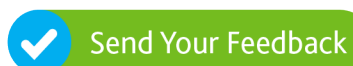


OUTLOOK

7 March 2024



Contacts

Warren Kornfeld +1.212.553.1932
SVP-Financial Institutions
warren.kornfeld@moody's.com

Rita Sahu, CFA +1.212.553.1648
VP-Sr Credit Officer
rita.sahu@moody's.com

Matt Cohen +1.212.553.0814
Lead Ratings Associate
matt.cohen@moody's.com

Jill Cetina, CFA +1.212.335.7000
Associate Managing Director
jill.cetina@moody's.com

Donald Robertson +1.212.553.4762
MD-Financial Institutions
donald.robertson@moody's.com

Ana Arsov +1.212.553.3763
MD-Financial Institutions
ana.arsov@moody's.com

Banking System Outlook – US

Outlook stays negative as asset risk grows, funding and profitability pressures persist

The outlook for the US banking system remains negative, reflecting our expectation that asset quality will continue to weaken, particularly for commercial real estate (CRE), profitability will remain below long-term averages in 2024, and still tight monetary policy will keep pressure on both the quantity and cost of deposits. We expect the operating environment will be stable in 2024, as [inflation retreats further, economic growth moderates to around 2.0% and unemployment remains low](#). Banks are likely to continue building capital in 2024 because of growing asset risk, their high level of low-yielding assets and, for banks with assets greater than \$100 billion, some tightening of capital rules, though likely less than [the current Basel III endgame capital proposal](#). Net interest income will likely decline, as higher deposit rates and increased market funds reliance raise banks' funding costs faster than their loans and securities reprice, and with loan growth subdued.

Exhibit 1

OVERVIEW OF KEY DRIVERS 2024

Operating environment	+ Inflation will retreat to level consistent with Fed target; economic growth will moderate to around 2.0% in 2024 from 2.5% in 2023, consistent with full-employment non-recessionary economy. - Average US unemployment rate projected to rise to around 4.0% in 2024, up only slightly from 3.7%, modestly weakening households' debt-repayment capacity and asset quality.
Asset risk	- CRE asset quality will continue to deteriorate along with pandemic-driven structural shifts, higher interest rates and tighter underwriting standards. - C&I asset quality will weaken because of elevated debt-servicing costs, tighter underwriting standards and modestly slowing economy. - Credit card and auto loan delinquencies and charge-offs will continue to rise above pre-pandemic levels as the economy cools and as poorly underwritten 2021-22 originations reach peak losses.
Capital	+ Banks are likely to continue building capital because of asset quality erosion, their high levels of low-yielding assets and, for the largest banks, some tightening of capital rules. - Two-tiered US bank regulation credit negative for banks with assets below \$100 billion and subject to less stringent regulation.
Profitability and efficiency	- Profitability will remain below long-term averages in 2024, driven largely by declining net interest income and rising loan-loss provisions. - NIMs will decline modestly – with funding costs rising a bit faster than assets reprice – but should gradually improve once the Fed funds rate declines materially. - Loan growth will be very modest in 2024 as banks look to increase capitalization.
Funding and liquidity	- Still tight monetary policy will keep pressure on system deposit levels; deposit costs will continue modest rise. - There is increased uncertainty around access to FHLB funding for banks under financial stress. - Bouts of Treasury market disruption could potentially place stress on bank funding. + Banks continue to reduce reliance on uninsured deposits and are keeping increased levels of liquidity, driven in part by tighter regulations. Largest banks have strong retail deposit franchises.
Government support	= We maintain our assumption of a moderate probability of government support for certain debt classes of only eight large US banks and no government support notching uplift for regional and community banks.

● IMPROVING ● STABLE ● DETERIORATING

Source: Moody's Ratings

Negative outlook reflects growing asset risk and persistent funding and profitability pressures; stable operating environment, increasing capitalization provide support

Operating environment is stable, driven by [low unemployment and solid economic growth in 2024](#). We expect economic growth will moderate to around 2.0% in 2024 from 2.5% in 2023 and inflation to retreat to a level consistent with the Federal Reserve's 2.0% target. As job growth slows, we forecast average unemployment to rise slightly to around 4.0% in 2024 from 3.7% currently. We expect interest rates to remain elevated in 2024, with the Fed likely to make four 25-basis-point reductions in the federal funds rate this year, beginning in the second quarter. A risk for those rated US banks that have large quantities of low-yielding fixed-rate assets is that Fed rate cuts do not materialize in 2024.

Asset quality metrics will deteriorate, particularly for CRE, credit cards and auto loans. Asset quality performance held strong in 2023, but will decline as the economy and job market slow, as high interest rates reduce debt affordability, and as excess consumer and commercial liquidity wanes. In addition, tight underwriting standards increase borrowers' refinancing risk. The median loan loss allowance for rated US banks was about three times nonperforming loans as of Q4 2023, providing a significant buffer to absorb loan losses. The high level of allowances also suggests that further reserve build will likely be gradual unless there is a sharp economic downturn or a slump in broader CRE markets beyond the office sector. CRE office is a prominent asset risk hot spot because of changing work patterns, but other CRE categories are also under pressure from structural factors and higher interest rates, including elder care facilities and some types of retail and multifamily properties. Commercial and industrial loan performance remains strong, but more leveraged corporate borrowers will feel the pinch of still elevated interest rates and a slowing economy. Smaller corporate borrowers are likely to face more credit challenges with fewer sources of borrowing. Credit card and auto loan net charge-offs (NCOs) are likely to [continue rising through most of 2024](#).

Capitalization is generally adequate to absorb effects of weakening asset quality. Banks are likely to continue building capital in 2024 because of asset quality erosion, their high level of low-yielding assets and, for the largest banks, some tightening of capital rules, though likely less than the current Basel III endgame capital rule proposal. As a result, many banks are likely to continue to restrain lending and to keep common share repurchases modest in 2024 to preserve capital. In addition, banks are increasingly looking at [credit risk transfer transactions](#) to increase their risk-based capitalization ratios.

Profitability will remain below long-term averages in 2024. Net interest income (NII) will likely decline in 2024 as a modest rise in deposit costs and higher reliance on market funds raise funding costs faster than loans and securities reprice, and with loan growth subdued. Banks with large amounts of low-yielding securities and loans or weaker asset quality may need to raise deposit rates more sharply than peers to stem deposit outflows as well as to avoid crystallization of unrealized losses. Fee income diversifies revenue and provides a partial offset to declining NII, particularly for the largest banks that rely less on interest income than regional and community banks. However, tighter financial conditions will keep pressure on fee income from segments like asset management and mortgage banking. Provisions should also increase modestly as asset quality weakens.

Funding costs will continue modest rise, with still tight monetary policy keeping pressure on system deposit levels. Despite continued shrinkage in the Fed's balance sheet, US banking system reserves remain well above their level at the time of Silicon Valley Bank's (SVB) March 2023 failure, aided by a steep drop in the Fed's overnight reverse repo program (ON RRP). However, [ON RRP outflows have slowed appreciably](#) since the January FOMC¹. The slowdown in ON RRP outflows, combined with runoff of the Bank Term Funding Program after its cessation on 11 March and an increase in Treasury General Account balances around the 15 April tax deadline, will likely lead to fairly material declines in banking system reserves in the next couple of months, though most banks are typically well prepared for the annual deposit outflows to fund income tax payments. Assuming quantitative tightening continues, banks' reserve balances at the Fed are unlikely to fall back near to levels before SVB's failure of about \$3 trillion until year-end. However, we believe the lowest comfortable level of banking system reserves likely exceeds \$3 trillion because of greater bank demand for precautionary liquidity. Lastly, [there is increased uncertainty around access to FHLB funding](#) for banks under financial stress, though [discount window funding](#) could possibly rise as a result. Banks are likely to continue reducing their reliance on uninsured deposits and to keep liquidity elevated, driven in part by tighter oversight as well as potential changes to regulation for the largest banks²

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

Government support assumptions for US banks are unlikely to change over the next 12-18 months. Our US bank ratings do not incorporate any uplift for government support other than those incorporated into certain debt and deposit ratings of eight G-SIBs³.

Exhibit 2

Aggregate key indicators for rated US banks

	Q3 2023	2022	2021	2020	2019
KEY RATIOS					
Problem Loans / Gross Loans	0.9%	0.9%	1.0%	1.3%	1.1%
Tangible Common Equity / Risk Weighted Assets	12.2%	12.0%	12.9%	12.6%	12.5%
Net Income / Tangible Assets	1.2%	1.1%	1.4%	0.9%	1.3%
Market Funds / Tangible Banking Assets	12.4%	11.7%	9.2%	10.3%	13.0%
Liquid Banking Assets / Tangible Banking Assets	30.0%	30.6%	36.6%	33.6%	28.7%
ADDITIONAL RATIOS					
Loan Loss Reserves / Problem Loans	220.2%	259.2%	224.4%	201.8%	150.4%
Loan Loss Provisions / Average Gross Loans	0.7%	0.5%	-0.2%	1.1%	0.4%
Net Interest Margin	3.4%	3.2%	2.8%	3.0%	3.2%
Net Income / Average RWA	1.6%	1.5%	2.0%	1.3%	1.7%
Pre Provision Income / Average RWA	2.5%	2.4%	2.3%	2.4%	2.4%
Cost / Income Ratio	59.3%	59.6%	61.3%	60.2%	59.0%
Shareholders' Equity / Total Assets	9.7%	9.5%	10.3%	10.6%	11.7%

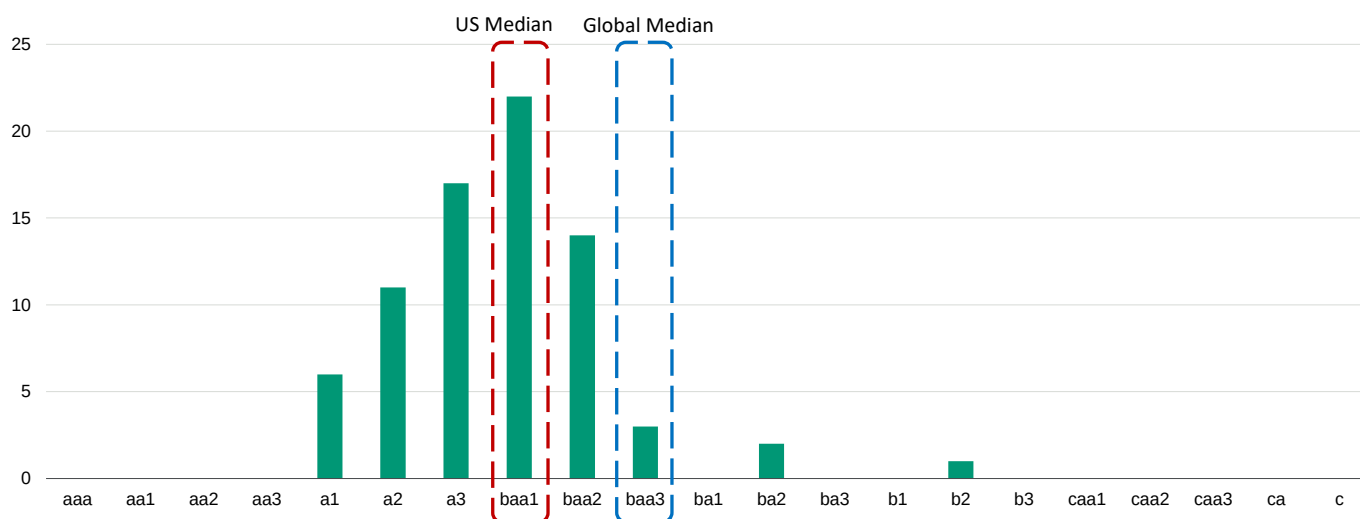
Source: Moody's Ratings

Rated universe

As of 1 March, US banks' Baseline Credit Assessments (BCAs) are distributed over an eleven-notch range from a1 to b2 (Exhibit 3). The median US bank BCA is baa1, two notches higher than the global median of baa3. We rate 71 banking groups in the US with 76 banking subsidiaries (Exhibits 4 and 5).

Exhibit 3

US bank BCA distribution as of 1 March 2024



Source: Moody's Ratings

Exhibit 4

Rated US banks of 1 March 2024 (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	POS
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	NEG
American Express Company	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	A2	STA
Bank of America Corporation	a2	a2	Aa1	P-1	Aa1	Aa1(cr)	P-1(cr)	A1	STA
Commerce Bancshares, Inc.	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	-	STA
Cullen/Frost Bankers, Inc.	a2	a2	Aa3	P-1	A3	A1(cr)	P-1(cr)	-	NEG
JPMorgan Chase & Co.	a2	a2	Aa1	P-1	Aa2	Aa1(cr)	P-1(cr)	A1	STA
PNC Financial Services Group, Inc.	a2	a2	Aa3	P-1	A2	A1(cr)	P-1(cr)	A3	NEG
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	RUR
U.S. Bancorp	a2	a2	Aa3	P-1	A2	A1(cr)	P-1(cr)	A3	NEG
Wells Fargo & Company	a2	a2	Aa1	P-1	Aa2	Aa1(cr)	P-1(cr)	A1	STA
Bank of Hawaii Corporation	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	(P)Baa1	STA
BMO Financial Corp.	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	STA
BOK Financial Corporation	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	RUR
Citizens Financial Group, Inc.	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	Baa1	NEG
Comerica Incorporated	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	Baa1	NEG
Fifth Third Bancorp	a3	a3	A1	P-1	A3	A2(cr)	P-1(cr)	Baa1	NEG
First Hawaiian Bank	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	STA
First Merchants Corporation	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	NEG
Huntington Bancshares Incorporated	a3	a3	A1	P-1	A3	A2(cr)	P-1(cr)	Baa1	NEG
M&T Bank Corporation	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	Baa1	STA
Old National Bancorp	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	Baa1	NEG
Prosperity Bancshares, 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	NEG
UMB Financial Corporation	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	(P)Baa1	STA
United Bankshares, Inc.	a3	a3	A1	P-1	Baa1	A2(cr)	P-1(cr)	-	NEG

Source: Moody's Ratings

Exhibit 5

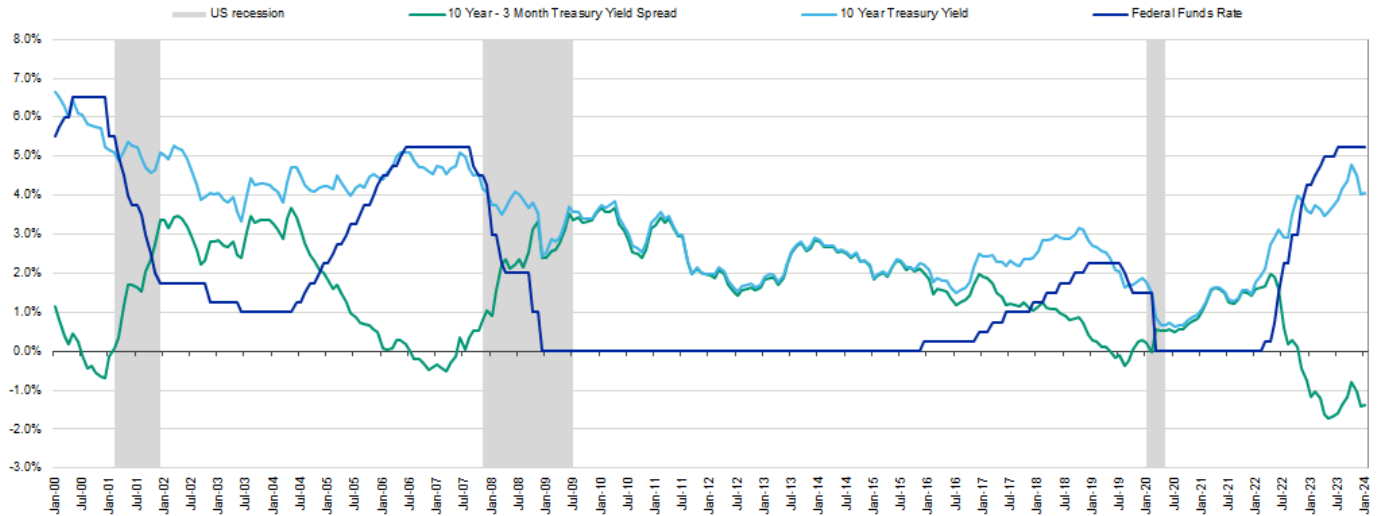
Entity Name	BCA	Adjusted BCA	Bank Deposit LT Rating	Bank Deposit ST Rating	Bank Sr/ Issuer Rating	Bank LT CRA	Bank ST CRA	HoldCo Sr Rating	Bank Issuer Outlook
Amarillo National Bancorp, Incorporated	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	STA
BankUnited, Inc	baa2	baa2	A3	P-2	Baa3	Baa1(cr)	P-2(cr)	Baa3	STA
Cadence Bank	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	NEG
City National Bank	baa1	a2	Aa3	P-1	A2	A1(cr)	P-1(cr)	-	STA
Citigroup Inc.	baa1	baa1	Aa3	P-1	Aa3	Aa3(cr)	P-1(cr)	A3	STA
CTBC Bank Corp. (USA)	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	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	RUR
F.N.B. Corporation	baa1	baa1	A2	P-1	-	A3(cr)	P-2(cr)	Baa2	NEG
First Citizens BancShares, Inc.	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	NEG
First National of Nebraska, Inc.	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	STA
Fulton Financial Corporation	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	NEG
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)	-	NEG
KeyCorp	baa1	baa1	A2	P-1	Baa1	A3(cr)	P-2(cr)	Baa2	NEG
Morgan Stanley	baa1	a3	Aa3	P-1	Aa3	Aa2(cr)	P-1(cr)	A1	STA
Pinnacle Financial Partners, Inc.	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	NEG
Simmons First National Corporation	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	NEG
Washington Federal, Inc.	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	NEG
Webster Financial Corporation	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	Baa2	STA
WSFS Financial Corporation	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	STA
Zions Bancorporation, National Association	baa1	baa1	A2	P-1	Baa2	A3(cr)	P-2(cr)	-	STA
Ally Financial Inc.	baa2	baa2	A3	P-2	Baa2	Baa1(cr)	P-2(cr)	Baa3	NEG
Associated Banc-Corp	baa2	baa2	A3	P-2	-	Baa1(cr)	P-2(cr)	(P)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)	-	NEG
Berkshire Hills Bancorp, Inc.	baa2	baa2	A3	P-2	Baa3	Baa1(cr)	P-2(cr)	(P)Baa3	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
First Horizon Corporation	baa2	baa2	A3	P-2	Baa3	Baa1(cr)	P-2(cr)	Baa3	NEG
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)	A2	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)	Baa2	STA
SouthState Corporation	baa2	baa2	A3	P-2	Baa3	Baa1(cr)	P-2(cr)	-	STA
Synovus Financial Corp.	baa2	baa2	A3	P-2	Baa3	Baa1(cr)	P-2(cr)	-	STA
Texas Capital Bancshares, Inc.	baa2	baa2	A3	P-2	-	Baa1(cr)	P-2(cr)	-	STA
Merchants Bancorp	baa3	baa3	Baa1	P-2	Ba1	Baa2(cr)	P-2(cr)	-	STA
Popular, Inc.	baa3	baa3	Baa1	P-2	Ba1	Baa2(cr)	P-2(cr)	Ba1	STA
SLM Corporation	baa3	baa3	Baa1	P-2	Ba1	Baa2(cr)	P-2(cr)	Ba1	STA
Western Alliance Bancorporation	baa3	baa3	Baa1	P-2	Ba1	Baa2(cr)	P-2(cr)	(P)Ba1	STA
Bread Financial Holdings, Inc.	ba2	ba2	Baa3	P-3	Ba3	Ba1(cr)	NP(cr)	Ba3	STA
New York Community Bancorp, Inc.	b2	b2	Ba3	NP	B3	B1(cr)	NP(cr)	-	RUR

Source: Moody's Ratings

Appendix

Exhibit 6

Yield curve inversion persists, a challenge for bank NIMs and the broader economy
 Rising interest rates helped banks initially but now present a challenge

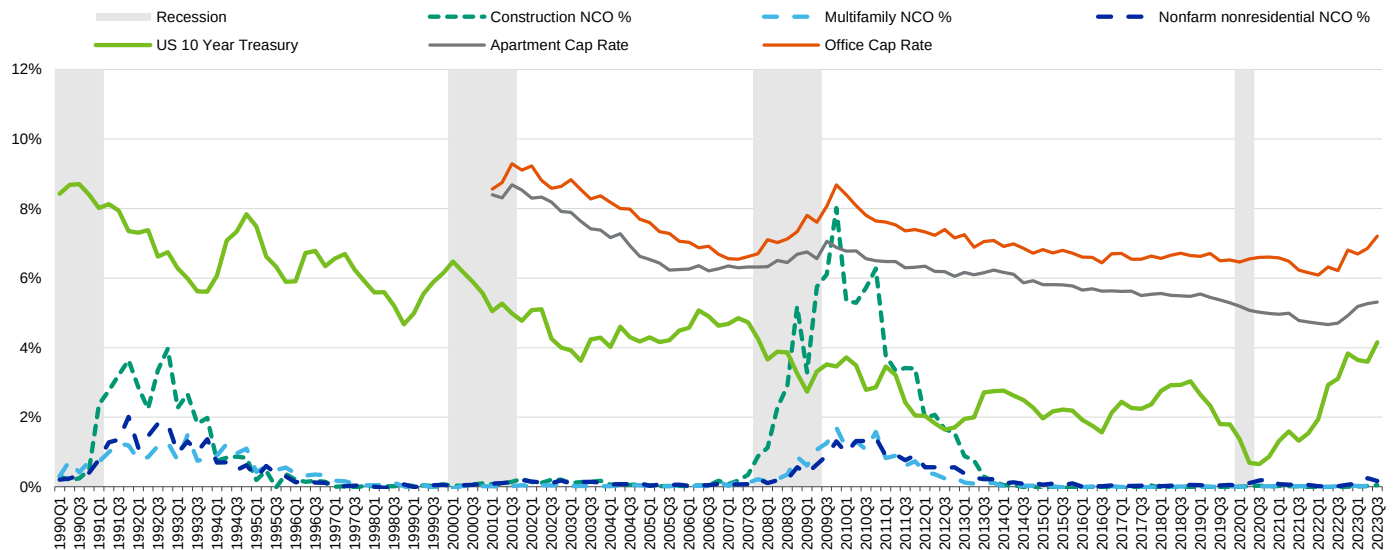


1) The charts above show data from 31 January 2000 - 31 January 2024.

Source: U.S. Board of Governors of the Federal Reserve System, Bloomberg, Moody's Ratings

Exhibit 7

Higher cap rates and office vacancy signal higher CRE charge-offs ahead
 US bank CRE net charge-offs % average loans, Q1 1990 – Q3 2023



Source: Moody's Ratings, FDIC - Quarterly Loan Portfolio Performance Indicators

Exhibit 8

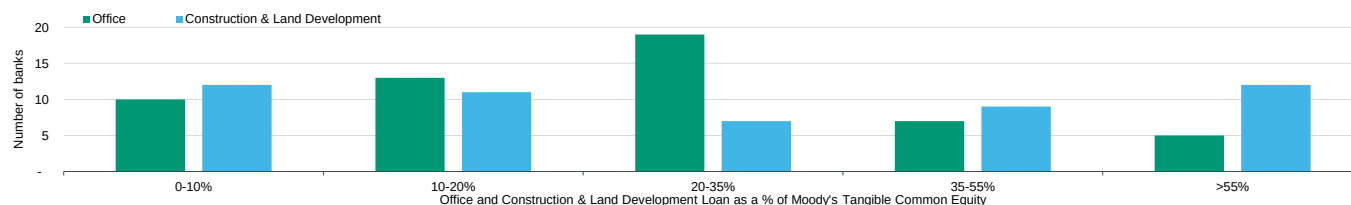
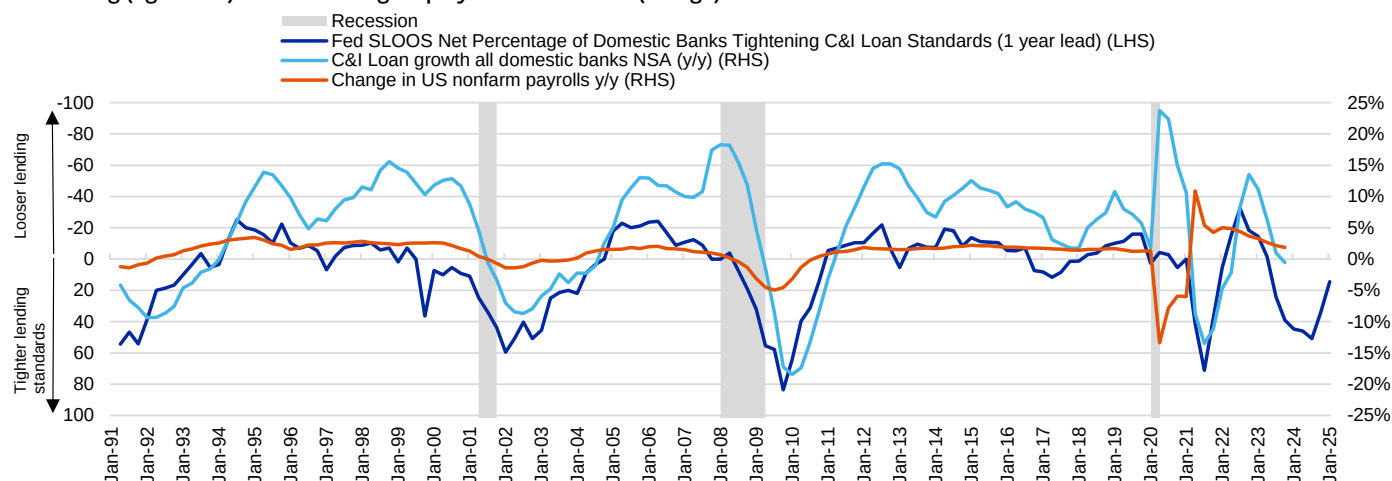
US banks have large exposure to office and construction loans relative to tangible common equity (TCE)Surveyed banks have medians of 26% and 30% of TCE exposed to office loans and construction loans, respectivelySource: [Moody's 2023 CRE survey of rated US banks](#), Moody's Ratings

Exhibit 9

Tightening lending standards (dark blue) moderate a bit in Q4 2023; previous senior loan officer survey results point toward contraction in C&I lending (light blue) and weakening employment conditions (orange) in 2024

Source: Federal Reserve, Moody's Ratings

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 The Federal Reserve's Federal Open Market Committee
- 2 Acting OCC Comptroller Hsu's speech on 18 January proposed a new regulatory requirement for mid-size and large banks to have sufficient liquidity to cover stress outflows over a five-day period: <https://www.occ.gov/news-issuances/speeches/2024/pub-speech-2024-4.pdf>
- 3 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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