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# Are Negative Rates Coming to North America?

Louise Pitt Brindle | September 2019

# The Presenter

**Louise Pitt Brindle**

Head of Research

Louise brings to the firm a deep expertise in analyzing global financial institutions. She spent 17 years at Goldman Sachs in London and New York and had been a Managing Director there since 2005. Covering Global Financial Institutions both from the publishing and desk analyst perspective, she has a specialty in European Financials, which she began covering in 1998. Louise began her career in London at JP Morgan in a trading and research role, moving to Credit Suisse First Boston after 4 years as the Senior Analyst covering European Financial institutions. She is one of the most respected analysts in her field among issuers and investors globally and will continue to cover these sectors at RPIA, in addition to overseeing four credit analysts who make up RPIA's research team.

Louise is a British citizen and has a B.A. (Hons) degree in Hispanic and Latin American Studies from the University of Bristol. She is Chair of the Board of Music for Autism in the U.S. and is also a member of the Advisory Board of the IBP Institute.

Louise joined RPIA as Head of Research in September 2019.



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# Are Negative Rates Coming to North America?

- No - we think negative rates are an extremely low possibility event in the foreseeable future in North America.
- The discussion in North America and the U.K. is different to what has driven negative rates in the Eurozone; the more challenging equity levels of the banks, sovereign weakness, no banking union and lack of fiscal unity.
- Rates will go lower in North America , but not into negative territory. We think there will be one additional rate cut in the U.S. in 4Q19, but there are no structural imbalances such as those in 2008.
- Other differences between Europe and North America include demographics, the strength and growth of underlying economies, employment levels, the existence of a centralized Treasury in the U.S..
- Fiscal stimulus is easier in North America than in Europe; still flexibility through QE and balance sheet expansion, possible legal impediments in the U.S. to negative rates.
- North American banks benefit from listed equity, better starting levels of capital and profits, depth of capital markets, sophistication of investor base.
- Investors should be more focused on the possibility of yield curve inversion than outright negative absolute rates headed into 2020.



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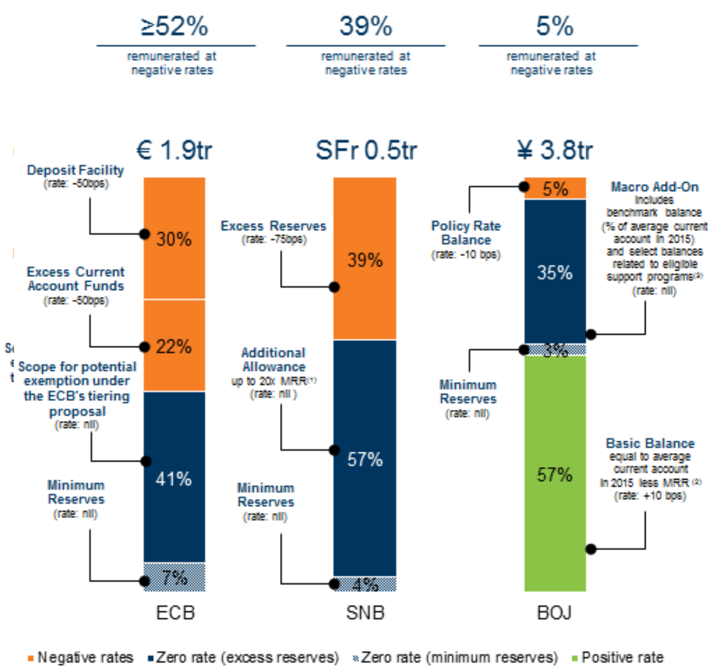
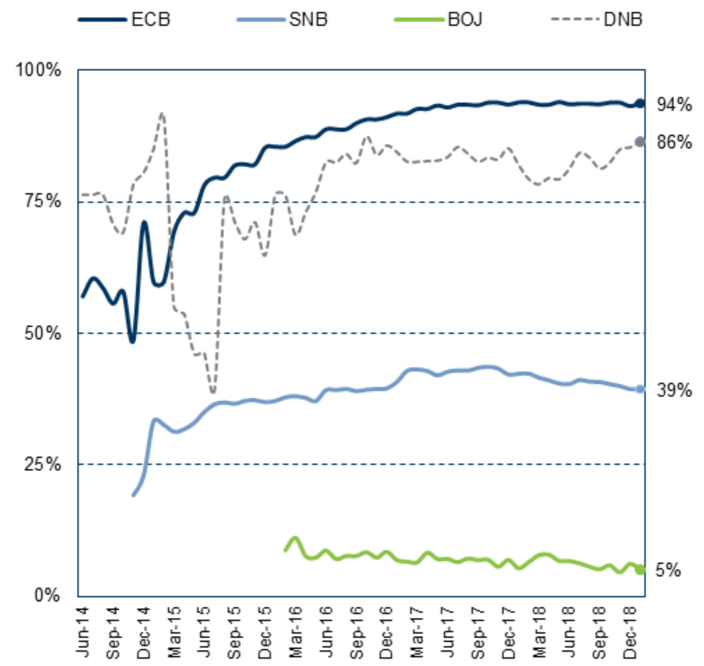
# In The Eurozone, Reserve Tiering Partially Offsets Negative Rates

- Reserve tiering exempts a portion of bank reserves from negative rates.
- Tiering was necessary as ~93% of the ~EUR2tr of reserves at the ECB were subject to negative rates, compared with only 39% at the SNB and 5% at the BOJ.
- The banks will now get a small, short-term boost to profitability from the tiering.




(1) Allowance of up to 20x the minimum requirement cumulative of Minimum Reserve Requirement; (2) Average current account balances during the reserve maintenance period in 2015 less Minimum Reserve Requirement; (3) 'Loan Support Program', 'Funds-Supplying Operation to Support Financial Institutions in Disaster Areas' and Funds-Supplying Operation to Support Financial Institutions in Disaster Areas of the Kumamoto Earthquake'.
Source: ECB, SNB, BOJ, Goldman Sachs Global Investment Research




Source: ECB, SNB, BOJ, Goldman Sachs Global Investment Research



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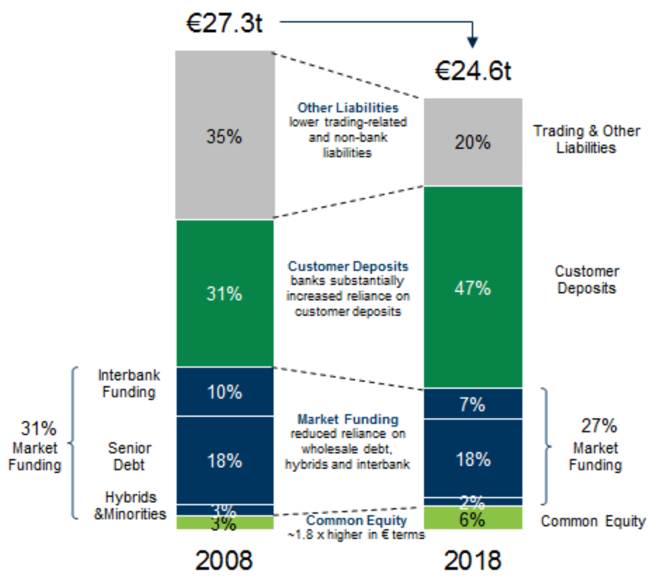
# Eurozone Banks More Important Factor in Negative Rates

- The drivers of negative rates in the Eurozone include the weaker capital positions and ability of the banks to absorb necessary losses post the financial crisis.
- Many banks are not equity-listed, individual countries did not want to bail out other countries' banks, sovereign fundamentals differ greatly, and corporate Europe is more reliant on bank lending than the capital markets.
- It has taken a decade to improve the strength of the capital of the banking sector, profitability is still a problem.
- Debt securities have performed very well though as wholesale funding has decreased as a result of higher focus on cheaper deposits and higher-quality capital through the retention of common equity.

**Total Equity & Liabilities**

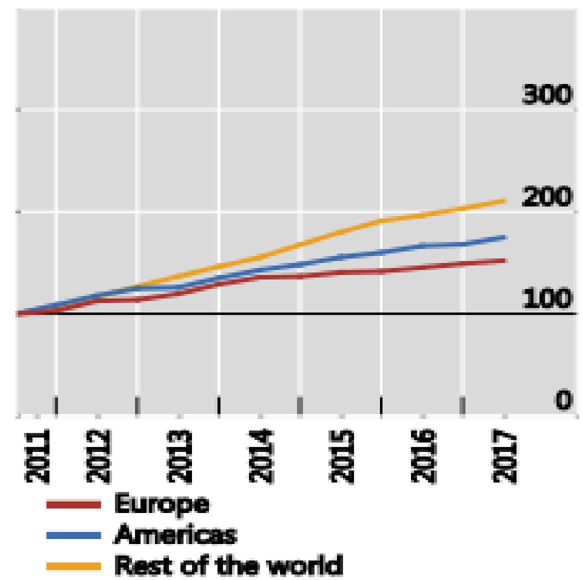
-10% decline over last decade (despite growth and M&A)




European banks under coverage at Goldman Sachs
Source: Company data, SNL, Goldman Sachs Global Investment Research

**Change in CET1 by Region**

June 2011 = 100




Source: Basel Committee on Banking Supervision



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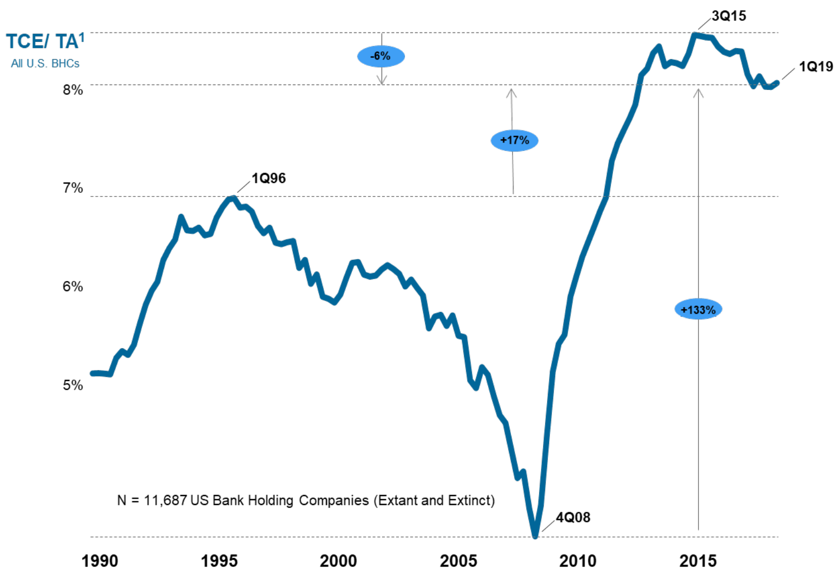
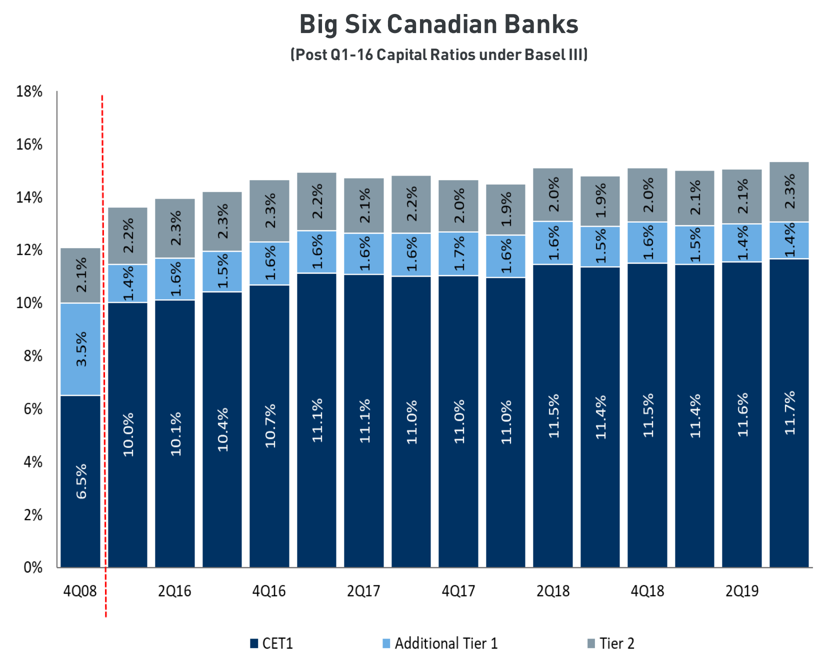
# North American Banks' Capital and Profitability are Strong

- The discussion on negative rates in North America is much less centered on the banking system.
- Capital and profitability levels of the U.S. and Canadian banks are very strong, although clearly low rates will pressure profitability and equity prices – but not necessarily credit spreads, which we are focused on.
- The quality and quantity of equity at U.S. and Canadian banks have improved meaningfully in the last decade and most have access to equity markets if needed, which is important in supporting bondholder value.
- While profitability will remain under pressure in this low rate environment, NIMs and equity levels are adequate and stress testing is stringent.




[1] Capital Adequacy measured as TCE/ TA, see slide 11 for details
Source: Consolidated Financial Statements for U.S. Bank Holding Companies (FR Y-9C), BMO Capital Markets

Source: RBC Dominion Securities



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