Spectrum Asset Management

Principal Asset Management℠

August 9, 2023

Moody's U.S. bank rating actions; Italy taxes its banks

Moody's U.S. bank rating actions

On August 7, Moody's took various rating actions on 24 United States regional banks and the three trust banks. Ten banks experienced downgrades, six had their ratings placed under review for downgrade (including all three trust banks), and eleven banks had their rating outlooks changed to negative. Moody's said that these rating actions are being driven by rising funding costs and profit pressures, possible adverse effects of a mild recession in early 2024 with attendant concerns about weakening of loan quality (including for commercial real estate) and concerns about capital levels, especially *vis-à-vis* larger U.S. banks and global peers. These actions come after similar moves in March and April, and a change in Moody's U.S. banking system outlook to negative in March. We note, too, that proposed regulations will further raise the capital bar for large U.S. banks— a credit plus.

Spectrum has been focused on these matters for some time and continues to take actions to optimize portfolios. Spectrum also notes that all the large banks that underwent the June stress test by the Federal Reserve (Fed) passed. According to the Fed, "This year's stress test includes a severe global recession with a *40 percent decline in commercial real estate prices, a substantial increase in office vacancies*, [emphasis added] and a 38 percent decline in house prices. The unemployment rate rises by 6.4 percentage points to a peak of 10 percent and economic output declines commensurately. The test's focus on commercial real estate shows that while large banks would experience heavy losses in the hypothetical scenario, they would still be able to continue lending." So, not only do the tested banks pass this onerous test, but they are also in good enough shape to continue to do business—a higher bar. In Spectrum's view, the matters Moody's cites are more related to earnings challenges than solvency concerns, which the affected banks' ratings continue to demonstrate. In addition, Spectrum believes that the major banks in which it invests will continue to have the demonstrated capacity to service their preferred stock.

Italy taxes its banks

The Italian Government's surprise August 7 plan to impose a special one-time tax on banks' net interest income, based on year-over-year growth, to fund tax cuts for other constituencies and subsidies for first-time homebuyers, is being reduced in size due to adverse market reaction. Italian bank stock prices dropped over EUR 9 billion in reaction to this original announcement. The tax level now will be capped at 0.1% of a bank's assets. This cap should reduce the tax amount payable by Italian banks by perhaps one-third from previous estimates of EUR 3-4 billion, with details still to be determined, such as how foreign and insurance income will be treated. Spectrum reiterates that we do not anticipate this tax will impair banks' ability to meet regulatory capital minimums; it's an earnings issue. It is unclear if this tax remains a 'one-off'.

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MM13605A | 08/2023 | 3051595-082024