Spanish banks 2025 outlook

Dynamic economy supports loan growth, but extension of banking tax could erode profitability

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Table of contents

Spanish banks enjoyed another quarter of peak profitability in Q3, driven by high interest margins and low loan-loss provisions. The challenge in 2025 will be to return to steady loan growth while adjusting revenues towards a higher component of commissions as interest margins start to shrink. The extension of and structural changes to the banking tax could also erode profitability in 2025.

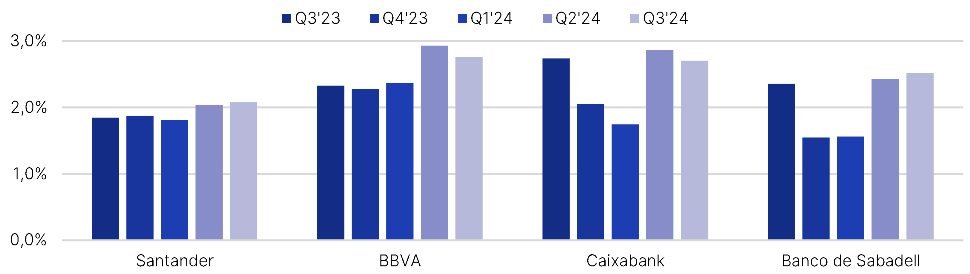
Robust profitability but decline expected in 2025. Q3 results were aligned with the strong performance of the previous quarter, driven by net interest income. We expect profitability to decrease in 2025 but RoE to be above 11%, supported by loan growth, mostly in retail and consumer where margins remain relatively high.

Asset quality is set to come under pressure by H2 2025. While Spain's (A/Stable) favourable economic environment benefits asset quality, the growth in retail lending could translate into higher NPLs and increased cost of risk. The effects on asset quality from customers affected by the DANA weather phenomenon have been contained for now but could materialise in the second half of 2025 as government relief measures and debt suspensions expire.

Capital levels remain aligned to management targets. Although capital levels remain adequate, banks are actively managing excess capital via shareholder remuneration and RWA growth, which has led to CET1 ratios tightly aligned with management targets. We expect this to remain the case in 2025.

We expect more aggressive competition in lending to profitable segments as most banks are willing to speed the recovery in volumes, which could further tighten margins and accelerate the reduction in still-strong profitability expected for 2025.

Figure 1: Spanish banks' annualised return on risk weighted assets*



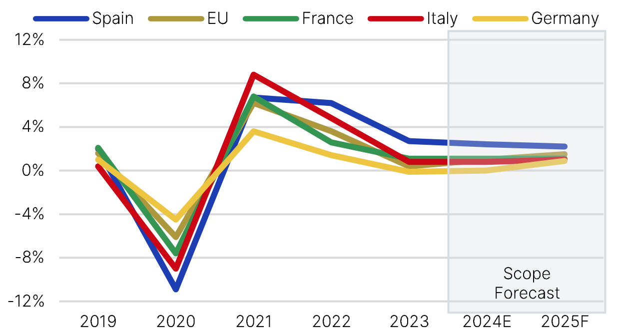
* Proxy for capital generation before distribution, annualised net profit to avg. RWA (QoQ). Source: Banks' financial data, Scope Ratings.

Expected 2025 trends for Spanish banks		
Profitability	Mildly negative, decreasing slightly compared to 2024	↘
Asset quality	Mildly negative, loan deterioration should materialise	↘
Funding & liquidity	Stable, deposit base stabilising	→
Capital	Stable, organic capital growth offset by higher RWA and payouts	→

Economic resilience amid, headwinds from recent weather events

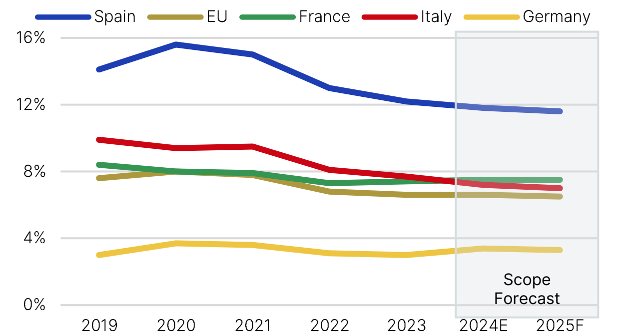
Spain's economic growth has outpaced the EU demonstrating remarkable resilience, with forecast GDP growth of 2.4% for 2024 and 2.2% in 2025. A dynamic, diversified economy reaping the benefits of past reforms and positive labour market trends driven by net migration flows are key strengths that support the operating environment for Spanish banks and hence our expectations for the sector's performance in 2025.

Figure 2: GDP growth



Source: Scope Ratings Macroeconomic Board

Figure 3: Unemployment rate



Source: Scope Ratings Macroeconomic Board

The economic damage caused by DANA is localised in Valencia, Spain's fourth largest region by nominal GDP and home to its largest container port. Preliminary estimates are that 22% of the region's output will be affected by the floods, while it is estimated to have an effect of around 2% of Spain's GDP. Several industrial parks are unable to operate and will require reconstruction, while agriculture and farming will be beset by severely damaged land.

The Bank of Spain identified estimated total exposure of EUR 20bn for Spanish banks, of which EUR 13bn is retail loans (mostly mortgages) and EUR 7bn SME and commercial loans. While the total economic effects are still not measurable, the Spanish government approved a series of economic measures (law decree RD-6/2024) to support the affected regions including:

(i) a EUR 5bn government guarantee to cover financing granted by credit institutions to affected households, companies and the self-employed, to be used as bridge loans while indemnity and insurance cover is claimed.

(ii) A temporary suspension of outstanding debt for retail, the self-employed and SMEs with turnover below EUR 6m with properties affected by the event or that have been displaced due to damage, in the agriculture, fishing, forestry, manufacturing and industrial sectors.

Spanish banks are providing additional relief measures for clients from the affected zones, mostly in the form of credit lines and a freeze on transaction fees. Due to the highly localised nature of the event, we believe a material effect on banks' loan portfolios is unlikely. The government guarantees and potential for further support measures should in most cases cover immediate household losses. Medium to long-term effects are most likely to be felt by SMEs, as operating capacity and production could remain subdued in the event of lengthy reconstruction periods, adding pressure to the viability of their operations.

Profitability will remain robust in 2025 but higher cost of risk and tax extension may pose challenges

RoE peaks and we expect the effect of loan repricing to adjust downwards

Spanish bank performance in Q3 was robust and confirmed our expectations for a record year. Our sample of banks (BBVA, Santander, Banco de Sabadell and CaixaBank) achieved an average return on equity (RoE) of 14.5% in the quarter, stable compared to 14.4% in Q2, and the highest since Q1 2023. The strong performance of net interest income (NII) remained supportive but is starting to decrease as margins are tightening at almost all banks.

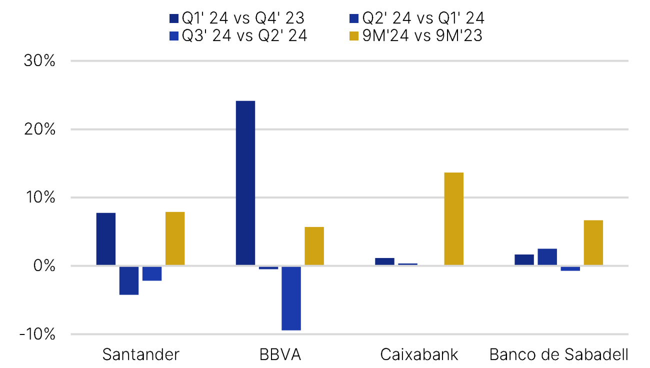
For the first nine months of 2024, NII grew on average by 8.5% compared to 9M23 for the banks in our sample. Net interest income has been driven by the full repricing of loan portfolios just as lending volumes (mostly consumer loans) are growing, while the cost of deposits has stabilised in the second half of the year. For all banks, NII to average total assets for 9M24 was 10bp-20bp above 9M'23.

For 2025, we expect NII to decrease as margins start to reflect the reduction in interest rates while the cost of deposits remains stable as the share of time deposits stays broadly unchanged due to their maturity features, at least for the first half of 2025.

Fee and commission income decreased QoQ, due to lower fees related to credit cards and payments but also because of lower commissions from wholesale and commercial banking activities. However, for 9M24, net fees and commissions outperformed the same period of 2023 for most of the banks. We expect this positive trend to remain for 2025, as economic growth and the recovery in loan volumes provide a larger customer base hence a larger foundation for transaction fees.

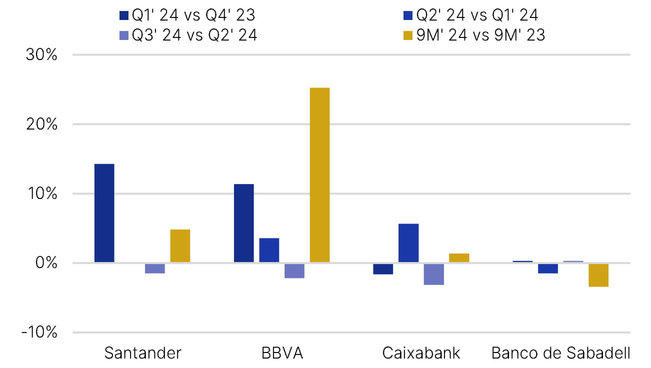
The extension of the banking tax for another three years, proposed recently by the government and expected to be approved by parliament before the end of the year, will pressure profitability targets. If approved, the current 4.8% levy on NII and fees will switch to a range of 1% to 6% and will, by definition, have a bigger effect on larger banks as their revenue bases are bigger, further eroding their potential for higher profitability.

Figure 4: Net interest income, QoQ and 9M comparison



Source: Banks' financial data, Scope Ratings

Figure 5: Net fees and commissions, QoQ and 9M comparison



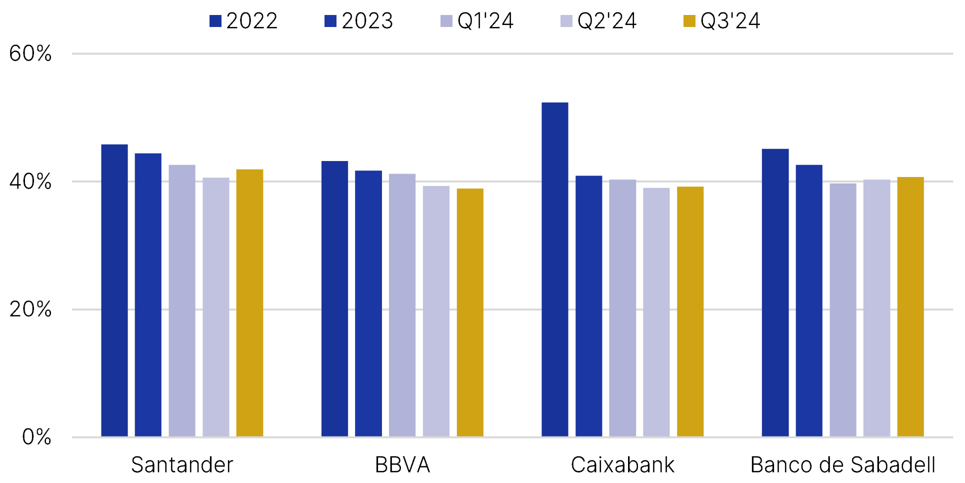
Source: Banks' financial data, Scope Ratings

Efficiency levels stable at 40% for most banks

Efficiency ratios have continued to improve QoQ and are aligned across all four banks in our sample, reaching 39%-40% in Q3, a significant improvement compared to the levels of 40%-45% in 2023. The effect of salary increases and inflationary pressure on suppliers' costs continues to be well absorbed by strong revenue generation. Restructuring and one-off costs are no longer material, as was the case for Banco de Sabadell and the restructuring of its UK operation (TSB Bank), and Santander with the One Transformation project that has achieved the planned 200bp-250bp efficiency effect.

We expect banks to maintain strong cost discipline in 2025 and efficiency levels to stabilise at 40%-42%, as most inflationary pressure should already have been absorbed, while restructuring measures implemented in the past year are finally seeing results.

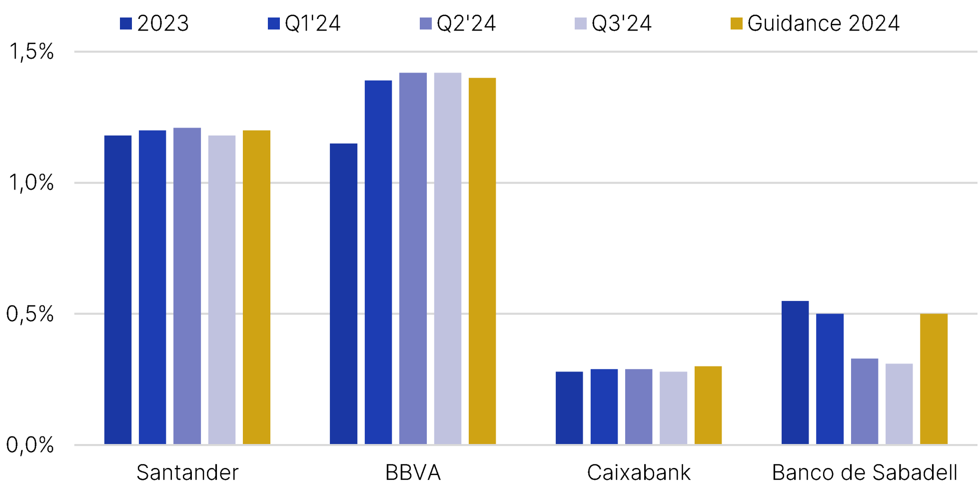
Figure 6: Efficiency, cost-to-income ratio



Source: Banks' financial data, Scope Ratings.

Cost of risk showed a slight decrease QoQ for most banks in Q3, due to better-than-expected asset quality, a release of provisions and lower inflows of NPLs. While we expect cost of risk to increase in Q4, it should remain close to guidance for most of the banks. Positive employment prospects, strong economic dynamics, rising real incomes and immigration flows remain the key elements supporting Spanish banks' asset quality. That said, we do expect cost of risk to increase in 2025 as loan deterioration materialises from the growing consumer lending and from commercial loans exposed to sensitive sectors like trade and wholesale, which could face uncertainties on growth prospects as geopolitical risks remain high.

Figure 7: Cost of risk (bp)



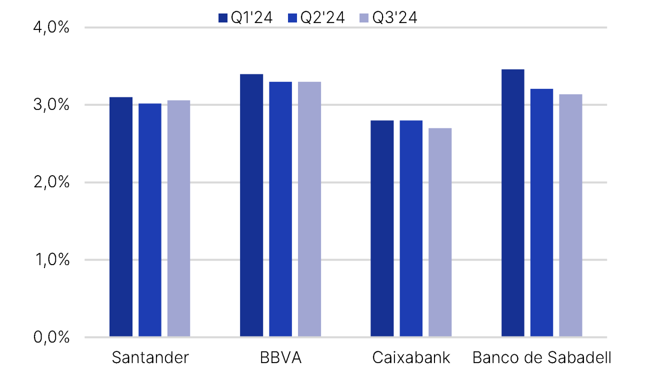
Source: Banks' financial data, Scope Ratings.

Asset quality, NPLs stable while Stage 2 slightly increasing

Asset quality deterioration to come most likely from growth in consumer loans

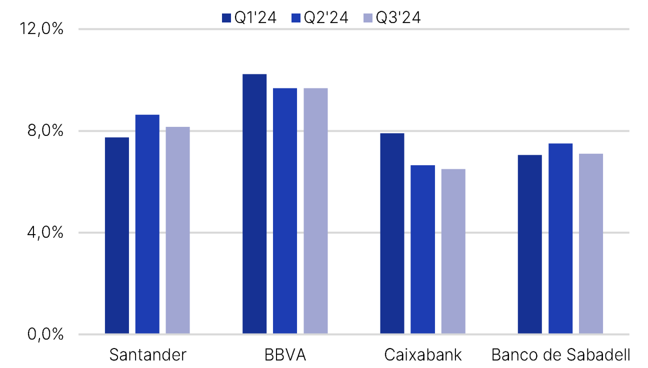
NPL ratios remained stable QoQ and slightly decreased for CaixaBank and Sabadell, following more active credit risk management, higher recoveries, and lower inflows of new NPLs from Spanish portfolios. Santander reported an increase in impaired loans from its retail and payments portfolio (with a sector specific NPL ratio at 5.52% as of Q3 24), partially offset by better performance in CIB. BBVA highlighted positive dynamics in Spain and South America, offset by higher NPLs in Mexico and Türkiye. Stage 2 loans are decreasing QoQ for all banks, supporting our view of better-than-expected developments in asset quality in 2024.

Figure 8: NPLs, QoQ comparison



Source: Banks' financial data data, Scope Ratings

Figure 9: Stage 2, QoQ comparison



Source: Banks' financial data, Scope Ratings

We do not expect NPLs to deteriorate significantly in Q4, as any potential losses from DANA will not yet have materialised. None of the banks in our sample have significant portfolio concentration in the regions affected. Most loan exposure is with regional players.

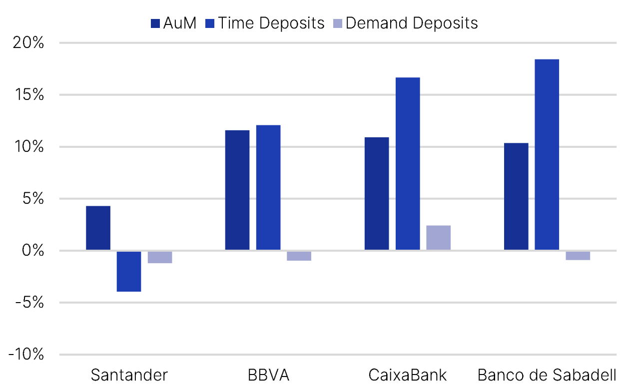
Considering also the government measures, any potential losses will likely only be seen after Q2 2025. For 2025, we continue to expect asset quality to normalise, with NPLs above those of 2024 as the growth in consumer and retail lending comes with higher risk than collateralised loans or mortgages. As mentioned above, additional deterioration could come from still-subdued activity in sectors highly exposed to international trade (mostly trade and wholesale), as the macroeconomic and geopolitical scenario for 2025 remains uncertain.

Deposits and off-balance customer funds see strong growth

Higher component of time deposits and off-balance sheet customer funds

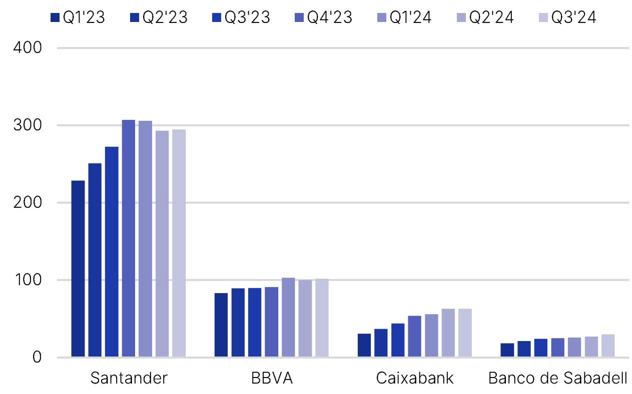
Customer funds continue growing for most of the banks, as the high-interest-rate environment remains attractive for customers seeking savings products with better remuneration. Time deposits as well as wealth management products have grown more than 10% so far this year for most of the banks. The shift from current or transaction accounts to time deposits is now stabilising. Time deposits were almost flat in Q3 QoQ. However, they will remain a relevant component of funding, representing 15% of total deposits for Sabadell as of Q3 2024, 17% for CaixaBank, 23% for BBVA and 30% for BBVA.

Figure 10: Customers funds by type, year-to-date grow



Source: Banks' financial data, Scope Ratings

Figure 11: Time deposits: quarterly growth (EUR m)



Source: Banks' financial data, Scope Ratings

We expect the stock of time deposits to remain stable in the first half of 2025 and to weigh on funding costs for all banks, with further cost reductions mostly in the second half of 2025 as the effect of interest-rate cuts starts to emerge and provides some room for banks to adjust remuneration rates down. We also expect the large increase in AuM and wealth management products to sustain the positive trend of higher fees and commissions at BBVA and CaixaBank, since for both banks the AuM component of customers funds is the largest (31% and 30%, respectively as of Q3 2024).

Capital remains stable as profits used mainly to remunerate shareholders and RWA growth

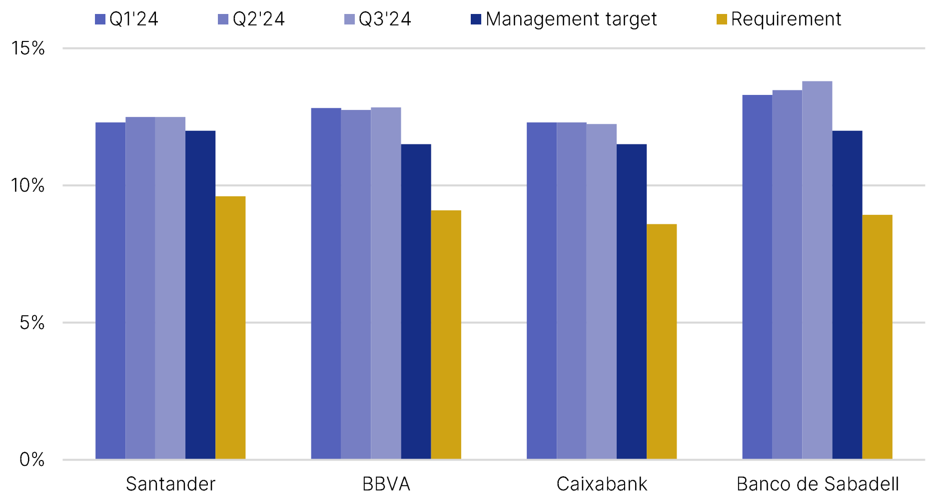
Capital levels aligned with management target, following optimisation strategies

Spanish banks continue to maintain adequate levels of capital. The average CET 1 ratio in Q3 was 12.85% for our sample, almost unchanged from Q2 2024, since the large shareholder distributions via dividends and share buy backs offset the potential for capital accumulation.

Spanish banks have actively optimised their capital targets, with most of the banks in our sample reporting CET 1 ratios close to management targets, while the buffer above regulatory requirements remains below the average of EU peers. Business-model differences and strong prospects for highly profitable RWA deployment (in consumer lending, for example) further support this strategy.

We do not anticipate significant changes in capital and distribution strategies for our sample of banks. Organic capital generation will support expected growth in lending volumes, and distribution to shareholder will likely continue to be at least 50% of profits.

Figure 12: CET 1 ratio QoQ, target and requirements



Source: Banks' financial data, Scope Ratings

Competitive dynamics could pressure growth prospects in 2025

Competition to intensify, mostly in highly profitable segments

BBVA's acquisition of Sabadell is progressing more slowly than expected. Spain's competition authority (CNMC) has moved the transaction to phase-2, which will see a more in-depth analysis of the market concentration that could result from the combination of the two banks. The process will also be open to comments from third parties with legitimate interests and concerns related to potential market concentration.

This additional step has delayed BBVA's initial expectations, which were to conclude the takeover by the end of 2024, and have been extended to H1 2025. It is worth noting that the group has already received a green light for the transaction from authorities in the US and UK, plus a no objection from the ECB.

The uncertainty related to the success of the transaction puts pressure on existing competitive dynamics in the Spanish banking sector. We expect more aggressive competition in lending to profitable segments (consumer, SMEs) as most banks are willing to speed up the recovery on lending volumes, which could further tighten margins and accelerate the reduction in still-strong profitability expected for 2025.

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