BANKING SECTOR REPORT – May 2021

EXECUTIVE SUMMARY

US banks outperformed the broad market again in May 2021, the 8th month in a row of outperformance after five consecutive months of weaker dynamics. BKX index increased by 5.0% MoM vs +0.5% MoM of SPX index, the 4th month in a row of positive absolute performance. Absolute May performance was +0.6 std from the mean monthly performance and it is in the top 24% since index inception. Relative May performance was +4.4% MoM. It is +0.9 std from the mean monthly performance and it is in the top 14% of relative performance vs SPX index since index inception. Despite to significant outperformance in recent months, when BKX index outperformed SPX by 46.2% over the last 8 months, it still underperformed the broad market by 9.4% since the end of 2019. However, the first 5 months of 2021 were the best start of the year at least for the last 30 years.

US banks dynamics was relatively uniform in May with positive MoM dynamics for all banks in our sample except for SBNY and EWBC. The key outperformers were banks that were laggards in April as a result of not as strong as it had been expected results. In turn, the majority of May underperformers demonstrated better dynamics in April.

Loan growth of US banks remained weak in the first two months of 2Q21 even despite significant acceleration of the economic recovery as well as rates dynamics after the strong growth of the long end in 1Q21. Notwithstanding, estimates continue going up driven by clearly strong 1Q21 results, ongoing improvement of the economic outlook and rising inflation. Thus, 2Q21 EPS estimates were revised up by 0.5% MoM in May, +10.5% qtd or +28.2% ytd. FY21 EPS increased by 0.5% MoM, +18% qtd or +43.6% ytd. In turn, FY22 EPS estimates was revised up just 0.1% MoM, +4.5% qtd or +12.7% ytd, being markedly below compared to quotes growth of US banks in 2021. Despite the April Fed minutes contained a very clear hint of a possible near term announcement of future tapering, the long end even decreased on MoM basis, implying that this news is already in the price. So, despite rates outlook is markedly better than it was few quarters ago, it means that bank will operate in challenging rate environment still long enough. Unsurprisingly, revenue estimates were almost unchanged in May. 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 historical averages. Thus, banks are trading with -0.4/-0.4 std on P/E CY and +0.8/+1.0 std on P/E NY (on the basis of samples from 2000 and 2010 years to the current moment) relative to historical averages (as of May 28, 2021). As for relative to S&P 500, banks are currently trading at -1.7 std and -1.0 std from the sample mean (2010-current moment) for P/E CY and P/E NY, respectively. On P/B, banks are trading with +1.1 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 rich valuations and a lack of catalysts for an acceleration of the profit growth, at least near term.**

EU banks increased noticeably on an absolute basis again in May, the 4th consecutive month of a positive absolute return. It even outperformed the broad market on relative basis, the second month in a row. Thus, on an absolute basis, SX7P increased by 4.9% MoM in May, or +0.7 std from the mean, and it is the top 21% of absolute monthly performance of SX7P index. On the other hand, relative monthly performance was +2.7% MoM, or +0.8 std, and it is in the top 16% of relative monthly performance in SX7P index history. So, it was the very strong first five months of the year after clearly weak dynamics during three previous years. Thus, SX7P index underperformed in each of last three years and it is still 24.1% lower than it was at the end of 2017, underperforming STOXX 600 index by 33.9% over this period.

The key driver of EU banking stocks was the earnings season. Thus, banks which demonstrated much better than expected 1Q21 figures increased by more than 15% MoM in May (UniCredit, Commerzbank and Sabadell). In turn, Sweden banks were among the underperformers because of rumors of possible extra tax.

European banks reported markedly better results in 1Q21 as they did in three previous quarters after clearly weak figures in 1Q20. Both revenue and net income demonstrated positive surprises. Thus, 30 out of 35 banks from SX7P index for which estimates were available reported better revenue figures vs 22 out of 33 in 4Q20. Net income was also better than expected with 25 out of 27 banks with positive surprises vs 24 out of 29 in 4Q20. EPS was higher for all 30 banks with available estimates in 1Q21 vs 20 out of 25 banks in 4Q20. The key driver of better results was lower provisions due to the improved economic outlook. In turn, NII/NIM figures were weak again and it will remain a headwind in coming quarters even despite to a substantial growth of the long end in recent months. Notwithstanding, earnings momentum continues improving after significant worsening in 1H20. Thus, a median growth of operating profit of SX7P index members was +20% in 1Q21 (flat vs 4Q19) vs -37% yoy in 4Q20. A median growth of revenue was 5.6% yoy in 1Q21 (even +1.0% vs 4Q19) after it decreased by 4.4% yoy in 4Q20 and by 1.4% in 3Q20. In turn, a median revenue surprise was +3.8% better than a median quarterly surprise over the last 10 years and higher than +2.2% in 4Q20. Revenue growth was driven by non-II which skyrocketed by 13.1% in 1Q21 vs -2.6% yoy in 4Q20 and +1.4% yoy in 3Q20. Due to better earnings season and overall optimism as a result of the vaccination campaign and better macro data, market perception of the results was positive. Thus, median 1-day performance of SX7P index members around the earnings date was +0.3% vs 10yr average of +0.2% and 4Q20 figure of +0.6%. So, overall performance since the start of the earnings season was overwhelming with the growth of SX7P index by 11% (from April 20, 2021 till the end of May 2021), while STOXX 600 index increased only by 3% over the same period.

Median growth of EU banks' net income (SX7P index members) was 74% yoy in 1Q21 after dropping by 26% yoy in 4Q20 and by 13% yoy in 3Q20. Of course, such an impressive growth on yoy basis is primarily due to the effect of a low base. For example, 1Q21 net income was 22% lower than 4Q19 one. And it seems that banks will manage to reach pre-pandemic levels not earlier than in 2H22 given the negative rate environment in the foreseeable future. At least, current estimates imply that FY22 net income estimates are 7% lower than FY19 net income actuals (a median decline of SX7P index) but +49% vs FY20 NI. The key driver of NI growth was provisions which decreased by 52% qoq. So, median ROE of EU banks slightly increased on qoq basis, and it still remained weak, +56 bps qoq, but -198 bps yoy, just 4.7%, not far from the lowest figure over the last 30 quarters. Due to a positive EPS surprise and improved economic expectations, estimates have increased meaningfully in recent weeks. Thus, a median growth of FY21 NI was +10.7% ytd (but -21.4% since the beginning of 2020), implying a growth of 42% yoy. As of FY22 NI estimates, a median growth was +3.7% ytd (but -11% since the beginning of 2020), implying a growth of 15% yoy. On the other hand, revenue estimates added 1.8% ytd for FY21 revenue, but still -5.3% since the beginning of 2020.

As a result of a better earnings season and better earnings visibility due to the ongoing vaccination campaign and an expected GDP growth acceleration, we anticipate that growth of EU banks could continue in the near future but we no more expect substantial outperformance vs the broad market given more rich valuations. EU banks no longer are traded with a discount to historical averages while the discount to US peers is just slightly wider than it was historically. Thus, a premium to historical averages is 10% (+0.6 std at the moment from mean P/E NY of SX7P index members, sample from 2010 to the present) but a discount to US peers (on median P/E NY of BKX

index vs SX7P index) is 23% as of May 28, 2021 vs an average since 2010 of 20%, or -0.2 std. On the other hand, due to meaningful EPS upgrades, EU banks still don't look very expensive either even after a 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.

MARKET PERFORMANCE

US

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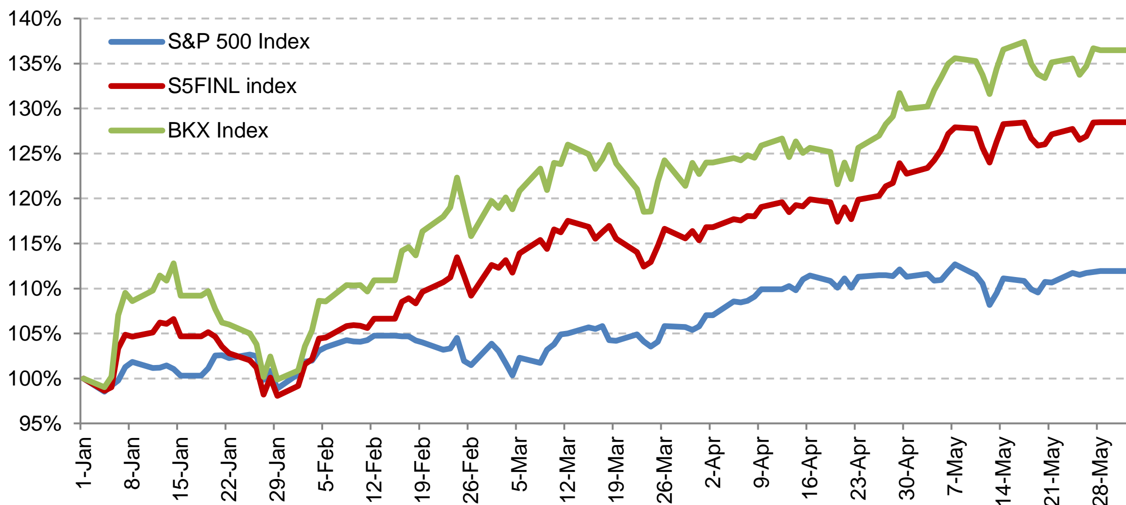
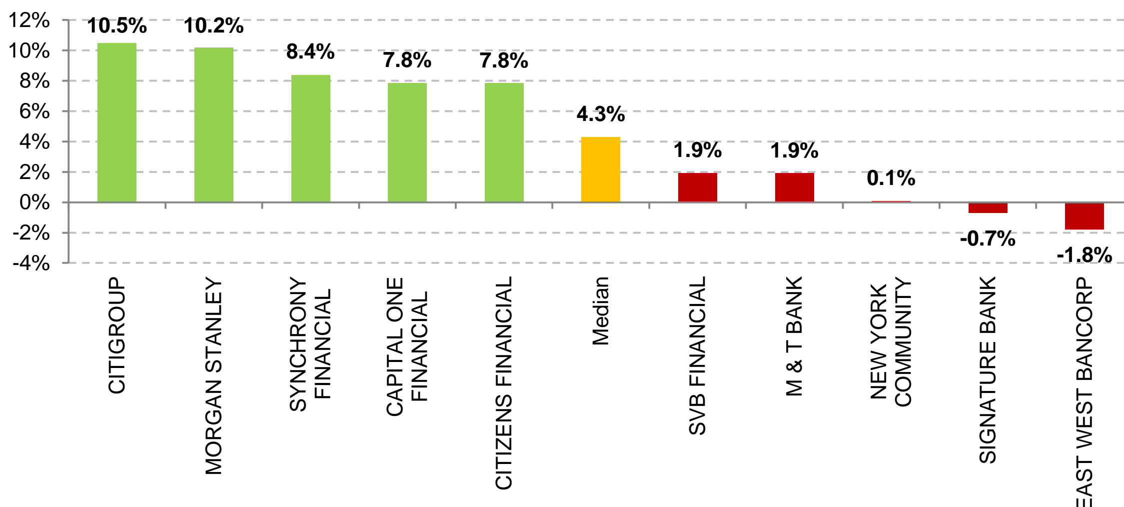
Chart 1. US Banks Performance. BKX Index vs S&P500 & S5FINL Indexes



Source: Bloomberg

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



Source: Bloomberg

Europe

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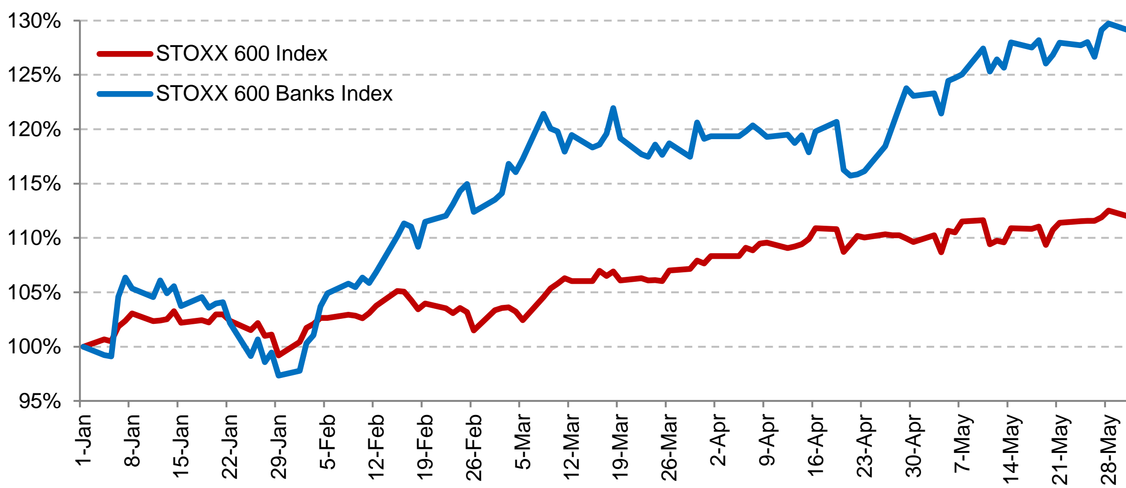
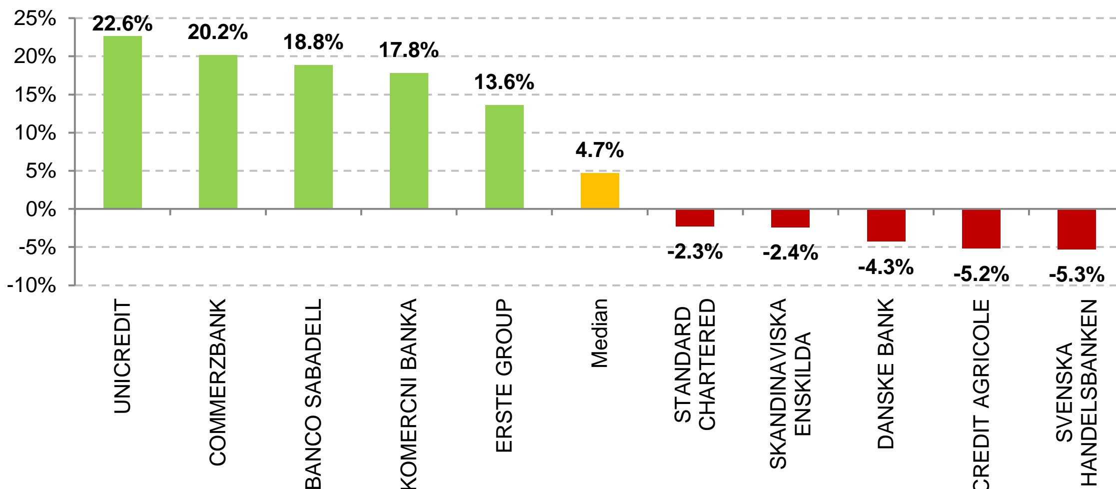
Chart 3. EU Banks Performance. SX7P Index vs STOXX 600 Index



Source: Bloomberg

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



Source: Bloomberg

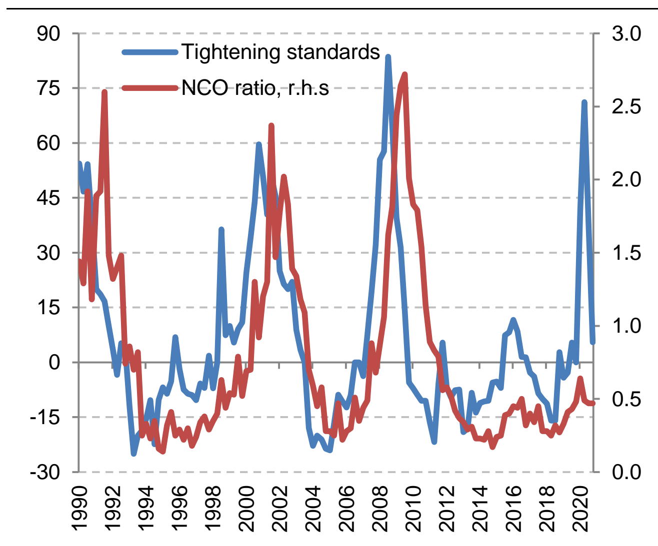
MACROECONOMIC NEWS

US

C&I loans

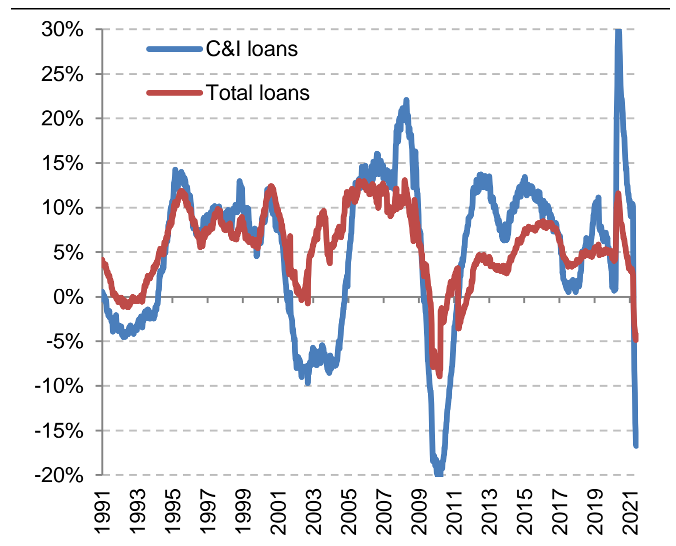
C&I loan growth remains clearly weak despite to a significant accelerations of the US economy. And if a substantial decline on yoy basis is quite understandable due to the high base of 2Q20 because of liquidity needs due to uncertainty related to the first wave of the pandemic, then a weak ytd loan growth raises some questions given the pace of the economic recovery in recent months. Indeed, from May 2020, when C&I loans reached the local high, it decreased by $514 Bn, or -16.7%, explaining more than 100% of the total loan portfolio decline over this period. So, it will be negative on yoy basis in the nearest quarters even despite to the ongoing vaccination campaign, new fiscal stimulus and an acceleration of the US recovery. But the situation is gradually beginning to improve. At least, banks stopped tightening lending standards. According to the Fed H.8 survey, C&I loans decreased by 16% yoy (as of May 13, 2021) vs +31.1% yoy one year ago. On ytd basis, corporate loans declined by 2.0% vs -0.2% ytd of total loans.

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



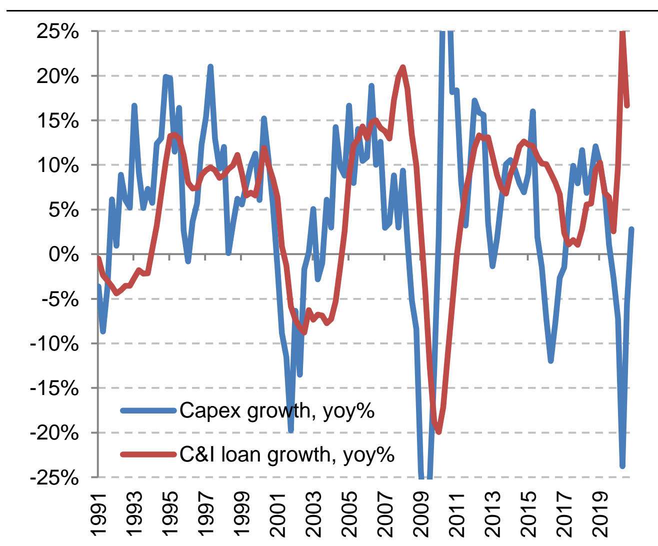
Source: Bloomberg

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



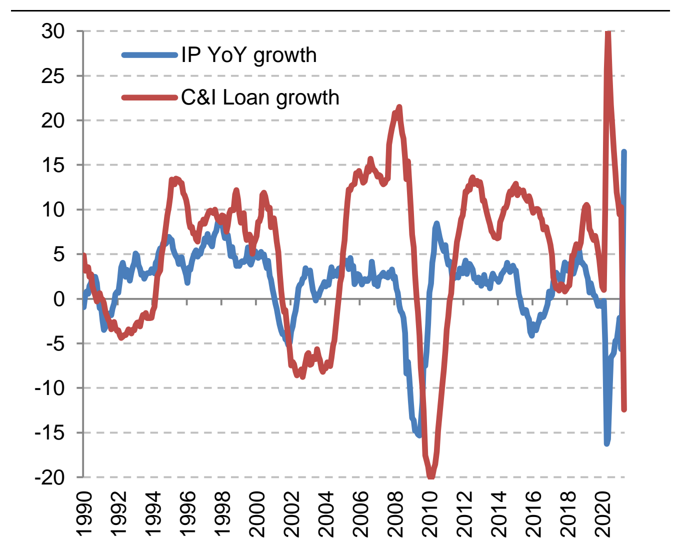
Source: Bloomberg

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 (much faster than it was expected 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 a skyrocketing 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 risks are gradually decreasing.

Despite concerns about deterioration of C&I credit quality over the recent quarters (and total loan portfolio at all), it remains benign so far and there wasn't any significant deterioration of credit quality in 2H20 after a noticeable deterioration in 2Q20. 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 strong quality of the C&I loan portfolio. FDIC's NCO ratio tumbled by 21 bps both qoq and yoy to 0.26% at the end of 1Q21, being lower relative to pre-pandemic levels. Noncurrent rate decreased by 9 bps qoq, but it is still +8 bps yoy, to 0.9%. According to the Fed data, delinquency ratio increased by 3 bps yoy, but -11 bps qoq, to 1.17% in 1Q21. It is already -12 bps from the highest figure over last 13 quarters. In turn, NCO ratio decreased by 11 bps qoq, or -28 bps yoy, to 0.29% in 1Q21, being markedly below historical averages.

Till the start of the pandemic, the financial health of the US corporate sector was solid even despite to its relatively high leverage. Thus, ROA was high, quick ratios were sound while interest expense coverage was strong but deteriorating as total profit of the sector was flat during previous quarters. The situation changed considerably in March 2020 and it continued to deteriorate in 2Q20-3Q20 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 a skyrocketing growth of corporate spreads, especially for non-investment grade companies (but the spreads have already declined markedly from the recent highs), we saw a significant drop of interest coverage ratios in 1H20 even despite the fed funds rate was cut to zero. From the other hand, the situation has improved considerably in recent quarters. Thus, median EBIT to interest expense ratio of S&P 500 index (excluding Financials) 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 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 four quarters in a row. So, it seems that the situation has almost returned to normal, and we do not expect a significant deterioration in the financial stability of the US corporate sector even after the end of the supporting fiscal programs. At least, we believe that credit quality of C&I portfolio will remain strong in the foreseeable future.

April 2021 Senior Loan Officer Opinion Survey indicated that C&I lending standards and terms were eased in 1Q21, for the first time over recent 7 quarters. Easing wasn't broad based but it is quite understandable in the current circumstances. So, the key reasons for easing are a more favourable and less uncertain economic outlook, improvements in industry-specific problems, and increased competition in the industry. It wasn't surprising for us given a better GDP growth projections for 2021 and 2022 years. Notwithstanding, banks reported a weaker demand again in 1Q21. On the other hand, banks noted that inquiries from potential borrowers increased in the last quarter. The key drivers of weaker

demand were “decreases in customers’ investment in plant or equipment, in customers’ precautionary demand for cash and liquidity, and in customers’ accounts receivable financing needs as important reasons for weaker demand”. It is in-line with expectations but it seems that in 2Q20 the situation will improve even despite banks noted that lending standards remains tighter vs pre-pandemic levels for the majority of borrower’s categories except for large investment-grade firms.

Macro data published in May 2021 were markedly worse than expected with a significant miss for the majority of indicators except for PMI figures, both manufacturing and services components. Thus, ISM manufacturing index decreased by 4 pts MoM to 60.7 pts in April, markedly missing consensus of 65 pts, after it demonstrated noticeable positive surprises in February and March. Employment report was also significantly worse than expected in April, after quite strong figures in two previous months. Thus, manufacturing payrolls decreased by 18K in April vs consensus of +54K, after it went up by 54K in March (revised up from initial estimate of +53K). Also, total payrolls increased only by 266K in April vs consensus of +1000K, after it increased by 770K in March (revised down from initial estimate of +916K). In any case, employment is still 8 mln lower than it was before the pandemic. So, unemployment rate increased by 30 bps on a MoM basis to 6.1% vs consensus estimate of 5.8%. Unemployment remains elevated but it is already markedly lower than the high of the GFC and it is much lower than it was feared one year ago. Given new fiscal stimulus and an acceleration of the recovery, street estimates continue improving. Thus, according to Bloomberg survey conducted in May 2021, GDP growth rates were estimated at +6.6%/4.1%/2.4% yoy for 2021/2022/2023, respectively, vs +6.2%/4.1%/2.4% in April 2021. Industrial production increased by 0.7% MoM in April vs consensus of +0.9% MoM after a growth of 2.4% in March (it was revised up from initial estimate of +1.4%). But, it is still -2.7% from its pre-pandemic level as a result of the meltdown in 2Q20, when IP decreased to levels last seen during the GFC. Capacity utilization increased by 0.5% MoM in absolute terms to 74.9% in April but it was slightly lower than consensus estimate of 75%. Unsurprisingly, it is still markedly below pre-pandemic levels. In turn, Empire manufacturing index decreased by 2 pts MoM to 24.3 pts in May, after three consecutive months of a substantial growth. But it remains markedly higher than the average level of 2019. Preliminary Markit manufacturing PMI increased by 1 pts MoM to 61.5 pts in May vs consensus of 60.2 pts, the third consecutive month of positive dynamics. So, it is still more than 25 pts higher than its 2020 low and even more than 10 bps higher than pre-pandemic levels, despite the economy hasn’t fully opened yet. Notwithstanding, consensus IP growth forecasts slightly deteriorated recently in May 2021 projections to +5.9%/+4.0%/+2.4% yoy in 2021/2022/2023, respectively, from 6.4%/+4.0%/+2.2% in April 2021 survey.

CRE

The growth rate of commercial real estate loans wasn’t strong ytd despite to a strong rebound of the sector and a significant acceleration of the economy. On the other hand, it remains positive on yoy basis, even taking into account a substantial negative impact 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 +1.5% yoy (as of May 12, 2021) vs +6.5% yoy one year ago. In spite of a significant deterioration of CRE fundamentals in 2Q20 and 3Q20, there were clear signs of their improvements in the recent months. Despite to an acceleration of the price growth and higher volumes, CRE fundamentals remain under pressure. At least, same-store NOI growth and effective rent growth are negative on yoy basis, especially in the most suffered subsegments and geographies. The sector is clearly out of the woods but it is a bumpy road ahead, even despite to a gradual reopening of the economy. Although we remain bullish on the sector, we believe that its fundamentals will remain under pressure for some time with elevated

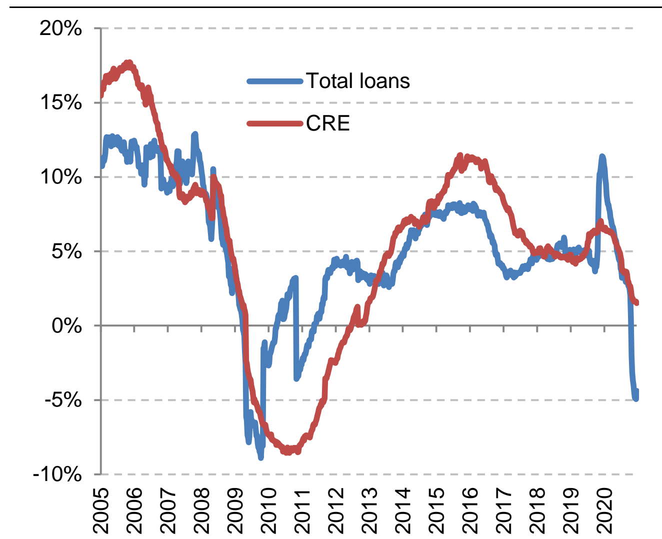
vacancy rates and a negative rent growth. As a consequence, a loan growth may get slightly worse before it gets better and it is quite possible that quality characteristics could slightly deteriorate in 2021. Notwithstanding, REITs increased by 16.6% ytd vs SPX index growth of +11.9% ytd. On the other hand, BBREIT index remained 0.8% lower than its pre-pandemic high, while SPX index is 23.9% higher compared to its pre-pandemic levels.

Credit quality remains strong so far but early signs of its deterioration were already seen in 2H20. Notwithstanding, it improved in 1Q21 and the majority of the indicators are not far from the pre-pandemic levels. According to the Fed data, CRE NCO ratio increased by 3 bps qoq, or +9 bps on a yearly basis, to 0.13% in 1Q21, while delinquency ratio increased by 20 bps yoy, but -11 bps yoy, to 1.02%. 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 their average levels of last two cycles. In turn, non-current rates increased noticeably in all major segments on yoy basis – 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 leading indicator of future credit quality, 30-89 days delinquency ratio improved markedly in three recent quarters and it is even lower on yoy basis. 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 NCO ratio high of the current cycle will reach the high of the GFC even despite to significant problems in retail and hotel segments (according to REIS estimates, the deterioration in retail in 2020 was worse than in 2009) due to a shorter period of the recent downturn and much tighter lending standards during the last credit cycle. Moreover, the percent of rent collections still remains very high in the majority of segments and growing. The price growth has remained positive on yoy basis so far and it even accelerated in recent months. It could be distorted by lower transaction volumes but the fact is that CRE remains strong at least so far, especially taking into account that it was one of the most suffered industries because of the health crisis.

Transaction volumes increased by 66% yoy in April 2021 as a result of the low base because of lockdowns during the first wave of the pandemic. Deal activity continues improving but it was lower volumes in April vs an average level of last 5 years leading up to the pandemic. According to the RCA, "the increase in U.S. commercial real estate investment in April might suggest that the market is through the worst effects of the Covid-19 pandemic. Still, while there were high double-digit annual growth rates in commercial property sales for the month, all the problems from the pandemic are not yet in the rearview mirror". Volumes are markedly above the lows of the GFC and the situation is likely to only get better in the near future. Notwithstanding, the difference between bid and ask prices is still high, especially in some segments such as NY apartments. From the other hand, almost all distressed CRE concentrated in only two segments, namely hotels and retail. Notwithstanding, prices remained resilient, still showing a positive yoy growth and it even accelerated markedly in recent months. Thus, apartment price index added +8.4% yoy as of the end of April 2021 vs +5.2% yoy one year ago. Even price index of retail CRE turned positive again in March 2021 after being negative for 11 months in a row and it is currently +1.2% yoy vs -0.4% yoy one year ago. The growth of prices of industrial CRE decelerated to +9.45% yoy in April 2021 from +11.9% yoy printed in July 2019. The growth rate of office

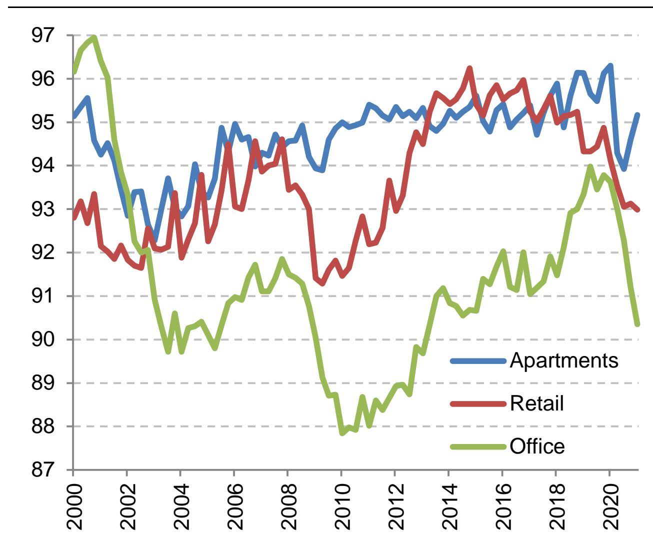
prices slightly decelerated to +3.0% yoy from +4.3% yoy at the end of 2019.

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



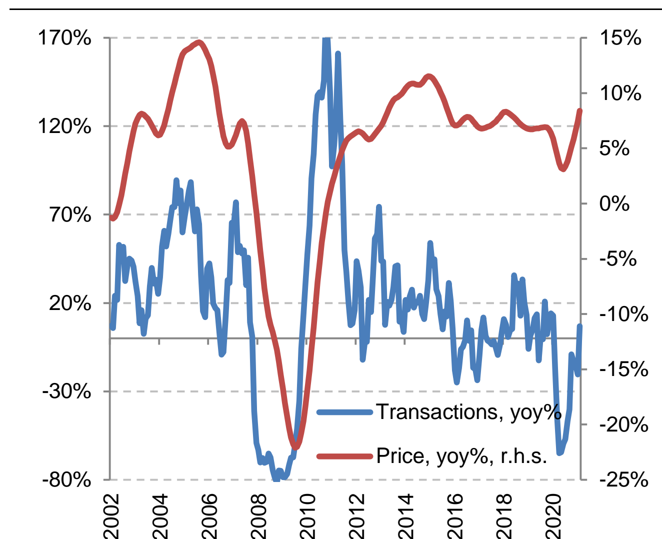
Source: Bloomberg

Chart 10. CRE. Occupancy rates, %



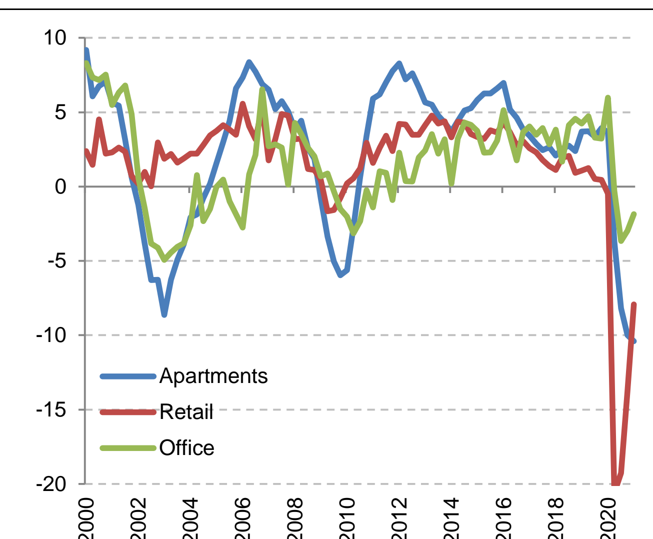
Source: Bloomberg

Chart 11. CRE. Price Growth vs Transactions Volumes



Source: Bloomberg

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



Source: Bloomberg

Despite to early signs of the recovery in CRE, difficult times for the sector remains in the near future, accompanied by lower occupancy rates, lower rents and so on. Faster than feared economic recovery improved prospects of the sector, however, CRE fundamentals deteriorated meaningfully in 2Q20 and 3Q20 in all major segments but it was slightly better on qoq basis in 4Q20 and 1Q21. 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 and -7.9% yoy in 1Q21. The lowest figure of the GFC was just -1.7% yoy in 2Q09. Office NOI declined by 1.9% yoy in 1Q21 vs -3.7% yoy in 3Q20 and -0.3% yoy in 2Q20 or the deepest drop during the GFC of -3.2% yoy in 2Q10. Apartments NOI decreased by 10.4% in 1Q21 vs -8.3% yoy in 3Q20 and -3.7% yoy in 2Q20, even lower than the trough growth rate during the GFC, -6.0% in 4Q09. But the situation should start to improve in the near future given the lack of supply in residential mortgage sector. Occupancy rates also decline substantially across all major segments except for industrials in 2Q20/3Q20 but it increased in apartments in 1Q21 while office and retail ratios decreased again on qoq basis. The majority of REITs decreased or suspended dividends as a result of negative effect of the health crisis in 1H20 but the situation began improving in 2H20 and 1Q21. On an absolute basis, it still markedly

lower than it was at the end of 2019 but it seems that the situation will improve in the near future.

In 1Q21, banks continue tightening standards for construction loans while multifamily standards were eased. Standards on commercial real estate loans secured by nonfarm nonresidential properties remained basically unchanged. For construction loans it was the 24th quarter of tightening in a row while for multifamily loans standards were eased for the first time over the last 23 quarters. Also banks noted weaker demand for nonfarm nonresidential properties but it was better demand in multifamily and construction segments. According to 1Q21 SLOOS, “for nonfarm nonresidential loans and construction and land development loans, significant net shares of banks lowered loan-to-value (LTV) ratios, and moderate net shares reduced the market areas served” during the last year. It seems that banks will continue to ease lending standards given an acceleration of the economy and much better perspectives of even the most suffered subsegments such as retail and hotels.

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 a significant growth of housing sales and still relatively high refinancing activity. Mortgage loans declined by 0.6% ytd as a consequence of tighter lending standards for mortgage loans because of a significant deterioration of the financial health of the US consumer, at least for a number of them (the overall health of the US consumer remains solid due to plentiful government support). Thus, mortgage loans decreased by 1.8% yoy (as of May 12, 2021) vs +5.3% yoy at the end of 2019. From the other hand, mortgage activity remains very high with the growth of MBA’s application index of almost +1.7% in 2021 vs 2020, even taking into account very strong 2020 figures and a significant growth of mortgage rates ytd. Recall that an average level of the index in 2020 increased by more than 60% vs 2019 year. Given higher GDP growth estimates, new fiscal stimulus and the 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 will start to ease lending standards even despite to lower affordability of homes, much higher rates ytd and still elevated unemployment. Mortgage credit availability index remained relatively unchanged in 2021, at 128.1 pts in April. So, it was just slightly up, +9.5 pts from its September 2020 low, or +6 pts ytd. But it is still not far from the lowest level over more than 6 years, or -52 pts from the pre-pandemic levels, implying that lending standards remain relatively tight. On the other hand, affordability ratios have already declined meaningfully from the cycle high but they also increased meaningfully in recent quarters because of a substantial decline of key benchmark rates. At least, even 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. But banks prefer to remain on the sidelines (at least for new mortgage borrowers) given still elevated unemployment ratio even despite to its significant decline in recent months. So, we don’t expect that NPL and NCO ratios will even approach the values that we saw 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 cycle, the 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. Housing market also looks significantly healthier with no obvious imbalances (except for a skyrocketing growth of home prices) as it was just before the last recession when it was a key engine of the economic contraction. We expect that NCO ratio dynamics will be more like the one during the recession of early 2000s with the highest figure of 0.3%. Moreover, percent of rent payments markedly improved in February-April 2021 after a slight deterioration in January. According to the National Multifamily Housing Council Rent Payment Tracker, 80% of

apartment households made a full or partial rent payment by May 6, 2021 Vs 76.6% in January 2021, 80.2% in May 2020 and 81.7% in May 2019. Given recent stimulus and an acceleration of the GDP growth, it seems that the situation will continue improving.

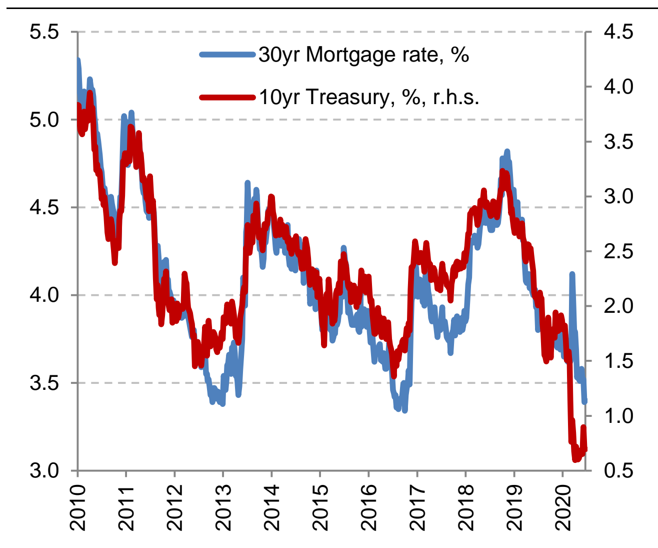
Due to an acceleration of the US recovery, hiring also went up meaningfully. After relatively weak payrolls within the period from November 2020 till January 2021, figures of March 2021 were quite strong while payrolls of the first two months of the year were revised up. Notwithstanding, April figures were disappointing. Thus, it was added 266K jobs in April vs consensus of 1000K while March figure was revised down from an initial estimate of 916K to 770K. Private payrolls were also markedly weaker, adding just 218K in April vs expectations of +933K, after it added 708K in March. Nevertheless, employment still remains much below its pre-pandemic levels. It is significantly better than it was feared 1-2 quarters ago and the situation still continues improving even despite to weak April figures. Jobless claims decreased substantially in recent months after being relatively flat for six consecutive months. It is still markedly higher relative to pre-pandemic levels but May 2021 figures were the lowest claims since the middle of March 2020. Average April claims decreased by 26% MoM and it seems that they will continue to go down in coming months even despite to ongoing restrictions in a number of industries with high contact. So, overall median forecasts of average monthly payrolls for 2021-2023 years improved again in May to +589K/+286K/+180K vs +564K/+275K/+181K in April survey. Unemployment rate increased by 30 bps MoM to 6.1% vs consensus of 5.8%. So, it is -8.7 p.p. from the April 2020 peak, but +2.6 p.p. from the pre-pandemic level. In turn, underemployment rate continued going down, -30 bps MoM to 10.4% in April 2021, -12.5 p.p. from its April 2020 high. And unemployment projections also improved in May vs April to 5.4%/4.2%/3.9% for 2021/2022/2023 years, respectively (vs 5.5%/4.3%/3.8%). Despite to a significant growth of unemployment in April 2020, it seems that the negative impact of this factor on quality of mortgage portfolio was restricted due to forbearance programs and a positive impact of fiscal stimuli. But further dynamics of quality characteristics will depend on how quickly the economy will recover. Thus, according to the MBA, “the total number of loans now in forbearance decreased by 3 basis points from 4.22% of servicers' portfolio volume in the prior week to 4.19% as of May 16, 2021”. Around 2.1 million homeowners are still in forbearance plans, 0.15 mln lower on MoM basis. The key driver of loans in forbearance decline was the return of homeowners to work. As for Fannie Mae and Freddie Mac data, the share of loans in forbearance declined for the 11th month in a row to 2.21%, -3 bps during the week ended May 16, 2021.

Mortgage credit quality was very strong so far. According to the Fed data, NCO ratio in the segment decreased by 2 bps both yoy and qoq to -0.04% in 1Q21, while delinquency ratio increased by 1 bps qoq, or +36 bps yoy, to 2.75%, still not far from the lowest figure over last 12 years. According to the FDIC, the quality of mortgage portfolio remains also very strong with NCO ratio at -0.03% in 4Q20, -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 decreased by 35 bps qoq to 6.38% in 1Q21, the third consecutive quarter of decline, after the highest level over last 9 years of 8.22% was shown in 2Q20. Notwithstanding, it is still 261 bps higher than its all-time low, which was shown in 4Q19. In turn, foreclosures declined again, -2 bps qoq or -19 bps yoy, to 0.54%, the 36th quarter of decline in a row and the lowest figure since 1982. According to NY Fed, “the share of mortgages that transitioned to delinquency remained low at 0.5%, as the option to enter forbearance remained. Meanwhile, 50% of loans in early delinquency transitioned to current, a higher rate than before the pandemic as delinquent loans enter forbearance. Foreclosures remain on pause for most loans due to the CARES-provisioned moratorium, and the first quarter saw only 11,000 new foreclosure starts”. So, we expect that quality of mortgage loans will remain much better than GFC’s average figures of NCO and delinquency ratios as

underwriting standards were much stronger during the last credit cycle.

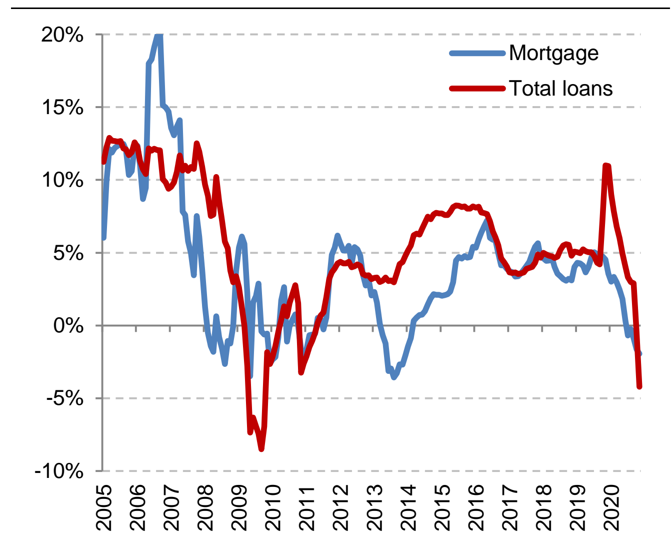
Lending standards for the most of mortgage segments were eased in 1Q21, after it was unchanged in 4Q20, following three consecutive quarters of tightening. It is quite consistent with the expectations of banks, voiced at the end of last year, that the standards will be eased in 2021. It was unsurprising given the much better labor market, an acceleration of the economic growth and the very strong housing market. According to NY Fed 1Q21 report on HH debt and credit, "mortgage originations, measured as appearances of new mortgage balances on consumer credit reports and which include refinances, were at $1.1 trillion, only slightly below the record high seen in 2020Q4". "Median mortgage origination credit scores edged up, with the median credit score of newly originated mortgages at 788, reflecting both a high share of refinances and tightening of underwriting standards".

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



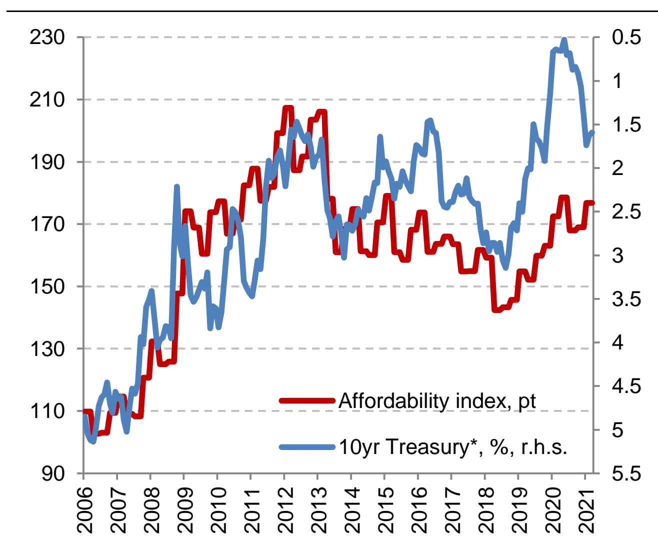
Source: Bloomberg

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



Source: Bloomberg

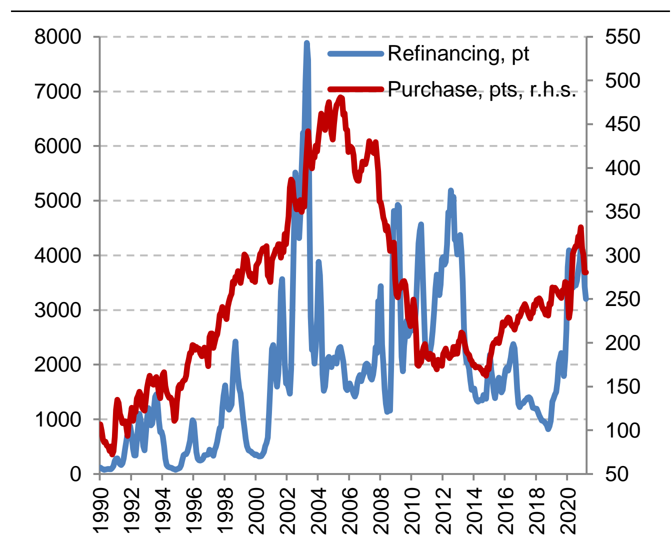
Chart 15. Mortgage. Aff. Index vs 10yr Treasury yield



*reversed order

Source: Bloomberg

Chart 16. Mortgage. MBA Applications Indexes



Source: Bloomberg

Mortgage demand slightly strengthened again, the 8th consecutive quarter of strengthening. But banking answers were mixed. Large banks noted that it was unchanged for RRE and lower for HELOCs while small banks reported strengthening demand across most RRE loan categories. According to 4Q20 SLOOS, loan demand expectations on 2021 year also were mixed. Banks expect weaker demand for GSE-eligible mortgage loans but unchanged

demand for nonconforming jumbo residential mortgage loans. As well as for other loan categories, it is expected by a moderate share of banks that loan performance will deteriorate in RRE and HELOCs segments.

Mortgage rates dynamics is still weak but they are higher ytd. Notwithstanding, monthly average rate of 30yr fixed mortgage decreased by 7 bps MoM to 3.08% in May, the second consecutive month of decline after its significant growth in February and March following 9 consecutive months of fall due to narrowing spreads because of the normalizing economic situation. In turn, 10yr treasury decreased by 3 bps MoM to 1.59% as of end of May (still +68 bps ytd). 15yr fixed rate mortgage (national average, Bankrate.com) decreased by 7 bps MoM to 2.43% as of the end of May (in-line with its all-time low, first shown in January). In turn, 30-yr mortgage rate (effective rate, MBA) was flat MoM at 3.28% (as of May 21, 2021), +29 bps ytd and -20 bps from its 2021 high.

Housing market indicators published in May were weaker than expected after several consecutive months of better figures. One of the key reasons for worse housing figures, from our point of view, was the lack of supply and a skyrocketing growth of home prices in recent months. Notwithstanding, due to a significant drop in interest rates in 1H20 and the faster than expected economic recovery, the majority of housing indicators still look pretty resilient even despite to the recovery of the long end in recent months. NAHB index was flat MoM at 83 pts in May, in-line with consensus, but +9 pts vs its pre-pandemic levels. Construction spending increased by 0.2% MoM in March, markedly missing consensus of +1.6% MoM, but February initial estimate was revised up from -0.8% MoM to -0.6% MoM. So, mortgage origination forecasts remain very strong but relatively flat MoM. Thus, according to Fannie Mae's May 2021 housing forecast, total mortgage originations increased by 2.1% MoM for 2021 year (+4.5% from January estimates) and +1.6% MoM for 2022 year (-6.0% from January estimates). Currently, it is expected that total originations will decrease by 10% yoy in 2021 and by 25.6% yoy in 2022. The key driver of total originations decline will be refinancing originations which were the key driver of its skyrocketing growth in 2020. According to MBA's forecast published in May 2021, total mortgage originations will decrease by 11.1% yoy in 2021 (+3.5% vs April 2021 forecast) driven by refinancing which are estimated to decrease by 27% yoy in 2021. Total originations are also expected to decrease by 32% yoy in 2022 (flat vs both April and March forecast). The key driver of refinancing originations was a significant decline of mortgage rates. However, the latter have started to soar recently, following a significant growth of 10yr treasuries yield. Total mortgage debt outstanding is expected to go up by 5.6% yoy in 2021 and by 5.7% yoy in 2022.

Housing starts were 1569K in April vs expectations of 1704K, -164K MoM vs slightly revised down March figure, still in-line with pre-pandemic levels. In turn, building permits were almost in-line with estimates. Thus, April building permits were 1760K vs estimate of 1770K, +5K vs slightly revised down March estimate. Existing home sales decreased again in April, the third consecutive month of decline. So, it was 5.85 mln in April vs consensus of 6.07 mln, -0.16 mln MoM, or -0.9 mln from its local high of October 2020 but it remains slightly higher compared to pre-pandemic levels. New home sales missed expectations either, -54K MoM to 863K in April vs consensus of 950K. March estimate was revised down from initial estimate of 1021K to 917K. It remained markedly higher Vs pre-pandemic levels but recent sales data demonstrated weakness because of supply constraints and a significant growth of housing prices. Thus, FHFA house price index increased by 1.4% MoM in March vs consensus of +1.0% MoM, the 10th month of growth of 0.9% or more in a row. It added 13.9% yoy and this 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 1.2% MoM in March, vs consensus of 1.6% MoM and this is a marked acceleration vs January and February. On yoy basis, it was +13.3% vs consensus of

12.6%, almost the highest price growth since the index inception. Currently, the median existing home sales price is more than 40% higher than the GFC peak. Unsurprisingly, as existing home inventory is at a multi-year low.

Consumer

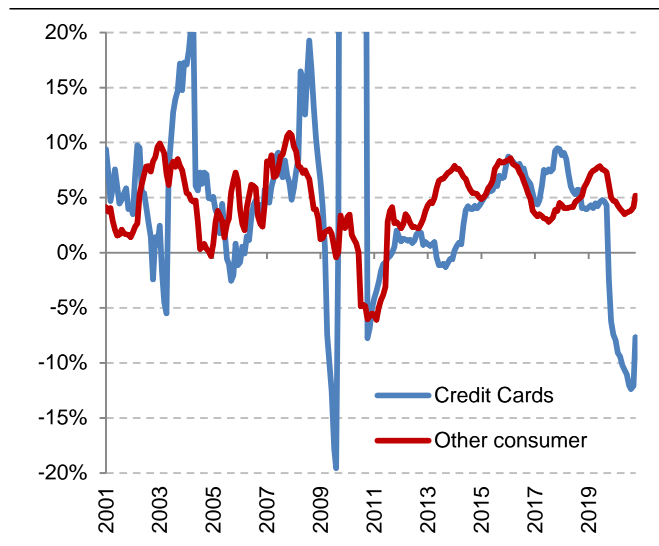
Consumer loans are the key driver of total loan portfolio in 2021 after it demonstrated relatively weak dynamics in 2020. Notwithstanding, it returned to a positive yoy growth only few weeks ago, driven by other consumer loans such as auto etc. while credit cards growth is still negative ytd. Given the much better labour market than it was feared one year ago and substantial fiscal stimulus, it is not surprising. According to Fed H8 data, the growth rate of consumer loans is +1.2% yoy (through May 12, 2021) vs -0.7% one year ago, or -4.4% yoy as of the end of 2020. On ytd basis, it increased by 1.9%, driven by other consumer loans. In turn, CC growth rate was -4.0% yoy (as of May 12, 2021) vs +4.9% yoy at the end of 2019. On ytd basis, CC loans decreased by 0.2% as credit card limits remained cut but it seems that the situation begins to improve. Net change of consumer credit in March 2021 was +$25.8 Bn, markedly beating consensus of +$20.0 Bn, near the highest figure since the end of 2017 and the second consecutive month of $25+ Bn growth. Other segments of consumer credit accelerated markedly in recent weeks, adding 6.6% yoy (as of May 12, 2021) vs 5.0% yoy at the end of 2019, +3.9% ytd vs total loans growth of -0.2% ytd. According to 1Q21 HH debt and credit survey by NY Fed, "aggregate household debt balances increased by $85 billion in the first quarter of 2021, a 0.6% rise from 2020Q4, and now stand at $14.64 trillion. Balances are $499 billion higher than at the end of 2019. Balances on home equity lines of credit (HELOC) saw a $14 billion decline, the 17th consecutive decrease since 2016Q4, bringing the outstanding balance to $335 billion. Credit card balances declined in the first quarter, by $49 billion, a substantial drop and the second largest quarterly decline seen since the series began in 1999. Credit card balances are $157 billion lower than they had been at the end of 2019, consistent with both paydowns among borrowers and reduced consumption opportunities. Auto loan balances increased by $8 billion in the first quarter. Student loan balances increased by $29 billion. In total, non-housing balances declined by $18 billion, with increases in auto and student loans offset by the declining credit card balance, and are now $49 billion below the 2019Q4 level".

Despite to an unprecedented drop of the US GDP in 2Q20 and a skyrocketing growth of unemployment, the state of the US consumers was pretty resilient so far due to massive government support programs. And it will remain strong in the near future due to an adoption of new fiscal stimulus and the faster economic recovery. Unsurprisingly, GDP growth estimates continue to go up as a result of the start of the vaccination campaign and a positive impact of stimulus. According to Bloomberg estimates compiled in May 2021, it is expected that the US GDP will increase by 6.6% yoy in 2021, by 4.1% yoy in 2022 and +2.4% yoy in 2023 (vs April estimates of +6.2%/+4.1%/+2.4% yoy, respectively). As of unemployment, it is estimated to be as high as 5.4% at the end of 2021, while it was as high as 13% at the end of 2Q20. But, it is possible that we could see some deterioration of asset quality in consumer segment after the fiscal cliff and the end of forbearance programs. However, it is obvious for us that the worst is over and that a potential size of problems loans will be much smaller than feared in the middle of 2020. Banks have already begun to release reserves in the consumer segment. Of course, low income/wage consumers will suffer the most, but DSR and FOR of median HH still remain markedly lower than historical averages. So, we still don't expect that the highs of NCO ratios of the current cycle will come any closer to the highs of the GFC (the highs of the previous crisis NCO ratio for credit cards of 10.5% and for other consumer loans of 3.3%).

According to the Fed data, total consumer NCO ratio tumbled by 75 bps yoy, but +2 bps

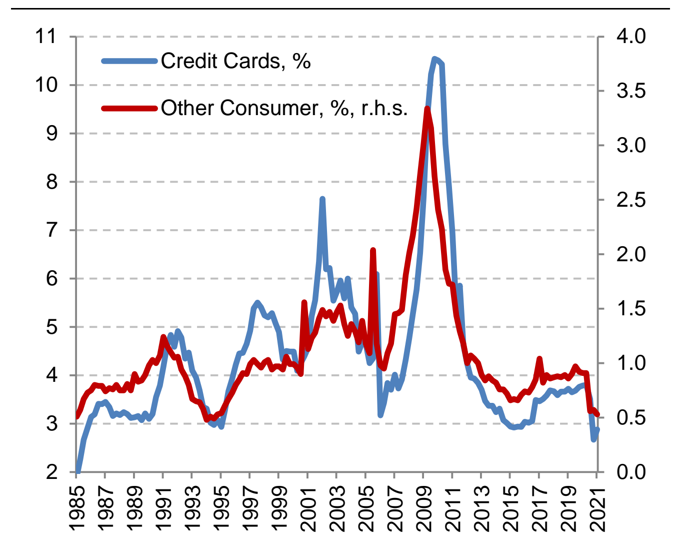
qoq, to 1.54% in 1Q21. NCO ratio in CC segment decreased by 91 bps yoy, but +21 bps qoq, to 2.88% while NCO ratio of other consumer loans decreased by 4 bps qoq, or -38 bps yoy, to 0.53%, the lowest figure over more than 25 years. In turn, delinquency ratio decreased by 78 bps yoy, or -14 bps qoq, to 1.74%. CC delinquency ratio decreased by 23 bps qoq, or -81 bps yoy, to 1.89% in 1Q21 while other consumer loans ratio went down by 16 bps qoq, or -66 bps yoy, to 1.59%. 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 (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 decreased meaningfully again in 1Q21, 114K vs 121K in 4Q20 and 189K in 1Q20, a new historical low. According to NY Fed, "of the $448 billion of debt that is delinquent, $343 billion is seriously delinquent (at least 90 days late or "severely derogatory", which includes some debts that have been removed from lenders' books but upon which they continue to attempt collection)".

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



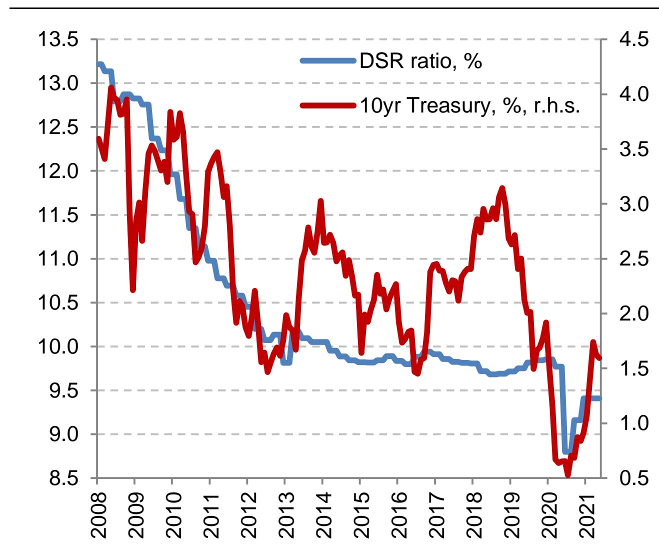
Source: Bloomberg

Chart 18. Consumer. NCOs Ratios, %



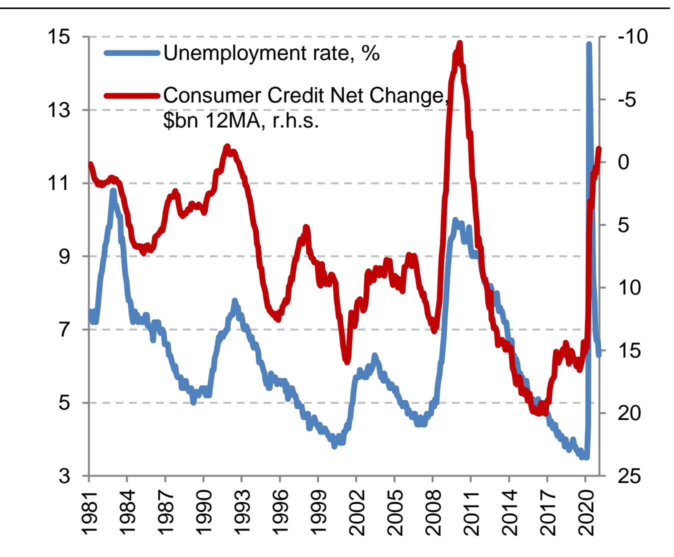
Source: Bloomberg

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



Source: Bloomberg

Chart 20. Unemployment vs Net Change of Cons Credit



Source: Bloomberg

April 2021 SLOOS survey indicated that "banks also eased standards across all three consumer loan categories – credit card loans, auto loans, and other consumer loans. Meanwhile, demand for credit card and other consumer loans remained basically unchanged, and demand for auto loans moderately strengthened". It is in-line with expectations of banks at the end of the last year. According to NY Fed, "the median credit score on newly originated auto loans also rose, up to 720, reflecting declining subprime shares of overall originations. Only 15% of the $153 billion of newly originated auto loans were originated to borrowers with credit scores below 620, the lowest share seen in the history of our data". Also, it was noted that "the number of credit inquiries within the past six months – an indicator of consumer credit demand – was at 116 million, a 3% decline from the previous quarter. Inquiries have been subdued since the second quarter of 2020 when the large effects of the pandemic hit the US".

Consumer activity data published in May were clearly weak after very strong April figures due to a positive effect of new fiscal stimulus, the ongoing vaccination campaign and the renewed recovery of the labour market. Notwithstanding, we expect that consumer confidence will continue improving steadily in coming months as a result of an acceleration of the economic recovery and a gradual lifting of the restrictions. Thus, conference board index decreased by 0.3 pts MoM to 117.2 pts, driven by expectations index which declined by 8.8 pts MoM from the revised down April figure. It was again below 100 pts in May, reflecting, from our point of view, inflation concerns. But we think that it is a temporary phenomenon, taking into account the pace of the economic recovery. At least, present situation index skyrocketed again, adding 12.4 pts MoM to 144.3 pts in May, the new post pandemic high. In result, the aggregate index is just 11 pts lower relative to its pre-pandemic levels and it is +35 pts from its March 2020 low. On the other hand, consumer sentiment indicator published by Michigan University decreased by 5.5 pts MoM to 82.9 pts in May vs consensus of 90 pts. It is just 11 pts higher than the pandemic low, shown in April 2020. The decline was driven by both the expectations index and the current situation index. Notwithstanding, despite to May figures weren't strong, consumption forecasts continue improving. According to May 2021 Bloomberg survey, consumer spending is expected to increase by 7.7% yoy in 2021, by 4.1% 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 the employment published in summer and autumn of the previous year were clearly optimistic and much better than anticipated. But figures of the first two months of the recent winter demonstrated clear signs of slowdown. At least, jobless claims even increased slightly while payrolls were weaker than expected in three consecutive months. However, March 2021 employment report showed that it was a temporary phenomenon. And we haven't changed our mind even after clearly disappointing April employment report. Thus, nonfarm payrolls increased only by 266K vs expectations of +1000K while March initial estimate of +916K was revised down to +770K. Also, private payrolls increased just by 218K vs estimate of +933K, after it increased by 708K in March. Given much better weekly jobless claims in recent months and the faster economic recovery, we expect that the employment situation will improve materially in the nearest future. Unemployment ratio increased by 10 bps MoM to 6.1% in April 2021 vs consensus of 5.8%. Average hourly earnings increased by 0.7% MoM in April vs consensus of flat MoM dynamics, partially reflecting labour shortages in some sectors, from our point of view. Also, underemployment ratio decreased by 30 bps MoM to 10.4% in April, after its noticeable decline in March. It is already significantly lower the high of the Great Recession of 17.2% but still markedly higher than 6.7% at the end of 2019. In any case, more than 3.5 mln workers are still filling continuing jobless claims which is not far from the peak level of the GFC. Continuing claims remain very important indicator to track the employment situation. Moreover, the employment population ratio is still near levels last seen 50 years ago. On a year-over-year basis, hourly earnings were +0.3% vs consensus of -0.4% yoy

and March figure of +4.3% yoy. Average weekly hours were up by 0.1 hour MoM to 35, markedly higher in contrast to its pre-pandemic level. So, initial jobless claims decreased by 26% MoM in May 2021, the 4th consecutive month of decline, but initial jobless claims over the recent 4 weeks still exceeded its pre-pandemic levels by more than 2 times. Notwithstanding, the financial health of the average US consumer remains quite strong, but a further rate of employment growth will inevitably decelerate in coming quarters. Moreover, lower income households continue to suffer more than average income households.

Interest Rate

Despite the April Fed meeting was perceived as dovish one, the minutes sent a clear hawkish signal to the market. At least, the meeting doesn't look so dovish anymore but the growth of LT rates on the news was temporary. Recall that monetary policy left unchanged at the April meeting after there was a slight change of the wording of the FOMC statement and a publication of new economic projections at the March meeting (also with no changes for the monetary policy and guidance). Moreover, it was noted during the press conference that it is too early to start thinking about thinking about tapering (in-line with March comments about no preemptive hikes). Given more optimistic comments about the economic recovery (despite new economic projections were released just 1 month ago) and more lenient wording regarding risks, "no tapering" assertion looked slightly dovish and questionable. So, the sentence from minutes, where it was noted that "a number of participants suggested that if the economy continued to make rapid progress toward the Committee's goals, it might be appropriate at some point in upcoming meetings to begin discussing a plan for adjusting the pace of asset purchases", slightly contradicts what was stated earlier, from our point of view. So, the point that the issue will be raised in the nearest 2-3 months remains intact, especially taking into account April's inflation figures which were very high. Moreover, dot plots were already hawkish in March vs December. Thus, 7 participants out of 18 expect rate hike in 2023 vs 5 participants out of 17 in December. Moreover, 4 participants (vs 1 in December) expect the rate hike as early as in 2022. On the other hand, the dot plot isn't the best guide for the future monetary policy path (at least, it wasn't in the recent past). Moreover, targeting inflation on an average basis adds flexibility to the Fed to hike rate rather later. Even taking into account a significant acceleration of the US economy due to new fiscal stimulus, the economy is still far from the Fed employment targets (April data were much weaker than expected). Thus, "more generally, the sectors of the economy most adversely affected by the pandemic remain weak but have shown improvement. While the recovery has progressed more quickly than generally expected, it remains uneven and far from complete". So, the Fed keeps "the target range for the federal funds rate at 0 to 1/4 percent and expects it will be appropriate to maintain this target range until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time. In addition, the Federal Reserve will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals". So, we don't expect that monetary policy will change significantly in the nearest 2-3 quarters but it is quite possible that the tapering will be announced till the end 4Q21 and it will begin in 1H22. So, we expect that the growth of the long end will resume in the near future after some rollback in recent two months and that 10yr yield could exceed 2% in 2021. On the other hand, FF rate will remain at the current level for a long time but the first hike is closer for us than it was several months ago.

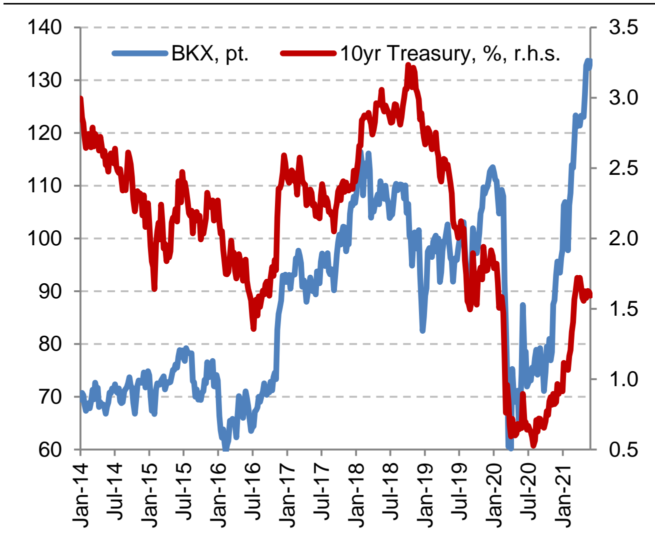
Although economic projections were revised meaningfully up at March Fed meeting, economic comments at April meeting were more upbeat again. However, GDP growth figures in 1Q21 were slightly lower than expected. According to the Fed, "the path of the

economy continues to depend significantly on the course of the virus and the measures undertaken to control its spread" but "indicators of economic activity and employment have strengthened". Recall, that according to March FOMC projections the GDP will increase by 6.5% in 2021, by 3.3% yoy in 2022 and by 2.2% yoy in 2023 (vs +4.2%/+3.2%/+2.4% in December). However, the longer run GDP growth was unchanged at 1.8%. As of unemployment ratios, it is implied that it will be 4.5% at the end of 2021, 3.9% at the end of 2022 and 3.5% at the end of 2023 (vs December projections of 5.0%/4.2%/3.7%, respectively). Longer run unemployment ratio was also lowered by 10 bps to 4.0%. Notwithstanding, it was emphasized that unemployment still remains elevated with the overall employment 9.5 mln below the pre-pandemic level. PCE inflation forecasts revised significantly up for 2021 but it was also higher for 2022/2023 years. So, it is implied that inflation will be 2.4% in 2021 and it will decline to 2.0% and 2.1% in 2022 and 2023, respectively (vs 1.8%/1.9%/2.0% in December). Longer-run inflation projection was unchanged. Overall, FOMC projections are relatively close to consensus forecasts which were markedly improved MoM in March as a result of fiscal stimulus adoption. According to Bloomberg May 2021 survey, the US GDP growth will be equal to +6.6%/+4.1%/+2.4% yoy in 2021/2022/2023 years, respectively, vs +5.5%/+4.0%/+2.4% yoy in March. Unemployment forecasts decreased from 5.8%/4.6%/4.2% in 2021/2022/2023 years, respectively, in March 2021, to 5.5%/4.3%/3.8% in May 2021.

For us, 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. Notwithstanding, uncertainty is still relatively high but declining gradually due to the ongoing vaccination campaign. Also, new fiscal measures were already announced and it will help the US economy to accelerate substantially in 2H21. Unsurprisingly, the prospects of US banks have improved recently due to the faster than feared economic recovery and the growth of the long end. At least, we have already seen some signs of NII stabilization, despite the majority of earning assets are priced based on the short end. Thus, NIM/NII forecast has already begun to improve (at least, stopped deteriorating). Median NIM 2021 of BKX index members decreased by 0.6 bps MoM, or -5 bps ytd, to 2.51%. Median NIM 2022 decreased by 0.4 bps MoM, or -2.3 bps ytd, to 2.6%.

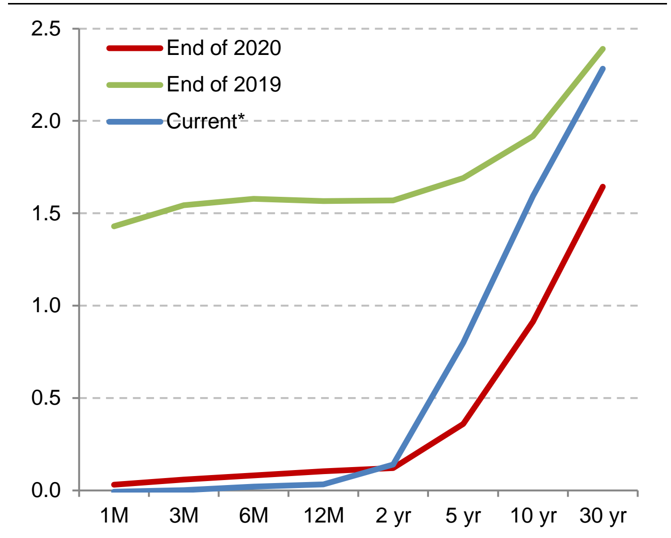
Median NII decline of our group of banks was -4.3% yoy, or -1.0% qoq, in 1Q21 vs -1.8% yoy but +1.5% qoq in 4Q20, the 5th consecutive quarter of yoy decline of NII in a row. The key driver of weak NII dynamics was a decline of NIM again which was driven by a higher decline of EA yield in a comparison of IBL cost fall even despite a significant growth of the long end in recent months. Given the recent growth of a number of benchmark rates and the fact that banks began investing highly liquid assets in higher yield assets, it seems that NIM has already reached the trough while NII will eventually start to grow in coming quarters. Notwithstanding, a median NII surprise of BKX index members was negative again, -1.0% (vs estimates for April 13, 2021), after +1.4% in 4Q20 and -0.6% in 3Q20. 14 out of 24 our group of banks showed a negative surprise on NII in 1Q20 vs 9 in 4Q20 and 15 in 3Q20. On the other hand, total NII of our group of banks exceeded estimates by 1.0%. 20 out of 24 our banks showed a negative surprise on NIM in 1Q21 with a median negative surprise of 3 bps vs 13 banks in 4Q20 with a median surprise of -0.3 bps and 21 in 3Q20 with a median surprise of -4.2 bps. Median NIM of BKX index members decreased by 3 bps qoq, or -54 bps yoy, to just 2.49% in 1Q21 (the lowest figure over decades, -36 bps vs the lowest figure of the last cycle, shown in 3Q16) vs -8 bps qoq, or -47 bps yoy, in 4Q20. On yoy basis, it was the 8th consecutive quarter of decline of median NIM after 9 quarters of growth in a row.

Chart 21. BKX Index vs 10yr Treasury Yield



Source: Bloomberg

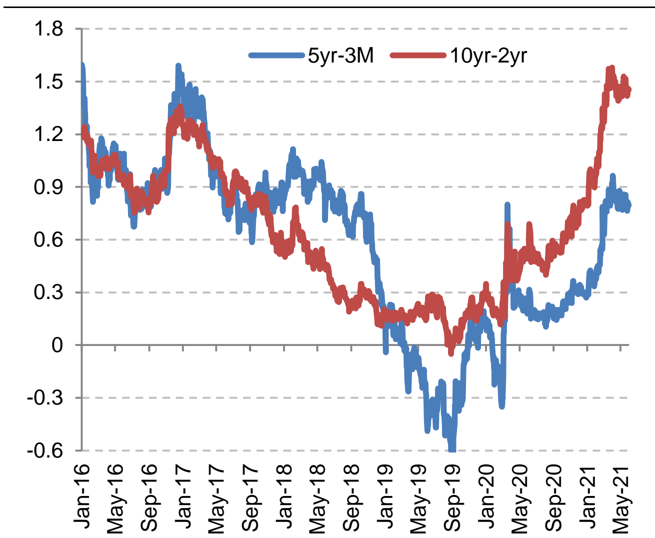
Chart 22. US Yield Curves, %



*As of the end of May 2021

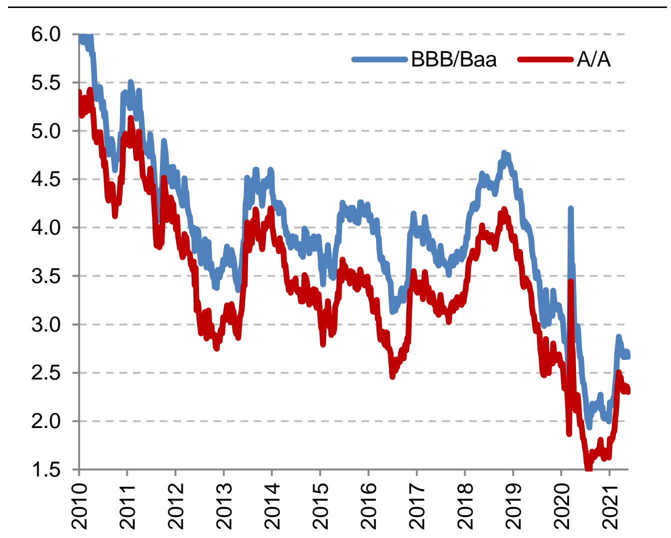
Source: Bloomberg

Chart 23. Treasury Spreads, %



Source: Bloomberg

Chart 24. Corporate spreads, %



Source: Bloomberg

The median growth of NII income of our group of banks was negative on qoq basis again after an unexpected growth in 4Q20 following a substantial decline in 2Q20 and 3Q20. Total NII of our group of banks was 11% below than it was one year ago. Notwithstanding, 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. At least, NII/NIM prospects improved markedly in the recent months due to the growth of the long end and an expected acceleration of the US economy as a result of new fiscal stimulus. There is no room to improve NIM by lowering deposit costs which are near zero at the moment. In turn, loan-to-deposit ratio was already below 60%, the record low, and it could be a good driver for NIM in case of loan growth acceleration, which however is still weak. Also, banks could invest excess liquidity into higher yield assets. It will negatively impact on NIM but NII will increase.

The short end of the curve remained relatively flat in May 2021 as it did in 7 previous months while the long end decreased slightly after it declined noticeably in April. But the growth in 1Q21 was quite strong and it remained significantly higher ytd. Thus, 1M yield decreased by 0.3 bps to -0.008%, while 3M yield was flat MoM at 0.003%. 2yr yield decreased by 1.8 bps MoM to 0.14%, while 5yr yield decreased by 4.7 bps MoM to 0.8%.

10yr yield went down by 3.2 bps MoM to 1.59% (it is still -32 bps relative the end of 2019 but +100 bps from its April 2020 low). Generic 30yr yield decreased by 1.4 bps MoM to 2.28%. We didn't expect a significant growth of the yield curve until the end of 2020, at least no growth of the short end. But the situation has changed rapidly in the recent months. We still don't expect any growth of the FF rate in the nearest two years but it seems that the most part of the yield curve could be meaningfully higher. According to current forwards, the yield curve in 2 years will be higher than the current one by 43-94 bps even despite to the substantial growth of the long end. It is expected that only 30yr yield will be 14 bps lower in 2 years.

So, spreads moved down markedly in April and May after three consecutive months of their growth. Spreads were markedly higher vs the end of 2019 but 5yr/3M is still slightly lower than an average level of 2017 year, while 10yr/2yr is already markedly higher. Thus, 5yr/3M spread decreased by 4.7 bps to +0.8% and it is still 17.4 bps lower than an average level of 2017 year, while 10yr-2yr spread is 52 bps higher (as of the end of May 2021). Spread (10yr-2yr) decreased by 1.4 bps MoM to +1.45%.

According to Bankrate.com data, loan yields stopped going down in February 2021 and they were slightly up in March-April but again declined in May despite to the significant growth of the long end ytd. Thus, average 30yr mortgage rate decreased by 3 bps MoM to 3.08% as the end of May 2021, the second consecutive month of decline after relatively strong growth in 1Q21. Average rate decreased by 7 bps MoM to 3.08% and it remains not far from the all-time low. So, the decline of 30yr mortgage yield from the end of 2019 level is already bigger than the decline of 10yr treasury yield. Notwithstanding, it seems that mortgage rates have already reached the bottom of the cycle (+20 bps from December 2020 lows). Average 15yr mortgage rate decreased by 7 bps MoM, to 2.36%. Auto loans rate (new loans, 60 mnth) went down by 1 bps MoM to 4.22%, remaining relatively flat at the all-time low.

Despite to the growth of the long end ytd, deposit rates continued to decline in May on average basis but the rate of decline decelerated significantly in 2021 vs 2020. So, it was the 13th 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 FF rate cut again (near zero probability in coming quarters). Thus, national average cost of 6 month deposits decreased by 1 bps MoM to 0.16%; average 3yr CDs cost declined by 2 bps to 0.37%; average 5yr CDs cost decreased by 2 bps MoM to 0.45% while cost of interest checking accounts increased by 4 MoM to 0.45%, the second consecutive month of growth and it is +25 bps from the all-time low, shown 9 months ago. In turn, average cost of money market accounts decreased by 1 bps MoM to 0.08%, renewing its all-time low again.

Europe

Corporate

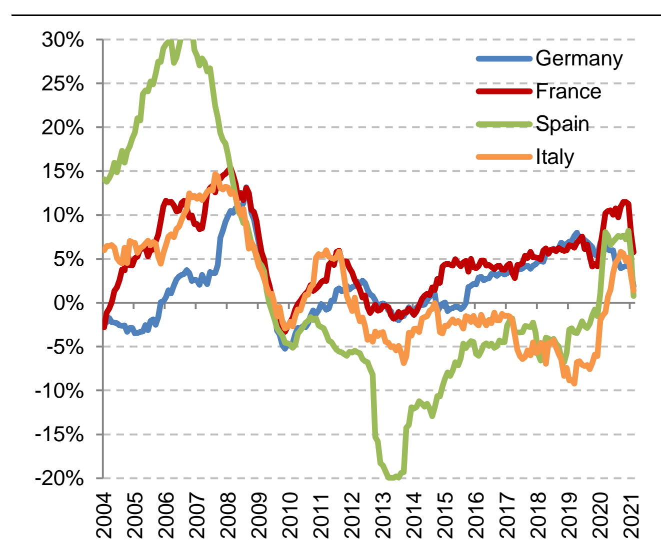
In Europe, the corporate loan growth markedly accelerated in the spring 2020, driven by emergency liquidity needs. But so high growth was unsustainable given the very deep recession in 1H20, the second technical recession in 4Q20-1Q21, still relatively strict restrictions even despite the acceleration of the vaccination campaign and tightening of the lending standards. The EU economy has already accelerated and it will grow relatively fast in coming quarters but it doesn't mean that the corporate loan growth will be strong either (in the first months of recovery). At least, the example of the United States convinces us of the opposite. So, corporate loans decreased by 0.5% MoM in April 2021 after it went up for three consecutive months. On yoy basis, its growth rate decelerated markedly (as a result of the high base of 2Q20 due to high liquidity needs) after relatively flat dynamics in 11 previous months when it was hovering around 5.4% yoy. Thus, loans up to 1 year decreased by 2.4% MoM, or -12% yoy, in April, the weakest growth rate on yoy basis since January 2010. In turn, loans 1-5 yrs decelerated to 3.5% yoy vs +15.2% at the end of 2020. It decreased by 1.9% MoM in April, the biggest monthly decline since the end of 2013. Loans over 5 yrs were +6.2% yoy in April vs +4.5% yoy one year ago, +0.6% MoM. Total corporate loans increased by +1.8% yoy vs +5.1% yoy one year ago. 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 a recession time given an imminent decline of revenues. Notwithstanding, various government guarantee programs helped the majority of companies to remain solvent in a very tough period of time. In 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 an 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 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 spring 2020 lockdowns. Notwithstanding, asset quality of 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 recently due to the acceleration of the world economic growth.

According to April 2021 Euro Area bank lending survey, demand for corporate loans declined again in 1Q21, for the third consecutive quarter after it surged in 1H20 as a result of emergency liquidity needs. In 2Q20, demand reached the highest net balance since the survey was launched in 2003. Net decline for demand was stronger for SMEs. Banks also noted that a negative impact on loan demand had lower demand for fixed investments.

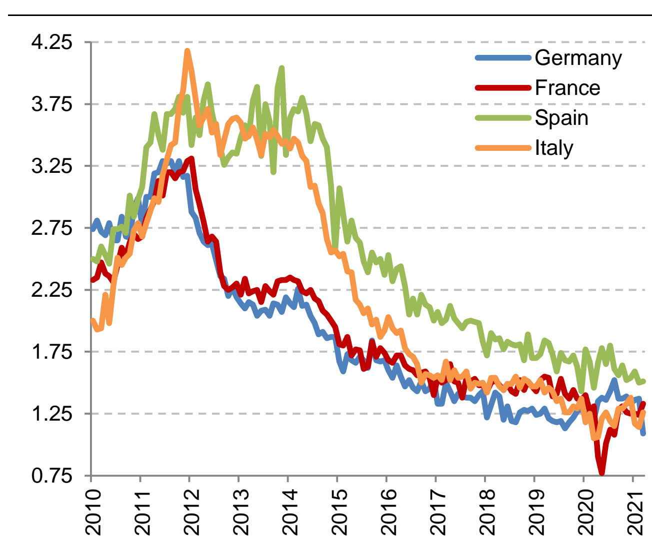
“Banks indicated the use of alternative sources of financing by firms, like internal financing or market-based financing, as a factor restraining loan demand”. But banks expect a net increase in firms’ loan demand in 2Q21, especially in SMEs. Credit standards for corporate loans tightened again in 1Q21 but the tightening was lower than expected 1 quarter ago. “The lower net tightening may be related to the prolongation of fiscal support measures, the continued support from monetary policy and supervisory measures, and the broader improvement in risk sentiment in the first quarter of 2021”. The net tightening moderated for both SMEs and large companies. Also, it was less severe for both ST and LT loans. “The tightening impact of risk perceptions related to the deterioration in the general economic and firm-specific situation became considerably smaller but continued to be the main factor contributing to the tightening of credit standards on loans to firms”. As a result of uncertainty regarding the severity on the economic impact of the third wave of the pandemic and lower than expected vaccination speed, banks expect that standards will continue to be tightened.

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 1.8% yoy at the end of April 2021, the 43th consecutive month of positive growth on yoy basis. In turn, adjusted for sales and securitizations loans increased by 2.7% yoy, the 69th consecutive month of positive yoy growth. Thus, it returned to the end-2019 levels. We expect that it will continue weakening but it should remain positive on yoy basis in the nearest months even despite to the second technical recession over the recent 5 quarters and a gradual closing of the government guarantee programs. But we don’t exclude that it could be negative in the nearest quarters even despite to the acceleration of the economic recovery as a scope for new investments are limited while debt burdens (which were mainly used to build liquidity) markedly increased, especially in SME’s debt. But the period of the negative loan growth shouldn’t be prolonged.

German outstanding corporate loans (unadjusted figures) increased by 1.9% yoy as of the end of April, but -0.8% MoM, vs +6.4% yoy at the end of 2019. French corporate loans outstanding (unadjusted figures) added 5.8% yoy, or +0.1% MoM, as of the end of April, the second month in a row of positive monthly growth. Due to a significant MoM growth in the spring 2020, Spanish loan growth is still positive in yearly terms but it is significantly lower than it was one year ago. And it is quite possible that it will be negative yoy again in the nearest months. Thus, Spanish outstanding corporate loans added just 0.8% yoy, but -1.0% MoM, vs +5.1% yoy one year ago. Italian loan growth turned positive in June 2020 after being negative on yoy basis for more than 8 years. Thus, it added +1.4% yoy, or

-0.6% MoM, in April 2021 vs -1.4% yoy in April 2020.

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. Thus, average EU corporate loan rates (all maturities, new business lending, adjusted for loan sales) tumbled by 9 bps MoM, or -1 bps yoy, to 1.28% in March 2021. From the other hand, back book yields of EU banks continuously decreased on yoy basis since April 2014 and the rate of decline went up in 2Q20 after being relatively flat over the previous year. It declined by 15 bps yoy, or -3 bps MoM, to 1.67% in March.

Dynamics of rates within major European countries was opposite in March with positive growth in France, Italy and Spain, while German and Dutch yields declined. Thus, Spanish yield went up by 1 bps MoM to 1.49%, after it tumbled in February. Notwithstanding, it remained positive on yoy basis, adding 5 bps. Italian one increased by 12 bps MoM to 1.27%. So, it is 21 bps higher on yoy basis. In turn, German corporate rate on new loans tumbled by 28 bps MoM, or -11 bps yoy, to 1.09% in March, the lowest figure in history. French yield on new corporate loans increased by 9 bps MoM to 1.33%, the highest number over last 14 months. And it was even +2 bps yoy, positive yoy growth for the first time over last 20 months. In turn, Dutch yield decreased by 6 bps MoM to 1.36%, the third consecutive month of substantial drop with an overall decline of 42 bps. But it still remained +12 bps yoy at 1.36%. But Dutch corporate yield remains very volatile.

EU back book yield decreased by 3 bps MoM, or -15 bps yoy, to 1.67%. The yield decreased in all major European countries. Thus, German yield declined by 5 bps MoM to 1.7% in March, still remaining -14 bps lower than it was one year ago. French yield decreased by 3 bps MoM to 1.4%, -21 bps yoy. Italian yield went down by 1 bps MoM to 1.76%, or -21 bps yoy. Spanish yield tick down by 3 bps MoM to 1.7% and it is just 3 bps lower on yoy basis, the lowest rate of decline among major European countries. Dutch yield decreased by 5 bps MoM to 1.84%, -10 bps yoy. So, the spread between new and outstanding rates increased by 6 bps to 0.39% in March, the third consecutive month of widening. But it is 14 bps lower than it was one year ago and it is not far from the narrowest spread since the middle of 2008.

Despite negative rates on new corporate deposits, their growth rate remains significant and it has even accelerated in recent months. Thus, EU corporate deposits increased by 11.1% yoy as of the end of April (significant deceleration vs mid-2020 growth rate) driven by overnight deposits and deposits with agreed maturity, where average rate was -0.01% and -0.1% in March, respectively vs 0.0% and -0.07% one year ago (new business). Notwithstanding, growth rates are very different among major EU countries, varying from +3.2% yoy in Italy to +23.3% yoy in Spain.

Consumer

The EU consumer is the main driver of the loan growth again. It decreased slightly on MoM basis in March and April of 2020 but the growth resumed then 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 flat on yoy basis so far. Notwithstanding, it continues accelerating and it seems that it could accelerate further, given the faster economic recovery, the growing sentiment, excess savings and the record high net worth as a result of a sustained growth of property and financial markets. 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 expiration of government support programs as a result of gradual return to normal life could negatively impact on the financial health of some income groups. On the other hand, the unemployment rate still remains relatively stable while consumer confidence increased slightly in recent months. Moreover,

indebtedness of euro area households remains relatively low, stabilized near 58% of GDP. Given very low rate environment, household debt burdens are also near their multi-year lows and it will remain at these levels or only slightly higher in the nearest years because of prolonged negative rate environment. Currently, households' debt interest burden is 40-50% lower for the majority of European countries than it was just before the US mortgage crisis. So, we believe that overall quality of consumer credit portfolio of European banks should remain markedly better in the current crisis vs GFC levels and it should even improve in the coming quarters.

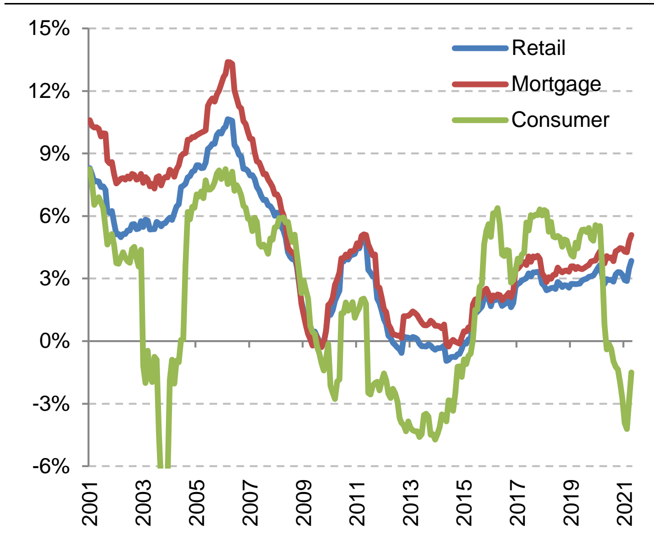
EU loans to households increased by 3.9% yoy, or +0.2% MoM, in April 2021, the third consecutive month of positive monthly growth after it was flat MoM in January. The consumer loan growth remained quite strong so far, demonstrating the fastest yoy growth in a decade, and we no more expect any significant deceleration of consumer loan growth even despite to tighter lending standards and an imminent growth of unemployment in 2021. But loan growth rates continue to differ widely across countries (as well as for corporate loans). Thus, German household loans increased by 4.9% yoy in April, or +0.4% MoM, French retail lending added 6.4% yoy and +0.4% MoM (a marked acceleration vs summer 2020 levels), while household loans in Spain decreased by 0.4% on yoy basis, the 22th month in a row, after non-negative loan growth for 13 consecutive months. Italian consumer loans added just 3.2% yoy in April, or +0.1% MoM.

Consumer lending (excluding mortgage) was the key driver of EU household loan in pre-pandemic time but it was negative on yoy basis for the last 11 months while the growth of mortgage loans continues to accelerate. On MoM basis, consumer credit decreased by 0.7% MoM, or -1.5% yoy, in April. It was the 4th month of decline on MoM basis over last 6. In turn, EU mortgage loans increased by 5.1% yoy as of the end of April, +0.4% on MoM basis. According to April 2021 bank lending survey from the ECB, loan demand for housing loans decreased moderately in 1Q21 after two consecutive months of demand growth. In turn, demand for consumer credit increased in 1Q21 after a decline in 4Q20 but it remained below historical averages. The key drivers of weaker demand were the reacceleration of the pandemic and, as a result, "lower consumer confidence and decreased spending on durable goods". Notwithstanding, banks expect that demand for both consumer credit and mortgage loans will increase in 1Q21 even despite lending standards remain relatively tight. Thus, banks tightened standards again for consumer loans while standards for mortgage loans eased slightly for the first time since 2019.

Consumer credit loans remained quite volatile but its decline during the pandemic and the recession looks quite logic given its risky nature. Consumer credit grew by more than 5% in mid-2019 but it is already -1.5% yoy. The most significant decline of growth rates was demonstrated by Netherlands, where consumer loans tumbled by 24.8% yoy, or -1.5% MoM. It also remains negative on ytd basis, -1.9% as of the end of April 2021.

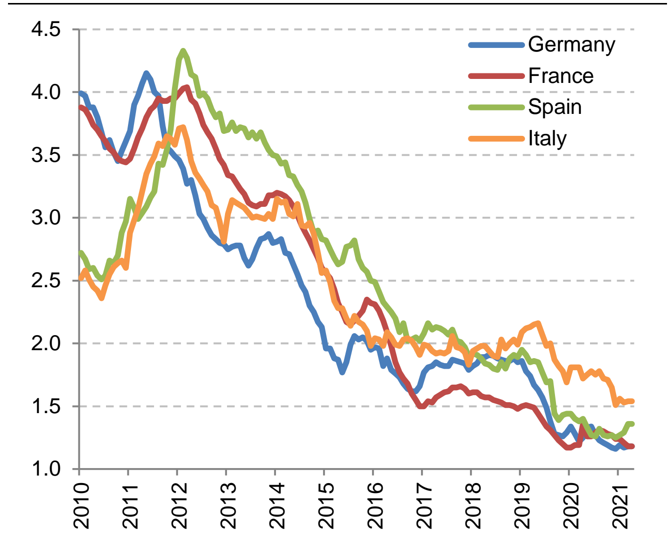
As of mortgage lending standards, it was eased slightly in 1Q21 after tightening for the four quarters in a row. "The net easing of credit standards for housing loans was supported by competition from other banks and non-banks. Furthermore, on balance, banks did not report any major additional concerns compared with the significant tightening impact of risk perceptions related to the economic outlook in the second and third quarters of 2020". "Across the largest euro area countries, overall terms and conditions on housing loans eased in Spain and France, while they did not change in Germany and Italy. In Spain, banks indicated both competitive pressure and favourable bank funding cost as factors contributing to the easing".

Chart 27. EU Consumer Loan Growth, YoY



Source: Bloomberg

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



Source: Bloomberg

Average EU rate on new mortgage loans decreased by 1 bps MoM basis to 1.31% in March 2021, the second consecutive month of decline. So, it is still 6 bps lower than it was one year ago. It was hovering around 1.82-1.83% over 8 months from July 2018 to February 2019 but it declined by 50 bps since then because the key benchmark yields for mortgage rates declined markedly ytd, except for the short end which is relatively flat vs the end of 2019. 10yr generic yield increased by 2.4 bps MoM to -0.18% as of the end of May 2021, the second month in a row of growth. So, it remained 39 bps higher ytd, almost in-line with the end of 2019 level and more than 50 bps higher than its all-time low, recorded in March 2020. In turn, 30yr yield continued its growth either, adding 2 bps MoM to 0.38% at the end of May. Notwithstanding the most of the yield curve still remains deeply below 0% at the moment (but not the entire curve as it was earlier). In March, German rates on new mortgage loans increased by 1 bps MoM to 1.18%, -4 bps yoy. In turn, Italian mortgage rate went up by 7 bps MoM to 1.36% but it is still 2 bps lower than it was one year ago. French yield went down by 3 bps MoM at 1.18% in March, the second consecutive month of decline after it was flat in January. Notwithstanding, it is still just -1 bps yoy. Spanish mortgage rate increased by 1 bps MoM to 1.54% but it is 21 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, -16 bps yoy for all Eurozone mortgage loans. On a month-over-month basis, it decreased by 2 bps to 1.76%, after an unexpected growth by 1 bps MoM in February following 11 months in a row of decline. The rate of decline increased from 4.5 years low of -12 bps yoy which was shown in May-July of 2019 because of a significant drop of benchmark rates, which, however, started to grow again a few months ago. Back book yields went down on MoM basis in all major European economies except for Spain where it was flat MoM in March.

As for other consumer loans, EU new business rates tumbled by 12 bps MoM, or -35 bps yoy, to 5.1 % in March. Dynamics wasn't uniform across major European economies. Thus, German yield decreased by 38 bps MoM, or -54 bps yoy, to 5.27% in March. In turn, French rate went up by 5 bps MoM to 3.51%, still -20 bps yoy. Spanish rate went up by 19 bps MoM to 6.54%. But, it is still -49 bps on yoy basis, remaining quite volatile. Italian consumer yield decreased by 12 bps MoM, or -15 bps yoy, to 6.34% in March.

Average European new consumer deposits rate (with agreed maturity) decreased by 3 bps MoM to 0.25% in March, after two months in a row of growth. Notwithstanding, it is still lower on yoy basis, but just -9 bps yoy, much slower rate of decline than a loan yields drop. So, cost of outstanding deposits (with agreed maturity) also decreased by 3 bps MoM to

1.15% in March. But it remained relatively flat over last 11 months, being in range of 1.15%-1.19%. Total cost of deposits declined by 1 bps MoM to 0.19% after it was flat for four months in a row. On yoy basis, it is just 4 bps lower than it was one year ago. So, spread between total loans yield and cost of total deposits decreased by 14 bps yoy, or -2 bps MoM, to 1.83% in March, renewing its all-time low.

The consumer deposits growth remains healthy, adding 7.3% yoy in April 2021, a slight acceleration vs +5.3% at the end of January 2020 and still not far from the fastest growth since 2H09. The growth rates of consumer deposits are between 5.7%-9.2% yoy for all major European countries despite increasingly clear threats by banks to start shuffling off the burden of negative rates on to consumers. Loans to deposits ratio declined by 0.5%, or -5.1% yoy on absolute basis, to just 93.6% as of the end of April, the new all-time low.

Overall Macro

The European economy is starting to accelerate after quite difficult five previous quarters when there were two technical recessions. The acceleration of the vaccination campaign, accompanied by a gradual reopening of the economy, and new fiscal stimulus will be the key drivers of the recovery in the near term. Uncertainty continues declining but the ECB remains cautious. Thus, according to ECB's April introductory statement, "while the recovery in global demand and the sizeable fiscal stimulus are supporting global and euro area activity, the near-term economic outlook remains clouded by uncertainty about the resurgence of the pandemic and the roll-out of vaccination campaigns. Persistently high rates of coronavirus (COVID-19) infection and the associated extension and tightening of containment measures continue to constrain economic activity in the short term". It's hard to disagree with the point, especially taking into account that the majority of restrictions remained in place in April 2021. So, ECB's GDP growth projections were almost unchanged in March (vs December forecasts) as "the ongoing vaccination campaigns, together with the gradual relaxation of containment measures – barring any further adverse developments related to the pandemic – underpin the expectation of a firm rebound in economic activity in the course of 2021". And it is quite possible that projections will remain unchanged at the June meeting as well. But 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 sector is still suffering 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 decreased in 1Q21 as a result of restrictions because of the second wave of the pandemic. Thus, the EU GDP decreased by 0.6% qoq, or -1.8% yoy, in 1Q21 vs 4Q20 growth rate of -0.7% qoq, or -4.9% yoy, and 1Q20 growth rate of -3.8% qoq, or -3.3% yoy. On yoy basis, the EU GDP growth was negative in each of the last 5 quarter but the situation will change in 2Q21, given the low base of 2Q20 because of strict lockdowns during the first wave of the pandemic. So, it is the second technical recession over 5 recent quarters. German GDP decreased by 1.7% qoq, or -3% yoy in 1Q21, vs 4Q20 growth rate of +0.5% qoq, but -4.3% yoy, and 1Q20 growth rate of -2.3% qoq, or 1.8% yoy. French GDP increased by 0.4% qoq, or +1.5% yoy, in 1Q21 vs decline of 1.4% qoq, or -4.8% yoy, in 4Q20 and 1Q20 decline rate of -5.8% qoq, or -5.5% yoy. Italian GDP went down by 0.4% qoq, or -1.8% yoy, vs decline of 1.8% qoq, or -6.6% yoy, in 4Q20 and 1Q20 growth rate of -5.5% qoq, or -5.8% yoy. Spanish GDP decreased by 0.5% qoq, or -4.3% yoy, vs 0.0% qoq but -8.9% yoy in 4Q20 and 1Q20 decline rate of -5.4% qoq, or -5.5% yoy. According to Bloomberg compiled estimates, 2Q21 GDP growth rate will be in the range of +0.4% qoq in France to +1.8% qoq in Germany. GDP projections are slightly higher than it was 3 quarter ago but it is expected that the EU economy will return to 2019

level only in the middle of 2022, still remaining more than 5% below its pre-pandemic level. Thus, according to Bloomberg consensus estimates compiled in May 2021, the EU GDP will increase by 4.1% yoy in 2021 (vs +4.3% yoy in March), by 4.1% 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 May 2021 were roughly in-line with expectations as it was in April. Positive surprises were shown in retail sales and PMI figures while industrial production was lower than expected. Given recent PMI figures and gradually removed restrictions, we expect that the economic recovery will continue accelerating, especially taking into account the faster vaccination in May than it was in April and March. Notwithstanding, economic surprise indices were relatively flat in May as well as the majority of economic projections. Thus, Citi's economic surprise index went down by 10 pts MoM to 155 pts as of the end of May, -34 pts ytd. In turn, Bloomberg surprise index increased by 0.02 pts to 0.93, +0.44 pts ytd and near the highest level over last 20 years.

Composite PMI (preliminary figure), which is usually well correlated with the GDP growth (but relation was less tight than usually in 2020), slightly beat expectations in May 2021 after positive surprises in April and March. So, it has already well exceeded 50 pts and it is markedly higher than an average level of 2018, pointing to an acceleration of the recovery in recent months. Composite PMI increased by 3.1 pts MoM to 56.9 pts, being noticeably higher than consensus of 55.1 pts. The key driver of composite PMI surprise was markedly better dynamics of services PMI as a result of gradual reopening. However, the manufacturing component also remained exceptionally strong even despite to ongoing restrictions in some countries. Thus, manufacturing PMI decreased by 0.1 pts MoM to 62.8 pts in May vs consensus of 62.5 pts. It was +13.6 pts relative its pre-pandemic level. In turn, services PMI increased by 4.6 pts MoM to 55.1 pts vs consensus of 52.5 pts. So, it is already 2.5 pts higher than it was in February 2020. 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 slightly in May as a result of an effect of supply-chain disruptions. Thus, German manufacturing PMI decreased by 2.2 pts MoM to 64 pts in May vs consensus of 65.9 pts, following a significant growth in 1Q21. It is still significantly higher than it was in pre-pandemic times but it is quite possible that it will continue to go down from its extremely high levels in the near future. In turn, German services PMI increased by 2.9 pts MoM to 52.8 pts vs estimate of 52.0 pts, +0.3 pts from February 2020. Thus, composite PMI increased by 0.4 pts MoM to 56.2 pts vs consensus of 57.1 pts, +5.5 pts vs its pre-pandemic level. In turn, French composite PMI skyrocketed by 5.4 pts MoM to 57.0 pts in May vs consensus of 53.7 pts, the third consecutive months of a marked growth. So, it is already 5 pts higher than it was in February 2020. Positive PMI dynamics was driven by services component. Thus, services PMI increased by 6.3 pts MoM to 56.6 pts vs consensus of 53.0 pts, being +4.1 pts higher than February 2020 level, but remaining -0.7 pts from its local high shown in July 2020. In turn, manufacturing PMI went up by 0.3 pts MoM to 59.2 pts in May vs consensus of 58.5 pts. Despite to better soft manufacturing data in recent months, industrial production was markedly weaker than expected in the EU in April 2021 while March figure was revised down. Thus, IP increased by 0.1% MoM vs consensus of 0.8% MoM. However, it is +10.9% yoy as a result of the low base of March 2020 but it is still -1.5% comparing to its pre-pandemic level. Given recent PMI figures, it seems that IP will continue its recovery and it could even accelerate substantially in coming months, even despite "weaker corporate balance sheets and uncertainty about the economic outlook are still weighing on business investment". So, estimates slightly improved in May vs April projections, in spite of relatively weak IP figures in two recent months. Thus, according to estimates compiled by Bloomberg, it is expected that IP will increase by 8.8% yoy in 2021, by 3.8% yoy in 2022 and by 1.9% yoy in 2023 vs +8.7% yoy/+3.7% yoy/+1.8% yoy as it was estimated in April

survey.

EU consumer sentiment started to improve in the beginning of 2021 and it continues improving due to vaccination campaigns, more fiscal stimulus, gradual reopening of the economy and the faster economic recovery. Uncertainty about unemployment 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 May Bloomberg survey, private consumption will increase by 3.1% yoy in 2021, 5.1% yoy in 2022 and by 2.0% yoy in 2023 (vs 2.9%/+4.7%/+1.9% estimated growth rates in April). Unemployment could increase slightly in 2021 but if this happens, the growth will be insignificant. In any case, the growth rate of unemployment will be much lower than it was in the US in 1H20. Unemployment rate declined by 10 bps MoM to 8.0% in April in-line with the consensus, the lowest figure over last 11 months but it is still 50 bps higher in contrast to its pre-COVID levels. So, May consensus estimates of unemployment rates for 2021, 2022 and 2023 years, compiled by Bloomberg, were revised down again, to 8.4%/8.2%/7.7% vs February estimates of 8.9%/8.5%/7.9%. ECB's March unemployment projections were less pessimistic, being at 8.6%/8.1%/7.6% for 21/22/23 years, respectively. In turn, retail sales increased by 2.7% MoM in March vs consensus estimate of +1.6% after a significant growth in February. Moreover, initial February estimate of +3.0% MoM was revised up to +4.2% MoM. As a result of the low base of March 2020, it was +12.0% yoy. So, May consumer confidence improved markedly, even exceeding pre-COVID levels. Thus, it increased by 3 pts MoM to -5.1 pts in May vs consensus of -6.5 pts, +16.8 pts from April 2020 or +1.3 pts from pre-pandemic levels. It was the highest consumer confidence over the last 2.5 years.

Rates

The monetary policy was left unchanged at the April ECB meeting but the key question is whether the policy will remain unchanged at the upcoming meeting, which will be held on June 10. So, rates remained at the current levels and it was noted there is no chance of a change in the situation in the near future. It was again noted that a total envelope and the duration of the PEPP remained unchanged – "the Governing Council will continue to conduct net asset purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1,850 billion until at least the end of March 2022 and, in any case, until it judges that the coronavirus crisis phase is over". Notwithstanding, it was emphasized again but already in the press release that purchases under the PEPP in the current quarter to be conducted at a significantly higher pace than in 1Q21. Although it is something new for the ECB's forward guidance, it wasn't unexpected as the absence of this statement could be interpreted as a hawkish signal which is currently undesirable given a significant growth of the long end in the recent months. On the other hand, it is an additional instrument for communication further path of the monetary policy with the market participants. It was also noted that monthly purchases is more important indicator vs weekly one. However, ECB's President Christine Lagarde emphasized at the meeting that there is no tapering on the horizon and any discussion about tightening is premature. At least, it was noted that near-term risks are still tilted to the downside and "preserving favourable financing conditions over the pandemic period remains essential to reduce uncertainty and bolster confidence, thereby underpinning economic activity and safeguarding medium-term price stability". Notwithstanding, medium-term risks remain more balanced. 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". Recall, that answering the question about the yield curve control at the March meeting, Mrs. Lagarde emphasized again that there was no

reference to any kind of yield curve control. As for EUR currency, it was noted that there were no any particular target for exchange rate of the EUR currency, but it monitored carefully as it could impact on economic activity and the outlook for price stability in the euro area. The key near-term aim of the ECB is to prevent tightening of the financial conditions which deteriorated recently because of the significant yields growth. Given noticeable yields growth and spreads widening in the recent months, it is quite possible that the PEPP purchases will be conducted at pace of 2Q21 in 3Q21 either which is significantly higher that 1Q21 one. But we expect that it will be announced later (in 3Q21) that the PEPP purchases will be reduced to 1Q21 volume in 4Q21. So, it will be some sort of tapering but the monetary policy will remain accommodative for longer as well as negative rate environment will remain in the mid-term.

According to March ECB's introductory statement, "while the overall economic situation is expected to improve over 2021, there remains uncertainty surrounding the near-term economic outlook, relating in particular to the dynamics of the pandemic and the speed of vaccination campaigns". So, "incoming economic data, surveys and high-frequency indicators point to continued economic weakness in the first quarter of 2021 driven by the persistence of the pandemic and the associated containment measures. As a result, real GDP is likely to contract again in the first quarter of the year". Notwithstanding, March GDP growth projections were almost unchanged vs December figures (despite containment measures last moderately longer than it was expected given the vaccination campaign started two months ago). Thus, it is implied that the EU GDP will increase by 4.0% yoy in 2021 (vs +3.9% yoy in December), 4.1% yoy in 2022 (vs +4.2% yoy 1 qtr ago) and by 2.1% yoy in 2023 (in-line with December forecasts). Moreover, unemployment projections were even improved to 8.6%/8.1%/7.6% for 2021/2022/2023 years, respectively (from 9.3%/8.2%/7.5% in December). From the other hand, near-term inflation forecast increased meaningfully because of temporary factors, while projections for further years were little changed. Thus, HICP inflation projections increased from 1.0%/1.1%/1.4% for 2021/2022/2023 years in December to 1.5%/1.2%/1.4% now. We expect that projections will be upgraded at June meeting but revisions will be minor anyway.

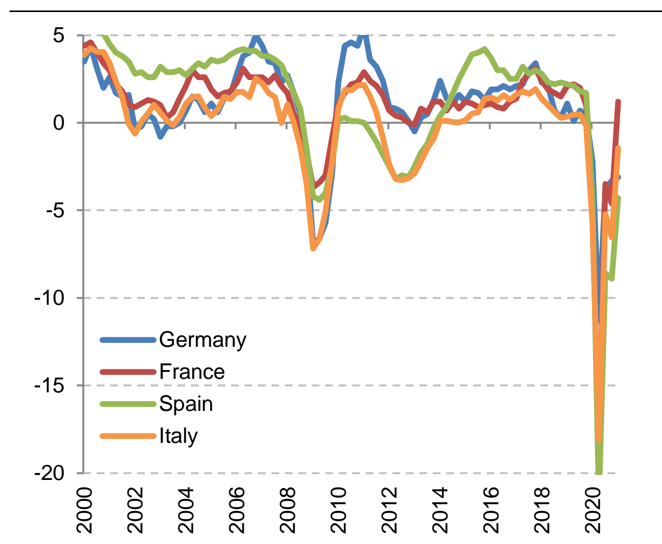
The ECB continues to preserve favourable financing conditions and being as flexible as it can, but it still has a negative impact on banks' revenues and profits, even taking into account a positive effect of TLTRO, favourable conditions of which could be extended even further despite TLTRO conditions were improved a number of months ago, especially in case of the deterioration of economic conditions. So, banks will continue to suffer from a negative rate environment and a relatively muted economic growth, but it seems that the light at the end of the tunnel has finally appeared at this matter. However, the outlook for banking NII/NIM remains relatively weak even despite banking shares outperformance in recent months as a result of more positive view on both LT rates and the economic recovery. We expect that NII/NIM forecasts will begin to improve in the very near future. At least, the long end has skyrocketed recently. On the other hand, the overall yield curve is still much lower than it was at the end of 2019. So, NII outlook stopped worsening recently even despite key rates will remain negative for longer (but not as longer as it was expected few months ago). Thus, a median NII decline of EU banks was 5% yoy despite to significant earning assets growth during the pandemic as NIM continues decreasing even despite more favourable TLTRO terms. Median NIM decreased by 4.3 bps qoq, or -17.1 bps yoy, to 1.51% in 1Q21, the lowest figure since 1Q13. On the other hand, a median growth of NII FY21/NII FY22 estimates of EU banks was 0.0% both ytd and qoq. Median NIM FY21 estimate decreased by 7.6 bps ytd but it was flat MoM at 1.43% in May while NIM FY22 declined by 3.2 bps ytd, but +3.4 bps MoM, to 1.45%, implying even positive yoy dynamics in 2022 due to the higher long end and improved rates outlook.

Key forward rates slightly increased in May after a small growth in April. Thus, 3M Euribor

(Dec 2021) ticked up by 0.5 bps MoM to -0.53% (as of the end of May), or -26 bps vs the end of 2019, while 3M Euribor (Dec 2022) went up by 1.5 bps MoM to -0.45% and it is -32 bps vs the end of 2019. It is implied that the rate will turn positive only in 2H25.

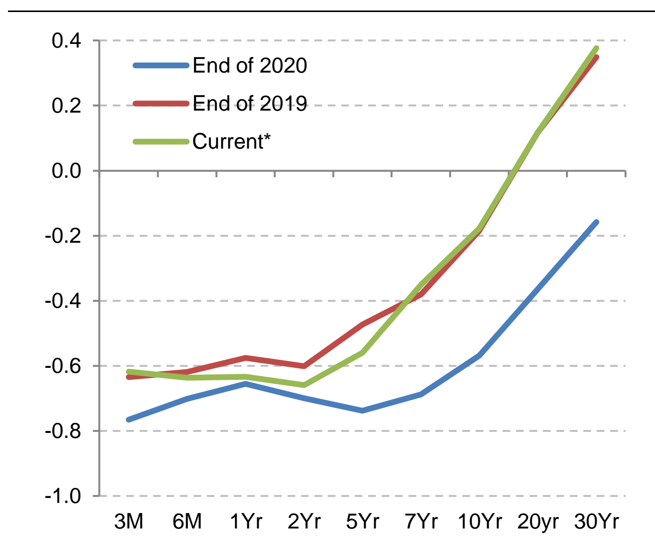
The direction of dynamics of generic yields was almost uniform in May 2021 with a slight growth of all key yields except for 6M and 1yr figures. Thus, 3M yield increased by 0.6 bps MoM to -0.62%. 6M yield went down by 0.2 bps to -0.64%. 1yr generic yield decreased by 2.3 bps MoM to -0.63%, while 2yr yield ticked up by 0.9 bps MoM to -0.66%. 5yr yield went up by 1.7 bps to -0.56%, while 10yr yield increased by 2.4 bps to -0.18%. Overall, the yield curve remains slightly inverted in the middle part but it is almost back to the end of 2019 levels. Spreads increased slightly in May after a small growth in April. Thus, spread between 10yr yield and 1yr yield went up by 4.7 bps MoM to 0.46%, while spread between 5yr and 3M yields increased by 1.1 bps MoM to 0.06%. Both spreads are much higher than the April 2020 trough 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

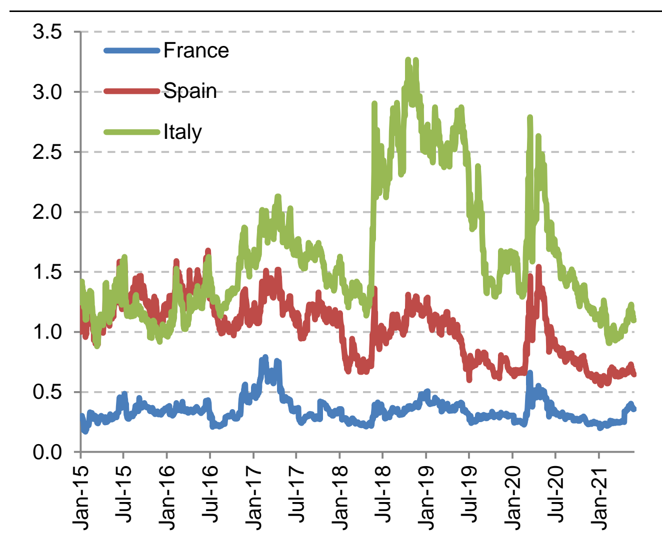
Chart 30. EU Yield Curves, %



*as of the end of May 2021

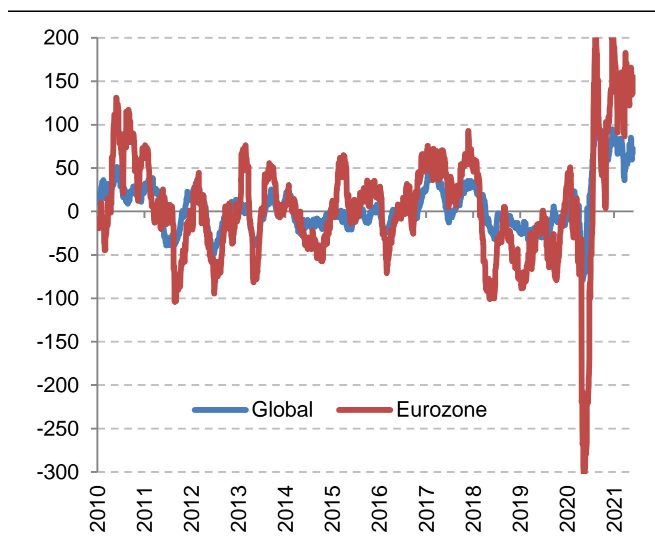
Source: Bloomberg

Chart 31. EU Countries Sov. Spreads vs Germany, 10Yr, %



Source: Bloomberg

Chart 32. Citi Economic Surprise Indexes, pts



Source: Bloomberg

THEME OF THE MONTH

EU Banks 1Q21 Overview

European banks reported markedly better results in 1Q21 as they did in three previous quarters after clearly weak figures in 1Q20. Both revenue and net income demonstrated positive surprises. Thus, 30 out of 35 banks from SX7P index for which estimates were available reported better revenue figures vs 22 out of 33 in 4Q20. Net income was also better than expected with 25 out of 27 banks with positive surprises vs 24 out of 29 in 4Q20. EPS was higher for all 30 banks with available estimates in 1Q21 vs 20 out of 25 banks in 3Q20. The key driver of better results was lower provisions due to a better economic outlook. In turn, NII/NIM figures were weak again and it will remain a headwind in coming quarters even despite to the substantial growth of the long end in recent months. Notwithstanding, earnings momentum continues improving after significant worsening in 1H20. Thus, a median growth of operating profit of SX7P index members was +20% in 1Q21 (flat vs 4Q19) vs -37% yoy in 4Q20. A median growth of revenue was 5.6% yoy in 1Q21 (even +1% vs 4Q19) after it decreased by 4.4% yoy in 4Q20 and slid down by 1.4% in 3Q20. In turn, a median revenue surprise was +3.8% better than a median quarterly surprise over the last 10 years and higher than +2.2% in 4Q20. Revenue growth was driven by non-II which skyrocketed by 13.1% in 1Q21 vs -2.6% yoy in 4Q20 and +1.4% yoy in 3Q20. Due to better earnings season and overall optimism as a result of the vaccination campaign and better macro data, market perception of the results was positive. Thus, median 1-day performance of SX7P index members around the earnings date was +0.3% vs 10yr average of +0.2% and 4Q20 figure of +0.6%. So, overall performance since the start of the earnings season was overwhelming with a growth of SX7P index by 11% (from April 20, 2021 till the end of May 2021), while STOXX 600 index increased only by 3% over the same period.

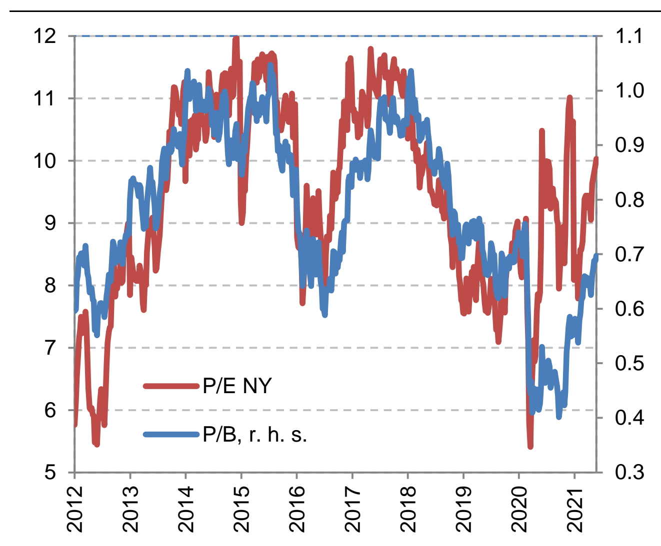
A median growth of EU banks' net income (SX7P index members) was 74% yoy in 1Q21 after dropping by 26% yoy in 4Q20 and by 13% yoy in 3Q20. Of course, such an impressive growth is primarily due to the effect of a low base. Thus, 1Q21 net income was 22% lower than 4Q19 one. And it seems that banks will manage to reach a pre-pandemic level not earlier than in 2H22 given the negative rate environment in the foreseeable future. At least, current estimates imply that FY22 net income estimates are 7% lower than FY19 net income actuals (a median decline of SX7P index) but +49% vs FY20 NI. The key driver of NI growth was provisions which decreased by 52% qoq. So, median ROE of EU banks slightly increased on qoq basis, and it still remained weak, +56 bps qoq but -198 bps yoy, just 4.7%, not far from the lowest figure over the last 30 quarters. Due to a positive EPS surprise and improved economic expectations, estimates have increased meaningfully in recent weeks. Thus, a median growth of FY21 NI was +10.7% ytd (but -21.4% since the beginning of 2020), implying growth of 42% yoy. As of FY22 NI estimates, a median growth was +3.7% ytd (but -11% since the beginning of 2020), implying growth of 15% yoy. On the other hand, revenue estimates added 1.8% ytd for FY21 revenue but still -5.3% since the beginning of 2020.

Revenue environment remains very challenging for European banks even despite to markedly better momentum due to gradual reopening of the economy and the accelerating recovery. But we don't expect that revenue environment will be much better in the rest of 2021 because of ongoing negative rate environment. But non-II should remain strong. Thus, a median NII decline of EU banks was 5% yoy despite significant earning assets growth during the pandemic as NIM continues decreasing even despite to more favourable TLTRO terms. Median NIM decreased by 4.3 bps qoq, or -17.1 bps yoy, to 1.51% in 1Q21, the lowest figure since 1Q13. Unsurprisingly, 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 decline of NII FY21 estimates of EU banks was 0.0% ytd (-7.6% since the beginning of 2020), while FY22 estimates declined by 0.1% ytd (-8.6% since the beginning of 2020). Median NIM FY21 estimate increased by 7.6 bps ytd to 1.43%, while NIM FY22 decreased by 3.2 bps ytd to 1.45%.

A median growth of non-interest revenue was 13.2% yoy, or +8.2% qoq, in 1Q21 after a decline by 2.6% yoy in 4Q20. Although the key reason of significant growth was relatively low base 1Q20 figures because of the first wave of the pandemic and first lockdowns, it was clearly strong fee income in 1Q21, which was even +7.4% higher than 4Q19 one. Notwithstanding, non-II estimates remain relatively flat ytd despite to the acceleration of the recovery and gradual reopening of the economy.

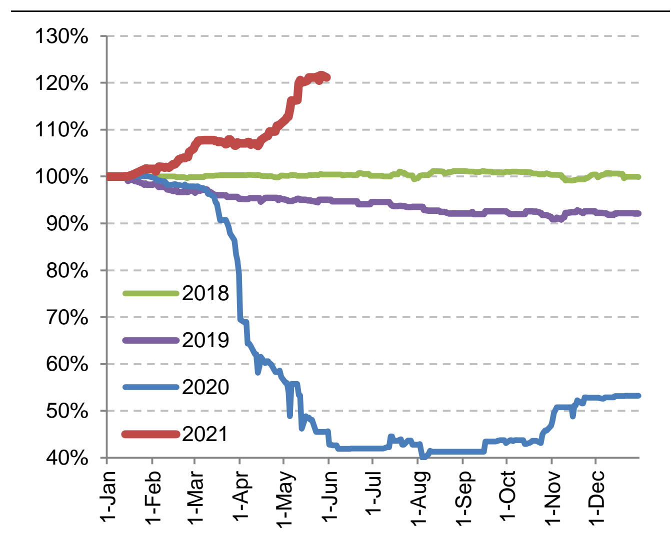
Chart 33. EU Banks. Multipliers, Median*



*SX7P index

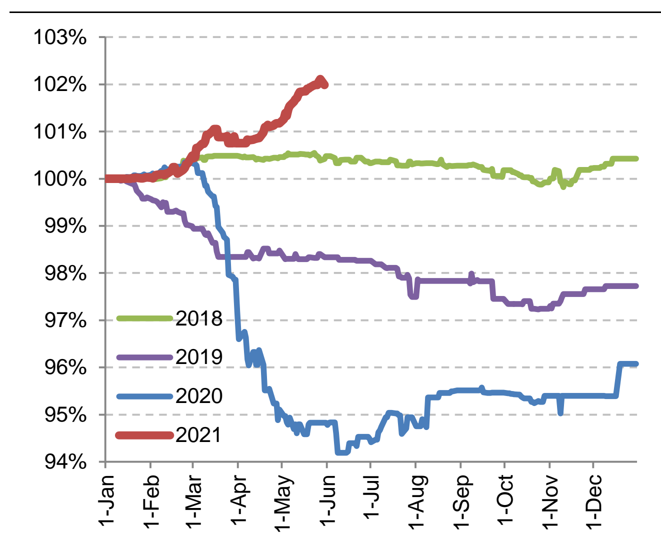
Source: Bloomberg

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



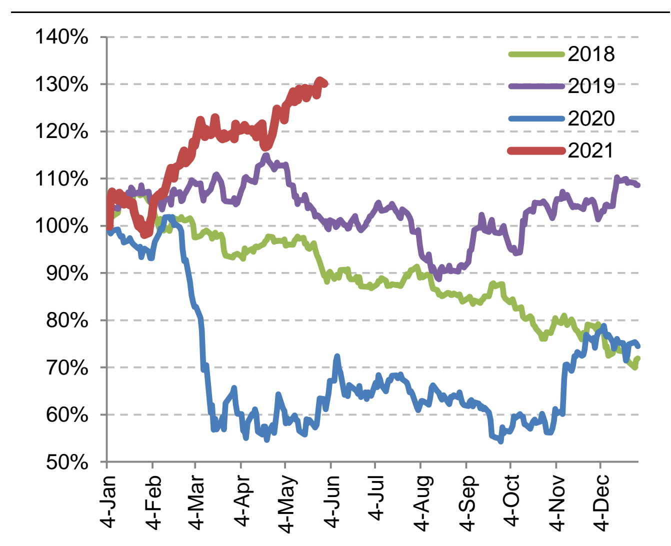
Source: Bloomberg

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



Source: Bloomberg

Chart 36. SX7P Index. Price dynamics



Source: Bloomberg

A median decline of OpEx was 1.1% yoy in 1Q21 vs a growth of +0.2% yoy in 4Q20. It was the third quarter of OpEx decline over last 4. Despite higher expenses related to the pandemic, such as remote work expenses, OpEx continue to go down as a result of relatively weak revenues and cost cutting initiatives. Operating leverage was positive again due to substantial yoy revenue growth after it was negative in 4Q20 following two quarters

in a row of positive figures. It was +4.2% in 1Q21 (vs -6% in 4Q20). So, efficiency ratio tumbled by 924 bps qoq in absolute terms to 60.6%. Given challenging revenue environment, a number of banks have announced new cost cutting programs. Moreover, OpEx optimization could be the key driver of the bottom line in case of M&A wave which is quite possible given recent trends and ECB's position on this issue.

Credit quality of European banks remained quite strong so far, despite an unprecedented decline of the EU economy in 1H20. So, provisions decreased significantly on yoy basis in the last three quarters after a meaningful reserve build in 1H20. Thus, a median decline of provisions was 66% yoy, or -53% qoq, after 7 consecutive quarters of positive yoy growth. Due to better economic perspectives and positive provisions surprises in recent quarters, provision expense estimates of SX7P index members continue going down but the decline for FY22 provisions wasn't significant. Thus, provision estimates decreased by 24.4%/8.4% ytd for 2021 and 2022 years, respectively. Median NPLs ratio decreased by just 2.8 bps qoq, or -5.4 bps yoy, to 2.7% in 1Q21 but it is quite low vs 10yr average. So, coverage ratio increased by 10.3% yoy, or +1.3% qoq, in absolute terms to 69.6%, the highest level over more than a decade. Further dynamics of provisions will depend on many factors, but it is quite possible that we will see a gradual decline of provision expenses in the near term given high reserve build in 1H20 and better than feared economic growth. Actual losses will inevitably increase after the end of fiscal programs but we don't expect that it will be a problem for the majority of EU banks.

Capital of European banks continues strengthening due to ongoing dividend ban (the ECB has only partially lifted the restrictions), no significant growth of NPLs and positive net income of the majority of banks. Thus, median CET1 ratio of SX7P index members increased by 123 bps yoy, but flat qoq, to 14.9% in 1Q21. It seems that dividend ban will be removed completely in the near future. So, dividend estimates increased meaningfully in the recent months. Thus, a median growth of DPS estimates was 20.2%/+6.7% ytd for 2021/2022 years, respectively. Despite a substantial growth of EU banking shares ytd, dividend yields still remain relatively high with median figures of 3.6% and 4.5% for FY21 and FY22, respectively, being markedly higher than US peers yields.

As a result of better earnings season and better earnings visibility due to the ongoing vaccination campaign and the expected GDP growth acceleration, we anticipate that a growth of EU banks could continue in the near future but we no more expect substantial outperformance vs the broad market given more rich valuations. EU banks are no longer traded with a discount to historical averages while a discount to US peers is just slightly wider than it was historically. Thus, a premium to historical averages is 10% (+0.6 std at the moment from mean P/E NY of SX7P index members, sample from 2010 to the present) but a discount to US peers (on median P/E NY of BKX index vs SX7P index) is 23% as of May 28, 2021 vs average since 2010 of 20%, or -0.2 std. On the other hand, due to meaningful EPS upgrades, EU banks still don't look very expensive either even after a 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 31/05/21, $	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	160.1	153.1	-4.4%	160.6	89.1	64.9	128.6	1.1%	1.2%	1.2%	21.8	17.6	15.0	5.3	N. A.	25.5	29.8	34.6	10.1	13.5
JP Morgan Chase	JPM	164.2	165.8	1.0%	165.7	90.8	62.3	497.2	2.2%	2.4%	2.6%	12.6	13.7	12.8	2.0	2.5	15.9	14.1	14.0	6.0	13.1
PNC Financial	PNC	194.7	194.3	-0.2%	203.8	97.1	57.0	82.7	2.4%	2.5%	2.8%	15.8	15.0	13.3	1.6	2.0	10.4	10.2	11.2	9.6	12.2
Bank of America	BAC	42.4	42.9	1.3%	43.3	22.4	59.7	363.3	1.8%	2.0%	2.3%	14.1	13.7	12.2	1.5	2.0	10.4	10.1	10.3	6.5	11.9
Citigroup	C	78.7	84.7	7.6%	79.3	40.5	67.2	162.7	2.7%	2.8%	3.1%	8.9	9.6	8.4	0.9	1.0	10.2	8.7	8.8	6.9	11.7
Truist Financial Corp	TFC	61.8	64.9	5.1%	62.7	33.5	57.8	83.1	3.0%	3.1%	3.3%	13.9	12.9	11.2	1.4	2.5	9.5	10.0	11.1	7.3	10.0
Goldman Sachs	GS	372.0	387.4	4.1%	377.0	185.5	62.8	131.8	1.5%	1.7%	1.8%	8.5	10.5	9.8	1.4	1.5	17.8	13.1	13.0	6.9	14.7
Bank of NY Mellon	BK	52.1	52.2	0.3%	52.8	32.7	61.5	45.6	2.5%	2.7%	3.2%	12.9	11.5	9.9	1.1	2.3	8.7	9.1	10.0	4.6	13.4
Comerica	CMA	78.5	76.9	-2.1%	79.8	33.0	59.1	11.0	3.5%	3.5%	3.5%	11.5	14.9	13.8	1.4	1.5	12.0	9.1	9.1	8.0	10.3
Citizens Financial	CFG	49.9	51.5	3.2%	51.1	22.5	59.2	21.3	3.2%	3.3%	3.4%	10.7	11.7	11.2	1.0	1.6	9.3	7.9	8.2	7.7	10.0
Regions Financial	RF	23.4	23.2	-0.9%	23.5	9.8	62.3	22.5	2.8%	2.9%	3.1%	11.0	11.8	11.5	1.4	2.0	12.1	10.5	11.3	8.0	9.8
Discover Financial	DFS	117.3	117.4	0.1%	121.4	45.4	62.0	35.8	1.5%	1.6%	1.7%	9.0	10.0	9.2	3.2	3.3	34.4	26.3	27.5	8.4	13.1
M&T Bank	MTB	160.7	166.8	3.8%	168.3	88.5	51.8	20.7	2.8%	2.8%	2.9%	12.4	12.9	11.8	1.4	2.0	10.4	9.4	9.7	7.5	10.0
Fifth Third Bancorp	FITB	42.1	42.8	1.6%	43.1	17.3	59.1	29.7	2.6%	2.8%	3.0%	12.5	13.0	11.8	1.5	1.9	11.4	10.5	11.9	8.3	10.3
Huntington Bancorp	HBAN	15.9	17.5	10.2%	16.9	8.0	54.4	16.1	3.8%	4.0%	4.2%	11.0	11.5	10.9	1.5	1.8	12.3	11.9	13.4	7.1	10.0
Northern Trust	NTRS	121.2	114.9	-5.2%	123.0	72.7	65.6	25.2	2.4%	2.5%	2.7%	17.8	16.4	13.9	2.2	2.4	13.0	13.7	14.9	6.4	13.4
People's United	PBCT	18.9	18.7	-1.4%	19.6	9.7	54.6	8.1	3.8%	3.9%	4.3%	13.9	14.4	13.6	1.1	1.8	7.5	7.0	7.0	7.5	10.5
Synchrony Financial	SYF	47.4	50.6	6.7%	48.2	20.2	65.2	27.6	1.9%	2.1%	2.3%	8.5	8.8	8.0	2.2	2.6	24.7	21.7	22.0	10.4	15.9
KeyCorp	KEY	23.0	22.8	-1.0%	23.6	10.9	57.8	22.4	3.3%	3.5%	3.5%	10.7	11.7	10.8	1.4	1.7	12.8	10.9	11.4	7.9	9.7
State Street Corp	STT	87.0	90.6	4.1%	89.3	56.7	57.6	30.2	2.4%	2.6%	2.8%	12.4	10.9	9.1	1.3	2.3	10.2	11.1	11.9	4.7	12.3
US Bancorp	USB	60.8	61.6	1.4%	62.5	34.0	56.7	90.5	2.8%	2.9%	3.1%	13.1	14.0	12.8	2.0	2.8	14.7	13.2	14.4	6.7	9.7
Zions Bancorp	ZION	57.9	60.2	4.0%	60.6	27.6	52.8	9.5	2.4%	2.5%	2.7%	10.8	13.3	12.5	1.3	1.5	11.6	8.7	9.0	7.8	10.8
Morgan Stanley	MS	91.0	91.9	1.1%	91.3	44.0	67.6	169.2	1.7%	1.9%	2.1%	13.3	13.1	11.5	1.7	2.3	13.0	12.2	13.2	6.9	17.4
Capital One Financial	COF	160.8	162.9	1.3%	162.8	57.3	67.1	72.6	1.0%	1.3%	1.3%	8.6	10.0	9.3	1.3	1.8	13.8	11.5	12.0	10.0	13.7
Wells Fargo	WFC	46.7	47.7	2.2%	48.1	20.8	60.4	193.1	1.2%	2.1%	2.6%	12.9	13.6	11.1	1.2	1.4	9.2	8.2	9.6	7.1	11.6
First Republic Banks	FRC	191.4	186.1	-2.8%	192.5	100.4	62.4	33.7	0.4%	0.5%	0.5%	27.0	24.9	21.6	3.1	3.2	11.1	10.8	11.2	7.0	9.7
NY Commercial Bancshares	NYCB	12.0	15.3	28.0%	13.2	7.7	50.8	5.6	5.7%	5.7%	5.7%	10.0	8.5	N. A.	0.9	1.4	9.1	11.0	N. A.	7.2	9.7
SVB Financial	SIVB	582.9	609.6	4.6%	592.3	199.8	58.3	31.7	0.0%	0.0%	0.0%	20.7	22.7	19.8	3.6	3.7	16.4	13.2	13.7	6.7	11.0
Signature Bank	SBNY	249.8	291.2	16.6%	260.4	71.5	57.1	14.4	0.9%	0.9%	0.9%	19.2	16.3	12.6	2.2	2.2	12.3	12.9	14.5	7.9	9.9
East West Bancorp	EWBC	74.8	88.2	17.9%	82.4	30.6	46.6	10.6	1.8%	1.9%	N. A.	13.2	13.4	12.5	2.0	2.2	14.6	13.2	13.4	9.3	12.7
Synovus Financial	SNV	49.1	53.1	8.1%	50.5	17.7	57.3	7.3	2.7%	2.8%	2.9%	11.5	12.0	11.1	1.6	1.8	13.2	11.7	N. A.	7.7	9.7
First Horizon National	FHN	19.1	20.7	8.5%	19.4	8.3	57.7	10.5	3.1%	3.3%	3.4%	10.7	11.5	11.5	1.4	1.8	12.3	10.8	10.6	6.9	9.7
BOK Financial	BOKF	91.0	92.6	1.7%	99.0	48.4	53.6	6.3	2.3%	2.3%	2.4%	12.6	14.2	13.2	1.2	1.6	9.4	8.0	8.2	9.0	12.0
Median				**1.7%**			**59.1**		**2.4%**	**2.5%**	**2.8%**	**12.5**	**13.0**	**11.7**	**1.4**	**2.0**	**12.1**	**10.9**	**11.4**	**7.5**	**11.0**

Source: Bloomberg

APPENDIX

Table 2. EU Banks: Valuations

Company	Ticker	Currency	Price* (31/05/21)	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	33.6	34.6	2.8%	35.0	16.7	71.9	14.4	3.8%	4.3%	4.8%	13.1	10.7	9.5	0.9	1.0	7.1	8.3	9.0	4.8	14.2
Raiffeisen Bank	RBI AV	EUR	19.5	21.1	8.2%	20.0	11.7	61.9	6.4	4.3%	4.6%	5.5%	9.7	7.2	6.3	0.5	0.6	6.2	7.2	9.1	6.7	13.6
KBC Groep	KBC BB	EUR	66.9	70.4	5.3%	69.0	40.9	57.2	27.9	7.1%	5.5%	5.8%	13.0	12.8	11.9	1.3	1.5	10.1	10.1	10.9	5.8	18.1
Komercni Banka	KOMB CK	CZK	768.5	780.9	1.6%	776.0	460.0	79.8	5.7	3.7%	6.7%	6.8%	15.6	13.1	11.5	1.3	1.4	7.9	9.5	10.0	8.9	21.7
Jyske Bank	JYSK DC	DKK	311.5	314.0	0.8%	329.7	173.6	56.6	3.0	2.6%	0.0%	0.0%	8.8	8.5	7.6	0.7	0.7	7.3	6.6	6.5	5.0	17.9
SydBank	SYDB DC	DKK	194.1	206.9	6.6%	201.0	96.5	65.4	1.6	4.6%	5.3%	5.6%	10.0	9.0	8.5	1.0	1.0	9.3	9.7	9.7	6.8	18.8
Danske Bank	DANSKE DC	DKK	113.0	135.0	19.4%	125.6	80.3	44.2	13.1	5.3%	6.4%	7.3%	9.1	8.0	7.2	0.6	0.6	6.4	6.8	7.3	3.7	18.3
BNP Paribas	BNP FP	EUR	55.9	60.7	8.7%	57.9	28.8	60.2	69.8	5.7%	5.9%	6.4%	9.8	8.8	8.2	0.7	0.7	6.4	6.8	7.1	3.7	12.8
Natixis	KN FP	EUR	4.1	3.8	-5.2%	4.2	1.8	44.9	12.8	4.9%	6.6%	7.7%	13.9	10.8	9.1	0.7	N. A.	5.2	6.8	7.4	2.7	11.6
Societe Generale	GLE FP	EUR	26.2	25.5	-2.6%	26.7	10.8	65.8	22.4	4.7%	5.2%	6.5%	10.4	8.5	6.8	0.4	0.4	4.3	4.9	5.6	3.8	13.2
Credit Agricole	ACA FO	EUR	12.2	14.2	16.5%	13.5	6.5	45.2	35.6	5.9%	6.5%	6.9%	9.7	8.5	7.7	0.5	0.7	6.3	7.4	11.1	2.1	13.1
Virgin Money	CYBG LN	GBp	211.1	205.4	-2.7%	214.0	70.3	61.4	3.5	0.0%	0.0%	0.0%	10.1	8.9	8.1	0.6	0.7	5.5	7.2	7.8	4.9	13.4
HSBC	HSBA LN	GBp	455.3	469.9	3.2%	462.0	281.5	60.0	108.1	0.1%	0.1%	0.1%	8.2	7.2	6.3	0.8	0.9	5.3	6.5	7.5	5.2	15.9
NatWest Group	NWG LN	GBp	207.0	224.2	8.3%	209.1	90.5	64.2	27.9	0.0%	0.1%	0.1%	11.6	9.9	8.5	0.7	0.8	4.9	5.9	7.0	4.0	18.5
Barclays	BARC LN	GBp	183.1	207.7	13.4%	190.3	88.9	54.2	36.2	0.0%	0.0%	0.1%	8.0	7.9	7.2	0.6	0.7	6.9	7.2	7.3	3.5	15.1
Standard Charted	STAN LN	GBp	507.8	579.6	14.1%	533.2	334.3	53.0	18.4	0.0%	0.0%	0.1%	7.2	6.1	5.2	0.5	0.6	4.6	5.4	6.0	5.0	14.4
Lloyds	LLOY LN	GBp	49.9	50.5	1.3%	50.1	23.6	70.0	41.1	0.0%	0.0%	0.1%	8.5	9.1	8.5	0.8	N. A.	8.5	7.8	8.5	4.3	16.2
Commerzbank	CBK GY	EUR	6.6	6.2	-5.5%	6.7	3.6	73.4	8.3	0.2%	1.1%	3.8%	47.1	13.1	8.3	0.3	0.3	-0.4	2.1	4.0	4.6	13.2
Deutsche Bank	DBK GY	EUR	12.2	10.8	-11.7%	12.5	6.8	69.3	25.2	1.4%	2.6%	3.6%	14.9	10.2	8.8	0.4	0.5	2.5	4.4	4.9	3.6	13.6
UniCredit	UCG IM	EUR	10.5	10.6	1.1%	10.5	6.1	71.2	23.5	3.5%	4.4%	5.7%	11.0	8.1	6.8	0.4	0.5	3.5	5.0	5.5	5.4	16.0
Mediobanka	MB IM	EUR	9.8	10.9	11.5%	10.0	6.0	59.7	8.7	5.9%	6.1%	6.4%	11.2	10.7	10.3	0.8	N. A.	7.4	7.6	7.8	11.3	16.1
Intesa Sanpaolo	ISP IM	EUR	2.4	2.6	7.6%	2.4	1.4	64.3	47.0	6.3%	6.9%	7.5%	12.0	10.3	9.3	0.8	0.9	6.2	7.3	7.8	5.0	14.7
Emilia Romagna	BPE IM	EUR	2.0	2.3	13.4%	2.2	1.0	56.7	2.9	2.9%	3.8%	4.8%	23.3	8.2	7.0	0.4	0.5	9.1	4.5	5.1	5.8	17.7
ING Groep	INGA NA	EUR	11.3	12.2	7.5%	11.5	5.6	67.4	44.3	7.7%	5.6%	5.9%	10.6	10.1	9.2	0.8	0.8	7.5	7.6	8.1	5.7	15.5
ABN Amro	ABN NA	EUR	10.9	11.6	6.1%	11.2	6.6	57.0	10.3	5.1%	5.6%	7.2%	17.1	10.0	8.1	0.5	N. A.	2.6	5.2	6.2	4.8	17.7
DNB	DNB NO	NOK	184.5	182.4	-1.1%	188.2	125.3	56.8	28.1	5.9%	5.4%	5.8%	13.4	12.3	11.3	1.3	1.3	9.3	9.9	10.4	7.7	18.7
BBVA	BBVA SQ	EUR	5.1	5.2	2.2%	5.2	2.1	66.8	34.2	3.3%	4.0%	4.9%	11.5	10.0	8.7	0.8	0.8	6.3	6.9	7.7	5.8	12.2
Santander	SAN SQ	EUR	3.4	3.5	1.7%	3.5	1.4	69.1	59.4	3.9%	5.1%	5.8%	9.6	8.6	7.8	0.7	0.9	6.9	7.9	8.5	4.4	12.3
Bankinter	BKT SQ	EUR	4.7	4.5	-4.1%	4.9	2.2	55.2	4.2	3.4%	4.2%	5.0%	10.8	11.4	9.8	0.8	0.9	6.0	7.4	8.7	4.9	12.3
Sabadell	SAB SQ	EUR	0.6	0.6	-11.5%	0.7	0.3	56.9	3.5	1.3%	3.2%	5.3%	27.3	10.4	7.5	0.3	0.4	1.4	2.8	4.4	4.2	12.6
CaixaBank	CABK SQ	EUR	2.8	2.9	4.9%	2.9	1.5	60.7	22.6	3.0%	5.0%	6.2%	11.5	9.3	8.1	0.6	0.7	11.5	7.0	7.8	4.8	13.6
SEB	SEBA SS	SEK	106.1	111.0	4.7%	111.6	75.6	48.0	22.9	6.8%	5.4%	5.3%	11.0	10.7	10.0	1.3	1.4	11.9	11.6	11.9	5.4	21.0
Handelsbanken	SHBA SS	SEK	93.0	105.4	13.3%	101.2	71.7	41.7	18.2	7.4%	6.8%	7.4%	10.8	10.1	9.4	1.1	1.1	9.6	9.8	10.2	5.1	20.3
Swedbank	SWEDA SS	SEK	149.1	177.5	19.1%	165.9	116.3	51.3	16.6	7.5%	6.2%	6.3%	9.3	8.8	8.4	1.1	1.2	11.5	11.5	11.1	5.3	17.5
Nordea	NDA SS	SEK	88.9	99.8	12.2%	90.6	63.5	64.3	35.5	0.8%	0.7%	0.7%	11.1	9.5	7.6	1.1	1.2	9.5	9.6	10.0	5.3	17.1
Julious Baer	BAER SW	CHF	61.6	64.5	4.7%	62.1	35.7	62.0	12.5	3.1%	3.3%	3.5%	12.7	12.2	10.2	2.1	3.5	15.8	15.4	15.5	3.6	14.9
Credit Suisse	CSGN SW	CHF	9.8	11.4	16.1%	13.4	8.4	56.9	22.7	1.8%	2.5%	2.9%	9.2	6.4	5.7	0.5	0.6	2.7	7.6	8.2	4.7	12.9
UBS	UBSG SW	CHF	14.6	16.4	12.5%	15.0	9.4	61.2	51.2	2.7%	2.8%	2.9%	8.4	8.2	7.4	1.0	1.1	9.2	9.8	10.4	4.7	13.8
Median					**5.1%**			**60.4**		**3.6%**	**4.5%**	**5.4%**	**10.9**	**9.4**	**8.2**	**0.7**	**0.8**	**6.7**	**7.3**	**7.8**	**4.9**	**15.0**

Source: Bloomberg

APPENDIX

Table 3. Calendar

Date	Regio	Section	Event	Period
1-Jun	EU	Macro	Unemployment Rate	Apr
1-Jun	EU	Macro	CPI	May
1-Jun	US	Macro	Construction Spending	Apr
1-Jun	US	Macro	ISM Manufacturing	May
2-Jun	EU	Macro	PPI	Apr
3-Jun	US	Macro	ADP Employment Change	May
4-Jun	EU	Macro	Retail Sales	Apr
4-Jun	**US**	**Macro**	**Employment Report**	**May**
4-Jun	US	Macro	Factory Orders	Apr
7-Jun	US	Macro	Consumer Credit	Apr
8-Jun	EU	Macro	Household Consumption	1Q
8-Jun	EU	Macro	ZEW Survey Expectations	Jun
8-Jun	US	Macro	Trade Balance	Apr
9-Jun	US	Macro	Wholesale Inventories	Apr
10-Jun	**EU**	**Macro**	**ECB Main Refinancing Rate**	**Jun 10**
10-Jun	US	Macro	CPI	May
10-Jun	US	Macro	Monthly Budget Statement	May
11-Jun	US	Macro	U. of Mich. Sentiment	Jun
14-Jun	EU	Macro	Industrial Production	Apr
15-Jun	EU	Macro	Trade Balance	Apr
15-Jun	US	Macro	Retail Sales	May
15-Jun	US	Macro	PPI	May
15-Jun	US	Macro	Empire Manufacturing	Jun
15-Jun	US	Macro	Industrial Production and Capacity Utilization	May
16-Jun	US	Macro	Housing Starts and Building Permits	May
16-Jun	**US**	**Macro**	**FOMC Rate Decision**	**Jun 16**
17-Jun	EU	Macro	EU27 New Car Registrations	May
17-Jun	EU	Macro	Construction Output	Apr
17-Jun	US	Macro	Philadelphia Fed Business Outlook	Jun
17-Jun	US	Macro	Leading Index	May
18-Jun	EU	Macro	ECB Current Account	Apr
21-Jun	US	Macro	Chicago Fed Nat Activity Index	May
22-Jun	US	Macro	Existing Home Sales	May
23-Jun	EU	Macro	Markit Eurozone Manufacturing, Services and	Jun
23-Jun	US	Macro	Markit US Manufacturing, Services and Composite PMI	Jun
23-Jun	US	Macro	New Home Sales	May
25-Jun	EU	Macro	M3 Money Supply	May
25-Jun	US	Macro	Personal Income and Spending	May
29-Jun	EU	Macro	Consumer Confidence	Jun
29-Jun	US	Macro	FHFA House Price Index	Apr
29-Jun	US	Macro	Conf. Board Consumer Confidence	Jun
30-Jun	EU	Macro	CPI	Jun
30-Jun	US	Macro	ADP Employment Change	Jun
30-Jun	US	Macro	Pending Home Sales MoM	May