Scope Ratings

Asset-quality review

European banks at a crossroads in 2024

For the first time since 2015, the stock of NPLs on European banks' balance sheets is rising, albeit at a moderate pace. We believe that the most likely scenario is a gradual deterioration of banks' asset quality as a result of higher interest rates and a modest economic recovery in most European countries. But this will have only a marginal impact on the creditworthiness of European banks. An NPL shock is unlikely to materialise. However, if the economic slowdown is more pronounced, a broader materialisation of credit risk could occur in the second half.

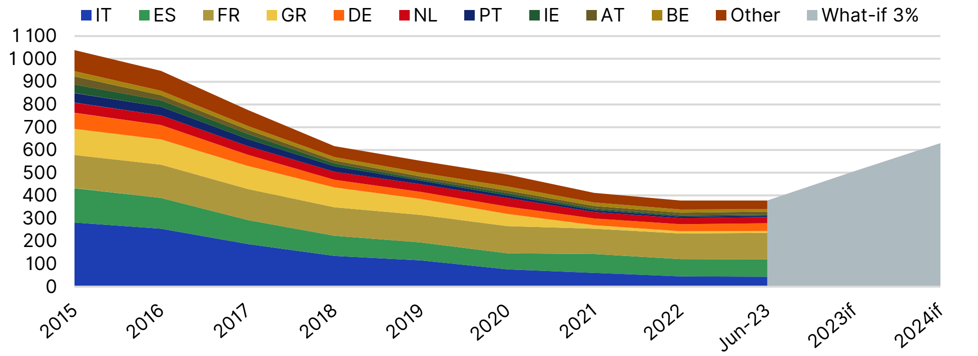
The rapid rise of interest rates is the main driver of the turnaround in asset quality, putting the most vulnerable borrowers more at risk of defaulting. On a positive note, however, NPL formation has been contained and is spread widely across countries and sectors. At the same time, higher interest rates are boosting earnings for many European banks while their credit loss-absorption capacities are stronger.

We believe NPLs will continue rising in 2024 but we do not think it is realistic to expect a near doubling of NPLs to reach the 3% mark, assuming static loan books. Several strong arguments point to resilient asset-quality metrics in the coming year:

- The reversal of the asset-quality improvement trend is starting from a low point.
- There is no broad-based deterioration of asset quality at this point. The focus on identified pockets of risk, such as commercial real estate and corporate credit exposures tends to be granular.
- The euro area's economic recovery is likely to be modest but we do not foresee recession. Scope's forecast for GDP growth is 1.1% in 2024 versus 0.7% in 2023.
- Higher interest rates provide a boost to earnings generation and loss-absorption capacity.

Asset-quality concerns could be exacerbated in the case of a prolonged period of tight monetary policy. Still, we do not believe a repeat of the previous asset-quality cycle, with NPLs reaching 2015-like levels, is on the cards. Business model de-risking, better origination standards, more proactive supervision of credit risk and a largely positive inflation outlook are key differentiating factors compared to a decade ago. Countries that contributed extensively to the accumulation of NPLs in the past (e.g. Italy or Greece) are due to perform well compared to peers.

Figure 1: a rapid accumulation of NPLs in 2024 to a 3% ratio not a baseline expectation



Source: EBA risk dashboard, Scope Ratings

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Related Research

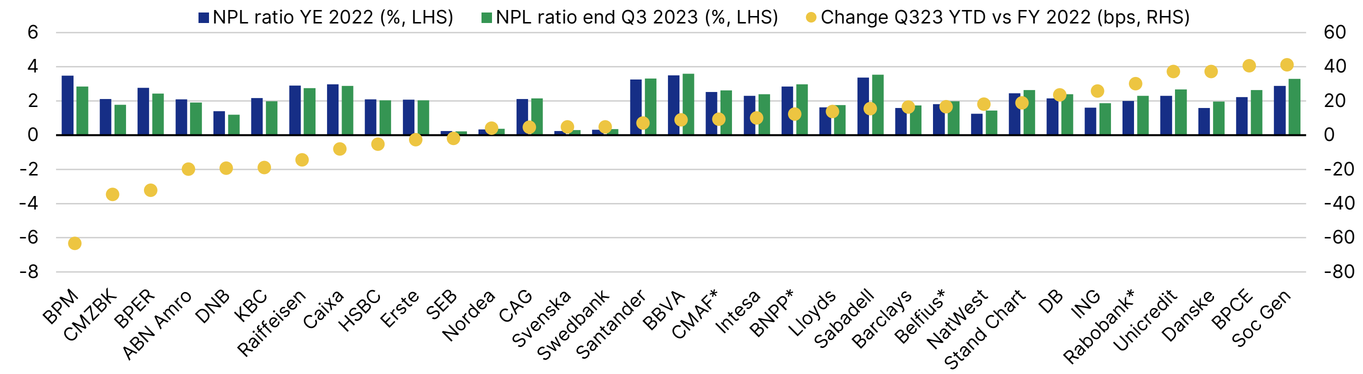
See page 12 for a list of related research and commentary.

Rising NPLs but stronger credit loss-absorption capacity

Despite the rapid increase in interest rates over the last 18 months or so, the average EU NPL ratio reported by the EBA has moved only marginally, by a few basis points, remaining close to 1.8%. Over the first nine months of 2023, NPL ratios increased for most large European banks but the increase was modest. The largest increase was less than 0.5 percentage points and NPL growth has been balanced (Figure 2).

Credit risk in the commercial real estate sector has not diminished since our last review in May 2023 and remains under the spotlight. Price corrections continue and tighter refinancing conditions are adding pressure. We view the recent insolvency of the Austrian company Signa as an outlier rather than a typical example of the challenges facing the sector. Banks' exposures are manageable in comparison to their loss-absorption capacity.

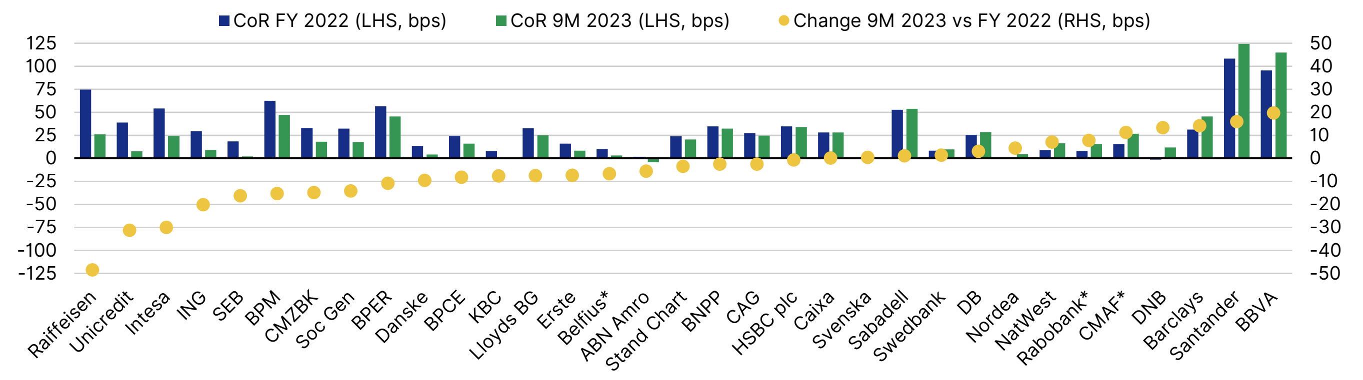
Figure 2: NPL ratios



*Data as of June 2023. Scope Ratings calculations may differ from banks' reported data. Source: banks, SNL, Scope Ratings

Cost of risk was modest in the first nine months of the year and very much in line with or below 2022 figures (Figure3). There is a growing expectation among banks that cost of risk for the full year will be closer to the through-the-cycle or medium-term averages. We do note that the proportion of provisions related to Stage 3 loans is trending higher, though, indicating an increasing materialisation of credit risk. Cost of risk as reported by the EBA stayed at around 45bp at EU level, a level at which it has remained for years and following the pandemic period during which banks accumulated precautionary provisions. These buffers are still largely in place and can be used to proactively manage NPLs as they emerge.

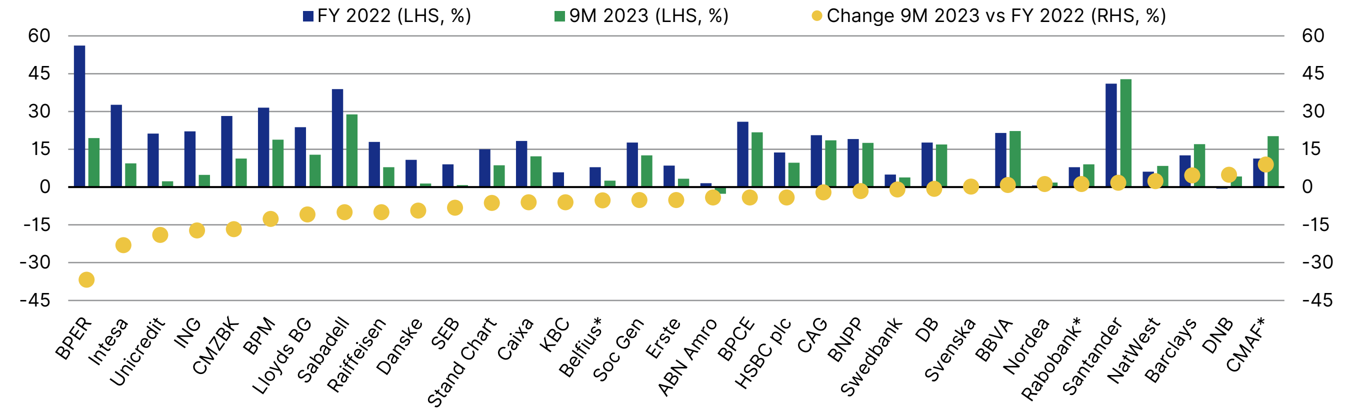
Figure 3: Cost of risk to customer loans (bp)



% of average net customer loans . *Data as of June 2023. Scope Ratings calculations may differ from banks' reported data. Source: banks, SNL, Scope Ratings

The loss-absorbing capacity of many banks has increased substantially as net interest income (hence operating income) has grown faster than cost of risk. This is a positive, albeit temporary, development because of the expected normalisation of interest margins. Large banks also tend to display balanced risk-return profiles: those with the highest cost of risk to total loans ratios or high cost of risk to pre-impairment operating income ratios still have supportive profitability metrics.

Figure 4: Cost of risk as a % of pre-impairment income improved across the board



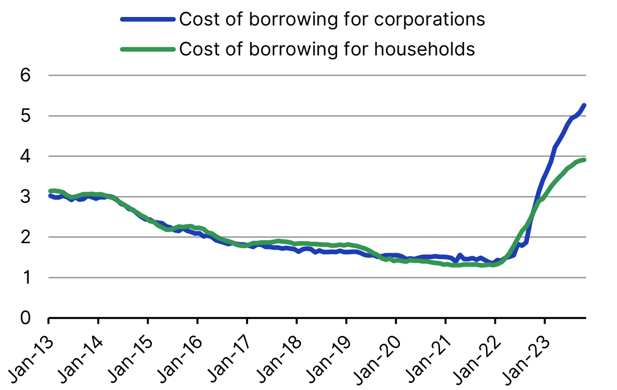
*Data as of June 2023. Scope Ratings calculations may differ from banks' reported data. Source: banks, SNL, Scope Ratings

What's next? A mild downside scenario for banks' operating conditions

Since June 2022, borrowers in Europe have experienced the fastest increase in borrowing costs in a decade (Figure 5). This is the main driver of the continuing economic slowdown in 2023-2024. Growth will stay below potential in many countries. Operating conditions for banks will therefore be tougher in 2024, with real GDP growth expectations reducing in many countries (Figure 6).

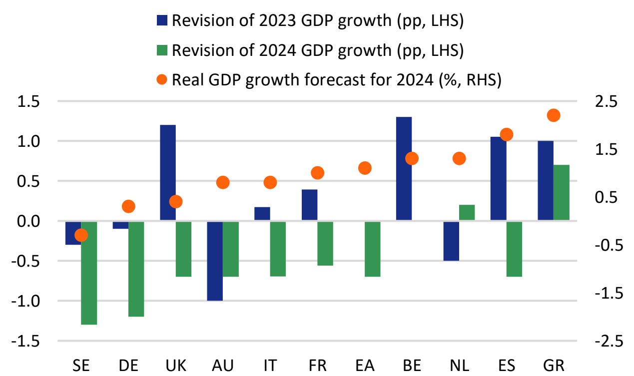
On a positive note, despite this meaningful downward economic growth revision, we expect only a handful of economies, including Sweden, to contract over the full-year period (for full details see our Sovereign Outlook 2024). Our baseline scenario also points to a stabilisation or modest increase in unemployment rates. The possibility of a mild economic growth performance is a positive signal and a key input into banks' forward-looking provisioning policies.

Figure 5: The fastest increase of borrowing costs (%) …



Annualized agreed rate (AAR) on new loans. MFI interest rate statistics Source: ECB, Scope Ratings

Figure 6: … puts economic growth more at risk in 2024

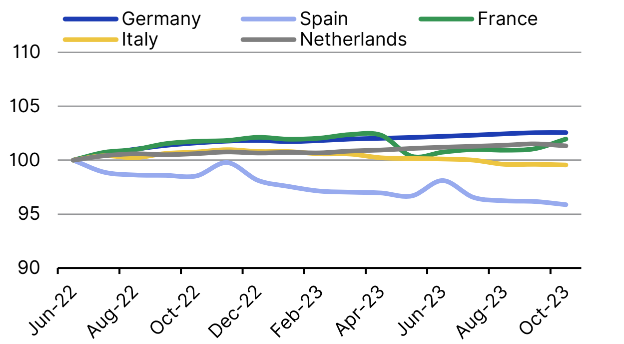


Revision of real GDP growth forecast between Scope Ratings' 2023 Sovereign Outlook and Scope Ratings' 2024 Sovereign Outlook. Source: Scope Ratings

Elevated interest rates and tougher macroeconomic conditions are translating into reducing loan production. At the moment, loan portfolios are holding up well and this is a key supporting factor for earnings generation and banks' loss-absorption capacity.

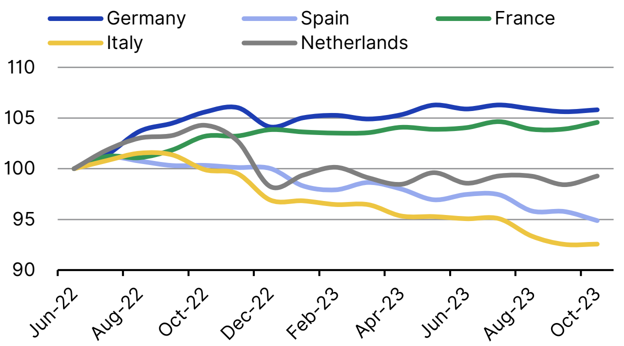
A prolonged period of elevated interest rates is the main risk for retail and corporate borrowers already suffering from reduced net disposable income or compressed profit margins. It will likely put a break on credit demand, impact loan production further and increase default risk. It will also impact the dynamism of the real estate and construction sectors. The most recent inflation expectations published by the ECB do not suggest that a downward revision of interest rates will start any time soon.

Figure 7: Outstanding loans to households (100=June 2022)



Source: ECB, Scope Ratings

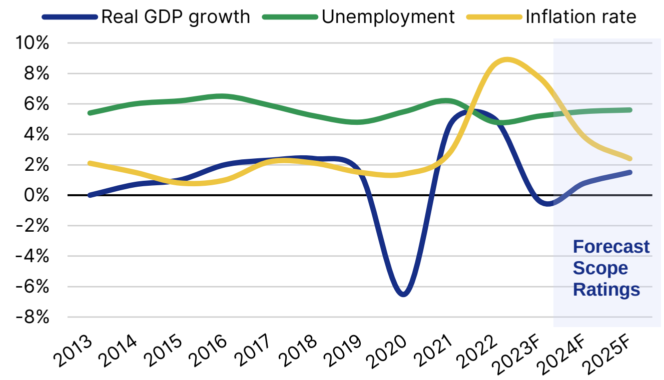
Figure 8: Outstanding loans to corporates (100=June 2022)



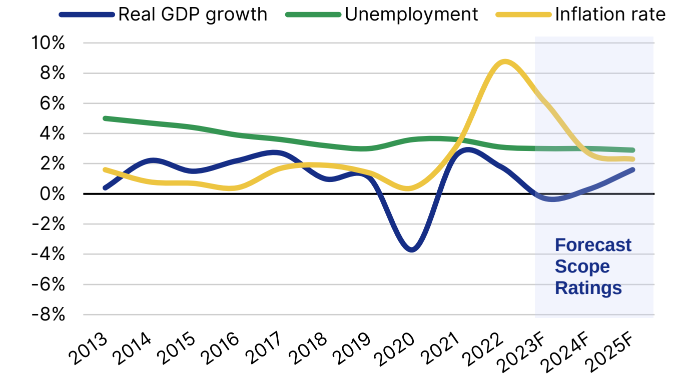
Source: ECB, Scope Ratings

Austrian and German banks

A1: Macroeconomic performance: Austria

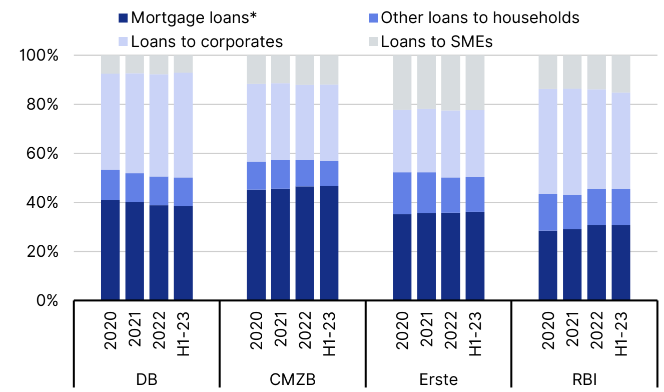


A2: Macroeconomic performance: Germany

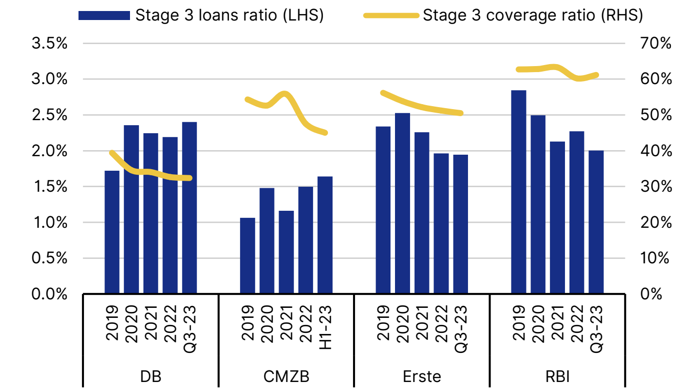


Scope Ratings forecasts as of December 2023. Shaded area represents forecasted values. Inflation rate: average consumer prices. Source: IMF, Scope Ratings

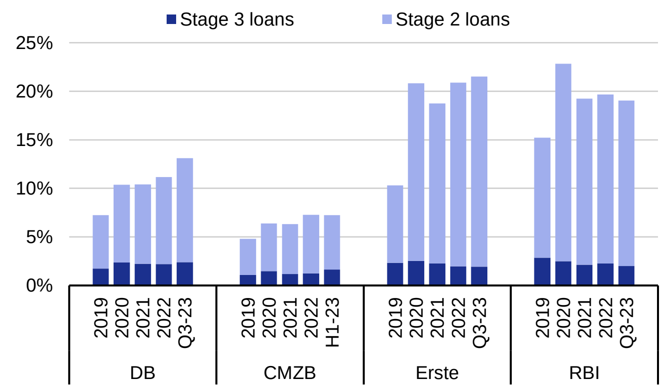
B. Breakdown of total loans



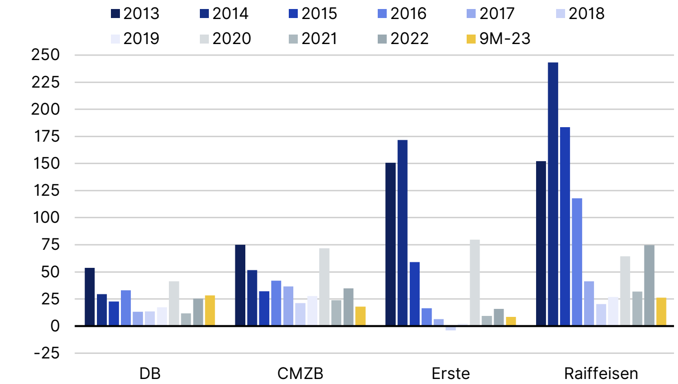
C. Stage 3 ratio and coverage of Stage 3 loans



D. Stage 2 and Stage 3 customer loans



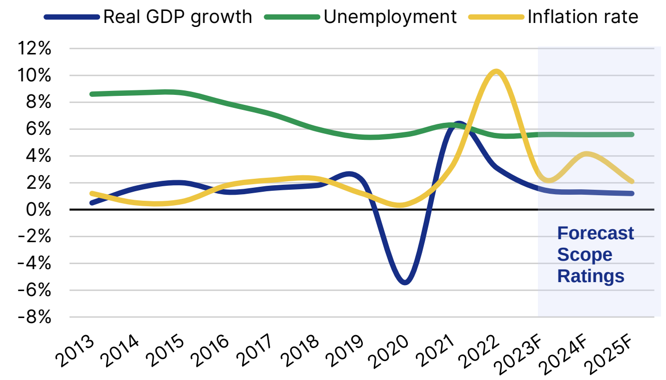
E. Credit cost (bp)



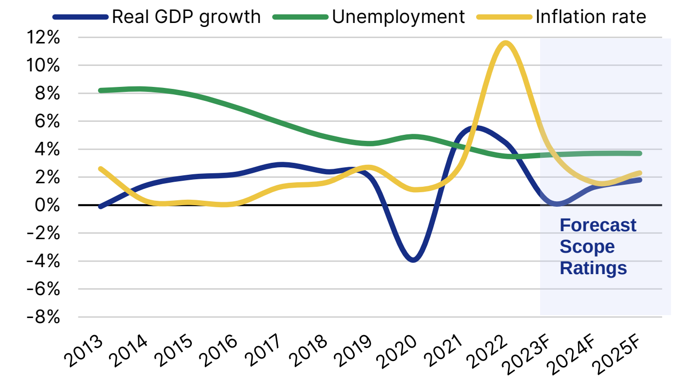
Notes: DB: Deutsche Bank; CMZB: Commerzbank; Erste: Erste Group; RBI: Raiffeisen Bank International.
**CMZB: estimated IFRS9 staging using Disclosure report.
Figure B: *Mortgage loans: Loans to households collateralised by residential immovable property.
Figure E: Provision for customer loan losses as a percent of average net loans to customers held at amortized cost.
Scope Ratings calculations may differ from banks' reported data. Source: SNL, EBA, banks, Scope Ratings.

Belgian and Dutch banks

A3: Macroeconomic performance: Belgium

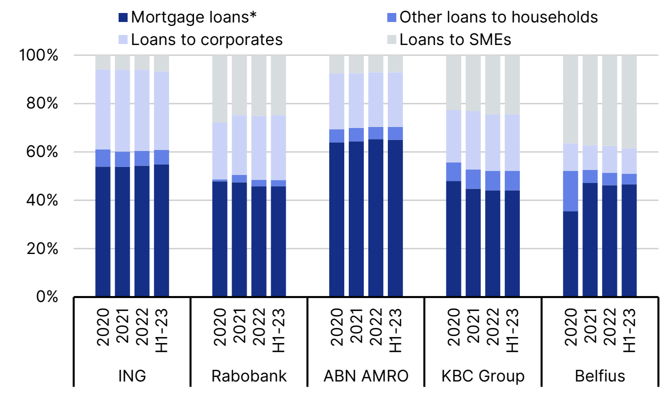


A4: Macroeconomic performance: Netherlands

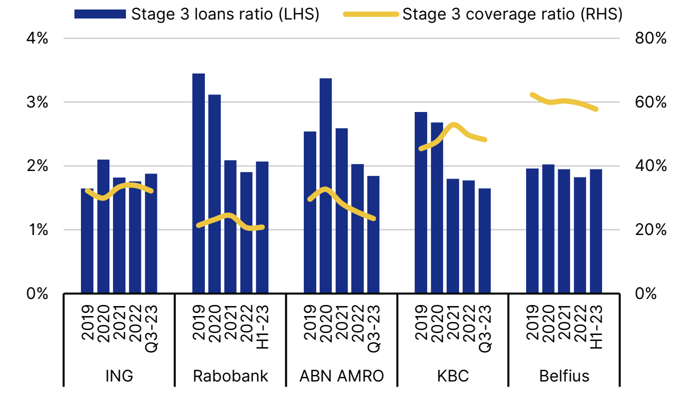


Scope Ratings forecasts as of December 2023. Shaded area represents forecasted values. Inflation rate: average consumer prices. Source: IMF, Scope Ratings

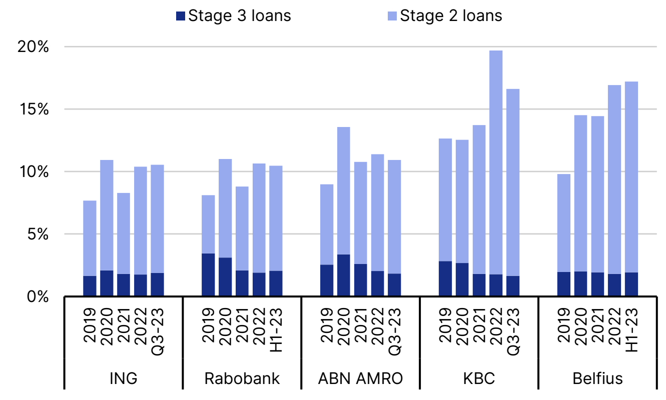
B. Breakdown of total loans



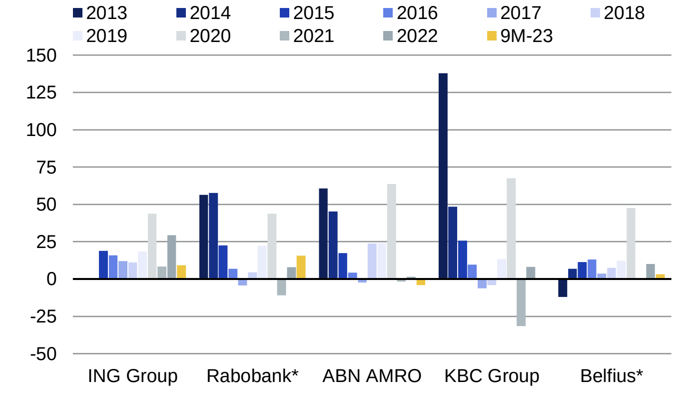
C. Stage 3 ratio and coverage of Stage 3 loans



D. Stage 2 and Stage 3 customer loans



E. Credit cost (bp)



Notes: ING: ING Group; Rabobank: Coöperatieve Rabobank; ABN AMRO: ABN AMRO Bank; KBC: KBC Group. Rabobank and Belfius publish interim and full-year data.
Figure B: *Mortgage loans: Loans to households collateralised by residential immovable property.
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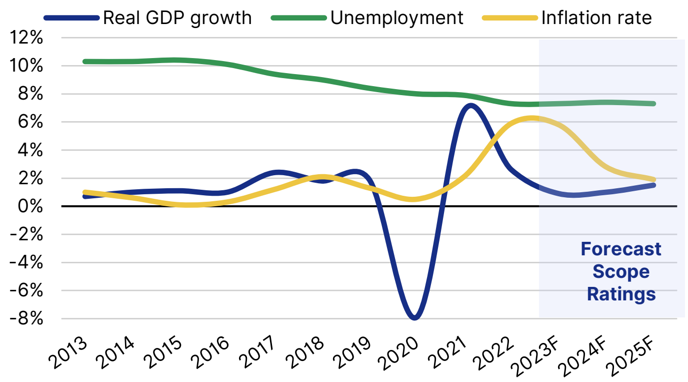
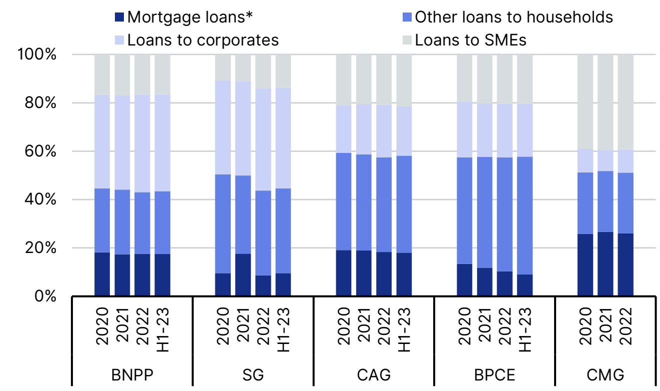
French banks

A: Macroeconomic performance

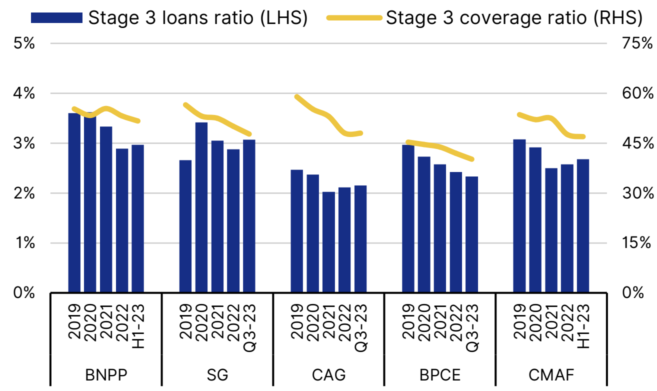


Scope Ratings forecasts as of December 2023. Shaded area represents forecasted values. Inflation rate: average consumer prices. Source: IMF, Scope Ratings

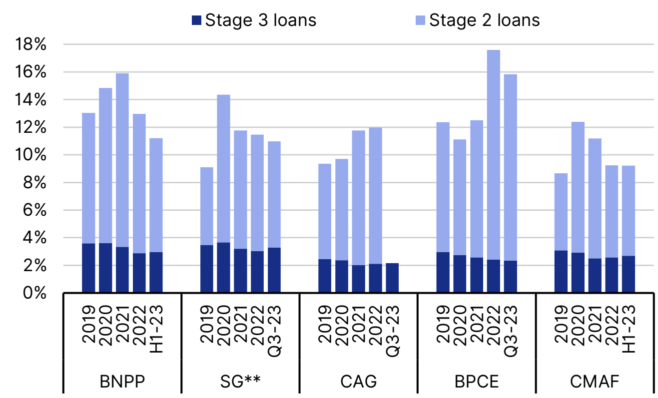
B. Breakdown of total loans



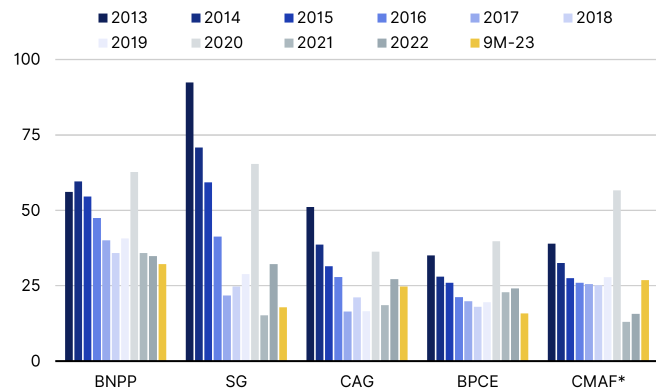
C. Stage 3 ratio and coverage of Stage 3 loans



D. Stage 2 and Stage 3 customer loans



E. Credit cost (bp)



Notes: BNPP: BNP Paribas; SG: Société Générale; CAG: Crédit Agricole Group; BPCE: BPCE Group; CMG: Crédit Mutuel Group; CMAF: Crédit Mutuel Alliance Fédérale (part of Crédit Mutuel Group). CMAF publishes interim and full-year data.

Figure B: *Mortgage loans: Loans to households collateralised by residential immovable property.

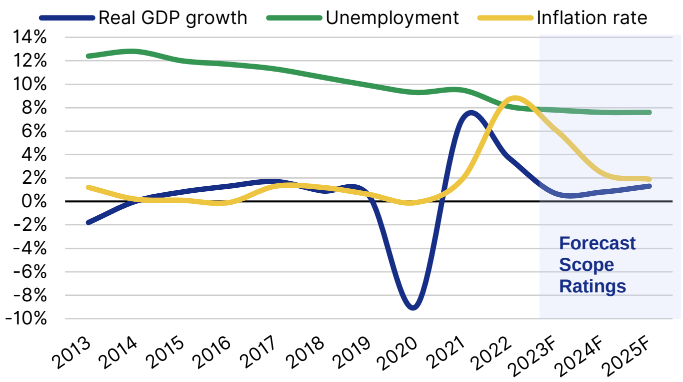
Figure D: **SG: estimated evolution of Stage 2 loans.

Figure E: Provision for customer loan losses as a percent of average net loans to customers held at amortised cost.

Scope Ratings calculations may differ from banks' reported data. Source: SNL, EBA, banks, Scope Ratings.

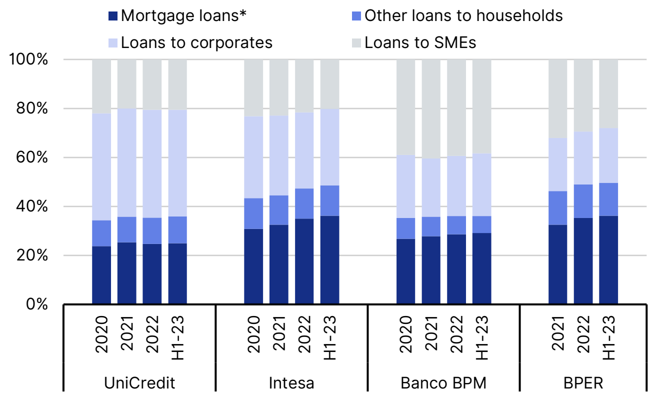
Italian banks

A: Macroeconomic performance

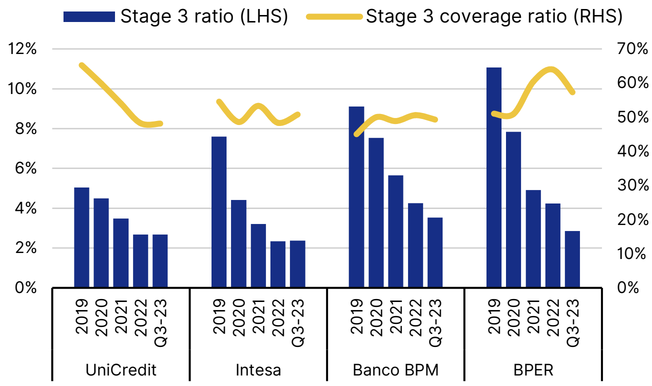


Scope Ratings forecasts as of December 2023. Shaded area represents forecasted values. Inflation rate: average consumer prices. Source: IMF, Scope Ratings

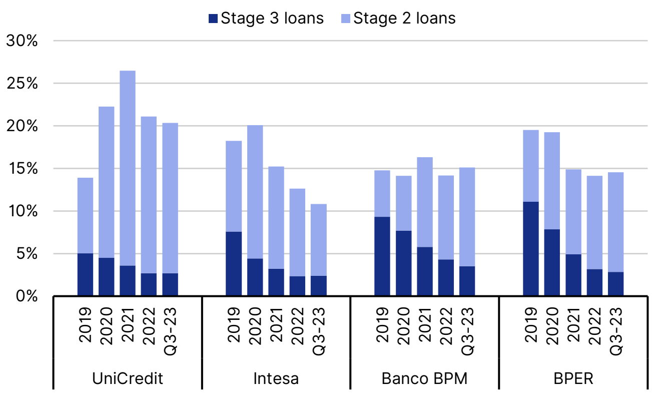
B. Breakdown of total loans



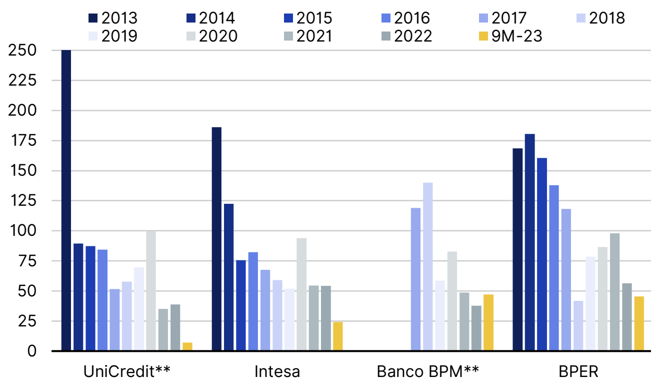
C. Stage 3 ratio and coverage of Stage 3 loans



D. Stage 2 and Stage 3 customer loans



E. Credit cost (bp)



Notes: Intesa: Intesa Sanpaolo (in figure C, 2019 and 2020 data were not restated to account for UBI acquisition carried out in 2020); BPER: BPER Banca.

Figure B: *Mortgage loans: Loans to households collateralised by residential immovable property.

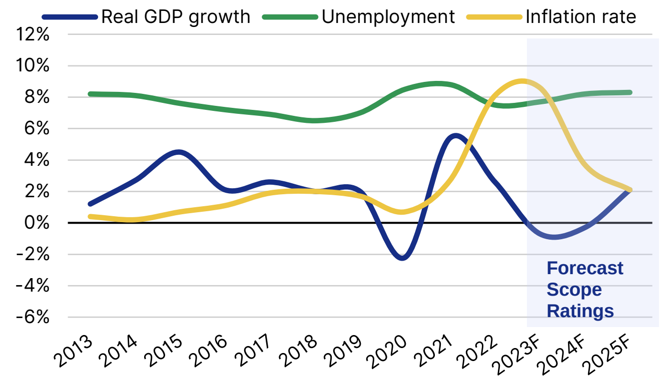
Figure E: Provision for customer loan losses as a percent of average net loans to customers held at amortized cost. **UniCredit, Banco BPM: 9M-23 data as reported by banks.

Data for Banco BPM starts from the bank's inception (2017).

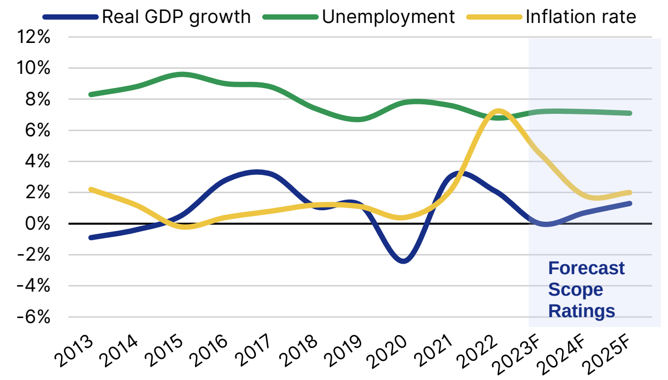
Scope Ratings calculations may differ from banks' reported data. Source: SNL, EBA, banks, Scope Ratings.

Nordic banks

A5: Macroeconomic performance: Sweden

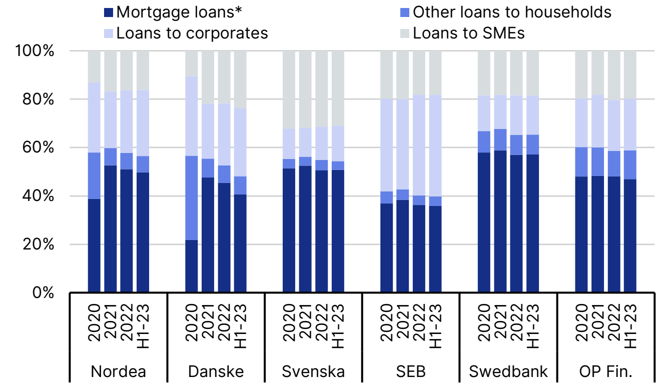


A6: Macroeconomic performance: Finland

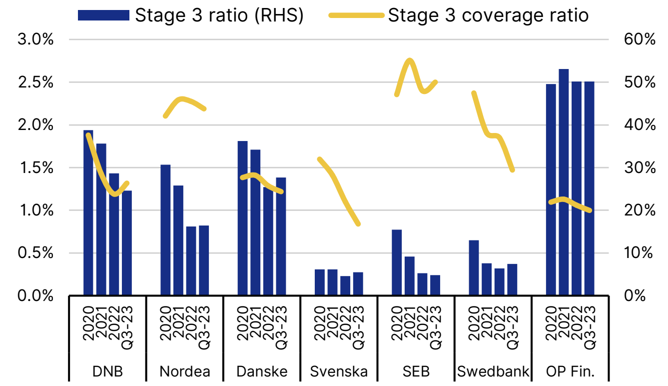


Scope Ratings forecasts as of December 2023. Shaded area represents forecasted values. Inflation rate: average consumer prices. Source: IMF, Scope Ratings

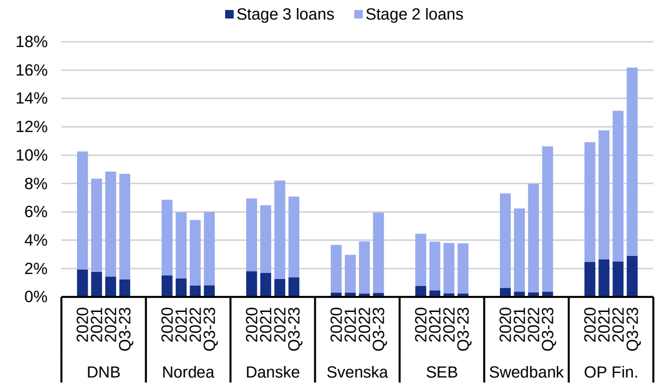
B. Breakdown of total loans



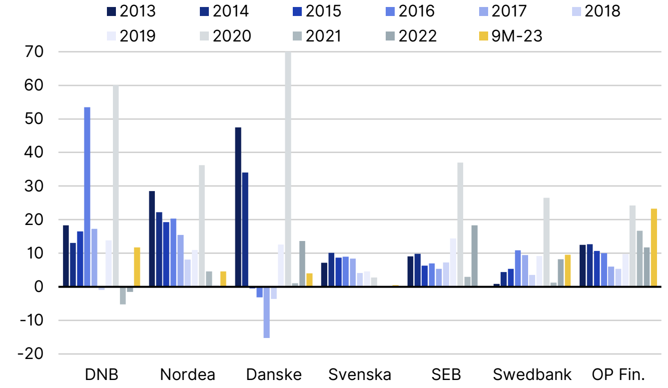
C. Stage 3 ratio and coverage of Stage 3 loans



D. Stage 2 and Stage 3 customer loans



E. Credit cost (bp)



Note: DNB: DNB Bank; Nordea: Nordea Bank; Danske: Danske Bank; Svenska: Svenska Handelsbanken; SEB: Skandinaviska Enskilda Banken; OP Fin.: OP Financial Group.

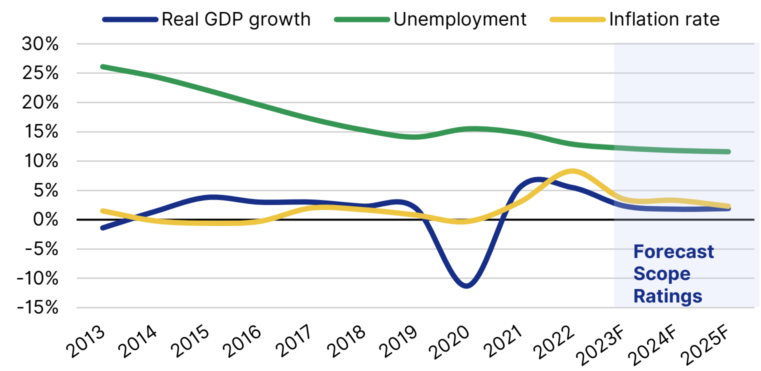
Figure B: *Mortgage loans: Loans to households collateralised by residential immovable property.

Figure E: Provision for customer loan losses as a percent of average net loans to customers held at amortized cost.

Scope Ratings calculations may differ from banks' reported data Source: SNL, EBA, banks, Scope Ratings.

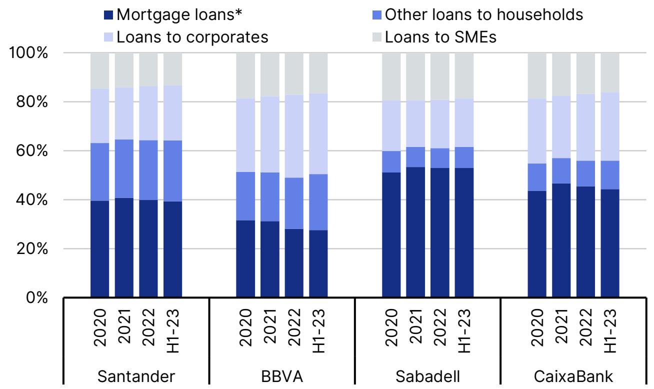
Spanish banks

A: Macroeconomic performance

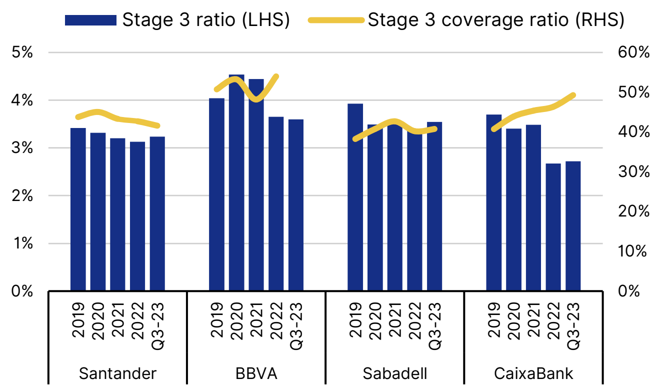


Scope Ratings forecasts as of December 2023. Shaded area represents forecasted values. Inflation rate: average consumer prices. Source: IMF, Scope Ratings

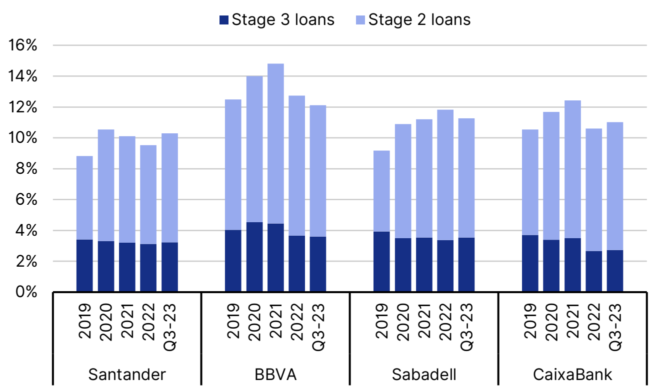
B. Breakdown of total loans



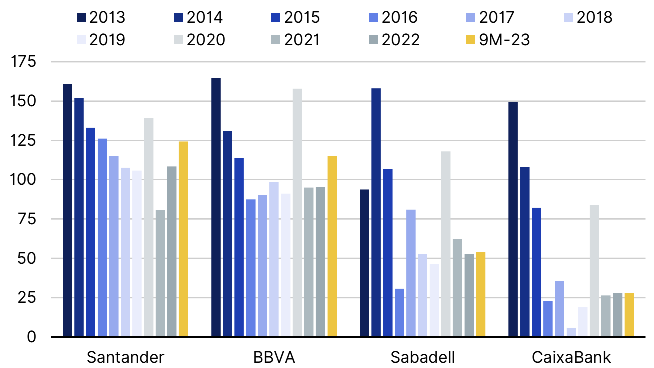
C. Stage 3 ratio and coverage of Stage 3 loans



D. Stage 2 and Stage 3 customer loans



E. Credit cost (bp)



Notes: Santander: Banco Santander; BBVA: Banco Bilbao Vizcaya Argentaria; Sabadell: Banco de Sabadell.
CaixaBank: figures C, D, E standalone in 2019 and 2020.
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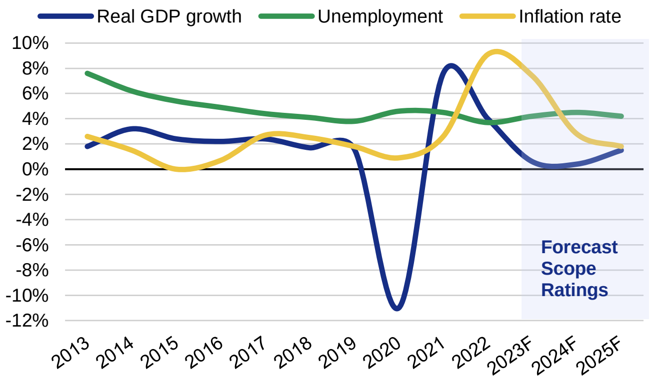
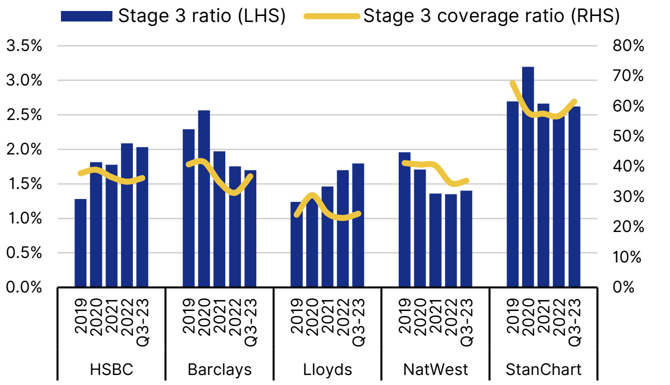
UK banks

A: Macroeconomic performance

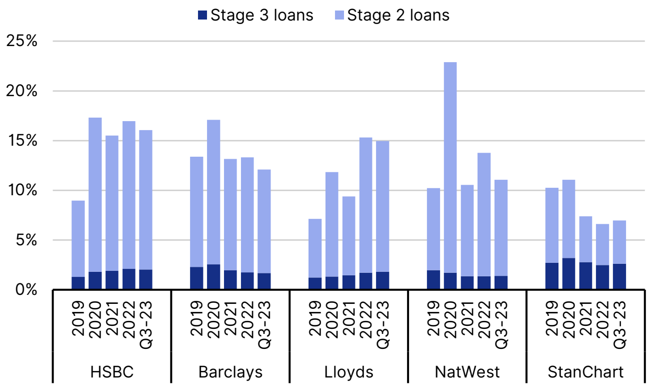


Scope Ratings forecasts as of December 2023. Shaded area represents forecasted values. Inflation rate: average consumer prices. Source: IMF, Scope Ratings

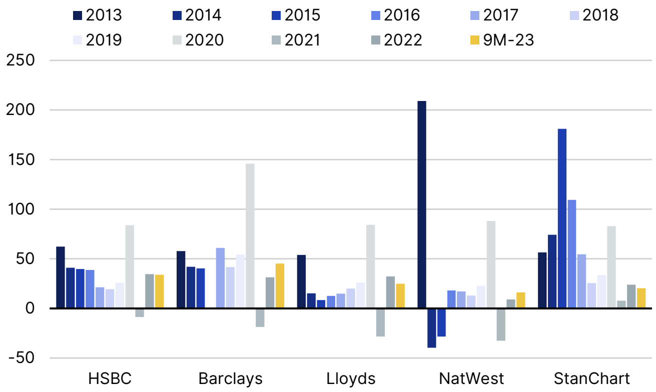
B. Stage 3 ratio and coverage of Stage 3 loans



C. Stage 2 and Stage 3 customer loans



D. Credit cost (bp)



Note: HSBC: HSBC Holdings; Lloyds: Lloyds Banking Group; NatWest: NatWest Group; StanChart: Standard Chartered.
Figure E: Provision for customer loan losses as a percent of average net loans to customers held at amortized cost.
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