

EU Banks' Creditworthiness Under Covid-19

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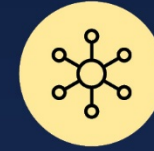
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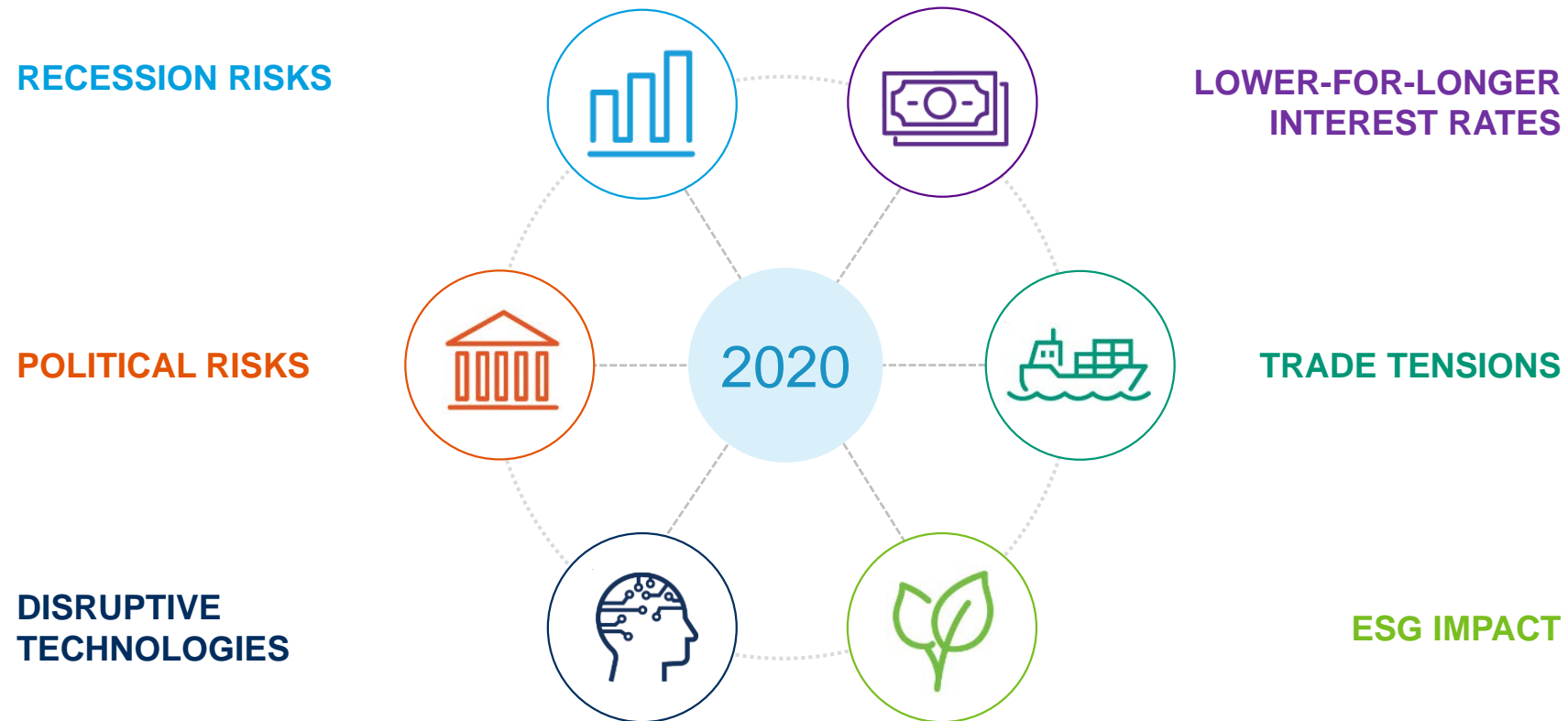
Agenda

1. Credit Risks In Turbulent Times
2. Main take-ways from large selected EU banks' Q1 disclosures
3. Focus on IFRS 9

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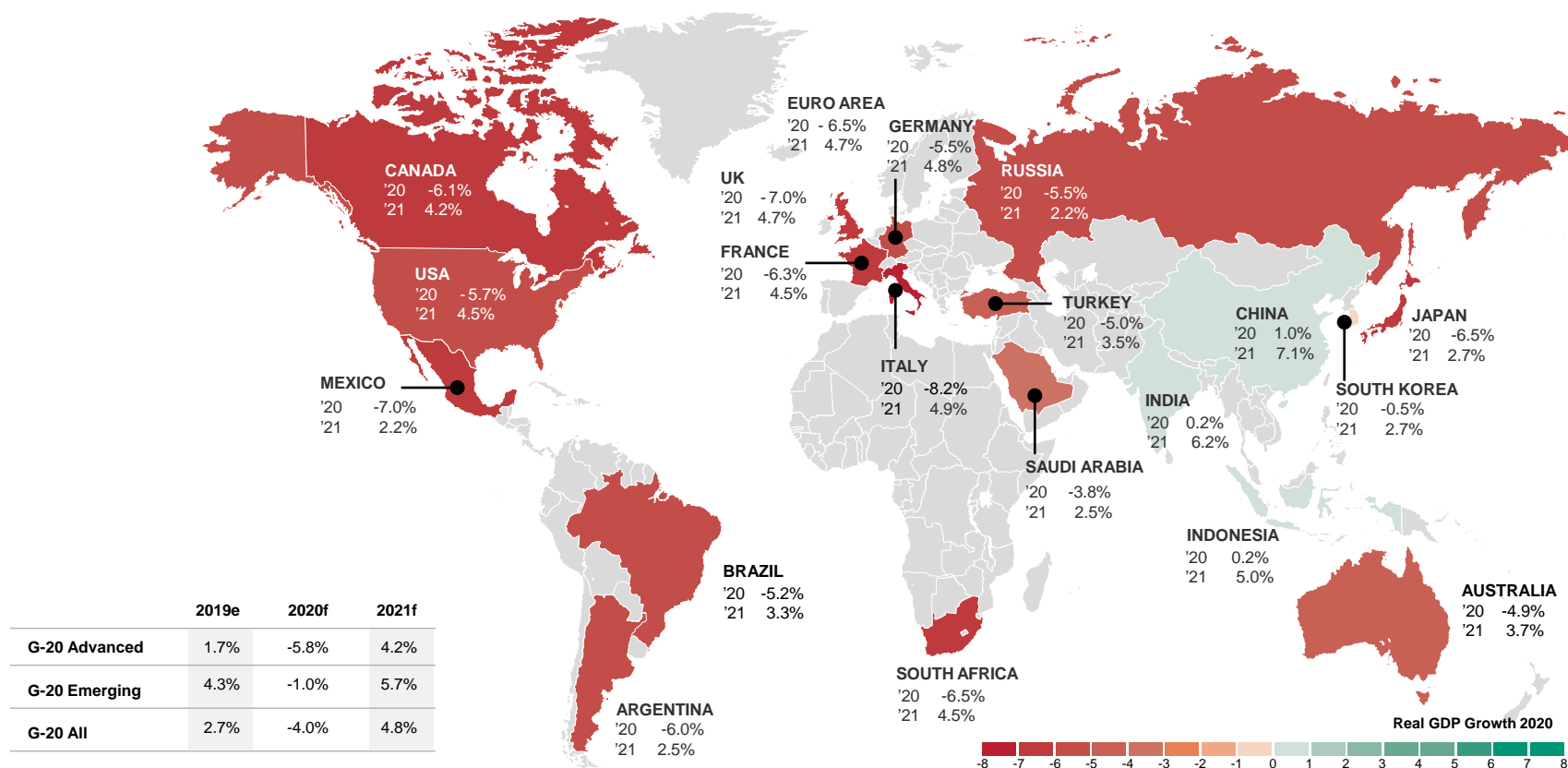
Credit Risks In Turbulent
Times

Six themes will shape credit in 2020



Restrictions exact high economic cost

Real GDP growth forecast (%) for G20 Economies 2020-21 (April 28, 2020 Update)



Source: Moody's Investors Service

G-20 outlook is grim

Economies	Real GDP Growth			GDP loss compared to pre-coronavirus baseline	
	19	2020F	2021F	20F	21F
G-20	1.7	-5.8	4.2		
Advanced					
US	2.3	-5.7	4.5	-7.3%	-4.9%
Euro area	1.2	-6.5	4.7	-7.6%	-4.6%
Japan	0.7	-6.5	2.7	-6.8%	-4.9%
Germany	0.6	-5.5	4.8	-6.4%	-3.2%
UK	1.4	-7.0	4.7	-7.9%	-4.5%
France	1.3	-6.3	4.5	-7.6%	-4.8%
Italy	0.3	-8.2	4.9	-8.7%	-4.9%
Canada	1.6	-6.1	4.2	-7.6%	-5.3%
Australia	1.8	-4.9	3.7	-7.0%	-5.9%
South Korea	2.0	-0.5	2.7	-2.5%	-2.3%
Emerging	4.3	-1.0	5.7		
China	6.1	1.0	7.1	-4.6%	-3.3%
India	5.3	0.2	6.2	-6.0%	-6.5%
Brazil	1.1	-5.2	3.3	-7.0%	-6.3%
Russia	1.3	-5.5	2.2	-6.9%	-6.4%
Mexico	-0.1	-7.0	2.2	-8.2%	-8.0%
Indonesia	5.0	0.2	5.0	-4.3%	-4.1%
Turkey	0.7	-5.0	3.5	-7.8%	-7.3%
Saudi Arabia	0.3	-3.8	2.5	-6.2%	-6.8%
Argentina	-2.2	-6.0	2.5	-3.6%	-2.6%
South Africa	0.2	-6.5	4.5	-7.4%	-4.4%
All	2.7	-4.0	4.8		

Growth forecast adjustment from the previous outlook

X.X Adjustment < 0.3 pp X.X An upward adjustment ≥ 0.3 pp X.X A downward adjustment ≥ 0.3 pp

And risks remain to the downside



Upside risks ...



The availability of a vaccine or effective treatment more quickly than expected would support:

- » A resumption of economic activity on a steadier basis
- » Improved consumer and business confidence



Downside risks ...



New outbreaks in H2: A resurgence of the virus could cause further lockdowns and make it harder for governments to finance and implement support measures and transfers



Financial stress: Asset quality will decline if longer or repeated shutdowns increase business closures and keep the unemployment rate elevated. Increased margin pressure in the financial sector would add to economic and financial strains



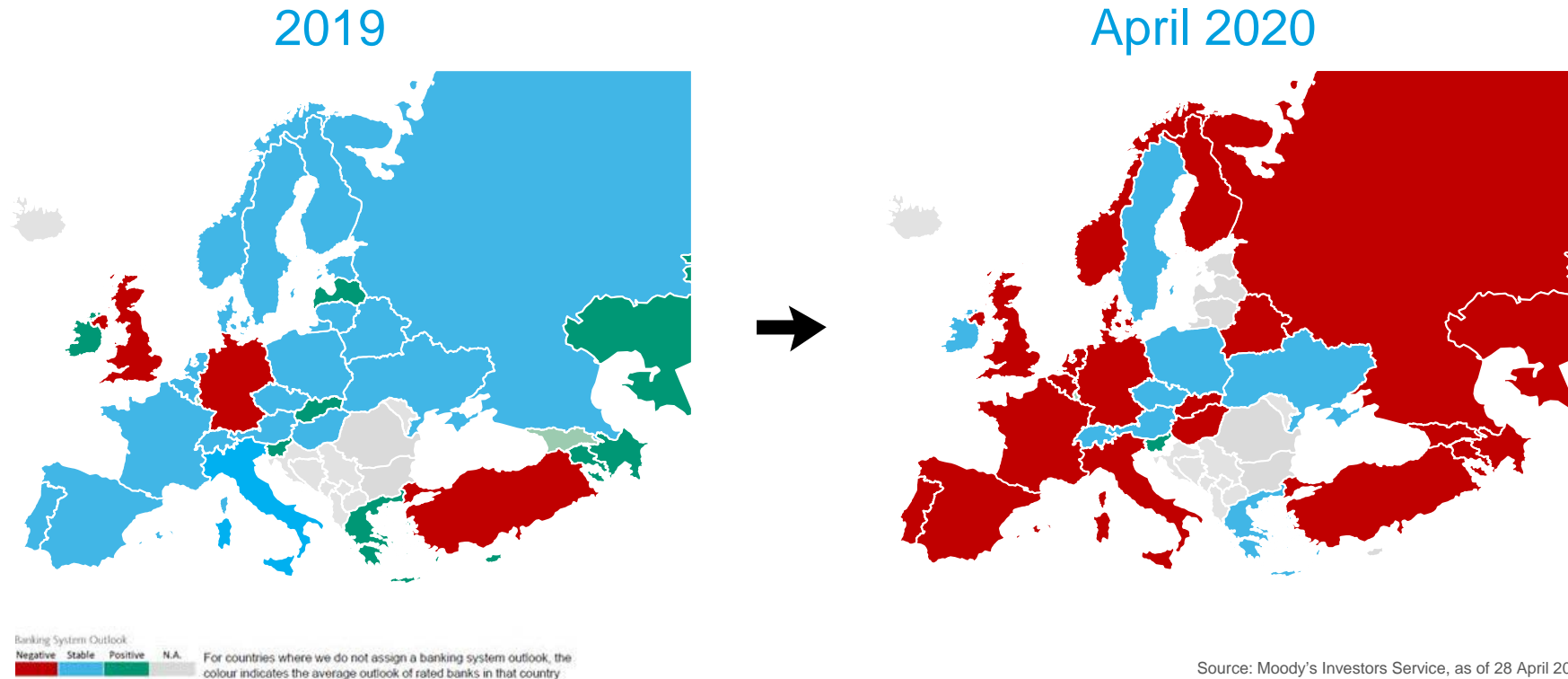
Behavioral shifts: Permanent changes in consumption and business behavior would disrupt some sectors and supply chains, causing a structural change in the pace of economic activity



Lack of global coordination: Without countries working together to combat the virus' spread, risks of a resurgence and more severe economic outcomes are high



Banking System Outlooks mostly negative



Driven by operating environment, asset risk and profitability

Country	Overall BSO	Operating environment	Asset Risk	Capital	Profitability and efficiency	Funding and liquidity	Government support
Austria	Stable	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Stable
Belgium	Negative	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Stable
Denmark	Negative	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Stable
France	Negative	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Stable
Germany	Negative	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Stable
Ireland	Stable	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Stable
Italy	Negative	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Stable	Stable
Netherlands	Negative	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Stable
Norway	Negative	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Stable
Portugal	Negative	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Stable
Spain	Negative	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Stable
Sweden	Stable	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Stable
Switzerland	Stable	Deteriorating	Stable	Stable	Deteriorating	Stable	Stable
United Kingdom	Negative	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Deteriorating

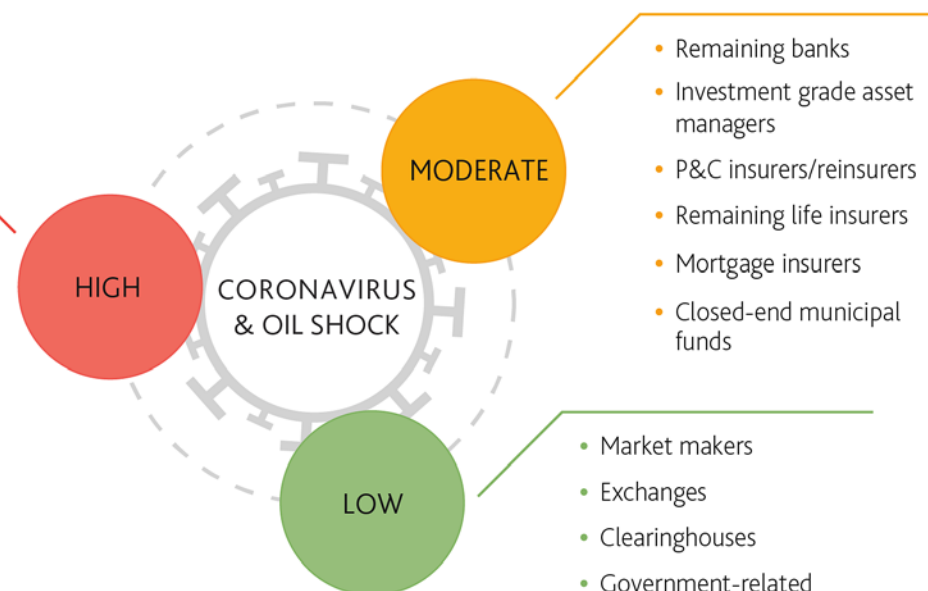
Regional banks most affected by coronavirus

Entering the crisis...

- » Banks have strengthened capital and high liquidity
- » Asset quality supported by government loans, liquidity support to corporates and individuals

Impact of coronavirus on FIG sectors

- Regional banks in affected areas or highly exposed to affected sectors
- Select life insurers
- Trade credit insurers
- Aircraft lessors and fuel/transport finance companies
- Interest rate or equity market sensitive service providers
- Prime money market funds and closed-end equity/high yield funds



Source: Moody's Investors Service

Shock now likely to reduce bank capital

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SPECIAL YEARS Credit Risks in Turbulent Times

SECTOR IN-DEPTH
4 May 2020

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Banks – Global
Coronavirus shock likely to reduce some banks' capital, increase credit vulnerabilities

The rapid global spread of the coronavirus has led to a deteriorating economic outlook, sharply lower oil prices and broad financial market upheaval, generating an unprecedented credit shock across many sectors worldwide. Our current [baseline economic scenario](#) assumes pandemic-driven disruption of economic activity through the second quarter of 2020 will be followed by some modest recovery in the second half of 2020. However, the potential for a prolonged downturn is increasing.

The shock has not led to immediate or wholesale changes in the underlying credit strength of banks, as represented by their Baseline Credit Assessments. However, the credit strength of many banks will become increasingly vulnerable to the extent that the economic shock broadens and lengthens. The current deterioration in profitability coupled with further weakening of asset quality will likely lead to weakening capital for at least some banks. Thus, when comparing a bank to its peers, the level of capital with which the bank entered this recession and its ability to retain capital throughout the next several years take on particular importance.

Under these conditions, we expect to continue to place more banks on negative outlook. Changes in ratings would most likely be triggered at the point where our forward view is that capital will materially deteriorate without a return to pre-crisis levels within two to three years.

Banks' strong capital and liquidity entering the crisis have limited the immediate erosion of their underlying credit strength and ratings

Our assessment of bank credit is properly grounded in a forward view of solvency and liquidity. For solvency, gross risk is the risk of a loss of value in the bank's assets and potential mitigants include capital and profit generation. For liquidity, gross risk is the risk of a loss of funding and potential mitigants include access to cash and liquid asset reserves, including routine central bank facilities¹.

Banks entered this crisis with much stronger capital positions than ahead of the last global crisis in 2007-08. However, the strains on households and corporates will likely lead to a steep increase in loan loss provisioning, if this is not already happened. For some banks this will expose profitability as a weak spot in their solvency profiles, and their limited means to absorb losses via the income statement means that sustained pressure on asset quality will raise the risk to their capital, although with some variation in degree of severity globally.

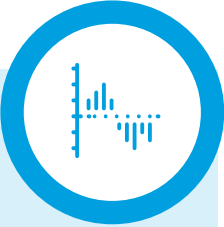
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Coronavirus impact will be long-term too

The coronavirus experience will be a defining event for many societal, business and credit trends and identifying its long-lasting impact will be paramount for credit analysis.

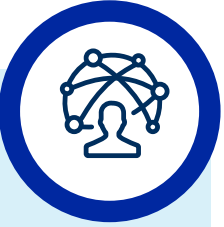
The crisis has accelerated existing disruptive trends with profound long-term effects.



Interest rates will remain severely depressed, eroding profitability. However, the increasing role of fiscal stimulus creates uncertainty for the **long-term inflation** outlook



The outbreak is causing a large-scale **shift to digital** services and a rethinking of old business habits, **accelerating the transformation of business models**



The health crisis and economic hardship is increasing attention on **corporate social behavior**, accelerating a shift in focus to a wider range of stakeholders

2

Main take-ways from large
selected EU banks' Q1
disclosures

Key messages



First quarter results marked by a material increase in loan loss provision

11 out of 12 top European banking groups reported substantial drop in earnings



Mixed revenue performance

Most banks reported muted or negative operating income growth. Active cost control and fees and commissions insufficient to offset depressed NII and financial market shocks



Reported loan losses varied significantly

Future quarters will reveal if consistent level of conservatism. Broadly stable asset quality indicators



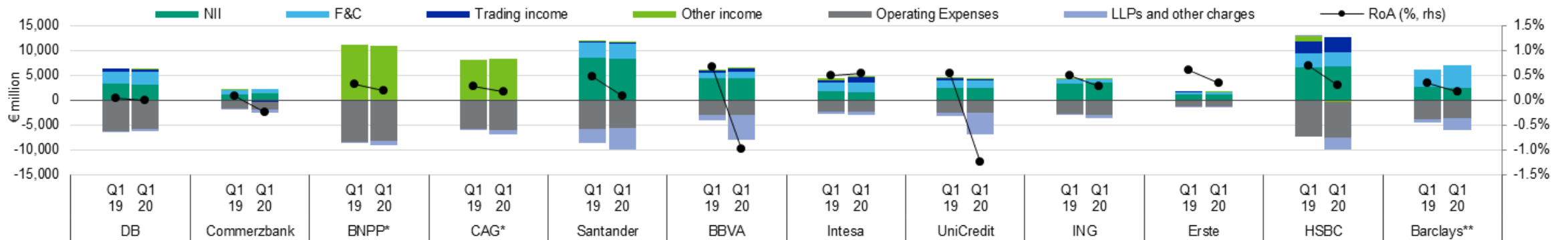
Ample capital buffers provide room for unexpected credit losses/Liquidity remained sound

Capital ratios eroded. Need to tap capital markets has subsided and liquidity above minimum requirements across all banks

Profitability declined from already low levels

Credit cost related to the coronavirus outbreak was the common driver behinds this quarter's poor performance.

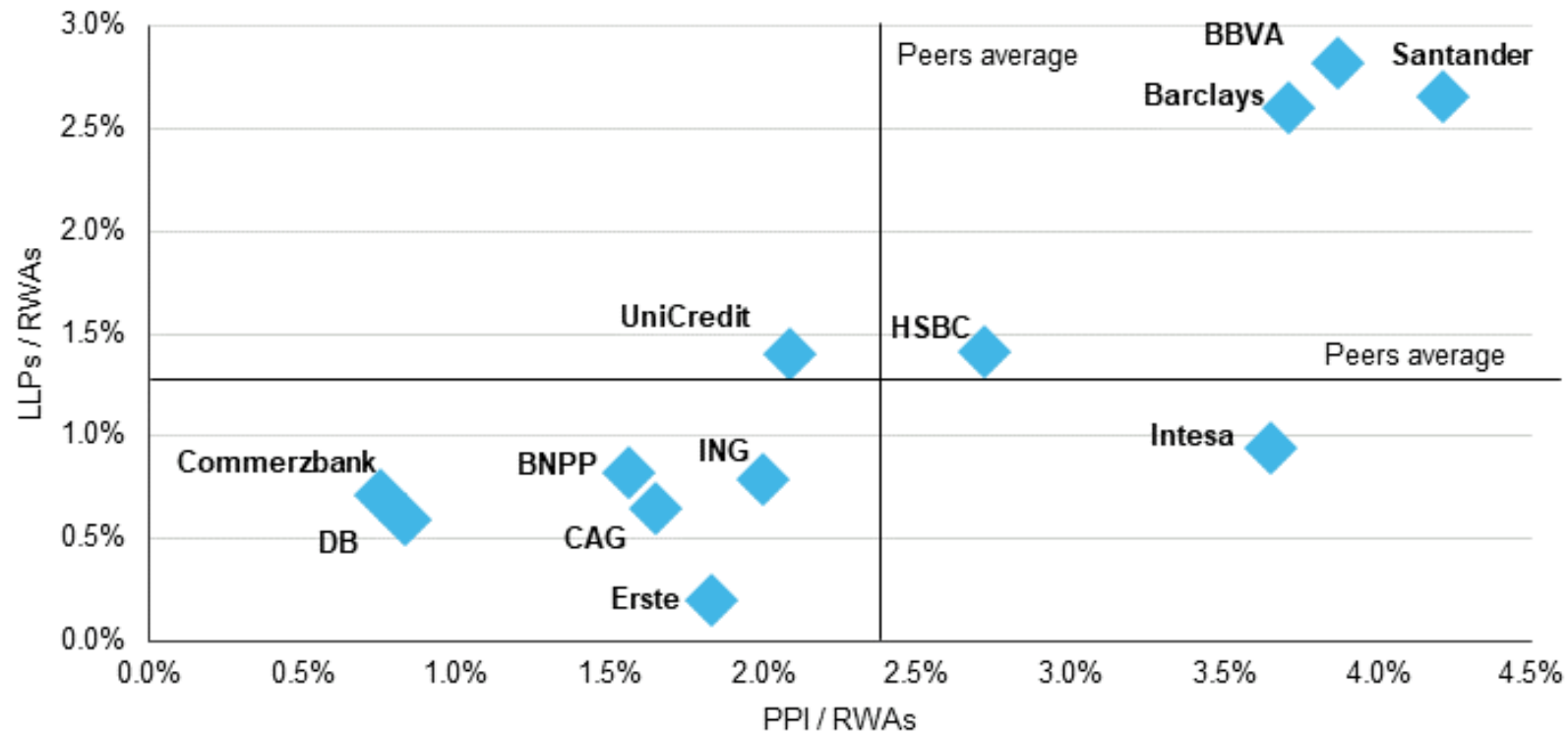
Fees and commission income and cost control were supportive but insufficient to offset negative impact of market shocks and subdued evolution of net interest income.



* BNP and GCA do not disclose gross operating income breakdown ** Barclays does not disclose split between F&C and other operating income
Source: Banks' financial statements,

Most profitable banks made largest provisioning effort

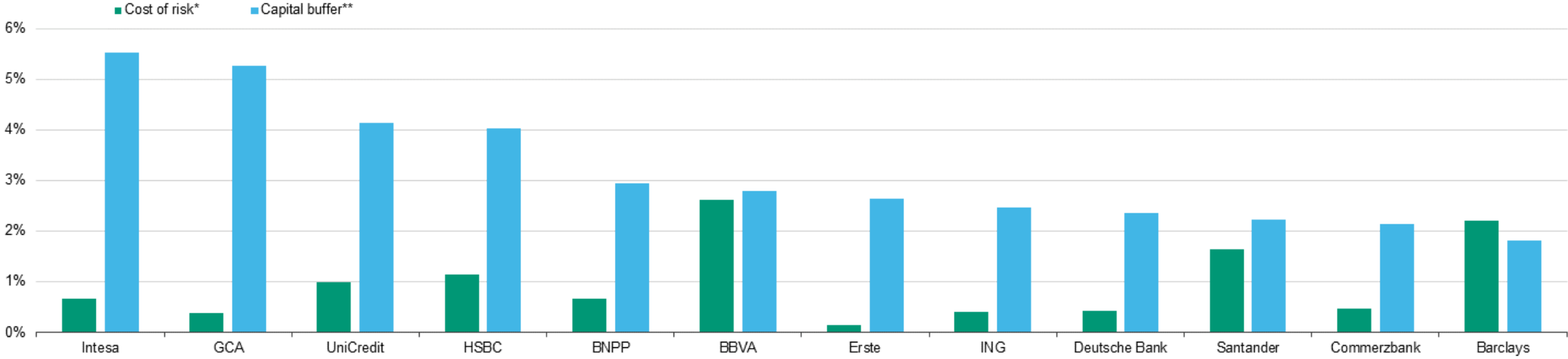
Intesa will reinforce its provisions with the expected capital gains from the sale of Nexi in Q2/Q3.



Source: Banks' financial statements,

CET1 buffers provide room to absorb credit shocks

Regulatory capital fell in the quarter with the exception of Intesa and Unicredit. Revisions to 2020 capital targets have been limited.

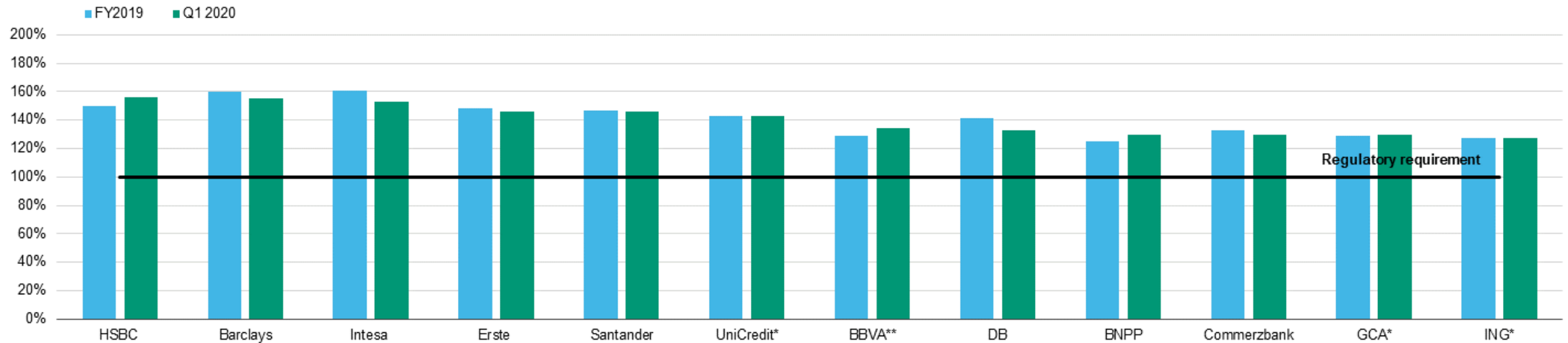


* Q1 2020 annualised cost of risk ratio ** Headroom over SREP4 requirement (assuming 25% tax rate) as % of gross loans Source: Banks' financial statements

Source: Banks' financial statements,

LCR ratios remain well above minimum requirements

The need to tap capital markets at high spreads has subsided



* 12M average LCR

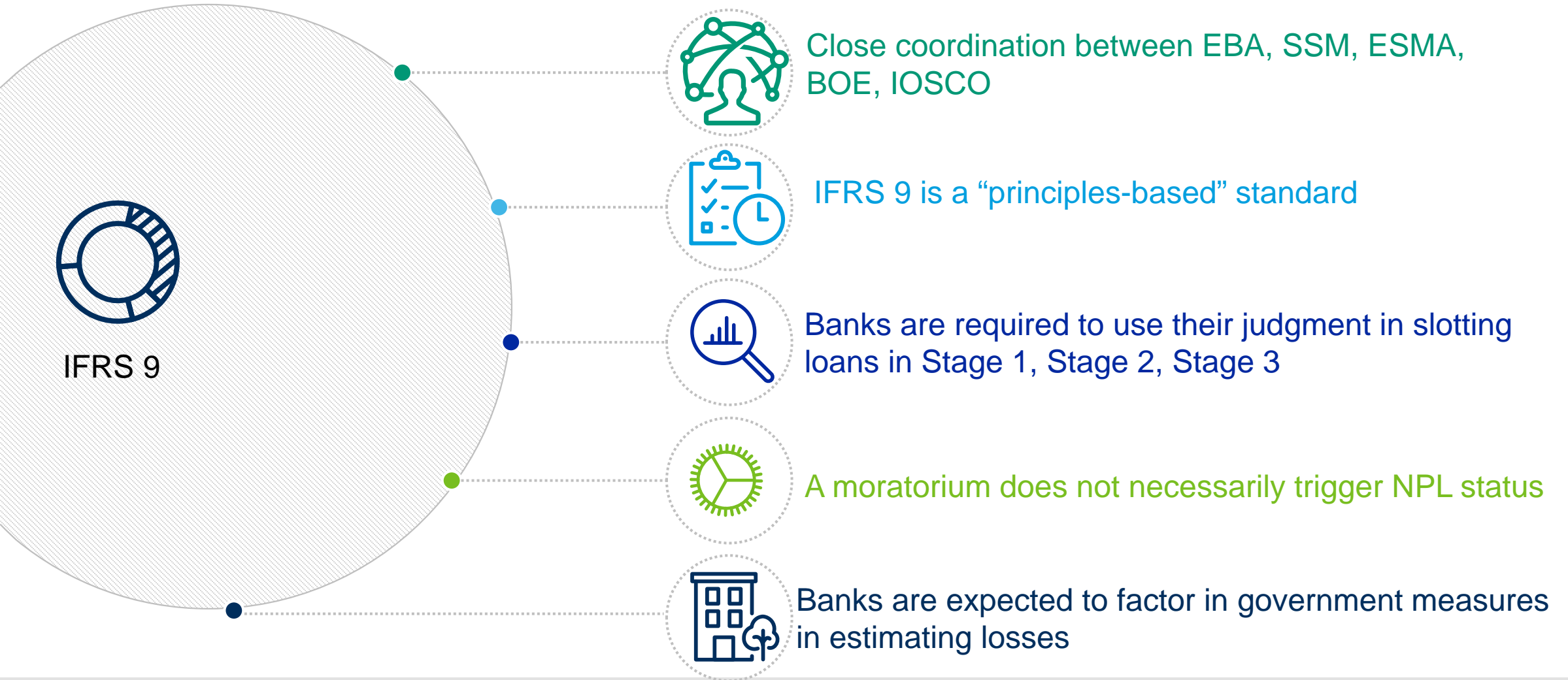
** Reported BBVA's LCR ratios do not consider excess liquidity outside the Eurozone. If included, LCR ratio would have amounted to 158% and 156% at end-December 2019 and end-March 2020, respectively

Source: Banks' financial statements,

3

Focus on IFRS 9

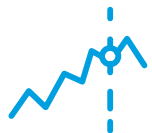
Accounting Standard – IFRS 9



IFRS 9 Under Revised CRR2 “Quick Fix”



Banks can opt for IFRS 9 “transitional” approach



Transitional approach is extended by two years



Banks have not yet communicated about whether they will shift to the transitional approach



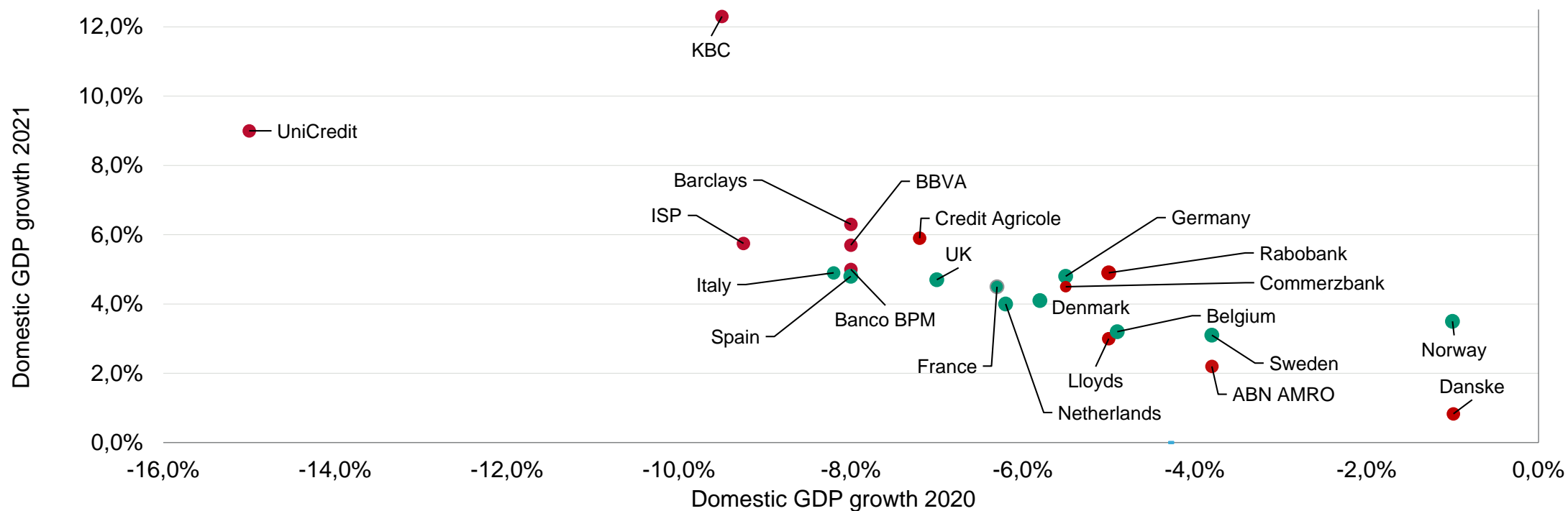
ECB seeks to avoid stigma for banks shifting to the transitional approach



Impact of COVID related provisions, except those on impaired loans on CET1 are neutralized (100% in 2020 and 2021)

Economic scenarios vary

GDP growth for 2020 and 2021 provided by banks on their domestic economy (red dots) and Moody's forecasts (green dots)

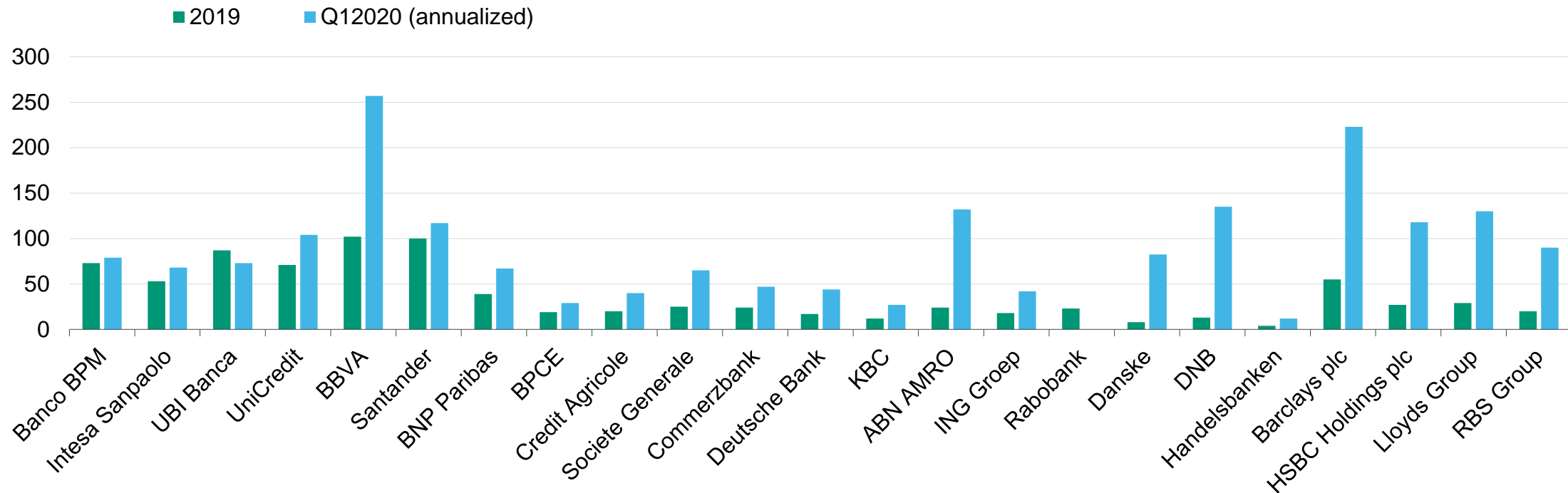


Note : Base case scenario's forecasts have been taken in consideration
Sources: Banks' presentations, interim reports and Moody's Investors Service

Banks booked high provisions

Provisioning charges have jumped in the first quarter of the year

Loan-loss provisioning (cost of risk) in basis points of total loans by bank

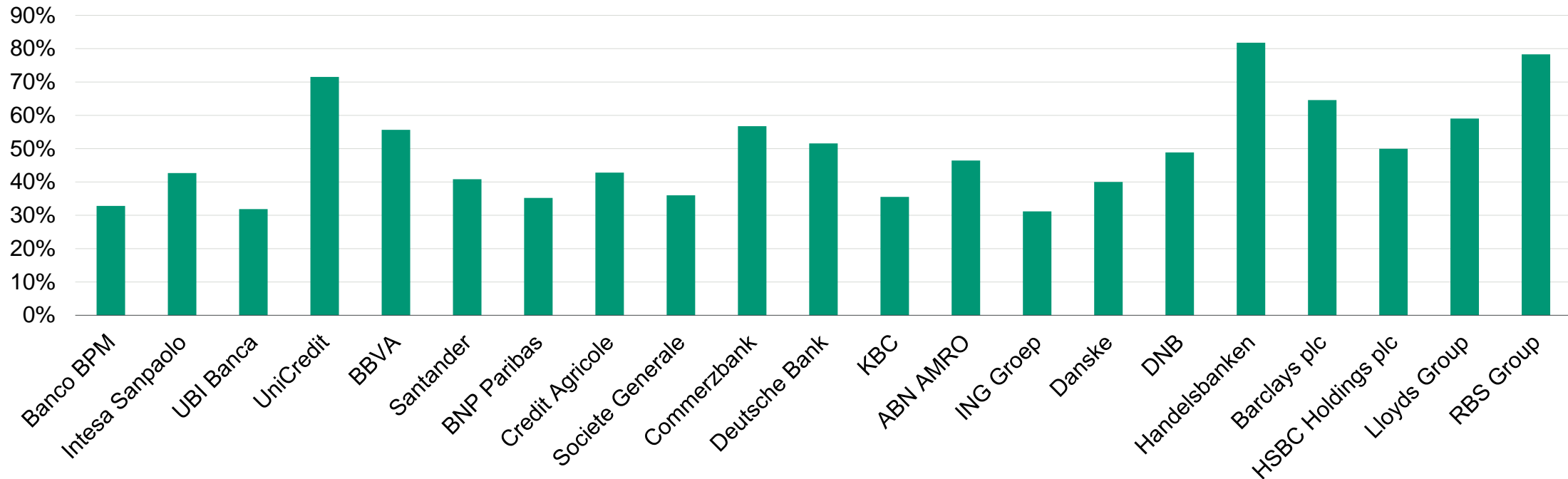


Note: Handelsbanken 1Q reported figures have been annualised by multiplying the underlying credit risk by four and adding the coronavirus overlay
Source: Banks' presentations, interim reports and Moody's Investors Service

Share of COVID-related provisions differs

Estimates as to the impact of COVID-19 on provisions vary appreciably

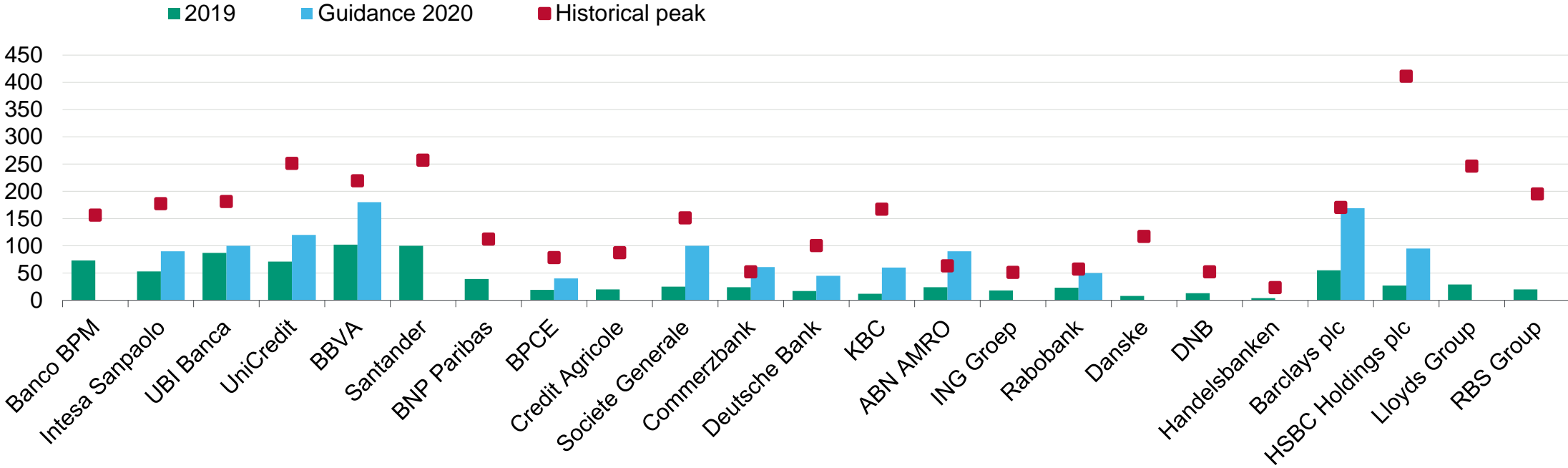
COVID-related provisions (as a % of total provisions)



Note: COVID-19 provisions exclude the impact of low oil prices when separately disclosed
Source: Banks' presentations, interim reports and Moody's Investors Service

2020 guidance below previous peak

Provisioning guidance for 2020 provided by bank (bps) compared with financial crisis peaks



Note: Commerzbank, Rabobank, Barclays and HSBC's guidances are based on Moody's calculations
 Note: For banks with a range of guidance, we took the upper bound
 Note: Historical peak is the highest since 2007 (calculated as Loan loss provisions/Gross loans)
 Source: Banks' presentations, interim reports and Moody's Investors Service

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