Research Update:

UniCredit Outlook Revised To Stable From Negative; 'BBB/A-2' Ratings Affirmed

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Overview

- Economic risk in most of the countries where UniCredit operates has receded, in our view.
- We think UniCredit's significant geographic diversification and the progress it has made over the past few years to improve its financial profile will help mitigate the risks to its creditworthiness posed by the pandemic.
- We are therefore revising our outlook on UniCredit to stable from negative and affirming the 'BBB/A-2' issuer credit ratings.
- The stable outlook reflects our view that the bank's credit profile will remain resilient.

Rating Action

On June 24, 2021, S&P Global Ratings revised its outlook on UniCredit SpA to stable from negative. At the same time, we affirmed our 'BBB/A-2' long- and short-term issuer credit ratings on the bank.

We also affirmed all our other ratings on the bank.

Rationale

We consider that UniCredit's significant geographic diversification will help mitigate residual risks over the remainder of the credit cycle. Despite the continuing negative trend that we see for economic risks in Italy, we are now observing easing downside risks in other important markets where UniCredit operates, such as Germany and Austria. Aided by unprecedented levels of fiscal support, these economies showed resilience during the pandemic. While nonperforming exposures (NPEs) will likely keep rising into 2022, for UniCredit (as for European peers) we now see reduced uncertainty as to how badly the downturn will affect the bank's asset quality. This gives us more confidence that UniCredit will demonstrate resilience to pandemic-related stress.

The progress UniCredit has made in recent years--to increase its capital base, clean up its balance sheet, and enhance its credit risk management--will cushion it against expected asset quality deterioration, in our view. UniCredit has now almost entirely disposed of its large legacy NPEs and, since the pandemic began, has set aside a provisioning buffer. While we expect NPEs to start rising in 2021 and 2022 once most of the authorities' supporting measures taper off, we anticipate credit losses to gradually decline to about 70 basis points (bps) on average in 2021-2023 from about 114 bps in 2020. In our base-case scenario, we assume the deterioration will eventually be manageable for UniCredit and significantly less severe than what it experienced during the previous downturn.

We anticipate UniCredit's revenues to remain under pressure and take time to recover amid longer term challenges to operating conditions such as low-for-longer interest rates and intense competition. Despite its recent restructuring efforts and its large size, UniCredit is less diversified from a business perspective than some of the other large European banking groups; it has no insurance business and sold its asset management businesses. This leaves it more exposed to the intrinsically low profitability of some of its core banking businesses. These structural constraints, paired with cyclical headwinds, such as low-for-longer interest rates, weigh on its earnings, in our view. We expect the group's bottom-line profitability will only gradually recover to pre-pandemic levels, helped by fee income and cost-containment initiatives. We note the new management team's commitment to tackle the bank's structural profitability challenge and we will monitor its risk appetite in pursuing this goal. While we note that management could use M&A as a growth accelerator, we will assess the risks of any potential transaction if it were to materialize.

We expect UniCredit's capitalization to remain sound. We estimate its risk-adjusted capital (RAC) to remain at about 8% in the next two years, from an estimated 8.1%-8.4% as of December 2020. Our RAC calculation is sensitive to potential changes in economic risk in Italy, where we currently see a negative trend. We calculate that the overall sensitivity of the projected RAC ratio to it would be about 40-50 bps. Our forecast assumes about a 75%-80% dividend payout in 2021-2023, pending European Central Bank (ECB) approval. We expect the bank to partially distribute its regulatory capital buffer while maintaining sound regulatory capital ratios.

At the 'BBB' rating level, we see limited downside risks under our peer analysis or from sovereign developments. While we continue to look out for signs of sustainable growth that reinforces the bank's profitability and covers its cost of capital, on a peer-comparison basis we see UniCredit's credit standing as similar to peers. Key peers around the 'BBB' rating level include Intesa, Mediobanca, Deutsche Bank, Commerzbank, Bank of Ireland, and Barclays. Furthermore, we expect Italy will benefit from the ECB's highly supportive monetary stance and the forthcoming EU recovery fund. This support should help mitigate the pandemic-related deterioration of the sovereign's public finances.

Outlook

The stable outlook on UniCredit primarily reflects our view that, at the current rating level, the bank's credit profile will remain resilient over the next two years despite the pandemic-related economic impact. Specifically, we anticipate the bank's profitability will gradually recover and support its capitalization with its RAC ratio remaining comfortably above 7% and asset quality metrics remaining in line with peers'.

Downside scenario

We could lower the ratings on UniCredit if we concluded that the economic risks in its main geographies have substantially increased and, contrary to our expectations, its asset quality and capital buffers have meaningfully deteriorated. We could also lower the ratings if the bank undertook aggressive acquisitions that we considered detrimental to its financial profile. If we were to lower our ratings on Italy, this would not necessarily lead us to lower our ratings on UniCredit if the bank continued to build up loss-absorbing buffers to protect senior bondholders and contain its exposures in Italy, all of which would improve its chances of withstanding a sovereign default.

Upside scenario

Although unlikely at this stage of the credit cycle, we could upgrade UniCredit if we concluded that the bank's creditworthiness had improved sufficiently, for example if it materially reduced further nonperforming loans and at the same time substantially strengthened its profitability, while being able to withstanding a sovereign default.

Ratings Score Snapshot

UniCredit SpA Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB/Stable/A-2	BBB/Negative/A-2
SACP	bbb	bbb
Anchor	bbb	bbb
Business Position	Strong (+1)	Strong (+1)
Capital and Earnings	Adequate (0)	Adequate (0)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and	Average and (0)	Average and (0)
Liquidity	Adequate	Adequate
Support	0	0
ALAC Support	0	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	None	None

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- 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: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
UniCredit SpA		
Issuer Credit Rating	BBB/Stable/A-2	BBB/Negative/A-2