Daiwa Capital Markets

European Banks – Credit Update

- The recent increase in excess liquidity placed at the ECB will cost euro area banks an additional EUR1.3bn per year, assuming constant excess liquidity levels. Yet as the latter is in fact expected to increase further, the ECB will be under pressure to adjust the tiering multiplier.
- Primary market activity remained adequate, backed by the strong rally in secondaries. This resilience of the primary market has eased concerns on banks' funding and liquidity needs, raised after the unsecured market closed for several weeks from mid-February.

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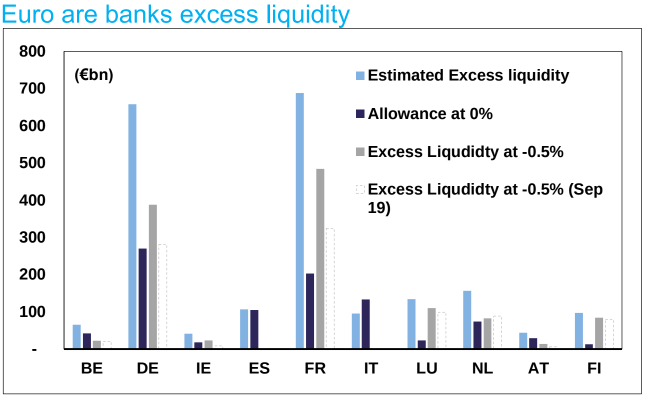
ECB Tiering

The ECB announced on Thursday an increase and extension of its pandemic emergency purchase programme (PEPP). In particular, the total volume of assets to be purchased under the programme was increased by EUR600bn to EUR1.35trn, EUR100bn more than expected. The move was well received by the markets, yet, disappointingly for euro area banks, the central bank did not amend the tiering multiplier (*excess reserves placed at the ECB amounting to less than 6 times minimum reserve requirements are exempt from the -0.5% deposit rate.)*

This tiering system was implemented in September 2019, when total excess liquidity in the euro system stood at EUR1.76tn. Following the increase in the volume of purchased assets by the ECB since the beginning of the pandemic, excess liquidity has now increased to EUR2.17tn, and is expected to rise further as the volume of assets purchased by the ECB continues to increase.

Euro are banks excess liquidity



Data as of end-April 202020. Source: ECB and Daiwa Capital Markets Limited.

Based on the current level of excess liquidity, euro area banks will pay about EUR6.2bn per year to the ECB according to our estimates, up from the EUR4.9bn estimate based on September 2019 data, albeit still down from the EUR 7.1bn paid in 2018. Based on these figures, an increase of EUR 410bn in excess liquidity has generated an additional cost of EUR1.3bn for euro area banks. As excess liquidity is likely is to continue to increase rapidly, we see a strong rationale for the ECB to increase the tiering multiplier in order to reduce the pressure on the already strained profitability of euro area banks.

Primary and secondary markets

Activity in the **primary market** continued to be adequate last week, albeit it was largely concentrated on Tuesday (02 June), as issuers avoided the ECB's policy announcement on Thursday and the release of US payroll data on Friday, although both were supportive to spreads. The continued positive sentiment, reflected in both credit and equity markets, led to strong demand, sizeable tightening from IPTs, reduced or negative NIC and continued supply of higher risk Tier 2 issuance. Credit Suisse was the most active issuer, placing a total of USD2.45bn (equivalent) in Sr HoldCo debt and USD1.5bn in Sr OpCo debt. This continuous resilience of the unsecured primary market for European banks has eased concerns on banks' funding and liquidity needs, raised after the unsecured market closed for several weeks from mid-February.

(Table 1) Key Transactions

Bank	Rank	Amount	Maturity	Final Spread (bps)	IPT (bps)	Book Orders
Deutsche Bank	SP Green	EUR500m	6NC5	MS+167	MS+200	> EUR4.5bn
Credit Suisse	Sr HoldCo	GBP750m	8NC7	G+223	G+240	>GBP2.5bn
Credit Suisse	Sr OpCo	USD2bn	3Y	T+88	T+115	> USD4.2bn
	Sr HoldCo	USD1.5bn	6NC5	T+188	T+215	> USD4.6bn
StanChart	Tier 2	EUR1bn	10.25NC5	MS+280	MS+320	> EUR5.25bn
BNP Paribas	SNP	USD2bn	6NC5	T+190	T+220	> USD6.2bn
Nordea	SP	USD1bn	3Y	T+83	T+105	> USD4.1bn
Intesa	Tier 2	GBP350m	10Y	UKT+490	UKT+520	
Nykredit	SP	EUR750m	5Y	MS+90	MS+115	> EUR1.4bn
Op Corporate	Tier 2	EUR1bn	10NC5	MS+200	MS+230	> EUR1.5bn

Source BondRadar, Bloomberg.

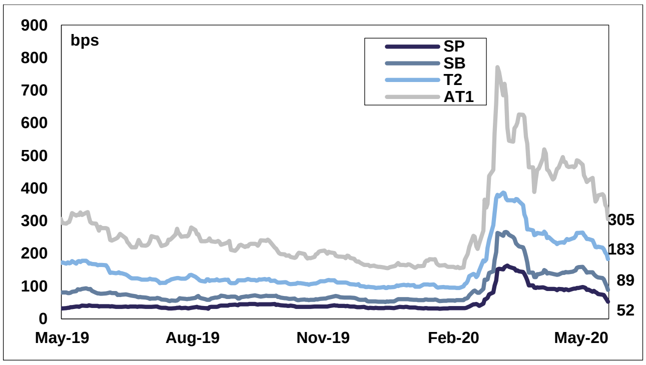
Secondary spreads continued to rally last week amid the lavish and increasing levels of liquidity in the market resulting from the substantial monetary loosening implemented by central banks globally in recent months. The ECB's higher than expected increase in PEPP purchases, and the surprise decline in the unemployment rate in the U.S. were the main drivers of last week's tightening. EUR SP spreads tightened by another 28bps, whilst EUR SNP tightened by a substantial 46bps last. The tightening in USD spreads was lower yet still sizeable, falling by 13bps for USD SP bonds on aggregate, and by 43bps for USD SNP paper.

Senior unsecured spreads are now only 10bps wider Y/Y on aggregate for European banks in both the EUR and USD market. Yet this is not reflective of banks' actual fundamentals, which are bound to deteriorate in coming quarters as a result of the current crisis.

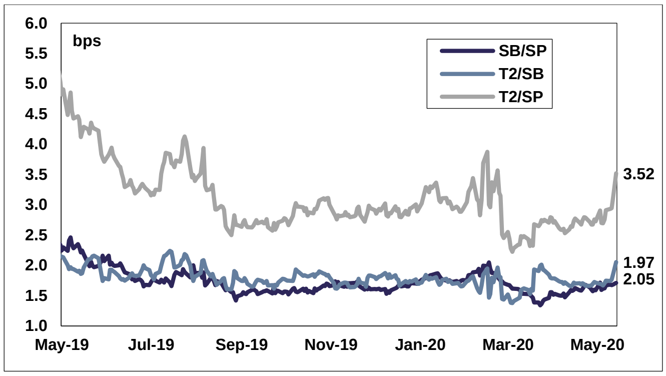
Last week's positive market sentiment was also reflected in share prices, with the STOXX Europe 600 Banks (SX7P) closing the week up by 16.67%, the best weekly performance since March 2009.

Western European Banks EUR Spreads and Yields

Aggregate Z-spread LTM (bps)



Multiples (x)



Source: Bloomberg, Daiwa Capital Markets Europe. SP = Senior Preferred/Senior OpCp; SB = Senior Non- Preferred/ Senior HoldCo; T2= Tier 2; AT1 = Additional Tier 1. All figures based on Z to worst spread of public benchmark issuances.

Selected Names

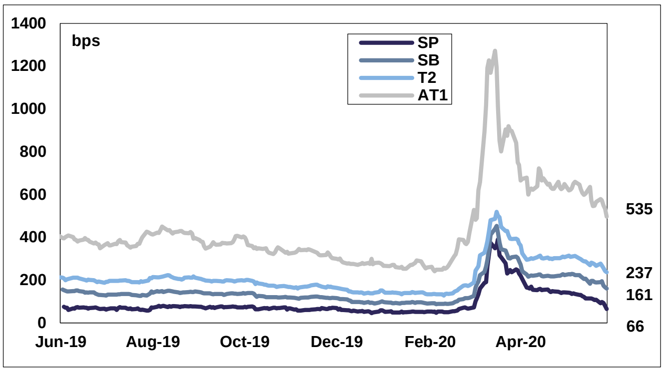
	Sr Preferred/Sr OpCo					Sr Non-Preferred/Sr HoldCo					Tier 2				
	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD
Commerz	4.9	0.8	96	-40	47	4.2	1.3	148	-64	74	5.2	3.1	323	-54	131
Barclays	3.8	0.6	78	-41	35	3.4	0.8	101	-53	48	5.6	2.4	226	-119	106
BBVA	4.9	0.6	76	-26	27	4.5	0.9	110	-47	50	6.0	1.9	212	-59	94
BFCM	4.1	0.2	39	-22	10	9.3	0.8	83	-37	23	5.4	1.5	154	-30	76
BNPP	2.7	0.1	28	-23	9	5.3	0.7	80	-35	26	5.5	1.3	139	-35	50
BPCE	3.8	0.2	43	-23	13	4.7	0.7	85	-37	32	2.9	1.0	123	-37	62
Credit Ag.	3.4	0.2	32	-19	2	5.1	0.6	78	-34	26	5.1	1.9	195	-38	57
Credit Sui.						6.7	0.9	98	-56	35					
Danske	3.0	0.2	43	-26	8	3.3	0.9	113	-42	41	6.8	2.1	227	-47	80
Deutsche	3.1	0.8	101	-43	23	2.9	1.5	163	-78	40	5.0	4.1	418	-58	117
DNB	3.4	0.1	29	-34	-2						7.0	1.5	167	-37	108
HSBC	3.3	0.1	34	-24	7	3.2	0.3	46	-44	6	5.9	1.1	117	-50	32
ING	1.7	0.1	34	-18	20	5.2	0.6	67	-35	19	5.5	1.5	170	-32	71
Intesa	4.6	1.1	125	-59	50						5.5	2.6	270	-42	117
Lloyds	2.2	0.1	31	-30	1	4.0	0.8	100	-52	49	7.6	1.7	195	-63	81
Nordea	4.6	0.0	25	-26	-1	3.0	0.4	66	-29	28	3.3	1.5	138	-47	88
Rabobank	2.5	-0.1	17	-22	1	6.3	0.5	65	-25	26	2.9	0.8	104	-48	55
RBS						3.6	1.1	133	-52	58					
Santander	4.0	0.2	40	-30	7	4.9	0.7	93	-44	38	5.7	1.6	176	-44	75
San UK	3.1	0.3	49	-28	18	3.5	1.0	129	-49	70					
SocGen	2.0	0.2	41	-20	16	5.9	1.0	115	-40	47	4.5	1.4	156	-47	74
StanChart						6.8	1.0	117	-58	46	4.1	2.0	191	-161	100
Swedbank	4.8	0.3	53	-20		4.3	0.7	87	-35	23	7.2	1.7	186	-37	85
UBS	1.5	0.1	31	-19	14	3.6	0.5	70	-37	29					
UniCredit	4.2	1.3	137	-62	54	5.1	1.9	204	-85	101	2.8	3.5	340	-103	163

Source: Bloomberg, Daiwa Capital Markets Europe. Dur.= Duration. Yield= Yield to worst (%). Z = Z-Spread to Worst (bps). Z 5DΔ = last 5 days Z-spread net change (bps). Z YTD = year to date Z-Spread net change (bps). Blank cells represent lack of statistically significant data. Figures may not be representative of the whole market.

Daiwa Capital Markets

Western European Banks USD Spreads and Yields

Aggregate Z-spread LTM (bps)



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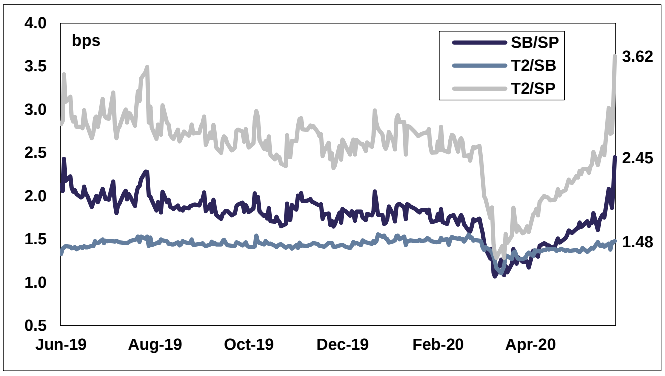

Source: Bloomberg, Daiwa Capital Markets Europe. SP = Senior Preferred/Senior OpCp; SB = Senior Non- Preferred/ Senior HoldCo; T2= Tier 2; AT1 = Additional Tier 1. All figures based on Z to worst spread of public benchmark issuances.

Selected Names

	Sr Preferred/Sr OpCo					Sr Non-Preferred/Sr HoldCo					Tier 2				
	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD
Barclays	2.7	1.2	90	-3	46	4.5	2.1	150	-34	54	5.6	3.1	237	-41	86
BFCM	2.4	1.1	80	-16	32										
BNPP	1.9	0.6	27	-12	-4	4.7	2.3	153	-19	73	5.2	2.8	203	-26	87
BPCE	2.5	1.2	96	-9	43	4.3	2.3	163	-17	84	3.7	2.6	206	-26	120
Credit Ag.	1.7	1.1	66	-19	29	3.4	2.0	138	-12	61	8.2	2.8	188	-18	83
Credit Sui.	1.8	0.9	64	-12	23	4.8	2.1	141	-14	71					
Danske	1.5	1.0	79	-29	15	3.1	2.3	181	-21	89					
Deutsche						3.1	3.1	250	-12	130	6.7	5.8	501	-61	138
HSBC	4.0	2.1	179	-4	70	5.1	2.1	146	-13	63	10.8	3.9	273	-13	125
ING	1.1	0.5	23	-19	3	4.9	1.8	116	-21	51	4.7	2.9	249	-12	127
Intesa	3.7	2.7	243	-22	111						4.1	4.5	387	-63	181
Lloyds	3.3	1.6	121	-16	49	3.8	1.9	138	-27	60	5.1	2.7	204	-19	84
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RBS						4.6	2.1	154	-28	64	3.1	2.7	224	-28	127
Santander	5.8	2.0	152	-27	65	5.3	2.5	182	-19	91	4.8	3.0	231	-18	139
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SocGen						4.2	2.5	186	-14	98	4.6	3.5	271	-14	144
StanChart	6.4	4.6	345	229	93	4.5	2.6	198	-9	105	5.8	3.3	288	-15	147
UBS	9.6	1.8	112	-10	61	4.8	1.8	122	-20	49					
UniCredit	2.4	3.2	283	-32	126	2.3	3.6	301	-65	176	7.9			-44	157

Source: Bloomberg, Daiwa Capital Markets Europe. Dur.= Duration. Yield= Yield to worst (%). Z = Z-Spread to Worst (bps). Z 5DΔ = last 5 days Z-spread net change (bps). Z YTD = year to date Z-Spread net change (bps). Blank cells represent lack of statistically significant data. Figures may not be representative of the whole market.

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February 2020