

European Banks – Weekly Credit Update

- UBS' capitalization metrics rebound in Q2 was credit positive, yet its results for the second quarter were largely underwhelming.
- The ECB is reportedly looking into extending its request for a halt on dividend payments until the end of the year, which we see as somewhat sensible amid the uncertain environment.
- Primary markets remained quiet, with only UBS and RBI tapping the market; secondaries tightened noticeably amid the approval of the €750bn recovery fund by the EU council.

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2Q20 Earnings: UBS

UBS was the only name in our coverage universe to report their Q2 result last week. After a solid Q1, its Q2 figures were rather underwhelming, as lower USD interest rates impacted wealth management earnings whilst Equities trading disappointed. Positively, the bank reported a strong rebound in its CET1 ratio (+50bps Q/Q to 13.3%), partly recovering from the 90bps decline in Q1, whilst the leverage ratio, the bank's actual capital binding constrain, was up by 10bps Q/Q to 5.5%, after a 30bps decline in Q1.

In global markets, the bank saw FICC earnings rise by 118% Y/Y (above the +95% aggregate of the top 5 American banks, albeit from a smaller base), yet Equities trading, which is supposed to be the bank's strength, were down 9% Y/Y, as strong Cash Equities and Financing Services were offset by lower Equity Derivatives. Interestingly, the share of capital markets income arising from Equities trading in 2Q20 was 53%, vs. 47% from FICC, whilst the split in 2Q19 was 73% / 27%. Yet this is more reflective of the volatile nature of trading income, rather than a targeted change in strategy by the bank.

Loan loss provisions remained at a low 14.7% of pre-impairment profit in 2Q, flat Q/Q, highlighting the strong quality of the bank's loan book and limited exposure to consumer and corporate lending. UBS has signaled that pandemic driven provisioning levels have now peaked, with its baseline scenario for Switzerland projecting a 5.5% decline in GDP in 2020, followed by a 4.4% recovery in 2021.

This week is going to be far busier in terms of Q2 results, with Barclays, Santander and Deutsche reporting on Wednesday, Standard Chartered, Credit Suisse, BBVA and Lloyds on Thursday, and BNP Paribas and RBS (now called NatWest Group) on Friday. Focus will remain on provisioning levels, which we expect to be material, but partially offset by strong FICC performance in those banks with sizeable capital markets activities. Capitalization metrics will also be of great interest, as they have generally beaten expectations so far, a welcome development following sharp deteriorations in Q1.

Euro Area Banks Dividends

Following an ESRB [recommendation](#) from May 2020, the ECB is reportedly looking into extending the request for euro area banks to halt dividend payments until the end of the year. Currently in place until October, the extension would be marginally supportive to subordinated debt. Yet large, strong banks might resist the request, given the already very low attractiveness of their shares, as reflected in their low market capitalization. That said, as furlough schemes and payment holidays are still in place across a number of euro area countries, it will still take time for banks to materially feel the actual impact of the pandemic on their balance sheet. Together with concerns of a second Covid-19 wave in Europe, the potential ECB's move would come as somewhat sensible. We note however that European banks started the current crisis with strong capital and liquidity levels, and have been subsequently further supported by various measures announced by regulators and governments to support the economy and financial sector. Accordingly, amid the lower *ad infinitum* interest rate environment, we expect profitability to be the main negative credit driver for euro area banks in the medium term rather than solvability or liquidity.

Primary and secondary markets

Primary market activity remained limited last week amid the earnings season and the summer low, yet UBS and RBI took advantage of the positive market sentiment and investors' chase for yields to tap the market for AT1 placements. UBS' placement, which came a day after the release of its Q2 earnings, was met with a strong 7.7x coverage, whilst RBI's was met with a decent 3.2x coverage. **Secondary** spreads tightened noticeably last week following the EU approval of its €750bn recovery plan, particularly for lower ranked Italian and Spanish euro paper.

(Table 2) Key Transactions

Bank	Rank	Amount	Maturity	Final Spread (bps)	IPT (bps)	Book Orders
UBS	AT1	USD750m	PNC6	5.125% (coupon)	5.75% (coupon)	>USD5.75bn
		AUD1bn	30 July 23	3mBBSW+67	3mBBSW+75/80	
UBS	Sr Op Co	AUD1.25	30 July 25	3mBBSW+87	3mBBSW+95/100	
		AUD0.5bn	30 July 25	BBSW+87	BBSW+95/100	
RBI	AT1	EUR500m	PNC6	6.0% (coupon)	6.5% (coupon)	>EUR1.6bn

Source BondRadar, Bloomberg.

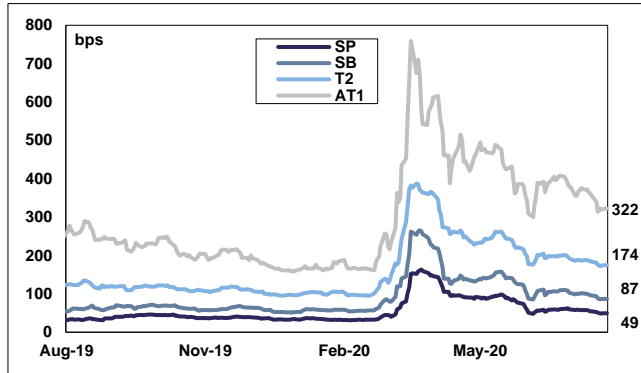
(Table1) UBS 2020 Financials

(\$m)	2Q20	1Q20
Revenues	7,403	7,934
Expenses	5,821	5,926
Impairments	272	268
Net Profit	1,232	1,595
WM ¹ AuM (\$bn)	2,590	2,339
WM ¹ Net New Money (\$bn)	9.2	11.6
Ratios (%)		
CIR	75.8	72.3
RoTE	9.6	12.8
CET1	13.3	12.8
Leverage Ratio	5.5	5.4
LR TLAC	9.6	9.8
RWA TLAC	32.7	32.7
LCR	155.0	145.0

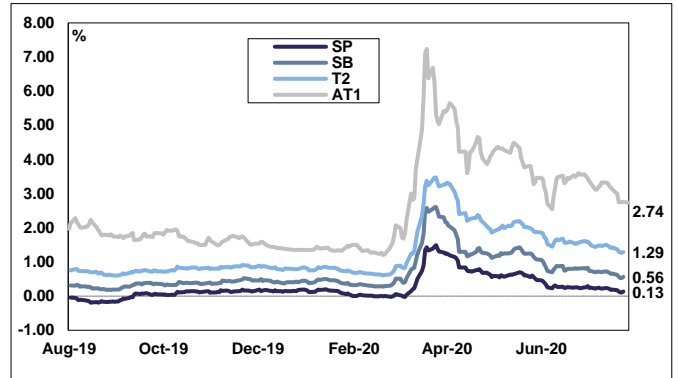
Source: UBS. Figures as stated by the bank. ¹WM=Wealth Management

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.

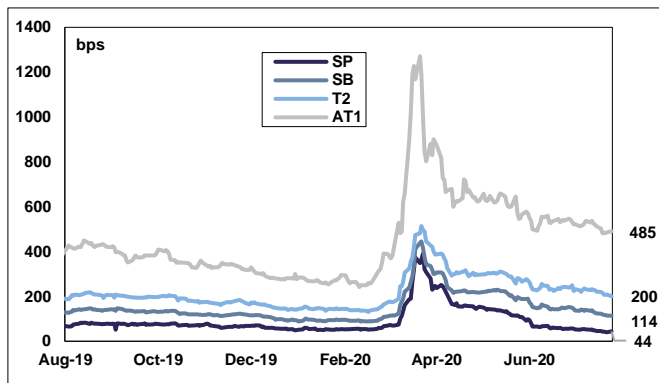
Selected Names

	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	0.5	77	-12	29	4.1	1.0	135	-11	64	5.0	3.2	345	-16	148
Barclays	3.7	0.5	73	-4	28	3.3	0.5	87	-12	32	3.6	1.7	171	-54	41
BBVA	4.8	0.4	70	-9	19	4.4	0.8	108	-10	52	5.9	1.8	211	-20	97
BFCM	3.9	0.1	41	-6	10	9.2	0.6	83	-8	21	5.3	1.2	151	-9	58
BNPP	2.5	0.0	29	-5	11	5.1	0.5	86	-9	30	4.9	1.1	139	-7	56
BPCE	3.8	0.1	43	-6	14	4.6	0.5	80	-9	30	2.8	0.7	102	-13	42
Credit Ag.	3.4	0.0	35	-4	5	5.6	0.5	81	-9	30	5.0	1.8	202	-9	63
Credit Sui.	4.7	0.5	77	-12	29	6.5	0.8	107	-7	39	4.1	2.0	161	-7	64
Danske	2.8	0.0	39	-6	3	2.8	0.7	106	-9	31	6.3	1.6	194	-23	48
Deutsche	4.8	0.4	77	-13	-10	2.8	1.2	143	-12	22	4.8	3.2	349	-26	61
DNB	3.3	0.0	35	-6	4	4.1	0.7	102	-1	65	6.5	1.1	138	-10	78
HSBC	3.2	0.1	42	-7	8	3.0	0.3	61	-8	18	5.9	0.9	121	-7	37
ING	1.5	-0.1	27	-6	13	5.1	0.3	57	-10	11	5.4	1.2	147	-10	51
Intesa	4.5	0.9	115	-12	38	5.1	0.3	57	-10	11	5.4	2.2	246	-25	95
Lloyds	2.1	-0.2	11	-5	-14	3.9	0.5	83	-9	32	7.5	1.6	193	-13	79
Nordea	4.4	-0.1	25	-4	1	2.9	0.2	50	-12	12	2.0	0.9	101	-13	49
Rabobank	2.5	-0.1	21	-4	4	6.2	0.3	59	-8	22	2.2	0.4	70	-5	22
RBS	3.6	0.4	70	-3	31	6.2	0.3	59	-8	22	2.2	0.4	70	-5	22
Santander	3.9	0.2	51	-7	9	5.2	0.8	112	-11	34	5.5	1.5	177	-20	76
San UK	3.0	0.0	33	-9	2	3.3	0.8	105	-15	45	5.5	1.5	177	-20	76
SocGen	1.9	0.1	42	-5	15	6.0	0.9	116	-10	45	3.3	1.1	138	-11	51
StanChart	4.1	0.3	58	-4	6	6.7	0.8	112	-8	40	2.2	1.0	81	-10	15
Swedbank	4.7	0.2	55	-3		4.2	0.4	69	-10	6	7.1	1.3	163	-7	61
UBS	1.4	-0.1	27	-6	7	3.5	0.3	63	-7	22	0.8	2.4	212	-77	10
UniCredit	4.0	1.1	133	-10	51	5.3	2.0	221	-10	67	2.7	2.7	292	-46	112

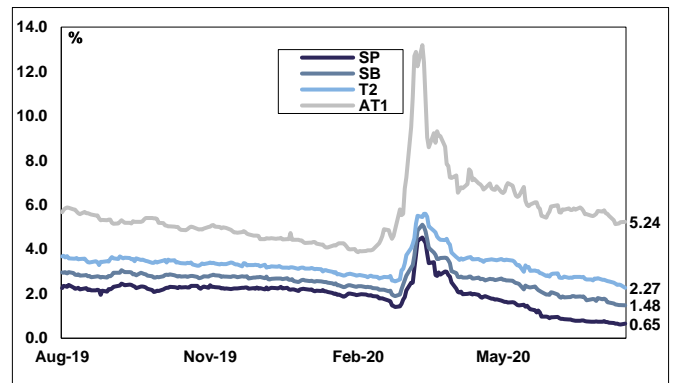
Source: Bloomberg, Daiwa Capital Markets Europe. Dur.= Duration. Yield= Yield to worst (%). Z = Z-Spread to Worst (bps). Z 5DΔ = last 5 days Z-spread net change (bps). Z YTD = year to date Z-Spread net change (bps). Blank cells represent lack of statistically significant data. Figures may not be representative 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 5D Δ	Z YTD	Dur.	Yield	Z	Z 5D Δ	Z YTD	Dur.	Yield	Z	Z 5D Δ	Z YTD
Barclays	2.6	0.8	55	-4	2	4.4	1.6	128	-10	16	5.4	2.8	228	-12	55
BFCM	2.5	0.8	59	-4	5	4.4	1.6	128	-10	16	5.4	2.8	228	-12	55
BNPP	1.7	0.4	18	-2	-13	4.6	1.5	109	-8	29	5.1	2.1	172	-10	53
BPCE	2.4	0.9	62	-4	10	4.2	1.7	124	-7	26	3.6	2.1	172	-3	62
Credit Ag.	2.2	0.8	57	-8	6	3.9	1.2	80	-14	13	8.2	2.2	155	-10	40
Credit Sui.	1.7	0.7	38	-3	4	4.3	1.6	99	-10	38	2.8	3.5	317	-27	99
Danske	1.5	0.8	76	-2	4	2.9	1.6	131	-12	34	2.8	3.5	317	-27	99
Deutsche						3.0	2.2	181	-10	39	6.6	5.6	507	-32	103
HSBC	3.9	1.6	141	3	32	4.8	1.7	123	-8	30	10.8	2.7	215	-16	91
ING	1.0	0.4	18	-6	-7	4.8	1.2	80	-8	6	3.1	2.1	171	-7	71
Intesa	3.7	2.2	181	-17	47	4.8	1.2	80	-8	6	4.1	4.0	358	-35	119
Lloyds	3.2	1.2	90	-6	24	3.7	1.1	80	-8	0	5.0	2.2	179	-11	41
Nordea	2.8	0.6	34	-3		2.9	1.3	88	0	19	2.0	1.4	93	-9	25
Rabobank	2.4	0.6	31	-3	-8	3.8	1.0	58	-7	-1	4.9	1.6	123	-9	26
RBS	2.4	0.6	31	-3	-8	3.8	1.0	58	-7	-1	4.9	1.6	123	-9	26
Santander	5.8	1.5	114	-13	28	5.2	1.8	143	-17	30	4.7	2.5	207	-12	97
San UK	2.4	0.7	49	-1	10	2.3	1.3	90	-10	10	4.5	2.7	233	-9	86
SocGen	4.8	1.1	79	-3		4.1	1.9	154	-10	56	4.5	2.7	231	-6	79
StanChart	0.9	0.9	68	-19	-184	4.4	2.0	163	-9	63	5.7	2.7	232	-13	94
UBS	9.9	1.4	86	-11	34	4.7	1.3	89	-8	16	5.7	2.7	232	-13	94
UniCredit	2.2	2.3	214	-21	54	2.2	2.4	196	-24	71	7.5	4.9	434	-23	92

Source: Bloomberg, Daiwa Capital Markets Europe. Dur.= Duration. Yield= Yield to worst (%). Z = Z-Spread to Worst (bps). Z 5D Δ = 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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[Moody's]

The Name of the Credit Rating Agencies Group, etc

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The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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