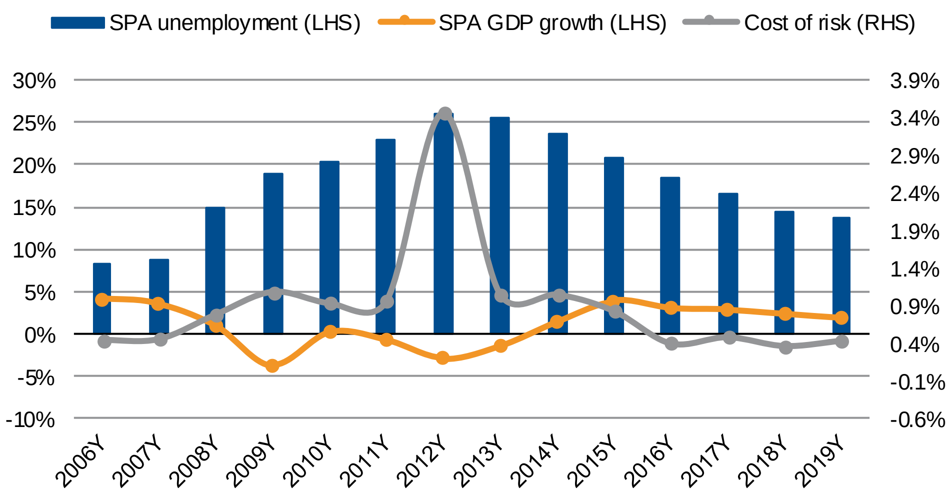
Spanish banks: mainly positive earnings despite trebling of provisions

There were few surprises in the operating results of the leading Spanish banks. First-half earnings were generally weak, but excluding extraordinary items related to Covid-19 and other factors, they could have been worse. Credit provisions trebled from very low levels but most banks reported a positive bottom line and a couple pointed to a recovery in June.

All in all, cost-of-risk guidance for Spain – ranging from 70bp-100bp for most banks – looks manageable and will likely be absorbed out of ordinary profits. The bigger question mark is around 2021 asset-quality developments. The banks are not guiding here and there is little current visibility, given uncertainties about a second peak and the effects of new localised or regional lockdowns."

Current guidance is, in fact, well below the cost of risk seen in the euro area debt crisis, when mandated real estate provisions forced most banks into net losses in 2012. See Figure 1.

Figure 1: Growth and unemployment vs banks' Cost of Risk



Source: Scope

One key reason for the milder credit cycle this time around is the greater liquidity support to the entire system, starting with the banks. The authorities moved swiftly, allowing payment holidays, injecting liquidity and loosening supervisory constraints. The environment is very different from the last crisis, when austerity and deleveraging were the buzzwords. This time, authorities are encouraging banks to lend with the right incentives, something that just was not there in the previous cycle.

Of note, some of the international operations of Spain's two multinational banks have become a source of risk in this crisis. BBVA and Santander have material exposures to the US, Brazil and Mexico, where the pandemic is less under control than in Europe. That said, this is the nature of their well-diversified business models, which Scope sees as credit friendly.

There will always be fluctuations in the business fortunes of the major international banks in some of their countries of operation, which may hit earnings and prevent the shares from re-rating to their full potential. On the plus side, there is also less volatility at group level, as local fat-tail events are diluted in the larger earnings streams. Diversification is generally good for credit.

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Spanish banks: cost of risk manageable in 2020 but watch the shape of any recovery

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Summary details of H1 earnings:

Kitchen-sinking forces EUR 10.8bn loss

Santander's EUR 10.8bn H1 loss contained a lot of kitchen sinking, although the EUR 12.6bn of DTA and goodwill write-downs in the UK, US and Poland had no impact on liquidity or credit risk positions or the CET1 ratio (+26bp QoQ to 11.84%). Underlying results were solid enough, although the weaker dollar was a factor and may yet hurt going forward.

H1 20 revenues were in line with H1 19 on a constant-currency basis, OpEx fell 5% in real terms, while net operating income rose 2% (South America, +8%, compensating for Europe, -11%). The NPL ratio fell 25bp to 3.26% and coverage rose 4 p.p. to 72%. Net loan loss provisions rose 63% YoY. CoR guidance remains 140bp-150bp. The group earned RoTE of 5.19%, although management is sticking with the 13%-15% target. The bank pointed to signs of lending normalisation in June: new mortgage and consumer lending increased while lending to SMEs and corporates reduced from its peak in April.

Model provisions drive CoR increase

BBVA reported weak results but the group was profit-making (attributable profits fell 49.5%). Operating income was flat YoY (+17.6% on a constant currency basis) while OpEx fell 4.9% in constant-currency terms. The fully-loaded CET1 ratio rose 38bp QoQ to 11.22% (+263bp over minimum requirements). Model provisions are driving an increase in the cost of risk. For the group, annualised CoR was 151bp in Q2, compared to 257bp in Q1, although the number varies wildly by region: 100bp for Spain (consistent with a slightly riskier book); 180bp for the US, 271bp for Turkey; 364bp for South America; 495bp for Mexico). The 3.7% NPL ratio was broadly consistent with previous quarters; coverage ending the half at 85%.

Bankia's results were also weak (RoE fell 4.1 p.p.to 2.2%) but again the group remained in profit, albeit attributable profits fell 64.4% owing to extraordinary provisions. Management has guided for a small profit for the full year. H1 20 CoR was 73bp. The NPL ratio was broadly unchanged at 4.86% and coverage increased slightly to 55.6%. The fully-loaded CET1 ratio rose 100bp from Q1 to Q2 to 13.95% pro forma. Following the results, Scope affirmed its BBB+ rating on Bankia, with a stable outlook. Bankia's business model is defensive, with a focus on domestic low risk mortgages. We expect impacts from Covid-19 to be manageable for the rest of the year.

Bankinter's H1 results were weak, too, (RoE -5.3 p.p. to 7.6%; cost of risk and other provisions +53.4%). While group net profit fell 65% year-over-year, the bank was profitable and has guided for a full year profit. The group's 2.5% NPL ratio is below the 4.73% sector average and NPL coverage increased 10 p.p. QoQ to 59%. The annualised cost of risk was roughly 70bp, of which macro impacts contributed 23bp. The fully-loaded CET1 ratio ended the period at 11.8%, comfortably above the 7.675% SREP requirement.

Caixabank reported a 67% decline in attributable profits, following Covid-19 provisions. The NPL ratio ended the period at 3.5% (down 6bp on the year), with coverage rising by 8 p.p. to 63%. The CET1 ratio closed the half at 12.3%. The 12-month RoTE was 5.6%. The cost of risk (last 12 months) was 61bp after provisions. The annualised H1 20 CoR stood 106bp.

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