Nordic Credit Rating

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NATIONAL BANKING MARKET ASSESSMENT - NORWAY

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Nordic Credit Rating (NCR) applies a score of 'a' for the Norwegian banking market and expects the domestic operating environment for Norwegian banks to remain somewhat benign over the next 2-3 years. Despite higher capital requirements, Norwegian banks have outperformed their European peers in terms of earnings and efficiency and have managed a downturn in the oil and offshore segment with strong loss performance in recent years. Weakening international growth prospects constitute a risk factor, counterbalanced by robust government finances and a weak currency. The banking market score is a component of NCR's issuer ratings on financial institutions. Depending on the nature of a rated entity's exposure and geographic profile, the score can affect up to 20% of an overall issuer credit rating.

Figure 1. Norway – scoring of national indicators

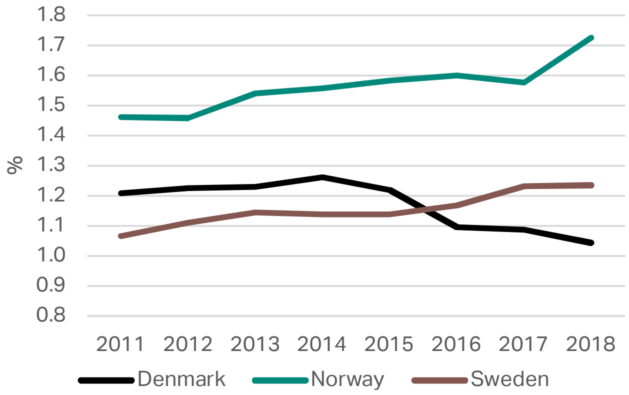
SUBFACTOR	SCORE	RATIONALE
Sovereign strength	aa	Major credit rating agency average: AAA, minimum: AAA.
Output growth	a	Lower support from oil investments and weaker international cycle generate lower economic growth, but still close to 2%.
Credit growth	bbb	Credit growth is more than twice GDP growth, but is slowing due to regulations, higher interest rates and high debt levels.
Housing prices	a	Housing prices have stabilised due to higher interest rates, regulations and increased supply.
Unemployment	aa	Unemployment is expected to remain low.
Available stable funding	a	Available stable funding in the form of stable deposits and domestic covered bonds exceeds monetary financial institution private-sector loans in most likely market conditions.
International cycle	bb	Global growth prospects are weakening, though supported by significant monetary stimulus. An international trade war and the UK's intended departure from the EU could affect economic growth. Asset prices are at or near peak levels but are expected to remain high.

Figure 2. Norway – key banking metrics

	2016	2017	2018	Oct. 2019	2019–2020
Growth in credit to the private non-financial sector (%)	4.6	6.4	5.6	5.6	Lower growth
Real housing price growth (%)	12.5	-1.2	2.8	0.9	Flat
Net interest margin (%)	2.7	2.7	2.6	2.8*	Increasing
Problem loans/gross loans (%)	1.0	1.1	1.3	na	Flat

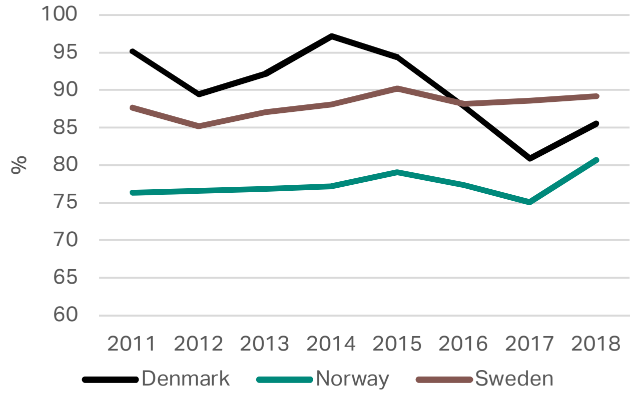
*Q3/19. na-not available. Source: Bank for International Settlements, aggregated bank reports.

Figure 3. Nordic banks' net interest margin, 2011–2018



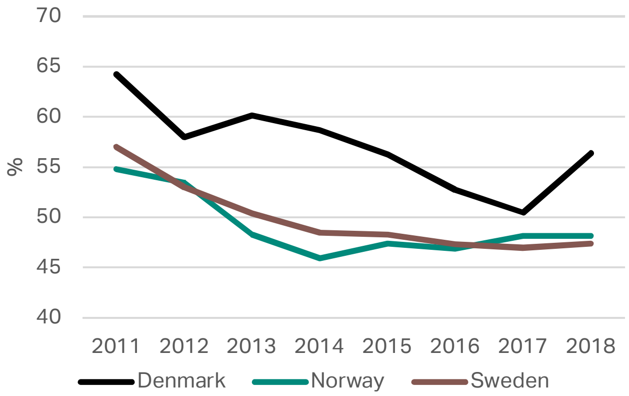
Source: Aggregated bank data

Figure 4. Nordic banks' net interest and fees to operating income, 2011-18



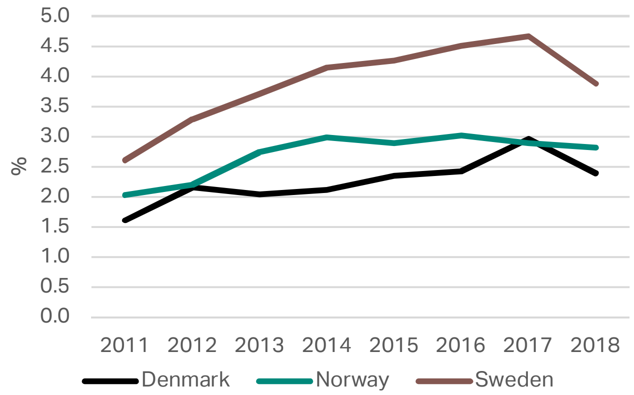
Source: Aggregated bank data

Figure 5. Nordic banks' cost-to-income ratios, 2011–2018



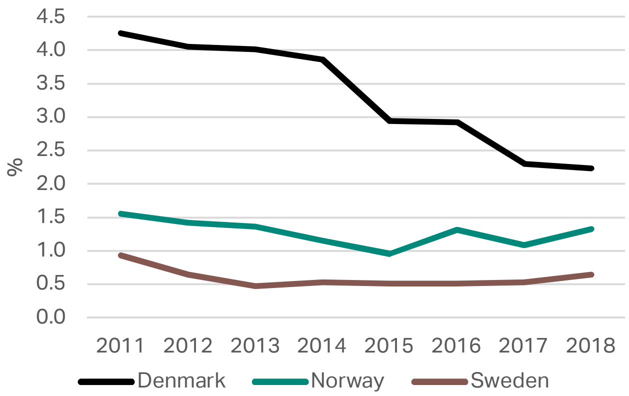
Source: Aggregated bank data

Figure 6. Nordic banks' pre-provision profit to avg risk-weighted assets, 2011-2018



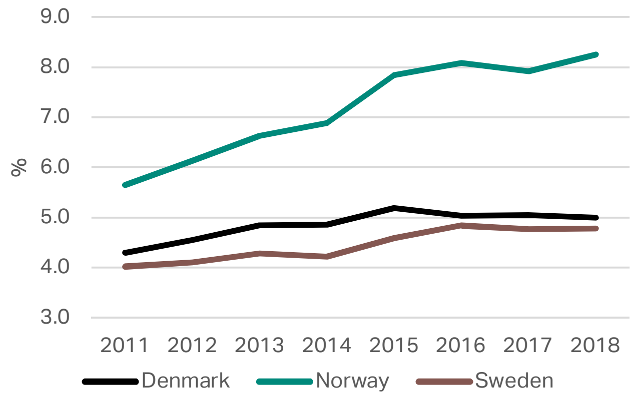
Source: Aggregated bank data

Figure 7. Nordic banks' problem loans to gross loans, 2011–2018



Source: Aggregated bank data

Figure 8. Nordic banks' leverage ratios, 2011–2018



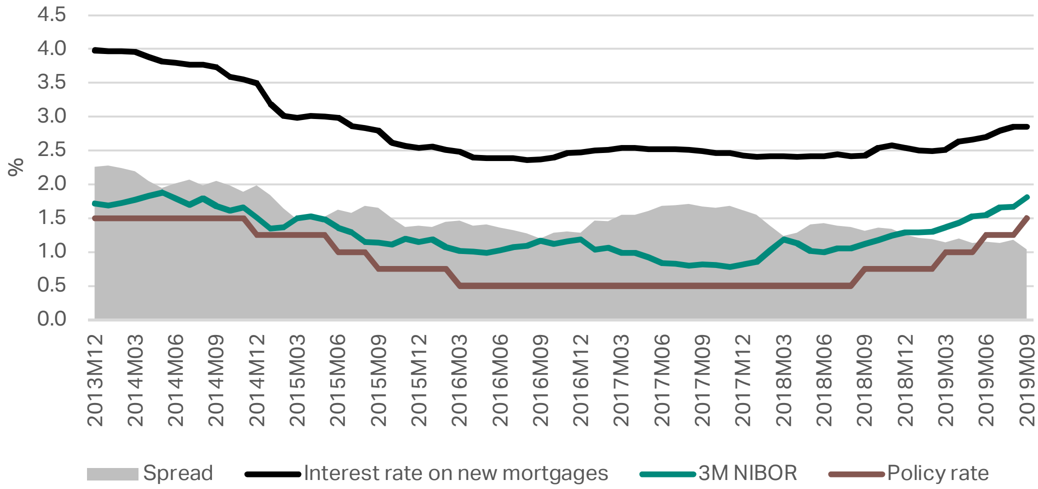
Source: Aggregated bank data

NATIONAL ECONOMY

In a recent publication[1], Statistics Norway said that even though the global economy is slowing, the outlook for Norwegian growth actually improved in the most recent quarter. Among the reasons are a significantly lower likelihood of the UK leaving the EU without a withdrawal deal, and the fact that the deadline for the US administration imposing import tariffs on European cars has passed.

Norway's economy has been growing marginally above trend for the past few years, after a period of low growth in large part due to volatility in the oil segment. We expect growth rates to fall over the next few years due to lower support from oil investments than in 2019 and low international growth. Mainland GDP will, however, continue to be supported by a weak currency and low interest rates and is expected to grow by 2.1% in 2020. Higher than expected production cuts by the Organisation of Petroleum Exporting Countries (900,000 barrels per day compared with an expected 500,000), are also supportive of oil prices and thus the Norwegian economy.

Figure 9. Norwegian interest rates, 2013–2019



Source: Statistics Norway

Figure 10. Norway – Key national metrics, 2015–2021e

	2015	2016	2017	2018	2019e	2020e	2021e
GDP growth* (%)	2.0	1.1	1.9	2.2	2.5	2.1	1.8
Core CPI growth (%)	2.7	3.1	1.4	1.6	2.3	2.2	2.1
Unemployment rate (%)	4.3	4.7	4.2	3.8	3.5	3.4	3.5
Current account balance/ GDP (%)	7.9	4.4	5.7	8.1	5.5	6.1	6.8
Monetary policy rate	0.8	0.5	0.5	0.8	1.5	1.6	1.6

*Mainland
Based on Economist Intelligence Unit data and NCR consensus estimates. e–estimate. CPI-consumer price index.

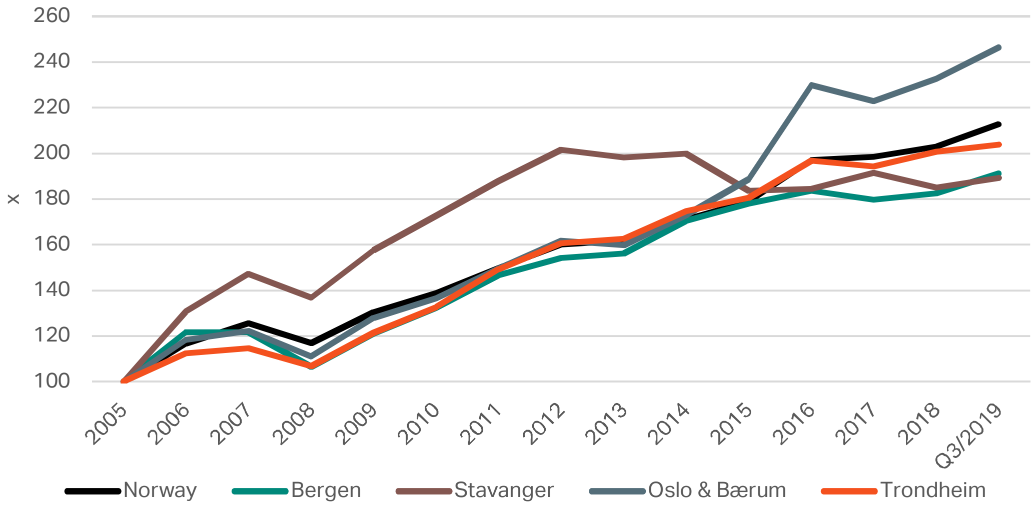
[1]Economic trends for Norway and abroad, Statistics Norway, 5 Dec. 2019

Compared with our Norwegian Banking Market assessment from last year, both GDP growth and unemployment estimates for 2020 have marginally increased. Interestingly, the core CPI expectation for 2021 is up from 1.7% to 2.1% while the central bank now expects a policy rate 1.6% against 1.72% previously. This is apparently because low interest rates internationally give the central bank little room for manoeuvre.

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 since then rebounded, 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. However, average growth on housing prices has been moderate over the past five quarters and Statistics Norway expects that housing investment will virtually stagnate in the period 2020-2022 after growth of just over 1% this year.

Figure 11. Norwegian regional housing prices, 2005–Q3/2019

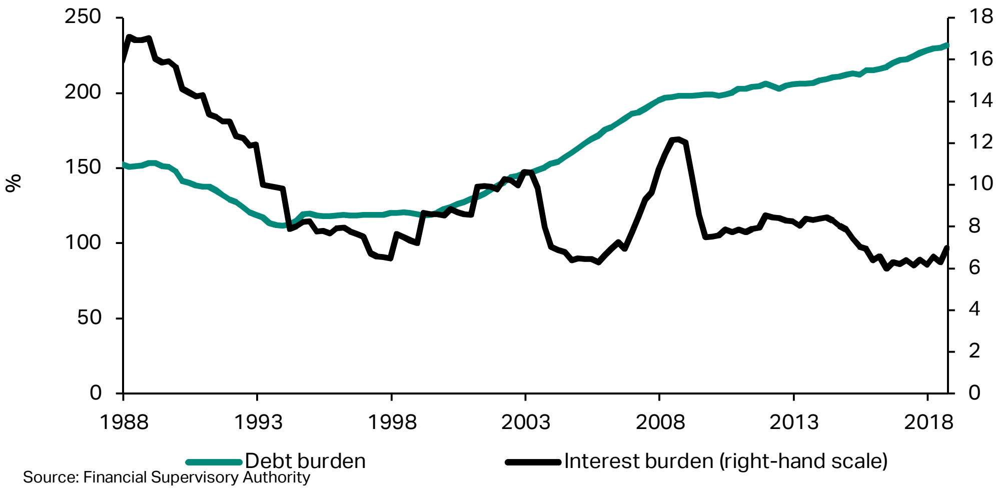


Based on data from Statistics Norway and NCR.

CREDIT GROWTH

In recent years, lending growth in Norway has been stable at around 6% a year, albeit higher in the Oslo region. However, the annual increase in household debt has been falling since 2012 and stood at 4.9% as of the third quarter of 2019 on a past 12 months basis, its lowest level since 1996, when comparable records began. Nevertheless, 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 carry floating interest rates. The regulator has also voiced its concerns over the growing consumer loan market by introducing restrictive underwriting guidelines into law, which should serve to reduce the attractiveness and size of consumer loans.

Figure 12. Norwegian household debt and interest burden, 1988–2018

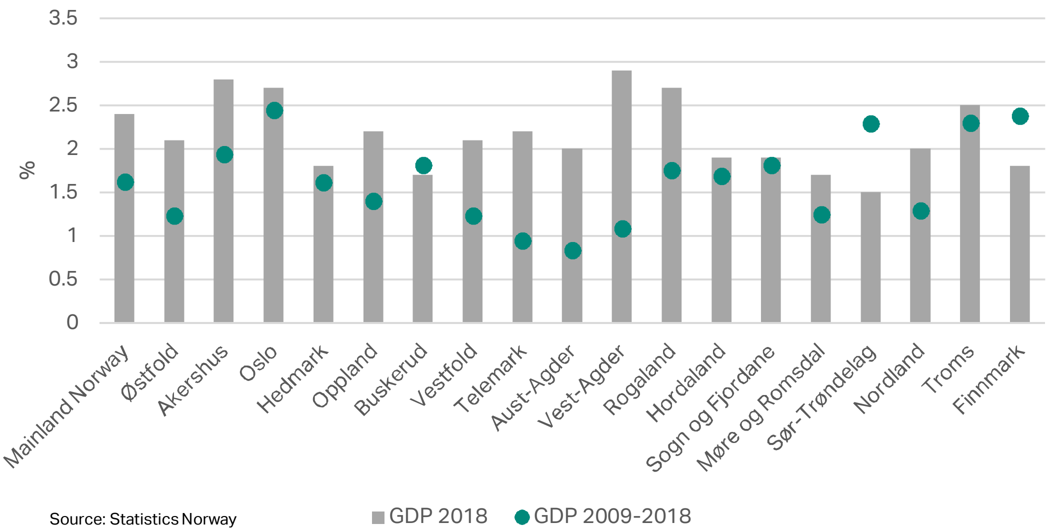


Source: Financial Supervisory Authority

REGIONAL ANALYSIS

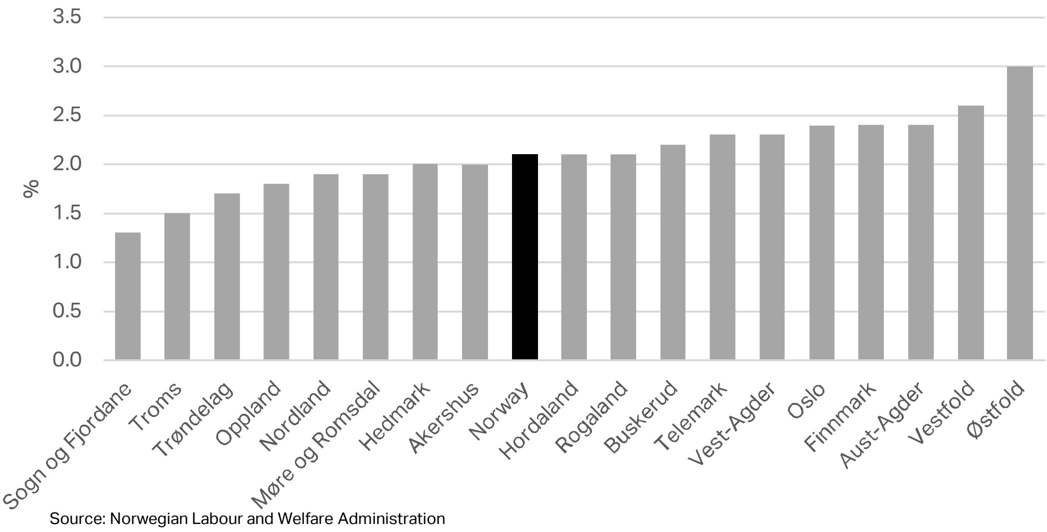
There have been significant variations in economic development in the different regions of Norway due to differences in exposure to the oil sector. Most notably the counties of Rogaland and Hordaland in western Norway and the Agder counties in southern Norway have been affected by higher unemployment and falling housing prices as a result of lower activity in the oil sector, although Rogaland and Vest-Agder rebounded in 2018. Other regions have benefited from weakness in the Norwegian currency, low interest rates, housing investment and public-sector spending on infrastructure. These factors have been particularly beneficial to the non-oil sector in oil-exposed regions and have also contributed to strong local 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. As a result, no county in Norway has a registered unemployment rate above 3%, as illustrated in Figure 14.

Figure 13. Average economic growth by county, 2009–2018 and 2018



Source: Statistics Norway

Figure 14. Unemployment in Norway by county as of Nov. 2019 (registered unemployed as % of workforce)

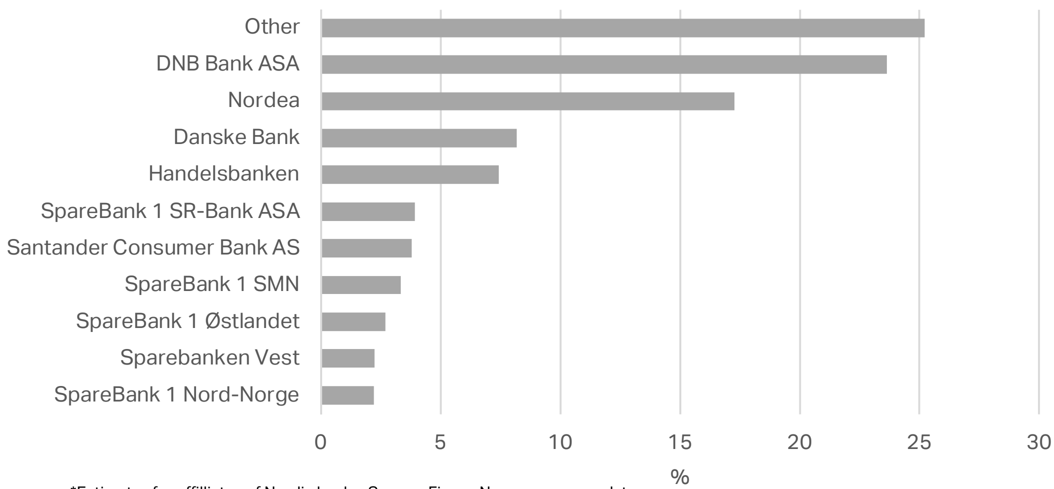


Source: Norwegian Labour and Welfare Administration

BANKING MARKET

We expect that a slightly decreasing trend in gross domestic debt to the general public will continue over the next few years due to stricter regulations and recent hikes in interest rates (ref. Figure 9), even if interest rate expectations have been reduced. Statistics Norway expects the average mortgage rate to increase from 3% in 2019 to 3.4% in 2021. Twelve months ago, the prognosis for 2021 was 3.7% based on higher money market rate expectations. In the short term, higher money market rates 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 (ref. Figure 3). This depends, however, on competition for mortgage loans and the ability of banks to pass higher funding costs on to customers. All else being equal, higher interest rates will generate more non-performing loans, but low unemployment and a strong business cycle, particularly in the oil industry, will most likely keep such loans in check.

Figure 15. Lending market share of banks in Norway, 2018*



*Estimates for affilliates of Nordic banks. Source: Finans Norge, company data

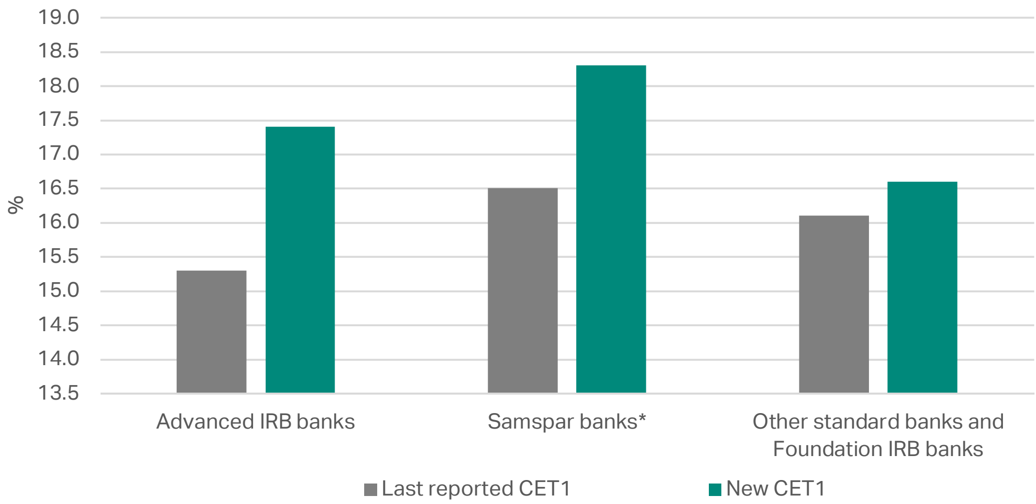
Norway's banking market has undergone less consolidation than those of other Nordic countries; the country has 99 savings banks and 26 commercial, consumer and other niche banks. In addition, 25 foreign banks operate in Norway, including Nordea Bank, Danske Bank and Svenska Handelsbanken, which have significant numbers of branches. As a result, only DNB and government-owned

Kommunalbanken are defined as systemically important financial institutions for capital requirement purposes. However, in total 9 banks will be given individual MREL requirements from Finanstilsynet.

CAPITAL

Norwegian banks have developed significant equity buffers, particularly since 2011, when stricter capital requirements were introduced. However, this has not been obvious looking at reported capital ratios due to Norwegian high-risk weight floors. From year-end 2019, Norway will implement EU capital requirement regulations not already incorporated into domestic legislation. These regulations – CRR and CRD IV – allow a 23.8% capital discount for banks' SME customers and stipulate removal of the transitional Basel I floor for Norwegian banks using the advanced internal ratings-based (A-IRB) approach for calculating risk exposure amounts (REA). In response, the Norwegian Ministry of Finance has increased the systemic risk buffer by 1.5pp to 4.5% to compensate for the resulting lower REAs for the country's banks. However, the implementation of the systemic risk increase has been postponed to 31 Dec. 2020 for A-IRB banks and to 31 Dec. 2022 for banks using the foundation IRB based (F-IRB) approach or the standardised approach. The Ministry says that this will give Finanstilsynet time to amend the Pillar 2 requirements for the banks which will not benefit from the removal of the Basel I floor, which we interpret as an indication that standardised banks will not be required to increase their capital by the entire 1.5pp. We examined the effect of the earlier proposed changes in legislation in the article Proposed changes in Norway's capital regulations likely to punish small banks, 1 Oct. 2019, and the outcome indicates that the banks not using the A-IRB approach will be better off due to later implementation and probably lower Pillar 2 requirements. Figure 16 is lifted from the article and illustrates the effect of lower risk weights on common equity Tier 1 (CET1) ratios. Note that the new regulations also will be implemented for foreign banks operating in Norway, which means a more level playing field for Norwegian banks.

Figure 16. Reported CET1 ratios (Q2 2019) and CET1 ratios after removal of Basel 1 floor and implementation of SME discount*



*Samspar banks are smaller savings banks in the Sparebank 1 Alliance. Based on NCRa and company data.

AVAILABLE STABLE FUNDING

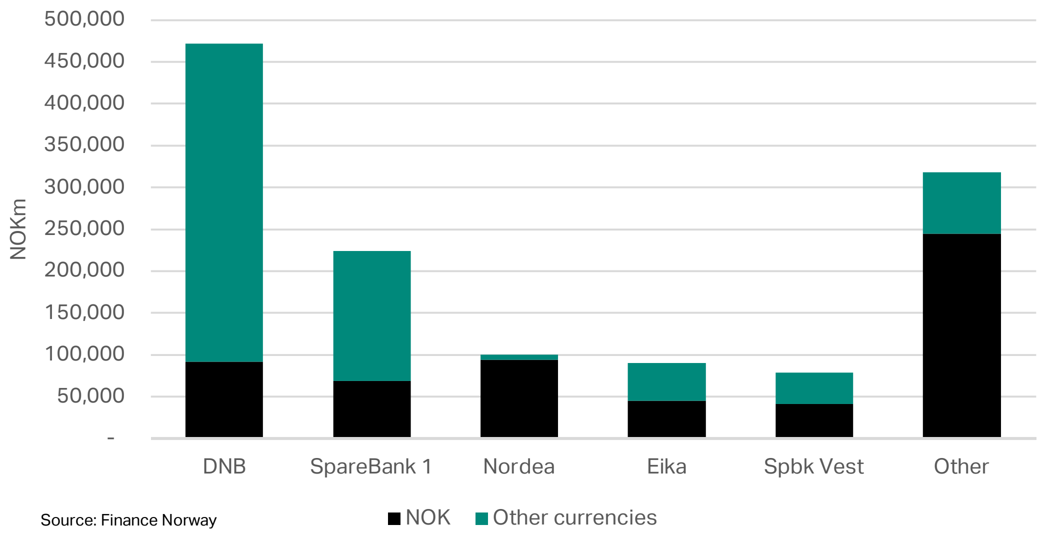
Given the high share of private savings entrusted to institutional investors via mutual funds and pension assets, the loan-to-deposit ratio of Norwegian banks is not an ideal measure of the market's stable funding. Accordingly, our evaluation of Norwegian bank funding also considers domestic covered-bond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

In part due to investment restrictions on the NOK 10,000bn Government Pension Fund Global, Norwegian banks are reliant on international investors to buy a material share of their issued covered bonds. The fact that only 45% of the total NOK 1.3tr on issue is denominated in domestic currency leads us to consider covered bonds denominated in foreign currencies (48% in euro, 4% in US dollars and 3% 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 their Nordic peers. This is a factor that could be exacerbated during a stressed scenario, when investors could shift to more established, liquid issuers.

Norway's implementation of the EU's bank recovery and resolution directive increases the already strong protection for covered-bond investors by excluding them from bail-ins. 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 bank financing at long maturities and reasonable spreads.

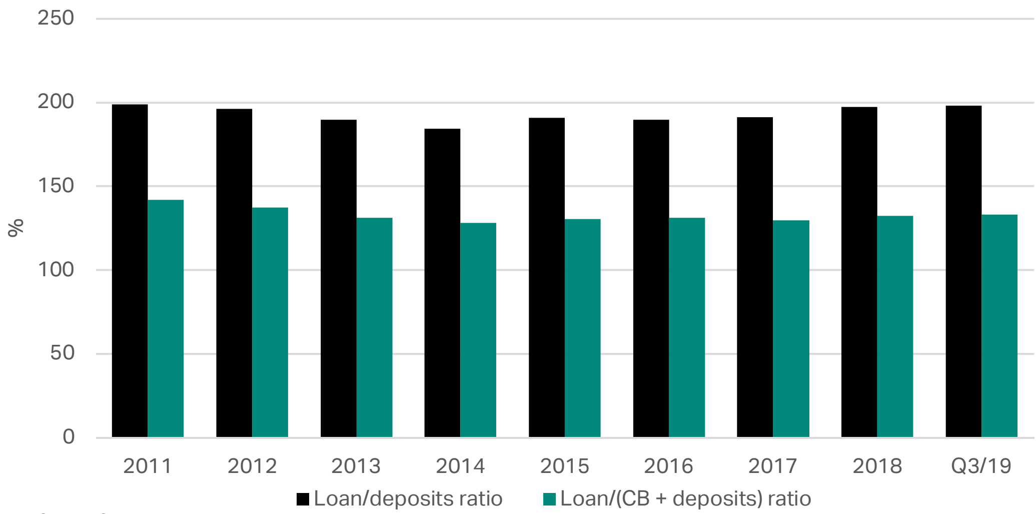
During the 2008 financial crisis, the Norwegian government demonstrated its willingness and ability to set up liquidity facilities for the Norwegian banking sector in a credit crunch. Moreover, Norwegian banks have lower gearing than their international peers and a large part of their market funding is long-term, which makes the banks less vulnerable in a short-lived credit crunch.

Figure 17. Norwegian covered-bond companies – outstanding volume as of Q3 2019



Source: Finance Norway

Figure 18. Norwegian banks' loans as % of deposits and covered bond (CB) financing



Source: Statistics Norway, Finance Norway.

BANKING MARKET ASSESSMENT

The banking market score of 'a' for Norway is a component of NCR's issuer ratings on 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 overall issuer credit rating. For more information, please refer to Financial Institutions Rating Methodology.

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