Banks in Emerging Markets

15 Countries, Three COVID-19 Shocks

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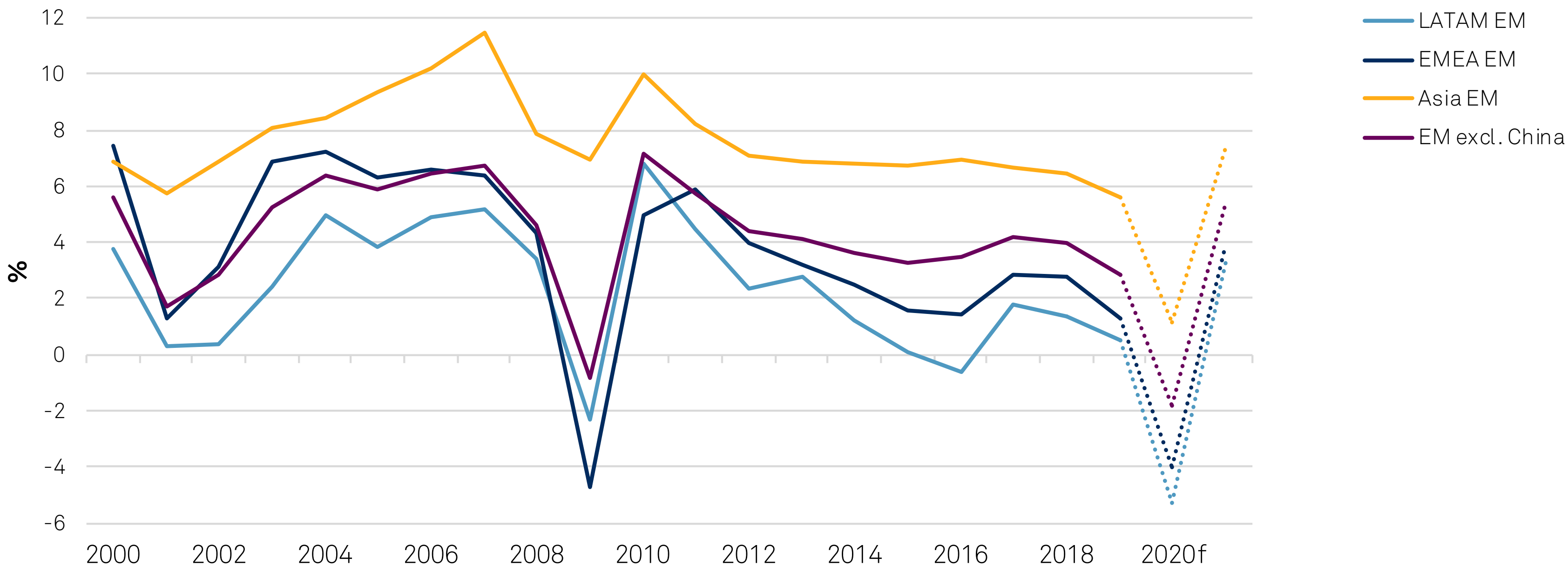
Key Takeaways

- About one-third of banks we rate in emerging markets now have a negative outlook following several rating actions and Banking Industry Country Risk Assessment changes in recent weeks reflecting the shift in their operating environment as a result of the COVID-19 pandemic.
- We see three channels through which COVID-19 could affect EM banks: deteriorating asset quality; heavy dependence on external funding; or, third, a lack of government capacity to extend support, weaker governance, or heightened likelihood of political or social tensions.
- The current shock will affect profitability rather than capital. Profitability in most EM bank systems will decline in 2020 on higher cost of risk and weaker interest revenues.

EM Economies | 2020 Will Be The Worst In Decades

– We forecast EM GDP will contract in 2020.
– The recovery will be uneven, depending crucially on policy responses to help limit economic dislocation.
– Risks are on the downside.

Emerging Markets' Real GDP Growth



Note: The average GDP aggregates are based on PPP GDP weights of selected major key EM economies covered in this report. EM--Emerging markets. Sources: Oxford Economics, S&P Global Ratings' forecasts.

EM Banks | Three Channels Of COVID-19 Shock

We see three main ways the COVID-19 shock may harm EM banks' creditworthiness:

– Deteriorating asset quality deterioration due to lower economic growth and concentration of EM economies on specific sectors such as hospitality or industrial or service exports to developed countries or commodities such as oil or gas.

– Heavy reliance on external funding amid changing investor sentiment toward some EMs.

– Lack of government capacity to provide extraordinary support, weaker governance, and a higher likelihood of political and social tensions.

Emerging Markets Banking Industry Country Risk Assessment (BICRAs) as of May 22, 2020

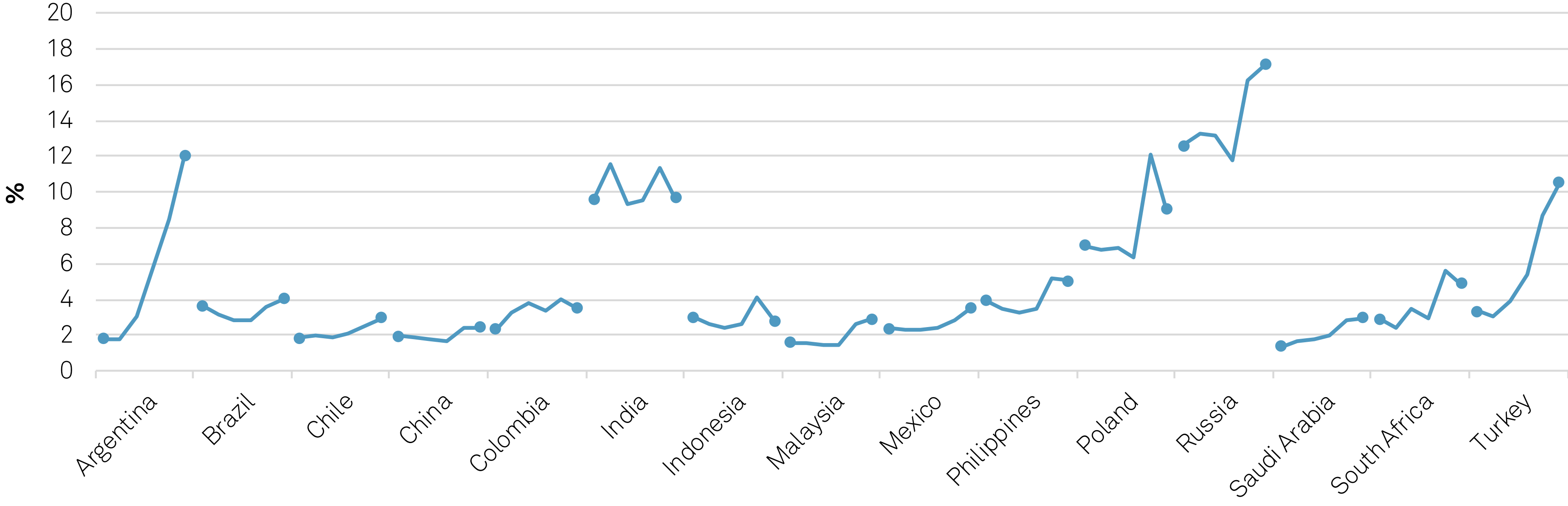
Country	BICRA group	Economic resilience	Economic imbalances	Credit risk in the economy	Economic risk	Institutional framework	Competitive dynamics	Systemwide funding	Industry risk
Argentina	9	Extremely high	High	Extremely high	10/S	High	High	Very high	7/N
Brazil	6	Very high	Intermediate	High	7/S	Intermediate	High	Intermediate	5/S
Chile	3	High	Low	Intermediate	4/N	Low	Intermediate	Low	3/S
China	6	Intermediate	High	Very high	7/S	High	High	Very low	5/S
Colombia	6	High	High	High	7/S	High	Intermediate	Intermediate	5/P
India	5	High	Low	Very high	6/N	High	High	Low	5/S
Indonesia	6	High	Low	Very high	6/N	High	High	Intermediate	6/S
Malaysia	4	High	Low	High	5/S	Intermediate	Intermediate	Low	3/S
Mexico	5	Very high	Very low	High	6/S	Intermediate	Intermediate	Low	3/S
Philippines	5	Very high	Low	High	6/S	High	Intermediate	Intermediate	5/S
Poland	4	High	Low	Intermediate	4/N	Intermediate	High	Intermediate	5/N
Russia	8	Very high	High	Very high	8/S	Very high	High	High	7/S
Saudi Arabia	4	High	Intermediate	Intermediate	5/S	Intermediate	Intermediate	Low	3/S
South Africa	6	Very high	High	High	7/N	Intermediate	Intermediate	High	5/S
Turkey	9	High	Very high	Very high	8/N	Very high	Very high	Very high	9/N

BICRA--Banking industry country risk assessment. N--Negative. P--Positive. S--Stable. Source: S&P Global Ratings.

EM Banks | Asset Quality Will Deteriorate

- We expect asset quality to deteriorate across the board, with NPLs increasing by more than 50% on average and potentially doubling in some countries. Factor to watch: Regulatory forbearance on classification that would delay the recognition of the problems.
- Banks with high exposure to SMEs, real estate lending, unsecured retail, or large corporates with open FX positions would be the most affected.

Asset Quality Indicators Will Deteriorate
NPLs as a percentage of total loans, 2016-2021f



f--Forecast. NPL--nonperforming loan. Source: S&P Global Ratings.

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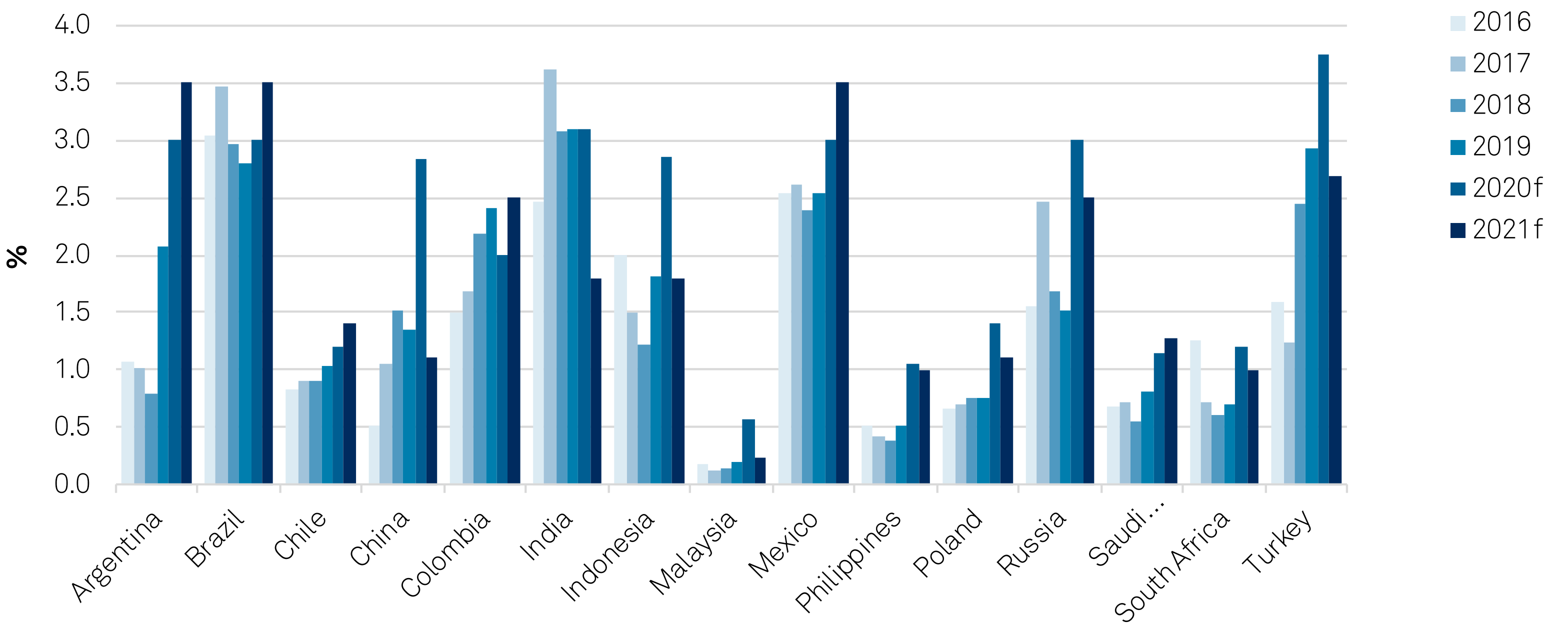
EM Banks | Credit Losses Will Increase

- While credit losses will increase, we think regulatory forbearance may delay their recognition and push some of the increase into 2021.
- Measures implemented by most central banks in the regions are helpful, but generally do not reduce credit risk on banks' balance sheets.

And Credit Losses Will Increase in 2020-2021



Note: Data for Argentina, Brazil, Chile, Colombia, and Mexico include net charge-offs. f--Forecast. Source: S&P Global Ratings.

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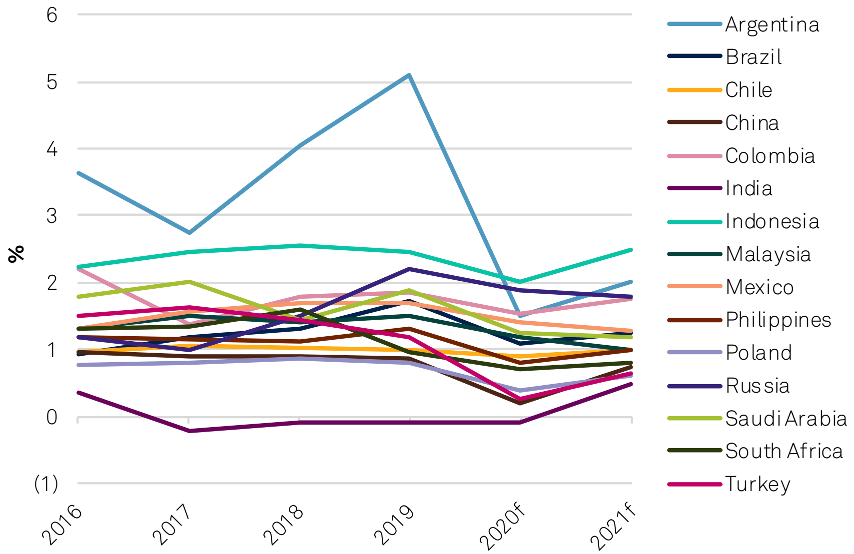
EM Banks | A Profitability, Not A Capital Event

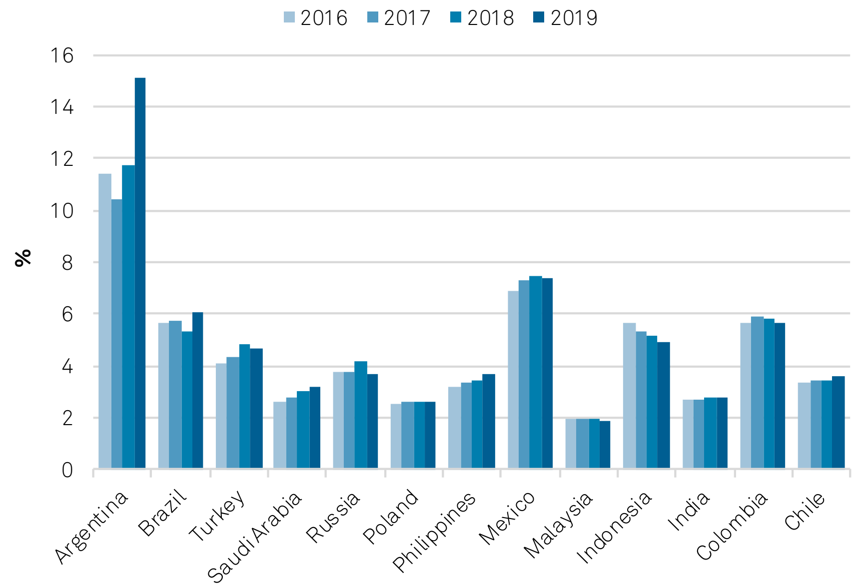
- Profitability will decline due higher cost of risk and, for some systems, lower interest margins. But we expect banks to remain profitable in 2020, except for those banks in India that are already grappling with a significant backlog of NPLs that will be aggravated by the current shock.
- EMs banks remain much more profitable than developed market banks due to hefty interest margins and good efficiency (in most countries, labor costs remain lower).

Profitability Will Deteriorate
Return on assets



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

But Banks Enjoy Strong Interest Margins
Net interest income to average earning assets

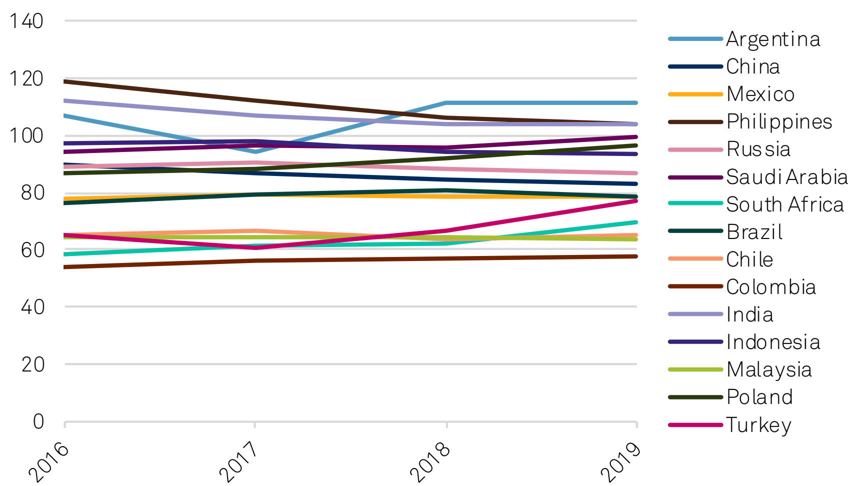


Source: S&P Global Ratings.

EM Banks | External Funding Is A Source Of Risk For Some Systems

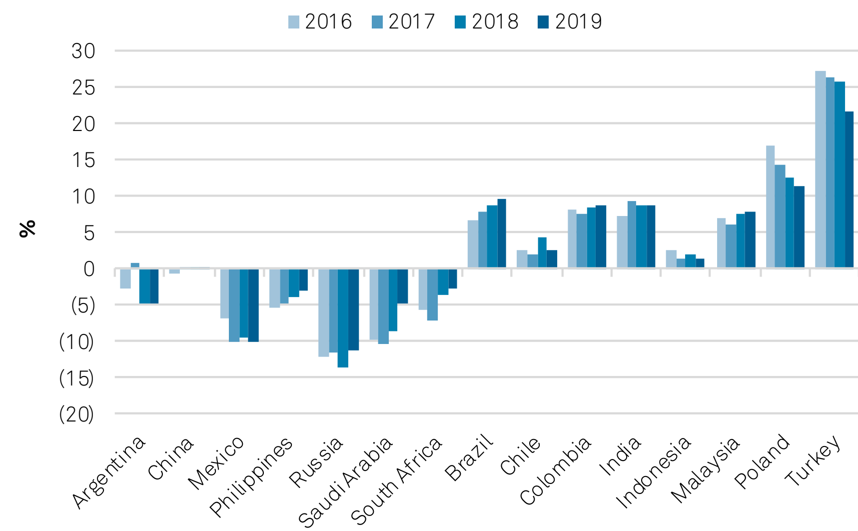
- EM banks fund their lending portfolios mainly through core customer deposits, sometimes supplemented with domestic capital markets. They are therefore either in net external asset position or have limited net external debt.
- Turkey is the exception. Its significant external debt, typically short term, exposes the banking system to roll-over risks. So far, banks have been able to roll a large portion of maturing debt. They also have some foreign currency denominated liquidity (a large portion of it is placed with the CBT).

Customer Deposits Dominate Funding Profile
Core customers deposits / systemwide loans



Source: S&P Global Ratings.

And Reliance On External Debt Is Limited
Net external debt / systemwide loans

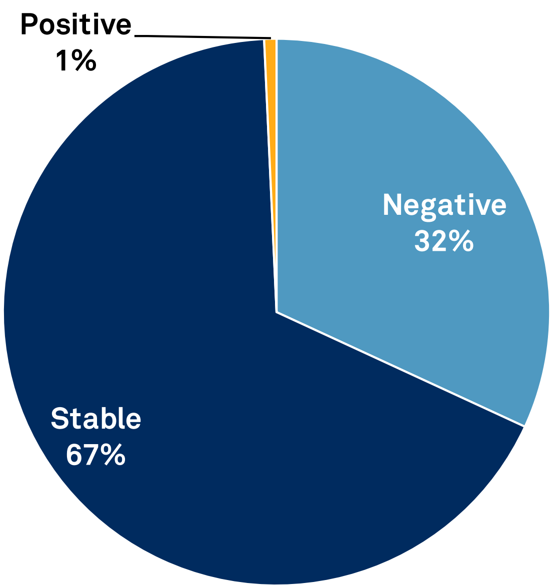


Source: S&P Global Ratings.

EM Banks | Risks Are Tilted To The Downside

- We recently revised our BICRA "economic Risk trend" to negative on Chile, India, Indonesia, and Poland. We revised the Economic Risk score on Mexico (to '6' from '5') and on South Africa ('7' from '6'). We revised the "Industry Risk" trend on Turkey to negative.
- Following in several rating actions on EM banks over the past weeks, and the risks remain tilted to the downside.

The Outlook Bias Is Turning Negative
As of May 22, 2020



Source: S&P Global Ratings

0% negative	1% to <32%	33% to <66%	67% to <99%	100% negative
Malaysia	Brazil	Colombia	Mexico	Argentina
Philippines	China	India	Poland	Chile
Saudi Arabia	Russia			Indonesia
South Africa				Turkey

Source: S&P Global Ratings,

EM Banks | Government Support Mitigates Risks

- We assess some countries as highly supportive and expect they would provide support to systemically important banks, if needed.
- Some jurisdictions are making progress to enhance their regulatory toolkits, but policymakers are cautious about eliminating possible extraordinary government support.

EMs Government Support Assessment (As of May 22, 2020)

Country	Government Support Assessment	FC Sovereign Ratings
China	Highly supportive	A+/Stable/A-1
India	Highly supportive	BBB-/Stable/A-3
Indonesia	Highly supportive	BBB/Negative/A-2
Malaysia	Highly supportive	A-/Stable/A-2
Philippines	Highly supportive	BBB+/Stable/A-2
Saudi Arabia	Highly supportive	A-/Stable/A-2
Brazil	Supportive	BB-/Stable/B
Chile	Supportive	A+/Negative/A-1
Colombia	Supportive	BBB-/Negative/A-3
Mexico	Supportive	BBB/Negative/A-2
Russia	Supportive	BBB-/Stable/A-3
Argentina	Uncertain	SD/--/SD
Poland	Uncertain	A-/Stable/A-2
South Africa	Uncertain	BB-/Stable/B
Turkey	Uncertain	B+/Stable/B

Source: S&P Global Ratings

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