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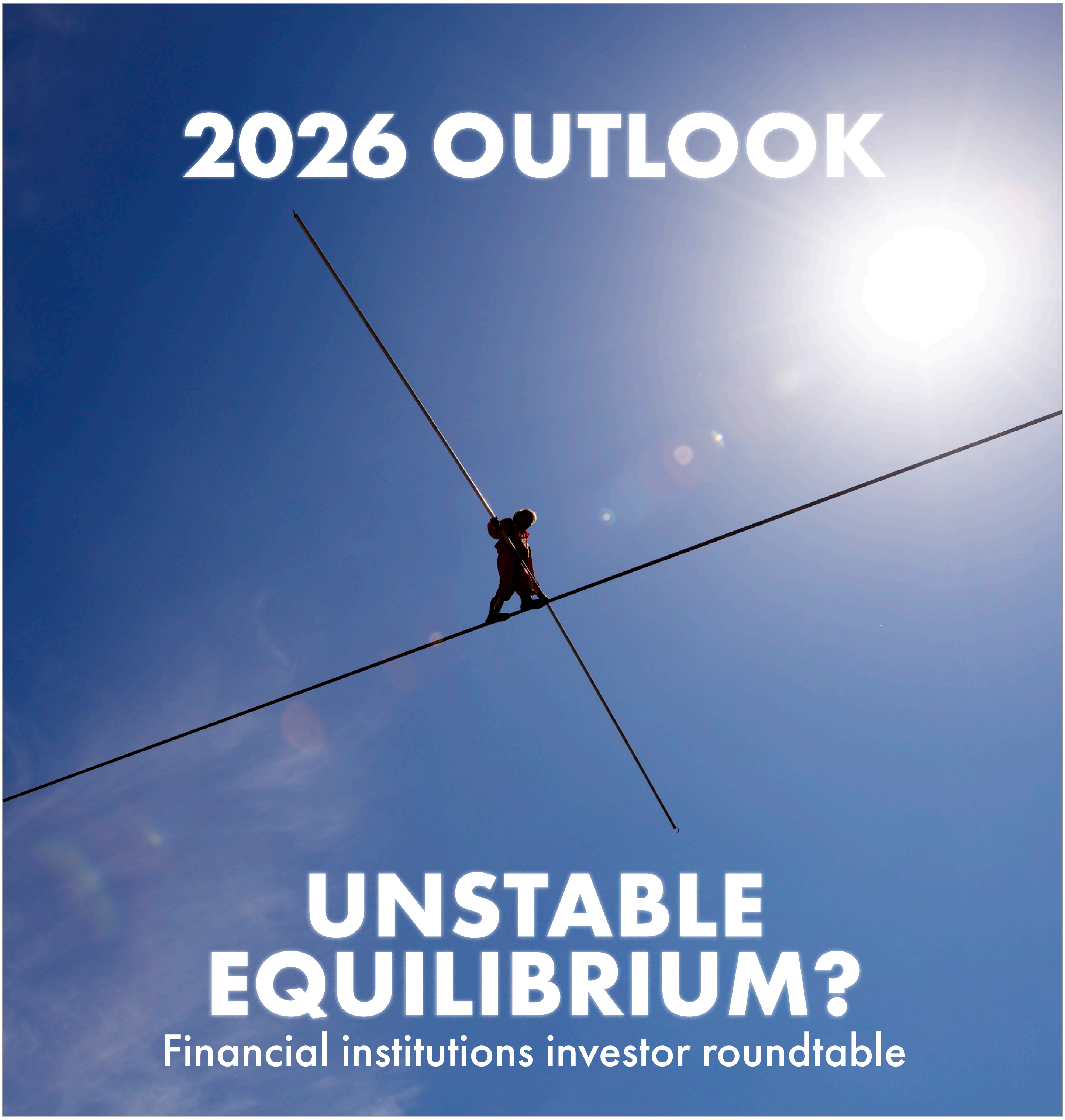

2026 OUTLOOK

UNSTABLE EQUILIBRIUM?

Financial institutions investor roundtable

NOVEMBER 2025

2026 Outlook
Unstable equilibrium?

Tight valuations have persisted through 2025, but will the technicals that have supported this resilience last into 2026? A lack of conviction suggests the market could be easily knocked off its finely-balanced path. *Bank+Insurance Hybrid Capital* and Crédit Agricole CIB invited investors to share their insights into macro, market and regulatory developments for our latest annual roundtable on 12 November.

Michael Benyaya, co-Head of DCM Solutions and Advisory, Crédit Agricole CIB

Jérémie Boudinet, Head of Financial & Subordinated Debt/ Portfolio Manager, Crédit Mutuel Asset Management

Kyra Guerrida, Head of Continental Europe Credit Sales, Crédit Agricole CIB

Vincent Hoarau, Global Head of FIG Syndicate, Crédit Agricole CIB

Shrut Kalra, Portfolio Manager, Brevan Howard

François Lavier, Head of Financial Debt Strategies, Lazard Frères Gestion

Matthieu Loriferne, Bank Credit Analyst and Portfolio Manager, PIMCO

Sebastiano Pirro, CIO & Financial Credit Portfolio Manager, Algebris

Julien de Saussure, Senior Credit Portfolio Manager, Edmond de Rothschild Asset Management

Marc Schoucair, UK Credit Sales, Crédit Agricole CIB

Gildas Surry, Head of Banks Research, Crédit Agricole CIB

Neil Day, Managing Editor, Bank+ Insurance Hybrid Capital, and moderator

Neil Day, Bank+Insurance Hybrid Capital: What can we expect from financials in the coming year in terms of supply, always a key consideration when it comes to the outlook?

Vincent Hoarau, Crédit Agricole CIB: We don't yet have final numbers, but we are well advanced in our projections. We have calculated the MREL needs of 60 significant European banks that represent 85%-90% of the entire financial institutions space, and it is already clear that, whether you look at it on a gross or net basis, all the supply will be very manageable. Gross supply from these European banks — everything from covered bonds to Additional Tier 1 — is for 2025 likely to land in the context of €550bn, and looking into 2026, we are talking €500bn, so down some 10%.

Drilling down into different segments, pure MREL needs are forecast at around €160bn for 2026, down €40bn versus 2025's €200bn. MREL redemptions are quite similar, at €143bn this year and €140bn next. So this net supply of MREL funding will be the major change, down from positive €60bn to €20bn — again, completely manageable.

Going down the capital structure, on the Tier 2 side supply will also be down compared to this year — with one caveat: quite a lot of French 10 year bullets issued in 2016 are coming due next year and will constitute a substantial part of redemptions. Nonetheless, gross supply in the Tier 2 space is going to be relatively stable and very manageable.

For Tier 1, we look at what is up for call in the next 15 months or so, i.e. January 2026 to June 2027, and here we have €36bn in AT1 across currencies, of which €15bn has already been refinanced. To the resulting €21bn of gross supply, we add €9bn-€10bn in terms of bucket optimisation and €2bn in RWA growth, ultimately giving us gross supply of some €32bn in 2026, versus €48bn in 2025 and €46bn in 2024.

So the main takeaway regarding supply next year in the FI world is that it looks like it will be extremely manageable, and that is certainly going to further support the bond bullish narrative, at least for financial institutions.

Corporates is a different story. The gigantic funding needs attached to the financing of AI have complex ramifications in the funding dynamics beyond the world of wholesale funding for financial institutions. Acceleration of SRT could also play positively into the above big picture for banks.

François Lavier, Lazard Frères Gestion: Globally-speaking, I agree with your supply expectations in terms of MREL instruments. 2026 should be a big year in terms of redemptions, and thanks to these maturities coming due, we expect the supply to decline substantially.

On the Tier 1 part of the equation, 2025 has been a bigger year in terms of first call dates than 2026, which points to less issuance next year, while banks have indeed already refinanced a lot of Tier 1 securities that are coming up for call next year, so net-net, that should be absorbable without too much difficulty.

Net supply in the Tier 2 segment should be negative taking into account the big maturities we have, including the bullets issued 10 years ago that you mentioned. Tier 2 net supply was forecast to be slightly negative this year and could perhaps end up flat, while we expect next year to be deeply negative.

Hoarau, Crédit Agricole CIB: Spot on. €17bn of French 10 year bullet Tier 2 redeems next year. This is a substantial amount, playing favourably for the segment as we don't expect that stock to be replaced.

An additional element that justifies a positive outlook for Tier 1 issuance is that the average reset for the bonds that are up for call over the next 15 months is in the context of 580bp. This is quite an important figure supporting the narrative around supply in the Tier 1 market, bearing in mind that we are now in the context of 300bp-350bp depending on the name.

'The financials bias makes a lot of sense to me'
Shrut Kalra, Brevan Howard

Jérémie Boudinet, Crédit Mutuel Asset Management: Regarding expectations for AT1s and RT1s, something we may see, and which I would like to see, is newcomers to the market finally making an entrance. Monte dei Paschi di Siena, of course, but also maybe the largest banks from Poland, Slovenia and so on. Perhaps we could see the kind of issuer that already has a broad investor base in MREL issues now tap the AT1 market to optimise their capital stack a little more. And in RT1, issuances from, say, Austria and the Nordics to bring more diversity to the market.

Shrut Kalra, Brevan Howard: The financials bias makes a lot of sense to me — it's indeed quite bullish for bank credit not to have too much net supply, something that has been well flagged. What's interesting for me is that we've come out of a three-year period of very strong tailwinds for credit as an asset class, and that's about to change. It will be interesting to see the anticipated wave of AI-led financing hitting public and private credit markets, as yields are moving lower — specifically in the US, and I think financials are going to be an outperformer.

I'm a little bit more mixed on the bond bullish narrative. That may get tested coming into next year, and then we'll see how macro developments pan out.

Within credit, it's always a question of

> **'In Tier 2, we are around the tights versus seniors, but looking at some technicals, next year will probably be even stronger'**
> **Kyra Guerrida, Crédit Agricole CIB**

RV across the matrix, and a lot of these issuers, especially the ones who will come to the public markets, are very high quality — I know there was a recent jitter in some of these names, but when you actually go through the balance sheets, the balance sheet of these issuers is easier to understand most of the time than financials. I think there is going to be enough demand for that type of paper to make the net negative supply look interesting, meaning at the tight end of the range, I'm not sure that you can necessarily go tighter. I think you could go wider in spreads, although you'd expect financials to outperform in that scenario.

Day, BIHC: Maybe we can just take a bit of a step back before delving further into some of those interesting points, to look at how we got to the tight levels we're at right now, in spite some episodes through the year. Does it make sense where we are now in financials?

Kalra, Brevan Howard: Like I said, there were lots of good tailwinds in the last three years. Rates went higher. There are a lot of people in the world who believe in the wonders of compounding, and so fixed income really had a solid place, with good balance sheets in place. We finally realized European banks are clean. We finally realized that actually rates going up is positive, not negative. And Europe is a place where there's a lot of demand for fixed income paper. It's not so in the US, because, of course, the marginal retail buyer is more interested in owning Nvidia stock than they are in owning 5% yielding paper, whereas Europe is quite different. So, in that context, the last three years are easily explained.

Looking ahead, investors need to question the metrics that supported valuations. The one metric that sticks very strongly is that the balance sheet quality within financials is pretty strong, both in the US and Europe.

I would argue, as we go into the AI capex cycle, which I spend a lot of time thinking about, that there will be some bad money spent. Europe does not have AI-related spend, so hopefully it's going to be in the US, but it doesn't mean Europe won't get infected if the AI capex bubble bursts. But thinking about the impact of that spend and if it was done correctly is still possibly something for two to three years from now.

> **We finally realized that European banks are clean**

So, it makes total sense where we are coming from. Does that hold? That's an open question.

Lavier, Lazard Frères Gestion: It's true that we have some new issuers coming to the market, including some big ones with the AI investment. I would add that while we might not have AI in Europe, we have infrastructure spending. There will be investment in energy and plenty of other things in Germany and more broadly in Europe.

A third element that we have not yet seen to a great extent is M&A. It has not been a big catalyst in terms of issuance, but there is plenty of hope that at some point in 2026, once we have passed the worst of the uncertainty linked to tariffs, we could see more M&A. And as we have seen in the past, each time M&A picks up strongly, it results in more issuance.

So the mix of AI investment, plus infrastructure investments, plus M&A, ultimately implies more supply from corporates in general, eventually leading to some potential spread pressure.

I share your view that financials are in very good shape — there is no doubt about the health of the sector, both in Europe and also the US. But indeed, we cannot escape the overall market; the supply and demand imbalance will have some impact on valuations, at least.

Kyra Guerrida, Crédit Agricole CIB: It's important to bear in mind the community of investors who are not around the table — i.e. non-specialists on financials — but who have a decent influence on technicals and on spreads.

In Tier 2, we are around the tights versus seniors — even if there has been some slight weakness and repricing in recent sessions — but looking at some technical elements, next year will probably be even stronger. The pension reforms in the Netherlands, for example, are going to have an important impact on flows in financials. And if you look at the Tier 2 space, specifically — focusing more on pure IG-land, on the single-A, triple-B-plus area — at the end of the day yield buyers can get around 3.75%-4% on names like CBA and CaixaBank that have come lately. You can struggle to find such yields on IG corporates in the same tenor (looking at the call date). So while we may be at the tights in the Tier 2 space, these are mitigating factors, so it still makes sense on a relative value basis — even if I can't say if it will go tighter. Fundamentals are strong and for a generalist population it offers good value for money.

Matthieu Loriferne, PIMCO: One of the key factors why spreads on bonds generally speaking have done so well is also reflected in the very strong performance in

the equity market. The fact that the anchor to the entire capital stack, from AT1s to senior and depositors, is up 60% on average this year, and in some cases has more than doubled in value, is a huge contributing factor in my view to the strong performance of AT1s and senior asset classes. Three years ago, barely 20% of the SX7E (Euro Stoxx Banks) was at book value, but 90% of the US market. Today, it is almost on a par, i.e. 90% of each sector trades at or above book value. So there has been a huge rehabilitation — to Shrut's point, that the equity market finally has come to the conclusion that not only are fundamentals robust in terms of balance sheet, in terms of capital, but also profitability. If you think about the profitability of banks for a second, they are now on a constant leverage basis as profitable as 2007, and clearly the sustainability is a lot, lot stronger because of the 15 years of rehabilitation we went through. So their rehabilitation on the equity market has been a huge supporting factor, for sure.

Day, BIHC: And do you see the performance of or relative value in financials persisting?

Loriferne, PIMCO: I would say profitability will probably come down a bit from where it is today, especially in some of the European floating rate markets, where it is probably too high. But for as long as rates do not go back to anywhere close to or below 1% in euros and sterling, we think most banks can sustain, say, low to mid-teens return on equity, which in turn is very manageable for both credit and equity investors.

'I just fear we are in an unstable equilibrium'
Julien de Saussure, Edmond de Rothschild Asset Management

Day, BIHC: Julien, you've yet to opine.

Julien de Saussure, Edmond de Rothschild Asset Management: I totally agree with what's been said.

I just fear we are in an unstable equilibrium, because, basically, we hope for rates to stay where they are. If they go up, we know that it will dry up some of the demand, and if they go down, it has an impact on profitability. So if they can stay here, it's fine.

And the same for spreads: I am not hoping that spreads tighten — although it would probably mean positive performance on an absolute basis, I share the feeling that, with the dynamics of resets,

I don't necessarily understand the fascination for primary

etc, having a whole generation of very tight resets might create problems for the coming years — even though, at the moment, no one cares.

So we all hope for that unstable equilibrium. But history tells you that if you have no margin for error, that's probably when the unknown unknown happens. So, let's stay vigilant.

Hoarau, Crédit Agricole CIB: Looking at Tier 2 valuations, in 2018 and 2021 we had a wave of Tier 2 between swaps plus 80bp-90bp. In the secondary market today, stronger names are in non-call fives around the 100bp mark — DNB's €400m 10.25 non-call 5.25 green Tier 2 that was launched at 130bp in March, for example, is trading close to 100bp. Do we see a world where in 2026 Tier 2 could in primary again cross the 100bp figure, maybe for, let's say, a strong Nordic name? Even if — coming back to Kyra's point — the yield complex is somewhere else today: in 2018 swaps were negative and in 2021 they were only just positive, 30bp-40bp.

Lavier, Lazard Frères Gestion: We hope not. But if demand stays as strong as it has been this year and — as we touched on before — we have negative supply, that, at least, gives a strong tailwind to push spreads a bit tighter. And after that, who knows?

Sebastiano Pirro, Algebris: There has to be some differentiation between Tier 2 and senior — one is at zero in case of a problem, the other will have a haircut — and seniors are not *that* tight, which is what is keeping Tier 2s reasonable. So you would have to have a material tightening of senior before you would have Tier 2 inside 100bp.

Hoarau, Crédit Agricole CIB: If you look at the spread complex today on five years, taking a solid Nordic name, we are talking 50bp-65bp for senior, and 95bp-100bp for Tier 2 in the secondary market on non-call five adjusted, so it's extremely compressed. I agree with you that senior would have to tighten a lot — or we accept to live with differentials between senior preferred and senior non-preferred, and SNP and Tier 2 that are significantly lower than what we are used to.

Pirro, Algebris: Not necessarily: you should understand that one is structurally subordinated, but perhaps people don't — fair enough. But there is a material difference between the two.

Loriferne, PIMCO: Also, the secondary market is extremely liquid across the stack, so I don't necessarily understand the fascination for primary, especially for larger banks. For some of the very large issuers, you have 10-15 bonds to choose from in AT1s, another 10 in Tier 2s, and dozens in seniors, across multiple tenors and currencies, favouring relative value. I get the negative supply picture, but there is still enough outstanding to express one's view in financials. Also, it would be good to see some discipline on the asset management side as well — don't get sucked into very tight new issues or compressed subordination premiums.

Gildas Surry, Crédit Agricole CIB: Our house view is that rates will not necessarily decrease in 2026 as the market anticipates, but simply plateau in euros and also in dollars. So those investors jumping on the primary bandwagon expecting to benefit from rates decreasing could be disappointed.

What we are witnessing in the macro space is a tectonic shift in monetary policy from both the ECB and the Bank of England. This was highlighted in a panel in Frankfurt last Friday involving the Bank of England's Victoria Saporta and the ECB's Imène Rahmouni-Rousseau.

They were discussing, among other topics, the ECB's implementation of its new operational framework, as announced in March 2024, whereby they will move away from short term rates being set at the floor of their corridor, in order to have the short term rates instead moving with a higher sensitivity in the middle of the corridor between the deposit facility and the marginal lending facility. Short term rates are thereby expected to move with a higher sensitivity as reserves are being withdrawn from the sector in the last phase of the quantitative tightening. What was very interesting to hear was BNP Paribas group treasurer Nicolas Pillet's reaction to Imène, saying, well, yes, you are actually withdrawing liquidity from the sector, but beware, you've gone down the easiest part of the trajectory, and now we're going to reach a level where indeed banks may be short of liquidity, and so it may trigger some moves on the short term interest rates path. Taking up Kyra's point about what's going to happen with the Dutch pension fund reform on the long term part of the curve, the shorter part of the curve also may be choppier than what we have seen before.

The Bank of England is also moving towards a regime where short term rates are expected to be more volatile, or at least untested, moving from a supply-driven type of liquidity on offer to the market, to a demand-driven one. Saporta released some nice graphs where you see the short term rates moving back to this range they call the PMRR, the Preferred Minimum Range of Reserves.

So we are seeing a shift in the monetary landscape, with an increasing use of repos and away from non-standard monetary operations, where the ECB and the Bank of England want banks to use essentially repos. So no VLTRO, no TLTRO — all the funky stuff from the central banks' arsenal. They will stick to the standard MRO and LTRO. So any liquidity going back into the system will come from a much more constrained and untested sort of mechanism. That's something to keep in mind for next year, where we could see some bumps. Saporta mentioned earlier on in November in a recent speech one such bump, when overnight General Collateral gilt repo rates rose to over 30bp above Bank Rate. Some people still have unhappy memories of November 2011 with the experience of dollar funding for French banks. And we could see some weaker banks being caught out by this tectonic shift of monetary policies.

We could see some weaker banks being caught out

'What we are witnessing in the macro space is a tectonic shift in monetary policy'
Gildas Surry, Crédit Agricole CIB

Kalra, Brevan Howard: Do you have an estimate of what it means in terms of liquidity?

Surry, Crédit Agricole CIB: The Bank of England suggested that, based on surveys from banks, the PMRR will be in the region of £375bn, so probably half of where Bank of England reserves sit now as we reach the end of QT. But when you listen to the ECB debating with the banks, it's clear that it's very much an untested relationship, where the reaction function of commercial or private banks versus the lender of last resort doesn't have any sort of history. So you can model a decrease in the amount of liquidity, but at the moment, any path is possible — the ECB's balance sheet can shrink, or can be stable, depending on how the banks behave. So it's difficult to anticipate. It may be also take longer than 2026 to play out. But what you can say is that while banks previously considered that the ECB put was not too far in the money, in this new environment the ECB put is probably a bit further away.

Day, BIHC: That's given us a lot of detail on Europe, but you also mentioned that rates in the US will not be as low as the market anticipates.

Surry, Crédit Agricole CIB: Our expectation is that there will be inflation that will limit the capacity of central banks in both regions from continuing to move lower. Nothing too significant — for example, we expect rates 20bp higher than where the market expects them to decrease to by January.

Day, BIHC: Julien, you spoke about an unstable equilibrium and the downsides of rates going either higher or lower, but what do you expect to happen?

Saussure, Edmond de Rothschild Asset Management: I guess the view is still that rates will go down slightly in the US. Until recently we were of the view that the ECB cycle might be over, but I'm not so sure of that anymore, so we are probably repricing a bit the potential for cuts in Europe. So there's still the view that inflation is well contained — even though there might be some inflationary angst on the longer end of the curve.

But again, it's a lazy picture of a bullish environment for credit and probably wishful thinking. It's not a self-fulfilling prophecy; things can change very, very quickly.

Hoarau, Crédit Agricole CIB: Perhaps it's a lazy picture, but it may also be true. I think many observers are potentially underestimating some downside risks to growth in France, but also in Germany. It may only be a gut feeling, but if you look at AI developments, the car industry, the momentum around China, the political limbo in France, and so on, I think 2026 has the capacity to disappoint in Germany and France when it comes to macro data. If there is one conviction I do have, it is that the ECB will pivot sooner rather than later. And this is indeed why at the beginning of the conversation I was insisting on the bullish narrative for financial bonds. In terms of assumptions and predictions, the ECB could surprise nicely. Our research view is the status quo by the end of 2026, and I would not be very surprised if at the end of the day in Q2 we move in the opposite direction.

Marc Schoucair, Crédit Agricole CIB: This year you've had a lot of volatility in Fed rates, in terms of standard deviation in the money market curve, and you haven't had that in Europe. Yet, if you look at European credit versus dollar credit, it has not been a function of short term volatility in rates, it has been a function of real rates. And so if you look at dollar rates, like, say, five year-five year real rates in dollars versus real rates in euros, and you chart it versus European and dollar credit, you'll see that it tracks exactly. So I'm not sure that portfolio managers look at so-called carry adjusted to volatility. And that's why I'm not sure that a spike of volatility in the short end of the money market euro curve is actually going to change something in terms of how portfolio managers look at carry.

The second thing is, the performance of financials versus corporates has been a function of the curve. In fact, with financials, you're trading rates, you're trading 2s-10s. And 2s-10s have steepened, so financials have outperformed corporates. Lately 2s-10s, 10s-30s have been pretty much stable. And if the curve starts to flatten, you should expect financials to underperform corporates.

It's a lazy picture of a bullish environment for credit

Surry, Crédit Agricole CIB: The beauty of our sector is that the instruments benefit from rates decreasing, but fundamentals suffer, and vice versa when rates increase. And so you've got a sort of diversified play between your instruments and your fundamentals, depending on the rate scenario.

Boudinet, Crédit Mutuel Asset Management: What I fear is that if there is a rates steepening, theoretically, that's good for the fundamentals of banks, but I'm afraid that it could trigger a spread curve steepening, too. If you have uncertainty and volatility on the long end of the rate curve, that may be detrimental for bondholders. So while it's true that rate steepening is good for fundamentals, I'm afraid that overall for credit markets, especially the high beta credit market, that could be bad for us in terms of the consequences for spreads.

'You're better off sticking to defensive names'
Jérémie Boudinet, Crédit Mutuel Asset Management

Day, BIHC: We've already talked a little about some of relative value questions when it comes to different instruments within financials, but perhaps I can ask more directly about positioning going into 2026.

Boudinet, Crédit Mutuel Asset Management: I'm kind of bearish. So while I am mainly focused on AT1 and RT1, I would say that you're better off sticking to the senior parts of the curve in 2026 — again, fearing spread widening across the board.

One exception to this view could be short-dated AT1 bonds, which have the benefit of having very high coupons, very high reset spreads, so to some extent you may naturally be shielded, even though cash prices are very high — so again, you could see some detrimental effect.

But apart from this, I would say that for 2026, short-dated paper is best — meaning from maybe two years to four years. And I'd say you're better off sticking to defensive names.

Loriferne, PIMCO: It's true that all the relationships you can think about are very compressed today. High beta to low beta, Yankees to US banks in senior, Tier 2s to seniors in particular. Cash credit curves are relatively flat. So being defensive in such an uncertain environment makes sense.

Fundamentals tend to anchor performance and ultimately the fundamentals of the sector should support financials' resilient characteristics.

One thing that is interesting is that while the Yankee premium has in general shrunk significantly nowadays — with the seniors of large Europeans versus US names normalised, similarly for Tier 2 — you still have a meaningful gap in AT1. Granted, there are plenty of reasons for that, including regulation and the weaker structure versus the US equivalent, i.e. prefs, but is the premium still justified? We'll see.

Kalra, Brevan Howard: Instead of trying to pick beta within this financials complex, if you were hungry for yield and really willing to look at solid banks outside of Europe, an opportunity set for me is Turkish banks. There will, of course, be other CEEMEA countries that come through, but we find them a bit less exciting than Turkey. Once we have picked our special situation, we then learn everything we need to about the macro within that country, trying to make sure that we don't get that wrong.

But if you have the luxury to move outside of the financials space, which I suspect everyone does to a certain degree, you could have loads of opportunity in January. It's difficult to make a bull case for going long spreads into a big supply technical in January.

The other thing I would highlight is Trump and the Fed next year. I know that we all have our biases in terms of where US rates should be, but the truth is, effectively you can imagine the Fed's independence being challenged next year, and so it's going to be a very interesting year in terms of how that policy is set, how much of that is based on fundamentals and actual US economic data.

The US long end rallied a couple of months ago when Treasury secretary Bessent's paper on how the Fed should be run came out, in particular the thinking about the long end, but I am actually of a slightly different view. I think, as long as it's within their power, the US isn't going to allow the 30 year UST to unhinge in any fashion, which means that actually you're more guaranteed stability of yields in the US.

Regarding the ECB, I'm very open minded. We could be at 1%; equally, we could see growth from the huge fiscal spend. I can see a very nice story to 1%, and I can also see a little pick-up where European banks lend a little more and we finally have some RWA growth, and there could be an exciting story for Europe over the next two, three years.

I actually think US rates may be really boring — and if it does get unhinged, it's because the US administration cannot control it, which is not a good risk scenario. In that case, we're not going to be worrying about long end spreads! So I'm quite excited about what happens in Europe.

Hoarau, Crédit Agricole CIB: So you see a world where solid growth materialises in Germany next year?

There is a lot of execution risk in Friedrich Merz's infra and defence spending plans announced in March 2025. And as and if things materialise in 2026, it will be in terms of announcing how and when. But in terms of execution, this is something for 2027, 2028. So I don't see how solid growth will or could materialise so quickly in Germany. Even if you can argue that the announcement alone could push analysts to revise upwards growth projections, that would only be visible in numbers in 2027. Recent manufacturing PMI are not great, same for the trajectory of the German trade deficit with China, and the feared shock from this industrial giant may be a story of 2026. Therefore I believe the market is underestimating the probability of additional rate cuts from the ECB.

> **'The market is underestimating the probability of additional rate cuts from the ECB'**
>
> **Vincent Hoarau, Crédit Agricole CIB**

Saussure, Edmond de Rothschild Asset Management: I agree with you, but it's still a timing issue — the money is going to be spent — and I don't anticipate the ECB lowering just for one year. But then there is the question of differentiating between France and Germany, and I think that still makes a lot of sense.

The question of momentum in France versus the rest of Europe is interesting, because French banks are probably less sensitive to rates going down, and you see some margin expansion — unless it's eaten by the widening of the sovereign. So that's diverging dynamics against a backdrop where all the axes of risk are compressed.

One of the areas I'm worried about is third tier banks, particularly in southern countries. Some of these have been very late in diversifying away from NII to fees, are not even reaching cost of equity at this point of the cycle — they're not going to make it when things turn sour. So that's somewhere we are shying away from. I still believe that there are some jurisdictions outside of the core countries that are more interesting, simpler in terms of profitable banks.

And indeed, we may talk about 'core', but there's no safe haven anymore. You have maybe the Nordics, but then if Russia invades, you have a problem. Switzerland is not a safe haven because you only have UBS, and UBS is probably the bank with the biggest capital uncertainties.

Coming back to France, the supply picture is not easy. Everything has been pre-financed, except France. French banks are probably more picky in precisely timing their issuance. We've seen some new insurance issuers coming to the French market. So it's still a very open question, how the market could react to the potential further development of political uncertainty in France — I think it's still a fair risk factor going forward.

Schoucair, Crédit Agricole CIB: I love how we're looking at periphery. Twenty-five years ago, I started on the Bund trading desk at Deutsche and my boss explained to me how the deliverable on the Bund future would soon be any sovereign in Europe — it could be Greece, it could be Italy. Everything was going to trade flat. And in 2001 BTPs traded inside 20bp to Bunds. That was periphery doing better versus Germany; today, it's actually going to be Germany doing worse versus periphery, because the Germans are going to be spending. So we're going to have the same dynamic, just the other way around.

Saussure, Edmond de Rothschild Asset Management: In terms of allocation, we are keen on investing more in Germany for the benefit of potential higher growth. The problem is that the banking industry in Germany has a weird shape, between the cooperative sector, the mutual sector, the smaller commercial banks, the exposure to CRE. Austria is even worse: there's not one single bank in Austria that is comparable to another. Within the European risk matrix, these are jurisdictions that deserve a slightly higher allocation, but it's difficult to deploy.

Kalra, Brevan Howard: To context Germany getting worse: they're going from 60% to 80% debt-to-GDP, assuming no growth. Everybody's asked them to spend for 15 years running, and now they're spending money. For me, the bear case in Germany is if Merz is not able to hold on to his seat. If he holds onto his seat, he's probably the first German politician who's got some of the ducks in a row to deliver something better than the last 10 years

and it will allow spending in the right way, possibly for Europe, too — although maybe not France.

I actually think it would be very good for France if we got a political change. This limbo is costing France a lot more than bringing in someone who's untested but can deliver a sensible budget with support from the republicans.

When it comes to periphery, they are really used to managing their debt in times of stress. They've learned it over

I would highlight that in Europe, we have infinite liquidity

15 years. They actually did really well out of the 2022 situation. Greece, Portugal, Ireland, they all took the medicine. Italy was the only one that didn't, and actually higher rates are super-helpful.

That said, if there really is no growth in Germany, I would put a question mark against the whole of Europe.

Hoarau, Crédit Agricole CIB: Perhaps I can put on the table some risk factors for next year: swap spread volatility; equity correction driven by AI valuations; weakness in private credit and everything related to the leveraged loan markets; the midterms in the US; and indeed what is going to happen around the Fed. Aside from that, I would say it's very difficult to see an obvious or potential black swan derailing a relatively constructive scenario for the credit market in 2026. What do you think?

'There's never one thing; there's three, four, and then all of a sudden it looks pretty bleak'

Sebastiano Pirro, Algebris

Pirro, Algebris: I don't need to tell you: you never see the black swan. And the things you mentioned are normally in addition to the one that you didn't expect. There's never one thing; there's three, four, and then all of a sudden it looks pretty bleak. That's how things sell off.

I am of the view that when spreads are super-tight, it's just a matter of time… But then again we had the same situation a year ago and this year we haven't really widened — fair enough.

I would highlight that in Europe, we have infinite liquidity. The ECB hikes rates, but in the end, there is no pass-through, because the management fee on cash is the ECB base rate. There is no competition for deposits, which obviously benefits bank profitability. Last year they made a 4% management fee on cash — this is eight times the one of the average actively managed fund. And doing nothing. There is no competition — especially in southern Europe. Nobody is thinking, I could get a couple billion of new deposits because nobody wants to disrupt this. It's not normal.

If growth picks up and there are opportunities to lend, then all of a sudden, the whole thing could rebalance. This doesn't necessarily mean that BNP is going to trade at €150, because ultimately, margins for some businesses may actually compress, if the market were functioning normally. So the ECB is probably keen to restore a market where they raise rates and the transmission channel functions together with loans — currently, we only see it in mortgages, because they don't have it. They've been easing and injecting liquidity into the market for

‘One should not expect any lower capital requirements for European banks’

Michael Benyaya, Crédit Agricole CIB

10 years, and currently they are still at a point where there is no tightness. I don’t know when it’s going to happen — there is no historical data. And now it doesn’t look particularly necessary to tighten in Europe, because inflation is nowhere to be seen. We had a supply shock, we had 10% inflation, with gas prices shooting up. But today, we don’t have that, inflation is pretty soggy. And so they can cut rates — but they are still tightening on the QT side of things. They haven’t found an equilibrium — yet.

The inflows that we get are a reflection of the fact that nobody is able to make anything on their cash. It’s not that, say, Italian institutions are geniuses in manufacturing asset management profits — they’re not; the point is, they are not paying on deposits. So it all comes back to the same thing. You don’t need to be bearish to imagine that spreads may widen. You simply need a lower amount of inflows.

So I think when spreads are tight, they can only widen.

Boudinet, Crédit Mutuel Asset Management: This is so true about the technical aspects and the inflows that we’ve been encountering. What I would add is that we have experienced a lot of volatility shocks, but they did not last long, because everybody was buying the dip. But if we don’t have that kind of technical backdrop, I’m afraid that volatility shocks could last for longer. So I don’t know about the nature of the shocks, but we may have longer periods of uncertainty, of spread widening, and this in itself can change the behaviour of investors, who may then review valuations a lot more than they did in the past few years.

Day, BIHC: The latest shock was First Brands, Tricolor and that whole episode, with Jamie Dimon’s remark about more cockroaches coming out. Do you have any fears of more emerging on this front?

Loriferne, PIMCO: As bank analysts, we are always on the lookout for the emergence of credit risks from within or outside the banking system. Whilst banks have done a very good job at cleaning up, restructuring, etc, they will remain exposed to fraud or bad underwriting risks, as seen over the past couple of months with the examples you highlighted.

If one uses historical precedents, including the most recent incidents, unchecked credit growth, weak credit underwriting and leverage have been associated with increased credit losses at banks.

The key, though, is the ability to absorb that. For some banks that are highly diversified and highly profitable, that’s 1%-5% of their quarterly profit. For some of the more concentrated banks, it can be up to 15% of their quarterly profit.

Are we going to see more of these things? Potentially, as it tends to happen when you have rapid credit expansion. And where has the credit expansion taken place over the past 10 years? It’s clearly outside of the banking system. What will be interesting is, how does it come back to banks? We’ve seen it through securitisation, through lending to those vehicles, whatever they may be. And so I would continue to monitor banks’ exposure towards this rapidly growing asset class and encourage much improved disclosure from banks on this NDFI segment.

Day, BIHC: Turning from the more directly market-oriented topics to capital requirements and the instruments themselves, Michael, what would you highlight as the current developments to watch?

Michael Benyaya, Crédit Agricole CIB: I would first of all highlight the ECB initiative to try to simplify the regulatory framework, with the taskforce due to deliver a report by the end of the year. People should not expect any decrease in capital requirements, because simplification is not deregulation or lowering capital requirements, in the view of the ECB. It will be focused on simplification of processes — reporting requirements, in particular. We may also expect a simplification of the buffer framework, which is super-complex in Europe, with its multiple buffers — systemic buffer, O-SII buffer, G-SIB buffer, and so on. But at the end of the day, one should not expect any lower capital requirements for European banks.

There is also a lot of focus on the structure and the future of AT1. My view is pretty simple, it’s that we should not expect any significant change. I don’t feel it’s the priority at the moment to change the structure of the AT1 product, and given the level of complexity of the current framework and the interplay among the various requirements — Pillar 1, Pillar 2, Leverage Ratio, and so on — for me, it’s not the right time to look at the AT1 structure. Of course, I know there have been some developments in Australia, where they phased it out, and in Switzerland, seeking to amend the structure a little. But as I like to say, these are only one country; the EU, it’s 27 countries. So I think it would be much more difficult to find a consensus around the AT1 product in Europe. Therefore, I don’t feel that we should expect any meaningful change. But happy to hear views from investors on this.

Lavier, Lazard Frères Gestion: Frankly, I share your view, in the sense that simplification is what we could expect, and not so much deregulation, and given the fact that Europe is so complex to make changes. Personally, I have plenty of wishes, but I guess these will remain wishes and not be implemented. To give you an example, I think MDA regulation is excessively complex with too marginal usefulness. We have too many MDA buffers and so on, with different capital ratios. So at the end of the day, we should get rid of it. But I suppose it will never occur, at least for the next couple of years. Maybe in the next iteration of regulation we will see something different, but I also have low expectations there.

Something that is interesting is what the BaFin is pushing a bit in Germany, having a simplified regulatory environment for smaller banks. Indeed, we have it in the UK. Coming back to the point about being paid for deposits and having more competition, simplifying regulation for smaller banks could be good. So let's see if it goes forward or not.

Boudinet, Crédit Mutuel Asset Management: While Europe is trying to simplify things, in the US they're going to get rid of the Basel III endgame and possibly parts of Dodd-Frank/Basel III. They may not implement any long term debt requirements. They still refuse to have a proper supervision of their regional banks. In the UK, we have also seen steps towards true deregulation for second tier, challenger banks. Europe will eventually deregulate to some extent, because European banks are going to again lose market share, especially in capital markets, versus US banks, and I think that they will try to lobby for that. But it will take a lot of time, and that's going to be, again, detrimental for the competitiveness of European banks, for the level playing field. So that's an issue.

Regarding the Swiss case, I don't think that markets are correctly pricing the true regulatory and legal risk embedded in what is envisioned for the future of Swiss AT1 bonds, and especially the coupon risk. For the first time in eight, nine years, we may see coupon risk returning to the fore, something not seen since the available distributable items issue for a few German and Austrian banks back in 2016.

'Simplification is what we could expect, and not so much deregulation'

François Lavier, Lazard Frères Gestion

This has not yet been taken into account. I don't think that it will pose a contagion risk for all AT1 bonds. Nevertheless, I expect a lot of financial media attention towards that question.

Day, BIHC: When discussing supply, we talked a bit about AT1 calls. Has there been any evolution in issuers' call management strategies?

Benyaya, Crédit Agricole CIB: The development of liability management techniques has further reduced the likelihood of any non-call event, meanwhile increasing call expectations among investors. The vast majority of AT1 refinancings now have a liability management component, and I would expect that to continue.

This is also a space where we could see more simplification. The process involving the ECB is still extremely difficult and cumbersome for issuers, and I feel that the ECB could massively simplify the LM process for banks to further make it smoother, also for market participants.

Day, BIHC: We've mainly talked about banks, but we don't want to neglect insurance, and indeed there's recently been a recent flurry of issuance, from France in particular. What would you highlight on this front?

Saussure, Edmond de Rothschild Asset Management: Part of the French issuance we've seen is a refinancing of the grandfathered Tier 1s that were issued in in 2015. It's not only French bancassurance, it's also the instituts de prévoyance and so on. Part of that flow is also driven by M&A, because a lot of these smaller mutuals have been diversifying their business mix. These guys are only coming to the capital market once in 10 years so they can't be wrong about when they issue and the picture for French risks is somewhat uncertain at the moment. They're interesting stories, although they don't really have much read-across for the wider market.

The development I find interesting in the RT1 space is that it is not confined to the perp non-call 10 format anymore. One of the key problems I had with RT1s was that the perp non-call 10s meant that the allocation to that bucket in risk terms was always super-big. So the fact that now they accept that you can issue perp non-call five, non-call seven smoothens a bit the disequilibrium between AT1s and RT1s. I'm happy about that, because I like the RT1 space, but the duration aspect of it made it problematic to justify in a portfolio.

Benyaya, Crédit Agricole CIB: I'd agree. The RT1 supply was indeed driven by the refinancing of legacy perp instruments, and also probably by the compression between RT1 and Tier 2, which makes RT1 more attractive to insurers. For next year, we expect less insurance supply. Also because the Solvency 2 review will probably result in the release of capital for insurance companies, maybe around 10 points of Solvency 2, so there will be a bit more flexibility.

Hoarau, Crédit Agricole CIB: Going back to valuations, a couple of weeks ago we had an RT1 from Axa and then this week an AT1 from Barclays 100bp or

more wider — what is behind such an optically elevated differential?

Pirro, Algebris: Banks are much bigger and much more concentrated in people's portfolios. You have some pricing power when a name like Barclays comes with its 17th or whatever AT1 and the larger names tend to have wider spreads, to some extent. Barclays is also bracketed with names like Deutsche, at the wider end of the market — it doesn't make much sense if you look at ratings, for example, but it is UK, with investment banking, etc.

Meanwhile, Axa is much smaller and scarcer. Remember Generali's really tight effort — you could buy the 30 year BTP with a similar coupon. It made no sense. Insurance is a bit of its own niche.

And structurally, AT1s are weaker. There is also the potential extension, which is perhaps less relevant on an RT1 given the non-call 10 format of most bonds. They also haven't really been tested. It may be that wider levels are justified for RT1s. But from my perspective, AT1s are more attractive because they are wider. ●

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