U.S. Bank Outlook 2024: Facing A Slower Economy, Tighter Regulation, And A Potential Drop In Rates

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S&P Global Ratings

This report does not constitute a rating action

Contents

Key Takeaways

Key expectations

- The U.S. banking industry has found greater stability following bank failures in March and April 2023, and we expect most banks to perform well and build capital in 2024.
- Still, potential further declines in deposits, funding cost pressures, unrealized losses, commercial real estate (CRE) exposures, and economic uncertainty remain key risks.
- Regulators last year proposed important changes to capital and resolution requirements. They could finalize those in 2024, perhaps with some alterations. They also may propose further updates to supervision and regulation in response to last year’s failures.

Key assumptions

- With the Fed holding rates flat before pivoting to rate cuts sometime in mid-2024, we expect banks to see deposits decline modestly and funding costs to rise incrementally in the first half of the year.
- Profitability will dip but remain in good shape, and banks will build capital. While net interest income (NII) may decline in 2024, we expect banks to generate a return on common equity of 10%-11% and to build capital through earnings retention, particularly as they plan for more stringent capital regulation.
- Asset quality pressure will increase but remain manageable. Most asset quality measures have been normalizing. While we expect further weakening in 2024, we believe banks' pre-provision earnings generally place them well to absorb the associated credit losses.

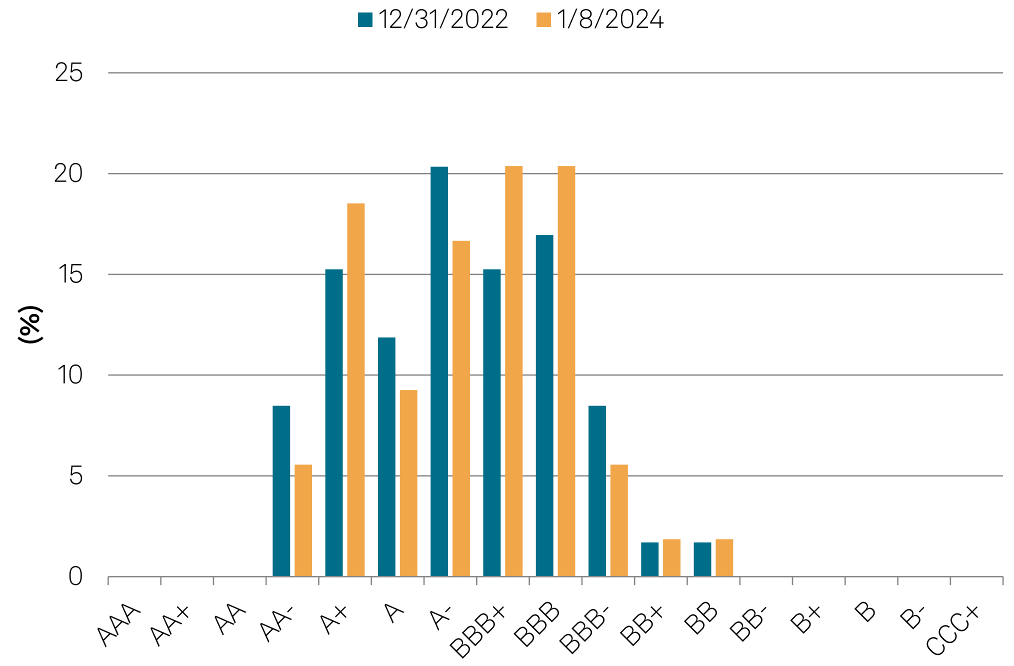
Key risks

- The Fed is unable to engineer a soft landing, the economy enters a recession with higher unemployment, and asset quality deteriorates significantly.
- Inflation is more persistent than expected despite a slowdown in growth, forcing the Fed to maintain higher rates for longer, thereby further pressuring bank balance sheets, including funding, liquidity, and unrealized losses.
- An extension of the higher-for-longer rate environment and a tepid economy limit rebounds in fee income sources like asset and wealth management, investment banking, and mortgage banking.

U.S. Bank Rating Outlooks Remain Largely Stable Entering 2024

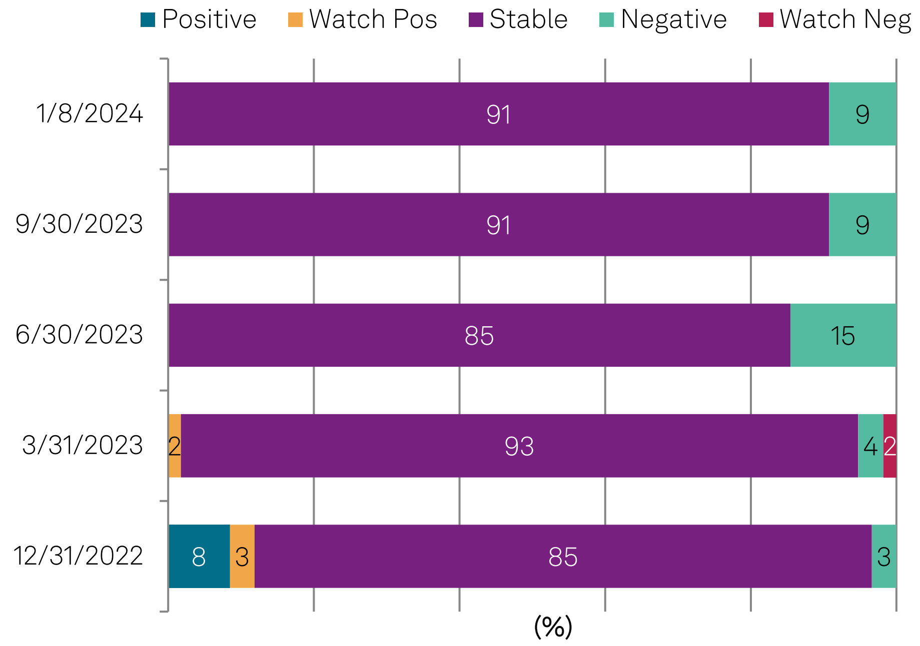
- In 2023, we lowered ratings on nine banks, revised outlooks on five banks to negative (excluding those we downgraded), and revised outlooks to stable from positive on four banks.
- Assuming the economy continues to grow and inflation abates further, we see a lower probability for negative actions in 2024.

Operating company rating distribution



Note: Includes banks domiciled in Puerto Rico. Source: S&P Global Ratings.

Outlook distribution



Note: Includes banks domiciled in Puerto Rico. Source: S&P Global Ratings.

U.S. Economic Outlook | Slower Growth Increases Odds Of Rate Cuts

S&P Global U.S. economic forecast overview

November 2023

Key indicator (year % change)	2019	2020	2021	2022	2023f	2024f	2025f	2026f
Real GDP	2.5	-2.2	**5.8**	1.9	2.4	1.5	1.4	1.8
Real consumer spending	2.0	-2.5	8.4	2.5	2.2	1.8	1.6	2.1
Real equipment investment	1.1	-10.1	6.4	5.2	0.0	0.8	2.2	2.7
Real nonresidential structures investment	2.5	-9.5	-3.2	-2.1	11.3	0.4	0.3	1.5
Real residential investment	-1.0	7.2	10.7	-9.0	-11.1	-0.1	3.9	2.5
Core CPI	2.2	1.7	3.6	6.2	4.8	2.8	2.3	2.1
Unemployment rate (%)	3.7	8.1	5.4	3.6	3.7	4.3	4.6	4.5
Housing starts (annual total in mil.)	1.3	1.4	1.6	1.6	1.4	1.3	1.4	1.4
10-Year Treasury (%)	2.1	0.9	1.4	3.0	4.1	4.3	3.5	3.1

Note: All percentages are annual averages, unless otherwise noted. Core CPI is the Consumer Price Index excluding energy and food components. f--forecast.
Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Federal Reserve, Oxford Economics, and S&P Global Economics' forecasts.

- After stronger-than-expected growth in 2023, the ongoing resiliency of the U.S. economy will be tested in 2024, as the lags of monetary-policy tightening feed through the economy.
- The economy will likely still eke out growth, but it's poised to cool off in the coming quarters with growth below the long-run potential.
- As disinflation progresses toward the 2% target, will the Fed opt to put off cuts, as was the case in 2006-2007, or will it employ cuts at the first signs of an uptick in unemployment as in the mid-1990s?

Key Risks For U.S. Banking Sector

Slowing economy

More challenging interest rate management owing to **persistent inflation**

Maturities and stress affecting commercial real estate

Broad asset quality **deterioration**

Further rises in the cost of deposits, due to competition for funding and liquidity

Geopolitical risk

Business and financial challenges related to **changing regulations**

Challenges from fintech, cybersecurity, and digital transformation

Forecast | Earnings Dip, But Banks Still Generate Double-Digit Profitability

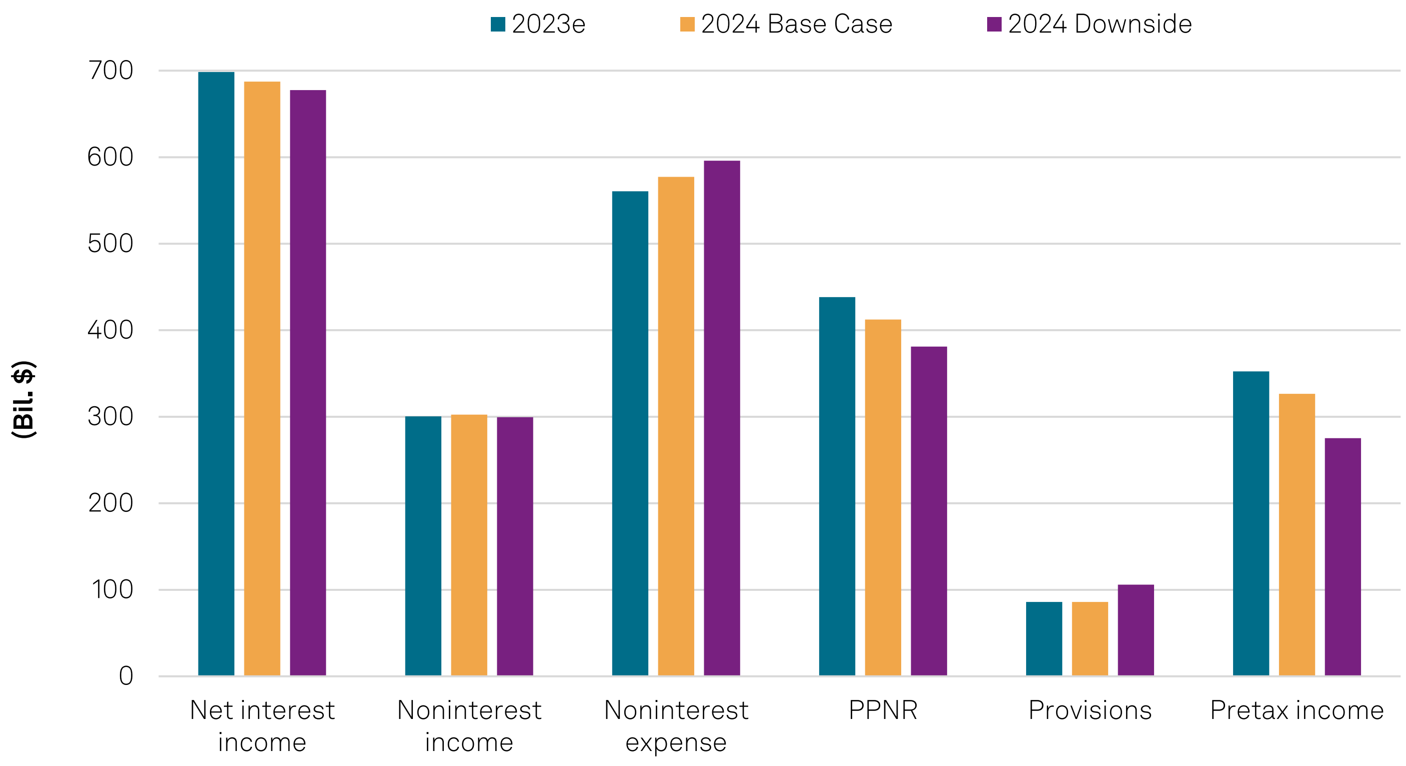
Worsening — Neutral — Improving

Revenues	NII will likely be moderately down, with funding costs up incrementally in the first half and asset yields down if the Fed cuts rates. Fee income may pick up in some areas, especially if rates fall, such as mortgage and investment banking. Trading revenues may remain relatively robust.
Expenses	Banks will keep focusing on expenses, consolidating branches, and digitizing. However, inflation and investments in technology will raise expenses further.
Profitability	Profitability will weaken somewhat with expenses growing moderately and revenues little changed. We think provisions in 2024 won't change materially from 2023 levels. We expect an industry return on common equity of 10%-11%, down from an estimated 12%-13% in 2023.
Credit quality	While most measures of credit quality remain in good shape, we expect delinquencies and charge-offs to continue rising toward historical averages amid limited economic growth, declining consumer savings, and stress in areas like commercial real estate.
Capital	Many banks will increase capital ratios further by limiting payouts to support confidence and in anticipation of potentially stricter capital rules.
Funding and liquidity	Deposits will fall moderately until the Federal Reserve finishes quantitative tightening, increasing competition for and raising the cost of funding somewhat further in the first half of the year. Deposit betas could vary meaningfully. Still, pressure on funding and liquidity ratios should abate if the Fed holds rates flat and potentially cuts them in the middle of the year.

Note: Forecast for next 12 months. Source: S&P Global Ratings.

Forecast | Lower NII Weighs On Profits, But Banks Still Earn 10%-11% ROE

Earnings forecast, all FDIC-insured banks: base case and downside case

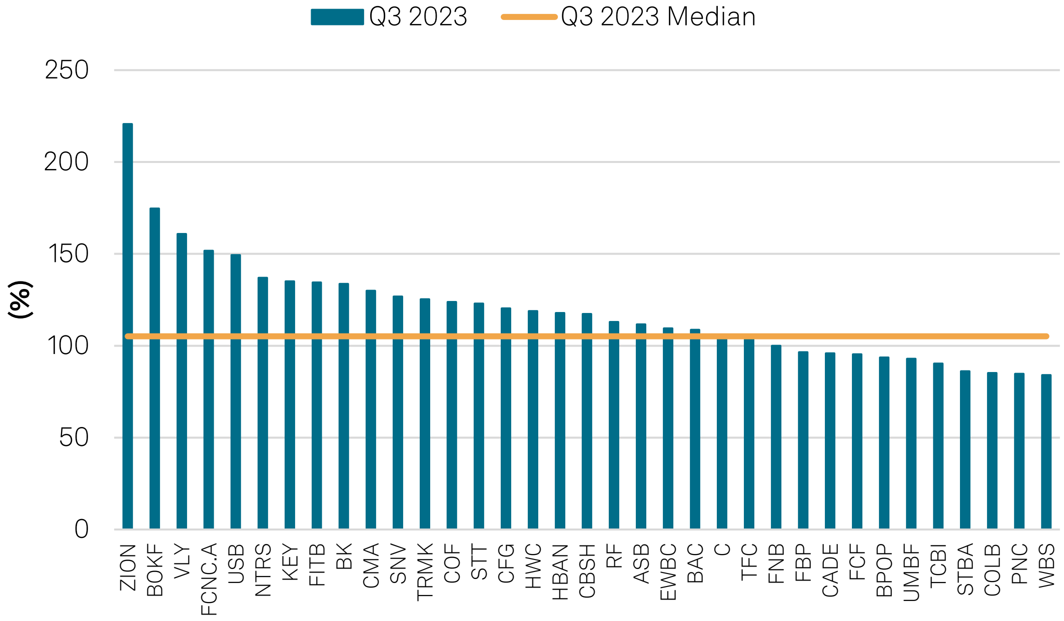


- In our base-case forecast, higher funding costs weigh on NII in 2024. However, with NII starting at an elevated level, banks still earn a return on equity (ROE) of around 10%-11%.
- A greater-than-anticipated slowdown in the economy or additional funding pressures could lower ROE into the single digits.

Deposit Betas Are Likely To Climb Further Prior To Potential Rate Cuts

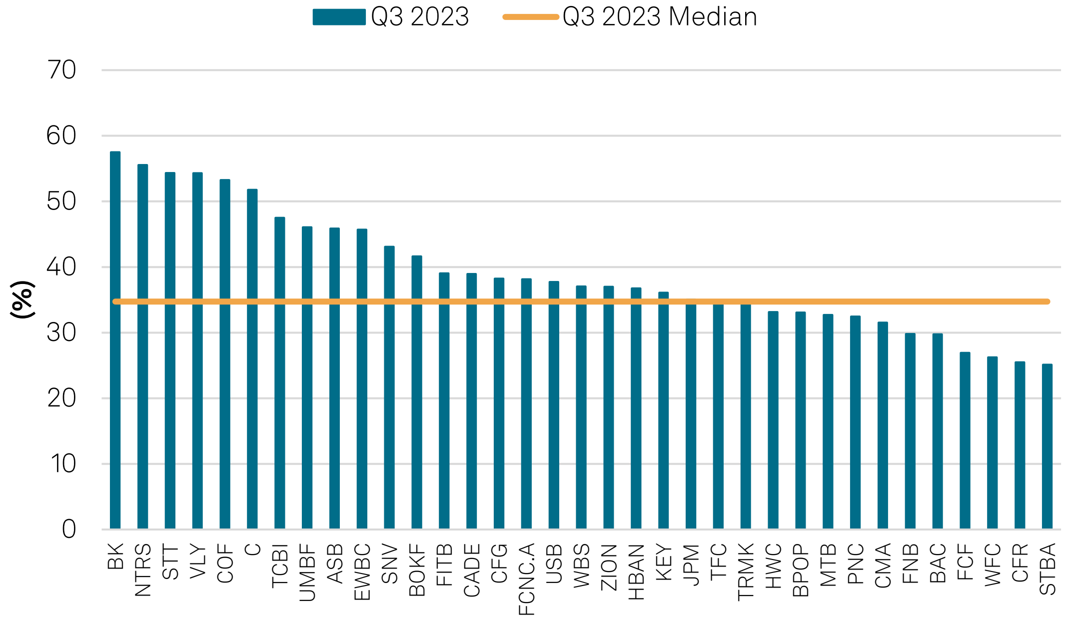
- Deposit betas accelerated in recent quarters, rising to almost 105% of the rate of change in the average daily effective fed funds rate in the third quarter. We think deposits cost will inch higher at least in the first half of 2024.
- If the Fed begins to lower rates in the second half of the year, asset yields will likely initially fall faster than deposit costs.

Quarterly deposit betas of rated banks in Q3 2023



Note: The deposit beta is calculated as the change in the cost of total deposits from Q2 2023 to Q3 2023 divided by the change in the average daily effective fed funds rate from Q2 2023 to Q3 2023. Sources: FDIC data and S&P Global Ratings.

Full cycle deposit betas of rated banks in Q3 2023



Note: The deposit beta is calculated as the change in the cost of total deposits from Q1 2022 to Q3 2023 divided by the change in the average daily effective fed funds rate from Q1 2022 to Q3 2023. Source: S&P Global Ratings.

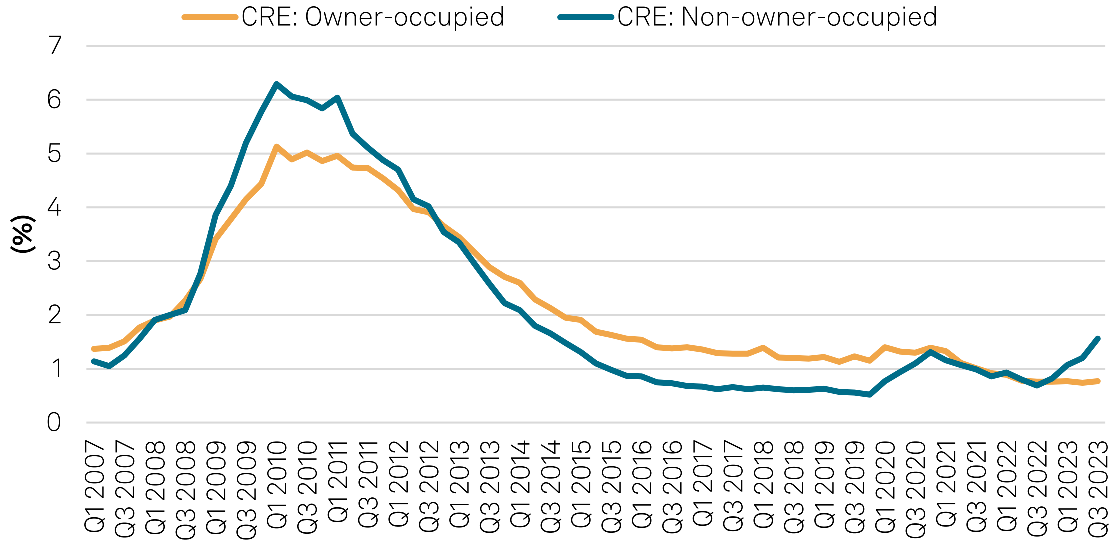
S&P Global Ratings

CRE Charge-Offs, Delinquencies And Criticized Loans Will Likely Rise

- Banks' broadly diversified loan portfolios and conservative underwriting should mitigate losses.
- Office is the largest contributor to rising delinquencies and criticized loans.
- CRE exposures are more concentrated at a subset of regional banks.

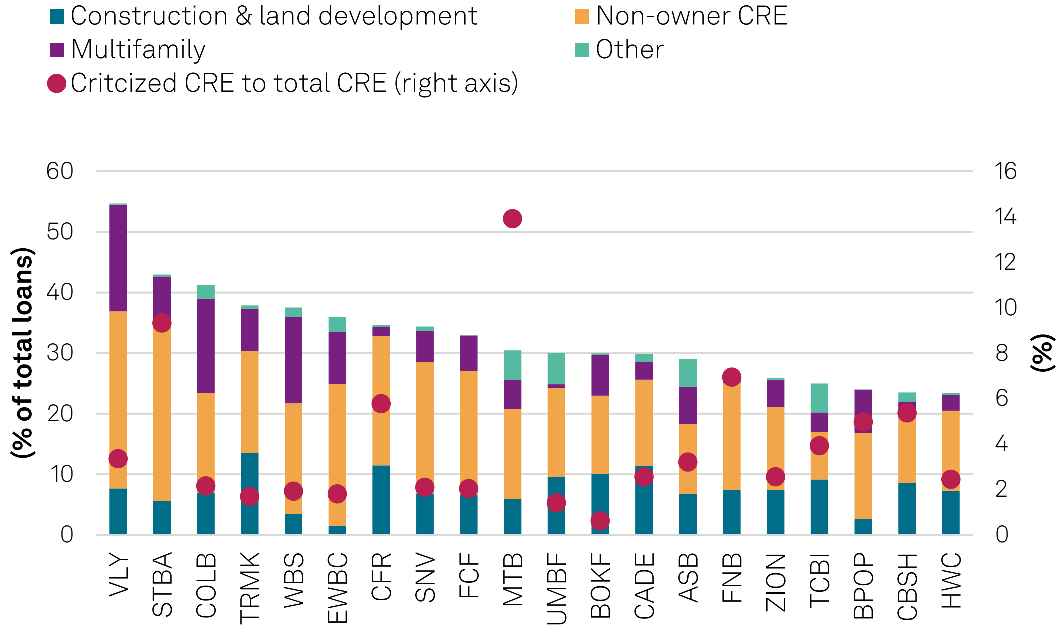
CRE past due and nonaccrual loans

Loans of U.S. commercial banks at least 30 days past due



CRE--Commercial real estate. CET1--Common equity Tier 1. Sources: FDIC data and S&P Global Ratings.

Top CRE loan exposure of rated banks

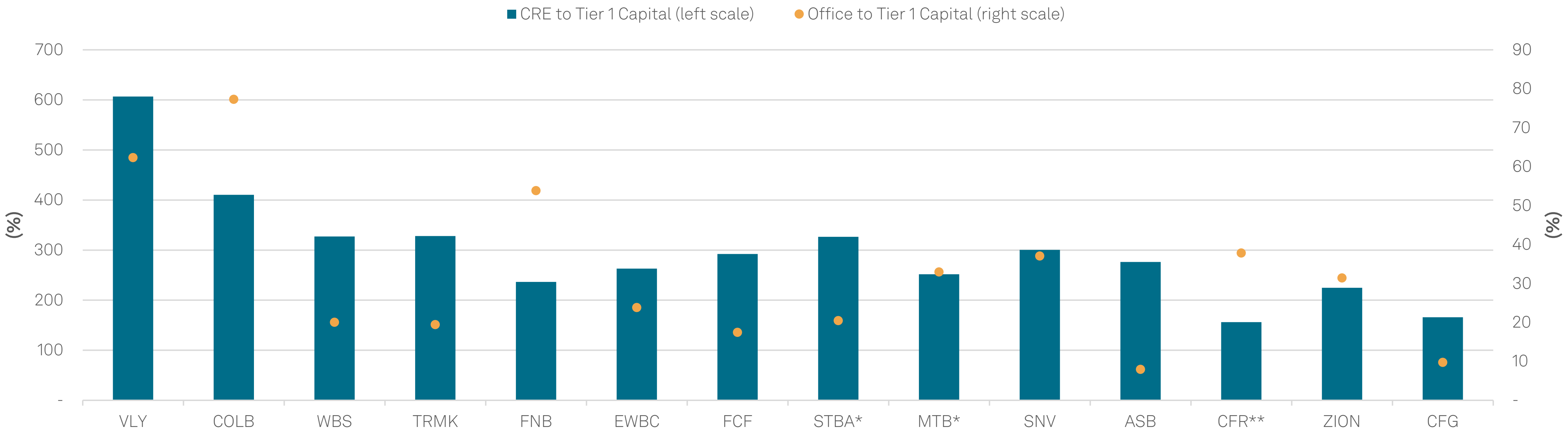


Data as of Sept. 30, 2023. Note: The chart shows rated banks with the higher percentage of CRE loans to total loans. CRE--Commercial real estate. Sources: FDIC data, company presentations and 10-Q filings, and S&P Global Ratings.

Office Loans Are A Small Portion Of Banks' CRE Portfolios

- For rated banks, office loans represents less than one-quarter of total CRE loans and a small portion of Tier 1 capital at the median.
- For banks with elevated exposure to office CRE, the property's location and quality can be important differentiators of performance.

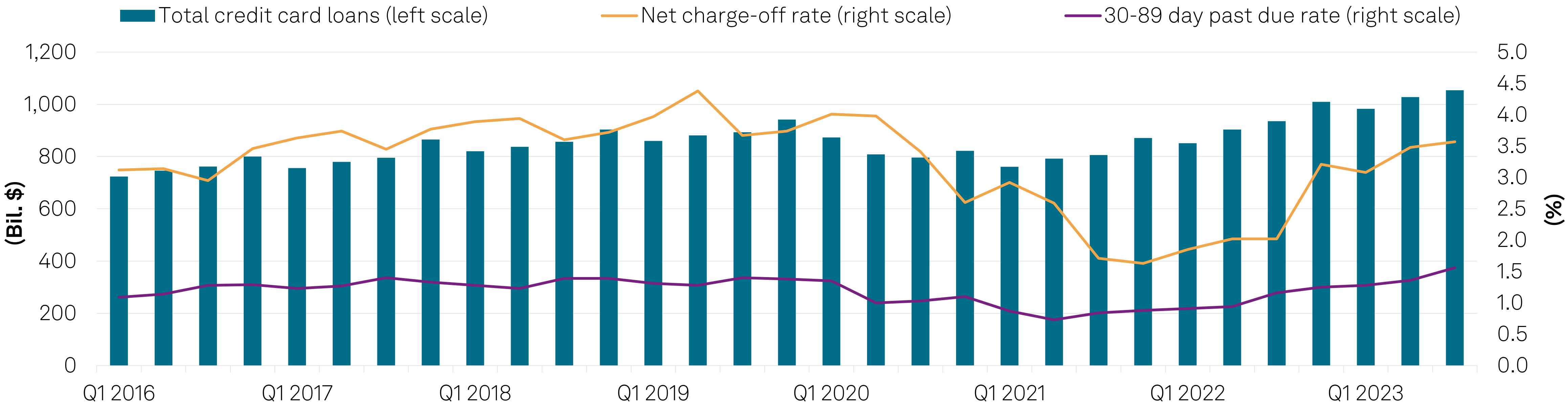
Office exposure for select rated banks with CRE/Tier 1 common capital >300% or office/Tier 1 >30%



Note: Bank CRE loans excludes owner-occupied. *Office CRE allocation as of Q1 2023. **Office CRE allocation as of Q4 2022. Sources: S&P Global Ratings, FDIC data, and company Q1 2023 and Q2 2023 earnings presentations and 10-Qs.

Credit Card Balances Grow And Charge-Offs Will Likely Trend Higher

- We expect charge-offs to rise amid slowing U.S. economic activity, still-high rates, and potentially higher unemployment.
- Originations have been robust over the last two years, and seasoning should add to credit deterioration.



Top 10 largest credit card lenders as of third-quarter 2023 (bil. $): sample is roughly 93% of total industry card loans

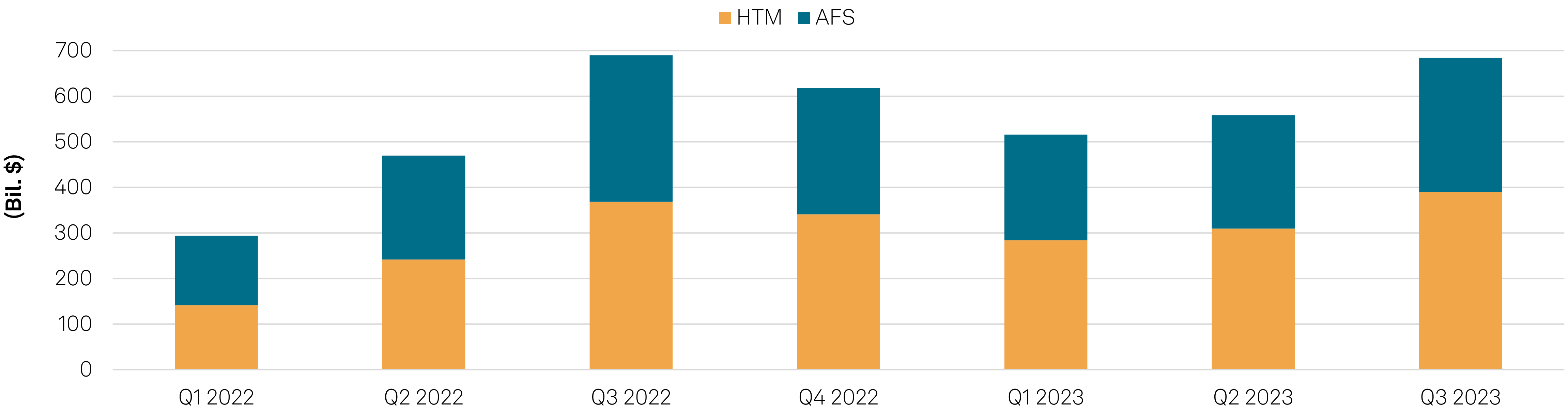
JPMorgan: 172 | Citigroup: 163 | Capital One: 134 | Bank of America: 99 | Discover: 97 | Synchrony: 92 | American Express: 90 | Wells Fargo: 49 | Barclays US LLC: 29 | U.S. Bancorp: 27

Sources: S&P Global Ratings, FDIC Quarterly Banking Profile, and regulatory filings.

Unrealized Losses On Securities Are Still Significant But Likely Will Decline

- Unrealized losses will hinge on long-term rates, which fell in the fourth quarter, and the duration of banks' securities portfolios.
- As banks' securities portfolios mature, unrealized losses should also decline.

All FDIC-insured banks: unrealized losses on securities

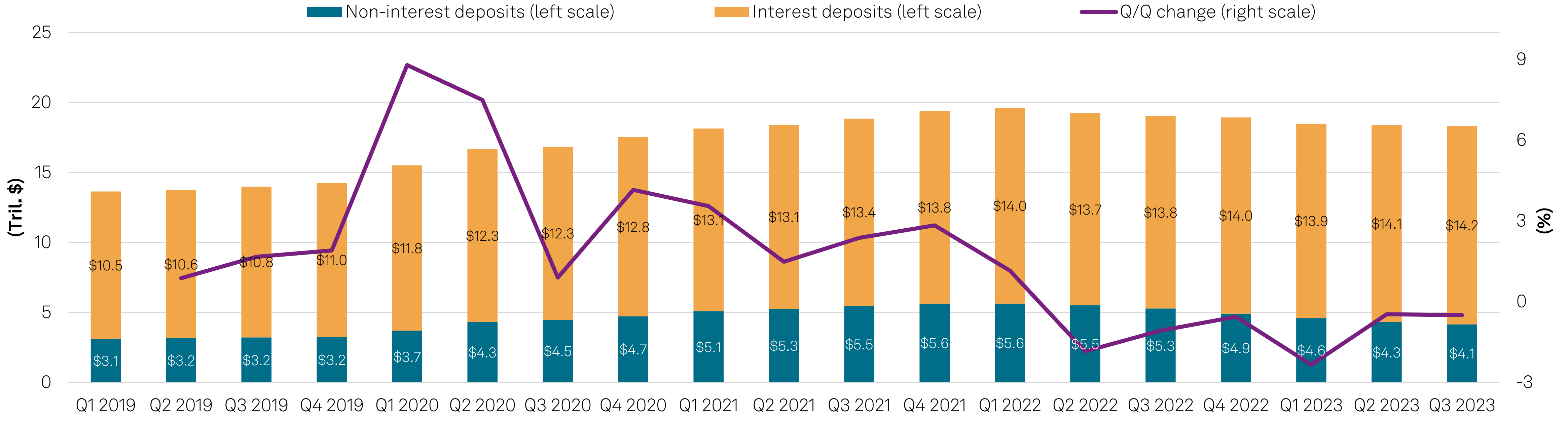


FDIC--Federal Deposit Insurance Corp. AFS--Available for sale. HTM--Held to maturity. Sources: S&P Market Intelligence and FDIC.

We Expect Deposits To Decline Modestly With Funding Costs Leveling Off

- Deposits may fall somewhat further as long as the Fed is quantitatively tightening. However, an expected end to rate hikes should help stem the drop as well as the shift into higher-cost interest-bearing accounts.
- Banks though will likely need to continue offering higher yields to maintain deposits at least through the first half.

All FDIC-insured banks: total deposits



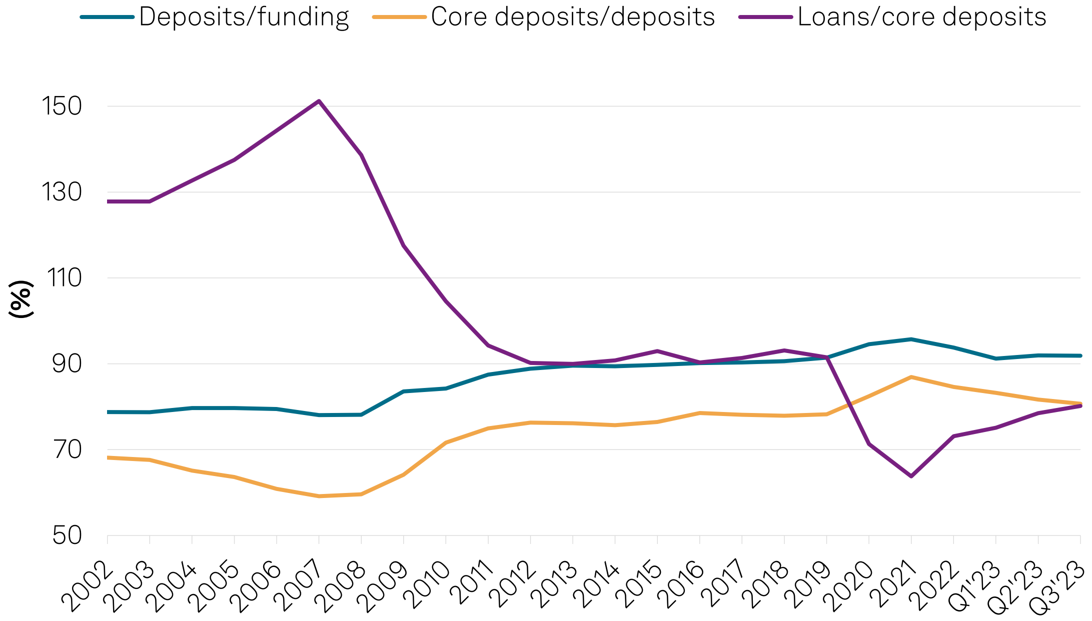
Source: S&P Global Market Intelligence.

Pressure On Funding And On-Balance-Sheet Liquidity May Abate

- We expect the loans-to-core deposits ratio to incrementally climb. However, flat rates in the first half and potential cuts in the second half should ease pressures.
- Banks will likely continue to closely manage liquidity, in part by maintaining good access to contingent sources of funding.

Funding measures of commercial banks

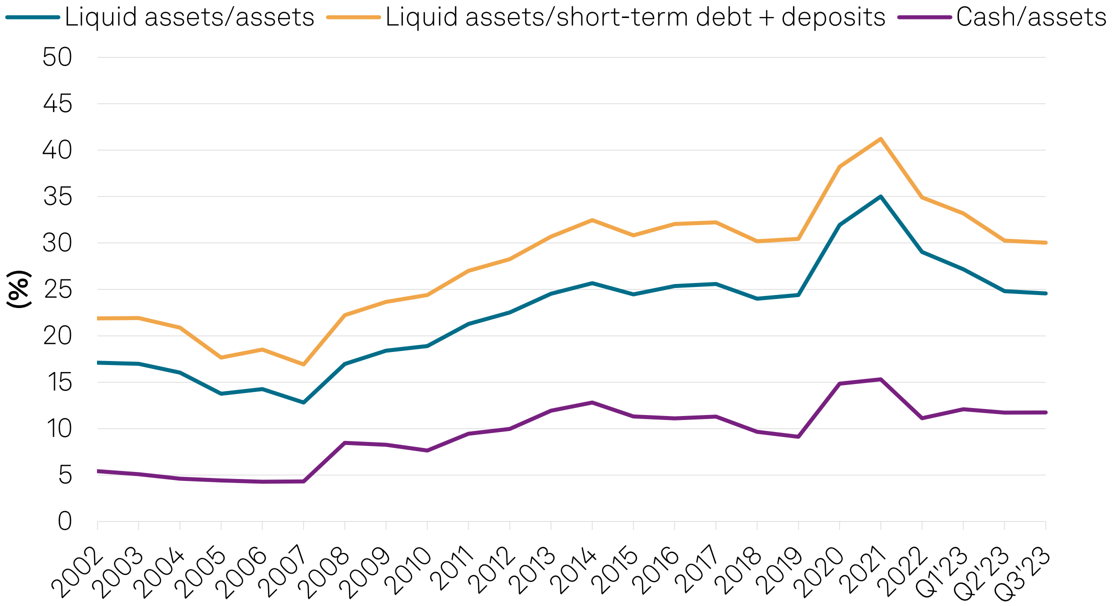
Core deposits = deposits less brokered, jumbo, and foreign deposits



Source: S&P Global Market Intelligence.

Liquidity measures of commercial banks

Liquid assets = cash + unpledged securities + Fed funds



Source: S&P Global Market Intelligence.

Basel III Endgame Could Lead To More Stringent Capital Requirements

- The inclusion of AOCI in regulatory ratios will be phased in for category III and IV banks.
- The proposed rules will likely result in higher RWA inflation for some GSIBs owing to more stringent charges to market risk.
- We are uncertain when regulators will finalize the rules and whether they will significantly change the original proposal.

Capital regulations	Category I US G-SIBs	Category II ≥$700 bil. total assets or ≥$75 bil. cross jurisdictional activity	Category III ≥$250 bil. total assets or ≥$75 bil. in nonbank assets, weighted short-term wholesale funding or off-balance sheet exposure	Category IV $100 bil. to $250 bil. total assets
Risk-based requirements				
Market risk	Currently applicable with changes to methodology	Currently applicable with changes to methodology	Currently applicable with changes to methodology	Currently applicable with changes to methodology
Operational risk	Currently applicable with changes to methodology	Currently applicable with changes to methodology	Newly applicable	Newly applicable
Credit risk	Currently applicable with changes to methodology	Currently applicable with changes to methodology	Currently applicable with changes to methodology	Currently applicable with changes to methodology
CVA risk	Currently applicable with changes to methodology	Currently applicable with changes to methodology	Newly applicable	Newly applicable
AOCI Inclusion	Currently applicable with no changes	Currently applicable with no changes	Newly applicable	Newly applicable
G-SIB surcharge	Currently applicable with changes to methodology	N.A.	N.A.	N.A.
CCyB	Currently applicable with no changes	Currently applicable with no changes	Currently applicable with no changes	Newly applicable
Leverage capital	Enhanced SLR			
SLR	Currently applicable with no changes	Currently applicable with no changes	Currently applicable with no changes	Newly applicable

Currently applicable with no changes — Currently applicable with changes to methodology — Newly applicable

N.A.--Not applicable. CCyB--Countercyclical buffer. Sources: US Basel III Endgame Proposal and S&P Global Ratings.

Category II-IV Banks Will Likely Need To Issue LTD To Support Resolution

- We estimate these banks will need to issue more than $70 billion of debt to meet the proposed requirements.
- We could consider raising ratings on some bank subsidiaries, depending on the amount of LTD and other factors.

	Higher of Hold co. LTD Min: RWA, assets, or leverage	Potential LTD issuance need (excluding holdco. deposits)	Potential LTD issuance needs if holdco. deposits restructured as LTD	ALAC ratio based on current debt outstanding (%)	Expected ALAC ratio after LTD debt issuance (%)
Ally Financial Inc.	RWA	9.2	5.1	5.5	8.6
American Express Co.	RWA	7.6	0	8.0	8.0
Capital One Financial Corp.	RWA	14.7	0	6.2	6.2
Charles Schwab Corp.	Assets	13.1	13.1	9.0	14.5
Citizens Financial Group Inc.	RWA	8.3	7.2	1.6	4.9
Discover Financial Services	RWA	4.4	4.3	1.9	4.5
Fifth Third Bancorp	RWA	8.3	2.9	3.8	5.1
Huntington Bancshares Inc.	RWA	6.8	3.8	3.1	5.6
KeyCorp	RWA	7.0	5.4	2.0	5.0
M&T Bank Corp.	RWA	8.2	7.7	0.9	5.5
Northern Trust Corp.	RWA	0.6	0.6	3.8	4.3
Regions Financial Corp.	RWA	7.1	5.9	1.1	5.1
Synchrony Financial	RWA	3.5	1.4	3.1	3.9
The PNC Financial Services Group Inc.	RWA	10.1	8.0	3.2	4.7
Truist Financial Corp.	RWA	14.5	6.2	4.1	5.4
U.S. Bancorp	RWA	12.2	0.4	4.8	4.9
Total	-	135.5	72.1	-	-

Data as of Q3 2023. Note: Total does not include excess deposits. Holdco. and subsidiary banks LTD requirement is based on max of 6% of RWA, 3.5% of average consolidated assets, or 2.5% of leverage exposure for banks subject to supplementary leverage ratio. Holdco. estimated eligible LTD is the sum of other borrowed money with a remaining maturity of more than one year and subordinated notes and debentures (FR Y-9LP Schedule PC 14. + FR Y-9LP Schedule PC 16. - FR Y-9LP Schedule PC-B Memo 2). Subsidiary banks' estimated eligible LTD is the sum of subordinated debt and the holdco.'s non-equity investments in bank subsidiaries (Call Report Schedule RC 19. + FR Y-9LP Schedule PC-A 1.b.1). We make no deduction for debt maturing within one to two years due to lack of available data. Such data may lead to somewhat higher LTD requirements than shown here. Holdco. deposits in subsidiary banks is from FR Y-9LP Schedule PC 1.a. These estimates assume the intercompany deposits could be restructured. S&P Global Ratings RWA used to calculate ALAC ratio is as of year-end 2022. LTD--Long-term debt. RWA—Risk-weighted assets. Holdco.--Holding company. Sources: Company filings, S&P CapIQ Pro, and S&P Global Ratings.

Subgroups Of Rated Banks

Money center banks

Bank of America Corp.
Citigroup Inc.
JPMorgan Chase & Co.
Wells Fargo & Co.

Trust banks

Northern Trust Corp.
State Street Corp.
The Bank of New York Mellon

Broker-dealers

Morgan Stanley
The Goldman Sachs Group Inc.

Note: Large regional and consumer-focused banks may be included with regional banks throughout presentation. Data in presentation may exclude certain domestic subsidiaries of foreign banks and certain other banks that do not file Y-9Cs.

Large regional banks

Ally Financial Inc.
BMO Financial Corp.
Citizens Financial Group Inc.
Fifth Third Bancorp
First Citizens Bancshares Inc.
HSBC USA Inc.
Huntington Bancshares Inc.
KeyCorp
M&T Bank Corp.
PNC Financial Services Group Inc.
Regions Financial Corp.
Santander Holdings USA Inc.
Truist Financial Corp.
U.S. Bancorp

Consumer-focused banks

American Express Co.
Capital One Financial Corp.
Discover Financial Services
SLM Corp.
Synchrony Financial

Regional banks

Associated Banc-Corp
Bank of North Dakota
BOK Financial Corp.
Cadence Bank
Columbia Banking System, Inc.
Comerica Inc.
Commerce Bancshares Inc.
Cullen/Frost Bankers Inc.
East West Bancorp Inc.
First Commonwealth Financial Corp.
FirstBank Puerto Rico
F.N.B. Corp.
Hancock Whitney Corp.
OFG Bancorp
Popular Inc.
S&T Bank
Synovus Financial Corp.
Texas Capital Bancshares Inc.
Trustmark Corp.
UMB Financial Corp.
Valley National Bancorp
Webster Financial Corp.
Zions Bancorporation N.A.

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