Nordic Credit Rating

SECTOR COMMENT

27 Jan. 2022

Swedish banking market prepared for continued uncertainty in 2022

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Nordic Credit Rating (NCR) expects Sweden's banks to continue to outperform most European peers on profitability and capitalisation. Swedish banks have experienced only modest impacts from the ongoing pandemic in terms of credit losses, but face declining margins due to competition for commercial and retail mortgages. Despite margin pressure, the banks maintain relatively strong risk-adjusted earnings and efficiency due to high levels of automation. Strong savings rates and capital market access supports the banks' balanced funding models.

We apply a score of 'a-' for the Swedish banking market and expects continued economic growth in Sweden throughout 2022. This is likely to be led by consumer spending on goods, along with an expected rebound in spending on services in late spring and summer, by which time reimposed COVID-19 pandemic restrictions are likely to have been lifted. We believe the Omicron variant of the virus is unlikely to have a material impact on the economy, as Swedes have adapted to the ongoing pandemic and are better able to deal with the virus following the vaccine roll-out.

Despite material government support during the pandemic, Sweden's creditworthiness remains strong, which bolsters our assessment. Swedish manufacturers have reported high order intake and confidence indicators point to continued strong performance in manufacturing, even in the face of labour and material shortages. However, global supply chain disruptions are likely to remain a risk for manufacturers in 2022 and a downside risk for the Swedish economy. We anticipate a tighter labour market but believe that wage growth is unlikely to be dramatically affected by current inflation levels. We expect housing price growth to slow following strong price rises in spring 2021 and believe price growth will reflect a long-term trend of 6–7% in 2022.

Figure 1. Sweden: key banking metrics 2017–2023e

%	2017	2018	2019	2020	Q3 2021	2022e–2023e
Growth in household lending	7.0	5.5	5.0	5.4	6.5	Lower growth
Real housing price growth	-2.5	2.0	4.5	11.5	12.4	Lower growth
Net interest margin	1.3	1.3	1.2	1.2	1.0	Increasing
Problem loans/gross loans	0.4	0.4	0.4	0.5	0.4	Flat

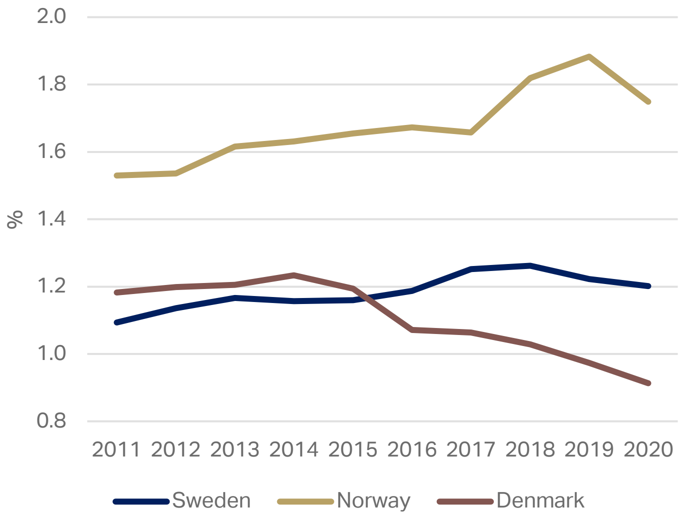
Source: European Banking Authority risk dashboard, the Swedish central bank, ValueGuard HOX Index, Statistics Sweden & aggregated bank reports. e–estimate.

Figure 2. Sweden: key national metrics, 2018–2023e

%	2018	2019	2020	2021e	2022e	2023e
GDP growth	2.2	1.4	-1.9	4.4	3.3	2.1
Core CPI growth	2.2	1.7	0.5	2.4	2.0	1.6
Unemployment rate	6.3	6.8	8.3	8.6	7.5	7.0
Current account balance/GDP	2.6	5.5	5.7	5.5	5.1	5.0
Monetary policy rate	-0.5	-0.5	-0.3	0.0*	0.0	0.1

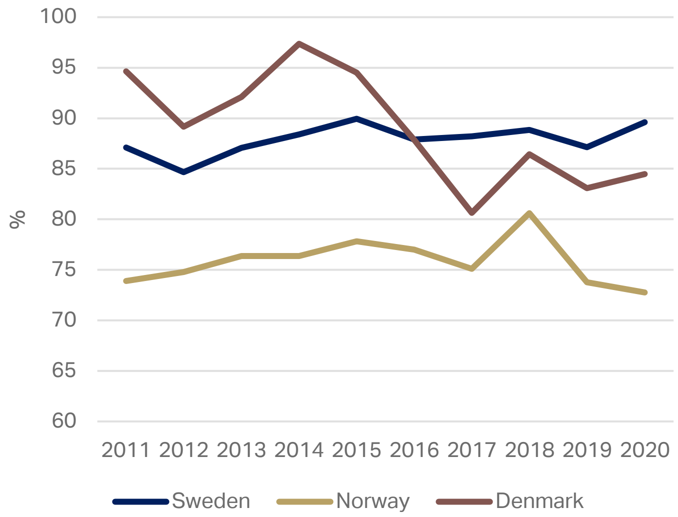
Based on data from Statistics Sweden, Swedish central bank & NCR consensus estimates. e–estimate. CPI–Consumer price index. *Actual year-end.

Figure 3. Nordic banks' net interest margins, 2011–2020



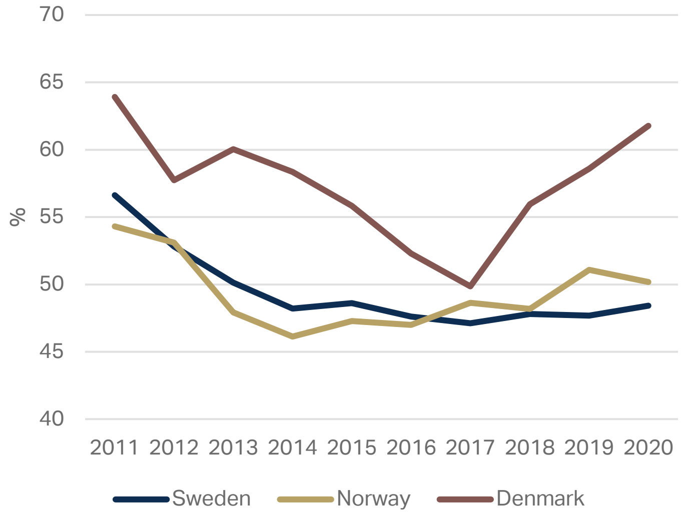
Source: Aggregated bank data.

Figure 4. Nordic banks' net interest and fee income to operating income, 2011–2020



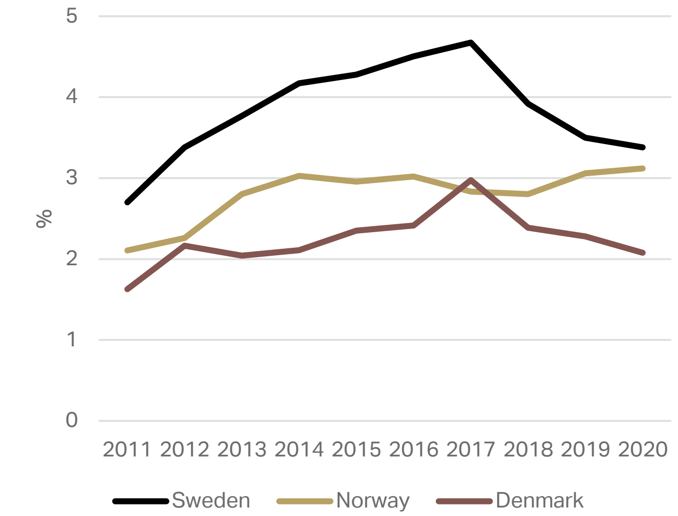
Source: Aggregated bank data.

Figure 5. Nordic banks' cost-to-income ratios, 2011–2020



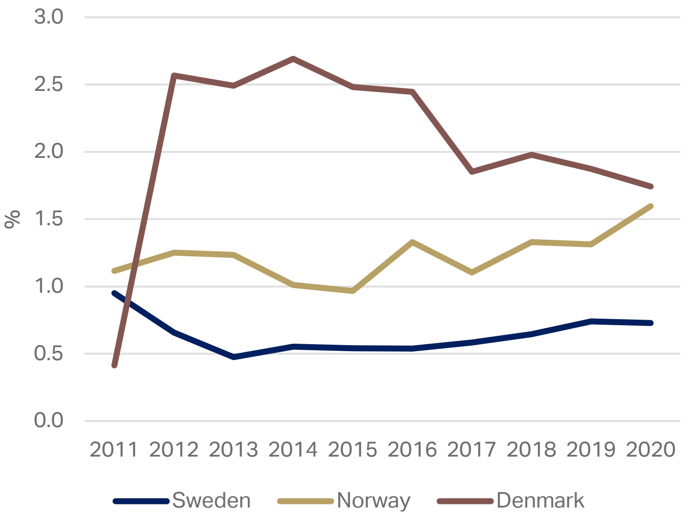
Source: Aggregated bank data.

Figure 6. Nordic banks' pre-provision profit to average risk-weighted assets, 2011–2020



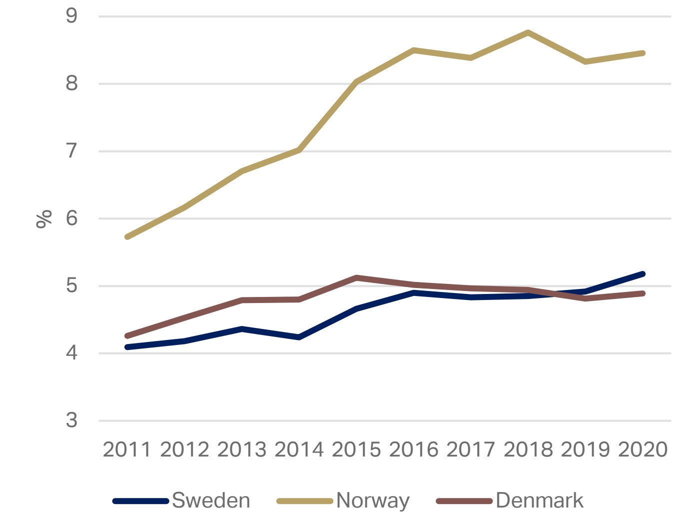
Source: Aggregated bank data.

Figure 7. Nordic banks' problem loans to gross loans, 2011–2020



Source: Aggregated bank data.

Figure 8. Nordic banks' leverage ratios, 2011–2020

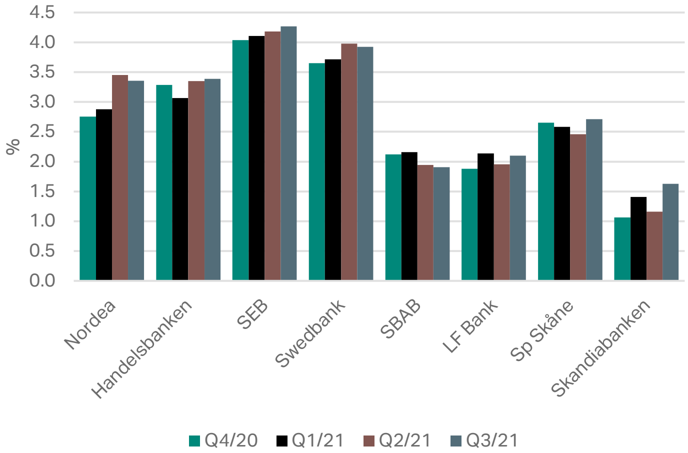


Source: Aggregated bank data.

LOW CREDIT LOSSES AND HIGH PROFITABILITY OFFSET FALLING INTEREST MARGINS

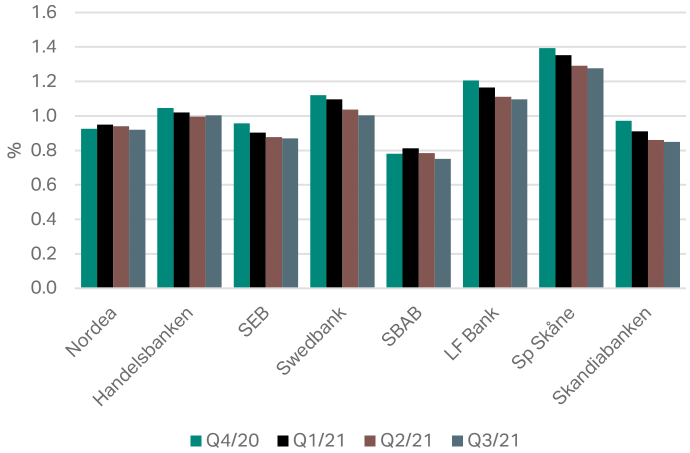
Despite increased margin pressure, Sweden's banks continue to outperform most European peers on profitability and capitalisation. Swedish banks have also experienced only modest impacts from the ongoing pandemic in terms of credit losses, and began writing back reserves from the first half of 2020 by early 2021. The banks face declining margins due to competition for commercial and retail mortgages, but have maintained relatively strong risk-adjusted earnings and efficiency due to high levels of automation. Customer behaviour has also allowed them to make significant cost savings through smaller branch networks and reduced staffing, even as volumes and revenues rise.

Figure 9. Swedish banks' quarterly pre-provision earnings to risk exposure amount, 20Q4–21Q3



Source: bank reports.

Figure 10. Swedish banks' quarterly net interest margins, 20Q4–21Q3

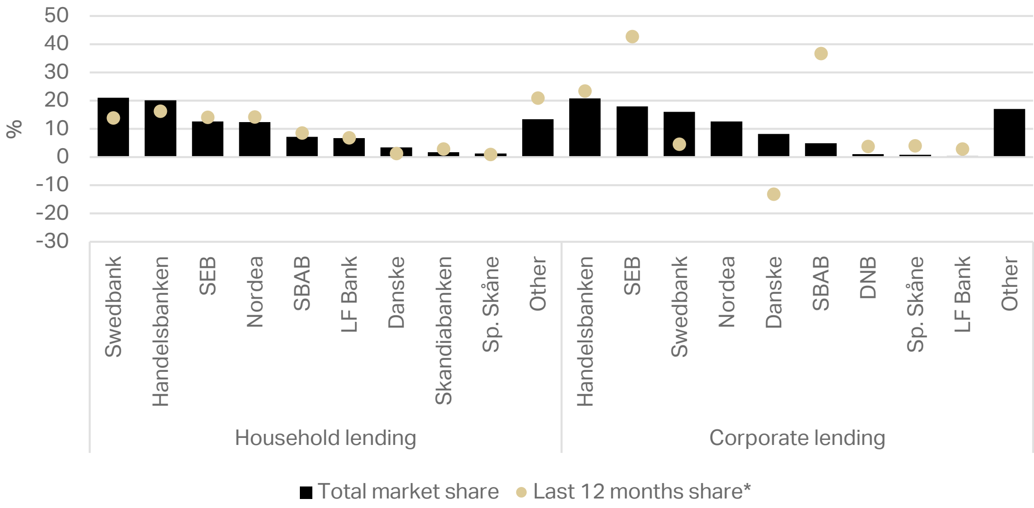


Source: bank reports.

Increases in risk weights for commercial real-estate exposures and the shift of commercial real-estate financing to the capital markets are likely to affect the banking market. As of 30 Nov. 2021, real-estate activities accounted for around 50% of Swedish banks' non-financial corporate exposures. Although 2020 underlined 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 current high return on equity expectations, with consequences for share prices and risk appetite. In addition, NCR believes 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 about 67% of both the lending and deposit market. However, these areas are becoming increasingly competitive as challenger banks take market share in the mortgage segment and niche banks offer more attractive rates for depositors. SEB has accelerated its expansion into corporate loans, capturing 43% of the marginal growth over the last 12 months ending 30 Nov. 2021. Swedbank's sluggish performance resulted in a further decline in market share, with the bank gaining 4.5% of the marginal growth over this period. SBAB increased its market share to 5% of corporate lending, primarily via commercial real estate and housing association loans, up from 4.3% for the same period of the previous year.

Figure 11. Domestic market share and last 12 months' marginal share of lending, as of Nov. 2021



Based on data from Statistics Sweden. *Share of marginal growth in corporate and household lending until 30 Nov. 2021.

Swedish mortgage lending has historically been dominated by Swedbank and Handelsbanken, which together held 45% of the market as of 30 Nov. 2021. Swedbank's and Handelsbanken's share of mortgage lending has declined over the last two decades as they have captured a smaller proportion of the marginal growth in lending to sustain their market share. For the last 12 months ending 30 Nov. 2021, the banks saw their market shares decline further in favour of larger competitors SEB and Nordea, as well as challenger banks such as SBAB and Länsförsäkringar Bank (LF Bank). Swedbank and Handelsbanken are losing a relatively greater share of the single-family home market, in which their marginal growth rates have been 7pp and 5pp under their current market share, respectively, for the last 24 months. We expect challenger banks to continue gaining market share in 2022. For further analysis of competition in the Swedish mortgage market over time, see The Swedish mortgage market, which is updated quarterly.

We do not expect Swedish savings banks to reintroduce pandemic-related loss provisions, nor do we expect regulators to prohibit banks' dividend payments in response to renewed restrictions. The prolonged impact of the pandemic negatively affects our view of banks' growth, but we believe that savings banks' interest margins will improve over 2022. Swedish savings banks are well capitalised and have material liquidity buffers to cope with any temporary turbulence. The Swedish financial supervisory authority has increased its attention on savings banks, which we believe could be an indicator of future market consolidation of savings banks to gain synergies in governance and other regulatory costs (see also Swedish savings banks show stable performance heading into 2022, 20 Dec. 2021).

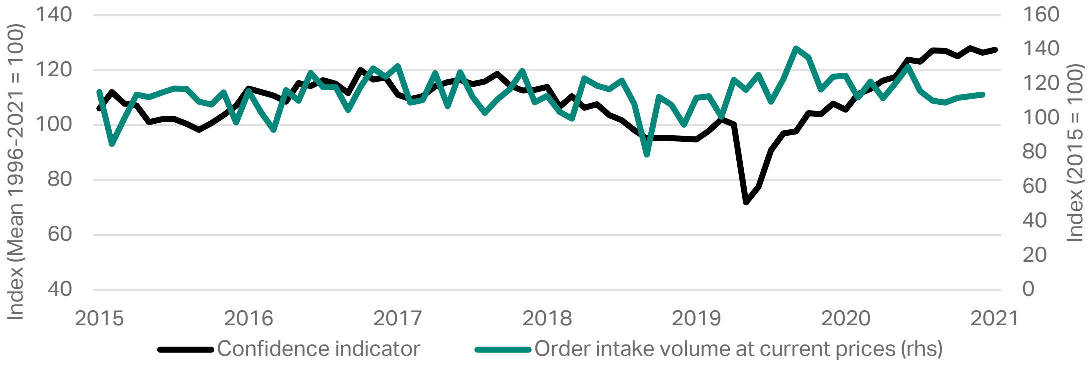
Nordic niche banks performed better than we expected in 2021, but face weaker growth prospects in 2022 due to renewed pandemic-related restrictions and increased regulatory focus. We expect the Swedish regulator to pay closer attention to niche banks, with potential regulatory changes or measures to protect consumers. We expect lower growth to increase existing pressure on traditional consumer loan margins and believe niche banks will pursue new growth opportunities in credit cards, short-term buy-now-pay-later loans and non-traditional mortgages to support profits. We do not anticipate increased loan loss provisions but see higher revaluation risk in response to lower pricing of non-performing loan portfolios (see Nordic niche banks well-prepared for continued uncertainty in 2022, 13 Jan. 2022).

VOLATILE ENERGY PRICES AND INTERNATIONAL BOTTLENECKS TO CONSTRAIN GROWTH

NCR expects the Swedish economy to continue its recovery in 2022, despite the recent reinstatement of COVID-19 related restrictions to slow the surge of the Omicron variant. This is likely to temporarily stall the recovery in consumer spending on services, although consumer spending on goods remains strong. We do not expect the restrictions to evoke the same response as in spring 2020, when households dramatically shifted from spending to saving. During the second half of 2021, Sweden experienced a rise in inflation following the release of pent-up of demand and a rebound in spending on services when restrictions were initially lifted, although we expect the Swedish central bank to keep the policy rate at zero throughout 2022. We believe that the surge in energy prices will dampen consumer spending levels relative to 2021, resulting in a slow start and a drag on full-year GDP for 2022.

We expect household spending to rise in the spring, when energy prices should normalise from peak levels and social-distancing restrictions are likely to recede as they have over the past two years. We expect full-year real GDP growth of 3.3% in 2022 and 2.1% in 2023, driven by increased corporate investment in manufacturing combined with higher spending levels. The manufacturing confidence index is at its highest levels in over a decade, despite global supply chain disruptions that could prohibit manufacturers from meeting the high order intake at the end of 2021.

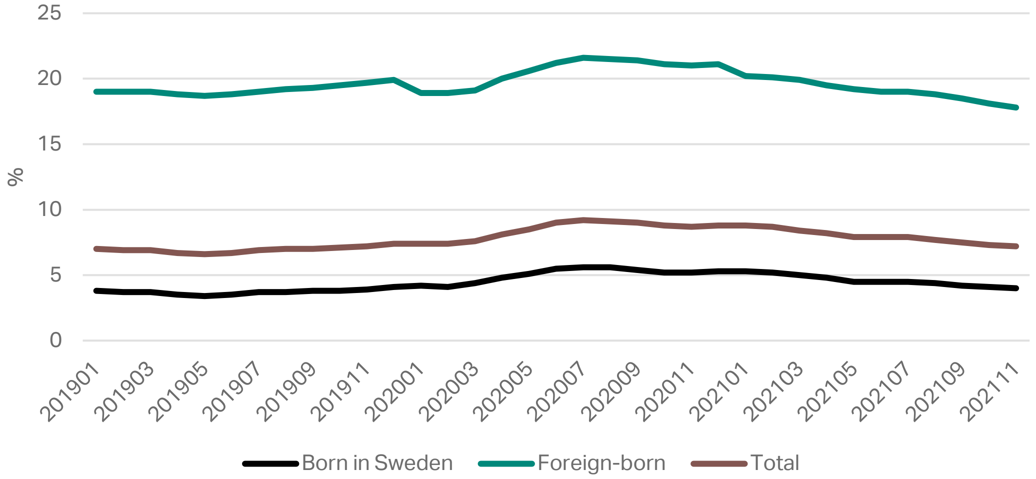
Figure 12. Swedish manufacturing economic indicators, 2015–2021



Source: Statistics Sweden.

Swedish registered unemployment has declined steadily since peaking in the summer of 2020 and waws 7.2% in November 2021. We expect the labour market to tighten over the next few years as more industries are reporting labour shortages, but we do not foresee significant wage growth. Sweden faces a structural problem of integrating people born outside Sweden into the workforce with skillsets poorly matched to available employment opportunities. As of 30 Nov. 2021, the unemployment rate for people born outside Sweden was 17.8%, while for those born in Sweden unemployment was 4.0% (see Figure 13), much closer to Danish and Norwegian unemployment levels.

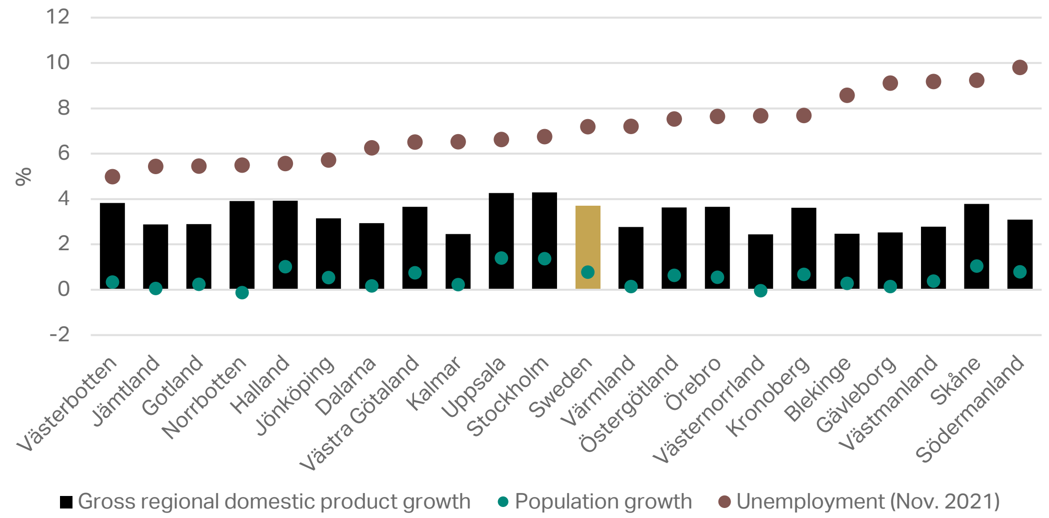
Figure 13. Swedish registered unemployment, Jan. 2019–Nov. 2021



Source: Swedish Public Employment Service.

Regional differences in unemployment are partly due to a higher share of population growth owing to immigration, as well as to the growth of the regional economy. The figure below highlights the relative importance of Sweden's largest markets, Stockholm, Västra Götaland and Skåne, to growth, as well as major differences in unemployment rates due to significant variations in the foreign-born population and more volatile industry concentrations, especially in the major manufacturing regions of Södermanland and Västmanland.

Figure 14. Unemployment in Sweden (Nov. 2021), annual economic & population growth since 2000, by county

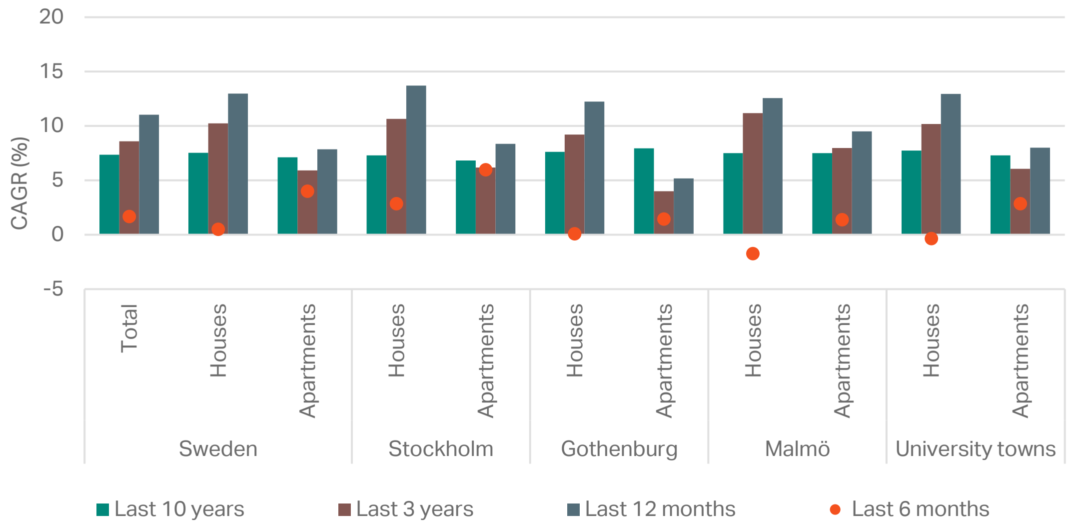


Source: Statistics Sweden & Swedish Public Employment Service. Gross regional domestic product and population CAGR 2000–2020.

HOUSING PRICE GROWTH SLOWING

Growth in housing prices is stabilising at lower levels after significant price increases in 2020 and the first half of 2021. Price increases have been particularly high in the single-family home segment, as the COVID-19 pandemic has resulted in households revaluating the need for space to accommodate more working from home. We regard the growth in hybrid work (working partly on-site and partly from home) as supporting long-term demand for larger homes and longer, less frequent commutes. We consider the high price increases in the spring as unsustainable in the long run and expect price growth to moderate, given low wage growth and modest growth in disposable income. NCR anticipates that housing price growth will slow to around 6% in 2022, but notes that it could surprise on the upside should energy prices decline in combination with higher wage growth.

Figure 15. Annualised growth rates of Swedish housing prices by region and type, Nov. 2021



Source: ValueGuard HOX Index. CAGR–Compound annual growth rate.

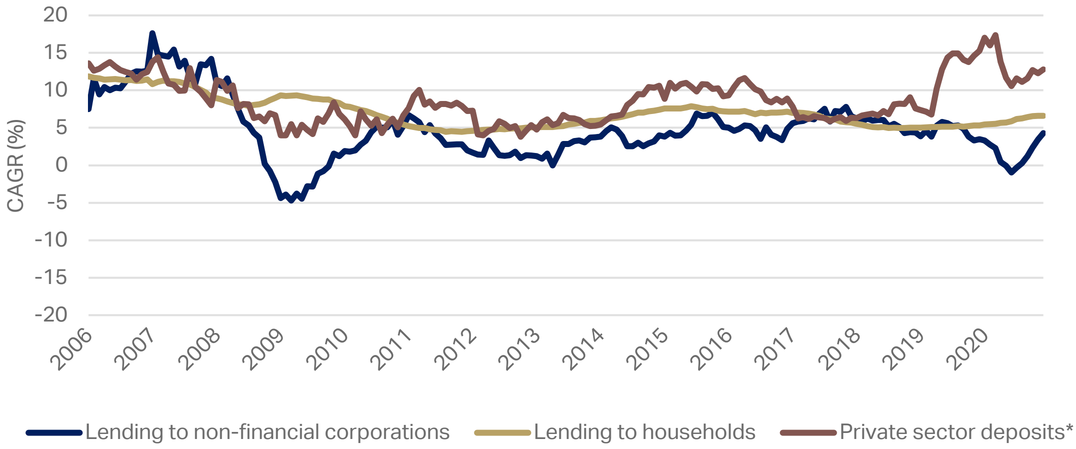
CHEAP FINANCING AND INVESTMENTS TO FUEL CREDIT GROWTH

As of 30 Nov. 2021, monetary financial institutions' lending to domestic non-financial corporations and households amounted to SEK 7,254bn, 53% of which was household mortgage loans, 35% non-financial corporate lending and the remaining 12% other household loans. The share of real-estate collateral for non-financial corporates loans remained flat throughout 2021 relative to 2020 at 56.3% of total collateral value, which is exceptionally high compared with other European countries.

On the back of strong housing price growth, household lending increased by 6.6% year on year as of 30 Nov. 2021, up from 5% since amortisation requirements were implemented in 2017. We anticipate that total household lending growth will decline to about 5%, based on our expectations of weaker housing price growth than in 2020 and 2021. In August 2021, the regulator reinstated amortisation requirements for mortgage loans following a temporary repeal at the start of the pandemic. We expect the reintroduction of amortisation requirements and more modest housing price increases to dampen credit growth among households. Regulators are paying greater attention to consumer loans, which could result in restrictive measures to protect consumers in the coming years. After 6% year-on-year growth in consumer loans as of 30 Nov. 2021, we believe domestic consumer loans will see similar growth in 2022, unless the regulator implements tighter restrictions.

Corporate lending grew by 4.3% over the corresponding period. We do not expect the Swedish central bank to raise interest rates in the near term, as current inflation levels should be temporary. This should enable continued access to cheap financing, which could fuel credit growth throughout 2022. While bank loans remain the dominant source of corporate borrowing, we expect a larger proportion of Swedish corporations, especially real-estate companies, to obtain capital market funding over the next few years. We expect the growth trends in capital markets funding to reduce demand for long-term corporate loans from banks. The lower lending growth for corporations in 2021 was due to weaker demand for credit among large companies, which borrowed extensively in 2020 to protect their liquidity position. The bond market disruption in March and April of 2020 highlighted the refinancing risk in the Swedish bond market and caused the Swedish central bank to initiate its corporate bond-purchasing programme in September 2020 to support liquidity. Although useful in 2020, we foresee the central bank's programme for buying corporate debt having a minimal impact on the market in 2022.

Figure 16. Swedish 12-month growth in private sector loans and deposits, 2006–Nov. 2021



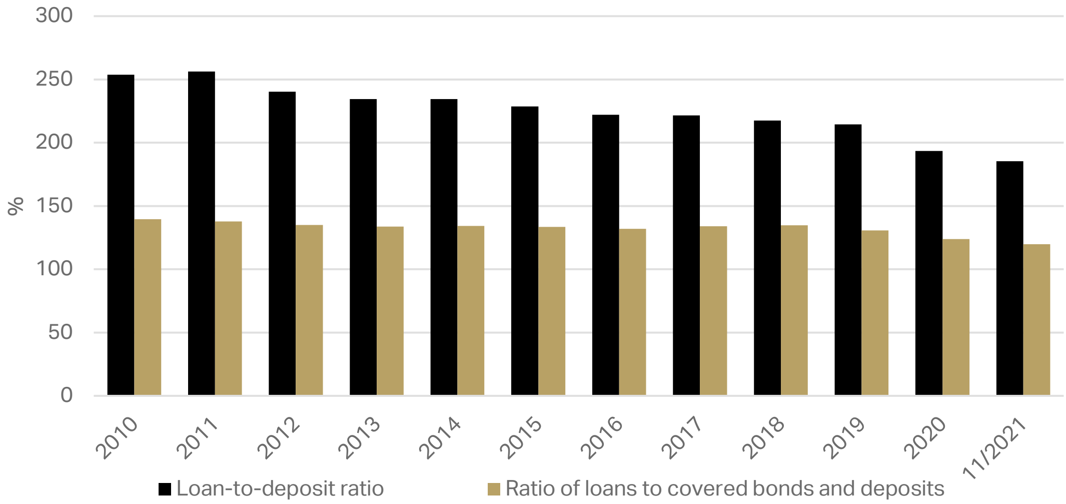
Source: Swedish central bank. *Non-financial corporation and household deposits.

SWEDISH BANKING SECTOR HAS STRONG, STABLE FUNDING

Given the high share of private savings with 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.

Monetary financial institution's (MFI) Swedish private-sector loans as a share of private-sector deposits improved to 185% as of 30 Nov. 2021, down from 194% at year-end 2020. Household and non-financial corporate deposits increased by 8.0% and 15.4%, respectively. Deposit growth has outpaced loan growth over the course of the COVID-19 pandemic, despite low or even negative short-term deposit rates for corporations. This increase was attributable to higher household savings rates and increased liquidity on-hand to meet potential turbulence among non-financial corporates. Including covered-bond financing, MFI customer loans represented about 120% of stable funding sources, a 20 percentage point improvement since 2010. The cheaper financing offered by deposits relative to stable funding sources makes them attractive for offsetting margin pressure, but at the expense of having a more stable funding base.

Figure 17. Swedish MFI's private-sector loans as a share of deposits and covered-bond financing, 2010–30 Nov. 2021



Source: Statistics Sweden. MFI–monetary financial institutions.

SWEDISH 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 further information, please refer to *Financial Institutions Rating Methodology*, 13 Aug. 2018.

Figure 18. Sweden: scoring of national indicators

Subfactor	Score	Rationale
Sovereign strength	aa	Major credit rating agency average: AAA, minimum: AAA.
Output growth	bbb	We expect continued economic growth driven by consumer spending on goods and by investments in manufacturing, but note that supply constraints might inhibit growth.
Credit growth	bbb	Credit growth has increased during the pandemic, driven by higher mortgage volumes and housing price increases.
Housing prices	bbb	We expect housing price growth to move towards the long-term trend level of 6% in 2022, following a period of strong price appreciation that has outpaced fundamentals.
Unemployment	bbb	Unemployment levels are below pre-pandemic levels and we expect the labour market to tighten. However, unemployment rates are structurally higher than other Nordic countries.
Available stable funding	a	Increased savings have increased deposits and demand for domestic covered bonds provides medium-term funding at very low rates. Access to other forms of long-term senior financing remains strong.
International cycle	bbb	Global growth prospects have weakened following widespread lockdowns. We expect supply chain disruptions to be the major theme for 2022.

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