

Bank Outlook 2023: Running out of energy

European bank fundamentals are being pressured by the ongoing energy crisis. Risks from direct exposure to the energy sector are heading higher. Additionally, energy-intensive sectors stand to suffer from higher energy prices. We take a look at which banks are more exposed to the impacts of the energy crisis

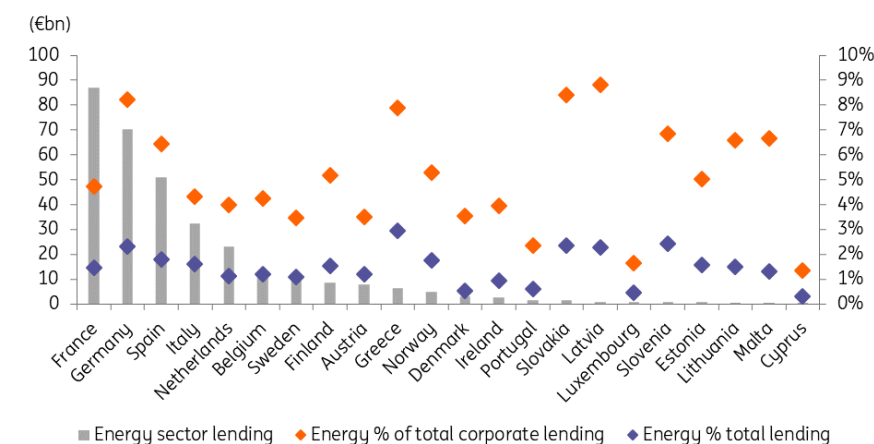


Substantial exposure to the energy sector

EU banks had €322bn in outstanding loans towards the energy sector (NACE sector D: electricity, gas, steam and air conditioning supply) as of the second quarter of this year, up by 18% year-on-year (or €50bn) according to the EBA. Since then, exposure to the energy sector has further increased. The substantial growth is being driven by the energy crisis as banks have supported energy companies and provided credit lines for them to meet their margin calls.

Energy sector lending accounts for 5.2% of total corporate lending but only 1.6% of total lending. The largest energy sector exposures are in French banks, but with large total books, their share of the total corporate lending is more contained at 4.7% and below 1.5% of their total lending. Banks with the proportionally largest energy sector exposures versus the size of the total corporate book include German banks (8.2%) and Greek banks (7.9%), where the share of total loans is also the highest among the larger EU countries.

Energy sector exposures in banks by selected countries as of 2Q22



Source: ING, EBA

It is important to note that energy sector lending is by no means one homogeneous group of exposures. Some of these corporates have benefited from higher energy prices, while others have ended up requiring state assistance or have even collapsed.

In the second quarter of this year, non-performing energy loans increased by 6% YoY. The nonperforming loan (NPL) ratio for the sector increased to 1.4% from 1.3% the previous quarter. The levels are still very low, but the risks have since increased. The energy sector has been a target of substantial government support measures in several countries. The massive energy package launched by the German government will likely indirectly support banks by limiting the credit risks of the energy sector for individual banks. Greece has also taken some measures to support households and businesses facing soaring energy bills.

The link between energy sector derivatives and banks

Banks provide energy companies with many types of services, which means that the massive increase and volatility in energy prices caused by supply disturbances impacts the banking sector. Energy companies use derivatives for hedging purposes. Banks act as a link between companies and central counterparties (CCPs), while some larger companies may access CCPs on their own account. Higher energy prices and volatility increase margin requirements on derivatives contracts forcing these companies to post additional collateral against the positions. For this purpose, banks may extend credit lines or provide bank guarantees.

EU banks held €50bn in financial assets held for trading that are related to commodity derivatives in the first quarter of the year, more than doubling on a year-on-year basis. Around 40% of these are said to be energy related. The exposures have further increased by 10% in 2Q22 according to the EBA preliminary statistics. The reported exposure value towards commodity CCPs for the top 20 banks was €129bn in June 2022, up by 15% from the year-end based on EBA. The exposures were in Belgium, Germany, Denmark, Spain, France, Ireland, Italy, the Netherlands and Sweden. The figures particularly increased in the Netherlands, Belgium and Germany. The amount of original large exposures cleared as of June 2022 amounted to €88bn (+88% from the year-end). These exposures also include commodity exposures.

Energy intensive lending

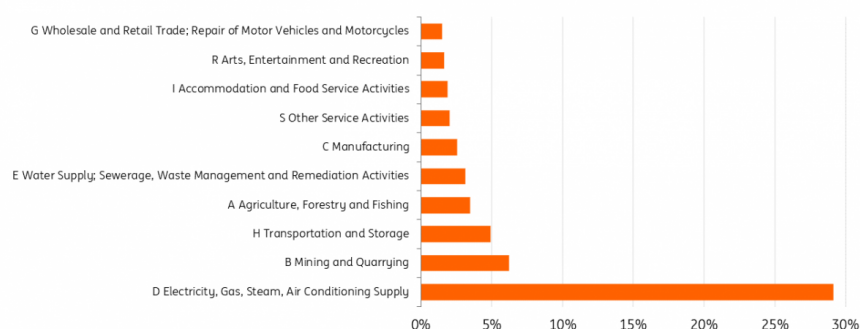
In addition to direct impacts, the energy crisis also impacts banks in an indirect fashion. Corporates that are heavily reliant on energy in their main function are likely to be more impacted by the disturbances in energy markets than those that require less energy for their operations. We are not discussing the actual energy sector here but rather sectors such as mining and quarrying, transportation and storage, agriculture, forestry and fishing, and water supply and manufacturing, which are all energy-intensive sectors. When ranked by their usage of energy outputs to total output, these sectors rank top.

EU banks are very exposed to corporates in high energy-intensive sectors

EU banks are very exposed to corporates in high energy-intensive sectors (excluding the energy sector) with the exposures amounting to €1.7tr or 27.9% of their total corporate lending books as of 2Q22. The exposures correspond to around 8% of total lending.

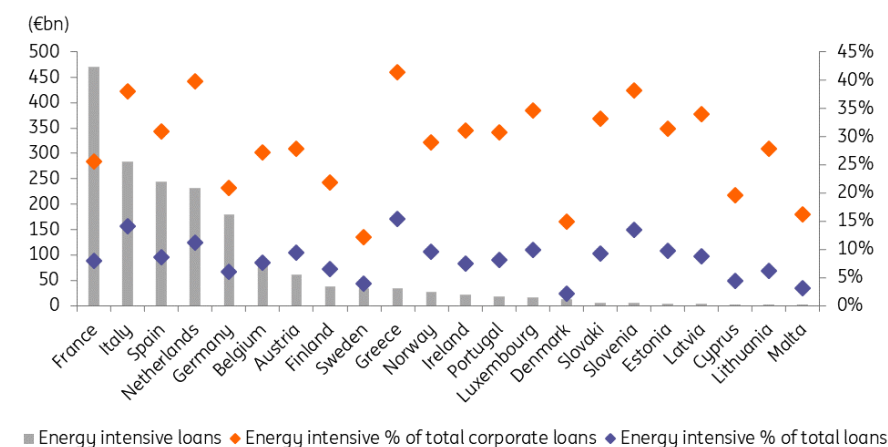
The highest absolute exposures are in French, Italian and Spanish banks. The share of energy-intensive sectors as a proportion of the whole corporate book or total lending is higher in countries such as Greece, Italy and the Netherlands when looking at larger countries, with the share in Spain positioned below them due to higher total loans.

Energy intensity by NACE sector (energy as a share of total output)



Source: ING Macro research

Energy intensive lending vs total corporate lending by selected countries as of 2Q22

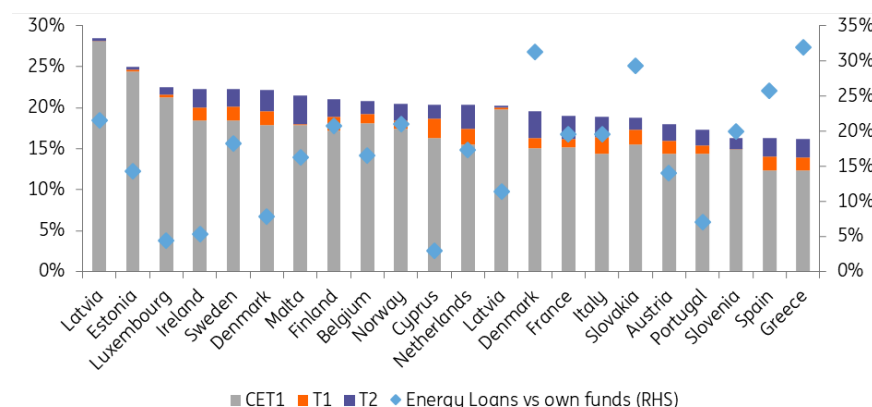


Capital buffers provide shelter from higher risks in lending

The various impacts of the energy crisis will pressure bank loan quality. The degree of impact depends on several factors, including possible government intervention, the extent to which the ECB tightens monetary policy, and the economic slowdown.

In our opinion, banks in general have very healthy capital buffers. The chart below shows that among the larger countries, banks in the Nordics remain among those with stronger risk-based capital buffers, while banks in southern Europe have relatively thinner risk-based capital buffers. Energy lending as a share of total own funds is higher in countries including Greece, Germany and Spain as banks have, on a relative basis, both higher exposures and lower capital buffers. The share gives some general indication of which banks' capital buffers are more exposed to the changes in the credit quality of these exposures.

Risk-based capital ratios vs energy exposures



Conclusion

In our view, the European banking sector is well-positioned to weather the upcoming negative

impacts of the energy crisis. However, the impact will not be experienced in the same way across the sector, due to differences in loan books. We would be more vigilant of banks that have high shares of lending to energy-intensive sectors. We note that while energy sector lending is at the centre of the current crisis, the impacts across the sector are very mixed. Substantial government support reduces the risks for banks.

We believe that banks in Germany, Greece, Italy, and the Netherlands are exposed to the impacts of the energy crisis via corporate lending. The largest absolute energy sector exposures are in French banks, but banks with the proportionally largest energy sector exposures include German and Greek banks. The indirect impacts are likely felt the most by corporate sectors that are energy-intensive. French names also have large exposures, but again proportionally the share of energy-intensive lending is higher in Greece, Italy and the Netherlands.

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