Pre-close call Q1 2020

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Investor Relations

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Claus I. Jensen – Danske Bank – Head of IR

Good afternoon and welcome to the Danske Bank Q1 2020 pre-close call. My name is Claus Ingar Jensen, and I am Head of Investor Relations. With me, I have John Bäckman and Robin Løfgren from our IR team. Please note that this call is being recorded for compliance reasons, and the script used for this call will be published on the Investor Relations website after the call.

In today's call, I will highlight relevant data and one-offs that you should be aware of before the start of the silent period on 9th April ahead of the publication of our interim report for the first quarter of 2020 on 30th April. I will go through the P&L statement line by line and remark briefly on capital at the end. Afterwards, we will open up for a Q&A session.

But before we start, I would like to briefly highlight the obvious: I will be commenting only on already disclosed information and one-offs as well as publicly available data. In this connection, I wish to stress that developments in specific indices may not always have the same effect on our performance. I will limit my response to follow-up questions so as to not include non-published information or qualitative remarks on performance in Q1. In addition, I would like to draw your attention to company announcement number 1 of 16th March, in which we announced our expectation for a negative impact on net profit for 2020 and simultaneously suspended our 2020 guidance due to the COVID-19 situation. In this connection, we qualitatively guided the market towards higher loan impairment charges and lower trading income, however, we have not quantified any of these effects.

I would also like to remind you of the reclassifications concerning the Group P&L that we announced in the annual report for 2019. With effect from Q1 2020, income from the hedging of assets under insurance contracts in the former SEB Pension Danmark is reclassified from net fee income to net trading income. Further, income from the health and accident business at Danica Pension is reclassified from other income to net fee income. Please remember these effects when forecasting individual line items. Further information can be found in note G41 on page 175 of the annual report for 2019, and reclassifications will be published on the Investor Relations website before the publication of the interim report for the first quarter of 2020.

That said, let's start by having a look at net interest income. Please remember that Q1 has one less interest day than Q4. Our usual guidance is for an NII impact of around DKK 30-40 million per day. During the quarter, the Norwegian and Swedish krone depreciated by 5.6% and 2.2%, respectively, on average against the Danish krone, while the pound sterling only depreciated by around 0.6% on average.

On the funding side, we issued three benchmark instruments during Q1. The first one, a 5 billion Norwegian kroner tap of a covered bond issue, was issued on 7th January at a spread of 18 basis points over 3-month EURIBOR. The second one, a covered bond of 1 billion euro, was issued on 8th January at a spread of 14 basis points over 3-month EURIBOR. And the third one, a non-preferred senior bond of 750 million pound Sterling, was issued on 14th January at a spread of 121 basis points over 3-month EURIBOR. Please also revisit page 29 of our Q4 conference call presentation to see the redemption profile for maturing funding.

With regard to volume developments, we refer to publicly available sector statistics as the only externally available source of insight. We have nothing to add to this.

Market rates have developed in opposite directions, especially towards the end of the quarter, with 3-month NIBOR decreasing 18 basis points while 3-month STIBOR increased 19 basis points on the basis of quarterly averages.

As a response to the changes in market rates, we hiked the rate on Swedish 3-month mortgages by 12 basis points with effect from 1st March. This affects the front book immediately and the back book at the next interest reset, and it covers regular customers as well as our partnership agreements with SACO and TCO. No material price changes have been made for deposits in Sweden.

In Norway, we cut the rate on 3 to 10-year fixed-rate mortgages on both 3rd and 6th March. Rates were cut by 35 to 42 basis points in total, depending on the fixing, as a response to changes in market rates. These rate cuts affect only the front book. Additionally, we have cut both lending and deposit rates for our partnership customers in Akademikerne by 7 basis points as a response to changed market dynamics. Changes to lending rates will affect the front book from 9th March and the back book from 20th March, whereas changes to deposit rates will affect both front and back books from 18th May.

On 13 March, the Norwegian central bank cut their official rate by 50 basis points to 1%. In response to this, we have announced a cut of 35 basis points on mortgage lending in Norway for all customers. This will affect the entire back book from 5th April and the front book from 20th March. Further, we have announced deposit rate cuts of 10-45 basis points depending on the product. This will affect the entire back book from 25th May.

On 20 March, the Norwegian central bank cut their official rate by a further 75 basis points to 0.25%. In response to this, we have announced lending rate cuts of 40 basis points for our partnership customers in Akademikerne and 50 basis points for ordinary customers. This affects the front book from 30th March and the back book from 5th April. Further, we have announced deposit rate cuts of 5-50 basis points depending on the product. This will affect the entire back book from 7th June.

On 19 March, the Danish central bank hiked their leading interest rate by 15 basis points to -0.60%. As a response to this, we have decided to hike deposit rates by 15 basis points for Danish commercial customers from 1st April. The rate hike will also apply to Danish retail customers, which means that the previously announced introduction of negative deposit rates on 1st June will be at a rate of -0.60%.

This concludes our messages on net interest income.

Looking at fee income, please note that Q4 included seasonal performance fees of 358 million kroner, which will not reoccur in Q1. Besides this seasonality, fee income at Danske Bank is, as always, dependent on market developments for our Asset Management business and activity levels for our banking operations.

Markets have been turbulent during Q1, with a 10% decrease in the OMX C25 index in Copenhagen and a 20% decrease in the S&P 500 index, just to name a couple. At Banking DK, remortgaging activity was very high in 2019 but seems to have slowed considerably, as expected. Sector statistics show that Realkredit Danmark has seen 17 billion kroner worth of early redemptions in Q1, against 52 billion kroner in Q4. As a rule-of-thumb, we typically earn around 50 basis points on remortgaging, with the majority booked as fee income and the rest split between trading income and NII, in that order. Please note that the actual effect is uncertain, as some customers may have chosen to leave Danske Bank.

Turning to trading income, please note that we do not guide on this specific line item. As mentioned in company announcement number 1 of 16th March, the global financial markets were impacted by very high volatility in Q1, which may have had a negative impact on trading income in the quarter. We have also observed a significant widening of global credit spreads in general and on Danish kroner-denominated covered bonds specifically. For reference, the OASs on Danish 30-year callable bonds and 5-year non-callable bonds have widened by around 25 basis points and 20 basis points, respectively, now pricing at around 33 basis points and 10 basis points, respectively. As a further reference, the spread between Danish and German 10-year government bonds has widened by around 25 basis points.

Please note that trading income will be impacted by income from the auctions of Danish variable-rate mortgage bonds for refinancing purposes. These auctions typically affect Q4 and Q1, and for Q1 2020, the auction size was slightly smaller than in Q1 2019 as customers more often choose fixed-rate loans or longer-dated variable-rate loans. For reference, income from the Q1 2019 auction amounted to 145 million kroner. Please also note that trading income includes the investment result from the health and accident business at Danica Pension.

We do not have any specific comments on Other income.

This concludes our comments on the income lines.

If we look at the cost line, please remember that Q4 2019 included many one-off items as well as standard seasonality with year-end booking of costs. For Q1, we have not communicated any one-off items, and we have no specific comments to add on cost developments during the quarter.

With regard to loan impairment charges, we expect to see an effect from the significant worsening of the macroeconomic outlook because of the COVID-19 situation. On an exposure level, we cannot rule out that we may also see an impact from the significantly lower oil price. Our preliminary assessment, based on input from changes to model assumptions, is that loan impairment charges are likely to increase due to more severe scenarios. For reference, our current downside scenario under IFRS 9 implies far lower impairments than for instance the adverse scenario in the EBA stress test, which is due to much milder assumptions.

Since the lockdown of all of Europe in March, the markets have had a significant focus on how regulators will allow for a more flexible interpretation of impairment rules and model scenarios under IFRS 9 due to the COVID-19 situation. In Denmark, the FSA published new guidelines on 19th March, which include more flexible conditions for credit facilities granted to customers with good credit ratings. For customers with weaker credit ratings, impairments will be increased if we assess that a customer's financial situation post-COVID-19 will be unsustainable. With regard to the interpretation of the various macroeconomic scenarios, the Danish FSA on 2nd April published additional guidelines, including a recommendation to use the latest macroeconomic scenarios from the Danish central bank published on 1st April.

Let me also direct your attention to interviews with the head of the Danish FSA on Bloomberg and Risk.net yesterday and today that confirm the general market observation that, in a historical context, the Danish FSA adopts a stricter and more conservative approach than other jurisdictions.

At present, we have no further guidance on the magnitude of loan impairment charges in Q1.

On the Non-core and tax lines, we have no specific comments to add.

This concludes our comments on the P&L.

As a final point, I would like to touch on capital. In light of the COVID-19 situation, Denmark, Sweden, Finland and the UK have completely removed the countercyclical capital buffer, and Norway has reduced the countercyclical capital buffer from 2.5% to 1%. Consequently, our fully phased-in countercyclical buffer requirement will decrease to around 0.1%, a significant decrease from the level at Q4 2019, which was 1.7%. Our MREL requirement will see a decrease of roughly the same magnitude, all else being equal.

Further, we have communicated that we are reassessing what we will propose for dividend for 2019. Any reduction in the dividend proposed for 2019 will increase our CET1 capital immediately after the new proposal is made. For reference, the previously communicated dividend proposal for 2019 amounted to DKK 7.3 billion, corresponding to around 1% of the CET1 capital ratio.

As always, our capital position will be impacted by earnings less a 60% dividend accrual. The risk exposure amount is subject to growth, general market volatility and FX movements as always. We have not communicated any extraordinary impact on the risk exposure amount in Q1.

This concludes our initial comments in this pre-close call. Before we move to the Q&A session, I would like to highlight that we enter our silent period on 9th April. Shortly, we will also start collecting consensus estimates with a contribution deadline on 15th April. Finally, we will publish our interim report for the first quarter of 2020 on 30th April.

Operator, we are now ready for the Q&A session.