AUGUST 14, 2023

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Moody’s downgrades US banks

Equity markets continued to slide last week as Moody’s cut the credit ratings of 10 US regional banks. This came a week after Fitch downgraded the sovereign credit rating of the US. The Moody’s downgrade reignited fears of a banking crisis following the failures of US banks such as Silicon Valley Bank, Signature Bank, and First Republic Bank earlier this year.

Weaknesses of US banks

Moody’s cut the ratings of 10 small and mid-sized US banks last week. Below, we summarize the recent comments of Moody’s on the weaknesses of regional US banks.

- “US banks continue to contend with interest rate and asset-liability management risks with implications for liquidity and capital.”
- “The wind-down of unconventional monetary policy drains system wide deposits and higher interest rates depress the value of fixed-rate assets.”
- “Many banks’ Q2 results showed growing profitability pressures that will reduce their ability to generate internal capital.”
- “Risks may be more pronounced if the US enters a recession. A mild US recession is on the horizon for early 2024.”
- “Asset quality looks set to decline from solid but unsustainable levels, with particular risks in some banks’ commercial real estate portfolios.”

More downgrades to follow?

On top of the ratings cut of 10 banks, Moody’s placed six major US lenders (including Bank of New York Mellon, US Bancorp, and State Street Financial) under review for a potential downgrade. In addition, Moody’s changed its outlook to negative for 11 smaller US banks.

Credit concerns

The recent downgrade of US banks has rekindled fears of a credit crunch. This comes after the US experienced a banking crisis and multiple regional bank failures from March up to May this year. Markets have been jittery amid growing concerns over further credit rating downgrades. These include potential downgrades of the US sovereign debt rating and further cuts to the credit ratings of regional banks. Investors are likewise concerned of the risks posed by vulnerable sectors such as US commercial real estate, particularly office landlords and shopping mall operators.

Philippine banks remain healthy

Despite the growing credit concern on US banks, Philippine banks have maintained their strength as they benefit from post-pandemic economic growth. The sector's loan book grew by 9.4% YoY in May while asset quality metrics are at manageable levels. This was led by the strong performance and robust financial condition of the country's three biggest banks (BDO, BPI, MBT) that jointly account for 42% of the banking sector's total assets. The Bangko Sentral ng Pilipinas (BSP) implemented various prudential measures such as requiring minimum ratios for capital, liquidity coverage, and net stable funding. Most (if not all) major banks have ratios that comply with regulatory thresholds set by the BSP, thus highlighting the Philippine banking sector's overall health.

Moody's downgrade worsens sentiment

Though the US economy displayed strong GDP growth and easing inflation, market sentiment was dented by the ratings downgrade of several US banks. This exacerbated the prevailing market weakness caused by Fitch's downgrade of the US sovereign credit rating in the previous week. Moody's highlighted how the US banking system would be negatively impacted by a weaker outlook for the US economy. Recession fears have resurfaced due to growing credit concerns brought about by the recent actions of Fitch and Moody's. Meanwhile, the Philippine economy posted a GDP growth of 4.3% in 2Q23, notably below the government's 6-7% target range. It is therefore important to reassess the economic outlook while considering the impact of escalating prices of crude oil and rice on a slowing economy.

Peso falls by 3%

The spate of credit rating downgrades ushered financial market volatility. The sovereign and corporate downgrades pushed bond yields higher, thereby driving the rebound of the US dollar and the decline of the peso. Since the Fitch downgrade, the US dollar (DXY) has gained 1% while the peso has fallen by 3%. The S&P 500 and the PSEi dipped by 2.7% and 2.8%, respectively. It is ironic that the peso and the PSEi fell sharply while the US dollar gained after the credit rating of the US was cut. It is clearly essential to monitor credit developments and understand their impact to financial markets and the economy. As seen in the recent market move, credit rating downgrades by Fitch and Moody's had a material effect on the performance of the peso and the Philippine stock market.

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