Nordic consumer banks increase credit losses

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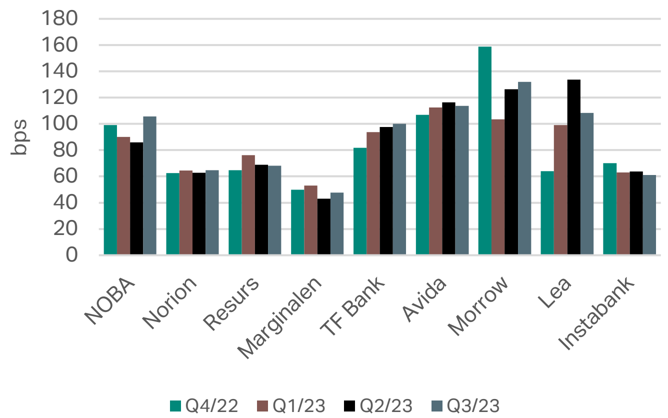
The third quarter of 2023 saw increased losses and marginal declines in earnings for niche consumer banks in the Nordic region. Most of the banks in our sample of nine regional consumer banks maintained strong earnings and cost efficiency in the quarter, which continued to offset elevated loan-loss provisions. However, we continued to see challenges for the sector. Low deposit growth in the Nordic countries and Europe is increasing competition and funding costs for Nordic consumer banks. In addition, the proportion of loans showing increasing signs of weakness (Stage 2 loans) is increasing and banks continue to indicate that payment patterns could be at risk as economic conditions worsen. These impacts could result in increased loan-loss provisioning and hinder capital generation across the sector.

Nordic central banks have demonstrated considerable patience in their recent interest rate decisions, although we believe it likely that the Norwegian central bank will raise rates one more time in December. We expect interest rates across the region to remain elevated well into 2024, before some likely reductions, although recent cost inflation is likely to continue to constrain repayment capacity. We expect the combination of higher costs and interest payments to result in elevated loan-loss provisions throughout 2024. Furthermore, we anticipate that earnings margins will face pressure due to intensified competition as the deposit market remains stagnant heading into 2024. In consequence, we expect this combination of negative factors to drive weaker performances across the sector for at least the next few quarters.

LOAN-LOSS PROVISIONS INCREASE FURTHER

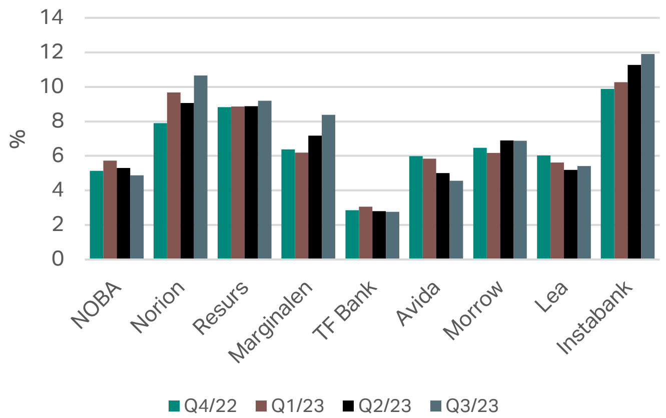
Additional interest rate hikes in all markets continue to put stress on the repayment capacity of Nordic households. During the third quarter, asset quality indicators weakened, with weighted average credit provisions rising to 89 basis points of average net loans, from an average of 82 basis points in the previous three quarters. The primary explanation for the increase in our sample is a rise in provision levels for NOBA, given its relative size. Excluding NOBA, loan losses for the remainder of the sample banks were similar to the previous quarter. Similar to NOBA, TF Bank's increased provisions largely reflect its increasing volume of credit cards which have a higher loan loss ratio (6.2%) than its average. Lea Bank showed a material reduction in provisions compared with the second quarter, but also said that loan applications were rejected at a higher rate than previously due to weaker liquidity among applicants, which partly explains its modest loan growth over the past two quarters.

Figure 1. Nordic consumer banks' loan-loss provisions to average net loans, Q4 2022–Q3 2023



Source: bank reports.

Figure 2. Nordic consumer banks' net Stage 2 loans to net loans, Q4 2022–Q3 2023



Source: bank reports.

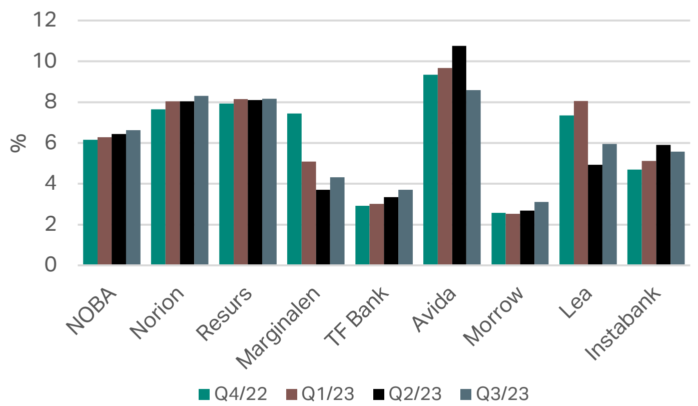
The level of net loans at Stage 2, i.e., showing signs of weakness but not yet non-performing, increased to 6.9% in the third quarter from 6.6% in the second and 5.7% a year earlier. The increase was largely driven by increasing Stage 2 corporate and real estate loans at Norion and increased Stage 2 loans at Marginalen and Instabank. When loans move from Stage 1 (performing normally) to Stage 2, our sample banks' increase loan-loss provisions to 11.1% of gross Stage 2 loans from 1.4% for Stage 1 loans to reflect the increasing risk. A bigger increase in loan-loss provisions for the sample banks occurs when Stage 2 loans deteriorate further to Stage 3, increasing the average provision rate to 47.4% of gross Stage 3 loans, which tends to drive increasing credit losses. For this reason, Stage 2 loans are a good indicator of possible larger losses in the quarters ahead, given that they have given indications of weakness.

NON-PERFORMING LOAN MARKET REMAINS WEAK

Non-performing loan (NPL) metrics also rose slightly in the third quarter compared to the previous three quarters, with weighted average net Stage 3 loans at 6.7%, an increase of about 10bps over previous levels. With the exception of Avida Finans, most banks in the sample showed a quarter-on-quarter increase in net NPLs. After recording relatively large NPL sales in the second quarter, Lea and Marginalen saw the largest increase in net NPLs during the third. We believe that recent problems at debt purchasing companies continue to impede banks' ability to offload NPLs.

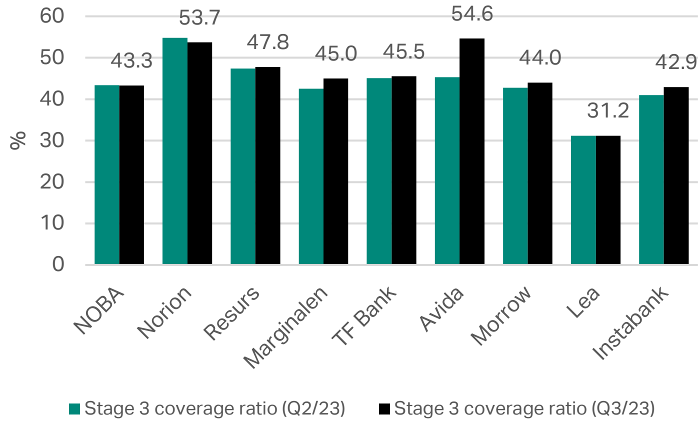
Using a weighted average, Stage 3 coverage ratios slightly increased to 47.4% in the third quarter from 46.8% in the second. Avida's increased coverage ratio during the quarter gives it the highest provision level in the sample. The increase reflects a SEK 162m increase in Stage 3 loan-loss reserves during the quarter, despite a SEK 110m decrease in gross Stage 3 loans. Norion's loan-loss provisioning remains high, nonetheless, with 55.3% Stage 3 provisions for private loans and 45.9% for corporate and real-estate exposures. Lea continues to stand out due to a change in its definition of default in the fourth quarter of 2022, which raised its levels of gross Stage 3 loans. We anticipate higher Stage 3 coverage ratios in the sector due to a weaker NPL market and heightened credit risk in the next few quarters.

Figure 3. Nordic consumer banks' net Stage 3 NPLs to net loans, Q4 2022–Q3 2023



Source: bank reports.

Figure 4. Nordic consumer banks' Stage 3 coverage ratios, Q2 2023–Q3 2023



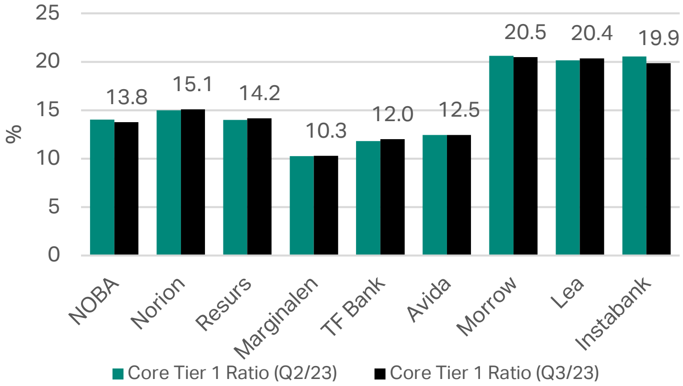
Source: bank reports.

CAPITAL RATIOS STABLE, CAPITAL INSTRUMENTS REMAIN EXPENSIVE

Weighted average common equity Tier 1 (CET1) ratios remained consistent with the second quarter at 14.3%. The most significant changes during the third quarter were for NOBA, which continues to grow faster than it can generate capital despite a lack of dividends, resulting in a 27bps reduction in its CET1 ratio. The bank called additional Tier 1 and Tier 2 instruments previously issued by Bank Norwegian during the third quarter, resulting in a 45bp decline in its tier 1 capital ratio and a 96bp decline in its total capital ratio during the quarter. Instabank's CET1 ratio fell 67bps during the quarter due to strong loan growth. TF Bank issued SEK 150m in new additional Tier 1 instruments in September, restoring its Tier 1 ratio to 13.7% (13.9% at year-end 2022). Norion Bank received approval to adopt the alternative standardised approach for operational risk, which we expect to increase its capital ratios as of the fourth quarter.

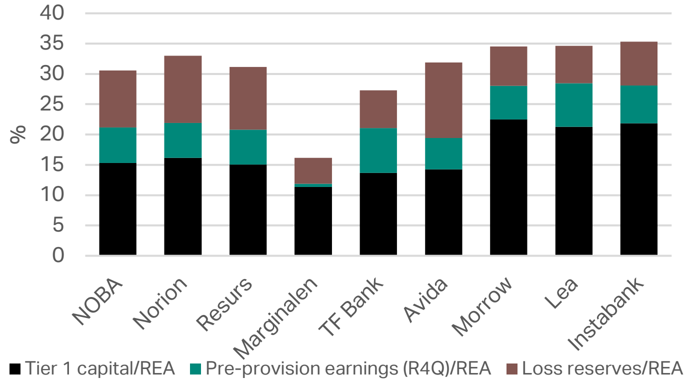
In October, Marginalen elected not to call an SEK 300m Tier 2 instrument on its 30 October call date. Given normal market practice of calling capital instruments on their call date and the regulatory amortisation of capital instruments (effectively reducing their impact on capital ratios as they approach maturity), the decision was seen as unusual and could affect the bank's access to and pricing of future capital instruments. Marginalen has an additional SEK 500m in Tier 2 instruments with call dates in 2024 and says that it is working to optimise its capital structure.

Figure 5. Nordic consumer banks' CET1 ratios, Q2 2023–Q3 2023



Source: bank reports. Marginalen's capital ratios are shown as the consolidated ratios reported by its parent company, ESCO Marginalen AB.

Figure 6. Nordic consumer banks' loss-absorbing buffers as a proportion of REA, Q3 2023

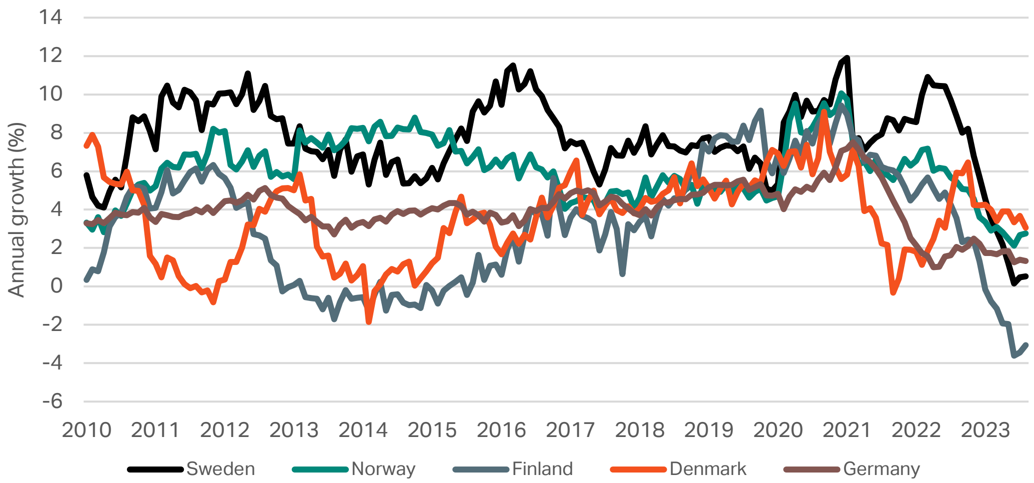


Source: bank reports. Marginalen's capital ratios are shown as the consolidated ratios reported by its parent company, ESCO Marginalen AB.

A reduction in the Norwegian systemic risk buffer threshold (NOK 5bn compared with NOK 32bn previously) will be applicable to all Norwegian banks in our sample as of end-2023. The Swedish regulator has also announced that it will apply the Norwegian systemic risk buffer of 4.5% to Norwegian exposures by end-2023. The greatest impact will be on NOBA as more than 20% of its lending is located in Norway. Finland's 1% systemic risk buffer will be in place from April 2024, and could eventually be subject to regulatory reciprocity for the Finnish exposures of the banks in our sample.

HOUSEHOLD DEPOSIT GROWTH STAGNANT

Figure 7. Annual household deposit growth in the Nordic countries and Germany, 2010-Sep. 2023



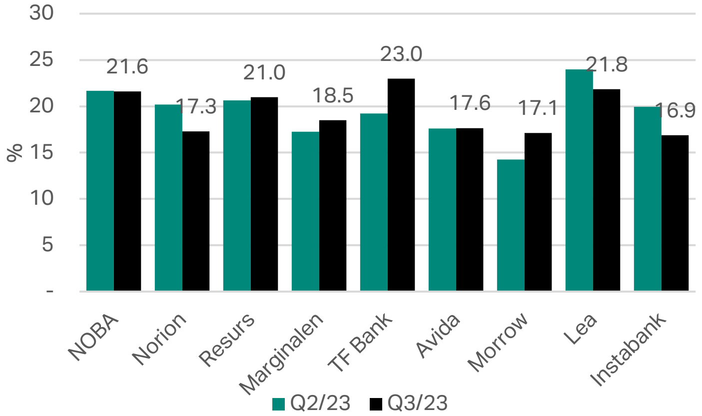
Source: Statistics Sweden, Statistics Norway, Statistics Denmark, ECB.

Savings rates remain low across Europe. This has resulted in lower household deposit growth in Nordic and German markets. Rising interest rates have also increased competition from larger Nordic banks, which see deposits as a more cost-effective alternative to senior unsecured financing amid higher interest rates and spreads.

In our view, the risk associated with on-demand, price-sensitive deposits has been elevated by recent bank runs in the US and Swiss banking sectors, though the banks in our sample operate with high levels of government guarantees. NCR-rated Nordic consumer banks have around 95% of their deposits guaranteed, reducing such risk, but we note that elevated reputational risk could have severe effects on liquidity in a digital banking environment.

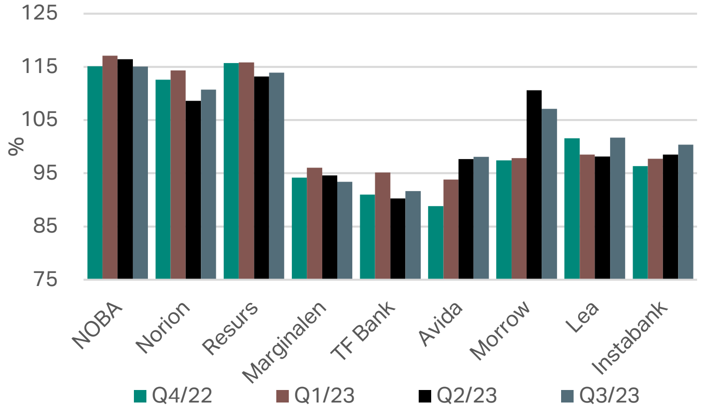
As competition for deposits increases, it is important for banks to maintain liquid buffers against prospective outflows of deposits. During the third quarter, the average ratio of liquid assets to customer deposits stabilised and remained at 19.4% among the banks in our sample, though this was down considerably from 22.3% at end-2022. However, four of the nine banks saw a net reduction in customer deposits, which is masked by the stable sample average. Norion's liquidity buffer fell to 17.3% from 20.2% in the second quarter given a large decline in cash balances. Instabank's buffer also fell materially to 16.9% from 20.0% a quarter earlier. Conversely, TF Bank increased its ratio of liquid assets to customer deposits to 23.0% from 19.2% in the second quarter.

Figure 8. Nordic consumer banks' liquid assets to customer deposits, Q4 2022–Q3 2023



Source: bank reports.

Figure 9. Nordic consumer banks' loan-to-deposit ratios, Q4 2022–Q3 2023

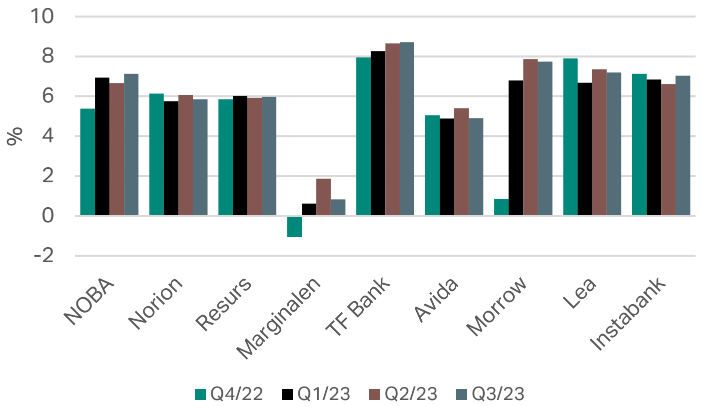


Source: bank reports.

MARGIN PRESSURE FROM HIGHER DEPOSIT RATES LIKELY

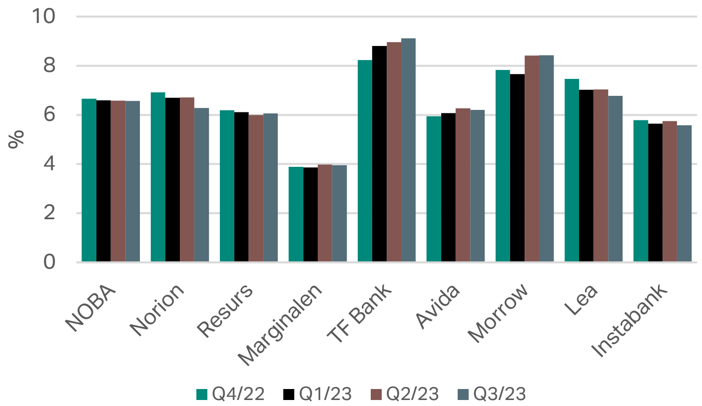
We anticipate that competition for deposits will result in higher interest rates on customer deposits and lead to a decline in net interest margins. However, the weighted average net interest margin in our sample remained stable at 6.5%, unchanged since the fourth quarter of 2022. This is partly explained by an increase in high-margin credit card lending, particularly by TF Bank, which continued to increase its margins. Norion's margins were impacted by a reduction in net interest income associated with specific NPLs.

Figure 10. Nordic consumer banks' annualised pre-provision income to average REA, Q4 2022–Q3 2023



Source: bank reports.

Figure 11. Nordic consumer banks' annualised net interest margins, Q4 2022–Q3 2023

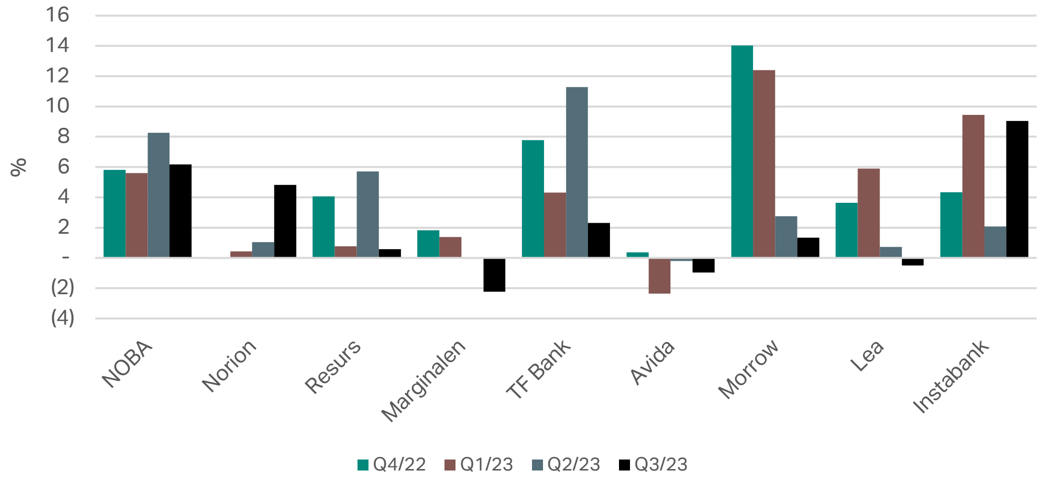


Source: bank reports.

Risk-adjusted earnings remained relatively stable during the third quarter, falling marginally to 6.2% from 6.3% in the second. Most of the decline was due to one-off write downs associated with third-party NPLs at Marginalen, and the sample average remains much higher than the 5.2% reported in the third quarter of 2022. Similarly, cost-income ratios remained stable for most of the sample, though including Marginalen the average ratio increased to 39.6% from 38.0% a quarter earlier. NOBA saw the largest improvement in earnings and efficiency due to strong growth and new synergies.

FOREX VOLATILITY CONSTRAINS LOAN GROWTH; BANKS INCREASINGLY CAUTIOUS

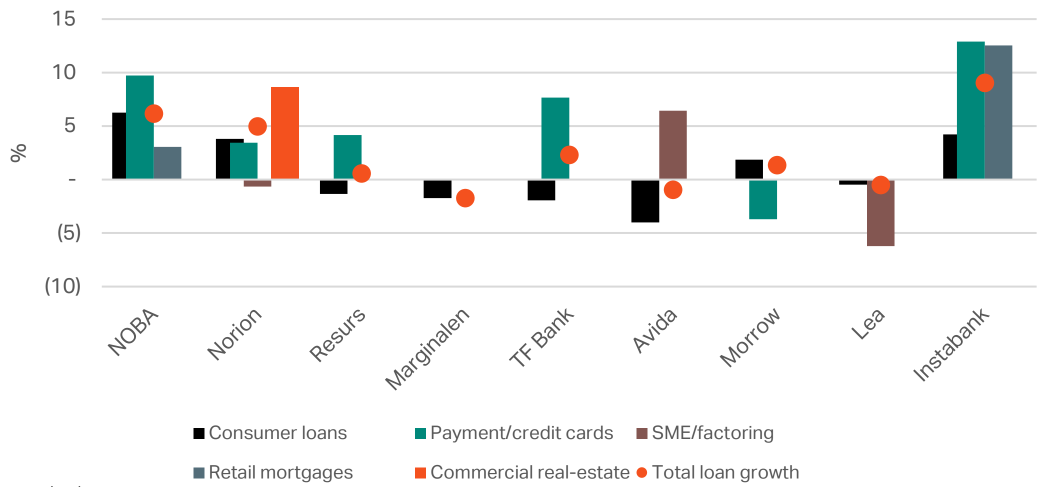
Figure 12. Nordic consumer banks' net loan growth, Q4 2022–Q3 2023



Source: bank reports.

Weighted average net loan growth fell to 3.5% in the third quarter from 5.2% in the second. The reporting currencies in the sample appreciated against the euro after material depreciation in the second quarter, with the Swedish krona rising 1.9% in the third quarter (compared with a decline of 4.5% in the second) and the Norwegian krone, up 3.7% from a decline of 3.0% previously). This had a negative impact on loan growth in Denmark, Finland, Germany, Austria, Latvia, Lithuania, and Estonia. Of the sample banks, TF Bank (2.3% reported growth compared with 4.0% growth in local currencies), NOBA and the Norwegian banks had the highest levels of euro-denominated loans, explaining much of the volatile growth figures in the last two quarters. Only NOBA, Norion, and Instabank reported growth of over 2.5% in the third quarter, while Marginalen, Avida and Lea reported a decline in net lending.

Figure 13. Nordic consumer banks' net loan growth by segment, Q3 2023



Source: bank reports.

Across the sample, consumer loans grew by 2.5% (5.3% in the second quarter), payment and credit card volumes increased by 6.6% (9.0%), and retail mortgages rose by 4.1 (4.5%). After a period of low growth, Norion expanded its corporate and real estate lending by 8.7%, while also increasing its consumer and payment lending. TF Bank and NOBA expanded payment and credit card lending by 7.7% and 9.7%, respectively. Instabank's recent growth has been mainly driven by non-standard Norwegian mortgage products, which now make up 40% of the bank's total loan book. In addition, Instabank launched a new SME lending product and continues to diversify away from consumer loans. By contrast, Morrow continued to scale back its point-of-sales business and Avida continued to transition towards SME lending from consumer loans. Lea continued to wind down its SME lending operations and redirected capital towards the expansion of consumer lending, though this was hidden by foreign exchange effects.

NCR-RATED CONSUMER BANKS

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

Figure 14. NCR ratings on Nordic consumer banks

	Resurs Bank	Norion 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' earnings compensate elevated credit losses, 11 Sep. 2023.
(ii) Nordic consumer banks' loss provisions remain elevated, 28 Jun. 2023.
(iii) Nordic consumer banks increase loss provisions amid rising cost of living, 31 Mar. 2023.
(iv) Nordic consumer banks improve margins to offset higher loss provisions, 11 Nov. 2022.

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