BANKING SECTOR REPORT – August 2021

EXECUTIVE SUMMARY

US banks outperformed the broad market noticeably in August 2021, after two consecutive months of their significant underperformance. Thus, BKX index increased by 5.2% MoM vs +2.9% MoM of SPX index, the first growth in absolute terms during last 3 months. Absolute August performance was +0.6 std from the mean monthly performance and it is in the top 23% since the index inception. Relative August performance was +2.2% MoM. It is +0.5 std from the mean monthly performance and it is in the top 28% of relative performance vs SPX index since the index inception. Despite to weak performance in June and July, banks outperformed SPX in all other months of the current year. So, the absolute performance of the first 8 months of the year is the strongest one over last 26 years while the relative performance is the strongest one over last 19 years.

US banks dynamics were relatively uniform in August with positive MoM growth for all members of BKX index except for WFC, which declined meaningfully on the last day of the month because of rumors about new claims of the regulator. The key outperformers (SBNY, ZION, GS and HBAN) added more than 10% MoM.

The loan growth of US banks still remained weak but improving. On the other hand, the Fed tries to be as dovish as it can under current circumstances, and it seems that rate expectations will be revised down in the near future, negatively impacting on estimates of banking fundamentals. Notwithstanding, the estimates still continue going up, driven by clearly strong 2Q21 results, ongoing improvement of the economic outlook and rising inflation. Thus, 3Q21 EPS estimates were revised up by 0.4% MoM in August, or +34.7% ytd. FY21 EPS increased by 0.3% MoM, or +54% ytd. In turn, FY22 EPS estimates were flat MoM, but +12.8% ytd, being markedly slower comparing to the quote growth of US banks in 2021. FY21 revenue projections were also almost unchanged MoM, but +4.9% ytd. On the other hand, banks are still trading with a significant discount to S&P 500 but it is no more trading with a substantial discount to their historical averages. Thus, banks are trading with -0.9/-0.8 std on P/E CY but +0.4/+0.6 std on P/E NY (on the basis of samples from 2000 and 2010 years to the current moment) relative to their historical averages (as of August 27, 2021). As for relative to S&P 500, banks are currently trading at -1.8 std and -1.3 std from the sample mean (2010-current moment) for P/E CY and P/E NY, respectively. On P/B, banks are trading with +0.7 std from the sample mean (2010-current moment) vs SPX with +2.9 std. **So, we no more expect an outperformance of US banks vs the broad market given their rich valuations and a lack of catalysts for an acceleration of the profit growth, at least near term. But we think that the loan growth acceleration will help banks to avoid underperformance vs SPX, at least in the near term.**

EU banks increased markedly on an absolute basis in August 2021 as well, after two consecutive months of negative dynamics. They outperformed the broad market slightly, for the first month over recent three. Thus, on an absolute basis, SX7P increased by 2.2% MoM in August, or +0.3 std from the mean, and it is the top 41% of absolute monthly performance of SX7P index. On the other hand, relative monthly performance was just +0.2% MoM, or +0.1 std, but it is in the top 43% of relative monthly performance in SX7P index history. Notwithstanding, it was very strong price performance during the first eight months of the year, +25.8% ytd, after clearly weak dynamics in three previous years. However, SX7P index underperformed in each of last 3 years and it is still 26.2% lower than it was at the end of 2017, underperforming STOXX 600 index by 39% over this period.

The key EU outperformers were banks, which released relatively good quarterly results. Thus, ABN Amro increased by 20.4% MoM in August, driven by a growth of 8.6%

on the day of 2Q21 earnings. On the other hand, banks with weaker quarterly results underperformed.

European banks reported markedly better results in 2Q21 as they did in four previous quarters after clearly weak figures in 1Q20. Both revenue and net income demonstrated positive surprises. Thus, 27 out of 32 banks from SX7P index for which estimates were available reported better revenue figures vs 30 out of 35 in 1Q21. Net income was also better than expected with 23 out of 30 banks with positive surprises vs 25 out of 27 in 1Q21. EPS was higher for 25 out of 30 banks with available estimates in 2Q21 vs 30 out of 30 banks in 1Q21. The key driver of better results was lower provisions due to the better economic outlook and the ongoing revenue momentum. Even NII/NIM figures weren't weak as it was in the previous quarters, although the prospects for an acceleration of NII growth in coming years still remain questionable, given expected pace of key rates dynamics. Notwithstanding, the earnings momentum continues improving after its significant worsening in 1H20. Thus, the median growth of operating profit of SX7P index members was +43% in 2Q21 vs +30% in 1Q21, but -37% yoy in 4Q20. The median growth of revenue was 4.2% yoy in 2Q21 (even +0.2% vs 4Q19) after it increased by 5.6% yoy in 1Q21, following negative dynamics over four consecutive quarters. In turn, the median revenue surprise was +2.2%, markedly better than a median quarterly surprise over the last 10 years of 1.1%, but lower than +3.8% in 1Q21. The revenue growth was driven by non-II which skyrocketed by 13.3% in 2Q21, the second consecutive quarter of its substantial growth after weak dynamics in three previous quarters. Despite better earnings season, the acceleration of the recovery and lifting restrictions on capital deployment, market perception of the results was restrained. Thus, a median 1-day performance of SX7P index members around the earnings date was +1.1% vs 10yr average of +0.2% and 1Q21 figure of +0.3%. On the other hand, the overall performance since the start of the earnings season was relatively weak with a growth of SX7P index of 2.0% (from July 12, 2021 till the end of August 2021), while STOXX 600 index increased by 2.2% over the same period.

The median growth of EU banks' net income (SX7P index members) was 102% yoy in 2Q21 after the median growth of 56% yoy in 1Q21 and the decline of 41% yoy in 4Q20. Of course, such an impressive growth is primarily due to the effect of a low base. Moreover, 2Q21 net income was even 9% higher than 4Q19 one due to significant reserve releases. Thus, provisions decreased by 85% yoy and provisions were negative for 12 members of SX7P index out of 38 (vs 6 banks in 1Q21). Notwithstanding, consensus forecasts still imply that FY22 NI will be lower by 25% vs FY19 NI. Also, median ROE of EU banks markedly increased on a quarterly basis in 2Q21 but it still remains lower than it was in 2019. Thus, median ROE increased by 188 bps qoq, or 159 bps yoy, to 7% in 2Q21 while it exceeded 8% in 2019. Due to positive EPS surprise and improved economic expectations, the estimates have increased meaningfully in recent months. Thus, the median growth of FY21 NI was +45% ytd (but -8.9% since the beginning of 2020), implying a growth of 58% yoy. As of FY22 NI estimates, the median growth was +12.4% ytd (but -6.9% since the beginning of 2020), implying a growth of 3.3% yoy. On the other hand, revenue estimates added 3.5% ytd for FY21, but still -4.5% since the beginning of 2020.

As a result of better earnings season and better earnings visibility due to the ongoing vaccination campaign and an expected GDP growth acceleration, we anticipate that the growth of EU banks' quotes could continue in the near future, but we no more expect their substantial outperformance vs the broad market given their rich valuations. EU banks are no longer traded with a discount to their historical averages while a discount to US peers is just slightly wider than it was historically. Thus, a premium to historical averages is 3.0% (+0.2 std at the moment from mean P/E NY of SX7P index members, sample from 2010 to the present moment) but a discount to US peers (on median P/E NY of BKX index vs SX7P index) is 25% as of August 27, 2021 vs an average

since 2010 of 21%, or -0.4 std. On the other hand, due to meaningful EPS upgrades, EU banks still don’t look very expensive either, even after the significant quotes growth ytd.

MARKET PERFORMANCE

US

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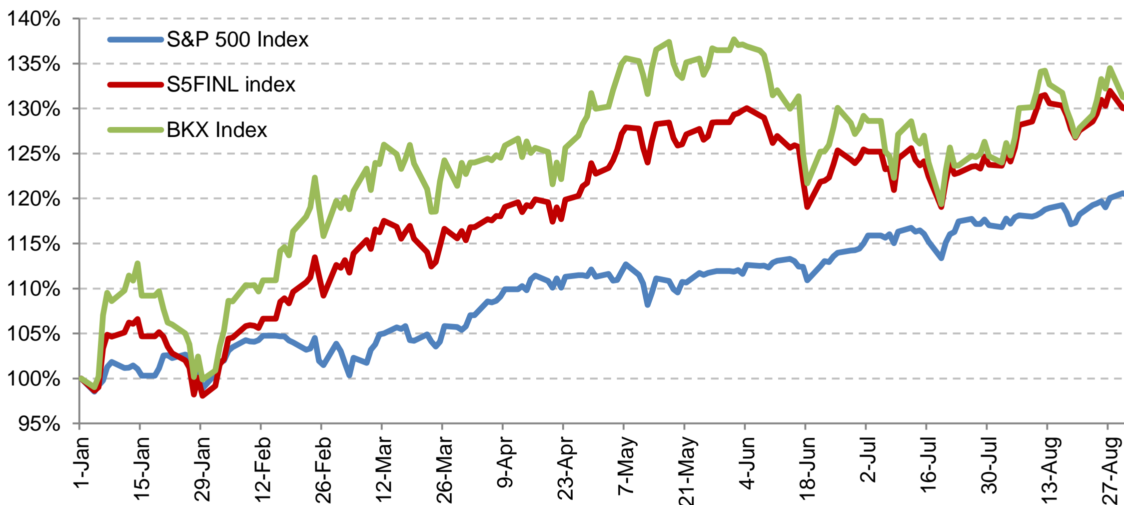
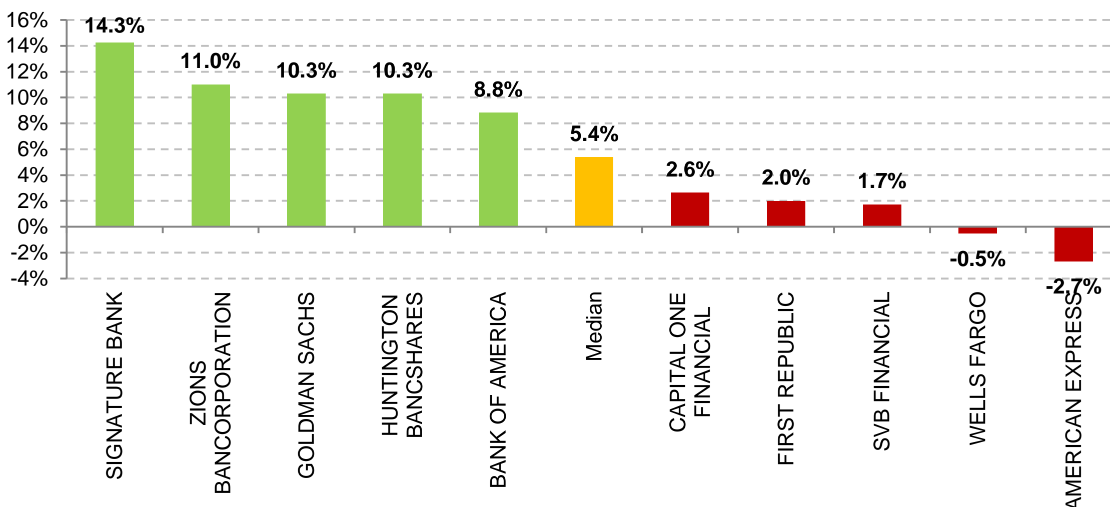
US banks dynamics were relatively uniform in August with a positive MoM growth for all members of BKX index except for WFC, which declined meaningfully on the last day of the month because of rumors about new claims of the regulator. The key outperformers (SBNY, ZION, GS and HBAN) added more than 10% MoM.

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



Source: Bloomberg

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



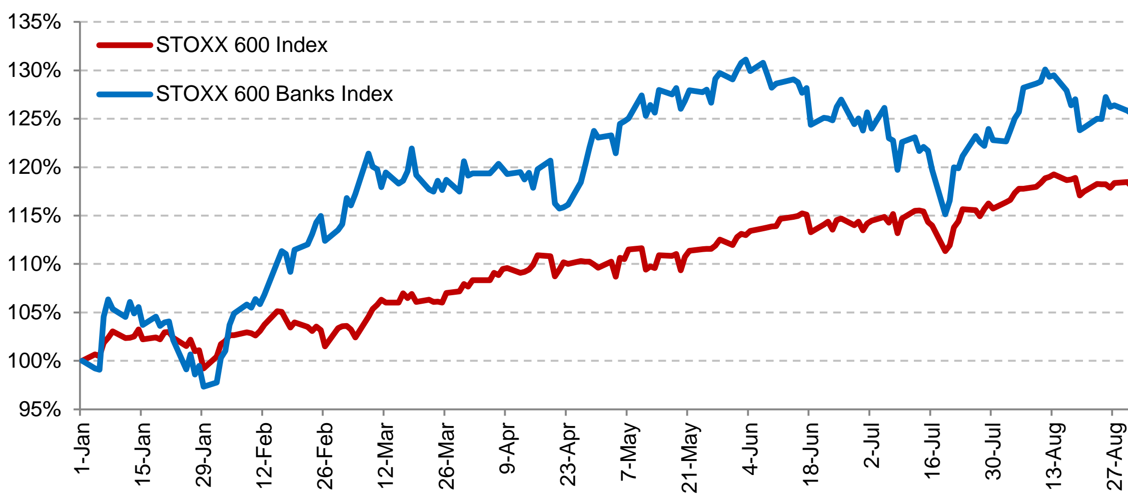
Source: Bloomberg

Europe

EU banks increased markedly on an absolute basis in August 2021 as well, after two consecutive months of their negative dynamics. They outperformed the broad market slightly, for the first month over recent three. Thus, on an absolute basis, SX7P increased by 2.2% MoM in August, or +0.3 std from the mean, and it is the top 41% of absolute monthly performance of SX7P index. On the other hand, relative monthly performance was just +0.2% MoM, or +0.1 std, but it is in the top 43% of relative monthly performance in SX7P index history. Notwithstanding, it was very strong price performance in the first 8 months of the year, +25.8% ytd, after clearly weak dynamics in three previous years. However, SX7P index underperformed in each of last 3 years and it is still 26.2% lower than it was at the end of 2017, underperforming STOXX 600 index by 39% over this period.

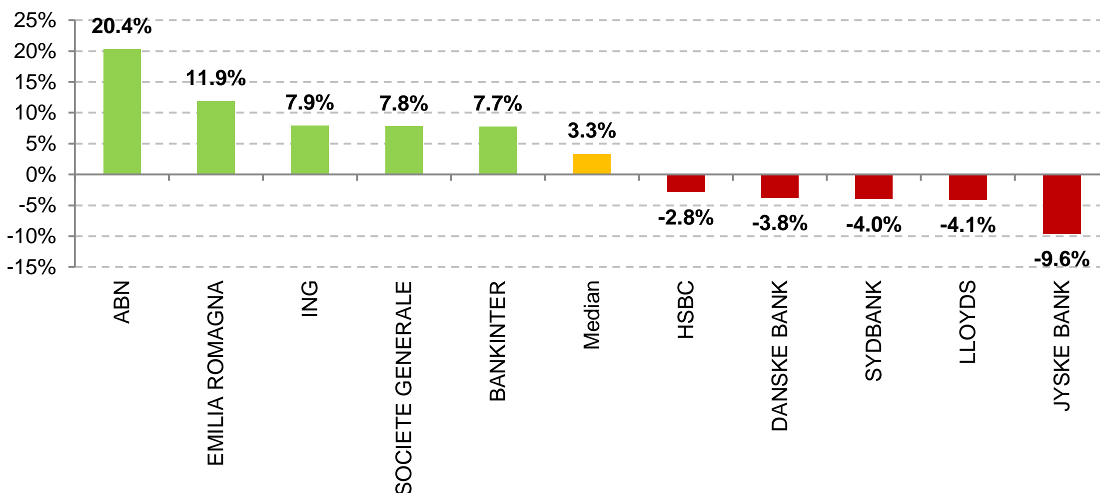
The key EU outperformers were banks, which released relatively good quarterly results. Thus, ABN Amro increased by 20.4% MoM in August, driven by a growth of 8.6% on the day of 2Q21 earnings. On the other hand, banks with weaker quarterly results underperformed.

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



Source: Bloomberg

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



Source: Bloomberg

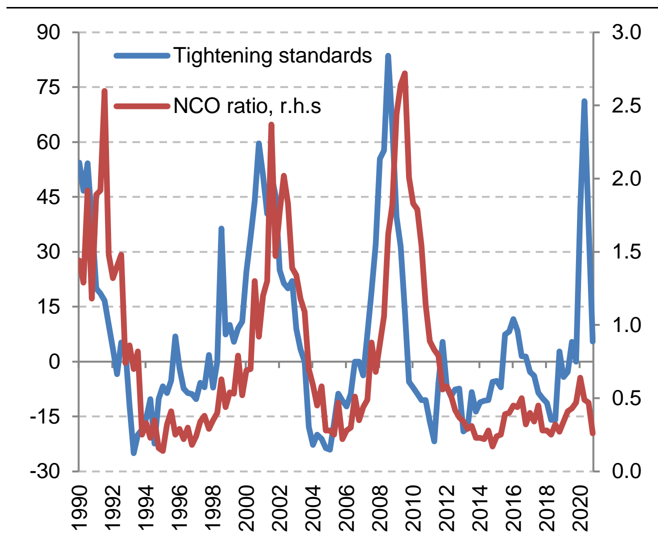
MACROECONOMIC NEWS

US

C&I loans

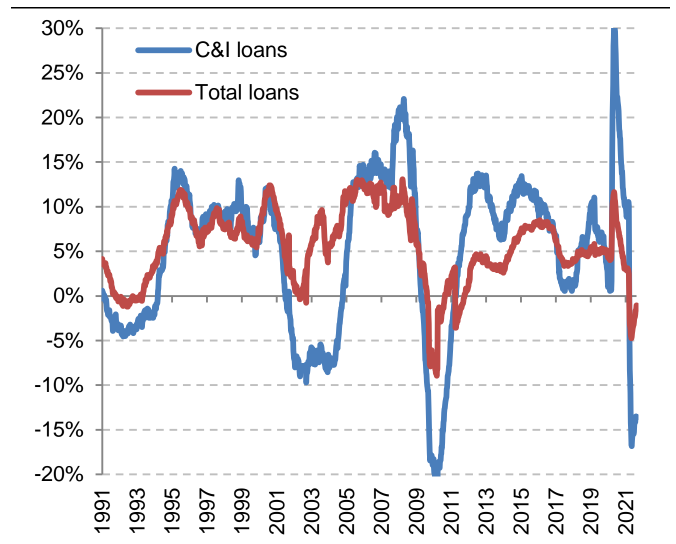
The C&I loan growth remains clearly weak despite to the significant acceleration of the US economy. And if its substantial decline on yoy basis is quite understandable due to a high base of 2Q20 because of liquidity needs in 1H20 as a result of uncertainty related to the first wave of the pandemic, then the weak ytd loan growth raises some questions given the pace of the economic recovery in recent months. Indeed, from the middle of May 2020, when C&I loans reached their local high, they decreased by $644 Bn, or -21%, explaining approximately 150% of the total loan portfolio decline over this period. So, it will be negative on yoy in the nearest quarters even despite to the ongoing vaccination campaign, new fiscal stimulus and the acceleration of the US recovery. But the situation is beginning to improve gradually. At least, banks stopped tightening lending standards in the corporate segment. According to the Fed H.8 survey, C&I loans decreased by 13.6% yoy (as of August 18, 2021) vs +18.6% yoy one year ago. On ytd basis, corporate loans declined by 6.3% vs +0.8% ytd of total loans.

Chart 5. C&I. Loan Standards vs NCOs, %



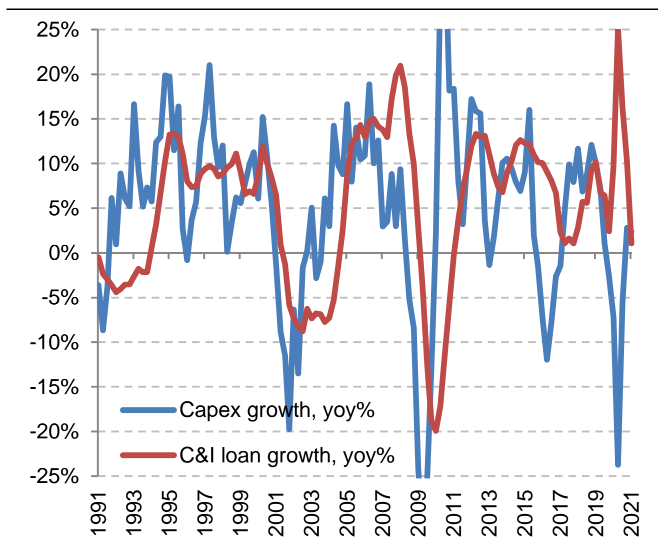
Source: Bloomberg

Chart 6. Loan Growth. C&I vs Total loans, YoY%



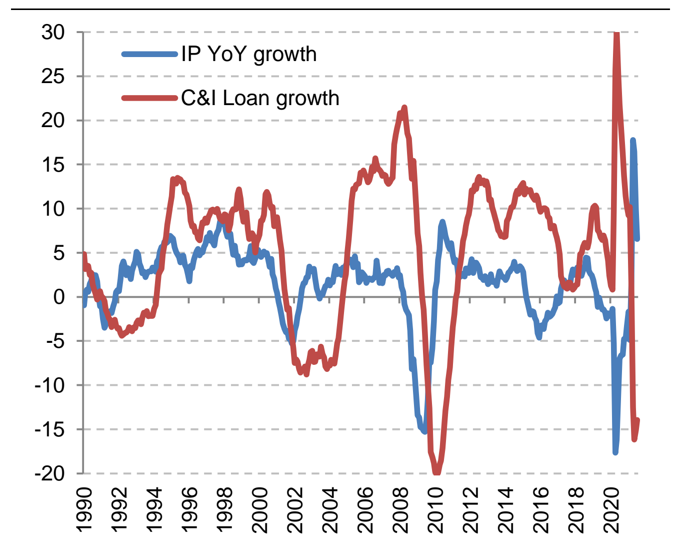
Source: Bloomberg

Chart 7. C&I. Loan Growth vs CAPEX



Source: Bloomberg

Chart 8. C&I. Ind. Production vs Loan Growth YoY%



Source: Bloomberg

Support measures have certainly had a positive impact on the financial health of the US corporate sector. So, credit indicators look pretty resilient at the moment and they will improve in the near future given the path of the economic recovery. Thus, we don't expect any more that the quality indicators may get worse before they get better. The US economy will exceed its pre-pandemic level in the current year (a much faster recovery than it was feared 2-3 quarters ago). Unsurprisingly, banks have already begun releasing corporate reserves and easing credit standards. Moreover, corporate bond spreads decreased below their historical averages after an overwhelming growth in 1H20. However, it doesn't mean that the situation has completely returned to its normal stance. At least, spreads in the most affected sectors are still elevated. Notwithstanding, it definitely means for us that the worst is over and the risks continue gradually decreasing.

Despite to concerns about the deterioration of C&I credit quality during the first wave of the pandemic (and the total loan portfolio at all), it remains benign so far and there wasn't any significant deterioration of credit quality since 1H20. As of industry-average figures (the latest available data), according to the FDIC data, 30-89 delinquency was relatively flat during 4 recent quarters but it declined by 7 bps yoy to 0.26% in 1Q21. It is still not far from the last cycle low, confirming the strong quality of the C&I loan portfolio at the moment. FDIC's NCO ratio tumbled by 21 bps both qoq and yoy to 0.26% at the end of 1Q21, remaining below its pre-pandemic levels. Noncurrent rate decreased by 9 bps qoq, but still +8 bps yoy, to 0.9%. According to the Fed data, delinquency ratio decreased by 21 bps yoy, or -11 qoq, to 1.05% in 2Q21, it is the lowest figure over last 2 years. In turn, NCO ratio decreased by 8 bps qoq, or -21 bps yoy, to just 0.21% in 2Q21, remaining markedly below its historical averages. Moreover, total NPLs of BKX index member (for those banks that provide this data) decreased by 30% qoq in 2Q21.

Before the start of the pandemic, the financial health of the US corporate sector was solid even in spite of its relatively high leverage. Thus, ROA was high, quick ratios were sound while interest expense coverage was strong but deteriorating as the total profit of the sector was flat during recent quarters. The situation changed considerably in March 2020 and it continued to deteriorate in 2Q-3Q of 2020, even despite to the relatively fast economic recovery. Given the high leverage of the US corporate sector and an inevitable decline of revenues because of the deep recession in the US in 1H20, accompanied by an explosive growth of corporate spreads, especially for non-investment grade companies (but the spreads have already declined markedly from their recent highs), we saw a significant drop of interest coverage ratios in 1H20 even despite to the fed funds rate was cut to zero. On the other hand, the situation has improved considerably in recent quarters. Thus, median EBIT to interest expense ratio of S&P 500 index (ex. financials companies) increased from 5.2x at the end of 2Q20 to 9.3x at the end of 1Q21, being even higher than it was in 2019. Notwithstanding, the percent of companies with the ratio below 1.0 remains relatively high, 9.8% in 1Q21 vs just 6.3% in 4Q19, implying that the stress in the economy is still high. But it continues gradually decreasing from the 2Q20 high of 21.7%, for the fourth quarter in a row. So, it seems that the situation has almost returned to normal, and we do not expect a significant deterioration of the financial stability of the US corporate sector in the foreseeable future even after the end of the supporting fiscal programs. We believe that the credit quality of C&I portfolio will remain strong while corporate loans will return to a growth in 2H21. At least, some of regional banks demonstrated a strong QoQ growth even in 2Q21 despite to ongoing repayment of PPP loans which decreased approximately by 1/3 in 2Q21.

July 2021 Senior Loan Officer Opinion Survey indicated that C&I lending standards and terms were eased in 2Q21, the second consecutive quarter of easier standards after 6 quarters in a row of tighter of flat standards. Easing was broad based, pointing to more positive bank's views on the future economic growth. Thus, the key reasons for easing are

“a more-favorable or less uncertain economic outlook, more-aggressive competition from other banks on nonbank lenders, and improvements in industry-specific problems as important reasons for doing so”. Also, banks reported stronger demand in 2Q21 and it was stronger both for small and for large firms. So, banks noted again that inquiries from potential borrowers increased in the last quarter. The key drivers of stronger demand were “customers’ needs to finance inventory, accounts receivable, investment in plant or equipment, and mergers and acquisitions”. It was in-line with expectations. Moreover, banks noted that “their lending standards on C&I loans are currently at the easier end of the range of standards between 2005 and the present”, but “ending standards were basically unchanged, on net, relative to the July 2019 survey”.

Macro data published in August 2021 were mixed after slightly better figures in July following lower than expected prints in May and June. Thus, ISM manufacturing index decreased by 1.1 pts MoM to 59.5 pts in July, markedly missing its consensus estimate of 61 pts. It is 5.1 pts lower than the high of 2021 but it is still higher than an average level of 2017-2019 years. In turn, employment report was markedly better than expected in July again, the second consecutive month of better figures. Thus, manufacturing payrolls increased by 27K in July vs the consensus of +25K, after it went up by 39K in June (revised up from initial estimate of +15K). Also, total payrolls increased by 943K in July vs the consensus of +870K, after it increased by 938K in June (slightly revised up from the initial estimate of +850K). However, employment is still around 6 mln lower than it was before the pandemic. Notwithstanding, unemployment rate tumbled by 50 bps MoM to 5.4% vs the consensus estimate of 5.7%. Unemployment remains elevated but it is already significantly lower than the high of the GFC and it is much lower than it was anticipated one year ago (just 190 bps higher than it was in February 2020). Despite to new fiscal stimulus and the acceleration of the recovery, street estimates weren’t improved significantly in recent months given weaker employment figures and some deceleration of forecasted GDP growth rates. Thus, according to Bloomberg survey conducted in August, GDP growth rates were estimated at +6.2%/+4.3%/+2.3% yoy for 2021/2022/2023, respectively, vs +6.6%/+4.2%/+2.3% in July. Industrial production increased by 0.9% MoM in July vs the consensus of +0.5% MoM after its growth by 0.2% in June (it was revised down from the initial estimate of +0.4%). But it still remains -0.2% relative its pre-pandemic level as a result of the meltdown in 2Q20, when IP decreased to the levels last seen during the GFC. Capacity utilization increased by 0.7% MoM in absolute terms to 76.1% in July, and it was slightly higher than the consensus estimate of 75.7%. Unsurprisingly, it is still below its pre-COVID levels but just -0.2% in absolute terms. In turn, Empire manufacturing index tumbled by 24.7 pts MoM to 18.3 pts in August, after it skyrocketed in July to the highest figure in the index history. Markit manufacturing PMI decreased by 2.2 pts MoM to 61.2 pts in August vs the consensus of 62 pts. However, it is still more than 17 pts higher than its 2020 low and even more than 9 bps higher than its pre-COVID levels. Notwithstanding, consensus IP growth forecasts decreased slightly in August to +5.6%/+4.1%/+2.6% yoy in 2021/2022/2023, respectively, vs +6%/+4.2%/+2.4% yoy in July.

CRE

The growth rate of commercial real estate loans wasn’t strong ytd despite to the ongoing rebound of the sector and the significant acceleration of the economy. On the other hand, it remains positive on yoy basis, even taking into account a substantial negative effect of the pandemic on some CRE subsegments and geographies, such as retail/hotels and NY/CA. Thus, according to the last Fed H8 weekly report, CRE loan growth was +2.7% yoy (as of August 18, 2021) vs +6.2% yoy one year ago. In spite of the significant deterioration of CRE fundamentals in 2Q20 and 3Q20, there were clear signs of their improvements in the recent months. However, despite to the acceleration of the price growth and higher volumes, CRE fundamentals still remain under pressure. At least, same-store NOI and

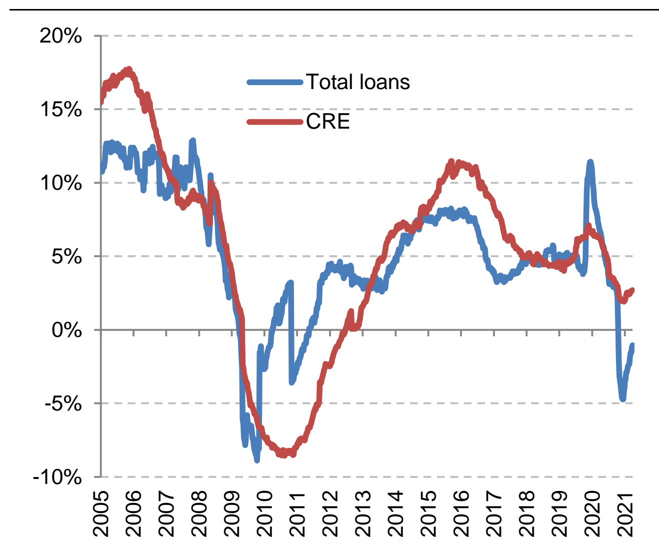
effective rent are still markedly lower as compared to their pre-pandemic levels, especially in the most suffered subsegments and geographies, but they are positive on yoy basis due to the effect of the low base of 2Q20. The sector is clearly out of the woods now, but it is a bumpy road ahead, even despite to the gradual reopening of the economy. In any case, we remain bullish on the sector but we believe that fundamentals will remain under pressure for some time with elevated vacancy rates and a negative rent growth (at least in some segments). As a consequence, the loan growth may remain restrained for some time before it gets better but we no more expect a deterioration of quality characteristics. So, REITs increased by 26.8% ytd vs SPX index growth of +20.4% ytd. On the other hand, BBREIT index was just 7.6% higher than its pre-pandemic high while SPX index is 33.5% higher in contrast to its pre-pandemic levels.

The credit quality remains strong so far but early signs of its deterioration were already seen in 2H20. Notwithstanding, it improved in 1H21 and the majority of the indicators are not far from their pre-pandemic levels. According to the Fed data, CRE NCO ratio decreased by 1 bps both qoq and yoy basis to 0.07% in 2Q21, while delinquency ratio increased by 2 bps qoq, but -6 bps yoy, to 0.95%. According to the FDIC data, NCO ratio for commercial mortgage decreased by 14.6 bps qoq, but still +4.2 bps yoy, to 0.07%. NCO ratio of construction and development loans increased by 1.5 bps qoq, or +2.4 bps yoy, to 0.02%, while NCO ratio of multifamily loans went up by 0.3 bps qoq, or +1.7 bps yoy, to just 0.01% in 1Q21. So, NCO ratios of all CRE subsegments remain markedly below than average levels of last two cycles. In turn, non-current rates increased noticeably in all major segments on yoy basis. Thus, commercial mortgage noncurrent ratio is 0.97%, +33 bps yoy; construction one is 0.72%, +26 bps yoy; multifamily noncurrent ratio is 0.25%, +12 bps yoy. As for the leading indicator of future credit quality, 30-89 days delinquency ratio improved markedly in three recent quarters and it is even lower now on yoy basis too. The figure of commercial mortgage decreased by 7.4 bps qoq, or -10 bps yoy, to 0.27%; in construction it was -5.8 bps qoq, or -16 bps yoy, at 0.39%; in multifamily it was -7.2 bps qoq, or -2.5 bps yoy, at 0.17%. In any case, NCO ratio highs booked in domestic offices were very different during three last recessions. According to the Federal Reserve data, the GFC's high was 2.82%, comparable to the recession of early 1990s figure of 2.44%, but significantly higher that just 0.15% of the recession of early 2000s. And we don't expect that the NCO ratio high of the current cycle will reach the high of the GFC even despite to significant problems in retail and hotel segments due to a shorter period of current downturn and much tighter lending standards during the last credit cycle. Moreover, the percent of rent collections remains very high in the majority of segments and still growing. The price growth has remained positive on yoy basis so far and it even accelerated in recent months.

Transaction volumes skyrocketed yoy in 2Q21 as a result of the low base of 2Q20 due to lockdowns during the first wave of the pandemic. So, it has already returned to its pre-pandemic levels and it seems that the activity will remain elevated at least in the nearest months given the current pace of the recovery. According to the RCA, "compared with the average deal volume trend for second quarters in 2015 to 2019, activity in the second quarter of 2021 was 14% greater. Compared with the slump seen in Q2 2020, investment activity grew at a triple-digit rate. In a sign of market strength, it was the sale of individual assets rather than portfolio and entity-level deals which spurred the growth. The dollar level of single property transactions in Q2 2021 was 17% above the trend seen before Covid-19 hit U.S. shores. Both the industrial and apartment sectors registered the strongest second quarter on record for sales across all deal structures. The hotel sector was boosted by one supersized entity-level deal". Also, "U.S. commercial real estate sales climbed in July and the rate of price growth accelerated as most but not all property sectors advanced past the pandemic recovery phase. Deal volume for the month rose 74% from a year ago and was above the average pace set across each July since 2005". Despite to fundamentals of the

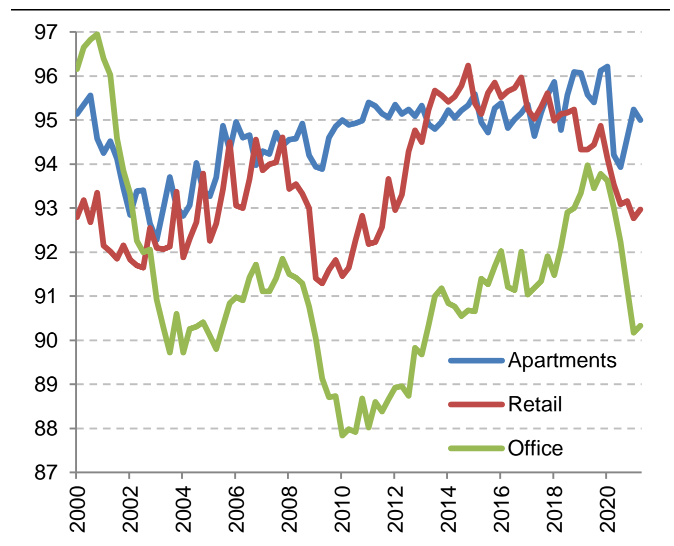
most suffered segments such as NY apartments are far from their pre-pandemic levels, the majority of other segments continue their fast rebound while prices in all major segments have already been at new all-time highs. Thus, the apartment price index added +13.5% yoy at the end of July 2021 vs +7.7% yoy one year ago. Even the price index of retail CRE turned positive again in March 2021 after being negative for 11 months in a row and it is currently +7.5% yoy vs -2.8% yoy one year ago. The growth of industrial CRE prices accelerated to +11.8% yoy in July 2021 vs +9.1% yoy in July 2020. The growth rate of office prices accelerated to +8.8% yoy from +0.5% yoy one year ago. So, the all-property CRE index increased by 11.8% yoy in July, the fastest growth rate since April 2006.

Chart 9. Loan Growth. CRE vs Total Loans, YoY, %



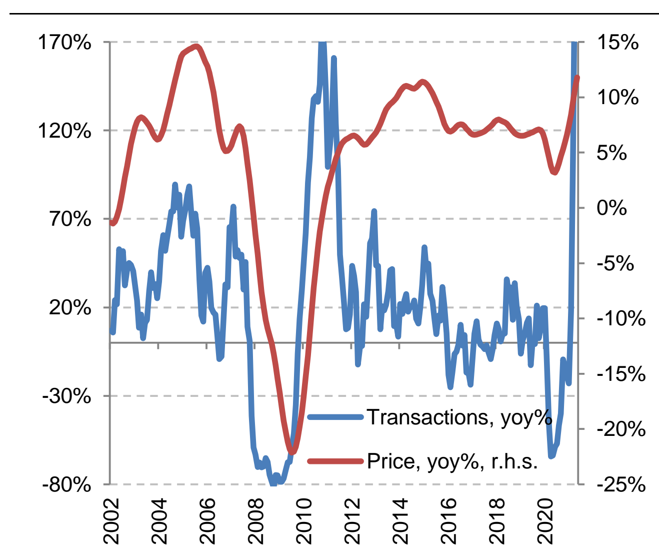
Source: Bloomberg

Chart 10. CRE. Occupancy rates, %



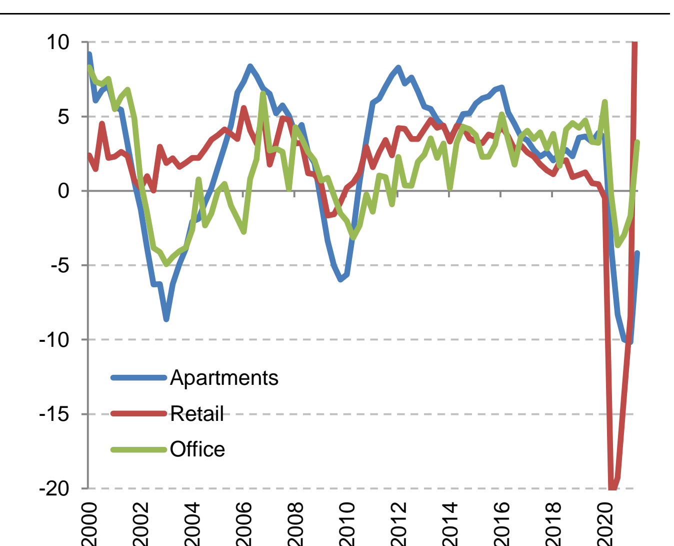
Source: Bloomberg

Chart 11. CRE. Price Growth vs Transactions Volumes



Source: Bloomberg

Chart 12. CRE. Same-Store NOI Growth, %



Source: Bloomberg

Despite to the fast recovery in the CRE segment, CRE fundamentals remained under pressure in 2H21, but improving. Thus, retail same-store NOI tumbled by more than 20% yoy in 2Q20 and by 19% yoy in 3Q20, but it was -13.5% yoy in 4Q20, -7.9% yoy in 1Q21 and +20.8% yoy in 2Q21, the fastest growth rate in the index history. The lowest figure of the GFC was just -1.7% yoy in 2Q09. Office NOI increased by 3.3% yoy in 2Q21 vs -1.9% yoy in 1Q21, -3.7% yoy in 3Q20 and -0.3% yoy in 2Q20, compared with the lowest growth during the GFC of -3.2% yoy, shown in 2Q10. Apartments NOI decreased by 4.2% in 2Q21 vs -10.4% yoy in 1Q21, -8.3% yoy in 3Q20 and -3.7% yoy in 2Q20, still near the trough

growth rate of the GFC, -6.0% yoy in 4Q09. But the situation will continue to improve in the near future and the majority of segments will returned to their pre-pandemic levels in 2H21. Occupancy rates also decline substantially across all major segments except for industrials in 2Q20/3Q20 but it increased for all major segments on qoq basis in 2Q21.

In 2Q21, banks stopped tightening standards for CRE loans for all major CRE segments for the first time in years. Thus, standards for construction and multifamily loans were eased while standards on commercial real estate loans secured by nonfarm nonresidential properties remained basically unchanged. It was the first quarter of eased standards for construction loans after 24 consecutive quarters of tightening while multifamily standards were eased for the second quarter in a row after 23 consecutive quarters of tightening. Also, banks noted stronger demand for all CRE categories. Notwithstanding, “for CRE loans, banks reported standards that are tighter than the midpoints of their historical ranges for nonfarm nonresidential loans and construction and land development loans, and standards that are near the midpoint of the range for multifamily loans”, but “the net shares of banks reporting standards on the tight end of their ranges fell since 2019 for all CRE categories”.

Mortgage

The growth rate of mortgage loans decelerated markedly in recent months Vs the end of 2019 and it turned negative on yoy basis in early December 2020, even despite to the significant growth of housing sales and still relatively high refinancing activity. Mortgage loans increased only by 0.7% ytd as a consequence of tighter lending standards for mortgage loans, lower affordability as a result of a surge in prices and a lack of supply. Thus, mortgage loans decreased by 0.8% yoy (as of August 18, 2021) vs +5.3% yoy at the end of 2019. On the other hand, mortgage activity remains very high with a decline of MBA’s application index of just 3.2% in 2021 vs very strong 2020, still driven by refinancing activity despite to a substantial growth of rates from all-time lows shown not so long ago. Recall that an average level of the index in 2020 increased by more than 60% vs 2019 year. Given higher GDP growth estimates ytd, new fiscal stimulus and the ongoing vaccination campaign, we expect that mortgage activity will remain high and it will eventually be accompanied by a growth of mortgage loans as banks has already started to ease lending standards even despite to lower house affordability, still higher rates ytd and elevated unemployment. Mortgage credit availability index increased by 0.3 pts MoM, but -7.8 pts yoy, to 119.1 pts in July 2021 after it tumbled in June. So, it returned back to the lowest level since the middle of 2014 and now it is more than 60 pts below than an average level of 2018-2019 years, implying that lending standards remain very tight. Moreover, affordability ratios have already declined meaningfully from the cycle highs to the lowest levels over more than 2 years. Thus, affordability ratio decreased by 6 pts MoM, or -27 pts yoy, to 146.3 pts in June, just +8.3 pts from the last cycle low. Although the current level of affordability ratios isn’t low from the historical averages point of view, as well as household debt burden isn’t either, we expect that the affordability will continue to deteriorate given the skyrocketing growth of housing prices accompanied by a gradual growth of mortgage rates. Unsurprisingly, banks prefer to remain on the sidelines (at least for new mortgage borrowers) given still elevated unemployment ratio even despite to the significant decline of the ratio in recent quarters. However, we don’t expect that NPL and NCO ratios will even approach the values that we saw during 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 last cycle, stronger financial health of the US Consumer now vs 2007-2008 years, the very strong recovery of housing after the pandemic and a lack of housing supply. The housing market also looks significantly healthier with no obvious imbalances (except for an overwhelming growth of home prices in recent months) as it was just before the last recession when it was the key engine of the economic contraction. We expect that NCO

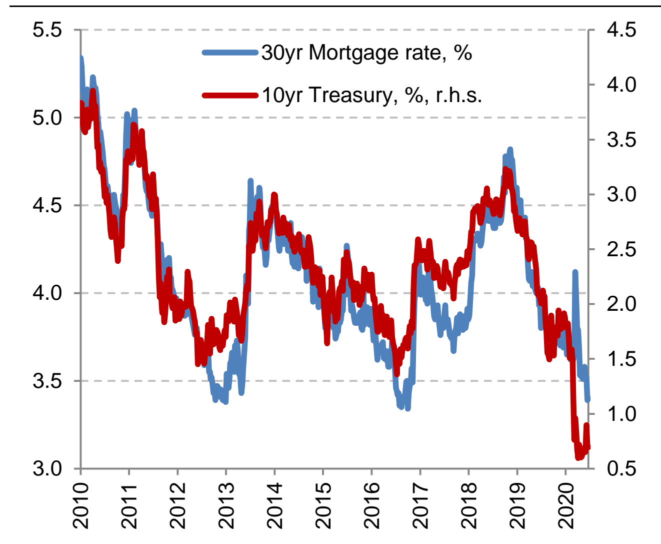
ratio dynamics will be more like one that was observed during the recession of early 2000s with the highest figure of 0.3%. However, the percent of rent payments markedly deteriorated in May 2021 but it slightly improved since then. According to the National Multifamily Housing Council Rent Payment Tracker, 80.2% of apartment households made a full or partial rent payment by August 6, 2021 vs 76.5% in July 2021, 79.3% in July 2020 and 81.2% in July 2019. Given recent stimulus and the acceleration of GDP growth, it seems that the situation should continue to improve in the nearest months.

Due to the acceleration of the US recovery, hiring also went up meaningfully. After relatively weak payrolls within the period from November 2020 till January 2021, March figures were quite strong while payrolls of the first two months of the year were revised up. Notwithstanding, April and May figures were disappointing again while there was a substantial improvement in June and July. Thus, it was added 943K jobs in July 2021 vs the consensus of 870K, while the June figure was markedly revised up from its initial estimate of 850K to 938K. In turn, private payrolls were almost in-line, adding 703K in July vs expectations of +709K, after they added 769K in June. Nevertheless, employment still remains well below its pre-pandemic level, although it is significantly better now than it was feared even 1-2 quarters ago and the situation still continues improving even despite to weak figures of April and May. Jobless claims decreased substantially in recent 6 months after being relatively flat from September 2020 to February 2021. It is still markedly higher relative their pre-pandemic levels but August figures were the lowest claims since the middle of March 2020. Average August claims decreased by 8.4% MoM and it seems that they will continue to go down in coming months even in spite of ongoing restrictions in a number of industries with high contact. So, overall median forecasts of average monthly payrolls for 2021-2023 years improved slightly in August 2021 to +585K/+300K/+180K vs +551K/+290K/+195K in July. Unemployment rate decreased by 50 bps MoM to 5.4% vs the consensus of 5.7%. So, now it is -9.4 p.p. from its April 2020 peak, but +1.9 p.p. as against its pre-pandemic level. In turn, underemployment rate continued going down, -60 bps MoM to 9.2% in June 2021, -13.7 p.p. from its April 2020 high. So, unemployment projections also improved slightly MoM in August 2021 to 5.5%/4.2%/3.7% for 2021/2022/2023 years, respectively (vs 5.6%/4.2%/3.8% in July). Despite to a significant growth of unemployment in April 2020, it seems that a negative impact of this factor on the quality of mortgage portfolio was restricted due to forbearance programs and a positive impact of fiscal stimuli. Notwithstanding, the situation continues improving due to the significant acceleration of the economy. Thus, according to the MBA, "the total number of loans now in forbearance remained unchanged relative to the prior week at 3.25% as of August 22, 2021". Around 1.6 million homeowners are still in forbearance plans, 140 thsd lower on MoM basis. The key driver of loans in forbearance decline was return of homeowners to work. As for the Fannie Mae and Freddie Mac data, the share of loans in forbearance declined for the 14th month in a row to 1.66%, being flat during the week ended August 30, but around -18 bps MoM.

The mortgage credit quality was very strong so far. According to the Fed data, NCO ratio in the segment decreased by 4 bps yoy, but it was flat qoq, to -0.04% in 2Q21 while delinquency ratio decreased by 21 bps qoq, or -6 bps yoy, to 2.49%, still not far from the lowest figure over 12 years. According to the FDIC, the quality of mortgage portfolio remains also very strong with NCO ratio at -0.03% in 1Q21, -1.5 bps yoy. 30-89 days delinquency ratio decreased by 16 bps yoy, or -14 bps qoq, to 0.72%. In turn, noncurrent ratio increased markedly, +70 bps yoy, but -4 bps qoq, to 2.6% in 1Q21. MBA's mortgage delinquencies ratio tumbled by 91 bps qoq to 5.47% in 2Q21, the fourth consecutive quarter of decline, after it reached its 9-year high of 8.22% in 2Q20. Notwithstanding, it is still 170 bps higher than its all-time low, which was shown in 4Q19. In turn, foreclosures declined again, -3 bps qoq or -17 bps yoy, to just 0.51%, the 37th quarter of decline in a row and the lowest figure since 1982. According to the NY Fed, "the share of mortgage balances 90+

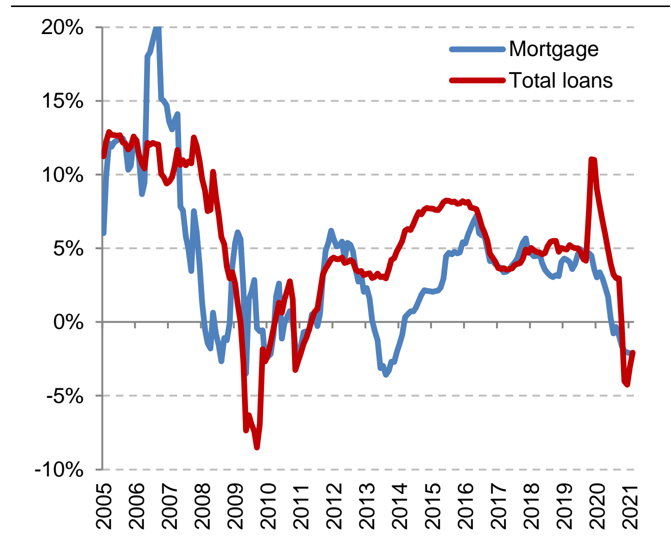
days past due fell to 0.5%, a historic low as forbearance remains an option and foreclosures are mostly on hold. About 8,100 individuals had a new foreclosure notation added to their credit reports between April 1 and June 30, by far the lowest number of foreclosures we have seen since the beginning of our series in 1999, with foreclosures effectively on legal hold due to CARES Act and other restrictions". So, we expect that the quality of mortgage loans will remain much better than GFC's average figures of NCO and delinquency ratios as underwriting standards were much stronger during the last credit cycle.

Chart 13. Mortgage. 30yr Fixed Mrtg vs 10yr Tr yield, %



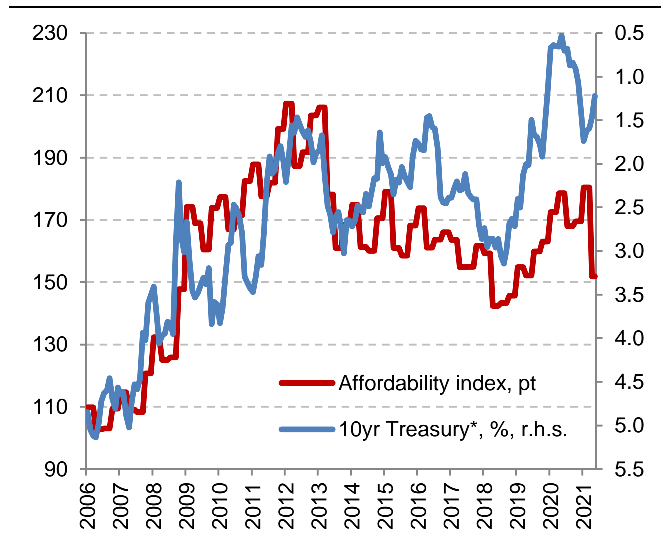
Source: Bloomberg

Chart 14. Loan Growth. Mrtg vs Total Loans, YoY, %



Source: Bloomberg

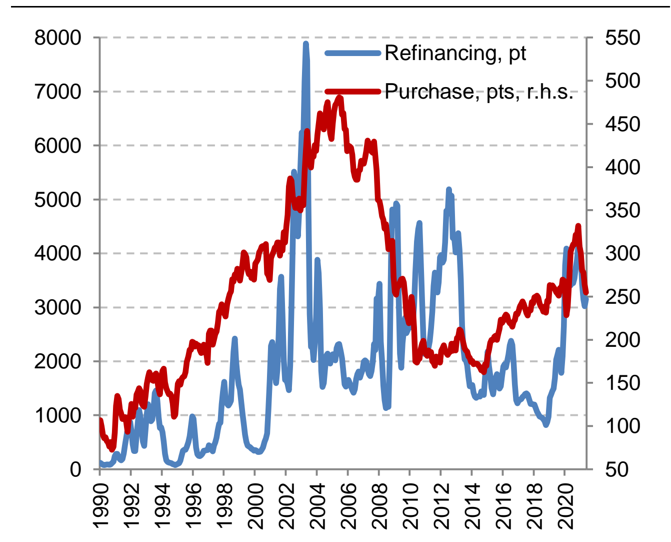
Chart 15. Mortgage. Aff. Index vs 10yr Treasury yield



*reversed order

Source: Bloomberg

Chart 16. Mortgage. MBA Applications Indexes



Source: Bloomberg

Lending standards for the most mortgage segments were eased again in 2Q21, the second consecutive quarter of easing after it was unchanged in 4Q20, following three consecutive quarters of tightening. It is quite consistent with the expectations of banks, voiced at the end of last year, that the standards will be eased in 2021. It was unsurprising given the much better labor market, the acceleration of the economic growth and the very strong housing market in the US. According to the NY Fed 2Q21 report on HH debt and credit, "there was $1.22 trillion in newly originated mortgage debt in 2021Q2, with 71% of it originated to borrowers with credit scores over 760". "New extensions of installment credit

hit series highs in 2021Q2 for both mortgages and auto loans. Mortgage originations, measured as appearances of new mortgage balances on consumer credit reports and which include refinances, were at $1.2 trillion, surpassing the volumes seen in the preceding 3 quarters. In the 4 quarters ending in 2021Q2, mortgage originations reached a historic high, with nearly $4.6 trillion in mortgages originated. With the robust pace of originations in the past 4 quarters, 44% of the outstanding mortgage balance is originated in the past year".

Mortgage demand slightly strengthened again, the 9th consecutive quarter of strengthening. Thus, "the strengthening in demand was most pronounced for jumbo loans, with significant net shares of banks reporting stronger demand for QM and non-QM jumbo mortgages". Despite to easing of the lending standards in two recent quarters, "moderate net shares of banks reported that lending standards for residential mortgages – GSE-eligible, government, and jumbo mortgages – were on the tight ends of their ranges, while a significant net share of banks reported standards for HELOCs were on the tight end of their range. Though the net shares of banks reporting relatively tight standards have declined since the 2020 survey, they are still higher than in the 2019 survey for most RRE categories".

Mortgage rates dynamics is still weak but they remain higher ytd. Moreover, monthly average rate of 30yr fixed mortgage was flat MoM at 3.03% in August 2021, after a decline of 9 bps MoM in July. Notwithstanding, it decreased in three quarters over last five with an overall decline of 21 bps. The key driver of the decline was weak dynamics of the long end, which, however, increased slightly in August. Thus, average 10yr treasury added 8.7 bps MoM and rose to 1.31% in August (still +40 bps ytd). In turn, average 15yr fixed rate mortgage (national average, Bankrate.com) decreased by 3 bps MoM to 2.32% in August (the new all-time low). In turn, 30-yr mortgage rate (effective rate, MBA) was flat MoM at 3.11% (as of August 20, 2021), +11bps ytd, but -21 bps from its 2021 high.

Housing market indicators published in August 2021 were mixed after three months in a row of weaker figures following several consecutive months of better figures. The key reasons for worse housing figures, from our point of view, were the lack of supply and an explosive growth of home prices in recent months. Notwithstanding, due to a significant drop in interest rates in 1H20 (they still remains relatively low even after their noticeable growth ytd) and the faster than expected economic recovery, the majority of housing indicators still look pretty resilient. NAHB index decreased by 5 pts MoM to 75 pts in August Vs the consensus of 80 pts, but it is still +1 pts vs its pre-pandemic levels. Construction spending increased by 0.1% MoM in June, markedly missing the consensus of +0.4% MoM, while its May initial estimate was revised up from -0.3% MoM to -0.2% MoM. So, mortgage origination forecasts remain very strong and continue to go up on MoM basis. Thus, according to the Fannie Mae's May housing forecast, total mortgage originations increased by 3.6% MoM for 2021 year (+11.5% from January estimates) and +2.3% MoM for 2022 year (+2.9% from January estimates). Currently, it is expected that total originations will decrease by 4.0% yoy in 2021 and by 24.1% yoy in 2022. The key drivers of the total originations decline will be refinancing originations which were the key driver of the skyrocketing growth in 2020. According to the MBA's forecast published in August 2021, total mortgage originations will decrease by 5.7% yoy in 2021 (+1.0% MoM vs July 2021 forecast) driven by refinancing activity which are estimated to decrease by 17.3% yoy in 2021. Total originations are also expected to decrease by 34.6% yoy in 2022 (flat vs July forecast). The key driver of refinancing originations was a significant decline of mortgage rates. However, the latter increased markedly ytd, following the significant growth of 10yr treasuries yield (but weak dynamics in five recent months). Total mortgage debt outstanding is expected to go up by 5.6% yoy in 2021 and by 5.7% yoy in 2022.

Housing starts were 1534K in July vs expectations of 1600K, -116K MoM vs the slightly

revised up June figure, still relatively in-line with its pre-COVID levels. In turn, building permits beat estimates. Thus, July building permits were 1635K vs the estimates of 1610K, +41K MoM vs the slightly revised down June estimate. Existing home sales increased slightly in July, the second month in a row of growth after four consecutive months of decline. Thus, it was 5.99 mln in July vs the consensus of 5.83 mln, +0.12 mln MoM or -0.74 mln from its local high of October 2020, but it remains slightly higher relative to pre-COVID levels. New home sales beat expectations slightly, +7K MoM to 708K in July vs the consensus of 697K. June estimate was revised up noticeably from the initial estimate of 676K to 701K. It was the first month of growth after 5 consecutive months of decline, when new home sales decreased by one third comparing to their January level. So, the figure remained below pre-pandemic levels driven by supply constraints and the significant growth of housing prices. Thus, FHFA house price index increased by 1.6% MoM in June vs the consensus of +1.9% MoM, the 13th month in a row of growth above +0.9% MoM. It added 18.8% yoy and it is the highest price growth rate in the index history (at least since 1992). S&P CoreLogic home price index for 20 cities also increased meaningfully, adding 1.77% MoM in June, vs the consensus of 1.8% MoM and it is a marked acceleration vs January and February. On yoy basis, it was +19.1% vs the consensus of 18.6%, the highest growth rate in the index history. Currently, the median existing home price is more than 40% higher than pre-GFC peak. Unsurprisingly, considering that existing home inventory is at its multi-year low.

Consumer

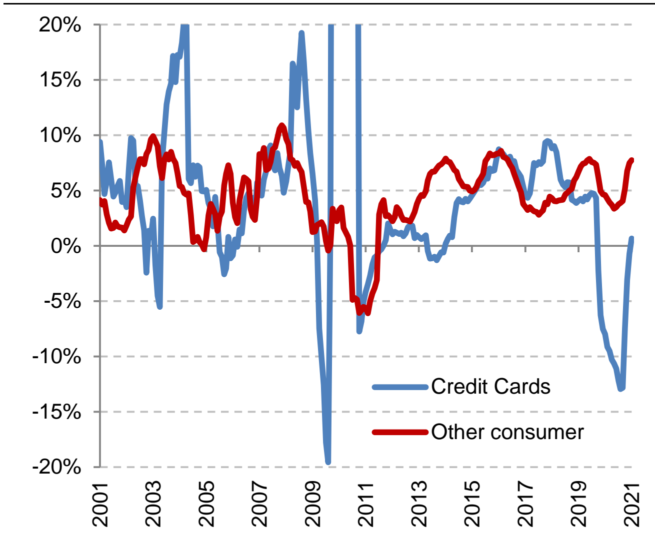
Consumer loans are the key driver of the total loan portfolio growth in 2021 after it demonstrated relatively weak dynamics in 2020. Notwithstanding, it returned to a positive yoy growth only few months ago, driven by other consumer loans such as auto, personal loans etc., while the credit cards growth became positive on yoy basis again only at the end of June 2021. Given the much better labour market than it was anticipated one year ago, the accelerating of the US recovery and the quite strong health of the average US consumer, it is not surprising. According to the Fed H8 data, the growth rate of consumer loans is +5.3% yoy (through August 18, 2021) vs -3.0% yoy one year ago and -4.4% yoy at the end of 2020. On ytd basis, it increased by 4.8%, mainly driven by other consumer loans. However, the CC growth rate accelerated meaningfully in recent months as well and it was +2.4% yoy (as of August 14, 2021) vs +4.9% yoy at the end of 2019 and -11.7% yoy at the end of 2020. On ytd basis, CC loans increased by 3.5% as consumer spending has already increased above the level of 2019 year. Net change of consumer credit in June 2021 was +$37.7 Bn, significantly beating the consensus of +$23 Bn, the highest absolute monthly change in history (the second month in a row). Other segments of consumer credit also accelerated markedly in recent weeks, adding 8.2% yoy (as of August 18, 2021) vs +5.0% yoy at the end of 2019, +6.2% ytd vs the total loans growth of +0.8% ytd. According to the 2Q21 HH debt and credit survey by the NY Fed, “aggregate household debt balances increased by $313 billion in the second quarter of 2021, a 2.1% rise from 2021Q1, and now stand at $14.96 trillion. Balances are $812 billion higher than at the end of 2019 and $691 billion higher than 2020Q2. The 2.1% increase in aggregate balances was the largest seen since 2013Q4 and marked the largest nominal increase in debt balances since 2007Q2. Balances on home equity lines of credit (HELOC) saw a $13 billion decline, the 18th consecutive decrease since 2016Q4, bringing the outstanding balance to $322 billion. Credit card balances grew in the second quarter, by $17 billion, after a $49 billion decline in the first quarter. Still, credit cards balances remain $140 billion lower than they had been at the end of 2019. Auto loan balances increased by $33 billion in the second quarter. Student loan balances declined by $14 billion. In total, non-housing balances grew by $44 billion, with increases in auto loans and credit card balances offsetting the decline in student loan balances”.

Despite to the unprecedented US GDP drop in 2Q20 and the overwhelming growth of unemployment, the health of the US consumers remained pretty resilient even then due to massive government support programs. Since that time, it improved significantly due to the much faster economic recovery than expected, which was accompanied by the fast decline of unemployment rate. It remains quite strong from historical point of view even taking into account markedly lower employment level vs pre-pandemic times. And it will continue improving given the ongoing fast recovery of the US economy due to the successful vaccination campaign and the ongoing positive effect of stimulus. According to Bloomberg estimates compiled in August 2021, it is expected that the US GDP will increase by 6.2% yoy in 2021, by 4.3% yoy in 2022 and by 2.3% yoy in 2023 (vs April estimates of +6.6%/+4.1%/+2.3% yoy, respectively). As of unemployment, it is estimated to be 5.5% at the end of 2021 while it was as high as 13% at the end of 2Q20. However, it is possible that we could see some deterioration of the asset quality in the consumer segment after the fiscal cliff and the end of forbearance programs. But it is obvious for us that the worst is over and that the potential size of problem loans will be much smaller than feared in the middle of 2020. Banks have already begun to release reserves in the consumer segment. Of course, low income consumers will suffer the most, but DSR and FOR of a median household still remain markedly lower than their historical averages. So, we continue to expect that the credit quality of consumer loans will remain very strong vs historical averages. Given the fact that banks continue to release reserves, they expect a further decline of NCO/NPL ratios in coming quarters.

According to the Fed data, total consumer NCO ratio tumbled by 32 bps qoq, or -102 bps yoy, to 1.22% in 2Q21. NCO ratio in the CC segment decreased by 50 bps qoq, or -42 bps yoy, to 2.39%, while NCO ratio of other consumer loans decreased by 25 bps qoq, or -62 bps yoy, to 0.28%, the lowest figure in the history. In turn, delinquency ratio decreased by 14 bps qoq, or -37 bps yoy, to 1.56%. Credit cards delinquency ratio decreased by 26 bps qoq, or -86 bps yoy, to 1.58% in 2Q21, while other consumer loans ratio went down by 7 bps qoq, or -14 bps yoy, to 1.52%. According to the FDIC, credit cards NCO ratio tumbled by 109 bps yoy, but +33 bps qoq, to 2.92% in 1Q21; in other consumer loans NCO ratio decreased by 6 bps qoq, or -42 bps yoy, to 0.55%; Auto NCO ratio also went down by 10 bps qoq, or -51 bps yoy, to 0.38%. 30-89 delinquency ratios (the leading indicator of credit quality deterioration) tumbled by 51 bps qoq, or -79 bps yoy, to 1.2% in 1Q21: 0.9% (-48 bps yoy) in credit cards, 0.89% (-62 bps yoy) in other consumer loans and 1.09% (-97 bps yoy) in Auto. The number of bankruptcy filings slightly increased in 2Q21, 119K vs 114K in 1Q21, but it is much lower than 189K in 1Q20, remaining near its historical low. According to the NY Fed, "of the $405 billion of debt that is delinquent, $316 billion is seriously delinquent (at least 90 days late or "severely derogatory", which includes some debts that have been removed from lenders' books but upon which they continue to attempt collection)".

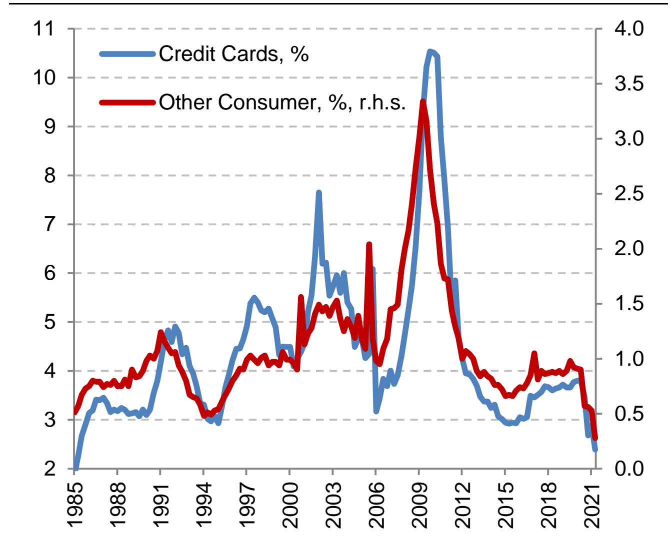
July 2021 SLOOS survey indicated that "a significant net share of banks eased standards for credit card loans, and moderate net shares of banks eased standards for auto loans and for other consumer loans. Consistent with easier lending standards, a significant net share of banks reduced the minimum required credit score on credit card loans, and moderate net shares of banks did so on auto and other consumer loans. Additionally, a significant net share of banks increased credit limits on credit card accounts. Other surveyed terms on consumer loans either remained basically unchanged, on net, or had a modest net share of banks report easing". It is in-line with expectations of banks at the end of last year. According to the NY Fed, "the median credit score on newly originated auto loans declined, by 10 points at both the median and the 10th percentile". Also, it was noted that "the number of credit inquiries within the past six months – an indicator of consumer credit demand – increased to 121 million, a 3.7% increase from the previous quarter, after having declined since the second quarter of 2020".

Chart 17. Consumer. Loan Growth Rates, YoY, %



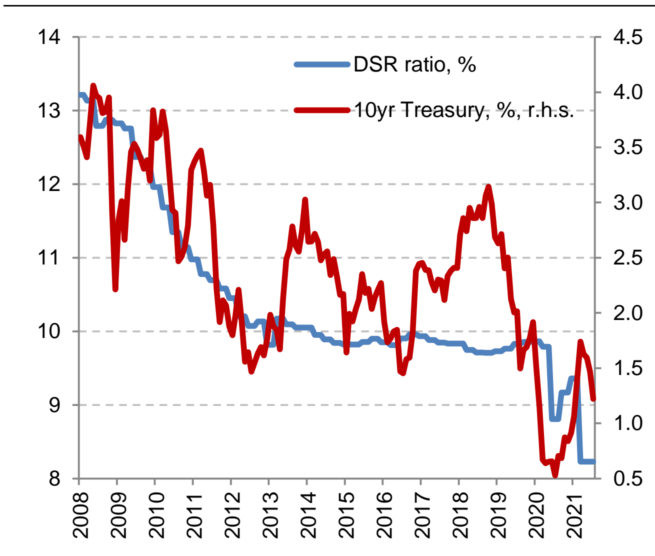
Source: Bloomberg

Chart 18. Consumer. NCOs Ratios, %



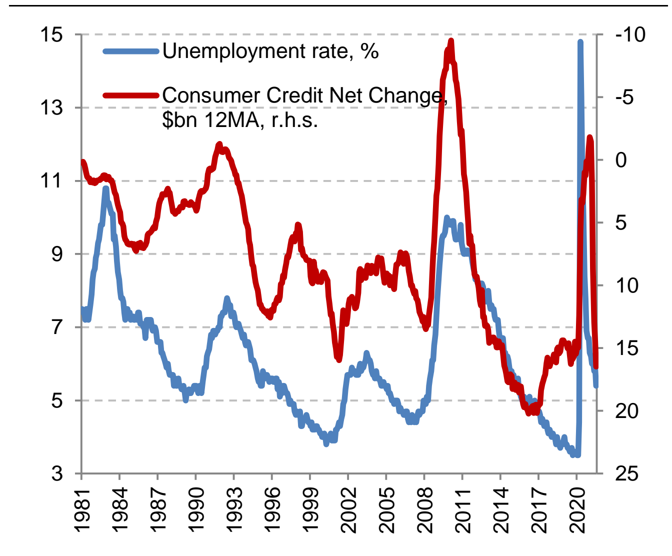
Source: Bloomberg

Chart 19. Debt Service Ratio vs 10yr Treasury Yield, %



Source: Bloomberg

Chart 20. Unemployment vs Net Change of Cons Credit



Source: Bloomberg

Consumer activity data published in August 2021 were mixed again after slightly better figures in July. Employment figures were markedly better than expected, but retail sales, personal consumption and sentiment indicators were weaker, pointing to a slower GDP growth in the coming quarters. We expected a gradual improvement of consumer sentiment in 2H21 as result of the faster economic growth, better employment and inevitable lifting of all restrictions. But the reality, as usual, turned out to be much more complicated. Thus, conference board index tumbled by 11.3 pts MoM to 113.8 pts August (from revised down July figure), driven by both the present situation index and the expectations index. It is still not very far from its pre-pandemic high, but it doesn't mean that the situation looks cloudless. At least, consumer sentiment indicator published by Michigan University tumbled to the lowest level since 2011, being even lower than the pandemic trough. Thus, it decreased by 11 pts MoM to 70.2 pts in August vs the consensus of 81.2 pts, driven by both expectations and current condition indices. Given relatively high inflation and a new surge of COVID cases because of the Delta variant spreading, consumer confidence decline doesn't look surprising. But it also means that the recovery will moderate in coming quarters. It would have happened anyway, but it will happen a little earlier than expected. So, GDP forecasts have already decreased slightly while consumer spending projections

were relatively flat MoM in August, but still much higher ytd. According to August Bloomberg survey, consumer spending is expected to increase by 8.2% yoy in 2021, by 3.8% yoy in 2022 and by 2.4% in 2023 vs January estimates of +5.2%/+4.1%/+2.5% yoy, respectively.

All data which are related to employment published in summer and autumn of 2020 were clearly optimistic and much better than expected. But figures of 1H21 were mixed with the weak start of the year, very strong March figures but lower than expected payrolls in April and May despite to the acceleration of the recovery and the gradual reopening of the economy. But we think that it was a temporary phenomenon and employment situation will continue to improve in the coming months. At least, jobless claims decreased by more than half ytd while July employment report was quite strong again, for the second month in a row. Thus, nonfarm payrolls increased by 943K vs expectations of +870K while the June initial estimate of 850K was revised up to +938K. However, private payrolls increased by 703K vs estimate of +709K, after it increased by 769K in June. Unemployment ratio decreased by 50 bps MoM to 5.4% in July vs the consensus of 5.7%. Average hourly earnings increased by 0.4% MoM in July vs the consensus of 0.3% MoM. Also, underemployment ratio decreased by 60 bps MoM to 9.2% in June, the 5th consecutive month of decline after flat dynamics in February. It is already significantly lower than the high of the Great Recession of 17.2%, but still markedly higher than 6.7% observed at the end of 2019. In any case, almost 3 mln workers are still filling continuing jobless claims which is not far from the peak level of the GFC. Moreover, employment population ratio is still near levels last seen 50 years ago. On a year-over-year basis, hourly earnings were +4.0% vs the consensus of 3.9% yoy and markedly higher than May figure of +1.6% yoy. Average weekly hours were up by 0.1 hour MoM to 34.8 hours per week vs the consensus of 34.7 hours per week. So, initial jobless claims decreased just by 8.0% MoM in July, but it was the 6th consecutive month of decline. However, initial jobless claims over the recent 4 weeks still exceeded their pre-COVID levels by more than 70%. Notwithstanding, the financial health of an average US consumer remains quite strong, but a rate of the employment growth will inevitably decelerate in the coming quarters. Moreover, lower income households continue to suffer more than an average income household.

Interest Rate

In the absence of the FOMC meeting in August 2021, all the attention was focused on the Fed Chair Jerome Powell's speech at Jackson Hole on August 27, as a lot of very important statements were made at the similar events in previous years. Given clearly hawkish signals of both the June meeting and the minutes of the July meeting, it was expected that Powell would continue to prepare the market participants to the upcoming announcement of tapering. But he was again quite cautious, sending dovish signals and confirming that the Fed is not going to rush with the announcement of tapering, especially if the recovery moderates (or it is more correct to say, if it evolves not as it is anticipated) which is quite likely, given spreading of delta variant. Notwithstanding, we still expect that the tapering decision will be announced till the end of the year while more clear signals about tapering will be sent at the next FOMC meeting in September. The more important, from our point of view, is that there was a direct statement that tapering didn't signal upcoming rate hikes, which somewhat contradicts to June dot plots, which imply the first rate hike till the end of 2022. Thus, "the timing and pace of the coming reduction in asset purchases will not be intended to carry a direct signal regarding the timing of interest rate liftoff, for which we have articulated a different and substantially more stringent test. We have said that we will continue to hold the target range for the federal funds rate at its current level until the economy reaches conditions consistent with maximum employment, and inflation has reached 2 percent and is on track to moderately exceed 2 percent for some time". Recall, that the dot plot which was updated in June implies two rate hikes till the end of 2023. 13

out of 18 participants expect at least one rate hike till the end of 2023, while 11 of 18 expect two rate hikes vs just 7 out of 18 expected 1 rate hike in March. The key reason for more hawkish market view on future rates path is inflation which remains relatively high at the moment, however, it is still perceived by the Fed as a temporary phenomenon. So, considerable time was devoted to inflation and explaining why it should be perceived as a temporary phenomenon. In other words, the speech was dovish, from our point of view. So, the market reaction was corresponding with a decline of the key yields and lower dollar vs Euro. Notwithstanding, we still expect that we will see the first rate hike in 2023 and that the growth of the long end will resume in the near future after some rollback in recent months but we no more expect that 10yr yield could exceed 2.0% in 2021. So, NII dynamics will remain restrained in the nearest quarters even in the case of the loan growth acceleration.

Although GDP growth projections were revised markedly up at the June meeting, unemployment projections were almost unchanged even despite it was noted that employment indicators continued to strengthen. According to the Fed, “real GDP this year appears to be on track to post its fastest rate of increase in decades. Much of this rapid growth reflects the continued bounce back in activity from depressed levels. The sectors most adversely affected by the pandemic remain weak, but have shown improvement.” It was also noted that the recovery was incomplete and that risks to the economic outlook remained. Thus, according to June FOMC projections, GDP will increase by 7.0% in 2021, by 3.3% yoy in 2022 and by 2.4% yoy in 2023 (vs +6.5%/+3.3%/+2.2% in March forecasts). However, the longer run GDP growth rate was unchanged at 1.8%. As of unemployment ratios, it is implied that it will be 4.5% at the end of 2021, 3.8% at the end of 2022 and 3.5% at the end of 2023 (vs March projections of 4.5%/3.9%/3.5%, respectively). The longer run unemployment ratio was unchanged at 4.0%. Notwithstanding, it was emphasized that unemployment still remains elevated, being “at 5.8 percent, and this figure understates the shortfall in employment, particularly as participation in the labor market has not moved up from the low rates that have prevailed for most of the past year”. PCE inflation forecasts revised significantly up for 2021 again but it was revised up just slightly for 2022/2023 years. So, it is implied that inflation will be 3.4% in 2021 and it will decline to 2.1% and 2.2% in 2022 and 2023, respectively (vs 2.4%/2.0%/2.1% in March forecasts). The longer-run inflation projection was unchanged at 2.0%. Overall, FOMC projections were markedly better than the consensus forecasts which were revised slightly down in recent months. According to Bloomberg August survey, the GDP growth will be +6.2%/+4.3%/+2.3% yoy in 2021/2022/2023 years, respectively, vs +6.6%/+4.1%/+2.4% yoy in March. In turn, unemployment forecasts were lowered to 5.5%/4.2%/3.7% in 2021/2022/2023 years, respectively.

Despite to the quite optimistic tone of two last FOMC meetings, there is still no doubt that challenging rate environment for US banks will persist for relatively long period of time but the outlook has improved significantly in recent months. So, we believe that the worst is behind us even despite to the significant decline of the long end in recent months. Notwithstanding, uncertainty is still remained but declining very fast. Unsurprisingly, the prospects of US banks have improved recently due to the markedly faster economic recovery than it was expected even in the beginning of the year, increased rate expectations and the gradual accelerating of the loan growth. At least, we have already seen some signs of NII stabilization, although the majority of earning assets are priced based on the short end. Thus, NIM/NII forecasts have already begun to improve. Median NIM 2021 of BKX index members decreased by 0.3 bps MoM, or -4.4 bps ytd, to 2.51%. Median NIM 2022 increased by 0.3 bps MoM, or +2.0 bps ytd, to 2.59%.

A median NII decline of our group of banks was -1.5% yoy, but +0.2% qoq, vs -10.8% yoy, or -2.1% qoq, in 1Q21, the 5th consecutive quarter of NII decline on yoy basis in a row. The key driver of weak NII dynamics was the decline of NIM again which was driven by a higher

decline of EA yield in a comparison to an IBL cost fall, even despite to the growth of the long end on yoy basis and deployment of the liquidity in higher yielding assets. Given recent hawkish signals from the Fed and signs of the near-term acceleration of the loan growth, it seems that NIM has already reached the trough while NII will eventually start to grow as early as in 3Q21. Notwithstanding, a median NII surprise of BKX index members was negative again at -1.0% (vs estimates for July 12, 2021), after -1.0% in 1Q21 and +1.4% in 4Q20. 15 out of 24 our group of banks showed a negative surprise on NII in 2Q21 vs 14 in 1Q21 and 9 in 4Q20. Total NII of our group of banks also missed estimates by 1%. 16 out of 24 our banks showed a negative surprise on NIM in 2Q21 with a median negative surprise of 3.5 bps vs 20 banks in 1Q21 with a median surprise of -3 bps and 13 in 4Q20 with a median surprise of -0.3 bps. Median NIM of BKX index members decreased by 15 bps yoy, but +2 bps qoq, to 2.51% in 2Q21 (the first quarterly growth over last 5 quarters, but -34 bps vs the lowest figure of the last cycle, shown in 3Q16) vs -3 bps qoq or -54 bps yoy in 1Q21. On yoy basis, it was the 9th consecutive quarter of median NIM decline after the same period of growth.

A median growth of NII income of our group of banks was positive on qoq basis for the first time over 5 last quarters. Notwithstanding, total NII of our group of banks was 4.8% below than it was one year ago. However, we believe that the worst for NII is behind us even despite NIM will remain relatively weak in 2021 and the loan growth is still tepid (but improving). At least, NII/NIM prospects improved markedly in the recent months due to the growth of the long end and the expected acceleration of the US economy as a result of new fiscal stimulus as well as the more hawkish Fed (than it was even a quarter ago) because of inflation acceleration. Although there is no room to improve NIM by lowering deposit costs which are near zero at the moment, NIM could begin to grow in the near future due to deployment of the excess liquidity into higher yield assets as a result of the long end growth ytd and the acceleration of the loan growth, especially taking into account that loan-to-deposit ratio was already below 60%, the record low, and there is no need to compete for deposits even in case of growth of ST rates.

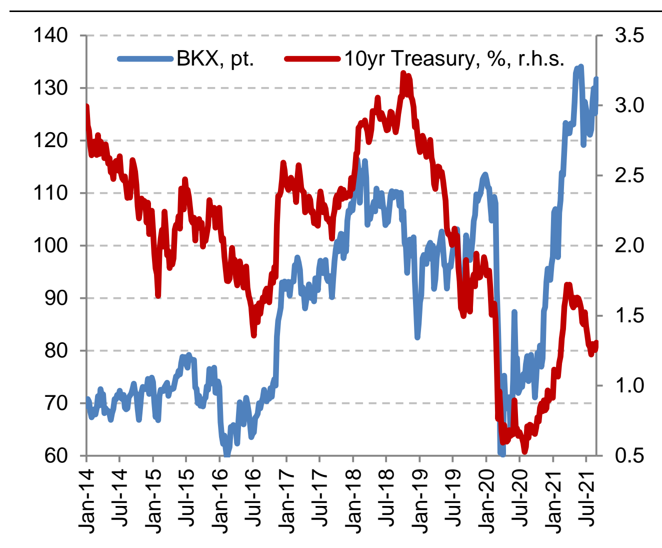
The short end of the curve was almost flat in August 2021 (as it was in all months in 2021) while the long end increased slightly after it went down in four consecutive months. Notwithstanding, the growth in 1Q21 was quite strong. So, the long end still remained significantly higher ytd. Thus, 1M yield decreased by 0.8 bps MoM to +0.025%, while 3M yield lost 0.5 bps MoM to 0.036%. 2yr yield increased by 2.5 bps MoM to 0.21%, while 5yr yield went up by 8.7 bps MoM to 0.77%. 10yr yield rose by 8.7 bps MoM to 1.31% (it is still -61 bps relative to the end of 2019, but +70 bps from its April 2020 low). Generic 30yr yield increased by 4 bps MoM to 1.93%, still below 2.0%. We still don't expect any growth of the FF rate in the nearest year but it seems that most part of the yield curve could be meaningfully higher even without it. At least, the 2yr forward yield curve skyrocketed in 2Q21, especially the short end, as a result of the more hawkish Fed. According to current forwards, the yield curve in 2 years will be higher than the current one by 40-95 bps. It is expected that only 30yr yield will be 15 bps lower in 2 years.

So, spreads moved markedly up in August 2021 after four consecutive months of negative dynamics. Due to the very strong growth in 1Q21, spreads still remains meaningfully higher ytd. Also, spreads remained noticeably higher vs the end of 2019, but 5yr/3M is still lower than its average levels of 2017 year, while 10yr/2yr is markedly higher. Thus, 5yr/3M spread increased by 9.2 bps to +0.74% and it is still 22.9 bps lower than its average level of 2017 year, while 10yr-2yr spread is 16.5 bps higher (as of the end of August). Spread (10yr-2yr) decreased by 6.1 bps MoM to +1.1%.

According to Bankrate.com data, loan yields resumed to decline in August 2021 after a small growth in June and July. But ytd dynamics remained mixed across the segments. Thus, average 30yr mortgage rate was flat MoM at 3.03% in August, but it is still +14 bps

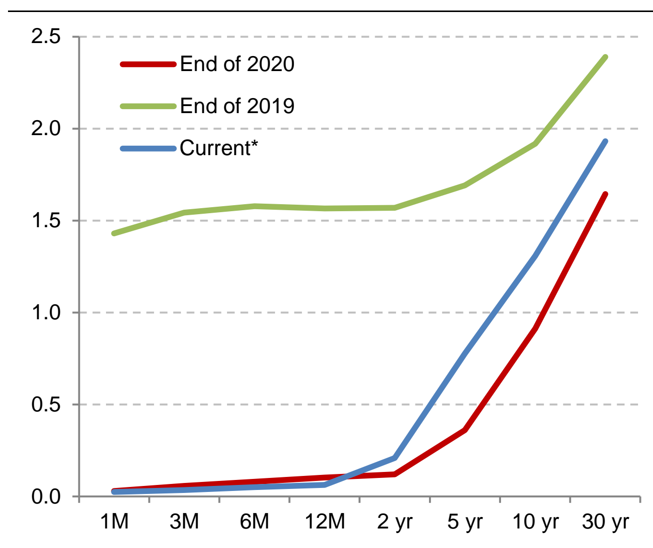
ytd. In turn, fixed 15yr mortgage rate decreased by 3 bps MoM, or -7 bps ytd, to 2.32%, the lowest figure in history. On the other hand, auto rates were relatively flat ytd in August with a decline of 2-5 bps depending on the loan term. The most significant decline was shown by personal loans which yield went down by 38 bps ytd but +5 bps MoM.

Chart 21. BKX Index vs 10yr Treasury Yield



Source: Bloomberg

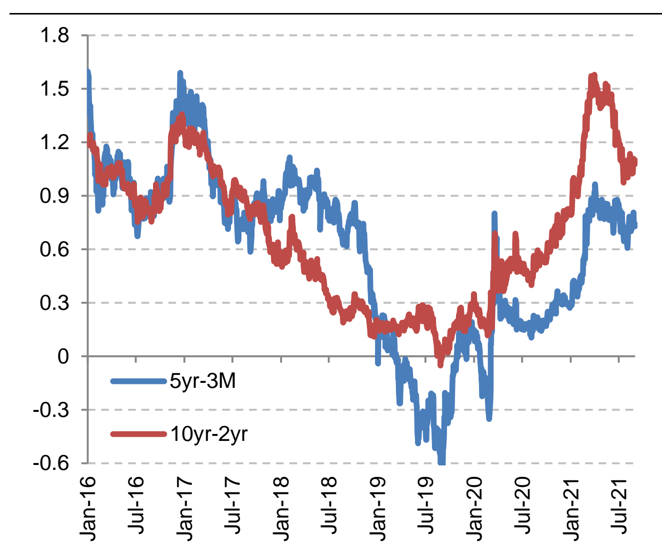
Chart 22. US Yield Curves, %



*as of the end of August 2021

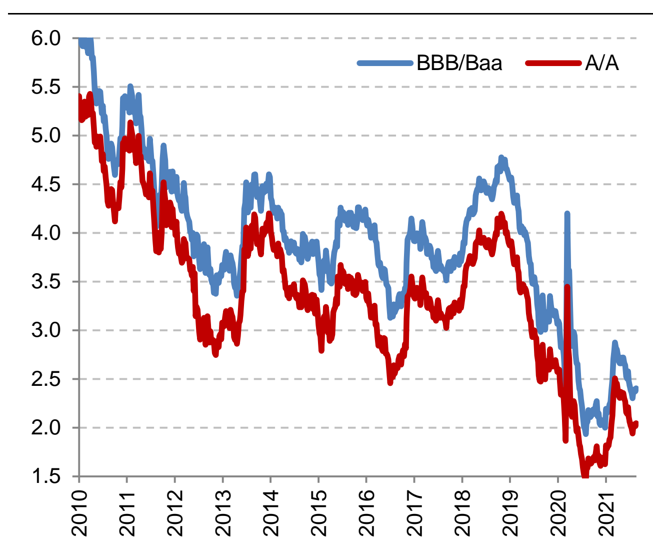
Source: Bloomberg

Chart 23. Treasury Spreads, %



Source: Bloomberg

Chart 24. Corporate spreads, %



Source: Bloomberg

Despite to the growth of the long end ytd, deposit rates continued to decline in 1H21 on an average basis but the rate of decline decelerated significantly in 2021 vs 2020 and it almost stopped going down in the summer of 2021 on MoM basis (even despite to the substantial decline of the long end in April-July of 2021). So, it was the 16th month in a row of average rates decline (or being flat). So, we think that deposit costs will be no more any significant mitigation factor for NIM until the FF rate cut again (near zero probability in coming quarters). Thus, national average cost of 6 month deposits was flat MoM at 0.11% (-12 bps ytd); average 3yr CDs cost was flat MoM at 0.36% (-14 bps ytd); average 5yr CDs cost decreased by 1 bps MoM to 0.44%, while cost of interest checking accounts increased by 2 MoM to 0.53%, the 5th consecutive month of growth and it is +33 bps from its all-time low, shown 9 months ago (+4 bps ytd). In turn, average cost of money market accounts was also flat MoM at 0.08%, staying at its all-time low (-12 bps ytd).

Europe

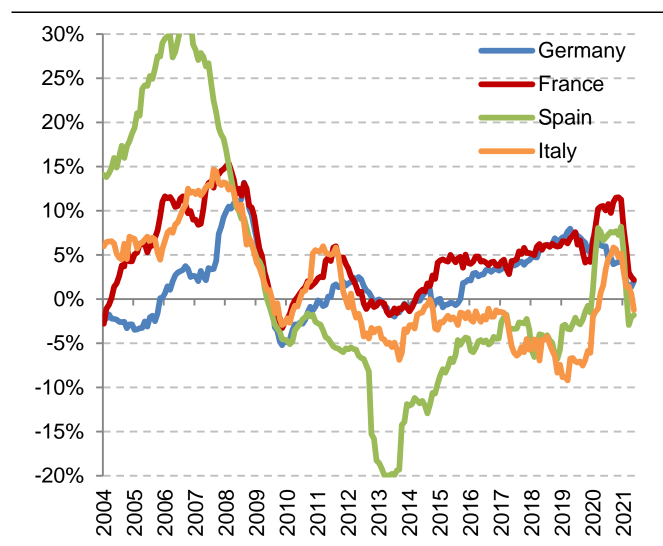
Corporate

The corporate loan growth markedly accelerated during the spring of 2020, driven by emergency liquidity needs. But this rapid growth was unsustainable given the deep recession in 1H20, the second technical recession in 4Q20-1Q21 and relatively severe restrictions because of the pandemic. Unsurprisingly, the loan growth decelerated noticeably in the recent months even despite to the acceleration of the vaccination campaign and the acceleration of the recovery. The EU economy has already returned to the growth again and it will grow relatively fast in coming quarters but economic activity will not return to its pre-pandemic levels until 1Q22. Moreover, the acceleration of the economy is not immediately transformed into the loan growth, especially taking into account that some sectors such as leisure and hospitality are still under pressure. However, corporate loans increased by 0.2% MoM in July 2021 after they declined by 0.1% MoM in June. The growth was negative on QoQ basis in 2Q21. On yoy basis, corporate loans growth rate decelerated markedly in recent months (as a result of the high base of 2Q20 due to high liquidity needs) after relatively flat dynamics during previous 11 months when it was hovering around 5.4% yoy. Thus, loans up to 1 year decreased by 0.3% MoM or -12.8% yoy in July, (vs -7.0% yoy at the end of 2020, the weakest growth rate on yoy basis since February 2010). In turn, loans 1-5 yrs decreased by 3.1% yoy vs +15.2% yoy at the end of 2020. They increased by 0.1% MoM in July 2021 after three consecutive months of decline with a total drop of 3.9% in 2Q21. Loans over 5 yrs were +6.1% yoy in July 2021 vs +5.9% yoy one year ago, +0.3% MoM. Total corporate loans increased by +0.3% yoy vs +5.5% yoy one year ago. The credit growth in the EU still varies markedly across countries.

European corporations benefited from low interest rate environment so far but it was little consolation in recession times given an imminent decline of revenues. Notwithstanding, various government guarantee programs help the majority of companies to remain solvent in a very tough period of time. In the May 2021 ECB's Financial Stability Review it was noted that the third wave of the pandemic had weighed on the near-term economic outlook. But the negative impact was increasingly concentrated in some sectors and countries, where vulnerabilities had been observed before. In any case, "while the availability of vaccines has improved the medium-term economic outlook, uncertainties remain in the near term. In addition, the slow start to the vaccine roll-out in the euro area makes it unclear when the euro area will reach herd immunity and return to normal economic activity. Moreover, the virus continuing to evolve poses considerable tail risks as vaccine-resistant mutations may yet emerge, necessitating a prolonged period of constrained social and economic activity". Moreover, even taking into account the acceleration of the economic recovery, it doesn't mean that the sky is cloudless on the horizon. Yes, the worst is behind us. But, for example, "debt-to-equity ratios have increased considerably among the most leveraged firms, with the 90th percentile increasing from 220% at end-2019 to over 270% in the final quarter of 2020", while corporate earnings remain weak and markedly below their pre-pandemic levels. So, any tightening of funding conditions will inevitably lead to lower corporate profits and higher default rates given the fact that the financial health of the EU corporate sector has not yet fully recovered from the previous lockdowns. Notwithstanding, the asset quality of the corporate portfolio remains relatively strong so far. Banks are adequately reserved at the moment, but we expect some deterioration of the asset quality, especially among small and mid-sized companies, which "are more exposed than larger firms to tightening credit conditions once loan guarantees expire". Notwithstanding, recent macro data were encouraging while economic projections continues being revised up. Risks to the euro area growth outlook remain on the downside but the outlook itself has improved noticeably in recent months due to the acceleration of the world economic growth and the gradual reopening of the economy.

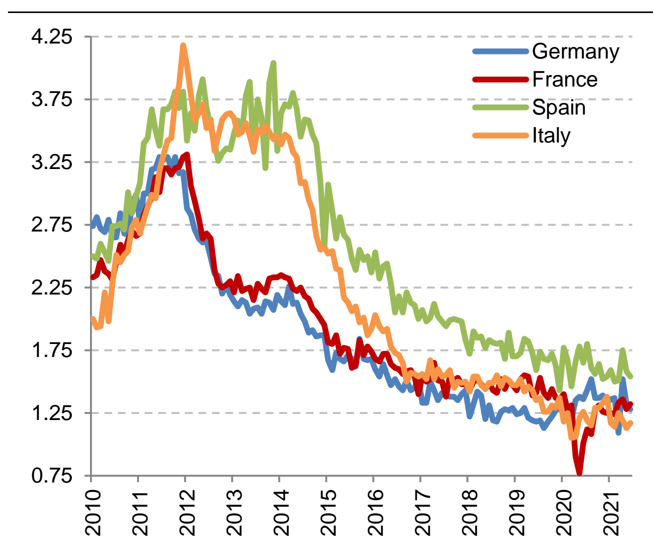
According to the July 2021 Euro Area bank lending survey, demand for corporate loans increased moderately in 2Q21 (as it was expected in 1Q21 BLS) after three consecutive quarters of decline followed its significant expansion in 1H20 as a result of emergency liquidity needs. In 2Q20, demand reached the highest net balance since the survey was launched in 2003. As for 2Q21, the demand increased for both SMEs and large firms. By the same token, it was noted that the demand increased for LT loans but it decreased for ST loans. Banks also noted that firms' financing needs for fixed investment contributed positively to loan demand for the first time since 3Q19. "In addition, banks reported a considerable positive impact on loan demand from debt refinancing and restructuring, as well as M&A activity". Also banks expect a stronger net increase in firms' demand for loans in 3Q21, especially for SMEs. Notwithstanding, credit standards for corporate loans were broadly unchanged in 2Q21 after the significant net tightening of credit standards for loans to firms in the second half of 2020 and the moderate net tightening in the first quarter of 2021. "The broadly unchanged credit standards reflect the overall improvement in the euro area economy, as also suggested by recent business sentiment indicators such as the PMI, and come in spite of more modest and volatile industrial production developments in the second quarter which are probably related to supply chain bottlenecks". Loan standards were broadly unchanged for SMEs and slightly eased for large firms. Also, they were eased for ST loans, but unchanged for LT loans. "On balance, banks reported unchanged risk perceptions in the second quarter of 2021, suggesting a stable assessment of credit risks, while banks' risk tolerance continued to have a small net tightening impact". Banks expect a slight tightening in 3Q21 but a considerable deterioration of the credit supply and a sharp reduction in lending in the coming months are not expected.

Chart 25. EU Corporate Loan Growth, YoY



Source: Bloomberg

Chart 26. EU Corporate Loan Rates, New Loans, %



Source: Bloomberg

Unadjusted EoP corporate loans increased by 0.3% yoy at the end of July 2021, the 47th consecutive month of positive growth on yoy basis. In turn, adjusted for sales and securitizations loans increased by 1.2% yoy, the 72th consecutive month of positive yoy growth. But it was the lowest growth rate over last 63 months. We expect that it will continue weakening but it should remain positive on yoy basis in the nearest months even despite to the high base of 2020 and a gradual closing of the government guarantee programs. But we don't exclude that it turns negative for a while even despite to the acceleration of the economic recovery as scopes for new investments are limited while debt burdens (which were mainly used to build liquidity) markedly increased, especially SME's debt.

German outstanding corporate loans (unadjusted figures) increased by 2.0% yoy as of the

end of July 2021, or +0.6% MoM, vs +6.4% yoy at the end of 2019. French corporate loans outstanding (unadjusted figures) added 2.2% yoy, or +0.9% MoM, as of the end of July, the second consecutive month of a noticeable growth after the figure decreased by 0.3% MoM in May. Due to the significant monthly growth during the spring of 2020, Spanish loan growth was positive for 14 consecutive months (from March 2020 till April 2021), but it turned negative again in May 2021 and dropped further by 1.8% yoy, or -0.2% MoM, in July 2021 vs +8.0% yoy in May 2020, the third month of decline over the last four. Italian loan growth turned positive in June 2020 after being negative on yoy basis for more than 8 years. But it decelerated meaningfully in recent months and it is again negative. Thus, the figure lost 1.2% yoy, or -0.6% MoM, in July 2021 vs +1.5% yoy one year ago.

European corporate rates increased meaningfully in 4Q20 from its spring 2020 lows due to spreads widening, while benchmark rates dynamics remained weak. It moved back in 1Q21 and finally turned negative again in March 2021 following 7 consecutive months of positive dynamics. In April and May of 2021 they again were higher on yoy basis, but were flat in June 2021. Thus, average EU corporate loan rate (all maturities, new business lending, adjusted for loan sales) was flat both yoy and MoM, staying at 1.35%, in June after the decline by 13 bps MoM in May. From the other hand, back book yields of EU banks continuously decreased on yoy basis since April 2014 and the speed of decline went up in 2Q20 after being relatively flat over the previous year. The rate was relatively flat in 2Q21. Thus, it increased by 1 bps MoM, but -11 bps yoy, to 1.66% in June 2021, remaining near its all-time low.

Dynamics of rates within major European countries was mixed in June 2021 with a decline of yields in Germany and Spain and a growth in France, Italy and Netherlands. Thus, Spanish yield went down by 4 bps MoM to 1.54%, the second month in a row of decline after it skyrocketed in April. So, it declined by 26 bps on yoy basis. Italian yield increased by 4 bps MoM to 1.17%. But it was just 2 bps lower on yoy basis. In turn, German corporate rate on new loans decreased by 4 bps MoM, or -15 bps yoy, to 1.28% in June, +19 bps from the lowest figure in history, shown in March 2021. French yield on new corporate loans increased by 4 bps MoM to 1.32%, +20 bps yoy, the only one among the major EU economies with positive yoy dynamics. In turn, Dutch yield increased by 9 bps MoM to 1.31%, after it tumbled May. But it was flat yoy and remains very volatile as for the monthly basis.

EU back book yield increased by 1 bps MoM, but still -8 bps yoy, to 1.66%. However, its dynamics in major European economies was mixed. Thus, German yield was flat MoM at 1.71% in June, still remaining -9 bps lower than it was one year ago. French yield increased by 4 bps MoM to 1.42%, -3 bps yoy. Italian yield went down by 2 bps MoM, or -13 bps yoy, to 1.71%. Spanish yield decreased by 3 bps MoM to 1.69% and it is just 5 bps lower on yoy basis. Dutch yield increased by 3 bps MoM to 1.81%, -13 bps yoy. So, the spread between new and outstanding rates increased by 1 bps to 0.3% in June 2021, the second consecutive month of growth after it tumbled by 26 bps MoM in April. But it is 4 bps lower than it was one year ago.

Despite to negative rates on new corporate deposits, their growth rate remains significant and it has even accelerated in 1Q21, but in 2Q21 the growth rates decelerated substantially. Thus, EU corporate deposits increased by 6.4% yoy as of the end of July 2021 (a significant deceleration vs the mid-2020 growth rate) still driven by overnight deposits while deposits with agreed maturity and redeemable deposits were negative on yoy basis. Notwithstanding, growth rates are very different among major EU countries, varying from just +0.8% yoy in Netherlands to +17.1% yoy in Spain.

Consumer

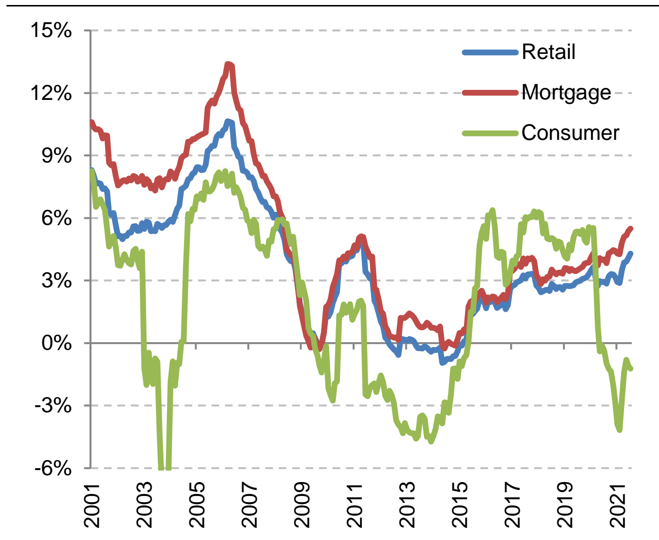
Consumer loans have become the main driver of the total loan growth in the EU again.

Their growth decreased slightly on MoM basis in March and April of 2020, but the growth resumed later as a result of employment supporting programs and the economic recovery. The growth continues and it even accelerated in 2021. But, frankly speaking, it remained relatively muted on yoy basis until early 2021 and accelerated only during last 5 months. Notwithstanding, it continues accelerating and it seems that it could accelerate further, given the faster economic recovery, growing sentiment, excess savings and record high net worth as a result of the sustained growth of property and financial markets. The financial health of the EU consumer is very strong but it should be noted that there are considerable differences across countries and income groups. So, the end of government support programs as a result of a gradual return to normal life could negatively impact on the financial health of lower income groups, given that "there are still 3.3 million fewer people employed than before the pandemic, especially among the younger and lower skilled". Notwithstanding, the unemployment rate still remains relatively stable while consumer confidence increased markedly in recent months and savings rate is very high. Moreover, indebtedness of euro area households remains relatively low, stabilized near 58% of GDP. Given very low rate environment, household debt burden is also near its multi-year lows and it will remain at these levels or only slightly higher in the nearest years because of the prolonged negative rate environment. Currently, households' debt interest burden is 40-50% lower for the majority of European countries than it was just before the US mortgage crisis. So, we believe that the overall quality of consumer credit portfolio of European banks should remain markedly better in the current crisis vs GFC levels and it should even improve in the coming quarters.

EU loans to households increased by 4.3% yoy, or +0.6% MoM, in July 2021, the 6th consecutive month of positive monthly growth after it was flat MoM in January. The consumer loan growth remained quite strong so far, demonstrating the fastest yoy growth in a decade, and we no more expect any significant deceleration of the consumer loan growth even despite to tighter lending standards and a possible growth of unemployment in 2021. But loan growth rates continue to differ widely across countries (as well as rates of corporate loans growth). Thus, German household loans increased by 5.3% yoy in July 2021, or +0.6% MoM, French retail lending added 6.7% yoy, or +1.0% MoM, (a marked acceleration vs summer 2020 levels), while household loans in Spain increased by just 0.1% on yoy basis, the second non-negative month of growth on yoy basis after 24 consecutive months of decline. Italian consumer loans added just 3.5% yoy in July 2021, or +0.9% MoM.

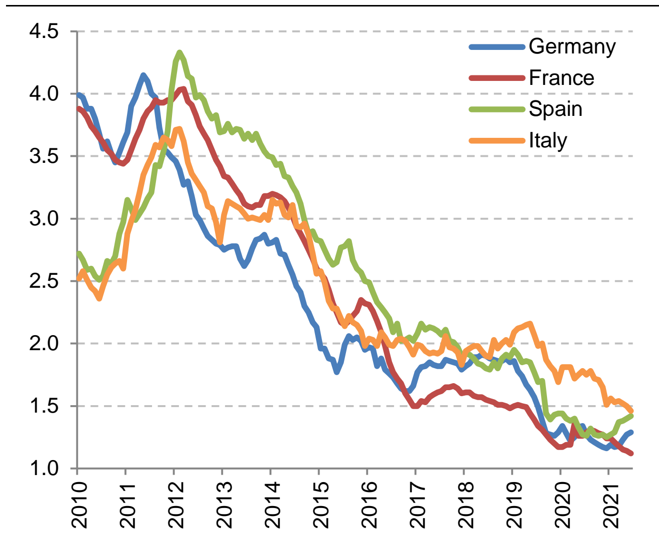
Consumer lending (ex. mortgage) was the key driver of EU household loan growth in pre-COVID times, but it was negative on yoy basis for the last 12 months, while the growth of mortgage loans continues to accelerate. On a MoM basis, consumer credit increased by 0.3% MoM, but still -1.2% yoy, in July 2021. It was the third monthly growth in a row. In turn, EU mortgage loans increased by 5.5% yoy as of the end of July, or +0.6% on a MoM basis (the fastest mortgage growth rate on yoy basis over more than 13 years). According to the July 2021 bank lending survey from the ECB, loan demand for housing loans demonstrated a strong increase in 2Q21 after a moderate decline in 1Q21. "Improving consumer confidence, favourable housing market prospects and the low general level of interest rates all contributed positively to strong housing loan demand". Also, demand for consumer credit increased in 2Q21 after two consecutive quarters of decline and it was also above historical averages. "Higher consumer confidence, an increased spending on durable goods and the low general level of interest rates were the most important factors explaining the net increase in these countries". Also, banks expect that demand for both consumer credit and mortgage loans will increase in 3Q21 even though lending standards remain relatively tight. However, banking lending standards were relatively unchanged for both consumer and mortgage loans in 2Q21 after several consecutive quarters of tightening.

Chart 27. EU Consumer Loan Growth, YoY



Source: Bloomberg

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



Source: Bloomberg

Consumer credit loans remained quite volatile but their decline during the pandemic and recessions looks quite logic given their risky nature. Consumer credit grew by more than 5% in the middle of 2019, but it is -1.2% yoy now. The most significant slowdown of growth rates was demonstrated by Netherlands, where consumer loans tumbled by 20.6% yoy, but +3.3% MoM. The rates also remain negative on ytd basis, -14.5% as of the end of July 2021. Notwithstanding, the consumer loan growth should accelerate in the near future given the acceleration of the recovery and the relatively strong health of the EU consumer.

As of mortgage lending standards, they were unchanged in 2Q21 and eased slightly in 1Q21 after tightening for the four quarters in a row. "Risk perceptions related to the improved economic outlook and competitive pressures from other banks had an easing impact on credit standards. By contrast, banks' funding costs and balance sheet situations had a slight net tightening impact". "This suggests that euro area banks consider, on balance, that their loan approval criteria for housing loans are broadly appropriate given the economic situation and borrowers' credit risks, following a stronger net tightening in 2020". Lending standards were eased in Germany, but tightened in France, while standards remained unchanged in Spain and Italy. Banks expect that the standards will remain broadly unchanged in 3Q21.

An average EU rate on new mortgage loans decreased by 1 bps MoM basis to 1.3% in June 2021, the second consecutive month of decline after its unexpected growth by 1 bps MoM in April. Notwithstanding, it is still 12 bps lower than it was one year ago. It was hovering around 1.82-1.83% over 8 months from July 2018 till February 2019, but it declined by 50 bps since then because the key benchmark yields for mortgage rates declined markedly, except for the short end which is relatively flat vs the end of 2019. 10yr generic yield increased by 7.8 bps MoM to -0.38% as of the end of August 2021, after it declined significantly during two previous months. So, it still remained 19 bps higher ytd, but 20 bps lower than the end of 2019 level. In turn, 30yr yield increased by 7 bps MoM to just 0.09% as of the end of August. So, the most of the yield curve still remains deeply below 0% at the moment (but not the entire curve as it was earlier).

In June 2021, German rates on new mortgage loans increased by 2 bps MoM to 1.29%, still -5 bps yoy, but it was the 4th consecutive month of growth. In turn, Italian mortgage rate went up by 2 bps MoM to 1.42% and it is already 15 bps higher than it was one year ago, the 6th month of growth in a row (the only country among the major EU economies with positive yoy dynamics). French yield went down by 2 bps MoM to 1.12% in June, the 5th consecutive month of decline after it was flat in January. So, it is -14 bps yoy. Spanish

mortgage rate decreased by 4 bps MoM to 1.46% and it is 32 bps lower than it was one 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 1 bps to 1.7%, the 4th consecutive month after an unexpected growth of 1 bps MoM in February following 11 months in a row of decline. The rate of decline increased recently from 4.5 years low of -12 bps yoy, which was shown in May-July of 2019, because of the significant drop of benchmark rates, which, however, were relatively flat in recent months. In June 2021, back book yields went down on a MoM basis in all major European economies except for France.

As for other consumer loans, EU new business rates increased by 14 bps MoM, but +10 bps yoy, to 5.15 % in June 2021. Dynamics wasn't uniform across major European economies. Thus, German yield increased by 3 bps MoM, or -32 bps yoy, to 5.40% in June. In turn, French rate went down by 13 bps MoM to 3.4%, still +8 bps yoy. Spanish rate decreased by 7 bps MoM to 6.61%. And it is -3 bps on yoy basis, remaining quite volatile. Italian consumer yield increased by 3 bps MoM, or +36 bps yoy, to 6.47% in June.

An average European new consumer deposits rate (with agreed maturity) decreased by 2 bps MoM to 0.21% in June 2021, the second month of decline after being flat in April. So, it is still lower on yoy basis, but just -6 bps yoy, much slower rate of decline comparing to the loan yields drop. In turn, cost of outstanding deposits (with agreed maturity) increased by 1 bps MoM to 1.15% in June 2021. But it remained relatively flat over last 11 months, being in range of 1.15%-1.19%. Total cost of deposits decreased by 1 bps MoM to 0.18% after being flat for two months in a row. On yoy basis, it is just 4 bps lower than it was one year ago. So, the spread between the total loans yield and the cost of total deposits was flat MoM at 1.8% in June 2021, -13 bps yoy, remaining at its all-time low.

The consumer deposits growth remains healthy, adding 6.7% yoy in July 2021, a slight acceleration vs +5.3% at the end of January 2020 and still not very far from the fastest growth since 2H09. But the growth was flat in monthly terms during recent 3 months. The growth rates of consumer deposits are between 5.6%-8.7% yoy for all major European countries despite to increasingly clear threats by banks to start shuffling off the burden of negative rates on to consumers. Loans to deposits ratio declined by 0.2 p.p., or -3.7 p.p. yoy, on absolute basis to just 92.9% as of the end of July 2021 to its new all-time low.

Overall Macro

The European economy is starting to accelerate after quite difficult 5 previous quarters when there were two technical recessions. The acceleration of the vaccination campaigns, accompanied by the gradual reopening of the economy, and new fiscal stimulus will be the key drivers of the recovery in the near term. Uncertainty continues to decline, but the ECB still remains relatively cautious. Thus, according to the ECB's July introductory statement, "the economy rebounded in the second quarter of the year and, as restrictions are eased, is on track for strong growth in the third quarter. We expect manufacturing to perform strongly, even though supply bottlenecks are holding back production in the near term. The reopening of large parts of the economy is supporting a vigorous bounce-back in the services sector. But the delta variant of the coronavirus could dampen this recovery in services, especially in tourism and hospitality." It's hard to disagree with the point, especially taking into account that a number of restrictions still remained in place so far and growing risks of COVID delta variant. So, it is expected that the EU economy could be fully reopened only in early 2022. However, ECB's GDP growth projections improved markedly in June 2021 vs prior March forecasts "driven by a sharp rebound in private consumption and an easing of supply bottlenecks. This should allow real GDP to exceed its pre-crisis level from the first quarter of 2022 onwards, one quarter earlier than previously projected." Notwithstanding, it should be noted that the impact of the pandemic on the economy is not

uniform, both across the sectors and among the countries. Thus, manufacturing is recovering much faster due to foreign demand while some services sectors are still suffering both from social interaction and mobility restrictions. But recent PMI figures were quite optimistic, pointing to the acceleration of the recovery in the services sector.

The European real GDP markedly increased in 2Q21 as a result of the gradual reopening of the EU economy after the second wave of the pandemic. Thus, the EU GDP increased by 2.0% qoq, or +13.6% yoy, in 2Q21 vs the consensus of +1.5% qoq and +13.2% yoy comparing to the 1Q21 growth rate of -0.3% qoq, or -1.3% yoy. On yoy basis, the EU GDP growth was negative in each of the previous 5 quarters. So, the EU economy has already emerged from the second technical recession and it is expected to grow by more than 1.0% qoq in each quarter of 2H21. German GDP increased by 1.6% qoq, or +9.8% yoy, in 2Q21 vs the consensus of +2.0% qoq and +9.6% yoy, as compared to the 1Q21 growth rate of -2.0% qoq or -3.3% yoy. French GDP increased by 1.1% qoq, or +18.7% yoy, in 2Q21 vs the consensus of +0.8% qoq and +17.5% yoy and the 1Q21 growth rate of 0.0% qoq, or +1.5% yoy. Italian GDP went up by 2.7% qoq, or +17.3% yoy, in 2Q21 vs the consensus of +1.3% qoq and +15.6% and the 1Q21 growth rate of +0.2% qoq, but -0.7% yoy (up from the initial estimate of +0.1% qoq and -0.8% yoy). Spanish GDP skyrocketed by 2.8% qoq, or +19.8% yoy, vs the consensus of +2.1% qoq and +18.9% yoy and the 1Q21 decline rate of -0.4% qoq, or -4.2% yoy. According to Bloomberg compiled estimates, 3Q21 GDP growth rate will remain strong and be in the range from +2.0% qoq in Italy to +2.7% qoq in Germany and Spain. GDP projections are slightly higher than they were at the beginning of the year but the EU economy still remains more than 3% below its pre-pandemic level. Thus, according to Bloomberg consensus estimates compiled in July 2021, the EU GDP will increase by 4.7% yoy in 2021 (vs +4.3% yoy in March), by 4.4% yoy in 2022 (vs 4.1% yoy in March) and by 2.0% yoy in 2023 (+1.9% yoy in March).

European macro data published in August 2021 were weaker than expected after mixed figures in July. The majority of key indicators missed expectations. There weren't significant negative surprises, but the fact remains. Notwithstanding, economic forecasts continue to be upgraded. Thus, street projections were improved for GDP growth, consumption and unemployment in August. On the other hand, economic surprise indices continue to go down, having reached their one year lows at the end of August. Thus, Citi's economic surprise index went down by 51 pts MoM to -10.8 pts as of the end of the month, for the first time in negative territory since the pandemic. Bloomberg surprise index tumbled by 0.39 pts MoM to 0.272.

Composite PMI (preliminary figure), which is usually well correlated with the GDP growth (but the correlation was less tight than usually in 2020), slightly missed expectations in August 2021 after 5 consecutive months of positive surprises. Notwithstanding, it is still well above 50 pts and it is markedly higher than an average level of 2018, continue pointing to a further acceleration of the recovery. Composite PMI decreased by 0.7 pts MoM to 59.5 pts, being slightly lower than the consensus of 59.6 pts. The key driver of the composite PMI negative surprise was worse dynamics of manufacturing PMI. Thus, it decreased by 1.3 pts MoM to 61.5 pts in August vs the consensus of 62.0 pts. It was +12.3 pts relative its pre-COVID level. In turn, services PMI decreased by just 0.2 pts MoM to 59.7 pts vs the consensus of 59.5 pts. So, it is still 7.1 pts higher than it was in February 2020. Despite to the miss, manufacturing PMI is consistent with ECB's view that activity in the manufacturing sector held up well. The key driver of EU manufacturing remains Germany but its manufacturing PMI missed estimates markedly in August as well. Thus, German manufacturing PMI decreased by 3.3 pts MoM to 62.6 pts in August 2021 vs the consensus of 65.0 pts. It is still significantly higher than it was in pre-COVID times, but it is quite possible that it will continue going down from the still extremely high level in the near future. In turn, German services PMI decreased by just 0.3 pts MoM to 61.5 pts vs the estimate of

61.0 pts, after two consecutive months of a very strong growth and it remains being 9 pts higher in contrast to its pre-COVID levels. So, German composite PMI went down by 1.8 pts MoM to 60.6 pts vs the consensus of 62.0 pts, +9.9 pts vs its pre-pandemic level. French composite PMI decreased by 0.7 pts MoM to 55.9 pts in August 2021 vs the consensus of 56.1 pts, the second consecutive month of decline after it grew for four months in a row. But it is 3.9 pts higher than it was in February 2020. Negative PMI dynamics was driven by both services and manufacturing components. Thus, services PMI decreased by 0.4 pts MoM to 56.4 pts vs the consensus of 58.3 pts, being +3.9 pts higher relative its February 2020 level and it was just -1.4 pts from its local high recorded in July 2020. In turn, manufacturing PMI went down by 0.5 pts MoM to 57.5 pts in August vs the consensus of 57.2 pts, the third consecutive month of decline. So, industrial production decreased by 0.3% MoM in June 2021, being slightly weaker than the consensus forecast of -0.2% MoM. Also, May IP growth was revised down from the initial estimate of -1.0% MoM to -1.1% MoM. It was the second consecutive month of decline. However, it is +9.7% yoy as a result of the low base of 2Q20 and it was even +2.6% from its pre-pandemic level. Given recent PMI figures, it seems that IP will resume its solid growth in coming months, even despite to "weaker corporate balance sheets and uncertainty about the economic outlook are still weighing on business investment". However, estimates slightly deteriorated in August 2021 vs previous July projections. Thus, according to the estimates compiled by Bloomberg, it is expected that IP will increase by 8.5% yoy in 2021, by 3.9% yoy in 2022 and by 2.1% yoy in 2023 vs +8.8%/+4.1%/+2.0% yoy, respectively, as it was estimated in July.

EU consumer sentiment started to improve in 1H21 and it will continue improving due to the faster vaccination campaigns, more fiscal stimulus, the gradual reopening of the economy and the acceleration of the economic recovery. Uncertainty about employment remains but it is steadily going down. On the other hand, household income was maintained by government support programs, savings are high while the wealth is near record levels. So, deferred consumption will inevitably impact positively on the recovery. According to August Bloomberg survey, private consumption will increase by 2.8% yoy in 2021, by 5.3% yoy in 2022 and by 2.1% yoy in 2023 (vs the estimates of +3.1%/+5.1%/+2.0% in May). Unemployment could increase slightly in 2021 but if this happens, the growth will be insignificant. Unemployment rate declined by 20 bps MoM to 7.8% in June 2021 vs the consensus of 7.9%, the lowest figure over the last year and it is just 40 bps higher relative to its pre-COVID levels. So, August consensus estimates of unemployment rates for 2021, 2022 and 2023 years, compiled by Bloomberg, were slightly revised down again, to 8.0%/7.8%/7.5% vs February estimates of 8.9%/8.5%/7.9%. However, ECB's June unemployment projections were more pessimistic, being at 8.2%/7.9%/7.4% for 2021/2022/2023 years, respectively. Notwithstanding, it should be noted that employment is still 3.3 mln lower than it was in the pre-pandemic times. In turn, retail sales increased by 1.5% MoM in June 2021, the second consecutive month of substantial growth but it slightly missed estimates (consensus was +1.7% MoM), while its initial May estimate was revised down from 4.6% MoM to 4.1% MoM. Unsurprisingly, August consumer confidence deteriorated again, for the second consecutive month, after several months of improvement in a row. But it is still exceeding its pre-COVID levels. Thus, it decreased by 0.9 pts MoM to -5.3 pts vs the consensus of -4.9 pts, +16.6 pts from April 2020 or +1.1 pts from its pre-COVID levels.

Rates

There was no ECB meeting in August 2021, so all the intention was focused on the minutes of the July meeting, which wasn't eventless even despite to just the wording of the forward guidance was changed. It was perceived as more dovish vs June one. The minutes also showed that it wasn't unanimous decision and there were also hot debates about the

further pace of asset purchases. Recall, “the Governing Council agreed a symmetric inflation target of two per cent over the medium term. The key ECB interest rates have been close to their lower bound for some time and the medium-term outlook for inflation is still well below the Governing Council’s target. In these conditions, the Governing Council today revised its forward guidance on interest rates. It did so to underline its commitment to maintain a persistently accommodative monetary policy stance to meet its inflation target”. During the press conference it was also specified that “well ahead first of all is determined by judgment of the Governing Council but it is essentially the midpoint in our overall horizon”. The monetary tools were remained unchanged in July. So, net purchases under the PEPP will be conducted at a significantly higher pace in 3Q21 than it was in 1Q21, it is about €80 Bn per month vs around €60 Bn in 1Q21 but the duration of the program was still unchanged – “until at least the end of March 2022 and, in any case, until it judges that the coronavirus crisis phase is over”. Moreover, it was again reaffirmed during the press conference that the discussion about exit from the PEPP remained premature. It is quite understandable decision given the significant growth of the long end as well as some widening of spreads ytd and ECB’s wish for accommodative monetary policy. In any case, it was given a clear signal again that the ECB will not rush to tighten monetary policy even taking into account much higher mid-term inflation projections (LT projections remained unchanged and much below ECB’s target) and “more balanced” risks. So, “the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 0.00%, 0.25% and -0.50% respectively”. As for the APP, it “will continue at a monthly pace of €20 billion”. Also, “the Governing Council will continue to provide ample liquidity through its refinancing operations. In particular, the latest operation in the third series of targeted longer-term refinancing operations (TLTRO III) has registered a high take-up of funds”. Moreover, TLTRO volume has increased considerably in recent months, implying that banks are more confident in achieving lending targets. Given the tone of the recent meeting, it seems that our expectations of announcement of lower PEPP purchases later in 3Q21 could be premature but we still believe that tightening signals will be sent to the market till the end of 2021 (at least, the announcement that the PEPP will end in March 2022). On the eve of the next meeting, which will be held on September 9, 2021, the key market discussion develops around whether the current pace of the PEPP will be preserved in 4Q21 or not. From banks' point of view, it is absolutely not important. What really matters is that the negative rate environment will remain for years while the first rate hike will not happen earlier than in two-three years.

According to the July introductory statement, “the recovery in the euro area economy is on track. More and more people are getting vaccinated, and lockdown restrictions have been eased in most euro area countries. But the pandemic continues to cast a shadow, especially as the delta variant constitutes a growing source of uncertainty. Inflation has picked up, although this increase is expected to be mostly temporary. The outlook for inflation over the medium term remains subdued”. Unsurprisingly, June GDP growth projections were revised substantially up vs March figures. It is expected that economic activity will accelerate in 2H21 due to further lifting of containment measures. The key drivers of the acceleration will be a pick-up in consumer spending, strong global demand and accommodative both fiscal and monetary policies. Thus, it is implied that the EU GDP will increase by 4.6% yoy in 2021 (vs +4.0% yoy in March forecasts), by 4.7% yoy in 2022 (vs +4.1% yoy 1 quarter ago) and by 2.1% yoy in 2023 (in-line with both March and December forecasts). Moreover, unemployment projections were revised down to 8.2%/7.9%/7.4% for 2021/2022/2023 years, respectively (from 8.6%/8.1%/7.6% in March). Unsurprisingly, near-term inflation forecast increased meaningfully because of temporary factors, while projections for further years were little changed. Thus, HICP inflation projections increased from 1.5%/1.2%/1.4% for 2021/2022/2023 years in March to

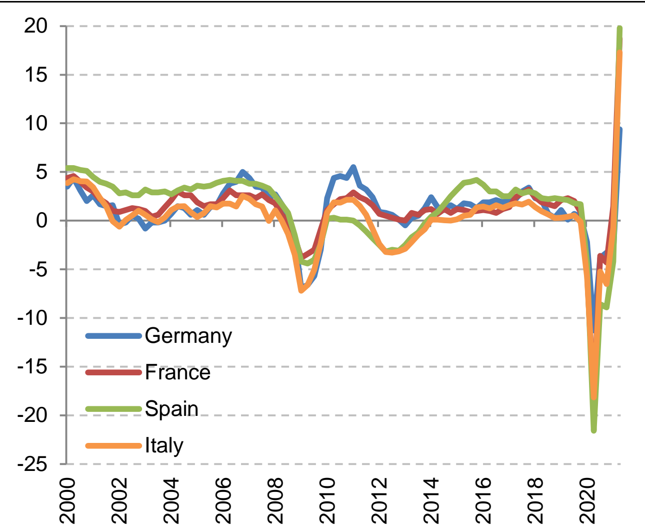
1.9%/1.5%/1.4% in June. However, headline inflation is expected to remain below ECB's target over the projected horizon. Also, the ECB sees that "the risks surrounding the euro area growth outlook as broadly balanced" (vs "skewed to the downside in the near term and more balanced over the medium term" previously).

The ECB continues to preserve favourable financing conditions and being as flexible as it can, even taking into account more clear rate guidance. Notwithstanding, it still has a negative impact on banks' revenues and profits, even despite to a positive effect of the accommodative monetary policy on the economic recovery. So, NII outlook for EU banks remains grim, even taking into account the noticeable growth of the long end ytd and hopes for an acceleration of the loan growth in the near future (at least in the consumer segment). Yields continue going down while TLTRO incentive rates expire in mid-2022, implying that NIM dynamics will remain negative in the near future, especially taking into account dovish signals of the July ECB meeting for the short end, which is implied to return to the positive territory not earlier than in 2026 and then only if there are no negative external or internal shocks to the EU economy. So, banks will continue to suffer from the negative rate environment, especially Spanish and Italian ones, which are more geared to the growth of the short end. The outlook for banking NII/NIM still remains relatively weak while market expectations of the first rate hike in 2H23 looks too optimistic, from our point of view, given the current inflation outlook. Notwithstanding, we expect that NII/NIM forecasts will begin to improve in the very near future due to markedly steeper yield curve which has already returned to 2019 levels (but we don't see a significant room for further steepening) and the acceleration of the loan growth. At least, NII outlook stopped worsening recently. Thus, median NII decline of EU banks was 5.0% yoy despite to a significant earning assets growth during the pandemic as NIM continues decreasing. Median NIM increased by 3.1 bps qoq, but -1 bps yoy, to 1.54% in 2Q21, still -16 bps vs 4Q19. On the other hand, a median growth of NII FY21 was flat MoM, but -0.4% ytd, as of the end of August 2021, while NII FY22 was flat MoM, but +1.2% ytd. Median NIM FY21 estimate decreased by 5.7 bps ytd, or -1.7 bps MoM, to 1.45% in August, while NIM FY22 declined by 4.5 bps ytd, but +2.1 bps MoM, to 1.43%, still implying negative yoy dynamics in 2022 despite to the higher long end ytd.

Key forward rates decreased slightly MoM in August 2021. But roughly speaking, forward rates remain relatively flat for more than a year. Thus, 3M Euribor (Dec 2021) decreased by 0.5 bps MoM to -0.55% (as of the end of August), or -27 bps vs the end of 2019, while 3M Euribor (Dec 2022) went down by 2.5 bps MoM to -0.48% and it is -339 bps vs the end of 2019. It is implied that the rate will turn positive only in 2026.

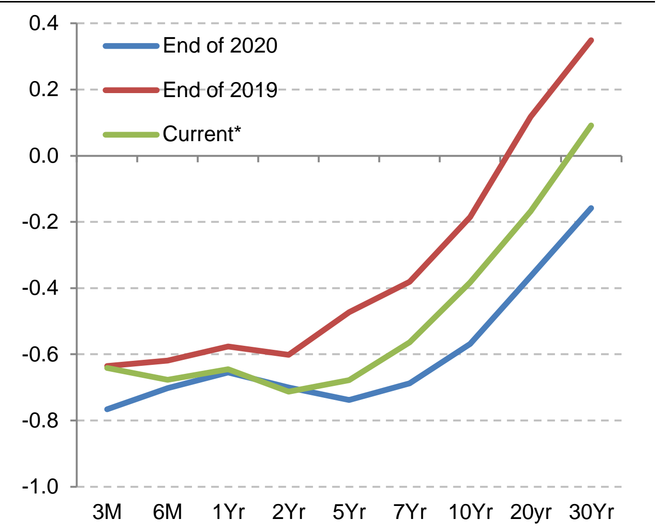
The direction of dynamics of generic yields was mixed in August with almost flat/slightly negative short end but a noticeable growth of the long end. Thus, 3M yield increased by 0.2 bps MoM to -0.64%. 6M yield went down by 3.5 bps MoM to -0.68%. 1yr generic yield decreased by 1.1 bps MoM to -0.65%, while 2yr yield increased by 4.9 bps MoM to -0.71%. 5yr yield went up by 6.4 bps MoM to -0.68%, while 10yr yield increased by 7.8 bps MoM to -0.38%. Overall, the yield curve remains markedly inverted in the middle part. Spreads increased noticeably in August 2021 after their negative dynamics in July. Thus, the spread between 10yr yield and 1yr yield went up by 8.9 bps MoM to 0.26%, while the spread between 5yr and 3M yields increased by 6.2 bps MoM to -0.04%. Both spreads are much higher than their April troughs but they remain much lower vs the end of 2019. Almost entire yield curve is still below 0.

Chart 29. EU Countries Real GDP Growth, YoY, %



Source: Bloomberg

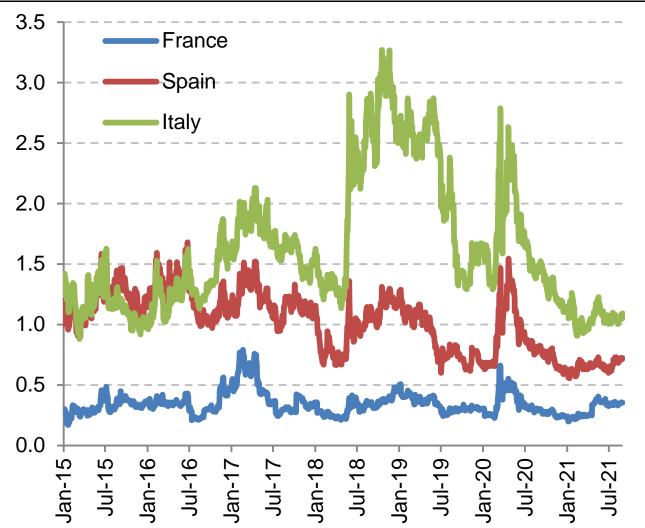
Chart 30. EU Yield Curves, %



*as of the end of August 2021

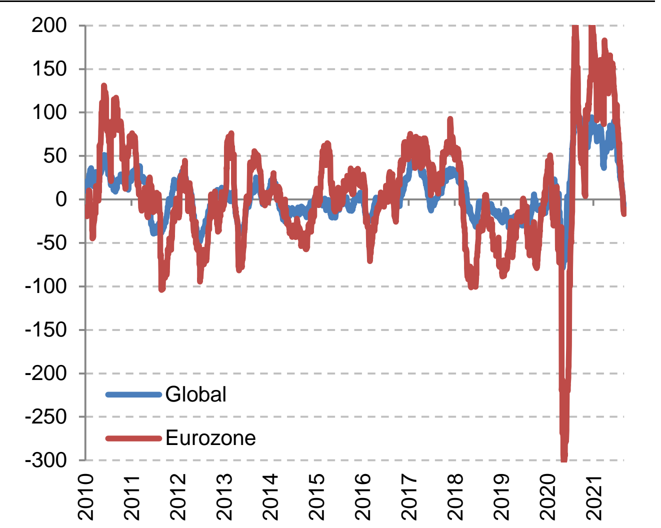
Source: Bloomberg

Chart 31. EU countries sovereign spreads vs Germany, 10Yr, %



Source: Bloomberg

Chart 32. Citi Economic Surprise Indexes, pts



Source: Bloomberg

THEME OF THE MONTH

EU Banks 2Q21 Overview

European banks reported markedly better results in 2Q21 as they did in four previous quarters after clearly weak figures in 1Q20. Both revenue and net income demonstrated positive surprises. Thus, 27 out of 32 banks from SX7P index for which estimates were available reported better revenue figures vs 30 out of 35 in 1Q21. Net income was also better than expected with 23 out 30 banks with positive surprises vs 25 out of 27 in 1Q21. EPS was higher for 25 out of 30 with available estimates in 2Q21 vs 30 out of 30 banks in 1Q21. The key driver of better results was lower provisions due to the better economic outlook and the ongoing revenue momentum. Even NII/NIM figures weren't weak as it was in the previous quarters, although the prospects for accelerating NII growth in coming years remain questionable, given the expected pace of key rates dynamics. Notwithstanding, the earnings momentum continues improving after its significant worsening in 1H20. Thus, a median growth of operating profit of SX7P index members was +43% in 2Q21 vs +30% in 1Q21, but -37% yoy in 4Q20. A median growth of revenue was 4.2% yoy in 2Q21 (even +0.2% vs 4Q19) after it increased by 5.6% yoy in 1Q21, following negative dynamics over previous four quarters. In turn, a median revenue surprise was +2.2%, markedly better than a median quarterly surprise over last 10 years of +1.1%, but lower than +3.8% in 1Q21. The revenue growth was driven by non-II which skyrocketed by 13.3% in 2Q21, the second consecutive quarter of substantial growth after weak dynamics in three previous quarters. Despite to the better earnings season, the acceleration of the recovery, and lifting restrictions on capital deployment, market perception of the results was restrained. Thus, median 1-day performance of SX7P index members around the earnings date was +1.1% vs 10yr average of +0.2% and 1Q21 figure of +0.3%. On the other hand, overall performance since the start of the earnings season was relatively weak with a growth of SX7P index of 2.0% (from July 12, 2021 till the end of August 2021), while STOXX 600 index increased by 2.2% over the same period.

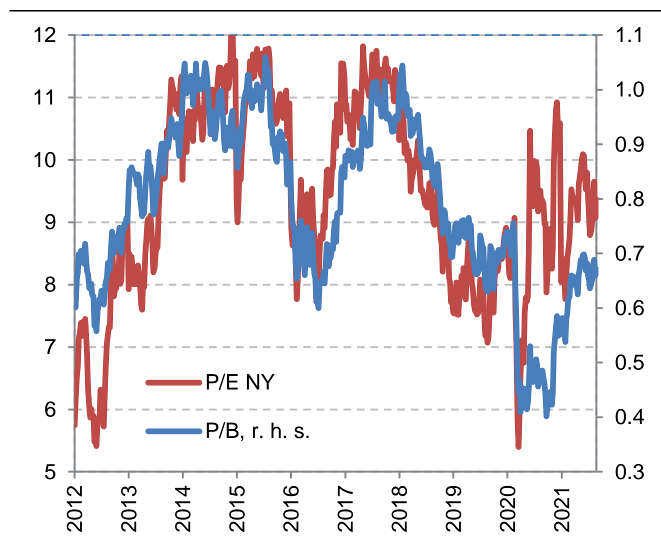
A median growth of EU banks' net income (SX7P index members) was 102% yoy in 2Q21 after a growth of 56% yoy in 1Q21 and a decline of 41% yoy in 4Q20. Of course, such an impressive growth is primarily due to the effect of a low base. Moreover, 2Q21 net income was even 9% higher than 4Q19 one due to significant reserve releases. Thus, provisions decreased by 85% yoy and provisions were negative for 12 members of SX7P index out of 38 (vs 6 banks in 1Q21). Notwithstanding, consensus forecasts still imply that FY22 NI will be lower by 25% vs FY19 NI. Also, median ROE of EU banks markedly increased on a qoq basis in 2Q21 but it still remains lower than it was in 2019. Thus, median ROE increased by 188 bps qoq, or 159 bps yoy, to 7% in 2Q21 while it exceeded 8% in 2019. Due to a positive EPS surprise and improved economic expectations, estimates have increased meaningfully in recent months. Thus, a median growth of FY21 NI was +45% ytd (but -8.9% since the beginning of 2020), implying a growth of 58% yoy. As of FY22 NI estimates, a median growth was +12.4% ytd (but -6.9% since the beginning of 2020), implying a growth of 3.3% yoy. On the other hand, revenue estimates added 3.5% ytd for FY21 revenue but still -4.5% since the beginning of 2020.

Revenue momentum remains strong, driven by fee income as a result of the much faster economic recovery than it was expected even a few quarters ago, but revenue environment still remains challenging, from our point of view, given bleak perspectives of NII growth in coming years. As for fee income, we also don't expect a significant growth after the economy will fully return to normal. It is expected that FY22 revenue will be 8.1% lower than FY19 revenue for our group of banks, according to Bloomberg estimates (a median growth rate). In any case, NII dynamics remain negative. Thus, a median NII decline of EU banks was 0.1% yoy in 2Q21, the 5th consecutive quarter of negative dynamics. On the

other hand, it was positive on qoq basis with a median growth of +2.4% as a result of additional day count in 2Q21 and a noticeable growth of a number of key benchmark rates ytd. Thus, median NIM increased by 3.1 bps qoq, but -1 bps yoy, to 1.54% in 2Q21, still -16 bps vs 4Q19. Also, NII outlook stopped worsening in the recent months as a result of ECB's actions aimed at easing the effect of negative rates on banks' P&L, the growth of the long end, and expectations of the faster recovery in coming years. Thus, a median growth of NII FY21 was flat MoM, but -0.4% ytd as of the end of August 2021, while NII FY22 was flat MoM, but +1.2% ytd. Median NIM FY21 estimate decreased by 5.7 bps ytd, or -1.7 bps MoM, to 1.45% in August, while NIM FY22 declined by 4.5 bps ytd, but +2.1 bps MoM, to 1.43%, still implying negative yoy dynamics in 2022, even despite to the higher long end ytd.

A median growth of non-interest revenue was 13.3% yoy, but -4.8% qoq, in 2Q21 after it increased by 10.9% qoq in 1Q21. Although the key reason of the significant growth was the relatively low base of 1H20 as a result of the first wave of the pandemic and the first lockdowns, it was clearly strong fee income in 2Q21, which was +6.7% higher than 2Q19 one. As a result of better fee income in 1H21, estimates were revised up markedly, +4.9% ytd for FY21 and +2.6% for FY22 (fee income estimates).

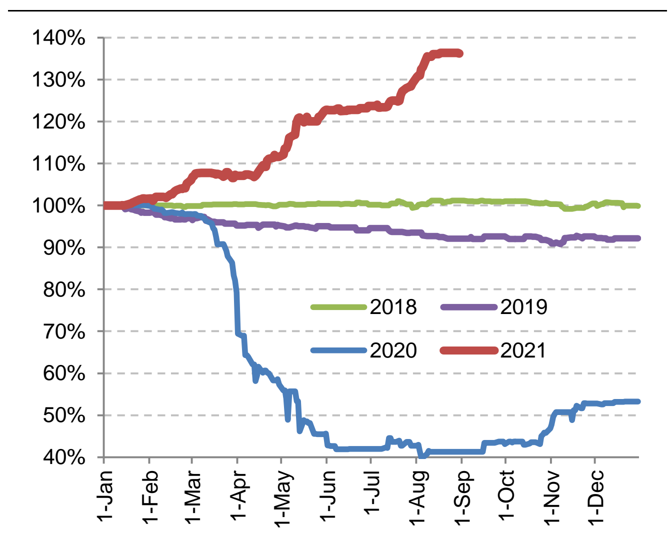
Chart 33. EU Banks. Multipliers, Median*



*SX7P index

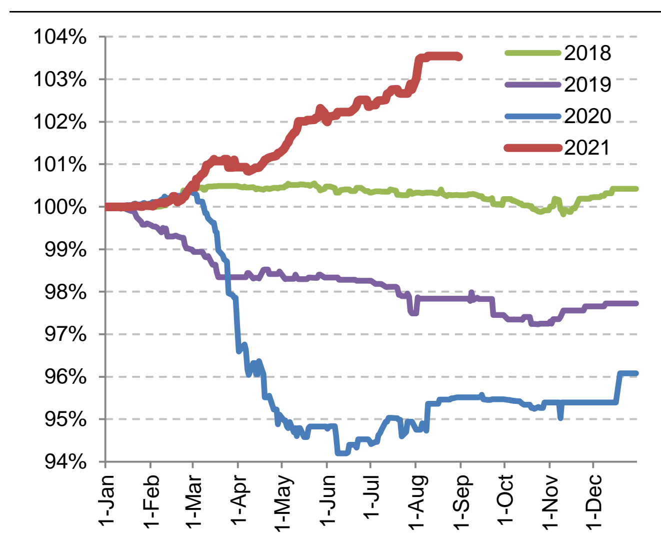
Source: Bloomberg

Chart 34. EU Banks. Median CY EPS Est. Dynamics



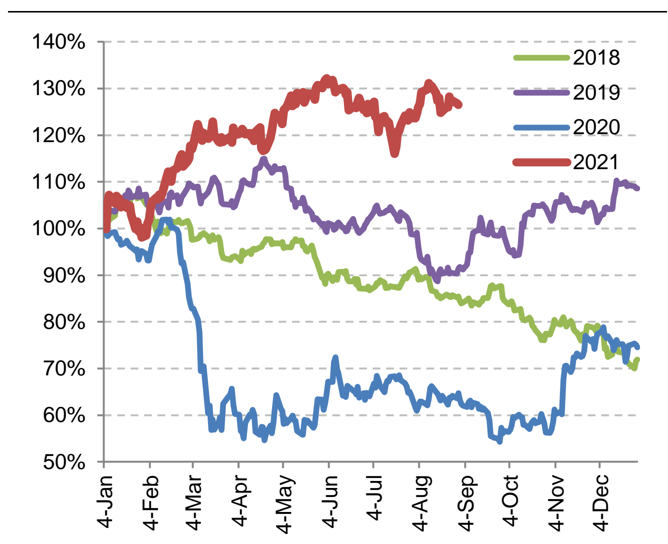
Source: Bloomberg

Chart 35. EU Banks. Median CY Rev Est. Dynamics



Source: Bloomberg

Chart 36. SX7P Index. Price dynamics



Source: Bloomberg

A median growth of OpEx was 5.0% yoy in 2Q21 vs a decline of 4.3% yoy in 1Q21. It was the first growth of OpEx on yoy basis after four consecutive quarters of decline. Despite to a significant growth of OpEx, the operating leverage was positive again, for the fourth quarter over last five. It was +0.5% in 2Q21 (vs +4.3% in 1Q21 and -5.3% in 4Q20). So, efficiency ratio decreased by 177 bps yoy in absolute terms to 57.8%.

The credit quality of European banks remained quite strong so far, despite to an unprecedented decline of the EU economy in 1H20. So, provisions decreased significantly on yoy basis in last four quarters after the meaningful reserve build in 1H20. Thus, a median decline of provisions was 85% yoy, or -36% qoq, the second quarter of decline after 7 consecutive quarters of positive yoy growth. Due to better economic perspectives and positive provision surprises in recent quarters, provision expense estimates of SX7P index members continue going down but decline for FY22 provisions wasn't very significant yet. Thus, provision estimates decreased by 39.6%/16.5% ytd for 2021 and 2022 years, respectively. Median NPLs ratio decreased just by 3.2 bps yoy, or -10.2 bps yoy, to 2.6% in 2Q21 and it remains quite low vs 10yr average. So, coverage ratio increased by 4.7% yoy, or +1.8% qoq, in absolute terms to 71.4%, the highest level over more than a decade.

Capital of European banks continues strengthening due to the dividend ban, which was in effect until recently, and better profit dynamics in recent quarters. Thus, median CET1 ratio of SX7P index members increased by 78 bps yoy, or +45 bps qoq, to 15.4% in 2Q21. Given positive results of the recent EBA stress test and the ECB's decision about capital deployment, dividend projections increased meaningfully in recent months. Thus, a median growth of DPS estimates was 38.4%/13.4% ytd for 2021/2022 years, respectively. Despite to a substantial growth of quotes of EU banks ytd, dividend yields still remain relatively high with a median figures of 4.3%, 4.7% and 5.6% for FY21, FY22 and FY23, respectively, being markedly higher comparing to US peers yields.

As a result of better earnings season and better earnings visibility due to the ongoing vaccination campaigns and the expected GDP growth acceleration, we anticipate that the growth of EU banks quotes could continue in the near future, but we no more expect their substantial outperformance vs the broad market given their rich valuations. EU banks are no longer traded with a discount to their historical averages, while a discount to US peers is just slightly wider than it was historically. Thus, a premium to historical averages is 3.0% (+0.2 std at the moment from mean P/E NY of SX7P index members, sample from 2010 to the present moment), but a discount to US peers (on median P/E NY of BKX index vs SX7P index) is 25% as of August 27, 2021 vs an average since 2010 of 21%, or -0.4 std. On the other hand, due to meaningful EPS upgrades, EU banks still don't look very expensive either, even after the significant quotes growth ytd. We believe that the worst in terms of operational results is behind us but it is a bumpy road ahead with a still challenging revenue environment and relatively low ROE/ROA in the near term. Although we expect that EPS estimates will return to 2019 levels not earlier than in 2H22, it seems that the market is currently looking much further in time.

APPENDIX

Table 1. US Banks: Valuations

Company	Ticker	Price as of 31/08/21, $	Target price, $	Upside	52-week price, $		RSI	MCap, $ bn.	Dividend yield			Price/Earnings			Price to book	Price to tang. book	ROE, %			TCE ratio, %	CET1 ratio, %
					High	Low			2021E	2022E	2023E	2021E	2022E	2023E			2021E	2022E	2023E		
American Express	AXP	166.0	183.4	10.5%	179.7	89.1	49.7	131.8	1.1%	1.1%	1.2%	18.9	17.6	14.9	5.2	N. A.	30.0	32.3	36.3	10.1	13.5
JP Morgan Chase	JPM	160.0	167.9	5.0%	167.4	91.4	56.2	478.0	2.4%	2.6%	2.7%	11.4	13.6	12.4	1.9	2.3	16.7	13.6	13.8	6.0	13.1
PNC Financial	PNC	191.1	202.7	6.0%	203.8	101.7	54.3	81.2	2.5%	2.8%	3.0%	13.3	13.5	12.4	1.6	2.1	11.9	11.3	11.7	9.6	12.2
Bank of America	BAC	41.8	43.1	3.3%	43.5	23.0	57.8	351.3	1.9%	2.1%	2.4%	13.0	13.8	12.3	1.4	1.9	11.1	9.7	10.4	6.5	11.9
Citigroup	C	71.9	83.4	15.9%	80.3	40.5	53.4	145.7	2.9%	3.0%	3.3%	7.4	9.3	8.0	0.8	0.9	11.1	8.0	8.7	6.9	12.1
Truist Financial Corp	TFC	57.1	63.2	10.8%	62.7	34.9	53.4	76.2	3.3%	3.5%	3.7%	11.8	11.8	10.5	1.2	2.2	10.3	9.7	10.2	7.3	10.0
Goldman Sachs	GS	413.5	418.4	1.2%	420.7	185.5	62.6	145.4	1.6%	2.0%	2.2%	7.9	11.1	10.5	1.5	1.6	20.6	13.1	12.8	6.9	14.7
Bank of NY Mellon	BK	55.2	55.8	1.0%	56.6	32.7	61.2	47.7	2.4%	2.6%	3.1%	13.5	12.2	10.2	1.2	2.3	8.7	9.1	10.2	4.6	13.4
Comerica	CMA	73.9	76.1	3.0%	79.8	35.8	55.1	9.9	3.7%	3.7%	3.9%	9.5	13.6	12.3	1.3	1.4	14.0	9.3	9.9	8.0	10.3
Citizens Financial	CFG	43.8	51.8	18.3%	51.1	23.5	50.0	18.7	3.6%	3.7%	3.9%	8.5	10.1	9.2	0.9	1.3	10.1	8.0	8.7	7.7	10.0
Regions Financial	RF	20.4	22.5	10.3%	23.8	10.6	53.2	19.5	3.2%	3.5%	3.7%	8.4	10.2	10.0	1.1	1.6	13.6	10.6	10.6	8.0	9.8
Discover Financial	DFS	128.2	133.9	4.4%	135.6	51.7	49.8	38.4	1.5%	1.6%	1.6%	8.1	10.2	9.5	3.2	3.2	41.0	26.9	25.8	8.4	13.1
M&T Bank	MTB	140.0	159.4	13.9%	168.3	88.5	52.4	18.0	3.2%	3.3%	3.3%	10.9	11.5	10.3	1.2	1.7	10.4	9.2	9.7	7.5	10.0
Fifth Third Bancorp	FITB	38.9	42.9	10.4%	43.1	19.3	56.2	26.8	2.9%	3.2%	3.4%	10.7	11.9	10.9	1.3	1.7	12.0	10.4	11.2	8.3	10.3
Huntington Bancorp	HBAN	15.5	17.1	9.9%	16.9	8.5	60.8	22.9	3.9%	4.1%	4.3%	11.7	10.9	10.3	1.3	1.9	11.8	11.0	12.0	7.1	10.0
Northern Trust	NTRS	118.5	119.6	0.9%	123.0	74.0	57.1	24.7	2.4%	2.6%	2.8%	17.3	16.1	13.5	2.1	2.2	13.0	13.3	14.9	6.4	13.4
People's United	PBCT	16.4	18.4	11.7%	19.6	9.7	53.2	7.0	4.4%	4.5%	4.8%	11.8	12.9	11.8	0.9	1.5	7.7	7.0	7.0	7.5	10.5
Synchrony Financial	SYF	49.8	55.6	11.8%	52.1	24.2	50.8	28.3	1.8%	1.9%	2.1%	7.9	9.2	8.8	2.1	2.5	28.1	21.4	21.5	10.4	15.9
KeyCorp	KEY	20.3	22.1	8.8%	23.6	11.3	50.6	19.4	3.7%	4.1%	4.3%	8.4	10.4	9.7	1.2	1.5	13.8	10.5	10.9	7.9	9.7
State Street Corp	STT	92.9	97.4	4.8%	94.6	56.7	61.6	31.9	2.3%	2.5%	2.9%	12.6	11.2	9.4	1.4	2.3	10.9	11.5	12.4	4.7	12.3
US Bancorp	USB	57.4	63.5	10.7%	62.5	34.2	52.4	85.1	3.1%	3.3%	3.4%	11.5	12.8	11.9	1.8	2.5	15.5	13.1	14.4	6.7	9.7
Zions Bancorp	ZION	57.9	58.5	1.1%	60.6	27.6	62.2	9.4	2.4%	2.6%	2.7%	9.1	12.8	12.1	1.2	1.4	14.0	9.0	9.1	7.8	10.8
Morgan Stanley	MS	104.4	101.7	-2.6%	105.8	45.9	64.0	190.5	2.0%	2.8%	2.9%	14.2	14.5	12.8	1.9	2.6	14.0	13.0	14.0	6.9	17.4
Capital One Financial	COF	166.0	181.9	9.6%	177.9	66.3	47.3	74.0	1.5%	1.4%	1.5%	6.8	9.6	9.3	1.3	1.7	17.6	11.6	11.0	10.0	13.7
Wells Fargo	WFC	45.7	50.2	9.9%	51.4	20.8	41.2	187.7	1.3%	2.2%	2.9%	10.9	12.8	10.6	1.1	1.3	10.4	8.2	9.4	7.1	11.6
First Republic Banks	FRC	198.9	206.8	3.9%	204.6	100.4	52.3	35.6	0.4%	0.5%	0.6%	26.8	25.0	21.6	3.2	3.2	11.6	11.1	11.3	7.0	9.7
NY Commercial Bancshares	NYCB	12.5	15.4	22.7%	13.2	7.7	58.3	5.8	5.4%	5.4%	5.5%	9.9	8.7	N. A.	0.9	1.5	9.0	10.6	N. A.	7.2	9.7
SVB Financial	SIVB	559.5	661.6	18.3%	608.3	222.6	47.4	31.8	0.0%	0.0%	0.0%	18.0	20.3	18.1	3.2	3.2	17.3	13.2	13.1	6.7	11.0
Signature Bank	SBNY	259.3	315.7	21.7%	268.2	71.5	57.3	15.7	0.9%	0.9%	0.9%	18.1	15.7	12.6	2.2	2.2	13.1	13.1	14.2	7.9	9.9
East West Bancorp	EWBC	73.3	88.5	20.7%	82.4	30.6	50.5	10.4	1.8%	1.9%	N. A.	12.1	12.3	11.4	1.9	2.1	15.5	13.9	13.7	9.3	12.7
Synovus Financial	SNV	43.1	51.8	20.1%	50.5	19.4	50.5	6.3	3.1%	3.2%	3.2%	9.6	10.5	9.8	1.3	1.5	13.9	11.7	N. A.	7.7	9.7
First Horizon National	FHN	16.4	19.5	19.0%	19.5	8.5	53.8	9.0	3.7%	3.8%	4.1%	8.6	10.4	10.2	1.2	1.5	13.2	10.2	10.1	6.9	9.7
BOK Financial	BOKF	88.1	91.6	4.0%	99.0	48.4	54.1	6.1	2.4%	2.4%	2.5%	11.3	13.5	12.7	1.3	1.6	10.1	8.0	8.2	9.0	12.0
Median				**9.9%**			**53.4**		**2.4%**	**2.6%**	**3.0%**	**11.3**	**12.2**	**10.7**	**1.3**	**1.8**	**13.1**	**11.0**	**11.2**	**7.5**	**11.0**

Source: Bloomberg

APPENDIX

Table 2. EU Banks: Valuations

Company	Ticker	Currency	Price* (31/08/21)	Target price*	Upside	52-week price*		RSI	MCap, € bn.	Dividend yield			Price/Earnings			Price to book	Price to tang. book	ROE, %			TCE ratio, %	CET1 ratio, %
						High	Low			2021E	2022E	2023E	2021E	2022E	2023E			2021E	2022E	2023E		
Erste Group	EBS AV	EUR	33.9	37.8	11.5%	35.5	16.7	49.7	14.6	5.5%	5.1%	5.6%	10.0	9.5	8.7	0.9	1.0	8.9	9.2	9.7	4.8	14.5
Raiffeisen Bank	RBI AV	EUR	20.3	23.7	16.4%	21.2	11.7	49.0	6.7	5.4%	4.9%	5.8%	7.5	6.6	5.9	0.5	0.6	7.3	7.7	8.5	6.7	13.6
KBC Groep	KBC BB	EUR	71.3	72.7	1.9%	72.7	40.9	55.3	29.7	7.5%	5.4%	5.6%	12.2	13.0	12.5	1.4	1.5	11.7	10.5	11.2	5.8	18.1
Komercni Banka	KOMB CK	CZK	827.5	865.7	4.6%	849.5	460.0	58.0	6.2	5.1%	7.2%	5.8%	15.1	13.0	11.8	1.3	1.4	8.6	10.1	10.9	8.9	21.7
Jyske Bank	JYSK DC	DKK	275.3	313.1	13.7%	331.8	173.6	37.2	2.7	2.0%	0.0%	0.0%	7.1	7.8	7.0	0.6	0.6	8.1	6.5	6.4	5.0	17.9
SydBank	SYDB DC	DKK	184.4	226.5	22.8%	213.6	96.5	32.7	1.5	7.2%	5.8%	6.0%	8.5	8.3	8.0	0.9	0.9	10.4	10.1	9.9	6.8	18.8
Danske Bank	DANSKE DC	DKK	105.9	133.5	26.1%	125.6	80.3	46.4	12.3	6.5%	7.3%	8.1%	7.5	7.3	6.6	0.5	0.6	7.4	7.4	8.0	3.7	18.3
BNP Paribas	BNP FP	EUR	53.7	62.7	16.7%	57.9	28.8	50.6	67.2	6.8%	6.4%	6.9%	8.4	8.1	7.5	0.6	0.7	7.2	7.1	7.6	3.7	12.8
Societe Generale	GLE FP	EUR	26.7	31.1	16.7%	27.7	10.8	50.5	22.7	5.9%	5.9%	6.9%	7.5	7.6	6.5	0.4	0.4	5.6	5.7	6.3	3.8	13.2
Credit Agricole	ACA FO	EUR	12.2	15.0	22.5%	13.5	6.5	53.2	37.8	7.6%	7.6%	7.4%	7.8	8.0	7.4	0.6	0.9	7.9	7.4	7.7	2.1	13.1
Virgin Money	VMUK LN	GBp	212.5	227.9	7.2%	215.0	70.3	61.7	3.6	0.0%	0.0%	0.0%	7.0	7.5	7.6	0.6	0.7	8.8	7.8	9.8	4.9	13.4
HSBC	HSBA LN	GBp	386.2	476.4	23.3%	462.0	281.5	41.3	91.9	0.1%	0.1%	0.1%	6.2	6.1	5.3	0.6	0.7	6.3	6.5	7.7	5.2	15.9
Natwest Group	NWS LN	GBp	213.1	242.7	13.9%	222.2	90.5	63.7	28.6	0.0%	0.1%	0.1%	8.6	9.6	8.2	0.7	0.8	7.2	6.2	7.3	4.0	18.5
Barclays	BARC LN	GBp	184.9	220.0	19.0%	190.3	88.9	62.7	36.5	0.0%	0.0%	0.0%	6.1	7.4	6.9	0.6	0.7	9.1	6.8	7.3	3.5	15.1
Standard Charted	STAN LN	GBp	454.8	566.8	24.6%	533.2	334.3	54.1	16.4	0.0%	0.1%	0.1%	5.8	5.4	4.6	0.4	0.5	5.1	5.4	5.9	5.0	14.4
Lloyds	LLO LN	GBp	43.8	52.5	19.9%	50.4	23.6	39.2	36.2	0.1%	0.1%	0.1%	6.1	7.7	7.3	0.7	0.8	10.4	7.7	8.4	4.3	16.2
Commerzbank	CBK GY	EUR	5.3	6.1	14.9%	6.9	3.9	43.9	6.7	0.0%	1.4%	4.4%	30.9	10.3	6.6	0.3	0.3	-0.5	2.2	4.0	4.6	13.2
Deutsche Bank	DBK GY	EUR	10.5	11.3	6.9%	12.6	6.8	43.6	21.8	2.2%	3.2%	4.2%	10.5	8.2	7.3	0.4	0.4	3.0	4.6	5.0	3.6	13.6
UniCredit	UCG IM	EUR	10.6	11.9	13.0%	11.0	6.1	55.1	23.6	4.1%	4.5%	5.6%	9.4	8.0	6.7	0.4	0.4	4.4	5.1	5.5	5.4	16.0
Mediobanka	MB IM	EUR	10.0	11.3	13.5%	10.1	6.0	53.1	8.9	7.0%	6.9%	7.2%	10.6	10.2	9.8	0.8	N. A.	7.6	7.7	7.8	11.3	16.3
Intesa Sanpaolo	ISP IM	EUR	2.4	2.7	13.5%	2.5	1.4	50.1	46.6	8.0%	7.3%	8.1%	11.4	9.8	8.9	0.8	0.9	7.1	7.5	8.3	5.0	14.7
Emilia Romagna	BPE IM	EUR	1.8	2.3	25.4%	2.2	1.0	56.5	2.6	3.1%	4.2%	5.3%	40.9	7.6	6.4	0.4	0.4	7.2	4.7	5.3	5.8	17.7
ING Groep	INGA NA	EUR	11.7	13.0	11.4%	11.8	5.6	60.9	45.7	7.7%	5.5%	6.0%	9.9	10.2	9.3	0.8	0.8	8.0	7.8	8.3	5.7	15.5
ABN Amro	ABN NA	EUR	11.8	12.9	9.5%	11.8	6.6	68.2	11.1	6.5%	5.5%	6.1%	13.0	10.1	8.6	0.6	N. A.	4.4	5.8	6.5	4.8	17.7
BBVA	BBVA SQ	EUR	5.5	5.9	6.1%	5.9	2.1	48.0	37.0	3.8%	4.3%	5.0%	9.8	9.3	8.2	0.8	0.9	7.6	7.9	8.6	5.8	12.2
Santander	SAN SQ	EUR	3.1	3.7	19.7%	3.5	1.4	46.6	54.2	5.1%	6.1%	6.6%	7.9	7.4	6.9	0.6	0.8	8.2	8.5	8.6	4.4	12.3
Bankinter	BKT SQ	EUR	5.0	4.8	-3.4%	5.0	2.2	59.3	4.5	3.8%	4.5%	5.2%	7.4	11.2	9.6	0.9	1.0	16.4	8.1	9.5	4.9	12.3
Sabadell	SAB SQ	EUR	0.6	0.6	0.3%	0.7	0.3	54.3	3.4	2.0%	3.8%	5.6%	14.4	8.9	6.4	0.3	0.3	2.3	3.7	4.6	4.2	12.6
CaixaBank	CABK SQ	EUR	2.6	3.1	17.2%	2.9	1.5	52.1	21.2	4.5%	6.0%	7.3%	7.0	8.1	7.2	0.6	0.7	12.3	7.8	8.5	4.8	13.6
SEB	SEBA SS	SEK	115.9	118.6	2.3%	120.0	75.6	54.1	25.0	6.4%	5.6%	5.3%	10.9	11.1	10.5	1.4	1.4	12.9	11.8	12.0	5.4	21.0
Handelsbanken	SHBA SS	SEK	97.1	107.8	11.1%	102.0	71.7	49.5	18.9	7.3%	6.7%	7.2%	10.7	10.3	9.7	1.1	1.1	10.1	9.9	10.3	5.1	20.3
Swedbank	SWEDA SS	SEK	166.6	187.3	12.4%	171.7	136.3	49.6	18.5	6.9%	5.5%	5.9%	9.5	9.4	9.0	1.2	1.3	12.4	11.8	11.8	5.3	17.5
Nordea	NDA SS	SEK	101.4	110.0	8.5%	104.9	64.6	56.1	40.3	0.8%	0.6%	0.7%	11.3	9.5	8.1	1.2	1.3	10.7	10.4	10.8	5.3	17.1
Julious Baer	BAER VX	CHF	62.6	68.4	9.3%	63.8	35.7	59.2	12.8	3.3%	3.4%	3.7%	11.5	11.5	10.5	2.0	3.3	18.3	16.9	17.2	3.6	14.9
Credit Suisse	CSGN VX	CHF	9.7	10.9	12.7%	13.4	8.4	58.6	23.8	1.7%	2.5%	2.9%	12.1	7.1	6.4	0.5	0.6	2.4	7.5	7.9	4.7	12.9
UBS	UBSG VX	CHF	15.3	17.4	13.6%	15.8	9.4	55.5	52.3	2.6%	2.7%	2.8%	8.1	8.2	7.4	1.0	1.1	10.3	9.8	10.3	4.7	13.8
Median					**13.5%**			**53.2**		**4.3%**	**4.7%**	**5.6%**	**9.4**	**8.3**	**7.5**	**0.6**	**0.8**	**7.9**	**7.7**	**8.3**	**4.9**	**15.0**

Source: Bloomberg

APPENDIX

Table 3. Calendar

Date	Region	Section	Event	Period
1-Sep	EU	Macro	Unemployment Rate	Jul
1-Sep	US	Macro	ADP Employment Change	Aug
1-Sep	US	Macro	Construction Spending	Jul
1-Sep	US	Macro	ISM Manufacturing	Aug
2-Sep	EU	Macro	PPI	Jul
2-Sep	US	Macro	Trade Balance	Jul
2-Sep	US	Macro	Factory Orders	Jul
3-Sep	EU	Macro	Retail Sales	Jul
3-Sep	**US**	**Macro**	**Employment Report**	**Aug**
7-Sep	EU	Macro	GDP	2Q
7-Sep	EU	Macro	ZEW Survey Expectations	Sep
8-Sep	US	Macro	Consumer Credit	Jul
9-Sep	**EU**	**Macro**	**ECB Main Refinancing Rate**	**Sep 9**
10-Sep	US	Macro	PPI	Aug
14-Sep	US	Macro	CPI	Aug
15-Sep	EU	Macro	Industrial Production	Jul
15-Sep	US	Macro	Empire Manufacturing	Sep
15-Sep	US	Macro	Industrial Production and Capacity Utilization	Aug
16-Sep	US	Macro	Retail Sales	Aug
17-Sep	EU	Macro	CPI	Aug
17-Sep	US	Macro	U. of Mich. Sentiment	Sep
20-Sep	US	Macro	NAHB Housing Market Index	Sep
21-Sep	US	Macro	Housing Starts and Building Permits	Aug
22-Sep	EU	Macro	Consumer Confidence	Sep
22-Sep	US	Macro	Existing Home Sales	Aug
22-Sep	**US**	**Macro**	**FOMC Rate Decision**	**Sep 22**
23-Sep	EU	Macro	Markit Eurozone Manufacturing, Services and	Sep
23-Sep	US	Macro	Markit US Manufacturing, Services and Composite	Sep
23-Sep	US	Macro	Leading Index	Aug
23-Sep	US	Macro	Kansas City Fed Manf. Activity	Sep
24-Sep	EU	Corporate	Standard Charted. Investor Day	Sep 24
24-Sep	US	Macro	New Home Sales	Aug
27-Sep	US	Macro	Dallas Fed Manf. Activity	Sep
28-Sep	US	Macro	FHFA House Price Index	Jul
28-Sep	US	Macro	Conf. Board Consumer Confidence	Sep
28-Sep	US	Macro	Richmond Fed Manufact. Index	Sep
29-Sep	EU	Macro	Economic and Industrial Confidence	Sep
29-Sep	US	Macro	Pending Home Sales	Aug
30-Sep	EU	Macro	Unemployment Rate	Aug
30-Sep	US	Macro	GDP	2Q
30-Sep	US	Macro	Personal Consumption	2Q