Nordic consumer banks' loss provisions remain elevated

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The first quarter of 2023 confirmed the development that started at the end of last year for Nordic consumer banks. Loss provision levels remained elevated as persistent cost inflation and higher interest expenses pressured consumers. Breaking with a recent trend, however, non-performing loan (NPL) metrics increased slightly for most banks, indicating that much of the offloading of NPL portfolios due to the implementation of the NPL backstop regulation is complete.

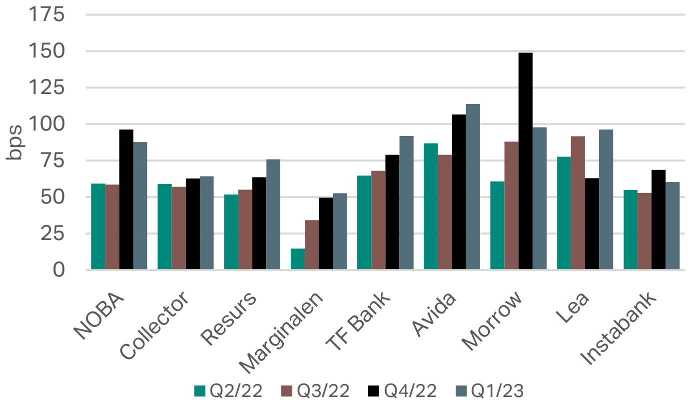
Weighted average loan growth for the quarter fell to 3.4% from an average of 4.4% in the previous three quarters. Nonetheless, capital ratios declined for nearly all banks in the sample, signifying weaker capital generation and a decline in return on equity. Margins fell for most issuers due in large part to increased competition for deposit funding, given higher spreads on capital market financing and concerns associated with high-profile bank runs in the US and Switzerland.

We maintain the view that increasing political and cost-of-living risks are weighing on the consumer lending segment. We expect the combination of higher living costs and interest rates to continue to drive up loss provisions for the banks in our sample throughout 2023 and 2024. Consumer bank customers tend to have relatively weak financial profiles, making them more susceptible to inflationary pressures and higher interest expenses, which reduces demand for consumer loans.

LOAN LOSS PROVISIONS REMAIN ELEVATED, NPL TREND SUBSIDES

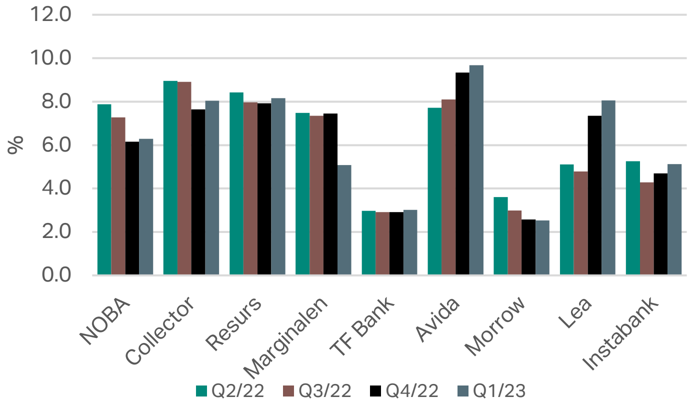
Consumers' concerns about cost inflation continue, and asset quality dipped in the first quarter as loan loss provisions increased for most of the sample. The weighted average first-quarter credit provision was 81 bps of net loans, in line with the fourth quarter of 2022. In addition to higher non-payments, loss levels remained relatively high for NOBA (formerly Nordax), Marginalen and Avida, and increased for Lea, Resurs and TF Bank. Morrow's (formerly Komplett) loss levels decreased from fourth-quarter one-off impacts but remained high due to stage 1 provisions on the back of significant loan growth. NOBA also reported a high share of stage 1 provisions associated with strong growth. Lea Bank reported weakening credit performance in Sweden and Finland, which led to the increase in loss provision for the quarter.

Figure 1. Nordic consumer banks' loan loss provisions to net loans, Q2 2022–Q1 2023



Source: bank reports.

Figure 2. Nordic consumer banks' net stage 3 NPLs to net loans, Q2 2022–Q1 2023



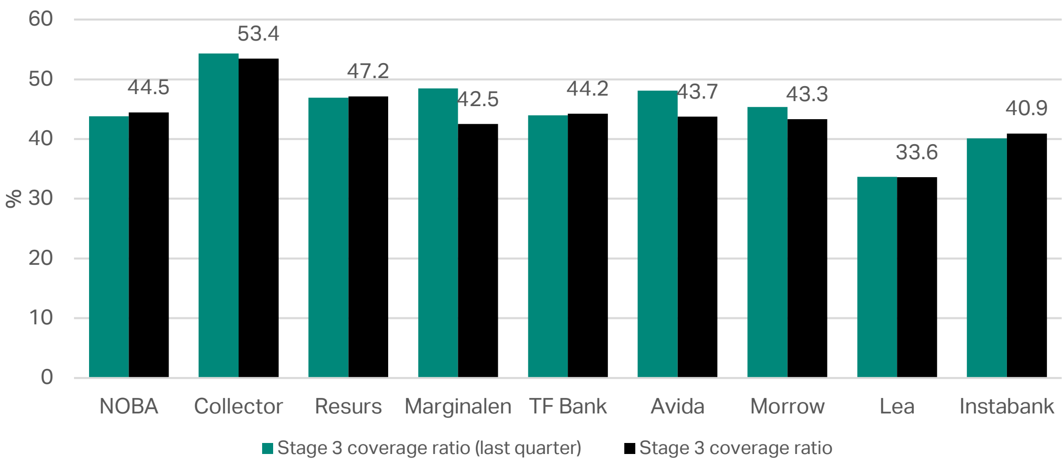
Source: bank reports.

The positive trend in net NPL metrics ended abruptly, with weighted average net stage 3 NPLs stable at 6.6%, compared with 8.4% at year-end 2021. In our view, this indicates that much of the offloading of NPL portfolios to reduce the capital impact of the NPL backstop regulation is complete. We further note that turbulent markets have also had a negative impact on debt purchasers' ability to buy portfolios, which could affect future pricing and loan loss provisioning.

Only Marginalen, which completed a SEK 800m transfer of NPLs to its subsidiary Sergel Finans AB (of which SEK 448m was included as own-generated stage 3 loans), reduced NPLs materially in the first quarter. The bank and its subsidiary also sold NPL portfolios included within the NPL backstop regulation to external parties in April. Lea Bank also announced the sale of NPLs early in the second quarter, which would reduce its gross reported NPLs to 5.8% from 11.3% at 31 Mar. 2023.

Using a weighted average, stage 3 coverage ratios fell to 46.6% in the first quarter from 47.5% at year-end, but in line with recent quarters. Lea is still an outlier, given the bank's fourth-quarter change in its definition of default, which increased the levels of gross stage 3 loans. Collector's provisioning is the highest in the peer group, reflecting a 53.7% stage 3 provision level for private loans and a 51.6% level for corporate and real-estate exposures.

Figure 3. Nordic consumer banks' stage 3 coverage ratios, Q4 2022–Q1 2023

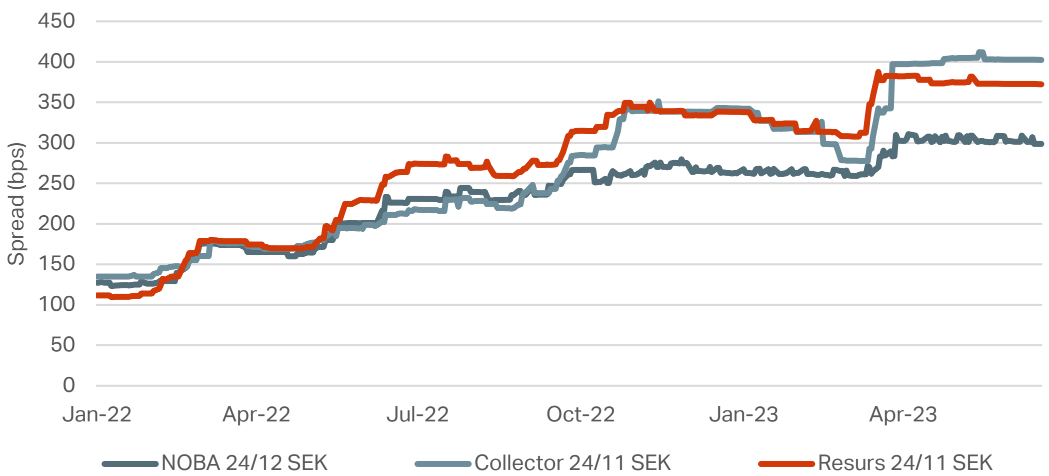


Source: bank reports.

DEPOSIT GROWTH OFFSETTING CAPITAL MARKETS FINANCING

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. Market spreads are still elevated following the bank runs on US and Swiss banks in the first quarter. We expect banks to increase their reliance on price-sensitive retail deposits in the coming quarters as bond financing matures, increasing pressure on deposit margins.

Figure 4. Bond spreads for selected senior instruments, Jan. 2022–20 Jun. 2023



Source: Capital IQ.

Banks have supported loan growth with Nordic and German deposits, with liquidity buffers above 20% of customer deposits on average for the sample, although over half the banks in the sample were below this level. The recent developments in the US and Swiss banking sectors have shown the speed with which depositors can react to negative information in a digital banking environment. Despite the high share of government guarantees for the sample banks, we consider the risks associated with on-demand, price-sensitive deposits to have been elevated by recent events. NCR-rated consumer banks have around 95% guaranteed deposits, reducing the risk, but we note that reputational risk could have severe effects on liquidity.

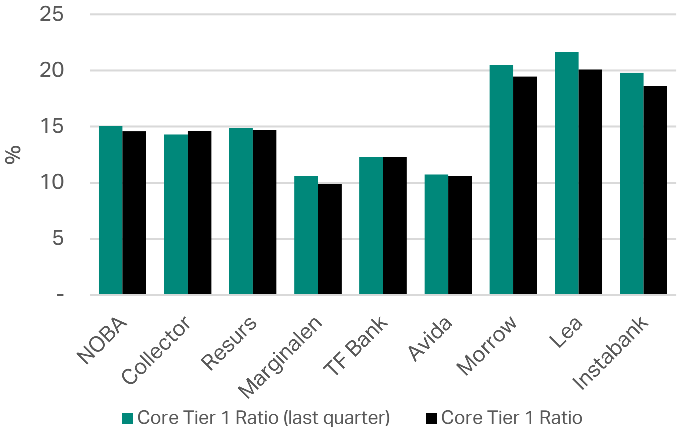
Increasing demand for deposit funding is cutting into banks' interest margins. In addition, pressure on household budgets has reduced savings rates, limiting supply. With the volume of household deposits flat since the summer of 2022 in Sweden, Norway and Germany, we expect banks to have to reduce their margins to maintain deposit customers.

LOAN GROWTH AND LOWER RETURN ON EQUITY DRIVE DOWN CAPITAL RATIOS

Weighted average common equity Tier 1 (CET1) ratios fell by 25bps to 14.3% at the end of the first quarter of 2023. Aside from Collector and TF Bank, which showed a considerable decrease in growth, ratios among the sample declined during the first quarter. Marginalen stands out as having the lowest capital and earnings buffers among the peer group, with a CET1 ratio of 9.9% and rolling 12-month pre-provision earnings of only SEK 34m because of one off write-downs and relatively weak cost efficiency among the peer group.

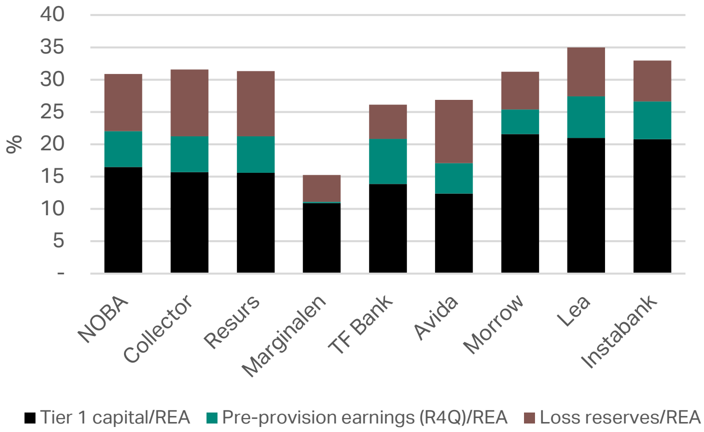
Banks are actively adding new equity to support growth. Avida completed a SEK 201m rights issue in the second quarter, which improved the proforma CET1 ratio to 12.3% from 10.6% as of 31 Mar. 2023. Instabank also added equity in the second quarter, raising its proforma CET1 ratio to 20.5% from 18.6% as of 31 Mar. 2023. Morrow completed an equity increase as well, improving its proforma CET1 ratio to 20.5% from 19.4% at 31 Mar. 2023.

Figure 5. Nordic consumer banks' CET1 ratios, Q4 2022–Q1 2023



Source: bank reports.

Figure 6. Nordic consumer banks' loss-absorbing buffers as a proportion of REA, Q1 2023



Source: bank reports. REA–risk exposure amount.

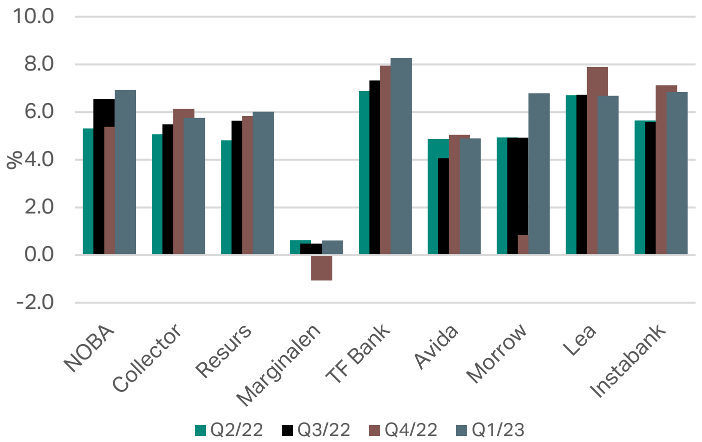
Regulatory adjustments continue to affect the banks' capital requirements. The European systemic risk board accepted a lower threshold for the Norwegian systemic risk buffer, which will be applicable to all the Norwegian banks in the sample from year-end 2023. In May, the Swedish regulator announced it would apply the Norwegian systemic risk buffer of 4.5% to Norwegian exposures. The increase has the largest impact on capital requirements for NOBA and TF Bank, which have over 20% of loans in Norway. Finally, the Finnish regulator announced its own systemic risk buffer of 1% from April 2024, which we expect to be applied to the sample banks' Finnish exposures. The Swedish banks in the sample will also be affected by changes to the methodology for calculating Pillar 2 guidance (P2G) capital requirements announced in May.

MARGIN PRESSURE FROM HIGHER DEPOSIT RATES

Pressure for consumer banks to raise interest rates on customer deposits increased in the first quarter, resulting in most banks reporting moderately lower net interest margins in the first quarter. We expect that this rise in funding costs will continue as spreads on capital market financing remain high for the sample banks, but also for the large commercial and savings banks competing for customer deposits amid lower deposit growth. In total, the weighted average net interest margin decreased slightly to 6.46% from 6.51% in the fourth quarter, ending a period of increasing quarterly margins.

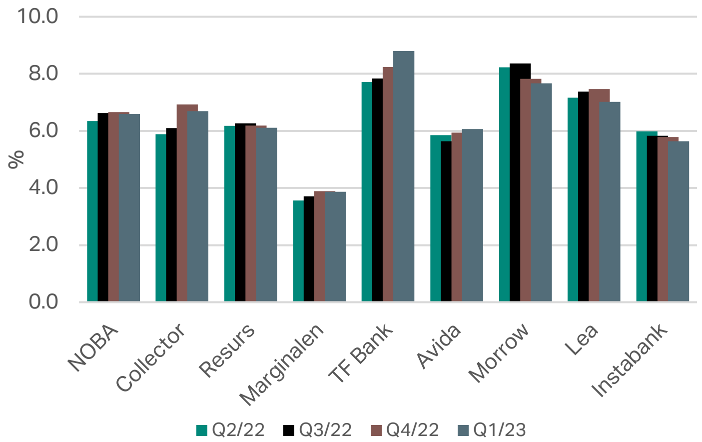
Despite the pressure on margins, risk-adjusted earnings improved materially in the first quarter of 2023, due to a reduction in one-off charges described in our fourth-quarter report (see relevant research below). In total, the sample reported a weighted average annualised pre-provision income-to-risk exposure amount of 5.9%, an improvement from 5.1% in 2022. However, significant one-off effects from Marginalen and Morrow reduced the ratio by 60bps in the fourth quarter of 2022. Increasing synergies and fewer one-off charges for NOBA were a major factor as well, with a ratio of 6.9% for the first quarter of 2023 compared with 5.4% for the fourth quarter of 2022.

Figure 7. Nordic consumer banks' annualised pre-provision income to average REA, Q2 2022–Q1 2023



Source: bank reports. REA–Risk exposure amount.

Figure 8. Nordic consumer banks' annualised net interest margins, Q2 2022–Q1 2023

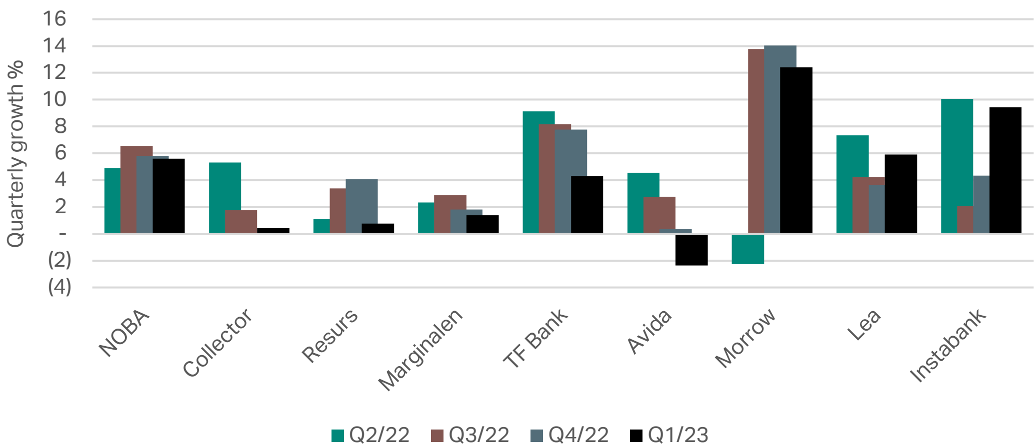


Source: bank reports.

LOAN VOLUMES GROW IN ALL SEGMENTS

Weighted average net loan growth fell to 3.4% for the first quarter of 2023 from 4.1% in the previous quarter, reflecting minimal growth for Collector and Resurs and a decline in net loans for Avida. Morrow continues to show very high growth given its target to reach NOK 12bn in gross loans by the end of 2023 (NOK 10.2bn at 31 Mar. 2023), a 25% increase on year-end 2022. NOBA, Lea and Instabank reported growth of over 5% for the quarter, while TF Bank's growth rate nearly halved to 4.3% in the quarter.

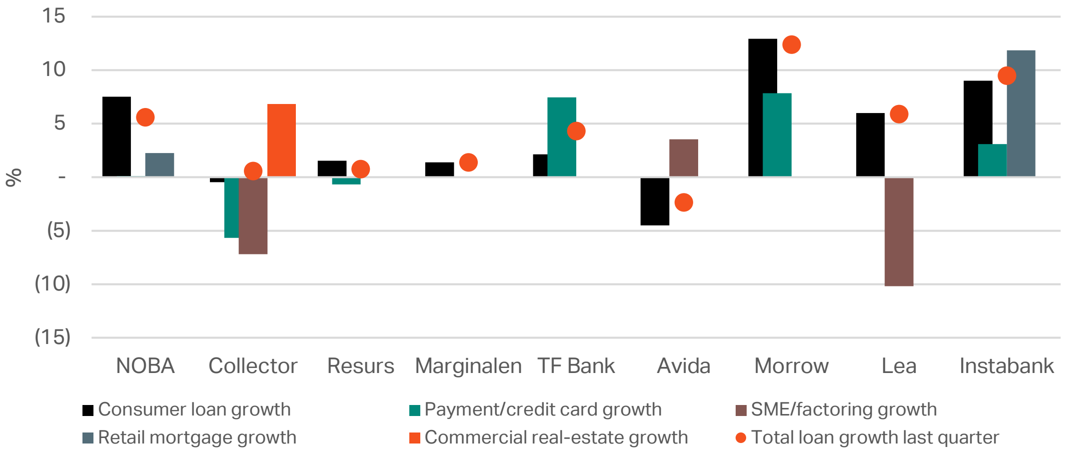
Figure 9. Nordic consumer banks' net loan growth, Q2 2022–Q1 2023



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 by 0.9%, and retail mortgages by 3.2%. At individual bank level, Morrow had a 12.9% growth rate in consumer loans in the quarter. Instabank's rapid growth included 11.8% in non-standard Norwegian mortgage loans and 9% in consumer loans in the first quarter. Collector's growth in real-estate lending was offset by a reduction in its SME and consumer loan book, with the bank reporting 0.6% growth in the quarter. Avida's decline in growth reflects a reduction in consumer loans in favour of SME loans. Lea continued to unwind its SME lending business, reallocating capital to growth in consumer loans.

Figure 10. Nordic consumer banks' net loan growth by segment, Q1 2023



Source: bank reports.

NCR-RATED CONSUMER BANKS

The following table summarises NCR's ratings on Nordic consumer banks as of 26 Jun. 2023.

Figure 11. NCR ratings on Nordic consumer banks

	Resurs Bank	Collector Bank	NOBA Bank Group
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	bbb-
Performance indicators (15%)	bbb+	bbb+	bbb+
Ownership adjustment	0	0	0

See NCR's company rating reports for details.

RELEVANT RESEARCH

(i) Nordic consumer banks increase loss provisions amid rising cost of living, 31 Mar. 2023.
(ii) Nordic consumer banks improve margins to offset higher loss provisions, 29 Nov. 2022.

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