

BankDirector.

Breakout 3:
**Tightening Bank
Regulation – The
Pendulum Swings:
What it Means for
Bank Creditworthiness**

Christopher Wolfe

Fitch Ratings, Inc.

#A0BA24

The background features an aerial view of a city with various buildings and streets. Overlaid on this are several large, semi-transparent geometric shapes: a grey chevron pointing down and to the right, and a red chevron pointing up and to the right. The text is positioned on the left side of the image.

FitchRatings

North American Banks Outlook 2024

Navigating in a Higher for Longer
Rate Environment

Christopher Wolfe
Managing Director and Head of
North American Banks

January 30, 2024



#1

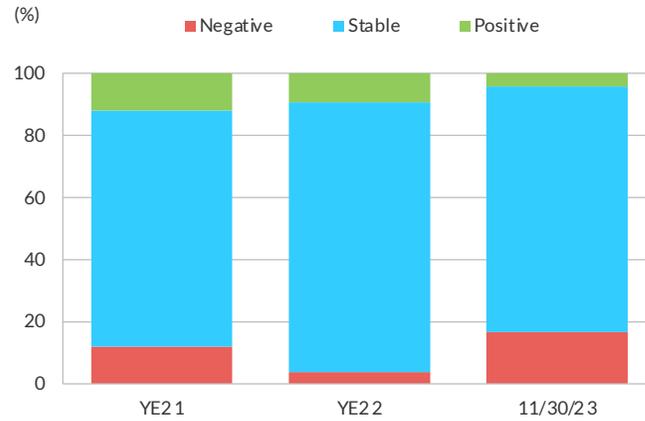
U.S. Banks Outlook

Navigating in a Higher
for Longer Rate
Environment

FitchRatings

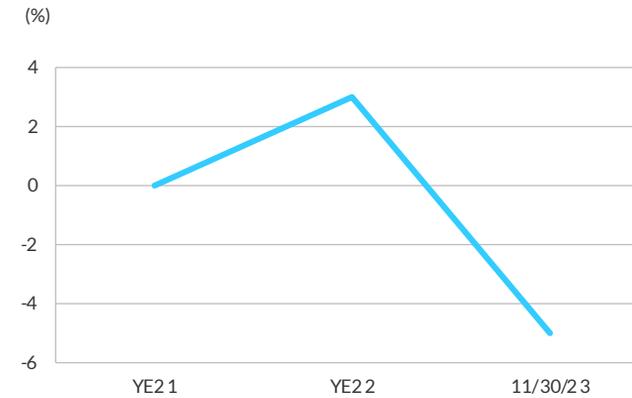
U.S. Banks Ratings Activity

U.S. Banks – Rating Outlooks/Watch



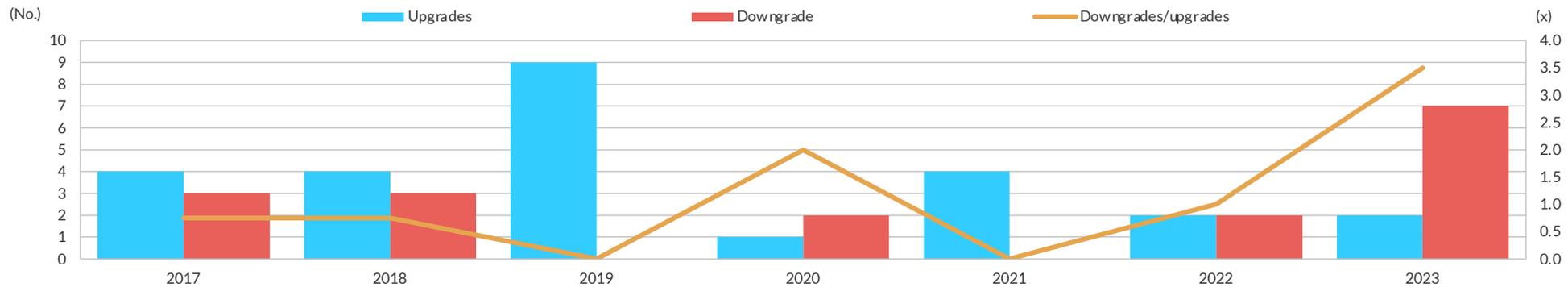
Source: Fitch Ratings

U.S. Banks – Net Outlook Balance



Source: Fitch Ratings

U.S. Banks – Rating Changes



Source: Fitch Ratings

Banks Contending with Slowing Economic Growth and Monetary Policy Uncertainties

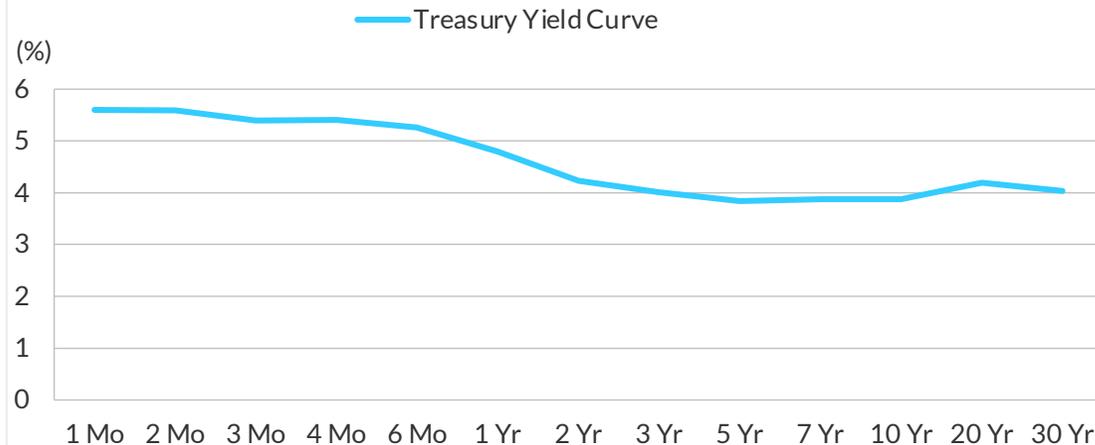
U.S. Economic Forecast Summary

(%)	Ann. Av. 2018–2022	2022	2023F	2024F	2025F
GDP	2.2	1.9	2.4	1.2	1.4
Consumer Spending	2.6	2.5	2.2	1.3	1.2
Fixed Investment	2.8	1.3	0.2	-1.4	2.2
Net Trade (contribution pps.)	-0.5	-0.5	0.5	0.0	-0.2
CPI Inflation (end-year)	3.6	6.5	3.3	2.6	2.4
Unemployment rate	4.9	3.6	3.6	4.6	4.8
Policy Interest Rate (end-year)	1.40	4.5	5.5	4.75	3.50
Exchange Rate, USD/EUR (end-year)	0.88	0.94	0.93	0.93	0.93

Source: Fitch Global Economic Outlook Dec. 2023.

Treasury Yield Curve

(As of 12/29/2023)



Source: U.S. Department of Treasury, Fitch Ratings

Potential Tailwinds

Potential Headwinds

Interest Rate Cuts

Weakening Credit Performance

Falling Inflation

Slowing Economic Growth

Quantitative Tightening

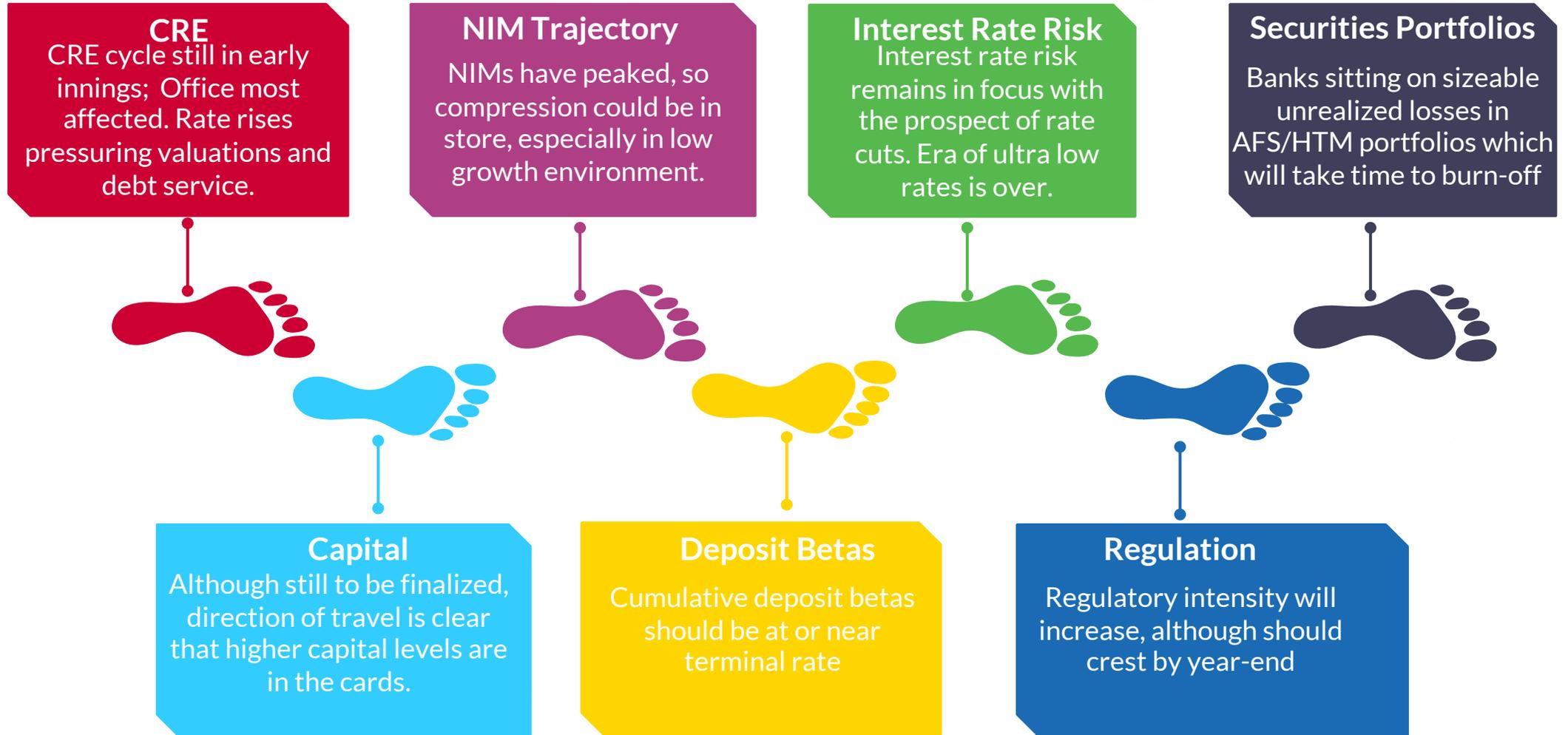
2024 Key Fundamental Expectations Reflect Ongoing Deterioration

2024 Fitch Expectations (vs. 2023)

	Base Case	Comments
Net Charge-offs		Net charge-offs are expected to rise for both consumer and commercial loans as the U.S. economy slows. Weaker repayment capacity as a result of declining profits for businesses, lower wage growth for consumers and an increasing debt service burden will also contribute to higher losses. Credit losses will likely accelerate in 2024.
Loan Loss Provision		Loan loss provisions will be driven upward by deteriorating economic conditions and should move higher in advance of loan losses. The increase will also be driven by the level of exposure to consumer and CRE, specifically office real estate loans.
Net Interest Income		Expected to decline next year, based on low loan growth and sustained NIM compression due to a shift in both the loan/securities portfolio mix and deposit mix.
Non-Interest Income		Decelerating economic growth, higher rates for longer and a potential reduction in credit card fees will weigh on retail fee income. However, this is likely to be offset by corporate banking, underwriting and advisory business revenues.
Operating Expenses		Operating expenses likely to be adjusted down to accommodate higher credit costs and weaker revenue growth.
Operating Profitability		Although highly dependent on economic growth trajectory, higher loan loss provisions as delinquencies continue to normalize will likely exceed revenue growth and result in lower profitability relative to 2023.
Loan Growth		We expect a continued moderation of loan growth as the effects of the Fed's tightening monetary policy result in slowing economic growth and banks tighten their underwriting standards.
Deposit Growth		The effects of the Fed's tightening of monetary policy, including quantitative tightening, are expected to result in higher outflows and net shrinkage in bank deposits though to a lesser extent than in 2023, as customers redeploy excess cash into higher yielding alternatives.
Capitalization		U.S. banks' risk-based capital ratios are expected to increase slightly in 2024 as banks conserve capital in light of current regulatory uncertainty.
Funding and Liquidity		Loan to deposit ratios are expected to increase further in 2024 and net outflows of bank deposits could lead to a higher reliance by some banks on less stable brokered deposits and wholesale funding sources.

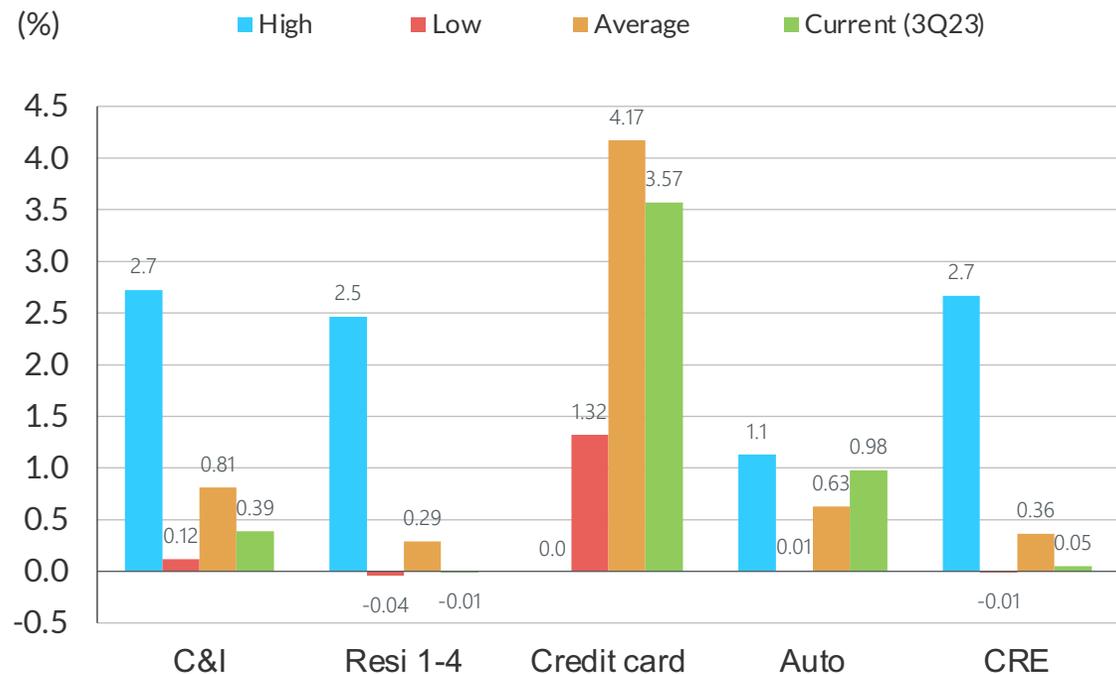
Source: Fitch Ratings.

Navigating in a Higher for Longer Rate Environment – “Walking the Walk”



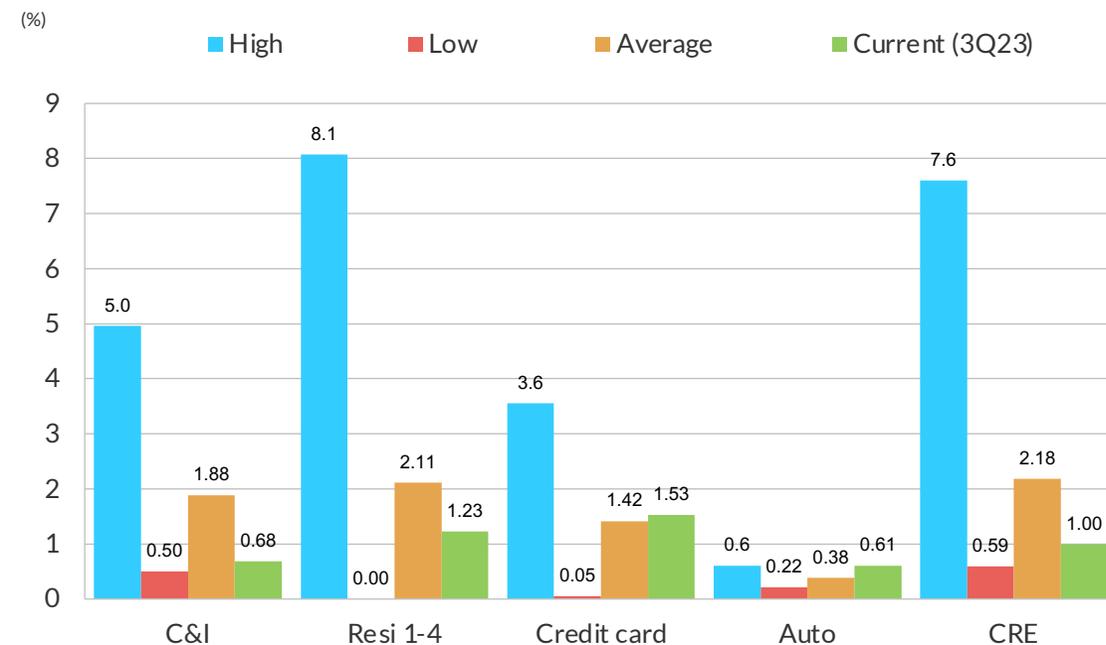
Asset Quality Performance Set to Revert to Long-Run Averages

Charge-off Rates Below Historical Averages



^aPeriod between 1Q84 and 3Q23. Note: High credit card charge-off rate excluded for scale purposes (13.21%)
Source: Fitch Ratings, FDIC

Delinquency Rates Below Historical Averages^a



^aPeriod between 1Q84 and 3Q23; Loans > 90 days past due and in non-accrual status
Source: Fitch Ratings, FDIC

CRE – Delinquencies Rising, Losses to Come

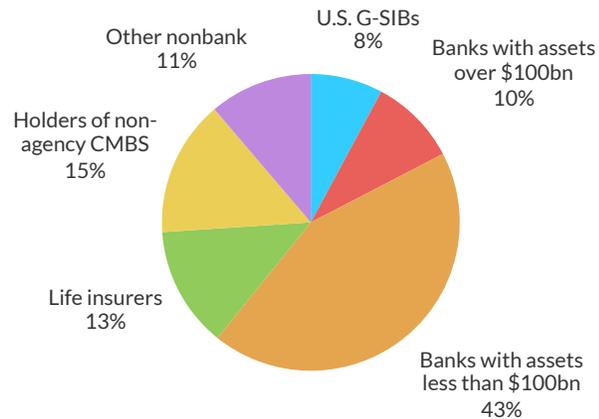
CRE NPLs by bank size over time

	Jun 2023-YTD	Mar 2023-YTD	Dec 2022-YTD	Sep 2022-YTD	Jun 2022-YTD	Mar 2022-YTD	Dec 2021-YTD	Sep 2021-YTD	Jun 2021-YTD
>\$250bn	2.05%	1.74%	0.67%	0.64%	0.62%	0.84%	0.87%	0.95%	1.10%
\$100bn - \$250bn	1.11%	1.09%	0.89%	0.89%	1.06%	1.11%	1.24%	1.26%	1.32%
\$10bn - \$100bn	0.47%	0.44%	0.40%	0.41%	0.45%	0.51%	0.43%	1.06%	1.43%
\$1bn - \$10bn	0.55%	0.52%	0.51%	0.55%	0.56%	0.62%	0.69%	0.80%	0.90%
<\$1bn	0.68%	0.59%	0.61%	0.65%	0.69%	0.74%	0.80%	0.90%	0.97%

source: Fed Fis

Holdings of Nonfarm Nonresidential CRE

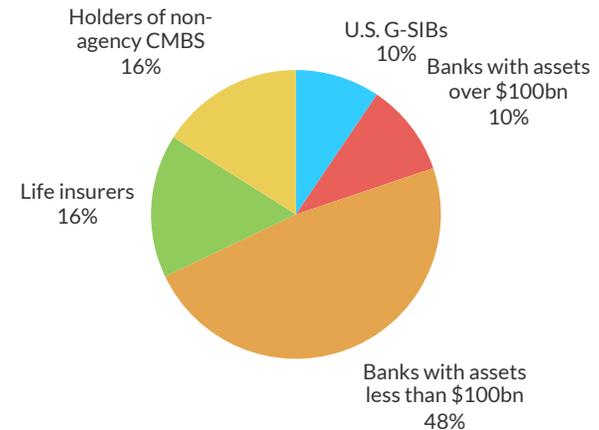
Universe \$3.57Trillion



Source: Federal Reserve

Holdings of Office and Downtown Retail CRE

Universe \$1.06Trillion



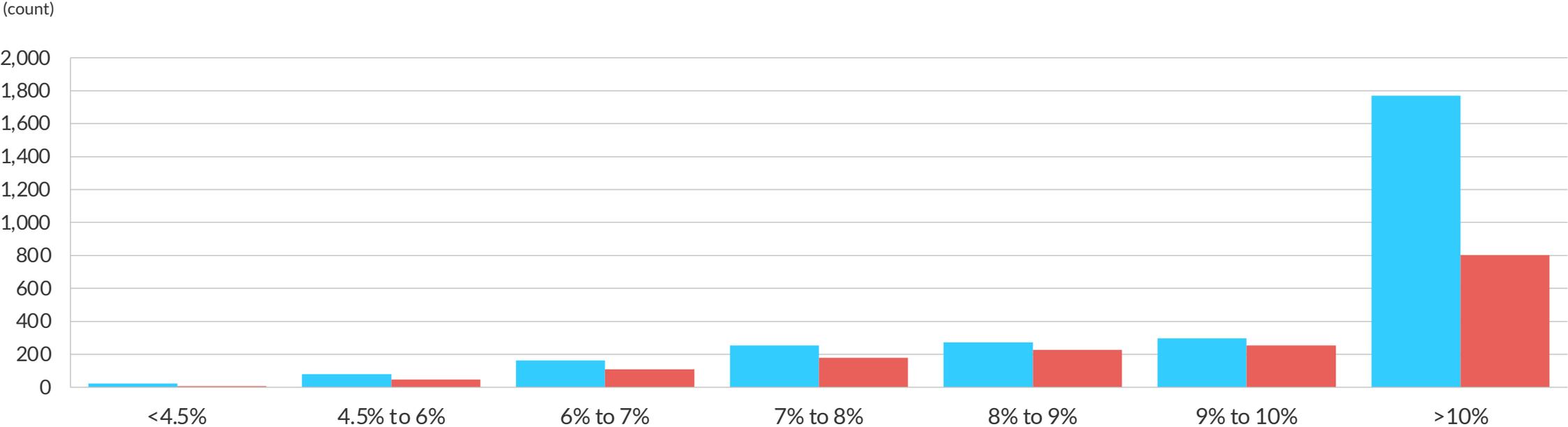
Source: Federal Reserve

CRE DFAST Stress Applied Across Industry Causes a Few Banks to Breach PCA Thresholds

Estimated Capital Ratios under DFAST CRE-only Loss Scenario

Subtitle

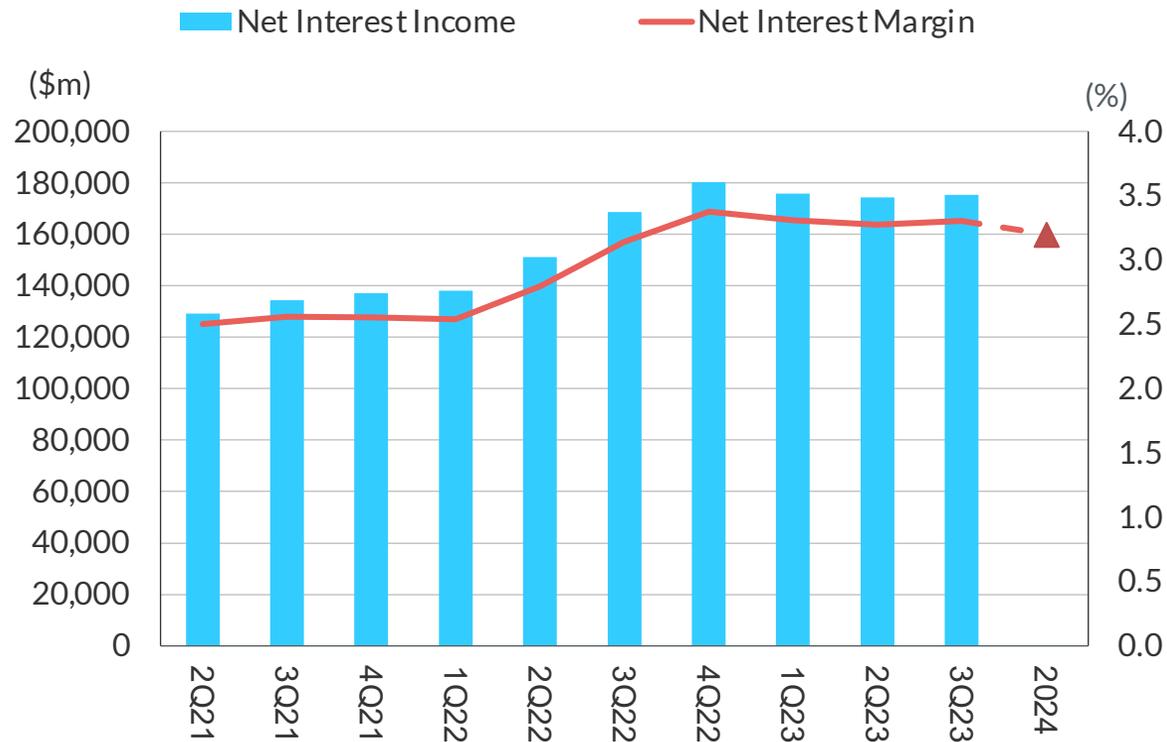
■ Pro forma CET1 ■ Pro forma CBLR



Source: Fitch

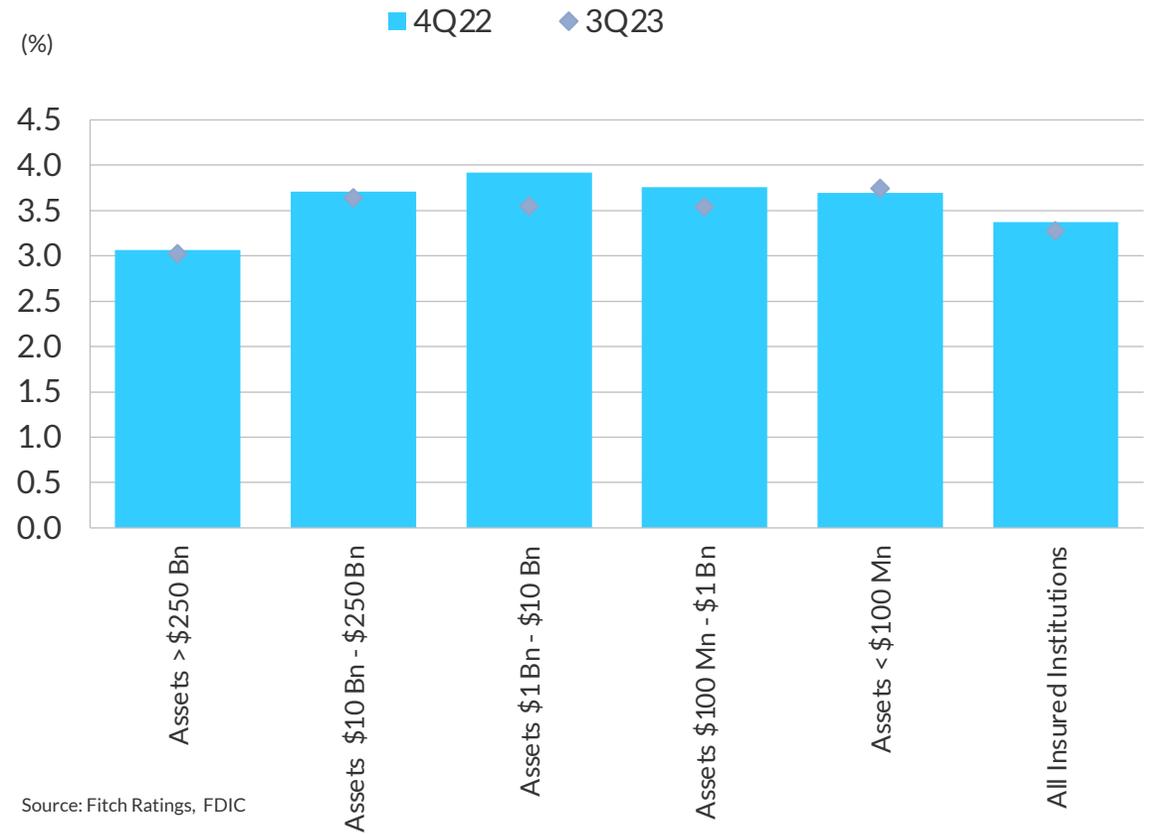
NIM Compression Expected, Although Varies by Bank Size

NIM Compression Anticipated in 2024



Note: Net interest Income and NIM for all FDIC-insured Commercial Banks and Savings Institutions
 Fitch's expectation is the 2024 Net Interest Margin decline from 3Q23 levels.
 Source: FDIC

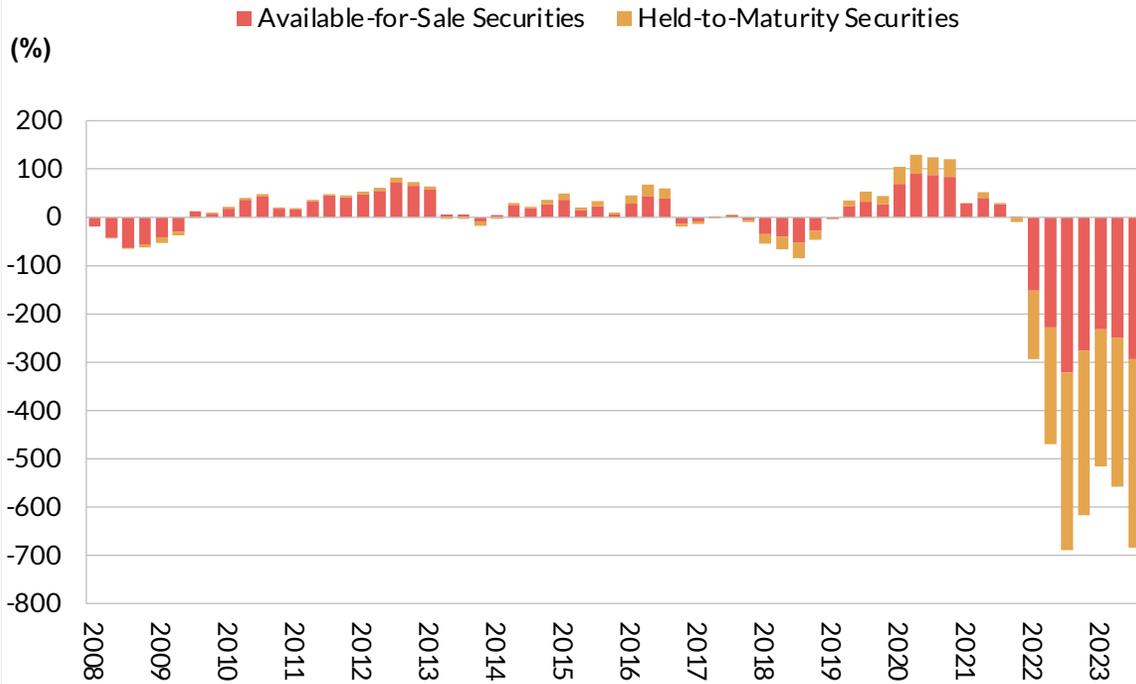
NIM Compression Varies by Bank Size



Source: Fitch Ratings, FDIC

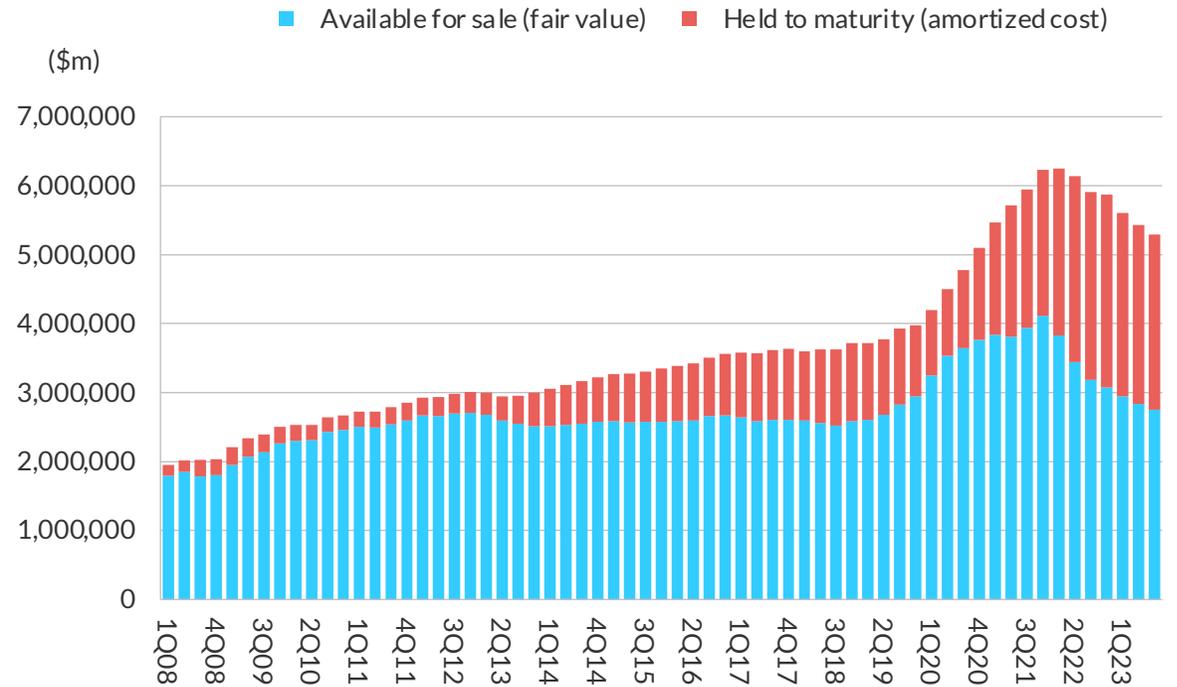
Prospect of Interest Rate Cuts Should Reduce Unrealized Losses on Securities Portfolios

Unrealized Gains (Losses) on Investment Securities



Source: FDIC, Fitch Ratings

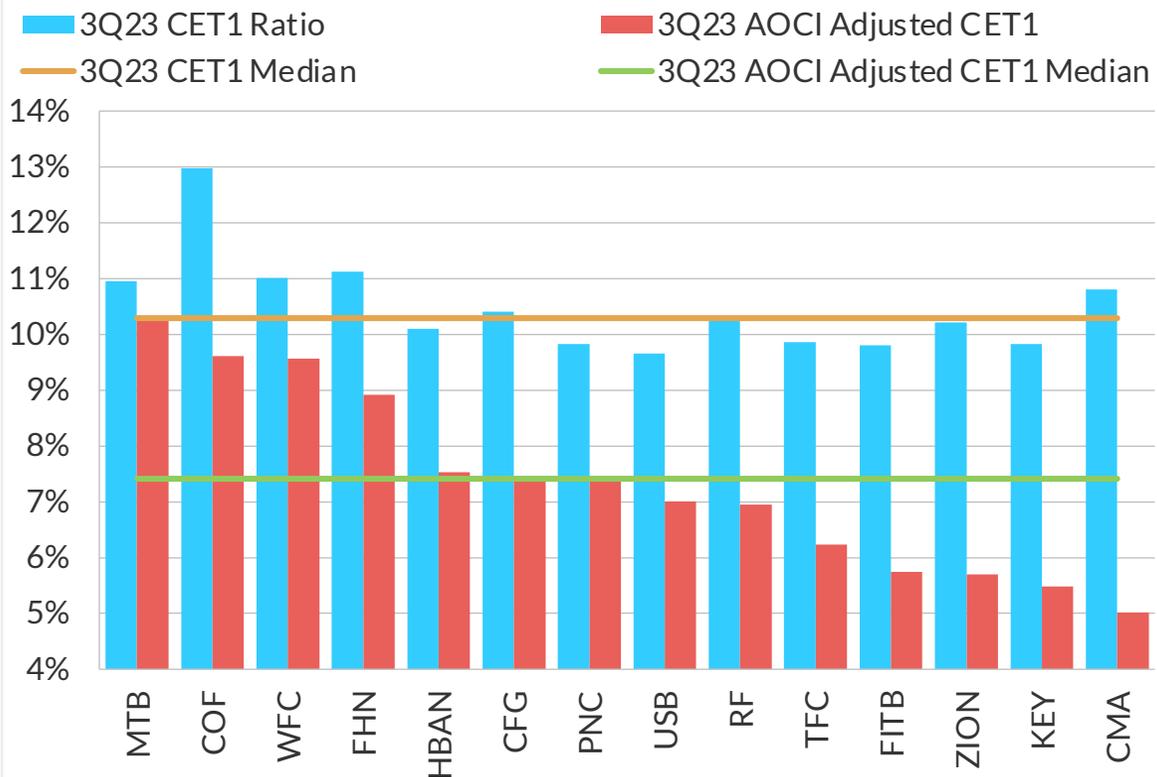
Total HTM vs. AFS Securities



Source: FDIC, Fitch Ratings

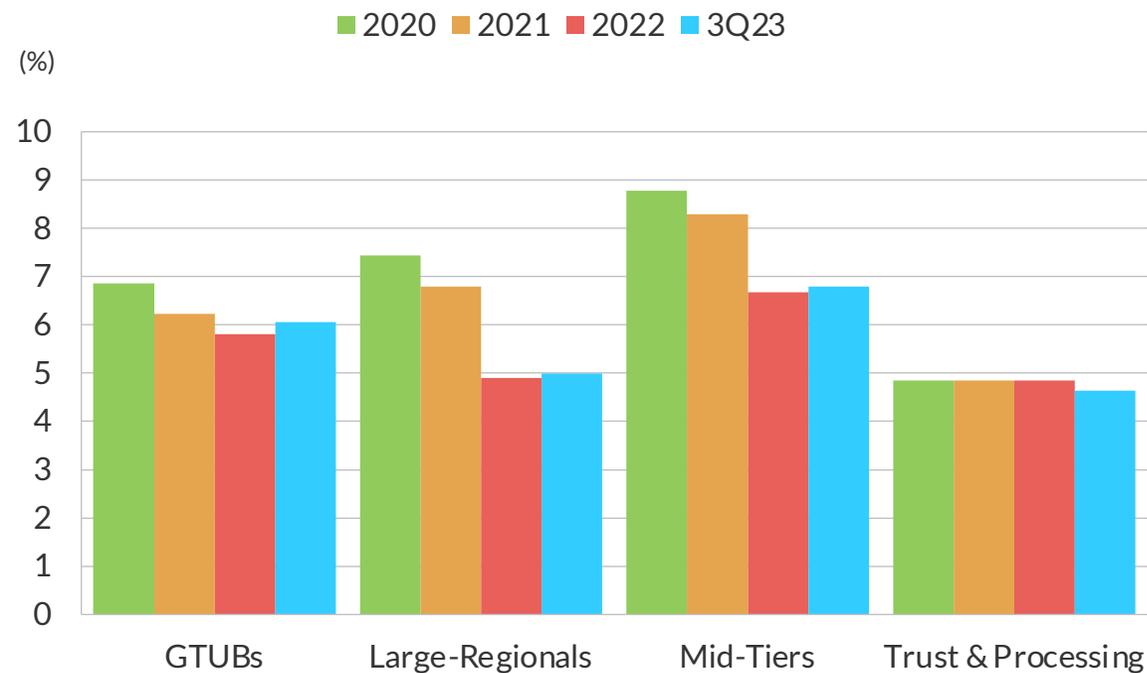
Capital Ratios for Cat I-IV Banks Set to Increase with Basel III Proposal

Large Regionals AOCI Impact on CET1



Source: Fitch Ratings, FedFIS

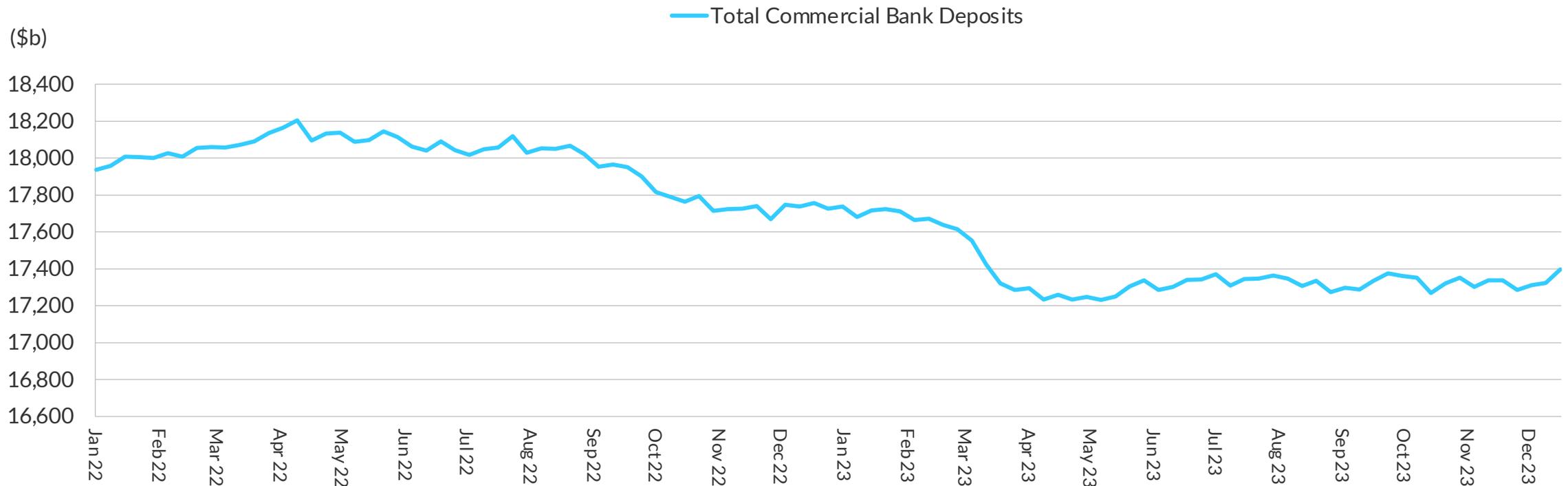
Median TCE Ratio



Source: Fitch Ratings, FedFIS

Funding and Liquidity Normalizes After Wild 2023

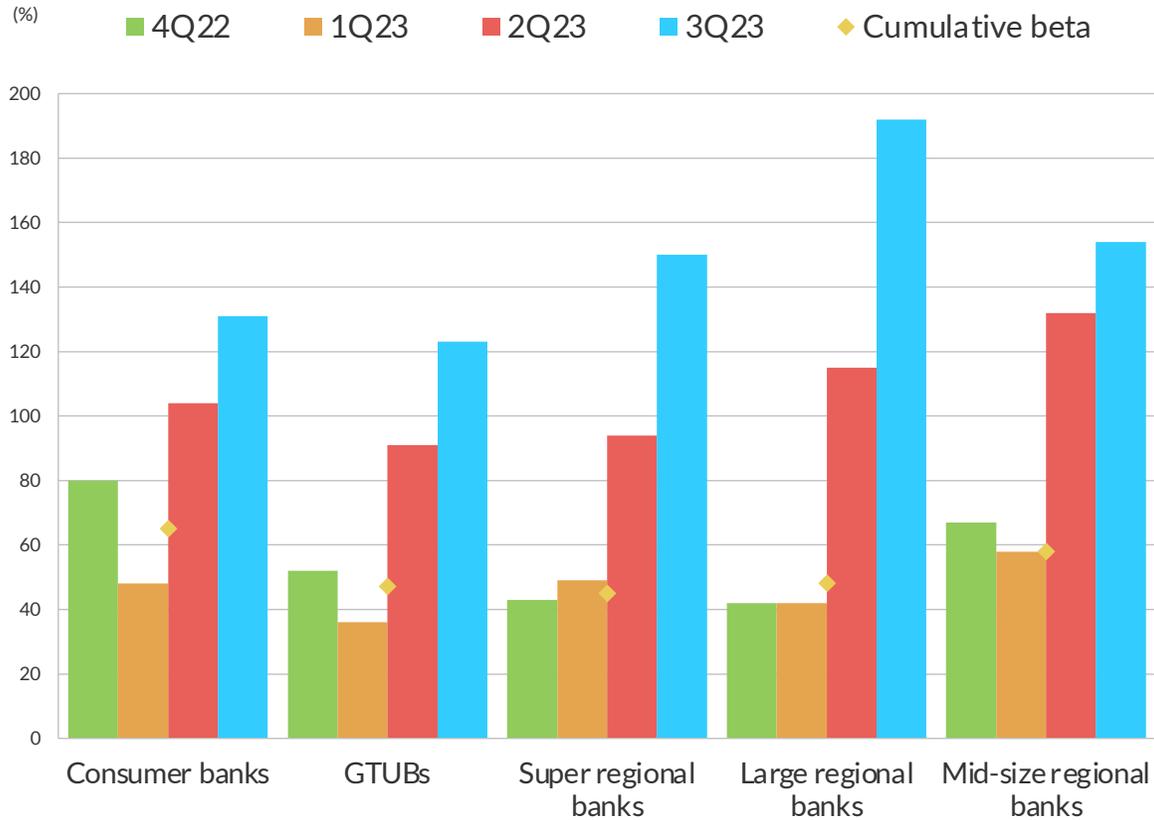
Total Deposits in All Commercial Banks



Source: St. Louis Fed, Fitch Ratings

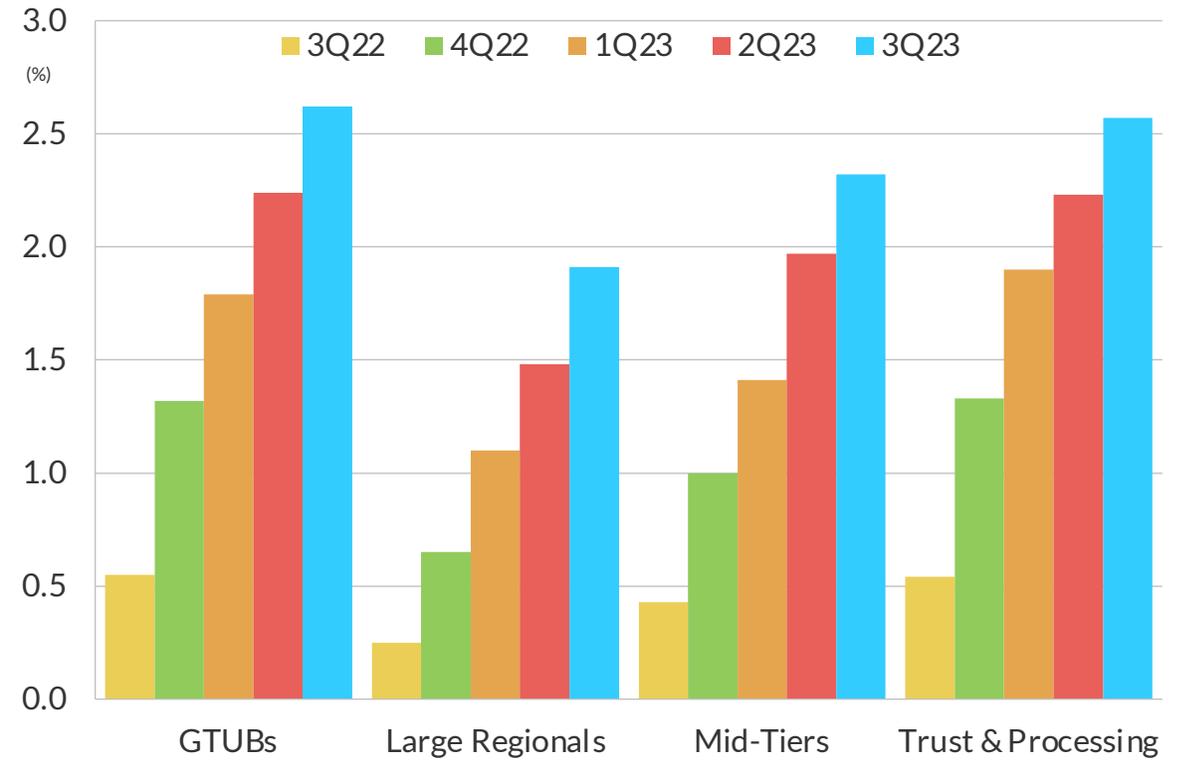
Deposit Betas and Costs Stabilizing

Sequential Deposit Betas



Source: Fitch Ratings, Company filings

Total Cost of Deposits



Source: Fitch Ratings, FedFIS



#2

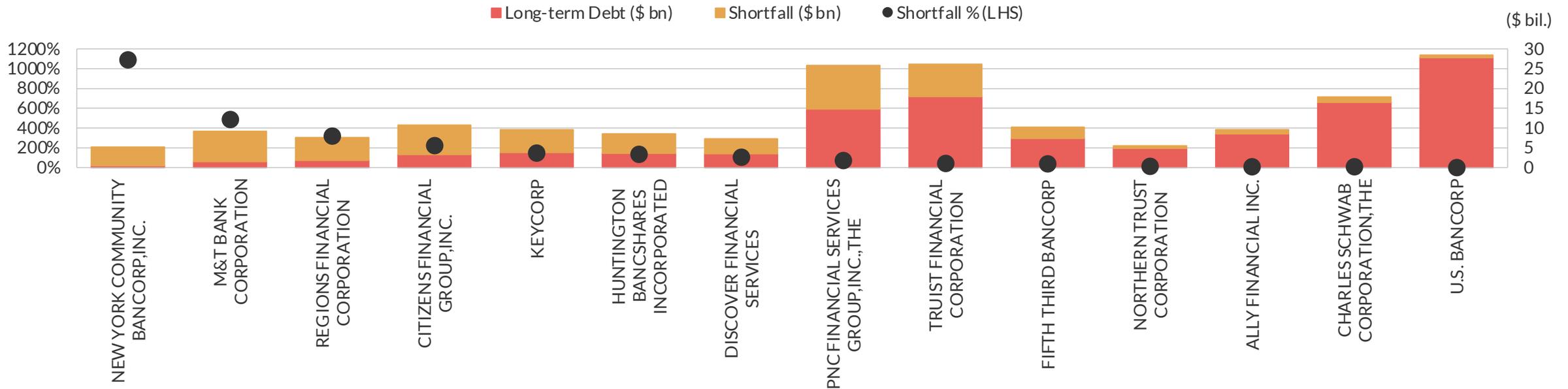
**U.S. Banking
Regulation and
Consolidation
Endgame**

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U.S. Bank Regulation: Long-Term Debt Impacts

- Long-term Debt requirement for regional banks (>\$100 billion in assets);
- Extending Liquidity Coverage Ratio (LCR) and Net Stable Funding Requirement (NSFR) to Category IV banks;
- Basel III Endgame Capital Proposal

Regional Bank LTD Requirement

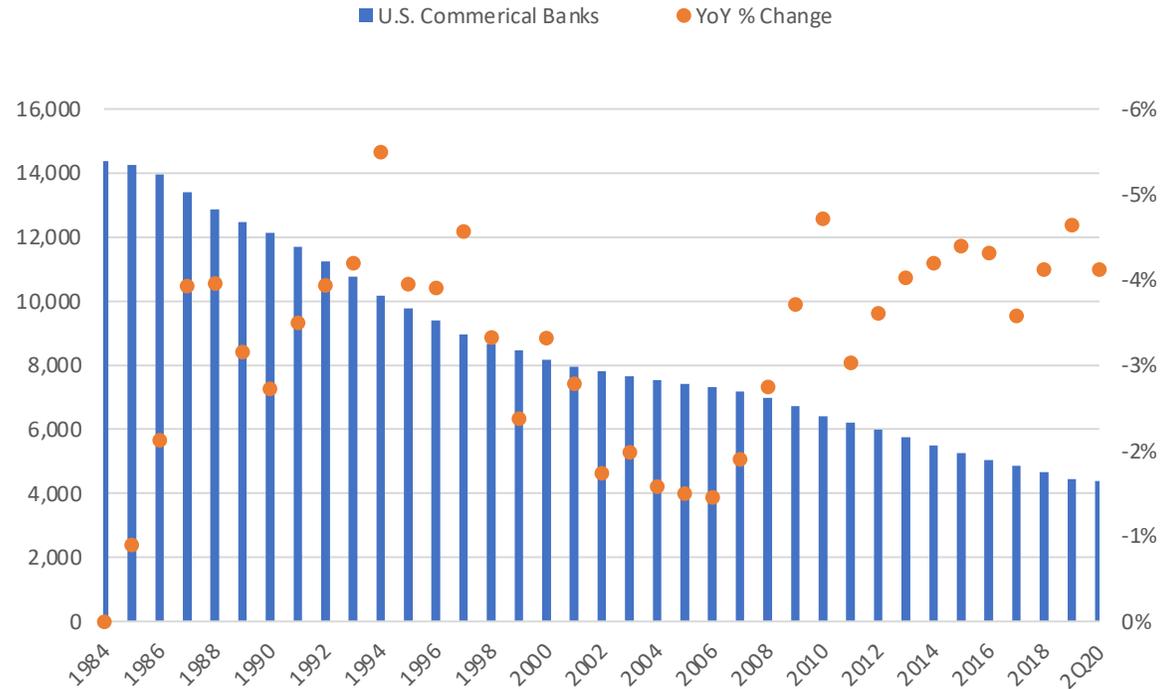


Source: Fitch Ratings

U.S. Bank Consolidation Expected to Continue...

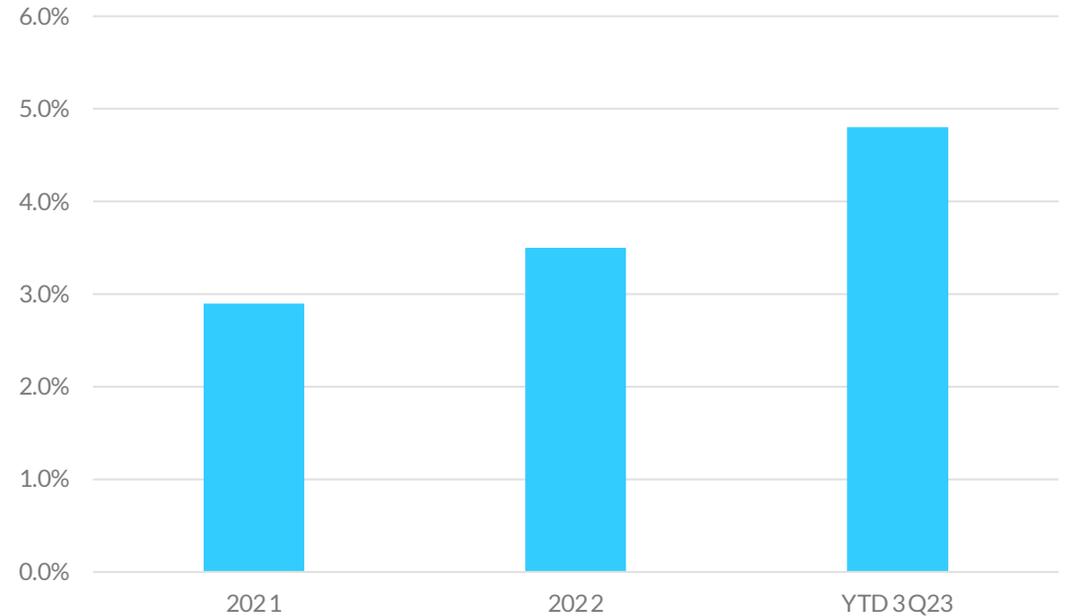
Total U.S. Commerical Banks

1984-2Q20



Source: Fitch Ratings, FRED

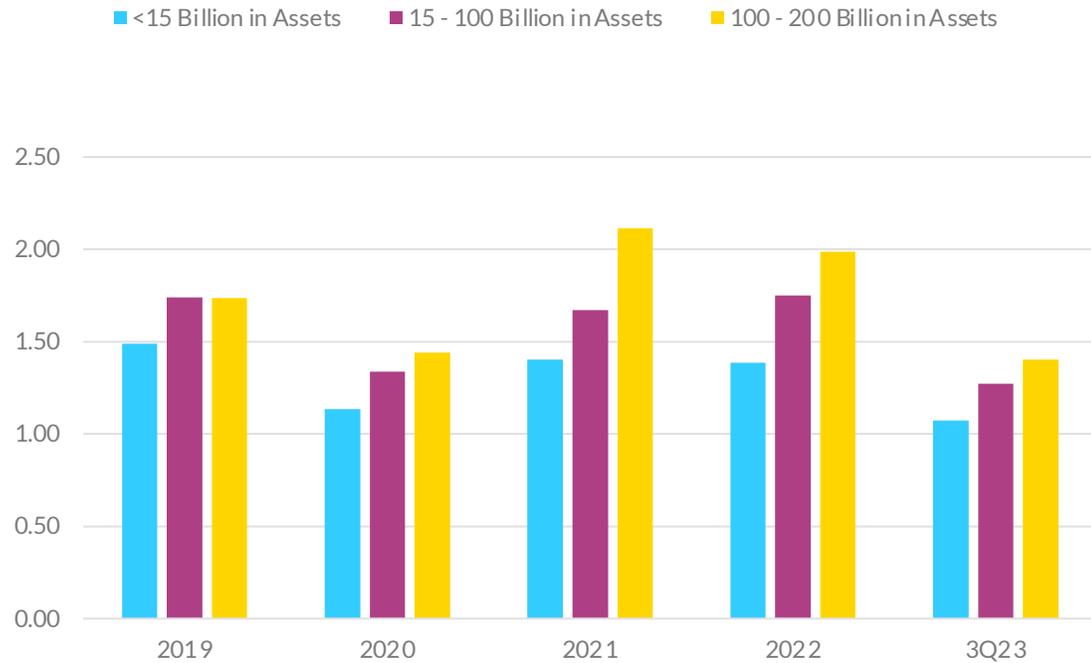
Proportion of Community Banks with Net Losses



Source: Fitch Ratings, FedFIS

....Although Waiting on Certainty of Asset Performance, Valuation, and Execution

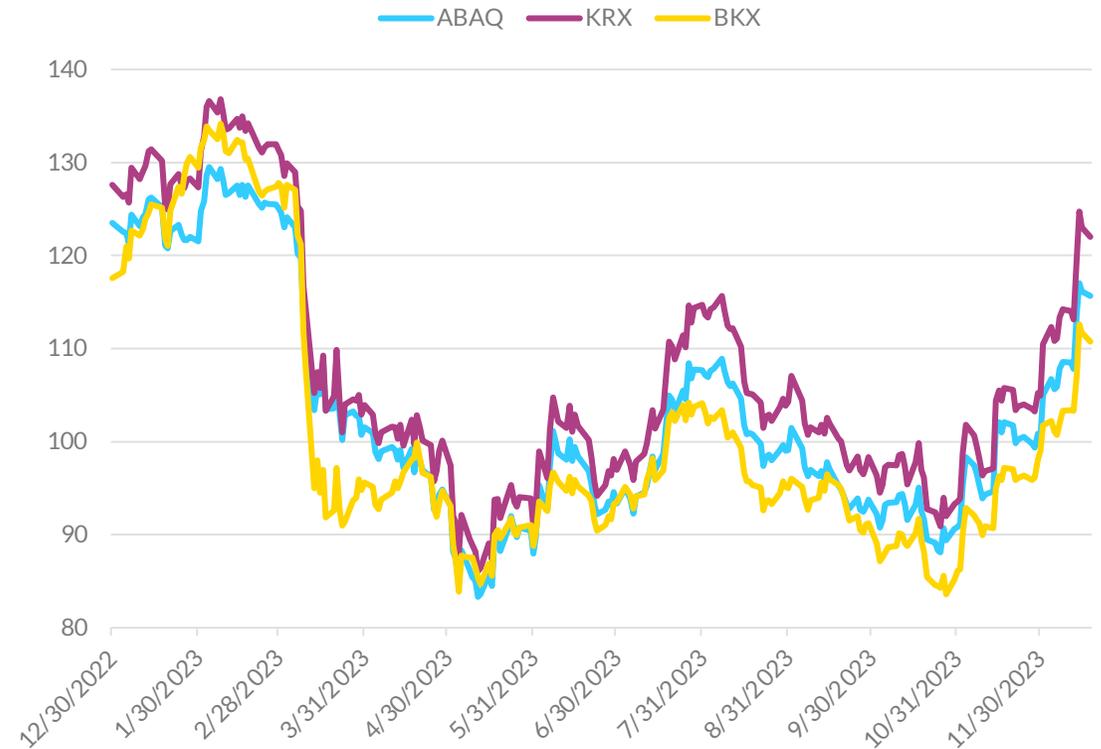
Price to Tangible Book



Source: Fitch Ratings, Factset

Stock Performance YTD 2023

YTD through 12/19/23



Related Research

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[U.S. Banks Outlook 2024](#)

[U.S. Regional Banks Factoring Climate Risks into Credit Decisions, Investment Strategies](#)

[Global Banking Regulation Outlook 2024](#)

[Basel III: Product Impact and Use of Ratings](#)

[What Investors Want to Know: Enhancements to Rating Analysis Following US and Credit Suisse Bank Failures](#)

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Breakout 3:
**Tightening Bank Regulation
– The Pendulum Swings:
What it Means for Bank
Creditworthiness**

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Christopher Wolfe

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