

Research Update:

Cooperatieve Rabobank Outlook Revised To Negative On Constrained Earnings; Ratings Affirmed

April 23, 2020

Overview

- Despite governments' measures to contain the COVID-19 pandemic, the Netherlands, and other countries where Cooperative Rabobank (Rabobank) operates, are facing unprecedented challenges and there are substantial downside risks.
- We expect the COVID-19-pandemic-related weaker economic prospects to affect Rabobank's profitability and asset quality.
- We are therefore revising to negative from stable the outlook on Cooperatieve Rabobank, core subsidiary Rabohypotheekbank, and highly strategic subsidiary Rabobank New Zealand, and affirming our issuer credit ratings.
- The negative outlook reflects debilitated short-term earnings prospects and asset-quality risks.

Rating Action

On April 23, 2020, S&P Global Ratings revised to negative from stable its outlook on Cooperatieve Rabobank, core subsidiary Rabohypotheekbank, and highly strategic subsidiary Rabobank New Zealand Ltd. We affirmed our 'A+/A-1' long- and short-term issuer credit ratings on Cooperatieve Rabobank, our 'A+' rating on Rabohypotheekbank, and our 'A/A-1' ratings on Rabobank New Zealand.

Rationale

The outlook revision follows a review of several Western European banking sectors, under which we revised our economic risk trend for the Dutch banking sector to negative from stable (see "Negative Rating Actions Taken On Multiple Benelux Banks On Deepening COVID-19 Downside Risks," published today on RatingsDirect). The revision of our outlook on Rabobank to negative from stable reflects market and economic stress prompted by the COVID-19 pandemic. Over the next 18-24 months Rabobank may face a material increase of problem loans and credit losses due to the COVID-19 pandemic, given the Dutch economy's heavy reliance on international trade.

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In addition to the human cost, the pandemic has caused large parts of global economic activity to grind to a halt. With isolation strategies still very much in force, we expect a sharp economic contraction in 2020, with a forecast 7.3% GDP decline in the eurozone (see "Europe Braces For A Deeper Recession In 2020," published April 20, 2020, on RatingsDirect). We project a rebound in 2021 but risks will likely persist, and the effects of COVID-19 will be evident long after the crisis subsides.

We continue to believe that, under the current circumstances, Rabobank's strengthened balance sheet, including its strong capital position by all measures, low risk appetite, and intervention from various stakeholders to support the real economy, are all important mitigating factors. In particular, we consider that the Dutch government has the fiscal flexibility to provide support to the real economy, as captured in our credit analysis of the Netherlands (AAA/Stable/A-1+). The strength of Rabobank's business model lies in its robust retail franchise in a wealthy country, focus on low-risk businesses, and brand recognition in the food and agriculture business globally. Nevertheless, the group is exposed to some segments that may be particularly set back by the current recession, especially its small business and entrepreneur clientele, and corporates active in the consumer discretionary spending segment. Although manageable in the context of a strong pre-provisioning income, we think the group's earnings will face an increase in International Financial Reporting Standards 9 credit impairments. The bank's capital generation through retained earnings is bolstered by its decision not to pay distributions on the upcoming scheduled payment dates, until at least Oct. 1, 2020, on its cooperative certificates (Rabobank Certificates), which are classified as core Tier 1 as per regulation.

An increase in problem loans could happen at a time where Rabobank's revenue generation capabilities are constrained by the low interest rates and its cost base remains high. Rabobank's cost to income for 2019 stood at 63.8% and may moderately deteriorate in 2020. We also note the importance for the bank to maintain access to long-term wholesale funding sources, which are going to be more expensive in the next quarters. On a positive note, Rabobank maintains a large buffer of liquid assets (€111 billion at end-2019), mainly comprising high-quality liquid assets, and manages its balance sheet with the objective to withstand difficult market conditions for a period of over one year.

Our long-term issuer credit rating on Rabobank New Zealand is one notch below that of the parent, reflecting our opinion of the subsidiary's highly strategic status for the group. We believe Rabobank New Zealand assumes an integral role in Rabobank's groupwide strategy, which emphasizes food and agriculture lending. Rabobank New Zealand is one of the largest bank lenders to this sector in New Zealand, with a market share of around 17%. Rabobank New Zealand's philosophy of supporting its customer base "through the cycle" benefits the bank's rapport with its customers and in turn its business stability.

Outlook

Cooperatieve Rabobank

The negative outlook reflects our expectation that, over the next 18-24 months, Rabobank may face a surge in problem loans and credit losses due to the COVID-19 pandemic. This points to the very open Dutch economy, with its large reliance on international trade. We also take into account the sensitivity of the bank's clients--many of them small and midsize enterprises and corporates in the food and agriculture sector--to logistical disruption and global demand.

Downside scenario

We would take a negative rating action if Rabobank were to encounter a more severe and prolonged asset quality deterioration than we currently expect, which could durably affect earnings and dent the bank's currently robust capital position, to an extent that our risk-adjusted capital ratio could decline below 10% by 2021.

Upside scenario

We would revise the outlook to stable in the next 18-24 months if the economic situation in the Netherlands stabilizes more rapidly than we currently expect, and the bank's operating performance proved resilient, thanks for instance to efficient countercyclical support measures from the authorities. This would also hinge on problem loans staying manageable. Any revision of the outlook to stable assumes the bank maintains an adequate liquidity buffer and good access to wholesale funding.

Rabobank New Zealand Ltd.

The negative outlook on Rabobank New Zealand mirrors that on its parent Rabobank. This is because we expect to maintain the long-term rating on Rabobank New Zealand one notch below that on its parent, recognizing the subsidiary's highly strategic importance to the broader group.

Downside scenario

We would lower our ratings on Rabobank New Zealand, if we were to lower our ratings on the group. We expect additional loss-absorbing capacity (ALAC) support would continue to flow through to Rabobank New Zealand.

We currently see very limited prospects of a significant deterioration in Rabobank New Zealand's operating performance or relevance for the group within the next two years such that we would consider revisiting the strategic importance of the New Zealand operations to the overall group, which would also be a trigger for a lower rating.

Upside scenario

We would revise the outlook to stable in the next 18-24 months, if we were to revise to stable the outlook on the parent, Cooperatieve Rabobank U.A.

Ratings Score Snapshot

Cooperatieve Rabobank

	To	From
Issuer Credit Ratings	A+/Negative/A-1	A+/Stable/A-1
SACP	a	a
Anchor	bbb+	bbb+

Cooperatieve Rabobank

	To	From
Business Position	Strong (+1)	Strong (+1)
Capital & Earnings	Strong (+1)	Strong (+1)
Risk Position	Adequate (0)	Adequate (0)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	+1	+1
ALAC Support	+1	+1
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

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
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Negative Rating Actions Taken On Multiple Benelux Banks On Deepening COVID-19 Downside Risks, April 23, 2020
- How COVID-19 Risks Prompted European Bank Rating Actions, April 23, 2020

- Europe's AT1 Market Faces The COVID-19 Test: Bend, Not Break, April 22, 2020
- How COVID-19 Is Affecting Bank Ratings, April 22, 2020
- Europe Braces For A Deeper Recession In 2020, April 20, 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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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