

Lower interest margin will lead to a drop in profitability for Norwegian savings banks

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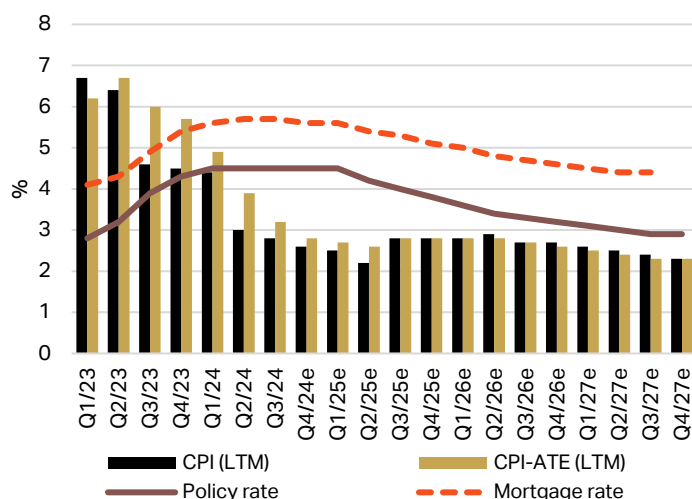
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Net interest margins for Norwegian savings banks have widened significantly on the back of rising interest rates since 2021. This, together with strong lending growth, has boosted earnings across the sector. The expected fall in interest rates did not materialise in 2024 and net interest margins held up better than we expected in the beginning of the year. However, we believe that falling interest rates, heightened competition and marginally increased loan losses will lead to slow earnings growth and lower return on equity in 2025 and 2026.

As intended, high interest rates are helping slow the economy. High interest rates and weaker economic conditions led to somewhat higher loan-loss provisions among domestic savings banks in 2023 and 2024. We expect a more flattish development in provisions during the next two years.

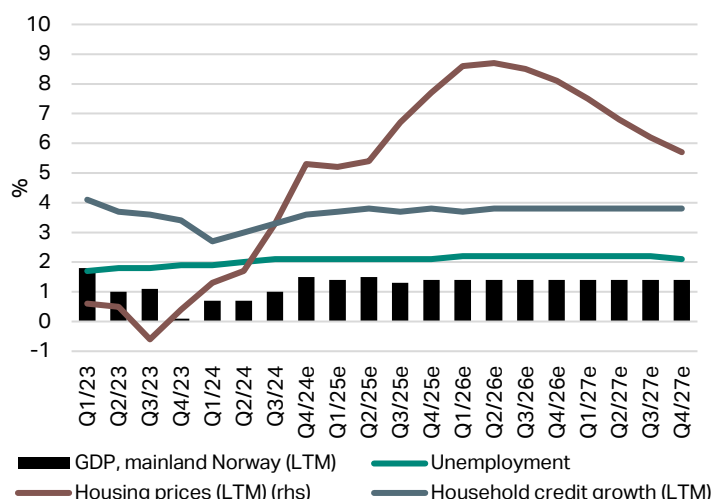
Norwegian savings banks are well capitalised and have strong pre-provision profitability, which makes them relatively resilient to possible increased credit losses. The EU's Capital Requirements Regulations III (CRR3), which will be implemented in 2025, will increase the capital buffer for banks that use the standardised method, which in turn may trigger more aggressive loan growth for these banks.

Figure 1. Norwegian inflation and interest rates, 2023–2027e



Source: central bank. e-estimate. CPI-consumer price index. LTM-last 12 months. ATE-adjusted for tax changes and excluding energy products.

Figure 2. Norwegian economic indicators, 2023–2027e



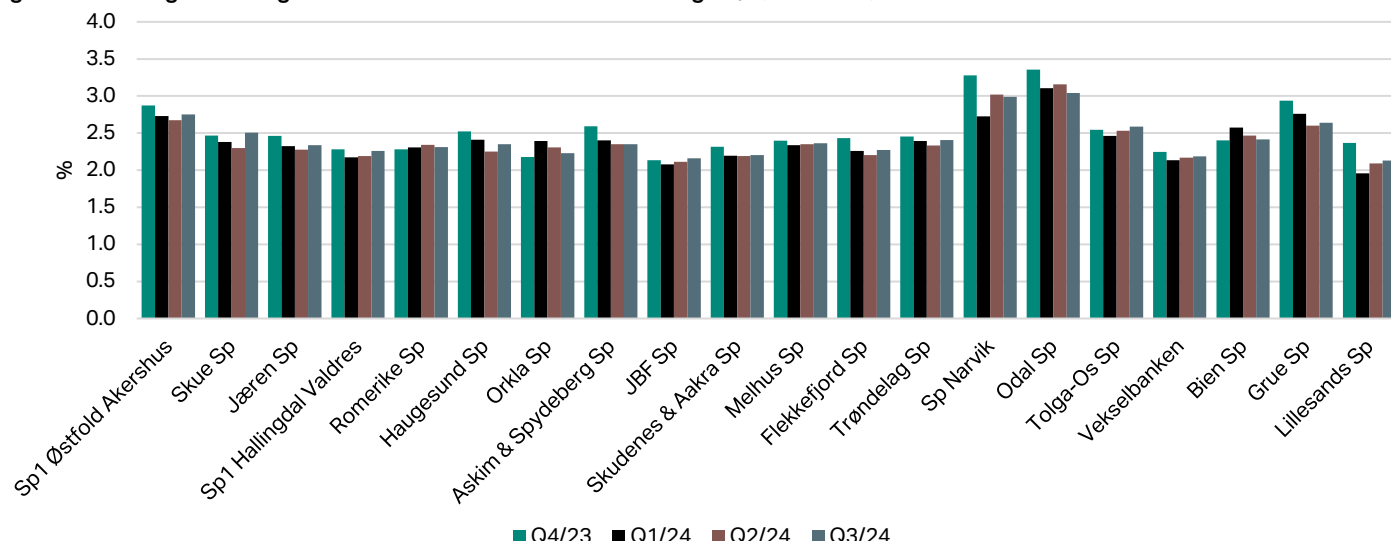
Source: central bank. e-estimate.

INTEREST MARGINS ON THE WAY DOWN

The Norwegian central bank policy rate and NIBOR increased by 450bps to December 2023 from September 2021. This strengthened banks' net interest margins, both due to higher yield on their free equity and lending rates increasing more than deposit rates. Norges Bank's policy rate path indicates that the policy rate will be cut by 25bps in March 2025 by about 150bps through 2026.

We believe falling interest rates will weaken net interest margins, while high capitalisation (boosted by CRR3) will lead to increased competition and margin pressure independent of interest rate movement. We expect net interest margins will fall by a moderate 10bps both in 2025 and 2026, after a 4bps decline in 2024.

Figure 3. Norwegian savings banks' annualised net interest margins, Q4 2023–Q3 2024



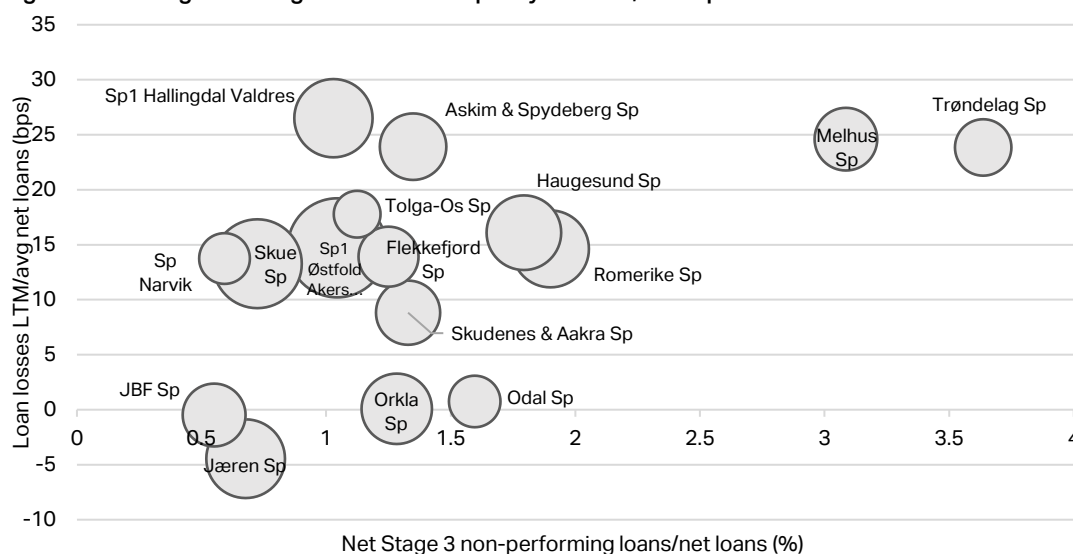
Source: bank reports.

MODERATE LOAN LOSSES

Annual growth rates in the wider Norwegian banking sector fell to 3.6% in November 2024 (from 3.8% in October), while growth in non-financial corporations was lower at 1.9% (2.3%) for the same period. Nevertheless, we expect NCR-rated savings banks will have increased gross lending organically by about 7% in 2024 and will increase by 6% in 2025. These banks have taken a share of the market from the large commercial banks, which have been less aggressive in the rural regions in particular, probably due to lower risk appetite in the current phase of the cycle. We believe that credit growth will increase in 2025 due to lower interest rates. We expect savings banks will increase lending by more than our original aggregated forecast due to improved capitalisation following the implementation of CRR3 (see below).

Most Norwegian banks are exposed to residential real estate, with retail mortgages accounting for 48% of total lending. They also have significant exposure to commercial real estate (23% of total lending). This leads to a material exposure to housing price and commercial real estate fluctuations even though price growth over the past decade has strengthened collateral across the wider banking sector.

Figure 4. Norwegian savings banks' asset quality metrics, 30 Sep. 2024

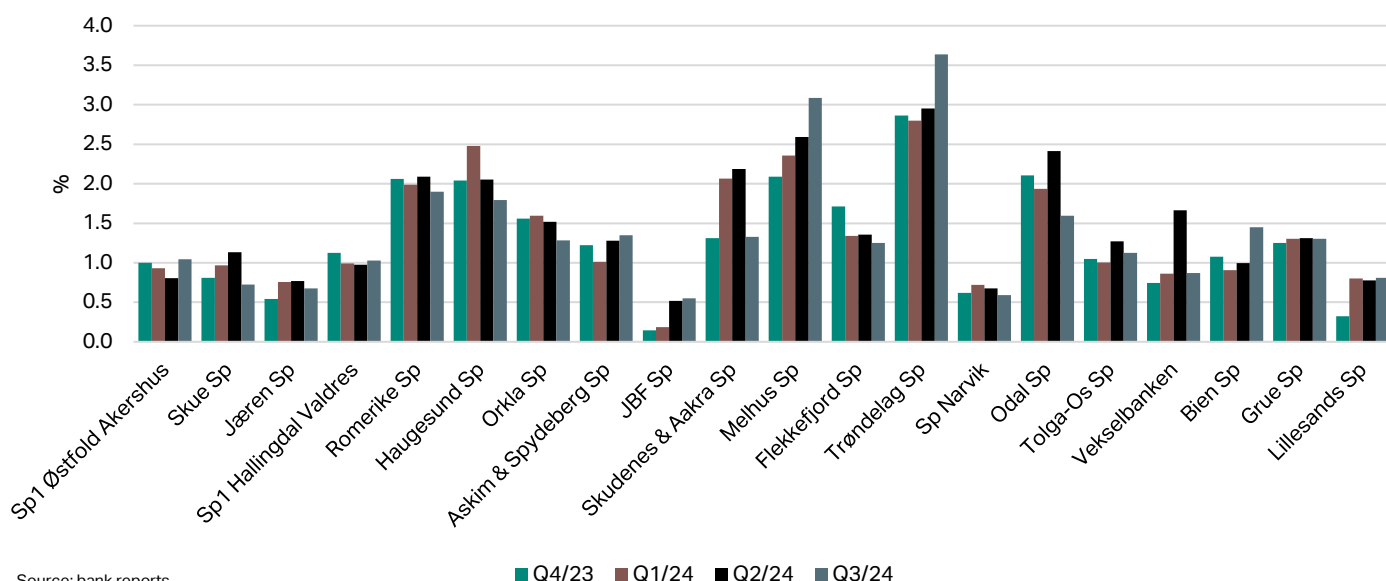


Source: bank reports. Bubble sizes reflect net loan volumes.

We are not overly concerned about a significant increase in mortgage loan losses due to low levels of unemployment and Norway's strong social security rights. Furthermore, we anticipate that property values will rise in 2025 due to lower interest rates and a limited number of new dwellings, which could increase the value of collateral held on savings banks' loan books.

Across the sample of 20 NCR-rated savings banks that we reviewed for the purposes of this report, we expect stage 3 loans will increase by 10bps to 140bps in 2024, but decline by 10bps in 2025 due to lower interest rates.

Figure 5. Norwegian savings banks' net Stage 3 loans to net loans, Q4 2023–Q3 2024



OUTLOOK FOR NCR-RATED SAVINGS BANKS

Among NCR-rated Norwegian savings banks, we expect loan growth will counteract pressure on margins. Savings banks generate commission income mostly from transfers of mortgage loans to partly owned covered-bond companies. We expect increasing transfers and lag effects in re-pricing of loans will lead to an increase in net commissions. Banks' other income, including contributions from alliance-owned product companies, where insurance has been particularly volatile in recent years, was positively impacted by non-recurring items in 2024. We expect this to normalise in 2025. Thus, we expect total operating income to only modestly increase by 5% in 2025 vs 8% growth in 2024. Savings banks are also exposed to cost inflation and higher wages, but tend to have a strong focus on costs. We believe the banks in the Eika Alliance, one of three savings bank groups that dominate the sector, will report lower IT costs from 2025. We expect aggregated cost/income ratio to fall to 44.6% in 2025 from 45.1% in 2024. Moreover, we expect loan losses to remain moderate with net loans falling by 2bps to 12bps in 2025, the same level as in 2023. Broadly, we expect 6% higher net profit across the sector in 2025.

Figure 6. Aggregate estimates for NCR-rated Norwegian savings banks, 2022–2026e

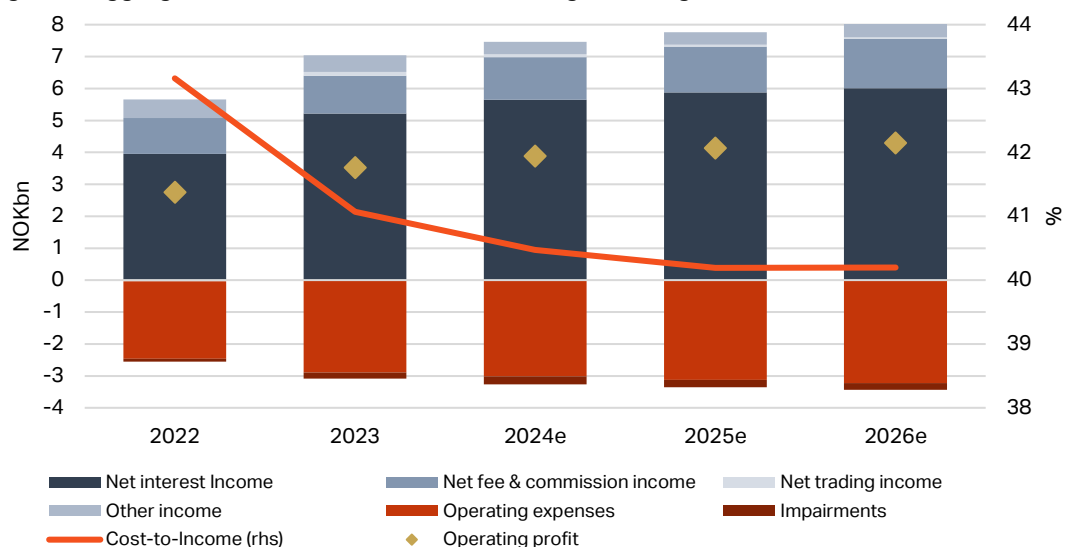
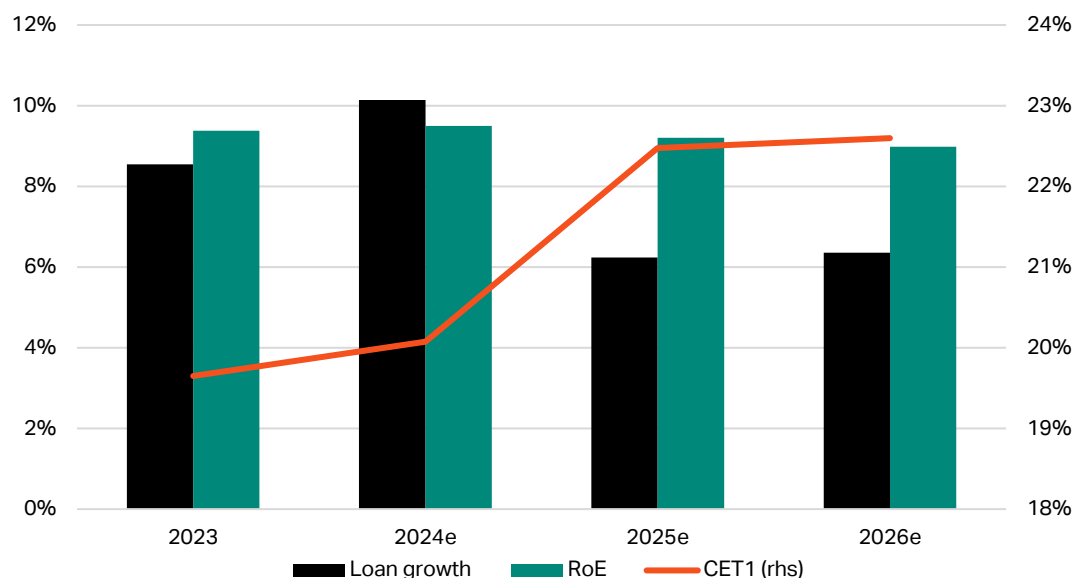


Figure 7. Average key ratios for NCR-rated Norwegian savings banks, 2022-2026e



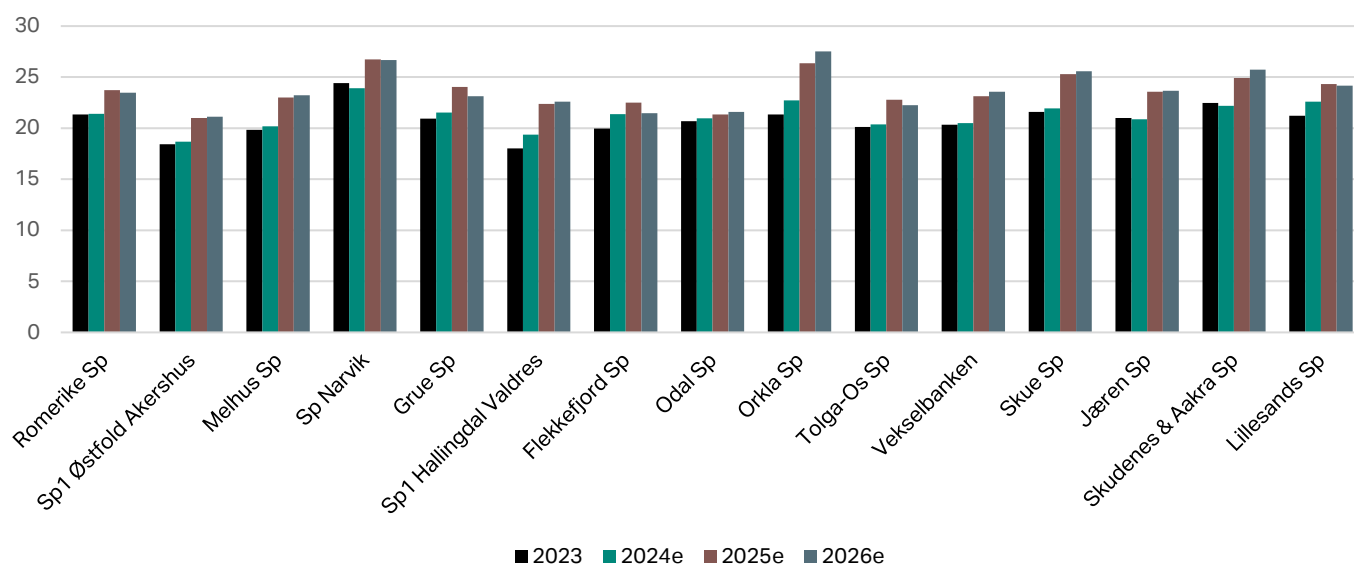
Based on NCR and company data. *Including CRR3 effect from 2025..

THE NEW STANDARDISED APPROACH WILL IMPROVE CAPITAL RATIOS

The new standardised approach will improve small and medium sized Norwegian banks' capital ratios. This approach entails regulatory amendments that, among other changes, will reduce regulatory requirements for the safest mortgage loans by lowering the required risk weight to 20% from 35%. These amendments are part of Norway's implementation of CRR3. Under CRR3, the new standardised approach also involves reduced risk weights for commercial real estate loans with low loan-to-value ratios.

We assume that most NCR-rated banks will increase their Common Equity Tier 1 (CET1) ratios by about 2.5pp. The main exception being members of the SpareBank 1 Alliance, who we believe will report a smaller increase since the jointly owned mortgage company uses the internal ratings-based approach.

Figure 8. Norwegian savings banks' Tier 1 capital ratios including CRR3 effect, Q4 2023–Q3 2024



Based on NCR and company data.

We take a forward-looking approach in our capital analysis. Where we expect banks to report growth or pay out extraordinary dividends, we view temporary improvements in capital ratios as having little impact on capital. However, if banks commit to maintaining higher capital buffers, we view improvements in capital ratios as positive, given improved capital flexibility and increased distance above strict regulatory minimums (see Relevant research).

CRR3 will be implemented under Norwegian law through an amendment to existing capital requirement regulations. The amendment cannot take effect until CRR3 is adopted by the entire European Economic Area (EEA), which includes Iceland and Liechtenstein. CRR3 will enter into force in the EEA after any constitutional reservations in Iceland and Liechtenstein have been lifted.

Figure 9. NCR ratings on Norwegian banks

Issuer	Long-term rating	Outlook	Short-term rating
Skudenes & Aakra Sparebank	A-	Stable	N2
Lillesands Sparebank	BBB+	Stable	N2
Flekkefjord Sparebank	BBB+	Stable	N3
Romerike Sparebank	A-	Stable	N2
Sparebanken Narvik	A-	Stable	N2
Grue Sparebank	BBB+	Stable	N2
Sparebank 1 Hallingdal Valdres	A-	Stable	N2
Melhus Sparebank	A-	Stable	N2
Tolga-Os Sparebank	BBB+	Stable	N2
Voss Veksel- og Landmandsbank ASA	BBB+	Stable	N2
Haugesund Sparebank	BBB+	Stable	N2
Odal Sparebank	BBB+	Stable	N2
Askim & Spydeberg Sparebank	A-	Stable	N2
Trøndelag Sparebank	BBB+	Stable	N2
JBF Sparebank	A-	Stable	N2
Bien Sparebank ASA	BBB+	Stable	N2
Skue Sparebank	A-	Stable	N2
Orkla Sparebank	A-	Stable	N2
Eiendomskreditt AS	BBB	Stable	N3
Jæren Sparebank	A-	Positive	N2
Kredittforeningen for Sparebanker	A-	Stable	N2
SpareBank 1 Østfold Akershus	A	Stable	N2

Source: NCR.

RELEVANT RESEARCH

- (i) [NCR Comments: Norway moves to adopt new standardised approach to capital requirements](#), 6 Dec. 2024.
- (ii) [Nordic consumer banks' earnings continue to offset elevated provisions](#), 10 Sep. 2024.
- (iii) [Norwegian savings banks' capitalization boosted by CRR3](#), 26 Jun. 2024.
- (iv) [Swedish savings banks face weaker earnings and low loan growth in 2024](#), 6 Feb. 2024.

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