An overview of Q4 2019 of the Banking sector

From the fourth quarter the banking sector statistics no longer include data on Danske Bank and Scania Finans, and in consequence the yearly growth in loans was 7.3% in the fourth quarter. Loan growth continues to be led more by households, and demand from them for consumption loans has increased in recent quarters. The growth in housing loans has remained stable at the same time though. The loan stock of non-financial companies, including state-owned companies, grew by 6.2% over the year, while the yearly loan growth of private sector companies was 2.7%. The stock of deposits was up 12% over the year in the fourth quarter and was 1.2% more than in the previous quarter. The faster growth in deposits than in loans brought the loan-to-deposit ratio down to 101%, leaving it almost exactly in balance.

The Banking sector	Q3 2019	Change	Q4 2019
Annual growth in the loan stock	7,1%	?	7,3%
Yearly growth in the stock of deposits	12%	?	12%
Loan-to-deposit ratio	103%	?	101%
Share of long-term overdue loans in the portfolio	0,84%	?	0,75%
Liquidity coverage ratio	150%	?	146%
Profit	78 mln €	?	75 mln €
Ratio of expenses to income	50%	?	54%
Return on equity	9,8%	?	9,0%
Return on assets	1,18%	?	0,97%
Core Equity Tier 1 ratio	25,4%	?	25,8%

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The quality of the loan portfolio continued to strengthen and improve in the fourth quarter, and at the end of the quarter the aggregate share of non-performing loans was 1.6%, which was 0.2 percentage point lower than in the previous quarter. This improvement in the quality of loans may be partly linked to the strong economic environment, while the faster growth in the loan portfolio of the sector may also have had a positive statistical effect. This means the fall in the share of non-performing loans came mainly from the decline in non-performing loans, but also came from the growth in the loan portfolio of the sector. The share of loans overdue more than 90 days also showed an improvement in the quality of the loan portfolio, as such loans made up 0.75% of the total volume of loans of the sector at the end of the fourth quarter, having been 0.84% at the end of the third quarter. Leaving aside the branches of Luminor, the share of long-term overdue loans was the same as in the previous quarter at 0.43%. The banks have again written down more of their long-term overdue loans than the average.

The liquidity of the banks remained good in the fourth quarter and all the banks met the Liquidity Coverage Ratio (LCR) with sufficient margin. The sector held on average 1.5 times the minimum LCR. Alongside the funds dedicated for meeting the Liquidity Coverage Ratio, the banks also have other liquid assets, notably deposits in credit institutions, and including these, liquid assets were more than a fifth of assets at the end of the year. The share of non-resident deposits fell from 10.5% in the previous quarter to 10.0%.

The banking sector earned net profit of 75 million euros on an individual basis in the fourth quarter, which was 3 million euros less than in the third quarter. Removing the figures for Danske and Scania from the comparison means the profit in the fourth quarter was 11 million euros less than in the previous quarter though. The lower net profit in the sector brought the return on equity of the banks down to 9.0% in 2019, which was 0.8 percentage point less than the figure for the current year in the previous quarter. The comparative return on equity in the banking sector of the European Union was 6.6% in the third quarter. Higher costs in the fourth quarter raised the current income-to-expenses ratio of the banking sector for the year to 53.7% from 50.4% in the third quarter.

The aggregate indicator for capitalisation stopped falling in the fourth quarter and the CET1 ratio climbed by 0.4 percentage point from the previous quarter to 25.8% as CET1 assets increased and risk assets decreased.

The banks have to hold sufficient capital buffers to cover their risks

Finantsinspektsioon assessed the quality of corporate governance, risk management and internal control systems at all the banks operating in Estonia and the sustainability of their business models. It also carried out in-depth analysis of the main risk categories of the banks and ran stress tests.

Finantsinspektsioon found that the generally applicable Pillar 1 capital requirements in the European Union legislation were not sufficient to cover the risks of any of the banks in Estonia. It calculated additional capital requirements for each bank so that the risks of the bank would be covered in full. Additional capital requirements for small banks were of 56 million euros, which was 37% higher for them than the Pillar 1 capital requirements. The additional capital requirements rose mainly because of credit risk and concentration in the loan portfolio and from strategic and reputational risk. On the advice of Finantsinspektsioon, the additional capital requirements were set for the larger banks at 471 million euros, which exceeded the Pillar 1 requirements by 38%. The largest part of the capital requirements for the large banks related to concentration in the loan portfolio and interest risk.

Main development trends and risks

- Loan growth in the sector is accelerating, and this is especially noticeable in consumption loans aimed at households. Consumption loans make up 5-6% of the loan portfolio of the whole sector, and so the direct risks from consumption loans are small. Rapid growth in loans affects the smaller banks most of all. The risks for all loan types come primarily from the economic environment.
- The credit quality of the banks remains good as the share of bank loans overdue more than 90 days declined to 0.75% by the end of the fourth quarter. Loan quality was brought down by the addition of the Luminor branches at the start of the year, but in the fourth quarter they started to have a positive effect on the indicator for the whole banking sector. Long-term overdue loans are covered by write-downs.
- The banks have liquidity. The average Liquidity Coverage Ratio (LCR) of the banking sector was 1.5 times the requirement at the end of the fourth quarter. As well as meeting the requirement, the banks held additional liquidity in non-LCR instruments.
- The profitability of the banks remains good and the return on equity in the fourth quarter was 9.0%, which was 0.8 percentage point lower than a quarter earlier but remains well above the European Union average of 6.6%.
- Real estate prices in Sweden rose a little in the fourth quarter. The risks related to the Swedish real estate sector remain high and any realisation of these risks could impact the Estonian banking market. This makes it important that the banks hold sufficient capital buffers to cover the realisation of any risks, as such buffers will reduce the cross-border transfer of these risks.

Quarterly reviews of the banking sector