

NATIONAL BANKING MARKET ASSESSMENT

SWEDEN

ANALYSTS

Geir Kristiansen
+47 90 78 45 93
geir.kristiansen@nordiccreditrating.com

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

COMMERCIAL MANAGERS

Gustav Liedgren
+46 736 49 65 43
gustav.liedgren@nordiccreditrating.com

Kristine Klyve Sunde
+47 99 32 69 79
kristine.sunde@nordiccreditrating.com

Nordic Credit Rating (NCR) applies a score of 'a-' for the Swedish banking market and views the domestic operating environment as stable. Swedish banks have outperformed most of their international peers in recent years due to steady lending growth and increased margins. Until 2018, Sweden's economy had been driven by significant construction activity to address a material housing shortage and accommodate a growing population. Since then, lower building activity and a weaker international outlook have led to lower GDP forecasts for 2019/2020. Environmental, social and governance (ESG) issues related to the Baltic money laundering scandal are not included in Figure 1 but are considered in our final assessment. The banking market score is a component of NCR's issuer ratings for financial institutions. Depending on the nature of a rated entity's exposure and geographic profile, the score can affect up to 20% of the overall credit rating.

Figure 1. Sweden – scoring of national indicators

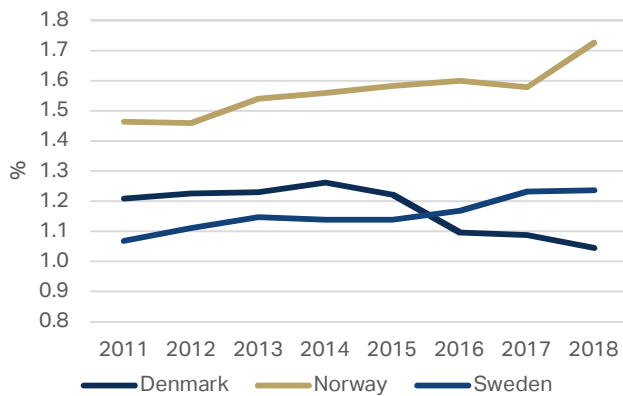
SUBFACTOR	SCORE	RATIONALE
Sovereign strength	aa	Major credit rating agency average: AAA, minimum: AAA.
Output growth	a	We expect slowing economic growth due to a reduction in recent capital investment and a weakening of the international outlook.
Credit growth	bbb	Credit growth is more than twice GDP growth, but remains stable and we expect it to slow as interest rates normalise or economic growth subsides.
Housing prices	bbb	A cooling housing market has led to lower building activity. This could trigger a new housing price boom.
Unemployment	a	Unemployment is higher than in Nordic neighbours in large part due to high unemployment among recent immigrants. Long-term unemployment is the lowest in the EU.
Available stable funding	a	Available stable funding in the form of deposits and domestic covered bonds falls short of monetary financial institution (MFI) private-sector loans, but access to other forms of long-term senior financing remains strong.
International cycle	bb	Global growth prospects are weakening, though supported by significant monetary stimulus. Trade rhetoric and a hard Brexit could affect economic growth. Asset prices are at or near peak levels but are expected to remain high.

Figure 2. Sweden – key banking metrics

	2016	2017	2018	Nov. 2019	2019–2021
Growth in credit to the private non-financial sector (%)	(3.6)	3.3	6.0	4.9	Falling
Real housing price growth (%)	8.3	8.4	0.0	4.5	Flat
Net interest margin (%)	1.2	1.2	1.2	na	Flat
Problem loans/gross loans (%)	0.5	0.5	0.4	0.5	Flat

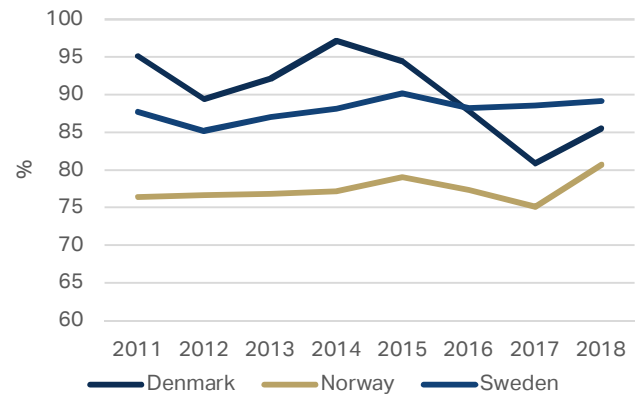
Source: Bank for International Settlements (BIS), aggregated bank reports, ValueGuard, Statistics Sweden

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



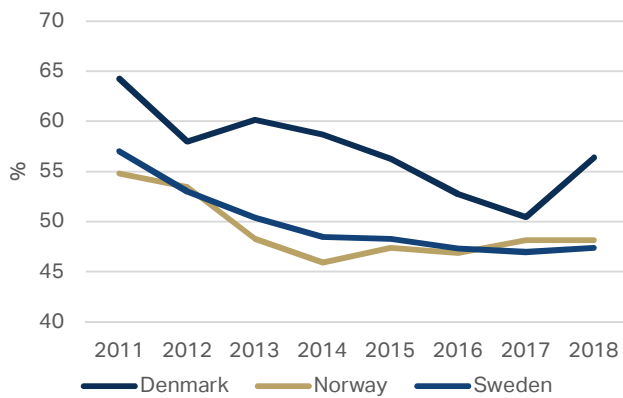
Source: Aggregated bank data

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



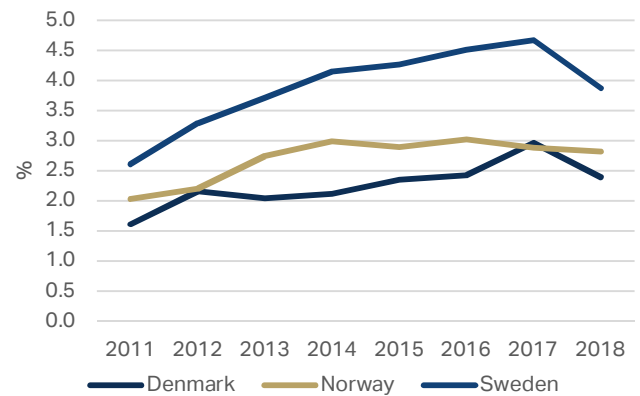
Source: Aggregated bank data

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



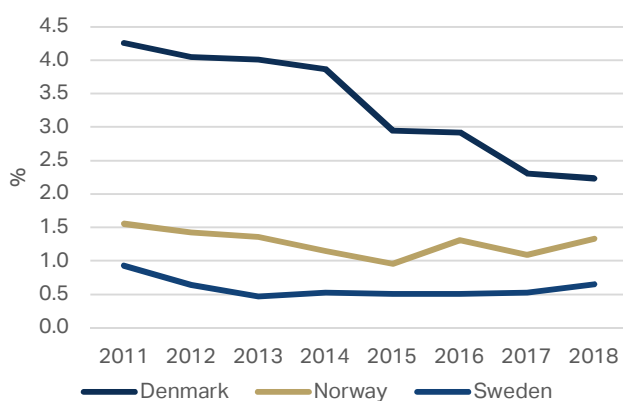
Source: Aggregated bank data

Figure 6. Nordic banks' pre-provision profit to avg RWAs, 2011–2018



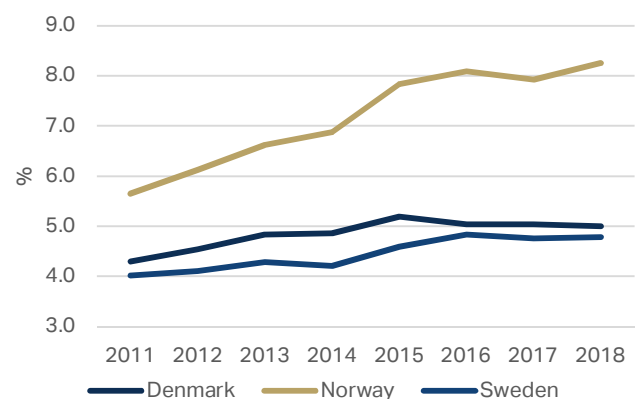
Source: Aggregated bank data

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



Source: Aggregated bank data

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

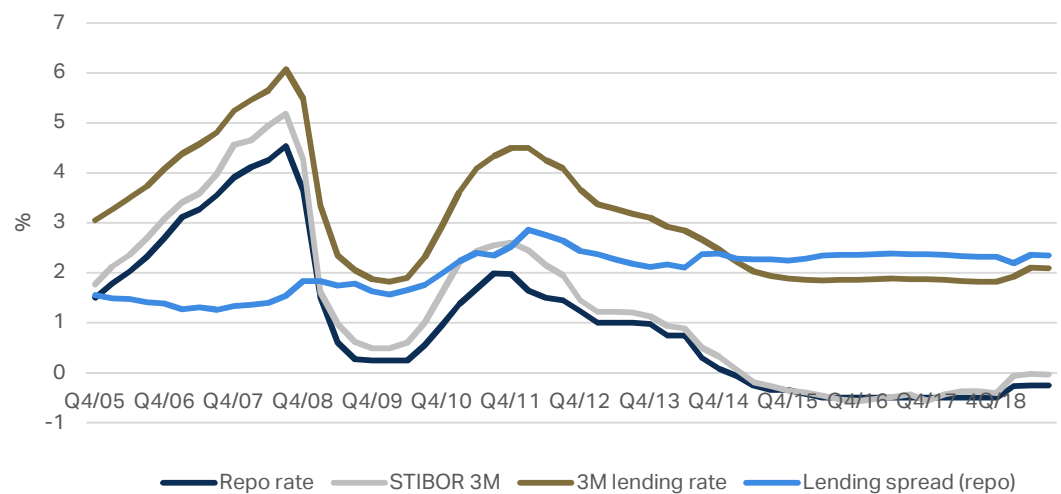


Source: Aggregated bank data

NATIONAL ECONOMY

Swedish GDP is expected to drop from a healthy level of 2.3% in 2018 to 1.3% in 2019 and 1.2% in 2020, based on consensus estimates. Estimates have come down due to weaker international growth expectations. Construction activity is lower as housing investments drop from peak levels and manufacturing industries feel the headwinds from weak international sentiment. Consequently, unemployment is expected to increase by 0.4pp to 6.7% in 2019 and 7.1% in 2020, propped up by a 15% unemployment rate among foreign-born immigrants and mismatches between recent immigrants' skillsets and available employment. NCR expects currently low interest rates to persist in the coming years, with the domestic repo rate remaining at zero through 2020 and possibly longer.

Figure 9. Swedish interest rates*, 4Q 2005–Q3 2019



*STIBOR: Stockholm Interbank Offered Rate. Source: Statistics Sweden, Riksbanken

Export industries are, however, supported by the currently weak krona and the outlook for the international economy has improved in the most recent quarter. Among the reasons are a significantly lower likelihood of the UK leaving the EU without a deal, and the passing of a deadline for the US administration imposing import tariffs on European cars. Swedish government finances remain exceptionally strong, with a recent history of budget surpluses and declining government debt to GDP.

Figure 10. Sweden – key national metrics, 2015–2021

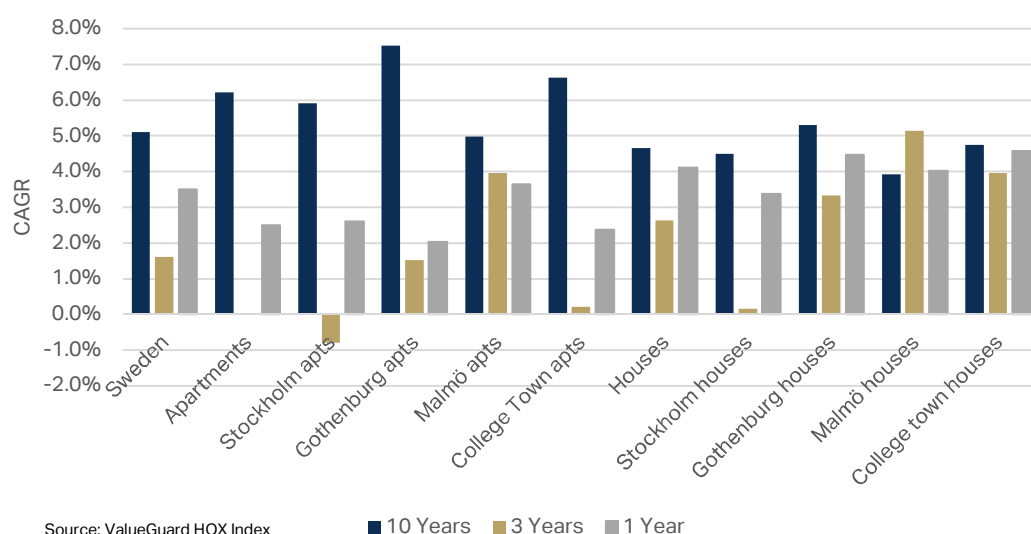
	2015	2016	2017	2018	2019e	2020e	2021e
GDP growth (%)	4.3	3.1	2.4	2.3	1.3	1.2	1.7
CPI growth (%)	0.9	1.3	2.0	2.1	1.7	1.6	1.5
Unemployment rate (%)	7.4	6.9	6.7	6.3	6.7	7.1	7.2
Current account balance/GDP (%)	4.7	4.9	3.7	3.4	4.2	4.2	4.0
Central bank policy rates (%)	-0.35	-0.50	-0.50	-0.25	0.00	0.00	0.20

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

HOUSING MARKET

Many years of strong housing price appreciation in Sweden, particularly in Stockholm, were followed by a modest correction in 2017/18 as the market responded to a high level of newly produced residences and an announcement of further tightening of amortisation requirements by the Swedish financial regulator. However, year-to-date housing price growth has been robust (3.5% in the last 12 months through October 2019 as shown in Figure 11, and the market's three-year compound average growth rate (CAGR) of 1.6% indicates that home owners still have plenty of equity as housing prices are only slightly below their 2017 peak. We project that real house prices will grow moderately in 2020 as potential buyers' options have increased materially with newly produced apartments available for rent or purchase in most cities.

Figure 11. CAGR of Swedish housing prices by region and type, Oct. 2019

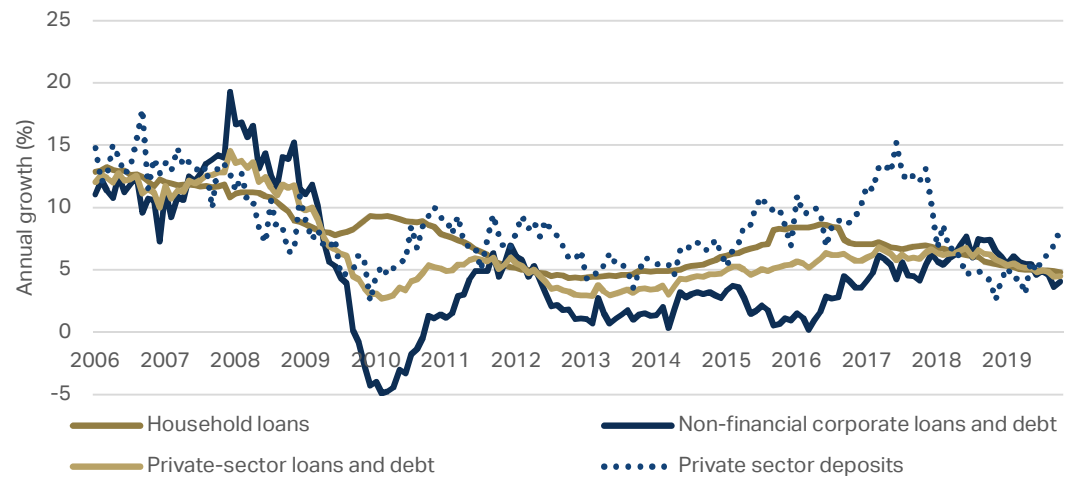


CREDIT GROWTH

MFI lending to the private sector consists 52% of household mortgage loans, 37% of non-financial corporate lending (50% of which with real-estate collateral) and 11% of other household loans including consumer loans.

Growth in private-sector loans has shown mean reversion of around 5% since 2009, supported by annual growth of about 8.4% in deposits from the private sector. Households have increased borrowing faster than has been justified by growth in the wider economy, which is largely due to rising housing prices, low interest rates and willingness and ability on the part of banks to provide mortgage loans at attractive expanded lending margins. However, a calmer housing market and regulatory initiatives to reduce household leverage led to slower growth in housing and unsecured consumer lending in 2018 and are expected to dampen growth further over the next two years to around 4% annually. Corporate credit demand from MFIs remains rather muted, but growth rates are above the private-sector average for the first time since 2012, in part because of higher debt issuance and attractive borrowing rates available in the capital markets.

Figure 12. 12-month growth in private-sector loans by sector and deposits, Oct. 2019

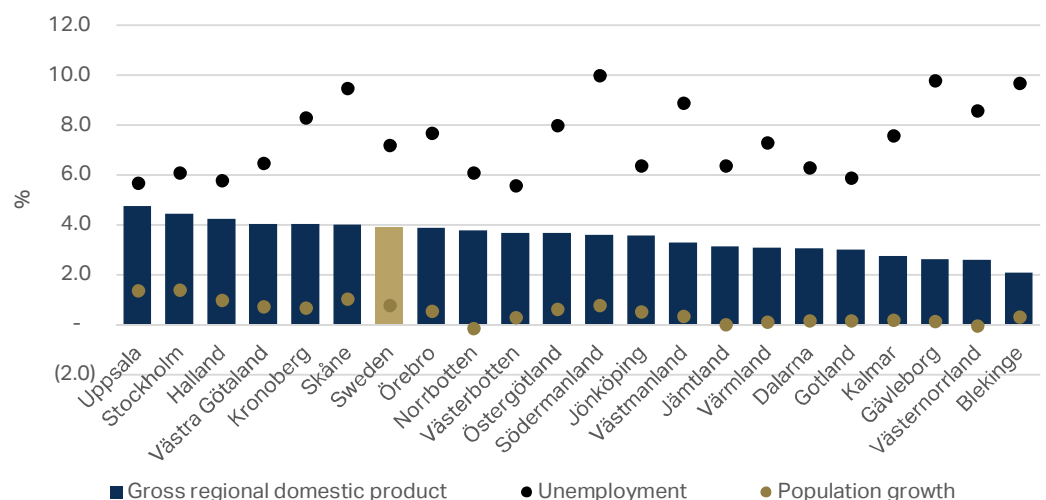


Source: Statistics Sweden

REGIONAL ANALYSIS

Swedish urbanisation continues apace and is apparent not only in the significant historical differences in housing prices between Stockholm and Gothenburg (in Västra Götaland), but also in county level unemployment and population growth statistics. Regions with growing populations are the driving force for economic growth and this factor has also supported growth in smaller markets. However, fewer than half of Sweden's 21 counties have experienced native-born population growth since 2000 and strong immigration has supported population growth in some regions, creating challenges of integration due in part to higher unemployment among foreign-born immigrants.

Figure 13. Unemployment (Nov. 2019), annual economic & population growth since 2000, by county



Source: Arbetsförmedlingen, Statistics Sweden. Gross regional domestic product CAGR from 2000-2017.

BANKING MARKET

Swedish investors tend to be highly focused on ESG issues, and Swedbank, Danske Bank and SEB have encountered ESG challenges in their Baltic operations which have impacted their domestic customer perception and market share. The banks' need to address internal compliance issues and the potential

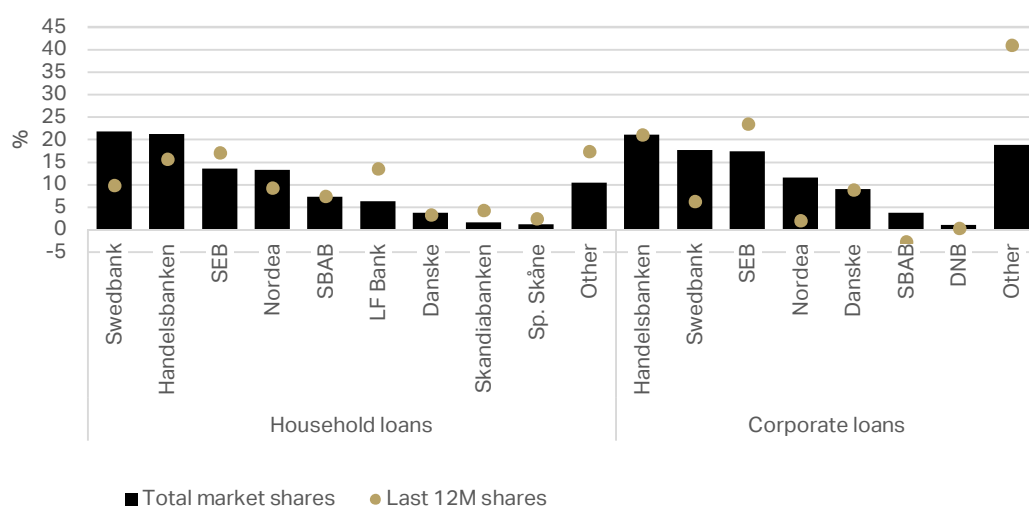
for material fines in the wake of international investigations have weakened the Swedish bank market during the past year (see [Swedbank's controversy spills over to Swedish savings banks](#), 29 Mar. 2019).

Looking ahead, increases in risk weights for commercial real estate exposures proposed by the Swedish regulator could materially affect the banking market. Real estate activities represent around 60% of Swedish banks' corporate exposure (compared with only 27% at the EU/EEA level according to the European Banking Authority). Higher capital requirements and higher required interest rates from commercial real estate exposures could push more creditworthy real estate borrowers into the capital markets, affecting growth prospects for Swedish banks. Banks could be forced to pursue growth in other channels (for example, retail mortgages and/or consumer lending) or reduce their currently-high return on equity expectations as a result, with consequences for share prices and risk appetite. In addition, NCR expects that margin pressure from existing and new competitors could affect banks' future earnings from mortgage lending as policy rates are expected to remain stable throughout 2020 and 2021.

Despite these headwinds, Sweden's banks continue to outperform their European peers in key areas. The banks have strong regulatory capital ratios even after implementation of 25% risk weight floors for residential mortgages. They have also maintained relatively strong earnings and efficiency as automation and customer behaviour have allowed for significant cost savings, smaller branch networks and reduced staffing even as volumes and revenues rise. Finally, Sweden continues to stand out among its European peers with respect to asset quality and loss performance, allowing for efficiency gains to be passed through to shareholders.

Sweden's four largest banks hold close to 70% of both the lending and deposit markets, but both markets are evolving. Nordea moved its headquarters from Sweden to Finland on 1 Oct. 2018, materially reducing the size of the domestic banking market, but also creating some ill will and affecting customer volumes at the region's largest bank. As illustrated in Fig 14, Nordea has shown little to no growth in household lending over the 12 months ending September 2019 and has also lost domestic market share in corporate lending over the past year.

Figure 14. Lending market share of banks in Sweden, as of Sep. 2019



Source: Statistics Sweden, NCR data

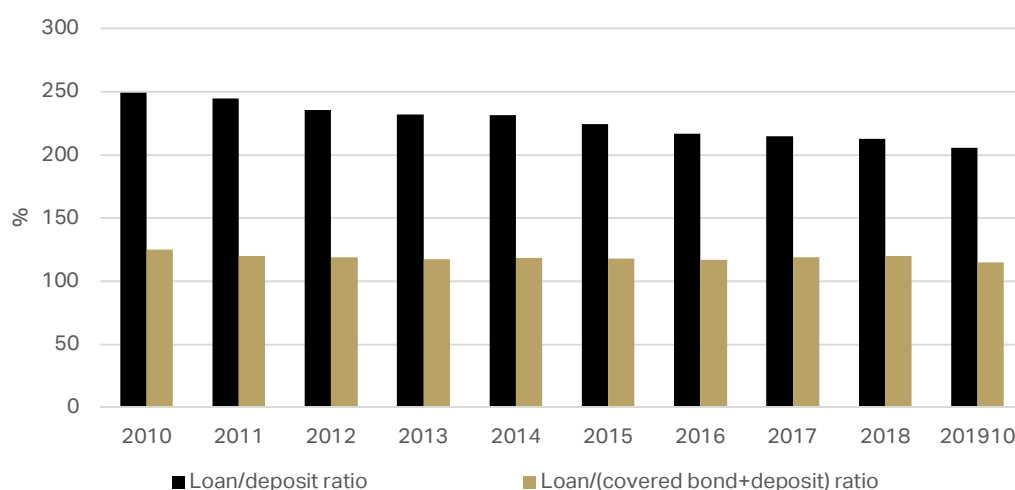
In the competitive residential mortgage market, current market leader Swedbank is also losing market share (currently 22% of household loans and 18% of the corporate market). Handelsbanken is more resilient to increased competition with a 21% market share in both segments. Among the gainers of market share in the past 12 months are SEB, which is taking back market share lost in 2018, Länsförsäkringar Bank and Skandiabanken. They also include smaller banks, among them niche banks and fintech lenders. See [Competition in the Swedish mortgage market heats up](#), 15 Aug. 2019.

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 for Swedish banks is not an ideal measure of the market's stable funding. Our evaluation of Swedish bank funding therefore considers not only deposit funding, but also covered-bond financing, given the demonstrated resilience, perceived support and liquidity of covered bonds. The exclusion of covered bonds from bail-in and protection from the impact of a bank resolution as part of the EU's bank recovery and resolution directive supports our view of covered-bond financing as stable funding. In addition, the use of long-term senior unsecured financing is a key fixture of Swedish 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 Swedish financing at long maturities and reasonable spreads and considers senior unsecured funding with maturities over one year to be stable.

Despite strong access to wholesale financing markets, the loan-to-deposit ratio for Swedish banks (including their international operations) improved to 205% as at October 2019 from 249% at year-end 2010. This was largely due to high household savings rates, despite available deposit rates being very low or even negative for short-term corporate deposits. Including covered-bond financing, banks' customer loans represent 115% of stable funding sources, an improvement from 125% in 2010.

Figure 15. Loans as a share of deposits and covered-bond financing for Swedish banks



Source: Statistics Sweden

BANKING MARKET ASSESSMENT

The banking market score of 'a-' for Sweden is a component of NCR's issuer ratings for financial institutions operating in the Swedish 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 6. Sweden – key credit metrics, 2012–2018

	2012	2013	2014	2015	2016	2017	2018
Credit to households (%)	80.4	82.2	83.0	83.6	86.4	88.2	88.6
Credit to non-financial corporations (%)	149.3	151.5	152.1	151.3	146.3	150.2	155.5
Growth in credit to the private non-financial sector (%)	2.1	4.0	1.5	(0.4)	(2.1)	5.7	5.7
Household savings/disposable income (%)	14.4	15.0	16.4	15.0	16.0	15.1	16.8
Debt service ratios of households (%)	11.6	11.2	11.2	11.1	11.2	11.4	11.4
Nominal residential property prices, 2010 = 100	103.7	109.4	119.7	135.4	147.1	156.5	155.0
Real residential property prices, 2010 = 100	99.8	105.4	115.5	130.7	140.6	146.9	142.8
Source: BIS							

Figure 17. Sweden – key banking market metrics, 2012–2018

	2012	2013	2014	2015	2016	2017	2018
Net interest margin (%)	1.1	1.2	1.2	1.2	1.2	1.3	1.3
Net interest & fee income/op. income (%)	84.6	87.0	88.3	90.0	88.0	88.3	88.9
Cost to income (%)	52.7	50.3	48.5	48.5	47.6	47.3	47.6
Pre-provision profit/avg. RWA (%)	3.4	3.8	4.2	4.3	4.5	4.6	3.9
ROAA (%)	0.6	0.6	0.7	0.7	0.7	0.7	0.8
ROAE (%)	12.3	12.6	13.6	12.5	11.6	12.3	13.6
Loan loss provision/avg. gross loans (%)	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Problem loans/gross loans (%)	0.7	0.5	0.5	0.5	0.5	0.6	0.7
Problem loan growth (%)	(28.2)	(25.3)	23.2	0.2	6.4	13.6	32.4
CET1 ratio (%)	16.3	18.0	18.9	21.0	22.4	22.0	16.7
Capital ratio (%)	18.9	20.0	23.7	26.2	28.1	26.9	20.7
IFRS Tier 1 leverage ratio (%)	4.2	4.4	4.2	4.7	4.9	4.8	4.9
Net loans/deposits (%)	235.2	231.7	231.3	224.2	216.8	214.7	212.7
Source: Aggregated bank financials. RWA–Risk-weighted assets. ROAA–Return on average assets. ROAE–Return on average equity. CET1–Common equity Tier 1. IFRS–International Financial Reporting Standards.							

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

Disclaimer © 2020 Nordic Credit Rating AS (NCR, the agency). All rights reserved. All information and data used by NCR in its analytical activities come from sources the agency considers accurate and reliable. All material relating to NCR's analytical activities is provided on an "as is" basis. The agency does not conduct audits or similar warranty validations of any information used in its analytical activities and related material. NCR advises all users of its services to carry out individual assessments for their own specific use or purpose when using any information or material provided by the agency. Analytical material provided by NCR constitutes only an opinion on relative credit risk and does not address other forms of risk such as volatility or market risk and should not be considered to contain facts of any kind for the purpose of assessing an issuer's or an issue's historical, current or future performance. Analytical material provided by NCR may include certain forward-looking statements relating to the business, financial performance and results of an entity and/or the industry in which it operates. Forward-looking statements concern future circumstances and results and other statements that are not historical facts, sometimes identified by the words "believes", "expects", "predicts", "intends", "projects", "plans", "estimates", "aims", "foresees", "anticipates", "targets", and similar expressions. Forward-looking statements contained in any analytical material provided by NCR, including assumptions, opinions and views either of the agency or cited from third-party sources are solely opinions and forecasts which are subject to risk, uncertainty and other factors that could cause actual events to differ materially from anticipated events. NCR and its personnel and any related third parties provide no assurance that the assumptions underlying any statements in analytical material provided by the agency are free from error, nor are they liable to any party, either directly or indirectly, for any damages, losses or similar, arising from use of NCR's analytical material or the agency's analytical activities. No representation or warranty (express or implied) is made as to, and no reliance should be placed upon, any information, including projections, estimates, targets and opinions, contained in any analytical material provided by NCR, and no liability whatsoever is accepted as to any errors, omissions or misstatements contained in any analytical material provided by the agency. Users of analytical material provided by NCR are solely responsible for making their own assessment of the market and the market position of any relevant entity, conducting their own investigations and analysis, and forming their own view of the future performance of any relevant entity's business and current and future financial situation. NCR is independent of any third party, and any information and/or material resulting from the agency's analytical activities should not be considered as marketing or a recommendation to buy, sell, or hold any financial instruments or similar. Relating to NCR's analytical activities, historical development and past performance does not safeguard or guarantee any future results or outcome. All information herein is the sole property of NCR and is protected by copyright and applicable laws. The information herein, and any other information provided by NCR, may not be reproduced, copied, stored, sold, or distributed without NCR's written permission.