Moody’s Downgrades 28 Spanish Banks on Sovereign Risk

By Charles Penty and Dakin Campbell - Jun 25, 2012

Banco Santander SA (SAN) and Banco Bilbao Vizcaya Argentaria SA (BBVA), Spain’s largest lenders, were downgraded by Moody’s Investors Service because of the country’s sovereign debt and souring real-estate loans.

At least a dozen lenders were lowered to junk status, Moody’s said yesterday in a statement. The ratings company downgraded six banks by four levels and 10 by three grades with the rest getting one- and two-tier declines.

“In Spain you have a combination of a significant sovereign-debt burden coupled with a collapsing real estate market,” said Bruce Simon, chief investment officer at Los Angeles-based City National Bank, which manages $14 billion in client assets and doesn’t own debt issued by the lenders. “That’s doubling the pressure on Spanish banks.”

Moody’s issued a three-step reduction in Spain’s credit grade on June 13, citing the debt, a weakening economy and limited access to capital markets. Spain was lowered to Baa3, the lowest investment-grade rating, from A3 and remains on review for a further cut after announcing plans to borrow 100 billion euros ($125 billion) from European Union rescue funds to recapitalize banks.

The lenders are facing the “reduced creditworthiness” of the nation as well as the “expectation that exposures to commercial real estate (CRE) will likely cause higher losses, which might increase the likelihood that these banks will require external support,” the ratings firm said in its statement.

Banco Santander

Banco Santander had its long-term debt rating cut to Baa2 from A3. That’s one step higher than the sovereign rating because of the Madrid-based lender’s geographical diversification and “manageable” level of direct exposure to Spanish debt, Moody’s said. BBVA, based in Bilbao, is rated Baa3, down from A3.

The ratings company, based in New York, also downgraded 16 Spanish banks on May 17.

The latest cuts reflect the government’s reduced creditworthiness, which lessens its ability to support the lenders, as well as Moody’s expectation that losses linked to commercial real estate will keep rising, according to yesterday’s statement.

Moody’s downgraded 15 global banks last week, saying their capital-markets businesses suffered from volatility and the potential for “outsized losses,” according to a statement. The ratings firm also cited the companies’ exposure to Europe. The ratings on Bank of America Corp. and Citigroup Inc. (C) were cut to two levels above junk.

Banking Rescue

Concern that Spain will struggle to bail out its banks as their loan losses mount has driven up the country’s
borrowing costs. The extra yield investors demand to hold Spain’s 10-year bonds rather than German bunds ballooned to 517.4 basis points on June 25 from 479.9 basis points on June 22. A basis point is a hundredth of a percentage point.

Spain requested the banking bailout in a letter to Luxembourg’s Jean-Claude Juncker, who leads the group of euro-area finance ministers.

Moody’s “views positively the broad-based support measures being introduced by the Spanish government to support the Spanish banking system as a whole,” analysts including Greg Bauer, global banking managing director, said in the statement. The ratings firm will assess the impact of the measures “once the final amount, timing and form of funds flowing to each individual bank are known.”

**Stress Tests**

The government of Prime Minister Mariano Rajoy published results of stress tests on June 21 that showed Spain’s banks may need as much as 62 billion euros of capital to withstand a worst-case economic scenario.

Oliver Wyman Ltd. estimated banks would need 51 billion euros to 62 billion euros should Spanish gross domestic product shrink by 6.5 percent over three years and housing prices drop 60 percent from their peak. Roland Berger Strategy Consultants said lenders would need 51.8 billion euros under those conditions.

The ratio of bad loans to total lending at Spain’s banks surged to 8.72 percent in April, the highest since 1994, from less than 1 percent in 2007, according to Bank of Spain data. Lenders have 184 billion euros of what the regulator terms problematic real estate-related assets after taking property onto their books following the collapse of Spain’s property boom in 2008.

“Moody’s action was fairly well telegraphed,” said Blake Howells, an analyst at Portland, Oregon-based Becker Capital Management Inc., which oversees $2.3 billion. “The market is well aware of the challenges these banks face.”

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