FINANCIAL TIMES

May 17, 2012 7:08 pm

22

Two tiers, one crisis for Spanish banks

By Patrick Jenkins and Miles Johnson

Who is right – the International Monetary Fund or the market? Until a couple of weeks ago, nervous investors had ignored the IMF's recent assessment that about 70 per cent of Spain's banks looked essentially healthy and instead had sent all bank shares tumbling by about 40 per cent on the previous year.

Only over the past week have investors really begun to discriminate, following Bankia's part-nationalisation and the government requirement that all banks boost their loan loss provisioning by about €30bn.

Click to enlarge

Santander's shares, the best performing, are down only 4 per cent over the past 10 days; Bankia's, the worst, have slumped 42 per cent.

Finally, say analysts, the market is drawing a clear line between strong and weak, distinguishing between the management and lending standards of the "Big Three" – Santander, BBVA and La Caixa – and some of Spain's sicklier cajas or savings banks, which were often run by politicians with little understanding of modern banking.

"The larger Spanish banks have international business, access to greater resources, especially funding and capital, and their toxic and legacy Spanish positions are a relatively minor problem for them," says Justin Jenk, a partner at European Resolution Capital Partners, an advisory group working with Spanish government agencies, commercial banks and investors on bank restructuring and asset resolution programmes.

Mr Jenk says the Big Three are able to liquidate toxic property assets at lower prices than their smaller rivals without it significantly damaging their earnings.

"These larger banks are under pressure from their international shareholders to do the right thing and liquidate unnecessary assets," he says. "The smaller domestic banks have to contend with the clearing prices for disposals being set by their bigger rivals."

La Caixa, soon to become Spain's largest domestic bank following its merger with Banca Cívica, has managed to pull away from other Spain-focused lenders to be seen to sit alongside Santander and BBVA as a result of its size, efficiency and profitability.

Yet La Caixa, which listed its banking operations last year as Caixabank, lacks the international diversification of the other two large banks, meaning it is stuck with a powerful branch franchise in a market mired in recession. This weakness, however, is seen by analysts as a threat more to La Caixa's profitability than to its solvency and stability.

"The problem of La Caixa is that the profitability of its branch network in Spain is low – but that is not a question of risk in the short term, but more of the equity story of the bank," says one equity sales banker.

Some other smaller Spanish banks, such as Basque savings bank BBK and Bankinter, are seen as relatively healthy, too, thanks to their respected management teams, lower real estate exposure and prudent lending compared with some peers. Yet they also lack scale in a consolidating market.

Profitability and balance sheet data support the anecdotal views. First-quarter net profits at Santander and BBVA – at €1.6bn and €1bn respectively – were more than 10 times greater than their nearest rival, La Caixa, as the cost of topping up provisioning took its toll.

Capital looks solid across the board. Of the half-dozen listed banks, all bar one – Sabadell – have core tier-one ratios, a key measure of capital strength, above 10 per cent, putting them towards the top end of banks globally.

But the concern is that, with non-performing loan rates running at close to 8 per cent at Bankia and at a still elevated 4 per cent at Santander and BBVA, Spanish losses could eat into those capital reserves.

On top of the woes caused by disastrous property developer loans, the Spanish recession and unemployment, now nudging 25 per cent, risk triggering new loan losses in the domestic mortgage market.

The Spanish authorities say their two-phase bank reform package, launched in February and built on last week, adds €82bn of fresh loan loss coverage to a previous allotment of €55bn, and that 45 per cent of the overall €307bn of property developer loans have now been written down.

Critics make two points – that losses in Ireland in many cases ate up more than half of overall exposures, so even topped-up provisioning may still not be enough, especially at the smaller, more loss-prone lenders; and that a large chunk of coverage – 15-20 per cent – is provided for in the form of a capital buffer, rather than fresh provisions, in effect just carving out an element of existing capital and undoing the benefit of banks being relatively well capitalised.

Banks must now try to raise the necessary finance to cover the new provisioning requirements – and may need to do more once BlackRock and Oliver Wyman complete their independent assessment of banks' loans.

- While Santander and BBVA are expected to be able to use profit generation to bridge the gap, others have a bigger challenge – again reinforcing Spain's two-tier banking system.

The danger for big banks, though, is that if the Spanish government is forced to bail out weaker banks to such a degree that the sustainability of government debt is imperilled, then it will come back to haunt the likes of Santander and BBVA, too.

They, after all, have been some of the biggest buyers of government debt in the wake of the European Central Bank's €1tn longer-term refinancing operation liquidity infusions.

Printed from: http://www.ft.com/cms/s/0/19ce9880-a03f-11e1-90f3-00144feabdc0.html

Print a single copy of this article for personal use. Contact us if you wish to print more to distribute to others.

© **THE FINANCIAL TIMES LTD 2012** FT and 'Financial Times' are trademarks of The Financial Times Ltd.