

National banking market assessment Denmark

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Nordic Credit Rating (NCR) has lowered its assessment of the Danish banking sector to 'bbb+' from 'a-' due to the economic effects of the COVID-19 pandemic. We have revised down our scores and expectations for output growth, housing prices, unemployment and the international cycle (see Figure 1). In addition, we have increased the impact of sovereign strength in our overall assessment given the government's substantial support for individuals, banks and corporations.

NCR views the outlook for the domestic operating environment as negative given the abrupt reduction in economic activity and the uncertain prospects for and timing of any recovery. Initially, the government's efforts to counter the severe macroeconomic disruption could prove effective. However, we believe that maintaining stability, especially in terms of bank earnings and credit losses, will become increasingly difficult the longer economic activity remains subdued and especially if there is a second wave of the pandemic.

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. Denmark—scoring of national indicators

SUBFACTOR	SCORE	RATIONALE
Sovereign strength	aa	Major credit rating agency average: AAA.
Output growth	bb (a)	We expect negative economic growth due to the COVID-19 pandemic in 2020, before a rebound in 2021
Credit growth	bbb	Credit growth has been lower than GDP growth in recent years.
Housing prices	bbb (a)	Moderate growth in housing prices; we expect prices to fall in 2020.
Unemployment	bbb (aa)	Unemployment has spiked during the COVID-19 pandemic, from a low level.
Available stable funding	aa	Available stable funding in the form of deposits and domestic covered bonds exceeds monetary financial institution private-sector loans by a good margin at both a consolidated level and at individual banks and mortgage companies.
International cycle	b (bbb)	International growth prospects are weak given global shutdowns and expected contractions in most economies on the back of COVID-19 responses.

Figure 2. Denmark—key banking metrics

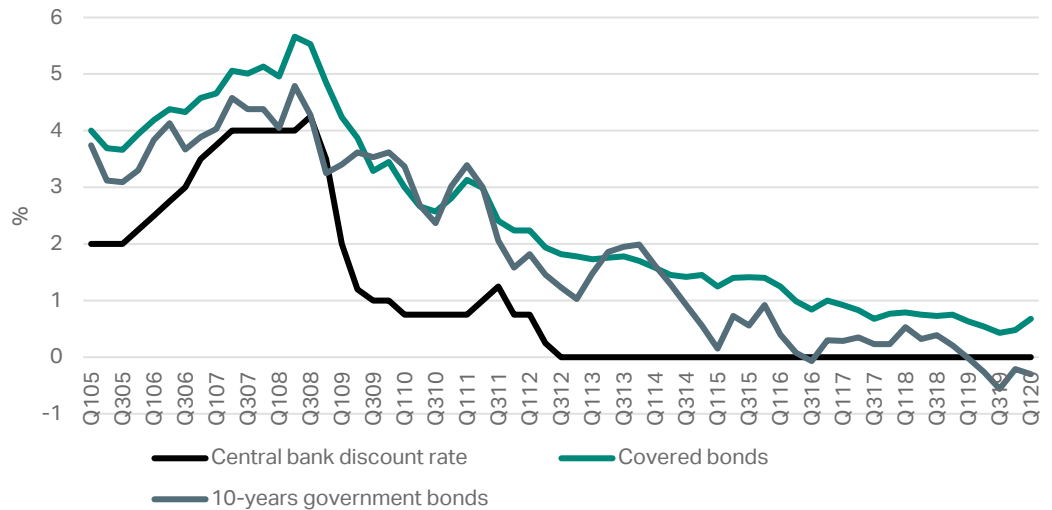
	2017	2018	2019	Q1/20	2020–2021
Growth in credit to households (%)	0.9	1.2	0.5	2.3	Lower
Housing price growth (one-family housing) (%)	3.5	4.2	3.7	0.3	Flat
Net interest margin (%)	1.09	1.04	0.99	na.	Falling
Problem loans/gross loans (%)	2.2	2.2	2.1	na.	Increasing

Source: Statistics Denmark, the Danish central bank, and BIS

NATIONAL ECONOMY

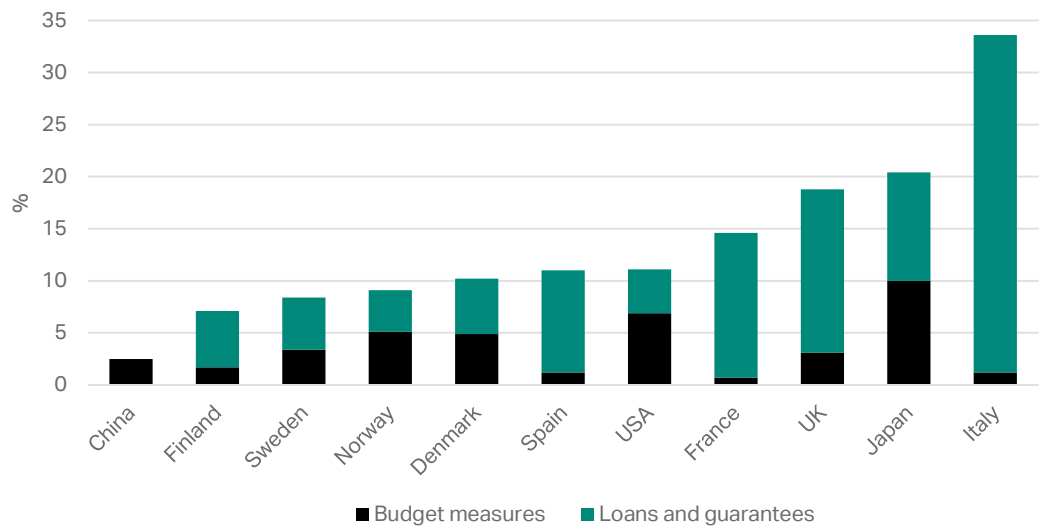
The Danish economy is less cyclical than the other Nordic countries and both the pharmaceutical industry and large food and agricultural industries have managed well so far through the COVID-19 pandemic. Moreover, the Danish government has put in place an extensive support package which, together with low interest rates, is likely to soften the current recession. However, social lockdown in recent months has had a significant impact on unemployment and demand, and the Danish economy is not unaffected by the wider international recession. While around 132,000 people were unemployed as at March 11, the number had risen to roughly 174,000 as of June 10. This number is expected to fall, however, as the economy gradually reopens.

Figure 3. Danish interest rates, 2005-Q1/20



Source: Statistics Denmark

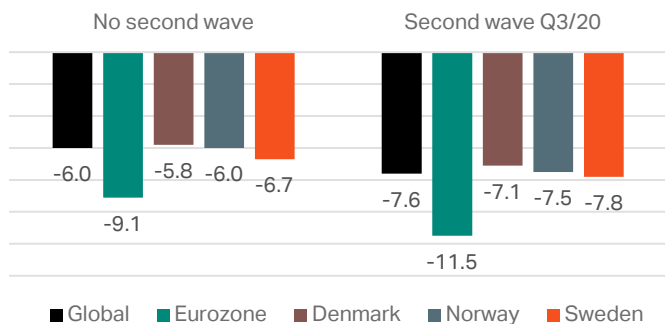
Figure 4. Selected countries' political response to COVID-19 (% of GDP)



Source: International Monetary Fund, Ministry of Finance

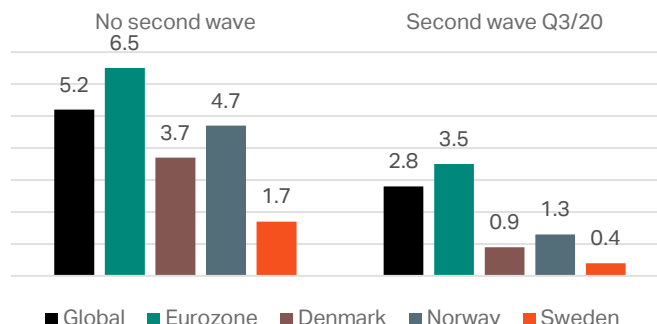
Danish GDP is likely to decline by about 6% this year before rising again by about 5% in 2021, according to consensus estimates. This is largely in line with projections for the other Nordic countries. In the most recent [OECD Economic Outlook](#), published 10 Jun. 2020, the organisation presents two scenarios for economic growth, depending on whether or not a second wave of the COVID-19 pandemic occurs. Denmark's GDP is expected to fall by 7.1% in 2020 in the case of a second wave in the second half of the year and 5.8% if no second wave emerges. The projected rebound in 2021 is also expected to be more moderate in the case of a second wave.

Figure 5. GDP growth: Two scenarios 2020



Source: OECD

Figure 6. GDP growth: Two scenarios 2021



Source: OECD

Figure 7. Denmark—key national metrics, 2015–2021e

	2015	2016	2017	2018	2019e	2020e	2021e
GDP growth (%)	1.6	2.0	2.4	2.2	2.4	-6.2	5.2
CPI growth (%)	0.5	0.3	1.1	0.9	0.8	0.8	2.0
Unemployment rate (%)	4.6	4.2	4.3	3.6	5.1	6.3	5.8
Current account balance/GDP (%)	8.8	7.3	7.9	5.7	7.9	6.0	7.0
Central bank policy rates	(0.65)	(0.65)	(0.65)	(0.65)	(0.75)	(0.60)	(0.60)

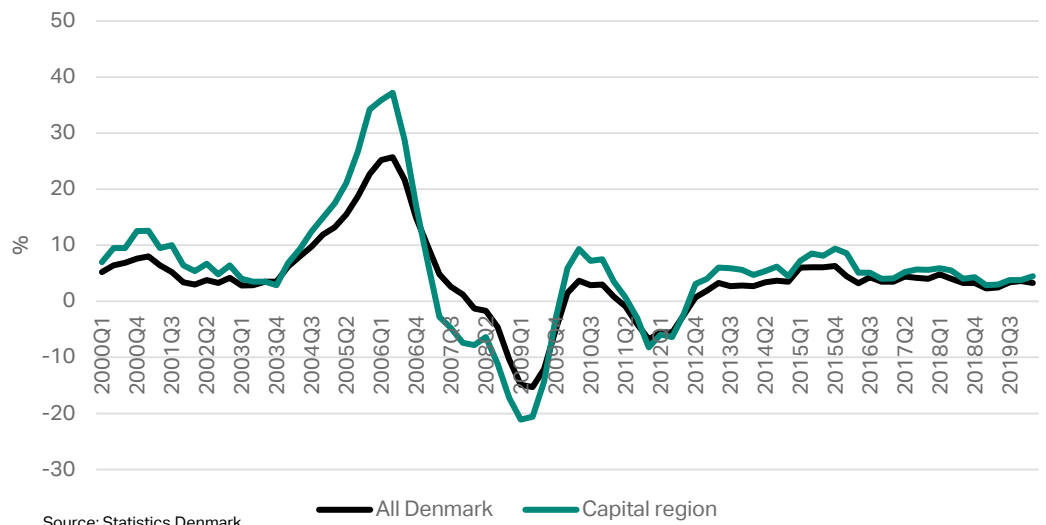
Based on NCR consensus estimates. e—estimate.

HOUSING MARKET

The Danish housing market went through a period of boom and bust before and during the 2008-2009 financial crisis. However, housing prices have stabilised in recent years and were on average up by 3.6% in 2019 supported by low unemployment and low interest rates. A protracted period of low interest rates would continue to support the housing market. However, prices of one-family houses were down by 4.2% from February to March, according to Statistics Denmark, and we find it likely that increased unemployment and general uncertainty will impact housing prices negatively in the short term.

Changes in the Danish property tax law, which will take effect from 2021, could have a negative impact on housing prices for higher value properties, with some analysts estimating general price falls of 5-10% in Copenhagen and Aarhus. Associated property valuations will be rolled out through 2020, with the initial tax implications for individual borrowers starting from 2021. Once the new valuations are available, the impact of future taxation could have an immediate impact on pricing.

Figure 8. Annual change in Danish one-family housing prices, 2000-Q1/20

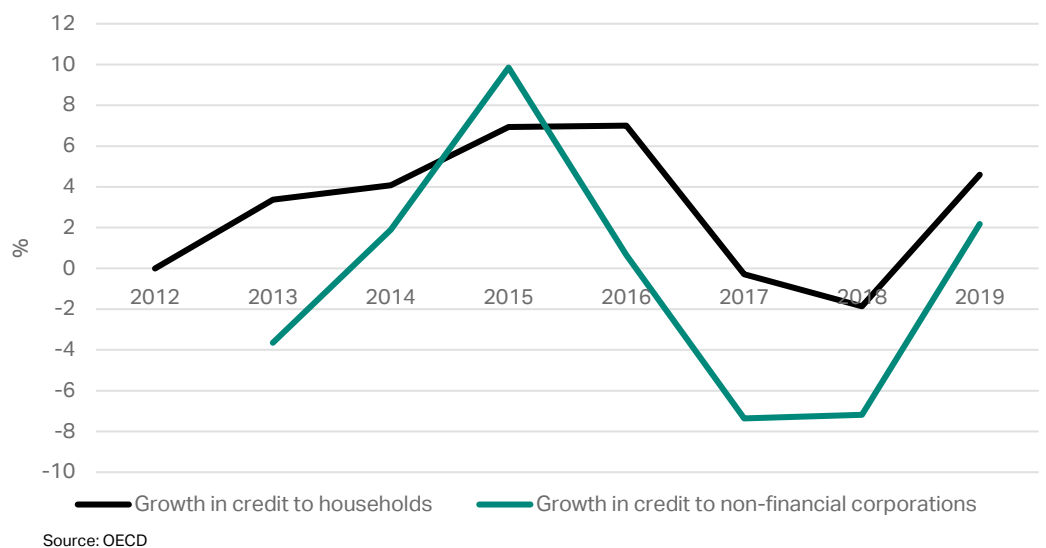


CREDIT GROWTH

Total mortgage and bank lending to Danish households has been moderate in recent years and there has been modest de-leveraging in real terms. This is mainly apparent at the larger banks, while medium sized banks have increased lending due to expansion into growth areas. Danish corporations have shown stronger demand for loans than households after a period of de-leveraging following the 2008 financial crisis, but growth remains at a moderate level. According to the central bank, loans to non-financial corporates were up by 1.5% in the year to May 2020, while loans to households were down by 0.3%. The current crisis could have a positive impact on corporate credit demand in the short-term for liquidity reasons, but is likely to impact demand negatively over the medium term.

According to the Danish Financial Supervisory Authority, Denmark has a higher credit-to-GDP ratio than other EU member states, at about 163% in 2018 compared with about 130% in Sweden and 90% in Finland. The country's high credit-to-GDP ratio reflects a high level of home ownership and is offset by the considerable financial assets held by households, such as pension assets.

Figure 9. Growth in private-sector loans, 2012-2019

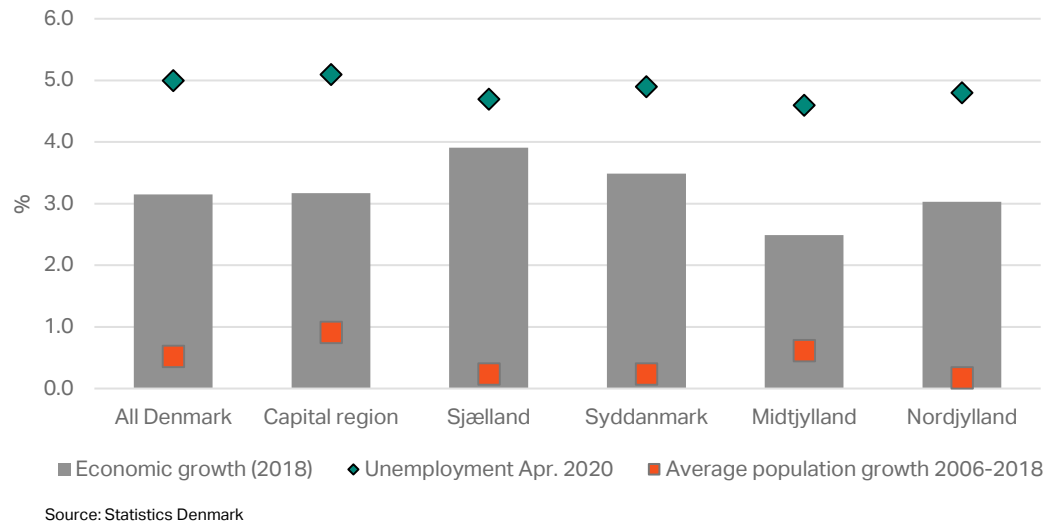


REGIONAL ANALYSIS

A trend of urbanisation has benefited the Capital region (Copenhagen) as well as Aarhus in Midtjylland, where we see higher-than-average population and economic growth. Denmark is relatively small with good communications, and economic growth in the country's regions is less

dependent on the performance of local industries than larger countries. Moreover, agriculture is a major industry in Denmark, increasing the importance and vitality of rural areas. Accordingly, there are very small differences in unemployment between regions and regional housing prices tend to be strongly correlated, albeit with somewhat higher volatility in the Capital region.

Figure 10. Danish unemployment, economic growth, and population growth, by region

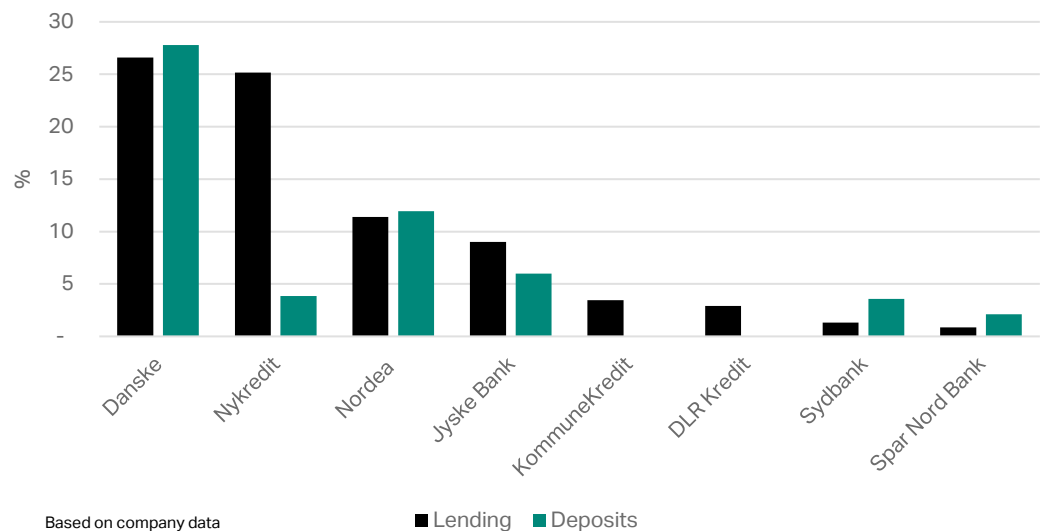


BANKING MARKET

The Danish banking market consists of a combination of large banking groups and mortgage companies and smaller regional savings banks. The mortgage market overshadows the banking market structure given the volume of residential and commercial mortgage loans which are concentrated on a few covered bond issuers. Many customers of local and regional banks keep their savings in their local banks, but obtain mortgage loans from Nykredit, primarily through subsidiary Totalkredit, and DLR Kredit. Accordingly, Denmark's four largest banks represent over 70% of domestic lending, though only 50% of customer deposits.

Danske Bank is the market's largest entity by loans and deposits, with its customers' own mortgage loans mostly issued by its subsidiary, Realkredit Danmark. Of all Danish banks, Danske Bank is the only one with significant international business, primarily as a large-scale operator in the other Nordic countries. Jyske Bank operates similarly. Nordea operates as a branch of its Finnish parent as well as a domestic mortgage institution, Nordea Kredit Realkredit.

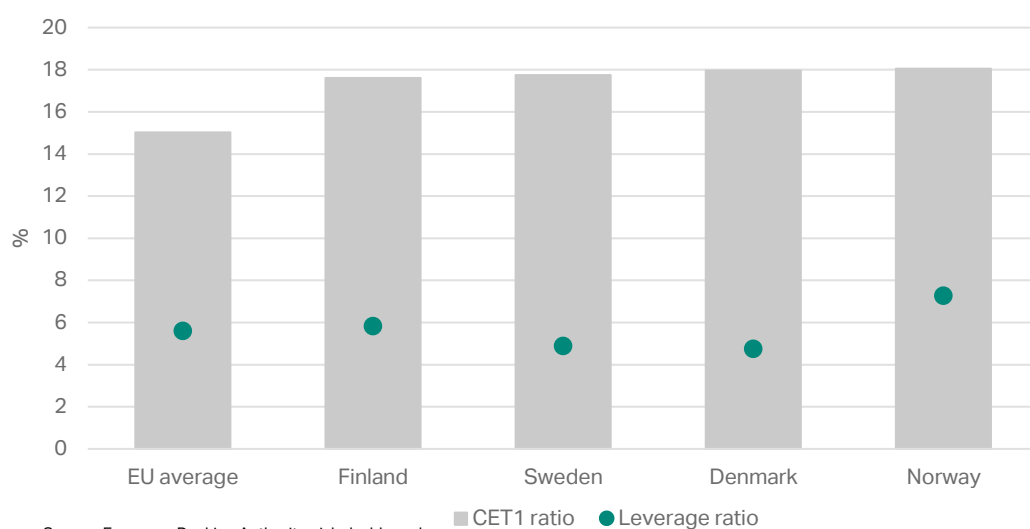
Figure 11. Market shares of the eight largest banks in Denmark, 2018



Relatively slow credit growth in Denmark has increased competition for new customers and pressured margins. Despite negative interest rates on covered bonds with tenors of up to 10 years and 30-year covered bonds with 0.5% coupon rates, mortgage banks are still able to earn a relatively stable margin and collect refinancing fees from customers seeking to lock in mortgages at historically low interest rates. However, Denmark has had negative interest rates since 2015 and deposit margins are under pressure given banks' desire to maintain a 0% floor on most retail deposits. However, a growing number of banks are charging higher net worth individuals for retail deposits. Given rapidly shifting global economic conditions, NCR expects that margin pressure and slow credit growth will continue to affect banks' earnings forcing them to pursue digital solutions and automation to reduce costs.

Danish banks had strong earnings in 2019 because of high levels of refinancing and associated fees. This is unlikely in 2020. While Danish banks have relatively strong common equity Tier 1 (CET1) ratios, their leverage ratios are among the lowest in Europe. This gives them the ability to cope with lower margins than their international peers (see Figure 16).

Figure 12. Nordic countries' and EU's average CET1 and leverage ratios

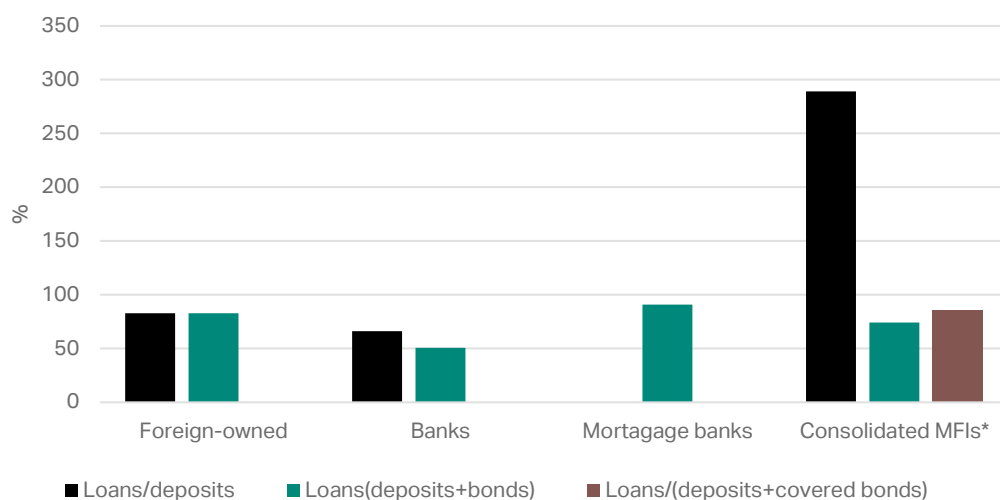


AVAILABLE STABLE FUNDING

Denmark has a highly functioning covered bond market, which accounts for a huge proportion of overall monetary financial institution financing (about 60% of customer deposits and debt issued). As a result, the consolidated market has a very high loan-to-deposit ratio of over 250%. However, this ratio falls to 85% when covered bonds are taken into account. The availability of mostly domestic stable funding stands out positively in the Nordic markets. We view the Danish covered bond market as a stable source of financing, a property it has demonstrated throughout its long history. This is attributable to the "balance principle", which reduces market risk and currency mismatches, and the lack of refinancing risk for bonds issued since 2014. For banks, household deposits are enough to finance both corporate and retail borrowing, with non-financial corporate deposits as excess, reducing vulnerability outside the mortgage market.

The share of foreign ownership of Danish covered bonds is around 15%, a much lower level than in Norway and Sweden and the financing is fed by the fully-funded Danish pension system, which contributes new assets to invest into the covered bond market, even in periods of financial stress, making it considerably more stable than domestic deposits historically.

Figure 13. Danish Bank's loans as a share of deposits, bond and covered-bond financing, 2018



*Monetary Financial Institutions. Based on NCR data

Figure 14. Denmark—key credit metrics, 2013–2019

	2013	2014	2015	2016	2017	2018	2019
Credit to households (%)	127.7	125.1	120.5	118.4	116.6	114.2	111.7
Credit to non-financial corporations (%)	111.7	114.9	117.4	117.0	111.7	109.4	107.3
Growth in credit to the private non-financial sector (%)	(10.5)	0.6	(2.1)	(2.5)	(7.1)	(4.8)	(4.5)
Household savings/disposable income (%)	2.3	(2.9)	3.9	4.5	6.2	7.0	na
Debt service ratios of households (%)	18.4	17.7	16.7	16.3	15.5	15.1	14.8
Nominal residential property prices, 2010 = 100	99.4	103.1	110.3	116.1	121.3	126.6	129.2
Real residential property prices, 2010 = 100	93.7	96.7	102.9	108.1	111.7	115.6	117.1

Source: Bank for International Settlements

Figure 15. Denmark–key banking market metrics, 2013–2019

	2013	2014	2015	2016	2017	2018	2019
Net interest margin (%)	1.2	1.3	1.2	1.1	1.1	1.0	1.0
Net interest & fee income/op. income (%)	92.2	97.2	94.4	87.8	80.9	86.2	82.9
Cost to income (%)	60.3	58.7	56.3	52.7	50.5	56.6	58.8
Pre-provision profit/avg. RWA (%)	2.0	2.1	2.3	2.4	3.0	2.4	2.3
ROAA (%)	0.2	0.3	0.4	0.5	0.6	0.5	0.5
ROAE (%)	4.5	4.9	7.1	9.5	11.1	8.3	8.8
Loan loss provision/avg. gross loans (%)	0.5	0.4	0.2	0.1	(0.0)	0.0	0.1
Problem loans/gross loans (%)	3.5	3.6	2.8	2.8	2.2	2.2	2.1
Problem loan growth (%)	(3.3)	9.5	(22.0)	(11.3)	(20.6)	8.3	(1.3)
CET1 ratio (%)	14.7	15.3	16.5	17.0	18.1	17.9	18.4
Capital ratio (%)	19.2	18.3	19.6	21.0	21.9	21.4	22.5
IFRS Tier 1 leverage ratio (%)	4.8	4.9	5.2	5.1	5.1	5.0	5.0
Net loans/deposits (%)	252.0	261.2	279.5	281.0	262.2	267.4	263.2

Based on 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.

Figure 16. Nordic banks' net interest margin, 2011–2019

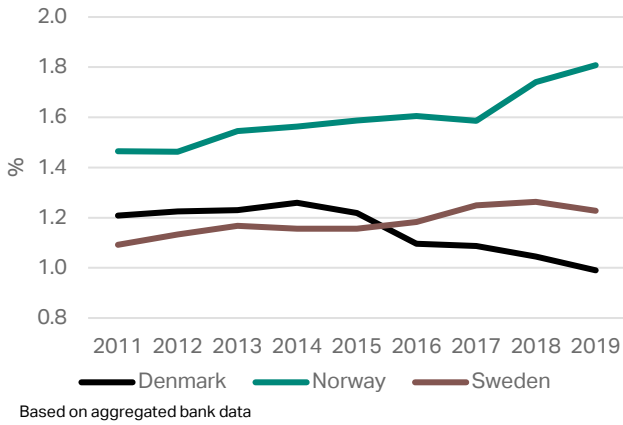


Figure 17. Nordic banks' cost-to-income ratios, 2011–2019

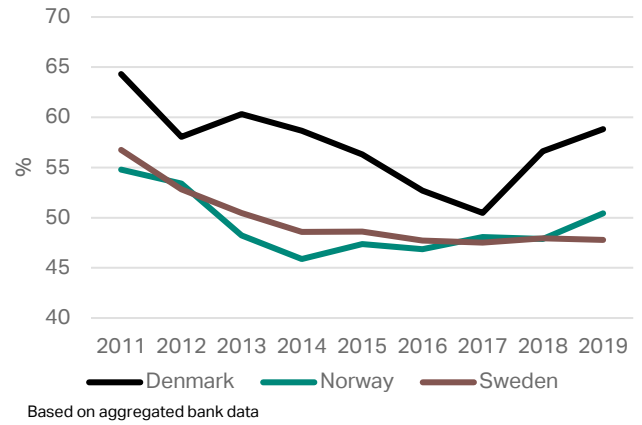


Figure 18. Nordic banks' pre-provision profit to avg RWAs, 2011–2019

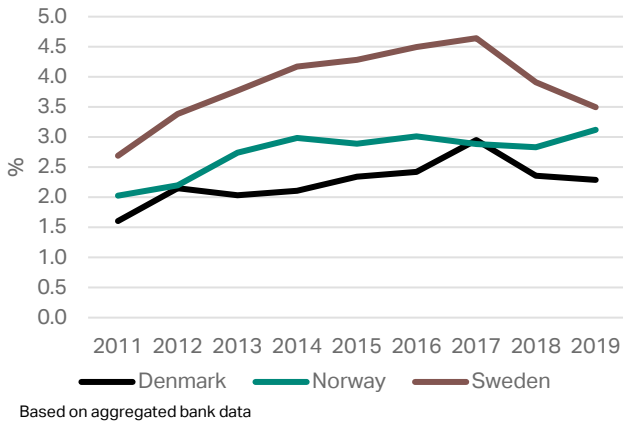


Figure 19. Nordic banks' problem loans to gross loans, 2011–2019

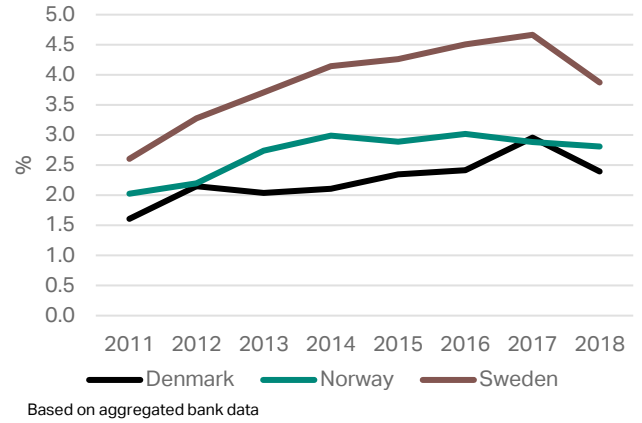


Figure 20. Nordic banks' CET1 ratios, 2011–2019

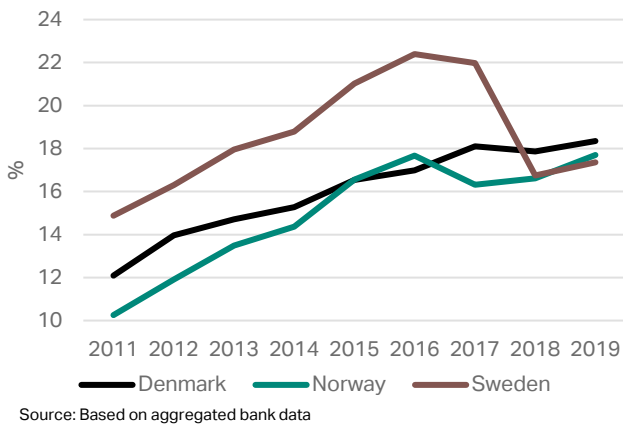
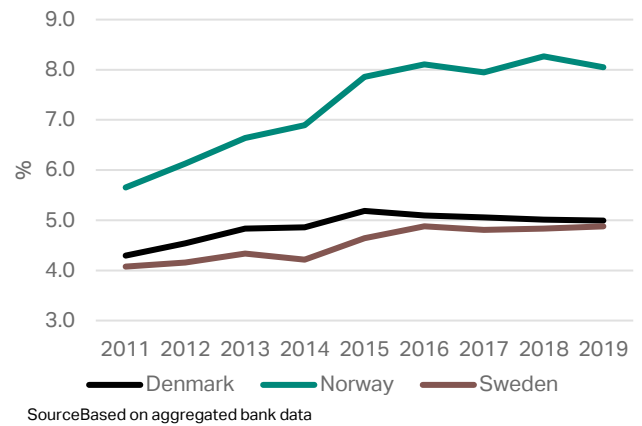


Figure 21. Nordic banks' leverage ratios, 2011–2019



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