



## Is The Banking Sector About to Experience a Golden Age?

### Description

The banking sector has experienced a mixed decade. The financial crisis caused severe pain and distress for a wide range of investors. Some institutions went under, while others were forced to receive state aid. Few left investors with anything but large paper losses, and this caused many investors to become rather downbeat about the prospects for the sector.

### Improving performance

However, in the years following the financial crisis, the banking sector has enjoyed a more [prosperous period](#). Monetary policy has helped to stabilise economic performance across the developed world, with lower interest rates boosting GDP growth rates.

Similarly, quantitative easing has helped to improve the balance sheets of a wide range of banks. Today, many banking stocks have balance sheets that are far stronger than they were prior to the financial crisis. This means that the risks involved in buying bank shares have declined, and this could provide investors with a more attractive risk/reward ratio.

### Growing profitability

Of course, a lower interest rate has also made it more difficult for banks to generate rising profitability. Certainly, it has stabilised economic performance across the developed world, but it has also meant that there has been little difference between the rate they pay to customers for holding their cash and the rate they receive from investing in short-term securities.

Looking ahead, however, this situation could be in the process of changing. An improved outlook for global economic growth means that interest rate rises have already commenced in the US. Further rate rises are expected to take place over the medium term, while in Europe the improving outlook for the economy could mean that monetary policy begins to tighten during the current calendar year.

The impact of a rising interest rate could be positive for the banking sector. It may provide a [tailwind](#) which helps to catalyse earnings across the industry. With interest rates likely to move higher over the

coming years, this could create further growth opportunities in the long run.

## Economic outlook

With the banking sector's overall performance being closely linked to the outlook for the wider economy, the sector could enjoy a strong period in future years. While risks to the global macroeconomic outlook remain, such as political risk in the US and the situation in North Korea, the overall picture for global GDP growth remains positive. This could lead to higher demand for borrowing by consumers and businesses, as well as lower default rates from existing borrowers.

With a number of banking stocks continuing to trade on low valuations due in part to investors being cautious about the overall sector, the investment potential of the industry seems high. While volatility may be high as monetary policy in the US and Europe begins to tighten, the overall performance of banking shares could improve. As such, now seems to be the right time to invest in them for the long term.

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