S&P Global
Ratings

Global Banks Country-By-Country 2021 Outlook:
Toughest Test For Banks Since 2009

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Key Takeaways

- A key risk is that economic disruption from COVID-19 gets worse or lasts longer than our base case of a sustainable economic recovery in 2021 and a widely available vaccine by mid-2021.
- Additional tests to banks include overhangs from forbearance and other public supports, anticipated higher corporate insolvencies, and stress in property.
- We believe many banking jurisdictions globally will not recover to pre-pandemic financial strength until 2023 or beyond.

This year has been hard for banks. Next year may be even harder. S&P Global Ratings believes 2021 could turn out to be the toughest test for banks since the aftermath of the global financial crisis. Supports that have steadied banks and helped borrowers survive cannot last forever. Their withdrawal will reveal a truer picture of underlying bank asset quality, even as economies start to recover. We likewise note, however, that the dynamics of the current downturn are different. Strong fiscal support for economies is benefiting banks, funding markets are accommodative, and in our view, banks are better equipped than they were in 2009 to withstand economic pressures.

Our ratings on the banks reflect the long road ahead. Since the onset of the pandemic, we have taken 236 negative rating actions on banks globally (as of Nov. 9, 2020). The majority of these were changes to negative outlooks or placements on CreditWatch negative (77%), though nearly a quarter were downgrades (23%). We have made negative revisions to about half of our 87 Banking Industry Country Risk Assessments (BICRAs). These include revisions to economic trends or industry trends, and in some cases downward adjustments to our country risk assessment itself.

Twelve months ago, before COVID-19 struck, banks faced the new year with relative calm. The scenario for banks heading toward 2021 is a sharp contrast. For many banking jurisdictions, we do not envisage recovery to pre-COVID-19 2019 levels until 2023 or beyond.

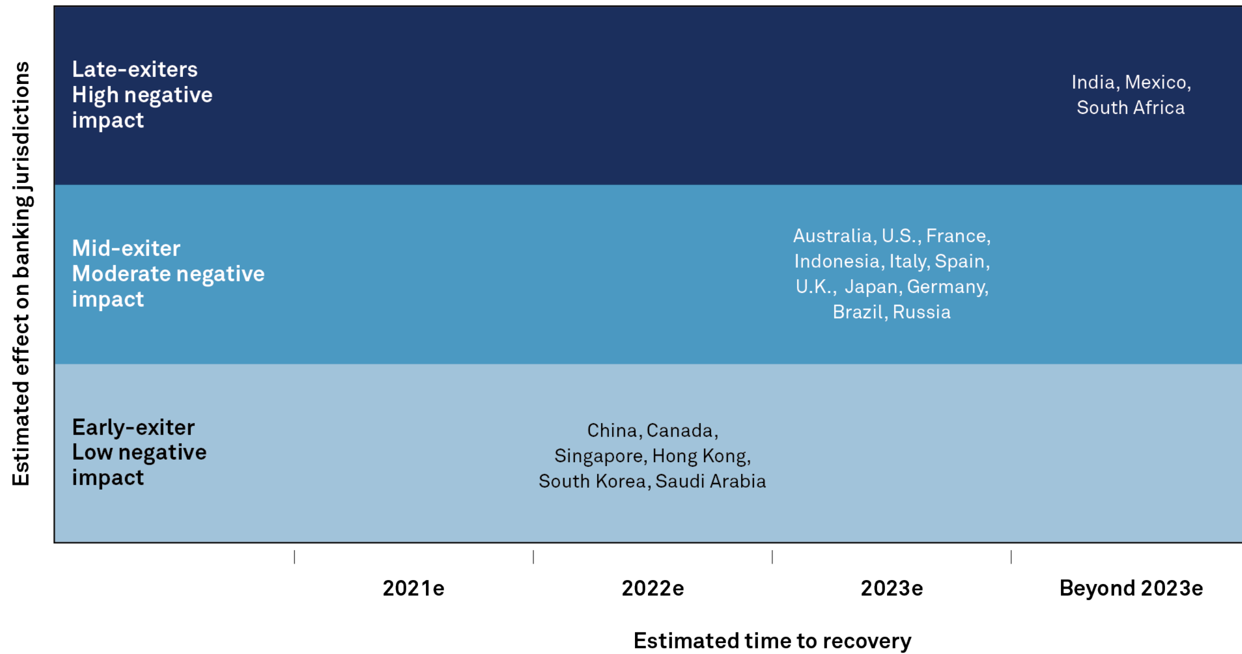
Shared Pain But Diversified Paths To Normalization

The recovery of banking jurisdictions globally to pre-COVID-19 2019 levels will be slow, uncertain, and highly variable across geographies. For 14 of the top 20 jurisdictions, we estimate that a return to pre-COVID-19 levels of financial strength won't occur until 2023 or beyond (see "Global Banking: Recovery Will Stretch To 2023 And Beyond," published on RatingsDirect on Sept. 23, 2020).

Some emerging market banks will have a difficult year in 2021, and many will struggle to recover quickly from the pandemic. An exception may be China, where recovery of the banking sector to pre-COVID-19 financial strength could be earlier. Even for potential early-exiter banking jurisdictions from COVID-19, such as China, we don't expect recovery until year-end 2022 (see chart 1).

Chart 1

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



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

We expect banks' financial profiles to worsen across many jurisdictions until the economic recovery takes hold. Even then, there will be a lag effect on banks' credit profiles before they improve as they work through asset quality difficulties. For banks globally, we estimate the pandemic will help drive credit losses of about $2.1 trillion by year-end 2021 (see "The $2 Trillion Question: What's On The Horizon For Bank Credit Losses," July 9, 2020). This will mostly be on the back of souring corporate and personal sector loans.

While profitability will stay depressed in 2021, many banks overall are in better shape to withstand stress compared with 2009. They are better capitalized and less leveraged, due largely to tougher standards implemented in the wake of the global financial crisis, and have significant provisioning levels to buffer weaker asset quality. Furthermore, funding markets are stable. Nonetheless, our negative outlooks on about one-third of banking groups globally reflect our view of uncertainties and risks in the coming year. We see four key risks to watch.

Key Risk #1--Economic Disruption From COVID-19 Gets Worse Or Lasts Longer

A widely available vaccine from mid-2021 and a strong economic recovery next year is our central premise. While negative pressure on bank ratings will persist until a meaningful and enduring economic recovery can take hold, most bank ratings may hold at current levels if our base case unfolds as envisaged. Should the economic malaise because of COVID-19 become worse or last longer outside the boundaries of our base case (see table 1; and “Global Debt Leverage: Risks Rise, But Near-Term Crisis Unlikely," Oct. 27, 2020), however, then we can plausibly expect a negative step-change in bank credit quality in 2021.

The health crisis and consequent economic recovery is likely to continue to be variable across geographies in 2021. Several noteworthy differences are already evident heading toward 2021 (see chart 2). In some high income economies (mainly in Asia) the virus is currently contained with zero (or close to zero) new infections and deaths; however, significant constraints on borders, mobility, and social gatherings will continue to hinder the economic recovery. In some other high income economies, notably the U.S. and in Western Europe, the virus is resurging.

Many emerging economies are challenged to contain the virus and we expect recovery of some banking systems to pre-pandemic levels will be slow. Furthermore, on the pathway to recovery, factors influencing emerging markets' bank credit quality may be volatile.

Table 1

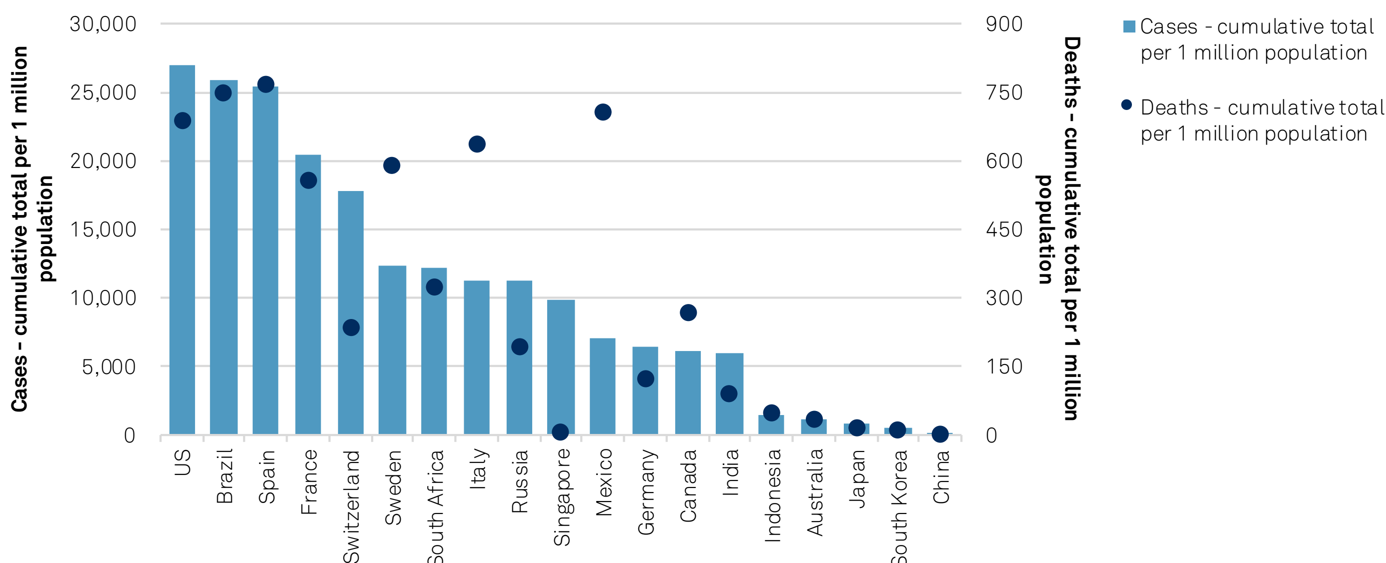
GDP Growth Forecasts

	Current forecast (%)					Difference from previous forecast (percentage points)				
	2019	2020	2021	2022	2023	2019	2020	2021	2022	2023
U.S.	2.2	(4.0)	3.9	2.4	2.6	(0.2)	1.0	(1.2)	(0.6)	(0.20
Eurozone	1.3	(7.4)	6.1	3.0	2.0	0.0	0.4	0.6	0.0	0.0
China	6.1	2.1	6.9	4.8	5.2	0.0	0.9	(0.5)	0.0	(0.1)
Japan	0.7	(5.4)	3.2	1.0	0.9	0.0	(0.5)	(0.2)	0.0	0.0
India*	4.2	(9.0)	10.0	6.0	6.2	0.0	(4.0)	1.5	(0.5)	0.0
Brazil	1.1	(5.8)	3.5	3.0	2.9	0.0	1.2	0.0	(0.4)	0.0
World**	2.8	(4.1)	5.3	3.8	4.0	0.0	(0.3)	0.0	(0.2)	0.0

*The fiscal year for India is April of the reference year to March the following year.
**This is calculated with purchasing power parity exchange rates. Sources: S&P Global Economics and Oxford Economics. See also S&P Global Ratings: "Global Debt Leverage: Risks Rise, But Near-Term Crisis Unlikely," Oct. 27, 2020.

Chart 2

Impact Of COVID-19 On Selected High-Income And Emerging Economies



Source: World Health Organization. Data as of Nov. 2, 2020.

Key Risk #2--Short-Term Support To Banks And Borrowers May Leave Longer-Term Overhangs

Public authorities have acted swiftly and decisively in responding to COVID-19 by providing unprecedented levels of fiscal support as well as significant funding and other support, particularly in advanced economies (see chart 3; and "Global Credit Conditions: The K Shaped Recovery," Oct. 7, 2020). Support measures have largely counterbalanced the effect on bank credit as significant economic volatility flowed through to bank borrowers.

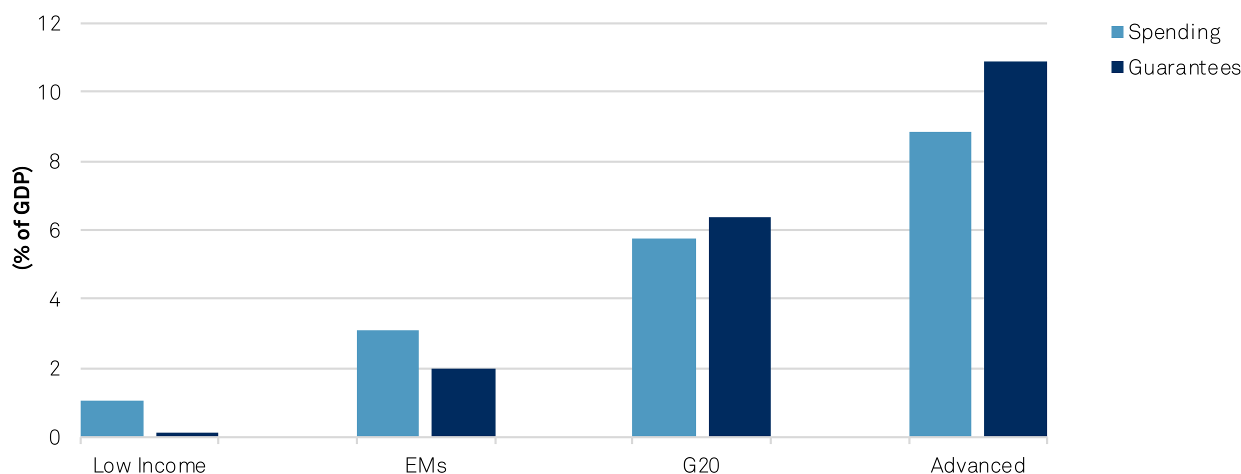
Well-conceptualized and well-timed actions by authorities will be critical in 2021. Should monetary and fiscal stimulus diminish too early then a drawn-out recovery is likely. This could result in more damage to households and corporate balance sheets--and consequently to banks.

Public authorities must contend with a delicate balancing act, however. Measures that benefit banks in the short term could contribute to an overhang of household and corporate debt not commercially bankable in normal times, or introduce moral hazard by encouraging banks to relax lending standards or misprice risks, among other vulnerabilities (see "Five Dangers For Credit Markets Awash With Liquidity," Oct. 29, 2020). Banks are likely to be facing years of lower profitability due to the squeeze on interest margins in an environment of ultra-low interest rates.

A continuation of orderly funding and derivatives markets will be vital for banks to navigate the lingering effects of COVID-19. While not our base case, any major disruptions in funding or derivatives markets would compound adversity for banks.

Chart 3

COVID-19 Related Fiscal Measures



EM—Emerging markets. Source: S&P Global Ratings: "Global Credit Conditions: The K Shaped Recovery", Oct. 7, 2020.

Key Risk #3--Surge In Leverage And Anticipated Higher Corporate Insolvencies

The ongoing surge in corporate leverage and expected higher corporate defaults in 2021 will pose a material risks for banks. While banks are constrained by prudential guidelines including limits on their own leverage, we anticipate potential adverse spillover effects from heavy corporate borrowing in both the bond and bank markets at a time when earnings are under enormous pressure in many industries. Furthermore, some businesses may be less

commercially viable in a post-pandemic world due to structural changes in consumer behavior. Many companies will have to substantially adjust their business models in the new business environment.

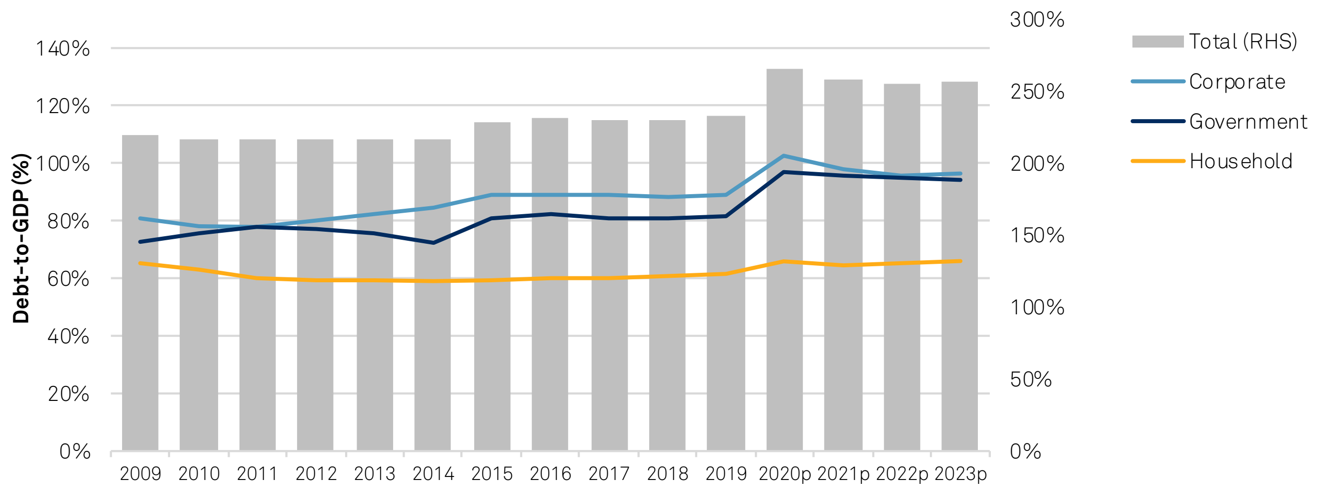
We expect global corporate debt to surge to an average 103% of GDP in 2020 (from 89% in 2019), and government debt to 97% of GDP (from 82% in 2019), before a moderate deleveraging (see chart 4; and "Global Debt Leverage: Risks Rise, But Near-Term Crisis Unlikely," Oct. 27, 2020). This higher stress is indicated our baseline for the 12-month trailing speculative-grade corporate default rate, which we expect to double in the U.S. (to 12.5% by June 2021, from 6.3% in September 2020) and Europe (to 8.5%, from 4.3%) (see "Global Debt Leverage: Risks Rise, But Near-Term Crisis Unlikely," Oct. 27, 2020).

We fully expect that bank asset quality and profitability (taking into account high credit costs and low interest margins) will remain under significant pressure in 2021. Despite the surge in provisioning in 2020, based on banks' expectation of increased nonperforming assets, we see a risk that further top-ups will be required. Lower profitability will continue to translate into weaker internal capital generation.

Higher government leverage has the potential to constrain the future capacity, if not the willingness, of some sovereigns to provide extraordinary support for systemically important banks, in the event it were required. For banking jurisdictions where we currently factor government support into bank ratings, however, we do not anticipate any material diminution in supportiveness over 2021.

Chart 4

Global: COVID-19 Aggravates Debt Rise



p--Projected. Source: S&P Global Ratings: "Global Debt Leverage: Risks Rise, But Near-Term Crisis Unlikely", Oct. 27, 2020.

Key Risk #4--Property: The Age-Old Nemesis For Bank Credit

Borrower repayment moratoriums, forbearance by landlords in some jurisdictions, renegotiation of borrower arrangements by banks, and record low interest rates may be masking underlying asset quality problems. We think this is particularly the case for property, where banks typically maintain high security levels and can contend with short-term or temporary borrower cash flow difficulties. Furthermore, COVID-19 is accelerating pre-existing threats in segments of the commercial property market, such as retail malls challenged by online shopping. The office sector faces structural changes that could arise if work-from-

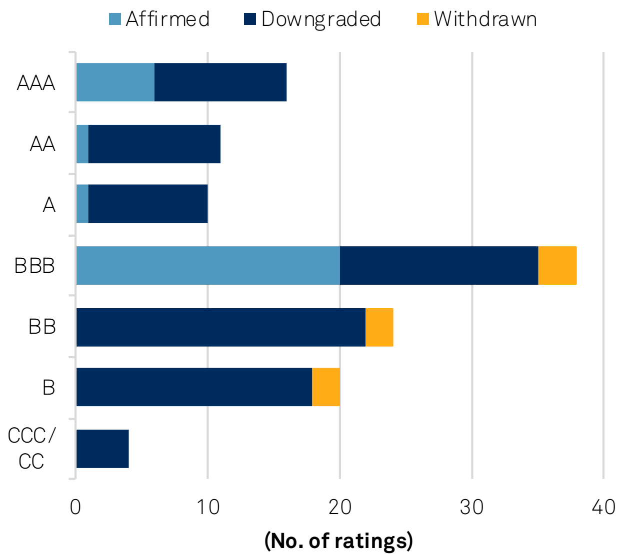
home trends prove enduring. We see increasing risks in 2021 of commercial property risks potentially hitting banks' asset quality.

Additionally, there is a risk in certain markets that repayment holidays and wage subsidies could be delaying trouble that won't crystalize until support diminishes or is withdrawn. This includes borrowers' residential property assets used to secure small business operations and for investment purposes. One positive for banks is that residential property prices have held up quite well globally across many markets, allaying some concerns regarding a more pronounced fall in prices at the onset of the pandemic. In addition, borrower affordability will continue to be supported in 2021 by low interest rates.

Insights from rated transactions in commercial mortgage backed securities (CMBS) offer some visibility--though the view is not great. Stresses in the commercial property sector for transactions in rated pools may point to impending asset quality issues for banks with commercial property exposures on their balance sheets. A recent review of U.S. CMBS ratings resulted in 185 downgrades, comprising 88 single-asset/single-borrower (SASB) and large loan classes, and 97 conduit classes. In European CMBS since the COVID-19 outbreak, we've taken actions on about 20% of rated transactions. (see charts 5-6; and "U.S. And European CMBS COVID-19 Impact: Retail And Lodging Are The Hardest Hit," Sept. 28, 2020). Rating actions were most severe in the SASB subsector backed by retail malls--a sector which is experiencing considerable stress on several fronts.

Chart 5

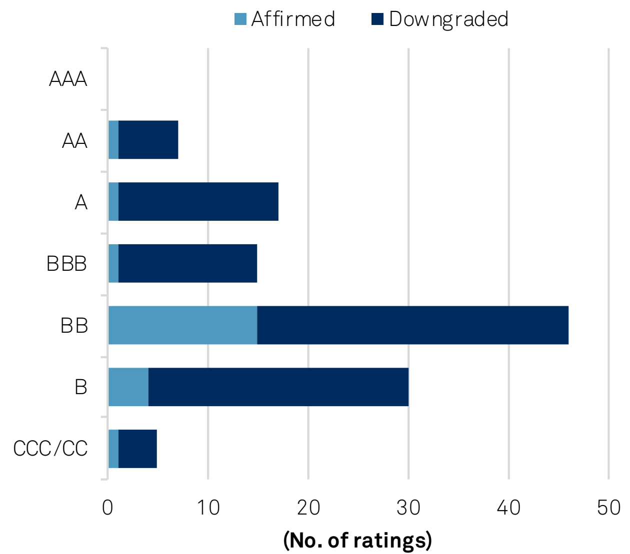
Rating Actions On U.S. Retail And Lodging SASB And Large Loans Transactions



(i)As of September 2020. SASB--Single-asset/single-borrower. Source: S&P Global Ratings.

Chart 6

Rating Actions On U.S. CMBS Conduit Transactions(i)



(i)As of September 2020. Includes 24 additional rating actions that occurred as a result of the review. Source: S&P Global Ratings.

Other Risks on the Radar

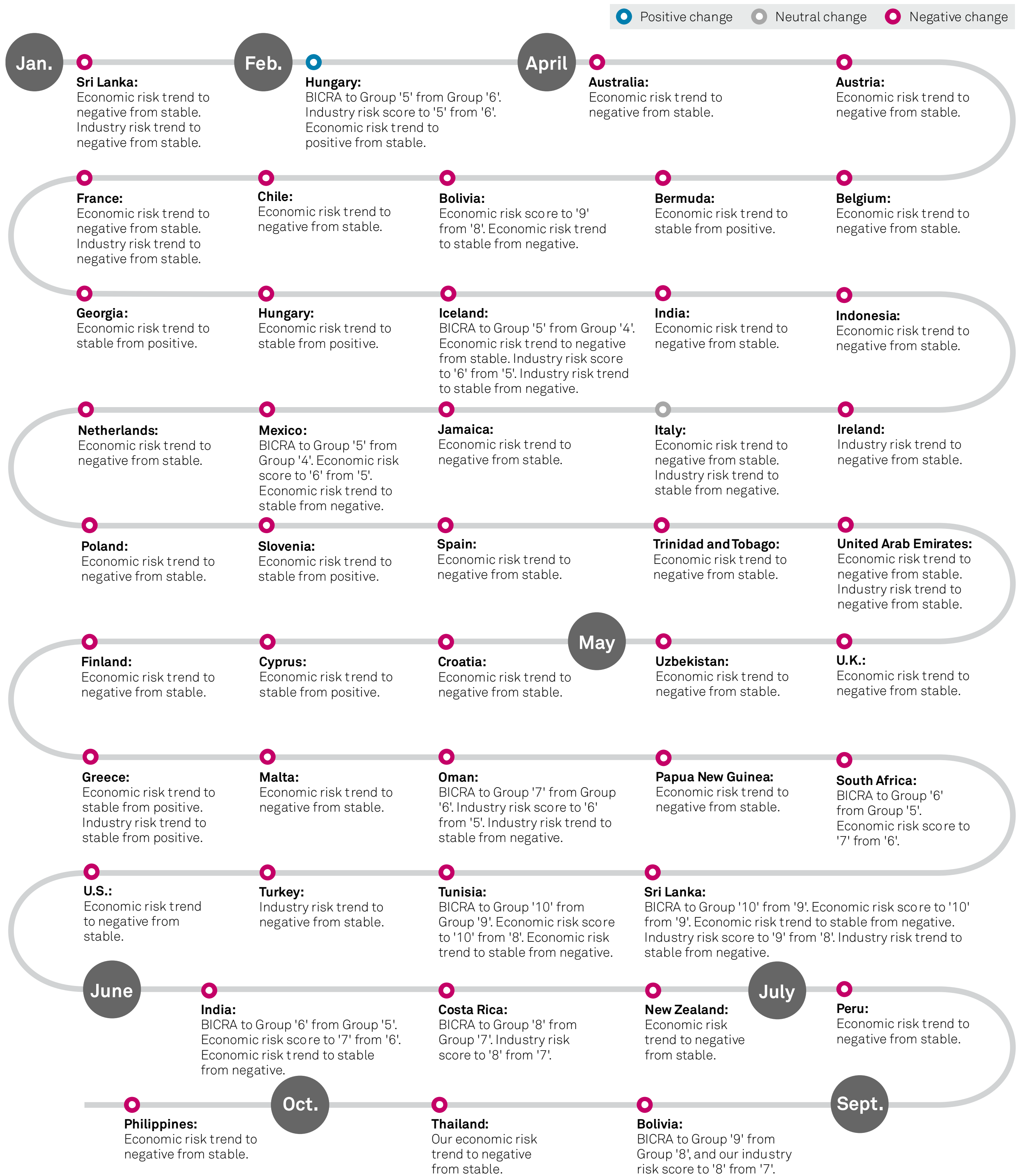
While we highlight four critical risks, there are numerous other tests for bank credit quality in 2021 and beyond.

- **EM vulnerability:** Emerging market banking systems are exposed, by varying degrees, to local economies' heavy reliance on external funding, concentration on specific sectors (such as the hospitality sector or industrial or service exports to developed countries) or commodities (such as oil or gas). Another vulnerability in some countries is the lack of government capacity to continue providing meaningful support. Further headwinds include the impact of lower interest rates on interest margins and lower lending growth on profitability (noting that interest margins are typically higher compared with developed markets), increasing credit costs as regulatory forbearance measures are progressively lifted, and potential challenges refinancing external debt for some jurisdictions. We also expect to see a greater divergence in the performance of the larger and smaller banks in some of these markets.
- **Digital disruption:** The prospects for digital disruption to incumbent banks is increasing. Potential step-changes in digital technologies could have a profound impact on how intermediation plays out between savers and investors, and public authorities and citizens, among other spheres. In turn, this could affect competitive dynamics--or other key risk factors--for banks. However, we also emphasize that digital disruption is ushering in many opportunities for banks in meeting customers' evolving expectations, while at the same time assisting banks to expand and diversify revenues, and control costs. Investment in new technologies has enabled banks to offer a quality service to customers despite the various containment measures that have severely disrupted other businesses. We see that COVID-19 is accelerating innovation and digitalization of many banking markets. 2021 could see the further major developments, including the ongoing exploration by central banks of opportunities related to digital currencies. The central banks of Sweden, Canada, Switzerland, the U.K., and Japan, plus the European Central Bank, have formed a working group with the Bank for International Settlements to share findings as each investigates potential cases for central bank digital currencies (CBDCs). They have already published views on the principles and key features of CBDCs as well as the necessary infrastructure. In China, the central bank has given away Chinese renminbi 10 million (US$1.5 million) of digital currency in a public test of the digital renminbi payment system. As well as exploration on e-currencies, we expect banks to materially invest into technology platforms including cloud transformation to streamline back-end processes.
- **ESG:** Investors and their stakeholders now demand more clarity on environmental, social, and governance (ESG) issues for decision-making. While key ESG considerations have always been integral in ratings decision-making concerning banks, this trend is likely to gain even further traction, driving increasing ratings diversification. Similar to digitization, ESG presents rewards as well as risks for banks that can skillfully navigate the ESG landscape in 2021 and longer term.
- **Geopolitics:** Economic nationalism and geopolitical tensions constitute one of the top risks (see "Global Credit Conditions: The K Shaped Recovery", Oct. 7, 2020). The U.S.-China strategic confrontation is important for bank credit quality in many economies, not just the U.S. and China. This dispute has implications for large global manufacturing economies and their banking sectors, such as Germany and Japan; as well as primary producer and mineral-exporting economies.
- **New benchmark rates:** The planned introduction of new interest rate benchmarks in 2022 is another critical development worth monitoring, as banks transition. Management of related operational, commercial, legal, and financial risks will be key.

A Note On Our Coronavirus Assumptions

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

Global BICRA Developments In 2020



BICRA--Banking Industry Country Risk Assessment. Data as of Oct. 27, 2020.
Source: S&P Global Ratings.

Country-By-Country Outlook

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Note: 87 countries are included in the report. Countries are listed in alphabetical order by region.

North America

BICRA groups: lowest to highest

Group '1' to '10', from lowest to highest risk. BICRAs--Banking Industry Country Risk Assessments.
Data as of Oct. 27, 2020. Source: S&P Global Ratings.

Bermuda | BICRA Group: 5

Deep Economic Contraction, Notwithstanding A Resumption Of Tourism Activity, Will Weigh On Banks' Asset Quality

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Key takeaways

- Bermuda's tourism sector and economy have started to recover with the resumption of commercial flights in July 2020, though the full economic recovery will take time and in the meantime weigh on banks' asset quality.
- Following an initial period of forbearance granted to borrowers, we expect an acceleration of credit losses and nonperforming assets, which Bermuda's banks will weather thanks to the strength of their capital positions.
- We believe the pandemic will prolong the correction phase of Bermuda's real estate market, where prices have dropped about 11% since 2008 with an even steeper drop in condo prices, notwithstanding recent stabilization.

Key credit drivers

COVID-19. We expect increased pressure on banks' asset quality and limited loan growth in the near term, though banks maintain strong capitalization. The pandemic and associated travel restrictions, though lifted currently, have hurt Bermuda's tourism sector, putting pressure on any directly or indirectly affected personal or business loans.

Residential real estate market. Bermuda is experiencing a prolonged correction period in its real estate sector that started following the global financial crisis. We expect the pandemic will prolong the correction phase, given near-term economic pressures, though there might be upside from interested buyers looking to work remotely from the island.

Key assumptions

Deep pandemic-induced recession, followed by a rebound in 2021. We project real GDP will decline by 7% in 2020 due to the economic shock from the pandemic, while the international financial sector will provide some stability. Real GDP growth will snap back thanks to base effects in 2021 (5% growth) before plateauing at its pre-pandemic level of about 1%.

Continued appeal as an international financial center. We believe the EU's white-listing of Bermuda earlier this year, confirming that the territory complies with the EU's tax good governance principles, will help the country maintain its appeal as an international financial center.

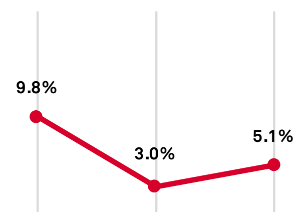
What to look for over the next year

Asset quality deterioration. We expect the shock to the tourism sector in particular will lead to a deterioration in asset quality over 2020 and into 2021. While banks have granted borrowers some short-term relief, the slowness of the recovery and uncertainty around the tourism outlook will keep pressure on asset quality high.

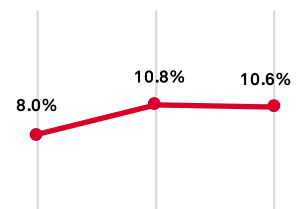
House price development. House prices have declined by about 11% since 2008, with an even steeper drop in condo prices. Notwithstanding some stabilization before the pandemic's outbreak, we believe the anticipated weak recovery and uncertainty around the outlook for the tourism sector will sustain pressure on real estate prices. However, Bermuda recently began offering one-year residencies for non-Bermudians, allowing them to work remotely from the island. If expanded, this measure could bolster Bermuda's real estate sector.

Bermuda

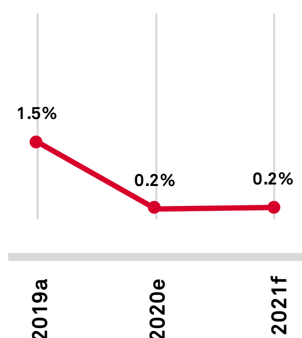
Loan growth



NPA ratio



RoAA



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Canada | BICRA Group: 2

Strong Fundamentals And Economic Recovery, Albeit Uneven, Provide Support As Uncertainties Linger

Key takeaways

- Canadian banks confronted the dual shock of the pandemic and oil price decline from a strong position, with diversified revenue streams, historically low loss rates, and good liquidity and capital buffers.
- Higher provisioning levels, particularly in the commercial and unsecured loan segments, will pressure earnings in 2020, but an economic recovery should support returns in 2021.
- Continued extremely accommodative fiscal and monetary policy has cushioned the economic blow and supported banks, but potential spikes in credit losses in the near term and lower-for-longer interest rates over the medium term will weigh on banks' earnings.

Key credit drivers

The pace of economic recovery. Concurrent shocks from the drop in oil prices and pandemic pushed Canada's economy into its deepest contraction on record, from which it has begun to recover. Despite a quicker-than-expected first-phase recovery, the recovery remains uneven and uncertainty remains high.

Earnings and capital. Notwithstanding an expected 30%-50% contraction in earnings in 2020, banks remain largely profitable, while capitalization is healthy. Although the economic recovery should support bank balance sheets in 2021, if pressure on banks' profitability or capitalization intensifies, ratings could come under pressure.

House price trends. Home resales and housing starts have rebounded strongly in recent months, but we still expect uncertainties around the economic recovery and a slow labor market recovery could pressure house prices in the near term. In the medium term, we believe fundamental factors, especially supply-demand imbalances, will continue to support house price growth.

Key assumptions

An uneven and incomplete recovery. We forecast the Canadian economy will contract by 5.6% in 2020 before gaining 4.9% in 2021. We believe the unemployment rate peaked at 13.7% in May 2020 but will not reach pre-pandemic levels before 2024.

Fiscal and monetary policy will remain accommodative. Canada's government recently extended several of its fiscal support measures, which should continue to support the recovery in 2021 and 2022.

What to look for over the next year

Asset quality deterioration. Payment deferral and forbearance programs, coupled with generous fiscal measures that have recently been extended, will help borrowers in the near term, but asset quality could deteriorate beyond our current expectations if unemployment remains elevated when these programs expire, with a potential payment cliff in mid-2021.

House price development. We will monitor whether the potential house price correction becomes protracted as the labor market and economy take time to recover. This, in turn, could pressure Canada's highly leveraged households. Fundamentally, we believe continued supply-demand imbalances, driven in part by continued net migration, will support house price growth over the medium term. We also expect a correction in house prices would be short-lived.

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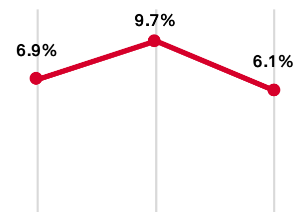
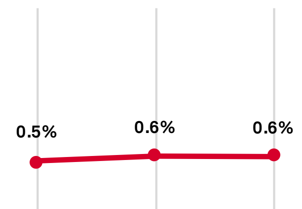
Canada

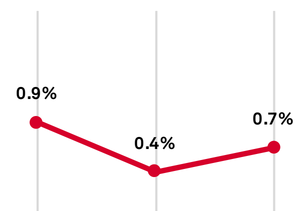
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

U.S. | BICRA Group: 3

Banks Have Weathered The Pandemic Well, Though Major Uncertainty Remains

Key takeaways

- U.S. banks saw an improvement in earnings and some key asset quality indicators in the third quarter of 2020, but major uncertainty remains about the pandemic, the economy, and asset quality.
- We expect bank earnings to improve in 2021 but remain somewhat muted, while provisions for credit losses should fall from 2020's elevated levels but remain material and ultralow interest rates will continue to weigh on spread income.
- If the economy stalls or the government fails to provide more stimulus, banks could see greater deterioration in asset quality, earnings, and capital than we expect, triggering negative rating actions.

Key credit drivers

The strength of the economy. The economy should be the biggest determinant of banks' asset quality. Since the economic rebound began, loans on forbearance have fallen, and nonperforming assets have not changed materially. Still, if the rebound sputters, asset quality problems likely would intensify.

The extent and effectiveness of government support measures. Congress and the president have not agreed on a way to extend key fiscal stimulus measures that have expired. While monetary support remains ample, a lack of additional fiscal support in 2021 could lead to increased asset quality problems.

Earnings and capital. Banks have largely remained profitable in 2020 with good capital, notwithstanding high levels of provisions and pressure from ultralow interest rates. We expect that to continue in 2021, but if banks suffer material bottom-line losses or drops in capital, ratings could come under pressure.

Key assumptions

GDP will grow modestly in 2021 with further fiscal stimulus. The economy grew somewhat faster than expected in the summer, but we expect GDP to fall 4.0% in 2020 before rebounding 3.9% in 2021. S&P Global economists expect $500 billion of additional stimulus in their base case.

Pandemic-related losses will approach 3%. While banks have reported sharp drops in loans on forbearance in recent months, we still expect them to report pandemic-related charge-offs, mostly in 2021, at about half the 6% rate the Federal Reserve projects in the severely adverse scenario of its annual stress test. We believe many banks would have to more than double the already large provisions they have taken in the first three quarters of 2020 to cover those losses.

Relatively muted earnings. If banks ultimately provision enough over the next year to cover 3% of pandemic-related charge-offs, we would expect them to generate positive but relatively muted earnings. The pressure of low interest rates on spread income will also continue to weaken earnings.

What to look for over the next year

The impact of the elections. President-elect Joe Biden's administration could push for more stimulus, higher corporate taxes, and tougher enforcement of consumer regulations. However, a Republican retention of power in the Senate could hinder some of those efforts.

Regulatory limitations on shareholder payouts. The Fed has prohibited large banks from repurchasing shares or increasing their dividends through the end of 2020, which has contributed to higher capital ratios. A relaxation of that prohibition in 2021 could reverse some of those increases.

The performance of commercial real estate (CRE). CRE loans have emerged as one of the most challenged asset classes. Struggles in retail, office, and lodging markets could significantly affect banks that lend in those sectors.

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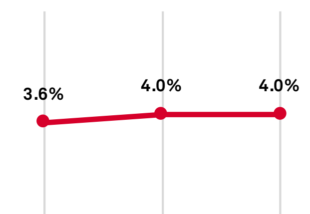
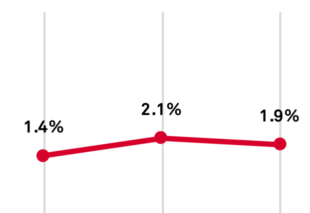
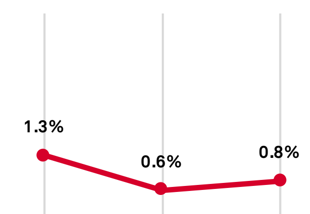
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

LATAM

Group '1' to '10', from lowest to highest risk. BICRAs--Banking Industry Country Risk Assessments. LATAM--Latin America and Caribbean. Data as of Oct. 27, 2020. Source: S&P Global Ratings.

Argentina | BICRA Group: 9

Not All Challenges Stem From The Pandemic

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Key takeaways

- Despite the sovereign's agreement to restructure its debt, Argentina's banking industry continues to grapple with very challenging economic conditions, which the pandemic exacerbated.
- The prolonged lockdown has caused a severe GDP contraction in 2020, while we forecast only a partial recovery in 2021. Therefore, high economic risk and imbalances would persist over the next few quarters.
- These factors result in a very high average risk for banks operating in the country, and the sovereign's credit quality limits ratings on financial entities.
- To withstand volatility and the adverse operating conditions, the system strengthened its liquidity position and regulatory capitalization.

Key credit drivers

Conditions were already weak before the pandemic. The country was suffering from economic malaise, and market and political volatility before the pandemic hit.

Authorities took actions but with limited flexibility. To cope with the effects of the pandemic, the authorities in the country took actions such as direct transfers to the low-income slice of population, lending to help SMEs and individual borrowers, loosened criteria for classifying past-due loans, established the refinancing of credit card and loan debts, and recapitalized the FoGar trust. However, the extent of these actions lag those of some other countries in Latin America that have more financial muscle.

Banks strengthened liquidity and capital to cope with volatility. Banks have consistently reduced lending in foreign currency, while keeping high levels of liquidity in domestic and foreign currencies. Banks also maintain sufficient regulatory capital metrics given the higher weight of liquid assets and restrictions to distribute dividends until the end of the year.

Key assumptions

The pandemic's severe impact in 2020 with only a mild GDP rebound in 2021. We project GDP to shrink 12.5% in 2020 due to the prolonged lockdown. The persistence of imbalances in the economy would result in only about 5% GDP growth in 2021.

No credit growth in real terms in 2020. Credit penetration in Argentina is the lowest in Latin America, at about 11% (measured as credit to GDP). We don't expect lending growth in real terms for 2020, given inflation of about 43% and the lending contraction in foreign currency, compensated by growth in domestic currency lending.

Profitability down but positive in real terms. Profitability has declined from the 2019 peak because of lower rates of central bank securities and the impact of inflation adjustment on financial statements. However, despite the increasing provisions, banks have generated profitability in real terms due to still low funding costs, and holdings in central bank securities and associated instruments.

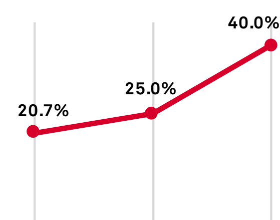
Further deterioration in asset quality. Asset quality metrics will further erode due to the impact of the pandemic, but they will materialize in 2021 due to the loan moratoriums.

What to look for over the next year

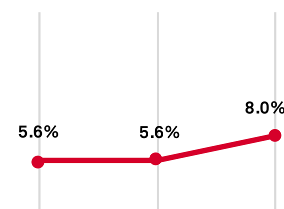
Developments in the economy. We're closely monitoring developments in the economy particularly of the impact of market and political volatility on the banking system in terms of asset quality, profitability, and liquidity. Significant withdrawals of foreign currency deposits occurred during presidential election last year, with continued volatility since then but at a much lower pace. In addition, the trajectory in access to foreign currency and investments is very relevant to the economic recovery.

Argentina

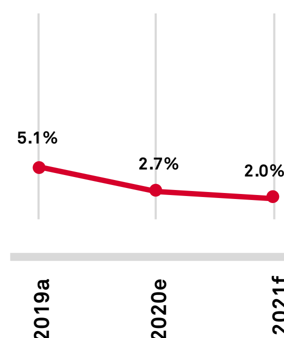
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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a--Actual. e--Estimate. f--Forecast.

Bolivia | BICRA Group: 9

Lockdown And Directed Lending Heighten Credit Risks

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Key takeaways

- Risks in the domestic financial system have increased due to the economic lockdown resulting from the pandemic.
- Government-directed lending will likely continue to pressure the banking industry's net interest margins and profitability.
- The new president, Luis Arce, will face the challenge of managing fiscal and external imbalances, as well as the social and economic impact of the COVID-19 pandemic with limited resources and health care infrastructure.

Key credit drivers

Weakening macroeconomic conditions are weighing on credit growth and asset quality. The pandemic has increased risks in the Bolivian financial system because the economic lockdown is hurting credit growth and pressuring the credit losses, profitability, and capital metrics of domestic banks. Moreover, although the banking system has lessened its exposure to dollar-denominated loans and deposits in recent years, we still believe the deterioration in the country's external conditions could weaken the domestic financial industry during the next two years.

Directed lending is narrowing profits. Government-directed lending is likely to continue producing stiff competition and lessening margins among domestic banks. This is because the law regulates ceilings on lending rates and requires banks to comply with minimum credit quotas aimed at the low-income housing and productive sectors such as agriculture, mining, manufacturing, and tourism.

Key assumptions

Challenging economic conditions. We forecast Bolivia's economy to contract in 2020 as a result of decline in global energy prices and lockdowns stemming from the pandemic. However, the GDP should rebound during 2021.

Manageable credit losses despite lockdowns. We expect the nonperforming assets ratio to increase to 2.6% by 2021 due to the economic paralysis. Moreover, continued aggressive lending competition and underwriting standards could widen further credit losses afterwards.

What to look for over the next year

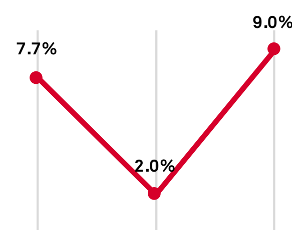
Political transition. Luis Arce, from the Movement for Socialism (MAS) political party, was elected president on October 18. The successor of the former president, Evo Morales, will have to address fiscal and external weaknesses, primarily due to the decreasing exports of natural gas and a still wide fiscal deficit. Mr. Arce will also have to confront the economic and social implications of the pandemic, as well as Bolivia's still weak public institutions and high levels of corruption.

Liquidity strains in the next months. The government law allowing borrowers to postpone payments until the end of 2020, along with a potential scenario of deposit volatility due to political turbulence in the middle of the presidential transition, could add risks to the system's funding and liquidity.

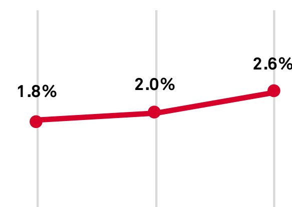
Enterprises' high debt levels and lending concentration. Regulatory lending quotas and interest-rate caps have encouraged rapid credit growth for borrowers in the productive sectors, which could lead to high debt levels. At the same time, Bolivian laws encourage increasing lending volumes, and concentration in cyclical sectors with high loan amounts and longer durations in order for banks to meet targets, which could ratchet up credit risks in the system.

Bolivia

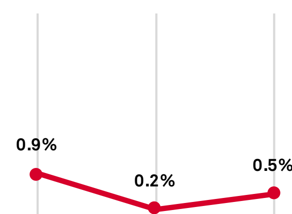
Loan growth



NPA ratio



RoAA



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Brazil | BICRA Group: 6

Regulatory Measures Should Mitigate The Impact Of COVID-19

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Key takeaways

- Brazil has performed better than expected due to the combination of a strong stimulus and relatively loose lockdown measures.
- Expected asset quality deterioration led banks to increase substantially provisions for credit losses, jeopardizing bottom-line results.
- However, we expect credit losses to remain manageable thanks to banks' conservative growth strategies in the past two years and the regulatory measures that help cushion the impact.

Key credit drivers

A narrower-than-expected economic drop. Brazil will fall into a mid-single digit recession in 2020 due to a strong stimulus and relatively loose containment measures, despite at one point becoming a global COVID-19 hotspot.

Regulatory relief measures will help mitigate the impact on banks. Brazil's central bank has introduced a comprehensive set of measures to diminish the impact of COVID-19 including liquidity support, guarantees on loans, and capital and provisioning relief. These measures have also prompted banks to boost lending, which we expect to grow 12% this year driven by corporate lending.

Credit cost and net income to sink in 2020. The expected weakening asset quality has led banks to increase substantially provisions for credit losses, jeopardizing bottom-line results. On the other hand, the coronavirus outbreak had mixed effects on credit growth, given that demand in the corporate sector spiked, while that for consumer products such as credit cards, mortgages, and auto loans stagnated.

Key assumptions

We expect nonperforming loans to peak in 2021. We expect credit losses to hit hard the Brazilian banking system and forecast them to be wider than in the last economic crisis. However, banks' still high margins and consistently high provisioning coverage will help mitigate the impact on their balance sheets. In addition, banks implemented conservative growth strategies in the past two years that focused on granting payroll deductible loans to government employees, mortgages with conservative loan-to-value ratios, and corporate loans with stronger guarantees.

Recognition of weaker asset quality will be delayed. The central bank has allowed banks to offer loan moratoriums to borrowers while maintaining the risk classification prior to the pandemic, a similar trend to those of other countries. Banks have offered loan payment deferments to about 21% of borrowers. On the other hand, major banks continued to classify their borrowers based on their risk profiles, and started to raise additional provisions during the first half of 2020 based on their internal modelling.

What to look for over the next year

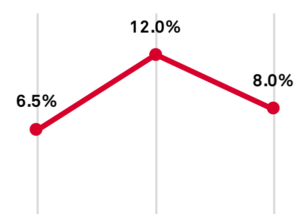
Uncertainty over the country's structural reform agenda has increased. Ongoing disagreement between the legislative and executive branches, which could become more acute as the pandemic lingers and social pressure increases, could limit the passage and implementation of significant structural reforms during the rest of the administration's term, in our opinion.

Problem loans could heighten. The Brazilian banking system was recovering from the prior economic crisis before the pandemic hit; therefore, a number of corporations entered the pandemic in fragile conditions. If economic activity takes longer to recover, some businesses' sustainability could come under pressure.

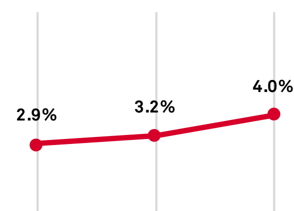
Economic rebound could take longer than expected. If the economic recovery is much weaker than we expect after the pandemic's shock dissipates, banks' operating performance could struggle.

Brazil

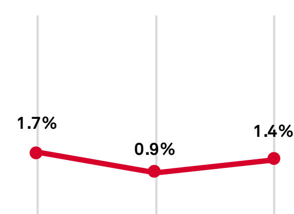
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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Chile | BICRA Group: 3

Banks Are Coping With The Pandemic, But Other Challenges Remain

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Key takeaways

- The pandemic and residual effects of social unrest in late 2019 are hampering banks' asset quality and profitability. This is occurring amid the population's lower GDP per capita and the country's higher corporate debt than among peers.
- Therefore, rated financial entities in Chile have negative outlooks, including the state-owned bank, reflecting the outlook on the sovereign.
- The authorities in Chile took several early actions to ensure banks' liquidity and solvency, as well as measures to buffer the impact of the economic contraction and higher unemployment. In addition, the recent allowance to access pension savings provided additional relief to individuals facing financial hardship.

Key credit drivers

Strains stemming from the pandemic and last year's social unrest. The GDP contraction in 2020, because of the pandemic and the residual effects of last year's social unrest, is augmenting economic risk and stressing banks' asset quality, credit losses, and profitability. Chilean corporations and enterprises also have higher leverage and individuals have lower income levels than those in Chile's global peers.

The regulator took actions to ensure stability and to mitigate the impact. Authorities took several measures to shore up liquidity and solvency in the system and to diminish the pandemic's pernicious effect on the economy.

Key assumptions

Credit growth in 2020 driven by guaranteed credit lines. We expect credit lines under the FOGAPE program (loans guaranteed by the government) including the refinancing of existing loans to cause an estimated nominal lending growth of 6%-8% in 2020. For 2021, we expect guaranteed loans to start amortizing and to be replaced by regular loans that accrue higher rates.

Worsening asset quality and higher provisions. We expect the deterioration in asset quality to materialize in 2021, as the borrower relief measures begin to be phased out. We forecast nonperforming loans to be about 2.0%-2.2% in 2020 and 2.5%-3.0% in 2021 amid climbing unemployment and mitigated by the withdrawal of pension savings.

Recovery in 2021. Conditions in the country should start improving in 2021, especially in the second half, given better prospects for global economy, especially in China, and higher copper prices.

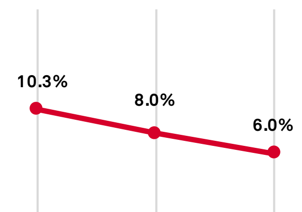
What to look for over the next year

Social issues are at the forefront and the new constitution is under discussion. Discussions about changes to the constitution will start in 2021 after the recent plebiscite in favor. These were planned for April but postponed due to the pandemic. The completion of such discussions will enable the economic recovery to strengthen.

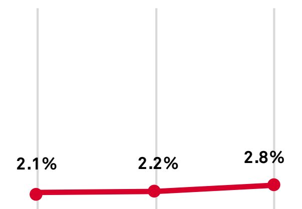
Final impact of shocks still unclear. It will take time to measure the final effects of the pandemic, social unrest, and the measures taken to mitigate them on companies and banks' loan portfolios. The performance of SMEs and large corporate groups are factors to monitor, which could spill over into the banking sector.

Chile

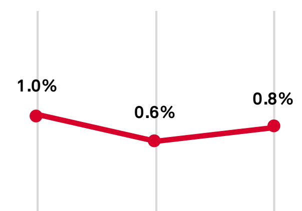
Loan growth



NPA ratio



RoAA



2019a | 2020e | 2021f

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Colombia | BICRA Group: 6

COVID-19 Will Slow Credit Growth And Hit Asset Quality And Profitability

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Key takeaways

- Credit rebound will remain on hold until 2021-2022 because of the coronavirus pandemic.
- The weakened economy will take time to recover due to high unemployment, hurting asset quality and profitability metrics.
- Regulatory improvements aim to align banks' capitalization with international standards and improve funding diversification.

Key credit drivers

The more positive pre-pandemic economic conditions will allow faster recovery in 2021-2022. The government's measures to contain the virus, which include a moderate monetary and fiscal stimulus, will help restore pre-pandemic economic dynamics, which in turn will support Colombian banks.

Expansion to Central America provides diversification but pressures capitalization. We estimate that one-third of the three largest banks' balance sheets are exposed to Central America. This boosts diversification, but the goodwill related to acquisitions stresses capitalization levels.

The adoption of Basel III capitalization rules in Colombia continues despite the pandemic. However, once these rules are implemented, it's not clear that banks' risk-adjusted capitalization will strengthen in relation to international standards.

Key assumptions

Credit rebound won't occur until 2021-2022. Given the strong link between economic growth and credit expansion, we expect the latter won't accelerate until 2021-2022 when we expect the economy to grow 4.5% and total loans to expand about 8%.

Asset quality will worsen due to the pandemic. We expect the nonperforming assets ratio to be 4.5%-5.0% in 2020-2021--fully covered by reserves--while loan loss provisions would represent 4% of total loans.

Sinking interest rates and deteriorating asset quality will hit profitability. Since the beginning of the year, the central bank has lowered its policy rate by 250 basis points, which along with higher provisions will pressure profitability. We expect return on assets to be about 0.5% in 2020-2021.

What to look for over the next year

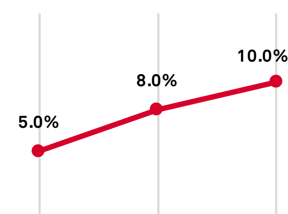
Evolution of banking regulation changes. Implementation of Basel III capitalization rules could have repercussions on our risk-adjusted capital ratios, and banks will likely seek to increase retail deposits to strengthen regulatory net stable funding ratios.

Colombia's weakening external profile could bring risks to the banking system. COVID-19 and the slump in oil prices are widening the current account deficit. This could hurt banks through higher external funding costs and by the impact on borrowers that operate in economic sectors sensitive to currency fluctuations.

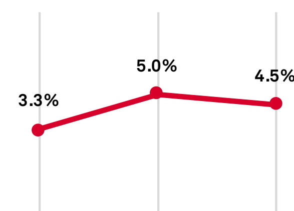
Developments in nonperforming assets due to COVID-19. Even before the pandemic, unemployment was rising in Colombia. As a result of COVID-19, unemployment has spiked, and the impact on banks' asset quality will depend on the severity and duration of the pandemic-related recession.

Colombia

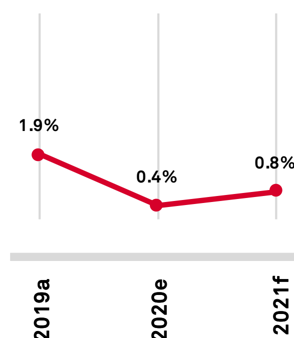
Loan growth



NPA ratio



RoAA



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Costa Rica | BICRA Group: 8

Deeper GDP Contraction And The Pandemic Will Hurt Banks' Asset Quality And Profitability

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Key takeaways

- Higher loan-loss reserves will decrease banks' bottom-line results and profitability.
- An already weakening asset quality will take a further hit from the recession in 2020 and continue suffering throughout 2021.
- On June 9, 2020, we lowered our global scale ratings on Costa Rica to 'B' from 'B+', reflecting our expectations of a deeper contraction in GDP and more persistent deterioration of the government's fiscal profile in 2020 and 2021. The negative economic risk trend on the BICRA reflects pressures on the sovereign's political, economic, fiscal, and debt trajectories, exacerbated by the COVID-19 pandemic.

Key credit drivers

Insufficient fiscal reform. Limited fiscal reform is bound to continue weakening public finances, resulting in continued large fiscal deficits and higher debt levels. The economy continues to show resiliency, although growth has slowed down in the past two years, and we expect a GDP contraction of about 3.6% in 2020 because of the COVID-19 pandemic. However, we expect a growth of 3.3% in 2021 and 3.0% in 2022-2023.

Relief programs will provide short-term breathing space but will lengthen the recovery period. Given the measures that the regulator and banks have taken to support customers amid this crisis, we believe non-performing assets will rise in late 2020 and throughout 2021. This will widen credit losses, putting pressure in the system's financial flexibility.

Distorted competitive dynamics in the banking system bite into profitability. The two largest banks in the country are state-owned and control about 40% of market share in terms of loans, which causes market distortions and depresses profitability (average ROE for the past four years was about 5%).

Key assumptions

Asset quality will deteriorate amid the recession. We expect the nonperforming assets ratio to reach a peak of 4.2% by 2020--fully covered by reserves—and remain above 3.5% for 2021. We also expect that the cost of risk in the system will increase to levels above 1% for the next two years.

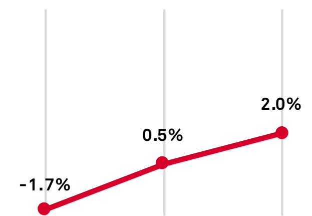
Higher provisions and lower interest rates will dent profitability. For the past couple of years, we observed a steady decline in profitability in the Costa Rican banking system. Due to the pandemic-induced economic shock, we believe that this trend will exacerbate as banks are forced to increase their loan-loss reserves. Additionally, the declining interest rates towards historically low levels are ratcheting up pressure on net interest margins and active lending rates for core banking products.

What to look for over the next year

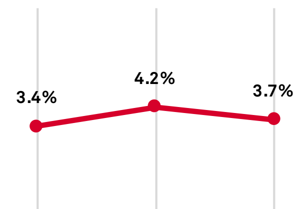
Stagnating consumer loans will restrain credit growth. Weak economic activity and higher unemployment will take a toll on the consumer lending segment, but it will be the sole source for credit growth during 2020-2021.

Costa Rica

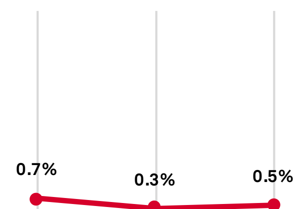
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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El Salvador | BICRA Group: 8

COVID-19 To Hurt Banking System's Key Figures

Key takeaways

- We expect asset quality to worsen following the shutdown of non-essential business activities in response to the COVID-19 pandemic. We also expect delinquency levels to double and profitability to drop below 0.7% this year.
- The sovereign's already high debt burden could limit fiscal flexibility under adverse market conditions. We expect funding from the International Monetary Fund (IMF), other official creditors, and international markets to provide some liquidity and funding sources to maintain modest credit expansion for 2020 and 2021.
- Despite the country's economic and political challenges, the banking system continues to have relatively stable funding sources and liquidity needs while relying on a large and diversified deposit base.

Key credit drivers

Economic stability subject to political consensus. Beyond the pandemic, raising economic growth in the coming years will require reforms to foster competition and investment, supported by sustained measures to reduce crime and the large informal sector, which we estimate employs about 70% of the working-age population. A divided legislature will continue to be a challenge for policy implementation to repair economic growth once the pandemic eases.

Credit risk in the economy is rising. Despite manageable delinquency levels and credit losses, modest access to banking, and diversified loan portfolios, we think the pandemic and the country's inherent economic, social, and political challenges could harm asset quality metrics.

Room to improve institutional framework. In response to the impact of COVID-19, the regulator allowed banks to undertake voluntary loan restructurings with troubled borrowers. Additionally, it has been proactive in monitoring banks' liquidity, solvency metrics, and credit losses during the pandemic. Still, El Salvador's overall framework remains a step behind those of countries with a Basel III framework, the adoption of which could strengthen bank supervision going forward.

Key assumptions

The economic contraction will delay the government's plans to boost long-term growth. We expect the economy to contract about 7.5% in 2020 and grow 3.5% in 2021. We also expect low per capita income to stand at about $3,800 for 2020. The country has experienced only moderate economic growth in past years because it has suffered from many years of low investment, political gridlock, weak competition, and high emigration.

Moderate credit expansion. We expect credit to keep expanding modestly in El Salvador, reflecting the country's sluggish economic growth and the highly challenging conditions during the pandemic. We forecast credit to expand 1.5% in 2020 and 4.0% in 2021 amid modest profitability.

What to look for over the next year

Government's ability to restore investor confidence. Raising economic growth in coming years will require reforms to foster competition and investment, supported by measures to reduce crime.

Remittance performance. Remittances account for about 20% of GDP and come mainly from the U.S. As of September 2020, remittances have began growing again after they contracted in April and May 2020. We'll monitor this growth since it could boost household income capacity, and consequently, overall economic performance.

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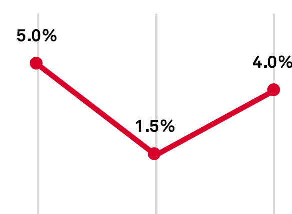
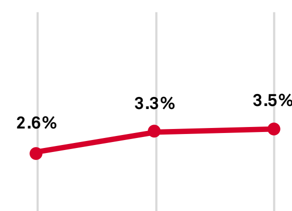
El Salvador

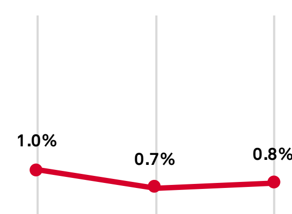
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Guatemala | BICRA Group: 7

Retail Portfolios To Sharply Contract Due To The Economic Slowdown

Key takeaways

- Lower business volumes in retail segments for Guatemalan banks due to the lockdowns and recession.
- We forecast the system's nonperforming assets to increase to about 3.4% in 2021 because of the virus-induced economic crisis after the forbearance and relief programs end.
- We expect a deeper deterioration in the asset quality metrics of financial institutions focused on the microfinance and consumer segments.

Key credit drivers

Banking system with a stable funding base. Thanks to reliance on a large retail deposit base and to adequate lending and underwriting standards, the financial system is stable with few market distortions. Nonetheless, we expect the higher credit losses arising from the COVID-19 pandemic to hamper banks' profitability.

Dependence on the U.S. economic recovery. The Guatemalan economy relies heavily on its exports to the U.S. and remittance inflows from it. A prolonged recession in the U.S. would impair the trade activity and the remittances, and consequently, private consumption.

Low GDP per capita limits household debt. Close to 60% of the population is below the poverty level. This, along with a large informal sector with low income levels, results in low access to banking that limits the population's debt capacity and access to the financial system.

Key assumptions

Slow economic recovery in 2021. In our view, Guatemala's GDP will contract in 2020 and the recovery will be gradual--although faster than other countries in the region--which will lead to credit growth of about 3.6% this year and about 4.7% in 2021. Nonetheless, we expect investor confidence and the volume of infrastructure projects in the country to rise next year.

Weaker asset quality metrics, especially in the retail segment. We expect nonperforming assets to increase to about 3.4% in 2021 due to the economic shock caused by the pandemic. However, we believe Guatemala's largest banks—which focus on corporate loans--have enough capital to absorb the likely larger credit losses.

Significant lag in implementing Basel III. There are still many international regulatory requirements pending; therefore, we don't expect Basel III to be fully implemented in the next few years.

What to look for over the next year

Economy and public finances. Guatemala has relatively stable macroeconomic indicators with controlled debt and inflation metrics. However, the expected economic contraction and rising government fiscal deficit in 2020 could lead to persistently weak public finances over the next several years.

Infrastructure projects and investments from the private sector. We expect the government will boost development of the infrastructure sector. We believe the success of these programs and a greater participation of the private sector will be crucial to boosting the country's economic recovery in the next few years.

The agriculture industry's recovery. This industry represents more than 10% of GDP. As a result, more than 70% of the SMEs in the sector have faced liquidity strains from the pandemic and related lockdowns.

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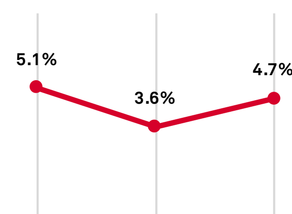
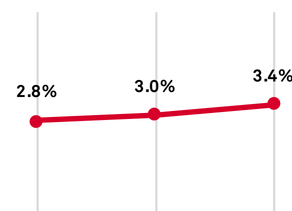
Guatemala

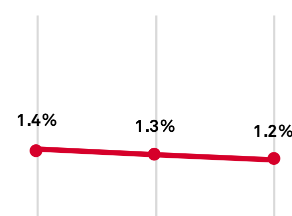
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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Honduras | BICRA Group: 8

Economy Significantly Hit By Lockdowns And Downturn In Agriculture

Key takeaways

- We expect Honduran banks' profitability to suffer because of higher provisioning due to a depressed consumer lending segment stemming from the COVID-19 pandemic.
- We think the extended lockdowns of diverse productive sectors in the country will hamper the Honduran economy in 2020.
- Honduras has one of the highest poverty levels in the region, with a large share of the population living in adverse conditions and a significant level of crime and violence, reflected in a low GDP per capita.

Key credit drivers

The consumer lending segment is taking the brunt of the recession. We expect that the Honduran banks and financial entities focused on low-income borrowers--small and midsize enterprises and individuals--will take longer to recover due to higher credit losses and a more pronounced hit to their profitability metrics.

Vulnerability to external shocks, mainly the U.S. Honduras relies heavily on the U.S. economy: exports to this country represent almost 40% of the country's GDP. We think the deep recession in the U.S. will cause this indicator to fall sharply, leading to a very slow recovery in Honduras.

Banking system with a diversified and stable funding base. The biggest banks in the country still have a large retail deposit base that provide liquidity flexibility to withstand the current economic turmoil. Additionally, their focus on traditional lending to corporations and mid- to high-income retail borrowers translates into manageable asset quality metrics.

Key assumptions

Low credit growth expected for the banking system. In our view, credit growth this year will come mainly from the corporate sector where many customers drew down pre-existing credit facilities to cope with their liquidity needs. On the other hand, we believe the retail and consumer segments will continue to be highly depressed and will likely recover very slowly in the next few years.

Weaker asset quality metrics, although still manageable for the largest banks. We expect nonperforming assets to increase to about 2.9% in 2020 due to the impact of the COVID-19 pandemic. However, we believe the largest banks have enough capital to absorb the potentially greater credit losses.

Large human development needs. Honduras has one of the highest poverty levels in the region and a significant level of crime and violence, which is reflected in a low GDP per capita. In our opinion, these factors will continue limiting households' debt capacity.

What to look for over the next year

Economic recovery pace. We believe the Honduran economy will suffer in 2020 as a downturn hits its agricultural sector and individuals' spending slumps. We expect a prolonged and severe economic downturn that will hurt GDP growth, resulting in deeper fiscal deficits for the next several years.

Energy sector. The government-owned electricity company Empresa Nacional de Energía Eléctrica (ENEE) poses a major fiscal weakness. Focusing on reducing ENEE's losses leaves the government with little room to expand basic services, which require long-term expenditures.

Political climate. The presidential election will occur in 2021, and we believe there could be social tensions and protests if the government fails to address institutional weaknesses in key public institutions and establish clear rules for reelection.

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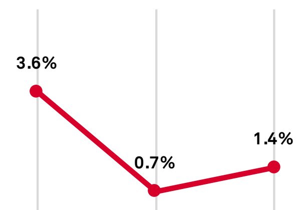
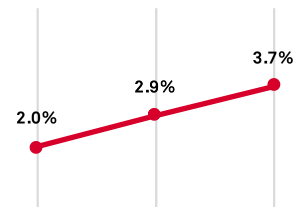
Honduras

Loan growth



NPA ratio



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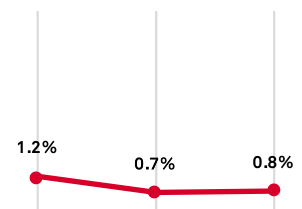

2019a 2020e 2021f

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a--Actual. e--Estimate. f--Forecast.

Jamaica | BICRA Group: 8

The Pandemic Is Fueling Risks To The Industry While Regulation Helps Mitigate Increasing Cross-Border Risks

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Key takeaways

- The temporary halt in Jamaica's economic growth due to the COVID-19 pandemic has increased risks in the domestic financial system.
- Economies highly dependent on tourism, such as Jamaica, are facing severe implications due to lockdowns, which is weakening banks' asset quality.
- As systemic risks rise because of increasing connections between businesses in various Caribbean countries--as a result of mergers and acquisitions (M&As)--Jamaica's banking regulator has made advances toward centralized supervision to mitigate such risks.

Key credit drivers

Difficult domestic conditions are pressuring the industry's metrics. Jamaica has made progress in achieving economic stability in recent years, mostly thanks to the government's commitment to fiscal prudence and the country's improving external position. The pandemic has raised risks in the Jamaican financial system because the economic lockdown is denting the banks' credit growth, asset quality, profitability, and capital metrics. Compounding the situation, the tourism sector is one of the main drivers of the local economy--it provides employment to about 30% of the labor force. Consequently, we believe lockdowns are eroding families' income, which would ultimately take a toll on the banks' asset quality during the following months, once debt moratorium policies are phased out.

M&As demand centralized oversight. Caribbean conglomerates are undertaking M&As, which could introduce spillover risks in events of distress because of increased cross-border business links across the region. In our view, it's crucial that acquisitions move in parallel with strengthened systemic risk management. The Jamaican regulator is leading initiatives to move toward integrated oversight.

Key assumptions

Economic contraction this year. We expect real GDP and employment to decelerate significantly in 2020 due to the lockdown, but partially recovering during 2021.

Pressures on asset quality. We estimate asset quality to slip during the next two years because of lockdowns. However, credit losses would still be manageable under our current base-case scenario.

What to look for over the next year

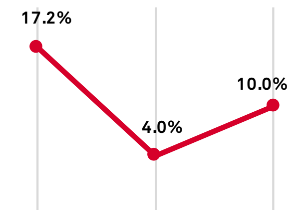
Lockdowns and global distress are stressing the industry. Continued economic paralysis because of the pandemic is impairing the sector's growth and profitability, while potentially jeopardizing liquidity in a scenario of volatile deposits. The government's measures provided some relief, but their extent is narrower than those in other countries in the region.

Adoption of stronger regulations. We expect regulatory bodies to implement initiatives that will help set the basis for a more developed financial industry, which could attract foreign investors in the medium term. For example, an improved and centralized oversight framework is important, given the increasingly interconnected risks across the Caribbean.

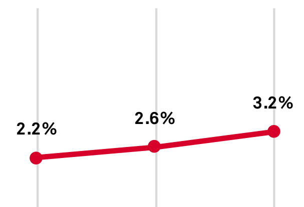
Non-regulated players introduce market distortions. The increasing presence of unregulated credit unions, which generate stiff competition through lower lending interest rates, will continue pressuring the system's stability, in our view. However, regulators have started an initiative to supervise these entities formally, which should help lessen market distortions if the initiative goes into effect.

Jamaica

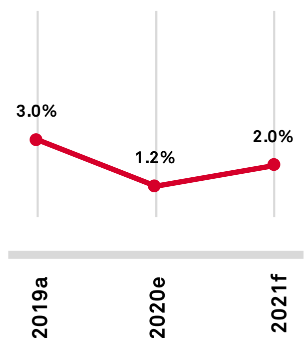
Loan growth



NPA ratio



RoAA



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Mexico | BICRA Group: 5

Weak Economic Recovery In 2021 Will Pressure Operating Performance

Key takeaways

- The recession this year and the weak recovery in 2021-2022 will limit credit growth.
- Asset quality will worsen and profitability will slip due to the severe economic contraction.
- Sound capitalization will continue to be a credit strength in 2020-2021 and adequate liquidity will persist, supported by the central bank's measures to alleviate the economic crisis.

Key credit drivers

Economic recovery will take longer in Mexico due to preexisting economic weaknesses. Low levels of investment, delays in virus containment measures, and limited economic policy responses will slow recovery. This will set the stage for challenging operating conditions for Mexican banks.

Mexican banks entered the pandemic with good credit fundamentals. Low levels of access to banking--measured by credit to GDP--have allowed banks to grow with healthy asset quality and adequate profitability, while liquidity and capitalization metrics remain sound.

COVID-19 will hit asset quality and profitability. The pandemic and the collapse in oil prices will exacerbate preexisting economic weaknesses, damaging Mexico's labor market. Therefore, we expect banks' asset quality to worsen and consequently hamper profitability through higher provisions.

Key assumptions

Credit demand will remain subdued. Mexico's economy will continue to contract this year, and the recovery for 2021 will be weak (about 3.7% real GDP growth). The damage to the labor market and investment dynamics will result in modest credit demand in 2020-2021.

Asset quality will slip amid the recession. We expect the nonperforming assets ratio to peak at 3.5%--fully covered by reserves--while new loan loss provisions would represent between 3.5% and 4.5% of total loans in 2020-2021.

Higher provisions and lower interest rates will hit profitability. Since the beginning of 2020, the central bank has lowered its policy rate by 300 basis points. Higher provisions will also pressure profitability. We expect return on equity to be near 8% in 2020 and pick up to 12% in 2021.

What to look for over the next year

Government's ability to correct preexisting economic weaknesses and restore economic growth. Because of Mexico's limited economic policy responses thus far, we expect severe damage to the labor market and small to midsize enterprises that will result in a slow economic recovery.

Severity of the impact on asset quality. Loans under the borrower relief program represent about 20% of total loans. We estimate that as of the end of the third quarter, borrowers have resumed payments on 50%-60% of these loans and this ratio will rise further in the last quarter of the year, reducing pressure on banks' asset quality.

Effectiveness of the central bank measures to alleviate the economic crisis. These measures focus on providing ample liquidity (in local and foreign currency) and substantial financing resources at more accessible costs to the domestic financial system.

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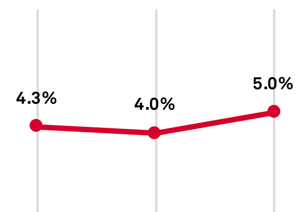
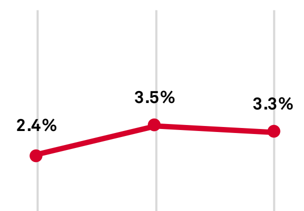
Mexico

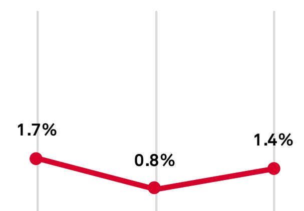
Loan growth



NPA ratio



RoAA



2019a | 2020e | 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Panama | BICRA Group: 5

Flat Credit Growth This Year With Weakening Asset Quality And Profitability Metrics

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Key takeaways

- Asset quality metrics will remain manageable, although they will slip in the next 12 months. Although we anticipate loan forbearance measures, some borrowers won't recover after COVID-19 is under control.
- Profitability levels will be lower than expected and start gradually recovering in 2022.
- Although Panama doesn't have a central bank or formal lender of last resort, the government has successfully used the public-owned bank, Banco Nacional de Panama, as the vehicle to provide liquidity to the banking system during the pandemic.

Key credit drivers

Weakening asset quality indicators, but still manageable. We forecast NPLs and credit losses to reach their peak at 3.5% and 1.4%, respectively, in 2021 from about 2.0% and 1.0% in 2019. In our view, both indicators are still manageable and lower than most of Panama's Banking Industry Country Risk Assessment (BICRA) peers. We believe that adequate lending and underwriting standards, and restrained risk appetite will keep the banking system's asset quality resilient during the COVID-19 pandemic.

Lack of lender of last resort. Panama doesn't have a central bank or formal lender of last resort, or an effective deposit insurance system to support distressed financial institutions. To address the economic impact of COVID-19, the regulator allowed banks to use the accumulated dynamic provisioning (about $1.3 billion or 2% of GDP) to absorb the impact of credit losses. It also allowed banks to undertake voluntary relief programs with some borrowers. Finally, the government has successfully used the public-owned bank, Banco Nacional de Panama, as the vehicle to provide liquidity to the banking system during the pandemic through short-term liquidity facilities and other programs to support SMEs and self-employed segments.

Key assumptions

Economic contraction in 2020, but recovering afterwards. We expect Panama's economy to contract about 10% in 2020 and grow 7% in the following year. We predict policies to contain the pandemic to severely hurt the construction, tourism, and retail sectors. The ramping-up of Cobre Panama's copper production at a new mine might be slower than expected due to the virus outbreak. Given the importance of Panama's logistics sector, a persistent disruption in international trade would increase downside risks for the country's economic growth, potentially damaging growth prospects. Therefore, we expect credit growth for Panama's banking system will be flat for 2020 and grow to 3.5% in 2021.

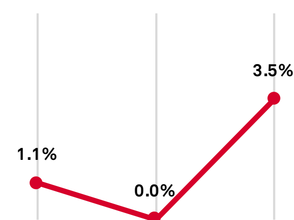
What to look for over the next year

Lower profitability levels for the next 18 months. Profitability levels will be lower than expected and start gradually recovering in 2022. System-wide returns will represent about 0.7% in 2020 and 0.5% in 2021 of the sector's adjusted assets, compared with 1.3% as of December 2019. The latter reflects higher loan-loss provisions because some borrowers won't recover from the pandemic-induced recession, as well as lower interest income and fees/commissions.

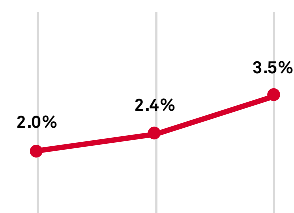
Efforts to strengthen the banking system's supervision and institutional framework. The country's financial system regulation continues to improve, reducing the gap with international regulators, although implementation challenges remain. During 2019, the Financial Action Task Force (FATF) placed Panama back on its "grey" list of countries with insufficient preventative measures against money laundering and financing terrorism. The FATF's recommendations for Panama are primarily outside the financial sector, limiting the possibility of a significant impact on the financial system.

Panama

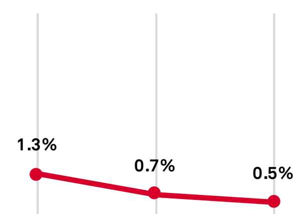
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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a--Actual. e--Estimate. f--Forecast.

Paraguay | BICRA Group: 8

Asset Quality Evolution Will Be The Main Factor To Monitor

Key takeaways

- Paraguay's economic contraction will be milder than regional peers in 2020, while a stronger recovery would be contingent on favorable agricultural prospects, weather conditions, and global demand.
- We expect credit growth to remain in the single digits this year mainly due to the pandemic, but to accelerate with the economic recovery in upcoming quarters.
- Asset quality will weaken in terms of NPAs (nonperforming assets: 60 days past-due loans + stock of repossessed assets) and in terms of the RRR (renewed, refinanced, and restructured) loan portfolio and under central bank temporary measures that allow companies to refinance some loans.

Key credit drivers

Weaker economy will pressure asset quality even as credit growth resumes. Credit growth will remain in the single digits this year due to the pandemic, but we expect it to pick up as economic activity recovers. Loans in local currency will drive credit growth and will compensate for the contraction in the U.S. dollar portfolio (partly moderated by the Paraguayan guarani depreciation). We expect asset quality to recover more slowly than credit.

High dollarization and exposure to cyclical sectors. Paraguay's banking system has high levels of foreign-currency lending (almost 50% of the banking system's total lending) and high exposure to cyclical sectors such as agriculture and cattle (34% of the loan portfolio).

Measures taken to cope with the pandemic aligned with regulators in the region. The local regulator took several measures--such as liquidity facilities, new set of transitory measures to refinance and restructure loans affected by the pandemic, and programs to provide guarantees to small to midsize enterprises--to mitigate the impact of COVID-19 on the banking system and economy, which are largely similar to those implemented by regulators globally.

Key assumptions

Milder GDP contraction in 2020 and stronger recovery in coming years. In our base-case scenario, the economy will contract less severely than regional peers, paving the way for a faster recovery in the next two years, although contingent on favorable agricultural prospects and a recovery in external demand.

Weakening asset quality metrics. Asset quality, measured by NPAs, slipped last year due to flat economic growth, although partially mitigated by temporary measures issued by the regulator that allowed banks to refinance loans affected by the drought. We forecast NPAs, loans in the RRR categories, and loans under the new pandemic-related temporary measures will all continue to rise because of the pandemic's impact.

Profitability and capitalization. We expect the banking system's profitability to decline, pressured by lower margins and expenses related to higher provisioning. Credit losses will increase in 2020 because of worsening credit quality and legacy provisioning deferrals. Banks entered the shock with adequate regulatory capital, but capitalization could decline due to lower profitability despite low asset growth.

What to look for over the next year

Economic activity. We'll keep monitoring Paraguay's economy recovery over the rest of 2020 and 2021, along with those of Brazil and Argentina (the main destinations for Paraguay's exports), especially Argentina, which has weaker recovery prospects. Weather events could also affect the economy, such as the recent wildfires, the low flow of rivers (main export channel), or other impacts on agricultural harvests.

Asset quality and RRR loan portfolio. We'll observe how asset quality evolves in order to monitor potential increases in credit losses in coming years, which could hurt the financial system's profitability and capitalization levels that in turn could limit credit growth once the pandemic ends.

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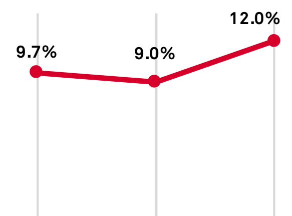
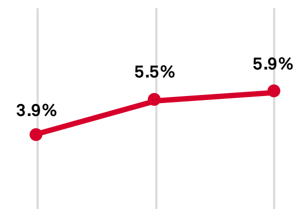
Paraguay

Loan growth



NPA ratio



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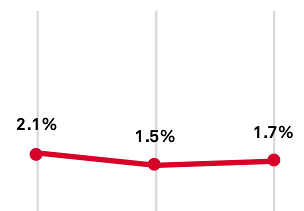

2019a 2020e 2021f

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Peru | BICRA Group: 5

Increasing Risk Due To COVID-19 And Political Disruption

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Key takeaways

- Even though the government passed a considerable stimulus package, the Peruvian economy was hit hard in 2020 by the pandemic and long and strict lockdown, but recovery should be robust in 2021.
- Asset quality will deteriorate due to the economic contraction, given the large informal economy and low-income levels. Yet, because of the loan moratorium, banks will feel the full effect in 2021.
- The higher provisions because of the virus-induced economic shock, lower margins on guaranteed loans, and flatter fees have weakened the banks' bottom-line profits, but strong margins and cost controls helped mitigate the impact.

Key credit drivers

Despite the government's substantial stimulus package, the quarantine and global lower demand for commodities have taken a toll on Peru's economy. We believe the risk of mounting credit losses in Peru is increasing and could dent banks' profitability and capitalization. Consequently, we revised the economic risk trend of the banking industry to negative from stable, reflecting that their risk-adjusted capitalization ratios could fall. This could occur because under a weaker economic risk assessment, we would increase the risk weights we apply to Peruvian banks.

Among the largest stimulus packages in the region. To help offset the economic damage, the authorities launched a stimulus package, including loan guarantees worth about 12% of GDP. Along with the increased health spending, the package includes direct transfers to support the poorest families affected by the quarantine, subsidies to informal workers, deferrals of tax, electricity, and water payments, and several initiatives to help small and midsize enterprises absorb the impact of shutdowns.

Credit losses to surge in 2020. We expect NPLs to increase due to the economic contraction, because of the large informal economy and low-income levels. Nevertheless, given the loan payment deferrals, bad loans will show up on banks' balance sheets in 2021. However, we expect credit losses to increase sharply in 2020 as banks strengthen their provisioning coverage.

Key assumptions

Economic recovery in 2021. We expect a solid recovery in the next three years, thanks to the comprehensive stimulus package and the expected recovery in China, one of Peru's key trading partners.

Recognition of asset quality deterioration will be delayed. Domestic regulators are allowing banks to renegotiate loans without marking them as nonperforming. Therefore, we believe it will take some time for the weaker asset quality to be fully reflected on banks' balance sheets.

Peru's Congress has voted to impeach President Martin Vizcarra over corruption accusations. The head of Congress, Manuel Merino, assumed the presidency but later resigned. Despite the current uncertain political scenario, we assume broad continuity in Peru's macroeconomic policy framework.

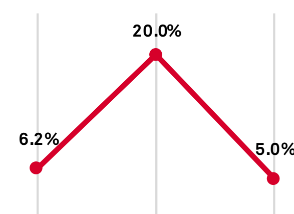
What to look for over the next year

Political instability and social unrest could hinder the economic recovery. The departure of President Vizcarra, who still had the support of the population, could generate social discontent. In addition, Congress could carry out policies that could affect the financial system.

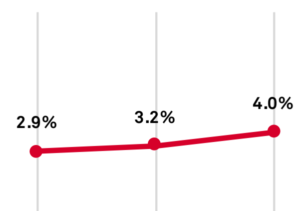
Problem loans could rise. The Peruvian financial system has disbursed a meaningful amount of loans to cyclical sectors such as small business and middle-market loans (about 27%). If economic activity takes longer to recover, some companies and micro businesses could struggle to remain viable. Under that scenario, banks' operating performance could struggle.

Peru

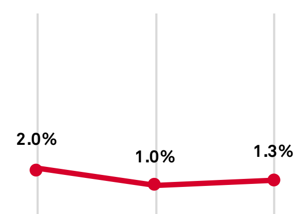
Loan growth



NPA ratio



RoAA



2019a | 2020e | 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Trinidad & Tobago | BICRA Group: 6

A Double Hit From Lower Hydrocarbon Prices And COVID-19

Key takeaways

- Pressure on banks' asset quality, and a sharp reduction in net interest margins and fee-based revenue this year, as the pandemic-induced drop in activity and lower oil prices contribute to a deeper economic contraction.
- Despite the loan payment moratoriums offered to troubled borrowers, the banks' adoption of IFRS 9 accounting standards should cause most of loan-loss provisions to be recognized during 2020.
- The banking system has posted strong results despite the recession in the past four years. Moreover, banks entered the economic crisis caused by COVID-19 with sound capital and liquidity levels, which should help absorb the economic shocks.

Key credit drivers

Energy crisis. Although T&T's banks are not heavily exposed to oil companies (about 4% of total loans), the economy is heavily dependent on the energy sector, which has historically contributed over a third to the government's revenue and the country's real GDP, and accounted for more than 80% of exports.

COVID-19. We expect pressure on banks' asset quality to ratchet up and business growth to slow as the coronavirus outbreak deepens the economic contraction. We believe that a consecutive contraction of economy since 2015 will impair companies' finances, while the rising unemployment could hinder the individual borrowers' ability to service their loans.

Sound capital and profitability. Despite the expected reduction in banks' revenues and increase in loan-loss provisions in the next 12 months, the banking system entered the economic crisis with robust profitability (ROE above 20% in the past two years) and strong capital levels.

Key assumptions

Economy. We estimate a real GDP contraction of 4.5% this year and unemployment rate climbing to 6%.

Manageable credit losses. Banks were able to contain the damage to asset quality stemming from the years-long recession amid weak energy prices but relatively controlled unemployment and inflation rates. However, the rising unemployment could spike credit losses more than we currently expect.

Regulatory relief. We believe the full impact on asset quality will take time to materialize, given the regulatory and banks' measures to lessen the strain, although the bulk of credit provisioning will occur this year given the future losses approach under IFRS 9.

What to look for over the next year

Presidential election in 2020. T&T held elections in August of this year that resulted in a narrow victory for the ruling party, People's National Movement (PNM). We expect T&T's stable parliamentary democracy and social stability to continue to anchor the country's institutions over the next few years.

Unemployment. In our view, unemployment is a key indicator for a deeper credit stress in the financial system. Household debt service has risen consistently over the past few years and could be a source of vulnerability if economic activity or the labor market softens for a prolonged period.

Exchange rate. The country's heavily managed exchange rate has resulted in U.S. dollar shortages in the last few years, which have constrained economic activity, weakening local businesses' ability to pay suppliers and obtain key imports. In this context, the banking system maintains a long position in U.S. dollars and it has limited foreign currency loan disbursements.

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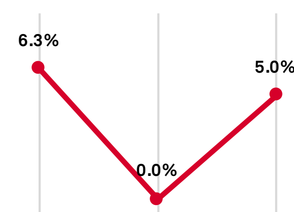
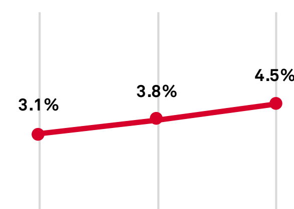
Trinidad & Tobago

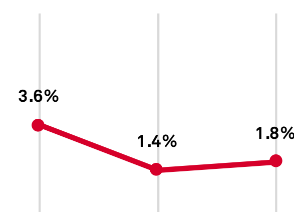
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Uruguay | BICRA Group: 6

Resilience To Economic Contraction

Key takeaways

- Uruguay's economy has been performing as expected, showing more dynamism in the second part of the year, and with projected recovery over coming years supported by infrastructure investments.
- Asset quality metrics remained stable, but pressures are likely to surge. However, will take time to materialize given the regulatory measures to mitigate the downturn's impact.
- We expect banks' liquidity levels to remain sound, deposit bases stable, and solvency levels adequate, despite pressures on profitability and margins.

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Key credit drivers

Pressure on asset quality metrics. Asset quality metrics remained stable during the first part of the year amid regulatory measures to support the financial system. Measures include extending maturities of existing loans that are performing without penalties and lowering reserve requirements for loans granted in Uruguayan pesos in order to encourage credit growth in that currency. We believe that asset quality will weaken but will take time to show up on banks' balance sheets.

Limited monetary flexibility. In September, the central bank shifted from the use of money supply variables to that of reference rate in order to improve transparency and anchor inflation expectations in the medium term. However, high inflation of about 9% and still extensive dollarization continue to limit Uruguay's monetary policy flexibility. In this sense, over 50% of resident loans and more than 70% of resident deposits are in dollars.

High dollarization and exposure to cyclical sectors. Significant dollarization in the economy and some sector and customer lending concentrations increase risks. Loans to the agriculture sector represent about 15% of total loans.

Key assumptions

GDP contraction followed by economic rebound. We expect GDP to contract in 2020, stemming from a sharp fall in consumption because of the pandemic and weak global and regional demand, together with high unemployment and persistently high inflation. We estimate the economy to rebound in 2021, reversing the contraction of 2020, as growth in consumption resumes and planned investment projects ramp up.

Flat real credit growth. Private sector's access to credit remains low, at about 30% of GDP, and we expect it will be at the same level in the next 12-18 months, given the stagnate economy. However, we expect nominal credit growth of 10% in the next two years, influenced by the depreciation of the Uruguayan peso, high inflation, and the economy's rebound in 2021.

Stable and predictable political institutions. We believe Uruguay's broad political consensus and its stable and well-established institutions have anchored--and will continue to anchor--economic stability.

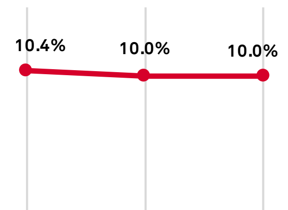
What to look for over the next year

Profitability under pressure. For the next few quarters, we expect banks' profitability to take a hit from lower returns in investment portfolios, given negligible international interest rates, higher cost of risk, and tight margins. The banking system's excess liquidity is allocated in low-risk instruments, mainly U.S. Treasury securities. However, this will be partly compensated by gains in exchange-rate fluctuations due to most banks' active long position in dollars.

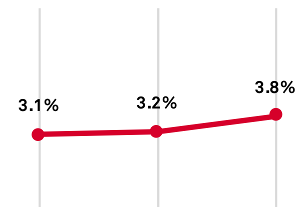
Funding base. We expect the deposit base to remain stable, with nonresident deposit base at current levels, accounting for 10% of total deposits, mainly from Argentineans given that country's financial turmoil.

Uruguay

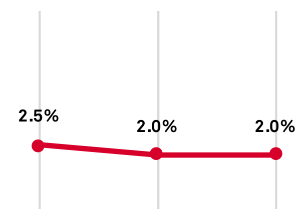
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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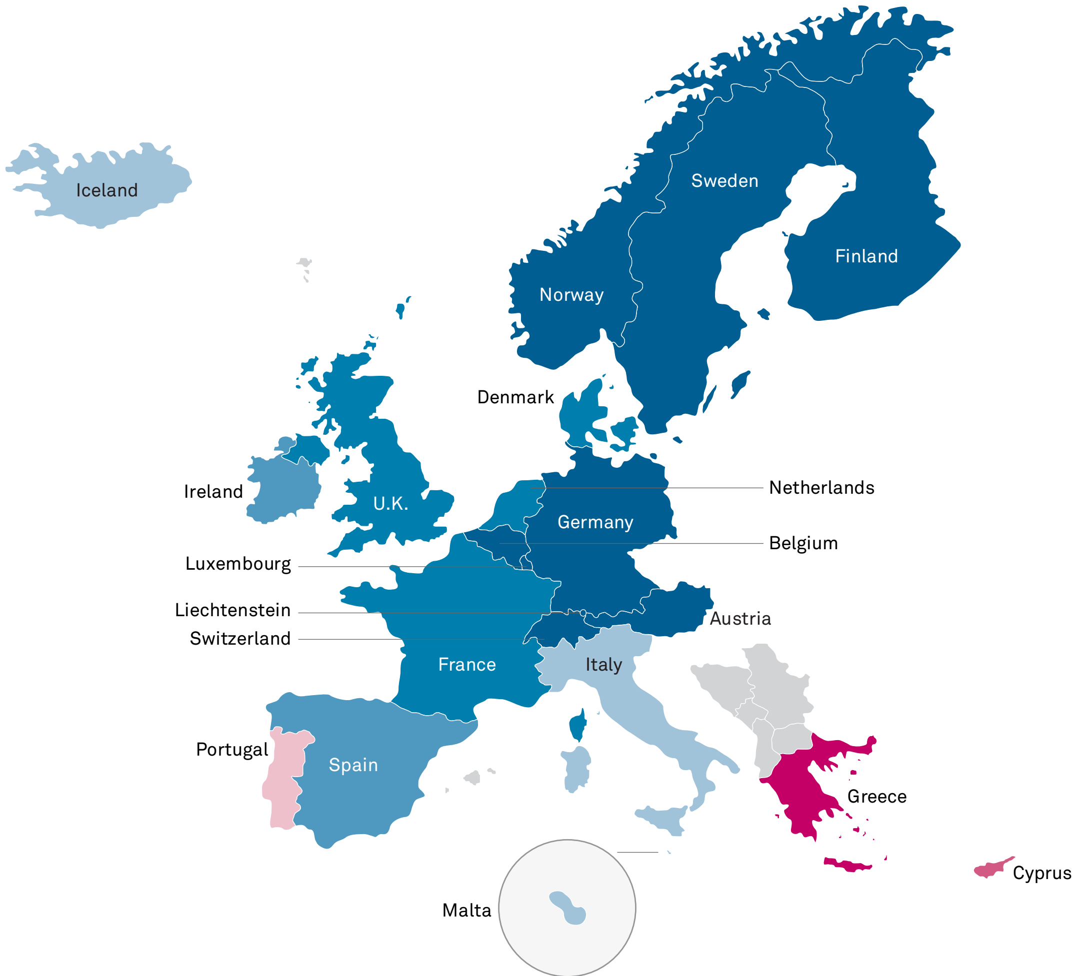
Western Europe



Group '1' to '10', from lowest to highest risk. BICRAs--Banking Industry Country Risk Assessments.
Data as of Oct. 27, 2020. Source: S&P Global Ratings.

Austria | BICRA Group: 2

COVID-19 Impact Calls For Greater Efficiency And Digital Transformation

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Key takeaways

- Austrian banks are facing the downturn in good shape, with robust capital, liquidity, and asset quality.
- This, together with the resilient private sector and large-scale government support programs, is aiding the banking system through the recession.
- In the event of a more-adverse economic scenario, some banks might have little buffer to absorb the spike in risk costs and further decrease in margins, because of the high share of interest income, very tight interest margins, and low efficiency at many banks.

Key credit drivers

Strong drop in profitability. Domestic risk costs will likely to increase in 2020 and 2021, up to 30 basis points of the total domestic lending portfolio, and domestic return on equity is likely to decrease to a low-single-digit percentage level for most Austrian banks. However, we expect that a profitability decrease will not lead to capital depletion or a greater risk appetite, and banks' lending policies will remain prudent.

The economic downturn requires more efficiency measures for Austrian banks. Despite material progress, the cost efficiency of domestic operations remains a weakness for many Austrian banks, notably because of a still-dense branch network, legacy IT systems, and decentralized structures. We believe these remain the key obstacles to banks' efforts to fully embrace scale benefits and digital opportunities, and realize the potential of new technologies to increase efficiency and strengthen revenue generation.

Key assumptions

A sharp recession in 2020, followed by strong rebound. In our base-case scenario, because of the COVID-19 pandemic, we expect real GDP contraction of 6.7% in 2020, followed by a 4% recovery in 2021. We expect the Austrian economy to absorb this shock, thanks to its diversity and strong growth in recent years--real GDP growth averaged 1.9% in the past five years, supported by exports in particular.

The banking sector's stability will continue in the downturn. Austrian banks are in a better position to withstand the downturn than in previous downturns. Despite the material one-off deterioration of the sector's performance that we expect for 2020 and 2021, overall sector stability is unlikely to deteriorate, given banks' comfortable capital and provisions, as well as government programs and the social benefits system. The Austrian government was quick to introduce virus-containment measures, and set up a support program of about 10% of GDP to help the economy through the pandemic.

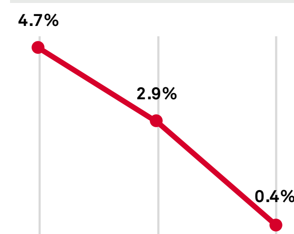
What to look for over the next year

Economic downturn beyond our base-case expectations. There is significant risk to our baseline scenario, owing to the economic effects of the pandemic, which--if more prolonged or deeper than we expect--could result in a deterioration of household and corporate sector financial health, particularly given the Austrian economy's focus on service industries.

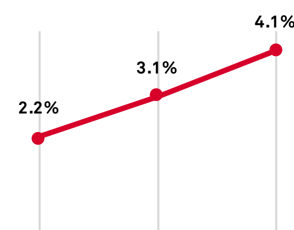
Digital transformation and increased efficiency. In our view, risks to the banking system from tech disruption are contained, mainly because of still-conservative consumer preferences. However, COVID-19 is likely to be a strong catalyst for transforming these preferences. Austrian banks' business models will therefore increasingly rely on achieving operational efficiency and a lean and modular information technology setup that enables them to respond quickly to changes in trends and expand into adjacent services.

Austria

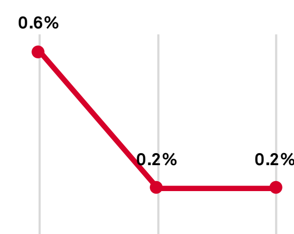
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Belgium | BICRA Group: 2

Resilient Banking System Suffers Short-Term Profitability Shock

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Key takeaways

- Belgian banks entered 2020 with a high credit standing thanks to strengthening capitalization over the past decade, their risk-adverse nature, and ample liquidity from loyal customers' deposits.
- The effectiveness of government measures in response to the COVID-19 pandemic, as well as the pace of recovery will be key in coming quarters. Federal and regional governments, along with the European Central Bank, have implemented significant measures to support the economy. Still, the pandemic is testing Belgian banks' small and midsize enterprise (SME) and corporate loan books, and their traditional low impairment levels compared with peers'.
- Loan provisions will hit Belgian banks' profitability in 2020 and 2021, but longer-term prospects remain sound on the back of continuous efficiency efforts.

Key credit drivers

Belgium's domestic credit losses compared with peer countries' will be key for future ratings. Belgian banks start from a position of strength compared with most countries owing to decent margins, low credit risk, and ample liquidity. The COVID-19 pandemic is putting the private sector's risk-averse nature and consequent low impairment levels to the test. New provisions should peak in 2020 in anticipation of future nonperforming loans, before gradually reducing in 2021 on the back of the assumed economic recovery. Banks' domestic loan books' higher resilience than that of peers will be fundamental to maintaining current rating levels.

Domestic credit should continue to rise. Credit to the private sector has increased faster than GDP over recent years, because households have taken advantage of low interest rates. However, rising indebtedness, now on par with the European average, is not an immediate concern. This is because net wealth levels in Belgium remain among the highest in Europe. We expect credit growth will stay broadly stable; higher lending volumes to SMEs and corporates in 2020 should offset lower household demand because of COVID-19-related lockdowns. Over the medium term, a further material disconnect between credit and GDP trajectories could weigh on the banking system's economic risk.

Key assumptions

We expect Belgium, like neighboring countries, will see a sharp contraction before gradual recovery. In our view, real GDP will contract by 7.6% in 2020 due to the pandemic, recovering to 5.5% growth in 2021. We anticipate the unemployment rate will peak at about 6.4% in 2021, up from 5.4% at end-2019.

SMEs and corporates will feel the most pressure. We believe federal and regional governments' response will support the banking system through the downturn. However, we believe banks' SME and corporate loan books could suffer in the next two years given the country's very open economy. The social security system and the general population's wealth should limit impairment in the retail sector.

Capital and liquidity should support ratings. Banks' capital strengthening over the past decade will help them bridge the downturn, in our view. The funding profile will remain a key positive factor against peers, thanks to significant sticky deposits.

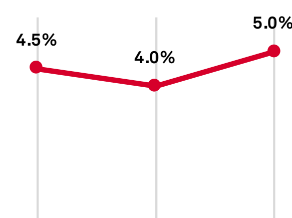
What to look for over the next year

The magnitude and pace of economic recovery. Downside risks to our assumptions remain, and a material downward revision of our macroeconomic forecasts could lead to a downward revision of our Banking Industry Country Risk Assessment (BICRA).

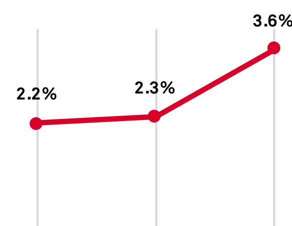
Efficiency measures for the future. Until the start of the pandemic, most banks were making efforts to improve their efficiency to mitigate the low-interest-rate environment. The downturn might have momentarily shifted managements' focus, but these efforts should accelerate in coming years.

Belgium

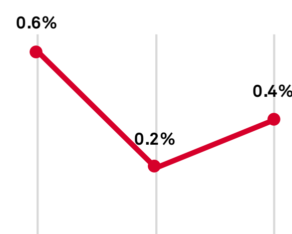
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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a--Actual. e--Estimate. f--Forecast.

Cyprus | BICRA Group: 8

COVID-19 Will Weigh On Banks' Asset Quality And Profitability

Key takeaways

- Cypriot banks are still completing the clean-up of legacy problematic assets from the 2008 financial crisis, but economic prospects will make it tougher.
- A deteriorating environment, coupled with high private sector debt, recent changes to the foreclosure legal framework, and poor take-up of the Estia mortgage debt relief scheme increase risks, particularly to banks' asset quality.
- Current economic stress will further hamper banks' profitability, due to ultra-low interest rates, declining transaction volume, and higher provisioning needs.

Key credit drivers

Already-weak asset quality will likely worsen. The stock of problematic assets is one of the highest in Europe (about 26% of gross loans at June 30, 2020), even after the carve-out from the banking system and sizable market sales in 2018 and 2020. The historically embedded poor payment culture and high concentration in the real estate sector (15% of loan book) and tourism (7%) will likely result in higher default rates over the coming quarters.

Cost savings are needed to cushion bottom-line results. Banks' ability to further streamline cost structures and network overcapacity while investing in digital transformation to become more efficient will be key to accommodating decreased revenue from low interest rates, muted lending volume, and subdued fee income.

Banks' funding profiles will likely remain unbalanced. Funding comes almost entirely from customer deposits, which are still recovering from the 2013 bail-in, and reliance on nonresident deposits is higher than peers' (representing over 25% of deposits). Access to wholesale funding will remain narrow.

Key assumptions

The economy is more vulnerable to external shocks. Due to its small, open nature and high concentration in tourism and real estate, we expect that the Cypriot economy will be materially affected by the fragile economic health of both EU and Commonwealth of Independent States countries, and forecast a GDP contraction of about 7.5% in 2020, before recovering by about 5.5% in 2021.

Credit losses will push banks into overall losses. Although supportive fiscal and monetary measures will somewhat cushion the impact on small and midsize enterprises and households, our credit loss estimates will likely push banks into loss-making territory in 2020, with a gradual recovery in 2021, although still close to break-even.

Bank capitalization has some buffer to absorb deterioration. Cypriot banks face this shock with comfortable capital metrics. The average common equity tier 1 ratio stood at about 16.8% at March 31, 2020.

What to look for over the next year

Potential real estate market price correction. Given some banks' exposures to real estate from foreclosure activity in recent years, and the potential impact of the recent suspension of the Golden Passport Scheme (under which the government granted Cypriot passports to foreign investors), banks run the risk of incurring losses if they cannot dispose of their real estate assets in a capital-neutral manner.

Credit quality after moratoria ends. Government-sponsored moratoria and other fiscal measures will delay the impact on credit quality deterioration until mid-2021. Redefault rates on already-restructured loans (30% at March 31, 2020 compared with 14% in 2017) might increase more unless the poor payment culture is tackled effectively.

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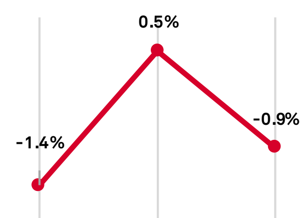
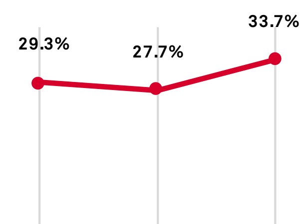
Cyprus

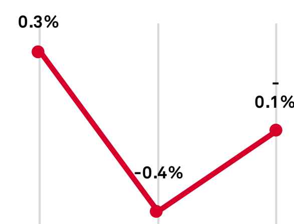
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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a--Actual. e--Estimate. f--Forecast.

Denmark | BICRA Group: 3

Banks Remain Resilient, Despite Pressure On Profitability

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Key takeaways

- A resilient economy and robust welfare system suggest comparably low sector credit losses as a result of the COVID-19 pandemic in a European context.
- Still, increased provisioning, negative interest rates, cost inflation, and competition further weigh on earnings.
- While the banking sector relies substantially on wholesale funding, the market shows resilience thanks to its depth and unique characteristics.

Key credit drivers

Relatively low credit loss expectations in a European context. We expect the Danish economy's structure will offer more resilience than those of other Nordic countries amid the COVID-19 pandemic. This resilience, together with the Danish welfare system's robustness and the government's policy response to the pandemic are, in our view, efficient mitigating factors against the potential pressure on banks' asset quality. Overall, we expect bank provisioning needs will peak in 2020 at 35 basis points of the total sector loans, mostly driven by nonmortgage credit exposures toward small and midsize enterprises.

Sector profitability is under pressure, but bank capitalization is robust. Higher credit losses and revenue attrition linked to the COVID-19 pandemic add to existing headwinds from negative interest rates, compliance investments, competition, and the cost of already well-advanced minimum requirement for own funds and eligible liabilities (MREL) buffers. Still, we expect that the capitalization of rated Danish banks will remain robust in a European context through 2022, supported by reductions in dividend payments and buybacks.

High dependence on functioning wholesale funding. Danish banks' share of wholesale funding is high relative to other European banking systems. That said, we see this risk as partly mitigated by a deep domestic bond market with a steady flow of mandatory pension savings and the various supporting features of the Danish covered bond framework, not least its soft bullet structure. The government's willingness to ensure liquidity in the system has also supported the market's continued functioning during the turbulence of March 2020.

Key assumptions

A deep recession in 2020, though less severe than in other Nordic counties. We forecast Danish GDP to contract by 4.7% in 2020, before bouncing back to positive 3.3% in 2021. The pharmaceuticals industry materially contributes to the relative stability of GDP compared with other Nordic countries.

Sustained moderate house price increase. Overall, we expect generally sound supply and demand fundamentals will continue to support the Danish housing market, and that house prices will continue their slow appreciation in real terms through 2022.

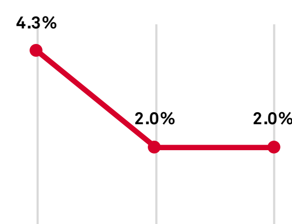
What to look for over the next year

Asset quality trends. We expect COVID-19-related provisions have, to a great extent, been front-loaded in the first quarters of 2020 in Denmark, but we expect actual losses to increase in the coming quarters.

Development in house prices and unemployment. A severe second wave of the coronavirus and resumed lockdown are examples of factors which could lead to pressure on house prices and unemployment, pushing credit losses higher than in our base case.

Denmark

Loan growth



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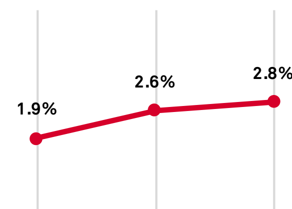
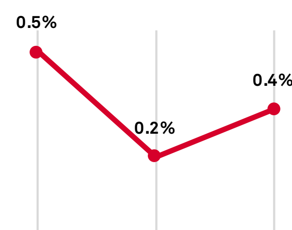


RoAA



2019a 2020e 2021f

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a--Actual. e--Estimate. f--Forecast.

Finland | BICRA Group: 2

Resilient Banking Sector Amid Small Economy Facing Risks

Key takeaways

- Finland's banking sector is facing a deep, COVID-19-triggered contraction in 2020, but government policy measures, strong capitalization, and sound profitability provide a modest buffer.
- Banks depend on conservative commercial practices that promote stability within the concentrated banking market, but historically high household indebtedness could become a risk if not curbed by additional macroprudential measures.
- Banks respond to the structural funding gap by increasing the share of wholesale funding, which makes them dependent on external funding and investor confidence.

Key credit drivers

Increased economic risks. Finland's economy was already facing structural headwinds entering the COVID-19 pandemic, and will suffer a severe contraction in 2020. As a result, we anticipate that asset quality will weaken and the cost of risk for the banking system will materially increase. That said, we expect the sector's strong capitalization and sound profitability to absorb the burden.

Persistent growth in household debt is an ongoing concern. Household debt to disposable income reached a historical high of 130.5% in June 2020, mainly because of continuous growth in housing loan stock and, recently, in consumer loans. However, overall debt levels are lower than for Nordic peers thanks to the Finnish payment culture.

Material share of external wholesale funding is a key weakness. A major part is linked to the largest players, but smaller domestic banks have also expanded funding profiles to covered bonds. Still, we recognize that banks maintain good access to euro-denominated markets, and hold a safe-haven status from foreign investors, suggesting funding stability.

Key assumptions

Significant GDP contraction of 4.5% in 2020 followed by only modest rebound. With 2.25% expected GDP growth in 2021, recovery is likely to be less pronounced than in other Nordic countries. This reduces the business prospects for domestic banks.

Increased credit risk. We expect domestic NPAs to increase to about 1.4%-1.5% of domestic systemwide loans in 2020-2021, up from 1.0% in 2019.

What to look for over the next year

Domestic and external recovery from the COVID-19 pandemic. Government support has cushioned the economic shock although some effects might only become visible at a later stage. As a small, open economy, Finland depends on trade with eurozone members. Consequently, we are also keeping an eye on external economic recovery.

Potentially weaker private sector debt capacity could harm banks' asset quality. Financial distress, especially at small and midsize companies, combined with increased unemployment could lead to credit losses beyond our base case. We will closely monitor the effect of renegotiated loans with interest-only periods on banks' asset quality.

Finnish banks' focus on digitalization. While large banks' digital agenda is well advanced, we expect smaller banks' ongoing investments in core banking renewal and digitalization to weigh on profitability.

Senior nonpreferred issuance postponed. Resolution strategies are taking shape yet some aspects, such as the subordination requirement, remain open.

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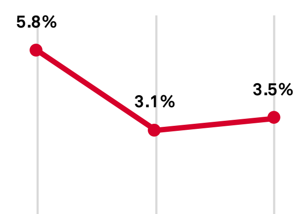
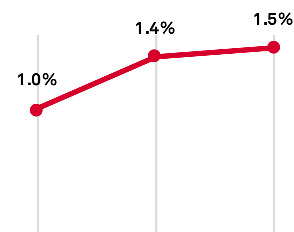
Finland

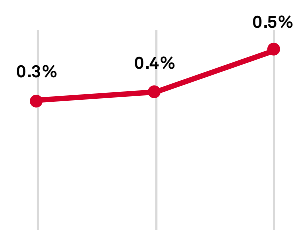
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

France | BICRA Group: 3

Increased Downside Risks For Banks, With A Rise In Credit Losses

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Key takeaways

- Sharp GDP contraction in 2020 will be followed by a recovery in 2021, but not one that would entirely offset damage to the economy and various corporate sectors.
- The downturn comes at a time when the French banking sector is already suffering profitability pressures from low interest rates and heavy cost bases.
- Profitability will weaken in 2020 due to a rise in loan impairment provisions. However, French banks' fundamentals remains sound, with diversified banking and insurance activities and robust balance sheets to support their creditworthiness.

Key credit drivers

The strength of the economic recovery will be critical. The COVID-19 pandemic and its implications will lead to a sharp downturn this year, followed by an expected dynamic rebound in 2021. A deeper and more prolonged economic recession would increase downside risks for French banks, through weaker revenue (derived from net interest margin reduction and lower business volumes) and higher credit losses, resulting in a more significant toll on banks' profitability.

Profitability deterioration to drive cost-efficiency initiatives and pricing discipline. We expect all French banks will target efficiency improvements, while investing in digitalization to meet customers' needs. We also look at banks' pricing in residential mortgages loans, where margins are lower than in other markets, but have been slightly up since the end of 2019.

Key assumptions

Sharp GDP contraction followed by recovery. We believe COVID-19 will result in real GDP contracting by 9% in 2020, with a recovery in the second half of 2020, leading to an expansion of 7.7% in 2021. The wide-ranging fiscal and related monetary measures have supported the banking system through the pandemic.

Earnings significantly reduced in 2020. Banks' overall profitability has withstood the effects of the low interest rates, thanks to their universal banking model and lower share of interest-sensitive activities than other markets. Increased provisioning for risks will result in the bottom line being more than halved in 2020, but credit losses will not push large banks into losses.

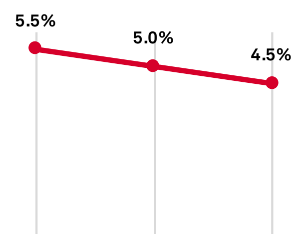
What to look for over the next year

Domestic loan losses will be a key indicator of economic risks in France. We project French banks' credit losses on domestic operations will reach at least 50 basis points this year--double that of 2019, and above the long-term French average.

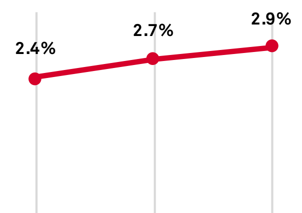
A buildup of economic imbalances and corporate indebtedness. A significant component of the fiscal support package comprises additional indebtedness for the sovereign, some households, and many businesses. This may increase their vulnerability if the economic recovery is delayed, testing the banks' resilience and balance sheets in a European context.

France

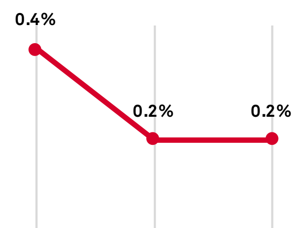
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Germany | BICRA Group: 2

Amplified Economic And Industry Risks Weigh On Bank Outlooks

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Key takeaways

- We expect a sharp GDP contraction in 2020 followed by rebound in 2021 that will not immediately or entirely offset the damage to the economy, household wealth, and various corporate sectors from COVID-19.
- German's fiscal and monetary measures will help to mostly mitigate the pandemic's adverse economic effects and protect the banking sector's stability, although we expect bank earnings, asset quality, and (in some cases) capitalization to weaken.
- German banks entered the pandemic already suffering stress on profitability, notably due to low interest rates and a heavy cost base.

Key credit drivers

A weaker-than-anticipated or delayed economic recovery could increase pressure. This would imply a far more negative effect on German banks' credit strength and could also follow negative developments at individual banks.

Deteriorating revenue and asset quality will test German banks. COVID-19 is pushing Germany's banking system to cover a manageable increase in the cost of risk and demonstrate sufficient earnings resilience amid great competition and still-low interest rates. This keeps pressure on banks to cut costs, consolidate, or find new revenue sources.

The pandemic has accelerated disruption risk from fintech and big tech players. Many German banks need to improve their core IT systems. Larger groups need to further optimize costly branch networks, improve cost-to-income ratios to better withstand the economic crisis, and transform operating models. The lockdowns in response to COVID-19 are catalyzing customers' adoption of digital banking and speeding up digitalization.

Key assumptions

Strong recovery will offset sharp GDP contraction. COVID-19 will induce a 5.4% real GDP contraction in 2020 versus 7.4% in the eurozone. This will be compensated by a strong German rebound with 4.7% expansion in 2021, and 2.4% in 2022.

Substantial, rapidly deployed government support measures. After Germany's fiscal and monetary measures substantially mitigated the cyclical shock in first-half 2020 to both the economy and banking system and helped limit German banks' credit losses, we expect the government to retain its accommodative fiscal policy stance.

German banks' earnings and asset quality will weaken in 2020, but financial profiles will be resilient. Additional stress on interest margins, loss in revenue, and material increase of credit costs from historical lows could result in much lower bottom-line results for many German banks in 2020.

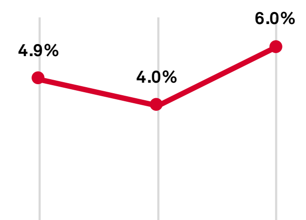
What to look for over the next year

Profitability to suffer in cyclical shock. We expect German banks will need to improve efficiency, invest in digitalization to meet customers' needs, and maintain prudent underwriting standards and risk-adjusted pricing to mitigate difficult credit conditions.

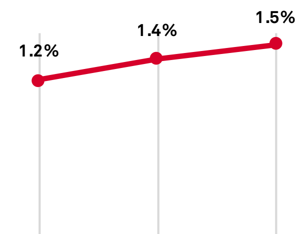
Pressure on asset quality. We project German banks' credit losses on domestic and foreign operations will increase materially in 2021 but remain manageable. A significant component of the government's fiscal support package includes additional debt--for the sovereign, some households, and many businesses. However, expiring temporary debt moratoria for corporates might lead to a sharper increase in credit losses.

Germany

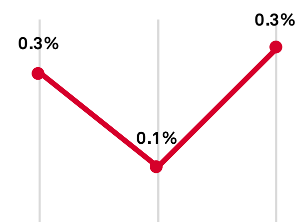
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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Greece | BICRA Group: 9

The Pandemic Hit Banks Amid A Delayed Recovery

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Key takeaways

– Government measures to contain the COVID-19 outbreak have stopped the momentum the Greek economy and its banks were enjoying before the pandemic.

– The resulting global economic slowdown and its effect on Greece's tourism, travel, and services sector will likely result in new NPEs inflows, although banks have already progressed in cleaning up their legacy problem loans with the support of some government initiatives.

– We expect the pandemic to temporarily hinder banks from enhancing their precarious earnings and asset quality and from further diversifying their funding profiles.

Key credit drivers

Further weakening of economic prospects, which could lead to new nonperforming exposure (NPE) exceeding our forecasts, or delay planned NPE and noncore asset disposals. This could increase the additional cost--notably the reduction in capital--to banks from these sales, forcing them to downsize the planned securitizations. This would particularly harm banks with limited capital buffers.

The pace of the economic rebound, notably regarding the performance of the real estate markets, and unemployment levels. These factors will determine the pace of new problem loans, the price and demand for the upcoming NPE securitizations, recovery prospects for the denounced loans backed by real estate, and the collection performance of distressed debt purchasers.

Funding risks that remain extremely low. Deposits have kept increasing, despite the abolition of capital controls, reflecting increased confidence in the banking system. Moreover, the European Central Bank's (ECB) March 2020 €750 billion emergency bond purchase program allows the purchase of Greek government debt.

Key assumptions

We estimate real GDP will contract 9.0% in 2020, followed by a rebound of 6.8% in 2021. This is chiefly because of the pandemic's effect on the trade and tourism, travel, and construction sectors.

We expect credit losses to range from 160-200 basis points during 2020 and 2021. This higher cost of risk--which excludes the additional one-off capital impact from banks' large securitizations--and limited prospects for new lending will pressure banks' bottom-line earnings and already weak capital formation.

Net loans will contract due to NPE write-offs and sales. Net interest margins should remain resilient despite the pandemic. Greek banks retain access to the ECB's long-term refinancing lines at attractive terms.

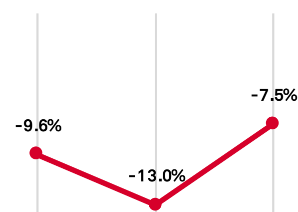
What to look for over the next year

The pace of the new loan disbursements. We do not expect the continuation of the strong first-half trend vis-à-vis the resumption of new lending during the rest of 2020. The resumption of lending matters more for Greek banks, because their quality of capital and earnings remain weaker after years of weakening interest and fee income generation.

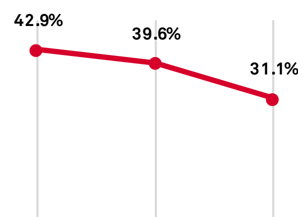
The pandemic's effect on private sector creditworthiness and property markets. Foreign investments largely determine Greek real estate prices, which were just picking up before the pandemic, following a decline of about 40% since 2008. The fallout from COVID-19 will determine the pace of the activity in secured debt sales by banks and the payment capacity of indebted households, whose net equity has turned negative over the years.

Greece

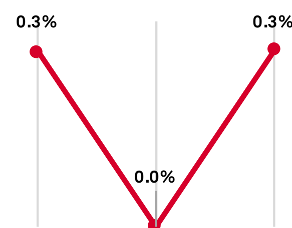
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

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Iceland | BICRA Group: 5

Weak Operating Environment And Profitability Challenge The Sector

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Key takeaways

- Icelandic banks operate in a wealthy economy; however, economic volatility and high concentration in areas such as real estate and tourism, reflected in loan books, expose the banking sector to higher risks.
- We expect the COVID-19 pandemic to exacerbate banks' existing structural weaknesses and stress already-modest profitability.
- Unlike the 2008 financial crisis, banks are facing this downturn with comfortable capital and liquidity buffers.

Key credit drivers

Material concentration risks in banks' loan books, offset by strong capital. We view the risks to be elevated due to the banks' structural exposures to local small and midsize enterprises--including tourism and commercial real estate--which we see as more vulnerable sectors currently. However, the banks counterbalance the risks embedded in the local economy with high capital ratios.

Risk of a prolonged decline in profitability levels. We view the banks' short-to-medium-term earnings prospects as bleak given the sharp reduction in economic activity in 2020, the fast decline of interest rates and mounting credit provisions.

Funding and liquidity positions are stable. Banks' wholesale funding needs are limited for the rest of 2020. This, coupled with the additional central bank liquidity facilities, deposits growth, and dividend payment cancellations, supports liquidity buffers. However, we expect banks to continue to tap both domestic and foreign markets to finance loan growth and upcoming maturities.

Key assumptions

We expect GDP to fall by more than 7% in 2020, followed by a rebound of almost 5% in 2021. The longer and deeper the economic contraction, the more it could impair Icelandic banks' asset quality, increase credit losses, reduce business and revenue generation, and erode capital.

Credit provisions will increase materially as the pandemic's effects persist. We expect total nonperforming assets on average loans to exceed 5% in the next two years (from about 3% in 2019).

The privatization of the two state-owned banks is likely to be delayed. We anticipate that banks will put capital optimization and IPO discussions on hold until there is greater certainty regarding the effects of the pandemic.

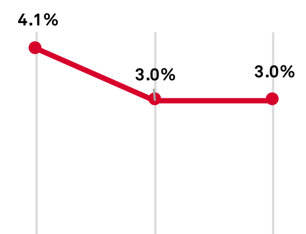
What to look for over the next year

Deteriorating asset quality trend. Economic risks are increasing for Icelandic banks due to rising imbalances in the corporate sector, combined with asset quality deterioration. The pandemic's duration and long-term effects, especially on tourism-related activities and real estate, largely determine the asset quality trend. Currently, this is on the downside, although it is highly fluid.

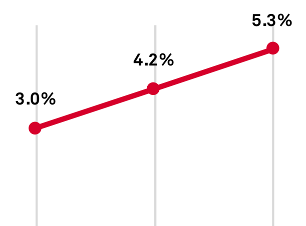
Real estate price developments. Dropping GDP, unemployment rising sharply in 2020, and the supply of properties at a sustained level add uncertainties to real estate prices. This particularly applies to commercial real estate, where prices have increased materially in recent years but have seen a sharp contraction, in some cases by 20% year-on-year, in second-quarter 2020.

Iceland

Loan growth



NPA ratio



RoAA

2019a | 2020e | 2021f

Loan growth – Sector-average growth in loans.

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a--Actual. e--Estimate. f--Forecast.

Ireland | BICRA Group: 4

COVID-19 Pandemic Continues To Weigh On Profitability

Key takeaways

- The pandemic has taken a toll on the Irish economy, which is forecast to see a sharp 6.5% GDP contraction in 2020, based on the underlying domestic economy, followed by a recovery in 2021-2022.
- The shock has put Irish banks under significant pressure, taking into account the structural profitability challenges that the banking sector faces.
- We think Irish banks' balance sheets remain robust and should support the banks' creditworthiness through the sharp recession.

Key credit drivers

Economy vulnerable to shocks. As a small and very open economy, Ireland is very sensitive to global developments, such as this year's recession. We expect Ireland's real GDP (based on the underlying domestic economy) to contract by 6.5% in 2020, after posting one of the strongest growth rates among advanced economies in recent years. The government has put in place a package of emergency measures to safeguard incomes and prevent business closures. These measures, together with Ireland's productive human and physical capital and flexible labor and product market regulations, position the economy well for a recovery, although there is still considerable uncertainty regarding its timing.

Pressure on profitability. Irish banks profitability was already weak before the pandemic, with banks continuously missing profitability targets due to their high cost bases. The average cost-to-income ratio of about 70% is higher than that in other European banking systems. Cost reduction remains a priority, and a challenge. Irish banks have been investing in business transformation and digital capabilities while facing compressed interest margins and a lack of business diversity. 2020's economic contraction has caused a significant increase in loan impairments compared with 2019 and our previous expectations. We also expect weaker revenue generation on the back of business slowdowns and stiff competition due to high industry concentration and the relatively small size of the domestic economy and bankable population. The combination of these factors will inevitably dampen banks' bottom lines over the next several years.

Good capital buffers and liquidity cushion. Thanks to years of deleveraging and cleaning up their balance sheets, Irish banks entered the pandemic with good capital buffers and ample liquidity. So far, domestic banks' capital positions (whether measured by regulatory ratios or S&P Global Ratings metrics), remain robust. This should allow Irish banks to withstand the drop in profitability and absorb unexpected credit losses. However, the damage to banks' financial profiles could be more severe if the operating dynamics of the first half of 2020 persist and if the expected economic rebound is materially delayed.

Key assumptions

Credit costs have risen, despite support and forbearance measures to contain the damage from the pandemic. At present, we estimate that domestic credit losses could rise to 180 bps in 2020 and 70 bps in 2021, from just 21 bps in 2019.

Nonperforming assets to increase. Mortgages represent a substantial part of Irish banks' loan portfolios and their quality has improved after nonperforming loans were sold, underwriting standards improved, and the regulator imposed macroprudential rules. In our view, the major risks to asset quality come from exposures to domestic midsize enterprises and corporates. We are only likely to have better visibility on the quality of banks' loan portfolios and their impact on bank performance in 2021.

What to look for over the next year

External risks. Pre-pandemic concerns related to a disruptive Brexit and an escalation of global protectionism have not disappeared and remain medium-term risks for both the Irish economy and banks.

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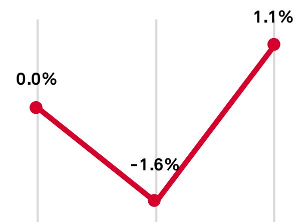
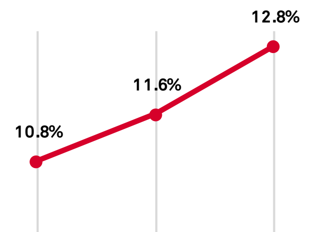
Ireland

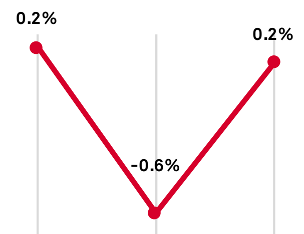
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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RoAA – Sector-average return on average assets.

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Italy | BICRA Group: 5

Economic Downturn Could Accelerate Structural Sector Changes

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Key takeaways

- In 2021, existing moratoriums on over €300 billion of customer loans, mostly to small and midsize enterprises (SMEs), are likely to end. Thereafter, we expect the effect of the recession triggered by the COVID-19 pandemic on private sector creditworthiness to start to crystallize.
- In our view, most Italian banks appear better equipped to deal with a near-term shock than they were when the previous recession hit, although the downturn will amplify some institutions' weakness.
- Consequently, we expect sector consolidation to remain a key theme in 2021.

Key credit drivers

The pace and strength of the recovery. The policy responses in Italy may not succeed in totally avoiding permanent economic damage. If the recovery is not as robust as we currently anticipate, this could have a meaningful effect on asset quality, revenue, profitability, liquidity, and potentially capitalization.

European authorities' supportive measures cushion downside risks. We anticipate that they will support Italy's economic recovery and mitigate the risks arising from Italian banks' exposure to market turbulence.

Key assumptions

It will take more than two years to recover the GDP lost in 2020. We expect Italy's economy to gradually bounce back from next year onward. After a sharp contraction in GDP of about 8.9% in 2020, GDP is forecast to grow 6.4% in 2021, 2.3% in 2022, and 1.5% in 2023, when it will return to the 2019 level.

A steep rise in credit losses. We expect cumulative credit losses in customer loans to be 260 bps-290 bps in 2020-2021, and then ease to about 80 bps in 2022, which is still higher than the 70 bps reported in 2019. This will stem from a rapid increase in nonperforming exposures we anticipate will occur in the first quarters of 2021, once the government lifts the moratoriums and other supporting measures, which primarily assisted SMEs. Although high, we forecast that these losses will be lower overall than those experienced at the peak of the previous double-dip recession. We expect most of the losses to come from SMEs, particularly in those sectors more affected by persistent restrictive measures.

The European Central Bank's (ECB's) enhanced liquidity measures and large deposit base to mitigate refinancing risk. Italian banks' access to affordable unsecured wholesale funding remains constrained by uncertain economic prospects and sovereign creditworthiness. That said refinancing risk for the near- to medium-term has abated, given that Italian banks have taken over €350 billion in cheap ECB funding and have large deposit funded bases. In addition, the banking sector has a very low external position--only 5% of its funding is wholesale.

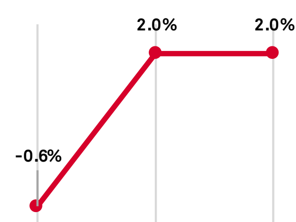
What to look for over the next year

Asset quality trends and government guarantees could mitigate the impact on banks' balance sheets. The recession will severely test the resilience of banks' credit quality, and the progress banks have made in recent years to improve management and underwriting standards. The latter should be a differentiating factor, compared with the previous financial crisis.

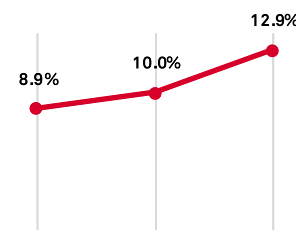
Further consolidation in the banking sector. We anticipate that this recession could further impair the Italian financial system's modest earning capacity and amplify business model sustainability risks for a number of banks, especially the smaller and undiversified ones. In our opinion, the relatively high cost base, compared with the amount of revenue banks can generate, constrains banks' ability to cushion rising business and credit losses. We think this could create more economic incentives for structural changes in the banking sector, including further consolidation over time. This will follow Intesa Sanpaolo's recently completed takeover of UBI Banca.

Italy

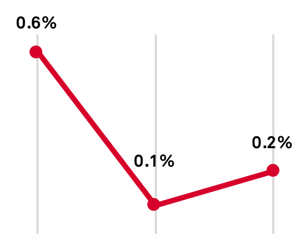
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Liechtenstein | BICRA Group: 2

Strong Bank Ratings That Have Relatively Little Sensitivity To Recession

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Key takeaways

- Ratings are less susceptible to domestic economic swings, but exposed to global wealth levels, which depend on capital market valuations.
- Despite a push for global tax conformity over recent years, Liechtenstein's banks have fared relatively well, with only temporary money outflows.
- Extreme market volatility can lead to margin calls and sometimes losses in Lombard lending, despite generally conservative risk management.

Key credit drivers

Banks in Liechtenstein remain vulnerable to reputational risk. Private banks' activities are quite confidence sensitive. We see the main risks as: a major outflow of funds, which could be triggered by tax-code revisions in other countries; reputational damage in the event of money-laundering allegations; and weak investment performance.

High competition and margin pressure. The slump in asset valuation during the early stage of the COVID-19 pandemic caused only a temporary reduction in the banks' earnings base and was followed by a strong recovery in asset prices. Nevertheless, we expect competition to remain strong and margins to be strained by the prolonged low rate environment.

Key assumptions

Lombard lending capacities will play a vital role in new customer generation, especially in Asia. Lombard lending--lending backed by liquid assets--is a key product offered by private banks and complements the advisory and wealth management business. We assume that banks will not ease their underwriting standards in their quest to attract new customers. That said, varying degrees of Lombard usage by customers in their asset allocation will lead to volatile lending volumes and related interest income.

Lending will remain low risk. Banks' sound risk management practices, predominantly collateralized, low-risk lending, and wealthy customers imply that traditionally low credit losses are unlikely to increase materially in a downturn.

Liechtenstein's open economy is quite resilient to GDP shocks and will quickly recover. This should ensure relatively low credit losses from the domestic lending business, which is also largely collateralized. Based on the banks' low sensitivity to the domestic economy, we do not expect ratings to change as a result of the 2020 recession.

What to look for over the next year

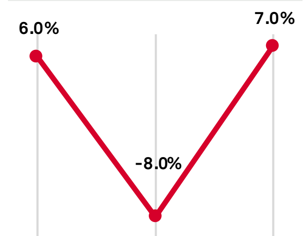
Release of the local minimum requirement for own funds and eligible liabilities (MREL) framework and bank-specific requirements. Material subordination requirements and clear paths to achieve them could provide for additional loss-absorbing capacity buffers for senior unsecured creditors, potentially leading to rating uplift for systemically important banks.

Banks' appetite to increase scale through inorganic growth. Large mergers and acquisitions could temporarily reduce capitalization. The pandemic-induced expected slump in profitability and continuing margin pressure may push out smaller banks and could let established players to reconsider their private banking footprints.

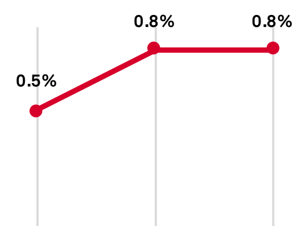
Continuing pressure from tax-conformity and regulatory initiatives, such as the EU's Markets in Financial Instruments Directive, referred to as MiFID II. We expect increasing price transparency and competition are likely to continue to weigh on global private banking margins.

Liechtenstein

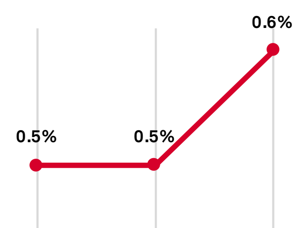
Loan growth



NPA ratio



RoAA



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Luxembourg | BICRA Group: 2

Prosperous Economy, Transient Cool-Off In Market Dynamics

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Key takeaways

- Luxembourg is a prosperous economy with strong employment. Its strong economic growth has been interrupted in 2020 by the COVID-19 pandemic. The government has implemented emergency measures to shield the economy from a liquidity shock. If the pandemic evolves as we expect, we predict a strong economic rebound in 2021.
- Residential property prices have risen rapidly in recent years, with sustained increases in domestic credit moderately outpacing underlying economic growth. The banking sector enjoyed a low cost of credit risk, which is to increase in 2020, and local banks benefit from a strong deposit base.
- Banking supervision is complex--most players are subsidiaries of foreign banks and there is a sizable nonbanking financial sector. The banking sector is vulnerable to regulatory and reputational risks.

Key credit drivers

Real-estate prices have been rising rapidly for several years. On the plus side, this has not been fueled by credit. The strong price increase was primarily due to the lack of supply and an expanding population. That said, we think that a further spike in house prices could hit affordability, undermining consumption and economic growth. Potential overvaluation could also create a risk of financial instability. Although the current economic situation may temporarily curb the rising trend in real estate prices, we do not expect a significant correction, given that the population is likely to continue growing, employment perspectives remain favorable, and there are supply constraints.

Domestic credit to the private sector is growing faster than GDP. Domestic credit growth has been on a marked upward trajectory in the past three years. We estimate that credit risk in the system is low and underwriting standards have not relaxed during this period, but the sustained increase in domestic credit, in excess of GDP growth, informs our view on economic risks and potential imbalances in the banking sector.

Key assumptions

Luxembourg's economic growth will halt in 2020. We expect GDP to decline by 5.9% in 2020, which is less severe than in most other European countries, before recovering in 2021.

Real-estate prices will remain high. Increases in inflation-adjusted housing prices accelerated in 2019 and averaged a high 7% over the past four years. We expect this trend to continue in the coming years.

Domestic credit will continue growing and we expect a spike in the cost of risk. Over 2020-2021, we forecast that the annual increase in domestic credit to the private sector will average 4%, supported by moratoriums and the state guarantee for bank loans, made in response to the pandemic. We expect the cost of risk in domestic credit to show a sizable increase from the very low level of 2019.

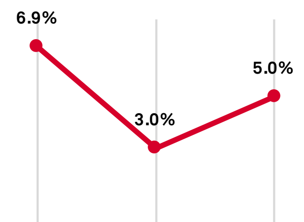
What to look for over the next year

Trends in domestic lending and house prices. Several years of strong dynamics in domestic credit and real-estate prices led us, in January 2020, to see an increased risk of a build-up of economic imbalances. We will continue to monitor the risk of overheating. The European macroenvironment and trends in Luxembourg's GDP will be underlying key parameters.

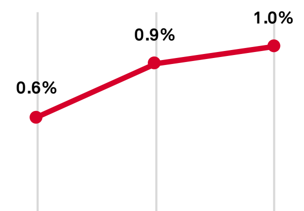
Luxembourg's approach to international tax initiatives and changes to its tax regime. Luxembourg has engaged in adjusting its tax regime to face pressures from the international community, including the European Commission's review of certain rulings under EU state-aid rules. It has changed its approach to fiscal competition, focusing increasingly on headline tax rates rather than on tax exemptions. The changes are likely to be gradual, but, by altering the Luxembourg tax regime, further measures to adapt to international tax competition and regulation could weigh on the economy and, in turn, on banking revenue.

Luxembourg

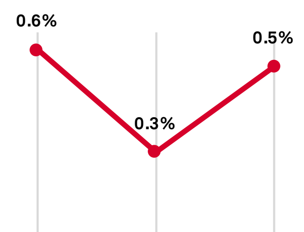
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Malta | BICRA Group: 5

COVID-19 Will Undermine The Banking Sector's Performance

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Key takeaways

- The sharp contraction in economic activity will affect the tourism and real estate sectors, which account for an important share of banks' credit exposure.
- Maltese banks' asset quality is likely to weaken, eroding the sector's profitability in 2020.
- Jurisdiction reputational risks are still high, but we expect Malta's regulators will increasingly address supervision shortcomings and strengthen banking sector oversight.

Key credit drivers

Credit risks for Maltese banks are rising. The country's banking sector has high exposure to tourism-related activities, and we think there is rising risk of a residential property price correction.

Nonperforming exposure is likely to increase. We expect a reversal of the positive momentum that saw nonperforming asset (NPA) reduction reach 4.8% in 2019. However, forbearance measures are likely to delay most of loans' recognition as nonperforming to 2021.

Malta and its financial sector are still facing high reputational risks. Weaknesses in regulatory financial and anti-money-laundering supervision represent a risk to the sector's macrofinancial stability. Domestic banks are focusing on de-risking activities and strengthening internal functions.

Key assumptions

The Maltese economy will enter a recession in 2020. We expect the country's GDP to contract by 8% in 2020, before gradually resume growing by 5.5% in 2021-2022. Malta's small and open economy, with its large share of tourism, makes it vulnerable to economic slowdown in the eurozone. Tourism is likely to be among the last activities to rebound.

Credit losses will increase substantially. We expect the steps taken by the government and central bank will somewhat support the affected businesses and households, but will not prevent an increase in credit losses in 2020 before a gradual recovery in 2021. This will materially erode the banking sector profitability in 2020.

The funding and liquidity profile will remain solid. Due to significant household savings, the banks enjoy a solid funding base from customer deposits. At the same time, banks are very liquid, with a systemwide domestic loan-to-deposit ratio of below 60%.

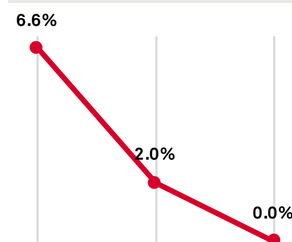
What to look for over the next year

Reputational risks of the jurisdiction and the banking sector. Maltese supervisory bodies are actively working to address deficiencies in financial sector oversight, such as shortcomings in the anti-money-laundering framework identified by international institutions. We view the measures as positive and expect to see additional progress. Failure to address these weaknesses in a timely manner could further stress the financial sector in Malta.

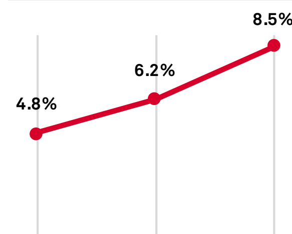
The trend in residential property prices. After several years of a booming real estate market, largely supported by tourism demand, we now think there is increasing risk of a price correction, mostly in tourism-related investment properties. Considering 65% of Maltese banks lending is to the real estate sector (commercial and residential mortgages), this poses risks to the banking system's financial performance.

Malta

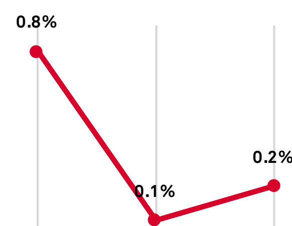
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

The Netherlands | BICRA Group: 3

Balance Sheets And Business Models Remain Resilient Against A Weak Earnings Outlook

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Key takeaways

- The COVID-19 pandemic will take a toll on the Dutch economy in 2020, but government support measures have so far prevented serious damage to the private sector's credit quality.
- Profitability will weaken in 2020 due to an inevitable rise in loan impairments and persistent pressure on net interest margins, and the earnings recovery in 2021 will be only gradual.
- Still, Dutch banks' fundamentals remain sound, with overall low risk profiles, healthy capitalization, and digitally advanced business models.

Key credit drivers

Sharp recession in 2020, dynamic rebound in 2021. Implications of the COVID-19 pandemic will lead to a 5.2% GDP contraction 2020. However, thanks to a comprehensive package of government support to shield businesses and employees from pandemic's consequences, the emergence of new defaults and arrears for banks have been minimal so far. The sovereign's sizable fiscal space allows for further support measures if needed, for instance if the COVID-19 situation remains difficult in 2021 and the economy fails to recover.

Pressure on banks' profitability is inevitable. Higher loan impairments and revenue attrition from the pandemic add to pre-existing headwinds, such as the low interest rate environment and compliance or technology investments. The domestic loan loss rate should converge towards 40 basis points (bps) in 2020, reducing to 30 bps in 2021. For the largest Dutch banks, the total loss rate will likely be higher because it includes riskier international activities. Pockets of risks include export-oriented corporates, small and midsize enterprises, and cyclical sectors such as energy or transportation. Profitability metrics will weaken in 2020, but Dutch banks should remain profitable with robust balance sheets.

Banks' operating conditions remain fundamentally healthy. We observe supportive price discipline in the competitive mortgage lending segment, a large part of Dutch banks' balance sheets, and favorable dynamics in the property market (structural supply shortage). Due to their well-advanced digital strategies, banks have generally efficient cost bases and lean operating models, which help in an environment of persistently low interest rates and rapidly changing customer preferences.

Key assumptions

An economic rebound in 2021. We expect a 3.8% GDP rebound in 2021 thanks to unprecedented policy responses from an 'AAA'-rated sovereign. As some support measures gradually expire, nonperforming loans should peak in 2021 at about 3.6% and decline gradually to 3% from 2022.

Household leverage remains high on a gross basis. We consider that household indebtedness will continue to reduce over time with the gradual move away from interest-only mortgages, while remaining high in a European context. Still, Dutch households' substantial savings and financial assets mitigate credit risks in the retail segment for banks. We expect the residential real estate sector will remain sound, with only a mild price correction of 1.5% in 2021 after several years of dynamic growth.

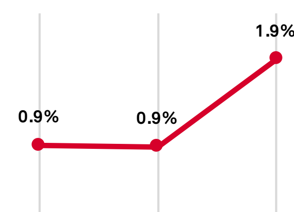
What to look for over the next year

Pre-pandemic external risks remain. Concerns related to global trade tensions and Brexit remain a lingering risk for the open Dutch economy and its banks.

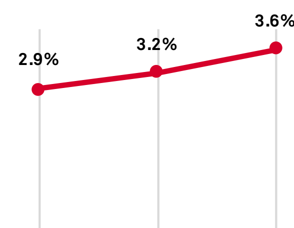
The Dutch banking sector will need to adapt to upcoming regulatory reforms. Banks will have to continue strengthening their balance sheets, adjusting their business models and financial strategies to final Basel III regulatory capital rules (Basel IV).

The Netherlands

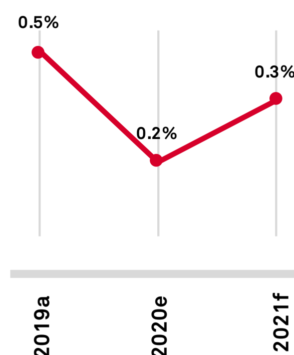
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

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Norway | BICRA Group: 2

A Resilient Banking Sector Despite COVID-19 Stress

Key takeaways

- Strong capital and liquidity buffers, a diversified economy, and ample reserves in Norway's sovereign wealth fund will help banks withstand pressure from the COVID-19 pandemic combined with the oil price decline.
- However, current macroeconomic stress will intensify pressure on the banking sector's asset quality, revenue, and profitability over the next two years.
- Despite Norwegian banks' traditional reliance on wholesale funding, the capital markets show resilience, benefiting the sector's access to funding.

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Key credit drivers

Increased economic risks owing to a challenging macroeconomic environment. We expect Norway to undergo a recession in 2020, followed by a rebound in economic growth from 2021. This--together with the central bank of Norway's unprecedented move cutting the key policy rate to zero in May 2020--will result in a tougher environment for the banking sector, weighing significantly on banks' margins, asset quality, revenue, and profitability over the next two years.

High household debt is a potential concern, although mortgage portfolios are expected to show resilience. We believe residential mortgage portfolios, which account for about half of total bank loans, will be more resilient to the current stress than corporate sector exposure, thanks to various government employment and income support measures. That said, we recognize some latent risks to banks from structurally high household debt (227% of GDP at end-2019), driven by strong growth in house prices over the past decade, and banks' exposure to the cyclical commercial real estate segment.

Sector profitability is under strain, but robust capitalization and advanced digital transformation will help Norwegian banks weather the stress. The banking sector has accumulated strong capital buffers due to solid profitability over recent years, cushioning the expected deterioration of asset quality. Moreover, Norwegian banks have benefited from being at the forefront of digital transformation. Amid social distancing requirements, this should enable banks to continue providing high-quality service to customers and control their costs.

Key assumptions

Significant economic contraction of 2.2% in 2020, followed by a rebound of average 2.6% growth in 2021-2023. These forecasts are based on our current expectations regarding recovery in the domestic and international economy, with a potentially slower-than-expected economic recovery representing a downside risk.

Increase in credit risk in the next two years. We expect credit costs to reach 0.3%-0.4% in 2020-2021 compared with 0.15%-0.20% in the previous two years.

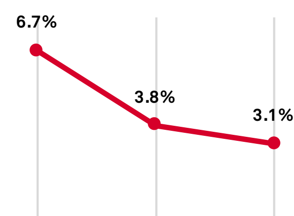
What to look for over the next year

The pace of domestic and global economic recovery is key to restoring asset quality and profitability to banking. Efficient safety nets and extraordinary government support have cushioned some of the economic shock. However, as a small and open economy, Norway's recovery prospects are closely linked to how fast international trade and global economic growth recovers.

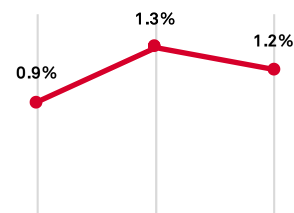
We expect the corporate sector to scale down its investment plans and borrowing in response to current economic uncertainties. At the same time, many borrowers in the sectors most hit by the outbreak of coronavirus may no longer be commercially viable in a post-pandemic world due to structural changes in consumer behavior, which might further deteriorate asset quality in the long term.

Norway

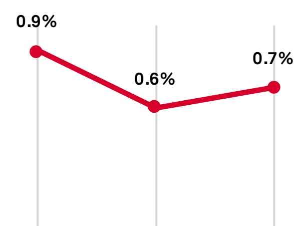
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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Portugal | BICRA Group: 6

2020 Economic Shock Will Delay Convergence Toward Peers

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Key takeaways

- Portugal's small and open economy will only partially recover next year and will likely remain smaller than it was prior to the COVID-19 pandemic until 2023. Recovery may be undermined if the second wave of contagion proves harsher than expected.
- Portugal's private sector faces the pandemic with far less debt than in previous years, having deleveraged significantly over the past decade, but indebtedness remains high, at about 155% of GDP at end-2019.
- Portuguese banks will continue to benefit from an ample and stable customer deposit base, but their asset quality and profitability will deteriorate from already weaker levels than those of closest European peers, even if we have witnessed little signs of asset quality deterioration so far. Banks' domestic nonperforming exposures (NPEs) will likely rise above 11% in 2021, and return on equity (ROE) will remain below 1% next year.

Key credit drivers

Banks' already high NPE ratio as a result of the prior downturn will only be exacerbated by the current crisis. We estimate the domestic NPE ratio was 8.5% at end-2019, which is higher than European peers', despite significant heterogeneity among the largest players. We expect NPEs will peak at above 12%, but only in 2022 given the extensions of both private and public moratoria in the country, the latter until September 2021. Cost of risk will likely remain significantly high next year, at about 175 basis points.

Heightened pressure on already limited profitability prospects. The hit from the COVID-19 pandemic will aggravate banks' earnings prospects, which are already under pressure from ultra-low interest rates and weak margins. This, together with higher credit losses, will leave the banking system only modestly profitable next year, with barely positive ROE.

Rebalanced funding profiles. Portuguese banks have significantly rebalanced their funding profiles over the past decade, with deposits now accounting for the bulk of their funding structures and exceeding their loan books, while benefitting from ample liquidity.

Key assumptions

The economy will rebound only partly in 2021. We anticipate that this year's global recession will hit Portugal hard, with GDP contracting by 10.0% in 2020, before expanding by 6.2% in 2021 and 3.9% in 2022. The budget will only return to a surplus in 2022, and net debt will remain high at about 128% of GDP by end 2021.

The property market will recover next year. The slight price correction that we anticipate in 2020 (-0.6% in nominal terms) will thus be temporary. We forecast a moderate price increase (1.2%) compared with a cumulative about 30% increase in 2017-2019.

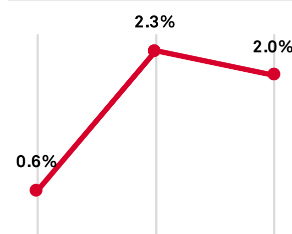
What to look for over the next year

Magnitude and pace of economic developments. If next year's economic rebound is milder than expected, banks will face a harsher scenario than we currently envisage and heightened downside risks.

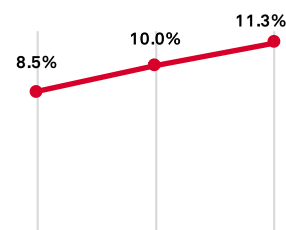
Asset quality trends. The extension of moratoria in Portugal will mask the full extent of banks' asset quality deterioration until 2022, although banks front-loaded COVID-19 related provisions this year and will continue to do so next year.

Portugal

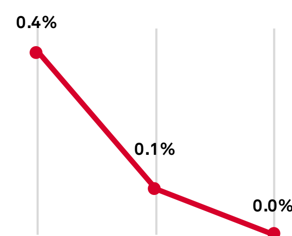
Loan growth



NPA ratio



RoAA



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Spain | BICRA Group: 4

Banks' Prospects Hinge On Economic Rebound

Key takeaways

- The fates of Spanish banks largely depend on the economy's ability to rebound strongly in 2021. Risks stem from the ongoing second wave of COVID-19 and a complex political landscape.
- The evolution of banks' asset quality will be key in 2021.
- The majority of our ratings on Spanish banks are on a negative outlook, largely reflecting that their loan book performance could be weaker than we expect, potentially leading to capital depletion.

Key credit drivers

A solid economic rebound is key to banks' prospects. Although we are expecting a strong rebound in 2021, Spain may face hurdles on the way. In particular, the ongoing second wave of COVID-19 could require more social distancing and even confinement measures if pressure on the health care system becomes unsustainable. Equally, the country will need to take decisive action to reduce the fiscal deficit and make public debt more sustainable. However, the necessary political consensus may be difficult to achieve given the fragmented, complex political landscape.

The scale of asset quality problems will become more evident in 2021. There is little evidence of higher delinquencies so far--thanks to the extensive and unprecedented support provided to households and corporates--however, they will materialize eventually. Our base case projects credit losses of 80-100 basis points in 2021, similar to those in 2020, with NPAs climbing to 9.6% by end-2021, from 7.3% at end-2019. SME and consumer lending are the more vulnerable asset classes. Spanish banks' existing capital cushions are enough to absorb the shock, but some by only a slim margin. The ratings on these banks are therefore more vulnerable to downgrades if recovery is significantly softer than our base case.

Profitability to remain weak. Although bottom-line results could slightly improve in 2021 from 2020, they will remain weak and well below banks' cost of capital. Profitability challenges are more significant for midsize banks. With net interest income still under pressure amid negative interest rates, reducing costs is critical, which probably explains the ongoing consolidation wave.

Key assumptions

The economic shock will be severe, but short. The economy will rebound in 2021 (8.2% GDP growth versus 11.3% contraction in 2020), and recover to pre-COVID-19 levels in 2022, containing structural damage.

The ECB will remain supportive. Banks will not face funding constraints, having access to sizable funding at attractive prices.

What to look for over the next year

Economic developments. A harsher scenario than we expect, namely a milder, longer recovery could weaken our ratings on some banks.

Evolution of loan quality. This will be key to assessing the underlying performance of banks' loan books and their ability to absorb losses from their current capital buffers.

Banks' initiatives to ensure the sustainability of their business models, including consolidation. Banks will have to act decisively to adapt to lower-for-longer interest rates and an increasingly digitalized environment, generating more fee income to offset margin pressure as well as improving their efficiency. They will also need to undertake IT investments and process restructuring to digitalize their businesses. We will continue to monitor consolidation, which we expect to pick up.

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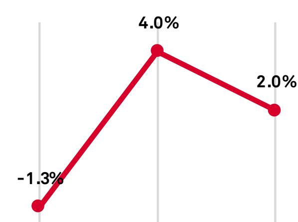
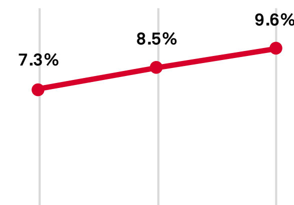
Spain

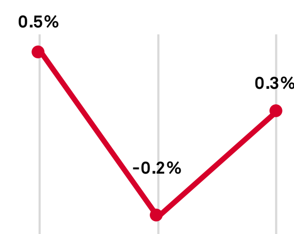
Loan growth



NPA ratio



RoAA



2019a | 2020e | 2021f

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Sweden | BICRA Group: 2

Substantial Financial Flexibility Supports Swedish Banks

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Key takeaways

- Swedish banks entered the COVID-19 crisis from a position of strength in terms of profitability, asset quality, and capital levels compared with the European average and we continue to expect resilient earnings from the Swedish banks in 2020-2022.
- The Swedish housing market will remain broadly stable, yet banks remain highly sensitive to property price volatility.
- High private-sector debt in Sweden could pose risks if the pandemic-induced downturn continues for longer than expected.

Key credit drivers

Swedish banks are vulnerable to swings in the housing market. Material exposure to property markets makes banks vulnerable to changes in house prices and households' debt-servicing capacity. However, we expect the government measures, solid social-security safety net, and the temporary removal of the amortization requirement to support a moderate increase in real estate prices in 2020-2022. Therefore, we anticipate that mortgage losses will be limited.

Banks entered the crisis well prepared. Large capital buffers, digital maturity, and high cost efficiency and profitability will allow the banks to absorb the expected weaker asset quality and increased loan loss provisions in 2020-2021.

High dependence on wholesale funding. The higher share of wholesale funding, relative to other European banking sectors, increases the Swedish banking sector's confidence sensitivity. That said, the country's deep debt capital markets and the government's willingness to ensure liquidity and a well-functioning domestic covered bond market mitigate this risk.

Key assumptions

A deep downturn in 2020 followed by fast recovery. We forecast Swedish GDP will contract by 5% in 2020 before bouncing back to 4% growth in 2021. That said, the economic recovery has already started, supported by resilient household consumption and the wide-ranging fiscal, monetary, and regulatory support measures to the real economy.

Some property price volatility can be expected. Although we do not rule out a price correction in commercial property, in real terms, we believe the impact on banks will be manageable, given banks' focus on cash flows in commercial property transactions. However, if the overall economy sees more adverse developments, we could revise up our view of the risk of economic imbalances from intermediate.

What to look for over the next year

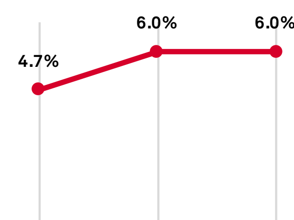
Asset quality trends. The expected credit losses reported by banks in the first three quarters of 2020 diverged widely and there was a wide range of assumptions in their provisioning. The coming quarters should make their relative resilience clearer.

Senior nonpreferred issuance likely to be delayed. The National Debt Office's decision to extend the phase-in deadline for subordination of minimum requirement for own funds and eligible liabilities to 2024 (from 2022) will delay the buildup of additional loss-absorbing capacity buffers at systemically important banks in Sweden.

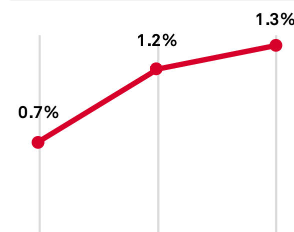
Swedish banks will be able to manage the expected increase in maximum distribution amount (MDA) thresholds. The Swedish Financial Supervisory Authority announced its proposed interpretation of the EU banking package for capital requirements on Sept. 25, 2020. At this time, we do not anticipate that the implied changes to the MDA thresholds will affect our ratings on Swedish banks' hybrid issues.

Sweden

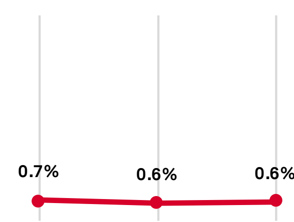
Loan growth



NPA ratio



RoAA



2019a | 2020e | 2021f

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Switzerland | BICRA Group: 2

The Banking Sector Will Remain Resilient

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Key takeaways

- Swiss banks' profitability prospects have weakened and asset quality will deteriorate in the wake of COVID-19, but banks will contain credit losses more than sectors in most peer countries.
- The sector will remain resilient against this economic shock, bolstered by the superior financial strength of both the household and corporate sectors and banks' prudent underwriting standards focusing on collateralized lending.
- Banks' revenue will remain under pressure given permanent ultra-low interest rates, and political initiatives could further constrain the sector's profitability.

Key credit drivers

A very wealthy household sector. Switzerland's net per capita wealth levels place it among the top countries globally, with wealth evenly allocated among the population. We do not foresee any constraints on Swiss inhabitants' ability to service debt obligations because of COVID-19, thanks to the government's large corporate and household support schemes.

A stress-proof corporate sector. The sector is significantly stronger than that of other countries. It has proven its resilience to shocks, including the global financial crisis and the drop of the franc's peg to the euro in 2015. The banks' reported nonperforming loans remain low and we have seen almost no increase in corporate bankruptcies following these events, which indicates superior resilience.

Residential mortgage loans dominate most customer portfolios. Switzerland ranks among the countries with the highest share of collateralized lending, mainly residential mortgage loans. Cyclical consumer loans occupy a niche in most Swiss banks' portfolios, which will support the robustness of asset quality during the economic downturn.

Key assumptions

Expectation of a strong economic rebound. We expect Swiss GDP to contract 4.3% in 2020 because of the COVID-19 pandemic, before rebounding by 3.9% in 2021 and 2.8% in 2022. Government support measures for the corporate and household sectors are substantial and we think Switzerland's economy will rebound swiftly, given its competitive and innovative economy.

Stable housing markets. We expect prices in single-family housing and owner-occupied apartments to increase by about 2% annually, which is low compared with previous years' average rates. In our view, the risk for a severe price correction is low, given that it would require a significant rise in unemployment, which we consider unlikely. We also expect risks in the investment property segment to remain moderate, although the first signs of a price correction manifested before COVID-19 in some areas after immigration slowed.

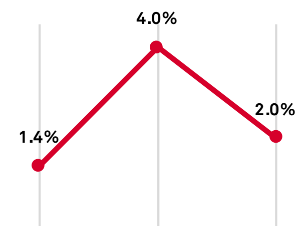
What to look for over the next year

Pressure on banks' profits. Low interest rates are keeping margin pressure on core products. Two political initiatives could further constrain profitability. Abolishing the imputed rental value could decrease the size of banks' loan books and revenue capacity. Furthermore, removing lending restrictions on state-owned Post Finance would increase competition in the domestic market. The success and timeline of both initiatives remains highly uncertain, reflecting complex approval processes in the country.

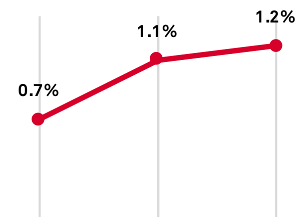
Combating money laundering. The stability of Switzerland's banking sector hinges on compliance with the highest anti-money-laundering-standards. In our view, the regulator has stepped up controls, which has also led to the discovery of weaknesses in several banks. However, future allegations of serious money laundering could lead us to review the sector's market discipline and the effectiveness of its supervision.

Switzerland

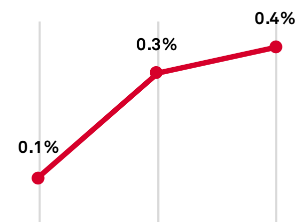
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

United Kingdom | BICRA Group: 3

Short-Term Earnings Misery But Long-Term Balance-Sheet Resilience

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Key takeaways

- In 2020, U.K. banks' earnings face a triple whammy from a net interest margin squeeze, reduced retail lending volume, and a sharp spike in loan-impairment provisions.
- The Bank of England and U.K. government have implemented several significant measures to support U.K. banks, businesses, and households in the wake of COVID-19.
- We believe U.K. banks' balance sheets remain robust and should support creditworthiness through the economic downturn.

Key credit drivers

Systemwide domestic loan losses will show the evolution of economic risk. We estimate that the domestic loan loss rate could rise to 100 basis points (bps) in 2020, about 5x the level in each of the past six years. In 2021, on the back of the assumed economic recovery, we think that the loss rate could fall to about 60 bps--closer to, but slightly above, the long-term U.K. average.

The pace and strength of the economic recovery will be critical. As with many other countries, we assume that the U.K.'s economic recovery that started in third-quarter 2020 will not falter. The country has suffered from significant investor caution, mainly owing to the political impasse after the 2016 EU referendum and lasting through the conclusive outcome of the December 2019 general election, a period when economic growth was lackluster. Failure to conclude a satisfactory new trading arrangement with the EU by the start of 2021 might dampen the recovery.

Cost efficiency will underpin profitability. With interest rates lower than we assumed at the start of 2020, we see an even greater focus on lowering operating expense, including reappraisal of property and staffing needs. Digitalization and technology investments are inflating costs now, but will ultimately enable incremental headcount reductions and drive permanent efficiency gains.

Key assumptions

Credit losses likely won't push most major banks into losses. We expect most major U.K. banks to be profitable in 2020. The absence of payment protection insurance charges in 2020, in contrast to the cumulative £52 billion of provisions over the prior nine years, will provide partial support to year-on-year statutory profit comparisons.

Bank capitalization will remain solid. U.K. banks started the year with comfortable capital metrics, whether measured by regulatory ratios or S&P Global Ratings' metrics. More generous IFRS9 transitional arrangements are helping metrics in 2020, as is the Bank of England's decision forcing banks to cancel their year-end 2019 and interim 2020 dividends. Notwithstanding the earnings shock in 2020, we assume most major banks will be positioned to resume some form of shareholder distributions in 2021.

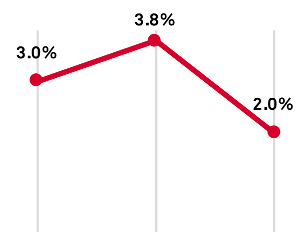
What to look for over the next year

The degree to which the housing and mortgage markets recover. The £1.5 trillion domestic residential mortgage market comfortably represents the largest component of U.K. banks' loan books. Following a collapse in second-quarter 2020, there is evidence of a strong rebound in mortgage approvals, housing transactions, house prices, and mortgage spreads, in part aided by a temporary relaxation in stamp duty. If these trends continue, they could help bank revenue more than we assume and lead to mortgage provision releases.

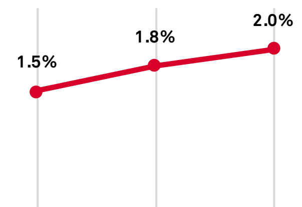
Smaller lenders. More than 20 smaller banks, building societies, and finance companies compete for business, either directly or at the margin, against the dominant banks. For many, the economic downturn is the first true test of the robustness of their business models.

United Kingdom

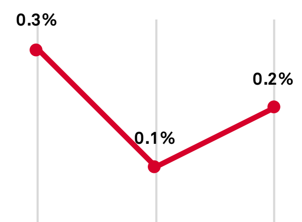
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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a--Actual. e--Estimate. f--Forecast.

CEEMEA

BICRA groups: lowest to highest

Russia
Belarus
Poland
Czech Rep.
Ukraine
Hungary
Slovenia
Croatia
Kazakhstan
Georgia
Uzbekistan
Azerbaijan
Armenia
Turkey
Tunisia
Morocco
Israel
Jordan
Kuwait
Egypt
Saudi Arabia
Qatar
Bahrain
Oman
United Arab Emirates
Nigeria
Kenya
South Africa

Group '1' to '10', from lowest to highest risk. BICRAs--Banking Industry Country Risk Assessments. CEEMEA--Central and Eastern Europe, Middle East, and Africa. Data as of Oct. 27, 2020. Source: S&P Global Ratings.

Armenia | BICRA Group: 8

More Severe Negative Impact Of The COVID-19 Pandemic On The Economy

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Key takeaways

- We now expect the pandemic to encumber the Armenian economy more severely than we previously anticipated, and predict a GDP contraction of about 6.8% in 2020.
- We expect nonperforming loans (NPLs) to increase to about 8% and profitability in the banking sector to halve in 2020, followed by a recovery starting in 2021.
- It is uncertain whether a recently agreed deal and political resolution of the Nagorno-Karabakh conflict will prove sustainable.

Key credit drivers

Depreciation of the Armenian dram could exacerbate the deterioration in credit quality caused by the pandemic. Armenian banks face extremely high credit risk because a very high share of loans is denominated in foreign currencies, particular loans to unhedged retail borrowers and companies.

Possible outflows of nonresident deposits. Nonresident deposits, mainly from the Armenian diaspora, accounted for about 30% of total domestic deposits at midyear-2020. We consider these more vulnerable to outflows during times of stress, such as that caused by the pandemic and the Nagorno-Karabakh conflict with Azerbaijan.

Key assumptions

We expect a severe economic contraction in 2020 due to the pandemic. We revised our GDP growth forecast for Armenia to reflect that we now expect GDP to contract by 6.8% in 2020, followed by an average annual growth of 4.5% in 2021-2022.

The banking system will remain highly dollarized. Even though we expect the gradual reduction in dollarization to continue, about 50% of loans and deposits will still be denominated in U.S. dollars, a higher level than in peer countries.

Loan growth outpaces deposit growth. We anticipate banks to make more loans than they take in deposits in 2020-2021 as consumers and small and midsize enterprises (SMEs) take out loans under government support programs.

What to look for over the next year

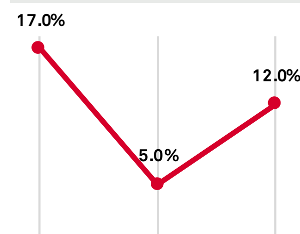
Developments regarding the conflict over Nagorno-Karabakh. Resumed military conflict with Azerbaijan over the Nagorno-Karabakh region could weigh on the Armenian economy, fiscal position, and banking sector by causing possible customer deposits outflows; increasing dollarization in the banking system; and, potentially, damaging the confidence of international investors.

Asset quality will deteriorate, but is expected to remain stronger than that of some international peers. We expect that NPLs (loans over one day overdue) in the banking system could increase to 8%-9% in 2020-2021, from 6.5% at end-August 2020, and credit costs could increase to 3% in 2020-2021, from about 1.5% in 2019.

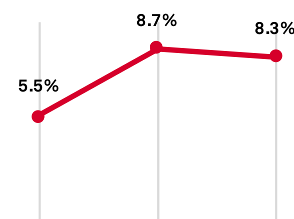
Profitability will deteriorate, in line with international peers. We expect the banking system will remain stable, with no significant changes to the competitive landscape. At the same time, we expect return on assets to decrease to about 0.8% in 2020, from 1.5% in 2019, due to a slowdown in loan growth, pressure on net interest margins, and an increase in the cost of risk.

Armenia

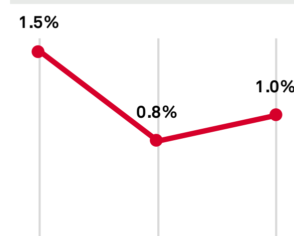
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Azerbaijan | BICRA Group: 9

Economic Downturn Will Hit Banks' Financial Performance

Key takeaways

- The escalation of the conflict over the Nagorno-Karabakh region in late September 2020 increased risks to Azerbaijan's fiscal performance, external balance sheet, and macrofinancial stability.
- We expect the economy to contract by 6.9% in 2020 because of the COVID-19 pandemic, combined with a decline in oil prices; this will increase banks' credit losses.
- We expect nonperforming loans (NPLs) to double and profitability to erode in 2020, leaving some banks with barely breakeven financial results.

Key credit drivers

Elevated risks from military conflict over Nagorno-Karabakh. It is not currently clear to us whether recently agreed deal and political resolution of the conflict could be sustainable. The economy has already been adversely impacted by the pandemic and lower oil prices this year. Azerbaijan derives about 40% of its GDP, 50% of government revenue, and more than 90% of exports from the hydrocarbon sector. Low oil prices will further weigh on Azerbaijan's economic growth prospects. Combined with high sensitivity to potential currency depreciation, this exposes the banking sector to high economic imbalances and increases the pressure on asset quality.

Operating conditions are weighing on banks' performance. For 2020, we expect that Azerbaijani banks' new lending will slow. Meanwhile, credit costs will likely increase to 4.0% of the average loan book, compared with an average of 3.2% over 2015-2019.

Key assumptions

Sharp GDP contraction followed by gradual recovery. We expect an economic contraction of 6.9% in 2020 followed by a rebound of 3% over 2021. Azerbaijani banks face growing challenges to their business growth and earnings prospects. These, combined with persistent external vulnerabilities, could hit banks' capital buffers, asset quality, and funding stability harder than we previously envisaged.

Pressure on asset quality. We assume that reported NPLs may rise to 12%-15% in 2020-2021, from about 8% at year-end 2019. At the same time, we believe that the peak in NPLs and the bulk of asset quality deterioration could crystallize only in 2021. Thus, the impact on Azerbaijani banks' profitability from additional provisioning could be deferred over 2020-2021.

What to look for over the next year

Increasing pressure on the funding base. Steep depreciation of the Azerbaijani manat over the past few years has led to protracted currency imbalances between banks' assets and liabilities, due to the increased share of foreign currency funding in banks' customer funds (more than 60%). The exchange rate remains under pressure in a volatile macroeconomic environment. Disorderly adjustments to parity might destabilize the macroeconomic environment and increase credit risks in the banking sector. We understand that, so far, domestic resident savings have not been converted to foreign exchange at an increased rate, nor have there been substantial outright deposit outflows from the banking system.

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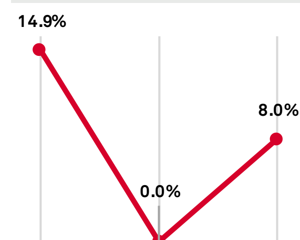
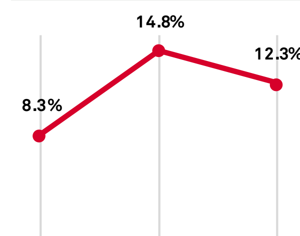
Azerbaijan

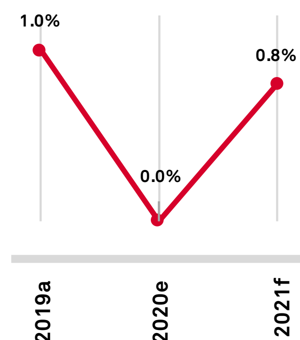
Loan growth



NPA ratio



RoAA



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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Bahrain | BICRA Group: 7

Asset Quality May Wane, But Risks Remain Contained

Key takeaways

- We expect the decline in real estate prices, asset quality indicators, and the profitability of retail banks to accelerate because the COVID-19 pandemic and low oil prices will have an adverse effect on Bahrain's economy.
- Although its contribution to the overall funding profile is moderate, external debt could prove vulnerable to domestic or regional stresses.

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Key credit drivers

Exacerbated pressure on real estate. The pandemic and low oil prices will both weigh on Bahrain's economy. We expect this to cause an accelerated decline in real estate prices and to weaken asset quality indicators and the profitability of retail banks. However, under our base-case scenario, the deterioration would occur toward the end of 2020 and beginning of 2021 and should remain broadly manageable.

External vulnerabilities. Retail banks' net external debt was still contained at 10.8% of systemwide domestic loans on June 30, 2020, compared with 9.8% at end-2019. We expect it to climb to around 15% in the next 12-24 months, as banks raise external funds. However, we understand that a large portion of the banking sector's external funding is from the Gulf Cooperation Council (GCC) countries and likely to remain stable, assuming no domestic or regional stresses.

Key assumptions

Bahrain's economy to contract. We forecast that Bahrain's real GDP will contract by 5% this year, because of the effects of the pandemic and lower oil prices on consumption and investment activities. Although we do not expect a decline in the oil and gas sector--as a small producer, Bahrain is not subject to the OPEC+ cuts--other large sectors, such as financial services and manufacturing, will likely slow. We expect the economy to recover moderately in 2021, with real GDP expanding by 3.5%. We expect growth to average around 2.3% in 2022-2023. Bahrain's relatively diverse economy benefits from its proximity to the large market of Saudi Arabia, sound regulatory oversight of the financial sector, and a relatively well-educated work force.

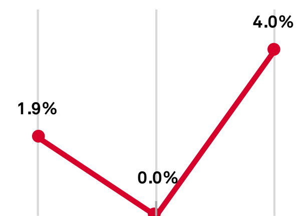
What to look for over the next year

Profitability is likely to weaken. We expect loan growth will remain below 5% in 2021-2022 as economic conditions gradually improve. Coupled with lower margins and high cost of risk, we expect the overall profitability of the banking system to decline.

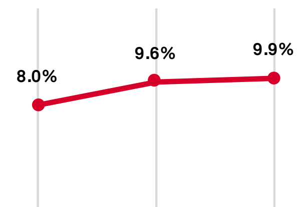
GCC support. The $10 billion of financial support from other GCC sovereigns will partly cover the government's funding needs until 2023. We consider that the Central Bank of Bahrain (CBB) has limited ability to maintain the peg of the Bahraini dinar to the U.S. dollar, since the country's reserves do not cover the monetary base. However, inflows from other GCC sovereigns have supported the reserve position in the past 12 months and we expect further support, if needed.

Bahrain

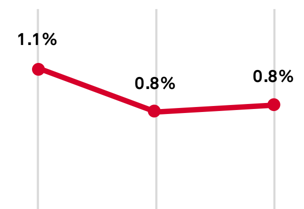
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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Belarus | BICRA Group: 10

High Credit Costs Will Persist Amid A Deteriorating Economic Environment

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Key takeaways

- Rising economic, financial-stability, and external risks in the aftermath of Belarus' disputed presidential elections in August this year, exacerbated by the COVID-19 pandemic, have increased risks for the banking sector.
- Potentially protracted political uncertainty could weigh on Belarus' medium-term growth prospects.
- Financial system stability is under increased pressure following elevated deposit conversion into foreign currency and increased deposit withdrawals from domestic banks.

Key credit drivers

High political uncertainty after the disputed presidential election in August 2020, as well as vulnerable balance-of-payment and fiscal positions, have increased risks to financial system stability. After weeks of heightened volatility, we believe there is an increased risk of a protracted political stalemate, which could weigh on Belarus' medium-term growth prospects. We expect the negative effect on the domestic economy will exacerbate Belarus' already-weak growth performance over the past two years, potentially compounded by the impact of the pandemic. This would have a negative impact on new business growth, profitability, and asset quality in the banking sector. Furthermore, Belarus' fiscal and balance-of-payments positions remain vulnerable due to a high proportion of government debt denominated in foreign currency, a heavy debt repayment schedule, and sensitivity to external conditions. Belarusian ruble has depreciated by more than 20% since the end of 2019, further increasing risks for the banking sector given high levels of dollarization.

Funding stability and liquidity have been under pressure since August this year. Deposit erosion in Belarus and elevated demand for foreign currency beginning in first-half 2020 intensified in August, spurred by heightened political uncertainty. We believe the risk of deposit outflows could persists and weigh on banks' funding profiles and liquidity buffers. A high share of irrevocable deposits (about two-thirds of term-retail deposits as of July 1, 2020) mitigates this risk, but only to a limited extent.

Key assumptions

A sharp GDP contraction in 2020 will likely be followed by economic recovery, but downside risks are high. We forecast the economy will contract by 3% in real terms this year, with all main components (exports, consumption, and investment) exhibiting a weak dynamic. This will have a negative impact on new business growth, profitability, and asset quality in the banking sector.

Rise in credit losses. The challenging macroeconomic environment, local currency volatility, and the potential for a protracted period of political uncertainty and public protests will put additional pressure on the debt-servicing capacity of Belarusian companies and households, taking a toll on banking sector asset quality over the next two years. We expect nonperforming loans will increase to about 15% in 2020 from about 12% as of end-2019, and credit losses will rise to 3.5%-4.0% in 2020-2021 versus approximately 3.0% in 2019.

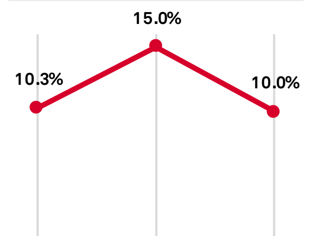
What to look for over the next year

Resolution of the political turmoil. The negative effects of political turmoil on the domestic economy will exacerbate Belarus' already-weak growth performance over the past two years, compounded by the impact of the pandemic.

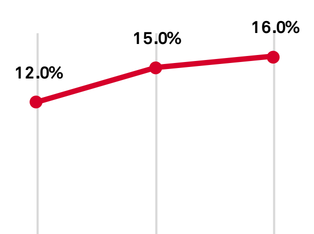
Stability of customer deposits. Although we consider that banks currently have sufficient liquidity to manage deposit outflows, a prolonged period of increased deposit volatility will have a negative impact on the sector's stability, especially given the central bank's limited foreign exchange reserves that have decreased by 20% since end-2019.

Belarus

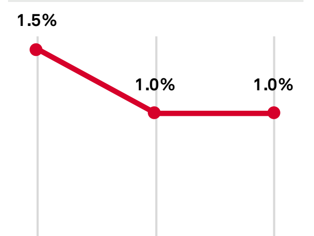
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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a--Actual. e--Estimate. f--Forecast.

Croatia | BICRA Group: 7

Deepening COVID-19 Risks Might Affect Asset Quality

Key takeaways

- We expect Croatian banks' earnings and asset quality to weaken through end-2020 and 2021, but banks to remain profitable.
- Economic recovery expected from 2021 will help contain credit losses.
- We anticipate that banks will receive capital, liquidity, and operational support from foreign strategic shareholders if needed.

Key credit drivers

Nonperforming exposures (NPEs) are higher than peers'. Croatian banks have made significant progress in reducing their NPEs. By end-2019, the systemwide NPE ratio had fallen to about 7%, from 17% at end-2014. However, we expect this trend to reverse, and asset quality to deteriorate in the coming quarters as the economy contracts and tourism activity is reduced. Specifically, we forecast NPEs will stand at about 9%-10% in 2020 and 2021.

We anticipate that domestic banks' profitability will decline. Reduced business volumes and compressed interest margins will likely constrain revenue generation. Combined with the growing cost of credit, this will affect bottom-line performance. However, we still expect Croatian banks to report positive results and preserve their capital position.

We expect support from foreign shareholders. Foreign strategic shareholders are likely to remain committed to supporting their Croatian subsidiaries. Additionally, we expect that their solid liquidity buffers and the central bank's support measures will reduce liquidity pressure from the loan moratorium.

Key assumptions

We expect that GDP data for the third quarter will confirm that Croatia is experiencing a deep recession, owing to a sharp contraction in domestic demand and falling tourism receipts. We expect Croatia's GDP to contract by 8% in 2020, followed by a 5.6% rebound in 2021. However, this upturn will not immediately and entirely offset damage to the economy. We chiefly attribute this to the COVID-19 pandemic's impact on the tourism sector (which contributes about 20% of GDP).

The private sector has not fully recovered from the previous recession, a decade ago. That said, nonfinancial corporations are more resilient than they were during that time. We view this as positive, because much of the banking sector's heavy credit losses came from that segment. That said, private-sector indebtedness is still high, at 93% of GDP at end-2019. This is one of the highest levels among Central and Eastern European peer countries.

Credit losses will remain higher than peers'. We anticipate that asset quality will remain a key issue for the Croatian banking sector. As a result, we forecast ongoing high credit losses, at around 170 bps per year in 2020-2021, up from about 80 bps in 2019.

What to look for over the next year

We expect banks will remain profitable, although we anticipate a decline in bottom-line profits. In our view, return on equity will fall to about 5%-6% by end-2021, from 9.9% at end-2019.

Despite the Croatian government's measures to contain the spread of COVID-19, banks face an unprecedented challenge. We are acutely mindful that our current base case remains subject to significant downside risks. Even under our economic view, the Croatian government's policy responses may not prevent permanent economic damage. Therefore, we expect that, even after the pandemic subsides, Croatia will continue to see its effects, mainly in reduced revenue and increased risk costs.

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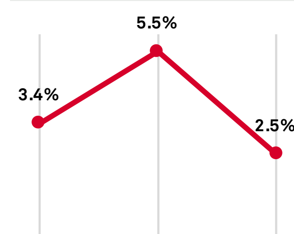
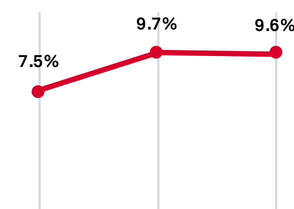
Croatia

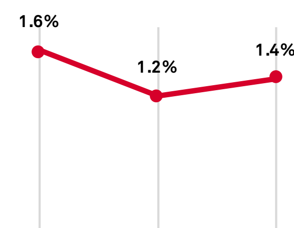
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Czech Republic | BICRA Group: 3

Czech Banks Will Weather The Pandemic Better Than Many Peers

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Key takeaways

- We expect a sharp GDP contraction in 2020 followed by a more prolonged recovery in 2021, similar to other Central and Eastern European (CEE) countries.
- Timely and proactive regulatory actions and solid financial profiles before the pandemic will enable Czech banks to weather the downturn without material distortions.
- We expect nonperforming loans (NPLs) to peak in 2021 and profitability to contract, before economic recovery starts in 2021 with a lagging positive impact on the banking sector during 2022.

Key credit drivers

Potential delays in the economic recovery or a more pronounced recession than we expect. Either factor could increase risks for Czech banks. With the government's announcement to return to a full shutdown in October 2020, risks have increased.

Rapid growth in residential property prices. Accelerating growth in real estate prices could lead to a buildup of economic imbalances. Recent falls in borrowing costs because of substantial interest rate cuts by the central bank, and intense margin competition among banks, make properties attractive for buyers. Housing market activity indicates further acceleration of residential property prices, but a second lockdown might delay this, leading to pent-up demand as soon as the economy reopens.

Key assumptions

A sharp GDP contraction followed by a prolonged recovery. Combatting the pandemic, including through a second lockdown, will take a heavy toll on the Czech economy in 2020. We expect real GDP will contract 8%-9% this year, with a subsequent recovery of about 5% in 2021. We expect GDP will reach 2019 levels only in second-half 2023. Authorities are using ample fiscal and monetary policy space to cushion the downturn's effects. We expect more supporting measures from policymakers.

Continuing swift and effective regulatory responses to COVID-19 to support Czech banks. We think the Czech National Bank has taken timely and proactive measures to support the banking system during the pandemic by increasing provision of liquidity to banks, relaxing regulatory capital adequacy requirements and debt metrics, and recommending that banks withhold dividend payments. We expect this to continue in fourth-quarter 2020 and first-quarter 2021, if needed.

Decreasing net external banking sector debt. We think the high level of nonresident deposits at Czech banks will decrease in 2020-2021 due to sharply reduced differences in the interest rate levels in the Czech Republic and eurozone, and the self-funded profile of banks.

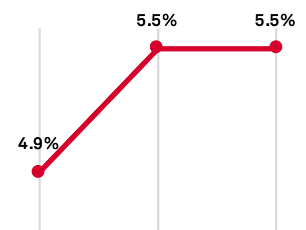
What to look for over the next year

Delayed asset quality deterioration. We think NPLs (loans more than 90 days overdue) could rise as high as 3.7% in 2020-2021 from 2.4% as of end-August 2020. Credit holidays of up to six months could relieve the asset quality pressure; nevertheless, they might simply mask asset quality issues until after the end of the moratorium.

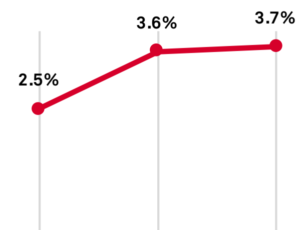
Profitability deterioration. We expect that loan growth of about 5.5% in 2020 and 2021 will somewhat offset pressure on net interest margins. In our view, the main profit factor is a rise-of-cost of risk of up to 1% that will result in return on assets decreasing to 0.5% in 2020-2021 from 1.1% on average over the past five years. Strong margins, cost efficiency, and solid capitalization at the onset of the pandemic provide enough buffer to absorb this deterioration such that banks will fare better through the downturn than many international peers.

Czech Republic

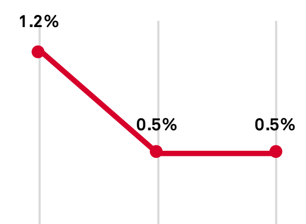
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Egypt | BICRA Group: 9

Bank Creditworthiness Is Linked To That Of The Sovereign

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Key takeaways

- We forecast higher credit losses for banks as the economy slows down.
- Measures from the Central Bank of Egypt (CBE) might cushion the economic impact of the pandemic.
- Digital banking could enhance financial services' penetration.

Key credit drivers

Banks are still heavily exposed to the government. Significant investments in government securities have supported banks' profitability in previous years, while increasing their link to the sovereign. Direct exposure to sovereign debt accounted for almost 40% of systemwide assets as of June 2020. Although we expect customer loans to expand faster than sovereign debt in the coming years, we anticipate the latter will remain sizable.

Banks' asset quality will deteriorate. We forecast that nonperforming loans will increase to about 6.5%-7.0% by June 2021 because of the negative impact of the pandemic on exposed sectors such as tourism and small and midsize enterprises (SMEs). We expect large corporates, which represent the bulk of the banks' lending books, to be more resilient to weaker economic activity.

Good systemwide liquidity buffer. We forecast that Egyptian banks' liquidity will remain strong, owing to low loan leverage and relatively stable customer deposits. Despite the uncertainties, systemwide deposits grew about 17.5% in the fiscal year ending June 30, 2020. The growth was strongly supported by the saving certificates offered by public institutions National Bank of Egypt and Banque Misr between March 2020 and September 2020. These yielded 15%.

Key assumptions

We expect the pandemic to affect economic growth. We forecast a further slowdown in real GDP growth to 2.5% in FY2021, compared with 3.5% growth in FY2020 and 5.6% in FY2019.

Cost of risk will increase. We forecast credit losses for Egyptian banks will increase to 200 bps-240 bps in 2020-2021, owing to the impact of the pandemic on private borrowers, particularly SMEs.

What to look for over the next year

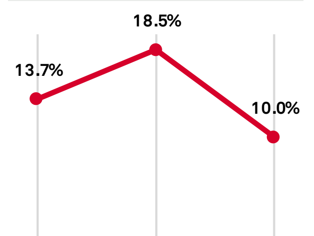
How the pandemic affects SMEs. In our view, the SME sector, which represents about 20% of the largest institutions' lending books, is likely more exposed to the direct and indirect economic effects of social distancing measures than large corporates. In our view, the magnitude of the impact will depend on the duration of the pandemic and the speed of the economic recovery. As the CBE's six-month moratorium on principal and interest ended in September 2020, the effect on borrowers' creditworthiness is likely to become more evident in the coming months.

A lower interest rate environment could support lending activities. Depressed global economic activity and renewed pandemic-induced restrictions in Egypt could lead the corporate sector to postpone near-term capital expenditure further. That said, we expect economic activity to start recovering in the second half of FY2021, which could trigger an increase in demand for credit. In such a scenario, we consider that the CBE's decision to cut interest rates by 50 bps in September 2020, following a 300 bps cut in March 2020, could play a positive role by providing additional stimulus.

Use of digital banking might accelerate. New technologies could support financial inclusion. We understand that, amid the lockdown, Egyptian players made increasing use of digital channels such as phone calls, mobile banking, and ATMs to interact with their customers.

Egypt

Loan growth



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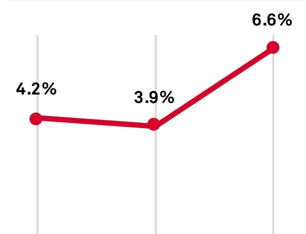
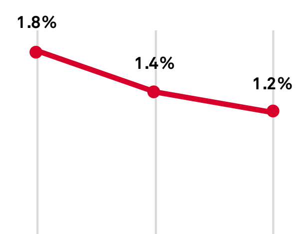


RoAA



2019a 2020e 2021f

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Georgia | BICRA Group: 8

Asset Quality To Gradually Normalize From 2021

Key takeaways

- We expect the economy to gradually recover from 2021, with real GDP rising by 3%.
- Cost of risk will gradually normalize after a sharp increase in provisions imposed by the National Bank of Georgia (NBG) in Q1 2020.
- Recovery of international travel will be key for overall economic recovery.

Key credit drivers

Better-than-average regulation protects Georgia's banks. The NBG has been addressing increased risks related to the volatile macroeconomic environment. It started to stem aggressive growth in retail lending as early as 2018 and has routinely forced banks to keep additional capital buffers for currency-induced credit risk. It has also encouraged a conservative approach to provisioning, forcing banks to recognize losses averaging 3.4% of loan books as early as Q1 2020.

Dollarization remains high. Despite the NBG's efforts to decrease dollarization in the banking sector over recent years, banks entered the COVID-19-related shock with 55% of their loan books denominated in foreign currency, which will pressure portfolio quality.

External funding will remain stable. Net external debt funds about 30% of loans in Georgia, which is high in an international context. We believe that the elevated share of international financial institutions (40% of total banking sector debt) represents less risk to the stability of the funding base compared with wholesale funding from capital markets, and supports funding stability in times of stress.

Key assumptions

We expect economic growth to rebound in 2021, supporting banking sector recovery. We think the institutional framework (which we view as better than regional peers'), flexible economy, and international support will allow the banking sector to withstand the current stress and return to strong growth and profitability. We forecast GDP to rebound to 3% in 2021, after a 6% contraction in 2020.

Lending growth will remain modest. After years of rapid credit growth (almost 20% per year over 2015-2019), lending will stay subdued in 2021. Georgian banks will need to strengthen their capital base in anticipation of the re-introduction of currency-induced credit risk buffers waived by NBG in 2020. Debt-service capacity of individuals and enterprises will remain constrained as recovery will be fairly slow.

Cost of risk will gradually normalize. NBG already forced banks to create new provisions of approximately 3.4% of their portfolios in Q1 2020. We expect that cost of risk will begin to normalize in 2021 on the back of economic recovery, lowering to 200 bps from approximately 400 bps that we expect in 2020.

What to look for over the next year

Evolution of safety measures. Tourism is an important contributor to the Georgian economy at about 9% of GDP, with 9.3 million international arrivals in 2019 (dropping to around 1.5 million for the first nine months of 2020), compared with a population of 3.7 million. Resumption of international travel will be a major spur to economic rebound. However, it will also depend on global economic recovery and how quickly international travel barriers are lifted.

Exchange rate volatility. Volatile investor confidence toward emerging markets, and possible spillover effects from neighbouring Turkey and Russia, are likely to result in increased volatility of the Georgian exchange rate. This will likely hinder NBG's efforts to reduce the dollarization of banking sector balance sheets.

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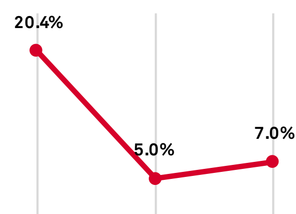
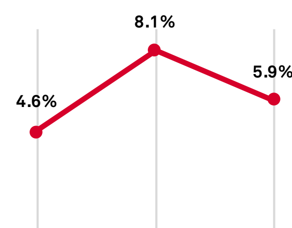
Georgia

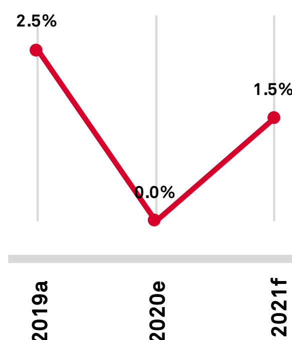
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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Hungary | BICRA Group: 5

Resilient Banks Able To Withstand Rising Credit Losses

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Key takeaways

- The GDP reduction has been higher than expected in 2020, but we expect a solid rebound in 2021.
- The government will continue with measures supporting significant credit growth during the pandemic.
- Well-prepared and profitable banks compensate for higher credit losses.

Key credit drivers

A delayed recovery would increase risks for Hungarian banks. Banks will inevitably suffer a rise in credit losses in 2020, and 2021, but we consider structural economic risks in the economy lower than during the 2008-2009 financial crisis.

Real estate prices fall in Budapest. Real estate price growth had been very high over the past four years. But the government's order to close borders has led to fewer tourists and foreign students, resulting in an unprecedented 20% decrease in rental prices in Budapest in second-quarter 2020. We expect the downturn to have a somewhat positive impact, preventing the risk of overheating and an eventual real estate bubble bursting. Banks' prudent lending standards since the financial crisis and regulatory measures reduced risks of overheating significantly. Main risks relate to commercial real estate portfolios, especially those with exposure to tourism, transportation, and the office sector persist.

Loan growth is strong due to high moratorium usage and government support. Amortization of loans decreased significantly as many Hungarians applied for the loan moratorium. With the introduction of support loan programs, loan growth remained high at 8.4% in the second-quarter compared with the same period a year earlier. The extension of banks' moratorium for at-risk groups of people would delay clarity on the extent of credit losses further.

Key assumptions

Despite its border closure, Hungary will exceed the average EU-27 GDP growth. We expect a more severe GDP contraction of -6.1% in 2020, followed by a U-shaped rebound of 4.75% in 2021. We see Hungary well-prepared for a solid rebound as it entered the pandemic after a robust expansionary phase. The country's unemployment figures are still relatively low after strong economic and wage growth.

Higher credit losses will remain manageable. Hungary's banks benefited from robust lending margins and low credit costs in recent years, leading to sound levels of profitability and strong capitalization. We expect that, despite decreased revenue and increased risk costs, return on equity will remain above that of many peers, given high demand for credit, comfortable lending margins, and relatively high interest rates.

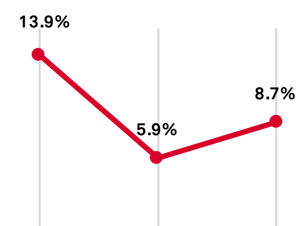
What to look for over the next year

Ongoing fiscal support might weaken public finances. After providing substantial support to the private sector during the first half of the year, longer-than-expected substantial support by the Hungarian government could lead to an increased risk of excessive public debt levels.

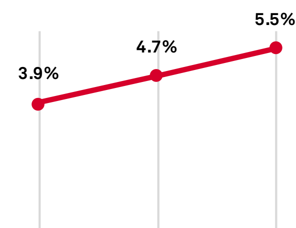
The development of unemployment and housing prices is uncertain. With a second wave hitting European countries and border closures continuing, Hungary's industries face considerable uncertainty. Together with a prolonged absence of tourists, housing prices in Budapest might be further dampened.

Hungary

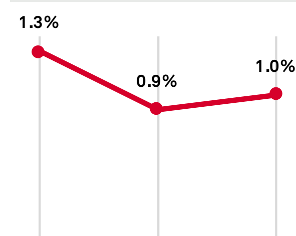
Loan growth



NPA ratio



RoAA



2019a | 2020e | 2021f

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Israel | BICRA Group: 3

Banks Holding Up Well, But Economic Risks Are Rising

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Key takeaways

- Israeli banks face gloomier profitability prospects and asset quality deterioration in 2020.
- We expect the Israeli banking sector to remain resilient to the pandemic-related economic shock, thanks to solid profitability and capitalization and ample liquidity. Nevertheless, downside risks are on the rise.
- The government and central bank have extended measures to support households until mid-2021 and extended the loan moratorium period until year-end 2020.

Key credit drivers

Economic fundamentals are strong and banking sector regulatory oversight is prudent. Positive macroeconomic conditions have supported the profitability and asset quality of the banking sector over the past decade. Prudent regulatory oversight and structural changes in the economy have led banks to reduce their exposures to large borrowers and leveraged finance. Banks' capitalization is also solid after several years of profit accumulation.

Risks in mortgage lending seem contained. After the regulator applied macroprudential measures more than five years ago, we think banks have contained the risk in their mortgage portfolios, which comprise 35% of total lending, on average. The average loan-to-value ratio was 54% at year-end 2019; this is relatively low, by global standards.

Growing risks for profitability resilience. Downside risks to economic recovery could be heightened by a second nationwide lockdown. A slower-than-expected labor market recovery and declining prices in commercial real estate are the key risks for banking sector profitability over 2020-2021.

Key assumptions

Sharp GDP contraction in 2020 and a rebound in 2021. We expect GDP to contract by 5% in 2020 because of lower external and internal demand, followed by a 4.5% recovery in 2021. Growth will be supported by economic recovery at Israel's key trading partners, combined with the country's strong macroeconomic fundamentals, which include a dynamic economy, a not-particularly-leveraged private sector, and a strong external position.

Sizable support package should prevent permanent damage to the country's productive capacity. Our base-case assumption is that the government's programs will support a recovery of the labor market and relieve the pressure on households and small businesses, which have been hardest hit by the current crisis.

Housing market stability. The residential property market has stabilized over the past few years, and we do not expect an abrupt house price correction, thanks to strong domestic demand stemming from population growth, and considering supply-side limitations. The stable performance of the residential real estate market in the first half of 2020 was also supportive.

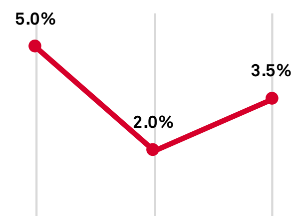
What to look for over the next year

Pressure on asset quality. We expect credit losses to increase in 2020 to 0.9%-1.0%, and to weigh on banking sector profitability, before recovering to more normalized levels. A significant share of credit loss provisions stems from unsecured retail lending and from small and micro businesses lending. We expect to see some crystallization of credit losses once moratorium measures cease, likely through 2021-2022.

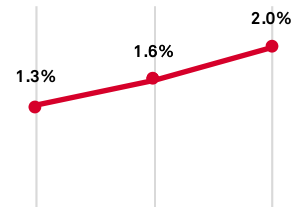
Efficiency efforts will continue and will partly offset the effect of growing credit losses. After several years of implementing efficiency plans, we expect the banking sector to improve its operational efficiency further and to invest in digitalization as the current environment offers new opportunities.

Israel

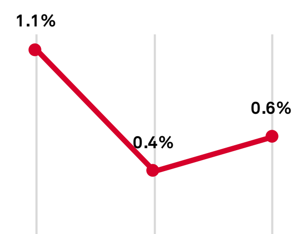
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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a--Actual. e--Estimate. f--Forecast.

Jordan | BICRA Group: 8

Asset Quality And Profitability To Deteriorate Amid COVID-19 Pandemic

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Key takeaways

- The COVID-19 pandemic erupted in a battered economy already weakened by regional tensions and limited government flexibility.
- This additional shock will lead to a slowdown in economic activity and a rise in problem loans and cost of risk for Jordanian banks.
- Monetary policy easing, initiated to mitigate the shock, will impede banks' profitability.

Key credit drivers

The pandemic is likely to exacerbate existing problems. We forecast that Jordan's GDP will contract by 5.5% in 2020 and that this will depress credit quality. We expect only a slight recovery in 2021. Several external shocks--including the Syrian conflict and influx of refugees--have strained Jordan's economic growth over the past few years. In this context, the pandemic threatens the government's economic agenda to improve competitiveness, foreign direct investment (FDI), and exports, as well as hampering the nascent recovery in Jordan's services sector, particularly tourism. We expect unemployment to rise to 24% in 2020, from an already-high 19.1% in 2019.

Banks have concentrated loan books. Given the small economy and corporate sector, banks are exposed to single-name and sector lending concentrations, which inflates risks during recessions.

Pre-crisis credit fundamentals are sound. Banks entered the crisis with sizable buffers to absorb additional credit losses. These include the regulatory capital ratio standing at 18.3%, nonperforming loan (NPL) ratio of around 5%, and still-sound profitability.

Key assumptions

Deterioration in banks' asset quality. We expect the short-lived yet sharp contraction in domestic output will cause NPL ratios to reach 7%-8% and credit losses to spike to about 200 basis points in 2020, from 90 basis points in 2019. Because of the loan moratoriums in place for affected clients, we anticipate that NPLs will only peak in 2021.

Real estate prices to decline only marginally. Banks are vulnerable to the real estate sector since it accounts for about a quarter of their lending books. However, we do not expect the economic recession will lead to a material correction in real estate prices because residential housing investment is mostly nonspeculative--prices have been flat for several years.

No escalation in the region's political situation. Risks related to domestic political tensions and the Syrian conflict have eased, but remain elevated.

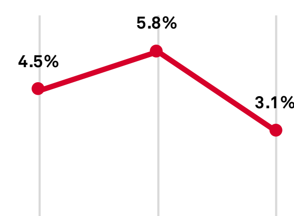
What to look for over the next year

We see rising pressure on banks' profitability. The central bank has cut policy rates by 150 basis points so far in 2020, and further easing remains a possibility. Although this will support borrowers' credit quality, the pressure on net interest margins will weigh on banks' profitability, as will the higher cost of risk.

Funding pressure is likely to intensify. Jordanian banks are fully funded by core customer deposits, but deposit growth remains sluggish due to low economic and income growth rates in Jordan and across the Gulf, which means tighter liquidity. We consider that the pandemic has intensified the pressure, especially on the smallest banks, since their larger peers benefit from stronger market entrenchment, which helps them to attract new deposits.

Jordan

Loan growth



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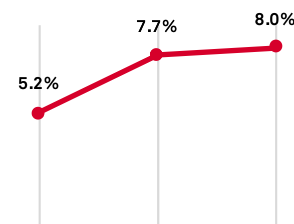
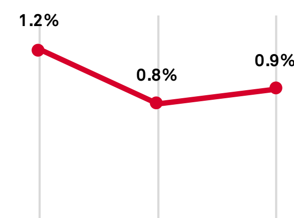


RoAA



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Kazakhstan | BICRA Group: 9

High Credit Costs To Persist Amid COVID-19 And Economic Pressures

Key takeaways

- Credit costs for Kazakh banks will remain high at about 4%-5% of total loans in 2020-2021 because of the depressed economy and continued pressure from legacy problem assets.
- We expect that government and shareholder support will partly offset the pressure on banks' asset quality and capitalization.
- Banks' profitability will be under pressure in 2020-2021, and we expect financial results in the sector to vary.

Key credit drivers

Extremely high credit risks remain a key weakness for Kazakh banks. We expect that the system's Stage 3 loans may increase to 23-25% of total loans in the next two years, from about 20% as of mid-2020. We anticipate that provisions for credit losses will remain elevated, at 4%-5% in 2020-2021. Several banks will need to create additional provisions for legacy problem loans following the asset quality review completed by the regulator in February 2020. In addition, asset quality in the sector is likely to deteriorate further because of quarantine measures, low oil prices, and depreciation of the Kazakhstani tenge. The tenge fell by 13% over the first nine months of 2020.

Government and shareholder support will likely mitigate the pressure. The government has implemented programs to support households and businesses while measures to contain the pandemic are in effect and in view of the subsequent economic contraction. These amount to about 8%-9% of GDP and we anticipate that they should provide a certain amount of support for individual and corporate borrowers' creditworthiness. The government has provided additional five-year guarantees to several banks to support their legacy problem loans. Shareholders also provided new capital to some banks to help them meet the requirements identified after the asset quality review earlier this year.

Key assumptions

We expect real GDP will contract by about 2.2% in 2020, followed by a recovery from 2021. Our forecast takes into account the combination of declining oil prices and external and internal demand shocks caused by the pandemic. We expect the economy will return to growth in 2021. Consequently, we expect new lending in the banking sector to slow in 2020 and return to growth next year.

Banking sector profit will likely be under pressure in 2020-2021. Many small and midsize banks are likely to report weak results, reflecting narrow margins, elevated provisioning expenses, and increased funding costs. Results at established players may be less affected, due to better underwriting procedures and sustainable fee and commission income.

What to look for over the next year

Banking sector consolidation will likely continue. The sector may see further consolidation, with weaker banks leaving the market as it becomes increasingly difficult for them to survive the tough environment and keep up with competitive pressure and increasing regulatory requirements.

Digitalization trends will increase pace. We have observed an increasing move toward digital transformation at several banks in recent years. The measures to curb the pandemic, including the lockdown, served as an additional stimulus for banks to strengthen their online services. We expect that investments in digitalization will increasingly provide a competitive advantage and support banks' cost optimization.

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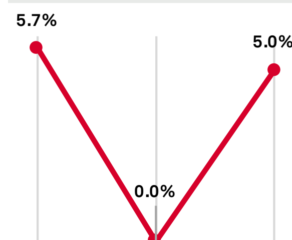
Kazakhstan

Loan growth



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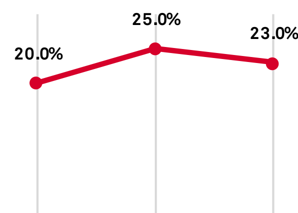

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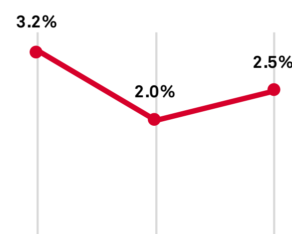

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Kenya | BICRA Group: 9

The Global Downturn Is Hampering Banks' Asset Quality And Profitability

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Key takeaways

- Credit intermediation will be subdued in 2020, despite the lift of interest rate caps.
- Large government debt and vulnerability to external shocks could derail the sector's recovery.
- Sector stability will likely continue to be tested.

Key credit drivers

Fiscal performance and external vulnerabilities are in the shadow. The global economic contraction is slowing Kenya's fiscal consolidation, with the fiscal deficit reaching almost 8% in 2020-2021. In addition, sizable current account deficits will induce a significant increase in external debt. This presents risks to the banking sector's recovery.

Credit growth will be subdued despite the lift on the cap on interest rate in November 2019. Domestic credit growth will be challenged in 2020 amid the pandemic. We forecast 5% loan growth in 2020 and 7% in 2021 because we expect the economy will grow by a mere 1%. Consumer lending and small and midsize enterprises (SMEs) will be hit hard, particularly those in the tourism sector.

The sector's stability will continue to be tested. While top-tier banks have been resilient to the interest cap on lending, midsize banks will continue to face pressure to consolidate to ensure viability of their business model, largely tested by the cap and (more recently) the lockdown.

Key assumptions

Slower economic growth. After two quarters of poor growth in mid-2020, we foresee the economy regaining some momentum toward the end of the year. However, we forecast GDP will grow by only 1% in 2020 before recovering to 4% growth in 2021.

Debt levels will remain high. We estimate general government debt will remain high, at above 65% over 2020-2023, with about half of the stock being external debt. Positively, foreign exchange reserves will stay broadly stable under our base-case scenario supported by multilateral institutions and bilateral commitments.

Asset quality will be under pressure. We expect NPLs will rise to around 16% of total loans through 2021 from 12.7% in 2019.

What to look for over the next year

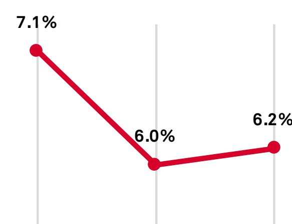
Curtailed SMEs recovery might dampen credit and GDP growth. The SME sector growth was held back by the cap on interest rates in 2016-2019. Now that these are removed, we expect the recovery to be delayed because of the pandemic's effect.

Higher general government debt will constrain banks' effective financial intermediation. The global economic downturn will likely lead banks to increase their exposures to government debt instead of taking on more credit risks.

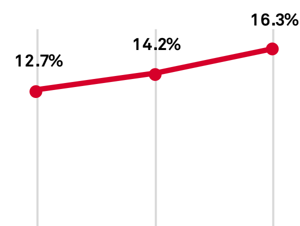
Profitability will come under pressure amid higher impairments. Overall, the system's return on equity will likely halve in 2020 before recovering to about 15% in 2021, but this is still sufficient for banks to maintain capitalization well above the minimum requirements. We believe smaller banks could face some capital issues.

Kenya

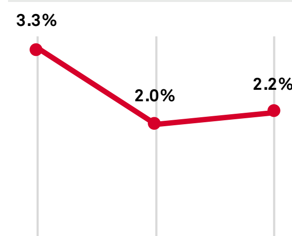
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Kuwait | BICRA Group: 4

Risks Remain Contained For Now

Key takeaways

- Good funding profiles and strong capitalization support Kuwaiti banks' creditworthiness.
- We expect the weaker macroeconomic environment to pressure asset quality.
- Banks' profitability will decline on lower margins and lending volumes, and higher credit costs.

Key credit drivers

Existing buffers will help banks weather the challenging environment. We consider that the provisions banks have accumulated over the past few years will help them navigate this difficult time. However, we see a risk that a delay to the government's support to the economy, if it is needed, could exacerbate pressure on the banking system.

Decline in real estate prices and the activities of some Kuwaiti banks in riskier markets and segments to pressure asset quality. The banking sector's substantial exposure to real estate and construction remains a concern, especially given the falling real estate prices. We expect NPLs to increase and the cost of risk to almost double in 2020 compared with 2019. Banks have increased their provisioning levels to prepare for the expiration of regulatory forbearance measures.

Comfortable funding and liquidity position. We expect banks to maintain high levels of core deposits--from the government and its related entities--in their funding bases, and their liquidity metrics will remain comfortable.

Key assumptions

We expect real GDP to contract by 7% this year. We anticipate that exports, investment, and consumption will all contract by 5%-9% in 2020. In addition, we project no growth in 2021, largely due to the continuation of OPEC+ production volume cuts. However, recovery should gather pace from 2022.

Alternative financing arrangements for the fiscal deficit are not yet in place. We forecast that Kuwait's central government deficit will widen to 30% of GDP in 2020 from an estimated 10% in 2019. Meanwhile, we estimate that the government's main source of budget deficit funding, the General Reserve Fund, will be insufficient to cover this deficit on its own. A timely and sufficient policy response to address a potential hard budget constraint in the coming months has yet to emerge.

What to look for over the next year

Lower profitability. We expect moderate loan growth of around 1%-3% in 2020-2022 as economic conditions gradually improve. Net interest margins will decline on the weaker interest rate coupled with tightening liquidity conditions. We also expect cost of risk to increase, leading to an overall decline in profitability.

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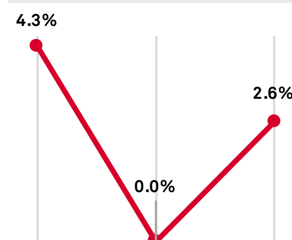
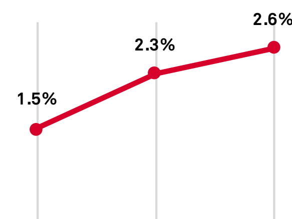
Kuwait

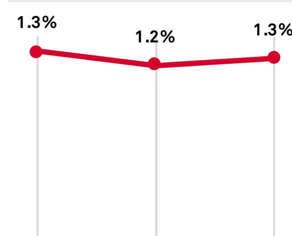
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

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a--Actual. e--Estimate. f--Forecast.

Morocco | BICRA Group: 7

The Pandemic Tanks Key Sectors And Casts A Cloud Over The Future

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Key takeaways

- Due to severe COVID-19 impacts on Morocco's external and domestic demand, real GDP will likely contract by 5.5% in 2020 before gradually recovering in 2021.
- We expect Moroccan banks' asset quality will deteriorate, particularly in sectors like tourism and real estate development.
- Higher provisions will dent Moroccan banks' profitability, but they are facing these challenges with relatively good metrics.

Key credit drivers

A lower middle-income economy, burdened by high social needs. We believe Morocco's economy is still skewed toward cyclical sectors--particularly agriculture. We expect the pandemic to materially weigh on the Moroccan economy, which we expect to contract by 5.5% in 2020 before a gradual recovery by 4.2% on average in 2021 and 2022.

The Moroccan banking system is one of the largest and most concentrated in North Africa. Before the pandemic, the banking sector reported an average return on equity of 9.4%, with an adequate solvency ratio of 15.6%. While we expect these ratios to deteriorate, the starting point provides some buffers to absorb additional credit losses.

Expansion in Africa brings diversification benefits, but also potential unpleasant surprises. Large Moroccan banks have expanded rapidly into the rest of Africa, where risks are typically higher than in Morocco.

Key assumptions

The depressed economic environment will hinder past dynamic performance. The government has announced measures to fuel credit to nonfinancial companies, including lending facilities, subsidized interest rates, and a partial state guarantee. Still, we expect modest private sector credit growth of about 3.5% for 2020 because of expected higher unemployment and depressed demand from households.

The central bank will continue to provide support. Bank Al-Maghrib has expanded the range of collateral accepted for repos and credit guarantees, increased refinancing operations to support lending to small and midsize enterprises, and provided foreign currency swaps to domestic banks.

Asset quality will deteriorate. Several important economic sectors--like tourism, export-oriented businesses (for instance, textile, auto, and aeronautic), and real estate--are strongly affected by the pandemic. We anticipate domestic nonperforming assets will deteriorate to 11%-12% over the next two years.

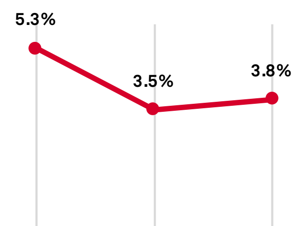
What to look for over the next year

Additional loan book provisions will dent capital. We expect weaker results from the higher cost of risk and lower revenues following margin reduction will lower banks' profitability in 2020 and 2021. A dividend ban by the central bank will help cushion the impact on capitalization.

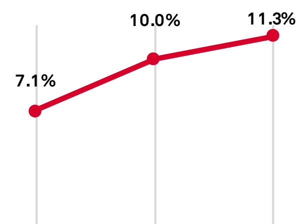
The pandemic's full impact on the economy is uncertain. Potential long-term effects could include further hindrance of tourism activities and fledgling industries in the auto and aeronautic sectors. The expected Moroccan economic rebound will depend largely on the shape of the recovery in Europe.

Morocco

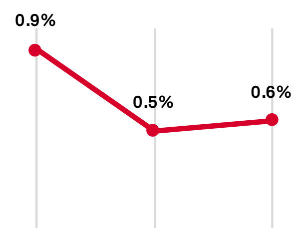
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Nigeria | BICRA Group: 10

An Uncertain Operating Environment

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Key takeaways

- A slow economy, combined with oil price volatility, weighs on the pace of the banking sector recovery.
- Banks are vulnerable to U.S. dollar outflows.
- Risks associated with Nigerian naira depreciation could re-emerge.

Key credit drivers

High dependence on the oil sector. Nigeria's economy still depends heavily on the hydrocarbon industry, which accounts for over 85% of export receipts and at least half of fiscal revenue. Combined with its sensitivity to currency depreciation and high inflation, this exposes banks to high economic imbalances and short credit cycles.

Loan book concentration exacerbates the risks. The banking sector has high credit risk because of the structure of the economy, and high single-name and industry concentrations.

Significant foreign currency exposures. The sector also faces liquidity risks because banks' balance sheets are dual currency. The sector also has foreign currency-denominated financial obligations that could strain its U.S. dollar liquidity if foreign currency reserves dropped because of declining oil prices.

Key assumptions

Slow economic growth. We expect GDP to contract by 3.8% in 2020 and average 2% in 2021-2022. Rated banks' material exposure to the oil sector (30% on average) weighs on asset quality and earnings.

Pressure on asset quality. We expect restructured loans will double to about 20% in 2020, from about 10% in 2019, given our lower oil price assumptions. Meanwhile, loans under forbearance will reach 20%-25%. Nonperforming loans will also rise, to 10%-12% through 2021 from 6.1% in 2019. We forecast credit losses will increase to about 2.5% in 2020-21 before dropping to around 2% in 2022, from an estimated 1.2% in 2019.

External refinancing risk is a tail risk. Net banking sector external debt persists but will remain at manageable levels around 13% of systemwide loans in 2020-2021. Most banks have overcome their short-term liquidity challenges following the introduction of the Nigerian Autonomous Foreign Exchange Fixing Mechanism (NAFEX) window in April 2017 but foreign exchange shortages have re-emerged.

What to look for over the next year

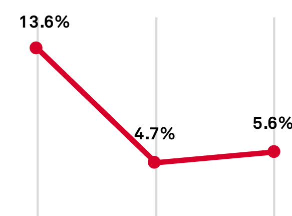
Declining profitability. Profitability will be weaker on the back of higher impairments and lower net interest margins, due to a combination of weakening asset quality and limited participation in the central bank's securities auctions. However, we still expect top-tier banks' financial performance to be resilient, with return on equity averaging 14% in 2020 for the sector.

Naira liquidity is manageable. The Central Bank of Nigeria (CBN) has some flexibility to release additional liquidity through the reserve requirement ratio, which sits at 27.5%. Bank credit to the private sector will likely be subdued, despite the CBN introducing a minimum loan-to-deposit ratio of 65% to boost credit growth.

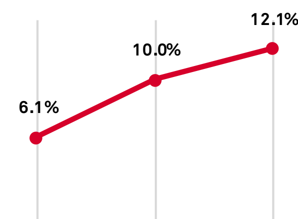
The CBN's predictability is key. Lower foreign currency inflows tied to lower oil receipts are likely to make it more difficult for the CBN to set exchange rate and foreign-exchange-reserve policy. We think some banks could breach minimum capital adequacy ratios if the naira weakens by more than 20%, but this is higher than our current assumption for 2020.

Nigeria

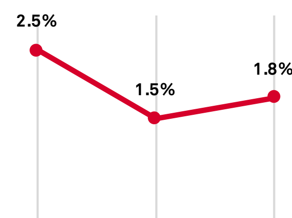
Loan growth



NPA ratio



RoAA



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Oman | BICRA Group: 7

Forbearance Will Push The Recognition Of Problem Loans To 2021

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Key takeaways

- The economy will contract by 5% in 2020, followed by a mild recovery of 2% in 2021.
- Depressed oil prices and reduced economic activity due to the COVID-19 pandemic will lead to higher problem loans and provisioning needs. However, forbearance measures will push the recognition of problem loans to 2021.
- Lower-for-longer interest rates, weaker lending growth, and higher credit losses will lead to prolonged lower profitability for Omani banks.

Key credit drivers

Operating conditions weigh on banks' performance. Asset quality and profitability will deteriorate in 2020-2021 as a result of the economic recession. We forecast GDP contracting by 5% in 2020. We expect that slightly higher oil production and a recovery in domestic demand and tourism from 2021 will support real growth averaging 2.1% annually over the next three years.

Weakening financial profile of the government and related entities. Omani banks have significant exposure to the government and related entities in the oil, transport, and services sectors, which are under financial pressure from the pandemic and low oil prices. Although the Omani government guarantees some of these exposures, we consider that risks to banks' balance sheets are increasing, resulting in higher credit losses.

Banks rely heavily on public sector deposits. Omani banks are predominantly funded by domestic customer deposits and make limited recourse to external funding. Customer deposits also include funds from the government and related enterprises (more than one third of total deposits). Although the government and related entities withdrew some deposits from the banking system in first-half 2020, we consider this a short-term measure to fund deficits rather than a structural change.

Key assumptions

Lending book to remain muted. Given the economic slowdown and low demand from retail customers, we expect lending growth to remain weak in 2020-2021, mainly driven by increasing exposure to cash-strapped GREs.

Private sector indebtedness remains high. Oman's high private sector indebtedness and declining property prices pose risks for banks, particularly amid the economic downturn. Housing prices have moderated in major cities as well as in lower-tier cities; we estimate a price decline of 25%-30% in the past four years nationwide.

The government's capacity to support the banking system has reduced. We expect the fiscally constrained Omani government to be less supportive of its banking system.

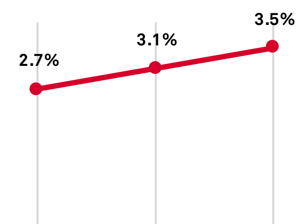
What to look for over the next year

Increasing credit losses. Owing to the challenging economic environment, we expect banks' asset quality to deteriorate in 2020-2021--particularly in the retail and residential real estate sectors--as well as in the contracting, utilities, trade, and transport sectors, which are under stress. We anticipate a spike in NPLs and higher credit losses once regulatory forbearance measures are withdrawn. In our view, cost of risk will increase to around 160 bps by 2021, compared with 55 bps in 2015-2019.

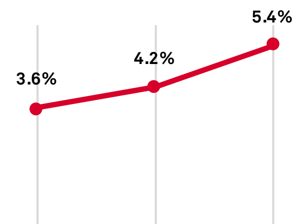
Bank profitability to remain low. We expect Omani banks' profitability to decline because of lower margins and higher credit losses. Lower-for-longer interest rates mean Omani banks will remain less profitable than before the pandemic.

Oman

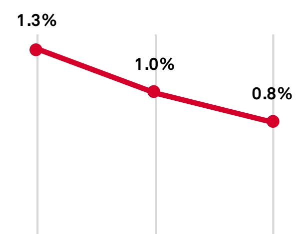
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Poland | BICRA Group: 4

Cost Of Risk Is High, And Sector Profitability Is Under Pressure

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Key takeaways

- Poland's broad-based, well-balanced, and flexible economy could experience a smaller 2020 GDP contraction and a stronger 2021 rebound than many other European countries.
- Pressure on profitability has increased due to lower interest rates (0.1% from 1.5%) and rising risk costs, combined with a government-imposed, balance-sheet based banking tax.
- A sizable legacy Swiss franc mortgage portfolio (22% of the retail mortgage loans as of June 2020) remains the main source of litigation risk and related costs for several midsize banks.

Key credit drivers

If recovery is delayed, pressure on Polish banks' risk-return will increase. Polish banks reported comparably high nonperforming loans (NPLs) and credit losses prior to the COVID-19 pandemic, at about 7% and 70 basis points (bps)-90 bps, respectively. These could increase by several percentage points at their peak, but should moderate toward end-2021 and in 2022. Also, historically low interest rates at 0.1%, plus a government-imposed banking tax, reduce the sector's profitability buffers against elevated risks.

Legacy Swiss franc mortgage loans portfolio burdens some banks. Banks' exposure to mortgage loans denominated in foreign currency remains high, at 22% of total household mortgage loans as of June 30, 2020. Potential costs, given the 2019 European Court of Justice decision allowing the annulment of some mortgage contracts, is a clear latent risk, despite a relatively low NPL level in that portfolio.

Funding and liquidity remain solid. Poland's banking sector is almost fully funded with deposits, with the level even increasing amid the recession. There are only marginal covered bonds or subordinated debt issuances. Foreign funding is decreasing toward 10% and short-term wholesale funding remains marginal.

Key assumptions

Sharp GDP contraction followed by robust recovery. We believe the COVID-19 pandemic will result in real GDP contracting by about 3.4% in 2020, with recovery starting in second-half 2020, leading to an expansion of 4.5% in 2021. Fiscal and monetary policy space is being used to cushion the recession.

Unemployment will remain elevated at the end of 2020 and peak in 2021, but will moderate thereafter. We assume unemployment could be one of the key drivers for an increase in banks' risk costs, given that Polish households' savings rates or financial assets remain among the lowest in Europe.

Regulatory and government response to the pandemic will be effective. We believe the Polish central bank and financial regulator have taken timely measures to support the banking system, through dividend stoppage, lowering the required capital reserves, decreasing high regulatory capital requirements, or providing liquidity if necessary. Large government programs support borrowers hit by the recession.

What to look for over the next year

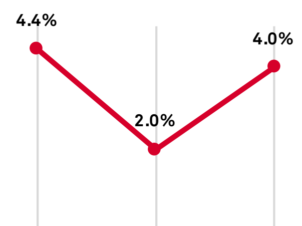
Falling net interest income in an elevated credit loss environment. It will be challenging for banks to further cut operating costs and search for alternative earnings sources in the new-for-Poland, almost-zero-interest-rate environment.

Some consolidation possible. We expect some small or midsize banks will struggle to earn their cost of capital in the post-pandemic environment. This may trigger further market consolidation.

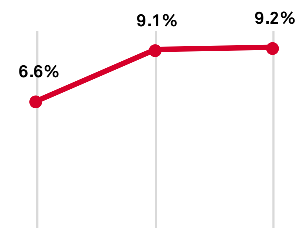
Postponed minimum requirement for own funds and eligible liabilities (MREL) issuance, until 2024. However, we expect banks will start issuing senior nonpreferred debt and other eligible instruments in 2021-2022.

Poland

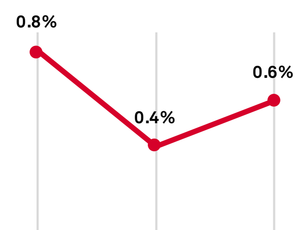
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Qatar | BICRA Group: 5

Damage Likely To Be Manageable But External Debt Is High

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Key takeaways

- We expect profitability to fall this year and that credit losses will increase in 2021 as the dual impact of the COVID-19 pandemic and lower hydrocarbon prices eventually take a toll on the Qatari economy.
- Risks posed by significant external debt remain high and could increase further.
- The Qatari government is wealthy and will maintain a highly supportive stance.

Key credit drivers

Hydrocarbon prices. Credit growth in Qatar is closely linked to hydrocarbon prices and to planned public sector capital expenditure projects. Since Qatar's 2017 boycott, most lending growth has come from services and trade, as companies in these sectors developed to replace other regional hubs. Given the low hydrocarbon prices, the Qatari government has postponed some of its discretionary projects and many of its infrastructure projects are nearing completion. We therefore expect credit growth to moderate from an average of 11% over 2017-2019 to around 7% over 2020 to 2022. The development of new gas fields could provide some additional lending opportunities.

External funding vulnerability. External deposit collection has been one of the main sources of funding for domestic credit growth in the past few years and domestic deposits remain relatively flat. We view this dependence on external funding as a source of risk, given the region's high geopolitical risks. Although nonresident deposits have remained relatively stable over 2020, external debt has continued to increase through debt securities, interbank, and loans from head offices. These flows can be volatile because of market instability. That said, we expect some of the associated risks to be offset by the government's highly supportive approach to the banking system. It has substantial fiscal assets at its disposal.

Key assumptions

Economic contraction and slower loan growth. We're expecting real GDP growth to fall by around 5% in 2020 before recovering in 2021, with risks still to the downside. The Qatari economy is wealthy; GDP per capita is one of the highest in the world. This should help support retail lending, but domestic demand and consumer confidence is expected to remain low.

Asset quality will deteriorate. The government and government-related entities have a significant presence in loan books, which should somewhat mitigate the extent of asset quality deterioration. That said, we still expect that small and midsize businesses, particularly in hospitality and real estate, will add to the formation of nonperforming loans. We expect system nonperforming assets to climb to 3.7% by 2021, but this figure is likely to mask a divergence between those banks with access to high-quality, strategically important borrowers, and those without.

External funding likely to remain high. Nonresident deposits in Qatar have remained relatively steady over 2020, but external debt has started to climb. The proportion of domestic loans funded by domestic customers could fall below 60%.

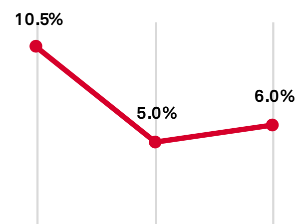
What to look for over the next year

Macroeconomic performance. A second spike of COVID-19 infections and the reimposition of restrictions could permanently dent demand and place nonlinear strain on banks that are exposed to those sectors most affected--namely, real estate and hospitality.

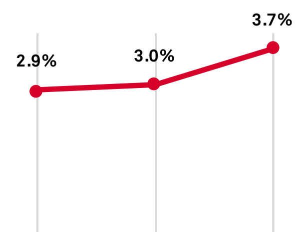
Higher-than-expected outflow of external funding. Should nonresident deposit outflows become disorderly, funding strains could quickly develop and require official support, which has been extended in the recent past. If external liabilities grow as uncertainties moderate, banks could be more vulnerable.

Qatar

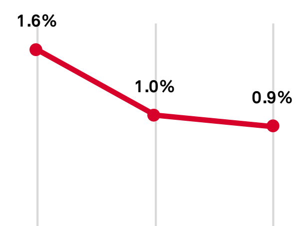
Loan growth



NPA ratio



RoAA



2019a | 2020e | 2021f

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Russia | BICRA Group: 8

Elevated Credit Costs As Economy Contracts And Market Volatility Rises

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Key takeaways

- Russia's economy expected to contract by 3.5% in 2020, exacerbated by the pandemic. This will increase credit losses.
- Nonperforming loans (NPLs) will likely double and profitability will halve in 2020, although a gradual recovery should start in 2021, when we anticipate seeing an economic rebound.
- Banks' sound capital and liquidity accumulated over the past few years will somewhat soften the downside risks.

Key credit drivers

Downside risk depends on the economic recovery scenario. If economic recovery takes longer than we currently anticipate, and the measures to contain the COVID-19 pandemic last longer than we currently expect, the risks for Russian banks would substantially increase, eating into their profitability and casting doubt on the adequacy of their capital buffers.

Asset quality will deteriorate because of pressure from the pandemic and a decline in oil prices. Higher risks could stem from banks' exposures to small and midsize enterprises and unsecured retail lending, which we anticipate will be hit harder than larger enterprises under our current macroeconomic scenario. We assume that Stage 3 loans may reach 15% by year-end 2020 or early 2021; by contrast, the largest banks reported Stage 3 loans of about 8% in 2019. We estimate credit losses in Russia's banking sector could reach 3% of the average loan book in 2020 before slightly moderating to 2.0%-2.5% in 2021.

Key assumptions

GDP contraction in 2020, followed by recovery. The pandemic, combined with the decline in oil prices, will likely cause real GDP to contract by about 3.5% in 2020. We think Russia's economy can absorb the current shocks and will likely start to recover in 2021, provided that oil prices increase and the global economy recovers. We estimate that growth could be about 3.0% in 2021.

Impact on the banking sector will remain manageable. We expect the system to demonstrate resilience in the face of this short-term event. We consider most large Russian banks better prepared to cope with adverse economic conditions than they were before past recessions. They started 2020 with stronger balance sheets, strengthened capital ratios, and improved risk management frameworks. In addition, the most troubled institutions have been bailed out or removed from the market in recent years, improving the sector's stability.

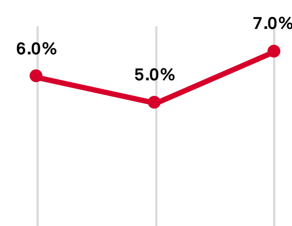
What to look for over the next year

Pace of economic recovery. If the pandemic worsens or drags on for longer, economic recovery will be significantly slower than we currently forecast. This means higher-than-expected NPLs and credit losses. Customers' economic stress will also flow through to banks' profit-and-loss statements. The degree to which banks' financial strength can accommodate the dip prior to the expected rebound will be an important rating consideration.

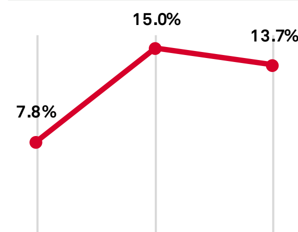
Material variation in future reporting. The expected increase in problem loans and credit losses is likely to have more far-reaching consequences over 2020-2021. The strongest and most conservative banks will likely recognize weaker exposures and create provisions for future potential problems earlier than weaker and less conservative banks. We expect to see substantial inconsistency in the way banks report their bad debt in 2020-2021. Elevated credit losses will weigh on the banks' profitability, leaving some of them with break-even results, at best.

Russia

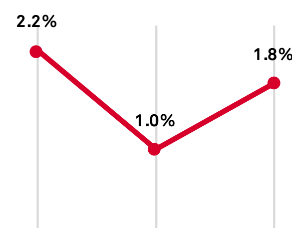
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans. Measured as Stage III loans under IFRS classification.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Saudi Arabia | BICRA Group: 4

Banks' Profitability Will Suffice To Absorb Higher Credit Losses

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Key takeaways

- The economy will contract by around 4.5% in 2020.
- Gradual phase-out of support programs will contain lending growth and increase cost of risk.
- Profitability will remain solid, despite lower margins.

Key credit drivers

Still heavily dependent on oil price. The Saudi banking system has largely demonstrated its resilience despite the low oil prices and weak economic growth. However, growth depends substantially on the dynamics of the oil market and is vulnerable to global economic and regional geopolitical trends.

Credit conditions had just normalized before the 2020 shocks. Muted investment activity of the corporate sector over 2017-2019 resulted in anemic credit growth in the economy (outside the mortgage segment), which only resumed growth in the last quarter of 2019. Banks' prudence in 2017-2019 will help mitigate the adverse impact of the economic shock in 2020-2021.

Funding profiles remains stable. Despite gradual build-up of external funding, the Saudi banking sector remains predominantly funded by customer deposits, which have been stable. Although we expect some further increase in external debt, the banking sector will remain a net external creditor.

Key assumptions

Lending growth will be contingent on government stimuli. Higher-than-expected lending growth of 10% in 2020 is predominantly driven by government stimulus for mortgages and small and midsize enterprise (SME) financing--this accounted for over 75% of the increase. Under our base case, we expect that some of the SME support facilities will be extended but not increased, slowing down growth rates. Mortgage growth will stay strong, but will also slow down as the market starts to mature.

Cost of risk will pick up. We believe that the pandemic will have a stronger impact on the non-oil part of the economy than the decline in oil prices in 2014. As deferral programs are gradually phased out and the economy adjusts to the new normal, the cost of risk will remain elevated in 2021, increasing to 130 bps-140 bps (from 80 bps in 2019), before starting to gradually normalize in 2022.

Profitability will stay resilient. Lower interest rates, slow growth, and the higher cost of risk will put pressure on Saudi banks' profitability. That said, we expect Saudi banks will be able to navigate these headwinds and maintain a return on average assets of about 1.2% in coming years.

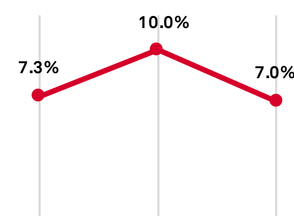
What to look for over the next year

Evolution of safety measures. Travel restrictions have affected the Saudi economy directly, through the sharp fall in the number of pilgrims, and indirectly via oil prices. As a result, economic growth will depend on lifting travel restrictions and the scale of the Hajj and Umrah pilgrimages.

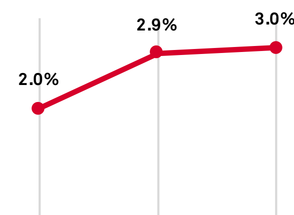
Fiscal response will evolve. As low oil prices strain the government's fiscal position, pushing the fiscal deficit to record high levels of 11% of GDP in 2020, the government will have to solve the conundrum of preserving fiscal stability while providing sufficient support and stimulus to the economy. The expected stabilization in oil prices will help--we expect the deficit to improve to around 6% of GDP in 2021. That said, the government's ambitious goal of balancing the budget by 2024 may require a material change to fiscal policy.

Saudi Arabia

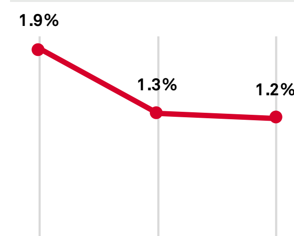
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Slovenia | BICRA Group: 4

Recent Improvements Provide Buffers Against Economic Downturn

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Key takeaways

- The recession provoked by COVID-19 will delay Slovenia's further economic convergence with the eurozone average.
- Slovenian banks entered the economic downturn from a position of strength, with sufficient capital and liquidity buffers to absorb pressure on asset quality and earnings.
- Significant stress on the corporate sector will push asset quality down and risk costs up, but large-scale government support programs should usher the banking system through the pandemic.

Key credit drivers

COVID-19 rapidly halted the country's improving trajectory in GDP and bank asset quality. Given Slovenia's reliance on exports and tight integration into European supply chains, weak external demand puts significant pressure on the domestic corporate sector and its credit quality. In addition, tourism and the close trade relationship with Italy are further areas of risk. However, we believe the setback in Slovenia's economic convergence with the eurozone average will be temporary, and the country is well positioned to benefit from the expected rebound in 2021.

Banks entered the downturn from a position of strength. Private-sector deleveraging and asset quality improvements in past years mean that Slovenian banks' buffers to weather the temporary shock are better than in previous downturns. Banks' comfortable capital and liquidity buffers further support overall sector stability and balance pressure on asset quality and earnings. Stronger governance and underwriting criteria since the financial crisis should limit the rise of nonperforming assets (NPAs) and credit losses.

Key assumptions

Sharp economic contraction followed by a robust recovery. We expect Slovenian GDP will contract by 7.0% in 2020 because of the pandemic. Slovenia was the first EU country to lift most pandemic related restrictions in May and the domestic economy has since bounced back well. Despite the recent reintroduction of anti-pandemic measures, we forecast real GDP will rebound by 5.2% in 2021. In addition, we believe banks are better prepared to enter the second lockdown period as processes for operations continuity are in place and risk management approaches are more targeted.

Credit pressure on corporate sector. Slovenian banks' asset quality hinges critically on the performance of corporates and small and midsize enterprises, which are still burdened by an NPA ratio well above the 2.2% for the banking sector overall. We expect that domestic credit losses will rise to 80 basis points (bps) for 2020, versus our five-year average of 20 bps, and we believe the corporate sector will be the main driver. We expect credit losses from mortgage lending will be limited given government support programs, but more stress will accompany rising unemployment.

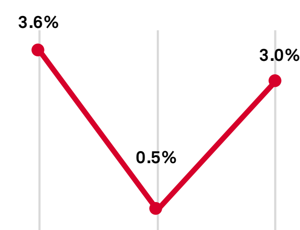
What to look for over the next year

We see risks that our base-case scenario could worsen. If the downturn lasts longer or the rebound is more tepid than our economists forecast, it could imply a more negative effect on the banking system. These risks were illustrated by the country's renewed lockdown measures amidst surging COVID-19 cases in mid-October. Risk costs rising significantly above our expectation, severely deteriorating asset quality, and sustainably weakening profitability could further stress bank ratings.

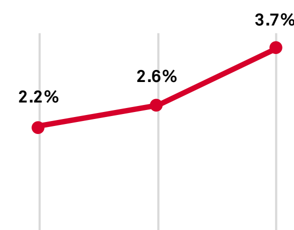
Loan moratorium will delay loss recognition. Although regulatory forbearance will help weaker borrowers, it can also delay recognition of, and perhaps also adequate provisioning against, NPAs. Borrowers' ultimate ability to service their loans will become clearer once the mandatory loan moratorium ends and other government support measures begin phasing out. These factors add greater uncertainty to the timing of increases in NPAs.

Slovenia

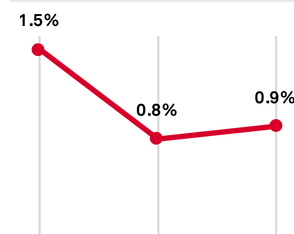
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

South Africa | BICRA Group: 6

Deep Economic Contraction Will Result In Higher Credit Losses

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Key takeaways

- Retail and small and midsize enterprises will be the most affected by the lockdown, despite support measures.
- Risk of portfolio outflows will persist for the rest of 2020.

Key credit drivers

Total credit will contract. We anticipate total private sector credit (from banks and capital markets) will contract to about 80% of GDP through 2021 (from 87%in 2019) because of the sharp economic drop. We forecast credit to the private sector will shrink by about 5% in 2020, followed by growth of 2.4% in 2021.

Asset quality will deteriorate. Household debt and affordability metrics will come under pressure in 2020, despite lower interest rates. In addition, we expect the strict lockdown and gradual reopening of the economy in 2020 to strain the commercial real estate sector. As a result, we forecast credit losses will rise to 1.8% in 2020.

Risk of portfolio outflows will persist. The combined effect of uncertainties linked to the pandemic and the exit of South Africa bonds from the FTSE Russell WGI index in May 2020 will likely lead to sustained low portfolio flows through 2020. Because it expected potential volatility in this ratio if outflows persist, the South Africa Reserve Bank lowered the liquidity coverage ratio to 80% from April 2020.

Key assumptions

Sharp economic contraction. We estimate real GDP will contract by 8.2% in 2020, largely because of the effect of the COVID-19 pandemic, before rebounding 5% in 2021.

Fiscal risks are at their highest. The weak macroeconomic environment will weigh heavily on fiscal revenue. We expect the headline fiscal deficit will widen significantly in 2020. At the same time, the debt burden will continue to rise, exceeding 80% of GDP.

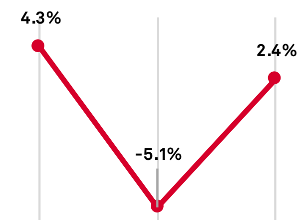
What to look for over the next year

Stable banking sector despite a profitability dip. We expect banks' regulatory capital ratios to remain strong, despite revenue coming under significant pressure from higher impairments in 2020-2021. A combination of muted risk appetite, cost optimization, and regulatory forbearance measures will support capitalization.

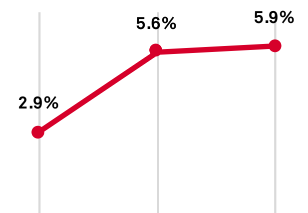
Reforms will slow. The prudential authority provided capital relief measures. We continue to believe that a deposit insurance scheme, and ultimately an effective resolution regime, will be introduced. However, the timeline has become uncertain in the wake of the current global crisis.

South Africa

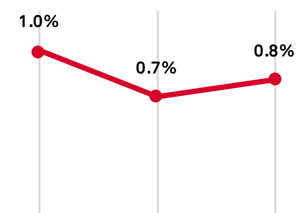
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Tunisia | BICRA Group: 10

Banks' Performance And Capitalization Will Be Severely Hit

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Key takeaways

- The economic shock caused by COVID-19 and political instability will increase pressure on already-high current account and fiscal deficits.
- This will further undermine Tunisian banks' already-weak asset quality indicators, profitability, and capitalization.
- The Central Bank of Tunisia will continue extending significant liquidity support to the system.

Key credit drivers

Deteriorating economic conditions are weighing on banks' performance. The expected sharp recession in 2020, followed by an only mild recovery in 2021, will have a significant impact on the banking system's already-weak asset quality, profitability, and capitalization. For now, regulatory forbearance measures are delaying the recognition of problematic loans, and we expect the deterioration will become evident only in 2021, peaking in 2022.

Banks liquidity and funding profiles remain dependent on the Central Bank of Tunisia (CBT). We expect the CBT's support will remain essential--and potentially even more significant--in the recession's aftermath. In recent years, the CBT has extended significant financial support to the banking system, to cover both its structural gap between customer loans and deposits and its limited access to external funding. The loan-to-deposit ratio has moderately decreased in the past 12-18 months, as banks competed to attract savings in converging to the 120% regulatory limit.

Key assumptions

The COVID-19 pandemic will likely have a lasting impact on the economy. Given its reliance on tourism and export-oriented manufacturing, we expect Tunisia's economy to contract by more than 5% in 2020 and unemployment to rise, followed by a shallow recovery in 2021.

The real estate price correction will accelerate. The real estate sector, which has been dealing with softening prices since 2016, will suffer an abrupt correction over the coming quarters as increasing unemployment dampens domestic demand and the global recession reduces external demand from Tunisian expatriates.

Credit losses will increase. Banks' exposures to retail, tourism, real estate, and some exporting industries will mildly increase the cost of risk in 2020 and more significantly so in 2021-2022, ultimately weighing on banks' profitability.

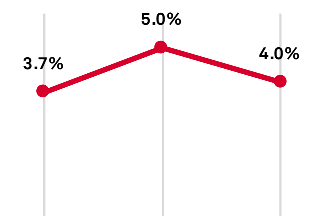
What to look for over the next year

Risk of excessive monetary stimulus. The central bank cut its key rate twice in March and October, by a cumulative 150 basis points (to 6.25%), while continuing to provide banks with significant liquidity support (total refinancing volume was about 10 billion Tunisian dinar as of October). While inflation and foreign exchange have remained under control so far, we cannot exclude the possibility that monetary stimulus will have distorting effects in the medium term, potentially stressing the dinar further.

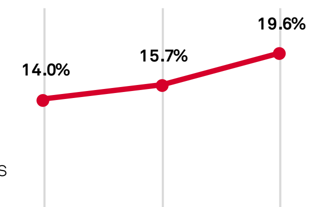
Political instability. Lack of political stability could jeopardize the country's ability to cope with the pandemic's aftermath, continue receiving support from multilateral institutions, and implement the needed reforms to stimulate recovery. Following the election of a highly fragmented parliament in October 2019, three different governments have followed in less than 12 months. The most recent one received a confidence vote in early September.

Tunisia

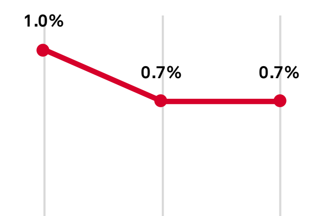
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Turkey | BICRA Group: 9

Refinancing External Debt And Asset Quality Are Key Risks

Key takeaways

- The Turkish banking sector will remain sensitive to shifts in investor sentiment and emerging market capital flows due to high reliance on short-term external funding.
- Increasing deposit dollarization is exacerbating pressure on the funding profile.
- Asset quality will continue to deteriorate, further straining profitability and capital.

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Key credit drivers

Banks are exposed to high refinancing risk. As of August 2020, banks had $84.6 billion of external debt to roll over by July 2021, including about $38 billion of nonresident deposits. In our central scenario, we expect banks to roll over about 80%-90% of their debt, at rising costs, and the lira to depreciate by about 20% versus the U.S. dollar in 2020.

Profitability and capitalization are under pressure. We expect banks' capitalization to weaken because of increased credit losses, strong lending growth, and the weaker Turkish lira. The change in calculating regulatory capital adequacy ratios will likely neutralize the effect of the weaker lira in the short term, but banks will have to strengthen their capital afterward. Given their strong lending growth, public banks are likely to have to reinforce their capitalization.

Large credit stimulus contributes to lending expansion. Domestic credit expanded by 34% through October 2020, compared with the beginning of the year. We expect full year expansion to total 40% in 2020. Although the lira's weaker exchange rate explains some of this rapid rise--more than a third of domestic loans are denominated in foreign currencies--we consider the main driver to be a strong government-lending stimulus, mainly administered through the public banks. The government offered guarantees and implemented measures incentivizing private banks to lend more, which also contributed. In our view, the speed and size of the credit growth has underpinned the re-emergence of the economic imbalances that have frequently characterized the Turkish economy in the past. For example, the current account deficit has substantially widened this year. In addition, we think that the divergence between the expansion in lending by public and private banks is distorting the banking sector's competitive dynamics.

Key assumptions

Economy will contract in 2020. We forecast that Turkey's GDP will decline by 2.5% in 2020 before recovering by 4% in 2021. The recession in 2020 follows an already weak economic performance in 2019, when output expanded by just 0.9% in real terms.

Credit growth will decelerate. In our baseline scenario, we expect credit growth to slow down throughout the rest of 2020 and in 2021. In real terms, we expect it to expand by close to 5% in 2021.

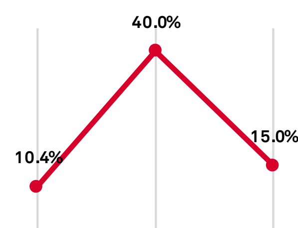
What to look for over the next year/rest of the year

We expect asset quality to deteriorate because of the economic recession and weaker lira. That said, forbearance measures and loan moratoriums might delay the point when the deterioration becomes apparent. We expect the nonperforming loan (NPL) ratio to reach around 11% by the end of 2021 and problematic loans (NPLs plus restructured loans) to exceed 20% of total loans. We forecast the cost of risk will rise to 390 bps in 2020, from an already high 270 bps in 2018-2019.

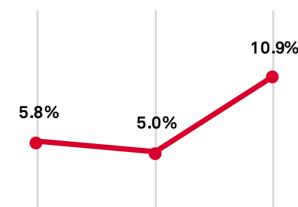
Banks might suffer from the general decrease in confidence. Greater risk aversion from international investors might affect banks' ability to roll over their external debt. Domestic depositors could increasingly convert their savings into foreign currency, increasing the pressure on the banking sector.

Turkey

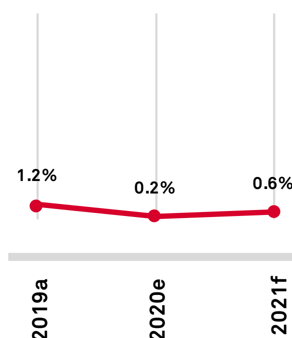
Loan growth



NPA ratio



RoAA



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Ukraine | BICRA Group: 10

COVID-19 Will Have Less Impact On Ukrainian Banks Than The 2014-2015 Crisis

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Key takeaways

- The Ukrainian banking system entered the pandemic in a stronger position than before the 2014-2015 crisis due to strengthened banking regulation and supervision, and a sector clean-up that largely eliminated weak, nonviable banks.
- We expect the write-offs of legacy problem loans at state-owned banks will more than offset new nonperforming loans (NPLs) due to the COVID-19 pandemic, thus reducing total NPLs in the system to about 30% by year-end 2022 from about 48% currently.
- Ukraine's parliament approved a law in mid-May 2020 stipulating no reversal of PrivatBank's nationalization, which mitigates the pressure on the bank's stability and boosts depositor and investor confidence in the banking sector.

Key credit drivers

Reduction in the very high level of legacy problem loans. Reported systemwide NPLs stood at about 48% at mid-2020, mostly legacy loans originated many years ago, reflecting very weak asset quality at public banks, high related-party lending, a large share of loans in foreign currency, and delayed NPL resolution.

Privatization of state-owned banks. Four state-owned banks, accounting for about 55% of system assets and reporting the highest NPL levels, distort the system by creating an uneven competitive field for private banks. The state intends to eventually sell PrivatBank and minority stakes in other public banks, which should reduce this distortion.

Key assumptions

The pandemic is likely to cause milder macroeconomic stress in Ukraine in 2020-2021 than we saw in the 2014-2015 crisis. We expect Ukraine's economy will contract by about 6% in 2020 because of COVID-19-related pressure and countermeasures, followed by average growth of 3.3% in 2021-2023. We expect milder GDP contraction, Ukrainian hryvnia (UAH) depreciation, and inflation than in 2014-2015.

PrivatBank's nationalization is final and irreversible. Ukraine's parliament approved a law in mid-May 2020 stipulating that the former owners of PrivatBank may no longer contest its nationalization. This should remove any investor or depositor uncertainty about the future development of the country's largest bank, as well as support banking sector stability.

Effective regulatory response to the COVID-19 pandemic will support Ukrainian banks. Ukraine's banking regulator has taken timely and proactive measures to support the banking system during the pandemic, including reducing the key rate to 6%, providing additional liquidity, relaxing capital requirements, and recommending dividend suspension, among other measures.

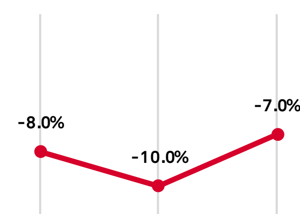
What to look for over the next year

Reduction of NPLs at state-owned banks. The government recently approved plans by state-owned banks to reduce their NPLs by UAH305 billion over 2020-2023. Thus, we expect that bad debt reductions at state-banks will more than offset NPL inflow over 2020-2021 resulting from the pandemic, which the National Bank of Ukraine estimates at about 10%-15%.

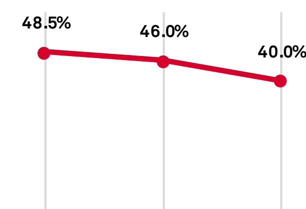
Profitability to deteriorate markedly from 2019's record levels. We expect return on assets will decrease to below 1.5% in 2020-2021 from 4.7% in 2019, due to slower loan growth, pressure on the net interest margin, and a marked increase in cost of risk to about 3.0%-3.5% from 1.1% in 2019.

Ukraine

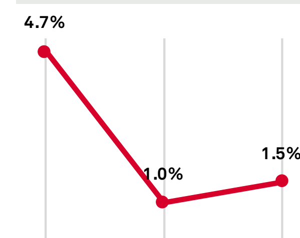
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

United Arab Emirates | BICRA Group: 5

Slowing Economy Will Weaken Banks' Asset Quality And Profitability

Key takeaways

- We expect the economy to contract by around 8.5% in 2020, followed by a mild recovery in 2021.
- Asset-quality indicators will be affected by the weaker macroeconomic environment and continued correction in the real estate sector, combined with the negative impact of the COVID-19 pandemic. However, regulatory forbearance measures will delay recognition of the problems to 2021.
- Higher cost of risk and lower margins will reduce profitability for 2020-2021. That said, we expect most UAE banks to remain profitable.

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Key credit drivers

Operating conditions are weighing on banks' performance. We expect asset quality and profitability to deteriorate in 2020-2021 as the economy experiences a sharp recession. We expect GDP to contract by approximately 8.5% in 2020 and recover only modestly next year. Lending growth will remain muted, as most banks will focus on managing the impact of the operating environment on their asset-quality as regulators lift their forbearance measures.

Relaxation of certain prudential requirements carries risks for the banking sector. To counter the impact of the pandemic, the Central Bank of UAE (CBUAE) relaxed certain prudential requirements, which risks eroding banks' strong capital buffers. Measures implemented include requiring that banks not classify exposures as nonperforming if they suffered from cash flow pressures related to the pandemic; asking banks to defer repayments on their loans to struggling companies and retail clients; and providing banks with liquidity. The CBUAE has also raised the limit on banks' exposure to the real estate sector and increased the loan-to-value limits for first-time homebuyers. Finally, the CBUAE halved banks' required deposit reserve requirements and reduced regulatory capital conservation buffers.

Key assumptions

Forbearance measures to be lifted progressively. We expect CBUAE's measures to control the impact of pandemic and low oil prices on the UAE economy to be lifted only progressively from 2021. This should help maintain confidence in the banking system.

We expect the government to continue supporting the banking system. Such support is likely to materialize, directly or indirectly, in case of need. Because the banking system is regulated and supervised at the federal level, we anticipate that any extraordinary support would come from the federal authorities.

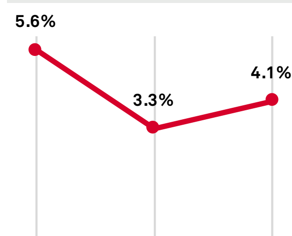
What to look for over the next year

Asset quality to deteriorate. The fall in oil prices and economic slowdown will prompt a rise in problem loans and the cost of risk, at a time when the real estate sector was already under significant stress. Other sectors, such as hospitality and discretionary consumer goods, are also experiencing a significant decline in revenue, which weighs on their credit quality. Because of ongoing regulatory forbearance measures, we anticipate that nonperforming loans will reach a peak in 2021. The fraud case in one large corporate and the recent liquidation of a major construction company, combined with banks' strategies to start building additional provisions, will push credit losses to 180 bps-200 bps in 2020-2021.

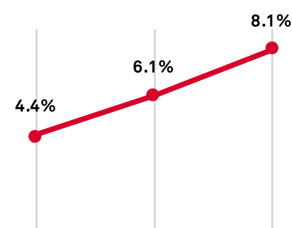
Bank profitability to remain low. Margins have tightened by 30 bps-40 bps due to lower interest rates. Lower margins and higher credit losses would lead to lower profitability for UAE banks. We believe UAE banks' reduced profitability will last longer due to the high proportion of non-interest-bearing deposits in their funding structures and lower revenue on the asset side.

United Arab Emirates

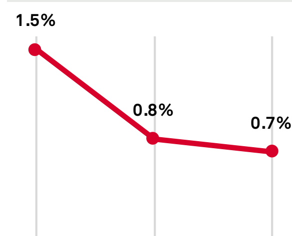
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Uzbekistan | BICRA Group: 8

Higher Credit Costs And Slower Economic Growth

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Key takeaways

- Economic growth is set to decelerate in 2020 to 1%, largely because of measures taken to curb the COVID-19 pandemic. This leads to increased credit losses in the banking sector.
- We expect credit losses to grow to about 3%-4% in 2020 while nonperforming loans (NPLs) rise to about 4%-5% in 2020.
- In our view, the growing economic risks will mean increasing difficulties for Uzbek banks, especially smaller players, constraining their business growth, earnings prospects, and funding sustainability.

Key credit drivers

Asset quality will deteriorate as economic activity slows down. We believe that Uzbek banks' credit losses will increase significantly in 2020-2021 to 3%-4%, from 1.6% in 2019, and NPLs will rise to 4%-5% in 2020 before gradually decreasing in 2021.

Downside risk relates to the economic scenario. If the economic recession is deeper and pandemic containment measures last longer than we currently expect, this would substantially increase risks for Uzbekistan's banks.

Key assumptions

Decreased GDP growth and still-high inflation. We expect GDP growth of only 1% in 2020 because measures to contain the pandemic will hit domestic and external demand. The economy has the capacity absorb the current shock, however. We predict it will return to growth of 5% on average in 2021-2022 and that inflation will remain about 13% over 2020.

The impact on the banking sector will be manageable, but smaller banks will feel greater pressure. We expect the system to demonstrate resilience to this event. For the largest, state-related banks, solid capital buffers support their profiles and asset quality will likely take less of a hit. These banks have higher exposure to state-owned enterprises (SOEs) and subsidized mortgages, and lower exposure to small and midsize enterprises (SMEs) and private entrepreneurs. We anticipate that SOEs will benefit from government support and that subsidized mortgages will demonstrate greater resilience than loans to small private businesses and unsecured retail loans. Therefore, the funding profiles of large players are likely to be stable, supported by deposits from SOEs and government entities. We expect that smaller banks will report credit costs, NPLs, and restructured loans above the system average.

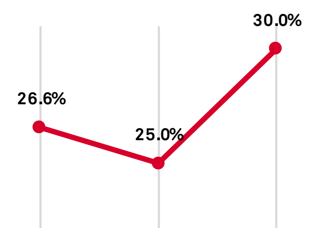
Economic reforms will continue. We expect the government will proceed with its wide-ranging reform agenda. The impact of the reforms on SOEs, including banks, could be the most important change for the sector in the medium term. Despite the tougher economy, we expect the government to make progress toward privatizing the state-owned banks in the coming years.

What to look for over the next year

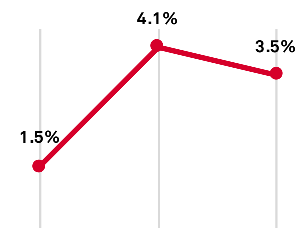
Asset quality dynamics are among the key metrics to watch. Many borrowers saw their interest holidays end in October 2020. We will be closely monitoring the evolution of banks' asset quality and credit losses as the pandemic progresses and the economy slows. We anticipate significant differences between banks' 2020 full-year accounts in the way they book provisions against future credit losses and report Stage 3 loans. These could differ significantly from the statutory reported NPLs.

Uzbekistan

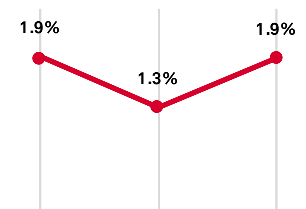
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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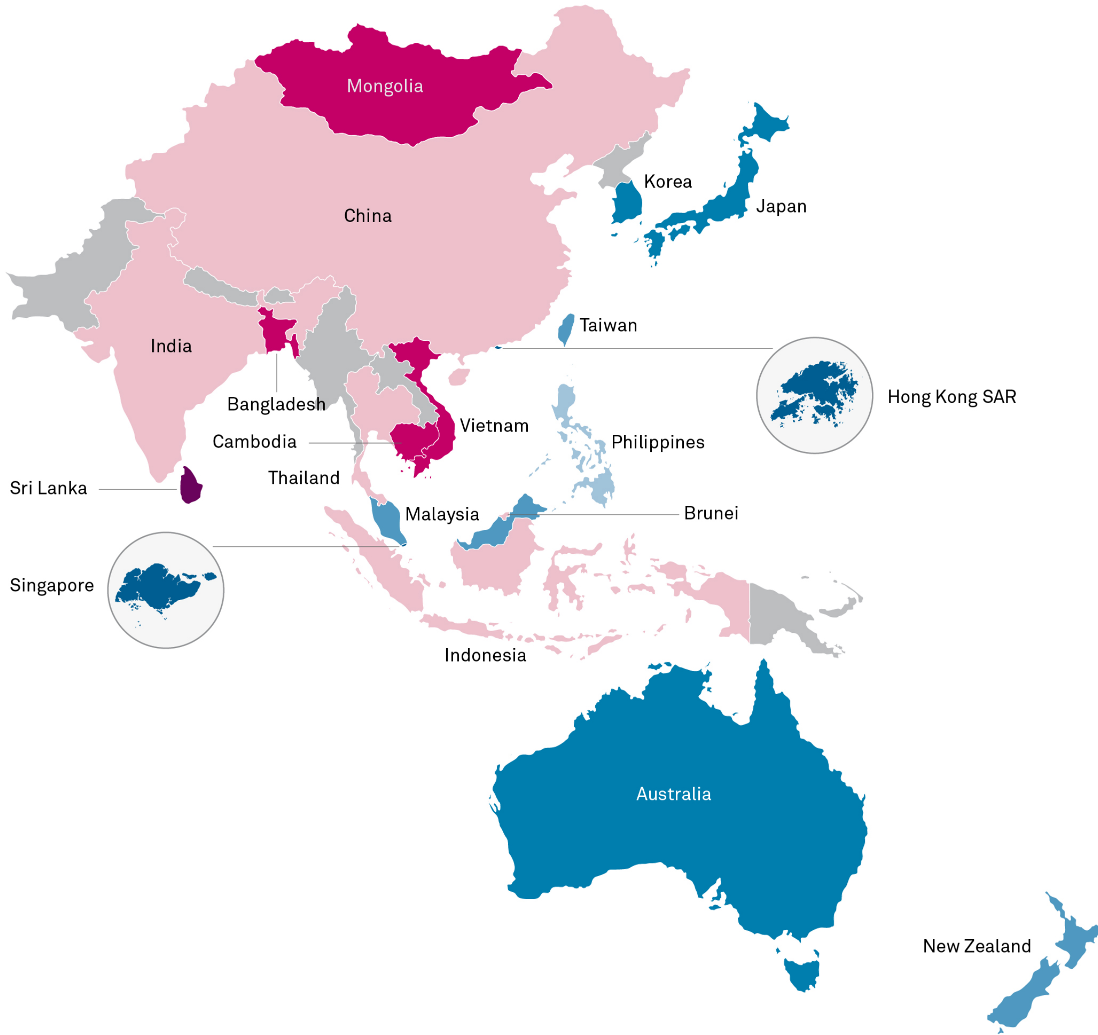
Asia-Pacific



Group '1' to '10', from lowest to highest risk. BICRAs--Banking Industry Country Risk Assessments.
Data as of Oct. 27, 2020. Source: S&P Global Ratings.

Australia | BICRA Group: 3

Banks Will Struggle To Regain Pre-COVID Earnings Metrics

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Key takeaways

- We forecast credit losses will rise to more than six times those in 2019 before easing.
- We expect growth in house prices to resume soon.
- Bank earnings should remain sufficient to absorb higher credit losses despite lower interest and fee income.

Key credit drivers

Fiscal and monetary support should soften the blow from COVID-19 driven recession. We expect the pandemic to drive a 4% contraction in Australia's GDP in 2020 before the economy rebounds with 4.2% growth in 2021. Large fiscal stimulus by the government and moratoriums on loan repayments offered by the banks should cushion the blow for many borrowers. In addition, timely and coordinated monetary support from the central bank has alleviated bank funding and liquidity risks, in our view.

Banks are well placed to absorb increased credit losses. Low interest rates, weak credit growth, and a drop in fee income will curtail bank earnings. However, the earnings should still remain sufficient to absorb the higher credit losses, in our view. In addition, we expect the banks to maintain their capital strength by cutting dividend payments and issuing new capital, if needed.

Key assumptions

Credit losses to rise by six times. A contracting economy, rising unemployment, and weak consumer and business sentiment will weaken the banks' asset-quality metrics. We forecast that annual credit losses will peak at about 85 basis points (bps) of gross loans by 2021; more than six times the historical low in fiscal 2019. This credit-loss ratio should ease to about 45 bps in 2022, in line with our broader economic forecast.

House market to recover. We expect a modest growth in house prices to resume soon on the back of economic recovery. Travel restrictions continue to impede immigration-driven population growth and consumer sentiment remains weak. These factors should rein in house-price appreciation in the next few months. Nevertheless, low interest rates, easing of responsible lending rules, and housing supply shortages could reignite a spurt in prices over the next two years.

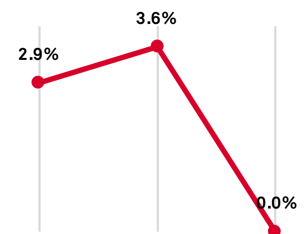
What to look for over the next year

Post COVID-19 path to economic recovery. The recovery of earnings and credit losses to pre-COVID levels will be drawn out. Banks will struggle to regain earning metrics, reflecting the longer-term trend of gradual erosion in earnings, and low interest rates that are likely to prevail for some time. In addition, the effect of COVID-19 on banks' asset quality will become clearer when moratoriums on loan repayments end and the government reduces the fiscal support. A number of households and businesses are likely to struggle to meet their financial obligations at that time, in our view.

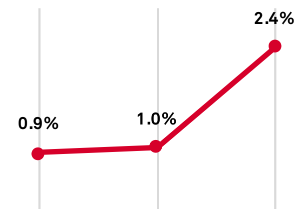
Technology-driven changes in the banking industry. The sector is entering a period of significant change as market participants respond to new technologies and increasing customer demand for tech-driven convenience. In our opinion, social distancing measures to limit COVID-19 transmission will increase consumer adoption of financial technologies, accelerating Australia's transition to a technology-driven financial system with a reduced physical footprint. We believe that the major banks are well placed to deal with tech disruptions, given their dominant market positions. Nevertheless, their earnings could compress as technology may intensify competition in some parts of the value chain.

Australia

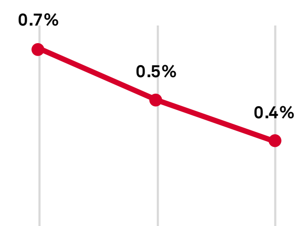
Loan growth



NPA ratio



RoAA



2019a 2020a 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Figures are for June year-end.

Bangladesh | BICRA Group: 9

Structural Weaknesses Not Going Away Anytime Soon

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Key takeaways

- Global economic recession and supply chain disruptions will weigh on the banking system.
- Asset quality risks remain extremely high with the government having little ammunition to boost underlying economic strength and address corporate defaulters.
- Lending rate caps to keep interest margins low and squeeze the already stressed banking system.

Key credit drivers

Nonperforming loans to reach new heights. COVID-19 has accelerated a deterioration in the banking system that began several years ago. While we expect GDP and credit growth to rebound in 2021, COVID-19 will leave permanent scars--namely bad debts. Relaxations in loan classification standards in the past two years and loan moratoriums may result in better headline NPL metrics but the underlying asset quality is likely to remain weak. We note that the impact of moratoriums on NPL numbers is a global issue.

Weak industry profitability and capitalization will continue. The banking sector is fragmented with about 60 banks, and new banks continuing to enter this crowded market. Fragmentation is one of the many factors that undermine the sector's efficiency and overall profitability, although the average hides the significant gap between good and poor performing banks. While the country is implementing Basel III regulation, progress is slow and frequently takes backward steps. Many banks will continue to struggle to meet the minimum capital requirements (including provisioning standards). Loan moratoriums and government interest rate controls will drag on bank earnings.

Key assumptions

Macroeconomic conditions to remain challenging. Global economic conditions will weigh on Bangladesh's exports, remittances, and overall GDP. We expect remittance inflows to fall from record highs given employment for Bangladesh workers will wane in regions such as the Middle East. The relatively low cost of Bangladeshi labor and production may help to maintain jobs. However, the ability of workers to travel to their international employers depends on how well the relevant countries contain COVID-19.

Weak asset quality. Bangladesh's banking industry will likely face structural asset quality challenges due to weak lending standards and foreclosure laws. Regulatory forbearance to reschedule weak loans undermines credit discipline. State-owned banks will continue to hold a large amount of weak assets.

What to look for over the next year

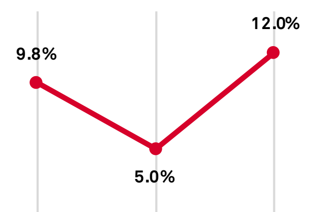
Credit growth to stay muted. We expect credit growth to stabilize. Global supply chain disruption and the subsequent fall in trade financing volumes has hurt demand, although this is starting to alleviate with global economies restarting. The central bank, however, continues to take various measures to revive credit growth especially for small and medium enterprises and the agriculture sector. It also slightly raised the advance-to-deposit ratio for scheduled commercial banks to 87%, reduced reverse repo rates and cash reserve ratios, among other actions.

Rising pressures on margins. We expect interest income to remain low as loan payments halt during the moratorium. Further, the central bank imposed a lending rate cap of 9% on all loans barring credit cards effective April 2020, and a 4% cap on existing and new farm loans. This will likely squeeze bank margins.

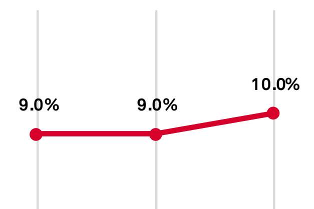
Liquidity pressures for small banks building. Smaller banks could face liquidity crunches as the 12-month blanket moratoriums for all loan repayments, with no penalty (additional interest or fees). This undermines cash flows and may have long-standing effects on creditor repayment culture.

Bangladesh

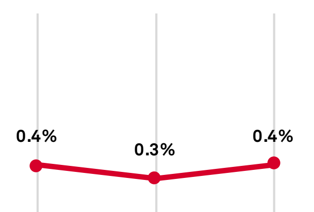
Loan growth



NPA Ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Brunei | BICRA Group: 6

Strong Public Finances And Improving Energy Prices Support Banks

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Key takeaways

- We expect the economy to benefit from improving energy prices and a stabilized public health situation in 2021.
- Profitability is likely to dip in 2021 as interest margins decline and credit costs rise.
- Banks remain well buffered due to historically high profitability and strong balance sheets.

Key credit drivers

Moderation in profitability. We expect bank loan books to expand at low single digits in the next few years. On the wholesale banking side, growth is likely to be driven by the government's efforts to diversify the economy; including by welcoming foreign direct investment projects, and supporting local firms through contracts from government-linked companies. Household debt servicing caps to constrain retail lending.

Interest margins are set to decline given global "lower for longer" settings. Credit cost won't rise much in 2020, due to COVID-19 regulatory forbearance, but will likely jump in 2021. Banks have options to defer payment of principal on loans until March 2021 for wholesale clients, and deferment or tenor extension (by conversion into term loans) for retail loans such as credit-card debt, personal loans, vehicle loans, and home loans.

Range-bound deterioration in asset quality. We expect systemwide credit losses to reach 100 bps of total loans in 2021 from a low base of 35 bps over 2017-2019, due to the twin effects of weak energy prices and the global pandemic. That said, the economy has held up relatively well with GDP growth exceeding 2.5% in the first half of 2020. Brunei has been able to effectively control the spread of COVID-19 (around 150 confirmed cases only) and new production facilities in downstream petrochemical products have buffered against energy price declines.

Bank balance sheets are strong. The banking sector had a Tier-1 capital ratio of 20.1% and a loans to deposit ratio of 41% as of June 2020. Brunei banks have robust liquidity given the strong surpluses at the country's government and related enterprises, and limited lending opportunities.

Key assumptions

Strong fiscal position insulate the economy from oil price shocks. The oil and gas industry accounts for half of Brunei's GDP and more than 70% of government revenues. The economy remains exposed to declines in oil and gas prices. In our view, the government's strong net fiscal asset position and accumulated oil wealth help it to buffer the economy against shocks through countercyclical spending.

Oil prices have rebounded since their lows in mid-April. This is largely because of massive supply cuts from OPEC and Russia and the gradual reopenings of global economies. Brent is now trading in a $40-$45/barrel range, or twice the levels of mid-April.

Government to remain supportive. We expect a high likelihood that the Brunei government would provide timely and sufficient extraordinary support to major local banks if needed.

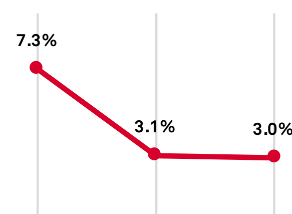
What to look for over the next year

Financial sector reforms. Progress is being made toward establishing a bond market and a stock exchange to create alternative funding routes.

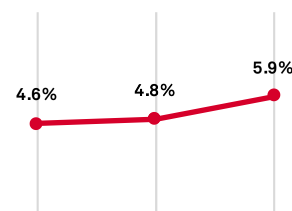
Downside risks. We expect the banks' operating environment to remain relatively resilient owing to ongoing support from the government and rebounding energy prices. Nevertheless, a substantially larger and more prolonged slowdown of the global economy than our base-case forecast could weaken Brunei's banking system's stability.

Brunei

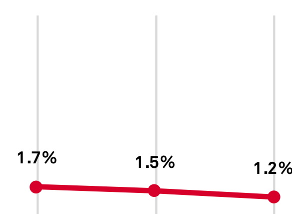
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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a--Actual. e--Estimate. f--Forecast.

Cambodia | BICRA Group: 9

Real Estate Is The Biggest Risk

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Key takeaways

- Credit growth will likely rebound in 2021, alongside the broader economy, as foreign investment, particularly from China, resumes into tourism, manufacturing, and construction.
- China export demand will only partly offset the impact of the EU's diluting of tariff preferences for Cambodia.
- Asset quality is vulnerable to a sharp correction in the real estate sector.

Key credit drivers

Risk of a sharp correction in construction and property segments. The banking sector's high exposure to real estate-related activities and the use of property as collateral are key risks to the financial sector. Ongoing uncertainty around the pandemic could give pause to the marginal buyer of property, depressing values. Other correction triggers include a change in foreign sentiment and investment, particularly from China. Loans to the construction and real estate sectors have grown rapidly in recent years; in 2019, they jumped by 37%.

High dependence on China. A recovery in the Chinese economy is key to the Cambodian economy and financial system. In 2019, China accounted for more than a third of tourist inflows and about 50% of foreign direct investment in Cambodia.

Key assumptions

Global macroeconomic conditions to remain testing. The EU's partial withdrawal of tariff preferences under the "Everything But Arms" (EBA) scheme exacerbates weak conditions in Cambodia's export- and tourism-dependent economy. This withdrawal affects around 20% of Cambodia's significant yearly exports to the EU. An announced (but not publicly detailed) trade agreement with China may provide some offset, but this is likely insufficient to offset the EBA, at least in next year.

We expect credit growth to accelerate. COVID-19 has hit hardest on sectors such as tourism and manufacturing, causing a contraction in Cambodia's GDP this year. We expect loan growth to pick-up in 2021 as tourism, appetite for foreign investment (particularly given a movement of low-cost manufacturing away from China), and general global economic conditions improve.

What to look for over the next year

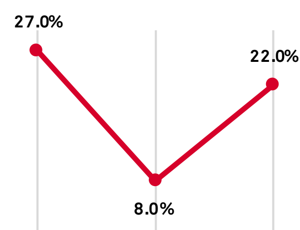
Restructured loans to climb. We expect that restructured loans will rise following the central bank's directive for banks to restructure loans for borrowers in the tourism, textile, construction, and transport and logistics sectors that were hurt by the pandemic. While headline nonperforming asset levels may not materially increase, we believe asset quality will inherently and understandably deteriorate given underlying economic issues. We continue to believe risks are building in Cambodia, but the availability of credit somewhat hides the recognition of these risks.

Implementation of capital conservation buffer (CCB) delayed. Similar to many other bank regulators, the National Bank of Cambodia has delayed the implementation of CCB by one year, which should help preserve banks' liquidity and encourage credit growth. We expect that the central bank will remain committed to improving capital buffers and enhancing regulatory supervision post COVID-19.

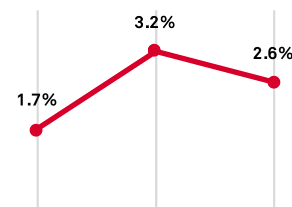
Cashless transactions getting a boost. We expect COVID-19 to accelerate the speed of digital adoption in banking-related services. The central bank has strongly pushed banks and customers to transact via cashless means, which should be a boon for banks with solid digital banking platforms.

Cambodia

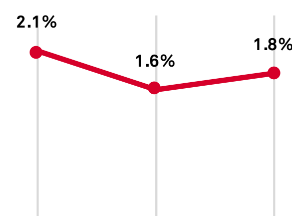
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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a--Actual. e--Estimate. f--Forecast.

China | BICRA Group: 6

China Banking Is A Potential Early-Exiter From COVID-19

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Key takeaways

- We revised our NPA ratio for Chinese banks to 8.5% in 2020 from 10%, as China's economic recovery gains momentum. The pre-pandemic ratio was about 5%.
- While some banks may report losses this year, longer-term banking industry and economic trends remain stable.
- A strong customer deposit base and deepening domestic capital markets continue to underpin the banking sector's solid funding profile. This is despite faster growth in credit than in deposits.

Key credit drivers

Stable economic risk trend. Some banks may report losses for 2020. Overall, however, the country's banking sector is well buffered to absorb worsening asset quality due to the pandemic. Normalization will also be supported by China's relatively early exit from COVID-19 economic shocks. We anticipate the Chinese banking system will recover to pre-COVID strength by the end of 2022.

COVID effects are manageable for major banks. We believe the largest China banks are adequately placed to manage the fallout from COVID-19. Credit divergence with smaller and weaker banks will likely increase. The risk of a banking crisis in China is not high over the next 12 months, in our view. It's unlikely that problematic banks would be allowed to fail, or conspicuously rescued as per last year, as authorities emphasize financial stability amid the pandemic, prioritizing credit support to the real economy.

Key assumptions

NPA ratio to significantly increase. Reported nonperforming loans will likely only moderately rise, largely because forborne obligations will be classified as special-mention loans or earmarked as normal loans, rather than NPLs. However, we project a significant deterioration in NPAs because we include forborne loans in our broader metric for assessing China banks' asset quality. We assume NPAs will jump to 8.5% of gross loans, from around 5% before the pandemic.

Increased policy efforts will alleviate some pain. Credit support to small businesses hit by the pandemic should ease near-term downside risk. In addition, forbearance policies were extended to March 2021. Nevertheless, we expect credit cards, manufacturing, wholesale, and retail trade to be hit hard.

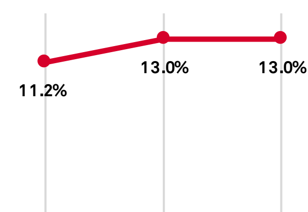
What to look for over the next year

High credit growth but lower profitability and high NPAs. We estimate overall loan growth at about 13% in 2020 and 2021, buoyed by supportive lending policies for preferred sectors. Small business loan growth will be high, while unsecured consumer lending will slow, in our view. Manufacturing and infrastructure investment loans could increase above trend. Nonetheless, higher NPAs from COVID-19 could take years for banks to digest. While we expect large banks to continue to make reasonable loan loss provisions, some weaker banks may manage the impact on asset quality and profit over a longer period of time.

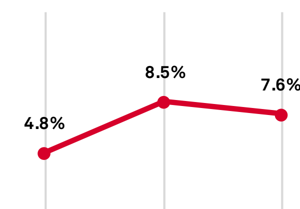
Unwavering shadow banking reform despite deadline extensions. The chance of a surge in shadow banking exposures is not high as the overall direction of regulatory tightening has not changed, in our view. We expect growth in shadow lending to continue to slow in 2020. This is demonstrated by a muted increase in Chinese banks' issuance of off-balance-sheet wealth management products (WMPs) in 2019, and banks' transitioning of their portfolios ahead of implementation of the new asset management rule now extended to end-2021.

China

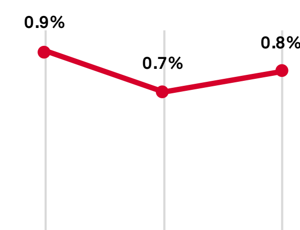
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Hong Kong SAR | BICRA Group: 2

Recovery To Pre-COVID-19 Levels Is Unlikely Before 2022

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Key takeaways

- Improved outlook, however U.S.-China tension remains a risk.
- Credit costs are likely to gradually temper and fee income should recover toward 2021, but a low interest rate environment could still weigh on profitability.
- Prudent underwriting standards, sustainable capital, robust funding and liquidity, together with effective regulatory monitoring should help contain risks to banks.

Key credit drivers

Uncertain operating conditions. Hong Kong's recent relaxation of social distancing measures, a potential travel bubble with Singapore, and the rebound in China's economy underscore a more positive note for the banking sector. Still clouding the operating environment, however, are recent political developments around China's imposition of a National Security Law and the tough U.S. response. The risk of tougher U.S. sanctions on Hong Kong banks increases compliance costs and could weigh on the near-term investment climate.

Strong fundamentals. Bank capitalization has strengthened over the past couple of years owing to controlled lending, regulatory additional Tier-1 capital issuances, sufficient internal capital generation, and, in some cases, asset disposals. This provides banks with more buffers to absorb losses. Banks also benefit from stable customer deposits and limited reliance on short-term wholesale funding.

Key assumptions

Recovery is on its way. We expect the economy to rebound in 2021, supported by fiscal stimulus as well as global demand recovery, particularly in China. We forecast GDP will grow by 5.3% in 2021 after contracting 7.2% this year with the unemployment rate tapering to below 5% in 2021 from over 6% as of end-September 2020. We expect a lag between the economic recovery and a sustainable improvement to the banking sector's financial strength. Also, our outlook incorporates our view that the economic damage on households and businesses is manageable at current rating levels.

Low interest rates. We expect the U.S. Federal Reserve will keep interest rate at low levels to aid economic recovery, which will pressure banks' net interest margin into the next year.

Moderate correction in property prices. In our view, a structural housing supply shortage, accommodative monetary policy, and room for policy maneuvering should moderate drops in property prices, limiting the impact on the banking sector.

What to look for over the next year

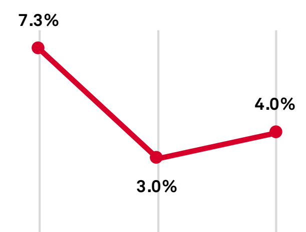
Earnings recovery. A moderate decline in credit losses and cost discipline could relieve some pressure on profitability. We expect the ratio of new loan loss provisions to average gross customer loans to decline to about 55 basis points in 2021, from 70 basis points for 2020. A pick-up in economic activity in Greater China, in particular, will contribute to the sector's noninterest revenues.

Accelerated pace of digitalization. Bank budgets for technology spending will likely rise because COVID-19 has accelerated the need for technology upgrades. Seven virtual banks have been launched this year but we expect these to be largely niche players, mainly operating in the retail and small and medium enterprise sectors.

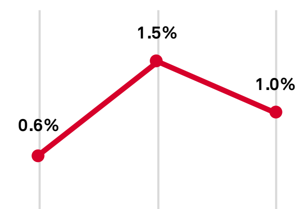
Issuance of loss-absorbing capacity (LAC) eligible instruments. We expect that some banks could issue senior non-preferred debt, a cheaper alternative to the regulatory additional Tier-1 and Tier-2 capital, to meet the banking regulator's LAC requirements.

Hong Kong SAR

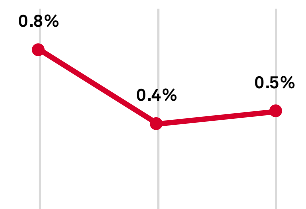
Loan growth



NPA ratio



RoAA



2019a | 2020e | 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

India | BICRA Group: 6

Pandemic Exacerbates Problem Assets

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Key takeaways

- We expect bank asset quality to deteriorate, and profitability to be abysmal in fiscal 2021, due to the challenging operating environment.
- Stronger nonbank financial companies (NBFCs) will gain market share and benefit from differentiated funding access, while weaker NBFCs could have a harder time.
- Government and central bank measures to provide some respite. A very high likelihood of government support underpins the creditworthiness of government-owned banks, in our opinion.

Key credit drivers

Challenging operating environment. COVID-19 has slammed the economy and delayed the recovery process. While we expect real GDP growth of about 10% in fiscal 2022 (ending March 31, 2022), this is largely on low base as we project a 9% contraction in the current fiscal year.

Resolutions to pick up. NPL recoveries under the insolvency and bankruptcy code (IBC) are set to regain momentum in fiscal 2022, once new cases can resume under the IBC and the economy rebounds. The government has suspended the initiation of new insolvency cases for defaults occurring in the nine-month period from March 25, 2020 (with an option to extend for up to a year). Recoveries in the current year, though lower than previous years, have nonetheless exceeded our expectations.

Key assumptions

The government remains supportive. The government has supported state-owned banks, as reflected in its ongoing recapitalization plan including Indian rupee (INR) 200 billion announced for the current fiscal year. While the government may reduce its stake in these institutions, it will continue to maintain control over these banks, in our view. Hence, we anticipate a very high likelihood of government support.

Medium-term growth prospects remain strong. We expect the Indian economy to remain a long-term outperformer versus peers of a similar level of income, with growth of 6.0% in fiscal 2023 and 6.2% in 2024. The economy's long-term outperformance highlights its historical resilience. India's wide range of structural trends, including healthy demographics and competitive unit labor costs, work in its favor.

What to look for over the next year

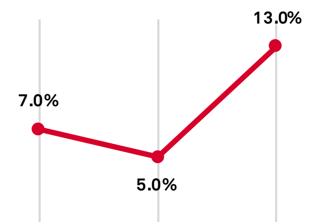
Asset quality stress. We project the banking sector's NPLs will shoot up to 10%-11% of gross loans as on March 31, 2022, from 8% on June 30, 2020. The central bank has allowed for a one-time restructuring of debt, including extensions or partial conversion of debt to equity. That should reduce slippage in the current fiscal year, but may spread recognition over the next year or so. In our base case, about 5%-8% loans could get restructured. Government initiatives including the emergency credit guarantee scheme for SMEs and the partial guarantee scheme should partly alleviate system stress.

Differential in risk premium to widen for the NBFC sector. NBFC performance is gaining momentum. Collections are improving, some have been raising equity, and government schemes have ensured good liquidity for the sector. As a result, financing costs have fallen sharply for some; however, risk premiums for weaker NBFCs (or those with perceived governance issues) have been rising. We could see differentiated business niches with weaker NBFC resorting to originate and distribute models.

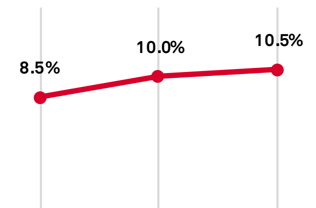
Need for capital replenishment. We forecast profitability will remain abysmal in the next 12 months, with a return on average assets of 0.2% in fiscal 2022. This is due to elevated credit costs over this year and the next. We expect some state-owned banks to report losses and will need to raise capital to avoid breaching the regulatory minimum requirement and to grow. Even with capital infusions from the government, we see many banks (both private and public) tapping the market to raise capital.

India

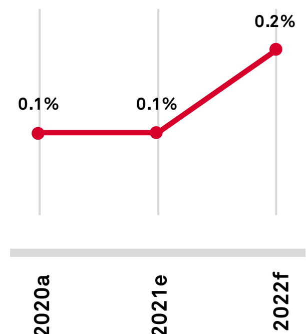
Loan growth



NPA ratio



RoAA



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming loans as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Figures are for fiscal year ending March.

Indonesia | BICRA Group: 6

Economic Recovery And Currency Stability Are Key Credit Factors

Key takeaways

- Negative outlook on banks given rising economic risk from the pandemic.
- Downside risks buffered by strong capital ratios and provisioning built up by banks over several years.
- ROA is taking a COVID hit but Indonesian banks remain among the region's most profitable.

Key credit drivers

Rising economic risk. Indonesia is among the hardest hit countries in Southeast Asia, and we believe economic risk for Indonesian banks is rising due to COVID-19. Restructured loans grew to about 18.6% of total loans in August 2020, and could continue inching up. Regulatory forbearance allowing restructured loans to be classified as performing until end March 2021 have mitigated damage to bank financials. We believe underlying deterioration in asset quality could become more apparent in 2021 after expiry of regulatory relaxation.

Ratings underpinned by strong capital and provisioning buffers. Capital and provisioning buffers built up over the years should support Indonesian banks through the economic downturn. The banks' average Tier-1 capital ratio of 20.9% and capital adequacy ratio of 22.6%, as of June 2020, are among the highest in the region. Internal capital generation should support capital positions despite a likely decline in net profit, offset by muted loan growth which we forecast at 2% in 2020 and 5% on 2021.

Key assumptions

Decline is a cyclical event and Indonesia's structural growth story is intact. We expect a flattish U-shaped recovery with 6.3% growth in 2021, from a 1.1% contraction in 2020. The pace of economic expansion is likely to return to 5% levels in the next two to three years.

Profitability will be suppressed, attaining pre-COVID levels only in 2022. We expect the combination of low loan growth and elevated credit costs to crimp the revenues of Indonesia banks up until 2022. Multiple policy rate cuts and interest rate discounts given to debtors under loan restructuring programs will also constrain interest margins. We have forecast a decline in 2022 ROA to 2%, versus a pre-COVID average of 2.5%. Despite this, Indonesia banks will continue to rank among the most profitable in the region.

What to look for over the next year

Economic recovery and currency stability in 2021. Downside risks for Indonesia's banking sector could be exacerbated if the COVID-19 pandemic worsens or drags on for longer, leading to significantly slower economic growth compared with our forecast, translating to higher nonperforming assets and credit losses than we expected. In addition, another round of depreciation of the Indonesian rupiah due to the turmoil in financial markets could result in a further weakening of Indonesia's external position or higher delinquencies among corporate borrowers, which may affect banks.

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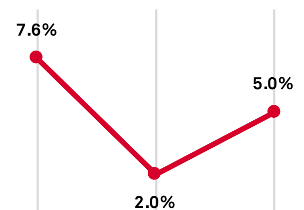
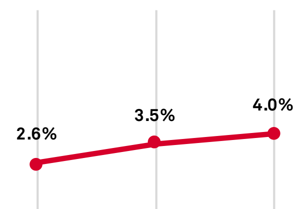
Indonesia

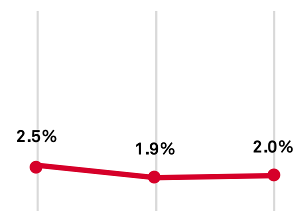
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Japan | BICRA Group: 3

COVID-19 Pandemic To Further Compress Profitability

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Key takeaways

- Credit loss ratios will more than double this year to 0.4%-0.5% of gross loans.
- Regional banks face a tough road ahead as operating conditions remain weak.
- Progress in restructuring will be key to the industry's profitability.

Key credit drivers

Pressure on profitability. Economic strain stemming from the pandemic points to a squeeze in profitability. Credit losses will rise as asset quality deteriorates, and falling global interest rates will weigh on wafer-thin interest margins.

Overcapacity in the banking industry. We view the nation's banking system as vulnerable to risks as a result of a fragmented industry structure. Overcapacity and dwindling interest margins due to competition create an increasingly challenging operating environment for banks and will therefore continue to constrain industry returns.

Evolving asset-liability mismatches. Core deposits comprise a significant portion of Japanese banks' funding. Nonetheless, we are cautious about expanding foreign currency funding in line with increasing overseas exposures to offset low returns from domestic operations. Although the banks are able to exchange ample Japanese currency funding to access non-yen funding, they face an increased risk of asset-liability mismatches.

Key assumptions

Recessionary pressure due to COVID-19. We expect the pandemic to hit business cycles in the short term, after which a gradual recovery should take hold. Our forecasts put Japan's economic growth at 3.2% in 2021 after shrinking 5.4% in 2020. A delay in Japan's recovery would heighten economic risks for banks operating in the country.

Muted contribution to profit from loan growth. Increased demand for working capital from corporates is driving growth in loans. However, a fall in interest margins will counterbalance the upside in earnings from credit growth, leading to muted returns, in our view.

Asset quality will be tested. We expect the economic slump will hurt both large corporates and small and midsize enterprises (SMEs). Although Japanese banks had good asset quality compared with global peers prior to COVID-19, they have limited headroom in their earnings to absorb increasing credit losses.

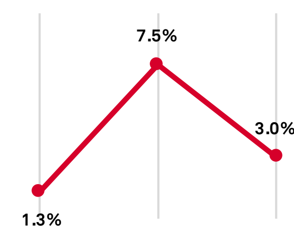
What to look for over the next year

Increase in credit costs. The government's swift and large-scale support to companies has mitigated the increase of banks' credit cost. However, we still expect banks' credit costs to surge to 0.4%-0.5% of gross loans this year, before dropping to 0.25% in 2021. Nonperforming assets will increase to 2.4% in 2020, then partially recover to 1.5% in 2021. These scenarios are subject to our assumption that an economic recovery will start from mid-2021.

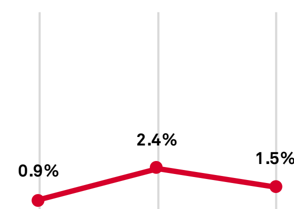
Restructuring of domestic operations to accelerate. Faced with a surge in credit costs and a squeeze on net interest margins, both major and regional banks are being forced to reduce less-profitable operations. Also, they simultaneously face the need for new investment in fintech. Accordingly, we expect restructuring of less profitable areas (such as domestic retail operations) to accelerate in 2021.

Japan

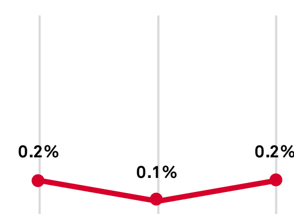
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Korea | BICRA Group: 3

Banks Can Cope With COVID-19

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Key takeaways

- Improved risk management enables Korea's banks to manage upward pressure on credit costs amid economic headwinds from COVID-19.
- Moderate asset growth should support bank capitalization despite weakened profitability.
- Banks are pro-innovation and will likely stand their ground as the pandemic accelerates digital transformation.

Key credit drivers

Improved risk management. Banks should be able to manage some deterioration in asset quality due to COVID-19, backed by tightened underwriting, built-in additional provisioning, and reduced exposure to weak corporate sectors such as shipbuilding, shipping, and real estate project-financing loans. Low loan-to-value ratios of around 50%-55% for mortgage loans, and tightened oversight on borrowers' repayment capability should also mitigate some strain on household loan quality. COVID-19 forbearance measures such as maturity extensions of principal payments for small and midsize enterprises and unsecured household loans are modest, at about 3% of banks' total loans as of June 2020.

Adequate capitalization. We believe Korean banks will maintain adequate capital buffers as loan growth reverts to moderate level in 2021 onwards. This is despite weakened profitability attributable to high credit losses relative to pre-pandemic levels. Persistent low interest rates will also pressurize the banks' net interest margins.

Key assumptions

Moderating credit growth. We expect household loan growth to slow down due to the banks' tightened underwriting standards alongside steady regulatory measures on the property market. Corporate loan growth will also be moderate, in our view, after some pick-up in 2020 due to funding and liquidity support for affected businesses, led by policy banks and guarantees provided by the government agencies.

Stability of the property market. Stringent regulatory measures will likely limit significant increase in real estate prices especially in Seoul and major satellite cities, in our view. We note that nationwide average housing prices have increased only modestly in real terms over the past decade, and they are relatively low and stable compared with other Asia-Pacific countries such as Hong Kong, Australia, and Singapore.

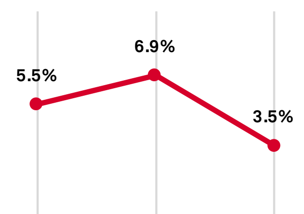
What to look for over the next year

Recovery of profitability. We expect the banks' return on average assets to gradually improve after a drop to around 0.3% in 2020 from around 0.5% in previous years. This will be led by a reduction in credit costs as the economy rebounds in 2021 onwards. We forecast Korea's economy will grow 3.6% in 2021 after a contraction of 0.9% in 2020, supported by a rebound in global demand and the government's fiscal stimulus and market-stabilization measures. That said, a prolonged outbreak of COVID-19 and intensifying trade tensions between the U.S. and China could lead to higher credit losses.

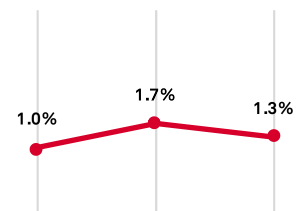
Banks to accelerate digital transformation. Korea's advanced IT infrastructure and deep smartphone penetration, as well as banks' technology investments, enable the banks to stay ahead of technology trends. The two internet-only banks collectively comprise only about 0.5% of the loans in the system as of June 2020. Fintech companies mainly focus on simple transactions such as money transfers and settlement services, which have not been a major revenue source for banks.

Korea

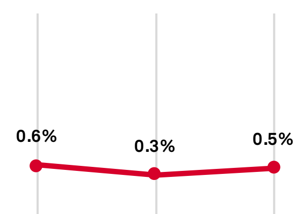
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

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a--Actual. e--Estimate. f--Forecast.

Malaysia | BICRA Group: 4

Asset Quality Will Stay Weak In 2021 Despite Economic Recovery

Key takeaways

- We expect reported NPL ratios of Malaysian banks to catch up with credit cost in 2021 as the six-month blanket moratorium expired after September 2020.
- The sector-average NPL ratio will likely rise to nearly 4% and credit costs will stay elevated at 60-70 bps by the end of 2021, the highest levels since the global financial crisis.
- Asset quality risks are partially mitigated by banks' solid capital buffers and prudent risk appetite.

Key credit drivers

Asset quality is deteriorating. Our base-case assumes the sector's nonperforming loan (NPL) ratio will be 3.9% of gross loans by the end of 2021, from a projected 2.9% (excluding moratorium distortion) this year. Credit costs will fall only slightly, to 62 basis points (bps) next year, from 66 bps in 2020. While Malaysian authorities have encouraged domestic banks to extend further relief to vulnerable borrower groups, the next phase of targeted assistance relief will likely cover a much smaller portion of loans compared with the blanket moratorium to all retail and SME customers offered prior to September 2020. As a result, we expect local banks' loan book to be under a negative transition currently, and the real asset quality picture will start to crystalize in the last quarter of 2020.

Solid capital and reduced dividend payout buffers stress. We believe Malaysian banks' solid capital buffers (14.6% common equity Tier-1 ratio) and reduced appetite for dividend payouts this year are important mitigants that could partially offset credit losses from the abrupt and acute COVID-19 shock to the economy. However, a sharp compression of net interest margin adds further pain to bottom line performance in 2020, which should moderately improve in 2021.

Key assumptions

U-shaped recovery is a bridge for banking sector normalization. We expect real GDP to stage a strong 8.4% recovery in 2021, following a 5.0% contraction in 2020. Our base case also assumes no significant deterioration of the COVID-19 infection curve and that a vaccine is widely available by mid-2021. Any meaningful deviations from those baseline assumptions will trigger a review of our banking sector forecast.

Employment conditions critical for banks. Banks' asset quality hinges critically on the employment situation in the country, given 58% of the system's loan book is exposed to the household sector. We expect the unemployment rate to remain largely stable, increasing to 4.5% in 2020 and moderately declining to 4.1% in 2021. The employment conditions for Malaysia have shown good resilience so far, and as a result we have turned somewhat less pessimistic.

What to look for over the next year

Bad asset quality indicators, good growth. We forecast loans will expand by 8.0% in 2021, in line with our forecast of a U-shaped recovery in 2021. The loan growth is likely to be driven both by the low base effects in 2020 and some pent-up demand from business and household sectors. That said, asset-quality conditions will remain challenging as the delayed NPL recognition starts to bite in 2021 and banks keep credit costs high and write off more aggressively.

An initial glimpse of new digital-only banks. While the pandemic has delayed Bank Negara Malaysia's implementation of a digital banks' licensing framework, the industry may get an initial glimpse of the new digital-only banks and their business models by the end of 2021 or early 2022.

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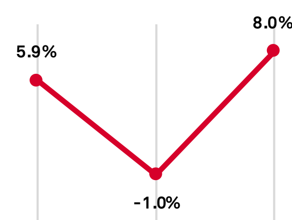
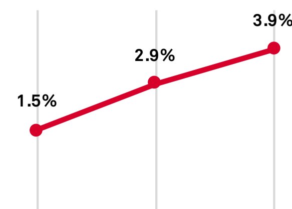
Malaysia

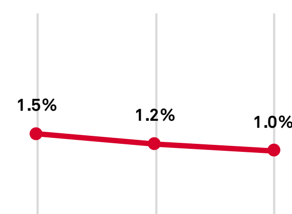
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Mongolia | BICRA Group: 9

High Growth Appetite Could Mask Asset Quality Issues

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Key takeaways

- COVID-19 forborne loans will add burden to asset quality metrics and further strain profitability as the banking sector looks for growth opportunities.
- Loan growth will sharply accelerate in 2021 as commodity activity picks up.
- The economy remains susceptible to external factors, particularly fluctuations in commodity prices.

Key credit drivers

Susceptible to commodity cycles. Mongolia's economy is heavily dependent on commodities, and its trading partner concentration amplifies the banking sector's susceptibility to acute shifts in commodity prices.

Gaps in regulations and disclosures compared with international practices. Regulators in Mongolia have been taking steps to gradually reduce gaps with international practices in recent years. These include an asset quality review of the banking sector, which contributed to tighter loan classification and provision requirements. Banks also have to meet higher capital requirements. While Mongolian banks' asset quality recognition and provisioning standards have improved in recent years, there are still gaps with international standards, in our view. Recently, the Financial Action Task Force removed Mongolia from its grey list for monitoring money laundering and related issues.

Key assumptions

Economic growth will recover in 2021. External uncertainties due to COVID-19 weigh on exports and hence output, given Mongolia is an export-driven economy. We expect Mongolia's real GDP will bounce 8.5% in 2021 after a contraction of 1% this year. The growth rate was about 5% in 2019.

Credit appetite to remain high. While we expect economic headwinds and strengthened regulations to constrain banks' loan growth in 2020, a sharp rebound is likely next year as commodity activity drives economic activity. China, which accounts for more than 90% of total exports, has already seen a rebound in economic activity. Banks have undergone rapid growth in the past, especially during commodity price upcycles. Although some banks face capital constraints due to the gradual phasing in of conservation buffers, they may look at rebalancing the asset portfolio toward loans to achieve growth. We note that rapid growth may mask asset quality issues in the gestation phase.

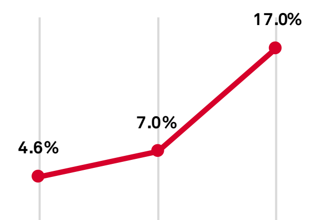
What to look for over the next year

Asset quality to deteriorate. The asset quality metrics of Mongolian banks could deteriorate in 2020 (due to macroeconomic headwinds related to COVID-19), particularly when banks adopt International Financial Reporting Standards 9 (IFRS9) at the end of 2020 (delayed from the previously planned implementation in January 2020). Pandemic-related loan forbearance adds further pressure. While we expect nonperforming assets to increase, the estimated asset quality deterioration will be masked, to an extent, by the effects of higher loan growth.

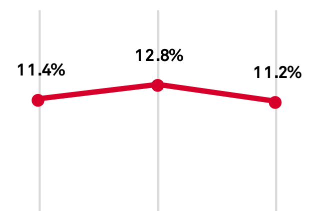
Profitability to remain under pressure. We expect only a moderate improvement in 2021 after a tough 2020, with profitability still much below historical levels. Net interest margins will contract and credit costs will increase due to the various measures implemented by the government to relieve the debt-servicing burden amid COVID-19. We see export-oriented corporates and unsecured retail loans as particularly susceptible to deteriorating asset quality.

Mongolia

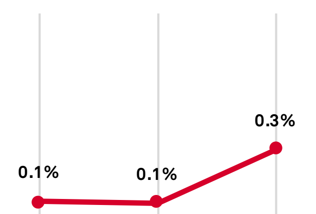
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

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RoAA – Sector-average return on average assets.

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New Zealand | BICRA Group: 4

Good Earnings Headroom Cushions COVID-19 Impact

Key takeaways

- We see a one-in-three possibility that the economic hit to the banking sector could be significantly more severe or prolonged than our base case of a substantial but temporary rise in economic risks.
- We forecast a multifold increase in credit losses for New Zealand banks from the cyclical low levels in fiscal 2019, peaking at about 80 bps of gross loans in fiscal 2021.
- House prices are set to increase, by about 5% in fiscal 2021, driven by historically low interest rates, significant fiscal stimulus, and the regulator's temporary removal of its loan-to-value restrictions.

Key credit drivers

Fiscal and monetary support should soften the blow from COVID-19 driven recession. We expect the COVID-19 outbreak to drive a 5.5% contraction in New Zealand GDP in 2020 before the economy rebounds with 5.2% growth in 2021. The government has announced various stimulus measures, which should support the economy. Moratoriums on loan repayments offered by the banks will also cushion the blow for many borrowers. In addition, timely and coordinated monetary support from the central bank has alleviated bank funding and liquidity concerns, in our view.

Banks are well placed to absorb increased credit losses. We believe that most New Zealand banks retain good headroom within their earnings to absorb our forecast sizable increase in credit losses in conjunction with a significant contraction in interest income. House prices have also been holding up, which should further soften the impact.

High vulnerability to external shocks. Risks remain around the funding profiles of New Zealand banks. The banks' significant dependence on offshore short-term borrowing, the country's persistent current account deficits, and its exposures to fluctuations in commodity prices, all make New Zealand vulnerable to external shocks.

Key assumptions

Twelvefold increase in credit losses. A contracting economy, rising unemployment, and weak consumer and business sentiment will weaken banks' asset quality metrics. We forecast that annual credit losses will peak at about 80 basis points (bps) of gross loans by fiscal 2021, about 12x their historical low in fiscal 2019. In line with our broader economic forecast, we expect that credit losses will ease to about 50 bps of gross loans and advances in fiscal 2022, consistent with our long-term through the cycle expectations.

New Zealand bank subsidiaries to remain core to Australian parents. We envisage no change in the four major New Zealand bank subsidiaries' strategic importance to their Australian parents. This will assist credit quality of these New Zealand banks – which account for over 90% of New Zealand banking industry assets.

What to look for over the next year

Path to economic recovery. The hit from COVID-19 on banks' asset quality will become clearer when moratoriums on loan repayments end on March 31, 2021, and the government reduces fiscal support. We expect that a number of households and businesses are likely to struggle to meet their financial obligations at that time. In addition, we see a one-in-three possibility that the impact of economic downturn due to the COVID-19 outbreak and containment measures on the banking sector could be significantly more severe or prolonged than our base case.

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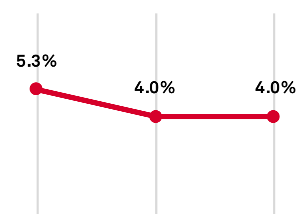
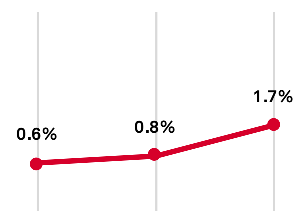
New Zealand

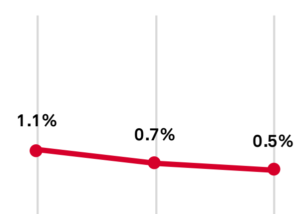
Loan growth



NPA ratio



RoAA



2019a 2020a 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Figures are for fiscal year ending in June

Philippines | BICRA Group: 5

Deep Recession Increases Downside Risks For Banks

Key takeaways

- Economic contraction and tough employment conditions will weaken banks' asset quality, earnings, and capitalization.
- A longer or deeper recession than our forecast could result in substantially higher credit losses.
- Banks' capital and provisioning buffers will help them manage rising risks.

Key credit drivers

COVID-19 pushes economy into deep recession. The economic risk trend for Philippine banks is negative, in our view. We expect the Philippine economy to shrink by 9.5% in 2020 owing to strict lockdown measures and subdued consumer spending.

Corporate and household leverage are manageable. At about 60% of GDP, private sector leverage is moderate, despite rising steadily in recent years. Philippines' household leverage, at 10% of GDP, is among the lowest globally, and lending rates are on a decline, which should support the sector's repayment capacity.

Banks can absorb credit losses. The banking sector's good capital position (15% Tier-1 ratio) and more than 100% provisioning of NPLs provide a cushion against challenging operating conditions.

Key assumptions

Credit losses to stay elevated. We expect the banking sector's credit costs to stay elevated at 1.5%-2.0% of gross loans over 2020 and 2021 compared with the five-year average of 0.4%. The consumer, micro, and SME portfolios will contribute to higher NPLs in the coming quarters. Large conglomerates, with their strong business profiles by domestic standards and good access to liquidity, are better placed to weather the storm. If the recession is longer or deeper than our forecast, this could set off sharper asset quality deterioration for banks, due to potential stress in large corporate book.

Earnings will decline. We expect high credit costs and downward pressure on margins to weigh on the sector's profitability in 2020 and 2021. Any further cut in banks' regulatory reserve requirement could partly mitigate the downward pressure on margins.

What to look for over the next year

Regulatory forbearance will delay true recognition. The effect on individual banks in the coming quarters will be uneven, hinging on their exposure to vulnerable segments and their accounting and provisioning standards. While regulatory forbearance will provide a breather to weaker financial institutions, it will also delay recognition of NPLs and provisioning in some cases.

Economic recovery will be key. This year's recession is likely to impair the debt-servicing ability of consumers, small businesses, and leveraged companies. The extent of the impact on banks depends on the economic recovery and stabilization of credit conditions in 2021. We expect operating conditions for banks and borrowers in the Philippines to improve only gradually, on the back of 9.6% growth in the economy in 2021. These projections assume an eventual flattening of the COVID-19 curve. In our base case, we expect banks' recovery to pre-COVID-19 levels will likely stretch beyond 2022, noting their fairly strong performance prior to the crisis.

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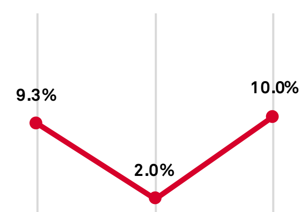
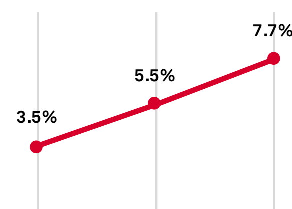
Philippines

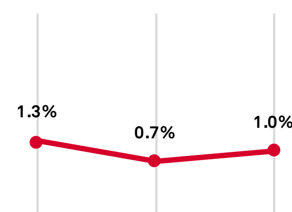
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Singapore | BICRA Group: 2

Defensive Strategy Amid COVID-19 Fallout

Key takeaways

- Singapore banks have pre-emptively raised provisioning and capital buffers ahead of expiry of loan moratoriums.
- Net profit in 2021 will likely be 20%-30% lower than pre-pandemic levels.
- COVID-19 has accelerated fintech adoption in Singapore.

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Key credit drivers

Profitability hit from COVID-19. Profits of Singapore banks will continue to remain under pressure in 2021 due to significant provisioning set aside for expected credit losses from the COVID-19 recession. Ultra low interest rate environment will likely persist and put the squeeze on interest margins. We forecast 20%-30% lower net profit in 2021 compared with pre-pandemic 2019 levels.

Focus on beefing up financial buffers. Singapore banks have raised capital and increased provision coverage to buffer against downside risk. We believe Singapore banks will continue to build buffers in 2021 to defend against higher delinquencies as loan moratorium gradually expires. Even though large domestic banks maintained healthy Tier-1 capital adequacy ratios of about 15%, the regulator have instructed banks to limit 2020 dividends to 60% of the amount paid in 2019 to bolster their resilience.

Key assumptions

Rebound in 2021 after deep recession in 2020. We are forecasting a U-shaped recovery in 2021 with GDP growth improving to 6.3%, after a 5.8% contraction in 2020, before returning to steady-state growth of about 2.5% thereafter. We expect the unemployment rate to increase in 2020 to 2.7% before tapering down to 2.4% in 2021, reflecting robust government measures to protect businesses and save jobs.

Government is highly supportive. We believe the Singapore government is highly supportive of the country's banking system, and will provide timely financial support to ensure stability, if needed. Multiple stimulus packages to support businesses and minimize unemployment have also mitigated the direct impact of COVID-19 on banks.

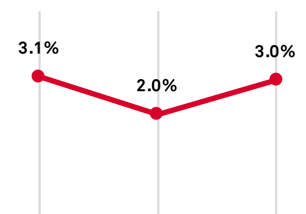
What to look for over the next year

Potentially higher NPL upon expiry of moratorium. The expiry of loans under moratorium, estimated at around 5%-15% of total loans, could lead to higher NPLs in 2021. We are not expecting a cliff effect or NPL spike, unless the recession deepens or drags on beyond our base case. The progressive phase out of the moratorium over the course of 2021, with the longest extension granted to businesses needing the most help, should also smooth the transition.

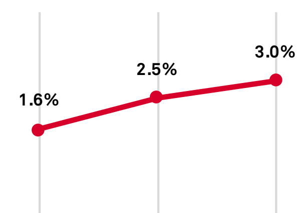
COVID-19 has accelerated fintech adoption. The case for digital banking services in Singapore will become stronger due to COVID-19. A record number of digital banking transactions have taken place during the COVID-19 outbreak, pointing to a strong acceleration in fintech adoption. We believe that consumers who were initially resistant to digital channels are adopting out of necessity.

Singapore

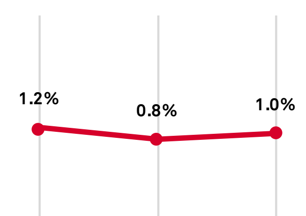
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Sri Lanka | BICRA Group: 10

Strong Increase In Nonperforming Loans Anticipated

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Key takeaways

- The COVID-19 pandemic has accentuated risks facing Sri Lanka's economy and banking system.
- Higher credit costs, lower profitability, and potentially weaker funding profiles will keep the heat on bank performance.
- The system's credit culture could be hurt by frequent regulatory forbearance on loan repayment.

Key credit drivers

Heightened economic risk. We expect weak operating conditions for Sri Lankan financial institutions to persist. The economy entered the pandemic on a relatively weak footing, as growth has been consistently languishing below potential in recent years, due to a confluence of exogenous shocks and intractable political difficulties. Moreover, tourism and export activities declined due to COVID-19, leading to another major blow in 2020. Our forecast growth rate is 4.3% in 2021, after a contraction of 1.2% in 2020.

Elevated external risks for the sovereign. The Sri Lankan financial institutions will not likely be immune to increasing credit pressures on the sovereign. The external profile of the sovereign remains weak, given that the high share of dollar-denominated debt exposes the government to shifts in risk sentiment. Uncertainty over the pandemic and the associated economic fallout have increased Sri Lanka's external financing risks. This could hit the banking sector, although banks in Sri Lanka have limited reliance on external funding compared to the sovereign.

Key assumptions

Profitability to remain subdued. We expect banks' margins to remain under pressure due to low interest rates, subdued business activity, and frequent administrative controls that deter banks from pricing rationally. Rising credit costs emanating from a prolonged economic slowdown and lower margins are set to hurt banks' profitability in 2021. We expect credit costs to be 1.4% of total loans in 2021. This ratio is down from our expected 1.8% in 2020, but remains elevated compared with 90 basis points in 2019.

Asset quality to weaken. Weak operating conditions are already increasing credit risks for Sri Lanka's banks. We expect NPLs to rise to about 8.5% of total loans in 2021 from 4.7% in 2019 and 5.4% as on June 30, 2020. The export-oriented manufacturing sector, already-hobbled tourism, and related sectors such as food and beverages and hospitality will stay stressed. SMEs in particular would be vulnerable because they tend to have weak liquidity. The household sector could also bear the brunt of a slowing economy, lower worker remittances, and higher unemployment.

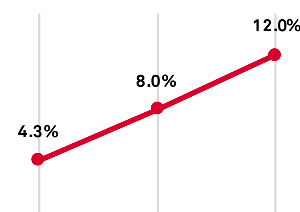
What to look for over the next year

Government and central bank steps to provide some respite. In our base case, we believe steps taken by the government and the central bank--including multiple rate cuts and moratoriums--should provide some respite for Sri Lanka's banks. Since the Easter terrorist attacks in 2019, the central bank has been allowing banks to provide a moratorium (recently extended a further six months up to March 31, 2021) on loans. Regulatory forbearance may delay recognition of bad loans but may not address the problem. In our view, protracted moratoriums could hurt the credit culture of the banking system.

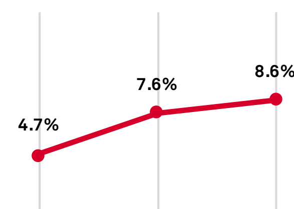
Funding profiles could weaken. Sri Lankan banks are already seeing higher pricing for their external funding, which could hurt profitability. If the external financing conditions of the sovereign deteriorate, investor confidence may weaken and the risk of funding or liquidity stress for banks may increase.

Sri Lanka

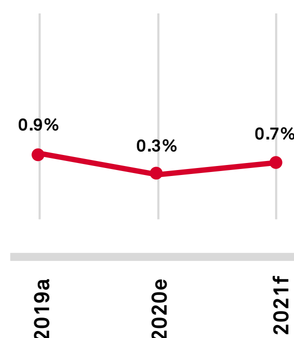
Loan growth



NPA ratio



RoAA



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming loans as % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Taiwan | BICRA Group: 4

Solid Capitalization Provides Buffer

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Key takeaways

- Profitability will only partially recover next year after halving in 2020, by our projections.
- Solid capitalization to provide additional cushion toward higher credit loss and lower profits.
- New virtual banks to speed up fintech development.

Key credit drivers

COVID-19 and the U.S.-China trade dispute. Given Taiwan's high reliance on exports, weak external demand poses risks for Taiwan. We expect that reduced demand due to COVID-19 and the U.S.-China trade dispute will constrain business growth and weaken asset quality in Taiwan's banking sector.

Lower interest rate globally and domestically. Policy rate cuts in the U.S. and some Asian countries will compress interest spreads on foreign-currency loans. Moreover, the Taiwanese central bank's rate cut and high competition in Taiwan will continue to strain banks' net interest margin.

Solid capital buffer. Banks have strengthened their capital over the past few years following regulatory requirements, with the average common equity Tier-1 capital ratio at 12.1% as end of 2019, which would provide an additional buffer to absorb rising credit costs.

Key assumptions

Economic growth should rebound in 2021. We project Taiwan's economy will expand by 3.0% next year after slowing to 1.0% in 2020. Growth will normalize at about 2.5% over 2022-2023. COVID-19 has a lesser impact on Taiwan domestic economic activity compared with peers due to effective containment and mitigation measures. Nonetheless, Taiwan's open economy will still be hit by weak external demand. Accordingly, we expect muted loan growth in 2020, followed by 4.5% growth in 2021. However, there is upside possibility on loan growth in 2020 due to government stimulus and on-shoring of Taiwan corporates.

Government's proactive measures should help. Government relief measures--fiscal stimulus, monetary easing, soft loans, credit guarantees, tax reduction, and compensation to virus-hit businesses--will help support borrowers' debt servicing capacity, in our view.

What to look for over the next year

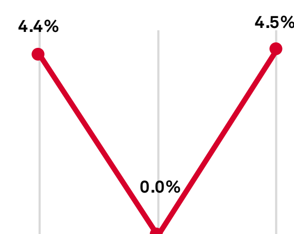
Asset quality metrics to weaken in 2020 and improve by end of 2021. We expect banks' nonperforming assets ratio to weaken in 2020, and improve in 2021 as the disruptions from COVID-19 ease. Nonetheless, loan moratoriums may push NPA recognition into 2021. In our opinion, overall asset quality should remain manageable given the nonperforming assets are increasing from a low base and banks have sufficient provision buffers.

Bottom line will regain some strength in 2021. We project banks' profitability will be slashed by about half in 2020 before recovering somewhat in 2021. Key constraints are enlarging credit costs and policy rate cuts. The volatile capital markets will also add pressure on profitability.

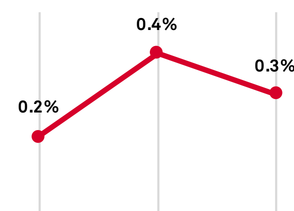
Three new virtual banks to catalyze fintech adoption. COVID-19 has increased digital banking transactions in Taiwan. We anticipate the three virtual banks, set to launch operations in late 2020 and early 2021, will accelerate fintech adoption. Most banks have raised their IT capital expenditure and continue to enhance virtual connections with customers. Nonetheless, these developments are unlikely to change the banking sector landscape over the next two years.

Taiwan

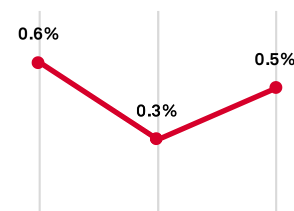
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Thailand | BICRA Group: 6

Weak SMEs And Leveraged Households Pose High Risk

Key takeaways

- Banks in Thailand remain more vulnerable to COVID-19 than Asian peers, given the country's reliance on tourism, and widening economic imbalances. Already high household and corporate leverage add to the risk.
- Government relief measures will mitigate, but not eliminate, downside risks.
- Credit losses will jump to 2.0% of gross loans this year and remain at an elevated 1.7% in 2021.

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Key credit drivers

Heightened economic risk. The global pandemic has hit Thailand hard due to the country's reliance on tourism and exports. The 7.2% contraction in Thailand's economy this year (by our estimates) will hurt the debt-servicing ability of small and midsized enterprises (SMEs) and low-income households. Moreover, it is leading to a buildup in economic imbalances and a further rise in corporate and household leverage, increasing vulnerabilities.

Thailand's high household leverage and banks' SME exposure pose risks. Credit risk is already heightened in Thailand, given very high household debt and corporate debt as well as relaxed bank lending and underwriting standards. Thailand's household leverage, at 79%, is one of the highest among emerging markets. Economic weakness accompanied by job losses in the tourism and general commercial sectors could lead to higher delinquencies. Export-oriented SMEs are also vulnerable in this challenging environment; those competing on cost are getting squeezed out by more efficient manufacturers in neighboring Vietnam and Cambodia. We expect banks' asset quality to plummet in the next 12-24 months and the NPL ratio to rise sharply to 6%, the highest since the 2009 global financial crisis.

Key assumptions

Government relief measures will soften the blow to banks. We believe that steps taken by the government and central bank should reduce the hit to banks. However, Thailand's relief programs could delay recognition for Thai banks vis-à-vis banks in peer countries, where the measures were not as liberal.

Credit losses to remain elevated. In our opinion, temporary relief measures are unlikely to eliminate risks for weaker and more vulnerable debtors, although they may lessen the strain and delay recognition of problem loans. We forecast that credit losses will remain elevated at 1.7% in 2021 after jumping to 2% in 2020 (our estimate), from 1.2% in 2019.

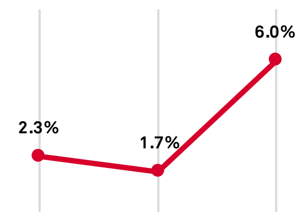
What to look for over the next year

Profitability could decline. Higher credit costs and lower margins, although tempered by cost control measures, will drag down the banking system's return on assets to 0.9% in 2021, from 1.4% in 2019 (and estimated 0.8% in 2020). In our view, banks' good capital levels will continue to provide a cushion. Thai banks have maintained high provision coverage ratios of 144% (as on June 2020), but they are likely to dip into their provisions this year. This, in our view, will somewhat temper the pressure on profitability.

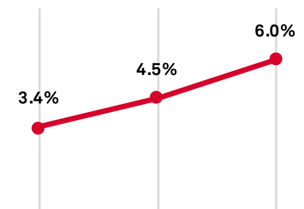
Economic revival is key to credit conditions. We forecast a U-shaped recovery in 2021 with GDP growth of 6.2%. This revival is needed to stabilize credit conditions. A prolonged delay in Thailand's economic recovery would deepen the downside scenario for domestic banks, given high household leverage and the weakness in the SME sector. In our opinion, some banks are more vulnerable to downgrades, if we come to believe their credit costs or loan quality won't meet our base-case expectations. Of the six rated Thai banks, two have been placed on CreditWatch with negative implications, and two have negative outlooks.

Thailand

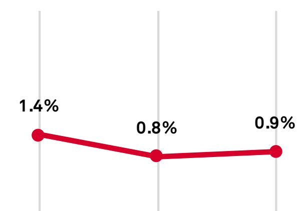
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming loans as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Vietnam | BICRA Group: 9

Banks Will Still Take Provision Hits As Economy Roars Back

Key takeaways

- Vietnam's economy and credit growth will see double-digit rebounds in 2021.
- Lower lending rates to support borrowers affected by the COVID-19-related slowdown, and higher credit costs, will weigh on profitability.
- Low profitability along with thin capital buffers will continue to pose risks for some banks.

Key credit drivers

Deterioration in asset quality over the next 12-15 months. While banks have stepped up provisions in 2020, a sizable chunk is getting pushed to next year due to forbearance. The regulator has directed banks to extend debt relief to affected borrowers, and eased requirements on loan classification and provisioning. Banks can reschedule the principal/interest payments for the affected borrowers for up to a year. One such restructuring is allowed without changing the loan classification. Rated banks had rescheduled 1.5%-4% of their loans by the middle of 2020.

On the wholesale side, small and midsize enterprises are facing higher delinquencies, especially in sectors such as tourism, transport, aviation, logistics, construction, construction material, textiles, and hospitality. Individuals have applied for restructuring due to reduced incomes and consumer confidence amid furloughs, wage reductions, or lost jobs.

Moderation in profitability. We expect Vietnam banks' earnings to be hit by higher credit costs and reduced net interest margins as banks keep interest rates low to support borrowers facing difficulties. Policymakers have also encouraged banks to pass on the rate cuts to borrowers.

Key assumptions

Economic recovery to be quick following a sharp downturn. We forecast GDP growth of only 1.9% in 2020. However, Vietnam's economy is well-placed to achieve a rapid recovery, given domestic mobility is normalizing faster than most other parts of world and the country seems well-positioned to enjoy some lift from improving global trade. We expect growth to rebound to 11.2% in 2021, before settling closer to Vietnam's long-term trend of 6.0%-7.0% growth from 2022 onward.

Credit costs to increase. We expect credit losses of Vietnam banks to double to 130-190 basis points of gross loans due to the COVID-19 fallout. The country has a huge disparity among banks' operating profitability and capitalization; hence, weaker banks are susceptible to high credit costs.

What to look for over the next year

Capital management. Given weaker profitability, Vietnam banks are likely to conserve capital buffers by curtailing dividends and raising capital. Some state-owned banks need urgent help to improve capitalization.

Downside risk. Downside risks for Vietnam banks could emanate from a prolonged reduction in global and domestic economic activity. This would substantially increase credit losses, given the economy is relatively open, has high leverage, and low income. Bank portfolios are yet to fully season after brisk loan growth in the past three to four years.

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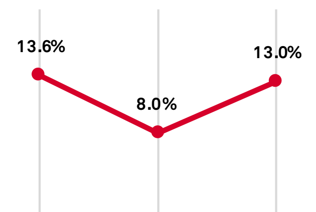
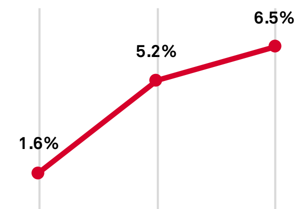
Vietnam

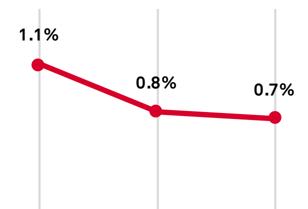
Loan growth



NPA ratio



RoAA



2019a 2020e 2021f

Loan growth – Sector-average growth in loans.

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Appendix

The table below presents S&P Global Ratings' views on key risks and risk trends for banking sectors in countries where we rate banks. For more detailed information, please refer to the latest Banking Industry Country Risk Assessment (BICRA) on a given country. According to our methodology, BICRAs fall into groups from '1' to '10', ranging from what we view as the lowest-risk banking systems (group '1') to the highest-risk (group '10').

BICRA Summary Table

				Economic risk			Industry risk		
Country	BICRA Group	Economic risk trend	Industry risk trend	Economic Resilience	Economic Imbalances	Credit risk in the economy	Institutional framework	Competitive dynamics	Systemwide funding
Argentina	9	Stable	Negative	EH	H	EH	H	H	VH
Armenia	8	Stable	Stable	VH	I	EH	VH	H	VH
Australia	3	Negative	Stable	VL	H	L	L	L	I
Austria	2	Negative	Stable	VL	L	L	I	I	L
Azerbaijan	9	Stable	Stable	VH	H	EH	EH	H	VH
Bahrain	7	Stable	Stable	H	H	VH	I	H	H
Bangladesh	9	Stable	Stable	VH	L	EH	EH	EH	I
Belarus	10	Stable	Stable	VH	VH	VH	EH	VH	VH
Belgium	2	Negative	Stable	L	L	L	I	I	VL
Bermuda	5	Stable	Stable	I	VH	I	I	L	I
Bolivia	9	Stable	Stable	VH	H	EH	VH	VH	H
Brazil	6	Stable	Stable	VH	H	H	I	H	I
Brunei	6	Stable	Stable	I	L	H	EH	I	L
Cambodia	9	Stable	Stable	VH	H	EH	EH	H	VH
Canada	2	Stable	Stable	VL	I	I	VL	L	L
Chile	3	Negative	Stable	H	L	I	L	I	L
China	6	Stable	Stable	I	H	VH	H	H	VL
Colombia	6	Stable	Positive	H	H	H	H	I	I
Costa Rica	8	Negative	Stable	H	H	VH	H	EH	H
Croatia	7	Negative	Stable	H	H	VH	H	H	I
Cyprus	8	Stable	Stable	I	VH	EH	H	VH	VH
Czech Republic	3	Stable	Stable	I	L	I	I	I	I
Denmark	3	Stable	Stable	VL	L	I	I	I	I
Egypt	9	Stable	Stable	EH	H	VH	EH	H	H
El Salvador	8	Stable	Stable	EH	I	EH	H	I	VH
Finland	2	Negative	Stable	VL	L	L	I	L	I
France	3	Negative	Negative	L	I	L	I	I	L
Georgia	8	Stable	Stable	VH	H	VH	H	H	VH
Germany	2	Negative	Negative	VL	VL	L	I	I	VL
Greece	9	Stable	Stable	VH	VH	VH	H	H	EH
Guatemala	7	Stable	Stable	EH	I	VH	H	I	I
Honduras	8	Stable	Stable	VH	I	EH	VH	I	H
Hong Kong	2	Stable	Stable	L	I	I	VL	L	VL
Hungary	5	Stable	Stable	H	H	I	I	H	I

Iceland	5	Negative	Stable	L	H	I	I	H	H
India	6	Stable	Stable	H	H	VH	H	H	L
Indonesia	6	Negative	Stable	H	L	VH	H	H	I
Ireland	4	Stable	Negative	L	H	H	I	I	I
Israel	3	Stable	Stable	I	L	I	I	H	L
Italy	5	Negative	Stable	I	H	H	I	I	H
Jamaica	8	Negative	Stable	EH	I	VH	H	VH	VH
Japan	3	Stable	Stable	L	VL	L	I	H	VL
Jordan	8	Stable	Stable	EH	I	VH	H	H	H
Kazakhstan	9	Stable	Stable	H	VH	EH	EH	VH	H
Kenya	9	Stable	Stable	VH	I	EH	EH	VH	H
Korea	3	Stable	Stable	L	VL	H	I	H	L
Kuwait	4	Stable	Stable	H	I	I	H	I	L
Liechtenstein	2	Stable	Stable	L	L	L	I	I	L
Luxembourg	2	Stable	Stable	VL	I	L	I	I	VL
Malaysia	4	Stable	Stable	H	L	H	I	I	L
Malta	5	Negative	Stable	I	L	H	VH	I	I
Mexico	5	Stable	Stable	VH	VL	H	I	I	L
Mongolia	9	Stable	Stable	H	VH	EH	EH	H	VH
Morocco	7	Stable	Stable	VH	I	VH	I	H	H
Netherlands	3	Negative	Stable	VL	I	I	I	I	L
New Zealand	4	Negative	Stable	VL	H	I	I	L	H
Nigeria	10	Stable	Stable	EH	H	EH	EH	I	EH
Norway	2	Stable	Stable	VL	I	L	I	L	I
Oman	7	Negative	Stable	VH	H	H	I	H	H
Panama	5	Stable	Stable	I	H	I	I	L	VH
Paraguay	8	Stable	Stable	VH	I	EH	VH	VH	H
Peru	5	Negative	Stable	H	VL	VH	L	I	I
Philippines	5	Negative	Stable	VH	L	H	H	I	I
Poland	4	Negative	Negative	H	L	I	I	H	I
Portugal	6	Stable	Stable	I	H	H	I	H	H
Qatar	5	Stable	Negative	I	H	I	I	I	H
Russia	8	Stable	Stable	VH	H	VH	VH	H	H
Saudi Arabia	4	Stable	Stable	H	I	I	I	I	L
Singapore	2	Stable	Stable	VL	I	I	VL	L	L
Slovenia	4	Stable	Stable	I	I	H	I	I	I
South Africa	6	Negative	Stable	VH	H	H	I	I	H
Spain	4	Negative	Stable	I	I	I	I	I	I
Sri Lanka	10	Stable	Stable	VH	VH	EH	VH	VH	VH
Sweden	2	Stable	Stable	VL	I	L	I	L	I
Switzerland	2	Stable	Stable	VL	L	L	L	L	L
Taiwan	4	Stable	Stable	I	L	I	I	VH	VL
Thailand	6	Negative	Stable	H	L	EH	I	H	L
Trinidad and Tobago	6	Negative	Stable	VH	I	H	H	H	L
Tunisia	10	Stable	Stable	EH	H	EH	EH	H	VH
Turkey	9	Negative	Negative	H	VH	VH	VH	VH	VH
U.K.	3	Negative	Stable	L	I	H	I	I	L
U.S.	3	Negative	Stable	VL	L	H	I	I	VL

Ukraine	10	Stable	Stable	VH	VH	EH	VH	VH	VH
United Arab Emirates	5	Negative	Negative	L	H	H	I	H	I
Uruguay	6	Stable	Stable	H	L	H	H	H	H
Uzbekistan	8	Negative	Stable	VH	I	VH	EH	H	VH
Vietnam	9	Stable	Stable	VH	H	EH	EH	VH	I

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)

Data as of Oct. 27, 2020. Source: S&P Global Ratings.

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