10 August 2023 | Financial Institutions

Spanish Bank Quarterly: earnings solid but limited room for growth from here

Spanish bank earnings continued to improve in the second quarter, driven by margin expansion in the back book and low credit impairments. Liquidity and funding metrics confirm the strength of their balance sheets. We see limited room for further improvements from here, however.

Assets will continue repricing but the cost of deposits is starting, slowly but convincingly, to pick up. Net new production is and will remain muted for the rest of the year, providing no upside to interest income.

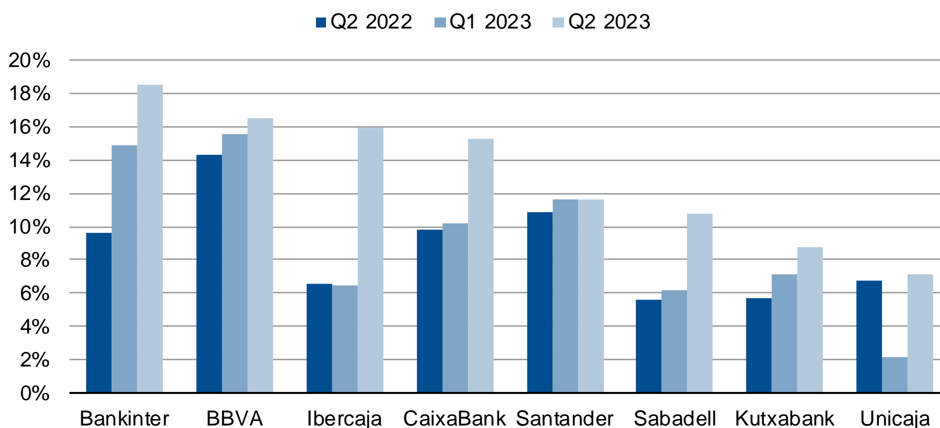
With little evidence of asset-quality deterioration, banks' initial assumptions around cost of risk in 2023 seemed conservative. We still expect credit deterioration to materialise but with some delay. On the plus side, coverage levels have strengthened considerably and macro overlays are still sitting partially unused.

Liquidity and funding profiles are solid, with less than 20% of TLTRO funding on average left to be repaid, LCRs comfortably above the 100%-mark, small deposits outflows and good access to wholesale debt markets across all levels of seniority. As system liquidity dries up, though, we do not expect further upside from current positions.

Stronger earnings have supported some upward revisions in pay-out ratios and, more recently, new rounds of share buy-backs.

The outcome of the 2023 stress tests was especially positive for Spanish lenders, demonstrating how resilient they are to downturns. Solvency ratios show adequate buffers to minimum requirements. This is the case also under stress. With limited capital drawdowns under the 2025 adverse scenario, Spanish banks were among the best performers in the stress tests.

Figure 1: Spanish bank profitability (ROE) rises QoQ and YoY



Source: SNL, Scope Ratings

Table 1: Q2 2023 trends for Spanish banks	
Profitability	Mildly positive ↗
Funding and liquidity	Stable →
Asset quality	Mildly negative ↘
Capital and buffers	Mildly positive ↗

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Earnings supported by widening margins

Spanish banks delivered another strong set of results in the second quarter. ROE improved across the board, reaching 13% on average for our sample – Santander, BBVA, Bankinter, CaixaBank, Sabadell, Unicaja – from 10% in Q1 2023.

Domestically, the main driver once again was net interest income growth, which accelerated further in the quarter. Cost of deposits picked up more strongly than in Q1, but the pass-through of higher interest rates to depositors has been slower than initially expected. Accordingly, banks are revising deposit beta guidance to the lower end of the range initially assumed, ending the year at around 20%.

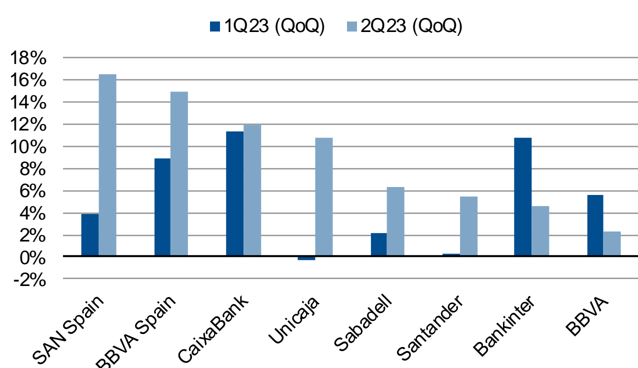
Diverging dynamics in the speed of asset repricing will translate into material upside still for domestic net interest income for BBVA and Santander in the second half, while for CaixaBank, Bankinter, Sabadell and Unicaja growth will be in the high-single digits at best.

Margins will remain the only driver for NII for 2023, as overall books are flat to shrinking, yields of securities in ALCO portfolios are rising and are expected to continue to contribute to the top line hence offset the impact from monetary policy changes. Since the beginning of the third quarter, minimum reserves are no longer remunerated, slightly penalising the top line after contributions from TLTRO phased out in 2022.

Fees and commission remained weak although BBVA was an exception, showing a good performance both domestically and abroad.

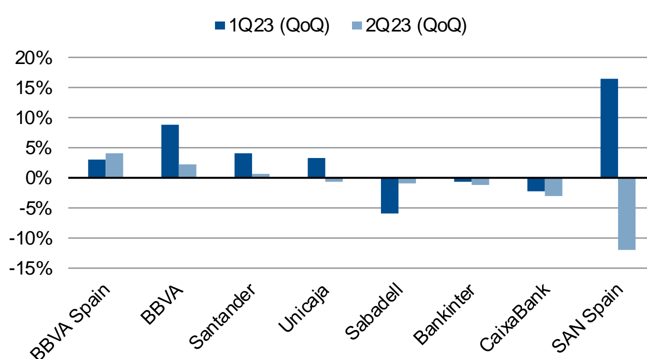
Operating income in the second quarter improved by 11% on average, supported by the windfall tax on 2022 core revenues levied in Q1. The tax charge on the banks in our sample will be EUR 1.1bn in 2023, and we expect an additional EUR 2bn charge in 2024.

Figure 2: Net interest income picks up steam



Source: Company data, Scope Ratings

Figure 3: Fees and commissions remain weak

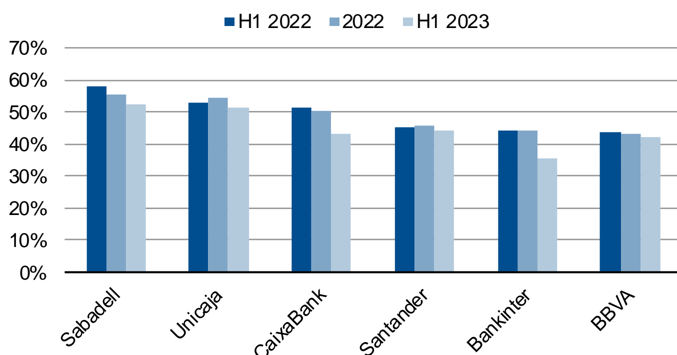


Source: Company data, Scope Ratings

Operating expenses increased in the second quarter QoQ and YoY. Outliers here were BBVA (albeit still positive in constant EUR) and Unicaja, where a recent restructuring drove a YoY decline. On a half-year basis, cost increases were well contained, even for Santander and BBVA for which the inflationary environment outside Spain played a material role in expanding the cost base. This, combined with stronger revenues, led to a further decline in cost-to-income ratios to around 43% in H1 from 50% at YE2022.

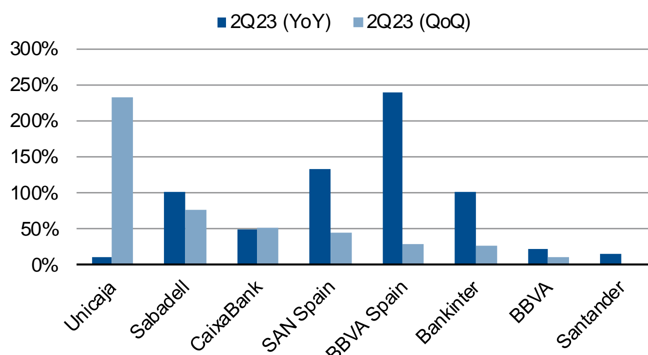
Credit impairments were generally in line with the first quarter. Cost of risk increased marginally for Unicaja, although it remained within its initial 30bp to 35bp guidance. Overall net profits improved materially, by close to 70% on average in the second quarter and 50% YoY.

Figure 4: Cost to income improves across the board



Source: Company data, Scope Ratings

Figure 5: Net result trending up



Note: BBVA Q2 2022 includes one-off for office purchases. Source: Company data, Scope Ratings

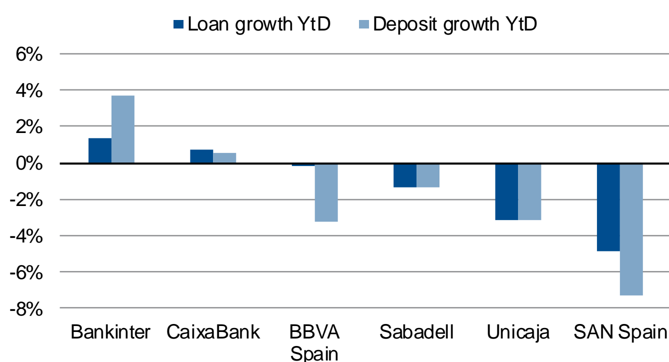
Deposits outflows contained, little pressure on balance sheets from credit environment

There has been little evidence of competition for deposits so far, as excess liquidity is still in the system. Bank of Spain data from June show a deposit beta of 12% (5% for households and 19% for companies). That is still low but has picked up, especially for corporates, by around 450bp since May. But that is still among the lowest in Europe.

Deposits outflows were contained: for our sample of banks domestic deposits grew by 1% on average in the quarter after recording a 3% decline in Q1. Santander saw some stabilisation after CIB customer-related outflows in the first quarter.

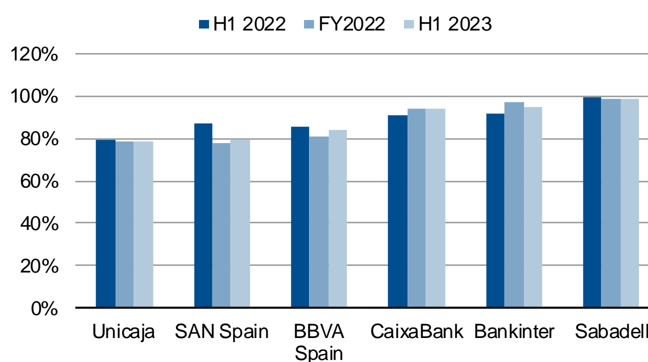
Lending remains subdued Bankinter is the only bank showing loan and deposit growth, in low and mid-single digits, respectively. In Spain, loan-to-deposit ratios remain below the 100% mark for all lenders, in most cases comfortably so.

Figure 6: Domestic balance sheets in deleveraging mode



Source: Company data, Scope Ratings

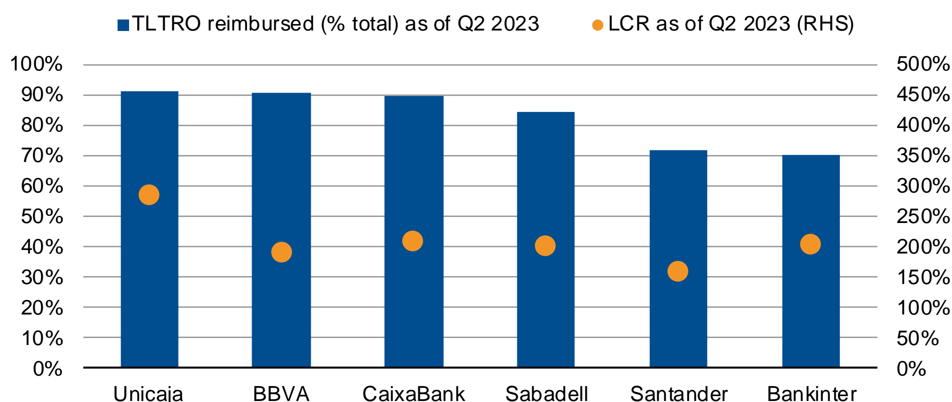
Figure 4: Loan-to-deposits ratios remain supportive



Source: Company data, Scope Ratings

As of June, banks in our sample had repaid 83% of their TLTRO III funding on average. LCRs sit comfortably above minimum requirements. The bulk of residual TLTRO maturities are concentrated in 2024, therefore we do not expect any cliff effects this year.

Figure 8: Comfortable LCR position after TLTRO repayments



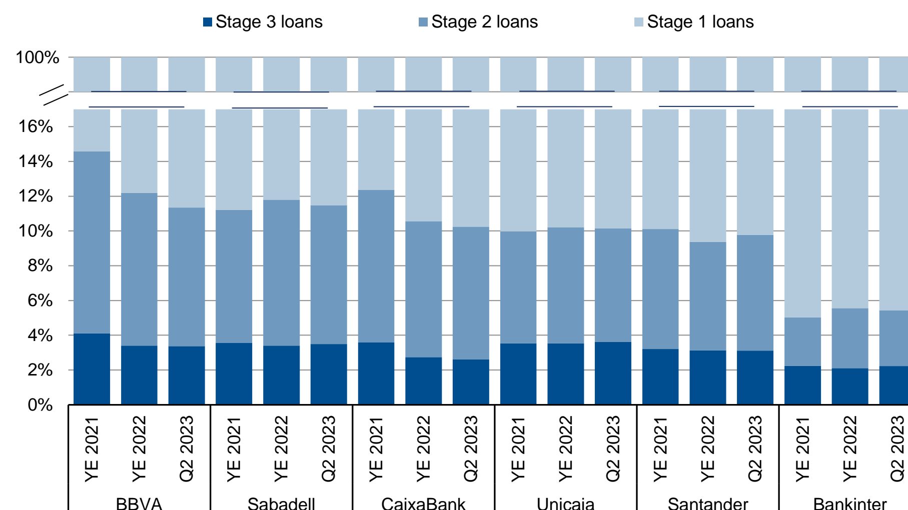
Source: Company data, Scope Ratings

Stage 3 ratios have reached the bottom

Bank of Spain data from May point to a second consecutive monthly increase in NPL ratios to 3.6%, albeit just 10bp overall. The stock of doubtful loans to the private sector reached its low in March 2023, and has shown since than a marginal increase. Asset quality-metrics have so far proved resilient, although the decline in Stage 3 ratios since 2019 seems to have reached the bottom. Stage 2 ratios stand on average at around 7%, flat YoY but still 150bp above pre-covid (YE2019) figures. Spanish banks compare favourably on this metric with most banks in other European countries.

We regard specific portfolios, such as highly leveraged corporate debt and consumer finance more at risk in this environment. However, we deem the build-up of provisions, which still sit partially unused on banks' balance sheets, as an adequate shield against materially higher impairments. Positive signals also come from some banks adjusting slightly downward cost of risk guidance for the year.

Figure 9: Limited room for further improvement in asset-quality



Source: Company data, Scope Ratings

Buffers to capital requirements remain adequate, even when stressed.

Spanish banks' capital positions are sound and improving. Rising retained earnings are supporting the build-up of excess capital. All banks now stand adequately above their respective guidance.

Given the limited room for organic growth and no prospects for bank M&A, returns to shareholders have increased, initially through higher pay-out ratios and more recently through the announcement of a fresh round of share buy backs. BBVA plans to return EUR 1bn to shareholders; CaixaBank EUR 500m.

While for international comparisons Spanish banks' solvency ratios are not particularly strong, the ECB/EBA 2023 stress test highlighted their resilience against downturns. Stronger earnings under stress were able to absorb increasing impairments, leading to a very limited deterioration in capital ratios.

Spanish banks' fully-loaded CET1 drawdown under the 2025 adverse scenario compares well with European peers. Sabadell had the biggest drawdown (374bp). Still, the bank shows a marked improvement versus the 2021 stress test (550bp).

Under the 2025 adverse scenario, all banks in our sample maintained headroom above minimum capital requirements (including buffers): 120bp on average for CET1, 90bp for the Tier 1 ratio, and 60bp for total capital ratio. BBVA's stressed total capital ratio ends up at 13%, in line with the current requirement plus buffers. A similar result for Sabadell, ending close to its 13% total capital requirement.

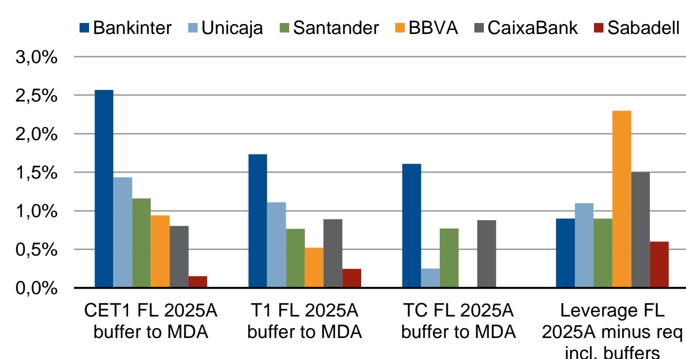
Bankinter, with a 159bp CET1 drawdown, had a slightly worse outcome than in 2021 results (of 10bp), although the bank remains the best performer within the domestic peer group.

Figure 10: 2023 Stress test points to resilience

	YE2022 CET1 FL	2025A FL CET1	Drawdown
Bankinter	11.90%	10.30%	-159
Unicaja	13.00%	9.70%	-326
Santander	12.00%	10.30%	-170
BBVA	12.60%	9.70%	-295
CaixaBank	12.50%	9.30%	-313
Sabadell	12.60%	8.80%	-374

Source: EBA, Scope Ratings

Figure 51: Stressed ratios above MDA triggers



Source: EBA, Company data, Scope Ratings

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