Spanish banks quarterly

Trade uncertainty pressures asset quality; fee and commission income key to profitability

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While Spanish banks achieved record profitability in 2024, fourth-quarter results suggest that net interest margins and customer spreads have peaked. Higher bond yields driven by fiscal expansion in the euro area may slow the rate-easing cycle, but the combination of lower rates and competitive pressures on lending dynamics will squeeze margins in 2025. Increasing fees and commissions will be key to maintaining strong profitability for most banks.

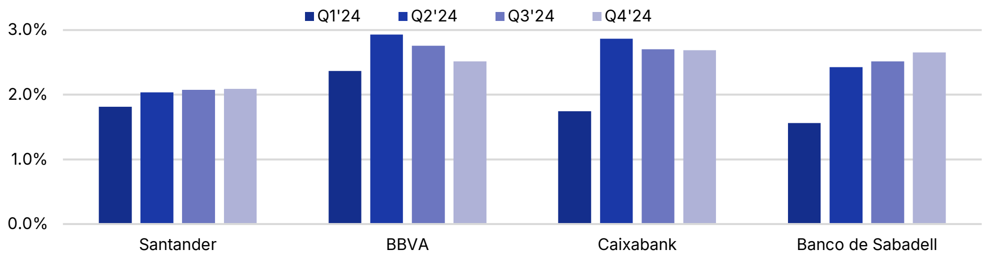
Asset quality under pressure in the second half of 2025. Spain's (A/Stable) economy continues to perform well, but banks' asset quality will likely deteriorate, not just because of strong growth in retail lending. Commercial loans could also suffer if export demand weakens following the imposition of US tariffs.

Funding costs to stabilise with the shift from deposits to mutual funds ending. While Spanish banks had one of the lowest deposit betas of EU banks in 2022-2023, the increase in deposit costs and wholesale funding as interest rates went up has finally changed direction, giving the banks better visibility on funding costs for 2025.

Capital remains adequate. Capital levels remain almost unchanged QoQ, but banks are actively managing excess capital via shareholder remuneration, significant risk transfer and growth in risk-weighted assets. As a result, CET 1 ratios are tightly aligned with management targets. Final Basel III implementation is not expected to have any effects on banks' capital metrics.

Rating Outlook. Our Stable outlooks assigned to the public ratings on BBVA (A+/Stable) and Banco Santander (AA-/Stable) indicate that risks are broadly balanced in 2025.

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



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

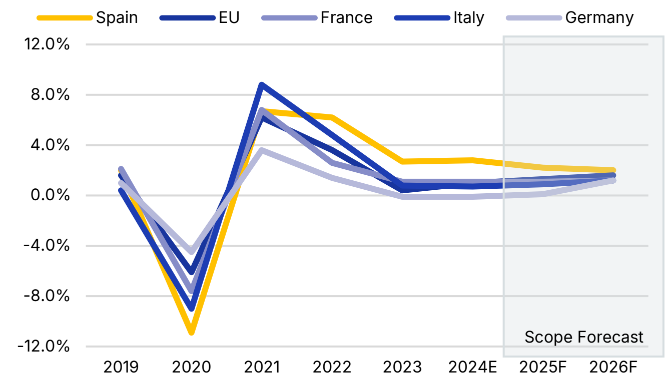
Expected 2025 trends for Spanish banks		
Profitability	Mildly negative, decreasing slightly compared to 2024	↘
Asset quality	Mildly negative, NPLs and cost of risk likely to increase	↘
Funding & liquidity	Stable, shift from sight to time deposits finally over	→
Capital	Stable, increase in RWAs and payouts offsetting organic generation	→

Strong domestic economy, but risks increasing from global trade dynamics

Spain's economic growth has outpaced the EU, demonstrating remarkable resilience with expected GDP growth of 2.8% for 2024 and a Scope forecast of 2.2% for 2025. Growth has principally been driven by a robust performance by services exports, a resilient manufacturing sector, and strong domestic consumption, facilitated by a tight labour market that continues to be supported by significant inflows of migrant workers that have increased labour force participation.

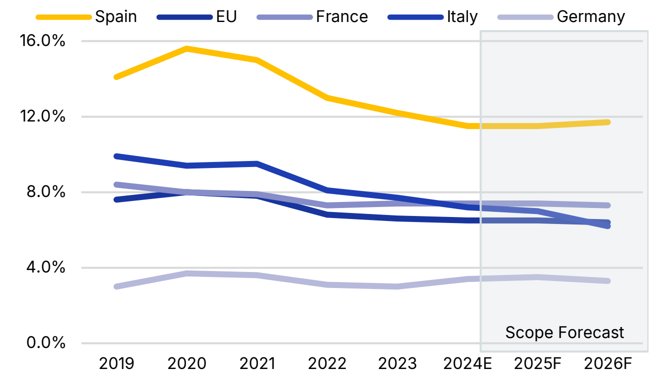
Geopolitics and global trade dynamics present risks to growth, but the dynamic domestic economic should continue to support higher loan volumes in 2025.

Figure 2: GDP growth



Source: Scope Ratings Macroeconomic Board

Figure 3: Unemployment rate



Source: Scope Ratings Macroeconomic Board

According to the Bank of Spain, expectations for manufacturing and production activity are still positive. However, the main concerns are related to the potential increase in energy costs and the uncertainty related to the proposed increase in the minimum salary (Salario Minimo Interprofesional) that could be from 3% to 5%.

The aim of the minimum salary is to boost demand and reduce inequality, but it also increases labour costs, posing risks for competitiveness, most obviously in labour-intensive industries. However, despite rising wages, Spain's overall wage levels remain relatively low, which supports further growth in purchasing power. This in turn should continue to drive consumer demand, including loan volumes, even as businesses face higher cost pressures.

Profitability should remain strong, subject to volume recovery

RoRWA normalising at 2.0%-2.5%

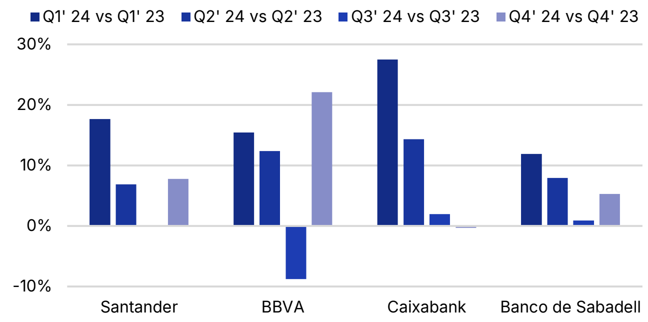
Spanish banks' Q4 performance was strong but weaker than previous quarters. Our sample of banks (BBVA, Santander, Banco de Sabadell and CaixaBank) achieved an average return on risk weighted assets (RoRWA) of 2.49% in the quarter, stable compared to Q3 (2.5%), but below the Q2 peak of 2.56%.

Net interest income (NII) for our sample grew by 8.4% in 2024 year over year, driven by the full repricing of loan portfolios as lending volumes (mostly consumer loans) continued growing while cost of deposits stabilised in the second part of the year.

Interest margins and customer spreads in Q4 fell for all banks. CaixaBank achieved a customer spread of 3.3% in Q4 (from a peak of 3.6% in Q1 24), BBVA's decreased to 3.3% (from a peak of 3.4% in Q4 23), and Sabadell's reached 3.16% (from a peak of 3.18% in Q2 24). The net interest margin of Santander's EU business fell to 1.87% (from a peak of 1.95% in Q3 23). We expect this downward trend to continue, as competitive dynamics exert further pressure on growth in loan volumes in 2025.

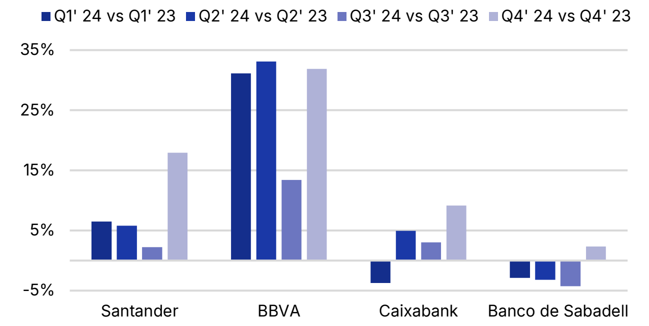
Fee and commission (F&C) income increased in Q4 vs Q3 for all banks in our sample, due to seasonality in payments and credit card usage. F&C income also grew in FY 2024 for most banks compared to 2023, BBVA showing the largest increase due to the outstanding contribution from activity in Turkey. We expect this positive trend to continue in 2025, as economic growth and the recovery in loan volumes provide a larger customer base, hence a larger foundation for transaction fees.

Figure 4: Net interest income, YoY comparison



Source: Banks' financial data, Scope Ratings

Figure 5: Net fees and commissions, YoY comparison

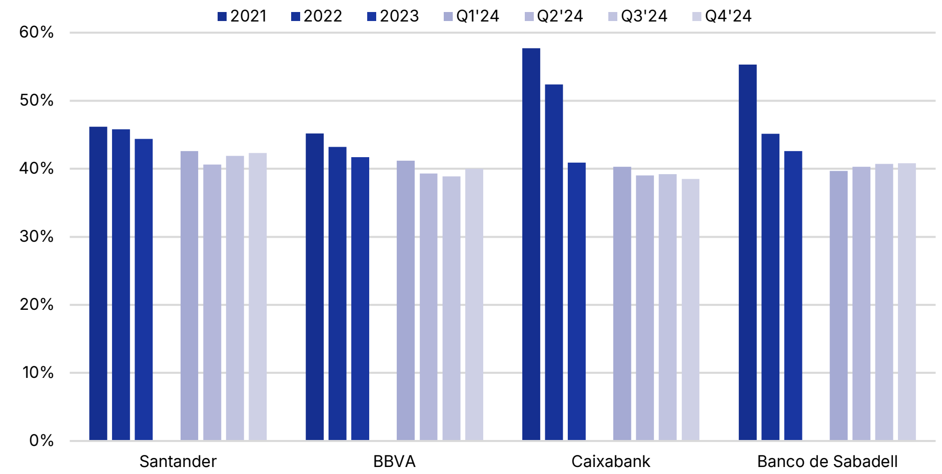


Source: Banks' financial data, Scope Ratings

Efficiency levels stable at 40% for most banks

Cost-income ratios have stabilised and are aligned across all four banks in our sample, ranging between 38%-42% in Q4, a significant improvement compared to 40%-45% in 2023. The effect of salary increases and inflationary pressure on suppliers continues to be absorbed by strong revenue generation. We expect banks to maintain strong cost discipline in 2025 and cost-income ratios to stabilise between 40%-42%, as most restructuring measures implemented in the past year are finally seeing results while the revenue base decreases slightly compared to 2024.

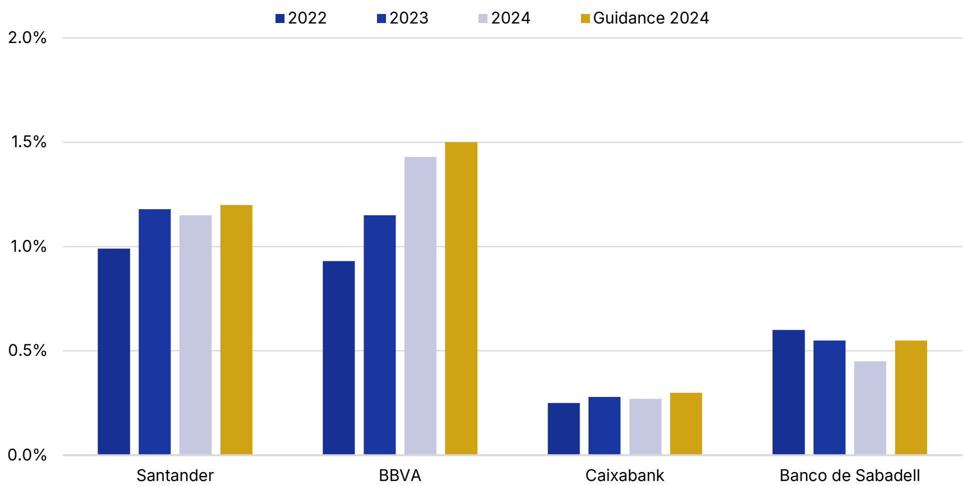
Figure 6: Efficiency, cost-to-income ratio



Source: Banks' financial data, Scope Ratings.

Cost of risk was mostly stable in Q4 2024 compared to the previous quarter. Full-year cost of risk was lower than in 2023 and below the levels banks had guided to for 2024. This was mainly driven by better-than-expected asset quality in Spain, the release of provisions and lower inflows of NPLs. However, we do expect cost of risk to increase in 2025 as loan quality deteriorates, in particular on consumer lending and from commercial loans exposed to sensitive sectors like trade and wholesale.

Figure 7: Cost of risk (bp)



Source: Banks' financial data, Scope Ratings.

Better-than-expected asset quality remains a strength

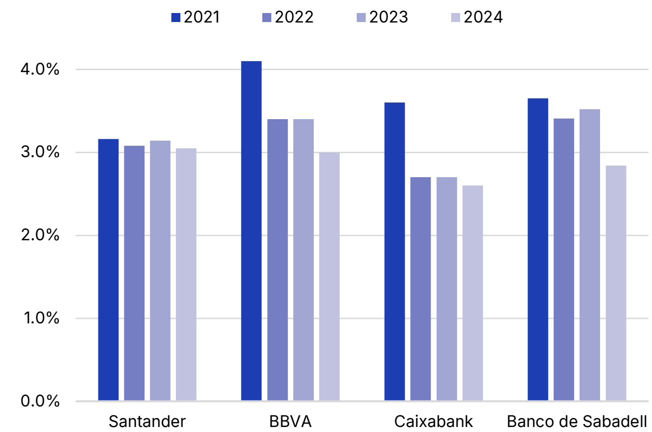
NPL ratios decreased QoQ for all banks in Q4 2024 to a range of 2.8% to 3.0%, thanks to more active credit risk management, higher recoveries and lower inflows of new NPLs, mostly from Spanish portfolios.

Asset quality remains strong, with better-than-expected NPL and stage 2 ratios

Sabadell reported the most significant reduction in NPL ratios in Q4 2024 to 2.8% (from 3.1% in Q3) due to a loan recovery related to a favourable court ruling and lower NPL inflows. For Santander and BBVA, for which consumer loans represent a significant component of total loans, NPL ratios remain higher than for Sabadell and CaixaBank.

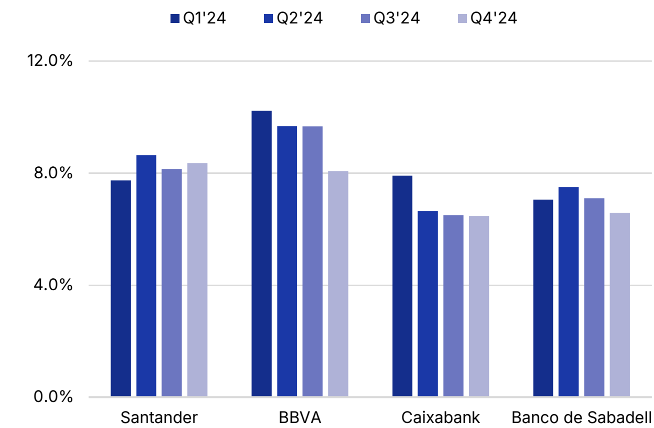
Stage 2 loans are decreasing QoQ for all banks, supporting the better-than-expected asset quality in 2024.

Figure 8: NPL ratio, evolution YoY



Source: Banks' financial data, Scope Ratings

Figure 9: Stage 2 ratio, QoQ



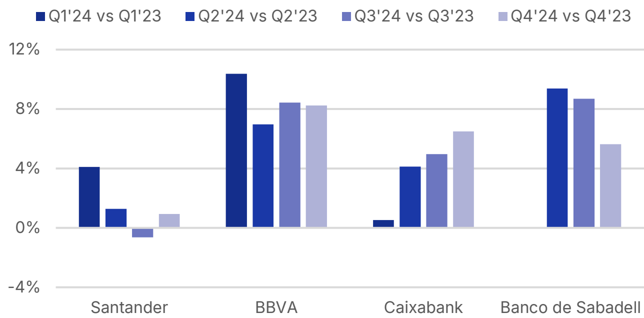
Source: Banks' financial data, Scope Ratings

Customers deposits are back to levels closer to 2022

The shift by customers from current accounts or transaction accounts to time deposits and wealth management products is stabilising, as customer deposits continued growing in aggregate in Q4 vs Q3. The normalisation of the deposit base, following the end of several quarters in which deposits fell as customers shifted to savings products paying higher remuneration, provides better visibility on cost of funding for 2025.

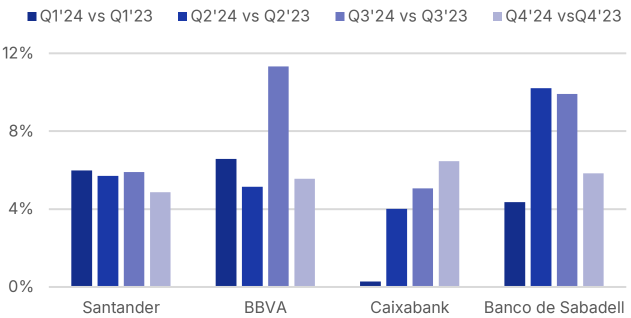
Higher component of time deposits and off-balance sheet customer funds

Figure 10: Total deposits, YoY



Source: Banks' financial data, Scope Ratings

Figure 11: Deposits, Spain only, YoY



Source: Banks' financial data, Scope Ratings

Capital stable, remuneration to shareholders increases

Capital levels aligned with management target, following optimisation strategies

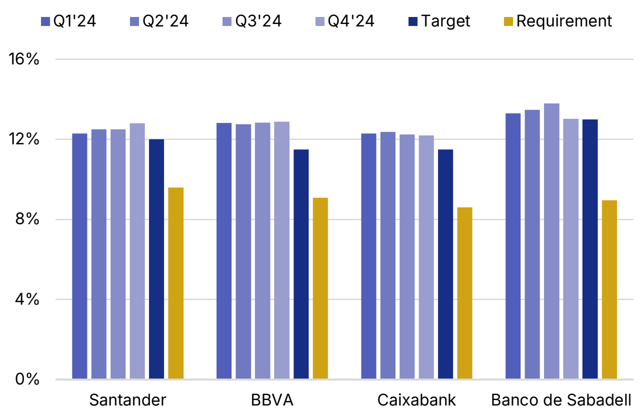
Spanish banks maintain optimised capital targets, with most of the banks in our sample reporting CET 1 broadly aligned with targets, although the buffer above regulatory requirements remains below the EU average.

The average CET 1 ratio of our sample was 12.73% in Q4, lower than the previous quarter because large shareholder distributions via dividends and share buybacks offset further capital accumulation. Sabadell, BBVA and Santander completed Significant Risk Transfer (SRT) transactions to release capital, although the increase in retail loans offset the benefits on available capital.

Santander and Sabadell confirmed that the application of final Basel III rules should have no impact on current capital levels.

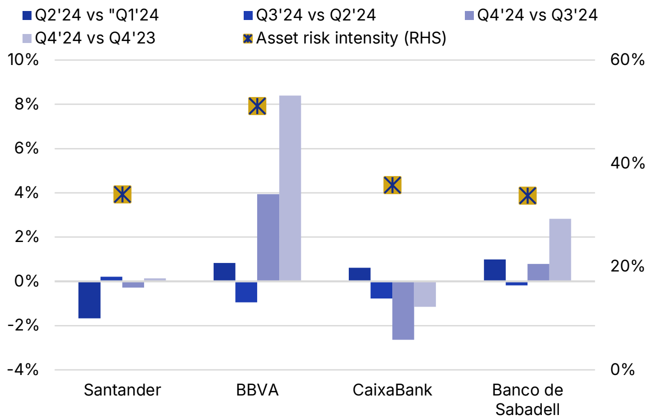
We do not anticipate significant changes in capital and distribution strategies for our sample of banks in 2025. Organic capital generation will support expected growth on RWAs (mostly consumer lending), and distribution to shareholders will likely continue to be between 50% to 60% of profits.

Figure 12: CET 1 ratio QoQ, targets and requirement



Source: Banks' financial data, Scope Ratings

Figure 13: RWAs evolution QoQ, Asset Risk Intensity



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