

# Apples to oranges: Banks aren't using the same assumptions when evaluating the economic future

Article

**The news:** In preparation for an economic downturn, US banks have set aside large sums of money to boost loan provisions and capital reserves in 2023. But the lack of data around the economic assumptions these banks are using makes it difficult to tell if they are preparing enough, or if they're being a little too optimistic, per American Banker.

**Rose-colored glasses:** Though bank profits fell in Q3, revenues were strong due to increasing interest rates, and banks spoke confidently about their ability to weather an economic downturn. Many banks set aside reserves to cover potential loan losses in the event that consumers were unable to keep up with their repayments.

But in determining the amounts to set aside, banks used a broad range of economic assumptions that could have led them to differing conclusions. Analysts at Jefferies found the following:

- The average baseline scenario that banks used included an assumption of low, single-digit growth in GDP and a 4% unemployment rate in 2023. These assumptions are pretty similar to the current economic landscape. In October, the unemployment rate was 3.7%, and Q3 GDP rose by 2.9%.
- The median worst-case scenario included assumptions of 7% unemployment and a low, single-digit contraction in GDP.
- **What's worrisome is that the median worst-case scenario resembles some of the baseline scenarios used by some US megabanks:** Bank of America is estimating unemployment will swell above 5% by Q4 2023, and Wells Fargo predicts unemployment will reach 6.1% by that time. Wells Fargo is also assuming GDP will fall by 1.1% in Q2 2023 before growing 1% in Q4.

While it's hard to exactly compare the assumptions—each bank likely uses its own weighting and forecasting methods, and they provide very little transparency into the process—the assumptions differ enough to cause concern that some banks may not actually be doing enough to prepare.

**No recession next year:** One example of a larger bank with a particularly optimistic outlook is Goldman Sachs. Analysts at the bank compiled 10 reasons why the US won't experience a recession into the next 12 months. Here are just a few of the reasons:

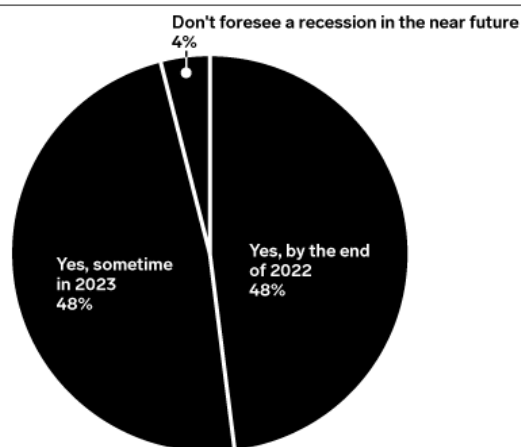
- Jobless claims are low. The bank acknowledged that the non-farm payroll numbers are softening, but it still believes the labor market looks strong.

- Though layoffs have been dominating the news, they've been relatively small and confined to the tech sector. Goldman Sachs doesn't expect layoffs to extend much further beyond tech.
- The bank also sees long-run inflation expectations falling in line, meaning inflation won't stick around forever.
- And US GDP grew in Q3 2022. Goldman expects GDP to continue to grow in 2023 and beyond.

Goldman did suggest, however, that a recession may come about in 2024. It also set aside \$515 million for [loan loss provisions in Q3](#), citing the potential impact of broader concerns regarding the macroeconomic outlook.

### Do US Banking Executives Believe There Will Be a Recession?

% of respondents, June 2022



Source: IntraFi, "Bank Executive Business Outlook Survey Q2 2022," July 25, 2022

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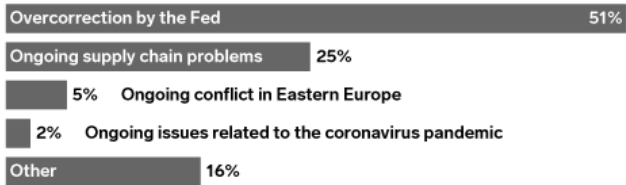
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**The big takeaway:** Despite feeling confident going into the new year, banks should remain wary of the unsettled economy. They must not become too attached to increasing revenues driven by high interest rates without also considering the potential for consumers to default on their payments as a result of leaning too heavily on credit.

Banks should also be mindful of the struggles that consumers face. A rosy outlook might cause banks to overlook their customers' need for support and guidance—a request that's been growing louder and more widespread as inflation continues to take a toll.

## Primary Cause of a Recession According to US Banking Executives, June 2022

% of respondents



Note: numbers may not add up to 100% due to rounding

Source: IntraFi, "Bank Executive Business Outlook Survey Q2 2022," July 25, 2022

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