BANKING SECTOR REPORT – February 2021

EXECUTIVE SUMMARY

US banks skyrocketed in February 2021 after relatively flat dynamics in January. BKX index increased by 16% MoM vs just +2.6% MoM of SPX index. February was the 5th consecutive month of outperformance after five months in a row of underperformance. Absolute February performance was the ninth-best monthly performance since index inception and it was +2.2 std from the mean. Relative February performance was +13% MoM. It is +2.7 std from the mean monthly performance and it is the sixth-best monthly relative performance vs SPX index since index inception. Despite to significant outperformance in recent months, when BKX index outperformed SPX by 36.9% over the last 5 months, it still underperformed the broad market by 18% since the end of 2019.

All members of BKX index ended the month in the green but dynamics wasn't uniform. Thus, key outperformers, such as SBNY and PBCT, increased by more than 30% MoM while trust banks, which were the main laggards, went up just by 4-7% MoM.

Despite to strong 4Q20 results, there was a technical correction in US banks in January 2021, but rapid growth resumed in February as a result of optimism about better fee income in 1Q21 and a rapid growth of key benchmark rates. Thus, the average monthly 10yr treasury yield increased by 18.6 bps MoM to 1.24% in February while 30yr mortgage rate increased by 11 bps to 2.95% after it declined MoM for 10 consecutive months. On the other hand, LIBOR rates and the short end are still very far from pre-pandemic levels. Mortgage volumes remain elevated as well as capital markets/IB volumes but loan growth is still muted. Given current macro forecasts, we expect that credit quality will remain strong and banks will continue to release reserves in coming quarters. In other words, fundamentals are much better than it was feared a half-year ago but it is a relatively long road ahead to fully return to business as it was before the pandemic.

Despite to significant outperformance in recent months, banks are still trading with a meaningful discount to S&P 500 and with a small one to historical averages. Thus, banks are trading with -0.4/-0.3 std on P/E CY and +0.1/+0.3 std on P/E NY (on the basis of samples from 2000 and 2010 years to the current moment) relative to historical averages (as of the end of February). As for relative to S&P 500, banks are currently trading at -1.7 std and -1.3 std from the sample mean (2010-current moment) for P/E CY and P/E NY, respectively. On P/B, banks are trading with +0.3 std from the sample mean (2010-current moment) vs +2.5 std for SPX index. **Given the ongoing momentum in US Financials, we continue to recommend buying US banks as risks/reward is still attractive.**

EU banks also skyrocketed in February 2021 after two consecutive months of negative dynamics, following an overwhelming performance in November. Thus, on an absolute basis, SX7P increased by 15.5% MoM in February. It was the third-best absolute monthly performance in the index history and it was +2.2 std from the mean monthly performance. On a relative basis, SX7P increased by 12.2% MoM and it was +3.3 std from the mean. It was also the third-best month of relative performance in index history. Thus, SX7P showed the best second and the best third months in its history during the last 4 months when SX7P added 46.1% and it outperformed the broad market by 22.8%. Notwithstanding, SX7P index underperformed in each of the 3 last years and it is still 34% lower than it was at the end of 2017, underperforming STOXX 600 index by 37% over this period.

Key outperformers in February were French banks and VMUK which were laggards during the previous months. Just two members of SX7P index ended the month in the red zone. Thus, Swedbank decreased by 6.2% MoM as a result of weaker 4Q20 results

while CBK went down by 0.9% MoM because of disappointing strategy.

European banks reported markedly better results in 4Q20 as they did in 2Q20 and 3Q20 after clearly weak figures in 1Q20. Both revenue and net income figures demonstrated positive surprises. Thus, 22 out of 33 banks from SX7P index for which estimates were available reported better revenue figures vs 30 out of 40 in 3Q20. Net income was also better than expected with 24 out 29 banks with positive surprises. EPS was higher for 20 out of 25 banks in 4Q20 vs 25 out of 35 banks in 3Q20. The key driver of better results was lower provisions due to a better economic outlook. In turn, NII/NIM figures were weak again and it will remain a headwind in the coming quarters even despite a substantial growth of the long end in recent months. Notwithstanding, earnings momentum began to improve after significant worsening in 1H20. Thus, a median decline of operating profit of SX7P index members improved from -44% yoy in 2Q20 to -23% yoy in 4Q20. A median decline of revenue was -6.1% yoy in 4Q20 after it decreased by 1.4% yoy in 3Q20 and felt by 4.3% in 2Q20. In turn, a median revenue surprise was +2.2% better than a median quarterly surprise over the last 10 years but lower than +3.1% in 3Q20. Revenue decline was driven by NII which decreased by 6.3% in 4Q20 vs -4.8% yoy in 3Q20 and -2.8% yoy in 2Q20. Due to better earnings season and overall optimism as a result of the vaccination campaign and better macro data, market perception of the results was positive. Thus, median 1-day performance of SX7P index members around the earnings date was +0.6% vs 10yr average of +0.2% and 3Q20 figure of -0.9%. So, overall performance since the start of the earnings season was overwhelming with growth of SX7P index by 8.1% (from January 20, 2021 till the end of February 2021), while STOXX 600 index decreased by 1.4% over the same period.

A median decline of EU banks' net income (SX7P index members) was 29.5% yoy in 4Q20 after dropping by 20.7% yoy in 3Q20 and by 43.3% yoy in 2Q20. And it seems that banks will manage to reach a pre-pandemic level not earlier than in 2H22 given the negative rate environment in the foreseeable future. At least, current estimates imply that FY22 net income estimates are 16% lower than FY19 net income actuals (a median decline of SX7P index). As a result of higher provisions on qoq basis, net income declined again sequentially after positive dynamics in 3Q20. So, median ROE of EU banks continues declining, -72 bps qoq or -374 bps yoy to just 4.2%, the lowest figure over the last 30 quarters. Due to positive EPS surprise and improved economic expectations, estimates have increased meaningfully in recent weeks. Thus, a median growth of FY21 NI was +3.9% ytd (but -37.6% since the beginning of 2020), implying a growth of 26% yoy. As of FY22 NI estimates, a median growth was +2.0% ytd (but -22.6% since the beginning of 2020), implying a growth of 25% yoy. On the other hand, revenue estimates were relatively flat with a growth of just +0.2% ytd for FY21 revenue but a decline of -7.2% since the beginning of 2020.

Revenue environment remains very challenging for European banks even despite markedly better momentum due to the ongoing vaccination campaign. And we don't expect that revenue environment will be much better in the coming quarters. As a result of better earnings season and better earnings visibility due to the ongoing vaccination campaign and expected GDP growth acceleration, we anticipate that outperformance of EU banks will continue in the near future. Moreover, due to meaningful EPS upgrades, the sector still remains relatively cheap even taking into account a significant price growth in recent months. From our point of view, the worst is behind us but it is a bumpy road ahead with risks still tilted to the downside. Despite we expect that EPS estimates will return to 2019 levels not earlier than in 2H22, it seems that the market is currently looking much further in time. EU banks are still trading with a small discount to historical averages while discount to US peers is markedly wider than it was historically. Thus, discount to historical averages is 5.0% (-0.3 std at the moment from mean P/E NY of SX7P index members,

sample from 2010 to the present) but discount to US peers (on median P/E NY of BKX index vs SX7P index) is 27% as of February 26 vs an average level since 2010 of 20%, or -0.8 std. **So, we are tactically bullish on EU banks at the moment but we continue to prefer US banks to EU ones in the longer run.**

MARKET PERFORMANCE

US

US banks skyrocketed in February 2021 after their relatively flat dynamics in January. Thus, it was the 5th consecutive month of outperformance after five months in a row of underperformance. BKX index increased by 16% MoM vs just +2.6% MoM of SPX index. Absolute February performance was the ninth-best monthly performance since index inception and it was +2.2 std from the mean. Relative February performance was +13% MoM. It is +2.7 std from the mean monthly performance and it is the sixth-best monthly relative performance vs SPX index since index inception. Despite to significant outperformance in recent months, when BKX index outperformed SPX by 36.9% over the last 5 months, it still underperformed the broad market by 18% since the end of 2019.

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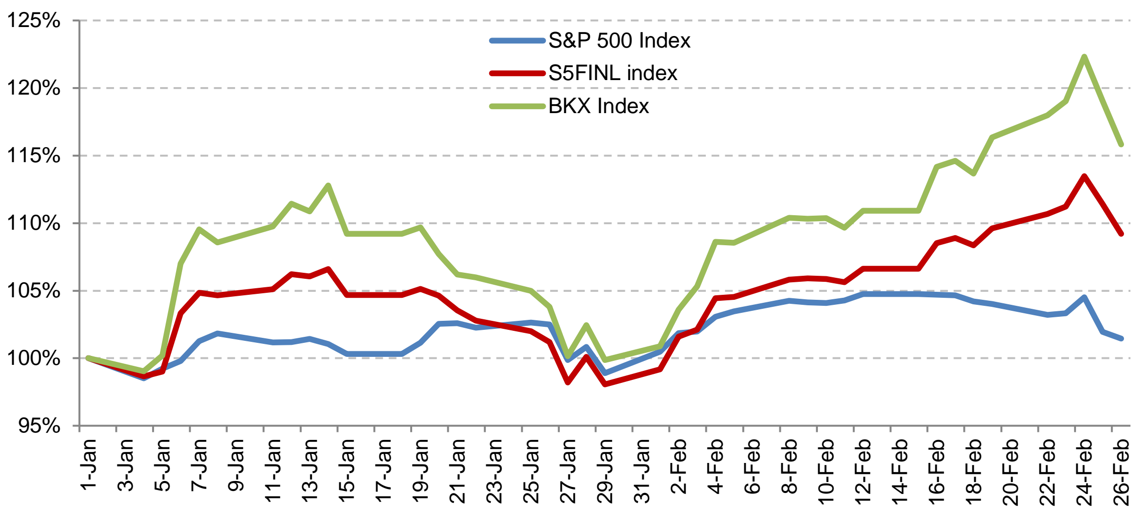
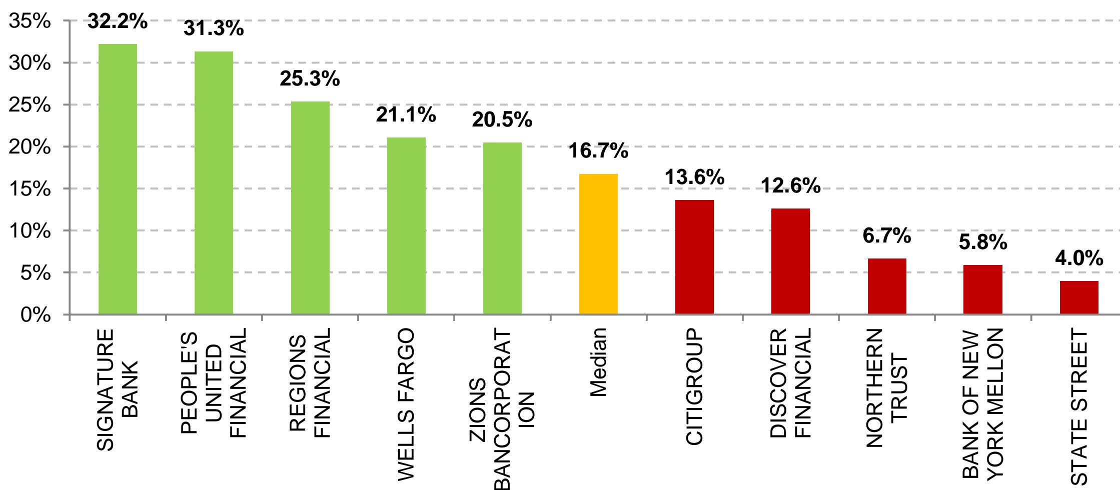
Chart 1. US Banks Performance. BKX Index vs S&P500 & S5FINL Indexes



Source: Bloomberg

Chart 2. February US Banks Performance. Leaders and Laggards, MoM Price Change,%



Source: Bloomberg

Europe

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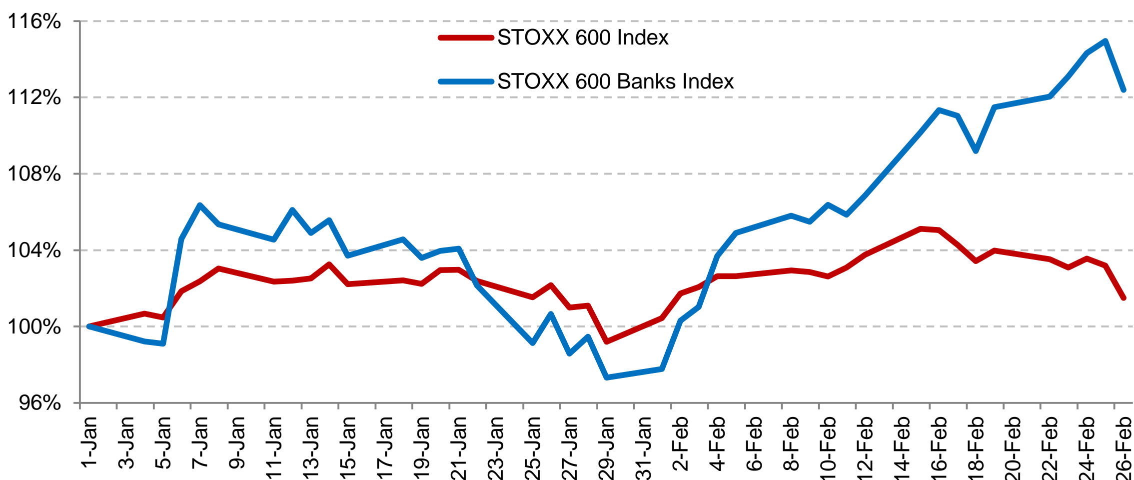
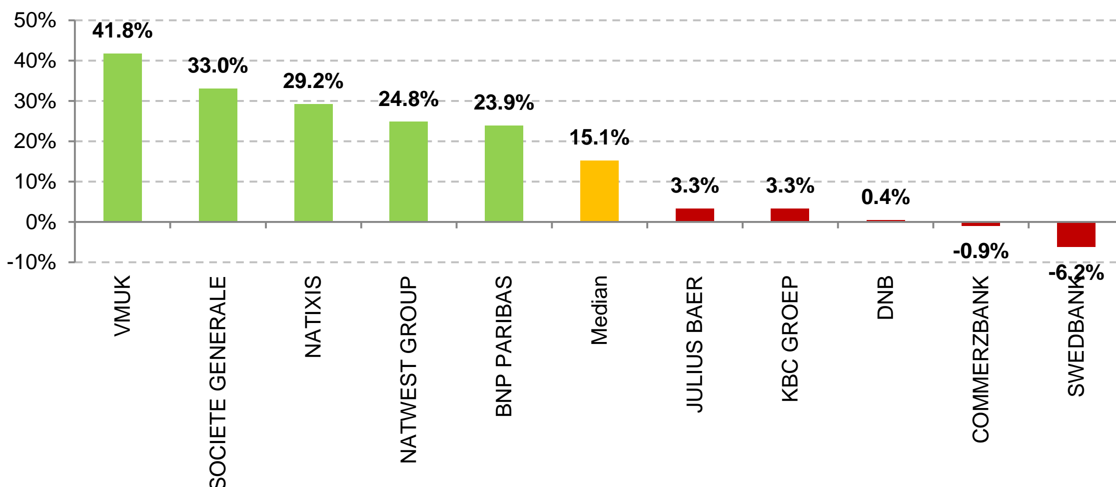
Chart 3. EU Banks Performance. SX7P Index vs STOXX 600 Index



Source: Bloomberg

Chart 4. February EU banks performance. Leaders and Laggards, MoM Price Change,%



Source: Bloomberg

COMPANY NEWS

US

Wells Fargo. A Light Appeared at the End of the Asset Cap Tunnel

According to media reports on February 17, 2021, the Fed accepted the proposal of WFC's plan to overhaul risk management and governance. It is the key step for WFC's future asset cap lift which has been negatively impacting WFC's fundamentals for years. Unsurprisingly, market perception of the news was clearly positive with the growth of WFC shares of 5.2% on the day of the news vs +0.4% of BKX index and flat SPX index. Notwithstanding, it is too early to talk about it as a fait accompli. At least, a number of important steps are necessary ahead. It is necessary to adopt and implement the plan, to perform a review of the implementation by a third party, and to get the final cancellation of the asset cap by the Fed. The general belief is that the cap will not be lifted till early 2022. But even if it happens later, significant uncertainty has already removed given that WFC was under asset cap restriction since 2018 while regulatory claims began in 2016, when details of the scandal had emerged. WFC underperformed BKX index by more than 45% since early 2018 as the fundamentals of the bank were much weaker than industries' fundamentals. Moreover, it was worse than even lowered expectations almost every quarter over last 3 years (10 times over 12) while the majority of BKX index members commonly presented better figures.

Chart 5. WFC vs Industry. Key Fundamentals*

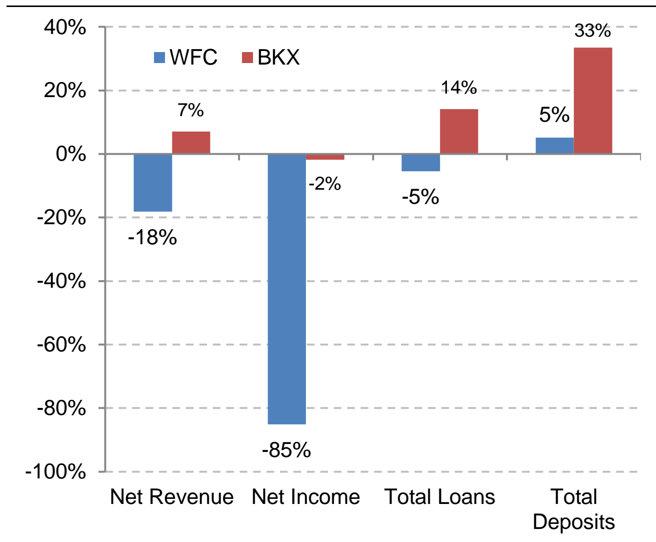
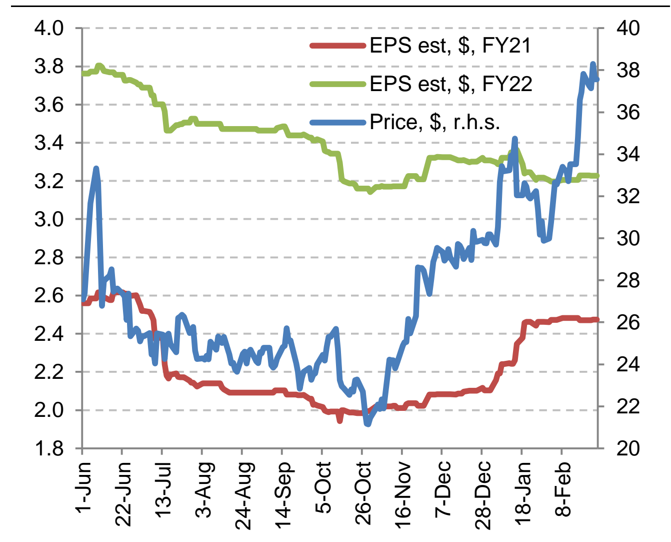


Chart 6. WFC. Price and EPS dynamics



*BKX index members median. FY 2020 vs FY 2017

Source: Bloomberg

Source: Deutsche Bank

Given the news, we expect that WFC's estimates should be revised up in the coming weeks as, from our point of view, the street didn't take into account that it could happen so soon. Notwithstanding, estimates will not improve significantly, at least for the nearest two years and its profitability will remain to be below peers median. WFC's fundamentals were much worse than the industry figures in the last three years. Thus, WFCs total loan portfolio decreased by 5.4% since the end of 2017 while median growth of BKX index members (ex. WFC) was 14.2% over the same period. WFC's total assets were flat vs total assets of BKX members increased by 23%. As for total deposits, the gap was even slightly bigger, +5.1% vs +33%. Unsurprisingly, revenue growth was much weaker, WFC's revenue decreased by 18.4% in 2020 vs 2017 while median growth of BKX index members was +7%. So, WFC's NIM decline in 2020 (FY20 vs FY19) was -50 bps vs -37 bps of an industry median while NII decline was -16% vs relatively flat NII dynamics for BKX index members. According to Bloomberg estimates (as of February 24, 2021), it is expected that a median growth of

revenue of BKX index members (FY22 vs FY17) will be 11.1% while WFC's one will be negative, -20.4%. As for net income, it will be +23.8% vs -44.7% (FY22 vs FY17).

WFC reported disappointing quarterly figures, being under pressure of various regulatory issues and a significant decline of key benchmark rates. Even WFC's longer-term profitability targets remain meaningfully lower than an industry averages but uncertainty related to WFC's business has decreased substantially due to recent news. Notwithstanding, fundamentals will remain under pressure for some time. Unsurprisingly, WFC is trading with a discount to peers on P/B. Current WFC's P/B is 0.9x with consensus 2021E ROE of 6.3% vs 1.2x of US banks and 9.9% ROE estimates. P/E 21E & 22E are 14.6x and 11.2x, respectively, vs 12.5x and 11.9x for US banks. So, WFC's investment thesis improved as it is clearly the worst remained in the past but it is a bumpy road ahead for the bank. **So, we are bullish on WFC and our 12M price target increased from $40 to $45.**

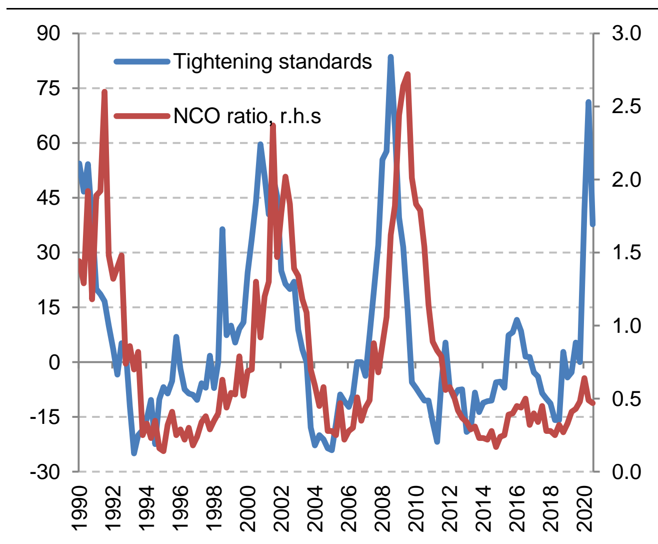
MACROECONOMIC NEWS

US

C&I loans

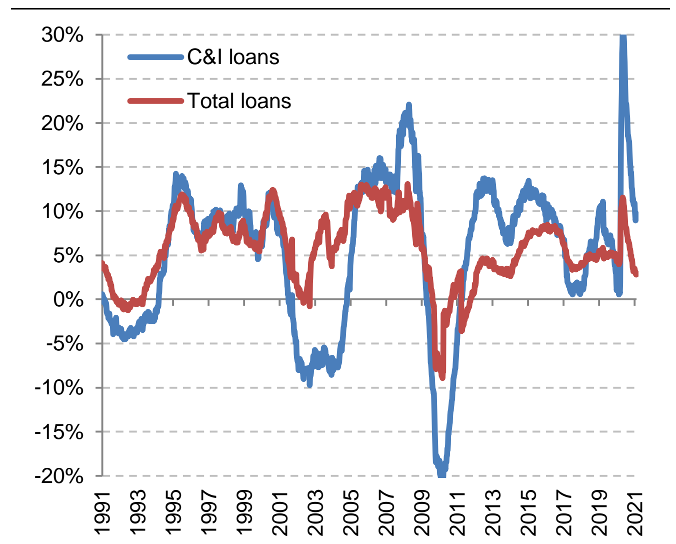
C&I loan growth remains negative on qoq basis with a relatively weak start of the year. After skyrocketing growth in 1H20 as a result of liquidity needs, it declined on qoq basis in both quarters of 2H20 due to normalization of liquidity situation, boom on debt markets and lower CAPEX needs. Since May 13, 2020, when it reached the local high, it decreased by $495 Bn, or -16.2%, explaining more than 90% of total loan portfolio decline over this period. It still remains relatively strong on yoy basis but we expect that it will continue decelerating in the near term despite to an acceleration of the US economy as a result of the vaccination campaign and new fiscal stimulus. At least, banks continue to tighten lending standards while CAPEX and inventory financing needs remain weak, and demand for liquidity is going down. According to the Fed H.8 survey, C&I loans increased by 9.8% yoy (as of February 10, 2021) vs +0.5% yoy one year ago. On ytd basis, C&I loans declined by 1.3% vs -0.4% ytd of total loans.

Chart 7. C&I. Loan Standards vs NCOs, %



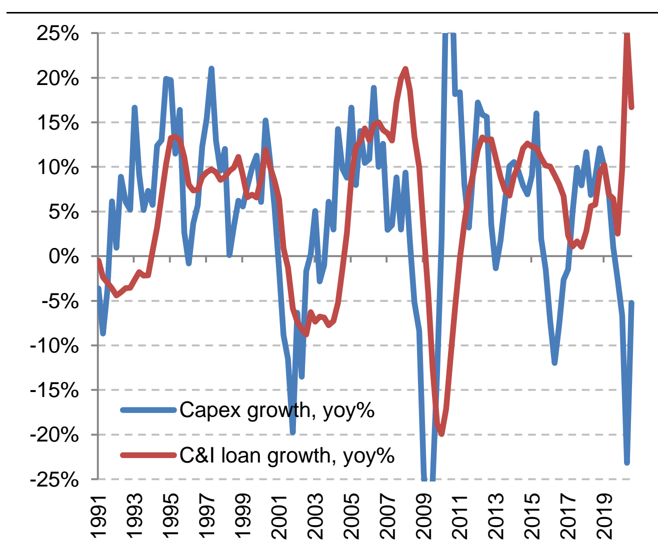
Source: Bloomberg

Chart 8. Loan Growth. C&I vs Total loans, YoY%



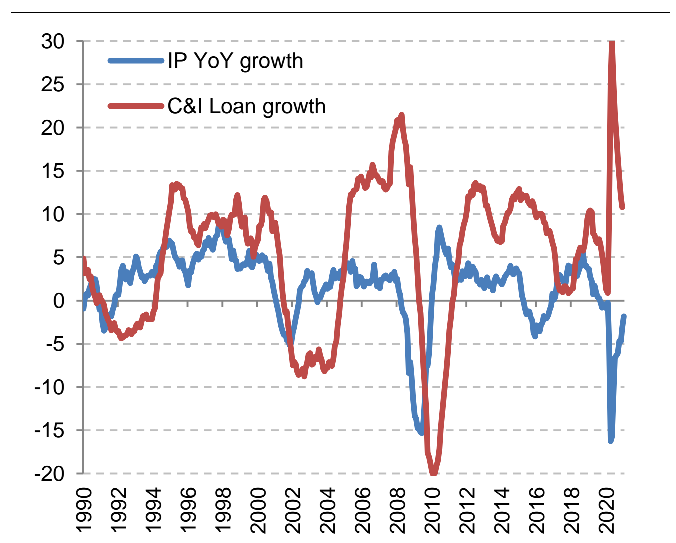
Source: Bloomberg

Chart 9. C&I. Loan Growth vs CAPEX



Source: Bloomberg

Chart 10. C&I. Ind. Production vs Loan Growth YoY%



Source: Bloomberg

Support measures have certainly had a positive impact on the financial health of the US corporate sector, and credit indicators still look pretty resilient at the moment, especially taking into account a degree of the turmoil and relatively high leverage of the US corporate sector before the pandemic. Notwithstanding, risks are still relatively high as a result of the second wave of the pandemic. From the other hand, the long term prospects look encouraging as a result of the start of the vaccination campaign and adoption of new fiscal stimulus. The quality indicators may get worse before they get better, but banks have already begun releasing corporate reserves, implying that the current situation is much better than feared. Moreover, corporate bond spreads decreased below its historical averages after an explosive growth in 1H20. However, it doesn't mean that the situation has completely returned to normal. At least, spreads in the most affected sectors are still elevated. Notwithstanding, it definitely means for us that the worst is over.

Despite to concerns about deterioration of C&I credit quality over the recent quarters (and total loan portfolio at all), it remains benign so far and there wasn't any significant deterioration of credit quality in 2H20 after noticeable deterioration in 2Q20. As of industry figures (latest available data), according to the FDIC data, 30-89 delinquency rate even decreased by 5 bps yoy, or -1 bps qoq, to 0.26% in 4Q20. Being a leading indicator of asset quality, it confirms that it remains in a good shape so far despite the recent recession in the US economy. FDIC's NCO ratio decreased by 1 bps qoq, but +5 bps yoy, to 0.48%, still lower than average figures of the last two cycles. Noncurrent rate increased by 20 bps yoy, but -4 bps yoy, to 0.99%. According to the Fed data, delinquency ratio increased by 17 bps yoy, but flat qoq, at 1.3% in 4Q20, the highest figure over last 13 quarters. In turn, NCO ratio decreased by 10 bps qoq, but +6 bps yoy, to 0.42% in 4Q20, still just 2 bps higher than average over last 10 years.

Till the start of the pandemic, financial health of the US corporate sector was solid even despite to relatively high leverage. Thus, ROA was high, quick ratios were sound while interest expense coverage was strong but deteriorated as total profit of the sector was flat in recent quarters. Situation changed considerably in March 2020 and it continued to deteriorate in 2Q-3Q even despite to a relatively fast economic recovery. Given high leverage of the US corporate sector and an inevitable decline of revenues because of the dramatic recession in the US in 1H20, accompanied by a skyrocketing growth of corporate spreads, especially for non-investment grade companies (but spreads have already declined markedly from the recent highs), we saw a significant drop of interest coverage ratios in 1H20 even despite the fed funds rate was cut to zero. From the other hand, situation has improved considerably in recent quarters. Thus, median EBIT to interest expense ratio of S&P 500 index (ex. Financials) companies increased from 5.2x as of the end of 2Q20 to 8.5x as of the end of 2020 (a preliminary figure), being even higher than it was in 2019. Notwithstanding, the percent of companies with the ratio below 1.0 remains relatively high, 13.6% in 4Q20 vs just 6.3% in 4Q19, implying that the stress in the corporate sector is still high. The Fed actions just slowed down somewhat a growth of NPLs and NCOs but don't prevent it. However, we don't expect that it could be a problem for US banks given the size of reserves which has already built in 2020.

January 2021 Senior Loan Officer Opinion Survey indicated that C&I lending standards and terms were tightened again in 4Q20. Tightening was broad based across all major loan terms but not across bank sizes. Unsurprisingly, the key reasons for tightening were a less favourable and more uncertain economic outlook, worsening of industry-specific problems, and reduced tolerance for risk. It is a bit surprising given markedly better growth projections for 2021 and 2022 years. Banks also reported a weaker demand again in 4Q20. From the other hand, banks noted that inquiries from potential borrowers were relatively unchanged in 4Q20. The key drivers of weaker demand were lower needs for inventory and receivables financing as well as lower investment needs in plant or equipment. As for 2021

expectations, “banks reported expecting tighter standards for most business loans”, “except C&I loans to large and middle-market firms, for which banks expect to leave standards unchanged over 2021”. “Meanwhile, significant net shares of banks expect stronger demand across all business loan categories. Additionally, banks expect loan performance to deteriorate for all types of business loans, with the notable exception of C&I loans to large and middle-market firms, for which credit quality is expected to improve over 2021”.

Macro data published in February 2021 were contradictory again. On the one hand, manufacturing figures were relatively strong with positive surprises on industrial production, composite PMI, retail sales and better factory orders. On the other hand, employment data were clearly weak again. Notwithstanding, we believe that the worst is behind us but there will be a bumpy road ahead even in spite of higher probability of new stimulus and the start of vaccination campaign. ISM manufacturing index decreased by 1.8 pts MoM to 58.7 pts in January, markedly missing consensus of 60.0 pts after better figures in December. Employment report was significantly worse than expected in January, reflecting a slowdown in the labor market recovery. Moreover, manufacturing payrolls decreased by 10K in January vs consensus of +30K, after it went up by 31K in December. In turn, total payrolls increased by 49K in January vs consensus of 105K, after decline of 227K in December (revised down from initial estimate of -140K). And the miss was more widespread that it was in December, when it was driven by few industries, such as leisure and hospitality where employment tumbled by 500K. Nevertheless, employment is still 10 mln lower than it was one year ago. But the situation should start to improve in coming months. Unemployment rate tumbled by 40 bps on MoM basis to 6.3% after it was flat in December, following 7 consecutive months of decline. But one of the main reasons of decline was labour force exits. So, unemployment remains elevated but markedly below the high of the GFC and it is quite resilient given the second wave of the pandemic. Given expectations of new fiscal stimulus, street estimates continue improving. Thus, according to Bloomberg survey conducted in February 2021, GDP growth rates were estimated at +4.9%/3.7%/2.5% yoy for 2021/2022/2023, respectively vs +4.1%/3.5%/- in January. Industrial production increased by 0.9% MoM in January vs consensus of +0.4% MoM after growing by 1.3% MoM in December (revised down from initial estimate of +1.6% MoM). But it is still -1.8% yoy as a result of the meltdown in 2Q20, when IP decreased to levels last seen during the GFC. Capacity utilization increased by 0.7% MoM in absolute terms to 75.6% in January, from revised up by 40 bps December estimate. But it also remains 1.4% below pre-COVID levels. In turn, Empire manufacturing index increased by 8.6 pts MoM to 12.1 pts in February, after four consecutive months of decline. And it is again slightly higher than an average level of 2019. Preliminary Markit manufacturing PMI decreased by 0.7 pts MoM to 58.5 pts in December vs consensus of 58.8 pts after it increased markedly in January. Notwithstanding, it is still remaining more than 20 pts higher than 2020 low and even 8.6 bps higher than pre-COVID levels, despite to the second wave of the pandemic and weaker employment figures in recent months. So, consensus IP growth forecasts improved meaningfully in the recent months, to 5.9%/+3.4%/+2.4% yoy in 2021/2022/2023 in February, respectively, from +4.6%/+3.2%/- in January.

CRE

A growth rate of commercial real estate loans still remains pretty resilient despite to a significant negative effect of the pandemic on some CRE subsegments and geographies, such as retail/hotels and NY/CA. However, a loan growth rate has decelerated markedly in recent months and it was flat ytd even despite CRE fundamentals in a number of segments have already begun to recover from the summer trough. Thus, according to the last Fed H8 weekly report, CRE loan growth was +3.2% yoy (as of February 10, 2021) vs +6.4% yoy one year ago. Despite to a significant deterioration of CRE fundamentals in 2Q20 and 3Q20, there were clear signs of improvements in the recent months. The start of the

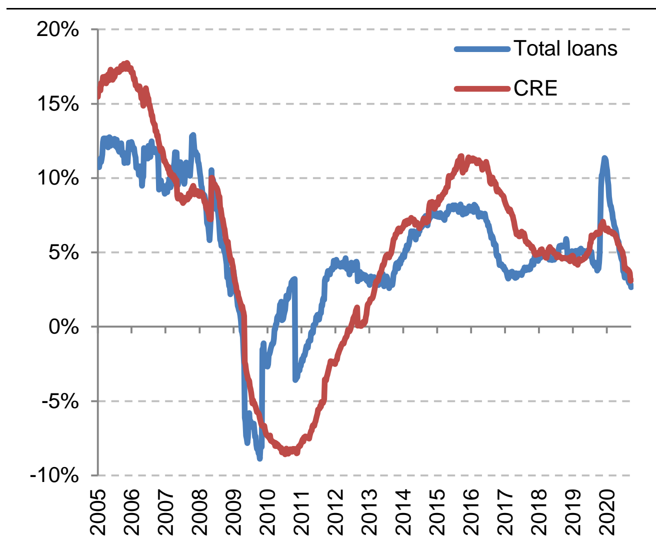
vaccination campaign isn't a panacea right now, at least for a number of CRE subsegments, and it seems that the process may be longer than it was initially expected but it is quite probable that the worst is behind us. Further fiscal stimulus will only accelerate CRE recovery even in spite of some structural issues will be a kind of challenge for some CRE sub-sectors. At least, transaction volumes have already increased on qoq basis while prices began to accelerate again, skyrocketing by more than 7% in 2H20. Effective rent, especially in the most affected segments, remains relatively weak but even here a light at the end of the tunnel could be seen. Moreover, 2H20 rent collections were better than expected (and it continues to improve), especially for retail segment, where the majority of properties were closed or were operating in a limited functionality mode while volumes increased on MoM basis in a number of CRE segments. Nevertheless, short-term forecasts probably will continue to be revised down (at least in the most affected segments) with lower rent, higher vacancy rates, negative absorption and declining prices, while longer-term prospects are markedly brighter than it was just few quarters ago. As a consequence, a loan growth may get worse before it gets better and it is quite possible that quality characteristics will slightly deteriorate in 2021. The worst is behind us but a bumpy road is ahead. Unsurprisingly, REITs quotes were relatively flat ytd after it rallied in 4Q20. Thus, BBREIT index increased by 2.5% ytd vs +1.5% ytd of SPX index and +9.2% ytd of S5FINL index.

Credit quality remains strong so far but early signs of deterioration have already been seen in recent months. Obviously, CRE's credit quality will continue to worsen in the coming quarters. According to the Fed data, CRE NCO ratio increased by 4 bps qoq, or +12 bps yoy, to 0.15% in 4Q20 while delinquency ratio increased by 15 bps qoq, or +48 bps yoy, to 1.16%. According to the FDIC data, NCO ratios for all CRE subsegments except for commercial mortgage were stable, near 0% during last year. Commercial mortgage NCO increased by 4 bps qoq, or +16 bps yoy, to 0.22% in 4Q20 but it still remains markedly below than an average level of last two cycles. In turn, non-current rates increased markedly in all major segments in recent quarters – commercial mortgage noncurrent ratio is 1.0%, +49 bps yoy; construction one is 0.65%, +22 bps yoy; multifamily noncurrent ratio is 0.26%, +15 bps yoy. As for leading indicator of future credit quality, then 30-89 days delinquency ratio improved slightly in 2Q20 vs 1Q20 although it increased slightly in 2H20 but it still remains not far from multi-year lows. The figure of commercial mortgage increased by 3 bps qoq to 0.34%; in construction it was +8 bps qoq at 0.45%; in multifamily it was +8 bps qoq at 0.24%. In any case, NCO ratio highs booked in domestic offices were very different during three last recessions. According to the Federal Reserve data, the GFC's high was 2.82%, comparable to the recession of early 1990s figure of 2.44%, but significantly higher that just 0.15% of a recession of early 2000s. And we don't expect that NCO ratio high of the current cycle will reach the high of the GFC even despite to significant problems in retail and hotel segments (according to REIS forecasts, deterioration in retail in 2020 was worse than it was in 2009) due to a shorter period of current downturn and much tighter lending standards during the last credit cycle. Moreover, the percent of rent collections still remains very high in majority segments and growing. Price growth has remained positive on yoy basis so far and it even accelerated in recent months. It could be distorted by lower transaction volumes but the fact is that CRE segment remains strong, at least so far, especially taking into account that it was one of the most suffered industries because of the health crisis.

Transaction volumes tumbled on yoy basis in 4Q20 as it was in 2Q20 and 3Q20 but it was up on qoq basis and there were clear signs of improvements in traded volumes in recent months. According to the RCA, "U.S. sales volume fell 32% versus 2019 and for the fourth quarter dropped a more modest 19%. The industrial sector overtook the office sector as the second most active real estate market in 2020, as the pandemic focused investor attention on the warehouses needed for online retailing, and raised questions about future demand

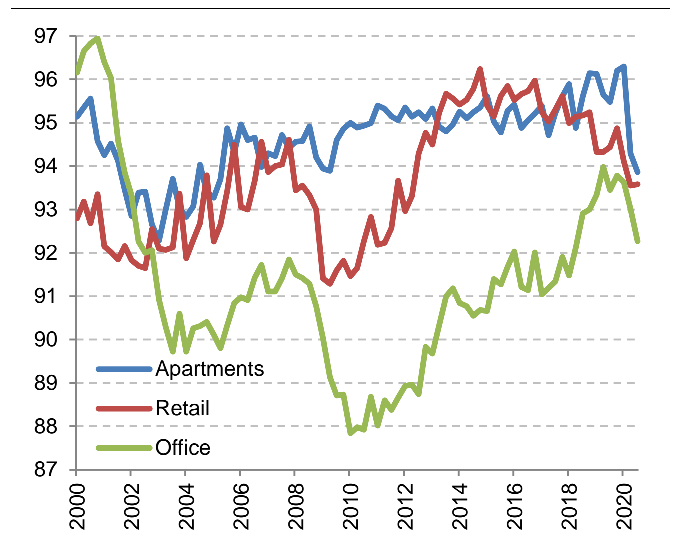
for office space with the increase in home-working". Volumes are still markedly above the lows of the GFC. Notwithstanding, the difference between bid and ask prices is still high, especially in some segments such as NY apartments. From the other hand, almost all distressed CRE concentrated in only two segments, hotels and retail. Illiquidity continues negatively impacting on commercial real estate and even extremely low interest rates can't change the situation, at least so far. Notwithstanding, prices remained resilient, still showing a positive yoy growth and it even accelerated markedly in 2H20. Thus, an apartment price index added +6.8% yoy as of the end of January vs +6.6% yoy as of the end of 2019. In turn, a growth of a price index of retail CRE turned negative in May 2020 and it is currently -1.8% yoy vs +1.6% yoy one year ago. A growth of prices of industrial CRE decelerated to +8.3% yoy from +11.9% yoy in July 2019. A growth rate of office prices slightly decelerated to +3.3% yoy from 4.1% yoy as of January 2020. CRE all-property index was relatively strong, demonstrating even the faster growth rate vs pre-pandemic levels.

Chart 11. Loan Growth. CRE vs Total Loans, YoY, %



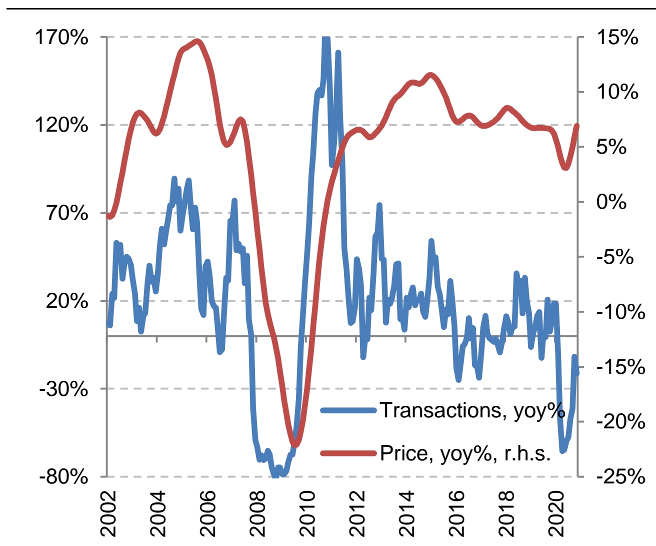
Source: Bloomberg

Chart 12. CRE. Occupancy rates, %



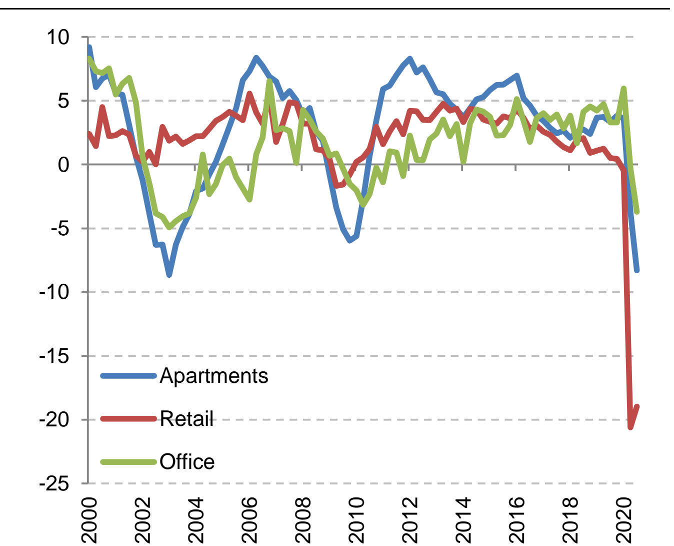
Source: Bloomberg

Chart 13. CRE. Price Growth vs Transactions Volumes



Source: Bloomberg

Chart 14. CRE. Same-Store NOI Growth, %



Source: Bloomberg

Despite to early signs of recovery in CRE, difficult times for the sector remains in the near future, accompanied by lower occupancy rates, lower rents and so on. Faster than anticipated economic recovery improved prospects of the sector, however, CRE fundamentals deteriorated meaningfully in 2Q20 and 3Q20 in all major segments. Thus,

retail same-store NOI tumbled by more than 20% yoy in 2Q20 and by 19% yoy in 3Q20 as a result of low rent collections. The lowest figure of the GFC was just -1.7% yoy in 2Q09. Office NOI declined by 3.7% yoy in 3Q20 and by 0.3% yoy in 2Q20 vs +5.97% yoy in 1Q20 and the lowest growth during the GFC of -3.2% yoy in 2Q10. Apartments NOI decreased by 8.3% yoy in 3Q20 vs -3.7% yoy in 2Q20 and +3.4% in 3Q19, even lower than trough growth rate during the GFC, -6% in 4Q09. Occupancy rates also decline substantially across all major segments except for industrials in 2Q20/3Q20, and we expect that they will continue declining in coming quarters. Majority REITs decreased or suspended dividends as a result of negative effect of the health crisis in 1H20 but the situation began improving in 2H20. On absolute basis, it still markedly lower than it was one year ago, but dividend yield remains relatively stable due to shares decline. Situation is still challenging as restrictions remains but we expect significant improvement in 2H21 due to reopening of the economy as a result of positive effect of the vaccination.

In 4Q20, banks continue to tighten standards for CRE loans. Standards were tightened for all three major CRE loan categories. For construction loans it was the 23th quarter of tightening in a row, while for multifamily loans standards were tightened by significant net fraction of banks for the 4th consecutive quarter after flat standards in 4Q19 following 17 consecutive quarters of tighter standards. Also banks noted weaker demand for nonfarm nonresidential properties but it was unchanged in the multifamily segment. In 3Q20 SLOOS, "major net fractions of domestic and foreign banks reported that the current levels of their standards for all major categories of these loans are at the relatively tighter ends of the ranges that have prevailed since 2005 on balance". As for expectations, banks expect to ease standards for multifamily loans in 2021 but unchanged standards for other CRE segments. From the other hand, demand should be stronger but loan performance will probably deteriorate (in-line with current market expectations).

Mortgage

A growth rate of mortgage loans decelerated markedly in recent months vs. the end of 2019 and it turned negative on yoy basis in early December, even despite to a significant growth of housing sales and very high refinancing activity. Mortgage loans declined by 0.6% ytd as a consequence of tighter lending standards for mortgage loans because of a significant deterioration of financial health of the US consumer, at least for a number of them (overall health of the US consumer remains solid due to a plentiful government support). Thus, mortgage loans decreased by 0.7% yoy (as of February 3, 2021) vs +5.3% yoy at the end of 2019. From the other hand, mortgage activity remains very high with growth of MBA's application index of almost 40% yoy as of February 12, 2021. An average level of the index in 2020 increased by more than 60% vs 2019 year. Given higher GDP growth estimates, new fiscal stimulus and the start of the vaccination campaign, we expect that mortgage activity will remain high and it will eventually be accompanied by a growth of mortgage loans as banks will start to ease lending standards even despite to lower affordability of homes and still elevated unemployment. Mortgage credit availability index increased by 2.5 pts MoM to 124.6 pts in January but it still remains just slightly up, +6 pts, from September low. So, the index is still near the lowest level over more than 6 years, implying that lending standards remain relatively tight. On the other hand, affordability ratios have already declined meaningfully from the cycle highs but they should increase in the near future because of a substantial decline of key benchmark rates. However, even current level of affordability ratios isn't low from the historical averages point of view, as well as household debt burden isn't either. But banks prefer to remain on the sidelines (at least for new mortgage borrowers) given still elevated unemployment ratio even despite to its significant decline in recent months. So, we don't expect that NPL and NCO ratios will even approach the values that we saw in the last crisis (2.72% for NCO ratio and 10.5% for delinquency ratio) due to more cautious approach of US banks to the mortgage lending during all the

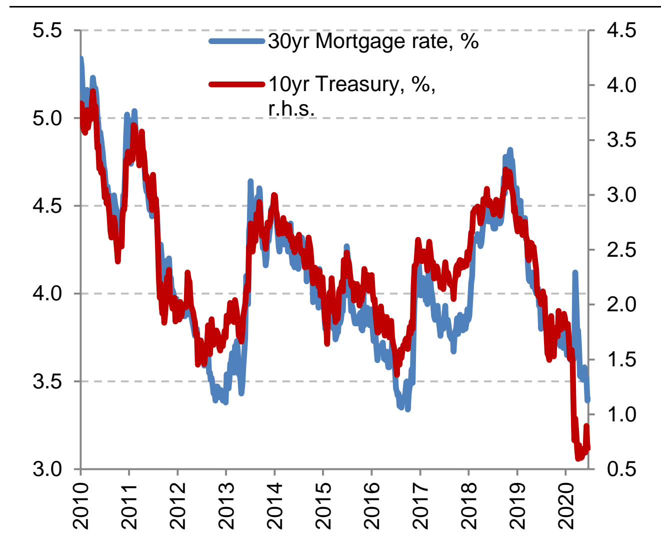
cycle, stronger financial health of the US Consumer now vs 2007-2008 years, very strong recovery of housing after the pandemic and a lack of housing supply. Housing market also looks significantly healthier with no obvious imbalances as it was just before the last recession when it was a key engine of an economic contraction. We expect that NCO ratio dynamics will be more like the one during a recession of early 2000s with the highest figure of 0.3%. Moreover, a percent of rent payments markedly improved in February after a slight deterioration in January. According to the National Multifamily Housing Council Rent Payment Tracker, 79.2% of apartment households made a full or partial rent payment by February 6, 2021 vs 76.6% in January 2021 and 81% in February 2020. Given upcoming stimulus and an acceleration of GDP growth, it seems that situation will continue improving.

The US economy lost 227K payrolls in December (revised down from an initial estimate of -140K) and it was added just 49K in January vs expectations of +105K. Private payrolls were also weaker, adding just 6K in January vs expectations of +163K, after it was lost 204K payrolls in December. Nevertheless, employment still remains much below pre-COVID levels, although it is much better now than it was feared 1-2 quarter before and the situation will begin to improve relatively soon. Jobless claims decreased substantially from March highs but it still remains meaningfully higher than it was in the beginning of 2020. Moreover, it even increased on MoM basis in recent months and it remained elevated. However, an average figure of 806K in February was 4.0% lower than an average level of January, but approximately 80% lower than it was in April 2020, however, still 4x higher than January-February 2020 levels. Notwithstanding, overall median forecasts of average monthly payrolls for 2021-2022 years were almost unchanged at +360K/+259K/+188K in February vs +369K/+249K/- in January. Unemployment rate declined by 40 bps MoM to 6.3% vs consensus of 6.7% and it is markedly lower than the peak of the GFC. Moreover, underemployment rate tumbled by 60 bps MoM to 11.1% in January, -11.7 pps from the April 2020 high. And unemployment projections also decreased in February vs January at 5.8%/4.6%/4.2% for 2021/2022/2023 years, respectively (vs 6.0%/5.0%/- in January). Despite to a significant growth of unemployment in April, it seems that a negative impact of this factor on quality of mortgage portfolio could be restricted, at least near term, due to forbearance programs and a positive impact of new fiscal stimulus. But further dynamics of quality characteristics will depend on how quickly the economy will continue to recover. Thus, according to MBA, “the total number of loans now in forbearance decreased by 6 basis points from 5.35% of servicers' portfolio volume in the prior week to 5.29% as of February 7, 2021”. Around 2.6 million homeowners are still in forbearance plans, slightly lower on MoM basis. The key driver of loans in forbearance decline was return of homeowners to work but situation with employment stopped to improve in the recent months. As for Fannie Mae and Freddie Mac data, a share of loans in forbearance declined for the 8th month in a row to 3.01%, -6 bps during the week ended February 7.

Mortgage credit quality was very strong so far. According to the Fed data, NCO ratio in the segment decreased by 3 bps yoy to -0.03% in 4Q20 while delinquency ratio decreased by 5 bps qoq, but +39 bps yoy, to 2.74%, still not far from the lowest figure over 12 years. According to the FDIC, the quality of mortgage portfolio remains also very strong with NCO ratio at -0.02% in 4Q20, -3 bps yoy. 30-89 days delinquency ratio decreased by 1 bps yoy to 0.87%. In turn, noncurrent ratio increased markedly, +72 bps yoy to 2.49% in 4Q20, +3 bps qoq. MBA’s mortgage delinquencies ratio decreased by 92 bps qoq to 6.73% in 4Q20, the second consecutive quarter of decline, after a 9-year high of 8.22% was shown in 2Q20. Notwithstanding, it is still 296 bps higher than its all-time low, which was recorded in 4Q19. In turn, foreclosures declined again, -3 bps qoq, or -22 bps yoy, to 0.56%, the 35th quarter of decline in a row and the lowest figure since 1982. According to NY Fed, “with federally-backed mortgages also eligible for forbearances, the share of mortgages that transitioned into delinquency fell to 2%(annualized) in the fourth quarter, down one and a half percentage points since the fourth quarter of 2019”. One of the key reasons that credit

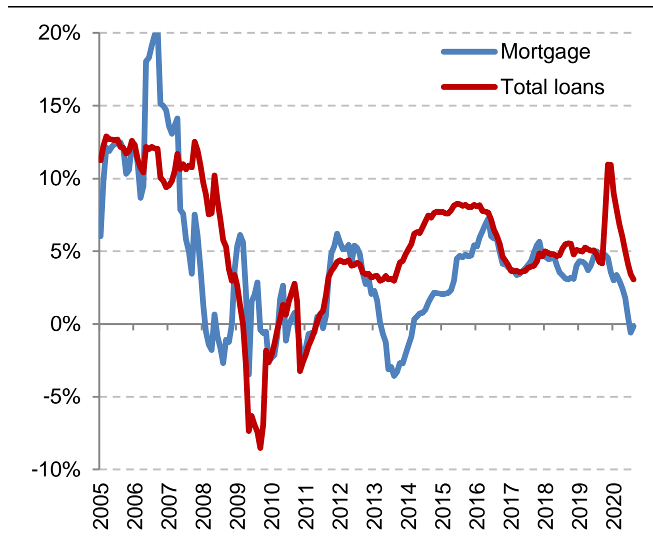
quality still remains very strong is that skyrocketing growth of unemployment mainly affected renters not owners. Also, government support programs were very helpful for consumers. So, we expect that quality of mortgage loans will remain much better than GFC's average figures of NCO and delinquency ratios as underwriting standards were much stronger during the last credit cycle.

Chart 15. Mortgage. 30yr Fixed Mrtg vs 10yr Tr yield, %



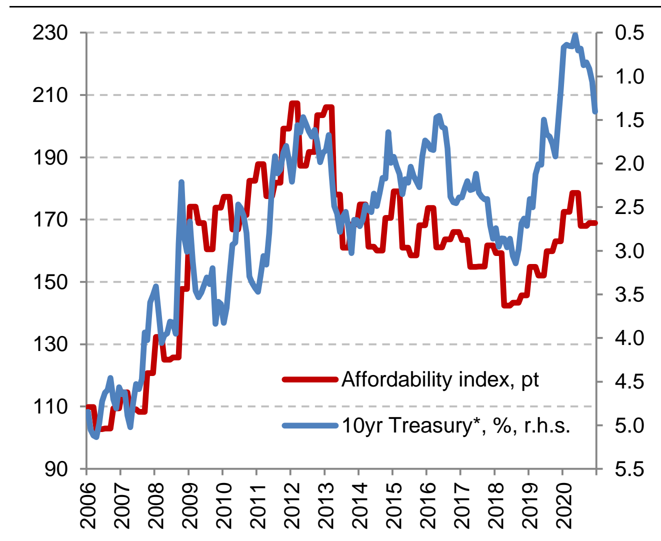
Source: Bloomberg

Chart 16. Loan Growth. Mrtg vs Total Loans, YoY, %



Source: Bloomberg

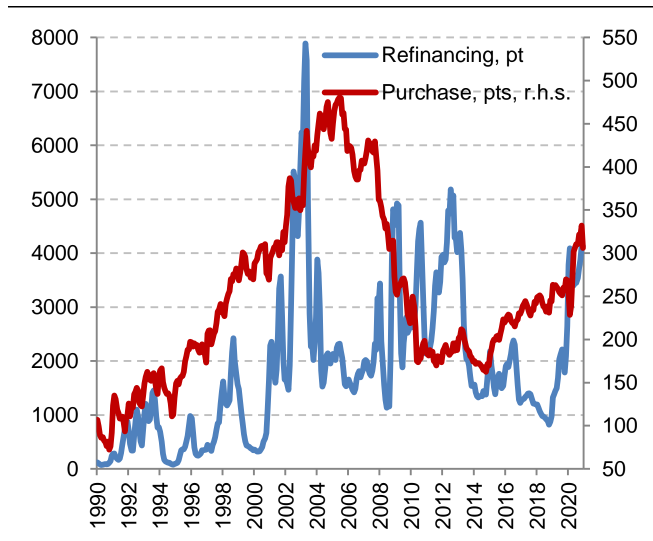
Chart 17. Mortgage. Aff. Index vs 10yr Treasury yield



*reversed order

Source: Bloomberg

Chart 18. Mortgage. MBA Applications Indexes



Source: Bloomberg

Lending standards for most mortgage segments were unchanged in 4Q20, after tightening during three consecutive quarters. As for expectations, a moderate share of banks expects that standards will be eased in 2021. It was unsurprising given much better labor market, an acceleration of an economic growth and a very strong housing market. According to NY Fed 4Q20 report on HH debt and credit, "mortgage originations, measured as appearances of new mortgage balances on consumer credit reports and which include refinances, were at $1.2 trillion, surpassing in nominal terms the volumes seen during the historic refinance boom in 2003Q3". "Median mortgage origination credit scores remained roughly stable at a high level, with the median credit score of newly originated mortgages at 786, reflecting a high share of refinances".

Mortgage demand slightly strengthened again, the 7th consecutive month of strengthening.

But banking answers were mixed. Large banks noted that it was unchanged while small banks reported strengthening demand across most RRE loan categories. Loan demand expectations on 2021 year also were mixed. Banks expect weaker demand for GSE-eligible mortgage loans but unchanged demand for nonconforming jumbo residential mortgage loans. As well as for other loan categories, it is expected by a moderate share of banks that loan performance will deteriorate in RRE and HELOCs segments.

Mortgage rates are still weak despite to key benchmark rates remained relatively flat in April-September of 2020 and treasury yields have already increased significantly from lows, showed in last August. Monthly average rate of 30yr fixed mortgage increased slightly after 9 months in a row of decline due to narrowing spreads because of a normalizing economic situation. In turn, 10yr treasury skyrocketed by 34 bps to 1.45% MoM as of the end of February (one year high). 30yr fixed rate mortgage (national average, Bankrate.com) increased by 37 bps MoM to 3.25% as of the end of February (still not very far from its all-time low). In turn, 30-yr mortgage rate (effective rate, MBA) increased by 21 bps MTD to 3.22% (as of February 22, 2021), not far from its all-time low and 78 bps below the end of 2019 level.

Housing market indicators published in February were strong again but mostly in-line with expectations after several consecutive months of the strong beat. Due to a significant drop in interest rates in 1H20 and a faster than expected economic recovery, the majority of housing indicators still look pretty resilient. NAHB index increased by 1 pts MoM to 84 pts in February, slightly beating consensus of 83 pts, pointing to higher optimism of homebuilders. Also, construction spending increased by 1% MoM in December, slightly beating consensus of +0.9% MoM, and November initial estimate was revised up from 0.9% MoM to 1.1% MoM. So, mortgage origination forecasts remain very strong with a growth of MBA's projections for 2021 on MoM basis, but flat for 2022 and 2023 years. In turn, Fannie Mae's forecasts increased for 2021 but decreased for 2022. Thus, according to Fannie Mae's February housing forecast, total 2020 mortgage originations increased by 1.5% MoM for 2020 year and +3.8% MoM for 2021 year, but -1.3% MoM for 2022 year (+117%/+106% for 2020/21 years vs January 2020 forecasts). Currently, it is expected that total originations will decrease by 8% yoy in 2021 and by 22% yoy in 2022. The key drivers of total originations decline will be refinancing originations which were the key driver of their skyrocketing growth in 2020. According to MBA's forecast published in February, total mortgage originations will decrease by 19.9% yoy in 2021 (+8.8% vs January 2021 forecast) driven by refinancing which are estimated to decrease by 39% yoy in 2021. Total originations are also expected to decrease by 25.6% yoy in 2022 (flat vs January forecast). The key driver of refinancing originations remains a significant decline of mortgage rates. However, the latter have started to grow recently, following a significant growth of 10yr treasuries yield. Total mortgage debt outstanding is expected to go up by 5.6% yoy in 2021 and by 5.7% yoy in 2022.

Housing starts were 1580K in January vs expectations of 1660K, -89K MoM December estimate, remaining near pre-COVID levels but much higher than an average level of 2015-2019 years. In turn, building permits beat estimates significantly, 1881K vs a consensus of 1680K. Existing home sales increased slightly in January to 6.69 mln but from revised down initial December estimate (from 6.76 mln to 6.65 mln). But it was markedly higher than consensus of 6.6% mln and it is still significantly higher than pre-COVID levels, being at the highest level since the end of 2006. In turn, new home sales increased by 38K MoM to 923K in January, markedly beating consensus of 856K, after a small growth in December following two consecutive months of decline. However, December initial estimate was revised up meaningfully. New home sales have already surpassed pre-pandemic levels by 149K and it is currently at mid-2007 levels. So, housing prices skyrocketed in recent months as a result of demand growth. Thus, FHFA house price index increased by 1.1%

MoM in December vs consensus of +1.0% MoM and November figure of 1.0% MoM. S&P CoreLogic home price index for 20 cities also increased meaningfully, adding 1.25% MoM in December, in-line with consensus but slightly lower November growth of +1.45 MoM. On yoy basis, it was +10.1% vs consensus of 9.9%, the highest loan growth since early 2014.

Consumer

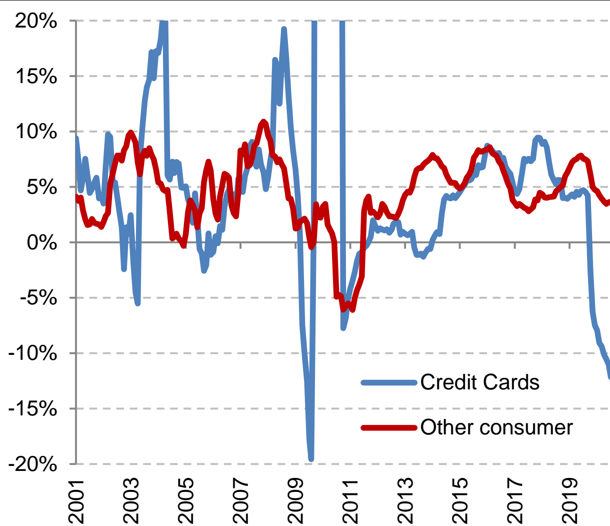
A consumer loans growth decelerated significantly in April and May of 2020 but stabilized later in summer months and it was relatively flat till early December. Since then, it began to decrease again. According to Fed H8 data, a growth rate of consumer loans even turned negative in early May 2020 and it is currently -4.9% yoy (through February 10, 2021) vs +5.9% one year ago, the lowest growth rate since the end of 2011. On ytd basis, it declined by 0.8%, driven by credit cards. Thus, CC growth rate was -12.5% yoy (as of February 10, 2021) vs +4.9% yoy as of the end of 2019. On ytd basis, CC loans decreased by 0.9% as credit cards limits remained cut as a result of a rapid deterioration of the US economy in 1H20. Net change of consumer credit in December was +$9.7 Bn, markedly missing consensus of +$12 Bn, after a growth by $13.9 Bn in November (markedly revised down from initial estimate). Other segments of consumer credit also decelerated significantly, adding just 3.7% yoy (as of February 10, 2021) vs 7.6% yoy at the end of 2019, +0.5% ytd. According to 4Q20 HH debt and credit survey by NY Fed, “aggregate household debt balances increased by $206 billion in the fourth quarter of 2020, a 1.4% rise from 2020Q3, and now stand at $14.56 trillion. Balances are $414 billion higher than at the end of 2019. Balances on home equity lines of credit (HELOC) saw a $13 billion decline, the 16th consecutive decrease since 2016Q4, bringing the outstanding balance to $349 billion. Credit card balances increased in the fourth quarter, by $12 billion, a modest seasonal increase following the sharp $76 billion contraction in the second quarter and $10 billion decrease in the third. Credit card balances are $108 billion lower than they had been at the end of 2019, the largest yearly decline seen since the series begins in 1999, consistent with continued weakness in consumer spending as well as paydowns by card holders. Auto loan balances increased by $14 billion in the fourth quarter. Student loan balances increased by $9 billion. In total, non-housing balances increased by $37 billion, but remain $31 billion below the 2019Q4 levels”.

Despite to an unprecedented drop of the US GDP in 2Q20 and an explosive growth of unemployment, the state of the US consumer was pretty resilient so far due to massive government support programs. And, as it is widely expected, a new fiscal stimulus will be adopted in the coming months. So, the US Consumer will remain strong even despite still elevated unemployment rate. Unsurprisingly, GDP growth estimates continue to go up as a result of the start of vaccination campaign and upcoming stimulus. According to Bloomberg compiled estimates in February 2021, it is expected that the US GDP will increase by 4.9% yoy in 2021, by 3.7% yoy in 2022 and +2.4% yoy in 2023 (vs January estimates of +4.1%/+3.5%/- yoy, respectively). As of unemployment, it is estimated to be as high as 5.8% at the end of 2021, while it was as high as 13% at the end of 2Q20. But it is quite possible that we will see a deterioration of asset quality in consumer segment after the fiscal cliff and the end of forbearance programs. But it is obvious for us that the worst is over and that a potential size of problems loans will be much smaller than feared in the middle of 2020. Banks have already begun to release reserves in the consumer segment. Of course, low income/wage consumers will suffer the most, but DSR and FOR of a median HH still remain markedly lower than their historical averages. So, we still don’t expect that the highs of NCO ratios of the current cycle will come any closer to the highs of the GFC (the highs of the previous crisis equal to NCO ratio for credit cards of 10.5% and for other consumer loans of 3.3%).

According to the Fed data, total consumer NCO ratio tumbled by 33 bps qoq, or -82 bps

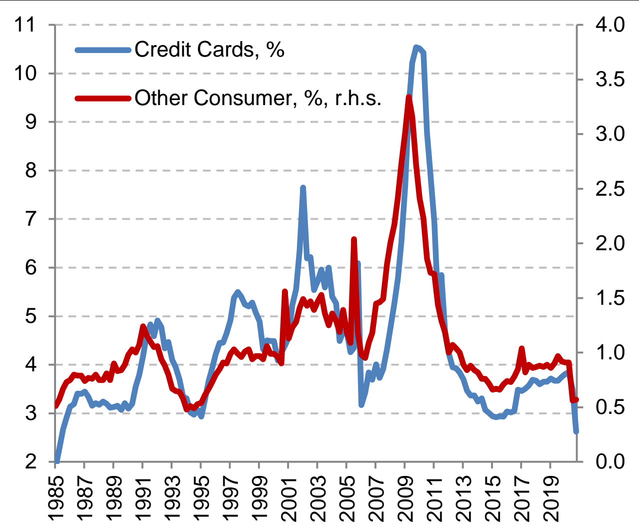
yoy, to 1.49% in 4Q20. NCO ratio in CC segment decreased by 87 bps qoq, or -113 bps yoy, to 2.62% while NCO ratio of other consumer loans increased by 1 bps qoq, but -35 bps yoy, to 0.57%. In turn, delinquency ratio increased by 12 bps yoy to 1.96% (but it is still -40 bps yoy). Both credit cards delinquency ratio and other consumer one increased by 10 bps qoq to 2.12% and 1.76%, respectively. According to the FDIC, credit cards NCO ratio tumbled by 85 bps qoq to 2.56% in 4Q20 (-119 bps yoy); in other consumer loans NCO ratio increased by 6 bps qoq, but -50 bps yoy, to 0.61%; Auto NCO ratio also went up by 16 bps qoq, but -56 bps yoy, to 0.48%. 30-89 delinquency ratios (a leading indicator of credit quality deterioration) increased by 20 bps qoq to 1.71% in 4Q20 but remains much lower on yoy basis (-44 bps): 1.1% (-28 bps yoy) in credit cards, 1.33% (-35 bps yoy) in other consumer loans and 1.74% (-62 bps yoy) in Auto. A number of bankruptcy filings decreased meaningfully again in 4Q20, 121K vs 132K in 3Q20 and 189K in 1Q20, a new historical low. According to NY Fed, “of the $462 billion of debt that is delinquent, $349 billion is seriously delinquent (at least 90 days late or “severely derogatory”, which includes some debts that have been removed from lenders’ books but upon which they continue to attempt collection)”.

Chart 19. Consumer. Loan Growth Rates, YoY, %



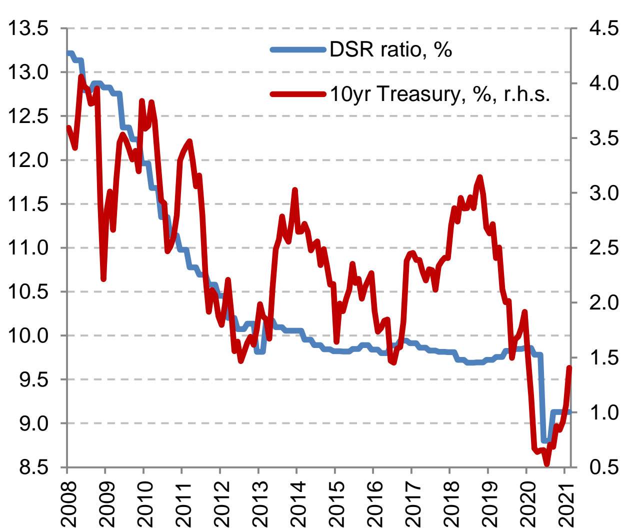
Source: Bloomberg

Chart 20. Consumer. NCOs Ratios, %



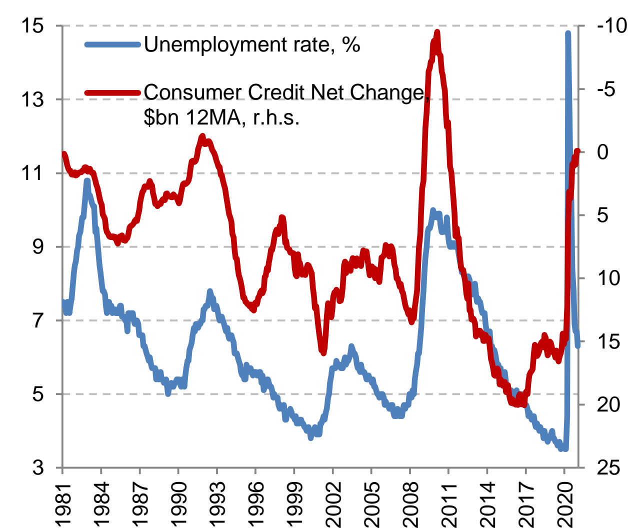
Source: Bloomberg

Chart 21. Debt Service Ratio vs 10yr Treasury Yield, %



Source: Bloomberg

Chart 22. Unemployment vs Net Change of Cons Credit



Source: Bloomberg

January 2020 SLOOS survey indicated that “a moderate net share of banks reported easing standards for credit card loans, and modest net shares of banks eased standards for auto loans and for other consumer loans. Consistent with easier lending standards, modest net shares of banks increased credit limits for credit card accounts, and moderate and modest net shares of banks narrowed the rate spreads charged on outstanding balances over their cost of funds for auto loans and for other consumer loans, respectively”. As for demand, banks reported stronger demand for credit card and other consumer loans but weaker demand for auto loans. Banks expect that demand for consumer loans will strengthen in 2021. Also, a significant net share of banks expect to ease standards for credit card in 2021 and a moderate net share of banks expect to ease standards for other types of consumer loans. According to NY Fed, “the median credit score on newly originated auto loans increased, from 712 to 717”.

Consumer activity data published in February 2021 were mixed with still relatively weak employment figures but very strong retail sales and ongoing optimism on housing market. From the other hand, key confidence indicators moved in opposite directions in February. We expect that consumer confidence will begin to improve steadily in coming months as a result of a successful vaccination campaign and gradual lifting of restrictions. Moreover, upcoming fiscal stimulus will further impact positively on consumer confidence. Conference board index increased by 2.4 pts MoM to 91.3 pts but it is still just 5.8 pts higher than its local low reached in April 2020. It was again slightly above consensus of 90 pts. The key driver of the growth was present situation index which increased by 6.5 pts to 92 pts in February from revised up January estimate. Expectations index ticked down by 0.4 pts to 90.8 pts after a marked growth in the previous month. From the other hand, consumer sentiment indicator published by Michigan University decreased by 2.8 pts MoM to 76.2 pts vs expectations of 80.9 pts. And it is just 4.4 pts higher than its April 2020 low and it is more than 20 bps lower than pre-COVID levels. Notwithstanding, despite to a 2Q20 consumer spending decline was the biggest on record, consumption forecasts continue improving. According to February Bloomberg survey, consumer spending will increase by 5.2% yoy in 2021, by 4.1% yoy in 2022 and by 2.5% in 2023 vs January estimates of +5.0%/+3.7%/- yoy, respectively.

All data which are related to employment published in summer and autumn of 2020 were clearly optimistic and much better than anticipated. But figures of the last two months demonstrated clear signs of slowdown. At least, jobless claims even increased slightly while payrolls were weaker than expected for the third month in a row. Thus, January employment report showed that nonfarm payrolls increased only by 49K vs expectations of +105K after a decline by 227K in December. Also, private payrolls increased only by 6K, markedly missing a consensus estimate of +163K. But the situation will start to improve in the near future due to new fiscal stimulus and a gradual removal of restrictions due to the vaccination which, however, is going not as fast as expected. Unemployment ratio decreased by 40 bps MoM in January to 6.3%, markedly lower than consensus of 6.7%. Average hourly earnings increased by 0.2% MoM in January vs expectations of +0.3% MoM and +0.7% MoM in December. From the other hand, underemployment ratio was 11.1% in January, -0.6 bps MoM and it is already significantly lower than the high of the Great Recession of 17.2% but still much higher than 6.7% at the end of 2019. In any case, more than 4.5 mln workers are still filling continuing jobless claims which is not far from the peak level of the GFC. Continuing claims remain very important indicator to track the employment situation. Moreover, employment population ratio is still near levels last seen 50 years ago. On a year-over-year basis, hourly earnings were +5.4% vs consensus of +5.0% yoy. Average weekly hours were down by 0.3 hour MoM to 35, slightly higher than expected. Notwithstanding, initial jobless claims decreased by 4% MoM in February, after two consecutive months of growth, and initial jobless claims over recent 4 weeks still exceeded pre-COVID levels about four times. Financial health of an average US consumer

remains strong, but further rate of employment growth will inevitably decelerate in coming quarters. Moreover, lower income households continue to suffer more than an average income household.

Interest Rates

The minutes of the Fed January meeting, which were published in February, confirmed that the Fed is not going to rush to tighten the monetary policy, even despite to the inflation will probably exceed the target in the nearest future. At its January meeting, the FOMC slightly changed wording of the statement but key guidelines were unchanged. It was recognized that an economic recovery moderated in recent months and that the weakness concentrated in the most affected sectors, e.g. leisure and hospitality. Undoubtedly, the key uncertainty factors are the course of the virus and the progress on vaccination. It was also removed the indication of time period in the sentence about risks. Thus, "the ongoing public health crisis continues to weigh on economic activity, employment, and inflation, and poses considerable risks to the economic outlook". So, risks remain but it is the near term risks, not medium term risks. Moreover, it was noted during the press conference that the vaccination could help the US economy to accelerate in 2H21. Despite to a more optimistic tone about future stance of the economy, it was emphasized that the economy is far from its full recovery. And it was one of the key arguments in the minutes why the possible acceleration of inflation isn't a threat to financial stability. But it was also acknowledged that obtaining herd immunity is a relatively slow process. So, financial conditions will remain accommodative and it is premature to talk about tapering in the near future. Thus, "the Federal Reserve will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals". Rates remained unchanged and it was unanimous decision. Also, the Fed reaffirmed its longer-run goals and monetary strategy. Given a more optimistic market view on the GDP growth and commentaries about tapering and inflation, the meeting was perceived as hawkish one with the key takeaway that tapering will be sooner than expected even though the Fed remains as flexible as it can under current conditions. We don't expect that monetary policy will change significantly in the nearest 2-3 quarters but it is quite possible that there will be hints of upcoming tapering in 4Q21. So, we expect that the growth of the long end will continue. On the other hand, FF rate will remain at current level for longer but the first hike is closer for us that it was expected a few months ago.

Despite to high-frequency data showed some weakness in recent months, hard and soft data remained markedly better than it was expected a few quarters ago. So, 2020 projections were improved meaningfully at December meeting as it was done at September one (and it is quite possible that projections will improve meaningfully at March meeting as well). The Fed continues to emphasize that the outlook for the economy remained highly uncertain and it would depend in a large part on the success in keeping the virus in check even despite the recovery was better than the Fed expected. Spending in some service sectors is still quite weak. Notwithstanding, according to December FOMC projections, GDP will decline only by 2.4% in 2020 but it will increase by 4.2% yoy in 2021, by 3.2% yoy in 2022 and by 2.4% in 2023 (vs -3.7%/+4.0%/+3.0%/2.5% in September projections). However, longer run GDP growth was decreased by 10 bps to 1.8%. As of unemployment ratios, it is implied that it will be 6.7% at the end of 2020, 5.0% at the end of 2021, 4.2% at the end of 2022 and 3.7% at the end of 2023 (vs September projections of 7.6%/5.5%/4.6%/4.0%, respectively). Longer run unemployment ratio was unchanged at 4.1%. PCE inflation forecasts revised slightly up and it is implied that inflation will be 1.2% in 2020 and it will rebound to 1.8%, 1.9% and 2.0% in 2021, 2022 and 2023, respectively (vs 1.2%/1.7%/1.8%/2.0% in September). Overall, FOMC projections are relatively close to

consensus forecasts which were slightly improved MoM in January although recent macro data weren't strong. According to Bloomberg February survey, the GDP growth will be equal to +4.9%/+3.7%/+2.5% yoy in 2021/2022/2023 years, respectively, vs +4.1%/+3.5%/- yoy in January. Unemployment forecasts decreased from 6.0%/5.0%/- in 2021/2022/2023 years, respectively, in January to 5.8%/4.6%/4.2% in February.

For us, there is still no doubt that challenging rate environment for US banks will persist for a relatively long period of time but the outlook has improved markedly in recent months. So, we believe that the worst is behind us. Notwithstanding, uncertainty is still very high but declining gradually due to the start of the vaccination campaign. Also, new fiscal measures will be announced in coming months and it will help the US economy to accelerate in 2H21. The Fed overcome the liquidity crisis by massive injections but it doesn't mean that saved companies will operate as usual given a substantial growth of leverage for many of them during recent months which had been quite high before. So, we still expect a wave of bankruptcies in the corporate sector in 2H21-1H22, but it shouldn't be a threat to the financial stability. Thus, prospects of US banks have improved recently due to a faster than feared economic recovery and the growth of the long end. Despite to the majority of earning assets are priced based on the short end, some NIM/NII forecast has already begun to improve. Thus, median NIM 2021 of BKX index members decreased by 0.7 bps MoM and -2.4 bps ytd to 2.53%. Median NIM 2022 increased by 0.3 bps MoM but -1.1 bps to 2.56%, +11 bps from the low which was demonstrated 5 months ago.

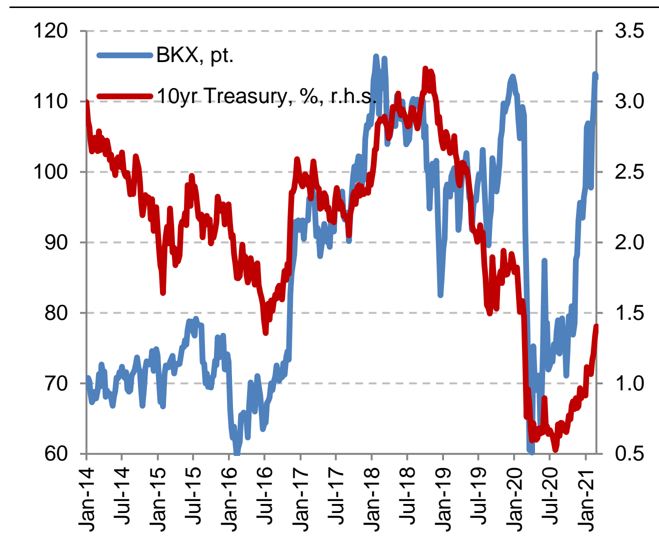
Median NII decline of BKX index members was -1.8% yoy, but +1.5% qoq, in 4Q20 vs -1.9% both qoq and yoy in 3Q20, the 5th consecutive quarter of yoy decline of NII in a row. The key driver of weak NII dynamics was again a decline of NIM which was driven by both a meaningful decline of key average benchmark rates and investing strong deposit inflows into highly liquid assets. Given a recent growth of the long end and the fact that banks began investing high liquid assets into higher yield assets, it seems that NIM has already reached the trough while NII will gradually grow in coming quarters. At least, median NII surprise of BKX index members was +1.4% (vs estimates for January 14, 2021), after -0.6% in 3Q20 and -0.4% in 2Q20. 15 out of 24 BKX members showed a positive surprise on NII in 4Q20 vs 9 in 3Q20 and 11 in 2Q20. On the other hand, 11 out of 24 BKX members showed a positive surprise on NIM in 4Q20 with a median negative surprise of -0.3 bps vs 3 banks in 3Q20 with a median surprise of -4.2 bps and 5 in 2Q20 with a median surprise of -9 bps. Median NIM of BKX index members decreased by 8 bps qoq, or -47 bps yoy, to just 2.52% in 4Q20 (the lowest figure over decades, -33 bps vs the lowest figure of the last cycle, shown in 3Q16) vs -6 bps qoq, or -44 bps yoy, in 3Q20. On yoy basis, it was the 7th consecutive quarter of a median NIM decline after 9 quarters of growth in a row.

Median growth of NII income of BKX index members was positive on qoq basis for the first time after two quarters in a row of decline. Moreover, it was negative for 6 quarters over last 8. Total NII of BKX index members is 7% below than it was one year ago. Notwithstanding, we believe that the worst for NII is behind us even despite to NIM will remain relatively weak in 2021. On the other hand, NII/NIM prospects improved markedly in the recent months due to a growth of the long end and an expected acceleration of the US economy as a result of new fiscal stimulus. There is no room to improve NIM by lowering deposit costs which are near zero at the moment. In turn, a loan-to-deposit ratio was already below 60%, the record low and it could be a good driver of NIM in case of loan growth acceleration, which however is still weak. Also, banks could invest excess liquidity into higher yield assets. It will negatively impact on NIM but NII will increase.

The short end of the curve remained relatively flat in February as it did in four previous months while the long end skyrocketed, the second consecutive month of a meaningful growth. Thus, 1M yield decreased by 3 bps to 0.015% while 3M yield went down by 1.5 bps

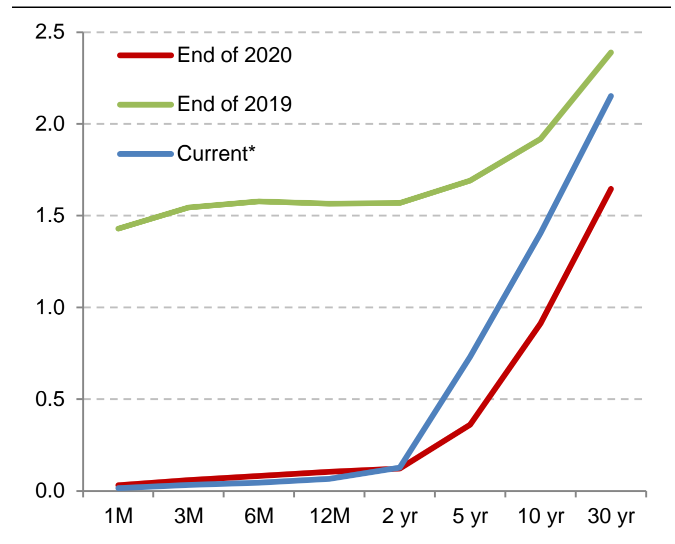
MoM to 0.03%. 2yr yield increased by 1.8 bps MoM to 0.13% while 5yr yield increased by 31.2 bps MoM to 0.71%, one year high. 10yr yield skyrocketed by 33.9 bps MoM to 1.4% (it is still -52 bps relative the end of 2019, but +81 bps comparing to April 2020 low). Generic 30yr yield went up by 32.2 bps MoM to 2.15%. We didn't expect a significant growth of the yield curve until recently, at least for the short end. But the situation has changed rapidly in the recent months. We still don't expect any growth of the FF rate in the nearest years but it seems that most part of the yield curve could be meaningfully higher. According to current forwards, the yield curve in 2 years will be higher than the current one by 50-90 bps even despite to a substantial growth of the long end. It is expected that only 30yr yield will be 6 bps lower in 2 years.

Chart 23. BKX Index vs 10yr Treasury Yield



Source: Bloomberg

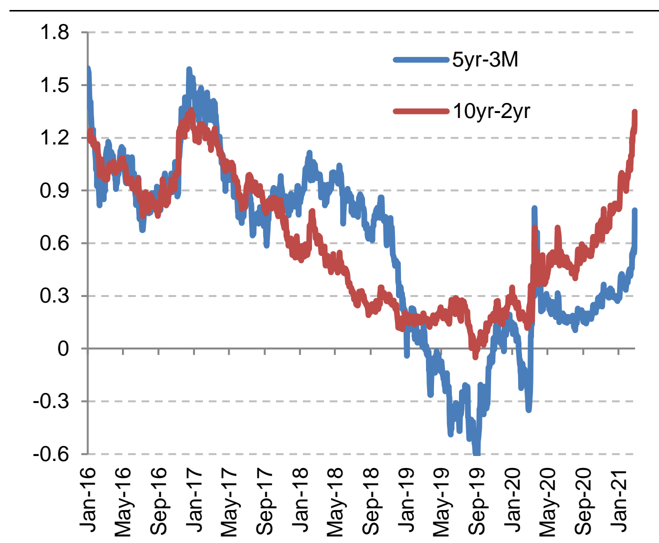
Chart 24. US Yield Curves, %



*as of the end of February 2021

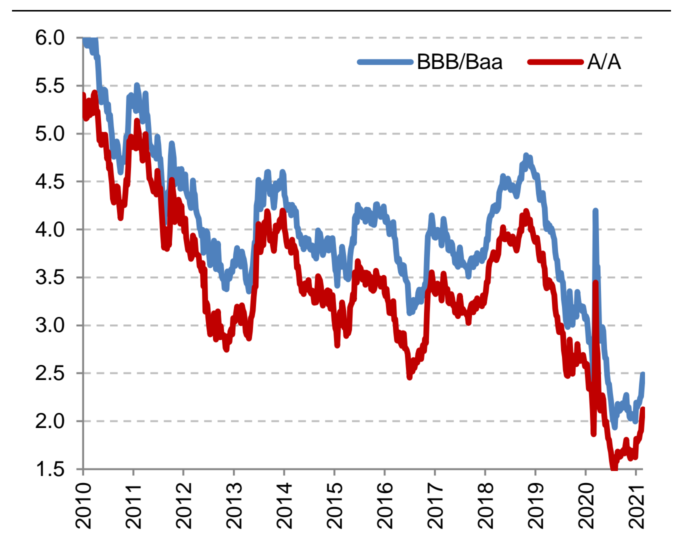
Source: Bloomberg

Chart 25. Treasury Spreads, %



Source: Bloomberg

Chart 26. Corporate Spreads, %



Source: Bloomberg

So, spreads moved up substantially in February, the second consecutive month of growth. Spreads were markedly higher vs the end of 2019, but 5yr/3M is still markedly lower than average levels of 2017 year, while 10yr/2yr is already markedly higher. Thus, 5yr/3M spread increased by 32.7 bps to +0.7% and it is still 27 bps lower than an average level of 2017 year while 10yr-2yr spread is 34.3 bps higher (as of the end of February). Spread (10yr-2yr) increased by 32.2 bps MoM to +1.28%.

According to Bankrate.com data, loan yields stopped going down in February. Notwithstanding, a decline of rates was minor. Thus, average 30yr mortgage rate increased by 37 bps MoM to 3.25% at the end of February, after 10 consecutive months of decline. An average rate increased by 7 bps MoM to 2.95% but it is now just where it was 4 months ago. Notwithstanding, a decline of 30yr mortgage yield relative to the end of 2019 level is already bigger than a decline of 10yr treasury yield. But it seems that mortgage rates have already reached the bottom of the cycle. Average 15yr mortgage rate increased by 18 bps MoM, to 2.53%, after three consecutive months of decline. Auto loans rate (new loans, 60 mnth) went down by 1 bps MoM to 4.21%, the 7th consecutive month of decline.

Despite to a growth of the long end, deposit rates continued to decline in February on an average basis but the rate of decline decelerated. So, it was the 17th month in a row of average rates decline (or being flat). Even checking accounts cost decreased again after three month in a row of growth. Notwithstanding, we think that deposit costs will be no more any significant mitigation factor for NIM until FF rate cut again (near zero probability in coming quarters). Thus, national average cost of 6 month deposits increased by 1 bps MoM to 0.21%; average 3yr CDs cost declined by 3 bps to 0.42%; average 5yr CDs cost went down by 6 bps MoM to 0.46% while cost of interest checking accounts decreased by 2 bps MoM to 0.4% (but still +20 bps over last six months. Average cost of money market accounts decreased by 3 bps MoM to 0.09%.

Europe

Corporate

A corporate loan growth markedly accelerated in the spring 2020, driven by emergency liquidity needs. But it seems that so high growth is unsustainable given a deep recession in 1H20, a deceleration of economic recovery in recent months (the second technical recession in 4Q20-1Q21), still relatively strict restrictions even despite the start of the vaccination campaign and tightening of lending standards. Notwithstanding, corporate loans increased by 0.1% MoM in January 2021 after a decline by 0.7% MoM in December, being -0.3% lower comparing to the end of May 2020. On yoy basis, the growth rate remains relatively flat over last 10 months, hovering around 5.4%. But the growth rates remain very different for different loan periods. Thus, loans up to 1 year increased by 0.1% MoM, but -8% yoy, in January, the weakest growth rate on yoy basis since 2H10. In turn, loans 1-5 yrs accelerated to 14.7% yoy from +3.4% yoy in February 2020, -0.5% MoM. Loans over 5 yrs were +7% yoy in January vs +2.4% yoy one year ago, +0.4% MoM. Total corporate loans increased by +5.3% yoy vs +1.7% yoy one year ago. Credit growth in the European countries still varies markedly across countries. So, we still see very healthy growth rates in Germany and France (and other Northern countries) on yoy basis while Italian corporate loans growth turned positive on yoy basis only in June 2020 after it was negative for 8 consecutive years. From the other hand, Spanish and Italian growth were weak in two recent months while French loan growth was strong after the reverse pattern was observed in August and September.

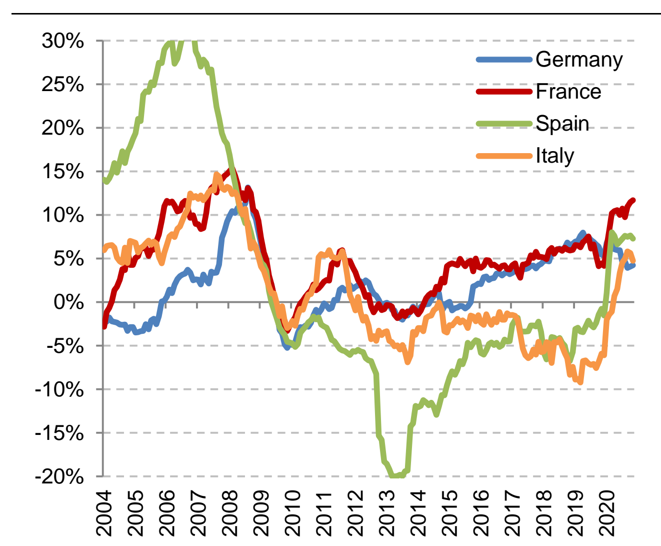
European corporations benefited from low interest rate environment so far but this will be little consolation in a recession time given an imminent decline of revenues. At the end of last year, there was hope for a stabilization of the macroeconomic situation, but the coronavirus spreading intensification disrupted these hopes. In November 2020 ECB's Financial Stability Review it was noted that the coronavirus pandemic remained the predominant force shaping both the current economic and financial environment and the future prospects for euro area financial stability. So, the primary focus of policymakers is efforts to mitigate the economic damage to corporates and households from the pandemic. "While the signs of recovery in economic activity over the summer and recent progress on vaccines give cause for some optimism, governments continue their efforts to contain the spread of the virus. So there is a long road ahead, and authorities will have to make difficult decisions on whether and how to extend policy measures and, eventually, deal with the debt they create". The second wave of the pandemic will inevitably lead to lower corporate profits and higher default rates given the fact that financial health of the EU corporate sector has not yet recovered from the spring lockdowns. Notwithstanding, asset quality of corporate portfolio remains relatively strong so far, not least because of government support programs. Banks are adequately reserved at the moment but we expect a further deterioration of the asset quality, especially among small and mid-sized companies, which "are more exposed than larger firms to tightening credit conditions once loan guarantees expire". At least, recent data showed that the EU economy lost momentum and it is expected to decline again in 4Q20 and 1Q21 on qoq basis, the second technical recession over 5 quarters. Despite to a slight growth of composite PMI index in February, it still remained below 50 pts ignoring the start of vaccination campaign and relatively strong manufacturing activity. Unsurprisingly, the key driver of weaker activity is a services sector. Given remaining restrictions in many European countries, it is quite probable that the majority of economic indicators will remain weak near term. Unsurprisingly, risks to euro area growth outlook remain on the downside but outlook has improved due to an acceleration of the world economic growth.

According to January 2020 Euro Area bank lending survey, demand for corporate loans declined again in 4Q20, for the second consecutive month after it surged in 1H20 as a

result of emergency liquidity needs. In 2Q20, demand reached the highest net balance since the survey was launched in 2003. Banks also noted that a negative impact on loan demand had lower demand for fixed investments while demand for inventories and working capital had positive contribution but it is lower than it was in 1H20. But banks expect a net increase in firms' loan demand in 1Q21. Credit standards for corporate loans tightened in 4Q20 and it was broad-based tightening across all major sectors in 2H20. The most suffered sectors are CRE, wholesale and retail trade. Notwithstanding, "while the tightening was above the historical average (8%), it remained below the peaks observed during the great financial crisis and the sovereign debt crisis (average tightening of 52% from the fourth quarter of 2007 to the first quarter of 2009; peak of 30% in the fourth quarter of 2011). The smaller net tightening over the course of the pandemic compared to previous crises is likely related to supportive monetary and fiscal policy actions". Risk perception remains the key driver of tighter standards. Banks expect further net tightening of standards in 1Q21 as a result of "the continued uncertainties around the further development of the pandemic and its effects on borrowers' credit risk".

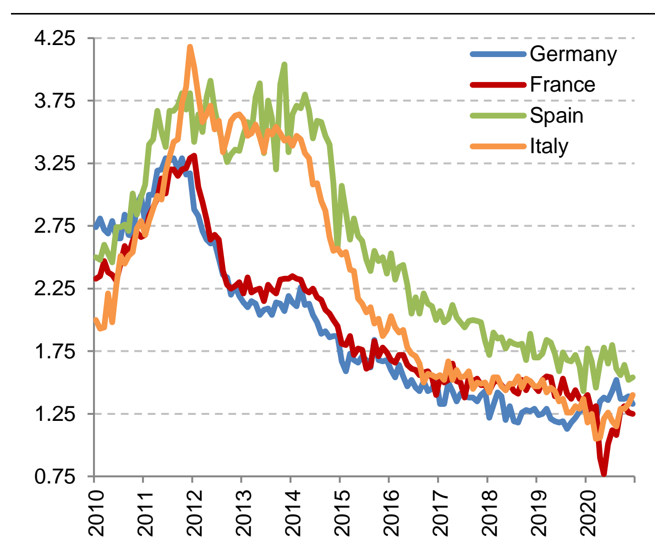
Unadjusted EoP corporate loans increased by 5.3% yoy at the end of January, the 40th consecutive month of positive growth on yoy basis. In turn, adjusted for sales and securitizations loans increased by 6.2% yoy, the 66th consecutive month of positive yoy growth. It remained near the highest rate of growth since the beginning of 2009. Notwithstanding, it should continue weakening in coming months given the depth of the recession, a normalization of the situation with liquidity and the second technical recession. We don't exclude that it will be negative in several quarters given the high base of April-May of 2020. Accompanied by challenging rate environment for a long period of time, it will have double negative effect on NII and profit.

Chart 27. EU Corporate Loan Growth, YoY



Source: Bloomberg

Chart 28. EU Corporate Loan Rates, New Loans, %



Source: Bloomberg

German outstanding corporate loans (unadjusted figures) increased by 4.2% yoy at the end of January, or +0.3% MoM, vs +6.4% yoy at the end of 2019. French corporate loans outstanding (unadjusted figures) added 11.7% yoy, or +0.2% MoM, at the end of January vs +4.4% yoy one year ago, the 4th month in a row of growth after two consecutive months of decline following five months in a row of MoM growth above 1%. Due to a significant MoM growth in the spring months, a Spanish loan growth is much higher now than it was one year ago and it even accelerated in the Autumn after negative dynamics in every of the summer months. Thus, Spanish outstanding corporate loans added 7.3% yoy, but -0.6% MoM, vs -0.8% one year ago, the second consecutive month of decline on monthly basis. Italian loan growth turned positive in June after being negative on yoy basis for more than 8

years. Thus, it added +4.7% yoy, but -0.3% MoM in January 2021 vs -5.9% yoy in January 2020.

European corporate rates increased meaningfully from their spring lows due to spreads widening while benchmark rates dynamics remained weak. It moved back in November but it remains positive on yoy basis during four months in a row after 18 consecutive months of decline. Thus, average EU corporate loan rates (all maturities, new business lending, adjusted for loan sales) was flat MoM at 1.43% in December, but it remained +2 bps on yoy basis. From the other hand, back book yields of EU banks continuously decreased on yoy basis since April 2014 and a rate of decline went up in 2Q20 after being relatively flat over the previous year. It declined by 17 bps yoy, or -2 bps MoM, to 1.7% in December.

Dynamics of rates within European countries was divergent in December with a decline in Germany and France, but a significant growth in Italy and Netherlands. Thus, Spanish yield went up by 2 bps MoM to 1.54%, after it tumbled by 12 bps MoM in November. Notwithstanding, it was +11 bps yoy vs just +2 bps in Eurozone. Italian one increased by 7 bps MoM to 1.4%, the second consecutive month of growth after being flat in October following a significant growth in September (+25 bps from August). But it was just +3 bps on yoy basis. German corporate rate on new loans decreased by 6 bps MoM to 1.33% in December, after a growth of +2 bps MoM in November. So, it was +4 bps yoy even despite to relatively weak dynamics in three recent months. French yield on new corporate loans went down by 1 bps MoM to 1.25%, the second consecutive month of decline. And it was -11 bps yoy, the only country with negative dynamics among major European countries. In turn, Dutch yield skyrocketed by 25 bps MoM to 1.78%, following a significant decline in November. So, it was +14 bps yoy. But Dutch corporate yield remains very volatile.

EU back book yield declined by 2 bps MoM, or -17 bps yoy, to 1.7%. The yield declined in all major European countries except for Netherlands. Thus, German yield declined by 2 bps MoM to 1.76% in December, still -13 bps yoy. French yield declined by 1 bps MoM to 1.41%, -26 bps yoy. Italian yield decreased by 2 bps MoM, or -21 bps yoy, to 1.79%. Spanish yield went down by 3 bps MoM to 1.7% and it is just 7 bps lower on yoy basis, the lowest rate of decline among major European countries along with Dutch one. Dutch yield increased by 3 bps MoM to 1.93%, -7 bps yoy. So, spread between new and outstanding rates declined again in December after a small widening in November. It declined by 2 bps MoM to 0.27%, the lowest spread since the middle of 2008.

In spite of negative rates on new corporate deposits, their growth rate remains significant and it has even accelerated in recent months. Thus, EU corporate deposits increased by 19.4% yoy at the end of January driven by overnight deposits and deposits with agreed maturity, where average rate was -0.01% and -0.17% in December, respectively, vs +0.01% and +0.03% one year ago (new business). Notwithstanding, growth rates are very different among major EU countries, varying from +5.7% yoy in Netherlands to +30.7% yoy in Spain.

Consumer

Consumer loans were the main driver of total loans growth in the EU till the beginning of the pandemic. They decreased on MoM basis in March and April of 2020 but the growth resumed then as a result of employment supporting programs and an economic recovery. The growth continues but it remained relatively flat on yoy basis over last 50 quarters despite to all the changes in the economic situation and tightening of the loan standards. The latter was quite predictable action given a rapid deterioration of the EU economy, which should inevitably lead to a significant deterioration of financial health of the EU consumer (not yet visible due to various government support programs). But unemployment rate has already started to grow while consumer confidence declined to the levels unseen from the last crisis. It should also be noted that a sustained growth of property markets

which positively impacted on household wealth during recent years could be replaced by a fall in coming quarters. Notwithstanding, a positive moment is that the indebtedness of euro area households remains relatively low, stabilized near 58% of GDP. Given very low rate environment, household debt burdens are also near multi-year lows and it will remain at these levels or only slightly higher in the nearest years because of prolonged negative rate environment. Currently, household debt interest burden is 40-50% lower for the majority of European countries than it was just before the US mortgage crisis. So, we believe that overall quality of consumer credit portfolio of European banks should be markedly better in the current crisis vs GFC levels even despite to new restrictions because of the second wave of the pandemic and a relatively long road back to normalcy despite to a recent start of the vaccination campaign.

EU loans to households increased by 2.9% yoy, but were flat MoM, in January 2021 after 8 consecutive months of positive MoM growth. A consumer loan growth remained relatively strong so far and we no more expect any significant deceleration of consumer loan growth even despite to tighter lending standards and an imminent growth of unemployment in 2021. But loan growth rates continue to differ widely across countries (as well as for corporate loans). Thus, German household loans increased by 4.6% yoy in January, or +0.1% MoM, French retail lending added 5.3%, or +0.1% MoM, (a marked acceleration vs the first four months of 2020), while household loans in Spain decreased by 1.3% on yoy basis, the 19th month in a row, after a non-negative loan growth rate for 13 months in a row following more than 7 years of a negative yoy growth, and -0.3% MoM, the second consecutive month of decline. Italian consumer loans added just 1.5% yoy in January, but were flat MoM, after it declined in December following three consecutive months of a growth of +0.4% MoM.

Consumer lending (ex. mortgage) remained the key driver of EU household loan in pre-COVID times but it was negative on yoy basis during last 9 months while a growth of mortgage loans continues to accelerate. On MoM basis, consumer credit tumbled by 1.2% MoM, or -3.9% yoy, in January. In turn, EU mortgage loans increased by 4.3% yoy as of the end of January, +0.2% on MoM basis. According to January 2021 bank lending survey from the ECB, loan demand for housing loans increased again in 4Q20, for the second consecutive quarter after a considerable decline in 2Q20. In turn, demand for consumer credit declined in 4Q20 after its growth in 3Q20 but it remained in line with historical averages. The key driver of weaker demand was a reacceleration of the pandemic. Notwithstanding, banks expect that demand for consumer credit will increase in 1Q21 even despite to banks continued to tighten credit standards. Banks also expect that standards will be tightened in 1Q21. In turn, banks expect that demand for mortgage loans will slightly decline in 1Q21.

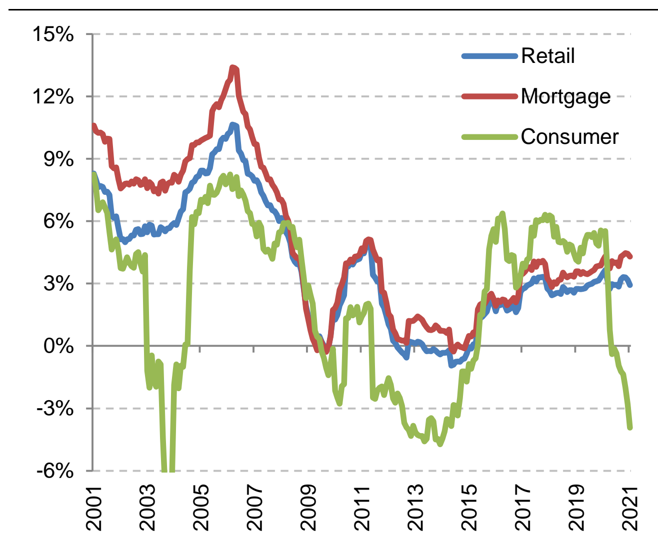
Consumer credit loans remained quite volatile but their decline during the pandemic and recessions looks quite logical given their risky nature. Consumer credit grew by more than 5% yoy in the middle of 2019 but it is already -3.9% yoy. The most significant decline of growth rates was demonstrated by Spain, where consumer loans increased by 13.8% yoy as of the end of April 2019 but it was -4.6% yoy, or -1.5% MoM, at the end of January 2021 and it continues to decelerate.

As of mortgage lending standards, it was tightened in 4Q20 for the fourth quarter in a row. However, “the net tightening was smaller than in previous quarters of 2020 and close to the historical average since 2003”. Risk tolerance and risk perceptions regarding the general economic outlook were among key drivers of tighter standards. On the other hand, risk perceptions related to housing prospects positively impacted on the standards. Notwithstanding, banks expect that standards will be tightened again in 1Q21. “Across the largest euro area countries, credit standards tightened in France, while they remained unchanged in Germany, Spain and Italy. Banks in Spain reported a notable net easing

contribution from cost of funds and balance sheet constraints".

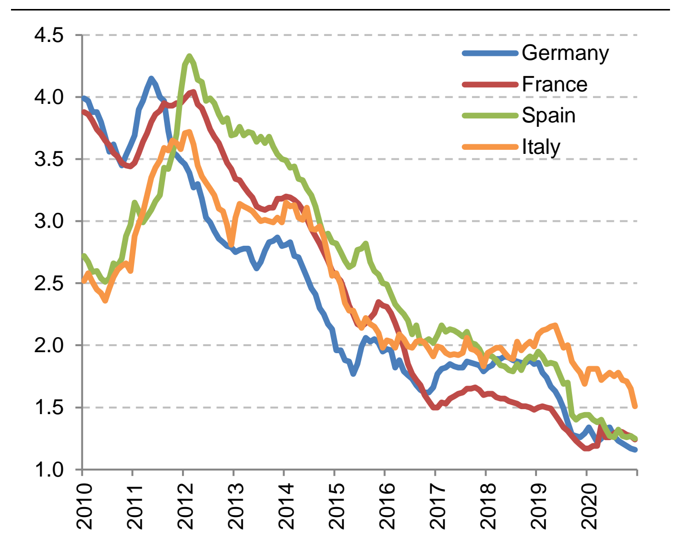
An average EU rate on new mortgage loans decreased by 2 bps MoM basis to 1.34% in December, the fourth consecutive month of decline after flat dynamics in August. So, it is still 8 bps lower than it was one year ago. It was hovering around 1.82-1.83% over 8 months from July 2018 to February 2019 but it declined by more than 40 bps since then because the key benchmark yields for mortgage rates declined markedly ytd, except for the short end which is relatively flat vs the end of 2019. 10yr generic yield skyrocketed by 27 bps MoM to -0.25% as of the end of February 2021 and it is already just -6 bps vs the end of 2019 and +61 bps from its all-time low. 30yr yield went up by 28.9 bps MoM but -14 bps vs the end of 2019 but it was positive again as of the end of February, +0.21%. So, the most of the yield curve still remains deeply below 0% at the moment (but not the entire curve as it was during previous months). In December, German mortgage rates on new loans decreased by 1 bps MoM to 1.16%, -13 bps yoy. In turn, Italian mortgage rate went down by 2 bps MoM to 1.25% and it is still 19 bps lower than it was one year ago. French yield decreased by 3 MoM to 1.24% in December, the fourth consecutive month of decline but it is still +7 bps yoy. Spanish mortgage rate tumbled by 14 bps MoM to 1.51% and it is 18 bps lower than it was one year ago (the fourth consecutive month of MoM decline with an overall downturn of 25 bps). Because of lower front book yields, we continue to see declining back book rates on year-over-year basis, -16 bps yoy for all Eurozone mortgage loans. On month-over-month basis, it decreased by 2 bps to 1.79%, the 10th month of decline in a row after an unexpected growth in February. The rate of decline increased from 4.5 years low of -12 bps yoy which was shown in May-July of 2019 because of a significant drop of benchmark rates. Back book yields went down on MoM basis in all major European economies.

Chart 29. EU Consumer Loan Growth, YoY



Source: Bloomberg

Chart 30. EU Mortgage Loan Rates, New Loans, %



Source: Bloomberg

As for other consumer loans, EU new business rates tumbled by 15 bps MoM, or -22 bps yoy, to 5.22% in December. Notwithstanding, dynamics was almost uniform with a decline in all major European countries, except for Spain. Thus, German yield declined by 14 bps MoM in December after it was flat in October and November, -27 bps yoy to 5.48%. French rate decreased by 12 bps MoM to 3.45%, after being flat in November, just -7 bps yoy. Spanish rate skyrocketed by 50 bps MoM to 6.32%, after four consecutive months of a significant decline. It is -34 bps on yoy basis, the deepest decline among major European countries and it remained the most volatile consumer yield among major European countries. Italian consumer yield decreased by 20 bps MoM in December to 5.96%, and it is -22 bps yoy.

Average European new consumer deposits rate (with agreed maturity) decreased by 3 bps MoM to 0.22% in December after it was flat in November following an unexpected growth in October, when it added 2 bps. Notwithstanding, it is still lower on yoy basis, but it is just 6 bps lower, a much slower rate of decline than a loan yields drop. In turn, cost of outstanding deposits (with agreed maturity) decreased by 1 bps MoM to 1.15% in December after an unexpected growth by 1 bps in November. But it remained relatively flat over last 10 months, being in range of 1.15%-1.19%. Total cost of deposits flat MoM at 0.2% in December, after it declined by 1 bps MoM in November. On yoy basis, it is just 6 bps lower than it was one year ago. So, spread between total loans yield and cost of total deposits decreased by 14 bps yoy or -2 bps to 1.86% in December (new all-time low), after it was flat MoM in November following 9 consecutive months of MoM decline with a total drop of 12 bps.

Consumer deposits growth remains healthy, adding 8.1% yoy in January, a slight acceleration vs +5.3% at the end of January 2020, and the fastest growth since 2H09. The growth rates of consumer deposits are between 7.1-10% yoy for all major European countries despite to increasingly clear threats by banks to start shuffling off the burden of negative rates on to consumers. Loans to deposits ratio was flat MoM but it declined by 6.4% yoy on absolute basis to 94.5% as of the end of January.

Overall Macro

The European economy contracted at a record pace in 1H20 with a double-digit decline on qoq basis in 2Q20 but it recovered then markedly faster than expected in 3Q20. A high level of uncertainty remains and it increased substantially in recent months as a number of new COVID-19 cases in Europe skyrocketed across the majority of EU countries at the end of 2020 while the vaccination campaign started just several weeks ago. So, the majority of restrictions are still in place. According to January introductory statement of the ECB, "the incoming data confirm our previous baseline assessment of a pronounced near-term impact of the pandemic on the economy and a protracted weakness in inflation". But it was more pessimistic view in the minutes of January meeting – "output was likely to have contracted in the fourth quarter of 2020 and the intensification of the pandemic posed some downside risks to output in the first quarter of 2021". So, the start of the vaccination campaign imply better visibility for 2H21 and higher 2022 GDP growth projections, but it will not help to avoid the second technical recession in 4Q20/1Q21 over the last 5 quarters. Notwithstanding, the manufacturing sector continues to be relatively strong while unemployment ratio is still relatively low given the depth of the economic downturn. But risks are still high and tilted to the downside. So, it is still necessary to preserve favourable monetary conditions and impose more fiscal stimulus, especially if the effectiveness of the vaccination is not as high as it is supposed to be.

The European real GDP meaningfully increased in 3Q20 after its record decline in 2Q20. In turn, 3Q20 growth was markedly higher than it was initially expected and it even exceeded the highest estimates. From the other hand, 4Q20 activity was much weaker given restrictions because of the second wave of the pandemic. Thus, the EU GDP decreased by 0.6% qoq, or -5% yoy, in 4Q20 vs 3Q20 growth rate of +12.4% qoq, but -4.3% yoy, and 4Q19 growth rate of +0.1% qoq, or +1.0% yoy. On yoy basis, the EU GDP growth was negative in each quarter of 2020 and it is expected that it will be negative again in 1Q21 German GDP increased by 0.3% qoq, but -3.7% yoy, vs 3Q20 growth rate of +8.5% qoq, but -4% yoy, and 4Q19 growth rate of 0.0% qoq, or 0.4% yoy. French GDP decreased by 1.4% qoq, or -4.9% yoy, in 4Q20 vs a growth of +18.5% qoq, but -3.7% yoy, in 3Q20 and 4Q19 growth rate of –0.2% qoq, but 0.8% yoy. Italian GDP went down by 2% qoq, or -6.6% yoy, vs a growth of +16% qoq, but -5.1% yoy, in 3Q20 and 4Q19 growth rate of -0.4% qoq, but +0.1% yoy. Spanish GDP increased by 0.4% qoq, but -9.1% yoy, vs +16.4% qoq, but

-9% yoy in 3Q20 and 4Q19 growth rate of +0.4% qoq, or 1.7% yoy. According to Bloomberg compiled estimates, 1Q21 GDP growth rate will be in the range of 0.0% qoq in Italy to -1.4% qoq in Germany while it will be more than 2% qoq across all major EU economies in 2Q21. GDP projections are slightly higher than it was 2 quarter ago but it is expected that the EU economy will return to 2019 level only in 2H22. Thus, according to Bloomberg consensus estimates compiled in February, the EU GDP will increase by 4.2% yoy in 2021 (vs +4.3% yoy in January), by 4.0% yoy in 2022 (vs +3.9% yoy) and by 1.9% yoy in 2023.

European macro data published in February 2021 were slightly better than expected with positive surprises on GDP and PMI but weaker retail sales and industrial production. Given recent PMI figures and ongoing restrictions, we expect that an economic recovery won't resume earlier than in 2Q21, especially taking into account that the vaccination is not going as fast as expected. However, economic surprise indices increased markedly in February as they did in January. Thus, Citi's economic surprise index went up by 32 pts MoM to 160 pts as of the end of February, after it decreased significantly in January. Bloomberg surprise index also increased, adding 0.072 pts MoM to 0.616 pts. It remains elevated vs pre-COVID levels.

Composite PMI (preliminary figure), which is usually well correlated with a GDP growth (but relation was less tight than usual in 2020), slightly beat expectations in February after it missed in January. So, it still remains weak, pointing to negative GDP dynamics on qoq basis. Composite PMI increased by 0.3 pts MoM to 48.1 pts, being a bit higher than a consensus of 48.1 pts. The key driver of composite PMI drop was a strong growth of manufacturing PMI while services indicator remains quite weak. Thus, manufacturing PMI increased by 2.9 pts MoM to 57.7 pts in February vs consensus of 54.3 pts. It was +8.4 pts relative to its pre-COVID level, near the highest number over last 3 years. In turn, services PMI declined again, -0.7 pts MoM to 44.7 pts vs consensus of 45.9 pts. So, it is 7.9 pts lower than it was in February 2020. Manufacturing PMI is consistent with ECB's view that activity in manufacturing sector held up well. The key driver of EU manufacturing remains Germany which manufacturing PMI increased by 3.5 pts MoM to 60.6 pts vs consensus of 56.5 pts after its marked decline in January. It is 12.5 pts higher comparing to pre-COVID levels. In turn, German services PMI decreased by 0.8 pts MoM to 45.9 pts vs estimate of 46.5 pts, -6.6 pts from February 2020. Thus, composite PMI increased by 0.5 pts MoM to 51.3 pts vs consensus of 50.5 pts, roughly in-line with pre-pandemic level. In turn, French composite PMI decreased by 2.5 pts MoM to 45.2 pts in February vs consensus of 47.5 pts, the second consecutive month of marked decline. So, it is still 6.8 pts lower than it was in February 2020. Negative PMI dynamics was driven by services sector, which PMI decreased by 3.7 pts MoM to 43.6 pts vs consensus of 47 pts, the lowest figure since May 2020. In turn, manufacturing PMI skyrocketed by 3.4 pts MoM to 55 pts in February vs a consensus of 50.5 pts. Despite to better soft manufacturing data, industrial production was markedly weaker than expected in December, after its strong growth in November. Thus, IP decreased by 1.6% MoM vs consensus of -0.8% MoM, but November figure was revised up from initial estimate of 2.5% MoM to 2.6% MoM. In result, it declined just by 0.8% on yoy basis vs October figure of -3.5% yoy. Given recent PMI figures, it seems that IP will continue its recovery but at a slower rate than it was expected few months ago, especially taking into account that "weaker corporate balance sheets and uncertainty about the economic outlook are still weighing on business investment". So, estimates slightly deteriorated in February vs January projections. Thus, according to estimates compiled by Bloomberg, it is expected that IP will increase by 6.4% yoy in 2021, by 3.8% yoy in 2022 and by 1.9% yoy in 2023 vs +6.9% yoy/+3.8% yoy/- as it was estimated in January.

Financial health of the EU consumer continues deteriorating despite to massive support programs and the start of the vaccination campaign, which, however, is somewhat slower,

than it was expected few quarters earlier. So, the pandemic is far from over and risks are still tilted to downside with more prolonged period of various restrictions. But it seems that prospects have improved in recent months. According to February Bloomberg survey, private consumption will increase by 3.4% yoy in 2021, 4.7% yoy in 2022 and by 2.0% yoy in 2023 (vs +3.9%/+4.3%/- estimated growth rates in January). Unemployment should increase slightly in 2021 even despite to massive support measures for employment. Notwithstanding, the growth rate of unemployment will be much lower than it was in the US in 1H20. But consumer confidence has already declined significantly. Unemployment rate was flat and in-line with consensus at 8.3% in December, after markedly better figures in November, when it went down just by 10 bps MoM despite to new restrictions were imposed. So, February consensus estimates of unemployment rates for 2021, 2022 and 2023 years, compiled by Bloomberg, were revised down again, to 8.9%/8.5%/7.9% vs January estimates of 9.1%/8.6%/-. ECB's unemployment projections are more pessimistic, being at 8.5%/9.5%/8.8% for 2021/2022/2023 years, respectively. Retail sales increased significantly in December after very weak figures in November but it was worse than expected, +2.0% MoM vs consensus of 2.8% MoM. However, the November figure was revised up slightly from its initial estimate of -6.1% MoM to -5.7% MoM. So, it is positive again on yoy basis after it turned negative in November, +0.6% yoy in December vs consensus of +1.2% yoy and -2.2% yoy in November. So, February consumer confidence improved slightly but it remained depressed. Thus, it increased by 0.7 pts MoM to -14.8 pts in February vs consensus of -15.0 pts, just +7.1 pts from April 2020, but -8.4 pts from pre-COVID levels.

Rates

After new monetary stimulus were announced at December ECB's meeting, the monetary policy was left unchanged at January one, as it was widely expected. Given the ECB's belief, risks are less pronounced now than they were one month ago. So, it is quite a logical decision. From the other hand, the minutes of the January meeting were more cautious about near term economic activity than Christine Lagarde was at the press conference. Notwithstanding, it was noted in the January introductory statement that the PEPP envelope may not be used in full (earlier, it was only mentioned during the press conference). Recall that at December meeting, the PEPP was extended by 9 months till "at least the end of March 2022" and the size of the program was increased by €500 Bn to €1850 Bn. Notwithstanding, "the envelope can be recalibrated if required to maintain favourable financing conditions to help counter the negative pandemic shock to the path of inflation". Also, the APP "will continue at a monthly pace of €20 billion". As for the most favourable instrument of the monetary policy for EU banks at the moment, TLTRO, "the Governing Council will continue to provide ample liquidity through its refinancing operations". Also, it was announced that three additional operations, about which it was announced at the previous meeting, would be conducted in 2H21 on new eased terms. Recall that TLTRO III program was extended on more favourable terms by 12 months to June 2022 at December meeting. Moreover, total borrowing amount was increased from 50% to 55% of stock of eligible loans. Due to these decisions, profit of some European banks could increase up to 10-15% in 2021-2022 years, all other things being equal. However, although lending rates are at the lowest levels ever, banks noted that demand remains weak and they continue to tighten lending terms. Key policy rates were remained unchanged and we expect that it will remain unchanged in the foreseeable future. Answering the question about the yield curve control, Mrs. Lagarde said that it is not on the agenda at the moment but this possibility was discussed. In any case, "in this environment ample monetary stimulus remains essential to preserve favourable financing conditions over the pandemic period for all sectors of the economy". It was reiterated again that euro exchange rate was monitoring carefully. So, challenging revenue environment for banks

with negative key rates will last rather longer even despite to more optimistic ECB's view on an economic recovery longer term and a significant growth of headline inflation in 2021 (it could be even higher than ECB's target for some time) but it will be just a temporal overshooting growth of prices.

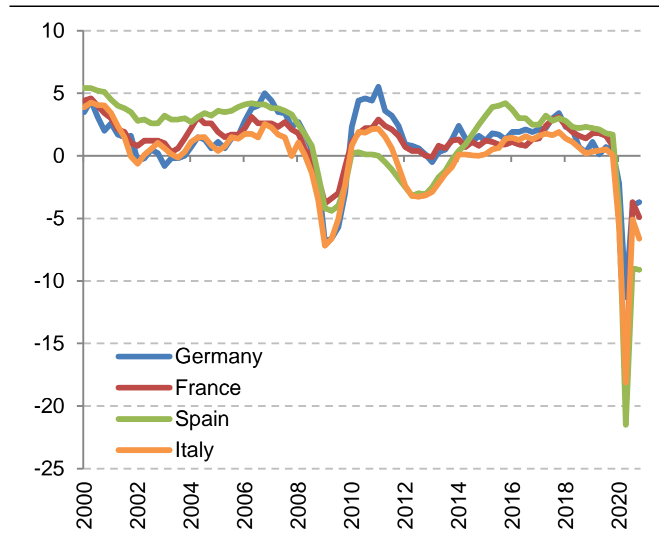
According to the January introductory statement, "activity in the manufacturing sector continues to hold up well, but services sector activity is being severely curbed, albeit to a lesser degree than during the first wave of the pandemic in early 2020. Output is likely to have contracted in the fourth quarter of 2020 and the intensification of the pandemic poses some downside risks to the short-term economic outlook" but "overall, the incoming data confirm our previous baseline assessment of a pronounced near-term impact of the pandemic on the economy and a protracted weakness in inflation". Notwithstanding, due to the start of the vaccination campaign and last moment Brexit agreement, it was noted that risks are less pronounced than before even despite to new strains of the coronavirus and extensions of lockdowns across a number of European countries. Given January PMI figures, it seems that the optimism might be premature, at least for short-term EU economy dynamics. New economic projections will be released at March meeting when the situation could slightly worsen. Notwithstanding, overall GDP projections released in December are almost in-line with current market forecasts. According to the ECB, it is implied that EU GDP will decline by 7.3% yoy in 2020 (vs -8.0% yoy in September projections), but it increased by 3.9% yoy in 2021 (vs +5.0% yoy 1 quarter ago) and by 4.2% yoy in 2022 (vs +3.2% yoy previously). Unemployment projections were also improved to 8.0%/9.3%/8.2% for 2020/2021/2022 years, respectively (from 8.5%/9.5%/8.8% in September). In turn, inflation forecasts were revised slightly down, from 0.3%/1.0%/1.3% for 2020/2021/2022, respectively, in September to 0.2%/1.0%/1.1% in December. Given macro data of early 2021, it seems that estimates will be revised down at March meeting even despite to an optimistic tone of the January meeting.

The ECB continues to preserve favourable financing conditions and being as flexible as it can, but it has a negative impact on banks' revenues and profits, even taking into account a positive effect of TLTRO, favourable conditions of which could be extended even further despite to conditions were improved a number of months ago, especially in case of a further deterioration of economic conditions. So, banks will continue to suffer from negative rate environment and a relatively muted economic growth, even despite to a positive effect of the TLTRO program. So, the outlook for banking NII/NIM remains weak even despite to banking shares outperformance in recent months as a result of a more positive view on both LT rates and an economic recovery. Notwithstanding, the yield curve is still much lower than it was at the end of 2019 even despite to a substantial growth of the long end in recent months. However, NII outlook stopped worsening recently even despite to key rates will remain negative for longer. Thus, a median NII decline of EU banks was 6.3% yoy despite to a significant earning assets growth yoy as NIM continues decreasing even despite to more favourable TLTRO terms. Median NIM decreased by 0.5 bps qoq, or -11 bps yoy, to 1.54% in 4Q20, the lowest figure since 1Q17. Unsurprisingly, NII outlook continues to worsen despite ECB's actions aimed at easing the effect of negative rates on banks' P&L and expectations of a faster recovery in coming years. Thus, a median decline of NII FY21 estimates of EU banks was 0.3% ytd (-7.9% since the beginning of 2020) while FY22 estimates declined by 0.2% (-10.2% since the beginning of 2020). Median NIM FY21 estimate increased by 4 bps ytd to 1.55% while NIM FY22 decreased by 3 bps ytd to 1.48%, implying a further decline yoy in 2022 despite to a better economic outlook.

Key benchmark rates increased markedly in February but forward rates still remained significantly lower vs the end of 2019. Thus, 3M Euribor (Dec 2021) increased by 6.5 bps MoM to -0.52% (as of the end of February), or -23 bps vs the end of 2019, while 3M Euribor (Dec 2022) went up by 6.5 bps MoM to -0.48% and it is -35 bps vs the end of 2019.

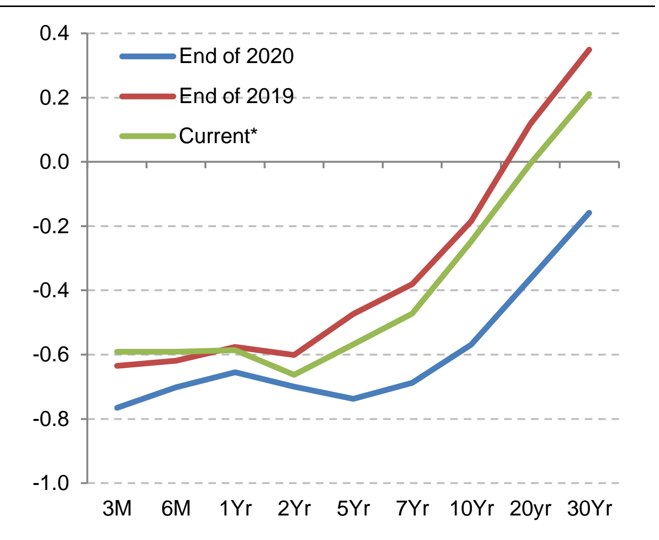
The direction of dynamics of generic yields was uniform in February 2021 but a growth of the long end was much higher than a growth of the short end. However, even the long end still remains meaningfully lower than it was at the end of 2019. 3M yield increased by 3.3 bps MoM to -0.59%. 6M yield went up by 3.5 bps to -0.59%. 1yr generic yield increased by 3.6 bps MoM to -0.59%, while 2yr yield ticked up by 7 bps MoM to -0.66%. 5yr yield went up by 16.7 bps to -0.57%, while 10yr yield increased by 27 bps to -0.25%. Overall, the yield curve remains slightly inverted in the middle part. So, spreads increased meaningfully in February. Thus, spread between 10yr yield and 1yr yield went up by 23.4 bps MoM to 0.34%, while spread between 5yr and 3M yields increased by 13.4 bps MoM to just -0.02%. Both spreads are higher than April 2020 trough but they remain much lower vs the end of 2019. Almost entire yield curve is still below 0.

Chart 31. EU Countries Real GDP Growth, YoY, %



Source: Bloomberg

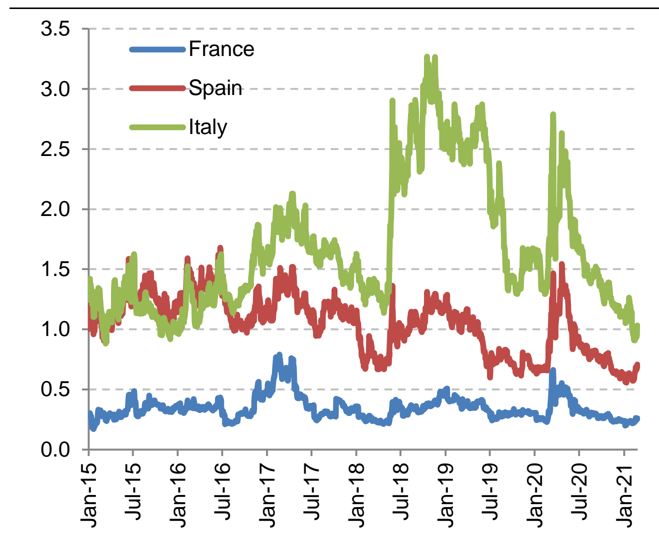
Chart 32. EU Yield Curves, %



*as of the end of February 2021

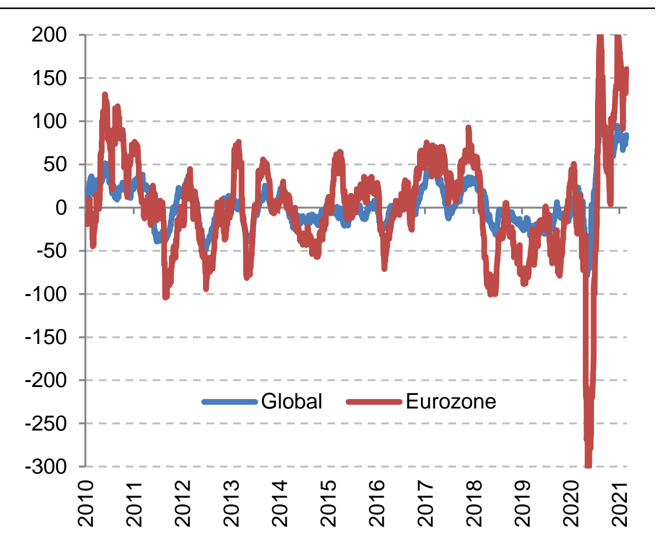
Source: Bloomberg

Chart 33. EU Countries Sov. Spreads vs Germany, 10Yr, %



Source: Bloomberg

Chart 34. Citi Economic Surprise Indexes, pts



Source: Bloomberg

THEME OF THE MONTH

EU Banks. 4Q20 Overview

European banks reported markedly better results in 4Q20 as they did in 2Q20 and 3Q20 after clearly weak figures in 1Q20. Both revenue and net income figures demonstrated positive surprises. Thus, 22 out of 33 banks from SX7P index for which estimates were available reported better revenue figures vs 30 out of 40 in 3Q20. Net income was also better than expected with 24 out 29 banks with positive surprises. EPS was higher for 20 out of 25 banks in 4Q20 vs 25 out of 35 banks in 3Q20. The key driver of better results was lower provisions due to a better economic outlook. In turn, NII/NIM figures were weak again and it will remain a headwind in coming quarters even despite to a substantial growth of the long end in recent months. Notwithstanding, earnings momentum began to improve after significant worsening in 1H20. Thus, a median decline of operating profit of SX7P index members improved from -44% yoy in 2Q20 to -23% yoy in 4Q20. A median decline of revenue was -6.1% yoy in 4Q20 after it decreased by 1.4% yoy in 3Q20 and by 4.3% in 2Q20. In turn, a median revenue surprise was +2.2% better than a median quarterly surprise over the last 10 years, but lower than +3.1% in 3Q20. A revenue decline was driven by NII which decreased by 6.3% in 4Q20 vs -4.8% yoy in 3Q20 and -2.8% yoy in 2Q20. Due to a better earnings season and an overall optimism as a result of the vaccination campaign and better macro data, market perception of the results was positive. Thus, a median 1-day performance of SX7P index members around the earnings date was +0.6% vs 10yr average of +0.2% and 3Q20 figure of -0.9%. So, overall performance since the start of the earnings season was overwhelming with growth of SX7P index by 8.1% (from January 20, 2021 till the end of February), while STOXX 600 index decreased by 1.4% over the same period.

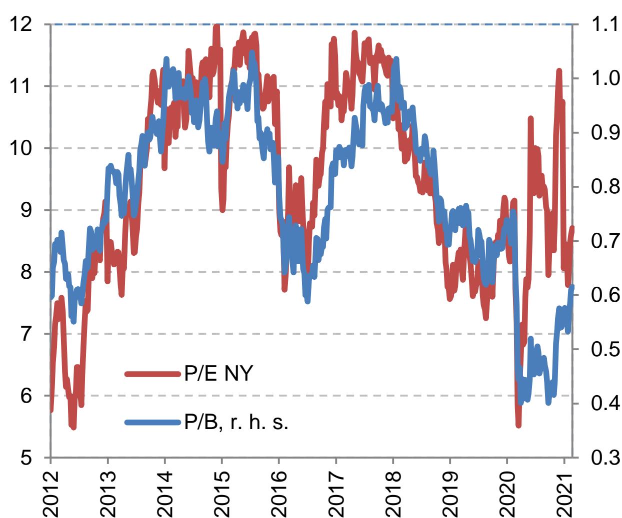
A median decline of EU banks' net income (SX7P index members) was 29.5% yoy in 4Q20 after dropping by 20.7% yoy in 3Q20 and by 43.3% yoy in 2Q20. And it seems that banks will manage to reach the pre-pandemic level not earlier than in 2H22 given the negative rate environment in the foreseeable future. At least, current estimates imply that FY22 net income estimates are 16% lower than FY19 net income actuals (a median decline of SX7P index). As a result of higher provisions on qoq basis, net income declined again sequentially after positive dynamics in 3Q20. So, median ROE of EU banks continues declining, -72 bps qoq, or -374 bps yoy, to just 4.2%, the lowest figure over the last 30 quarters. Due to a positive EPS surprise and improved economic expectations, estimates have increased meaningfully in recent weeks. Thus, a median growth of FY21 NI was +3.9% ytd (but -37.6% since the beginning of 2020), implying growth of 26% yoy. As of FY22 NI estimates, a median growth was +2.0% ytd (but -22.6% since the beginning of 2020), implying growth of 25% yoy. On the other hand, revenue estimates were relatively flat with a growth of just +0.2% ytd for FY21 revenue, but a decline of -7.2% since the beginning of 2020.

Revenue environment remains very challenging for European banks even despite to a markedly better momentum due to the ongoing vaccination campaign. And we don't expect that revenue environment will be much better in 2021 because restrictions as a consequence of the second wave of the pandemic still remain while the vaccination of the majority of the population will last at least till 2H20. Moreover, a further economic recovery will depend on future fiscal stimulus as financial health of the most suffered industries remains quite weak. Thus, a median NII decline of EU banks was 6.3% yoy despite to a significant earning assets growth yoy as NIM continues decreasing even despite to more favourable TLTRO terms. Median NIM decreased by 0.5 bps qoq, or -11 bps yoy, to 1.54% in 4Q20, the lowest figure since 1Q17. Unsurprisingly, NII outlook continues to worsen despite to ECB's actions aimed at easing the effect of negative rates on banks' P&L and

expectations of a faster recovery in coming years. Thus, a median decline of NII FY21 estimates of EU banks was 0.3% ytd (-7.9% since the beginning of 2020) while FY22 estimates declined by 0.2% (-10.2% since the beginning of 2020). Median NIM FY21 estimate increased by 4 bps ytd to 1.55% while NIM FY22 decreased by 3 bps ytd to 1.48%, implying a further decline yoy in 2022 despite to a better economic outlook.

A median decline of non-interest revenue was 2.5% yoy, but +0.2% qoq, in 4Q20 after a growth by 1.5% yoy in 3Q20. Despite to a decline, it was relatively good quarter, given very strong 4Q19 fee income. Notwithstanding, non-II estimates remain flat ytd despite to structural tailwinds and expectations of much higher economic activity when lockdowns lift.

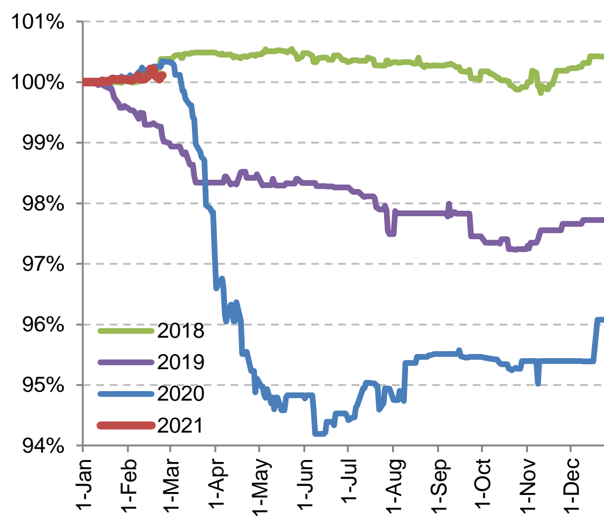
Chart 35. EU Banks. Multipliers, Median*



*SX7P index members

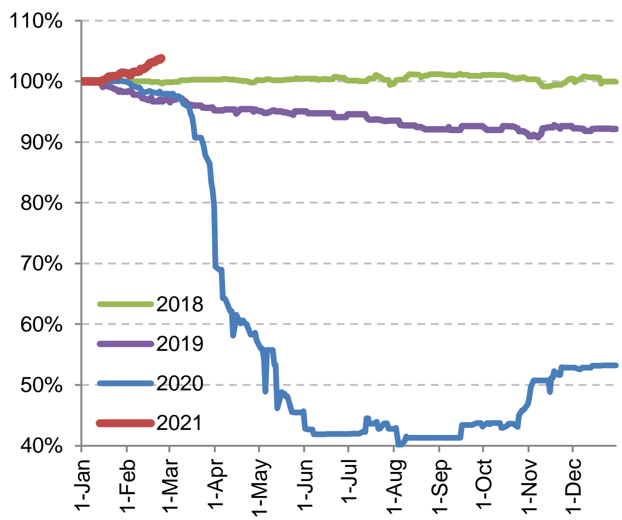
Source: Bloomberg

Chart 36. SX7P Index. Median CY EPS Est. Dynamics



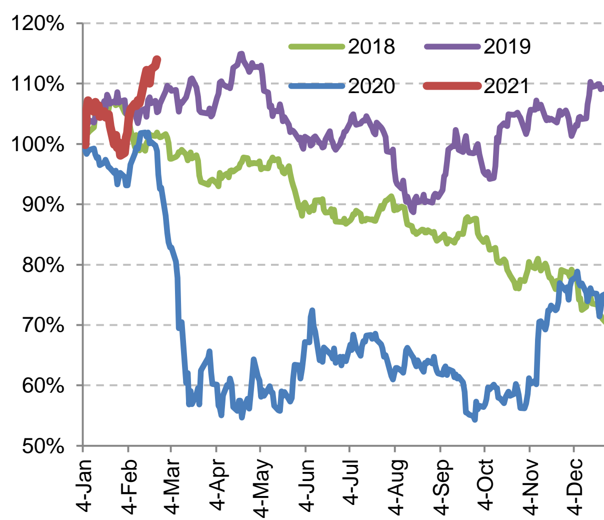
Source: Bloomberg

Chart 37. SX7P Index. Median CY Rev Est. Dynamics



Source: Bloomberg

Chart 38. SX7P Index. Price dynamics



Source: Bloomberg

A median decline of OPEX was 1.8% yoy in 4Q20, in-line with 3Q20 OPEX decline. It was the third consecutive quarter of decline on yoy basis after 5 quarter in a row of growth. Despite to higher expenses related to the pandemic, such as remote work expenses, OPEX continue to go down as a result of lower revenues. Notwithstanding, operating leverage was negative again in 4Q20 after two consecutive quarters of positive numbers. It was -1.8% in 4Q20 (vs +2.3% in both 2Q20 and 3Q20) as a result of a significant decline of revenues. So, efficiency ratio increased by 546 bps qoq in absolute terms to 64%, the

highest figure since 1Q20. Given challenging revenue environment, a number of banks have announced new cost cutting programs. Moreover, OPEX optimization could be the key driver of the bottom line in case of M&A wave which is quite possible given recent trends and ECB's position on this issue.

Credit quality of European banks remained quite strong so far, despite to an unprecedented decline of the EU economy in 1H20. So, provisions decreased significantly on yoy basis in both 3Q20 and 4Q20 after a meaningful reserve build in 1H20. Thus, a median growth of provisions was 14% yoy, or +18% qoq, after a significant sequential decline of provisions in 3Q20. On yoy basis, provisions increased for the 7 consecutive quarters after 23 quarters of decline in a row. Despite to better economic perspectives and lower 4Q20 provisions, a median decline of provision expense estimates of SX7P index members wasn't significant ytd. Thus, provision estimates decreased by 6.3% and 2.8% ytd for 2021 and 2022 years, respectively. Median NPLs ratio decreased by just 2 bps qoq, but just +2 bps yoy, to 2.6% in 4Q20. So, coverage ratio increased by 7.3% yoy, but -0.5% qoq, in absolute terms to 64.8%, still near the highest level over more than 10 years. Further dynamics of provisions will depend on many factors, but it is quite possible that we will see a gradual decline of provision expenses in the near term given the high reserve build in 1H20 and a better than feared economic growth. Actual losses will inevitably increase after the end of support fiscal programs but we don't expect that it will be a problem for the majority of EU banks.

Capital of European banks continues strengthening due to ongoing dividend ban (the ECB has only partially lifted the restrictions), no significant growth of NPLs and positive net income of the majority of banks. Thus, a median CET1 ratio of SX7P index members increased by 105 bps yoy, but was flat qoq, to 14.9% in 4Q20. It seems that the dividend ban will be removed completely in the near future. But, dividend estimates were relatively flat ytd even despite to more optimistic expectations of a profit growth. Thus, a median growth of DPS estimates was just +7.5%/+2% ytd for 2021/2022 years, respectively (remaining significantly lower than it was one year ago).

As a result of better earnings season and better earnings visibility due to the ongoing vaccination campaign and an expected GDP growth acceleration, we anticipate that the outperformance of EU banks will continue in the near future. Moreover, due to meaningful EPS upgrades, they still remain relatively cheap even taking into account their significant price growth in recent months. From our point of view, the worst is behind us but it is a bumpy road ahead with risks still tilted to the downside. Although we expect that EPS estimates will return to 2019 levels not earlier than in 2H22, it seems that the market is currently looking much further in time. EU banks are still trading with a small discount to historical averages, while their discount to US peers is markedly wider than it was historically. Thus, discount to historical averages is 5% (-0.3 std at the moment from mean P/E NY of SX7P index members, sample from 2010 to the present), but discount to US peers (on median P/E NY of BKX index vs SX7P index) is 27% as of February 26, 2021 vs average since 2010 of 20%, or -0.8 std. **So, we are tactically bullish on EU banks at the moment but we continue to prefer US banks to EU ones in the longer run.**

APPENDIX

Table 1. US Banks: Valuations

Company	Ticker	Price as of 26/02/21, $	Target price, $	Upside	52-week price, $		RSI	MCap, $ bn.	Dividend yield			Price/Earnings			Price to book	Price to tang. book	ROE, %			TCE ratio, %	CET1 ratio, %
					High	Low			2021E	2022E	2023E	2021E	2022E	2023E			2021E	2022E	2023E		
American Express	AXP	135.3	131.5	-2.8%	141.0	67.0	62.4	109.0	1.3%	1.4%	1.5%	20.9	15.2	13.1	4.7	5.8	22.2	30.2	31.8	10.1	13.5
JP Morgan Chase	JPM	147.2	148.2	0.7%	154.9	77.0	62.3	449.1	2.5%	2.6%	2.7%	14.2	13.0	11.9	1.8	2.3	12.6	13.3	15.5	6.0	13.1
PNC Financial	PNC	168.4	164.4	-2.4%	180.6	79.5	58.2	71.4	2.8%	2.9%	2.9%	17.4	14.1	12.5	1.4	1.7	8.2	9.6	10.2	9.0	12.1
Bank of America	BAC	34.7	36.0	3.8%	37.0	18.0	59.8	299.7	2.2%	2.5%	2.9%	14.3	12.2	10.7	1.2	1.7	8.3	9.1	9.6	6.5	11.9
Citigroup	C	65.9	78.5	19.2%	69.4	32.0	57.0	137.5	3.2%	3.4%	3.7%	10.1	8.2	7.2	0.8	0.9	7.4	8.5	8.8	6.9	11.7
Truist Financial Corp	TFC	57.0	57.5	0.9%	61.2	24.0	60.0	76.7	3.2%	3.3%	3.6%	13.9	12.4	10.9	1.2	2.1	8.6	9.1	10.4	7.6	10.0
Goldman Sachs	GS	319.5	336.2	5.2%	335.8	130.9	64.9	115.1	1.6%	1.8%	1.9%	10.8	9.7	8.9	1.3	1.4	12.3	12.4	12.2	6.9	14.7
Bank of NY Mellon	BK	42.2	48.6	15.2%	46.8	26.4	47.8	37.0	3.1%	3.4%	3.9%	10.7	9.3	8.2	0.9	1.8	8.4	9.0	10.1	4.6	13.1
Comerica	CMA	68.1	64.7	-5.0%	73.5	24.3	60.0	9.5	4.0%	4.0%	4.1%	13.4	13.7	13.3	1.2	1.4	8.9	8.5	8.3	8.0	10.3
Citizens Financial	CFG	43.4	45.1	3.9%	47.0	14.1	59.9	18.5	3.6%	3.7%	3.8%	11.4	11.0	10.6	0.9	1.4	7.4	7.3	7.7	7.7	10.0
Regions Financial	RF	20.6	20.3	-1.6%	22.6	7.0	60.2	19.8	3.1%	3.2%	3.3%	11.1	10.9	10.4	1.2	1.8	9.9	9.8	10.4	7.8	9.8
Discover Financial	DFS	94.1	105.9	12.5%	100.8	23.3	53.1	28.9	1.9%	2.0%	2.1%	10.5	9.0	7.8	2.9	3.1	24.6	25.5	26.6	8.4	13.1
M&T Bank	MTB	150.9	157.2	4.1%	164.7	85.1	56.3	19.4	2.9%	3.0%	3.1%	12.8	12.4	11.6	1.3	N. A.	9.6	9.4	10.1	7.5	10.0
Fifth Third Bancorp	FITB	34.7	34.8	0.4%	36.8	11.1	63.2	24.6	3.2%	3.2%	3.4%	12.2	11.4	10.7	1.2	1.5	9.3	9.3	9.9	8.3	10.3
Huntington Bancorp	HBAN	15.3	15.6	1.8%	16.5	6.8	60.1	15.6	4.0%	4.2%	4.9%	12.2	11.4	10.2	1.4	1.8	10.8	11.9	12.8	7.1	10.0
Northern Trust	NTRS	95.1	104.1	9.4%	101.9	60.7	47.1	19.8	3.0%	3.1%	3.3%	14.7	13.4	11.8	1.7	1.8	12.3	13.2	14.4	6.4	13.4
People's United	PBCT	17.9	17.2	-3.9%	19.4	9.4	69.5	7.6	4.1%	4.1%	4.5%	13.9	13.7	13.0	1.0	1.7	7.0	6.8	6.9	7.5	10.5
Synchrony Financial	SYF	38.7	45.0	16.2%	40.7	12.2	56.3	22.6	2.4%	2.5%	2.8%	9.0	8.0	6.4	1.9	2.3	18.1	20.1	22.8	10.4	15.9
KeyCorp	KEY	20.1	19.8	-1.7%	21.8	7.5	59.4	19.5	3.8%	3.9%	4.2%	11.1	11.0	10.3	1.2	1.5	10.5	9.9	10.1	7.9	9.7
State Street Corp	STT	72.8	86.0	18.2%	81.1	42.1	46.8	25.6	2.9%	3.1%	3.4%	10.6	9.3	7.9	1.1	2.0	9.9	10.6	11.9	4.2	12.3
US Bancorp	USB	50.0	53.8	7.7%	53.5	28.4	57.9	75.1	3.4%	3.5%	3.6%	13.4	12.0	10.9	1.6	2.1	11.3	12.1	13.4	6.7	9.7
Zions Bancorp	ZION	53.2	53.3	0.2%	57.7	23.6	60.0	8.7	2.6%	2.7%	3.1%	12.5	12.9	11.8	1.2	1.4	8.9	8.3	8.7	7.8	10.8
Morgan Stanley	MS	76.9	83.2	8.2%	81.4	27.2	58.7	144.7	1.9%	2.2%	2.4%	13.5	11.9	10.7	1.5	1.8	11.0	11.7	12.2	6.9	17.4
Capital One Financial	COF	120.2	130.9	8.9%	125.8	38.0	60.8	55.2	1.3%	1.5%	1.7%	9.6	8.9	8.1	1.0	1.4	9.1	9.5	10.5	10.0	13.7
Wells Fargo	WFC	36.2	38.0	4.9%	42.9	20.8	59.2	149.5	1.4%	2.3%	2.9%	14.6	11.2	8.9	0.9	1.1	6.3	7.5	8.7	7.1	11.6
First Republic Banks	FRC	164.8	166.7	1.2%	180.3	70.1	55.7	28.7	0.5%	0.5%	0.6%	25.5	22.8	20.9	2.8	2.9	10.6	10.6	10.4	7.0	9.7
NY Commercial Bancshares	NYCB	12.2	12.3	0.3%	13.2	7.7	65.2	5.7	5.6%	5.6%	5.6%	10.9	10.0	N. A.	0.9	1.4	7.8	8.4	N. A.	7.3	9.7
SVB Financial	SIVB	505.4	512.1	1.3%	550.4	127.4	54.1	26.2	0.0%	0.0%	0.0%	24.9	23.1	21.7	3.3	3.4	12.7	12.2	11.1	6.7	11.0
Signature Bank	SBNY	218.3	222.6	1.9%	230.6	69.1	69.7	12.5	1.0%	1.0%	1.1%	18.1	15.9	14.0	2.0	2.0	11.3	11.6	12.0	7.9	9.9
East West Bancorp	EWBC	72.2	71.3	-1.1%	75.2	22.6	69.9	10.2	1.8%	1.9%	N. A.	14.6	13.9	13.1	1.9	2.1	12.8	12.4	12.5	9.3	12.7
Synovus Financial	SNV	42.3	44.4	4.9%	45.3	10.9	59.3	6.3	3.2%	3.2%	3.8%	11.7	11.0	9.9	1.4	1.5	10.9	11.0	N. A.	7.7	9.7
First Horizon National	FHN	16.2	17.3	7.0%	17.3	6.3	59.1	9.0	3.7%	3.9%	4.6%	10.8	10.5	10.3	1.2	1.6	10.5	10.1	10.2	6.9	10.7
BOK Financial	BOKF	86.1	86.2	0.2%	91.1	34.6	60.5	6.0	2.4%	2.5%	2.5%	12.2	13.0	11.8	1.2	1.6	8.9	8.1	8.2	9.0	11.9
Median				**1.9%**			**59.8**		**2.9%**	**3.0%**	**3.2%**	**12.5**	**11.9**	**10.7**	**1.2**	**1.8**	**9.9**	**9.9**	**10.4**	**7.5**	**11.0**

Source: Bloomberg

APPENDIX

Table 2. EU Banks: Valuations

Company	Ticker	Currency	Price* (26/02/21)	Target price*	Upside	52-week price*		RSI	MCap, € bn.	Dividend yield			Price/Earnings			Price to book	Price to tang. book	ROE, %			TCE ratio, %	CET1 ratio, %
						High	Low			2021E	2022E	2023E	2021E	2022E	2023E			2021E	2022E	2023E		
Erste Group	EBS AV	EUR	27.3	30.0	9.9%	31.6	15.2	56.4	11.7	3.8%	5.0%	6.0%	11.9	9.4	8.6	0.8	0.9	6.4	7.6	8.5	4.8	14.2
Raiffeisen Bank	RBI AV	EUR	16.8	20.9	24.0%	19.3	10.7	47.5	5.5	4.1%	5.6%	6.2%	7.7	6.4	5.9	0.5	0.5	5.9	6.8	6.5	7.3	13.6
KBC Groep	KBC BB	EUR	59.6	64.2	7.6%	64.0	33.4	50.2	24.8	5.9%	5.7%	6.1%	13.9	11.9	10.9	1.2	1.3	8.9	9.9	10.3	5.8	18.1
Komercni Banka	KOMB CK	CZK	678.0	711.9	5.0%	755.0	460.0	51.7	4.9	5.0%	6.2%	6.7%	14.3	11.9	10.8	1.1	1.2	7.7	8.9	9.2	8.9	21.7
Jyske Bank	JYSK DC	DKK	266.3	267.8	0.6%	278.0	150.5	62.3	2.6	0.8%	0.0%	0.2%	9.4	8.0	6.9	0.6	0.6	6.2	6.1	6.1	5.0	17.9
SydBank	SYDB DC	DKK	140.8	147.8	5.0%	143.8	83.0	64.7	1.1	3.7%	4.5%	5.8%	11.3	10.3	8.1	0.7	0.7	6.4	6.7	8.0	7.3	17.8
Danske Bank	DANSKE DC	DKK	113.7	120.9	6.4%	117.8	68.0	56.7	13.2	5.2%	6.3%	7.2%	9.9	8.2	7.3	0.6	0.6	6.1	7.1	7.6	3.7	18.3
BNP Paribas	BNP FP	EUR	49.3	53.2	8.0%	51.3	24.5	66.9	61.6	5.8%	6.0%	6.8%	9.6	8.2	7.4	0.6	0.7	5.9	6.5	7.1	3.7	12.8
Natixis	KN FP	EUR	4.0	3.7	-9.5%	4.1	1.5	80.4	12.7	4.5%	6.3%	7.7%	15.2	11.0	9.0	0.7	N. A.	4.1	6.3	6.9	2.8	11.6
Societe Generale	GLE FP	EUR	20.5	21.0	2.1%	26.0	10.8	74.4	17.5	3.7%	6.0%	7.8%	12.4	7.6	5.7	0.3	0.3	2.6	4.2	5.5	3.8	13.2
Credit Agricole	ACA FO	EUR	11.6	13.0	11.9%	12.0	5.7	68.5	33.9	5.1%	6.2%	6.7%	10.2	8.4	7.7	0.6	0.8	5.8	6.3	7.0	2.1	13.2
Virgin Money	VMUK LN	GBp	183.8	157.9	-14.1%	190.5	46.1	72.2	3.1	0.0%	0.0%	0.0%	20.9	9.1	7.9	0.5	0.6	3.1	6.6	7.4	4.9	13.4
HSBC	HSBA LN	GBp	426.2	425.1	-0.2%	529.7	281.5	58.8	100.1	0.1%	0.1%	0.1%	9.6	7.4	6.5	0.7	0.8	4.4	6.3	7.3	5.2	15.9
Natwest Group	RBS LN	GBp	184.2	188.0	2.0%	189.6	90.5	63.9	25.8	0.0%	0.1%	0.1%	14.9	9.7	8.3	0.6	0.7	3.4	5.8	6.5	4.0	18.5
Barclays	BARC LN	GBp	159.6	172.8	8.3%	165.8	73.0	60.7	32.0	0.0%	0.0%	0.1%	10.0	7.3	6.8	0.5	0.6	5.1	6.5	7.1	3.5	15.1
Standard Charted	STAN LN	GBp	462.1	532.1	15.1%	576.8	334.3	43.5	16.8	0.0%	0.1%	0.1%	7.7	5.7	5.0	0.4	0.5	3.8	5.0	6.1	5.2	13.8
Lloyds	LLO LN	GBp	39.0	41.9	7.5%	52.0	23.6	60.6	31.9	0.0%	0.0%	0.1%	26.0	10.5	8.0	0.6	N. A.	1.8	5.7	7.2	4.3	16.2
Commerzbank	CBK GY	EUR	5.4	5.8	7.6%	6.0	2.8	50.7	6.8	0.3%	1.4%	4.6%	-319.4	11.2	7.2	0.3	0.3	-0.7	2.2	4.0	5.5	13.2
Deutsche Bank	DBK GY	EUR	10.2	8.4	-17.4%	10.8	4.4	66.4	21.1	0.7%	2.1%	3.5%	21.5	9.5	8.3	0.4	0.4	0.7	3.9	4.9	3.6	13.6
UniCredit	UCG IM	EUR	8.5	9.6	12.3%	11.7	6.0	56.7	19.1	4.5%	5.7%	7.2%	9.4	6.6	5.7	0.3	0.3	3.3	5.1	5.3	6.2	16.0
Mediobanka	MB IM	EUR	8.6	9.8	13.4%	9.2	4.1	55.8	7.6	5.5%	6.2%	6.0%	10.7	9.7	9.1	0.7	0.9	6.6	7.3	7.7	11.3	16.1
Intesa Sanpaolo	ISP IM	EUR	2.1	2.4	11.6%	2.2	1.3	66.9	41.5	6.8%	7.8%	8.5%	11.1	9.0	8.3	0.7	0.8	6.1	7.1	7.6	5.2	14.7
Emilia Romagna	BPE IM	EUR	1.8	2.2	20.6%	2.5	1.0	56.2	2.6	2.9%	4.1%	5.0%	12.0	8.0	6.9	0.4	0.5	5.2	3.9	3.3	5.8	17.7
ING Groep	INGA NA	EUR	9.0	10.4	15.5%	9.4	4.2	66.6	35.3	8.0%	6.6%	7.1%	9.4	8.4	7.6	0.6	0.7	6.5	7.2	8.0	5.7	15.5
ABN Amro	ABN NA	EUR	9.5	10.1	6.4%	12.9	5.7	65.9	8.9	5.1%	6.8%	8.4%	17.7	8.7	6.8	0.4	N. A.	2.2	5.1	6.4	5.1	17.7
DNB	DNB NO	NOK	168.7	170.8	1.3%	176.1	94.3	50.4	25.0	5.4%	5.7%	6.1%	12.9	11.4	10.4	1.1	1.2	8.8	9.7	10.2	7.7	18.7
BBVA	BBVA SQ	EUR	4.6	4.7	1.0%	4.8	2.1	62.4	30.7	3.4%	4.2%	5.0%	11.4	9.7	8.3	0.7	0.7	5.8	6.4	7.2	5.8	12.2
Santander	SAN SQ	EUR	2.9	3.1	8.4%	3.3	1.4	57.4	50.2	4.0%	5.4%	6.5%	10.1	8.0	7.0	0.6	0.8	5.7	7.1	8.3	4.4	12.3
Bankia	BKIA SQ	EUR	1.6	1.5	-7.0%	1.7	0.7	61.0	5.0	1.4%	3.6%	4.2%	48.1	15.1	12.3	0.4	0.4	1.1	2.6	3.1	6.0	16.7
Bankinter	BKT SQ	EUR	5.5	5.0	-8.3%	5.7	3.0	65.5	4.9	2.8%	3.7%	4.2%	16.6	13.0	11.4	1.0	1.0	5.9	7.0	8.3	4.9	12.3
Sabadell	SAB SQ	EUR	0.4	0.4	-2.8%	0.8	0.3	59.9	2.3	1.7%	4.3%	6.5%	21.9	8.2	5.3	0.2	0.2	0.9	2.4	3.7	4.2	12.6
CaixaBank	CABK SQ	EUR	2.4	2.6	6.5%	2.5	1.5	63.0	14.4	3.4%	5.3%	5.9%	12.0	8.8	8.1	0.6	0.7	4.8	6.2	6.7	4.8	13.6
SEB	SEBA SS	SEK	97.2	102.8	5.8%	99.9	59.8	61.6	20.9	6.9%	5.6%	6.4%	10.9	10.0	9.5	1.2	1.3	10.9	11.4	11.9	5.4	21.0
Handelsbanken	SHBA SS	SEK	89.0	98.9	11.1%	100.3	71.7	62.0	17.3	7.1%	6.9%	7.7%	10.8	9.9	9.5	1.0	1.1	9.4	9.8	9.8	5.1	20.3
Swedbank	SWEDA SS	SEK	148.0	177.7	20.0%	165.9	99.1	45.3	16.4	7.1%	6.0%	6.4%	9.4	8.7	8.6	1.1	1.2	11.3	11.6	11.1	5.3	17.5
Nordea	NDA SS	SEK	76.3	86.6	13.4%	78.8	48.0	66.0	30.3	0.9%	0.7%	0.8%	10.6	9.4	7.6	0.9	1.0	8.6	9.1	9.4	5.3	17.1
Julious Baer	BAER VX	CHF	55.8	58.0	3.9%	57.5	23.9	56.0	11.4	3.2%	3.4%	4.3%	12.8	11.8	10.8	1.9	3.2	13.3	14.1	14.2	3.6	14.9
Credit Suisse	CSGN VX	CHF	13.1	14.4	9.4%	13.5	6.1	64.2	29.3	2.4%	2.5%	2.6%	9.1	7.8	6.5	0.7	0.8	7.7	8.4	9.3	4.7	12.9
UBS	UBSG VX	CHF	14.1	15.2	8.0%	14.6	6.8	58.4	49.6	2.8%	2.9%	3.0%	9.5	8.5	7.5	0.9	1.0	8.0	8.8	9.3	4.7	13.8
Median					**7.5%**			**61.0**		**3.7%**	**5.0%**	**6.0%**	**11.1**	**9.0**	**7.9**	**0.6**	**0.7**	**5.9**	**6.6**	**7.3**	**5.1**	**15.1**

Source: Bloomberg

APPENDIX

Table 3. Calendar

Date	Region	Section	Event	Period
1-Mar	US	Macro	Construction Spending	Jan
1-Mar	US	Macro	ISM Manufacturing	Feb
2-Mar	EU	Macro	CPI	Feb
3-Mar	EU	Macro	PPI	Jan
3-Mar	US	Macro	ADP Employment Change	Feb
4-Mar	EU	Macro	Unemployment Rate	Jan
4-Mar	EU	Macro	Retail Sales	Jan
4-Mar	US	Macro	Factory Orders	Jan
5-Mar	US	Macro	Employment Report	Feb
5-Mar	US	Macro	Trade Balance	Jan
5-Mar	US	Macro	Consumer Credit	Jan
9-Mar	EU	Macro	Employment	4Q
9-Mar	**EU**	**Macro**	**GDP**	**4Q**
9-Mar	US	Macro	NFIB Small Business Optimism	Feb
10-Mar	US	Macro	CPI	Feb
10-Mar	US	Macro	Monthly Budget Statement	Feb
11-Mar	**EU**	**Macro**	**ECB Main Refinancing Rate**	**Mar 11**
12-Mar	EU	Macro	Industrial Production	Jan
12-Mar	US	Macro	PPI	Feb
12-Mar	US	Macro	U. of Mich. Sentiment	Mar
15-Mar	US	Macro	Empire Manufacturing	Mar
16-Mar	US	Macro	Retail Sales	Feb
16-Mar	US	Macro	Industrial Production and Capacity Utilization	Feb
17-Mar	EU	Macro	Construction Output	Jan
17-Mar	US	Macro	Building Permits and Housing Starts	Feb
17-Mar	**US**	**Macro**	**FOMC Rate Decision**	**Mar 17**
18-Mar	EU	Macro	Trade Balance	Jan
18-Mar	US	Macro	Philadelphia Fed Business Outlook	Mar
18-Mar	US	Macro	Leading Index	Feb
22-Mar	US	Macro	Existing Home Sales	Feb
23-Mar	US	Macro	New Home Sales	Feb
23-Mar	US	Macro	Richmond Fed Manufact. Index	Mar
24-Mar	EU	Macro	Markit Eurozone Manufacturing, Services and	Mar
24-Mar	EU	Macro	Consumer Confidence	Mar
24-Mar	US	Macro	Durable Goods Orders	Feb
24-Mar	US	Macro	Markit US Manufacturing, Services and Composite	Mar
25-Mar	**US**	**Macro**	**GDP**	**4Q**
26-Mar	US	Macro	Wholesale Inventories MoM	Feb
26-Mar	US	Macro	Personal Income and Spending	Feb
30-Mar	EU	Macro	Economic and Industrial Confidence	Mar
30-Mar	US	Macro	FHFA House Price Index	Jan
31-Mar	EU	Macro	CPI	Mar
31-Mar	US	Macro	ADP Employment Change	Mar
31-Mar	US	Macro	Pending Home Sales	Feb