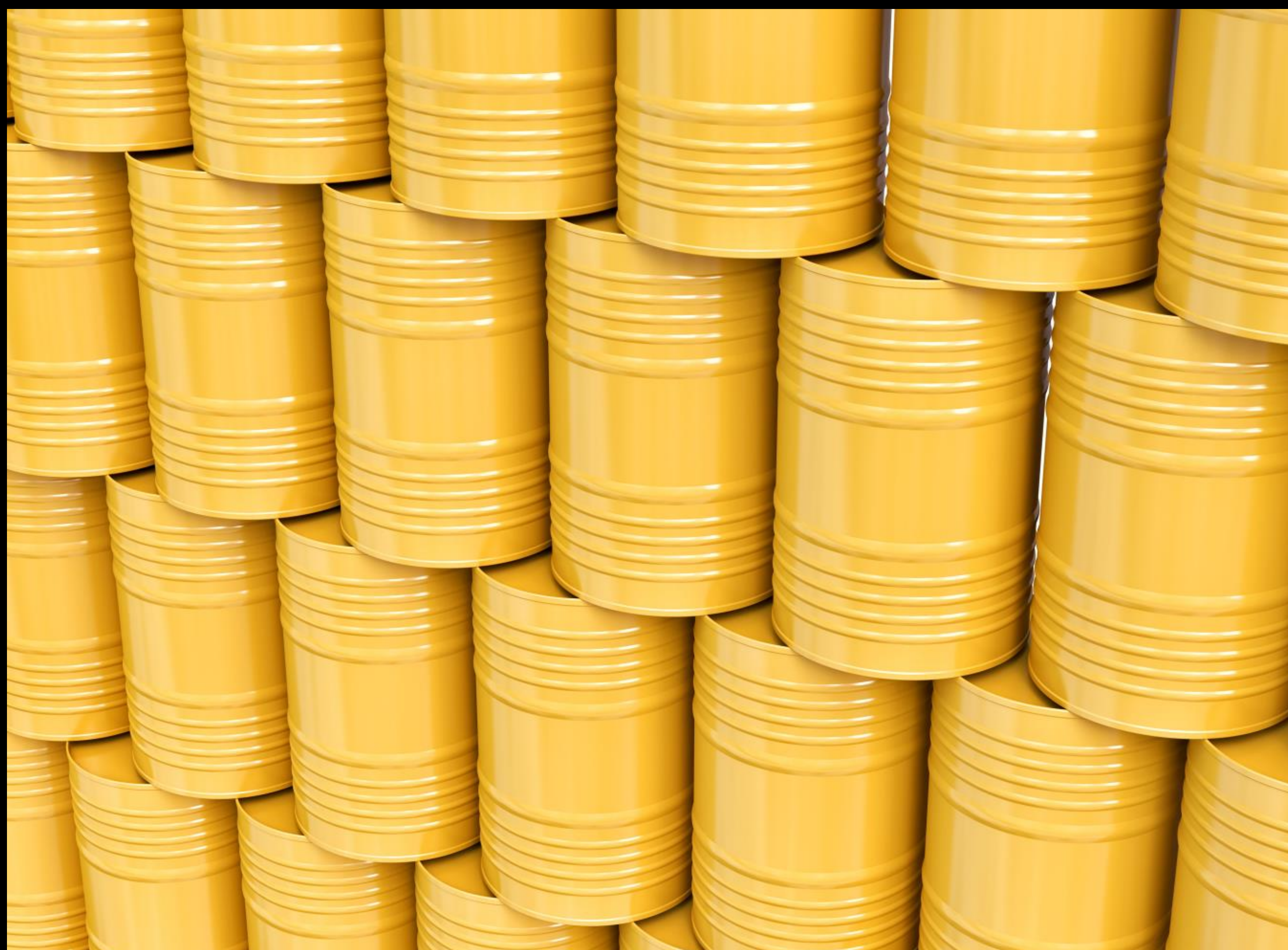
Nordic Borrowing Trends

June, 2016

Rebounding



S&P Global
Ratings

NORDIC BORROWING TRENDS

SUMMARY

- Borrowings by non-financial corporates in the Nordic region have declined over the past year as the slowdown in economic growth has caused companies to scale back capex investment.
- The loan market remains the dominant source of funding for businesses in the region and we expect that overall financing conditions will remain borrower-friendly, as the prevailing low-interest-rate regime is likely to increase competition in the loan market leading to a further easing in terms and conditions.
- The bond market has seen muted activity, especially with Norwegian firms becoming less active. But with oil prices recovering from record lows and with spreads of a few Norwegian oil companies tightening, these issuers could soon recover access to the markets.

CAPEX INVESTMENT SLIDES

With Nordic economies having faced economic headwinds in the recent past, the region's non-financial corporate firms have seen a considerable drop in their borrowing activity flow. Capital investment activity has slowed in commodity-related sectors and remains somewhat lackluster in most other sectors owing to the relatively weak recovery in Europe and the severe dislocation being experienced in the commodity sectors with associated deflationary pressures. This has particularly hurt the primary bond and loan markets in the region.

However, these trends seem to be bottoming out. Table 1 highlights that the fall in capital expenditure in the Nordic region has been particularly steep, owing to weaker oil prices. Companies' capex during the last two years has been affected more than the rest of Western Europe, largely due to oil firms in Norway and oil-related industries in Denmark scaling down their capex plans. Consensus forecasts indicate that capital investment activity is poised to stabilize in 2016.

Coupled with this, the increasing need to refinance in the coming years could drive Scandinavian corporates in the region to tap the bond and loan markets with greater frequency in the coming years, albeit the recovery could be gradual and near-term improvement may be likely but not imminent as a few headwinds still persist. In this report we discuss the trends that we are likely to witness in the loan and bond markets in the Nordic region over the next few months.

Investment-grade corporate funding costs in Europe declined sharply in early 2016 in anticipation of the ECB widening its asset-purchase program. The trend gained further momentum after the ECB finally unveiled its corporate-bond buying program in early March. Corporate borrowing costs for non-euroarea firms based in Scandinavia too appear to have benefitted from this trend. Borrowing costs for firms in the region have seen a marked drop during the last two years, for investment-grade firms in particular. The average yield on investment-grade bonds issued by non-financial corporates in the Nordic countries has shrunk since 2013, while spreads on investment-grade loans have tightened modestly during the last two years. This trend is likely to continue as central banks in the region and the ECB are likely to maintain an accommodative stance for the foreseeable future.

The loan market accounted for about 70% of total non-financial corporate borrowing in the Nordic region during 2015, compared with about 67% in 2011, highlighting that it still is the most preferred channel for borrowing for non-financial firms in the region.

TABLE 1 | CAPEX GROWTH IN SCANDINAVIA

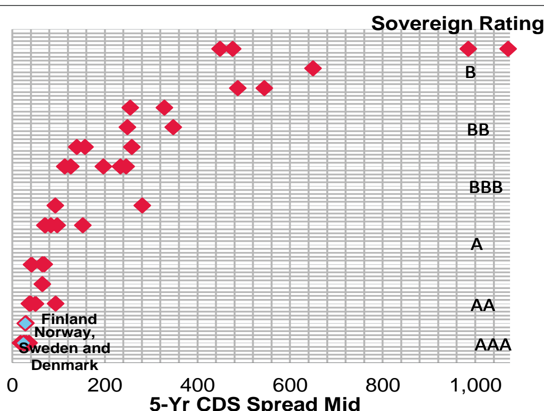
		Capex Growth (Real, YoY %)						
	2015 Capex ($bn)	2010	2011	2012	2013	2014	2015	2016f
Norway	23	0.8	7.1	30.6	-6.1	-7.8	-16.5	3.3
Sweden	15	-3.3	8.1	5.2	-6.8	-9.8	-1.8	7.0
Denmark	13	-19.4	14.3	5.5	0.9	2.9	-11.2	-2.5
Scandinavia	55	-4.9	7.6	15.3	-5.1	-6.3	-10.9	2.1
W. Europe	530	-7.0	5.0	8.1	3.6	-7.1	-8.7	-0.9

Source: S&P Global Ratings Capex 2000; S&P Global Market Intelligence Global

OVERALL CREDIT CONDITIONS REMAIN SANGUINE

Despite the recent slowdown in economic growth, the Nordic region continues to have an edge over other major global economies in terms of credit conditions as the region has relatively low sovereign risk (see chart 1). Central banks there have recently set stricter capital buffers in order to mitigate economic threats, while rising profits of banks in the region has aided them to meet central banks' relatively conservative norms.

CHART 1 | MARKETS AND SOVEREIGN RATINGS IN NORDIC COUNTRIES COMPARED TO OTHER SOVEREIGNS IN EMEA



Source:S &P Global Ratings, S&P Global Market Intelligence, S&P Global calculations. Data as of 30 Apr 2016

Investment-grade corporates in these economies account for a sizeable 70% of S&P's rated universe. However, in line with the trend seen globally, the share of high-grade credits in Scandinavia and Finland combined has fallen over the last ten years. This has been entirely an outcome of new ratings on speculative-grade credits, as there has been an equal number of fallen angels and rising stars since 2006 in Scandinavia and Finland combined.

IT HAS NOT BEEN A SMOOTH RIDE ENTIRELY

Mentioned below are a few developments from the credit markets that are particularly noteworthy.

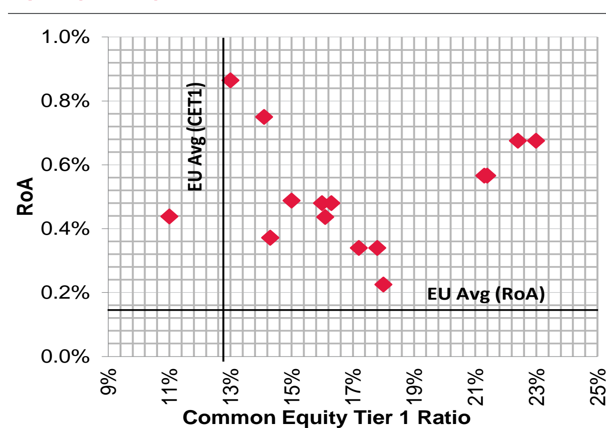
- Issuance volumes in the primary-bond market have not replicated the trend seen in Europe. Bond issuance by Nordic corporates declined in 2015 and the annual corporate-bond issuance volume in 2015 by firms in the region was the lowest since 2011. The fall in issuance has been particularly steep in the case of Norwegian firms — corporate-bond issuance declined by about 38% year-on-year (YoY) in 2015 due to stress from commodity prices.
- Slowing economic conditions weighed on the loan market too. Like the bond market, the Scandinavian loan market too failed to match the trend seen in Europe. The overall lending to Nordic corporates declined in 2015 from the record levels seen during the preceding year. Again, Norway was the laggard — investment-grade and leveraged loans combined slipped around 31% YoY in 2015.
- Norwegian oil firms have witnessed a widening in spreads. In 2013, when oil prices were higher, they managed to finance their deals with attractive terms, compared with firms from a similar credit spectrum in the EU. However, this trend has completely reversed as the fall in oil prices has pushed oil-related firms in Norway to restructure their debt.
- The Norwegian high-yield market remains shut for rig and oil service firms, as lenders weigh options to address overleveraged capital structures given the new lower oil price environment.
- Sweden's refiner Corral Petroleum (B+) recently refinanced a PIK toggle at a yield of 12.125%. Though the company's fundamentals appear fairly sound, the weak security package and the volatile nature of its earnings pushed the firm to pay a high rate. This deal indicated that European markets are less inclined to take risky bets on high-yield Nordic names.

Larger investment-grade players in Europe's energy sector such as Shell and Total have managed to tap the bond markets with relative ease during recent weeks. Norwegian oil names too could follow suit, with spreads of larger oil firms beginning to tighten following the recovery in oil prices. Moreover, companies from sectors exposed to the oil market have managed to source their funding from the loan market, albeit, they had to pay up owing to the transition in their sector. As per a report recently published by Norges Bank, slightly below NOK25 bn of bonds issued by the oil service industry is due to mature in 2016 and 2017.

For oil-related firms in the speculative-grade segment, the bond market remains shut. Upcoming bond maturities coupled with bank debt maturing in the coming years would mean that the energy sector is set to hit a maturity wall.

Against this backdrop, we believe that the Norwegian banks will begin to face a pick-up in loan losses in the oil-related sector. However, the situation is not alarming and we do not envisage any severe threat to Norway's overall financial stability. Banks in Norway have managed to amass substantial capital buffers over the years. The Norwegian central bank in a recent report indicated that if Norway's SR-Bank and DNB Bank were to absorb loan loss of 25% of total loans to the oil-related sector, it would amount to an average of 124% of profit before tax. This would lead to only a marginal fall in both the bank's capital ratios, which are at comfortable levels. Overall banks' exposure is not high and as highlighted in chart 2, banks in Norway and other economies in the Nordic region remain well capitalized to absorb these losses.

CHART 2 | HEALTHY CAPITAL ADEQUACY RATIO AMONG NORDIC BANKS



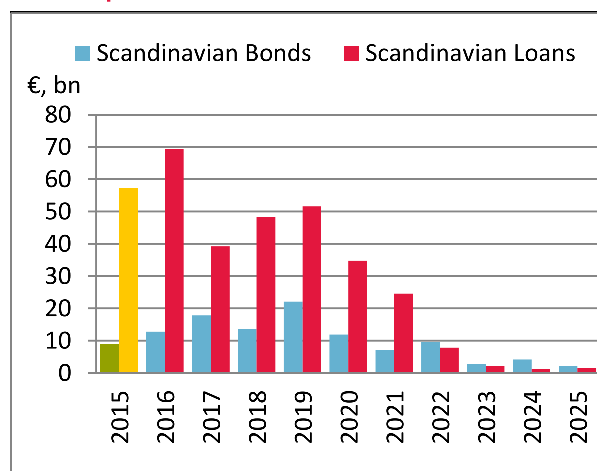
Source: Norges Bank, Danmarks Nationalbank, The Riksbank, European Central Bank, S&P Global Market Intelligence. Data based on the latest financial stability reports published by the respective central banks. Data includes all the major banks from Norway, Denmark and Sweden. Common Equity Tier1 Ratio is a measurement of a bank's core equity capital compared with its total risk-weighted assets. RoA–return on assets.

REFINANCING ACTIVITY POISED TO GARNER MOMENTUM

As highlighted earlier, the volatility in oil prices during the recent years has had a disproportionate impact on Norwegian firms' funding environment. With overseas investors being apprehensive to buy into bond issued by less-renowned players from the Nordic countries in the primary bond markets, skepticism will prevail until a few firms from the lower-end of the credit spectrum test the waters in order to regain investor confidence.

But in the next few months, borrowers' fund-raising activities are likely to increase because of their refinancing needs. A substantial portion of the outstanding loans which are due for refinancing could be completed during the next few years, as firms in the region look to capitalize on the drop in borrowing costs. As of the beginning of 2016, about €80bn of corporate loans and bonds were due to mature this year, compared to about €65bn loan and bond borrowing in 2015 (see chart 3).

CHART 3 | REFINANCING TO GATHER MOMENTUM*



Source: Dealogic; S&P Global Ratings' calculations. *Data includes non-financial corporates from Finland

Unlike the high-yield market, borrowing costs in the leveraged loan market declined YoY in 2015, so although there should be some rebound in bond issuance, we believe the continued borrower-friendly nature of the loan market—as well as the amount of debt to be refinanced – will mean that it will remain the most preferred channel for fundraising in the near term.

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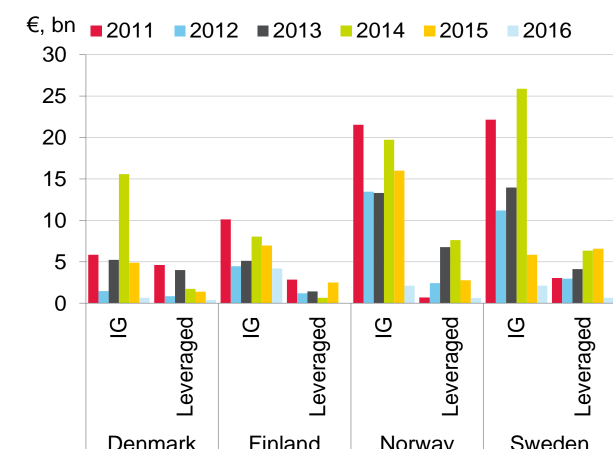
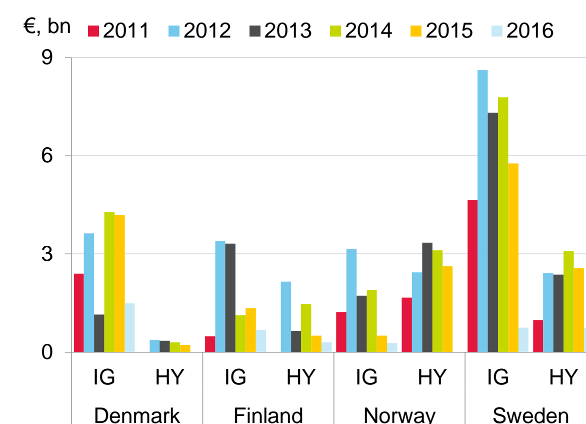
CHART 4 | NORDIC LOAN VOLUMES



Source: Dealogic, S&P Global Ratings Calculations, 2016 data as of 30th April

CHART 5 | NORDIC BOND ISSUANCE



Source: Dealogic, S&P Global Ratings Calculations, 2016 data as of 30th April

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