

Baltic loan losses to accelerate

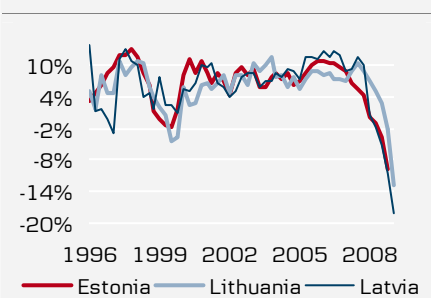
Economic situation in the Baltics is worse than feared

New GDP numbers from Latvia showed that the actual situation is worse than the already gloomy expectations. The flash estimate on GDP growth in Q1 09 showed a decline in GDP by 18% y/y compared with a decline of 10% y/y in Q4 08. Thereby the “worst case” scenario for the medium term outlook with regard to Latvia has become a reality. Taking into account further tightening on the fiscal front, which should be implemented as soon as possible – otherwise Latvia will not qualify for the international aid package – the downturn could become even more pronounced in the coming quarters. Estonia and Lithuania are currently experiencing severe difficulties as well with Lithuanian GDP falling 12.6% in Q1 (y/y), see below.

Key points

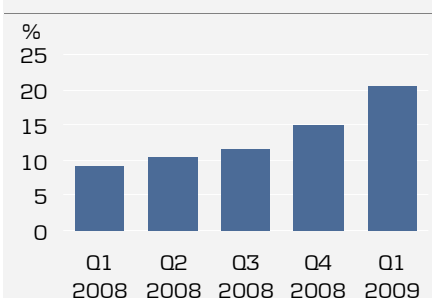
- Development of growth rates in the Baltics worse than feared
- The Latvian FSA has revealed that 20.5% of all loans are currently in arrears
- Some Nordic banks have large Baltic operations

Baltic GDP growth (y/y)



Source: Ecowin

Ratio of Latvian loans that are overdue



Source: Latvian FSA & Danske Markets

Loan arrears are exploding

On the same day that the Latvian GDP numbers were announced, the Latvian Financial and Capital Markets Commission released numbers on domestic loans currently in arrears.

By the end of Q1 2009, loans in arrears in Latvia amounted to 20.5% of the aggregate loan portfolio of Latvian banks (up 5.5 percentage points from the end of 2008). The aggregate loan portfolio of the Latvian banks was worth LVL 16.4bn (approx. EUR 23bn) at the end of March 2009. Of the bank loans issued to households in Latvia, 22.1% were in arrears at the end of March 2009. Furthermore no less than 21% of mortgage loans were in arrears by March. If history and other markets are of any guidance, there is a considerable risk that commercial loans may bring even greater losses than the household sector.

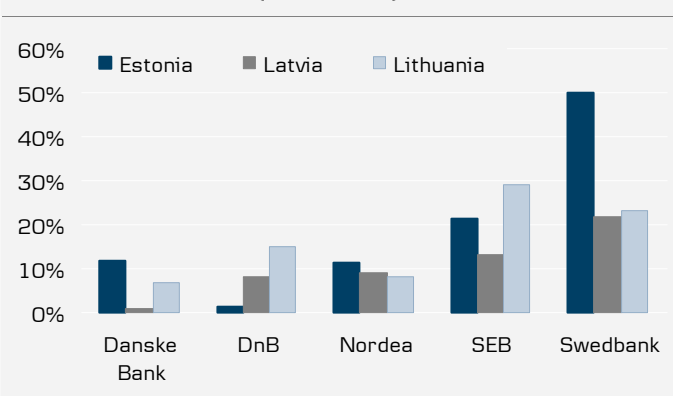
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We are quite concerned about the speed at which the non-performing loans are rising. Considering the gloomy outlook for the rest of 2009 NPLs are probably set to increase even more. We highlight that there is not a 1:1 relationship between NPLs and loan losses, but nevertheless these data cause us to believe that bank loan losses will go much higher than current levels – particularly in Latvia but also in the other countries.

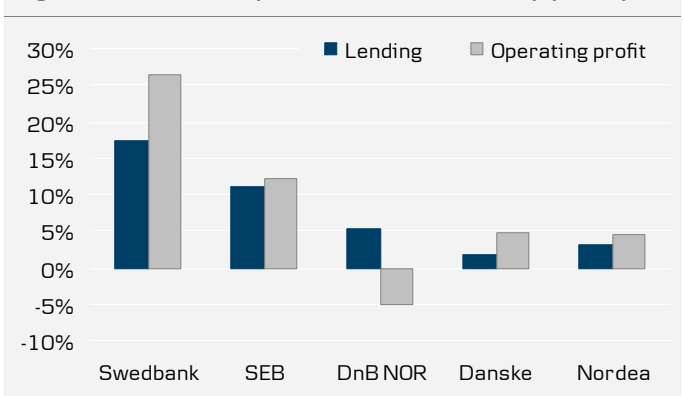
The Nordic banks are the largest in the Baltic countries and will be hit by this adverse development. Swedbank is the most exposed to the Baltic downturn both in an absolute and a relative context while SEB is also quite exposed. The other banks are not as exposed to the Baltic countries and for those banks we do not view the Baltic exposure as the main driver of the asset quality development (please note that Svenska Handelsbanken is omitted as it has virtually no exposure to the Baltics). For a more detailed analysis of the Baltic exposure of Nordic banks we refer to our publication from 24 March (*Nordic banks and the Baltic downturn*).

Baltic markets' shares (total assets)*



*Estonia is end 2008; Latvia & Lithuania are H108. Source: National banking federations

Significance of Baltic operations relative to Group (2008)



Source: Annual reports

We reiterate our SELL recommendation on both Swedbank and SEB although we note that for senior paper we consider a default event to be extremely unlikely. Thus we would not recommend a stressed sale of these issuers' senior bonds due to the very high expected government support likelihood. We prefer subordinated debt from the stronger names (Svenska Handelsbanken, Nordea and DnB NOR) to senior debt from the weaker names (SEB and especially Swedbank).

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Disclosure

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