RESEARCH & ANALYSIS

Strong loan growth, margin expansion cannot save US bank earnings in 2022

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Market Intelligence

Bank earnings will fall by 8.42% in 2022, S&P Global Market Intelligence projects in the newly released U.S. Bank Market Report, as an especially challenging year-over-year comparison will mitigate the benefits of higher interest rates.

The Take

The Federal Reserve's efforts to combat inflation will boost banks' net interest margins, but mountains of excess liquidity will prevent the key metric from returning to pre-pandemic levels in excess of 3.30% until 2026. At the same time, bank earnings will no longer receive a huge boost from reserve releases. Higher rates will support notable earnings growth in 2023 even as credit quality normalizes, but the gains might fall short for many banks and should encourage more M&A activity.

Bank industry aggregate profitability metrics (%)

	2021A	2022P	2023P	2024P	2025P	2026P
Efficiency ratio	61.02	59.63	56.62	53.38	51.62	50.47
Net interest margin	2.48	2.69	2.89	3.12	3.25	3.32
ROAA	1.22	1.06	1.11	1.33	1.36	1.43
ROAE	12.18	10.54	10.76	12.65	12.77	13.19
YOY earnings growth	90.65	-8.42	6.46	23.29	6.20	8.75

Data compiled March 7, 2022.
A = actual; P = projected
Source: S&P Global Market Intelligence, proprietary estimates

Click here to read the full 2022 U.S. Bank Market Report.

Click here to access data exhibits and the U.S. banking industry's projections template.

Higher rates offer much-needed relief for margins

The Fed began tightening monetary policy in mid-March and is expected to continue moving interest rates higher during the remainder of 2022 through a series of rate hikes and the shrinkage of its nearly $9 trillion balance sheet. Those actions will cause bank margins to expand by 21 basis points in 2022 to 2.69%, but the figure should still remain below 2020 levels.

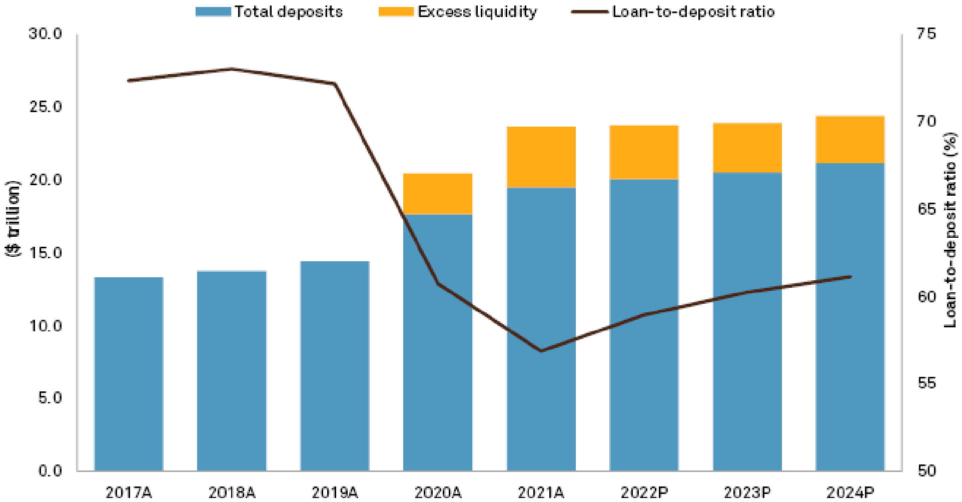
The IHS Markit forecast for federal funds, which is incorporated in our projections, assumes the Fed will raise short-term rates three more times in 2022. We have also assumed that the central bank will begin shrinking its balance sheet in the second half of the year.

The Fed's balance sheet reduction and utilization of some of the nearly $2.7 trillion in excess savings that consumers have accumulated through the pandemic is expected to lead to slower deposit growth, allowing loan-to-deposit ratios to recover from depressed levels.

Deposits are projected to grow 3.00% from year-ago levels in 2022 and climb 2.25% in 2023, falling well short of the 6.75% and 4.50% projected loan growth in the respective periods.

That growth would mark a considerable reversal from the trend seen throughout much of the pandemic, when explosive deposit growth overshadowed loan growth, leaving banks sodden with excess liquidity and lackluster margins.

Loan-to-deposit ratios will rebound in '22 but banks will still be flooded with excess liquidity



Data compiled Feb. 15, 2022.
A = actual; P = projected
Excess liquidity calculated by assuming the industry maintained their loan-to-deposit ratios reported at year-end 2019. Deposits that push the industry below the reported 2019 loan-to-deposit ratios are considered excess liquidity.
Sources: S&P Global Market Intelligence; proprietary estimates

Stronger loan growth will allow the industry to deploy some of the estimated $4.14 trillion in excess liquidity at year-end 2021. We expect excess liquidity will decline in 2022, 2023 and 2024 but remain above $3 trillion even as the economic recovery continues.

While excess liquidity will remain a headwind to earnings, the mountain of cash sitting on bank balance sheets means institutions will not have to react that quickly to increases in short-term rates by raising their deposit costs.

Deposit betas, or the percentage of changes in the federal funds rate that banks pass through to depositors, will be far lower in the current rate hike cycle than in the past few tightening cycles. We expect the banking industry to record a deposit beta of 5.93% in 2022, 17.07% in 2023 and 34.82% in 2024, leading to a cumulative beta of 17.94% by the end of 2024.

That experience would be less than in the last two tightening cycles. Between the fourth quarter of 2015 and the fourth quarter of 2018, the industry recorded a cumulative beta of 25.42%.

As deposit costs rise slowly, earning-asset yields will reprice higher, leading to notable net interest margin expansion for the banking industry. Earning-asset yields are poised to rise after facing pressure during the pandemic, buoyed by expected increases in short-term and long-term interest rates.

Stronger loan growth still not enough to drive earnings higher

Heightened loan demand and higher rates should help boost loan yields, but historically low loan-to-deposit ratios among the nation's largest banks should lead to strong competition for new loans. Market Intelligence expects the industry's loan yield to increase to 4.44% in 2022 from 4.29% in 2021. Market Intelligence then sees the yield on loans rising to 4.70% in 2023 and 4.99% in 2024.

While stronger margins are certainly a positive for banks, the boost will not be enough to match the tailwind that reserve releases provided to bank earnings in 2021, when reserves declined by $58.1 billion from 2020 levels. Regulatory pressure and emerging competition from neobanks should contribute to weaker noninterest income as many large institutions have eliminated overdraft fees. Lower refinancing activity due to higher interest rates should also pressure mortgage banking income.

Still, higher rates will drive considerable margin expansion over the next few years. Combined with stronger loan growth, this should support strong earnings growth in 2023 even as credit costs increase to more normal levels.

Those increases still might not be great enough, at least at some banks, to support necessary investments in infrastructure and customer-facing digital channels to remain competitive and could lead those institutions to pursue sales to larger banks. For most of the industry, though, the projected earnings growth and resultant returns would be seen as favorable by most bankers and the investment community.

Large bank loan growth stronger than the industry as whole

Analysis limited to top 20 US banks by assets*

Company (ticker)	Total assets ($B)	Q4'21 ROAE (%)	Q4'21 Loan-to-deposit ratio (%)	Q4'21 Net interest margin (%)	Q4'21 QOQ Loan growth (%)	Q4'21 QOQ Deposit growth (%)
JPMorgan Chase & Co. (JPM)	3,744	14.41	46.19	1.50	3.08	2.50
Bank of America Corp. (BAC)	3,169	10.36	50.35	1.59	5.41	5.07
Citigroup Inc. (C)	2,291	6.31	53.19	1.94	1.25	-2.13
Wells Fargo & Co. (WFC)	1,948	12.19	61.74	2.08	3.18	0.82
U.S. Bancorp (USB)	573	12.11	70.12	2.38	5.27	2.98
The PNC Financial Services Group Inc. (PNC)	557	9.33	63.55	2.27	-0.58	1.87
Truist Financial Corp. (TFC)	541	9.36	70.67	2.74	1.26	2.62
TD Group US Holdings LLC (TD)	524	6.82	42.70	1.76	0.53	2.99
Capital One Financial Corp. (COF)	432	15.52	91.07	6.55	5.80	1.65
SVB Financial Group (SIVB)	211	10.05	35.03	1.90	7.79	10.52
Fifth Third Bancorp (FITB)	211	11.80	68.64	2.54	2.96	2.59
UBS Americas Holding LLC (UBSG)	210	5.61	70.94	1.06	4.71	12.67
BMO Financial Corp. (BMO)	194	8.11	65.47	2.01	6.27	-1.09
Citizens Financial Group Inc. (CFG)	189	9.09	85.09	2.67	3.97	1.25
KeyCorp (KEY)	186	14.40	68.89	2.40	4.09	0.35
Ally Financial Inc. (ALLY)	182	14.88	86.76	3.41	6.87	1.52
First Republic Bank (FRC)	181	10.44	86.33	2.63	5.12	7.57
RBC US Group Holdings LLC (RY)	175	7.40	79.92	1.44	6.71	3.48
Huntington Bancshares Inc. (HBAN)	174	8.27	79.16	2.87	1.51	0.99
Regions Financial Corp. (RF)	163	9.56	63.60	2.84	5.44	5.51
Top 20 median		**9.81**	**68.77**	**2.33**	**4.40**	**2.54**
Industry		**10.79**	**56.87**	**2.50**	**3.01**	**2.72**

Data compiled March 24, 2022.
Institutions presented on a top-tier consolidated basis.
* Excludes institutions with loan/assets ratios below 25% as well as institutions with loan/deposit ratios above 125% at Dec. 31, 2021.
Based on regulatory filings.
Source: S&P Global Market Intelligence

Scope and methodology

Market Intelligence analyzed nearly 10,000 banking subsidiaries, covering the core U.S. banking industry from 2004 through 2021. The analysis includes all commercial and savings banks and savings and loan associations, including historical institutions, as long as they were still considered current at the end of a given year. It excludes several hundred institutions that hold bank charters but do not principally engage in banking activities, among them industrial banks, nondepository trusts and cooperative banks.

The analysis divided the industry into five asset groups to see which institutions have changed the most, using historically significant regulatory thresholds. The examination looked at banks with assets of $250 billion or more, $50 billion to $250 billion, $10 billion to $50 billion, $1 billion to $10 billion, and $1 billion and below.

The analysis looked back more than a decade to help inform projected results for the banking industry by examining long-term performance over periods outside the peak of the asset bubble from 2006 to 2007. Market Intelligence has created a model that projects the balance sheet and income statement of the entire industry and allows for different growth assumptions from one year to the next.

The outlook is based on management commentary, discussions with industry sources, regression analysis, and asset and liability repricing data disclosed in banks' quarterly call reports. While taking into consideration historical growth rates, the analysis often excludes the significant volatility experienced in the years around the credit crisis.

The outlook is subject to change, perhaps materially, based on adjustments to the consensus expectations for interest rates, unemployment and economic growth. The projections can be updated or revised at any time as developments warrant, particularly when material changes occur.

Russia invasion of Ukraine leads to slower economic growth in '22

	2022	2023	2024	2025	2026
Unemployment rate (%)	3.56	3.53	3.67	3.68	3.68
GDP growth (%)	2.76	2.89	2.92	2.56	2.30
Fed funds (%)	0.66	1.62	2.08	2.39	2.63
10-year Treasury (%)	1.97	2.54	2.84	2.99	3.05

Data compiled March 7, 2022.
Figures for the federal funds rate, 10-year Treasury yield, unemployment rate and GDP are based on 4-point averages of estimates provided by IHS Markit.
Actual reported figures used when available.
Source: IHS Markit

IHS Markit is now part of S&P Global.

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