Where Next for Bank Shares?

Description

The global banking sector has endured a tough decade. The credit crunch sent valuations at most major banks sharply downwards, while some banks didn't survive the biggest recession in a generation. Since then, tighter regulations aimed at reducing the chances of a repeat performance have caused profitability to disappoint across the sector.

Certainly, banks are now much healthier than at any point since the credit crunch. But their returns have also been somewhat disappointing compared to the pre-credit crunch era. However, could that all be about to change?

New regulation

When it comes to banking regulations, the new US administration is likely to make major changes compared to its predecessor. Donald Trump has signalled in the past that he believes regulations need to change, which fits in with his general standpoint on reducing red tape and bureaucracy. This could have a huge impact on the banking sector. Lighter regulations could lead to an ability to take more risks with less capital. This would be likely to stimulate profitability and could lead to greater share price gains for global banks.

Opportunities for growth

Aside from the potential catalyst of lighter regulation in the US, there are also growth opportunities for banks in emerging markets. In recent years, a number of the world's major banks have sought to position themselves within the Asian economy in particular. Since wealth across the region is forecast to rise rapidly and China is pursuing a more consumer-focused economy, there are likely to be lending opportunities on offer. This would include lending to businesses as well as individuals, since GDP growth in Asia and the emerging world remains relatively high. As such, growth potential within the banking sector remains attractive.

Potential risks

Of course, the banking sector also faces a somewhat risky outlook. Brexit could lead to greater uncertainty among businesses, consumers and investors. In turn, this could mean global GDP growth forecasts are trimmed over the medium term. Alongside this, new economic policies in the US may cause heightened uncertainty. While this could include less regulation for banks, rising inflation and a higher budget deficit could also lead to potential difficulties further down the line. Although a banking crisis is relatively unlikely, it can never be ruled out.

Takeaway

The banking sector has had a rather turbulent decade on the whole. Other sectors have generally offered superior risk/reward ratios during that time. However, things could be set to change for bank shares. Reduced regulation in the US could kick-start their profitability, while the growth opportunities in emerging economies remain high.

Certainly, there are risks from changes such as Brexit and the impact of a potentially looser fiscal policy in the US. However, buying banks with sound balance sheets at fair prices could prove to be a highly profitable strategy over the coming years.

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