Commentary

Greek Banks: Improved Operating Performance and Risk Profile Support Further Strengthening in Capitalisation in H1 2023

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Overview

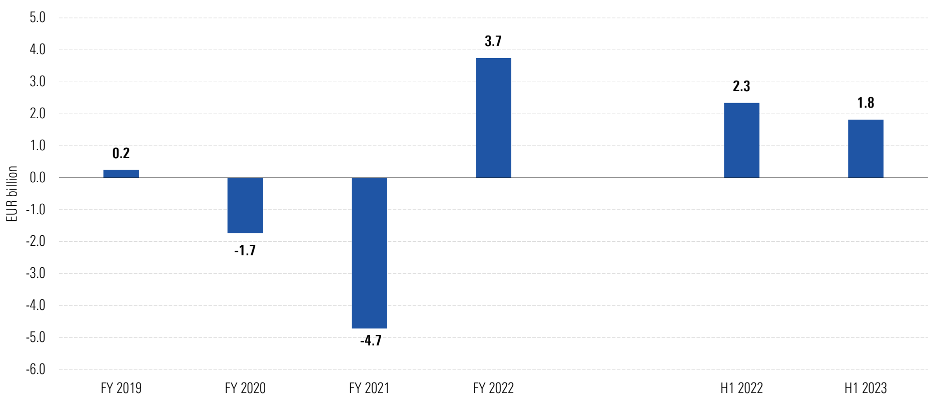
Large Greek banks (Alpha Bank, Eurobank, National Bank of Greece, and Piraeus) reported an aggregate net profit of EUR 1.8 billion in H1 2023 (Exhibit 1), down 22% Year-On-Year (YOY), although H1 2022 included sizeable positive one-off items attributable to trading and other income. Higher core revenues, cost control and lower credit costs supported results in H1 2023.

Revenues in H1 2023 have seen a strong increase in net interest income (NII), with banks benefitting from the rapid hike in interest rates despite lower new loan volumes, as well as higher net fees although to a lesser extent. We expect NII to decelerate in coming quarters, reflecting our view of a slowdown in the tightening of the European Central Bank's (ECB) monetary policy, as well as the likely increase in funding costs, and the introduction since May 2023 of an interest rate cap on performing domestic retail mortgages. Operating efficiency remained strong.

In H1 2023, the annualised cost of risk (CoR) was in line with 2022 but below the very high levels of the recent past. We see CoR to likely increase from the level in H1 2023 reflecting higher asset quality risks. Nonetheless, asset quality has continued to improve in H1 2023, thanks to low new non-performing loan inflows and de-risking, and despite lower new loan volumes.

Ample and sticky deposit bases have enabled Greek banks to keep a comfortable liquidity position despite TLTRO III repayments. Deposits are shifting towards more rewarding solutions although less than initial expectations. Sustained organic capital generation in H1 2023 has strengthened capitalisation, however the quality of capital remains relatively weak. The EBA 2023 Stress Test results indicated a better performance of Greek banks compared to the European average.

Exhibit 1 Aggregate Net Income



Source: DBRS Morningstar, Company Documents.

Higher Core Revenues and Strong Operating Efficiency Support Recurring Operating Profits

In H1 2023, total revenues were down 4% YOY (Exhibit 2), however H1 2022 included sizeable non-recurring trading profits and other income. Core revenues (NII and net fees) were up 45% YOY in H1 2023, mainly supported by higher NII and, to a lesser extent, net fees.

In H1 2023, aggregate NII was up 60% YOY (Exhibit 3), with banks benefitting from the rapid hike in interest rates despite some slowdown in new loan volumes. While most of the rate increases have been passed-through to customer loan rates, this has occurred to a lesser extent to customer deposit rates. We expect NII growth to decelerate in coming quarters, reflecting our view of a slowdown in the tightening of the ECB monetary policy, as well as the likely increase in funding costs, including deposits and wholesale. The evolution of loan volumes coupled with the pace of the customer shift towards more rewarding deposit solutions remains key to assess the impact on net interest margin (NIM) going forward. Also, in order to alleviate the pressure due to the higher cost of borrowing, for twelve months starting in May 2023 the largest Greek banks have implemented an interest rate cap based on the Euribor level at end-March 2023 minus 20 bps on performing domestic retail mortgages. This will cost some interest income benefit, however it will likely mitigate the negative impact on asset quality. Moreover, the contribution to NII from the mandatory reserve held at the central bank will be removed from September 2023 following a recent policy change.

In H1 2023, net fees were up 4% YOY, mainly underpinned by transactional and lending activities. Nonetheless, the proportion of net fees remained at a moderate level of 17% of total revenues in H1 2023.

Operating costs were up 4% YOY in H1 2023, mainly affected by inflationary pressure, digital investments, and further restructuring costs. However, thanks to the benefits from the recent restructuring phase, the average cost-to-income ratio was at a strong 35% in H1 2023.

Exhibit 2 Aggregate Total Revenues and Core Revenues

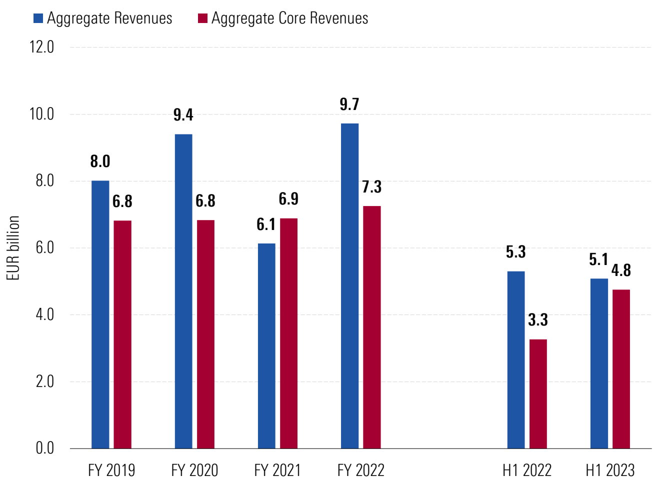
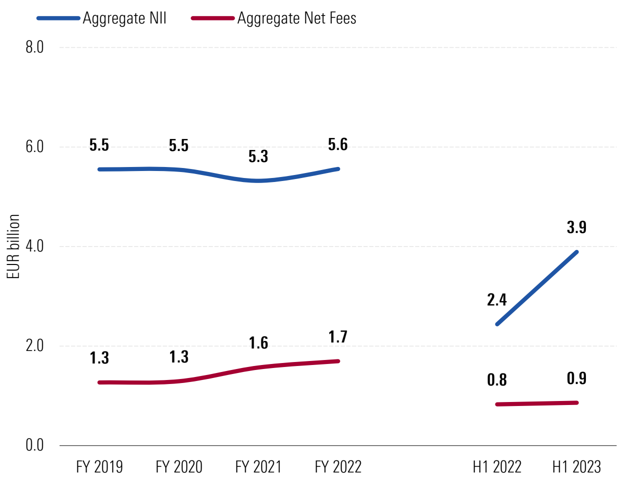


Exhibit 3 Aggregate NII and Net Fees



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

CoR Remains Below Recent Very High Levels Due to Benign Asset Quality Dynamics

In H1 2023, loan loss provisions (LLPs) were down 21% YOY (Exhibit 4), thanks to relatively benign asset quality dynamics and reflecting the recent improvement in risk profiles. While remaining significantly below the levels reported in 2019-2021 period, the average annualised cost of risk (CoR) stood at a very high 112 bps in H1 2023, broadly in line with 2022 and including provisions booked for additional de-risking (Exhibit 5).

Our view is that CoR in 2023 is likely to remain above the European average as Greek banks' asset quality profiles still compare relatively unfavourably despite the significant improvements. Also, we see CoR to likely increase from the level reported in H1 2023, reflecting the expected deterioration in asset quality mainly due to higher interest rates and high inflation. Nonetheless, at this stage we do not foresee CoR to reach the very high levels reported prior to 2022. We also note that economic performance in Greece has been largely better than the European average so far, and we expect this trend to potentially continue in the short-to-medium term.

Exhibit 4 Aggregate LLPs

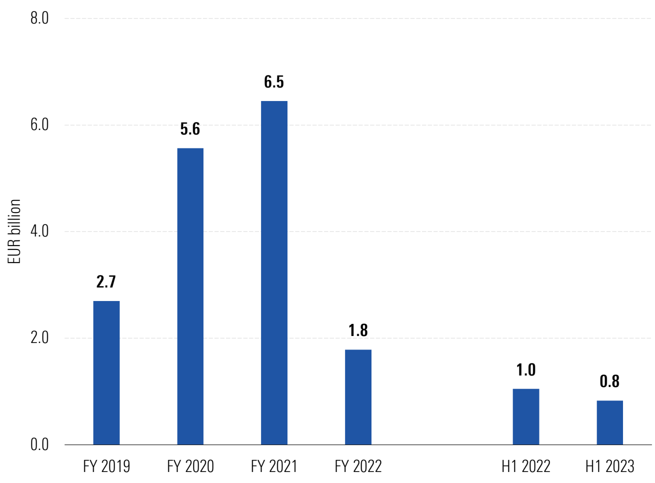
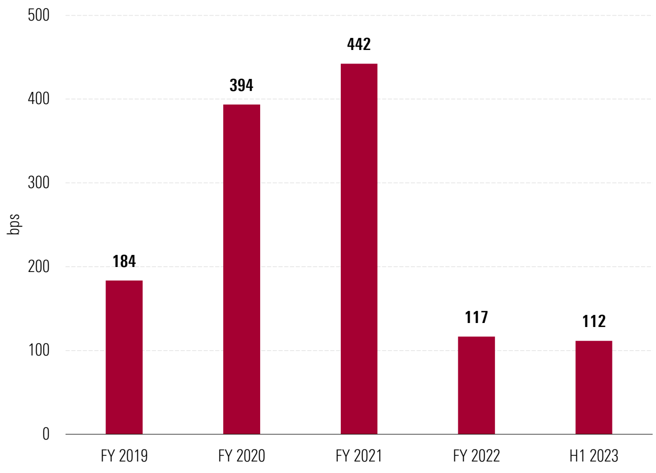


Exhibit 5 Average Cost of Risk



Source: DBRS Morningstar, Company Documents.

Improved Asset Quality Amidst Low Pick Ups in NPE Inflows, and Despite Lower New Loans

Notwithstanding some pick up in new non-performing exposure (NPE) formation in Q2 2023 and a slowdown in new loan generation in H1 2023, Greek banks' asset quality profile has continued to improve, driven by organic workout activities as well as inorganic actions. As a result, the average gross and net NPE ratios fell to 5.8% and 2.4% respectively as of end-June 2023 from 6.2% and 2.6% at end-2022 (Exhibit 6). The average NPE coverage level, based on total allowances, stood at an adequate 60% at end-June 2023, broadly in line with the level at end-2022. The cumulative reduction in the stock of gross NPEs from 2019 to end-June 2023 reached a sizeable 87%, mainly achieved inorganically, leveraging off the Hellenic Asset Protection Scheme (HAPS).

We note that new loan volumes in Greece slowed down in H1 2023 with a decrease of around 2% YOY (Exhibit 7). This is mainly the result of higher interest rates and high inflation which have reduced flexibility for new mortgage demand as well as triggered higher loan repayments by corporates with high liquidity cushions. Nonetheless, banks foresee a recovery in new disbursements in H2 2023, mainly resulting from a pipeline of corporate projects connected with the development of the country and EU Recovery and Resilience Facility (RRF) funds. This, along with continued de-risking, should help mitigate the expected deterioration in asset quality.

Exhibit 6 Average Gross and Net NPE Ratios

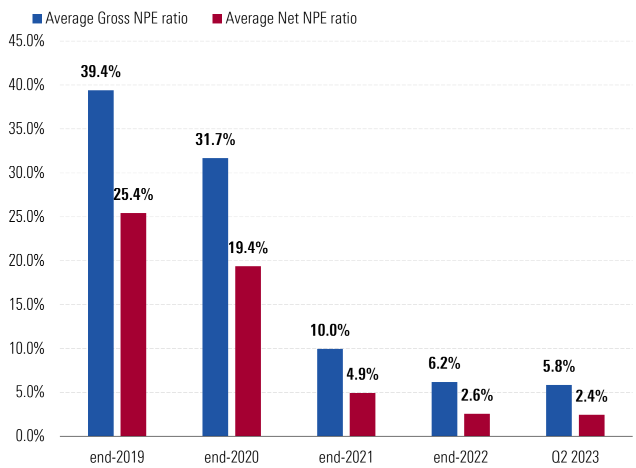
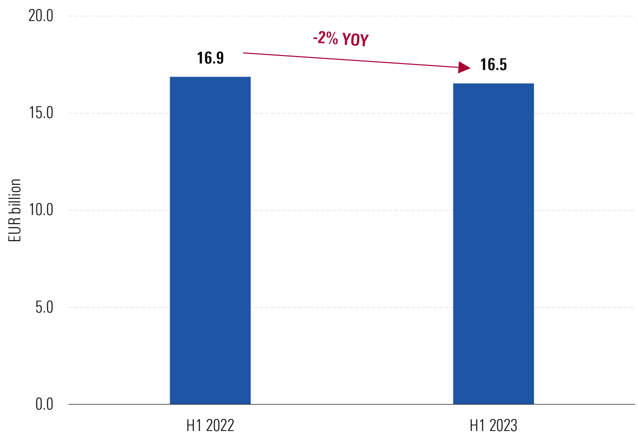


Exhibit 7 New Loan Volumes in Greece



Source: DBRS Morningstar, Company Documents.

Sticky, Albeit Slightly More Costly, Deposits Keep Sector's Liquidity at Comfortable Levels

Greek banks are mostly funded via deposits. Customer deposits were around 85% of total funding at end-June 2023, mostly raised from granular and typically sticky retail clients. After some outflows occurred in Q1 2023, mostly driven by liquidity usage by corporates, deposits recovered in Q2 2023 and ultimately were unchanged at end-June 2023 compared to end-2022, and 26% above the level at end-2019 (Exhibit 8). The proportion of time deposits has increased since end-2022, with customers searching for solutions with higher remuneration (Exhibit 9). However, the 25% share of time deposits at end-June 2023 still remains lower than banks' initial expectations which, in turn, has contributed to keep deposit betas at moderate levels.

Exhibit 8 Aggregate Customer Deposits

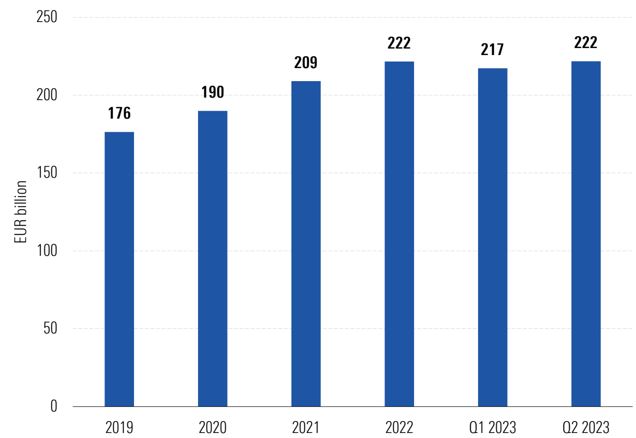
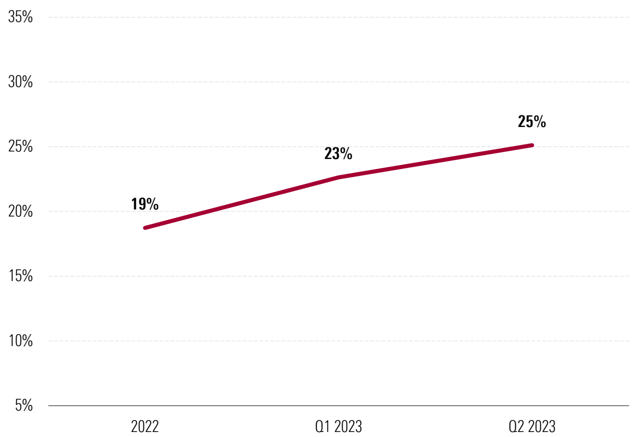


Exhibit 9 Time Deposits as % of Total Deposits



Source: DBRS Morningstar, Company Documents.

ECB funding is the second main funding source for Greek Banks, accounting for around 8% of total at end-June 2023. Greek banks had around EUR 20 billion of outstanding ECB funding at end-June 2023, mostly consisting of TLTRO III, down 60% since early November 2022 following early repayments and maturities. The outstanding ECB funding of Greek banks represented around 3% of the total Eurosystem (Exhibit 10). Notwithstanding the TLTRO III repayments, the sector's liquidity position remained sound at end-June 2023 with an average Liquidity Coverage Ratio (LCR) above 200%, an average Net Stable Funding Ratio (NSFR) of around 130%, and an average Loan-to-Deposit ratio of 68% (Exhibit 11).

Debt securities issued accounted for just 4% of Greek banks' funding at end-June 2023 although our expectation is that banks will likely issue more in coming years to meet the MREL final regulatory requirements by end-2025. However, issuances might be lower than initial expectations considering the recent good levels of organic capital generation.

Exhibit 10 ECB Funding - Greece vs Total Eurosystem

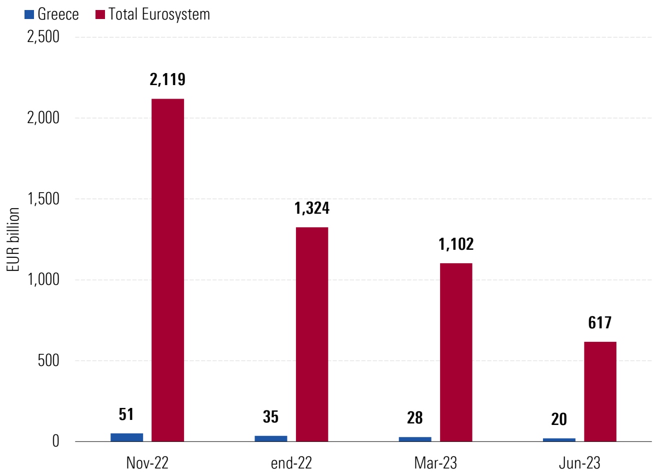
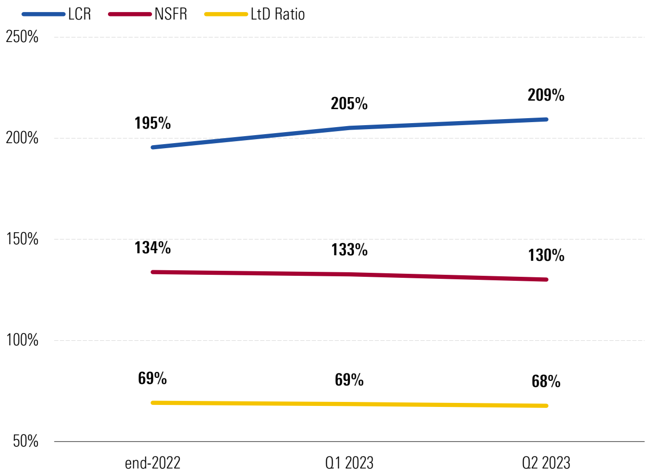


Exhibit 11 Average LCR, NSFR, LtD Ratio

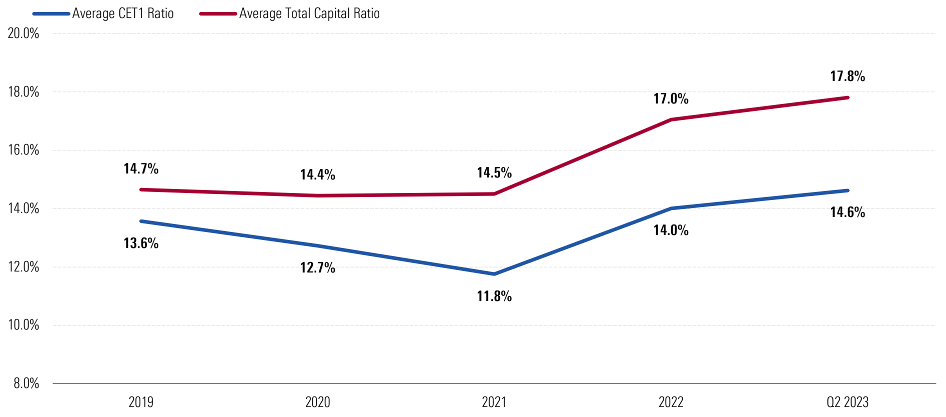


Source: DBRS Morningstar, Company Documents, ECB.

Capitalisation Up on Sustained Organic Generation

The accelerated de-risking significantly affected Greek banks' capitalisation in 2020 and 2021, however the sector's capital position has strengthened since then. At end-June 2023, the average fully loaded CET1 ratio was 14.6% whereas the average fully loaded Total Capital ratio was 17.8%, up from 11.8% and 14.5% at end-2021 (Exhibit 12). This level of capital ratios ensures satisfactory average buffers of around 480 bps and 320 bps respectively for CET1 and Total Capital ratios over the 2023 minimum requirements. However, the quality of capital remains relatively weak with deferred tax credits (DTC) representing around 62% of CET1 Capital as of end-June 2023. On the back of the recent sustained organic capital generation, Greek banks are starting dialogues with regulators to resume dividend payments from 2024.

Exhibit 12 Average CET1 and Total Capital Ratios (Fully Loaded)



Source: DBRS Morningstar, Company Documents.

The EBA 2023 Stress Test indicated better results for Greek banks than for European peers in both the baseline and adverse scenarios. Capital accretion for the fully loaded CET1 ratio in the baseline scenario was around 360 bps in 2025 for the Greek sample, compared to the European average of 136 bps (Exhibit 13). In the adverse scenario, the average level of capital depletion was approximately 228 bps for Greek banks, compared to 459 bps across Europe. The favourable comparison with the European average was also confirmed with regards to the fully loaded leverage ratio, with a negative impact of around 93 bps in 2025 in the adverse scenario, lower than 110 bps for Europe (Exhibit 14).

Exhibit 13 EBA 2023 Stress Test - FL CET1 Ratio (Greece vs Europe)

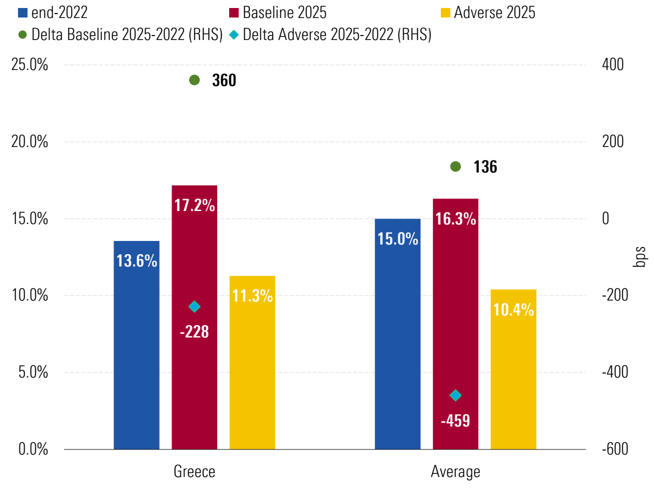
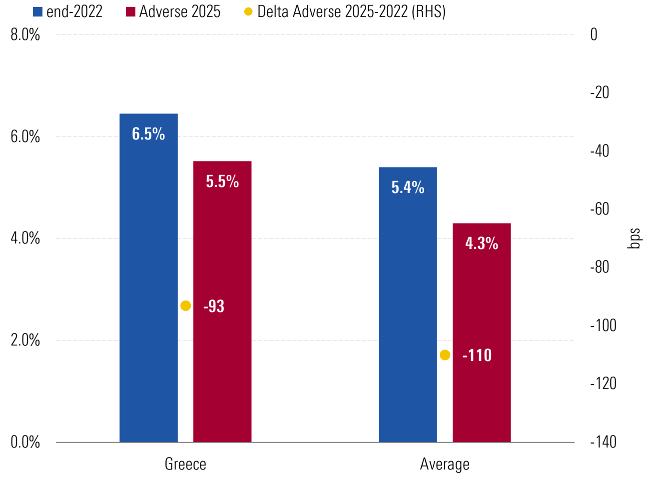


Exhibit 14 EBA 2023 Stress Test - FL Leverage Ratio (Greece vs Europe)



Source: DBRS Morningstar, EBA 2023 Stress Test. Note: fully loaded (FL).

Related Research

- EU Banks Proved Resilient in the 2023 EBA Stress Test, 7 August 2023.
- Forthcoming 2023 EBA Stress Test – Unique Scenario, Unique Results?, 24 July 2023.
- Can EU Banks Maintain Deposit Rates at Current Levels? A Test for European Banks' Structural Profitability, 20 June 2023.
- European Banks' Cost of Risk Remained Low In 2022; But With Signs of Deterioration, 20 April 2023.
- Greek Banks: Positive Revenues Momentum and Cleaner Balance Sheets Drive FY22 Results; Funding Profiles are Solid, 21 March 2023.
- EU Banking Sector: Risks from Unrealised Losses Appear Manageable, but Challenges Remain, 17 March 2023.
- DBRS Morningstar Confirms the Hellenic Republic at BB (high), Stable Trend, 10 March 2023.
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- European CRE: FIG and CMBS Analysis Indicates Risks are Rising, 19 January 2023.
- European Bank 2023 Outlook: Higher Rates Will Help in Navigating Weaker Economies, 16 January 2023.
- ECB Requires European Banks to Step Up Climate-Related Risk Management Practices, 9 November 2022.
- European Banks Face an Increase in Residential Mortgage Risks as Interest Rates Rise, 8 November 2022.
- Growth in European Banks' Stage 2 Loans Poses Risks Amid Weakening Economic Outlook, 12 October 2022.
- European Banks' Exposure to China, Hong Kong, Taiwan: a Snapshot, 11 October 2022.
- Gender Diversity on European Bank Boards: More Work Still to be Done, 20 September 2022.
- DBRS Morningstar Confirms the Hellenic Republic at BB (high), Stable Trend, 16 September 2022.

Notes:

All figures in Euros unless otherwise noted.

Sources: Company Documents, ECB, EBA. 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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