European banks: Outlook in 2025… and beyond

Solid prospects in a year of change

→ The outlook for European banks remains solid in 2025, with improving economic growth and rising risk appetite supporting activity, despite falling interest rates; nevertheless, risks related to interest rates, growth, debt, geopolitics and various political or policy issues, including EU–U.S. trade tensions remain.

→ Banks appear poised to increase investment in technology and artificial intelligence (AI) to boost efficiency and control costs.

The Eurozone economy is expected to show some lackluster improvement in 2025, despite softer growth prospects for France and Germany and uncertainty related to EU-U.S. trade tensions

The macroeconomic outlook
According to the latest projections, albeit still demonstrating a lackluster performance, the Eurozone economy is expected to show some improvement in 2025 with growth of about 1.5 percent, up from about 0.7 percent in 2024. However, the outlook has been downgraded on weaker prospects for France, Spain and Germany. Despite uncertainty related to EU-U.S. trade tensions, improving real wages, a solid labor market, and easing financial conditions should underpin activity.[1] In the United States forecasters expect growth to moderate in 2025 following robust performance in 2024, while activity in China should continue to decelerate.[2]

With inflation declining, the European Central Bank (ECB) is expected to continue easing. In the U.S., a slower pace of easing is projected. The looser stance of the ECB will translate to increased net interest income (NII) pressures on Eurozone banks relative to their U.S. peers amid the Eurozone's already lackluster growth outlook and increasing risks.[3]

Political risk and uncertainty will cloud the Eurozone outlook in 2025. With Germany's economy slowing, agreement on fiscal policy will top the post-election agenda. Meanwhile, in France, fiscal policy and rising sovereign debt spreads will remain a key touchpoint. Risk and uncertainty over potential tariffs with the U.S., U.S. support for Ukraine, and geopolitics remain. Macroeconomic and political developments tend to impact the stability of the banking system through various channels, including borrowing costs and sentiment. The Spanish sector will also face the bank tax, an obstacle to maintaining its strong international competitiveness.[4]

Earnings prospects

Earnings will be driven by a combination of NII,[5] improving loan volume, and rising fee revenue, with funding costs remaining supportive. Nevertheless, loan loss provisions and ongoing cost pressures will weigh on profits. That said, streamlining branch networks and investing in digital service delivery could reduce costs while maintaining customer engagement in an increasingly online banking environment. Despite a slight increase in the European Banking Authority's overall capital requirements for the sector in 2025, some banks may also proceed with capital distributions.[6]

Earnings will be driven by declining, but still solid net interest income (NII), accelerating loan volume, and rising fee revenue

NII will remain a key source of income despite lower rates. Many Eurozone banks have reduced reliance on short-term deposits by improving deposit management strategies, protecting NII.[7] Still, NII is expected to decline, with estimates suggesting that a 100-bps reduction in the ECB's deposit facility rate would reduce interest incomes by about €30 billion across large banks in the Eurozone.[8] For some banks in Spain and Italy, and more broadly, smaller banks, where NII tends to be particularly sensitive to interest rate fluctuations, earnings may slow markedly in the coming years.[9] On the other hand, European banks have also expanded fee-based revenue streams such as wealth management or advisory services. Lower rates should also support market activity and transactions, lifting fees revenue and boosting asset inflows in 2025.

After near zero growth over 2024, total bank lending across the Eurozone is forecast to grow 3.1 percent in 2025 and 4.2 percent in 2026.[10] With economic prospects among the best in the Eurozone, Spain is expected to be a bright spot in 2025.[11]

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Funding costs and liquidity should remain stable in 2025, with the low deposit betas paid by European banks on customer deposits helping to contain costs.[12] Even so, loan loss provisions, especially in the commercial real estate sector in some economies, and rising operational costs, which are on track to outpace inflation at most European banks over 2025-26, will pressure profits.[13] Cost cutting and efficiency will also be key determinants of performance.

Risks

In 2025 key risks to European banks are tilted to the downside, stemming mostly from macroeconomic, political/policy, and structural issues. Key upside risks in 2025 include stronger growth and higher rates (better NII), faster loan growth (higher fees revenue), and stronger than expected markets activity (improved fees and asset inflows).

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Downside risks include weaker growth (lower interest rates, fees and loan growth) and political/ policy risks. A weaker macroeconomic environment could also lead to a deterioration in asset quality, particularly in the commercial real estate sector, where ongoing hybrid work arrangements may reduce demand for office space and lead to increased defaults.[14] Geopolitical risks (Ukraine, Middle East, *etc.*) have the potential to disrupt supply chains and lead to commodity price spikes, while fiscal policy risks in France and Germany remain pertinent.

Trade disputes, especially potential U.S.-EU tariffs, could reduce trade finance activity and weaken credit demand in export-dependent sectors, necessitating adjustments in loan portfolio strategies. Financial market volatility and risk aversion could also increase in a scenario where stronger than expected growth leads to materially tighter financial conditions.[15]

Structural shifts including artificial intelligence (AI), cyber threats, and climate change necessitate a transformation in business models and risk management practices.[16] With the European AI Act phasing in, banks will need to increase investments in AI-driven security systems to meet compliance and mitigate the growing frequency of ransomware attacks.

Long-term trends

Long-term trends including consolidation and the growing role of artificial intelligence (AI) will continue to shape the future of the sector

Long-term trends including consolidation and the growing role of AI intelligence will be key themes across the European banking sector in 2025.

The transformation of the banking model will continue to advance in 2025, with AI here to stay. According to the European Banking Authority, more than 80 percent of European institutions use AI for different purposes and are leveraging it to change operational processes and service offerings.[17]

Banks are moving forward with plans to deploy AI-based tools, which, while costly upfront, should eventually improve productivity.[18] In October, Italian lender, BPER Banca, announced plans to reduce its workforce by 10 percent by leveraging AI-based tools.[19] Examples of AI's application in the sector include, client verification, fraud detection, portfolio optimization, default screening, and customer service automation, which, if done well, reduce operational costs and improve customer satisfaction.[20] Banks could introduce flexible digital solutions in consumer lending and payments to counter fintech disruptions, focusing on enhancing user experience and speed of service. AI can also be used to improve cyber defenses and risk management with cyber-attacks on the rise.[21]

Notes

[1] https://www.goldmansachs.com/insights/articles/the-euro-area-is-forecast-to-avoid-recession-despite-trump-tariffs; https://www.ecb.europa.eu/press/key/date/2024/html/ecb.sp241218~c88acfb65f.en.html

[2] https://www.reuters.com/markets/us/futures-inch-higher-markets-await-fed-decision-2024-12-18/

[3] Carbó Valverde, Santiago. Divergentes hojas de ruta monetarias y financieras. *Cinco Días.* 12 December 2024.

[4] Carbó Valverde, Santiago. Retos tecnológicos para la banca. *La Vanguardia.* 8 December 2024.

[5] Defined as the difference between the interest income earned from lending activities (*e.g.,* loans, mortgages, bonds) and the interest paid on liabilities.

[6] https://www.bankingsupervision.europa.eu/activities/srep/2024/html/ssm.srep202412_aggregatedresults2024.en.html#toc6

[7] Charney, N., Kroll, K., Edwards, G., S&P Global, November 25th, 2024 "European Banks Will Pull Multiple Levers to Protect Operating Performance In 2025-2026."

[8] Ibid.

[9] https://www.imf.org/en/Publications/WP/Issues/2024/07/09/Bank-Profitability-in-Europe-Not-Here-to-Stay-551129; https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/southern-european-banks-outperform-in-h1-as-lending-income-outlook-strengthens-82193773

[10] https://www.ey.com/en_gl/newsroom/2024/09/following-two-years-of-little-to-no-growth-the-eurozone-credit-cycle-is-turning-a-corner-with-strong-bank-lending-forecast-from-2025#:~:text=Total%20bank%20lending%20is%20forecast,2025%20and%205.6%25%20in%202026

[11] Charney, N., Kroll, K., Edwards, G., S&P Global, November 25th, 2024 "European Banks Will Pull Multiple Levers to Protect Operating Performance In 2025-2026."

[12] Ibid.

[13] Ibid.

[14] Charney, N., Kroll, K., Edwards, G., S&P Global, November 25th, 2024 "European Banks Will Pull Multiple Levers to Protect Operating Performance In 2025-2026"; Volland, E., S&P Global, November 14th, 2024 "Global Banks Outlook 2025: Cautiously Confident."

[15] Volland, E., S&P Global, November 14th, 2024 "Global Banks Outlook 2025: Cautiously Confident."

[16] Charney, N., Kroll, K., Edwards, G., S&P Global, November 25th, 2024 "European Banks Will Pull Multiple Levers to Protect Operating Performance In 2025-2026"; Volland, E., S&P Global, November 14th, 2024 "Global Banks Outlook 2025: Cautiously Confident."

[17] Carbó Valverde, Santiago.Retos tecnológicos para la banca. *La Vanguardia.* 8 December 2024.

[18] https://www.mckinsey.com/featured-insights/lifting-europes-ambition/videos-and-podcasts/the-state-of-gen-ai-implementation-among-european-banks; https://finance.yahoo.com/news/ai-coming-european-bank-jobs-133225485.html?guccounter=1

[19] https://finance.yahoo.com/news/ai-coming-eurozropean-bank-jobs-133225485.html?guccounter=1

[20] Charney, N., Kroll, K., Edwards, G., S&P Global, November 25th, 2024 "European Banks Will Pull Multiple Levers to Protect Operating Performance In 2025-2026."; https://finance.yahoo.com/news/ai-coming-european-bank-jobs-133225485.html?guccounter=1

[21] Volland, E., S&P Global, November 14th, 2024 "Global Banks Outlook 2025: Cautiously Confident."