FITCH: CREDIT SUISSE'S 2Q17 RESULTS SHOW UNDERLYING IMPROVEMENTS

Fitch Ratings-London-31 July 2017: Credit Suisse Group AG's (Credit Suisse) 2Q17 results show progress in the bank's targeted cost reductions and sound performances in the group's wealth management businesses, although performance in Asia Pacific was still dragged down by weak trading results and Investment Banking and Capital Markets had a weak quarter. Results were also materially undermined by continued losses from the group's non-core assets.

Credit Suisse's well-executed cost reductions should result in reduced earnings volatility, and cost control will remain key to preserving the profitability of the group's re-sized franchise, with a smaller revenue base. The group generated a 3% return on equity in 2Q17. We expect the drag from non-core assets, which to date has remained within management guidance, to result in subdued earnings in the medium-term, despite greater operating leverage and a strong wealth management franchise. Management expects non-core losses to shrink to USD1.4 billion in 2018, from USD1.1 billion in 1H17.

Credit Suisse generated CHF582 million of pre-tax profit in 2Q17, materially higher than in 2Q16 (CHF184 million adjusting for a non-recurring gain on sale) but still weighed down by the Strategic Resolution Unit (SRU), which the bank aims to reintegrate into the business by end-2018. Pre-tax profit accounted for 89bp of phased-in Basel III risk-weighted assets (RWA), and this would have almost doubled to 176bp excluding the SRU.

Performance at the Swiss Universal Bank (SUB) was sound, generating CHF502 million pre-tax profit, 11% higher yoy. The improvement was led by tight cost control and the corporate and institutional client segment, which benefitted from higher net interest income related to higher deposit balances and an uptick in domestic investment banking revenue. A number of individual exposures led to an increase in loan impairment charges compared with the last five quarters, but these are still in line with low historical losses, at CHF25 million. Corporate and Institutional clients accounted for just over half of SUB's pre-tax profit.

SUB's private banking segment generated sound net new asset growth of 3% and benefitted from higher transactional revenue, but pre-tax profit was slightly down as cost increases outpaced revenue growth. Gross and net margins on assets under management (AuM) fell yoy, reflecting higher AuM of CHF202 billion at end-2Q17, but remained sound at 146bp and 44bp respectively.

International Wealth Management (IWM) showed the strongest improvement, as pre-tax profit rose 49% yoy to CHF365 million. Private banking revenue, which accounted for almost three quarters of total divisional revenue, increased 14% yoy, due mainly to an 18% increase in net interest income, benefitting from higher net loans and US dollar interest rates. Recurring and transactional income also increased in IWM's private banking segment, leading to an increase in net AuM margins to a strong 36bp, despite strong 6% net new asset inflows in the quarter. The bank aims to improve collaboration revenue in IWM as it enhances the range and depth of its structured product offering. Asset management revenue remained broadly unchanged but with a higher proportion of fee income.

IWM's gross impaired loan ratio jumped 20bp qoq in 2Q17 to a still low 1%, as certain collateralised export finance exposures became impaired. Specialty financing, which includes collateralised lending to private banking clients, notably to finance ships, aviation and exports, remains a material part of the IWM loan portfolio.

A prolonged lull in market volatility and activity in Asia Pacific extended the fall in the absolute and relative revenue contribution of trading activities. These accounted for 61% of Asia Pacific divisional revenue in 2015, 47% in 2016 and 34% in 2Q17. Equity sales and trading revenue fell 40% yoy to CHF194 million, but remained ahead of fixed- income trading revenue, which were down 29% yoy. Trading activities in the region benefitted from expense reductions and posted a third consecutive quarterly loss, albeit much smaller at CHF8 million.

Private banking, underwriting and advisory activities in Asia Pacific remained the key drivers of the division and generated CHF196 million pre-tax income, 78% higher yoy due largely to higher transactional and recurring revenue. This led to improved net AuM margins, despite a higher AuM base and sound net new money inflows. Stronger advisory and underwriting revenue, linked to the bank's ultra-high net worth and entrepreneur clients, also helped divisional performance.

Global Markets (GM) generated CHF257 million pre-tax income in 2Q17, an improved performance on a weak 2Q16. Credit Suisse made progress towards meeting its targeted annual CHF6 billion revenue and CHF4.8 billion cost base for the division, but return on regulatory capital remained a muted 8%. Credit trading revenue rose 22% yoy to CHF926 million, led by the bank's strong franchise in securitised products and leveraged finance. This was a stronger performance than global trading and universal bank peers in a challenging quarter for fixed-income trading. However, credit accounted for 59% of divisional revenue, which in our view exposes GM to a cyclical downturn in credit markets.

Pre-tax profit in Investment Banking and Capital Markets fell 30% yoy, as strong underwriting and a healthy pipeline for mergers and acquisitions did not fully translate to revenue, which fell 6% yoy in 2Q17.

Credit Suisse's fully-loaded Basel III CET1 ratio rose 160bp qoq to a comfortable 13.3%, following the completion of a CHF4.1 billion rights issue in 2Q17. The bank now exceeds its Swiss too-big-to-fail going concern leverage ratio requirement of 3.5% of leverage exposure in CET1 capital by 30bp, and its going concern capital requirement of 5% of leverage exposure by 20bp. The Swiss regulator FINMA has imposed an add-on on Credit Suisse's operational risk exposures effective 3Q17 in respect of its residential mortgage-backed securities legal settlements. This would likely result in rising RWAs, which could however be mitigated by lower operational-risk RWAs in the SRU, subject to FINMA approval.

Contact:

Claudia Nelson
Senior Director
+44 20 3530 1191
Fitch Ratings Limited
30 North Colonnade
London E14 5GN

Luis Garrido
Associate Director
+44 20 3530 1631

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@fitchratings.com.

Additional information is available on www.fitchratings.com