Daiwa Capital Markets

European Banks – Credit Update

- In line with the trend of recent quarters, the 3Q18 earnings season was relatively uneventful.
- Expectations for a new round of TLTRO for euro area banks is growing. The ECB might provide some signals to the market in December, whilst the final details could be provided in March 2019.

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Sector Developments

In line with the trend of recent quarters, the 3Q18 earnings season was relatively uneventful. In the Nordics, **Nordea** is yet to reverse its - now prolonged – downward trend in revenues, whilst **Danske** provided no significant update on its anti-money laundry issues. In the UK, banks had a generally good quarter, with the earnings from **HSBC** and **Standard Chartered** boosted by Asia, whilst **Barclays** was a positive surprise. In contrast to most of its peers, it reported strong performance in FICC and Equities trading. In France results were mixed, **BNPP**'s figures were rather unimpressive, impacted by weak FICC and domestic retail banking; whilst **SocGen's results** were strong, backed by resilient domestic banking and benefiting from good numbers in asset and wealth management. BPCE also showed good earnings, yet increased restructuring costs dampened the bottom line. In Germany, **Deutsche**'s results were expectedly weak in 3Q18, with revenues down across divisions, yet what raised some concerns was the bank's statement that it was gaining significant market share in leveraged finance, which is precisely the area under increasing scrutiny by regulators due to a weakening of related underwriting standards across the industry. In Switzerland, **UBS** was solid once again, whilst **Credit Suisse** was hit by FICC trading. That said, **Credit Suisse** performed well in IB, and confidently affirmed it had gained market share against its American peers, although some data manipulation was required to reach that conclusion. In Italy, **Intesa** was a positive surprise, showing non-tangible effects from the Italian political turmoil, yet **Unicredit** was impacted by a material write-off on its participation on the Turkish bank Yapi Kredi, wiping out most of the bank's 3Q18 profit.

Share Price Movements (%)			
Top 5 day Δ		Top YTD Δ	
BCP PL	12.7	FBK IM	15.2
SWEDA SS	7.2	SWEDA SS	4.9
BARC LN	4.2	EBS AV	4.2
INGA NA	3.6	DNB NO	2.0
RBI AV	3.0	CBG LN	1.7
Bottom 5 day Δ		Bottom YTD Δ	
MTRO LN	-18.4	DBK GY	-44.9
AIBG ID	-11.4	DANSKE DC	-40.6
UBI IM	-10.1	MTRO LN	-36.8
BKIA SQ	-8.5	SYDB DC	-34.9
BNP FP	-8.5	CBK GY	-32.1

5Y Sr CDS Movements (bps)			
Top 5 day Δ		Top YTD Δ	
UBI	-14.2	RBI	+4.2
Sabadell	-13.8	Erste	+4.9
Danske	-7.1	SEB	+11.2
Bankia	-5.3	Bankinter	+15.3
Swedbank	-4.2	Natixis	+16.7
Bottom 5 day Δ		Bottom YTD Δ	
RBS	+20.4	BPM	+233.2
Barclays	+18.6	UBI	+173.1
Lloyds	+18.3	Mediobanca	+158.3
SCB	+10.8	Intesa	+128.3
HSBC	+9.7	Unicredit	+122.4

Source: Bloomberg

Expectations for a new round of Targeted Long Term Refinancing Operations (**TLTRO**) is increasing. Although the first TLTRO-II operations don't mature until June 2020, banks will have to start complying with the Net Stable Funding Ratio (NSFR) from 2019, which requires the institutions to maintain minimum levels of long-term funding (over 1 year). TLTRO facilities would not hence count for NSFR purposes from June 2019, making the need to address the issue more urgent. The current outstanding amount of TLTRO-II is around €383bn, the large majority of which taken by Italian and Spanish banks. In that context, the objective of the new round of TLTRO is likely to differ from the last one. Whilst the TLTRO-II aimed to increase bank lending in the euro area, the main objective of TLTRO-III will likely be to facilitate funding for banks with constrained access to markets. It will therefore perform more of a financial stability function, rather than a monetary policy one. Some signal by the ECB on the topic is expected in December, with the final details potentially being provided in March 2019.

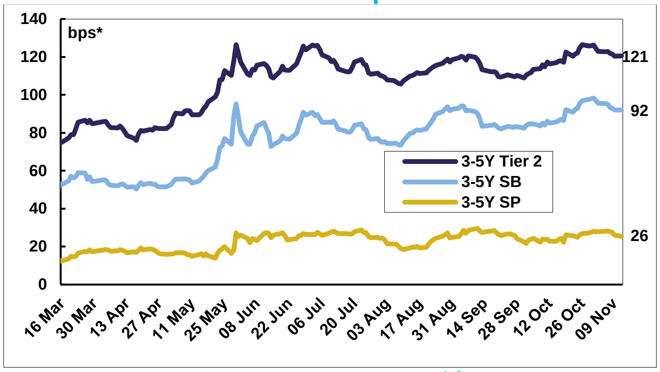
Markets

Activity in the primary market was fairly muted in October amid the equity sell-off, Italian budget discussions, Brexit negotiations and the earnings season's blackout periods. According to Dealogic, October was the weakest month of the year for € issuance. The difficult conditions were also felt in the secondary markets, with a continuation of the widening of EUR and USD spreads, particularly for sub-senior papers.

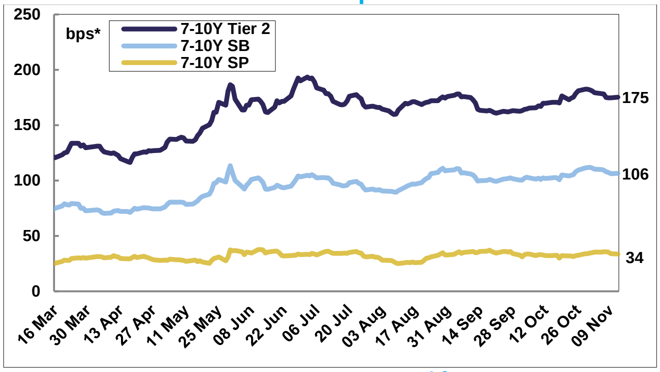
Activity in the primary market started to pick up last week however, as the earnings season came to an end. ING pursued its objective of further developing the USD green market with a €/$ dual currency green bond. The paper was issued in HoldCo format, amounting to $1.25bn and €1.5bn, priced at T+150bps/MS+135bps and with maturity of 7Y/12Y respectively. Other key transactions came from Santander UK and Barclays, which decided to tap the dollar market following the conclusion of the US mid-term elections, and subsequent positive market reaction. Santander UK issued a paper with three tranches, two in the OpCo format, 3Y, priced at T+83bps/3mL+66bps, amounting to $500m each, and one in the HoldCo format, amounting to $1bn, 6NC5, priced at T+173bps. In the Samurai market, UBS tapped the market in the first week of November, the bank's first Yen public transaction since an OpCo Samurai issued in 2008. The bank launched a two-tranche 6NC5/10NC9 HoldCo paper, amounting to ¥130bn/¥20bn and priced at YSO+55bps/65bps. Meanwhile Standard Chartered announced a 6NC5 Samurai deal for this week, to be priced on Thursday, initial guidance at YSO+72/77bps.

Daiwa Capital Markets was a joint lead manager at the UBS deal, and is participating in the announced Standard Chartered transaction.

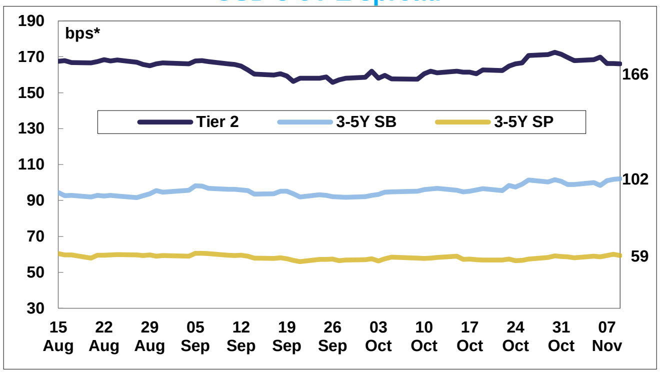
EUR 3-5Y Z spread[1,2]



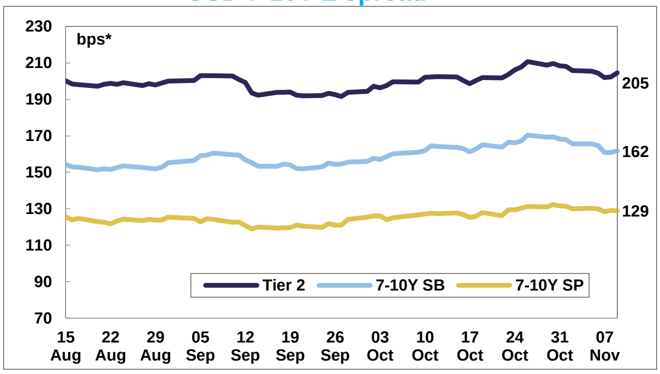
EUR 7-10Y Z spread[1,2]



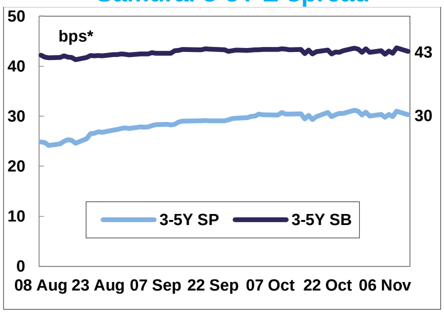
USD 3-5Y Z spread[1,2]



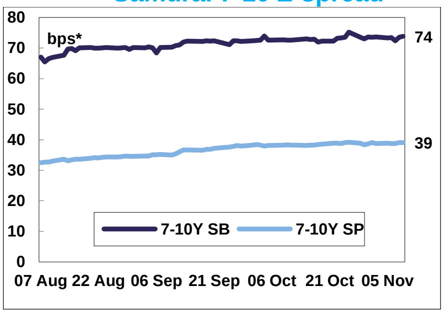
USD 7-10Y Z spread[1,2]



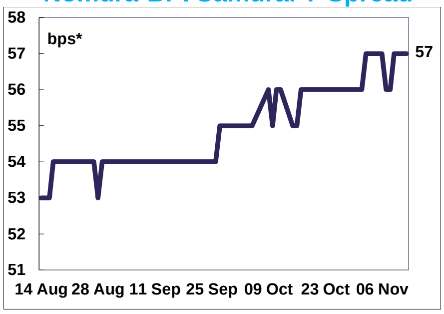
Samurai 3-5Y Z-spread[1,2,3]



Samurai 7-10 Z-spread[1,2,3]



Nomura-BPI Samurai T-Spread[4]



Spread Movements

	Today	Δ 1d	Δ 14d	Δ 1M	Δ 3M
EUR 3-5 years Z Spread (bps)					
T2	121	0	-5	4	9
SB	92	0	-6	6	11
SP	26	-1	-2	3	19
EUR 7-10 years Z Spread (bps)					
T2	175	1	-7	5	39
SB	106	0	-5	4	10
SP	34	-1	-1	1	8

	Today	Δ 1d	Δ 14d	Δ 1M	Δ 3M
USD 3-5 years Z Spread (bps)					
T2	166	0	-5	5	-1
SB	102	0	1	5	8
SP	59	-1	2	1	-1
USD 7-10 years Z Spread (bps)					
T2	205	2	-6	2	4
SB	162	1	-9	-2	7
SP	129	0	-2	2	3

	Today	Δ 1d	Δ 14d	Δ 1M	Δ 3M
Samurai (JPY) 3-5Y Z-Spread (bps)					
SB	43	-1	-1	0	1
SP	30	-1	-1	0	5
Samurai (JPY) 7-10Y Z Spread (bps)					
SB	74	0	-1	1	4
SP	39	0	1	3	6
Nomura-BPI Samurai Index (bps)					
Index	57	0	1	2	4

Source: Daiwa Capital Markets Europe Ltd, Bloomberg. SP= Senior Preferred; SB=Senior Bail-in.

[1]Average of the largest European banks' debt securities. Herein included figures may not be reflective of the whole market. [2]Mid Z Spread to maturity/call. [3]Liquidity and transparency of the samurai secondary market is significantly lower than that of the EUR and USD markets. Average formed by a lower number of bank's given reduced number of European banks issuing in JPY when compared to EUR and USD issuers. [4] Weighted average of OAS versus the JGB yield of JPY denominated foreign bonds.

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