Commentary

Greek Banks: H122 Shows Improved Credit Fundamentals, but Momentum Likely to Decelerate due to Slowing Economy

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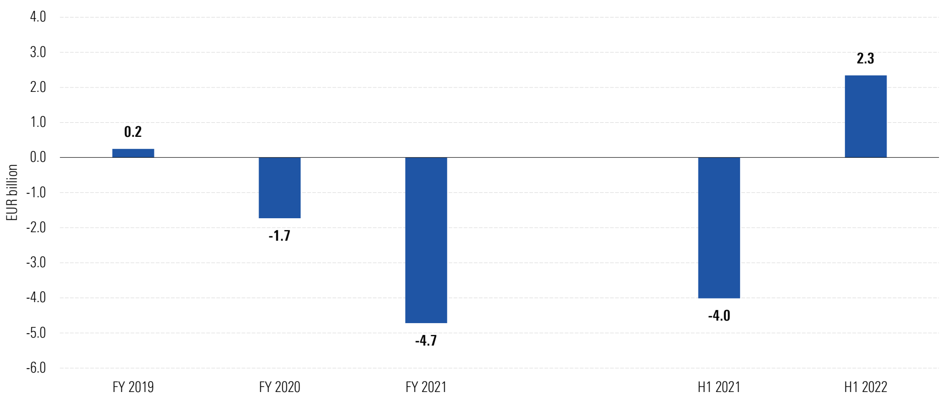
Overview

Large Greek banks (Alpha Bank, Eurobank, National Bank of Greece, and Piraeus) reported aggregate net profit of EUR 2.3 billion in H1 2022 which compares to a net loss of EUR 4 billion in the same period of 2021 (Exhibit 1). The improvement was driven by higher revenues, lower operating expenses and reduced credit costs which are a testament to the significant progress made around de-risking and restructuring in recent years along with recovery in the Greek economy from the COVID-19 global pandemic.

Revenues held up well despite continued pressure on net interest income (NII) due to de-risking, supported by net fees, trading and other income. In H1 2022, credit demand recovered markedly in the corporate sector and we expect growth to continue going forward, although potentially curbed by higher interest rates. Overall, the increase in the ECB's reference interest rate in July as well as further hikes expected in the coming months to counteract high inflation, should boost Greek banks' NII due to a faster repricing of assets compared to liabilities.

In H1 2022, loan loss provisions and cost of risk reduced significantly, thanks to the strong improvement in risk profile. While the indirect negative effects due to Russia's invasion of Ukraine might contribute to a slowdown in the economy and add pressure on credit quality in the medium-term, our view is that cost of risk will remain below the very high level experienced in recent years but above the European average as Greek banks' risk profiles still compare unfavourably by international standards. However, asset quality metrics continued to improve in H1 2022, supported by negative Non-Performing Exposure (NPE) formation and new loan originations exceeding expectations.

Exhibit 1 Aggregate Net Income (2019-H1 2022)



Source: DBRS Morningstar, Company Documents.

After being severely affected by accelerated de-risking in 2020 and 2021, banks' capital levels started to recover in H1 2022, supported organically and inorganically. With most of the planned loan clean-up process already absorbed, we view Greek banks' capitalisation as set to benefit from improved internal capital generation going forward, on the back of higher revenues in the context of progressively higher interest rates and sound new loan generation, as well as reduced credit costs.

Revenues Holding Up Despite NII Pressure Due to De-Risking

In H1 2022, total revenues more than doubled YoY (Exhibit 2), driven by net fees and other income which, however, included a sizeable negative one-off associated with NPE securitisations in H1 2021. Total revenues would have gone up 16% YoY in H1 2022 excluding this one-off, supported by net fees, trading and other income. Core revenues (net interest income or NII and net fees) were down 5% YoY in H1 2022 as higher net fees did not compensate for the pressure on NII (Exhibit 3).

In H1 2022, aggregate NII was down 12% YoY, as the positive contribution from growth in performing loans and bond portfolios was more than offset by forgone NII due to de-risking. Credit demand recovered markedly in the corporate sector, benefiting from a continued rebound in business activities in Greece, whereas it remains subdued in the retail segment. We believe that loan demand could continue to grow going forward also fuelled by the Recovery and Resilience Facility (RRF) funds, however the hike in interest rates might somehow curb this trend. The 50 bps increase in the ECB's reference rate in July as well as further hikes expected in the coming months to counteract high inflation, should boost Greek banks' NII due to a faster repricing of assets compared to liabilities. As a result, some Greek banks revised upwards their guidance for revenues in FY 2022, on the back of higher rates and new loan volumes above expectations.

In H1 2022, net fees were up 20% YoY, underpinned by payment, card and lending activities, which more than offset the negative impact in investment and asset management due to heightened volatility connected with geopolitical tensions. We see room for Greek banks to improve their revenue mix towards fee income businesses, and this will depend on their franchise strength.

Exhibit 2 Aggregate Total and Core Revenues (2019-H1 2022)

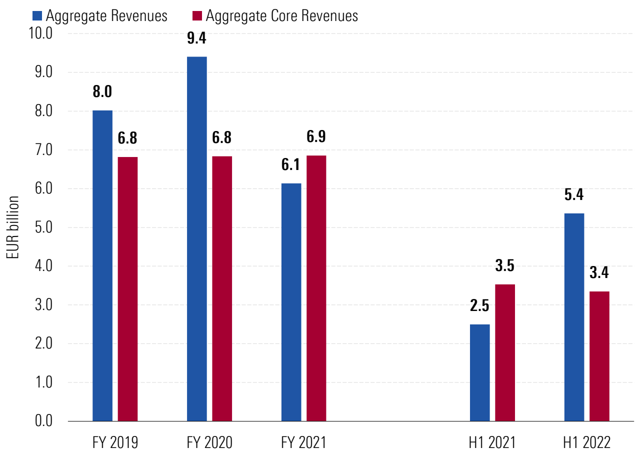
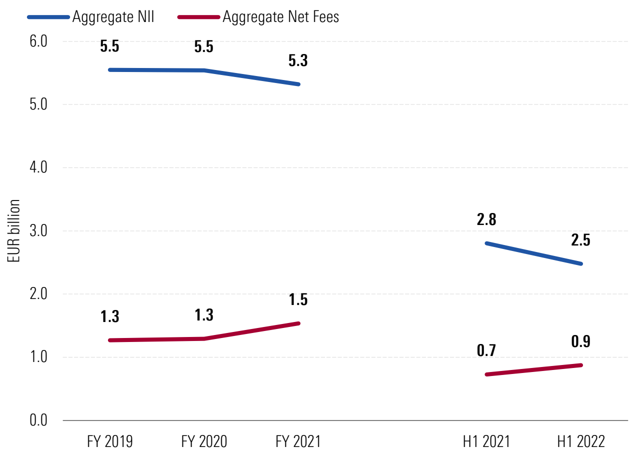


Exhibit 3 Aggregate NII and Net Fees (2019-H1 2022)



Source: DBRS Morningstar, Company Documents. Note: core revenues include net interest income (NII) and net fees.

Operating costs were down 11% YoY in H1 2022, reflecting benefits from recent restructuring, while the average cost-to-income ratio stood at a strong 35%, although this included sizeable trading gains which we do not expect to be repeated. In our view, investments to support digitalisation and business strategies, as well as inflationary pressure will likely absorb a significant portion of further cost savings expected from ongoing efficiency actions.

LLPs and CoR Down on Massive Improvement in Risk Profile

In H1 2022, loan loss provisions (LLPs) were down 74% YoY, thanks to the strong improvement in risk profile achieved recently (Exhibit 4). While Greek banks should continue with their further planned de-risking actions, also benefiting from the Hellenic Asset Protection Scheme (HAPS) which will remain in place until October 2022, we expect additional LLPs to materialise as inflationary pressure and higher energy price affect households' disposable income and corporates' cost structures. However, Greece's relatively moderate reliance on Russian gas, the fiscal support expected for more vulnerable customers, and the good profitability levels recently reported by corporates, also supported by strong momentum in tourism, represent mitigating factors to the vulnerability of the Greek economy and its banking sector to the challenging operating environment.

The average annualised cost of risk (CoR) remained at a very high level of 145 bps in H1 2022, although significantly reduced compared to 394 bps in 2020 and 459 bps in 2021, and below the pre-pandemic level of 184 bps in 2019 (Exhibit 5). Cost of risk is likely to remain above the European average in the short-term as Greek banks' risk profiles still compare unfavourably by international standards, however we expect it to continue decreasing as banks continue to de-risk. While the indirect negative effects due to Russia's invasion of Ukraine might contribute to a slowdown in the economy and add pressure on credit quality in the medium-term, our view is that cost of risk will remain below the very high level experienced in recent years.

Exhibit 4 Aggregate LLPs (2019-H1 2022)

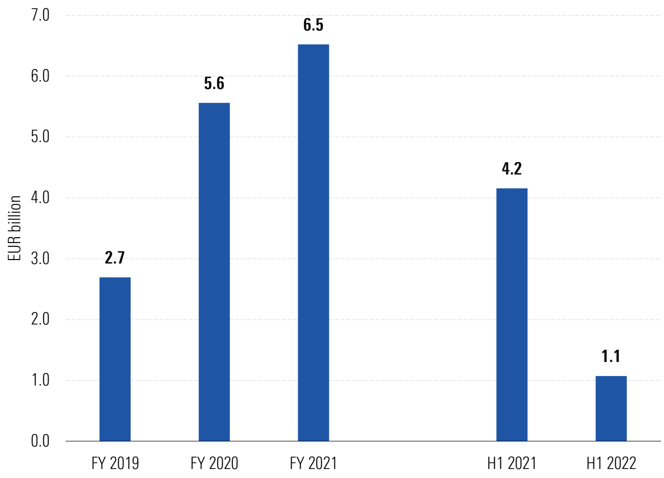
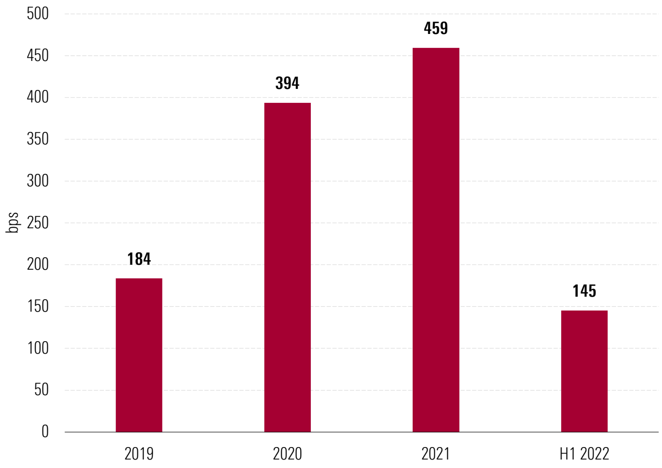


Exhibit 5 Average Annualised Cost of Risk (2019-H1 2022)



Source: DBRS Morningstar, Company Documents.

De-Risking Continues, Driven by Negative NPE Formation and New Loan Originations Above Expectations

NPE formation remained negative in H1 2022 despite the expiry of support measures activated to alleviate the impact due to COVID-19, including debt moratoriums, the government-subsidised "Bridge" programme on retail and corporate mortgage repayment ("Gefyra 1" and "Gefyra 2"), and bank-specific step-up solutions. Asset quality deterioration has been significantly lower than initial expectations to date, and it has been more than offset by NPE cures, repayments and sales.

Greek banks' asset quality metrics continued to improve in H1 2022, with the average gross and net NPE ratios falling to 7.2% and 3.3% respectively as of end-June 2022 from 10% and 4.9% at end-2021 (Exhibit 6). The cumulative reduction in the stock of gross NPEs since end-2019 reached a sizeable -84% as of end-June 2022, and it was mainly achieved inorganically, leveraging off the HAPS scheme for NPE securitisations. The improvement in H1 2022 was also driven by growth in the loan book, supported by sustained new disbursements, up 52% YoY in H1 2022 (Exhibit 7). New loans were primarily related to the corporate sector, especially manufacturing, infrastructure, hospitality, and energy. Thanks to new loan originations exceeding expectations, we note that some banks revised upwards their guidance for net credit expansion in FY 2022.

Our view is that de-risking should continue in the Greek banking sector going forward although at a slower pace considering the huge progress achieved so far. In addition, we expect new NPE inflows to materialise due to the slowdown envisaged in the operating environment as a result of indirect implications connected with Russia's invasion of Ukraine. Nonetheless, asset quality metrics should gradually converge to the European average, incorporating higher and better quality new loans.

Exhibit 6 Average Gross and Net NPE Ratios (2019-H1 2022)

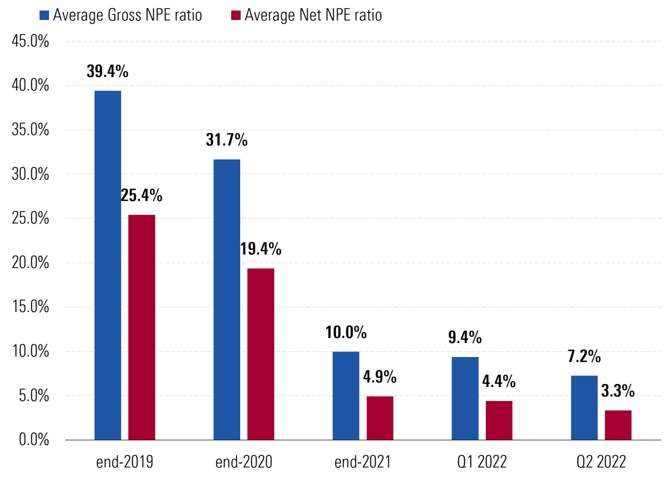
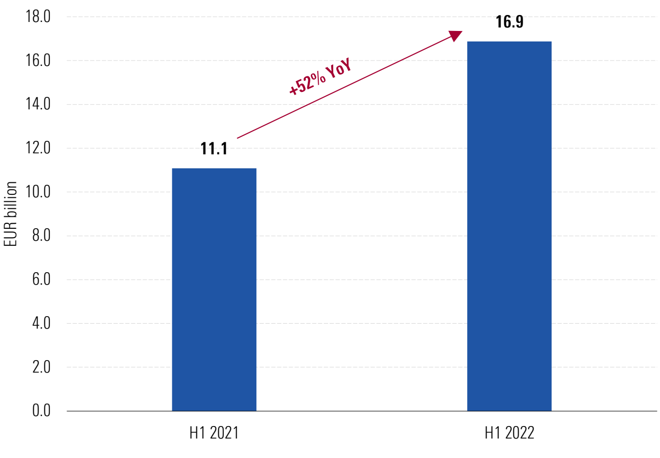


Exhibit 7 New Loan Volumes in Greece (H1 2021-H1 2022)



Source: DBRS Morningstar, Company Documents.

Capitalisation Set to Benefit From Improved Internal Capital Generation

After being severely impacted by accelerated de-risking in 2020 and 2021, capitalisation started to regain ground in H1 2022 with the average CET1 ratio, fully loaded, reaching 12.6% as of end-June 2022, up from 12% at end-2021 although remaining below the reported level of 13.6% at end-2019. As a result, the average CET1 cushion over the minimum requirement strengthened by 50 bps to over 300 bps in H1 2022, excluding the ECB's flexible regime on capital ratios which will end in 2023. The improvement in H1 2022 was achieved organically and inorganically through the disposal of non-core assets and other capital management actions. This allowed Greek banks to absorb the negative impact on their capitalisation due to the recent widening in the Greek sovereign spread. The reclassification of the vast majority of Greek sovereign bond holdings to amortised cost (AC), however, limits the sensitivity of Greek banks' capital ratios to a rise in sovereign spreads.

With most of the planned loan clean-up process already absorbed, we view Greek banks' capitalisation as set to benefit from improved internal capital generation going forward, on the back of higher revenue generation in the context of progressively higher interest rates and sound new loan generation, as well as reduced credit costs. As such, we note that some Greek banks revised upwards their guidance for capital ratios at end-2022, while also confirming their intention to resume dividend payments in 2023-2024 albeit moderately.

Related Research

- Potential Stoppage of Russian Gas to Europe - Ongoing Impact from Russia's Invasion of Ukraine on European Banks, 28 April 2022.
- ESG Factors for Banks, Part Three: Social Factors, 11 April 2022.
- Greek Banks: 2021 Driven by De-Risking; Growth Opportunity Ahead, but Geopolitical Tensions Add Uncertainty, 23 March 2022.
- DBRS Morningstar Upgrades the Hellenic Republic to BB (high), Trend Changed to Stable, 18 March 2022.
- European Banks' Direct Exposure to Russia and Ukraine Is Manageable, But Risks Have Increased, 16 March 2022.
- European Banks' Exposure to Potential Russia-Ukraine Conflict, 2 February 2022.
- European Banks: Rating Outlook Stable for 2022, 27 January 2022.
- ESG Factors for Banks, Part Two: Governance Factors, 19 October 2021.
- DBRS Morningstar Upgrades the Hellenic Republic to BB, Trend Changed to Positive, 17 September 2021.

Notes:

All figures in Euros unless otherwise noted.

Sources: Company Documents. For Alpha Bank, Eurobank, and Piraeus, data refer to the consolidated financial statements of Alpha Services and Holdings S.A., Eurobank Ergasias Services and Holdings S.A., and Piraeus Financial Holdings S.A. respectively.

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