

## Nordic consumer banks increase loss provisions amid rising cost of living

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The fourth quarter of 2022 showed signs that there are tougher times ahead for Nordic consumer banks. Loss provision levels ticked up for all but one bank in our sample as the rising cost of living and interest expenses put additional pressure on Nordic consumers. Despite increased loan loss provisions, many banks' non-performing loan (NPL) metrics continue to fall as they clear balance sheets to minimize the impact of NPL backstop regulation on capital ratios.

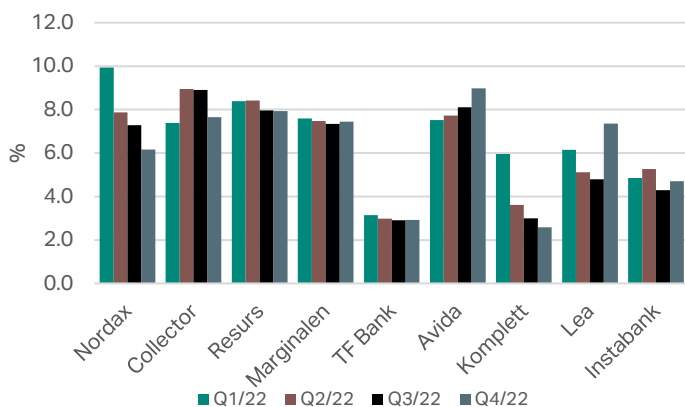
Weighted average loan growth for the quarter was 4.1%, but capital ratios improved slightly due to strong earnings. Margins increased for most issuers during the quarter as loan repricing made up for rising funding costs. Thus far, banks have been able to support loan growth with Nordic and German deposits. However, high-profile bank runs in the US and Switzerland have demonstrated the speed with which depositors can react to negative information in a digital banking environment. We continue to view the banks' deposit customers as highly price-sensitive, but believe that a high level of granularity and government guarantees mitigate the immediate risk.

We have recently revised our view of the operating environment for consumer banks down to reflect the increasing political and cost-of-living risks. We expect the combination of higher living costs and interest rates to continue to drive higher loss provisions for the banks in our sample over the next two years. Consumer bank customers tend to have relatively weak financial profiles, making them more susceptible to inflationary pressures. In addition, housing price declines are affecting customer sentiment and household wealth. We believe these factors could impact consumption patterns and demand for consumer loans through to the end of 2023.

### LOAN LOSS PROVISIONS INCREASE, NPL TREND CONTINUES

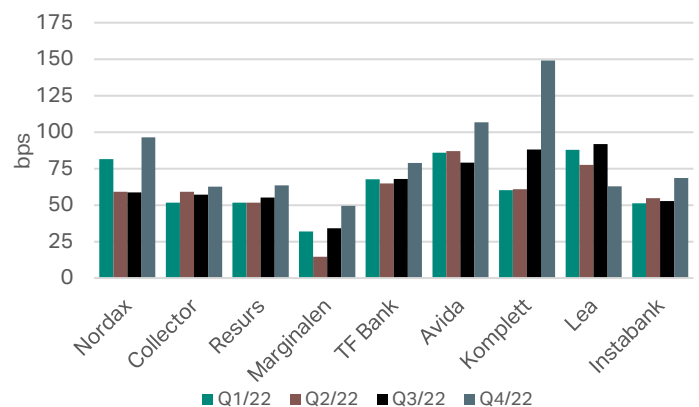
Concerns about inflation continue, and asset quality dipped in the fourth quarter as loan loss provisions increased for most of the sample. Nordax, Marginalen, Avida and Komplet reported materially higher loss rates. In Nordax's case, fourth-quarter provisions include SEK 120m due to the worsening macro economy and Marginalen's losses also include SEK 35m in macro reserves. Lea reported macro provisions associated with Finnish and Swedish loans, and said lower quarterly losses were due to the implementation of a new definition of default and the reversal of previous provisions for the wind-down of its SME portfolio. We expect other banks to increase macro-related provisions during 2023. Avida reported a SEK 11m one-off charge as it migrated Finnish consumer loans, while Komplet reported a NOK 14m one-off item for the "clean-up of older cases" and increased stage 1 provisions due to significant loan growth during the quarter.

Figure 1. Nordic consumer banks' net stage 3 NPLs to net loans, Q1 2022–Q4 2022



Source: bank reports.

Figure 2. Nordic consumer banks' loan loss provisions to net loans, Q1 2022–Q4 2022



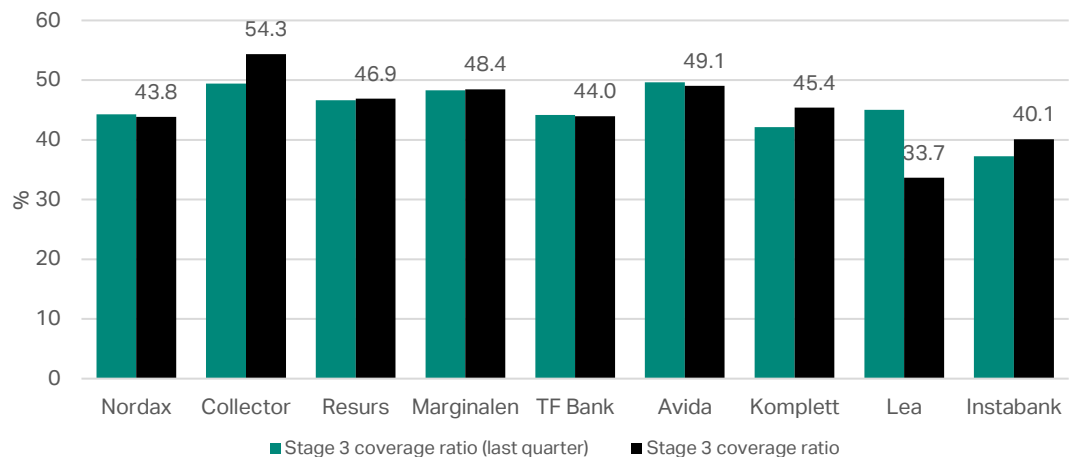
Source: bank reports.

The weighted average fourth-quarter credit provision increased to 81 bps of net loans, compared with an average of 60bps in the first three quarters of 2022. In addition to higher non-payments, credit loss levels were affected by the continued sell-off of NPLs and increased loss provisions for some NPL portfolios. For example, Marginalen reported a SEK 36m write-down associated with the sale of NPLs in the fourth quarter and an additional SEK 30m associated with future sales due to a general reduction in pricing in the secondary NPL market.

The positive trend in net NPL metrics continued, driven by further portfolio sales and continued loan growth. In our sample, weighted average net stage 3 NPLs decreased by 58bps in the fourth quarter to 6.6% (compared with 8.4% at year-end 2021), led by a steep decline for Nordax to 6.2% from 10.3% at year-end 2021. Komplet Bank continued to reduce its NPL ratio and has now cut it to 2.6%, just short of TF Bank's 2.9%. Avida's share of net NPLs continued to increase and is now the highest in the sample at 9%, or 16% on a gross basis.

Using a weighted average, stage 3 coverage ratios increased by 0.9% in the fourth quarter to 47.5% from 46.6%. Lea reported the largest change in the stage 3 coverage ratio, decreasing to 33.7% from 45.0% due to a change in its definition of default that led to an increase in reported stage 3 loans in the quarter. Collector increased its coverage ratio to 54.3% from 49.4%, reflecting an increase in its coverage ratio for consumer loans to 53.3% from 51.7%. It also reported a 40% reduction in stage 3 loans in its corporate and real-estate portfolio in the quarter, which lifted the corporate coverage ratio to 61.4% from 40.1%.

Figure 3. Nordic consumer banks' stage 3 coverage ratios, Q3 2022–Q4 2022



Source: bank reports.

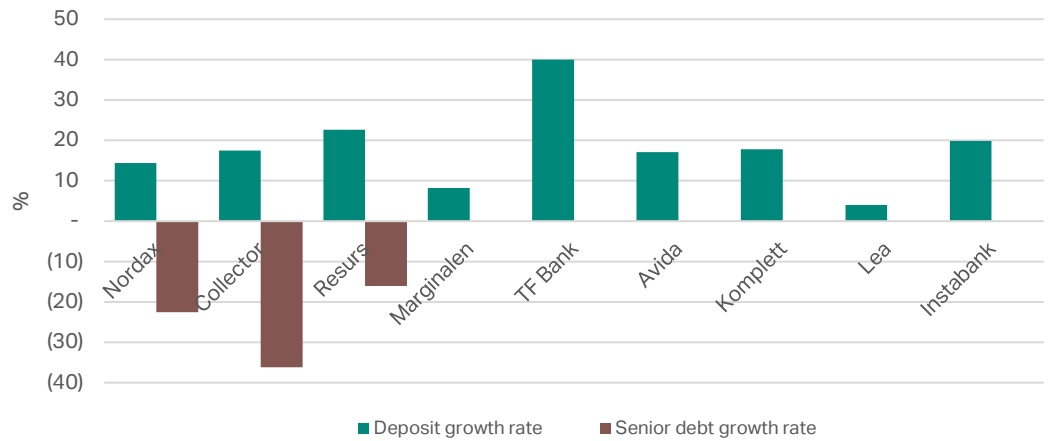
### DEPOSIT GROWTH OFFSETTING CAPITAL MARKETS FINANCING

Economic uncertainty has risen in early 2023 and recent developments in the US and Swiss banking sectors have contributed to further increases in bond spreads for Resurs, Collector and Nordax. As risk premiums and market rates for capital market financing remain elevated, funding from customer deposits has become even more important, more competitive and more expensive. Banks have raised rates on their customer deposits in an effort to build up liquidity for forthcoming maturities, but they remain well below costs for market funding.

Banks in our sample have supported strong loan growth with Nordic and German deposits, securing liquidity buffers. However, recent developments in the US and Swiss banking sectors have demonstrated the speed with which depositors can react to negative information in a digital banking environment. NCR-rated consumer banks maintain around 95% guaranteed deposits, reducing the risk, but we note that reputational risk could have severe effects on liquidity.

In addition, pressure on household budgets has reduced savings rates, with household deposits now decreasing in Sweden, Norway and the euro zone. In Sweden, until the fourth quarter of 2022, the last quarterly decline in Swedish household deposits was the first quarter of 2015, and the pace of decline has increased through February 2023.

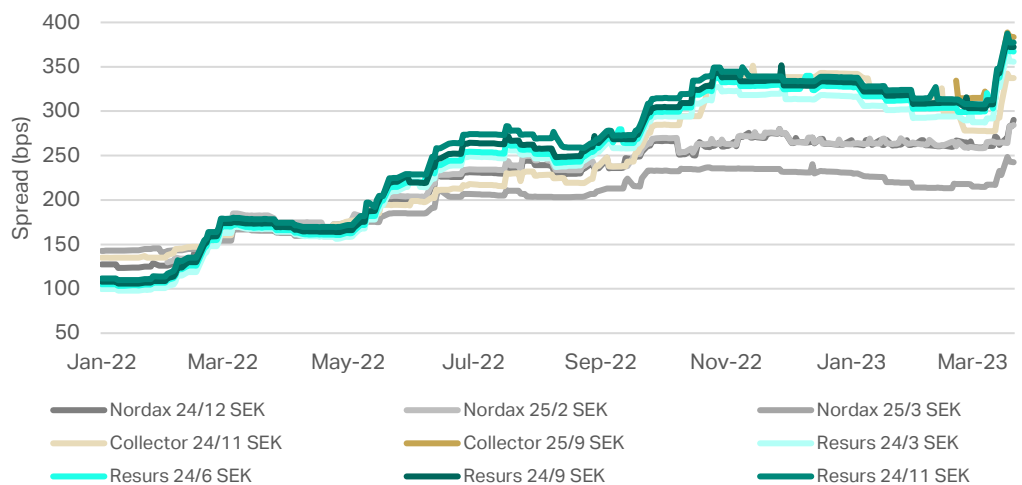
Figure 4. Nordic consumer banks' growth in customer deposits and senior debt, 2022



Source: bank reports.

Market spreads fell from November to mid-March before spiking again in the wake of recent bank collapses. We expect banks to maintain strong liquidity buffers to reduce refinancing risk in the capital markets. Collector Bank is the only bank in the sample to issue senior unsecured debt since the invasion of Ukraine. In September, the bank issued a 3-year SEK 300m instrument with an interest rate of 240bps over three-month STIBOR. By comparison, Nordax issued a 3-year SEK 500m instrument in early February 2022 with a 115bps spread over STIBOR.

Figure 5. Bond spreads for SEK-denominated instruments maturing in 2024 and 2025, Jan. 2022–23 Mar. 2023



Source: Capital IQ

**LOAN GROWTH DRIVES LOWER CAPITAL RATIOS FOR MOST BANKS**

Weighted average common equity Tier 1 (CET1) ratios increased by 10bps to 14.5% at the end of the fourth quarter of 2022. Aside from Komplett's 1.7pp reduction in capital, due to strong growth and a material one-off write down of intangible assets, the sample remained relatively stable from the third to the fourth quarter.

Sweden-based banks in our sample – Nordax, Collector, Resurs, Marginalen, TF Bank and Avida – continue to await feedback from the Swedish regulator about the Pillar 2 guidance (P2G) capital requirements. We expect P2G to be higher than the sector-wide 1–1.5% level indicated by the regulator, due to the strong focus on consumer lending. Where capital ratios need to be increased, we expect the P2G to be implemented on a bank-specific timeline agreed with the regulator, rather than being applied as an immediate capital requirement.

On 27 Mar. 2023, Avida announced a SEK 202m rights issue, to be completed in April 2023, which would improve the proforma CET1 ratio to 12.4% from 10.7% as of year-end 2022.

Figure 6. Nordic consumer banks' CET1 ratios, Q4 2022

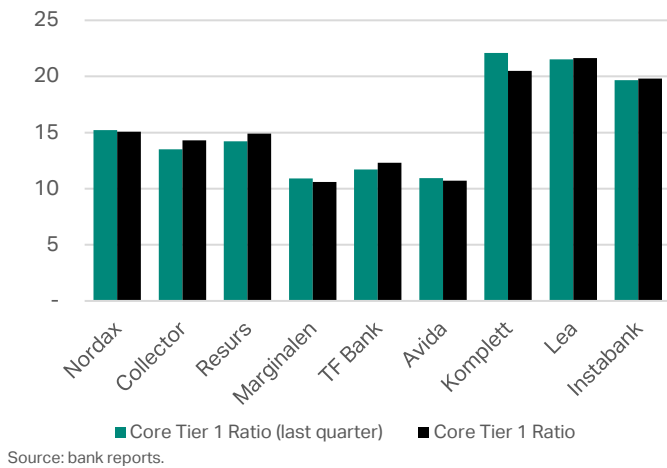
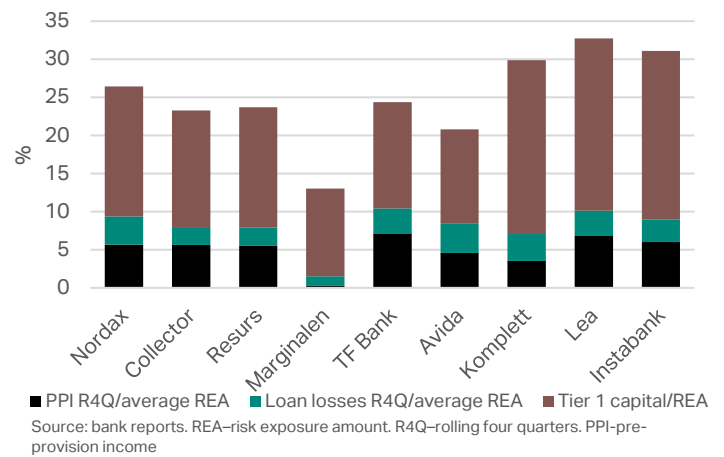


Figure 7. Nordic consumer banks' loss-absorbing buffers as a proportion of REA, Q4 2022



### SHORT-TERM MARGIN PRESSURE FROM HIGHER INTEREST RATES

Consumer banks have raised interest rates on customer deposits, and we expect that this rise in funding costs will be increasingly offset by loan repricing. As a sign of this, the weighted average net interest margin increased to 6.5% from 6.3% in the third quarter.

Risk-adjusted earnings fell in the fourth quarter, though this is largely associated with material one-off charges at Komplett and Marginalen. In total, the sample reported a weighted average pre-provision income to risk exposure amount of 5.0%, a decline from 5.2% in the third quarter. However, excluding Marginalen and Komplett from the sample, the ratio improved by 60bps, showing the impact of higher margins and continued loan growth. The significant improvement in Lea's pre-provision earnings reflect a material increase in the value of the bank's liquidity portfolio in the fourth quarter as credit spreads tightened.

Figure 8. Nordic consumer banks' annualised pre-provision income to average REA, Q1 2022–Q4 2022

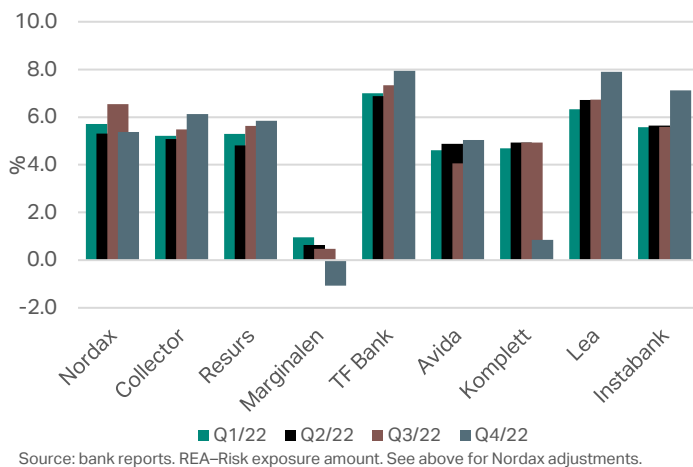
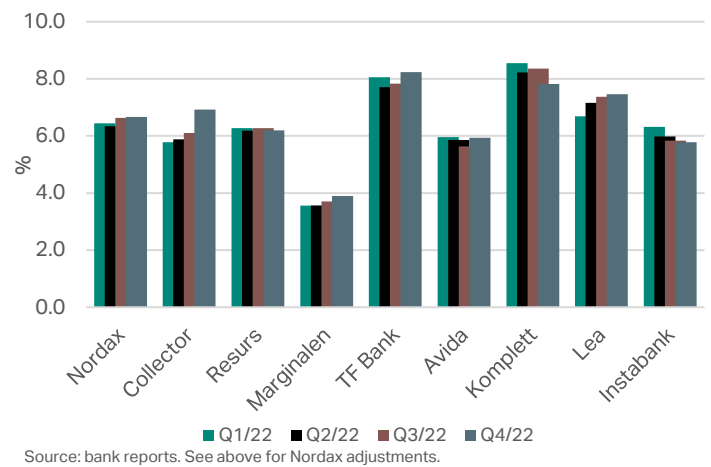


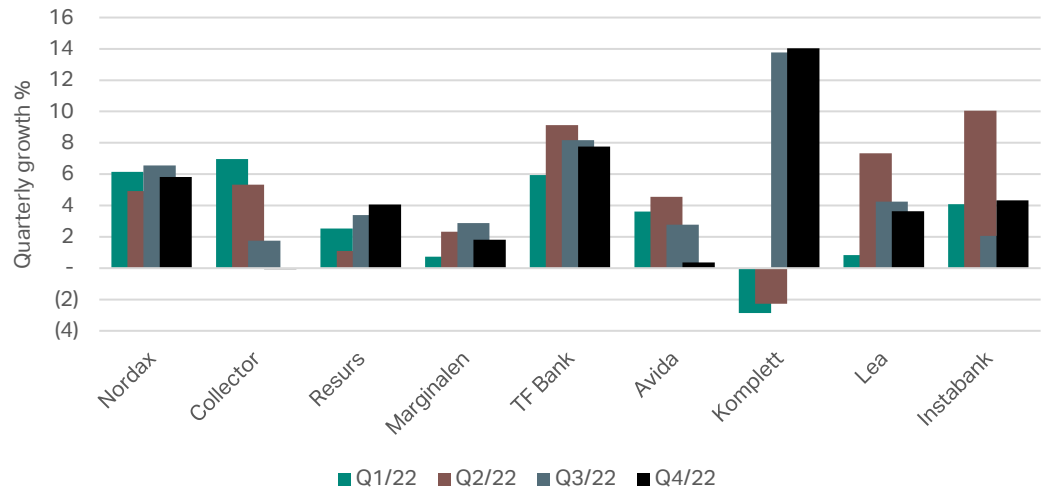
Figure 9. Nordic consumer banks' annualised net interest margins, Q1 2022–Q4 2022



### LOAN VOLUMES GROW IN ALL SEGMENTS

Weighted average net loan growth fell to 4.1% for the quarter from 4.8% in the third quarter, reflecting minimal growth for Collector and Avida, despite very high growth from Komplett. Komplett has established a growth target of NOK 12bn in gross loans by the end of 2023, a 25% increase from year-end 2022. These efforts will add to competitive pressure in Nordic consumer loans, especially given our expectations that market growth will be modest in 2023 as banks tighten underwriting and borrowers reconsider their consumption patterns.

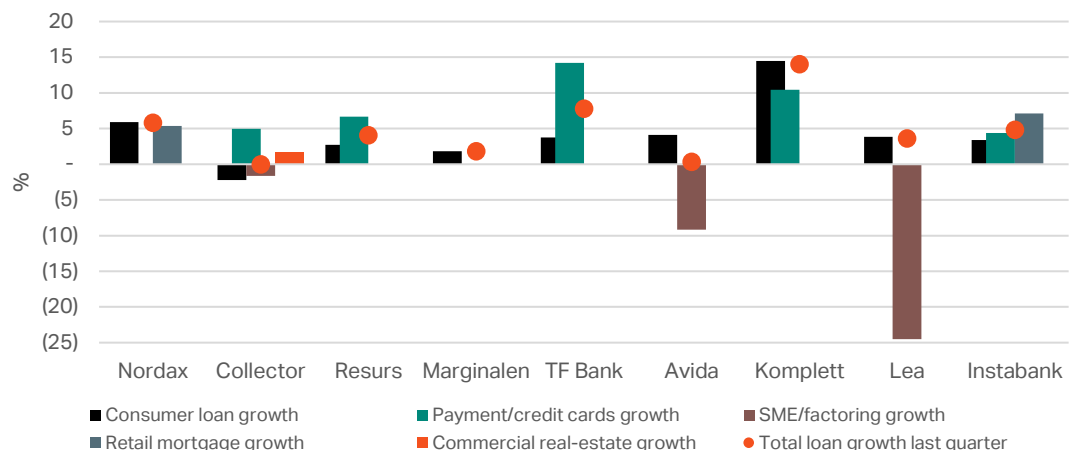
Figure 10. Nordic consumer banks' net loan growth, Q1 2022–Q4 2022



Source: bank reports.

The source of growth within the sample varied by segment. On aggregate, consumer loans grew by 4.4%, payment and credit cards increased by 8.4% (see Nordax note in Figure 11), and retail mortgages increased by 5.5%. At individual bank level, Komplett had a 14.5% growth rate in consumer loans during the quarter. TF, Komplett, Resurs and Collector grew short-term payment loans during the fourth quarter. Collector saw a reduction in its SME and consumer loan book and reported no growth in the quarter. Avida also reported very low growth as SME loans declined in favour of consumer loans. Lea continued to unwind its SME lending business, reallocating capital to growth in consumer loans exposure.

Figure 11. Nordic consumer banks' net loan growth by segment, Q4 2022



Source: bank reports. In November, Nordax and Bank Norwegian completed their intra-group merger. The end of Bank Norwegian's reporting resulted in a loss of detail for consumer and payment loans for Nordax.

## NCR-RATED CONSUMER BANKS

The following table summarises NCR's ratings on Nordic consumer banks as of 28 Mar. 2023.

Figure 12. NCR ratings on Nordic consumer banks

	Resurs Bank	Collector Bank	Nordax Bank
Long-term issuer rating	BBB	BBB-	BBB
Outlook	Stable	Stable	Stable
<b>Subfactors:</b>			
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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