips during the Dutch speculative bubble. The second stage is characterized by a situation in which market participants, mainly speculators, realize the profits from their investments while seeing a favourable environment for further investments. The third stage involves an increasing number of players entering the market, resulting in accelerated credit actions aimed at covering the costs of these investments. These obligations are incurred in a situation where requirements regarding the creditworthiness of borrowers become increasingly less restrictive. At the same time, the market becomes flooded with new financial instruments whose structure exposes potential owners to greater risks than in a standard market situation present in earlier stages. The presence of psychological aspects, such as the herd instinct of investors who are increasingly willing to participate in these risky ventures, is crucial here. In the fourth stage, the speculative bubble reaches its peak, and prices reach their maximum level. Smaller investors, after realizing their premiums, decide to sell their products, which ultimately leads to the fifth stage – panic. The initial enthusiasm is replaced by extremely negative emotions. Herd behaviour becomes evident again as investors hastily try to dispose of their holdings in often ill-considered ways. The economic situation forces borrowers to stop repaying their credit obligations, and banks reduce their asset portfolios due to falling prices. This phenomenon is known as the "Minsky Moment", characterized by banks being cornered and facing the need to sell assets that are considered safe and profitable in order to repay their outstanding obligations (Caloromis 2009).

ECB response to the crisis

The 2008 crisis was an illustration for the described stages of an economic downturn, while the crisis triggered by the COVID pandemic had completely different causes. At the peak of the sub-prime crisis, many markets reached record-low levels, triggering a wave of margin calls, mass asset sell-offs to cover debts, and higher default rates. In the case of the COVID pandemic, nationwide lockdowns implemented by governments on almost all continents led to a sharp collapse in consumption. Although these events had different backgrounds and causes, they ended up with the same outcome: widespread insolvencies. These laid the groundwork for central bank interventions. The European Central Bank was no exception. It utilized various financial mechanisms to introduce a series of support measures within the European Union. These measures included:

- Supporting European economies in mitigating the shocks caused by the crisis;
- Stabilizing credit prices;
- Providing preferential loans to businesses and individuals;
- Mitigating the impact of temporary issues on credit actions;

Monitoring and overseeing the stability of the financial system through international cooperation (European Central Bank 2023).

One of the large-scale actions during this time was the implementation of the so-called PEPP (Pandemic Emergency Purchase Programme), which involved the central bank purchasing various types of assets in the financial market and resulted in. the increase in the prices of these assets, ultimately leading to a reduction in interest rates. It allowed consumers to access credit, which otherwise would have been impossible due to the costs of credit at high interest rates. The PEPP stimulated economic activity and helped maintain inflation at its regulatory target of 2%. Between March 2020 and March 2022, the European Central Bank allocated unprecedented nearly EUR 1.85 trillion for this purpose, (European Central Bank 2020).

As emphasized by representatives of the ECB themselves, commercial banks played a significant role during the pandemic, as they acted as intermediaries for the assistance provided to consumers by the government. The banks themselves owe their relatively good condition during the lockdowns to a series of decisions by regulatory bodies over the past decades. The previous major crisis in 2007 played a huge role, as it prompted a re-evaluation of the content of the Basel agreements, ultimately leading to the preparation of the third package of regulations and the establishment of the banking union in 2014 (Gostomski 2016). The aim of the banking union was to strengthen supervision and harmonize regulations within the Community. The Basel agreements became the basis for these assumptions, and in addition to them, the Single Supervisory Mechanism (SSM) and the Single Resolution Fund (SRF) were introduced, among other measures. The SSM transferred responsibility for the supervision of the largest banks in the euro area to the European Central Bank (ECB), while the SRF provided funds for financing restructuring or liquidation measures in the event of bank failures (Gortsos 2017, Zaleska 2013).

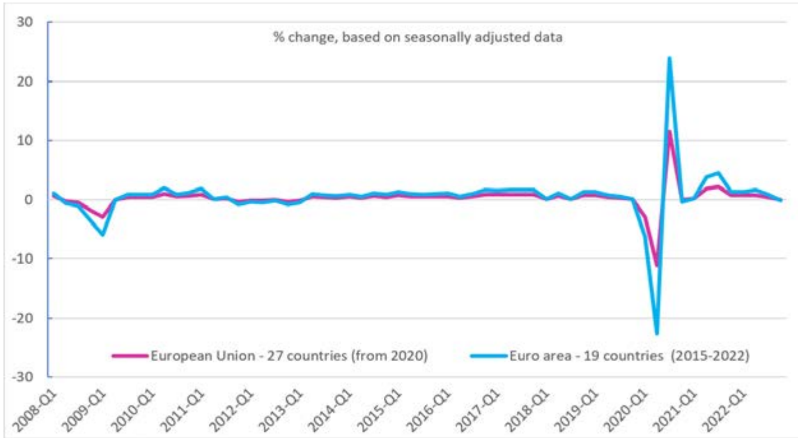
European banks face greater competition and pricing challenges compared to their counterparts in the United States. The banking sector in the European Union consists of numerous banks that have relatively high operational costs and compete for the same customer base. The ownership structure of European banks also plays a role in increasing competitive pressure, as only 30% of banks under the Single Supervisory Mechanism are publicly traded companies, unlike most banks in the US. In the Eurozone, many non-listed banks, including savings banks, regional banks, and cooperative banks, operate with objectives other than purely maximizing profits, which further impacts pricing. This is particularly noticeable in countries like Germany, where a significant number of non-listed banks operate under a non-profit charter. Moreover, competition is intensified by the emergence of new players such as Big Tech and fin-tech companies, which possess agile business models and operate in a less regulated environment (Wunsch 2023, Abad 2022).

Considering the regulatory aspect, it is worth looking back for a moment. Already at the turn of the 21st century, a decision was reached to strengthen supervision over the banking system. The Basel Committee on Banking Supervision (BCBS) was responsible for its creation, and the latest version, Basel III, is owed to the 2008 crisis. It was during that time that additional regulations regarding capital adequacy and liquidity buffers were introduced. Among the numerous changes, the most important ones include increasing the required capital from 2% to 4.5% of common equity as a percentage of a bank's risk-weighted assets (with an additional buffer of 2.5%). Tier 1 capital was raised to 6% from 4% (Waligóra 2013, Toniolo 2025). However, as the result of the Russian invasion of Ukraine, the Basel Committee decided to postpone the final implementation of Basel III to January 1, 2023. However, the essence of Basel III has significantly contributed to mitigating the negative effects of COVID-19 on the banking sector. Some of the introduced regulations and additional liquidity buffers helped banks navigate the pandemic crisis relatively smoothly, and it allowed the banking sector to play a crucial role in the economy immediately after the post-COVID recovery (The Basel Committee 2023).

Macroeconomic consequences of the pandemic and war

Reactions of the market

Figure 1 illustrates the GDP growth in the Eurozone countries between 2016 and 2022 together with forecasts (The European Commission 2023a). Evidently, the European economy experienced a significant

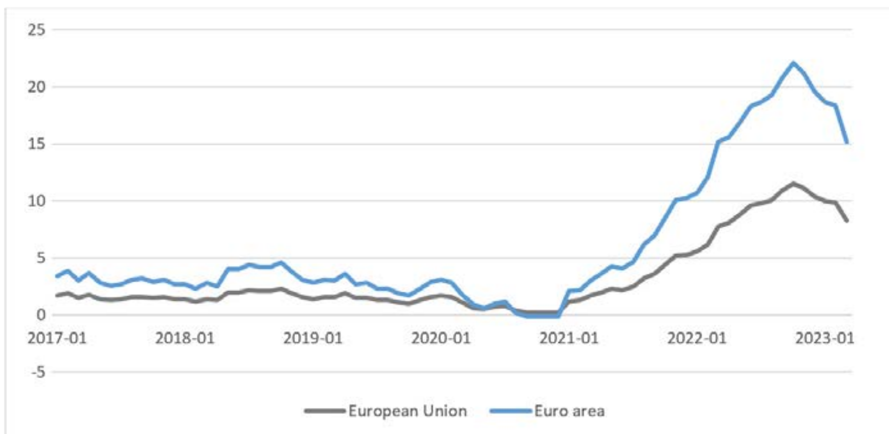


Source: Author's elaboration based on figures published by Eurostat (The European Commission 2023a).

Figure 1. GDP growth rates over the same quarter of the previous year

downturn immediately after the outbreak of the COVID pandemic. Furthermore, the prolonged lockdown measures have sustained the economic slowdown until the invention of the vaccine and its widespread implementation into daily life. The biggest rebound had taken place in the second quarter of 2021 when the average growth for the entire Eurozone ranged from 13% to 14%. In the following months, there was a decline and stabilization of the growth level around 5%. However, another significant decrease occurred after Russian invasion of Ukraine in February 2022. In many economies, GDP deteriorated in the following months, and the average GDP growth rate for the Eurozone was 2% in the last quarter of 2022.

Additionally, the inflation rate has emerged as a pivotal factor in the aftermath of the Russian invasion of Ukraine. The rapid rise of energy prices constituted one of the most crucial factors contributing to the prevailing situation and.was strongly related to the issue with supply chain in energy sector as. the main supplier for most of the EU member states was Russia.. Inflation did not play as important role during the lockdown caused by COVID pandemic Altogether high inflation rate in Europe pushed the European Central Banks to raise the interest rate to one of the highest levels in the history. The Figure 2 shows the fluctuations of inflation rate within last years.



Source: Author's elaboration based on figures published by Eurostat (The European Commission 2023a).

Figure 2. Annual inflation rate in Euro area and the European Union

The inflation rate in Europe surged following the outbreak of the COVID pandemic due to multiple factors. Notably, the disruption in global supply chains caused a shortage of goods and services, leading to upward price pressures, particularly for critical commodities such as medical supplies and food. Additionally, the economic slowdown resulting from the pandemic reduced the demand for goods and services, compounding the inflationary pressure. To cushion the impact of the pandemic on households and businesses, governments and central banks implemented expansionary fiscal and monetary policies, such as providing loans and cash transfers. The increased money supply further fuelled inflation, contributing to the upward trend. The shift to remote work and e-learning created a surge in demand for home goods and electronics, leading to higher prices for these items. From the global perspective, we can see that Europe was the region most affected by various economic shocks in 2022 (see Figure 3).

The recent shocks in the global economy have led to a rise in volatility and significant changes compared to the relatively stable conditions since the financial crisis in 2007. These shocks are interrelated, with prices of food, fuel, and commodities increasing as the result of pandemic's impact on global supply systems and spreading due to the ripple effects of Russia's war on Ukraine. However, the impact of these shocks varies across different regions, with some benefiting and others struggling. Consequently, the reactions of central banks and governments have also varied, with some hiking rates to control inflation, while others dealt with the consequences of COVID-19 lockdowns. However, it is not possible to analyse these shocks in detail within this research (for more in-depth analysis, consult Cook 2022).

One of the primary contributing factors to the challenging circumstances in Europe is the notable fluctuations in energy pricing (Figure 4). Considering the average price of the electricity in the European Union in the first half of 2022, it is was almost 36% higher than it in the given period a year before and stood at €0.1833 per kWh. The highest price has been observed in Greece (€0.3042 per kWh) and the lowest in Finland and Sweden (€0.0808 per kWh and €0.1117 per kWh, accordingly) (Eurostat 2023). At the same time, the country average electricity prices are significantly lower overseas: the average electricity price in the United States in September 2022 was €0.0953 per kWh (U.S. Bureau of Labour Statistics 2023). Even though the average US price was almost 23% higher than in September 2021, compared to the European market, it was still 48% lower than the average price for the European industry.

The energy crisis turned out to be one of the biggest obstacles that Europe had to struggle with. Before the Russian aggression on Ukraine, almost 40% of gas imported to Europe came from Russian Federation.

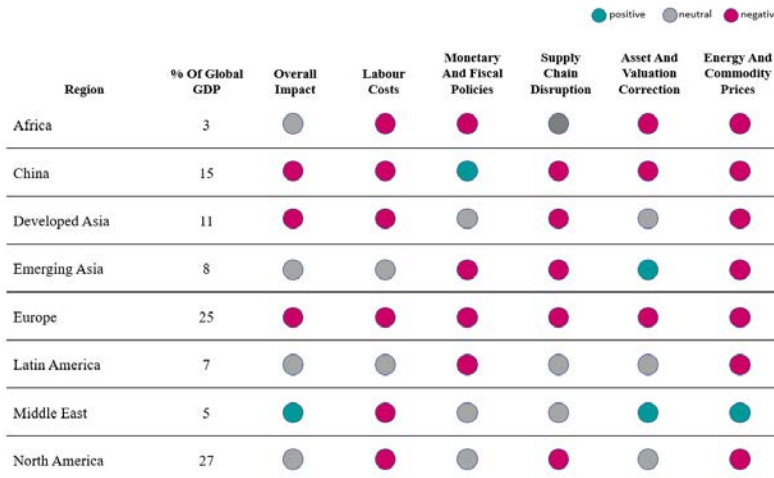
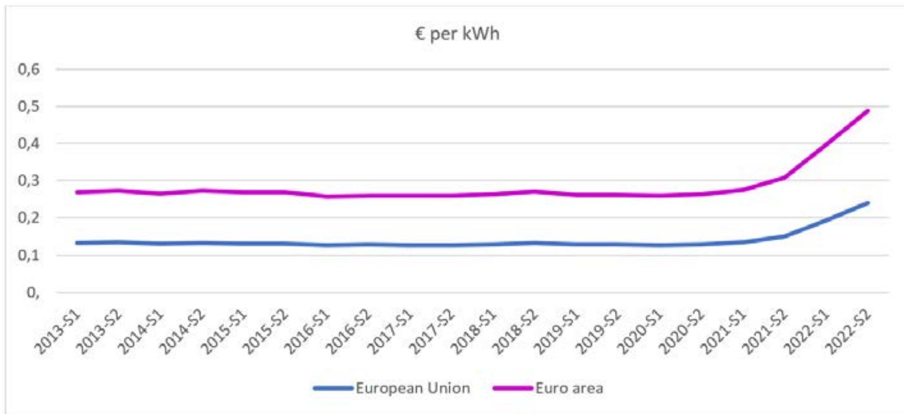


Figure 3. The Impact of shocks in 2022 across regions



Source: Authors' elaboration based on figures published by Eurostat (2023).

Figure 4. Electricity prices for household consumers across years

After 24 February 2022 – the day of Russian invasion of Ukraine – the European Union decided to impose severe economic sanctions limiting imports from Russia. That move resulted in a decrease in the share of natural gas imported from Russia to 22.9% in the second quarter of 2022. This shortage in the European market forced many countries to either change their gas supplier or completely transform their energy mix. Poland was an example of a country strongly dependent on Russian gas and coal delivery. After completing the Baltic pipe and launching the fuel terminal in Świnoujście, the dependence on the Russian fuels has been drastically reduced. Instead, Norway became the primary energy partner for the biggest country in the CEE region. It is worth mentioning that Norway has established itself as a leading example in terms of its renewable-based electricity system. Due to a substantial RE share in the energy mix (RES stands for 98% of energy generation in 2020), this Nordic country is more resistant to energy price shocks. Therefore, other European countries decided to follow this path as well. However, the data for spot market in Europe is showing that prices in January 2023 dropped significantly in comparison to December 2022 (EMBER 2023).

Concluding, the banking industry experienced a strong rebound in revenue growth and high Tier 1 capital ratios following the pandemic, but the current context has introduced new challenges. These include a series of interconnected shocks, such as geopolitical and economic effects of the pandemic, which have increased vulnerabilities. The aftermath of COVID-19 and geopolitical tensions have caused significant disruption to the global economy and financial sector. The lingering effects of the pandemic have resulted in supply chain disruptions and changes in employment patterns. The geopolitical landscape has also seen a shift, with the Russian invasion of Ukraine and heightened tensions over Taiwan, disrupting a period of relative stability. These events have exacerbated the impact of the pandemic and led to new shocks, including an energy supply crisis in Europe. The combination of these factors has created an environment of high uncertainty, which is detrimental to the global economy. The impact of inflation and interest rates is likely to further accentuate regional disparities, including in advanced economies. The European economy has experienced the risk of contracting GDP and rising energy prices, which could increase systemic risk and reduce demand for credit.

Profitability in banking sector after covid and russian war *on ukraine*

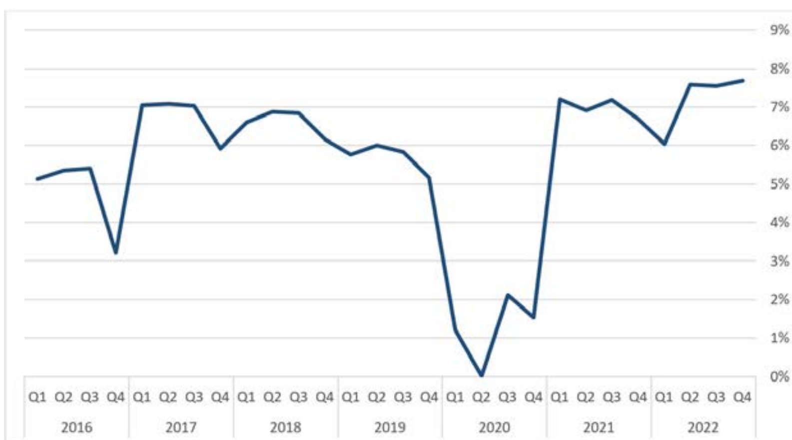
Analysing the returns on equity over the past two decades, the level does not shine as brightly as the widely recognized "golden age", which extended from the early 21st century until the global financial crisis in 2008. During the mentioned period ROE oscillated between 13-17 percent and then dropped to 3.5 per-

cent when the downturn has begun. Even though such peak has never been touched again after the crisis, the level of ROE in the last few years has achieved strong position and accounted for around 10 percent in 2022. This resulted from relatively high net margins in banks which were possible due to interest rates growth. However, that means that return on equity was nearly as high as the cost of equity. According to Global Banking Outlook, in 2022 almost half of the banks in the world earned less than given cost of equity. Nevertheless, 2022 was a pivotal moment for the financial sector: this new era allowed banks to operate with 2-3 percent returns above the cost of equity (Cooke 2022).

The post-pandemic economic recovery led to a significant increase in the mentioned ROE, reaching an aggregate of 6.7% in 2021 (Figure 5). Despite macroeconomic and geopolitical pressures in 2022, ROE continued to grow, reaching 7.6% in the first three quarters of the year, mainly driven by increased net interest income. However, the growth in net fee and commission income came to a halt due to falling asset prices, impacting income from asset management, and declining fees from securities issuance. Operating expenses rose slower than inflation due to digitalization and branch closures, and impairments remained subdued in the first half of the year, except for banks with significant exposure to Russia. However, impairments started to pick up in the third quarter, reflecting the deteriorating growth figures, high inflation, and fuel price increases affecting household disposable income and corporate profits. Although the banks' business models have proven relatively robust, they needed to focus on strategic steering, cost control, and risk management to navigate the uncertain times ahead (ECB Banking Supervision 2023).

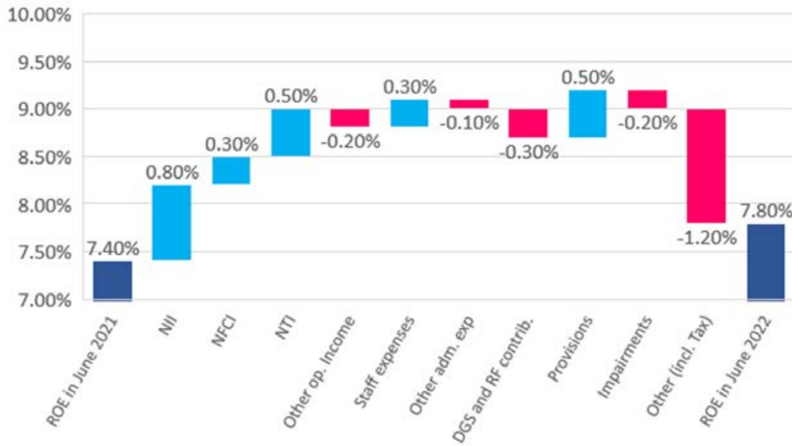
The main positive driver for ROE was high net interest income (NII), and despite inflationary pressures, the banks were able to keep their staff expenses under control. The banks also benefited from lower provisions, except for those related to credit impairments, which contributed to the overall improvement in profitability over the whole 2022. However, the negative impact of the "Other" category, which includes taxes, was due to the absence of large one-off gains, such as negative goodwill adjustments resulting from certain corporate operations, that were recorded in 2021 (Figure 6).

Nonetheless, the transition phase and the full effects of the pandemic and war are uncertain, and banks may experience a slowdown in volume growth, higher costs, and greater delinquencies in the future. Economic growth deterioration could lead to a slowdown in payments, transactions, saving, and investment, and higher rates could deter loans, mortgages, bond issuances, and IPOs. Banks will have to face rising costs due to inflation, including technology and branch operations. If the recession hits hard, some customers



Source: Authors' elaboration based on Figures published by ECB (2023, 69).

Figure 5. Return on equity for the EU by reference period



Source: Author's elaboration, based on figures published by European Banking Authority (2022, 69).

Figure 6. Components of return to equity for EU banks, as a percentage of total equity (2021-2022)

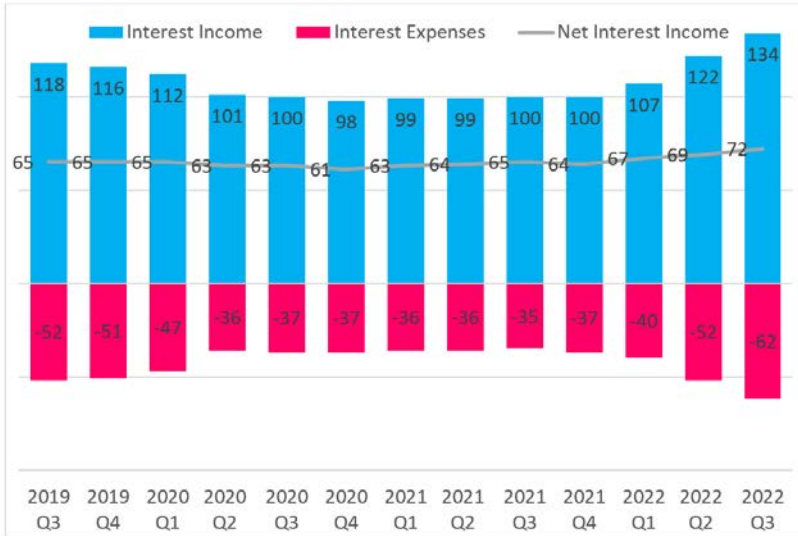
may default on their loans, and many others may need to restructure them. This uncertainty is reflected in the valuations of banks, which remained depressed in the first half of 2022 despite positive margin news.

Higher interest rates can help earnings of the European banks because they increase the spread between the interest rates on their loans and the interest rates on their funding. When interest rates rise, banks can charge more for their loans while still paying roughly the same amount for deposits and other sources of funding. This can lead to an increase in net interest margin, which is a key measure of a bank's profitability, however, the impact of higher interest rates on bank earnings can be dampened if the economy enters a recession. In a recession, demand for loans typically falls, which can offset the benefit of higher interest rates. Additionally, higher interest rates can make it more difficult for borrowers to repay their loans, which can lead to higher loan losses and delinquencies for banks (European Banking Authority 2022). Furthermore, the impact of higher interest rates can vary across different regions and banks. For example, banks in Europe that are heavily focused on mortgage lending may be more sensitive to changes in interest rates than those that focus on corporate lending. In addition, the impact of higher interest rates may depend on the specific economic conditions and policy actions in each country.

Overall, while higher interest rates may initially benefit European bank earnings, the impact is likely to be tempered by the potential for a recession and other factors. It is important for banks to carefully manage their balance sheets and risks in order to navigate these challenges and maintain profitability over the long term.

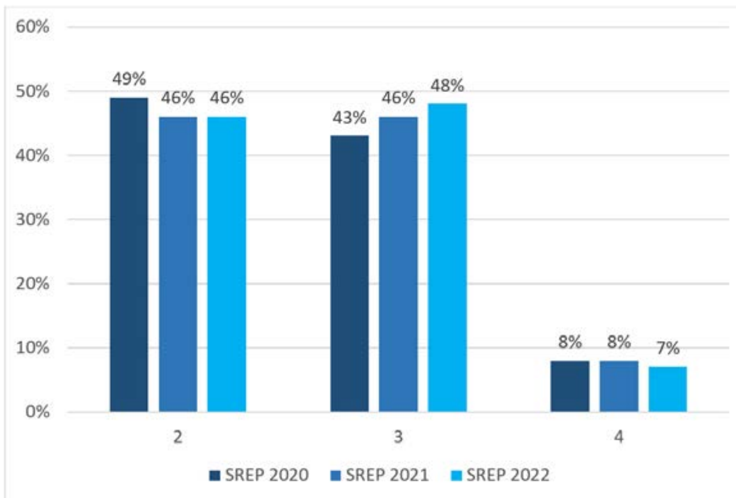
Banks have recently experienced a significant increase in profitability, something that has not been observed in over a decade, since global crisis in 2008. This boost can be attributed to the upward shift of the yield curve, which has had a predominantly positive impact on banks' profitability by strengthening their lending margins. Although interest rates for deposits have not increased significantly, lending rates for all parties on new loans have surged. This stands in contrast to previous years, during which banks' margins declined, forcing them to increase lending volumes to maintain their net interest income (NII) at a stable level. Thanks to the current environment, banks have been able to raise their NII by approximately 10% overall (see Figure 7).

In 2022, the overall SREP scores did not vary significantly compared to previous cycles (as shown in Figure 8). The proportion of banks with a score of 3 increased, whereas the percentage of banks with a score of 4 decreased slightly. Due to the impact of external factors such as the ongoing COVID-19 pandemic and the Russian invasion of Ukraine war, supervisors remained cautious in their evaluations. Most



Source: Author's elaboration based on figures published by European Banking Authority (2022, 102)..

Figure 7. Evolution of net interest income and interest expenses in last quarters (EUR billions)



Source: Author's elaboration, based on figures published by European Banking Authority (2022).

Figure 8. Overall SREP scores 2020-2022

institutions (92%) received the same overall SREP score as in 2021, while a small percentage (4%) experienced a decline in their scores (ECB Banking Supervision 2023).

At the same time NPL ratio seems to gradually decrease quarter by quarter in the last 8 years till third quarter of 2022 when it stabilized the position at the level of 1.8%. In last quarter of 2022, we saw even a slight increase by 0.1%. While banks have generally managed NPL flows well, there were some signs of stress. Between June 2021 and June 2022, the EU banks reported NPL inflows of around EUR 180 bn, while NPL outflows reached almost EUR 250 bn. In H1 2022, NPL inflows increased by approximately 30%

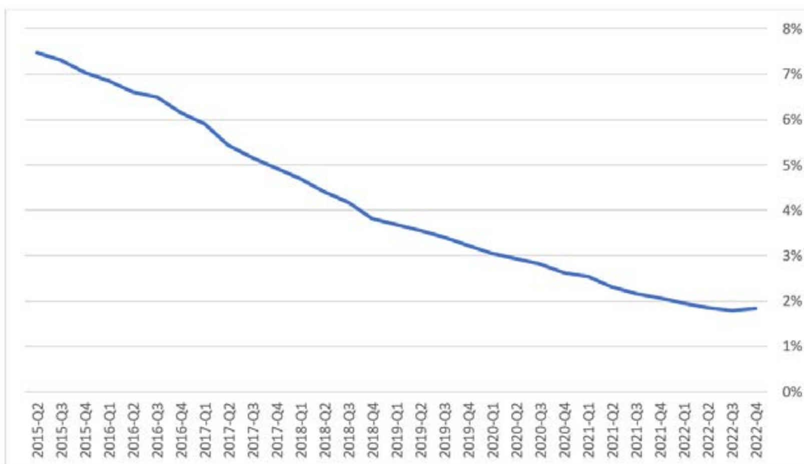
compared to H2 2021, while NPL outflows were only 5% higher. The EU banks reported NPL inflows of more than EUR 100 bn and outflows of more than EUR 120 bn in H1 2022, resulting in a net NPL outflow just below EUR 20 bn, considerably lower than the EUR 50 bn reported in H2 2021. The impact of Russia's invasion of Ukraine is also evident in the country-level data of NPL flows, with CEE countries and France reporting a net inflow of NPLs in H1 2022 (Ibid, 33-36).

It appears that the expected rise in credit risk due to the pandemic has not yet materialized, and banks have been able to write-back unused COVID-19 provisions. This may be due in part to government support measures that have helped cushion the economic impact, though post-pandemic vulnerabilities and downside risks are looming.

As of June 2022, NPLs in the EU/EEA have continued to decrease, albeit at a slower pace, and stood at 1.8% of total loans. Banks have reduced their NPLs by close to EUR 75 bn YoY. Forborne loans amounted to EUR 350 bn or 1.7% of total loans, which was EUR 50 bn less than in June 2021. Italian and Greek banks have been particularly successful in reducing their NPLs, and government-backed securitization schemes have played a role in this. Only Greek banks reported an average NPL ratio above 5% in June 2022, having reduced it from 14.8% in June 2021. Hungarian banks were the only ones reporting a marginal increase in their NPL ratio, reflecting the impact of the Russian invasion of Ukraine. However, the macroeconomic outlook is worsening, and higher interest rates driven by increased inflation combined with the prospect of slower economic growth, because of the energy crisis, will likely put financial pressure on over-indebted borrowers. This could potentially lead to an increase in NPLs in the future.

Despite the reduction in non-performing loans (NPL), the current macroeconomic environment has become unfavourable due to a sudden increase in inflation, rising interest rates, and the energy crisis, leading to greater uncertainty in global politics. These factors pose significant risks to economic growth, which is further affecting households, particularly vulnerable ones, who are now allocating a larger proportion of their budgets towards essential items such as food, energy, and debt repayment. Consequently, the capacity to service debts, particularly for highly indebted non-financial corporations (NFCs) and households, was under threat.

There were already indications of stress in the banking sector, as loans are being reclassified into stage 2. Banks have classified 9.5% of loans in this stage, the highest level since the introduction of the International Financial Reporting Standard (IFRS) 9 in June 2022. This occurred alongside a strong loan growth that increased the volume of stage 1 loans by 5.4% YoY. The volume of stage 2 loans rose by 14%, reaching



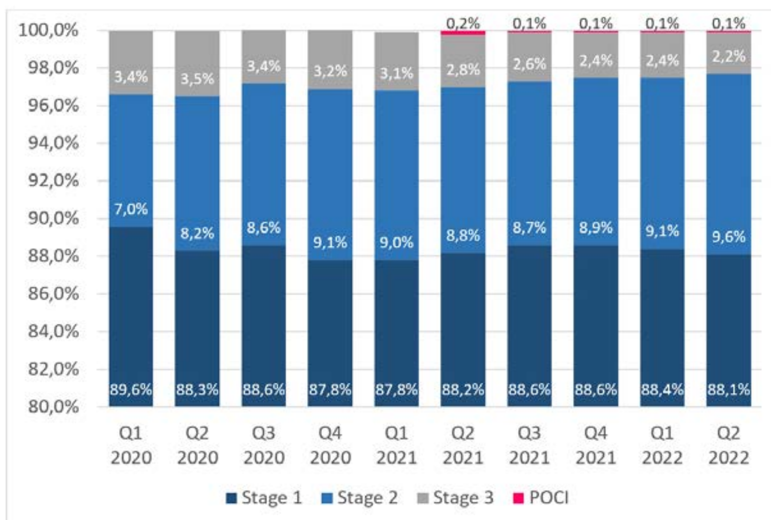
Source: Author's elaboration based on figures published by European Banking Authority (European Central Bank 2023).

Figure 9. NPL ratio by years

a value of EUR 1.45tn. The increase was mostly due to French and German banks, which account for more than 80% of the rise in stage 2 loans. EU/EEA banks have significantly increased the share of stage 2 loans, mainly because of loans' migration from stage 1 to stage 2. In the first two quarters of 2022, banks migrated more than EUR 460bn from stage 1 to stage 2, while only transferring less than EUR 290bn from stage 2 to stage 1. The magnitude of loan migration from stage 1 to stage 2 was only comparable to June 2020, during the pandemic's outset. However, movements between stage 2 and 3, or stage 1 and 3, were less significant and had a minimal effect on the overall allocation of loans into stages (Figure 10).

During the last quarter of 2022, banks experienced an increase in their capital ratios. The fully loaded CET1 ratio rose from 14.8% in the previous quarter to 15.3% in Q4 2022, providing banks with a substantial buffer of capital over regulatory requirements. This buffer acted as a safeguard, allowing banks to continue lending to the real economy during times of economic hardship. However, the biggest local declines occurred in the quarters immediately following the outbreak of the pandemic and the beginning of Russian full-scale war against Ukraine. Both were ultimately compensated for, and the CET1 and Tier 1 ratios increased in the last quarter and remained at the levels of 15.27% and 16.60%, respectively.

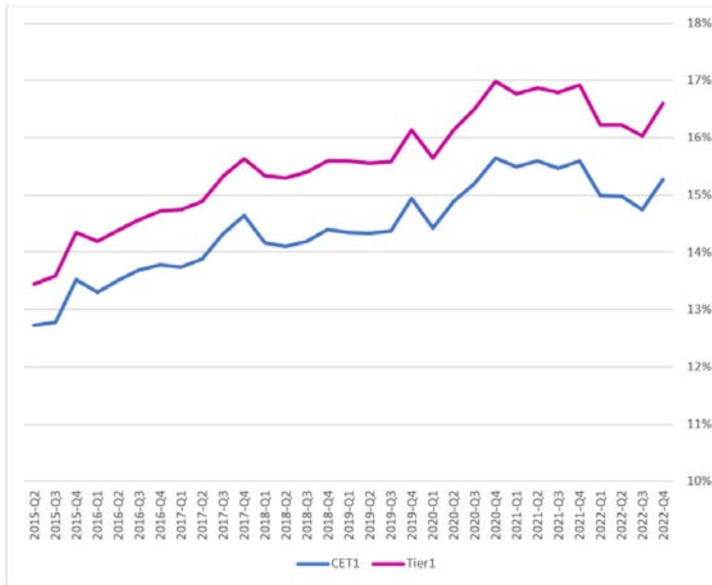
The rise in overall capital requirements and guidance can mainly be attributed to the impact of macro-prudential policies established by national authorities. Throughout 2022, multiple increases were announced in countercyclical capital buffers and systemic risk buffers, which were aligned to be applicable in 2023. Such adjustment may result in an average combined buffer requirement of 3.8% of RWA (risk weighted assets) in the first quarter of 2023[1], compared to 3.6% of RWA in the first quarter of 2022. The increase in risk-weighted assets (RWA) of EU/EEA banks by 4.9% from June 2021 was driven by an increase in lending volumes. Credit risk, which represents 83.3% of total RWA, showed a 3.7% increase since June 2021. Market risk, on the other hand, has achieved strongest growth rate of 29.7%, reflecting the market volatility triggered by macro uncertainties and geopolitical turmoil, as well as the repricing of bonds due to increasing rates. Credit valuation adjustment (CVA) and other risks have also increased by 27.5%, reflecting the rise in counterparty risk on the credit derivatives markets. Although operational risk increased by 1.8%, it remains



Source: Author's elaboration based on figures published by European Banking Authority (European Central Bank 2023, 35).

Figure 10. Distribution of impairments stages EU banks

[1] Data for 2023 were not available in the moment of preparing this paper.



Source: Author's elaboration based on figures published by European Banking Authority (European Central Bank - Statistical Data Warehouse 2023).

Figure 11. Evolution of CET1 and Tier1 ration across last years

the second largest RWA component at 9.5% of total RWA. Due to the surge in market and CVA risks, the composition of banks' RWA has changed, with market risk now representing 4.1% and CVA representing 3.0% of total RWA (Ibid, 37).

Conclusion

In this article, we examined how COVID-19 and the Russian aggression against Ukraine have affected European banking systems. Even though it is still too early for a comprehensive assessment of the impact of these events on the European banking system (due to the ongoing real-world implications for the ECB's current monetary and fiscal policy), we can draw some initial conclusions by assessing their effects. As of now, during the first 10 months of 2023, no significant problems have been observed in the banking sector. By significant problems, we mean the failure of any of the so-called G-SIB[2] – which has not occurred. At this point, it is worth noting the difficulties faced by Credit Suisse; however, it is challenging to directly link these issues to the sector's vulnerability resulting from the events. This is because Credit Suisse grappled with numerous scandals that ultimately led to its acquisition by UBS.

Nevertheless, other risks and obstacles have been highlighted by the European Central Bank. The ECB conducted a review of banks' risk control frameworks and found concerns in areas such as internal governance, risk management, and insufficient resources for control functions. Many banks lacked clarity on their risk appetite and inadequate practices to assess and manage climate-related risks. Additionally, the Russian war against Ukraine increased operational and IT/cyber-related risks, leading to deficiencies in outsourcing arrangements and IT security frameworks. While NPLs continued to reduce, the credit risk scores of over halves of the banks remained unchanged. Latent credit risk signs emerged, and scores were underpinned by persisting risk control deficiencies in loan classification and the implementation of loan origination and monitoring guidelines.

[2] G-SIB- Global Systemically Important Institution

Undoubtedly, part of the relative stability in today's banking sector is due to the 2007 crisis, which contributed to stricter criteria and methods for assessing the condition of commercial banks. As a result, the European system is now more sensitive to deviations from the norms, allowing it to react more swiftly and effectively to various anomalies. More specifically, this is attributed to the Basel regulations and the Single Supervisory Mechanism, which, even though they have not been fully implemented, have still contributed to improving the crisis management mechanism.

Concluding, the effect of the COVID pandemic and the Russian aggression against Ukraine was visible in the financial indicators used by the European Central Bank. However, after several months of turmoil, a clear recovery is now visible. The level of capital requirement seems to be stable at the moment. In the coming months, the ECB's strategy should mainly focus on interest rate policies, while in the long term, attention should be paid to the development of digitalization in the banking sector and managing cyber security risks.

This paper was prepared during the post-COVID era and the ongoing Russian war against Ukraine. It should be considered an initial assessment of the aforementioned factors, with the potential for further and more in-depth analysis in the future, particularly when the Russia-Ukraine war concludes, and new data becomes available.

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