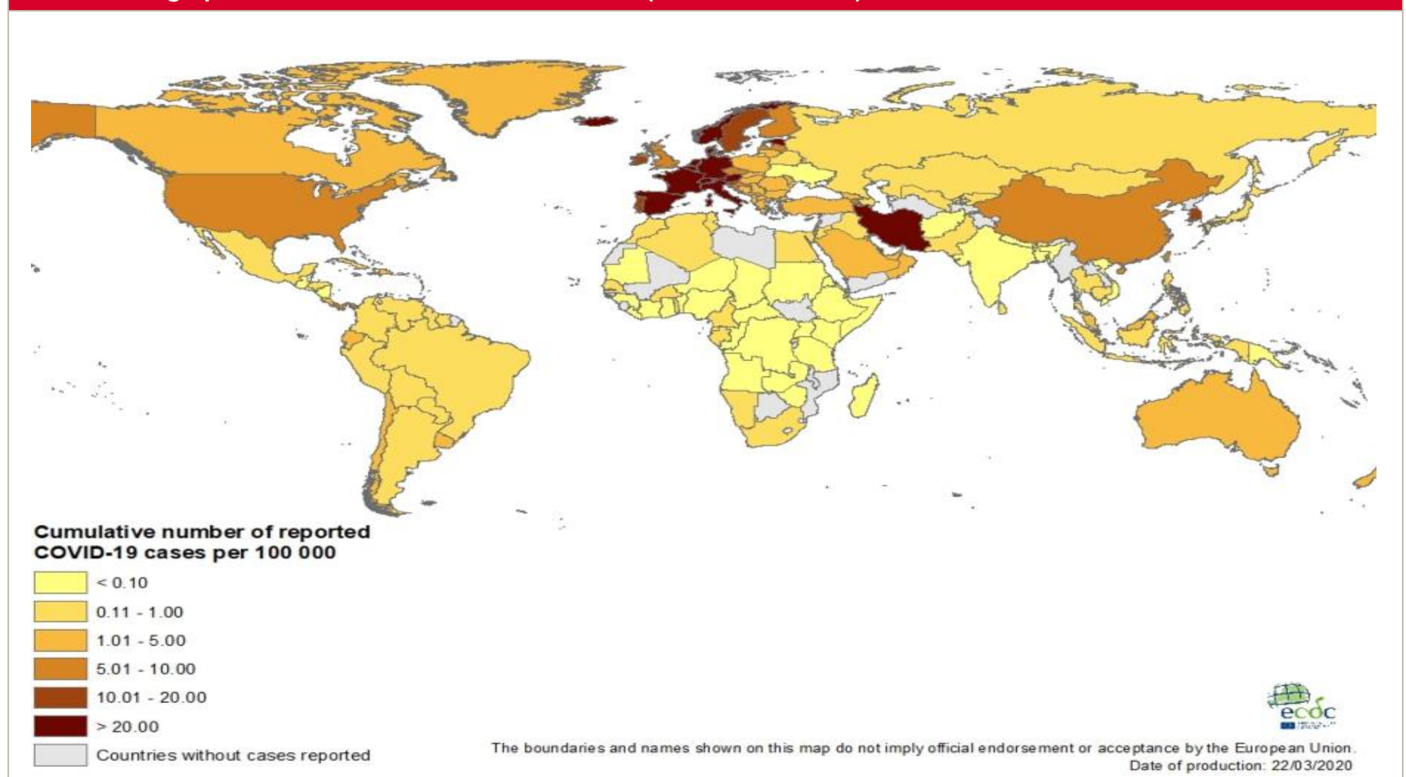
A. The COVID-19 Pandemic - Current Situation

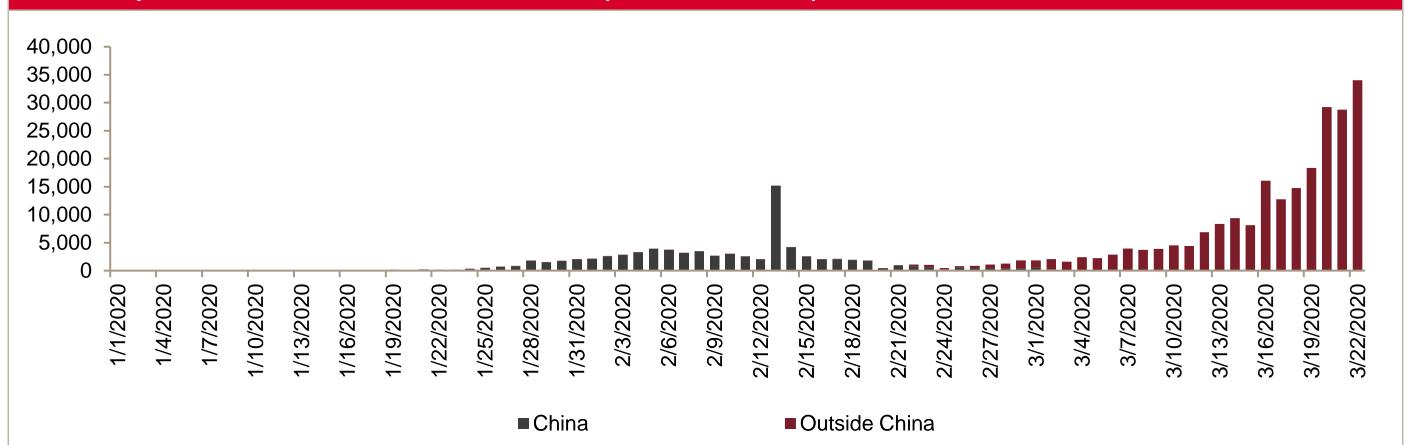
The Coronavirus (COVID-19) pandemic spreads rapidly, sending shockwaves across the global economies: The COVID-19 pandemic continues to spread rapidly in different parts of the world, causing widespread shocks to the global economies and financial markets which are struggling to stay afloat amid the government-imposed travel bans, tourism restrictions, and supply chain disruptions. The virus has already infected around 340,000 people and caused ~14,000 deaths globally *(Source: European Centre for Disease Prevention and Control, see Chart 1 for details*). The epicentre of the infection has now shifted from China, where it emerged in late-2019, to Europe, with the largest number of infections being reported in Italy and Spain. US also has been witnessing a sharp rise in infections, with 35,000 cases reported so far. China, on the other hand, is now reporting a decline in new infected cases, thanks to its significant quarantine and lockdown efforts (*see Chart 2*). The pandemic outbreak is likely to result in the weakest first quarter across many countries since the 2008-09 global financial crisis (GFC). This is particularly because the pandemic has now spanned almost the whole of the first quarter of 2020 and is most likely going to prolong. China being the hardest hit country, might report a significant contraction in its Q1 output, with spill over effect on many other countries, which either have trade related dependencies on China and/or are epidemic struck.

Chart 1: Geographical Distribution of COVID-19 Cases (as of 22-Mar-2020)



Source: European Centre for Disease Prevention and Control; an agency of the EU

Chart 2: Spread of COVID-19 Cases Outside China (as of 22-Mar-2020)



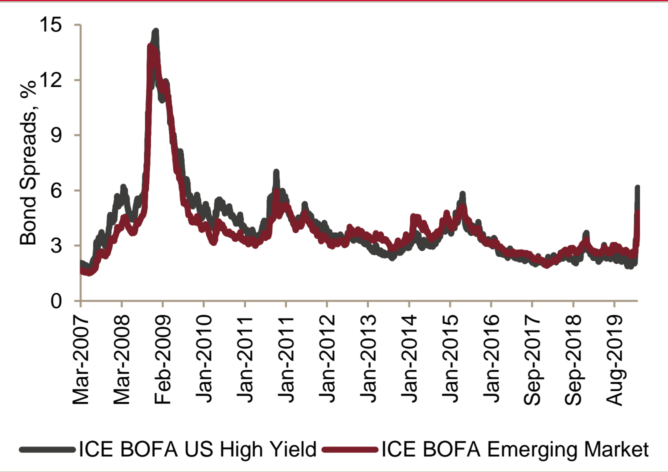
Source: European Centre for Disease Prevention and Control; an agency of the EU

B. Impact of the Outbreak on Global Economies and Financial Markets

The coronavirus contagion, which is a grave threat to both public health and economic stability, has increased the likelihood of a global recession: The rapid spread of COVID-19 has substantially increased the odds of both a more severe pandemic and higher repercussions on global economies. The pandemic is now spreading at an alarming rate in countries outside China, with the US, South Korea, Iran, Italy, and Spain being worst hit by the outbreak. The measures undertaken to mitigate the public health risk, including quarantines, travel and tourism restrictions, and national lockdowns (imposed in China, Italy, France, the Netherlands, and Spain), have disrupted global economic activity, pushed many corporates (particularly those operating in the airlines, dining, and hospitality industry) to the brink of bankruptcy, and significantly increased the likelihood of a worldwide recession.

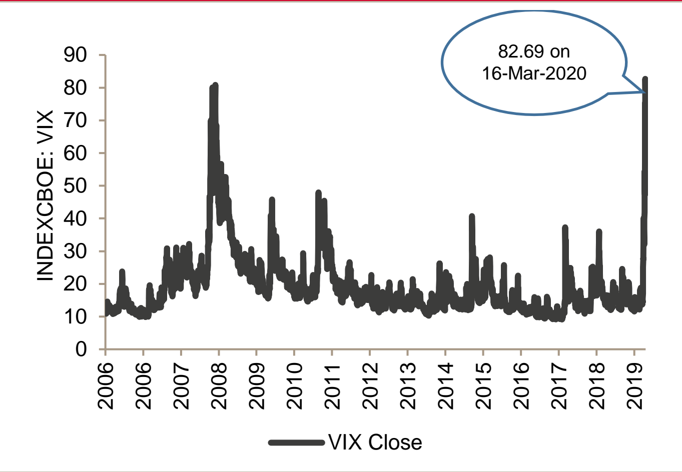
The pandemic outbreak has jolted the financial markets as investors resort to panic selling to raise cash: The coronavirus crisis has had a visible impact not just on the economic activity, but also on the global financial markets, which have exhibited massive correction and volatility over the past few days, with major stock indices plunging by 10-20% and some even triggering circuit breakers, as investors panic over the threat posed by the virus. Surging coronavirus cases has affected the international bond markets too, leading to a sharp decline (or in some cases, temporary halt) in corporate issuances across the major economies. Moreover, the credit spreads, particularly of the lower quality borrowers, have been widening across markets, while the US Treasury yields have hit all-time lows as investors flock to safe havens amid the crisis. Oil markets are also affected by dwindling demand as the coronavirus crisis has prompted countries to impose travel bans, while the price wars between major oil producers, Saudi Arabia and Russia, have made matters worse (see Charts 3, 4, 5, 6, for more details). The tightening of credit conditions is likely to prolong the recovery of global economies, in our view.

Chart 3: Widening Spreads of Emerging Markets and US High Yield Bonds



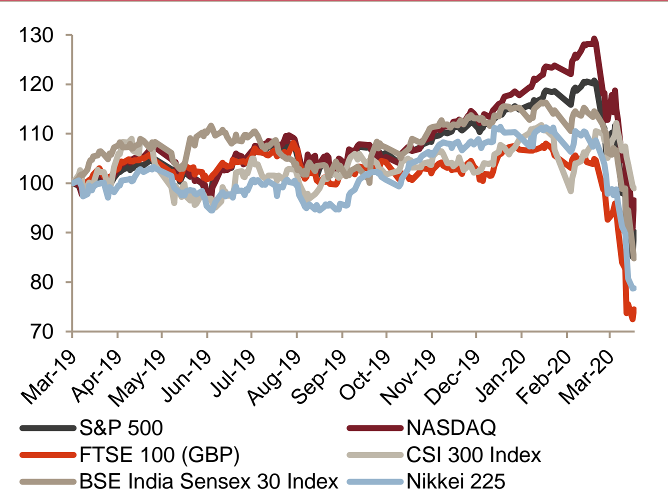
Source: Federal Reserve Economic Data

Chart 4: CBOE Volatility Index (for S&P 500)



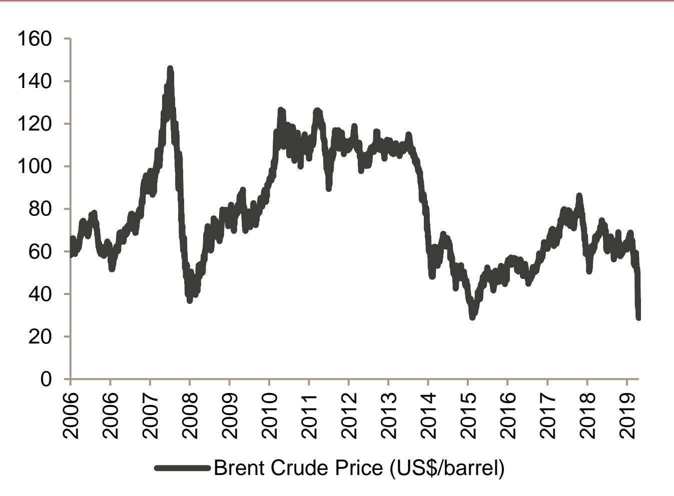
Source: CBOE

Chart 5: Performance of Major Global Stock Indices (Rebased to 100 on 1-Mar-2019)



Source: IMF

Chart 6: Brent Crude Price (USD/barrel)



Source: SNL

C. 2008 GFC vs. 2020 Coronavirus Pandemic – what has changed?

The 2020 coronavirus crisis bears an uncanny resemblance with the 2008 GFC in terms of market performance but differs in terms of trigger point: The current circumstances – falling markets, severe panic among global investors, fear of recession, and the governments' extraordinary stimulus to keep the markets buoyant – bear a stark resemblance with the 2008 crisis. However, while the GFC was mainly caused by the subprime mortgage crisis, which had led the major global banks with thin capital buffers to succumb to the shock, thus requiring government bailouts and liquidity injections, the current crisis is triggered by the coronavirus, which is proving to be a severe risk to both public and global economic health.

The pandemic is likely to be more destabilizing to the global markets than the GFC: The COVID-19 crisis likely to be more distressing to the global markets than the GFC and there are two underlying reasons for the same: a) while GFC was mainly a demand shock, the current crisis has hit the world with both demand and supply shocks, and b) the coronavirus crisis is relatively more complex and is still evolving - to deal with the coronavirus crisis, the fundamental requirement is to contain the spread of virus, and in order to do so, the global economic activity has to brought to a near standstill, thereby inflicting more damage to an economy which is already crippled by the ongoing crisis. Moreover, the emergency liquidity measures undertaken by the central banks (See Section D for details) are proving to be incapable of quelling investor concerns and restoring business and consumer confidence, which is visible in the recent plunge in the US stock futures and dip in the euro and sterling currency markets. In our view, the panic in the markets will prevail until the global healthcare systems fix the core problem, i.e., eradicate the virus, which, on the contrary, is still spreading at an alarming rate.

Banking system today is better-equipped to sustain economic shocks but is not immune to failures: While we recognize that banks today are well-capitalized and hold stronger liquidity buffers, thereby making them relatively less vulnerable to the economic shocks than they were during 2008-09, we also note that the synchronized accommodative monetary policy easing by the global central banks and increased likelihood of borrower defaults amid the current crisis is likely to weigh on the credit fundamentals of the global banking system in the medium term (see Section F for details).

D. Stimulus Measures by the Governments to Combat the Coronavirus Fallout

Massive fiscal and monetary stimulus packages announced to stem the virus fallout, but a sustained economic rebound is unlikely in the near term: The rapid spread of the virus and its impact on the global economies and financial markets has prompted the central banks and governments to undertake extraordinary monetary and fiscal stimulus measures to cushion the blow from the pandemic. A majority of the stimulus measures announced by the central banks are aimed at injecting liquidity in the markets to help calm the investors, improve business confidence and revive the economy. While these drastic stimulus measures (mainly the fiscal stimulus, which will have an immediate effect on the economy) could help the economic participants, especially the small business owners, consumers, and sectors most affected by the pandemic like airline and travel and leisure, survive the crisis, a sustained rebound in the financial markets or a recovery in the industrial production is highly unlikely in the near term. This is primarily because the economic recovery is largely dependent on the restoration of demand along with the reversal of supply shocks in the global markets, which seems unlikely in the near term, given the accelerating rate at which the virus is spreading across countries.

Key Measures undertaken by the Major Economies

Measures	US	UK	EU	Japan	Australia	China
Rate Cut[1]; Current Rate	By 150bps (cumulative); 0.125%	By 65bps (cumulative); 0.1%	Unchanged; 0%	Unchanged; -0.1%	By 50bps (cumulative); 0.25%	By 10bps; 4.05%**
Quantitative Easing	Unlimited QE[2]	Government and corporate bonds - GBP200bn (USD232bn)	Government debt and private securities (EUR750bn or USD810bn) Increased existing asset purchase program of EUR20bn/USD21.6bn a month with a one-off EUR120bn/USD130bn*	Government bonds (JPY200bn or USD1.8bn)	Government bonds (AUD5bn or USD2.9bn)	-
Emergency Funding Facility	Commercial Paper Funding Facility[3]; Primary Market Corporate Credit Facility[4]; Secondary Market Corporate Credit Facility[5]	Commercial paper purchase program (unlimited size)	-	-	-	-
Emergency Lending Facility	Primary Dealer Credit Facility[6] Money Market Mutual Fund Liquidity Facility[7]	Government-guaranteed loans (GBP330bn or USD383bn) to virus-hit businesses	Additional LTRO to provide immediate liquidity support Bank loans guaranteed by the government provided by Germany (EUR550bn/USD594bn) and France (EUR300bn/USD324bn)	JPY1.5trn (USD13.5bn) loans to virus-hit SMEs	AUD90bn or USD52bn funding facility for SMEs	Medium-term Lending Facility (CNY600bn or USD84bn)
Repo Operations	Increased the size of overnight and term repo operations (max USD500bn)	-	-	-	Injected AUD8.8bn or USD5.5bn in repo operations	CNY1trn/USD140 bn via 7-day repo operations; CNY400bn/USD56bn via 14-day repo operations
Fiscal Stimulus	Bailout of airlines (~USD100bn); direct cash payment to citizens or tax cuts (~USD550bn); SME assistance (~USD300bn)	GBP30bn/USD35bn of fiscal stimulus which covers welfare and business support and tax relief, among others	Deferral of tax payments, additional grants to virus-hit companies	Relief package for healthcare systems	AUD17.6bn (USD10.2bn) of stimulus package which covers direct cash payment to citizens, cash grants to small businesses, and wage subsidies, among others	Spending to ramp-up infrastructure investment; support for medical instruments; tax relief for small businesses hit by outbreak
Currency Swap Lines	The US Fed established currency swap lines worth $450bn with 9 additional central banks - the Reserve Bank of Australia, the Banco Central do Brasil, Danmarks Nationalbank (Denmark), the Bank of Korea, the Banco de Mexico, the Reserve Bank of New Zealand, the Norges Bank (Norway), the Monetary Authority of Singapore, and the Sveriges Riksbank (Sweden) to boost USD liquidity					

*Source: Central Banks' websites, SNL; *ECB has also expanded the range of eligible assets under the corporate sector purchase program; **loan prime rate*

[1] *Between 1-Jan-2020 to 19-Mar-2020*
[2] *Announced on 23-Mar-2020*
[3] *Through the CPFF, the Fed will provide short-term credit to eligible companies that issue short-term debt.*
[4] *Announced on 23-Mar-2020, the PMCCF is intended to help ensure corporations are able to issue new bonds and loans*
[5] *Will ensure liquidity in the secondary corporate bonds markets*
[6] *Available only to 24 primary dealers that are counterparties to the New York Fed, which will offer cash loans of up to 90 days to those firms starting on 20-Mar-2020*
[7] *Will provide 1-year loans to financial institutions against high quality assets like US T-bonds purchased from money market mutual funds*

E. Non-Monetary/Supervisory Measures by Central Banks

With monetary stimulus not being enough to alleviate the health-crisis driven operational burden on banks, central banks across various countries relaxed various supervisory and prudential norms, listed below by country. We expect more such easing measure to be forthcoming. These modifications will provide operational flexibility to banks, by easing the regulatory burden and at the same time delivering the much needed credit distribution in the wake of the COVID-19 outbreak.

Potential areas of financial relief	Central Banks/Regulatory Bodies	Countries Impacted	Period of relaxation	Relaxation criteria	Our View
Capital Buffers/ CCB / CCyB	ECB	Eurozone	Temporary	Banks allowed to operate temporarily below level of capital defined by the Pillar 2 guidance & CCB(=2.5%) Appropriate relaxation of CCyB taken to 0% by the national macroprudential authorities Banks will also be allowed to partially use capital instruments that do not qualify as Common Equity Tier 1 (CET1) capital, for example Additional Tier 1 or Tier 2 instruments, to meet the Pillar 2 Requirements The "structural review" on formulation of price stability, monetary policy toolkit, economic and monetary analyses and communication practices will be delayed	**'Credit neutral' – Banking systems across the covered geographies had nearly one and half times higher loss absorbing capacity (in terms of risk based capital position) in 2019 versus the 2008 global financial crisis. Nevertheless, while this offers tactical flexibility to management, capital buffers are likely to get eroded in the event of a prolonged crisis scenario.** **COVID-19 is expected to have an imminent negative impact** on the banking systems' revenues, asset quality, funding conditions and solvency. **Regulatory response** in terms of capital forbearance is at an early stage, but will be **critical in strengthening confidence** in the financial markets by clear signalling that regulators stand ready to intervene. **The announced relaxations in CCB buffers** are expected to create capacities for the banks to maintain or increase their lending in case of adverse economic contraction. CCyB is an ideal tool, but less effective in Europe, as it has been upto the discretion of national regulators and has been cut to near zero in countries like Italy, Germany and the UK. Also, the banks would benefit by being allowed to meet part of their pillar-2 requirement through subordinated debt. **Further relief could come from** flexibility allowed on supervisory capital assessments like assessing credit and market risks, relaxation in GSIB, TLAC, MREL requirements and a delay in implementing BASEL IV. **In our view, the relaxation of capital requirements would provide a transitory relief**, that in a crisis scenario (leading to a strong spike of loan loss provisions), would help avoid synchronous capital increases, arguably a necessary avoidance. However, **we think that the capital build up would have to come at a later stage**(sooner for mid-sized ,if not the large banks) , either via postponed capital increases and/or retained earnings at the expense of the following years' dividend pay-outs or even recapitalisation through tax payer support in some countries.
	Bank of England	UK	Until further notice	Cut in CCyB requirements to 0% of RWAs, from earlier 1%.	
	US Fed	US	Next 12 months effective 16 March 2020	Cut in CCyB requirements to 0% of RWAs, from earlier 2.5%.	
	Other Noteworthy announcements by-	Australia, Canada, Sweden,	Temporary	Allowed relaxation in either CCB or CCYB or both	

Potential areas of financial relief	Central Banks/Regulatory Bodies	Countries Impacted	Period of relaxation	Relaxation criteria	Our View
	APRA,Australia, OSFI, Canada	Denmark, Norway			
Delay in Stress test	EBA	Eurozone	Postponed to 2021	Postponed the EU-wide stress test exercise to 2021	**'Credit Positive' – A delay or cancellation of stress tests will allow banks to focus on immediate business challenges and prioritise operational continuity**. It will enable banks to utilise their resources in their core and critical functions and maintain their support to the customers- household and corporate sectors, particularly to small and medium enterprises. We note that the EBA will carry out an additional **EU-wide transparency exercise for 2020**, in order to provide updated information on banks' exposures and asset quality to market participants.
	Bank of England	UK	Cancellation of 2020 stress test ; wait and watch stance on climate risk stress testing	Cancellation of the 2020 stress test .Regarding climate risk testing, BOE will take stock of the responses to the discussion paper published on the 2021 BES on the financial risks from climate change	
	US Fed	US	No guidance provided. DFAST submission deadline is April 6th	-	
LCR NSFR norms/ Leverage ratio	ECB	Eurozone	Temporary	Allowed to operate below LCR Ratio	**'Credit Positive' – For most banks across the countries, Liquidity Coverage Ratio and NSFR ratios are currently greater than 100% and at a record highs.** **Relaxation in the LCR limits** will help banks to maintain sound financing operations during the current economic disruptions and in case of a more protracted recession, which could result in higher than expected credit losses absorbing much of the capital relief announced by central bank. **Relaxation in NSFR** will reduce the locking up of deposits for longer term translating into higher circulation of money and economic activity. However, we would like to highlight that in the **Eurozone, in particular, lack of liquidity has not been a problem** for most banks outside of Italy and France for quite some time**, but excess liquidity and negative rates have**. The issue, we anticipate, is that banks would rather deposit their liquidity at the ECB at a loss (-0.5% of the deposit facility rate) than lend it at the now significantly heightened risk of losing the principal. **Hence, from banking sector perspective, in our view, solvency is another pressing issue** that needs to be addressed in the face of this crisis, potentially arising most significantly from SME and retail lending. **Regulators could relax the proposed rules over supplemental leverage ratio** and take steps that could allow banks to take on higher proportion of loans with lower credit ratings,
	Bank of England	UK	Until further notice	Allowed liquidity buffers to be used to address temporary shocks	
	US Fed	US	Temporary	Allowed to use liquidity buffers	

Potential areas of financial relief	Central Banks/Regulatory Bodies	Countries Impacted	Period of relaxation	Relaxation criteria	Our View
					now with governments stepping in to provide credit guarantees and shoulder part of the insolvency burden.
IFRS 9/CECL called back/delayed	ECB	Eurozone	To be implemented in stages between 2020 to 2023	Supervisory flexibility in application of IFRS 9 related to loan loss provisioning	**'Credit Neutral' – IFRS9 provisions are capital dilutive given that losses are booked at the time of origination, disincentivising lending during recessionary times. Temporary suspension or delay of the expected credit loss modelling could provide a tactical respite to the management and help maintain the credit flow to the impacted sectors.** In the wake of **banks being forced to grant loan repayment holidays, there is an increasing need for greater respite from regulators**, particularly on the reporting of bad debts and provisioning calendar under IFRS9. Regulators need to clarify that relaxation on amortization doesn't classify a previously healthy exposure as NPL. **CECL, the new accounting standard ,** that recognizes lifetime expected credit losses compared to the current "incurred-loss" approach, **is more punitive and will account for catastrophic potential credit losses , particularly in the event of a recession. Counterintuitively, it will force banks into early recognition of loan losses, put a limit on the amount of risky lending and increase the capital requirement.** In our view, **implementing CECL will exacerbate the credit retrenchment by the banks and deepen the recession**, while postponing it will encourage more lending. Also, borrowers may go for refinancing at lower interest rates, resulting in additional loss allowance. **Other potential areas of relaxation under IFRS9** include relaxation in the terms of covenant breaching; and opening the asset reclassification window to allow banks to reclassify their securities to contain MTM losses and minimise adverse impact to the capital during the heightened economic volatility.
	Bank of England/PRA	UK	Temporary	PRA has formally announced the use of repayment holidays provision to prevent moving customers who may miss their term due to COVID 19 impact, into Stage 2	
	Office of the Comptroller of the Currency (OCC)	US	-	OCC is considering the delay in application of CECL standard for banks by 1 year.	
Cut on shareholder distributions	ECB	Eurozone	No guidance provided	--	**'Credit Positive'- Dividend cuts /omissions are perceived as very effective methods to improve financial strength of banks by retained earnings (high quality capital). Regulating shareholder distributions during the economic uncertainty sends clear signal that supervisors prioritise stability and solvency over excess distributions.** None of the regulators have provided any guidance on cut in shareholder distributions, thus far. However, **PRA and EBA have set out their supervisory expectation** that banks should not increase dividends or other distributions in response to the relaxation in capital and liquidity buffers and the released funds should support households and businesses. **We expect increased regulatory scrutiny around shareholder remuneration practices** (already promised dividends and buybacks, in particular) and capital allocation strategies **as the recent fall in stock prices have created opportunities for banks to repurchase the securities at attractive prices.** In the event of longer-than expected crisis, we anticipate supervisory proposal for **regulating bank dividends as a complement of relaxed capital requirements and promoting capital accumulation out of retained earnings**; as retained earnings make
	Bank of England	UK	No guidance provided	-	
	US Fed	US	No guidance provided	-	

Potential areas of financial relief	Central Banks/Regulatory Bodies	Countries Impacted	Period of relaxation	Relaxation criteria	Our View
					the core component of high quality capital at a low direct costs when compared to issuing equity.
Transition from LIBOR to new interest rate benchmarks may be delayed	ECB	Eurozone	No guidance provided	-	**'Credit Positive'-Cost containment during the volatile times** **We believe it would be prudent to delay or otherwise alter the phasing out of LIBOR into other alternative rates,** until the economic situation stabilises. Major banks have devoted large internal teams to manage the transition from LIBOR to other benchmark rates. An extension or delay in any legislation (like the recent proposed legislation for US Dollar LIBOR contracts by the Alternative Rates Reference Committee) would help banks to utilise their resources for more pressing operational challenges during the current economic disruption. In our view, **COVID-19 pandemic presents a good opportunity for the financial regulators to scrutinize (and improve) the soundness of alternative rates** (for eg. SOFR in the US) during distressed and volatile economic cycle.
	Bank of England	UK	No guidance provided	Current deadline of transitioning away from LIBOR is 2021	
	US Fed	US	No guidance provided	-	
Disclosure on climate related risk delayed	ECB	Eurozone	No guidance provided	Responses and situation will decide the way forward for climate risk exercise in the summer.	**'Credit Positive '-A delay in climate risk exercise will provide the banks a much needed window to focus on lending without any extra burden on the bottom line and capital**. In accordance with Task Force on Climate-related Financial Disclosures' (TCFD) on disclosures required to review the impact of climate change on the sector, banks are expected to produce qualitative and narrative disclosures, complemented with quantitative disclosure. For this, **banks need to develop comprehensive analytical frameworks structured around four thematic areas** - governance, strategy, risk management and metrics and targets, to assess and mitigate the impact from three types of identified climate risks- physical risks, liability risks and transition risks for facilitating orderly transition to a low-carbon economy. In our view, banks would have to provision for significant regulatory costs, given the massive scale of this exercise. Special regulatory reporting and tracking requirements can arguably be burdensome during this time of crisis and hence should be postponed to allow banks focus on more critical operations.
	Bank of England/FSB/FCA	UK	FCA has announced the proposals to improve climate related disclosures by listed companies	-	
	US Fed	US	No guidance provided	-	

F. Impact of the Stimulus Measures on the Banking System and Outlook

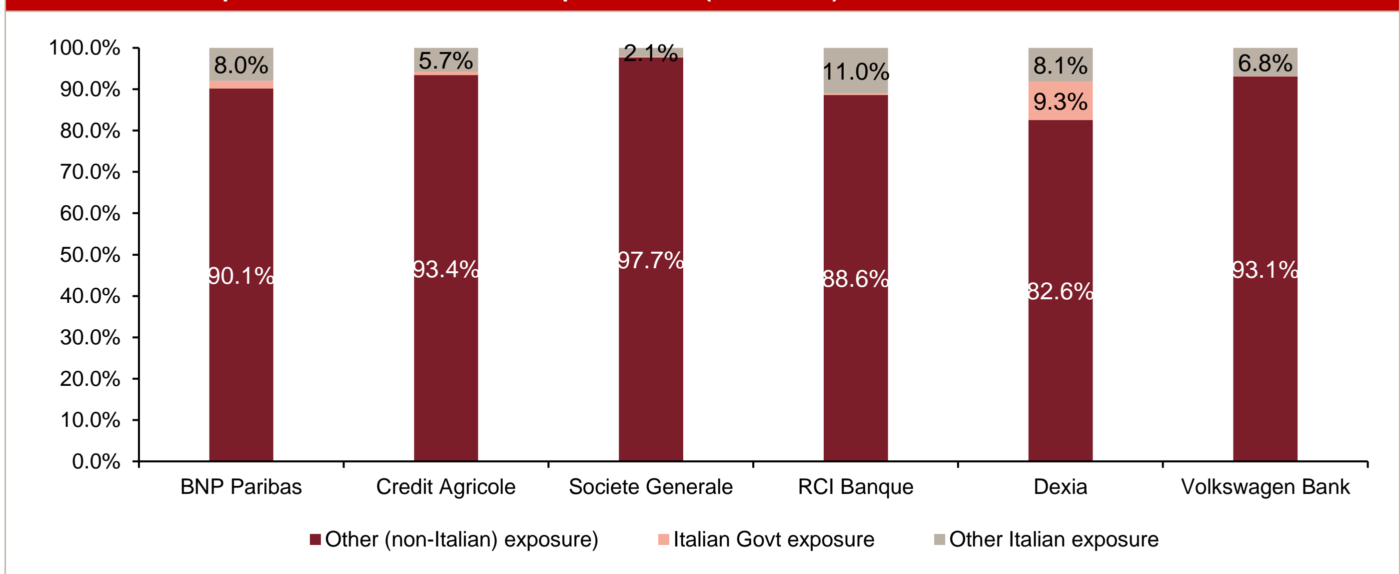
Stimulus measures likely to soften the impact of the outbreak on asset quality and liquidity buffers of the banking system in the near term…: The government-guaranteed loans and funding facilities offered at discounted rates by the central banks (via the banking system) to the virus-hit corporates is likely to support the banking system's asset quality and liquidity over the near term by providing the borrowers operating in the stressed sectors access to cheap credit and relaxing the repayment norms, and thereby averting the risk of credit defaults in the near term.

…but downside risks remain especially if the virus transmission continues through the medium term: While we acknowledge that the stimulus packages will help the banking system stay intact in the near term, its effects won't be lasting if the pandemic deepens through 2020-2021, which could considerably exacerbate the downside risks to the banks' asset quality and liquidity buffers. Moreover, the significant rate cuts implemented by the major economies will also pressurize the banks' margins, given we do not expect to see any meaningful near to medium term improvement in credit growth due to monetary easing. Profitability of banks will also be impacted by a spike in provisions over the near to medium term due to a likely deterioration in the creditworthiness of corporate borrowers, especially those which are operating in the virus-hit sectors.

European lenders, particularly the Italian banks, are more vulnerable to economic turmoil than their US counterparts in case of a prolonged pandemic: For the European banks, which are already grappling with low rates and weak economic growth, the economic catastrophe caused by the outbreak is likely to be more disturbing, especially for the stressed banks like Germany's Deutsche Bank and Italy's UniCredit, which are already struggling to improve their financial fundamentals amid the adverse operating environment in Europe. In addition, the overall Italian banking system is already under fire for its lax underwriting standards, which led to the default and subsequent government bailouts of multiple banks like Banca Popolare di Bari (in Dec-2019) and Banca Carige SpA (in Jan-2019), and three more bailouts[8] in FY17. The current economic shutdown in Italy is likely to result in more such defaults and perhaps even bailouts in the coming quarters. The non-Italian European lenders are also exposed to the risk of a material weakening in Italy's economic health, given some of the large European banks hold a sizeable share of sovereign and private Italian debt on their balance sheet (*see Chart 7 for details*). US banks in general are slightly better positioned to weather the crisis, given their robust asset quality, and superior margins when compared to their European counterparts. That being said, we also acknowledge that given the CECL implementation in the US has not been repealed yet, the banks will be required to make steep provisions, due the significantly weaker global economic outlook, in 1Q20 itself. These provisions could severely impact the profitability and capital buffers of the US banks. However, given the ongoing wave of policy easing and regulatory loosening, it seems plausible that the CECL implementation will be delayed beyond 2020.

Our overall outlook on the global banking system is 'negative': An escalation of coronavirus crisis will be damaging to the global banking system, which is likely to witness massive corporate defaults and a hit to their profitability and capital cushion. And given the crisis is still evolving, it is difficult to ascertain the amount of damage that would be caused by the economic disruptions to the global banking system. We will continue to closely monitor the developments in the global economies and revise our outlook on the global banking system accordingly.

Chart 7: Italian Exposure with Some of the European Banks (as of 1H19)



Source: EBA Transparency Exercise, 2019

[8] *Banca Popolare di Vicenza, Vento Banca, and Monte Paschi*

G. Assessment of Key Risks for the Major Global Banking Systems

In the table below, we have summarized our views on the key banking systems:

Impact of the COVID-19 Pandemic on the Key Banking Systems*					
Region	**Asset Quality Risk**	**Profitability Risk**	**Capitalization Risk**	**Funding and Liquidity Risk**	**Rationale**
APAC					
China	High Risk	High Risk	High Risk	Moderate Risk	High exposure to stressed SMEs is likely to be a severe drag on profitability, asset quality, and capitalization, but refinancing and liquidity risk would be somewhat mitigated by government support.
Japan	High Risk	High Risk	High Risk	Moderate Risk	Asset Quality of Japanese megabanks and regional/rural banks will be hit by a material deterioration in creditworthiness of SMEs. Profitability, which is already impacted by NIRP, will be further pressurised by a surge in loan losses. Capital buffers, albeit sound, will be impacted by MTM losses due to high cross-shareholdings. However, funding profile is unlikely to be severely hit, given the low reliance on capital markets' funding, particularly in case of regional banks, while the funding risk is expected to be more visible in case of megabanks.
Australia	High Risk	High RIsk	Moderate Risk	High Risk	The Australian banking system's asset quality, albeit sound, remains vulnerable to significant downside risks stemming from substantial household debt and an overheated real estate market amidst a likely weakening in economic conditions, which would exacerbate these risks and undermine the banks' asset quality. Profitability, which is already under pressure from falling interest rates and intense competition, will be further impacted by a spike in loan losses. Funding will also be adversely impacted, given the banks' considerable (albeit declining) reliance on capital markets. However, robust capital buffers would provide a cushion against economic shocks.
Americas					
US	Moderate Risk	Moderate Risk	Moderate Risk	Low Risk	Large US banks are relatively less vulnerable to economic shocks, thanks to their healthy capitalization. Asset quality is likely to worsen, but is expected to fare better than the Asian and European lenders. US banks' profitability compares favourably against their major European/APAC banking peers. Thus, we expect the decline in profitability (due to a spike in loan losses, lower margins and MTM losses on equity holdings) to be less severe in case of US banks than the other banking systems (assuming that the CECL implementation is delayed beyond 2020). Strong liquidity profile, which will be reinforced by the Fed's extraordinary easing policies, would also help manage the liquidity crisis.
Canada	High Risk	Moderate Risk	Moderate Risk	Low Risk	The Canadian banking system's strong liquidity profile and solid capital position makes it relatively better-positioned to endure an economic crisis when compared to its global peers. However, asset quality, albeit strong, is exposed to the significant downside risks stemming from high household indebtedness and an overheated property market. These risks are likely to become more pronounced in case of a recession, which could cause material deterioration in the banks' asset quality, with spill-over effects on capitalization and profitability.
Europe					
Italy	High Risk	High Risk	High Risk	High Risk	We expect the Italian banking system to be severely impacted by the coronavirus crisis, which has prompted the government to impose national lockdown, bringing virtually all the economic activity to a standstill. The Italian banking system is characterized by several fundamental weaknesses including high pile of bad loans, thin capital buffers, along with weak profitability and high funding costs, the latter partly impacted by the deteriorating sovereign creditworthiness. The ongoing pandemic is likely to further impair the credit quality of the Italian banks, even beyond repair for few of the vulnerable lenders, thus requiring government bailouts.
Spain	High Risk	High Risk	High Risk	Moderate Risk	With soaring daily fatalities and new virus cases, Spain is the second worst-hit country in Europe after Italy, and is currently under national lockdown. While the Spanish banks have made better headway in reducing problematic legacy loans and asset quality ranks better than Italy (but weaker than that of other Western European countries like France and Germany), the virus crisis is likely to severely pressurise the banks' profitability and capitalization. Weakening economic conditions are also likely to push up the loan losses and stock of impaired loans. However, the banks' weak funding profile will be partly supported by the ECB's implementation of additional LTROs, which will be available until the implementation of TLTRO III in Jun-2020.
France	Moderate Risk	High Risk	Moderate Risk	Moderate Risk	The French banks' strong capital buffers will provide cushion against the economic crisis. Asset quality, which is supported by an affluent customer base, is likely to fare better than its Spanish and Italian peers amid an economic crisis. However, the banks' profitability, which is already suppressed by protracted period of low interest rates and low cost efficiency, will be further pressurised by a rise in loan losses, pushing the return ratios lower than some of their European peers. Funding profile, which benefits from the abundant household savings,

Impact of the COVID-19 Pandemic on the Key Banking Systems*					
Region	**Asset Quality Risk**	**Profitability Risk**	**Capitalization Risk**	**Funding and Liquidity Risk**	**Rationale**
					will be further supported by availability of LTROs by the ECB, limiting any material deterioration in the funding profile.
Germany	High Risk	High Risk	Moderate Risk	Moderate Risk	Germany's highly fragmented banking sector renders its credit fundamentals extremely vulnerable to economic shocks. The German banks have struggled to improve their profitability since the GFC owing to their crowded banking system, resulting in competitive pricing pressure, the effect of which is compounded by low rates. However, capital buffers are strong, which will provide some support against the crisis. Funding profile will weaken amid the crisis due to high reliance on capital markets, but the ECB's funding support is likely to provide some respite.
Others					
UK	Moderate Risk	High Risk	Moderate Risk	Moderate Risk	Although we expect the UK banking system's credit fundamentals to deteriorate amid the crisis, we also acknowledge that its sound asset quality, robust capitalization and healthy liquidity buffers position it well to endure the economic shocks. However, the rise in loan losses are likely to drive the profitability metrics of the UK banks lower that their US peers.

**High Risk – indicates a material deterioration in the credit fundamentals from the current levels in the near term due to the pandemic crisis; Moderate Risk – indicates a modest deterioration in credit fundamentals; Low Risk – indicates that the credit fundamentals are likely to remain intact or decline marginally in the near term.*

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