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2015: "another lost year" for the banking industry?

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Key topics

I. State of the banking industry

- In Q3 2015, global banks managed to partly recover from the huge losses suffered during the decline of global stock markets in August/September—overall, 2015 was another lost year for the banking industry with a TSR of -2.3% year-over-year
- Tumultuous start to 2016, trading was repeatedly halted on China's stock market during the first days of 2016—DAX lost over 8% in one week while global banks lost more than 6%

II. Economic environment and key banking drivers

- The economic environment in Q4 2015 was mainly influenced by contrary decisions of ECB and US Fed, leading to an upward shift of US money market rates and short term fluctuations of FX rates
- For the second time in a row, economic sentiments indicate a negative outlook for all major regions
- Profitability and CIR of global top 100 banks deteriorated slightly in Q3 2015:RoE of 11.3%
- Stable RWA density for US and BRICS institutions, Western European banks with decreasing tendency in 2015

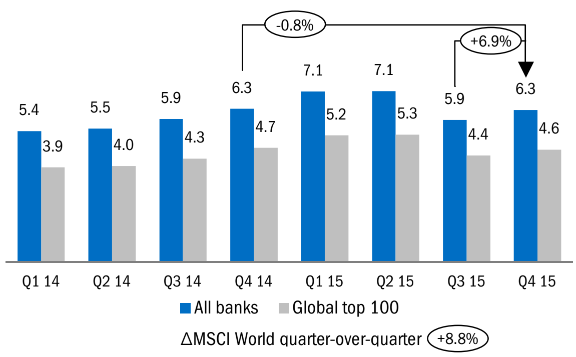
III. Replacing the CEO—the new TSR booster?

- High number of CEO replacements—only 30% of all global top 100 banks have been managed by the same CEO during the last 5 years
- Positive impact on TSR performance in the short-term—long-term effects remain to be seen

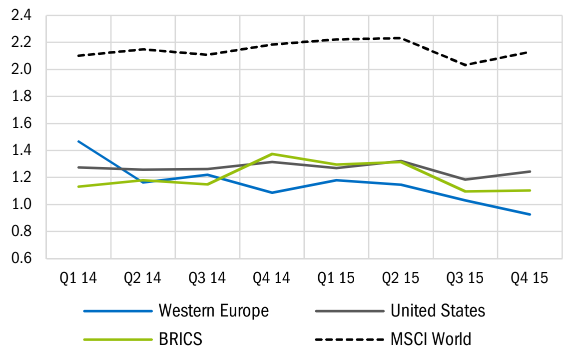
I. State of the banking industry

In Q4 2015, global banks managed to partly recover from huge losses suffered during the global stock market declines in August/September. Despite this promising end, 2015 goes down in history as “another lost year” for banks (in terms of market performance) and 2016 also started turbulently. The new plunge of China's stock market in early January hits global capital markets again (for possible consequences of Chinese market turmoils see also zeb.market.flash #15).

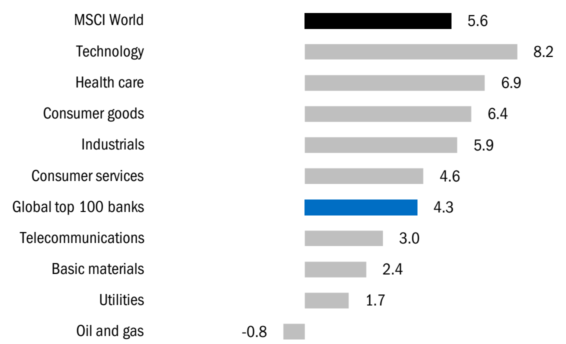
Market capitalization of the banking sector (end of quarter, in EUR trillion)[1)]



Price-to-book ratio of global top 100 banks and MSCI World[2)]



TSR of industry sectors worldwide (10/2015-12/2015, in %)[3)]



Top/low TSR performance among global top 100 banks (10/2015-12/2015, in %)

Top performers	Country	TSR
Sberbank	Russia	34.5
Bank Rakyat Indonesia	Indonesia	32.1
Haitong Securities	China	24.1
Westpac Banking	Australia	18.7
VTB Bank	Russia	17.7

Low performers	Country	TSR
Allied Irish Bank	Ireland	-64.5
National Bank of Abu Dhabi	United Arab Emirates	-16.4
Standard Bank	South Africa	-15.9
Kasikornbank	Thailand	-12.0
FirstRand Bank	South Africa	-11.8

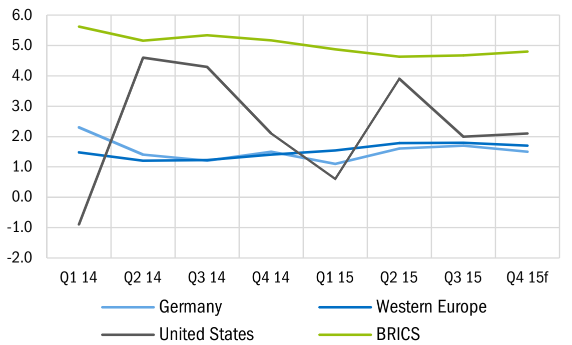
1) All banks worldwide according to Bloomberg classification. Global top 100 banks contain largest banks by market capitalization on December 31, 2014. Figures are aggregated in EUR, without adjustments for foreign currency effects; 2) Western Europe: Euro area, Denmark, Norway, Sweden, Switzerland, UK. BRICS: Brazil, Russia, India, China, South Africa; 3) Total shareholder return (TSR) of industry sectors other than banking are based on global sector total return indices, aggregated and provided by Thomson Reuters Datastream. Average total shareholder returns of global top 100 banks are weighted by the market capitalization of each bank; Source: Bloomberg, Thomson Reuters Datastream, zeb.research

- The global banking sector showed a slight recovery in Q4. All banks’ market cap increased by 6.9% and global top 100 banks grew by 5.6%. However, after going down by more than 16% in Q3, the banking sector is still not back on track. The TSR of the global top 100 banks was positive in Q4 (+4.3%) but well below market average.
- Overall, full year 2015 figures are not satisfying: market cap and P/B ratios of our global top 100 banks are below Q4 14 figures and the total shareholder return (although positive in Q4) is negative for the total year (-2.3%).
- A closer look at our banking sample shows significant regional differences: in the last quarter, US and BRICS banks performed best with average TSRs of above +6%. Western European banks lost value again with a TSR of -1.4% as especially several large players such as Credit Suisse, UniCredit and Barclays showed negative TSRs of -7% to -10% due to structural reforms and poor results.
- TSR low performer in Q4 2015 was Allied Irish Banks. Despite good Q3 figures, the stock price collapsed in November as the Irish government announced a possible sale of its current 99.8% stake.

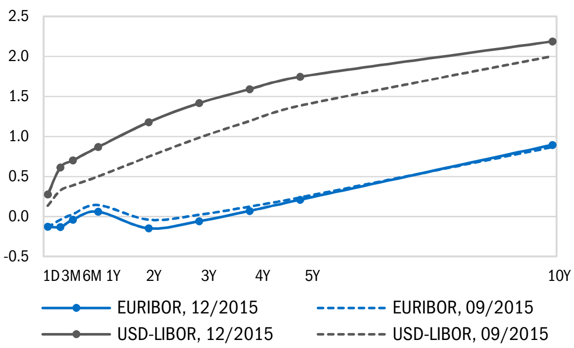
II. Economic environment and key banking drivers

The economic environment in the fourth quarter of 2015 was mainly influenced by the contrary decisions of the European Central Bank and Federal Reserve Bank, leading to an upward shift of US money market rates and short term fluctuations of FX rates. For the second time in a row, economic sentiments indicate a negative outlook for all major regions whereas the business climate index for Germany remains stable.

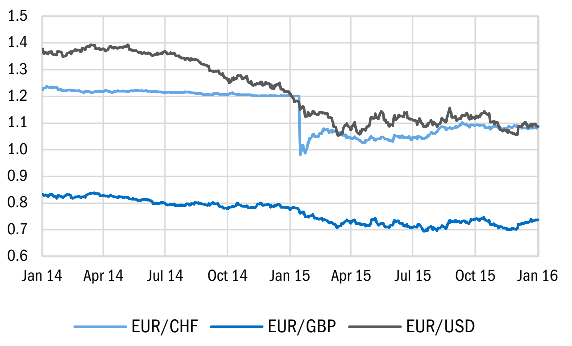
GDP growth and forecasts (real GDP, year-over-year growth rates, in %)[1)]



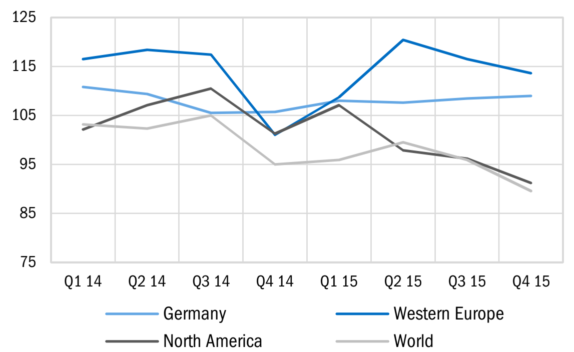
Money and capital market rates



FX rates (EUR/CHF, EUR/GBP, EUR/USD)



Economic sentiments (ifo Business Climate Index)[2)]

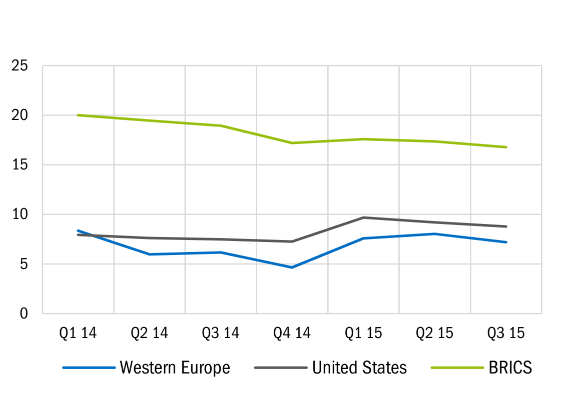


1) Western Europe: Euro area, Denmark, Norway, Sweden, Switzerland, UK. BRICS: Brazil, Russia, India, China, South Africa; Q4 15 based on forecasts; 2) The ifo Business Climate Index is an indicator for economic activity based on a survey among companies on their current business situation and outlook for the upcoming six months (2005 = 100). The ifo Institute only provides data for selected countries and regions. North America includes Canada and the US, no separate data for BRICS countries available; Source: Bloomberg, ifo Institute for Economic Research, Thomson Reuters Datastream, zeb.research

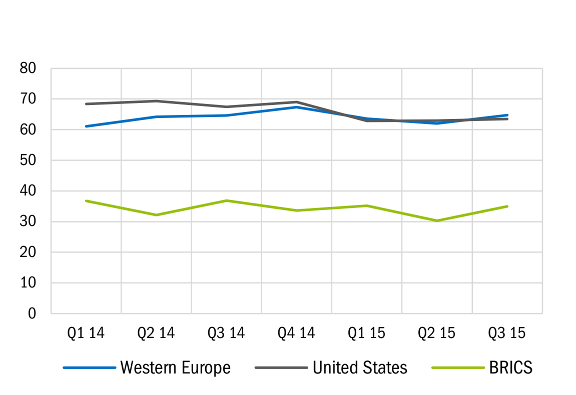
- As expected, on December 12th, the US Fed decided to increase the target range for the federal funds rate to 0.5% which led to a pronounced upward shift of the USD-LIBOR curve. For the euro area, the money and capital market rates hardly changed and short-term rates even decreased due to the ECB's decision in December to keep the key interest rates unchanged and to expand the quantitative easing (QE) program.
- These contrary decisions also affected FX rates in the fourth quarter. Especially the euro fell against the dollar to $1.06 prior to the central bank meetings but jumped back to $1.09 (highest value since November) after the ECB's decision as the market was expecting much sharper QE actions.
- While the economic climate deteriorated for all major regions (indices declined for the second time in a row) in Q4, the German economic outlook bucked the trend and remained stable.

The profitability and CIR of global top 100 banks deteriorated slightly in Q3 2015 as well as for the full year 2015. Differences concerning RoE and CIR between BRICS and Western Europe as well as United States are still evident. While the RWA density for US and BRICS institutions remained stable, Western European banks showed a decreasing trend in 2015. Customer interest rates in the euro area declined further and remained on their downward trend.

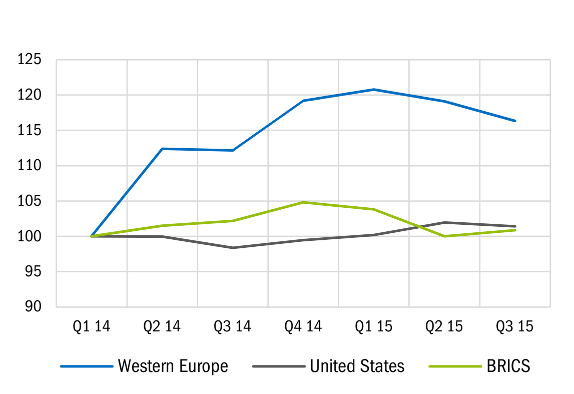
RoE after tax of global top 100 banks (in %)[1)]



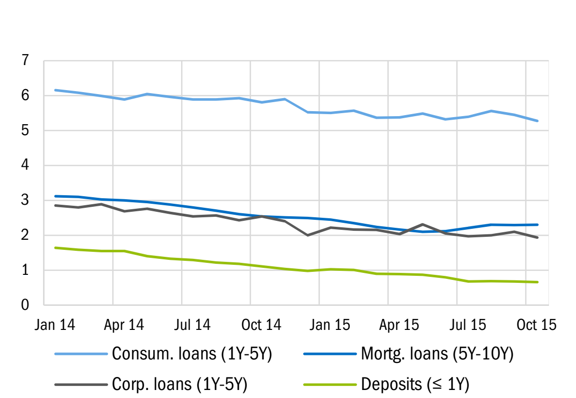
Cost-income ratio of global top 100 banks (in %)[2)]



RWA density development of global top 100 banks (in %)[3)]



Customer interest rates in the euro area (new business, in %)[4)]



Q4 15 data not yet available at the time of writing; 1) Post-tax RoE (Return on Equity): post-tax profit to average total equity; 2) Cost-income ratio: operating expenses to total income; 3) RWA density: risk-weighted assets (RWA) to total assets; RWA density indexed to 100 at March 31, 2014; Source: Bankscope; ECB, zeb.research

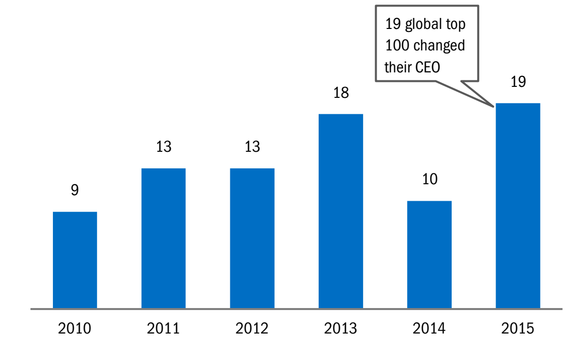
- The profitability of global top 100 banks declined slightly in Q3. The post-tax RoE for US banks was 8.8% and with 7.2% the post-tax RoE in Europe came back down approximately to the level of Q1.
- Since 2014, the CIRs of Western European and US banks have converged to reach a level around 63% in Q2 2015—the CIR for banks from BRICS countries increased.
- For US and BRICS institutions the RWA density has not changed significantly over the last 1.5 years. For Western European banks the RWA density rose sharply in 2014. Since Q1 2015, however, the RWA density of Western European banks has shown a decreasing tendency.
- The continuing low interest rate policy of the ECB has gradually transmitted to the market resulting in decreasing consumer interest rates (loans and deposits) since 2014. The spread between loan and deposit rates has remained constant.

III. Special topic

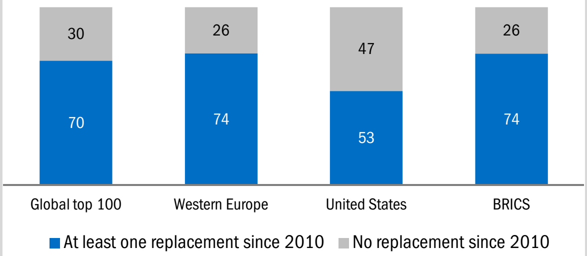
Replacing the CEO—the new TSR booster?

During the last few years, the fluctuation of chief executives, also called CEO turnover, has increased in the global banking industry. Replacing the CEO is often a last resort for the supervisory board to improve performance or to change strategy. This article tries to investigate the impact of CEO replacements on the banks' TSR performance.

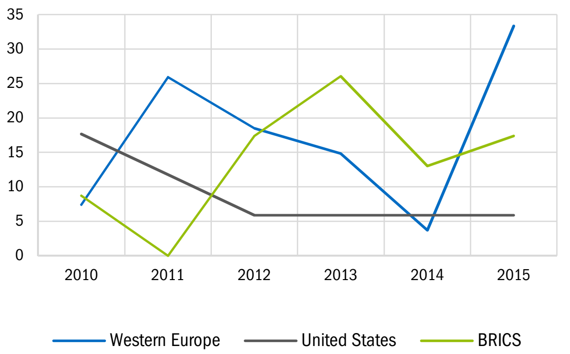
CEO turnover in global top 100 banks (in %)[1)]



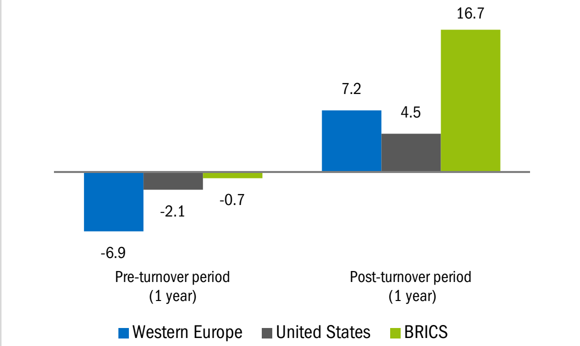
Relation of CEO turnover vs constant management board since 2010 by region (in %)



CEO turnover in global top 100 banks by region (in % of regional sample)[1)]



Performance of global top 100 banks by region (TSR relative to the sector performance in %, 01/2010-12/2015)[2)]



1) Global top 100 banks contain largest banks by market capitalization on December 31, 2014. The sample includes 27 banks from Western Europe (Euro area, Denmark, Norway, Sweden, Switzerland, UK), 17 US banks, 23 banks from BRICS countries (Brazil, Russia, India, China, South Africa) and 33 banks from other countries. A replacement is defined as the start of work of a new CEO which is provided by Bloomberg database; 2) The values are computed by the average of bank's TSR over a period of 1 year prior to the latest CEO replacement as well as 1 year after the latest replacement, compared to the corresponding TSR of the global banking sector; Source: Bloomberg, zeb.research

The high number of CEO replacements is mainly driven by Western European and BRICS banks. In the United States only around 50% of the banks have replaced their CEO. Overall, only 30% of all global top 100 banks have been managed by the same CEO during the last 5 years.

In Europe, exactly one third of Western European banks' CEOs have been replaced in 2015. To name just a few examples, in June 2015, Brady Dougan (Credit Suisse) was replaced by Tidjane Thiam and the Standard Chartered CEO Peter Sands was forced to step down and replaced by Bill Winters. Anshu Jain and Jürgen Fitschen (Deutsche Bank) joined the long list of CEO exits in Europe when in July 2015, John Cryan (former CFO at UBS) took over the management of Deutsche Bank.

Among other reasons, such as retirement or turnover related to merger and acquisitions, the supervisory board of a company often tries to reverse negative performance by changing their CEO. In fact, several studies found a positive correlation between poor stock performance of a company and a CEO replacement, see Kaplan and Montion (2012).[1] This is confirmed by a closer look at the TSR performance of global top 100 banks which have replaced their CEO since 2010. For all regions, these banks underperformed compared to the global banking sector with (on average) -6.9% for banks from Western Europe, -0.7% for BRICS institutions and -2.1% for US banks.

Generally, the effect on the performance of a bank can be divided into a short-term and a long-term effect. The data of the global top 100 banks indicates a positive impact for the short-term (1 year after a CEO replacement) with an increase in performance of 7.2% for Western Europe, 16.7% for BRICS and 4.5% for the US. A possible conclusion is that a CEO replacement indicates a turning point of the bank's TSR performance in the short-term. Whether these positive short-term effects are also applicable for the long-term remains to be seen.

[1] Literature: Kaplan, Steven N. and Bernadette A. Minton, 2013. How has CEO turnover changed? International Review of Finance 12 (1), pp. 57-87.

About zeb.market.flash

zeb.market.flash is a quarterly compilation of market data, putting the total shareholder return (TSR) performance of the global banking industry, economic fundamentals and key value drivers into perspective. It is published by zeb. All data and calculations of this issue are based on the date of January 4, 2016. The global top 100 banks cluster contains the largest banks by market capitalization on December 31, 2014 and is updated on an annual basis. Data is subject to ongoing quality assessment. As a consequence, minor adjustments could be applied to historical data as well as forecasts shown in previous issues of zeb.market.flash.

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