BANKING SECTOR REPORT – September 2020

EXECUTIVE SUMMARY

US banks decreased in September after moderate growth in August. So, the banking industry index broke down its growth channel and underperformed the broad market again. It was the 5th month in a row of relative underperformance with overall absolute decline of 36% ytd vs S&P 500 index growth of 4% ytd. BKX index decreased by 4.7% MoM in September vs -3.9% MoM of SPX index. Absolute performance on MoM basis was -0.8 std from the mean and it is in the bottom 19% of absolute MoM performance of BKX index. Relative September performance was -0.8% MoM. It is -0.15 std from the mean and it is in the bottom 44% of relative MoM performance vs SPX index since 1992. It was by a wide margin the worst first three quarters of the year on both absolute and especially relative basis in BKX index history.

Key outperformers in September 2020 were consumer finance companies again as quality characteristics of consumer loans remains resilient while employment dynamics is encouraging. The worst performer was Citigroup which tumbled by 15.7% MoM as a result of weaker mid-quarter guidance and news that regulators could take actions against Citi.

The earnings season of US banks will start on October, 13, when 3Q20 results are expected to be provided by JP Morgan and Citigroup. After that, within two weeks, all members of BKX index will release their quarterly results. US banks reported mixed figures in 2Q20 with much better EPS and revenue figures despite higher provisions and lower NII/NIM. We expect that positive EPS momentum is returning due to better than expected asset quality, still solid trading/IB/mortgage fees and strong deposit inflows. From the other hand, NIM and loan dynamics remain weak. Notwithstanding, EPS estimates were revised up substantially since the end of 2Q20. Thus, according to Bloomberg consensus, **median growth of 3Q20 EPS of BKX index members was 24.7% qtd but still -30.4% ytd (as of September, 28).** Full-year estimates for the current year was revised up by 10.5% qtd but still -46.2% ytd while next year EPS declined by 4.6% qtd / -34.7% ytd. In turn, 3Q20 revenue estimates increased by 0.4% qtd, still remaining negative ytd.

Revenue estimates increased by 0.4% qtd, driven by fees while NII remains a drag. Thus, non-interest income estimates increased by 3.7% qtd while NII declined by 2.4% qtd. Notwithstanding, according to Bloomberg consensus, non-interest income of BKX index members will decrease by 4.1% qoq and by 5.0% yoy in 3Q20, even despite capital markets and mortgage remains strong while other fees will inevitably recover after significant drop in 2Q20. In turn, it is implied that NII will be flat qoq but -1.6% yoy, even despite deceleration of loan growth in 3Q20 and NIM decline. Majority of quarterly average benchmark rates dropped meaningfully in 3Q20 while banks invest strong deposit inflows in highly liquid assets. So, 3Q20 NIM estimated declined by 13 bps qtd while 2021/2022 NIM projections declined by 3.0/3.4 bps qtd respectively, being -26/-33 bps ytd. We believe that NIM is already not far from the trough of the cycle but we don't expect that it will be markedly higher relative to current levels in foreseeable future, especially taking into account results of the recent Fed meetings and inflation forecasts.

Credit quality of US banks remains strong given the depth of recession in 1H20. Uncertainty is still high but early stage indicators have improved recently. Moreover, banks were also optimistic about credit during recent financial conferences and they don't expect any significant reserve build in 3Q20. Unsurprisingly, provision estimates decreased by 8.6% qtd and it is expected that median decline will be 59% qoq. Better asset quality and lower provisions could be a catalyst for outperformance of banking stocks in the near term, from our point of view.

Capital ratios of US banks remain strong and they will continue their growth in 2H20 as it is unlikely that regulatory restrictions on buybacks and dividends will be lifted in coming months even despite it is quite probable that all banks will pass 4Q20 stress test, the scenarios of which were released by the Fed recently.

Due to significant decline of EPS estimates ytd, banks in general are no more trading with discount to CY estimates, but they are still undervalued significantly to NY estimates and vs S&P 500. Thus, banks are trading at -1.6/-1.2 std on P/E NY (on the basis of samples from 2000 and 2010 years to current moment) relative to historical averages (as of September, 25). As for relative to S&P 500, banks are currently trading at -2.2 std and -2.4 std from the sample mean (2010-current moment) for P/E CY and P/E NY, respectively. On P/B, banks are trading at -1.9 std from the sample mean (2010-current moment) vs SPX. We still see some risks for fundamentals of US banks given unprecedented decline of US economy in 1H20, still high level of uncertainty about the speed of US economic recovery, mixed 2Q20 results and rising risk related to the elections. Notwithstanding, we are becoming more and more optimistic given recent improvement of earnings momentum and high to ignore discount to S&P 500 index. **So, we recommend buying US banks before 3Q20 earnings season as we expect better results and we believe that risk/reward looks attractive at the moment.**

EU banks tumbled significantly in September 2020 after substantial growth in August. And their index dynamics remains very weak. SX7P index ended 6 out of 9 months of 2020 in the red zone. On absolute basis, SX7P index went down by 10.7% MoM in September or -1.6 std from the mean and this result is in the bottom 6% of absolute monthly performance of SX7P since index inception. Relative monthly performance was -9.4% MoM or -2.5 std and it is the 5th worst month of relative performance in index history. Despite weak relative dynamics in two previous years when SX7P index underperformed the broad market by 12.1% and 17.1% in 2018 and 2017, respectively, EU banks continue to lag broad market considerably. On ytd basis, SX7P underperformed by 33.5% as the end of September.

Dynamics of European banks was uniform in September with all members of SX7P index ended the month in the red except for Bankia, which increased by 17.6% MoM due to 20% premium to its closing price of September, 3 in the announced M&A deal with CaixaBank. The key laggards were French banks because of significant growth of COVID-19 cases in the country in September.

Despite EPS estimates of European banks have finally stopped going down, investors continue to underweight them as a recovery of EU economy has decelerated recently while the second wave of the pandemic has already begun in majority of European countries and some of them started returning restrictions. So, composite PMI was a touch higher than 50 pts, pointing to almost no growth in the last month, with services PMI well below the edge. Despite inflation remains very weak while risks remain high and markedly increased in September, ECB left its policy unchanged at the last meeting. In such circumstances, it is difficult to imagine that investors will want to have banking shares in their portfolios, especially taking into account the continuing dividends ban and negative for longer rates. Fundamentals of EU banks remain weak and will remain so in the near future while multipliers don't look very attractive at the moment. Thus, EU banks are trading again with discount to historical averages while discount to US peers is still lower than usually. Thus, the discount to historical averages is 12% (-0.7 std at the moment from mean P/E NY of SX7P index members, sample from 2010 to the present) but the discount to US peers (on median P/E NY of BKX index vs SX7P index) is just 16.7% at the moment vs average since 2010 of 20.5%, out of synch with reality, from our point of view, given higher risks associated with EU banks which have not fully recovered from the previous crisis yet. **So, we continue prefer US banks to EU ones.**

MARKET PERFORMANCE

US

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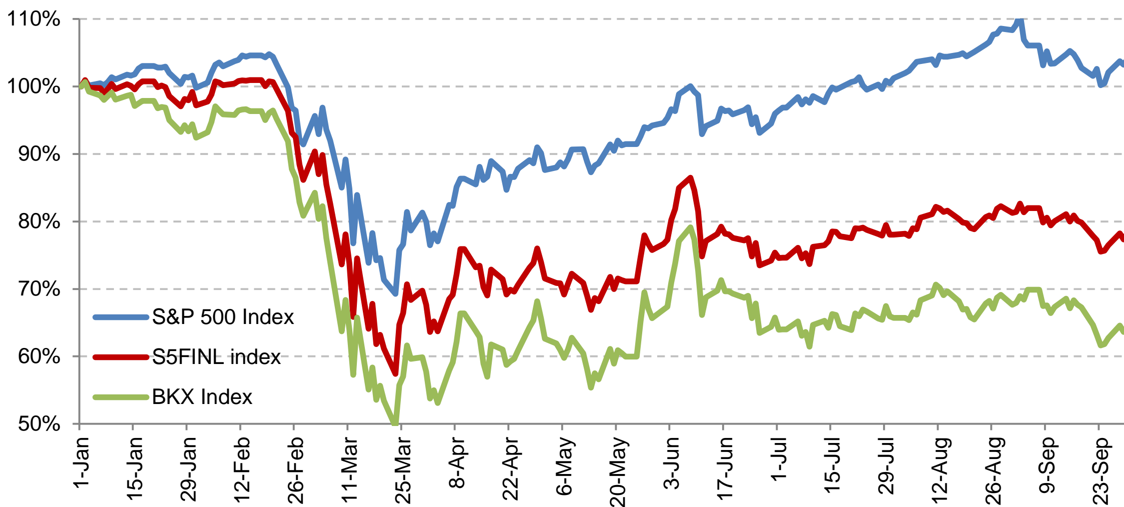
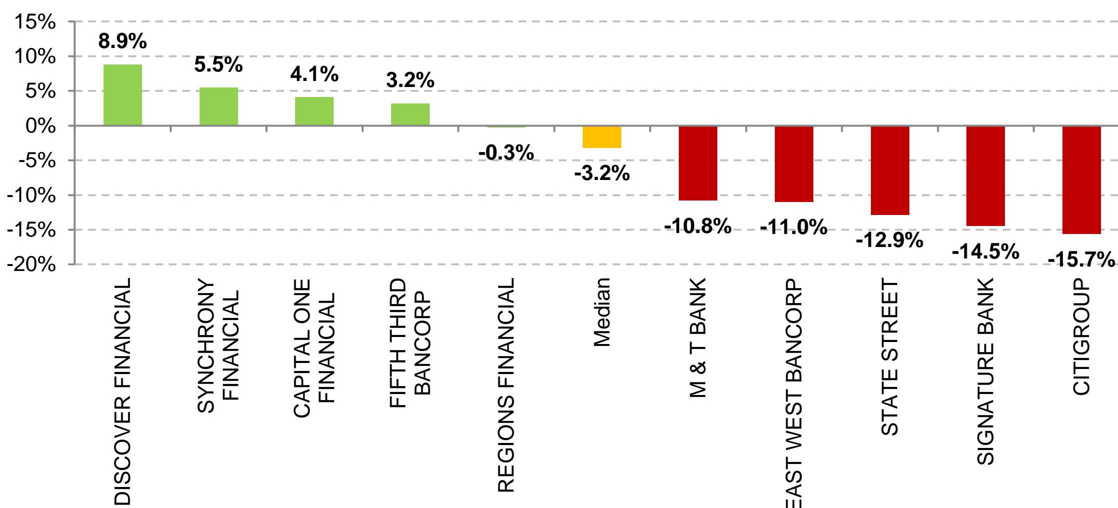
Chart 1. US Banks Performance. BKX Index vs S&P500 & S5FINL Indexes



Source: Bloomberg

Chart 2. September US Banks Performance. Leaders and Laggards, 1 Month Price Change,%



Source: Bloomberg

Europe

EU banks tumbled significantly in September 2020 after a substantial growth in August. And their dynamics remains very weak. SX7P index ended 6 out of 9 months of 2020 in the red zone. On absolute basis, SX7P index went down by 10.7% MoM in September, or -1.6 std from the mean, and this result is in the bottom 6% of absolute monthly performance of SX7P since index inception. Relative monthly performance was -9.4% MoM, or -2.5 std, and it is the 5th worst month of relative performance in index history. Despite weak relative dynamics in two previous years when SX7P index underperformed the broad market by 12.1% and 17.1% in 2018 and 2017, respectively, EU banks continue to lag broad market considerably. On ytd basis, SX7P underperformed by 33.5% as the end of September.

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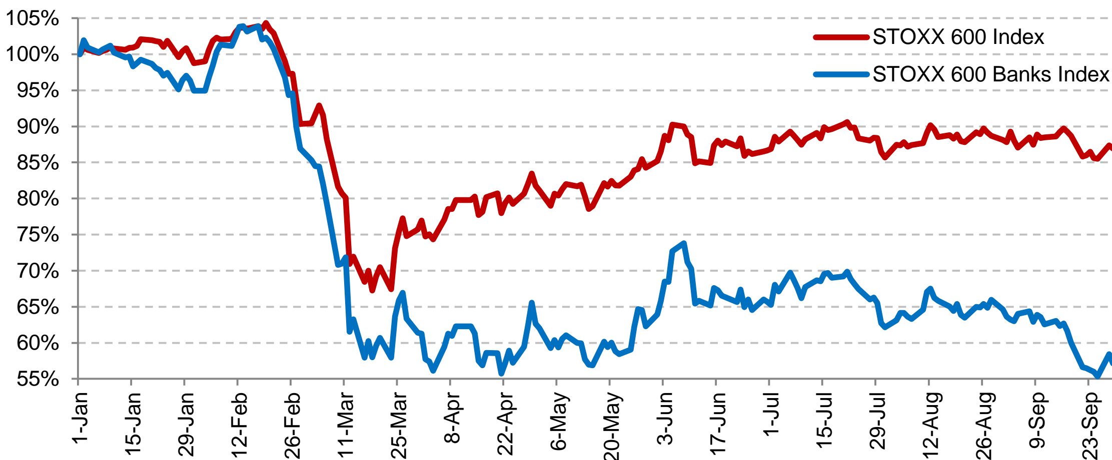
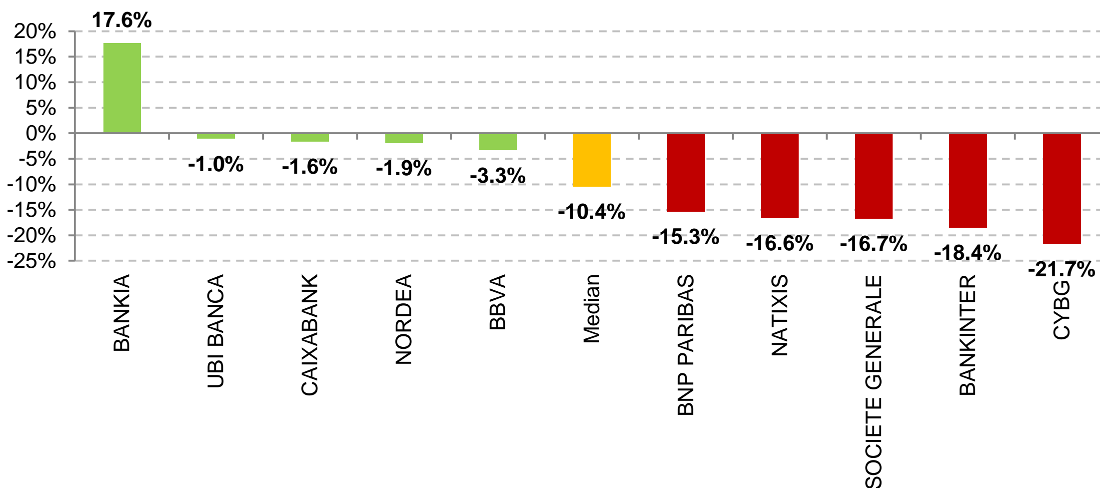
Chart 3. EU Banks Performance. SX7P Index vs STOXX 600 Index



Source: Bloomberg

Chart 4. September EU banks performance. Leaders and Laggards, 1Month Price Change,%



Source: Bloomberg

COMPANY NEWS

EU

CaixaBank + Bankia

On September, 17, it was announced that a merger between CaixaBank and Bankia was approved by boards of directors. It wasn't news as rumors were circulating since the beginning of September. The total consideration for 100% Bankia shares is €4.3 Bn, which implies €1.41 per share or 20% premium to unaffected share price (closing price of September, 3). Exchange ratio is 0.6845 of newly issued ordinary shares of CaixaBank for every Bankia share, slightly lower than it had been speculated in the press earlier in the month. It is expected that transaction will be approved in November and closed in 1Q21. The Caixa Foundation, the biggest shareholder, will own 30% of the new entity while state's FROB share will be equal to 16%. Overall, Caixa shareholders will own 74% of the new entity and Bankia shareholders will have 26%. Caixa Bank will remain as the brand.

The combined entity will be the largest domestic bank in Spain with 25% share of customer loans, 24% share of deposits and 29% share in long-term savings. Total number of customers is around 20 mln. Total number of branches exceeds 6K while FTEs is higher than 50K. It is expected that annual cost savings from the deal will be €770 mln, fully-phased from 2023. More than 90% of cost saves is expected to be achieved by the end of 2022. Overall, cost saves exceed 40% of Bankia's total costs. Revenue synergy is implied at €290 mln and it is expected to be achieved by the end of 2025. So, cost-to-income ratio should decline to 48% (from current pro-forma figure of 56% vs 63% of Spanish peers in 2019) and RoTE should exceed 8% as early as in 2022. EPS accretion for EPS 22E is estimated at 28% for Caixa and at 69% for Bankia. From the other hand, restructuring charges is estimated at €2.2 Bn or 2.86 times of expected early cost savings. The bulk of restructuring costs is expected to be charged in 2021 P&L and to be fully covered by badwill.

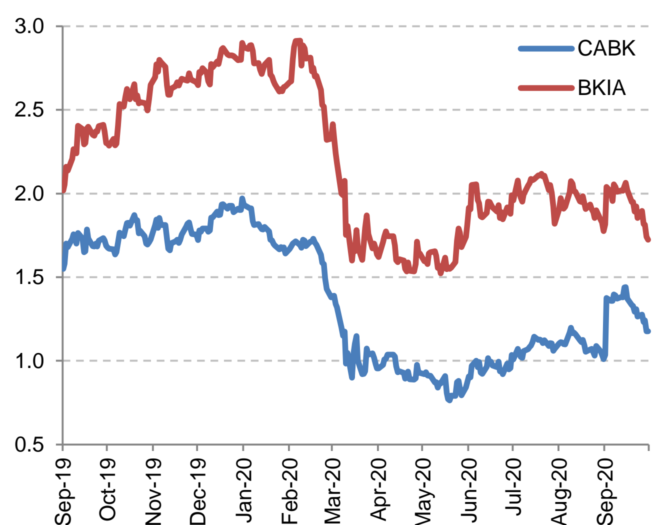
Table 1. CABK + BKIA

	CABK	BKIA	Combined entity
Customer loans*	€218 Bn	€126 Bn	€343 Bn
Deposits*	€210 Bn	€123 Bn	€334 Bn
Employees*	35.6K	15.9K	51.5K
Branches*	4.5K	2.3K	6.7K
NPLs Ratio*	3.6%	4.9%	4,1%
NPL Coverage*	61%	56%	59%
CET 1 Ratio*	12.29%	13.68%	12.77%
Efficiency Ratio*	56%	55.4%	55.65

*as the end of 2Q20

Source: companies data

Chart 5. CABK and BKIA shares performance



Source: Bloomberg

Pro-forma CET1 ratio for the combined entity is 12.8% as the end of 2Q20 (including IFRS9 transitional adjustments) vs estimated CET1 SREP of 8.45%. According to CABK, post-merger CET1 ex. IFRS9 transitional is estimated at 11.3% as the end of 1Q21 vs target range of 11.0%-11.5% with management buffer over SREP of 250-300 bps. Combined entity will have around €128 Bn in liquid assets and liquidity ratios well above requirements

and peers average. Also, combined entity's NPLs ratio will be lowest amongst main peers in Spain at 4.1% with coverage ratio of 64%.

Overall, we view this transaction as positive for both banks and overall EU banking industry given challenging revenue environment for years. But we remain neutral for both banks as cost and revenue synergy targets look ambitious, from our point of view.

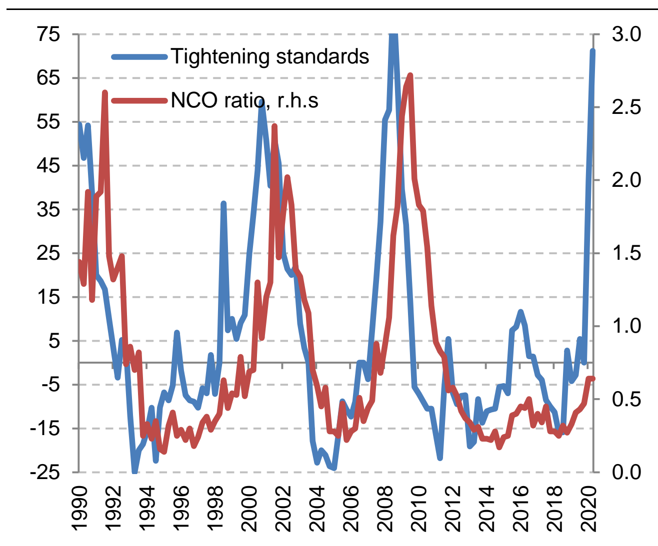
MACROECONOMIC NEWS

US

C&I loans

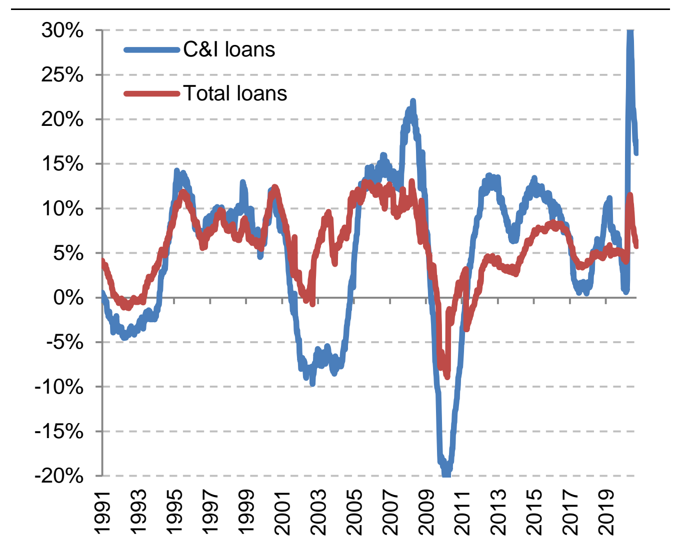
C&I loans growth accelerated to double-digit figures on yoy basis in March-May after anemic growth in the first two months of the year, but it has decelerated markedly from the peak as companies started to repay revolvers which had been taken out previously. C&I loans increased by $697 Bn since the end of February till the middle of May. But then it decreased by $305 Bn within next 4.5 months. We expect that growth will continue its decelerating and C&I loans will inevitably go down in coming quarters given depth of economic slowdown, accompanied by significantly higher number of bankruptcies and tighter lending standards. According to the Fed H.8 survey, C&I loans increased by 17.1% yoy (as of September, 9) vs 6.4% yoy 1 year ago and +1.0% yoy as the end of 2019. On ytd basis, C&I loans skyrocketed by 17.7% vs +4.5% ytd of total loans, 91% of which was driven by C&I loans growth.

Chart 6. C&I. Loan Standards vs NCOs, %



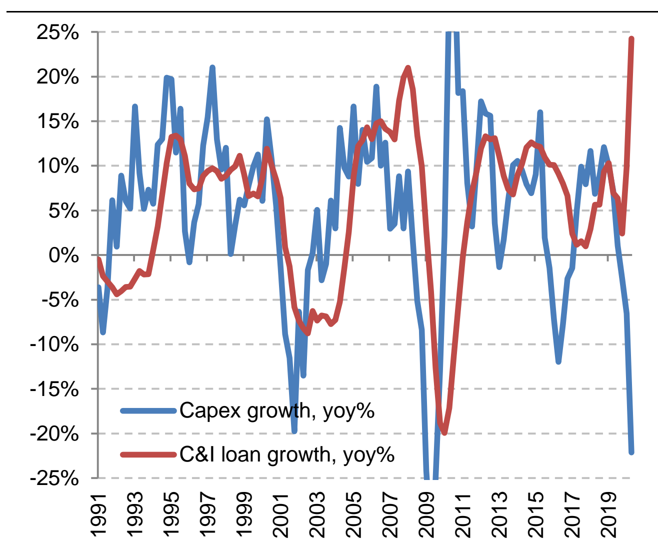
Source: Bloomberg

Chart 7. Loan Growth. C&I vs Total loans, YoY%



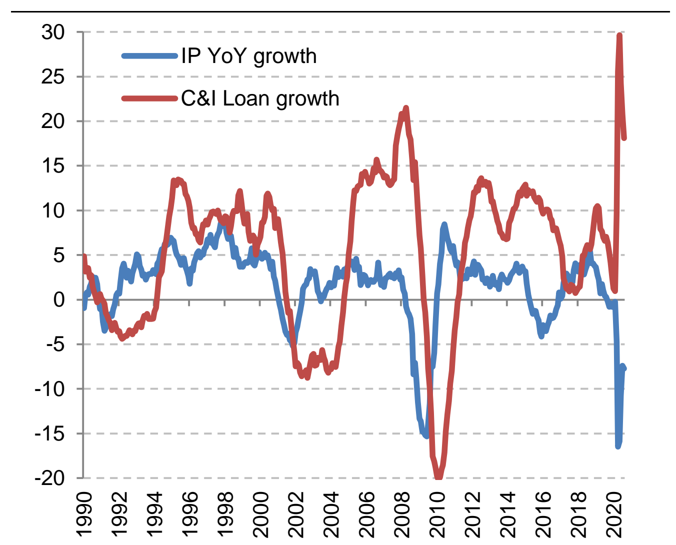
Source: Bloomberg

Chart 8. C&I. Loan Growth vs CAPEX



Source: Bloomberg

Chart 9. C&I. Ind. Production vs Loan Growth YoY%



Source: Bloomberg

Despite unprecedented support measures from both the Fed and the government, it will be difficult to avoid decline of C&I loans in coming quarters even taking into account banking forbearance programs and willingness to provide liquidity and restructure loans. Support measures have certainly had a positive impact on the financial health of the corporate sector, and credit indicators still look pretty resilient at the moment, especially taking into account a magnitude of the turmoil. Notwithstanding, indicators don't reflect the real picture given still a high number of rating downgrades and elevated unemployment. Moreover, risks are still tilted downside even despite faster than expected economic recovery after reopening. The quality indicators will inevitably deteriorate in the foreseeable future, but it will happen later than it could otherwise be. However, it shouldn't be a threat for US banks given significantly higher capital levels, lower leverage and more cautious approach to lending during the cycle while non-bank lenders may be hit hard, from our point of view.

Despite concerns about deterioration of C&I credit quality over the recent quarters (and total loan portfolio as a whole as well), it remains benign so far but it was deteriorated noticeably in 2Q20, especially for a number of banks. WFC's C&I NCO ratio increased by 35 bps yoy to 0.53% while RF's one increased by 70 bps yoy to 1.06%. For other banks, deterioration was less significant. As of industry average figures (latest available data), according to FDIC data, 30-89 delinquency rate even decreased by 1 bps yoy and -7 bps qoq to 0.27% in 2Q20. Being a leading indicator of asset quality, it confirms that it remains in a good shape so far despite recent recession in the US economy. FDIC's NCO ratio increased by 17 bps qoq or +31 bps yoy to 0.64%, still lower than average figures of the last two cycles. Noncurrent rate increased by 18 bps qoq and +21 bps yoy to 1.01%. According to the Fed data, delinquency ratio increased by 14 bps qoq or +21 bps yoy to 1.27%, the highest figure over last 11 quarters. In turn, NCO ratio increased by 7 bps qoq or +29 bps yoy to 0.62%, the highest figure since 4Q11.

So far, financial health of US corporate sector was solid even despite 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 relatively fast economic recovery. Given a high level of leverage of US corporate sector and inevitable decline of revenues because of deep recession in the US in 2Q20, accompanied by 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. Moreover, interest coverage ratios have already declined from an average level of 6.2x in 2019 to 4.6x in 2Q20, still markedly higher than the trough of the GFC but they haven't already looked safe, from our point of view. At least, Fed actions just slowed down somewhat growth of NPLs and NCOs but don't prevent it. The magnitude of the problem will depend on how long the recession lasts (it seems just 2 quarters and it has already ended) and whether there will be the second wave of the pandemic (the probability has increased meaningfully in recent weeks). But, from our point of view, the key risk for corporate credit quality comes from leveraged loans and its spillover effects on the economy as it grew rapidly during the cycle. Currently, corporate debt as a percent of GDP is higher than it was before the Great Recession while the share of covenant-lite leveraged loans issuance remained very high in recent years.

July 2020 Senior Loan Officer Opinion Survey indicated that C&I lending standards and terms were tightened for firms of all sizes again. Thus, net percent of domestic respondents tightening standards for C&I loans isn't far from the peak of the GFC, -71% in 2Q20 vs -84% in 3Q08, implying further deterioration of credit quality and loan growth deceleration in 2H20. Tightening was broad based across all major loan terms. Unsurprisingly, the key reasons for tightening are a less favourable and more uncertain economic outlook,

worsening of industry-specific problems and reduced tolerance for risk. Banks also reported a weaker demand in 2Q20. It was expected given significant growth of C&I loans in 1Q20 as a result of cash and liquidity needs. Also, banks noted a decline of inquiries from potential borrowers in 2Q20. The key drivers of weaker demand were lower needs for inventory and receivables financing as well as lower investment needs in plant or equipment.

Macro data published in September was relatively in-line after very strong figures observed in summer months. And it seems that the pace of economic recovery will continue to slow down in coming months. But we believe that the worst is behind us even in case of the second wave of the pandemic. The start of the economy after reopening was markedly better that it was anticipated but a majority of forecasts remain weak while an acceleration of the pandemic around the world and November elections added uncertainty to a future path of the recovery. So, we still don't believe that the US economy will return to its pre-COVID levels sooner than in 2022, even despite stock indices have almost moved back to pre-COVID levels. At least, 2Q20 GDP decline was the sharpest on record. But forecasts have improved significantly in recent months due to more optimistic macro data as well as economic surprise indices, which skyrocketed in three recent months from their multi-year lows printed in April 2020. ISM manufacturing index increased by 1.8 pts MoM to 56.0 pts in August, markedly beating consensus of 54.8 pts. It was the highest reading over almost two years. All subcomponents of the index increased significantly and a majority of them are again higher than 50 pts. Notwithstanding, employment component is still markedly below 50 pts even despite new orders index increased to its multi-year high in September. In turn, employment report was in-line with expectations after much better figures in previous months. But manufacturing payrolls missed expectations again while jobless claims still remained elevated. So, GDP growth rates for the nearest 3 years improved insignificantly in September again. Thus, according to Bloomberg survey conducted in September, expected GDP growth rates were equal to -4.5%/3.6%/2.7% yoy for 2020/2021/2022, respectively, vs -5.1%/3.7%/2.8% yoy in August. Manufacturing payrolls increased just by 29K in August vs consensus of +65K, after it went up by 41K in July. Total payrolls skyrocketed by 1.37 mln in August vs consensus of +1.35 mln, after growth of 1.7 mln in July. So, unemployment rate tumbled by another 1.8% p.p. to still elevated 8.4%. But it is already lower than the high of the GFC. Industrial production increased by 0.4% MoM in August vs consensus of +1.0% MoM after growth of 3.5% MoM in July (revised up from initial estimate of +3.0% MoM). But it is still -7.7% yoy as a result of a meltdown in 2Q20. So, capacity utilization increased only by 0.3% p.p. in absolute terms to 71.4%, from revised up July estimate. But it also remains more than 6.0% below pre-COVID levels. In turn, Empire manufacturing index increased by 13.3 pts MoM to 17.0 pts in August after significant decline in July. Preliminary Markit manufacturing PMI increased by 0.4 pts MoM to 53.5 pts in September, remaining 17 pts higher than 2020 low and even by 1.2 bps higher than an average level of 2019. So, consensus IP growth forecasts improved markedly in September after relatively flat dynamics in August and July, to -7.5%/+4.2%/+3.0% yoy for 2020/2021/2022, respectively, in September, from -8.2%/+3.8%/+2.8% in August.

CRE

Growth rate of commercial real estate loans still remains pretty resilient despite significant negative effect of the lockdown on some CRE subsegments and geographies, such as retail/hotels and NY/CA. On yoy basis, it even accelerated slightly. Thus, according to the last Fed H8 weekly report, CRE loan growth was +6.0% yoy (as of September, 9) vs +4.5% yoy 1 year ago. But recent uptick is temporary, from our point of view, given a severe recession in 1H20 and imminent deterioration of fundamental characteristics of the sector which were relatively healthy in 1Q20. However, we have already seen significant deterioration of some fundamentals in recent months. At least, transaction volumes

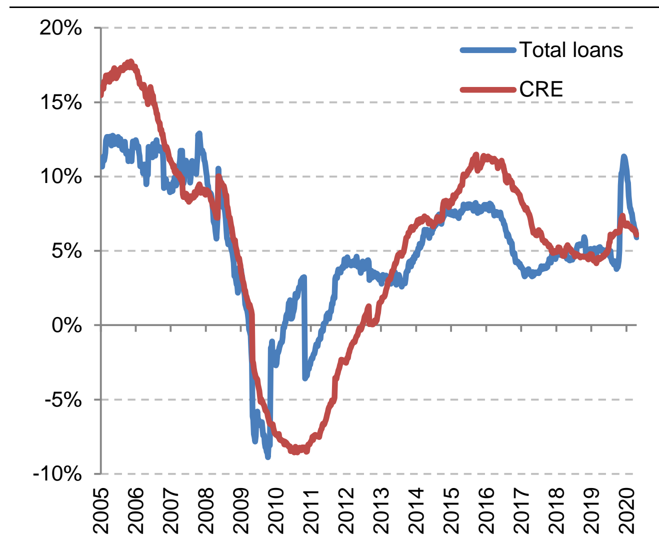
decreased by unprecedented rate across all major segments except for industrials while prices began to decline. From the other hand, 2Q20 and July rent collection was better than expected, especially for retail segment, where majority of properties were closed or were operating in a limited functionality mode. Notwithstanding, forecasts continue to be revised down with lower rent, higher vacancy rates, negative absorption and declining prices. As a consequence, loan growth will inevitably turn negative while NCO and NPL ratios will go up in the coming quarters. However, 2Q20 earnings season was relatively solid given the conditions in which the sector finds itself. Unsurprisingly, REITs quotes remain pretty resilient in recent months after collapse in March 2020. Thus, BBREIT index increased by 41% from the low of the year but it declined by 14.9% ytd and by 3.2% MoM.

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 worsen in coming quarters. According to the Fed data, CRE NCO ratio was almost flat on yoy basis at just 0.06% in 2Q20 while delinquency ratio increased by 9 bps qoq, or +25 bps yoy, to 0.92%. According to FDIC data, NCO ratio for all CRE subsegments (construction, multifamily, commercial mortgage) remains stable, near 0% during the last year. The most significant growth was demonstrated by commercial mortgage NCO ratio, which increased by 7 bps yoy to 0.1% in 2Q20. In turn, non-current rates increased markedly in all major segments in 2Q20. Thus, commercial mortgage noncurrent ratio is 0.78%, +22 bps yoy; construction one is 0.55%, +11 bps yoy; multifamily noncurrent ratio is 0.19%, +6 bps yoy. As for leading indicator of future credit quality, 30-89 days delinquency ratio improved slightly in 2Q20 vs 1Q20 and it still remains not far from its multi-year lows. The figure of commercial mortgage decreased by 7 bps qoq to 0.3%; in construction it went down by 14 bps qoq to 0.41%; in multifamily it was -4 bps qoq at 0.16%. In any case, NCO ratio highs booked in domestic offices were very different during three last recessions. According to Federal Reserve data, the high of the GFC was 2.82%, comparable to recession of early 1990s figure of 2.44%, but significantly higher that just 0.15% of recession of early 2000s. And we don't expect that NCO ratio peak of the current cycle will reach high of the GFC even despite significant problems in retail and hotel segments (according to REIS forecasts, deterioration in retail in 2020 will be worse than it was in 2009) due to a shorter period of current downturn and much tighter lending standards during last credit cycle. Moreover, the percent of rent collections still remains very high in majority segments. Price growth has remained positive on yoy basis so far but it decelerated markedly in recent months driven by office and retail segments even despite relatively strong apartment and industrial. Price index remained relatively flat during last 11 months. But we expect that prices will be negative on yoy basis in coming quarters, especially in the most affected segments, such as retail/hotels/offices and possibly in apartments in some regions. Notwithstanding, CRE price index still remained near its all-time high in August which is more than 30% higher than a peak of the previous cycle, but adding just +1.6% yoy as the end of the month vs +6.8% 1 year ago, the lowest growth rate since 1Q11.

Transaction volumes tumbled significantly both MoM and yoy in 2Q20 and the first two months of 3Q20 with few deals in majority of subsegments as market participants prefer to stay on the sidelines and preserve liquidity given high level of uncertainty. But volumes could increase somewhat in the nearest months given faster than anticipated recovery. However, the difference between buyers' and sellers' prices is currently near the high of the GFC. According to RCA, "illiquidity continued to plague the U.S. commercial real estate market in July, with volume across the property types falling at high double-digit rates". Even extremely low interest rates can't change the situation. So, total U.S. sales activity fell 68% versus August 2019, the 5th month in a row of a very low activity. On ytd basis, national sales decreased by 36%. However, "the monthly sales level is still trending above the lows set in 2009 during the Global Financial Crisis". But situation could worsen as "potential buyers are fearful to step up to higher prices in the face of struggling tenants and

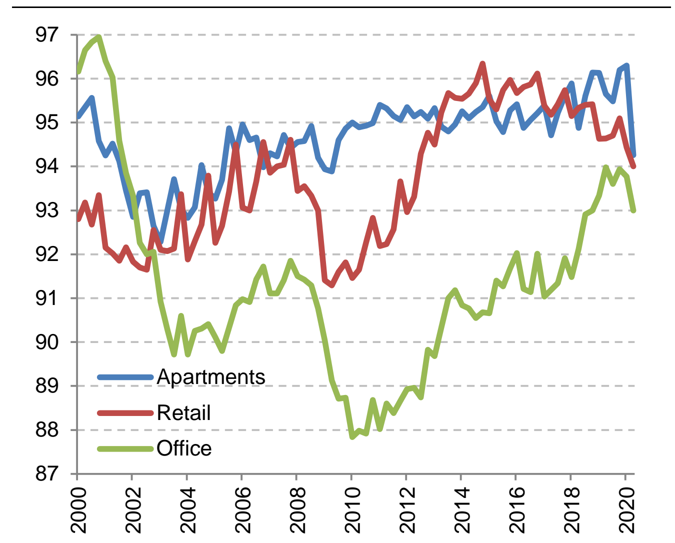
a hazy picture on future income trends". Notwithstanding, prices remained resilient so far showing positive but decelerating yoy growth. Thus, apartment price index added +7.4% yoy as of the end of August, a slight deceleration from its growth rate in the middle of 2019. In turn, price index of retail CRE turned negative in May 2020 and it is currently -4.1% yoy vs +2.6% yoy 1 year ago. Growth of prices of industrial CRE decelerated to +7.4% yoy from +11.9% yoy in July 2019. Growth rate of office prices decelerated to -0.5% yoy from 2.7% yoy as of August 2019. But CRE all-property index was still +0.2% on ytd basis.

Chart 10. Loan Growth. CRE vs Total Loans, YoY, %



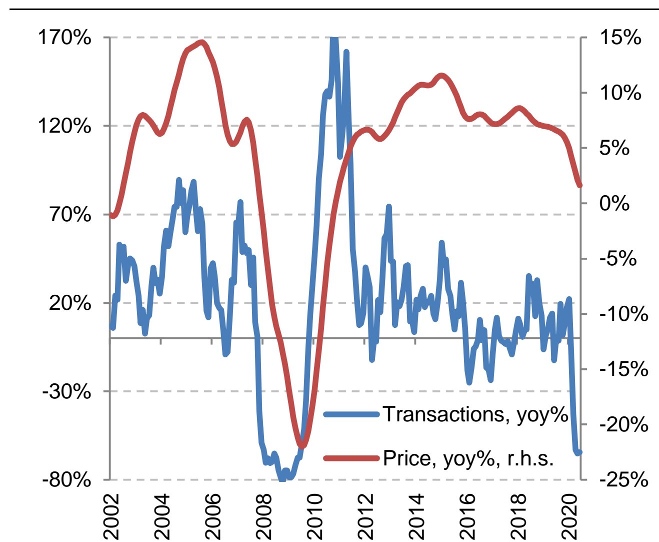
Source: Bloomberg

Chart 11. CRE. Occupancy rates, %



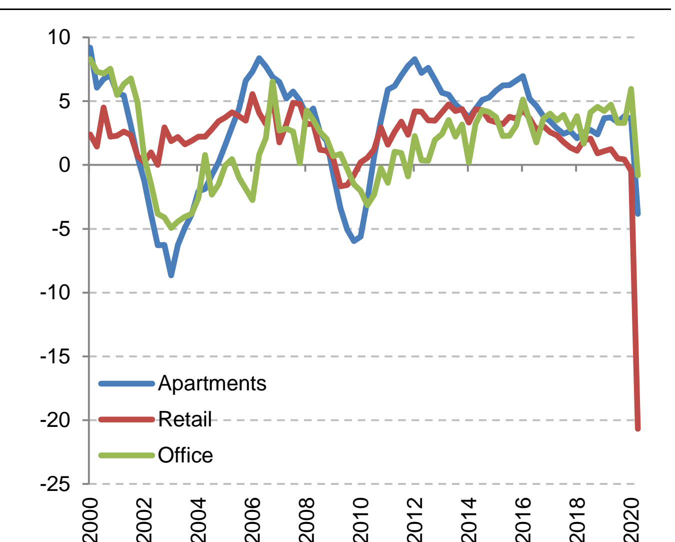
Source: Bloomberg

Chart 12. CRE. Price Growth vs Transactions Volumes



Source: Bloomberg

Chart 13. CRE. Same-Store NOI Growth, %



Source: Bloomberg

Solid but decelerating growth of US economy and rising employment supported CRE fundamentals till the early 2020, especially in office segment where we have seen growth of both same-store NOI and occupancy rates at the end of 2019. But the situation has changed dramatically in the 1st half of 2020 with an explosive growth of unemployment, closed malls and stores, social distancing and home working. All this suggests difficult times for the sector in the near future, accompanied by lower occupancy rates, lower rents and so on. So, fundamentals deteriorated meaningfully in 2Q20 in all major segments. Thus, retail same-store NOI tumbled by more than 20% yoy as a result of low rent collections. The lowest figure of the GFC was just -1.7% yoy in 2Q09. Office NOI declined by 0.82% 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 3.8% yoy in 2Q20 vs +3.6% in 1Q20 and the lowest growth rate during the GFC of -6.0% in 4Q09. Occupancy rates also declined substantially across all major segments except for industrials in 2Q20 and we expect that they will continue to decline in coming quarters. Some REITs (with higher leverage) have already announced suspension of dividends because of liquidity concerns. Moreover, a number of them didn't pay the principal and percentages on their loans since April 2020 and tried to renegotiate loan terms. Of course, it currently applies to the most levered companies but it may spread to the other companies in the industry over time. So, it is quite probable that we won't see normalization of the situation in the coming months, accompanied by significant deterioration of key CRE fundamentals, lower credit quality and negative loan growth. Notwithstanding, there were just few dividends cuts/suspensions during the recent months. But situation could worsen in coming quarters given quite possible acceleration of the pandemic in winter and no fiscal stimulus till the end of the year.

In 2Q20, banks continue to tighten standards for CRE loans. Standards were tightened for all three major CRE loan categories. For construction loans it was the 21th quarter of tightening in a row while for multifamily loans standards were tightened by significant net fraction of banks for the second consecutive quarter after flat standards in 4Q19 following 17 consecutive quarters of tighter standards. Also banks noted weaker demand for all three major loan categories of CRE. “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”.

Mortgage

The growth rate of mortgage loans decelerated slightly in recent months vs the end of 2019, given significant deterioration of economic situation. And it remains relatively flat ytd as a consequence of the fact that a number of banks have already announced tighter lending standards for mortgage loans because of significant deterioration of financial health of US consumer. Thus, mortgage loans increased by 1.6% yoy (as of September, 9) vs +3.7% yoy 1 year ago and +5.3% yoy as of the end of 2019. Credit availability index by MBA decreased markedly in August to 120.9 pts, -6 pts MoM, and it is the lowest level over more than 6 years. The key driver of the decline was tightening lending standards. Also, affordability ratios have already declined meaningfully from the cycle highs but they should increase in the foreseeable 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 a significant growth of unemployment ratio in the recent months and a forthcoming growth of problem loans as a consequence. 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 and stronger financial health of US Consumer now vs 2007-2008 years. 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 this time will be more like one we saw during the recession of early 2000s with the highest figure of 0.3%. But percent of rent payments slightly deteriorated in August. According to the National Multifamily Housing Council Rent Payment Tracker, 90.1% of apartment households made a full or partial rent payment by September, 20 2020 vs 90% in August 2020 and 91.8% in September 2019.

The US economy created 1.37 mln payrolls in August vs expectations of 1.35 mln after +1.8 mln in July and +4.8 mln payrolls in June. It was created more than 1 mln payrolls in the

last four months but employment still remains very far from pre-COVID levels as it was lost more than 22 mln payrolls in March and April. Moreover, an acceleration of employment growth in coming months remains questionable given a reacceleration of the pandemic in a number of states, still elevated jobless claims and some deceleration of economic recovery path in recent weeks. Jobless claims decreased substantially from March high but the figure still remains meaningfully higher than it was in the beginning of 2020. Average figure of 867K in September was 12.6% lower than average level of August, but still almost fourfold higher than January-February levels. So, median forecast of average monthly payrolls for 2020-2022 years were almost unchanged at -703K/306K/225K for 2020/2021/2022 years, respectively, in September comparing to -700K/300K/222K in August, and it seems that the worst is behind us. Unemployment rate declined by 1.8 p.p. MoM to 8.4%, meaningfully better than consensus estimate of 9.8%, but it is already markedly lower than peak of the GFC. Moreover, underemployment rate tumbled by 2.3 p.p. MoM to 14.2% in August. Unsurprisingly, unemployment projections were revised down significantly in September to 8.5%/7.0%/5.6% for 2020/2021/2022 years, respectively, from August estimates of 9.0%/7.4%/5.9%. Despite to a significant growth of unemployment in April, it seems that negative impact of this factor on a quality of mortgage portfolios could be restricted, at least near term, due to forbearance programs and positive impact of fiscal stimulus, although it is necessary to approve the new one as fast as possible. However, further dynamics of quality characteristics will depend on how quickly the economy will recover. Thus, according to MBA, “the total number of loans now in forbearance decreased by 8 basis point from 7.01% of servicers' portfolio volume in the prior week to 6.93% as of September 13, 2020. 3.5 million homeowners are in forbearance plans”, slightly down from 3.6 mln 1 month ago. The key driver of a decline of loans in forbearance is return of homeowners to work. As for Fannie Mae and Freddie Mac data, a share of loans in forbearance declined for the 15th week in a row.

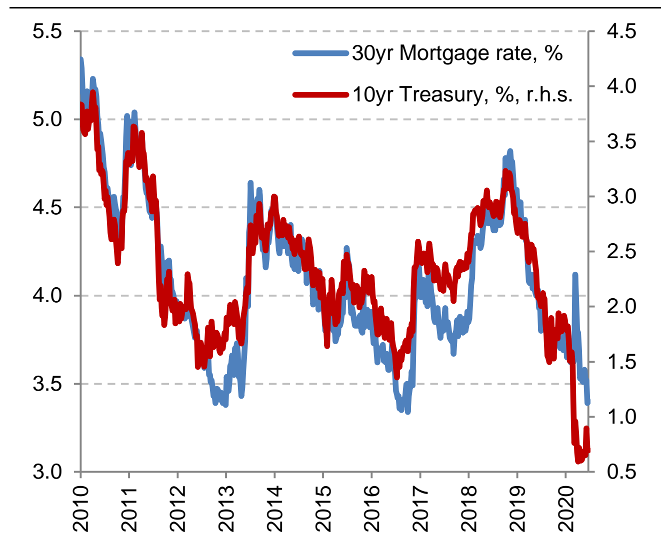
Mortgage credit quality was very strong so far. According to the Fed data, NCO ratio in the segment increased by 3 bps yoy to 0.0% in 2Q20 while delinquency ratio decreased by 7 bps yoy, but +12 bps qoq, to 2.49%, still near the lowest figure over 12 years. According to FDIC, the quality of mortgage portfolio remains also very strong with NCO ratio at -0.003% in 2Q20, +2.6 bps yoy. 30-89 days delinquency ratio decreased by 11 bps yoy to 0.79%. In turn, noncurrent ratio increased markedly, +21 bps yoy to 2.07% in 2Q20, +31 bps qoq. MBA’s mortgage delinquencies skyrocketed by 386 bps qoq to 8.22%, the highest level since 2Q11. It was the biggest quarterly increase on record of MBA’s survey. In turn, foreclosures declined again, -5 bps qoq, or -22 bps yoy, to 0.69%, the lowest figure over more than 35 years. According to NY Fed, “about 0.5% of current mortgage balances became delinquent in 2020Q2, as many borrowers enrolled in forbearance programs and about 24,000 individuals had a new foreclosure notation added to their credit reports between April 1 and June 30. This is by far the lowest level we have seen since the beginning of our series in 1999”. One of the key reasons that credit quality still remains very strong is that skyrocketing growth of unemployment mainly affected renters, not owners. But we expect that the quality of mortgage loans will remain very strong vs GFC’s average figures of NCO and delinquency ratios as underwriting standards were much stronger during last credit cycle.

Lending standards for most mortgage segments were tightened again in 2Q20, for the second consecutive quarter after five quarters in a row of relatively flat standards. In the SLOOS for 4Q19, banks noted that they weren’t going to tighten standards in mortgage segment but the situation had deteriorated very quickly and the net percentage of domestic respondents tightening standards isn’t far from the highs of the GFC. It is unsurprisingly given unprecedented levels of unemployment and still elevated jobless claims. According to NY Fed 2Q20 report on HH debt and credit, “origination credit scores for mortgages increased notably in the second quarter of 2020. The median credit score of newly

originating borrowers increased in the first quarter for mortgages, to 784, up 11 points from the previous quarter and 25 points from a year ago. The median credit score on newly originated auto loans declined, from 718 to 707".

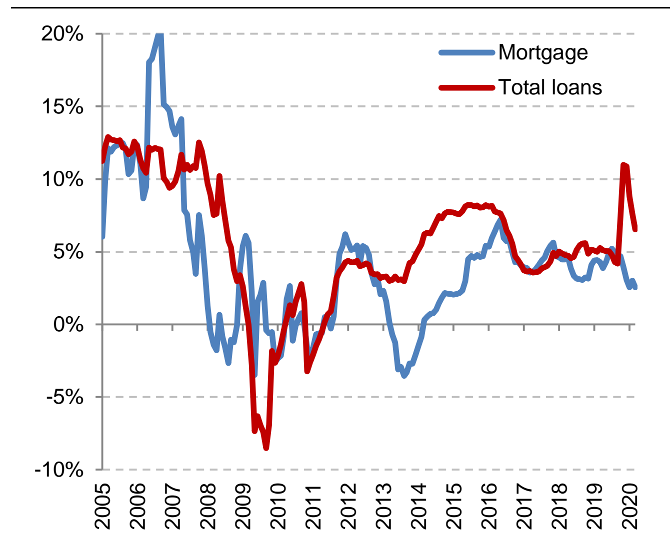
Mortgage demand strengthened for five recent quarters after several quarters in a row of weaker demand. Banks noted that weaker demand was demonstrated only in home equity segment. But mortgage demand will inevitably be weaker in coming quarters as a result of pandemic and consequences of the economic crisis. Despite a recent uptick of employment and relatively solid dynamics of the economy after reopening, unemployment rate remains elevated.

Chart 14. Mortgage. 30yr Fixed Mrtg vs 10yr Tr yield, %



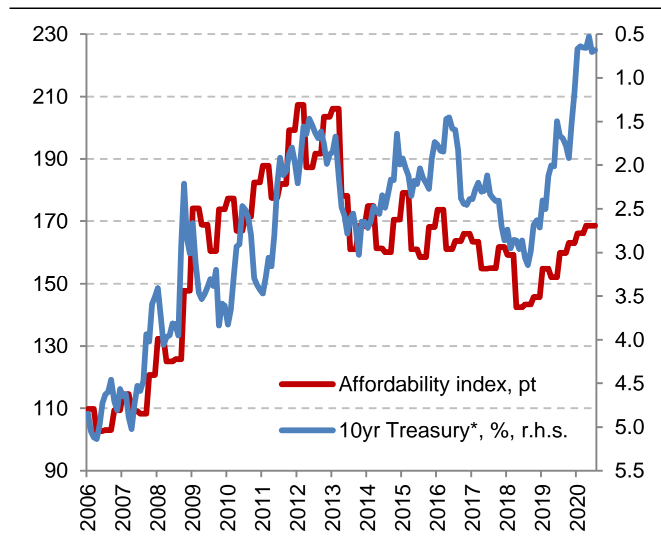
Source: Bloomberg

Chart 15. Loan Growth. Mrtg vs Total Loans, YoY, %



Source: Bloomberg

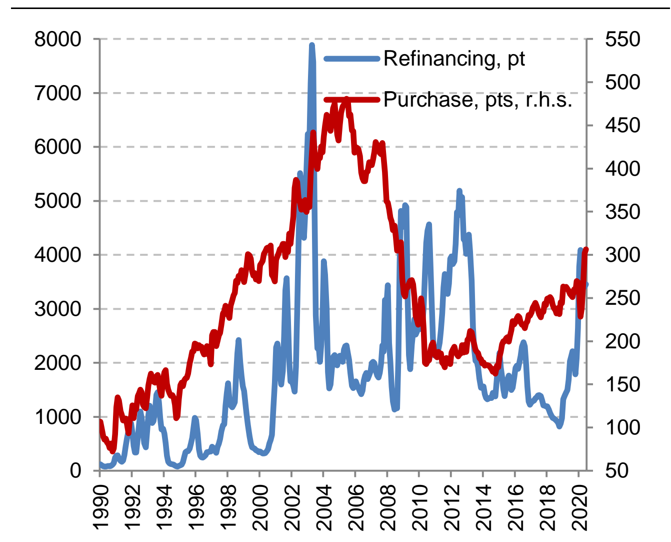
Chart 16. Mortgage. Aff. Index vs 10yr Treasury yield



*reversed order

Source: Bloomberg

Chart 17. Mortgage. MBA Applications Indexes



Source: Bloomberg

Mortgage rates continued going down though key benchmark rates have remained relatively flat over recent 6 months. Monthly average rate for mortgage rates declined for the sixth month in a row due to narrowing spreads because of normalizing economic situation. Thus, 10yr treasury yield declined by 2 bps MoM to 0.68%, but it continues hovering around 0.7% over last half of the year. 30yr fixed rate mortgage (national average, Bankrate.com) decreased by 2 bps MoM to 3.08% as of the end of September. So, 30-yr mortgage rate (effective rate, MBA) decreased by 19 bps qoq, but +1 bps MoM, to 3.2% (as

of September, 25), remaining near all-time low.

Housing market indicators published in September 2020 were slightly worse than expected after relatively strong figures in the summer months. Due to a significant drop of interest rates and faster than expected economic recovery a majority of macro indicators looks pretty resilient ytd. Unsurprisingly, NAHB index increased by 5 pts MoM to 83 pts in September, markedly beating consensus of 78 pts, pointing to a high level of optimism of homebuilders. In turn, construction spending increased only by 0.1% MoM in July, markedly missing consensus of +1% MoM. Notwithstanding, mortgage origination forecasts remain pretty resilient in recent months even despite a sharp decline of the US economy in 2Q20. Thus, according to Fannie Mae’s September housing forecast, expected total mortgage originations increased by 13.5% MoM for 2020 year and +3.7% MoM for 2021 year (+89.3%/+31.4% respectively vs December 2019 forecasts). Currently, it is expected that total originations will increase by 57.1% yoy in 2020, but the figure will decrease by 33.6% yoy in 2021. The key driver of applications will be refinancing originations. According to MBA’s forecast published in September, total mortgage originations will increase by 45% yoy in 2020 (+5.3% vs August forecast) driven by refinancing which are estimated to increase by 94% yoy in 2020, but total originations will decrease by 29.8% yoy in 2021 (+4.3% MoM vs August forecast). The key driver of refinancing originations remains significant decline of mortgage rates.

Housing starts were 1416K in August vs expectations of 1488K, +78K MoM from slightly revised down July figure (initially it was 1496K), still slightly lower pre-COVID levels. Building permits also missed estimates, 1470K vs consensus of 1512K. Existing home sales slightly increased in August after skyrocketing growth in July, being in-line with expectations at 6.0 mln, +0.14 mln MoM. So, it is markedly higher relative to pre-COVID levels, being at the highest level since the end of 2006. New home sales increased by 5.0% MoM to 1011K in August, significantly beating consensus of 890K. It was the fourth consecutive month of an explosive growth and markedly better than consensus figures. Moreover, July initial estimated was revised up by 7.0%. New home sales have already surpassed pre-pandemic levels and it was also the best figure since the end of 2006. So, housing prices increased significantly in July as a result of demand growth. Thus, FHFA house price index skyrocketed by 1% MoM in July vs consensus of +0.5% MoM and June figure of 1.0% MoM (slightly revised down up from initial estimate of +0.9% MoM). S&P CoreLogic home price index for 20 cities also increased meaningfully, adding 0.55% MoM in July vs consensus of 0.1% and flat dynamics in June. On yoy basis, it was just +3.95% and it is not far from the lowest level since the end of 2012, a significant deceleration from price growth of early 2018 of 6.7% yoy.

Consumer

Consumer loans growth decelerated significantly in April and May but then stabilized in summer months. According to Fed H8 data, a growth rate of consumer loans even turned negative in early May and it is currently -2.9% yoy (through September, 9) vs +5.6% 1 year ago and +6.2% yoy as of the end of 2019, the lowest growth rate since the end of 2011. On ytd basis, the figure already declined by 4.6%, driven by credit cards. Thus, CC growth rate was -9.2% yoy (as of September, 9) vs +5.0% yoy at the end of 2019. On ytd basis, CC loans decreased by 10.8% as credit cards limits were markedly cut because of a rapid deterioration of the US economy. Net change of consumer credit in July was +$12.25 Bn, slightly missing consensus of +$13.0 Bn, after a growth by $11.4 Bn in June. Other segments of consumer credit also decelerated significantly, adding just 4.3% yoy (as of September, 9) vs 7.6% yoy at the end of 2019, just +2.5% ytd. According to 2Q20 HH debt and credit survey by NY Fed (the latest available one), “aggregate household debt balances declined by $34 billion in the second quarter of 2020, a 0.2% drop, and now stand

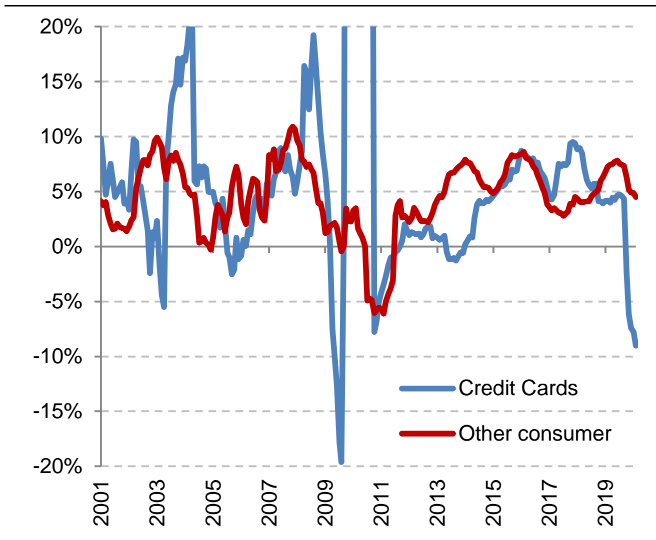
at $14.27 trillion. The drop was the first decline since the second quarter of 2014 and the largest decline since the second quarter of 2013. Balances are $1.59 trillion higher, in nominal terms, than the previous peak (2008Q3) of $12.68 trillion and 27.9% above the 2013Q2 trough".

We didn't expect a marked deterioration of the quality of consumer loans (only return to historic averages) until the recent times, but the situation changed dramatically in 2Q20. Thus, GDP forecasts for the nearest years were revised down significantly in 2Q20 but improved markedly in 3Q20. According to Bloomberg estimates compiled in September 2020, the most pessimistic GDP growth forecast assumed a decline of around 10% yoy for 2020 US GDP, while a mean figure is equal to -4.5% yoy. As of unemployment, it is estimated to be as high as 8.5% as of the end of 2020 and it was 13% at the end of 2Q20. So, it is undoubtedly that quality characteristics of consumer portfolio will worsen significantly in 2H20 and later in 2021, especially taking into account the delay with approval of new fiscal stimulus even despite DSR and FOR of median HH is still markedly lower than historical averages. But the figures of low-income consumer, which is usually suffer the most during recession, is already at or higher than pre-financial crisis levels. The key drivers of still pretty resilient quality characteristics of consumer loans portfolio are forbearance programs and state aid which, however, has already ended. Even despite to the fact that quality characteristics of consumer loan portfolio were resilient in 1H20, banks continued to build reserves, especially in credit card segment. But we still don't expect that the peak levels of the previous crisis (NCO ratio for credit cards of 10.5% and for other consumer loans of 3.3%) will be reached this time due to forbearance programs, faster than expected recovery and the fact that financial health of US consumer is much stronger today than it was then. But, of course, it will depend on the further speed of economic recovery and whether there will be the second wave of the pandemic.

According to the Fed data, total consumer NCO ratio was flat qoq and just +2 bps yoy at 2.31% in 2Q20. NCO ratio in CC segment increased by 19 bps yoy to 3.91%, while NCO ratio of other consumer loans increased just by 1 bps yoy to 0.92%. In turn, delinquency ratio decreased by 35 bps yoy to 1.98%, driven by other consumer loans, which delinquency ratio decreased by 47 bps yoy to 1.65%. According to FDIC, credit cards NCO ratio decreased by 3 bps yoy to 4.0% in 2Q20; in other consumer loans NCO ratio was flat yoy at 0.82%; Auto NCO ratio also increased by 10 bps yoy to 0.71%. 30-89 delinquency ratios (a leading indicator of credit quality deterioration) decreased markedly in 2Q20: 1% (-28 bps yoy) in credit cards, 1.03% (-43 bps yoy) in other consumer loans and 1.32% (-66 bps yoy) in Auto. Number of bankruptcy filings decreased meaningfully in 2Q20, 136K vs 189K in 1Q20, a new historical low, as the courts remained closed in many states because of the pandemic. According to NY Fed, "as of June 30, 3.6% of outstanding debt was in some stage of delinquency, a 1.0 percentage point decrease from the fourth quarter of 2019. Of the $512 billion of debt that is delinquent, $372 billion is seriously delinquent".

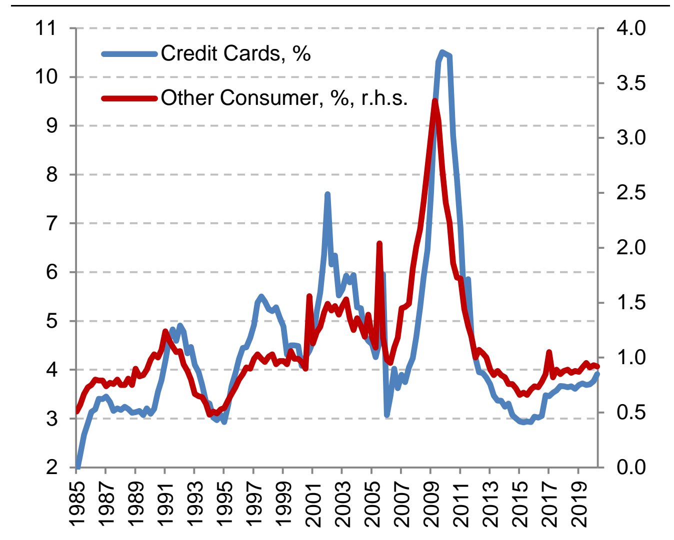
July 2020 SLOOS survey indicated that "major net shares of banks tightened lending standards on all categories of consumer loans. Major net fractions of banks also tightened important terms on credit card loans, including credit limits and minimum credit scores required. In contrast, a modest net share of banks reportedly reduced the minimum percent of outstanding balances required to be repaid each month. Meanwhile, significant net shares of banks tightened most surveyed terms on auto loans". Moreover, the net percentage of banks tightening standards is near the high of the GFC. As of demand, banks noted that demand was weaker across all three major categories of consumer credit. Unsurprisingly, given the rate of economic deterioration. According to NY Fed, "the median credit score on newly originated auto loans declined, from 718 to 707".

Chart 18. Consumer. Loan Growth Rates, YoY, %



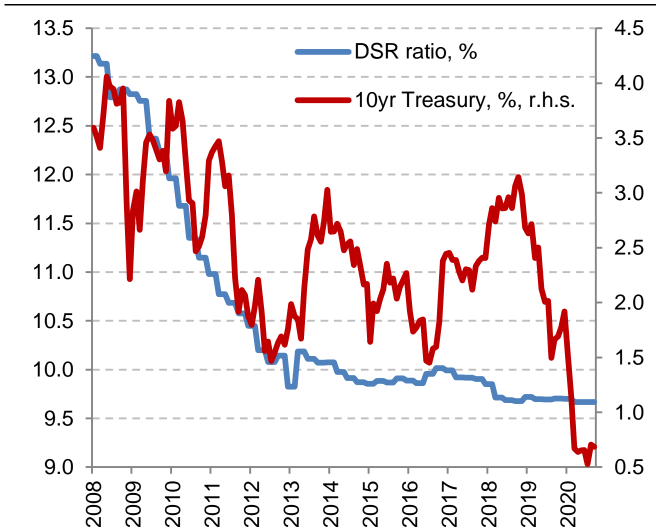
Source: Bloomberg

Chart 19. Consumer. NCOs Ratios, %



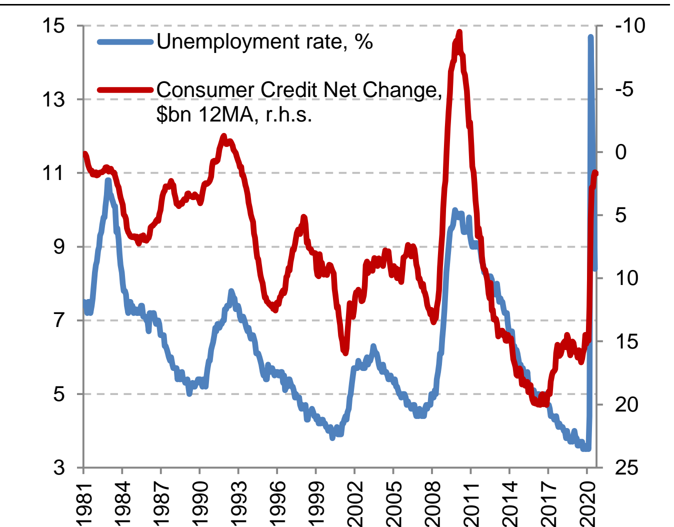
Source: Bloomberg

Chart 20. Debt Service Ratio vs 10yr Treasury Yield, %



Source: Bloomberg

Chart 21. Unemployment vs Net Change of Cons Credit



Source: Bloomberg

Consumer activity data published in September were slightly better than expected after weaker figures in July and August. Both indicators of consumer confidence are still markedly lower on ytd basis and it seems that they could go even lower in coming months given recent high frequency data, a growth of COVID-19 cases in summer months and still no positive news about an approval of new fiscal stimulus after extension of CARES act / the new state aid program. It seems that the new program will not be approved till the beginning of 2021. Thus, consumer sentiment indicator published by Michigan University increased by 4.8 pts MoM to 78.9 pts vs expectations of 75.0 pts. It is just 7.1 pts higher than April low and it is 22.1 bps lower than pre-COVID level. Unsurprisingly, 2Q20 consumer spending decline was the biggest on record. According to August Bloomberg survey, consumer spending will decline by 4.8% yoy in 2020. Conference board consumer confidence index was markedly stronger than expected and it increased by 15.5 pts MoM from revised up August initial estimate to 86.3 pts vs consensus of 90.0 pts. It was driven by expectations index which skyrocketed by 17.4 pts MoM to 104 pts although the situation with new fiscal stimulus remains uncertain.

All data which are related to employment published in summer months were clearly optimistic except for jobless claims which remain elevated, especially continuing jobless

claims. But we don't think that it means a V-shaped recovery in any case. It is just a result of reopening of the economy and employment will remain far from pre-COVID levels for a long time. Payrolls are more than 11 mln below pre-COVID levels at the moment. So, the most significant payrolls growth was demonstrated by industries which showed the largest losses in March and April. But uncertainty is still very high and businesses will inevitably collide with lower profitability and bankruptcies growth. So, employment recovery will be much slower than its destruction in 1H20. So, August employment report was in-line with expectations after significantly better reports in several previous months. Thus, nonfarm payrolls were 1.37 mln in August vs expectations of 1.35 mln, after a growth of 1.7 mln in July and 4.8 mln in June. In turn, private payrolls increased just by 1 mln vs consensus of 1.3 mln. The vast majority of sectors continue to demonstrate growth in August. The most significant growth was demonstrated in leisure and hospitality. Unemployment ratio declined by 1.8% p.p. to 8.4% in August vs consensus of 9.8%. Average hourly earnings increased by 0.4% MoM in August vs expectations of flat MoM dynamics after growth of just +0.1% in July and decline by 1.3% in June as a result of employment growth which was driven by low-wage workers. From the other hand, underemployment ratio was 14.2% in August, -2.3% p.p. and it is still not far from the high of the Great Recession of 17.2%. In any case, approximately 12 mln workers are still filling continuing jobless claims which is substantially higher than peak level of the GFC. Continuing claims remain very important indicator to track employment situation. Moreover, employment population ratio is still near levels last time seen 50 years ago. On a year-over-year basis, hourly earnings were +4.7% vs consensus of +4.5% and in-line with June figure. Average weekly hours were +0.1 MoM at 34.6 vs consensus of 34.5. Initial jobless claims markedly decreased in recent months, but overall initial jobless claims over recent 4 weeks still exceeded more than fourfold pre-COVID levels despite to better than expected economic recovery.

Interest Rates

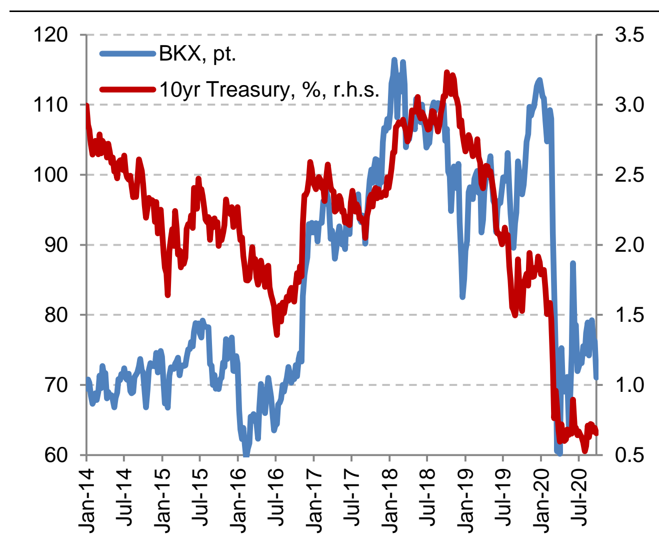
As it was widely expected after an announcement of the new longer-run monetary policy strategy at Jackson Hole, the Fed changed the wording of FOMC statement significantly at September meeting. Thus, "the Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With inflation running persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer-term inflation expectations remain well anchored at 2 percent. The Committee expects to maintain an accommodative stance of monetary policy, until these outcomes are achieved". So, the rates remained unchanged and they will remain unchanged until both employment and inflation targets will be reached. Released new projections imply that rates will remain at zero bound through 2023 at least. Notwithstanding, there were two members who voted against the action. It was the first time since mid-March meeting. Dot plot was remained almost unchanged for 2020-2022 years with 4 out of 17 FOMC members forecast a hike in 2023 (the latter projections were released for the first time). From the other hand, asset purchase guidance was almost unchanged and it seems that we will hear some announcements about QE at November meeting. As for macro forecasts, they were improved markedly but key positive changes were related to 2020 year. Jerome Powell noted that the US economy outperformed FOMC expectations but also he accented that risks still remained. Moreover, he emphasized that new fiscal stimuli were needed or risks would be raised. Overall, it was dovish meeting, from our point of view, but market reaction was controversial. After the statement was released, S&P 500 index increased by 0.5% and the curve became steeper but S&P 500 lost more than 1% since the press conference started and closed the day in red.

Despite high-frequency data showed some weakness in recent weeks, hard and soft data remained markedly better than expected. So, 2020 projections were improved

meaningfully. The Fed continues to emphasize that the outlook for the economy remained “extraordinary uncertain” and it would depend in large part on the success in keeping the virus in check even despite the recovery was better than the Fed expected. Spending in some services sectors is still quite weak. But it seems that the probability of the double dip continues to decrease even in case of the second wave of the pandemic. Thus, according to September FOMC projections, GDP will decline by 3.7% in 2020 but it will increase by 4.00% yoy in 2021 and by 3.0% yoy in 2022 (vs -6.5%/+5.0%/+3.5% in June Fed’s forecast). It was also released GDP growth forecast for 2023 which is 2.5%, while longer-run GDP growth projection was increased by 10 bps to 1.9% after significant downward revision previously. As of unemployment ratios, it is implied that it will be 7.6% at the end of 2020, 5.5% at the end of 2021 and 4.6% at the end of 2022 (vs June projections of 9.3%/6.5%/5.5%, respectively). As of the end of 2023, it is implied to decline to 4.0%. PCE inflation will be 1.2% in 2020 and it will rebound to 1.7% and 1.8% in 2021 and 2022, respectively (vs 0.8%/1.6%/1.7% in June forecast). Inflation target rate of 2.0% could be achieved only in 2023 that is quite consistent with current dot plot projections. Overall, FOMC projections are relatively close to consensus forecasts which were slightly improved MoM in September. According to Bloomberg September survey, GDP growth will be equal to -4.5%/+3.6%/+2.7% yoy for 2020/2021/2022 years, respectively, vs -5.1%/+3.7%/+2.8% yoy in August survey. Unemployment forecasts improved from 9.0%/7.4%/5.9% for 2020/2021/2022 years, respectively, in August survey to 8.5%/7.0%/5.6% in September one.

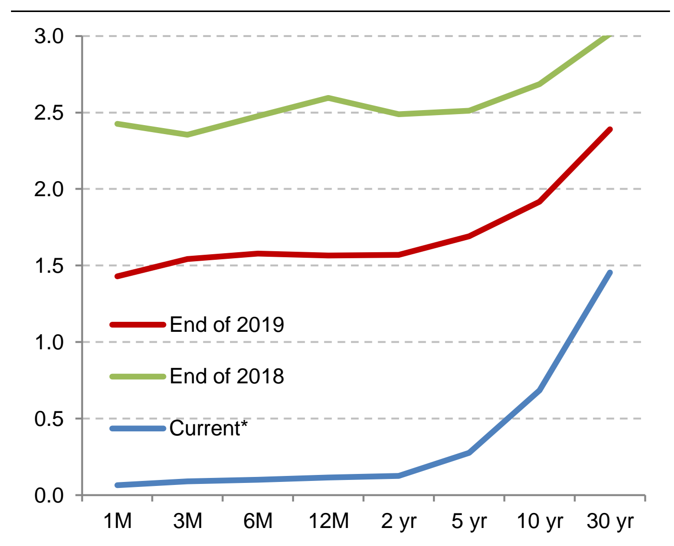
So, challenging rate environment for US banks will persist for an even longer time than it was expected a few months ago and NIM will remain a drag for US banks as well. We believe that the worst is behind us after US GDP tumbled by more than 30% in 2Q20 but we are still very far to be out of the woods. At least, uncertainty is still very high but declining, from our point of view. So, we believe that new measures to support the economy will be announced if situation deteriorate (both fiscal and monetary). But the key question whether it will be negative rates or a curve control. In any case, both alterations are negative for US banks earnings. At least, 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 corporate sector in coming quarters, unless, of course, the fed decides to continue supporting zombies with weak balance sheets. But it can’t go on forever since the long-term negative consequences for the economy will gradually outweigh the short-term benefits of this support.

Chart 22. BKX Index vs 10yr Treasury Yield



Source: Bloomberg

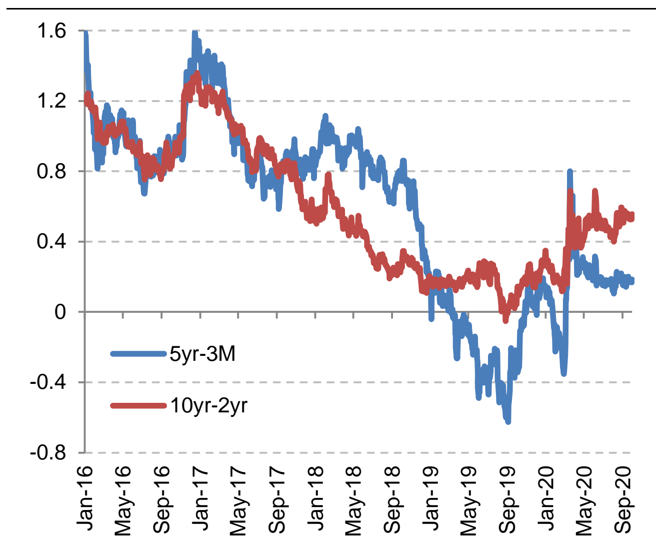
Chart 23. US Yield Curves, %



*As of end-September 2020

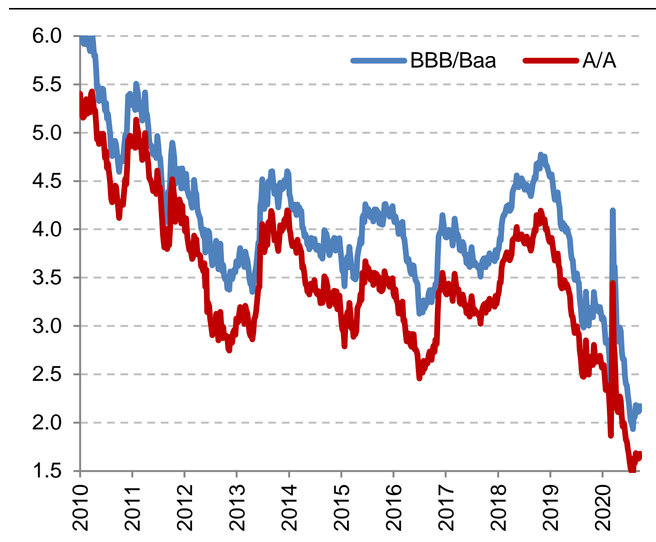
Source: Bloomberg

Chart 24. Treasury Spreads, %



Source: Bloomberg

Chart 25. Corporate Spreads, %



Source: Bloomberg

Median NII decline of BKX index members was -2.2% qoq and -3.1% yoy in 2Q20 vs +0.7% qoq and -0.6% yoy in 1Q20, the third consecutive quarter of yoy decline of NII in a row. The key driver of negative sequential NII dynamics was significant decline of NIM which was driven by both meaningful decline of rates and investing strong deposit inflows into high liquid assets. Taking into account that rates will stay low for foreseeable future, NII/NIM environment will remain very challenging. So, median NII surprise of BKX index members was -0.4% (vs estimates for July, 13), after +1.5% in 1Q20 due to very strong C&I loan growth because of emergency liquidity needs. Just 11 out of 24 BKX members showed positive surprise on NII in 2Q20 vs 18 out of 24 BKX members in 1Q20. Moreover, just 5 out of 24 BKX members showed positive surprise on NIM in 2Q20 with median negative surprise of -9 bps vs 18 out of 24 BKX index members and +3.1 bps in 1Q20. Median NIM of BKX index members tumbled by 37 bps qoq, or -46.5 bps yoy, to just 2.96% (the lowest figure over decades) vs +4 bps qoq, or -12 bps yoy, in 1Q20. Due to significantly worse NIM in 2Q20 and results of recent Fed meeting, Bloomberg consensus estimates of median NIM/NII of BKX index members continued to go down. Thus, median growth of 3Q20 NII estimates of BKX index members is -2.4% qtd or -2.0% ytd. In turn, 3Q20 NIM estimated declined by 13 bps qtd while 2021/2022 NIM projections declined by 3.0/3.4 bps qtd respectively, being -26/-33 bps ytd.

Median growth of NII income of BKX index members was negative on qoq basis despite favourable seasonality but it was expected given 2Q20 was the first full quarter of zero-bound range for the FF rate (after relatively short break). The key driver of negative NII surprise was much weaker NIM because strong deposit inflows were invested in high liquid assets while commercial loans declined qoq as a result of payoffs of previously using revolvers. Notwithstanding, NIM projections continue going down. And we expect that pressure on NII/NIM will remain in 2H20 as key benchmark rates will stay low in the foreseeable future, much lower than current back book yields while there are almost no opportunities left to offset lower yields by reducing the cost of funding. Banks also signaled during 2Q20 earnings season that 3Q20 NII will be lower than it was 1 year ago despite a significant growth of earning assets.

Treasury yields were relatively flat in September after substantial growth in August. Thus, 1M yield decreased by 1.5 bps MoM to 0.07% while 3M yield went down only by 0.2 bps MoM to 0.09%. 2yr yield decreased by 0.4 bps MoM to 0.13% and 5yr yield added 1 bps MoM (currently at 0.28%). 10yr yield decreased by 2 bps MoM to 0.68% (and it is still -123 bps ytd), while 30yr yield went down by 2 bps to 1.46%. We don’t expect significant further

growth of the yield curve in the foreseeable future. According to current forwards, the yield curve in next 2 years will be just 15-30 bps higher than the current one, except for 30yr yield which is 32 bps lower.

So, spreads also were also almost unchanged in September after significant growth in August, remaining near the highest levels over two years. Spreads were slightly higher on ytd basis but they are significantly lower than average levels of 2017 year. Thus, 5yr/3M spread increased by 1.2 bps to +0.19% and it is still almost 80 bps lower than an average level of 2017 year while 10yr-2yr spread is 37 bps lower (as of the end of September). Spread (10yr-2yr) decreased by 1.7 bps MoM to +0.56%.

According to Bankrate.com data, loan yields continued to go down despite the yield curve was flat in September. Notwithstanding, decline of rates was minor Thus, average 30yr mortgage rate decreased by 2 bps MoM to 3.06% as of the end of September, the sixth consecutive month of decline after unexpected growth in March. Period-end rate was slightly higher, 3.08% at the end of September but it is 49 bps lower ytd than decline of 10yr treasury yield. Notwithstanding, it seems that mortgage rates hit bottom, at least temporarily. Average 15yr mortgage rate decreased by 10 bps MoM either, to 2.53%, -68 bps ytd. Auto loans rate (new loans, 60 mnth) went down by 9 bps MoM to 4.35%, 19 bps lower ytd.

Deposit rates continued to decline in September on average basis but a rate of decline was much lower than it was in previous months. Notwithstanding, it was the 12th month in a row of a declining average rate. But we think that it will be no more any significant mitigation factor for NIM until FF rate cut again. Thus, national average cost of 6 month deposits decreased by 1 bps MoM to 0.32%, -47 bps ytd; average 3yr CDs cost declined by 1 bps to 0.56%, -64 bps ytd; average 5yr CDs cost decreased by 3 bps MoM to 0.64% (-77 bps ytd) while cost of interest checking accounts decreased by 1 bps MoM to 0.2%, -48 bps ytd. Average cost of money market accounts fell by 1 bps MoM to 0.23%, -34 bps ytd.

Europe

Corporate

Corporate loans growth markedly accelerated in Europe in the spring driven by emergency liquidity needs but it seems that this growth is unsustainable given deep recession in 1H20, deceleration of economic recovery in recent weeks and expected tightening of lending standards. So, corporate loans increased only by 0.3% in the last 3 months. Moreover, EU corporate loans growth was positive on MoM basis in every month of 2020. On yoy basis, it slightly decelerated in August vs June and May but remained elevated in comparison with historical averages. Thus, loans up to 1 year decreased by 2.0% MoM, or -4.6% yoy, in August. Loans 1-5 yrs accelerated to 14.9% yoy from +3.4% yoy in February and +5.1% yoy 1 year ago. Loans over 5yrs were +6.4% yoy in August vs +2.9% yoy 1 year ago, +0.6% MoM. Total corporate loans increased by +5.6% yoy vs +2.6% yoy 1 year ago, flat MoM after solid +0.4% MoM in July. Credit growth in the EU began to vary markedly again after period of synchronous rapid growth in spring months. So, we still see very healthy growth rates in Germany and France (and other Northern countries) while Italian corporate loans growth turned positive on yoy basis only in June after it was negative for 8 years. Spanish corporate loans growth rate turned positive in March and it was strong in 2Q20, exhibiting +7.7% yoy in June, and it was the highest yoy growth rate since the middle of 2008. But it was negative on MoM basis in every of the summer months.

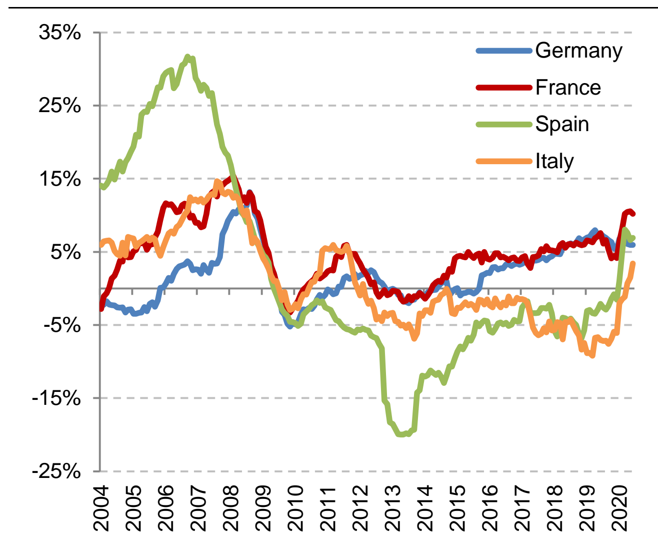
European corporations benefited from low interest rate environment so far but this will be a little consolation in a recession time given imminent decline of revenues. At the end of last year, there were expectations of a stabilization of the macroeconomic situation, but the coronavirus spreading disrupted these hopes. In May 2020 ECB's Financial Stability Review it was noted that the coronavirus pandemic caused the largest and sharpest economic contractions in history. "Economic indicators suggest an abrupt contraction in economic growth in the first half of 2020 with full-year figures likely to be weaker than in the year following the 2008 global financial crisis, according to private sector estimates". It will inevitably lead to lower corporate profits and higher default rates given the fact that financial health of EU corporate sector had already worsened even before lockdowns. Notwithstanding, "credit risk measures have surpassed their average values since 2014, but remained below the levels that had been observed during the financial and sovereign debt crises". Recent data showed significant recovery in recent months. Despite September composite PMI was slightly lower than expected it still remains above 50 pts. So, EU economy bottomed out in April 2020 and started to recover since then. But the recovery has decelerated recently and economic activity still remains well below pre-pandemic levels and growth slightly decelerated recently. Unsurprisingly, risks to euro area growth outlook remained on the downside, especially taking into account a significant acceleration of the pandemic in recent weeks.

According to July 2020 Euro Area bank lending survey, demand for corporate loans surged further in 2Q20 after significant growth in 1Q20. In result, it reached the highest net balance since the survey was launched in 2003. The key driver of demand growth remained emergency liquidity needs and precautionary build-up of liquidity buffers during the period when lockdown measures were intact. From the other hand, demand for fixed investments was weak again. Unsurprisingly, loan demand was strong across all EU countries. Also, banks expect that demand for corporate loans will continue to grow in 3Q20 but it will increase less than in 1H20. Credit standards remained broadly unchanged in 2Q20 but net percentage was still below the historical average since 2003. The key drivers for maintaining favourable credit standards in most countries were government guarantees. In turn, deteriorated economic outlook, worsened creditworthiness of borrowers and a lower risk tolerance remained the key arguments for tightening lending standards. So, banks expect considerable tightening of credit standards in 3Q20 as a result of termination of

state guarantee schemes in some large euro area countries.

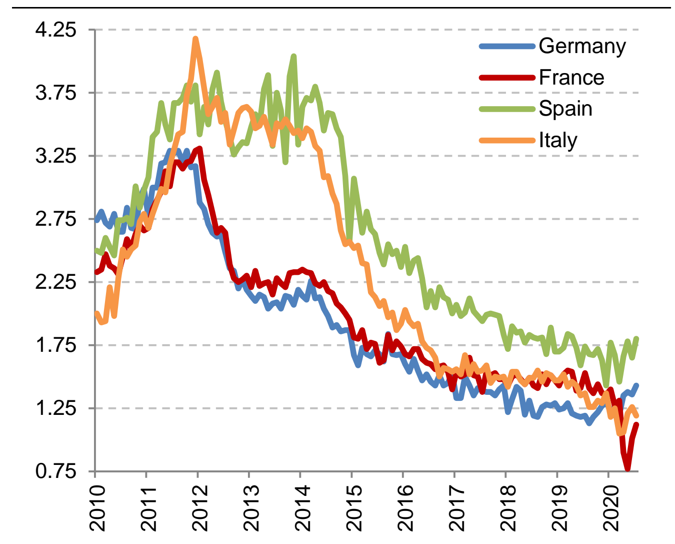
Unadjusted EoP corporate loans increased by 5.6% yoy at the end of July, the 35th consecutive month of positive growth on yoy basis. In turn, adjusted for sales and securitizations loans increased by 6.6% yoy, the 62th consecutive month of positive yoy growth. It was the highest rate of growth since the beginning of 2009. Notwithstanding, despite recent acceleration, it should begin to weaken in 2H20 given the depth of recession, normalization situation with liquidity and deceleration of economic recovery. We don't exclude that it will be negative in several quarters, accompanied by challenging rate environment for a long period of time, having double negative effect on NII and banks profit.

Chart 26. EU Corporate Loan Growth, YoY



Source: Bloomberg

Chart 27. EU Corporate Loan Rates, New Loans, %



Source: Bloomberg

German outstanding corporate loans (unadjusted figures) increased by 6.0% yoy as of the end of August, or +0.5% MoM, vs +6.4% yoy as of the end of 2019. French corporate loans outstanding (unadjusted figures) added 10.2% yoy, but -0.1% MoM, as of the end of August after five consecutive months of positive monthly growth above 1.0% MoM vs +7.6% yoy one year ago. Due to significant MoM growth in the spring months, Spanish loan growth was much higher than it was 1 year ago, but it was negative on MoM basis in each summer months. Thus, Spanish outstanding corporate loans added 6.9% yoy, but -0.9% MoM, vs -2.1% 1 year ago. Italian loan growth turned positive in June after being negative on yoy basis for more than 8 years. Thus, it added +3.4% yoy, or +0.2% MoM, in August 2020 vs -7.1% yoy in August 2019.

European corporate rates continued its negative dynamics on yoy basis but they increased substantially in June and July after being relatively flat for three months in a row. Thus, average EU corporate loan rates (all maturities, new business lending, adjusted for loan sales) increased by 4 bps MoM to 1.39% in July, currently being even higher relative to pre-pandemic level shown in February. But it remains 3 bps below its 1 year ago level. 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 and -3 bps MoM to 1.74% in July.

Dynamics of rates within European countries wasn't uniform in July 2020 with a skyrocketing growth of front book yields in France and Spain and a decline in Italy and Netherlands. Thus, Spanish yield went up by 15 bps MoM to 1.8%, after it declined by 13 bps MoM in June. In result, it is still +37 bps ytd and +6 bps yoy. Italian one came down by 7 bps MoM to 1.19%, after three consecutive months of growth. So, it is still -18 bps ytd and yoy. German corporate rate on new loans increased by 7 bps MoM in July to 1.43% and it

is 14 bps higher ytd and +24 bps higher than it was 1 year ago. French yield on new corporate loans went up by 11 bps MoM to 1.12%, +35 bps over two recent months but it is still -24 bps ytd and -41 bps yoy. Also, Dutch yield declined by 2 bps MoM to 1.32%, -32 bps ytd and -3 bps yoy. EU back book yield declined by 3 bps MoM and -17 bps yoy and dynamics across countries was relatively uniform with MoM decline in all major European countries except for Spain. Thus, German yield decreased by 2 bps MoM to 1.8% in July, -13 bps yoy. French yield decreased by 5 bps MoM to 1.45%, -23 bps yoy. Italian yield declined by 1 bps to 1.88%, -17 bps yoy. Spanish one increased by 1 bps MoM to 1.74%, -8 bps yoy. Dutch yield decreased by 5 bps MoM to 1.92%, -16 bps yoy. Thus, spread between new and outstanding rates decreased again, the fourth month in a row. It contracted by -7 bps MoM or -14 bps yoy to 0.35%, and this is the lowest figure since November 2008.

Consumer

EU consumer was the main driver of total loans growth till the beginning of the pandemic. It decreased on MoM basis in March and April but growth resumed later as a result of employment supporting programs. The growth continued despite banks started to tighten credit standards in 1H20. There were quite predictable actions given rapid deterioration of EU economy, which should inevitably lead to a significant deterioration of financial health of EU consumer (not yet). 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 sustained growth of property markets which positively impacted on household wealth during recent years will be inevitably 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, households debt interest burden is 40-50% lower for 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 better in the current crisis vs the levels seen during the GFC unless it will be L-shaped recovery rather than U-shaped one.

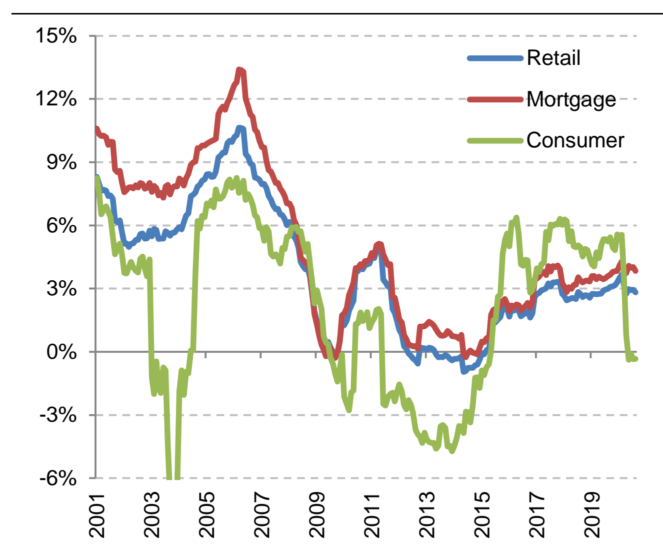
EU loans to households increased by 2.8% yoy and +0.1% MoM in August (the 4th consecutive month of positive MoM growth in a row following 2 consecutive months of decline). Consumer loan growth remained relatively strong so far but we expect that it should decelerate in the near term given more strict lending standards, very deep decline of economic activity in 1H20 and an imminent growth of unemployment in 2H20 and further in 2021. And it will continue to differ widely across countries (as well as corporate loan growth rates). Thus, German household loans increased by 4.1% yoy in August, or +0.2% MoM, French retail lending added 5.2%, or +0.2% MoM, (marked acceleration vs the first four months of 2020), while household loans in Spain declined by 1.3% on yoy basis, the 14th month in a row, after non-negative loan growth rate for 13 months in a row following more than 7 years of negative yoy growth. Italian consumer loans added 0.5% yoy in July, but -0.2% MoM, after three consecutive months of positive MoM dynamics.

Consumer lending (excluding mortgage) remained the key driver of EU household loan in pre-COVID time but it was negative on yoy basis for four last months. On MoM basis, it was non-negative in every of summer months after decline in each of spring months. In turn, EU mortgage loans increased by 3.8% yoy as of the end of August, +0.2% on MoM basis. According to July 2020 bank lending survey from the ECB loan demand for consumer credit was lower as well as net increase for housing loans because of worsening outlook. For more than 3 years, Spain demonstrated double-digit growth of consumer credit, significantly outperforming other major European countries. But the growth substantially decelerated in

recent months. Thus, Spanish consumer credit declined by 0.6% on yoy basis vs 11.1% yoy 1 year ago, the lowest growth rate since the middle of 2015 and it was -0.6% on MoM basis either. In turn, Spanish mortgage portfolio continues to stagnate, -1.8% yoy as of the end of August vs -1.6% yoy 1 year ago and -0.1% on MoM basis, the 15th month in a row of flat or negative dynamics.

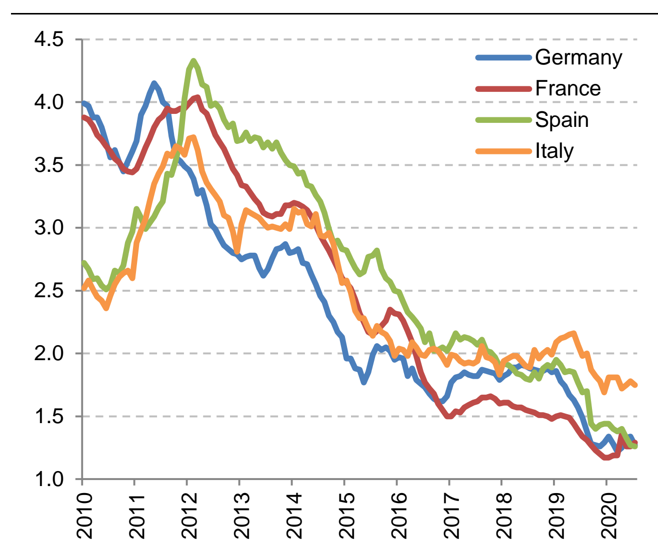
As for mortgage lending standards, it was tightened in 2Q20 as it was in 1Q20 after being broadly unchanged in 4Q19. Unsurprisingly, standards on consumer loans were also tightened in 2Q20 as a result of deteriorated economic outlook, worsened creditworthiness of borrowers and a lower risk tolerance. Banks expect that net tightening of standards on loans to households will continue in 3Q20. As for demand, it declined strongly for mortgage loans in 2Q20 while demand for consumer credit and other lending to households declined to a record low since survey was launched in 2003. “The demand for loans from households was dampened by weaker consumer confidence, worsened housing market prospects and lower spending on durable goods”. But banks expect that demand for both housing loans and other consumer loans will increase in 3Q20. Given dynamics of HH loans in May and June, it sounds quite plausible.

Chart 28. EU Consumer Loan Growth, YoY



Source: Bloomberg

Chart 29. EU Mortgage Loan Rates, New Loans, %



Source: Bloomberg

Average EU rate on new mortgage loans decreased by 2 bps MoM to 1.4% in July, the second month of decline in a row. So, it is still 28 bps lower than it was 1 year ago but just -2 bps ytd. It was hovering around 1.82-1.83% over 8 months from July 2018 to February 2019 but it declined by 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 decreased by 12.56 MoM bps to -0.52% and it is +34 bps from its all-time low. 30yr yield went down by 15.6 bps MoM and it turned negative again. So, entire yield curve still remains below 0% at the moment. In July, German mortgage rates on new loans decreased by 7 bps MoM to 1.27%, -22 bps yoy. Italian mortgage rate went down by 1 bps MoM to 1.26% and it is 43 bps lower than it was 1 year ago. In turn, French yield increased by 3 MoM to 1.29% in July after flat dynamics in June. Spanish mortgage rate decreased by 3 bps MoM to 1.75%, after two month of growth in a row but it is still 23 bps lower than it was 1 year ago. Because of lower front book yields, we continue to see declining back book rates on a year-over-year basis, -18 bps yoy for all Eurozone mortgage loans. On a month-over-month basis, it decreased by 2 bps to 1.86%, the 5th 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.

As for other consumer loans, EU new business rates increased by 16 bps MoM to 5.22% in July, after five consecutive months of a decline with a total drop of 62 bps. Consumer yields remain too volatile. On a year-over-year basis it decreased by 51 bps. Consumer yields decreased in Germany on MoM basis in July while it went up in other major European countries. Thus, German yield went down by 9 bps MoM to 5.63% in July, -48 bps yoy. French rate increased by 10 bps MoM to 3.42 bps, the third consecutive month of a significant growth with total increase of 86 bps, but it is still -27 bps yoy. Spanish rate skyrocketed by 31 bps MoM to 6.95%, but it is still -32 bps yoy. Italian consumer yield went up by 22 bps MoM in July to 6.33%, -45 bps yoy.

Average European new consumer deposits rate (with agreed maturity) decreased by 1 bps MoM to 0.265 in July, after it was flat in June. So, it still remains just 10 bps lower than it was 1 year ago, a markedly slower pace of decline than loan yields one. Cost of outstanding deposits (with agreed maturity) also decreased only by 1 bps MoM to 1.16% in July, being relatively flat over last 8 months. Total cost of deposits was flat MoM, at 0.22% in July, the third consecutive month of flat dynamics. On yoy basis, it is just 5 bps lower than it was 1 year ago. So, spread between total loans yield and cost of total deposits decreased by 2 bps to 1.91% in July, the 5th consecutive month of decline on MoM basis with total decline of 9 bps, after being relatively flat during 6 months, hovering around 2.0%.

Consumer deposits growth remains healthy, adding 6.3% yoy as of the end of August, a slight acceleration vs +5.2% as of the end of June 2019 and the fastest growth since 2H09. The growth rates of consumer deposits are around 5-9% yoy for all major European countries despite increasingly clear threats by banks to start shuffling off the burden of negative rates on to consumers. Corporate deposits growth also accelerated significantly in recent months, +17.7% yoy as of the end of July vs +7.7% yoy 1 year ago, the fastest growth on record as a result of preserving liquidity by EU corporations.

Overall Macro

European economy contracted at a record pace in 1H20 with a double-digit decline on qoq basis in 2Q20. A high level of uncertainty remains but diminished. Moreover, economic recovery in EU was faster than initially expected. Notwithstanding, it faded in recent months, especially in the services sector. According to ECB’s September introductory statement, “the incoming data since our last monetary policy meeting in July suggest a strong rebound in activity broadly in line with previous expectations, although the level of activity remains well below the levels prevailing before the coronavirus (COVID-19) pandemic”. Both high-frequency data and soft macro figures pointed to a deceleration of the recovery in recent months. Moreover, it was admitted by ECB that the strength of recovery remained surrounded by significant uncertainty and it remained highly dependent on future evolution of the pandemic. Given acceleration of new COVID-19 cases in many European countries in September, it seems that some restrictions will be back in the near future. But we don’t believe that there will be again new strict lockdowns in a majority of European states. A majority of key economic indicators increased significantly in summer months but figures published in September were slightly worse than expected. PMI indices skyrocketed in July but declined in August and September, pointing to a slower pace of economic recovery. ECB continues to support European economy with massive monetary stimuli and it seems that the size of the PEPP could be increased further at the end of 2020, especially if the recovery decelerates further.

European real GDP tumbled by 11.8% qoq, or -14.7% yoy, in 2Q20 vs initial consensus estimates of -12.1% qoq and -14.5% yoy, respectively, after significant drop in 1Q20 by 3.6% qoq, or -3.1% yoy. It was the biggest decline of EU GDP in history after the previous one shown in 1Q20. French GDP decreased by 13.8% qoq, or -18.9% yoy, vs initial expectations of -15.2% qoq, or -20% yoy, after decline of -5.3% qoq and -5.0% yoy in

1Q20, slightly revised up from initial estimates. Italian GDP decreased by 12.8% qoq, or -17.7% yoy, vs expectations of -15.5% qoq and -17.3% yoy, after decline by 5.2% qoq, or -4.1% yoy, in 1Q20. Spanish GDP declined by 18.5% qoq, or -22.1% yoy, in 2Q20 vs expectations of -16.6% qoq and -19.7% yoy, after drop of -5.4% qoq, or -5.3% yoy, in 1Q20. German GDP decreased by 9.7% qoq, or -11.3% yoy, in 2Q20 vs -5.5% qoq and -2.2% yoy in 1Q20. ECB estimates imply that EU GDP will decline by 8.7% yoy in 2020 and will rebound by 5.2% and 3.3% in 2021/2022 years, respectively. The market is slightly more optimistic. Thus, according to September estimates compiled by Bloomberg, EU GDP growth rates was expected to be equal to -8.1%/+5.5%/+2.4% yoy for 2020/2021/2022 years, respectively, vs -8.1%/5.7%/2.2% yoy in August.

European macroeconomic indicators published in August and September were slightly worse than expected after clearly strong figures in July. Notwithstanding, European economy continues to stabilize after a significant decline in March and April. But it is a little slower at the moment than before. However, expectations improved slightly in September vs August, but economic surprise indices moved in different directions in September. Thus, Citi's economic surprise index tumbled by more than 80 pts MoM to 47.8 pts as of the end of September after a significant growth in June and July. In May it crushed to an all-time low of -300 pts. From the other hand, Bloomberg surprise index increased from 0.338 pts to 0.658 pts as of the end of September, being near the highest print over last 3 years. But the recovery is still fragile, from our point of view, and risks remained tilted to downside. At least, growth of daily new COVID-19 cases has resumed in a number of European countries recently. So, we will see further deceleration of loan growth (after emergency liquidity needs demand for corporate loans will decline) and a growth of NPLs that is very negative for EU banks given very challenging revenue environment.

Composite PMI (preliminary figure), which is usually well correlated with GDP growth (but relation was less tight than usually in 1H20), markedly missed expectations in September and August, after strong beat in June and July. It decreased by 1.8 pts MoM to 50.1 pts in September vs consensus of 51.9 pts. So, it signaled that activity remained almost unchanged during last month. It was again driven by services PMI, which decreased by 2.9 pts MoM to 47.6 pts vs consensus of 50.6 pts. From the other hand, manufacturing PMI increased by 2.0 pts MoM to 53.5 pts vs consensus of 51.9 pts. Services PMI declined meaningfully in majority countries while manufacturing PMI increased, especially in Germany. Thus, German composite PMI decreased by 0.7 pts MoM to 53.7 pts vs expectations of 54.0 pts, with manufacturing PMI skyrocketed by 4.4 pts MoM to 56.6 pts vs consensus of 52.5 pts. In turn, services PMI declined by 3.1 pts MoM to 49.1 pts vs consensus of 53 pts. French composite PMI tumbled by 3.1 pts MoM to 48.5 pts vs consensus of 51.9 pts, driven by services PMI which decreased by 4.0 pts MoM to 47.5 pts vs consensus of 51.5 pts while manufacturing PMI increased by 1.1 pts MoM to 50.9 pts vs expectations of 50.6 pts. In turn, growth of industrial production remained elevated after meltdown in March in April. But it was again slightly below expectations. Thus, IP increased by 4.1% MoM vs expectations of 4.2% MoM and June figure of +9.5% MoM. On yoy basis, it was -7.7%. Given recent PMI figures, it seems that IP will continue its recovery but at a slower rate. Estimates were revised up slightly in September vs August projections. Thus, according to estimates compiled by Bloomberg, industrial production will decline by 9.9% yoy in 2020 and increased by 6.0% yoy in 2021 and by 3.9% yoy in 2022 vs -10.2% yoy/+6.1%/+3.2 yoy for 2020/2021/2022 years, respectively, as of August estimates.

EU consumer was the key driver of European economy, demonstrating strong growth of consumer spending due to ongoing and broad-based wage growth in the pre-COVID era. But the situation has changed dramatically and difficult times are ahead for EU consumers. According to September Bloomberg survey, household consumption will decline by 7.6% yoy in 2020 but increased by 6.2% yoy in 2021 and by 2.3% yoy in 2022 (in-line with July

estimates). Unemployment should increase markedly in 2H20 even despite massive support measures for employment and it will continue to grow in 2021. Notwithstanding, the growth rate of unemployment will be much lower than the US one. Unsurprisingly, consumer confidence has already decline significantly while companies have announced more and more job cuts, especially in the most affected industries. Unemployment rate was markedly better in July but it continues to deteriorate, 7.9% in July vs expectations of 8.0%, just +20 bps MoM. So, unemployment forecasts improved markedly in recent months but real employment picture is worse than official figures because of significant growth of part-time workers. Thus, September consensus estimate of unemployment rates for 2020, 2021 and 2022 years, compiled by Bloomberg, were 8.1%/9.3%/8.4% vs August estimates at 8.5%/9.3%/8.4% for 20/21/22 years, respectively. ECB's unemployment projections are more pessimistic, being at 8.5%/9.5%/8.8% for 20/21/22 years, respectively. Retail sales unexpectedly decreased in July after skyrocketing growth in the previous months. Thus, it declined by 1.3% MoM vs expectations of growth of 1.0% MoM. In result, it is just +0.4% yoy vs consensus of +1.9% yoy. Notwithstanding, September consumer confidence increased by 0.8 pts MoM to -13.9 pts, markedly higher consensus of -14.7 pts, +8.3 pts from April low, but -6.6 pts from the average level of 2014-2019 years.

Rates

The ECB again left its monetary policy unchanged. Moreover, there were even no changes in the policy statement. The outcome was widely expected but the market would like to hear some hints for the future monetary easing, especially taking into account negative inflation in August. So, interest rates on the marginal lending facility and the deposit facility will remain unchanged. "The Governing Council will continue its purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1,350 billion" and it will last at least till the end of June 2021. Notwithstanding, it was noted during press conference again that entire envelope of the PEPP will be used, unless there were significant upside surprises, which isn't the baseline scenario. Reinvestments of the principal payments from maturing securities purchased under the PEPP will last until at least the end of 2022. Also, "net purchases under the asset purchase programme (APP) will continue at a monthly pace of €20 billion, together with the purchases under the additional €120 billion temporary envelope until the end of the year". And the APP will run as long as necessary and it will end shortly before the ECB will start to raise rates. Also, ample liquidity will continue to be provided through refinancing operations such as TLTRO III, which help to support bank lending to firms and households. From the other hand, tiering multiplier will remain unchanged at 6.0 and the question wasn't even discussed at the last meetings. But it was noted again that two-tier system was working good so far. New staff projections were released but improvements were insignificant. Consistently with recent high-frequency indicators, it was noted that activity in manufacturing sector continued to improve while momentum in services sector slowed somewhat. Unsurprisingly, it was noted again that risks was still tilted to downside. Weaker inflation figures in August weren't unexpected given low energy prices and subdued demand. As for substantial euro currency appreciation, it was noted that it is not a policy target but it is monitored carefully and it is not a big problem at the moment. Despite there were no hints of monetary policy easing, we still expect that new monetary stimulus will be announced till the end of the year given recovery deceleration, weak current inflation and low inflation expectations. This can be done using any of the available tools, but it seems more likely by increase of the PEPP size.

According to the introductory statement, the incoming data suggest a strong rebound in activity but it was in-line with expectations and "the level of activity remains well below the levels prevailing before the coronavirus pandemic". Risks are still remains high. Thus, "the strength of the recovery remains surrounded by significant uncertainty, as it continues to be

highly dependent on the future evolution of the pandemic and the success of containment policies”. So, projections were only slightly improved. HICP inflation projections were unchanged for 2020 and 2022 years at 0.3% and 1.3%, respectively, while 2021 inflation forecast was increased by 20 bps to 1.0% (vs June projections). 2020 core inflation forecast was unchanged either while both 2021/2022 estimates were increased by 20 bps to 0.9% and 1.1%, respectively. Unsurprisingly, “ample monetary stimulus remains necessary to support the economic recovery and to safeguard medium-term price stability”. As for GDP projections, it was increased from -8.7% yoy to -8.0% for 2020 while 2021 growth estimate was lowered from +5.2% yoy to +5.0% yoy and 2022 growth was decreased from +3.3% as of June estimate to +3.2% currently.

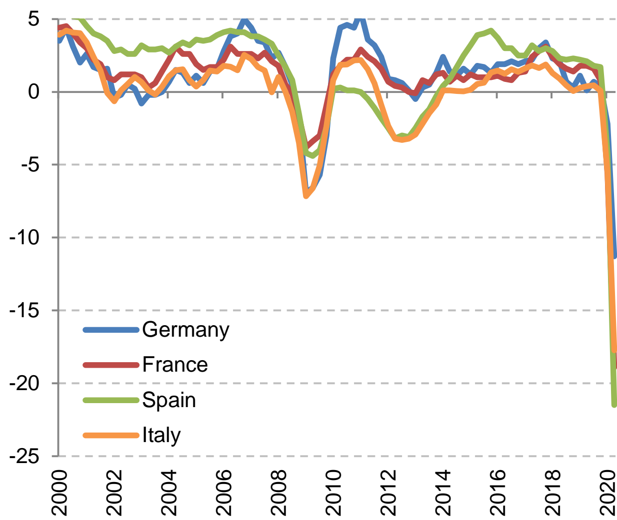
The ECB remains as flexible as it can and it is ready to expand its facilities further in case of deterioration of economic situation but outlook for banking NII/NIM remains weak given the fact that challenging rates environment will remain in the foreseeable future (years and years). At the moment, NII remains relatively flat as weaker margins were offset by strong loan growth due to emergency liquidity needs. But the latter will inevitably decelerate in coming months as it was in the USA. Moreover, asset quality will continue to deteriorate as a result of a sharp drop of economic activity. Thus, EU GDP tumbled by 12% qoq in 2Q20, the worst decline on record, after the second worst decline on qoq basis shown in 1Q20. As we had expected, new monetary easing measures were announced in June but it seems that another new measures could be announced till the end of the year. Accompanied by previous ECB’s liquidity and capital relief measures, it could ease some pressure on banking quotes and reduce the risk of dilution but fundamentals will remain weak in the foreseeable future.

Unsurprisingly, NII outlook continues to worsen despite ECB’s actions aimed at easing the effect of negative rates on banks’ P&L and spike in corporate lending as a result of active use of drawdowns. Thus, median decline of NII FY20 estimates of EU banks was 0.4% qoq, or -5.3% ytd, while FY21 estimates declined by 0.6% qoq and -6.8% ytd. Median NIM FY20 estimate decreased by 12.6 bps qoq to 1.58%, while NIM FY21 tumbled by 22.9 bps qoq to 1.51%.

Key benchmark rates decreased markedly in September after substantial growth in August. So, rates still remain significantly lower ytd. Thus, 3M Euribor (Dec 2021) decreased by 6 bps MoM to -0.54% (as the end of September), or -26.5 bps ytd, while 3M Euribor (Dec 2022) went down by 5.5 bps MoM to -0.51% and it is -38 bps ytd.

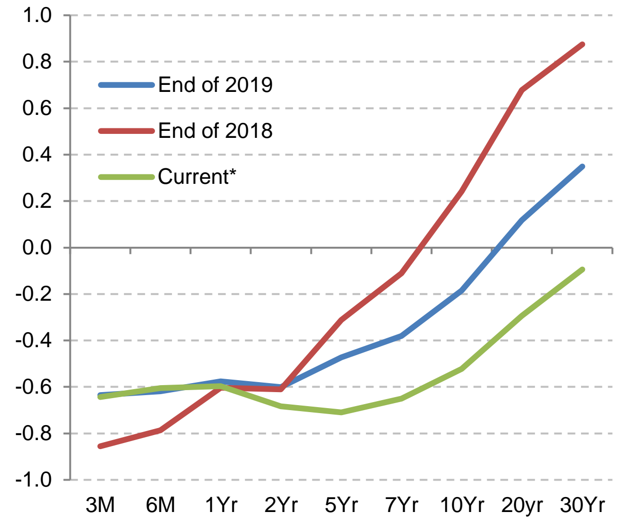
The direction of dynamics of generic yields was uniform in September 2020 with a decline across the yield curve, but the long end decreased more significantly. So, it still remains meaningfully lower than it was at the end of 2019. 3M yield decreased by 8.5 bps MoM to -0.64%. 6M yield went down by 0.3 bps to -0.61%. 1yr generic yield declined by 4.4 bps MoM to -0.6%, while 2yr yield decreased by 3.1 bps MoM to -0.68%. 5yr yield went down by 8.1 bps to -0.71%, while 10yr yield decreased by 12.5 bps to -0.52%. Overall, the yield curve remains slightly inverted in its middle part. Spreads moved in different directions in September. Thus, spread between 10yr yield and 1yr yield decreased by 8.1 bps MoM to 0.08%, while spread between 5yr and 3M yields went up by 0.4 bps MoM to still negative value of -0.07%. Both spreads are markedly higher than April trough but they remain much lower ytd. The entire yield curve is still below 0.

Chart 30. EU Countries Real GDP Growth, YoY, %



Source: Bloomberg

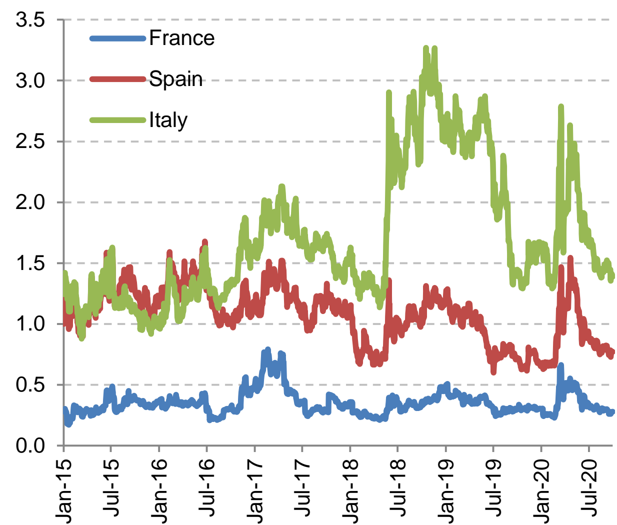
Chart 31. EU Yield Curves, %



*end of September

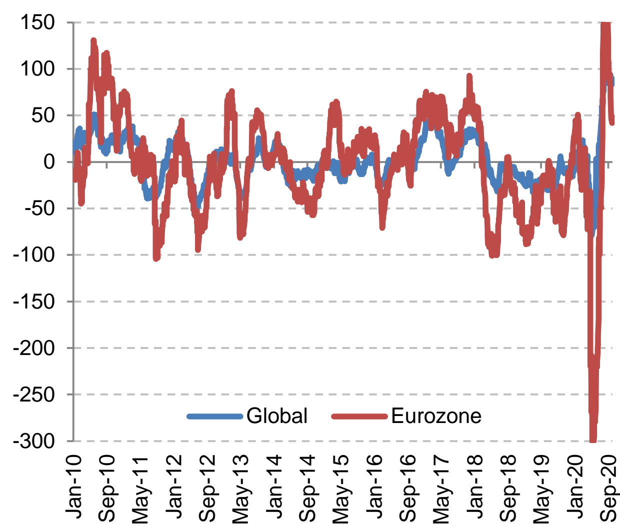
Source: Bloomberg

Chart 32. EU Countries Sov. Spreads vs Germany, 10Yr, %



Source: Bloomberg

Chart 33. Citi Economic Surprise Indexes, pts



Source: Bloomberg

THEME OF THE MONTH

US Banks. 3Q20 Preview

The earnings season of US banks will start on October, 13, when 3Q20 results should be provided by JP Morgan and Citigroup. After that, within two weeks, all members of BKX index will release their quarterly results. US banks reported mixed figures in 2Q20 with much better EPS and revenue figures despite to higher provisions and lower NII/NIM figures. We expect that positive EPS momentum is returning due to better than expected asset quality, still solid trading/IB/mortgage fees and strong deposit inflows. From the other hand, NIM and loan dynamics remain weak. Notwithstanding, EPS estimates were revised up substantially since the end of 2Q20. Thus, according to Bloomberg consensus, a median growth of 3Q20 EPS of BKX index members was 24.7% qtd, but still -30.4% ytd (as of September, 28). Full-year estimates for the current year was revised up by 10.5% qtd, but still -46.2% ytd, while next year EPS declined by 4.6% qtd and -34.7% ytd. In turn, 3Q20 revenue estimates increased by 0.4% qtd, still remaining negative ytd, -4.3%.

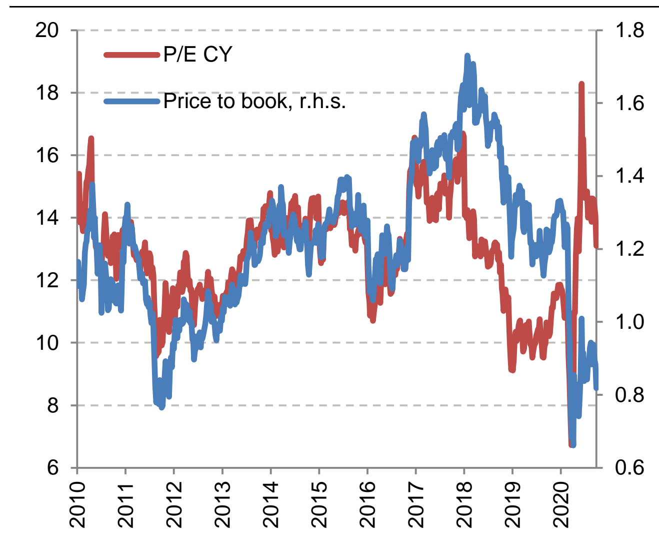
Despite key benchmark rates were relatively stable in 3Q20, average rates decreased meaningfully, that will continue to impact negatively on NIM. Thus, according to Bloomberg consensus estimates, a median decline of NIM of BKX index members in 3Q20 will be equal to 2.4 bps qoq and it is expected to decrease by 42 bps yoy, in-line with NIM decline in 2Q20. Notwithstanding, it is implied that NII will be flat qoq, but -1.6% yoy, even despite a deceleration of loan growth in 3Q20. From the other hand, deposits growth remains strong, negatively impacting on NIM but supporting NII. So, NII estimates were pretty resilient in recent months given decline of NIM. Thus, median growth of 3Q20 NII estimates of BKX index members is -2.4% qtd, or -2% ytd. In turn, 3Q20 NIM estimated declined by 13 bps qtd while 2021/2022 NIM projections declined by 3.0/3.4 bps qtd respectively, being -26/-33 bps ytd.

As of the end of September, average 1M Libor decreased by 19 bps qoq in 3Q20 to 0.16% and average 3M Libor lost 34 bps qoq to 0.25% while average prime rate was flat at 3.25%. Loan rates declined slightly in a majority of segments except for mortgage, where the decline was substantial. Thus, average rates in auto loans decreased only by 3-5 bps qoq vs decline by 16-24 bps qoq in 2Q20. In turn, mortgage rates tumbled by 36/43 bps qoq to 2.63%/3.10% for 15yr/30 yr fixed mortgage, respectively, vs decline of 20/21 bps qoq in 2Q20. All benchmarks for securities yields went down in 3Q20 either. Thus, according to BVAL, average 10yr AA/Aa, A/A and BBB/Baa yields decreased by 39.7 bps qoq, 51.2 bps qoq and 71.5 bps qoq to 1.42%/1.6%/2.1%, respectively. Yield curve was relatively unchanged in 3Q20 after significant volatility in 1H20. Thus, average 10yr-2yr spread increased by 1.5 bps qoq to 0.505% in 3Q20, higher than an average level of 2019 (0.17%) and an average level of 2018 (0.39%). Average 5yr-3Mo spread decreased by 6.6 bps to 0.17% in 2Q20, markedly higher than an average level of 2019 (-0.13%), but significantly lower than an average level of 2018 (0.79%). Fed futures (Dec 20/Dec 21) remained relatively flat MoM, pointing to no rate hikes in the nearest 2-3 years. Thus, implied rates increased by 4/5 bps qoq to 0.07%/0.04%. But taking into account recent Fed meetings, it seems that there will be no rate hike even longer, probably for next 4-5 years.

Negative impact of decreasing yields will be only partly diminished by decline of funding costs and balance sheet optimization in 3Q20. Usually, deposits are repriced more slowly than a majority of loans and a decline of deposit cost significantly decelerated in recent quarters. Thus, according to bankrate.com, average cost of 6Mo CDs decreased by 8 bps qoq to 0.33% in 3Q20 (vs -29 bps in 2Q20 and -14 bps qoq in 1Q20), average cost of 1yr CDs declined by 12 bps qoq to 0.46% (vs -43 bps in 2Q20 and -18 bps qoq in 1Q20), average cost of 5yr CDs went down by 15 bps qoq to 0.67% (vs -47 bps in 2Q20 and -17 bps qoq in 1Q20) while cost of interest checking accounts lost 1 bps qoq to 0.21% (vs -54

bps in 2Q20 and -14 bps qoq in 1Q20). The same time while cost of MMAs declined by 6 bps qoq to 0.24% (vs -17 bps in both 2Q20 and 1Q20). Recall that median cost of IBD decreased by 43.1 bps qoq or -73.1 bps yoy to 0.27% in 2Q20 vs -15.5 bps qoq or -24 bps yoy in 1Q20. Median cost of interest-bearing liabilities of BKX index members decreased by 49 bps qoq or -94.5 bps yoy to 0.52% in 2Q20 vs -21 bps qoq or -40.5 bps yoy in 1Q20.

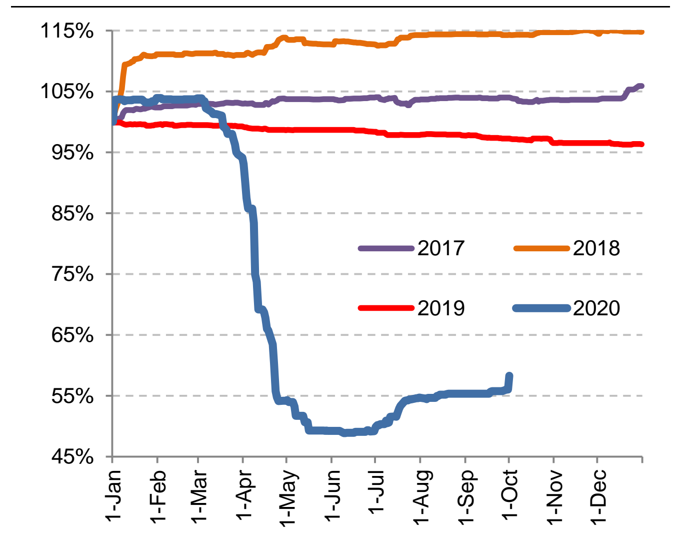
Chart 34. US Banks. Multipliers, Median*



*a sample of 34 banks which we are monitoring

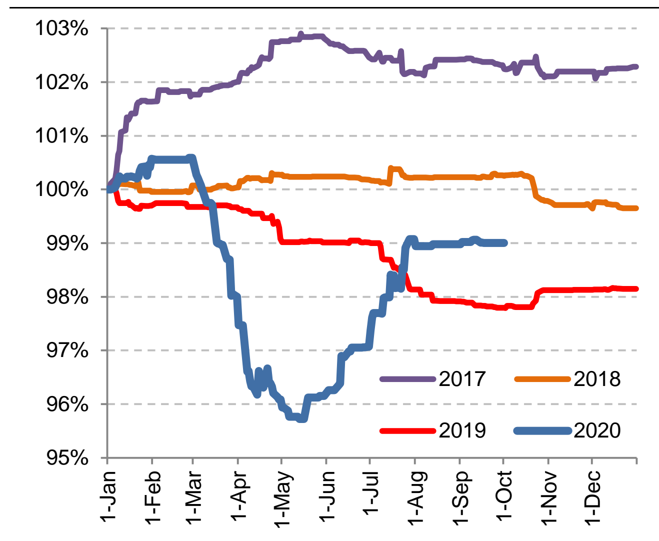
Source: Bloomberg

Chart 35. BKX Index. Median CY EPS Est. Dynamics



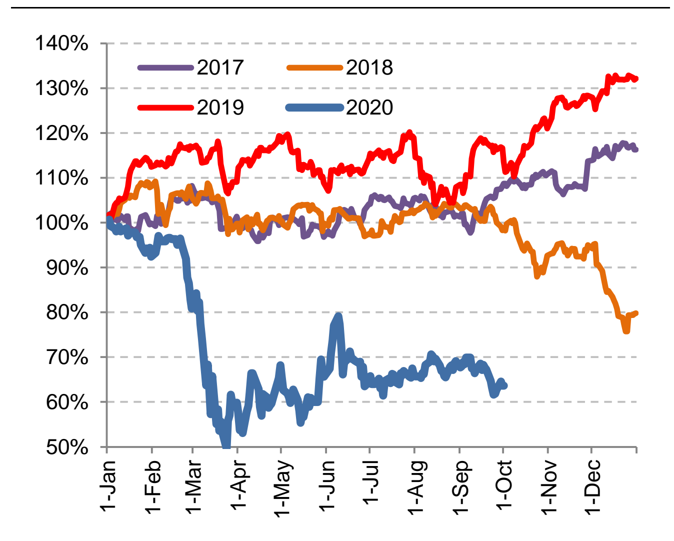
Source: Bloomberg

Chart 36. BKX Index. Median CY Rev Est. Dynamics



Source: Bloomberg

Chart 37. BKX Index. Price dynamics



Source: Bloomberg

Loan growth (EOP) was negative in 3Q20, declining by 1.0% vs the end of 2Q20 (as of September, 9). On yoy basis, it also decelerated meaningfully from 10-11% yoy in April-May to 6.1% at the moment. The key driver of decline was C&I segment, which was 3.1% lower qtd as a result of lower liquidity needs, better access to capital markets and weaker demand for CapEx and working capital. In turn, consumer loans look pretty resilient despite an unprecedented growth of unemployment in 2Q20. Unsurprisingly, average loans increased significantly on qoq basis due to meaningful acceleration of C&I loan growth in mid-March and April because of active using of revolvers caused by liquidity shortage amid spreading of COVID-19 around the world. Thus, C&I (EOP) added +17.1% yoy vs +1.0% yoy at the end of December 2019, -3.1% qtd. CRE added +6.2% yoy vs +5.9% as of the end of 4Q19. Due to significant decline of the long end, mortgage loans growth slightly

accelerated initially but it decelerated then as most of mortgage activity was concentrated in refinancing and loan growth is currently just +1.6% yoy vs +3.7% yoy 1 year ago, -0.7% ytd. Consumer loans growth turned negative on yoy basis in 2Q20 as a result of deep recession and significant growth of unemployment ratio. Thus, consumer loans decreased by 2.9% yoy, or -4.6% ytd / -0.1% qtd (as of September, 9) vs +5.6% yoy 1 year ago, driven by credit cards which decreased by 9.2% yoy, or -10.8% ytd / -1.1% qtd, vs +4.0% yoy 1 year ago. In turn, other consumer loans remain relatively resilient, adding +4.3% yoy, or +2.5% ytd / +0.8% qtd, vs +7.4% yoy 1 year ago. Unsurprisingly, banks reported tighter standards for majority of loan categories as a result of higher risks. And we expect that standards will remain tighter in coming quarters. Total assets of US banks increased just by 0.3% qtd but 14% ytd in 3Q20 (as of September, 25) while total liabilities decreased by 0.4% qtd but still +14.1% ytd in 3Q20.

Non-interest income of BKX index members will decrease by 4.1% qoq and by 5% yoy in 3Q20, according to Bloomberg consensus. Estimates went up qtd, median growth of BKX index members is +3.7% qtd but it is still -5.4% ytd. Moreover, we expect that estimates could increase further ahead of the earnings season given optimistic tone of many banks during recent financial conferences. At least, trading and IB fees remain strong, growing by double-digit rates yoy. But it will decline on qoq basis as result of lower volatility and tighter spreads. Also, mortgage originations continue to go up due to strong growth of refinancing activity. Thus, according to Fannie Mae's September housing forecast, total mortgage origination forecasts increased by 29% qoq for 2020 year and by 10.5% MoM for 2021 year. Currently, it is expected that total originations will increase by 57% yoy in 2020, but it will decrease by 34% yoy in 2021. Also, card fees and deposit service charges should also go up qoq, given significant recovery of consumer spending in 3Q20 and continued strong deposit inflows.

Expenses remain under control but estimates increased by 0.8% qtd, still remaining -0.5% ytd. According to Bloomberg consensus, a median decline of OpEx of BKX index members will be -0.6% qoq but flat yoy vs +2.2% yoy in 2Q20 and +3.8% yoy in 3Q19. In result, median efficiency ratio will decrease by 50 bps qoq but it will be higher by 140 bps yoy, at 59.3%. Unsurprisingly, operating leverage should be negative in the face of revenue drop and flat OpEx, for the 5th consecutive quarter after 9 months in a row of positive operating leverage. But the momentum begins to improve given better revenue dynamics and good cost control. Also, we expect that banks will work to cut costs, more actively using technology and digitalization, which were spent huge amounts of money earlier for. The stumbling block may be a significant growth of NPLs, but asset quality remains under control at the moment.

Credit quality of US banks stayed very strong so far but it will remain a cornerstone for banks in the nearest quarters as a result of significant decline of US economy in 1H20. Notwithstanding, we don't expect that key credit quality indicators will worsen significantly near term given faster than expected economic recovery and unprecedented both fiscal and monetary stimuli. At least, deferrals have already started to decline while early stage indicators of credit quality remain relatively stable. NCO and NPL ratios are still below historical averages. According to FDIC data, 30-89 days past due ratio decreased by 15 bps qoq or -8 bps yoy to 0.51% in 3Q20, being slightly lower than an average level of the ratio over recent 4 years. NCO ratio increased by 2 bps qoq, or +7 bps yoy, to 0.57%, remaining low from the historical point of view. According to September Master Trust data, credit card delinquency and NCO ratios remained pretty resilient so far, remaining below historical averages despite skyrocketing growth of unemployment in 2Q20. From the other hand, a number of defaults and rating downgrades have already increased markedly but it applies more to high yield segments rather than investment grade companies where credit quality remained pretty resilient so far. Notwithstanding, provision expenses will remain

elevated in 3Q20 but we don't expect higher levels than it was in 2Q20. According to Bloomberg consensus, total provision of BKX index members will increase by 142% yoy but -59% qoq. Median decline of estimates is 8.6% qtd while it remains +160% ytd, despite negative surprises on provision expenses in 2Q20 and growth of bankruptcies number. Thus, 15 out of 24 members of BKX index demonstrated provision expense higher than expected in 2Q20 vs 20 banks in 1Q20 and just 8 in 4Q19. Median excess of actual provisions over estimates for BKX index members was 30% vs 87% in 1Q20. But the key reason of higher provisions was significant reserves build while banks don't expect substantially higher provisions than NCOs in 3Q20.

Capital ratios remain strong and median CET1 ratio of BKX index members increased on qoq basis for the first time over last 10 quarters as a result of regulatory restrictions on buybacks and dividends. And it will continue its growth as restrictions of capital repayments remain while asset quality is still solid. Median Basel III CET1 ratio of members of BKX index increased by 13 bps qoq but -80 bps yoy in absolute terms to 10%, still not far from the lowest level over almost 7 years. Median TCE ratio decreased by 12 bps qoq or -72 bps yoy to 7.3%, the lowest figure since the middle of 2011 but still meaningfully higher than a median figure of 5.7% as of the end of 4Q07. The key area of uncertainty is how long will restrictions on capital distributions last. Many banks have already expressed their willingness to start returning capital to shareholders again but don't expect it till 1H21. The Fed released its scenarios for 4Q20 stress test in September and it is quite probable that all banks will pass the exam. But it shouldn't affect the Fed's position on dividends and buybacks.

Due to significant decline of EPS estimates ytd, banks is no more trading with discount to CY estimates but they are still undervalued significantly to NY estimates and vs S&P 500. Thus, banks are trading at -1.6/-1.2 std on P/E NY (on the basis of samples from 2000 and 2010 years to current moment) relative to historical averages (as of September, 25). As for relative to S&P 500, banks are currently trading at -2.2 std and -2.4 std from the sample mean (2010-current moment) for P/E CY and P/E NY, respectively. On P/B, banks are trading at -1.9 std from the sample mean (2010-current moment) vs SPX. We still see some risks for fundamentals of US banks given an unprecedented decline of US economy in 1H20, still high level of uncertainty about the speed of US economic recovery, mixed 2Q20 results and rising risk related to the elections. Notwithstanding, we are becoming more and more optimistic given recent improvement of earnings momentum and high to ignore discount to S&P 500 index. **So, we recommend buying US banks before 3Q20 earnings season as we expect better results and we believe that risk/reward looks attractive at the moment.**

APPENDIX

Table 1. US Banks: Valuations

Company	Ticker	Price as of 30/09/20, $	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			2020E	2021E	2022E	2020E	2021E	2022E			2020E	2021E	2022E		
American Express	AXP	100.3	105.4	5.2%	138.1	67.0	50.1	80.7	1.7%	1.8%	1.9%	28.8	15.0	11.3	3.8	N. A.	12.6	22.7	27.7	10.0	10.7
JP Morgan Chase	JPM	96.3	114.9	19.3%	141.1	77.0	46.2	293.4	3.7%	3.8%	4.0%	16.1	11.0	9.2	1.3	1.6	7.8	10.6	12.5	7.0	12.4
PNC Financial	PNC	109.9	117.8	7.1%	161.7	79.5	52.3	46.7	4.2%	4.2%	4.3%	13.3	15.1	12.3	1.0	1.2	7.3	5.9	7.8	9.8	9.5
Bank of America	BAC	24.1	27.8	15.4%	35.7	18.0	43.3	208.7	3.0%	3.2%	3.6%	15.2	11.4	8.8	0.9	1.2	5.7	7.0	8.7	7.2	11.2
Citigroup	C	43.1	66.2	53.5%	83.1	32.0	35.4	89.7	4.8%	4.9%	5.4%	13.3	7.0	5.2	0.5	0.6	3.9	6.8	9.2	7.7	11.8
Truist Financial Corp	TFC	38.1	44.5	16.8%	56.9	24.0	51.1	51.3	4.7%	4.8%	4.9%	12.3	11.9	9.0	0.8	1.5	6.4	6.4	8.7	7.3	9.5
Goldman Sachs	GS	201.0	249.0	23.9%	250.1	130.9	51.9	72.0	2.5%	2.6%	2.8%	11.2	8.7	7.4	0.9	1.0	6.8	9.7	10.6	7.5	13.3
Bank of NY Mellon	BK	34.3	43.6	26.9%	51.6	26.4	43.4	30.4	3.6%	3.7%	4.1%	8.9	8.8	8.0	0.8	1.6	8.8	8.5	8.7	4.8	12.5
Comerica	CMA	38.3	42.0	9.7%	73.3	24.3	46.6	5.3	7.1%	7.1%	7.2%	20.0	11.2	9.0	0.7	0.7	4.0	6.1	8.2	9.2	10.1
Citizens Financial	CFG	25.3	30.2	19.5%	41.3	14.1	47.5	10.8	6.2%	6.2%	6.4%	13.5	10.1	7.2	0.5	0.8	3.8	4.8	6.9	8.5	10.0
Regions Financial	RF	11.5	12.9	12.2%	17.5	7.0	51.9	11.1	5.4%	5.5%	5.7%	20.9	9.4	7.6	0.7	1.0	3.1	6.6	8.6	8.1	9.6
Discover Financial	DFS	57.8	62.0	7.3%	87.4	23.3	58.1	17.7	3.0%	2.9%	3.2%	49.8	10.1	6.8	2.0	2.1	3.2	14.3	21.3	9.6	11.2
M&T Bank	MTB	92.1	123.8	34.4%	174.0	85.1	36.9	11.8	4.8%	4.9%	4.9%	10.5	9.5	7.7	0.8	1.2	7.5	7.7	9.5	8.5	9.7
Fifth Third Bancorp	FITB	21.3	24.1	13.1%	31.6	11.1	54.0	15.2	5.1%	5.2%	5.4%	14.7	11.0	8.1	0.7	0.9	4.9	6.1	8.7	9.0	9.8
Huntington Bancorp	HBAN	9.2	10.9	18.4%	15.6	6.8	46.2	9.3	6.6%	6.7%	7.2%	14.7	9.6	7.6	0.9	1.1	5.9	8.1	11.2	7.8	9.9
Northern Trust	NTRS	78.0	84.3	8.1%	110.5	60.7	44.9	16.2	3.6%	3.7%	3.8%	13.4	13.2	12.1	1.4	1.5	11.9	11.7	12.5	7.6	13.2
People's United	PBCT	10.3	12.0	16.8%	17.2	9.4	47.6	4.4	7.0%	7.1%	7.2%	9.2	10.3	9.1	0.6	1.0	6.2	5.6	6.3	8.0	10.2
Synchrony Financial	SYF	26.2	28.8	10.0%	38.2	12.2	54.9	15.3	3.4%	3.4%	3.8%	16.3	9.0	6.2	1.4	1.7	7.0	12.0	17.9	11.7	14.1
KeyCorp	KEY	11.9	14.0	17.4%	20.5	7.5	45.4	11.6	6.2%	6.4%	6.6%	12.0	8.9	6.9	0.7	0.9	6.1	7.0	10.2	8.6	9.4
State Street Corp	STT	59.3	70.7	19.2%	85.9	42.1	36.5	20.9	3.5%	3.6%	3.8%	9.2	9.4	8.3	1.0	1.7	10.1	9.3	9.3	4.7	11.9
US Bancorp	USB	35.9	42.6	18.8%	61.0	28.4	47.1	54.0	4.7%	4.7%	4.8%	13.8	12.5	9.1	1.2	1.5	8.4	8.8	12.5	7.3	9.1
Zions Bancorp	ZION	29.2	36.7	25.7%	52.5	23.6	40.0	4.8	4.6%	4.8%	5.2%	13.4	9.5	7.5	0.7	0.8	5.1	6.4	8.2	8.5	10.2
Morgan Stanley	MS	48.4	60.1	24.3%	57.6	27.2	44.6	76.2	2.9%	3.0%	3.3%	9.3	9.7	8.4	1.0	1.1	10.3	9.4	10.1	7.2	16.4
Capital One Financial	COF	71.9	81.9	14.0%	107.6	38.0	53.8	32.8	1.3%	1.4%	2.0%	-33.4	11.0	6.2	0.6	0.9	-2.0	5.1	8.9	10.2	12.2
Wells Fargo	WFC	23.5	29.4	25.1%	54.8	22.0	44.1	96.9	5.2%	2.3%	4.0%	139.1	11.5	6.9	0.6	0.7	0.3	4.5	8.0	7.3	11.1
First Republic Banks	FRC	109.1	117.7	8.0%	125.1	70.1	50.9	18.7	0.7%	0.8%	0.8%	20.4	20.1	17.2	2.0	2.0	9.8	9.3	9.6	7.3	9.9
NY Commercial Bancshares	NYCB	8.3	11.6	40.1%	13.8	8.1	35.8	3.8	8.2%	8.2%	8.2%	9.5	7.9	7.1	0.6	1.0	6.4	7.5	8.1	7.4	9.9
SVB Financial	SIVB	240.6	258.5	7.4%	271.0	127.4	49.4	12.5	0.0%	0.0%	0.0%	16.5	16.0	13.1	1.8	1.8	11.3	10.1	11.4	8.4	12.6
Signature Bank	SBNY	83.0	132.9	60.1%	148.6	69.1	31.6	4.5	2.7%	2.7%	2.8%	8.5	7.0	6.1	0.9	0.9	10.7	11.5	11.7	9.4	11.6
East West Bancorp	EWBC	32.7	40.8	24.6%	51.8	22.6	41.3	4.6	3.4%	3.5%	3.7%	9.1	8.6	7.7	0.9	1.0	10.0	9.8	10.6	10.4	12.9
Synovus Financial	SNV	21.2	25.9	22.5%	40.3	10.9	49.1	3.1	6.2%	6.2%	6.4%	13.1	9.7	6.5	0.7	0.8	5.7	6.7	9.0	8.1	8.9
First Horizon National	FHN	9.4	11.9	25.7%	17.4	6.3	51.5	5.2	6.4%	6.5%	6.9%	11.1	7.2	5.9	0.6	0.9	7.4	8.7	10.4	7.5	9.2
BOK Financial	BOKF	51.5	60.4	17.2%	88.2	34.6	43.1	3.6	4.0%	4.0%	4.1%	10.2	9.8	8.4	0.7	0.9	6.6	6.7	7.7	9.0	11.4
Median				**18.4%**			**46.6**		**4.2%**	**4.0%**	**4.1%**	**13.3**	**9.8**	**7.7**	**0.8**	**1.0**	**6.6**	**7.7**	**9.3**	**8.1**	**10.7**

Source: Bloomberg

APPENDIX

Table 2. EU Banks: Valuations

Company	Ticker	Currency	Price* (30/09/20)	Target price*	Upside	52-week price* High	52-week price* Low	RSI	MCap, € bn.	Dividend yield 2020E	Dividend yield 2021E	Dividend yield 2022E	Price/Earnings 2020E	Price/Earnings 2021E	Price/Earnings 2022E	Price to book	Price to tang. book	ROE, % 2020E	ROE, % 2021E	ROE, % 2022E	TCE ratio, %	CET1 ratio, %
Erste Group	EBS AV	EUR	17.9	27.0	51.1%	35.8	15.2	31.5	7.7	3.2%	5.2%	6.7%	12.1	9.0	6.5	0.5	0.6	4.8	5.9	7.4	5.2	13.8
Raiffeisen Bank	RBI AV	EUR	13.1	19.6	49.9%	23.5	10.7	27.7	4.3	4.0%	5.4%	7.0%	7.3	6.4	5.1	0.4	0.4	5.8	6.1	6.8	7.3	13.9
KBC Groep	KBC BB	EUR	42.8	58.7	37.3%	73.6	33.4	35.1	17.8	4.4%	5.8%	7.1%	14.3	10.8	8.8	1.0	1.0	6.4	8.1	9.1	6.0	17.1
Komercni Banka	KOMB CK	CZK	486.0	666.3	37.1%	838.0	465.0	30.9	3.4	9.2%	7.3%	7.9%	11.9	10.1	8.5	0.8	0.9	7.7	8.3	8.7	9.0	19.1
Jyske Bank	JYSK DC	DKK	179.0	218.8	22.2%	285.4	150.5	29.9	1.7	1.5%	0.2%	0.9%	13.4	7.1	5.9	0.4	0.4	3.2	5.2	5.6	5.0	17.4
SydBank	SYDB DC	DKK	99.6	118.5	19.0%	162.3	83.0	29.4	0.8	5.2%	5.4%	6.2%	9.0	8.2	7.2	0.5	0.5	5.9	5.9	6.5	7.3	17.8
Danske Bank	DANSKE DC	DKK	86.1	114.5	33.0%	123.6	68.0	37.4	10.0	2.5%	6.4%	7.9%	20.8	7.9	6.4	0.5	0.5	2.2	5.9	7.0	3.9	17.3
BNP Paribas	BNP FP	EUR	31.0	44.1	42.5%	54.2	24.5	32.7	38.7	6.8%	7.1%	8.8%	6.9	6.7	5.3	0.4	0.4	5.5	5.1	6.4	4.0	12.1
Natixis	KN FP	EUR	1.9	2.8	44.2%	4.4	1.5	32.3	6.1	4.7%	9.6%	11.6%	37.0	8.4	6.0	0.4	0.5	0.7	4.0	5.3	2.5	11.3
Societe Generale	GLE FP	EUR	11.3	16.3	43.8%	32.2	10.8	31.4	9.7	2.1%	6.1%	11.2%	-20.5	7.8	4.2	0.2	0.2	-0.8	2.9	4.1	4.2	12.7
Credit Agricole	ACA FO	EUR	7.5	10.6	42.1%	13.8	5.7	33.9	21.6	4.3%	6.4%	8.4%	8.0	7.7	6.0	0.4	0.5	4.9	4.5	5.8	2.2	12.1
Virgin Money	CYBG LN	GBp	73.0	120.3	64.8%	222.1	46.1	33.0	1.2	0.0%	0.0%	0.1%	18.7	8.1	3.7	0.2	0.2	0.7	2.8	6.2	5.0	13.3
HSBC	HSBA LN	GBp	301.5	357.7	18.6%	628.3	281.5	41.4	67.7	0.0%	0.1%	0.1%	13.7	7.5	5.3	0.5	0.5	2.4	4.8	6.6	5.3	14.7
Royal Bank of Scotland	RBS LN	GBp	106.1	142.8	34.7%	265.0	90.5	50.8	14.2	0.0%	0.1%	0.1%	-25.3	11.4	5.6	0.3	0.4	-1.8	3.2	5.9	4.5	16.2
Barclays	BARC LN	GBp	97.6	141.5	44.9%	193.0	73.0	42.5	18.7	0.0%	0.1%	0.1%	23.2	7.6	4.7	0.3	0.3	1.0	4.2	6.2	4.0	13.8
Standard Charted	STAN LN	GBp	356.1	487.5	36.9%	740.8	334.3	41.9	12.4	0.0%	0.1%	0.1%	10.7	5.9	4.2	0.3	0.4	2.1	3.8	5.1	5.3	13.8
Lloyds	LLOY LN	GBp	26.4	36.2	37.4%	70.0	23.6	48.2	20.6	0.0%	0.1%	0.1%	29.3	7.5	5.3	0.4	0.5	1.4	7.1	7.3	4.3	13.6
Commerzbank	CBK GY	EUR	4.2	5.0	18.1%	6.8	2.8	36.1	5.3	0.2%	1.3%	2.6%	-167.7	26.9	7.3	0.2	0.2	-0.8	-0.1	2.5	5.5	13.4
Deutsche Bank	DBK GY	EUR	7.2	6.7	-7.1%	10.4	4.4	38.6	14.9	0.0%	0.3%	2.0%	-76.5	19.5	8.5	0.3	0.3	-1.5	0.7	3.5	3.8	13.6
UniCredit	UCG IM	EUR	7.0	9.8	38.9%	14.4	6.0	36.6	15.8	1.9%	4.4%	7.0%	28.8	7.8	4.9	0.3	0.3	-1.7	3.0	5.4	6.2	13.2
Mediobanka	MB IM	EUR	6.7	8.5	27.6%	11.0	4.1	40.3	5.9	6.7%	6.8%	9.0%	10.0	8.1	7.3	0.6	N. A.	5.8	6.9	7.7	11.5	16.1
Intesa Sanpaolo	ISP IM	EUR	1.6	2.1	31.3%	2.6	1.3	31.2	31.1	7.1%	7.6%	9.2%	10.9	9.2	7.4	0.5	0.6	5.5	5.4	6.7	5.2	13.9
Emilia Romagna	BPE IM	EUR	2.0	2.9	48.1%	4.7	1.8	35.8	1.0	0.0%	4.5%	7.2%	24.2	6.3	4.3	0.2	0.2	1.0	3.3	4.7	5.5	13.9
UBI Banca	UBI IM	EUR	3.6	3.2	-11.0%	4.5	2.1	43.5	4.1	1.2%	3.4%	5.2%	27.0	14.6	9.1	0.3	0.4	1.5	2.8	4.3	6.2	12.3
ING Groep	INGA NA	EUR	6.1	8.4	39.3%	11.3	4.2	36.6	23.6	5.6%	7.8%	8.7%	8.8	7.0	5.7	0.4	0.4	4.7	5.5	6.9	5.8	14.6
ABN Amro	ABN NA	EUR	7.2	10.9	52.1%	17.6	5.7	38.5	6.7	2.1%	9.1%	12.6%	-15.6	8.3	5.4	0.3	0.3	-2.4	3.8	6.0	5.7	18.1
DNB	DNB NO	NOK	129.3	145.6	12.6%	178.1	94.3	32.9	18.6	5.3%	6.2%	6.9%	12.4	10.1	8.9	0.9	0.9	7.6	8.6	9.3	7.5	18.6
BBVA	BBVA SQ	EUR	2.4	3.3	37.9%	5.3	2.1	44.3	15.8	1.6%	5.0%	6.9%	9.1	6.5	5.0	0.3	0.4	1.8	5.2	6.6	6.0	12.0
Santander	SAN SQ	EUR	1.6	2.4	50.3%	4.0	1.5	35.8	26.6	2.9%	5.7%	8.1%	8.0	6.5	4.8	0.3	0.4	-7.1	5.0	6.1	4.8	11.7
Bankia	BKIA SQ	EUR	1.2	1.4	12.9%	2.0	0.7	46.0	3.8	0.6%	2.3%	5.2%	59.1	23.9	10.6	0.3	0.3	0.5	1.4	3.0	6.2	14.3
Bankinter	BKT SQ	EUR	3.7	4.5	21.5%	6.9	3.0	28.2	3.3	1.1%	3.3%	5.3%	13.4	12.7	8.8	0.7	0.7	5.3	6.0	7.2	5.3	11.6
Sabadell	SAB SQ	EUR	0.3	0.4	23.1%	1.1	0.3	33.3	1.7	1.0%	3.0%	6.1%	-24.8	14.9	5.6	0.1	0.2	-0.1	1.3	3.1	4.7	12.4
CaixaBank	CABK SQ	EUR	1.8	2.4	31.8%	2.9	1.5	39.2	10.8	2.0%	4.9%	7.1%	13.0	9.5	6.9	0.4	0.5	3.3	4.6	6.1	5.5	12.0
SEB	SEBA SS	SEK	79.6	94.0	18.0%	104.9	59.8	39.4	16.7	6.0%	6.8%	7.5%	11.6	9.4	8.8	1.1	1.1	8.6	10.7	11.1	5.2	17.6
Handelsbanken	SHBA SS	SEK	75.3	92.5	22.8%	113.8	71.8	31.4	14.2	7.0%	6.9%	7.6%	10.3	9.4	8.6	0.9	1.0	8.6	9.1	9.5	4.9	18.5
Swedbank	SWEDA SS	SEK	140.7	171.2	21.7%	162.7	99.1	44.5	15.2	4.0%	5.7%	6.2%	12.3	9.1	8.2	1.1	1.2	8.2	11.4	11.7	5.1	17.0
Nordea	NDA SS	SEK	68.3	78.3	14.7%	86.7	48.0	47.0	26.3	0.5%	0.6%	0.7%	13.7	9.2	9.0	0.8	1.0	6.1	8.0	8.6	4.9	16.3
Julious Baer	BAER SW	CHF	39.3	46.4	18.2%	51.3	24.1	39.6	8.1	4.0%	4.2%	4.6%	9.8	10.5	9.2	1.4	2.5	13.1	11.6	12.4	3.3	14.0
Credit Suisse	CSGN SW	CHF	9.2	12.4	33.8%	13.7	6.1	38.8	21.0	3.1%	3.4%	3.6%	7.7	6.9	5.8	0.5	0.5	6.7	6.7	7.9	4.9	12.7
UBS	UBSG SW	CHF	10.3	13.0	26.6%	13.0	6.9	38.1	36.8	4.5%	4.5%	5.1%	8.0	8.1	7.1	0.7	0.8	8.2	7.3	8.5	5.0	13.7
Median					**33.4%**			**36.6**		**2.3%**	**5.0%**	**6.8%**	**11.2**	**8.2**	**6.2**	**0.4**	**0.5**	**3.3**	**5.2**	**6.5**	**5.2**	**13.9**

Source: Bloomberg

APPENDIX

Table 3. Calendar

Date	Region	Section	Event	Period
1-Oct	EU	Macro	PPI	Aug
1-Oct	EU	Macro	Unemployment Rate	Aug
1-Oct	US	Macro	Personal Income and Spending	Aug
1-Oct	US	Macro	ISM Manufacturing	Sep
2-Oct	EU	Macro	CPI	Sep
2-Oct	**US**	**Macro**	**Employment Report**	**Sep**
2-Oct	US	Macro	Factory Orders	Aug
5-Oct	EU	Macro	Retail Sales	Aug
7-Oct	US	Macro	Consumer Credit	Aug
13-Oct	**US**	**Corporate**	**JPMorgan Chase. Earnings Announcement**	**3Q20**
13-Oct	**US**	**Corporate**	**Citigroup. Earnings Announcement**	**3Q20**
13-Oct	US	Macro	CPI	Sep
14-Oct	EU	Macro	Industrial Production	Aug
14-Oct	US	Corporate	Bank of America. Earnings Announcement	3Q20
14-Oct	US	Corporate	Wells Fargo. Earnings Announcement	3Q20
14-Oct	US	Macro	PPI	Sep
15-Oct	US	Macro	Empire Manufacturing	Oct
16-Oct	US	Macro	Retail Sales	Sep
16-Oct	US	Macro	Industrial Production and Capacity Utilization	Sep
16-Oct	US	Macro	U. of Mich. Sentiment	Oct
19-Oct	US	Macro	NAHB Housing Market Index	Oct
20-Oct	US	Macro	Building Permits and Housing Starts	Sep
22-Oct	EU	Macro	Consumer Confidence	Oct
22-Oct	US	Macro	Leading Index	Sep
22-Oct	US	Macro	Existing Home Sales	Sep
23-Oct	EU	Corporate	Barclays. Earnings Announcement	3Q20
23-Oct	EU	Macro	Markit EU Manufacturing, Services and Composite PMI	Oct
23-Oct	US	Macro	Markit US Manufacturing, Services and Composite PMI	Oct
26-Oct	US	Macro	Chicago Fed Nat Activity Index	Sep
26-Oct	US	Macro	New Home Sales	Sep
26-Oct	US	Macro	Dallas Fed Manf. Activity	Oct
27-Oct	US	Macro	Durable Goods Orders	Sep
27-Oct	US	Macro	FHFA House Price Index	Aug
27-Oct	US	Macro	S&P CoreLogic CS 20-City	Aug
27-Oct	US	Macro	Conf. Board Consumer Confidence	Oct
27-Oct	US	Macro	Richmond Fed Manufact. Index	Oct
28-Oct	EU	Corporate	Deutsche Bank. Earnings Announcement	3Q20
29-Oct	EU	Macro	Economic and Industrial Confidence	Oct
29-Oct	**EU**	**Macro**	**ECB Main Refinancing Rate**	**Oct 29**
29-Oct	**US**	**Macro**	**GDP**	**3Q**
29-Oct	US	Macro	Pending Home Sales	Sep
30-Oct	EU	Macro	Unemployment Rate	Sep
30-Oct	**EU**	**Macro**	**GDP**	**3Q**
30-Oct	US	Macro	Personal Income and Spending	Sep