17 January 2018

ARBAT CAPITAL

BANKING SECTOR REPORT – DECEMBER 2017

EXECUTIVE SUMMARY

In December US Banks (BKX index) increased by 2.0% MoM vs +1.0% MoM of S&P 500 index after slight outperformance in November. Despite strong growth of banks quotes in the last four months (+14.8% in absolute terms) SPX index outperformed it during 2017: +19.4% vs +16.3% of BKX index. Absolute December performance on MoM basis was just +0.2 StD from the mean monthly performance and this result is in the top 44% of absolute monthly performance of BKX Index. Dynamics of the sector was mainly driven by approval of the tax reform, so the most impressive growth was shown by consumer finance companies which had the highest effective tax rate among US Finance sector.

The Fed increased the target range for the federal funds rate by 0.25% to 1.25% to 1.50% as it was widely expected (the market had estimated probability of it at almost 100% in early December). The policy statement had few changes. The key of them, from our point of view, related to evaluation of core inflation and more optimistic economic forecasts. The dot plot continued to imply three hikes in 2018 (as it was in 2017) and two hikes in 2019 and two more in 2020. The market priced currently just around 2 hikes. Due to still very low deposit beta, the number of hikes is very critical for almost all US banks, especially for the most asset sensitive ones. We expect 3 hikes in 2018 (but we believe it possible that the number of hikes could be more) and it seems, from our point of view, that not all of these hikes has currently priced in. However, the flatter yield curve is starting to bother us even despite the short end is more important for majority of US banks as it could negatively impact on bank's top line in the future. The Fed significantly increased the economic projections. It shouldn't be perceived as surprise after changed wording from "moderate" to "solid" at the previous meeting. But the size of upgrade was a positive surprise for us, at least estimate of GDP growth in 2018. The estimate of GDP growth for 2017 year was revised up by 10 bps to 2.5% (from September projection); for 2018 year by 40 bps to 2.5%; for 2018 by 10 bps to 1.8%; for 2019 year by 20 bps to 2%. Currently, consensus estimates implies that median NIM of BKX index will increase by 7 bps YoY in absolute terms in 2018, but given the current dot plots and the forward yield curve, NIM growth could exceed 10 bps in 2018.

Tax reform was signed by President Trump just few days before the New Year. It was widely expected event but there had been a chance that it could happen later. In any case, the tax reform is very positive for US banks and it will be one of the main drivers of bank EPS in the near years. The key benefit for banks is lowering of corporate tax rate from 35% to 21%. Moreover, the new tax rate will already be effective in the fiscal year 2018. In turn, eliminating of FDIC fee taxability and need to write down DTAs (for some banks) will negatively impact on both EPS and capital (temporary effect). But on the net basis, median growth of banks EPS will exceed 10% and that's without taking into account the secondary effects of the tax reform. Even despite the fact that the event was widely expected, the full effect of the reform isn't in consensus estimates of EPS yet, from our point of view.

Deregulation is the most critical issue for banks in the current year as it could be a very important driver of growth of both banking EPS and ROE and we are convinced that deregulation isn't in price yet. Deregulation will give banks more capital flexibility. From our point of view, the most important consequence of deregulation could

be M&A acceleration, especially among regional and super regional banks in case of rising of SIFI limit from $50 bn to $250 bn. So, we will see further multiples expansion.

Loan growth at US banks decelerated since September 2016 to its local low of 3% yoy in the end of August 2017. But after that total loan growth accelerated to 4.2% as the end of 2017. The key driver of weak loan growth was C&I which growth rate decreased from 9.1% yoy in October 2016 to 0.7% yoy in the early December 2017 (+1.6% yoy as the end of 2017). But we expect that C&I loans growth will accelerate from the current level due to faster growth of the economy and pick-up in CAPEX. We don't expect that total loan growth accelerate to the mid-cycle growth rate but we expect that it will not be a drag for banks operating results in 2018 as it was in 2017. We also think that quality of the loan portfolio of US banks will remain strong in 2018 with only slight increase of both NCO ratios and provisions even despite some red flags in Auto and Credit Cards lately.

From our point of view, it is highly likely that US banks will continue to outperform broad market in 2018 due to net positive effect of the tax reform, higher rates, expected growth of total payout ratios during CCAR and continuation of the deregulation process. Multipliers don't look cheap but relative to S&P 500 index banks don't also look expensive. We expect that credit quality will remain strong (except for some consumer areas) while loan growth rate will accelerate due to faster growth of the economy and pick-up in CAPEX. Overall, operating results of US banks remain strong with very healthy revenue and net income growth. Despite we don't expect strong figures during the 4Q17 earnings season because of tax reform related one-timers and relatively weak trading results due to still weak volatility, we wait for double-digit EPS growth of US banks in 2018 year. Currently, consensus estimates of median EPS growth of BKX index members are 22% yoy in 2018 and 12% in 2019. Our top peaks are Bank of America (BAC), JP Morgan Chase (JPM), Morgan Stanley (MS), Comerica (CMA) and Zions Bancorporation (ZION).

In December EU Banks increased by 0.9% MoM vs +0.6% MoM of STOXX 600 index. It was the second consecutive month of positive performance of EU banks but SX7P Index ended year lower than it was at the end of October. However, banks managed to outperform broad based index by +0.35% in 2017. Notwithstanding, EU banks continue trading in the narrow sideway channel for more than 8 months (175-191 pts on the SX7P index). Dynamics of European banks wasn't uniform in December. The key underperformers were Italian banks because of strong performance in November, uncertainty with upcoming elections and risk of more serious pressure from regulator for more aggressive NPLs reduction. Among banks with the best performance were CYBG, ABN, STAN, UBS and BARC (largely due to positive outcome of Basel 4, Brexit negotiations and US tax reform).

Steady economic expansion in the euro area continues with GDP YoY growth markedly higher than 2% and recent macro data indicates that it will remain solid in 2018. At least, ECB significantly increased its GDP forecasts at the last meeting. Last macro figures confirmed this point of view. ECB's GDP growth forecast for 2017 year was revised up from 2.2% to 2.4%, for 2018 from 1.8% to 2.3%, for 2019 from 1.9% to 1.7%. Composite PMI, which is well correlated with GDP growth, markedly increased in December after strong growth in November and it remained at multi-year high. Preliminary composite index increased by 0.5 pts to 58.0 pts, well above consensus estimate of 57.2 pts.

EU yields markedly increased in December and the yield curve continues to

become steeper and steeper turning to be a tailwind for European banks along with strong macro figures and growing profits. Lower regulation headwinds, less political uncertainty, stronger loan growth and decreasing NPLs also continue to contribute to the further growth of banking quotes given not very rich valuations for many of EU banks yet. We expect that EU banks will follow US peers and they will also outperform the broad based EU market in 2018, but the road of EU banks will be more bumpy because the short end of the curve will not change significantly in the near future even despite the strong growth of EU economy while a part of future rate hikes have already priced in, from our point of view. Our top pick in EU is UCG with the price target of €22 at the end of 2018.

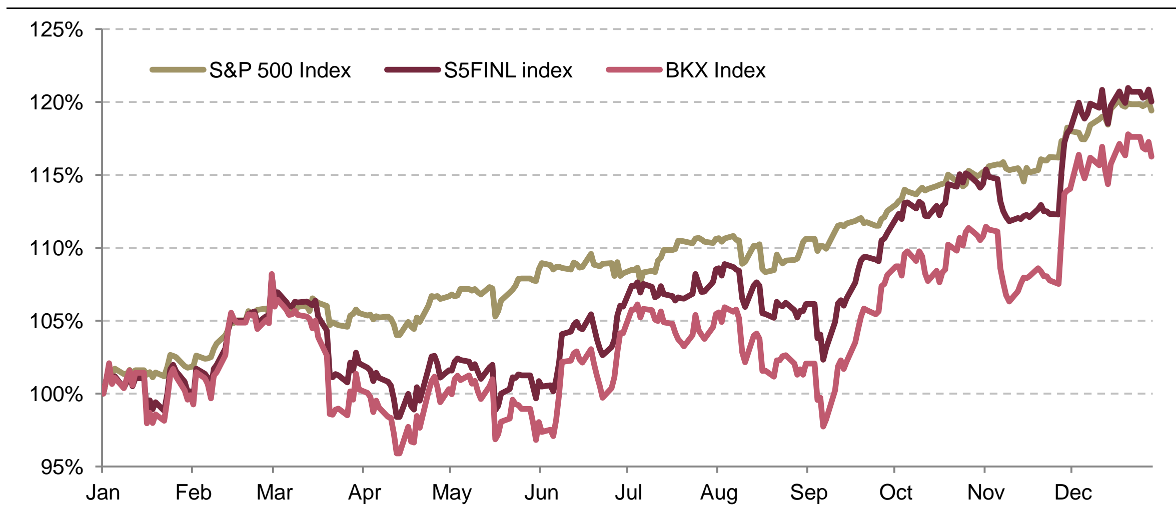
1. MARKET PERFORMANCE

US

In December, US Banks (BKX index) increased by 2.0% MoM vs +1.0% MoM of S&P 500 index after slight outperformance in November. Despite strong growth of banks quotes in the last four months (+14.8% in absolute terms) SPX Index outperformed it during 2017: +19.4% vs +16.3% of BKX index. Absolute December performance on MoM basis was just +0.2 StD from the mean monthly performance and this result is in the top 44% of absolute monthly performance of BKX Index. Relative December performance vs SPX index was +1.1% MoM in absolute terms, it is +0.22 StD from the mean, and this result is in the top 41% of relative performance of BKX index vs SPX.

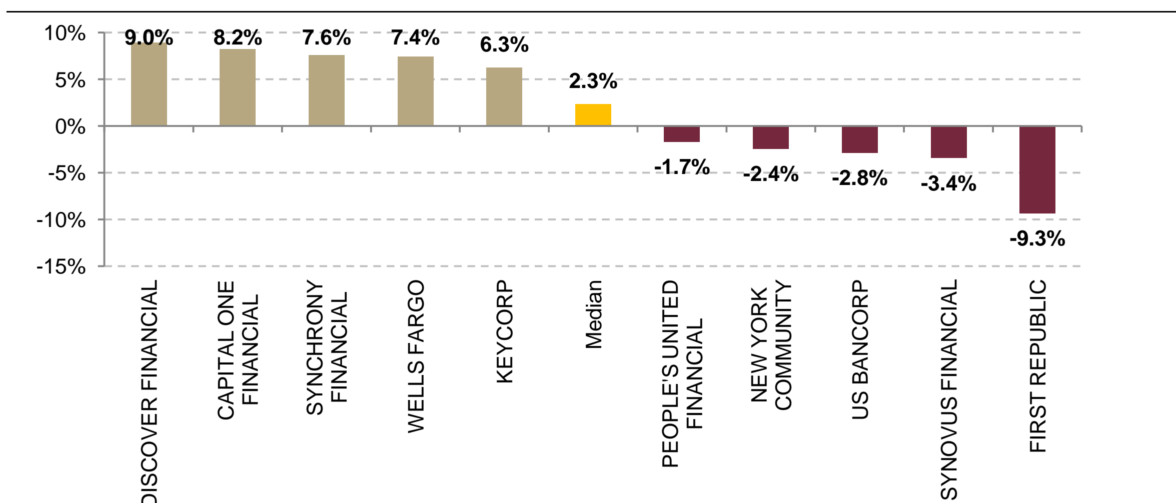
Dynamics of the sector was driven by approval of the tax reform, so the most impressive growth was shown by consumer finance companies (COF, DFS, SYF) which had the highest effective tax rate among US Finance sector. The worst dynamics was demonstrated by FRC (because of weak rate sensitivity), SNV, USB (for both strong performance in November) and NYCB (high share of CRE loans).

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



Source: Bloomberg

Chart 2. December US Banks Performance. Leaders and Laggards, 1Month Performance,%



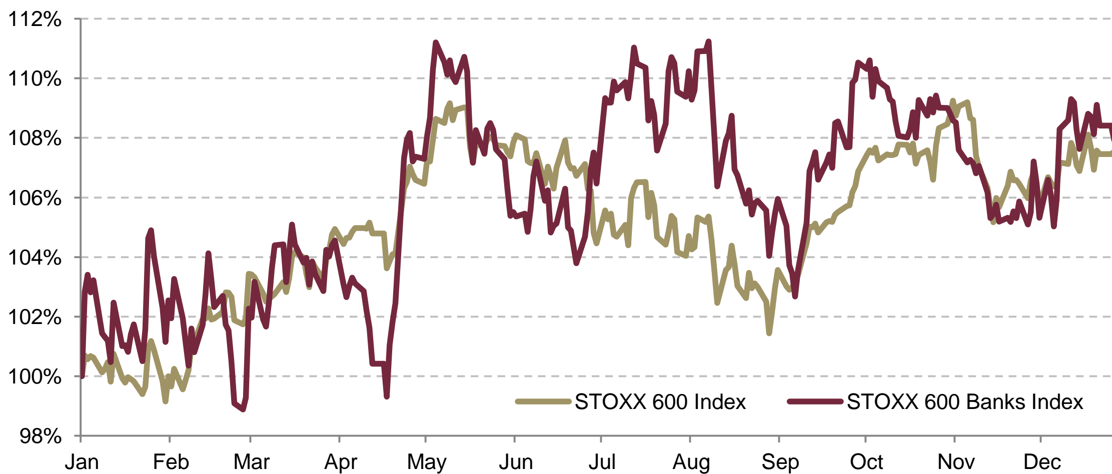
Source: Bloomberg

Europe

In December EU Banks increased by 0.9% MoM vs +0.6% MoM of STOXX 600 index. It was the second consecutive month of positive performance of EU banks but SX7P Index ended year lower than it was at the end of October. However, banks managed to outperform broad based index by +0.35% in 2017. Notwithstanding, EU banks continue trading in the narrow sideway channel for more than 8 months (175-191 pts on the SX7P index). Absolute December performance of SX7P was +0.07 std from the mean and this result is in the bottom 48% of absolute monthly performance of SX7P since the index inception. Relative performance of SX7P vs STOXX 600 index in December was +0.26% or +0.12 Std from the mean.

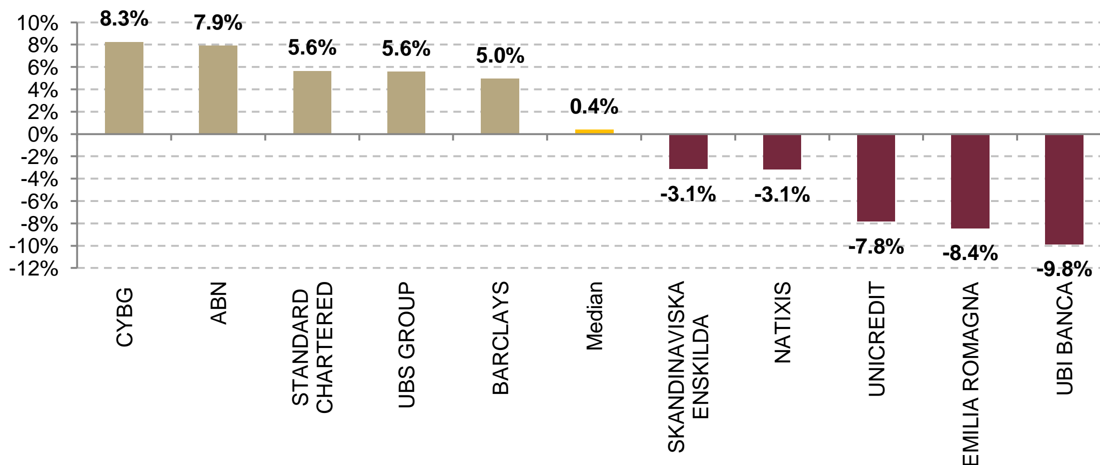
Dynamics of European banks wasn't uniform in December. The key underperformers were Italian banks because of strong performance in November, uncertainty with upcoming elections and risk of more serious pressure from regulator for more aggressive NPLs reduction. Among banks with the best performance were CYBG, ABN, STAN, UBS and BARC (largely due to positive outcome of Basel 4, Brexit negotiations and US tax reform).

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



Source: Bloomberg

Chart 4. December EU banks performance. Leaders and Laggards, 1Month Performance,%



Source: Bloomberg

ARBAT CAPITAL

2. COMPANY NEWS

UniCredit Capital Markets Day

UCG held its Capital Markets Day on December 12, confirming majority of its 2019 targets and improving NPE forecasts. Also, the bank increased both its FY2019 dividend payout ratio from 20% to 30% and post 2019 DPR from 30% to 50%. Overall, from our point of view, it was positive investor day, but market perception of it was negative (as UCG decreased by 6% during the four trading sessions after the Investor Day), however downward trend was also caused by the negative news flow about Italian NPLs. Yes, mgmt was relatively conservative around possible regulatory impact on capital, but the process of the UCG's restructuring is on track, financial targets on 2019 look deliverable while the bank continues trading with significant discount to European peers. There are many possible positive drivers for UCG's quotes in 2018 and we remain overweight on the stock with the price target of €22 at the end of 2018. The key risks are forthcoming elections, more strict regulation and economic downturn in Italy.

Revenue target for 2019 of €20.6 bn is confirmed. But it increased by €0.2 bn from the old target of €20.4 bn due to some methodological changes (reclassification of some loans). Cost target remains at the former level of €10.6 bn with the same CIR target of <52% despite small growth of the revenue target. Net income target also remains unchanged at €4.7 bn. ROTE target confirmed at 9.7% with improved risk profile.

The key improvements relate to asset quality. Gross NPE target decreased by €4 bn to €40.3 bn vs version of 2016 year. In turn, Net NPE target decreased by €2.5 bn to €17.7 bn while Gross NPE ratio went down by 60 bps in absolute terms to 7.8%. Currently, UCG's stake at NPLs transactions with FINO of €17.7 bn is already less than 20% so the bank shouldn't consolidate it. Non-Core unit is going to be fully wound down by 2025.

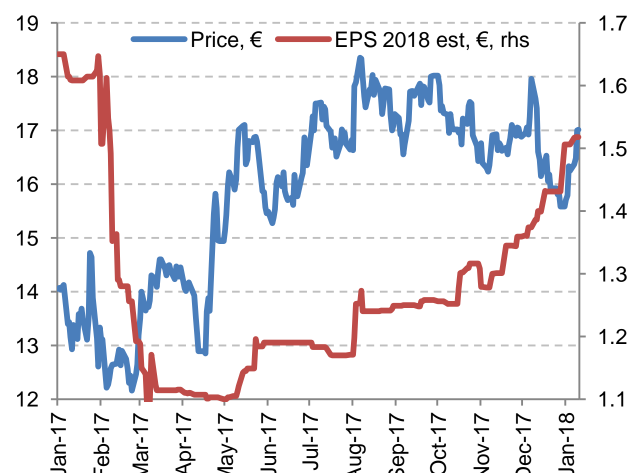
CET 1 ratio reiterated above 12.5% despite SREP requirement was reduced by 50 bps to 200 bps confirming the process of successful de-risking of UCG's BS. Dividend payout ratios was increased from 20% to 30% in FY19 (to be paid in 2020), post 2019 DPR increased from 30% to 50%. UCG's provided its own estimates of all future negative regulatory impact on CET1. The total cumulative effect is around 470 bps. The most important headwinds are EBA guidelines, Basel 4, Calendar provisioning and IFRS 9.

Table 1. UCG IM. Main 2019 targets

	2015	9M17	2019E
Revenues, € Bn	20.4		20.6
Cost, € Bn	-12.2	<11.7	-10.6
Net Income, € Bn	1.5		4.7
Cost/Income, %	60.0	57.9	<52
Cost of Risk, bps	103	54	55
RoTE, %	4	8	>9
CET1 ratio, %	10.4	13.8	>12.5
Gross NPE, € Bn	77.8	51.3	40.3
Gross NPE ratio, %	16	10.6	7.8
Net NPE, € Bn	38.3	22.3	17.7

Source: UniCredit

Chart 5. UCG IM. Price vs EPS estimates



Source: Bloomberg

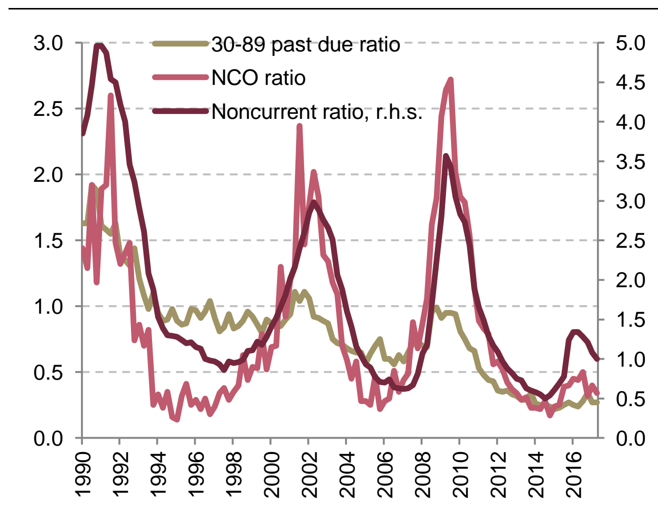
3. MACROECONOMIC NEWS

US

C&I loans

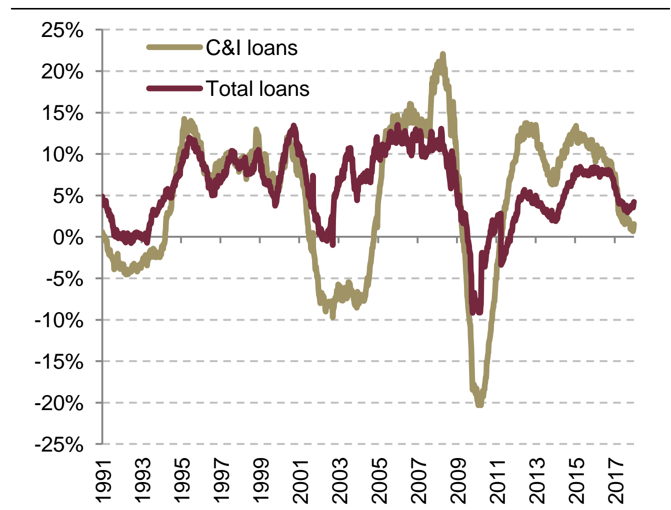
C&I loan growth continues to demonstrate weak dynamics despite more positive news about tax reform, optimism of management of US banks, easing lending standards for the third consecutive quarter and still solid macro figures. Actually, the lowest C&I loan growth level in 2017 year was shown in the early December. According to the last Fed H8 weekly report, C&I loan growth was just +1.6% yoy (as of December 27) vs +2.1% yoy (as the end of 3Q17) and +7.1% yoy as of 28 December 2016. It is near the lowest level in more than 6 years. During the last earnings season, banks named the same reasons of the slowdown as before – 'wait and see' approach of borrowers because of lack progress in reforms and switching of the large borrowers to capital markets.

Chart 6. C&I. Delinquencies vs NCOs, %



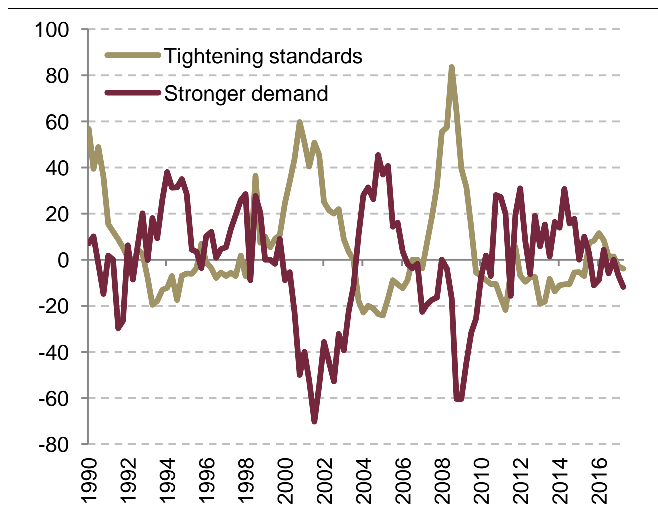
Source: Bloomberg

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



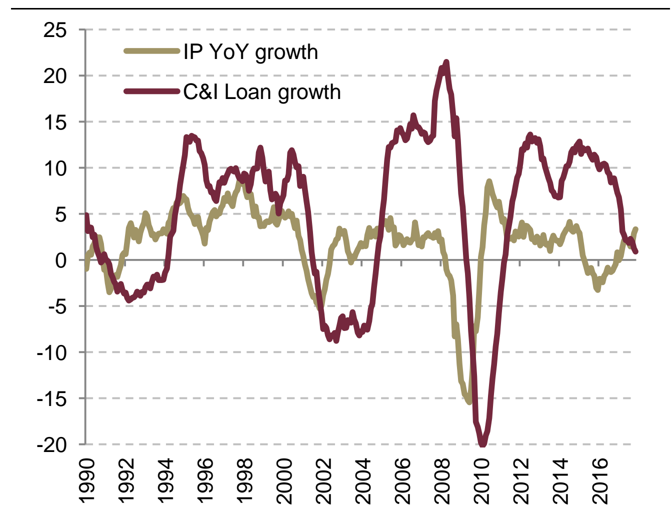
Source: Bloomberg

Chart 8. Credit Standards, %



Source: Bloomberg

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



Source: Bloomberg

The new one was temporary run-off of the loan portfolio. Notwithstanding, mgmt of banks remain optimistic regarding further C&I growth after successful implementation of the

promised reforms. However, the same optimism had been demonstrated in the beginning of the year, but the loan growth rate continued to go down then. We have no issue with possible acceleration of C&I loan growth in the next year due to reduction of uncertainty because of an approval of the tax reform in US but we do not expect that it will be significantly higher than the growth rate of nominal GDP as US economy is in the late cycle.

The October 2017 Senior Loan Officer Opinion Survey indicated that C&I lending standards were modestly eased to both small firms, large and middle-market ones over the past three months. Actually, banks slightly eased standards for the third consecutive quarter after tightening standards 6 quarters in a row. More aggressive competition from other banks was by far the most emphasized reason for easing. Notwithstanding, banks continue reporting weakening demand.

Macro was strong in December partly due to continuation of recovery of some data after negative readings in the previous months because of adverse impact of the hurricanes Irma and Harvey. Better than estimates figures were demonstrated by construction spending, manufacturing payrolls, factory orders and preliminary PMI December reading. In turn, industrial production, capacity utilization and empire manufacturing indexes slightly missed on the headline numbers in the last month. But overall Industrial production figures weren't weak. So, both Citi and Bloomberg economic surprise indexes continue to go up to its multi-years highs.

ISM manufacturing index decreased by 0.5 pts MoM to 58.2 pts in November vs expectations of 58.3 pts. But it remains near the highest level in more than 13 years. Manufacturing payrolls increased by 31k in November vs expectations of growth of +15k. But October's figure was revised down by 1K to +23K. Construction spending increased by 1.4% MoM in October vs expectations of +0.5% MoM. Factory orders decreased by 0.1% MoM in October vs expectations of -0.4% MoM after solid growth in September of +1.7% MoM (estimate was revised up by +0.3 in absolute terms). Industrial production increased by +0.2% MoM in November, slightly missing expectations of +0.3% after very strong growth in the previous month. Moreover, October figure was revised up from +0.9% MoM to +1.2% MoM. Empire manufacturing index was also weak in November, decreasing by 1.4 pts to 18.0 pts, missing estimates of 18.7 pts. Overall, macro data continues to indicate healthy growth of manufacturing sector but this growth hasn't transformed into acceleration of C&I loan growth yet because of the policy uncertainty, but situation may change in 2018 year due to successful enactment of the tax reform and changes in regulation.

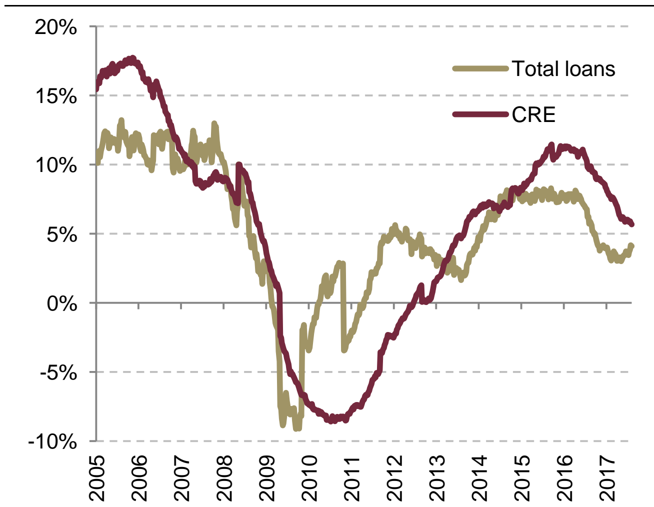
CRE

Commercial real estate still remains one of the fastest growing segment in US (+5.7% yoy through December 27th vs 4.1% yoy growth for total loans), but growth rate continues to decelerate (around +10% yoy as the beginning of December 2016). CRE fundamentals are still in good shape but we see more and more signs of deceleration of growth of sector earnings in the future. Price growth accelerated in the last months to 8.4% yoy as end of October 2017 while transaction volumes remained weak in 2017 (-17.3% yoy as the end of October), operating fundamentals are starting to lag behind prices and banks continue to tighten lending standards (for the ninth quarters in a row). From our point of view, it suggests that we are at a late stage of the cycle, although quality indicators still continue to improve. Tax reform isn't as negative for CRE as we feared early in the year, but it is also not as positive as it is for many other sectors. Nevertheless, the sector could benefit from the second order effects however it is not a near future event. The key risk for the sector remains rising rates but we don't expect that it will lead to any serious problems, at least in

the near future due to strong fundamentals of the sector at current moment.

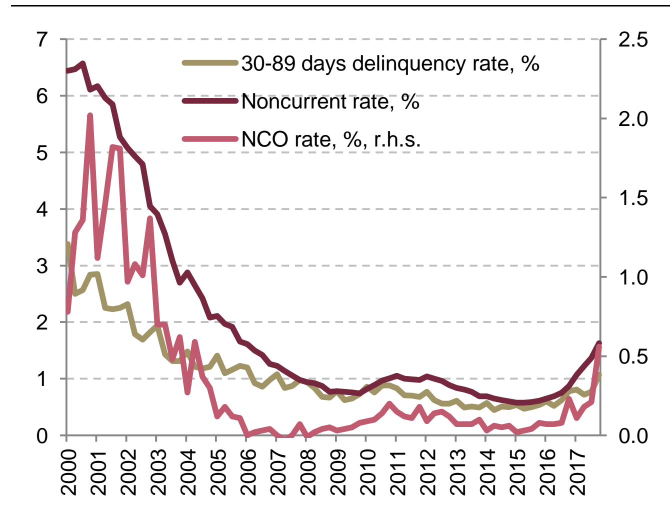
The October Senior Loan Officer Survey indicated that CRE lending standards were tightened for the ninth consecutive quarter. “A significant net fraction of banks reported tightening their standards for loans secured by multifamily residential properties, while banks reportedly left standards for loans secured by nonfarm nonresidential properties and those for construction and land development purposes basically unchanged on net”. Banks also reported that demand for CRE loans was weaker during the last quarter. Weaker demand was demonstrated by all major CRE segments (moderate for multifamily and modest for construction and for nonfarm nonresidential properties). Given a relatively strong correlation of tightening standards and deterioration of asset quality, ongoing growth of rates in the economy and the record level of prices, CRE could potentially have a negative impact on quality of the overall loan portfolio of US banks. But we expect that the impact will be limited because of low LTV ratios and relatively strict lending standards during the last credit cycle.

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



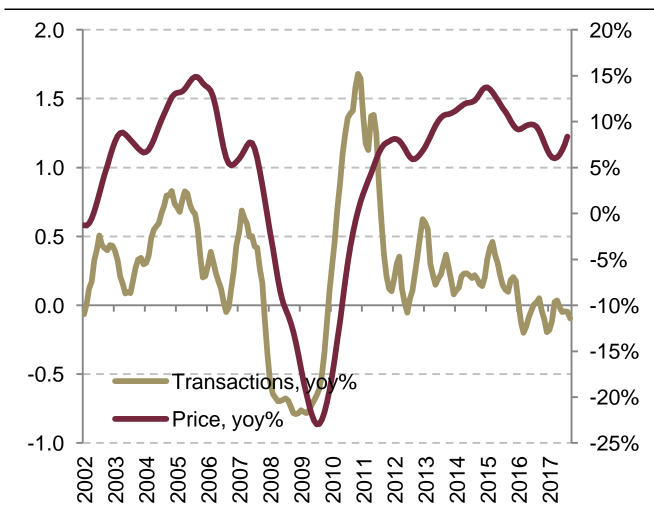
Source: Bloomberg

Chart 11. CRE. Delinquencies vs NCOs, %



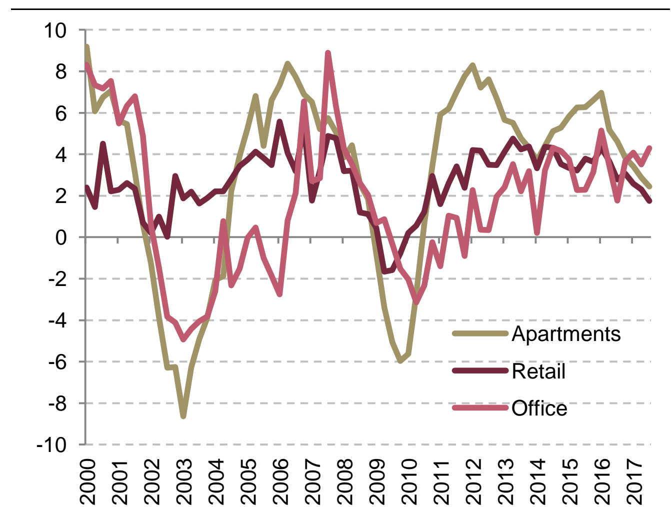
Source: Bloomberg

Chart 12. CRE. Price Growth vs Transactions Volumes



Source: Bloomberg

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



Source: Bloomberg

Overall, business cycle remains supportive for commercial real estate segment even taking into account significant growth of yields from the lows of 2016. Prices continue to go up, but the growth isn't uniform among sub-sectors. Thus, apartments price index added +9.8% yoy in October and Industrial CRE prices increased by 9.9% yoy while offices prices went up by 5.4% and retail CRE price index grew only by 2.2%. Current growth of CRE prices is markedly lower than it was few years ago, but it is still significantly higher than growth of prices for residential property. It seems that the lack of the growth of rates in the beginning of the year and seasonality were the main drivers of such a high growth of CRE prices recently. As for other fundamentals, they still demonstrate healthy state but it seems that majority of indicators have already shown their peaks of this cycle. NAREIT average same store NOI growth is still at relatively high levels but it has markedly decelerated from the peaks of the cycle, especially in apartments and retail segments where same-store NOI growth rates are at multi-year lows, but they remain positive in any case.

Mortgage

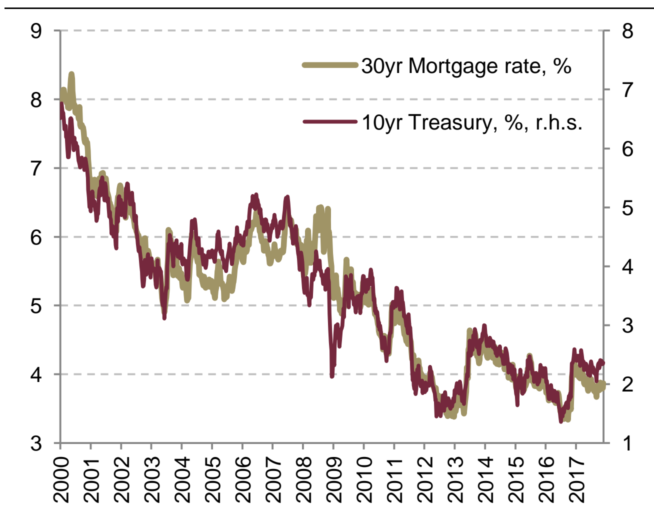
Mortgage loans growth rate decelerated to 3.9% yoy (as of December 27) vs +5.7% yoy 1 year ago, but it remains relatively stable since March 2017, hovering around 4%. It remained resistant even to significant volatility in mortgage rates during this year. The tax reform outcome for mortgage sector is slightly negative because of higher standard deductions (less mtg interest deductions). But the key risk for the sector is the growth of the long end (which wasn't as strong as growth of the short end in 2017) even despite the affordability is still at high level and financial health of US Consumer is very strong.

30-yr mortgage rate declined to the lowest level since November 2016 in early September, decreasing from February high of 4.19% to 3.67% in September, but it increased after that by 18 bps in absolute terms to 3.85% as the end of December. It is still -34 bps from the 1yr highs but it remains significantly higher than average rate of 2016. Growth of mortgage loans also remains immune to eased lending standards. The October Senior Loan Officer Survey indicated that lending standards for all surveyed categories of mortgage lending either eased or remained basically unchanged over the past three months. "Meanwhile, a moderate net share of banks reported weaker demand for all categories of RRE loans, and a modest net share of banks reported weaker demand for revolving home equity lines of credit". Specifically, banks eased standards for GSE-eligible loans or for jumbo qualified loans while standards for other categories were basically unchanged.

Housing market indicators were very strong in December, showing positive surprises for most indicators. Overall, fundamentals of housing market remain solid and we don't see significant risks in this segment at the moment (from quality of the loan portfolio point of view) but there are some imbalances in this segment indicating late cycle. Risks are still low, especially after successful adoption of the tax reform. The key problem for banks is relatively weak mortgage revenues because of tightening mortgage spreads and lower refinancing activity due to rising long end. In turn, mortgage indicators remained weak vs 1 yr ago despite significant decline of long-end from the highs of the last year. Mortgage applications ticked up in September but it went down since then and it remained significantly lower than average level of previous years while purchase applications didn't markedly increase in 2017. According to MBA's December 2017 forecasts, total mortgage originations will decrease by 16.6% yoy in 2017, driven by 40% yoy decline of refinancing volumes while purchase originations should increase by 5.5% yoy. The forecast also implies a further decline of total mortgage originations by 5.6% yoy in 2018, also driven by drop of refinancing originations.

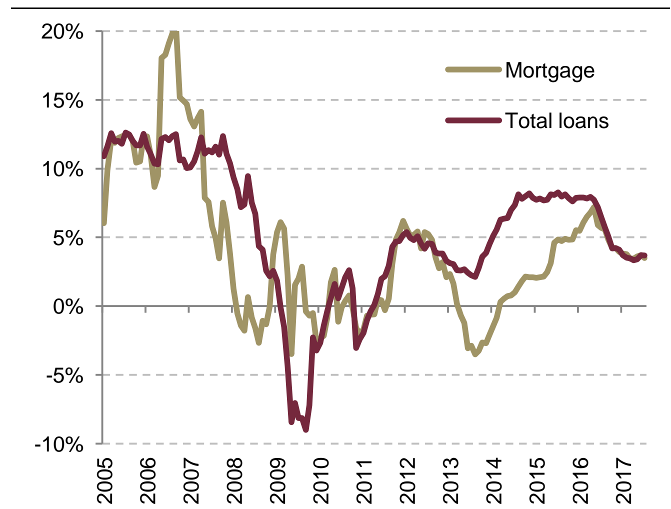
After short-lived negative impact from hurricanes, the indicators of the housing market resumed its growth. Construction spending increased by +1.4% MoM in October vs consensus of +0.5% MoM, the third consecutive month of positive growth. And it seems that the growth should continue given very strong builders confidence in the recent months. NAHB housing index increased by 5 pts to 74 pts in December vs expectations of 70 pts. It is the highest level of indicator since mid-1999 and it is just 4 pts lower than all-time high of the index. It is not a surprise for us, taking into account very low inventory level of homes to sale. Housing starts and building permits also were better than estimates in November, but month-over-month growth of these figures wasn't impressive. In turn, both existing and new home sales showed very strong growth in November. Existing home sales increased by 6% MoM to 5.81 mln units vs expectations of 5.53 mln. New home sales was 733K vs expectations of 655K and significantly revised October figure of 624K (from 685K). Housing prices also continue to grow and it was better than estimates in October. S&P CoreLogic index increased by 0.7% MoM in October vs expectations of +0.6%, marked acceleration vs September. On year-over-year basis, housing prices increased by 6.4% yoy, not very far from rate of growth of CRE prices.

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



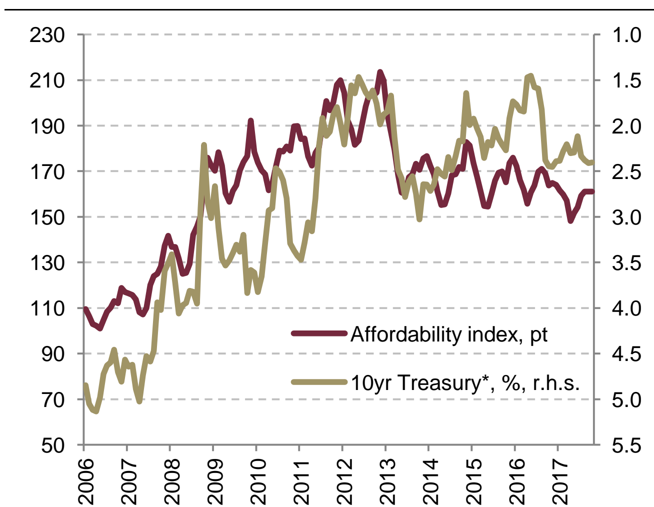
Source: Bloomberg

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



Source: Bloomberg

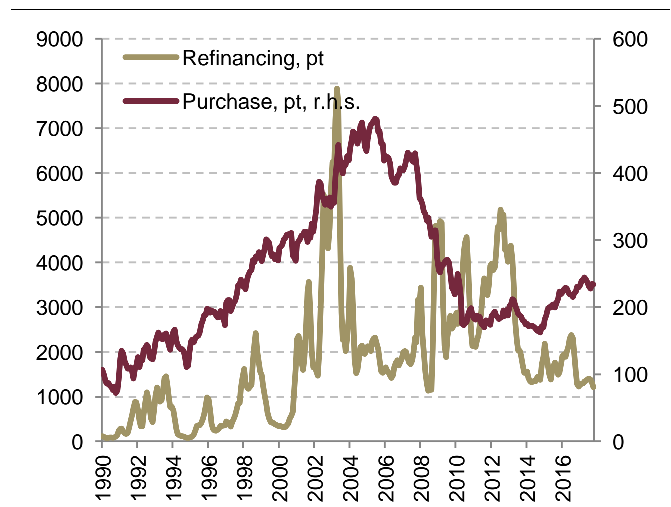
Chart 16. Mortgage. Aff. Index vs 10yr Treasury yield



*reversed order

Source: Bloomberg

Chart 17. Mortgage. MBA Applications Indexes

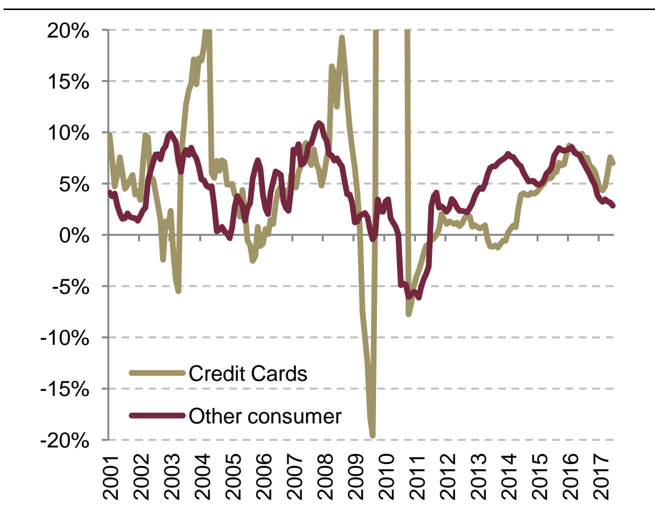


Source: Bloomberg

Consumer

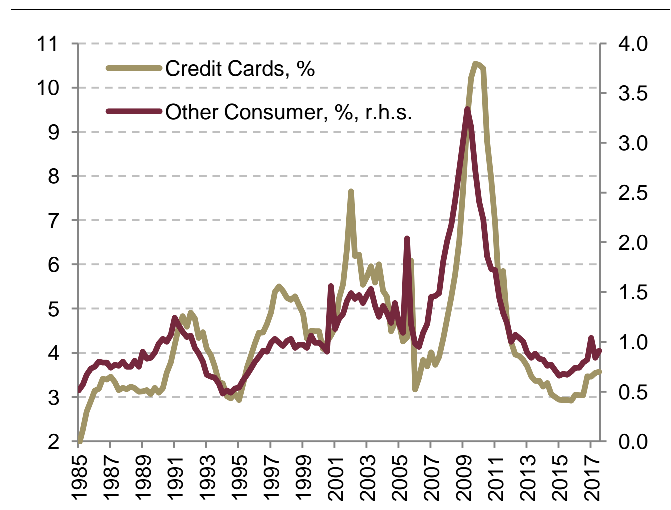
According to Fed H8 data, consumer loan growth yoy rate is currently +5.2% (through December 27th) vs 7.4% yoy 1 year ago. Consumer credit growth significantly accelerated during last month due to speed up of credit card loan growth which is currently at 7.2% yoy vs +7.7% 1 year ago and +4.7% yoy in yearly October 2017. Net change of consumer credit in October was +$20.52 bn vs consensus of +$17.0 bn. However, loan growth of other consumer (not credit cards) remains anemic at +2.9% yoy vs +7.3% yoy 1 yr ago (because of slowdown in Auto). Anyway, from our point of view, consumer loan growth isn't high enough despite strong job market and low levels of debt-service-ratios. The reasons are tightening loan standards because of accelerated loan growth in some consumer areas during the last credit cycle and growth of interest rates.

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



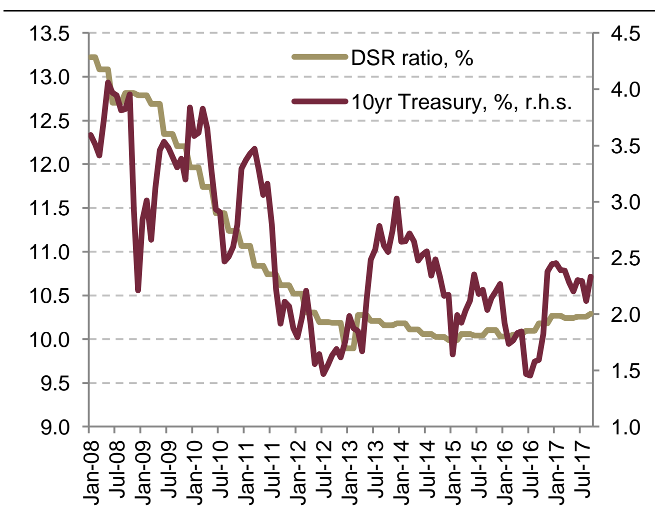
Source: Bloomberg

Chart 19. Consumer. NCOs Ratios, %



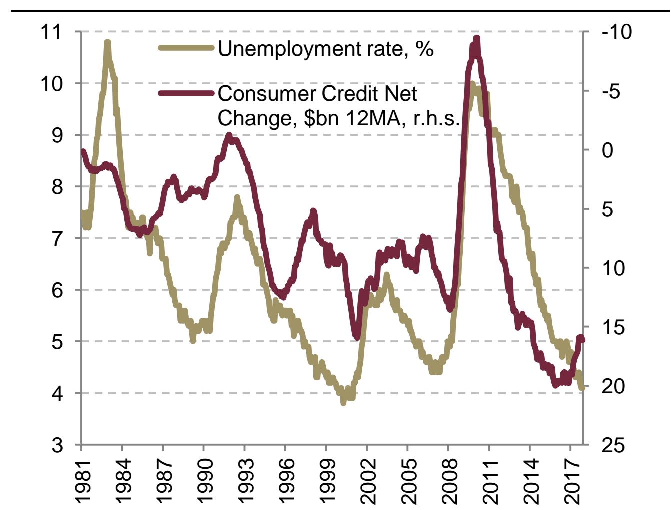
Source: Bloomberg

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



Source: Bloomberg

Chart 21. Consumer. Loan Growth Rate, YoY, %



Source: Bloomberg

The October Senior Loan Officer Survey indicated that lending standards for consumer loans were tightened in the last three months. Specifically, standards were tightened in Credit Cards and Auto loans while standards for other consumer loans were basically

unchanged. “Also, a moderate net share of banks reported an increased willingness to make consumer installment loans”. The other terms were basically unchanged. As for auto loans, banks tightened majority of surveyed terms. However, banks indicated that demand remained basically unchanged. Answering special questions, banks noted that they expected a less favorable or more uncertain outlook, deterioration in the quality of existing loan portfolios. Also, it was noted that rising rates and shifting from banks to non-banks were important reasons for weaker demand in the consumer segment.

Most measures of consumer activity continue to demonstrate strength, but many of them were weaker than expectations in December. Conference Board Consumer Confidence decreased by 6.5 pts in December to 122.1 points (vs expectations of 128 pts) from revised down November figure of 128.6 pts (from 129.5), but it remains no far from the highest level in 17 yrs. Consumer sentiment index of Michigan University was also worse than expectations, 95.9 pts in December vs expectations of 97.2 pts and November’s figure of 98.5 pts. It also remains near its post-housing bubble period peak. The main reason of decline of consumer confidence in December was uncertainty with the tax reform, from our point of view. But consumer’s sentiment will continue to be driven by good income prospects and strong labor market.

November employment data was good with strong beat by nonfarm payrolls. The latter increased by 228K in November vs expectations of 195K and October’s figure of 244K, which were revised down by 17K from the initial estimate. Unemployment ratio was flat in November at 4.1%, matching the expectations. The key disappointment of the employment report remained average hourly earnings which increased by +0.2% MoM vs consensus of +0.3% MoM. October’s figure was also revised down by 10 bps to -0.1% MoM. It was the second consecutive month of missing estimates. Initial Jobless Claims slightly decreased in December (avg of 235K vs 242K in November) and the indicator continues to be relatively stable and near more than 40-yr lows. Overall, financial health of US consumer remains strong. But banks continue to be cautious and they continue to tighten credit standards, especially in risky areas such as auto lending which significantly outgrew majority of other consumer segments during the last credit cycle. Taking into account ongoing rate hikes cycle, financial pressure on consumers will increase and it suggests further deterioration in the quality of the loan portfolio. Moreover, banks have already built card credit reserves recently. But we don’t think that it could be a significant threat for credit quality of the total loan portfolio, at least, in the near future.

Interest Rates

As it was widely expected (the market had estimated probability of it at almost 100% in early December), the Fed increased the target range for the federal funds rate by 0.25% to 1.25% to 1.5%. The policy statement had few changes. The key of them, from our point of view, related to evaluation of core inflation and more optimistic economic forecasts. The dot plot continued to imply three hikes in 2018 (as it was in 2017) and two hikes in 2019 and two more in 2020. The market priced currently just around 2 hikes. In turn, mgmt of some banks (JP Morgan and PNC Financial) noted during the last Goldman Sachs Conference that they expected four hikes in 2018. Due to still very low deposit beta, the number of hikes is very critical for almost all US banks, especially for the most asset sensitive ones. We expect 3 hikes in 2018 (but we believe it possible that the number of hikes could be more) and it seems, from our point of view, that not all of these hikes has currently priced in. However, the flatter yield curve is starting to bother us even despite the short end is more important for majority of US banks as it could negatively impact on bank’s top line in

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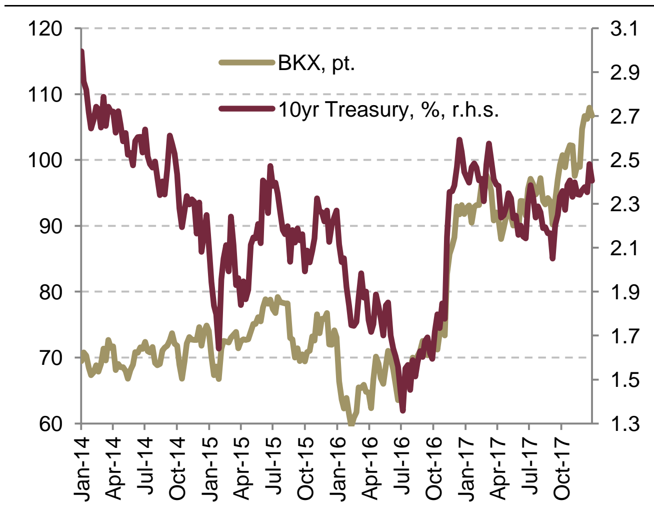
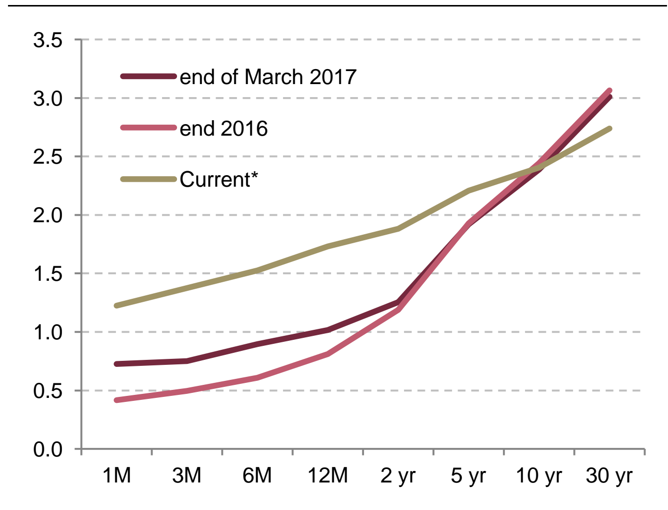
the future.

Chart 22. BKX Index vs 10yr Treasury Yield



Source: Bloomberg

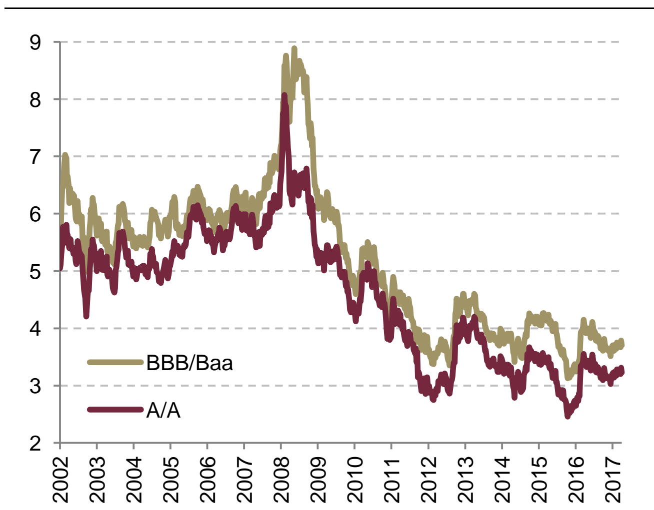
Chart 23. US Yield Curves, %



*As of the end of December 2017

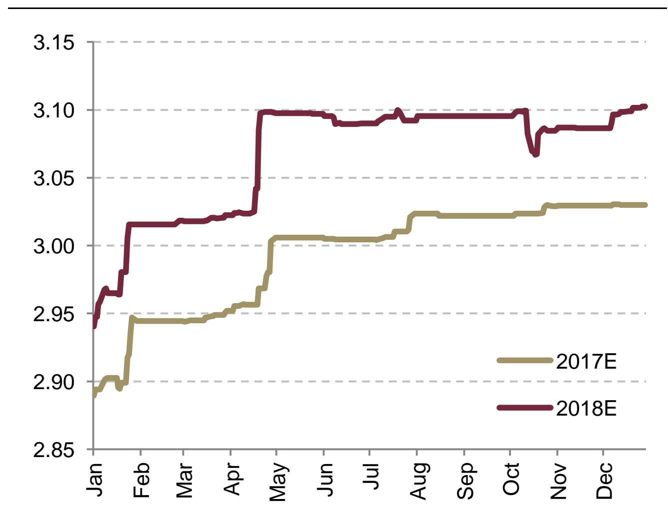
Source: Bloomberg

Chart 24. Corporate Yield Indices, 10yr



Source: Bloomberg

Chart 25. Median NIM of BKX index, %



Source: Bloomberg

The Fed significantly increased the economic projections. It shouldn't be perceived as surprise after changed wording from "moderate" to "solid" at the previous meeting. But the size of upgrade was a positive surprise for us, at least estimate of GDP growth in 2018. The estimate of GDP growth for 2017 year was revised up by 10 bps to 2.5% (from September projection); for 2018 year by 40 bps to 2.5%; for 2018 by 10 bps to 1.8%; for 2019 year by 20 bps to 2%. It was also noted that possible positive effects of the forthcoming tax reform was included in the projections. Unemployment forecasts were revised down by 20 bps for all forthcoming years and currently it is lower than 4% in 2018/2019 years. Inflation remains the key cornerstone for the FOMC members as it continues to lag behind the other economic indicators. Despite the majority of the FOMC members consider current low inflation as temporary phenomenon the minutes of the last FOMC meeting contained quite a long discussion about low inflation. Inflation projections were unchanged, although both GDP and unemployment forecast changes were hawkish. We agree that lagging inflation isn't a big threat for overall number of rate hikes in the coming years given the strong GDP

growth and multi-year lows of unemployment rates. But it could be a threat for timing of these rate hikes (not near term). And if we see the hikes later (than it is expected), the correction in banking quotes will be fast but not very deep.

Treasury yields markedly increased in December almost across the all curve except for the long end (10yr & 30yr yields). 1M yield went up by 10.1 bps MoM to 1.22% while 3M yield came up by 12 bps MoM to 1.38%, 2yr yield increased by 10 bps MoM to 1.88% and 5yr yield added +6.9 bps MoM (currently at 2.21%). In turn, long end went down, 10yr yield decreased by 0.4 bps MoM to 2.405% while 30yr yield declined by 8.7% bps MoM to 2.74%.

As short end of the curve continues its growth while the long end isn't growing so fast, spreads are still tightening. Currently, it is significantly below than it was in the early 2017 and they also remained much lower than the levels of previous years. Currently, treasury spread (5yr-3Mo) is 0.83% or -50 bps MoM (as end of December) vs 1.33% of 5yr-3Mo treasury spread in the end of February. Spread (10yr-2yr) tightened by 10.5 bps MoM to just 0.5% in December, it is multi-year low. Steeper yield curve is a positive driver for banks' profits, but we don't expect that the yield curve will become much steeper from current levels given the probable pace of the Fed rate hikes in the future.

According to Bankrate data, loan yields increased in November following the growth of the yield curve. 30yr mortgage rate went up by 5 bps MoM to 3.85% in December. Auto loans rate (New loans, 60 mnth) skyrocketed by 24 bps MoM to 3.55%. Deposit rates continue to be flat in December (the same dynamics as it was in November) except for 5yr CDs. 1yr CDs remained flat at 0.8%, while 2yr CDs were unchanged at 0.9%. 5yr CDs went up by 3 bps to 1.52% (through December 27st). 3Q17 earnings season showed that deposit betas continued to go up but, in any case, deposit betas are significantly lower vs the previous hike cycles, currently being around 30% and we expect that deposit beta will continue to grow further decreasing sensitivity of bank's balance sheets to future rate hikes (but it is not significant risk for NIM growth yet).

Europe

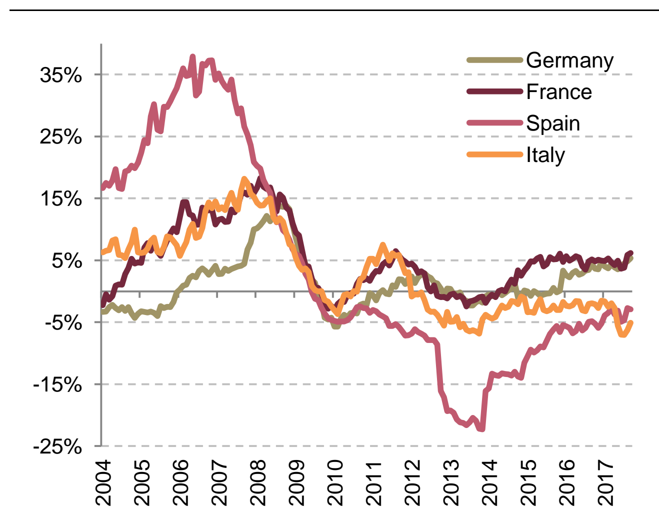
Corporate

According to October 2017 euro area bank lending survey, net demand for loans to enterprises continued to increase in 3Q17, but unadjusted EOP corporate loans increased by only 0.15% yoy in November, the second consecutive month of positive growth. In turn, adjusted loans increased by 2.4% yoy, 25th consecutive month of positive yearly growth. Despite relatively good adjusted figures, we still think that corporate loan growth remains weak given strong recent macro data with moderate acceleration of EU GDP growth this year (and significant upgrade of GDP growth Staff projections). Loan growth dynamics was relatively uniform among major European countries in November but loans continue to go down in Spain and Italy. On year over year basis, corporate loan growth accelerated in all major European countries except for Spain. But credit growth in the EU remains significantly different across countries. We see very healthy corporate loan growth in Germany and France while Italian and Spanish corporate loan growth is still deeply negative.

In line with October BLS, credit standards for corporate loans were broadly unchanged in 3Q17. But the net percentage remained considerably below the historical average since 2003, although it was above the expectation in the previous round (banks had expected slight easing). Bank's standards were broadly unchanged for small and medium-sized

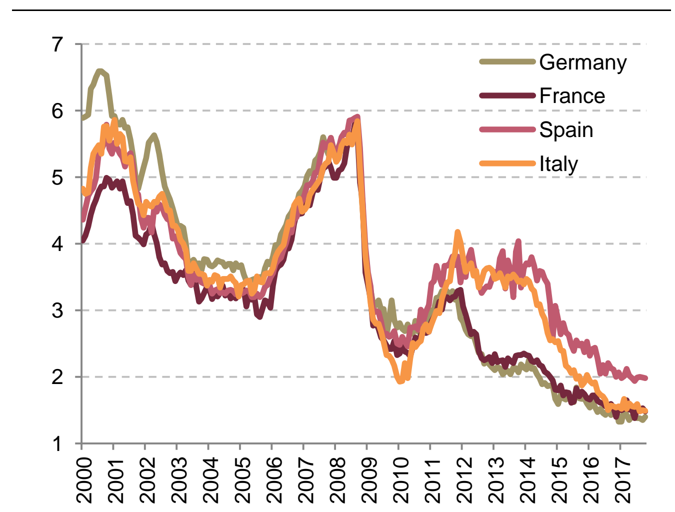
corporations, but eased on loans to large firms. "Across the large euro area countries, credit standards eased in Germany, tightened in Spain and remained unchanged in France and Italy". The key driver of easing standards remains competitive pressure, while effect of cost of funding and BS constraints was not decisive. Banks continue to point on narrowing margins on average loans as one of key drivers of easing standards. Net demand for loans to enterprises continued to increase in 3Q17, in line with expectations of the previous BLS. "Across the large euro area countries, net demand for loans to enterprises increased in Germany, Spain, France and Italy". The key drivers of demand growth were increase in CAPEX and ongoing low level of interest rates.

Chart 26. EU Corporate Loan Growth, YoY



Source: Bloomberg

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



Source: Bloomberg

Germany outstanding corporate loans increased by 5.3% yoy and +0.8% MoM in November vs 4.8% yoy in February 2017 and +4.8% yoy in November 2016. French corporate loans outstanding added +6.2% YoY +0.25% MoM vs +5.2% in November 2016. As for Spain and Italy, its outstanding corporate loans continue to decrease, -2.9% yoy and -5.1% yoy in November 2017, respectively. Moreover, the rate of fall of corporate loans in Spain slightly accelerated in November but after significant deceleration in October.

European corporate rates still demonstrate relatively weak dynamics. However, it has been appearing more and more encouraging signs recently. Average EU corporate loan rates (all maturities, new business lending) increased by 5.5 bps MoM in October to 2.12%. The yield has already grown by 14 bps from its June's low of 1.98%. Moreover, it added +6 bps. In turn, average rate of outstanding loans continues to go down, -0.5 bps MoM and -17 bps YoY in October. Back book yields of EU banks continuously decreased since April 2014 but it markedly decelerated recently. The most substantial increase was showed in France, where October rates on new corporate loans increased by 2 bps to 1.53%. Spanish and Italian rates on new corporate loans were flat in October at 2%. Germany rates decreased by 3 bps in October to 1.35% after flat dynamics in September. In fairness, spreads between new and outstanding rates continue to shrink but they still far from the positive territory for all major European countries except for Spain.

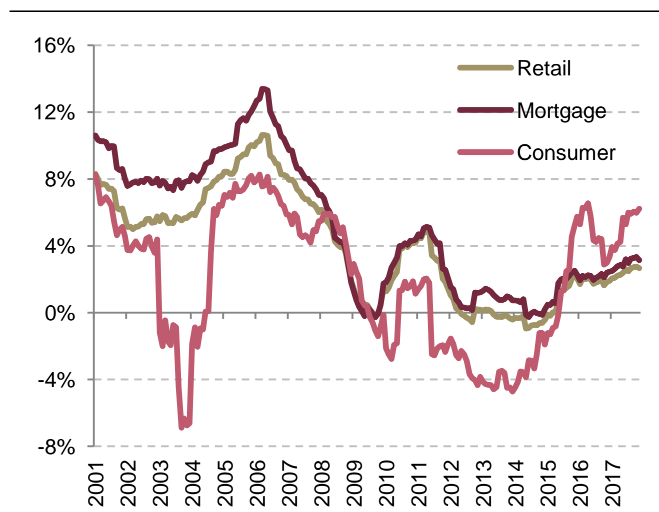
Consumer

EU loans to households increased by 2.7% yoy in November (vs +1.8% in November 2016) that it is markedly higher than average level of the last year, +1.7% yoy. Consumer loans keep gaining momentum but the rate of growth of the loan portfolio continues to differ

widely across countries, German household loans increased by 3.7% yoy in November, French retail lending added 5.5% yoy in November (significant acceleration vs January 2017 growth of 4% yoy), while household loans in Spain decreased by 0.3% yoy in November (the first time since 2011 year when the rate of growth pulled closer to positive value). Italian consumer loans added +1.3% yoy in November (vs -1.0% yoy growth 1 year ago). All major European countries except for Italy markedly accelerated consumer loan growth since the beginning of the year that fully consistent with the improvement of consumer financial health in Europe lately. Consumer confidence in Eurozone increased by 5.7 pts YoY to the highest level in 17 years, unemployment decreased by 0.8% YTD, retail sales continue to demonstrate robust growth.

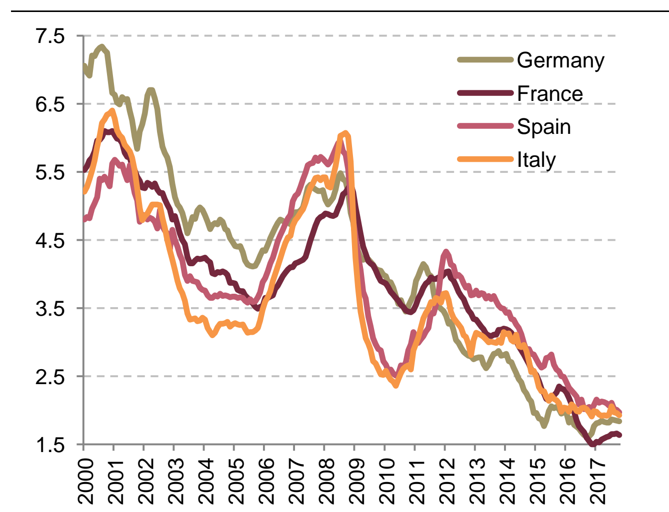
Consumer lending (ex mortgage) still remains the key driver of EU household loan portfolio, adding 6.2% yoy or +0.4 MoM in November, vs +3.0% yoy in November 2016. EU mortgage loans increased by 3.7% yoy in November (vs 3.5% yoy one year ago) slightly decelerating from the level of the last several months. And it broadly corresponds to what we saw in October 2017 lending survey from ECB, where it was noted 'positive net percentage of banks continued to report an increase in demand for housing loans'. The most impressive growth in consumer segment continue to be demonstrated by Spain, where these loans rose by 14.3% yoy in November (vs +12.5% 1 year ago), while Spanish mortgage portfolio continues to stagnate, -2.7% yoy in November (vs -3.1% 1 year ago).

Chart 28. EU Consumer Loan Growth, YoY



Source: Bloomberg

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



Source: Bloomberg

Average EU rates on new mortgage loans slightly decreased by 1 bps MoM in November, the second month in a row after seven consecutive months of growth. The rate has already increased by 12 bps from the minimum level of January 2017. Moreover, on year-over-year basis, this yield also showed positive growth of 7 bps yoy. The key driver of mortgage rates was the long end of the yield curve. 10yr generic yield grew by 6 bps MoM to 0.43% in December after flat dynamics in November. However, mortgage rates on new loans were relatively weak on month-over-month basis in all major European states in November. German rate decreased by 1 bps MoM to 1.85% in October, French rate increased by 1 bps MoM to 1.66%, Spanish rate went down by 4 bps MoM to 1.98% after significant drop in September and Italian mortgage rate on new loans decreased by 1 bps MoM to 1.96%. Unsurprisingly, we continue to see declining back book rates on year-over-basis, average EU rate decreased by 3 bps MoM in October. But there is a deceleration of the rate of

decline of back books recently due to steepening of the yield curve.

As for other consumer credits, EU new business rates decreased by 5 bps MoM to 5.59% in October, after the significant drop in September, but there was significant growth of consumer yields in the summer months. However, current front book yield of consumer loans remains not far from its 5-year high, although it continues to be highly volatile. Front book consumer rates significantly decreased in all major European countries in October except for Italy and Germany where they were flat. Spanish consumer front book yield decreased by 3 bps MoM to 7.79%, French yield also decreased by 3 bps to 3.72% in October.

Average European consumer deposits rate (with agreed maturity) for new deposits was flat on month-over-month basis in October at 0.38%. Cost of outstanding deposits (with agreed maturity) decreased by 0.6 bps MoM in October to 1.02% (-14.8 bps yoy) and it is not good for EU banks, as cost of deposits significantly decelerated its decline rate while yield of consumer loans continue to go down faster than cost of deposits.

According to the last BLS, "Credit standards for loans to households for house purchase eased further, with the change proving stronger than expected in the previous survey round. The net percentage is below the historical average since 2003. Banks eased their credit standards on housing loans across all the large euro area countries. Competitive pressure, banks' higher risk tolerance and lower risk perceptions contributed to the net easing of credit standards on housing loans, while the impact of cost of funds and balance sheet constraints was broadly neutral". Banks expect to continue ease credit standards further in 4Q17. As well as for loans to enterprises, the key driver of easing standards was narrowing margins on average loans. "Across all the large euro area countries, the general level of interest rates and housing market prospects continued to have a substantially positive effect on demand. Consumer confidence had a positive impact on demand in all the large countries except Italy, where it had a neutral effect".

Rates

As we expected, we didn't hear any significant news at the last ECB meeting which was held on 14 December. Rates were left unchanged. The Governing Council confirmed (with no further details) that monthly asset purchases would be reduced to €30 bn from January 2018 (until the end of September 2018, or beyond, if necessary). The key changes were centered on macroeconomic forecasts. Staff projections of EU GDP growth were significantly revised up while inflation forecasts were mainly unchanged. But the overall tone of the meeting wasn't significantly changed from the October session, when overall tone of the meeting was perceived as dovish.

The Staff projections imply that EU growth will remain robust in near years but real GDP growth will slow gradually from 2.4% in 2017 to 1.7% in 2020 "as the effects of a number of factors supporting growth slowly fade away", nevertheless it will remain above potential level of growth. ECB revised up GDP growth forecast for 2017 year from 2.2% to 2.4%, for 2018 from 1.8% to 2.3%, for 2019 from 1.9% to 1.7%. Also, ECB currently estimate GDP growth of 2020 year at 1.7%. The same figure is the ECB's estimate of inflation for 2020, but inflation estimates for other years were raised only slightly. Moreover, it wasn't clearly answered the question whether 1.7% inflation corresponds to the inflation target or not. From our point of view, inflation remains the main obstacle and risk to a more rapid tightening of the monetary policy in EU.

We maintain our point of view that further pace of monthly asset purchases will depend on

the incoming information, including inflation and volatility in the exchange rate. Given the market expectations, the first rate hike will not happen earlier than in 1H2019, from our point of view, and negative deposit facility rate environment will persist at least until the middle of 2020. So, we still think that it is too early to buy banks because of possible rising rates in future taking into account very strong outperformance of European banks in the last year. Of course, fundamentals will continue gradually improve but the short end of the curve will not change significantly until the key policy rates will eventually start to grow; low rate environment will persist for several more years; growth of long end is largely already priced in, from our point of view; valuations don't look as reasonable as before; loan growth is still sluggish, especially in corporate segment while credit quality issues remains.

10yr EU generic yield increased by 6 bps to 0.43% in December. It still remains markedly below of July's high, -17 bps, but it is materially higher than it was at the end of 2016, +18 bps in absolute terms. The dynamics of the generic yields was uniform during December, except for short end (3M yield decreased by 5 bps MoM to -0.78%, 6M yield went down by3 bps MoM to -0.72%). 1yr generic yield increased by 2 bps MoM to -0.61%, while 2yr yield increased by 5.7 bps MoM to -0.63%. Overall, the yield curve became much steeper in December. Spread between 10yr yield and 1yr yield increased by 4 bps MoM to 1.04%. Spread between 5yr and 3M yields increased by 5.5 bps MoM to 0.58%.

Macro indicators overview

Steady economic expansion in the euro area continues with GDP YoY growth markedly higher than 2% and recent macro data indicates that it will remain solid in 2018. At least, ECB significantly increased its GDP forecasts at the last meeting. Last macro figures confirmed this point of view.

Composite PMI, which is well correlated with GDP growth, markedly increased in December after strong growth in November and it remained at multi-year high. Preliminary composite index increased by 0.5 pts to 58.0 pts, well above consensus estimate of 57.2 pts. Manufacturing PMI also increased by 0.5 pts to 60.6 pts and it is currently at multi-year high, significantly beating consensus of 59.7 pts. Services PMI was also better than estimates, going up by 0.3 pts to 56.5 pts. PMI figures indicate that we will continue to see strong GDP growth further. It seems that strengthening euro has not had a significant negative impact on economic growth yet. PMI points at strong employment dynamics and business optimism figures. Economic sentiment in EU remains near six-year high. A majority of business climate and business confidence indicators remained strong in November. Eurozone industrial production increased by 0.2% MoM in October (vs estimations of flat dynamics), after deep decline in October. Consumer confidence continues to rally and it is currently at the highest level since 2001 year. December figure increased by 0.5 pts MoM to +0.5 pts vs expectations of 0.2 pts. Growing consumer confidence is not surprising as the unemployment rate continues to decline even despite growth in labor force.

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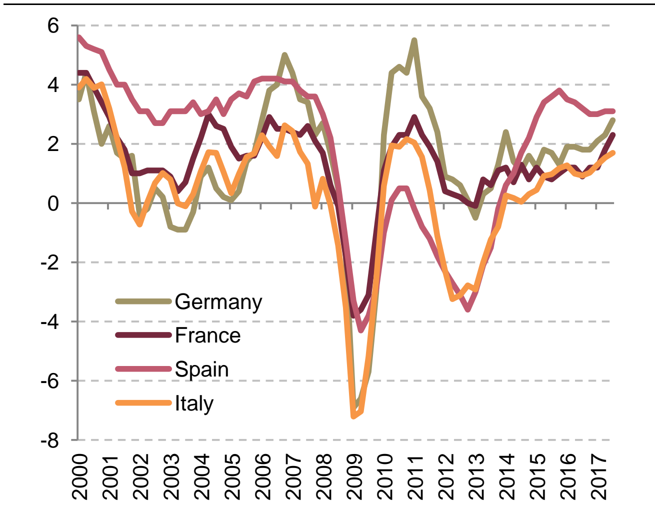
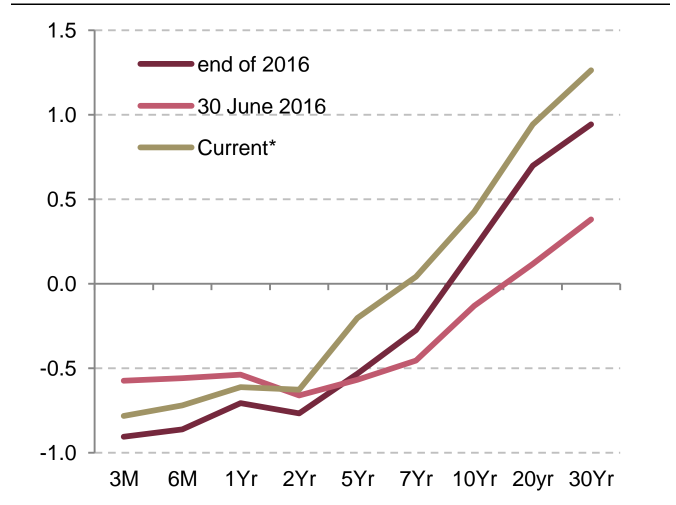
Chart 30. EU Countries Real GDP Growth, YoY, %



Source: Bloomberg

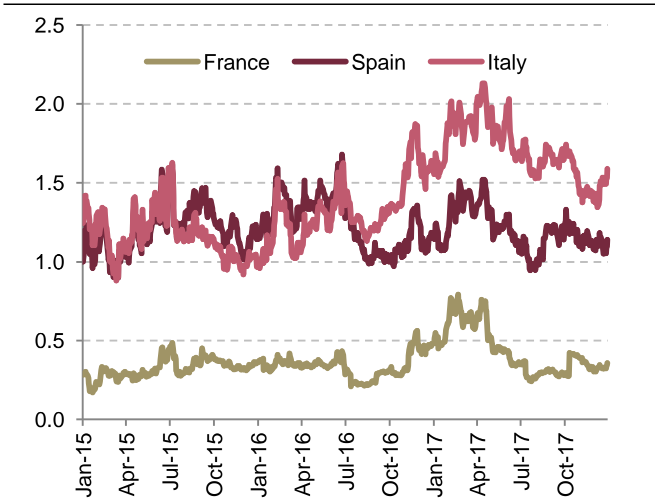
Chart 31. EU Yield Curves, %



*As of the end of December 2017

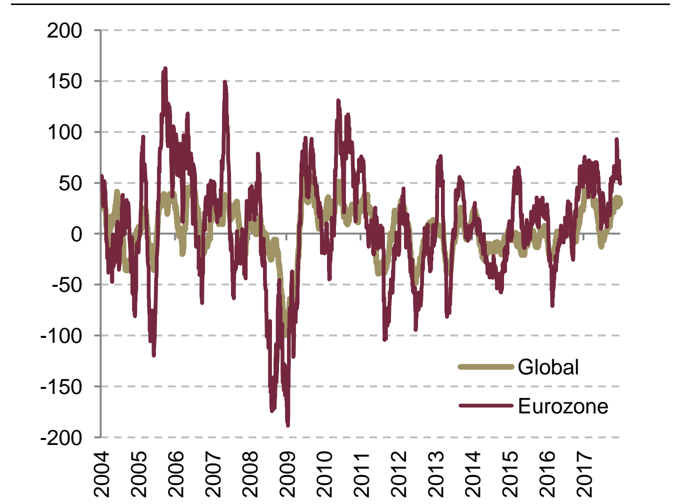
Source: Bloomberg

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



Source: Bloomberg

Chart 33. Citi Economic Surprise Indexes, pt



Source: Bloomberg

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4. THEME OF THE MONTH

US Banks in 2018

From our point of view, it is highly likely that US banks will continue to outperform broad market in 2018 due to net positive effect of the tax reform, higher rates, expected growth of total payout ratios during CCAR and continuation of the deregulation process. Multipliers don't look cheap but relative to S&P 500 index banks don't also look expensive. We expect that credit quality will remain strong (except for some consumer areas) while loan growth rate will accelerate due to faster growth of the economy and pick-up in CAPEX. Our top peaks are Bank of America (BAC), JP Morgan Chase (JPM), Morgan Stanley (MS), Comerica (CMA) and Zions Bancorporation (ZION).

Tax reform was signed by President Trump just few days before the New Year. It was widely expected event but there had been a chance that it could happen later. In any case, the tax reform is very positive for US banks and it will be one of the main drivers of bank EPS in the near years. The key benefit for banks is lowering of corporate tax rate from 35% to 21%. Moreover, the new tax rate will already be effective in the fiscal year 2018. In turn, eliminating of FDIC fee taxability and need to write down DTAs (for some banks) will negatively impact on both EPS and capital (temporary effect). But on the net basis, median growth of banks EPS will exceed 10% and that's without taking into account the secondary effects of the tax reform. Even despite the fact that the event was widely expected, the full effect of the reform isn't in consensus estimates of EPS yet, from our point of view. The key beneficiaries are the card companies which had the highest effective tax rate (DFS, SYF, SC) before the reform and these companies made high share of profits in the country. But our top peaks will also decrease its effective tax rate by 10-12% in 2018, only slightly less than consumer finance companies.

Rates will remain the key driver of net interest margin in 2018 due to still low deposit beta (even accelerating with each hike) and the more hawkish FED. We expect 3 hikes in 2018 (but we believe it possible that the number of hikes could be more) and it seems, from our point of view, that not all of these hikes have currently priced in. The next rate hike could happen as soon as on the March FOMC meeting. On the other hand, the flatter yield curve is starting to bother us even despite the short end is more important for majority of US banks as it could negatively impact on bank's top line in the future. But, from our point of view, this risk is not particularly relevant for 2018. Currently, consensus estimates implies that median NIM of BKX index will increase by 7 bps YoY in absolute terms in 2018, but given the current dot plots and the forward yield curve, NIM growth could exceed 10 bps in 2018. The other risk for NIM growth is spread tightening because of relatively anemic loan growth, clarity on tax reform and, as a result, increased competition for customers. But we think that significant growth of short-end is more important for banks in 2018. Comerica remains one of the most rate sensitive banks in US, but ZION and BAC have also high level of asset sensitivity.

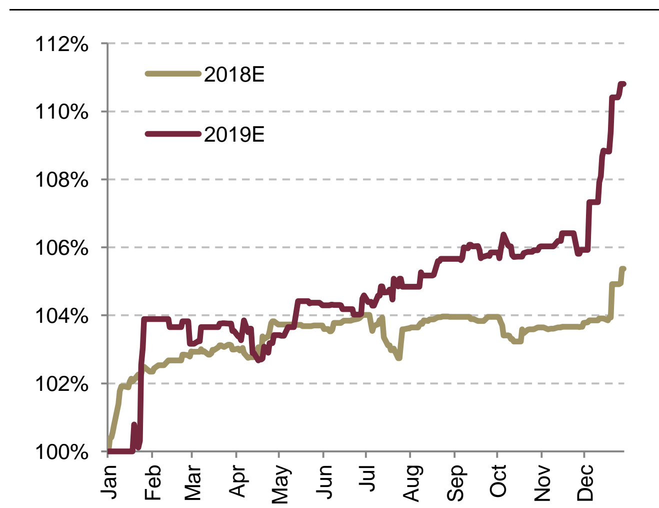
Deregulation is the most critical issue for banks in the current year as it could be a very important driver of growth of both banking EPS and ROE and we are convinced that deregulation isn't in price yet. Deregulation will give banks more capital flexibility. Taking into account that banks still have significant amount of excess capital (more than 5% of the current market cap) and more than 100% of payout ratios as a result of CCAR 2017, we expect that these ratios will grow further in the several coming years given expectation of more friendly regulation. From our point of view, the most important consequence of deregulation will be M&A acceleration, especially among regional and super regional banks

in case of rising of SIFI limit from $50 bn to $250 bn. So, we will see further multiple expansion. Of course, SIFI limit growth will positively impact on payout ratios along with easing of some requirements of CCAR (for example, easing or cancelation of DPR ceiling). Dodd-Frank changes along with other deregulation initiatives could improve capital markets revenues for the major US banks and also reduce regulation expenses, which were a significant drag for these banks not so long time ago.

Loan growth at US banks decelerated since September 2016 to its local low of 3% yoy in the end of August 2017. But after that total loan growth accelerated to 4.2% as the end of 2017. The key driver of weak loan growth was C&I which growth rate decreased from 9.1% yoy in October 2016 to 0.7% yoy in the early December 2017 (+1.6% yoy as the end of 2017). The key reasons of weak C&I loan growth were 'wait and see' approach of borrowers because of lack progress in reforms and switching of the large borrowers to capital markets, but after the approval of the tax reform the situation should change given the easing of C&I lending standards during the last several quarters. It is too early to draw a conclusion from the last acceleration of loan growth in the corporate segment, but we expect that C&I loans growth will accelerate from the current level due to faster growth of the economy and pick-up in CAPEX. We don't expect that total loan growth accelerate to the growth rate of the mid-cycle but we expect that it will not be a drag for banks operating results in 2018. We also think that quality of the loan portfolio of US banks will remain strong in 2018 with only slight increase of both NCO ratios and provisions even despite some red flags in Auto and Credit Cards lately.

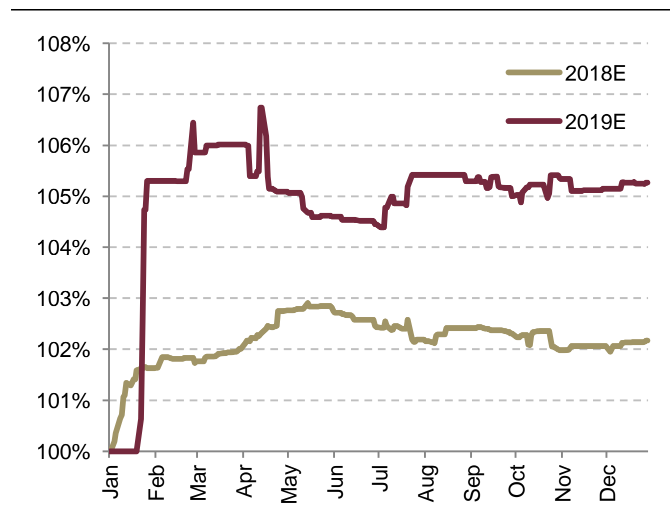
Overall, operating results of US banks remain strong with very healthy revenue and net income growth. Despite we don't expect strong figures during the 4Q17 earnings season because of tax reform related one-timers and relatively weak trading results due to still weak volatility, we wait for double-digit EPS growth of US banks in 2018 year. Currently, consensus estimates of median EPS growth of BKX index members are 22% yoy in 2018 and 12% in 2019. Moreover, we think that these figures will go higher during the current year as it was in 2017, especially if we see acceleration of deregulation process in the near future.

Chart 34. Median Growth of EPS of BKX Index



Source: Bloomberg

Chart 35. Median Growth of Revenue of BKX Index



Source: Bloomberg

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Table 1. US Banks: Valuations

Company	Ticker	Price, $ (29/12/17)	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			2017E	2018E	2019E	2017E	2018E	2019E			2017E	2018E	2019E		
American Express	AXP	99.3	105.9	6.7%	99.3	75.4	65.7	86.2	1.4%	1.5%	1.5%	17.5	14.4	13.2	4.1	N. A.	25.7	28.0	28.6	10.8	12.3
JP Morgan Chase	JPM	106.9	114.0	6.6%	106.9	81.6	69.1	371.1	2.0%	2.3%	2.6%	15.6	12.3	11.7	1.6	2.0	10.6	12.4	13.0	7.4	12.5
PNC Financial	PNC	144.3	152.8	5.9%	144.3	113.7	73.1	68.7	1.8%	2.2%	2.6%	17.2	13.6	12.4	1.6	2.1	9.6	10.5	11.2	9.1	10.6
Bank of America	BAC	29.5	32.8	11.3%	29.5	22.0	70.4	307.9	1.3%	2.0%	2.7%	16.6	12.1	10.5	1.2	1.7	7.7	9.6	10.3	8.0	12.1
Citigroup	C	74.4	82.2	10.5%	74.4	55.2	55.6	196.7	1.3%	2.0%	2.5%	14.3	11.8	10.3	0.9	1.1	5.5	7.9	8.7	10.1	14.9
BB&T Corp	BBT	49.7	53.3	7.3%	49.7	41.2	75.5	39.2	2.5%	2.8%	3.2%	16.0	13.0	12.4	1.5	2.4	9.4	10.1	10.5	7.8	10.2
Goldman Sachs	GS	254.8	269.8	5.9%	254.8	209.7	52.6	99.8	1.1%	1.2%	1.3%	13.4	12.0	10.8	1.3	1.4	9.8	10.8	11.4	8.4	13.1
SunTrust Banks	STI	64.6	69.8	8.1%	64.6	52.0	72.9	30.7	2.1%	2.6%	2.9%	15.9	13.4	12.3	1.4	2.1	8.6	9.4	9.9	7.3	9.6
Bank of NY Mellon	BK	53.9	60.1	11.5%	53.9	43.9	77.6	55.2	1.6%	1.9%	2.2%	15.2	13.2	12.1	1.5	3.5	10.1	10.8	11.3	4.6	9.7
Comerica	CMA	86.8	92.2	6.2%	86.8	64.1	77.0	15.1	1.3%	1.5%	1.8%	18.4	14.3	12.8	1.9	2.0	10.6	12.2	12.8	9.9	11.1
Citizens Financial	CFG	42.0	45.9	9.3%	42.0	31.5	76.7	20.7	1.5%	2.2%	2.5%	16.3	13.2	12.2	1.1	1.6	6.6	7.5	7.9	8.8	11.2
Regions Financial	RF	17.3	18.1	4.6%	17.3	13.0	74.9	20.0	2.1%	2.3%	2.7%	17.4	13.8	12.5	1.3	1.9	7.4	8.6	9.3	8.7	11.1
Discover Financial	DFS	76.9	87.9	14.2%	76.9	57.5	76.5	28.0	1.7%	1.9%	2.0%	13.0	10.4	9.5	2.7	2.8	20.4	22.2	23.0	11.2	13.2
M&T Bank	MTB	171.0	176.6	3.3%	171.0	141.2	66.6	25.7	1.8%	1.9%	2.1%	18.6	15.4	14.3	1.7	2.5	9.2	10.4	10.9	8.9	11.0
Fifth Third Bancorp	FITB	30.3	31.7	4.6%	30.3	23.3	70.2	21.4	2.0%	2.4%	2.7%	15.7	13.6	12.4	1.4	1.7	9.0	9.9	10.4	8.9	10.4
Huntington Bancorp	HBAN	14.6	16.3	11.6%	14.6	12.2	71.9	15.7	2.4%	3.1%	3.4%	14.9	12.4	11.6	1.6	2.2	10.4	12.1	12.6	7.0	9.6
Northern Trust	NTRS	99.9	106.1	6.2%	99.9	81.9	77.4	22.7	1.6%	1.8%	2.0%	21.0	17.0	15.9	2.4	2.5	12.0	13.7	14.4	7.0	12.4
People's United	PBCT	18.7	19.6	4.9%	18.7	16.0	62.1	6.5	3.7%	3.7%	3.7%	19.1	14.9	14.0	1.1	2.2	6.0	7.1	7.4	7.1	9.9
Synchrony Financial	SYF	38.6	45.7	18.2%	38.6	26.0	70.2	30.2	1.5%	1.7%	2.0%	15.0	11.3	9.2	2.1	2.4	14.4	17.3	20.1	14.2	17.2
KeyCorp	KEY	20.2	22.4	11.2%	20.2	16.3	73.5	21.7	1.9%	2.4%	2.8%	14.9	12.3	11.4	1.5	1.8	10.2	11.5	12.2	9.3	9.5
State Street Corp	STT	97.6	110.1	12.8%	97.6	75.1	76.8	36.2	1.6%	1.8%	2.0%	15.6	13.3	12.3	1.9	3.1	12.6	13.1	13.6	4.4	11.6
US Bancorp	USB	53.6	57.9	8.1%	53.6	49.5	67.9	88.9	2.2%	2.4%	2.7%	15.7	13.5	12.5	2.1	2.9	13.3	13.8	14.0	7.2	9.4
Zions Bancorp	ZION	50.8	55.3	8.9%	50.8	38.4	65.9	10.2	0.9%	1.9%	2.2%	18.4	14.5	13.1	1.4	1.6	8.1	9.2	10.0	9.5	12.1
Morgan Stanley	MS	52.5	59.4	13.2%	52.5	40.1	66.1	94.9	1.7%	2.1%	2.6%	14.8	12.1	10.7	1.3	1.5	9.1	10.6	11.4	7.4	16.9
Capital One Financial	COF	99.6	110.7	11.1%	99.6	76.1	73.7	48.3	1.6%	1.7%	1.8%	12.7	10.7	9.6	1.1	1.6	8.2	8.9	9.4	8.2	10.1
Wells Fargo	WFC	60.7	66.5	9.6%	60.7	49.3	69.5	298.8	2.5%	2.7%	2.9%	15.0	12.4	11.2	1.7	2.0	11.2	11.9	12.5	7.7	11.1
First Republic Banks	FRC	86.6	99.2	14.4%	86.6	84.6	53.0	13.9	0.8%	0.8%	0.9%	19.2	17.3	15.4	2.1	2.2	11.4	11.4	11.5	7.5	10.8
NY Commercial Bancshares	NYCB	13.0	13.3	2.5%	13.0	11.7	63.1	6.4	5.2%	5.2%	5.2%	18.6	15.6	15.2	1.0	1.7	5.8	5.9	6.3	7.9	10.6
SVB Financial	SIVB	233.8	260.4	11.4%	233.8	159.4	71.1	12.3	0.0%	0.0%	N. A.	24.6	17.8	15.6	3.0	3.0	12.4	13.6	15.2	8.2	12.8
Signature Bank	SBNY	137.3	155.8	13.5%	137.3	116.7	67.0	7.5	N. A.	N. A.	N. A.	19.7	13.1	12.2	1.9	1.9	10.2	12.4	12.2	9.3	11.9
East West Bancorp	EWBC	60.8	68.8	13.2%	60.8	48.2	74.4	8.8	1.3%	1.4%	1.6%	17.2	14.5	13.3	2.3	2.7	14.7	14.3	14.8	8.5	10.9
Synovus Financial	SNV	47.9	51.4	7.2%	47.9	38.0	67.0	5.7	1.3%	1.5%	1.7%	19.4	14.4	13.5	2.0	2.0	10.0	12.3	12.6	9.1	10.0
First Horizon National	FHN	20.0	22.7	13.4%	20.0	15.8	58.3	6.5	1.8%	2.1%	2.5%	17.9	13.8	11.9	1.9	2.1	10.2	10.2	11.6	7.4	9.9
BOK Financial	BOKF	92.3	93.9	1.7%	92.3	73.5	68.6	6.0	1.9%	2.0%	2.1%	17.3	15.0	14.1	2.0	2.3	10.1	10.0	10.3	8.6	11.2
Median				**9.1%**			**70.2**		**1.7%**	**2.0%**	**2.5%**	**16.5**	**13.4**	**12.4**	**1.6**	**2.1**	**10.1**	**10.8**	**11.5**	**8.3**	**11.1**

Source: Bloomberg

APPENDIX

Table 2. EU Banks: Valuations

Company	Ticker	Currency	Price* (29/12/17)	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			2017E	2018E	2019E	2017E	2018E	2019E			2017E	2018E	2019E		
Erste Group	EBS AV	EUR	36.10	40.1	11.2%	38.8	26.6	68.7	15.1	3.2%	3.7%	4.4%	12.8	12.1	11.3	1.2	1.3	9.9	10.0	10.2	5.1	13.1
Raiffeisen Bank	RBI AV	EUR	30.20	29.4	-2.7%	33.0	18.8	71.3	8.2	2.2%	3.0%	4.2%	10.6	9.6	8.7	1.0	1.1	10.8	9.6	9.7	7.2	13.9
KBC Groep	KBC BB	EUR	71.11	74.7	5.0%	75.9	56.2	74.7	29.3	4.3%	4.5%	5.1%	12.1	12.8	12.5	1.7	1.9	15.2	13.3	12.8	5.5	16.2
Komercni Banka	KOMB CK	CZK	915	1020.8	11.6%	1013.0	875.0	54.5	6.9	4.7%	4.6%	4.9%	14.2	14.0	13.5	1.8	N. A.	13.3	12.3	12.3	10.3	16.2
Jyske Bank	JYSK DC	DKK	353.2	360.7	2.1%	399.8	319.1	62.2	5.0	3.0%	2.8%	3.3%	11.7	11.8	10.6	1.0	1.0	9.2	8.1	8.3	5.3	16.5
SydBank	SYDB DC	DKK	249.9	263.5	5.4%	266.0	217.9	65.2	2.5	4.5%	4.4%	4.7%	12.1	12.1	11.0	1.4	1.5	13.1	11.9	12.4	7.8	16.1
Danske Bank	DANSKE DC	DKK	241.6	273.0	13.0%	259.5	216.4	62.5	32.1	4.1%	4.4%	4.7%	12.2	11.8	11.0	1.4	1.5	12.8	12.6	13.0	4.2	16.3
BNP Paribas	BNP FP	EUR	62.25	70.9	14.0%	69.2	54.0	68.0	81.9	4.8%	4.9%	5.3%	10.9	10.3	9.5	0.8	1.0	8.3	8.0	8.4	3.8	11.6
Natixis	KN FP	EUR	6.596	7.2	8.5%	7.0	5.1	65.7	19.3	5.6%	5.9%	6.5%	13.4	12.1	11.0	1.1	N. A.	7.9	9.0	9.6	2.7	10.8
Societe Generale	GLE FP	EUR	43.05	49.3	14.6%	52.3	40.7	70.2	40.1	5.0%	5.4%	5.8%	11.1	10.0	9.3	0.6	N. A.	6.0	7.0	7.5	4.0	11.8
Credit Agricole	ACA FO	EUR	13.8	15.9	15.3%	15.7	11.1	70.0	42.3	4.7%	4.9%	5.4%	12.6	11.4	10.3	0.7	N. A.	6.9	6.9	8.2	2.6	12.1
CYBG	CYBG LN	GBp	339.7	281.1	-17.2%	341.6	257.1	52.4	2.6	0.0%	0.1%	0.1%	14.1	12.6	10.7	0.9	1.0	5.9	7.3	7.8	7.1	12.4
HSBC	HSBA LN	GBp	766.9	767.6	0.1%	797.5	618.0	72.7	170.3	0.1%	0.1%	0.1%	12.2	11.3	10.4	1.1	N. A.	7.8	8.4	8.7	6.5	13.6
Royal Bank of Scotland	RBS LN	GBp	278	287.3	3.4%	293.8	213.4	73.5	33.0	0.0%	0.0%	0.1%	11.7	10.4	9.1	0.7	0.8	7.2	7.6	7.9	5.3	13.4
Barclays	BARC LN	GBp	203.1	207.2	2.0%	244.4	177.3	54.6	38.6	0.0%	0.0%	0.0%	11.9	9.0	8.5	0.6	0.7	3.3	5.6	6.6	4.2	12.4
Standard Charted	STAN LN	GBp	780.1	722.5	-7.4%	860.0	678.8	75.8	31.1	0.0%	0.0%	0.0%	16.2	11.4	9.3	0.7	0.8	3.8	5.0	6.1	6.8	13.6
Lloyds	LLOY LN	GBp	68.06	72.3	6.3%	73.5	61.8	64.8	52.6	0.1%	0.1%	0.1%	8.9	9.1	9.1	1.1	1.3	13.0	12.4	11.9	4.8	13.6
Commerzbank	CBK GY	EUR	12.505	11.4	-9.0%	13.3	7.0	68.1	13.9	0.0%	0.8%	2.4%	27.0	15.2	10.5	0.5	0.6	0.9	3.1	4.6	5.4	13.9
Deutsche Bank	DBK GY	EUR	15.875	14.6	-7.8%	17.8	13.1	44.7	31.2	0.7%	2.5%	3.7%	14.0	9.7	7.9	0.5	0.6	1.8	3.5	4.9	3.2	13.4
UniCredit	UCG IM	EUR	15.58	23.0	47.7%	18.4	11.9	59.4	37.1	1.8%	2.4%	4.3%	14.3	11.1	8.6	0.6	0.6	10.2	6.1	7.5	4.2	8.2
Mediobanka	MB IM	EUR	9.46	10.1	7.2%	10.0	7.3	64.8	7.8	4.3%	4.4%	4.7%	11.6	10.9	10.2	0.9	1.0	8.4	8.5	7.7	12.2	13.3
Intesa Sanpaolo	ISP IM	EUR	2.77	3.1	12.4%	3.0	2.0	68.0	48.7	7.3%	6.9%	7.3%	13.7	12.1	10.8	0.9	1.0	14.0	7.3	8.4	5.8	12.7
Emilia Romagna	BPE IM	EUR	4.21	5.2	23.5%	5.8	3.8	59.3	2.2	1.3%	2.1%	4.0%	15.8	9.1	7.0	0.4	0.4	2.2	2.8	6.8	6.8	13.8
UBI Banca	UBI IM	EUR	3.646	4.3	18.3%	4.6	2.6	61.2	4.7	2.8%	3.7%	5.2%	19.9	12.6	7.9	0.4	0.5	5.5	4.2	6.0	6.6	11.5
ING Groep	INGA NA	EUR	15.325	17.0	10.8%	16.5	12.8	76.9	61.4	4.5%	4.8%	5.0%	12.4	11.9	11.1	1.2	1.2	10.4	10.4	10.6	5.7	14.2
ABN Amro	ABN NA	EUR	26.9	27.8	3.4%	28.3	21.1	79.9	22.5	5.2%	5.2%	5.7%	10.3	10.6	10.2	1.2	N. A.	13.9	11.0	10.8	4.7	17.1
DNB	DNB NO	NOK	152.1	163.0	7.2%	164.3	131.1	61.2	27.1	4.4%	5.2%	5.7%	12.9	11.7	10.7	1.3	1.3	9.9	10.5	11.1	7.0	16.0
BBVA	BBVA SQ	EUR	7.112	7.5	5.4%	7.9	5.9	59.7	51.0	3.9%	4.0%	4.3%	12.0	11.1	10.3	1.0	1.2	9.0	9.2	9.5	5.2	12.1
Santander	SAN SQ	EUR	5.479	6.1	10.8%	6.2	4.9	65.9	85.4	3.8%	4.0%	4.3%	12.6	11.4	10.2	0.9	1.3	7.6	8.5	9.1	4.7	12.5
Bankia	BKIA SQ	EUR	3.987	4.1	3.6%	4.7	3.6	66.5	12.3	3.2%	3.5%	4.2%	13.4	12.6	11.4	0.9	N. A.	6.7	6.8	7.5	6.6	14.7
Bankinter	BKT SQ	EUR	7.904	7.9	0.3%	8.8	7.1	69.6	7.4	3.3%	3.7%	3.8%	15.7	14.5	13.0	1.7	1.8	11.5	12.1	12.4	5.8	11.8
Sabadell	SAB SQ	EUR	1.656	1.8	6.2%	2.0	1.3	72.3	10.6	3.5%	4.2%	5.0%	13.7	11.8	10.0	0.7	0.8	6.4	6.3	7.3	5.2	12.0
CaixaBank	CABK SQ	EUR	3.889	4.3	11.4%	4.5	3.2	68.2	26.4	3.7%	4.6%	5.1%	15.3	12.5	11.2	0.9	1.1	7.7	8.7	9.3	5.8	N. A.
SEB	SEBA SS	SEK	96.3	110.3	14.5%	109.0	94.1	65.1	23.5	6.0%	6.2%	6.5%	13.0	12.5	11.7	1.5	1.6	12.3	12.1	12.4	5.0	18.8
Handelsbanken	SHBA SS	SEK	112.2	118.0	5.2%	136.3	108.8	63.1	24.5	5.6%	5.4%	5.6%	14.7	14.2	13.5	1.6	1.7	11.8	11.7	11.9	4.8	25.1
Swedbank	SWEDA SS	SEK	197.9	222.4	12.4%	234.0	193.2	60.5	25.0	6.5%	6.5%	6.7%	12.7	12.2	11.7	1.7	2.0	14.5	14.0	14.1	5.4	25.0
Nordea	NDA SS	SEK	99.3	110.6	11.4%	115.7	95.9	60.2	43.3	0.7%	0.7%	0.7%	120.6	111.0	104.9	1.3	1.5	10.0	10.7	11.1	4.7	18.4
Julious Baer	BAER VX	CHF	59.6	61.8	3.7%	62.7	43.9	76.9	10.8	2.4%	2.8%	3.2%	15.4	13.7	12.4	2.5	5.2	14.1	15.0	15.1	2.7	16.4
Credit Suisse	CSGN VX	CHF	17.4	18.4	5.7%	18.1	12.9	65.0	33.4	1.9%	2.9%	4.0%	19.4	12.4	9.5	1.0	1.1	3.8	7.2	9.6	4.5	13.6
UBS	UBSG VX	CHF	17.94	18.7	4.0%	18.7	14.6	71.7	56.9	3.6%	4.1%	4.8%	12.4	11.6	10.4	1.2	1.4	7.9	9.6	10.3	5.1	16.8
Median					**6.2%**			**65.8**		**3.6%**	**4.0%**	**4.5%**	**12.8**	**11.8**	**10.5**	**1.0**	**1.1**	**8.7**	**8.6**	**9.4**	**5.2**	**13.6**

Source: Bloomberg

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Table 3. Calendar

Date	Region	Section	Event	Period
12-Jan	**US**	**Corporate**	**JPMorgan Chase Earnings Report**	**4Q17**
12-Jan	US	Corporate	Wells Fargo Earnings Report	4Q17
12-Jan	US	Macro	CPI	Dec
12-Jan	US	Macro	Retail Sales	Dec
15-Jan	EU	Macro	Trade Balance	Nov
16-Jan	US	Corporate	Citigroup Earnings Report	4Q17
16-Jan	US	Macro	Empire Manufacturing	Jan
17-Jan	EU	Macro	EU27 New Car Registrations	Dec
17-Jan	EU	Macro	Construction Output	Nov
17-Jan	EU	Macro	CPI	Dec
17-Jan	US	Corporate	Bank of America Earnings Report	4Q17
17-Jan	US	Corporate	US Bancorp Earnings Report	4Q17
17-Jan	US	Corporate	Goldman Sachs Earnings Report	4Q17
17-Jan	US	Macro	Industrial Production and Capacity Utilization	Dec
18-Jan	US	Corporate	Morgan Stanley Earnings Report	4Q17
18-Jan	US	Macro	Housing Starts and Building Permits	Dec
18-Jan	US	Macro	Philadelphia Fed Business Outlook	Jan
19-Jan	US	Macro	U. of Mich. Sentiment	Jan
22-Jan	EU	Corporate	UBS Earnings Report	4Q17
22-Jan	US	Macro	Chicago Fed Nat Activity Index	Dec
23-Jan	EU	Macro	ZEW Survey Expectations	Jan
23-Jan	EU	Macro	Consumer Confidence	Jan
24-Jan	EU	Macro	Markit Eurozone Manufacturing PMI	Jan
24-Jan	EU	Macro	Markit Eurozone Services PMI	Jan
24-Jan	US	Macro	FHFA House Price Index	Nov
24-Jan	US	Macro	Markit US PMI indices	Jan
25-Jan	**EU**	**Macro**	**ECB Main Refinancing Rate**	**Jan 25**
25-Jan	US	Macro	Wholesale Inventories	Dec
25-Jan	US	Macro	New Home Sales	Dec
25-Jan	US	Macro	Leading Index	Dec
26-Jan	**US**	**Macro**	**GDP QoQ**	**4Q**
26-Jan	US	Macro	Durable Goods Orders	Dec
29-Jan	US	Macro	Personal Income and Spending	Dec
29-Jan	US	Macro	Dallas Fed Manf. Activity	Jan
30-Jan	EU	Macro	Economic & Industrial Confidence	Jan
30-Jan	**EU**	**Macro**	**GDP QoQ**	**4Q**
30-Jan	US	Macro	Conf. Board Consumer Confidence	Jan
31-Jan	EU	Corporate	ING Earnings Report	4Q17
31-Jan	EU	Corporate	Santander Earnings Report	4Q17
31-Jan	EU	Macro	Unemployment Rate	Dec
31-Jan	EU	Macro	CPI Core	Jan
31-Jan	US	Macro	ADP Employment Change	Jan
31-Jan	US	Macro	Chicago Purchasing Manager	Jan
31-Jan	**US**	**Macro**	**FOMC Rate Decision**	**Jan 31**

Source: Bloomberg

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EQUITY RESEARCH

Sergey Fundobny
Head of Research, Strategy
(495) 780 01 11 (ext. 90-23)
Fundobny@arbatcapital.com

Mikhail Zavaraev, CFA
Senior Analyst, Finance
(495) 780 01 11 (ext. 90-54)
Zavaraev@arbatcapital.com

Vitaly Gromadin, CFA
Senior Analyst, Oil & Gas
(495) 780 01 11 (ext. 90-50)
Gromadin@arbatcapital.com

CONTACTS

ARBAT INVESTMENT SERVICES LTD
123001, Moscow
Sadovaya-Kudrinskaya Str. 32 bldg.1

Tel.: (499) 702 30 04
Fax: (499) 702 30 34
e-mail: research@arbatcapital.com

Internet
www.arbatcapital.com

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