Norwegian Savings Banks: strong profitability set to continue

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Norwegian savings banks have displayed strong profitability on the back of the supportive interest-rate environment. We expect this to continue even though the rate cycle may have peaked. The pace of credit expansion has abated but the banks have demonstrated an ability to continue growing their loan books. Costs have been elevated in the past year and this will continue into 2024, but we expect banks to be able to cope with the increased costs through their solid earnings capabilities.

Asset quality was resilient in 2023, helped by low unemployment rates on the retail side. There has been some softening in the corporate sector, but this comes from a strong starting point and we expect any potential weakening to remain manageable on the back of the banks' ability to generate earnings. We do expect to see more losses across the corporate sector in 2024; these will vary by industry. Commercial real estate and construction remain as well flagged points of risk in banks' portfolios.

Norwegian savings banks continue to chase deposits in a competitive market as wholesale funding continues to be more costly. Capital levels are expected to remain resilient in 2024, reinforced by organic capital generation. Requirements increased in 2023 in the form of a higher countercyclical capital buffer (to 2.5% effective 31 March) and a higher systemic risk buffer (to 4.5% from 31 December) for standardised model banks.

A multitude of bank's have benefited from capital relief from January 2024 as Pillar 2 requirements can be met with a mix of capital opposed to purely CET1 capital. Looking forward toward 2025, bank's using standardised models can expect to receive further capital relief in the form of regulatory updates that will increase their CET1 ratios.

The number of Norwegian banks has continued to decline; the consolidation trend is expected to continue into 2024.

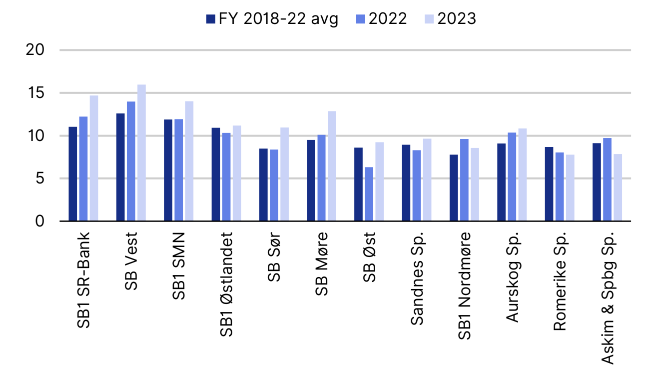
Trends for Norwegian savings banks in 2024		
Profitability	Continued solid profitability despite rate-hike cycle plateauing	↗
Asset quality	Some mild deterioration in corporate segments varying across industries, to remain manageable overall	↘
Funding & liquidity	Continued competition for deposits and elevated market funding costs	↘
Capital	Maintained at high levels due to requirements, capital levels expected to remain resilient	→

Profitability: strong performance amid high interest rates

Norwegian savings banks profitability remained sturdy throughout 2023. A strong net interest income performance was aided by the elevated interest-rate environment as banks were able to reprice loans. Norges Bank has signalled that the policy rate will remain at its current level of 4.5% for the foreseeable future, with market expectations that it will potentially begin to fall towards the end of 2024.

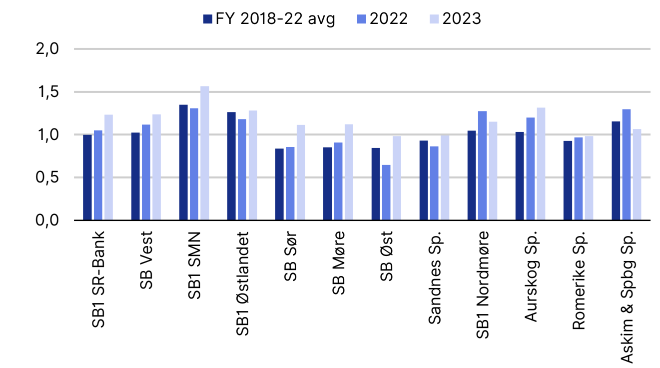
Our sample of 12 banks[1] reported solid results in 2023. The banks utilising the standardised approach (SB Sør, SB Øst, Sandnes, SB1 Nordmøre, Aurskog, Romerike and Askim & Spydeberg) achieved an average return on equity of 9.2% in 2023 up from 8.2% in 2022. Banks using the Internal Ratings based approach (SB1 SR-Bank, SB Vest, SB1 SMN, SB1 Østlandet and SB Møre) delivered an average RoE of 13.7% in 2023 up from 11.7% the year before.

Figure 1: RoAE (return on average equity, %)



Source: SNL, Scope Ratings.

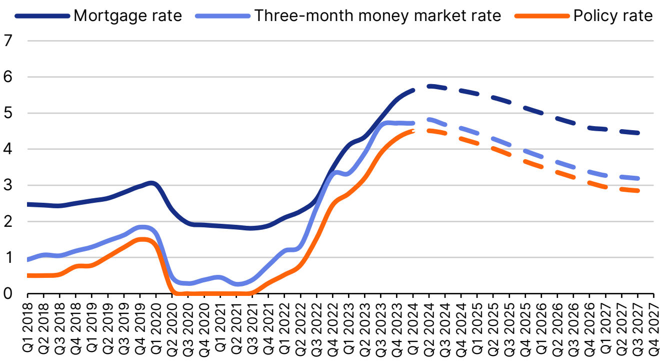
Figure 2: RoAA (return on average assets, %)



Source: SNL, Scope Ratings.

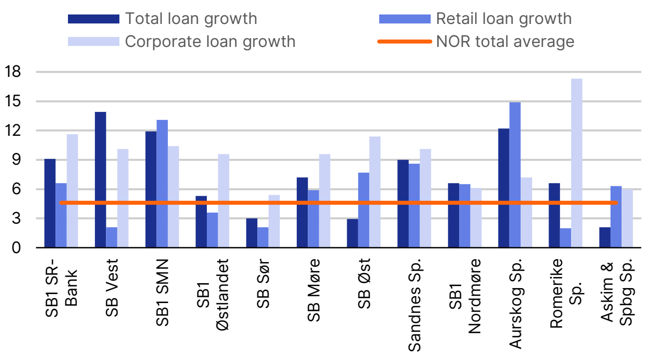
Credit growth continued to slow over the past year on the back of the higher interest-rate environment, although banks have continued to grow their loan books. At YE2023, the average reported 12 month loan growth for our sample was 7.2% (6.6% in retail lending and 9.6% in corporate lending). This exceeded the 4.6% growth for all Norwegian banks.

Figure 3: Interest rates (%)



Source: Norges Bank Monetary Policy Report March 2024, Scope Ratings.

Figure 4: Loan growth in 2023 (%)



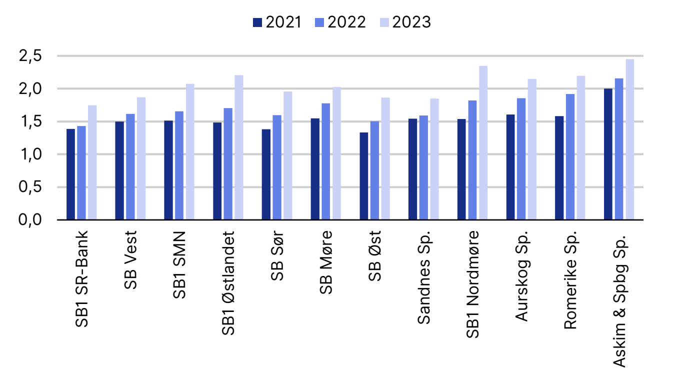
Source: Company data, Finanstilsynet, Scope Ratings.

[1] The sample of banks consist of some of the larger regional savings banks across Norway as well as a selection of smaller savings banks to provide a representative view of the performance of the Norwegian banking sector. Out of the sample, Scope has public ratings on Sandnes Sparebank (A-/Stable), Sparebank 1 Nordmøre (A-/Stable) and Aurskog Sparebank (A-/Stable).

The savings banks have managed their costs well despite high inflation in Norway. Wage growth this year is expected to be around 5%. The average cost-to-income ratio for the banks in our sample was 40% in 2023, down from 44% the year prior. The level of digitalisation in the Norwegian banking sector is high, which has helped drive efficiency over time. This also sets the Norwegian banks apart from their European counterparts.

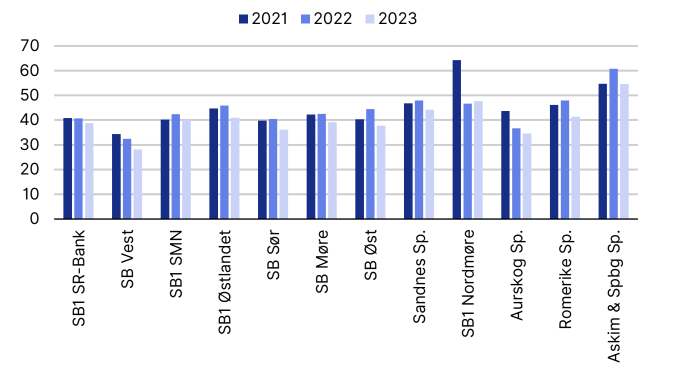
A lot of banks in Norway are members of alliances, which supports cost efficiency though shared IT systems and product companies. In addition to significant cost savings, this provides opportunities for future co-operation between banks as most banks in the country now use the same supplier (Tietoevry). We expect cost levels to generally remain elevated in the current environment but to be offset by the continued good profitability of banks.

Figure 5: Historical NIM (%)



Source: SNL, Scope Ratings.

Figure 6: Historical cost-to-income ratio (%)



Source: SNL, Scope Ratings.
Note: SB1 Nordmøre incurred one off costs in 2021 due to their merger with Surnadal Sparebank.

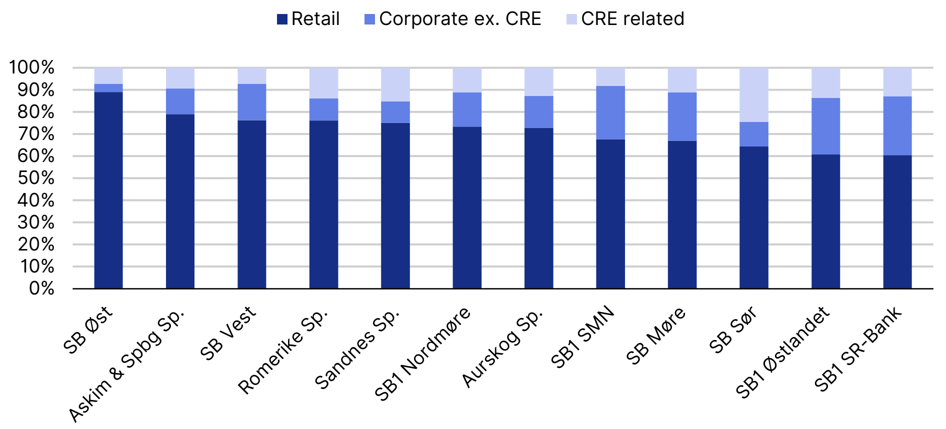
Asset quality: softening from a strong starting point

Norwegian savings banks' loan books are largely skewed towards the retail market. Corporate exposures vary depending on the structure of local markets. Commercial real estate (CRE) constitutes the largest corporate exposure for the majority of Norwegian savings banks and is a well flagged source of risk.

Commercial property prices decreased during 2023[2] and the construction industry has also seen a general slowdown over the past year as well as higher building costs. This could be a point of weakness for banks with more material exposures to the sector. Reassuringly, however, Norges Bank expects that CRE firms' rental income will rise, allowing them to withstand the high interest-rate environment.

[2] Norges Bank Financial Stability Report H2 2023

Figure 7: Sample banks loan book split (2023Y)

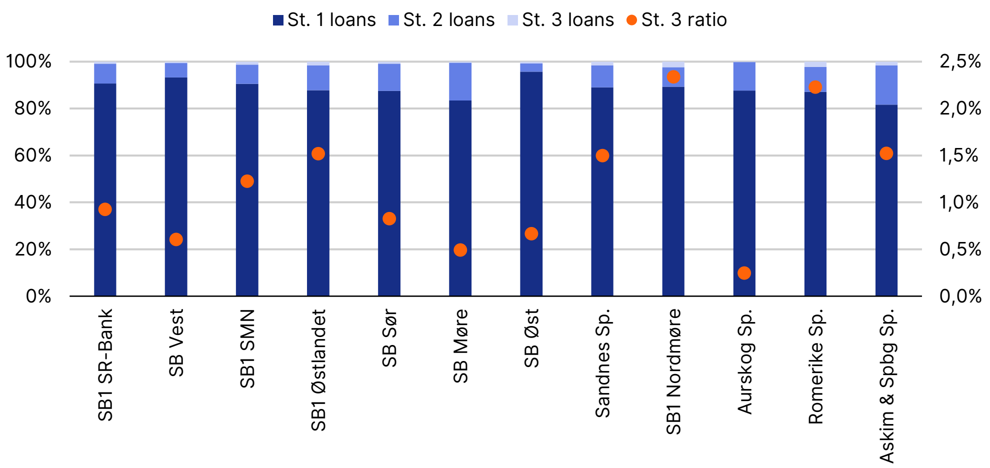


Source: Company data, Scope Ratings.
Note: Includes loans transferred to respective covered bond issuing entities.

Several savings banks (including Sandnes, SB1 SR-Bank and SB Vest) operating in the oil and gas region of Norway benefit from increased investment and activity levels in the petroleum industry which are expected to continue to 2027 (Figure 9). The country's oil and gas region suffered during the oil price downturn between 2014 and 2016 so new construction and property prices have developed differently to other parts of the country.

Asset quality remained sound as a whole over the past year. Low loan losses in retail lending continue to be supported by low unemployment. However, there have been some signs of weakening, albeit from a strong starting point: the average stage 2 loan ratio in 2023 for the banks in our sample rose from 9.1% in 2022 to 10.2% last year. The average stage 3 ratio rose to 1.2%, from 1%. NPLs in CRE and construction increased in 2023 but remain at relatively low levels (Figure 10).

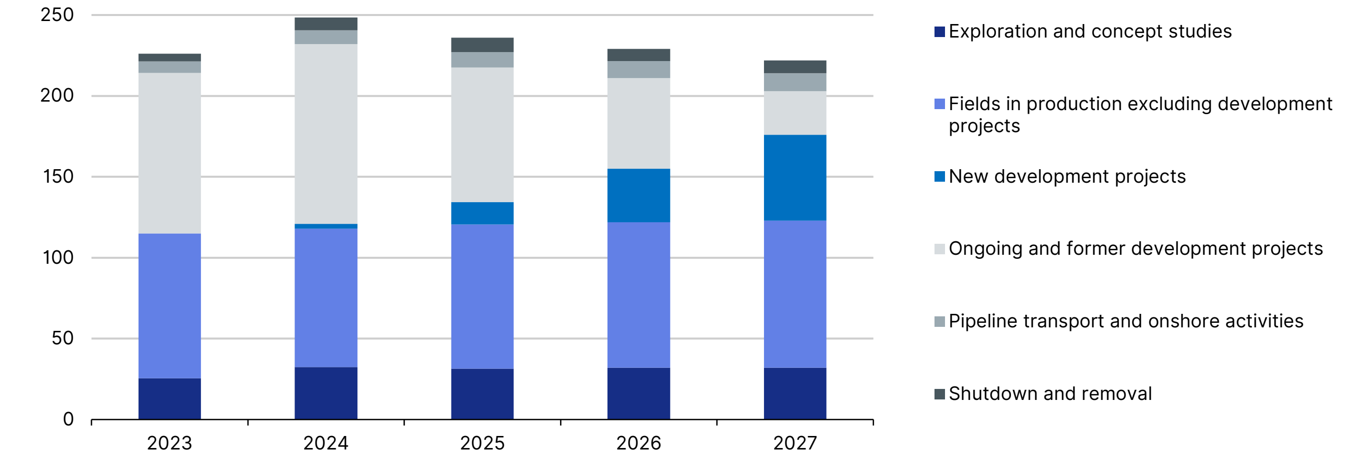
Figure 8: Loan staging 2023YE



Source: SNL, Scope Ratings.

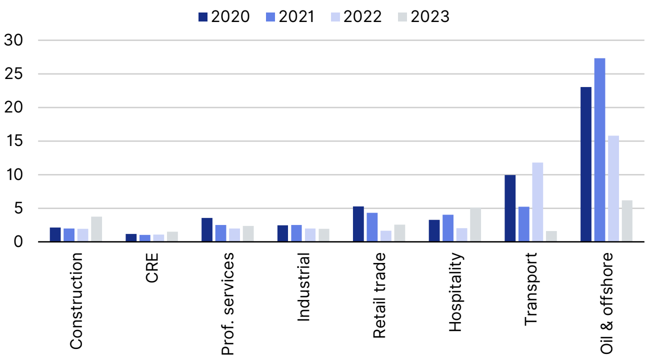
We expect corporate loan losses to increase in 2024, with varied performance across different sectors, but to remain at manageable levels as a whole. On the retail lending side, we expect developments to continue to be sturdy. Banks have yet to see significant increases in requests for payment deferrals: the number of requests remained somewhat limited at 1.2% for all Norwegian banks at year-end 2023. The strong profitability enjoyed by Norwegian banks continues to provide a first line of defence against any softening in asset quality.

Figure 9: Petroleum investment (NOK bn)



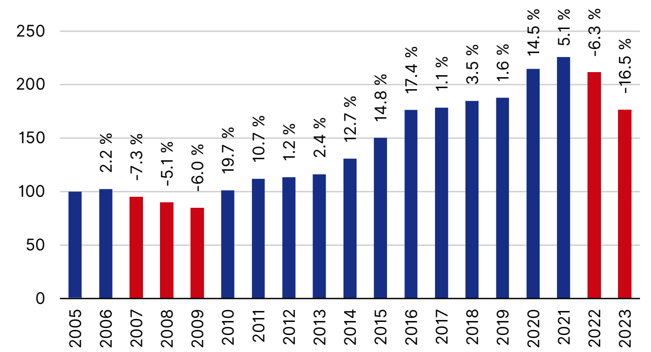
Source: Statistics Norway, Norges Bank.

Figure 10: NPLs as a % of gross loans by sector



Source: Finanstilsynet.

Figure 11: Indexed price indicator for CRE, adjusted for annual inflation of rental income – Oslo prime office



Source: Finanstilsynet, Akershus Eiendom.
Note: 2023 data as of 1st December.

Funding and liquidity: a competitive deposit market

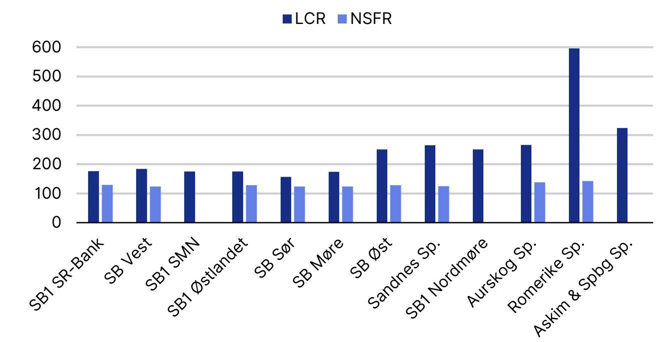
Deposits continue to be the main source of funding for Norwegian savings banks. However, they also have a material reliance on wholesale funding. Competition for deposits in the Norwegian market has been fierce as wholesale funding has remained more costly. The average growth in deposits in our sample amounted to 5.8% in 2023, compared to an average of 3.8% for all Norwegian banks[3]. Customers actively use deposit platforms, giving them an overview of the most competitive deposit rates available and providing banks with a platform to advertise and acquire more customers.

Banks have also continued to issue in capital markets and still enjoy good access to wholesale funding. Outstanding debt issued by all Norwegian banks increased to NOK 1.784trn in 2023 (NOK 1.631trn in 2022). AT1 and T2 issuance has also increased as Pillar 2 requirements no longer need to be met meet purely with CET1 capital. Covered bonds represent around a third of the Norwegian bond market.

Liquidity remains stable. Liquidity Coverage Ratios and Net Stable Funding Ratios across our sample of banks remained comfortably above requirements at the end of 2023.

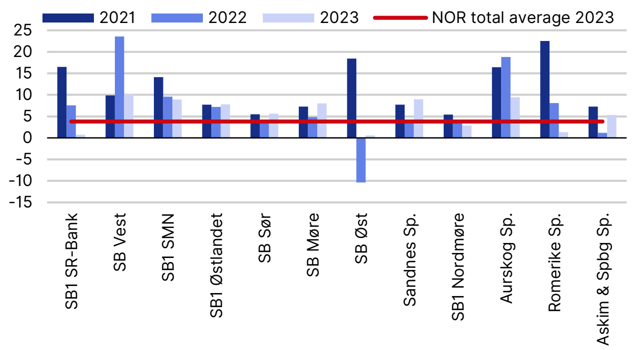
[3] Resultatrapport for finansforetak 2023

Figure 12: LCR & NSFR (%), 2023YE



Source: SNL, Company data, Scope Ratings.
Note: LCR for Askim & Spbg is as of Q3 2023, NSFR data NA for SB1 SMN, SB1 Nordmøre, Askim & Spbg.

Figure 13: Deposit growth (%)



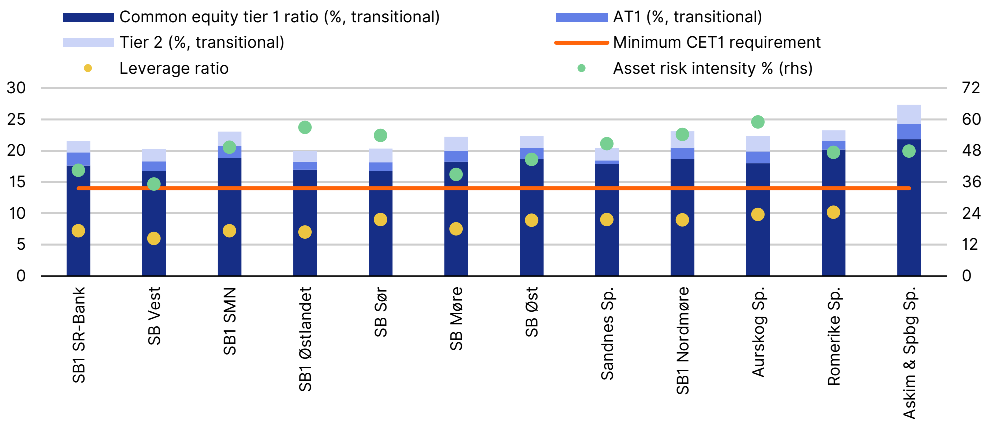
Source: Company Data, Finanstilsynet, Scope Ratings.

Capital: banks remain well capitalised

We expect capital levels to remain resilient through 2024 underpinned by the ability of banks to generate capital organically. Banks in Norway continue to be well capitalised, driven by stringent requirements. Capital requirements increased in 2023, with the countercyclical capital buffer increasing to 2.5% from March 2023 and the systemic risk buffer increasing to 4.5% from December 2023 for banks using standardised models. The systemic risk buffer had already increased to 4.5% in 2020 for banks using IRB models.

The minimum CET1 requirement for domestically focused banks stands at 14%, among the highest for European banks. The Norwegian FSA has become more explicit in assigning Pillar 2 Guidance for banks, with requirements generally ranging from 1%-1.5%. From January 2024, many banks benefited from some capital relief as they are now able to meet Pillar 2 requirements with a mix of CET1, AT1s and T2 capital, in line with CRD 5.

Figure 14: Capital ratios and asset risk intensity (2023YE)



Source: Source: SNL, Scope Ratings.
Note: Leverage ratio data for Askim & Spydeberg not available

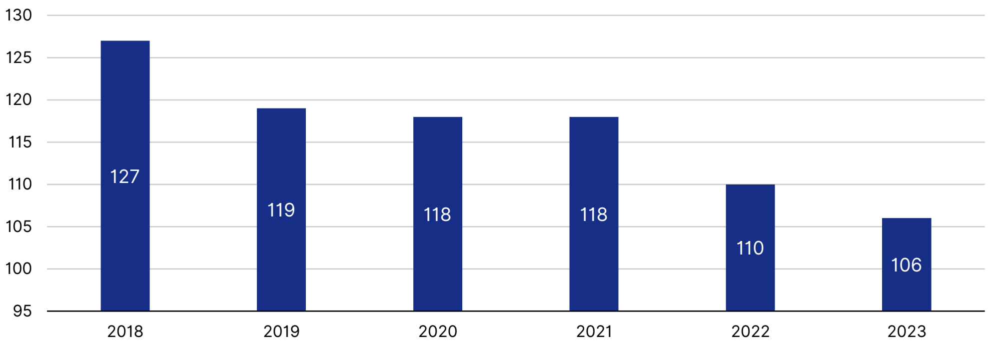
Smaller banks with a high proportion of low-LTV mortgage lending using standardised models will likely receive more capital relief when the updated simplified standardised method under CRR3 is implemented in Norway. Norges Bank estimates that the CET1 ratio of standardised model banks could increase by 3.6%[4]. Regulatory authorities are targeting implementation from January 2025, in line with the EU. Other changes include adjustments to the eligibility of exposures under the IRB approach and the introduction of input floors for banks' own estimates, which is expected to further level the playing field between smaller and larger banks.

Mergers expected to continue

Consolidation in the Norwegian banking sector is commonplace as smaller banks face increased competition, higher capital requirements, and more demanding supervisory expectations (including appropriate AML and ESG capabilities). At the end of 2023 there were 106 Norwegian banks following a number of mergers during the year (Figure 15).

Mergers that were announced in 2023 included: Sandnes Sparebank (NOK 34.4bn total assets) and Hjelmeland Sparebank (NOK 4.2bn), and Tysnes Sparebank (NOK 4.5bn) with Haugesund Sparebank (NOK 17.5bn). Announcements have continued in 2024 with SB1 Østlandet (NOK 176.3bn) and Totens Sparebank (NOK 26.5bn) announcing their merger. We expect to see the trend of mergers between banks to continue into 2024.

Figure 15: Total number of Norwegian banks



Source: Finanstilsynet, Scope Ratings.

Figure 16: Sample banks overview

Bank	Total assets (excl. assets transferred to CB entities) (NOK bn)	Assets transferred to covered bond entites (NOK bn)	Total assets (NOK bn)
SpareBank 1 SR-Bank	262.2	100.0	362.2
Sparebanken Vest	165.0	141.5	306.5
SpareBank 1 SMN	166.2	66.5	232.7
SpareBank 1 Østlandet	111.3	65.0	176.3
Sparebanken Sør	101.6	55.8	157.4
Sparebanken Møre	64.3	32.4	96.7
SpareBanken Øst	26.0	18.1	44.1
Sandnes Sparebank	20.4	14.0	34.4
SpareBank 1 Nordmøre	18.1	9.5	27.6
Aurskog Sparebank	14.8	2.6	17.4
Romerike Sparebank	12.7	4.0	16.7
Askim og Spydeberg Sparebank	9.2	3.4	12.6

Source: Company data, Scope Ratings.

[4] https://www.norges-bank.no/en/news-events/news-publications/Papers/Staff-Memo/2023/sm-8-2023-irb/

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