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Three Irish Banks Upgraded On Sound Domestic Economic Fundamentals And Expected Robust Asset Quality; Outlook Stable

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- We expect Ireland to enjoy domestic economic growth of about 2.0% in 2023--outperforming many countries in the eurozone--as well as low unemployment, which, in our view, will bolster the Irish banking sector.
- We also anticipate that Irish banks will be broadly on track to reduce non-performing loans to their publicly stated target levels by end-2023, and keep asset quality metrics around those levels.
- Furthermore, we project that the current high interest rate environment--as well as banks' focus on costs and their greater scale thanks to the consolidation of the domestic banking sector--will boost the resilience of domestic banks' overall creditworthiness.
- We therefore revised upward our economic risk assessment for Ireland's banking sector.
- Consequently, we raised our ratings on AIB Group PLC, Bank of Ireland Group PLC, and Permanent TSB Group Holdings PLC and their main operating banks.
- The outlook on all three groups is stable.

DUBLIN (S&P Global Ratings) June 14, 2023--S&P Global Ratings today said that it took the following rating actions:

- We raised our long- and short-term issuer credit ratings (ICRs) on holding company AIB Group PLC to 'BBB/A-2' from 'BBB-/A-3', and on Allied Irish Banks PLC (together AIB) to 'A/A-1' from 'A-/A-2'. The outlook on both entities is stable. We also raised our long-term resolution counterparty rating (RCR) on Allied Irish Banks to 'A+' from 'A' and affirmed our short-term RCR at 'A-1'. We raised all issue ratings on all of the bank's subordinated and hybrid instruments, including senior non-preferred, except for the legacy subordinated notes issued out of Allied Irish Banks.
- We raised our long- and short-term ICRs on holding company Bank of Ireland Group PLC to 'BBB/A-2' from 'BBB-/A-3', and on Bank of Ireland (together BOI) to 'A/A-1' from 'A-/A-2'. The outlook is stable. We also raised our long-term RCR on Bank of Ireland to 'A+' from 'A' and affirmed our short-term RCR at 'A-1'. We raised all issue ratings on all of the bank's subordinated and hybrid instruments, including senior non-preferred.
- We raised our long-term ICR on holding company Permanent TSB Group Holdings PLC to 'BB+'

from 'BB-' and affirmed the short-term rating at 'B'. We took the same action on its operating company, Permanent TSB PLC (PTSB), raising our long-term ICR to 'BBB+' from 'BBB' and affirming the 'A-2'short-term rating. Our outlook on the ratings is stable. We also raised our long and short-term RCRs on Permanent TSB PLC to 'A-/A-2' from 'BBB+/A-2'. We raised all issue ratings on all of the bank's subordinated and hybrid instruments, including senior non-preferred.

Rationale

The Irish economy--like other European economies--is set to slow this year but should continue to outperform peers over the next two years, bolstering Irish banks' asset quality. We note the downside risk attached to our macroeconomic forecast, but under our current base-case scenario, we expect the underlying Irish economy as measured by GNI* to expand by about 2.0% in 2023 versus the stagnation we anticipate for the eurozone economy, at GDP growth of 0.3%. The slowdown in Ireland's economic activity will spill over into the labor market, leading to moderate unemployment growth, peaking at only 5.0% in 2023, compared with 4.5% in 2022. The largest risk we therefore see for Irish banks is from inflation, anticipated to remain high in 2023 at 5.3% (down from 8.1% in 2022), weighing on both operating costs and borrowers' debt-servicing capacity.

We expect systemwide non-accrual loans to stabilize at around 3% over the next year. Elevated inflation and increasing interest rates will pressure the private sector's debt-servicing capacity. We anticipate that additional problem loans will emerge, mostly among small and midsize enterprises. Overall, we expect the effect to be manageable, with the average nonperforming exposure (NPE) level for the Irish banking system stabilizing at around 3% of total loans, as we expect the inflow of new NPEs to be largely offset by the outflow of cured NPEs as well as limited NPE portfolio sales. As of end-March 2023, nonaccrual (stage 3) loans accounted for about 3.4% of gross loans for AIB (down from 21.6% in 2016) and BOI (11.4% in 2016), and at 3.3% for PTSB (27.5% in 2016). The management overlays that banks hold should also help Irish banks to manage credit losses, and we expect additional credit costs of 30-40 basis points (bps) for 2023-2024.

Although we do not see an immediate threat to the banking sector, the structural imbalance of the property market is an element of risk to monitor. Housing-related debt forms about 70% of household debt and more than 54% of total private-sector debt. Household debt to disposable income remains high, at about 96% at end-2022, despite having improved over the past few years (123% in 2018). Over the next two years, we anticipate real house prices will decline temporarily, mostly due to high inflation. However, we note that even though price dynamics are not fuelled by credit growth, the structural demand-supply issue remains (from the expanding population and lagging supply), and nominal residential house prices match the 2007 peak despite being stagnated since October 2022. At the same time, we expect residential mortgage performance will likely hold thanks to still-high employment, and low average loan-to-value (LTV) ratios in the system (51% average LTV on the stock as of end-2022). Additionally, in 2022, the share of fixed-rate mortgages in new lending and mortgage refinancing has increased as borrowers sought to lock-in their mortgage payments in anticipation of further interest rate increases. This boosted the loan stock within the fixed-rate mortgage portfolio, to about 60% from 40% a year ago, helping reduce credit risk in the mortgage portfolio as interest rates continue rising.

Higher interest rates--alongside banks' continual focus on cost discipline and business momentum, thanks to consolidation within the banking sector--will improve Irish banks' operating profitability. The gradual repricing of loans, containment of funding costs given the large share of non-interest-bearing deposits, and the larger scale of market consolidation put Irish banks in a good position to benefit from increasing interest rates. We expect the domestic return on equity to exceed 10% in 2023 (from only about 6% pre-pandemic). Irish banks continue to rely on net interest income (around 80% in operating revenue), but work toward diversifying revenue sources and increase top-line results by expanding product offerings to insurance and wealth management. Although inflation will continue to pressure costs, higher interest rates and sector consolidation will strengthen revenue growth, which should help reduce average cost to income to 55%-57% over the next two years. In our view, current business momentum and significant growth in revenues over the next two years should also underpin domestic banks' digital agendas and bring structural improvements sustaining banks' cost efficiencies in the long run.

The positive trends outlined above led us to revise our economic risk score for the Irish banking sector to '3' from '4' (on a scale of 1-10, with 1 being the lowest risk) and we now classify Ireland as being in group 3, rather than group 4, under our banking industry country risk assessment (BICRA). Some other countries we classify in group 3 are Czech Republic, Israel, the Netherlands, the U.K., and Korea. Our industry risk assessment remains unchanged at '4'. As a result, we have revised upward our anchor, the starting point for assigning an issuer credit rating, for banks operating primarily in Ireland to 'bbb+' from 'bbb' and have incorporated this into our ratings on three Irish banking groups.

OUTLOOKS

AIB Group PLC (holding company) and Allied Irish Banks (operating company)

Primary analyst: Anastasia Turdyeva

We have revised upward AIB's group stand-alone credit profile (group SACP) to 'bbb+' from 'bbb' to reflect improvements in the Irish banking sector's economic risk profile and the group's strengthening creditworthiness. Particularly, the group reduced its NPE ratio to 3. 4% at the end of March 2023 from 21.6% in 2016.

Our ratings also reflect the group's solid presence in the domestic market, with a market share above 30% in mortgages and retail customer current accounts, and a robust capital base, as reflected in our projected RAC ratio expected to range 13.0%-13.5% by end-2025.

We continue to incorporate two notches for additional loss-absorbing capacity (ALAC) into the ratings on Allied Irish Banks, the operating bank, because we forecast its ALAC ratio will stay comfortably above the 6% threshold over the next two years. This does not apply to the rating on the holding company, AIB Group PLC, which is one notch lower than the group SACP to reflect its structural subordination.

The stable outlook on both AIB Group PLC and Allied Irish Banks reflects our expectation that the group's asset quality will reach the targeted 3% NPE level by end-2023 and won't deteriorate over the next 18-24 months thanks to relatively supportive--although slowing--domestic economic growth in 2023 and 2024, as well as solid underwriting standards. It also reflects our view that the group will continue to deliver on its strategy in 2023-2025, which we think will materialize through a more efficient, profitable, and diversified business model. Finally, we anticipate that the bank will maintain its robust capital base and solid funding and liquidity profiles.

Downside scenario

Though not our base-case scenario, we could lower our ratings over the next 18-24 months if the group's asset quality deteriorated versus its peer group or if our projected risk-adjusted capital (RAC) ratio declined below 10% due to more aggressive capital management.

Upside scenario

We are highly unlikely to take a positive rating action at this stage. An upgrade would hinge on an improved operating environment and the group performing consistently well compared with higher rated peers. Specifically, we could raise the ratings if we anticipated a significant structural improvement in efficiency and revenue generation capacity, which would allow AIB to demonstrate resilient performance through the cycle, while asset quality metrics remain in line with our expectations.

AIB Group PLC: BBB/Stable/A-2

Allied Irish Banks PLC: A/Stable/A-1

Group SACP: bbb+

- Anchor: bbb+
- Business position: Adequate (0)
- Capital and earnings: Strong (+1)
- Risk position: Moderate (-1)
- Funding and liquidity: Adequate and adequate (0)
- Comparable rating analysis: 0

Support: +2

- ALAC support: +2
- Government-related entity (GRE) support: 0
- Group support: 0
- Sovereign support: 0

Additional Factors: 0

ESG Credit Indicators: E-2, S-2, G-2

Bank of Ireland Group (holdco) and Bank of Ireland (opco)

Primary analyst: Letizia Conversano

We have revised upward BOI's group SACP to 'bbb+' from 'bbb' to reflect the improvements we have generally seen in the economic risk profile of the Irish banking sector and the resulting strengthening of the group's creditworthiness. BOI has notably reduced its NPE ratio to 3.4% at the end of March 2023 from 11.4% in 2016.

Our ratings also reflect the bank's dominant presence in the domestic market, with a market share above 20%, and a solid capital base, as reflected in our projected RAC ratio of 13.7%-14.2% by end-2025.

We continue incorporating two notches for ALAC into our ratings on Bank of Ireland, as we forecast its ALAC ratio will stay comfortably above the 6% threshold over the next two years. This does not apply to the long-term rating on the holding company, which remains one notch lower than the group SACP to reflect its structural subordination.

We have also raised our issue rating on BOI's Additional Tier 1 to 'BB-' from 'B'. The upgrade reflects the upward revision of BOI' SACP and our view that the bank will be able and willing to maintain its regulatory Common Equity Tier 1 ratio at least at 14% in the medium-to-long term, thus, allowing a minimum 700bp buffer above the outstanding Additional Tier 1 instruments' 7% capital trigger.

The stable outlook on both BOI's holding company and operating company reflect our expectations that the group's asset quality will remain close to the 3% NPE level in 2023 and won't deteriorate over the next 18-24 months. This is thanks to the relatively supportive--although slowing--domestic economic growth in 2023 and 2024, as well as solid underwriting standards. It also reflects our view that the group will continue to deliver on its new strategy in 2023-2025, which could lead to a more efficient, profitable, and diversified business model. Finally, we anticipate that the bank will maintain its robust capital base and solid funding and liquidity profiles.

Downside scenario

Though not our base-case scenario, we could lower our ratings over the next 18-24 months if the bank's asset quality deteriorated significantly versus its peer group, or if our projected RAC ratio declined below 10% on the back of more aggressive capital management.

Upside scenario

We are highly unlikely to take a positive rating action at this stage. An upgrade would hinge on an improved operating environment and the group performing consistently well compared with higher rated peers. Specifically, we could raise the ratings if we anticipated a significant structural improvement in efficiency and revenue generation capacity, which would allow BOI to demonstrate resilient performance through the cycle, while asset quality metrics remained in line with our expectations.

Bank of Ireland Group PLC: BBB/Stable/A-2

Bank of Ireland: A/Stable/A-1

Group SACP: bbb+

- Anchor: bbb+
- Business position: Adequate (0)
- Capital and earnings: Strong (+1)

- Risk position: Moderate (-1)
- Funding and liquidity: Adequate and adequate (0)
- Comparable rating analysis: 0

Support: +2

- ALAC Support: +2
- GRE Support: 0
- Group Support: 0
- Sovereign Support: 0

Additional Factors: 0

ESG credit indicators: E-2, S-2, G-2

Permanent TSB Group Holdings PLC (holdco) and Permanent TSB PLC (opco)

Primary analyst: Letizia Conversano

We revised upward PTSB's group SACP to 'bbb-' from 'bb+' to reflect the improvements we have seen in the economic risk profile of Irish banking sector, including PTSB, and the resulting strengthening of the group's creditworthiness.

Our ratings on PTSB reflect the bank's efforts to clean up its balance sheet over the past decade--with NPEs decreasing to 3.3% of its customer loans at March-end 2023, from 27.5% as of December 2016--as well as our expectation that the bank's NPEs will remain below 4% of its customer loans in 2023-2025. This is thanks to a generally supportive economic environment and good underwriting standards. At the same time, our ratings incorporate the challenges the bank may face to build a solid domestic franchise in a banking system dominated by the two big domestic banking groups, AIB and BOI.

We now consider that the bank's RAC ratio could remain comfortably above 15% in 2023-2025. That said, our projections incorporate some level of uncertainty around the bank's ability to expand its customer loan portfolio without eroding the net interest margin, as well as around the bank's excess capital and dividend policy. We also consider that the bank's profitability--although improving--is still below that of its peers, as measured by our earnings buffer. As a result, we maintain our capital and earnings assessment.

The stable outlook on PTSB reflects that we expect the bank to continue pursuing strategic initiatives to expand its franchise into the mortgage and SME domestic markets and boosting its risk-adjusted returns, while maintaining sound asset quality, in line with its peers.

Upside scenario

We could raise the ratings on PTSB over the next 18-24 months if considered that the bank's strategic initiatives underpin a competitive advantage in the domestic market and allow the Irish banking group to develop a more diversified, cost-efficient, and profitable business model throughout the credit cycle. We could also upgrade the bank if we observed that its RAC ratio were to stay sustainably above the 15% threshold, while improving its profitability metrics in line with peers and keeping sound asset quality metrics.

Downside scenario

Although not in our central scenario, we could downgrade the bank over the 18-24-month outlook horizon if its asset quality metrics were to deteriorate more than peers'.

Permanent TSB Group Holdings PLC: BB+/Stable/B

Permanent TSB PLC: BBB+/Stable/A-2

Group stand-alone credit profile: bbb-

- Anchor: bbb+
- Business position: Constrained (-2)
- Capital and earnings: Strong (+1)
- Risk position: Moderate (-1)
- Funding and liquidity: Adequate and adequate (0)
- Comparable rating analysis: 0

Support: +2

- ALAC support: +2
- GRE support: 0
- Group support: 0
- Sovereign support: 0

Additional Factors: 0

ESG Credit Indicators: E-2, S-2, G-2

Ireland

	To	From
BICRA Group	**3**	**4**
Economic Risk	**3**	**4**
Economic Resilience	Low Risk	Low Risk
Economic Imbalances	Intermediate Risk	High Risk
Credit Risk In The Economy	Intermediate Risk	Intermediate Risk
Economic Risk Trend	Stable	Stable
Industry Risk	**4**	**4**
Institutional Framework	Intermediate Risk	Intermediate Risk
Competitive Dynamics	High Risk	High Risk
Systemwide Funding	Low Risk	Low Risk
Industry Risk Trend	Stable	Stable

Ireland (cont.)

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 , March 2, 2022
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology , Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions , Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- General Criteria: Group Rating Methodology , July 1, 2019
- 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: Principles Of Credit Ratings , Feb. 16, 2011