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Research Update:

Spain-Based Bankia 'BBB/A-2' Ratings Affirmed Amid COVID-19 Risks; Outlook Remains Stable

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Overview

- Despite governments' measures to contain the COVID-19 pandemic, European economies, including Spain, face an unprecedented challenge ahead.
- We anticipate mounting pressure on Bankia's already feeble profitability, but its capital buffer is wide enough to ensure the bank copes with the economic shocks and remains adequately capitalized, in our view, even if economic risks intensify.
- We are therefore affirming our 'BBB/A-2' issuer credit ratings on Bankia and the 'BBB-/A-3' ratings on its nonoperating parent holding company, BFA Tenedora de Acciones.
- The outlook remains stable, balancing our view that Bankia's earnings and credit quality will deteriorate amid COVID-19's severe economic shock, resulting in very modest bottom-line, with our expectation that the bank will maintain adequate capitalization.

Rating Action

On April 29, 2020, S&P Global Ratings affirmed its 'BBB/A-2' long- and short-term issuer credit ratings on Spain-based Bankia S.A. The outlook remains stable.

At the same time, we affirmed our 'BBB-/A-3' long- and short-term issuer credit ratings on Bankia's parent company, BFA Tenedora de Acciones, S.A.U.

Rationale

Our rating action takes into account the much more challenging economic environment that Spanish banks will face over the next couple of years. This led us to revise to negative from stable our economic risk trend under our Banking Industry Country Risk Assessment for Spain.

In addition to the human cost, the COVID-19 pandemic has caused large parts of economic activity in Spain to grind to a halt. With isolation strategies still very much in force (Spain is heading for a two-month lockdown), our economists expect a sharp economic contraction in the second quarter of 2020, followed by a rebound starting in the third quarter. However, they are now more cautious on the strength of recovery through end-2020 and into 2021, envisaging that GDP in Spain will contract by 8.8% in 2020 and expand by 5.1% in 2021. It will take time for some sectors that are relevant for the Spanish economy, such as tourism, to recover, while the comparatively higher share of temporary workers in Spain will probably lead to a greater increase in numbers of unemployed compared with other countries. Indeed, we are forecasting unemployment to increase to 16.4% by end-2020, from 14.1% in 2019, and barely changing in 2021. The Spanish private sector faces this economic shock with significantly lower debt levels than in the past, the real estate market shows no sign of imbalances, and banks have largely worked out their legacy problematic assets from the previous recession, although their remaining nonperforming assets are still higher than those of other European countries.

Authorities have also delivered unprecedented policy responses in the form of monetary, fiscal, and regulatory support to their economies, and their measures will help to contain, although not fully avoid, the damage.

The affirmation of the ratings on Bankia reflects our belief that, despite mounting pressure on the bank's already feeble profitability, Bankia will be able to preserve its current capitalization through the downturn. In particular, we now project that Bankia's operating revenues will decline by more than 7% this year, before recovering slightly in 2021. In addition, we anticipate that its cost of risk will hike to about 60 basis points (bps), versus a reported 25 bps in 2019, excluding extraordinary provisions. This is lower than what we anticipate for many of Bankia's peers, but factors in Bankia's significant weight of mortgages--which represented 61% of its total loans at end-2019--and well-seasoned portfolio. Overall, we expect that the bank's return on equity before minorities will remain below 3% this year and next, improving somewhat in 2022.

Positively, in our view, Bankia's capital buffer is ample enough to support the bank's resilience to the economic shocks and remain at adequate levels, even if economic risks in Spain rise. A potential reassessment of economic risk in Spain to '5', from '4' currently, would translate to a deduction of around 110 bps from Bankia's risk-adjusted capital (RAC), as adjusted by S&P Global Ratings. We also expect that the bank will continue to build up its additional loss-absorbing capacity (ALAC) buffer, which we expect to account for around 4.5% of risk-weighted assets (RWAs) by end-2021. That said, such a buffer would also decline by somewhat more than 100 bps under heightened economic risks in the country.

Outlook

The stable outlook on Bankia reflects our expectation that there will be a sharp economic contraction in 2020 associated with the COVID-19 pandemic, and only a partial rebound in 2021. Although we assume Bankia's earnings and asset quality will consequently buckle over the next 18-24 months, we believe the bank will remain adequately capitalized. In particular, we anticipate that Bankia's RAC ratio will stand at about 8.75%-9.25% over the next two years, while the bank continues advancing the build-up of its additional loss-absorbing instruments. The stable outlook also incorporates our assumption that there will be an economic rebound from the second half of 2020 and throughout 2021. This, teamed with the authorities' support measures, should help limit the potential credit constraints. As such, we believe that Bankia will be able to defend its solid banking franchise in Spain and a balanced funding structure.

Under our stable outlook, we also assume Bankia will not undergo changes in management or strategic direction. The bank remains ultimately owned by the Spanish government through the Fund for Orderly Bank Resolution (FROB). The deadline for privatization is year-end 2021, although we believe it could be extended if needed, as in the past.

We could lower the ratings if we observed a further and more severe deterioration in economic and operating conditions, and greater-than-currently-anticipated pressure on Bankia's earnings or asset quality. Although not our base case, we could also lower the ratings if Bankia's capitalization erodes significantly, such that its RAC ratio falls sustainably below 7%.

Although unlikely in the current context, we could raise our ratings if Bankia builds an ALAC buffer above 5% of RWAs, while sustaining its risk profile within manageable levels.

The stable outlook on the holding company, BFA Tenedora de Acciones S.A.U., mirrors that on the group's operating entity, Bankia, as we expect the ratings on both the operating and holding company to move in tandem.

Ratings Score Snapshot

Bankia S.A.

Issuer Credit Rating	BBB/Stable/A-2
SACP	bbb
Anchor	bbb
Business Position	Adequate (0)
Capital and Earnings	Adequate (0)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

SACP--Stand-alone credit profile. ALAC--Additional loss-absorbing capacity. GRE--Government-related entities.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- How COVID-19 Risks Prompted European Bank Rating Actions, April 29, 2020
- Outlooks Revised To Negative On Several Spanish Banks On Deepening COVID-19 Downside Risks, April 29, 2020
- Coronavirus Impact: Key Takeaways From Our Articles, April 28, 2020
- Credit Conditions In Europe Darken As Costs Of Lockdowns Add Up, April 27, 2020
- Europe’s AT1 Market Faces The COVID-19 Test: Bend, Not Break, April 22, 2020
- How COVID-19 Is Affecting Bank Ratings, April 22, 2020
- Europe Braces For A Deeper Recession In 2020, April 20, 2020
- European Banks' First-Quarter Results: Many COVID-19 Questions, Few Conclusive Answers, April 1, 2020
- COVID-19: The Steepening Cost To The Eurozone And U.K. Economies, March 26, 2020
- Full Analysis: Spain, March 20, 2020
- Full Analysis: Bankia S.A., Dec 10, 2019