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OUTLOOK
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Banking System Outlook – US

Outlook changed to negative on rapidly deteriorating operating environment

We have changed to negative from stable our outlook on the US banking system to reflect the rapid deterioration in the operating environment following deposit runs at Silicon Valley Bank (SVB), Silvergate Bank, and Signature Bank (SNY) and the failures of SVB and SNY. Although the Department of the Treasury, Federal Reserve and FDIC announced that all depositors of SVB and Signature Bank will be made whole, the rapid and substantial decline in bank depositor and investor confidence precipitating this action starkly highlight risks in US banks' asset-liability management (ALM) exacerbated by rapidly rising interest rates. The Fed has announced a new temporary liquidity facility to offer loans to banks against eligible government securities collateral to help meet their funding needs and reduce contagion risks. However, banks with substantial unrealized securities losses and with non-retail and uninsured US depositors may still be more sensitive to depositor competition or ultimate flight, with adverse effects on funding, liquidity, earnings and capital. Banks with lower unrealized securities losses, stronger capitalization, diverse sectoral exposures, and granular insured deposit bases will be more shielded or benefit from a flight to quality. Our base case is for the Fed's monetary tightening to continue, which could deepen some banks' challenges. Further drivers of the outlook are detailed in the overview table and bullets that follow.

Exhibit 1

OVERVIEW OF KEY DRIVERS 2023

Operating environment	DETERIORATING	–	Continued tight monetary policy may exacerbate flaws in banks' asset-liability management, with Fed funds rate to peak at 5.25%-5.50%, even as inflation is set to decline to around 3% by year-end.
		–	The US will tip into mild recession in mid-2023, with real GDP growth likely to remain below average in 2023-24 and unemployment rising from an exceptional low of 3.4% in January 2023.
Asset risk	DETERIORATING	–	Asset quality metrics are unsustainably strong and will weaken as rising interest rates increase debt-servicing costs and refinancing risk for some borrowers.
		–	Stress on the banking sector could be detrimental to the broader economy, exacerbating asset risk.
		–	Banks have reserves to absorb increased credit losses, but likely need to make additional provisions.
Capital	STABLE	=	Banks are generally well capitalized to face the deteriorating environment, but unrealized losses on available-for-sale securities are a capital headwind.
		=	Risk-based capital requirements are increasing for some of the largest US banks, and we expect only modest capital reductions given banks' publicly stated capital targets.
Profitability and efficiency	DETERIORATING	–	Banks facing deposit outflows will pay sharply higher deposit rates; deposit betas already rising for most banks.
		–	Tighter financial conditions will continue to pressure asset management and mortgage banking.
		+	Rising rates will benefit interest income for banks with strong core deposit franchises.
Funding and liquidity	DETERIORATING	–	Heightened depositor sensitivity and tight monetary policy are increasing pressure on funding and liquidity; however, some banks with stronger fundamentals may have a deposit influx.
		=	The system loan to deposit ratio is near multi-decade lows, but securities holdings remain high, posing ongoing ALM risk, and quantitative tightening could further reduce funding.
Government support	STABLE	+	Temporary increase in government liquidity support for depositors, with incremental benefit for other creditors.
		=	We maintain our assumption of a modest probability of government support for certain ratings of only eight large US banks and no support assumptions for regional and community banks.

IMPROVING   STABLE   DETERIORATING

Source: Moody's Investors Service

Rapid deterioration in operating conditions will constrain funding, liquidity and capital at affected banks

Operating conditions have sharply deteriorated. Pandemic-related fiscal stimulus along with more than a decade of ultralow interest rates and quantitative easing resulted in significant excess deposit creation in the US banking sector. This has given rise to asset-liability management challenges, with some banks having invested excess deposits in longer-dated fixed-income securities that have lost value during the rapid rise in US interest rates, resulting in significant unrealized losses in banks' available-for-sale and held-to-maturity securities' portfolios. It appears SVB was forced to sell securities at a loss to meet unexpectedly pronounced deposit drawdowns, precipitating the deposit run that resulted in the bank's rapid failure. While the Federal Reserve's new Bank Term Funding Program (BTFP) is constructive, we expect depositor and investor focus will turn to banks that may have a similar mismatch between deposits and asset duration as well as weaker profitability and capital. We expect pressures to persist and be exacerbated by ongoing monetary policy tightening, with interest rates likely to remain higher for longer until inflation returns to within the Fed's target range. US banks also now are facing sharply rising deposit costs after years of low funding costs, which will reduce earnings at banks, particularly those with a greater proportion of fixed-rate assets. Combined with this most recent stress in the banking sector, further interest rate increases could deepen some banks' ALM and profitability challenges.

Our base case is that the US will enter a mild recession in the latter part of 2023, with real GDP growth likely remaining below trend in 2024. A gradual rise in the US unemployment rate from an exceptional low of 3.4% as of January 2023 to just under 5% will mute labor market disruptions compared with previous recessions. The housing sector is already weakening. The real estate, construction and manufacturing sectors are set to downshift as rising interest rates, the strong US dollar and weaker growth among trading partners hit domestic demand and exports. We expect headline and core inflation to decline over 2023-24, which should allow the Fed to move to a neutral policy stance in 2025.

Asset risk metrics will rise over the next 12-18 months from historical lows. Both nonperforming loans and net charge-offs (NCOs) are likely to rise following the more benign conditions that resulted from pandemic forbearance programs, multiple rounds of fiscal stimulus and very accommodative monetary policy. Higher interest rates are reducing debt affordability, excess consumer and corporate liquidity is waning, and financial conditions, particularly bank credit, are tightening. Average credit card and bank auto NCOs have been rising and are likely to peak at 5% and 1.5%, respectively, in 2024. Residential mortgage NCOs are likely to rise only modestly over the next several years. The asset quality of leveraged corporate borrowers and lower-income consumers are most at risk. The rise of private credit markets could result in elevated systemic risk, which may spill over to the banks' commercial and industrial lending via weakening underwriting. Commercial real estate (CRE) loan exposures may become riskier because of hybrid work arrangements. In previous downturns, high CRE concentrations, which are most common among small and mid-sized regional banks, have been a key source of bank credit strains, and even failures. We expect banks will need to increase reserves as the economy worsens later in the year. Banking sector stresses could, in turn, be detrimental to the broader economy, worsening banks' asset risk.

Banks are generally well capitalized to face the deteriorating operating environment, but unrealized securities losses are a headwind. US banks we rate generally have good capital buffers above regulatory requirements and, for most, capital ratios are likely to remain a core credit strength. For the G-SIBs[1], a rise in capital ratios over the last year is likely to continue, given increasing risk-based regulatory capital requirements. Capital requirements may also rise for large regional banks in 2023 in light of recent events [2]. Annual regulatory stress tests for the largest banks, as well as prudential requirements, may limit material erosion of their solid capital buffers. Some banks will curtail lending, common share repurchases and dividends to preserve capital and liquidity given the stressed operating environment.

Profitability will decline for many banks. Those banks facing increased ALM risk may need to raise deposit rates sharply to stem deposit outflows and avoid crystallization of unrealized losses. Deposit betas are already rising for most banks, and we expect them to rise further in 2023. For banks less affected by the deteriorating operating environment, especially those with strong core deposit funding, rising interest rates will help sustain increases in NIM[3] and NII[4] realized during 2022, though we do not expect much further improvement during 2023. Fee income provides revenue diversity, but tighter financial conditions will keep pressure on segments like asset management and mortgage banking. Trading revenue may benefit from volatile financial market conditions, though this will entail prudent risk management that may be more difficult in times of elevated volatility and tighter financial conditions. Investment banking fees will lag in the challenging operating environment, but may improve in the second half of 2023 from a weaker 2022. Higher credit provisions will be necessary to build loan loss reserves in a recessionary environment.

Funding and liquidity conditions have sharply deteriorated for some banks; the Fed's new bank funding facility is constructive. The deteriorating operating environment will be felt most keenly by banks exposed to deposit flight. Banks that are perceived to be the most stable will benefit from drawing deposits from other banks, with improvements to liquidity. The Federal Reserve's BTFP will provide a temporary but helpful backstop to reduce funding risks at banks. However, the Fed's quantitative tightening (QT) will continue to lower bank deposits, as will consumers' drawing down of savings to fund consumption amid higher inflation. QT will reduce banks' reserve balances at the Fed but the Fed's new BTFP, if meaningfully utilized, could boost banks' reserves at the Fed. Loan growth, while slowing, is likely to outpace deposit growth, which will increase the system's loan to deposit ratio from a near multi-decade low reached during the pandemic. Smaller banks have more rapidly resorted to wholesale funding, such as FHLB[5] advances, than larger peers, which will continue for those banks most exposed to deposit flight.

The Federal Reserve's BTFP also has incremental benefit for bank creditors through reducing liquidity risk and supporting franchise value. However, this is temporary support (advances can be requested until at least 11 March 2024) that only applies to eligible collateral that was owned by the banks as of 12 March 2023. Our US bank ratings do not incorporate any uplift for government support, other the existing support assumptions we incorporate into certain debt and deposit ratings of eight G-SIBs[6]. Our government support assumptions for US banks are unlikely to change over the next 12-18 months.

Exhibit 2
Aggregate key indicators for rated US banks

	Q3 2022	2021	2020	2019	2018
KEY RATIOS					
Problem Loans / Gross Loans	0.8%	0.9%	1.5%	1.3%	1.4%
Tangible Common Equity / Risk Weighted Assets	12.5%	13.9%	13.0%	13.0%	12.9%
Net Income / Tangible Assets	0.7%	1.4%	0.8%	1.2%	1.4%
Market Funds / Tangible Banking Assets	9.3%	7.3%	8.7%	11.2%	11.6%
Liquid Banking Assets / Tangible Banking Assets	31.0%	37.2%	34.0%	28.0%	27.2%
ADDITIONAL RATIOS					
Loan Loss Reserves / Problem Loans	265.3%	257.2%	250.4%	142.0%	138.8%
Loan Loss Provisions / Average Gross Loans	0.3%	-0.2%	1.0%	0.4%	0.4%
Net Interest Margin	3.0%	2.9%	2.9%	3.3%	3.4%
Net Income / Average RWA	1.7%	2.1%	1.3%	1.8%	1.9%
Pre Provision Income / Average RWA	2.5%	2.4%	2.5%	2.6%	2.8%
Cost / Income Ratio	76.3%	60.5%	59.9%	58.9%	58.4%
Shareholders' Equity / Total Assets	9.6%	10.9%	10.3%	11.4%	13.3%

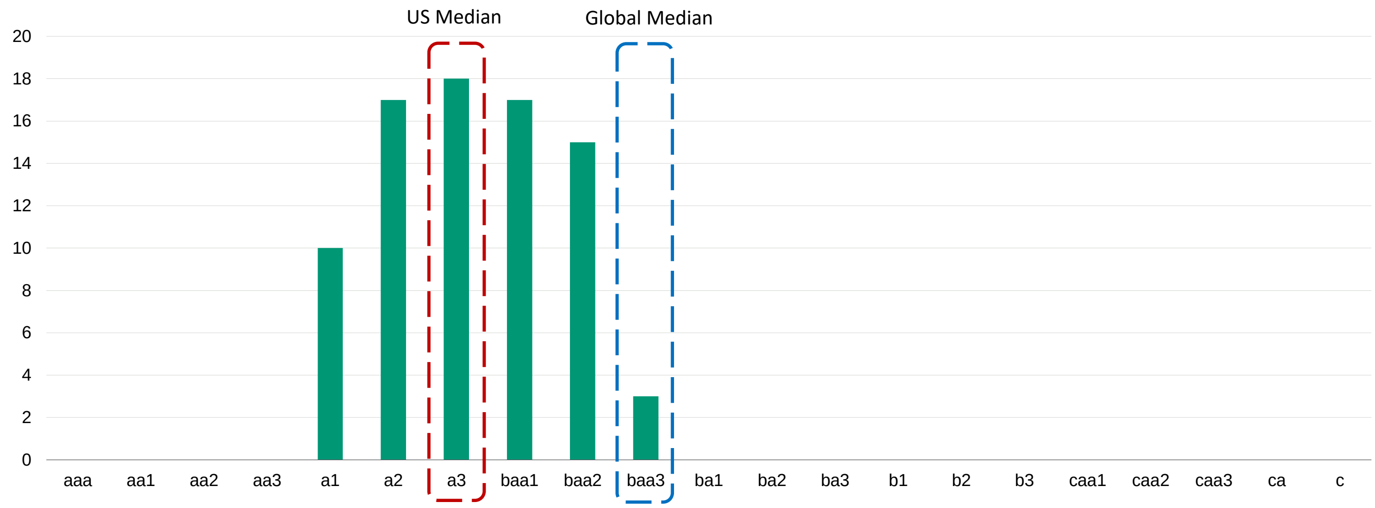
Source: Moody's Investors Service

Rating universe

US banks' Baseline Credit Assessments (BCAs) are distributed over a six-notch range from a1 to baa3 (Exhibit 3). The median US bank BCA is a3, three notches higher than the global median of baa3. We rate 72 banking groups in the US with 80 banking subsidiaries (Exhibits 4 and 5).

Exhibit 3

US bank BCA distribution as of 13 March 2023



Source: Moody's Investors Service

Exhibit 4
Rated US banks of 13 March 2023 (by BCA)

Entity Name	BCA	Adjusted BCA	Bank Deposit LT Rating	Bank Deposit ST Rating	Bank Sr/ Issuer Rating	Bank LT CRA	Bank ST CRA	HoldCo Sr Rating	Bank Issuer Outlook
Bank of New York Mellon Corporation (The)	a1	a1	Aa1	P-1	Aa2	Aa1(cr)	P-1(cr)	A1	STA
Commerce Bancshares, Inc.	a1	a1	Aa2	P-1	A2	Aa3(cr)	P-1(cr)	-	STA
Northern Trust Corporation	a1	a1	Aa2	P-1	A2	Aa3(cr)	P-1(cr)	A2	STA
State Street Corporation	a1	a1	Aa1	P-1	Aa3	Aa1(cr)	P-1(cr)	A1	STA
U.S. Bancorp	a1	a1	Aa2	P-1	A1	Aa3(cr)	P-1(cr)	A2	NEG
American Express Company	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	A2	STA
Bank of Hawaii Corporation	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	-	STA
BOK Financial Corporation	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	A3	STA
City National Bank	a2	a2	Aa3	P-1	A2	A1(cr)	P-1(cr)	-	STA
Comerica Incorporated	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	A3	RUR DOWN
Cullen/Frost Bankers, Inc.	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	A3	STA
First Hawaiian Bank	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	-	STA
JPMorgan Chase & Co.	a2	a2	Aa1	P-1	Aa2	Aa1(cr)	P-1(cr)	A1	STA
M&T Bank Corporation	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	A3	STA
Old National Bancorp	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	A3	STA
PNC Financial Services Group, Inc.	a2	a2	Aa3	P-1	A2	A1(cr)	P-1(cr)	A3	STA
TD Group US Holdings LLC	a2	a1	Aa2	P-1	A1	Aa3(cr)	P-1(cr)	-	STA
Truist Financial Corporation	a2	a2	Aa3	P-1	A2	A1(cr)	P-1(cr)	A3	STA
UMB Financial Corporation	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	-	RUR DOWN
Wells Fargo & Company	a2	a2	Aa1	P-1	Aa2	Aa1(cr)	P-1(cr)	A1	STA
Prosperity Bancshares, Inc.	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	-	STA
Amarillo National Bancorp, Incorporated	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	STA
Associated Banc-Corp	a3	a3	A1	P-1	-	A2(cr)	P-1(cr)	Baa1	RUR DOWN
Bank of America Corporation	a3	a3	Aa2	P-1	Aa2	Aa2(cr)	P-1(cr)	A2	RUR UP
BMO Financial Corp.	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	STA
Capital One Financial Corporation	a3	a3	A1	P-1	A3	A2(cr)	P-1(cr)	Baa1	STA
Citizens Financial Group, Inc.	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	STA
Fifth Third Bancorp	a3	a3	A1	P-1	A3	A2(cr)	P-1(cr)	Baa1	STA
First Merchants Corporation	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	STA
First Republic Bank	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	RUR DOWN
Fulton Financial Corporation	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	Baa1	STA
Huntington Bancshares Incorporated	a3	a3	A1	P-1	A3	A2(cr)	P-1(cr)	Baa1	STA
KeyCorp	a3	a3	A1	P-1	A3	A2(cr)	P-1(cr)	Baa1	STA
Pinnacle Financial Partners, Inc.	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	STA
Regions Financial Corporation	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	Baa1	STA
United Bankshares, Inc.	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	STA
Washington Federal, Inc.	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	NEG
Webster Financial Corporation	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	Baa1	NEG
Zions Bancorporation, National Association	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	Baa1	RUR DOWN

Source: Moody's Investors Service

Exhibit 5

Entity Name	BCA	Adjusted BCA	Bank Deposit LT Rating	Bank Deposit ST Rating	Bank Sr/ Issuer Rating	Bank LT CRA	Bank ST CRA	HoldCo Sr Rating	Bank Issuer Outlook
BankUnited, Inc	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	Baa2	STA
Cadence Bank	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	STA
Citigroup Inc.	baa1	baa1	Aa3	P-1	Aa3	Aa3(cr)	P-1(cr)	A3	STA
Deutsche Bank Trust Company Americas	baa1	baa1	A1	P-1	A1	A1(cr)	P-1(cr)	-	STA
Discover Financial Services	baa1	baa1	A2	P-1	Baa1	A3(cr)	P-2(cr)	Baa2	STA
F.N.B. Corporation	baa1	baa1	A2	P-1	-	A3(cr)	P-2(cr)	Baa2	STA
First Citizens BancShares, Inc.	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	(P)Baa2	STA
First National of Nebraska, Inc.	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	STA
Goldman Sachs Group, Inc. (The)	baa1	baa1	A1	P-1	A1	Aa3(cr)	P-1(cr)	A2	STA
Hilltop Holdings Inc.	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	STA
INTRUST Financial Corporation	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	RUR DOWN
Morgan Stanley	baa1	a3	Aa3	P-1	Aa3	Aa2(cr)	P-1(cr)	A1	STA
Simmons First National Corporation	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	Baa2	STA
Western Alliance Bancorporation	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	Baa2	RUR DOWN
WSFS Financial Corporation	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	POS
Ally Financial Inc.	baa2	baa2	A3	P-2	Baa2	Baa1(cr)	P-2(cr)	Baa3	STA
Bank of N.T. Butterfield & Son Ltd.(The)	baa2	baa2	A3	P-2	A3	A2(cr)	P-1(cr)	-	STA
Bank OZK	baa2	baa2	A3	P-2	Baa3	Baa1(cr)	P-2(cr)	-	STA
BMW Bank of North America	baa2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	-	STA
CIBC Bank USA	baa2	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	STA
Dime Community Bancshares, Inc.	baa2	baa2	A3	P-2	Baa3	Baa1(cr)	P-2(cr)	-	STA
First Horizon Corporation	baa2	baa2	A3	P-2	Baa3	Baa1(cr)	P-2(cr)	Baa3	RUR UP
Hancock Whitney Corporation	baa2	baa2	A3	P-2	Baa3	Baa1(cr)	P-2(cr)	-	STA
HSBC USA Inc.	baa2	a3	Aa3	P-1	Aa3	Aa3(cr)	P-1(cr)	A1	STA
New York Community Bancorp, Inc.	baa2	baa2	A3	P-2	-	Baa1(cr)	P-2(cr)	Baa3	STA
Peapack-Gladstone Bank	baa2	baa2	A3	P-2	Baa3	Baa1(cr)	P-2(cr)	-	STA
Santander Holdings USA, Inc.	baa2	baa1	A2	P-1	Baa1	A3(cr)	P-2(cr)	Baa3	STA
Synovus Financial Corp.	baa2	baa2	A3	P-2	Baa3	Baa1(cr)	P-2(cr)	-	POS
Texas Capital Bancshares, Inc.	baa2	baa2	A3	P-2	-	Baa1(cr)	P-2(cr)	-	STA
Axos Financial, Inc.	baa3	baa3	Baa1	P-2	Ba1	Baa2(cr)	P-2(cr)	Ba1	STA
Merchants Bancorp	baa3	baa3	Baa1	P-2	Ba1	Baa2(cr)	P-2(cr)	-	STA
SLM Corporation	baa3	baa3	Baa1	P-2	Ba1	Baa2(cr)	P-2(cr)	Ba1	STA
Popular, Inc.	baa3	baa3	Baa1	P-2	Ba1	Baa2(cr)	P-2(cr)	Ba1	STA

Source: Moody's Investors Service

Banking System Outlook definition

The Banking System Outlook reflects our view of credit fundamentals in the banking sector over the next 12 to 18 months. Banking sector outlooks are distinct from rating outlooks, which, in addition to sector dynamics, also reflect issuers' specific characteristics and actions.

The outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of rating outlooks.

Endnotes

1 Global Systemically Important Banks

2 See Fed Vice Chair Barr's inaugural speech on this topic

3 Net interest margin

4 Net interest income

5 Federal Home Loan Bank

6 The eight US global systemically important banks are Bank of America Corporation, Bank of New York Mellon Corporation (The), Citigroup Inc., Goldman Sachs Group, Inc. (The), JPMorgan Chase & Co., Morgan Stanley, State Street Corporation and Wells Fargo & Company.

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