

## European Banks – Credit Update

- Sweden’s 100bps rate hike was the largest for a western European country so far, putting rising asset risks in focus as borrowing costs rise and property values give way.
- Primary markets saw activity largely concentrated in SSAs as sizeable pick-ups against sovereign issuers drove demand.
- Secondary market spreads for senior deals held firm in EUR while we saw widening across the board in USD. Rate hikes by the Fed, BoE and others provided major impulses into secondary markets.

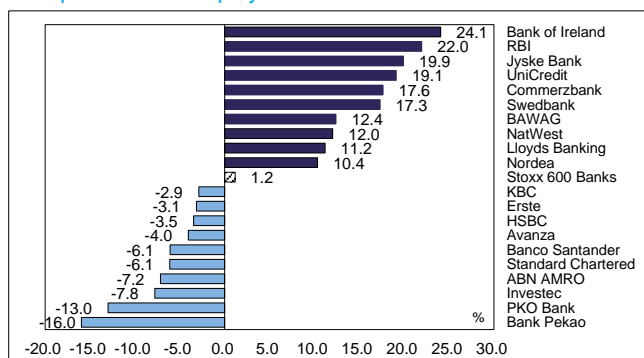
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### Rising rates stoke asset risks but help banks mitigate credit spread widening

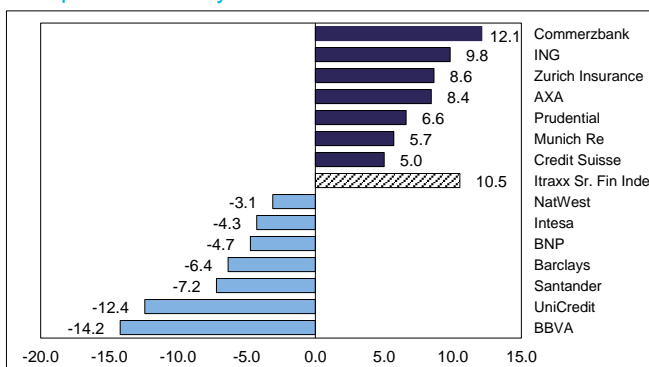
Last week, Sweden’s central bank, the Riksbank, raised its policy rate to 1.75% from 0.75%. The Riksbank also stated that it expects the rate to rise again within the next six months, averaging 2.5% by 3Q23. The 100bps increase in the policy rate is credit positive for banks’ top-line revenue performance but, together with subsequent hikes, may entail asset risks in the mortgage market. High inflation and a sharp increase in borrowing costs have already contributed to an 8.7% decline in house prices from their peak in March. This makes the Riksbank’s forecast of an 18% decline by 2024 appear feasible. This would bring house prices back to pre-pandemic levels following their 20% surge over the last two years. The announced rate hikes will reduce the 6% buffer rate that Swedish banks apply when calculating whether a potential mortgage borrower will have adequate funds to service their loan, after other essential expenses. Short-term borrowing rates could rise to 4% by 3Q23, leaving only a 200bps buffer, adding to asset quality concerns.

The most exposed lenders are Svenska Handelsbanken, SEB, Swedbank and Nordea as mortgages make up just under half of their respective loan books. Higher rates are also expected to be passed onto customers fairly soon as 80% of borrowers have fixed-rate mortgages at two years or less. A weakening housing market, high inflation and an increasing likelihood of a recession will be negative for banks’ asset quality measures but CET1 buffers at 2Q22 of 570bps, 480bps, 460bps and 630bps respectively provide comfort. More broadly, forecast revenue growth of 8-9% for European banks in 2023 should offset headwinds from rising costs, higher loan loss provisions or increases in the countercyclical capital buffer. Equity valuations have held relatively firm over the past three months, despite rising market volatility, while CDS price movements have only increased to a limited degree.

European Banks Equity Movers – 3Q22\*



European Banks 5-year CDS Movers – 3Q22\*



Source: Bloomberg, \*3Q22 data runs until 23<sup>rd</sup> September 2022

However, market turbulence has had an overall negative impact on credit spreads so far this year. Excess returns below are derived by taking total return percentages of bank bonds less the total return percentage of risk-matched interest-rate swaps. Year-to-date results have been in negative territory, albeit less pronounced than the poor 2Q22 figures. July and August data forms the pro-forma 3Q22 data set that saw a slight improvement in credit spreads but we would expect gains to be lower when taking September data into account. The below performance compares favourably to other sectors, arguably reflecting banks’ position of relative strength when entering this challenging period.

### Financial institution’s excess return percentage vs Swaps

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	1Q22	2Q22	3Q22*	YTD
EUR Senior	-0.3%	-0.8%	0.8%	-0.7%	-0.4%	-1.6%	1.8%	-0.5%	-0.3%	-2.7%	1.2%	-1.6%
EUR Subordinated	-0.8%	-1.9%	1.6%	-1.9%	-0.7%	-2.7%	2.4%	0.2%	-1.0%	-4.5%	2.6%	-3.0%
EUR Jr. Subordinated	-0.8%	-2.4%	1.8%	-1.4%	-0.1%	-3.5%	2.6%	0.5%	-1.5%	-4.9%	3.1%	-3.3%
EUR Banking Index	-0.4%	-1.0%	0.9%	-0.8%	-0.4%	-1.7%	1.9%	-0.5%	-0.4%	-2.9%	1.3%	-1.9%
USD Banking Index	-0.7%	-1.3%	0.2%	-0.9%	0.1%	-1.3%	0.6%	0.6%	-1.7%	-2.2%	1.2%	-2.6%
GBP Banking Index	-0.8%	-0.8%	0.3%	-1.4%	0.3%	-2.3%	2.1%	-0.7%	-1.3%	-3.3%	1.3%	-3.0%

Source: Bloomberg; ICE Bofa Bond Indices; \*3Q22 excludes September data

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## Primary and secondary markets

European **primary market** issuance volumes for SSAs stood at EUR21bn over the course of last week, above market expectations of EUR12-17bn. FIG supply of EUR6bn was just within the weekly forecast amount of EUR6bn-11bn. The total 2022 year-to-date FIG volume of EUR424.5bn is 20.9% ahead of last year's issuance volume. SSA volumes, however, remain behind last year's level, down 26.7% at EUR464bn. For the current week, survey data suggest SSA volumes will range between EUR11.5bn-16bn and FIGs are expected to issue EUR6bn-10.5bn.

Primary **SSA** deal flow remained largely intact, despite a multitude of monetary policy decisions, including those by the Fed, BoE and others. **Austria** government (AA+) followed a host of European sovereign issuers that launched deals in recent weeks to place its own EUR3.5bn 4-year deal. The final spread of MS-59bps offered a sizeable pickup of 42bps over Bunds and means the treasury has now completed 80% of its 2022 funding programme that stands at EUR60bn-65bn. The deal is thought to have priced with a small 5bps concession, in line with recent deals from Italy, France and Spain. **Asian Development Bank (ADB)** placed a USD4bn dual-tranche transaction last Tuesday, ahead of the Fed meeting. ADB offered a 2-year and a 10-year leg that tightened by 2bps and 1bp respectively. Demand for both tenors was almost identical at 1.7x, which is somewhat surprising given the uncertainty and market volatility ahead of the Fed announcements that may have otherwise damped interest in the longer leg. French agency **CADES** launched a EUR5bn social bond at 10-years for OAT+35bps (-1bp from IPT). The deal was launched alongside others from French issuers, such as Action Logement Services (ALS) or Ville de Paris. Recent spread widening and subsequent pick-up on offer from French issuers over the sovereign was less pronounced than in other core euro area markets, making these deals arguably more expensive and thus less attractive from an investor perspective. It was CADES' second euro benchmark transaction since the summer and its ninth for the year, taking total funding to EUR29bn. CADES has thus completed 72.5% of its 2022 mid- and long-term issuance target.

(Table 1) Key Transactions

Bank	Rank	Amount	Maturity	Final Spread (bps)	IPT (bps)	Book Orders
<b>SSA</b>						
ESM	Sr. Unsecured	EUR5bn	3Y	MS - 33	MS - 30	>EUR20bn
ADB	Sr. Unsecured	USD2.75bn	2Y	SOFR MS + 8	SOFR MS + 10	>USD4.7bn
ADB	Sr. Unsecured	USD1.25bn	10Y	SOFR MS + 51	SOFR MS + 52	>USD2.1bn
ALS	Sr. Unsecured (Sustainable)	EUR750m	15Y	OAT + 53	OAT + 53	>EUR770m
ICO	Sr. Unsecured (Social)	EUR500m	5Y	SPGB + 14	SPGB + 16	>EUR1.1bn
Rentenbank	Sr. Unsecured	USD1.25bn	5Y	SOFR MS + 37	SOFR MS + 39	>USD2bn
CCCIF	Sr. Unsecured	EUR500m	5Y	OAT + 48	OAT + 50	>EUR720m
KfW	Sr. Unsecured	EUR1bn	10Y	MS - 21	MS - 19	>EUR4.7bn
CADES	Sr. Unsecured (Social)	EUR5bn	10Y	OAT + 35	OAT + 36	>EUR11.5bn
Austria	Sr. Unsecured	EUR3.5bn	4Y	MS - 59	MS - 58	>EUR9.3bn
Spain	Sr. Unsecured	EUR5bn	20Y	SPGB + 7	SPGB + 9	>EUR40bn
Ville de Paris	Sr. Unsecured (Sustainable)	EUR300m	20Y	OAT + 36	OAT + 38	>EUR845m
<b>FIG (Senior)</b>						
Santander	SP	EUR1.5bn	4NC3	MS + 105	MS + 125	>EUR2.2bn
BPCE	SNP	GBP250m	6NC5	G + 265	G + 265/270	>GBP375m
<b>FIG (Subordinated)</b>						
Nykredit	Tier 2	EUR500m	10.25NC5.25	MS + 295	MS + 295	>EUR550m

Source BondRadar, Bloomberg.

**FIG** issuers were mostly absent from markets last week, with the exception of a handful of national champions. **Santander** launched the largest FIG deal of the week with a EUR1.5bn SP carrying a 4NC3 tenor. The issuer took advantage of a funding window ahead of several central bank monetary policy decisions and being one of the few deals in the market on Tuesday. Solid interest of 1.46x deal size helped tighten the spread by 20bps to MS+105bps, resulting in a new issue premium (NIP) of some 10bps. **BPCE** looked to diversify its funding base by issuing its first Sterling SNP and its first Sterling bond since December 2021 when it launched a Tier 2. The French bank currently has GBP2.6bn in debt outstanding, including last week's SNP deal. The 1.5x subscription level only translated to spread tightening of 5bps to G+265bps. The 10-15bps NIP on the deal can be considered a good outcome given the small nominal order book. Lastly, **Nykredit** from Denmark tested market appetite of its subordinated Tier 2. Just two weeks prior, the Danish central bank hiked its policy rate by 75bps to 0.65%. This move emulated that of the ECB, taking it the main rate out of negative territory. The move addresses the rise in inflation but is intended to protect the Danish Krone's peg to the Euro. The spread of MS+295bps for the 10.25NC5.25 Tier 2 was not able to improve from IPT as demand was muted. Orders only slightly surpassed deal size resulting in a NIP of some 35bps.

**Secondary market** spreads were mostly wider for EUR and USD. CDS indices on European senior (146bps) and subordinated financials (265bps) as measured by iTraxx benchmarks also priced +24bps and +44bps wider against the previous week's levels.

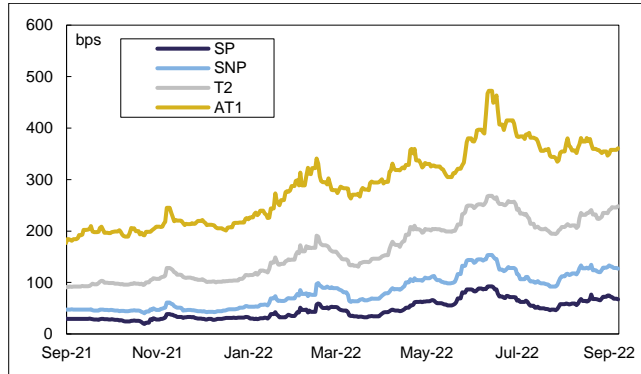
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Strong impulses into capital markets were provided by the Fed's 75bps hike in the federal funds rate to a range of 3-3.25% and expectation, presented in the dot-plots, of significant additional tightening thereafter to push the terminal rate above 4.50% with policy remaining restrictive for an extended period. In the UK, the BoE also hiked its Bank Rate by 50bps to 2.25% and also unanimously voted in favour of launching a programme of active Gilt sales in line with plans published last month. The government's subsequent fiscal event on Friday subsequently markedly increased the magnitude of unfunded tax cuts to come, sending Gilts and sterling into free-fall. Daiwa economists judge that a hike of 100bps in Bank Rate will be required at the next scheduled MPC meeting in November if not beforehand. In Sweden, the Riksbank hiked the policy rate to 1.75% from 0.75%, its biggest ever since the introduction of inflation targets. It also provided a target rate of 2.5% by 3Q22. Elsewhere, the central bank of Norway and Switzerland also raised their main policy rates by 50bps and 75bps respectively to a total of 2.25% and 0.5%. This week, a key impulse into the euro area will likely derive from the flash HICP inflation estimates for September (Friday).

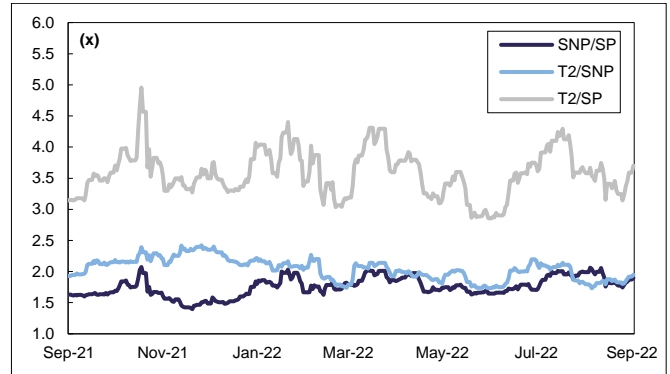
Weekly average EUR spreads were partially tighter with SP (-5.2bps), SNP (-4.0bps) and Tier 2 (+10.2bps). USD average spreads were wider throughout the week, with SP (+2.9bps), SNP (+7.7bps) and Tier 2 (+9.8bps). Based on Bloomberg data, 55% of FIG tranches and 46% of SSA tranches issued in September quoted wider 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

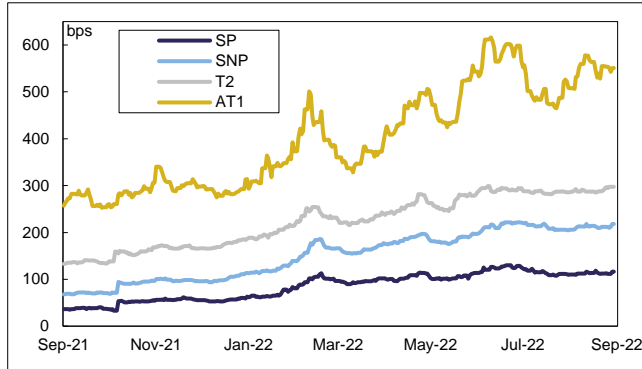
	Sr Preferred/Sr OpCo					Sr Non-Preferred/Sr HoldCo					Tier 2				
	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD
Commerz	3.7	3.7	64.1	-3.3	33.4	3.5	4.8	169.1	-2.7	87.8	3.2	5.9	278.5	9.2	132.2
Barclays	1.7	3.1	0.9	-1.1	-22.1	3.3	4.5	165.4	1.2	99.6	6.1	6.3	396.9	20.9	293.0
BBVA	4.0	3.9	85.8	-5.5	11.8	3.1	3.8	66.3	-2.7	29.8	3.9	5.4	247.0	9.9	147.2
BFCM	3.6	3.7	64.2	-6.3	25.8	6.3	4.4	140.7	-2.9	84.8	5.0	5.0	193.1	9.6	81.2
BNPP	2.1	3.1	6.3	-7.2	-19.8	4.6	4.4	133.5	-3.7	73.8	3.6	4.9	215.4	9.4	147.7
BPCE	3.2	3.5	37.8	-4.6	14.2	4.8	4.3	129.9	-3.0	57.4	6.6	5.2	174.9	2.2	81.8
Credit Ag.	3.8	3.2	26.6	-1.7	1.3	5.1	4.2	121.7	-3.5	57.2	3.3	4.9	184.6	6.1	98.9
Credit Sui.	5.0	5.7	261.7	-5.4	159.8	4.5	5.6	263.6	-34.7	169.3					
Danske	2.3	3.5	55.7	2.9	27.2	3.4	4.5	145.9	-1.4	84.4	6.6	6.1	297.6	14.1	194.9
Deutsche	2.6	3.8	70.8	-8.6	45.3	4.2	5.6	252.9	-5.8	143.0	3.2	6.4	329.9	13.7	156.2
DNB	3.4	3.6	51.8	-4.8	-2.6	6.2	4.2	115.1	-5.1	63.2	5.0	4.9	294.1	15.8	239.6
HSBC	4.8	3.6	58.4	-6.0	27.0	4.0	4.3	134.3	-1.9	80.4	3.9	4.5	138.6	7.2	77.0
ING	1.2	3.7	63.4	-23.1	-103.5	5.3	4.3	130.3	-2.5	68.7	6.4	5.6	256.6	10.0	170.3
Intesa	3.6	3.9	88.2	-3.0	50.5	3.3	5.0	190.7	-6.1	92.2	4.0	5.6	241.9	2.3	63.0
Lloyds	2.2	3.1	4.9	-10.0	-2.3	2.4	3.9	87.7	-2.9	47.3	5.4	6.4	373.6	38.9	318.5
Nordea	4.0	3.3	26.1	-7.4	16.7	6.0	4.0	101.4	-4.9	26.2	7.5	5.3			40.9
Rabobank	3.4	3.0	-9.2	-6.6	-18.5	5.0	4.1	109.2	-0.2	61.3	6.0	5.0	201.5	10.4	14.1
RBS	2.6	4.7	156.6	-6.8	101.1	5.0	4.1	109.2	-0.2	61.3	6.0	5.0	201.5	10.4	14.1
Santander	2.9	3.8	73.4	2.7	38.0	4.3	4.4	134.7	-1.5	78.8	3.9	5.2	210.5	12.5	114.4
San UK	2.4	3.1	-0.1	-8.7	-2.0	3.5	4.4	176.9	-1.4	74.7	3.9	5.2	210.5	12.5	114.4
SocGen	4.4	3.7	66.2	-5.7	26.9	5.0	4.5	151.6	-3.2	90.7	6.1	6.4	326.9	13.9	213.2
StanChart	3.4	3.7	65.7	-7.9	19.0	4.7	4.8	159.0	-3.2	102.6	5.5	6.1	300.2	9.6	179.7
Swedbank	4.0	3.6	54.6	-7.5	6.0	4.3	4.2	116.1	-4.1	55.7	5.1	4.5	243.1	16.1	93.8
UBS	3.7	3.7	64.8	-7.3	42.0	4.0	4.2	113.8	-3.4	62.4	3.0	4.4	70.4	34.4	-9.0
UniCredit	3.7	4.8	175.4	-5.7	119.0	3.8	5.6	249.3	-5.6	146.8	6.1	8.2	509.5	15.9	283.7

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.

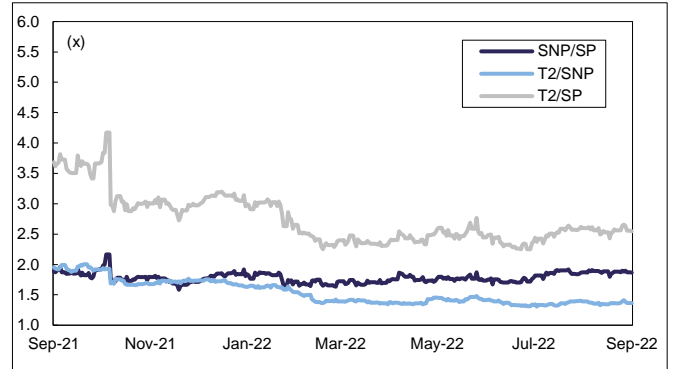
## Western European Banks USD Spreads and Yields

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Aggregate USD 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

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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	1.5					4.3	6.3	256.2	6.7	104.8	5.0	6.9	307.2	8.0	130.7
BFCM	3.6	3.7	64.2	-6.3	25.8	3.4	6.8	270.3	3.1	0.8	5.0	6.9	307.2	8.0	130.7
BNPP	2.1	3.1	6.3	-7.2	-19.8	4.6	6.2	219.0	4.9	109.7	3.9	6.1	212.2	7.8	80.8
BPCE	3.2	3.5	37.8	-4.6	14.2	4.6	6.4	234.9	4.8	110.2	2.7	6.5	231.9	6.8	101.7
Credit Ag.	3.8	3.2	26.6	-1.7	1.3	3.4	5.9	172.3	4.8	90.5	7.1	6.3	278.3	2.5	123.3
Credit Sui.	2.2	6.0	166.3	5.1	84.9	3.1	7.4	310.6	0.7	176.1	2.7	8.9	459.9	8.2	181.2
Danske	2.3	3.5	55.7	2.9	27.2	2.6	6.4	219.5	11.6	125.7	2.7	8.9	459.9	8.2	181.2
Deutsche	2.6	3.8	70.8	-8.6	45.3	3.0	7.2	296.3	8.2	158.0	7.2	9.0	528.2	12.0	317.9
HSBC	4.8	3.6	58.4	-6.0	27.0	3.5	6.2	223.3	4.2	95.1	8.6	6.6	305.0	6.1	93.9
ING	1.2	3.7	63.4	-23.1	-103.5	3.9	6.0	175.7	6.1	66.9	4.7	9.3	476.1	32.5	305.3
Intesa	3.6	3.9	88.2	-3.0	50.5	3.9	6.0	175.7	6.1	66.9	2.9	9.0	498.3	6.9	259.7
Lloyds	2.4					2.6	6.0	185.6	7.1	57.5	7.6	6.2	202.7	4.8	69.5
Nordea	4.0	3.3	26.1	-7.4	16.7	4.0	5.7	172.0	7.4	41.3	7.0	6.0			-13.7
Rabobank	3.4	3.0	-9.2	-6.6	-18.5	4.2	5.9	175.4	4.5	64.4	3.4	5.9	216.4	10.3	79.8
RBS	2.6	4.7	156.6	-6.8	101.1	4.2	5.9	175.4	4.5	64.4	3.4	5.9	216.4	10.3	79.8
Santander	2.9	3.8	73.4	2.7	38.0	4.6	6.5	256.3	6.9	115.1	6.8	7.2	349.1	9.7	176.2
San UK	1.5	4.9	50.9		7.7	4.0	6.6	245.8	7.6	129.2	2.7	6.5	232.5		55.4
SocGen	4.4	3.7	66.2	-5.7	26.9	3.9	6.5	254.9	3.4	126.5	3.5	6.4	222.5	4.5	78.4
StanChart	3.4	3.7	65.7	-7.9	19.0	2.9	6.2	200.9	8.2	106.9	8.1	6.8	333.1	5.1	101.7
UBS	2.2	5.2	65.8	7.9	32.4	4.2	6.0	197.6	6.5	58.3	8.1	6.8	333.1	5.1	101.7
UniCredit	3.7	4.8	175.4	-5.7	119.0	3.6	6.9	234.9	13.7	116.9	7.1	10.1	620.8	-0.1	332.4

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- 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 ¥10bn. 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).

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(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

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

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