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Research Update:

Bank of Ireland Group PLC Outlook Revised To Negative On Sharp Economic Contraction; Ratings Affirmed

April 28, 2020

Overview

- Despite governments' measures to contain the COVID-19 pandemic, European economies, including Ireland's, 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 Bank of Ireland Group PLC (BOIG)--taking into account structural profitability challenges that the local banking sector faces.
- We are revising the outlook to negative from stable and affirming our 'BBB-/A-3' issuer credit ratings on BOIG, the group's nonoperating holding company. We are also revising the outlook to negative from stable and affirming our 'A-/A-2' ratings on Bank of Ireland (BOI), 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 BOIG and BOI.

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Rating Action

On April 28, 2020, S&P Global Ratings revised its outlook on BOIG to negative from stable and affirmed the 'BBB-/A-3' long- and short-term issuer credit ratings on the bank.

At the same time, we revised the outlook to negative from stable, affirmed our 'A-/A-2' issuer credit ratings, and affirmed our 'A/A-1' resolution counterparty ratings on BOI.

We affirmed all the issue ratings.

Rationale

The outlook revision of BOIG and BOI reflects the sharp economic slowdown we anticipate in 2020 for Ireland and the U.K., where the bank also runs commercial operations, on the back of the COVID-19 pandemic. As a result, we see substantial downside risks to Irish banks' operating environment, leading to weaker business and profitability prospects. 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 BOIG's profitability is under increasing pressure due to compressing interest margins and a persistently high cost base--with a cost-to-income ratio remaining well above 60% over the next two years--as the group continues investing in business transformation and digital capability. BOIG has better diversification than other domestic players in terms of geographies and business lines, due to its large scale of operations in the U.K. and its established domestic wealth and insurance franchise. However, in the current environment, BOIG may not benefit much from this diversification, since the pandemic is harming almost all sectors and we foresee declining interest-related revenue and weaker fees from asset gathering businesses. The negative outlook reflects the significant downside risks that we see, and our expectation that we could lower ratings if the recession weakens BOIG's structural profitability beyond the inevitable increase in credit losses. In particular, we will monitor how BOIG's pre-provision income evolves.

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.

The ratings affirmation reflects our expectation that BOIG will be able to withstand the negative effects of a shock to the economy thanks to years of deleveraging, balance sheet cleanup, and risk management improvement. We therefore think BOIG has entered this crisis with good capital buffers allowing it to absorb unexpected credit losses. We expect the performance of the mortgage book, which represents the majority of BOIG's loan exposure--almost equally split between Ireland and U.K.--could slightly worsen. Exposure to domestic midsize enterprises and corporates could represent more significant asset quality risks and we forecast a rise in credit losses in 2020 and 2021 that will put additional pressure on the group's profitability. Before the emergence of the pandemic, BOIG was struggling to meet its profitability targets. This stemmed from difficulties in offsetting pressure from the low interest rate environment on income and investment in digitalization with equivalent cost savings. Therefore, we are likely to see deterioration in BOIG's return on equity, well below 5% in 2020, and some decline on our forecasted risk-adjusted capital, although we still expect it to remain above 10% over the next two years.

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

BOI Group PLC (nonoperating holding company)

The negative outlook on BOIG 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 BOIG's structural profitability beyond the inevitable increase in credit losses, to the extent that it substantially falls from the level reached at end-2019. This could also happen if BOIG's asset quality weaknesses reappear and credit costs increase on the back of a more prolonged and deeper crisis than we currently envisage. We could also take a negative rating action on BOIG if margin pressure intensifies or the recovery is weaker than anticipated.

Upside scenario

We could revise the outlook back to stable if economic and operating conditions stabilize and cost discipline allows the bank to sustain pre-provision income.

Bank of Ireland (operating company)

The negative outlook on BOI mirrors that on BOIG.

Downside scenario

We could lower the ratings on BOI if the buffer of bail-inable debt protecting senior creditors drops below 8.0% of S&P Global Ratings' risk-weighted assets, no longer qualifying for two notches of uplift, over the outlook horizon. This could happen because of a more aggressive capital policy than we currently expect, widening risk-asset base, or due to impaired access to capital markets.

Upside scenario

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

Ratings Score Snapshot

	To	From
Bank of Ireland (operating company)		
Issuer credit rating	A-/Negative/A-2	A-/Stable/A-2
Group SACP	bbb	bbb

Anchor	bbb	bbb
Business Position	Adequate (0)	Adequate (0)
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	(+2)	(+2)
ALAC Support	(+2)	(+2)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)
Additional Factors	(0)	(0)
Bank of Ireland Group PLC (nonoperating holding company)		
Issuer credit rating	BBB-/Negative/A-3	BBB-/Stable/A-3

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 Braces For A Deeper Recession In 2020, April 20, 2020
- COVID-19 Deals A Larger, Longer Hit To Global GDP, April 16, 2020

- Europe’s AT1 Market Faces The COVID-19 Test: Bend, Not Break, April 22, 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
- Bank of Ireland Upgraded To 'A-' On Stronger Bail-Inable Debt Cushion; Holding Company Rating Affirmed; Outlook Stable, Dec. 24, 2019