Spanish banks quarterly

Limited challenges in 2024 as profitability drivers remain supportive

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Spanish bank profitability in 2023 was driven by record net interest income. We expect that challenges in 2024 will be limited as profitability remains supportive and deposits are starting to recover. The windfall tax could be here to stay, however.

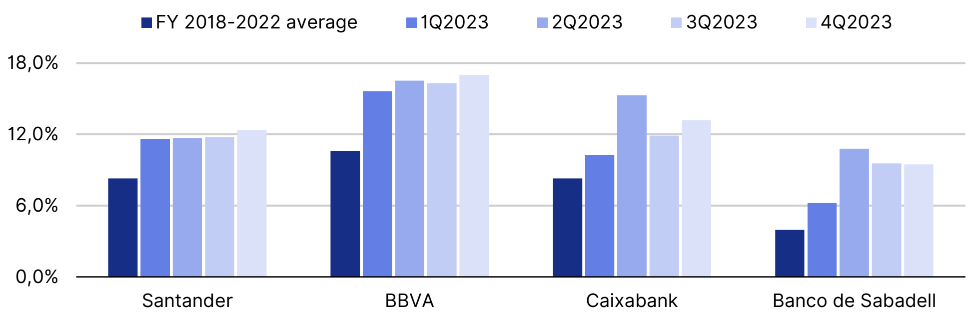
Profitability shows signs of stabilising, even though Q4 2023 results were the weakest of the year. RoE in our sample of banks remains above the 2018-2022 average. In the absence of full guidance for 2024, we expect returns on equity to remain at double digits for most banks.

The Spanish economy should remain resilient, supporting the performance of banks with a domestic market focus. We expect 1.8% GDP growth for 2024, faster than the euro-area average and slightly above medium-run potential. Challenges to the Spanish economy could come from vulnerable trade partners curbing exports at the same time as high interest rates dampen domestic demand. Even so, consumption and investments are still projected to fuel growth, buoyed by higher real incomes and the drawdown of household savings.

Deposits recover, with a growing component of time deposits. Deposits from households and corporates continued to grow in Q4, although these were mainly time deposits, implying a higher cost for banks that detracts from profitability.

The extension of the windfall tax approved by parliament in January 2024 could become permanent. We do not see the extension as material for banks' bottom lines given they easily absorbed the levy in 2023.

Figure 1: Spanish banks' RoE in 2023 beat historic levels



Source: Banks' financial data, Scope Ratings

Expected 2024 trends for Spanish banks		
Profitability	Stable, interest margins still high but decreasing in H2 2024	→
Asset quality	Mildly negative, high interest rates for longer add pressure to corporates and households	↘
Funding & Liquidity	Mildly positive, first signs of recovery of deposit inflows	↗
Capital	Stable, organic generation offset by higher payouts	→

Related research

See page 7, for a list of related research and commentary.

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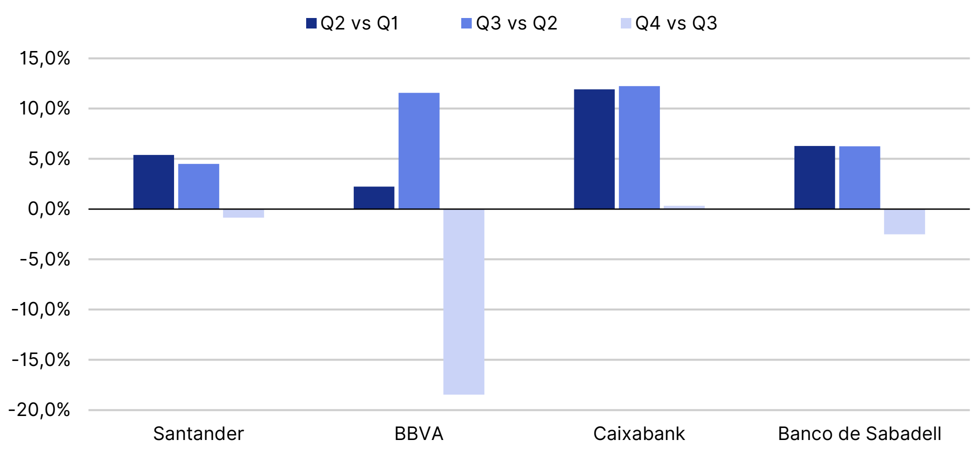
Profitability remains robust, while margins start to tighten fast

Spanish banks reported record results in 2023, achieving an average return on equity (ROE) of 13% for our sample of BBVA, Santander, Sabadell and Caixabank. Q4 results were the weakest of the year as margins decreased and loan losses were slightly higher. The Q4 profitability driver was still net interest income (NII). The repricing of assets following interest-rate hikes continued to be the largest contributor to NII, albeit at a slower pace as higher deposit costs kicked in.

The shrinking spread between interest earning assets and deposit costs impacts banks' profitability

Figure 2: Net interest income decreasing in Q4



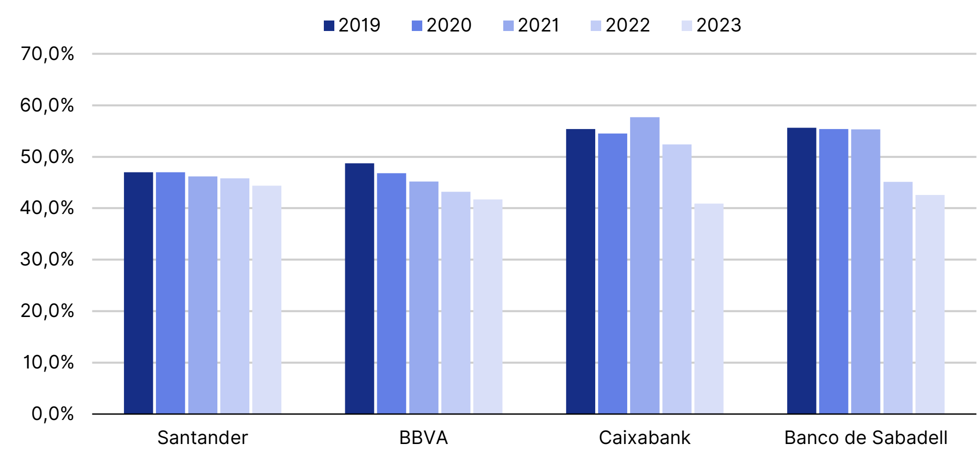
Source: Banks' financial data, Scope Ratings.

We expect NII to stabilise in the first half of 2024 as some loan repricing has yet to materialise (mostly commercial loans). But we expect to see limited growth or no growth QoQ as the pass-through to deposits constrains any further increase.

All four banks in our sample reached their efficiency targets with better cost-to-income ratios. Most banks have recently implemented restructuring measures that have allowed further improvements in their cost structures, which are now starting to crystallise. We expect this trend to remain favourable for 2024 as banks' strong revenues easily continue to absorb costs.

Cost-to-income improving consistently for all banks

Figure 3: Cost-to-income ratio improving consistently



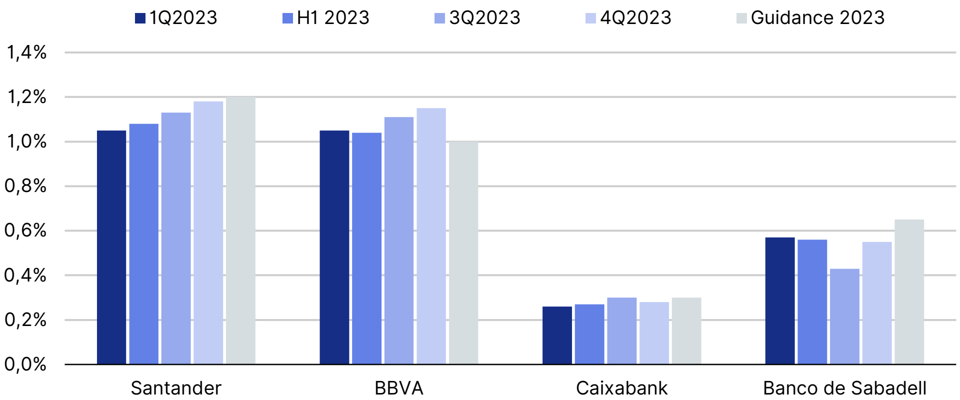
Note: In the case of Caixabank, operational costs do not include extraordinary items.
Source: Banks' financial data, Scope Ratings.

Cost of risk slightly increasing, mostly from retail and consumer loans

Cost of risk increased in Q4 vs Q3 for almost all banks but still remained below YE 2023 guidance. For BBVA, the cost of risk for YE 2023 was slightly higher than guidance due to a review of model parameters for stage 2 as well as further deterioration in its South American portfolio.

Cost of risk by YE 2023 below guidance for almost all banks

Figure 4: Cost of risk contained QoQ, and for most banks below 2023 guidance



Source: SNL, banks financial data, Scope Ratings.

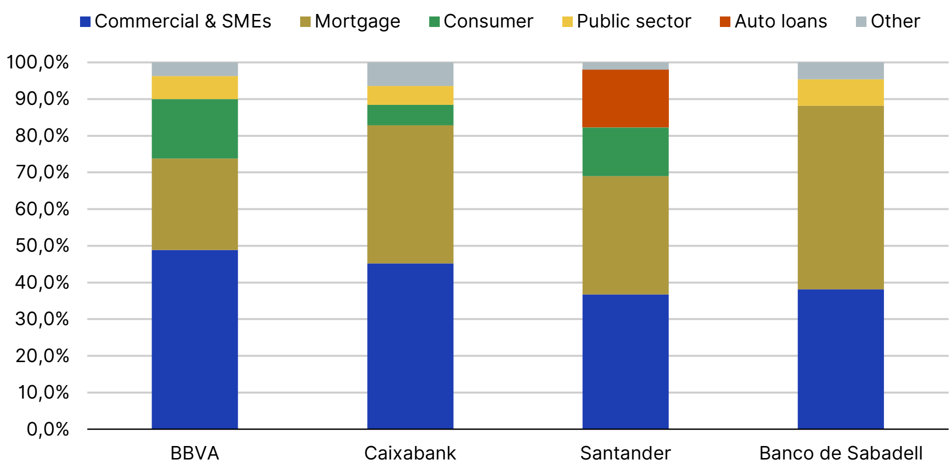
We foresee cost of risk trending closer to a normalised average across the cycle. We expect banks to provide guidance for 2024 slightly above that for 2023. The different dynamics are related to their business models, geographies and loan portfolio composition (Figure 5).

We expect household lending in Spain to remain flat at least for the first half of 2024. Banks with a higher component of mortgage and retails lending should see a contained increase in cost of risk due to the effect of a smaller loan base. Commercial and SME loans should start growing again as both interest rates and high inflation show a downward trend, mostly from Q2 2024 onwards.

For BBVA and Santander, with 16% and 30% of consumer/retail and auto loans in their portfolios, we expect cost of risk guidance to remain the highest in the sample.

Figure 5: Loan portfolios well balanced between consumer, commercial and mortgage

Business models and loan portfolio differences support divergence in cost of risk trends



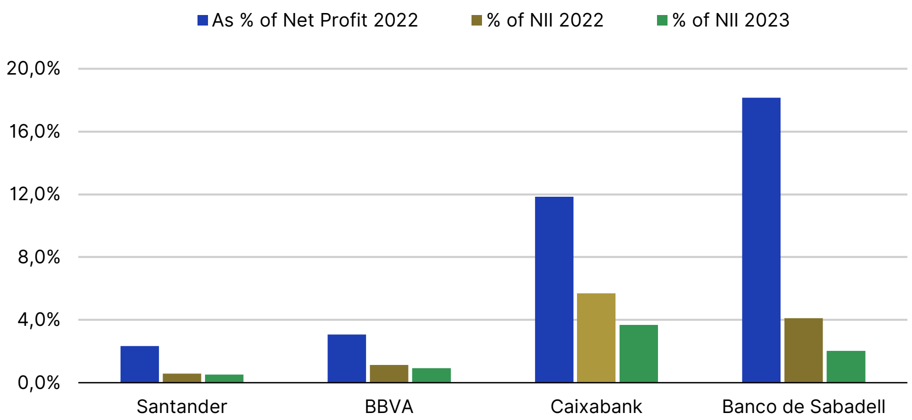
Source: Banks financial data, Scope Ratings.

Windfall taxes for banks could be here to stay

The windfall tax (calculated as a 4.8% charge on profits from net interest margins and commissions) levied on 2022 and 2023 results was extended for another year in December and promptly approved by parliament in January 2024. The indication is that it could become a permanent fixture. This supports our view that banks are increasingly to be seen as quasi-utilities, with regulatory and political considerations somewhat limiting their upside and downside risks. We see this as a credit-positive feature, even though it could limit growth and the sector's competitiveness and ability to attract equity capital in the medium term.

The overall impact of the windfall tax on banks' profits has been manageable. Thanks to their diversification, the impacts in 2023 were marginal for BBVA and Santander, both relative to their group NII and their bottom lines. However, it had a more material impact for Banco de Sabadell and Caixabank, as both banks generate more than 85% of their profits in Spain.

Figure 6: Spanish tax levy, not material for NII in 2023 (*)



(*) Based on Scope Ratings estimations.
Source: Banks financial data, Scope Ratings.

Considering that the effect of higher interest rates in 2023 was more pronounced than it was in 2022, we expect the nominal amount to be paid by each bank in 2024 to be higher than in 2023. However, as a portion of NII it should be lower (less than 4% for each bank), decreasing its relevance in terms of net profit to levels below 12% for Caixabank and Banco de Sabadell and to levels below 4% for Santander and BBVA.

A permanent, more stringent tax would hinder further consolidation in the Spanish banking sector, as internationally diversified banking groups would limit their exposure to countries where the tax burden is higher.

Smaller Spanish banks facing the challenge of reaching critical scale to improve efficiency could be more open to further consolidation to improve their competitiveness in terms of pricing and operational costs. We closely monitor the degree of sector concentration as it shapes competitive dynamics, an important consideration in our assessment of the operating environment.

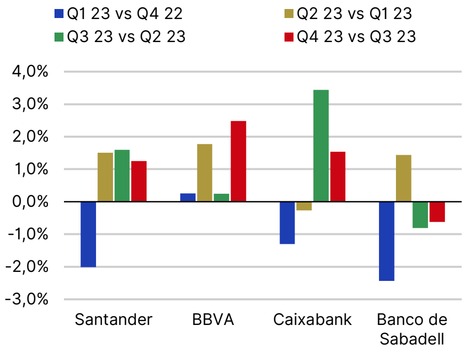
Deposits inflows start to growth back, almost to 2022 levels

Deposits from households and corporates continued to grow in Q4 over Q3, confirming the trend that we also observed in Q3. Spanish banks accelerated the pass-through of policy rates to time deposits. This helped to stabilise the deposit base, albeit with a negative impact on net interest margins as the inflow in deposits came almost exclusively in the form of time deposits. The proportion of time deposits to total deposits has grown significantly for all banks QoQ (Figure 8), representing between 15%-35%, compared to 6%-25% in 2022.

Deposit base starts showing signs of recovery

Figure 7:

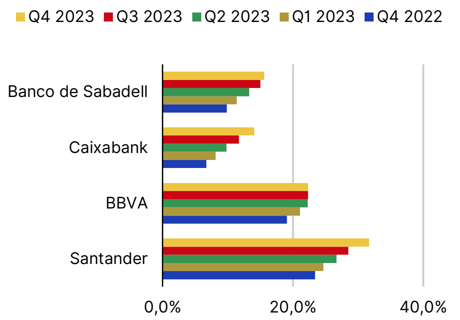
Total deposits QoQ change



Source: Banks financial data, Scope Ratings.

Figure 8:

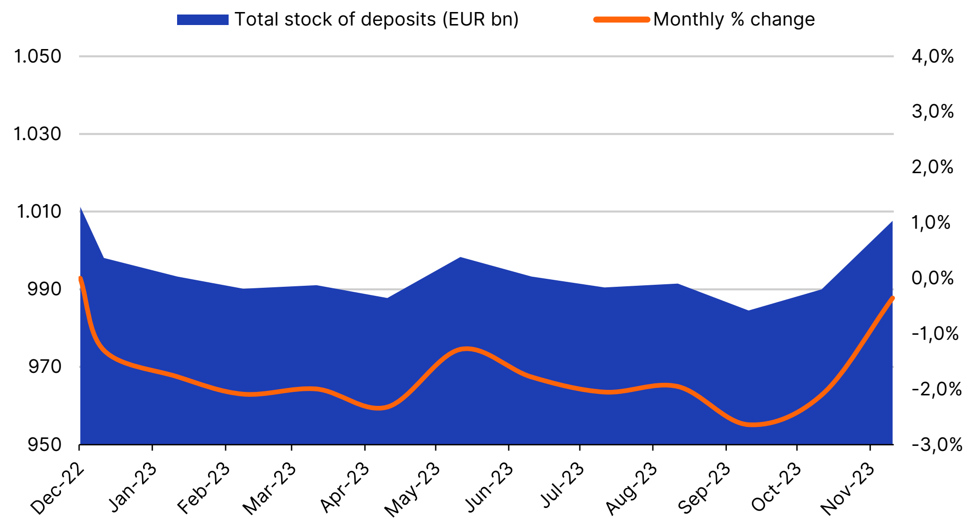
Time deposits as % of total deposits



Source: Banks financial data, Scope Ratings.

We still anticipate some QoQ volatility in the first half of 2024, but the stock of deposits for Spanish banks is finally returning to YE 2022 levels (Figure 9).

Figure 9: Spanish banks, stock of deposits last 12 months (*)



(*) Stock of deposits in Spanish banks from Dec-22 to Dec-23 and monthly % change.
Source: ECB data warehouse.

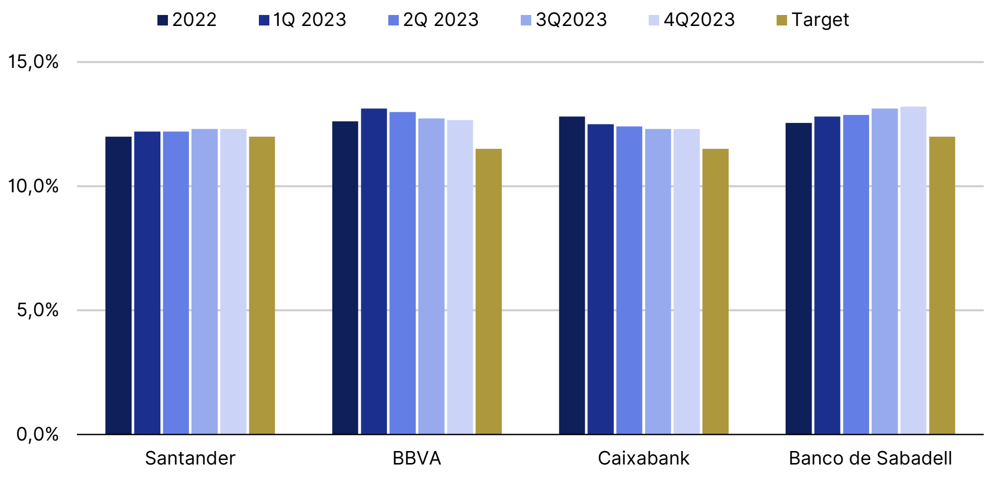
Capital remains adequate, while shareholders remuneration grows

High payouts will balance out organic capital growth, and we expect CET 1 ratios to remain broadly unchanged in 2024. Banks have steadily increased payouts to shareholders in the last two years, following the restrictions on dividend payments recommended by the ECB during the Covid 19 pandemic. Total payout ratios have increased through higher cash dividends and, more recently, share buyback programmes, given the limited opportunities to deploy capital profitably in a mature market. All the banks in our sample increased their payouts to 50%-60% in 2023 compared to levels closer to 40% in 2022.

Capital is adequate, largely above management targets

We do not expect banks to raise payouts beyond organic capital formation, so these will converge to medium-term targets in the near term. The macro picture remains uncertain, though, and we expect supervisors to discourage overly aggressive distribution policies. That said, we consider current capital positions for Spanish banks as adequate. All banks in our sample stand well above their requirements as well as their own capital targets. While they remain below the average of EU peers, this reflects differences in business models and asset-risk intensity.

Figure 10: CET 1 capital ratios largely above targets



Note: CET 1 ratios fully loaded for all banks. Source: Banks financial reporting, Scope Ratings.

Selected research available on scoperatings.com:

Italian bank quarterly: upbeat guidance to better earnings in 2024 should be treated with caution, February 2024

European Capital Quarterly: different Basel 3.1 timelines create challenges, February 2024

European banking outlook: sound fundamentals support credit profiles but profitability will decline, January 2024

French banks outlook, January 2024

Asset quality review: European banks at a crossroads in 2024, December 2023

Spanish banks outlook, December 2023

Swedish banks brace for subdued lending, poorer asset quality next year, buffered by strong earnings, November 2023

Commerzbank's updated strategy promises profitable future; implementation will be challenging, November 2023

Italian Bank Quarterly: growing resilience despite uncertainties, November 2023

European banks face disruptive retail funding dynamics, November 2023

European Bank Capital Quarterly, October 2023

French banks quarterly: sobering times, September 2023

SG strategy update: it doesn't have to be fancy, September 2023

Spanish Bank Quarterly: earnings solid but limited room for growth from here, August 2023

Italian Bank Quarterly: record Q2 results will be hard to repeat as windfall tax looms, August 2023

European Bank Capital Quarterly: funding and liquidity under the spotlight, July 2023

Asset-quality review: falling NPL ratios hide rising vulnerabilities, May 2023

Italian banks: strong Q1 results pave the way for a promising 2023, May 2023

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European Bank Capital Quarterly: Capital remains important support for sector, April 2023

Italian banks: solid funding and liquidity against challenging backdrop, April 2023

Sound fundamentals protect Swedish banks from emerging challenges, February 2023

Italian banks: promising 2023 outlook after bumper Q4, February 2023

European Bank Capital Quarterly: New year, new requirements, January 2023

2023 European Banking Outlook: strong ships in turbulent waters, January 2023

Issuer rating reports available to ScopeOne subscribers:

Banco Bilbao Vizcaya Argentaria SA

Banco Santander SA

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