



## EUROPE



# European banks

## Stress tested, worries remain

### Stress test results due

As many as 100 banks could be involved in a European stress test exercise by the end of July in order to shore up market confidence. Our analysis looks at the impact on capital from stressed earnings and writedowns on risky assets, in a similar fashion to the US stress test.

We expect the official conclusion to show few banks need capital. This outcome corresponds to our base case assumptions. The number of banks with a capital shortfall increases dramatically with more adverse assumptions on sovereign risk and commercial real estate. As a result, a formal stress test is unlikely to dissipate fears on European banks, in our view.

### Limited capital deficiency likely

We identify a handful of banks which would need more capital in a base case stress scenario; these are: all Greek banks, Bankinter, Postbank, Banco Popolare, BCP, Commerzbank and Sabadell. We expect similar conclusions to be published in the official stress test. These assumptions and conclusions may not go far enough to allay concerns.

### Test pass not an 'all clear'

Passing a stress test should be a prerequisite for any European bank. Stress scenarios typically drive much larger capital holes than can be foreseen on paper. In a more adverse stress scenario, we would expect larger write-downs on sovereign paper and CRE; the number of banks in our coverage universe of 46 that would require capital would rise from 11 to 22.

### Plenty left to worry about

Heavy bank lobbying may have diluted capital deductions and formal liquidity requirements, but we believe that regulators will still succeed in tightening the system. In particular, we expect: higher quality core capital and more of it, improved funding quality and more taxes.

Funding remains the main issue across the sector, with southern European banks particularly exposed. We expect increased funding costs to weigh on profitability. The ECB is offsetting more serious consequences so far, but we expect lower margins across the markets with the greatest funding pressure.

### Reiterate core Europe preference

We bias towards banks that are well capitalised in the event of both asset quality deterioration and further regulation and have limited funding cost pressure. We highlight our Outperform ratings on selected core Europe and CEE banks: BNP Paribas, UBS, SEB, DnB NOR, Nordea, and Erste Bank. We prefer caution on Iberian and Greek banks due to funding and profitability concerns.

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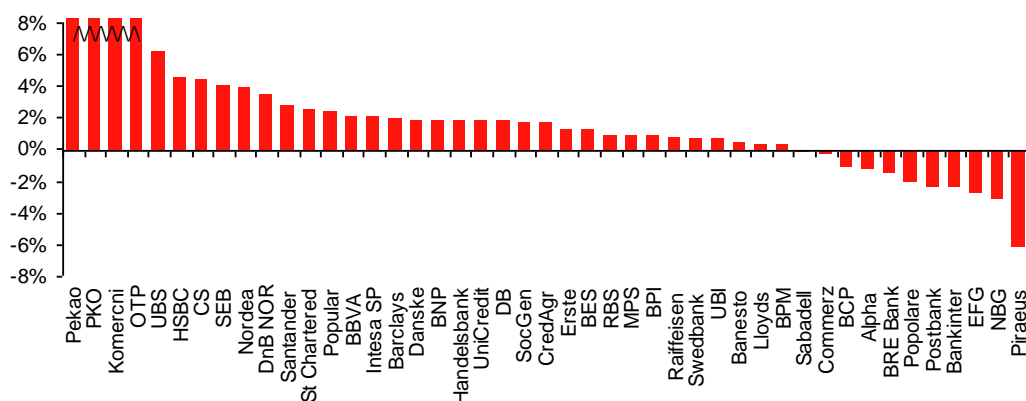
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# Summary

Our analysis shows that only a handful of banks would show a capital deficiency in a base case stress scenario. These are: all Greek banks, Bankinter, Postbank, Banco Popolare, BRE Bank, BCP, Commerzbank, and Sabadell. Banks which are close to capital deficiency are BPM, Lloyds, and Banesto. With the exclusion of Lloyds, we estimate that all major European banks would not need any extra capital; this is consistent with the message leaked by some European regulators, ahead of the European stress test, which should be presented to the market by the end of July.

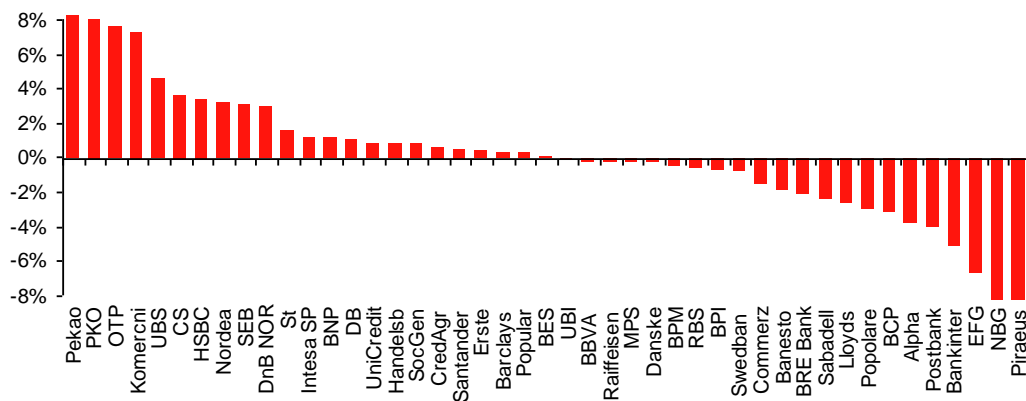
**Fig 1 Core Tier 1 surplus/ deficiency: base case stress test**



Source: Company data, Macquarie Research, June 2010

The number of banks with a capital shortfall increases dramatically with more adverse assumptions on sovereign risk and commercial real estate. Based on more severe assumptions on LLC and on a 40% mark on Greek debt (versus our 20% base case scenario), we estimate that as many as 22 banks would show a capital deficiency. These banks include: all the Greek banks, Bankinter, Postbank, BCP, Banco Popolare, Lloyds, Sabadell, BRE Bank (currently under capital increase), Banesto and Commerzbank.

**Fig 2 Core Tier 1 surplus/ deficiency: adverse stress test**



Source: Company data, Macquarie Research, June 2010

While passing a stress test should be a given for all large European lenders, this should not be seen as an 'all clear' signal. Impending changes in regulation are, in our view, the biggest challenge for European banks. In particular, the key original Basel components will still guide a new regulatory framework:

- **Higher quality core capital and more of it.** We still expect some harmonisation of the core capital definition between markets. Alternative leverage measures are also likely to remain in place (e.g. equity/ assets) as a further test.
- **Improved funding quality.** Even if the NSFR is dropped, we do not expect investor focus on the funding base to wane. We look to clearer, more transparent definitions of 'stable funding' that can be compared across the sector. Short-term funding ratios are likely to remain in place.
- **More taxes.** Regulation may be eased, but the banks must still contribute to the fiscal solution. Recently implemented measures continue to incentivise branch-based banking and longer duration, stable liability structures.

## Methodology

We use a methodology consistent with the Federal Reserve's Supervisory Capital Assessment Program (SCAP). As a starting point, we use our 2011e gross operating profits (GOP) from which we deduct our estimated decrease in NII, fees and trading revenues due to a stressed economic scenario. Then, we deduct our stressed Loan Loss Charges (LLC), which is calculated country by country on a consistent basis for all the banks (and not by product as in the SCAP).

We derive a stressed Core Tier 1 as a sum of 2010YE Core tier 1 plus/minus the net operating capital generation/consumption in 2011 multiplied by two (consistent with the two-year loan loss rate introduced by the US SCAP) less the writedowns on PGS Sovereign exposure.

We compare this stressed Core Tier 1 with what we believe is the minimum required Core Tier 1 in a stressed environment (6% for retail banks, 7% for retail and corporate banks and 8% for the investment banks and the CEE banks) and highlight capital surpluses/deficiencies.

As a caveat, we stress that there are several issues with the design of any stress test:

- **Stress tests do not capture revenue pressures.** We include a haircut to pre-provision profitability in our stress test, but this still does not capture the pressure that is seen across the P&L in a stress scenario. Stress tests focus heavily on the loan loss provision line, whereas in an adverse scenario revenues also tend to collapse.
- **Stress tests focus on solvency, not liquidity.** Being solvent on paper gives no guarantees that banks will have access to funding and liquidity. We believe that European banks will face rising funding costs which will reduce earnings capacity. We do not believe they will face funding availability issues, but this risk has increased given recent market concerns.
- **Adverse scenarios throw up the unexpected.** Stress tests tend to focus on assumptions of write-downs to on-balance sheet customer loans. This is a good starting point, but under pressure other parts of the balance sheet (including off-balance sheet items) often throw out unexpected problems which cannot be foreseen.
- **Domestic stress can breed international problems.** We believe that the regulator will focus on the domestic loan book in its stress test scenarios, and use our current forecasts for international operations. However, home market stress can cause profitability deterioration overseas.
- **External risk contagion:** The exposure to 'risky' assets overseas might be small but banks face counterparty risk to banks that have direct exposure (example: UK banks have close ties with German and French banks which have high exposure to PIGS debt).

## Stressed P&L

We estimate that an adverse economic scenario would have a negative impact on both revenues and on the cost of credit; in detail we assume:

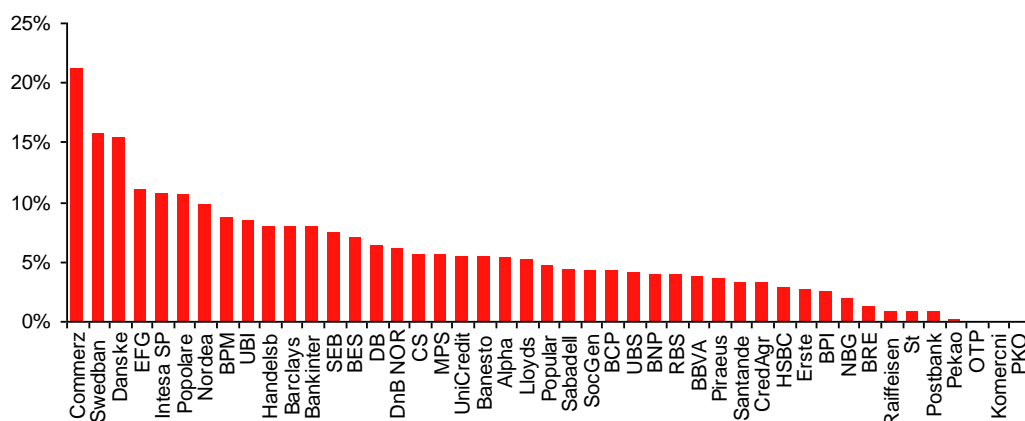
- a 100bp increase in the cost of refinancing expiring wholesale funding;
- a 20% decrease in fees and commissions;
- a 25% decrease in trading income;
- an increase of the loan charge in line with our assumptions country by country.

### Expiring wholesale funding: +100bp cost increase

We increase the cost of funding of wholesale securities expiring in 2011 by 100bp, in line with the average increase in the CDS spread for European banks in the last year. We estimate that the banks most affected are Commerzbank in Germany, and Danske and Swedbank in the Nordics, for which the amount of securities expiring in 2011 as a percentage of total funding is more than 10% versus an average of 5-10% for most European banks.

**We do not include any impact from a change in regulation on funding.** At the recent G20 meeting in Toronto, banks have been successful in shelving the Net Stable Funding Ratio (NSFR) measure. This is a positive for the banks that are in business to profit from maturity mismatch. Any measure to dis-incentivise this process would have been of clear detriment to the industry.

**Fig 3 Securities expiring in 2011 as a percentage of total funding**



Source: Company data, Macquarie Research, June 2010

### Commissions and fees: -20%

We assume a decrease in commissions of 10% driven by a 10% decrease in account-related fees, a 20% decrease in dealing commissions, a 30% decrease in asset management fees and a 20% decrease in other fees.

**Fig 2 Commissions decrease estimate**

	Percentage of total	Percentage decrease
Current accounts, credit cards, payments	40%	-10%
Dealing	10%	-20%
Asset Management, insurance	35%	-30%
Other net fee and commission income	15%	-20%
<b>Total</b>	<b>100%</b>	<b>-20%</b>

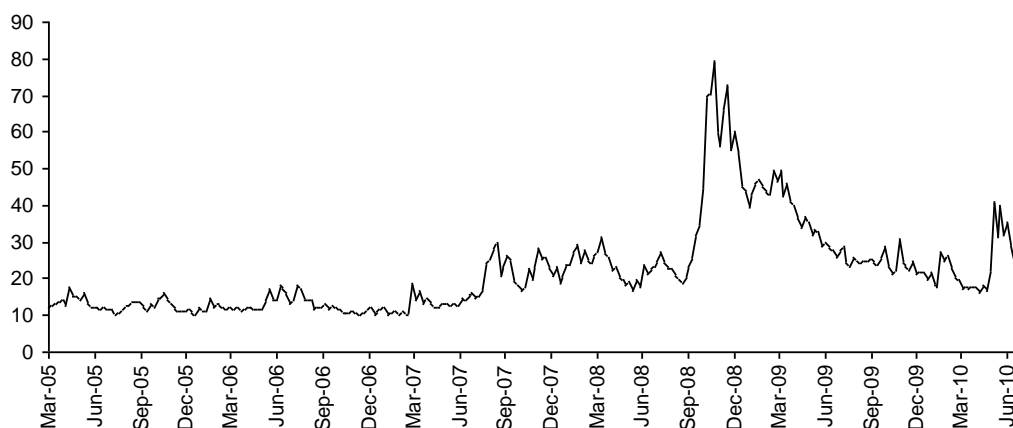
Source: Company data, Macquarie Research, June 2010

### Trading income: -25%

We estimate 25% lower trading revenues due to stressed market conditions and due to the new regulation on capital: right now, banks profits are inflated by the regulatory capital arbitrage as assets require significantly less equity underlying in trading compared to banking books. We expect future equity requirements for trading assets to rise by a factor 3-5x, hence profits will decrease.

We also believe that the new US legislation could have a negative impact. The bill contains restrictions in terms of prop trading as well as OTC derivatives: no more than 3% of their tier I capital should be invested into private equity and hedge funds; limits to proprietary trading will be defined in the bill, not be set by regulators; parts of the OTC business will have to be separated from deposit-taking institutions.

**Fig 4 VIX index**

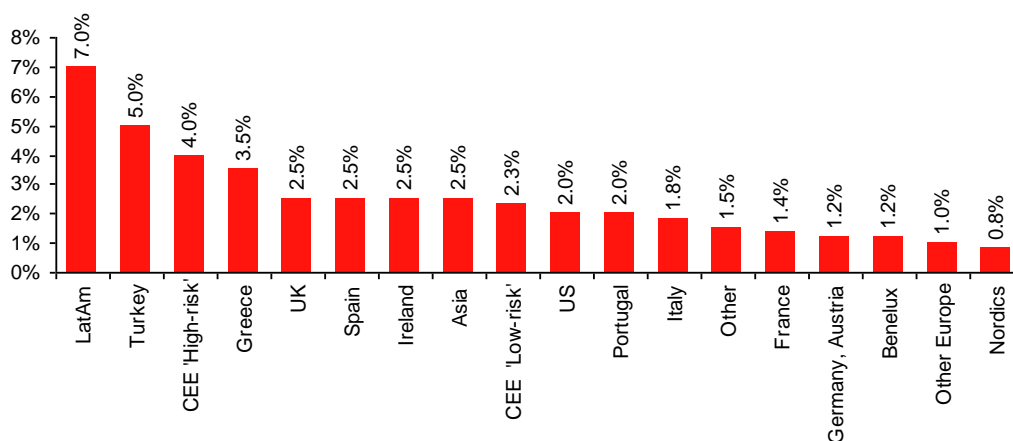


Source: Company data, Macquarie Research, June 2010

### Cost of credit: stressed scenario by country

We calculate a stressed loan loss charge (LLC) by country and not by product as in the case of the SCAP due to the different regulations in the European countries inconsistent with the USA single market. Our assumptions in terms of default rates and LLC are consistent with recent trends in the sovereign CDS spreads.

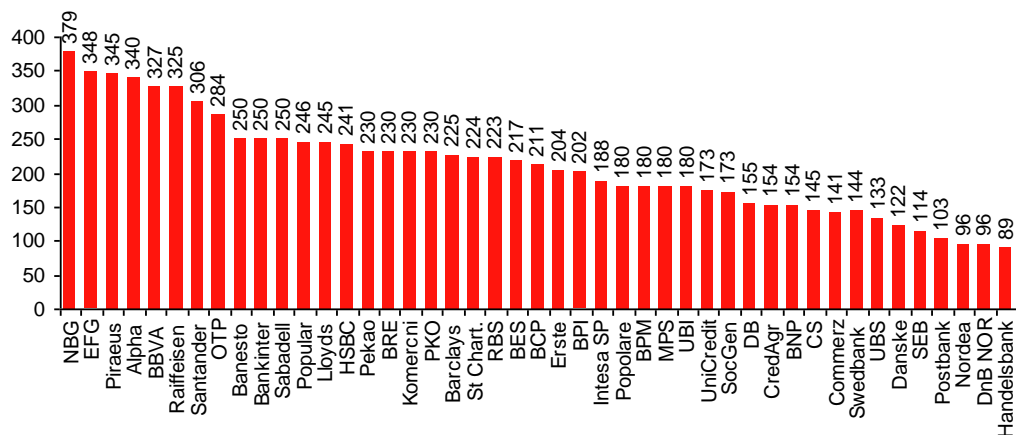
**Fig 5 Stressed LLC: our assumptions**



Source: Company data, Macquarie Research, June 2010

On the basis of our assumption on cost of credit, we derive 2011 stressed LLC. Note that with the exclusion of the Greek and the CEE banks, most banks show a cost of credit below 250bp, still manageable, given the current level of pre-provision profits.

**Fig 6 Stressed LLC (bp)**



Source: Company data, Macquarie Research, June 2010

## CRE exposure

We do not include any write-offs on risky assets, namely CRE (Commercial Real Estate) in Europe, in order to avoid double counting. For the benefit of the reader, we show a table with the exposures of Spanish and UK banks to CRE.

**Fig 7 Commercial Real Estate (CRE) exposures**

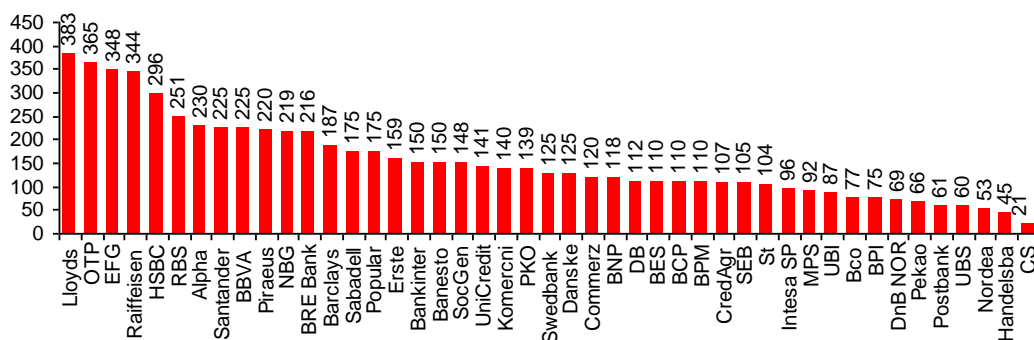
Local currency (bn)	CRE Spain	CRE UK	Total CRE
<b>Spain</b>			
Banesto	13	-	13
Bankinter	4	-	4
BBVA	37	-	56
Popular	23	-	23
Sabadell	10	-	10
Santander	41	-	89
<b>UK</b>			
Barclays	4	14	24
Lloyds	-	58	89
RBS	-	55	85
HSBC	-	-	70
St Chartered	-	-	7

Source: Company data, Macquarie Research, June 2010

**Stressed LLC and the 2009 LLC peaks**

Our stressed cost of risk is well above the cost of risk recorded in 2009. We believe that 2009 peak LLC has been relatively benign due to the following reasons: 1) Monetary policy has been very proactive and low interest rates have kept default rates low, particularly in mortgages and in consumer finance. 2) Banks have been using rescheduling of corporate debt, in order to keep default rates low. 3) The private sector has been helped by subsidies, which generally last for up to one year and allow mortgage debt to be repaid in time. 4) The financial position of the industrial sector was strong and the net financial debt position in many cases was positive due to strong cash flow generation in the previous five years, better technology to adjust production to demand and more proactive staff management.

**Fig 8 LLC in the 2009 peak (bp)**

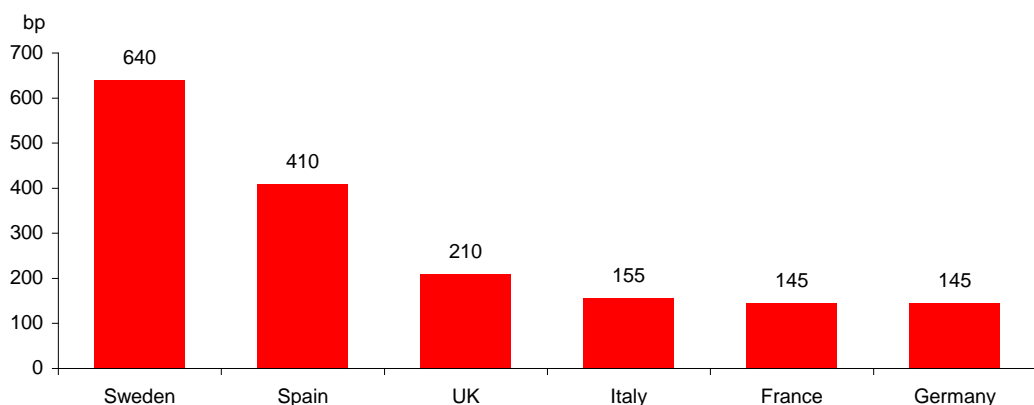


Source: Company data, Macquarie Research, June 2010

**Stressed LLC and the 1992 peak**

Our estimated stressed cost of risk is also above the one recorded in the 1992 peak, with the exclusion of the Nordic and the Spanish banks. In 1992 Nordic banks suffered a CRE meltdown due to aggressive lending in USD to speculative investors and Spanish banks' cost of credit was affected by major real estate issues and by the collapse of Banesto.

**Fig 9 LLC in the 1992 peak (bp)**



Source: Company data, Macquarie Research, June 2010

### Stressed LLC and the Supervisory Capital Assessment Program (SCAP)

Under the Supervisory Capital Assessment Program, “each participating BHC was instructed to estimate potential losses on its loan, investment securities, and trading portfolios, including off-balance sheet commitments and contingent liabilities and exposures, over the two-year horizon beginning with year-end 2008 financial statement data. For loans, the BHCs were instructed to estimate forward-looking, undiscounted credit losses – that is, losses due to failure to pay obligations (“cash flow losses”) – rather than discounts related to mark-to-market values. To guide estimation, the firms were provided with a common set of indicative loss rate ranges for specific loan categories under conditions of the baseline and the more adverse economic scenarios (see table below). Firms were allowed to diverge from the indicative loss rates where they could provide evidence that their estimated loss rates were appropriate.

The indicative loss rate ranges were derived using a variety of methods for predicting loan losses, including analysis of historical loss experience at large BHCs and quantitative models relating the performance of loans or groups of loans to macroeconomic variables. Supervisors viewed these indicative ranges as useful indicators of industry loss rates and in that way they can serve as a general guide, but recognized that they might not adequately capture differences across individual firms that could affect the performance and losses in significant ways. Thus, supervisors asked firms to provide granular data about the particular characteristics of their portfolios in order to make more tailored quantitative assessments of loss. Loss estimates for the SCAP thus relied ultimately on firm-specific information about factors such as past performance, origination year, borrower characteristics, and geographic distribution”.

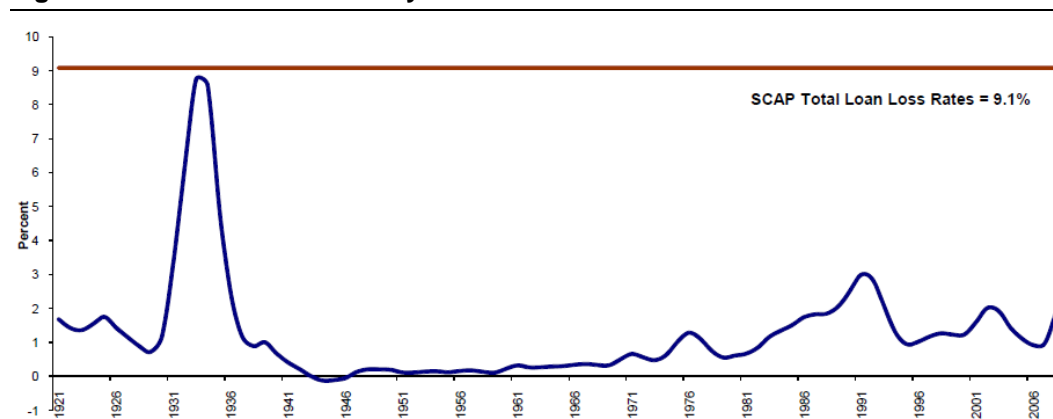
**Fig 10 Indicative loss rates provided to BHCs for SCAP (cumulative, two year)**

%	Baseline	Adverse
First Lien Mortgages	5 – 6	7 – 8.5
Prime	1.5 – 2.5	3 – 4
Alt - A	7.5 – 9.5	9.5 – 13
Subprime	15 – 20	21 – 28
Second/Junior Lien Mortgages	9 – 12	12 – 16
Closed - end Junior Liens	18 – 20	22 – 25
HELOCs	6 – 8	8 – 11
C&I Loans	3 – 4	5 – 8
CRE	5 – 7.5	9 – 12
Construction	8 – 12	15 – 18
Multifamily	3.5 – 6.5	10 – 11
Nonfarm, Non - residential	4 – 5	7 – 9
Credit Cards	12 – 17	18 – 20
Other Consumer	4 – 6	8 – 12
Other Loans	2 – 4	4 – 10

Source: Company data, Macquarie Research, June 2010

Below a long-term series with the two-year loan loss rates for commercial banks.

**Fig 11 Commercial bank two-year loan loss rates 1921-2008**



Sources: IMF (1920 -1933), FDIC (1934 -2007), and commercial bank reports on condition and income (2008)

Fig 12 2011 net profit in a stressed test scenario

Local currency (m)	Gross Operating Profits	New funding cost increase +100bp	Fee decrease -20%	Trading decrease -25%	LLC stressed by country	PBT stressed	Net profit stressed
<b>Benelux &amp; France</b>							
BNP Paribas	19,315	(346)	(2,072)	(3,153)	(9,935)	3,809	2,323
CredAgr	7,786	(208)	(956)	(1,455)	(6,576)	(1,409)	(982)
SocGen	10,027	(197)	(1,215)	(1,849)	(5,949)	818	528
<b>CEE</b>							
Pekao	4,156	(2)	(544)	(105)	(1,757)	1,748	1,393
BRE Bank	1,661	(7)	(131)	0	(1,207)	316	244
Erste Group	3,729	(42)	(414)	(113)	(2,530)	630	443
Komerčni	21,704	0	(1,642)	(792)	(8,563)	10,707	8,509
OTP	419,921	(0)	(29,755)	(1,279)	(180,557)	208,330	171,782
PKO	6,613	0	(584)	(13)	(2,681)	3,334	2,652
Raiffeisen	2,091	(4)	(295)	(47)	(1,542)	202	144
<b>Germany</b>							
Commerz	4,279	(1,239)	(781)	(370)	(5,100)	(3,211)	(2,315)
Postbank	1,283	(11)	(268)	(53)	(1,116)	(164)	(123)
<b>Greece</b>							
Alpha	1,012	(25)	(63)	(17)	(1,742)	(835)	(399)
EFG	1,543	(58)	(89)	(43)	(1,985)	(632)	(191)
NBG	2,717	(15)	(149)	(53)	(2,764)	(263)	(190)
Piraeus	584	(12)	(38)	(21)	(1,335)	(822)	(455)
<b>Investment Banks</b>							
CS	11,517	(261)	(3,208)	(3,318)	(3,333)	1,398	1,035
DB	9,916	(404)	(1,833)	(2,484)	(4,130)	1,065	738
UBS	10,342	(233)	(3,048)	(2,763)	(4,698)	(400)	(295)
<b>Italy</b>							
Popolare	1,409	(122)	(264)	(75)	(1,716)	(768)	(435)
BPM	708	(34)	(166)	8	(591)	(75)	(44)
Intesa SP	9,565	(464)	(1,226)	(249)	(7,007)	620	386
MPS	3,033	(91)	(451)	(24)	(2,743)	(276)	(170)
UBI	1,517	(91)	(292)	(30)	(1,764)	(660)	(330)
UniCredit	13,897	(362)	(1,948)	(415)	(9,770)	1,402	876
<b>Nordics</b>							
Danske	23,980	(2,788)	(1,703)	(1,997)	(21,387)	(3,895)	(2,921)
DnB NOR	20,936	(845)	(1,534)	(1,398)	(10,937)	6,221	4,695
Handelsbank	17,162	(1,292)	(1,644)	(529)	(13,324)	373	280
Nordea	4,895	(278)	(417)	(548)	(2,689)	963	712
SEB	17,764	(1,044)	(3,406)	(1,018)	(13,234)	(938)	(696)
Swedbank	12,031	(1,931)	(1,834)	(312)	(17,835)	(9,880)	(7,951)
<b>Portugal</b>							
BCP	983	(33)	(165)	(75)	(1,624)	(913)	(630)
BES	1,132	(46)	(153)	(96)	(1,193)	(355)	(234)
BPI	432	(8)	(67)	(28)	(611)	(282)	(145)
<b>Spain</b>							
Banesto	1,321	(32)	(122)	(42)	(1,889)	(764)	(535)
Bankinter	457	(16)	(41)	(27)	(1,006)	(633)	(456)
BBVA	11,532	(139)	(977)	(431)	(10,729)	(743)	(531)
Popular	2,065	(29)	(151)	(47)	(2,341)	(504)	(352)
Sabadell	922	(29)	(104)	(34)	(1,580)	(825)	(591)
Santander	24,640	(255)	(1,944)	(581)	(20,911)	949	662
<b>UK</b>							
Barclays	16,154	(375)	(2,252)	(2,174)	(10,624)	730	463
Lloyds	14,066	(336)	(2,196)	0	(16,190)	(4,656)	(3,363)
RBS	12,640	(265)	0	(1,429)	(12,720)	(1,774)	(928)
HSBC	38,025	(375)	(3,832)	(2,268)	(22,225)	9,325	6,656
St Chartered	8,491	(24)	(815)	(809)	(4,521)	2,322	1,609

Source: Company data, Macquarie Research, June 2010

# Capital impact

## Methodology

We derive a stressed Core Tier 1 as a sum of the 2010e Core tier 1 plus/minus the net operating capital generation/consumption in 2011 multiplied by two (consistent with the two-year loan loss rate introduced by the US SCAP) less the writedowns on PGS Sovereign exposure.

We compare this stressed Core Tier 1 with what we believe is the minimum required Core Tier 1 in a stressed environment (6% for retail banks, 7% for retail and corporate banks and 8% for the investment banks and the CEE banks) and highlight capital surpluses/deficiencies.

This approach is consistent with the Federal Reserve’s Supervisory Capital Assessment Program (SCAP) calculation.

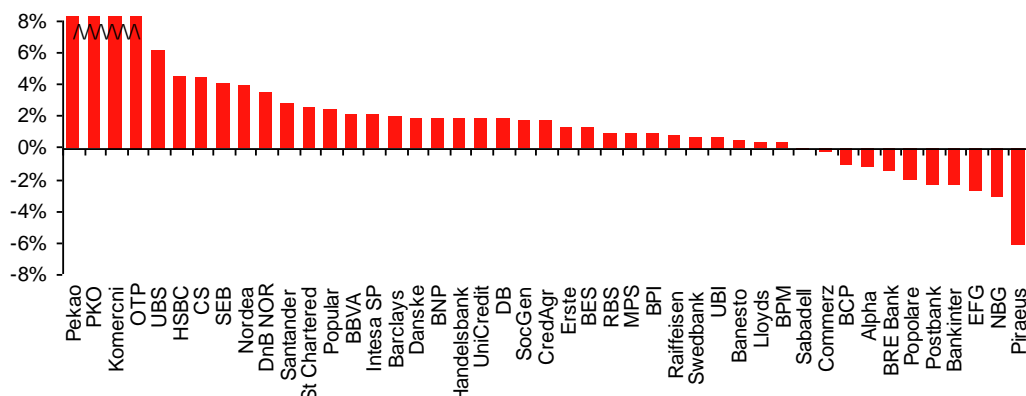
## PGS Sovereign exposure writedowns

As we stand, movement in sovereign spreads should not directly impact P&L significantly as much of the exposure seems to be held in HtM and AFS (AFS movements affect capital as it feeds through to equity). Assuming a worst-case scenario of default for Greece (we believe Portugal is not at risk of default), a 20% loss would represent a fair assumption, in our view. On the basis of our estimates, this would be unhelpful but in most cases would not have a disastrous impact on capital.

## Results: capital deficiency/ surplus

Our analysis shows that only a handful of banks would show a capital deficiency. These are: all Greek banks (due to markdowns on Greek sovereign debt), Bankinter, Postbank, Banco Popolare, BRE Bank (currently under capital increase), BCP, Commerzbank and Sabadell. We note Bankinter has displayed stronger-than-peer asset quality trends so far during the crisis and has lower direct exposure to CRE. Banks which are close to capital deficiency are BPM, Lloyds and Banesto. With the exclusion of Lloyds, we estimate that all major European banks would not need any extra capital; this is consistent with the message leaked by some European regulators, ahead of the European stressed test, which should be presented to the market by the end of July.

**Fig 13 “Stress test” Core Tier 1 surplus/ deficiency: base case scenario**



Source: Company data, Macquarie Research, June 2010

Fig 14 Impact on capital of a stressed scenario

	Core Tier 1	Core Tier 1 generation/consumption	Stressed Core Tier 1	Minimum Core Tier 1	RWA's	Capital surplus/deficit
<b>Benelux &amp; France</b>						
BNP Paribas	8.5%	0.3%	8.8%	7.0%	645,840	11,686
CredAgr	9.4%	-0.7%	8.7%	7.0%	336,192	5,771
SocGen	8.7%	0.0%	8.7%	7.0%	335,043	5,845
<b>CEE</b>						
Pekao	17.3%	1.8%	19.1%	8.0%	99,100	11,023
BRE Bank	6.0%	0.5%	6.6%	8.0%	60,413	(876)
Erste Group	8.9%	0.3%	9.3%	8.0%	128,156	1,632
Komerčni	13.8%	2.7%	16.5%	8.0%	357,000	30,248
OTP	13.3%	3.1%	16.5%	8.0%	7,161,088	605,732
PKO	14.1%	2.5%	16.6%	8.0%	138,824	11,894
Raiffeisen	8.5%	0.3%	8.8%	8.0%	65,879	496
<b>Germany</b>						
Commerz	8.5%	-1.7%	6.8%	7.0%	301,050	(740)
Postbank	5.4%	-0.8%	4.6%	7.0%	63,701	(1,500)
<b>Greece</b>						
Alpha	8.9%	-3.1%	5.7%	7.0%	51,106	(647)
EFG	8.2%	-4.0%	4.2%	7.0%	48,305	(1,335)
NBG	9.8%	-5.9%	3.9%	7.0%	72,969	(2,264)
Piraeus	7.5%	-6.6%	0.9%	7.0%	37,740	(2,319)
<b>Investment Banks</b>						
CS	11.8%	0.6%	12.3%	8.0%	243,770	10,568
DB	9.4%	0.3%	9.8%	8.0%	299,090	5,251
UBS	14.4%	-0.3%	14.1%	8.0%	225,000	13,699
<b>Italy</b>						
Popolare	4.8%	-0.9%	3.9%	6.0%	92,575	(1,944)
BPM	6.6%	-0.3%	6.3%	6.0%	34,922	105
Intesa SP	8.0%	0.1%	8.1%	6.0%	365,264	7,508
MPS	7.2%	-0.3%	6.9%	6.0%	113,157	1,000
UBI	7.4%	-0.8%	6.6%	6.0%	88,247	564
UniCredit	8.6%	0.2%	8.8%	7.0%	465,889	8,375
<b>Nordics</b>						
Danske	8.5%	-0.6%	7.8%	6.0%	942,858	17,400
DnB NOR	8.8%	0.6%	9.4%	6.0%	1,073,617	36,486
Handelsbank	7.8%	0.0%	7.8%	6.0%	973,072	17,515
Nordea	9.5%	0.4%	9.9%	6.0%	202,592	7,871
SEB	10.2%	-0.2%	10.1%	6.0%	850,839	34,601
Swedbank	8.5%	-1.9%	6.7%	6.0%	839,382	5,496
<b>Portugal</b>						
BCP	7.3%	-2.4%	4.9%	6.0%	57,231	(649)
BES	8.0%	-0.8%	7.2%	6.0%	68,536	839
BPI	8.3%	-1.5%	6.8%	6.0%	26,602	222
<b>Spain</b>						
Banesto	8.0%	-1.6%	6.4%	6.0%	67,451	299
Bankinter	6.4%	-2.8%	3.6%	6.0%	32,653	(786)
BBVA	8.4%	-0.4%	8.1%	6.0%	312,001	6,433
Popular	9.2%	-0.8%	8.4%	6.0%	89,392	2,171
Sabadell	7.8%	-2.0%	5.8%	6.0%	59,687	(99)
Santander	8.6%	0.1%	8.7%	6.0%	600,730	16,449
<b>UK</b>						
Barclays	9.8%	0.1%	10.0%	8.0%	438,170	8,591
Lloyds	8.7%	-1.4%	7.3%	7.0%	481,602	1,469
RBS	8.3%	-0.4%	7.9%	7.0%	544,928	5,002
HSBC	10.7%	0.8%	11.5%	7.0%	1,053,102	47,223
St Chartered	8.7%	0.8%	9.5%	7.0%	250,794	6,364

Source: Company data, Macquarie Research, June 2010

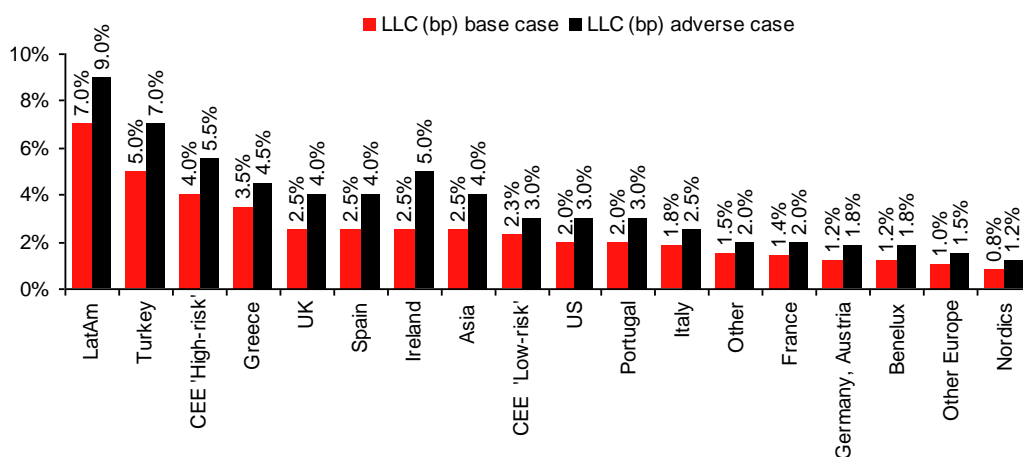
### Adverse scenario

We also run an adverse scenario, where the assumptions on revenues stay unchanged:

- a 100bp increase in the cost of refinancing expiring wholesale funding;
- a 20% decrease in fees and commissions;
- a 25% decrease in trading income;

However, we increase the expected cost of credit to reflect greater CRE and consumer credit losses.

**Fig 15 Stressed LLC: our assumptions in an adverse scenario**

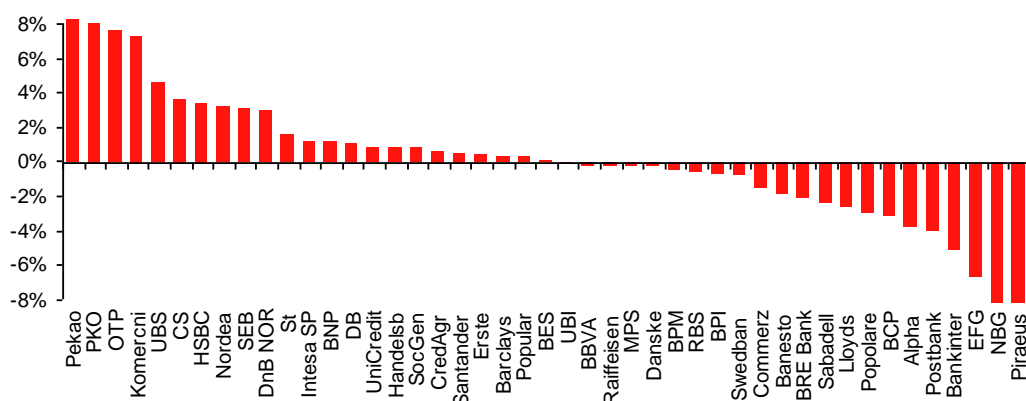


Source: Company data, Macquarie Research, June 2010

We also increase the markdowns on Greek government debt from 20% to 40%.

We estimate that in an adverse stress scenario, the number of large banks that would require capital would rise from 11 to 22. The banks are: all the Greek banks, Bankinter, Postbank, BCP, Banco Popolare, Lloyds, Sabadell, BRE Bank, Banesto and Commerzbank.

**Fig 16 "Stress test" Core Tier 1 surplus/ deficiency: adverse scenario**



Source: Company data, Macquarie Research, June 2010

## Regulation to add uncertainties

Despite passing a stress test should be a given for most European lenders, this should not be seen as an 'all clear' signal. Proposed regulation – laid out in the consultative document on strengthening the capital position of the banking sector by Basel Committee on Banking Supervision on December 17, 2009 – could bring some changes in the capital requirements due to the treatment of minorities, deferred tax assets, investments on associates and unrealised gains on securities.

The main Basel III proposals are:

- **Minority interest** will not be eligible for inclusion in the Common Equity Tier 1.
- **Goodwill and other intangibles** should be deducted from the Common Equity component of Tier 1. The amount deducted should be net of any associated deferred tax liability which would be extinguished if the goodwill becomes impaired or derecognised under the relevant accounting standards.
- **Deferred tax assets** which rely on future profitability of the bank to be realised should be deducted from the Common Equity component of Tier 1. The amount of such assets net of deferred tax liabilities should be deducted. Deferred tax assets which do not rely on the future profitability of the bank to be realised (e.g. prepayments to tax authorities) should be assigned the relevant sovereign risk weighting.
- **Investments in the capital of certain banking, financial and insurance entities which are outside the regulatory scope of consolidation.** Banks should apply a "corresponding deduction approach" to investments in the capital of other banks, other financial institutions and insurance entities where these fall outside of the regulatory scope of consolidation. This means the deduction should be applied to the same component of capital for which the capital would qualify if it was issued by the bank itself.
- **Unrealised gains and losses on debt instruments, loans and receivables, equities.** No adjustment should be applied to remove from the Common Equity component of Tier 1 unrealised gains or losses recognised on the balance sheet.

Following the 26-27 June G20 meeting in Toronto, it seems that some components of capital deductions and formal liquidity requirements could be diluted:

- **Capital deductions eased.** The adjustments proposed for core capital could be scaled back, with more lenient treatment of minorities and pension fund obligations in the capital base. We highlight Credit Agricole and Erste Bank as major beneficiaries of any easing of regulation, with both avoiding heavy capital deductions.
- **NSFR no more.** The formal Net Stable Funding Ratio (NSFR) measure of liquidity looks set to be dropped. Instead, a system of regulator oversight could be introduced.

In conclusion, while Basel proposals may be relaxed in these specific areas, we believe the key original components will still guide a new regulatory framework:

- **Higher quality core capital and more of it.** We expect some harmonisation of the core capital definition between markets, at least relative to the hotchpotch of standards we currently face. Alternative leverage measures are likely to remain in place (e.g. equity/assets) as a further test.
- **Improved funding quality.** Even if the NSFR is dropped, we do not expect investor focus on the funding base to wane. We look to clearer, more transparent definitions of 'stable and secure funding' that can be compared across the sector. Short-term funding ratios should stay in place.
- **More taxes.** Regulation may be eased, but the banks must still contribute to the fiscal solution. Recently implemented measures continue to incentivise branch-based banking and longer duration, stable liability structures.

# Appendix

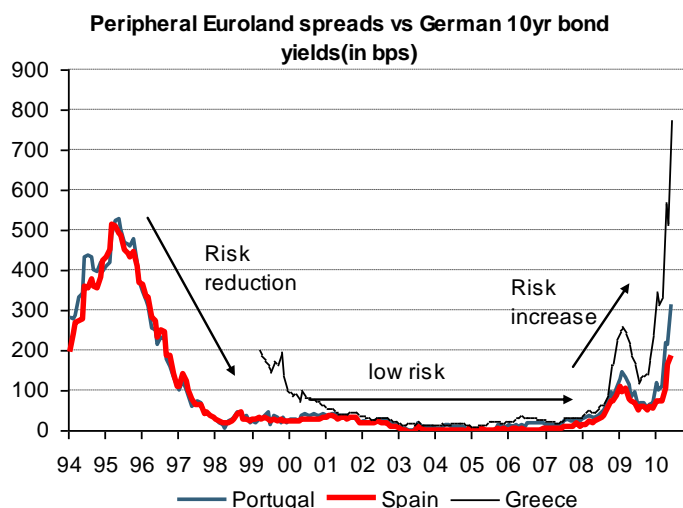
## Double dip scenario: how likely

The following is an abstract from the report *European equity strategy: Don't ignore the scepticism of bond investors* published by our strategists Matthias Joerss, Ralf Zimmermann and Paul Cavey on 28 June 2010.

Current economic consensus expects a moderate recovery of the European business cycle in 2010 with an increase of growth rates in 2011: Euroland is expected to grow some 1.3% in 2011 after 1.0% in 2010, UK is expected to grow 2.0% in 2011 after 1.2%. While there is upside risk on 2010 growth estimates, given the current strong rebound of new orders, the outlook for 2011 is turning more muted: key leading indicators have started to decline and there are several reasons to assume that this process will continue in coming months. It is unclear if this is a mid-cycle slowdown or whether the European economy is approaching a double-dip scenario. We do not call for a double-dip scenario, however we regard it as possible that the discussions about a double dip will increase. **Our scenario is a notable decline of growth in 2011 falling short of a double-dip in Europe but with some peripheral European countries facing a renewed recession.**

**The overriding issue is the ongoing European sovereign crisis which has implications for growth.** Despite the announcement of a €750bn rescue package, the spreads of the Euroland peripheral countries are still at 14 year highs and close to the panic levels ahead of the rescue pack. The spreads on Spanish sovereign bonds are particularly troublesome, as the US\$900bn exposure of foreign banks to Spanish debtors (incl. non government) is more than 4 times their exposure to Greek debtors. We expect the EU/IMF rescue package to be successful in preventing a default of Spain, although further measure may be necessary to reduce spreads notably implying further transfer of risk from Spain to Germany (i.e. common euro bonds); we expect a restructuring of the Greek debt in the next 2-3 years (given the sheer size of its debt and the extent of the deflationary shock which is necessary to regain competitiveness). This process will be slow as the German government is unwilling to make further steps.

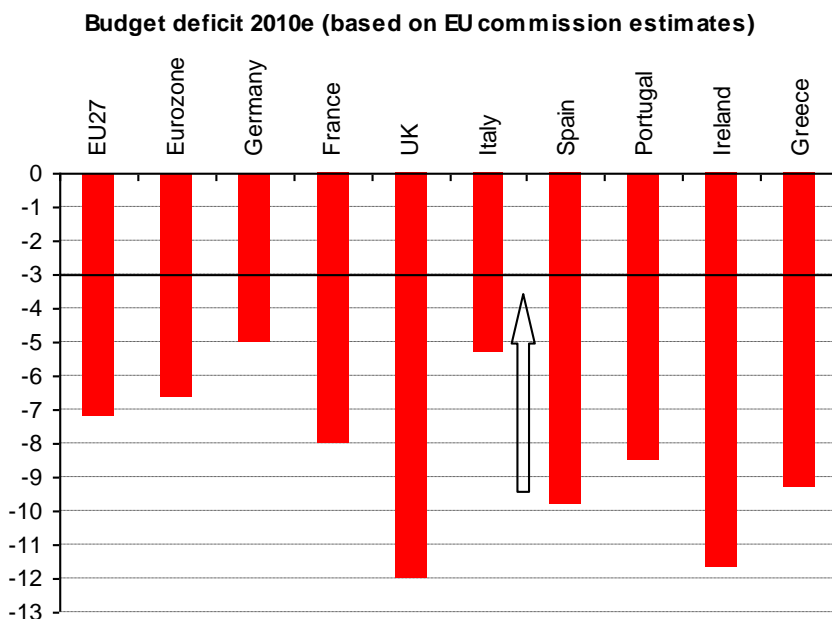
**Fig 17 The strong increase in sovereign risk will have economic repercussions**



Source: Thomson Financial Datastream, Macquarie Research, June 2010

**Bond markets are forcing European governments to fiscal tightening: a notable u-turn from the prior fiscal stimuli.** The strong increase in public debt in Greece and of private debt in Spain is an immediate issue and requires significant belt tightening. In the European heavyweights Germany, France and UK, fiscal tightening is a topic for 2011 while the business cycle in 2010 is still supported by the past fiscal stimuli. In our view, restrictive public budgets are not yet reflected in economic forecasts as the legislation process has only started and the final outcome is still uncertain. We expect the balance between cuts of expenses and increases of taxes to shift towards tax increases – which would have more negative long-term implications on growth.

**Fig 18 Going for the 3% deficit threshold means notable tightening in Europe**



Source: Thomson Financial Datastream, Macquarie Research, June 2010

The table below shows a rough calculation on the aggregated impact of a more restrictive fiscal policy in Europe. Most countries (ex Greece) target a *deficit/ GDP* ratio of 3% in 2013. Based on the estimated ratio in 2010 of 7% for Europe this would imply a yearly reduction of the deficit by 1% of GDP from 2011 to 2013 (assuming EU is growing by 1.5% p.a.). This compares to fiscal stimuli of some 1.5% in 2009 and 2010, which contributed to the stabilization and rebound of the European economy after the recession in 2008/09.

**Fig 19 Potential impact of fiscal tightening in Europe**

Government deficits in bn €		EU27		Eurozone
2010e		860		600
2013e if 3% Maastricht threshold (public debt/GDP) is reached and GDP is growing by 1.5% (EU27) resp. 1% (Eurozone) 2011-13		370		280
Cumulated reduction of public deficit from 2011-13 in bn €		490		320
Cumulated reduction of public deficit from 2011-13 in % of GDP		-3.1%		-3.1%
...in contrast to...				
...positive impact on GDP in 2010 and 2011		1.5% (09) resp. 1.4% (10)		1.5% (09 and 10)
... guarantees to financials sector		24.5% of GDP (thereof 8% been granted)		
... liquidity support to banks		4% of GDP		

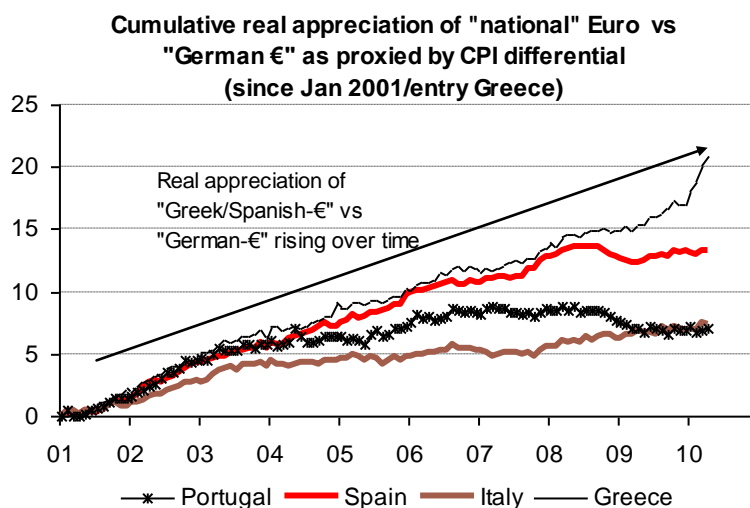
Source: European Commission, Macquarie Research, June 2010

**The public contribution to the economic rebound is decreasing and the question is whether private demand will fill the gap.** The budget in the UK yields a negative impact of 2% on 2011 GDP. At the same time, the government’s GDP forecast for 2011 has been decreased by only 30bps assuming a significant increase in private expenditures – which is unlikely, in our view. Although Germany has a comparatively decent public debt situation, fiscal consolidation ranks high on the German political agenda. The restrictive impulse is some 0.5% of GDP in 2011: in the first proposals the measures are equally split between higher taxes and lower expenses (including some foggy efficiency gains); as the political debate is increasingly focusing on the “social balance”, it is quite likely that the final outcome may include higher taxes for high income – which would have long-term more negative implications. France had been quite reluctant to regard tightening as a policy issue. However, as French sovereign spreads are as well around unprecedented 50 bps and with the discussions on France’s AAA rating, the tide has as well risen: the most recent indications are going for package comparable to Germany.

**The sovereign risk will impact private behaviour.** The longer sovereign spreads remain high, the higher the risk of spill over on corporate risk and private decisions. In the financial sector banks risk premia rise have a negative impact on funding costs and on the ability to lend. In the non-financial sector, corporate spreads increases drag investments. Discussions about higher taxes and contributions to social security systems etc. could further drag consumer sentiment and the perceived security of jobs.

**The current crisis makes Euroland structural imbalances visible. The Euro could force the periphery into a deflationary spiral, in order to regain competitiveness, with a risk of recession.** Since the introduction of the Euro, corporations in the peripheral countries have been gradually losing competitiveness versus corporations in the core countries due to inflation differential. The higher inflation in Greece and Spain led to a real appreciation of the "Greek" and "Spanish" Euro vs the "German" Euro. In Spain this was over-compensated by an ongoing strength of housing, construction and net immigration, in Greece by credit and EU transfers. However, in order to improve their position in the marketplace, peripheral countries' inflation rates need to undershoot German's inflation for a longer period of time. We believe that the periphery faces a long weak economic environment due to necessary structural reforms (labour market, social insurance etc.).

**Fig 20 Real appreciation in Greece and Spain enforces deflationary policies**

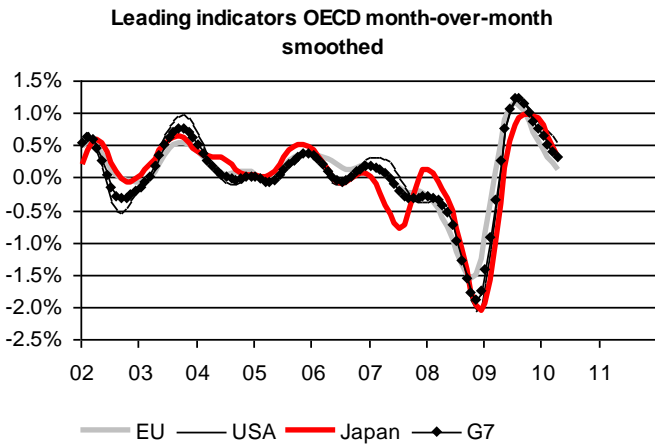


Source: Thomson Financial Datastream, Macquarie Research, June 2010

**A key issue to watch is the Spanish housing market.** Compared to the US, Spanish residential house prices have risen much stronger. In the US the peak-trough decline had been roughly 30%. In Spain prices have been declining by only roughly 10%. Further price falls are likely, which could spill over onto the Spanish consumers. Given the strong increase in private debt in Spain in recent years, falling housing prices could put many mortgages into negative equity. This means that Spain could be a drag on Euroland.

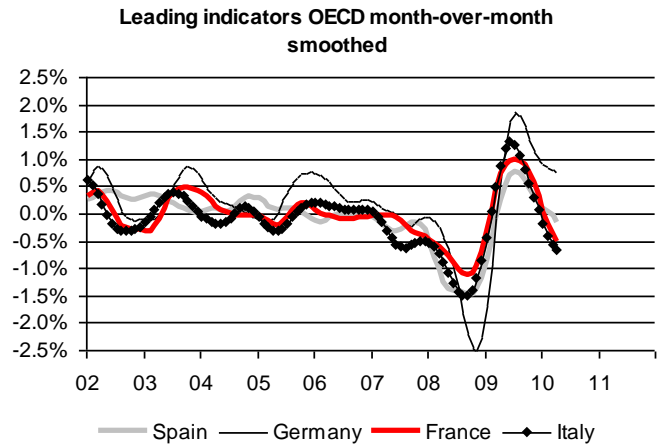
**European leading indicators have started to turn down. This strongly indicates that economic momentum is peaking now.** The support from export may decrease in upcoming quarters as key indicators have started to decline in other regions of the globe too. In the US indications for a renewed cooling of US residential housing markets are rising - new home sales hit in May the lowest level since 1963, new home mortgage applications hit a 14yrs low in June. The inventory-driven support for the economy is fading out. In China, we expect downside risks to current growth estimates in coming months. Housing and construction cooling is visible and this could spill-over to fixed investments. If this becomes more visible, we expect a shift at monetary policy from the current net tightening to a loosening bias at the end of the year. This would mean that export markets will continue to support European exports but to a smaller extent compared to the past.

**Fig 21 Broad-based declines**



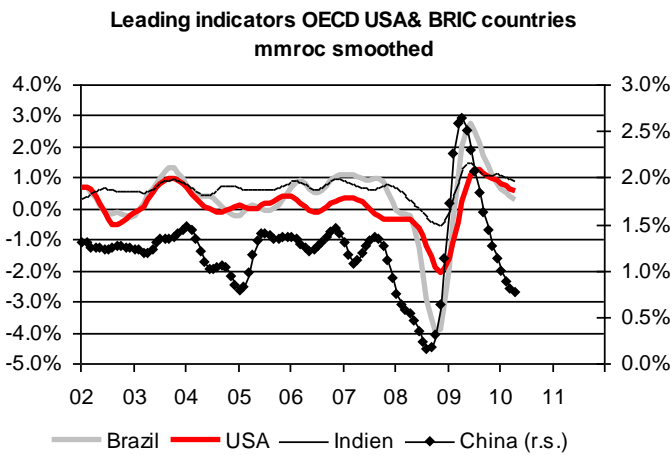
Source: Thomson Financial Datastream, Macquarie Research, June 2010

**Fig 22 Germany is outperforming**



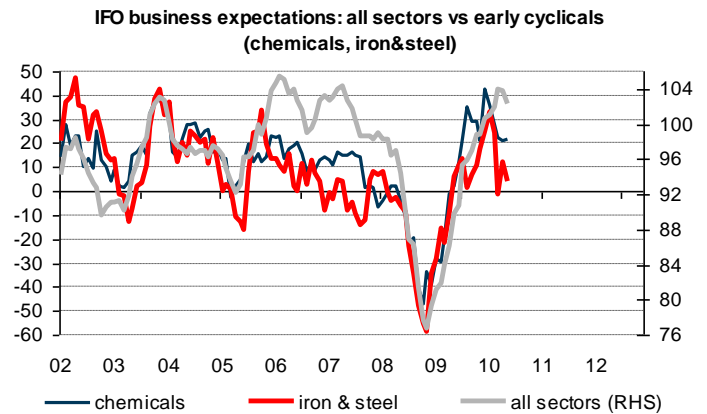
Source: Thomson Financial Datastream, Macquarie Research, June 2010

**Fig 23 Even in BRIC momentum will come down**



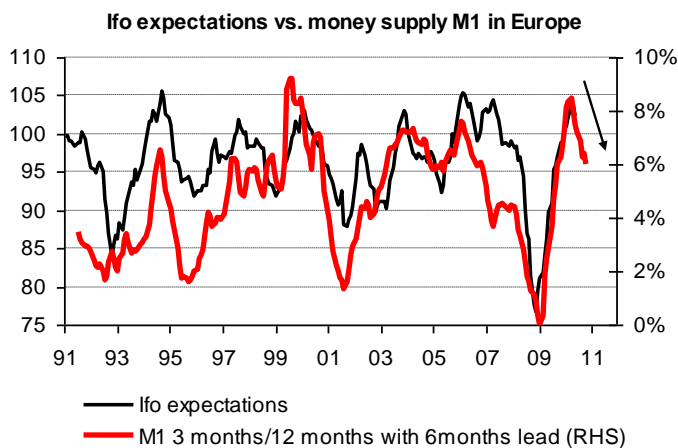
Source: Thomson Financial Datastream, Macquarie Research, June 2010

**Fig 24 Expectations at early cyclical sectors decline**



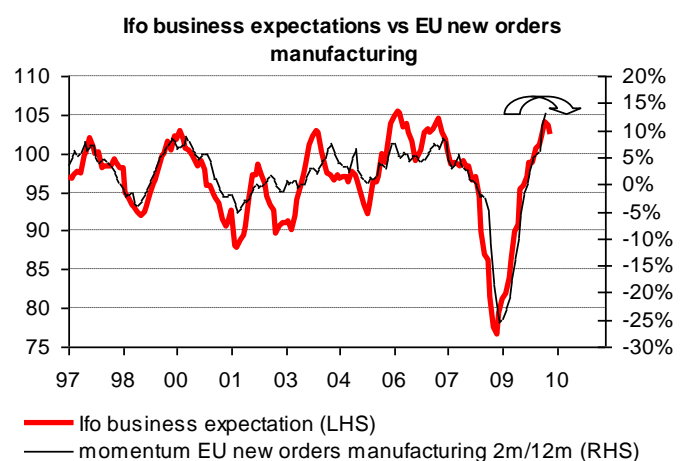
Source: Thomson Financial Datastream, Macquarie Research, June 2010

**Fig 25 Liquidity is calling for further declines at IFO**



Source: Thomson Financial Datastream, Macquarie Research, June 2010

**Fig 26 Economic growth is now at its peak**



Source: Thomson Financial Datastream, Macquarie Research, June 2010

**There are two positive consequences of the sovereign crisis: the ECB will keep interest rates low for a long period of time; the euro could remain weak for a longer period of time.** On interest rates, the monetary transmission from the low ECB rates to the economy remains sluggish as banks remain reluctant to lend: they face tougher capital requirements, higher funding costs and higher taxes. The Euro weakness is a positive factor but the past shows that the overriding issue is the change of European vs global demand.

Overall, we see limited economic risks for 2010, but some risk for 2011 due to the big shift in fiscal policy: the European economy is facing higher taxes which will hamper growth. We expect further falls in leading indicators and downward revisions of 2011 GDP forecast. This will increase economic uncertainty, even if a double dip in Europe should be avoided.

Fig 27 2011 net profit: stressed test scenario vs our current estimates

Local currency	Net Profit Macq	Net profit stressed	Net profit change	ROE	ROE stressed
<b>France, Benelux</b>					
BNP Paribas	8,559	2,323	-73%	10%	3%
CredAgr	4,192	(982)	neg	8%	neg
SocGen	4,214	528	-87%	9%	1%
<b>CEE</b>					
Pekao	3,027	1,393	-54%	15%	7%
BRE Bank	775	244	-69%	14%	4%
Erste Group	1,561	443	-72%	10%	3%
Komercni	13,578	8,509	-37%	16%	10%
OTP	229,136	171,782	-25%	16%	12%
PKO	4,015	2,652	-34%	16%	10%
Raiffeisen	774	144	-81%	11%	2%
<b>Germany</b>					
Commerz	909	(2,315)	neg	3%	neg
Postbank	605	(123)	neg	10%	neg
<b>Greece</b>					
Alpha	101	(399)	neg	2%	neg
EFG	67	(191)	neg	2%	neg
NBG	1,011	(190)	neg	11%	neg
Piraeus	45	(455)	neg	2%	neg
<b>Investment Banks</b>					
CS	8,293	1,035	-88%	18%	2%
DB	6,150	738	-88%	14%	2%
UBS	7,323	(295)	neg	13%	neg
<b>Italy</b>					
Popolare	438	(435)	neg	3%	neg
BPM	248	(44)	neg	6%	neg
Intesa SP	3,782	386	-90%	7%	1%
MPS	1,014	(170)	neg	5%	neg
UBI	505	(330)	neg	4%	neg
UniCredit	4,457	876	-80%	7%	1%
<b>Nordics</b>					
Danske	10,811	(2,921)	neg	10%	neg
DnB NOR	12,210	4,695	-62%	11%	4%
Handelsbank	8,934	280	-97%	10%	0%
Nordea	2,782	712	-74%	11%	3%
SEB	9,511	(696)	neg	9%	neg
Swedbank	5,264	(7,951)	neg	6%	neg
<b>Portugal</b>					
BCP	241	(630)	neg	3%	neg
BES	435	(234)	neg	6%	neg
BPI	154	(145)	neg	8%	neg
<b>Spain</b>					
Banesto	497	(535)	neg	8%	neg
Bankinter	150	(456)	neg	5%	neg
BBVA	4,422	(531)	neg	13%	neg
Popular	425	(352)	neg	5%	neg
Sabadell	337	(591)	neg	6%	neg
Santander	8,673	662	-92%	11%	1%
<b>UK</b>					
Barclays	6,136	463	-92%	11%	1%
Lloyds	3,200	(3,363)	neg	7%	neg
RBS	1,610	(928)	neg	2%	neg
HSBC	17,454	6,656	-62%	12%	5%
St Chartered	5,053	1,609	-68%	16%	5%

Source: Company data, Macquarie Research, June 2010

**Fig 28 Sovereign debt exposure to PGS countries (1Q10) and estimated writedowns**

Local currency (bn)	Greece	Portugal	Spain	Total	% Assets	% Core capital	Mark down
<b>France</b>							
BNP Paribas	5.0	na	na	<b>5.0</b>	0%	10%	-1.0
CredAgr	1.3	na	na	<b>1.3</b>	0%	4%	-0.3
SocGen	3.0	na	na	<b>13.0</b>	1%	47%	-0.6
<b>CEE</b>							
Pekao	0.0	0.0	0.0	<b>0.0</b>	nm	nm	<b>0.0</b>
BRE Bank	0.0	0.0	0.0	<b>0.0</b>	nm	nm	<b>0.0</b>
Erste Group	0.7	0.3	0.2	<b>1.2</b>	1%	11%	-0.1
Komerčni	7.7	0.0	0.0	<b>7.7</b>	1%	18%	-1.5
OTP	0.0	0.0	0.0	<b>0.0</b>	nm	nm	<b>0.0</b>
PKO	0.0	0.0	0.0	<b>0.0</b>	nm	nm	<b>0.0</b>
Raiffeisen	0.0	0.0	0.1	<b>0.1</b>	0%	1%	<b>0.0</b>
<b>Germany</b>							
Commerz	3.1	1.9	9.8	<b>14.8</b>	2%	56%	-0.6
Postbank	1.3	0.1	1.2	<b>2.6</b>	1%	67%	-0.3
<b>Greece</b>							
Alpha	4.0	nm	nm	<b>4.0</b>	6%	89%	-0.8
EFG	7.7	nm	nm	<b>7.7</b>	9%	188%	-1.5
NBG	19.5	nm	nm	<b>19.5</b>	17%	291%	-3.9
Piraeus	8.0	nm	nm	<b>8.0</b>	14%	276%	-1.6
<b>Investment Banks</b>							
CS	na	na	na	<b>na</b>	nm	nm	<b>0.0</b>
DB	na	na	na	<b>na</b>	nm	nm	<b>0.0</b>
UBS	na	na	na	<b>na</b>	nm	nm	<b>0.0</b>
<b>Italy</b>							
Popolare	0.0	0.0	0.0	<b>0.0</b>	nm	nm	<b>0.0</b>
BPM	0.0	0.0	0.0	<b>0.0</b>	nm	nm	<b>0.0</b>
Intesa SP	0.8	0.0	0.0	<b>0.8</b>	0%	3%	-0.2
MPS	0.0	nm	nm	<b>0.0</b>	nm	nm	<b>0.0</b>
UBI	0.0	0.0	0.0	<b>0.0</b>	nm	nm	<b>0.0</b>
UniCredit	1.0	0.0	0.6	<b>1.6</b>	0%	4%	-0.2
<b>Nordics</b>							
Danske	0.0	0.0	1.0	<b>1.0</b>	0%	1%	<b>0.0</b>
DnB NOR	0.0	0.0	0.0	<b>0.0</b>	0%	0%	<b>0.0</b>
Handelsbank	0.0	0.0	0.0	<b>0.0</b>	0%	0%	<b>0.0</b>
Nordea	0.4	0.0	0.4	<b>0.8</b>	0%	4%	-0.1
SEB	0.0	0.0	0.0	<b>0.0</b>	0%	0%	<b>0.0</b>
Swedbank	0.0	0.0	0.0	<b>0.0</b>	0%	0%	<b>0.0</b>
<b>Portugal</b>							
BCP	0.7	0.8	0.0	<b>1.5</b>	2%	35%	-0.1
BES	0.4	1.4	0.0	<b>1.8</b>	2%	34%	-0.1
BPI	0.5	2.9	0.0	<b>3.4</b>	7%	159%	-0.1
<b>Spain</b>							
Banesto	0.0	0.0	6.0	<b>6.0</b>	5%	113%	<b>0.0</b>
Bankinter	0.0	0.0	2.2	<b>2.2</b>	4%	110%	<b>0.0</b>
BBVA	0.2	0.1	24.0	<b>24.4</b>	4%	102%	<b>0.0</b>
Popular	0.0	0.2	5.7	<b>5.9</b>	5%	73%	<b>0.0</b>
Sabadell	0.0	0.2	3.5	<b>3.7</b>	4%	81%	<b>0.0</b>
Santander	0.2	3.3	24.0	<b>27.5</b>	2%	55%	<b>0.0</b>
<b>UK</b>							
Barclays	0.2	na	na	<b>0.2</b>	0%	1%	<b>0.0</b>
Lloyds	na	na	na	<b>na</b>	na	na	
RBS	1.5	<1.5	na	<b>3.0</b>	0%	6%	-0.3
HSBC	1.4	na	na	<b>1.9</b>	0%	2%	-0.3
St Chartered	0.0	0.0	0.0	<b>0.0</b>	0%	0%	<b>0.0</b>

Source: Company data, Macquarie Research, June 2010

Fig 29 Capital generation in 2011-2012e (two years)

Local currency	Net profit stressed	Net profits stressed less dividends	Net profits stressed less dividends x 2	PGS writedowns	Capital generation/consumption
<b>France, Benelux</b>					
BNP Paribas	2,323	1,510	3,020	(1,000)	<b>2,020</b>
CredAgr	(982)	(982)	(1,964)	(250)	<b>(2,214)</b>
SocGen	528	343	686	(600)	<b>86</b>
<b>CEE</b>					
Pekao	1,393	905	1,810	0	<b>1,810</b>
BRE Bank	244	158	317	0	<b>317</b>
Erste Group	443	288	576	(140)	<b>436</b>
Komerčni	8,509	5,531	11,062	(1,540)	<b>9,522</b>
OTP	171,782	111,658	223,316	0	<b>223,316</b>
PKO	2,652	1,723	3,447	0	<b>3,447</b>
Raiffeisen	144	94	187	0	<b>187</b>
<b>Germany</b>					
Commerz	(2,315)	(2,315)	(4,629)	(620)	<b>(5,249)</b>
Postbank	(123)	(123)	(245)	(260)	<b>(505)</b>
<b>Greece</b>					
Alpha	(399)	(399)	(798)	(800)	<b>(1,598)</b>
EFG	(191)	(191)	(382)	(1,540)	<b>(1,922)</b>
NBG	(190)	(190)	(380)	(3,900)	<b>(4,280)</b>
Piraeus	(455)	(455)	(909)	(1,600)	<b>(2,509)</b>
<b>Investment Banks</b>					
CS	1,035	673	1,345	0	<b>1,345</b>
DB	738	479	959	0	<b>959</b>
UBS	(295)	(295)	(591)	0	<b>(591)</b>
<b>Italy</b>					
Popolare	(435)	(435)	(869)	0	<b>(869)</b>
BPM	(44)	(44)	(88)	(2)	<b>(90)</b>
Intesa SP	386	251	502	(168)	<b>334</b>
MPS	(170)	(170)	(339)	(4)	<b>(343)</b>
UBI	(330)	(330)	(660)	(5)	<b>(665)</b>
UniCredit	876	569	1,138	(199)	<b>940</b>
<b>Nordics</b>					
Danske	(2,921)	(2,921)	(5,842)	0	<b>(5,842)</b>
DnB NOR	4,695	3,052	6,103	0	<b>6,103</b>
Handelsbank	280	182	364	0	<b>364</b>
Nordea	712	463	926	(80)	<b>846</b>
SEB	(696)	(696)	(1,392)	0	<b>(1,392)</b>
Swedbank	(7,951)	(7,951)	(15,903)	0	<b>(15,903)</b>
<b>Portugal</b>					
BCP	(630)	(630)	(1,261)	(140)	<b>(1,401)</b>
BES	(234)	(234)	(468)	(80)	<b>(548)</b>
BPI	(145)	(145)	(290)	(98)	<b>(388)</b>
<b>Spain</b>					
Banesto	(535)	(535)	(1,069)	0	<b>(1,069)</b>
Bankinter	(456)	(456)	(912)	0	<b>(912)</b>
BBVA	(531)	(531)	(1,061)	(46)	<b>(1,107)</b>
Popular	(352)	(352)	(704)	0	<b>(704)</b>
Sabadell	(591)	(591)	(1,182)	0	<b>(1,182)</b>
Santander	662	430	861	(40)	<b>821</b>
<b>UK</b>					
Barclays	463	301	602	(40)	<b>562</b>
Lloyds	(3,363)	(3,363)	(6,726)	0	<b>(6,726)</b>
RBS	(928)	(928)	(1,856)	(300)	<b>(2,156)</b>
HSBC	6,656	4,327	8,653	(280)	<b>8,373</b>
St Chartered	1,609	1,046	2,091	0	<b>2,091</b>

Source: Company data, Macquarie Research, June 2010

Fig 30 European banks – loans breakdown (local currency bn)

	UK	D, A	F	Bnx	I	E	PT	IE	Nord	Oth EU	GR	TK	CEE high risk	CEE low risk	US	Latam	MEast	Asia	Other	Total
<b>France</b>																				
BNP Paribas	-	18	389	81	80	10	-	-	-	-	-	5	4	17	38	-	-	-	5	646
CredAgr	-	19	311	-	29	-	-	-	-	-	22	-	-	-	-	-	-	-	46	428
SocGen	-	8	255	-	8	-	-	-	-	-	4	8	17	32	-	-	-	-	13	345
<b>CEE</b>																				
Pekao	-	-	-	-	-	-	-	-	-	-	-	-	-	76	-	-	-	-	-	76
BRE Bank	-	-	-	-	-	-	-	-	-	-	-	-	-	52	-	-	-	-	-	52
Erste Group	-	29	-	-	-	-	-	-	-	-	-	-	21	46	-	-	-	-	-	124
Komerčni	-	-	-	-	-	-	-	-	-	-	-	-	-	372	-	-	-	-	-	372
OTP	-	-	-	-	-	-	-	-	-	-	-	-	2,032	4,317	-	-	-	-	-	6,349
PKO	-	-	-	-	-	-	-	-	-	-	-	-	-	117	-	-	-	-	-	117
Raiffeisen	-	-	-	-	-	-	-	-	-	-	-	-	27	21	-	-	-	-	-	47
<b>Germany</b>																				
Commerz	-	218	-	-	-	-	-	-	-	-	-	-	-	24	28	-	-	-	92	361
Postbank	-	93	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	108
<b>Greece</b>																				
Alpha	-	-	-	-	-	-	-	-	-	-	40	-	7	-	-	-	-	-	4	51
EFG	-	-	-	-	-	-	-	-	-	-	43	1	8	5	-	-	-	-	1	57
NBG	-	-	-	-	-	-	-	-	-	-	51	13	8	-	-	-	-	-	1	73
Piraeus	-	-	-	-	-	-	-	-	-	-	30	4	-	-	-	-	-	-	4	39
<b>Inv. Banks</b>																				
CS	20	8	-	-	-	-	-	-	-	139	-	-	-	-	40	-	-	20	3	230
DB	15	95	-	-	20	15	2	-	-	60	1	-	2	3	46	-	-	2	6	267
UBS	10	10	-	-	-	-	-	-	-	240	-	-	-	-	35	-	-	35	24	354
<b>Italy</b>																				
Popolare	-	-	-	-	95	-	-	-	-	-	-	-	-	-	-	-	-	-	-	95
BPM	-	-	-	-	33	-	-	-	-	-	-	-	-	-	-	-	-	-	-	33
Intesa SP	-	-	-	-	343	-	-	-	-	-	-	-	10	20	-	-	-	-	-	372
MPS	-	-	-	-	152	-	-	-	-	-	-	-	-	-	-	-	-	-	-	152
UBI	-	-	-	-	98	-	-	-	-	-	-	-	-	-	-	-	-	-	-	98
UniCredit	-	181	-	-	306	-	-	-	-	-	-	-	18	60	-	-	-	-	-	565
<b>Nordics</b>																				
Danske	-	-	-	-	-	-	-	264	1,408	-	-	-	88	-	-	-	-	-	-	1,760
DnB NOR	-	-	-	-	-	-	-	-	-	-	-	-	57	-	-	-	-	-	-	1,139
Handelsbank	75	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1,506
Nordea	-	-	-	-	-	-	-	-	-	-	-	-	14	-	-	-	-	-	-	280
SEB	-	-	-	-	-	-	-	-	-	-	-	-	123	-	-	-	-	-	-	1,164
Swedbank	-	-	-	-	-	-	-	-	-	-	-	-	248	-	-	-	-	-	-	1,239
<b>Portugal</b>																				
BCP	-	-	-	-	-	-	60	-	-	-	5	-	-	9	-	-	-	-	2	77
BES	-	-	-	-	-	4	44	-	-	-	-	-	-	-	-	2	-	-	5	55
BPI	-	-	-	-	-	3	26	-	-	-	-	-	-	-	-	-	-	-	1	30
<b>Spain</b>																				
Banesto	-	-	-	-	-	76	-	-	-	-	-	-	-	-	-	-	-	-	-	76
Bankinter	-	-	-	-	-	40	-	-	-	-	-	-	-	-	-	-	-	-	-	40
BBVA	-	-	-	-	-	210	6	-	-	5	-	-	-	-	45	63	-	-	-	329
Popular	-	-	-	-	-	88	8	-	-	-	-	-	-	-	-	-	-	-	-	95
Sabadell	-	-	-	-	-	63	-	-	-	-	-	-	-	-	-	-	-	-	-	63
Santander	223	24	-	-	8	235	33	-	6	8	-	-	-	2	44	102	-	8	-	683
<b>UK</b>																				
Barclays	213	15	-	-	15	69	-	-	-	-	-	-	-	-	74	-	-	35	51	472
Lloyds	600	2	2	7	2	2	-	29	-	-	-	-	-	-	-	-	-	-	15	660
RBS	257	26	26	-	26	26	-	56	-	-	2	-	-	-	92	-	-	31	29	570
HSBC	329	4	72	-	-	-	-	-	-	-	-	-	-	-	221	48	23	181	45	922
St Chartered	15	-	-	-	-	-	-	-	-	-	-	-	-	-	15	-	9	140	22	202

Note: UK = UK; D, A = Germany, Austria; F = France; Bnx = Benelux; I = Italy; E = Spain; PT = Portugal; IE = Ireland; Nord = Nordics; Oth EU = Other Europe; GR = Greece; TK = Turkey; CEE high risk = CEE 'High-risk'; CEE low risk = CEE 'Low-risk'; US = USA; Latam = Latin America; MEast = Middle East; Asia = Asia.

Source: Company data, Macquarie Research, June 2010

Fig 31 European banks – loans breakdown (%)

	UK	D, A	F	Bnx	I	E	PT	IE	Nord	Oth EU	GR	TK	CEE high risk	CEE low risk	US	Latam	MEast	Asia	Other	Total
<b>France</b>																				
BNP Paribas	-	3	60	13	12	2	-	-	-	-	-	1	1	3	6	-	-	-	1	100
CredAgr	-	5	73	-	7	-	-	-	-	-	5	-	-	-	-	-	-	-	11	100
SocGen	-	2	74	-	2	-	-	-	-	-	1	2	5	9	-	-	-	-	4	100
<b>CEE</b>																				
Pekao	-	-	-	-	-	-	-	-	-	-	-	-	-	100	-	-	-	-	-	100
BRE Bank	-	-	-	-	-	-	-	-	-	-	-	-	-	100	-	-	-	-	-	100
Erste Group	-	23	-	-	-	-	-	-	-	-	-	-	17	37	-	-	-	-	-	100
Komerčni	-	-	-	-	-	-	-	-	-	-	-	-	-	100	-	-	-	-	-	100
OTP	-	-	-	-	-	-	-	-	-	-	-	-	32	68	-	-	-	-	-	100
PKO	-	-	-	-	-	-	-	-	-	-	-	-	-	100	-	-	-	-	-	100
Raiffeisen	-	-	-	-	-	-	-	-	-	-	-	-	56	44	-	-	-	-	-	100
<b>Germany</b>																				
Commerz	-	60	-	-	-	-	-	-	-	-	-	-	-	7	8	-	-	-	25	100
Postbank	-	86	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100
<b>Greece</b>																				
Alpha	-	-	-	-	-	-	-	-	-	-	78	-	13	-	-	-	-	-	9	100
EFG	-	-	-	-	-	-	-	-	-	-	75	2	14	8	-	-	-	-	1	100
NBG	-	-	-	-	-	-	-	-	-	-	70	18	11	-	-	-	-	-	2	100
Piraeus	-	-	-	-	-	-	-	-	-	-	78	11	-	-	-	-	-	-	11	100
<b>Inv. Banks</b>																				
CS	9	3	-	-	-	-	-	-	-	60	-	-	-	-	17	-	-	9	1	100
DB	6	36	-	-	7	6	1	-	-	22	0	-	1	1	17	-	-	1	2	100
UBS	3	3	-	-	-	-	-	-	-	68	-	-	-	-	10	-	-	10	7	100
<b>Italy</b>																				
Popolare	-	-	-	-	100	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100
BPM	-	-	-	-	100	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100
Intesa SP	-	-	-	-	92	-	-	-	-	-	-	-	3	5	-	-	-	-	-	100
MPS	-	-	-	-	100	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100
UBI	-	-	-	-	100	-	-	-	-	-	-	-	-	-	-	-	-	-	-	100
UniCredit	-	32	-	-	54	-	-	-	-	-	-	-	3	11	-	-	-	-	-	100
<b>Nordics</b>																				
Danske	-	-	-	-	-	-	-	15	80	-	-	-	5	-	-	-	-	-	-	100
DnB NOR	-	-	-	-	-	-	-	-	95	-	-	-	5	-	-	-	-	-	-	100
Handelsbank	5	-	-	-	-	-	-	-	95	-	-	-	-	-	-	-	-	-	-	100
Nordea	-	-	-	-	-	-	-	-	95	-	-	-	5	-	-	-	-	-	-	100
SEB	-	-	-	-	-	-	-	-	89	-	-	-	11	-	-	-	-	-	-	100
Swedbank	-	-	-	-	-	-	-	-	80	-	-	-	20	-	-	-	-	-	-	100
<b>Portugal</b>																				
BCP	-	-	-	-	-	-	78	-	-	-	7	-	-	11	-	-	-	-	3	100
BES	-	-	-	-	-	8	80	-	-	-	-	-	-	-	-	4	-	-	9	100
BPI	-	-	-	-	-	9	87	-	-	-	-	-	-	-	-	-	-	-	4	100
<b>Spain</b>																				
Banesto	-	-	-	-	-	100	-	-	-	-	-	-	-	-	-	-	-	-	-	100
Bankinter	-	-	-	-	-	100	-	-	-	-	-	-	-	-	-	-	-	-	-	100
BBVA	-	-	-	-	-	64	2	-	-	2	-	-	-	-	14	19	-	-	-	100
Popular	-	-	-	-	-	92	8	-	-	-	-	-	-	-	-	-	-	-	-	100
Sabadell	-	-	-	-	-	100	-	-	-	-	-	-	-	-	-	-	-	-	-	100
Santander	33	3	-	-	1	34	5	-	1	1	-	-	-	0	6	15	-	1	-	100
<b>UK</b>																				
Barclays	45	3	-	-	3	15	-	-	-	-	-	-	-	-	16	-	-	7	11	100
Lloyds	91	0	0	1	0	0	-	4	-	-	-	-	-	-	-	-	-	-	2	100
RBS	45	4	4	-	4	4	-	10	-	-	0	-	-	-	16	-	-	5	5	100
HSBC	36	0	8	-	-	-	-	-	-	-	-	-	-	-	24	5	2	20	5	100
St Chartered	7	-	-	-	-	-	-	-	-	-	-	-	-	-	7	-	4	69	11	100

Note: UK = UK; D, A = Germany, Austria; F = France; Bnx = Benelux; I = Italy; E = Spain; PT = Portugal; IE = Ireland; Nord = Nordics; Oth EU = Other Europe; GR = Greece; TK = Turkey; CEE high risk = CEE 'High-risk'; CEE low risk = CEE 'Low-risk'; US = USA; Latam = Latin America; MEast = Middle East; Asia = Asia.

Source: Company data, Macquarie Research, June 2010;

Fig 32 Stock ratings and target prices

Local Currency	Bloomberg Ticker	Rating	Share Price	Target Price
<b>Benelux &amp; France</b>				
	BNP FP	Outperform	43.75	68.00
	ACA FP	Underperform	8.35	10.00
	GLE FP	Neutral	33.8	47.00
<b>CEE</b>				
	PEO PW	Underperform	155.5	131.00
	BRE PW	Underperform	222.5	217.20
	EBS AV	Outperform	26.5	41.00
	KOMB CP	Neutral	3,500	3,934
	OTP HB	Outperform	4560	6,261
	PKO PW	Underperform	36.95	39.60
	RIBH AV	Outperform	32.8	46.80
	BGEO LI	Outperform	10.0	13.30
	SBER RU	Outperform	2.44	3.30
<b>Germany</b>				
	ARL GR	Neutral	13.86	18.00
	CBK GR	Neutral	5.81	7.10
	DPB GR	Outperform	23.86	28.00
<b>Greece</b>				
	ALPHA GA	Neutral	4.09	4.30
	EUROB GA	Underperform	3.67	3.50
	ETE GA	Neutral	8.80	9.95
	TPEIR GA	Underperform	3.36	3.25
<b>Investment Banks</b>				
	CSGN VX	Outperform	40.9	70.00
	DBK GR	Underperform	46.0	40.00
	UBSN VX	Outperform	14.5	18.00
<b>Italy</b>				
	BP IM	Neutral	4.51	5.30
	PMI IM	Neutral	3.40	4.70
	ISP IM	Outperform	2.14	3.30
	BMPS IM	Outperform	0.93	1.70
	UBI IM	Neutral	7.04	10.40
	UCG IM	Outperform	1.82	2.70
<b>Nordics</b>				
	DANSKE DC	Neutral	117.3	130.00
	DNBNOR NO	Outperform	63.1	80.00
	SHBA SS	Underperform	190.9	165.00
	NDA SS	Outperform	64.25	75.00
	SEBA SS	Outperform	41.9	57.00
	SWEDA SS	Neutral	72.2	65.00
<b>Portugal</b>				
	BCP PL	Neutral	0.61	0.70
	BES PL	Outperform	3.23	3.95
	BPI PL	Neutral	1.52	1.75
<b>Spain</b>				
	BTO SM	Underperform	6.47	6.80
	BKT SM	Underperform	4.91	4.00
	BBVA SM	Underperform	8.35	8.50
	POP SM	Neutral	4.16	4.80
	SAB SM	Underperform	3.66	3.20
	SAN SM	Neutral	8.45	8.90
<b>Switzerland</b>				
	EFGN SW	Outperform	13.4	20.00
	BAER VX	Outperform	30.96	42.00
	VONN SW	Underperform	28.8	30.86
<b>UK</b>				
	BARC LN	Outperform	2.67	4.54
	LLOY LN	Neutral	0.54	0.62
	RBS LN	Neutral	0.42	0.42
	HSBA LN	Outperform	6.16	8.80
	STAN LN	Outperform	16.6	18.75

Note prices are as of the close 30 June.

Source: Company data, Macquarie Research, June 2010

## Important disclosures:

## Recommendation definitions

**Macquarie - Australia/New Zealand**

Outperform – return >5% in excess of benchmark return  
Neutral – return within 5% of benchmark return  
Underperform – return >5% below benchmark return

**Macquarie – Asia/Europe**

Outperform – expected return >+10%  
Neutral – expected return from -10% to +10%  
Underperform – expected return <-10%

**Macquarie First South - South Africa**

Outperform – expected return >+10%  
Neutral – expected return from -10% to +10%  
Underperform – expected return <-10%

**Macquarie - Canada**

Outperform – return >5% in excess of benchmark return  
Neutral – return within 5% of benchmark return  
Underperform – return >5% below benchmark return

**Macquarie - USA**

Outperform (Buy) – return >5% in excess of Russell 3000 index return  
Neutral (Hold) – return within 5% of Russell 3000 index return  
Underperform (Sell) – return >5% below Russell 3000 index return

**Recommendations** – 12 months

**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

## Volatility index definition\*

This is calculated from the volatility of historical price movements.

**Very high-highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low-medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.

\* Applicable to Australian/NZ/Canada stocks only

## Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense  
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / epowa\*

**ROA** = adjusted ebit / average total assets

**ROA Banks/Insurance** = adjusted net profit / average total assets

**ROE** = adjusted net profit / average shareholders funds

**Gross cashflow** = adjusted net profit + depreciation

\*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

## Recommendation proportions – For quarter ending 31 March 2010

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	50.55%	62.20%	42.25%	42.39%	62.16%	46.74%	(for US coverage by MCUSA, 6.53% of stocks covered are investment banking clients)
Neutral	36.63%	19.02%	47.89%	50.35%	31.89%	34.78%	(for US coverage by MCUSA, 9.62% of stocks covered are investment banking clients)
Underperform	12.82%	18.78%	9.86%	7.27%	5.95%	18.48%	(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)

## Company Specific Disclosures:

Important disclosure information regarding the subject companies covered in this report is available at [www.macquarie.com/research/disclosures](http://www.macquarie.com/research/disclosures).

## Analyst Certification:

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