Nordic Credit Rating

SECTOR COMMENT

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Nordic consumer banks face higher financing costs

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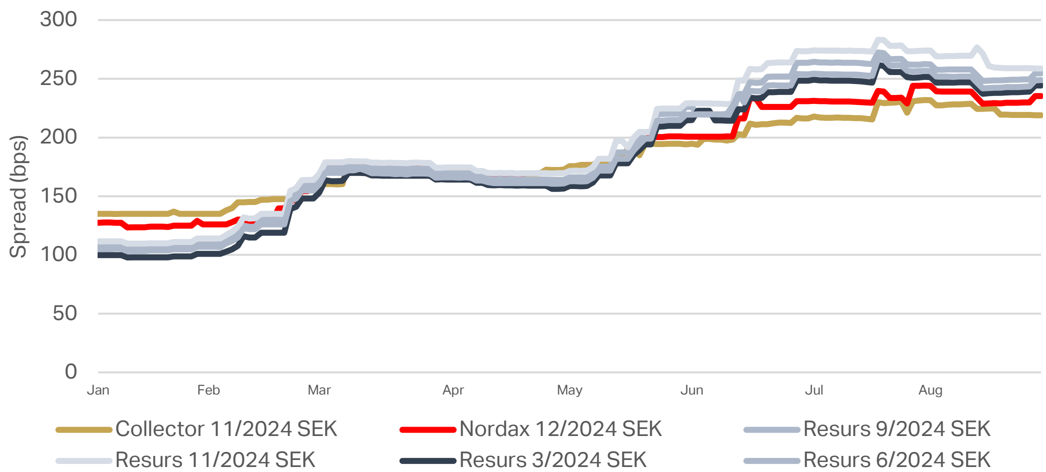
The second quarter of 2022 saw additional pressure on Nordic consumer banks' margins as interest rates rose and credit spreads widened. Credit provision and non-performing loan (NPL) metrics continued to fall, despite inflation and higher rates affecting customers' disposable income. But Nordic Credit Rating (NCR) expects inflation and interest rates to have a greater impact on consumer banks and their customers in the coming quarters. Banks are raising deposit rates in response to higher capital market funding costs, and individuals with already weak financial profiles are likely to be affected by food and energy price inflation in the autumn. Homeowners also face material increases in interest costs, and housing prices are coming down from record highs, affecting customer sentiment. We believe that these factors could impact consumption patterns and demand for consumer loans.

BOND SPREADS DRIVE UP DEPOSIT RATES

Inflation concerns and expectations of higher policy rates have increased bond spreads for those banks in our sample with outstanding bonds, i.e. Resurs, Collector and Nordax, including Bank Norwegian. The rise in the risk premium in the bond markets has increased the importance of customer deposits, with interest rates rising in Sweden and Norway, but to a lesser degree than indicated by bond spreads in Swedish kronor (SEK) and Norwegian kroner (NOK). Market spreads increased for all issuers, but there was greater differentiation among the banks, with spreads for Resurs widening in mid-June. This was about a week before the Swedish regulator issued a SEK 50m fine on 22 June, which Resurs has since appealed. Collector has had a more modest market reaction, despite nearly half of its loans being to the real-estate sector, which is also experiencing materially higher credit spreads and concerns about rising interest rates in general.

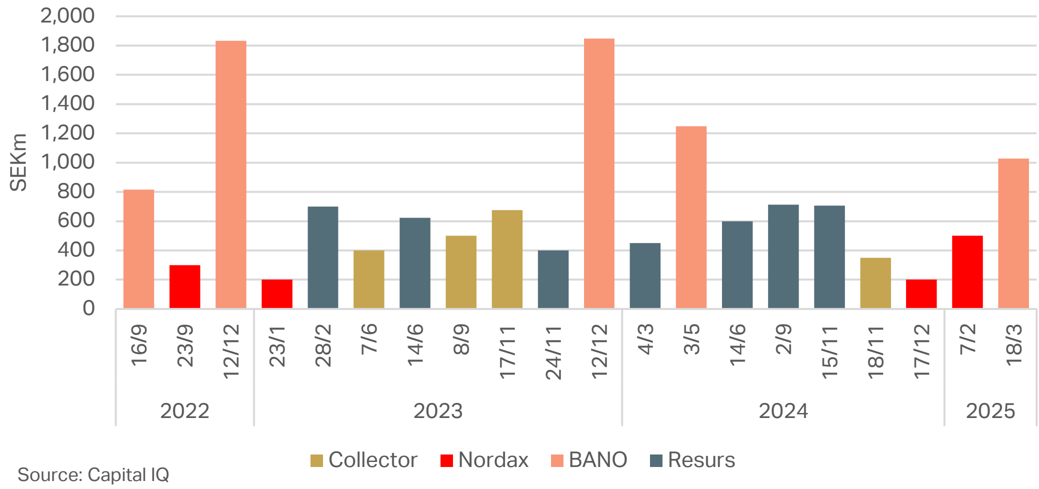
Figure 1. Bond spreads for SEK-denominated instruments maturing in 2024, Jan. 2022–26 Aug. 2022



Source: Capital IQ

Resurs announced last week it had raised its Swedish deposits rates to 1.3%, an increase of 55bps and a step change for a market where many banks still offer 0% for short-term retail deposits. Resurs had an SEK 700m bond maturity on 29 Aug. and has an additional SEK 1.8bn in outstanding bonds maturing by the end of 2023. We view the higher deposit rates as an effort to increase the share of deposits in the funding base and reduce the need for refinancing in the bond market if credit spreads remain at current levels.

Figure 2. Senior unsecured bonds by maturity date, SEKm

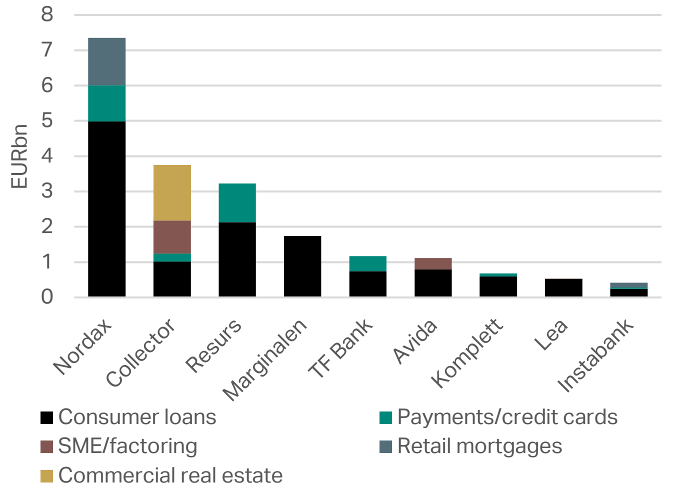


Source: Capital IQ

MORE STRUCTURAL CHANGES FOR THE INDUSTRY

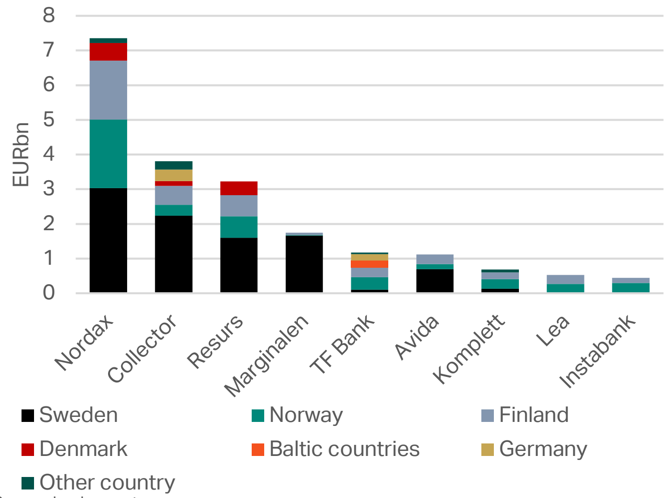
There have been several recent structural changes among the sample banks. In March, Danish consumer challenger bank Lunar Bank A/S announced a cash offer for all shares in Norway-based Instabank ASA. Despite reaching the minimum shareholder acceptance in April, Lunar has informed Instabank that it is unlikely to raise the additional equity necessary to fulfil its revised application to the Norwegian regulator for approval of the acquisition by 30 Sep. 2022. In its second-quarter report, Instabank says it expects Lunar to continue to seek regulatory approval of the transaction by the end of September. Meanwhile, Nordax Bank received the approval of Bank Norwegian ASA's board of directors to complete the intra-group merger and awaits regulatory approval from the authorities in Sweden and Norway. The rationale for the merger is to simplify the corporate structure and regulatory oversight of Nordax Group. In addition, the reverse merger between Collector Bank AB and its former parent, Collector AB, was completed on 15 August with minimal impact on Collector Bank AB's credit profile. Finally, BRABank has been rebranded as Lea Bank.

Figure 3. Nordic consumer banks' net loans by product type, Q2 2022



Source: bank reports.

Figure 4. Nordic consumer banks' net loans by country, Q2 2022



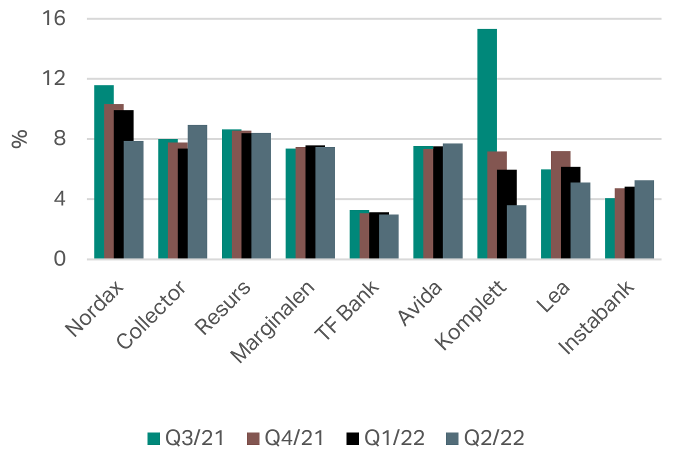
Source: bank reports.

LOAN LOSS PROVISIONS FALL FURTHER, NPL SALES CONTINUE

Despite inflation concerns, asset quality improved in the second quarter of 2022 as loan loss provisions fell for most banks. Nordax and Marginalen reported materially lower loss rates, and the sample average fell to 59bps from 65bps in the first quarter. Credit loss levels were affected by the continued sell-off of non-performing loans (NPLs) and higher sale prices than book value for some NPL portfolios.

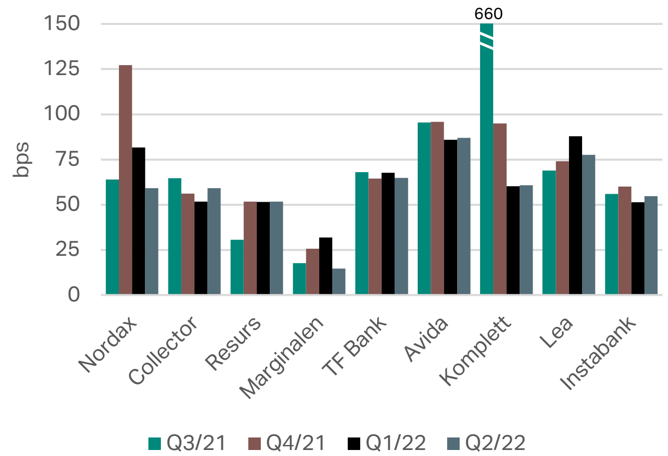
The positive trend in NPL metrics continued, driven by further portfolio sales and loan growth. In our sample, net stage 3 NPLs decreased by 40bps in the second quarter to 6.4%, continuing a steady decline that began in 2021. Norway's Komplett Bank has been the most active bank in reducing its NPL ratio, and has cut its net NPL ratio to 3.6% from over 15% (see Figure 5). Nordax (including Bank Norwegian before the merger) further reduced its share of NPLs to 7.9%, a 2pp decrease in the second quarter alone. Not all sample banks reported lower NPLs, with Collector's NPL ratio increasing, due primarily to concern over exposures in its commercial real-estate portfolio.

Figure 5. Nordic consumer banks' net stage 3 NPLs to net loans, Q3 2021–Q2 2022



Source: bank reports.

Figure 6. Nordic consumer banks' loan loss provisions to net loans, Q3 2021–Q2 2022

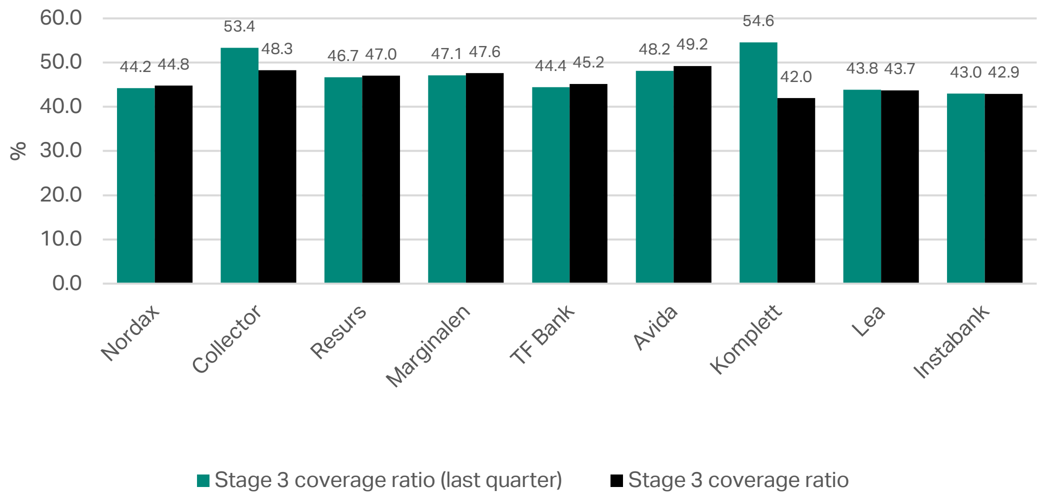


Source: bank reports.

NOTE: For all charts in the report, Nordax's Q3 2021 figures are based on a combination of Nordax Group and Bank Norwegian ASA's separately reported figures. Nordax's Q4 2021 figures exclude one-off acquisition expenses of SEK 563m.

On average, stage 3 coverage ratios declined by an average of nearly 2pp in the second quarter of 2022 to 45.7% for the sample. The decline was mainly due to Collector, which increased gross NPLs without materially increasing reserves in its real-estate exposures, and Komplett Bank, which ended a trend of increased coverage ratios since mid-2021 due to portfolio sales.

Figure 7. Nordic consumer banks' stage 3 coverage ratios, Q1 2022–Q2 2022

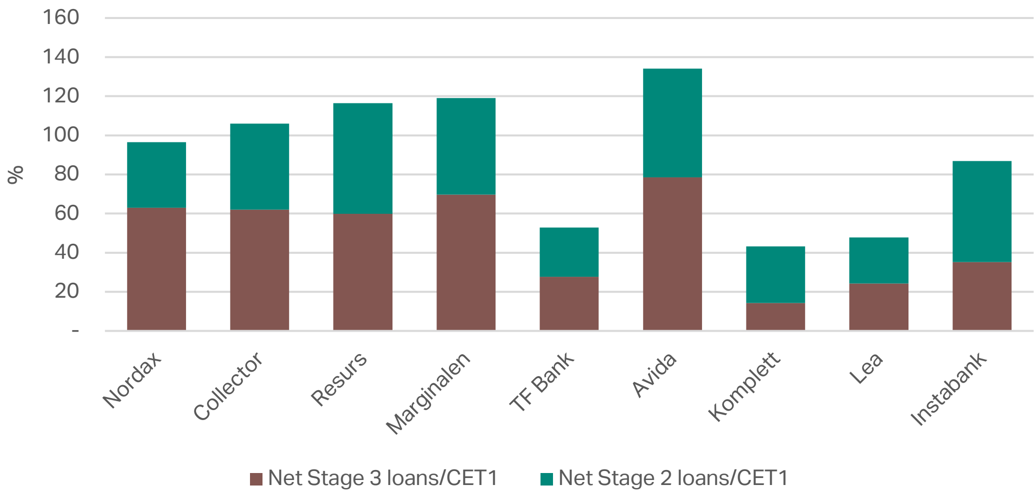


Source: bank reports.

VARYING LEVELS OF PREPAREDNESS FOR NPL BACKSTOP EFFECTS

The sale of NPLs has reduced the share of net stage 3 loans in relation to banks' common equity Tier 1 (CET1) ratios to 48.3% from 52.5% a year ago. However, there are significant differences among the peer group. Norwegian banks Komplett Bank, Lea and Instabank, and Sweden-based TF Bank average only 25% by this measure, while the other 5 banks in our sample average 67%. This indicates a much lower risk of revaluation of non-performing loans among the first group of banks that are associated with problem loans as the EU's NPL backstop regulations begin to affect loss provisioning this autumn. In our view, the backstop regulations could negatively impact secondary pricing of NPLs, which could lead to greater loss provisions as banks increase their NPL coverage ratios accordingly. You can read more about our view of the regulatory impacts on the sector in our year-end 2021 summary (Nordic consumer banks report strong fourth-quarter 2021 results, 3 Mar. 2022).

Figure 8. Net stage 2 and stage 3 loans as a percentage of CET1, Q2 2022

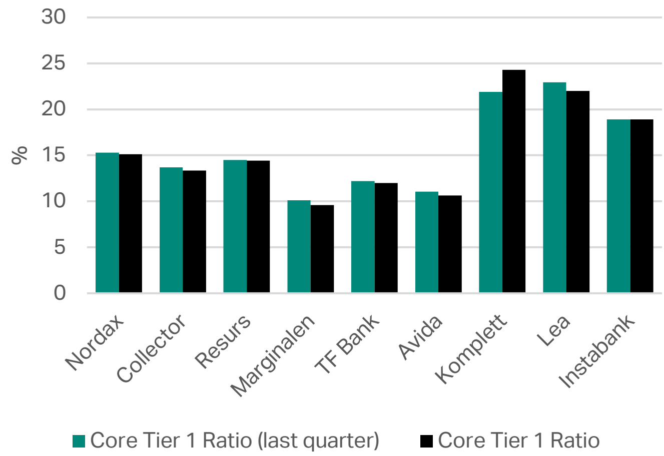


Source: bank reports.

LOAN GROWTH DRIVES LOWER CAPITAL RATIOS FOR MOST BANKS

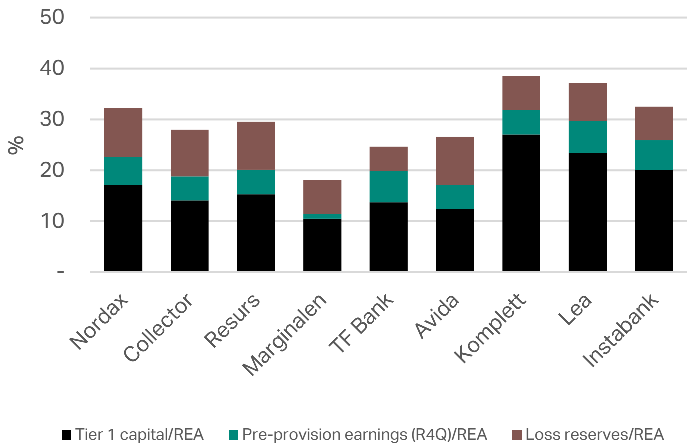
Capital buffers were stable on average at 15.6% at the end of the second quarter of 2022, though this represents a 2.4pp increase in the CET1 ratio for Komplett Bank and a 30bps average decline for the remaining sample. The banks' loss-absorbing buffers represent an average 29.7% of their risk exposure. Loss-absorbing buffers as a proportion of the total risk exposure amount (REA) consist of Tier 1 capital ratios, rolling four-quarter pre-provision earnings and loss reserves, which averaged 17.1%, 4.9% and 7.8%, respectively, down by 40bps from the previous quarter.

Figure 9. Nordic consumer banks' CET1 ratios, Q2 2022



Source: bank reports.

Figure 10. Nordic consumer banks' loss-absorbing buffers as a proportion of REA, Q2 2022



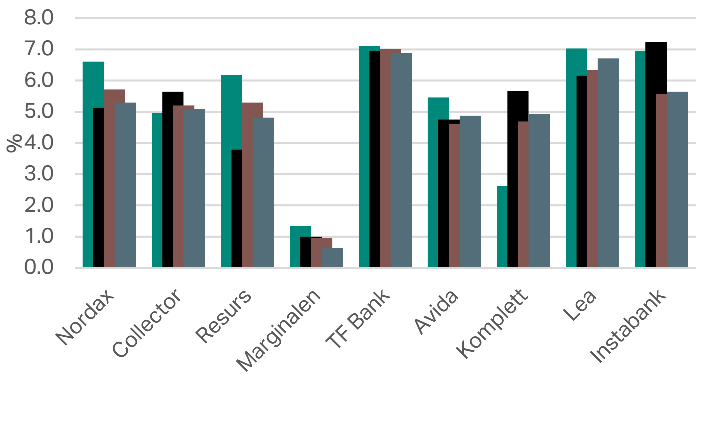
Source: bank reports. REA–risk exposure amount. See note above for Nordax adjustments.

SHORT-TERM MARGIN PRESSURE FROM HIGHER INTEREST RATES

Although consumer banks have raised the interest rates on customer deposits, we expect that this increase in funding costs will eventually be offset by increases in rates charged to customers over time. We also anticipate that banks will be cautious with broad interest rate hikes to avoid a spike in delinquencies by customers already under pressure from higher living costs and less disposable income.

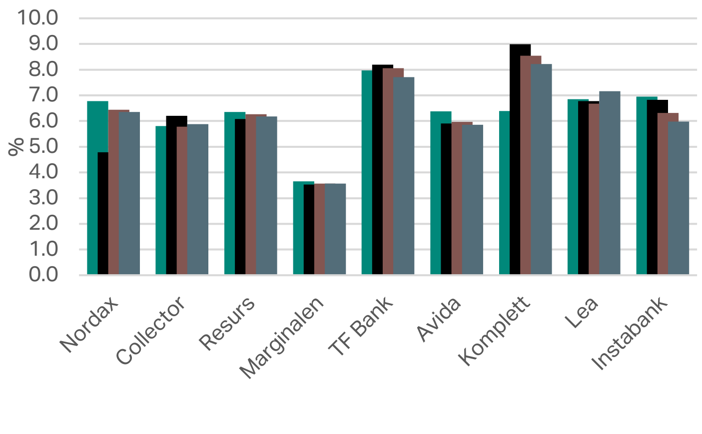
The average net interest margin fell slightly, to 6.3% from 6.4%, over the previous four quarters. However, risk-adjusted earnings (pre-provision income to REA), which has fallen steadily over the previous four quarters, was stable at 5.0% and remains very strong in the context of the Nordic banking market. Historically, banks have benefitted from rising interest rates, and we expect the banks to increase lending rates due to higher financing costs at the product level.

Figure 11. Nordic consumer banks' annualised pre-provision income to average REA, Q3 2021–Q2 2022



Source: bank reports. REA–Risk exposure amount. See note above for Nordax adjustments.

Figure 12. Nordic consumer banks' annualised net interest margins, Q3 2021–Q2 2022

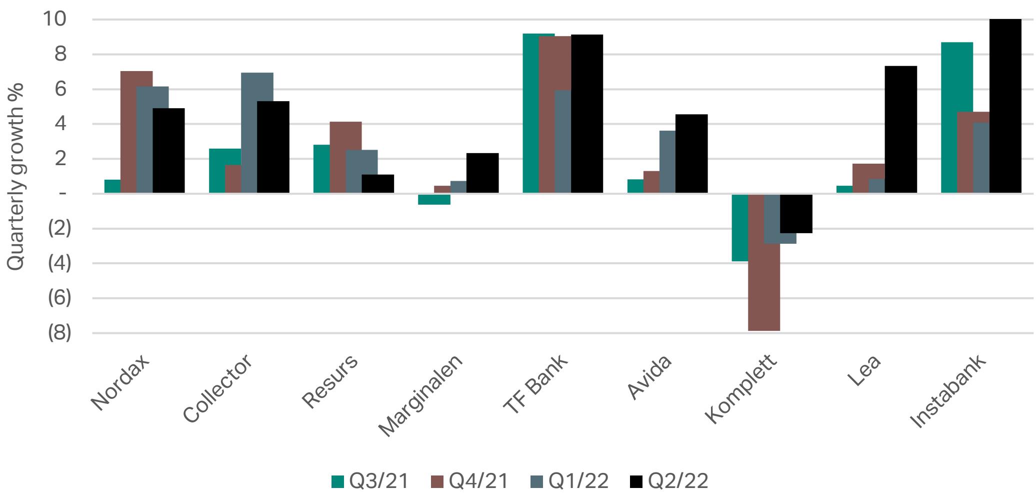


Source: bank reports. See note above for Nordax adjustments.

LOAN VOLUMES GROWING IN ALL SEGMENTS

Weighted average lending growth increased by 4.3% on average for the quarter, with only three of the nine banks below the group average. The sale of NPLs resulted in a reduction in net loans for Komplett Bank for the fourth quarter in a row.

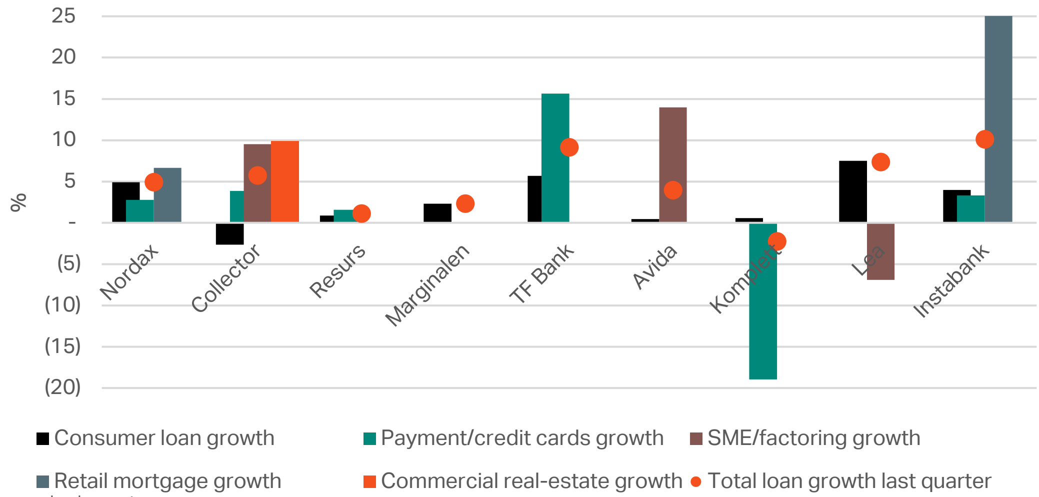
Figure 13. Nordic consumer banks' net loan growth, Q3 2021–Q2 2022



Source: bank reports.

The source of growth within the sample varied by segment in the second quarter. On aggregate, consumer loans grew by 2.9%, payment and credit cards by 3.4%, and retail mortgages by 8.1% in the quarter. At bank level, Nordax generated growth in all product types. Collector continued to grow its corporate and real-estate loan book at the expense of its consumer loans. TF Bank saw growth in consumer loans and credit cards, particularly in Germany. Avida grew primarily via factoring loans in its Business Finance segment. Instabank's lending growth was driven by non-traditional retail mortgages in Norway, a market that Resurs announced it will enter. In contrast, Lea has announced it will unwind its SME lending business and focus on consumer loans and expansion into Spain.

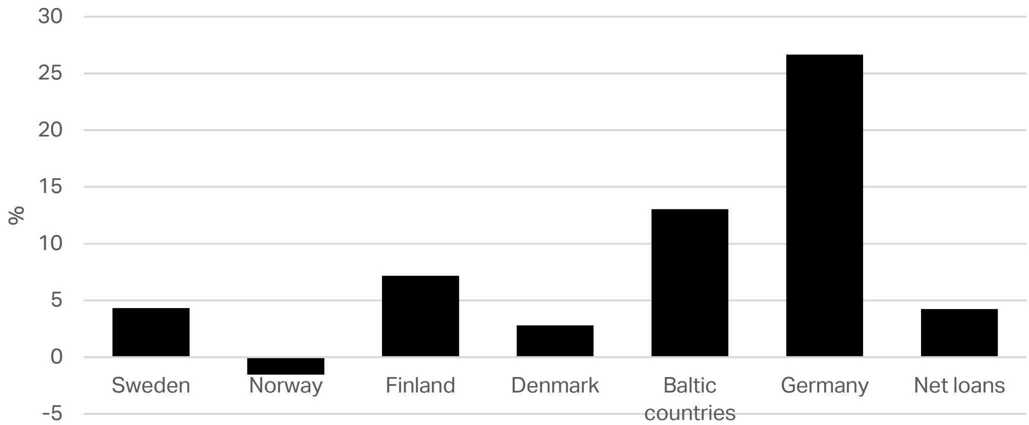
Figure 14. Nordic consumer banks' net loan growth by segment, Q2 2022



Source: bank reports.

Among sample banks, Norwegian exposures fell by 1.5% in the second quarter of 2022 after growing by 4% in the first quarter. Norwegian growth is primarily associated with non-traditional mortgages. Growth in euro-based exposures was supported by a strong appreciation of the euro in the second quarter, given that the banks report in either SEK or NOK.

Figure 15. Nordic consumer banks' net loan growth by country, Q2 2022



Source: bank reports. Nordax reports Germany and Spain combined, so Germany reflects growth in Collector and TF Bank.

NCR-RATED CONSUMER BANKS

The following table summarises NCR's ratings on Nordic consumer banks.

Figure 16. NCR ratings on Nordic consumer banks

	Resurs Bank	Collector Bank	Nordax Bank
Long-term issuer rating	BBB	BBB-	BBB
Outlook	Stable	Stable	Stable
Subfactors:			
Operating environment (20%)	bbb	bbb	bbb
Risk appetite (50%)	bbb	bbb-	bbb
Market position (15%)	bb+	bb	bb+
Performance indicators (15%)	bbb+	bbb+	bbb+
Ownership adjustment	0	0	0

See NCR's company rating reports for details.

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