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Research Update:

Permanent TSB Group Holdings PLC Outlook Revised To Negative On Sharp Contraction Of Irish Economy; Ratings Affirmed

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PRIMARY CREDIT ANALYST

Anastasia Turdyeva
Dublin
(353) 1-568-0622
anastasia.turdyeva@spglobal.com

SECONDARY CONTACT

Letizia Conversano
Dublin
353 1 568 0615
letizia.conversano@spglobal.com

Overview

- Despite governments' measures to contain the COVID-19 pandemic, European economies, including Ireland, face an unprecedented challenge on the back of the global slowdown of economic activity and international trade.
- We continue to expect the Irish government's wide-ranging fiscal and related monetary measures to substantially mitigate this extraordinarily sharp, cyclical shock to the economy, and support the banking system in its key role as a conduit of fiscal and monetary support.
- However, we think the shock caused by the COVID-19 pandemic will put significant pressure on Irish banks--including Permanent TSB Group Holdings PLC (PTSB Group)--and weigh on already structurally low profitability over the next two to three years.
- We are revising the outlook to negative from stable and affirming our 'BB-/B' issuer credit ratings on PTSB Group, the group's nonoperating holding company. We are also revising the outlook to negative and affirming our 'BBB-/A-3' ratings on Permanent TSB PLC (PTSB), the group's main operating bank.
- The negative outlook reflects our view that the economic contraction will make the operating environment in Ireland more challenging, leading to weaker business and profitability prospects for PTSB Group and PTSB.

Rating Action

On April 28, 2020, S&P Global Ratings revised its outlook on PTSB Group to negative from stable and affirmed the 'BB-/B' long- and short-term issuer credit ratings on the bank.

At the same time, we revised the outlook to negative from stable, affirmed our 'BBB-/A-3' issuer credit ratings, and affirmed our 'BBB/A-2' resolution counterparty rating on PTSB PLC.

We affirmed all the issue ratings.

Rationale

The outlook revision on PTSB Group and PTSB reflects the sharp economic slowdown we anticipate in 2020 for Ireland on the back of the COVID-19 pandemic. The revision also reflects 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. Growth opportunities are modest across the sector and competition is stiff given high industry concentration and the relatively small size of the domestic economy and bankable population. We think PTSB Group's profitability is under increasing pressure due to compressing interest margins and a persistently high cost base, with a cost-to-income ratio above 80% over the next two years.

With isolation strategies still very much in force, our economists expect sharp economic contraction in the second quarter of 2020, followed by a rebound starting in the third quarter. However, they are now more cautious on the strength of recovery through end-2020 and into 2021, envisaging 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 for long after the crisis subsides.

We have affirmed the rating on PTSB Group because years of deleveraging and balance sheet cleanup have substantially improved PTSB Group's capital position, leaving it better placed to cope with the current economic shock than a decade ago. That said, we expect the performance of mortgages, which dominate the group's loan exposure, to deteriorate somewhat. Therefore, for 2020 and 2021 we forecast an increase in credit losses, which were marginal over the past few years. This will put 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 improvement, with the proportion of fees representing less than 10% of revenue. This year, we expect PTSB Group to break even, at best, with some rebound over the next two years. However, we recognize there are downside risks to those forecasts. Our forecasted risk-adjusted capital is likely to decline, although we still expect it to remain above 10% over the next two years.

We estimate that pre-provision income to revenue share will remain significantly lower than both larger domestic players' and international peers'.

The affirmation also reflects unprecedented policy responses that authorities in Ireland and U.K. have delivered in the form of monetary, fiscal, and regulatory support to the economy. 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 fully successful in avoiding permanent economic damage later (see "COVID-19 Deals A Larger, Longer Hit To Global GDP," published on April 16, 2020). We note also that a significant component of the fiscal support package comprises additional indebtedness--for the sovereign, some households, and many businesses. The longer the delay in the recovery of economic activity, the less sustainable this extra debt will be.

Outlook

Permanent TSB Holdings Group PLC (nonoperating holding company)

The negative outlook on PTSB Group primarily reflects our view that the economic contraction associated with COVID-19 will make the operating environment in Ireland more challenging, leading to weaker business and profitability prospects.

Downside scenario

We would most likely lower the ratings over the next 18-24 months if the recession weakens PTSB Group's business stability and the structural profitability beyond the inevitable increase in credit losses. This could happen if net losses deplete its capital base to the extent that our forecasted RAC ratio falls below 10%. This could occur if PTSB Group pursues a more aggressive capital policy.

Upside scenario

We could revise the outlook back to stable if we considered that economic conditions had stabilized and that the bank was continuing to diversify earnings, supporting earnings stability.

Permanent TSB PLC (operating company)

The negative outlook on Permanent TSB PLC mirrors that on PTSB Group.

Downside scenario

We could lower the rating on the operating company if the bank is not able to overcome deteriorating operating environment and sustain its profitability. We could also take a negative rating action if we forecasted the ALAC buffer protecting senior creditors to fall below 6.0% of our RWAs over the outlook horizon. This could occur due to impaired access to capital markets or the dilution of capital buffers on the back of elevated credit costs, for example.

Upside scenario

We could revise the outlook to stable if the operating environment normalizes and we revise the outlook on PTSB Group to stable.

Ratings Score Snapshot

	To	From
Permanent TSB PLC (operating company)		
Issuer credit rating	BBB-/Negative/A-3	BBB-/Stable/A-3
Group SACP	bb+	bb+
Anchor	bbb	bbb
Business Position	Weak (-2)	Weak (-2)
Capital and Earnings	Strong (+1)	Strong (+1)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	(+1)	(+1)
ALAC Support	(+1)	(+1)

GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)
Additional Factors	(0)	(0)
Permanent TSB Group Holdings PLC (nonoperating holding company)		
Issuer credit rating	BB-/Negative/B	BB-/Stable/B

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

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
- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Outlooks Revised On Three Irish Banks On Deepening COVID-19 Downside Risks, April 28, 2020
- Europe’s AT1 Market Faces The COVID-19 Test: Bend, Not Break, April 22, 2020
- Europe Braces For A Deeper Recession In 2020, April 20, 2020
- COVID-19 Deals A Larger, Longer Hit To Global GDP, April 16, 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
- Permanent TSB Group Holdings PLC, Jan. 31, 2020
- Ireland-Based Permanent TSB PLC Upgraded To 'BBB-'; Holding Company Affirmed At 'BB-'; Outlook Stable, Dec. 4, 2019