Outlooks Revised On Three Irish Banks On Deepening COVID-19 Downside Risks

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- Despite governments' measures to contain the COVID-19 pandemic, European economies, including Ireland, face an unprecedented challenge due to the global slowdown in economic activity and trade.
- We continue to expect Ireland's wide-ranging fiscal and related monetary measures to substantially mitigate this extraordinarily sharp, cyclical shock to the economy, and so also support the banking system in its key role as a conduit of fiscal and monetary support.
- Even under our base case of an economic recovery starting in third-quarter 2020, we expect Irish banks' earnings, asset quality, and in some cases, capitalization, to weaken meaningfully through year-end 2020 and into 2021.
- The revision of our outlooks to negative from stable for the country's largest banks reflects our view that downside risks for these banks' financial profiles remain substantial.
- We could take further negative rating actions if we expect the cyclical economic recovery to be substantially weaker or delayed, as this would imply a far more negative effect on banks' credit strengths. Actions could also follow idiosyncratic negative developments at individual banks.

DUBLIN (S&P Global Ratings) April 28, 2020--S&P Global Ratings today took various rating actions on Irish banks (see Ratings List below).

We affirmed all the ratings and revised the outlooks to negative from stable on:

- Allied Irish Banks PLC (AIB), its nonoperating holding company (NOHC) AIB Group PLC (AIB Group), and U.K.-based subsidiary AIB Group (UK) PLC;
- Bank of Ireland (BOI) and its NOHC Bank of Ireland Group PLC (BOIG); and
- Permanent TSB PLC (PTSB) and its NOHC Permanent TSB Group Holdings PLC (PTSB NOHC).

We affirmed the ratings and stable outlook on KBC Bank Ireland PLC.

Today's rating actions follow a review of several banking systems in Western Europe amid the COVID-19 pandemic and its unprecedented effects on economies. The Irish economy is small and open, making it vulnerable to economic cycles and external shocks, like the ones caused by the COVID-19 pandemic. We expect the Irish economy to contract in 2020 and recover only gradually starting from 2021. However, despite the anticipated recovery, we believe that there will be significant pressure on Irish banks' operating environment and earnings prospects over the next two-to-three years. Of course, we expect a rise in credit costs after years of provision recoveries. However, we are revising our Banking Industry Country Risk Assessment (BICRA) industry risk trend to negative (as opposed to the economic risk trend for most other systems) to reflect the heightened downside risk we see for Irish banks to generate structurally sound profitability, which is more acute than fundamental and prolonged economic weakness in the economy. Indeed, profitability is under increasing pressure due to a persistently high cost base as Irish banks continue investing into business transformation and digital capabilities, amid compressing interest margins and a lack of business diversity. Growth opportunities are modest and competition stiff given high industry concentration and the relatively small size of the domestic economy and bankable population. The rating actions we have taken reflect that we now see Irish banks' profitability remaining structurally low for at least the next two years with return on equity in the low single digits.

Until the start of March, Irish banks were fully engaged with the same two key themes that have been paramount in recent years--harmonizing balance sheet strength with solid investor returns, and identifying how to refine business and operating models in the face of the looming risks and opportunities of the digital era. For the short term at least, the COVID-19 pandemic has changed (almost) everything. In addition to the human cost, large parts of economic activity in Ireland and much of the rest of Europe have ground to a halt. With isolation strategies still very much in force, our economists expect a sharp economic contraction in second-quarter 2020, followed by a rebound starting in the third quarter. However, they are now more cautious on the strength of recovery through year-end 2020 and into 2021, envisaging a 5.5% real GDP contraction this year to be followed by 5.5% growth in 2021. Even under this base case, the effects of COVID-19 will be evident long after the crisis subsides.

Authorities have delivered unprecedented policy responses in the form of monetary, fiscal, and regulatory support to their economies. The better-capitalized, better-funded, more-liquid banks that have gradually emerged in Ireland since the global financial crisis have played an instrumental role as a conduit of the expansion of low cost credit to affected households and businesses. However, while we expect banks in Ireland and across Europe to remain resilient in the face of this short-term cyclical shock, we expect that it will have a meaningful impact on asset quality, revenue, profitability, and, potentially, capitalization. We expect very few of these negative trends to be strongly evident in Irish banks' first-quarter results, but consider that they would become increasingly evident through the course of 2020 and persist into 2021. Banks' asset quality will be key to this outcome.

We are acutely mindful that this base case remains subject to significant downside risks. Even under our economic base case, the policy responses taken in Ireland may not be completely successful in avoiding permanent economic damage later (see "Europe Braces For A Deeper Recession In 2020," published April 20, 2020 on RatingsDirect). We note also that a significant component of the fiscal support package comprises additional indebtedness--for the sovereign, some households, and many businesses. At best, the easing of physical isolation will not start for some weeks, is likely to be slow, and could be subject to setbacks. The longer the delay in the recovery of economic activity, the less sustainable this extra debt will be.

Across the Irish banking sector, we have affirmed bank ratings in view of the resilience that we expect them to demonstrate in the face of this short-term cyclical event. Negative outlooks tend to reflect the significant downside risks that we see, and our expectation that we could lower ratings on one or several banks if the recession weakens the structural profitability of the banking sector beyond the inevitable increase in credit losses. We will look particularly at how pre-provision income evolves. We overlay this broad assessment with our view on the idiosyncratic features of individual banks, reflecting aspects such as pre-existing positive and negative rating pressures, their asset and funding profiles, and our view of their potential to absorb setbacks within earnings and so avoid significant capital depletion.

AIB Group PLC

The outlook revision to negative from stable reflects the sharp reduction in economic activity we anticipate for Ireland and the U.K., where the bank operates via its subsidiary AIB UK PLC, in 2020. It also reflects our view that there are downside risks to the ratings given the material uncertainties associated with the COVID-19 pandemic and to Irish banks' operating environment in general, leading to weaker business and profitability prospects. The longer and deeper the economic contraction, and related repercussion on capital markets, the more this could impair AIB's business prospects, revenue generation capacity, returns, and asset quality. The bank's structural exposure to local midsize enterprises and larger corporates--reliant on the domestic and global economies respectively--pose asset-quality risks. Indeed, we expect credit losses to rise in 2020, following recoveries in recent years. The group's relatively modest business and revenue diversification, compared with stronger international peers', could sharpen the downside risk to its earnings and internal capital generation capacity, in our view, since interest rates remain low and competition stiff. Still, the ratings affirmation reflects our expectation that AIB will be able to withstand the negative effects of a shock to the economy and private sector in the first nine months of 2020, while remaining committed to its medium-term business plan objectives, in particular cost discipline and asset-quality performance. Our view is supported by the measures announced by the Irish government and European Central Bank (ECB), which aim to provide liquidity support to affected corporates, small and midsize enterprises (SMEs), individuals, and financial institutions while potentially calming volatility in the capital markets. AIB's decade-long deleveraging and focus on risk-management improvement have better placed the bank to withstand an economic shock.

The negative outlook on AIB UK reflects that on its ultimate parent AIB Group. We consider AIB UK to be strategically important to its parent. As such, we cap the ratings at one notch below our 'bbb+' group credit profile (GCP) on AIB Group. This means that we could lower the ratings on the U.K.-based subsidiary following a similar action on the group.

Bank of Ireland Group PLC

The outlook revision to negative from stable reflects the sharp economic slowdown we anticipate in 2020 for Ireland and the U.K., where the bank operates commercial banking operations, on the back of the COVID-19 pandemic and our view that there are downside risks to Irish banks' operating environment, leading to weaker business and profitability prospects. The longer and deeper the economic contraction than we currently anticipate, the more this could impair BOI Group's business prospects, pre-provision income, returns, and asset quality. BOIG has better diversification compared with other domestic players in terms of geographies and business lines, due to its large operations in the U.K. and its domestic insurance franchise. However, in the current environment, BOIG may not benefit much from this diversification since the pandemic is negatively affecting different sectors and we forecast declining interest-related revenue and weaker fees from asset gathering businesses. We expect the performance of the mortgage book, which represents most of BOIG's loan exposure (equally split between Ireland and the U.K.) could slightly worsen, while exposure to domestic midsize enterprises and corporates could represent more significant asset-quality risks. We also forecast a rise in credit losses in 2020, which will put additional pressure on the group's profitability.

Before the emergence of the pandemic, BOIG was already struggling to meet its profitability targets due to pressure from low interest rates on income and necessary digital investments, which are hard to offset with equivalent cost savings. Still, the ratings affirmation reflects our expectation that it will be able to withstand the negative effects of a shock to the economy thanks to years of deleveraging, clean-up and focus on risk management improvement. Therefore, the bank has entered this crisis with good capital buffers and a liquidity cushion. The measures announced by the Irish government and ECB, aimed at providing liquidity support to economic agents and smoothing volatility in the capital markets, also support our view.

KBC Bank Ireland

We are affirming our 'BBB/A-2' ratings and maintaining the stable outlook on KBC Bank Ireland PLC (KBCI). The rating action primarily reflects our view that KBCI's parent, KBC Group, will remain willing and able to provide both ongoing and extraordinary support to its Irish subsidiary over the next 18-24 months. Specifically, we expect that KBCI will continue benefitting from funding, liquidity, portfolio de-risking, and capital support, as well as from the group's expertise and diverse experience in digitalization. In our view, this will allow KBCI to proceed with its ongoing business and digital transformation plan, notwithstanding a material deterioration in the surrounding macroeconomic environment. We expect the bank to suffer the same profitability pressures as domestic peers, in part due to its lack of diversification, but parental support should mitigate these risks. We also consider several positive factors in our assessment, including authorities' unprecedented policy responses. The measures introduced by the Irish government aim to provide liquidity support to affected SMEs, individuals, and financial institutions. Moreover, given KBCI's profile as a retail bank focusing on mortgage lending, we see the effects from the COVID-19 macroeconomic shock as more manageable than for corporate-exposed banks.

Permanent TSB Group Holding PLC

The outlook revision to negative from stable reflects the sharp economic slowdown we anticipate for Ireland in 2020 on the back of the COVID-19 pandemic and our view that there are downside risks in Irish banks' operating environment, leading to weaker business and profitability prospects. We forecast a reduction in interest-related revenue and fees because demand for new mortgages is likely to decline and interest rates remain low. We expect the performance of mortgages, which dominate the group's loan exposure, to deteriorate somewhat. Therefore, we forecast an increase in credit losses in 2020 and 2021, placing additional pressure on the group's already-modest profitability. In our view, the group's lack of business diversity remains the main impediment for profitability. However, we have affirmed the rating as years of deleveraging and balance sheet clean-up have substantially improved the group's capital position and better placed it to cope with the current economic shock than a decade ago.

BICRA Score Snapshot

Ireland

	To	From
BICRA Group*	4	4
Economic Risk	5	5
Economic Resilience	Low risk	Low risk
Economic Imbalances	High risk	High risk
Credit Risk in the Economy	High risk	High risk

Ireland (cont.)

	To	From
Industry Risk	4	4
Institutional Framework	Intermediate risk	Intermediate risk
Competitive Dynamics	Intermediate risk	Intermediate risk
Systemwide Funding	Intermediate risk	Intermediate risk
Economic Risk trend	Stable	Stable
Industry Risk Trend	Negative	Stable

*Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores are on a scale from 1 (lowest risk) to 10 (highest risk). For more details on our BICRA scores on banking industries across the globe, please see "Banking Industry Country Risk Assessment Update" published monthly on RatingsDirect.

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
- 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: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment 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 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
- COVID-19 Countermeasures May Contain Damage To Europe's Financial Institutions For Now, March 13, 2020
- The Coronavirus Will Shave 50 Basis Points Off Eurozone Growth, March 4, 2020
- Ireland's Election Ushers In A New Political Era, Feb. 11, 2020
- Ireland Upgraded To 'AA-/A-1+' From 'A+/A-1' On Prudent Policies and Vigorous Growth; Outlook Stable, Nov. 29, 2019

Ratings List

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Ratings Affirmed; Outlook Action		
	To	**From**
AIB Group PLC		
Issuer Credit Rating	BBB-/Negative/A-3	BBB-/Stable/A-3
AIB Group (U.K.) PLC		
Issuer Credit Rating	BBB/Negative/A-2	BBB/Stable/A-2
Allied Irish Banks PLC		
Issuer Credit Rating	BBB+/Negative/A-2	BBB+/Stable/A-2
*** * * * * * * * * * * * Bank of Ireland Group PLC * * * * * * * * * * * ***		
Ratings Affirmed; Outlook Action		
Bank of Ireland Group PLC		
Issuer Credit Rating	BBB-/Negative/A-3	BBB-/Stable/A-3
Bank of Ireland		
Issuer Credit Rating	A-/Negative/A-2	A-/Stable/A-2
*** * * * * * * * * * * * * * * KBC Group N.V. * * * * * * * * * * * * * * ***		
Ratings Affirmed		
KBC Bank Ireland PLC		
Issuer Credit Rating	BBB/Stable/A-2	
*** * * * * * * * * * * Permanent TSB Group Holdings PLC * * * * * * * * * ***		
Ratings Affirmed; Outlook Action		
Permanent TSB Group Holdings PLC		
Issuer Credit Rating	BB-/Negative/B	BB-/Stable/B
Permanent TSB PLC		
Issuer Credit Rating	BBB-/Negative/A-3	BBB-/Stable/A-3

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.