European Banks – Weekly Credit Update

- The very high take-up by euro area banks in the latest TLTRO.iii round will negatively impact their supply of CP, CB and SP paper and, for a while at least, further promote the 'doom loop'. Generous pricing conditions will allow for carry trades, partly offsetting costs from excess liquidity.
- The past week's market trend was mixed, with USD markets significantly outperforming their EUR equivalent following the Fed's announcement that it will finally start purchasing corporate bonds.

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TLTRO-iii

Euro area banks borrowed a record high EUR1.31trn from the ECB in the fourth TLTRO-iii round allotted last week. It was the first round to be conducted since the ECB increased the attractiveness of these long-term loans. The take-up, shared among 742 banks, was in line with expectations however, leading to relatively little market impact. Net of the early repayments from the TLTRO-ii operations of EUR214bn announced the week before, as well as the EUR603bn of TLTRO-ii and "bridge" LTRO funds set to mature this week, the new round implied a net injection of new liquidity of EUR548bn and a total of outstanding LTROs of EUR1.5trn by the end of month.

(Table 1) Disclosed TLTRO Intake

Bank	Total Intake (€bn)
Unicredit	94.3
Intesa	70.9
Caixabank	49.7
BBVA	35
Commerzank	32
Sabadell	27
Bankia	23
Rabobank	20

Source: Banks' statements, Bloomberg, Global Capital

Surveys suggest that this liquidity will eventually be primarily used to support lending to non-financial companies, growth in the stock of which already accelerated to 6.6%Y/Y in April from just 3.0%Y/Y in February. Indeed, the cumulative flow of loans to NFCs reached a record EUR194bn in March and April. And given that massive increase in business lending, most if not all participating banks will qualify for the most generous interest rate on today's loans, at 50bps below the deposit rate until 23 June 2021. So, that implies opportunity for sizeable near-term carry trade activity too, which shall partly offset charges paid by euro area banks resulting from excess liquidity. In addition to the generous pricing, the high intake was also backed by the increase in the allowance for each bank, which changed from 30% to 50% of the stock of eligible loans.

Based on data from the most recent EBA Transparency Exercise, the outstanding EUR1.5trn outstanding TLTRO is equivalent to around 40% of outstanding debt securities issued by euro area banks. Accordingly, we expect it to have a negative impact on the supply of Commercial Paper, Covered Bonds and Senior Preferred debt, with euro area bank issuance being driven by regulatory needs, rather than actual funding needs. One advantage which CBs and Senior Preferred Paper still have is the longer maturity, as TLTROs have a 3Y maturity only. That said, the large – and growing – intake of TLTROs will also increase the challenge to bring the facility to an end and allow banks to be fully self-sufficient again from a funding perspective. As a result, we see another TLTRO programme (TLTRO-iv) as likely, in order - at the very least – to allow for a gradual reduction in banks' reliance on ECB funding.

Disclosure on the intake by each bank has been limited so far, with Southern European banks being much more transparent (see table 1), and having largely maxed out on the TLTRO allowance. Banks in core European countries have been less keen on disclosing the amounts taken, although these are likely to have been material as well. Finally, the high intake will support euro area governments to fund their significant increase in debt issuance required to support national economies in the face of the covid shock. By the same token therefore, this will continue to promote the so-called "doom loop" reinforcing bank and sovereign risk.

Euribor (3M)

Source: Bloomberg.

Some TLTRO funds may be invested in short term assets, further pressuring front end rates, and potentially translating into further tightening in the 3M Euribor. The latter is now at pre-crisis levels.

In comparison, the take-up for the BoE's Term Funding Scheme with additional incentives for SMEs (TFSME) has been far less material to date, with the total lending amounting to GBP12.4bn as at 17 June 2020. This is on top of the outstanding GBP99.8bn drawing from the previous Term Funding Scheme (TFS). The contrasting difference is attributed to the less generous conditions of the TFSME. Moreover, UK banks had ample deposits before the crisis as a result of ring-fencing rules, which trapped liquidity in their retail operations.

Primary and secondary markets

There was no clear market trend last week, with the tightening observed early in the week being partly reversed by Friday. In the **primary market,** we've continued to see a decent stream of issues across geographies, currencies and debt rank. In the euro area, amid the vast TLTRO intake, issuance needs are now largely driven by regulatory requirements, rather than actual funding needs, leading to greater volumes of lower ranked paper.

Overall demand levels were adequate last week, with AT1s observing the largest book orders. IPT tightening ranged between 20 and 75bps and book coverage ranged between 1.6x and 5.5x, whilst NICs were largely limited.

In the **secondary market**, the trend was mixed for EUR credits, with the record high TLTRO intake by euro area banks having a limited impact on spreads. In the USD market however, the Fed announcement that it will finally start purchasing corporate bonds directly rather than through ETFs did support a noticeable tightening across the debt stack. EUR SP spreads widened 2 bps W/W, whilst EUR SNP tightened by 3bps. USD SP spreads tightened by 6bps W/W, more than offsetting the 2bps widening observed in the previous week, whilst USD SNP spreads were 17bps tighter W/W, vs a 9bps widening reported in the previous week. The outperformance of USD credits was also observed in the wider corporate sector, with the ICE BofA US Corporate index up 0.80% W/W, whilst the ICE BofA EUR Corporate Index was up by 0.17% W/W.

(Table 2) Key Transactions

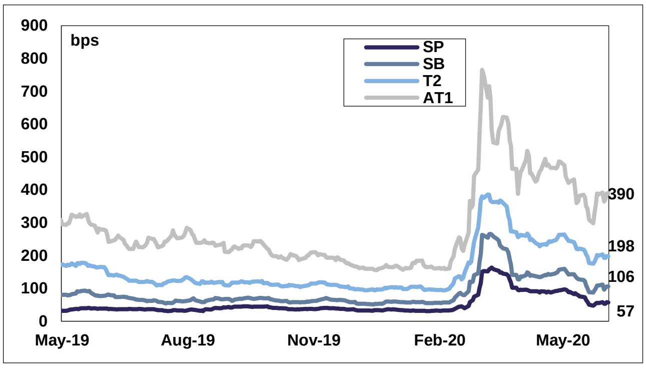
Bank	Rank	Amount	Maturity	Final Spread (bps)	NIC (bps)	IPT (bps)	Book Orders
Banco Santander	SNP Green	EUR1bn	7Y	MS + 140	9	MS +170	>EUR3.4bn
Sabadell	SP	EUR500m	3NC2	MS + 210	-	MS + 250	EUR2.7bn
Barclays Plc	Sr HoldCo	USD1bn	11NC10	T + 190	5	T + 225	USD2bn
Rabobank	SNP	USD1bn	6NC5	T + 100	0	T + 125	USD1.6bn
StanChart	AT1	USD1bn	PNC5	6.0% (coupon)	-	6.5% (coupon)	~USD5.5bn
AIB	AT1	EUR625m	PN5.5	6.25% (coupon)	-	7.0% (coupon)	>EUR5bn
RBI	Tier 2	EUR500m	12NC7	MS +315	-	MS + 350	>EUR1.6bn
Danske	SP	USD1.25bn	4NC3	MS + 100	5	MS + 125	USD1.9bn
Lloyds	SP NRF*	GBP500m	3Y	G + 155	25	G + 175	>GBP2bn

*Source BondRadar, Bloomberg. *NRF= Non ring-fenced*

Daiwa Capital Markets

Western European Banks EUR Spreads and Yields

Aggregate Z-spread LTM (bps)



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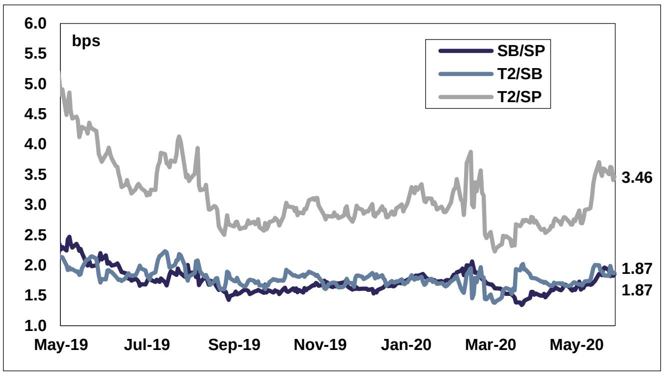


Source: Bloomberg, Daiwa Capital Markets Europe. SP = Senior Preferred/Senior OpCp; SB = Senior Non- Preferred/ Senior HoldCo; T2= Tier 2; AT1 = Additional Tier 1. All figures based on Z to worst spread of public benchmark issuances.

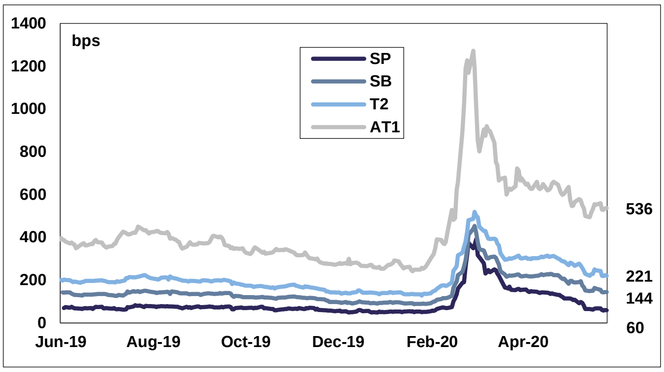
Selected Names

	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
Commerz	4.8	0.7	98	-1	49	4.2	1.3	155	-4	81	5.1	3.3	348	-8	154
Barclays	3.8	0.5	77	-4	33	3.3	0.9	120	-4	65	5.2	2.7	270	-18	149
BBVA	4.9	0.6	86	0	35	4.5	1.0	132	-3	74	6.0	2.0	232	-5	113
BFCM	4.0	0.2	46	1	16	9.2	0.9	97	-6	38	5.4	1.5	169	-5	80
BNPP	2.6	0.0	32	2	15	5.2	0.8	102	-1	45	5.5	1.5	164	-1	66
BPCE	3.8	0.2	51	0	22	4.7	0.7	100	-4	48	2.8	1.1	128	-4	70
Credit Ag.	3.4	0.1	37	0	8	5.1	0.7	95	-3	43	5.1	1.8	201	-3	72
Credit Sui.						6.7	1.0	122	-6	50					
Danske	2.9	0.1	45	1	10	3.2	0.9	124	-2	52	6.4	2.0	229	-4	82
Deutsche	4.0	0.8	104	-10	18	2.9	1.6	177	-6	54	4.9	4.0	416	-15	123
DNB	3.4	0.1	38	4	7						6.9	1.4	167	-5	108
HSBC	3.3	0.2	47	2	14	3.1	0.4	67	-2	24	5.9	1.0	122	-9	37
ING	1.6	0.1	39	2	25	5.2	0.6	80	-3	29	5.5	1.5	177	-7	80
Intesa	4.6	1.2	143	-5	62						5.4	2.5	275	-53	123
Lloyds	2.2	0.0	28	-5	-2	4.0	0.8	113	-4	57	7.6	1.9	217	-4	103
Nordea	4.5	0.0	29	1	3	2.9	0.4	72	0	34	2.5	1.4	132	-7	83
Rabobank	2.6	-0.1	22	2	6	6.3	0.5	76	-3	37	2.9	0.7	95	-2	46
RBS						3.6	1.2	147	-6	72					
Santander	4.0	0.3	59	3	22	5.3	1.0	125	-3	61	5.6	1.8	200	-1	99
San UK	3.1	0.2	49	-1	18	3.4	1.0	141	-3	79					
SocGen	1.9	0.2	48	2	22	6.1	1.1	136	-4	64	4.4	1.4	167	-2	79
StanChart						6.8	1.0	127	-6	59	3.1	2.2	172	-28	82
Swedbank	4.8	0.3	60	2		4.3	0.6	89	-2	25	7.1	1.6	183	-3	83
UBS	1.5	0.1	34	0	14	3.6	0.6	85	-3	41					
UniCredit	4.4	1.3	161	-1	74	5.0	2.2	238	-21	113	2.7	3.5	363	-27	167

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.

Western European Banks USD Spreads and Yields

Aggregate Z-spread LTM (bps)



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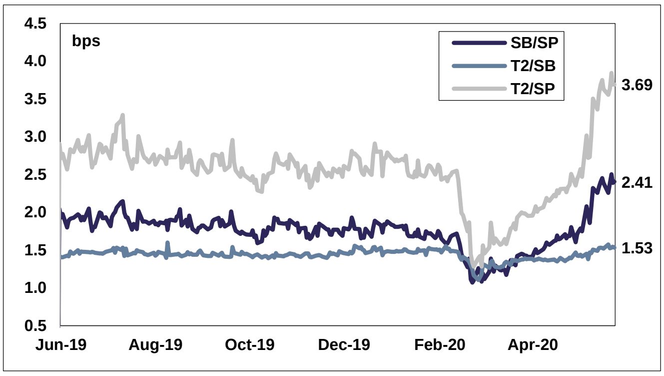

Source: Bloomberg, Daiwa Capital Markets Europe. SP = Senior Preferred/Senior OpCp; SB = Senior Non- Preferred/ Senior HoldCo; T2= Tier 2; AT1 = Additional Tier 1. All figures based on Z to worst spread of public benchmark issuances.

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	1.0	69	-14	19	4.5	1.8	141	-15	41	5.6	3.0	242	-22	78
BFCM	2.4	0.8	57	-9	13										
BNPP	1.8	0.6	29	-9	-2	4.7	1.8	138	-18	44	5.2	2.5	198	-22	72
BPCE	2.4	1.0	72	-5	21	4.3	2.1	156	-11	58	3.6	2.4	202	-13	86
Credit Ag.	1.7	0.9	37	-6	11	4.0	1.6	113	-11	42	8.2	2.5	175	-18	58
Credit Sui.	1.7	0.9	50	-13	11	4.8	1.9	119	-13	52					
Danske	1.4	0.7	47	-28	-17	3.1	2.1	174	-9	68					
Deutsche						3.1	2.8	229	-31	78	6.7	5.8	514	-34	130
HSBC	4.0	1.9	155	2	46	5.0	1.9	139	-22	44	10.8	3.6	271	-22	102
ING	1.1	0.6	35	1	11	4.9	1.5	101	-14	19	4.5	3.0	250	-10	100
Intesa	3.6	2.4	209	-9	76						4.1	4.1	359	-46	132
Lloyds	3.3	1.4	105	-24	39	3.6	1.4	105	-13	36	5.1	2.4	199	-14	64
Nordea	2.9	0.7	46	-4		3.0	1.5	120	-12	38	2.1	1.7	121	-16	50
Rabobank	2.4	0.7	38	-8	5	3.8	1.2	72	-7	17	5.0	1.9	138	-19	47
RBS						4.3	1.9	150	-18	47	3.2	2.4	205	-24	88
Santander	5.8	1.8	135	-11	48	5.3	2.3	181	-18	66	4.8	2.7	225	-29	110
San UK	2.5	0.9	66	-1	18	3.0	1.6	106	-15	36	4.6	3.1	261	-22	110
SocGen						4.2	2.2	176	-15	73	4.6	3.1	257	-20	109
StanChart	6.4	4.6	364	1	112	4.5	2.3	188	-18	81	5.7	3.1	257	-18	109
UBS	9.7	1.6	105	-10	57	4.7	1.6	104	-9	33					
UniCredit	2.3	2.9	260	-23	91	2.3	3.3	276	-34	138	7.6	5.1	445	-41	101

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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