

## UBS Global I/O®

# Global Banks Reality Check

## Remaining cautious on EM banks

### Equities

#### Global Banks

#### Q4 in-house survey – sentiment weakens further

Notwithstanding last week's market rally, sentiment towards the sector outlook has declined further. Reflecting global growth concerns and uncertainty over Fed funds rates, as well as volatility in oil prices and currencies, our latest in-house survey shows 42% of respondents now have a negative view on the outlook for the sector (up from 36% a quarter earlier), though those with a positive view also rose to 34% from 26%.

#### Key risk lies in EM; more constructive in DM

The aggregate outlook for banks in emerging markets (EM) has deteriorated further, with 52% of respondents now having a negative view. We are now cautious on banks in China, and very cautious on banks in Colombia, Greece and Singapore. In contrast, we have a more constructive stance on developed-market (DM) banks (44% of respondents), which we view as more defensive and attractively valued. We are most positive on US brokers and universal banks, as well as banks in the UK.

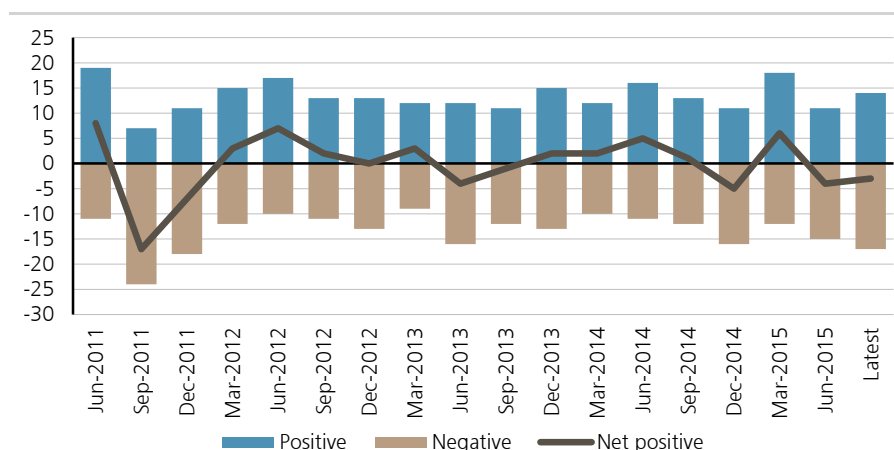
#### Fundamental expectations decline further, but valuations seen fair/cheap

Our Q4 survey indicates that loan-growth expectations have worsened, notably in EM (where 60% of respondents now see downside risk); the outlook for NIM remains skewed to the downside, although asset-quality expectations have improved slightly. Earnings risks have shifted further to the downside in both EM (49% see downside risk versus 15% upside) and DM (38% versus 19%), although the majority of respondents consider valuations to be fair (59%) or cheap (34%).

#### Underweight EM; prefer US and UK

Following our latest survey findings, we reiterate our underweight stance on EM banks: we now have a cautious view on banks in 11 EM countries including China, Colombia, Greece and Singapore. In contrast, we prefer banks in the US (top picks: Morgan Stanley, Bank of America, Citizens, and Fifth Third), and the UK (we recently upgraded HSBC to a Buy rating). We also maintain our underweight stance on Australia.

**Figure 1: Evolution of analyst outlook over time**



Source: UBS estimates

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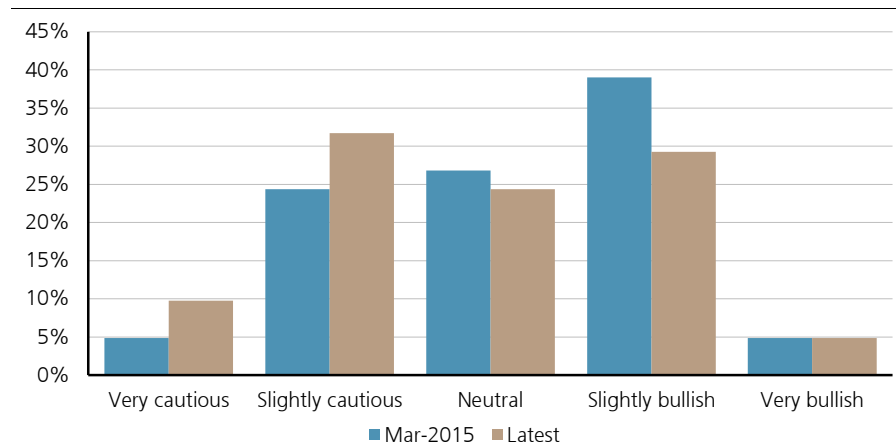
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# Executive summary

## Further deterioration in sentiment

Based on our latest in-house banking survey, sentiment towards the banking sector has deteriorated further over the past quarter. The decline in expectations on the banking outlook reflected rising global growth concerns, uncertainty over Fed funds rates, as well as volatility in commodity prices and currencies.

**Figure 2: What best describes your view on the outlook for your sector?**



Source: UBS estimates

## Outlook weakens further, especially in EM

Our survey found that sentiment towards the sector remained negative overall: 42% of respondents now have a negative outlook on the sector, up from 36% in the previous quarter; this is the highest level since June 2013. Interestingly, the level of respondents with a positive view on the sector also increased to 34% from 26% in the previous survey – an improvement of 8pp.

For emerging markets banks, the outlook in aggregate has deteriorated further, giving a strongly negative outlook. The number of respondents with a negative view increased to 52% from 44% in the previous survey, while the number of respondents having a positive view on the outlook has remained flat at 28%. The last time EM respondents were this cautious on the sector was in December 2013.

The most notable change in sentiment was towards China, where we have become more cautious and now have a slightly cautious view, driven by concerns over economic growth. Elsewhere, we are very cautious on Colombia, Greece, Singapore and Thailand (although our country analyst thinks Thai banks are now more fairly valued ([see report](#))), and slightly cautious on Georgia, Hong Kong, Malaysia, the Philippines, Poland, Taiwan and Turkey. We are slightly bullish on the United Arab Emirates, the Czech Republic, Hungary, Indonesia, Mexico, Peru and Russia.

In contrast, sentiment in developed markets has improved and is now somewhat positive. The improvement in outlook has been driven by a decrease in the number of respondents with a neutral view and a corresponding increase in those with a positive outlook: 44% of respondents now have a positive outlook on the sector (of which 13% are very bullish) compared to 25% in the previous survey, while the

**Mood towards EM most cautious since December 2013**

**We have become more cautious on Chinese banks**

**Confidence in the outlook for developed markets banks has improved**

number with a neutral outlook has fallen from 50% to 31%. The number of respondents with a slightly cautious outlook has remained flat at 25%.

By country, we are cautious on Australia, Austria, Spain, Switzerland and the United States (regionals). We are slightly bullish on Benelux, Ireland, Israel, Italy and Nordic banks, and very bullish on the UK and the US (brokers and universal banks).

## Views on fundamentals

- **Deteriorating loan growth expectations:** Looking ahead, the overall picture for loan growth has declined further compared with the previous survey: 49% of respondents (previously 42%) see downside risk to loan growth over the next 12 months versus 15% (previously 22%) seeing upside risk to loan growth.
- **In emerging markets,** the picture has become more gloomy: 60% of EM respondents now see downside risk to loan growth (UAE, Brazil, Chile, China, Colombia, Georgia, Greece, Hong Kong, India, Kazakhstan, Malaysia, Russia, Singapore, South Africa, and Taiwan), up from 52% in the previous survey, while only 12% (previously 24%) see upside risk (Czech Republic, Mexico and Poland).
- **In developed markets,** the loan growth picture has also deteriorated and is now skewed slightly to the downside: 19% of DM respondents see upside risk to loan growth (unchanged from the previous quarter), while 31% of respondents see downside risk (up from 25%). Developed markets where upside risk is perceived are Ireland, the UK and US (brokers and universal banks), versus downside risk in Australia, Canada, Japan, Switzerland and the US (regionals).
- **NIM outlook lowered and skewed to the downside:** In our latest survey, only 12% of respondents see upside risk to NIMs, versus 46% who see downside potential. This compares with a less negative outlook in the previous survey, when 22% of respondents expected upside potential and 37% saw downside risk.
- **For developed markets,** the view is also more negative than previously, with 6% of respondents seeing upside risk to NIMs (previously 13%) and 31% (unchanged) seeing downside risk. The only developed market seeing upside risk to NIMs is Switzerland, while those seeing downside risk comprise Canada, Japan, Spain, UK and US (regional).
- **In emerging markets,** 56% of respondents see downside risk to NIMs (40% in the previous quarter), while only 16% see upside risk (28% previously). EM respondents seeing downside risk are in Chile, China, Colombia, Georgia, Greece, Hong Kong, India, Indonesia, Korea, Poland, Taiwan, Turkey and UAE, while respondents seeing upside risk are in Brazil, Mexico, Russia and Singapore.
- **Slight improvement in NPL expectations:** In our survey, expectations on the outlook for NPL levels have improved slightly, but remained negatively skewed, with 37% (unchanged from the previous quarter) seeing upside risk to NPL forecasts, versus 24% seeing downside risk (17% previously).

**60% of EM respondents now expect downside risk to loan growth over next 12 months**

**The outlook for NIMs has weakened and is skewed firmly to the downside**

- **In emerging markets,** respondents remained biased towards seeing upside risk to NPLs, with 48% seeing upside risk to NPL forecasts (unchanged from the previous survey) versus 28% seeing downside risk (up from 16%). Upside risk to NPLs was seen in Brazil, China, Colombia, Greece, Hong Kong, Indonesia, Korea, Poland, Singapore, South Africa, Taiwan and Turkey, while downside risk was seen in Georgia, Hungary, India, Malaysia, Mexico and Russia.
- **In developed markets,** the aggregated picture is unchanged: we have a neutral overall view on the risk to NPLs with the vast majority (63%) of respondents seeing unchanged risk to NPL forecasts, and only 19% seeing downside risk, but 19% seeing upside risk.
- **Earnings risk clearly to the downside:** From our survey, for the next 12 months, our analysts are negative on risks to earnings forecasts in aggregate, with 49% seeing downside risk to earnings (up from 29%) versus only 15% seeing upside risk (down from 20%).
- **In developed markets,** 19% of respondents (unchanged) see upside risk to earnings, while the number of respondents seeing downside risk to earnings has increased significantly to 38% from 6% in the previous survey.
- **In emerging markets,** 56% of respondents now see downside risk to earnings (compared with 44% in the previous survey), while 12% see upside risk to earnings (20% in the previous survey).

**In EM, NPL expectations clearly skewed to downside...**

**Versus a neutral overall view on NPL in DM**

**38% of DM respondents see downside earnings risk (up from 6% a quarter earlier)...**

**The outlook in EM is even more pessimistic, with 56% seeing downside earnings risk (up from 44%)**

## Views on valuations

Despite the recent rally, the global banks sector has underperformed global equities by -5.3% year to date. Given this, the majority of respondents considered their banks to be either fairly valued (59%) or cheap/very cheap (34%) – a change from our previous survey, where 54% of respondents believed their banks were fairly valued and 37% considered them to be cheap/very cheap.

**The sector is largely considered to be between fair value and cheap**

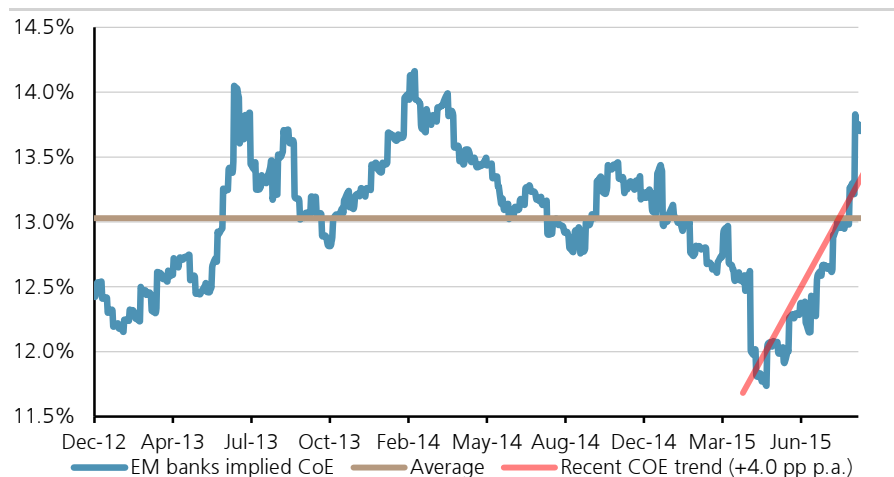
## Investment strategy

Notwithstanding last week's market rally, which we view as tactical and short term, sentiment towards the banking outlook – especially in emerging markets – remains cautious, as illustrated by our latest in-house banking survey. As we look to the final quarter of the year, we reiterate our preference for banks in developed markets over those in emerging markets. Against a backdrop of further global growth concerns, prospects of higher US Fed funds rates, and volatility in commodity prices and currencies, bank fundamentals have weakened further: our bottom-up 2015 EPS estimates for global banks have been revised down by 3.4% over the past year, with earnings risk seen largely to the downside.

**Despite recent tactical market rally, sentiment towards global banking outlook remains cautious**

Reflecting diverging policy rate trends, the margin outlook is mixed but skewed clearly to the downside, as indicated in our latest survey, while good cost control is expected as banks strive for greater efficiency and productivity. There is an emerging divergence in asset quality, with stability expected among banks in developed markets, but a clear deterioration anticipated for banks in emerging markets. Although sector valuations look supportive, cost of equity has been rising – especially in emerging markets – as shown in our implied cost of equity model, while earnings momentum has been negative.

**Figure 3: EM banks – implied CoE**



Source: I/B/E/S MSCI aggregates, MSCI indices, Thomson Financial DataStream, UBS

**Figure 4: Global banks – regional preferences**

Region	Rating	UBS comments
US	Overweight	GDP growth to recover further in 2015; prospects of Fed tightening. Broadening of credit demand; focus on costs, but slightly higher credit costs; positive earnings momentum; more constructive valuations. Top picks: MS (strong WM; asset sensitivity); Citizens Financial (earnings recovery); Bank of America (self-help story / free option on higher rates); Fifth Third (efficiency; capital distribution).
Canada	Neutral	Weaker macro growth reflecting falling commodity prices; banks have good funding and capital positions, while asset quality is healthy. Valuations look fair, with the sector on 10.4x PE, 2.0x P/TBV with 19.2% ROTE on 2016 estimates. Top pick is TD Bank (strategically well positioned).
Europe	Neutral	Additional ECB policy support (another round of QE?); ECB lending survey suggesting banks are increasingly willing to lend. QE putting pressure on bank margins, although asset quality holding up well. Sector valuations appear to be fair. Preference for UK and Benelux banks.
Japan	Neutral	Macro growth has deteriorated, with recent GDP data disappointing, weighing on banks' top-line growth. Lower earnings with normalisation of one-off gains (investments; provisions write-backs); stronger capital could boost dividends. Fair value: Sector trading on 9.4x PE, 0.7x P/BV, with RoE at 7.5%, on 2016 estimates.
GEM	Underweight	Macro risks are rising: growth concerns (notably in China), falling commodity prices, prospects of higher US rates and FX volatility. Loan growth expectations still coming down; NPLs/provisions set to rise; modest sector EPS growth at 8.3% in 2015E. U/W: China, Colombia, Greece, Singapore and Thailand; O/W: Czech Republic, Hungary, Indonesia, Mexico, Peru, Russia and UAE.
Australia	Underweight	GDP growth at 2.15% in 2016E; risks from fiscal drag, lower commodity prices, slower China, and a highly leveraged consumer. Loan growth modest; NIMs stable; limited signs of asset-quality deterioration, but regulatory capital risk remains elevated. Valuations still look relatively demanding, with the sector trading on 12.3x PE, 1.6x P/BV and 14.1% RoE on 2016 estimates.

Source: UBS estimates

## Reiterating underweight stance in EM

We remain underweight EM banks, reflecting ongoing external risks, disappointing macro growth trends and deteriorating sector fundamentals. Risk aversion towards the sector is expected to persist, given increasing uncertainties over Chinese/emerging markets growth, as reflected by falling commodity prices, while the Federal Reserve looks set to hike policy rates in the coming months.

In terms of fundamentals, emerging markets banks are facing two key areas of concern:

- **Loan growth** is expected to be the weakest since 2001: we currently forecast loan growth at 10.0% in 2015 versus 12.3% in 2014. This is supported by our

**Risk aversion expected to persist in EM, given growth worries and US rate uncertainties**

current in-house banking survey, where 60% of respondents see downside risk to loan growth over the next 12 months (see **Figure 12**).

- **Asset quality:** EM banks appear to be entering a new NPL cycle, with sector NPL forecast to rise from 2.32% in 2015 to 2.49% in 2016, before stabilising at 2.45% in 2017. This is reinforced by our latest survey findings, where 48% of respondents see upside risk to NPL forecasts (i.e. higher NPL risk) versus only 28% seeing downside NPL risk (see **Figure 18**).

Given these two fundamental concerns, emerging markets banks have experienced negative earnings momentum: EPS growth is now forecast at only 8.3% in 2015 and 10.7% in 2016. Sector ROE has fallen from 19.0% in 2012 to 15.6% in 2014. Currently, we forecast ROE at 15.6% in 2015 and 15.5% in 2016.

At the country level, we are underweight banks in China (macro growth worries, rising provisioning), Colombia (weakening macro, asset-quality risk, higher taxes), Greece (NPL worries, regulatory risk), Singapore (risk to top-line growth, falling ROE), and Thailand (negative earnings momentum). Our global banks least preferred list features a number of EM banks, such as **Bancolombia**, **Bank of East Asia** (Hong Kong), **Hana Financial Group** (Korea), **VTB** (Russia), and **Yapi Kredi** (Turkey).

We are overweight banks in Mexico (early credit cycle, falling NPLs, strong earnings growth), Peru (rising RoE upside, attractive valuations), Hungary (strong macro momentum, NIM bottoming out, improving asset quality), the Czech Republic (improving macro, earnings resilience), and Russia (stabilisation and moderate growth from 4Q15 onwards, better corporate asset quality, attractive valuations).

## Overweight US banks

In contrast, we reiterate our overweight stance on US banks, given the generally constructive GDP outlook that should further underpin the recovery in credit demand for consumer loans, as indicated by recent Fed surveys. The start of a new tightening cycle also bodes well for the outlook for NIM (although recently the timing of rate hikes has become less certain), while banks are likely to remain focused on efficiency improvements and credit trends are likely to remain strong.

We also see positive signs on the regulatory and capital front, as US banks continue to increase capital returns, and we have seen less rhetoric around ratcheting up the regulatory pressure. Additionally, both Congress and regulators appear willing to consider a proposal that would ease the burden for smaller banks.

Reflecting our positive stance on US banks, we include in our global banks preferred list **Morgan Stanley** (better-than-expected results driven by the wealth management (WM) business and the emerging asset sensitivity story), **Bank of America** (a self-help story with a free option on higher rates), **Citizens Financial** (an earnings recovery story that can grow earnings with or without higher rates), and **Fifth Third** (efficiency upside, capital distribution and attractive valuations).

## Neutral on Canada, Europe and Japan

- **Canada:** We have a neutral stance. Valuations for Canadian banks have come in to reflect some anxiety over credit costs; they are now trading on 10.4x P/E, 2.0x P/TBV with a 19.7% ROTE, on our 2016 estimates. Canada's oil-exporting economy has been vulnerable to the sharp fall in oil prices, prompting the central bank to announce a surprise 25bp rate cut in January 2015 and a

**Reiterating our overweight stance on US banks**

**Neutral on Canada with sector valuations fairly valued**

further 25bp rate cut to 0.5% in July 2015. Since January, inflation has remained low (seasonally adjusted CPI was 1.20% in August), but we believe a weaker Canadian dollar should boost exports. Our economics team believes the Bank of Canada will not immediately follow the Fed into a rate hike, and forecasts the overnight to remain at 0.5% during 2015 and to rise to just 1.0% by year-end 2016. Fundamentally, the sector looks reasonably healthy, with good funding and capital positions, but while asset quality has not deteriorated, we are cautious about what the drop in oil prices could mean for credit costs. Our top pick is **TD Bank** (strategically well positioned and diversified, with a growing US footprint).

- **Europe:** We retain our neutral stance, as we think the sector in Europe is at fair value while fundamentals are stable. Our economics team expects a recovery to be underpinned by the ECB's accommodative policy and the soft euro, despite rising external risks, and forecasts GDP growth of 1.4% in 2015 (versus 0.9% in 2014) and 1.9% in 2016.

Given heightened external risks, the ECB has turned more dovish recently, arguing that it stands ready to "do more" if needed, although our economics team views the hurdle to "QE-2" as still high, and sees an extension to the current QE programme that ends in September 2016 as more likely ([see report](#)). However, lower yields from QE have resulted in margin pressure for eurozone banks, which has contributed to the 12.3% downgrade to our 2015 EPS estimates since the start of the year.

In our global banks preferred list, we include two banks from Europe: **ING**, where we expect business restructuring to drive higher returns over time, and **HSBC**, which we recently upgraded to a Buy rating ([see report](#)). While we acknowledge that HSBC has emerging markets exposure, we also believe it has considerable restructuring potential that could boost the group's returns and capital levels, as illustrated by the recent sale of its Brazilian business.

**Japan:** We also maintain our neutral stance on the Japanese banking sector. Macro growth has deteriorated, with recent GDP data disappointing. Reflecting this, Japanese banks are struggling to generate top-line growth, given shrinking margins, even though equity-related gains and credit allowance reversals have contributed to better net profits. We are aware that the major Japanese banks are now facing market pressure, supported by the Tokyo Stock Exchange's (TSE) Corporate Governance Code and regulators' concern about banks' equity-holdings risk, to realise unrealised gains on their strategic shareholdings (so-called "cross-shareholdings"). We think the banks will make progress in unwinding cross-shareholdings, but not enough to improve their valuation significantly in the short term. Our top pick is **SMFG**, given what we see as its relatively attractive valuation and financial position, enabling it to follow MUFG's shareholder return policy – i.e. in starting share buybacks.

**Figure 5: Global banks – UBS top picks**

	Rating	Market Cap	UBS Adj PE		Price / Book		UBS Adj RoE (%)		Net Div Yield	
		(US\$m)	15E	16E	15E	16E	15E	16E	15E	16E
Most preferred										
Bank of America Corp.	Buy	164,931	11.0x	9.9x	0.7x	0.7x	6.9%	7.2%	1.3%	1.9%
Citizens Financial Group	Buy	12,591	14.6x	11.8x	0.6x	0.6x	4.5%	5.4%	1.7%	1.9%
Fifth Third Bancorp	Buy	15,423	11.8x	10.3x	1.0x	1.0x	9.1%	9.9%	2.8%	3.0%
HDFC Bank	Buy	39,151	21.4x	17.1x	3.8x	3.2x	19.0%	20.4%	0.9%	1.1%
HSBC	Buy	158,048	10.9x	10.8x	0.9x	0.8x	8.1%	8.0%	6.2%	6.3%
Inbursa	Buy	13,677	16.6x	13.1x	2.1x	1.8x	13.2%	14.8%	1.2%	2.1%
ING	Buy	56,400	11.1x	10.1x	1.1x	1.1x	9.5%	10.9%	8.7%	7.9%
Morgan Stanley	Buy	64,400	10.2x	10.1x	0.9x	0.9x	9.5%	9.0%	1.7%	2.0%
Sumitomo Mitsui Financial Group	Buy	54,904	8.6x	8.3x	0.7x	0.6x	8.2%	8.0%	3.1%	3.3%
TD Bank Financial Group	Buy	75,903	11.7x	10.9x	1.6x	1.5x	14.7%	14.1%	3.7%	3.9%

Source: UBS estimates

**Figure 6: GEM banks – UBS top picks**

	Rating	Market Cap	UBS Adj PE		Price / Book		UBS Adj RoE (%)		Net Div Yield	
		(US\$m)	15E	16E	15E	16E	15E	16E	15E	16E
Most preferred										
Akbank	Buy	10,016	9.7x	7.6x	1.1x	1.0x	11.7%	13.7%	1.6%	1.6%
Bank Rakyat Indonesia	Buy	17,674	11.2x	10.5x	2.1x	1.9x	20.6%	19.0%	3.0%	2.8%
Credicorp	Buy	9,160	9.5x	8.6x	1.8x	1.6x	20.0%	19.0%	0.0%	2.9%
Dubai Islamic Bank	Buy	7,384	8.4x	8.1x	1.3x	1.3x	17.9%	16.0%	5.9%	7.1%
HDFC Bank	Buy	39,151	21.4x	17.1x	3.8x	3.2x	19.0%	20.4%	0.9%	1.1%
Inbursa	Buy	13,677	16.6x	13.1x	2.1x	1.8x	13.2%	14.8%	1.2%	2.1%
Itau Unibanco	Buy	46,432	7.6x	6.8x	1.7x	1.4x	23.3%	22.6%	3.9%	5.1%
KB Financial Group	Buy	11,477	7.6x	8.9x	0.5x	0.5x	6.4%	5.2%	3.2%	2.8%
Kasikornbank	Buy	11,843	10.2x	9.4x	1.5x	1.3x	15.2%	14.7%	2.3%	2.4%
Sberbank	Buy	28,345	9.4x	5.2x	0.9x	0.8x	9.1%	15.1%	2.0%	4.6%

Source: UBS estimates

## Underweight Australian banks

We reiterate our underweight stance on Australian banks. The recent weakness in share prices has made sector valuations less demanding, but relative to banks in the rest of the world they remain unattractive at 12.3x PE, 1.6x P/BV and 14.1% RoE, based on 2016 estimates. However, with bad debt charges at record lows and regulatory headwinds continuing (net stable funding ratio (NSFR), term deposits, TLAC, "Basel 4", leverage ratio), the medium-term outlook remains challenging. Further asset repricing appears necessary, but may only serve to offset higher funding costs rather than stabilise ROE. As such, we expect bottom-line earnings growth to remain limited, with EPS growth at 0.5% in 2016E.

**Cautious on Australian banks, given regulatory risk and unfavourable valuations**

**Figure 7: Global banks – least preferred stocks**

	Rating	Market Cap	UBS Adj PE		Price / Book		UBS Adj RoE (%)		Net Div Yield	
		(US\$m)	15E	16E	15E	16E	15E	16E	15E	16E
Least preferred										
Bancolombia	Sell	9,176	9.0x	9.0x	1.5x	1.4x	14.4%	13.9%	3.4%	3.3%
Bank of East Asia	Sell	9,299	13.4x	13.2x	0.9x	0.9x	7.1%	6.8%	3.8%	4.0%
Hana Financial Group	Neutral	6,739	7.0x	6.9x	0.4x	0.3x	5.2%	5.0%	1.7%	1.7%
Handelsbanken	Sell	28,168	14.3x	13.7x	1.8x	1.7x	12.5%	12.6%	5.2%	5.5%
Sumitomo Mitsui Trust Holdings	Sell	14,795	10.2x	9.9x	0.7x	0.7x	7.5%	7.3%	3.0%	3.3%
VTB	Sell	14,726	-ve	17.5x	0.9x	0.8x	-10.1%	4.8%	0.0%	0.0%
Yapi Kredi Bank	Neutral	5,383	8.5x	6.9x	0.7x	0.6x	8.6%	9.6%	2.1%	2.1%

Source: UBS estimates

**Figure 8: Global banks – valuation summary**

	UBS Adj PE			Price / Book			UBS Adj RoE (%)			Net Div Yield (%)		
	15E	16E	17E	15E	16E	17E	15E	16E	17E	15E	16E	17E
Australia	12.3x	12.3x	12.2x	1.7x	1.6x	1.5x	15.3	14.1	13.5	6.1	6.2	6.3
Canada	11.1x	10.4x	9.7x	1.6x	1.5x	1.5x	16.0	15.6	15.7	4.1	4.5	4.8
Asia (ex-Japan)	7.5x	7.5x	7.1x	1.0x	0.9x	0.8x	15.0	13.9	13.8	4.4	4.2	4.5
EMEA	10.3x	8.5x	7.1x	1.1x	1.0x	0.9x	12.4	14.4	15.2	3.3	4.2	5.0
Latin America	8.2x	7.3x	6.6x	1.5x	1.3x	1.2x	19.4	19.2	18.7	3.8	4.6	5.2
Japan	9.5x	9.4x	8.9x	0.7x	0.7x	0.6x	7.8	7.5	7.4	2.8	2.9	3.1
United Kingdom	11.1x	10.6x	9.1x	0.9x	0.8x	0.8x	8.2	8.3	9.2	4.1	4.6	5.3
Europe	11.9x	10.4x	9.1x	0.9x	0.9x	0.8x	8.7	9.3	10.0	4.1	4.9	5.3
United States	11.1x	10.0x	9.0x	0.9x	0.8x	0.8x	8.5	8.9	9.2	1.7	2.1	2.6
GEM	7.9x	7.6x	7.0x	1.1x	1.0x	0.9x	15.2	14.7	14.6	4.1	4.3	4.7
GEM (ex-China)	10.5x	9.5x	8.3x	1.2x	1.1x	1.1x	14.5	14.9	15.3	3.3	3.6	4.1
<b>Global Banks</b>	<b>10.1x</b>	<b>9.4x</b>	<b>8.6x</b>	<b>1.0x</b>	<b>0.9x</b>	<b>0.9x</b>	<b>11.6</b>	<b>11.5</b>	<b>11.7</b>	<b>3.7</b>	<b>4.1</b>	<b>4.4</b>

Source: UBS estimates. Note: Prices as at 8 October 2015

# Survey findings

## Sentiment becomes more negative

Our survey found that sentiment towards the sector has remained negative overall: 42% of respondents now have a negative outlook on the sector, up from 36% in the previous quarter – the highest level since June 2013. Interestingly, the level of respondents with a positive view on the sector also increased to 34% from 26% in the previous survey – an improvement of 8pp. As a result of the increase in both positive views and negative views, the number of regions where we have a neutral view has declined significantly to 24% from 37% previously.

## EM outlook has become more negative

For emerging markets banks, the outlook in aggregate has deteriorated further, giving a strongly negative outlook. The number of respondents with a negative view increased to 52% from 44% in the previous survey, while the number of respondents having a positive view on the outlook has remained flat at 28%. The last time EM respondents were this cautious on the sector was in December 2013.

Countries showing notable changes in sentiment include China, where we have become more cautious and now have a slightly cautious view, driven by concerns over economic growth. We also have become slightly more cautious on Colombia (slowing macro outlook and asset-quality concerns), Singapore (US\$ strength and potential US rate rises and second-order China effects) and Thailand, and are now very cautious on those regions. We also maintain our very cautious view on Greece given ongoing economic concerns and the likelihood of a required bank recapitalisation.

On a more positive note, we are now more bullish on Korean banks, where we now have a neutral view on the outlook based on valuation and the prospect of long-term improvements in RoE driven by secular factors such as mobile banking (see [Korea Fintech Vol. 1: Mobile Banking – UBS Evidence Lab: Mobile banking – what does it mean for Korea Banks?](#)).

By country, we are very cautious on Colombia, Greece, Singapore and Thailand, and slightly cautious on China, Georgia, Hong Kong, Malaysia, the Philippines, Poland, Taiwan and Turkey. We are slightly bullish on the UAE, the Czech Republic, Hungary, Indonesia, Mexico, Peru and Russia.

## Improved confidence in DM outlook

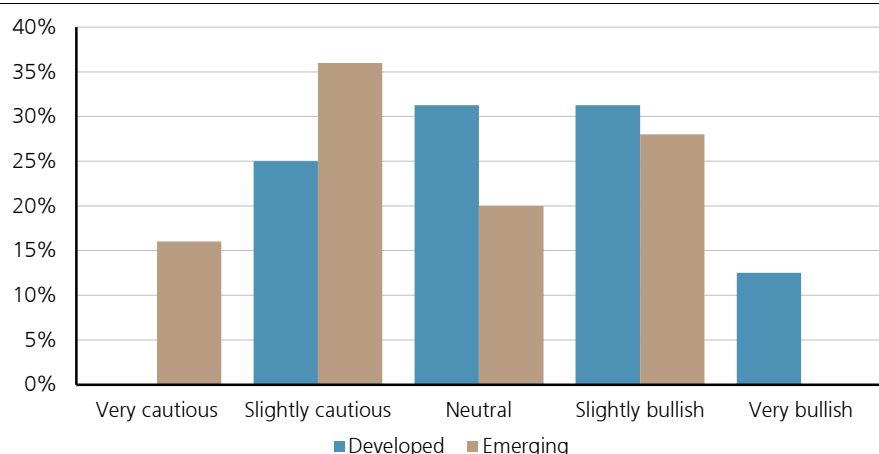
Sentiment has improved in developed markets and is now somewhat positive. The improvement in outlook has been driven by a decrease in the number of respondents with a neutral view and a corresponding increase in those with a positive outlook: 44% of respondents now have a positive outlook on the sector (of which 13% are very bullish) compared to 25% in the previous survey, while the number with a neutral outlook has fallen from 50% to 31%. The number of respondents with a slightly cautious outlook has remained flat at 25%.

By country, we are cautious on Australia, Austria, Spain, Switzerland and the United States (regionals). We are slightly bullish on Benelux, Ireland, Israel, Italy and Nordic banks, and very bullish on the United Kingdom and United States (brokers and universal banks).

**Further deterioration in sentiment towards EM banks**

**Confidence in the outlook for developed markets banks has improved**

**Figure 9: What best describes your view on the outlook for your sector?**



Source: UBS

## Sector upgrades/downgrades

In this survey, there have been a significant number of upgrades and downgrades in outlook, with the overall change balancing out at 13 upgrades and 13 downgrades.

As described above, we have become more cautious on China, where we are now slightly cautious, based on concerns over economic growth.

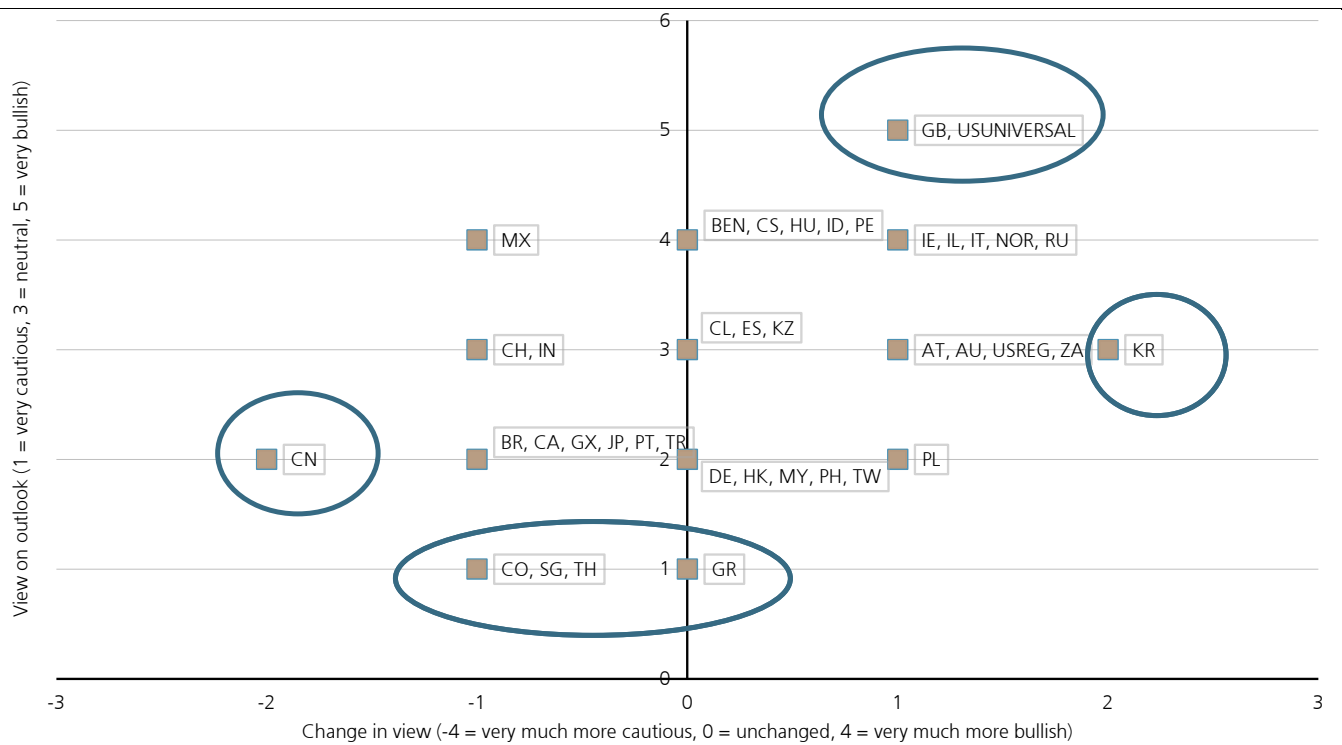
We have become slightly more cautious on Colombia, Singapore and Thailand, taking our outlook to a very cautious stance, and become slightly more cautious on Brazil, Canada, Georgia, Japan, Portugal and Turkey, where we are now slightly cautious. We have similar-scale downgrades in outlook, taking the outlook to a neutral stance, in Switzerland and India, and to a slightly bullish stance in Mexico.

In addition to the downgrades in outlook listed above, there have also been a similar number of upgrades in outlook. The biggest upgrade is in Korea, where we are now neutral based on valuation and the prospect of long-term improvements in RoE, driven by secular factors such as mobile banking.

Upgrades where we are slightly more bullish include Poland (now slightly cautious; we see political risk as still high, but also have clarity on the worst-case outcomes on FX mortgages), Austria, Australia, US regional banks and South Africa, where we now have a neutral view on the outlook, and Ireland, Israel, Italy, Nordic banks, and Russia, where we have a slightly bullish outlook.

We have also seen one-notch upgrades for the UK (valuation upside) and US brokers and universal banks (given more constructive valuations), and are now very bullish on those regions.

**Figure 10: Analyst views on the outlook by country (Y axis) and changes in the outlook over the past two months (X axis)**



Source: UBS analysts. Notes: AT = Austria, AU = Australia, BEN = Benelux, BR = Brazil, CA = Canada, CH = Switzerland, CL = Chile, CN = China, CO = Colombia, CS = Czech Republic, DE = Germany, ES = Spain, GB = United Kingdom, GR = Greece, GX = Georgia, HK = Hong Kong, HU = Hungary, ID = Indonesia, IE = Ireland, IL = Israel, IN = India, IT = Italy, JP = Japan, KR = Korea, KZ = Kazakhstan, MX = Mexico, MY = Malaysia, NOR = Nordic, PE = Peru, PH = Philippines, PL = Poland, PT = Portugal, RU = Russia, SG = Singapore, TH = Thailand, TR = Turkey, TW = Taiwan, USREG = United States (regionals), USUNIVERSAL = United States (brokers & universal banks), ZA = South Africa

# Macro views

## Macroeconomic growth concerns dominate

Overall in this survey, the macroeconomic growth outlook has remained the dominant risk that respondents would consider for their sector – this is hardly surprising given the market's preoccupation with the Fed's "will they/won't they/when will they?" debate around the raising of US rates during the survey period. This factor was cited by 44% of respondents, compared to 32% in the previous survey.

## Regulatory and policy issues

In this survey, there has been in aggregate a decline in the relative importance of regulatory and policy issues, which is now cited by only 15% of respondents and takes third place as the factor cited as the main risk to the sector by our respondents, just behind bad debts (17% of respondents).

However, despite the aggregate decline in importance of regulation, in developed markets this concern ranked joint first alongside the macroeconomic growth outlook (both issues being cited by 38% of respondents), although this is a slight decline from the previous survey, where regulatory and policy issues were cited by 38% of respondents.

## Macroeconomic concerns

For emerging markets, the major concern is still the macroeconomic growth outlook. It was cited by 48% of respondents (up sharply from 40% previously), including those in the UAE, Brazil, Chile, China, the Czech Republic, Hong Kong, Hungary, Malaysia, Mexico, Peru, South Africa and Taiwan.

In developed markets, the macroeconomic growth outlook is a resurgent risk factor, having been cited by 38% of respondents, gaining in importance from the previous survey where it was cited by 19% of respondents. In this survey, this is considered the most important risk factor in Benelux, Canada, Italy, Japan, the US brokers and universal banks, and US regionals.

## Bad debts

Bad debts remain an important risk factor in emerging markets, where 20% of respondents (unchanged from previously) cited this as the most significant risk for their banks. Countries where this was cited included Colombia, Greece, India, Korea and Thailand.

In developed markets, this risk factor is low, but it has remained almost unchanged at 13%, the countries cited being Austria and Portugal.

## Emerging markets currency depreciation

Given increasing market focus during the survey period on the possible hike in Fed funds rates, the effect of currency depreciation has increased slightly in importance as a risk factor in emerging markets. In our latest survey, it was cited by 16% of respondents (Georgia, Indonesia, Kazakhstan and Singapore), having been cited by 8% of respondents in the previous survey.

## Political risk

Political risk in emerging markets is now cited by 8% of respondents (unchanged from previously) – Poland and Turkey. However, it has declined in importance in developed markets, where it is no longer cited by any respondents, versus 6% previously.

## Inflation and interest rates

In emerging markets, this has declined in importance as a risk. It is now only the joint-third most important risk (along with currency depreciation and political risk), with 4% of respondents (previously 8%) citing this as the most important risk to their sector (Russia).

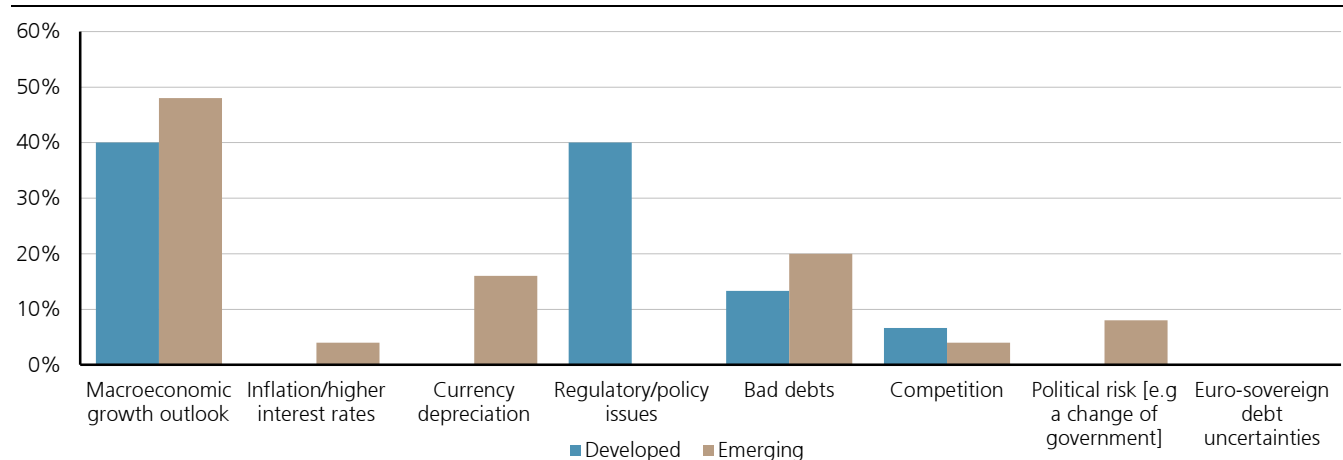
## Competition

As in our previous survey, in this survey, competition has been cited as the most important factor in both emerging markets (Philippines) and developed markets (the UK), although elsewhere it appears to be only a minor risk at this point.

## Euro-area sovereign debt uncertainties

As in our previous survey, none of our respondents cited euro-area sovereign debt uncertainties.

**Figure 11: What is the main risk to your sector?**

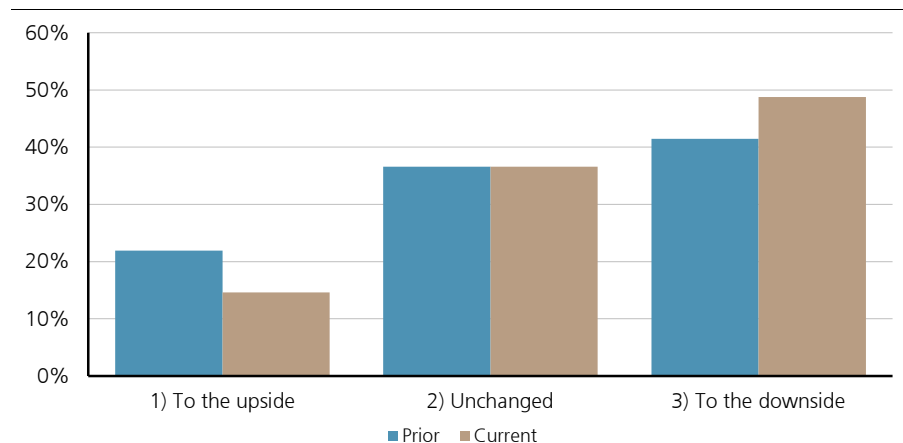


Source: UBS estimates

# Views on fundamentals

## Loan-growth expectations

**Figure 12: What is the risk to your loan-growth forecast (12-month outlook) – prior versus current?**



Source: UBS

The overall picture for loan growth has declined somewhat further compared to the previous survey, and is now significantly skewed to the downside, although the proportion of respondents believing that loan growth forecast risk has remained flat at 37%. In this survey, only 15% of respondents (previously 22%) believe there is upside risk to loan-growth forecasts, while 49% (previously 42%) believe there is downside risk.

Looking in more detail, it is apparent in emerging markets that there has been a further decline in the proportion of respondents seeing upside risk to loan growth (12% compared with 24% previously), while the percentage of respondents seeing downside risk has increased to 60% (versus 52% previously) – leaving the picture further skewed to the downside. Our EM respondents see upside risk to loan growth in the Czech Republic, Mexico and Poland, and downside risk in the UAE, Brazil, Chile, China, Colombia, Georgia, Greece, Hong Kong, India, Kazakhstan, Malaysia, Russia, Singapore, South Africa and Taiwan.

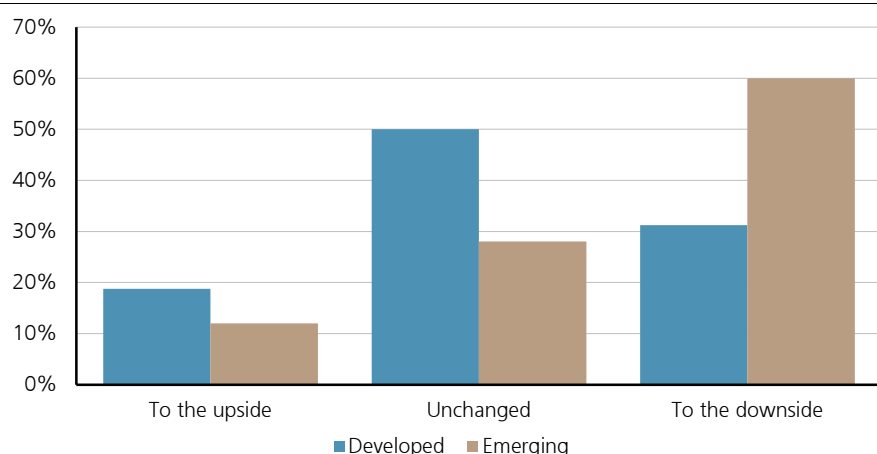
In developed markets, the picture has also deteriorated from our previous survey and is now skewed to the downside, although the majority (50%) of our DM respondents see unchanged risk to loan growth. Some 19% of respondents see upside risk to loan growth in their sector (unchanged from previously), while 31% see downside risk (versus 25% in our previous survey).

The developed markets where upside risk to loan growth forecasts is perceived are Ireland, the UK and US brokers and universal banks, while downside risk is seen in Australia, Canada, Japan, Switzerland and US regionals.

**Loan-growth expectations have declined and are now very negative**

**Downside risk to loan growth has increased in emerging markets**

**Figure 13: What is the risk to your loan growth forecast (12-month outlook)?**



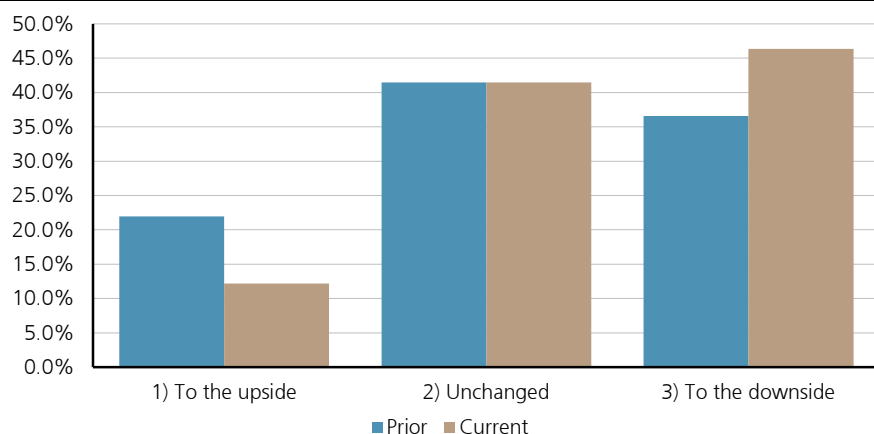
Source: UBS

## NIM outlook

The NIM outlook for the next 12 months has deteriorated further, and remains skewed firmly to the downside. In our latest survey, only 12% of respondents see upside risk to NIMs, versus 46% who see downside potential. This compares with a more positive outlook (but negative overall view) in the previous survey, when 22% of respondents saw upside potential and 37% of respondents saw downside risk.

**Outlook for NIMs has become even more negative**

**Figure 14: What is the risk to your NIM forecast (12-month outlook)?**



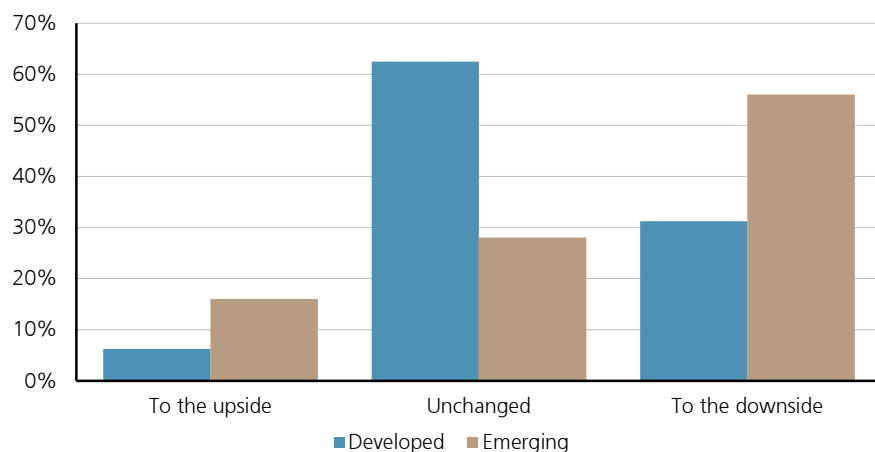
Source: UBS

In the previous survey, the NIM outlook was negative for both emerging and developed markets, but the outlook appears to have deteriorated further – particularly in emerging markets.

In emerging markets, 56% of respondents see downside risk to NIMs (compared to 40% in the previous survey), while only 16% see upside risk (versus 28% previously). EM respondents seeing downside risk are in the UAE, Chile, China, Colombia, Georgia, Greece, Hong Kong, India, Indonesia, Korea, Poland, South Africa, Taiwan and Turkey, while respondents seeing upside risk are in Brazil, Mexico, Russia and Singapore.

For developed markets, the view is also more negative than previously, with 6% of respondents seeing upside risk to NIMs (previously 13%) and 31% (unchanged) seeing downside risk to NIMs, while the proportion seeing unchanged risk has grown to 63%. The only developed market seeing upside risk to NIMs is Switzerland, while those seeing downside risk are Canada, Japan, Spain, the UK and US regionals.

**Figure 15: What is the risk to our NIM forecast (12-month outlook)?**



Source: UBS

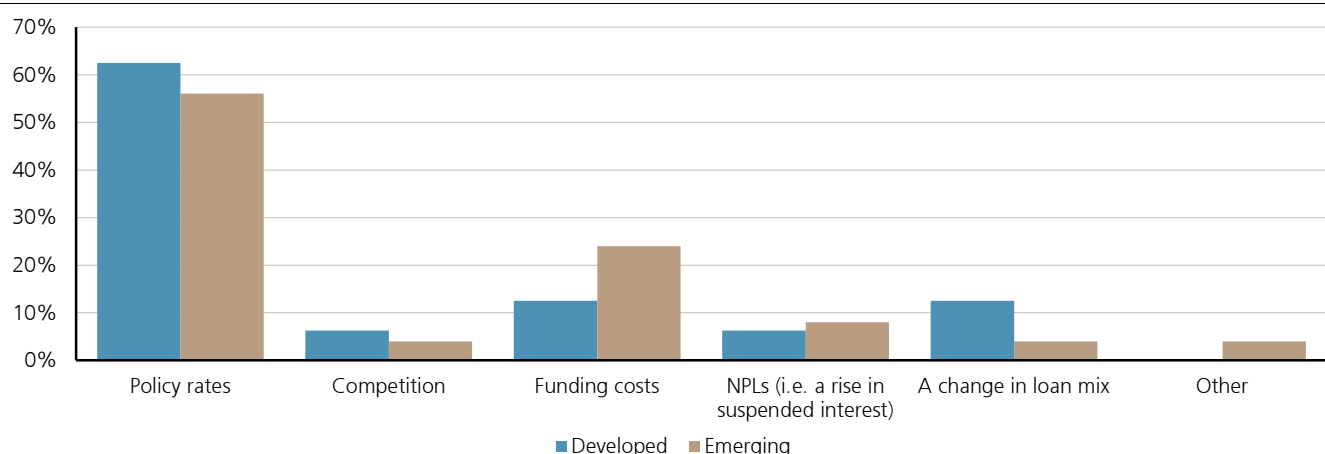
## Policy rates

Given the market's preoccupation with the Federal Reserve's decision on whether to raise rates or not at its September FOMC meeting, along with an ongoing QE programme in the eurozone and the prospect of a weaker Chinese economy, we are not surprised to see that policy rates are considered by far the most important factor likely to affect NIMs over the next 12 months, with 59% (previously 56%) of respondents in aggregate citing this as the most important factor likely to affect NIMs over the next 12 months. In emerging markets, 56% of respondents (unchanged from the previous survey) cited this as the primary factor: Brazil, Chile, China, Colombia, the Czech Republic, Hong Kong, Hungary, Indonesia, Kazakhstan, Korea, Mexico, Peru, Poland and Singapore.

In developed markets, a significant 63% of respondents cited policy rates as the primary factor likely to affect NIMs, somewhat higher than the 56% in the previous survey. Countries where this factor was cited included Austria, Canada, Germany, Israel, Italy, the Nordics, Switzerland, the UK, and US brokers & universal banks and regionals.

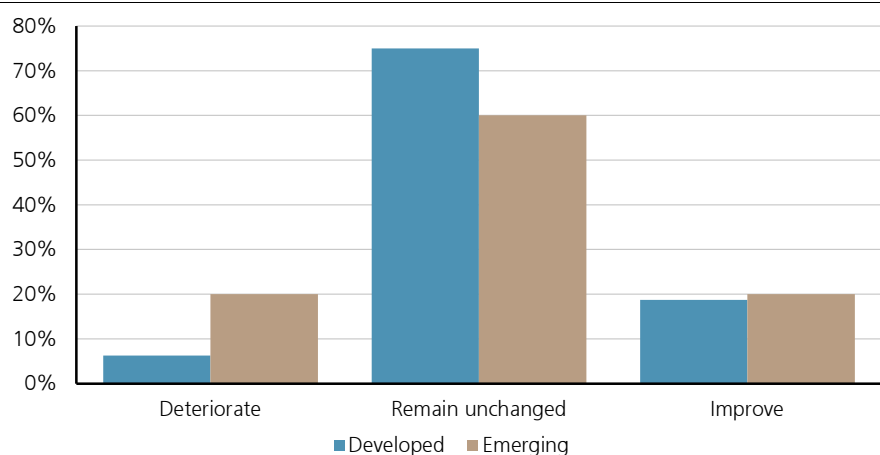
The second, though significantly less important, factor was funding costs, cited by 20% (previously 15%) of respondents (in the UAE, Georgia, Malaysia, Russia, South Africa and Turkey).

**Figure 16: What is most likely to affect net interest margins over the next 12 months?**



Source: UBS

**Figure 17: Do you expect the funding outlook for your banks over the next 12 months to:**



Source: UBS

Compared to our last survey, the funding outlook overall has improved slightly – driven by a small improvement in the funding outlook in developed markets – and is now slightly skewed to the upside, with 20% of respondents expecting the funding outlook to improve compared to 17% previously, while 15% expected the funding outlook to deteriorate (17% previously).

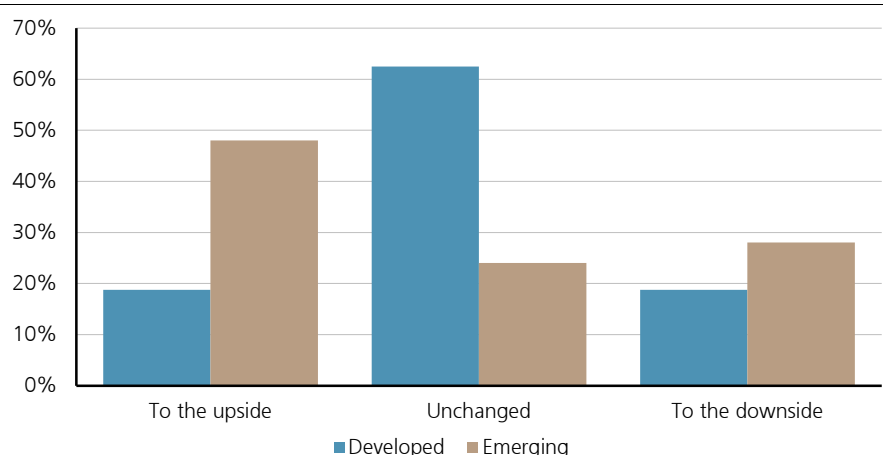
In emerging markets, the outlook on funding remains balanced, with those expecting an improvement in funding comprising Greece, India, Indonesia, Poland and Russia, while our survey respondents are expecting a deterioration in the UAE, China, Singapore, South Africa and Turkey.

In developed markets, we have seen a small improvement in the funding outlook, and now see an improvement for 19% of respondents (unchanged from previously) and a deterioration in 6% (19% previously). Regions where an improvement in the funding outlook is expected comprise Ireland, Italy and the UK, while a deterioration is anticipated in Australia.

**The funding outlook remains slightly more positive in developed markets than in emerging markets**

## Asset quality

**Figure 18: Is the risk to your NPL forecast over the next 12 months (downside/upside risk to current forecasts):**



Source: UBS

In our survey, expectations on the outlook for NPL levels have improved slightly, but remain skewed negatively, with 37% (unchanged from the previous quarter) seeing upside risk to NPL forecasts, versus 24% seeing downside risk (17% previously) – with the improvement in outlook coming from emerging markets.

Despite this improvement, emerging-markets respondents remain biased towards the upside, with 48% seeing upside risk to NPL forecasts (unchanged from previously) and 28% (previously 16%) seeing downside risk. Upside risk to NPLs was seen in the UAE, Brazil, China, Colombia, Greece, Hong Kong, Indonesia, Korea, Poland, Singapore, Taiwan and Turkey, while downside risk was seen in Georgia, Hungary, India, Malaysia, Mexico, and Russia.

In developed markets, the aggregate picture is unchanged: we see a neutral overall view on the risk to NPLs, with the majority (63%) of respondents seeing unchanged risk to NPL forecasts and 19% seeing downside risk, but also 19% seeing upside risk. In this survey, we see upside risk to NPL forecasts in Australia, Canada and Switzerland, and downside risk in Ireland, US brokers and universal banks and US regionals.

Since our last analyst survey, 2016E NPL/loan expectations have remained almost unchanged compared with the previous period, with 16 countries showing an improvement in forecast NPL levels against 17 countries where analysts forecast a deterioration in NPLs/loans. The largest increases (i.e. deterioration) in forecast NPL/loan expectations were in Thailand (+110bp to 3.86%), Russia (+97bp to 8.14%), Italy (+80bp to 15.03%), Hungary (+19bp to 19.87%) and Indonesia (+18bp to 1.49%).

Conversely, the largest improvement in 2016 forecast asset quality was in Greece (-29bp to 32.54%), Spain (-18bp to 4.86%), the Philippines (-12bp to 2.04%), Austria (-11bp to 7.92%) and Mexico (-9bp to 2.76%).

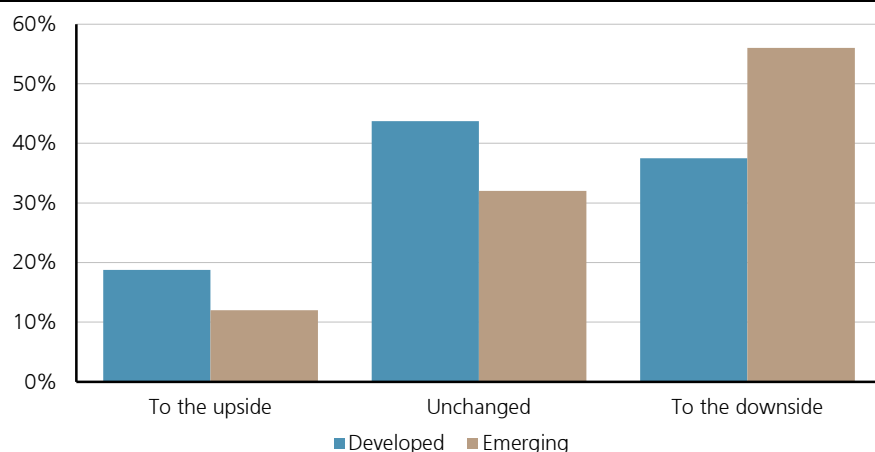
**Figure 19: Provisions/average loans**

	Provisions / average loans (bp)																		
	00	01	02	03	04	05	06	07	08	09	10	11	12	13	14E	15E	16E	17E	18E
Australia	31	41	31	28	24	20	18	24	61	72	40	29	33	25	17	18	21	23	25
Canada	51	79	114	46	11	24	20	28	49	81	53	43	39	32	30	31	37	41	43
Japan	59	109	45	118	160	47	23	34	117	65	31	14	15	-6	5	5	9	11	12
United States	23	46	290	211	159	130	92	154	315	434	271	125	75	43	46	55	74	82	85
Europe	53	81	80	87	64	56	58	60	111	160	103	89	91	89	72	55	49	49	48
United Kingdom	50	90	69	105	77	85	98	122	199	253	135	110	81	69	40	38	37	38	39
Developed	50	77	143	115	86	68	60	79	149	197	126	77	64	52	47	43	48	51	52
GEM	199	248	178	156	105	127	154	135	191	204	158	145	142	122	128	125	127	126	123
Global Banks	67	95	147	120	89	78	81	94	162	199	137	102	93	75	73	66	70	72	72

Source: UBS estimates

## Earnings outlook

**Figure 20: What is the risk to your earnings forecast (12-month outlook)?**



Source: UBS

Over the past year, reflecting the low growth outlook, 2015E earnings momentum for banks globally has been negative in terms of growth (-3.4%), and is significantly negative in terms of the number of downgrades.

Based on our coverage of global banks, the net number of 2015E EPS upgrades versus downgrades is -64 year to date (i.e. there have been 64 more stocks with EPS downgrades than upgrades), with the majority of the net downgrades being in Asia and Europe, where there have been 25 and 16 (respectively) more downgrades than upgrades. In Europe, there has been a 12.3% downgrade in earnings, while in Asia the downgrade to earnings has been more moderate at 1.7% – although when we exclude China the downgrade is more pronounced at 4.4%.

We have been even more pessimistic on Latin America, where there has been a smaller number of net downgrades (9), but that represents 75% of the stock coverage and a significant 5.4% aggregate downgrade in forecast earnings for the region.

Completing the negative outlook for emerging markets, in EMEA we have seen a net 15 downgrades to stocks, representing 44% of coverage and amounting to a

6.5% downgrade to earnings. In aggregate, emerging markets have seen 49 net downgrades (43% of stock coverage) and a 2.9% downgrade to earnings.

In the US, the picture is more optimistic: we have seen an aggregate 1.7% upgrade to earnings over the year to date and one net upgrade to EPS, while in Japan we have seen an 11.4% upgrade to earnings year to date and net EPS upgrades for 100% of the stock coverage.

Looking at 2016E EPS, a similar pattern emerges, with 87 net downgrades globally, almost half being in Asia (43 net downgrades), with another 18 net downgrades in Europe and 15 in EMEA. In Latin America, we have seven net downgrades since the start of the year. Overall in GEM, we have 65 net downgrades (58% of our coverage), with the aggregate EPS downgrade being 4.6%.

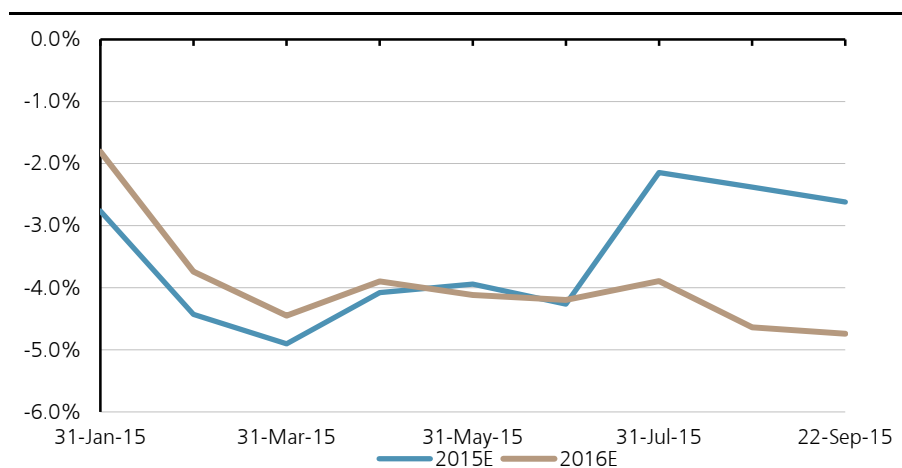
In the US, despite our positive EPS momentum for 2015, we have downgraded our 2016E EPS expectations by 4.1% since the start of the year, with four net downgrades overall.

From our survey, our analysts are negative on risks to earnings forecasts in aggregate for the next 12 months, with only 15% seeing upside risk to earnings forecasts and 49% seeing downside risk. Overall, this is significantly worse than the previous survey, where 20% of respondents saw upside risk to earnings and 29% saw downside risk.

In developed markets, there has been a significant worsening in the outlook on earnings and this now is skewed firmly to the downside, although the majority of respondents (44%) see the outlook as unchanged. The proportion of respondents seeing upside risk to earnings has remained flat at 19%, but the percentage of respondents seeing downside risk to earnings has also increased significantly, to 38% from 6% in the previous survey. The countries seeing upside risk comprise Ireland, Japan and the UK, while downside risk is seen in Australia, Canada, Portugal, Spain, US brokers and universal banks, and US regionals.

The outlook on earnings in emerging markets is even more pessimistic: 56% of respondents see downside risk to earnings, which is even worse than the 44% of respondents in the previous survey. Only 12% of respondents see upside risk to earnings compared to 20% in the previous survey. The emerging markets seeing upside risk comprise Korea, Mexico and Peru, while downside risk is seen in Brazil, China, Colombia, Georgia, Greece, Hong Kong, India, Kazakhstan, the Philippines, Poland, Singapore, South Africa, Taiwan and Turkey.

**Figure 21: Global banks – cumulative EPS changes ytd**

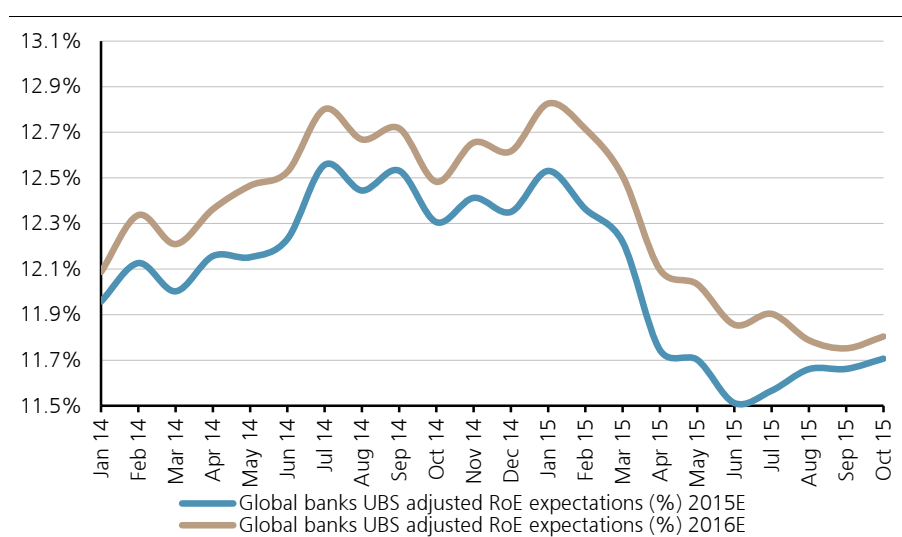


Source: UBS estimates (as at 23-Sep-2015)

In our prior survey publication, we reported that RoE expectations had bottomed out after falling for some time. The 2015E RoE trend appears to have peaked at around the start of the year, at 12.5%, and has since declined to 11.7%, having bounced back a little from the low in June. The 2016E RoE trend seems to be fairly closely tracking the 2015 estimates, albeit currently around 10bp higher.

**Expectations for global banks' RoE are significantly lower than at the start of the year, but have rebounded recently**

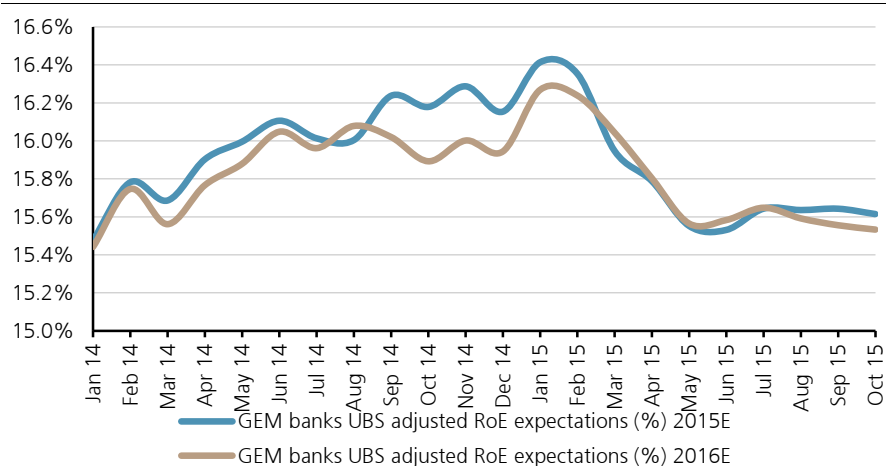
**Figure 22: Global banks – RoE expectations**



Source: UBS estimates (as at 23-Sep-2015)

Based on our bottom-up estimates, we currently forecast 2015 sector RoE for global banks at 11.7%, bang in line with the 2014 value of 11.7%, which was one of the lowest figures since 2000 apart from 2008 (8.0%) and 2009 (10.8%). The outlook is for RoE to recover modestly, rising to 11.8% in 2016E, 12.1% in 2017E and 12.4% in 2018E.

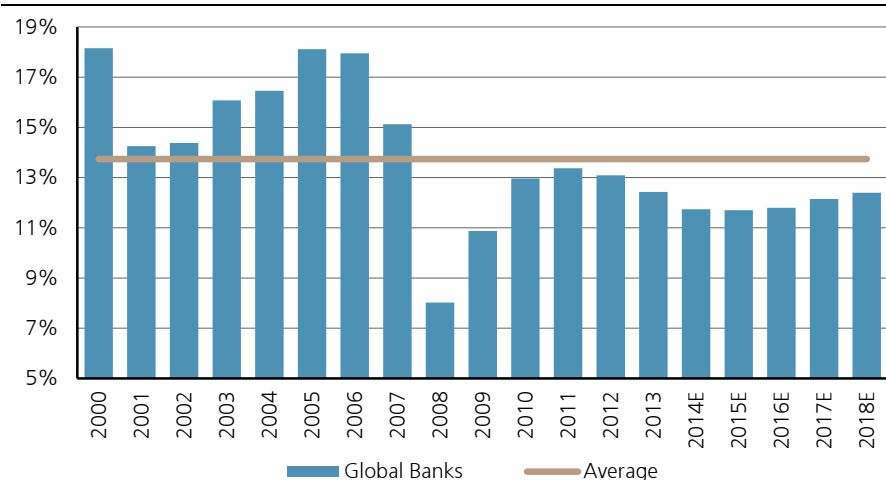
**Figure 23: GEM banks – RoE expectations**



Source: UBS estimates (as at 23-Sep-2015)

In emerging markets, 2015 RoE expectations have recovered slightly since the trough in June/July, having peaked at the start of the year, but now appear to be falling again. For 2015, RoE estimates are now 15.6% – about 56bp lower than a year ago. Estimates for 2016 have followed a similar trajectory and, at 15.5%, are slightly below our 2015 estimates.

**Figure 24: Global banks – RoE trends**



Source: UBS estimates

## Dividend outlook

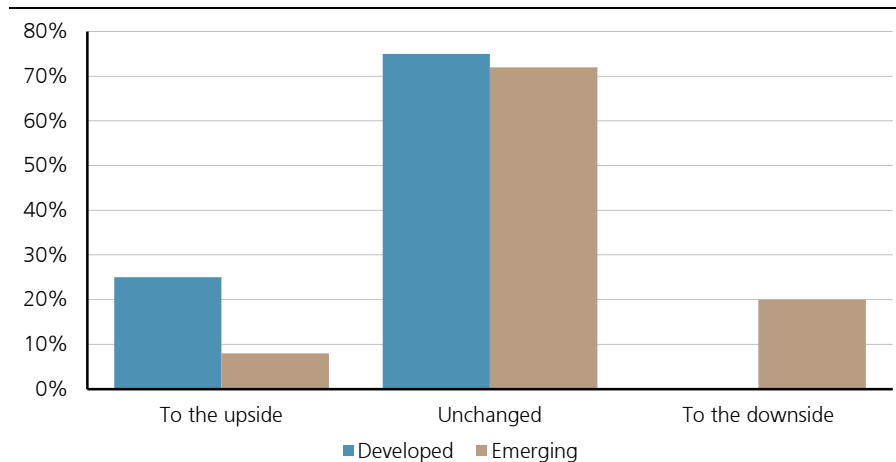
Despite the uncertain regulatory and policy position in some developed markets, as well as macroeconomic concerns, UBS analysts overall have an almost balanced view regarding risk to dividends, with 15% seeing upside risk and 12% seeing downside risk. This is a slightly more positive overall view than in our last survey, where 17% of respondents saw upside risk and 17% also saw downside risk.

In developed markets, there has been an improvement in the outlook for dividends compared to the previous survey: at present our respondents now have a balanced view on the outlook, with 25% of respondents (previously 19%) seeing upside risk and none seeing downside risk (previously 19%). Developed-markets analysts seeing

**UBS analysts have a balanced view of dividend risk**

upside risk to dividends include those covering Benelux, Ireland, Japan, and US brokers and universal banks.

**Figure 25: What is the risk to your dividend estimates for your sector over the next 12 months?**

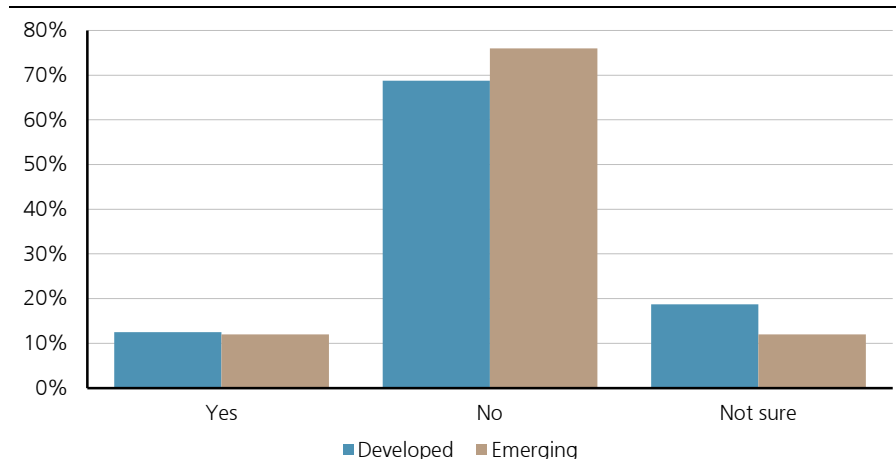


Source: UBS

In emerging markets, against a backdrop of slower Chinese growth, low credit demand, asset-quality concerns and uncertainties regarding developed-market policy rates, the dividend outlook has become more negative and the position is now skewed to the downside, with 8% of respondents (previously 17%) seeing upside risk and 20% (previously 16%) seeing downside risk. Upside risk to dividends is seen in the Czech Republic and Hungary, while downside risk is seen in Brazil, China, Kazakhstan, Poland and Taiwan.

## Recap risks

**Figure 26: Will your bank have to raise capital over the next 12 months?**



Source: UBS

Since our last survey, the perceived capital position of banks has improved somewhat, with the majority of respondents (73%) believing that the banks they cover will not need to raise capital over the next 12 months; this is more emphatic than previously, when 66% of respondents saw no need for capital raisings. In the current survey, 12% of respondents see capital raises over the next 12 months,

**Capital raising fears have continued to decline**

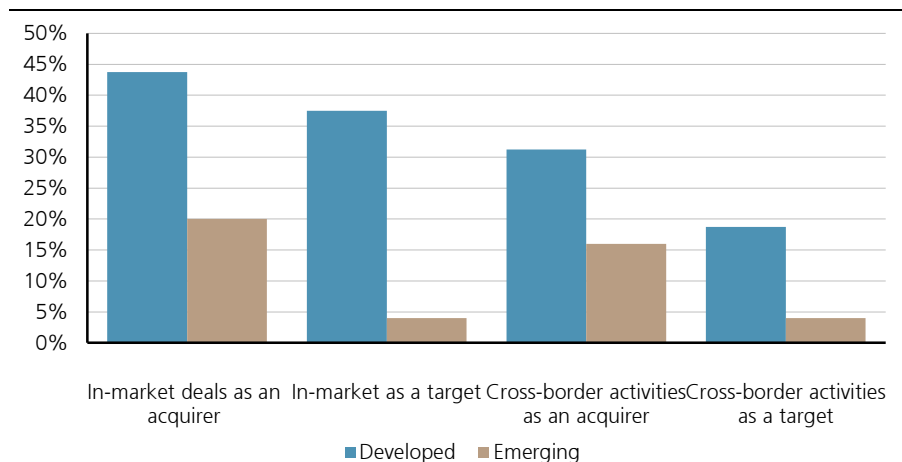
versus 24% in the previous survey, while the proportion of "not sure" responses has risen to 15% compared to 10% previously.

In emerging markets, 12% of respondents expect to see capital raises over the next 12 months, although we note this is a significantly lower proportion than in our previous survey, where 24% of respondents expected to see capital raises. EM countries where we expect capital raises include Greece, India and Taiwan.

There has been a small decline in the proportion of DM respondents expecting capital raises over the next 12 months, from 25% to 13%, although we note that there has been a round of capital raises in Australia recently. Developed markets where capital raises are expected include Australia and Portugal.

## M&A

**Figure 27: Do you expect your banks to be involved in any M&A activity over the next 12 months?**



Source: UBS

Over the next 12 months, 44% of developed-market respondents see the banks they cover being involved in in-market activity as an acquirer (previously only 38%), and 31% undertaking cross-border M&A as an acquirer (unchanged). In-market M&A acquisitions are expected in Germany, Italy, Japan, Portugal, Spain, Switzerland and US regionals, while cross-border acquisitions are expected from banks based in Canada, Germany, Japan, Spain and Switzerland.

For M&A activity where the respondents see their banks as M&A targets, 19% see cross-border activity (Germany, Spain, Switzerland), unchanged from the previous survey, while 38% (previously 25%) expect in-market activity (in Germany, Italy, Portugal, Spain, Switzerland and US regionals).

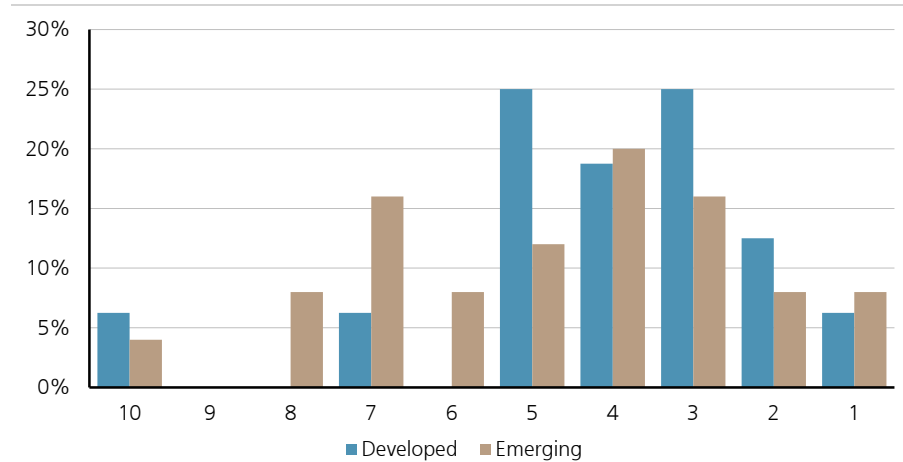
There is a significant expectation of M&A activity in emerging markets, too, both in-market and cross-border. The majority of this activity is expected to be with the researched banks acting as an acquirer, 20% in-market and 16% cross-border. In-market M&A acquisitions are expected in Brazil, Hungary, India, Korea and Mexico, while cross-border acquisitions are expected from banks based in Brazil, Hungary, South Africa and Taiwan.

There are lower expectations of M&A where our researched emerging-market banks are expected to be the target. For in-market M&A, this is only expected for 4% of markets (India), and for cross-border M&A, only 4% of markets (Greece).

## FX volatility

Given recent FX volatility, especially in emerging markets, our latest survey also included a question on the potential impact of currency movements on bank sector fundamentals. According to our survey findings, FX volatility was largely considered to have a low to medium impact on fundamentals, predominantly via translation effects, but also in terms of the impact on loan growth and potentially higher delinquencies via higher policy rates. In emerging markets, banking sectors that were considered vulnerable to FX volatility included Georgia, Hong Kong, Peru, Taiwan and Turkey, while in developed markets they included Canada and Switzerland.

**Figure 28: On a scale of 1-10 (where 1 is a minimal effect), how does FX volatility affect sector fundamentals?**

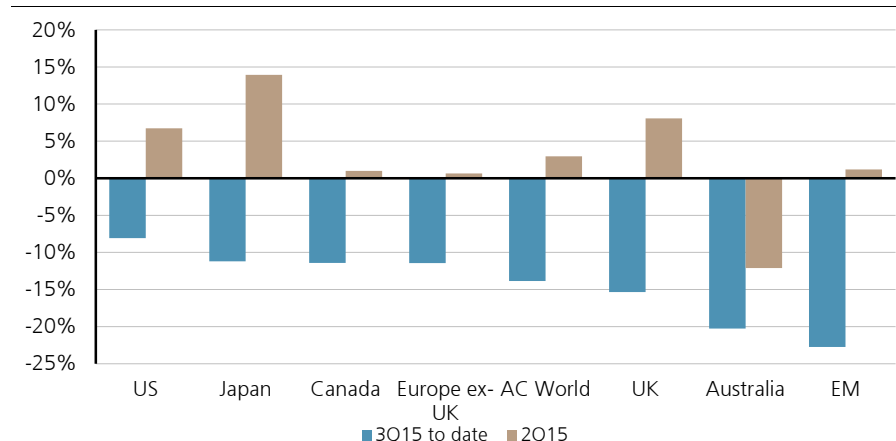


Source: UBS estimates

# Views on valuations

## Significant underperformance since start of Q3 15

Figure 29: Global banks' US\$ performance, Q3 15 versus Q2 15



Source: MSCI indices, Thomson Reuters DataStream, UBS. Note: based on closing prices up to 25-Sep-15.

The global banks' sector performance has been highly volatile. Since the start of 3Q15, the global banking index is down 10% (in US dollars), underperforming global equities by 4.8%. Since the start of the year, global banks are down 9.2%, underperforming global equities by 5.3%.

By region, the performance of DM banks, although still negative, has largely been better than that of EM banks. Since the start of 3Q15, Canadian banks' performance is down 5.4% (in US\$), followed by European (ex-UK) banks that are down 6.2% and US banks (-7.2%). Among DM banks, Australian banks' performance has been the weakest, down 15.0% since the beginning of 3Q15.

Given external worries (Chinese growth, lower commodity prices, Fed tightening and FX volatility), emerging-market banks' sector performance has been particularly poor, down 16.7% since the start of 3Q15, led by Brazil (-26.7%), China (-22.6%) and Taiwan (-18.1%).

## Fair value or cheap?

Reflecting regulatory and macroeconomic concerns, the majority of respondents consider the banks they cover to be either fairly valued (59% of respondents) or cheap/very cheap (34% of respondents), a change from our previous survey where the majority believed their banks were fairly valued (54% of respondents) or cheap/very cheap (37%). At the same time, only 7% of respondents believe the sector is expensive or very expensive, compared with 9% in the previous survey.

Our analysts' view on valuations in developed markets has remained broadly unchanged – believing the sector is on the cheap side. Currently, 31% of respondents believe their sector is cheap (0% very cheap), while in the previous survey 38% of analysts believed their sector was cheap and 0% very cheap. In the current survey and previous survey, no DM respondents believed their sector was expensive.

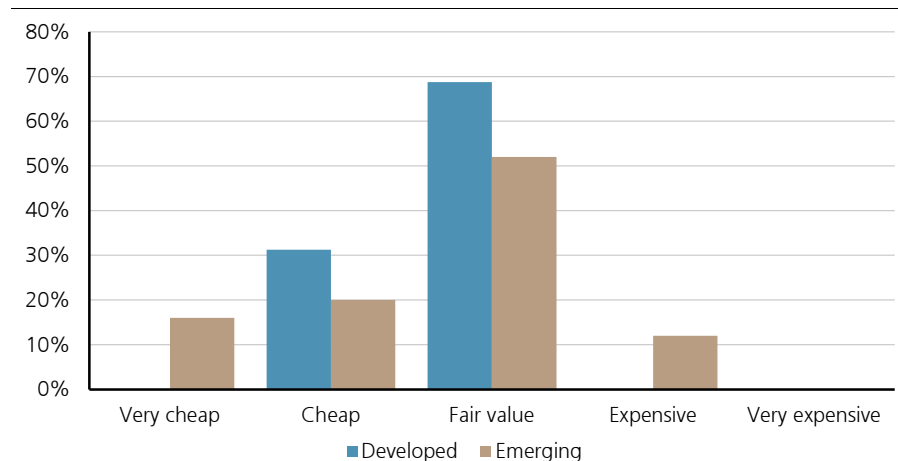
In emerging markets, the aggregate view remains skewed to the cheap side. In the current survey, 36% of respondents believe the sector is cheap or very cheap, the

**Global banks underperformed equities by 4.8% since start of Q3**

**The sector is largely considered by UBS analysts to be between fair value and cheap**

same as in our previous survey. The proportion of respondents believing their sector is expensive or very expensive has declined from 16% to 12% currently. The proportion of analysts believing their sector is at fair value has risen slightly to 52% from 48% previously.

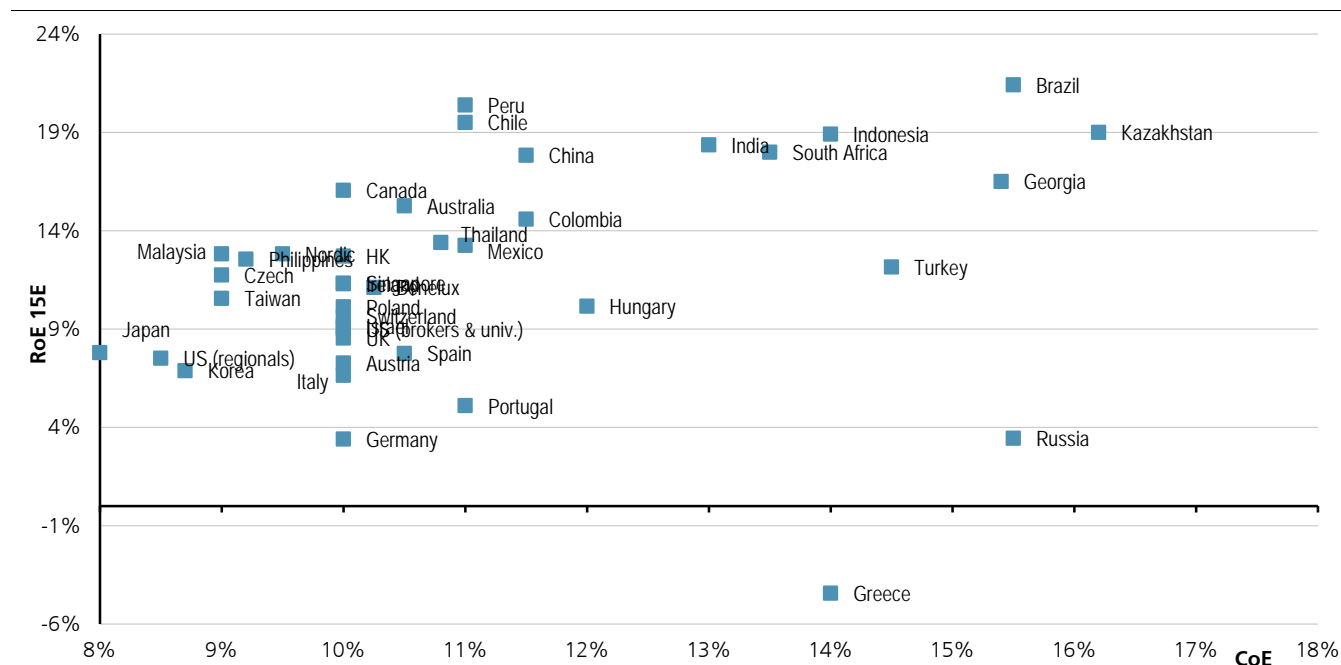
**Figure 30: Sector valuations – do you consider your sector to be:**



Source: UBS

The "expensive" category comprises only emerging markets: Colombia, the Philippines and Poland. The "cheap" category comprises Benelux, China, Indonesia, Japan, Mexico, Singapore, Thailand, the UK, US brokers and universal banks, and US regionals, while the countries in the "very cheap" category comprise Korea, Peru, Russia and Turkey.

**Figure 31: CoE estimates versus 2015E RoE**



Source: UBS estimates

## Statement of Risk

Sector forecasts and ratings are subject to developments in the wider economy and the macro environment. Stock prices could be negatively affected by rapid changes in interest rates or a slower-than-expected rebound in the economy, which, among other things, could result in higher loan losses and/or slower loan growth than is currently anticipated.

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Buy	FSR is > 6% above the MRA.	49%	33%
Neutral	FSR is between -6% and 6% of the MRA.	40%	26%
Sell	FSR is > 6% below the MRA.	12%	18%
Short-Term Rating	Definition	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 September 2015.

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<b>Bancolombia</b> <sup>4a, 5a, 6a, 16b</sup>	CIB.N	Sell	N/A	US\$38.93	08 Oct 2015
<b>Bank of America Corp.</b> <sup>2, 4a, 6a, 6b, 6c, 7, 16b, 18a, 22</sup>	BAC.N	Buy	N/A	US\$15.75	08 Oct 2015
<b>Bank of East Asia</b>	0023.HK	Sell	N/A	HK\$28.15	09 Oct 2015
<b>Bank Rakyat Indonesia</b>	BBRI.JK	Buy	N/A	Rp10,550	09 Oct 2015
<b>Citizens Financial Group</b> <sup>2, 4a, 5a, 6a, 6b, 7, 16b</sup>	CFG.N	Buy	N/A	US\$23.52	08 Oct 2015
<b>Credicorp</b> <sup>16b</sup>	BAP.N	Buy	N/A	US\$115.39	08 Oct 2015
<b>Dubai Islamic Bank</b>	DISB.DU	Buy	N/A	Dh6.85	08 Oct 2015
<b>Fifth Third Bancorp</b> <sup>5a, 6b, 6c, 7, 16b</sup>	FITB.O	Buy	N/A	US\$19.15	08 Oct 2015
<b>Hana Financial Group</b>	086790.KS	Neutral	N/A	Won26,750	08 Oct 2015
<b>Handelsbanken</b> <sup>5a</sup>	SHBa.ST	Sell	N/A	SKr123.50	08 Oct 2015
<b>HDFC Bank</b> <sup>2, 4a, 6a, 16b</sup>	HDBK.BO	Buy	N/A	Rs1,085.80	09 Oct 2015
<b>HSBC</b> <sup>2, 4a, 6a, 16a, 16b</sup>	HSBA.L	Buy	N/A	530p	08 Oct 2015
<b>Inbursa</b> <sup>5a</sup>	GFINBURO.MX	Buy	N/A	P34.46	08 Oct 2015
<b>ING</b> <sup>2, 4a, 5a, 6a, 16b</sup>	ING.AS	Buy	N/A	€12.86	08 Oct 2015
<b>Itau Unibanco</b> <sup>5a, 16b</sup>	ITUB4.SA	Buy	N/A	R\$29.75	08 Oct 2015
<b>Kasikornbank</b>	KBANK.BK	Buy	N/A	Bt184.50	09 Oct 2015
<b>KB Financial Group</b> <sup>16b</sup>	105560.KS	Buy	N/A	Won34,800	08 Oct 2015
<b>Morgan Stanley</b> <sup>2, 4a, 5a, 6a, 6b, 6c, 7, 16b, 22</sup>	MS.N	Buy	N/A	US\$32.99	08 Oct 2015
<b>Sberbank</b> <sup>4a, 18b</sup>	SBER.MM	Buy	N/A	RBL83.11	08 Oct 2015
<b>Sumitomo Mitsui Financial Group</b> <sup>2, 4a, 16b</sup>	8316.T	Buy	N/A	¥4,864	09 Oct 2015
<b>Sumitomo Mitsui Trust Holdings</b> <sup>4a</sup>	8309.T	Sell	N/A	¥467.7	09 Oct 2015
<b>TD Bank Financial Group</b> <sup>2, 4a, 4b, 5a, 5b, 6a, 6b, 6c, 7, 16b, 22</sup>	TD.TO	Buy	N/A	C\$53.55	08 Oct 2015
<b>VTB</b> <sup>18b</sup>	VTBR.MM	Sell	N/A	RBL0.07	08 Oct 2015
<b>Yapi Kredi Bank</b> <sup>5a</sup>	YKBNK.IS	Neutral	N/A	TRY3.61	08 Oct 2015

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