

FITCH WIRE

Delayed Novo Banco Sale Unfavourable for Portuguese Banks

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Fitch Ratings-London-30 September 2015: The sale of Novo Banco, halted on 15 September, may be delayed until mid-2016 and this could affect investor confidence in Portugal's still weak, but stabilising banking sector, says Fitch Ratings. The Bank of Portugal has indicated that sale talks will resume after the ECB publishes Novo Banco's stress test results.

Novo Banco was hived off from failed Banco Espirito Santo. As part of the resolution process, the Portuguese government provided a EUR3.9bn loan to the banking sector's Resolution Fund to recapitalise Novo Banco. Total capital injections reached EUR4.9bn. The difference was mostly covered by loans granted by Portugal's banks to the Resolution Fund. Proceeds from the sale of Novo Banco will be used to repay the loan, but if the sale price is lower than the size of the loan, the Portuguese banks will have to cover the shortfall. The banks therefore have an interest in achieving a timely and high-value sale.

The original plan had been to sell the entire capital of Novo Banco but, more recently, indications are that disposals may be staggered, with smaller stakes being offered for sale as and when market conditions permit. Should Novo Banco's performance improve, this could unlock greater value, although to date, Novo Banco has reported net losses. Another option, reported in the press, is to raise capital by selling off Novo Banco's real-estate assets.

Operating conditions for Portuguese banks remain tough, but 1H15 results of Fitch-rated banks showed a timid recovery in profitability. Most banks reported profits, with the exception of Montepio, which faces weak net interest income and material loan impairment charges. Credit-at-risk ratios, which measure asset quality, are rising far more slowly. This is good news because it suggests a slowdown in default rates.

The ECB's stress test, to be published by end-2015, should clear up some questions about Novo Banco's solvency position, paving the way for a resumption of the sale process. In the interim, however, the delayed sale, combined with uncertainties about the extent of related liabilities for the banking system, may undermine investor sentiment and affect Fitch's assessment of the system's capital adequacy.

Fitch assumes that, in the event of large losses at Novo Banco, banks' payments to cover the shortfall would be spread over several years, but the regulator has not yet provided information on that. Caixa Geral de Depositos and Banco Comercial Portugues are the largest contributors to the fund, although the potential costs for each individual bank depends on their relative capital and profitability levels as well as on any deferral mechanism.

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