Daiwa Capital Markets

European Banks – Credit Update

- Political pressure and looming sanctions make European banks look towards an exit from Russia, fraught with challenges
- Improved market sentiment encourages FIGs to access primaries with large deals and long tenors. New issue concessions remain in the double digits
- Secondary market spreads experienced modest tightening in EUR, while central bank action provided a degree of certainty to USD markets which saw spread tightening across payment ranks

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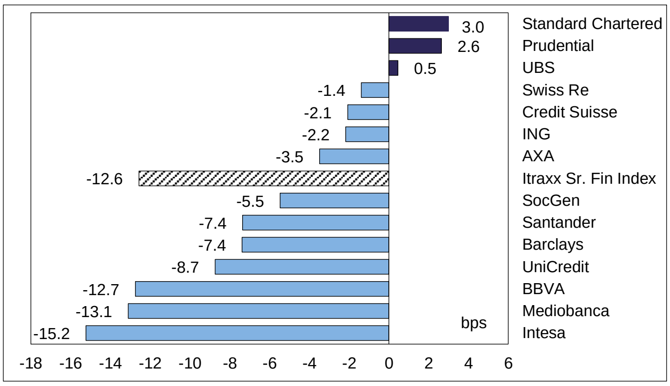
Retreat from Russia fraught with challenges

The issue of European bank exposures to Russia continues to dominate the headlines in the sector however, following a host of disclosures from institutions, the focus appears to have shifted towards formulation and feasibility of exit strategies. Lenders are coming under increasing political pressure to cut their ties to Russia, which has prompted a rethink among banks that had previously considered sitting the conflict out. This will be particularly challenging for lenders larger exposures such as Raiffeisen Bank International (RBI), UniCredit or Société Générale (SocGen). With banks scrambling to reduce their exposures, the downsides of a rushed exit are likely to culminate in steep discounts to bank franchises, as the list of potential buyers appears to be limited due to sanctions implications. Further complications may arise when trying to get the necessary approvals from Russian regulators when contemplating an exit. The threat of nationalisation of bank assets by the Russian state has prompted several lenders to sketch out potential 'worst-case scenarios' in which a complete write-down of regional assets were to occurs.

Weekly 5Y Sr. CDS price movement European FIGs



Source: Bloomberg; iTraxx Sr. Financials Index; Data as of 20.03.2022

Nevertheless, bank credit spreads and risk indicators improved over the past week. The iTraxx Senior Financials CDS index tightened 12.6bps over the course of last week. This was likely due to talks taking place between Russia and Ukraine that may lead to a peace agreement being reached. Furthermore, the initial market reaction to the conflict was likely overly pessimistic as additional discourses have highlighted mostly modest exposures while rate hikes by the Fed and Bank of England (BoE) provided a degree of certainty to markets. Lastly, the Russian government met coupon payments on two USD denominated sovereign bonds last Friday, easing doubts about its willingness and/or ability to honour debt repayments. However, upcoming repayments of USD2.6bn by early-April will show whether this commitment will last. Russia has USD4.5bn in coupon payments and redemptions to repay by end-2022.

RBI put out a statement last week in which they said that they are looking at all strategic options for their Russian operation, "up to and including carefully managed exit". This is the first time the company has openly considering exiting from the Russian market completely. Currently, it operates the 10th largest banking franchise in the country, displaying a significant degree of income dependence. Last year it generated EUR1.5bn in profits in Russia, around one-third of RBI's group total, paired with its operations in Ukraine and Belarus these dependencies become even greater. As RBI floated the possibility of a full retreat from the country this could impact the group's CET1 ratio of 13.1% by some 100bps. This takes into account a full-write down of investments, offset by RWA reductions. Under such circumstances, RBI's business model would become more closely aligned to that of its domestic rival Erste Group that does not have any direct exposure to Russia or Ukraine. Such a step would likely reinforce RBI's efforts in its remaining CEE network and other core markets which could help it narrow its historical valuation gap to Erste.

Intesa San Paolo (Intesa) was the latest major European bank to detail the extent of its Russian dealings. Loan exposures of EUR5.1bn are significantly smaller than those of domestic peer UniCredit. What caused the delay in reporting compared to others is not clear but it may stem from data gathering issues as Intesa traditionally had sparse disclosure on its dealings in Russia. A press release with additional information provides some clarity to the figures already presented in the group's 4Q21 earnings report. Compared to the group's overall balance sheet of EUR1tr and loans of EUR465bn the amounts reported are deemed manageable. Intesa's financial reporting thus far has only ever contained limited information on loan and sovereign debt exposures. The bank's 4Q21 reporting doesn't list Russia as a standalone country when it comes to providing balance sheet and income statement items. Rather, it groups it under Banca IMI, Intesa's Corporate & Investment Banking division. Almost two years ago, Banca IMI was incorporated into Intesa and seized to exist as a subsidiary, further limiting disclosures. With regards to Intesa remaining footprint in Central and Easter Europe (CEE) it provides adequate disclosure on the remaining 11 CEE countries as well as on Egypt.

Intesa's press release details loan exposures to Russian and Ukrainian clients, which represent about 1% of the group total and consist of EUR1.1bn in loans to customers and amounts due from banks at the local subsidiary and a further EUR4bn from the rest of the group extended to Russian clients. In total, the EUR5.1bn in loan exposures are held at the Russian subsidiary (18% of total), the Ukrainian subsidiary (4%) and the remainder at the group level (78%). Around EUR200m in loans to entities have been affected by international sanctions against Russia since its invasion of Ukraine. Under a worst-case scenario assuming a full write-down of all exposures, Intesa could take a hit to its CET1 of up to 200bps. Under such a scenario, the group's current CET1 ratio of 14.5% would still maintain a residual buffer to its MDA threshold of ~370bps. We deem Intesa to be in a strong position as the scenario does not take into account future retained earnings that could help absorb potential losses, nor any reductions in existing dividend payout plans. Intesa plans to pay out EUR3.4bn in dividends this year and return a total EUR22bn in shareholder capital by 2025. Senior management recently acknowledge that the 2022 profit target of EUR5.5bn has come under threat and we expect to receive further guidance at the 1Q22 results update.

Primary and secondary markets

European **primary market** issuance volumes for SSAs stood at EUR2bn over the course of last week, below the market expectations of EUR8bn-13bn. FIG supply of EUR24bn was well above the weekly forecast amount of EUR5.5bn-9.5bn. The total 2022 year-to-date FIG volume of EUR162bn is 35.4% ahead of last year's issuance volume. SSA volumes, however, remain behind last year's level, down 27.3% at EUR184bn. For the week ahead, survey data suggest SSA volumes will range between EUR14.5bn-18.5bn and FIGs are expected to issue EUR10bn-14bn.

SSA issuance volumes are still lagging last year's levels by some margin and the previous week did not do much in closing that gap. Daiwa Capital Markets Europe (DCME) was one of the lead managers for **Nordic Investment Bank's (NIB)** largest Kangaroo bond in over seven years. NIB accessed the short end of the curve for an AUD300m issuance, pricing at ASW + 20bps. DCME also supported Nederlandse Waterschapsbank with its Kangaroo bond less than four weeks ago, making it the second such deal in short succession. Tight spreads to Treasuries made it difficult for issuers to build significant momentum in their USD denominated books and consequently tighten pricing. **Swedish Export Credit (SEK)** found itself in such a situation, unable to tighten pricing, especially as investors have largely priced in further rate hikes by the Fed.

(Table 1) Key Transactions

Issuer	Rank	Amount	Maturity	Final Spread (bps)	IPT (bps)	Book Orders
SSA						
AfDB	Sr. Unsecured	EUR1.25bn	5Y	MS - 11	MS - 9	>EUR2.25bn
NIB	Sr. Unsecured	AUD300m	3.5Y	ASW + 20	ASW + 20	n.a.
BoE	Sr. Unsecured	USD2bn	3Y	T + 10	T + 13	>USD6.2bn
SEK	Sr. Unsecured	USD1bn	5Y	SOFR MS + 40	SOFR MS + 40	n.a.
FIG (Senior)						
NatWest	Sr. Unsecured	USD1bn	3Y	T + 135	T + 155	n.a.
NatWest	Sr. Unsecured (FRN)	USD500m	3Y	SOFR + 145	SOFR equiv.	n.a.
Santander	SP	USD1.25bn	3Y	T + 135	T + 145	n.a.
Santander	SNP	USD1bn	6NC5	T + 200	T + 225	n.a.
Credit Suisse	Sr. HoldCo	EUR2bn	4.5NC3.5	MS + 160	MS + 185	>EUR4.1bn
Credit Suisse	Sr. HoldCo	EUR1.5bn	10NC9	MS + 195	MS + 220/225	>EUR6bn
JPMorgan	Sr. Unsecured	EUR2.5bn	8NC7	MS + 110	MS + 110	>EUR8bn
Sabadell	SNP (Green)	EUR750m	4NC3	MS + 220	MS + 250	>EUR4.2bn
UBS	Sr. HoldCo	EUR1.5bn	3NC2	MS + 80	MS + 100	>EUR3.5bn
Credit Mutuel	SP	EUR1.5bn	3Y	MS + 50	MS + 70	>EUR2bn
Credit Agricole	SP	EUR1.25bn	3Y	MS + 45	MS + 60/65	>EUR2bn
FIG (Subordinated)						
Deutsche Bank	Tier 2	EUR1.5bn	10.25NC5.25	MS + 330	MS + 360	>EUR6.5bn

Source BondRadar, Bloomberg.

Last week's **FIG** markets were dominated by shorter dated senior deals as market sentiment appeared to improve. Issuers immediately tried to take advantage of better conditions by placing more challenging, MREL eligible debt as secured deals like covered bonds can be placed at any time. A trio of dual-tranche offerings, including those from **Credit Suisse** entered the market last week. The Swiss lender issued senior bonds at the HoldCo level with the longest maturities seen in over a month, an indication that some confidence has returned to markets following the outbreak of the war in Ukraine. Interest was skewed towards the longer 10NC9 leg, resulting in book orders 4x deal size while the shorter 4.5NC3.5 leg was 'only' 2.05x oversubscribed. However, it was **JP Morgan** that kicked off the senior FIG market in Euros with its EUR2.5bn offering, carrying a maturity of 8NC7. We mentioned previously that lenders most removed from the conflict in Europe were most likely to lead the market and unsurprisingly institutions with low exposure were those most active. **Sabadell** was among them and the only issuer with an ESG labelled bond in our list. It was also the first peripheral lender to access senior capital markets in almost two months, another sign of better conditions. Despite the improvement in the market, issuers generally still had to pay double digit new issue premiums, up to 25bps, in part driven by the larger deal sizes they chose after weeks of limited issuance. **Deutsche Bank** was the first lender in almost a month to come to market with subordinated debt as sentiment had improved somewhat. The German lender's status as national champion certainly facilitated the trade and helped it eventually tighten pricing by 30bps from IPT on the back of book orders 4.3x deal size.

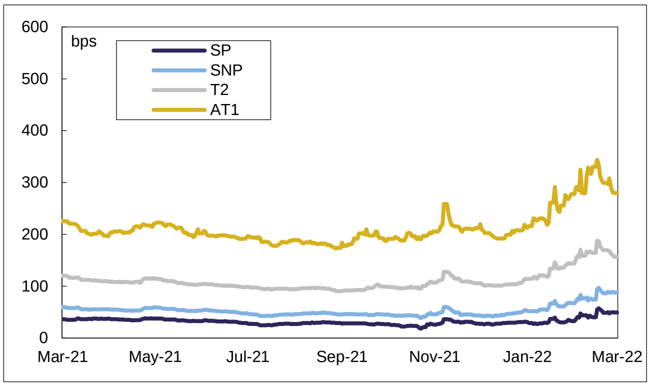
Secondary market spreads were tighter in EUR and USD as risk indicators also tightened week-on-week. CDS price indices on European senior (79bps) and subordinated financials (149bps), as measured by iTraxx benchmarks, priced -13bps and -24bps lower than last week's levels.

Market sentiment improved over the course of last week on the back of continued talks between Russia and Ukraine as well as central bank action that has provided a degree of certainty to markets. Last week, the BoE's monetary policy committee (MPE) tightened monetary policy for the third successive meeting with the increase of 25bps taking Bank Rate back to its pre-pandemic level and post-financial crisis peak of 0.75%. But the MPC moderated slightly its forward guidance from February, stating that "some further modest tightening in monetary policy might be appropriate in the coming months", rather than "is likely to be appropriate". Across the pond, the Fed also delivered its first rate hike for four years, of 25bps lifting the target range to 0.25-0.50%, which was the firm market expectation, with further increases expected over the course of the year. This should encourage USD issuance as markets grappled with tight spreads to treasuries.

Weekly average EUR spreads were mostly improved across payment ranks with SP (+0.4bps), SNP (-0.2bps) and Tier 2 (-6.6bps). USD average weekly spreads were also tighter week-on-week with SP (-7.6bps), SNP (-11.7bps) and Tier 2 (-17.1bps). Based on data collected from Bloomberg, 19% of FIG tranches issued in March and 0% of SSAs tranches quoted wider than launch.

Western European Banks EUR Spreads and Yields

Aggregate EUR Z-spread LTM (bps)



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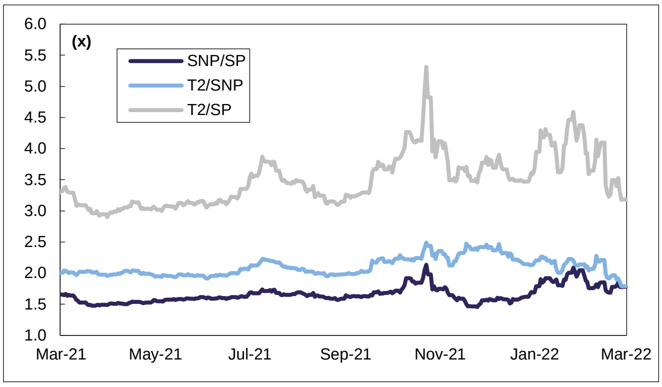


Source: Bloomberg, Daiwa Capital Markets Europe. SP = Senior Preferred/Senior OpCo; SB = Senior Non- Preferred/ Senior HoldCo; T2= Tier 2; AT1 = Additional Tier 1. All figures based on Z to worst spread of public benchmark issuances.

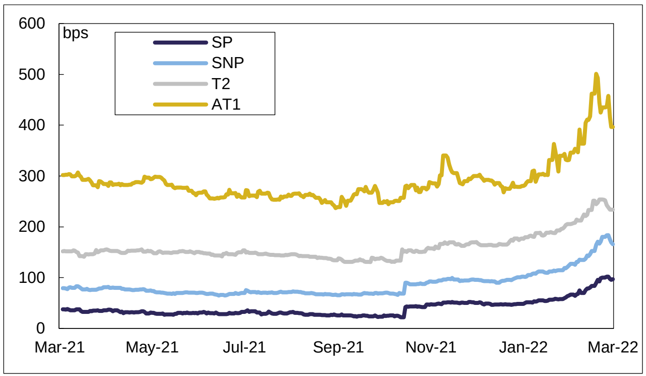
Selected Names

	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	3.9	1.2	53.5	0.2	23.7	2.9	1.5	88.0	-1.3	45.6	3.6	3.4	263.1	-9.7	111.0
Barclays	2.2	0.7	28.1	1.2	3.8	3.0	1.2	85.1	0.6	43.1	4.6	2.0	170.0	-11.6	72.1
BBVA	4.6	1.3	52.9	-2.8	17.3	3.6	1.3	62.1	-3.5	23.7	4.6	2.1	153.1	-13.9	45.9
BFCM	3.7	1.1	49.4	2.6	21.6	7.1	1.9	96.5	-1.4	42.9	4.4	1.9	115.2	-11.9	47.1
BNPP	2.4	0.8	30.9	-0.4	12.7	4.4	1.6	88.0	0.2	39.8	4.0	1.9	118.6	-9.4	50.3
BPCE	3.1	0.9	32.9	-0.1	9.2	5.3	1.8	104.7	-1.6	44.0	4.0	2.1	132.9	-5.2	40.7
Credit Ag.	4.0	0.7	30.3	3.0	2.3	5.7	1.7	93.7	-0.6	46.0	3.6	2.0	130.0	-10.7	53.0
Credit Sui.	5.6	2.4	162.6	1.6	57.7	5.1	2.3	159.9	23.9	84.6					
Danske	2.4	0.5	33.9	2.1	5.2	2.2	1.0	62.0	1.5	17.5	2.8	2.1	154.0	-2.1	50.2
Deutsche	1.4	0.6	29.1	-0.3	2.4	4.2	2.3	152.0	2.2	75.2	3.6	3.1	244.5	-4.2	131.7
DNB	3.7	0.8	35.7	2.7	15.7	6.8	1.8	99.5	2.1	46.2	5.1	1.0	115.6	-4.9	60.4
HSBC	3.8	1.0	46.8	1.0	23.1	4.4	1.2	79.8	2.4	37.6	4.3	2.0	127.7	-2.0	67.1
ING	1.7	1.7	138.5	1.4	-23.9	5.6	1.6	88.5	-0.6	40.6	6.0	2.0	142.4	-5.6	59.8
Intesa	4.4	1.1	47.9	-3.1	16.1	3.0	1.6	110.2	-3.5	35.7	4.1	2.9	217.2	-12.9	41.0
Lloyds	2.8	0.8	24.9	4.0	16.9	2.5	0.9	75.4	0.9	47.5	1.4	1.2	105.4	-2.6	59.4
Nordea	4.6	1.1	34.6	2.0	23.6	5.6	1.5	60.7	0.3	17.7	7.6	2.1	144.5	-2.2	61.8
Rabobank	3.5	0.8	15.5	-1.8	8.0	5.3	1.5	68.3	-0.3	27.3	1.3	0.2	7.5	-0.2	-0.2
RBS	3.0	2.0	126.1	-7.3	100.3	5.3	1.5	68.3	-0.3	27.3	1.3	0.2	7.5	-0.2	-0.2
Santander	3.4	0.9	39.6	0.3	14.1	4.9	1.7	92.9	-2.8	35.1	4.5	2.0	123.8	-12.2	32.6
San UK	2.9	0.9	32.4	4.9	28.3	1.5	0.5	78.1	0.6	46.4	4.5	2.0	123.8	-12.2	32.6
SocGen	4.6	1.4	76.5	0.9	41.4	5.6	2.1	128.7	-3.2	64.9	4.2	1.5	137.8	-11.7	64.3
StanChart	4.6	1.2	47.6	3.7	14.4	5.3	1.8	107.6	6.2	48.9	6.0	2.6	193.4	1.7	74.5
Swedbank	3.8	1.0	40.1	3.4	18.2	4.9	1.6	85.6	2.5	31.5	4.2	0.9	117.7	-1.9	61.7
UBS	4.1	1.2	52.0	4.1	27.7	4.2	1.5	79.2	6.0	35.4	1.0	1.4	134.0	-38.2	57.6
UniCredit	4.0	1.7	111.8	-0.6	48.7	3.9	2.2	153.6	-3.0	56.5	6.7	3.4	285.5	-8.4	103.9

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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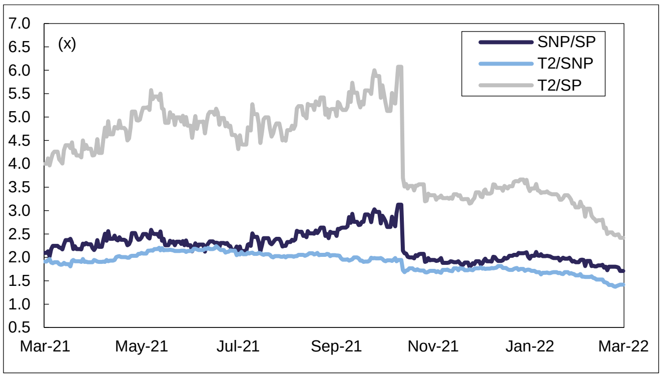

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Barclays	2.0					4.9	3.9	184.0	-21.4	63.0	5.3	4.4	241.6	-19.9	76.8
BFCM	3.7	1.1	49.4	2.6	21.6	4.9	3.9	184.0	-21.4	63.0	5.3	4.4	241.6	-19.9	76.8
BNPP	2.4	0.8	30.9	-0.4	12.7	5.2	3.9	183.9	-18.1	68.8	4.4	4.1	203.2	-14.3	76.9
BPCE	3.1	0.9	32.9	-0.1	9.2	5.0	3.8	169.0	-13.0	62.4	3.2	3.9	183.7	-11.0	61.7
Credit Ag.	4.0	0.7	30.3	3.0	2.3	3.1	3.6	146.1	-16.0	60.8	7.7	4.3	224.1	-18.1	81.0
Credit Sui.	2.1	2.9	81.3	-20.2	50.5	3.3	4.1	202.7	-12.6	95.6	1.4	4.5	246.0	-17.3	114.2
Danske	2.4	0.5	33.9	2.1	5.2	2.1	3.2	144.6	-7.5	57.7	1.4	4.5	246.0	-17.3	114.2
Deutsche	1.4	0.6	29.1	-0.3	2.4	3.5	3.8	185.8	-15.3	73.1	7.8	5.3	328.2	-33.2	114.0
HSBC	3.8	1.0	46.8	1.0	23.1	3.7	3.7	173.7	-18.7	63.3	9.5	4.6	250.6	-15.6	70.1
ING	1.7	1.7	138.5	1.4	-23.9	4.5	3.6	153.1	-14.2	62.6	2.3	3.5	180.0	-3.1	80.9
Intesa	4.4	1.1	47.9	-3.1	16.1	4.5	3.6	153.1	-14.2	62.6	3.4	5.6	349.7	-23.1	118.1
Lloyds	2.9					2.9	3.6	159.7	-17.6	71.5	8.6	4.3	223.0	-13.3	79.2
Nordea	4.6	1.1	34.6	2.0	23.6	2.8	2.9	161.8	-6.7	51.8	8.6	4.3	223.0	-13.3	79.2
Rabobank	3.5	0.8	15.5	-1.8	8.0	4.0	3.3	118.5	-11.7	48.1	3.9	4.1	196.8	-11.8	51.9
RBS	3.0	2.0	126.1	-7.3	100.3	4.0	3.3	118.5	-11.7	48.1	3.9	4.1	196.8	-11.8	51.9
Santander	3.4	0.9	39.6	0.3	14.1	4.8	3.9	189.0	-7.0	69.7	7.5	4.4	238.5	-21.5	68.3
San UK	2.0	2.8	84.1	6.5	40.9	4.5	3.8	175.4	-3.0	69.2	3.2				
SocGen	4.6	1.4	76.5	0.9	41.4	4.4	4.1	205.9	-14.8	83.6	3.6	4.4	231.6	-16.6	92.6
StanChart	4.6	1.2	47.6	3.7	14.4	3.5	3.7	173.0	-13.0	71.1	8.7	4.8	270.1	-12.2	67.7
UBS	2.5	2.9	80.2	-5.2	42.5	4.1	3.6	150.8	-16.1	52.5	8.7	4.8	270.1	-12.2	67.7
UniCredit	4.0	1.7	111.8	-0.6	48.7	4.0	4.3	228.5	-18.0	103.3	6.4	6.3	427.6	-25.9	135.7

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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4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

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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.
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