Swedish savings banks face uncertain 2021

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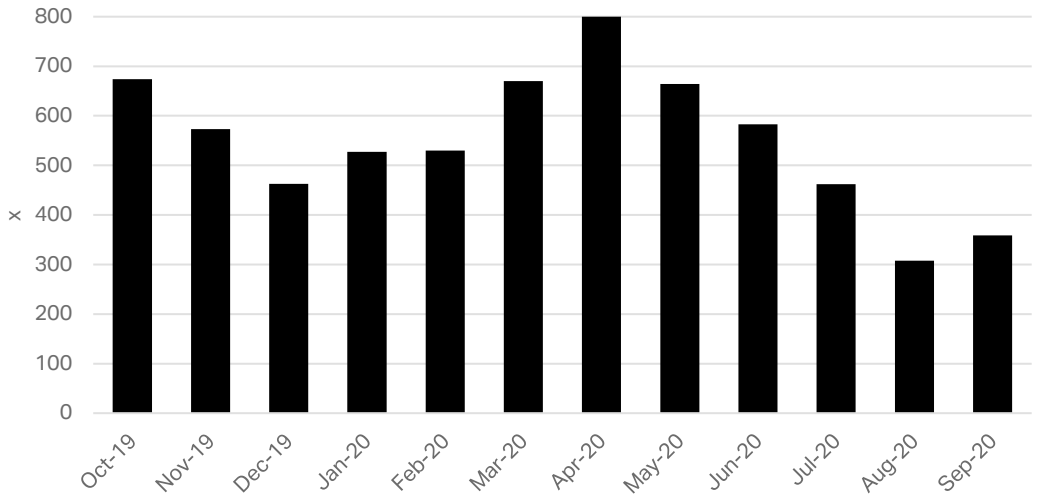
Given the economic impact of COVID-19, Swedish savings banks outperformed our expectations during the first nine months of 2020. A decision in December 2019 by the central bank to restore policy rates to 0% improved margins, as did a temporary increase in the Stockholm Interbank Offered Rate during the first half of 2020. A strong recovery of the capital markets supported commission revenues after a rapid decline in the first half of the year. Steady increases in residential housing prices, stable commercial real estate valuations, and government support for individuals and corporations have done their part to support credit performance. The country's savings banks have, however, had to increase their credit loss provisions, primarily due to deteriorations in modelled economic projections rather than a significant rise in actual customer defaults.

Nordic Credit Rating (NCR) sees a risk that some aspects of 2021 could be even more challenging than 2020 for Swedish savings banks. In particular, we see potential for increasing late-cycle loan losses and margin pressure amid low interest rates. Banks have taken measures to mitigate these impacts by increasing digitalisation and setting targets for long-term cost cutting. In addition, NCR expects that most savings banks are likely to benefit from a return to dividend payments by Swedbank AB, which withheld dividends for 2019, though regulatory pressure to maintain capital buffers and lending capacity will extend into 2021. NCR also considers that Swedish savings banks are generally well capitalised and have built strong liquidity buffers as private customers have increased already high savings rates resulting in an influx of deposits.

OUTLOOK STABLE DESPITE CHALLENGING OPERATING ENVIRONMENT

Following our downward revision of Swedish banks' operating environment to 'bbb+' from 'a-' in April, we believe that the remaining risk factors are more likely to affect individual institutions or banks than the wider banking sector and are better reflected in the outlooks and ratings on individual banks. We expect political measures in response to COVID-19 to continue to support households and businesses, as illustrated by the low number of bankruptcies in the first nine months of the year (see figures 1 and 2), but we expect these measures will at some point end. In the following note, we take a look at some of the drivers and challenges facing Sweden's savings banks in 2021.

Figure 1. Swedish corporate bankruptcies

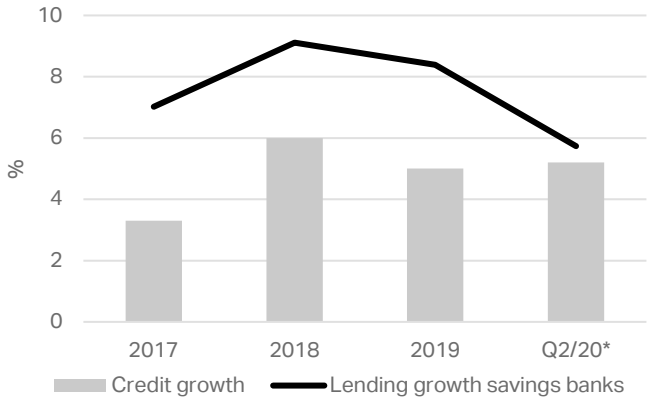


Source: Statistics Sweden.

LENDING DEMAND REMAINS THOUGH MARGINS ARE UNDER PRESSURE

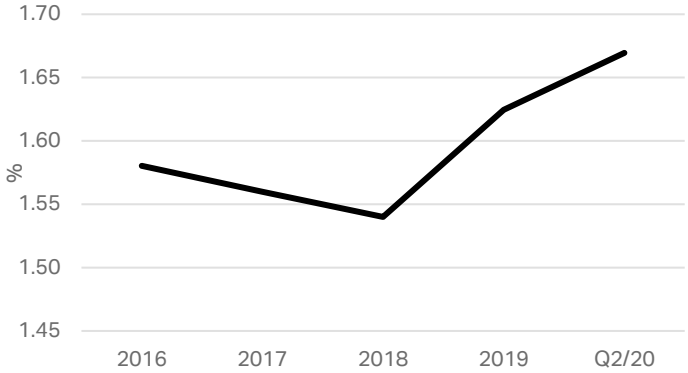
Swedish savings banks' core revenues have improved so far in 2020. Savings banks have increased their market share of total domestic credit in recent years, in part by maintaining a higher share of lending on their own balance sheets rather than transferring loans to Swedbank. Moreover, the reversal of the central bank's negative interest rate policy in December 2019 and the spike in the Stockholm Interbank Offered Rate in the first half of 2020 have helped to improve net interest margins for the largely-deposit-financed savings banks. We do not expect interest rates to rise in 2021 and anticipate that increasing competition from low-cost mortgage lenders will put pressure on lending rates. Accordingly, we anticipate a slight margin decline in 2021. Margin pressure is likely to be mitigated by increasing lending growth as the economic cycle improves, particularly in the second half. Growth in commission income will largely depend on the performance of the financial markets and the valuation of client assets transferred primarily to asset manager Swedbank Robur.

Figure 2. Growth in bank lending and credit growth



Source: company data (27 savings banks), central bank. *Annualised.

Figure 3. Net interest margins, savings banks

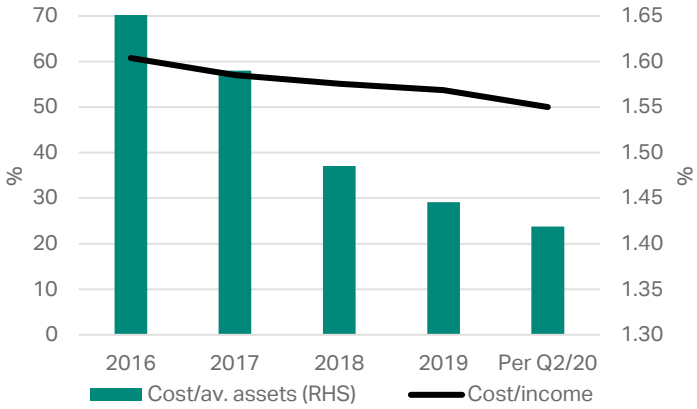


Source: company data (28 savings banks).

FOCUS ON COST CUTTING AND DIGITALISATION SUPPORTS PROFITABILITY

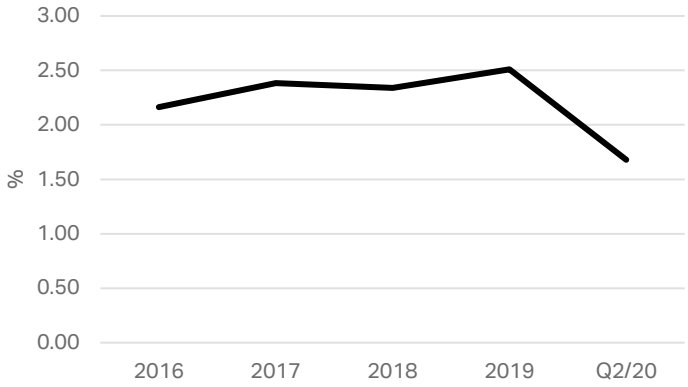
Swedish savings banks have improved cost efficiency through an increasing focus on digitalisation, which has been accelerated by social distancing. We expect nominal costs to increase marginally due to IT-development expenses, offset in part by reduced staffing. However, cost efficiency is likely to continue on a long-term positive trend. This, together with NCR's expectation that Swedbank will pay about 50% of its 2020 profits in dividends, assuming regulatory pressure subsides during 2021, should help banks improve their pre-impairment profits from the levels of 2020.

Figure 4. Cost/income ex. trading and costs/av. assets, savings banks



Source: Company data (27 savings banks)

Figure 5. Pre-impairment profit to average REA, savings banks



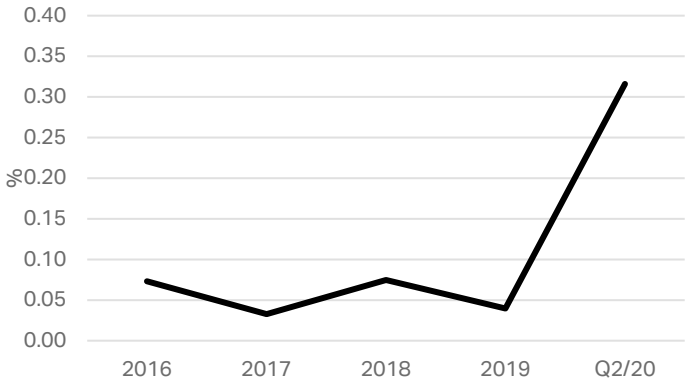
Source: company data (27 savings banks).

LOAN LOSSES ON THE RISE

Swedish savings banks have increased their loan loss reserves amid rising non-performing loans in 2020, although substantial government support programmes have supported asset quality. NCR sees increasing loan losses as a major risk factor in 2021, particularly when government support is reduced. In particular, we see a risk that companies will reduce credit to distressed customers and we expect long-term pressure on commercial property rents and values.

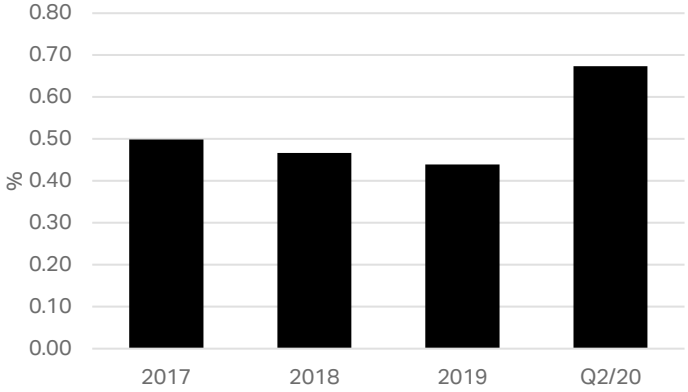
While we expect loan losses over the next few years to be elevated, we do not expect domestic loan losses to exceed 0.3% of lending in 2021. We note that savings banks have low exposure to the sectors most affected by COVID-19 restrictions. However, regional savings banks could have higher one-off losses, in particular if they run into problems with their commercial real estate exposures.

Figure 6. Loan losses to average loans, savings banks



Source: company data (27 savings banks).

Figure 7. Net stage 3 non-performing loans to net loans, savings banks

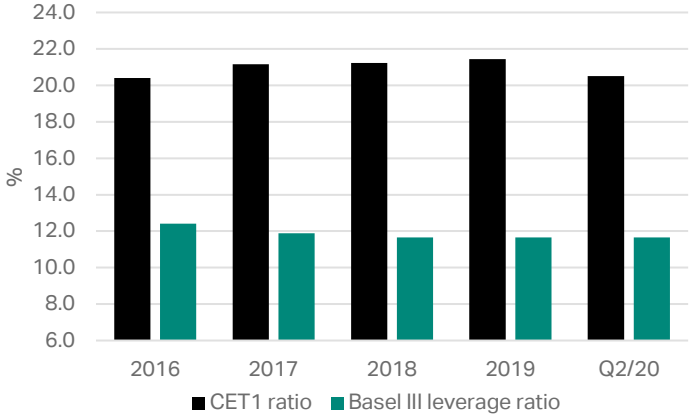


Source: company data (25 savings banks).

CAPITALISATION TO REMAIN STRONG

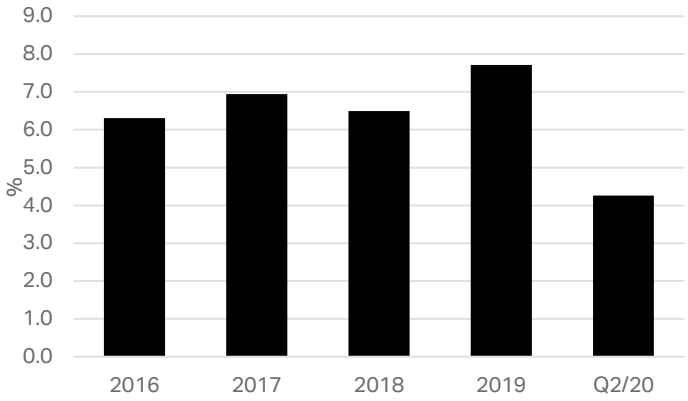
In our view, Swedish savings banks are likely to prove resilient to increasing loan losses due to their strong capital and leverage positions. During 2021 the Swedish financial supervisory authority will begin to issue Pillar 2 guidance for the country's smaller banks which currently have no such requirements. For most savings banks, this will result in a 5-10% increase in their capital requirements, but this is a formality given already high common equity Tier 1 (CET1) ratios. We expect Swedish savings banks to remain modestly profitable and careful with any divided payments in 2021. Accordingly, we do not expect them to reduce their capital levels in the course of the year.

Figure 8. CET1 and leverage ratios, savings banks



Source: company data (28 savings banks).

Figure 9. Return on average equity, savings banks



Source: Company data (27 savings banks)

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