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Two Belgian Bank Outlooks Revised To Stable On Economic Recovery As Pandemic-Related Problem Loans Loom

June 24, 2021

- Belgium's macroeconomic recovery on the back of unprecedented government support, the European Central Bank's ample monetary policy support, and ongoing vaccination rollout are improving prospects for domestic banks.
- Consequently, we estimate that risks to asset quality and banks' capitalization are receding, even though defaults of small and midsize enterprises (SMEs) and larger corporates are likely to increase as government support schemes are phased out.
- We therefore now see the economic risk trend in Belgium as stable and have revised our outlooks on KBC Group and Crelan to stable from negative.
- Our outlook on Belfius Bank remains stable although we now see less pressure on its stand-alone credit profile.
- We did not review Argenta Spaarbank since the outlook was already stable and not sensitive to the economic risk trend. Similarly, we did not review AXA Bank Belgium, since the rating is on CreditWatch negative due to a pending deal with Crelan.

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PARIS (S&P Global Ratings) June 24, 2020--S&P Global Ratings today took rating actions on Belgium-based KBC Group, Belfius Bank N.V., and Crelan S.A. and their respective subsidiaries (see Ratings list below).

Webinar: S&P Global Ratings will be hosting a live webinar on June 29, 2021 (9:00 a.m. EDT; 2:00 p.m. BST; 3:00 p.m. CEST) to discuss our views on European Banks. For more details, please visit:

https://event.on24.com/wcc/r/3252634/C509A2EA04B74CFC5B846E025A448F8D?partnerref=GMR

Rationale

The ongoing economic recovery underpins our rating actions, despite some uncertainty on its pace and potential future defaults of SMEs and corporates. Belgium's economy has proved resilient to the unprecedented COVID-19-related shock, with a real GDP contraction of 6.3% in 2020, less than our previous estimate. Although the pandemic continued to weigh on activity at the beginning of the year, we anticipate the economy will rebound by 4.0%-4.5% yearly over 2021-2022, underpinned by household consumption as restrictions to control the virus are lifted and vaccinations ramp up in Belgium and across Europe. However, risks from new variants of the virus or a slower-than-expected vaccine rollout could hamper the recovery. We estimate that unemployment peaking at close to 6% in the coming months, versus 5.4% before the pandemic, will not harm banks' retail portfolios. Moreover, we now expect corporate defaults to peak at a lower level than in our previous forecasts.

In addition, we now estimate the likely increase in credit losses and future nonperforming loans (NPLs) to be manageable for Belgian banks. Local banks have shown resilience to the pandemic's economic impact, thanks to their healthy capitalization and robust liquidity profiles owing to residents' large savings. Banks posted decent profitability in the European context despite having to increase provisions for future NPLs. We estimate banks' provisions in 2020 amounted to 47 basis points (bps) of the loan book. This is lower than the 55 bps we forecast a year ago but provides a good buffer to cover future defaults. Importantly, a large portion of these provisions is on performing portfolios through management layers, in anticipation of deterioration of loan quality in the coming quarters as government support schemes are gradually phased out. Given the pandemic's economic impact, NPLs will increase in the coming months, particularly in sectors most affected by lockdowns and suffering from changes in customers' consumption patterns. We estimate the most affected sectors represent around 5% of the SME and corporate lending books, or 2.5% of systemwide loans including households, which seems manageable. Moreover, loans under moratoria total below €5 billion according to the latest available figures, compared with more than €26 billion at their peak, and we understand the majority of borrowers exiting this scheme are repaying according to the original schedules. Regarding guaranteed loans, their uptake has been extremely low so far, which underscores local companies' capital and liquidity management before the pandemic. As a result, we project new loan provisions will be lower this year and next, at 20 bps-30 bps, and therefore now regard the economic risk trend in Belgium as stable rather than negative.

We consider the Belgian banking industry better positioned than those in other large markets such as France or Germany, but not immune to profitability challenges. Unlike in neighboring countries, pressure on lending margins in Belgium diminished a few years ago and market discipline has continued. Still, with interest rates staying lower for longer, the flat yield curve, and savings piling up on banks' balance sheets, net interest income will remain squeezed until treasury portfolios are fully repriced at current rates. Banks' prevalent universal model only partly offsets this through increasing fee income from insurance and asset-management products. Further efficiency improvements will therefore be key for banks to maintain profitability. This won't be an easy task, however, given still rising regulatory and IT development costs; so we anticipate that efforts to rein in personnel costs and general expenses will continue. All in all, we estimate that most banks' profitability should recover to prepandemic levels in the next two years, at best, but only be enough to cover their cost of capital. Moreover, given the concentrated market, with four large players, we estimate that scale will matter for retail banks as they cope with fixed costs, as shown by the ongoing deal between Crelan and AXA Bank Belgium. Consequently, we foresee a widening gap between the creditworthiness of large banks and small players unable to find a profitable niche business model.

KBC Group

Primary Analyst: Philippe Raposo

With its diversified and efficient business model and good geographic diversification, KBC is well positioned to benefit from the global economic recovery, in our view. We therefore revised our outlook on the holding company KBC Group N.V. and the insurance subsidiaries to stable from negative. Our outlooks on KBC's bank operating companies were already stable on the back of a comfortable additional loss-absorbing capacity (ALAC) buffer protecting senior creditors.

KBC's resilience is underpinned by its ability to maintain a favorable cost-to-income ratio during the pandemic: 57.9% in 2020 versus 56.3% in 2018 and 2019. KBC also posted a still reasonable return on average common equity of 7.4% in 2020 while adequately provisioning for future defaults on its large SME and corporate loan books. We expect KBC's net profit to rebound once new credit loss provisions recede to 25 bps-30 bps in the next few years.

Net interest income will remain under pressure in the low-interest-rate environment, with some potential upside from rate increases in Czech Republic. However, fee income should recover swiftly, and we see prospects for further strengthening over the medium term. Strong capitalization, with our risk-adjusted capital (RAC) ratio forecast at close to 12% over the next two years, and a historically sound funding and liquidity profile, support our view of the group's 'a' stand-alone credit profile (SACP).

Outlook

The stable outlooks on all KBC group entities, including insurance, reflect our estimates that the group will remain efficient and profitable in the next two years. Moreover, we estimate that credit loss provisions adequately capture future corporate and SME defaults in the group's markets. We expect the group to display strong and resilient earnings as it leverages its efficient bank-insurance operating model involving the sale of insurance and asset-management products to bank customers, which should help alleviate pressure from the low-interest-rate environment.

Downside scenario: We could lower the ratings if we were to revise downward our assessment of the group SACP, which could happen if the group departed from prudent capital management or its growth were more aggressive than we expect, organically or via acquisitions. We could also lower the ratings if credit losses over our two-year outlook horizon are significantly greater than we currently assume and lead us to change our assessment of the group's risk profile.

Our ratings on the core banking operating companies KBC Bank NV and its Czech subsidiary Ceskoslovenska Obchodni Banka A.S. include the assumption that ALAC will continue to support senior creditors. Although unlikely, in an alternative downside scenario for these entities, we would lower the ratings on the banks if the bailinable ALAC buffer fell short of 5.25% of our risk-weighted assets metric.

Upside scenario: We see a remote possibility that the group SACP will strengthen to 'a+' over the next two years, since that would require a more diverse business model or substantially lower risk exposure, which is constrained by growth in countries that carry higher risk than Belgium.

Belfius Bank SA/NV

Primary analyst: Anastasia Turdyeva

We believe Belgium's sound recovery prospects are easing the pressure on Belfius Bank's 'a-' SACP from the pandemic's economic impact. The bank's resilient performance over 2020, with the reported return on equity at 5.6% despite higher provisioning, positions it well to deliver on its 2025 strategy and return to prepandemic profitability over the next few years. We still anticipate pressure on net interest income as low interest rates persist, but expect it to be partly mitigated by lending growth and a gradual shift in exposures to corporates and SMEs from public-sector clients.

We expect some deterioration of asset quality, but view provisions set aside over 2020 as sufficient to cover potential losses once support measures start to wind down. Belfius Bank's solid capitalization, with our RAC ratio forecast at 10.5%-11.0% over the next two years, alongside stable funding and liquidity metrics, further support our decision to affirm our 'A-/A-2' ratings and maintain a stable outlook.

Outlook

The stable outlook reflects our view that the anticipated economic recovery in Belgium and Belfius Bank's bank-assurance model should support profitability and capitalization over the next two years.

Downside scenario: We see a downgrade as remote. However, we could lower the ratings if Belfius Bank departed from its current capital management policy. This could happen if the bank does not generate or retain enough earnings to mitigate a steep increase in risk-weighted assets, weakening its RAC ratio to well below 10%. We could also take a negative rating action if we saw a risk that the rebound we expect in profitability could be significantly hindered or delayed.

Upside scenario: We could consider raising the ratings if Belfius Bank's ALAC buffer increased substantially and sustainably above 5.0% of our risk-weighted assets metric. However, an upgrade would also depend on the bank further aligning its risk-adjusted profitability profile with that of its 'A' rated peers.

Crelan S.A.

Primary Analyst: François Monéger

We revised our outlook on Crelan to stable from negative since we believe risks from the difficult COVID-19-related operating environment have reduced, given the ongoing vaccination rollout, improving economic prospects, and the Belgian banking system's resilience so far. Despite some delays in receiving regulatory approvals, we assume Crelan's acquisition of AXA Bank Belgium (ABB) will take place in third-quarter 2021, leading to the creation of the fifth-largest banking group in Belgium.

Overall, our 'BBB+' long-term rating reflects our view of Crelan's low-risk retail-focused business model and leading franchise in the Belgian agriculture sector. Crelan enjoys recurring revenue. However, its scale and business diversification are limited compared with those of more diversified universal banks that dominate the Belgian market, and its profitability (and in particular efficiency) is weak.

With a RAC ratio above 10%, the group's capitalization is a rating strength. Regulators have asked Crelan to strengthen its balance sheet on closing the ABB acquisition, and start building its buffer to the minimum requirements for eligible liabilities shortly after, to comply with the regulatory requirements applicable in 2023. In view of this, and with the deal approaching completion, we are already factoring into our ratings one notch of uplift for ALAC support; this notch replaces the notch of positive adjustment for the transition toward building the ALAC buffer. We expect that, by the end of 2022, the group will have built up an ALAC ratio well above our 600 bps threshold for a one-notch uplift.

Outlook

The stable outlook reflects our view that, over the next two years, Crelan will focus on integrating ABB with a view to building up a stronger, more efficient franchise, while maintaining strong solvency and resilient asset-quality metrics. Although ABB's integration could create a retail group with relevant scale in the concentrated domestic market, we believe the process poses challenges, notably blending company cultures, two large branch networks, and information technology systems, while enhancing digital capabilities.

In addition, for the stable outlook we expect the group will issue more than €1 billion of Tier 2 and nonpreferred senior notes by the end of 2022, which will translate into an ALAC ratio that exceeds our 600 bps threshold for one notch of uplift for ALAC support.

Downside scenario: We could lower our rating if the integration of ABB posed substantial operating or business challenges that hinder the bank from turning around the profitability of its business model. While we do not consider it a likely scenario, we could downgrade Crelan if we saw a risk that the ABB transaction would eventually not go through, or if the group did not build its ALAC buffer in line with our expectations.

Upside scenario: We could consider raising our ratings on Crelan if the group increased its bailinable buffer and achieved our 1,000 bps threshold for a second notch of uplift for ALAC support. An upgrade would likely hinge on successful integration of ABB, subject to evidence that Crelan can derive material synergies and that the group can align its profitability and efficiency metrics with those of peers rated in the 'A' category.

BICRA Score Snapshot

Belgium

	To	From
BICRA Group	2	2
Economic Risk	2	2
Economic resilience	Low risk	Low risk
Economic imbalances	Low risk	Low risk
Credit risk in the economy	Low risk	Low risk
Economic risk trend	Stable	Negative
Industry Risk	3	3
Institutional framework	Intermediate risk	Intermediate risk
Competitive dynamics	Intermediate risk	Intermediate risk
Systemwide funding	Very low risk	Very low risk
Industry Risk Trend	Stable	Stable

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- 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: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Economic Outlook Europe Q3 2021: The Grand Reopening, June 24, 2021
- The European Speculative-Grade Corporate Default Rate Could Fall To 5.25% By March 2022, May 26, 2021
- Diverse Rating Actions On European Banks Highlight The Importance Of Robust Business Models To Long-Term Resilience, Feb. 26, 2021
- Capital Resilience Alone Won’t Stabilize European Bank Ratings In 2021, Feb. 3, 2021
- Low-For-Even-Longer Interest Rates Maintain Margin Pressure On European Banks, Feb. 2, 2021
- Lower And Later: The Shifting Horizon For Bank Credit Losses, Feb. 2, 2021
- Belgian Bank Crelan S.A. Assigned 'BBB+/A-2' Ratings; Outlook Negative, Dec. 21, 2020

Ratings List

************** **Belfius Bank SA/NV** **************		
Ratings Affirmed		
Belfius Bank SA/NV		
Issuer Credit Rating	A-/Stable/A-2	
Resolution Counterparty Rating	A/--/A-1	
**************** **CRELAN S.A.** ***************		
Ratings Affirmed		
CRELAN S.A.		
Resolution Counterparty Rating	A-/--/A-2	
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
CRELAN S.A.		
Issuer Credit Rating	BBB+/Stable/A-2	BBB+/Negative/A-2
*************** **KBC Group N.V.** ***************		
Ratings Affirmed		
KBC Bank N.V.		
Issuer Credit Rating	A+/Stable/A-1	
Resolution Counterparty Rating	AA-/--/A-1+	
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
KBC Group N.V.		
Issuer Credit Rating	A-/Stable/A-2	A-/Negative/A-2
KBC Insurance N.V.		
Issuer Credit Rating	A/Stable/--	A/Negative/--
Financial Strength Rating	A/Stable/--	A/Negative/--
KBC Group Re S.A.		
Issuer Credit Rating	A/Stable/--	A/Negative/--
Financial Strength Rating	A/Stable/--	A/Negative/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.