Non-performing exposure (NPE) tracker – Q1 2021

Shining a light on European lending

Banks have weathered risks well so far, helped by NPE disposals, despite this the outlook is still uncertain and we are starting to spot early signs of a change in the trend.

Welcome to EY NPE tracker, a new quarterly publication that aims to monitor key developments in European credit and NPE markets during the current downturn and beyond.

The tracker draws on data from European regulators and supervisors, quantitative data from other credible sources, and EY teams engagement with a wide range of clients (see methodology below for details).

Exhibit 1 – European NPL heatmap summary: most major markets are relatively stable

	Loans volumes		Loan distribution among stages – stage 2 vs. stage 3 (IFRS9)		NPL stock YTD (€bn)		NPL ratio YTD (%)			Loans under moratoria (YTD)		Loans with public guarantee (YTD)	
Country	Total loans Q1-21 (€b)	Total New loans YOY (%)	Stage 2 Q1-21 vs. Q1-20 (%)	Stage 3 Q1-21 vs. Q1-20(%)	NPL stock Q1-21 (€b)	NPL stock YoY Q1-21(%)	Historical max (%)	Q1-21 (%)	Q1-21 vs. Q1-20	Amount Q1-21 (€b)	% of total loans	Amount Q1-21 (€b)	% of total loans
Cyprus	29	5.5%	23%	-39%	3.1	-46.6%	47.8%	10.9%	-9.2%	0	-100.0%	0	0.0%
Germany	2,766	8.1%	75%	30%	32.5	8.3%	5.2%	1.2%	0.0%	2.4	-14.3%	11.2	0.4%
Spain	2,605	9.4%	38%	5%	69.7	-12.0%	9.4%	3.1%	0.0%	48.2	-16.8%	108.7	4.2%
France	5,641	3.7%	32%	11%	119.3	-0.7%	6.3%	2.1%	-0.3%	16.8	-59.4%	131.7	2.3%
Greece	214	1.6%	12%	-14%	53.7	-23.8%	45.6%	25.2%	-8.8%	2.2	-46.3%	5.3	2.5%
Ireland	241	8.2%	151%	48%	9.3	32.9%	25.7%	3.7%	0.4%	1.1	-38.9%	1.0	0.4%
Italy	1,960	5.6%	64%	-18%	76.7	-33.6%	18.1%	4.0%	-2.4%	70.8	-38.8%	100.5	5.1%
Netherland	1,988	7.3%	19%	12%	36.8	7.6%	3.2%	1.8%	-0.1%	1.5	-11.8%	3.1	0.2%
Portugal	201	-19.3%	2%	-28%	12.3	-18.5%	17.5%	4.5%	-1.7%	27.7	-33.3%	6.8	3.4%
EU/EEA	19,250	5.9%	40%	-0.8%	467.7	-19.9%	7.5%	2.5%	-0.5%	202.5	-36.4%	378.0	2.0%

Source: European Banking Authority Q1 2021, NPL markets

NPL outlook and risk level

Negative: high   Watchlist: medium   Stable: low

In this edition, we focus on four key areas:

1. Small and medium-sized enterprises (SMEs) were among the leading users of bank credit during Q1 2021

Across Europe, bank lending to the real economy increased by 8.8% yoy, reaching a total of €19.2t at Q1-21 — an important source of economic support during the downturn created by the COVID-19 pandemic. Q1-21 itself saw total lending increase by 5.9% up from €18.2t at Q4-20 and reversing the previous downward trend. Household lending increased by 3.1% yoy, while 'other' lending grew by 23.8% from €5.8t to €7.2t. Within lending to non-financial companies (NFCs), there was an increase of 12.1% in SME lending, reflecting that sector's need for additional capital. However, this was counterbalanced by a 12.7% decrease in lending to larger NFCs.

2. Asset quality remains finely balanced, but we see signs of a coming deterioration

Data on international financial reporting standards (IFRS) loan categories shows that European banks' stage 2 loans (performing, but with increased risk) grew by 40% yoy in Q1-21, including an uplift of 4.8% during Q1 itself (see exhibit 4). Stage 2 loans represented 9.0% of all loans and advances to non-financial customers.

Meanwhile stage 3 loans (those that are impaired) decreased by 0.8% yoy, but actually increased by 2.6% in Q1, reaching 3.1% of all non-financial loans and advances at the end of the quarter. Countries that experienced a significant increase in Q1 include Spain (13%) and Germany and France (both 8%).

Exhibit 2 — European banks' NPE outlook is positive for now (reporting season Q2-21)

Bank	Country	NPL expected inflows	ECL trend
Bank 1	Spain	Stable	Lower
Bank 2	Spain	Stable	Lower
Bank 3	Spain	Lower	Stable
Bank 4	UK	Stable	Lower
Bank 5	UK	Stable	Lower
Bank 6	UK	Stable	Stable
Bank 7	Italy	Stable	Higher
Bank 8	Italy	Lower	Higher
Bank 9	Italy	Lower	Higher
Bank 10	France	Stable	Stable
Bank 11	France	Stable	Lower
Bank 12	France	Stable	Lower
Bank 13	Germany	Lower	Stable
Bank 14	Germany	Lower	Stable
Bank 15	Ireland	Stable	Stable
Bank 16	Greece	Lower	Lower
Bank 17	Netherlands	Stable	Lower
Bank 18	Netherlands	Stable	Lower
Bank 19	Austria	Stable	Higher
Bank 20	Nordics	Stable	Lower

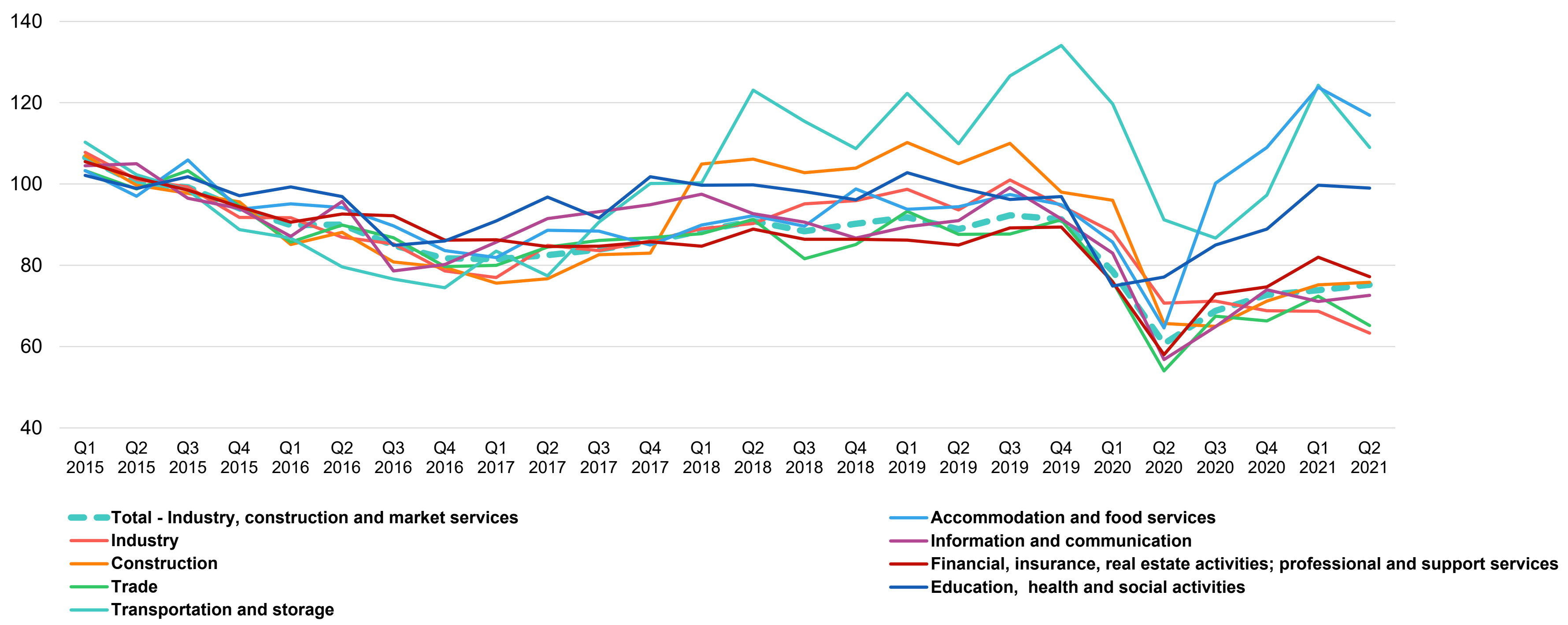
ECL: Expected credit losses. ECL trend corresponds to the quarterly change of loan-loss provisions reported by European banks in the sample. Source: EY analysis Q2 2021.

European banks' NPL ratios show a similar picture to the IFRS data (see exhibit 1). Aggregate European NPL ratios grew slightly to 3.0% during 2020, but fell back to reach 2.5% at Q1-21.

To better understand European banks' NPE consensus, EY has conducted an exercise to review banks' earnings calls transcripts for Q2-21 (see methodology for details). This research suggests that the asset quality situation remained finely balanced in the first half of 2021 (see exhibit 2). More specifically:

- Most European banks have lowered their expectations of NPL formation in the short-time. Some banks reported lower NPL ratios during Q2-21, but others saw NPLs as largely stable and a few banks saw NPL ratios increase.
- The combination of lower provisions and broadly stable NPL ratios meant that the number of banks reporting lower NPL coverage ratios exceeded those experiencing higher coverage. That is consistent with the trend during 2020, which saw coverage ratios pick up to 46.0% in Q1 before decreasing slightly to 44.9% at the end of Q4, virtually unchanged year on year.
- All the 20 banks experienced stable or slightly lower costs of risk during Q2-21 thanks to the enhanced economic outlook. Some banks maintained their provisioning levels while others reduced them slightly.
- Loan loss provision levels for almost all banks are expected to continue declining and only a few banks made higher provisions in Q2-21. For instance, EY's report 'Applying IFRS9 Disclosure of COVID-19 impact on expected credit losses of banks', reflects how UK and European Banks have embedded the impact of the pandemic into their estimation processes and incorporated the relevant information in their disclosures regarding the movement in the ECL.

Exhibit 3 — European declarations of bankruptcies are climbing



Source: Eurostat Q2 2021

In short, European banks' potential credit losses continue to remain on hold, with moratoria and government support largely ensuring that defaults have yet to materialize.

The question now is how different sectors of the economy will respond to evolving circumstances and the withdrawal of government support. Commercial bankruptcies are one potential indicator. These have trended down over recent years and fell further in Q2-20 as moratoria and guarantees were announced (see Exhibit 3). However, business failures increased in Q3 and have trended upwards since. In Q1-21 they grew in almost all sectors of the economy, with the steepest increases in accommodation and food, transport and storage, and education and social activities.

Exhibit 4 — Loan composition by stages Q1-21: Stage 2 loans are clearly growing

Country	Stage 1	QoQ	YoY	Stage 2	QoQ	YoY	Stage 3	QoQ	YoY
Cyprus	65.7%	8%	16%	17.1%	-2%	23%	17.2%	5%	-39%
Germany	89.1%	8%	1%	9.3%	9%	75%	1.6%	8%	30%
Spain	89.1%	9%	3%	7.5%	16%	38%	3.5%	13%	5%
France	89.0%	4%	10%	8.3%	2%	32%	2.7%	8%	11%
Greece	55.7%	1%	17%	13.7%	1%	12%	30.6%	3%	-14%
Ireland	79.2%	8%	0%	15.8%	10%	151%	5.0%	0%	48%
Italy	81.7%	6%	9%	13.3%	2%	64%	5.0%	4%	-18%
Netherlands	90.5%	8%	6%	7.2%	0%	19%	2.3%	3%	12%
PT	83.0%	-18%	-15%	11.6%	-23%	2%	5.4%	-24%	-28%
EU/EEA	87.9%	6%	7%	9.0%	4.8%	40%	3.1%	2.6%	-0.8%

Source: European Banking Authority Q1 2021

Stage 1: >85% | >75% - >=85% | <=75%

Stage 2: <=10% | >10% - >=15% | >15%

Stage 3: <=3.5% | >3.5% - >=7.0% | >7.0%

3. Moratoria and guarantees have laid the ground for a consumer-led recovery, but could harbor risks

Moratoria and public guarantee schemes in most European countries will expire during the second half of 2021. Italy, France, Spain and Portugal have the largest absolute volumes of loans under moratoria, while Portugal and Hungary have the highest relative proportion of loans under moratoria.

On the upside, loans under the European Banking Authority (EBA) eligible moratoria continued to decline, reaching €203b in Q1-21. Set against that, it is notable that stage 2 loans make up 27.3% of these loans. That is not only much higher than for all banking loans and advances (where stage 2 loans stand at 9.0%), but also than for loans under expired moratoria (23.7%). This implies that loans still under moratoria could be carrying higher levels of potential risk.

Loans under public guarantee schemes increased from €343b to €378b in Q1-21, with France, Spain and Italy accounting for the largest balances. The share of stage 2 loans within this portfolio was 13.6%, slightly higher than the average (9.0%). However, NPL ratios for these loans were actually lower (at 1.4%) than for all banking loans and advances (2.5%).

4. NPLs will increase — but the level is still uncertain

Across Europe, aggregate NPL ratios fell to 2.5% in Q1-21, a quarterly decrease of 10bps and 1.0% lower than in Q1-20. Nationally, NPL ratios in Q1-21 were at their highest in Greece (25.2%) and Cyprus (10.9%). Although both were significantly lower than at the end of the prior year, when they stood at 30.3% and 15.4% respectively (see exhibit 5).

In fact, most major markets except Spain saw NPL ratios remain stable or decline during Q1-21. NPL sales were a major factor, with many countries heavily affected by the financial crisis of 2008 — including Greece, Italy, Cyprus and Portugal — continuing to see NPL disposals during the year. The five countries with the largest absolute stock of NPLs at Q1-21 were France (€120b), Spain (€81b), Italy (€79b), the UK (€60b) and Greece (€54b).

In our view, the strong recovery of European economies experienced in 2021 has set aside, for the moment, our most severe scenarios. However it is expected that new inflows of NPLs will surge inevitably across European banks' balance sheets once moratoria's and support measures come to an end. In addition to the current legacy stock from the previous financial crisis, banks will need a proactive NPL approach monitoring and anticipating new inflows as well as enhancing their NPL deleveraging strategy with new asset types to avoid unmanageable volumes.

Exhibit 5 — NPL ratio heatmap: risk is concentrated in key markets and asset types

Asset type	Cyprus	Germany	Spain	France	Greece	Ireland	Italy	Netherlands	Portugal	EU/EEA
NPL ratio	10.9%	1.2%	3.1%	2.1%	25.2%	3.7%	4.0%	1.8%	4.5%	2.5%
Households	20.2%	1.7%	3.8%	2.6%	37.1%	5.1%	3.8%	1.3%	2.9%	2.9%
Mortgage	20.3%	1.0%	3.1%	2.4%	34.7%	5.0%	2.9%	1.0%	1.8%	2.3%
NFC	15.3%	2.5%	4.9%	3.9%	29.2%	6.5%	7.3%	4.5%	9.5%	4.7%
SME	17.7%	2.7%	7.0%	4.3%	42.9%	9.2%	9.9%	4.9%	9.9%	6.1%
Commercial real estate	13.9%	2.0%	10.0%	3.6%	47.3%	11.8%	13.4%	5.4%	14.6%	6.4%

Source: European Banking Authority Q1 2021

On average, NPL ratios are higher for loans to non-financial companies (4.7% in Q1-21) than for loans to households (2.9%). Within the NFC category, NPL ratios for SME loans (6.1%) and commercial real estate loans (6.4%) are particularly elevated. And while NPL ratios fell for most sectors of the economy during Q1-21, it is notable that they increased materially in accommodation and food (from 8.4% to 9.0%) and in arts, entertainment and recreation (from 7.2% to 7.9%).

Given the continued economic stress and renewed lockdowns in many European markets during Q4-20 and Q1-21, it seems likely that the withdrawal of support measures will lead to a subsequent increase in NPL ratios during the second half of 2021, especially in more vulnerable sectors. In this context, we also note that May's European Central Bank presentation on NPLs highlighted that almost half of 2020's stage 3 classifications transitioned directly from stage 1. The full impact of COVID-19 on European NPLs has not yet been felt.

NPE tracker methodology

1. The NPE tracker's main source of data is the EBA risk dashboard that summarises the main risks and vulnerabilities in the banking sector in the European Union (EU) by looking at the evolution of Risk Indicators (RI) among a sample of banks across the EU.
2. From the EBA risk dashboard, EY has analyzed aggregate data (at a country level) on a quarterly basis on key issues relating to credit lending origination, asset quality, provisions (including distribution among stages according to IFRS 9), NPL ratios, moratoria programs, public guarantee schemes, and the overall macroeconomic situation.
3. In addition, to follow the impact that the pandemic is having on European banks, we have tracked earnings call transcripts for 20 European banks to identify banks' current views in terms of NPLs/NPEs, asset quality performance, stage provisioning and NPL formation/deleveraging.

The banks sampling selection has been as follows:

- Top #3 banks in terms of total assets for each of the following key NPL core markets (France, Italy, Spain, the UK).
- Top #2 banks in terms of total assets in Germany and the Netherlands.
- Top #1 banks in terms of total assets in Austria, Ireland, Greece and The Nordic Region.

Conclusion

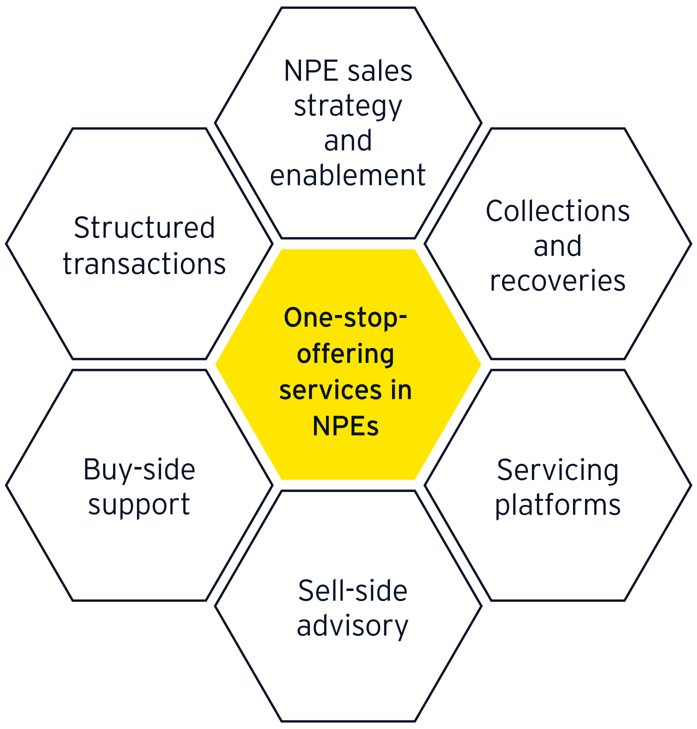
After a long period in hibernation, the full credit implications of the COVID-19 pandemic are starting to emerge into daylight. More specifically, the Q1-21 NPE tracker shows that:

1. SMEs were among the leading users of European bank credit during Q1-21
2. European asset quality remains finely balanced, although there are signs of coming deterioration
3. Moratoria and public guarantees have laid the ground for a consumer-led recovery, but could harbor pockets of risk
4. NPLs look set to increase – but to a manageable level

In short it seems likely that, as payment moratoria and public guarantees come to an end, the second half of 2021 will see the European credit downturn move out of its current holding pattern. By the end of the year, we should have a much clearer idea of the areas where provisioning and losses are growing – and of which sectors are likely to see the greatest transaction activity.

How EY teams can help

- EY teams combine transactional experience with strategic advice to support banks, credit investors and regulators in developing and helping implement key operational and cost-reduction strategies for bank deleveraging, loan portfolio management and financial stability safeguarding.
- We have a strong internal network, breadth of knowledge and vast array of credentials covering different macroeconomic landscapes.



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