

Half-yearly Report

for financial year 2018

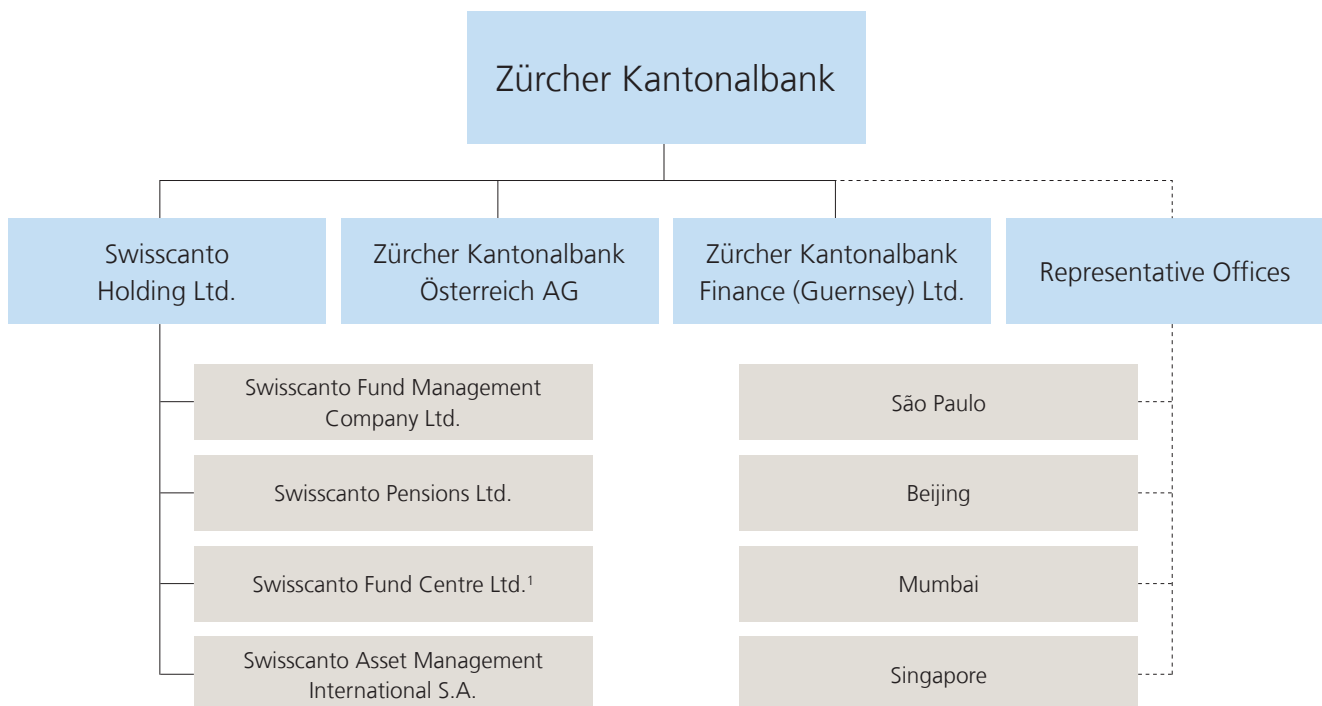
In Brief

Close to you

Zürcher Kantonalbank has successfully positioned itself as a full-service bank with a regional base as well as a national and international network. We are not only the largest cantonal bank in Switzerland, but also one of the largest Swiss banks. With a market share of around 50 percent, we are the top-ranked bank in the Canton of Zurich both in retail and corporate banking. We are also the third-largest fund provider in the country. Zürcher Kantonalbank is an autonomous public-law institution of the Canton of Zurich and benefits from a state guarantee.

Our public service mandate entails providing financial services for the public and businesses, supporting the canton in performing its economic, social and environmental responsibilities, and meeting sustainability and social requirements. We are part of life in the Canton of Zurich.

Group structure of Zürcher Kantonalbank



¹ On 23 April 2018, the sales agreement for the acquisition of Swisscanto Fund Centre Ltd. by Clearstream International S.A. Luxembourg was signed. The acquisition is expected to be completed in the third quarter of 2018.

About the figures:

The amounts stated in this report have been rounded off. The total may therefore vary from the sum of the individual values. The following rules apply to the tables:

- 0 (0 or 0.0) Figure that is smaller than half the unit of account used
- indication of figure not possible or not meaningful, or no figures are available

Key group figures

Income statement	in CHF million	1st half 2018	1st half 2017	Change 2018/2017 in %
Net result from interest operations		625	598	4.5
Result from commission business and services		396	378	4.9
Result from trading activities and the fair value option		151	187	-19.1
Other result from ordinary activities		39	22	73.7
Operating income		1,211	1,185	2.2
Operating expenses		-706	-706	-0.0
Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets		-65	-59	9.9
Changes to provisions and other value adjustments and losses		-5	-4	49.3
Operating result		436	417	4.5
Extraordinary result		8	7	7.8
Taxes		-5	-5	-1.3
Half-yearly consolidated profit		439	420	4.6

Balance sheet (before appropriation of profit)	in CHF million	30.6.2018	31.12.2017	Change in %
Balance sheet total		163,690	163,881	-0.1
Mortgage loans		80,271	79,087	1.5
Amounts due in respect of customer deposits		82,725	81,381	1.7
Provisions		582	585	-0.5
Equity		11,304	11,228	0.7

Key figures	in %	1st half 2018	1st half 2017
Return on equity (RoE)		8.0	8.0
Cost/income ratio (CIR) ¹		58.4	59.2
Common equity Tier 1 ratio (CET1) ²		16.3 ³	15.7
Core capital ratio ²		18.6 ³	17.9
Total capital ratio ²		18.6 ³	17.9
Leverage ratio ²		6.8	6.9
Liquidity coverage ratio (LCR) ⁴		136	132

Customers' assets	in CHF million	30.6.2018	31.12.2017	Change in %
Total customers' assets		298,167	288,802	3.2

Headcount/branches	Number	30.6.2018	31.12.2017	Change in %
Headcount after adjustment for part-time employees, as at the reporting date		5,144	5,117	0.5
Branches ⁵		75	78	

Rating agencies	Rating	30.6.2018	31.12.2017
Fitch		AAA	AAA
Moody's		Aaa	Aaa
Standard & Poor's		AAA	AAA

Scope of consolidation	Share in %	30.6.2018	31.12.2017
Zürcher Kantonalbank Finance (Guernsey) Ltd.		100	100
Zürcher Kantonalbank Österreich AG		100	100
Swisscanto Holding Ltd.		100	100

1 Calculation: Cost/income ratio (excl. changes in default-related value adjustments and losses from interest operations).

2 In accordance with the provisions for systemically important banks.

3 Incl. effects stemming from the changeover to IRB and SA-CCR as of 31.12.2017.

4 Simple average of the closing values on the business days during the 2nd quarter.

5 Incl. branches of Zürcher Kantonalbank Österreich AG in Salzburg and Vienna as well as six automated banks.

Business development

The first half of 2018 was marked by geopolitical events and a continuation of the negative interest rate environment. Considering this, the half-year result of Zürcher Kantonalbank appears in an even more positive light. With group profit of CHF 439 million, representing another year-on-year increase, Zürcher Kantonalbank posted an extremely gratifying result. We were once again able to boost our profitability despite heightening competition and the general pressure on margins. This performance confirms our diversification strategy and focus on internal efficiency.

The pleasing half-yearly result is reflected particularly in the main income positions. The result from interest operations was positive despite the low interest level and ongoing negative interest rates: it increased 4.5 percent to CHF 624.5 million. The result from commission business and services also rose, coming in at CHF 396.5 million, approximately 4.9 percent higher than in the previous year. The result from trading activities was not quite on a par with the previous year's very strong performance, but was nonetheless good, at CHF 151.4 million (previous year CHF 187.0 million). Operating expenses were stable year-on-year, at CHF 705.6 million. The half-year result was thus very positive.

This trend is reflected in the stable return on equity, amounting to 8.0 percent (1st half 2017: 8.0 percent). The cost/income ratio improved further, amounting to 58.4 percent (1st half 2017: 59.2 percent).

Equity and liquidity basis stable at a high level

Equity increased again due to the profit retained at year-end.

The equity ratio on 30 June 2018 was high, at 18.6 percent, compared with 17.9 percent on 30 June in the previous year. The ratio is significantly higher than the risk-based capital adequacy requirements for a systemically important bank (14.6 percent of risk-weighted assets) and testifies to Zürcher Kantonalbank's good capitalisation.

Likewise, the leverage ratio, at 6.8 percent, is still significantly higher than the 4 percent required for systemically important banks.

The LCR, which is calculated as a simple average of the closing values on the business days during the quarter under review, was 136 percent for the group, significantly higher than the required 100 percent.

AAA bank

The rating agencies Fitch, Moody's and Standard & Poor's continue to give Zürcher Kantonalbank first-class ratings: AAA, Aaa and AAA respectively.

Very pleasing half-year result

Zürcher Kantonalbank generated a very good consolidated profit of CHF 439 million in the first half of 2018, up by around 5 percent year-on-year. This result reflects not least the confidence and the satisfaction of our clients.

Increase in operating result

The operating result again increased year-on-year, by around CHF 19 million to CHF 436 million, and is thus 4.5 percent higher than in the prior-year period. A break-down of the operating result is shown in the related chart below.

Pleasing operating income

In the first half of 2018, operating income was CHF 1.2 billion, up by CHF 26 million or 2.2 percent compared with the prior-year period.

This shows that the diversified income structure is still of benefit. With a share of 52 percent, interest operations continue to represent one of the bank's most important income streams, followed by the commission business and services with a 33 percent share. Trading activities, the bank's third most important source of income, accounted for 12 percent of operating income.

Appealing interest income

Despite the many challenges posed by the heightening competition and the ongoing negative interest rates, Zürcher Kantonalbank was able to increase its net result from interest operations by 4.5 percent year-on-year. At the same time, the mortgage business grew in line with the market, picking up by 1.5 percent. For the first half of 2018, a net result from interest operations of CHF 625 million was reported (previous year: CHF 598 million).

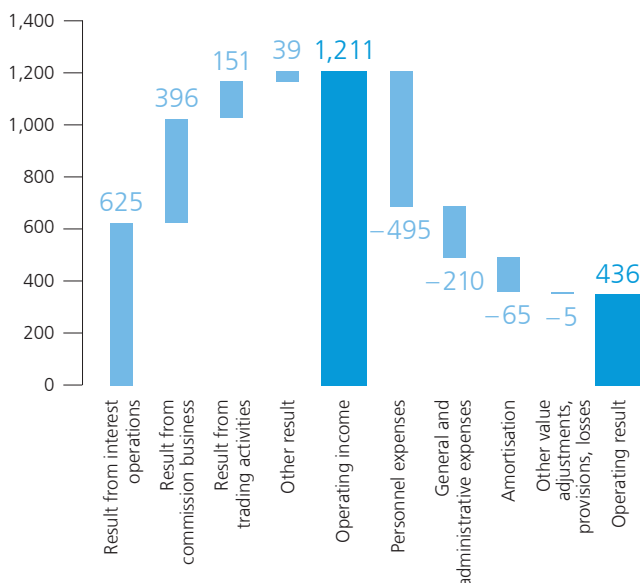
Zürcher Kantonalbank paid the Swiss National Bank negative interest amounting to around CHF 73 million.

Successful commission business and services

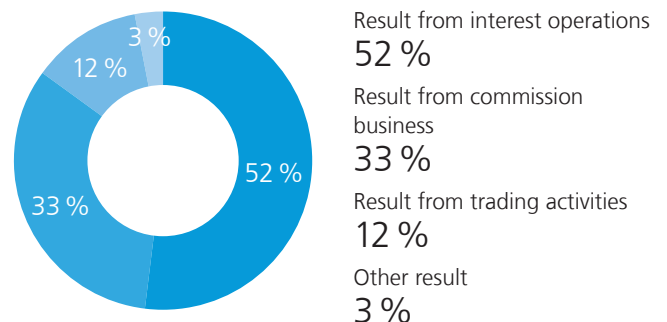
In the first half of 2018, the bank was able to continue the positive trend in the commission business and services. The result from commission business and services was CHF 396 billion, up by around CHF 18 million or 4.9 percent compared with the prior-year period.

Securities trading and investment activities continued to contribute the largest share (81 percent) to the result from commission business and services. The positive trend in this area was thus all the more significant.

Breakdown of operating result (in CHF million)



Breakdown of operating income (in %)



Robust trading activities

Zürcher Kantonalbank’s trading activities are still largely client-related. The market risks in the trading book (value at risk with a holding period of 10 days) remained low, averaging CHF 13 million.

At CHF 151 million, the result from trading activities was on target, but considerably below the very high prior-year level of CHF 187 million. The result from trading in bonds, interest rates and credit derivatives (CHF 36 million) in particular decreased nearly a third compared to the previous half-year result. This was primarily due to the above-mentioned geopolitical events and related uncertainties, influencing the market environment negatively.

Stable operating expenses

Operating expenses were CHF 706 million in the first half of 2018 and thus in line with the prior-year level. General and administrative expenses were slightly higher year-on-year, but this was offset by lower personnel expenses.

A breakdown of personnel expenses, totalling CHF 495 million (previous year: CHF 501 million), and general and administrative expenses, totalling CHF 210 million (previous year: CHF 205 million), is shown in the chart below entitled “Development of operating expenses”.

Compensation to the canton for its state guarantee, which is also included in general and administrative

expenses, amounted to CHF 11.3 million for the first six months of 2018, slightly down on the first half of 2017 (CHF 11.5 million).

The cost/income ratio improved further to 58.4 percent (1st half 2017: 59.2 percent).

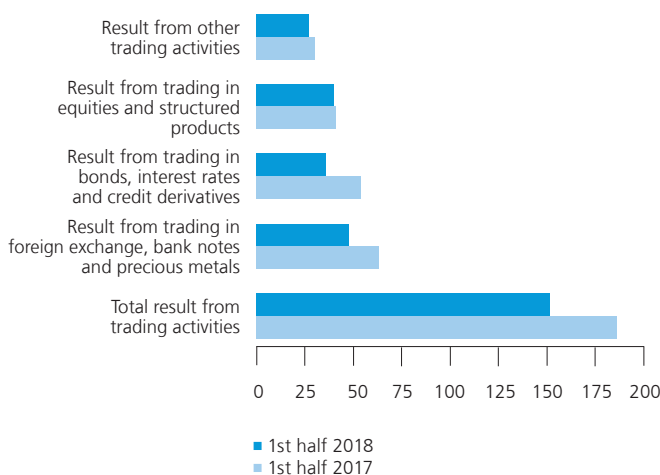
Reduction in the net allocation to value adjustments and provisions

Zürcher Kantonalbank assesses credit default risks and other recognisable risks on an ongoing basis. Where necessary, it makes appropriate value adjustments or provisions.

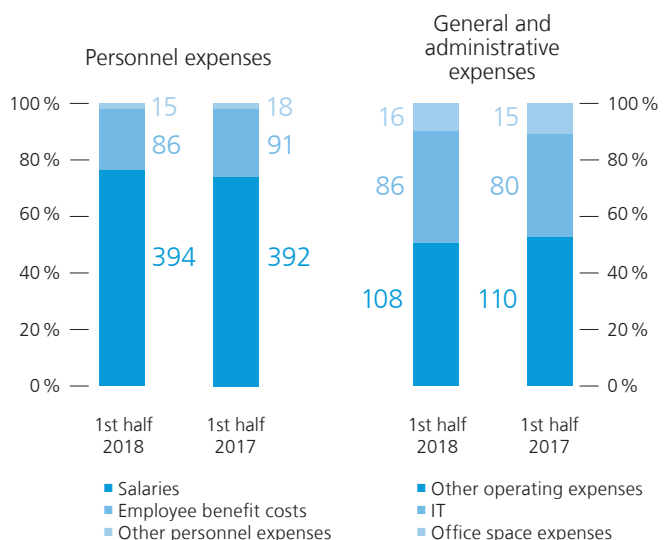
The first half of 2018 saw a net unwinding of value adjustments for default risks and losses from interest operations amounting to CHF 3 million (1st half 2017: net creation of CHF 7 million). Changes to provisions and other value adjustments and losses were CHF 5 million for the first half of 2018 and thus slightly up year-on-year (prior-year period: CHF 4 million).

Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets amounted to CHF 65 million, CHF 6 million higher than in the first half of 2017. This was mainly due to higher ordinary amortisation on the goodwill of the Swisssanto Group as a result of a further earn-out payment in autumn 2017.

Result from trading activities by area (in CHF million)



Development of operating expenses (in CHF million)



Comfortable refinancing situation

Total assets were CHF 163.7 billion as at 30 June 2018, down by an insignificant 0.1 percent compared with 31 December 2017. There were no material changes to assets and liabilities either. Mortgage loans amounted to CHF 80.3 billion versus amounts due in respect of customer deposits of CHF 82.7 billion.

Zürcher Kantonalbank's refinancing situation thus remains comfortable.

Adequate liquidity

Liquid assets were at a high level as at the middle of the year, totalling CHF 37.6 billion, although slightly lower than at the end of 2017. Deposits with the Swiss National Bank continued to account for most of the liquid assets.

These deposits are directly related to the liquidity requirements, which are particularly high for systemically important banks such as Zürcher Kantonalbank.

Ongoing mortgage growth

The total mortgage portfolio grew in the first six months of 2018 by CHF 1.2 billion or 1.5 percent to CHF 80.3 billion. This growth reflects the general market trend. The share of fixed-rate mortgages (including ZKB starter mortgages and ZKB environmental loans) amounted to 91 percent, unchanged from end-2017.

When granting mortgages, Zürcher Kantonalbank remains focused on loan quality. It therefore continues to base its affordability calculations on an imputed mortgage interest rate of 5 percent.

Slightly higher client deposits

Client deposits comprise savings and investments as well as other liabilities to clients. As at 30 June 2018, these amounted to CHF 82.7 billion, compared with CHF 81.4 billion at the end of 2017. This corresponds to an increase of 1.7 percent.

New investment world bears fruit

In the area of wealth management, Zürcher Kantonalbank launched a new advisory approach at the start of 2018, which combines the bank's full investment expertise with cutting-edge technology. The entire investment advisory approach is supported digitally. As all the bank's technical systems are linked, clients can get an overview of their

asset situation and position at any time. Our Chief Investment Officer (CIO), together with his team of experts, is responsible for providing strategy and analysis, as well as compiling a reference portfolio with an optimised risk/return ratio. The bank has introduced additional products for advisory mandates. Clients with advisory mandates can now also benefit directly from the investment expertise of the CIO and his team of experts and receive investment proposals based on their risk profile. Additionally, client portfolios are continually monitored and checked for potential risks. Clients thus receive investment solutions tailored to their needs with clearly defined services and fees.

Customers' assets increased by CHF 9.3 billion to CHF 298.2 billion in the first half of 2018. The net new money inflow was CHF 12.0 billion.

2018 remains challenging

In view of the global geopolitical environment and the resulting uncertainty in the markets, Zürcher Kantonalbank expects the year to remain challenging.

We are convinced that our broadly diversified business model and client proximity will continue to bear fruit. We expect the positive economic conditions to remain in place. However, it must be assumed that the political uncertainties will continue to shape the market environment. We are nonetheless confident that we will perform well again in the second half of 2018 and thus be able to present pleasing annual results.

Consolidated income statement

in CHF million	1st half 2018	1st half 2017	Change	Change in %
Result from interest operations				
Interest and discount income	881	776	105	13.6
Interest and dividend income from financial investments	24	25	-1	-4.6
Interest expense	-284	-196	-88	44.8
Gross result from interest operations	621	605	16	2.7
Changes in value adjustments for default risk and losses from interest operations	3	-7	-11	-
Subtotal net result from interest operations	625	598	27	4.5
Result from commission business and services				
Commission income from securities trading and investment activities	411	394	18	4.5
Commission income from lending activities	24	26	-1	-5.6
Commission income from other services	70	68	2	3.4
Commission expense	-109	-109	-0	0.2
Subtotal result from commission and business services	396	378	18	4.9
Result from trading activities and the fair value option	151	187	-36	-19.1
Other result from ordinary activities				
Result from the disposal of financial investments	2	0	2	906.0
Income from participations	30	14	16	108.9
– of which, participations valued using the equity method	1	2	-1	-41.6
– of which, from other non-consolidated participations	29	13	16	127.4
Result from real estate	3	4	-1	-23.4
Other ordinary income	5	4	1	23.3
Other ordinary expenses	-1	-1	-1	138.7
Subtotal other result from ordinary activities	39	22	17	73.7
Operating income	1,211	1,185	26	2.2
Operating expenses				
Personnel expenses	-495	-501	6	-1.1
General and administrative expenses	-210	-205	-5	2.6
Subtotal operating expenses	-706	-706	0	-0.0
Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets	-65	-59	-6	9.9
Changes to provisions and other value adjustments and losses	-5	-4	-2	49.3
Operating result	436	417	19	4.5
Extraordinary income	8	7	1	7.7
Extraordinary expenses	-	-0	-	-
Taxes	-5	-5	0	-1.3
Half-yearly consolidated profit	439	420	19	4.6

Balance sheet

before appropriation of profit

in CHF million	30.6.2018	31.12.2017	Change	Change in %
Assets				
Liquid assets	37,586	41,147	-3,561	-8.7
Amounts due from banks	4,550	4,457	93	2.1
Amounts due from securities financing transactions	14,763	14,326	437	3.0
Amounts due from customers	8,431	7,832	600	7.7
Mortgage loans	80,271	79,087	1,184	1.5
Trading portfolio assets	9,758	8,922	836	9.4
Positive replacement values of derivative financial instruments	1,529	1,535	-6	-0.4
Other financial instruments at fair value	-	-	-	-
Financial investments	4,918	4,740	179	3.8
Accrued income and prepaid expenses	338	281	57	20.4
Non-consolidated participations	133	130	3	2.5
Tangible fixed assets	750	775	-25	-3.2
Intangible assets	173	192	-19	-9.7
Other assets	490	458	32	6.9
Total assets	163,690	163,881	-191	-0.1
Total subordinated claims	148	188	-40	-21.2
- of which, subject to conversion and/or debt waiver	38	31	8	25.5
Liabilities				
Amounts due to banks	35,518	35,393	126	0.4
Liabilities from securities financing transactions	5,483	6,623	-1,140	-17.2
Amounts due in respect of customer deposits	82,725	81,381	1,345	1.7
Trading portfolio liabilities	2,158	1,859	299	16.1
Negative replacement values of derivative financial instruments	813	867	-54	-6.2
Liabilities from other financial instruments at fair value	2,954	2,869	85	3.0
Cash bonds	180	191	-10	-5.5
Bond issues	11,263	12,419	-1,156	-9.3
Central mortgage institution loans	9,411	9,275	136	1.5
Accrued expenses and deferred income	589	634	-44	-7.0
Other liabilities	709	558	151	27.0
Provisions	582	585	-3	-0.5
Bank's capital	2,425	2,425	-	-
Retained earnings reserve	8,445	8,026	419	5.2
Foreign currency translation reserve	-5	-4	-0	9.7
Half-yearly consolidated profit	439	782	-343	-43.8
Equity	11,304	11,228	76	0.7
Total liabilities	163,690	163,881	-191	-0.1
Total subordinated liabilities	1,494	1,513	-19	-1.3
- of which, subject to conversion and/or debt waiver	1,494	1,513	-19	-1.3
Off-balance-sheet transactions				
Contingent liabilities	3,903	4,086	-183	-4.5
Irrevocable commitments	8,388	8,015	373	4.7
Obligations to pay up shares and make further contributions	235	233	3	1.1
Credit commitments	-	-	-	-

Consolidated statement of changes in equity

in CHF million	Bank's capital	Retained earnings reserve	Consolidated profit	Foreign currency translation reserve	Total equity
Total equity as at 1.1.2017					
Opening amount	2,425	8,376	–	–8	11,793
Effect of any restatement	–	–	–	–	–
Capital increase	–	–	–	–	–
Capital decrease	–	–	–	–	–
Increase in scope of capital consolidation	–	–	–	–	–
Decrease in scope of capital consolidation	–	–	–	–	–
Other contributions/other capital paid in	–	–	–	–	–
Reclassifications	–	–	–	–	–
Currency translation differences	–	–	–	4	4
Dividends and other distributions	–	–351	–	–	–351
Valuation adjustments with no income effect	–	0	–	–	0
Other allocations to (transfers from) other reserves	–	–	–	–	–
Consolidated profit	–	–	782	–	782
Total equity as at 31.12.2017	2,425	8,026	782	–4	11,228

Total equity as at 1.1.2018

Opening amount	2,425	8,808	–	–4	11,228
Effect of any restatement	–	–	–	–	–
Capital increase	–	–	–	–	–
Capital decrease	–	–	–	–	–
Increase in scope of capital consolidation	–	–	–	–	–
Decrease in scope of capital consolidation	–	–	–	–	–
Other contributions/other capital paid in	–	–	–	–	–
Reclassifications	–	–	–	–	–
Currency translation differences	–	–	–	–0	–0
Dividends and other distributions	–	–363	–	–	–363
Valuation adjustments with no income effect	–	–0	–	–	–0
Other allocations to (transfers from) other reserves	–	–	–	–	–
Half-yearly consolidated profit	–	–	439	–	439
Total equity as at 30.6.2018	2,425	8,445	439	–5	11,304

Disclosure of capital and liquidity

A disclosure in line with capital and liquidity requirements is published in a separate report at zkb.ch (keyword "disclosures").

Condensed notes

Changes in accounting and valuation principles

In the first half of 2018, the following change to the accounting and valuation principles was made:

Property gains tax is a direct tax, like tax on profits and capital. It is charged on the sale of a property. In cantons with a two-tier system (such as Lucerne), this is taxed as ordinary tax on profits. In cantons with a one-tier system (such as Zurich), property gains are subject to a special tax. Previously, property gains tax was offset against gains from the sale of real estate and was recognised as extraordinary income. To improve comparability, property gains tax is now recognised separately in the income statement position taxes, with a corresponding impact on the position.

For further information about the applicable accounting and valuation principles, please see the annual report for 2017.

Factors affecting the 2018 half-yearly result

The global economy is in a much healthier state than it had been for a long time. The Swiss economy also proved to be extremely robust. In the first quarter, the economic indicators and the labour market in the euro zone pointed firmly upwards. At the same time, US wages grew at a pace that was last seen in 2009, sparking increasing inflationary expectations in the United States. This in turn prompted fears that the Federal Reserve and the European Central Bank (ECB) would start to tighten the monetary reins more quickly than expected at the end of last year. These fears weighed on the markets. However, in view of the continued moderate inflationary trend, there was no reason for the central banks to stifle the upswing with aggressive rate hikes. Accordingly, the European Central Bank postponed its policy reversal. The Swiss National Bank thus left its monetary policy unchanged. The financial markets were also influenced by geopolitical uncertainties, such as the heightening tension between North Korea and the United States in the first quarter and the trade dispute announced and initiated by the United States.

Extraordinary result

in CHF million	1st half 2018	1st half 2017
Extraordinary income		
Reversal of impairment on other participations	0	5
Income from sale of other real estate/bank premises	7	2
Income from sale of participations	–	–
Other	0	–0
Total	8	7
Extraordinary expenses		
Losses from sale of other real estate/bank premises	–	–
Loss from sale of participations	–	–
Other	–	0
Total	–	0

In the first half of the financial year, no material value adjustments or provisions no longer required were recorded.

Events occurring after the date of the interim financial statement

The investigations initiated in September 2011 by the US Department of Justice (DOJ) and the US Internal Revenue Service (IRS) into Zürcher Kantonalbank's cross-border business with US customers were concluded on 13 August 2018, with Zürcher Kantonalbank agreeing to pay a settlement of USD 98.5 million. Throughout the entire duration of the investigations, Zürcher Kantonalbank continuously assessed all arising risks and took necessary measures to mitigate these risks. The payment to the US Department of Justice will not negatively impact the bank's 2018 financial results, capital strength or profit distribution to the canton and municipalities. The payment will be made and recognised in the second half of 2018.

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