

Global Banks Outlook Midyear 2020

Emmanuel Volland
Elena Iparraguirre
Cynthia Cohen Freue
Gavin Gunning

Brendan Browne
Sharad Jain
Mohamed Damak

Temporary Shock, Profound Implications

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S&P Global
Ratings

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Key Takeaways

- Credit conditions deteriorated abruptly due to the **COVID-19** pandemic and the **oil shock**. Global growth is expected to rebound sharply in the second half of the year.
- **Downside risks** remain elevated and include a **second wave** of infections and the reimposition of government **restrictions** on people movement and travel.
- The **outlook bias** on bank ratings has turned markedly **negative** since April 2020. But strengthened balance sheets, massive support from authorities to retail and corporate markets, and our base case of a sustained economic recovery **will limit** bank **downgrades** this year.
- The **resilience of economies** and the continued effectiveness of **government support programs** will be major determinants of future rating actions.
- Central banks' responses are positive for funding but pressure banks' interest margins. COVID-19 will likely accelerate bank **digitalization**, trigger another round of **restructuring**, and push **consolidation**.
- The pandemic is likely to heighten **populism and political risk** in several countries. Additional risks stem from U.S.-China trade tensions, the upcoming U.S. presidential election, and a potential no-deal Brexit.

BICRA And Trends For The Top 20 Banking Markets

BICRA Scores And Economic And Industry Risk Trends



*The list includes only a selection of the changes made so far in 2020.

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).

Data as of July 8, 2020. Source: S&P Global Ratings.

BICRA changes in 2020*

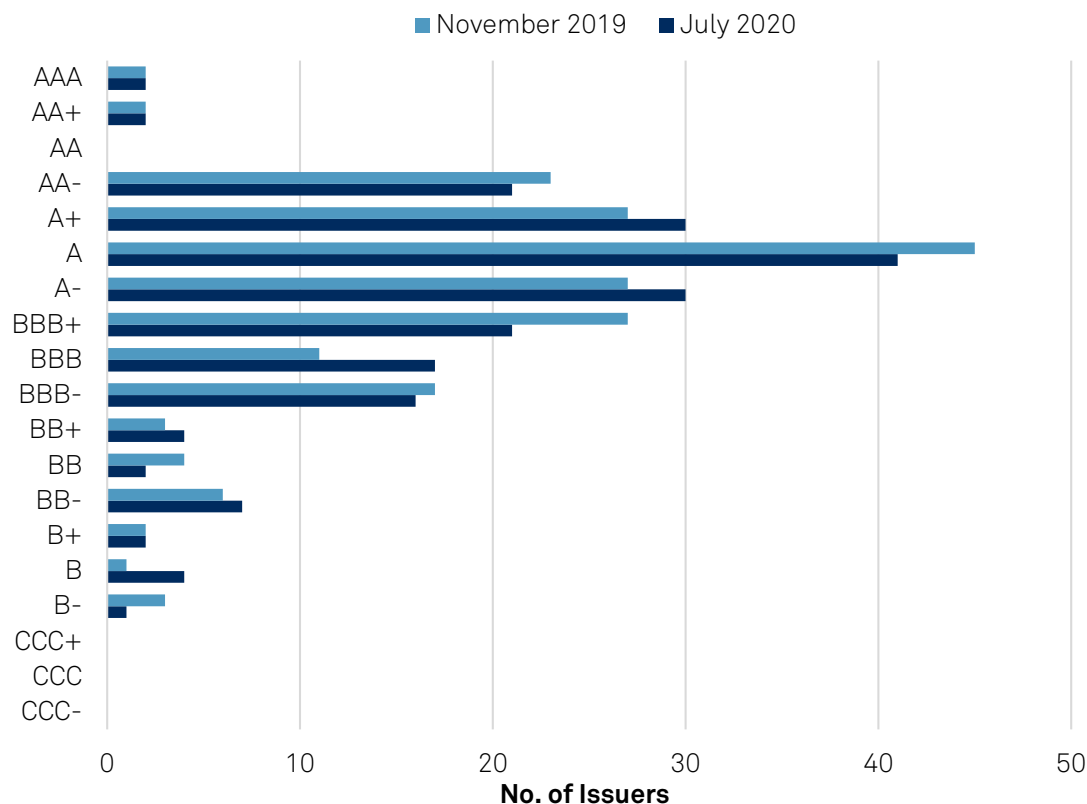
- Mexico **lowered** to 5 from 4
- South Africa **lowered** to 6 from 5
- India **lowered** to 6 from 5
- Iceland **lowered** to 5 from 4
- Oman **lowered** to 7 from 6
- Costa Rica **lowered** to 8 from 7
- Sri Lanka **lowered** to 10 from 9
- Tunisia **lowered** to 10 from 9

Trend changes in 2020*

- Economic risk to **negative** from stable for Australia, Austria, Belgium, Chile, Croatia, Finland, France, Iceland, Indonesia, Italy, Jamaica, Malta, Netherlands, New Zealand, Papua New Guinea, Poland, Spain, Sri Lanka, Trinidad and Tobago, UAE, U.K., U.S., Uzbekistan
- Industry risks to **negative** from stable on France, Ireland, Sri Lanka, Turkey, UAE
- Economic risk to **stable** from positive on Hungary, Slovenia, Georgia, Cyprus, Greece

Bank Ratings **Remain Resilient So Far**

Evolution Of Ratings Distribution For The Top 200 Rated Banks



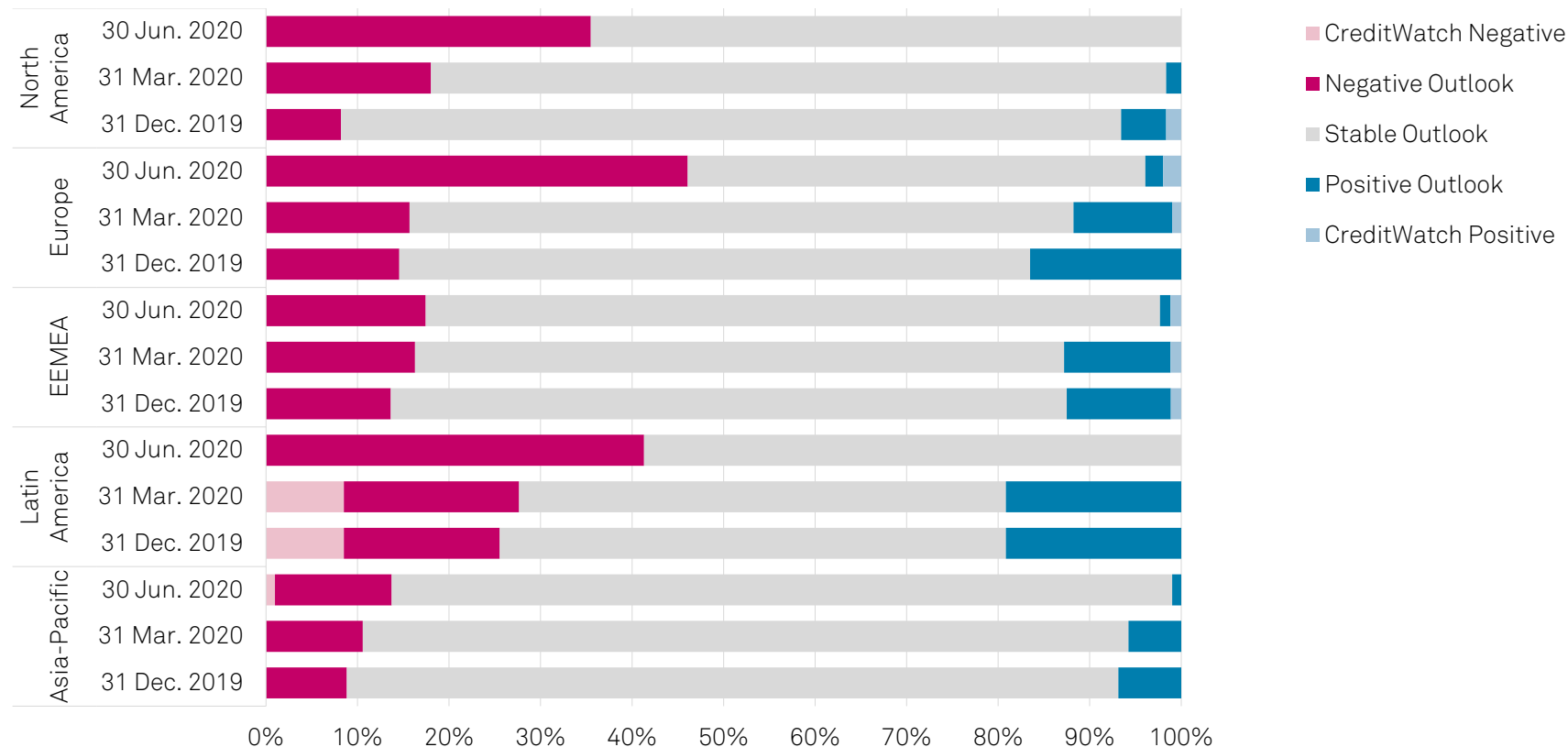
We took more than 200 rating actions on banks related to COVID-19 and/or the oil shock in the past four months:

- **75%** were outlook revisions
- **25%** were downgrades

Operating company issuer credit ratings. Data as of July 1, 2020. Source: S&P Global Ratings.

The Ratings Bias Turns Sharply Negative In April

Evolution Of Outlooks For The Top 200 Banks By Region



Note: Ratings bias is positive bias minus negative bias. Data as of June 30, 2020. EEMEA--Eastern Europe, the Middle East, and Africa.

Source: S&P Global Ratings Research.

Four Key Areas Are Driving Creditworthiness

Profitability

- Lower for longer rates are the new normal
- High corporate leverage may lessen credit demand
- Workout of COVID-19 asset quality stress
- Consolidation as a way to reduce overcapacity and improve efficiency
- Digitalization; cashless transactions

Technology

- More investment is needed to respond to changing customer preferences, but could boost efficiency
- Shifts to working from home; big data; artificial intelligence
- Cyberrisk
- Antifinancial crime

ESG

- Environmental, Social and Governance considerations are better integrated in risk management
- Offer growth opportunities
- A wider stakeholder approach, ability to reprice and restructure, and dividend policy

Regulations

- Use of regulatory buffers
- Path to regulatory normalization, speed and new requirements (like future of Basel IV)
- Resolution versus government support
- The way out of forbearance
- The unwinding of liquidity support



Interest Rates | Lower For Even Longer

- Ultralow interest rates and flat yield curves are squeezing banks' net interest margins.
- This is increasingly making weak profitability a structural problem for many banking sectors, particularly in Western Europe and Japan.
- Banks need to take strategic measures as the pain will worsen. Those less able to make structural changes, including cost cutting and digitalization, will suffer more.
- Mediocre profitability complicates capital buildup, both internally and externally, and increases the likelihood of a round of consolidation, especially in Europe.
- Extremely accommodative monetary policies mitigate immediate asset quality risks but could trigger imbalances over time.

Policy Interest Rates And S&P Global Ratings' Forecasts (%)

	U.S. (Fed)	Eurozone (ECB)		U.K. (BoE)	Switzerland (SNB)
Policy rates	Fed funds	Deposit rate	Refi rate		
2019	1.5-1.75	(0.44)	0.00	0.75	(0.75)
2020f	0-0.25	(0.50)	0.00	0.23	(0.75)
2021f	0-0.25	(0.50)	0.00	0.10	(0.75)
2022f	0-0.25	(0.50)	0.00	0.20	(0.75)
2023f	0.75-1.0	(0.50)	0.00	0.46	(0.75)

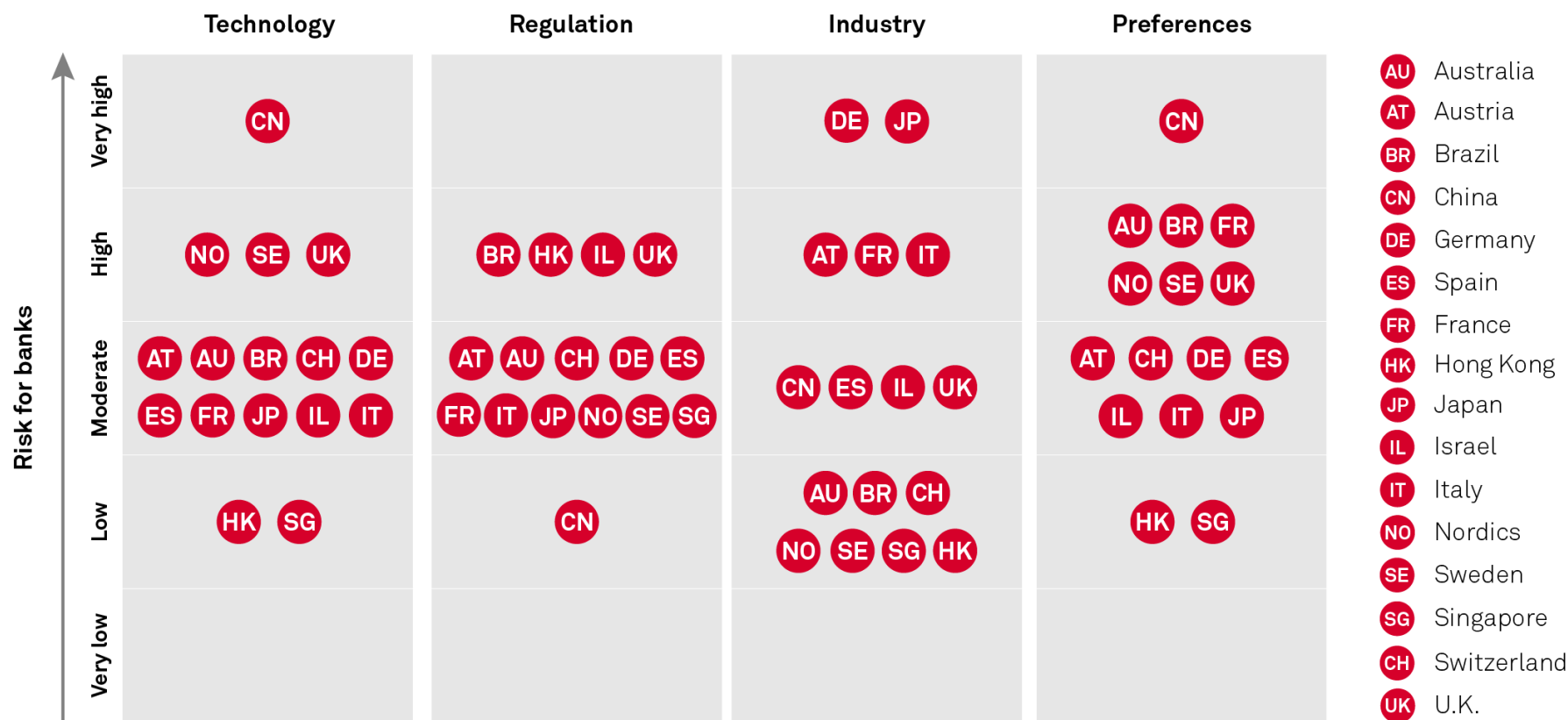
f--S&P Global Ratings forecast. Data at end of period, Q4 values. Source: Oxford Economics.

Digital Transformation Accelerated By COVID-19

- We expect COVID-19 to further accelerate the digital transformation of client preferences, even in countries known for cash business.
- Many Asian and Northern European banking markets lead by offering products fully digitally.
- Preparedness and agility to swiftly shift business models to the new digital normal become even more important to fulfill faster-changing client preferences.
- Regulators will further promote digital transformation by requiring detailed digital agendas and adjusting accounting rules to better allow bearing associated costs.

Tech Disruption Risks

We assess the risk of disruption in retail banking as part of our bank ratings. Opportunities and threats from tech disruption relate to four factors: technology, regulation, industry, preferences.



Source: S&P Global Ratings.

Emerging Markets Are Under More Severe Pressure

After a massive outflow of funds, ultra-accommodative monetary conditions in advanced economies, an easing of lockdowns, and the global economic recovery are shoring up investors' risk appetite.

- Investors are increasingly differentiating among countries, keying on debt dynamic.
- Lockdown fatigue is developing with lockdowns sometimes eased despite increasing COVID-19 cases.
- The low oil price is an additional drag on some economies and banking sectors.
- Some large countries are more severely hurt, including India, Brazil, Mexico, Nigeria, and South Africa.

We expect bank asset quality to deteriorate across the board, with problem loans typically increasing by more than 50% and potentially doubling in some countries.

- Credit losses will widen, but regulatory forbearance may delay bad debt recognition into 2021.
- Profitability will decline, but most banks should remain profitable in 2020 due to hefty interest margins and good efficiency.
- Geopolitical risks, political instability, and social protests could mount in a number of countries.
- High leverage in China remains a key concern, although the largest banks remain resilient.

Regulation | Pragmatism Reigns But Global Consensus Risks A Deeper Fracture

Regulators globally eased rules and guidance to soften procyclical effects and spur bank lending

- Most regulators moved quickly to ease capital and liquidity requirements and some could go further.
- Pragmatic interpretation or implementation of accounting and regulatory capital rules softened the impact of IFRS and U.S. GAAP.

Regulatory reform agenda is on hold, with deadlines pushed back

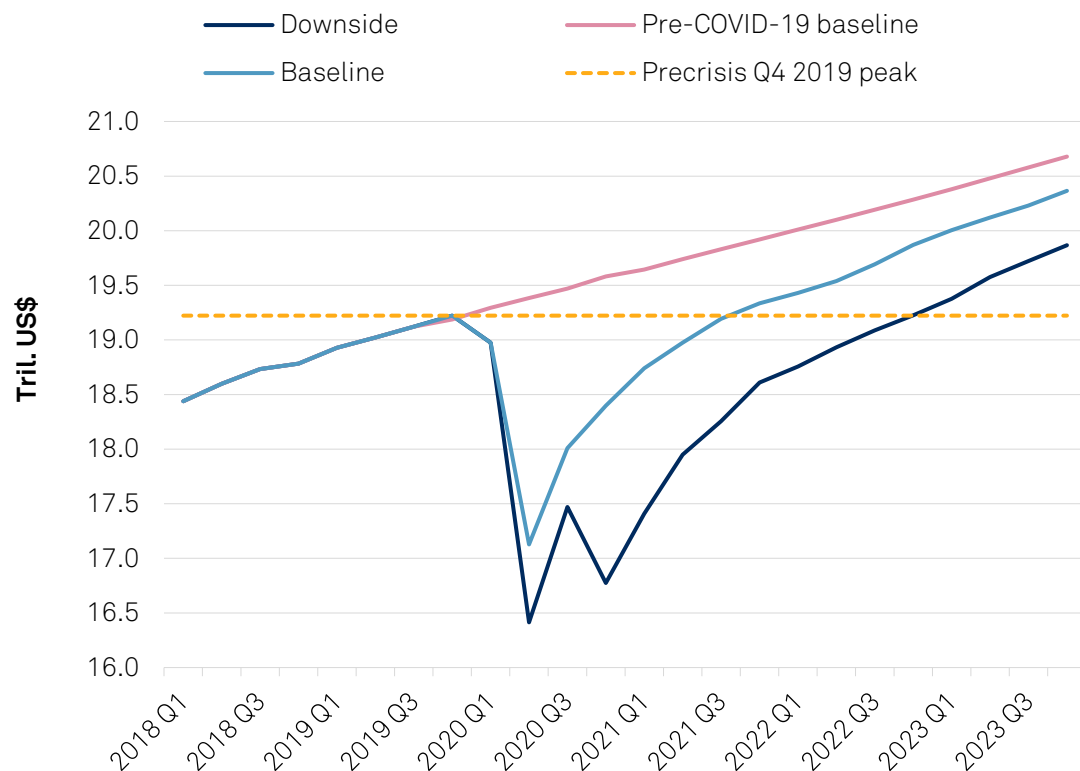
- Planned 2020-2022 implementation of aspects of Basel III rules has been delayed to later years.
- Across much of Europe, requirements to ramp up bail-in buffers were eased (speed and composition).
- G20 policymakers will be even more cautious about eliminating extraordinary government support, if not yet done (such as in Europe).

Risk of widening cracks in the global regulatory consensus

- Regulators will eventually choose how to unwind recent easing measures. It will likely be gradual and well-flagged, from 2022 onward. The pace could differ markedly by country and region.
- Increased risk of divergence in Basel implementation between the EU and the U.S. (e.g., treatment of sustainable finance, requirements for smaller banks, impact of “output floors” in Europe).

Credit Conditions | North America

The U.S. Faces A Longer And Slower Climb From The Bottom: Alternative Paths Of Real GDP Contraction And Recovery

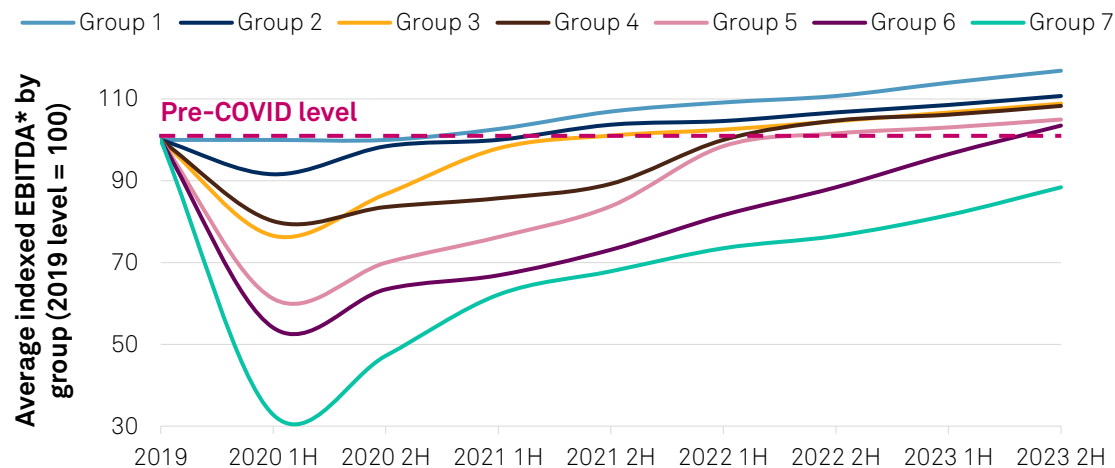


Sources: Bureau of Economic Analysis, S&P Global Economics' forecasts.

- We expect the U.S. economy to contract by 5.0% in 2020 and see downside risk to our forecasted 5.2% recovery in 2021.
- The unemployment rate won't reach precrisis levels until late 2023.
- The government's extraordinary monetary and fiscal stimulus helped stabilize credit markets and temper market volatility.
- We expect the benchmark federal funds rate to remain at 0% until 2023.

North America | Fragile, Uneven Sector Recoveries

Our Forecasts For The Shape Of The Recovery By Sector Group



- The depth of losses and the pace and extent of recovery are driven by industries' exposure to social distancing measures.
- Recovery of banks to pre-COVID-19 credit metrics will hinge on corporates and households.
- Household sector is under pressure as unemployment spikes.

*For years 2022 and after, our opinion on credit metrics is used as a proxy for EBITDA (earnings before interest expense, tax, depreciation and amortization).

Source: [Credit Conditions North America: Rolling Out The Recovery](#), June 30, 2020. S&P Global Ratings.

Group 1
No deterioration
– Tech – software
– Consumer staples

Group 2
Recovery: 1H 2021
– Defense contractors
– Engineering & construction
– Healthcare – pharmaceuticals
– Retail – essential
– Telecom

Group 3
2H 2021
– Ad supported media
– Healthcare – medical products
– Homebuilders & developers
– Paper & packaging
– Restaurants
– Tech – hardware/semi

Group 4
1H 2022
– Building materials
– Business & consumer services
– Capital goods
– Healthcare – services
– Oil & gas
– Power
– Real estate (REITs)
– Refining

Group 5
2H 2022
– Chemicals
– Consumer discretionary
– Fitness
– Gaming / Hotels
– Metals & mining
– Midstream
– Out-of-home ent.
– Utilities

Group 6
2023
– Automotive
– Commercial aerospace

Group 7
Beyond 2023
– Airlines
– Cruise
– Retail – non-essential

North American Banks

Key Expectations

- Allowances for loan losses--up sharply in the first half--will grow more incrementally and weigh heavily on full-year earnings. However, we expect most banks to remain profitable.
- Zero policy rates and reduced business activity will hurt income. Strength in sales and trading and debt underwriting will be one bright spot. Banks will continue to contain costs.
- Capital ratios will decline moderately. The halting of share repurchases and selective capital raising should limit the drops. Liquidity will remain robust thanks to deposit growth and the Fed's quantitative easing.

Key Assumptions

- Real GDP to contract by 5.0% in the U.S. and 5.9% in Canada in 2020.
- GDP does not reach year-end 2019 levels until fourth-quarter 2021 in both the U.S. and Canada.
- After reaching well into the teens, the unemployment rate declines into high single digits by end-2020.

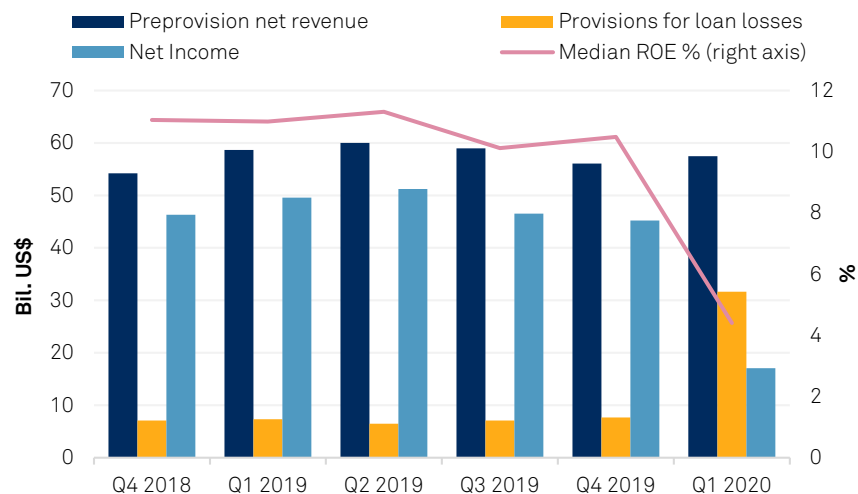
Key Risks

- The economic contraction is deeper than we expect or the rebound is more tepid.
- A larger portion of the loans that banks are modifying, mostly to provide deferral periods, ultimately do not perform and are charged off.
- Capital ratios fall significantly, triggering dividend cuts that market participants interpret more as a sign of distress than as a proactive way to preserve capital.

U.S. Bank Earnings **Fall On Provisions**

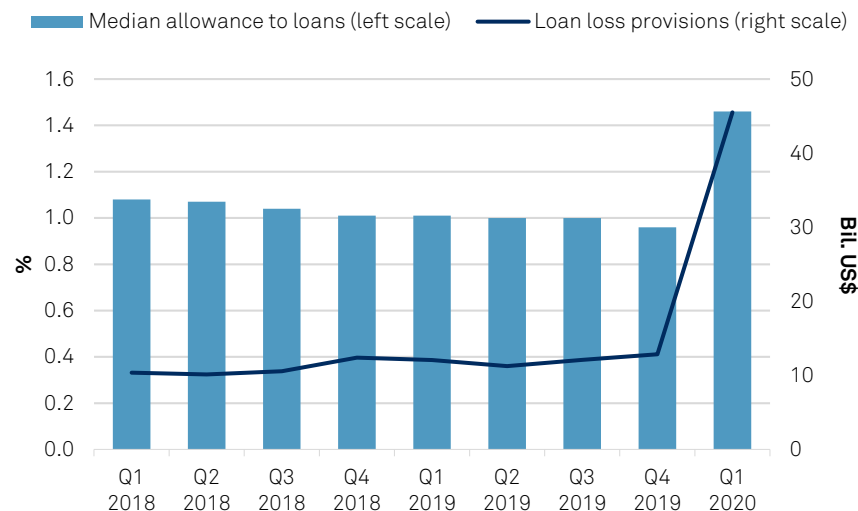
- U.S. banks are facing their greatest challenge since the 2008-2009 crisis. The pandemic and sudden recession have reversed what had been a few years of good fortune for these firms.
- Earnings fell more than 60% in first-quarter 2020 as provisions rose almost four times from the last quarter of 2019.
- Banks significantly increased their allowances under CECL (Current Expected Credit Losses), and we expect a further rise.
- The Fed's zero interest rate policy will weigh on net interest margins.

Earnings And Provisions Of Rated U.S. Banks



ROE--Return on equity. Source: S&P Global Ratings.

Sharp Rise In Allowances For Loan Losses



2020 Forecast | Wrestling With COVID-19 Stress

Worsening

Neutral

Improving

Revenues

Tumbling margins will limit interest income, though rising commercial loans provide an offset in the near term. We expect steep declines in consumer lending as joblessness soars and social distancing generates widespread stoppages in economic activity. Fee income could fall depending on declines in capital market volumes, asset valuations, and potentially some mortgage-related income.

Expenses

Expenses will come into sharp focus to protect bottom-line results. U.S. banks will continue to manage costs conservatively by redeploying personnel, consolidating branches, containing head count, and growing digitization, but rising servicing expenses will somewhat offset this. We expect positive operating leverage will remain elusive for many banks.

Profitability

We expect profitability to take a big hit when banks accelerate provisions to position themselves for sharp declines in asset quality. If the economic downturn is long lasting or the rebound more tepid than we currently assume, the earnings hit for banks could be substantial even in 2021 (not our base case).

Credit Quality

Despite the government's extraordinary and rapid response to contain the pandemic's impact on the economy, we expect declines in asset quality, particularly in areas facing elevated pandemic-related stress such as energy, segments of commercial, commercial real estate (including multifamily), and consumer lending. Deferral programs could render visibility on asset quality poor for few quarters.

Capital

Banks entered this stress period from a position of strength with adequate capital, but sharp hits to earnings, combined with large credit losses, will erode capital ratios. Banks will receive regulatory capital relief from a more relaxed timeframe for CECL adoption and some additional rules to facilitate lending.

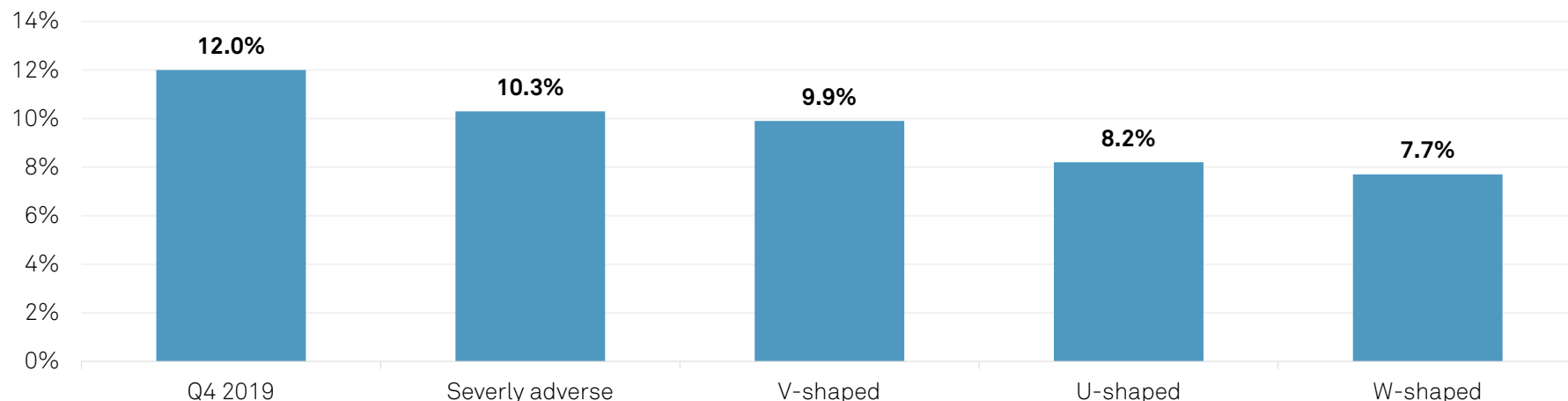
Funding and liquidity

Extraordinary expansion of the Fed's balance sheet after the onset of the pandemic has once again lowered deposit costs, which will likely persist. Despite large corporate draws, liquidity for most banks improved, aided by significant deposit inflows on the heels of the Fed's massive quantitative easing measures.

Fed Stress Test | Limited Capital Distributions

- In its June 2020 stress test, the Fed projected that large banks have sufficient capital to withstand a traditional severely adverse scenario, but in new COVID-19 stress scenarios, some banks approach minimum requirements. The Fed also has limited shareholder distributions for certain banks.
- A dividend reduction is typically positive for creditors, but underperformance that leads to a cut could pressure ratings.
- In our base case, we estimate loan losses over two years at about half the 6% rate the Fed projects in its severely adverse scenario, which could result in some downgrades.
- If loan losses exceed our base case or approach the Fed's three pandemic-related scenarios (V-, U-, and W-shape recessions), we would expect widespread downgrades.

Aggregate CET1 Capital Ratio Under Fed's Stress Test Scenarios

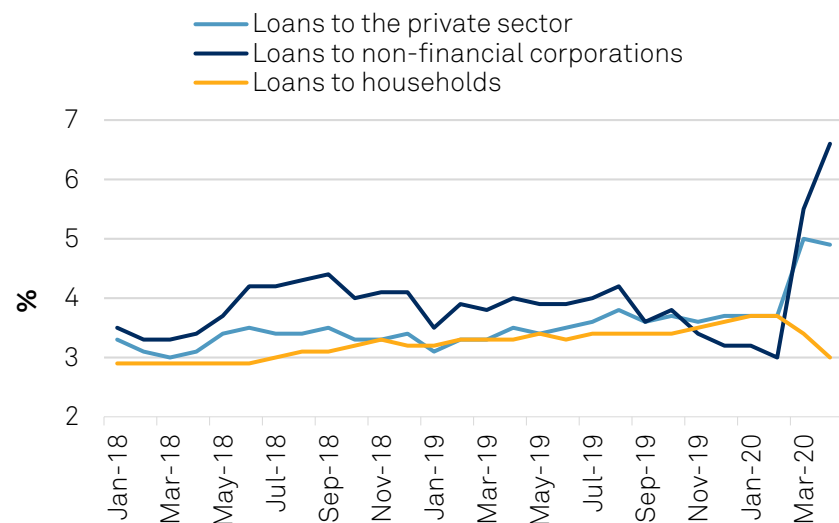


Source: The Federal Reserve. Note: Q42019 actual, projected 1Q022 post-stress. Sample consists of the 33 firms participating in DFAST ((Dodd-Frank Act Stress Test) 2020. For detailed assumptions of the Fed's stress test, see ["The Fed's Latest Stress Test Points To Limited Bank Capital Returns,"](#) published on June 30, 2020.

Credit Conditions | EMEA

- We expect eurozone GDP to decline 7.8% this year and rebound 5.5% next year. Authorities have responded promptly and massively, combining monetary, fiscal, and regulatory measures.
- Economic divergence is set to grow, given that Germany had a lower infection rate, high weighting in manufacturing, and responded with a bigger fiscal stimulus. The EU recovery fund will likely help reduce divergence, but in its current form will not be disbursed in time to finance the recovery.
- Risks that could affect the economic outlook include a second wave of contagion, renewed trade tensions (including uncertainty about U.K.-EU negotiations) and prolonged uncertainty.

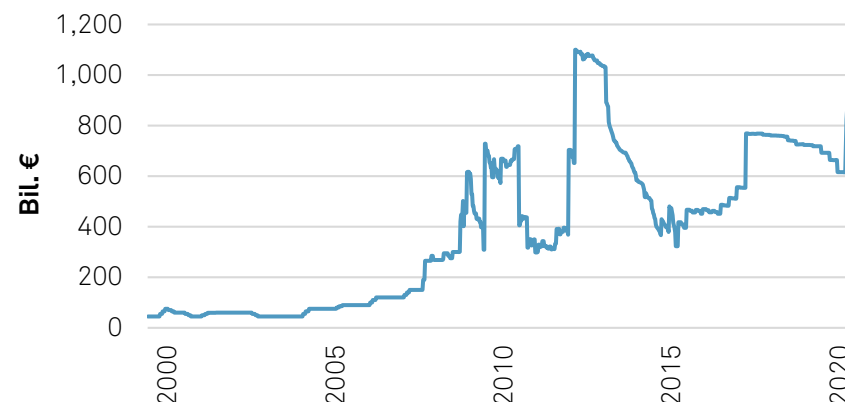
Lending To Corporates Picked Up Strongly



Source: European Central Bank.

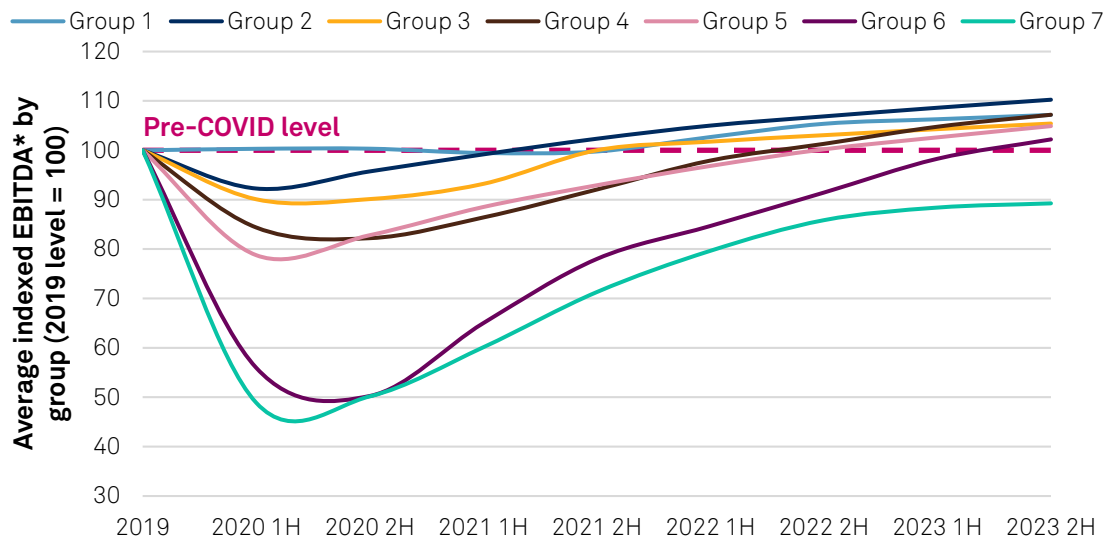
Cheap ECB Funding Has Played A Major Role

Total long-term refinancing operations outstanding



EMEA | Hardest-Hit-Sectors Longest To Recover

Our Forecasts For The Shape Of The Recovery By Sector Group



- Higher provisions and earnings pressure will result in a significant decline of banks' 2020 profits, by at least 50% in five major European countries.
- Banks are unlikely to recover their 2019 levels of profitability until at least 2023.

*For years 2022 and after, our opinion on credit metrics is used as a proxy for EBITDA (earnings before interest expense, tax, depreciation and amortization).

Note: The chart only represents our rated issuers in Europe. Source: [Credit Conditions Europe: Curves Flatten, Recovery Unlocks](#), June 30, 2020. S&P Global Ratings.

Group 1 No deterioration

- Defence contractors
- Other services
- Pharmaceutical
- Retail - essential

Group 2 Recovery: 2H 2020

- Agriculture, forestry, & fishing
- Consumer goods - staples
- Health - services

Group 3 1H 2021

- Telecom
- Health - equipment
- Paper & packaging

Group 4 2H 2021

- Education / Gaming
- Oil & gas
- Consumer goods - tobacco & alcohol
- Utilities
- Homebuilders & devel.
- Infra - toll roads
- Professional services
- Real estate (REITs)

Group 5 1H 2022

- Infra - rail / Media & ent.
- Refining / Theme parks
- Building materials
- Business & consumer services
- Capital goods / Chemicals
- Engineering & constr.
- Metals & mining
- Shipping

Group 6 2H 2023

- Airlines
- Autos
- Consumer - discretionary
- Cruise lines
- Infra - airports
- Lodging & hosp

Group 7 Beyond 2023

- Commercial aerospace
- Retail - nonessential
- Restaurants

EMEA Banks

Key Expectations

- Bank asset quality will deteriorate, with higher provisions adding to earnings pressure and profitability challenges.
- The scale of credit losses will depend on how fast the economy recovers. A softer, longer recovery would test resilience and weigh on bank ratings.

Key Assumptions

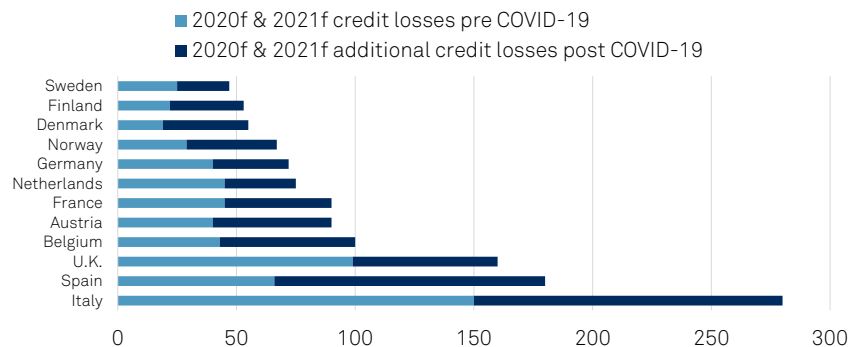
- The economic downturn will be short, and unprecedented government support measures toward households and companies help contain the damage.
- Banks extensively use moratoriums, government guarantees, and accommodative accounting, though low willingness to take advantage of regulatory capital and liquidity relief.

Key Risks

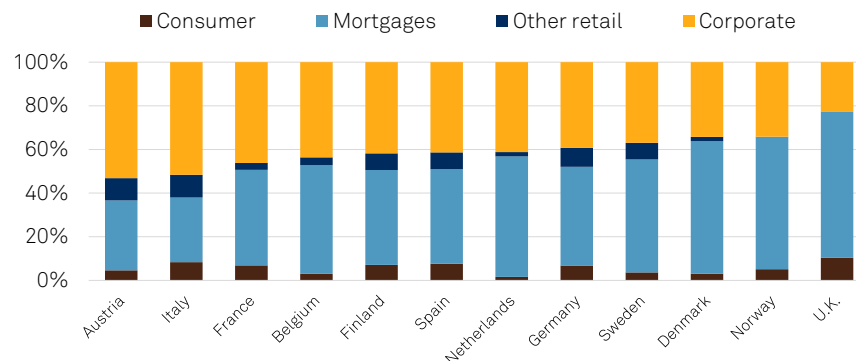
- A harsher macroeconomic environment, either because of a second wave of contagion or because agents' behavioral patterns change, leading to a slower or longer recovery phase. A sharp reversal of market confidence.
- For the U.K., a lack of agreement with the EU on its future trade relationship, resulting in a weaker macro outlook.
- Only partly effective government and bank measures to contain the stress of companies and households.
- Banks' lack of decisive responses to their profitability challenges, making low profitability a longer-term problem.

COVID-19 Will Hit Profitability In 2020

1. Credit Losses Will More Than Double Compared With Our Previous Estimate

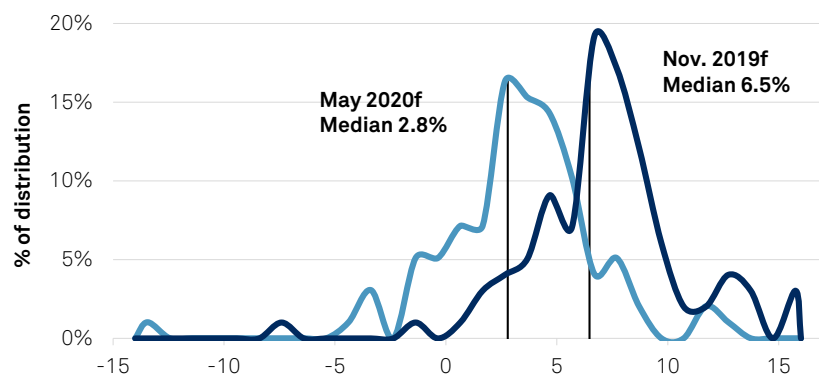


2. SME And Consumer Loans Are More Vulnerable Banking sector lending split

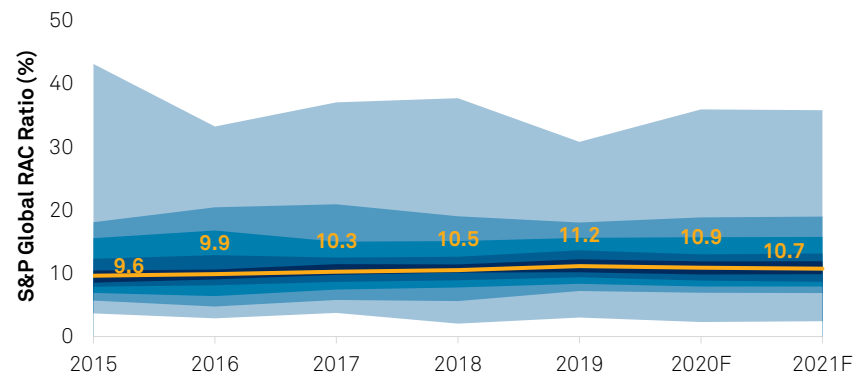


3. Banks' Results Will Sink

Revision of our ROE forecasts for 2020



4. Capital Should Hold Up Well

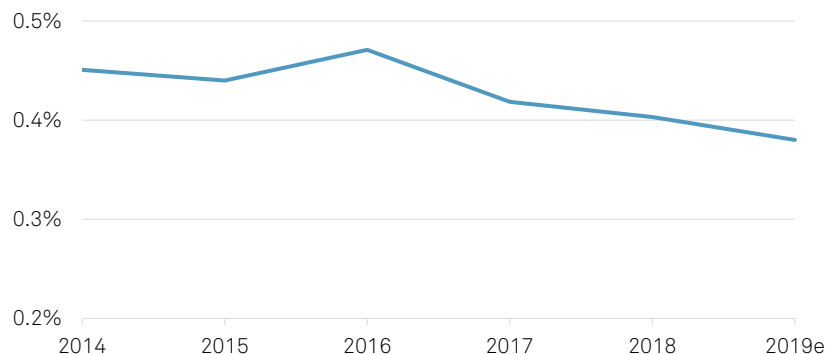


F--Forecast. 2. Data as of Dec. 31, 2019. ECB data. For the U.K. and Norway, central bank data. 3. Revision of our ROE forecast for the Top 100 European banks. 4. Data for the Top 100 European banks. Each band shows distribution of quintiles around the median. Yellow line and values refer to the median. 2019 refers to the actual or forecast if actual is unavailable. Source: S&P Global Ratings.

Key Issues In EMEA Banking Systems

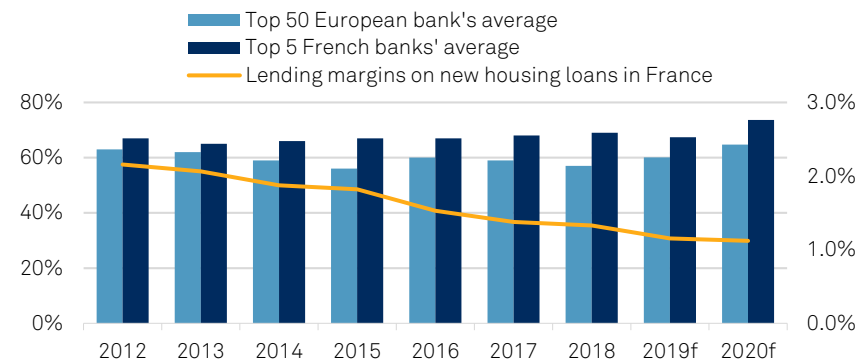
1. Germany: Limited Earnings Buffer

Pre-provision income to average assets

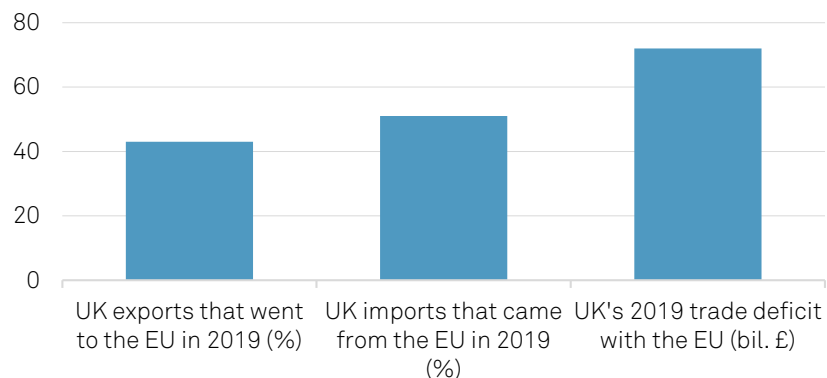


2. France: Need To Address Inefficiencies

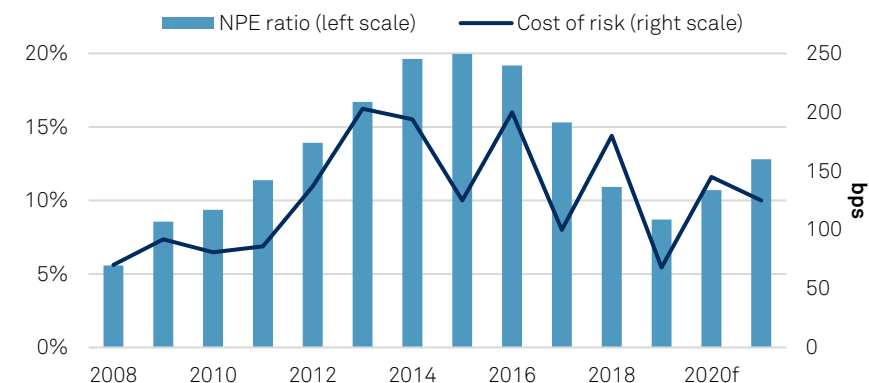
Cost-to-income ratio



3. U.K.: Uncertain Trade Agreement With EU



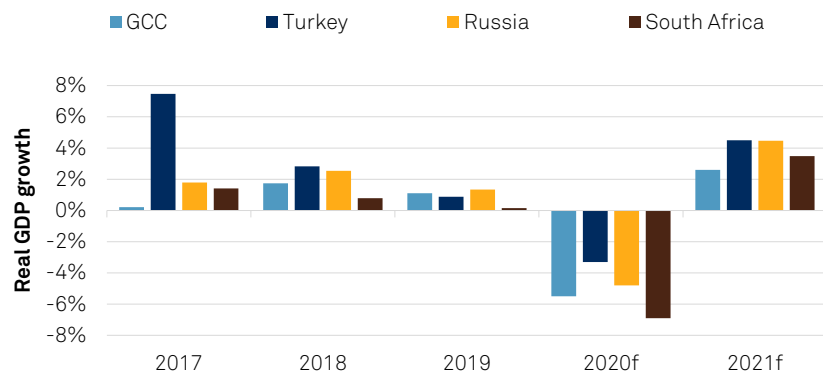
4. Italy: Banks Have Not Completed Cleanups



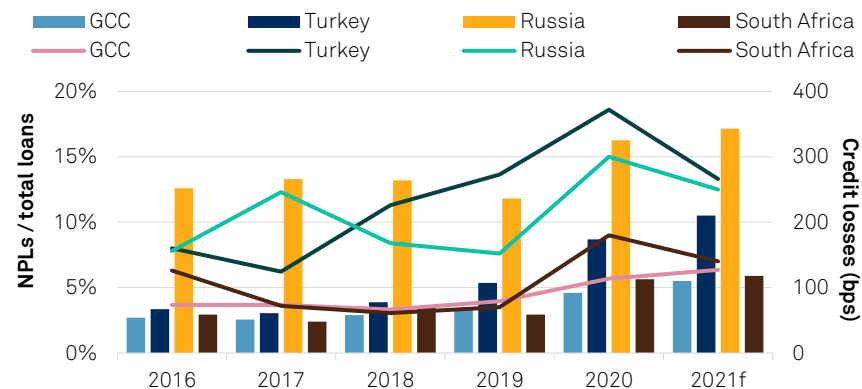
e--Estimate. f--S&P Global Ratings' forecast. NPE--Nonperforming exposures. 2. Note: Inefficiencies measured by the cost-to-income ratio. Sources: European Central Bank, S&P Global Ratings.

Prospect For Emerging Market Banks In EMEA

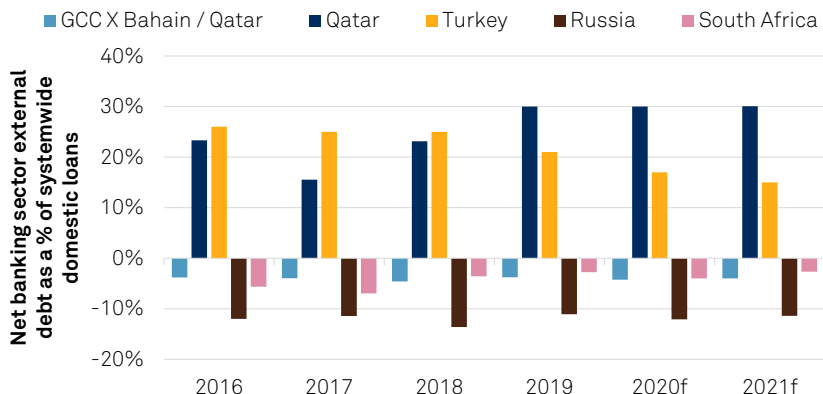
1. COVID-19 And Oil Trigger Recession



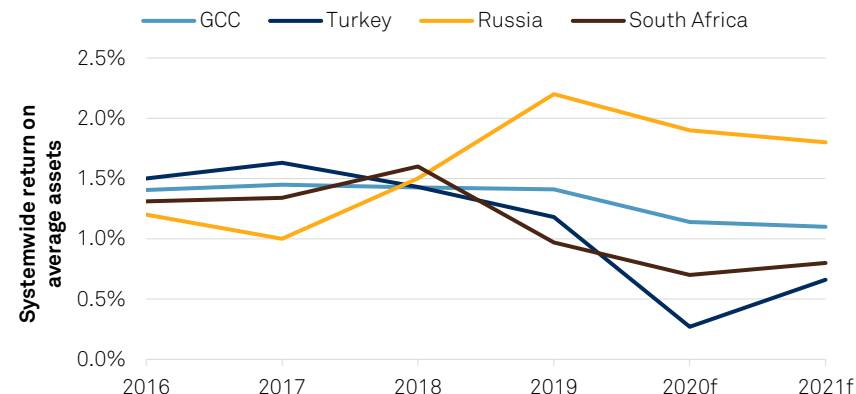
2. Asset Quality Takes A Hit



3. Vulnerable Funding In Turkey And Qatar



4. Profitability Will Decline Markedly

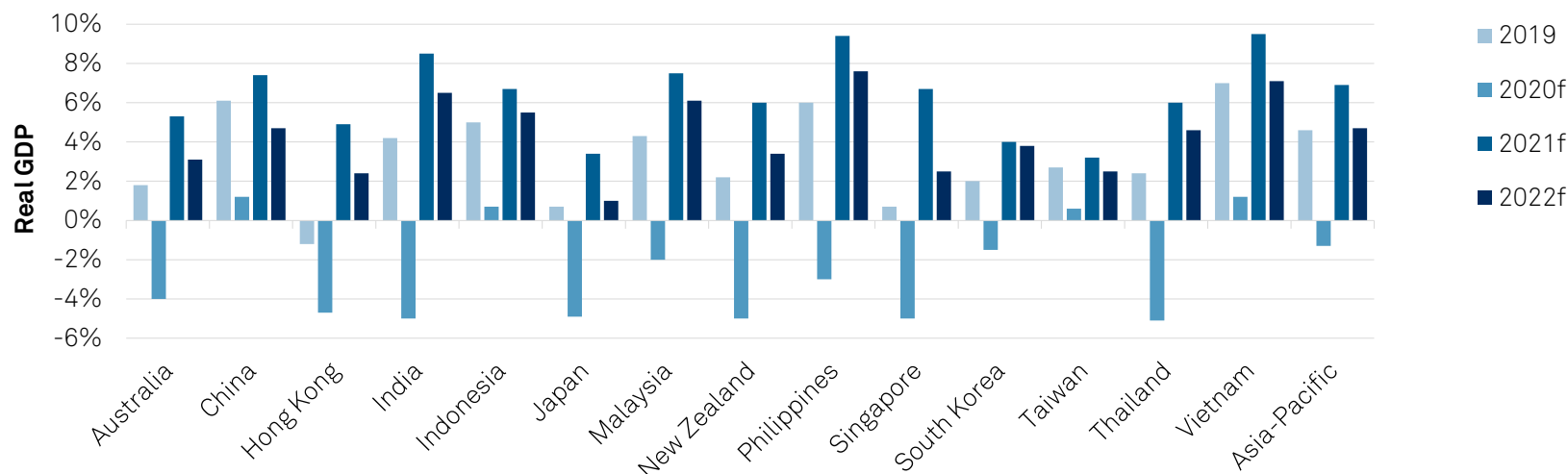


Source: S&P Global Ratings. bps--basis points. f--S&P Global Ratings forecast. NPLs--Nonperforming loans.

Credit Conditions | Asia-Pacific

- The region's GDP will contract 1.3% in 2020 compared with our forecast for 4.6% growth before the pandemic. We expect \$2.7 trillion of lost output over 2020 and 2021, despite a rebound of 6.9% in 2021. Government monetary, fiscal, and prudential actions are providing some short-term buffer but the debt overhang will jump.
- The economic recoveries will vary widely by country, and we expect the region's GDP trends to reach close to the pre-COVID-19 levels only by 2023. We anticipate China and South Korea to be among the early exiters, Japan to be a middle exit, and India and Indonesia to be among the late exiters.
- The top risks during recovery include a buildup of leverage, economic disruption from COVID-19 measures, economic spillover from the U.S.-China strategic confrontation, and uneven access to U.S. dollar funding. COVID-19-induced slump in demand on corporates, households, and governments has also emerged as a key risk.

COVID-19 Has Hit Several Asia-Pacific Economies Hard: Our Forecast For Real GDP



Note: For India, the fiscal year runs April to March (e.g. 2019 is the year ended March 31, 2020). For Australia and New Zealand, the fiscal year runs July to June. f--forecast. Source: S&P Global Ratings.

Asia-Pacific Banks

Key Expectations

- The outlook on most banks remains stable, but the balance of risks is on the downside, as reflected in 17% of financial institution ratings carrying a negative outlook at June 30.
- Good earnings capacity should cushion the blow. Many banks also benefit from healthy loan loss reserve levels.
- Persistent low profitability in the Japanese banking sector and heightened credit issues in India are exacerbating the impact of COVID-19.

Key Assumptions

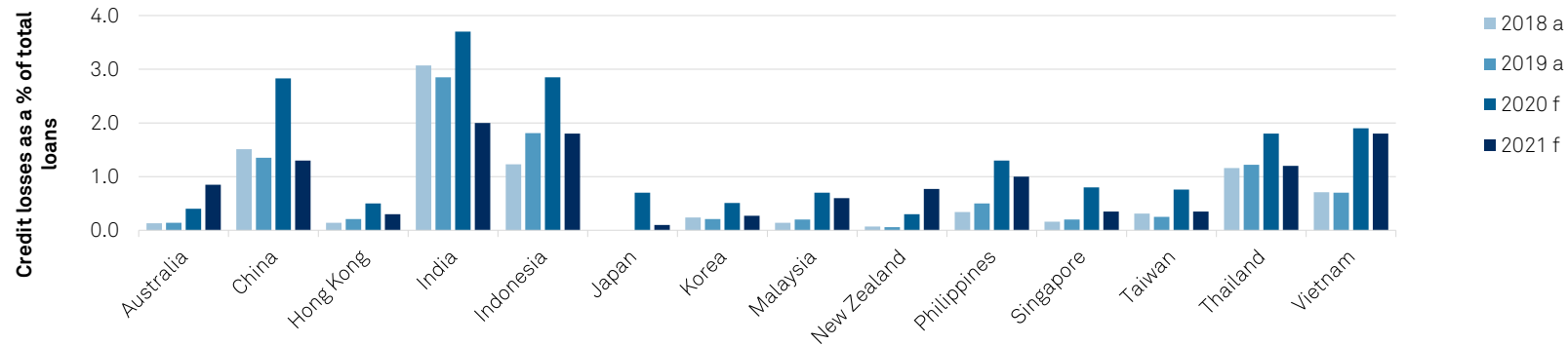
- We forecast GDP to contract in most countries in 2020 but a strong economic rebound subsequently.
- Asset quality metrics are set to weaken with a multifold increase in credit losses in most countries, although off historic lows. Bank asset quality in China, India, and Indonesia will be hardest hit.
- In contrast with Western Europe and the U.S., systemically important banks in most jurisdictions will likely benefit from extraordinary government support in case of need, in our view.

Key Risks

- Risks to banks would intensify if the economic downturn is more severe or prolonged than our current forecasts. The cyclical downturn in Asia-Pacific trade also remains a risk for some regional economies.
- A number of countries have high private-sector debt, which could exacerbate the risks to their banking sector.
- Defaults from the borrowers and credit losses increase faster than expected when fiscal support unwinds.

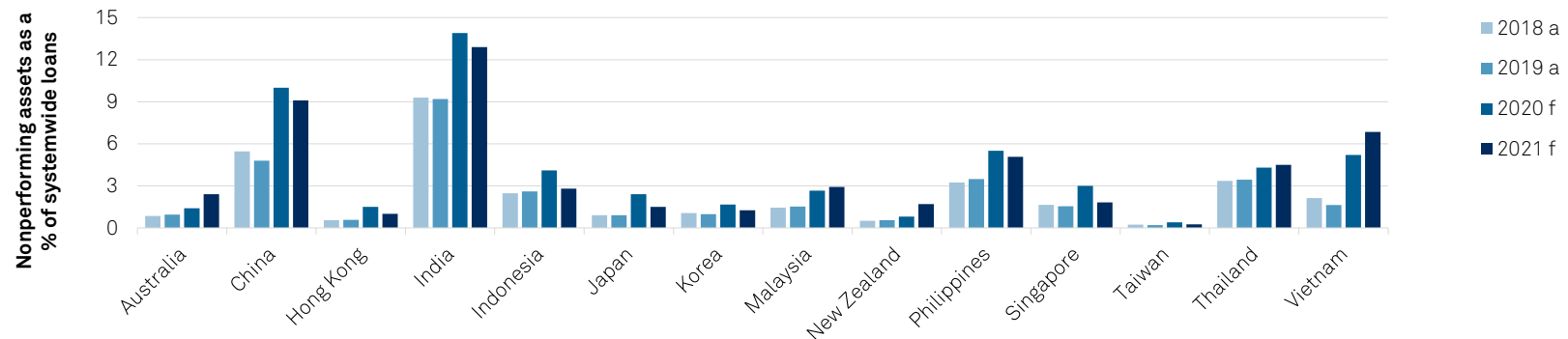
Asia-Pacific Banks | COVID-19 Pushes Up Credit Losses And Nonperforming Assets

Credit Costs Will Cool Off In 2021 After The Multifold Rise



Credit losses are net charge-offs of private-sector exposures or loan loss provisions allocated to cover potential losses on exposures to resident borrowers by resident banks. Both are expressed as a percent of the average of loans to domestic borrowers. a--Actual. f--Forecast. Source: S&P Global Ratings.

Nonperforming Assets To Remain Elevated In Many Countries

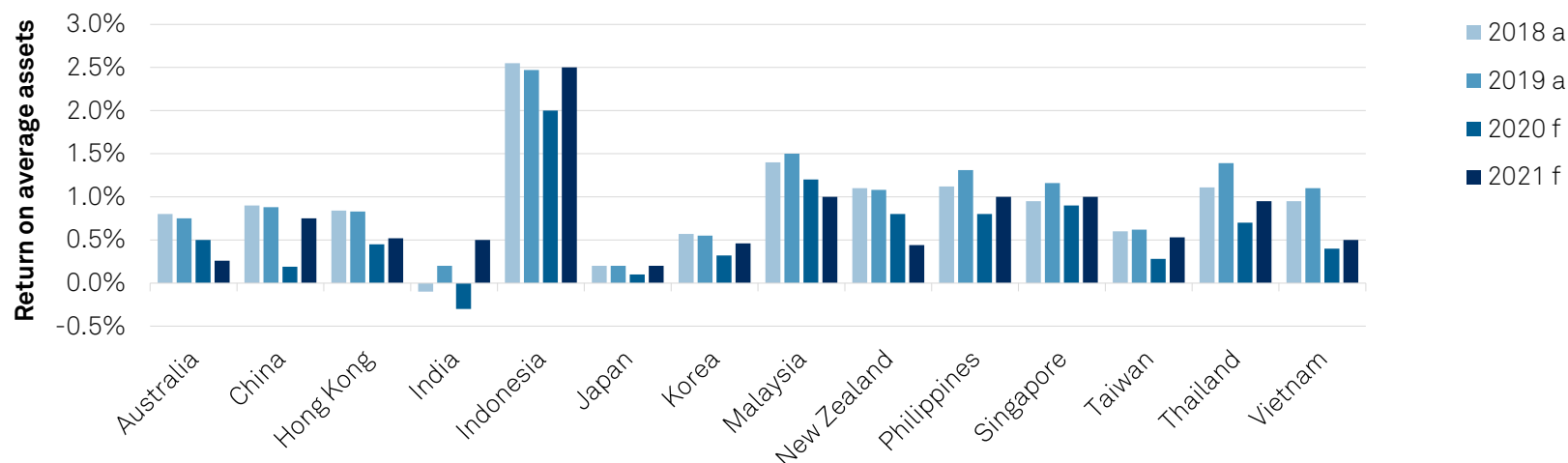


Sum of problematic exposures (including loans and foreclosed assets) due by resident private and public borrowers to a country's resident banks, expressed as a percent of total loans granted to domestic private and public borrowers. a--Actual. f--Forecast. Source: S&P Global Ratings.

Asia-Pacific Banks | Earnings Will Take A Hit

- For most systems, a steep rise in credit losses and fall in interest margins and fee income are likely to suppress earnings in the next two years.
- The Indian banking system, already saddled with high problem assets, could show a loss in 2021.
- Economic strain and lower interest rates will exacerbate the regional Japanese banks' ongoing struggle with low profitability.
- The speed and magnitude of forbore loans turning nonperforming would largely be driven by the strength of the recovery of the Chinese economy. A significant part of credit cost and profitability impact could be felt across two to three years.

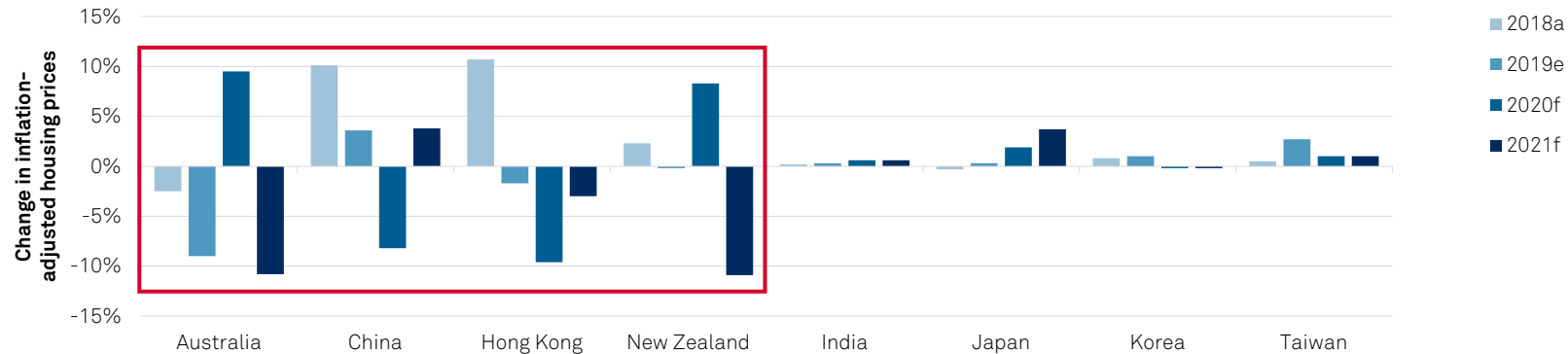
Elevated Credit Losses Will Dent Bank Earnings In The Next Two Years



We measure return on average assets (ROAA) as annual net income reported by resident financial institutions' domestic operations, expressed as a percent of their average adjusted domestic assets. a--Actual. f--Forecast. Source: S&P Global Ratings.

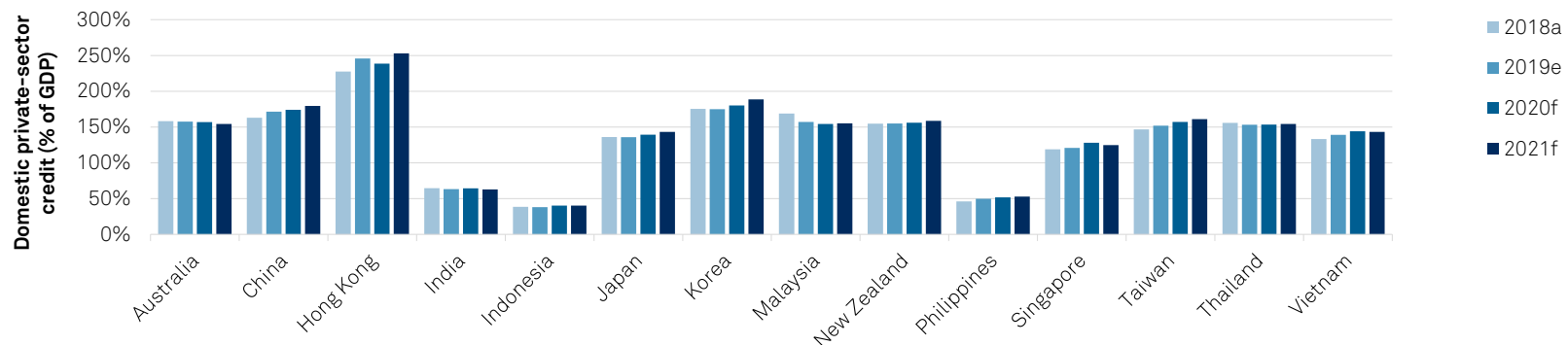
Asia-Pacific Banks | Risks From Falls In Asset Prices And High Private-Sector Indebtedness

COVID-19 To Trigger Significant Property Price Falls In Some Countries



Change in inflation-adjusted housing prices is calculated as annual percent change in residential house price, at a national level, adjusted for the change in the general price level. a--Actual. e--Estimate. f--Forecast. Source: S&P Global Ratings.

High Private-Sector Debt Poses Risks To Many Systems In Severe Downturn

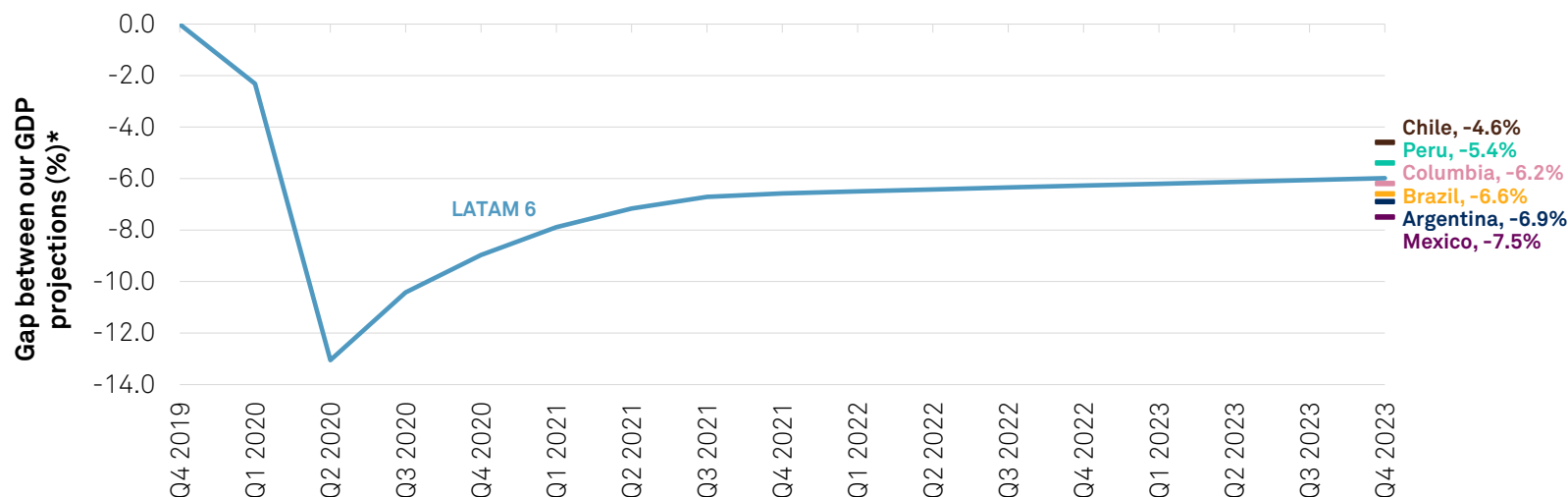


Domestic private-sector credit as % of GDP is calculated using aggregate amount of claims of resident depository corporations (other than the central bank) on nonfinancial private-sector residents, expressed as a percent of nominal GDP. a--Actual. e--Estimate. f--Forecast. Source: S&P Global Ratings.

Credit Conditions | Latin America

- We expect GDP in Latin America to contract 7.5% in 2020, followed by a rebound of 4% in 2021. It is likely to be the last region to exit the pandemic. Risks are mostly to the downside.
- We see economies with stronger policy support, such as Chile and Peru, having smaller permanent GDP losses than those where support has been limited or ineffective, such as Mexico.
- This deep economic contraction and slow recovery will weaken government finances. The room to maneuver in most countries is limited given fiscal rigidities, high poverty rates, and ill-equipped health systems. The risk of poor policy choices that would deepen the crisis is on the rise.

Latin American Economies Will Face Relatively High Permanent Losses



Source: S&P Global Ratings. *Gap between new projected GDP and pre-COVID-19 projected GDP. LATAM 6 is the PPP GDP weighted average of Argentina, Brazil, Chile, Colombia, Mexico and Peru.

Latin American Banks

Key Expectations

- Because of the economic slump, we expect a shock to asset quality, especially in sensitive economic sectors, SMEs, and self-employed workers who have limited financial flexibility to cope with the sudden stop in cash flow.
- Credit growth to be in the low single digits in 2020. Credit demand from the corporate sector is increasing due to liquidity needs but consumer and mortgage lending will partly offset this.

Key Assumptions

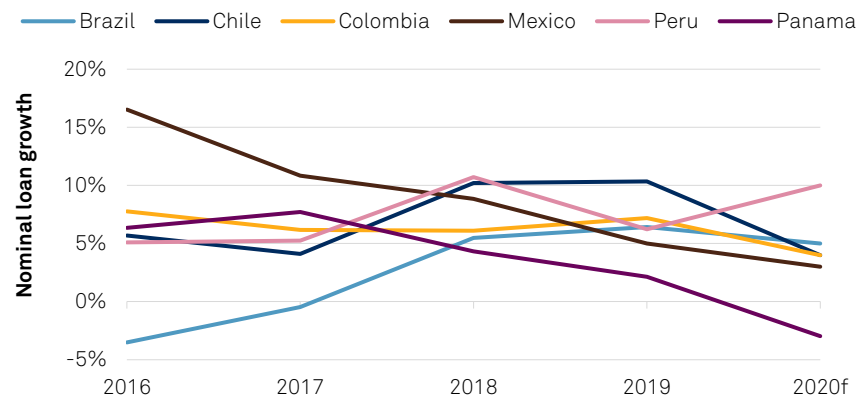
- Credit losses will significantly hit banking systems. However, banks' still high margins and provisioning coverage will lessen the hit to balance sheets.
- Debt moratoriums initiated by the authorities will allow banks to defer recognition of some bad loans and their consequent provisioning to 2021. Therefore, it is still early to assess the potential damage to asset quality.
- We expect an improvement in economic activity in 2021 thanks to the stimulus packages offered by the governments and the expected recovery in China. Mexico and Argentina will benefit less due to their lower stimulus packages.

Key Risks

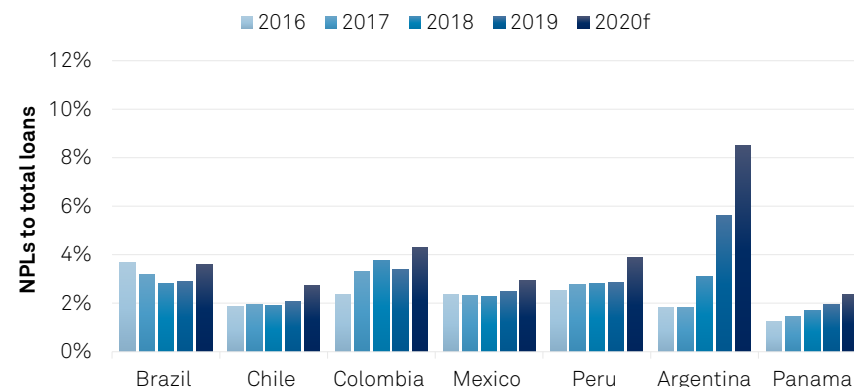
- The severe economic crisis and increasing number of individuals infected by COVID-19 could weigh on the fragile health system and lead to social discontent.
- If economic activity takes longer than expected to recover, more companies would struggle to remain viable and that could lead to higher unemployment. It would ultimately weaken asset quality and financial performance.

Latin American Banks

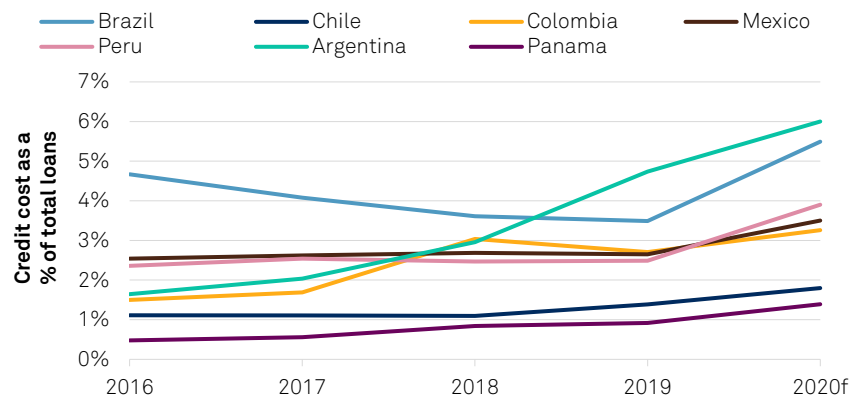
1. Loan Growth To Slow



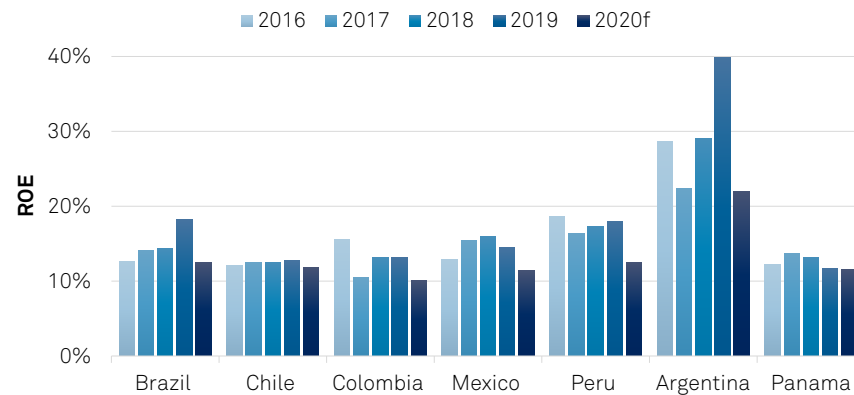
2. Nonperforming Loans To Escalate



3. Credit Cost Will Rise Sharply



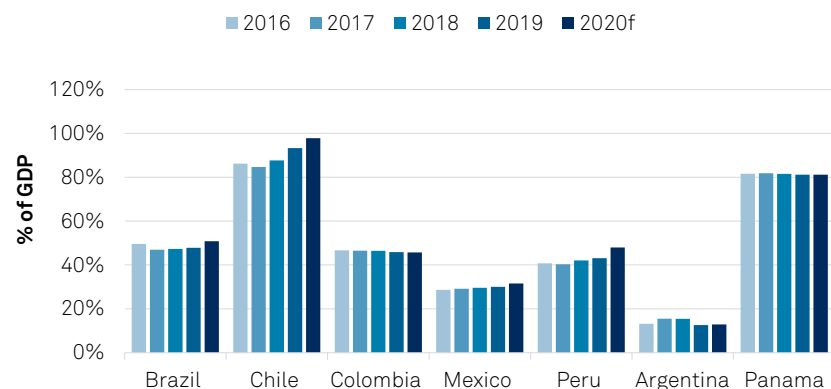
4. Sound Profitability Despite Challenges



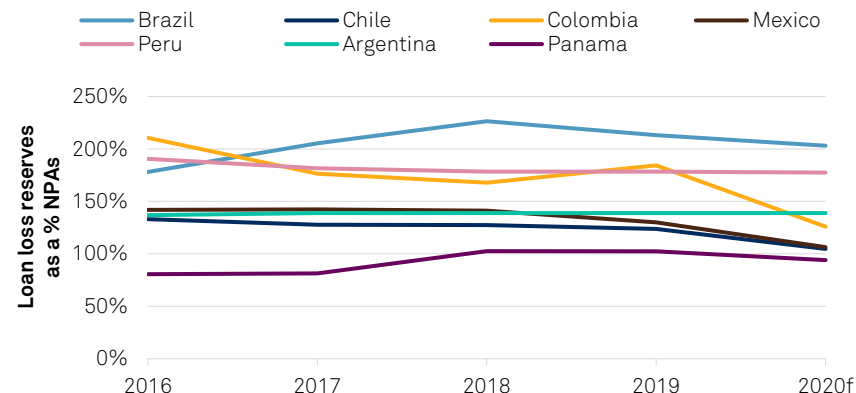
Source: S&P Global Ratings. f--Forecast. 2. Nonperforming loans as a percentage of total loans. 3. Credit cost as a percentage of total loans. 4. ROE-- Return on equity.

Latin American Banks

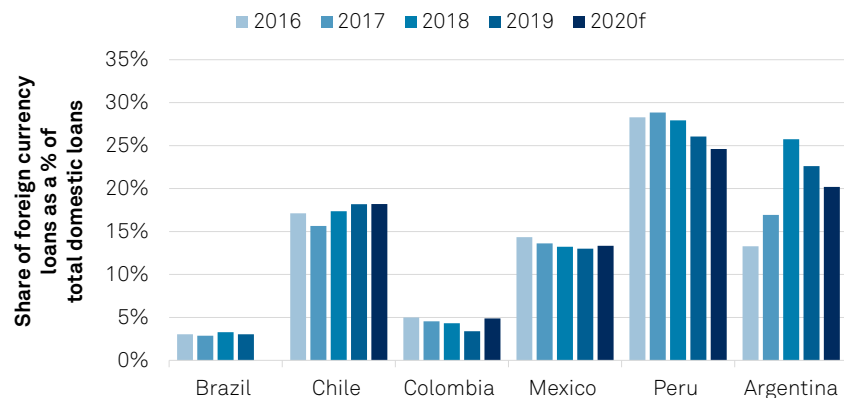
1. Low Credit To GDP (Except Chile And Panama)



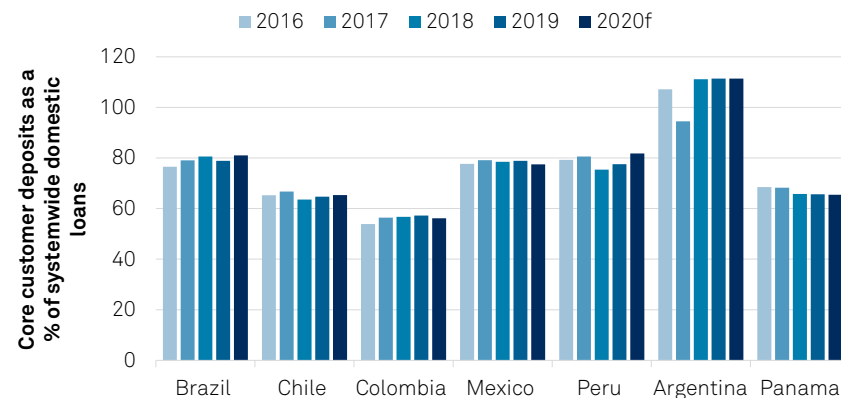
2. Comfortable Provisioning Coverage



3. Foreign Exchange Loans Directed To Exporters



4. Low Loan-To-Deposit Ratio



f--Forecast. 2. Provisioning coverage as measured by the ratio of loan loss reserves to nonperforming assets. 3. Percentage of loans denominated in foreign currency as a percentage of total loans. Source: S&P Global Ratings.

Related Research

- Global Banking Country-By-Country Outlook Midyear 2020: More Or Less Resilient To COVID-19 Shocks, July 9, 2020
- [The \\$2 Trillion Question: What's On The Horizon For Bank Credit Losses](#), July 9, 2020
- [Asset Quality Not ECB Liquidity Will Determine Eurozone Banks' Fates](#), July 2, 2020
- [Industry Report Card: COVID-19 A Further Blow To Japan's Regional Banks](#), July 1, 2020
- [The Fed's Latest Stress Test Points To Limited Bank Capital Returns](#), June 30, 2020
- [Banking Industry Country Risk Assessment Update: June 2020](#), June 26, 2020
- [Capital Markets Revenue Should Be A Bright Spot For Banks In A Tough 2020](#), June 23, 2020
- [Industry Report Card: Japanese Major Bank Credit Costs Rise On COVID-19](#), June 16, 2020
- [How COVID-19 Is Affecting Bank Ratings: June 2020 Update](#), June 11, 2020
- [Bank Regulatory Buffers Face Their First Usability Test](#), June 11, 2020
- [Banks In Emerging Markets: 15 Countries, Three COVID-19 Shocks](#), May 26, 2020
- [Banking Risk Indicators: May 2020 Update](#), May 18, 2020
- [Largest Brazilian Banks' First-Quarter Results Point To Mounting Credit Losses](#), May 18, 2020
- [For Large U.S. Banks, Loan Loss Expectations Will Be Key To Ratings](#), May 5, 2020
- [COVID-19 Effects Might Quadruple U.K. Bank Credit Losses In 2020](#), May 4, 2020
- [How COVID-19 Risks Prompted European Bank Rating Actions](#), April 29, 2020
- [Europe's AT1 Market Faces The COVID-19 Test: Bend, Not Break](#), April 22, 2020
- [China Banks After COVID-19: Big Get Bigger, Weak Get Weaker](#), April 17, 2020
- [European Banks' First-Quarter Results: Many COVID-19 Questions, Few Conclusive Answers](#), April, 1, 2020

Analytical Contacts



Global

Emmanuel Volland

Paris
+33-1-4420-6696
emmanuel.volland@spglobal.com



Global

Gavin Gunning

Melbourne
+61-3-9631-2092
gavin.gunning@spglobal.com



Asia-Pacific

Sharad Jain

Melbourne
+61-3-9631-2077
sharad.jain@spglobal.com



North America

Brendan Browne

New York
+1-212-438-7399
brendan.browne@spglobal.com



Latin America

Cynthia Cohen Freue

Buenos Aires
+54-11-4891-2161
cynthia.cohenfreue@spglobal.com



Western Europe

Elena Iparraguirre

Madrid
+34-91-389-6963
elena.iparraguirre@spglobal.com



CEEMEA

Mohamed Damak

Dubai
+971-4372-7153
mohamed.damak@spglobal.com

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