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Santander CEO Derides Surge in Spain Defaults: Mortgages

By Charles Penty and Esteban Duarte - Apr 27, 2012

JPMorgan Chase & Co. (JPM), the world's largest bond underwriter, predicts that Spanish mortgage arrears will surge as unemployment rises. That's also the view from the international debt market, which has driven up yields on Spain's bonds in a bet the country will have to bail out banks.

In Spain, Banco Santander SA (SAN) Chief Executive Officer Alfredo Saenz said yesterday that's nonsense. "Mortgages get paid in good times and in bad," he said in a news conference at the bank's headquarters outside Madrid. "Anyone raising this problem as one of the issues for the Spanish financial system is saying something stupid."

There's more at stake than the credibility of the CEO of the country's largest lender. If he's right, investors betting against his bank and the country will lose. If he's wrong and delinquencies rise, that will weaken the nation's banks as Spain's Prime Minister Mariano Rajoy seeks to restore the recession-hit economy. Concern about Spanish lenders already has helped push the country's 10-year borrowing costs to about 6 percent, adding to concern that borrowing costs may reach levels that prompted bailouts for Greece, Ireland and Portugal.

Saenz's comments underscore a growing gap between Spanish banks' statements about the mortgages they hold and forecasts such as those by the JPMorgan analysts for further losses as unemployment exceeds 24 percent. Santander said the ratio of defaults on its home loans fell in the first quarter, while the Bank of Spain said it's still below 3 percent nationally.

'Strange Contrast'

"There does seem to be a strange contrast between the high level of unemployment and the surprisingly low level of delinquencies on mortgages," said Georg Grodzki, who helps oversee $515 billion as head of credit research at Legal & General Plc in London. "This raises the issue of whether loans have been amended to make them look current when in fact they are distressed."

The more than 600 billion euros ($792 billion) of outstanding home loans on the books of lenders may be the "next elephant" for Spain as unemployment spurs defaults, JPMorgan analysts including Roberto Henriques and Gareth Davies wrote in a report published April 26. Spain's jobless rate rose to 24.4 percent in the first quarter, the highest level in 18 years, from 22.9 percent in the previous three months, the National Statistics Institute said today.

Even so, the ratio of home loan defaults dropped to 2.74 percent in December, down from 3 percent in 2009, according to Bank of Spain data. That compares with the 7.6 percent late payment rate in the U.S. where unemployment is 8.2 percent. In Ireland, joblessness is 14.3 percent and the delinquency rate is 9.2 percent.

Jobless Ratio

Spain's jobless ratio is at the highest level in almost two decades, with the economy mired in a recession that theInternational Monetary Fund predicts will cause it to shrink by 1.8 percent in 2012. Standard & Poor's yesterday cut the country's credit rating to BBB+ from A, on concern the nation will need to provide further fiscal support to the banking sector as the economy contracts. The yield on Spain's 10-year benchmark bonds rose 13 basis points to 5.96 percent at 11:31 a.m. in London.

Economists at JPMorgan forecast Spanish unemployment will reach 30 percent, and mortgages may be the "next leg downward in a prolonged banking crisis where sector solvency remains a risk," the analysts said.

"At a minimum we would expect arrears to increase significantly from the current levels," they wrote, adding that they "run into vocal objections" when they associate Spain's housing market with Ireland's. Davies declined to comment on Saenz's comments.

Spanish Culture

Saenz said Spanish culture is part of the reason why default rates remain low.

Spaniards tend to keep up their mortgage loans because borrowers respond with all their assets and not just their property if they default, Lorena Mullor, manager of the Spanish mortgage association, said in an interview. Many treat the purchase of their home as a valuable asset that will help fund their retirement and can rely on the support of their families to help them keep up payments if they lose their jobs, she said.

"It's a sociological thing and that's how it is," said Saenz.

Santander had 59.4 billion euros of loans made to Spanish households to buy homes at the end of 2011 out of a total loan book in Spain of about 200 billion euros. The default ratio was 2.6 percent in March, down from 2.7 percent at the end of 2011, the bank said.

"The data is good so let's not start debating the quality of the information," said Saenz. "Mortgage arrears are not a problem and are not going to be a problem."

Defending Loan Quality

Santander isn't the only Spanish bank defending its mortgage loan quality.

People "tend to look at the negative side, the unemployed that we have here," said Manuel Gonzalez Cid, chief financial officer of Banco Bilbao Vizcaya Argentaria SA (BBVA), Spain's second-biggest lender, in an April 25 webcast for analysts. "But we don't look at all the people who are working, who are paying their mortgages and paying their loans in a very normal fashion."

Of BBVA's 79 billion euros of residential mortgage loans in Spain, 2.37 billion euros, or 3 percent, were impaired at the end of 2011, according to the bank's annual report.

While default rates for Spanish mortgages remain broadly stable, wider data on bad loans point to a worsening asset quality problem for Spanish lenders that's hitting bank stocks and stirring concern that the task of supporting ailing lenders may pile up costs for the government. Non-performing loans as a proportion of total lending jumped to 8.16 percent in February, the highest level since 1994, according to Bank of Spain data.

Calling The Peak

Calling a peak for Spanish loan defaults has proved a tricky exercise for bankers including Saenz.

As recently as October last year, Saenz admitted he'd "got it wrong" when he gave a forecast three months earlier that the bad loans ratio would "plateau" from the start of 2012. Saenz yesterday said bad loans would keep rising into the first half of 2013.

Credit default swaps tied to Banco Santander rose to 409 basis points yesterday from 406 basis points a day earlier, according to Bloomberg data. The contracts that protect investors from a default on the Spanish lender's senior debt had risen this year from as low as 232 basis points on Feb. 7, signaling a deterioration of the creditworthiness.

Bondholder Confidence

Bondholder confidence in bonds tied to Spanish residential-mortgage backed securities deteriorated this month by the most of any major European country. Investors demand 565 basis points, or 5.65 percentage points, above the euro interbank offered rate, or euribor, to buy senior bonds backed by Spanish mortgages, according to JPMorgan. That's 65 basis points higher than in March and 225 basis points more than a year ago. Similar debt pooling British home loans pays a spread of 138 basis points.

Mortgage lending in Spain ballooned from 2000 to 2010, expanding more than four-fold as banks funded a housing boom. The more than 600 billion euros of home loans compares with about 300 billion euros in lending linked to property development.

"People have been focused on the commercial real estate but if the problem spreads to the residential mortgage side as it has in Ireland, then that's a major problem," said Olly Burrows, a credit analyst at Rabobank International in London."Because of the size of the mortgage book, even a small impact in non-performing loans would have a big impact."

House Prices

Concern about the default data for mortgages also reflects concern that house prices still have further to decline, said Burrows. Price declines would damage the value of collateral backing mortgage loans and lead to further losses for banks, he said.

Home prices have fallen 21.7 percent from the market's peak in 2007, according to the government's statistics institute. They may decline another 20 percent over the next four to five years, according to R.R. de Acuna & Asociados, a property consultancy company. House prices in Ireland have almost halved since their 2007 peak and some investors may assume that Spanish prices will eventually follow that path, said Burrows.

Based on Irish default levels, a similar trend in Spain would lead to losses of 59 billion euros for the banks there, according to the JPMorgan analysts.

The picture is clouded by the increasing willingness of banks to change the terms of loans to help customers keep up loan payments. Bankia SA (BKIA), Spain's third-biggest bank, said April 24 that it's making 110 changes to loan terms a day and that mortgages made up 45 percent of the 7,300 term adjustments it carried out in the first quarter.

"Mortgages for individuals in all markets, including the U.S. and the U.K., normally are very resilient and resistant when the situation changes," said Saenz. "That's because mortgages get paid."

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