

The Swedish banking market 2021

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Nordic Credit Rating (NCR) applies a score of 'bbb+' for the Swedish banking market and expects an economic upswing in 2021 led by external demand for Swedish exports and the eventual rebound in services and tourism during the third quarter of 2021. Our expectations of the economic environment are dependent on a large proportion of the population being vaccinated by the summer and the subsequent lifting of restrictions on travel and the service sector. As the rebound takes effect, we believe unemployment will fall quickly, especially among younger adults, who have been disproportionately affected by the loss of service and seasonal work. Despite material government support provided during the pandemic, Sweden's creditworthiness remains strong, which bolsters our assessment. Housing prices increased by 11.5% in 2020, with significant growth from May to November before the second wave of the pandemic slowed activity in December. NCR believes that the pace of housing price growth in 2021 will be more in line with the long-term 6% growth rate.

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. Sweden – scoring of national indicators (previous score in parentheses)

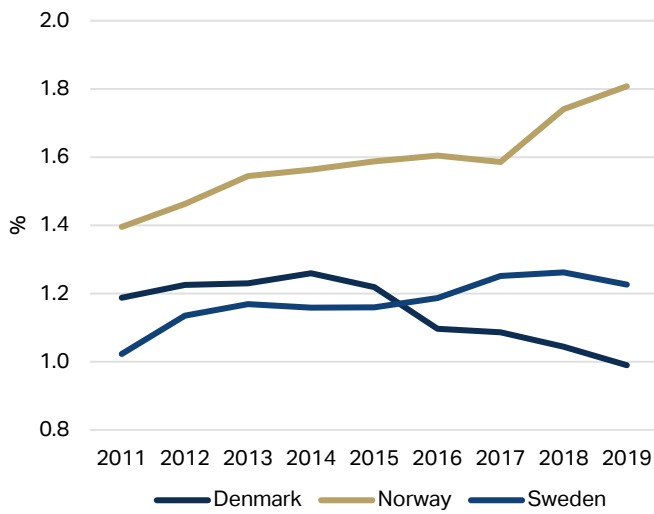
SUBFACTOR	SCORE	RATIONALE
Sovereign strength	aa	Major credit rating agency average: AAA, minimum: AAA.
Output growth	bbb (bb)	The economy contracted in 2020 due to COVID-19, but we note that a rebound is already underway and expect growth in 2021.
Credit growth	bbb	Credit growth has been running at more than twice GDP growth and continues to rise at about 5% a year despite COVID-19.
Housing prices	bbb (a)	COVID-19 had a short-term negative effect in April and May, but this has been followed by high growth since.
Unemployment	bb	Unemployment remains elevated due to the pandemic and is structurally higher than in other Nordic countries due to unemployment levels among recent immigrants.
Available stable funding	a	Available stable funding in the form of deposits and domestic covered bonds falls short of monetary financial institution private-sector loans, but access to other forms of long-term senior financing remains strong.
International cycle	bb	Global growth prospects have weakened, despite being supported by significant monetary stimulus. We expect a rebound in 2021. In our assessment, asset prices are at or near their peak levels.

Figure 2. Sweden – key banking metrics 2017–2022e

%	2017	2018	2019	Q3 2020	2021e–2022e
Growth in credit to households	7.0	5.5	5.0	5.2	Flat
Real housing price growth	8.3	0.0	2.7	6.0	Increasing
Net interest margin	1.3	1.3	1.2	1.0*	Flat
Problem loans/gross loans	0.6	0.8	0.9	0.7*	Increasing

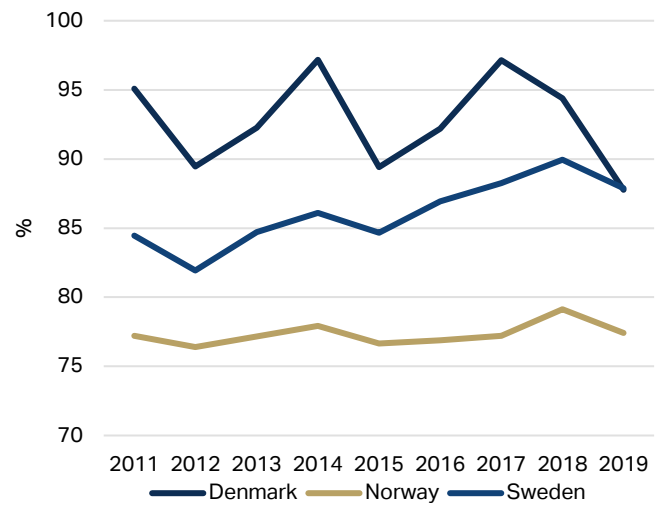
*NCR estimate. Source: BIS, SCB, aggregated bank reports.

Figure 3. Banks' net interest margin, 2011–2019



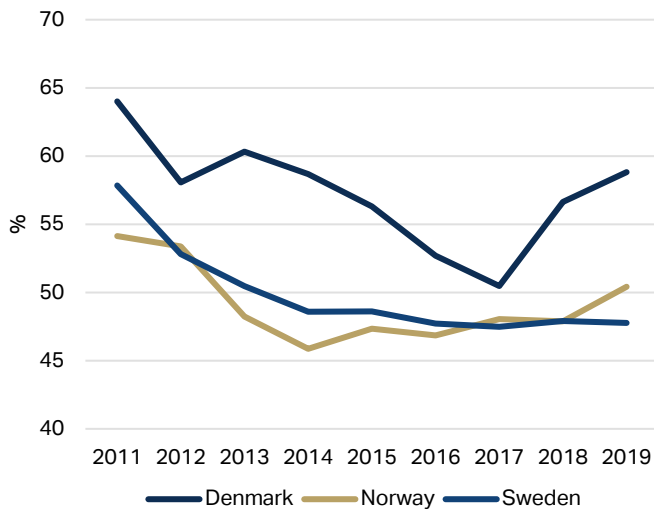
Source: Aggregated bank data.

Figure 4. Banks' net interest and fee income to operating income, 2011–2019



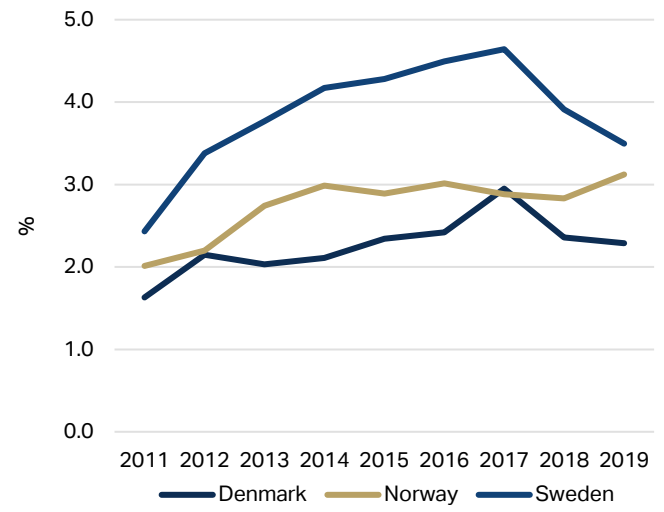
Source: Aggregated bank data.

Figure 5. Banks' cost-to-income ratios, 2011–2019



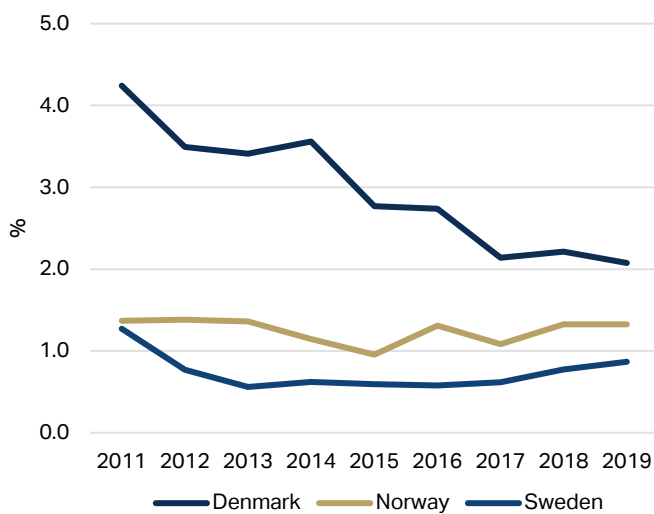
Source: Aggregated bank data.

Figure 6. Banks' pre-provision profit to avg. REA, 2011–2019



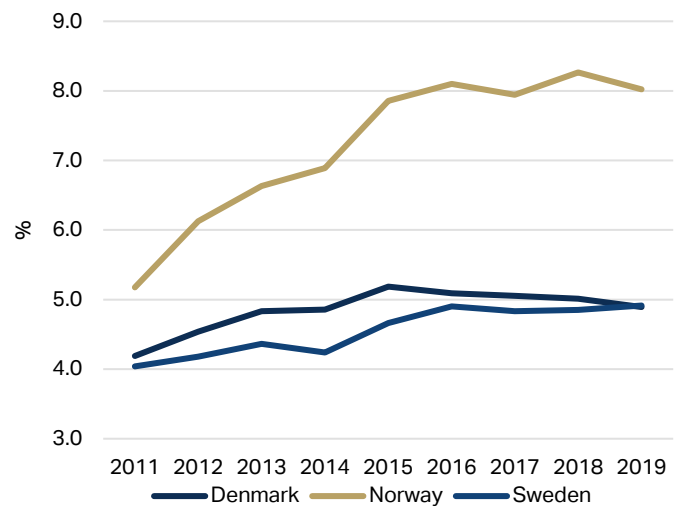
Source: Aggregated bank data. REA-Risk exposure amount.

Figure 7. Banks' problem loans to gross loans, 2011–2019



Source: Aggregated bank data.

Figure 8. Banks' leverage ratios, 2011–2019



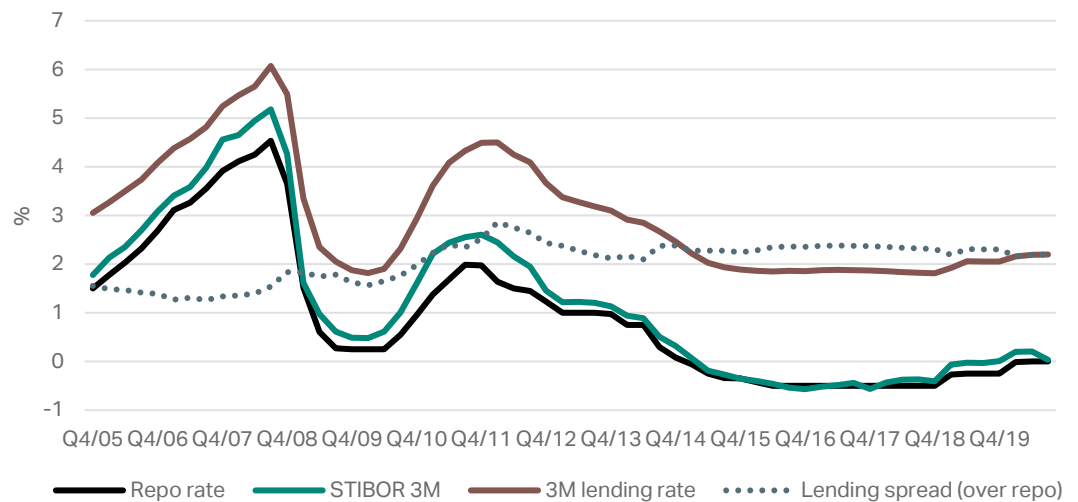
Source: Aggregated bank data.

NATIONAL ECONOMY

NCR expects Sweden to experience a significant upswing in economic activity after summer 2021, by which time a large proportion of the population should be vaccinated and the COVID-19 restrictions on the service sector should have been eased. The economic rebound will likely be predominantly driven by pent-up demand in services and tourism, which have been heavily affected by social-distancing measures and travel restrictions. Consequently, increased consumption levels are expected to result in GDP growth of 3.0% in 2021 following a decline of 3.5% in 2020, based on consensus estimates. NCR expects current low interest rates to persist over the next few years, with the policy rate remaining at zero through 2021 and possibly longer.

The unemployment rate remains elevated, although government support programmes have enabled companies to furlough employees, which should facilitate a speedy recovery in the second half of 2021. However, there has been a slower return of employees from furlough in Sweden than in neighbouring countries. Sweden has a higher rate of unemployment than its neighbouring countries, especially amongst immigrants whose skillsets are poorly matched with available employment opportunities. This latter group has been particularly impacted by the pandemic, with the year-on-year unemployment rate increasing by 4.7pp to 18.9% in the third quarter of 2020. The corresponding figure for the Swedish-born population was 4.4%, which is a year-on-year increase of 1.0pp.

Figure 9. Swedish interest rates (%), 2005Q4–2020Q4



Source: Statistics Sweden, Riksbanken

Export industries and manufacturing in Sweden have largely recovered and experienced a smaller impact from the second wave of the pandemic due to a better understanding of the virus. Production disruptions were broadly absent in the second half of 2020 and export orders have rebounded to pre-pandemic levels. However, given Sweden's dependence on exports, an appreciating krona is a risk factor that could affect the pace of recovery in 2021. We expect the international economic environment to improve in the second half of 2021, when vaccination programmes are anticipated to have a meaningful impact on Sweden's trading partners and infection control measures are gradually reduced. However, elevated unemployment levels, lower than anticipated consumer spending, and uncertainties and risks associated with the vaccine roll-out could hamper the projected recovery in 2021.

Swedish government support packages are projected to facilitate the economic recovery in 2021. Strong government finances add significant flexibility to pursue additional measures for boosting economic activity on the back of the central bank's expansionary monetary policy and quantitative-easing programme.

Figure 10. Sweden– key national metrics, 2016–2022e

%	2016	2017	2018	2019	2020e	2021e	2022e
GDP growth	2.7	2.4	2.1	1.3	-3.5	3.0	3.3
Core CPI growth	1.3	1.9	2.1	1.7	0.5	1.1	1.3
Unemployment rate	6.4	6.1	6.3	6.8	8.5	9.0	8.0
Current account balance/GDP	4.2	3.2	2.3	3.4	4.8	4.4	4.3
Monetary policy rate	-0.5	-0.5	-0.5	-0.3	0.0*	0.0	0.0

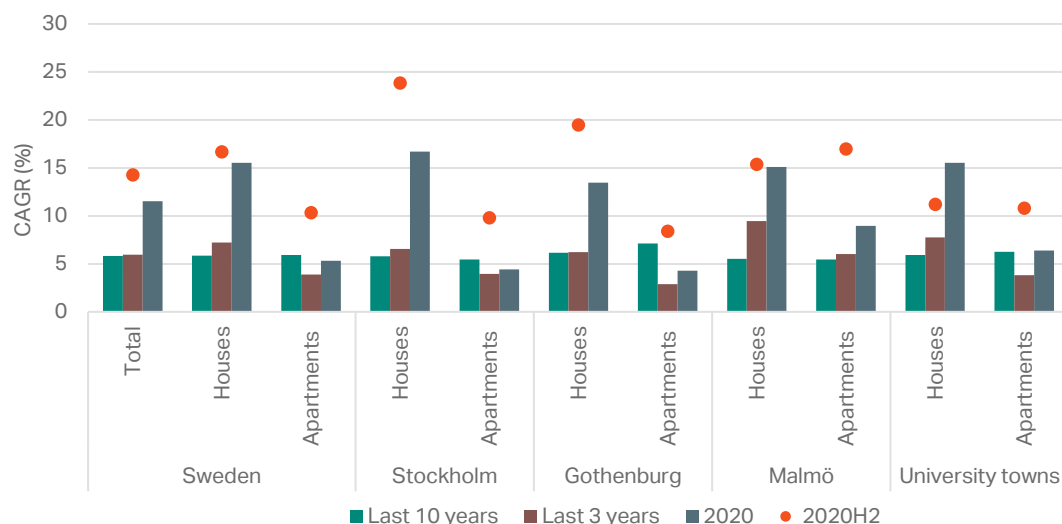
*Actual policy rate at the end of 2020. Based on consensus estimates. e–Estimate.

HOUSING MARKET

Housing prices in Sweden have historically appreciated at about 6% a year over the past decade. The HOX index continued to show housing prices increasing in the fourth quarter, but there was a notable reduction in the pace of growth since May. Most markets are at record highs, but, notably, the apartments market fell in December from its November 2020 peak. Price appreciation has been especially pronounced in the houses segment as households are looking for larger properties to accommodate an anticipated increase in working from home as a result of the pandemic. As shown in Figure 11, housing prices increased by 11.5% in 2020, raising the three-year average to 5.9%. The single-family housing market has become more attractive as lifestyles adapt to the ongoing pandemic (15.5% growth in 2020 versus annual growth of 5.9% over the past decade). The residential-apartments market grew by 10.3% in the second half of 2020, recovering early losses and resulting in a 5.3% growth rate for the full year 2020.

NCR believes that the pace of housing price growth will be more in line with the long-term 6% growth rate in 2021, in part due to continued social-distancing prior to the rollout of COVID-19 vaccines, but also due to comments by the regulator about reimplementing previous amortisation requirements during the year.

Figure 11. CAGR of Swedish housing prices by region and type, Dec. 2020



Source: ValueGuard HOX Index

CREDIT GROWTH

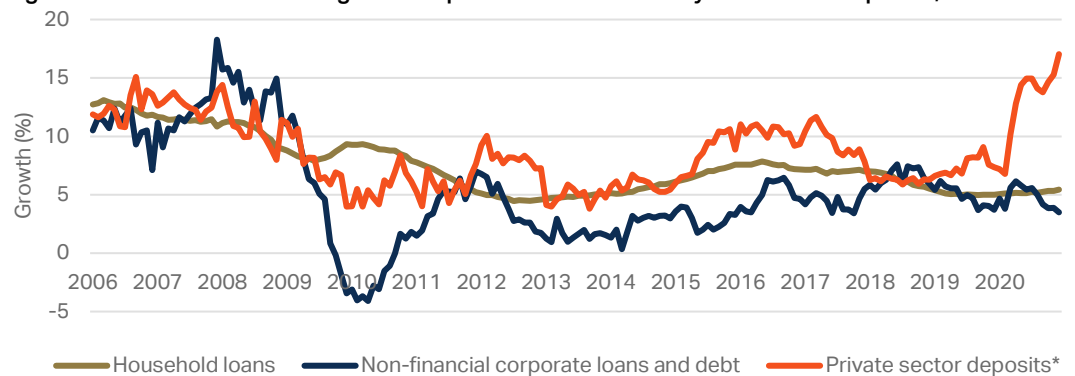
At year-end 2020, monetary financial institutions' lending to the private sector comprised 53% household mortgage loans, 36% non-financial corporate lending and 11% other household loans including consumer loans. In 2020, the share of non-financial corporate loans with commercial real-

estate collateral was 55.3%, an increase from 51.1% at year-end 2019, as corporations outside of the real-estate sector reduced investments due to the uncertain economic outlook.

Growth in private-sector loans diverged in 2020, with mortgage lending increasing slightly to 5.4% by the end of the year from 5.0% in 2019 and corporate lending growing by only 3.5% as loans taken up in March and April were repaid by the end of the year. Rising housing prices, confirmation that interest rates would remain low, and amortisation relief in the wake of the pandemic increased the rate of mortgage borrowing in 2020 to 5.8% from 4.9%. However, greater concern about pandemic-related credit losses on consumer loans resulted in only 2.4% annual growth in unsecured credits, the lowest growth rate since 2016 and down from 10% growth in 2019. We anticipate that the growth rate for household lending will decline to about 5% per annum again by 2022, given the return of amortisation requirements and our expectations of more moderate house price growth.

Corporate credit demand increased in March as companies drew down credit facilities to protect their liquidity positions. We expect longer-term corporate loan growth to remain low as we anticipate real-estate companies moving a higher proportion of their borrowing to the capital markets over the next few years. We note that the central bank's commitment to capital-market financing by corporations increased in 2020, with the central bank buying commercial paper to support liquidity and starting a corporate bond-buying programme in September 2020. However, the bond market disruption in March and April 2020 highlighted the refinancing risk in the Swedish bond market, increasing the need for transparency to support functioning markets in future crises.

Figure 12. Swedish 12-month growth in private-sector loans by sector and deposits, 2006–2020



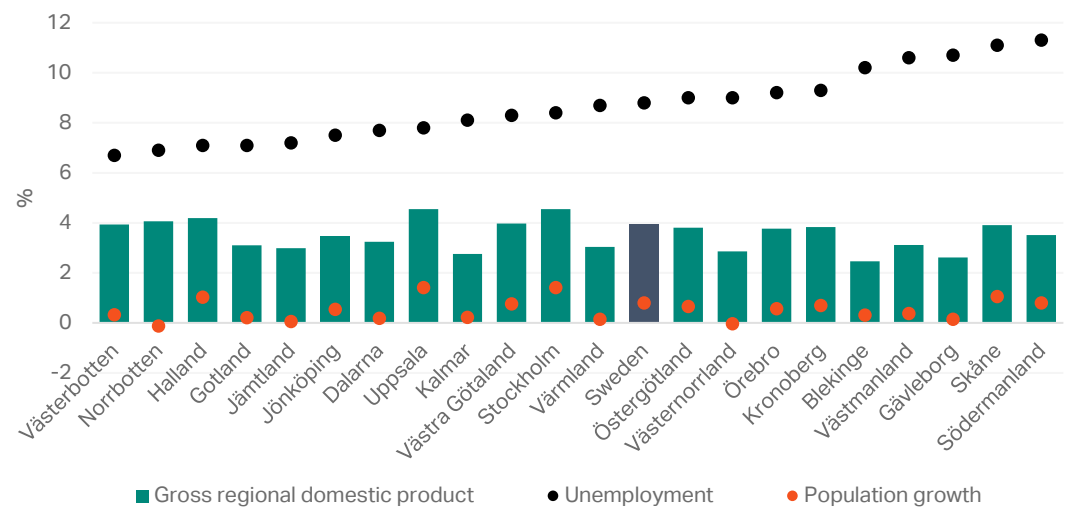
Source: Statistics Sweden. *Non-financial corporation and household deposits.

REGIONAL ANALYSIS

Swedish urbanisation continues apace and is further contributing to the significant historical differences in housing prices between Stockholm and Gothenburg (in Västra Götaland county), but also in unemployment at county level and population growth statistics. Regions with expanding populations are driving economic growth, a factor that has also supported growth in smaller markets within range of Sweden's largest cities. However, fewer than half of Sweden's 21 counties have experienced native-born population growth since 2000 and high immigration has supported population growth in some regions, creating integration challenges due, in part, to higher unemployment among immigrants.

The extent to which the pandemic has impacted regional economic growth depends on the industrial composition of regions and cross-border exposure. Southern Sweden outperformed the Stockholm and Gothenburg regions, largely due to strong performance in manufacturing, retail and the food industry, with close to pre-pandemic levels. Western Sweden, including Gothenburg, was particularly affected by the temporary shutdown of the automotive industry and reduced cross-border activity with Norway, but its economic performance has rebounded since the spring. Stockholm experienced the largest rise in unemployment since 1987 owing, in particular, to its very large service sector being affected by social-distancing guidance that has reduced in-store consumption, spending on services and related economic activity.

Figure 13. Unemployment in Sweden (Dec. 2020), annual economic & population growth since 2000, by county



Source: Arbetsförmedlingen, Statistics Sweden. Gross regional domestic product CAGR 2000-2019.

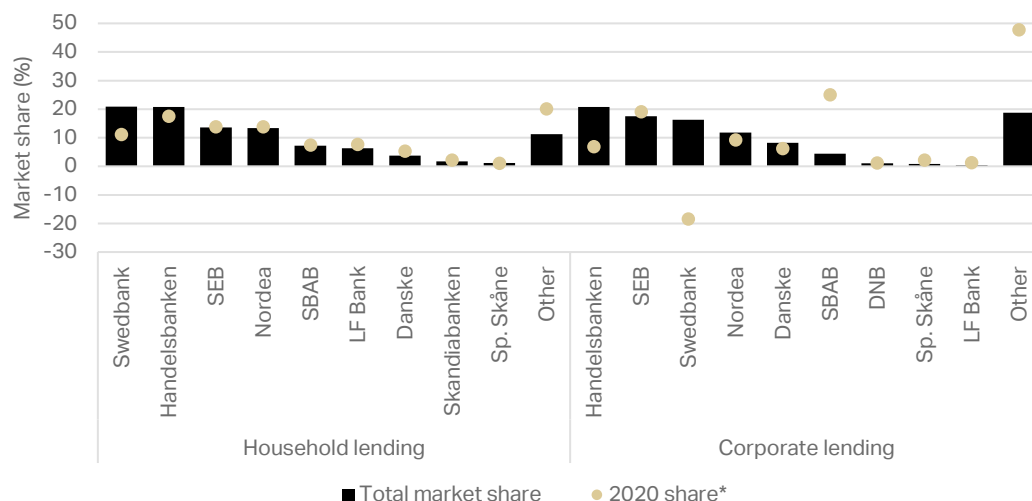
BANKING MARKET

Sweden's banks continue to outperform most European peers in key areas, despite increased credit losses in 2020. The banks retained and often improved already-strong regulatory capital ratios and received relief from the regulator when the countercyclical capital buffer was reduced to 0% from 2.5% in March 2020. 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. The relatively strong performance and capitalisation is evident in the banks' desire to pay out the maximum dividend allowed by the Swedish regulator until 30 Sept. 2021 of 25% of 2019 and 2020 earnings to shareholders.

Looking ahead, increases in risk weights for commercial real-estate exposures and the shift of commercial real-estate financing to the capital markets could materially affect the banking market. Real-estate activities account for around 60% of Swedish banks' corporate exposure (compared with only 24% at EU/EEA level according to the European Banking Authority as of June 2020). Although 2020 showed the value of having access to bank financing, higher capital requirements and higher required interest rates on commercial real-estate exposures are likely to continue to push real-estate borrowers into the capital markets, adversely affecting growth prospects for Swedish banks. In response, banks could be forced to pursue growth in other channels, such as retail mortgages and/or consumer lending, or reduce their currently high return on equity expectations, 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 our forecast period.

Sweden's four largest banks control close to 70% of both the lending and deposit markets, but these areas are becoming increasingly competitive, with challengers in the mortgage market and niche operators in the deposit market taking share from larger banks. As illustrated in Figure 14, the 12-month share gained by other banks in both the household and corporate segments outpaced that gained by larger Swedish banks in 2020. The most significant changes in 2020 were related to Swedbank, which lost significant market share and saw a reduction in its corporate lending to multi-family housing and tenant owner associations. In contrast, SBAB increased its lending to commercial real estate in these same areas, taking 25% of the marginal change in the corporate lending market and increasing its corporate market share to 4.4%.

Figure 14. Domestic market share and 2020 marginal share of lending, as of Dec. 2020



Source: Statistics Sweden, NCR analysis. *Share of marginal growth in corporate and household lending during 2020

Swedish mortgage lending has historically been dominated by Swedbank and Handelsbanken, which together account for 45% of the market. By segment, Swedbank accounts for 25.4% of the single-family home market and Handelsbanken for 22.5% of the apartment market. However, both banks lost market share in 2020. Challengers Länsförsäkringar Bank, Landshypotek Bank and SBAB made the largest market share gains during the year. For more information about the development of competition in the Swedish mortgage market over time, see [The Swedish mortgage market](#), which is updated quarterly.

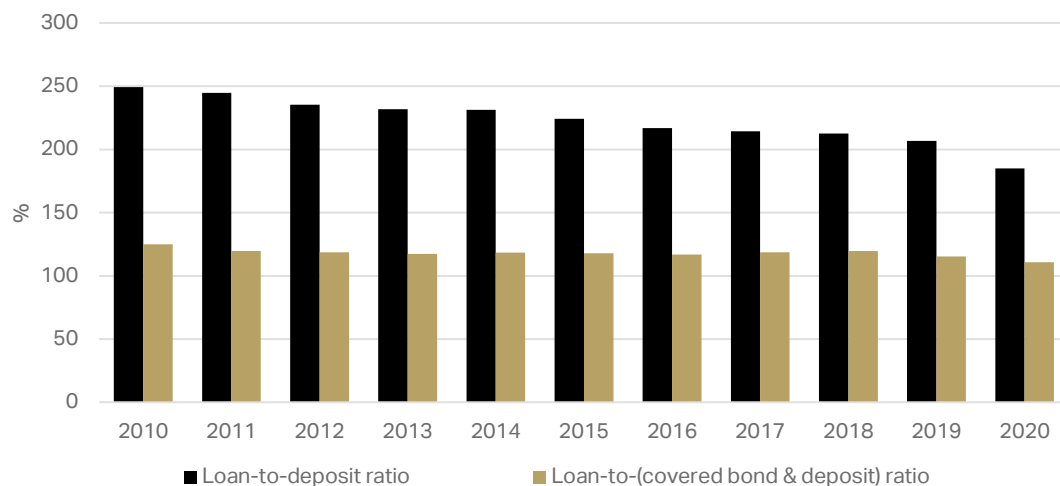
While Nordic banks performed better than expected in 2020 and have benefited from government relief packages, niche lenders have increased loss reserves in Sweden. As noted in our article [Significant risks remain for Nordic niche banks](#), loan losses are normally late in the cycle, which could be higher than expected once COVID-19 relief packages and support recede.

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 takes account not only of 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.

The loan-to-deposit ratio for Swedish banks (including their international operations) improved to 185% as of December 2020, down from 249% at year-end 2010. This was largely due to high household savings rates and an increase in corporate deposits in the wake of the pandemic. The increase occurred despite available deposit rates being very low or even negative for short-term corporate deposits. Including covered-bond financing, banks' customer loans represent 111% of stable funding sources, an improvement from 125% in 2010.

Figure 15. Swedish banks' loans as a share of deposits and covered-bond financing, 2010–2020



Source: Statistics Sweden

BANKING MARKET ASSESSMENT

The banking market score of 'bbb+' 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.

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