Credit Outlook For European Banks Amid COVID-19

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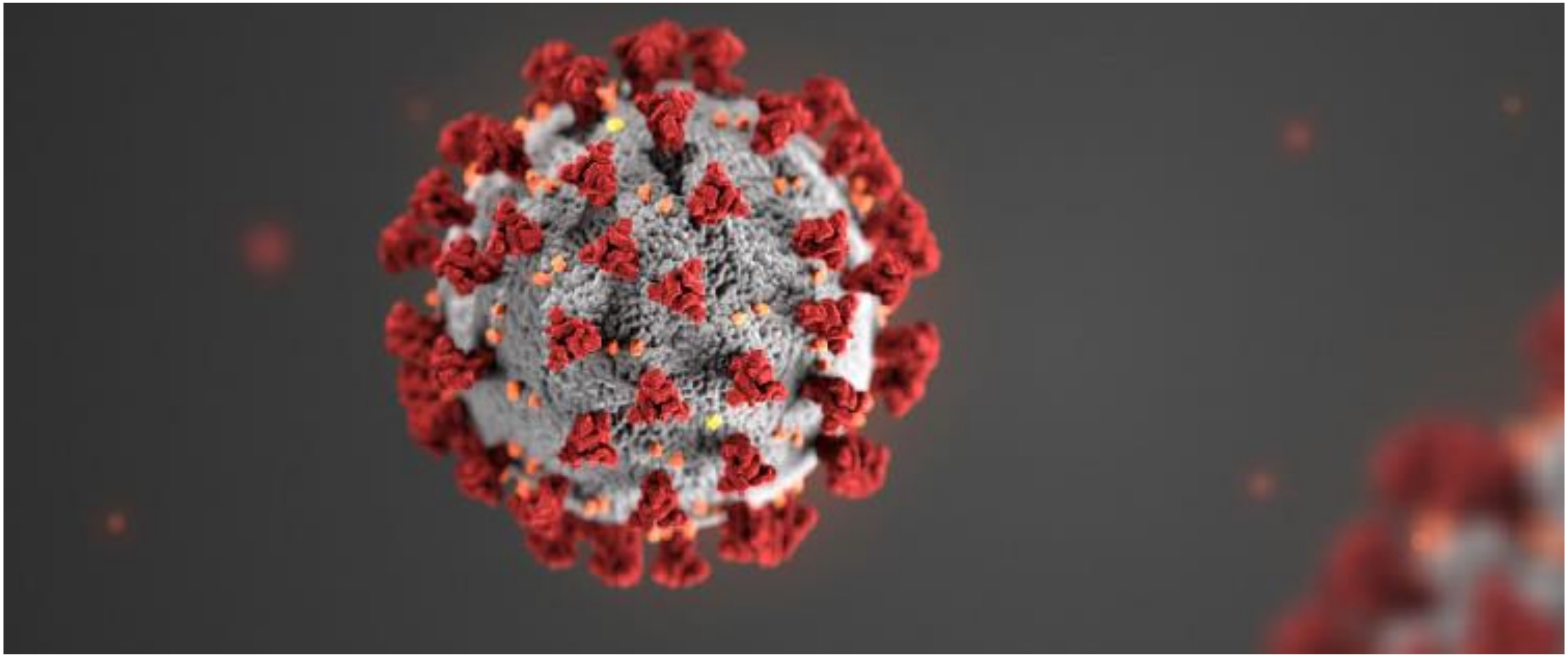
June 18, 2020



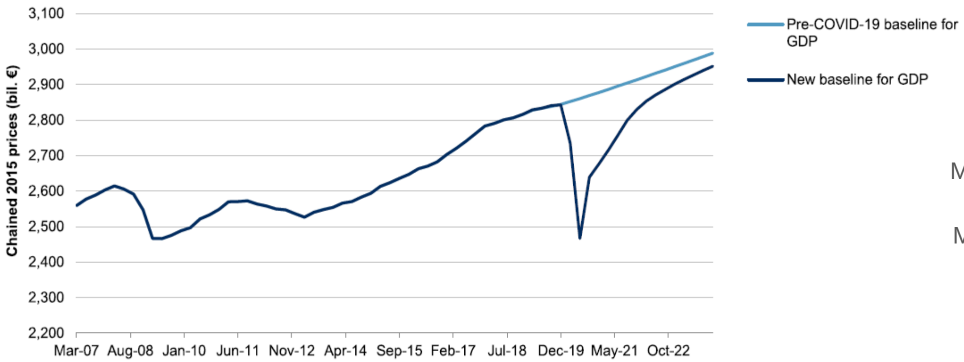
S&P Global
Ratings

European Banks | Revised Base Case Has Spurred Negative Rating Actions

1. Economic Base Case: Short, Sharp Cyclical Shock

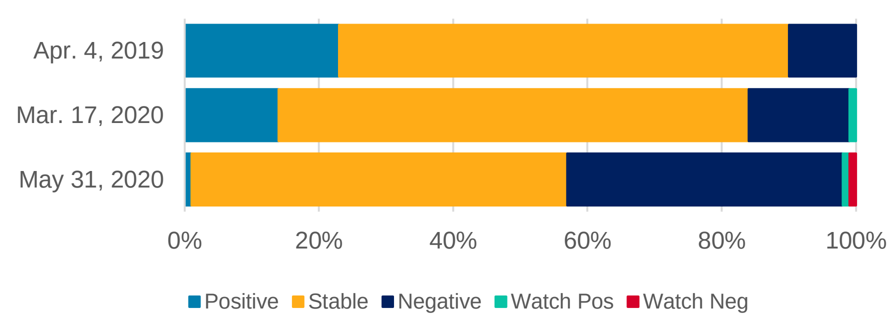
- We expect eurozone and U.K. GDP to shrink by 7.3% and 6.5% this year before rebounding by 5.6% and 6% in 2021.
- Ultra loose monetary policy, extensive fiscal support, and easing in bank capital and liquidity buffers offer substantial support to the real economy, bank asset quality, and bank capacity to extend credit without breaching buffer requirements.
- Still, the policy responses taken by countries across Europe may be less than totally successful in avoiding permanent economic damage.
- A significant component of these fiscal support packages comprises additional indebtedness--for sovereigns, some households, and many businesses.

2. Eurozone Economy Rebounds, But Loses Ground



Note: The Pre-COVID-19 baseline for GDP is as of November 2019. The new baseline for GDP also includes revised data prior to November 2019. Sources: Eurostat, S&P Global Ratings.

3. Sector Outlook Bias Is Now Heavily Negative



Data as of May 31, 2020. Reflects positioning of ICR outlooks. Implications for issue ratings on senior nonpreferred debt and other hybrids may be different as they are based on bank standalone credit profiles. Data covers Top 100 European banks.

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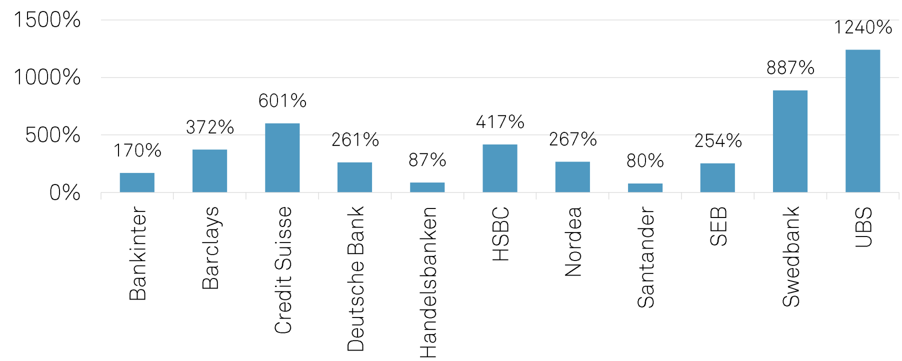
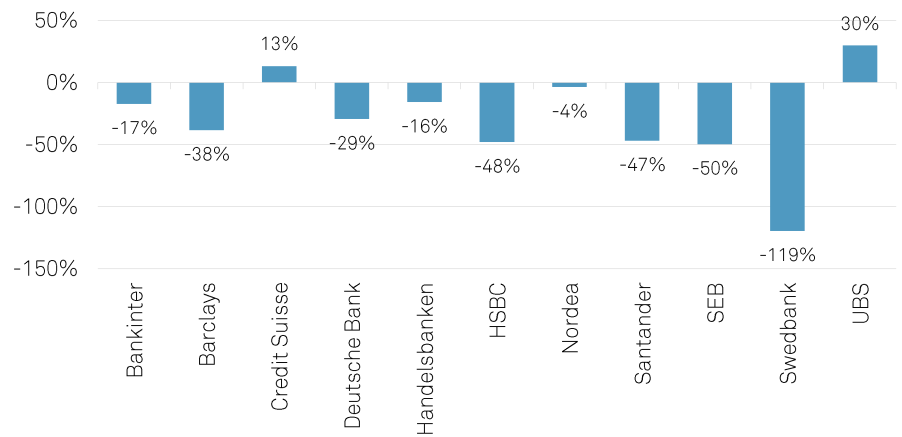
European Banks | Q1 Results Confirm A Sharp Rise In Impairments

- Q1 results are already showing the effects from the economic "stop" across much of Europe, but full effects will take longer to filter through.
- Widespread forbearance measures don't mean an automatic indication of further sharp rises in credit losses – but much depends on assumptions about an economic rebound later this year and into 2021.
- Still, losses will inevitably rise through 2020 and banks' transparency in reporting will be important to investor confidence.
- We expect the effect on bank liquidity and capital ratios to be uneven.
- Many market movements that will affect 2020 results may not be visible in first-quarter disclosures, such as further margin pressure from low base rates and likely widening in pension fund deficits.

Change in credit impairment charges



Change in profit before tax



Source: Company reports. Data compares Q1-2020 to Q1-2019. The selection of banks is driven by larger banks that have reported results by April 29, 2020.

European Banks | COVID-19 Weighs on Banks' Profitability ….(1/2)

1. Economic Base Case: Short, Sharp Cyclical Shock

- We expect **bank earnings, asset quality to weaken** through end-2020 and into 2021….
- **But opportunities exist** as well (energy transition, infrastructure etc…) for the banks/countries, which are forward looking.
- **Capital ratios** have improved after years of more stringent regualtory rules. Despite an expected decline, we do not expect large or systemic solvency issues.
- **Funding** should not be a problem, not least given ample availability of central bank funding. Wholesale markets have reopened but spreads will remain wider than before.

The proactive and massive reaction of governments and of the ECB (and BoE) are critical and should avoid a more dramatic economic collapse.

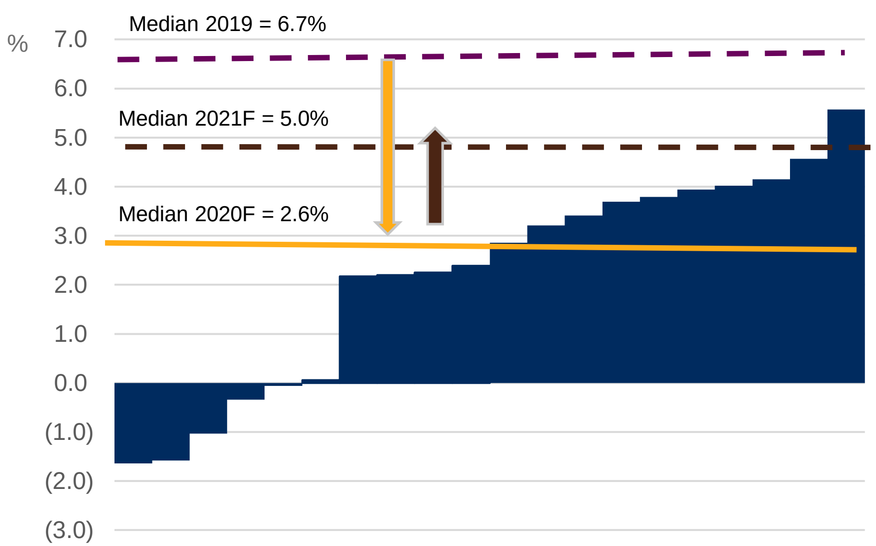
2. European Banks: Revenues Down, Credit Losses Up

	2020F	2021F
Revenues	-7%	3%
Noninterest expenses	-2%	-1%
Preprovision operating income	-16%	11%
Credit loss provisions	116%	-24%
Pretax profit	-58%	87%

Source: S&P Global Ratings. Data covers 20 of the largest European banks and reflects average year on year change. Data as of April 29, 2020.

European Banks | But Above All COVID-19 Adds To Existing Profitability Pressures (2/2)

3. Already Depressed, ROEs Will Suffer



Source: S&P Global Ratings. Data covers 20 of the largest European banks. Data as of April 29, 2020.

4. Downside Risks Aplenty, But Outcomes Could Vary

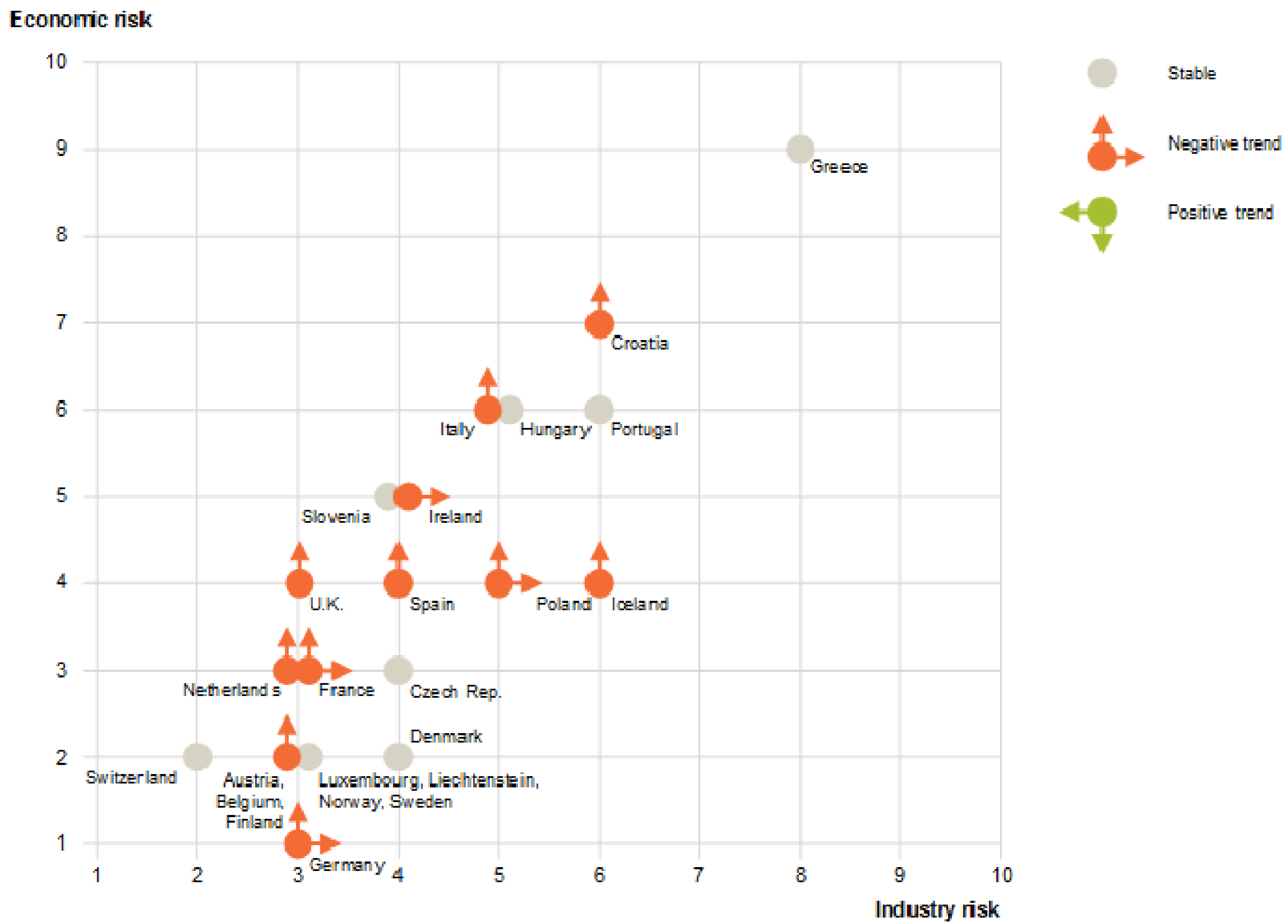
- **Outlook bias** across Europe is now heavily (but not totally) negative.
- **Individual banks** bring their own blend of strengths and weaknesses. But there are **two broad sources** of downside economic risk:

  1. Longer lockdowns, worsening financing conditions or further worsening of Europe's external environment

  2. The effectiveness of fiscal and monetary measures may be insufficient or else may vary: economic structure and fiscal support (in its size, blend, and deployment) differ from country to country; therefore, so could the implications for the banks.

- **Future actions** could therefore be across national banking sectors, or follow idiosyncratic developments at individual banks.

BICRAs Pointing To Rising Downside Risks



Data as of May 31, 2020. Our BICRA groups are on a scale of ‘1’ to ’10’, with ‘1’ denoting the lowest-risk banking sectors.
Source: S&P Global Ratings

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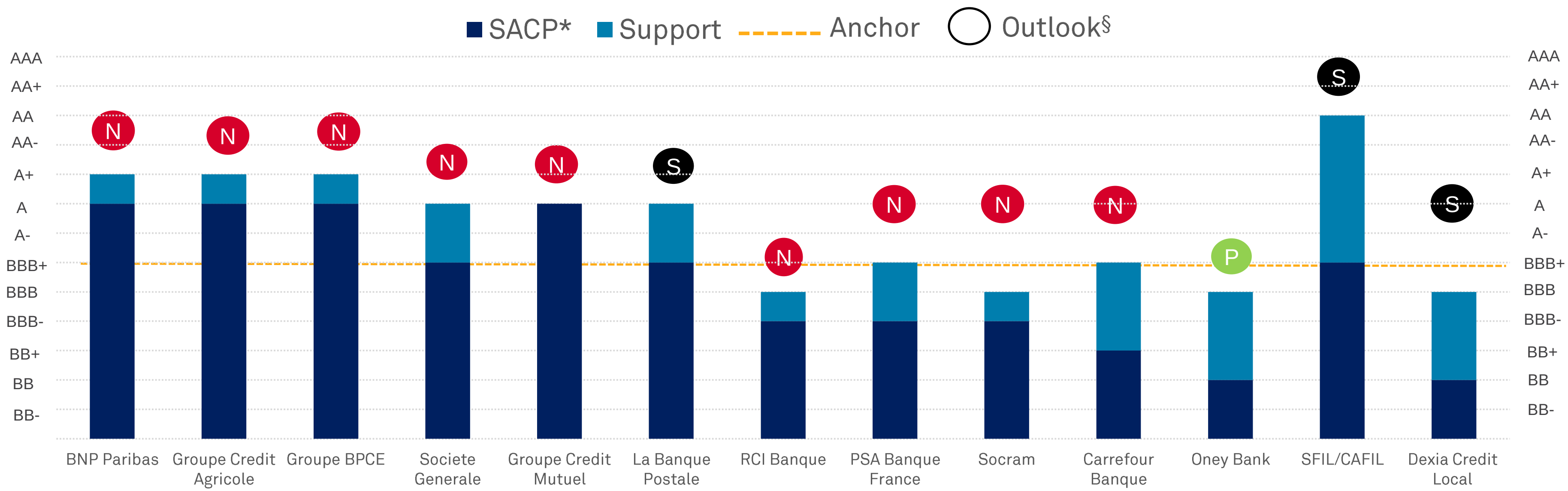
Covid-19 crisis : Rising risks for French Banks



*Stand-Alone Credit Profile or unsupported Group Credit Profile for Rated Groups. §P=Positive, S=Stable, All ratings as of 8th June 2020. Source: S&P Global Ratings.

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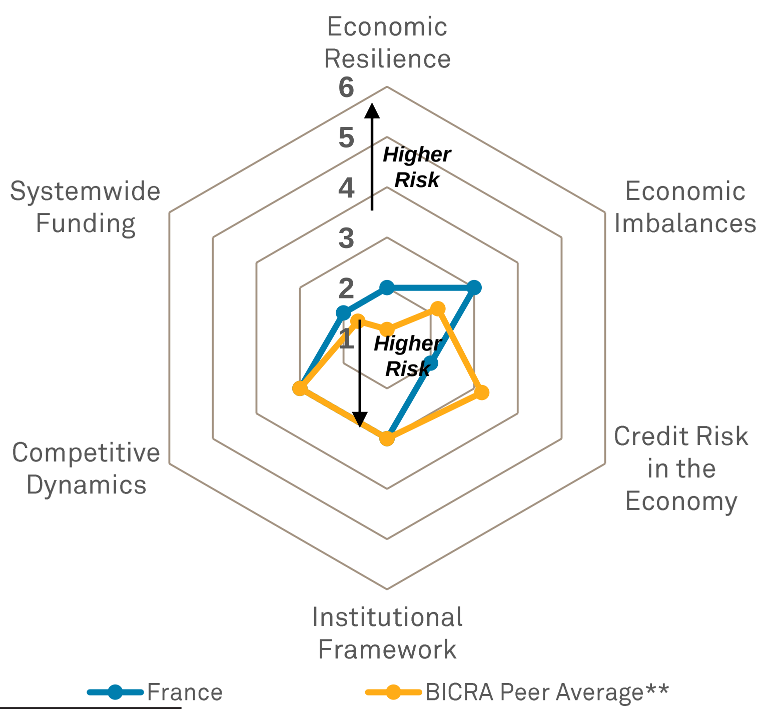
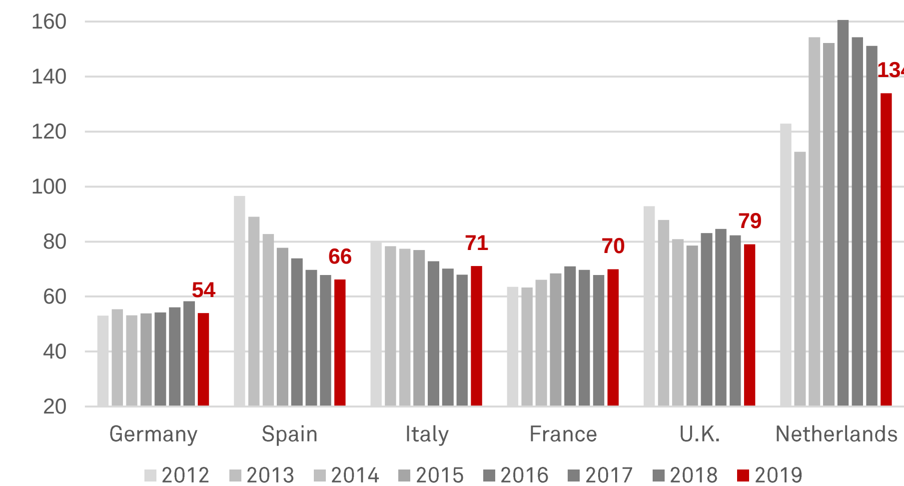
French Banks: Increasing Private Sector Leverage and Need For Efficiency Gains

Banking Industry Country Risk Assessment: France	
Sovereign Rating	AA/Stable/A-1+
BICRA Group / Anchor	3 / bbb+
Economic Risk	3
Industry Risk	3
Economic Risk Trend	Negative
Industry Risk Trend	Negative
Government Support	Uncertain

BICRA France compares better than many Western European economies

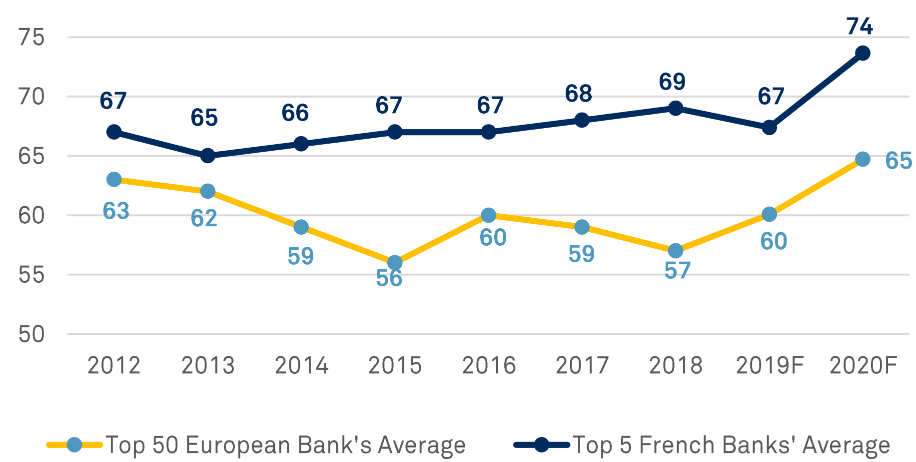


Corporate debt was rising faster in France than in other countries



Sources: Banque de France, AG data

French Banks demonstrate a higher cost-to-income ratio (%)



Source: Banks' Financial Statements and S&P Global Ratings calculations.

S&P Global Ratings

France | S&P Global Ratings Economic Outlook

- We expect the French economy to contract by 8.0% in 2020 because of restrained household spending and disrupted supply chains due to lockdown measures.
- The economy is likely to rebound strongly in 2021 (6.1%) as household spending and investment revert to normal, backed by fiscal stimulus of €45 billion (2% of GDP) and another €300 billion in public guarantees on corporate borrowings to circumvent liquidity issues.
- The latest business surveys show that industry has slowed the most since the financial crisis. While some factories have shut, the services sector, which accounts for nearly 80% of the economy, is set to be hit the most especially as tourism, transport, and hospitality grind to a halt.

	2017	2018	2019	2020F	2021F	2022F	2023F
Real GDP (% y/y)	2.4	1.7	1.3	(8.0)	6.1	4.5	2.3
Real exports (% y/y)	4.0	3.5	1.9	(7.5)	6.3	4.4	3.2
Real imports (% y/y)	4.1	1.2	2.2	(6.8)	7.7	5.7	2.9
Real fixed investment (% y/y)	5.0	2.8	3.6	(6.4)	7.7	4.3	4.8
Real private consumption (% y/y)	1.6	0.9	1.2	(12.0)	8.1	6.8	2.6
Real government consumption (% y/y)	1.5	0.8	1.3	2.8	1.0	0.6	0.6
CPI inflation (% y/y)	1.2	2.1	1.3	0.7	1.2	1.5	1.5
Unemployment rate (%)	9.4	9.1	8.5	9.5	9.7	9.1	8.7
Short term interest rate (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long term interest rate (%)	0.8	0.8	0.1	0.0	(0.1)	0.1	0.3
Exchange rate ($ per €)	1.1	1.2	1.1	1.1	1.1	1.1	1.1

F--S&P Global Ratings Research forecast. y/y--Year on year. Source: Oxford Economics.

spglobal.com/ratings