EU banks: Capital risk mispriced

Bullish conviction on EU banks increases based on new global capital benchmarking analysis

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EU banks overdiscount sovereign & capital risk

Source: Datastream, Dealogic, Nomura research

Relative performance not tracked credit markets
Large-cap EU banks capital exceeds global average

- EU bank Basel 3 fully phased core Tier 1 8.6% vs. global average 8.5%
- Capital generation slightly lower (ROTE 15.8% vs. 17.9%) but ample to earn organically into Basel 3 capital standards

Source: Company data, Bloomberg, Nomura estimates
EU bank valuation therefore looks attractive

EU banks trade on a Basel 3 capital-adjusted 2012 P/E of 8.5x compared with a global average of 9.0x
Although less attractively priced than Chinese banks, we believe that they look favourable relative to US banks

Source: Company data, Bloomberg, Nomura estimates
We do not believe accounting skews the picture

RWAs/Total assets vs. Net charge-offs/Total assets

- RWAs/Total assets differ globally due to business mix, asset risk and accounting differences
- The correlation between RWAs and charge-offs suggests that business mix and asset risk are the dominant drivers

Source: Company data, Nomura research
We expect almost all listed banks to pass the stress test

Forecast core Tier 1 in adverse scenario with sovereign shock

- We believe that the macro scenarios are credible, and the publication delay to July confirms they are well audited.
- With retained earnings and over EUR43bn raised since the 2010 test, we expect minimal failures net of capital plans under way.
- With debt markets already improving, we believe that benign results could catalyse a rally for the equity.

Source: Company reports, CEBS, Nomura research
Funding markets have already improved

Source: Dealogic, Nomura research
Economic surprises are the final catalyst

Source: Datastream, Nomura research

G10 Economic Surprise Index vs. EU banks relative

Economic surprises vs. banks relative

Jun-08 Sep-08 Dec-08 Mar-09 Jun-09 Sep-09 Dec-09 Mar-10 Jun-10 Sep-10 Dec-10 Mar-11

G10 Economic Surprise Index
EU banks vs. market
North/South divide

N/S divide in economic and bank indicators

Source: Datastream, Nomura research

<table>
<thead>
<tr>
<th>Indicator</th>
<th>North (GDP wtd)</th>
<th>South (GDP wtd)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt/GDP</td>
<td>214%</td>
<td>255%</td>
</tr>
<tr>
<td>External debt</td>
<td>34%</td>
<td>49%</td>
</tr>
<tr>
<td>Fiscal deficit</td>
<td>14%</td>
<td>10%</td>
</tr>
<tr>
<td>GDP growth</td>
<td>2.3%</td>
<td>7.4%</td>
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<tr>
<td>Unemployment</td>
<td>13.3%</td>
<td>37%</td>
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<tr>
<td>CDS</td>
<td>0.3%</td>
<td>1.6%</td>
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<tr>
<td>Loan growth</td>
<td>302</td>
<td>37</td>
</tr>
<tr>
<td>NPLs</td>
<td>7.7%</td>
<td>4.8%</td>
</tr>
<tr>
<td>Bank Tier 1</td>
<td>13.1%</td>
<td>9.7%</td>
</tr>
<tr>
<td>Bank P/TBV</td>
<td>1.12x</td>
<td>0.97x</td>
</tr>
</tbody>
</table>

Debt/GDP, External debt, Fiscal deficit, GDP growth, Unemployment, CDS, Loan growth, NPLs, Bank Tier 1, Bank P/TBV

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