Global Banks Outlook 2024

Forewarned Is Forearmed

November 16, 2023

S&P Global Ratings

This report does not constitute a rating action

Contents

Key Takeaways

- Our outlook for global banks remains steady. As of Oct. 31, 2023, 79% of bank rating outlooks were stable. This resilience is largely to due solid capitalization, improved profitability, and still sound asset quality.
- That said, the weak economic outlook presents headwinds for banks' business volumes, asset quality, and financing conditions. Positively, most banks' earnings will continue to benefit from high interest rates.
- Key risks could intensify. Although not our base case, a marked deterioration of economic conditions in Europe, the U.S, and China is possible, while inflation remains high. The Russia-Ukraine and Israel-Hamas wars also bring spillover risks.
- Commercial real estate (CRE) markets are suffering a significant downturn in some jurisdictions, with demand and prices falling, especially in the U.S., China, and some European countries. Related losses, although manageable, will be felt for a few years.
- We anticipate increasing credit divergence. Pressure will be more pronounced for nonbank financial institutions and entities with weak funding profiles or directly exposed to geopolitical risk.

Key Risks

Deviation from our economic base case

Emergence of material downside--including a full-blown recession with a sharp rise in unemployment and increasing geopolitical risks.

Greater property sector deterioration than expected

Acceleration of weakness in CRE markets, ultimately hurting banks' asset quality more than expected.

High corporate and government-sector leverage

This could exacerbate corporate insolvencies and trigger lower government support for the real economy.

Digitalization, climate change, and cyber to challenge banks' business models and risk management

Nontraditional risks add to the usual credit, market, funding, and operational risks.

BICRA Developments In 2023

January

Belarus
ER trend to negative from stable

February

Austria
IR trend to stable from negative

Germany
ER score to '2' from '1', trend to stable from negative

March

Armenia
ER trend to positive from stable

Kazakhstan
BICRA to Group '8' from Group '9', and IR score to '8' from '9'

U.S.
IR trend to stable from positive

April

Bolivia
BICRA to Group '10' from Group '9', and ER score to '10' from '9'

Cyprus
IR trend to positive from stable

Greece
BICRA to Group '7' from Group '8'. IR score to '7' from '8', trend to stable from positive

May

Italy
ER trend to positive from stable

New Zealand
ER trend to stable from negative

Egypt
ER trend to negative from stable

June

India
BICRA to Group '5' from Group '6', and ER score to '6' from '7'

Poland
IR trend to stable from negative

Ireland
BICRA to Group '3' from Group '4', and ER score to '3' from '4'

July

Hungary
ER trend to stable from negative

Switzerland
ER score to '1' from '2' and IR score to '3' from '2'

August

Bangladesh
IR trend to negative from stable

September

Malta
ER trend to stable from negative

Portugal
ER trend to positive from stable

October

Egypt
BICRA to Group '10' from '9'. ER score to '10' from '9', trend to stable from negative. IR score to '9' from '8'

Italy
ER score to '5' from '6', trend to stable from positive

Oman
ER trend to positive from stable

Israel
ER trend to negative from stable

November

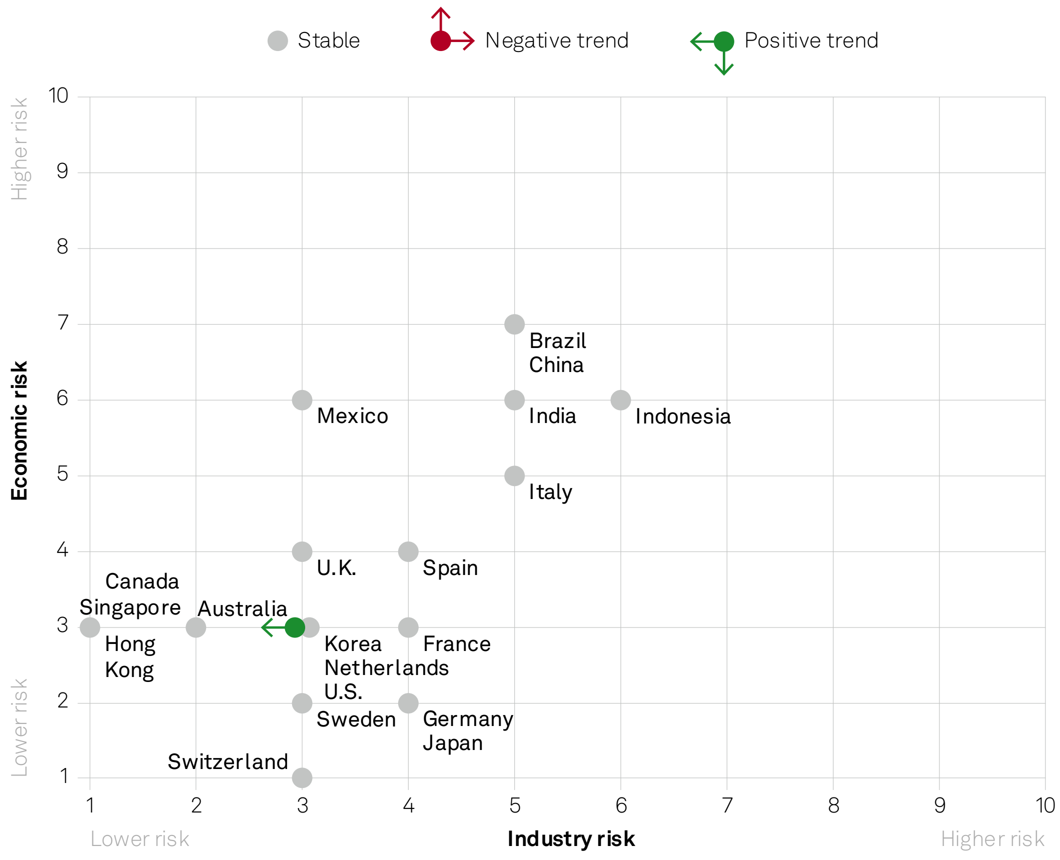
Turkey
ER and IR trends to stable from negative

Data as of Nov. 15, 2023. Chart includes changes in BICRA group, industry and economic risk trends and scores. BICRA--Banking Industry Country Risk Assessment. ER--Economic risk. IR--Industry risk.
Source: S&P Global Ratings.

BICRA | Stable Trends Dominate

BICRA scores and economic and industry risk trends

Top 20 banking markets



BICRA-related changes in the top 20 banking markets: 2023

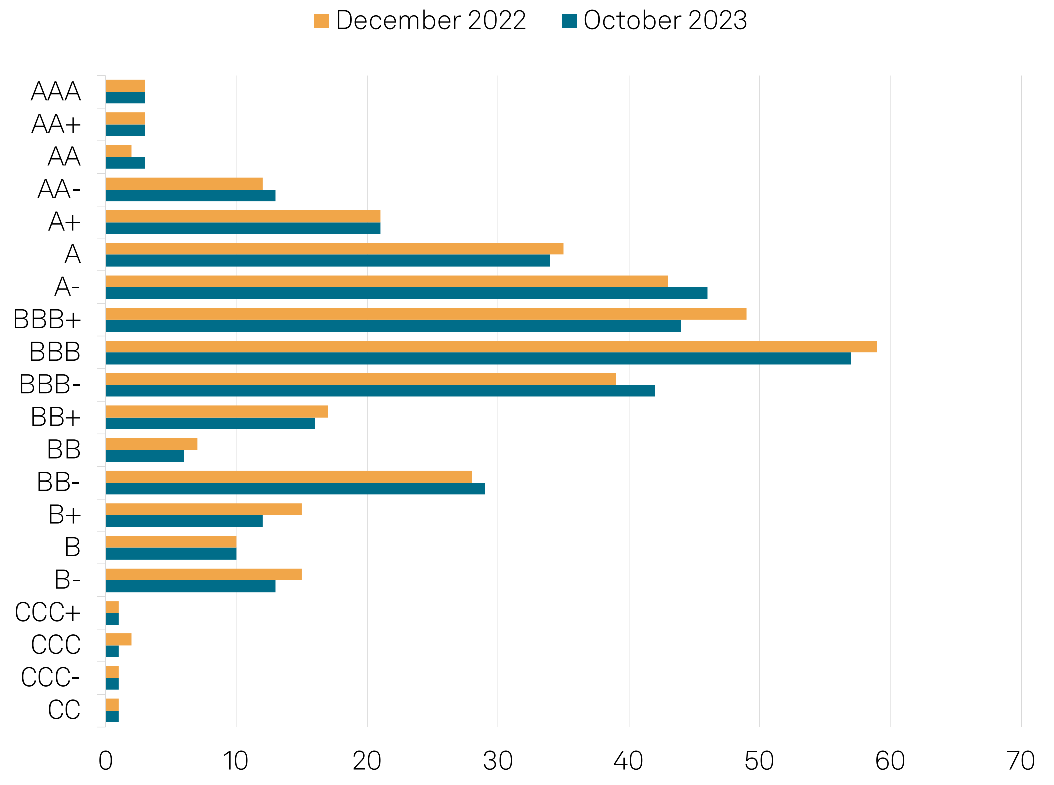
- **Germany:** Economic risk score to 2 from 1, trend to stable from negative (February)
- **U.S.:** Industry risk trend to stable from positive (March)
- **Italy:** Economic risk trend to positive from stable (May)
- **India:** BICRA group score improved to 5 from 6 (June)
- **Switzerland:** Economic risk score to 1 from 2, industry risk score to 3 from 2 (July)
- **Italy:** Economic risk score to 5 from 6, trend to stable from positive (October)

Data as of Nov. 15, 2023. 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). AUS--Australia. CAN--Canada. NLD--Netherlands. KOR--South Korea. SGP--Singapore. Source: S&P Global Ratings.

Banks | Generally Stable Outlook

We expect bank ratings to be resilient

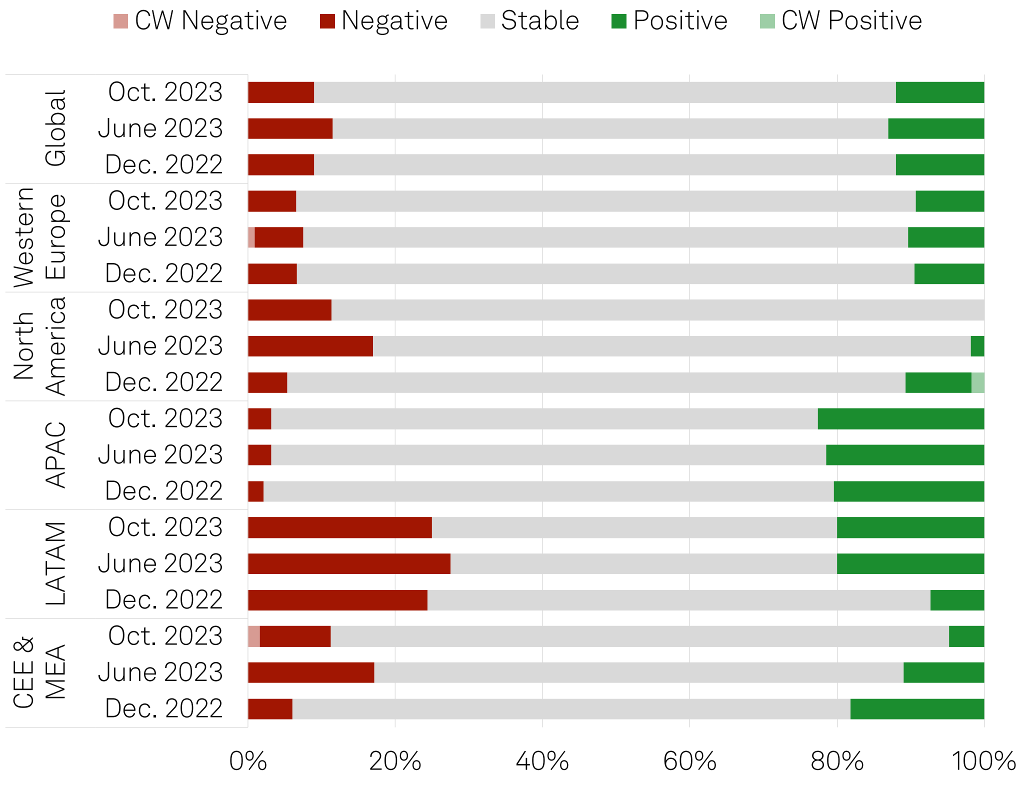
Evolution of ratings distribution for rated banks



Operating company issuer credit ratings. Source: S&P Global Ratings.

Bank outlooks are broadly stable

Evolution of outlooks for rated banks by region



APAC--Asia-Pacific. CEE--Central and Eastern Europe. CW--CreditWatch. LATAM--Latin America. MEA--Middle East and Africa. Source: S&P Global Ratings.

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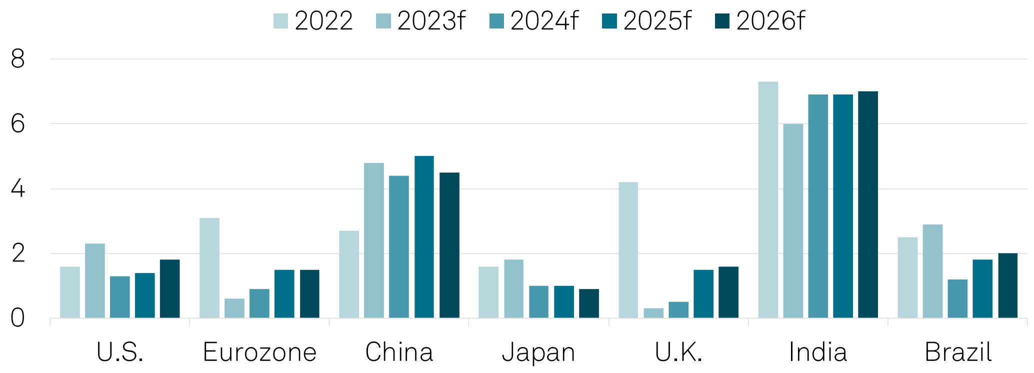
What We Are Watching In 2024

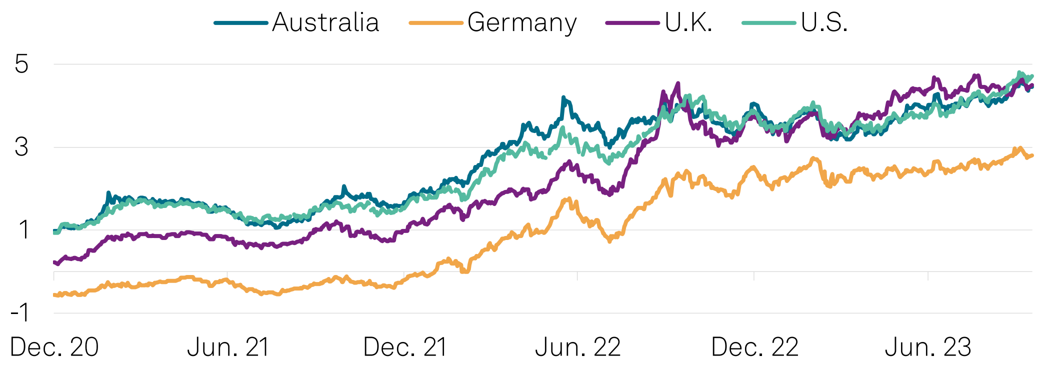
1. How much will slow economic growth hurt banks

GDP growth forecast by country (%)



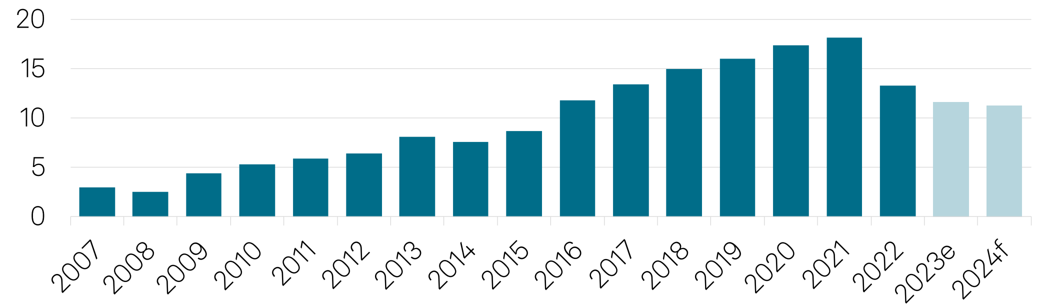
2. How long borrowing costs will remain high

10-year government bond yields (%)



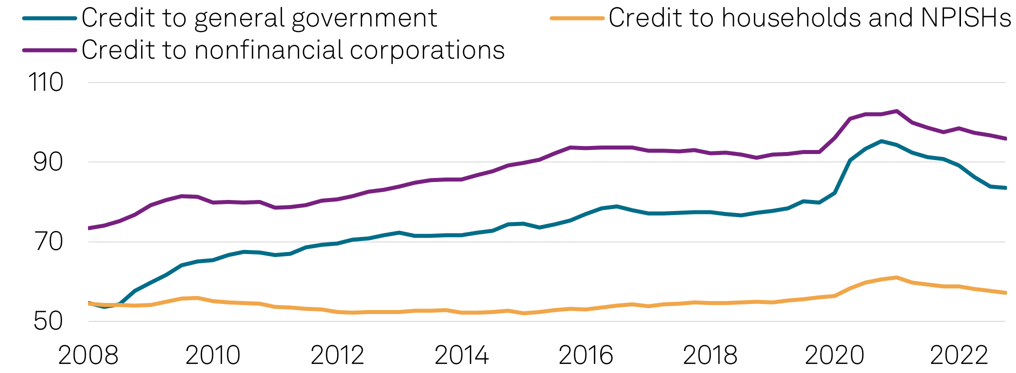
3. How much will property sector affect banks' asset quality

Annual property sales in China (tril. RMB)



4. Impact of high debt leverage on bank borrowers

Global debt-to-GDP trends, 2008-2022 (%)



1. For India, fiscal year beginning April 1 in the reference calendar year. f--Forecast. Source: S&P Global Ratings. 2. Source: S&P Global Market Intelligence, S&P Global Ratings. 3. RMB--Chinese renminbi. e--Estimate. Sources: National Bureau of Statistics of China, S&P Global Ratings. 4. NPISH--Nonprofit institution serving households. Sources: IIF; S&P Global Ratings.

Higher-For-Longer Interest Rates Weigh On Economies

- The macro picture is weak for 2024, with a period of subpar growth fueled by higher-for-longer rates ahead, with a relatively slower and softer adjustment back to steady states; this is conditional on strong labor markets.
- Inflation has peaked, but core measures have been sticky and remain well above central bank targets.
- The main risk is that demand and inflation pressures remain higher and stickier than expected, prompting higher policy rates, tighter financing conditions, and an eventual hard landing.

Policy interest rates and S&P Global Ratings' forecasts (%)

	U.S. (Fed)	Eurozone (ECB)		U.K. (BoE)	Switzerland (SNB)
Policy Rates	**Federal funds rate**	**Deposit rate**	**Refi rate**	**Bank rate**	**Policy rate**
2022	1.70	2.00	2.50	3.50	1.00
2023f	5.10	4.00	4.50	5.25	2.00
2024f	5.20	3.25	3.75	4.47	1.25
2025f	3.20	2.00	2.50	2.62	1.00
2026f	2.80	2.00	2.50	2.50	1.00

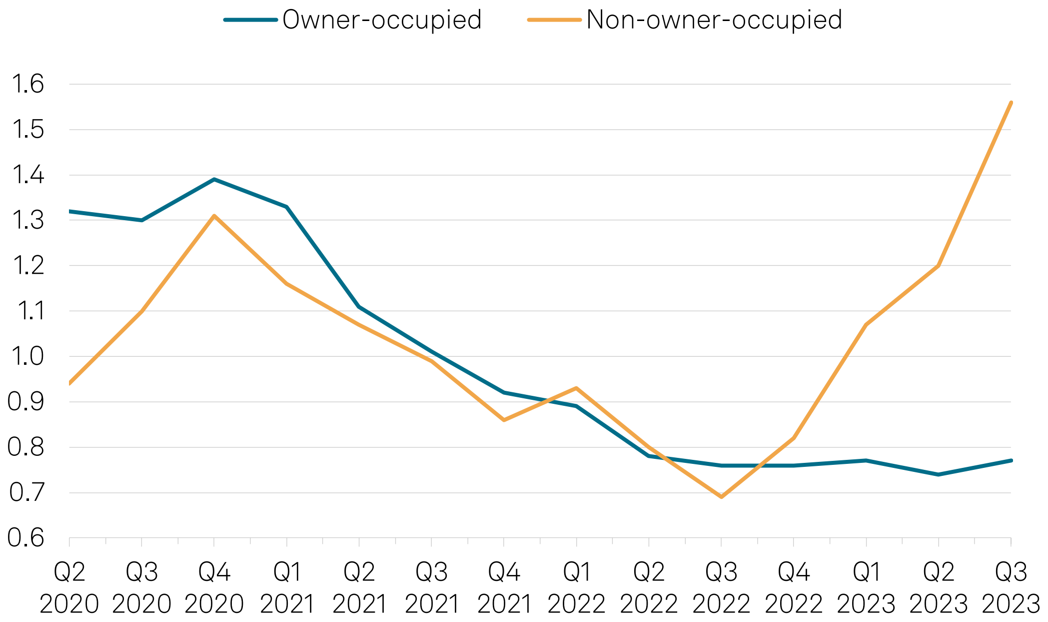
BoE--Bank of England. ECB--European Central Bank. f--S&P Global Ratings forecast. SNB--Swiss National Bank. Source: S&P Global Ratings Research.

CRE | Rising Credit Risk, But Exposures Are Manageable For Most

- Banks' broadly diversified loan portfolios and conservative underwriting should mitigate losses, even though office exposures could struggle over the longer term from secular changes in work arrangements

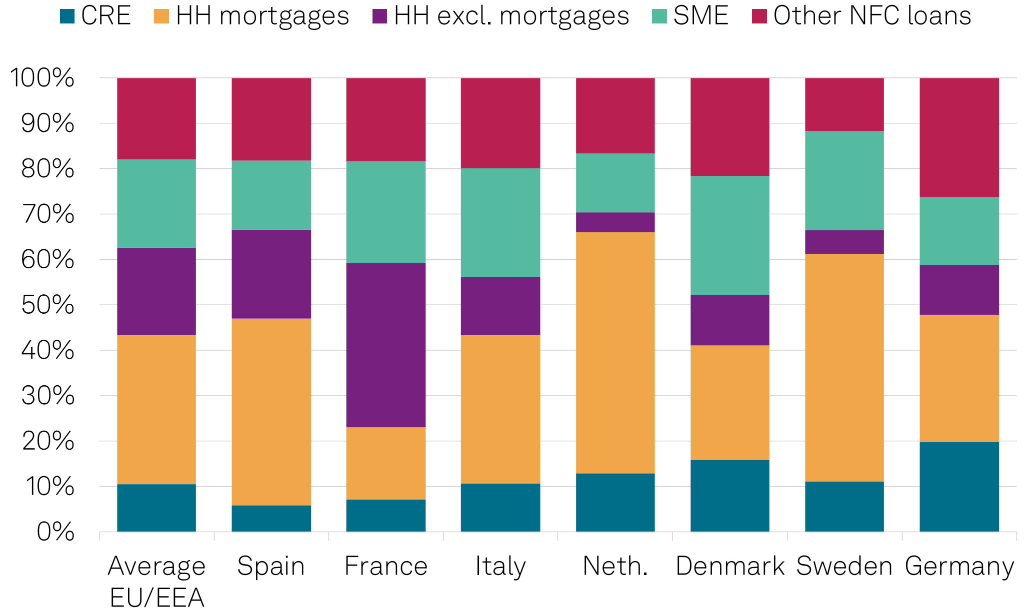
U.S. banks: CRE past due and nonaccrual loans accelerate

U.S. commercial banks' CRE loans at least 30 days past due (%)



CRE--Commercial real estate. Source: Federal Deposit Insurance Corporation (FDIC).

European banks: CRE loans represent around 11% of total lending for large EU banks

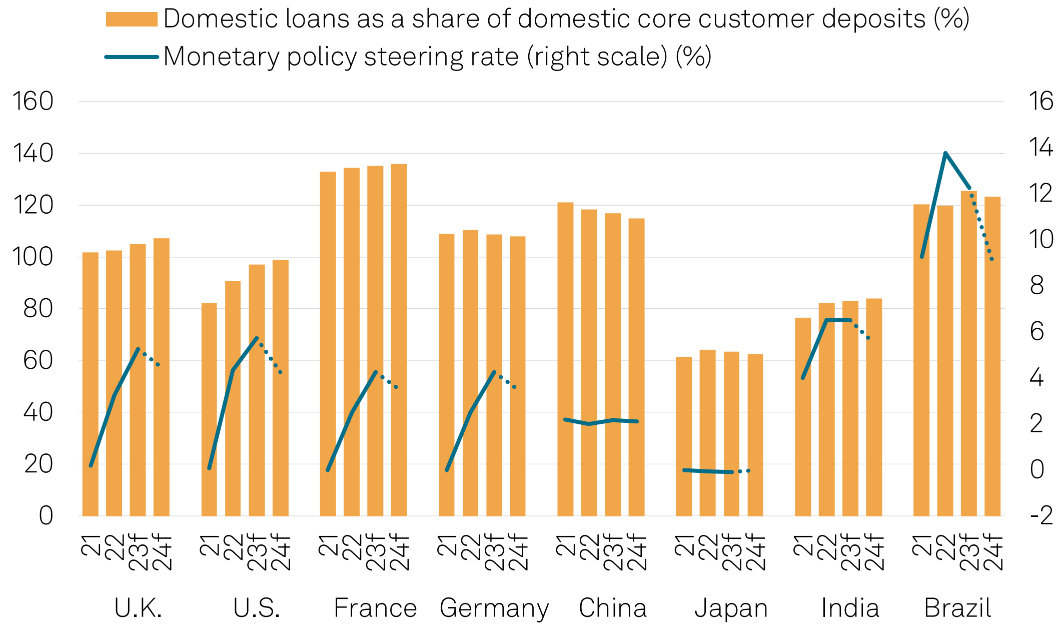


Data as of June 2023. NFC--non-financial corporates. Neth.--Netherlands. SME--Small and midsize enterprises. HH--Households. CRE--Commercial real estate. Note: In France, a large portion of residential housing loans are not subject to mortgage but rather to guarantees, and therefore are captured by the EBA in the category HH loans excl. mortgage. Source: European Banking Authority (EBA), S&P Global Ratings.

Funding And Liquidity Remains Adequate As Conditions Normalize

- Monetary policy normalization is taking place gradually and speed depends on central banks' actions against inflation. Banks are well placed to weather this transition, but strong funding franchises are becoming a competitive advantage again.

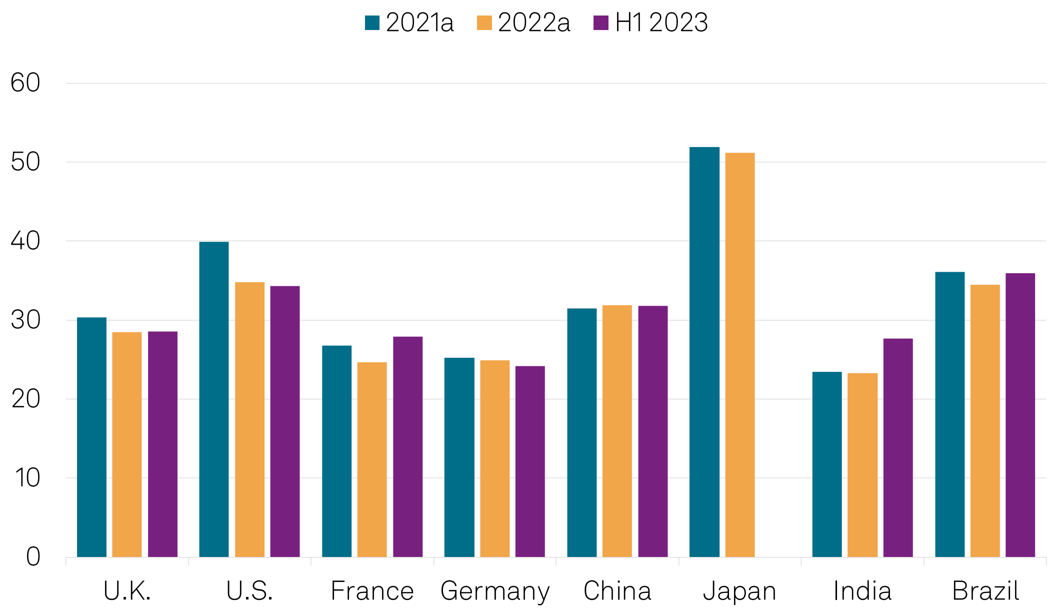
Higher policy rates and quantitative tightening is affecting banks' funding conditions in the U.S and, to a lesser extent, Europe.



Source: S&P Global Ratings.

Protecting liquidity will remain a key topic of attention for banks in 2024, and this will come at a cost

Broad liquid assets to total assets (%)



Data as Dec. 31 for 2021 and 2022 and June 30 fur 2023 (Japanese banks have not reported H1 2023 yet. a--Actual. Source: S&P Global Ratings.

S&P Global Ratings

Generative Artificial Intelligence Could Reshape The Banking Industry

While AI will be beneficial, it is not risk free

Pros

+ Full utilization of untapped revenue potential
+ Improved customer experience
+ Faster and more accurate decisions
+ Enhanced risk management practices
+ Simplified operations, driving efficiency and earnings

Cons

– Ethical concerns
– Security, privacy, and control risks
– AI regulation is only taking off
– Workforce risks
– Investment needs
– Environmental costs

AI strategies could have implications for banks' creditworthiness

Business franchise differentiation: Through personalized offerings that boost customer retention.

Financial performance: Through efficiency gains, enhanced revenues, and profit maximization.

Risk management enhancement: Relating to credit, market, liquidity, and operational risks, including cyber risks.

Key trends to watch over the next five years

1. Banks' development of AI strategies and AI governance frameworks.
2. Banks' move from testing generative AI to fully deploying it, including with customers.
3. Gradual shift from incremental to transformative innovation.
4. Evolution of customer preferences, regulations, and the competitive landscape across regions.
5. Potential increase in cyber risks as threat actors exploit generative AI.
6. Adoption of generative AI across sectors and societies could have amplifying effects for the economy.

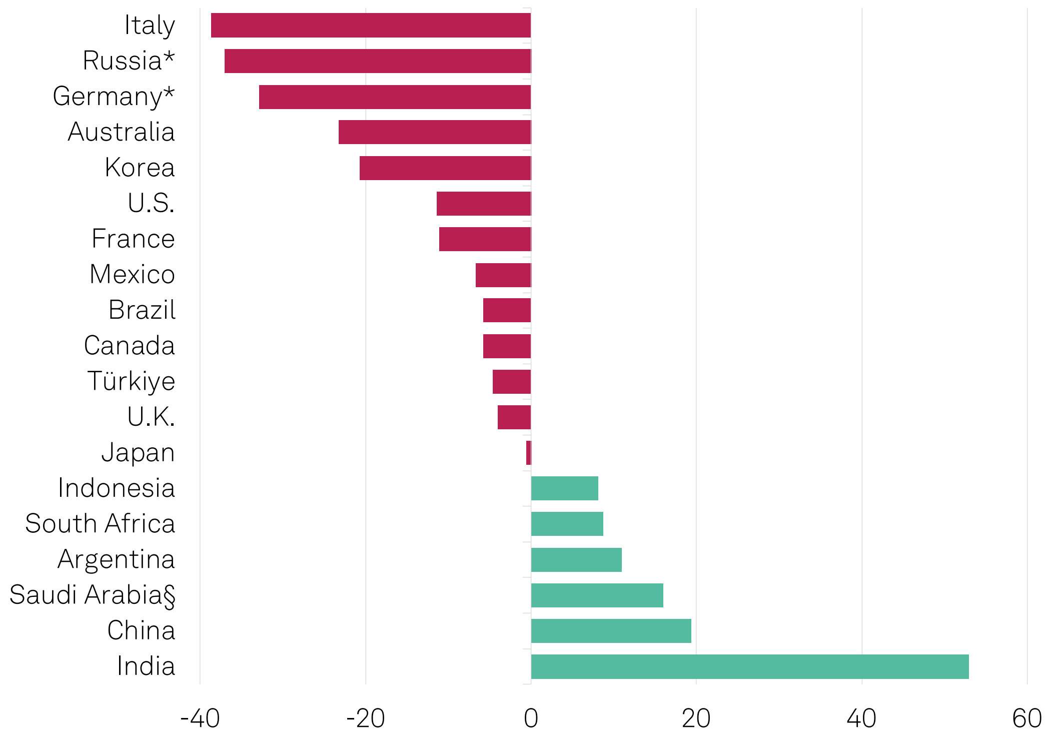
Read report here

Source: "Future Of Banking: AI Will Be An Incremental Game Changer," Oct. 03, 2023.

Digitalization Is Evolving Unevenly Across Banking Sectors

Evolution of commercial bank branches for G20 countries

Growth rate, 2012-2021 (%)



Note: G20 excluding the EU to avoid double-counting. *Last available data for Germany and Russia as of December 2020. §For Saudi Arabia, the number of branches started to reduce in recent years. Sources: IMF, U.K. Office for National Statistics (ONS).

- Tech adoption at banks is uneven and influenced by onsite infrastructure, binding regulation, local preferences, and competitive pressures.
- Spending on branches has been cut in many G20 countries due to declining demand and revenue pressures, notably resulting from the low interest rate environment over the last 10 years.
- The exception is emerging market countries, where branch networks have often grown along with economic wealth, banks' earning capacity, and with the provision of services to previously unbanked citizens and regions.
- Higher interest rates are boosting global bank profits, yet we do not expect a widespread return to branch network expansion because clients have come to appreciate the convenience and efficiency of digital banking.

Bank Strategies To Address Climate Change Are Evolving

Exclusion

Customer engagement

New product and services

Divestment

Financing of green projects and technologies

- Assessing, managing, and ultimately reducing climate-related risks are key priorities for an increasing number of banks. Positively, awareness and preparedness is gradually improving.
- More climate-related data is available, and methodologies/models are progressing. Regulatory climate stress tests are being developed rapidly across regions.
- While exclusion and divestment policies have the potential to rapidly reduce banks' climate risk, customer engagement is gaining traction.
- Banks are also increasingly committing to finance green projects and technologies.
- The energy transition offers large business opportunities for banks. The suite of "green" products and services offered is broadening (e.g. green mortgages and electrical vehicle loans).

Emerging Markets | Higher-For-Longer Will Bite

High interest rates and subdued economic activity will pressure some EMs

Lingering tight financing conditions amid higher interest rates

- Some EMs have begun easing their monetary policy while other have paused policy rate hikes. Most EM central banks remain cautious about inflation trends as key commodity prices remain high. Funding costs will remain elevated for EM issuers, which could lead to defaults of weaker issuers.

Geopolitical tensions and difficult domestic socio-political conditions erode credit fundamentals

- Political and geopolitical risks are on the rise with the Hamas-Israel war, no near-term expected resolution of the Russia-Ukraine war, and the complicated domestic political landscape across many EMs. This could slow reform implementation and reduce long-term growth.

There are a few bright spots

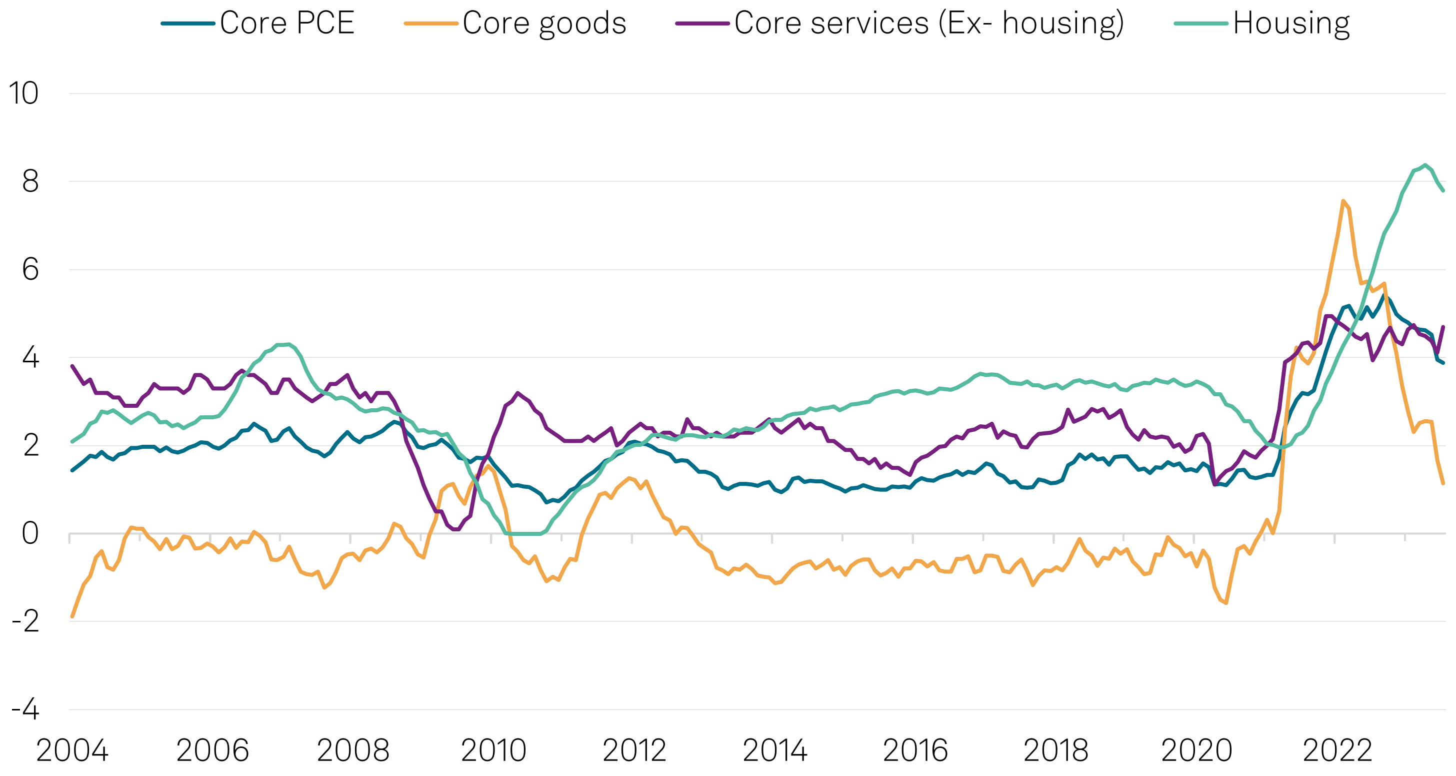
- A few EMs are relatively better placed, particularly the Gulf Cooperation Council (GCC) countries where profitability and asset quality indicators remain resilient.
- Indian banks' asset quality will continue to strengthen, benefiting from structural improvements in the operating environment and good economic prospects.

North America

Credit Conditions: North America

U.S. personal consumption expenditures (PCE) inflation

Year over year change (%)



Sources: Census Bureau, BLS, S&P Global Ratings Economics, Data through July 2023.

- U.S. economic data has been coming in stronger than expected, suggesting that an ever-elusive "soft landing" could occur. However, we see risks to the downside.
- While we expect the U.S. economy to avoid recession, we forecast it to grow at a below-potential rate of 1.3% in 2024 and 1.4% in 2025.
- Likewise, we expect Canada to grow 1.2% next year and 1.5% in 2025.
- U.S. core inflation, which has declined somewhat, should fall close to 2.0% in the second half of 2024, around the Federal Reserve’s target.

Credit Conditions: North America

Banks are operating cautiously amid higher-for-longer interest rates

Downside risks...

- **Slow economic growth and high rates.** S&P Global economists expect a resilient U.S. economy to avoid recession but endure a multiquarter period of below-potential growth. Monetary policy rates will be higher for longer and financial conditions will be tighter for longer.
- **Rising funding costs and falling liquidity.** If the Fed continues to quantitatively tighten, deposits and liquidity could gradually decline further in 2024.
- **Real estate stress.** Parts of commercial real estate markets in the U.S., particularly the office sector, have significant amounts of loans maturing, and property prices are falling. In Canada, elevated housing prices have weakened affordability and helped drive high consumer debt balances.

...and what they mean for the sector

- **Net interest margins (NIMs) will come under further pressure.** The higher-for-longer rates will likely lead to further lagged rises in deposit costs, placing some additional strain on NIMs and net interest income (NII) for many banks.
- **Unrealized losses could remain elevated.** The rise in rates since early 2022 has caused unrealized losses on securities and loans to rise. While those unrealized losses fell after peaking in the third quarter of 2022, they have since risen again with an increase in long-term rates.
- **Maturing office loans will create some challenges.** Loans on properties that have fallen in value could lead to impairments, especially as they mature.

What we expect for next 12 months

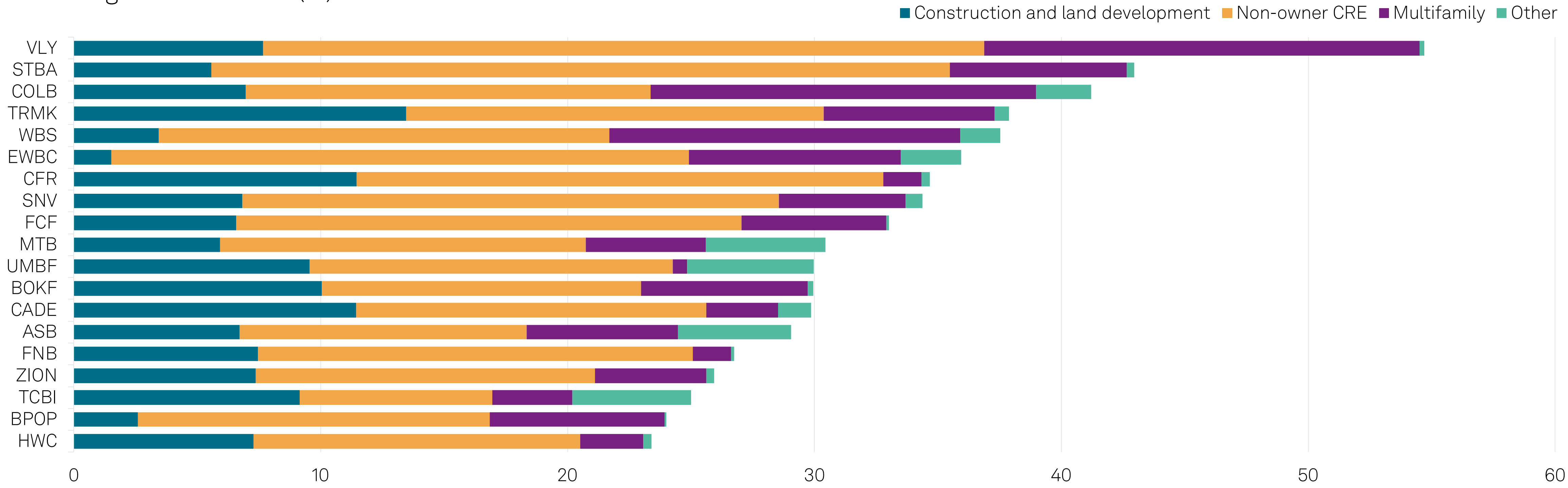
- **Rated banks will avoid unmanageable deposit outflows.** While deposits have declined and funding costs have risen in 2023, we do not believe that the banks we rate are currently seeing sharp deposit outflows.
- **Profitability will remain reasonably strong, and banks will build capital.** While NII may decline in 2024, we still expect banks in aggregate to generate a return on common equity of 9%-11% in 2024 and to build capital through earnings retention.
- **Asset quality pressure will increase but remain manageable.** Most asset quality measures have been worsening toward historical averages. While we expect further weakening in 2024, we believe that owing to pre-provision earnings, banks are generally well placed to absorb the associated credit losses.

CRE Delinquencies Accelerate, But Exposures Remain Manageable For Most

- Banks' broadly diversified loan portfolios and conservative underwriting should mitigate losses.
- Office could struggle long-term owing to secular changes in work arrangements.

Top CRE loan exposure of rated banks

Percentage of total loans (%)



CRE--Commercial real estate. CET1--Common equity Tier 1. CRE--Commercial real estate. Data as of June 30, 2023. Sources: FDIC data and S&P Global Ratings.

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Ratings

U.S. Forecast : Banks Generate Reasonable Profits Despite Funding Pressure

Worsening		Neutral		Improving

Revenues	Net interest income (NII) will likely be roughly flat to moderately down for many banks with funding costs rising somewhat further in 2024. With a slow-growing economy, fee income may remain tepid in certain areas, such as mortgage banking, but could rebound in others, such as 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 9%-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. The evolving outlook for the economy will also affect capital planning.
Funding and liquidity	Deposits will fall moderately further if the Federal Reserve continues quantitatively tightening, increasing competition for and raising the cost of funding. While banks are taking steps to build liquidity, we expect funding and liquidity metrics to weaken gradually.

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

Canada Forecast : Provisions And Elevated Expenses Strain Profitability

Worsening | | Neutral | | Improving

Revenues	Net interest income (NII) has been benefiting from higher rates though loan growth is moderating. Fee income could remain constrained and affect asset management and capital markets businesses, particularly if equity and capital markets continue to fall from current levels.
Expenses	Banks are managing expenses by reducing discretionary costs, delaying certain investments in technology, and reducing headcount, which could help moderate expense growth in 2024, though we expect expenses to remain elevated.
Profitability	Profitability will continue to be under pressure as provisions for loan losses are rising from very low levels and high expenses are placing pressure on operating performance. We expect an industry return on common equity of 9%-12% in 2024.
Credit quality	Delinquencies are rising. We expect asset quality to normalize from very strong levels and banks to continue to build allowances. We expect net charge-offs to rise but to remain manageable.
Capital	The Office of the Superintendent of Financial Institutions will increase the domestic stability buffer by 50 basis points (effective Nov. 1, 2023), which will lead to a common equity Tier 1 ratio requirement of 11.5%, so banks will have to hold higher levels of capital. We expect the banks to maintain risk-adjusted capital (RAC) ratios in our adequate range of 7%-10% (average was 9.7% in second-quarter 2023).
Funding and liquidity	Funding remains well diversified even though the deposit mix has changed with higher interest rates, driving growth in higher-yielding savings products such as guaranteed investment certificates. We expect demand deposits will resume growth once rates top off, and banks will continue to access global funding markets. We expect liquidity metrics to remain relatively unchanged.

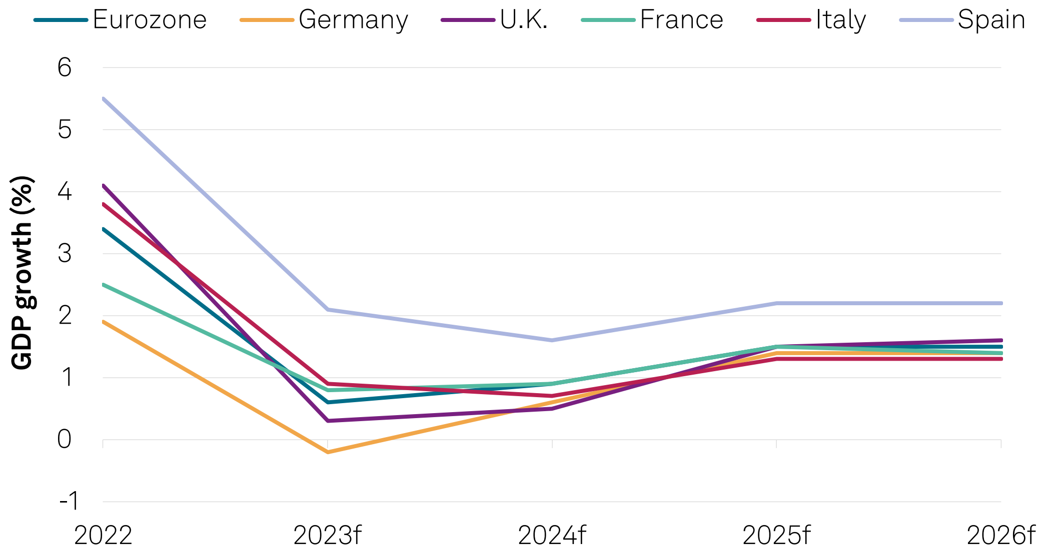
Note: Forecast for next 12 months. Source: S&P Global Ratings.

Europe & EMEA Emerging Markets

Credit Conditions: Europe

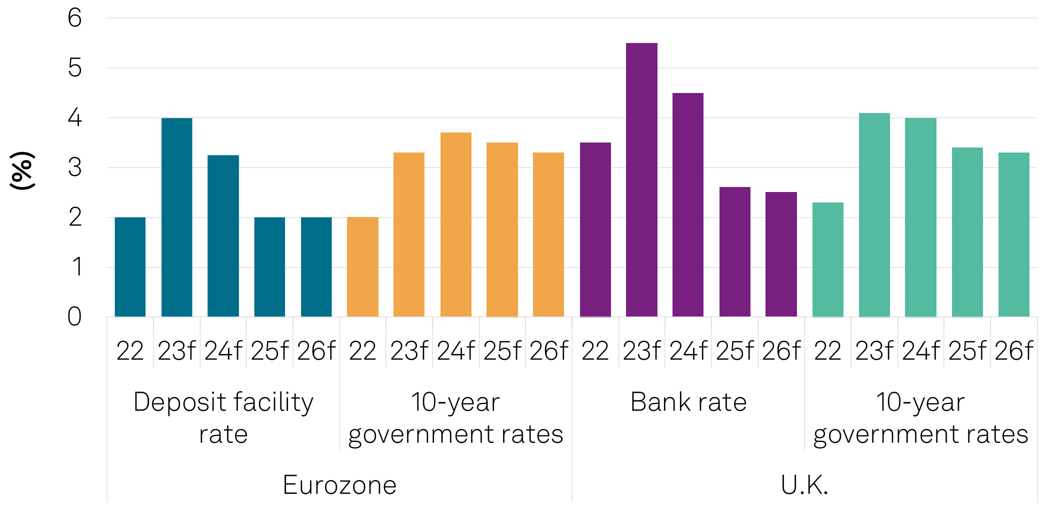
- Financing conditions will tighten: Interest rates may have peaked, but they will stay high for longer, while other monetary policy decisions could be yet to come, such as a more rapid exit of the asset purchase programs or higher mandatory reserve requirements for banks.
- Economic activity will be weak in 2024: Real GDP will rise by just 0.9% in the eurozone and 0.5% in the U.K.
- The labor market will lose steam but should remain fairly resilient.
- Lending growth will remain muted.

The return to positive real interest rates will take a toll on growth



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

Rates could start declining only late in 2024



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

S&P Global Ratings

Credit Conditions: Europe

Downside risks...

- A protracted, **painful recession**, leading to higher corporate insolvencies and unemployment.
- **Market volatility and financial instability** due to overly restrictive financial conditions.
- Banks' **failure to deliver commercially and operationally resilient business** models.

..and what they mean for the sector

- A recession could undermine the financial health of corporates and households, **weakening banks' asset quality** and business prospects.
- Tighter financing conditions would **pressure financial institutions with weaker funding structures**, especially non-bank financial institutions with high refinancing needs, and expose banks to higher counterparty risks.
- Failure to tackle inefficiencies, properly digitalize the business, and sustain resilience to cyber attacks could **challenge the long-term viability of some institutions.**

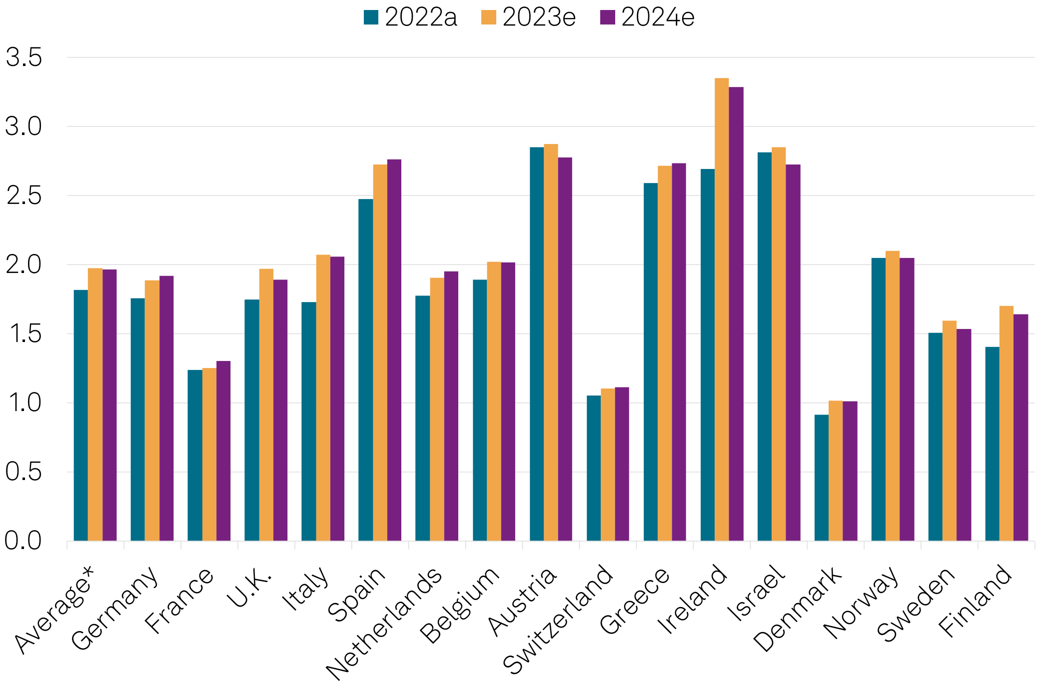
What we expect for next 12 months

- **European banks will be resilient** but divergent as the economic reset kicks in--higher interest rates, slower growth.
- The rise in (real) interest rates clouds the outlook for banks' business volumes and asset quality. **Credit costs will normalize**, with banks most exposed to commercial real estate, small and midsize enterprises, and unsecured retail loans seeing the biggest impact.
- As central banks drain off excess liquidity, **funding costs will continue to rise,** constraining further net interest margin upside. But earnings will remain comfortable and allow banks to easily absorb higher credit costs.
- **Solid capitalization and liquidity** will also provide resilience to potential shocks.

Profitability Should Remain Comfortable

Net interest margins will not grow, but will be largely preserved in 2024...

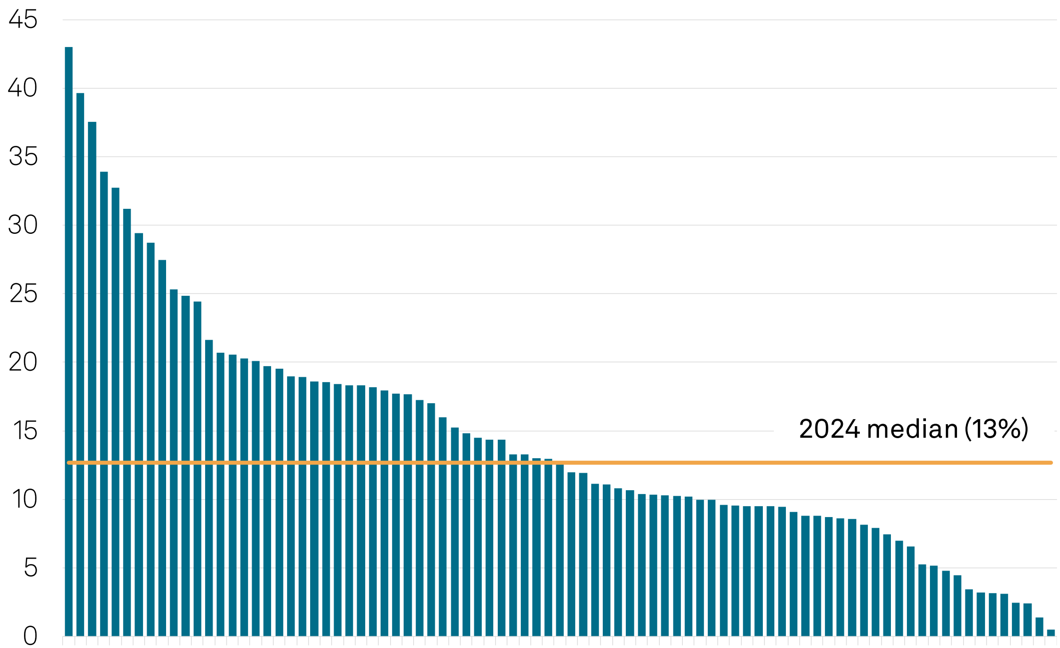
Evolution of net interest margins, top 50 European rated banks (%)



*Average for top 50 EMEA banks. a--Actual. e--Estimate. Source: S&P Global Ratings.

...Allowing banks to easily absorb more normalized credit costs

2024 credit losses as a proportion of pre-provision earnings, top 100 European rated banks (%)

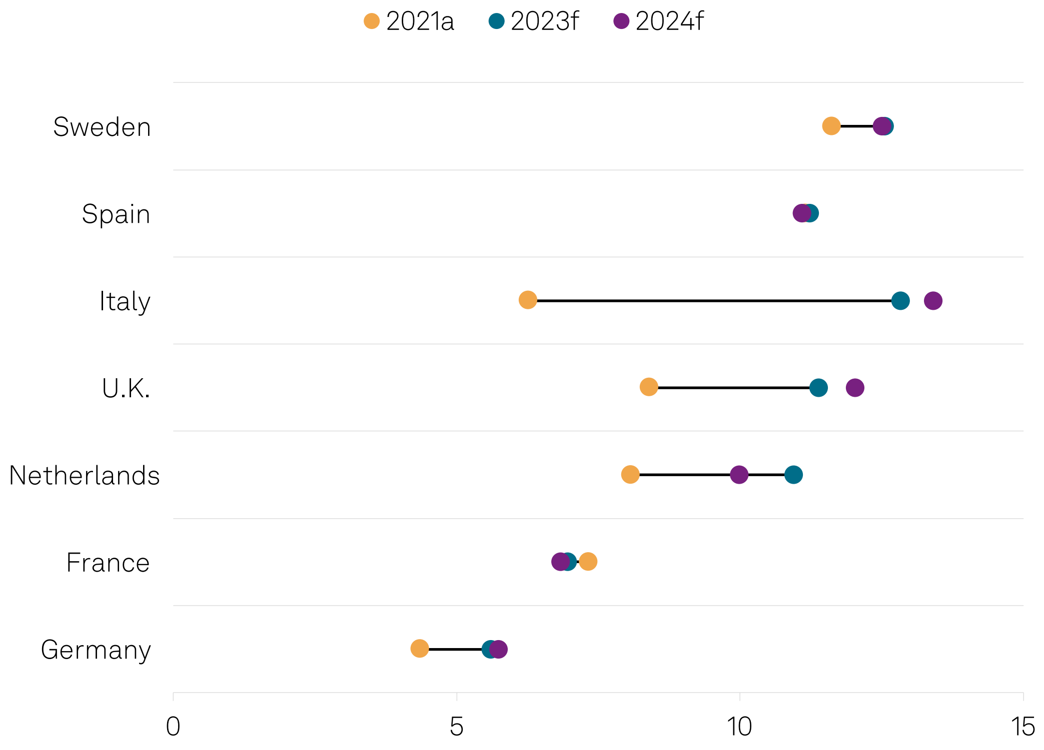


Source: S&P Global Ratings

Divergence In Performance Will Become Clearer

Returns will vary from bank to bank...

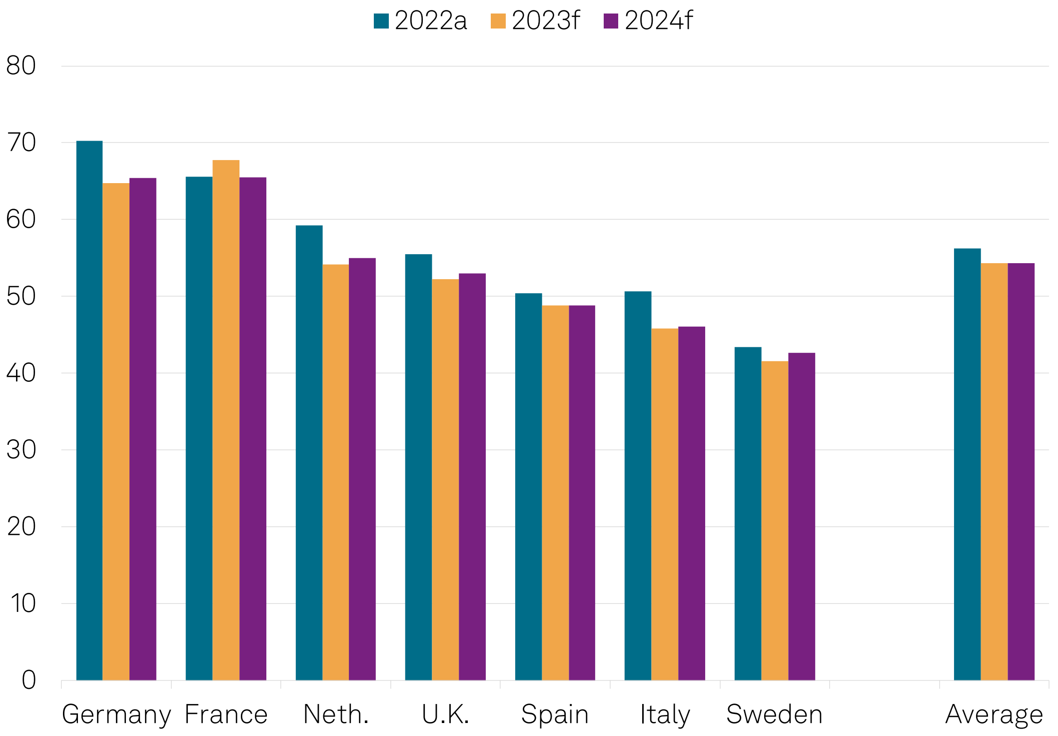
Weighted average return on average common equity for rated European banks (%)



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

...And efficiency will remain an issue for some

Weighted average cost-to-income ratio for rated European banks (%)

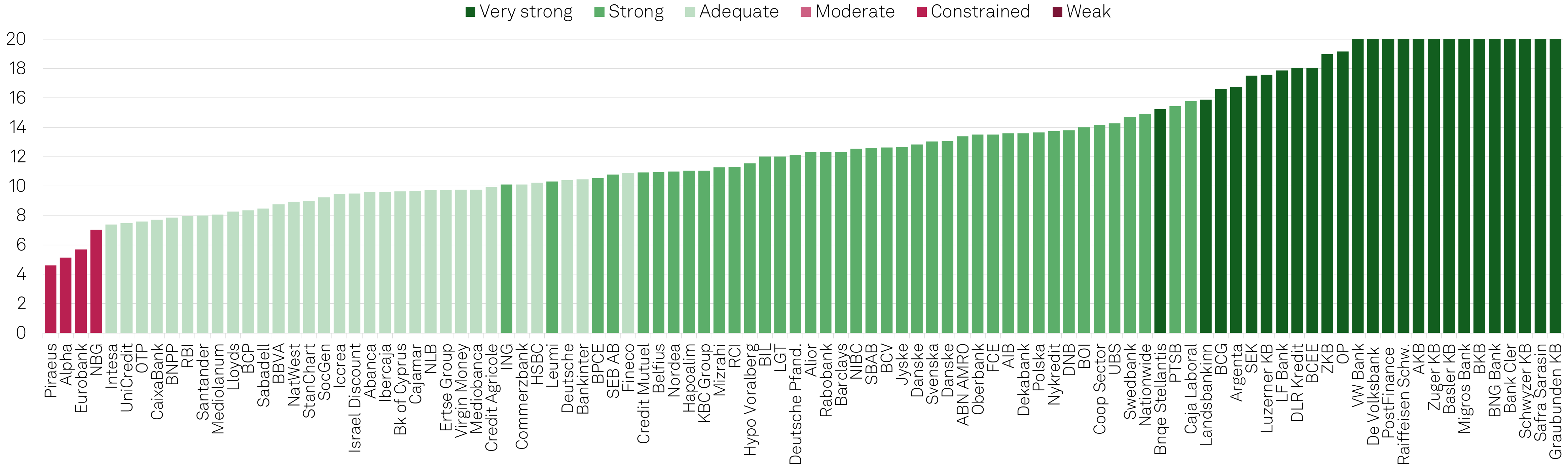


a--Actual. f--Forecast. Neth.--Netherlands. Source: S&P Global Ratings.

Capitalization Will Remain Resilient

Most banks have headroom within their current capital and earnings assessments

S&P Global Ratings' forecast 2024 RAC ratios for top 100 European rated banks

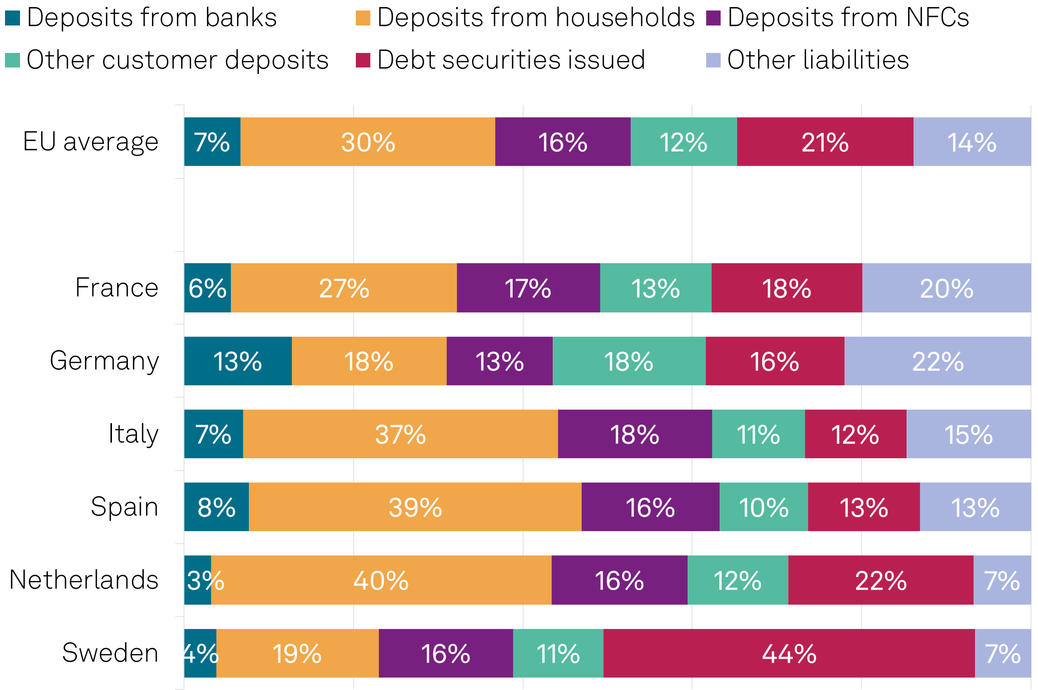


RAC--Risk-adjusted capital. Y-axis cut-off at 20%. Source: S&P Global Ratings.

Banks Are Well Positioned To Weather Liquidity Tightening

European banks are largely deposit-funded, with households contributing the highest share...

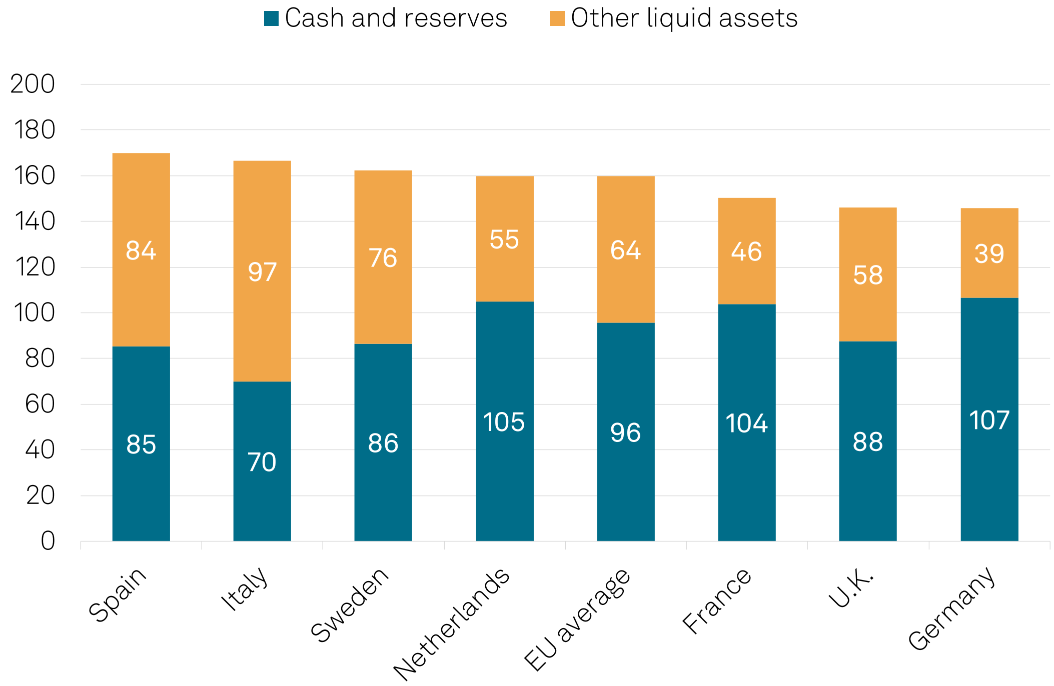
Liability composition of large EU banks on June 30, 2023 (%)



Sources: European Banking Authority (EBA) , S&P Global Ratings.

...And hold high liquidity buffers

Large European banks' LCR ratios and mix on June 30, 2023 (%)



LCR--Liquidity coverage ratio. Sources: European Banking Authority (EBA), S&P Global Ratings.

S&P Global Ratings

Key Risks For Banks In EMEA Emerging Markets

We foresee three main risks for EMEA-EM banks in 2024

Global liquidity

- Higher-for-longer interest rates and lower investor appetite for EMs will pressure externally leveraged EMEA-EM banks and countries.
- Key indicators for surveillance: net external debt contribution to total funding, nature of external debt, rollover rates throughout the year, access to foreign currency liquidity, and overall cost paid by banks.
- Most vulnerable banking systems: Turkiye, Tunisia, and Egypt.

Weaker asset quality

- For some EMEA-EM banks, lower economic growth, high inflation, higher interest rates, and expansion in riskier geographies are likely to weigh on asset quality indicators.
- Key indicators for surveillance: nonperforming loans, evolution of Stage 2 loans, cost of risk.

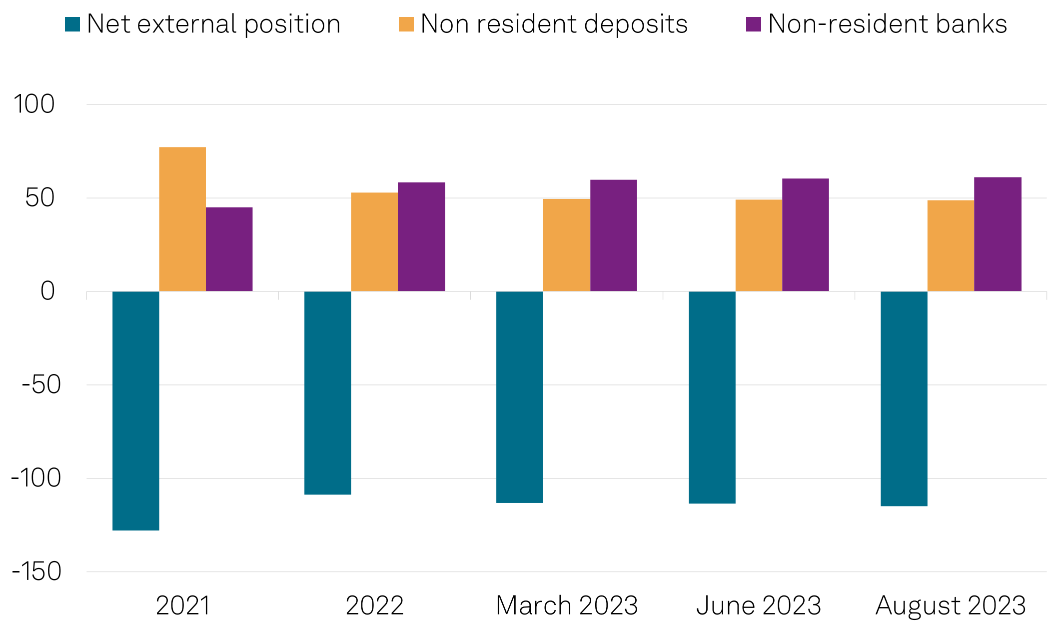
Policy choices

- Adoption of a resolution regime in South Africa, the provision of liquidity support in Saudi Arabia, implementation of reforms in Tunisia and Egypt, and the consolidation of policy shift in Turkiye are among the key drivers for EMEA-EM banks in 2024.

GCC | Are External Funds Shifting From Qatar To Saudi?

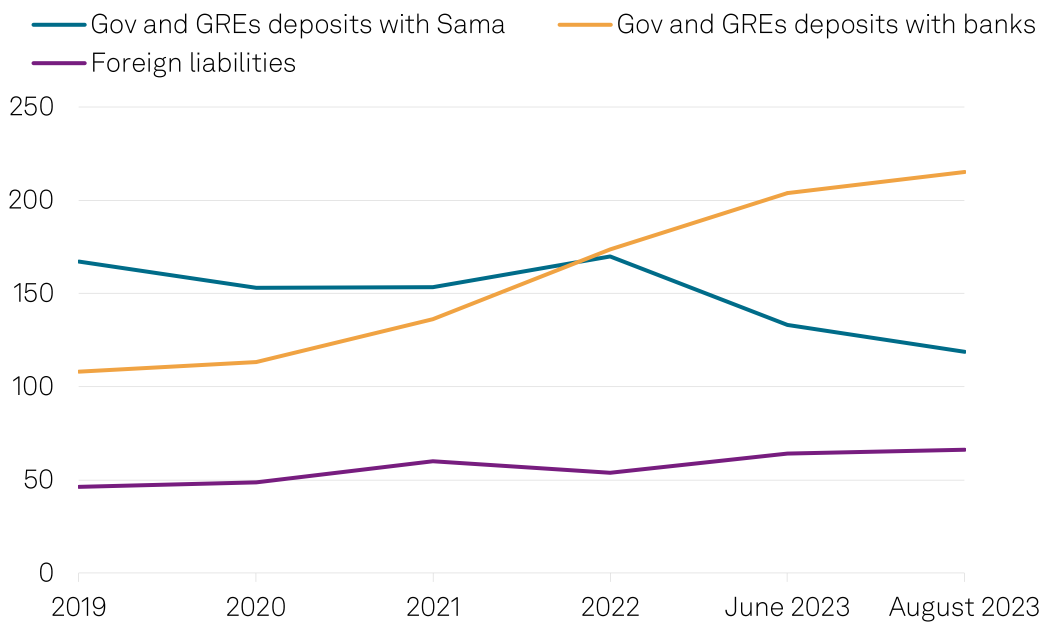
Qatari banks' external deleveraging stalled, while Saudi banks are becoming more aggressive on external funding

Qatari banking system external debt reduction stalled
(Bil. US$)



Funding gap equals total domestic loans minus total resident deposits.
Sources: Central Bank of Qatar, S&P Global Ratings.

Saudi banks are increasingly relying on the government
(Bil. US$)

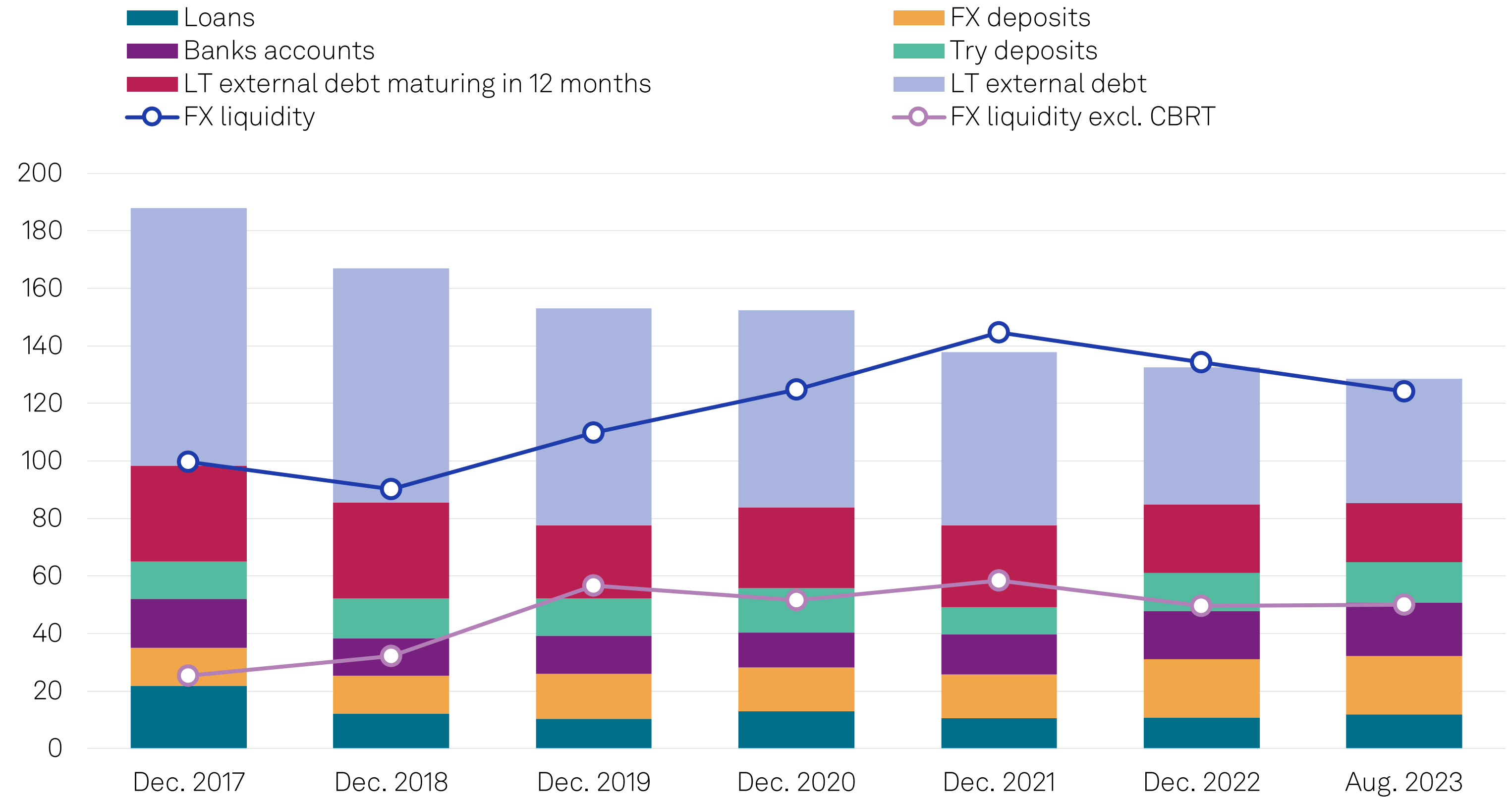


GREs—Government-related entities. Sama—Saudi Central Bank. Sources: Saudi Central Bank, S&P Global Ratings.

Turkiye | Slowly Stabilizing But Risks Remain High

External funding and foreign currency liquidity profile

(Bil. US$)



Note: 2022 Long-term external debt is an estimate. CBRT--Central Bank of the Republic of Turkiye. FX--Foreign exchange. LT--Long-term. TRY--Turkish lira.
Source: S&P Global Ratings, Banking Regulation and Supervision Agency data.

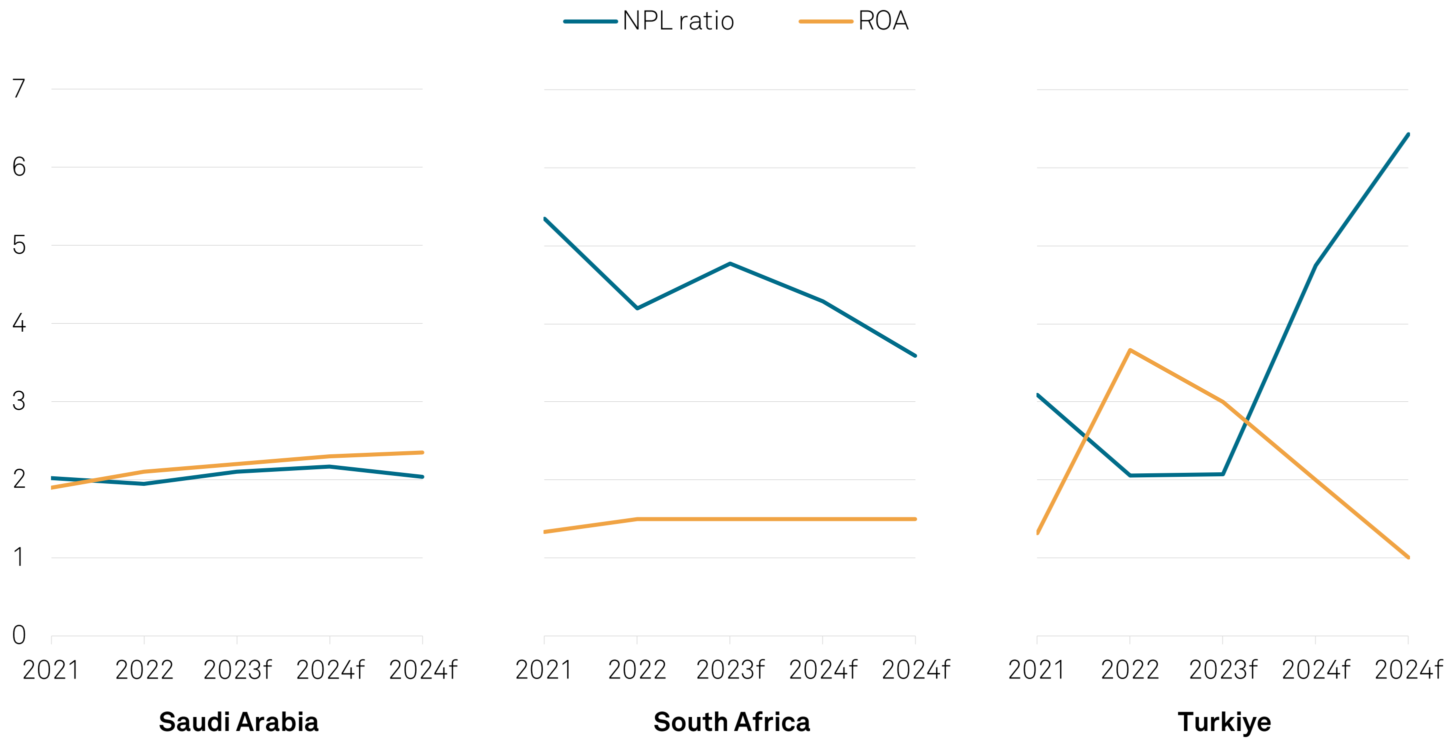
Our main expectations:

- Slower economic activity.
- Decelerating loan growth in nominal terms amid tightening financing conditions.
- Declining private sector leverage.
- Banks' external debt rollover rates--which have increased over the last quarter-- to remain above 100%.
- Moves to unwind the foreign currency protected deposits scheme and incentives to convert to local currency deposits that could gradually reverse the financial sector dollarization.

Asset Quality: Some Deterioration Ahead

Some countries will suffer more than others

Asset quality and profitability for selected EMEA-EM countries (%)

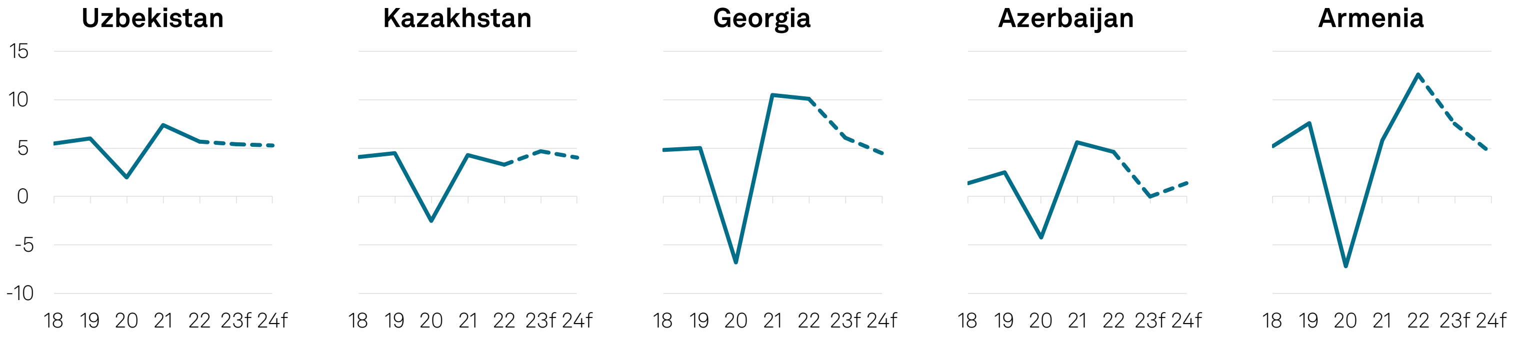


f--Forecast, NPL--Nonperforming loans. ROA--Return on assets. Source: S&P Global Ratings.

- Lower economic growth, still high or rising inflation, higher interest rates, and expansion in riskier geographies are likely to weigh on asset quality indicators in 2024 for some EMEA-EM banks.
- In Saudi Arabia, despite slowing of the economy and lending growth, we expect stable asset quality as most of the previous lending growth was driven by mortgages to civil servants.
- For South Africa, we expect a mild deterioration of asset quality in 2023 and, at the same time, a stabilization of cost of risk slightly above the historical level. Both elements should slightly improve subsequently as the economy recovers and pressure on households reduces thanks to stabilization of the interest rate cycle.
- Turkiye: The expected depreciation of the lira, slowing economic activity, and tightening financing conditions will drive credit losses to further increase to 350 bps by 2024 and the NPL ratio to rise with some time lag.

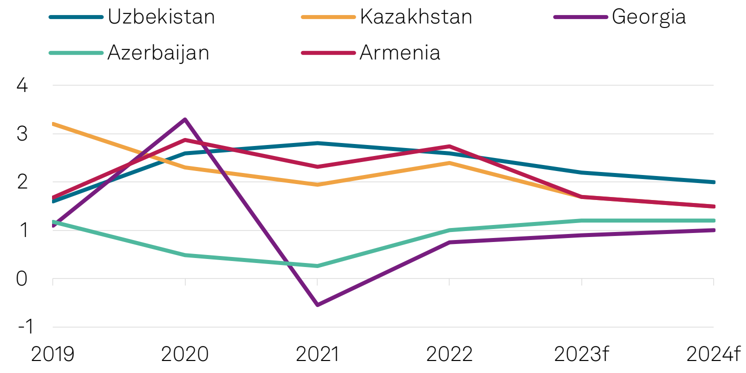
Central Asia And The Caucasus: Economic Conditions Are Supporting Banks

GDP growth prospects remain solid across the region (%)



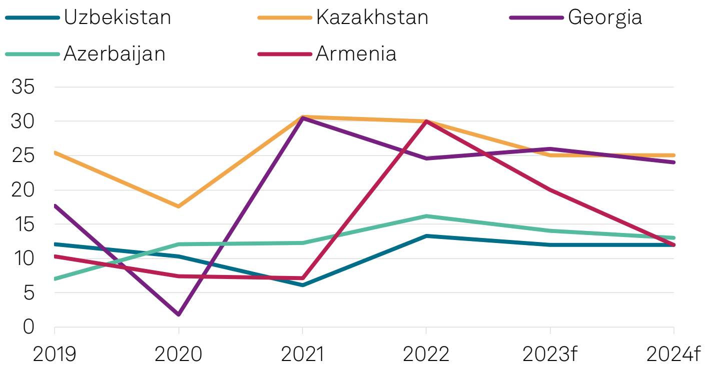
Credit costs are stabilizing on the back of economic recovery

Credit losses as a percentage of total loans (%)



ROE supported by business growth and noninterest income

Domestic banks' return on equity (%)



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

- Good economic growth prospects will continue supporting growth of business and stabilization of asset quality.
- Retail lending remains one of the main growth drivers while corporate lending growth is more modest.
- Gradual normalization of credit costs and stabilization of NPLs will contribute positively to profitability.
- Economies and banking sectors in Armenia, Georgia, Uzbekistan, and Kazakhstan experienced unusually high positive impact in 2022-2023 from a very strong inflow of migrants and nonresident deposits due to increased geopolitical instability in the region. These inflows have now started diminishing.
- External funding risk remains manageable.

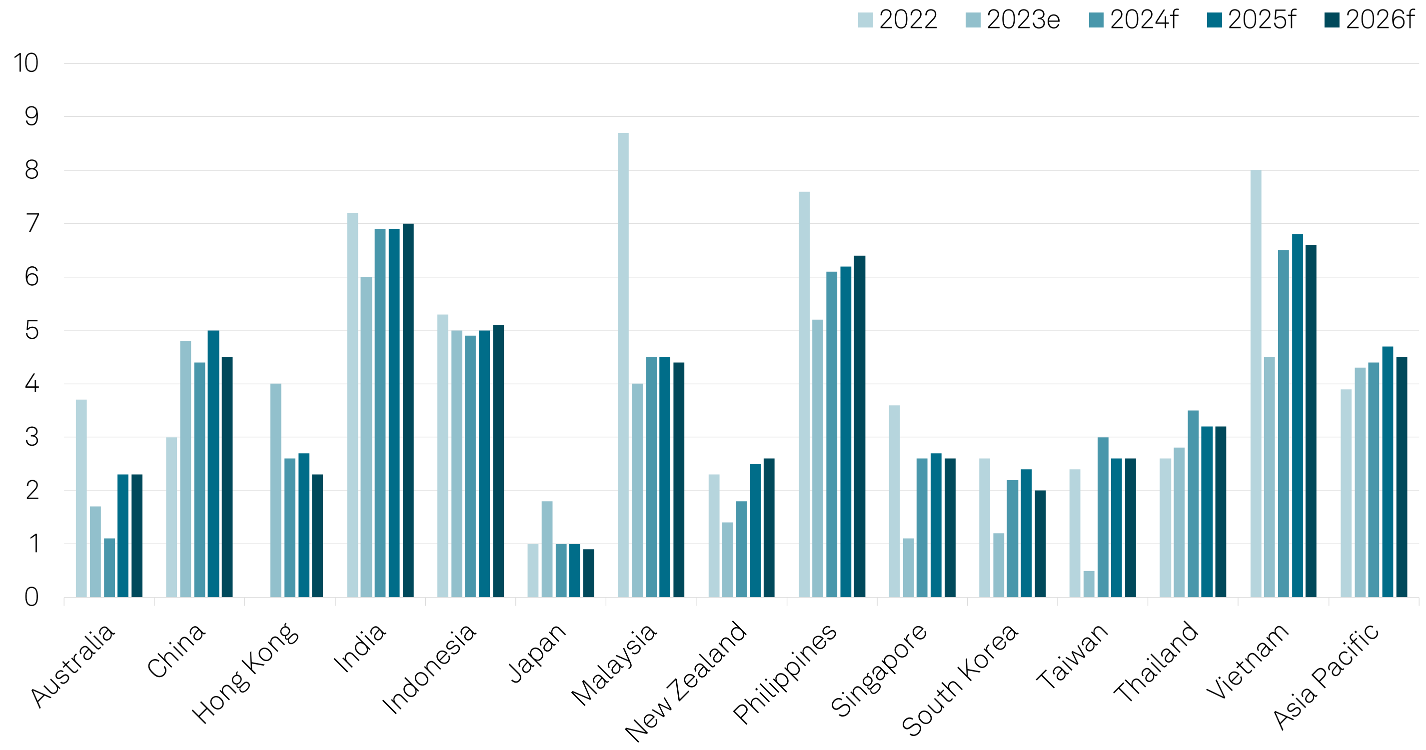
Asia-Pacific

Credit Conditions: Asia-Pacific

- **China's economy is unsteady.** A troubled property sector, uncertain local government finances, and softer exports are undermining the country's economic rebound from COVID lockdowns. Nor is substantial fiscal or monetary stimulus likely in the coming months, in our view. Consequently, we recently cut our real GDP growth forecast for China to 4.8% in 2023 and 4.4% next year.
- **Higher U.S. interest rates.** Inflation is still above the target rates of many central banks, including the U.S. Federal Reserve and the European Central Bank. As such, policy interest rates are unlikely to ease in coming months. Asia-Pacific's borrowers will face more costly servicing, particularly as loans and bonds roll over.
- **Lingering profit margin pain.** Costs remain high despite inflation easing. Sellers' ability to fully pass on costs to customers is still hampered by weakened business and consumer confidence. Food export curbs and high energy prices are added complications.
- **A U.S. soft landing.** We anticipate a U.S. and Europe soft economic landing is now more likely, which is incrementally positive for Asia-Pacific economies. We thus raised the growth forecast marginally for Asia-Pacific ex-China to 3.9% in 2023 and 4.4% next year.

Resilient economic growth amid China slowdown

GDP growth year over year (%)



Note: For India, 2022 = FY 2022 / 23, 2023 = FY 2023 / 24, 2024 = FY 2024 / 25, 2025 = FY 2025 / 26, 2026 = FY 2026 / 27. Source: S&P Global Ratings Economics.

Credit Conditions: Asia-Pacific

Banking sector is steady heading into the second half

Downside risks...

- **Economic and property downside risks intensify.** Materially weaker economic prospects or higher-for-longer rates will eventually hurt banks' asset quality. This is especially the case amid property markets stress - particularly in China and Vietnam – and already highly leveraged corporate, household, and government sectors.
- **Weaker confidence.** In the higher-rates, lower-growth environment, investor confidence could be easily shaken.
- **Structural risks**. Climate change, cyber risks, and digitalization trends affecting the competitive landscape are structural risks that will increasingly test banks and their borrowers.

...and what they mean for the sector

- **Greater credit differentiation**. We anticipate greater credit differentiation. More vulnerable are institutions with higher direct exposures to weaker sectors, more concentrated business profiles, and those that are not systemically important--such as some nonbank financial institutions.

What we expect for next 12 months

- **Most rating outlooks are stable.** We expect this scenario to persist in 2024. However, an economic downside scenario (beyond our base case) would contribute to negative ratings momentum.
- **Higher credit losses.** Weaker growth and generally high interest rates will contribute to higher credit losses from lending for property and other sectors.

What Are We Monitoring: China

China's economy is unsteady

- A troubled property sector, uncertain local government finances, and softer exports are undermining the country’s economic rebound from COVID.
- Consequently, we have cut our real GDP growth forecast for China to 4.8% in 2023 and 4.4% next year.

Property sector crisis deepens

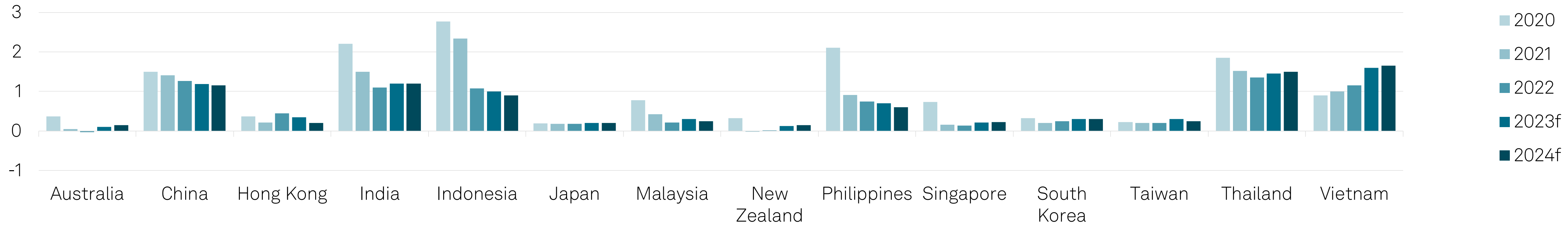
- China's real estate sector is taking another downward lurch. Residential property sales fell hard over the summer months, hitting property developers' cash flows. This should continue to weigh on the quality of loans to property developers.
- We project nonperforming loan ratios for property development will rise to 4.7% in 2023 and 2024, before recovering to 4.0% in 2025.

Local-government SOE debt risk

- Default risk is rising for the state-owned enterprises (SOEs). Delayed payments by SOEs could disrupt local credit-driven activities and hurt economic recovery.
- Our base case assumes any loan restructuring would be selective over time and on a case-by-case basis, because moral hazard considerations mean wholesale local government financing vehicle (LGFV) loan restructuring is unlikely.
- In a downside scenario, we estimate that the commercial banks would face a RMB5 trillion hit to capital from restructuring LGFV debt.

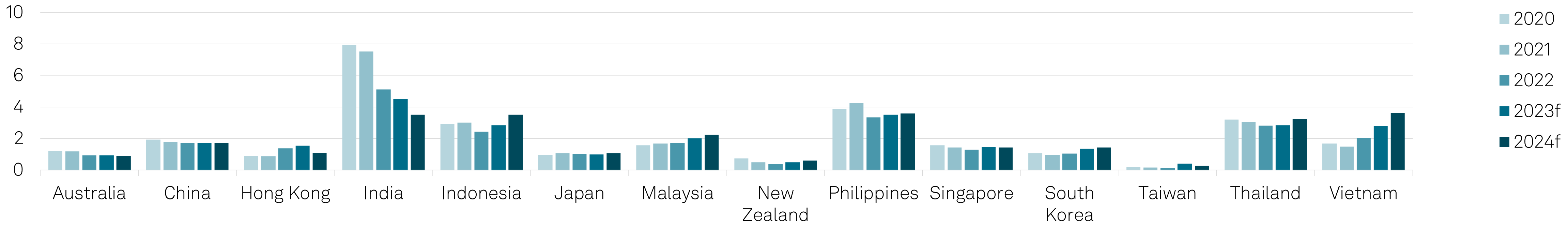
Asset Quality Will Strain

Credit losses could increase but for most countries remain below our expected long-term average (%)



Note: Credit losses as a % of gross customer loans. For India and Japan, 2020 refers to fiscal year ended March 31, 2021. f--Forecast. Source: S&P Global Ratings.

Nonperforming assets will remain elevated in some jurisdictions (%)

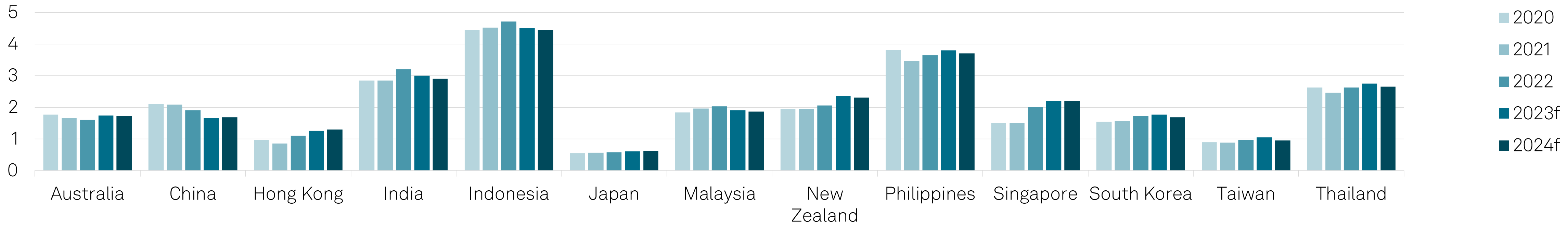


Note: Nonperforming assets as a % of systemwide loans (year-end). For India and Japan, 2020 refers to fiscal year ended March 31, 2021. f--Forecast. Source: S&P Global Ratings.

S&P Global
Ratings

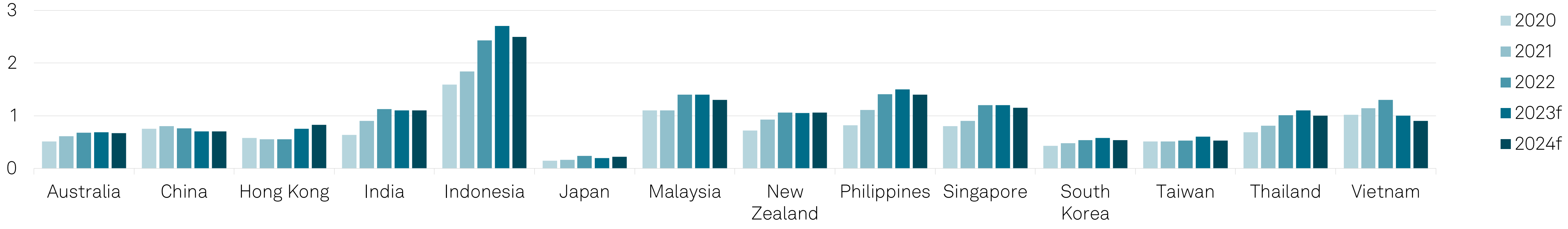
Earnings Yet To Recover To Pre-COVID Levels

NIMs recovering with rising interest rates (%)



Note: Net interest income (NII) to average earning assets. For India and Japan, 2020 refers to fiscal year ended March 31, 2021. f– Forecast. Source: S&P Global Ratings.

RoAA are yet to fully recover to pre-COVID levels for most banking systems in the region (%)

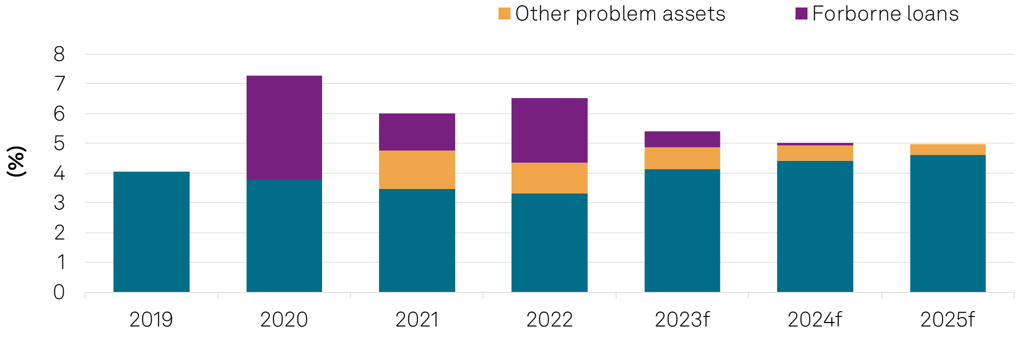


Note: Systemwide return on average assets (RoAA). For India and Japan, 2020 refers to fiscal year ended March 31, 2021. f--Forecast. 2021 is an estimate for India. Source: S&P Global Ratings.

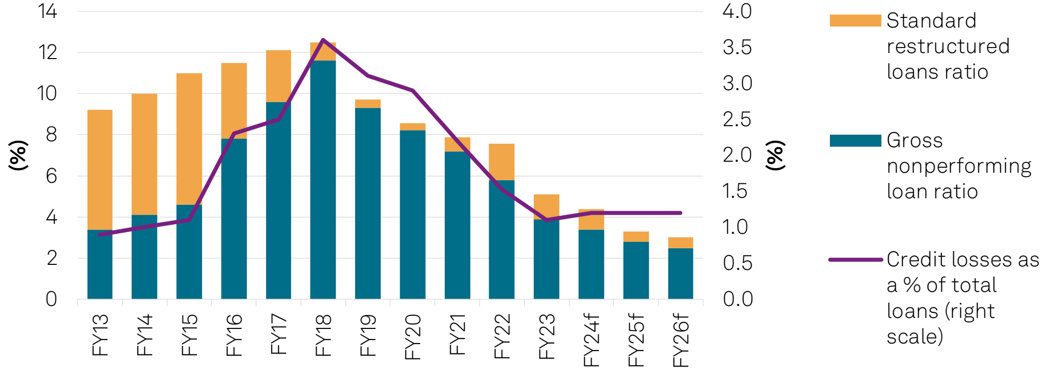
S&P Global Ratings

Asia-Pacific Banks

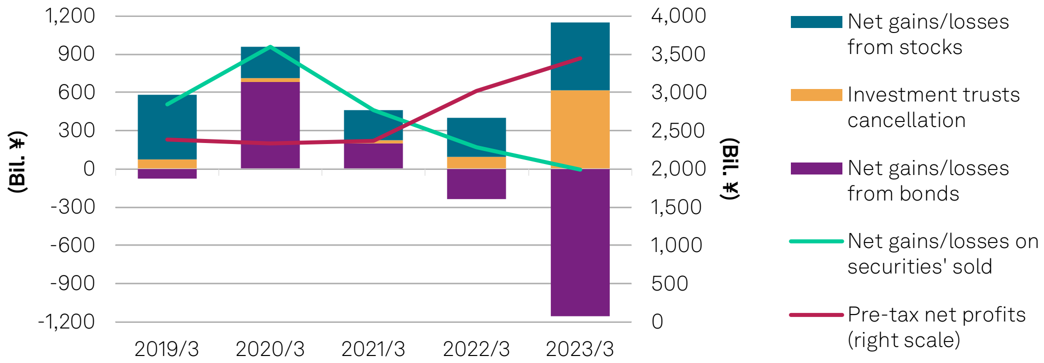
China: Official NPL and SML ratios likely to increase as more problem assets are recognized



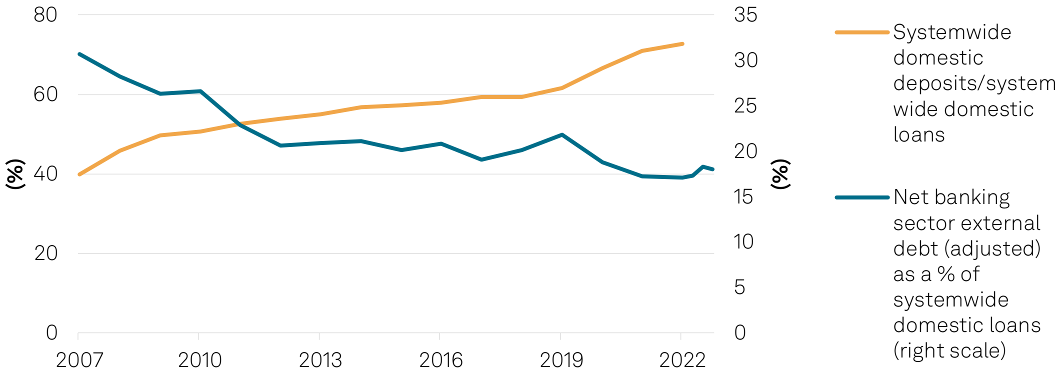
India: Banks' asset quality improvement to persist



Japan: Profits increase on growing interest incomes, and gains from other securities offset foreign bond losses



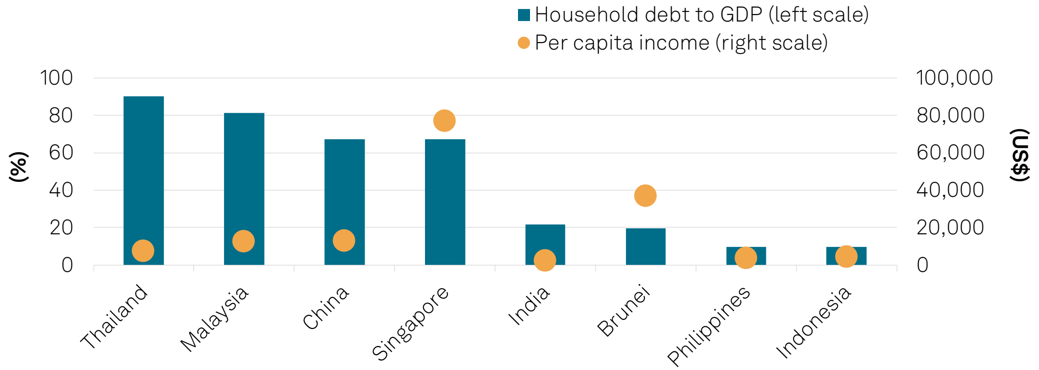
Australia: Industry risks could diminish if funding profile continues to improve



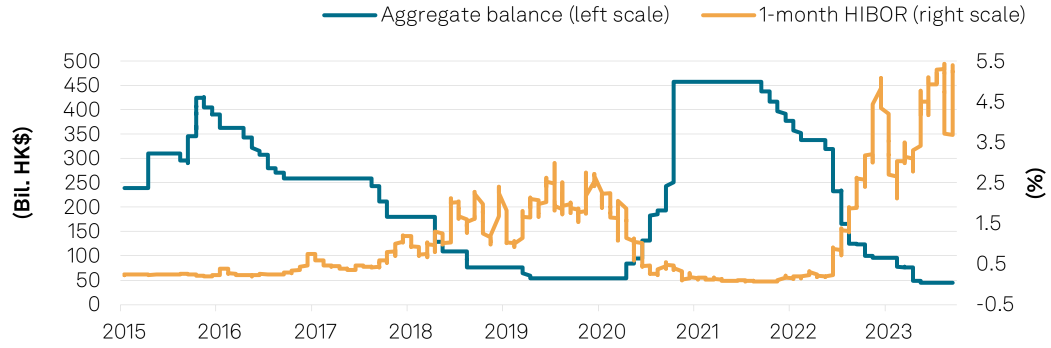
1. NPL--Nonperforming loan. SML--Special mention loan. NPA--Nonperforming assets. 2. Data for fiscal years, all ended March 31. FY--Fiscal year. Sources: Reserve Bank of India. S&P Global Ratings calculation and estimates. 3. Chart for Japan reflects "Pre-tax Net profits" and "Net gains/losses on securities' sold" at Japan's three major banking groups. Source: S&P Global Ratings, based on company disclosures.

Asia-Pacific Banks

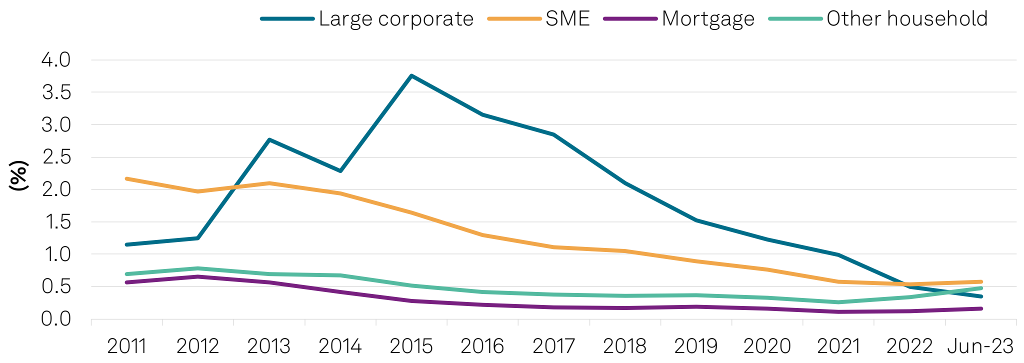
SSEA: High household leverage in Thailand and Malaysia poses credit risks



Hong Kong: With decline in interbank liquidity, HIBOR has risen to 15-year high levels – benefitting NIMs



Korea: Some asset quality deterioration will likely be manageable



Taiwan: Improved core earnings helps to absorb rising credit costs

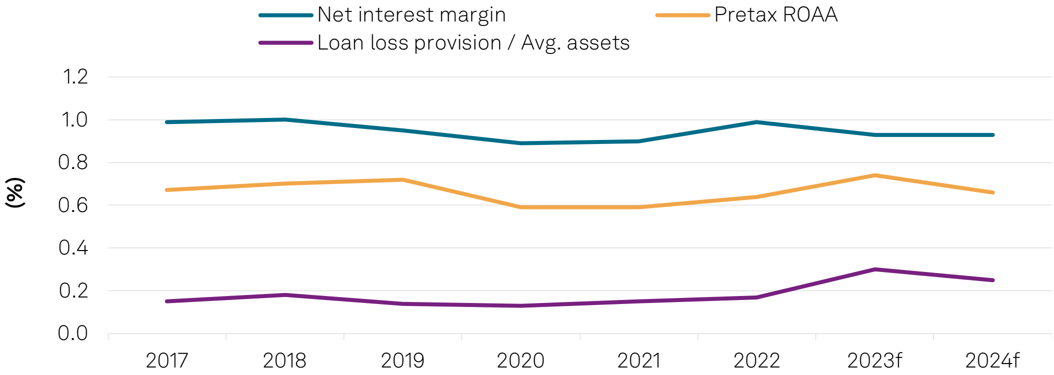


Chart reflects Korean banks regulatory nonperforming loan ratios by segment. SSEA--South and Southeast Asia. ROAA--Return on average assets. f--Forecasts. Sources: Financial Supervisory Commission. Taiwan Ratings Corp.

Latin America

Credit Conditions: Latin America

- We have increased our 2023 real GDP growth forecast for the region to 1.6% from 1.1% but have lowered it to 1.2% for 2024 from 1.5% previously. The main upward growth revisions are for Brazil and Mexico.
- We now expect the Brazilian economy to expand 2.9% this year, driven by strong agricultural production and continued impact of fiscal stimulus measures on household spending, and slow to 1.2% in 2024 . In Mexico, we now project a 3.0% growth this year (up from 1.8% previously), driven by strong consumption and robust remittances, resilient manufacturing output, and a sharp uptick in public nonresidential investment. We expect growth in Mexico to cool to 1.7% in 2024, mainly on weaker U.S. demand.
- We lowered our growth profiles for Argentina, Peru, Colombia, and Chile. In those countries, GDP growth contracted in the second quarter. The outlook for Argentina is highly uncertain given the upcoming presidential election and its implications for economic policy.

GDP growth forecasts (%)

	2019	2020	2021	2022	2023f	2024f	2025f	2026f
Argentina	-2.0	-9.9	10.7	5.0	-3.5	-1.0	2.0	2.1
Brazil	1.2	-3.6	5.3	3.0	2.9	1.2	1.8	2.0
Chile	0.7	-6.4	11.9	2.5	0.0	2.0	2.8	2.9
Colombia	3.2	-7.3	11.0	7.3	1.4	1.9	2.8	3.0
Mexico	-0.3	-8.8	6.1	3.9	3.0	1.7	2.0	2.1
Peru	2.2	-11.1	13.5	2.7	0.9	2.4	2.8	3.0

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

Credit Conditions: Latin America

Profitability To Remain Softer Than Historical Levels But Solid Relative To International Peers

Downside risks

- The risk of **disinflation being interrupted** by the increase in energy prices, or the potential impact of El Niño on food prices, is high. This would renew upward pressure on interest rates and accelerate the expected slowing of domestic demand. It could also worsen current account balances of net importers of energy, increasing the sensitivity of capital flows to interest rates.
- The U.S. economy goes from our current baseline of a "soft landing" to an **outright recession**. This would have significant negative implications for the global economy, with an outsize effect on several Latin American countries.

...and what they mean for the sector

- We expect **nonperforming loans (NPLs) to remain relatively high in 2024**, while credit losses should remain manageable thanks to good provisioning coverage. Soft economic growth and modest credit growth will likely offset the effect of stricter underwriting practices, resulting in relatively stable NPL ratios.
- Provisions will likely remain high, **denting profitability**. However, operating performance will likely remain solid thanks to banks' higher margins than those of peers. Banks will keep operating with solid capitalization and sound liquidity.

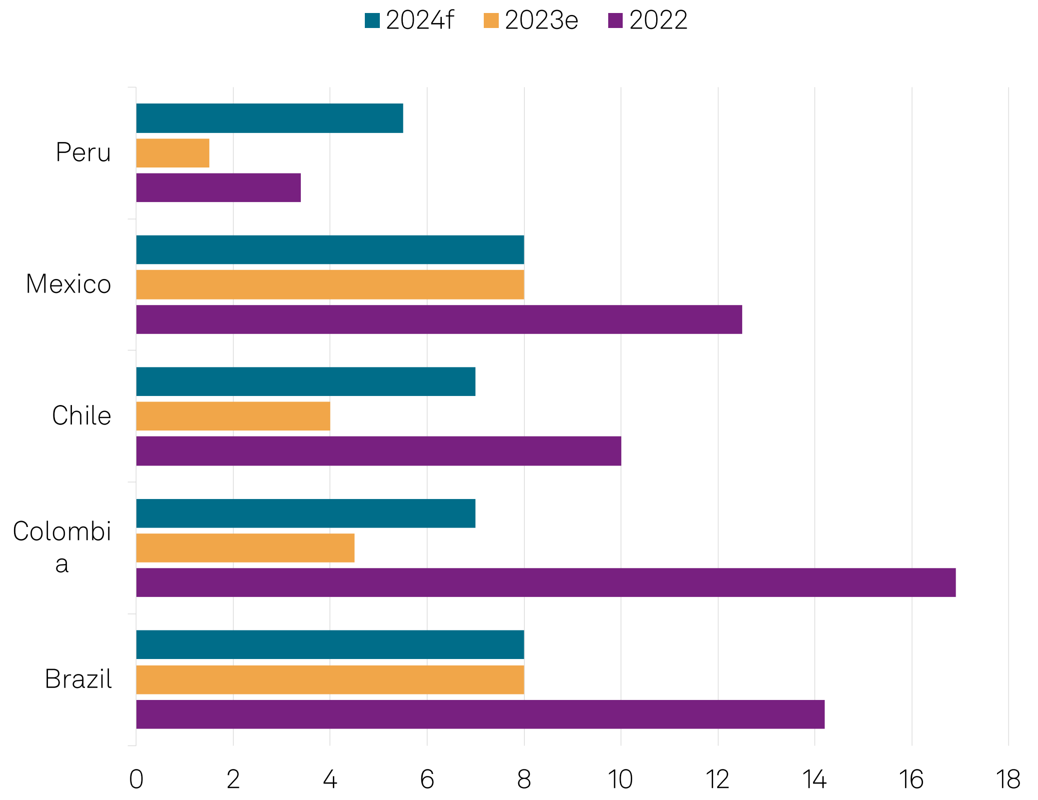
What we expect for next 12 months

- **Lending growth should slightly pick up in 2024 but** remain softer than historical levels as banks' risk appetite remains modest. The subdued economic performance will contribute to modest credit growth.
- Banks in Latin America are used to operating in **challenging operating conditions,** and have solid regulatory capital and liquidity levels, which will help them navigate the tougher environment. Local regulators are typically stringent given the volatile economies, and regulation is implemented across all regulated entities.

Soft Economic Performance Will Limit Credit Demand

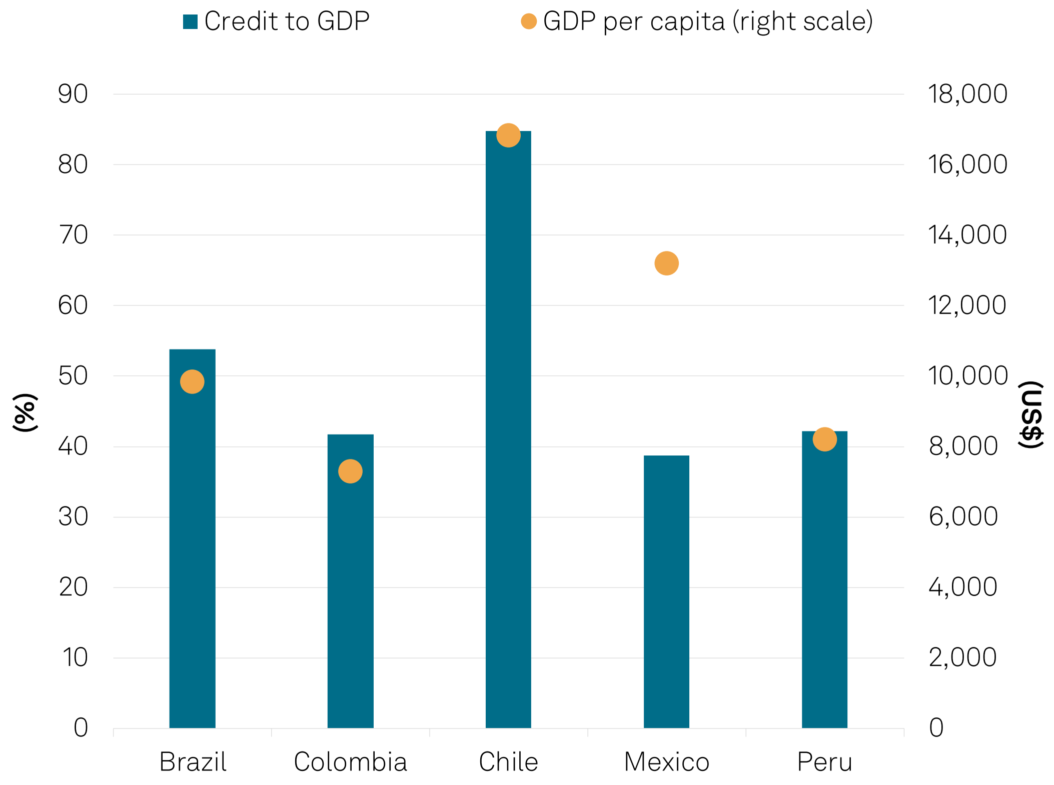
Weak credit growth in 2023 and modest rebound in 2024

Credit growth (%)



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

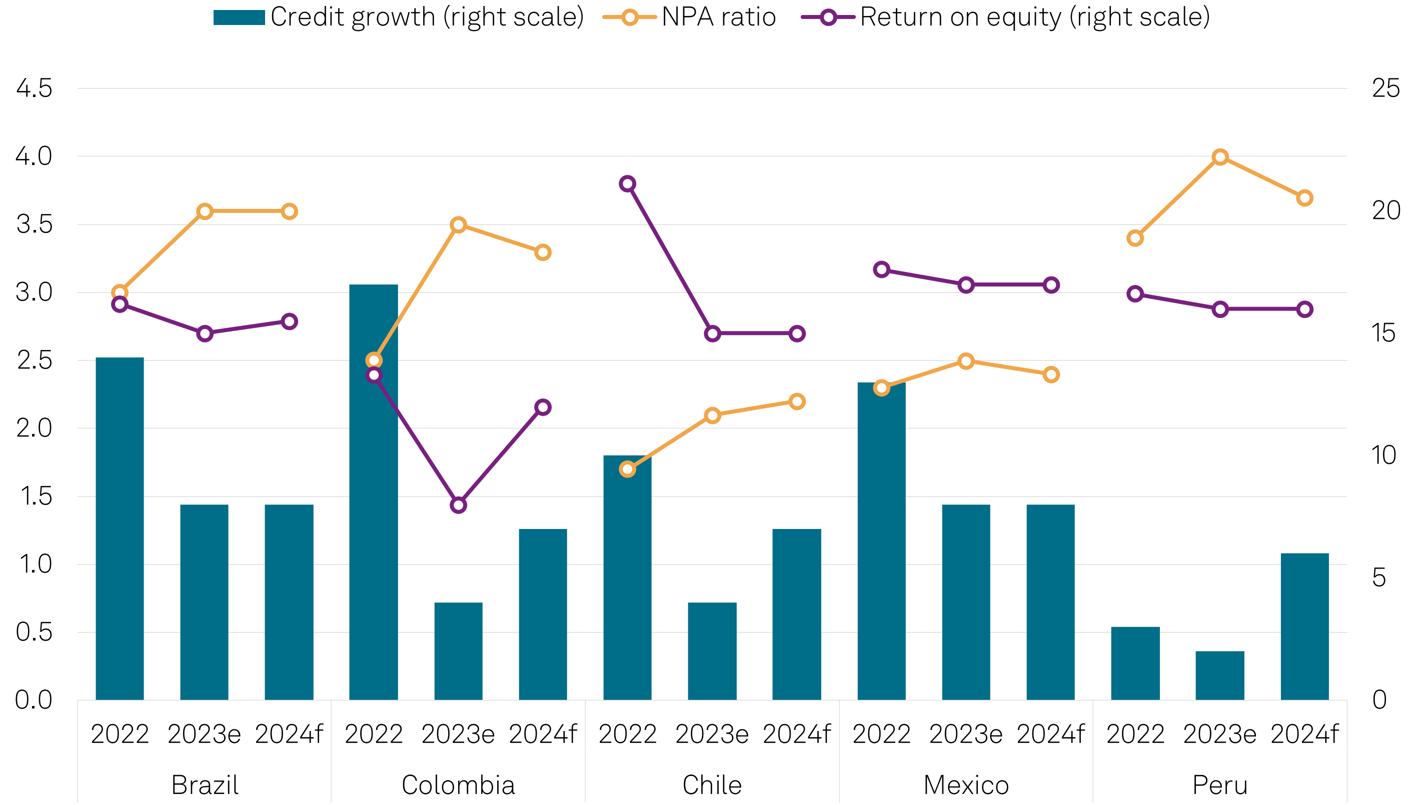
Access to credit remains low (except for Chile)



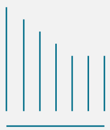
Source: S&P Global Ratings.

Stabilizing Asset Quality Metrics And Profitability

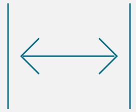
Profitability and asset quality metrics (%)



ROE--Return on equity. e—Estimate. f--Forecast. Source: S&P Global Ratings.



Profitability weakened in 2023 from strong levels, and we expect it to remain relatively stable in 2024.



Asset quality deteriorated in 2023 mainly due to weaker performance of retail unsecured portfolio. As a result, banks introduced more stringent underwriting practices and decreased their risk appetite, which should support stabilization in 2024.

Subdued economic growth that we expect in 2024 will keep pressuring asset quality metrics but at a slightly lower intensity than in 2023.

Interactive Dashboard

How to access the Global Banks Outlook 2024 Dashboard

The Global Banks Outlook 2024 Dashboard includes our in-house sector insights and trends, latest global and regional banking statistics and aggregate data.

Using the link, compare a banking system with its peers according to geographic region or BICRA group.

Click here

Global Banks Outlook 2024 Dashboard

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- Banking Industry Country Risk Assessment Update: October 2023, Oct. 27, 2023
- Eurozone Banks: Higher Reserve Requirements Would Dent Profits And Liquidity, Oct. 24, 2023
- ESG In Credit Ratings October 2023, Oct. 19, 2023
- Asia-Pacific Financial Institutions Monitor 4Q 2023: Outlook Stable, Strains Manageable, Oct. 18, 2023
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- U.S. Regional Banks 2Q2023 Update, Sept. 7, 2023

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