Scope Ratings

Spanish banks quarterly

Better than expected sector profitability amid shifting competitive dynamics

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Related research

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Spanish banks' better-than-expected profitability continued to be driven by record net interest income (NII) in the first quarter as the higher cost of deposits looks to have reached its peak. But the competitive dynamics could shift following BBVA's hostile bid for Banco de Sabadell.

The operating environment in Spain remains supportive for banks as the domestic economy is expected to outperform much of Europe in 2024. Scope expects the Spanish economy to grow by 1.8% this year, above the country's medium-run growth potential and outpacing growth in the euro area. But a downturn among Spain's trading partners could set growth back while a longer-than-expected period of higher interest rates could crimp domestic demand.

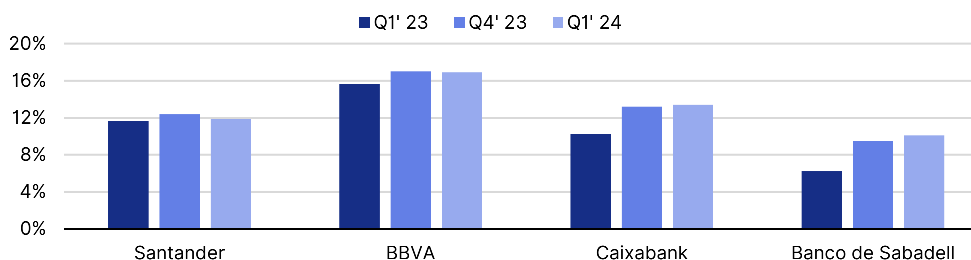
Spanish bank profitability is normalising from its 2023 peak but remains robust, primarily supported by NII. Q1 results were stable or lower than in previous quarters but the RoE of our bank sample remained above 10%. We expect most banks to maintain double-digit returns in 2024.

Deposits grew in Q1 from the same period last year, reaching levels similar those at end-2022. Household and corporate deposits continued to grow in Q1 as well as YoY, although these were primarily time deposits, implying a higher cost therefore reducing margins and profitability.

Capital levels remain adequate. The introduction of a 1% Countercyclical Capital Buffer (CCyB) for domestic exposures in October 2026 will most impact banks with a higher component of credit exposure in Spain (Caixabank and Banco de Sabadell).

BBVA's tender offer for Banco de Sabadell highlights the attractive risk-return opportunities in Spain's banking sector. If successful, this merger would create a larger player with better pricing power and ability to easily deploy capital, potentially changing the competitive landscape.

Figure 1: Spanish banks' RoE



Source: Banks' financial data, Scope Ratings.

Expected 2024 trends for Spanish banks		
Profitability	Stable, high net interest margins continue to offset higher costs	→
Asset quality	Mildly negative, financial pressure on corporates and households	↘
Funding & Liquidity	Stable, deposits are growing and liquidity is strong	→
Capital	Stable, introduction of 1% CCyB will not have a material effect	→

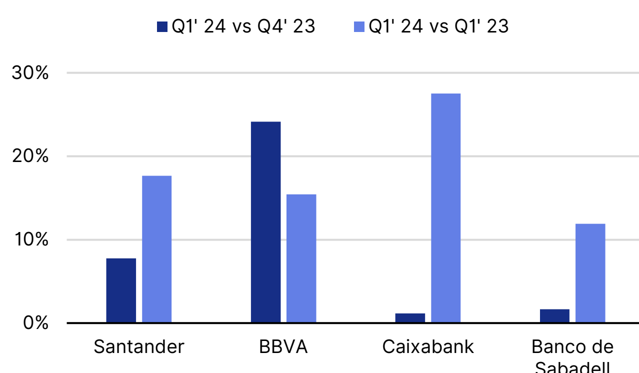
Profitability still robust, net interest margin still at the highest range

RoE continues to be supported by high net interest margins.

Spanish banks had a better-than-expected start to 2024. Our sample of banks (BBVA, Santander, Sabadell and Caixabank) achieved an average return on equity (ROE) of 13.1% in the first quarter of 2024. Even taking into account the effect of the temporary tax levy paid in Q1 against revenues generated in Spain in 2023, results still improved, as the cost of deposits stabilised, allowing margins to remain at their highest levels for the last 12 months for most banks.

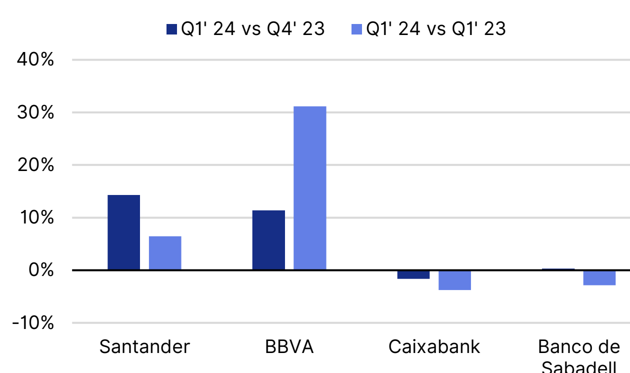
The repricing of assets following interest-rate hikes continues to be the largest contributor to NII, but fee and commission income is starting to recover QoQ, supported mainly by payments and income from wealth management products. We expect fees and commissions to show further growth in Q2 and Q3, as the positive economic scenario and seasonality from higher consumption will help banks with a higher retail component to generate additional income.

Figure 2: Net interest income, quarterly comparison



Source: Company data, Scope Ratings

Figure 3: Net fees and commissions, quarterly comparison



Source: Company data, Scope Ratings

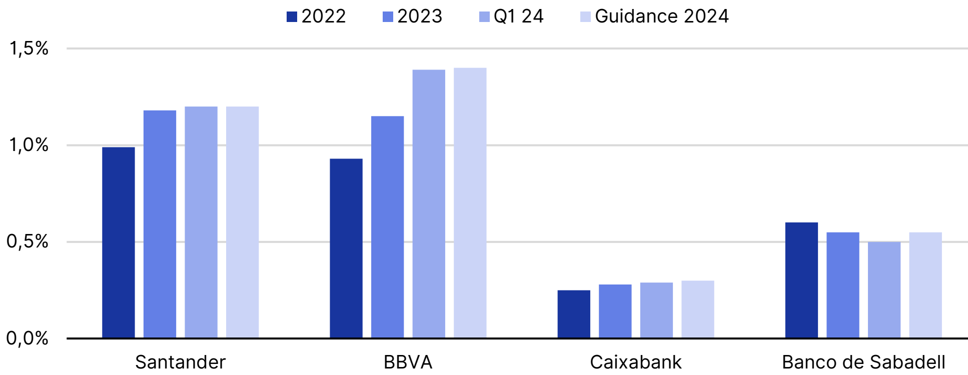
We expect NII to stabilise in the second quarter, remaining at levels similar to Q1, as some loan repricing (mostly on commercial loans) has yet to materialise. But we expect limited or no growth QoQ as the interest-rate scenario remains unchanged until the beginning of Q3, at which point we expect inflation dynamics to show signs of easing.

Cost-to-income improving consistently for all banks

Efficiency ratios at all four banks in our sample continued to improve in the first quarter, ranging from 39% to 43% (compared to 40%-45% in Q4 2023) due to the significant effects of a larger revenue base and to restructuring measures that have lightened cost structures. The effects of salary increases and inflation on suppliers' costs has been well absorbed, and we expect this trend to remain favourable for 2024 as banks' cost-to-income ratios remain aligned with their targets.

Cost of risk increased slightly in Q1 2024 vs Q4 2023 for almost all banks but is aligned with 2024 guidance. Higher volumes of retail and consumer loans as well as signs of deterioration in some economic sectors demonstrate that after years of steady decreases in cost of risk, a normalised average across the cycle is starting to materialise. However, for now the differences in loan portfolio composition and geographical diversification are the main drivers for the different levels of cost of risk evidence in our sample of Spanish banks.

Figure 4: Cost of risk (bp)



Source: Banks' financial data, Scope Ratings.

Windfall tax remains manageable, but has increased for all banks.

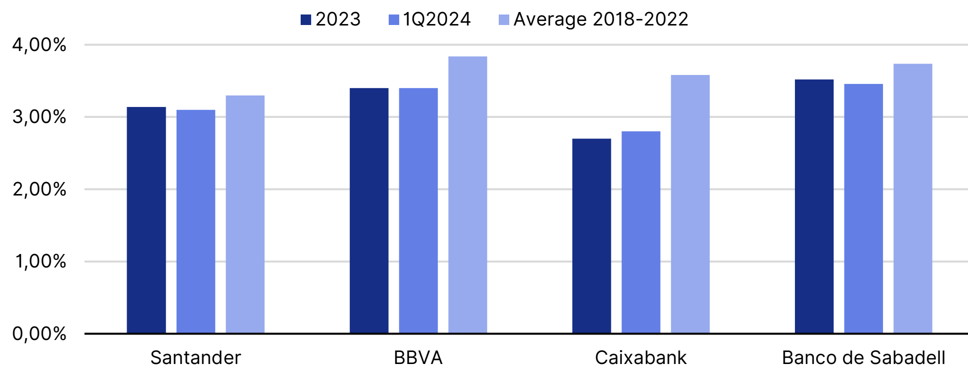
The impact of the windfall tax on banks' profits has been manageable. Due to strong results in 2023, the levy was higher for all banks, increasing YoY in a range of 20% to 50%. The impact was marginal for BBVA and Santander, as it represented just 3% and 4% of their net profits in 2023, respectively. 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, the payments represented 10%-15% of their 2023 net profits. We expect a normalisation of net interest income in 2024, so the windfall tax expected for 2024 should be similar to 2023.

Asset quality stable; NPLs below the 2019-22 average

NPL ratios for all four banks are contained, supported by the better-than-expected performance of commercial loan and mortgage portfolios. Caixabank's NPL ratio increased by 10bp QoQ in both mortgages and commercial loans but NPL ratios for all banks in our sample remain largely below the 2019-2022 average.

Stage 2 loans remain relatively stable, with levels below 10% for our sample. There is no significant variation between banks: the highest is BBVA (8.7%) and the lowest is Banco de Sabadell (7.21%).

Figure 5: Asset quality, NPL ratios



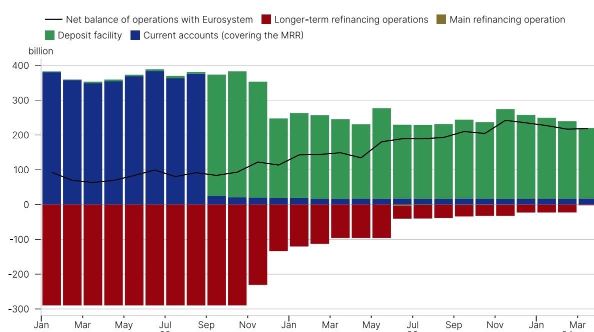
Source: Banks' financial data, Scope Ratings.

Funding profiles remain solid, as repayment of TLTRO III was completed and deposits continue to grow

Spanish banks repaid almost all their TLTRO III funds to the ECB in the first quarter, with little impact on liquidity ratios. The outstanding amount at consolidated sector level is now just EUR 2bn, far from the maximum of EUR 290bn reached in 2021. None of the four banks in our sample has any outstanding TLTROs as they entirely repaid them in Q1 24.

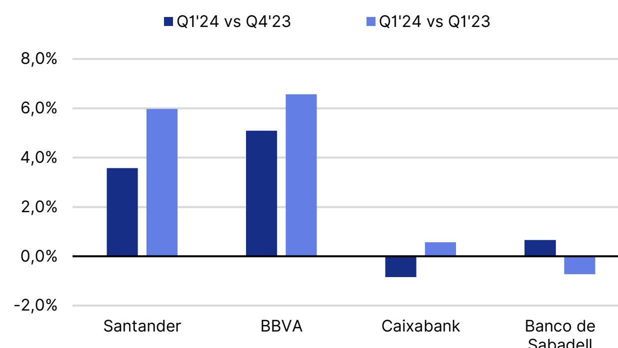
Household and corporate deposits continued to grow in QoQ and YoY for most of the banks, confirming the trend that started in Q3 2023 as banks accelerated the pass-through of policy rates to time deposits. This has pushed the deposit base back to levels close to YE 2022, albeit with the negative impact on net interest margins as the inflow in deposits continues to be more tilted to time deposits. The proportion of time deposits to total deposits has grown significantly for all banks but stabilised in Q1 at between 15%-30%, compared to 10%-25% in Q1 2023.

Figure 6: Spanish banks – Net position with the Eurosystem



Source: ECB, Macrobond, Scope Ratings

Figure 7: Deposits in Spain QoQ



Source: ECB, Scope Ratings

Capital remains adequate, introduction of CCyB reduces existing headroom

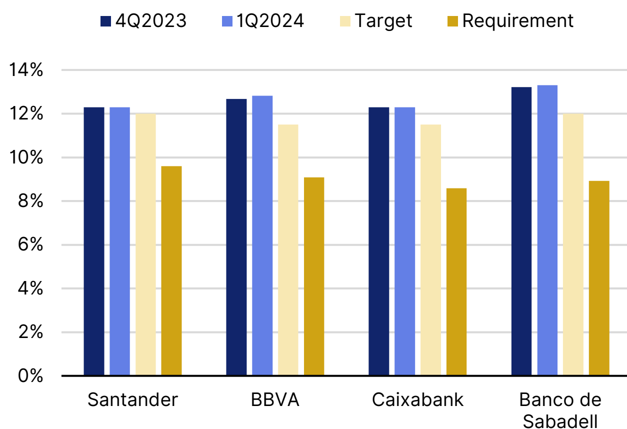
In line with the more proactive approach to macroprudential policies by European authorities, the Bank of Spain proposed[1] a 1% countercyclical capital buffer (CCyB) on domestic private-sector exposures from October 2026, with an interim requirement of 0.5% from 1st October 2025. The change from a 0% CCyB confirmed in March 2024 is down to a revision of the framework, which now incorporates activation of the CCyB under a standard (intermediate) level of systemic risk compared to the previous approach based on a faster build-up under a higher level of cyclical systemic risk. This is set to strengthen the banking sector's resilience in economic downturns, as the current economic scenario is allowing banks to significantly improve their capital generation capacities.

The incorporation of a higher CCyB will reduce existing headroom, with a larger effect on banks with a higher component of domestic exposure (Caixabank and Banco de Sabadell). Santander and BBVA's credit exposure to the Spanish market is much lower, at around 20%-35% of RWAs. But the higher CCyB requirement is expected to be well managed by all four banks considering their existing buffers as well as the ability to generate more organic capital under the current baseline scenario of positive bottom-line performance.

[1] Announcement made on 16 May 2024, consultation open to the public until 13 June 2024.

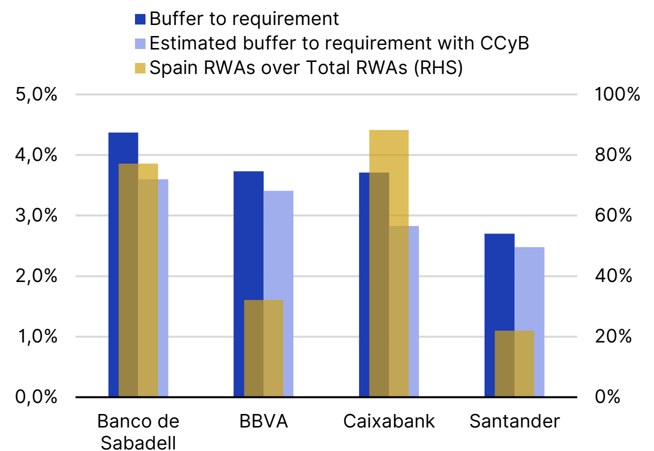
We expect payouts of 50%-60% to continue and to be balanced out by organic capital generation. CET 1 ratios should remain stable in 2024. We do not expect changes to management targets as all four banks have indicated a stabilisation of profits for 2024. That said, our view that Spanish banks maintain an adequate level of capital remains intact, even though it is still below the average of EU peers, reflecting differences in business models and asset-risk intensity.

Figure 8: CET 1, target and requirements



Source: Company data, Scope Ratings

Figure 9: Buffer to requirement, estimated including CCyB



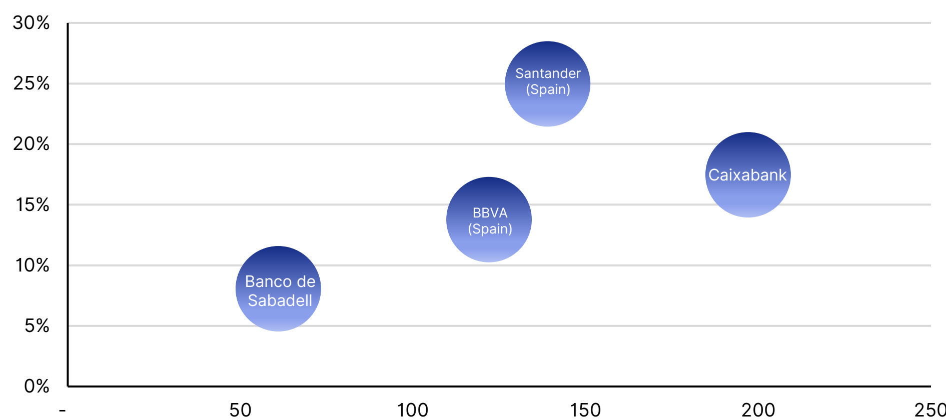
Note: Estimated buffer to requirement, Scope Ratings calculations based on Q4 and Q1 RWAs exposure per country. Source: Company data, Scope Ratings.

Changing competitive dynamics, more sector consolidation is possible

Further sector consolidation to increase scale, improve pricing power and reduce operational costs is on the cards for Spanish banks. The restructuring and downsizing process that several banks implemented after the global financial crisis has left the sector better positioned in terms of operating capacity. But the large number of smaller entities with a more regional focus remains a challenge, both for larger players seeking organic growth and smaller challengers facing tough competitive dynamics.

BBVA's tender offer for Banco de Sabadell will reshape sector dynamics.

Figure 10: Market share and RWAs (EUR bn), Spanish assets and loans only



Note: RWAs available data, market share estimated by Scope. Source: Banks financial data, Scope Ratings.

BBVA’s takeover offer for Banco de Sabadell highlights the positive momentum that the Spanish economy is providing for the banking sector (Scope affirms Spain’s credit ratings at A-, revises the Outlook to Positive), with growth prospects and attractive risk-return opportunities for commercial and retail banking.

The proposed takeover presents several strategic business model advantages, including stronger pricing power, a more comprehensive domestic franchise combining BBVA’s strength in retail with Sabadell’s SME focus, and opportunities for cost synergies from overlapping distribution networks. A larger banking group, if the deal goes ahead, will allow BBVA to close the gap with the historic leader in Spain, Santander group, but will leave a barbelled banking sector, with three universal banking giants controlling close to 65% of the market (Santander, BBVA, Caixabank) alongside a number of smaller institutions with a regional focus but which are still relevant in their respective niche segments.

However, the takeover is far from a done deal. The process is expected to take six to eight months. Risks to the deal come from the initial opposition to the offer by Sabadell’s board, based on what it sees as greater stand-alone potential and its dismissal of the valuation proposed. BBVA not only needs to obtain regulatory approvals but also to convince Sabadell’s shareholders. Apart from the strategic advantages that the merger could offer, it is also clear that customers will also have a say, as retaining customers is always a challenge during such processes.

For Sabadell, continuing on its own is an option, considering the improvement in profitability evidenced not only in its Spanish operation but also in the UK, with TSB Bank, its retail and consumer banking subsidiary. Sabadell’s challenge comes from opportunities to grow at a faster pace and to maintain its leadership in its regional market while the operating environment becomes more dynamic.

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