European Banks – Weekly Credit Update

- The argument that retail banks should be split from investment banking operations was strongly rebuffed again in the Q2 results of the largest U.S. banks last week.
- Nordic banks' Q2 results were decent, with a strong rebound in profitability and a stabilization in capital levels, yet their results cannot be extrapolated to those from other European regions.
- Primary markets were quiet, with less than a handful of deals in the market; secondaries tightened, backed by better than expected economic data in US and Europe.

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2Q20 Earnings: The Americans

The Q2 figures of American banks were another strong rebuff against the argument that investment banks should be separated from retail banks. The retail and commercial bank operations of JPMorgan, Bank of America, Citibank and Wells Fargo were either loss making or barely broke even in the quarter, yet these were offset by the Investment Banking and Global Markets operations at JPMorgan, BofA and Citi. Wells Fargo, which has very limited investment-banking activity, reported a loss in the quarter, its first since 2008. Goldman Sachs and Morgan Stanley meanwhile, with limited retail banking activities, reported healthy RoTEs of 11.8% and 17.8% respectively. That said, JPMorgan's RoTE of 9% despite a $10.5bn impairment charge was also noteworthy, comparing well against peers (Citi: 2.9%, BofA: 7.6%)

(Table 1) U.S. Banks IB Revenues Growth (2Q20 Y/Y %)

	Origination & Advisory	FICC	Equity
JPMorgan	+91	+99	+38
Citi	+40	+68	-3
Goldman Sachs	+55	+149	+46
Morgan Stanley	+39	+168	+23
BofA	+57	+50	+7
Aggregate	+59	+95	+27

Source: Banks' financial statements. Figures may not be directly comparable.

FICC earnings by the five largest American investment banks increased by an impressive 95% Y/Y on aggregate, backed by a strong performance across Rates, Currencies and Credit, as the market rebounded after the March selloff. Equity earnings were up by 27% Y/Y, backed by strong client activity, although bank-by-bank performance was mixed. Origination and advisory was up by 59%, reflecting an increase in industry-wide ECM and DCM underwriting volumes, driven by Goldman and JPMorgan.

The impressive FICC results in the US signals potentially strong results from Deutsche, Barclays and Credit Suisse, which have maintained sizeable FICC operations. Yet the strength of the performance reported by the American houses will be challenging for the Europeans to replicate.

2Q20 Earnings: The Nordics

Six of the largest names in the Nordics reported their Q2 results last week. Overall numbers were encouraging, as the significant decline in profitability observed in Q1 has rebounded, whilst the sharp deterioration in capitalisation levels has stabilized. Aggregate provisioning levels reduced from the Q1 peak, whilst the valuations of derivative books and bond inventories rebounded in Q2 following the March selloff.

NIIs were supported by higher lending and deposit volumes, yet Nordea, SHB and DNB were hit by lower margins in Norway, where the key policy interest rate was cut from 1.5% in February to 0% in May. Fees were generally lower across Nordic banks due to lower overall retail client activity as a result of the lockdowns, whilst asset management income was hit by lower average AuMs. Despite the still elevated provisioning levels, net profits were mostly adequate, leading to RoEs ranging between 3.1% from Nordea, to 13.5% from Swedbanka.

That said, the economic impact of the pandemic in the region is expected to be less significant than elsewhere in Europe. Accordingly, such benign results should not be extrapolated to the rest of the European banks.

Additional insights *(see Table 2 below for detailed figures)*

- **Nordea's** bottom line in the quarter looks weaker than its peers due to the bank's less conservative approach in Q1 on provisioning, which led it to significantly increase provisioning levels in Q2. Perhaps optimistically, the bank now expects total loan losses projected for 2020 to have been covered by the provisions already booked in the first half of the year.
- **SEB** also booked a Q/Q increase in impairments, yet these were more than offset by higher trading income, leading to a Q/Q growth in the bottom line.
- **Swedbank:** In addition to a rebound in trading activities, net profit rose sharply Q/Q also due to the one-off SEK4bn ($400m) fine announced by the Swedish FSA in March 2020 and booked in Q1 related to the bank's AML failure.
- **Danske's** Q2 results surprised the market on the strength of its core revenue generation, backed by higher deposit margins and higher deposit and lending volumes.
- **SHB** provisioning levels fell sharply Q/Q, yet lower NII resulting from higher liquidity reserves and interest rate cuts in Norway and the UK led to a flat net income Q/Q. The bank's very limited provisioning so far has been questioned by the market, as the bank seems to have barely assimilated the economic impact of the pandemic. Yet it argues its strong underwriting criteria and limited exposure to more sensitive sectors makes it well positioned to face the current crisis.

(Table 2) Nordic Banks 1H20 Figures

	DNB (NOKm)		SHB (SEKm)		SEB (SEKm)		Danske (DKKm)		Nordea (EURm)		Swedbank (SEKm)	
	Q2	Q1	Q2	Q1	Q2	Q1	Q2	Q1	Q2	Q1	Q2	Q1
Revenues	14,123	15,543	10,625	11,178	13,999	10,089	11,274	9,606	2,092	2,001	12,076	10,232
Expenses	5,698	5,297	5,474	5,506	5,712	5,646	6,953	6,764	1,088	1,248	4,843	9,370
Impairments	2,120	5,771	97	538	2,691	1,494	1,018	4,251	698	154	1,235	2,151
Net Profit	5,019	4,000	3,959	3,937	3,501	2,355	2,325	-1,289	243	460	4,845	-1,687
Net Profit (USD)	542	432	440	437	389	262	358	-198	278	527	539	-188
Ratios (%)												
CIR	40.4	35.3	51.5	49.3	41.0	56.0	61.7	70.4	52.0	62.4	40.1	91.6
RoE	8.7	6.5	10.2	10.3	8.7	6.0	5.7	-	3.1	5.9	13.5	-
CoR	0.51	1.41	0.04	0.08	0.46	0.25	0.22	0.90	0.79	0.18	0.51	0.28
Stage 3 loans	1.83	1.61	0.23	0.21	0.86	0.71	1.4	1.5	1.3	1.3	0.8	0.8
Stage 3 coverg.	31.3	30.4	39.0	41.6	44.16	46.5	44.5	41.0	43.1	38.7	44.0	44.0
CET1	18.2	17.7	18.7	17.6	17.8	16.8	17.6	17.6	15.8	16.0	16.4	16.1
Total Capital	21.8	21.4	23.5	22.4	22.2	21.2	22.1	22.3	20.1	20.2	20.2	20.1
Lev. Ratio	6.8	6.5	4.2	4.2	4.3	4.3	4.4	4.5	4.9	4.9	4.6	4.7
LCR	134	128	138	149	138	176	155.8	154.4	160	182	164	162

Source: Banks' financial statements. Figures as stated by the banks, may not be directly comparable.

ECB Tiering Multiplier

Lagarde stated on Thursday that the Governing Council has yet to see the need even to discuss potential changes to the ECB's tiering multiplier, although it has not ruled a potential change in the future. Based on the current level of excess liquidity in the euro area of €1.8tn, euro area banks will pay over €9bn per year to the ECB according to our estimates, which we see as a strong reason for the central bank to increase the tiering multiplier in a time of significant distress for European banks. As a matter of arithmetic, the sooner the tiering multiplier is increased, the more beneficial that will be for euro area banks.

Primary and secondary markets

Primary market activity was very limited last week, with only three deals from European banks, as the market enters the summer lull and banks' blackout periods. Despite some decent tightening from IPT, demand levels were just about adequate, and backed by sizeable NIC.

Secondary spreads tightened somewhat towards the end of the week, supported by some better than expected economic data, particularly with respect to retail sales in the US and France, and as EU leaders started their discussions on the €750bn recovery plan. EUR spreads closed the week at around 4bps tighter on SP, SNP and Tier 2 paper. In the USD market, the tightening was more material, with USD SP closing the week 8bps tighter, whilst USD SNP and Tier 2 debt declined by 15bps and 13bps respectively on aggregate. The short term outlook on spreads looks bleaker, however, given the intensification of the pandemic in the US, which has contributed to a weakening of high-frequency US data, a levelling off in improvement in the labour market, and a notable deterioration in consumer confidence.

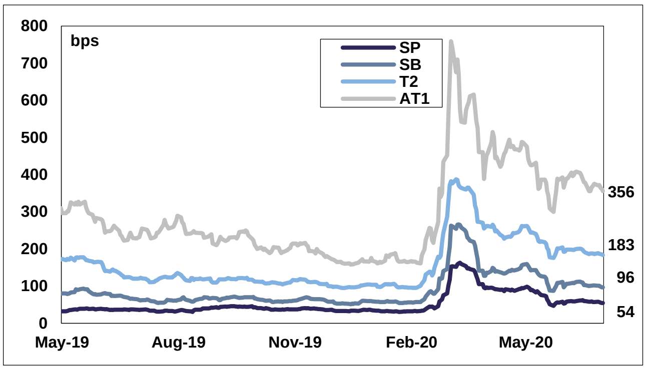
(Table 3) Key Transactions

	Rank	Amount	Maturity	Spread (bps)	IPT (bps)	NIC (bps)	Book Orders
Unicredit	Sr Non-Preferred	€1.25bn	7NC6	MS + 255	MS + 280	48	>€2.1bn
De Volksbank	Green Tier 2	€500m	10.25NC5.25	MS + 210	MS + 240	-	>€1.9bn
Nationwide	Sr Preferred	€1bn	5Y	MS + 60	MS + 80	21	>€1.4bn

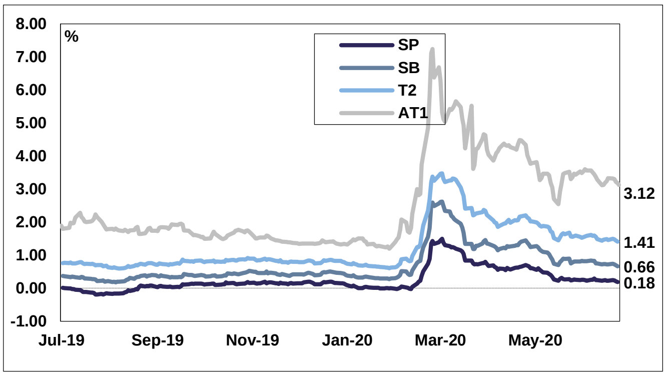
Source BondRadar, Bloomberg.

Western European Banks EUR Spreads and Yields

Aggregate Z-spread LTM (bps)



Aggregate Yields LTM (bps)



Source: Bloomberg, Daiwa Capital Markets Europe. SP = Senior Preferred/Senior OpCo; 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.

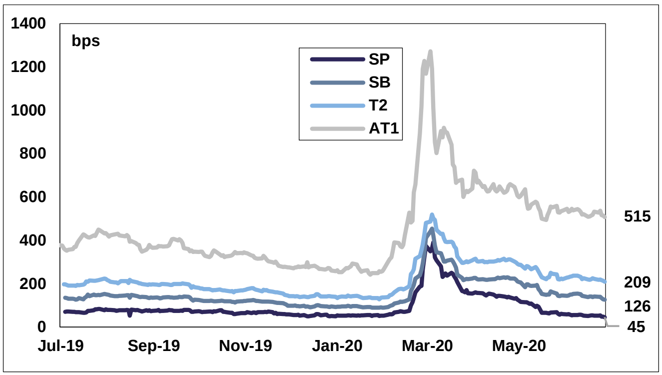
Selected Names

	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	4.7	0.6	91	-4	42	4.1	1.2	147	-6	75	5.1	3.4	360	2	163
Barclays	3.8	0.5	75	-1	32	3.3	0.7	99	-9	45	3.6	2.2	216	-20	95
BBVA	4.8	0.5	78	-5	27	4.4	0.9	118	-8	62	5.9	2.0	231	-6	115
BFCM	3.9	0.1	47	-2	16	9.2	0.8	91	-5	31	5.3	1.3	160	-3	67
BNPP	2.5	0.0	35	-1	16	5.2	0.6	96	-4	38	4.9	1.2	146	-3	63
BPCE	3.8	0.2	49	-4	20	4.6	0.6	90	-5	39	2.9	0.9	116	-5	58
Credit Ag.	3.4	0.1	39	-2	10	5.6	0.6	91	-4	39	5.0	1.8	206	-3	74
Credit Sui.						6.7	0.9	114	-6	44					
Danske	2.8	0.1	45	-1	10	2.8	0.8	115	-5	39	6.3	1.9	218	-8	71
Deutsche	4.8	0.6	91	-8	5	2.8	1.3	161	-8	38	4.9	3.5	376	-10	84
DNB	3.3	0.1	41	-1	10						6.8	1.2	147	-4	88
HSBC	3.2	0.2	49	-3	15	3.1	0.4	70	-3	26	5.9	1.0	128	-2	44
ING	1.5	0.0	34	-3	20	5.1	0.4	68	-5	21	5.4	1.3	159	-7	61
Intesa	4.6	1.0	127	-4	49						5.4	2.5	273	0	120
Lloyds	2.1	-0.2	15	-4	-9	3.9	0.6	92	-7	40	7.5	1.7	206	-3	92
Nordea	4.5	0.0	31	-1	5	2.9	0.3	62	-4	24	2.2	1.1	112	-6	62
Rabobank	2.6	-0.1	24	-1	7	6.2	0.4	68	-4	29	2.3	0.5	79	-4	30
RBS						3.5	0.9	123	-11	45					
Santander	3.9	0.2	57	-4	16	5.3	0.9	122	-6	46	5.6	1.7	198	-9	97
San UK	3.0	0.1	43	-2	12	3.3	0.9	120	-9	58					
SocGen	1.9	0.1	47	-4	21	6.1	1.0	128	-5	55	4.0	1.2	152	-4	63
StanChart						6.7	0.9	121	-3	49	2.2	1.4	89	-4	37
Swedbank	4.7	0.3	59	-2		4.2	0.5	80	-4	16	7.1	1.4	169	-3	68
UBS	1.4	0.0	32	-3	13	3.5	0.4	71	-8	29					
UniCredit	4.3	1.2	145	-3	61	5.0	2.0	229	1	82	2.7	3.1	332	-8	137

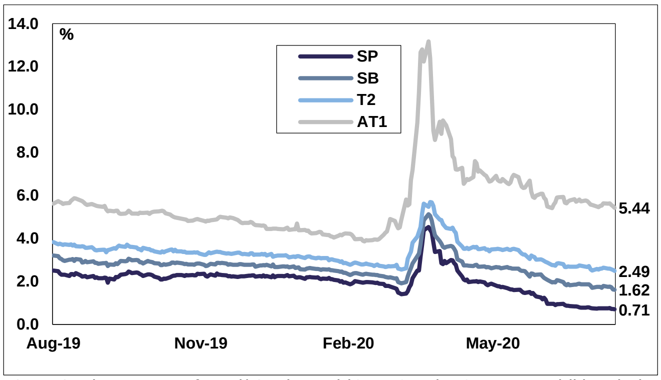
Source: Bloomberg, Daiwa Capital Markets Europe. Dur.= Duration. Yield= Yield to worst (%). Z = Z-Spread to Worst (bps). Z 5DΔ = last 5 days Z-spread net change (bps). Z YTD = year to date Z-Spread net change (bps). Blank cells represent lack of statistically significant data. Figures may not be representative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

Western European Banks USD Spreads and Yields

Aggregate Z-spread LTM (bps)



Aggregate Yields LTM (bps)



Source: Bloomberg, Daiwa Capital Markets Europe. SP = Senior Preferred/Senior OpCo; 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	2.6	0.8	59	-6	12	4.5	1.7	132	-11	29	5.5	2.9	241	-16	68
BFCM	2.3	0.8	57	-3	6										
BNPP	1.8	0.5	21	2	-11	4.6	1.6	119	-9	37	5.1	2.2	179	-8	61
BPCE	2.4	0.9	64	-4	13	4.3	1.8	136	-8	34	3.7	2.2	180	-13	66
Credit Ag.	2.2	0.9	60	-7	11	3.9	1.5	98	-4	26	8.3	2.3	170	-6	51
Credit Sui.	1.7	0.7	41	-7	1	4.5	1.8	109	-5	41					
Danske	1.6	1.0	73	-3	3	2.9	1.6	134	-12	34					
Deutsche						3.0	2.3	193	-12	43	6.6	5.9	533	-34	135
HSBC	3.9	1.7	138	-4	29	5.0	1.8	124	-7	40	10.8	3.0	236	-15	109
ING	1.1	0.5	24	0	0	4.8	1.3	88	-5	11	3.7	2.5	222	-8	79
Intesa	3.7	2.3	197	-7	66						4.1	4.3	384	-12	154
Lloyds	3.2	1.3	96	-4	30	3.7	1.3	90	-10	9	5.0	2.3	187	-9	52
Nordea	2.8	0.6	36	-1		2.9	1.3	97	3	19	2.1	1.4	103	-1	34
Rabobank	2.4	0.6	34	-3	-11	3.8	1.1	65	-3	5	5.0	1.7	128	-10	39
RBS						4.2	1.7	135	-9	34	3.1	2.3	204	-4	83
Santander	5.8	1.7	128	-6	41	5.2	2.1	163	-10	49	4.7	2.6	221	-6	109
San UK	2.4	0.7	50	-2	15	2.7	1.4	82	-3	19	4.5	2.9	237	4	96
SocGen	4.8	1.1	81	-15		4.1	2.0	160	-9	66	4.5	2.8	238	-7	90
StanChart	0.9	1.1	87	-7	-165	4.4	2.1	173	-9	69	5.7	2.8	246	-8	106
UBS	9.9	1.5	97	-1	45	4.7	1.3	93	-8	25					
UniCredit	2.3	2.7	248	-13	75	2.2	2.7	219	-9	95	7.5	5.1	452	-13	115

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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