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Covid-19 policy impact on the global banking sector: Europe, North America, Asia-Pacific and Gulf Sectors

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Abstract

Covid-19 impact on Economy

There is a big shift in the world economic market and the share market has witnessed crashes day by day. Factories, Restaurants, Pubs, Markets, Flights, Super Markets, Malls, Universities and Colleges etc. were shut down. Fear of corona virus has limited the movement of the individuals. People were not even going to buy the daily essentials and these all were somewhere impacting the economy of the world as a whole. The Organization for Economic Co-operation and Development (OECD)reveals that they have cut their expectation for global growth to 2.4% from 2.9%, and warns that it could fall as low as 1.5%.

Data used

Bloomberg analytics studies, S&P Global market intelligence, Thomason Reuters Eikon and various financial newspaper articles, internet etc.

Objective of the study

In this study paper we are trying to analyse the impact of devastating effects of COVID-19 on businesses, commercial banks currently have the issues of Cash Reserve Ratio (CRR) obligations to grapple with. CRR is a mandatory part of a bank's total deposit expressed in percentage, which a bank must maintain with the apex bank at all times, and subject to change at the discretion of the regulator.

Disclaimer

Various research papers has been used for reference of global impact analysis of Corona virus on banking sector.

Keywords

CRR, Credit downgrade, asset quality, Capital Relief Measures, Including Reduction in Minimum Capital Requirements, Temporary Relaxation of Pillar 2A, No Countercyclical Capital Buffer, Relaxation of Capital Conservation Buffer, Treatment of Restructured Credit Exposures, Including Payment Holidays, Don't Require Higher Capital Requirements, Temporary Relief of Liquidity Coverage Ratio Requirement.

Introduction

COVID-19 is an unprecedented calamity on human beings, society and the world in general. This pandemic has already taken several hundred thousand lives and has impacted human health across the globe. The pandemic has also given a massive jolt to the global economy. Consumption is declining. Industrial production is nosediving. GDPs of all major nations are falling. Unemployment is increasing. Interest rates are falling. Development projects are getting deferred. Workforce productivity is dwindling. Stock markets are collapsing. Supply chains are getting shattered. Overall the global economy is staring at a big recession. This is the biggest challenge we are facing after the great depression of 1930's. Being a key sector of the economy, banking and financial services industry has been affected tremendously. Organizations are struggling to keep vital services up and-running. Revenues are contracting. Cost reduction pressure is increasing. New forms of financial crimes such as fraud and cyber security are erupting. Liquidity risk is growing. Workforce productivity has reduced due to remote working. At the same time, new workload is getting added to manage relief package activities. Finally, on regular basis global regulators are providing new guidelines, and revised compliance obligations are being enforced.

The objective of this paper is to examine the adverse effect or debilitating events of covid-19 on the banking sector.

70% of banking sector debt affected by Covid-19 impact. A report by the Reserve Bank of India notes that the pandemic "has affected the best of companies" and businesses that were otherwise viable before the outbreak.

Covid-19's adverse impact on bank debt. The pandemic has impacted 19 sectors with Rs 15.5 lakh crore of debt which were not under stress before Covid-19 outbreak.

Covid-19 has disrupted global supply chains and this is generating spill over effects throughout different levels of supplier networks. Global trade in 2020 will fall in every region of the world, and will affect all sectors of the economy. This will impact countries that are strong exporters (no output for their local companies), but also those that are importers (lack of raw materials). The World Trade Organization (WTO) expects global trade to fall up to 32% this year due to the coronavirus pandemic.

From America to Africa all the banks are affected due to Covid-19. In African subcontinent, Nigeria is an oil rich country and in Nigeria the Top five banks; First Bank, UBA, GT Bank, Access Bank, and Zenith Bank suffered a N1.9trillion debits in CRR sequester in the second quarter, between April and June 2020. The banks have a total customer deposit (excluding subsidiary balances) of N18.26 trillion, thus CRR debits represented about 35.9 per cent of their total customer deposits as of June. The development has become a source of worry to stakeholders in the banking sector.

Challenges faced by the banking sector

As evidenced by the immediate measures taken by regulators to ease restrictions on liquidity and capital, banks are providing an important social good to economic actors and individuals in this time of crisis.

Although support measures introduced by regulators have certainly helped banks fill this role, they still face some immediate pressures on their capital and liquidity position, as the length and severity of this outbreak remain uncertain. These include:

1. Potential draw-down on credit facilities by clients

Banks play a critical role to ensure the availability of funds is sufficient to support individuals and businesses without jeopardizing their own liquidity position. As a result, banks may need to recalibrate their existing liquidity stress models to cater for sufficient capital if significant drawdown of loan facilities is required.

2. Revision to loan loss provision estimates

As the economic outlook remains highly volatile, expected credit losses previously calculated will need to be revisited to account for the uncertainty and scale of the pandemic. Banks is likely to witness an increase in their expected loan loss provision.

3. Additional capital requirements to maintain capital adequacy ratio

The economic downturn will likely see a rise in non-performing loans. Banks may have to perform a reassessment on their existing loan portfolio to account for any increase in credit exposure and to allocate more capital to address the higher credit exposure.

4. Compressed net interest income margin

The HKMA lowered its base rate to 0.86% in March 2020. Although the cost of funding will be lower, the yield on banks' asset may also decline mainly due to the increased competition in mortgage loans and flight to safety to investment grade assets. The impact will further compress banks' net interest margin and profitability.

The crux of the matter is that length of the crisis and the depth of its severity is still unknown both locally and globally. In the end, actions taken by regulators are meant to be temporary facilitative measures. While regulators will not suspend the measures overnight or without due warning, banks should be planning ahead for a return to normality. They should also be preparing for any adjustment to a new normal – we expect that regulators will be taking stock of what worked, and what did not, during this crisis. Banks can expect a certain amount of adjustment following the crisis as regulators fine-tune their approach and requirements on financial stability.

Asia Pacific Banking Sector

Asian banks are set for a slow revenue recovery in 2H, though provisions may remain the biggest swing factor and key differentiator for earnings outlooks, especially as moratoriums and regulatory relief get withdrawn in stages. Low interest rates and a weak economic backdrop is likely to remain a drag on lending and fee income, even though credit growth could recover faster in some countries, such as China and South Korea, than others. Margin and provision risks are likely to extend well into 2021 for most markets, more acutely for Hong Kong, Singapore, South Korea and Japan. Indian and smaller Chinese banks may raise fresh capital.

Banks' credit spreads, having tightened across the region, may be at risk from a second wave of virus contagion impacting economic recovery, loan moratoriums ending, and revenue headwinds in 2H. Regulatory forbearance and moratoriums on loan and interest repayments will play a huge role in delaying the impact of the Covid-19 pandemic and resulting borrower stress on Asian banks. While it's conceivable that moratoriums may be prolonged, they remain milestones in assessing bank asset quality stress across key Asian markets.

1. Governments, Regulators Lower Funding Costs

As a lack of last-mile credit availability may further deepen the economic recession, governments and central banks across most Asian markets are trying to incentivize banks to lend and lower borrowing costs for cash-strapped small and medium-sized enterprises (SME). Most Southeast Asian regulators are providing lower interest loan facilities to banks to encourage credit disbursement. India's RBI special refinance facility and TLTRO 2.0 operations of 500 billion rupees each aim to assist funding requirements and soften the liquidity crunch of agriculture and rural and cooperative banks, non-banking financiers, small industries and housing financiers.

While the Philippine's BSP doesn't have a special fund for SMEs, an April ruling allows lenders such as BPI, BDO and Metrobank to count SME loans toward reserve requirements.

2. Philippines, Thailand, Malaysia Could Extend Loan Moratoriums

Banks across key Asian markets are likely to reflect the true impact of Covid-19 once the moratorium and support measures are lifted, though it's likely the Philippines, Thailand and Malaysia may extend these timelines. Banks operating in Singapore, India and other Asian countries, including DBS, HSBC, Standard Chartered, OCBC, Maybank and CIMB, have extended differing forms and durations of relief measures to borrowers impacted by the virus. Lenders in most nations have offered debt payment deferral ranging from two to nine months while Indonesia allows all loan segments to be restructured for up to a year. Some banks also offered credit-card interest reduction and the option to convert outstanding balances to term loans.

Debt moratoriums refer to the suspension of loan obligations (principal/interest) for a limited period.

Market	Loan Segment	Relief Type	Duration, months	Start Date	End Date
India	All term loans	Debt payment deferral	6	1-Mar-20	31-Aug-20
Philippines	Covers all loans due within Enhanced Community Quarantine Period	Debt payment deferral	2	2-Apr-20	31-May-20
Indonesia	All segments	Restructuring	12	1-Apr-20	31-Mar-21
Malaysia	Hire Purchase	Debt payment deferral	6	1-Apr-20	30-Sep-20
	Fixed rate Islamic financing	Debt payment deferral	6	1-Apr-20	30-Sep-20
	Loans to Individual (such as mortgage, personal loan, overdraft, education, SME, ASB loan)	Debt payment deferral	6	1-Apr-20	30-Sep-20
	Loans to SME	Debt payment deferral	6	1-Apr-20	30-Sep-20
	Credit Card	Reduced interest rate, conversion to term loans	Convert to 3-year term loan	1-Apr-20	30-Sep-20
	Corporate Loan	Debt payment deferral, Restructuring	6	1-Apr-20	30-Sep-20
Thailand	Hire Purchase	Extend principal and interest payment for 3 months or principal payment freeze for 6 months	6	1-Apr-20	30-Sep-20
	Home Loan	Principal payment freeze for 3 months and consideration for reduction in interest per customer	3	1-Apr-20	30-Jun-20
	SME	Principal payment freeze for 3 months and consideration for reduction in interest per customer	6	1-Apr-20	30-Sep-20
	Credit Card	Reduced interest rate, conversion to long term loans	n.a.	1-Apr-20	n.a.
	Personal Loan	For commercial banks and SFIs: extend principal and interest payment for 3 months For other financial institutions, choose between: Extend principal and interest payment for 3 months or reduce instalment amount at least by 30% for 6 months	3	1-Apr-20	30-Jun-20
Singapore	Home Loan	Defer either principal or both principal and interest	9	6-Apr-20	31-Dec-20
	Personal Loan	Convert to reduced interest rate term loan	9	6-Apr-20	31-Dec-20
	SME	Defer principal payment, lower interest on loans	9	6-Apr-20	31-Dec-20
	Motor Vehicle, Hire Purchase	Debt payment deferral	8	6-May-20	31-Dec-20
	Renovation and Education Loan	Debt payment deferral	8	6-May-20	31-Dec-20
	Industrial, Commercial Property Loan	Debt payment deferral	8	6-May-20	31-Dec-20

Source: Bloomberg: ASEAN, India Debt Moratoriums by Market

3. Yes Bank's Moratorium Loans Share Leads Private-Sector Lenders in India

Yes Bank's 35-45% share of its loan book value under moratorium was the highest among private- sector banks as of fiscal 4Q ended March. ICICI Bank followed with 30%, Axis at 28%, and Kotak Mahindra and HDFC Bank, both at 26%. This compares with some public sector banks such as Bank of Baroda and IDBI Bank, with about 65-70% of their loan books under relief measures. SBI, Punjab National, and Canara Bank were lower at 17-30%. The Reserve Bank of India (RBI) recently extended its debt moratorium by another three months until end of August on installment payments of all term loans outstanding as of March 1, 2020.

An estimated 39% of India's banking system loans are now under moratorium, according to RBI data.

4. Thai Banks May Offer Relief beyond Minimum

Thailand's financial institutions including lenders Siam Commercial, Kasikornbank, Bangkok Bank and MUFG-owned Krungsri may extend relief packages beyond the minimum moratorium period set out by the central bank. These measures extend to all retail and SME lending segments and are eligible for borrower's affected by Covid-19 with no negative credit history. Lower credit card minimum repayment to below 10%, loan repayment holidays, higher temporary credit limit for personal loans, and interest and fee reduction are some of the other measures to assist borrowers. Bank of Thailand's relief measures are effective for two years until December 31, 2021.

Sector-wide loans outstanding under relief measures stood at 4.6 trillion baht as of 8 May, about 28% of total 1Q nationwide lending.

5. Indonesia Permits Loan Restructuring

Indonesia allows the restructuring of all loans that were in performing-loan status as of March 31, have been directly or indirectly impacted by Covid-19 and are not on the national blacklist. Lenders including Bank Mandiri, BRI and BCA can restructure loans using payment rescheduling, interest deferral or discount, extension of additional loans or a combination of these. Asset-quality assessment has also been relaxed to allow banks to manage their nonperforming loans for debtors with loans of up to 10 billion rupiah, with those above the limit to adhere to existing asset-quality determination rules stipulated by OJK. These relief measures are applicable until 31 March 2021.

Sector-wide restructured loans stood at 655.84 trillion rupiah as of mid-June, about 11% of total 1Q nationwide lending, up from 2% at end-April.

6. Lending Outlook Bright in Some Countries, Dismal in Others

Credit growth's outlook is relatively bright in China, Hong Kong and South Korea, yet remains dismal in Japan and Australia, based on consensus. Large Chinese banks' lending could resume high-single-digit gains in 2021 after 2020's rough patch as fiscal stimulus and recovering consumption boost demand. South Korea could see mid-single-digit lending growth, similar to this year's, underpinned by China's comeback from Covid-19 and global demand for high-tech exports. Lending in Hong Kong could rise 5.2% on average in 2021 vs. about a 1% decline in 2020, assuming fading anxiety over Beijing's security law.

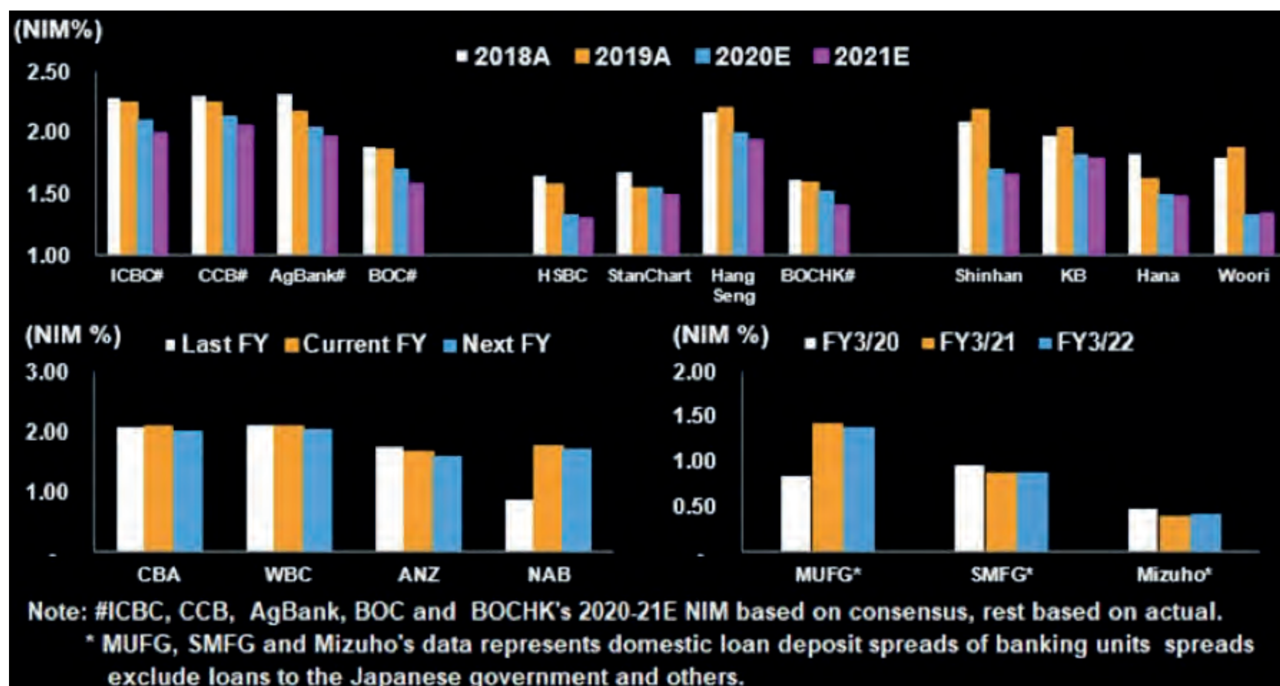
Japan megabanks' loan outlook hinges on emergency lending and the Olympic games, while consensus expects 1.4% average growth in fiscal 2022. Tension with China and a recession may limit Australian bank loan gains to 1-2%.

7. Banks' Margin Woes to Persist in Northern Asia, Australia

Northern Asian and Australian banks we track face lingering margin woes as a near-zero Fed rate keeps their policy and market rates in the doldrums. Fed chairman Jerome Powell's June 11 statement suggests low rates may stick around through 2022. Margins at ICBC and the other big three Chinese banks may lose 9-10 basis points in 2020, we believe, followed by a smaller contraction in 2021 as falling asset yields are partly offset by lower funding costs. Low cash rates may cut 6 bps off Australian lenders' margins in fiscal 2021. Loan spreads at Japan's megabanks may shrink 3-4 basis points on lower global asset yields.

Margins at Hong Kong lenders, led by HSBC, may face an average 14-bp narrowing in 2020, followed by another 7-bp contraction in 2021. Korean lenders' margins may keep shrinking after 2019's average 9-bp decline.

Margin Forecast, Large Asian Banks



Source: Company Filings, Bloomberg Intelligence

8. DBS Has More to Lose Amid Sibor Plunge

Net interest margins at Singapore lenders, led by DBS, are likely to decline by more than 10 bps as the Singapore interbank offered rate has compressed 134 bps since January. The U.S. Fed's 150-bp interest rate cut may keep rates suppressed. DBS, with Singapore's largest retail deposit base, stands to lose more than peers as lower interbank rates undermine its funding advantage against smaller domestic and foreign banks. Three-month Sibor's 134-bp decline compares with a 166-bp contraction in Libor this year.

DBS's deposit base is stronger than OCBC and UOB's, and has the highest proportion of current and savings deposits, partly from its 1998 acquisition of POSB. Standard Chartered and Maybank have substantial business in Singapore.

9. Malaysian Banks' Net Interest Margin to Compress on Low Rates

Malaysian banks' net interest margin may decline further this year by at least 10 bps as lenders are likely to pass on lower loan yields to customers following the 100 bp rate cut through May. Lower funding costs may partly ease the compression.

10. Vietnam Prosperity Bank Senior 2022 Yielding 6.3%

Vietnam Prosperity Bank is the only Vietnamese bank to currently have a dollar senior bond outstanding. It carries a B1 Moody's rating and has few comparables in Asia.

Vietnamese banks are challenged on governance - its state capitalist system is often compared to China's at an earlier stage - and have low capital ratios and suspect asset quality. But banks have robust domestic liquidity and are not reliant on borrowing in dollars, thanks to the country's current-account surplus. Vietnam is vulnerable to a trade shock but remains attractive for FDI. Vietnam also flattened its Covid-19 curve very early.

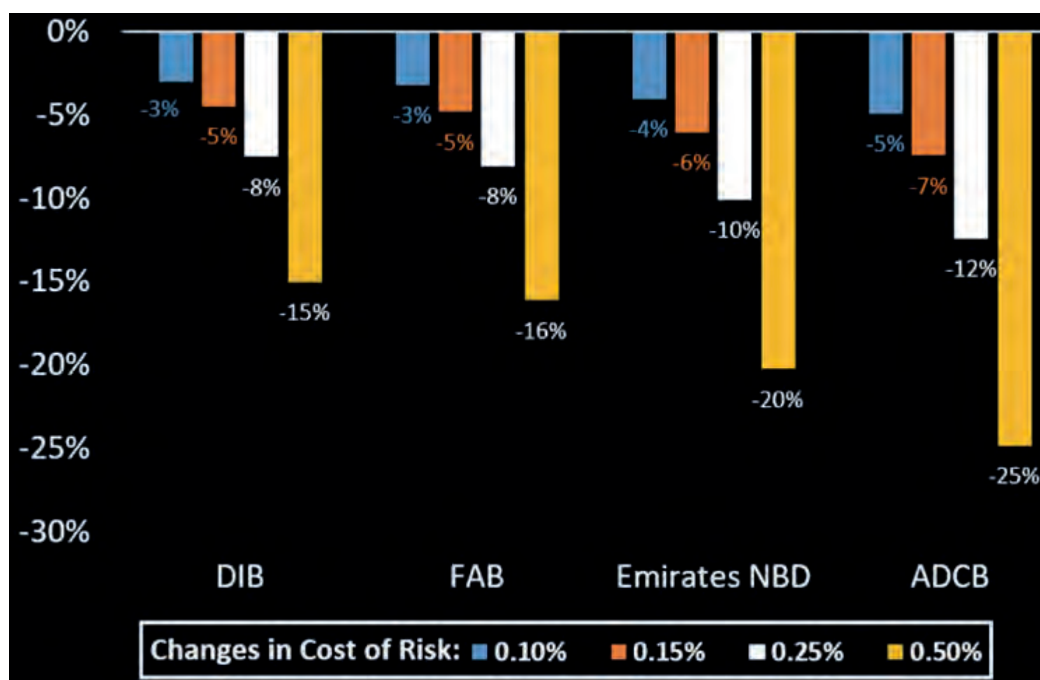
Gulf Banking Sector

Gulf banks with high-quality asset exposure and diversified business are better-placed to weather a rocky economic outlook, our research shows. They've also shown lower earnings sensitivity to cost- of-risk changes vs. banks with a heavy private-sector focus. A slow economic recovery raises asset- quality pressure, forcing banks to shore up provisions.

Lower interest rates, weak private-sector demand and reduced retail purchasing power put Gulf banks with higher exposure and closer ties to government entities in a better position to navigate the challenging economic climate vs. peers with a heavy private-sector focus. High-quality government assets make up 28% of FAB's total loan book, along with QNB (36%) and Al Rayan Bank (49%). These assets are capital-efficient and attract no credit charges. Conversely, Emirates NBD's 35% loan-book exposure to the Dubai government and its related entities is seen as a drag rather than a benefit, given its indebtedness and potential distress in a prolonged downturn.

Uncertainty over the broader effects of the coronavirus on the UAE's economy and Expo 2020 makes sensitivity analysis judicious to demonstrate potential increases in cost of risk (CoR) for the four largest banks -- given CoR is a forward-looking assessment of credit losses and the ensuing drag on earnings. The result of our scenario analysis is that changes in CoR of 10-50 bps would affect ADCB's earnings' most, followed by Emirates NBD. FAB and DIB have similar sensitivities.
Research shows the aggregate drag on the four largest UAE banks' earnings would be 4 percentage points for a 10-bp increase in CoR, 6 percentage points for 15 bps, 9 percentage points for 25 bps and 19 percentage points for 50 bps.

UAE Banks' Profit Sensitivity to Cost of Risk



Source: Bloomberg

1. Exposure, Provisions and Liquidity Vary

Falling oil prices and the coronavirus pandemic's effect on key events in Saudi Arabia (such as the pilgrimage season) are uncertain, but could curb transactions, remittances, hospitality and corporate activity, we believe. Our analysis enabled us to give a low ranking -- indicating a better position -- to those Saudi banks with less exposure to affected sectors. Higher capital and provision coverage gave similar benefits. Fewer branches and a lower presence in holy cities were also favored, along with ample liquidity and reduced profit sensitivity to cost-of-risk changes. Rajhi has many branches, yet its coverage, liquidity and low-sector exposure help its ranking. NCB has high branch numbers and is involved in affected sectors, but gains support from exposure to oil-importer Turkey, as well as solid liquidity and coverage.

2. Virus Shock and Oil Drop to Mean Devastating Saudi Recession:

Saudi Arabia's continued reliance on oil and its price collapse are bringing back memories of the post-2014 slump. The pandemic is adding to the pain. Under our base case scenario, we expect a rising number of bankruptcies, layoffs and departing foreign workers to result in an economic contraction of 4.7% this year.

3. South Africa Banks' Recovery Derailed by Escalating Virus Threat

The social threat from the Covid-19 pandemic continues to escalate in South Africa, which is being compounded by a sharp economic downturn. Economists -- based on consensus -- now expect a 7-8% GDP contraction this year, with Bloomberg Economics forecasting 9% shrinkage. Perhaps more worrying is the meager 2-3% recovery anticipated next year, which if correct, would wipe out all the economic uplift in the country since 2014. In a bid to contain the virus' spread, the government has imposed some of strictest lockdown measures globally, but the rules are taking a heavy economic toll. Unemployment rose to a decade-plus high of 30.1% in 1Q, marking the first time it has passed the 30% mark, and remains on an escalating trajectory, from about 27% in early 2019.

In a bid to stem the worsening economic conditions in the country, the South African Reserve Bank has cut policy rates by a combined 275 bps year-to-date, bringing it to a multi-year low of 3.75%. Yet that may not be enough to lift the economy without a corresponding fiscal stimulus. However, the government has limited flexibility given its already high budget deficit (expected to rise above
10% GDP), with the risk debt-to-GDP will exceed 100% by 2025 vs. less than 60% last year, according to latest government projections.

Lower policy rates are an additional blow to bank profitability, through margin squeeze drags on revenue prospects. That will add to rising credit impairments as the economic outlook deteriorates.

4. Slow Recovery May Trigger 15-25% Profit Cuts for S. Africa Banks

A near-halving of the South African banks' share index since the spread of Covid-19 wiped out eight years of gains, highlighting the dire earnings prospects for lenders. That's driven by plunging GDP growth, lower policy rates and rising unemployment. All this is in sharp contrast with the country's wider all-share index, which similarly plunged in March (about 30%), but has subsequently recovered almost all those losses, suggesting a near-40% underperformance of banks vs. the market in just four months.

5. Virus Threat Not Yet Contained

Despite imposing some of the strictest lockdown measures globally, South Africa remains the worst-affected African nation from the pandemic to date, with 373,628 cases and 5,173 deaths reported as of July 21. With the country already in recession before the virus struck, the subsequent collapse in demand, rising unemployment and large-scale business closures mean the operating backdrop for South Africa's largest banks will remain weak for potentially years to come.

6. Regulatory Easing Across Gulf, S. Africa Eases Strain on Banks

Emergency relief measures by regulators across the Gulf and in South Africa should ease capital and liquidity pressures on local banks, and should ensure banks can keep credit lines open, supporting domestic businesses. Strong capital ratios support that, but we do see risk to South Africa banks' dividends, which may be cut, or postponed this year.

7. Green Light to Release Capital Buffer Aids Some

The central bank's decision to reduce emergency buffers makes more capital available on bank balance sheets, as it cut the core capital requirement (including conservation and systematic importance) buffers to 8% (vs. about 10% for BI peers), per our calculation. This positions banks to support private sector and real estate lending. We believe this is particularly supportive for banks that have already hit their limit of 20% exposure from risk weighted assets. An increase in real estate exposure to 30% is now allowed, but at the cost of more capital.

8. More Liquidity to Support Corporates Is a Gift to Saudi Banks

The Saudi central bank (SAMA) has provided additional liquidity of 50 billion riyals to the banking sector to support loan restructuring and relief measures for the corporate sector. SAMA provided 30 billion riyals previously at no cost to offset the dilution on banks' margins from relief repayments offered to SMEs, of which about 70% was utilized in 1Q. Yet SME lending makes up a small part of banks' exposure, meaning that more support for other sectors is needed as asset- quality pressure accelerates. SAMA supported the banking sector by extending the liquidity program that's expected to be at zero cost and helping sectors beyond SMEs. If this is treated similar to SME grants, then uptake will be high and lenders can account for 1.7x this liquidity in their statutory loan-to-deposit ratio of 78.5% vs. the 90% threshold.

9. U.A.E. Central Bank IFRS 9 Filter Is a Gift to Troubled Banks

The U.A.E. central bank's temporary change to the IFRS 9 framework that any provision increases will be partially added back to regulatory capital is an important step, in our view. The change will be phased in over five years, with additional disclosures on its impact under Basel III reporting Pillar 3. As this filter will apply to any increases in provisions from December 2019, this could also bring relief to capital not only from Covid-19 but also from the existing pressure on cost of risk from the troubled real-estate sector. Measures announced on April 5 also support banking, particularly the extension of zero-cost funding that will increase the level of liquidity -- which is already comfortable -- within the system by reducing the reserve requirement vs. demand deposit and cut short-term liquidity ratio requirements.

Further Measures by U.A.E. Central Bank to Combat COVID-19:

- Prudential Filter to IFRS 9 Expected Credit Loss Assessment That Partially Adds Back Provision Increase to Capital and Phase It Over 5 Years
- Cut by Half Reserve Requirements Against Demand Deposit at Banks from 14% to 7%
- Extended Holiday Repayment and Interest Waiver Until End of 2020 and Capital Buffer Relief Until End of 2021
- Extended Zero Cost Liquidity Facility to Support SMEs Until End of 2020
- Banks Can Utilize Third of Liquidity Buffers. Min. LCR Was Cut to 70% from 100% and Eligible Liquid Asset Ratio to 7%

10. Kuwaiti Banks

Kuwaiti banks' strong provisions and capital buffers position them well to navigate challenges, but the revenue drag may be deeper than peers as Kuwait's central bank didn't compensate local lenders by offering an interest-free liquidity window -- unlike in the UAE and Saudi Arabia. Domestic banks have been voluntarily extending relief measures, easing the burden on the private sector, including deferring payments on personal loans, credit cards and small-business loans for six months vs. three to ease the burden amid Covid-19. Yields will be lower on banks' earnings assets, and revenue may be hurt by waiving related fees.

The central bank did create a subsidy program for SMEs' interest payments capped at 2.5%. It also cut the stringent liquidity and capital requirements to incentivize banks on better risk-adjusted returns.

11. Which Peg Is Exposed to Oil Rout? A Mideast Scorecard

Oil prices are facing a toxic mix: a massive collapse in demand due to the coronavirus and a deluge of supply as producer's flood the market. Who is most vulnerable in the Middle East? Bahrain appears to be the most exposed. It has the largest external and public debt as well as the widest budget deficit and the lowest reserves. It also has the second-highest external breakeven oil price. The analysis shows Oman, Iraq and already-struggling Iran are also fragile.

At the other end of the spectrum, Qatar, the U.A.E., Saudi Arabia and Kuwait appear more robust. They benefited from building up their international reserves and reducing debt during the oil boom of 2003-14.

Oil Vulnerability Scorecard

	Bahrain	Oman	Iraq	Iran	Qatar	U.A.E.	Saudi Arabia	Kuwait
External Breakeven Oil Price ($, 2020)	81.1	72.2	59.4	87.7	50.4	32.4	55.3	50.4
External Debt (% GDP, 2019)	192.9	105.6	32.2	2.4	107.6	72.6	30.4	45.5
Official Reserves (Months of Imports, 2019)	1.0	5.3	7.7	14.3	8.4	4.0	26.4	7.0
Fiscal Balance (% GDP, 2019)	-8.0	-6.7	-2.4	-4.5	7.0	-1.6	-6.1	6.7
Public Debt (% GDP, 2019)	101.7	59.9	51.1	30.7	53.2	20.1	23.2	15.2
Vulnerability Ranking (1 = Most Vulnerable)	1	2	3	4	5	6	7	8

Source: Bloomberg

12. Volume Weakens as Expatriates Drop, Enforcement Softens

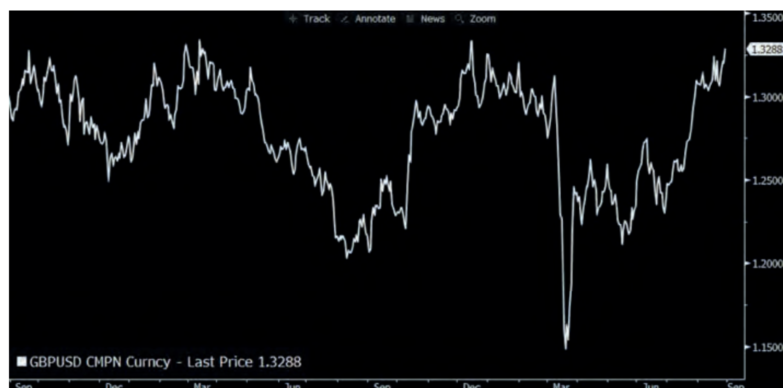
Medical-insurance enforcement raised the number of insured Saudi nationals by 293,000 in 2019, offsetting the 248,000 drop in insured expatriates. The Saudi takeup may weaken, while insured expatriates could fall further on private-sector pressure and softer enforcement. Total beneficiaries amount to 10.5 million vs. 1.14 million in 2019, the latest Saudi Council of Cooperative Health Insurance data show, largely due to a 9% drop in overseas workers as of June 25. Coverage was effective in 2013 for private-sector expat workers when their work permits were renewed, but for Saudis in the private sector, the enforcement started just over two years ago.

European Banks

Risk from a second wave of Covid-19 and further lockdown measures likely won't deter Europe's banks from aggressively attacking costs and headcount in 4Q and 2021. Regulatory scrutiny of variable compensation will be extremely high, with greater use of deferrals and stock payments helping to compensate for lower absolute payouts in 2020.

Dollar weakness -- while eroding some of the revenue power delivered by fixed income and equities trading at Barclays -- may perversely enable the bank to pay higher dollar bonuses in 2020 and manage its cost base of about 13 billion pounds. The greenback remains key for HSBC as well, which as a dollar reporter with an outsized sterling cost base, will need to aggressively cut U.K. expenses to avoid falling behind targets, with new medium-term financial goals and -- we suspect -- a new cost plan due with full-year results.

Dollar-Sterling Exchange Rate



Source: Bloomberg

1. HSBC Cuts Start With $3.3 Billion Variable Pay, Senior Bankers

Staff reductions, and employee compensation and benefits at HSBC -- $8.5 billion in 1H20 vs. $9.3 billion in 1H19 -- will be sensitive but critical levers for management to deliver on 2022 targets, and will likely begin in earnest with the upper echelons of the bank. Delivering a 35,000 promised headcount reduction -- out of 235,000 at year-end 2019 -- with further cuts inevitable as digital banking takes a greater hold, will likely focus on senior managers and Global Banking and Markets to start, though retail networks will take an increasing share of the burden in coming years.

CFO Ewen Stephenson noted on the 2Q call that headcount was down 3,800 in 2020 and 8,300 (including contractors) in the last 12 months. Variable compensation in 2019 cost $3.3 billion, and will be a key source of savings.

2. Trading Outlook: Slowdown is Coming

Two critical questions for wholesale- and investment-banking bosses is how quickly the trading environment normalizes after a bumper 1H and how to remunerate top performers, as 2020 regulatory scrutiny grows. JPMorgan's CEO commented on the 2Q call that investment-banking revenue would normalize or fall below a normal run rate in the coming quarters. The bank's assessment of the 2Q trading environment reflected the improvement in conditions, to a lesser or greater degree globally, experienced by banks in April, May and up to mid-June.Improved liquidity -- as both market confidence and vast government rescue programs grew -- after March's sharp shock has buoyed trading across fixed income, with the picture for equity derivatives much more mixed, though cash equities flows have, by and large, improved across the board. it was only later in June that activity began to revert to more normal levels. We saw strength across products and regions from both, flow trading and large episodic transactions. While strong client activity was a continuation of the first quarter theme, our market-making activity this quarter benefited from improved market liquidity and we were able to better monetize flows.

3. Covid-19 Banker Reprieve to Prove Only Temporary

HSBC continues to lead the charge on restarted redundancy programs, having noted at 2Q that it would deliver about $800 million of the promised $1 billion of savings in 2020 after a suspension in job cuts. The direction of sterling also remains a driver with significant volatility recently, which could impact absolute savings delivered as HSBC has an outsized sterling cost base and reports in dollars, and this metric is also key to Barclays' cost base. Deutsche Bank, UniCredit, Societe Generale and BNP have material cost-reduction plans in place that were discussed in detail at 2Q and likely stepped up into 2021.
Medium-term, the pace of branch closure, unlayering of excessive levels of management and organizational simplification will accelerate as, once again, the frailty of European banks' profitability is exposed.

4. Cost-Income Consensus to Improve

The focus of investors and management on bank cost-income ratios has been increasingly fruitless in recent years, as sliding revenue, combined with restructuring and investment spending, has rendered most targets redundant. This remains the case in 2020 though we expect that as banks revisit and update near- and medium-term return on capital and efficiency targets at 2Q and later in 2020, hard cost targets will be far more prevalent and efficiency goals fade into obscurity for all but the most tightly controlled business models.Cost income ratios are forecast to improve an average 2 percentage points in 2021, with the likes of Deutsche Bank (9 ppts), Commerzbank (3 ppts), NatWest (3 ppts) and Natixis (4 ppts) expected to report among the biggest improvements.

5. Cost Cuts Are Key after Surges at Nordea, Danske

Rattled by an extensive and prolonged money-laundering scandal, Nordic banks incurred a 12% increase in annual expenses over 2017-19, threatening their long-running status as Europe's most- efficient banks. Compliance costs and investments to enhance systems surged, while internal investigations added to the burden. Nordea's restructuring, downsizing its underperforming corporate bank and digitalizing processes across the company increased costs. Many of the cost hikes will likely be temporary, with compliance expenses peaking for Danske Bank and Swedbank this year, while Nordea's program largely completed last year. That raises the prospect of a sharp decline in nominal costs for the lenders, with analyst estimates factoring in a sizable 9% reduction in costs for the Nordic banks through 2022.

6. European Banks' 2020 Roller Coaster Enters Gentler Phase

The direction of travel for European banks' revenue, notably for 2021, has begun to stabilize and may even begin to recover, we believe, with the trajectory of cuts to-date showing that realism is now better reflected by revised consensus and revised 2020 guidance. Discounting a 2021 average cost of equity of nearly 11% -- with a 2021 dividend yield of below 5.5% and P/E of about 10.5x -- valuation is now towards the upper end of the sector's long-term range. UniCredit, Societe Generale, Barclays, HSBC, Deutsche Bank and Commerzbank should remain some of the most newsworthy companies, with updated restructuring, financial and headcount reduction delivery and plans to come.

7. European Bank P/Es Plumb Lows vs. Wider Market

The sharp rebound in 2020 average price-earnings estimates for the European banking sector (SX7P) reflected material cuts to revenue and an 80 billion-euro increase in provision forecasts, as the sector remains anchored within about 10% of decade lows. The key catalysts for the sector for the remainder of 2020 should include M&A, as well as detail on how much balance sheet and loan growth -- together with incremental interest income from TLTRO III use -- can offset declining fees. The accuracy of 1H guidance is also key, with lower 2H provision charges expected in most cases.

Estimates for 2021-22 are now the focus after 2Q updates added greater color to the likely cost of the Covid-19 fallout, with Autumn unemployment trends and year-end dividend discussions critical.

6-7x Multiple P/E Discount to Endure for EU Banks

Source: Bloomberg

8. Barclays, SocGen Share An 11%, 2021 Cost of Equity

Implied cost of equity remains a key metric to value banks, we believe, and for many European banks in 2020-21, it proves two key points to us. First, that visibility on 2021 and 2022 earnings is a prerequisite for share prices and sector valuations to recover, and second, that while 2020 estimates now look pretty sensible, 2021 remain opaque with the potential for revenue upgrades building. Using consensus estimates and rearranging our preferred bank valuation metric -- return- on-tangible equity/cost of equity (COE) equals the price-to-tangible book multiple -- we calculate that the sector discounts a 10.6% COE for 2021.

Societe Generale trades at 0.25x 2021 TNAV and its 11.3% 2021 COE is identical to that of Barclays and is lower than that for BNP, Lloyds Banking Group, Credit Suisse and ING.

9. ING, BNP, DNB Exemplify 2Q CET1 Beats, 2020 Payout Confidence

A common theme punctuating 2Q earnings was significant beats on CET1 vs. expectations. Transitional buffers to regulatory minimum now average 300-400 bps, with NatWest Group, Intesa and others comfortably above this. Lenders with the most-resilient business models, including BNP, ING and DNB, look best-placed to deliver above consensus payouts in 2021, we believe. They may also maintain robust capital positions, even as CET1 ratios may be set to fall in 2H with mounting headwinds and a reversal of some of the positive 2Q supports, including FICC trading and state guarantees.

10. New Dividend Policy Announced With 3Q Report

ING's former goal of delivering a progressive dividend -- lifting the nominal yearly payout -- could be missed this year, given relentless pressure on the lender's earnings prospects from Covid-19 fallout. The lender is adhering to ECB guidelines and has suspended payments until Jan. 1 at the earliest, though management has promised an updated dividend policy alongside 3Q earnings in early November.

Consensus calls for a near-halved payout of 36 cents in 2020, after 69 cents was announced for 2019, followed by a raise to 45.6 cents in 2021. Though cuts were severe, 2020 payout estimates have ticked up 15% since the early-April low.

11. 75% Payout to Return, But Nominal Dividends Face Cuts

With its sector-leading capital position and double-digit underlying profitability, excluding the temporary drag from Covid-19, DNB will return to a near sector-leading shareholder payout policy, we expect. The bank is due to consider its 2019 dividend and whether to reinstate a share buyback program for 2020 towards the end of this year, once there's more clarity on the impact of the virus. That leaves payouts highly uncertain this year, but we expect the bank to return to a total shareholder return of about 75% for 2021 and 2022, including share buybacks (of up to 4% of outstanding shares per year). That will rank it near the top of leading EU banks.

12. Covid-19 Impacts Banks at Many Levels

Articulating the sensitivities of bank profitability to different pandemic-recovery scenarios is somewhat fruitless, given the many balance-sheet and income-statement lines to flex. Chief among issues is the elephant in the room – bad debt – and how IFRS 9, government guarantees and internal models will drive cost of risk across Europe. Expenses will be cut and more job losses loom, but near-term benefits will be offset by vast restructuring and digital investment costs. Different speeds of macro recovery and Europe's long-standing North-South economic divide is also hard to quantify. Falling revenues, long the bain of bank investors, may be stemmed as TLTRO III and greater near- term loan growth surprise positively, as yield curves could steepen. That said, growth for fees and net interest income is challenging.

SX7P Aggregates - 3-Months Change (Eur Million)

Bloomberg — Bloomberg Intelligence: European Banks' Consensus & 3-Month Change

Stoxx 600 Banks Index	2020	3-Month Change	%	2021	3-Month Change	%
Net Interest Income	280,805	-5,885	-2.1%	280,221	-13,923	-4.7%
Non Interest Income	224,063	-13,839	-5.8%	227,351	-14,868	-6.1%
Total Revenue	**504,126**	**-14,287**	**-2.8%**	**510,528**	**-18,108**	**-3.4%**
Operating Expense	322,663	-6,146	-1.9%	319,625	-6,321	-1.9%
Pre-Provision Operating Profit	181,462	-8,142	-4.2%	190,903	-11,787	-5.6%
Loan Loss Provision	105,524	28,383	36.8%	76,178	17,399	29.6%
Pre-Tax Profit	**73,230**	**-39,824**	**-35.2%**	**110,615**	**-30,746**	**-21.7%**
Net Income	44,525	-31,736	-41.6%	70,485	-21,027	-23.0%

Source: Bloomberg Consensus Estimates

13. Commerzbank Relatively Less Exposed to 2nd-Wave Infection Risk

Bloomberg Economics (BE) has a base case of 8.8% GDP decline across the euro zone this year, though that could fall as much as 12%, should a second outbreak occur in 2H. In such a scenario, we would expect the lending outlook for banks to weaken further and potentially turn negative. Such trends, however, aren't uniform across the euro zone, with Germany's best-in-class response to the pandemic allowing it to avoid the most draconian containment measures seen elsewhere. Early indicators suggest an economic bounce is already under way in the country, indicating the hit to output may be less than half that in Spain, BE estimates. That should lead to differences in lending outlooks too, with German leaders Deutsche Bank and Commerzbank less-exposed than local lenders in Spain and Italy, in particular.

14. UniCredit, Peers Face 10% GDP Slump in CEE in Slow Recovery Case

Projecting banks' profitability in 2020-21 is complicated by uncertainty on Covid-19's economic impact. Whether a recovery is V- or U-shaped will determine the level of impairment required, as well as credit demand and revenue trajectories. Consensus calls for Central and Eastern Europe GDP to shrink by as much as 5.4% this year, rebounding 4.5% in 2021. We consider this as a fast recovery in our scenario analysis, which entails a rebound in economic activity in 3Q and 4Q. In the more likely slower recovery scenario, assuming a second outbreak later this year, the region's GDP contraction could double to as much as 10% and the 2021 recovery slow to 1.5% (based on OECD data).

Erste (50-80 bps), Raiffeisen (75 bps) and UniCredit (140-160 bps) assumed a V-shaped recovery in their 2020 cost-of-risk guidance

15. Money Multiplier, ECB's QE Programs

The ECB's various quantitative easing (QE) programs could support bank lending, offsetting some of the decline that would typically be expected, given the severity of the economic correction under way. The money multiplier, however, defined here as M3 divided by the monetary base, has fallen to about 4, down from nearly 9 in 2014, which suggests the effectiveness of those programs to boost bank lending has weakened. That likely reflects banks' fears over potential bad debts and the need to boost capital ratios in recent years. Bank lending is unlikely to recover meaningfully until both the appetite to borrow and the willingness to lend rise in tandem. Both are likely to remain subdued while the virus threat prevails, we suspect.

16. Provisions Range Reflects Low Visibility

Consensus 2020 and 2021 provisions for the largest banks in central and eastern Europe have more than doubled on average in the past six months to about 8 billion euros, contributing to EPS downgrades of as much as 50%. A range of about 3.4 billion euros between the lowest and highest estimates demonstrates limited visibility, with the gap most likely to start narrowing after 2Q results. The clarity on the effectiveness of the state-support measures to ease the effect of the pandemic remains a key unknown, with Raiffeisen suggesting its cost of risk in 2020 could be 50 bps higher, excluding any help. Assuming the banks' 2020 and 2021 provisions reach the highest consensus level, reflecting a slower, U-shaped, recovery, the group's pretax profit would be lower by 23% and 16% respectively.

Poland Banking Sector

The Polish banking industry is one of the most fragmented in the EU, with five lenders controlling less than 50% of assets vs. a 73% euro-zone average. Millennium's acquisition of Eurobank was the latest M&A deal in the country.

Revenue pressure from low-for-longer interest rates and elevated cost of risk add to domestic lenders' challenges, with an ever increasing regulatory burden and losses on non-zloty mortgages already obscuring the ROE outlook. Polish banks' return on equity fell to about 8% in 2019 vs. 16%-plus in 2011, based on IMF data. That's one of the lowest among regional peers, and compares with levels of well above 15% in Hungary and the Czech Republic.

Poland's Bank ROE Lowest Among Peers

Name	2019	2018	2017
▾ ROE % - average	15.1	14.8	9.4
Russia	19.5	13.0	7.9
Turkey	12.8	17.0	18.8
Poland	8.0	7.5	8.2
Hungary	19.5	19.4	19.7
Czech Republic	18.2	17.3	17.2
Slovenia	12.0	11.5	9.8
Romania	12.2	14.6	12.5
Bulgaria	11.3	11.8	9.3

Source: Bloomberg

1. Alior's $1 Billion Badwill Appeal May Reverse Pekao's 2018 View

PZU -- the largest shareholder in Pekao (20%) and Alior (32%) -- could seek to merge both lenders, in an aim to boost their competitive advantage ahead of challenging times for the country's banking industry. Pekao scrapped the idea in 2018 of taking over the much smaller, yet technologically advanced Alior, claiming such a transaction would generate little value for shareholders. In 2018 Alior's price-to-book averaged in excess of 1.2x vs. about 0.3x currently, with a market capitalization that's more than $1 billion below book value. That "badwill" could be used to cover integration costs and help accelerate Alior's balance-sheet cleanup. Pekao's assets would exceed 300 billion zloty post any potential merger with Alior, solidifying its position as Poland's No. 2 lender.

2. Badwill Is a Strong Incentive for M&A

European bank mergers and the treatment of "badwill" -- also known as negative goodwill, when a bank purchases an asset at less than its net fair market value -- was the topic of an ECB paper released on July 1, flagging the need for imminent consolidation across the region's banks. The paper clearly acknowledges the "strong likelihood that badwill will be generated," with the suggestion that any potential profit from badwill shouldn't be distributed to the shareholders of the combined entity until the sustainability of the business model is firmly established.

3. Coivd-19 to Accelerate Cost Cuts, Digitalization

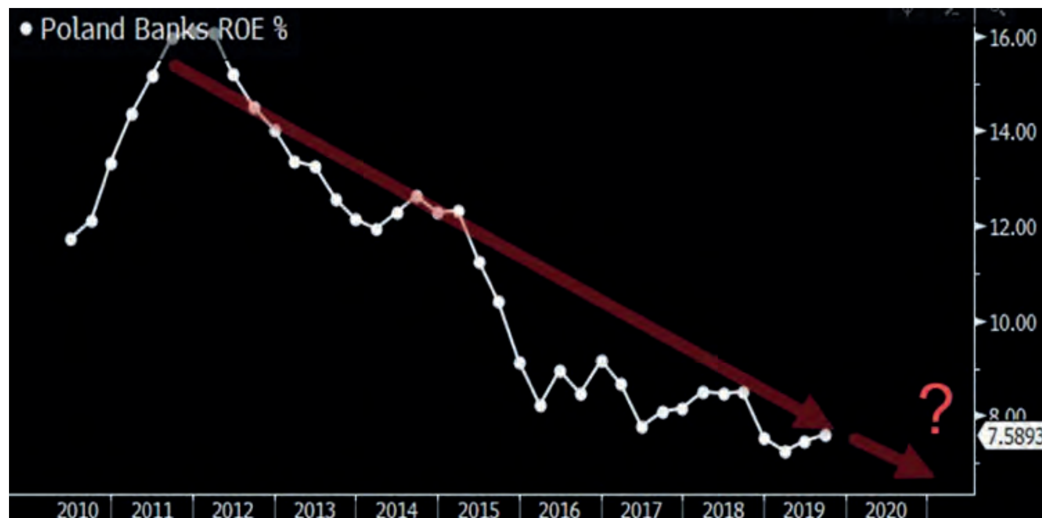
Millennium's "Through Covid-19" project is aimed at easing the effects of the pandemic, boosting the lender's competitiveness in the new post-virus world. The bank will further accelerate cost- savings efforts (10% in 2020 on top of Eurobank-acquisition synergies) and lower capital spending by as much as 17%. About 110 branches will be shuttered (vs. 60 planned prior), with management seeking to further boost online sales of unsecured consumer loans to 50% by year- end (vs. 48%). It is expected that other domestic banks to follow suit and outline more detailed plans and strategies to weather virus-driven damage.

4. Sub-5% ROE calls for Strategy Revisit

Polish banks' business strategies are likely to be reviewed during 2Q results, with RoE prospects darkening due to Covid-19. The industry's RoE has more than halved in less than a decade to below 8%, one of the lowest among regional peers. Near-zero interest rates and elevated provisioning could push RoE down to 3-5% in 2020 and 2021, with some lenders even facing a loss this year. Domestic lenders will likely need to outline more aggressive

cost-savings plans, with early digitalization investment a key lever. Revenue diversification and a greater focus on fees seem an inevitable move, with a consolidation of the sector necessary as smaller banks have few buffers to cope with post-pandemic challenges.

Polish Banks' ROE Continues to Decline



Source: Bloomberg

5. Pretax 2020-21 Cuts of 22 Billion

Consensus has pared back aggregate 2020 and 2021 pretax profit estimates for the top-seven Polish banks' by about 22 billion zloty in the past six months. While numbers have now stabilized, some lenders are nevertheless likely to warn of higher 2020 loan losses ahead of 2Q earnings. More than two-thirds of pretax cuts were driven by revenue downgrades (15 billion zloty) following 1H's 140-bp interest-rate cuts. Loan demand, net interest margins and the shape of the yield curve are the key unknowns, given government-funded emergency programs. Fees and cost savings will remain major levers to minimize the dent to profit (estimated to more than halve over 2020 and 2021).

Polish Banks' Tough 2020-21 Outlook

	2020	YTD Change	%	2020	YTD Change	%
Net Interest Income	34,246	(6,063)	-18%	33,848	(10,239)	-30%
Non Interest Income	15,285	608	4%	15,905	739	5%
Revenue	**48,812**	**(5,496)**	**-11%**	**49,234**	**(9,065)**	**-18%**
Expenses	23,119	125	1%	23,218	(91)	0%
PPOP	25,693	(5,622)	-22%	26,016	(8,974)	-34%
LLPs	12,015	4,731	39%	9,521	1,148	12%
Pre-tax Profit	8,915	(10,914)	-122%	10,942	(10,677)	-98%
Net Income	**6,517**	**(8,431)**	**-129%**	**8,207**	**(8,260)**	**-101%**

*based on consensus for PKO, Pekao, Santander, Mbank, ING, Alior, Millennium

Source: Bloomberg

North America

U.S. Recovery: Stalled if Outbreak Widens

A stalled economic rebound could delay the eventual recovery of regional banks such as Comerica and Zions, while analyst estimates could deteriorate with the current median-loss rate of 2.4% tracking lower vs. financial-crisis results. Still, banks hold ample capital for future losses, as our burn-down analysis suggests, with SVB and First Republic faring best.

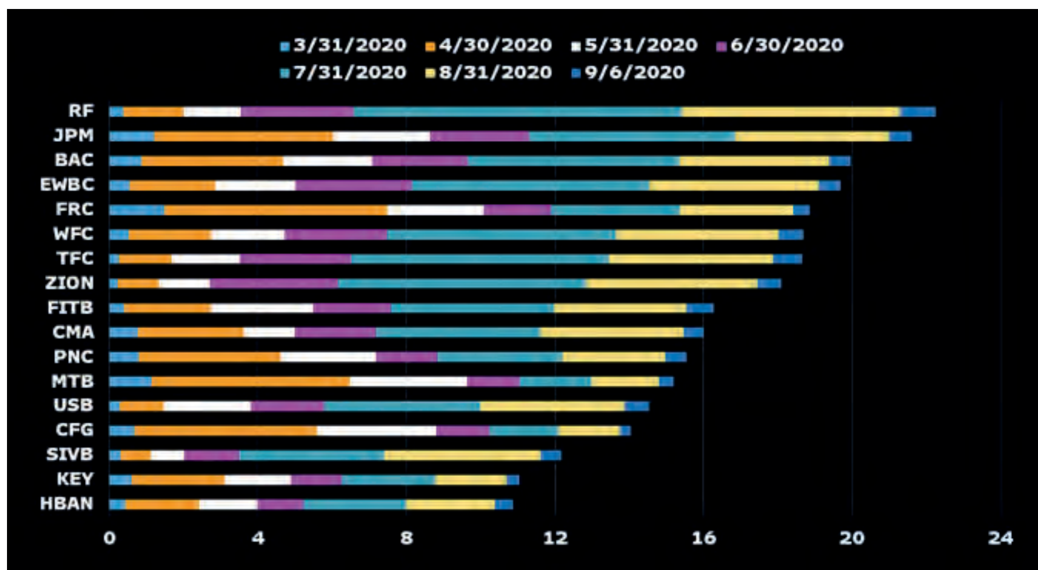
Canadians banks' earnings will be pressured as lockdowns feed slower economic trends, triggering credit concerns. The most-diversified peers such as RBC may have more earnings absorption to weather the storm.

1. Loan Losses Could Rise Amid Uneven Economic Recovery

Banks' eventual recovery depends on the pace of an economic rebound, and an uneven reopening could extend losses beyond estimated projections. Through 2022, consensus currently sees a cumulative loan-loss ratio of 2.4% for regional banks we track. This compares to financial-crisis losses of 6.8% at large banks and 6.3% in the most recent stress test. Fiscal stimulus and loan deferrals have helped bridge borrower obligations thus far, but the end of deferrals could portend higher losses in 2021. U.S. Bank has more projected losses due to credit-card exposure, while First Republic's big jumbo mortgage book may yield lower charge-offs due to high-net-worth focus.

2. Spread of Virus Shifting Across Markets

With Covid-19 infection rates varying across the U.S., county-level virus trends suggest banks that operate in the Midwest -- such as Huntington and KeyCorp -- may see an earlier rebound as the pandemic's effects recede. This could spark an economic reopening across their deposit footprints, and potentially these companies may see less asset-quality erosion. Virus caseloads in the Southeast and Southwest U.S. remain persistently higher, which could delay any rebound and hamper Truist, Regions and Zions, which operate in these regions. It was reviewed county-level infection rates, population counts and FDIC deposit data to derive a weighted-average infection rate across each bank's deposit footprint.



Source: Bloomberg

3. Forbearance Up, But New Deferral Requests Slow

Banks have supported borrowers by offering loan modifications to help bridge a liquidity gap, but forbearance may migrate to loan losses if a recovery is uneven. New deferral requests have slowed from a peak in March-April, while the so-called cure rates on modified loans appear encouraging, but could pick up as initial deferral periods expire. Comerica and KeyCorp have said requests for second deferrals have been modest, while stimulus loans have alleviated the need for another round of forbearance for some, according to East West. M&T and Truist have been more aggressive, deferring over 10% of loans vs. the median of 7%.

Recent regulatory guidance lessens the capital burden on Covid-19-related forbearance. Loans that were current before the pandemic and then modified aren't treated as restructured or nonaccrual loans.

4. Virus-Affected Loans Reveal Potential Stress

Banks' flagging of loans potentially affected by Covid-19 reveals large portions of the book at risk, with a median level at 11% of total credits. East West may have more exposure via its retail and hotel commercial-real-estate book, but a low loan-to-value ratio could limit losses, based on our calculations. First Republic, SVB, Truist and PNC appear less exposed to the most-affected sectors. Banks have offered detail on the potential fallout from the economic shutdown by highlighting commercial exposure to more at-risk sectors including leisure, restaurants and energy. U.S. Bancorp cited media and entertainment loans in its at-risk bucket, which rose to 12% of the total in 2Q vs. 10.8% as of 1Q. Regions refined its Covid-19 exposure by lowering amounts across commercial loans, but increasing its retail CRE risk segment.

5. Tailwinds May Provide Trading Support

Trading revenue at the largest global banks is expected to decline in 2H after a strong first half, though could still gain compared with the year-ago period, in our view. Consensus moved slightly higher after 2Q strength, yet expects flat overall trading as modestly higher fixed income offsets lesser equities. Much uncertainty remains around the coronavirus, and we expect a resurgence in volatility is possible in September. Seasonal trends may mute August activity, but the impact of reduced travel is unclear. Higher client asset levels entering 3Q are a positive, with equities trading likely to benefit from much higher primary issuance to start the quarter, while lower corporate deals may weigh.

6. U.S. Bank Provisions Show Caution

Sizable loan-loss reserve builds provide a cushion entering 2H, though the economic backdrop is uncertain and trends in the coming months will show if levels are conservative or more is needed. The largest U.S. banks' loss provisions generally exceeded expectations in both quarters, as reserve-building pushed ratios to 20-65% of stressed rates in 2020 Federal Reserve tests. Reserves partly reflect higher commercial provisioning against industries particularly affected by the pandemic and significant card build.

7. Stress-Test Losses Signal More Provisions Needed

CCAR regional banks' reserve levels relative to recent projections in the Fed's stress test could suggest a need for more reserve building. With median reserve coverage at 40% of stressed losses, banks such as Citizens and KeyCorp could see more provisions if weak economic conditions persist. We compare projected losses with current reserve levels to gauge banks' preparedness. Current conditions are more draconian vs. stress-test assumptions for certain metrics such as GDP, but fiscal stimulus remains a wild card to mitigate bad-debt formation.

8. Eyeing Stimulus Programs as Lending Tightens

With commercial underwriting standards tightening, regional banks look increasingly reliant on government-sponsored business lending such as the **Paycheck Protection Program** and the Fed's upcoming Main Street Lending Program. The most recent survey noted that a net 40% of banks tightened lending standards. As a means to mitigate risk amid economic uncertainty, regional banks likely will continue to focus on government programs to support commercial clients as these credits carry a lower risk-weighted capital charge, and capital preservation is now a primary concern. PPP loans are also guaranteed by the SBA. The stated maturity is two years, but the loans can be forgiven in eight weeks as long as proceeds are used for purposes such as payroll and employee levels are maintained. Huntington said it expects a majority of loans to be forgiven and exit the balance sheet.

9. Canadian Banks May Not Recover Until 2022

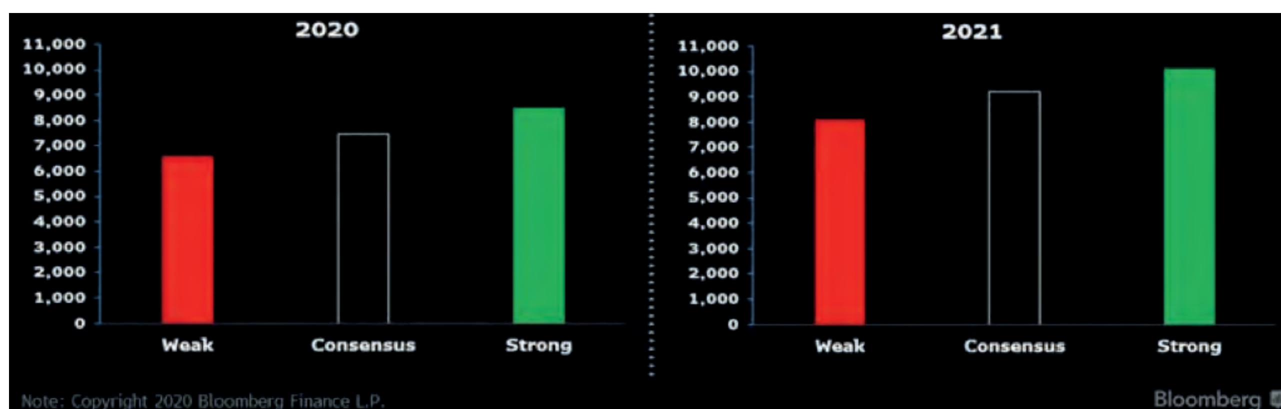
Canadian banks' recovery may not happen until 2022, if the pandemic leaves a bigger mark on the economy, triggering a deferrals cliff, in our view. Our weak-recovery scenario envisions a double- digit profit disappointment vs. consensus, but similar upside if consumers perform better than expected. All large banks have material retail exposure, leaving room for more reserve buildup.

10. Deferrals Uncertainty A Risk to Banks' Recovery

Canadian banks' 2021 recovery remains at risk as six-month deferrals on retail loans and mortgages will expire around the end of fiscal 2020 in October. Higher loan-reserve buildup into the next year may reduce median banks' income by 12% this year and another 8% next. While the banks in our coverage universe sounded confident in their performing-loans buildup, and we may see total provisions moderating from 2Q, elevated levels may extend through the next year. Bloomberg economists anticipate a healthy recovery in GDP and rebound in unemployment in 2021, yet they see downside risks to the scenario.

A deferrals cliff is a risk to banks with the most retail exposure, if unemployment remains elevated and consumers can't pay their postponed obligations. A strong recovery may spark double-digit upside to incomes.

Average Pretax-Income Scenario Outcomes (6 Banks)



Source Bloomberg

11. Canadian and U.S. Rate Pressure on 2020 Interest Income Grows

Bank of Canada's (BoC) turn to aggressive interest-rate cuts will pressure domestic net interest margin, despite steepening the yield curve, and stiff competition for deposits may push NIM lower. U.S. rates could pressure margin for banks that do business in U.S. dollars following reductions, yet overall interest income may still expand, helped by larger loan books. The Federal Reserve and the BoC will likely maintain rates near zero for some time. Banks with shorter-maturity loan books may see more NIM volatility.
National Bank, Scotiabank and CIBC may be more affected due to a large relative proportion of short-term loans. RBC, TD, BMO, CIBC and Scotiabank's expectation of a limited impact on Canadian interest margin may diminish and pressure could rise on U.S. margins in 2020.

12. Virus Pressures Canada Banks' Positive Operating-Leverage Goals

Canadian banks' expense growth may moderate in 2020-21, yet the promise of positive operating leverage is likely out of reach as revenue risks rise. Banks are prudently managing costs and working to improve efficiency ratios, despite higher technology spending, yet near-term operational uncertainty may pressure goals. Digitalization and technology costs are primary near-term drivers, despite core expense control. However, lower travel and marketing expense may offer savings amid lockdowns. Revenue uncertainty may make it impossible to attain near-term goals to improve efficiency ratios.

13. Efficiency Strides Are Paused by Virus

Canadian banks' work to improve domestic and international efficiency ratios, a measure of non- interest expense divided by revenue, have been hurt by the coronavirus. RBC, BMO, CIBC, Scotiabank and National Bank of

Canada have specific targets. RBC, Toronto Dominion and Bank of Montreal are focused on organic growth in the U.S., where it's more expensive to operate. Larger economies of scale support Canadian banks' domestic efficiency ratios, which are in the 40-50% range, compared with about 60% in the U.S. Most banks have levers to pull to achieve efficiency goals in the event of significantly slowing revenue growth. Yet economic pressure on recurring revenue streams can push near-term targets further out. Lower 2020 industry revenue forecasts place efficiency goals out of reach.

Conclusion

Global Changes

Governor's & Heads of Supervision bodies have announced the delay of "Basel III – Implementation" to enhance the operational capacity of supervisors and banks. Following are the changes in implementation timeline of outstanding Basel III standards:

Standard	Original date of implementation	Revised date of implementation
• Revised leverage-ratio framework & G-SIB buffer • Revised standardized approach for credit risk • Revised Internal Ratings Based (IRB) approach for credit risk • Revised operational risk framework • Revised CVA framework • Revised framework for the market risk • Revised Pillar 3 disclosure framework	1st Jan 2022	1st Jan 2023
• Output floor	1st Jan 2022; transitional arrangements to 1st Jan 2027	1st Jan 2023; transitional arrangements to 1st Jan 2028

Basel Committee on Banking Supervision' (BCBS) along with the 'International Organization of Securities Commissions' (IOSCO) have decided to postpone the implementation of final two phases of 'margin requirements for the non-centrally cleared derivatives' by 1 year.

- BCBS has opted to postpone the implementation of revised G-SIB framework by 1 year.

- BCBS has amended 'regulatory capital' treatment of expected-credit-losses (ECLs). As per BCBS' amendments and jurisdictions:
    - a) may apply current transitional arrangements, even in cases where these were not originally implemented (when banks had initially implemented the ECL model).
    - b) may allow banks to change from the static approach to dynamic approach for determining 'transitional adjustment amount'.
    - c) may utilize alternative approaches (that are similar to the cumulative difference between provisions under 'ECL accounting model' and that under 'prior incurred loss' accounting model)
    - d) for a 2 year period (2020—2021), may permit banks to add-back up till 100% of the 'transitional adjustment amount' to CET1.

References

1. Bloomberg for data and statistics.
2. Thomson Reuters for data and statistics.
3. The Economic Times and various media reports.

Footnotes

Global Macro Vitalsof Covid-19.

COVID-19: MACRO VITALS

Welcome to the combined app for Corona Virus and Macro Vitals

GLOBAL CASES ▸
SOURCE - Reuters

More Historical Data | **18 Sep**

Location	Cumulative	New Cases	Active	Recovered	Deaths	WHO Latest Actual	Update Chart
Global	30,237,190	116,228	8,631,451	20,660,530	945,209	29,737,453	XXX
USA	6,694,698	45,939	3,610,129	2,886,844	197,725	6,530,324	XXX
Italy	293,025	1,583	41,413	215,954	35,658	291,442	XXX
Spain	625,651	11,291	444,870	150,376	30,405	614,360	XXX
Brazil	4,455,386	36,303	567,369	3,753,082	134,935	4,382,263	XXX
Mexico	684,113	3,182	123,518	488,416	72,179	676,487	XXX
France	449,007	10,593	327,072	90,840	31,095	383,838	XXX
UK	412,029	3,395	369,980	344	41,705	378,223	XXX
Russia	1,091,186	5,905	170,784	901,207	19,195	1,085,281	XXX
India	5,214,677	96,424	1,017,754	4,112,551	84,372	5,118,253	XXX
Iran	413,149	2,815	35,493	353,848	23,808	410,334	XXX

European	Western Pacific	South-East Asia	Eastern Mediterranean	Americas	African

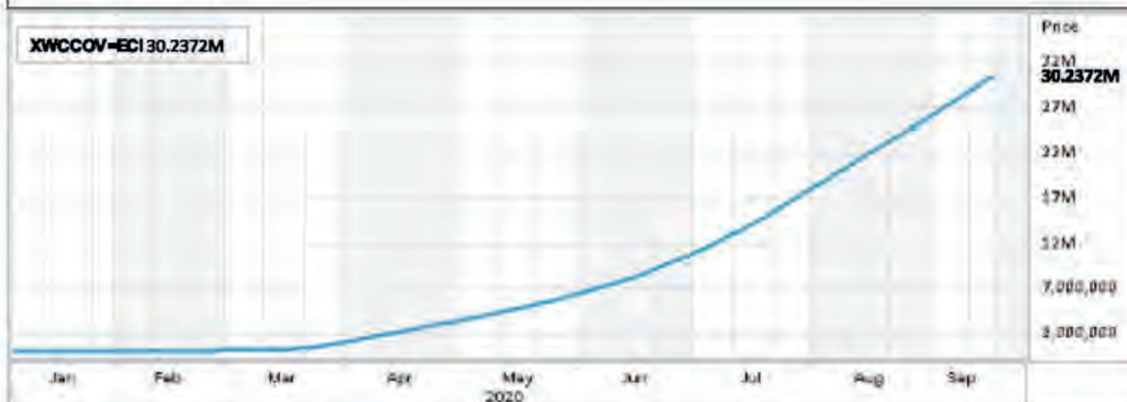
European

Location	Cumulative	New Cases	Active	Recovered	Deaths	WHO Latest Actual	Update Chart
Italy	293,025	1,583	41,413	215,954	35,658	291,442	XXX
Spain	625,651	11,291	444,870	150,376	30,405	614,360	XXX
Germany	266,161	1,561	20,468	236,353	9,340	265,857	XXX
France	449,007	10,593	327,072	90,840	31,095	383,838	XXX
Switzerland	48,795	530	12,633	34,400	1,762	48,154	XXX
UK	412,029	3,395	369,980	344	41,705	378,223	XXX
Netherlands	88,073	1,753	81,557	250	6,266	86,237	XXX
Austria	36,668	732	7,866	28,044	758	35,448	XXX
Belgium	95,948	1,153	67,241	18,772	9,935	95,854	XXX
Norway	12,499	106	2,885	9,348	266	12,393	XXX
Portugal	66,396	770	19,714	44,794	1,888	65,626	XXX
Sweden	87,885	310	71,858	10,163	5,864	87,575	XXX
Israel	171,768	1,303	44,984	125,619	1,165	161,213	XXX

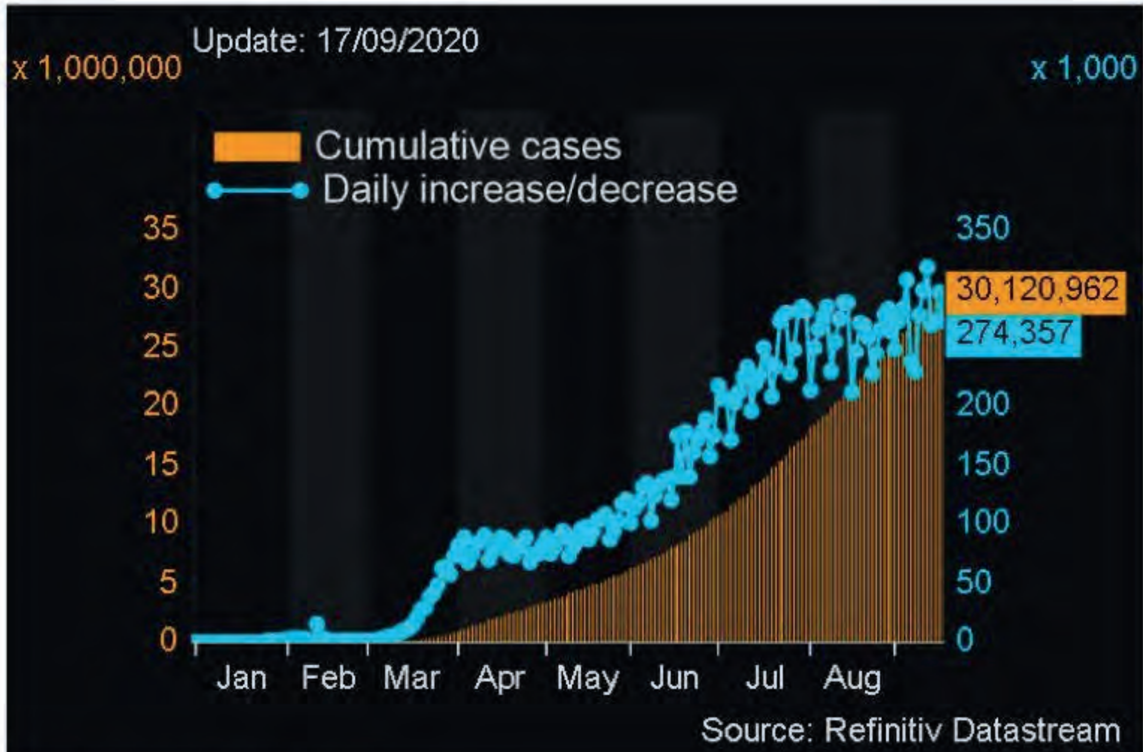
Turkey	296,391	0	26,540	262,602	7,249	296,391	XXX
Denmark	21,393	453	4,201	16,557	635	20,571	XXX
Czechia	44,155	1,416	20,289	23,377	489	41,032	XXX
Ireland	32,023	224	6,870	23,364	1,789	31,799	XXX
Luxembourg	8,698	0	1,434	7,140	124	7,394	XXX
Poland	77,328	757	11,746	63,312	2,270	75,734	XXX
Finland	8,858	59	1,019	7,500	339	8,750	XXX
Romania	108,690	1,679	61,128	43,244	4,318	107,011	XXX
Greece	14,400	359	10,271	3,804	325	14,041	XXX
Russian Federation	1,091,186	5,905	170,784	901,207	19,195	1,085,281	XXX
Iceland	2,206	17	84	2,112	10	2,189	XXX
Slovenia	4,058	104	1,588	2,334	136	3,960	XXX
Croatia	14,513	234	2,100	12,169	244	14,029	XXX
Estonia	2,814	36	439	2,311	64	2,756	XXX
Serbia	32,695	82	2,026	29,931	738	32,613	XXX
Armenia	46,671	295	3,515	42,231	925	46,671	XXX
Hungary	16,111	941	11,202	4,240	669	15,170	XXX
Bulgaria	18,544	154	4,404	13,391	749	18,390	XXX
Lithuania	3,565	61	1,297	2,181	87	3,442	XXX
Slovakia	6,256	235	2,827	3,390	39	5,860	XXX
Latvia	1,498	4	212	1,248	38	1,486	XXX
Andorra	1,483	0	485	945	53	1,483	XXX
San Marino	723	0	18	663	42	742	XXX
Bosnia	24,605	394	6,639	17,219	747	24,206	XXX
North Macedonia	16,274	186	1,964	13,635	675	16,088	XXX
Albania	11,948	132	4,813	6,788	347	11,816	XXX
Republic of Moldova	44,983	622	10,574	33,239	1,170	44,361	XXX
Cyprus	1,558	10	255	1,281	22	1,548	XXX
Malta	2,595	35	601	1,978	16	2,560	XXX
Ukraine	169,472	3,228	90,518	75,486	3,468	166,244	XXX
Azerbaijan	38,777	119	1,917	36,289	571	38,658	XXX
Belarus	74,987	224	1,249	72,967	1,671	74,763	XXX

Kazakhstan	107,134	78	3,853	101,610	1,671	137,058	XXX
Georgia	2,937	375	1,496	1,422	19	2,937	XXX
Uzbekistan	49,994	609	3,485	46,092	417	49,385	XXX
Liechtenstein	111	0	5	105	1	111	XXX
Kyrgyzstan	45,153	81	2,773	41,317	1,063	45,153	XXX
Montenegro	7,503	212	2,482	4,892	129	7,395	XXX
Monaco	207	5	42	161	4	181	XXX
Holy See	12	0	0	12	0	12	XXX
Tajikistan	9,214	43	1,153	7,988	73	9,171	XXX
Territories							
Faroe Islands	429	1	17	412	0	428	XXX
Kosovo	12,683	0	3,407	8,788	488	14,796	XXX
Isle of Man	339	0	3	312	24	339	XXX
Gibraltar	343	3	30	313	0	334	XXX
Greenland	14	0	0	14	0	14	XXX
Saint Pierre and Miquelon	9	0	4	5	0	11	XXX
Aland Islands	21	0	21	0	0	0	XXX

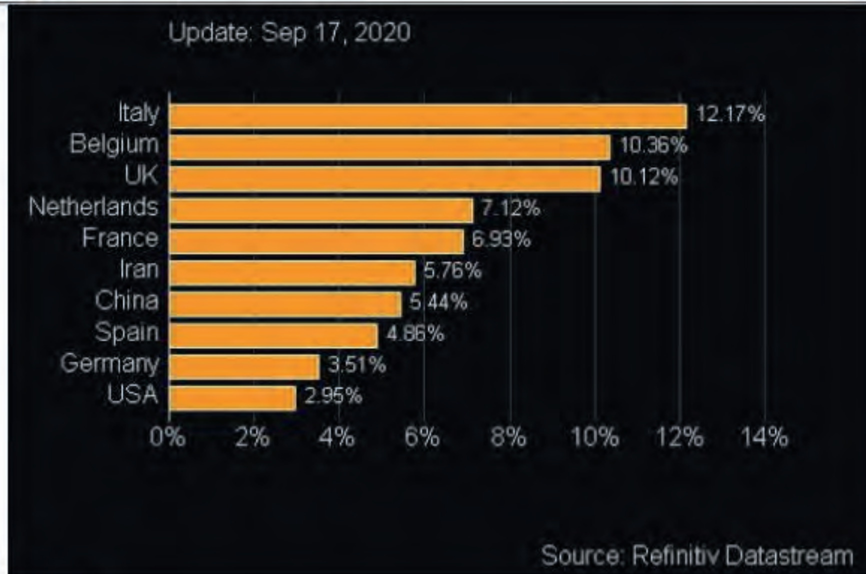
CASE TREND **XW**



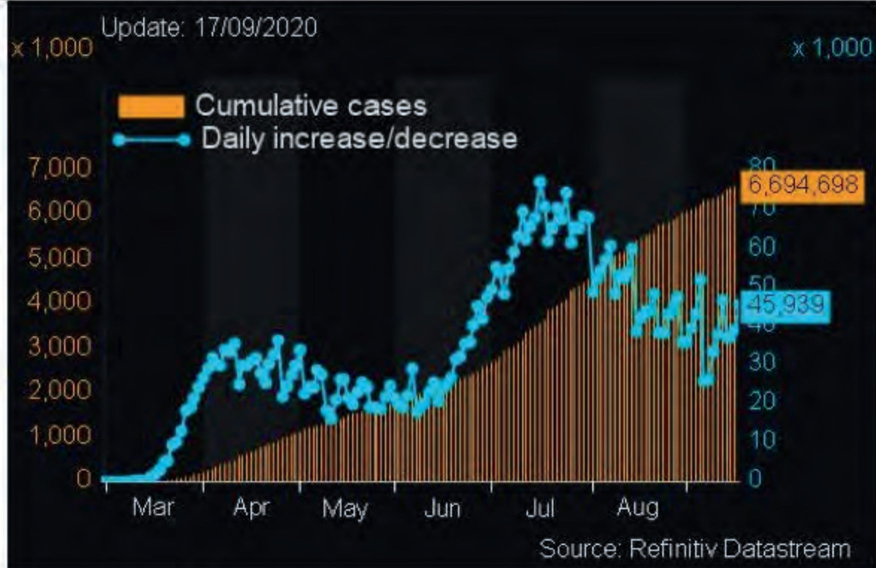
GLOBAL CUMULATIVE CASES
SOURCE - Reuters

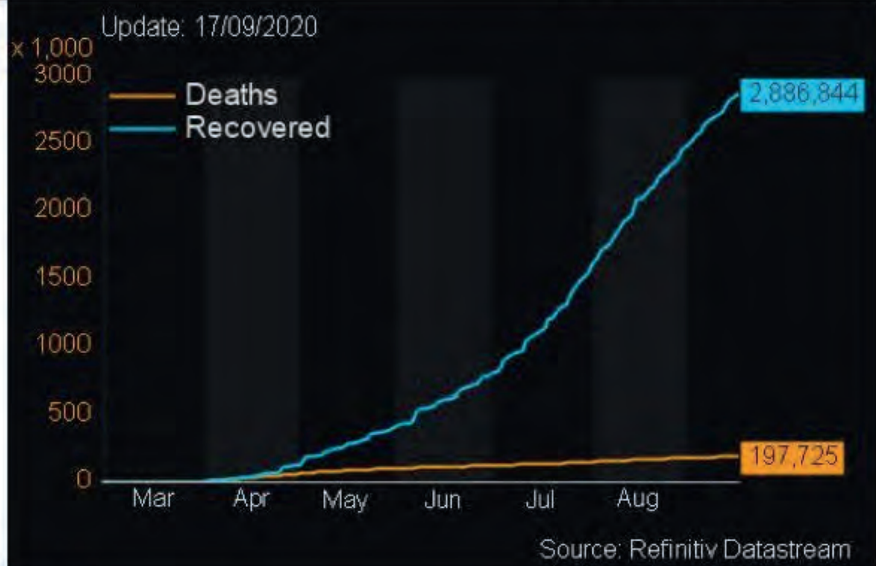


COVID-19 FATALITY RATE ANALYSIS
SOURCE - Reuters

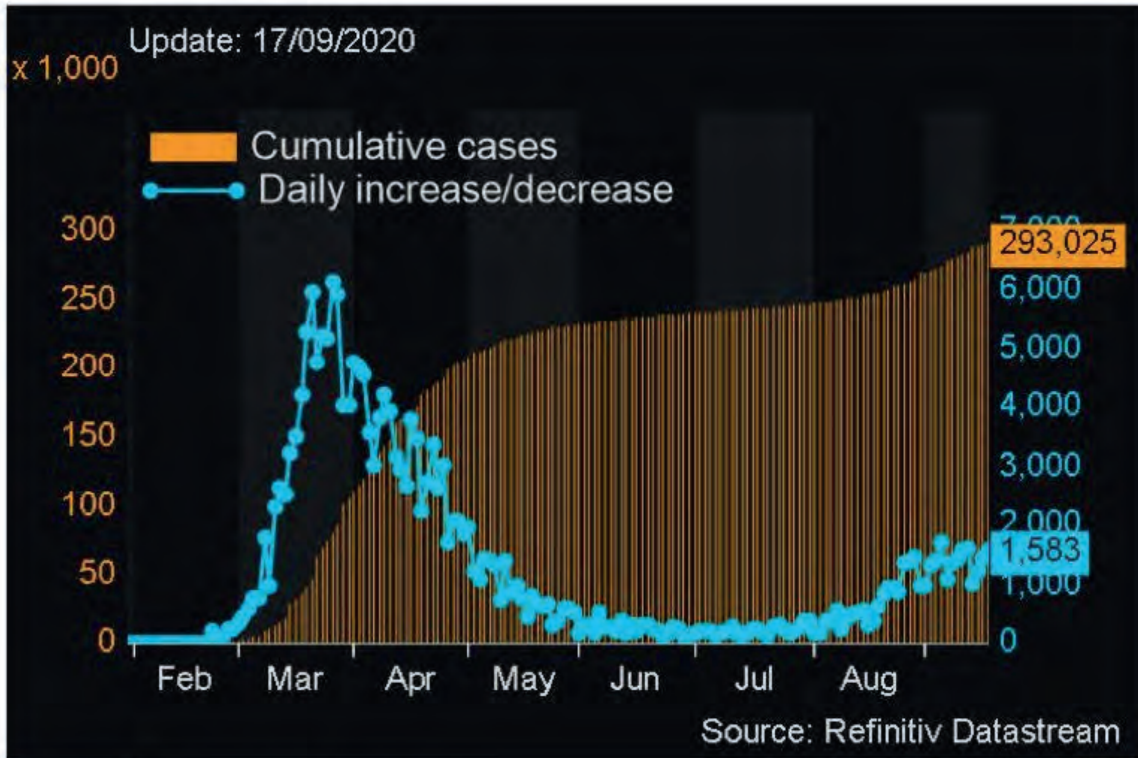


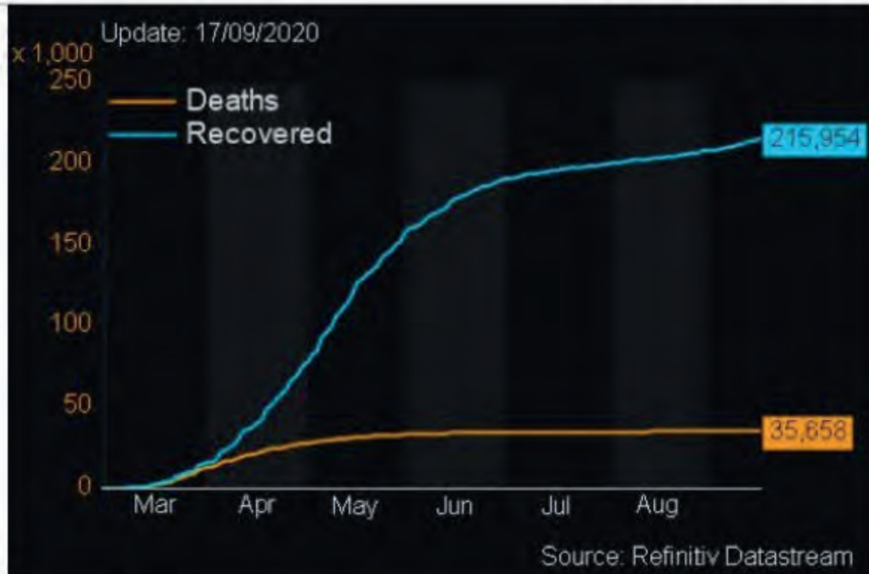
USA CASES TREND
SOURCE - Reuters



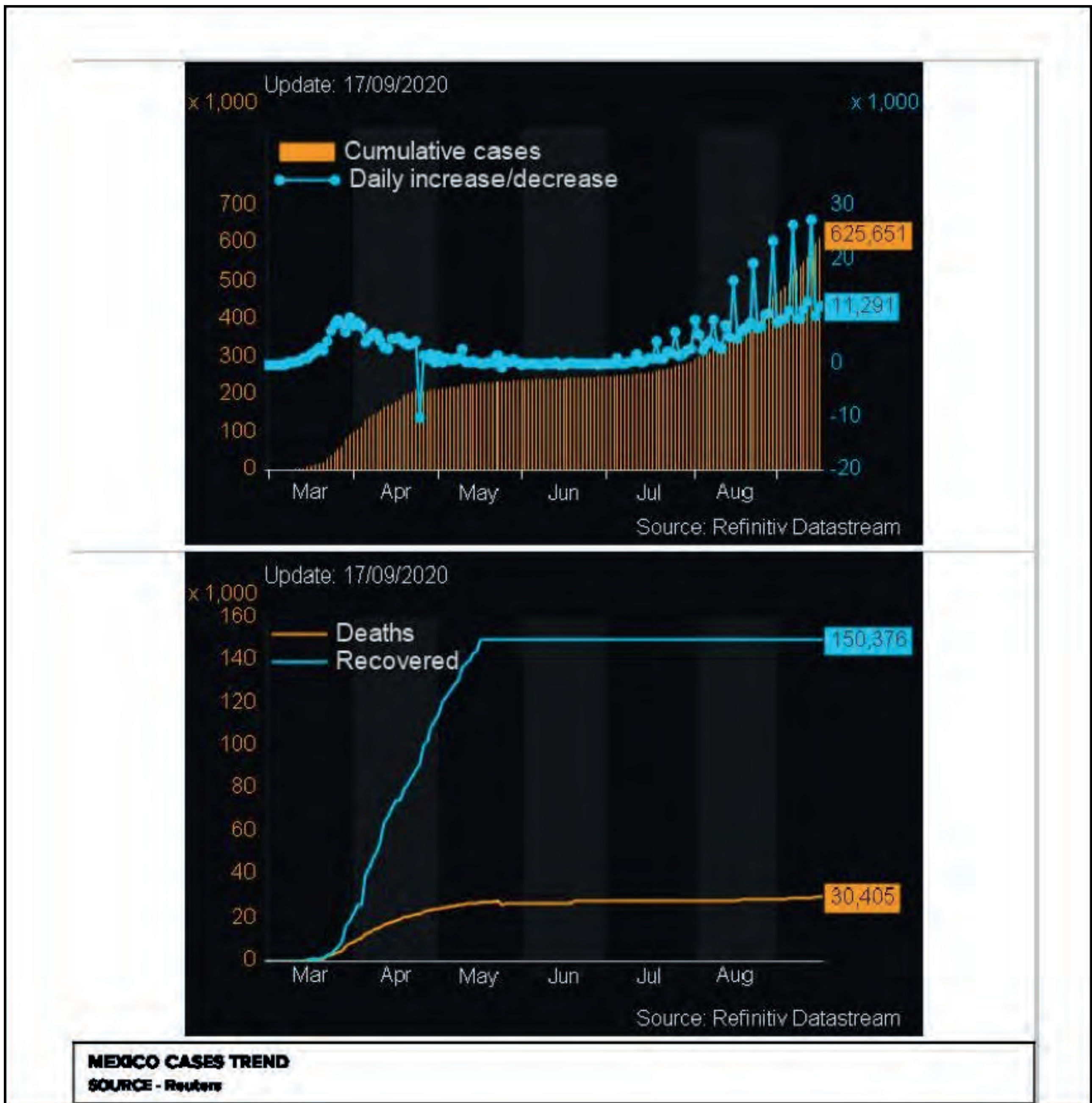


ITALY CASES TREND
SOURCE - Reuters

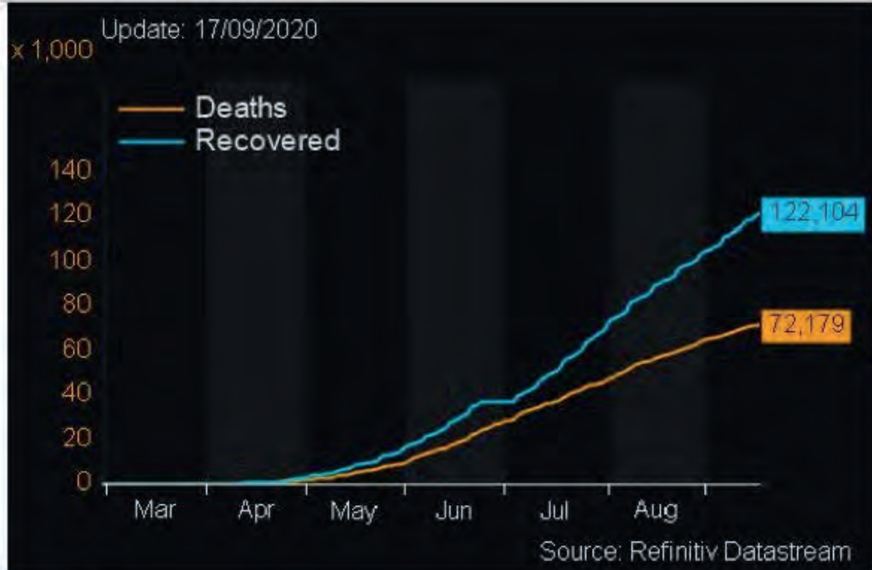




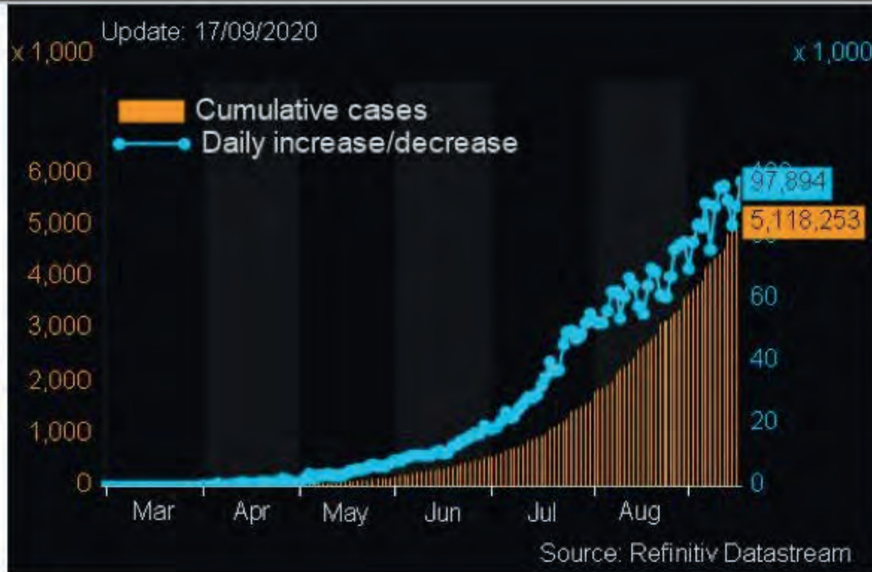
SPAIN CASES TREND
SOURCE - Reuters

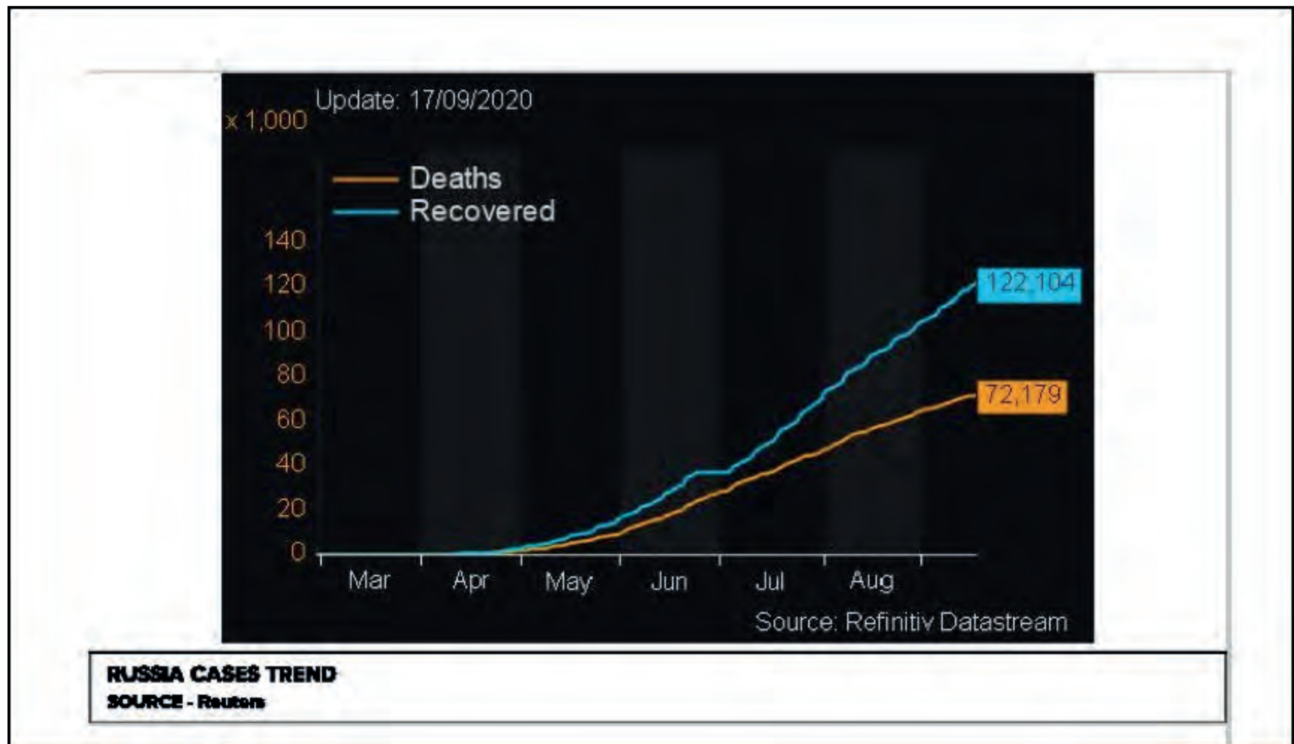


MEXICO CASES TREND
SOURCE - Reuters

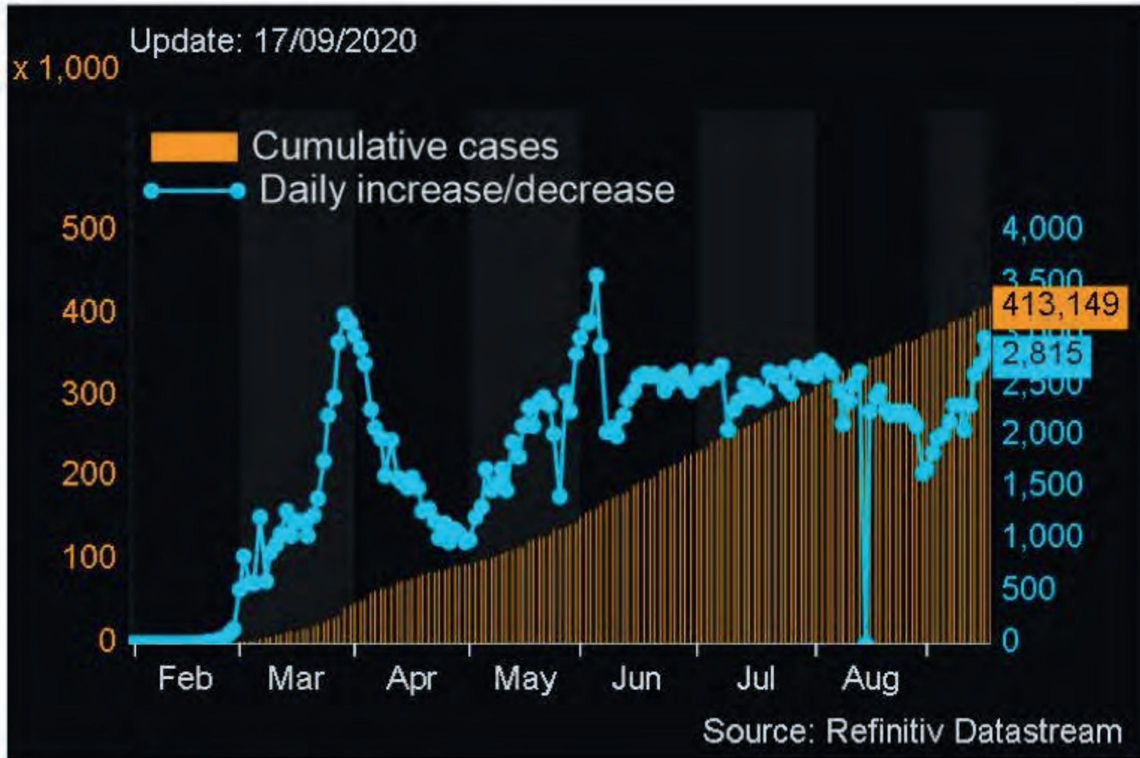


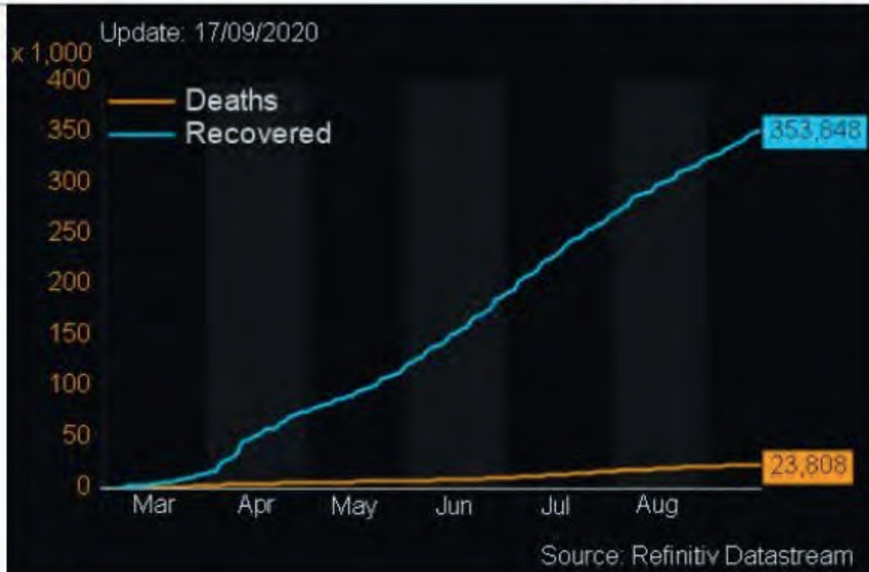
INDIA CASES TREND
SOURCE - Reuters



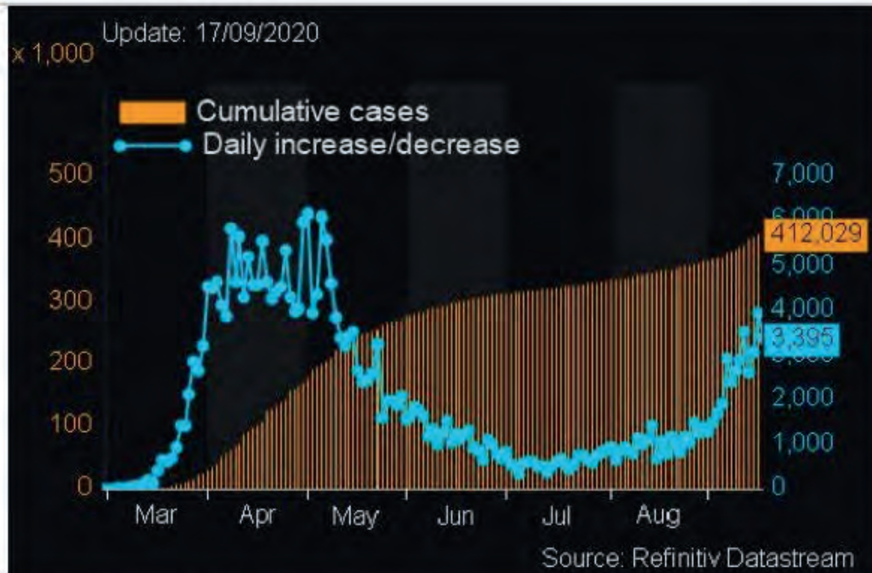


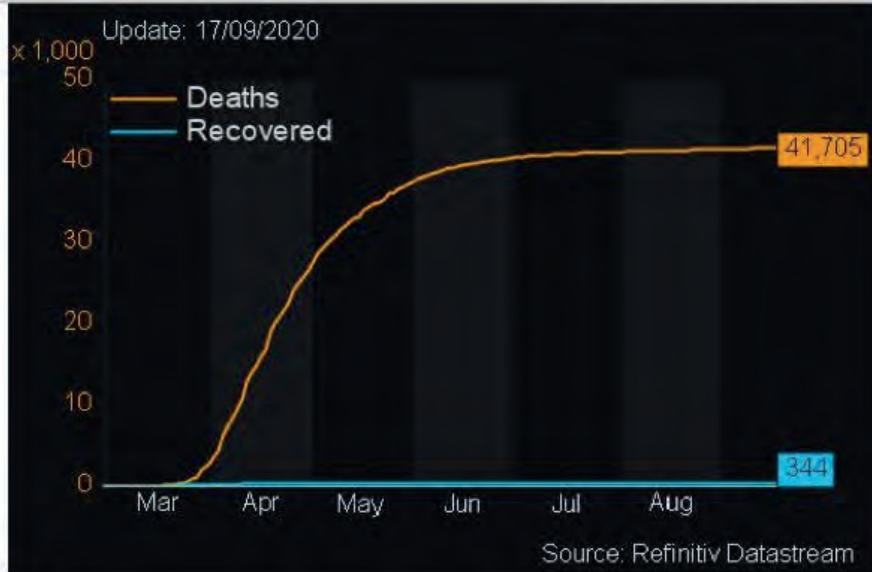
RUSSIA CASES TREND
SOURCE - Reuters





UK CASES TREND
SOURCE - Reuters


Update: 17/09/2020
x 1,000
Cumulative cases
Daily increase/decrease
500
400
300
200
100
0
7,000
5,000
4,000
2,000
1,000
0
412,029
3,395
Mar
Apr
May
Jun
Jul
Aug
Source: Refinitiv Datastream


Update: 17/09/2020
x 1,000
50
Deaths
Recovered
40
30
20
10
0
41,705
344
Mar
Apr
May
Jun
Jul
Aug
Source: Refinitiv Datastream