Questions That Matter

Banks | Will Returns Ever Recover?

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A widely available vaccine and sustained economic recovery in 2021 will not automatically solve banks' profitability issues in many regions.

How this will shape 2021

Banks' balance-sheet strength will continue to support their resilience in 2021. Combined with the likely only gradual withdrawal of support measures, strong balance sheets should continue to limit the number of bank downgrades. About one-third of our bank ratings globally are currently on negative outlook.

Profitability will remain a key weakness for many. Although we expect a sustained recovery next year, we believe banks in certain countries will struggle to offer adequate returns well beyond next year. This is based on our expectation that provisions will remain elevated, that lower-for-longer rates will dampen revenues, and that banks will need to continue investing in digitalization to meet evolving customer expectations and streamline long-term costs. Also, in Europe and Japan for instance, COVID-19 came on top of pre-existing structural profitability issues.

Further structural reform and consolidation ahead. Consolidation may accelerate in systems with excess capacity. There have been recent mergers or market chatter in Spain, Italy, and Japan, for instance. But consolidation is not a panacea, and integration often comes with operational complexities. Banks in most regions will continue to take a hard look at costs as the unfavorable interest rate environment and the rise in new forms of competition put further pressure on revenues.

The economic recovery will be the trigger for the gradual withdrawal of support measures, which will reveal a truer color of banks' underlying asset quality in 2021

We expect US$2 Trillion Of Credit Losses Over 2020-2021

What we think and why

Slow and uneven recovery ahead. Recovery of banking jurisdictions globally to pre-COVID-19 profitability will be slow, uncertain, and highly variable across geographies. For 14 of the top 20 jurisdictions, we estimate that a return to pre-COVID-19 financial strength won't occur until 2023 or beyond.

Emerging market banks in the spotlight. Some banks in emerging markets are exposed to additional risks compared with developed market peers. These include reliance on external funding, concentration in economies and business models, or lack of government capacity to provide support. We expect Chinese banks to be among the fastest to recover, even if full recovery may take until end-2022.

There will be a lag effect on banks' returns. The economic recovery will be the precondition to and trigger for the gradual withdrawal of support measures, which will reveal a truer color of banks' underlying asset quality in 2021. We therefore expect provisions to remain elevated in 2021 even as economic growth picks up.

Read more

Global Banking: Recovery Will Stretch To 2023 And Beyond Sep 23, 2020

Global Banks 2021 Outlook: Banks Will Face The Next Test Once Support Wanes Nov. 17, 2020

Global Banks Country-By-Country 2021 Outlook: Toughest Test Since 2009 Nov. 17, 2020

What could go wrong

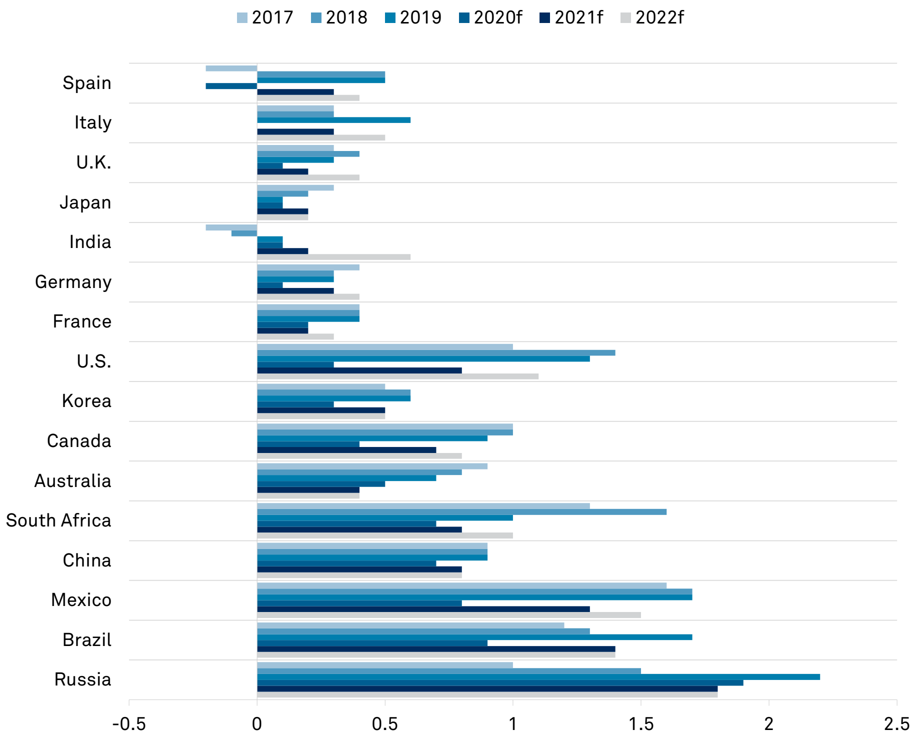
A severely adverse scenario could prompt more banks to report losses. We currently expect that the vast majority of banks will remain able to absorb credit losses through pre-provisioning income, limiting the expected erosion in capital levels. We project these credit losses at around US$2 trillion over 2020-2021, about double their 2019 annual level. A delayed or slower recovery, for instance in the event of a premature withdrawal of support measures, could tip banks into losses, especially given corporates' higher leverage.

Property exposure could become a key risk. Borrower repayment moratoria, landlord and bank forbearance, and record low interest rates may be masking underlying asset quality problems. The pandemic may also accelerate structural changes in segments of the retail and office sectors.

Chart 18

COVID-19 Is Dampening Prospective Returns

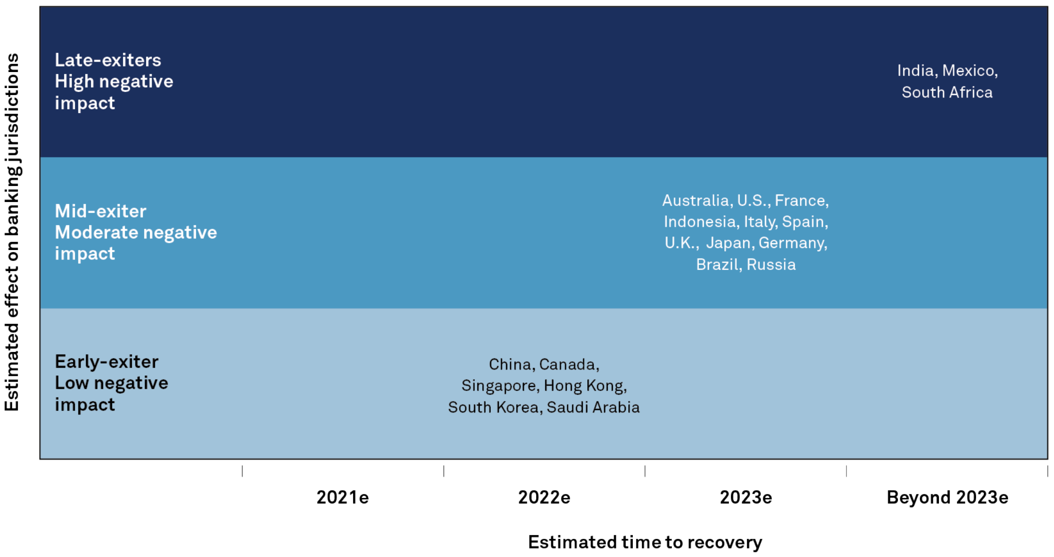
Return on average assets (%) - Selected Banking Jurisdictions



Source: S&P Global Ratings

Chart 19

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



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

This report is an extract from the S&P Global Ratings report, "Global Credit Outlook 2021: Back On Track?"

This report does not constitute a rating action

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

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