

## BANKING SECTOR: ANTONIO ROMAN'S OUTLOOK

### On fundamentals:

- Since the beginning of the year, analysts have raised their earnings expectations by more than 10% for 2022 and 2023, and by more than 15% for 2024. The consensus is that banks' earnings in 2024 should be 35% to 40% higher than in 2021, which would bring their ROE comfortably above 10%.
- The trends seen in Q2 continue and should be reflected favourably in Q3 results:
  - The sector is benefiting from strong corporate demand for credit, with inventory up 8% year-on-year.
  - The benefits of rate hikes are starting to show on the asset side, particularly for UK, German, and peripheral banks. Margins on new loans have increased significantly across the spectrum.
  - Defaults remain low in a context of strong nominal growth. Banks may increase prudential provisions slightly.
  - Traditional investment banking is suffering from lower activity in M&A and primary markets, but this is mainly a problem for US and Swiss banks. The dynamism of the trading rooms is driving the European business.
  - Whilst the first cost pressures are being felt, business volumes have so far grown faster than wages.
- Going forward, the debate is about the net effect of rate hikes on the one hand, and the impact of a recession and political pressures on the other:
  - A 100bps rate hike leads to an increase in ROE of 1.5 - 2 points (this effect fades when rates rise above 2%).
  - A doubling of defaults compared to the historical average leads to a 3-point drop in ROE. Typically, in recessions, a multiplication factor between 1.5x and 3x is observed.
  - Political pressures will remain important but are impossible to quantify. In the Eurozone, Spain has taken the hardest stance so far, but this has not prevented Spanish banks from significantly outperforming the market.

### On valuations:

- Price/earnings ratios are at historic lows. For some banks, they are reaching very low levels (4x for Société Générale, Deutsche Bank and Unicredit for example). This reflects market concerns on several fronts:
  - The prospect of a severe recession linked to the high cost of living and monetary tightening
  - The risks of a sudden and disorderly increase in interest rates that would not allow banks the time to recycle their assets at higher yields
  - Risks of adverse policy measures (special taxes, moratorium, forced increase in bank deposits, etc.)
- Price-to-book ratios range from 0.5x to 0.6x, which implies a market-estimated profitability of 5%-6% for the sector. This figure suggests that the market's central scenario is a combination of rising rates and a severe recession.

### On catalysts:

- Earnings season could give the sector some breathing space. As analysts have been cautious in their interest income expectations, banks will mostly come in above consensus by a considerable margin. Most will communicate higher targets for the coming years, while highlighting macroeconomic uncertainty.
- A further stabilisation of energy prices should bring some managers back to European cyclical, particularly across the Atlantic. Any evidence of resilient economic activity or a gradual moderation in inflation will be interpreted very favourably.

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Antonio started his career at Goldman Sachs Asset Management, where he focused on building optimal investment solutions for institutional clients with unique economic, regulatory and accounting constraints. He then moved to JP Morgan Asset Management, where he enhanced his insurance knowledge through the development of portfolio optimization tools under Solvency II.

Antonio joined Axiom in 2018 as a research analyst in the London office, where he supported PMs with insurance and banks coverage across the capital structure. He has been managing Axiom European Banks Equity alongside David Benamou since January 2019.

Antonio graduated from the Ecole Polytechnique (X2012) and the ENSAE (MSc in Statistics). He is a fully qualified actuary and holds the CFA and CAIA designations.

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