

● **CREDIT SUISSE BY OSTRUM
ASSET MANAGEMENT**

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This analysis has been written on March 16th by Cynthia Voorhees, Senior credit analyst, specialized on banking sector and based in the US.

Credit Suisse suffered repeated scandals and governance failures which resulted in a weaker business profile. They struggled for years to get the right management team during which time we saw the franchise weaken.

In late October 2022, the current management team laid out a strategy to transition to primarily a commercial bank and wealth manager. This would take time and involve spinning out Credit Suisse First Boston and reducing certain assets. The strategic plan was well received by the market, but by this time Credit Suisse had already suffered meaningful – albeit manageable – outflows of deposits, outflows of assets under management, and lower business activity compared to their peers. Their balance sheet strength, as measured by good assets and strong capital, was set to carry them through a restructuring year 2023 with expected losses. At this time, we marked them as weakened and more vulnerable to a market shock or other unexpected events.

The failure of Silicon Valley Bank, the perceived negative comments from the bank's largest shareholder were sufficient to spread fear among investors which culminated yesterday. While we will not have the exact outflows of deposits and business until the end of the first quarter, we suspect outflows may be meaningful.

Overnight we had two positive news. (1) the Swiss regulator FINMA and the Swiss Central Bank jointly confirmed their intent to support Credit Suisse with necessary liquidity and (2) Credit Suisse announced their intention to draw CHF 50Bn liquidity from the central bank under a covered loan facility and a short-term facility.

While this may by itself not be enough to restore Credit Suisse, it certainly calms things down and gives the bank time to explore in an orderly manner possible options opening to them. This is a first victory, because any escalation would imply contagion to the rest of the system given Credit Suisse systemic importance.

And finally, while things will still evolve, factors supporting a positive outcome for senior bondholders are meaningful: the Swiss regulators strong capital requirements by which the bank abided and strong asset quality.

Taking a step back and looking at the overall European banking sector, we believe it is facing the overall economic slowdown from a position of strength. Pushed by the highly disciplined European banking regulation, they exhibit strong capital and good liquidity positions, further reinforced by their preparedness to meet TLTRO maturities repayments, of which the largest portion is due June 2023. They do effectively keep about 12% of their total balance sheet in cash and deposits with central banks, thus leaving them ample cushion to meet maturities coming due.

The weak spot for European banks is their certain reliance on wholesale funding, offset in most cases by diversified business models, diversified sources of funding, and large and deep European covered bond market.

While this reliance has been significantly decreased during Covid thanks to outsized deposit growth across the board, we expect this to go back to normal. We emphasize we are not worried by deposit outflows per se. It is an assessment bank by bank in the light of its business model and its funding diversification. It is normal individuals and especially corporates put them back at work in the aftermath of covid. The impact for banks will be mainly an impact on interest margins, which after quite significant increase in 2022, will most likely feel a certain pressure, as funding costs will obviously increase.

The Credit Research Team Ostrum Asset Management

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