Spanish banks: solid Q2 performance; tax would erode repricing benefits

Spanish banks reported a solid set of results in Q2 2022. Quarterly progression of net interest income (NII) was positive across the board and most lenders confirmed or upgraded their 2022 guidance. Domestically, the impact from rising Euribor rates was varied but where the repricing effects were immaterial, higher volumes compensated.

All Spanish banks in our sample would be subject to the banking tax under discussion in the Spanish Parliament. If implemented as envisioned, it would considerably erode the 2023 benefits from rates increases.

Rising fees and commission revenue reinforced the positive Q2 trajectory. Operating expenses are trending up for more geographically diversified lenders, although below composite inflation, leading to flat to marginally improving operating leverage. Cost of risk was mostly in line or below initial guidance. While over 90% of State guaranteed lending (ICO loans) is repaying and default rates are manageable, lenders are cautious given the potential impact from the deteriorating macro picture.

Coverage levels are solid, however, as overlays have not been released. NPL ratios are trending down. Solvency ratios are mostly flat QoQ, though at times penalised by valuation adjustments.

P&L trends

Net interest income at Santander grew strongly QoQ thanks to the contribution of the US and Mexico. BBVA benefited from strong growth in Mexico and South America.

Overall, in Q2, domestic NII picked up after reaching a trough in the previous quarter. Most lenders highlighted a volume effect and slightly better yields, plus the contribution from ALCO portfolios. Ibercaja, Unicaja and Bankinter reported impacts from their variable-rate back books, which repriced at a higher 12-month Euribor rate. Second-half results should reflect this effect more strongly, in combination with higher fixed rates in the front book.

Spanish lenders confirmed (or reviewed upwards in the case of Santander) 12-month NII sensitivity to a +100bp parallel shift in interest rates, ranging from 10%-15% for Bankinter to 20% to 25% for CaixaBank. Some banks highlighted their assumptions on the likely deposit pass-through down the line, placing the deposit beta in the range of 25% to 30%.

Fee and commission performance was solid YoY, less so QoQ as market volatility negatively affected asset-management fees. Decline in non-banking commissions was more than offset, though, by growth in banking (payments, cards and other transaction fees) and insurance related commissions.

Overall H1 revenues proved resilient: YoY growth was especially strong for BBVA, Santander and Kutxabank. Bankinter and Sabadell showed a decline in gross operating income in Q2. However, in both instances, core revenue performance was positive.

Operating expenses were flat to declining for most domestic lenders both in the quarter and in H1, while Santander and BBVA's cost bases are growing below inflation and – crucially – below revenues, maintaining sound efficiency ratios. For CaixaBank and Unicaja, merger-related synergies are feeding through the cost base via lower personnel and administrative expenses; for the Valencian lender partially offset by higher D&A from IT investment.

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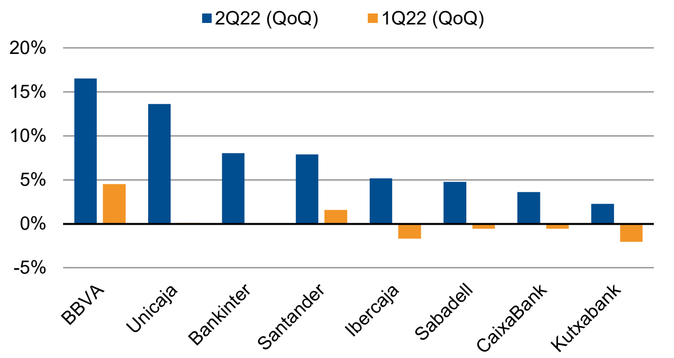
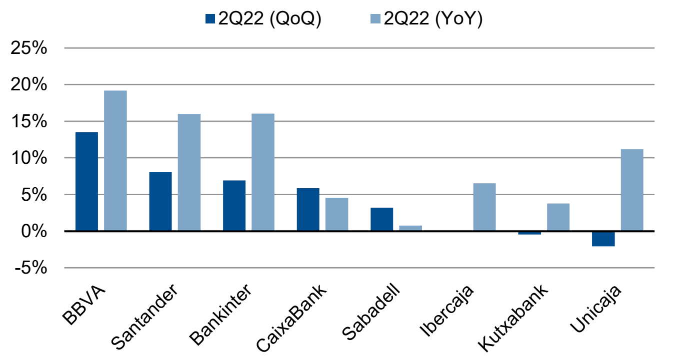
Figure 1: Net interest income growth



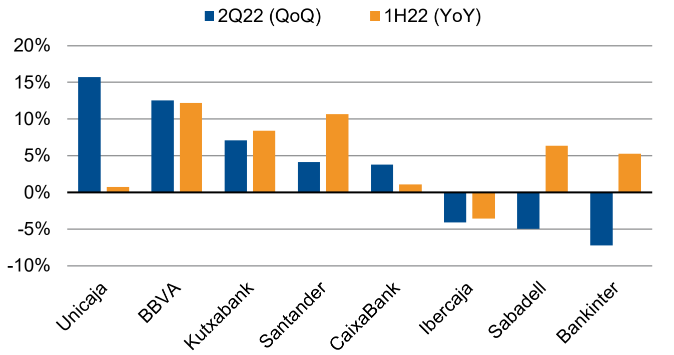
Source: Company data, Scope Ratings

Figure 2: Net F&C growth



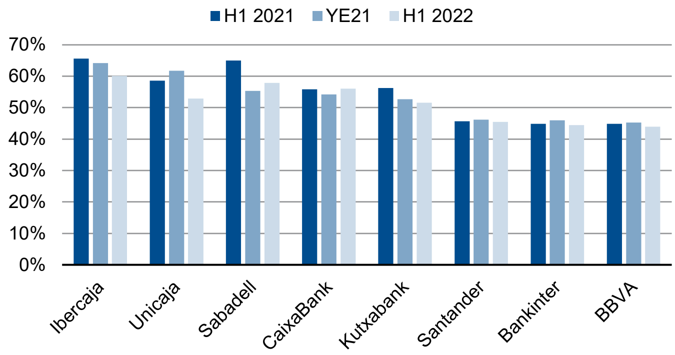
Source: Company data, Scope Ratings

Figure 3: Gross operating income growth



Source: Company data, Scope Ratings

Figure 4: Cost-to-income ratios

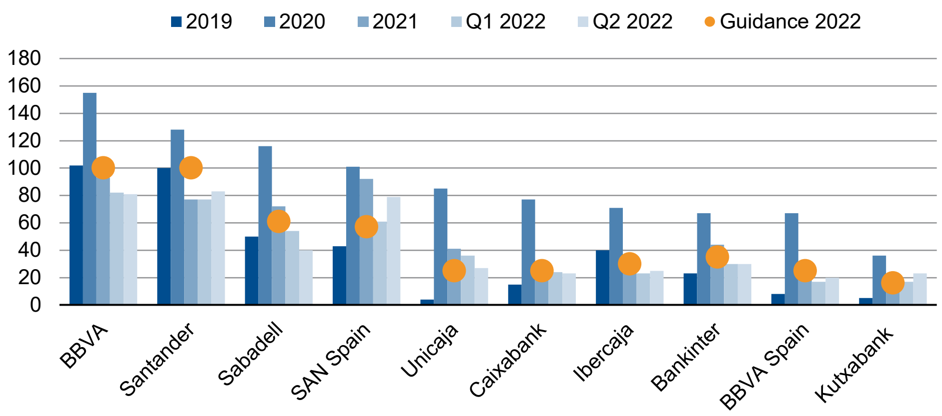


Source: Company data, Scope Ratings

Cost of risk in Spain in Q2 was on average in line with Q1 so most lenders left 2022 guidance unchanged. BBVA and Bankinter adjusted downwards by 5bp, to 25bp and 35bp respectively. Group cost of risk for BBVA and Santander was flat to marginally increasing with respect to YE2021 but still significantly below the 100bp guided for the year.

On average, CoR in Spain stood at 34bp, less than half compared to YE2020. Banks are still relatively conservative with respect to provisions releases, given some likely deterioration in the second half of 2022 and the first half of 2023. However, we do not expect any additional macro overlays in the second half of the year.

Figure 5: Cost of risk (bp)

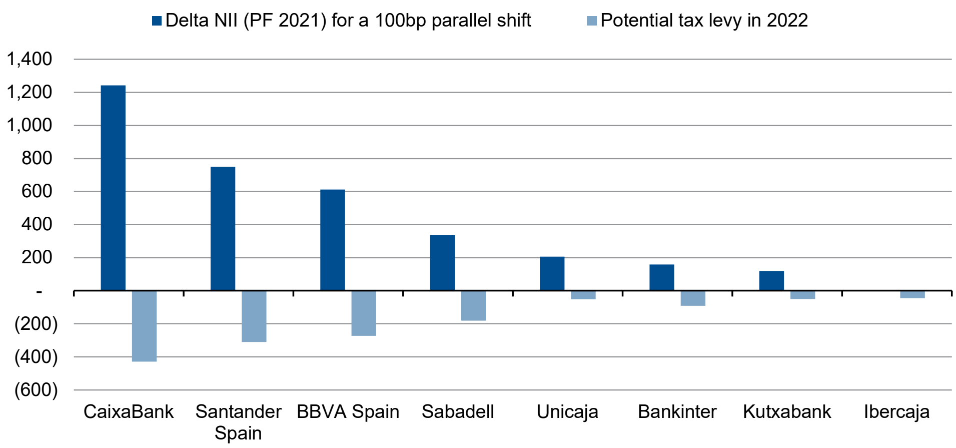


For Ibercaja target CoR. For Sabadell guidance for credit CoR (average 2019/2021) extended to total CoR.
Source: Company data, Scope Ratings

The proposed new banking tax under discussion in the Spanish Parliament sets a temporary 4.8% tax in 2022 and 2023, levied on 2021 domestic net interest and commission income of Spanish lenders with 2019 core revenues of at least EUR 800m. The tax cannot be transferred to consumers. All Spanish banks in our sample would be subject to the tax, which if implemented as designed would considerably erode modelled 2023 benefits from rates increases.

According to our estimates, while between 35% and 55% of rates benefit would be eroded in 2023, this figure would likely be materially higher in 2024 as higher rates are gradually passed on to depositors.

Figure 6: NII delta to rates increase versus potential tax levy impact (EUR m)



Note: data takes mid-range NII sensitivity. For Sabadell, NII increase over 2 years. For Kutxabank and Unicaja linear impact from multiple shifts, Ibercaja sensitivity not available.
Source: Company data, Scope Ratings

Asset quality

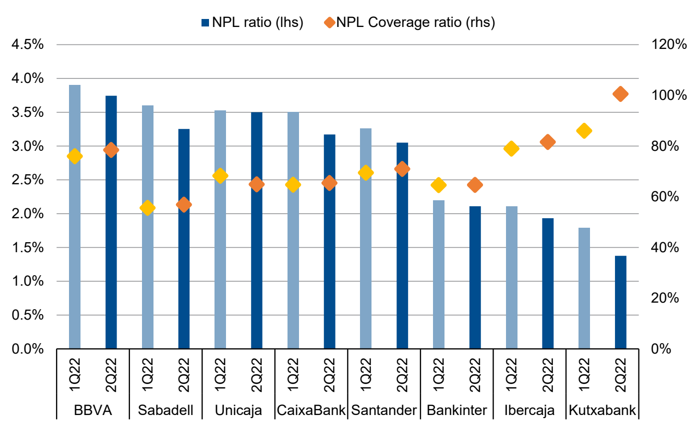
In most instances, headline asset-quality metrics showed an improvement. In a very productive quarter for NPL sales in Spain, stocks at CaixaBank, Sabadell, Santander and Kutxabank declined following transactions in both the secured and unsecured space. For most other lenders, flat net inflows on growing balance sheets translated into this metric improving both quarterly and over the year. Unicaja saw a slight deterioration in its gross NPL ratio (30bp in the year on a comparable basis given the Liberbank integration) to 3.5%; the NPA ratio improved over the same period, given material outflows of foreclosed real estate assets.

Over 90% of ICO lending has resumed payments on average and default rates differ significantly across lenders although defaults have not materially increased over time as grace periods have expired. The State guarantee covers over 70% of drawn amounts.

NPL coverage levels are solid and mostly improving: Ibercaja and Kutxabank stand out with 81.6% and 100% (excluding contingent risks and prudential coverage).

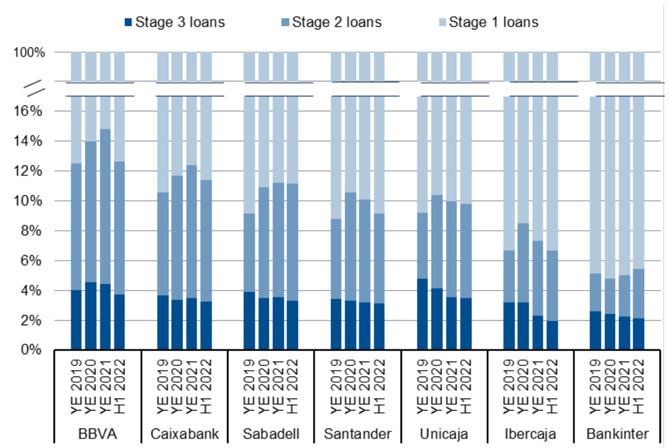
The share of gross customer lending classified as Stage 2 continued its downward trend, with the exception of Bankinter (which migrated certain SMEs and consumer portfolios without additional provisioning needs) and Sabadell, which reclassified sectors on the basis of assumptions about a deteriorating macro scenario. Overall, the share of Stage 2 loans stood at around 6.5% on average in H1, versus 6.7% in Q1 and 6.9% at YE2021.

Figure 7: NPL ratios and coverage



Source: Company data, Scope Ratings

Figure 8: Gross customer loans by stage

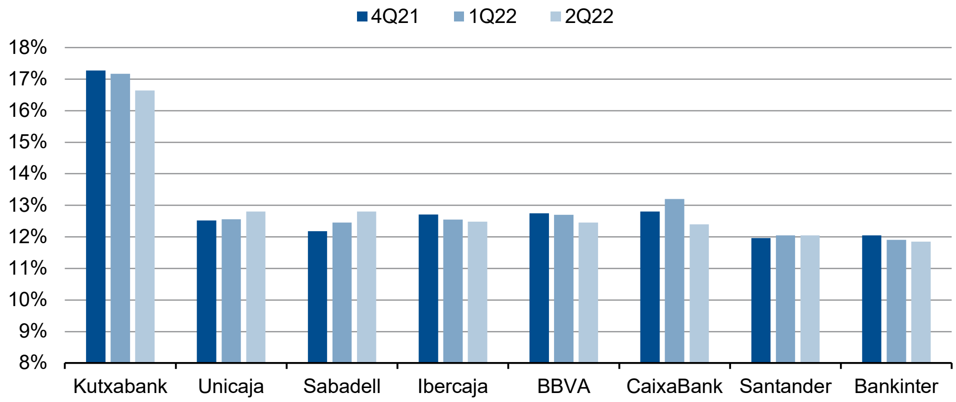


Source: Company data, Scope Ratings

Capital

Solvency ratios remained relatively stable in Q2. Organic capital formation was solid, although distributions and buy-backs, RWA inflation and market effects offset most of the increase. Once again, several banks reported negative impacts on capital from valuation adjustments on available-for-sale portfolios. Specifically, the impact on CET1 ratios in Q2 was -13bp for Santander (half of the quarterly capital generation in the quarter), -8bp for CaixaBank and Sabadell, -18bp for BBVA (including FX effects), -37bp for Ibercaja and -21bp for Kutxabank (equity and fixed-income portfolio). Bankinter, which added -3bp to the -15bp reported in Q1, is reclassifying securities over a certain maturity in the AC portfolio, reversing 13bp of impact, and trying to minimise impact on capital going forward.

Figure 9: CET1 ratios fully loaded



Source: Company data, Scope Ratings

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