Global Banks Midyear Outlook 2023

Resilience Will Be Tested

July 20, 2023

S&P Global
Ratings

This report does not constitute a rating action

Contents

Key Takeaways

- The weak economic outlook presents headwinds for banks' business volumes, asset quality, and financing conditions. Positively, most banks' earnings benefit from the high interest rates.
- Although not our base case, an economic recession in Europe and the U.S. is possible; inflation remains high; and the spillover from the Russia-Ukraine war continues.
- Commercial real estate (CRE) markets are suffering a downturn, with demand and prices falling, especially in the U.S. and some European countries.
- We expect bank rating outlooks to remain broadly stable (the net outlook ratio stood at 1% positive at midyear) due to solid capitalization and sound asset quality.
- We anticipate increasing credit divergence. Deterioration will be more acute for nonbank financial institutions and entities with weak funding profiles.

Key Risks

Our economic base case does not hold

A material downside emerges--including a full-blown recession with a sharp rise in unemployment.

High corporate and government sector leverage

It will exacerbate corporate insolvencies and trigger potentially less government support for the real economy.

Property sector deteriorates more than expected

Weakness in CRE markets accelerates, ultimately hurting banks' asset quality.

Banking sector contagion risks

While risks have moderated, sound funding and liquidity will remain integral to ratings stability

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

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

Austria
IR 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', and IR score to '7' from '8'

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

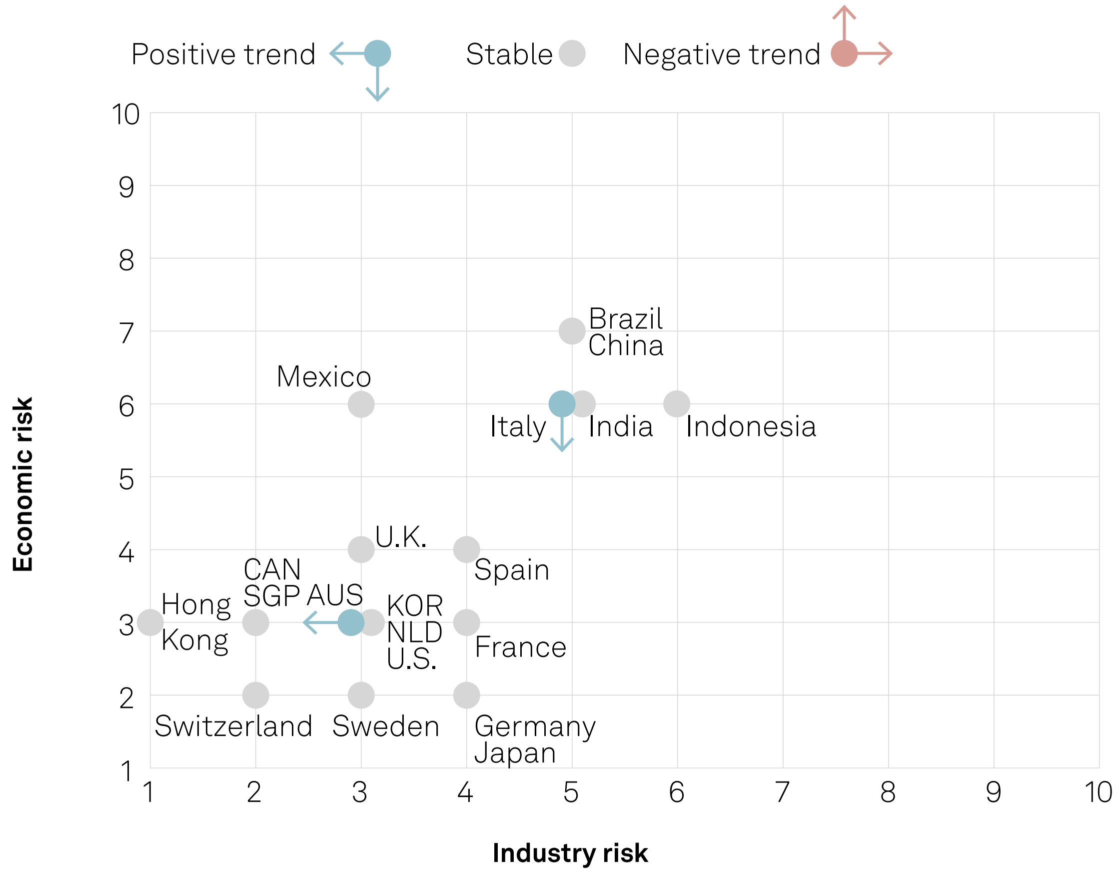
Ireland
BICRA to Group '3' from Group '4', and ER score to '3' from '4'

Data as of July 18, 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: H1-2023

- **Germany:** Economic risk score to 2 from 1, trend to stable from negative (Feb.)
- **U.S.:** Industry risk trend to stable from positive (Mar.)
- **Italy:** Economic risk trend to positive from stable (May)
- **India:** BICRA group score improved to 5 from 6 (Jun.)

Data as of July 18, 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.

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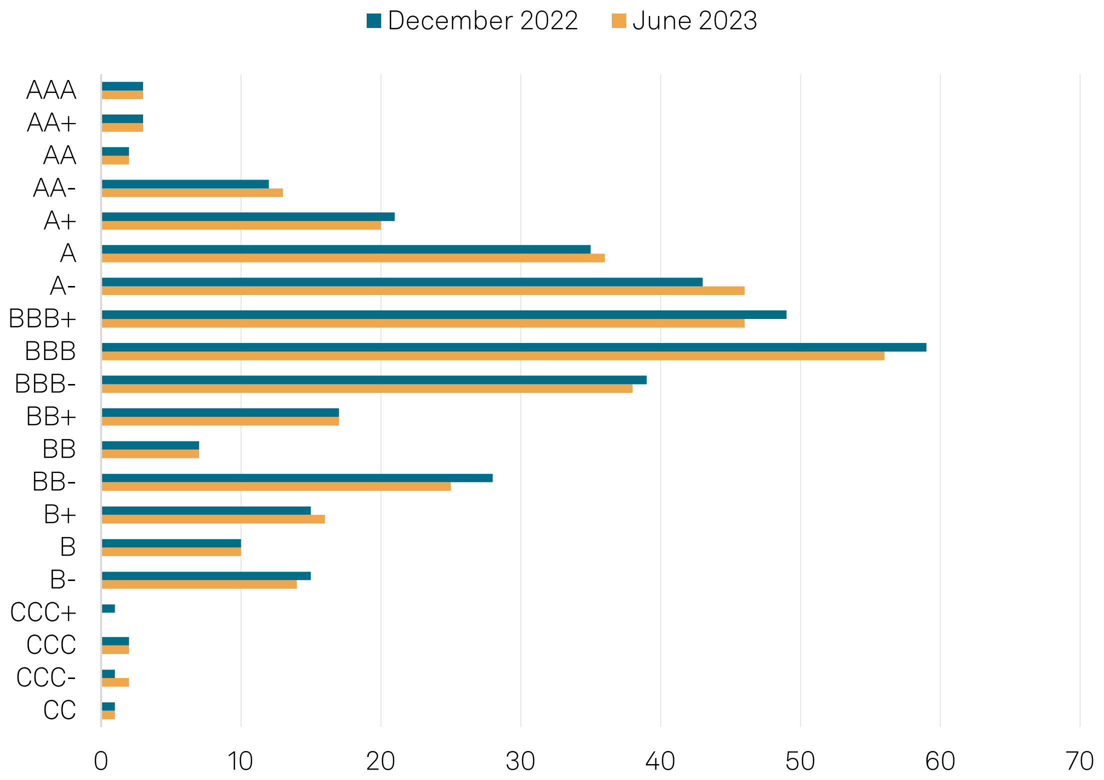
Banks | Generally Stable Outlook

Bank outlooks should remain broadly stable in 2H2023

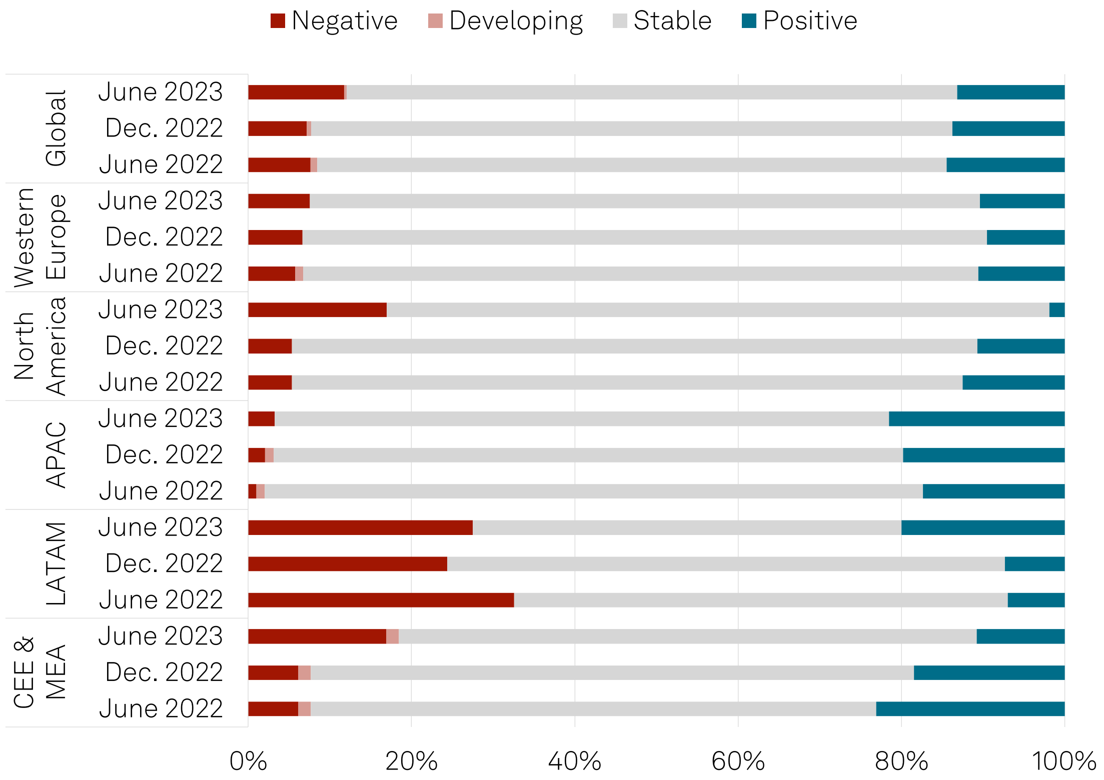
Evolution of outlooks for rated banks by region



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

We expect bank ratings to be resilient

Evolution of ratings distribution for rated banks

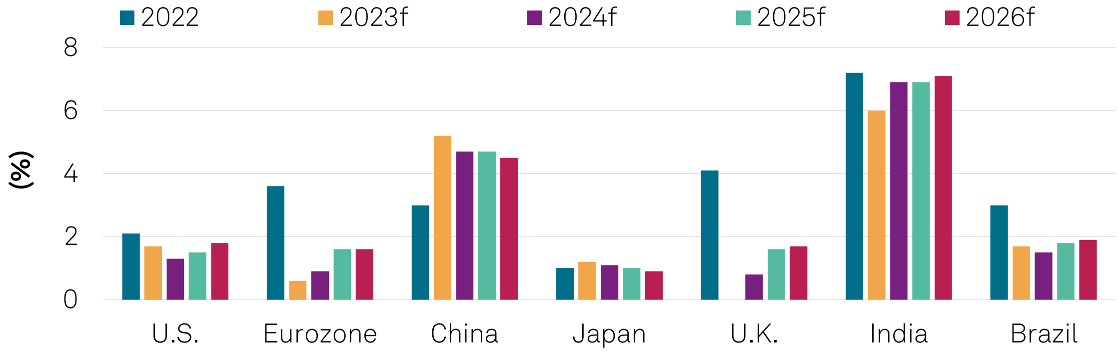


CEE--Central and Eastern Europe. MEA--Middle East and Africa. Source: S&P Global Ratings.

What Are We Watching In 2H2023?

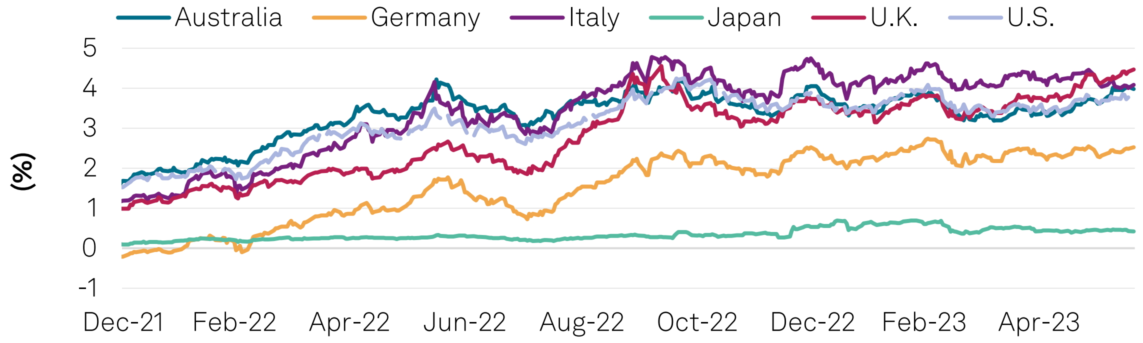
1. How much will weaker economic growth hurt banks?

A modest GDP growth outlook in the U.S. and Europe



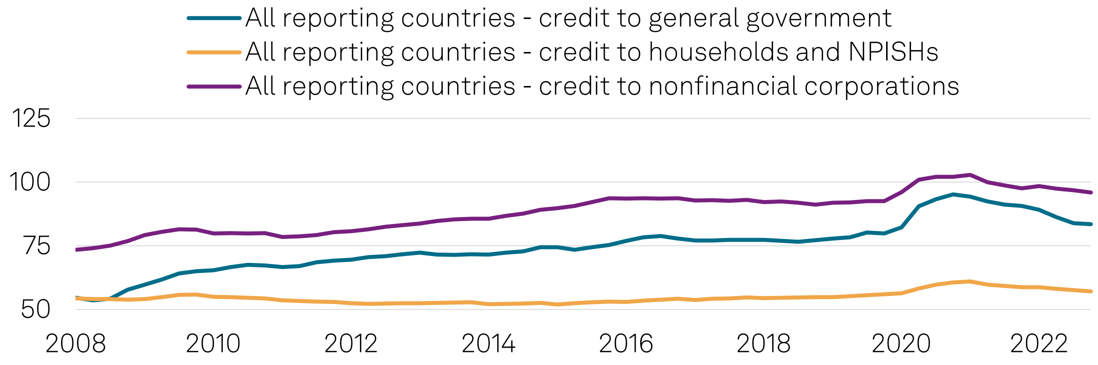
2. Borrowing costs remain high

10-year government bond yields largely stabilize



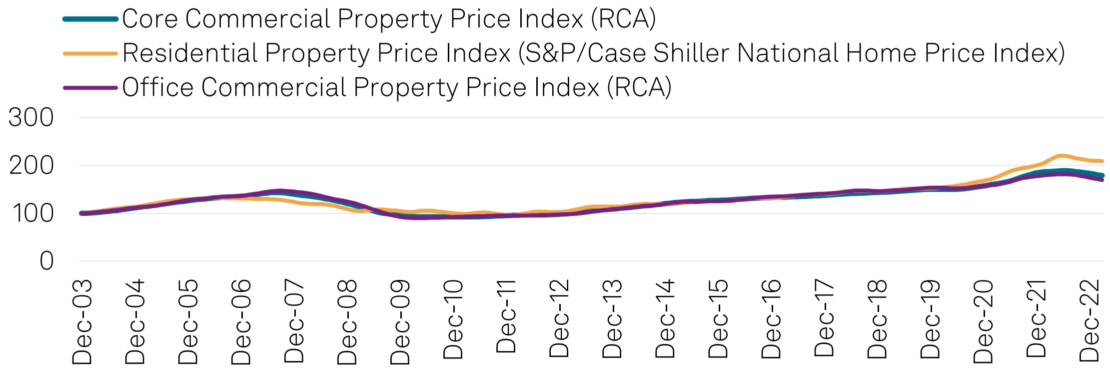
3. Debt leverage is stabilizing but could hurt banks

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



4. How much will property affect bank asset quality?

U.S. real estate prices: commercial versus residential



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. NPISH--Nonprofit institution serving households. Sources: IIF; S&P Global Ratings. 4. Index rebased to 100 as of year-end 2003. Sources: Bloomberg and S&P/Case-Schiller Index. Data is through March 31, 2023.

Higher-For-Longer Interest Rates Weigh On Economies

- The macro picture remains weak for the remainder of 2023 and 2024, with low economic growth and high inflation in several countries. The main challenge for central banks is to rein in and re-anchor expectations without causing a recession.
- We believe that the ECB will seek to raise rates once again in July before pausing.
- As economic growth remains low and financing conditions tight, we see a risk that high interest rates, persistent inflation, and consumer caution will push the U.S. and Europe into recession in the second half of 2023 or 2024.

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	1.7	2.0	2.5	3.5	1.0
2023f	5.1	3.75	4.25	5.25	1.75
2024f	5.2	3.0	3.5	4.25	1.0
2025f	3.6	2.0	2.5	2.5	1.0
2026f	2.7	2.0	2.5	2.5	1.0

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 | Tighter Funding Conditions Means Higher Credit Risk

Elevated CRE refinancing costs and lower collateral valuations mean higher--but manageable--credit losses for many banks. A more extreme CRE stress could see downgrades for the most exposed banks

In the U.S., a stress CRE loss rate of 10% equates to 29% of Tier 1 capital for the most exposed rated banks

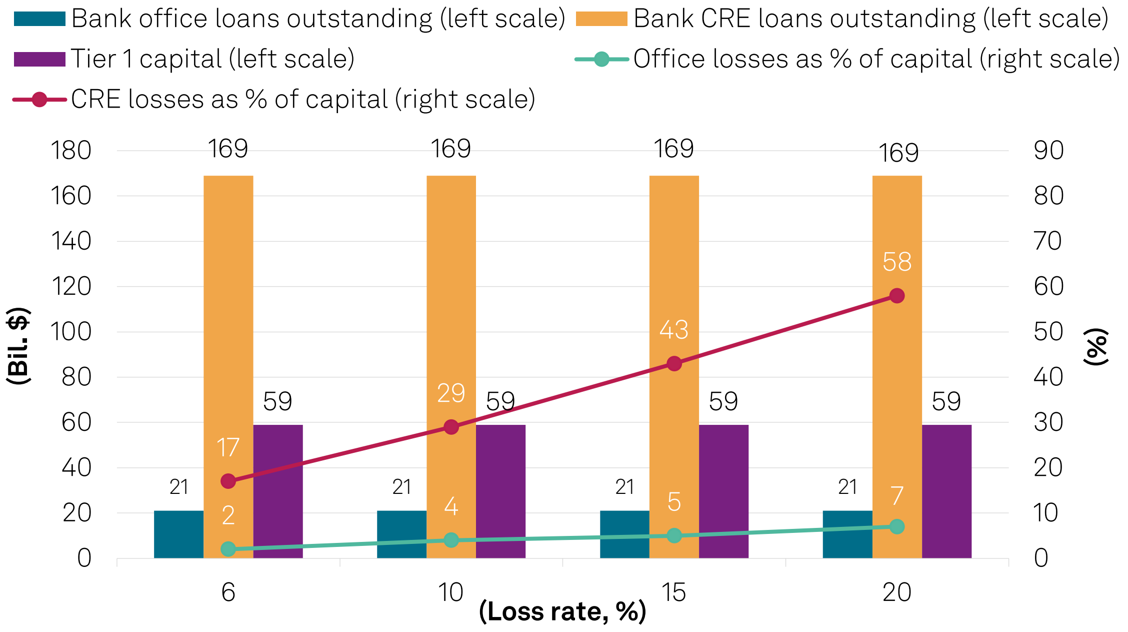


Chart shows sensitivity of CRE losses to Tier 1 capital for rated U.S. banks with a CRE exposure of more than 30%. Data as of March 31, 2023. Excludes owner-occupied.
Sources: S&P Global Ratings, FDIC data, and 1Q 2023 company earnings presentations and 10-Qs.

In Europe, banks in Germany and Sweden have highest exposure to CRE, though recent growth has been moderate

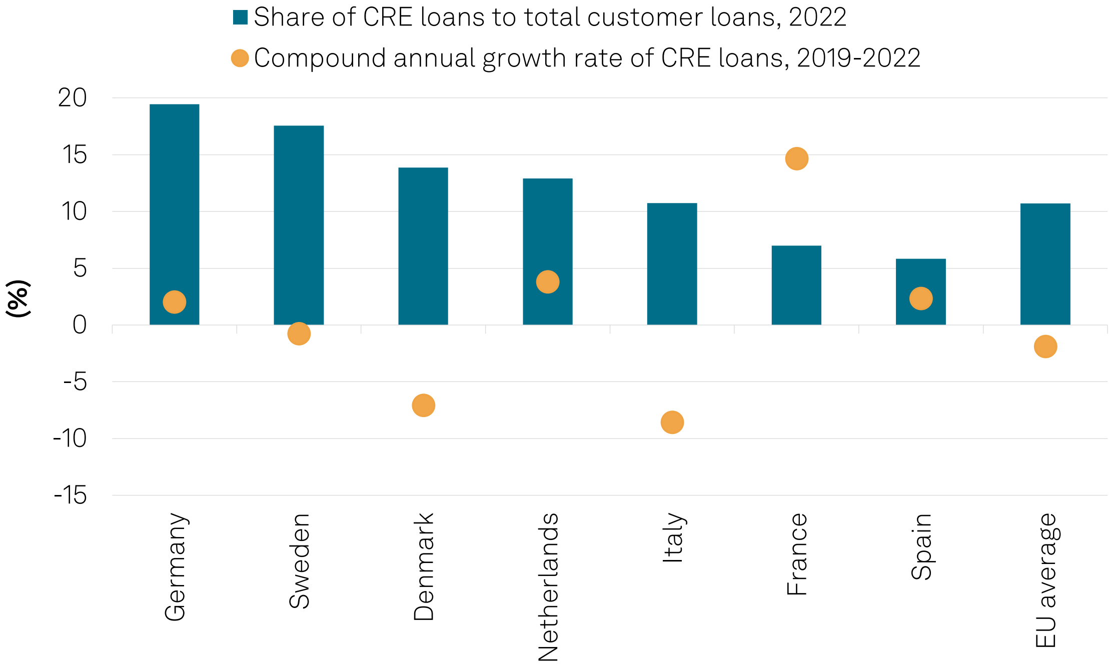


Chart shows relative exposure to CRE loans at large European banks at consolidated level as of Dec. 31, 2022.
Sources: EBA, S&P Global Ratings.

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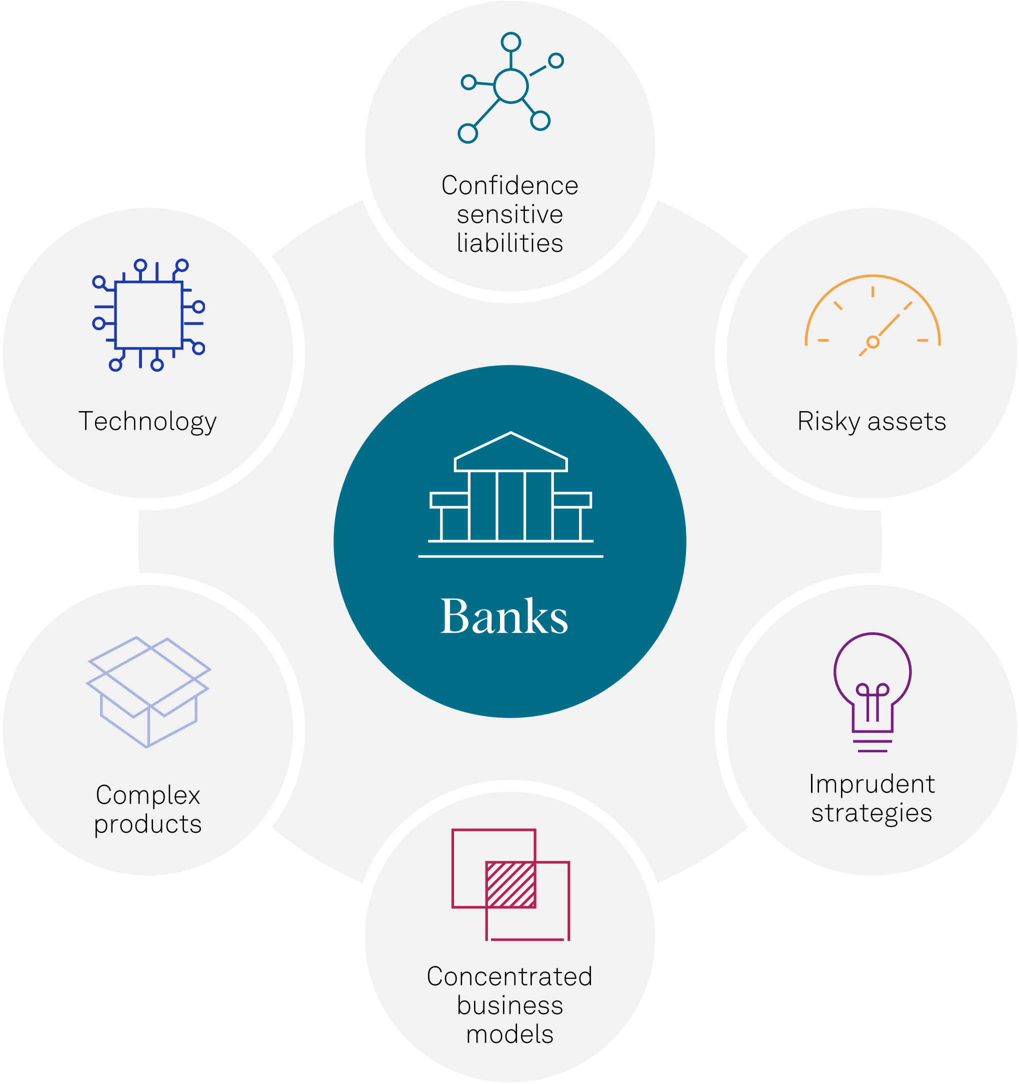
Contagion Risks To Banks Have Moderated But Remain On The Radar

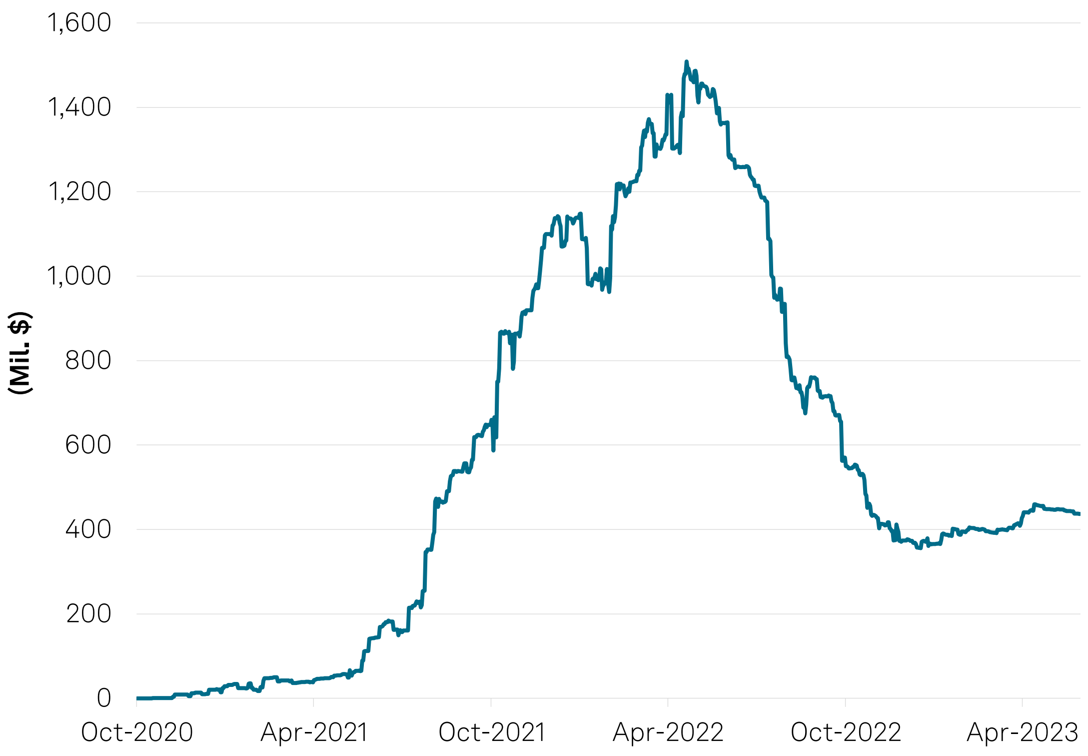
Factors of contagion can be numerous and diverse



The Crypto Ecosystem Is Evolving

And traditional finance is fighting back

Active loan value on selected blockchain lending protocols*



*Included protocols: Maple, Centrifuge, Credix, TrueFi, Goldfinch. Source: rwa.xyz.

- Blockchain technology promises a decentralization of the financial system but most adoption so far has taken place through centralized finance (CeFi) intermediaries.
- The failure of several CeFi entities in 2022 highlighted risk management and governance issues, and the contagion risks between them.
- Decentralized finance (DeFi) protocols largely weathered the storm, with minimal loan losses on the major collateralized lending platforms and the continued growth of decentralized exchanges.
- Yet DeFi still carries risks, and the lack of a regulatory framework and know-your-client/anti-money-laundering functionality hinders its adoption by traditional financial institutions.

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Artificial Intelligence To Empower Bank Business

AI could amplify banks' competitiveness, profitability and risk management if well implemented

Automate → *Predict* → *Generate*

Use cases

Automate
- Algorithmic trading
- Payments' routing
- Authentication system
- Document processing

Predict
- Product recommendator
- Robo advisor
- Risk management scoring
- Fraud detection
- Customer analysis
- Deposit run predictor

Generate
- Hyper-personalized products and financial advice
- Chatbots for employees
- Software engineering

AI has the potential to benefit banks

- Fully utilize untapped revenue potential with customers
- Simplify operations, reduce costs, and improve efficiency and earnings
- Achieve faster and more accurate decision making
- Enhance risk management practices
- Improve customers' financial wellbeing, literacy, and experience

Source: S&P Global Ratings.

Key risks for banks as AI-technology advances

Ethical concerns (unconscious bias, trust, and explainability)

Security and privacy risks as protecting sensitive customer data is key

AI regulation still in its infancy with gaps across regions, its scope and requirements

Workforce displacement versus adaptation to work with AI

Investment needs to integrate AI models with legacy IT infrastructure

Bank Strategies To Address Climate Change

Exclusion

Customer engagement

New product and services

Divestment

Financing of green projects and technologies

- Reducing climate-related risks is a key priority for an increasing number of banks. Awareness and preparedness is gradually improving.
- More climate-related data is available, and methodologies/models are progressing. Regulatory climate stress tests are developing 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 (green mortgages, electrical vehicle loans...).

Best Practices On Climate Transition

- Strengthen board expertise on environmental topics
- Train all employees
- Gain deeper sectoral expertise
- Engage with customers on their climate transition plan
- Build expertise in new decarbonization technologies
- Hire climate experts
- Anticipate future public policies
- Strengthen cooperation between sustainable team and business and risk divisions
- Develop climate KPIs and set up intermediary targets
- Build up detailed climate-related data and scenarios
- Increase focus on biodiversity and water
- Improve external disclosure

Emerging Markets | Lingering Tighter Financing Conditions

High interest rates and subdued economic activity will pressure some EMs

Tight financing conditions under a higher interest rate environment

- While inflation has peaked across most EMs, higher-for-longer domestic and global interest rates are reducing credit growth and affecting sovereigns, corporates, and households. Coupled with weakening demand, this could erode corporate profits, households' purchasing power, and banks' asset quality.

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

- Political and geopolitical risks remain high with no near-term expected resolution of the Russia-Ukraine war and a complicated domestic political landscape across many EMs. This could slow reform implementation and reduce long-term growth prospects.

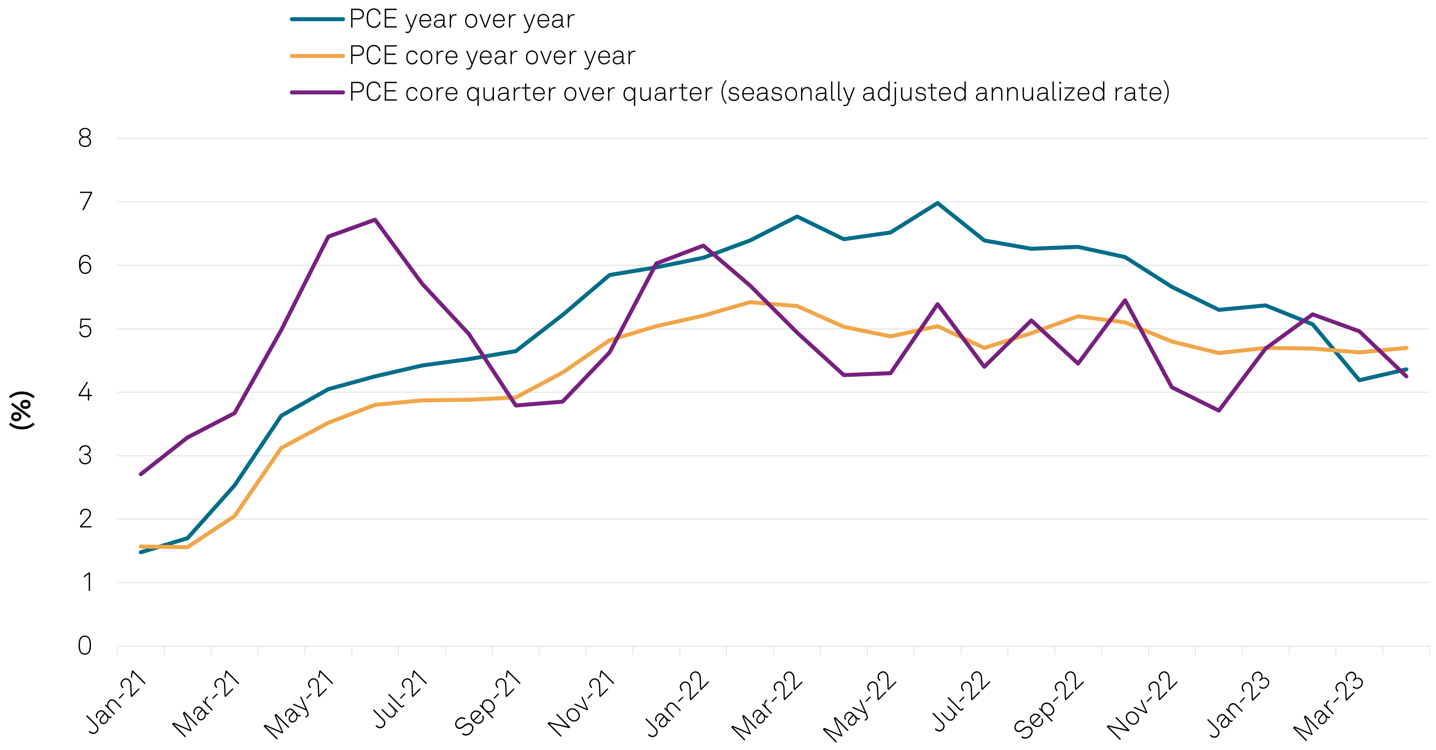
There are a few bright spots

- 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 expenditure (PCE) inflation



Sources: FRED, S&P Global Ratings Economics.

- We expect the U.S. economy to avoid recession but grow at less than 1.0% in the second half of 2023 and at a sub-potential rate of less than 2.0% annually in 2024-2026. Likewise, we expect Canada to grow 1.6% this year and 1.2% next.
- U.S. core inflation, which has declined somewhat, should fall below 3.0% in late 2024 and move toward the Federal Reserve's target in 2025 and 2026.

Credit Conditions: North America

Banks Showing Stability Following Failures But Challenges Remain

Downside risks...

- **Slow economic growth and high rates.** S&P Global economists expect a resilient U.S. economy to avoid recession but endure a multi-quarter period of sub-potential growth. Under this view, monetary policy rates will be higher for longer and financial conditions will be tighter for longer.
- **Rising funding costs and falling liquidity.** As the Fed continues to quantitatively tighten, deposits and liquidity most likely will continue to decline from robust levels.
- **Commercial real estate (CRE) stress.** Parts of CRE markets, particularly the office sector, have significant amounts of loans maturing and property prices are falling.

...and what they mean for the sector

- **Pressured net interest margins (NIMs).** The decline in deposits and increase in funding costs will likely cause NIMs and net interest income (NII) to fall for the industry each quarter, albeit from the high level at the end of 2022. NII will likely rise for the full year, but at a slower rate than we previously expected.
- **Unrealized losses could remain elevated.** The rise in rates since early 2022 has caused unrealized losses on securities and loans to rise. While they have fallen from a peak in the third quarter of 2022, they may remain substantial, especially if long-term rates rise.
- **Maturing office loans will create some challenges.** Loans on properties that have fallen in value could lead to impairments, especially as they mature.

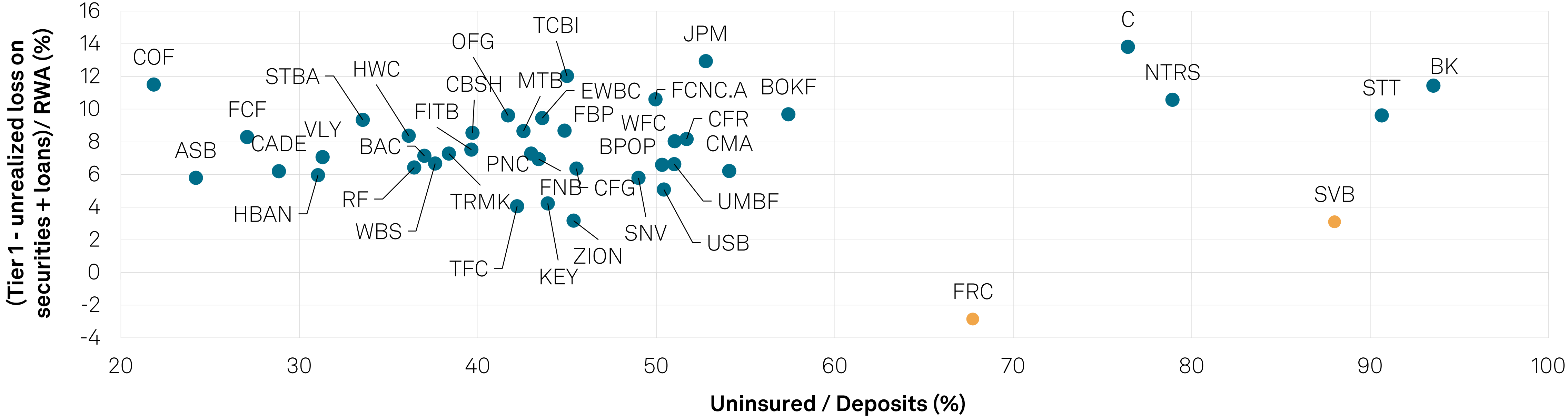
What we expect for next 12 months

- **Rated banks will avoid unmanageable deposit outflows.** While deposits are declining and funding costs are rising, 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 each quarter, we still expect banks in aggregate to generate a return on common equity of 9%-11% in 2023 and to build capital through earnings retention.
- **Asset quality pressure will increase but remain manageable.** Most asset quality measures have remained strong by historical standards. We expect provisions for credit losses to continue to increase but from last year's low levels.

Combinations Of Unrealized Losses, Uninsured Deposits Are Risk Factors

- But rated banks generally have less extreme combinations compared with the banks that failed in March and April.
- They generally have capital well in excess of unrealized losses on securities and loans.

Uninsured deposits/deposits and Tier 1 capital ratio adjusted for unrealized losses



Note: Uninsured deposits are sourced from 10-Q disclosures, where available. If unavailable, domestic uninsured deposits are sourced from regulatory call reports and compared to domestic deposits. For banks with meaningful foreign deposits, such as BK, C, NTRS, and STT, the ratio of domestic uninsured deposits to domestic deposits will likely differ from the ratio of total uninsured deposits to total deposits. For BAC, the ratio is based on the Q4 2022 data from the 10-K. Data for FRC and SVB are as of year-end 2022. RWA--Risk weighted assets.

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

Worsening | | Neutral | | Improving

Revenues	Net interest income (NII) will likely tick down each quarter as deposit and funding costs increase. Still, we expect NII to rise by a mid-single digit percentage for the full year given its increase during 2022. Fee income may remain tepid until mortgage banking and investment banking pick up.
Expenses	Banks will keep focusing on expenses, consolidating branches, and digitizing. However, continued inflation and investments in technology will raise expenses further.
Profitability	Profitability for the year will weaken somewhat on higher provisions and expenses despite some further annual increase in NII. Still, we expect an industry return on common equity of 9%-11%. A deeper recession would lead to higher provisions and weaker results.
Credit quality	While most measures of credit quality remain in good shape, we expect delinquencies and charge-offs to rise toward historical averages with a shallow recession. A recession of greater magnitude would cause a larger and faster increase in provisions and reserves.
Capital	Many banks will increase capital ratios 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 continue falling as long as the Federal Reserve is raising rates and quantitatively tightening, increasing competition for and raising the cost of funding. Funding and liquidity metrics will weaken further from the historically strong levels reached prior to the rate tightening cycle.

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

Canada Forecast : Rising Provisions And Expenses Pressuring Profitability

Worsening		Neutral		Improving

Revenues	Net interest income (NII) benefited in 2022 from higher rates, but growth is moderating as costs of funds are rising. Fee income could remain under pressure and affect asset management and capital markets businesses, particularly should equity and capital markets 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 (on average 10% in second quarter 2023 compared with one year ago), though we expect it to remain elevated.
Profitability	Profitability will be lower in 2023 than in 2022 as provisions are rising sharply from very low levels and high expenses are placing pressure on operating performance. We expect an industry return on common equity of 10%-13%.
Credit quality	While most measures of credit quality remain in good shape, delinquencies--particularly in consumer loans--are beginning to rise. We expect asset quality to normalize from very low levels and for the banks to continue to build allowances for performing loans. However, charge-offs will remain below pre-pandemic levels. A recession would cause a larger and more rapid increase in charge-offs and reserves.
Capital	The Office of the Superintendent of Financial Institutions increased the domestic stability buffer by another 50 bps (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% at year-end 2022).
Funding and liquidity	Funding remains well-diversified and banks continue to access global funding markets. Liquidity metrics remain relatively unchanged. Customer deposit growth should stabilize as the shift to higher yielding savings products such as guaranteed investment certificates starts to slow.

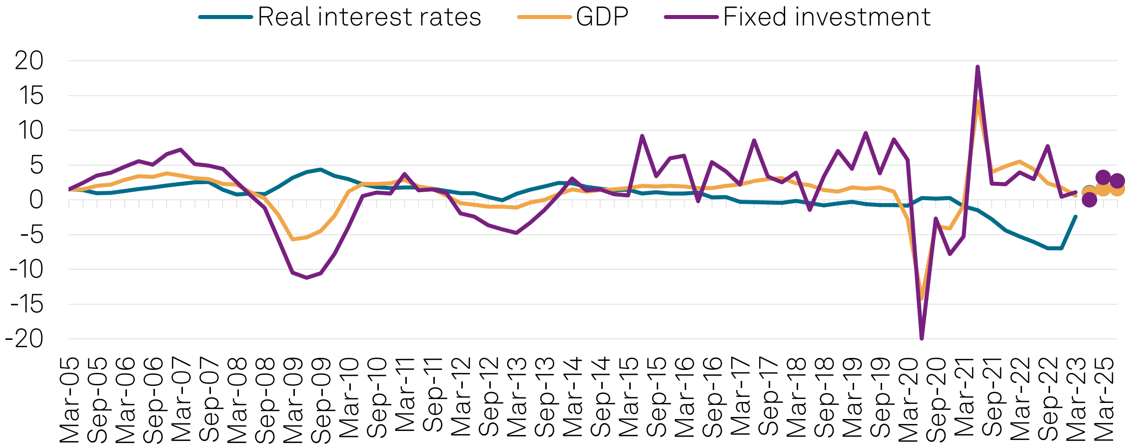
Note: Forecast for next 12 months. Source: S&P Global Ratings.

Europe & EMEA Emerging Markets

Credit Conditions: Europe

- We anticipate financing conditions will continue to tighten as European central banks maintain their laser focus on restoring price stability. Eurozone real interest rates are likely to turn positive again in 2024, after six years in negative territory.
- As recovery from the pandemic fades and higher (real) rates start to dampen demand, eurozone economic activity may contract modestly around the turn of the year.
- We forecast eurozone real GDP growth of just 0.6% this year and 0.9% next, while the U.K. should see zero growth this year and 0.9% the next. Labor markets are likely to remain fairly resilient despite the cyclical slowdown.

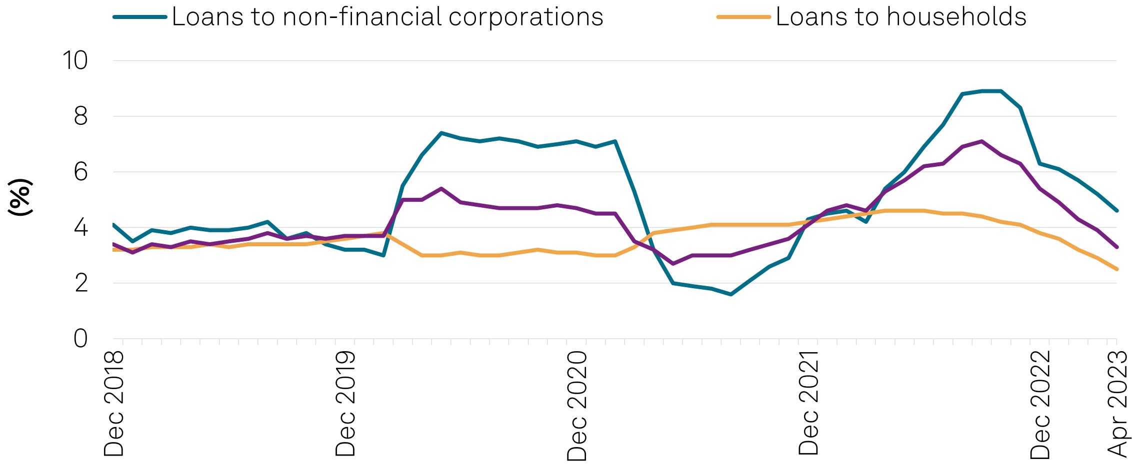
The return to positive real interest rates will take a toll on GDP and investment growth



Note: Real interest rates are 10-year government bond yields deflated by HICP inflation. The dots point to S&P Global Ratings full year forecasts for 2023 to 2026. Source: S&P Global Ratings.

Banks' lending growth is clearly decelerating

Annual growth rates of adjusted loans to residents provided by European banks



Source: ECB.

Credit Conditions: Europe

Downside Risks...

- A protracted, **painful recession**, leading to higher corporate insolvencies and unemployment.
- Overly restrictive financial conditions due to higher (real) interest rates and potentially an acceleration of quantitative tightening, leading to **market volatility** and/or **financial instability**.
- Banks' **failure to deliver commercially and operationally** resilient business models, in a context of high inflation.

...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.
- This scenario would pressure financial institutions with **weaker funding structures**, especially nonbank financial institutions with high refinancing needs. For banks, it would highlight the need for careful management of counterparty credit risks.
- Failure to tackle **inefficiencies**, properly **digitalize** the business, and sustain resilience to **cyber attacks** could challenge the long-term viability of some institutions.

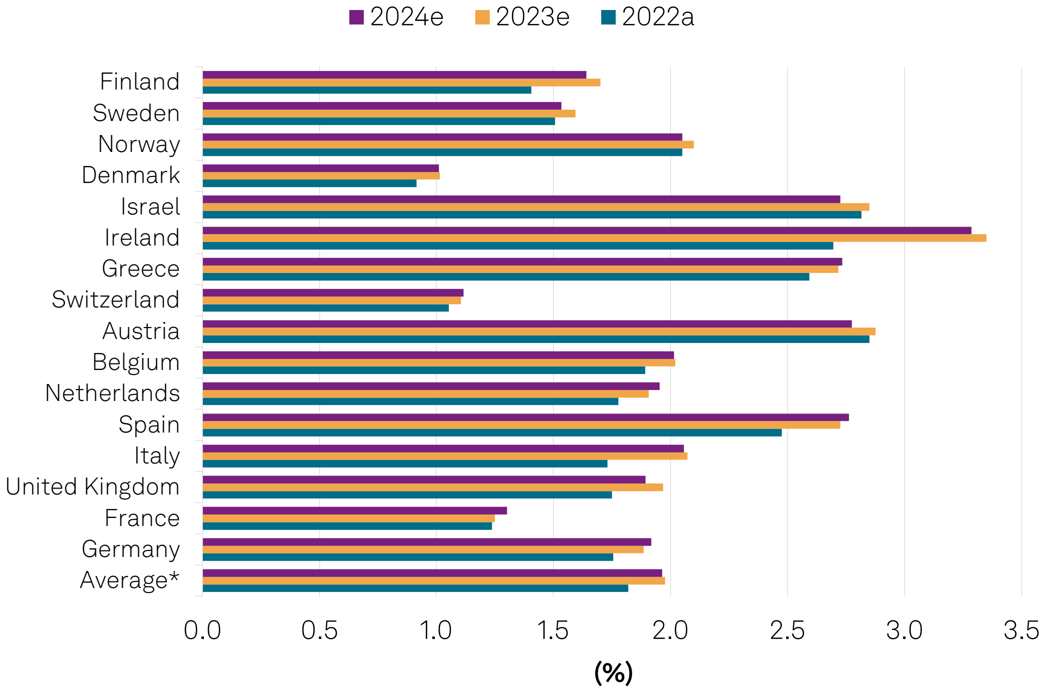
What we expect for next 12 months

- **European banks will be resilient** but divergent as the economic reset kicks in--higher rates, slower growth.
- The rise in (real) interest rates clouds the outlook for business volumes and asset quality. **Credit costs should gradually normalize**, with those 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**. Net interest margins and income should peak later this year, and strong deposit franchises will be a competitive advantage.
- Earnings should remain overall comfortable and allow banks to absorb future higher credit and funding costs. **Solid capitalization and liquidity** also provide resilience to potential shocks.

Comfortable Earnings And Adequate Capitalization Underpin Financial Resilience

Net interest margins should further rise and peak in 2023

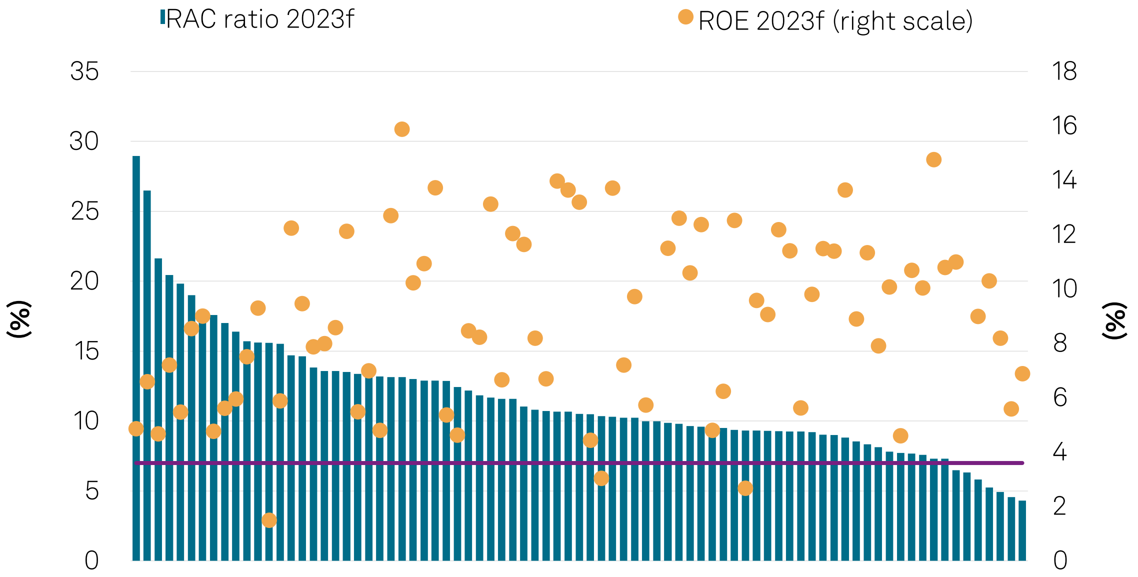
Evolution of net interest margins, top 50 European rated banks*



*Average for top 100 European rated banks excluding Swiss banks. a--Actual. e--Estimate.
Source: S&P Global Ratings.

Capitalization to remain adequate for most, and earnings provide further buffer

Our initial assessment of capital and earnings is adequate for banks with a risk-adjusted capital (RAC) ratio between 7% and 10%*



*Top 100 European banks excluding Swiss banks. Source: S&P Global Ratings

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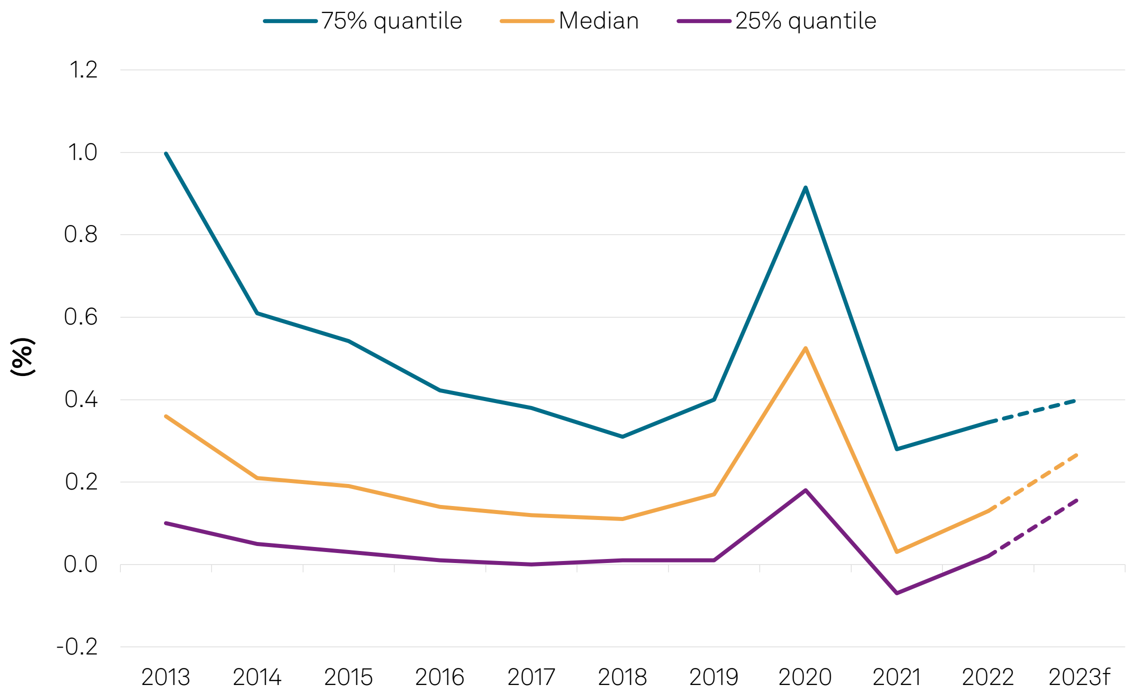
Credit Losses Will Rise From Recent Lows, Absorbing Some Of The Increase In Earnings

Credit costs will normalize in 2023

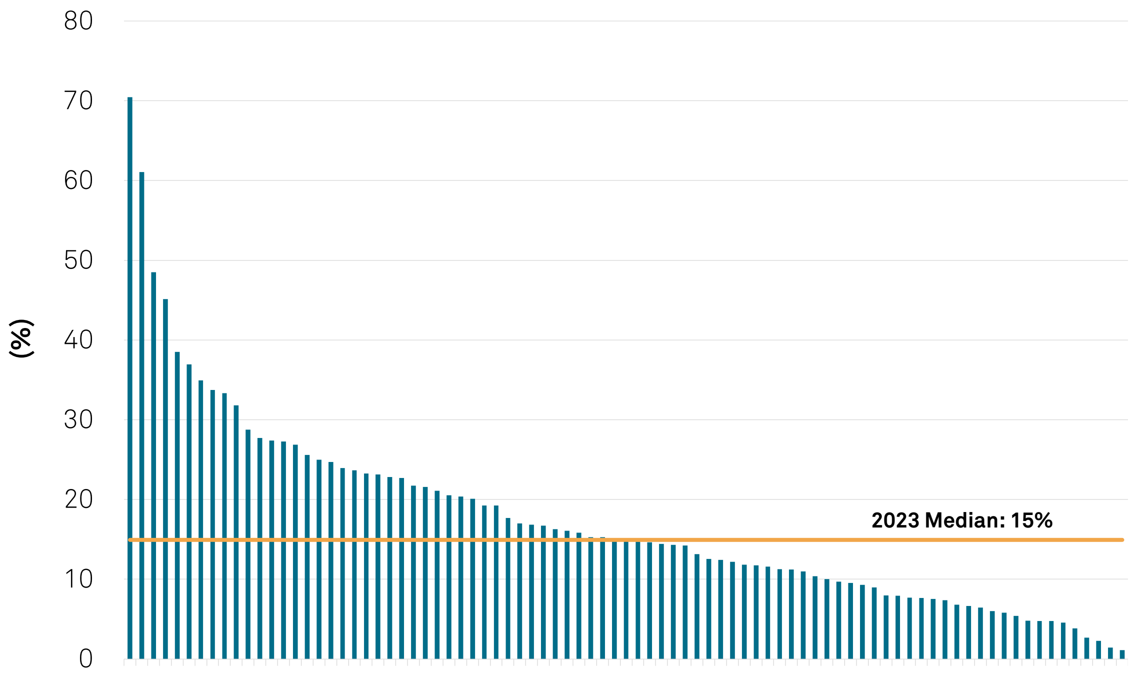
Net new credit loss provisions / gross customer loans (%) - European rated banks



Data for top 100 European rated banks excluding Swiss banks. f--Forecast. Source: S&P Global Ratings.

But additional credit provisions will be easily absorbed by earnings

Credit losses as a proportion of pre-provision earnings (2023f)



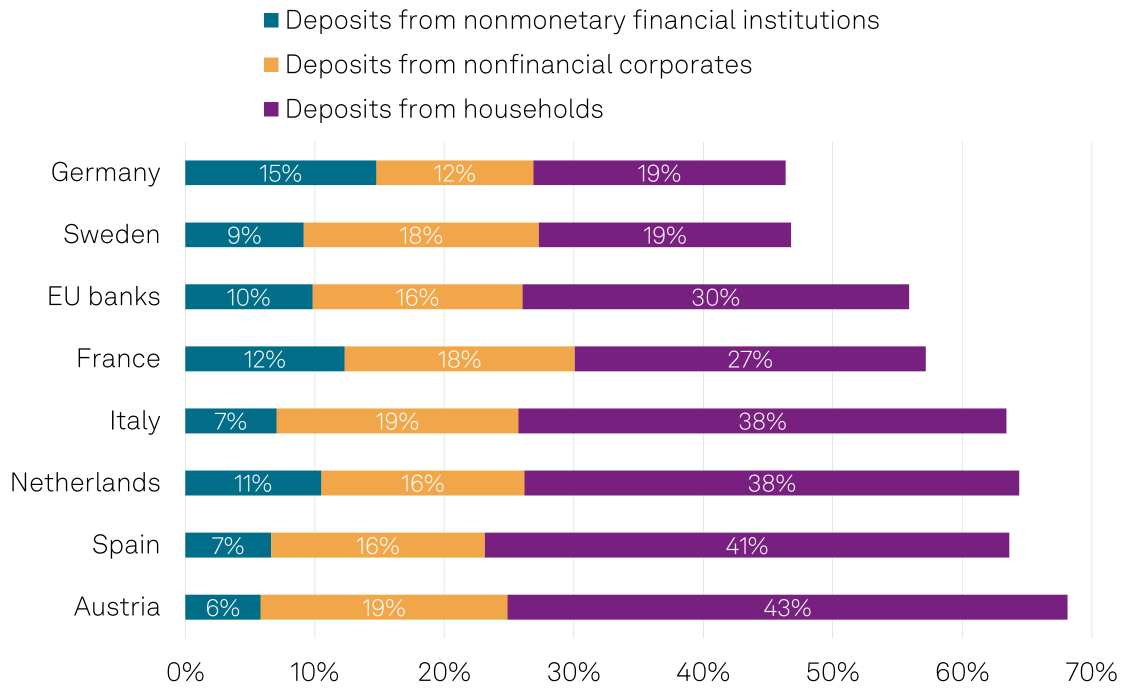
f--Forecast. Data for top 100 European rated banks excluding Swiss banks. Source: S&P Global Ratings.

S&P Global Ratings

Access To Stable And Low-Cost Funding Will Be A Competitive Advantage

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

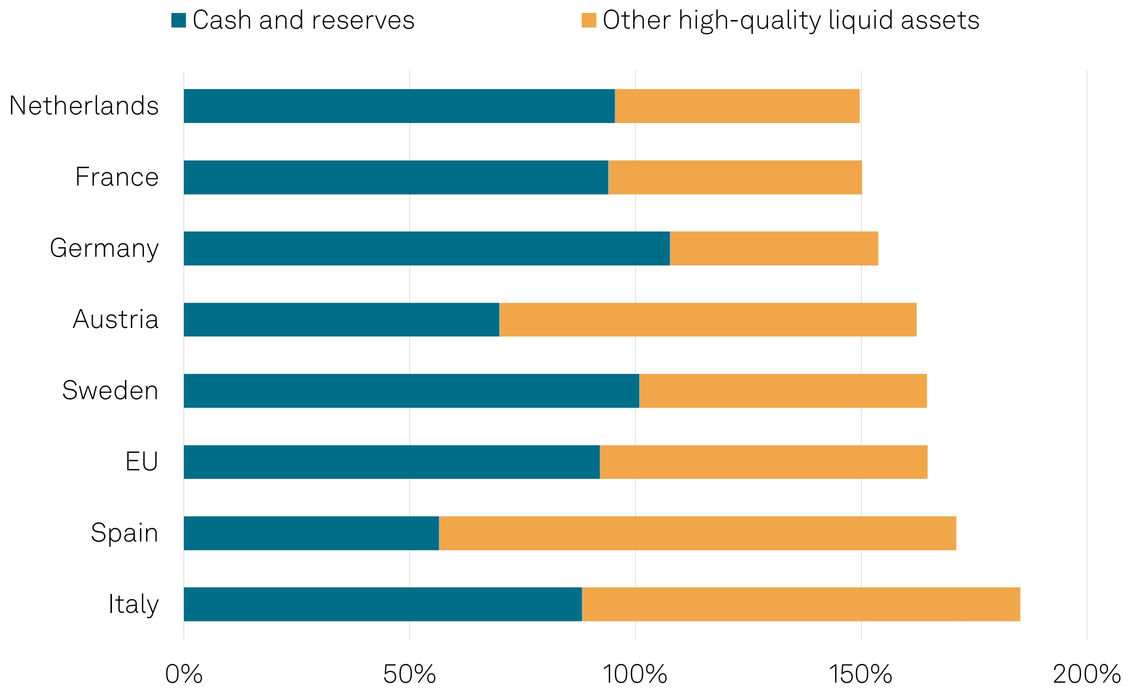
Share of customers' deposits over total funding for large European banks at year-end 2022



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

High liquidity buffers with limited duration risk provide resilience to potential funding shocks

Composition of liquidity coverage ratio of large European banks at year-end 2022



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

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Key Risks For Banks In Emerging Market (EM) EMEA

We foresee three main risks for EM-EMEA banks in 2023-2024.

Global liquidity

- Scarcer and more expensive global liquidity will pressure externally leveraged EM-EMEA banks and countries.
- Key indicators for surveillance: net external debt contribution to total funding, nature of external debt, rollover rates throughout the year, and overall cost paid by banks.
- Vulnerable banking systems: Turkiye, Tunisia, Egypt.

Weaker asset quality

- For some EM-EMEA banks, 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 2023-2024.
- Key indicators for surveillance: nonperforming loans, evolution of Stage 2 loans, cost of risk.

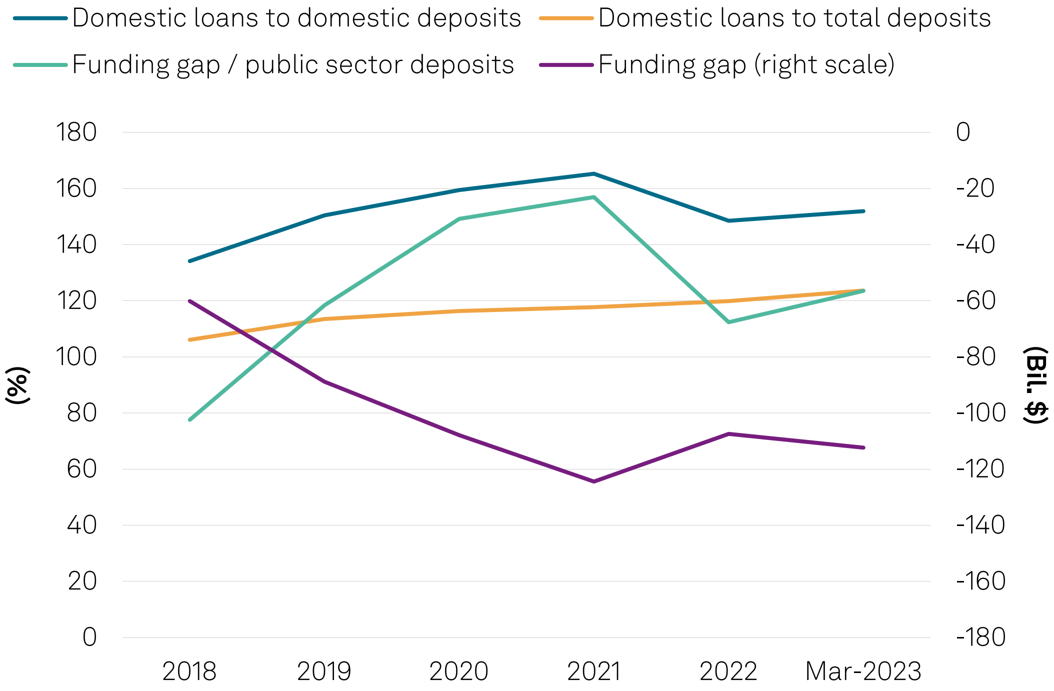
Policy choices

- Adoption of a resolution regime in South Africa, the provision of liquidity support in Saudi Arabia, and the evolution of monetary policy in Turkiye are among the key drivers for EM-EMEA banks in 2023-2024.

GCC | More Deposits Needed For Saudi, Lower External Funding For Qatar

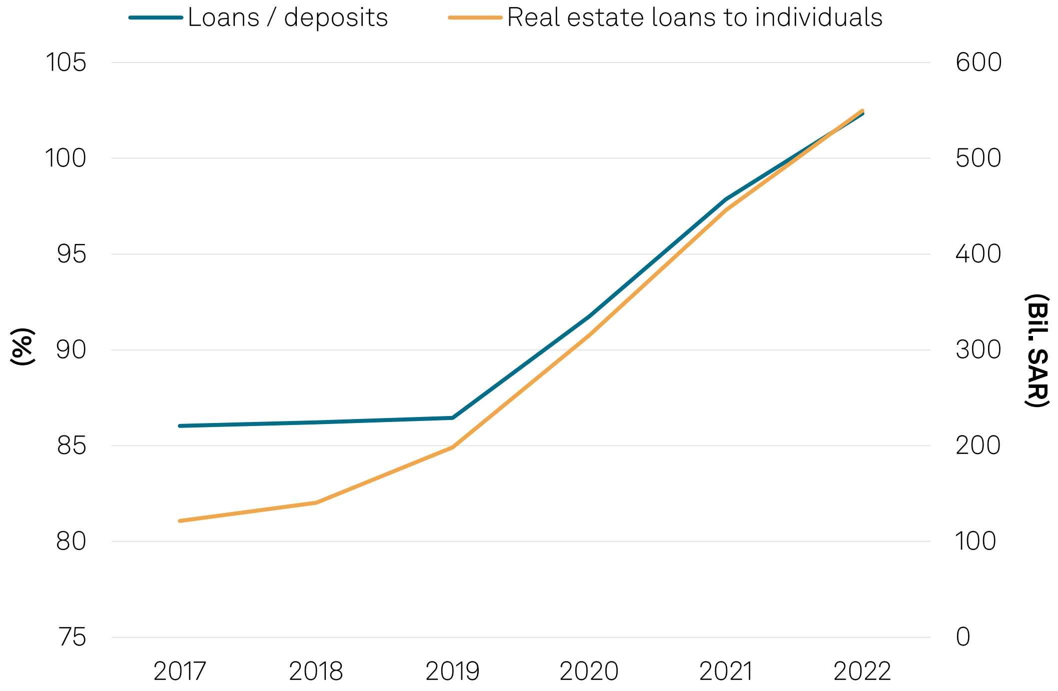
Qatari banks are the most vulnerable to external funding and Saudi banks may require additional support

Qatari banks' external debt is high



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

Saudi banks' deposits are no longer sufficient

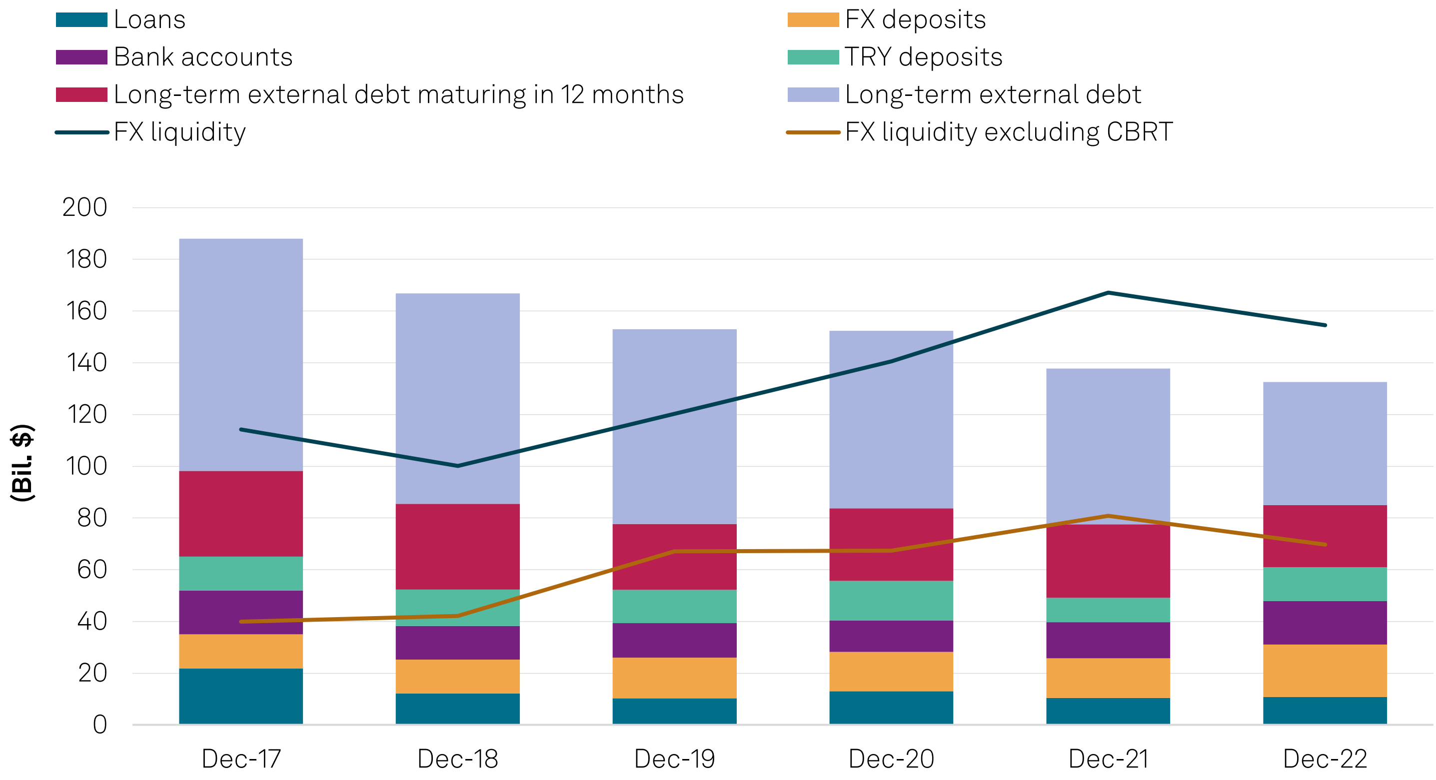


SAR--Saudi riyal. Sources: Saudi Central Bank, S&P Global Ratings.

S&P Global
Ratings

Turkiye | External Debt Rollover Rate Drop Is A Key Risk

External funding and foreign currency liquidity profile



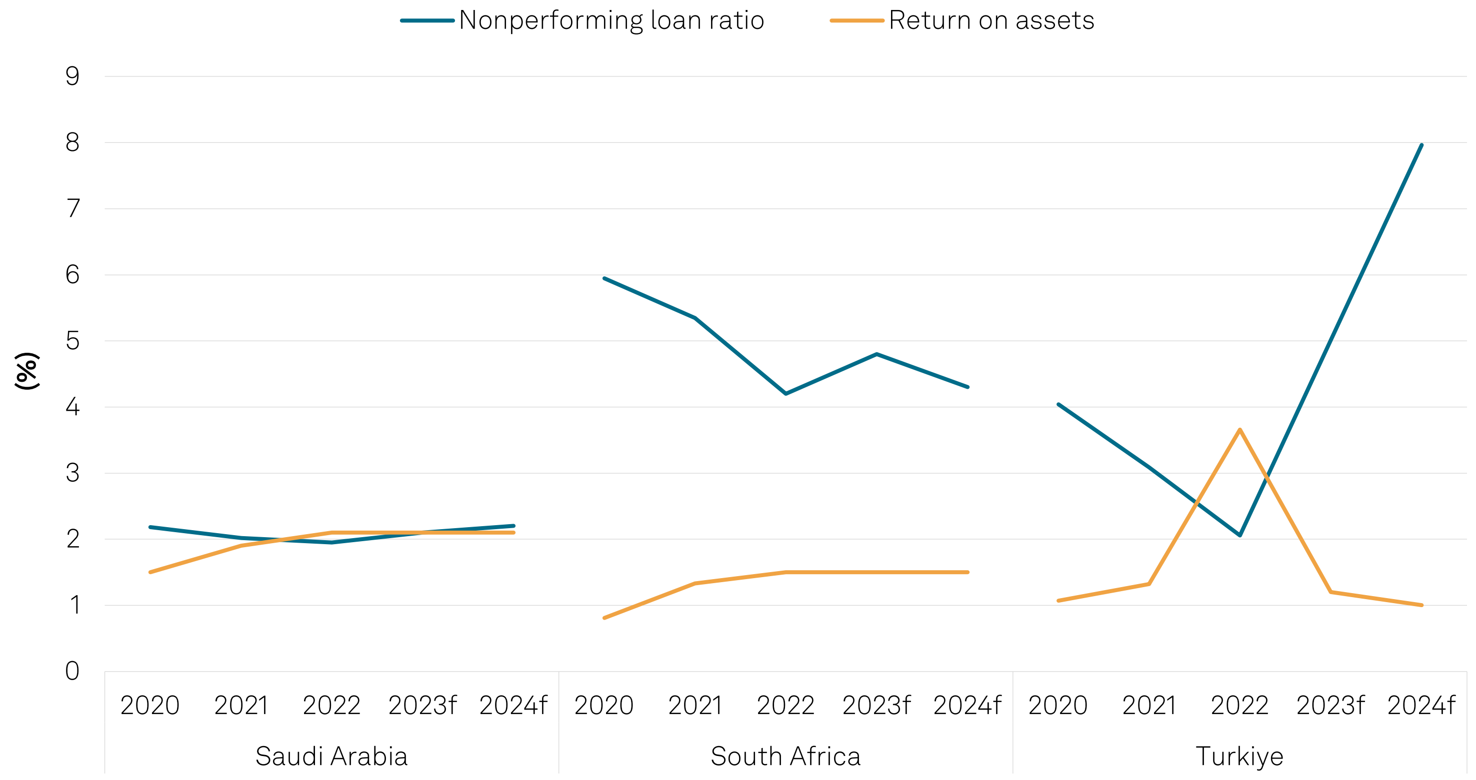
CBRT--Central Bank of the Republic of Turkiye. FX--Foreign exchange. TRY--Turkish lira. Source: S&P Global Ratings on CBRT and Banking Regulation and Supervision Agency data.

- Although declining, external debt is still high.
- Liquid assets in foreign currencies, before haircut, should be enough to cover upcoming wholesale funding maturities over the next 12 months.
- But these assets might not be fully and immediately available in case of need.
- Rollover rates need to remain relatively high to avoid banks using their foreign currency liquidity at the central bank.

Asset Quality: Some Deterioration Ahead

Some countries will suffer more than others

Asset quality and profitability for selected EM-EMEA countries

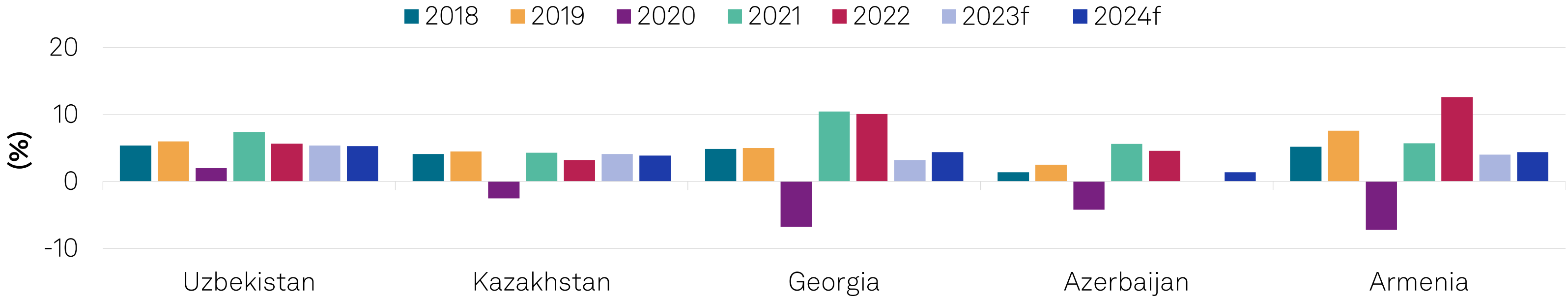


Source: S&P Global Ratings

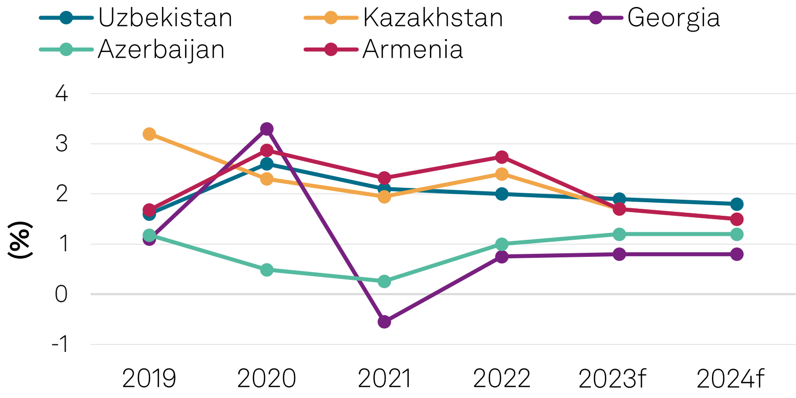
- Lower economic growth, still high or rising inflation, higher interest rates, and expansion in riskier geographies are likely to weigh on asset quality indicators in 2023-2024 for some EM-EMEA banks.
- Turkiye: Depending on how monetary policy evolves, we expect the unwinding of economic imbalances to result in a significant increase in nonperforming loans, while cost of risk will remain high (at about 350 basis points).
- For South Africa, the energy crisis, infrastructure gaps and pressured household income will likely result in a mild deterioration of asset quality.
- In Saudi Arabia, despite the slowing economy, we expect relatively stable asset quality as lending growth remains relatively strong.

Central Asia And The Caucasus: Economic Growth Supports Recovery

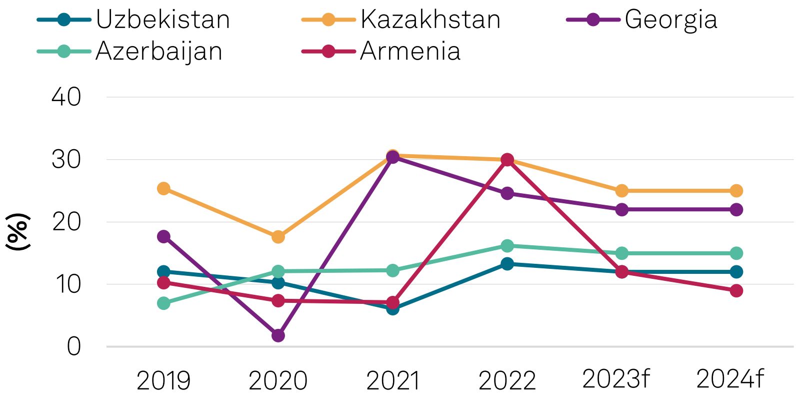
GDP growth prospects remain solid across the region



Credit costs are stabilizing on the back of economic recovery



ROE improvement in 2022 supported by business growth and noninterest income



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

- Except for Azerbaijan, good economic growth will continue supporting recovery in the banking sectors despite still high inflation and persisting high geopolitical risks. We expect retail lending to be the main growth driver over 2023-2024.
- Gradual normalization of credit costs and stabilization of nonperforming loans will support profitability. Unusually strong non-interest income in 2022 was an important contributor to profitability but will likely normalize in 2023.
- Economies and banking sectors of Armenia, Georgia, Uzbekistan, and Kazakhstan experienced high positive impact from a very strong inflow of migrants and money in 2022 due to the Russia-Ukraine war. We expect these inflows to start diminishing from 2023. External funding risk remains manageable.

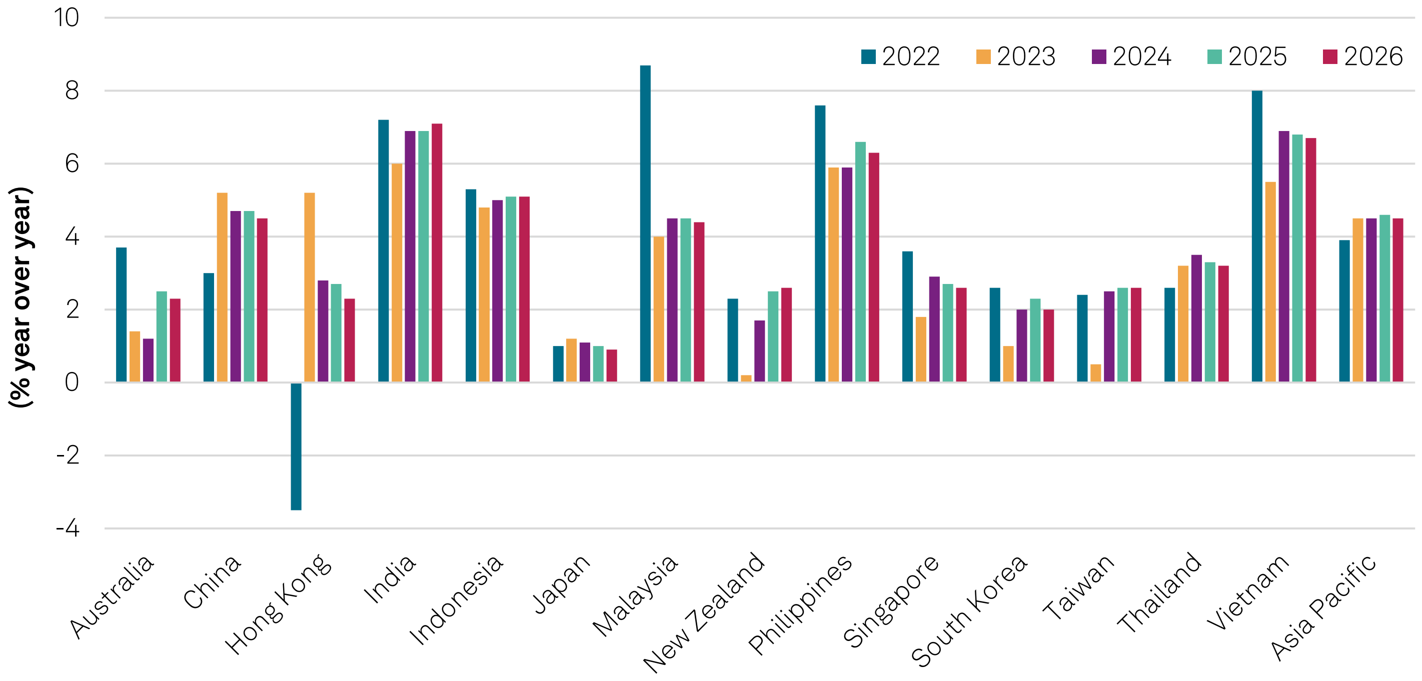
Asia-Pacific

Credit Conditions: Asia-Pacific

- **Evolving risks.** A desynchronized global economy in terms of growth, inflation and policy interest rate trends is complicating the region's credit outlook. The key export market of the U.S. seems headed for a soft economic landing.
- **High rates.** With interest rates and inflation set to stay high for longer (except China), borrowers and customers are increasingly accustomed to higher financing costs and prices. We therefore see risk around access to financing as high and unchanged.
- **Slower exports.** We assess the risk of a hard landing for the global economy as high and unchanged. While weaker global demand will slow export and manufacturing activities, the resumption of social mobility and consumption across the region will offset the drag. We've lowered Asia-Pacific's GDP growth marginally to 4.5% in 2023 and 2024.
- **China dims.** China's recovery momentum post-COVID is ebbing, waylaid by weak business and household confidence. High youth unemployment and lingering property weakness further sour sentiment. The introduction of policy stimulus could limit the slowdown in growth.

Domestic Demand, Inflation Relief Support Asia-Pacific's Outlook

Real GDP Growth Forecast



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 risks intensify.** Banks' net interest margins benefit from higher interest rates, but materially weaker economic prospects or higher-for-longer interest rates will eventually hurt banks' asset quality. A much weaker economic outlook could strain Asia-Pacific financial institutions. This is especially the case amid already-highly leveraged corporate, household, and government sectors, and a property market experiencing pockets of stress.
- **Weaker confidence.** A significant escalation of global banking turmoil or greater contagion spillover outside our base case could side-swipe otherwise sound Asia-Pacific banks.
- **Structural risks**. Climate change, cyber risks, and digitalization trends affecting the competitive landscape are structural risks that will increasingly test banks and borrowers.

...and what they mean for the sector

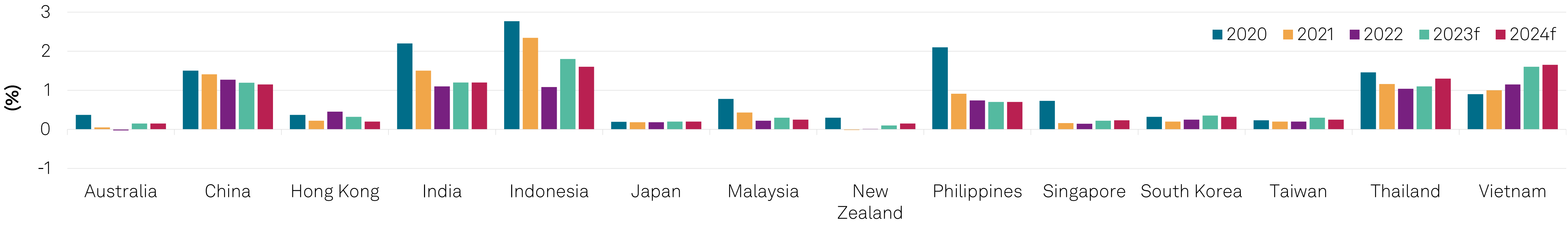
- **A strain on asset quality.** Net interest margins for most financial institutions are benefitting from higher interest rates. However, if economic hurdles are much worse than we now anticipate, this will dampen credit demand, strain corporate and household borrowers, and affect banks' asset quality.
- **Greater credit differentiation**. Potentially more vulnerable are Asia-Pacific financial institutions with high direct exposures to weak counterparties or sectors, or those that are inherently weaker and non-systemically important--such as some nonbank financial institutions

What we expect for next 12 months

- Most Asia-Pacific banks can absorb stresses associated with **funding and property** at current rating levels unless risks intensify meaningfully.
- Much weaker growth and higher interest rates **outside our base case** will test rating outlooks, as will much weaker-than-anticipated asset quality.
- **Most rating outlooks are stable**, and we expect this scenario to persist throughout 2023, noting that risks generally remain on the downside.

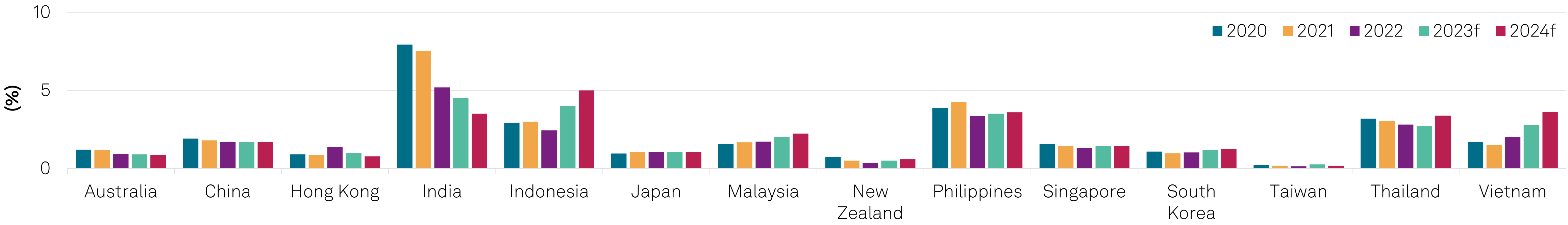
Asset Quality Will Strain

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.

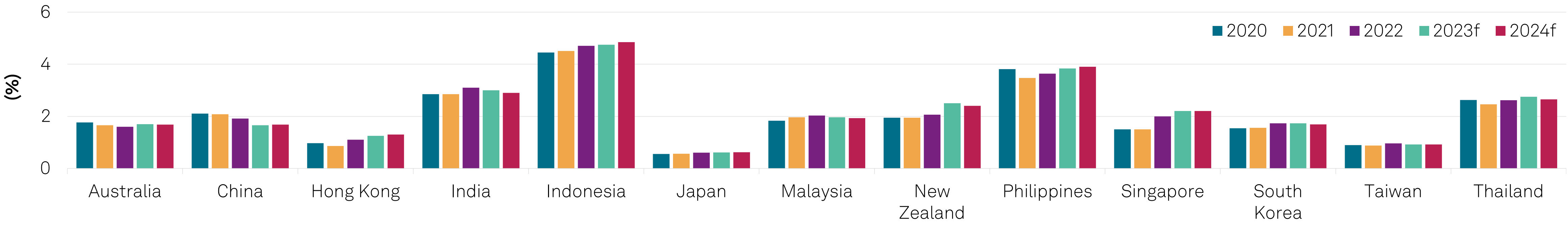
Nonperforming assets will remain elevated in some jurisdictions



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.

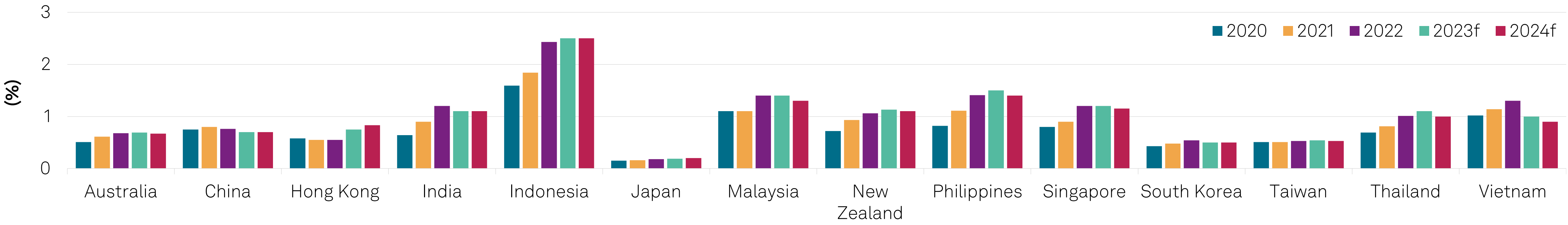
Earnings Yet To Recover To Pre-COVID Levels

NIMs recovering with rising interest rates



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

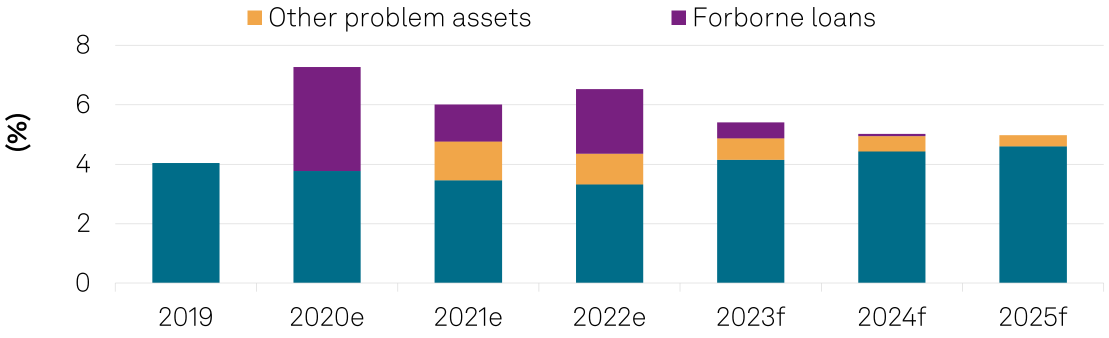
RoAA are yet to fully recover to pre-COVID levels for most banking systems



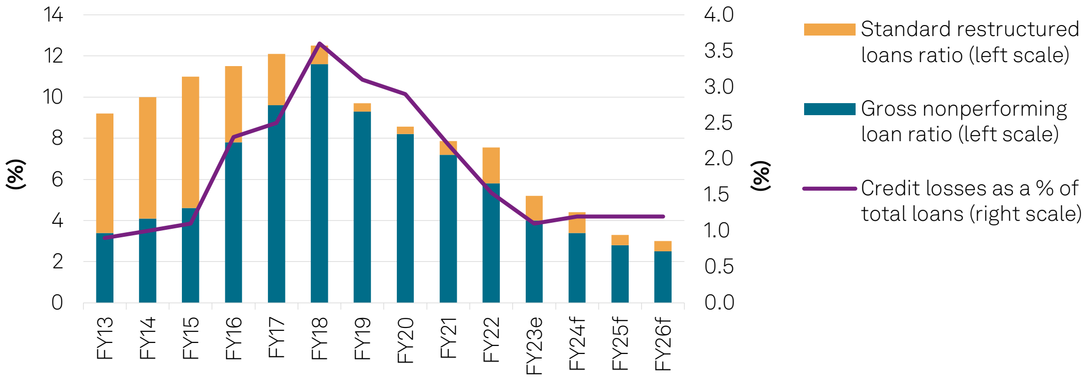
Note: Systemwide return on average assets (ROAA). For India and Japan, 2020 refers to fiscal year ended March 31, 2021. f--forecast. 2021 is an estimate for India. Source: S&P Global Ratings.

Asia-Pacific Banks

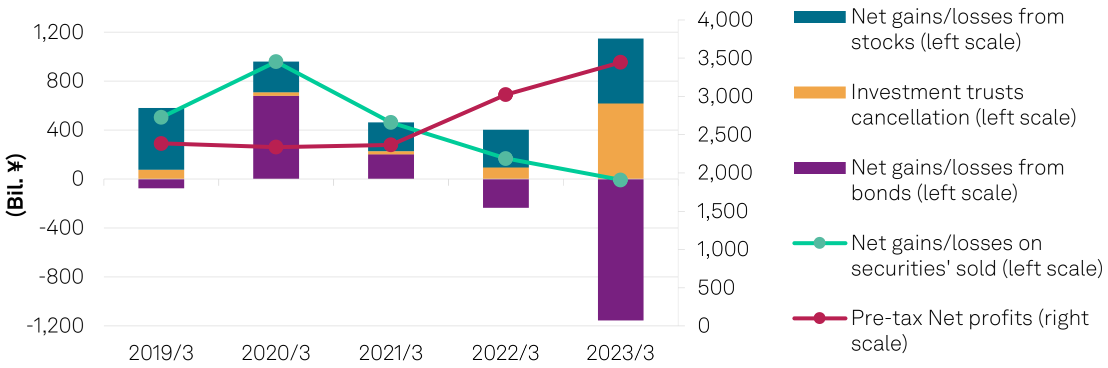
China: Official NPL and SML ratios likely to increase as more problem assets are recognized



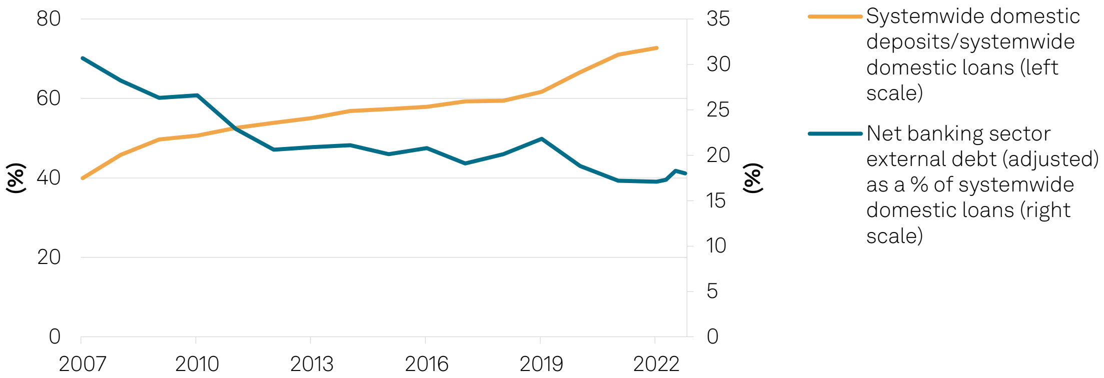
India: Banks' asset quality improvement to persist



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



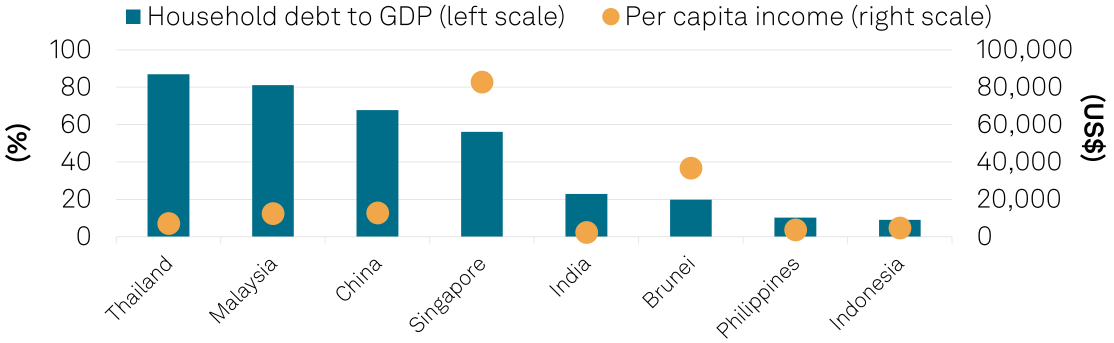
Australia: Industry risks could diminish in the next two years



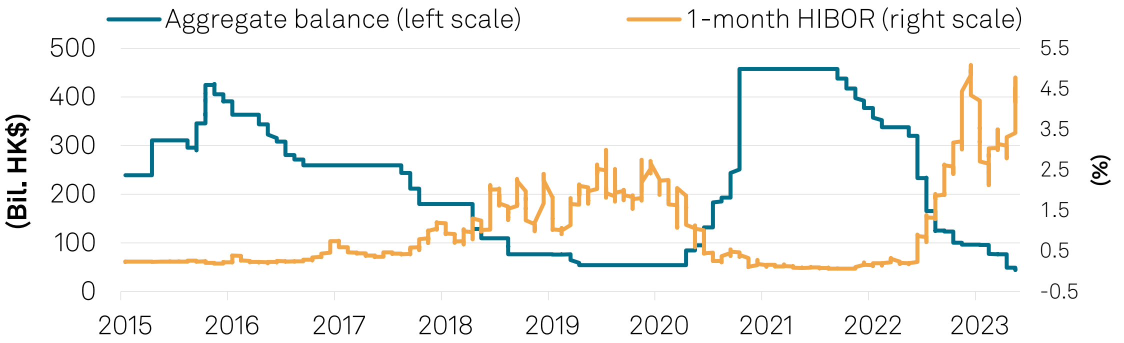
1. NPL--Nonperforming loan. SML--Special mention loan. NPA--Nonperforming assets. 2. Data for fiscal years, all ended March 31. FY--Fiscal year. Source: Reserve Bank of India, S&P Global Ratings calculation and estimates. 3. Chart for Japan reflects "Pre-tax Net profits" and "Net gains/losses on securities'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

Asia-Pacific Banks

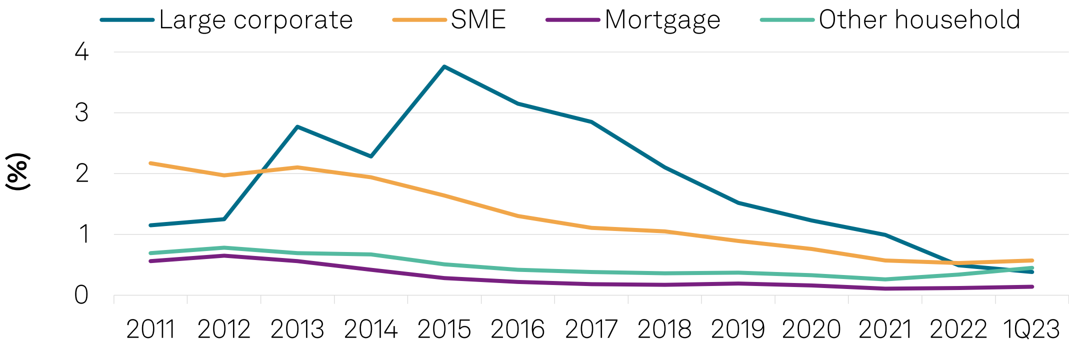
SSEA: High household leverage in Thailand and Malaysia poses credit risks



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



Korea: Some asset quality deterioration will likely be manageable



Taiwan: Improved core earnings helps to absorb rising credit costs

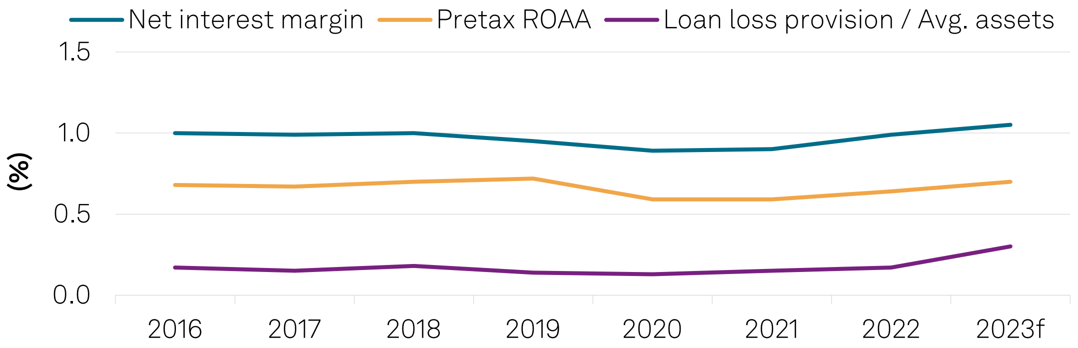


Chart reflects Korean banks regulatory nonperforming loan ratios by segment. ROAA--Return on average assets. f--Forecasts. Source: Financial Supervisory Commission, Taiwan Ratings Corp.

S&P Global Ratings

Latin America

Credit Conditions: Latin America

- We project GDP growth for the region to slow to 1.1% in 2023, from 3.7% in 2022, due to the weak domestic demand. We expect growth to recover only moderately to 1.5% in 2024, below its potential of 2.0%-2.5%.
- Weak domestic demand, lower commodity prices, and stronger exchange rates will help moderate inflation in the near term. This will allow central banks to start lowering interest rates, with Chile and Brazil starting this year and other major economies early in 2024.
- Downside risks to our outlook include weaker-than-expected growth and higher-than-anticipated interest rates in the U.S., as well as the potential impact of the El Niño climate pattern on inflation and agricultural production. Political uncertainty in the region remains high, which will keep investments subdued.

GDP growth forecasts (%)

	2019	2020	2021	2022	2023f	2024f	2025f	2026f
Argentina	-2.0	-9.9	10.4	5.2	-2.0	0.5	2.0	2.1
Brazil	1.2	-3.6	5.3	3.0	1.7	1.5	1.8	1.9
Chile	0.7	-6.2	11.9	2.5	0.3	2.4	2.8	2.9
Colombia	3.2	-7.3	11.0	7.3	1.4	2.0	2.9	3.0
Mexico	-0.2	-8.2	4.9	3.0	1.8	1.5	2.1	2.1
Peru	2.2	-11.1	13.5	2.7	1.8	2.6	2.8	3.0

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

Credit Conditions: Latin America

Profitability To Remain Solid Despite Weak Macro Conditions

Downside Risks...

- Given the **very rapid monetary tightening** and persistently high inflation in advanced economies in the region, the risk for monetary overshooting and an economic hard landing is significant. Uneven economic activity is weighing on global trade and commodity prices and creating problems for Latin American exporters.
- As inflation wanes, **policy rates should gradually fall at the beginning of 2024.** However, we don't expect them to go back to the low levels of past years. While financing conditions may improve as economic trends stabilize, persistently high rates will probably keep funding costs high for Latin American issuers, especially for lower-rated ones.

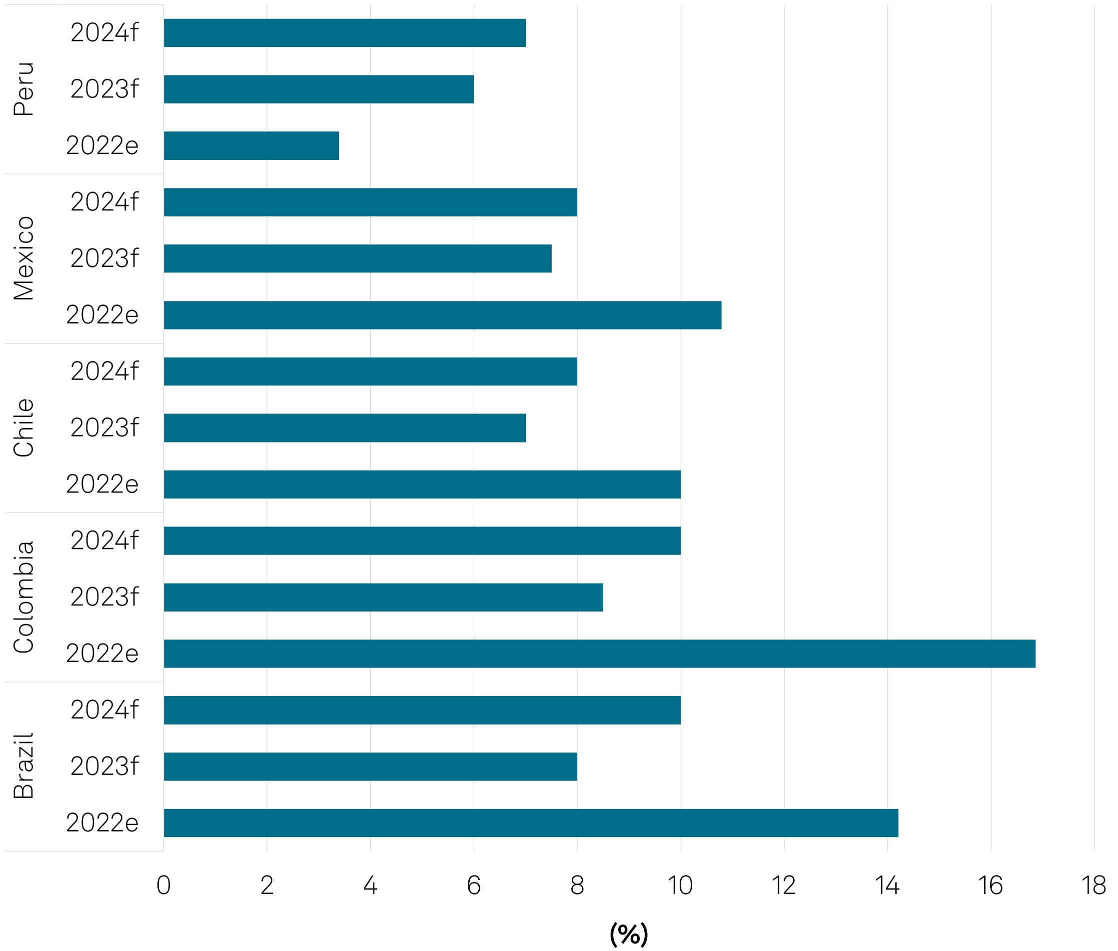
...and what they mean for the sector

- We expect **nonperforming loans (NPLs) to continue increasing**, while credit losses should remain manageable thanks to good provisioning coverage. Soft economic growth and lower credit growth will likely push up the NPL ratios. We expect unsecured consumer and middle market loans to drive asset quality deterioration.
- Provisions will likely **pressure profitability** this year. However, it will likely remain solid thanks to banks' high margins relative to peers. Banks will keep operating with solid capitalization and sound liquidity.

What we expect for next 12 months

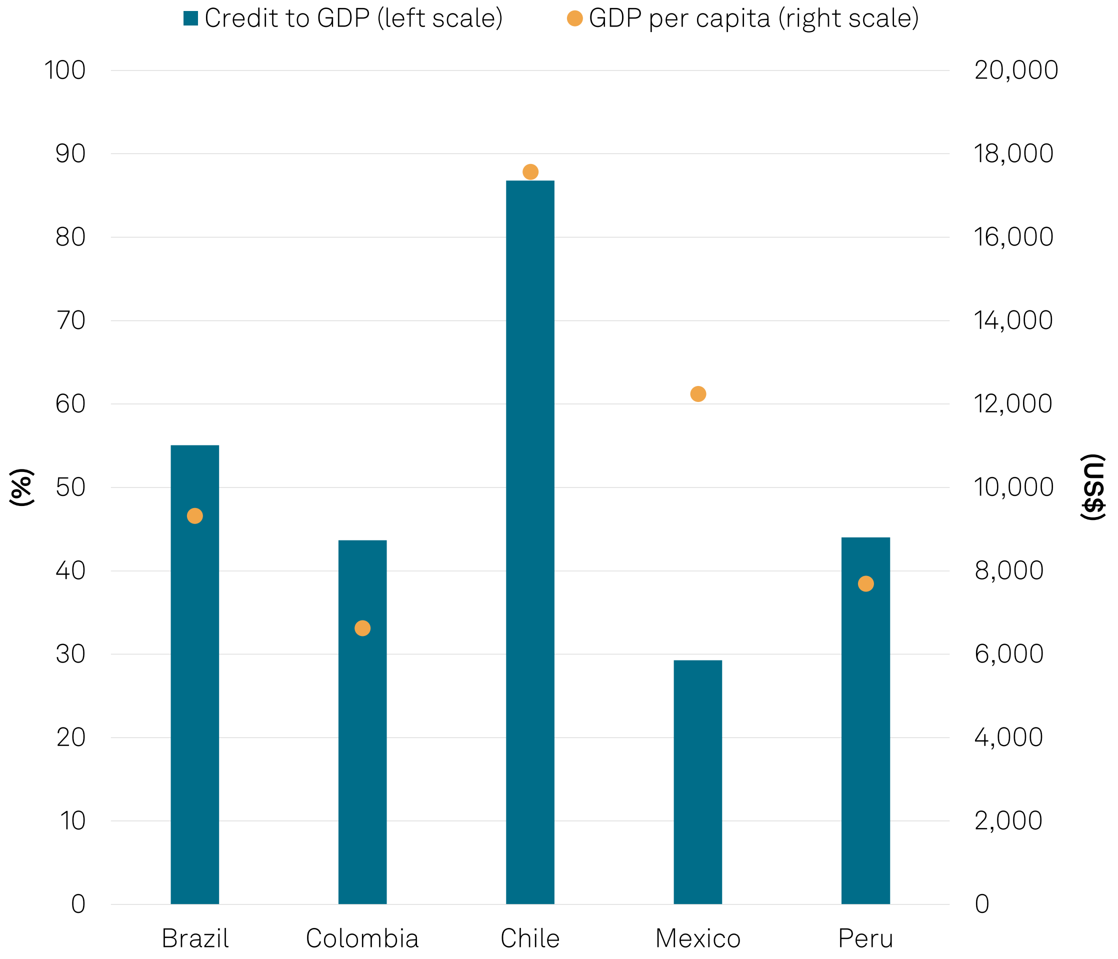
- **Lending growth should moderate in 2023**, due to banks' lower risk appetite as asset quality metrics continue to weaken. The soft economic performance and political uncertainty, which limit investment and internal demand, will contribute to slower credit growth.
- Banks are used to operating in **challenging 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 similarly to all regulated entities.

Weak credit growth in 2023 and limited rebound in 2024



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

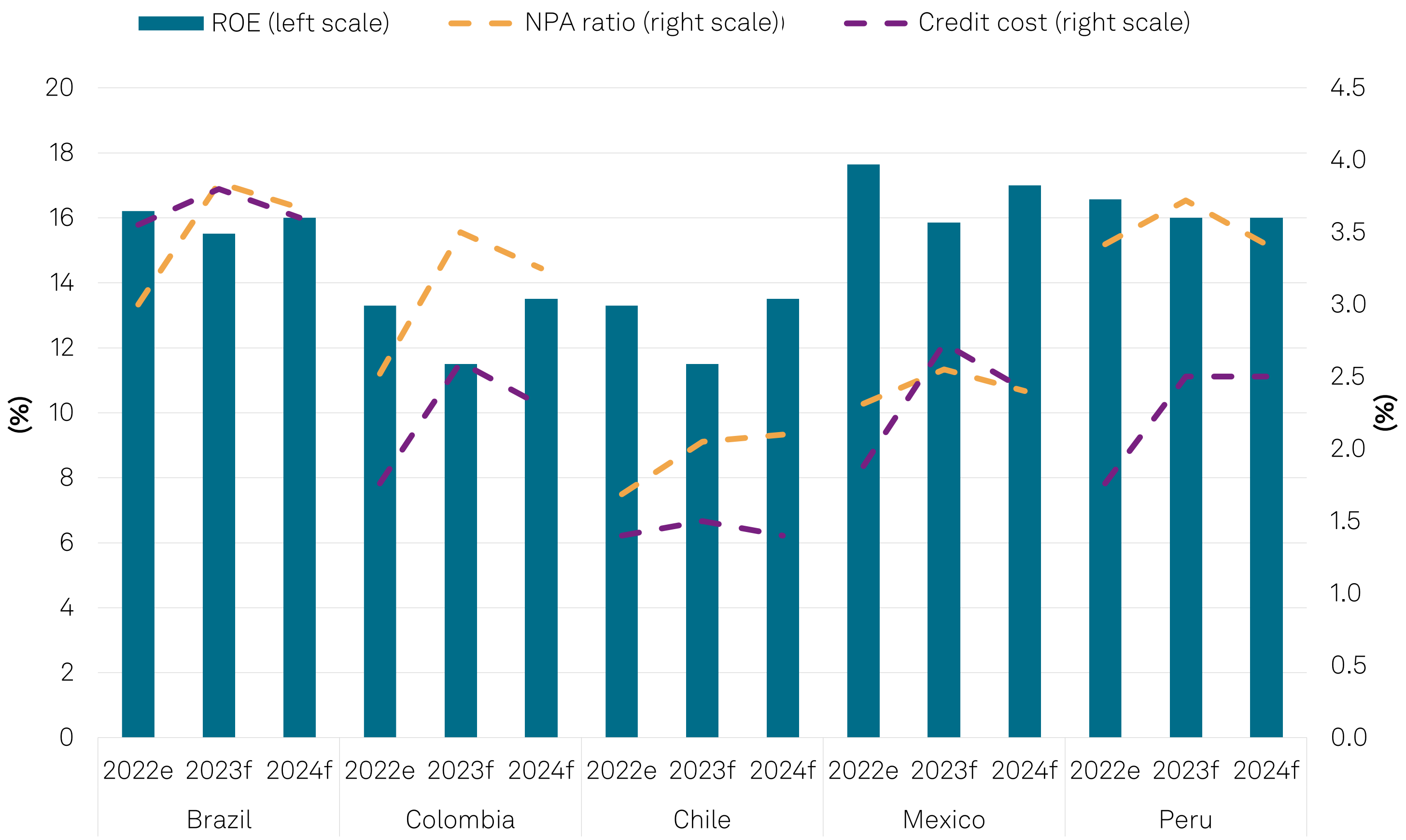
Access to credit remains low (except for Chile)



Source: S&P Global Ratings.

Weakening Asset Quality Metrics, But Still Good Profitability

Profitability and asset quality metrics (%)



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

- Although we expect profitability to moderate in 2023, it should remain sound.
- Asset quality is deteriorating and will stabilize in 2024.
- Credit cost is rising but will stay manageable.

Interactive Dashboard

How to access the Global Banks Midyear Outlook 2023 Dashboard

The Global Banks Midyear Outlook 2023 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.

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