S&P Global Ratings

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Global Banking: Recovery Will Stretch To 2023 And Beyond

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Key Takeaways

- Recovery of banking jurisdictions to pre-COVID-19 levels will be slow, uncertain, and highly variable across sectors and geographies.
- Many prominent banking systems may not recover until 2023 including the U.S., U.K., France, Germany, Spain, Italy, Japan, Australia, Brazil, Indonesia, and Russia.
- China, Canada, Singapore, Hong Kong, South Korea, and Saudi Arabia are among the banking systems likely to recover first--by the end of 2022.
- India, Mexico, and South Africa are among the banking systems that will be slower to recover to 2019 levels--likely beyond 2023.

COVID-19 and the oil price shock of 2020 are taking a heavy toll on global banks. S&P Global Ratings has taken 335 negative rating actions globally since the outbreak began, and we anticipate it will be difficult for the financial strength ratings on financial institutions to return to pre-crisis levels. We don't expect the world's largest banking sectors, including more than half of G20's, to recover to pre-COVID-19 levels until 2023, or beyond.

We have already negatively revised the economic or industry trends underpinning the financial strength of many banking jurisdictions globally. This trend should persist. Further, we have seen negative rating momentum affecting financial institutions in most major banking jurisdictions, indicating that downside risks are to the fore.

Even for less-affected banking jurisdictions, recovery to pre-COVID-19 levels will unlikely come before end-2022. These jurisdictions include China, Canada, Singapore, Hong Kong, South Korea and Saudi Arabia. Risks remain firmly on the downside for these banking jurisdictions, in our view.

The recovery for some other jurisdictions will likely be much further out. For India, Mexico and South Africa, a recovery to pre-COVID-19 levels may not arrive until after 2023.

The hit on financial institutions globally has been unambiguously negative. Our negative rating actions since March 1, 2020, to Sept. 7, 2020, include 234 rating actions on banks and 101 rating actions on nonbank financial institutions (NBFIs). Most rating changes are outlook revisions (236, or 70% of total rating actions). Rating downgrades and negative CreditWatch placements account for the remainder.

We have made negative revisions for 42 of our 88 Banking Industry Country Risk Assessments (BICRAs) since the onset of the crisis, including on our views of economic and industry trends. (see "Banking Industry Country Risk Assessment Update: August 2020," published on RatingsDirect on Aug. 21, 2020).

Even for those jurisdictions that have been more resilient, our outlook for banking sector credit metrics as well as metrics applicable to individual banks are uniformly weaker.

To estimate the shape of recovery for banks, S&P Global Ratings has analyzed 20 of the largest banking systems globally. The analysis takes into account our macro base-case scenario (see "Global Credit Conditions: The Shape Of Recovery: Uneven, Unequal, Uncharted," published July 2, 2020). This base case assumes that a vaccine is not available until about mid-2021.

Our base case considers the ongoing effects of the pandemic, the oil price shock, and other market stresses on our BICRAs and bank ratings. These 20 banking jurisdictions are segmented into three groups: early-exiters, mid-exiters, and late-exiters (see chart 1 and table 1).

Financial institutions across these 20 jurisdictions accounted for 195 rating actions of the 335 negative rating actions globally affecting financial institutions as of Sept. 7, 2020 (see chart 2).

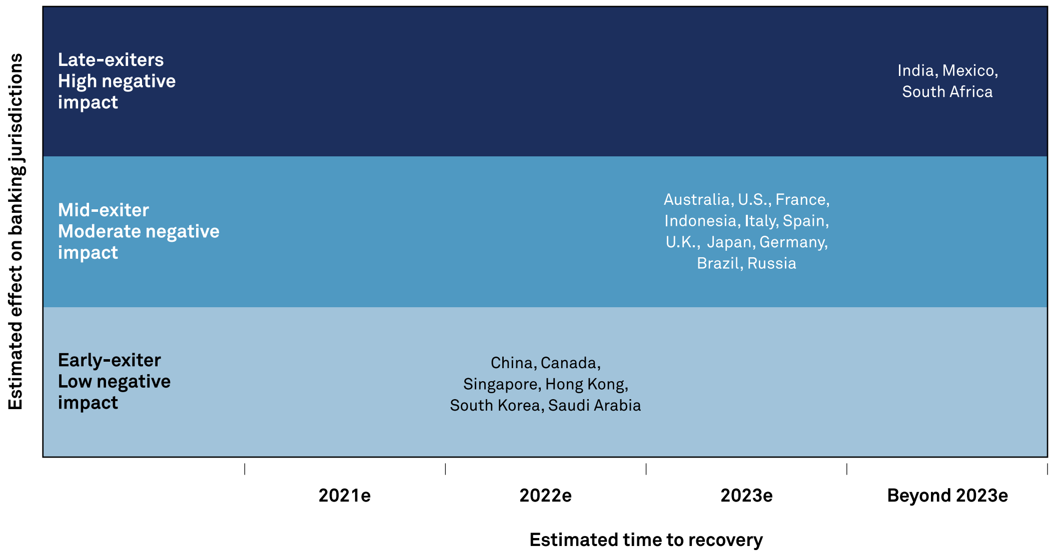
Many banking jurisdictions will only recover in 2023 or beyond. Early-exiter jurisdictions include those where there has been no hit on our BICRAs to date and limited effect on financial institutions ratings. For these jurisdictions we estimate that recovery to pre-COVID-19 status is nearest.

Late-exiter banking jurisdictions include those where BICRAs have already been negatively adjusted, post-COVID-19. For these jurisdictions we view the recovery to pre-COVID-19 levels as furthest away.

Our views on macro credit factors and forward expectations for BICRA and ratings primarily inform our views on this recovery. While they can be instructive, we are less focused on individual bank metrics and ratios pertaining to certain rating sub-factors.

Chart 1

Our Estimate Of Recovery Prospects For Selected Banking Jurisdictions Because Of COVID-19, Oil Price Shock, And Other Market Stresses



Note: The estimated time to recovery takes into account forward estimates of systemic and bank-specific credit factors guided by Banking Industry Country Risk Assessments (BICRA) and entity-specific rating actions to-date. Time periods are in years based on full calendar year. All information is based on analysts' estimates. Banking sector recovery prospects for early-exiter jurisdictions are sooner, for late-exiter jurisdictions are later, and mid-exiter jurisdictions in between. Estimated impact is driven by COVID-19, oil price shock, and other market stresses. e--Estimate. Source: S&P Global Ratings.

Recovery Will Vary Across Banking Jurisdictions

Our base case assumes an economic rebound in 2021 following the release of a vaccine by about the middle of that year. We anticipate a lag between when an economic recovery takes hold and when the credit strength of banks stabilizes.

Even for the least affected--the likely early-exiter banking jurisdictions--stabilization and recovery may take a full 18 months or more after an economic rebound.

We anticipate there will be much uncertainty on the recovery pathway. Banking sector recovery will not just depend on the economic recovery occurring broadly in accordance with our base case, but also on the nature and extent of the economic damage affecting firms and households prior to the onset of the economic recovery, and the extent to which this will hit banks. Already, we forecast credit losses of about US$2.1 trillion for 2020 and 2021 for the global banking sector, spurred by the pandemic (see, "The $2 Trillion Question: What’s On The Horizon For Bank Credit Losses," July 9, 2020).

Table 1

Early-, Mid-, and Late-Exiters--A Breakdown Of Terminology

Estimated shape of recovery for banking jurisdictions	Effect on banking sector credit outlook	Expected recovery	Description
Late-exiters	High negative	Beyond 2023	Late-exiter banking jurisdictions are those where COVID-19 and other stresses have already had a meaningful negative effect. That is, BICRAs have already been negatively revised. Potential recovery to pre-COVID-19 status is considered furthest, and timing is less certain after the onset of COVID-19.
Mid-exiters	Moderate negative	2023	Mid-exiter jurisdictions are mainly those where the BICRA is unchanged but the Economic Risk Trends or Industry Risk Trends underpinning BICRA have been revised negatively after the onset of COVID-19. It also includes jurisdictions where Economic Risk Trends or Industry Risk Trends underpinning BICRA have not been revised negatively post-COVID-19 but where other perceived vulnerabilities could delay recovery. These could include, but are not limited to, Economic or Industry Risk Trends already negative prior to the onset of COVID-19; higher-than-average negative rating actions on banks because of COVID-19; high COVID-19 infections that could affect recovery of banks notwithstanding no or limited effect on banks to-date; and inherently higher-risk banking systems where recovery could plausibly be further, rather than nearer, based on analyst estimates.
Early-exiters	Low negative	2022	Early-exiter jurisdictions are demonstrating the greatest resilience to the economic effects of COVID-19. So far, there has been no effect on BICRAs in these jurisdictions, and limited effect on financial institutions ratings. However, banking system metrics and entity-specific metrics have been negatively affected. Estimated recovery to pre-COVID-19 status is considered nearest.

BICRA--Banking Industry Country Risk Assessment. Information is based on analyst estimates. Source: S&P Global Ratings.

Early-, Mid-, and Late-Exiter Banking Jurisdictions

Country- and bank-specific credit developments in the year to date inform our assessment of the recovery prospects across banking jurisdictions. It has been about six months on average since the onset of the pandemic across countries, with the effect on banks becoming clearer.

Early-exiter banking jurisdictions (see chart 1 and table 1) have so far demonstrated the greatest resilience to the economic effects of COVID-19. We believe these jurisdictions will exit the effects of the pandemic the quickest.

The early-exiter jurisdictions are in general coping more satisfactorily with the huge slump in demand triggered by the pandemic. In these jurisdictions there have been no change so far in our BICRA or underlying economic or industry risk trends compared with pre-COVID-19 levels. Likewise, changes in bank ratings have been minimal.

This is not to say pandemic-induced economic strains won't eventually hit these jurisdictions, just that the effects have been muted so far.

Further, rating considerations with a less direct connection to the pandemic may yet hit bank credit in banking jurisdictions. We are mindful, for example, of the economic spillover effects on banking jurisdictions from the U.S.-China strategic confrontation.

Early-exiter banking jurisdictions are hardly escaping unscathed from the pandemic. Banking system metrics and banks' metrics are affected in these jurisdictions, as elsewhere. The hits are just not as material from a ratings perspective.

For China, banking sector stabilization and recovery are not likely until end-2022. That's despite being the only major economy globally for which we assume positive GDP growth in 2020, and where COVID-19 infections are low.

By contrast, late-exiter banking jurisdictions are those jurisdictions where COVID-19 and other stresses have already had a meaningful negative effect. We have already made negative revisions on our BICRAs in these jurisdictions, and on our ratings on banks and NBFIs.

We have taken negative rating actions on Indian banks and NBFIs as operating conditions have deteriorated through the crisis. The country entered the pandemic with an overhang of high nonperforming assets.

In Mexico and South Africa, the weaker economic outlook and sovereign rating actions have driven negative rating actions on banks and NBFIs. We anticipate their recovery to pre-COVID-19 status to be furthest out, and the timing less certain, among our sample of 20 large banking jurisdictions.

Mid-exiter jurisdictions cover a wide range. They include banking jurisdictions where our BICRA is unchanged but the Economic Risk Trends or Industry Risk Trends underpinning BICRA were revised after the onset of COVID-19 and oil price shock.

For the U.S., France, Australia, Indonesia, Italy, Spain, and the U.K. we revised economic risk trends to negative from stable. For France, we also revised the industry risk trend to negative from stable. For Italy, we revised industry risk trends to stable and revised economic risk trends to negative.

Mid-exiter jurisdictions also include jurisdictions where economic trends or industry trends underpinning BICRA have not been revised negatively post-COVID-19. However, in these jurisdictions, our estimates take into account the possibility that recovery may take up to three years.

Considerations include, but are not limited to:

- economic or industry risk trends that already negative prior to the onset of COVID-19;
- higher-than-average negative rating actions on banks because of COVID-19;
- high COVID-19 infections that could affect recovery of banks notwithstanding a limited or zero hit on banks to date;
- and inherently higher-risk banking systems where recovery could plausibly be further, rather than nearer, based on analyst estimates.

In Japan, we have taken 16 bank rating actions encompassing major banks, regional banks, and government-related financial institutions. Sovereign- and bank-specific rating factors drove the actions.

In Germany, we have undertaken seven negative rating actions on financial institutions as COVID-19 downside risks increase. We note that economic trends and industry trends in Germany were negative prior to the onset of COVID-19.

For Brazil, the stand-alone credit profiles of banks have held firm since the onset of COVID-19 and the Brazilian banking system seems to be holding up best among major Latin American jurisdictions. Sovereign rating considerations have driven rating actions to date affecting Brazilian banks. We have revised the outlook on the sovereign rating to stable from positive.

The Russian banking system has also been relatively resilient throughout COVID-19 and the drop in oil price. We view Russia's banking system as higher risk compared with China's and Brazil's.

The recovery prospects for the banking systems of Brazil, Russia, and other emerging markets appear more challenged than China's. China has significantly lower COVID-19 infections and still positive short-term economic growth prospects. As at Sept. 21, 2020, COVID-19 infections in China were under 100,000. This was much lower than Brazil (4.5 million), India (5.4 million), and Russia (1.1 million), according to John Hopkins Coronavirus Research Center.

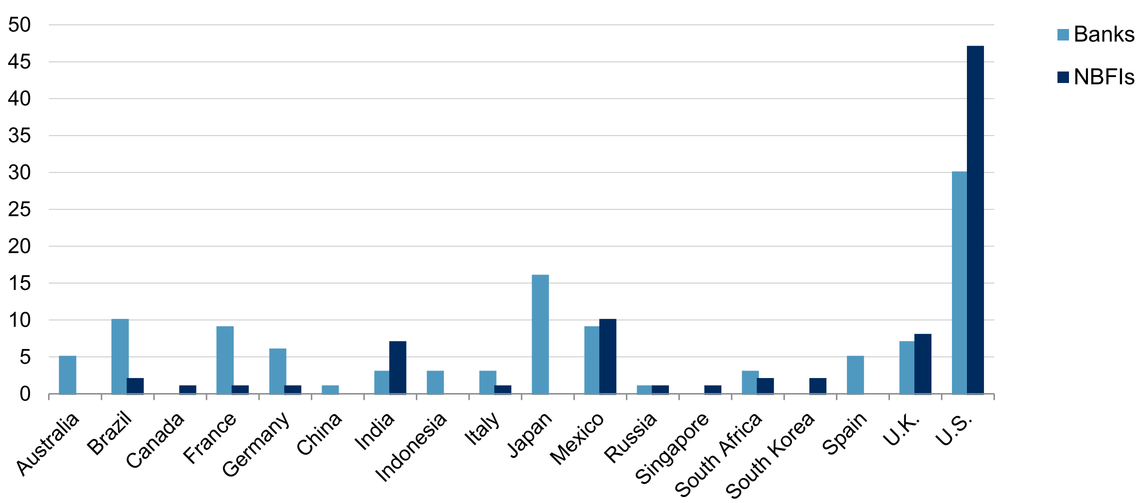
We believe that the Saudi Arabian banking sector may be an early-exiter. We anticipate an increase in credit losses in the country in 2020 and 2021 due to the end of regulatory forbearance. Post 2021, banks will likely use the cost of risk to avoid significant fluctuations in net income.

In Saudi Arabia, while metrics might only return to 2019 levels in 2023, recovery will likely be substantially complete before then. Further, the Saudi system benefits from solid structural profitability, allowing Saudi banks to comfortably absorb losses and likely keep the return on average assets above 1.2% across 2020-2023.

Chart 2

Negative Rating Actions Affecting Banking Jurisdictions Have Jumped Post-COVID-19

Number of affected financial institutions by jurisdiction



Note: Data as of Sept. 7, 2020. Number of affected ratings in part reflects the number of rated entities, by jurisdiction, which varies. For example, the U.S. has a large number of rated banks and nonbank financial institutions, by global standards. Ratings actions include rating downgrades and outlook revisions. NBFIs--Nonbank financial institutions. Source: S&P Global Ratings.

Bank Credit Is A Secondary Effect Compared With Corporate Credit

As for the corporate sector globally, where the effect of the pandemic on industries and regions has been highly variable (see "COVID-19 Heat Map: Post-Crisis Credit Recovery Could Take To

2022 And Beyond For Some Sectors," published June 24, 2020) the hit on banks is also uneven. A key difference between companies and banks is that the impact on bank credit is a "slower burn" compared with corporate credit. The economic spillover of COVID-19 on banks is more a secondary factor, rather than primary.

The effect of COVID-19 on large diversified banks is defrayed across a very large number of borrowers. The performance of these banks is more likely to mimic the shape of the economic recovery, compared with many corporate sectors, but with a lag.

It takes time for the economic downturn to manifest in bank credit. It also takes banks time to benefit from an economic recovery, given they are working through nonperforming loans accumulated during the downturn.

Some corporate sectors are more pro-cyclical than banks. We note also that banks didn't see the increase in leverage that many corporates experienced in the run-up to the pandemic (see "Next Debt Crisis: Earnings Recession Threat," Sept. 30, 2019). This is mainly because of banking regulations and prudential guidelines constraining banks' activities, including leverage.

BICRA Framework--A Lens To View Recovery

The BICRA framework is designed to evaluate and compare global banking systems. A BICRA analysis for a country covers rated and unrated financial institutions and incorporates the entire financial system of a country. It does this by considering the relationship of the banking industry to the financial system, including nonbank participants.

BICRA looks out three to five years. For banking systems where the pandemic has already hit BICRA scores, or where economic or industry risk trends have been negatively revised, banks' recovery back to pre-COVID-19 levels may be slow.

The rating methodology for banks uses the economic and industry considerations in the BICRA analysis to determine an anchor. This acts as a starting point for determining banks' stand-alone credit profiles (SACPs). Where BICRAs are negatively affected, this typically implies a negative SACP hit on banks within the jurisdiction.

The BICRA analysis incorporates the influence of government supervision and regulation of the banking system, including emergency system-wide support. It excludes the potential for targeted government intervention and the rescue of specific financial institutions.

Extraordinary government support for systemically significant institutions is reflected in a ratings uplift on the institutions. Ratings uplift can also be derived (as relevant) from an individual entity's parent group, or from additional loss-absorbing capacity (ALAC).

As many bank rating actions since the onset of COVID-19 and oil price shock have demonstrated, the creditworthiness of a sovereign and its banking sector are closely related.

In Brazil, the sovereign rating has driven negative rating actions to date on banks. The sovereign rating outlook was recently revised to stable from positive.

In other jurisdictions--such as in Japan, Mexico and South Africa--a mix of sovereign and bank factors have driven rating actions. The influence of a sovereign's creditworthiness on the related BICRA, and likewise on banks that are systemically important and considered by us to be likely beneficiaries of extraordinary government support, is clearly more pronounced when the sovereign's creditworthiness deteriorates.

This is not to say that BICRA or sovereign rating actions have driven all rating actions affecting financial institutions since the onset of the pandemic. Entity-specific considerations have driven numerous rating actions on banks, and many rating actions on NBFIs. This is particularly true for NBFIs in the U.S.

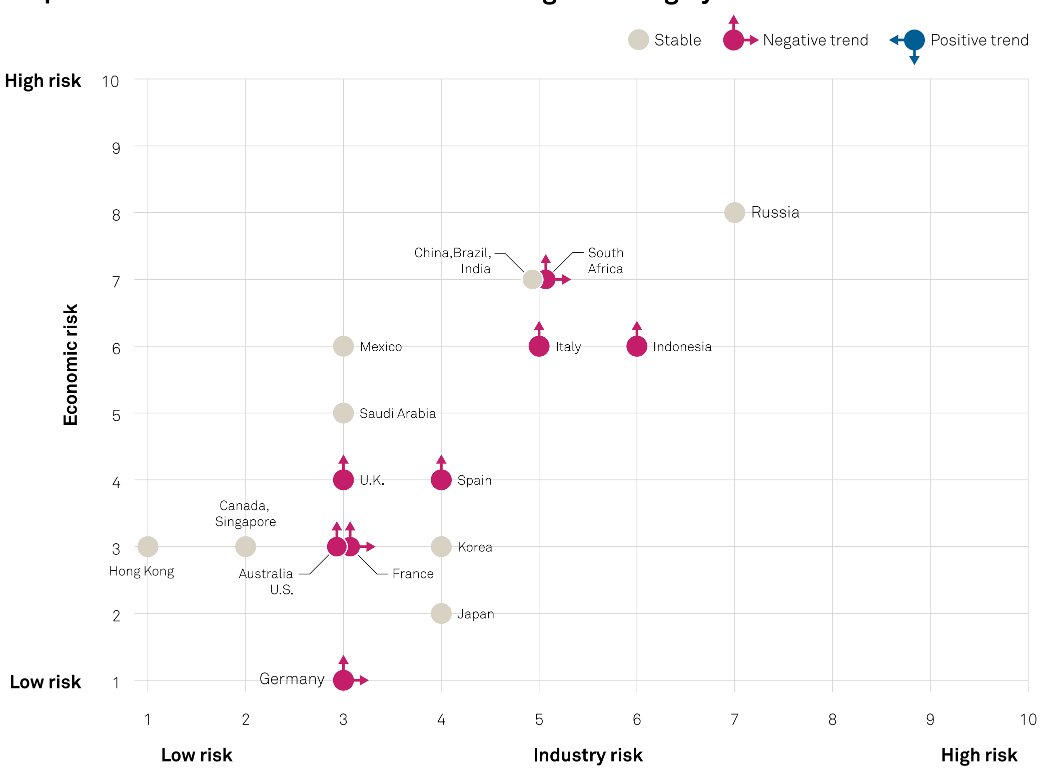
Broadly speaking, a mix of factors affecting BICRAs, sovereigns, and institution-specific factors, will drive the recovery for the global financial institutions.

In assessing the shape of the recovery back to pre-COVID-19 levels, this analysis takes into account that our BICRA framework covers 88 banking jurisdictions over a wide spectrum of economic and industry risks (see chart 3a, which shows our economic and industry risk assessments over 20 jurisdictions; plus chart 3b, which shows BICRA global developments in 2020).

Our analysis estimates when banking sector credit strength will recover to pre-COVID-19 levels. The starting point differs for each jurisdiction depending on its underlying country risk profile, and the characteristics of individual institutions.

Chart 3a

A Spectrum Of Risks Across 20 Selected Large Banking Systems



A BICRA (Banking Industry Country Risk Assessment) is scored on a scale from 1 to 10, ranging from the lowest-risk banking systems (group 1) to the highest-risk (group 10). The economic and industry risk trends are assessed as negative, stable or positive. Upward and sideways facing arrows have been used to indicate where economic and/or industry risk trends are negative. Data as of Aug. 21, 2020. Source: S&P Global Ratings.

Government, Regulatory Support Key To Recovery

Regulatory and government support across banking jurisdictions globally will also shape banks' recovery. With firms and households hit hard by the pandemic, authorities are using banking systems as a key transmission agent for economic and monetary policies. They aim to reduce the immediate slump in demand caused by the pandemic.

Authorities have deployed wide measures to encourage banks to continue lending and show forbearance toward struggling borrowers. Banking systems are receiving massive liquidity support, and regulations governing banks are being relaxed temporarily (see "Bank Regulatory Buffers Face Their First Usability Test," published June 11, 2020).

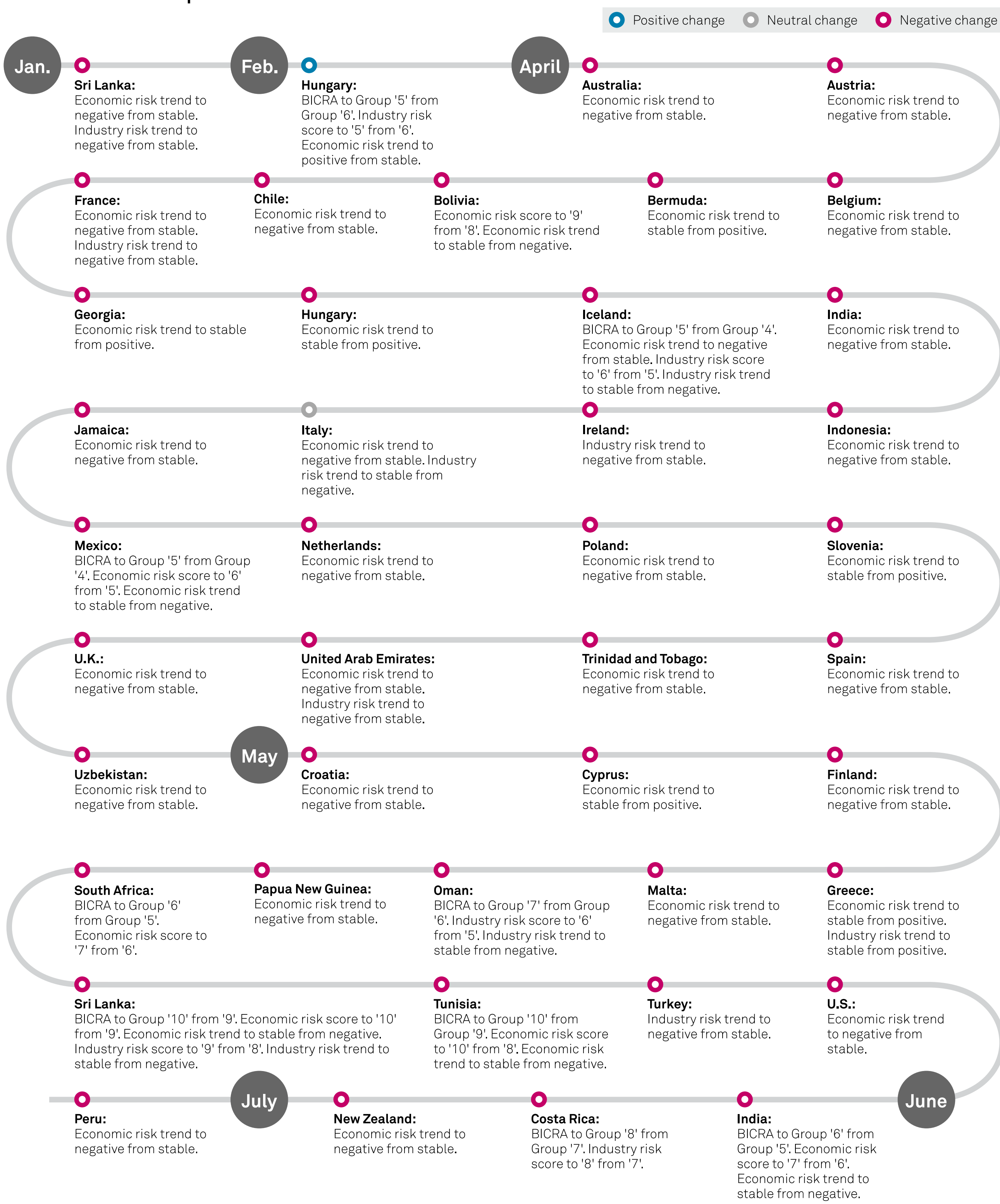
The positioning of BICRAs and bank ratings--and, more generally, our expectations for recovery across jurisdictions--accounts for our assumption that public authorities will continue to support institutions, when needed. The extent to which some governments may have less willingness or capacity to provide support in keeping with our current understanding will affect the shape of the recovery.

- banks' strengthened balance sheets over the past 10 years;
- the support from public authorities to household and corporate markets; and
- our base-case assumption of a sustained economic recovery beginning in 2021.

(See "How COVID-19 Is Affecting Bank Ratings: June 2020 Update," published June 11, 2020).

Chart 3b

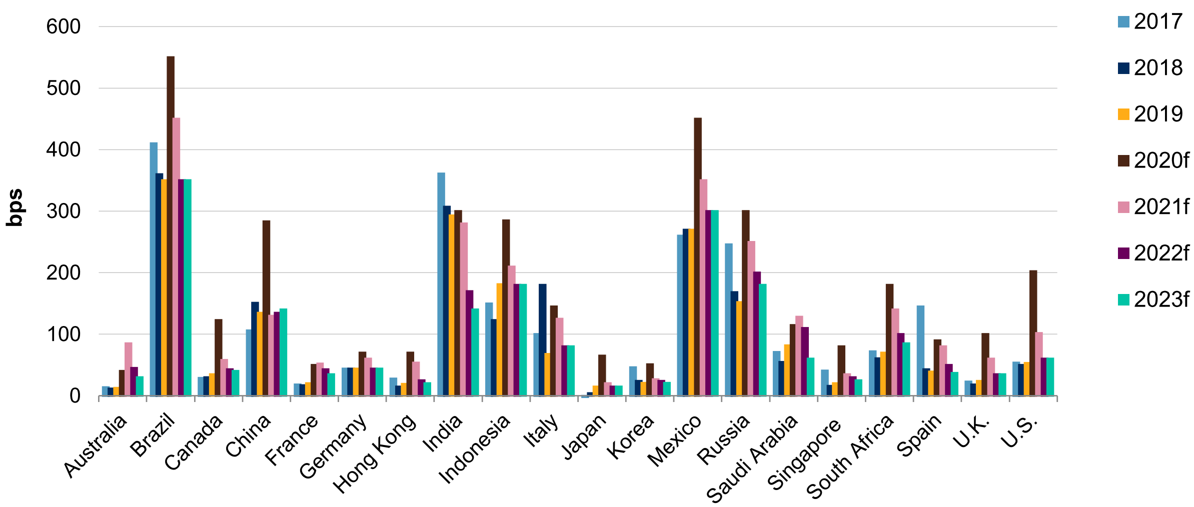
Global BICRA Developments In 2020



Data as of Aug 21, 2020. BICRA--Banking Industry Country Risk Assessment. Source: S&P Global Ratings.

Chart 4

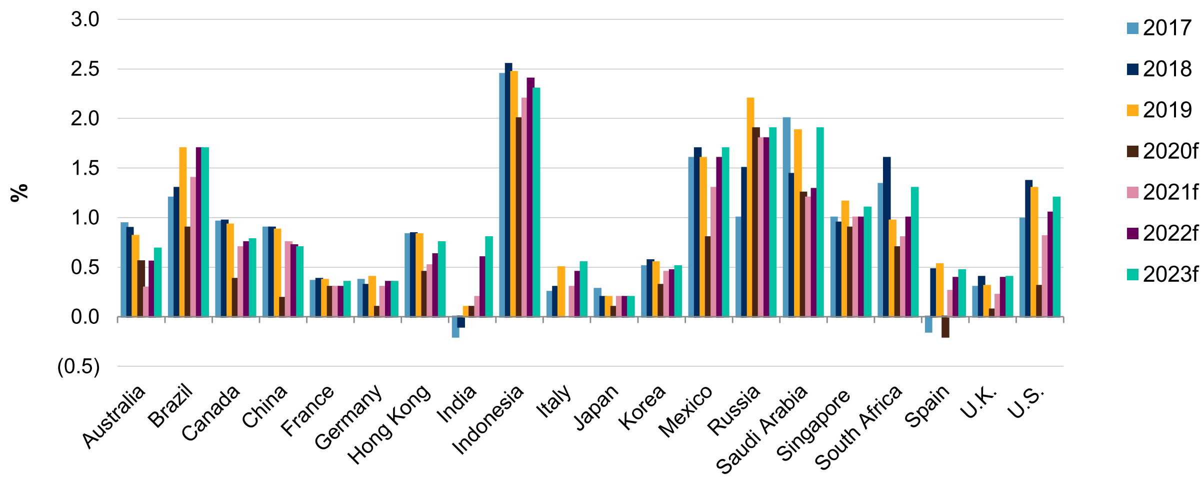
Selected Banking Jurisdictions: Credit Losses To Spike In 2020 And 2021
In basis points



Note: We measure credit losses by the sum of new loan loss provisions allocated to cover potential losses on exposures. For India and Japan, the figures are for fiscal year ending in March. For Canada, the figures are for fiscal year ending in October. For definitions of credit losses and return on average assets see, "Banking Risk Indicators: May 2020 Update," May 18, 2020. f--Forecast. bps--Basis points. Source: S&P Global Ratings.

Chart 5

Selected Banking Jurisdictions: COVID-19 Hits Profit Outlook Of Major Banking Systems
Return on average assets



Note: Annual net income expressed as a percentage of average adjusted assets. For India and Japan, the figures are for fiscal year ending in March. For Canada, the figures are for fiscal year ending in October. Figures for Spain for 2020 include the large goodwill write-offs by Santander Bank N.A. and Banco Bilbao Vizcaya Argentaria S.A. For definitions of credit losses and return on average assets see, "Banking Risk Indicators: May 2020 Update," May 18, 2020. f--Forecast. Source: S&P Global Ratings.

Bank Metrics Will Be Challenged To Recover By 2023

Last year marked the end of a record expansion across many economies. COVID-19 was the end of an extraordinarily long credit cycle for banks that began after the global financial crisis of 2008-2009. For most of the past 10 or so years, bank metrics in many jurisdictions have improved progressively--and in some cases substantially. Asset quality, provisioning and capitalization metrics in particular have strengthened.

We believe many banking jurisdictions will find it challenging to quickly return to 2019 metrics. We do not view 2019 as typical with "normal" metrics for many jurisdictions. It was, rather, a strong year at the tail end of a long economic upcycle.

Metrics would more quickly return to their pre-pandemic levels if those levels were not so strong. This is especially the case for credit losses in developed-market banking systems, which were atypically low in 2019.

It is a somewhat similar story for profitability. While profits have been strained for the past few years, lower-for-longer interest rates have become more widespread and entrenched post-COVID-19. Banks will likely strain to claw their way back to 2019 profit levels.

Much the same as why more BICRAs and bank ratings were not automatically raised when metrics were strong during the long cyclical upturn, many banking systems and banks will show some resilience at current levels.

Most systems and entities should be able to accommodate some diminution in metrics at current rating levels during the downturn, and manage a slow recovery in metrics after the downturn bottoms out. Our ratings reflect an assumption that operating conditions will vary, and we do not automatically change ratings simply because conditions improve or deteriorate.

However, if an institution shows less ability to cope with unfavorable conditions than we anticipated, or conditions worsen beyond what we had assumed in a typical cycle, we may lower ratings.

The current downturn is severe, of course. We have accordingly already adjusted a large number of ratings and rating outlooks on financial institutions.

Macro Credit Factors, Not Individual Metrics, Drive Recovery Views

Our analysis extends well beyond a simple arithmetic comparison of metrics and ratios across periods. If this were the case, then rated institutions in emerging markets such as Indonesia, Mexico, and Russia may be rated higher based on some metrics, such as traditionally high profitability metrics, by global standards. The building blocks of bank credit hinge more on fundamental factors. These include economic imbalances, credit risks in the economy, and banking industry regulations, industry competitive dynamics, and system-wide funding.

These and other fundamental factors are considered in our BICRA analysis, which in turn forms the anchor for setting ratings on individual financial institutions. Issues such as low profitability are as much a system-wide issue in highly competitive banking industries, as they are for individual institutions. We have negatively adjusted our BICRA industry risk assessment (Japan) and industry risk trend (Germany, France) in part because of persistently low profitability.

For bank metrics that recover slowly after a downturn, we may accommodate some diminution in metrics with no change in ratings when we are clear on the reasons for the deterioration. We would also look for clarity on the likely recovery of the metrics in the context of our outlook for macro drivers underlying bank credit.

Individual metrics can never tell the complete credit story. Alongside consideration of credit losses, for example, we typically take into account other metrics such as nonperforming asset levels, and provisioning coverage for nonperforming assets (NPAs), in assessing asset quality. We also factor in qualitative considerations such as policies and processes for the management of credit and other risks.

Likewise, return on assets is but one prism through which to view profitability. We also consider banks' returns versus equity and risk-weighted assets, qualitative factors influencing the stability, diversity and robustness of revenue streams, and cost efficiency.

Macro factors affecting BICRA and ratings have a closer connection with our views regarding the direction of ratings compared with individual metrics concerning single-rating factors.

Some individual metrics viewed in isolation could lead to conclusions about recovery to pre-COVID-19 levels that are more difficult to explain in the context of our macro view.

For example, the Indian banking sector is considered a late-exiter. Its recovery will be longer, but some ratios may return more quickly to pre-COVID-19 levels as they were weak prior to the onset of COVID-19 (in contrast with many other jurisdictions). There were significant asset-quality issues in India prior to the onset of COVID-19, while asset quality was on an improving trend in many other jurisdictions.

For numerous early- and mid-exiter jurisdictions, some ratios may not return to pre-COVID-19 levels until 2023 or beyond because their pre-COVID-19 starting point was strong.

Analysis Of Credit Losses And Return on Assets

In this analysis, we use the term "credit losses" to refer to the income statement charge (in U.S. dollars) by which banks add to their balance sheet provisions or allowances for expected losses on domestic customer loans. This may include direct write-offs of domestic customer loans.

Banks often describe credit losses as "provisions for" or "charges for expected credit losses," among other similar terms. Credit losses generally precede charge-offs, the actual write-down of loans that detract from the balance-sheet allowances for credit losses. Credit losses are shown in basis points as a proportion of customer loans.

Also in the analysis, return on average assets reflect annual net income reported by resident financial institutions' domestic operations, expressed as a percentage of their average adjusted domestic assets.

Both the above ratios reflect our definitions for our banking risk indicators, and include definitional nuances for some jurisdictions based on availability of data (see "Banking Risk Indicators: May 2020 Update," May 18, 2020).

For the shape of the recovery charts, actual values for 2019 for credit losses and return on average assets have been indexed at 100 and the values thereafter are based on the indexed values. The period at which the line cuts the x-axis indicates our estimates of when the metric may return back to 2019 levels.

Downside Risks Are More Prevalent

As indicated by the large number of financial institution ratings on negative outlook, our view for bank credit is downbeat. We see little upside for bank credit over the next few years, and some noteworthy downside risks.

If economies recover from about mid-2021--in keeping with our base case--financing conditions remain accommodative, and public authorities remain supportive, we anticipate a slow return to financial strength for banks.

Should the health-driven economic malaise worsen or persist longer than we envisage in our base case, or government impetus for fiscal support or other relief measures for borrowers diminish, then a further negative step-change in bank credit is likely.

Shape Of The Recovery--Regional Developments

Asia-Pacific Developed Banking Markets: Reversal From Benign Economic Conditions

In 2019, credit losses were near historical lows in almost all the higher-income countries in Asia-Pacific. Years of benign economic conditions have helped the region. We estimate that the COVID-19 shock to these economies will drive a multifold increase in credit losses. Economic recovery in the subsequent period should ease the credit losses, in our view.

We forecast that by 2022 or 2023, credit losses will approach 2019 levels. The timing depends on the jurisdiction.

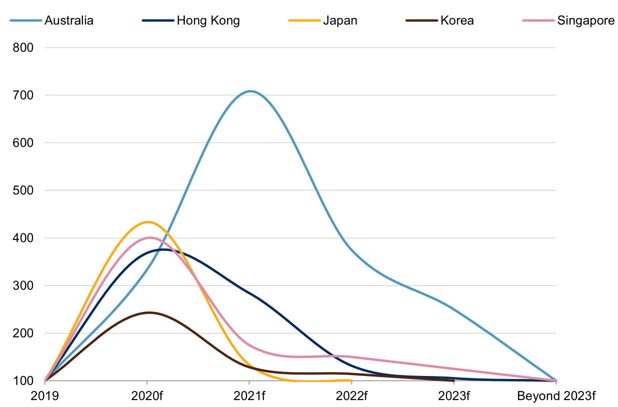
Likewise, banks in most countries in the region will likely struggle to recover to 2019-level earnings. The income of most banking systems in Asia-Pacific, ex-Japan will likely remain stronger than those of the larger European systems.

The jump in credit losses, along with a drop in noninterest income, will drive a sharp dip in earnings for banks in most Asia-Pacific jurisdictions in the next one to two years. Even as credit losses subside and credit growth resumes, we anticipate a continued trend of weakening interest margins, assuming low interest rates continue to suppress earnings.

By 2022, profitability may be on an improving trend. For Japanese banks, the results of 2019 (for the Japanese fiscal year ended March 2020) already reflects some pre-emptive provisions for borrowers affected by COVID-19.

Chart 6

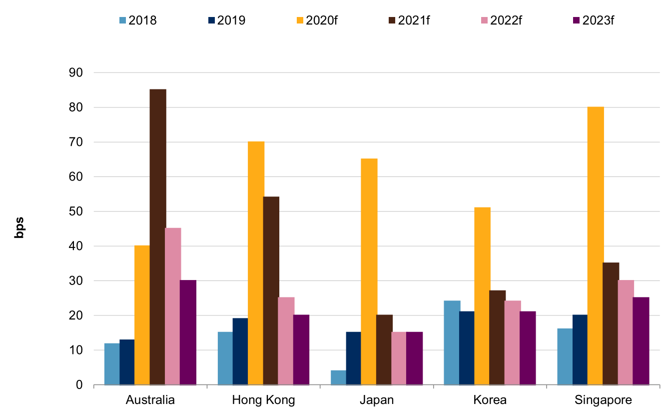
Credit Losses For Select Asia-Pacific Developed Banking Systems
Index rebased to 100 at start of 2019



Note: For Japan, the figures are for fiscal year ending in March. f--Forecast. Source: S&P Global Ratings.

Chart 7

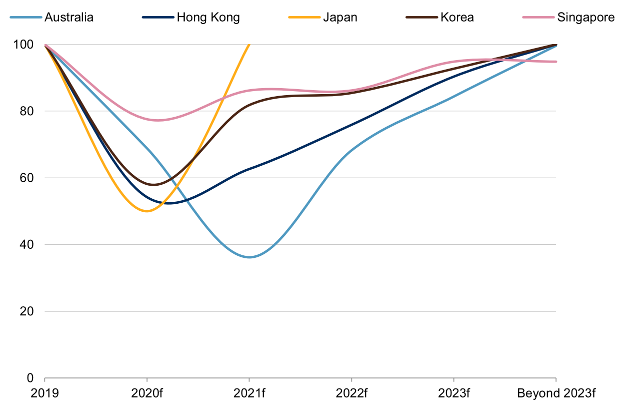
Credit Losses For Select Asia-Pacific Developed Banking Systems
In basis points



Note: For Japan, the figures are for fiscal year ending in March. bps--Basis points. f--Forecast. Source: S&P Global Ratings.

Chart 8

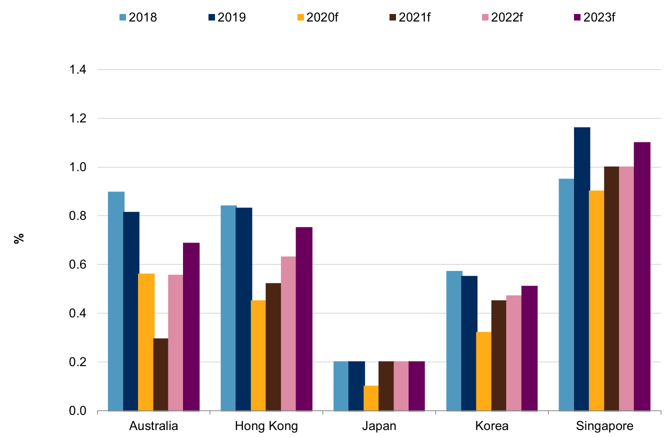
Return On Average Assets For Select Asia-Pacific Developed Banking Systems
Index rebased to 100 at start of 2019



Note: For Japan, the figures are for fiscal year ending in March. f--Forecast. Source: S&P Global Ratings.

Chart 9

Return On Average Assets For Select Asia-Pacific Developed Banking Systems



Note: For Japan, the figures are for fiscal year ending in March. f--Forecast. Source: S&P Global Ratings.

North American Banks: High Initial Credit Losses

Pandemic-related loan losses will likely sharply increase for the U.S. and Canadian banking systems in 2020 and 2021. Such losses should tail off thereafter, pending an economic rebound envisaged in our base case.

For the U.S. banking system, we anticipate credit losses to rise cumulatively to about 3% until year-end 2021, roughly half of the loan-loss rate the Fed estimated in its 2020 stress test for its base case.

We believe banks will take provisions to cover about 2% of those in 2020--with Current Expected Credit Losses (CECL) forcing banks to provision quickly for lifetime losses--and 1% in 2021.

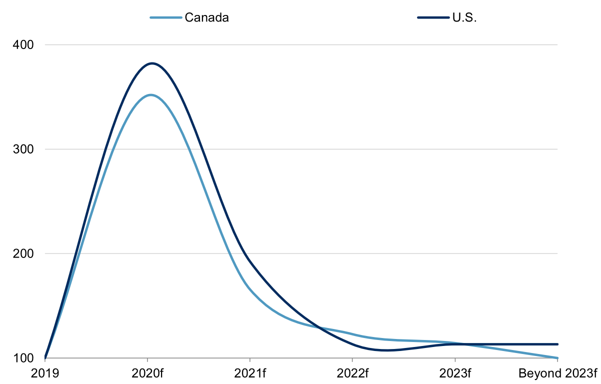
Similarly, Canadian banks' loan losses will likely remain elevated. Loan-deferral and fiscal-support programs should delay the banks' credit losses from materializing into 2021. Canadian banks typically end their fiscal years in October.

These increased provisions will have a huge effect on returns on assets. We expect U.S. and Canadian banks in aggregate to remain profitable in 2020. However, elevated provisions means earnings will be weak compared with recent years. Canadian banks' healthy efficiency ratios and strong profits going into the pandemic provide a cushion.

Earnings may improve in 2021 and 2022 as provisions decline and an economic recovery gains traction. However, pre-provision earnings will likely be under some strain and may be challenged to reach pre-crisis levels over the forecast horizon as low rates weigh on net interest margins.

Chart 10

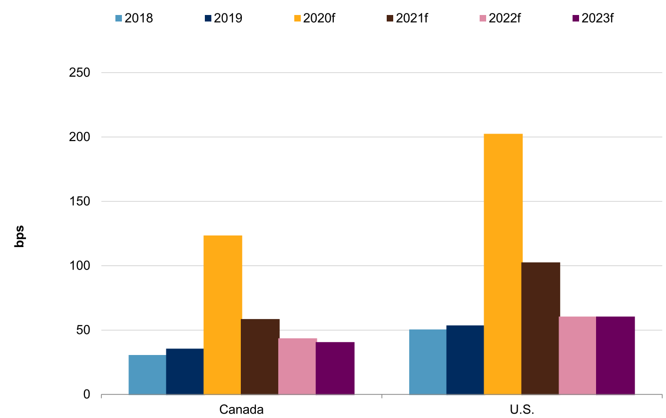
Credit Losses For Select North American Banking Systems
Index rebased to 100 at start of 2019



Note: For Canada, the figures are for fiscal year ending in October. f--Forecast. Source: S&P Global Ratings.

Chart 11

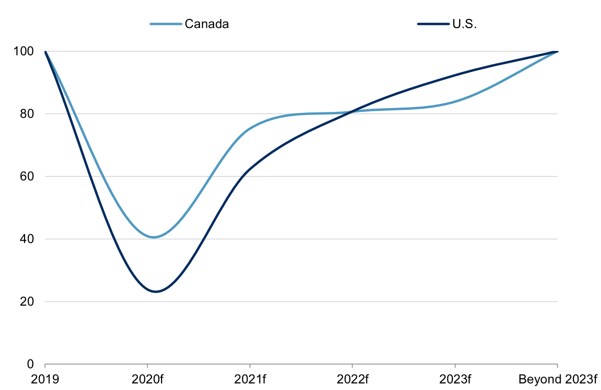
Credit Losses For Select North American Banking Systems
In basis points



Note: For Canada, the figures are for fiscal year ending in October. f--Forecast. bps--Basis points. Source: S&P Global Ratings.

Chart 12

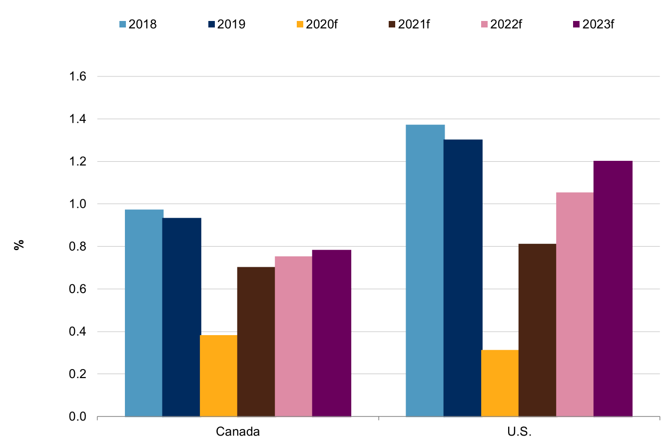
Return On Average Assets For Select North American Banking Systems
Index rebased to 100 at start of 2019



Note: For Canada, the figures are for fiscal year ending in October. f--Forecast. Source: S&P Global Ratings.

Chart 13

Return On Average Assets For Select North American Banking Systems



Note: For Canada, the figures are for fiscal year ending in October. f--Forecaset. Source: S&P Global Ratings.

Europe: Recovery Unlikely Before 2023 For Major Banking Sectors

Credit losses will likely rise significantly from historically low levels for European banks in 2020, and remain high in 2021. A full economic recovery could take several years under our base case.

This reflects our view that the full loss recognition will only take effect once fiscal support starts to ebb. Nevertheless, we see likely differences in the pattern of loss recognition: faster in the U.K. (similar to the U.S. and Canada), slower in France, and with German domestic lending probably faring the best overall among all five systems.

Our recent rating actions have mirrored these expectations. We revised BICRA trends negatively for four of the five largest European banking systems in April 2020. The German BICRA has already showed negative trends since September 2019, with the pandemic exacerbating existing pressures.

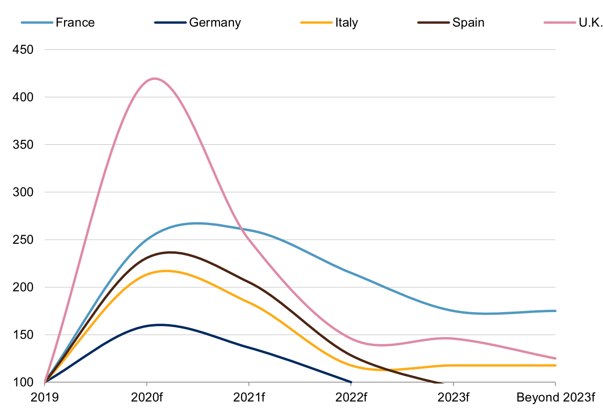
The pattern of credit losses heavily guides the European profit story. It also reflects a structurally weak revenue environment that existed before the pandemic, and will last long after COVID-19 fades. Concerns about long-term structural profitability led us to add a negative industry risk trend to the French BICRA in April, joining that of Germany.

U.K. bank profitability may rebound a bit faster than others given faster loss recognition and typically better efficiency. We note that credit issues associated with Brexit may weigh on bank profitability.

For all five European systems, we anticipate that the weak revenue environment, and banks' need to invest and restructure, will likely yield no material efficiency gains before 2023.

Chart 14

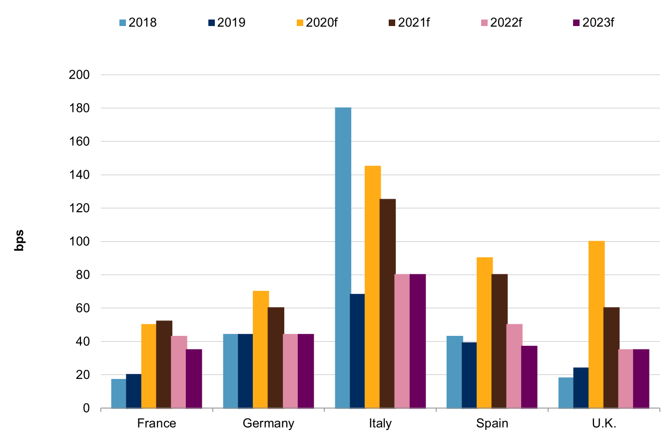
Credit Losses For Select European Banking Systems
Index rebased to 100 at start of 2019



f--Forecast. Source: S&P Global Ratings.

Chart 15

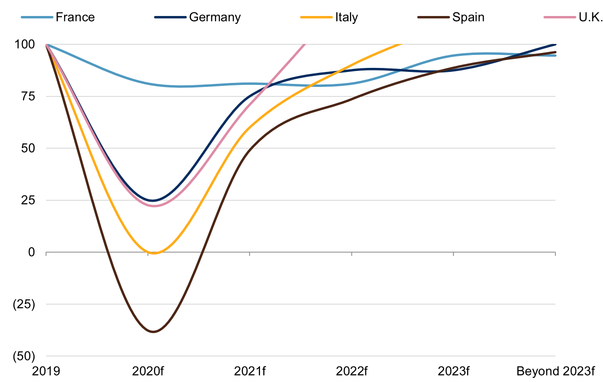
Credit Losses For Select European Banking Systems
In basis points



f--Forecast. bps--Basis points. Source: S&P Global Ratings.

Chart 16

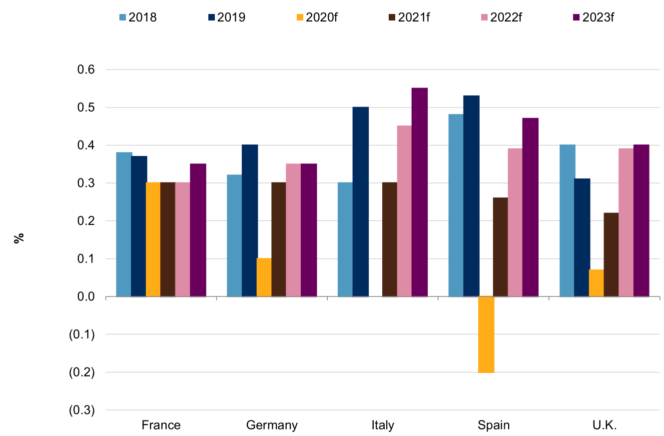
Return On Average Assets For Select European Banking Systems
Index rebased to 100 at start of 2019



Note: Figures for Spain for 2020 include the goodwill write-off by Santander Bank N.A. and Banco Bilbao Vizcaya Argentaria S.A. f--Forecast. Source: S&P Global Ratings.

Chart 17

Return On Average Assets For Select European Banking Systems



Note: Figures for Spain for 2020 include the goodwill write-off by Santander Bank N.A. and Banco Bilbao Vizcaya Argentaria S.A. f--Forecast. Source: S&P Global Ratings.

Emerging Markets Banks: Stronger Profitability Will Cushion Performance Slump

Emerging-market banks will likely see a sharp increase in credit losses in 2020. There is potential for a gradual improvement in the following years if economic activity rebounds, as envisaged in our base case. Given the banks' relatively strong profitability, we see some cushion to absorb the anticipated weak performance in the loan portfolio.

Recovery to pre-crisis levels could occur for the Chinese banking system by end-2022. Other emerging markets may recover in 2023 or later. We expect to see the full effect of the asset quality deterioration on banks' balance sheets in 2021.

The path to recovery will be more painful for emerging markets such as India. The banks' recovery to long-term averages for key asset quality and profitability ratios will take years.

Chinese banks' recovery may also be a bit earlier than other emerging-market banking systems. The banks benefit from existing high provisions relative to nonperforming loans.

We note the current 10% NPA expectation for China is broad, taking into account forborne loans that are currently performing but vulnerable to deterioration. It also accounts for standard nonperforming loans and special-mention loans.

For Indonesia and South Africa, we anticipate a material spike in credit losses in 2020. In broad terms (that is, not just constrained to credit losses) we believe that recovery for the Indonesian banking system may not occur until 2023. South Africa's recovery may stretch beyond 2023.

Brazilian banks may recover by 2023, given their resilient profitability and diversified business models. Brazil appears to be holding up best compared with all major Latin American banking systems. Brazil's recovery may be slower than China's considering Brazil has many more COVID-19 infections than China, and weaker short-term GDP expectations.

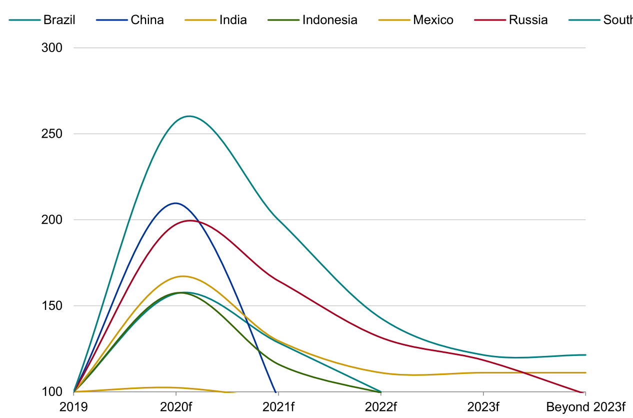
Mexican banks may not fully recover to 2019 levels until beyond 2023. We note their 2019 credit-loss metrics were at record lows.

Credit losses in Russia will likely increase to around 300 basis points (bps) in 2020, gradually declining toward normalized losses of around 150 bps beyond 2022, pending an economic rebound in keeping with our base case. These projections assume that Russia's real GDP may return to 2019 levels by early 2022.

That said, we believe Russian banks are in better shape during the current stress than they were in other crises of the past 11 years. They may show greater resilience and recover faster, provided economic growth is supportive, as assumed in our base-case scenario.

Chart 18

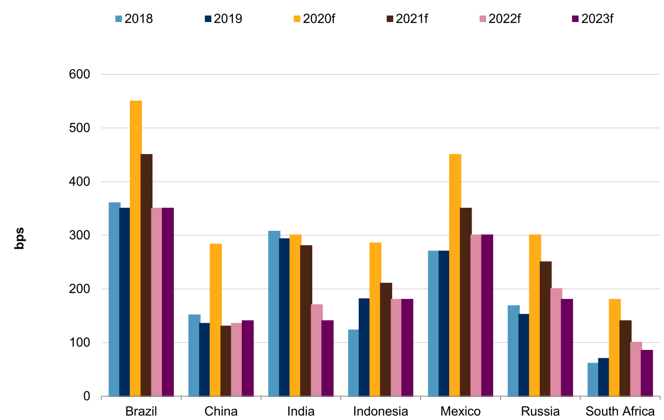
Credit Losses For Select Emerging-Market Banking Systems
Index rebased to 100 at start of 2019



Note: For India, the figures are for fiscal year ending in March. f--Forecast. Source: S&P Global Ratings.

Chart 19

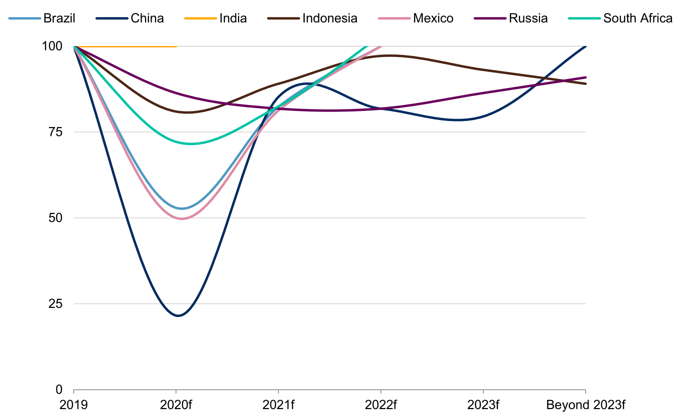
Credit Losses For Select Emerging-Market Banking Systems
In basis points



Note: For India, the figures are for fiscal year ending in March. f--Forecast. bps--Basis points. Source: S&P Global Ratings.

Chart 20

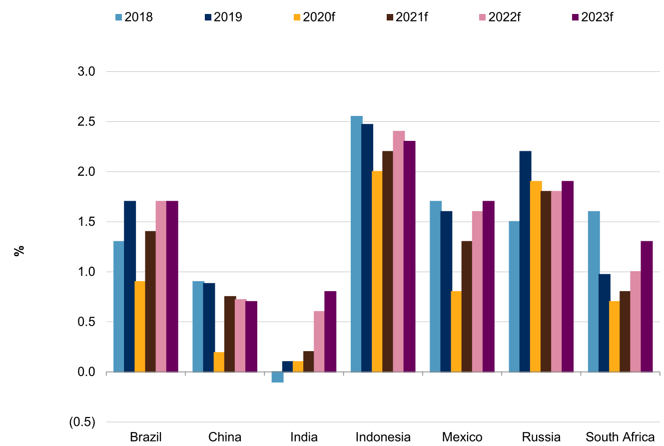
Return On Average Assets For Select Emerging-Market Banking Systems
Index rebased to 100 at start of 2019



Note: f--Forecast. Source: S&P Global Ratings.

Chart 21

Return On Average Assets For Select Emerging-Market Banking Systems



Note: For India, the figures are for fiscal year ending in March. f--Forecast. Source: S&P Global Ratings.

Related Research

- Banking Industry Country Risk Assessment Update: August 2020, Aug. 21, 2020
- The $2 Trillion Question: What's On The Horizon For Bank Credit Losses, July 9, 2020
- Global Banks Outlook Midyear 2020: A Series Of Reports Look At The Profound Implications Of The COVID-19 Shock, July 9, 2020
- Global Credit Conditions: The Shape Of Recovery: Uneven, Unequal, Uncharted, July 2, 2020
- COVID-19 Heat Map: Post-Crisis Credit Recovery Could Take To 2022 And Beyond For Some Sectors, June 24, 2020
- Bank Regulatory Buffers Face Their First Usability Test, June 11, 2020
- How COVID-19 Is Affecting Bank Ratings: June 2020 Update, June 11, 2020
- Banking Risk Indicators: May 2020 Update, May 18, 2020
- Global Banking Country-By-Country Outlook 2020: The Calm Before The Turn?, Nov. 18, 2019

This report does not constitute a rating action.

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