



European Banks: 2026 Q3

Another round of energy price-driven inflation can turn from a short-term boost into a medium-term headache.



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Key Takeaways

Valuation

- Stocks are fully priced in our view. Expectations of further interest rate increases have been building over the last quarter, which will drive short-term benefits for European banks on wider deposit margins. However, low economic growth paired with energy-price-driven inflation increases risks around affordability and interest coverage if these dynamics solidify.
- We see the sector close to peak profitability, enhancing focus on capital distributions and operating efficiency to drive the sector’s equity stories.
- Since our last quarterly update, developments have been tracking closer to our downside case.
- Upside case: Credit spreads remain low after their recovery, energy prices retreat, and economic activity accelerates again after a soft patch.
- Downside case: Energy prices remain elevated, forcing more aggressive interest rate responses, weighing on weakening economic activity. This could result in higher unemployment, credit losses, and lower loan demand.

Risks

- The sector looks healthy across Europe, with robust balance sheets and high capitalization levels.
- Interest rate hikes aimed at containing energy-related inflation in a weakening economy could drive up unemployment.
- Loan demand expectations are flat to slightly down across Europe, which could counteract wider margins on rising interest rates.

European Bank Valuations Look Modestly Expensive



Valuation

Opportunities are limited.

European Banks: Preferred Picks

BNP Paribas (BNP)

	<u>Market Cap</u>	<u>Moat Rating</u>	<u>Last Close</u>	<u>Fair Value Est.</u>	<u>Rating</u>
P/FV	EUR 100 bn	None	EUR 91.54	EUR 123	★★★★★
1.75	BNP Paribas offers a compelling mix of income, stability, and strategic growth at a discounted valuation. The stock trades at a 40% discount to the European banking sector's average price/tangible book ratio while delivering a 6% dividend yield. Its midcycle profitability may lag peers slightly, but not to the extent implied by such a steep discount. The bank is deploying capital effectively, focusing on bolt-on acquisitions in capital-light areas. The recent purchase of AXA's asset management operations is a case in point. Improving profitability will also support organic capital generation and allow BNP to return excess capital to shareholders.				
1.50					
1.25					
1.00					
0.75					
0.50					
0.25					

NatWest Group (NWG)

	<u>Market Cap</u>	<u>Moat Rating</u>	<u>Last Close</u>	<u>Fair Value Est.</u>	<u>Rating</u>
P/FV	GBP 52 bn	Narrow	GBX 651.4	GBX 750	★★★★★
1.75	NatWest offers the best risk/reward trade-off among UK banks, in our view. We see a strengthening franchise and improving structural profitability as the structural hedge continues to provide a long-tailed tailwind. We anticipate deposit franchise wins and a greater contribution of non-interest income after the acquisition of Evelyn Partners, which should improve earnings quality. NatWest has brought its capital levels in line with peers after a significant overhang following the government involvement after the global financial crisis during 2007-09. That said, improving profitability and a robust balance sheet support NatWest's progressive dividend and share buybacks. All-in-all we see a valuation gap between Lloyds and NatWest, which we both view as strong banking franchises, that we expect to close over time.				
1.50					
1.25					
1.00					
0.75					
0.50					
0.25					

Coverage Overview

Company/Ticker	Market Cap (Billions)	Moat Rating	Star Rating	P/FVE	P/E	P/B	Yield	YTD Return
ABN Amro Bank/ABN	EUR 68	None	★★★	1.06	12.9x	1.4x	4.2%	+39.1%
Banco Santander/SAN	EUR 171	Narrow	★★★	1.05	11.4x	1.5x	2.3%	+17.3%
Barclays/BARC	GBP 59	None	★★★	0.86	8.4x	0.9x	3.5%	-7.8%
BBVA/BBVA	EUR 131	Narrow	★★	1.32	11.4x	2.2x	4.4%	+18.8%
BNP Paribas/BNP	EUR 100	None	★★★★	0.74	7.8x	0.8x	6.6%	+13.3%
Commerzbank/CBK	EUR 43	None	★★	1.25	12.5x	1.4x	4.1%	+9.1%
Credit Agricole/ACA	EUR 51	None	★★	1.13	7.3x	0.7x	7.0%	-3.6%
Danske Bank/DANSKE	DKK 293	Narrow	★★	1.14	12.0x	1.8x	7.1%	+14.3%
Deutsche Bank/DBK	EUR 58	None	★★	1.22	9.3x	0.9x	3.7%	-6.3%
ING Group/INGA	EUR 86	Narrow	★★	1.21	12.1x	1.7x	4.4%	+26.0%
Intesa Sanpaolo/ISP	EUR 111	None	★★★	1.00	10.8x	1.9x	7.0%	+7.7%
KBC Groep/KBC	EUR 50	Narrow	★★	1.40	12.7x	2.0x	5.1%	+13.1%
Lloyds Banking Group/LLOY	GBP 59	Narrow	★★★	0.92	10.0x	1.3x	4.6%	+3.9%
NatWest Group/NWG	GBP 52	Narrow	★★★★	0.87	8.7x	1.3x	5.7%	-0.1%
Nordea Bank/NDA SE	SEK 652	Narrow	★★	1.12	11.6x	1.9x	5.8%	+10.5%
Skandinaviska Enskilda Banken/SEB A	SEK 446	Narrow	★★	1.20	13.9x	2.0x	4.3%	+17.5%
Societe Generale/GLE	EUR 48	None	★★★★	0.72	8.3x	0.7x	3.0%	-3.8%
Svenska Handelsbanken/SHB A	SEK 304	Narrow	★★	1.09	13.3x	1.7x	6.9%	+13.1%
Swedbank/SWED A	SEK 449	Narrow	★★	1.30	14.6x	2.2x	6.0%	+24.6%
UBS Group/UBSG	CHF 120	Narrow	★★★	0.98	10.7x	1.7x	2.7%	+5.7%
UniCredit/UCG	EUR 120	None	★★★	0.90	10.8x	1.7x	4.7%	+12.1%

Source: Morningstar, PitchBook. Data as of Oct. 2, 2026.

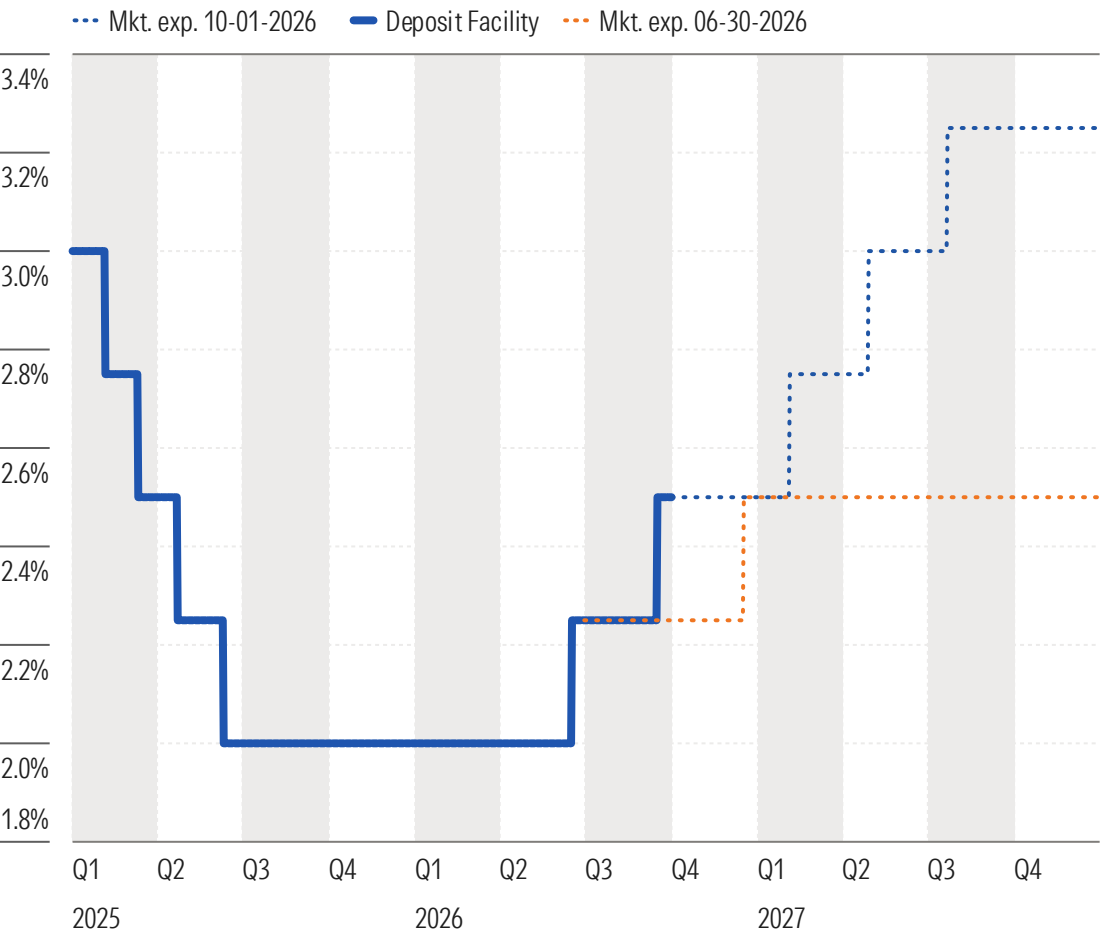
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Net Interest Income

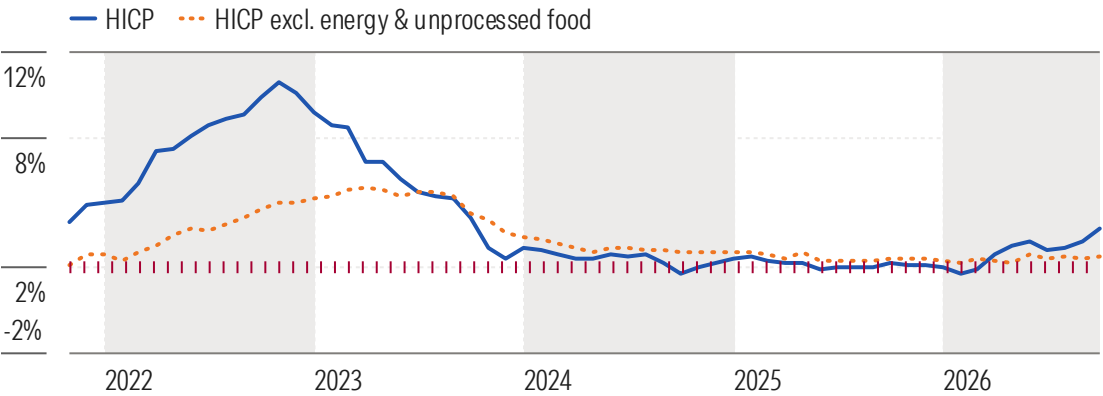
Energy price inflation delivers peak interest rate expectations.

Euro Area Interest Rates

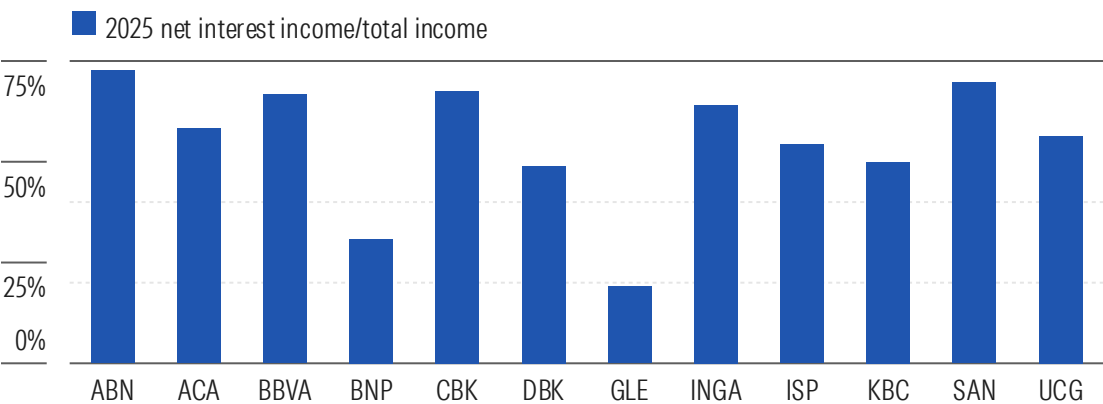
European Central Bank Is Expected to React to Rising Inflation Rate Expectations Are Running Up Again



Core Inflation Slightly Above Target As Energy Prices Driven Up Again



EU Banks' Interest Rate Income Share

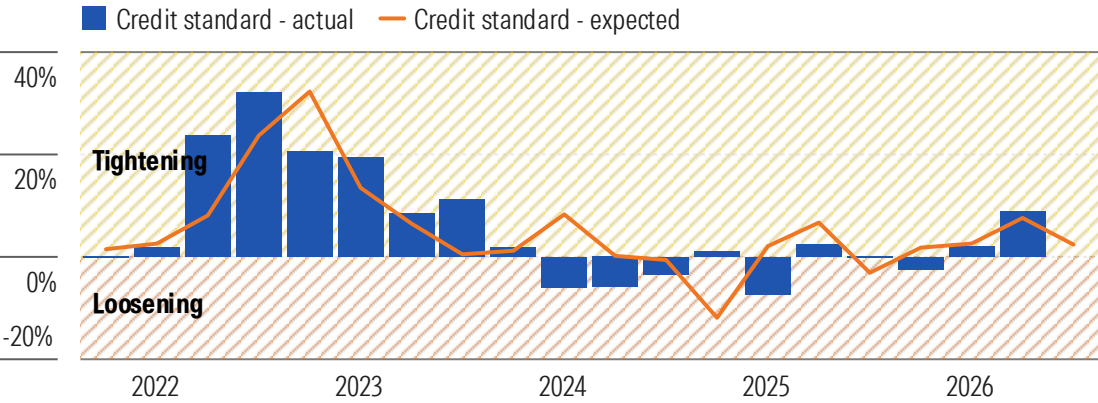


Source: European Central Bank, company reports, Macrobond. Data as of Oct. 2, 2026.

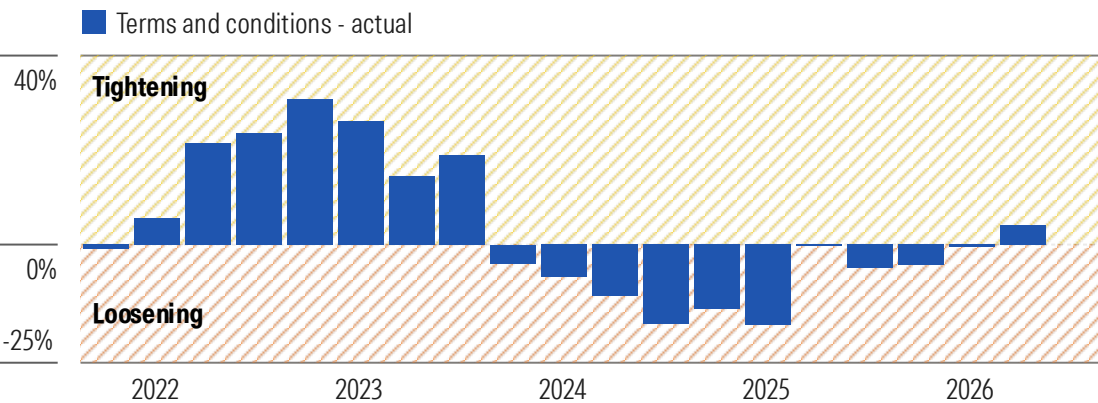
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Euro Area Mortgage Market

Credit Standards Have Been Held Stable

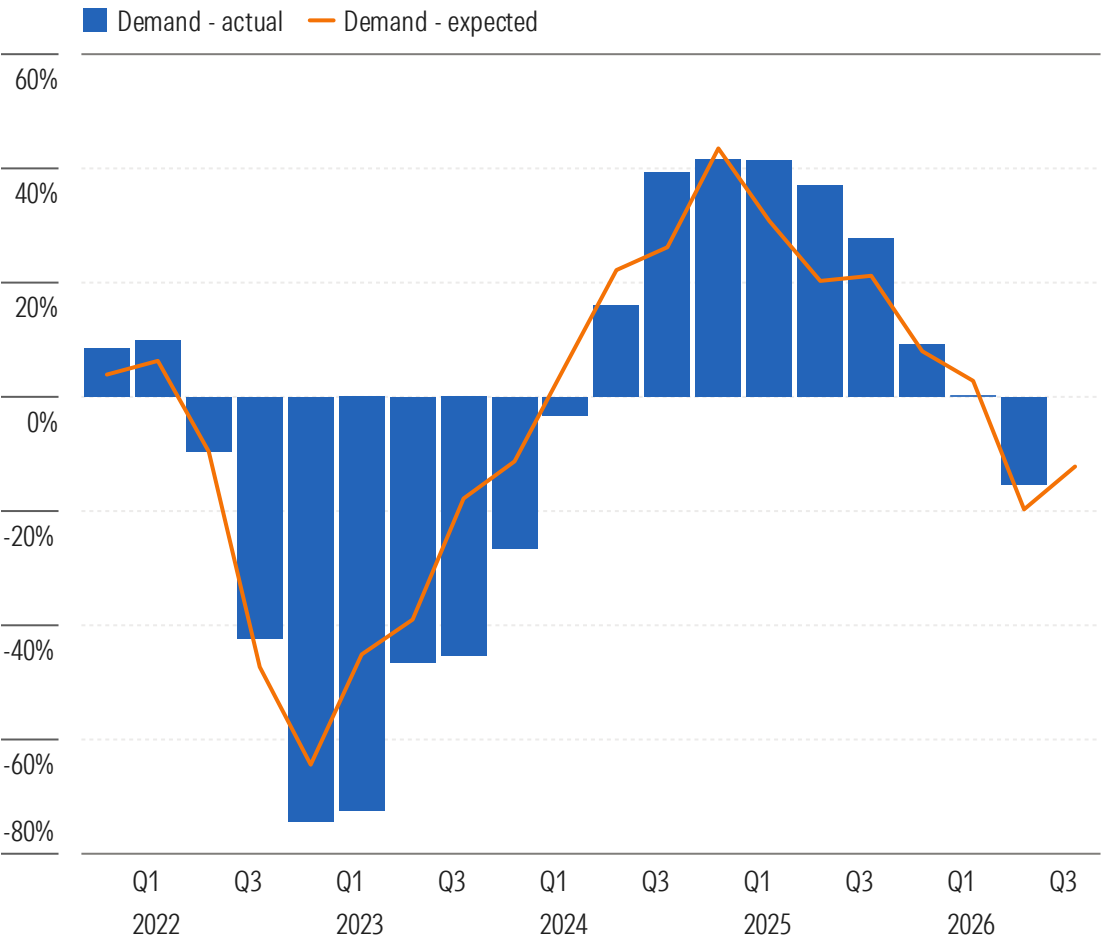


Loosening of Mortgage Terms and Conditions Has Been Paused



Mortgage Demand Expectations Signal Softening Market

Increasing living costs could dampen mortgage appetite.

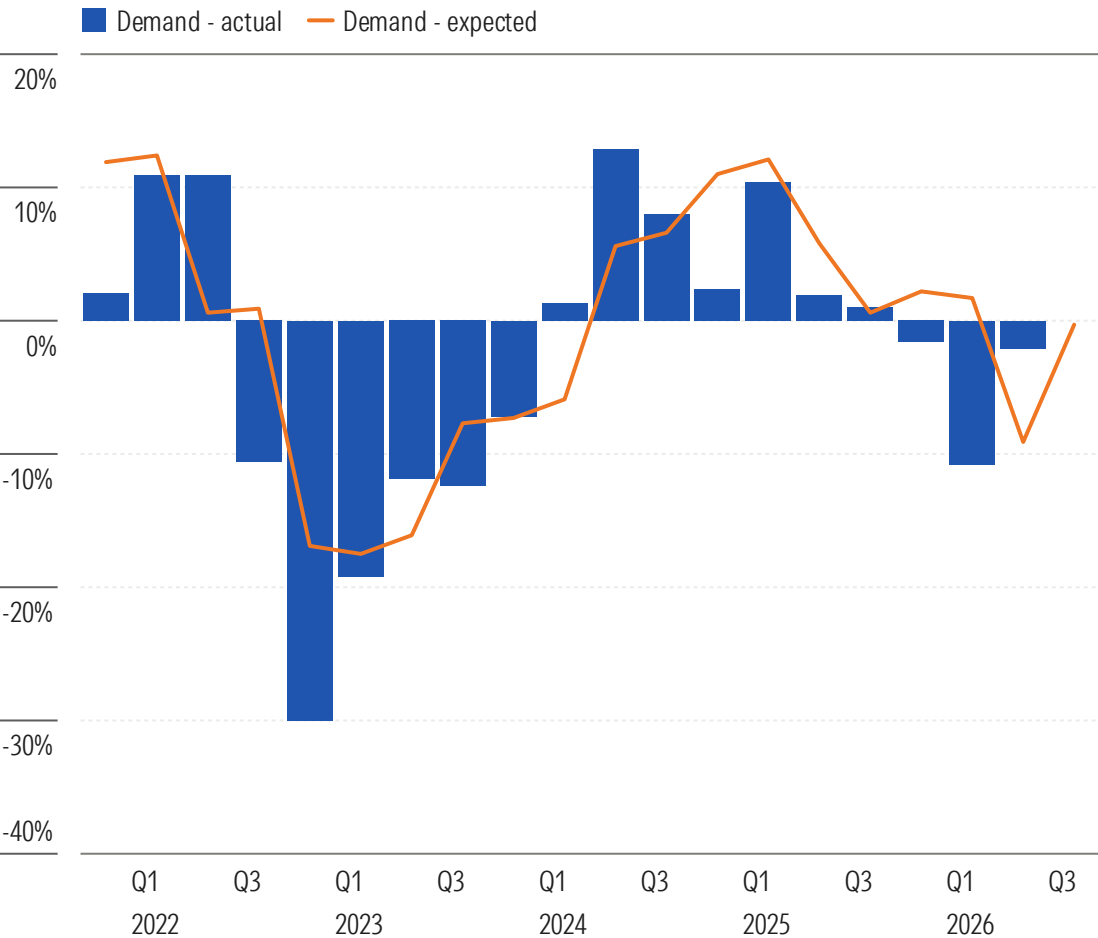


Source: ECB, Macrobond. Data as of Sept. 6, 2026.

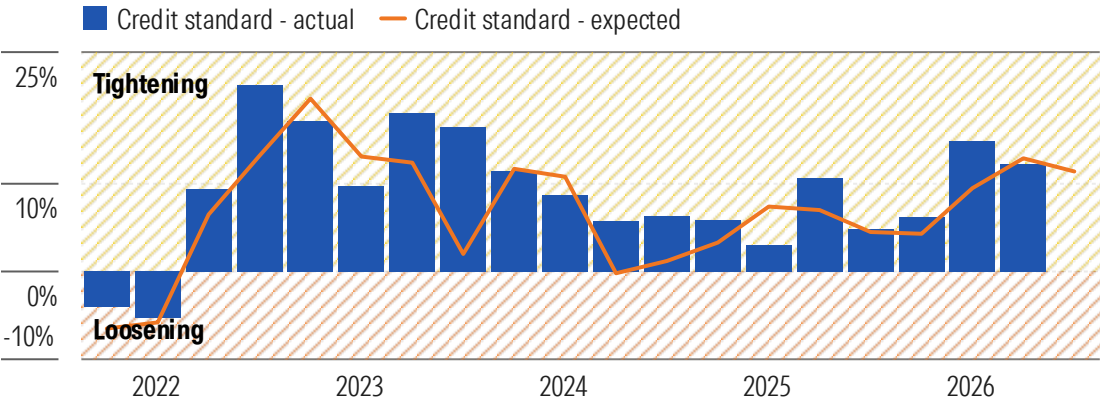
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Euro Area Consumer Credit

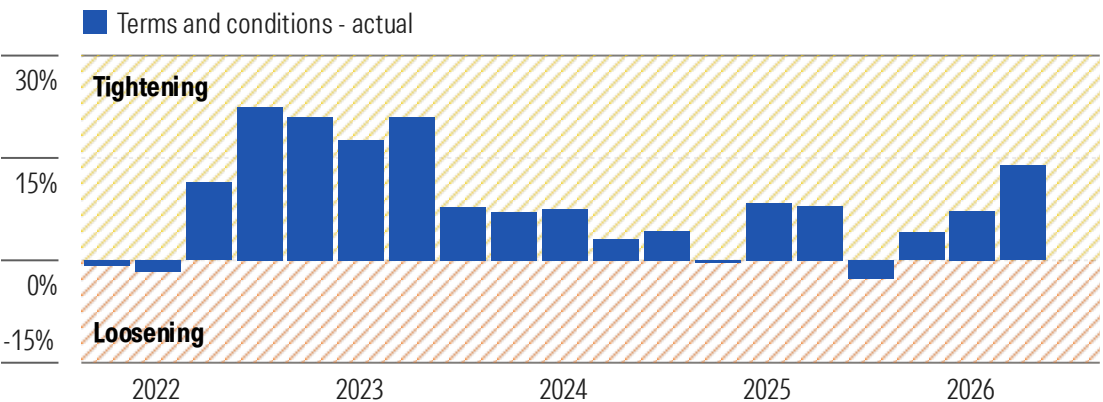
Demand for Consumer Credit Is Balanced



Banks Have Been Throttling Consumer Credit Application Approvals



Terms and Conditions Are Being Tightened

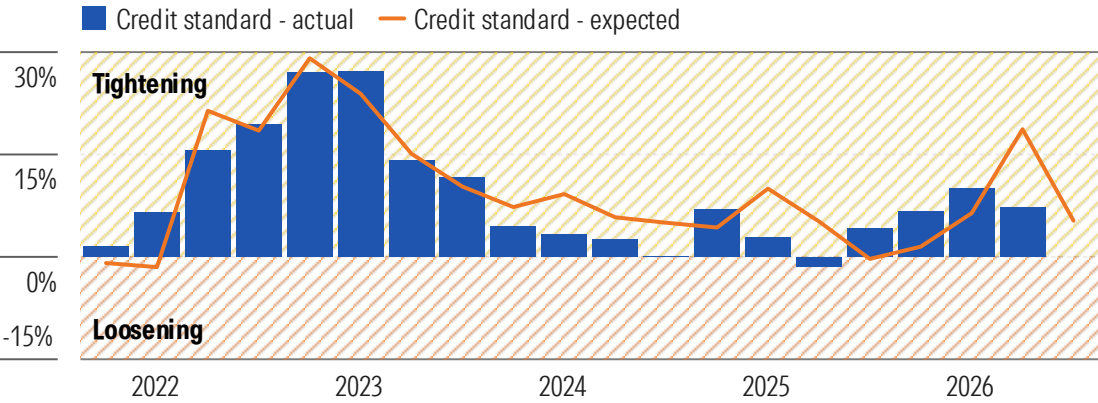


Source: ECB, Macrobond. Data as of Sept. 6, 2026.

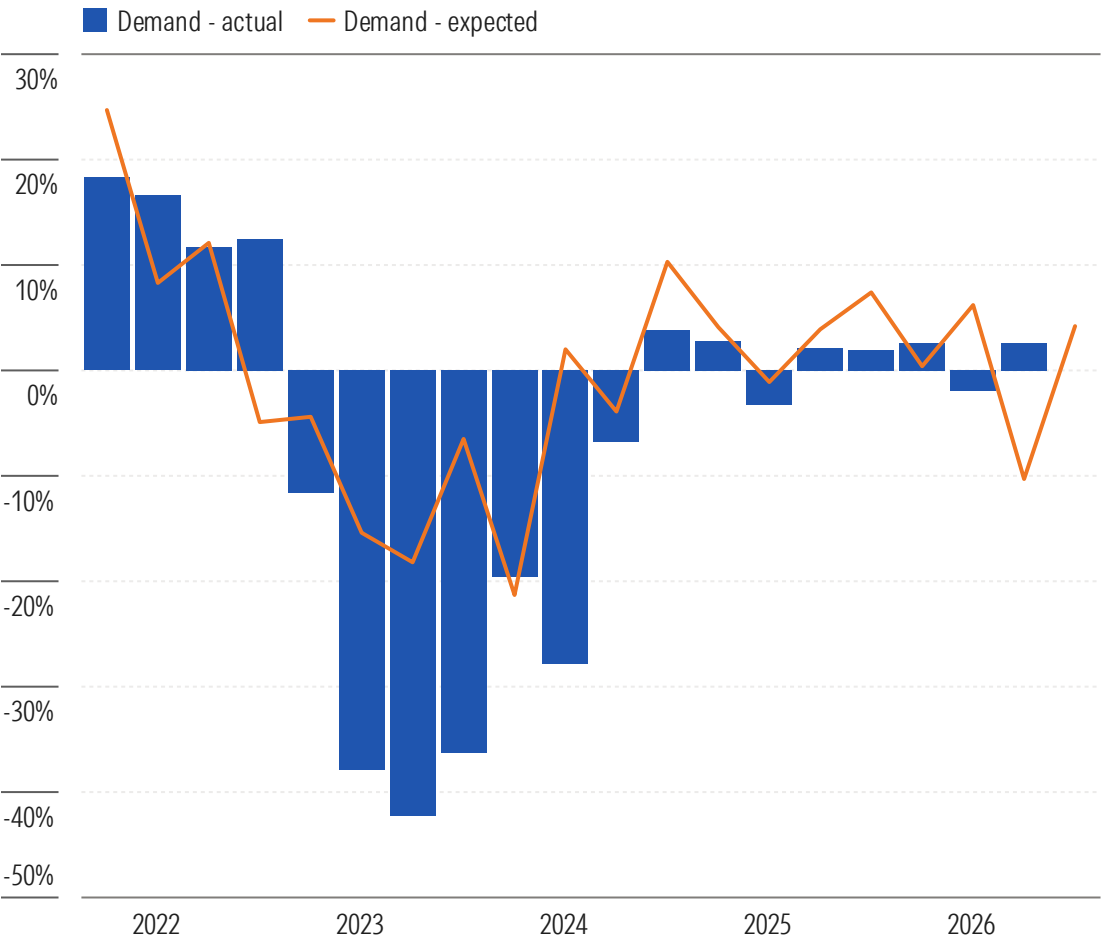
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Euro Area Corporate Lending

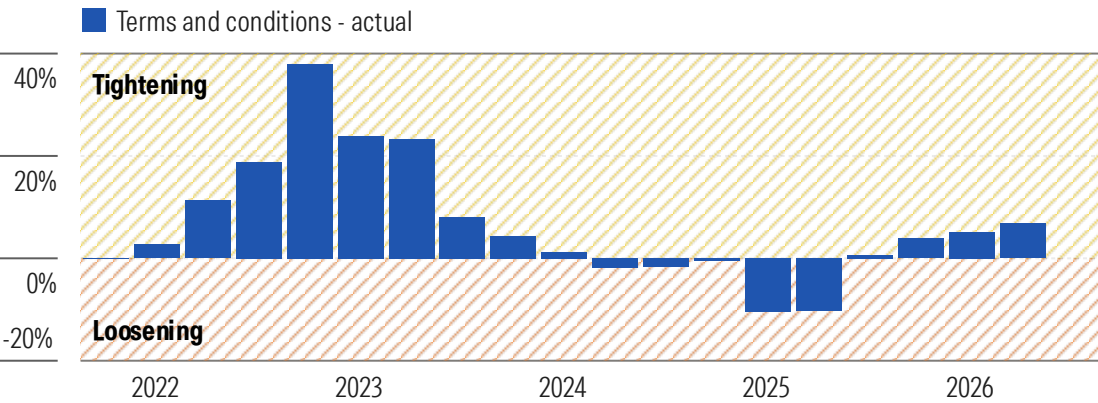
Underwriting Criteria Are Being Sharpened



Corporate Loan Demand Is Flat



Terms and Conditions Remain Largely Unchanged



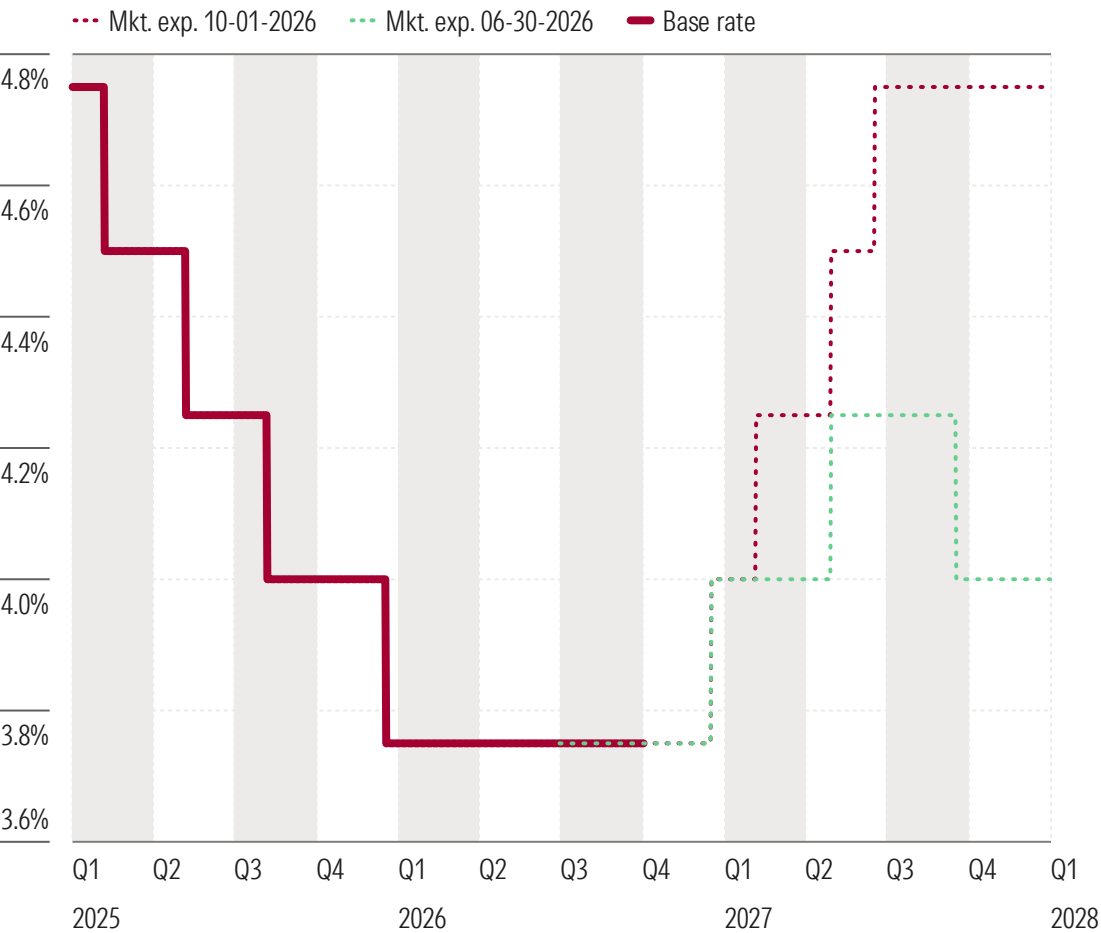
Source: ECB, Macrobond. Data as of Sept. 6, 2026.

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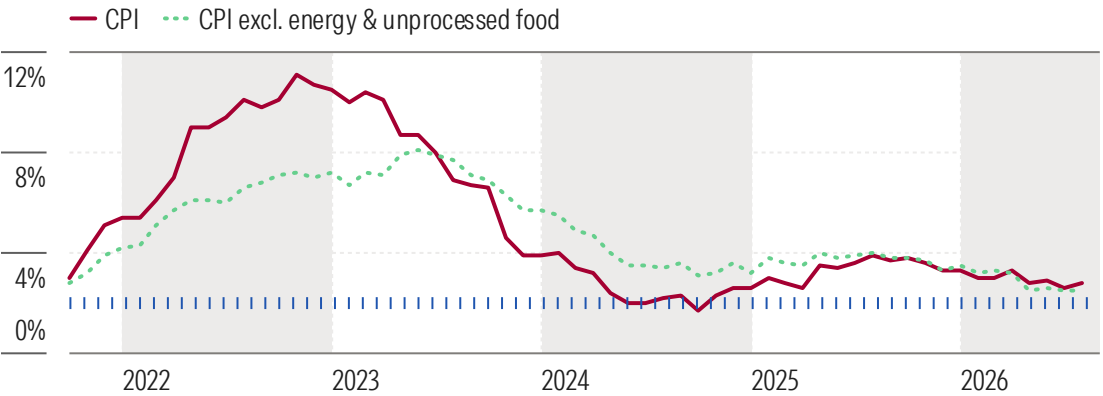
UK Interest Rates

Base Rate Expectations Have Moved Toward Hikes Starting at the End of the Year

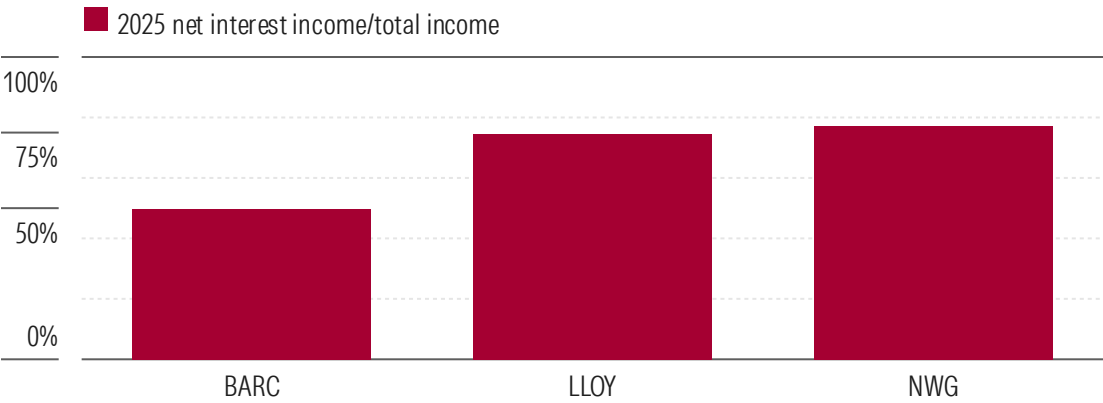
Markets now expect a more elongated interest rate-hike cycle.



Inflation Got Stuck Above Target Levels



UK Banks' Interest Rate Income Share

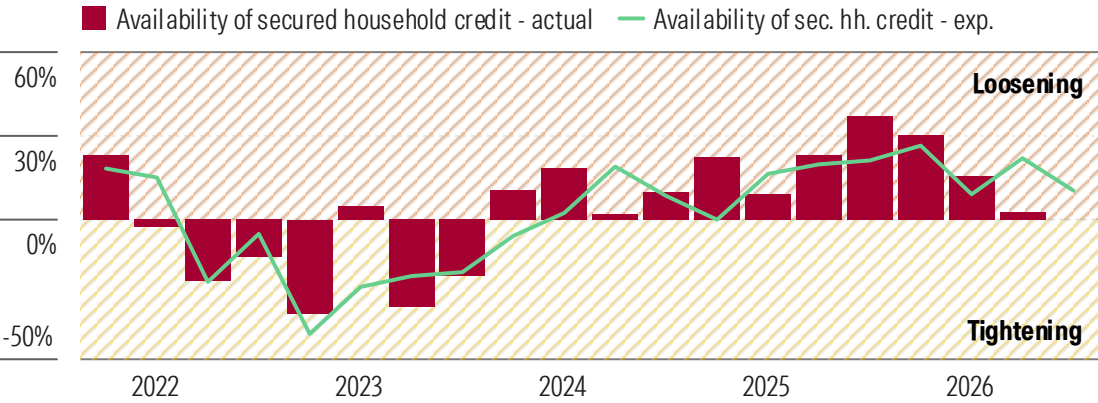


Source: Bank of England, company reports, Macrobond. Data as of Oct. 2, 2026.

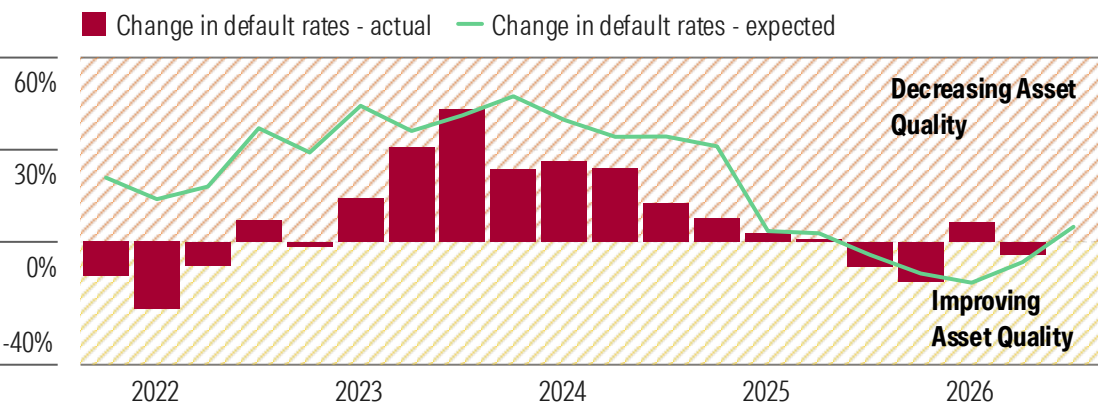
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UK Mortgage Market

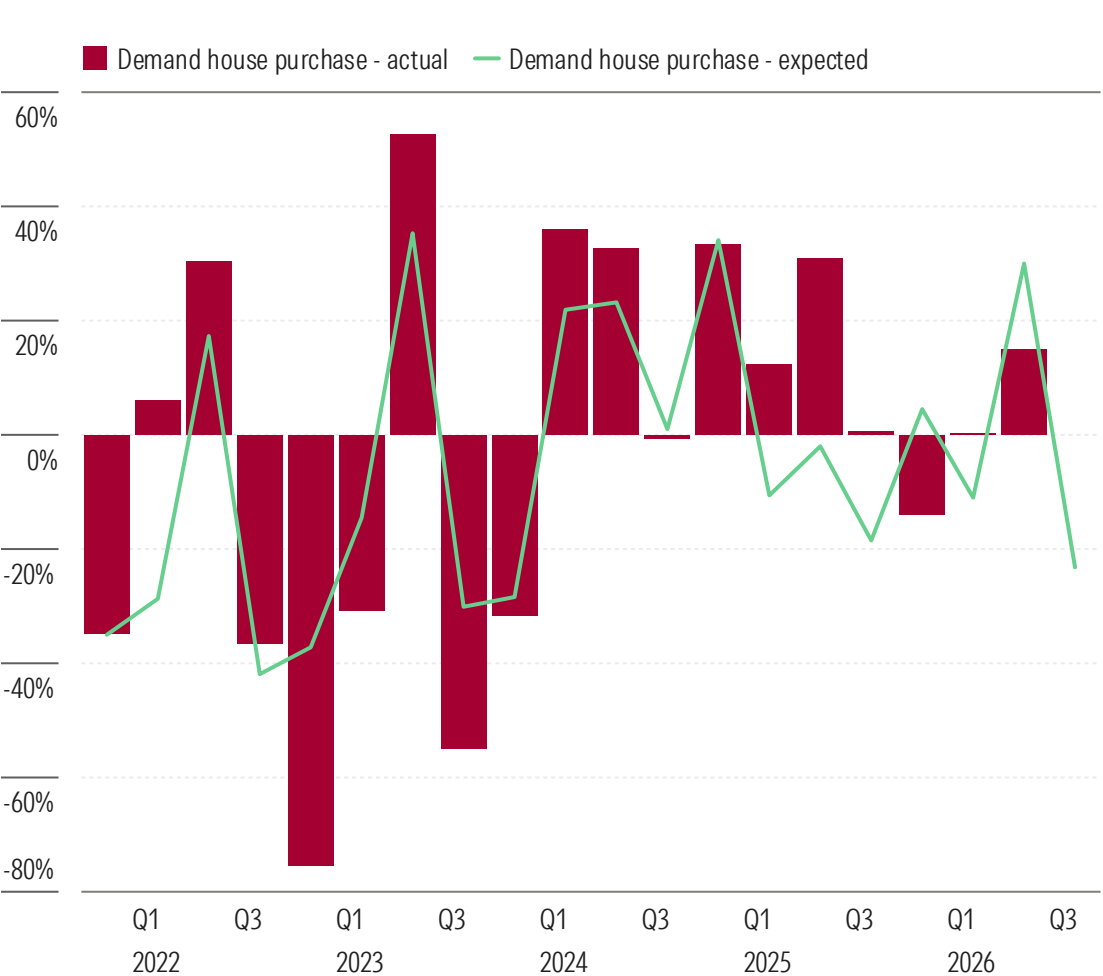
Banks Lower Hurdles to Secured Credit As Expectations for Demand Dwindle



Asset Quality Expectation and Performance Are Stable



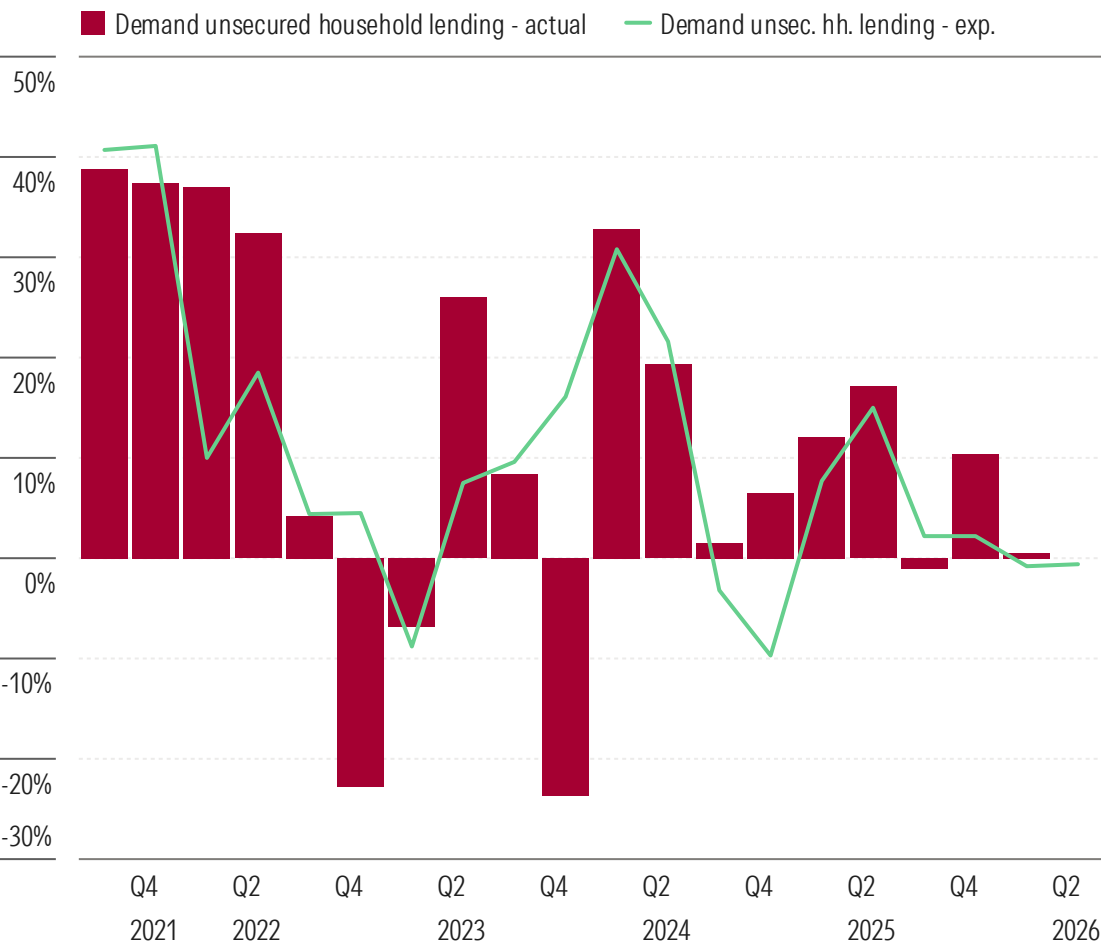
Mortgage Demand Is Expected to Slow Again



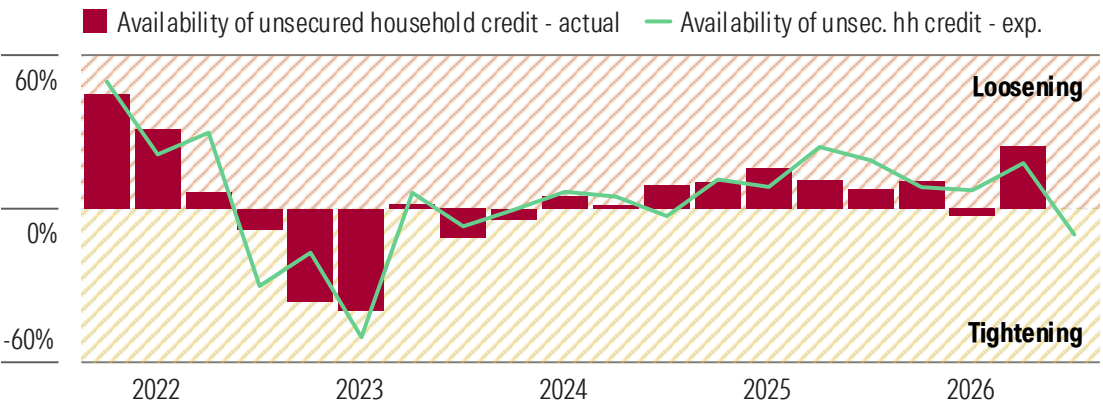
Source: Bank of England, Macrobond. Data as of Sept. 6, 2026.

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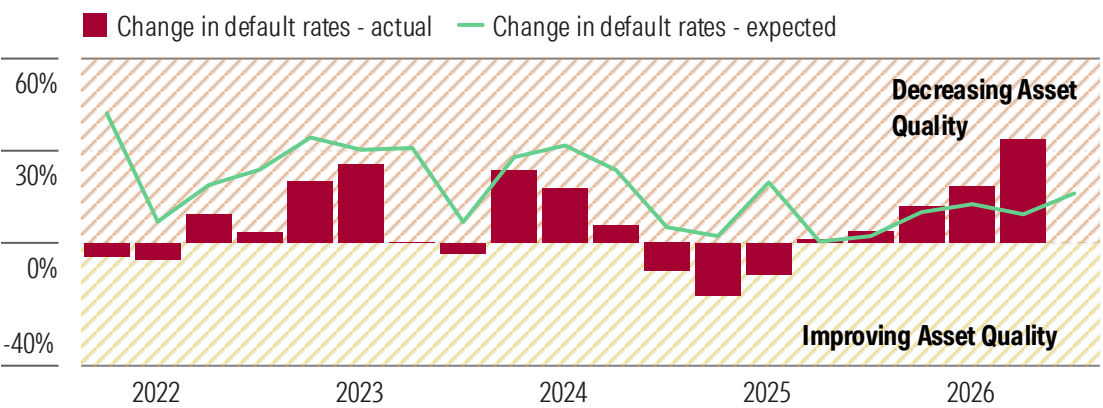
Demand for Unsecured Consumer Credit in Wait-and-See Mode



Unsecured Credit Access Is Expected to Tighten



Default Rates Show Continued Deterioration



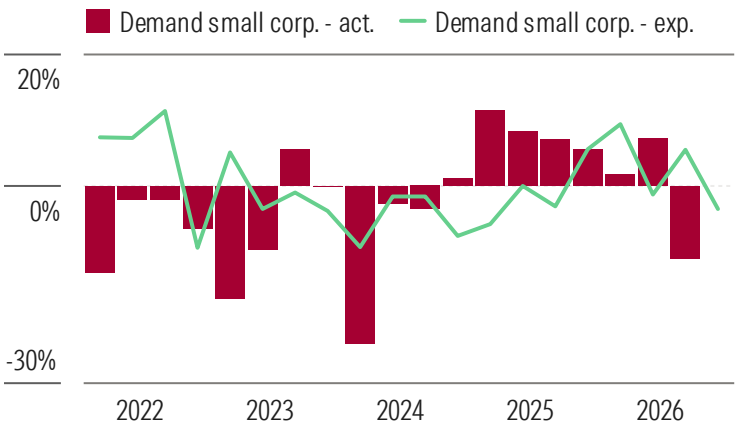
Source: Bank of England, Macrobond. Data as of Sept. 6, 2026.

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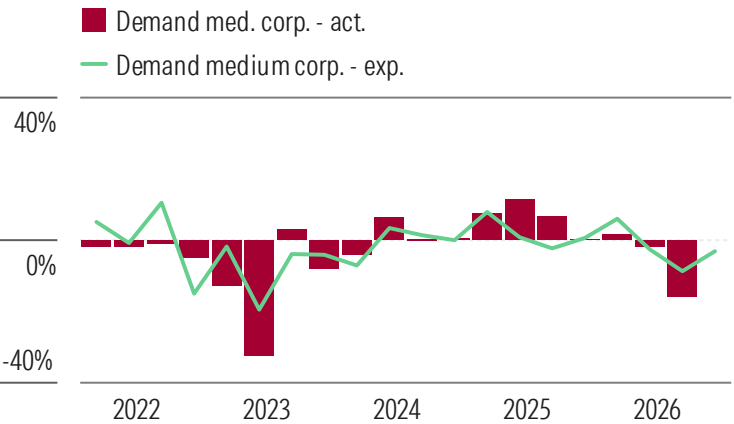
NET INTEREST INCOME

UK Corporate Credit

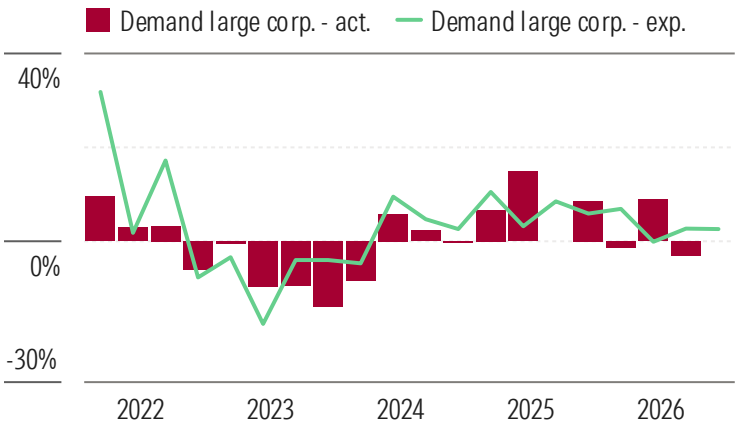
Small Corporate Credit Demand



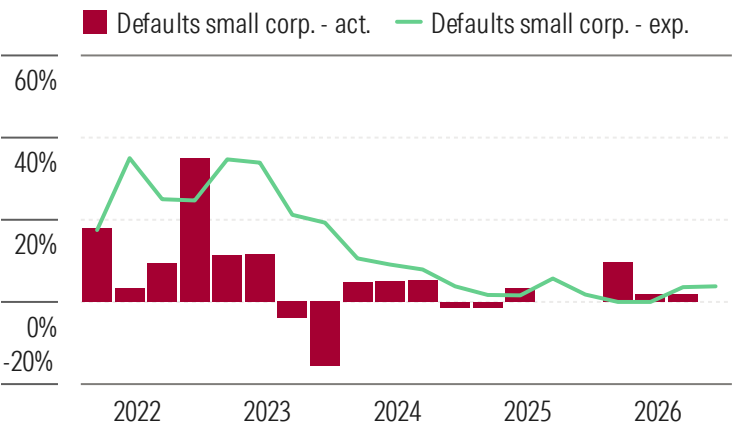
Medium Corporate Credit Demand



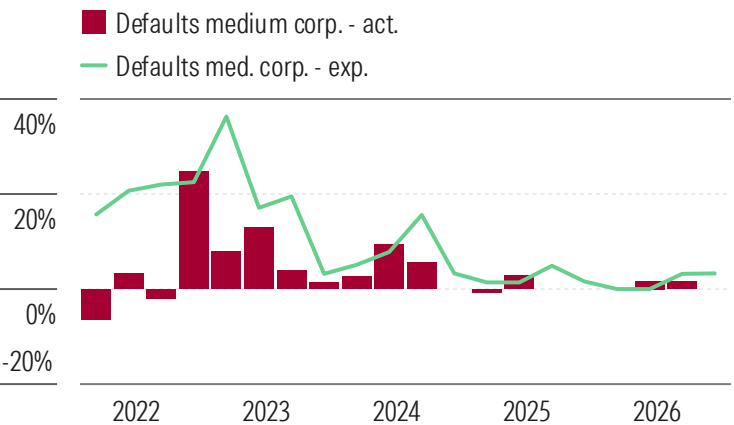
Large Corporate Credit Demand



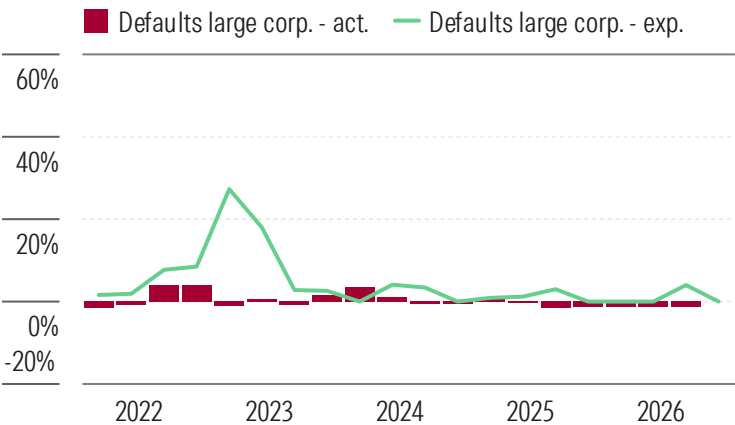
Small Corporate Defaults



Medium Corporate Defaults



Large Corporate Defaults



Source: Bank of England, Macrobond. Data as of Sept. 6, 2026.

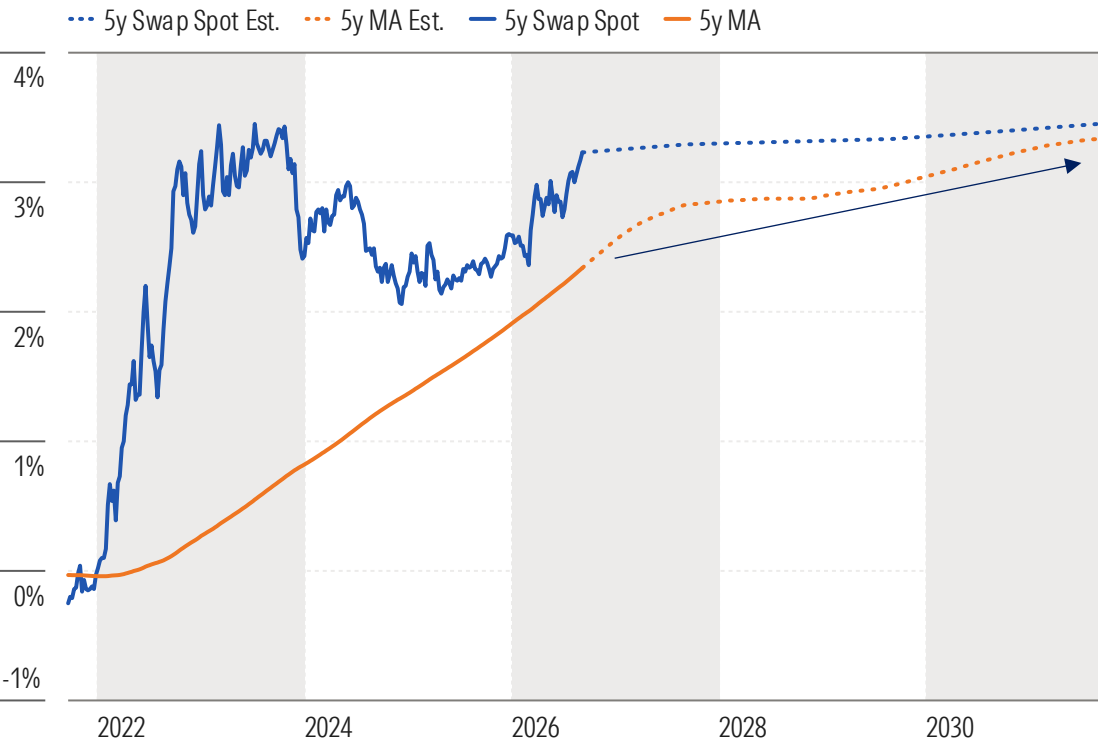
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Structural Hedges Will Drive Extended Tailwind to Net Interest Income

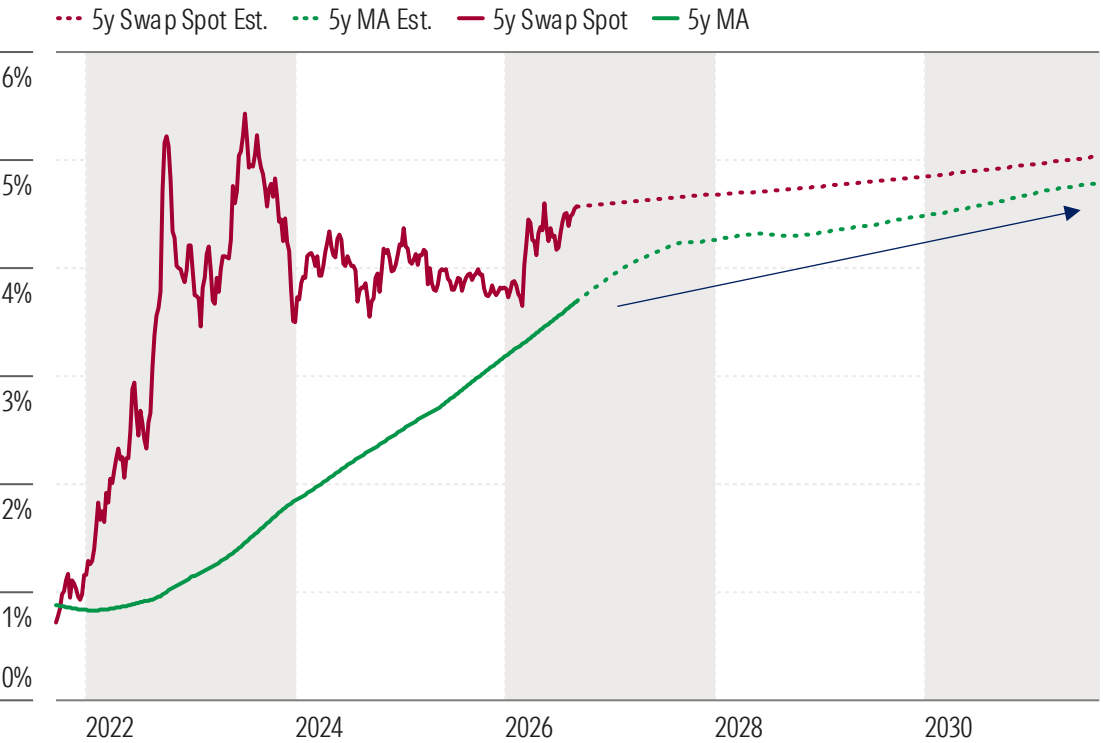
Higher swap rates have extended the expected tailwind from the structural hedge for European banks.

The low swap rates leading up to 2022 resulted in structural portfolios rolling onto higher swap rates until at least 2027—after which current swap rate curves suggest further, albeit more modest, gains until 2031.

European Union Structural Hedge to Support Net Interest Income Margins



The UK Structural Hedge Will Remain a Net Interest Income Tailwind

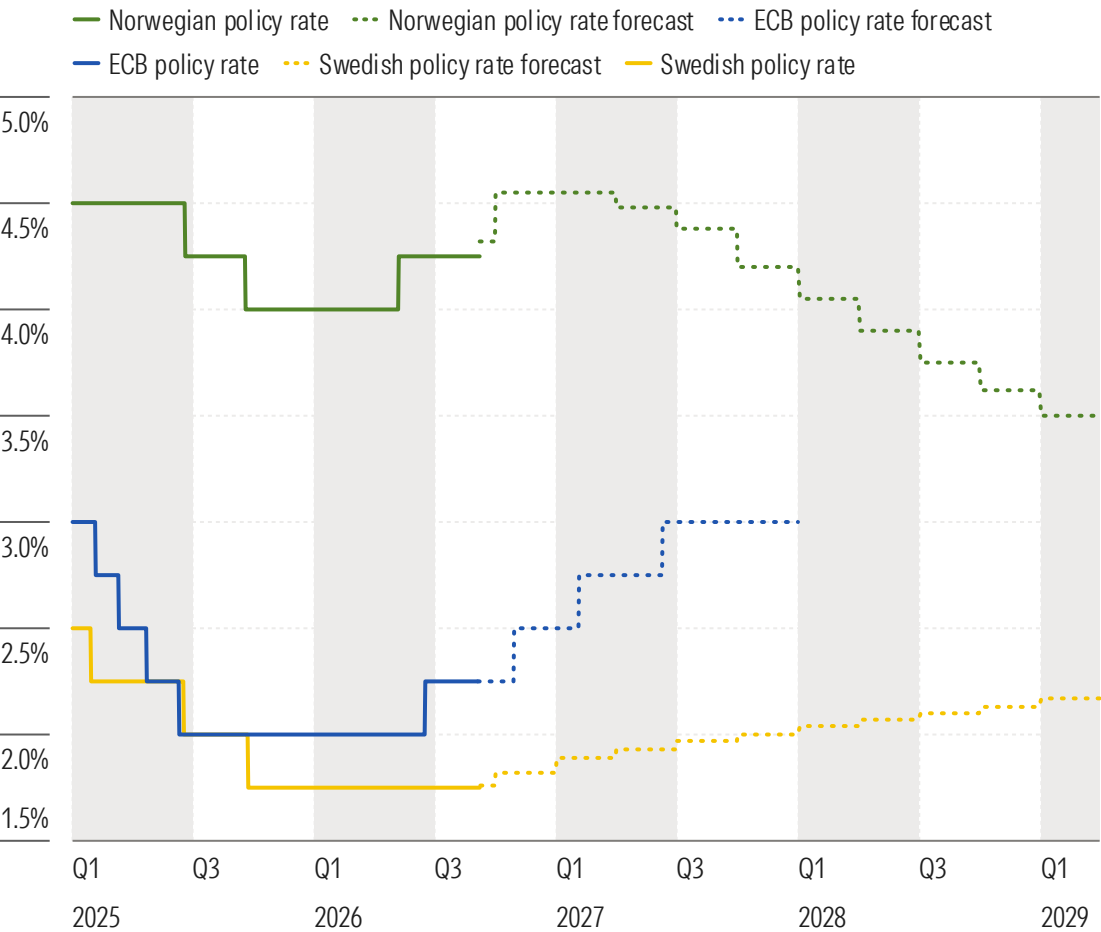


Source: ECB, BOE, Macrobond. Data as of September 6, 2026.

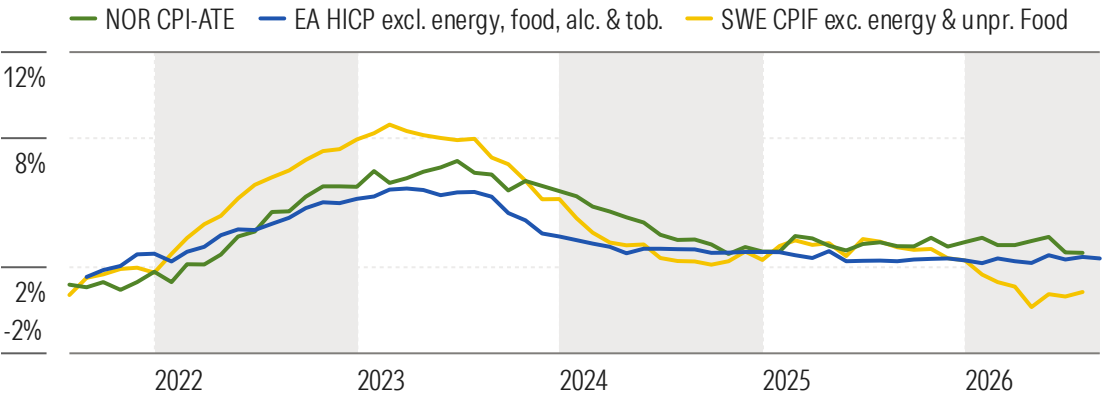
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Nordics Interest Rates

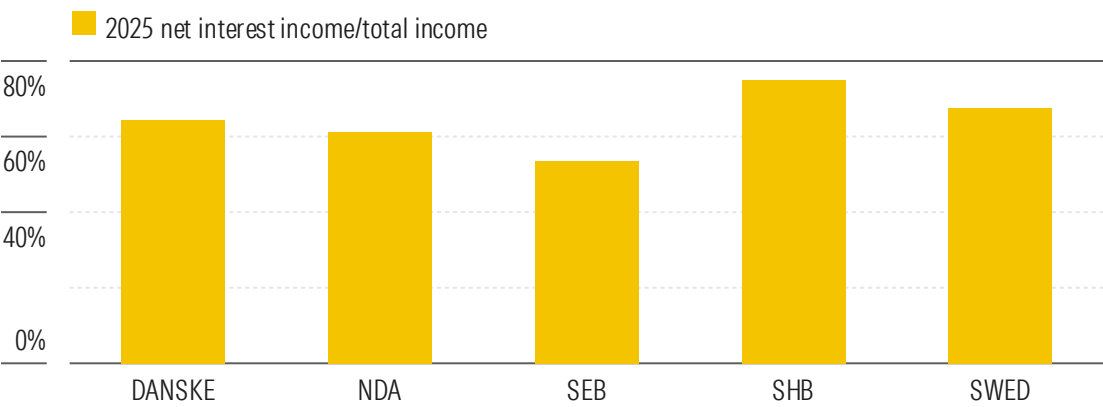
Nordic Interest Rates Diverge in Magnitude



Inflation Differential Highlights Differing Tasks for Nordic Central Banks



Nordic Banks' Interest Rate Income Share



Source: ECB, Riksbank, Norges Bank, company reports, Macrobond. Data as of Sept. 6, 2026.

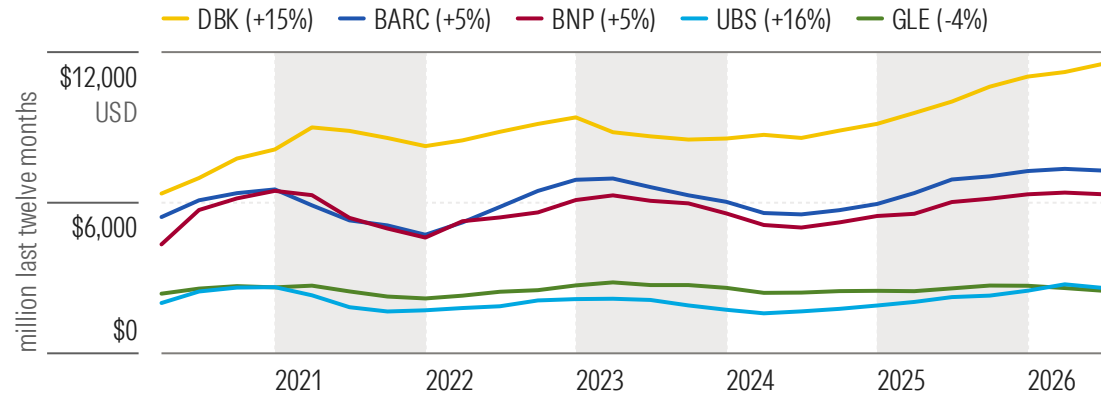
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Trading and Investment Banking Revenue

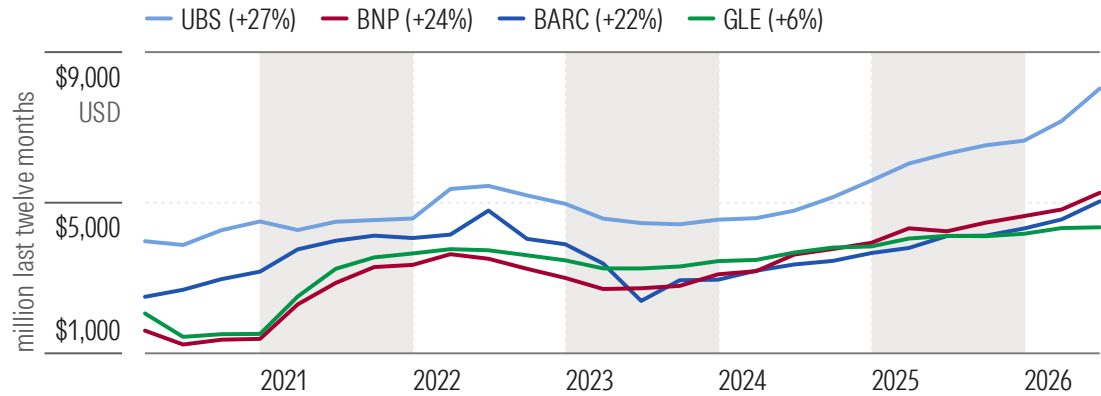
Trading has been a structural support of revenue, but faces tougher comparables.

Fixed Income and Equities Are Driving Good Results for European Investment Banks

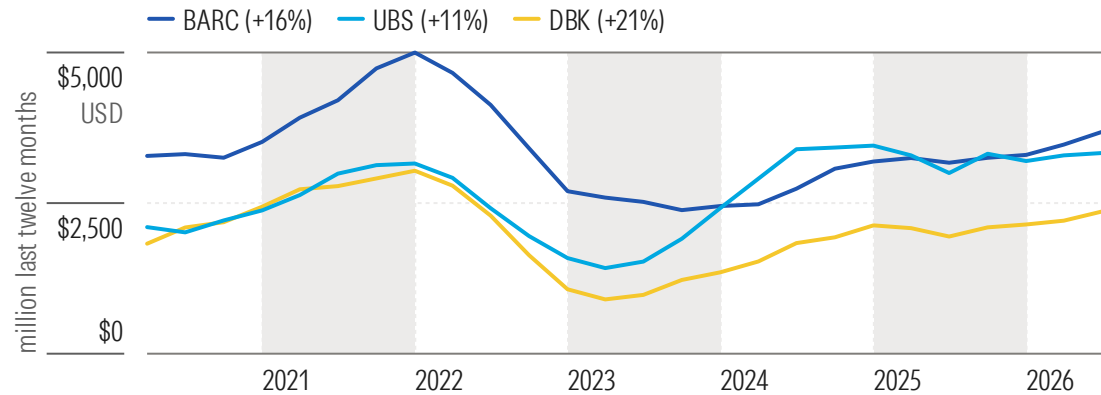
FICC Revenue Growth Has Increased Across Most European Banks



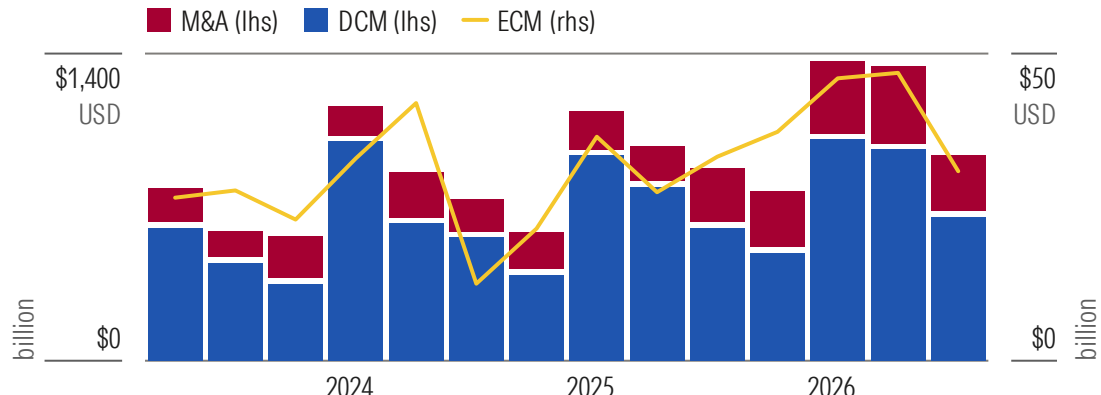
Equity Sales and Trading Revenue Has Benefited From Periods of Volatility



Investment Banking Revenue Has Been a Mixed Bag



Q3 2026 Performance Still Pointing Toward Slight Increase Year Over Year



Source: Company reports. Data as of September 2026. Values in brackets represent revenue growth last quarter, year over year.

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Credit Risks

Short-term calmness but increasing medium-term uncertainty.

Unemployment Edging Up, but Short-Term Asset Quality Looking Solid

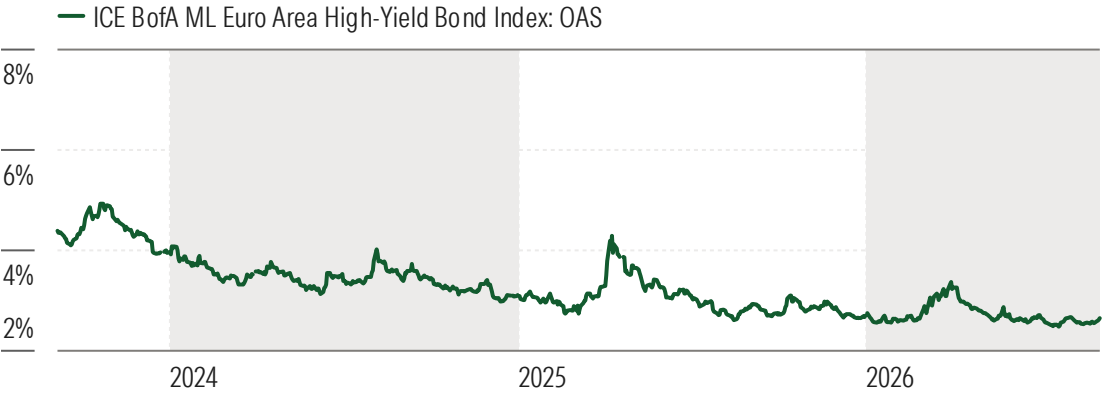
The unemployment rate can be a good leading indicator of any increased risk of households defaulting on their loans. Mortgage lending makes up, by far, the bulk of household lending in most European markets. Unemployment rates have been edging up across most European markets, and the labor market tightness that has previously underpinned wage growth is beginning to ease. The Middle East war introduces energy cost-based inflationary pressure, which will lower households' purchasing power. Although European central banks have a clear mandate to target inflation rather than employment, a potential scenario of rising unemployment and inflation could drive increased credit losses. In the short term, we view credit quality as good despite a more uncertain outlook.

European banks classify the bulk of their corporate loan books as below investment grade. Because defaults on corporate loan portfolios tend to cluster heavily in loans carrying low internal ratings, movements in European high-yield spreads serve as a timely market-based signal of credit deterioration—and are therefore a useful indicator of where loan-loss provisions are likely heading. Spreads widened in March 2026 related to the Middle East war, reflecting concerns about geopolitical and inflationary risks. Spreads have recovered fully since then; however, this signals more robust corporate balance sheets and peak earnings. We continue to view European banks' corporate loan books as more vulnerable than their household loan books.

Unemployment Is Inching Upward

Unemployment Rate	5yr avg.	25Q2	26Q2	Δ Y/Y	Δ5yr. avg
Belgium	5.8%	6.0%	6.4%	0.4%	0.6%
France	7.6%	7.6%	7.7%	0.1%	0.2%
Germany	3.4%	3.7%	4.0%	0.3%	0.6%
Italy	7.1%	6.4%	5.6%	(0.8%)	(1.6%)
Netherlands	3.7%	3.8%	3.9%	0.1%	0.2%
Spain	11.9%	10.6%	10.3%	(0.3%)	(1.6%)
Denmark	5.6%	6.3%	7.3%	1.0%	1.7%
Sweden	8.2%	8.7%	8.7%	0.1%	0.5%
United Kingdom	4.3%	4.4%	5.2%	0.8%	0.9%

High-Yield Corporate Credit Spreads Have Recovered After a Surge in March

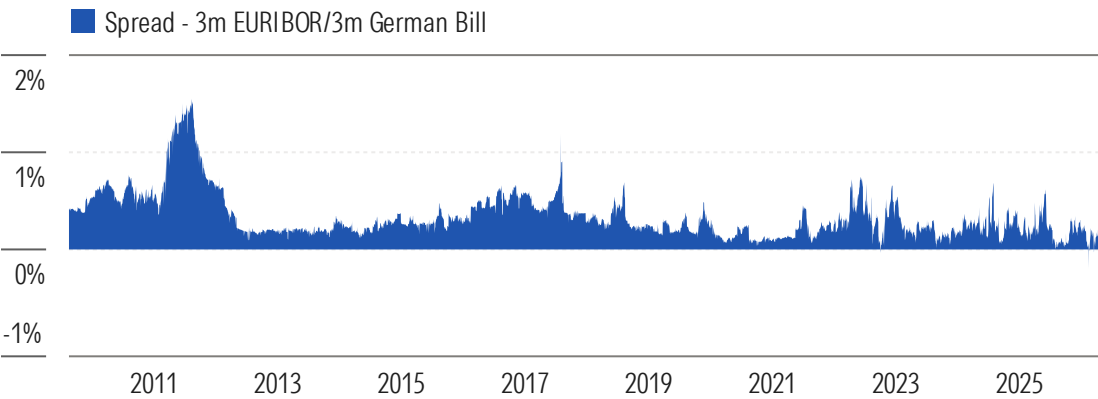


Capital and Liquidity

Banks are well capitalized.

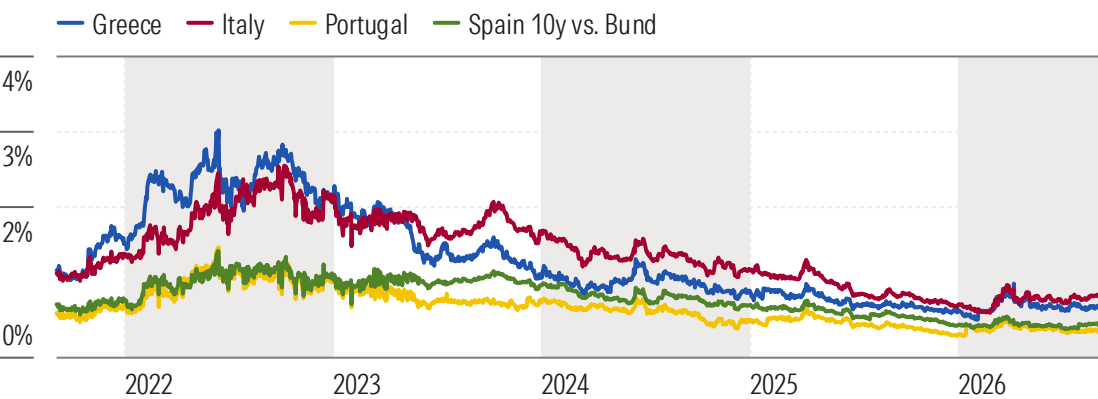
Liquidity Risk Indicators in the European Banking Sector Display Overall Calm Sentiment

Interbank Risk Indicators Signal Calmness



Interbank risk shows no sign of distress. Compared with large shocks such as the global financial crisis in 2008 or the European debt crisis in 2011, the current spread suggests limited risks in the interbank funding market. The Euro Interbank Offered Rate is the rate at which financial intermediaries are willing to lend to each other without collateral, in this case on a three-month basis. Compared with the German Treasury bill of the same tenor, which we use as a proxy for the risk-free rate, the spread gives an indication of banks’ default risk as judged by their peers and the health of interbank markets in general. The chart (top left) highlights how potent fiscal and monetary stimuli have been over the past decade, flushing the system with liquidity and supporting the real economy.

European Sovereign Risk Is Low



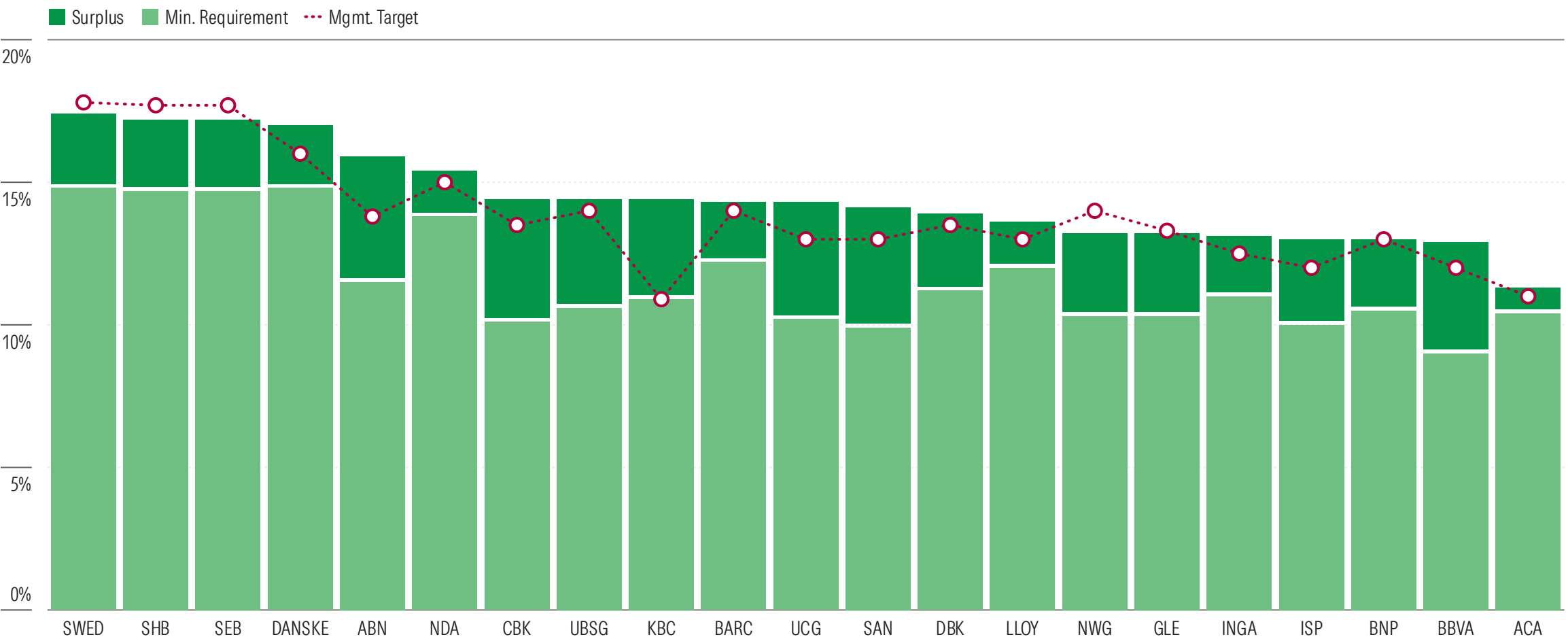
European sovereign risk has narrowed again after somewhat elevated levels through the rate-hiking period. Overall, better-than-expected economic developments throughout Europe and the anticipated support from lower interest rates have compressed sovereign credit risk spreads from higher levels in 2022. The Middle East war has widened spreads temporarily, but levels still remain well below what we would consider worrisome. European sovereign credit spreads are an important metric we keep an eye on, as banks are the primary holders of European government debt securities. The European debt crisis showed how a deterioration in a sovereign credit rating can affect a country’s financial system and weigh on an economy. Banks holding these debt securities can see their liquidity and funding sources tighten as a result.

Source: Macrobond, The European Money Markets Institute. Data as of Sept. 6, 2026.

See Important Disclosures at the end of this report.

Common Equity Tier 1 Ratios

European Banks Are Well Capitalized and Comfortably Exceed Regulatory Minimum Requirements



Source: Morningstar, company reports. Data as of September 2026.

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