Pre-close call Q3 2023

29 September 2023

Danske Bank – Investor Relations

Claus I. Jensen – Danske Bank – Head of IR

Intro

Good afternoon and welcome to the Danske Bank Q3 2023 pre-close call. My name is Claus Ingar Jensen, and I am Head of Investor Relations. With me, I have Katrine Strøbech and Nicolai Tvernø 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. Given that we conduct this call via Teams, please be aware that if you want to ask questions, you must log on via the Teams app or your browser. If you participate via a telephone line, the IR team will be available for questions after the call.

In today's call, I will highlight relevant public data and macroeconomic trends in our markets as well as one-offs that you should be aware of before the start of the silent period on 6th October ahead of the publication of our interim report on 27th October. I will go through the P&L statement line by line and comment on capital at the end. Afterwards, we will open-up for a Q&A session.

For the sake of good order, I would like to highlight the following. I will only answer questions related to already disclosed information as well as publicly available data as of 25th September, unless otherwise noted. In this connection, I wish to stress that developments in specific indices may not always have the same effect on our performance.

Finally, before we start, I would like to point out that we have an unusual high number of one-offs this quarter, which I will comment on separately after the income lines.

Macro

I would like to start by commenting on the current macroeconomic backdrop before we go through the line items.

In the euro area inflation is coming down but looks sticky, increasing the likelihood for higher rates for longer. Short-term economic sentiment has improved recently. In Denmark growth is driven in part by the pharmaceutical sector, although some cyclical sectors are more vulnerable. Also, the housing prices have stabilised faster than initially expected although the number of transactions remains very low. Our main scenario is a soft landing with modestly higher unemployment, albeit with high uncertainty as we have not yet seen the full effect of the interest rate hikes that have been made over the last year. The risk of a worse scenario therefore remains considerable.

We refer to our most recent economic outlook from 5th September.

With that, let us have a look at net interest income.

Net interest income

As always, please note the impact of currency fluctuations in the markets in which we operate. In the period from the beginning of the quarter until 25th September, we have seen appreciation in exchange rate of the Swedish krona and the Norwegian krone of approximately 1 and 2% respectively, whereas the GBP has increased less than 1%. Also please further note that Q3 has one more interest day than Q2 with an estimated day effect of around DKK 80 million.

Regarding volume developments for both lending and deposits, we refer to publicly available sector statistics as the only externally available source of insight. The most recent data as of the end of August 2023 points to a largely flat volume development compared to the second quarter. Overall, we note that the housing market activity remains subdued.

Since Q2, the 3-month STIBOR and NIBOR have risen by around 30 and 70 basis points respectively – on the basis of quarterly averages. Please be aware that when we observe increases in NIBOR and

STIBOR, the immediate impact on our NII is negative as higher customer rates in particular in Norway are subject to notice periods of up to 6 weeks.
In the second quarter, both the ECB and the Danish central bank hiked rates by 25 bps in May and by 25 bps on 15th June. In the third quarter, the ECB hiked the rate by 25 bps on 27th July, which was followed up by the Danish central bank also raising the rate by 25 bps on 28th July. Finally, the ECB hiked the rate by another 25 bps in September, which was followed by the Danish Central Bank and both the Swedish and Norwegian Central Bank.

Further to the increase in policy rates on 14th September, we have announced that we will start paying 25 basis points on retail deposits in Denmark of up to DKK 50,000. This will take effect on1st October and will not have any impact on NII in Q3. Additionally, we have raised the interest rates on several savings products, effective from 18th September. The net annual NII effect from the rate hike and our subsequent price adjustments is around DKK 0.1 billion.
With respect to our operations in the other Nordic countries, we continue to adjust pricing on the basis of central bank hikes and local market competition.

We confirm our current NII sensitivity of approx. DKK 700 million per 25 bps uplift across all currencies, on average over the next 100 bps within a 12-month period. In addition, there is an uplift of approximately DKK 300 million in the subsequent 12-24 month period caused by various balance sheet effects.
Please note that by far most of our sensitivity relates to DKK and EUR, in that order.

Turning to wholesale funding, we remain comfortable with our overall funding position. We have issued in various formats, including senior, covered bonds and private placements, bringing the total amount of debt transactions to more than DKK 80 billion year to date. Activity in Q3 included a GBP 350 million 5NC4 preferred senior bond priced equivalent to 3month Euribor +111 from the 16th of August, and USD 1.25bn 3NC2 preferred senior priced equivalent to 3month Euribor +89 issued on 19th September. On 26th September we have made a dual tranche covered bond transaction in total of CHF 300 million. Note that this has no effect in Q3.

Please see Danskebank.com Debt section for further details on terms and pricing for each issuance.

Finally on NII, as discussed at the Q2 call, centrally booked interest rate risk management costs related primarily to demand deposit hedging are allocated to the appropriate business units from Q2 with full impact within PC and BC deposit margins for Q3. Please note, this move does not affect Group NII.

Also, with full effect from Q3 and onwards, lending margins at BUs will be reduced due to internal allocation of funding costs previously booked as other interest expense. Again, this will not affect Group NII.

Fee income

In respect of fee income, the development is subject to market conditions in the financial markets, housing market activity and the general activity level among our customers.

Let us start with the development in investment fees. These will as always be subject to assets under management and the investment appetite of our customers, which could be negatively affected by the decline in the Danish OMX C25 index of more than 6 % and negative valuation impacts on Fixed income portfolios in our Asset management business as a result of higher interest rates.

Turning to activity driven fees, we note that in the past months, consumer sentiment as measured by Statistics Denmark is still negative, although stable.
According to our recent spending monitor by Danske Bank Macro Research, we have seen a slight increase in nominal spending growth recently although real spending fell for the second straight month.

Turning to fees from lending activities. Housing market activity in Denmark has improved, however from a very low level, and remain significantly below the peak in 2021. Also, please be aware that we do not have any refinancing auctions of Flexloans in the third quarter. In addition, remortgaging activity has been very low in the third quarter.

Activity in the capital markets has improved during Q3, however uncertainty remains. Activity in the ECM started to pick up in Q3, and we completed several transactions. Within DCM activity has been low but with small signs of improvement in the later part of Q3. In M&A, Nordic market activity has been subdued with relatively low market volumes compared to volumes in previous years.

Trading & Danica

Now turning our focus to trading income, please note that the continued uncertainty about central bank rates has continued to drive bond yields higher in a volatile market environment.
Yields and spreads on DKK callable mortgage bonds have been more or less unchanged during Q3 with relatively low volatility. Spreads on 5Y non-callable bonds have tightened close to 10bp due to low supply, while spreads on short-term non-callable bonds have widened somewhat.

Regarding our insurance activities, please be aware that higher longer-term interest rates may have a negative valuation effect on investment portfolios.

Other income

We have no comments in terms of Other Income.

One-offs
In this quarter, there are a number of one-offs, which I will now go through:

1. The first one-off relates to NII. Interest compensation from a tax dispute regarding valuation methods has a positive effect on NII by around 0.3 billion. Please be aware that this one-off is exempted from tax.

2. The second one-off relates to Trading. The impact comes from the release of a loss of 0.8 billion from OCI related to the CET1 FX hedge attributable to personal customers business in Norway, which was also announced in the Outlook presented at our Q2 2023 conference call.

3. The third one-off relates to Net income from insurance, related to a potential customer compensation case with an estimated impact of DKK 250 million. This was published on our website Tuesday this week.

4. The fourth one-off relates to Other Income. The sale of Danske IT to Infosys will have a positive impact of DKK 0.1 billion.

5. The last one-off relates to Tax. This is a reversal of a tax payment from 2019, , related to the tax dispute regarding valuation methods, which I mentioned in the first one-off. There will be a positive effect of around DKK 0.5 – 0.6 billion.

When comparing to 9 months of 2022, I would like to remind you that a number of non-recurring items related to income from insurance, expenses and impairments were booked in the third quarter of 2022.

Cost

We have no specific comments regarding the quarterly development in costs, but would like to note that the new collective agreement for employees in Denmark took effect on 1st July, with an salary increase of 4.5% in 2023 and 3% in 2024.

Tax

We refer to our previous comment regarding the tax-related one-off.

Impairments & credit quality

We remain comfortable with our credit quality. However, please note that while the overall macroeconomic outlook in Denmark has improved recently, some sectors of the economy are becoming more vulnerable, which will be reflected in our modelled scenarios, as we continue our prudent approach including when it comes to our PMA buffers. We would like to reiterate our guidance of loan impairment charges of up to DKK 1.5 billion for the full year.

This concludes our comments on the P&L.

Capital

We do not have any specific comments on REA, besides noting that market risk remains subject to volatility in the market.

Concluding remarks

This concludes our initial comments in this pre-close call.

Before we move on to the Q&A session, I would like to highlight that we enter our silent period on 6th October. Shortly after today's call, we will also start collecting consensus estimates with a contribution deadline on 6th October, end of day. Please note that we will publish our Q3 interim report on 27th October at 7.30am CET and that the conference call for investors and analysts will take place at 8.30am.

We are now ready for the Q&A session. If you wish to ask a question, please use the "raise your hand" function.