NATIONAL BANKING MARKET ASSESSMENT
NORWAY

PRIMARY ANALYST

Geir Kristensen
+47 90 78 45 93
geir.kristensen@nordiccreditrating.com

SECONDARY ANALYST

Sean Cotten
+46 732 32 43 78
sean.cotten@nordiccreditrating.com

Nordic Credit Rating (NCR) applies a score of 'a' for the Norwegian banking market and expects the domestic operating environment to be rather benign for Norwegian banks over the next two to three years. Despite higher capital requirements, Norwegian banks have outperformed European peers in terms of earnings and efficiency and have managed a downturn in the oil and offshore segment with robust loss performance in recent years.

The banking market score is a component of NCR's issuer ratings for financial institutions. Depending on the nature of the rated entity's exposure and geographic profile, the score can affect up to 20% of an issuer's overall credit rating.

Figure 1. Norway – scoring of national indicators

SUBFACTOR	SCORE	RATIONALE
Sovereign strength	aa	Major credit rating agency average: AAA, minimum: AAA.
Output growth	a	We expect moderate but increasing economic growth due to greater investment in the oil industry.
Credit growth	bbb	Credit growth is more than twice GDP growth, but growth is slowing due to expectations of higher interest rates and high debt levels.
Housing prices	bbb	We expect strong growth in housing prices to slow due to higher interest rates and increased supply.
Unemployment	aa	Unemployment is low and falling.
Available stable funding	a	Available stable funding in the form of stable deposits and domestic covered bonds exceeds monetary financial institution (MFI) private-sector loans in most foreseeable market conditions.
International cycle	bbb	Global growth prospects are improving, though supported by significant monetary stimulus. Increasing trade rhetoric and the prospect of the UK leaving the EU without a trade agreement could affect economic growth. Asset prices are at or near peak levels.

Figure 2. Norway – key banking metrics

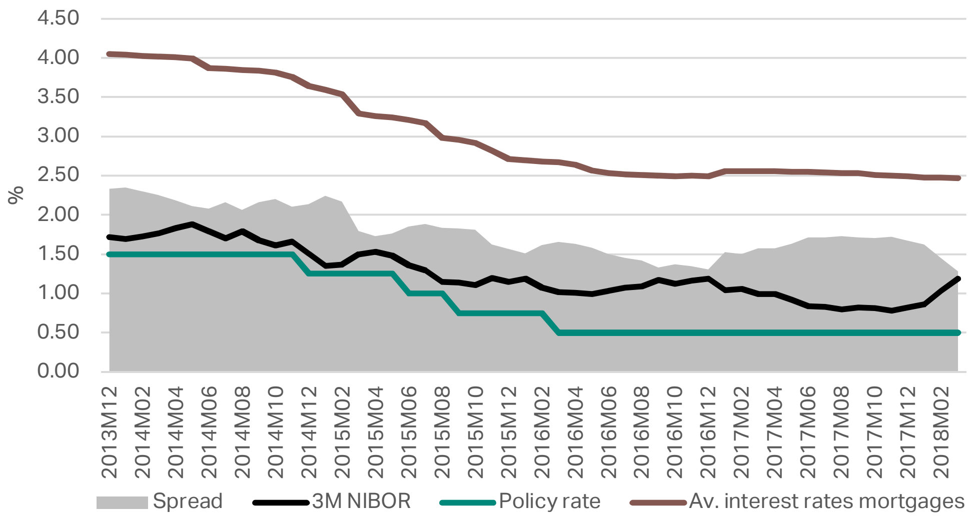
	2014	2015	2016	2017	2018–2020
Growth in credit to the private non-financial sector (%)	6.0	6.1)	4.6	6.4	Lower growth
Real housing price growth (%)	2.7	6.0	7.0	5.0	Flat
Net interest margin (%)	1.5	1.5	1.5	1.5	Slight decrease
Problem loans/gross loans (%)	1.0	0.8	1.2	0.9	Flat

Source: BIS, aggregated bank reports

NATIONAL ECONOMY

Norway is currently experiencing growth marginally above trend, after a period of low growth in large part due to the volatile oil segment. We expect Norway to show strong economic performance over the next few years. The Norwegian central bank estimates total GDP growth to be 1.8% for 2018 and 2.2% for 2019. Mainland GDP, which has been boosted by a weaker currency, low interest rates and increasing housing prices, is projected to grow by 2.5% annually over the next two years. Underlying the anticipated improvement is a return of international and domestic oil investment, offsetting an expectation of reduced real-estate projects, as well as a positive economic environment outside Norway.

Figure 3: Norwegian interest rates (%), 2013–2018



Source: Statistics Norway

In addition to higher growth expectations, the central bank is signalling a broad recovery from the fall in oil-related investment that has affected Norway since 2015. The central bank estimates that employment will grow by 1.6% in 2018, resulting in an unemployment rate below 4%. On 20 Sept. 2018 the central bank raised the policy rate by 25 bps to 0.75% and anticipates a gradual rise towards 1.9% in 2021. Increasing interest rates will be important to maintain the bank's 2% inflation target as the recovering oil sector could stimulate wage growth to pre-2015 levels.

Figure 4. Norway – Key national metrics, 2014–2020

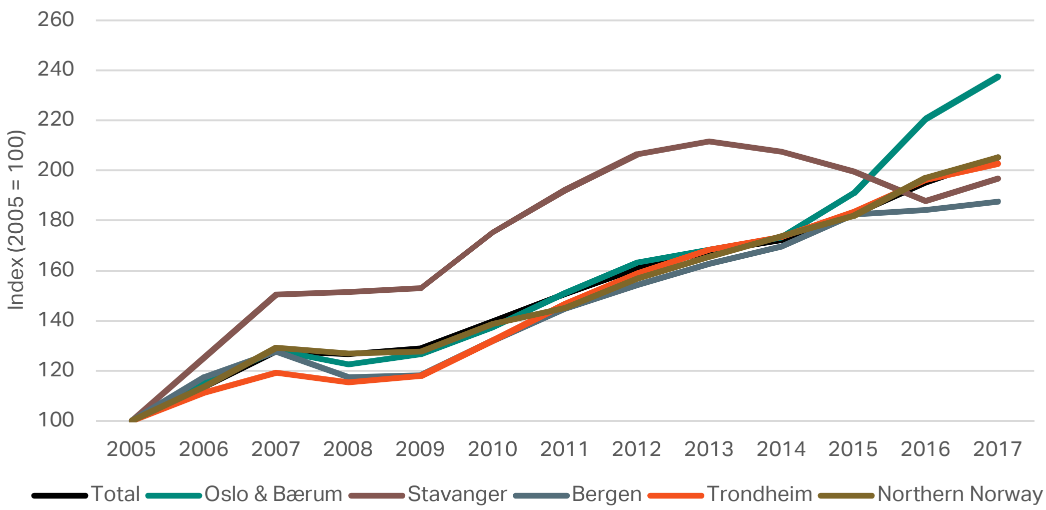
	2014	2015	2016	2017	2018e	2019e	2020e
Real GDP growth* (%)	2.2	1.4	1.0	1.9	2.4	2.3	2.0
Core CPI growth (%)	2.4	2.7	3.0	1.4	1.4	1.6	1.7
Unemployment rate (%)	3.6	4.5	4.7	4.1	3.7	3.5	3.3
Current account balance/ GDP (%)	11.0	8.0	3.9	5.7	8.1	7.8	8.3
Central bank policy rates	1.3	0.8	0.5	0.5	0.76	1.26	1.72

*Mainland
Source: Economist Intelligence Unit, NCR consensus estimates. e–Estimate.

HOUSING MARKET

A long period of growth in Norwegian housing prices was subject to a modest correction in 2017 as the market responded to new mortgage lending rules targeting the most indebted households and large volumes of new housing entering the market. Housing prices have rebounded in 2018, prompting the ministry of finance to extend mortgage lending restrictions associated with debt-to-income ratios and collateral values on residential mortgages and home equity credit lines until year-end 2019. We anticipate that the housing market will remain unsettled as borrowers adjust to new amortisation requirements and expectations of rising interest rates from recent historic lows, and as the market absorbs a relatively high level of housing completions.

Figure 5. Norwegian regional housing prices, 2005–2017

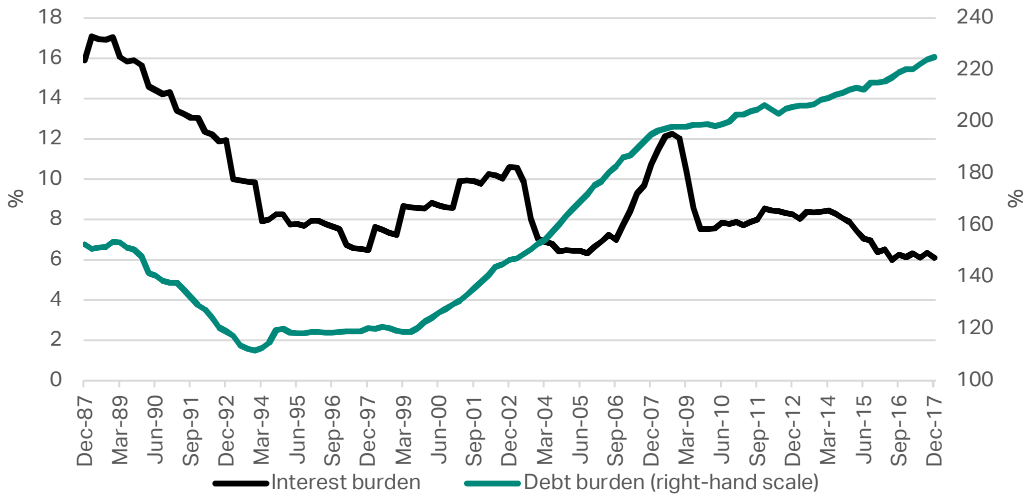


Source: Statistics Norway

CREDIT GROWTH

Lending growth in Norway has in recent years been stable at around 6%, albeit higher in the Oslo region. A major concern for the Norwegian financial regulator is the increased debt burden among households, which will become problematic if interest rates increase significantly, particularly since 95% of mortgage loans in Norway have floating interest. The regulator also demonstrated its concerns over the growing consumer loan market by introducing prohibitive underwriting guidelines into law, which should serve to reduce the attractiveness and size of consumer loans.

Figure 6. Norwegian household debt burden and interest burden, 1987–2017

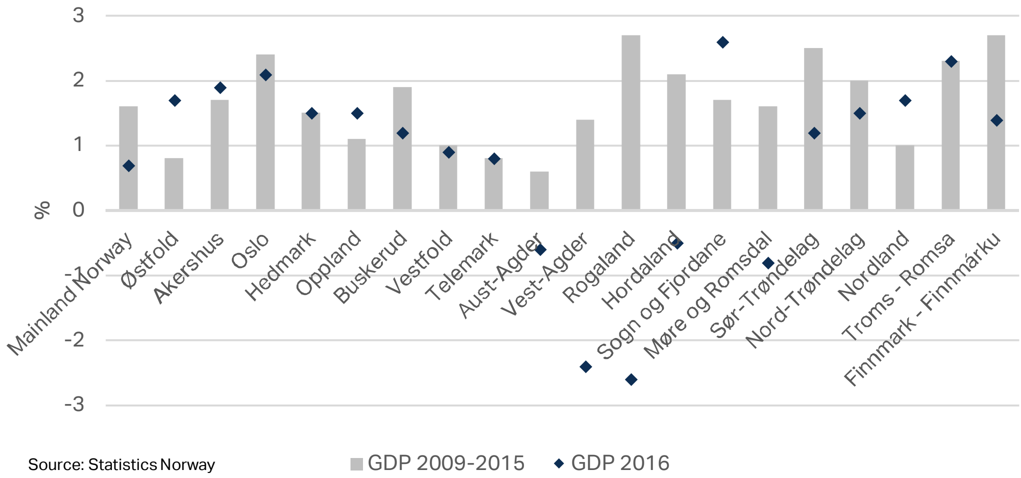


Source: FSA, Statistics Norway

REGIONAL ANALYSIS

There have been significant variations in economic development in the different regions of Norway due to differences in the exposure to the oil sector. Most notably the counties of Rogaland and Hordaland in western Norway and the Agder counties in southern Norway have been affected by higher unemployment and weaker housing price development than the average as a result of lower activity in the oil sector. However, other regions have benefited from the weaker Norwegian currency, low interest rates, housing investment and public-sector spending on infrastructure. These factors have been particularly beneficial to non-oil sectors in oil-exposed regions and have also contributed to strong economies in northern and eastern Norway. There has been a boom in a number of industries, including construction, tourism, salmon farming and fishing. Strong public finances, monetary stimulus and the weaker currency have protected the mainland economy from spillover effects from the recent downturn in the oil industry.

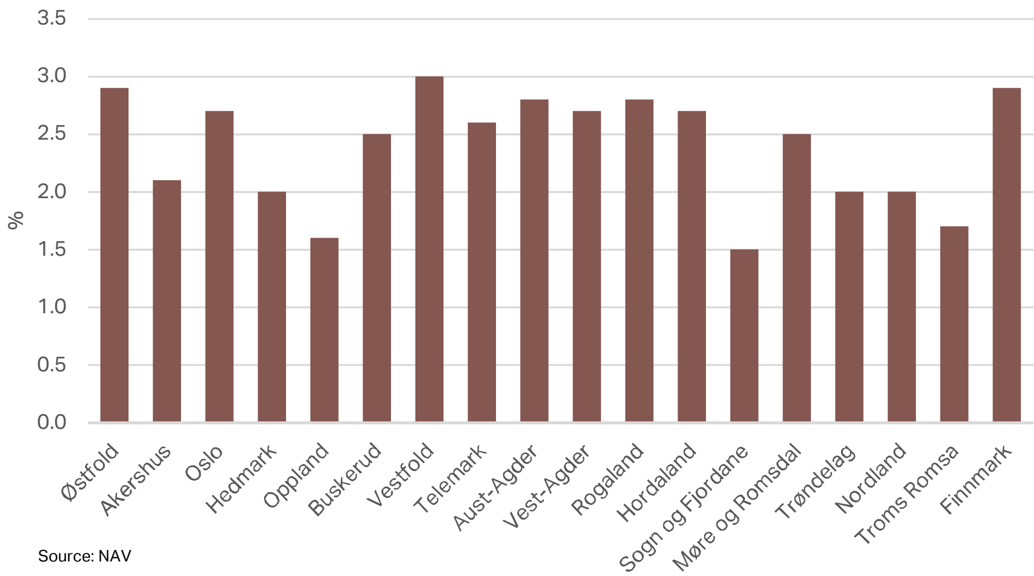
Figure 7. Effect of the oil crisis on Norway – average GDP growth 2009–2015, and per county in 2016



Source: Statistics Norway

The central bank's regional network report from 11 Sept. 2018 confirmed that all regions have experienced healthy economic growth over the past three-months and that the industry also expects the same or higher growth over the next three months. The strongest growth is seen in central, southern and eastern Norway, while the largest improvement is expected in northern Norway and capacity constraints are close to the historical average. Unsurprisingly, the report confirms that the oil industry is growing again, boosted by higher oil prices and the development of the Sverdrup oil field. Statistics Norway forecasts that investment in the oil industry will be up by 10% in 2019.

Figure 8. Unemployment in Norway by county as of Aug. 2018 (registered unemployed as % of workforce)



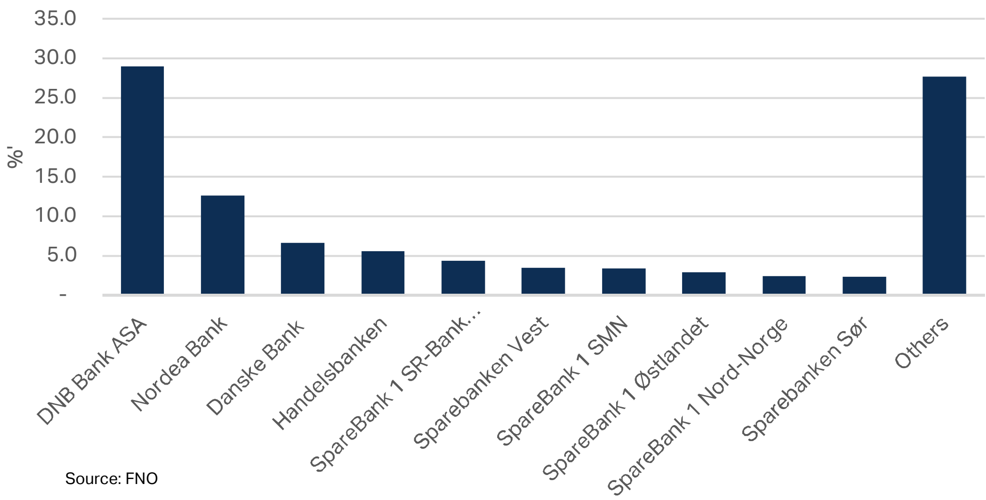
Source: NAV

BANKING MARKET

We expect that the slightly decreasing trend in the credit indicator C2 (gross domestic debt to the general public) will accelerate over the next couple of years due to higher interest rates and flattish housing price development. In the short term, we expect higher interest rates to reduce margins due to time-lag effects (six weeks lag in interest rate increases to households), but in the longer term higher interest rates should be beneficial for net interest margins. This depends, however, on competition for mortgage loans and the ability for banks to pass higher funding costs on to customers. Everything else being equal, we also expect higher interest rates to lead to more non-performing loans, but low unemployment and a strong business cycle, particularly in the oil industry, will most likely keep non-performing loans in check.

Norway's banking market has experienced far less consolidation than the other Nordic markets, with 99 savings banks and 22 commercial and consumer banks in the country. In addition, there are 25 foreign banks operating in Norway, including a significant number of branches of Nordea Bank, Danske Bank and Svenska Handelsbanken. As a result, only DNB and government-owned Kommunalbanken are defined as systemically important financial institutions (SIFI) for capital requirement purposes.

Figure 9. Lending market share of banks in Norway, Aug. 2018

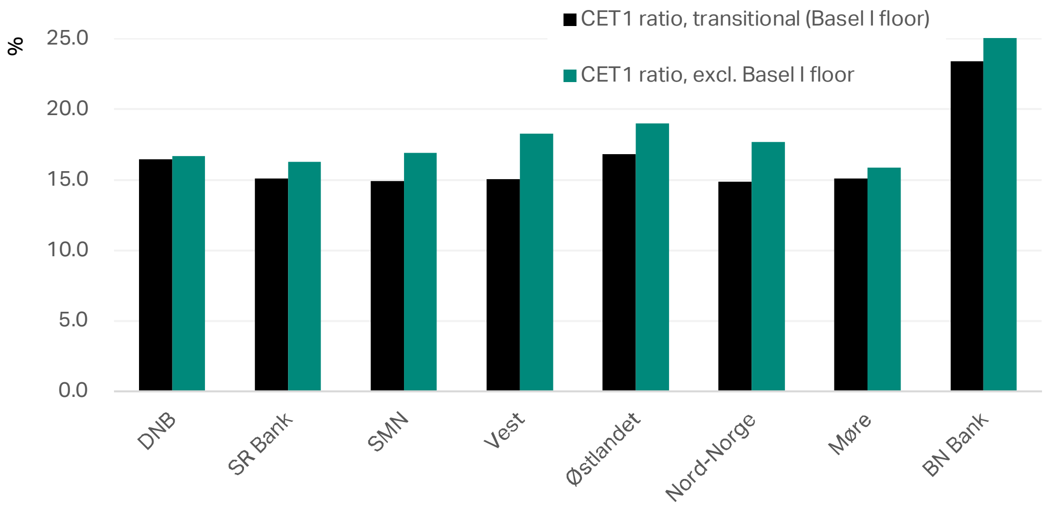


Source: FNO

CAPITAL

Norwegian banks have developed significant equity buffers, particularly since 2011 when stricter capital requirements were introduced. One key difference compared with other Nordic markets is that the common equity Tier 1 (CET1) ratios and capital requirements of Norwegian banks continue to be based on risk-weighted assets (RWA) using the Basel I floor. NCR considers capital ratios excluding the Basel I floor in its capital assessments to improve comparability, while remaining aware that the legal requirement is defined by RWA including the Basel I floor. The effect of the Basel I floor on Norwegian IRB banks is illustrated below; excluding the Basel I floor improves the average CET1 ratio for these banks by 1.8 percentage points, to 18.2% from 16.4% as of year-end 2017.

Figure 10. CET1 ratios for selected Norwegian banks with and without the Basel I floor, 2017



Source: NCR estimates using company data. From left: DNB ASA, SpareBank 1 SR-Bank, SpareBank 1 SMN, Sparebanken Vest, SpareBank 1 Østlandet, SpareBank 1 Nord-Norge, Sparebanken Møre, BN Bank

On 22 Oct. 2018, the FSA suggested that more Norwegian banks should be considered systemically important financial institutions (SIFI) and subject to higher capital requirements to ensure that they remain resilient during a downturn. In particular, the FSA proposes that six banks[1] with more than 10% regional market share should be defined as SIFIs and receive 2% additional CET1 requirement. It is noteworthy that this increase will effectively cancel out the impact of removing the Basel I floor from 2022 and, as such, follows the FSAs history of maintaining existing capital levels, despite changes in risk-weighted asset calculations. See a further discussion of Norwegian banks' capital in NCR's commentary *Nordic Banks Capital Measures Lack Comparability*, published on 20 Sept. 2018.

AVAILABLE STABLE FUNDING

Given the high share of private savings entrusted to institutional investors via mutual funds and pension assets, the loan-to-deposit ratio of Norwegian banks is not an ideal measure of the market's stable funding. Our evaluation of Norwegian bank funding therefore considers in particular domestic covered-bond financing, given the demonstrated resilience, perceived support and liquidity of domestic covered bonds.

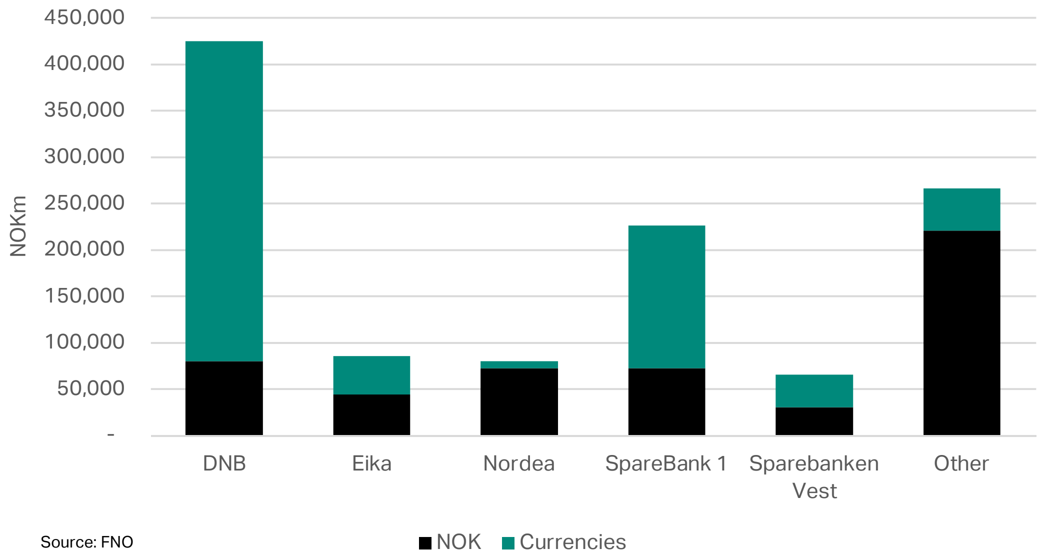
In part due to investment restrictions on the NOK 8bn Government Pension Fund Global, Norwegian banks are reliant on international investors for a material share of issued covered bonds. The fact that only 45% of the NOK 1.1tr is issued in NOK leads us to consider covered bonds in foreign currencies (49% in EUR, 4% in USD and 2% in other currencies) as less stable sources of funding. In addition, Norway has 26 issuers with outstanding covered bonds, resulting in more significant differences in liquidity and pricing among Norwegian covered-bond issuers than Nordic peers. This is a factor that could be exacerbated during a stressed scenario, when investors may flock to more established, liquid issuers.

[1]Sparebank 1 Nord-Norge, Sparebank 1 SMN, Sparebanken Vest, Sparebank 1 SR-Bank, Sparebanken Sør and Sparebank 1 Østlandet. DNB and Kommunalbanken are currently the only SIFIs in Norway.

We anticipate that Norway's implementation of the bank recovery and resolution directive (BRRD) will increase already strong protection for covered-bond investors by excluding them from bail-in. In addition, the use of long-term senior unsecured financing is a key fixture of Norwegian bank financing, in part as an alternative to covered bonds, leaving qualifying mortgages available for contingency financing via issuance and repurchase agreements with the central bank. NCR deems the markets to have a strong interest in Norwegian financing at long maturities and reasonable spreads.

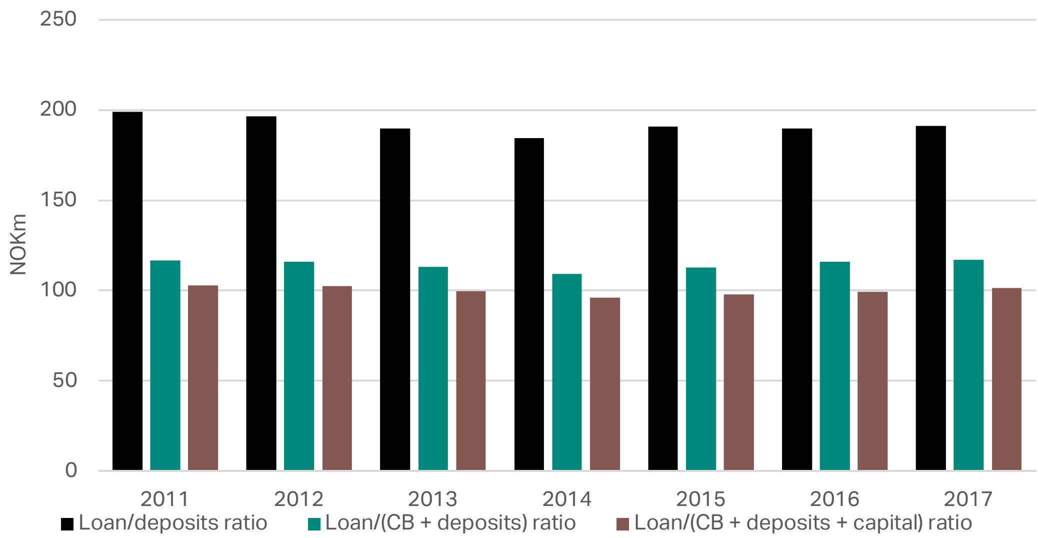
During the financial crisis, the Norwegian government demonstrated its willingness and ability to set up liquidity facilities for the Norwegian banking sector in a credit crunch. Moreover, Norwegian banks have relatively lower gearing than international peers and a large part of market funding is long term, which makes the banks less vulnerable in a short-lived credit crunch.

Figure 11. Norwegian covered-bond companies – outstanding volume as of Q1 2018



Source: FNO

Figure 12. Loans as % of deposits, covered-bond financing and Tier 1 and Tier 2 capital for Norwegian banks



Source: Statistics Norway

BANKING MARKET ASSESSMENT

The banking market score of 'a' for Norway is a component of NCR's issuer ratings for financial institutions operating in the Norwegian banking market. Depending on the nature of a rated entity's exposure and its geographic profile, the score can affect up to 20% of an issuer's overall credit rating. For more information, please refer to Financial Institutions Rating Methodology, 13 Aug. 2018.

APPENDIX

Figure 13. Norway – key credit metrics, 2011–2017

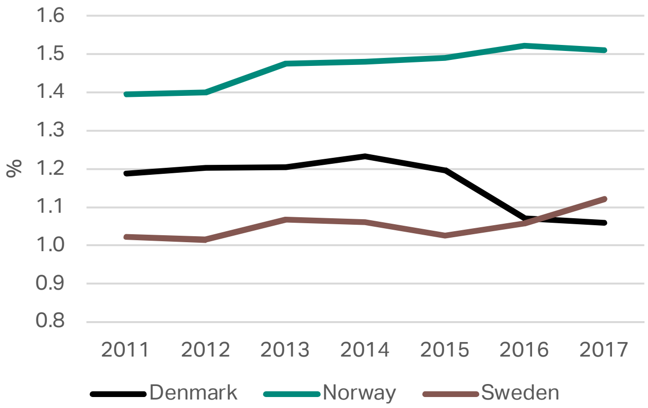
	2011	2012	2013	2014	2015	2016	2017
Credit to households (%)	81.5	82.9	85.6	89.1	95.2	101.4	102.3
Credit to non-financial corporations (%)	136.9	142.7	137.4	140.2	153.8	151.4	143.3
Growth in credit growth to the private non-financial sector (%)	(7.3)	7.2	(2.5)	6.2	19.7	3.8	(7.2)
Household savings/disposable income (%)	5.9	7.1	7.4	8.2	10.3	7.1	7.3
Debt service ratios of households	14.6	15.1	15.4	15.3	14.6	14.4	14.8
Nominal residential property prices, 2010 = 100	108.0	115.3	120.0	123.2	130.8	139.9	146.9
Real residential property prices, 2010 = 100	106.6	113.1	115.2	116.0	120.4	124.4	128.3
Source: BIS							

Figure 14. Norway – key banking market metrics, 2011–2017

	2011	2012	2013	2014	2015	2016	2017
Net interest margin (%)	1.0	1.0	1.1	1.1	1.0	1.1	1.1
Net interest & fee income/ op. income (%)	84.5	81.9	84.7	86.1	86.4	83.6	84.3
Cost to income (%)	57.8	54.1	52.3	50.3	50.2	51.9	52.4
Pre-provision profit/ avg. RWA (%)	2.4	3.0	3.3	3.7	3.9	3.9	4.0
ROAA (%)	0.5	0.5	0.6	0.6	0.6	0.6	0.6
ROAE (%)	10.9	11.6	11.5	12.6	11.8	11.2	10.8
Loan loss provision/ avg. gross loans (%)	0.08	0.15	0.13	0.12	0.11	0.12	0.11
Problem loans/ gross loans (%)	1.3	0.8	0.6	0.6	0.6	0.7	0.7
Problem loan growth (%)	(13.5)	(39.0)	(17.6)	8.9	(0.4)	10.3	9.5
CET1 ratio (%)	13.0	14.7	16.4	17.4	18.9	20.4	20.6
Capital ratio (%)	15.8	17.6	19.0	22.2	24.0	26.3	25.8
IFRS Tier 1 leverage ratio (%)	4.0	4.1	4.3	4.2	4.5	4.8	4.8
Net loans/deposits (%)	181.8	182.6	177.1	172.4	184.6	181.8	176.1

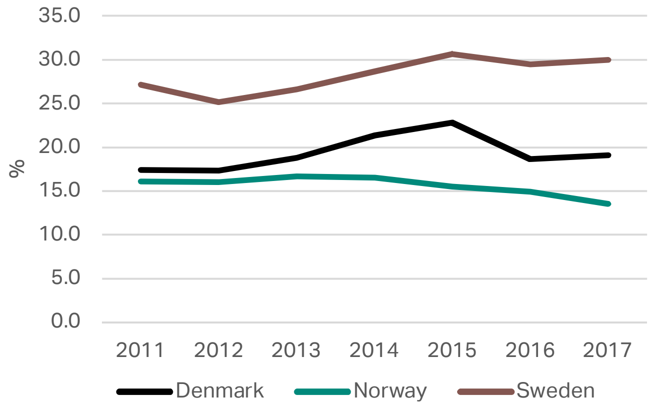
Source: Aggregated bank statistics. RWA–Risk-weighted assets. ROAA–Return on average assets. CET1–Common equity Tier 1. IFRS–International Financial Reporting Standards.

Figure 15: Banks' net interest margin, 2011–2017



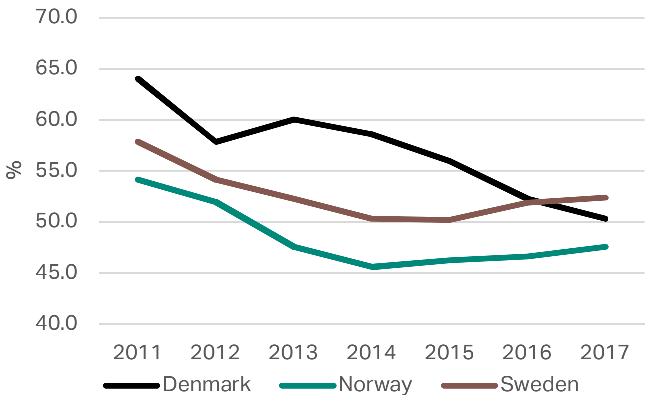
Source: Aggregated Bank Data

Figure 16: Banks' net fees & commission to operating income



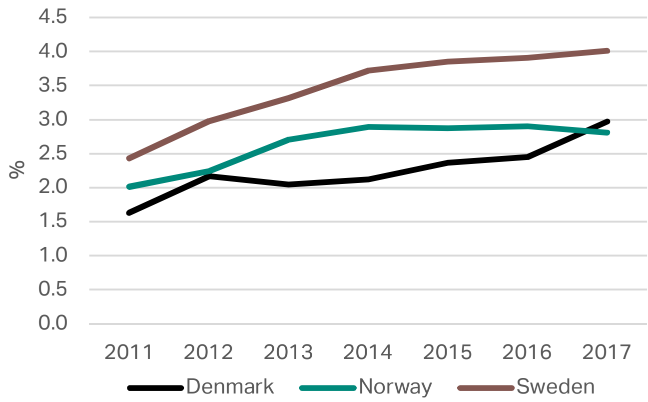
Source: Aggregated Bank Data

Figure 17: Banks' cost-to-income ratios, 2011–2017



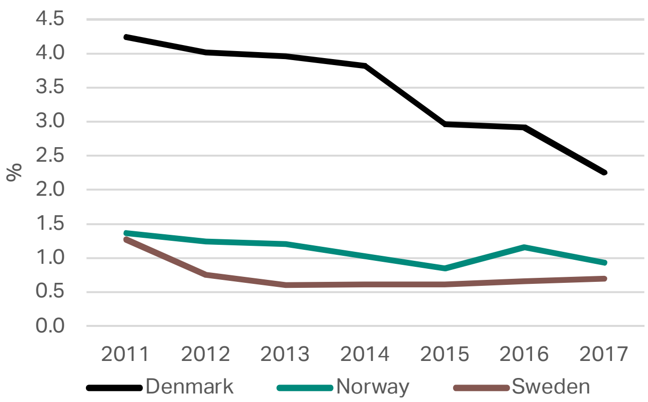
Source: Aggregated Bank Data

Figure 18: Banks' pre-provision profit to avg RWAs, 2011-2017



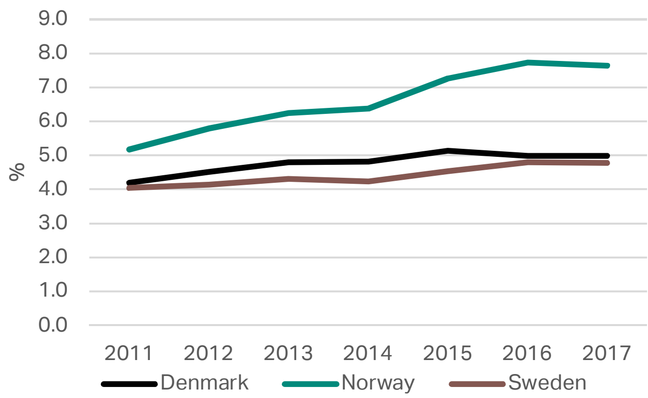
Source: Aggregated Bank Data

Figure 19: Banks' problem loans to gross loans, 2011–2017



Source: Aggregated Bank Data

Figure 20: Banks' leverage ratios, 2011–2017



Source: Aggregated Bank Data

NORDIC CREDIT RATING AS

OSLO
Biskop Gunnerus' gate 14A
0185 Oslo
Norway
www.nordiccreditrating.com
post@nordiccreditrating.com

STOCKHOLM
Engelbrektsgatan 9-11
114 32 Stockholm
Sweden

If you have questions or comments about our policies, please contact us at: compliance@nordiccreditrating.com