S&P Global Ratings

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Global Banks Midyear 2018 Outlook:
Trade And Political Tensions To The Fore

July 23, 2018

Contents

Key Takeaways

— Credit conditions for banks remain broadly supportive, but the escalating trade battle between the U.S. and its trading partners, notably China, is dragging down investor confidence and weakening economic momentum.

— Borrowing conditions remain favorable but are leading to unsustainable private-sector indebtedness and asset price inflation in several developed and emerging markets.

— Countries and banking sectors with high exposure to international funding may face capital outflows if investors allocate capital to higher-yielding securities in developed markets.

— U.S. banks will benefit from rising interest rates, loan growth, and tax cuts. The regulatory reform bill passed in May 2018 will lessen regulation mainly on regional and community banks. We see emerging risks in auto loan, credit card, commercial real estate, and leveraged lending.

— The moderate economic momentum in Europe should help banks maintain sound or improving balance sheets but only offers modest support to revenues. Systemic banks will continue to build their bail-in buffers, improving protection for senior creditors.

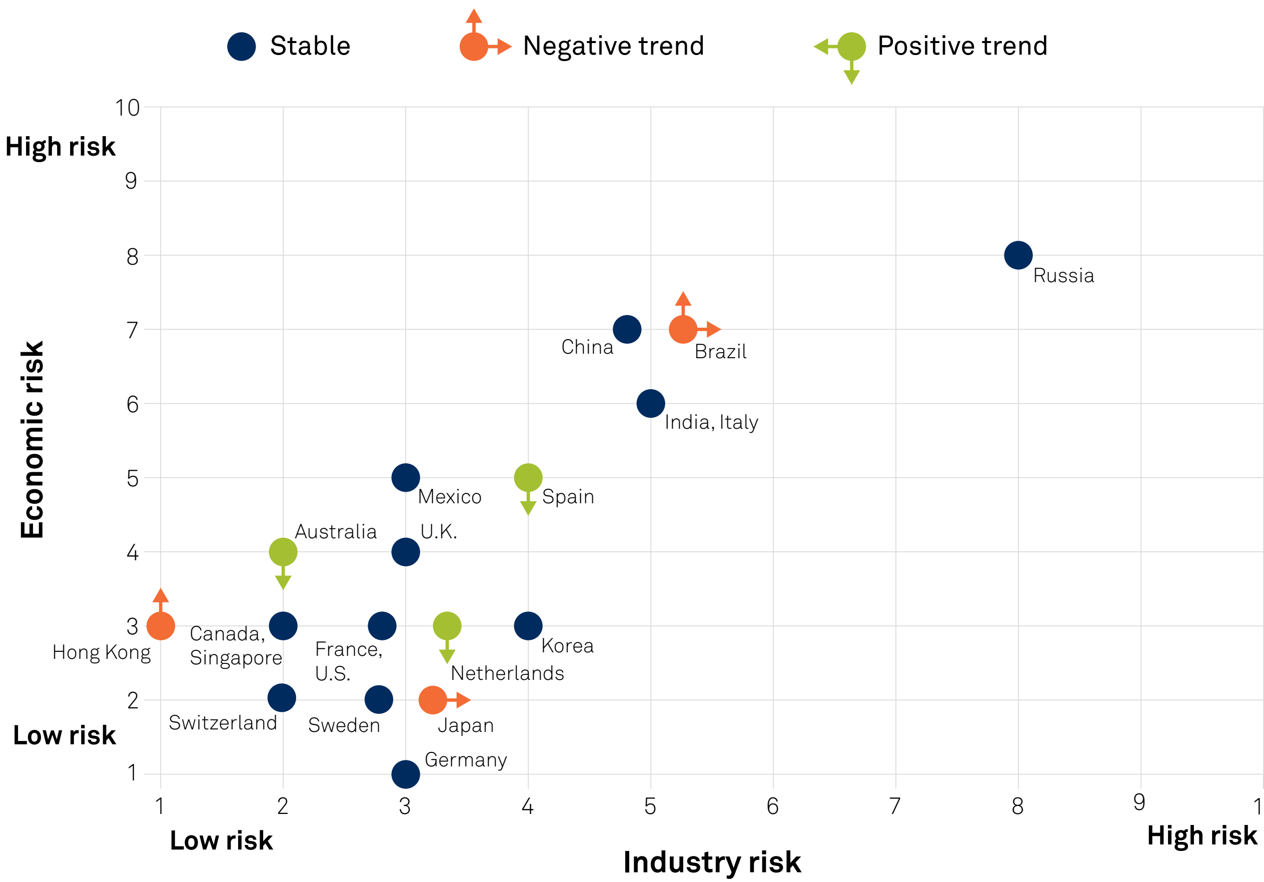
— The higher political risk in Europe is being translated into higher debt prices for banks, primarily in periphery countries. Concerns about fiscal sustainability in Italy could undermine confidence further. The risk of a disruptive Brexit is worsening.

— Political risk is on the rise in Latin America, especially in Argentina, Brazil, and Mexico. Pressure on the region's currencies could begin weighing on inflation and trigger monetary tightening.

— The implementation of IFRS 9 has not revealed significant hidden risks so far.

Trade and political tensions are increasing downside risks for banks at a time of high private-sector indebtedness and inflated asset prices.

BICRA And Trends: Top 20 Global Markets



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).

Key changes since Jan. 1, 2018

— BICRA on Spain **raised** to 4 from 5

— BICRA on Austria **raised** to 2 from 3

— BICRA on Turkey **lowered** to 7 from 6

— Industry Risk Score of Australia **lowered** to 3 from 2

— Economic Risk Score of Canada **lowered** to 3 from 2

Key trend changes since Jan. 1, 2018

— Economic Risk to **positive** from stable on Australia

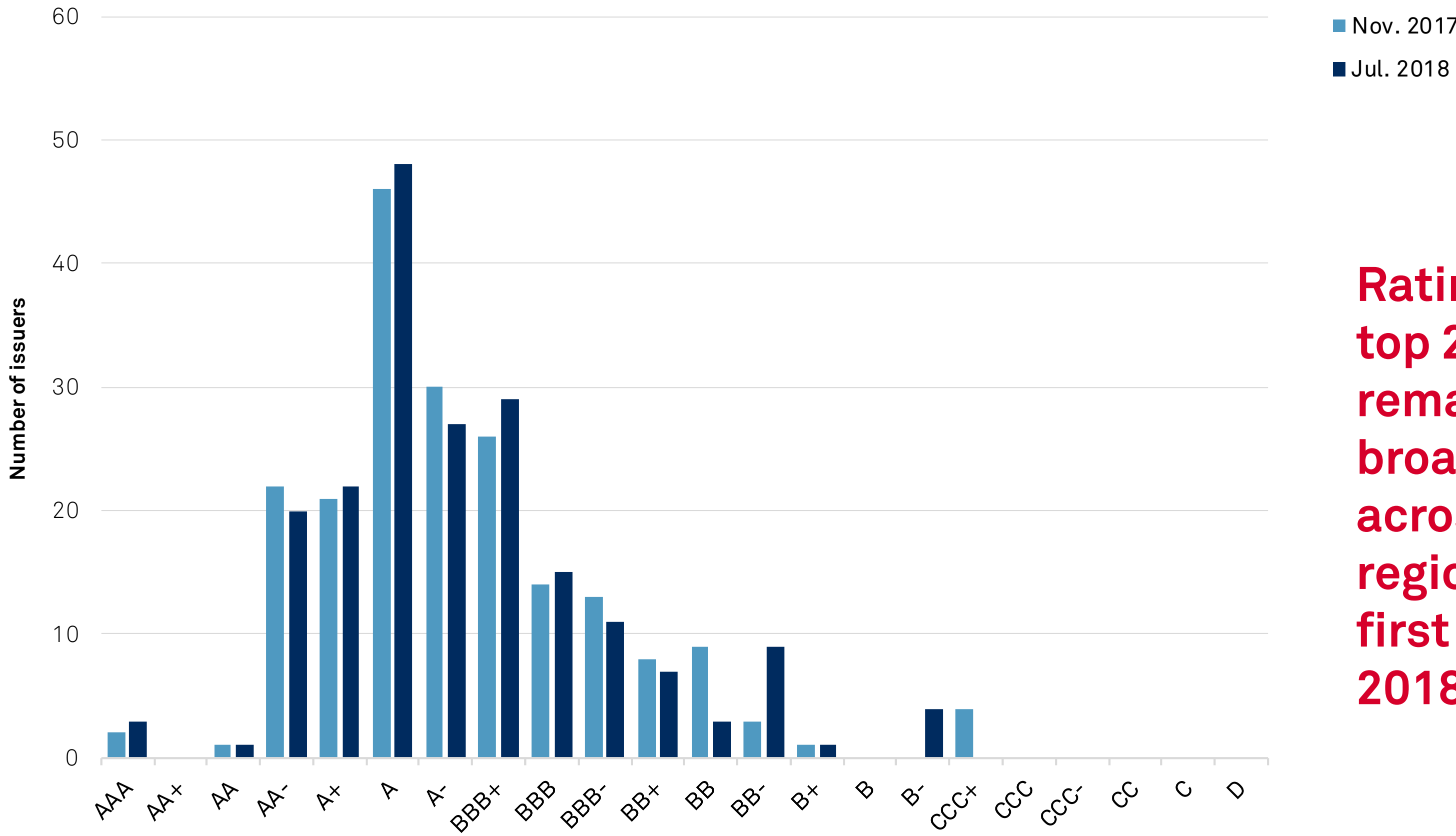
— Economic Risk to **positive** from stable on Greece

— Economic Risk to **positive** from stable on Egypt

— Economic Risk to **stable** from negative on Norway

— Economic Risk to **stable** from positive on Argentina

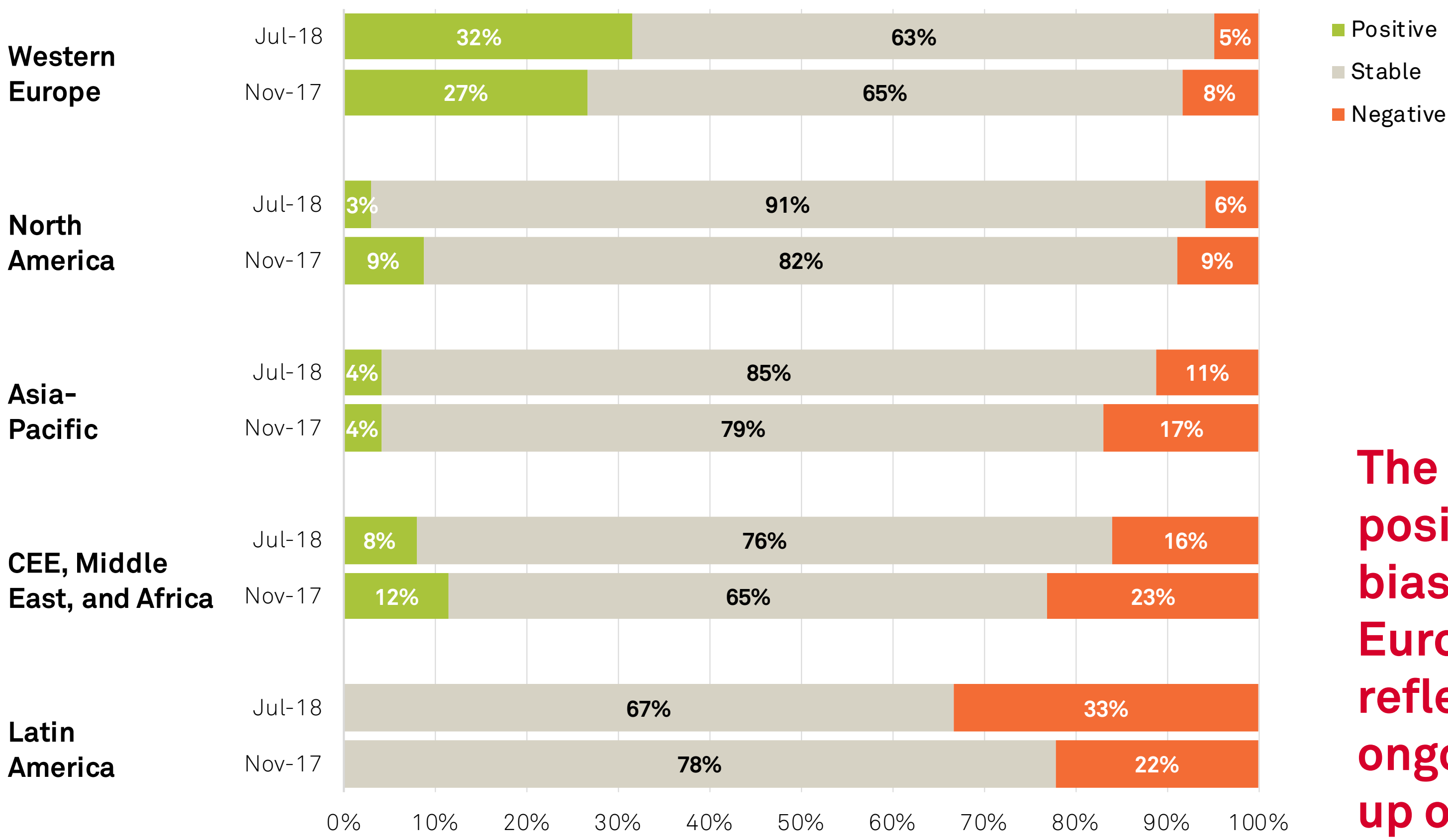
Ratings Distribution For The Top 200 Banks



Ratings of the top 200 banks remained broadly stable across various regions in the first half of 2018.

Operating company issuer credit ratings. Source: S&P Global Ratings. Data as of July 11, 2018.

Bank Outlooks By Region



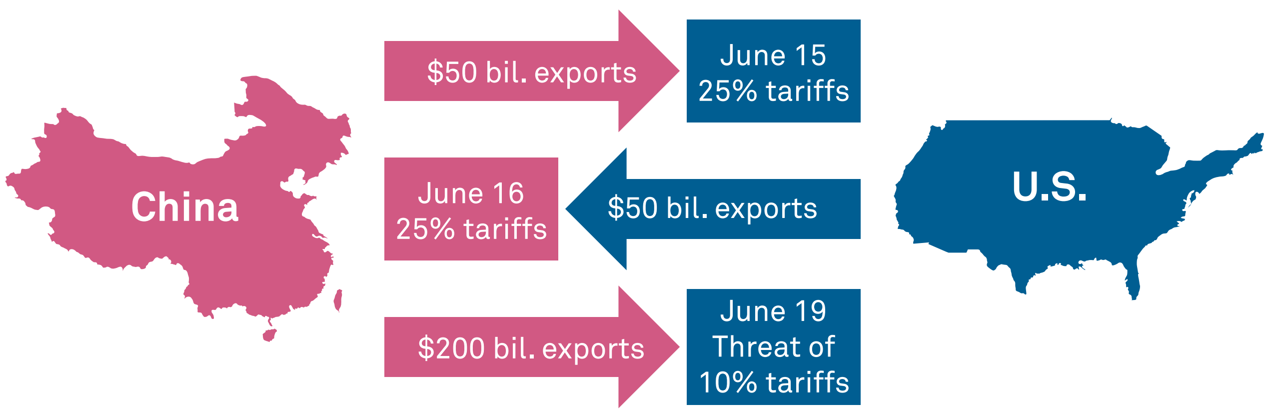
Source: S&P Global Ratings. Data as at July 11, 2018. Based on the top 200 rated banks

The large positive outlook bias in Western Europe partly reflects the ongoing build-up of ALAC.

Credit Conditions: Global And U.S.

- Global credit conditions remain broadly favorable but the escalating trade battle between the U.S. and some of its trading partners is dragging down investor confidence. It is unclear whether involved parties will negotiate new trade terms or retaliate into an all-out trade war. The actions thus far have infused higher uncertainty around the world.
- The positive economic growth that continues in all regions, although at different paces, is being tempered by trade and geopolitical tensions; asset price inflation; the Chinese debt overhang; and investor concerns about a turn in the U.S. credit cycle, which could lead to a liquidity pullback from emerging markets.
- U.S. economic momentum remains healthy, supported by a strong labor market and bullish consumer and manufacturing confidence. Interest rates are increasing at a measured pace.
- Beyond a full-blown trade war with China and increased tensions with other trade partners, the biggest risks to North American credit conditions are the rising corporate debt, upward pressure on borrowing costs, and imbalances on Canada's housing market.

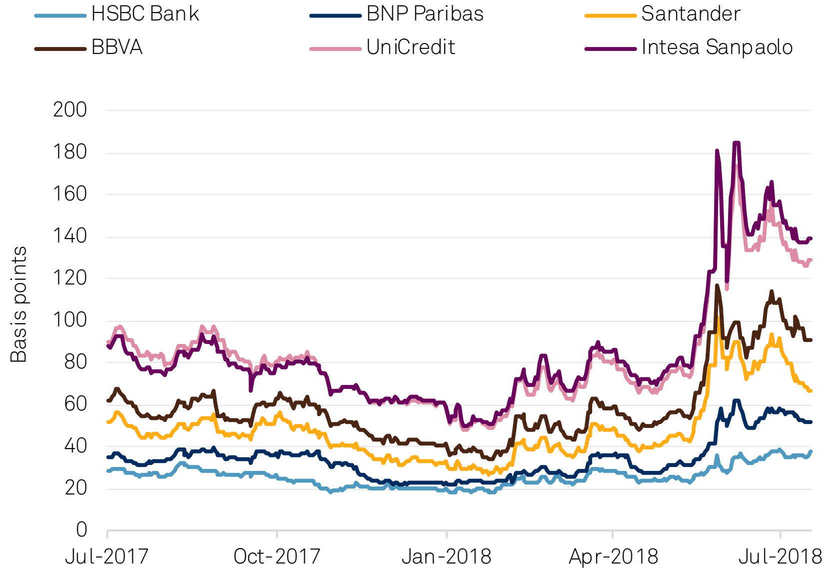
China-U.S. Trade Dispute: Tit-For-Tat Tariffs



Credit Conditions: Europe

- The economic environment in Europe has weathered recent shocks quite well. Eurozone growth remains above trend but momentum is slipping as concerns about trade and the investment climate increase. Italy remains the most vulnerable country given its less favorable fundamentals.
- Nationalistic and populist governments adopting social and economic policies that test EU regulations and solidarity present a key challenge for EU leaders. Trade and Brexit are two areas with potential for triggering widespread systemic impact.
- Financing conditions remain favorable, supported by the European Central Bank's accommodative monetary policy, particularly in the bank market where lenders have capital to deploy. But the sensitivity of financial markets is picking up and credit spreads have started to widen.
- Concerns over post-electoral fiscal sustainability in Italy could undermine business confidence and investment, particularly if a rising political risk premium caused financing conditions to tighten.
- The risk of a disruptive Brexit is worsening. Time is running out to agree and ratify a deal.

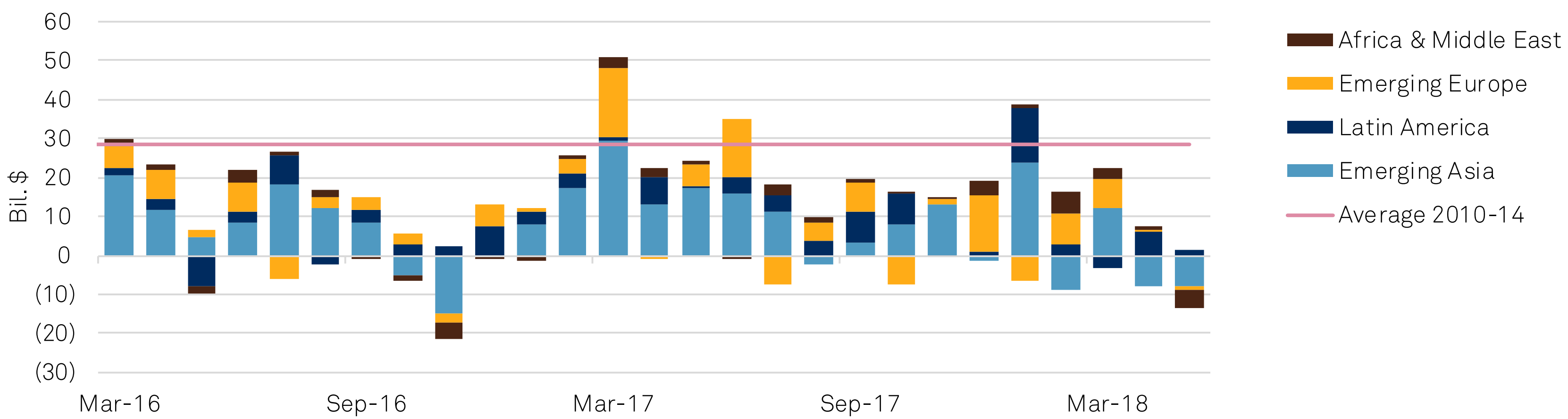
Recent Evolution Of Five-Year CDS Pricing For Selected Banks



Credit Conditions: APAC And LATAM

- Credit conditions are favorable in Asia-Pacific but risks emanating from the U.S. are increasing. Trade interruption risk is on the rise as the U.S. and China impose 25% tariffs on each other. There is upward pressure on interest rates and spreads.
- After improving for the past three quarters, financing conditions in emerging Asia--while still favorable--may start to face headwinds later in the year.
- Credit conditions in Latin America remain broadly favorable but downside risks are increasing. The region still benefits from economic growth, which we expect to be higher this year. However, a combination of external and domestic factors, including political risk related to elections, has resulted in falling currencies and tighter financing conditions.
- Financing conditions in Latin America remain neutral to slightly favorable but will likely face headwinds in the second half.

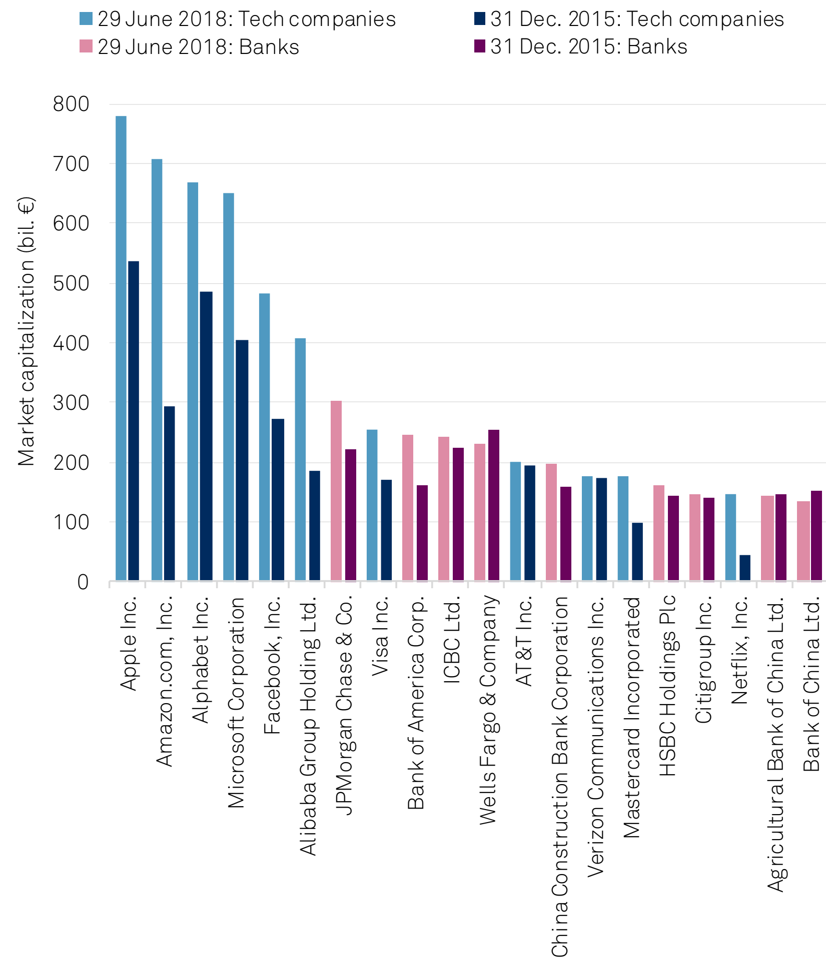
Net Non-Resident Portfolio Flows To Emerging Markets



Fintech Disruption Is Heating Up

- We expect the banking industry to continue to face increasing disruption from technological innovation. Regulations alone won't protect banks' market positions.
- The Payment Services Directive (PSD2) legislation on "open data" came into force in the EU earlier this year and will further boost new forms of competition.
- We therefore expect growing investments in technology, with a likely lag until banks reap some efficiency gains. Subdued revenue prospects for many banks accentuate the need for cost-saving initiatives.
- Competition of tech titans in the area of e-wallets is a case in point. They could leverage their strong customer bases and networks to potentially constrain banks' payment services revenues.
- The changing face of banking is also giving rise to new risks such as cyber-risk and cloud computing, which are attracting growing supervisory scrutiny.
- We see the risk that cryptocurrencies pose for global financial stability as limited. Their future will depend on a coordinated approach of global policymakers, but we note that their underpinning technology could strengthen conventional operations, notably for money transfers and financial market infrastructure companies.

Market Capitalization Of The Top 20 Banks And Tech Companies



North American Banks

Key Expectations

- U.S. banks will benefit from rising interest rates, loan growth, and tax cuts.
- The May 2018 legislative changes on regulation will not affect our BICRA and ratings on U.S. banks.
- Emerging risks include auto loan, credit card, commercial real estate, and leveraged lending.
- For Canadian banks, we expect a soft landing in the housing market, likely helped by policy tightening that took effect this year.

Key Assumptions

- We expect interest rates to increase gradually and GDP growth in both the U.S. and Canada to remain solid.
- No major disruption related to NAFTA renegotiations.
- Loan growth is likely to continue, roughly in line with nominal economic expansion.
- Credit losses have bottomed out and will gradually increase from 2019.

Key risks

- Rising interest rates could impact market valuations and banks' asset quality.
- Yields on deposits could rise further or more quickly than current ratings assume, implying more interest rate risk for liability-sensitive banks.
- A messy NAFTA renegotiation could undermine customer confidence and related business flows, which we see as more important for Canadian than U.S. banks.

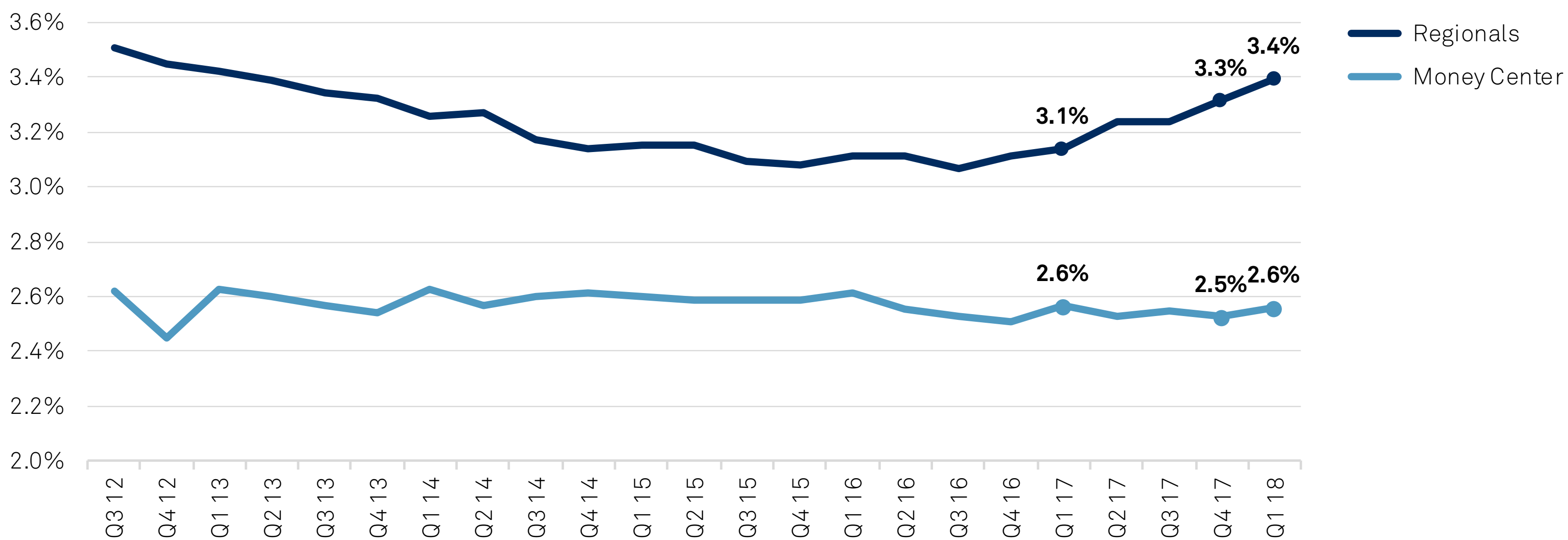
Outlook For U.S. Banks Is Slightly Positive

Worsening | Neutral | Improving

Revenues	We expect revenues to rise moderately on the back of recent increases in net interest margins and slightly higher loan growth. Fee income growth prospects look modest and mortgage volumes and margins may continue to be lackluster.
Expenses	We expect positive operating leverage. Banks will continue to keep costs stable by consolidating branches, containing head count, and growing digitalization. Regulatory-related expenses have likely peaked and are expected to moderate. However, investments in technology will be somewhat of an offset.
Profitability	Profitability should improve due to a pickup in revenues and limited expense increases, offset perhaps by higher credit provisions in the second half. The tax changes, economic growth, Fed's actions, market value trends, and capital markets conditions will also be important determinants of earnings.
Credit quality	While the tax changes may have extended the credit cycle, the path of interest rates will be a key driver of credit quality. NPAs and NCOs still remain historically low. Specific areas of potential risk include: leveraged loans, autos, credit cards, and pockets of CRE.
Capital	Capital ratios have likely peaked as banks balance their aspirations for growth and shareholder payouts with maintaining required regulatory ratios. We expect dividends and buybacks to generally increase, but payouts will hinge on 2018 Comprehensive Capital Analysis and Review (CCAR) results.
Funding and liquidity	Most banks are asset sensitive and stand to benefit from rising interest rates. Still, their funding mix could change if deposit growth abates. We will monitor noninterest-bearing deposit outflows and the pace of funding repricing and deposit sensitivity.

Rising Rates Are Driving NIMs And Revenues Higher

Median Rated Banks Net Interest Margin



S&P Global Ratings expects two more rate hikes this year, which should further support the expansion of the net interest margins.

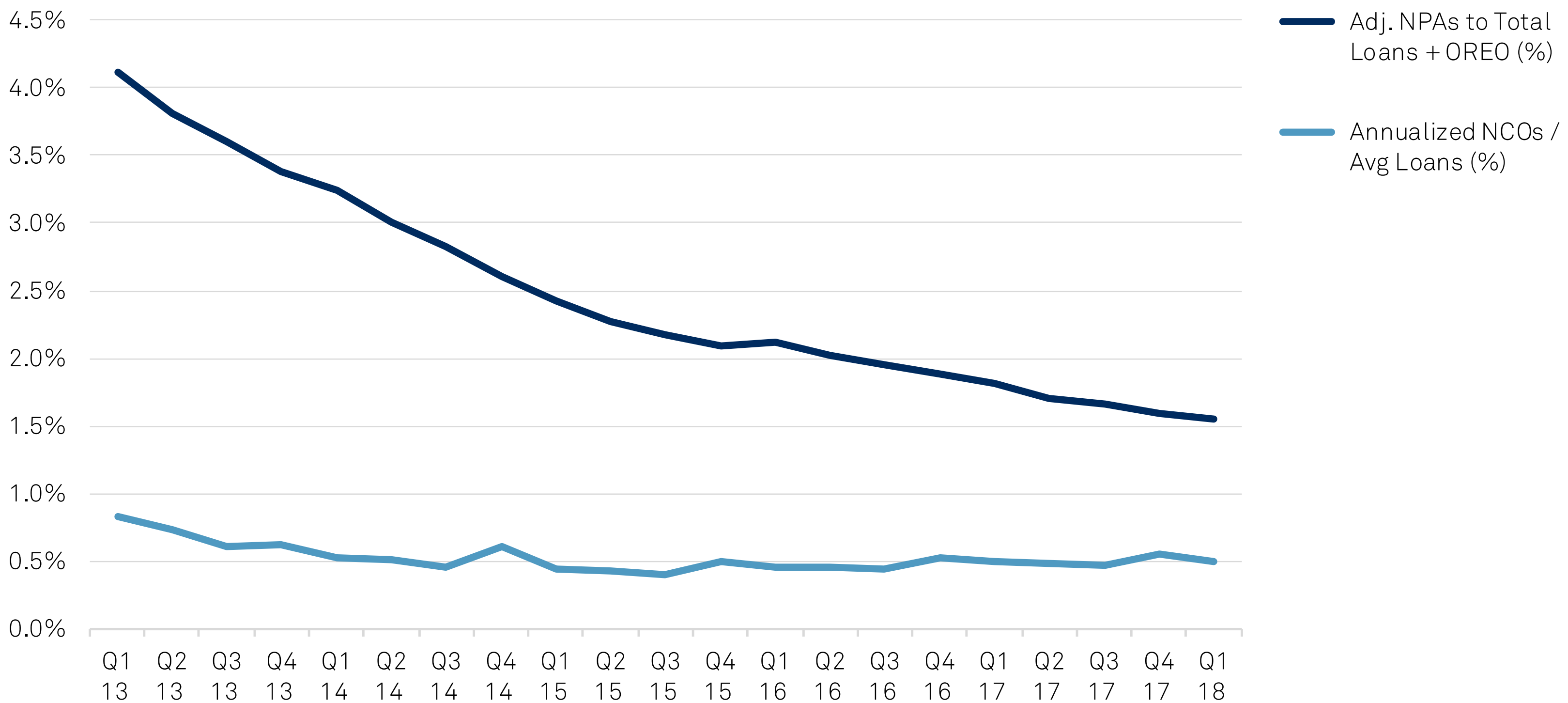
Tax Reform Has Also Boosted U.S. Bank Earnings

Company	Effective tax rate: Q1 2018	YoY Δ	Expected 2018 effective tax rate^
Median	**19%**	**-7%**	**20%**
JPMorgan Chase & Co.	18%	-4%	19%
Bank of America Corporation	18%	-10%	20%
Wells Fargo & Company	21%	-7%	19%
Citigroup Inc.	24%	-7%	25%
Goldman Sachs Group, Inc.	17%	6%	24%
Morgan Stanley	21%	-8%	22%-25%
U.S. Bancorp	18%	-7%	19%
PNC Financial Services Group, Inc.	17%	-6%	17%
Capital One Financial Corporation	19%	-9%	19%
Bank of New York Mellon Corp.	20%	-3%	21%
State Street Corporation	13%	-1%	16%
BB&T Corporation	19%	-1%	21%
SunTrust Banks, Inc.	19%	-7%	20%
American Express Company	22%	-10%	22%
Citizens Financial Group, Inc.	23%	-4%	NA
Fifth Third Bancorp	16%	-7%	15.5%-16%
KeyCorp	13%	-9%	18%-19%
Northern Trust Corporation	21%	-8%	23%-24%
Regions Financial Corporation	24%	-7%	20%-22%
M&T Bank Corporation	23%	-10%	25%-26%

Note: As reported with year-end earnings. Source: S&P Global Ratings, S&P Global Market Intelligence, companies' disclosures.

Asset Quality Remains Excellent For U.S. Banks

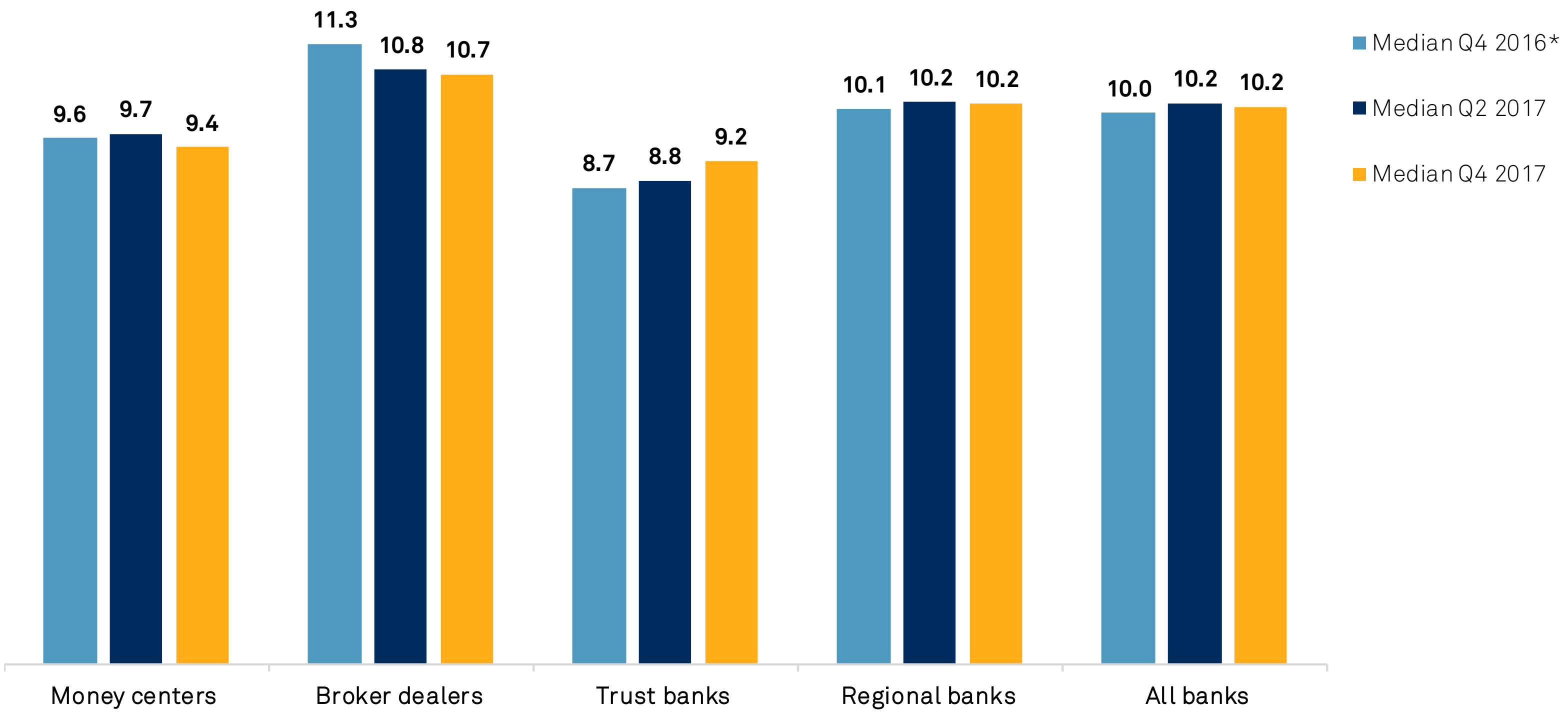
NPAs and NCOs: All FDIC



Note: Adjusted NPAs include nonaccrual loans, loans 90 days past-due, restructured loans, and OREO. All FDIC results estimated by aggregating Call Report data. Source: S&P Global Ratings; S&P Global Market Intelligence; Regulatory filings.

Capitalization To Decline Modestly For U.S. Banks

S&P Global Ratings Risk-Adjusted Capital (RAC) Ratio Median



Note: All results calculated under Risk-Adjusted Capital Methodology published on July 20, 2017. *Q4 2016 RAC calculations are pro forma under the new criteria. Source: S&P Global Ratings.

Regulation Eased On Small Banks In U.S., Maintained On GSIBs

- The regulatory reform bill passed in May 2018 will mainly lessen regulation on regional and community banks--potentially allowing for weaker financial management and greater risk-taking by these institutions.
- However, the legislation leaves banking groups holding about two-thirds of assets in the system under the strictest supervision.
- Regulators seem to be focusing on simplifying and clarifying Dodd-Frank regulation rather than sharply reducing it.
- As a result, we have maintained our Industry Risk score on the U.S. banking system, which we assign as part of our BICRA analysis. We also have maintained the stable trend on our Industry Risk assessment.

U.S. **BICRA Group 3/10**

Economic risk		Industry risk	
Score	3	Score	3
Trend	Stable	Trend	Stable

Impact Of Regulatory Reform Bill In The U.S.

Regulatory change	Banks affected	Impact
Raise the asset threshold for applying “enhanced prudential standards” to U.S. bank holding companies to $250 billion (and to $100 billion for foreign banking organizations) from $50 billion, no longer requiring them to pass certain capital stress tests and meet an LCR requirement	Roughly 17 of the 38 bank holding companies scheduled to go through CCAR this year as part of their enhanced supervision	Incremental and gradual decline in capital and liquidity ratios for affected banks; increased merger activity and competition; less transparency for investors; limited change in qualitative risk management practices; reduction in compliance costs, resulting in some improvement in profitability
Relieve bank holding companies with less than $100 billion in assets from performing any capital stress tests. Currently, banks with at least $10 billion in assets must perform at least a company-run DFAST capital stress test	Roughly 73 bank holding companies have assets of $10 billion to $100 billion	Incremental and gradual decline in capital for affected banks; increased merger activity and competition; less transparency for investors; limited change in qualitative risk management practices; reduction in compliance costs, resulting in some improvement in profitability
Instead of requiring an annual CCAR and DFAST, require bank holding companies with $100 billion to $250 billion in assets to undergo DFAST “periodically”	Roughly 12 bank holding companies have assets of $100 billion to $250 billion, and are not subject to enhanced supervision	Incremental and gradual decline in capital for affected banks; increased merger activity and competition; less transparency for investors; limited change in qualitative risk management practices; reduction in compliance costs, resulting in some improvement in profitability
Allow small banks to avoid Basel III risk-based capital requirements as long as they maintain a non-risk-based capital measure required to be set by regulators between 8% and 10%	Roughly 5,000 banking organizations have less than $10 billion in assets	Proportional increase in riskier assets (such as construction loans); potential drop in non-risk-based capital if regulators set the “off-ramp” leverage ratio closer to 8% than 10%; less willingness to breach the $10 billion assets threshold; reduction in compliance costs, resulting in some improvement in profitability
Clarify the definition of high-volatility commercial real estate loans	All banks	More willingness by banks to make construction loans, which receive an elevated risk weighting of 150% under capital rules
Lighten the qualified mortgage requirements for banks with less than $10 billion in assets as long as they retain those mortgages on balance sheet	Roughly 5,000 banking organizations have less than $10 billion in assets	Potential increase in risk on small bank balance sheets; unlikely to have a large impact on the mortgage market
Allow banks to count certain municipal securities in their LCRs as level 2B liquid assets	Banks subject to LCR (those remaining under enhanced supervision)	On day one, modest rises in most LCRs; longer-term increase in the attractiveness of municipal securities to banks subject to LCR
Amend the SLR to exclude deposits that custodial banks hold at central banks from the ratio’s denominator	Bank of New York Mellon, State Street, and Northern Trust	Limited impact as written since other capital ratios (e.g., Tier 1 ratio, total capital ratio) are the binding constraints on the capital levels of these banks

European Banks

Key Expectations

- Moderate economic momentum will help banks to maintain sound or improving balance sheets but offers only modest support to revenues that remain under pressure. Systemic banks will continue to build their bail-in buffers.
- Net new lending will remain modest, nonperforming loan formation low, and capital generally stable despite potentially higher dividend payouts.
- Increased political uncertainty translates into higher debt prices of banks, primarily in periphery countries.

Key Assumptions

- Economic conditions will remain broadly supportive, despite recent signs of weakening momentum. The ECB shift toward tightening monetary policy will be gradual, allowing banks time to adjust.
- Brexit will not be disruptive.
- Resolution authorities will continue to enhance bank resolvability, strengthening the safety net for senior creditors if a systemic bank fails.

Key risks

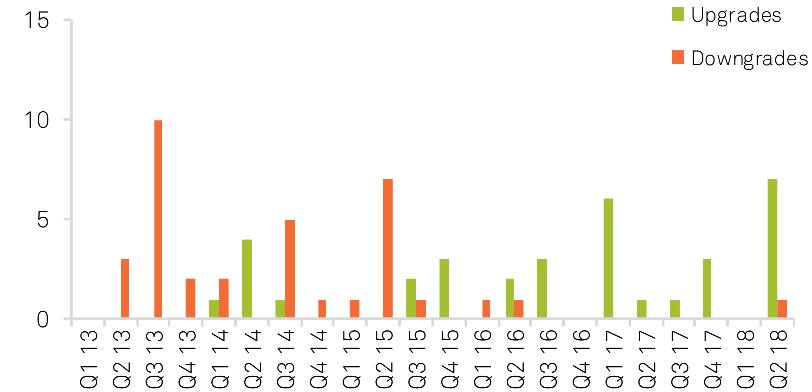
- A reversal of economic momentum that would: challenge our expectations of benign asset quality and slow the ongoing reduction of legacy problematic assets in the periphery; complicate the repositioning of banks' business models; stagnate banks' profitability at low levels.
- A disorderly Brexit, which would be damaging for the U.K. and thus a difficult scenario for U.K. banks to manage.
- An abrupt correction of the fixed-income markets, hitting capital through the mark-to-market of securities portfolios, and reducing lending and constraining access to market financing.

Positive Rating Actions And Outlook Bias

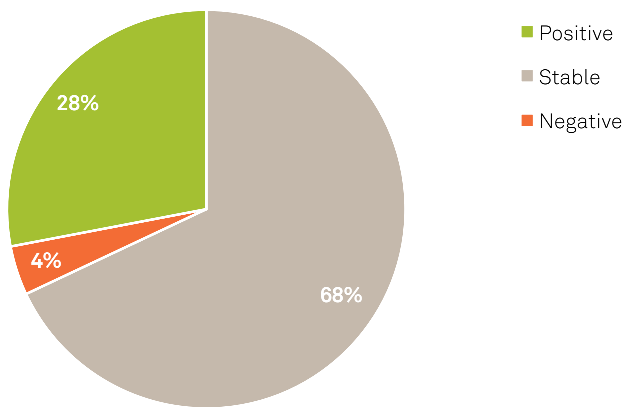
Some of our rating actions since Jan. 1, 2018:

- Royal Bank of Scotland **upgraded** to A-/Positive/A-2
- Lloyds Bank **upgraded** to A+/Stable/A-1
- Banco Santander **upgraded** to A/Stable/A-1
- BBVA **upgraded** to A-/Stable/A-2
- CaixaBank **upgraded** to BBB+/Stable/A-2
- Deutsche Bank **downgraded** to BBB+/Stable/A-2
- Outlook on Credit Suisse revised to **positive**
- Outlook on Danske Bank revised to **positive**
- Outlook on DNB Bank revised to **positive**

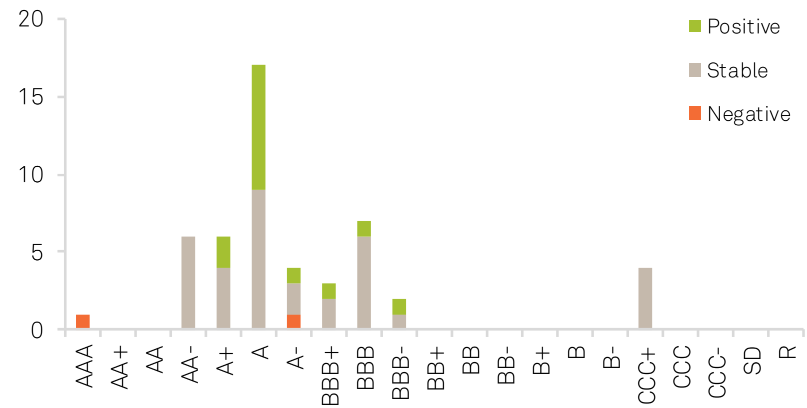
Downgrades And Upgrades: Top 50 European Banks
Issuer credit ratings



Outlook Distribution: Top 50 European Banks



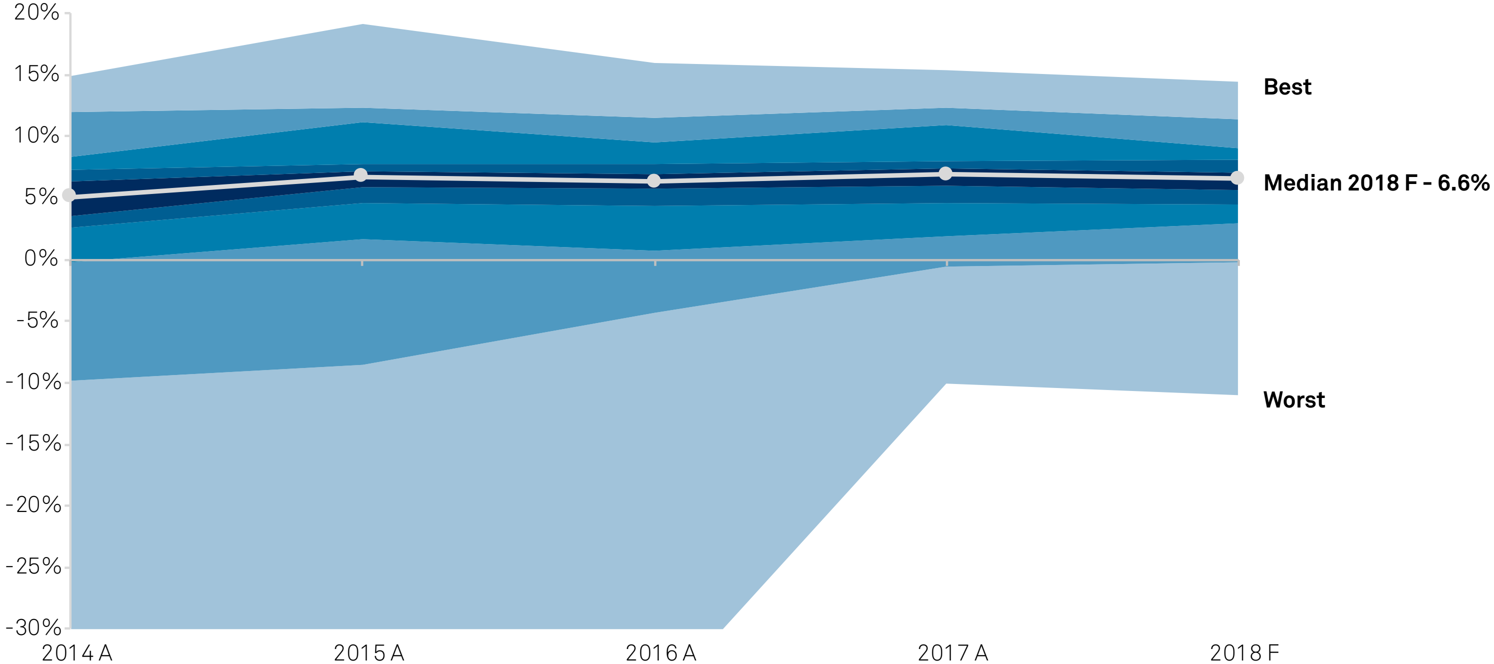
Rating Distribution: Top 50 European Banks
Operating company issuer credit ratings



Profitability Is Improving But Remains Subdued

Revenues will remain under pressure, forcing banks to focus on efficiency initiatives.

ROE For Top 50 European Banks



2014 A	2015 A	2016 A	2017 A	2018 F	
7	13	9	11	17	**Number of banks ROE > 10%**
11	9	8	5	4	**Number of banks ROE < 0%**

Each band depicts the distribution of 10 banks, with the darkest shade being the 10 closest to the median and then each lighter shade being the next 10 further away. Source: S&P Global Ratings. Data as at Jul. 4, 2018.

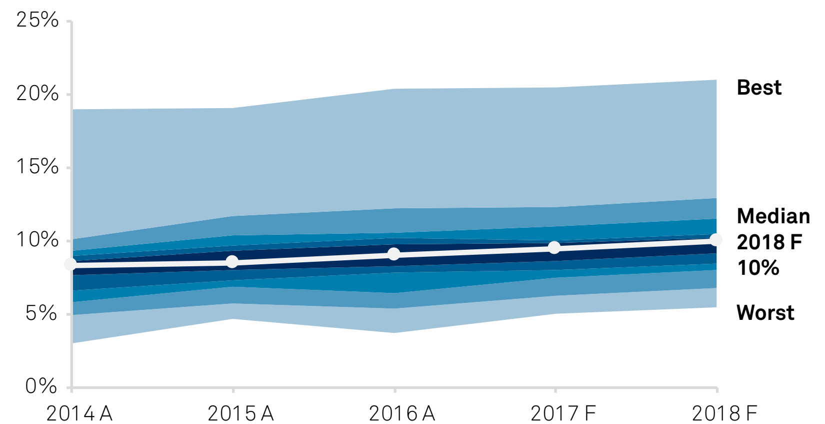
Economic Growth Supports Stable Or Improving Balance Sheets

Net new lending will remain modest, nonperforming loan formation low, and capital generally stable, despite potentially higher dividend payouts.

Net % Of Banks Reporting Tightening Credit Standards Or Positive Loan Demand

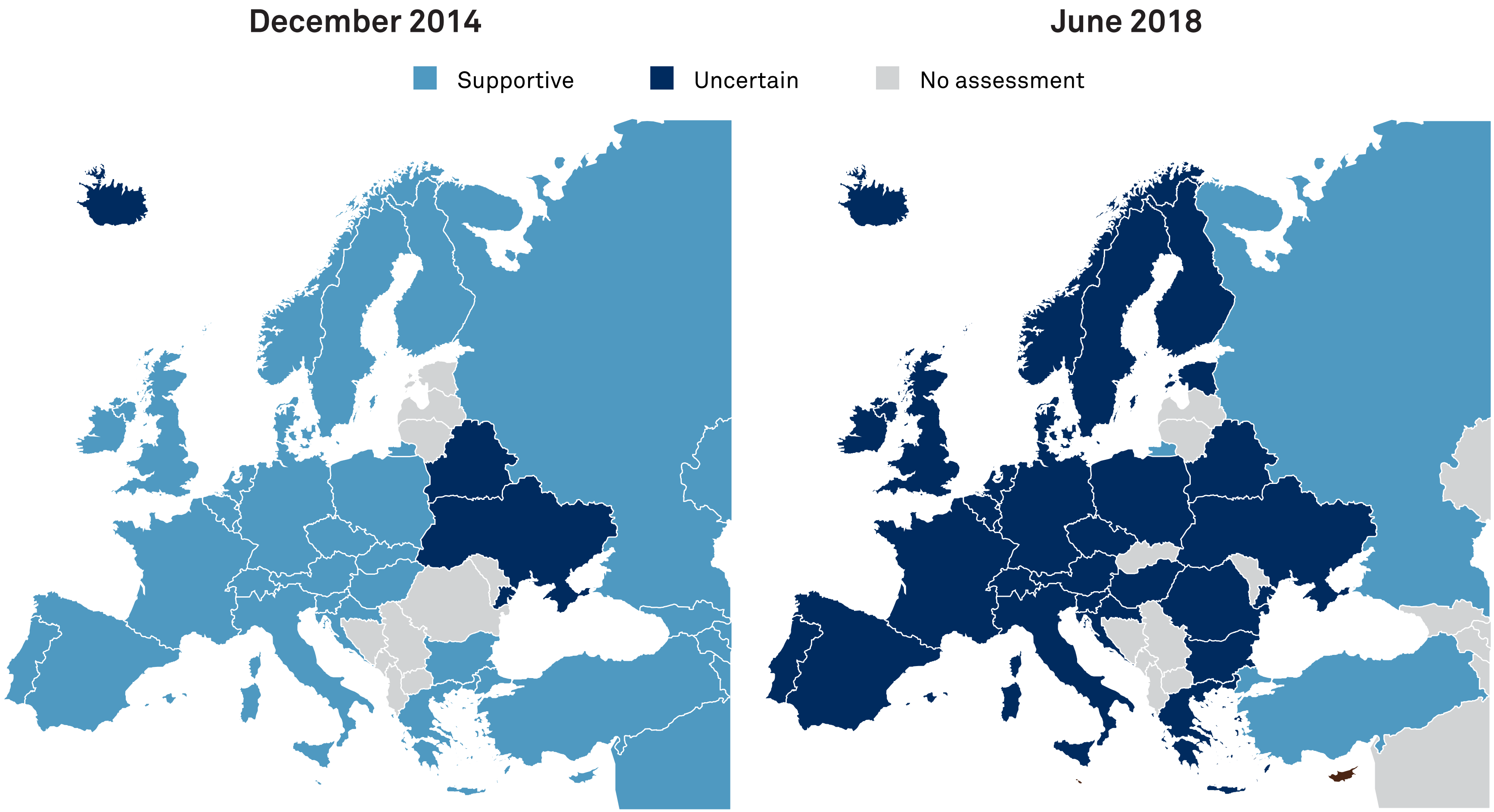
Source: Euro area bank lending surveys as of Q2 2018, European Central Bank.

RAC For Top 50 European Banks



Each band depicts the distribution of 10 banks, with the darkest shade being the 10 closest to the median and then each lighter shade being the next 10 further away. Source: S&P Global Ratings. Data as of Dec. 2017.

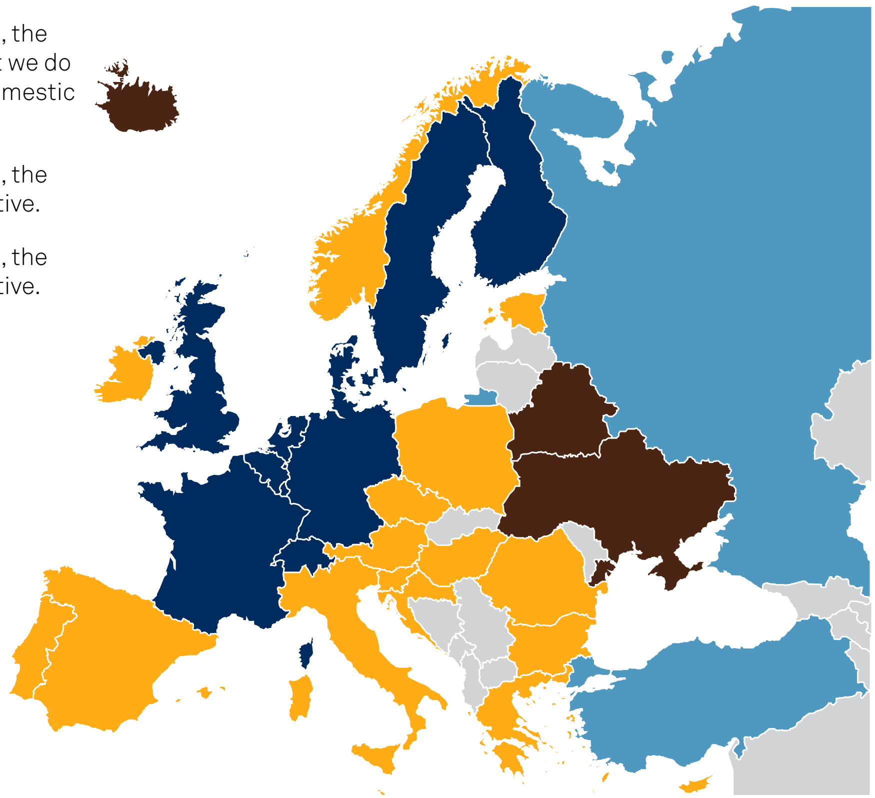
Going, Going, Gone: From Bail-Out To Bail-In



ALAC Notching Still Limited To A Few Banks

Government Support, Resolution Regimes, and ALAC Uplift in Europe

- Government remains supportive.
- Government support is uncertain, the resolution regime is effective, and we include ALAC uplift for some banks.
- Government support is uncertain, the resolution regime is effective, but we do not include ALAC uplift for any domestic banks.
- Government support is uncertain, the resolution regime is not yet effective.
- Government support is uncertain, the resolution regime is not yet effective.



Resolution and resolvability

— EU authorities are now constrained in their support, but genuine resolvability remains years away for many European banks.

— U.K. banks delivered ring-fencing, time-consuming but manageable, modest effect for rated subsidiaries.

— Creditor hierarchy changes ongoing – “senior subordinated” debt class emerging.

— Substantial issuance needed through 2018-2020 to expand bail-in buffers.

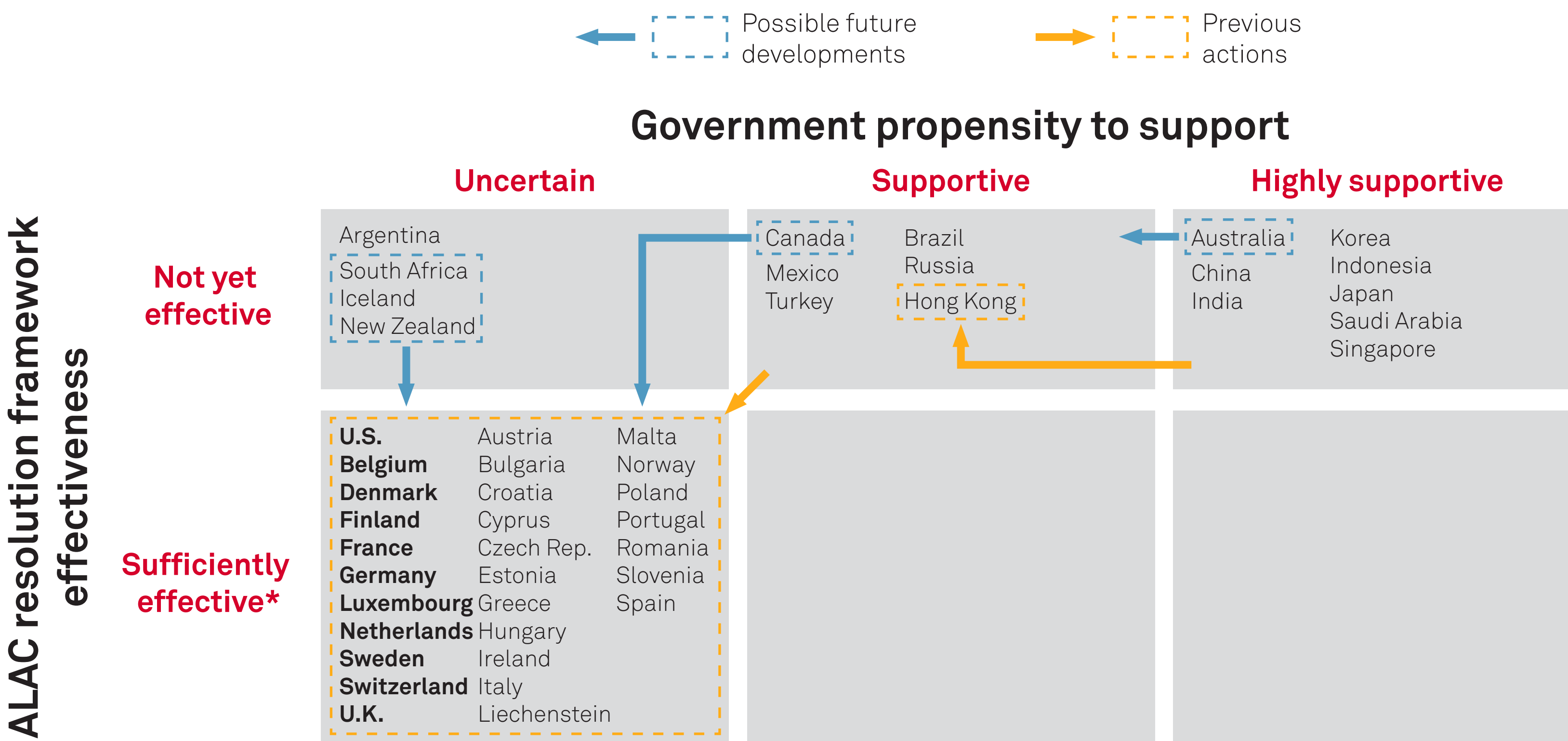
Rating implications

— Greater influence of new debt rated off the unsupported credit profile.

— Some upside potential as ALAC notching likely to widen across sector (unless sovereign caps).

— Downstreaming clarity could confirm or challenge assumptions for subsidiaries.

Europe And U.S.: Leading The Way On Resolution



Countries in **bold** are those where we currently give ALAC uplift to at least one bank.

*For factors that would lead us to conclude that a resolution framework is sufficiently effective, see paragraph 17 of Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, published April 28, 2015.

Asia-Pacific Banks

Key Expectations

- A slight negative outlook bias across the ratings portfolio is expected to persist.
- Asset quality should remain relatively stable. Nonperforming loans should remain relatively low in some jurisdictions (Taiwan, Australia, Singapore, Hong Kong, Singapore and Japan) but will remain much higher in some others, notably India.
- Earnings outlook for banks in many jurisdictions remain broadly supportive of current ratings.

Key Assumptions

- Macroeconomic and financing conditions should remain favorable overall but risks emanating mainly from the U.S. are increasing.
- Systemically important private-sector commercial banks should continue to benefit from government support in most jurisdictions.
- High debt levels and asset prices, and less certain bond markets are a backdrop for the potential emergence of a low probability but high impact negative scenario that will cause us to revise key assumptions.

Key risks

- High private-sector debt in China, Hong Kong, Australia, Korea, Singapore, Malaysia, and Thailand is a key risk factor, particularly should there be a reversal of current trends of low interest rates and unemployment.
- High property prices are a meaningful risk in China, Hong Kong, Australia, and New Zealand.
- Higher U.S interest rates could ultimately weaken financial institutions' credit quality. A downside risk of a sharp correction in asset prices, particularly if associated with a pullback in market liquidity, will likely lead to negative ratings momentum.

The Outlook Bias Is Stabilizing In APAC

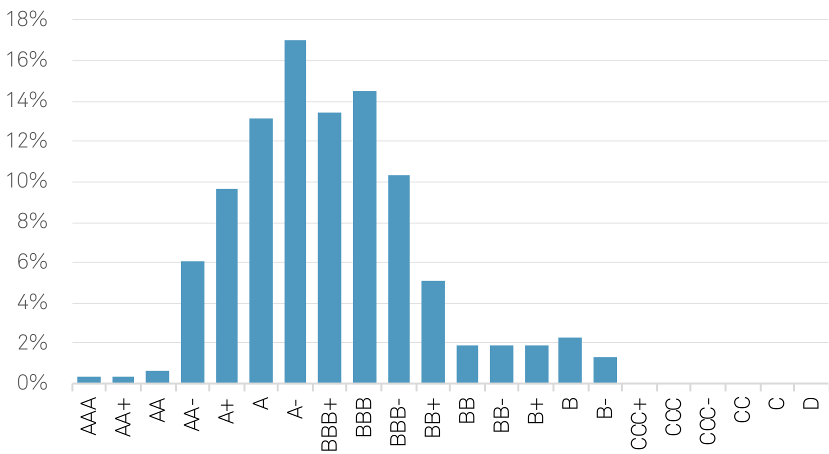
Key Trends

- Rating trends are stabilizing as indicated by the negative outlook bias, which improved to -4% in Q2 2018 from -10% in Q1 2018
- A negative bias persists mainly because of low bank profitability in Japan, potentially lower government support in Australia, and high property prices, high credit growth, and linkages to China in Hong Kong.

Key Risks

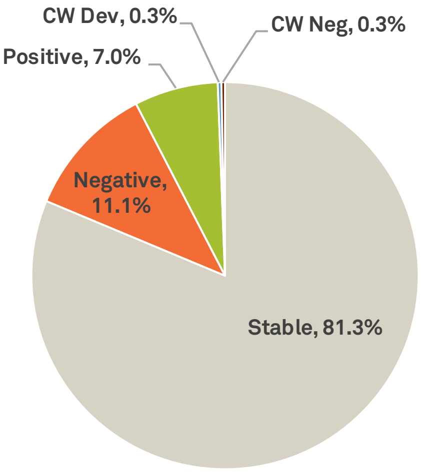
- Rating trends are stabilizing as indicated by high private-sector debt and increasing market risks, including high property prices and higher U.S. interest rates.
- Largely stable asset quality but a correction in asset prices will lead to negative ratings momentum.
- Possible diminution in government support in some jurisdictions.

Asia Pacific Financial Institutions Rating Distribution Q2 2018



Note: Data as of June 30, 2018. Source: S&P Global Ratings.

Asia Pacific Financial Institutions Outlook Distribution Q2 2018



Note: Data as of June 30, 2018. Source: S&P Global Ratings.

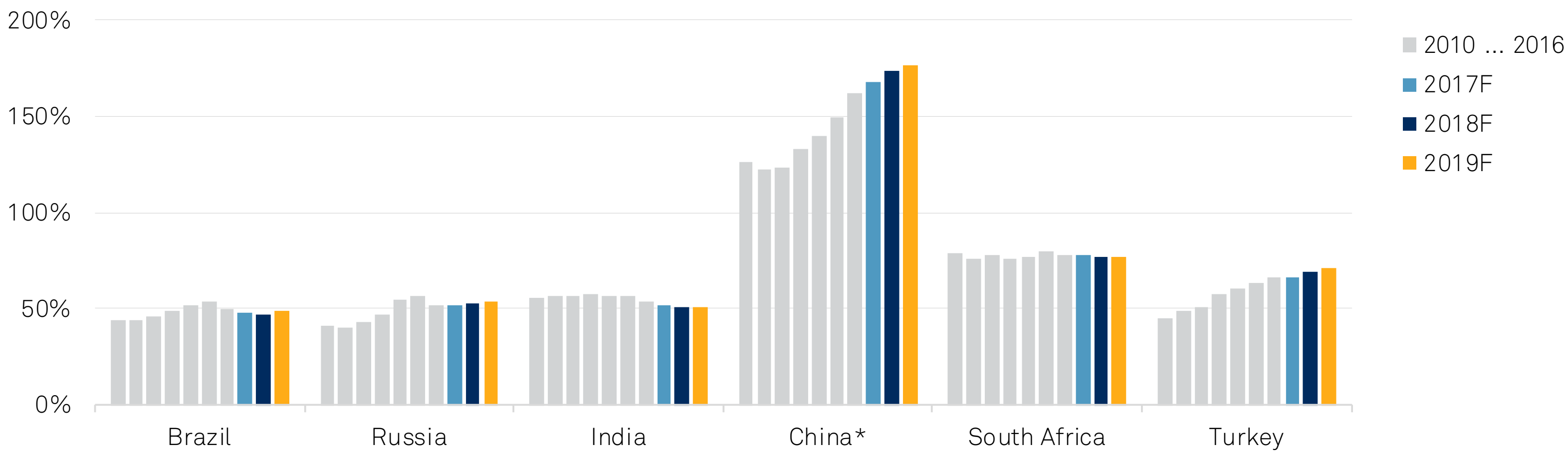
China: Deleveraging Is A Challenging Task

— The risk of a disorderly deleveraging seems to have stabilized. We notice progress being made by the authorities in limiting credit growth; moving back opaque wealth management products onto bank balance sheets; lowering interbank lending; letting interest rates and bond yields rise; and allowing for more defaults (although we expect them to remain very low).

— Asset quality as measured by nonperforming loans has remained extremely stable over the past years. However, the accuracy of Chinese banks' disclosure of loan quality has become a growing issue. The regulator required all 90-day delinquent loans to be classified as nonperforming by mid-2018. To soften the blow on profitability, the regulator recently lowered the minimum loan-loss reserve coverage and introduced a more flexible approach.

— We are of the view that "megabanks" are significantly better placed to adjust to reforms and we therefore believe that the credit quality between small and large banks will widen over time.

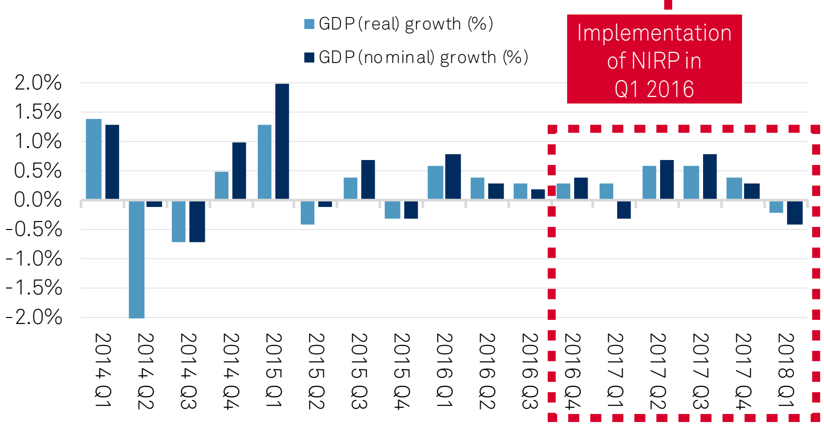
Private Sector Credit As % Of GDP



*Adjusted for quasi-public sector borrowing and shadow lending in the economy since 2012. F--forecasted.

Japan: Weakening Profitability Despite GDP Rebound

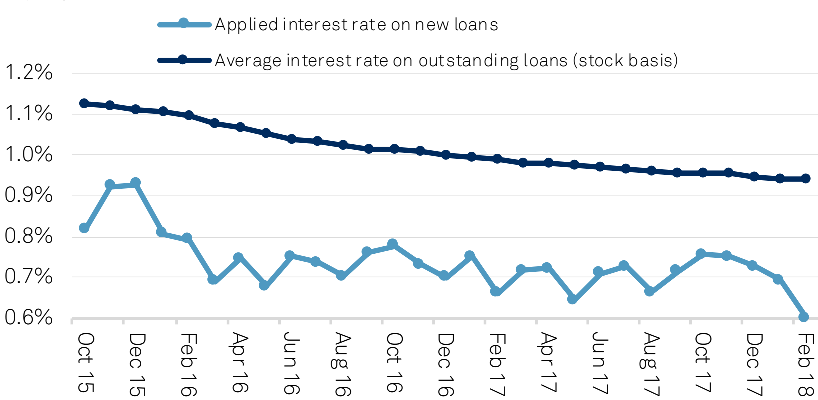
Recent Development Of GDP Growth



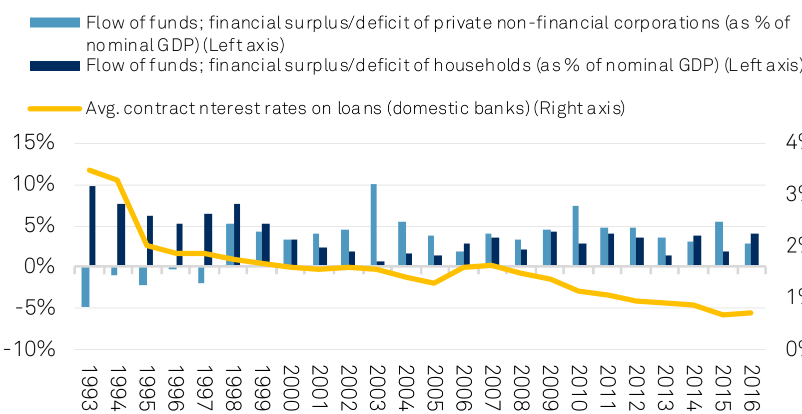
NIRP's Side Effects Emerge Strongly

- Japan's negative interest rate policy (NIRP) seems to have bolstered current domestic economic growth. We expect real GDP to grow by 2% in 2018.
- However, NIRP did not push up lending demand due to a fund surplus in private sectors.
- As loan growth remains very limited, banking sector margins are narrowing.
- Our credit analysis of the largest banking groups is centered on whether they will keep a subdued risk appetite even as their profitability declines.

Domestic Banks/Contract Interest Rate: Oct. 2015-Feb. 2018

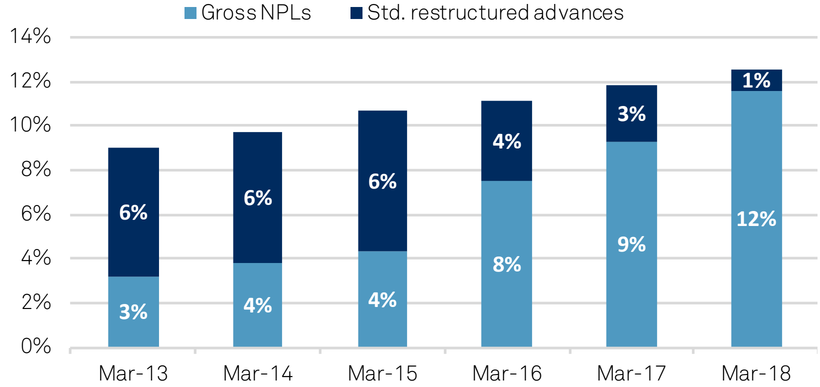


Private Sectors Have Been In A Surplus Position



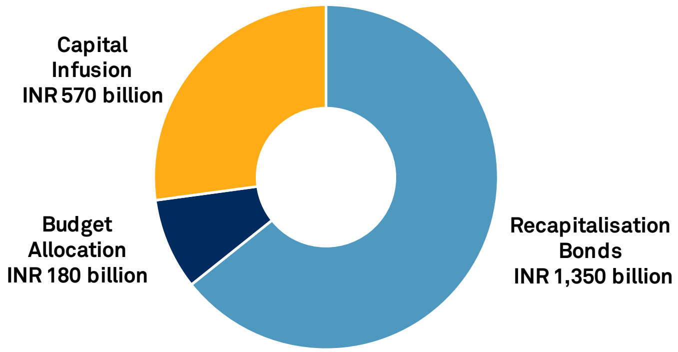
India: 4Rs Strategy Could Strengthen Banks

Better Recognition Of NPLs



NPLs--Nonperforming loans. Std--Standard. Note: The stressed-asset ratio in India is defined as gross nonperforming loans + standard restructured advances as a percentage of gross advances. Source: Research Bank of India.

India's INR 2.1 Trillion Recap Program Will Primarily Rely On Government



INR--Indian Rupee. Source: Government of India, S&P Global Ratings' estimates.

Resolution of NPLs

— Large NPLs were pushed through the new insolvency process. Our estimate is that the stock of weak assets is now about 13%-15%.

— Positively, the bankruptcy law passed in May 2016 gives lenders more power to recover assets. The Reserve Bank of India also introduced more stringent resolution norms.

— The government also put in place a large recapitalization plan of about $32 billion.

— We expect continued losses for many public-sector banks in fiscal 2019.

— We stand by our stable outlook on banks, with government support protecting most public-sector banks.

The Missing R: Reform Banks

— The recent fraud case at Punjab National Bank highlights weak internal controls and vulnerabilities in risk management at Indian banks.

— If successfully implemented, the reform has the potential to strengthen the sector over time.

— However, very few steps have been taken so far on the reform front and follow-through on announced reforms has been weak.

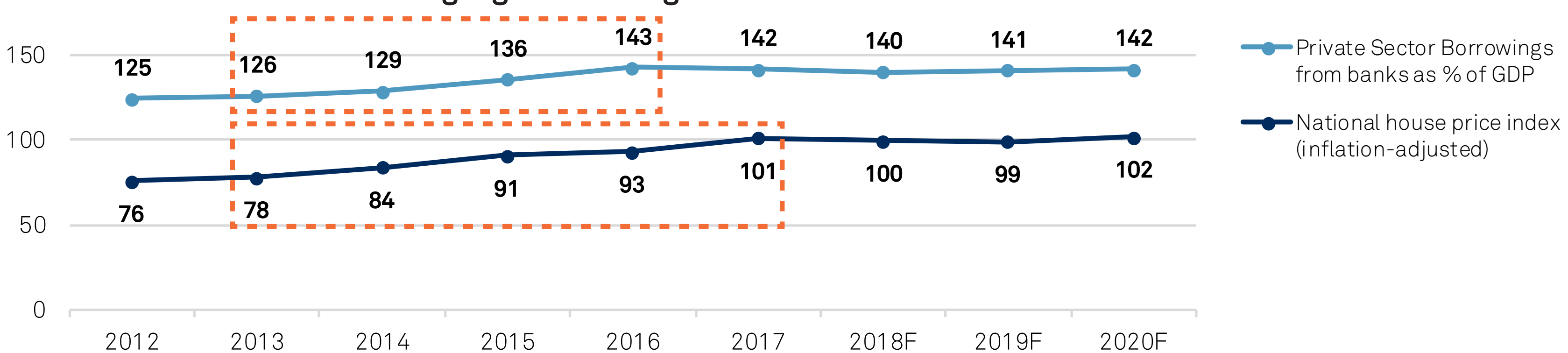
Australia: Potentially Lower Government Support

- Negative rating outlooks on systemically important banks reflect pressures on sovereign ratings and a possible tempering of government support.
- Economic imbalances are showing signs of easing, with low loan growth and a limited increase in house prices. We therefore revised our trend on Economic Risk to positive from stable.
- At the same time, weaknesses in the effectiveness of regulation, and the conduct, governance, and risk appetite shown by Australian banks led us to revise our view on the competitive dynamics and institutional framework of the industry. They remain low risk by global standards.

Scenario Analysis: Australian Major Bank Ratings

			A major Australian bank	
Australia scenarios	**Government supportiveness**	**Sovereign local currency ratings**	**Stand Alone Credit Profile (SACP)**	**Issuer Credit Rating**
Base-case	Highly supportive	AAA	a-	AA-
Scenario 1	Highly supportive	AA+	a-	A+
Scenario 2	Supportive	AAA	a-	A+
Scenario 3	Supportive	AA+	a-	A
Scenario 4	Highly supportive	AAA	a	AA-
Scenario 5	Highly supportive	AA+	a	A+
Scenario 6	Supportive	AAA	a	A+
Scenario 7	Supportive	AA+	a	A+
SACP	No change	1 notch better	1 notch worse	2 notches worse

Imbalances In Australia Showing Signs Of Easing



F—forecast. Source: S&P Global Ratings. Australian Bureau of Statistics. Australian Prudential Regulation Authority. Reserve Bank of Australia

Latin American Banks

Key Expectations

- Political uncertainties, corruption investigations, and NAFTA renegotiations continue hampering investor confidence.
- Currency depreciation could pressure inflation and interest rates, weakening asset quality.
- Gradual economic recovery in most countries could offset these burdens.

Key Assumptions

- Credit demand remains subdued in the largest economies of Brazil, Mexico, and Argentina due to weak investor confidence.
- Increasing interest rates could bolster banks' net interest margins because deposits provide the overwhelming majority of funding for lenders.
- We expect mild recovery in most economies, which should support stabilization or improvement in banks' asset quality. Our base-case scenario excludes a breakdown in the NAFTA renegotiations.

Key Risks

- Deposit stability is the major risk in Argentina, given the country's still recent history of unstable deposits. So far, deposits have remained relatively stable.
- Corruption investigations or a breakdown in NAFTA renegotiations could impair certain sectors of the economy.
- Significant changes in economic policies following elections could affect the banks' operating performance.
- Cybersecurity is an emerging risk, as seen in the recent spate of attacks in Mexico and Chile.

Latin American Banks Outlook

Brazil

- Improved economic conditions and lower interest rates are helping stabilize asset quality metrics.
- Banks' profitability has improved thanks to lower provisioning needs.
- Political challenges remain, with the presidential election ahead. Results could drag down investor sentiment if the winning candidate opposes important reforms or reverses recent changes. Such reforms are crucial to tackle fiscal challenges and rising debt.
- The impact of the truck drivers' strike is still to unveil and could stress credit demand and the performance of the SME sector.

Argentina

- Although it recently secured a standby line from the IMF, the country faces significant challenges in improving its fiscal position.
- Sharp currency depreciation, high interest rates and inflation, and lower economic growth will likely impair banks' asset quality.
- Deposit instability is the major risk given the country's history of unstable deposits.
- Lending growth will soften due lo lower demand from corporates and mortgage loans.

Chile

- Stronger economic growth and supportive investor and business confidence since the change of government will likely boost credit growth.
- Our outlooks on many Chilean banks remain negative because of economic imbalances stemming from a modest weakening of the sovereign capacity to face external shocks.

Mexico

- Uncertainties about policies after the presidential election and ongoing NAFTA negotiations will dent credit growth.
- Currency depreciation will have a manageable impact due to relatively low exposure to foreign currency loans (about 15%).
- Asset quality is expected to remain resilient.

Peru

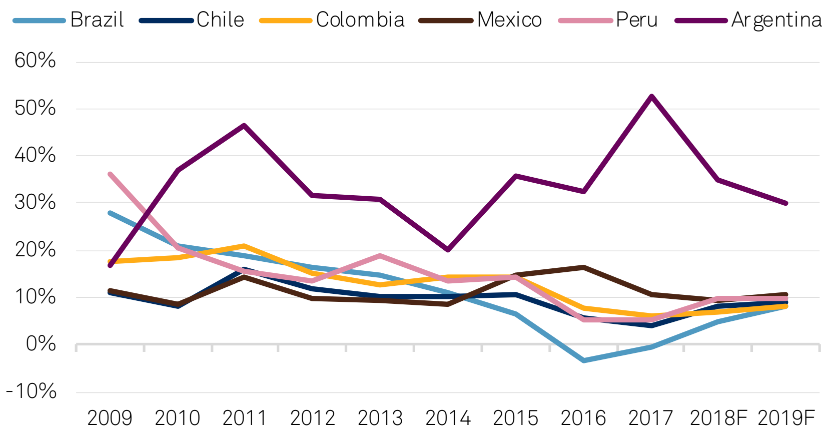
- The Peruvian government has recently approved a law on infrastructure projects affected by corruption investigations.
- These developments will help financing to flow again to construction companies.
- Political uncertainties seem to be stabilizing; investor and business confidence are improving.

Columbia

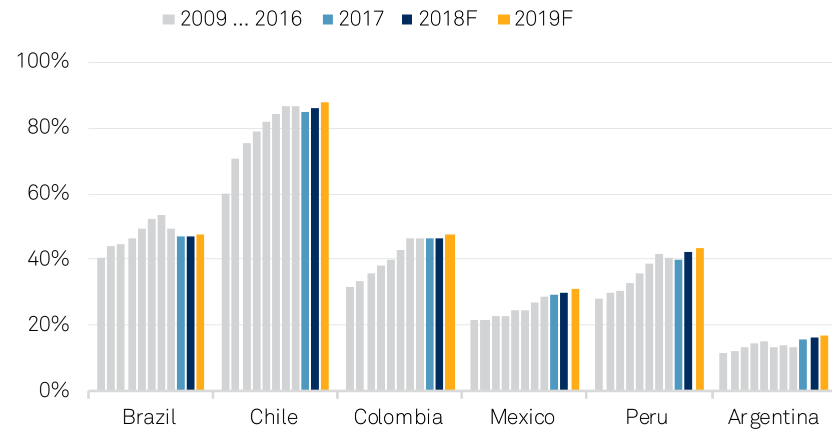
- The presidential election has slowed credit growth.
- Asset quality will likely improve from the second half of 2018 due to economic recovery, low inflation, and interest rates.
- Profitability will remain hampered by loan loss provisions.

Latin American Banks Outlook

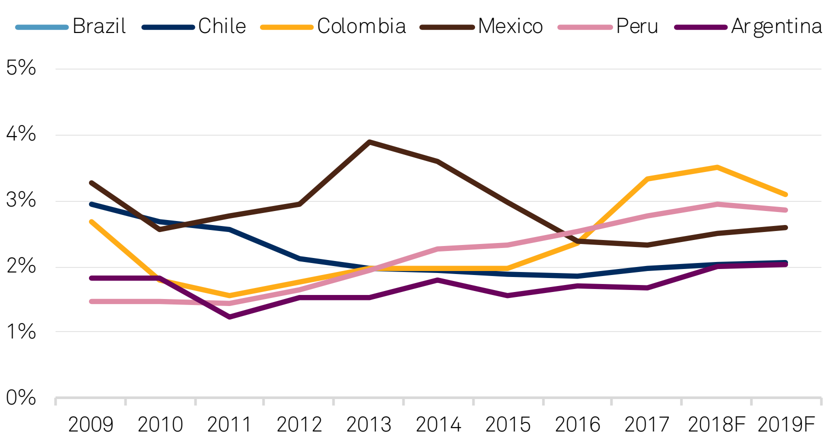
Nominal Loan Growth



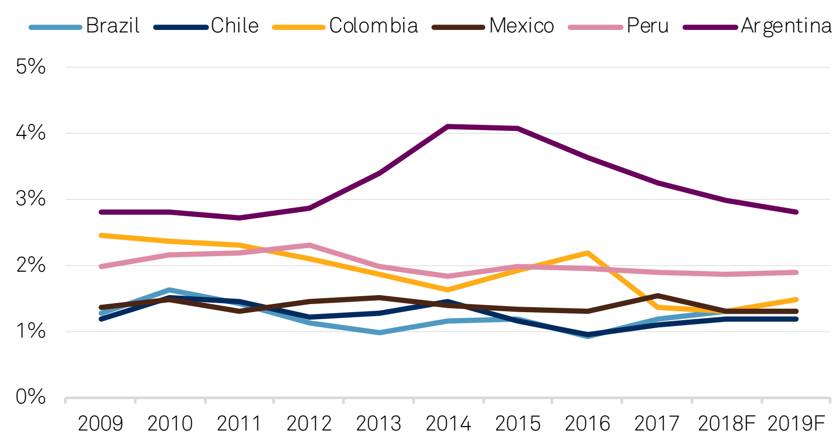
Penetration (Total Credit / GDP)



Nonperforming Assets As A % Of Systemwide Loans



Systemwide Return On Average Assets



Russia/CIS

— We expect GDP growth to remain stable or gradually improve over 2018-2019.

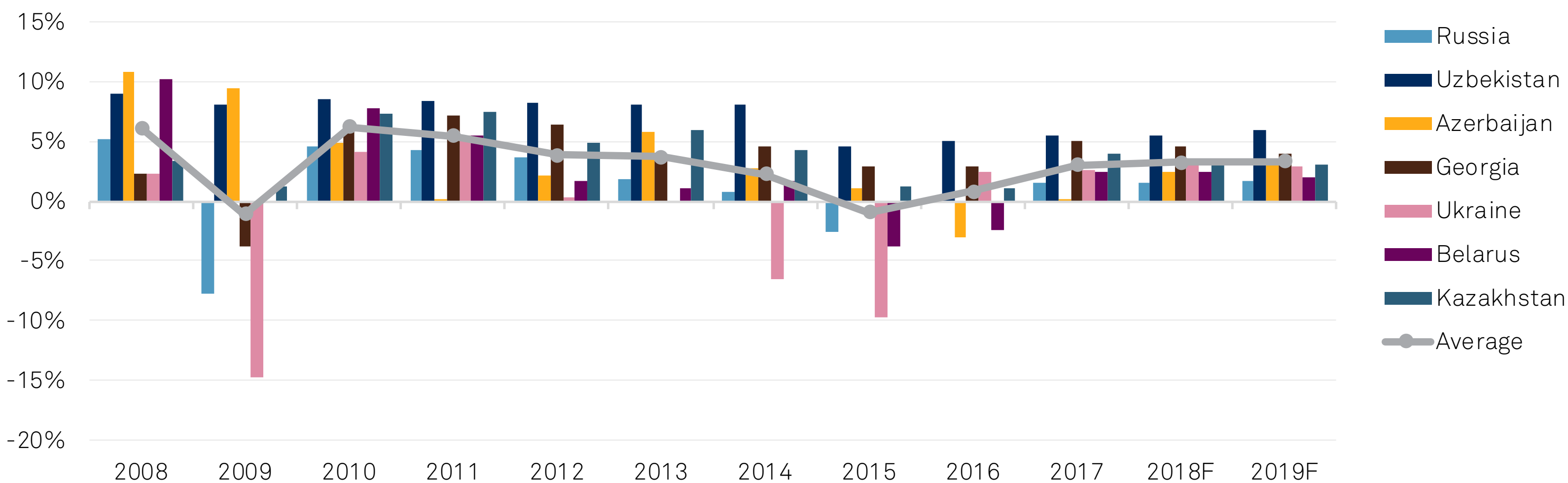
— However, it will remain lower compared to the previous decade. The high amount of problem loans and anemic demand for corporate investments will result in rather weak lending growth. Bank margins are under pressure in most of the countries of the region.

— Banks have been focusing on cost efficiency and lower risk over the past two years. We expect this trend to continue.

— Competitive pressure in the banking sector is expected to last due to banks' focus on quality borrowers.

— In Georgia, high household debt and high dollarization continue to weigh on the banking sector, balanced by high capitalization and stronger than peers' banking regulation and supervision.

Real GDP Growth



Russia/CIS: A Long Path To Recovery

Country	BICRA group	Economic risk trend	Industry risk trend	Economic risk: Economic resilience	Economic risk: Economic imbalances	Economic risk: Credit risk in the economy	Industry risk: Institutional framework	Industry risk: Competitive dynamics	Industry risk: System wide funding
Russia	8	Stable	Stable	VH	H	VH	VH	H	VH
Georgia	8	Stable	Stable	VH	H	VH	H	H	VH
Kazakhstan	8	Negative	Stable	H	H	EH	EH	H	H
Uzbekistan	9	Stable	Stable	VH	H	VH	EH	H	VH
Azerbaijan	9	Stable	Stable	VH	H	EH	EH	H	VH
Belarus	10	Stable	Stable	VH	VH	VH	EH	VH	EH
Ukraine	10	Stable	Stable	VH	EH	EH	EH	EH	EH

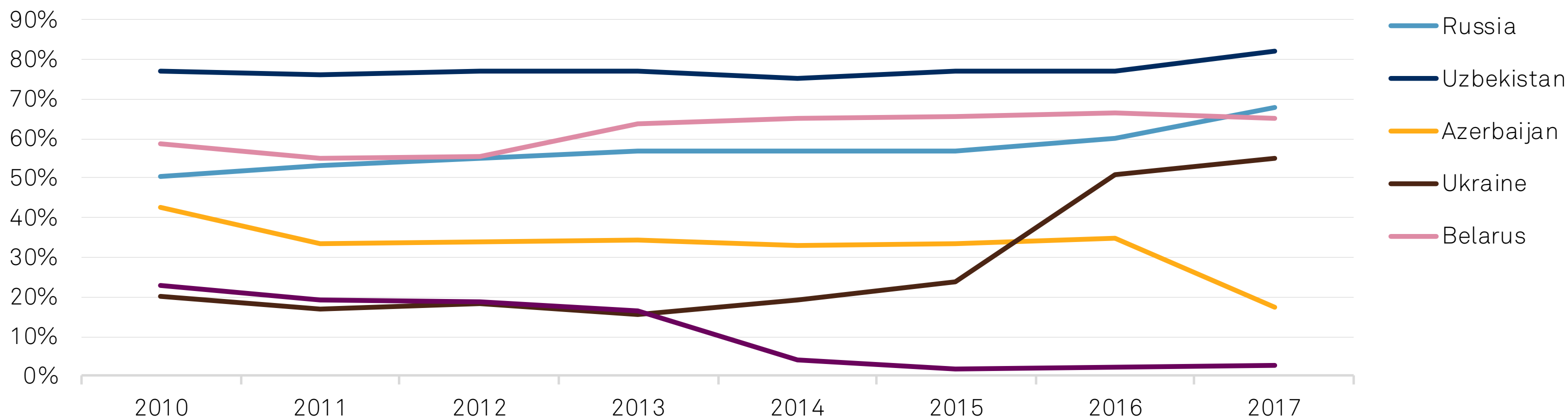
Color coding shows the countries where economic or industry risk trends are stable, positive, or negative

Positive economic or industry risk trend	Stable economic or industry risk trend	Negative economic or industry risk trend

Very low risk (VL)	Low risk (L)	Intermediate risk (I)	High risk (H)	Very high risk (VH)	Extremely high risk (EH)

Russia/CIS: A Long Path To Recovery

Market Share Of Government-Owned Banks



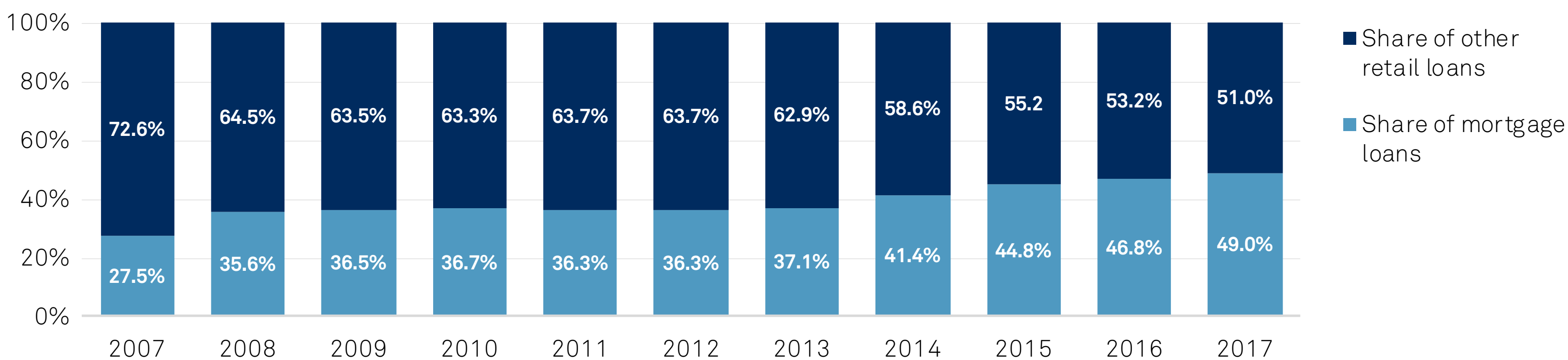
Source: S&P Global Ratings

- Government support provided to banks has been crucial for the stability of the sector in Russia, Kazakhstan, Ukraine, and Belarus in the past decade. 2017 figures for Azerbaijan reflect the restructuring of International Bank of Azerbaijan.
- Russia: The share of government-owned banks has been growing to reach almost 70%. The growing domination of government banks intensifies competitive pressure on remaining private players.
- Kazakhstan: Although the government does not own banks, the sector has benefitted from sizable support to clean up problem assets of BTA and KKB and capital support to five systemically important banks. Very small players are under the highest pressure.
- Ukraine: Following the restructuring and nationalisation of problem banks, the government needs to develop a strategy identifying next steps.
- Belarus and Uzbekistan: The government has traditionally dominated the banking sector and this will continue.

Russia: Competition/Sanctions Weigh On Funding

- Growing government ownership in the banking sector and the focus on quality borrowers has lead to increasing competitive pressure for banks.
- The government bailout of three large private banks in 2017 supported the stability of the sector but also questions the efficiency of banking supervision. The plan to privatize these banks after their clean-up appears unrealistic within the next two-three years.
- Strong growth in retail lending is driven by mortgage lending and will support asset quality.
- Lower interest rates could contribute to higher loan growth but could also reduce deposit growth.
- Banks' funding profiles remain under pressure because economic sanctions restrict external borrowing and deposit growth has slowed.
- Banks continue to focus on cost efficiencies and digital transformation.
- Capitalization of the sector remains weaker than for many peers.

Mortgage Lending Is Driving Retail Growth



GCC Banks: Resilient Amid High Geopolitical risks

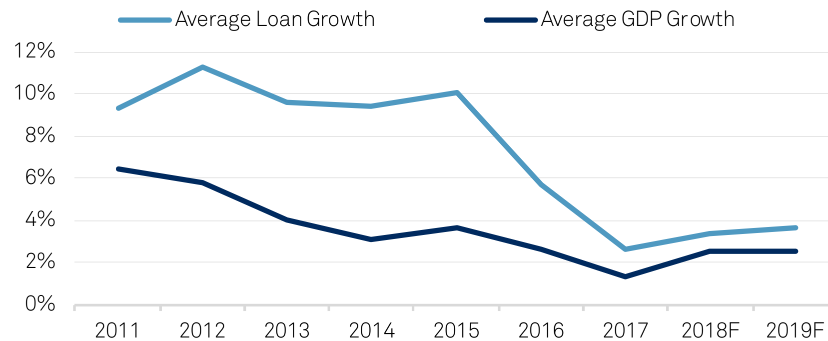
— Lending growth of Gulf banks is to remain subdued because of low economic growth across the GCC.

— Asset quality indicators will stabilize or deteriorate slightly barring any significant disruption to Gulf banks' operating conditions that could come from the materialization of geopolitical risks. NPLs are expected to stabilize at around 4%-5% by the end of 2018.

— Cost of risk will trend toward normalized levels because of IFRS 9 implementation. Real estate and hospitality sectors are under pressure in Qatar (because of the boycott) and in the UAE.

— Liquidity deployment is the challenge faced by some GCC banks in 2018. The liquidity picture improved significantly after GCC governments issued international and local debt or sukuk and injected the money in their economies. The rebound in oil prices is also an important boost for the GCC economies and banks.

Growth Of GCC Banks Loan Portfolios Versus GDP Growth



F--Forecast. Source: S&P Global Ratings, GCC Central Banks.

Evolution Of Oil Price

Turkish Banks: Higher Vulnerability

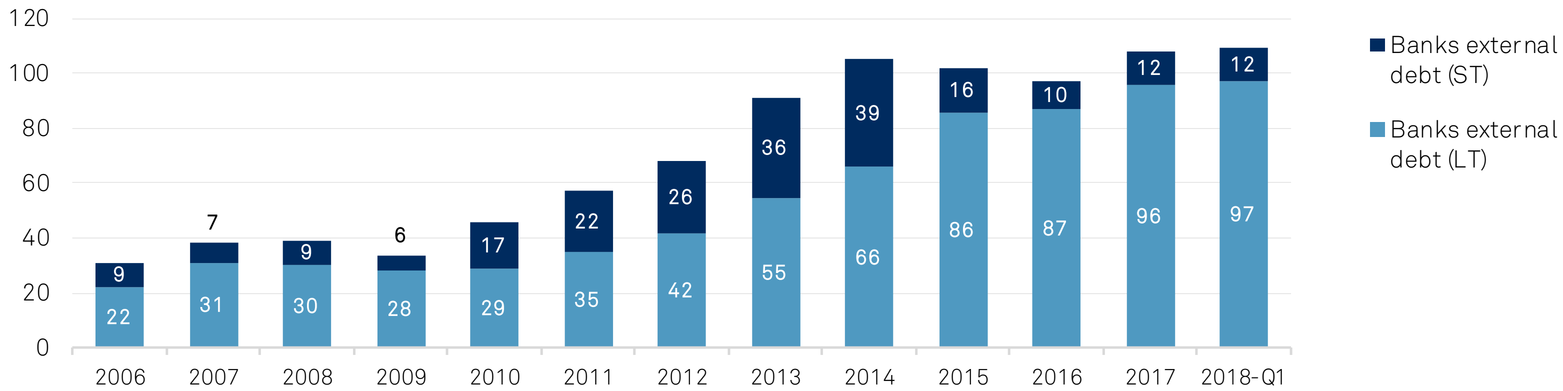
— Turkey's economy stands out as the most exposed in EMEA, due to its large current account deficit and significant external financing needs. A key question is whether the post-election government will return to more prudent economic policies or continue to stimulate the overheating economy, which would raise the risk of a hard landing.

— Turkish banks' external debt is high and exposes them to shifts in global credit conditions. The sharp decline in the Turkish lira and the uncertainty related to policy direction, as well as the deterioration of the country's relationship with Western allies, might weigh further on investor sentiment toward Turkey.

— For Turkey, the Fed rate increase will weigh on the capacity of corporates and banks to refinance their external debt. Following the recent restructuring of external debt by Dogus Holding and Yildiz Group, we do not rule out that other large corporates will follow as the refinancing of external debt becomes more difficult and expensive.

— The main risk for Turkish banks for the rest of 2018 lies in the areas of external funding refinancing and asset quality. We recently noticed a material increase in problem loans.

Turkish Banks External Debt



Data in Bil. US$, Source: S&P Global Ratings.

South Africa: Stability In A Weak Operating Environment

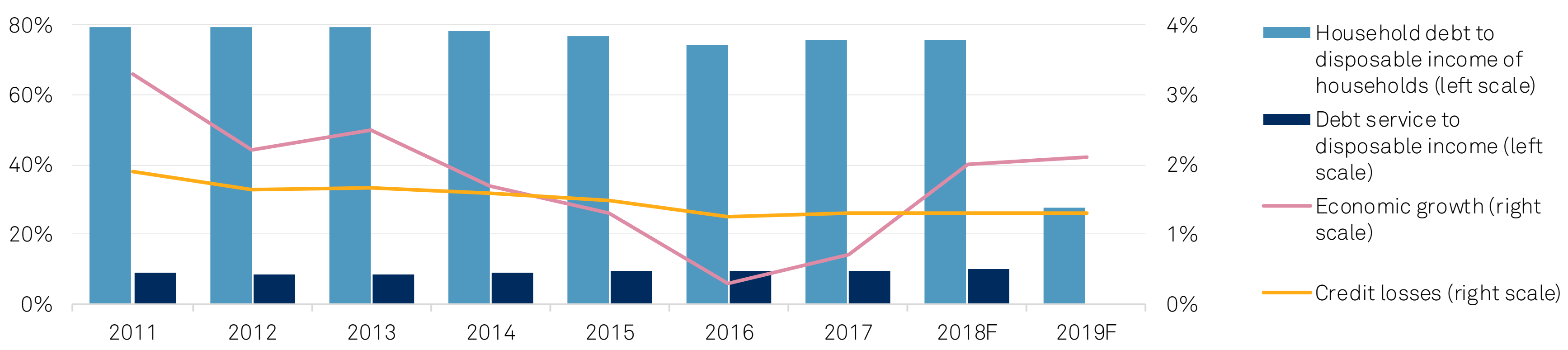
— The recent turmoil has largely reversed gains in currency and bond markets in the aftermath of the political transition. Despite the GDP contraction in the first quarter, we expect a rebound in the near term and GDP growth close to 2% in 2018.

— South African banks continue to perform reasonably well amid low economic growth, with solid financial results. They also improved their funding profile, meeting the minimum LCR (Liquidity Coverage Ratio) and NSFR (Net Stable Funding Ratio) ahead of schedule.

— Although improving, we expect growth of the banking system to remain muted mirroring that of the economy. More significant growth in the economy and the banking sector hinges on the implementation of key economic and social reforms.

— From a risk perspective, we continue to see the household sector as the main source of risk due to its high leverage and low income level compared with other emerging markets. More positively, we expect IFRS 9 implementation to have a moderately negative impact on capitalization and credit loss levels, and ultimately credit losses to remain relatively low and good profitability to support capitalization in 2018.

Evolution Of South African Household Sector Indebtedness



Related Research

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