European Banks – Credit Update

- ECB rate hike, removal of tiering multiple and unchanged TLTRO borrowing conditions give banks temporary arbitrage opportunity.
- Shorter week in primary market attracted several SSA and FIG deals, the latter of which were mostly confined to senior payment ranks while NIP remained elevated.
- Secondary market spreads partially tightened in EUR and USD following the ECB meeting. Delayed BoE MPC meeting gives markets more time to contemplate higher rate hike than expected.

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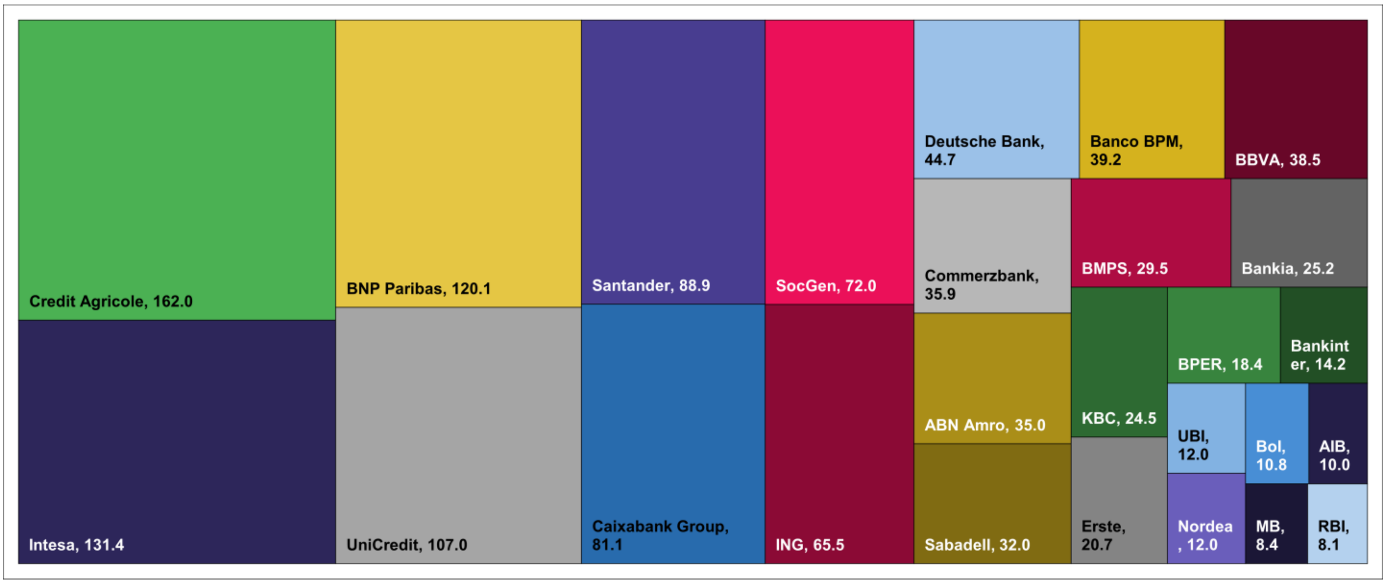
ECB rate hikes and adjustments to deposit tiering keep door open for TLTRO arbitrage

The ECB Governing Council's decision on 8 September to take steps to frontload its monetary policy tightening seemed increasingly likely following the prior week's upside surprise in the flash August euro area inflation data and evidence of broader-based price pressures. The ECB eventually increased its main policy rates by 75bps, taking the deposit rate to 0.75%, the marginal lending facility to 1.5% and the refinance rate to 1.25%. Among other things, policymakers also said they would continue to monitor bank-funding conditions to ensure that maturing operations under the third series of targeted longer-term refinancing operations (TLTRO III) don't interfere with the smooth transmission of its monetary policy.

In conjunction with the deposit facility rate turning positive for the first time since 2012, the ECB also suspended the tiering-system on banks' deposits. The tiering-system was put in place in 2019, exempting some bank reserves from negative rates. This covered six times the required reserve amount, plus the required reserves themselves. At the time, the ECB acknowledged that imposing negative rates on compulsory reserve amounts was not fair and aimed to provide some relief to banks. However, at its recent meeting, the ECB set the multiplier on the tiering-system to zero, meaning banks can now fully benefit from the higher deposit rate while still taking advantage from favourable TLTRO borrowing rates. Between June 2020 and June 2022 rates as low as -1% were available for banks that met certain lending requirements but these favorable conditions seized in June. Since then, the borrowing rate is the average deposit rate over the lifetime of the loan

We believe that one of the reasons that the ECB hasn't closed off this arbitrage opportunity is the temporary nature of the TLTRO programme that runs until end-2024. While more than half (55%) of the outstanding TLTRO loans are due to expire in June 2023 limiting the arbitrage period, banks will also have less of an incentive to repay the loans early. It is possible that the ECB wants to maintain excess liquidity in the euro area during this challenging period in order to cope with possible higher lending demands in the near-term. In last week's report, we mentioned that, in the short term, banks may benefit from rising interest rates, provided new credit demand remains supportive. However, deteriorating consensus views on macroeconomic growth implies pressure on banks' asset quality, which in turn may lead to higher provisioning levels. Gains from new lending activities could quickly be eroded by a combination of low growth, higher customer deposit rates and rising cost pressures.

TLTRO III uptake by banks (Total EUR1.25tr)



Source: Bloomberg; in EURbn

Primary and secondary markets

European **primary market** issuance volumes for SSAs stood at EUR15bn over the course of last week, within market expectations of EUR14bn-19bn. FIG supply of EUR14.5bn was also within the weekly forecast amount of EUR11.5bn-16.5bn. The total 2022 year-to-date FIG volume of EUR397bn is 22.8% ahead of last year's issuance volume. SSA volumes, however, remain behind last year's level, down 29% at EUR416bn. For the current week, survey data suggest SSA volumes will range between EUR16bn-20.5bn and FIGs are expected to issue EUR11bn-16bn.

Last week, **SSA** issuers were confronted with limited issuance windows due to Monday's labour day holiday in the US and Thursday's ECB Governing Council meeting. Issuers were keen to place deals ahead of these key events, including this week's US CPI data release on Tuesday. Consequently, we tracked four key USD transactions amounting to total issuance volume of USD8.5bn. Among these, the **International Finance Corporation (IFC)** drew the most investor interest with book orders exceeding deal size by 2.45x, resulting in 3bps spread tightening from IPT. In the euro market, sovereign issuers such as **France** and **Italy** attracted sizeable orders of EUR72.5bn, despite coming to market on the same day. Last week's limited funding opportunities still resulted in both transactions being highly sought after with subscription levels reaching 6.5x and 6.7x respectively. France raised EUR5bn with a 20-year maturity, ending its 2022 syndication programme, leaving a 4-5bps new issue premium on the table. Italy's transaction launched amidst a difficult backdrop as Moody's revised the outlook on its rating to 'negative' in early August while a snap election scheduled for 25th September could bring a less market-friendly government to office. This strengthened the case for the issuer to launch the deal ahead of any further potential volatility. Investors seemingly responded well to the April 2035 green-themed trade that tightened by 2bps and also priced with a concession of 4-5bps.

(Table 1) Key Transactions

Bank	Rank	Amount	Maturity	Final Spread (bps)	IPT (bps)	Book Orders
SSA						
AfDB	Sr. Unsecured (Social)	EUR1.25bn	7Y	MS -3	MS - 2	>EUR2.3bn
IADB	Sr. Unsecured (SDB)	USD3bn	7Y	SOFR MS + 46	SOFR MS + 48	>USD3.7bn
IFC	Sr. Unsecured	USD2bn	3Y	SOFR MS + 25	SOFR MS + 28	>USD4.9bn
AIIB	Sr. Unsecured (SDB)	USD2bn	5Y	SOFR MS + 63	SOFR MS + 64	>USD2.4bn
Région Wallonne	Sr. Unsecured	EUR1bn	15Y	BGB + 39	BGB + 40	>EUR1.39bn
JBIC	Sr. Unsecured	USD1.5bn	3Y	SOFR MS + 58	SOFR MS + 61	>USD2.55bn
Ferrovie dello Stato Italiane	Sr. Unsecured (Green)	EUR1.1bn	4Y	BTP + 87	BTP + 100	>EUR2.1bn
ASFINAG	Sr. Unsecured	EUR600m	6Y	MS - 12	MS - 8	>EUR6bn
France	Sr. Unsecured	EUR5bn	20Y	OAT + 7	OAT + 8	>EUR32.5bn
Italy	Sr. Unsecured (Green)	EUR6bn	Apr-2035	BTP + 5	BTP + 7	>EUR40bn
FIG (Senior)						
Credit Mutuel	SP	EUR1.5bn	5Y	MS + 90	MS + 115	>EUR2.8bn
Credit Mutuel	SP	EUR750m	10Y	MS + 120	MS + 145	>EUR2.25bn
OP Corporate Bank	SP	EUR1.25bn	3.25Y	MS + 65	MS + 85/90	>EUR2bn
BBVA	SNP	USD1bn	4NC3	T + 230	T + 250	n.a.
BBVA	SNP	USD750m	6NC5	T + 270	T + 290	n.a.
Santander (USA)	Sr. HoldCo (Sustainability)	USD500m	4NC3	T + 225	T + 250	n.a.
Deutsche Bank	SP	USD400m	5Y	T + 195	T + 210	n.a.
Abanca	SP (Green)	EUR500m	6NC5	MS + 305	MS + 325	>EUR1.2bn
Banco BPM	SNP (Green)	EUR500m	4Y	MS + 385	MS + 400	>EUR900m
HSBC	Sr. Unsecured	JPY44.7bn	4NC3	TONA + 135	TONA + 130/135	n.a.
HSBC	Sr. Unsecured	JPY41.5bn	6NC5	TONA + 175	TONA + 170/175	n.a.
HSBC	Sr. Unsecured	JPY13.9bn	10NC9	TONA + 185	TONA + 180/185	n.a.
FIG (Subordinated)						
HSBC	Tier 2	JPY11.9bn	10NC5	2.50%	2.50%	n.a.

Source BondRadar, Bloomberg.

FIG issuers remained very active last week but issuance was almost entirely limited to senior deals. **HSBC** was the exception here as it placed a four-part Samurai bond consisting of three senior HoldCo notes as well as a subordinated Tier 2. Total issuance volume was JPY112bn from 122 investors. Daiwa Capital Markets Europe (DCME) acted as joint-lead manager, making this the third Samurai transaction from a European bank this year following deals from Lloyds and BPCE. The shortest leg saw the strongest uptake with 55 accounts joining this tranche. The trend of higher quality issuers predominantly accessing markets continued, but there were some exceptions. Deals by Banco BPM and Abanca showed that even lower quality peripheral lenders could place senior MREL deals, albeit at a price. **Banco BPM's** green SNP deal for EUR500m had a maturity in line with most senior deals last week. Despite the ESG label and relatively short tenor, the spread was still high at MS+385bps. When compared to Intesa's green SNP from the week before, the final spread was 135bps wider despite carrying a one-year shorter maturity. Banco BPM's new issue premium is thought to have been around 60bps at issue. **Abanca** from Spain also launched a sustainable bond. The EUR500m SP note carried a green label, opening it up to a broader investor base. 2.4x book orders helped lower the spread to MS+305bps (-20bps from IPT) for the 6NC5 deal. The new issue premium is believed to be around 50bps.

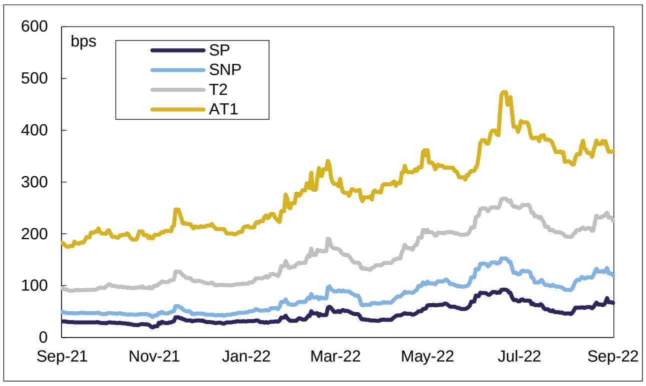
Secondary market spreads mostly tightened for EUR and USD, and CDS indices on European senior (112bps) and subordinated financials (202bps) as measured by iTraxx benchmarks also priced 19bps and 40bps tighter against the previous week's levels.

The ECB's 75bps rate hike took the deposit rate to 0.75% and the refi rate to 1.25%. The decision was unanimous on the Governing Council, suggesting that the differences in opinion between the hawks and doves are now more of nuance than of major substance. The ECB considered the hike to represent a "major step" to "front-load" efforts to normalise policy. But, with rates judged still to be well below any reasonable estimate of the "neutral" level, it stated that it expects to tighten steadily further "over the next several meetings". Meanwhile in the UK, given the period of national mourning now underway following the death of HM Queen Elizabeth II, the BoE postponed its next monetary policy announcement by one week to 22 September. Upcoming labour market data (tomorrow), the August inflation report (Wednesday) and retail sales figures for the same month (Friday) will inform the MPC's monetary policy decision. DCME economists expect a rate hike of at least 50bps next week.

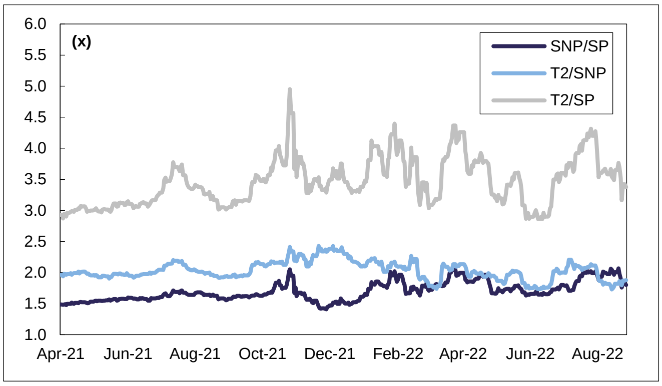
Weekly average EUR spreads were mostly tighter with SP (+5.8bps), SNP (-3.9bps) and Tier 2 (-0.9bps). USD average spreads were also only slightly changed week-on-week, with SP (+0.5bps), SNP (+/-0bps) and Tier 2 (-0.3bps). Based on Bloomberg data, 100% of FIG and SSA tranches issued in September quoted tighter than launch.

Western European Banks EUR Spreads and Yields

Aggregate EUR Z-spread LTM (bps)



Multiples (x)



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.

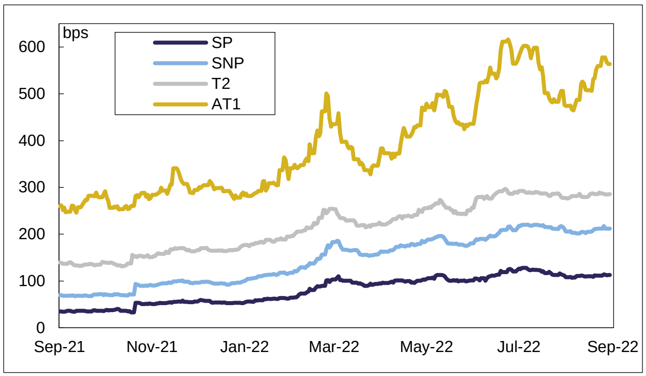
Selected Names

	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	3.7	3.0	61.7	-0.5	31.1	3.2	3.8	145.5	-3.9	78.3	3.2	4.9	250.4	-1.6	112.1
Barclays	1.7	2.5	4.1	2.8	-17.4	3.3	3.7	145.2	-3.7	104.9	6.2	5.6	366.8	3.0	272.5
BBVA	3.6	3.2	80.4	3.3	26.0	3.1	3.0	62.1	-4.1	21.0	4.0	4.3	202.9	-5.3	113.3
BFCM	3.6	3.0	65.9	15.9	28.9	6.4	3.8	131.5	-7.7	76.5	5.1	4.1	165.5	-3.9	66.8
BNPP	2.2	2.5	13.8	4.4	-6.3	4.7	3.7	133.0	-9.8	72.0	3.7	4.0	214.0	-4.1	114.5
BPCE	3.3	2.8	42.8	3.8	18.4	4.8	3.6	127.1	-7.0	53.9	6.7	4.3	167.6	-4.9	75.8
Credit Ag.	3.7	2.6	26.2	5.2	-5.0	5.1	3.6	116.6	-8.9	55.6	3.4	4.1	167.4	-1.3	87.9
Credit Sui.	5.0	5.0	263.1	4.6	161.5	4.6	5.3	285.6	-13.3	193.1					
Danske	2.4	2.8	50.4	14.4	21.6	3.4	3.8	145.2	0.0	83.0	6.6	5.1	273.7	0.2	177.2
Deutsche	2.7	3.1	78.4	9.3	49.1	4.2	4.9	254.5	-7.8	148.9	3.3	5.4	298.1	-8.6	130.5
DNB	1.6	2.2	1.1	7.4	-6.4	6.3	3.5	114.5	-0.5	64.4	5.1	4.5	275.5	17.1	224.6
HSBC	4.9	3.0	58.0	0.3	24.8	4.1	3.5	130.8	-5.5	72.1	3.9	3.6	117.8	-1.2	60.0
ING	1.2	3.6	110.1	-14.1	-48.0	4.6	3.5	106.4	-9.6	64.4	5.7	4.7	241.2	-1.5	153.9
Intesa	3.7	3.0	91.5	0.1	55.3	3.3	4.4	201.4	-12.0	91.4	3.6	4.5	211.4	-2.5	45.1
Lloyds	2.3	2.5	11.8	6.0	6.2	2.4	3.2	79.4	-4.5	55.1	5.4	5.3	314.9	13.2	272.0
Nordea	4.1	2.7	33.1	1.0	22.7	6.1	3.4	98.1	-5.6	28.4	7.6	4.5			40.9
Rabobank	3.4	2.3	-5.5	2.4	-14.1	5.1	3.5	99.2	-1.9	57.8	5.6	4.1	176.4	-14.3	-5.5
RBS	2.7	4.0	188.4	1.1	86.0	5.1	3.5	99.2	-1.9	57.8	5.6	4.1	176.4	-14.3	-5.5
Santander	3.0	2.9	57.1	3.9	31.4	4.4	3.6	126.4	-2.1	72.7	4.0	4.2	180.7	-0.9	90.9
San UK	2.4	2.5	10.2	-0.7	5.0	3.5	3.6	162.2	-10.7	59.3	4.0	4.2	180.7	-0.9	90.9
SocGen	4.4	3.0	68.5	1.5	30.6	5.0	3.8	140.6	-9.8	84.2	6.2	5.3	297.5	-10.3	190.4
StanChart	4.1	3.1	72.0	4.7	37.2	4.7	4.1	153.6	-6.5	108.1	5.4	5.1	275.3	0.3	161.1
Swedbank	4.1	2.9	58.9	2.5	11.9	4.4	3.5	111.2	-1.9	53.4	4.4	3.9	216.2	2.3	94.6
UBS	3.7	3.0	68.2	1.6	45.8	4.0	3.5	113.4	-5.4	61.0	2.4	2.8	52.2	-21.5	157.2
UniCredit	3.8	4.1	184.6	0.5	129.4	3.9	4.9	245.7	-1.3	145.9	6.1	7.2	478.3	-2.8	257.9

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 USD Z-spread LTM (bps)



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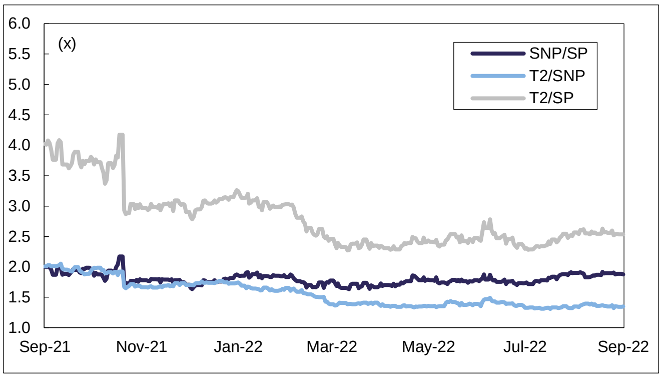

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	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD
Barclays	1.6					4.3	5.8	255.3	-1.6	99.3	5.0	6.3	303.3	-3.1	124.7
BFCM	3.6	3.0	65.9	15.9	28.9	3.5	6.0	266.2		0.0	5.0	6.3	303.3	-3.1	124.7
BNPP	2.2	2.5	13.8	4.4	-6.3	4.7	5.5	216.6	-3.3	109.0	4.0	5.5	213.3	-1.5	81.5
BPCE	3.3	2.8	42.8	3.8	18.4	4.6	5.7	226.7	0.1	94.7	2.7	5.8	231.9	-0.6	102.3
Credit Ag.	3.7	2.6	26.2	5.2	-5.0	3.4	5.2	174.2	-3.0	90.2	7.2	5.9	274.6	-1.0	120.2
Credit Sui.	2.3	5.2	157.4	-0.5	73.4	3.2	6.6	309.8	-5.1	158.7	0.9	6.5	230.9	15.5	93.7
Danske	2.4	2.8	50.4	14.4	21.6	2.2	5.4	173.0	4.1	99.7	0.9	6.5	230.9	15.5	93.7
Deutsche	2.7	3.1	78.4	9.3	49.1	3.0	6.4	292.7	0.5	146.8	7.3	8.5	528.5	14.7	309.0
HSBC	4.9	3.0	58.0	0.3	24.8	3.6	5.5	220.3	-2.1	93.8	8.3	6.2	293.0	-1.0	91.7
ING	1.2	3.6	110.1	-14.1	-48.0	4.0	5.2	175.7	0.0	59.8	2.7	7.6	362.3	-7.8	127.7
Intesa	3.7	3.0	91.5	0.1	55.3	4.0	5.2	175.7	0.0	59.8	3.0	8.6	516.6	0.0	256.0
Lloyds	2.5					2.7	5.3	181.5	-1.9	74.3	7.7	5.5	208.7	-1.7	78.0
Nordea	4.1	2.7	33.1	1.0	22.7	3.8	4.8	142.0	0.5	66.8	7.1	5.6			-13.7
Rabobank	3.4	2.3	-5.5	2.4	-14.1	4.2	5.1	166.3	-1.7	57.3	3.5	5.2	176.6	0.7	74.1
RBS	2.7	4.0	188.4	1.1	86.0	4.2	5.1	166.3	-1.7	57.3	3.5	5.2	176.6	0.7	74.1
Santander	3.0	2.9	57.1	3.9	31.4	4.6	5.8	246.8	-1.6	111.6	6.9	6.6	336.1	4.6	161.2
San UK	1.6				9.5	4.1	5.8	240.6	2.0	127.2	2.7				42.9
SocGen	4.4	3.0	68.5	1.5	30.6	3.9	5.8	244.2	1.3	119.2	3.5	6.4	306.5	2.8	82.2
StanChart	4.1	3.1	72.0	4.7	37.2	3.0	5.3	190.7	-3.1	99.3	8.2	6.4	319.6	-1.9	95.4
UBS	2.2	4.4	67.5	-1.0	32.8	4.3	5.4	199.3	-2.9	77.8	8.2	6.4	319.6	-1.9	95.4
UniCredit	3.8	4.1	184.6	0.5	129.4	3.6	6.1	222.8	2.9	112.2	7.2	9.7	634.2	3.1	342.9

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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Daiwa Securities Co. Ltd. and Daiwa Securities Group Inc.: Daiwa Securities Co. Ltd. is a subsidiary of Daiwa Securities Group Inc.

Other Disclosures Concerning Individual Issues:
1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies.
As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.

2) Daiwa Real Estate Asset Management is a subsidiary of Daiwa Securities Group Inc. and serves as the asset management company for the following J-REITS: Daiwa Office Investment Corporation (8976), Daiwa Securities Living Investment Corporation (8986).

3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.

4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of Y10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.

5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law
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If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.
Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association