FINANSTILSYNET
THE FINANCIAL SUPERVISORY
AUTHORITY OF NORWAY

Report

Risk Outlook

June 2025

Risk Outlook

Financial stability and well-functioning financial markets help ensure efficient use of society's resources, good services for consumers and other market participants and confidence in the financial system. The financial system should be able to cope with disruptions and unexpected events while carrying out its functions, thus preventing an economic downturn from being amplified. This requires sound and liquid financial institutions with good internal management and control.

The Risk Outlook report summarises Finanstilsynet's analyses and assessments of the stability of the Norwegian financial system. The report builds on Finanstilsynet's ongoing supervision of institutions and markets and provides an important basis for its work. The report is published twice a year, in June and December.

Developments in financial institutions and financial markets are discussed in more detail in the following reports from Finanstilsynet:

- Residential mortgage lending survey (in Norwegian only)
- Financial institutions' use of flexibility quotas in the lending regulations (in Norwegian only)
- Report on developments in consumer loans (in Norwegian only)
- Report on alternative investment funds (in Norwegian only)
- Risk and vulnerability analysis for ICT security in the financial sector

Cut-off date 4 June 2025.
Data in the charts updated as of 30 May 2025.

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SUMMARY

Over the past year, global economic growth has been moderate. The rate of consumer price inflation has moderated, aligning more closely with the central bank's inflation target, and many central banks have gradually reduced their policy rates. At the same time, political uncertainty and geopolitical tensions create a high degree of uncertainty regarding future developments. The risk of financial instability has increased. Some market players and forecasters have expressed concern that many economies will go through a period of low growth and high inflation.

In Norway, economic growth has been moderate over the past two years. Unemployment has risen from a low level. Both Norges Bank and Statistics Norway expect rising private consumption and public demand to contribute to a slight increase in growth in the period ahead. Norges Bank has kept its policy rate stable at 4.5 per cent and indicated in May that the policy rate could be lowered twice in 2025 to 4 per cent at the end of the year.

As a small, open economy, Norway and the Norwegian financial industry are vulnerable to international setbacks and turmoil. As a result of changes in the threat landscape, it is important to reduce vulnerabilities and enhance resilience in areas such as cybersecurity, technological dependencies and other operational risks.

Experience from previous crises shows that it can be particularly challenging to deal with incidents that are compounded by or originate from imbalances in the domestic economy. High household debt and elevated residential and commercial property prices remain the key vulnerabilities in the Norwegian financial system. Norwegian household debt, measured in per cent of disposable income, has decreased over the past three years. Households' credit growth has risen slightly over the past year but remains moderate. Nevertheless, the debt burden is high, both in a historical perspective and compared with other OECD countries, and many borrowers take out large loans relative to income and the value of their property.

In spite of a sharp increase in the interest rate level, there are few signs of serious debt servicing problems for the Norwegian household sector overall. The share of non-performing loans in the personal customer market has risen in recent years but is still below pre-pandemic levels. This development must be viewed in light of the fact that the overall level of economic activity in Norway has held up and that unemployment is low.

On average, commercial real estate (CRE) companies have high debt levels. The companies' interest expenses have increased strongly since late 2021, and their debt servicing capacity has clearly weakened. The yield on the properties is also low compared to the risk-free interest rate. If interest rates remain high, commercial property prices could fall further, while many CRE companies' debt servicing capacity could remain weak for an extended period. Most Norwegian banks have a significant loan exposure to CRE companies.

Overall, Norwegian banks are profitable and competitive. The rising interest rate level has helped boost banks' net interest income, while losses have remained low. Banks' operating expenses are low as a share of total assets. Norwegian banks' return on equity over the past couple of decades has been higher than in our neighbouring countries, while their market shares have been maintained.

The banks satisfy current solvency and liquidity requirements. Their common equity Tier 1 capital ratio was around 19 per cent at the end of the first quarter of 2025 and has changed little in recent quarters. Measured by the leverage ratio, banks' equity has been virtually unchanged over the past ten years.

This year's stress test of Norwegian banks is based on a scenario of geopolitical fragmentation, a global trade war and the introduction of high tariff barriers between countries. This contributes to declining international trade, higher inflationary pressures and a global economic setback. The Norwegian economy is also severely affected, and banks' loan losses increase significantly. Losses are high, particularly on corporate loans, but clearly lower than the banks' losses during the

banking crisis in the early 1990s. In the stress test, the capital adequacy ratios of most of the largest Norwegian banks fall below the overall CET1 capital requirements. The stress test and developments in the risk landscape underline the importance of maintaining strong solvency and liquidity levels in banks and other financial institutions.

Norwegian life insurers and pension funds generally have strong solvency levels. In the first quarter of 2025, their results were affected by geopolitical turbulence and announcements of increased tariffs, which led to a drop in the value of shares, a significant decline in returns and reduced buffer funds. Life insurers have diversified portfolios, with foreign assets representing approximately half of their investments. Pension institutions have achieved good returns in recent years, partly due to the depreciation of the Norwegian krone.

The profitability of non-life insurers has declined over the past two years due to several weather-related claims and strong cost growth. The tightening of terms contributed to better results in 2024 and improved profitability from insurance operations in the first quarter of 2025. Thus far this year, negative investment income has nevertheless had a severe impact on pre-tax profits.

Among policymakers, supervisory authorities and supranational organisations, there is a growing awareness of the need to simplify financial market regulation, which over time has become very extensive and detailed. Both nationally and internationally, efforts are being made to assess and implement simplifications in regulations, supervisory practice and reporting, and to provide better guidance. In several countries, powerful stakeholders are advocating for a reduction in capital and liquidity requirements for banks. In Finanstilsynet's opinion, it is important to retain regulatory requirements. Any regulatory streamlining should safeguard the key objectives of the regulation within the framework of international standards.

ECONOMIC DEVELOPMENTS AND RISKS

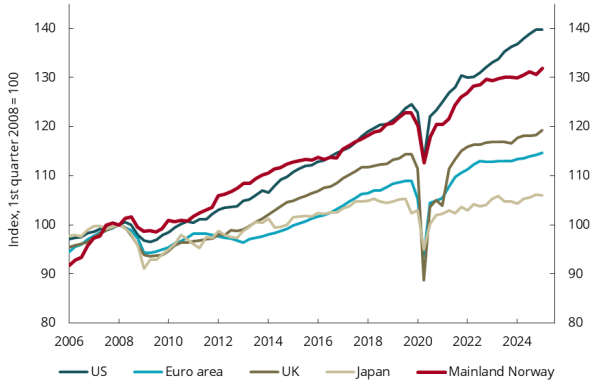
Prospects of weaker economic growth

Global economic growth has been moderate over the past year (chart 1.1). Figures for the first quarter of 2025 have been mixed, and in the US, value creation declined somewhat. The IMF has revised down its growth forecasts for 2025 and 2026 as a result of the introduction of increased US tariffs and unusually high uncertainty about evolving trade conflicts. According to the latest forecasts from the IMF, global GDP will grow by 2.8 per cent in 2025 and 3.0 per cent in 2026, revised downwards from the previous estimate of 3.3 per cent in both years. The revision of growth forecasts is particularly pronounced for the US, where the IMF now expects GDP growth of 1.8 per cent in 2025, down from the previously projected 2.7 per cent.

In Norway, economic growth has been moderate over the past two years. Unemployment has risen from a low level. Norges Bank and Statistics Norway expect rising private consumption and public demand to contribute to a slight increase in growth in the period ahead.

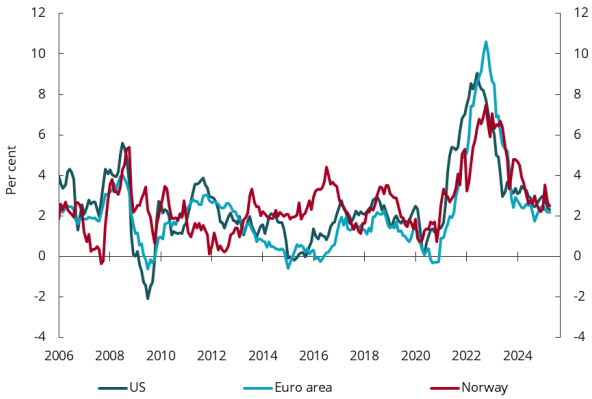
Consumer price inflation has been close to or somewhat above target inflation in most countries (chart 1.2). The IMF estimates that global consumer price inflation will decline from 5.7 per cent in 2024 to 4.3 per cent in 2025 and 3.6 per cent in 2026.

Chart 1.1 Gross domestic product



Last observation: first quarter 2025. Source: LSEG Datastream

Chart 1.2 Inflation



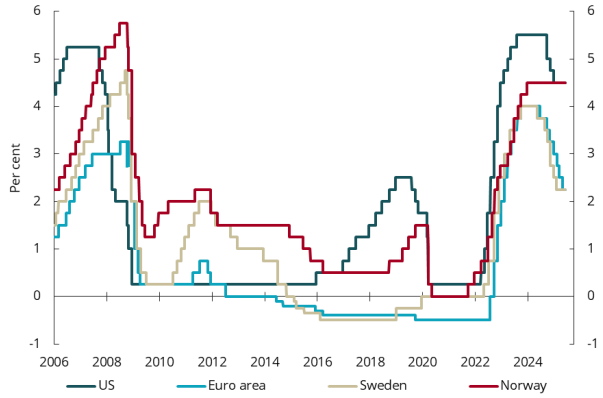
Last observation: April 2025. Source: LSEG Datastream

A number of central banks have implemented multiple rounds of policy rate cuts (chart 1.3). Norges Bank has kept its policy rate unchanged at 4.5 per cent since December 2023. Inflation in Norway has been somewhat higher than expected, wage growth has picked up, and there is considerable uncertainty about how international trade barriers will affect consumer prices in the period ahead. Norges Bank's latest forecasts indicate that the policy rate may be reduced twice to 4 per cent at the end of the year.

Greater economic uncertainty affects financial markets

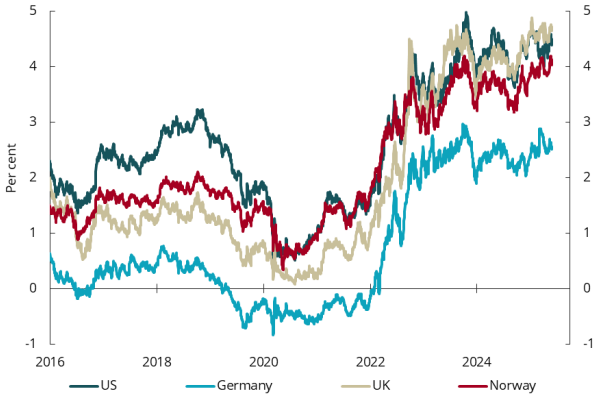
The combination of lower growth expectations and higher inflation projections has contributed to increased concern among market participants and forecasters that a number of economies will go through a period of stagflation. In a situation of particularly high uncertainty, it is common for investors to be more drawn to so-called safe havens, such as government bonds issued by low-risk countries. Developments in long-term government bond yields have been somewhat mixed since the turn of the year (chart 1.4). The US dollar index, which measures the value of the US dollar against six other currencies, has fallen steeply since January (chart 1.5). However, gold prices have risen sharply to new record highs (chart 1.6).

Chart 1.3 Policy rates



For the US, the upper limit in the target interval is shown. For the euro area, the deposit rate is shown, which is the lowest of the three official policy rates. Source: LSEG Datastream

Chart 1.4 10-year government bond yields



Monthly data. Source: LSEG Datastream

Chart 1.5 US dollar index

A lower index means a weaker dollar exchange rate, measured against six other currencies. Source: LSEG Datastream

Chart 1.6 Gold price

Source: LSEG Datastream

The multiple waves of new tariffs announced by the US in recent months have had a major impact on equity markets (chart 1.7). Industries that are highly exposed to international trade are most severely affected, but weaker economic growth, coupled with greater uncertainty about the future, has an impact on most countries and industries.

Oil prices have fallen (chart 1.8). The decline can partly be attributed to expectations of weaker economic growth but also to a much faster increase in oil production in the OPEC+ countries than previously announced.

Chart 1.7 Equities, total return

MSCI indices. Source: LSEG Datastream

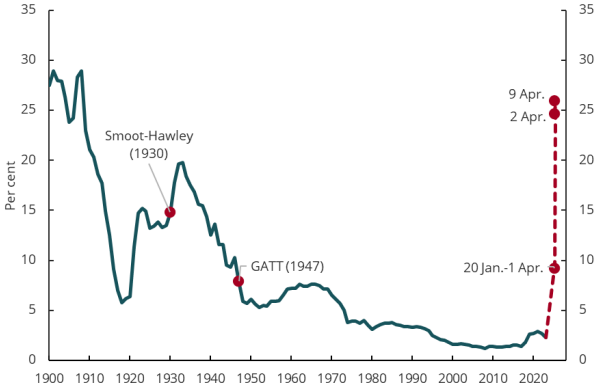
Chart 1.8 Oil price, Brent spot

Source: LSEG Datastream

High geopolitical risk and elevated risk of financial instability

Trade conflicts and geopolitical tensions have heightened the risk of a global economic downturn. There is particular uncertainty about trade policy and the use of tariffs by the new US administration, as well as their consequences (chart 1.9).

Chart 1.9 US effective tariff rates on imports



Source: IMF, World Economic Outlook April 2025, figure ES.1.

The IMF has revised down its growth prospects and believes that the risk of weaker than expected developments in the global economy has increased considerably. Global economic growth will be slowed by higher tariffs and trade conflicts but also by heightened uncertainty that reduces the risk and investment appetite of both firms and households. Higher tariffs will also lead to a rise in inflation and elevated interest rates, whereby economic growth may weaken further. Rising tariffs, inflation and interest rates and reduced global trade will bring down earnings in non-financial corporations and cause a rise in unemployment and may lead to an increase in banks‘ non-performing loans and loan losses.[1]

According to the IMF, the risk of global financial instability has risen substantially, mainly as a result of tighter financial conditions and increased market volatility. Valuations in the securities markets remain elevated, indicating a substantial downside risk. This vulnerability is exacerbated by greater concentration in capital markets.[2] The IMF also points out that non-bank financial institutions (NBFI) have been given a more prominent role through various types of investment funds. These are financed to varying degrees by banks, and in unstable markets, high debt-to-income (DTI) ratios in finance

[1] IMF, World Economic Outlook (April 2025)

[2] The US stock market accounts for more than half of the total market capitalisation in the global stock market, compared with 30 per cent 20 years ago.

companies may lead to liquidity problems and 'fire sales' of assets, which in turn may cause losses for the banks.[3]

Escalation of trade conflicts and political tensions could affect financial stability through various channels. Financial market volatility has already increased, and prices of equities and corporate bonds have fallen. The growth in producer and consumer prices may accelerate as a result of higher tariffs and supply chain disruptions. Interest rates and risk premiums in financial markets may rise further, and growth prospects may be dampened. Geopolitical tensions also entail an elevated risk of serious cyber incidents and other operational risk. The IMF emphasises the need for strengthened financial regulation and measures to manage elevated risk in the global financial system.

According to the European Systemic Risk Board (ESRB), the risk of financial instability in the EU remains high due to political uncertainty and geopolitical tensions. While markets have been resilient so far, the ESRB believes that trade restrictions and/or escalating geopolitical tensions could worsen the macroeconomic outlook and elevate credit and market risk. A further escalation of geopolitical tensions or trade restrictions could trigger a disorderly market correction.

In several NATO countries, defence spending is now increasing sharply as a result of the war in Ukraine and greater uncertainty about the future role of the United States. This may result in a larger deficit in public finances and raise sovereign debt. In countries with high debt-to-income ratios, elevated credit risk may also lead to higher interest rates on sovereign debt. That would reduce these countries' fiscal room for manoeuvre and their ability to counter future economic shocks. The IMF points out that the high sovereign debt levels globally may cause instability in government bond markets, particularly in countries with high debt levels.

The Norwegian economy is affected by international developments

This year's stress test is based on the assumption that geopolitical fragmentation, a global trade war and the introduction of high tariff barriers between countries will raise prices of imported goods and cause disruptions in supply chains. This contributes to declining international trade, higher inflationary pressures and a setback in the global real economy. Norway and the Norwegian economy are strongly affected by international developments, and banks' loan losses increase substantially, particularly on corporate loans. The capital adequacy ratios of most of the largest Norwegian banks fall below the CET1 capital requirement, see also the chapter 'Stress test of Norwegian banks'.

In Norway, as in many other countries, the cyberthreat level remains elevated and reflects geopolitical changes, cf. this year's Risk and vulnerability analysis. Criminal actors are developing new methods, interacting in new ways and using new technology. In the financial sector, defences against cybercrime, the institutions' governance models for ICT solutions and inadequate vendor management represent key vulnerabilities.

Prevention and preparedness in times of heightened uncertainty

In times of increased turbulence and uncertainty, there is a need for improved financial market oversight. The three European Supervisory Authorities, EBA, ESMA and EIOPA, have emphasised the need for heightened vigilance among financial institutions, particularly with regard to operational resilience and cyber security. Institutions are encouraged to strengthen risk management and establish contingency plans to deal with unforeseen incidents. The supervisory authorities consider increased geopolitical uncertainty, persistent inflationary pressures and intensified cyber threats to pose significant challenges for the financial sector.

Finanstilsynet is closely monitoring developments and cooperates with Nordic and European supervisory authorities on information exchange and vulnerability assessments. In uncertain times, Finanstilsynet is in more frequent contact with key institutions in the banking, insurance and pension sectors, as well as with securities market participants to gather information and assessments.

[3] IMF, Global Financial Stability Report (April 2025)

Particular attention is paid to the liquidity and funding of large Norwegian banks, mutual funds and alternative investment funds.

Experience from previous crises shows that a high level of resilience in the banking sector is crucial to reducing the risk of an amplified downturn in the financial system. In periods of high uncertainty, it is particularly important for banks to update their risk assessments and loss allowances. This includes internal risk models, which are the basis for calculating the capital requirement for banks using IRB models.

Financial regulation and simplification

Internationally, supervisory authorities and industry representatives are discussing whether significant changes should be made to financial market regulation (see box 'Changing financial regulation'). There is growing awareness of the need to simplify the regulatory framework, which over time has become very extensive and detailed. In addition, there are discussions concerning how regulations and supervision affect the financial industry's ability to offer credit and promote economic growth.

Political and geopolitical changes may have consequences for the willingness and ability to cooperate on common international financial market regulation. In a number of countries, there have been calls for adapting the regulation to national needs and preferences. This may both lead to a relaxation of regulations in areas where common standards currently exist and make it more difficult to develop regulation in new risk areas. The financial system is closely intertwined across the globe. Simpler regulation based on common international standards could be of benefit to society, while more fragmented and incomplete regulation increases the risk of financial instability and a less well-functioning international financial market.

Changing financial regulation

Developments in the US

After the change of president in January 2025, a new regulatory direction has been announced in the US. It includes a review of regulations for banks, capital markets and digital financial services, with the aim of simplifying the supervisory structure, adapting capital requirements and reducing burdens on financial institutions. The implementation of the final phase of the financial crisis reforms (the Basel endgame) has been suspended, and the requirements may be reviewed with regard to national adaptations and potential downscaling. The authorities express scepticism towards adopting international standards without first assessing their national relevance and benefits.

In some areas, the change of course is particularly significant, including sustainability (ESG) and regulation of crypto assets. Simplification of capital raising and reporting requirements are also expected for certain companies, particularly growth companies and non-listed issuers. A dedicated working group has been tasked with developing new regulations for crypto assets, and a national Bitcoin Reserve has been established based on government seizures.

The changes are taking place parallel to changes in the management of regulatory bodies such as the Federal Reserve, the Securities and Exchange Commission (SEC), the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC). At the same time, measures have been implemented to increase political control over the supervisory authorities, which are traditionally independent, including a requirement to submit important proposals and decisions for regulation to the Office of Information and Regulatory Affairs (OIRA) in the White House for prior approval. Major changes to the financial supervision structure are also being considered, including a possible closure or reorganisation of the Consumer Financial Protection Bureau (CFPB) and the Public Company Accounting Oversight Board (PCAOB).

The new regulatory policy in the US has international repercussions.

Developments in the UK

Following the UK's withdrawal from the EU, the UK authorities have initiated extensive reforms for the financial sector. The reforms aim to promote economic growth and strengthen London's position as an international financial centre, while maintaining its financial stability objective.

The UK regulators, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), have been given a new secondary international competitiveness and growth objective. It is supplemented by new reporting requirements and strengthened parliamentary oversight. Parallel to this, the supervisory authorities' regulatory competence has been extended in areas that were previously covered by EU regulation.

The FCA and the PRA have initiated reviews of their own operations to ensure more proportionate and effective supervision. The FCA has established a more principle-based approach in some areas and is considering easing reporting and disclosure requirements. The PRA has launched the 'Strong and Simple' prudential framework to develop a simplified but robust supervisory regime for small non-systemic banks. At the same time, both supervisory bodies have made it clear that regulation shall not undermine financial stability.

Structural changes to the regulatory regime have been implemented and proposed, including relaxations to the prospectus and listing regimes, adjustments to the Solvency II rules (Solvency UK) and relaxations to certain inherited EU rules within securities trading. Targeted regulatory relaxations have also been adopted, including the removal of the bonus cap for bank executives. In addition, changes to the ringfencing regime, which separates traditional banking from investment banking, are being considered. It is also being considered whether the rules for alternative asset managers, including buyout funds and hedge funds, should be relaxed.

The UK has postponed the implementation of the final phase of the financial crisis reforms (Basel 3.1) until 2027, referring to the uncertainty surrounding their implementation in the US.

Developments in the EU

There is increasing awareness in the EU that extensive and complex regulations can inhibit innovation and growth. In January 2025, the European Commission launched the Competitiveness Compass, which is a strategy to strengthen Europe's global competitiveness, based on the recommendations of the Letta and the Draghi Reports.

One of the measures is to simplify regulations and reduce the administrative burden by 25 per cent for the business sector in general and by 35 per cent for small and medium-sized enterprises (SMEs), partly through cross-sectoral 'omnibus' packages. The Commission has already put forward proposals on simplified sustainability reporting, including significant amendments to the Corporate Sustainability Reporting Directive (CSRD), the Corporate Sustainability Due Diligence Directive (CS3D) and the Taxonomy Regulation. The thresholds for which companies are covered will be raised, the requirements will be simplified, and the reporting obligation will be postponed for small enterprises to shield them from disproportionate burdens.

In March 2025, the Commission presented its strategy for a Savings and Investment Union (SIU) that will build on the Capital Markets and Banking Union. One of the objectives of the SIU is to harmonise legislation on securities, company law and bankruptcies, and to strengthen the authority of ESMA. It also aims to facilitate investments in European equities and securities, including through a common European framework for savings and investment accounts, and seeks to develop and promote participation in pension schemes that complement public schemes. The rules for securitisation are being simplified to increase banks' lending capacity, and changes to the rules for insurers (Solvency II) are intended to stimulate investment in equities and growth companies.

Parallel to this, an evaluation of the internal market banking sector, including the sector's competitiveness, is ongoing. This evaluation was originally planned to be completed during 2028 but has now

been moved forward to the end of 2026. During her confirmation hearing in the European Parliament in November 2024, the Commissioner-designate for Financial Services emphasised that financial stability is a prerequisite for competitiveness. The aim is to fully implement Basel III while reducing unnecessary burdens on the business sector without compromising the stability of the financial system.

The EU has previously postponed the new market risk regulations (FRTB) until 2026. In light of developments in the US and the UK, the EU is now considering further postponement.

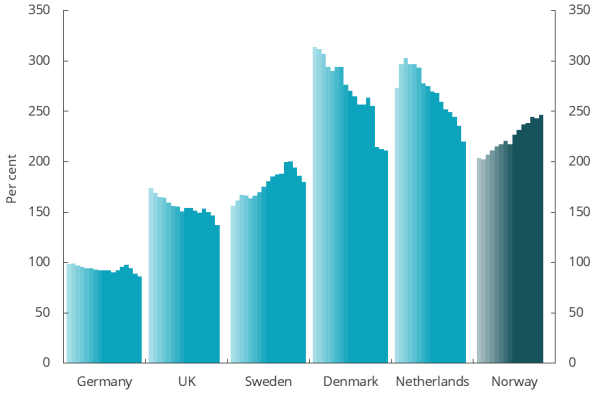
As a result of the EEA Agreement, simplifications and other changes to EU financial regulation will normally also apply in Norway. In addition, the Ministry of Finance has emphasised in the letter of allocation for 2025 that Finanstilsynet shall prioritise measures that provide simplification for the business sector. This process is now being followed up.

HOUSEHOLDS

Norwegian households are vulnerable to higher interest rates

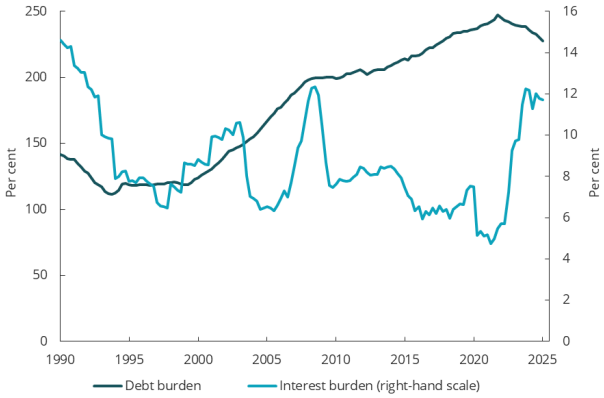
The debt burden[4] of Norwegian households is high, both in historical terms and compared with other OECD countries. While households in some countries reduced their debt burden in the wake of the international financial crisis in 2008–2009, the household debt burden in Norway continued to rise (chart 2.1). Since the end of 2021, the debt burden has decreased (chart 2.2). The reduction is due to lower credit growth and an increase in households' total nominal income during a period of high inflation. Growth in households' domestic loan debt (C2) has risen over the past year but is still below income growth. In the first quarter of 2025, households' average debt burden was 228 per cent.

Chart 2.1 Household debt burden in selected countries 2008–2024



The last observation is 2023 for the UK and the Netherlands and 2022 for Norway. Source: OECD

Chart 2.2 Household debt burden and interest burden



Last observation: first quarter 2025. Sources: Statistics Norway and Finanstilsynet

Reported figures from a selection of financial institutions on the use of the flexibility quotas in the Lending Regulations show that the proportion of residential mortgages granted outside Oslo that did not meet one or more of the requirements in the Lending Regulations (non-compliance rate) fell from 7.7 per cent (measured in volume) in the fourth quarter of 2024 to 6.1 per cent in the first quarter of 2025. For mortgages secured on residential property in Oslo, the non-compliance rate declined from 5.9 to 5.8 per cent during the same period. From the fourth quarter of last year to the first quarter of this year, there was a marked decline in the proportion of granted residential mortgages (particularly outside Oslo) that did not fulfil the maximum loan-to-value ratio (LTV ratio) requirement set in the regulations. This must be viewed in light of the increase in the maximum loan-to-value ratio requirement from 85 to 90 per cent in December 2024. For consumer loans, an increase in the non-compliance rate from 2.7 per cent in the fourth quarter of 2024 to 3.3 per cent in the first quarter of this year was reported. Over the past year, there has been a marked increase in the proportion of granted consumer loans that do not meet the requirement in the regulations on the payment of instalments.

According to Norges Bank's loan survey, the banks participating in the survey reported that household demand for loans increased from the fourth quarter of 2024 to the first quarter of this year and that they also expected demand to remain more or less unchanged from the first to the second quarter. Banks reported a slight easing in credit standards for households overall from the fourth quarter of last year to the first quarter of this year. Furthermore, the banks assume that credit standards for households will be more or less unchanged in the second quarter.

Households' interest burden[5] has increased significantly. From the second quarter of 2021 to the fourth quarter of 2024, households' average interest burden rose from a historically low level of 4.8 per cent to 11.8 per cent. Only a small proportion of Norwegian household debt carries fixed

[4] Measured as debt in per cent of disposable income.
[5] Measured as interest expenses in per cent of disposable income before deducting interest expenses.

interest rates.[6] Rising interest rates thus quickly lead to higher interest expenses for households. However, many Norwegian borrowers have annuity loans, which means that the liquidity effect of interest rate increases is partially offset by reduced instalment payments.

Loan default and payment problems

So far, there are few signs of serious debt servicing problems for the Norwegian household sector overall. Over the last couple of years, there has been an increase in both the volume and the number of non-performing loans for collection by debt collection agencies where the debtor is a private individual. The number of such debt collection cases increased by 4.5 per cent through 2024, but the average principal in these cases declined by 3.2 per cent. The share of non-performing bank loans in the personal customer market has increased in recent years but is still below pre-pandemic levels, and banks' loan losses remain low.

Statistics Norway and Norges Bank estimate that inflation will fall to a level just above the central bank's target of 2 per cent in 2028, while the interest rate level is expected to decline by between 1 and 1.5 percentage points. Unemployment is expected to remain low. These developments will probably help keep the number of debt collection cases and loan defaults down. There is considerable uncertainty associated with economic forecasts.

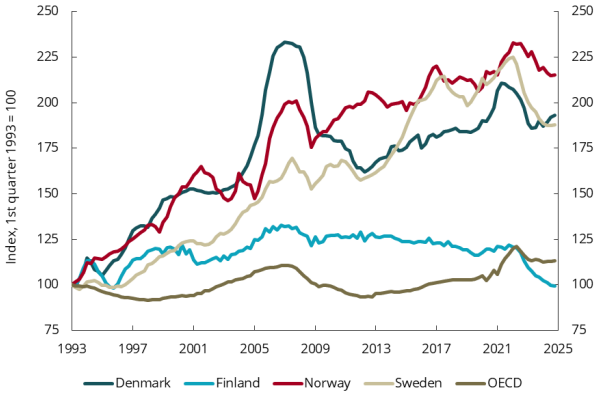
Norwegian households are affected to varying degrees by the higher interest rate level. Their financial resilience also varies. Some households have narrow margins between income and expenses and limited financial buffers to draw on. These households will be particularly vulnerable in the event of a loss of income, higher interest rates or a fall in house prices.

Higher house prices

Developments in house prices and household debt are closely interrelated. When house prices rise, many households will have to take out larger loans to finance home purchases. At the same time, the value of their collateral increases, both for first-time buyers and for households that already own a home, which provides a basis for borrowing more. There is a mutually reinforcing effect between house price inflation and increasing household debt.

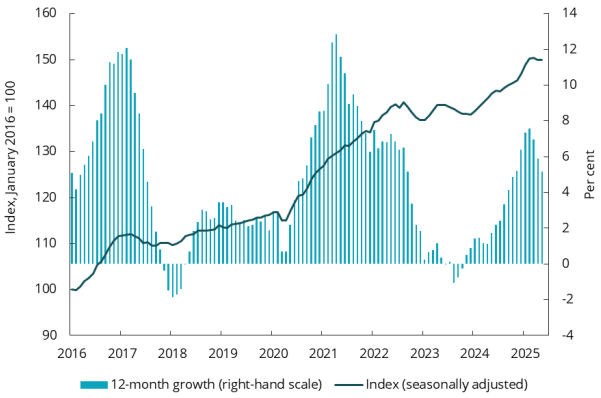
For a long period, house prices in Norway have risen at a faster pace than households' disposable income (chart 2.3). The ratio of house prices to disposable income per capita in Norway was at its highest in 2022. House prices changed little through 2023, while households' disposable income increased. In 2024, house prices and households' disposable income rose at roughly the same rate, and the ratio of house prices to disposable income per capita remained stable at a high level.

Chart 2.3 House prices as a share of disposable income per capita



Last observation: fourth quarter 2024. Source: OECD

Chart 2.4 House prices in Norway



Last observation: May 2025. Sources: Real Estate Norway, Eiendomsverdi and Finn.no

[6] At the end of the first quarter of 2025, 95.0 per cent of households' loans from banks and mortgage companies had no or short fixed-rate periods (up to three months).

Prices of existing homes rose steadily throughout 2024 and, as an annual average, were 3 per cent higher than in 2023. House price growth picked up in January and February this year, before slowing down in March. In April and May, there was a stall in house price growth, adjusted for seasonal variations, and twelve-month growth in May was 5.2 per cent on a national basis (chart 2.4). Increased household purchasing power, the easing of the maximum LTV ratio requirement in the lending regulations that came into force on 1 January, and expectations of interest rate cuts may have contributed to the strong growth in prices of existing homes in early 2025, while the postponement of policy rate cuts, greater uncertainty about the future path of the economy and an already high level of house prices may have gradually dampened the rise in house prices. Activity in the market for existing homes remained high during the first months of the year. Both the number of homes sold and the number put up for sale in the period January to May were around 16 per cent higher than in the same period in 2024.

In the new homes market, there were signs of improvement at the beginning of 2025. Sales of new homes in the first quarter of this year were up 38 per cent compared with the corresponding period last year, while housing starts increased by 31 per cent, albeit from low levels. However, this trend lost momentum in April, leaving both sales and housing starts during the first four months of the year about 20 per cent higher than in the corresponding period in 2024. In addition to the Easter holiday, the postponement of interest rate cuts and increased uncertainty may have contributed to the weaker performance in the new homes market in April.

After a sharp decline in both 2023 and 2024, Statistics Norway and Norges Bank share the expectation that housing investment will decrease by more than 10 per cent this year. According to Statistics Norway, the recent increase in sales of new homes and lower price differences between new and existing homes indicate that more homes will be built in the future. Norges Bank also points out that improved purchasing power among households could boost demand for both existing and new homes. Both Statistics Norway and Norges Bank expect a rise in housing investment over the next few years, projected at between 6 and 8 per cent in 2026, 10 to 15 per cent in 2027 and more than 8 per cent in 2028.

House prices are expected to increase further in the coming years. According to Statistics Norway, low residential construction, expectations of a housing shortage and a further rise in prices, combined with easing of the lending regulations, will exert upward pressure on house prices. The agency estimates that house prices will rise by 7 per cent in 2025 and 5.5 per cent in 2026, and that house price growth will slow to between 2 and 3 per cent in 2027 and 2028. Norges Bank also emphasises that increased purchasing power among households will contribute to higher house prices, while a somewhat higher than expected policy rate will dampen the upturn. According to Norges Bank's estimates, house prices will rise by around 8 per cent this year and in 2026 and by between 5 and 6 per cent in 2027 and 2028.

Future developments in house prices are uncertain and will depend on the access to land, construction costs, population growth, centralisation and developments in interest rates, unemployment and household income. If demand were to increase more than housing supply, there could be a sharper rise in debt and house prices.

NON-FINANCIAL CORPORATIONS

Losses on loans to non-financial corporations represent the most significant risk for most Norwegian banks. As stated in Risk Outlook December 2024, the debt servicing capacity of several main industries was impaired in 2022 and 2023, and the debt ratios of corporations with weak debt servicing capacity increased. There has been a gradual rise in the number of bankruptcies since the pandemic, and in the first quarter of 2025, 1 021 bankruptcy proceedings were initiated for non-financial corporations[7]. Measured as a 12-month moving average, the number of bankruptcies is roughly at pre-pandemic levels. Kredinor reported that the number of debt collection cases against businesses was stable but that the total outstanding amount for collection increased in 2024[8]. A broad selection of large, listed corporations' financial statements for the first quarter of 2025 indicate a slightly positive overall trend in the key figure 'annual profit in per cent of total assets' compared to last year. However, there are significant differences between corporations, and if 'energy and oil service' is excluded, the trend is somewhat negative.

According to the economic barometer for the first quarter of 2025[9] presented by NHO - Confederation of Norwegian Enterprise, the overall market outlook is cautiously optimistic, albeit with significant variation across industries. Figures from Norges Bank's regional network[10] indicated that corporations expected higher growth in the first and second quarters of 2025 than in the preceding quarters. Higher tariffs and the risk of persistent trade disruptions are causing greater uncertainty than normal. Deteriorating macroeconomic conditions and the potential for increased inflation and interest rates driven by higher tariffs and geopolitical fragmentation may undermine corporate profitability. Corporations whose debt servicing capacity has already been impaired may be particularly at risk if interest rates remain high for longer than expected or earnings weaken.

Corporate lending rates

The banks' weighted average lending rate[11] to various industries rose in step with the increase in Norges Bank's policy rate after the pandemic and up to 31 December 2023[12] (chart 3.1). During 2024, the weighted average lending rate was somewhat reduced, while the average lending rate remained unchanged. This may indicate that the interest rate on loans to large corporations has been somewhat reduced, while the interest rate on loans to small and medium-sized corporations is either unchanged or has been raised slightly.[13]

As shown in chart 3.2, the difference between the lending rate and 3-month NIBOR has decreased by 52 basis points from the fourth quarter of 2014 to the first quarter of 2025 for all industries combined. Most of the reduction has taken place after 2020. The decline may be related to the banks' increased net interest income and strong profitability in the period after the pandemic, as well as a sustained decline in the banks' expenses in per cent of total assets. The banks' operating expenses in per cent of total assets were lower in the period 2020–2024 than in the period 2014–2019, see chart 4.3 in the chapter on Norwegian banks. The fact that the banks' lending spread must also cover administrative costs may explain some of the reduction over time. The reduction does not appear to reflect changes in the banks' capital adequacy ratios, as the CET1 capital ratio for the banks combined remained stable in the period 2014–2024 (chart 4.5).

[7] Corporate bankruptcies from Statistics Norway less bankruptcies in financial enterprises
[8] See Kredinor innsikt #1 2025 (in Norwegian only)
[9] Key figures for the Norwegian business sector from NHO (in Norwegian only)
[10] Norges Bank's Regional Network 1/2025.
[11] Here, the banks' lending to Norwegian non-financial limited companies and public limited companies with interest rates specified in the exposure reporting is examined. Both Norwegian banks and foreign branches are included in the reporting. In charts 3.1 and 3.2, a large bank has been excluded from the sample due to an error in the most recent reporting, and the reporting as at 30 September 2024 has been excluded in its entirety in charts 3.1, 3.2 and 3.3.
[12] Reporting takes place annually up to 31 December 2023 and quarterly thereafter.
[13] The corporations' *actual* interest expenses in per cent of interest-bearing debt may differ from the prevailing lending rate if the corporation has fixed the interest rate on parts its borrowing in the fixed income market (see the section on commercial real estate below).

Chart 3.1 Weighted average lending rate to Norwegian non-financial corporations and 3-month NIBOR

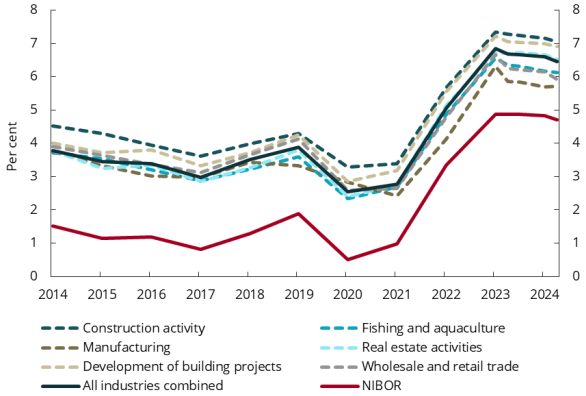
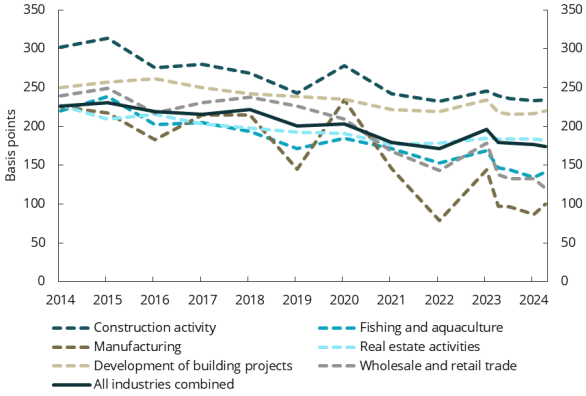


Chart 3.2 Lending spread over 3-month NIBOR, bank loans to Norwegian non-financial corporations

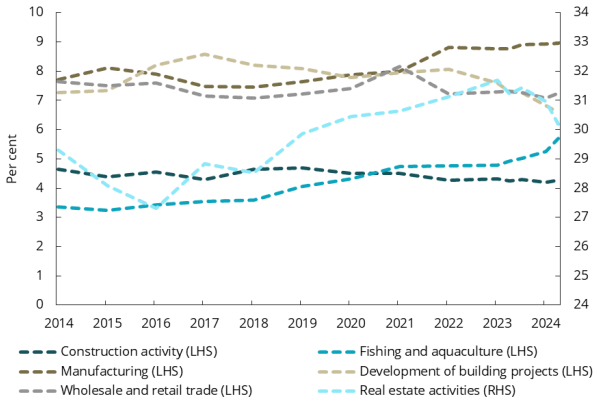


Last observation: first quarter 2025. The nominal interest rate is weighted based on the reported amount of debt drawn, based on figures in the exposure reporting. Sources: Finanstilsynet and Statistics Norway

The difference between the lending rate and NIBOR is often used as an indication of the risk premium in the lending market. It may seem paradoxical that credit risk appears to have increased across several industries in recent years due to corporations' weakened debt servicing capacity, while the average spread between lending rates and NIBOR has declined. The margin on loans to the 'wholesale and retail trade', 'manufacturing' and 'fishing and aquaculture' industries has shown the most pronounced decrease. However, it is demanding to decompose how much of the margin should cover the banks' administrative costs and how much should cover the credit risk premium. In addition, NIBOR should reflect the return a bank requires to provide unsecured loans to another bank, which means that this benchmark already includes a risk premium.[14]

Chart 3.3 shows developments in banks' loans to selected industries as a share of banks' total lending to all industries. The share of lending to 'manufacturing', 'fishing and aquaculture' and 'real estate activities' has increased compared to the period prior to the pandemic. The share of lending to property development companies has declined the most since the pandemic, reflecting a low number of housing starts and weak profitability within the industry. These figures have remained fairly stable over time, but there has been greater variation in lending to 'real estate activities' than to other industries. There was a particular increase in the share of lending to this industry from 2016 to 2023, which was a period marked by low interest rates and rising commercial property prices. As at 31 March 2025, lending to this industry accounted for around 30 per cent of the banks' total lending to non-financial corporations and was by far the banks' largest industry exposure.[15]

Chart 3.3 Loans to selected industries as a share of total lending to Norwegian non-financial corporations



Last observation: first quarter 2025. Source: Finanstilsynet

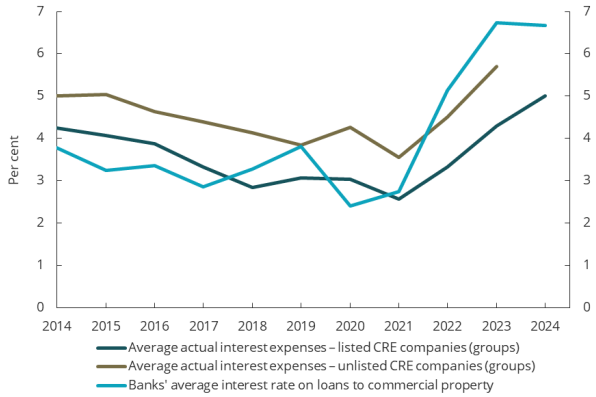
[14] See https://nore-benchmarks.com/about-nibor/ for more information about NIBOR.
[15] Of lending from both Norwegian banks and foreign branches to Norwegian non-financial corporations. 'Real estate activities' is a subcategory of commercial real estate and is in this analysis limited to including the industrial codes 68100 and 68209.

Commercial real estate

The commercial real estate market can be categorised according to *activity* (renting/operating, buying/selling and project development), *type of property* (office, retail, warehouse/logistics, hotel/ restaurant, etc.) and *location* (central or less central). Publicly available statistics and information on rental and sales prices, vacancy rates, yield targets, etc. are generally only available for commercial properties with prime locations in the largest Norwegian cities. In Oslo, there was a decrease in the volume of signed lease contracts in 2024. Office vacancy rates increased throughout 2024 and in the first quarter of 2025. Although the vacancy level in 'Central Oslo' is still relatively low, it has not been higher since 2018. In 'Oslo's eastern peripheral areas', office vacancy rates have increased over the past couple of years from approximately 8 to 13 per cent. Average rental prices rose slightly in 2024 (around 2 per cent), but there were significant differences between districts.[16]

On average, commercial real estate (CRE) companies have high debt levels relative to earnings and are therefore particularly vulnerable to interest rate increases. In 2022 and 2023, the banks' average nominal interest rate on loans to CRE companies increased by approximately 4 percentage points, while unlisted and listed CRE companies' estimated *actual* interest expenses in per cent of interest-bearing debt rose by 2.1 and 1.7 percentage points, respectively (chart 3.4).[17] An important reason why actual interest expenses increased less than the banks' lending rates was that in the years prior to the interest rate hikes, many companies fixed the interest rate on parts of their debt at very low levels. In 2024, the banks' average lending rate remained more or less unchanged, while listed companies' estimated actual interest expenses increased by around 0.7 percentage points.[18] This indicates that fixed-rate contracts entered into at low interest rate levels were replaced by contracts with higher interest rates.

Chart 3.4 Banks' average lending rate and Norwegian CRE companies' actual interest expenses



Sources: Listed CRE companies' annual and interim financial reports and Finanstilsynet

Remaining fixed-rate contracts entered into at low interest rates will expire over the coming years. CRE companies that take out new loans or have to renegotiate loan and fixed-rate contracts now have to pay an average interest rate of between 6 and 7 per cent.[19] Many companies have to pay higher interest rates than this.

So far in 2025, the policy rate has remained unchanged, while short-term interest rates (NIBOR) have declined slightly and long-term interest rates have increased marginally. Norges Bank's policy rate path, revised upward at the end of March this year, indicates that the policy rate may be gradually reduced to 3 per cent by the end of 2028. If this proves to be the case and the spreads between the

[16] Sources: See, for example, Malling, Arealstatistikk, Union, Akershus Eiendom and CBRE Research (in Norwegian only).
[17] Actual interest expenses are defined as the year's recognised net interest expenses in per cent of average interest-bearing debt throughout the year. It is the actual interest expenses that determine the individual company's interest servicing capacity. Sources: Finanstilsynet and listed CRE companies' annual and interim financial reports
[18] Annual accounts for 2024 for non-listed companies are not yet available.
[19] For example, the banks' average weighted interest rate on new loans with a loan-to-value (LTV) ratio of less than 55 per cent for financing office properties in Oslo was 2.7 per cent in the second quarter of 2020, while it was 5.9 per cent in the latter part of the second quarter of 2025. Source: UNION M2 Analyseportal. According to figures from Finanstilsynet's exposure database, which includes practically all the banks' CRE loans (regardless of their LTV ratio), the weighted lending rate increased from around 2.4 to 6.7 per cent during the same period.

policy rate on the one hand and NIBOR and long-term interest rates on the other hand equal the average for the last decade, risk-free long-term interest rates can be estimated to be around 4.3 per cent and NIBOR approximately 3.9 per cent at the end of 2028.[20]

Borrowers must also pay a credit risk premium, which can vary significantly across companies.[21] Today, the banks' average interest rate on commercial property loans ranges between 6 and 7 per cent, while NIBOR is around 4.6 per cent. This implies an average credit risk and administration margin of between 1.4 and 2.4 percentage points, which is lower than in the years prior to the interest rate increases, when credit risk within commercial real estate was generally considered to be very low. As mentioned above (see chart 3.2 and accompanying text), the reduction may be partly due to lower administrative costs.

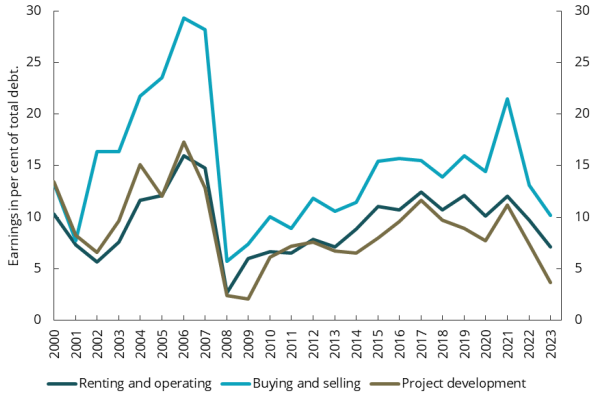
Based on these assumptions and estimates, the average lending rate for listed and unlisted CRE companies could range between 5.3 and 6.3 per cent at the end of 2028. At year-end 2023, an estimated 40 per cent of unlisted CRE companies' debt was issued to companies with weak debt servicing capacity.[22] If unlisted companies showed a similar performance as listed CRE companies in 2024, the proportion of companies with a weak debt servicing capacity increased during the year. This indicates that many CRE companies now have so much debt that they have, or may have, problems paying interest and instalments.

Developments in main categories of commercial property

In 2022 and 2023, all the main groups of CRE companies experienced a sharp decline their debt to earnings ratio debt (chart 3.5). If the earnings of unlisted companies developed along the same lines as those of listed CRE companies in 2024, their debt servicing capacity could approach the low levels seen during the financial crisis in 2008.

On average, CRE companies' debt servicing capacity was better before the financial crisis than before the interest rate hikes in the latter part of 2021. In the years following the financial crisis, there was a general improvement in companies' debt servicing capacity as a result of falling, and eventually very low, interest rates and generally strong demand for commercial premises and elevated rental prices. Developments over the coming years remain highly uncertain. Even if interest rates were to decline significantly, many CRE companies may face several years of weak debt servicing capacity, rather than just one or two years as experienced during the financial crisis.

Chart 3.5 Earnings in per cent of total debt. [23] Limited liability companies (non-consolidated accounts)



Source: Finanstilsynet

[20] This is marginally higher than the market's expectation for NIBOR at end-March 2028 (3.7 per cent). Sources: Makrobond/Akershus Eiendom, Mandagsmakro.
[21] In addition to the credit risk margin, interest income must cover costs associated with monitoring and administering lending activity.
[22] See chart 19 in Risk Outlook December 2024.
[23] Earnings are defined as 'Profit before changes in the value of financial assets and before tax'. Total debt includes all debt, including intra-group debt.

At the end of 2023, the three industry groups in chart 3.5 had total debt of around NOK 2 300 billion, including intra-group debt. 'Renting and operating' accounted for 73 per cent of total debt, 'project development' for 18 per cent and 'buying and selling' for 9 per cent. Most of the debt is in companies located in central areas, but CRE companies have operations throughout Norway.[24] There can be major differences between companies both within and between different segments and regions. However, as illustrated in chart 3.5, the three main categories have shown broadly aligned trends in debt servicing capacity since the early 2000s. The same largely applies to regionally distributed exposures within the three categories. There are currently no accounting figures available after 2023 for unlisted CRE companies. For many CRE companies, 2024 and the first part of 2025 have been challenging, especially within 'project development'. Norwegian banks' total lending to this CRE segment is limited, although a few small banks have a significant exposure.

Future prospects

If interest rates develop in line with Norges Bank's policy rate path, CRE companies' actual interest expenses will remain high over the next few years. If the rise in interest expenses is not offset by higher rental income, many companies will face an extended period of weak debt servicing capacity. and a significant risk of reduced liquidity and solvency buffers. Postponement of necessary investments and instalment payments and/or injections of new equity may enable companies with weak debt servicing capacity to remain financially viable for several years. Prolonged inability to service debt or make investments may lead to excessive debt accumulation and run-down, outdated and uncompetitive premises. The companies' creditors, which are mainly banks, must also take this risk into account in their assessments.

Earnings and return on investments in commercial real estate[25]

CRE companies' interest expenses have increased markedly in recent years, which has contributed to weakening the companies' debt servicing capacity. As a result of higher interest rates, commercial real estate investors' opportunity cost has also increased. Long-term (virtually) risk-free rates, such as the yield on 10-year Norwegian government bonds, are often used as benchmarks for commercial real estate investments. If an investor achieves the same current return from investing in risk-free fixed-income securities as from investing in commercial real estate, the latter becomes a less attractive option. If the *value of* the property increases, the investment may still provide a higher yield than the risk-free rate over time, see more about this below.

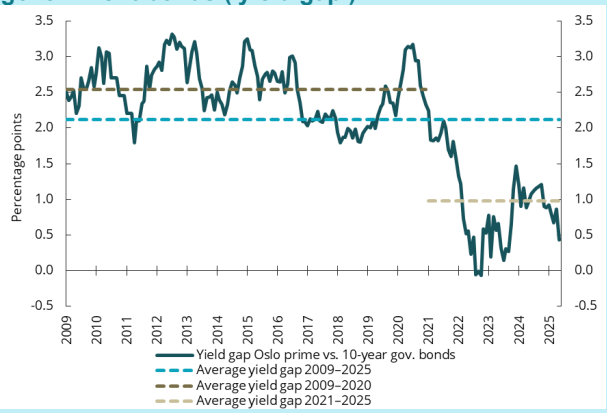
During the period 2009–2021, investors in 'Oslo prime office' demanded an average yield that was around 2.5 percentage points higher than the risk-free long-term rates (a 'yield gap' of 2.5 percentage points) (chart 3.6).[26] From late 2021 until now, the yield gap has on average been lower than 1 percentage point. This is low both in historical terms and in light of the prevailing uncertainty about future developments.

[24] If 'central areas' are defined as Oslo, Lysaker, Bergen, Trondheim and Stavanger, and the rest of the country is defined as 'less central areas', around two-thirds of CRE companies' total debt is in 'central areas' and around one-third in 'less central areas'. It should be noted that 'central areas' also includes peripheral areas and other areas outside the most central parts of the largest cities, such as 'Oslo prime office', see example in box.

[25] The example used here is 'Oslo prime office', which is usually assumed to be the most attractive office location in Norway with the highest rental income per square metre. There can be major differences between central and less central areas, office property and other commercial property (shopping centres, hotels, warehouses/logistics, etc.), whether the company that owns the commercial property is listed or not, whether the owners are private individuals, whether the real estate company is large or small, etc. However, the main principles are the same for all types of *rental activity*. During periods of significant and abrupt changes in operating conditions, *project development* (e.g. in the cabin and holiday home market) is often particularly vulnerable. As an example, having a large number of half-finished, unsold property projects at a time when both interest expenses and other expenses have risen sharply and are unlikely to fall markedly over the next few years is more risky than having a fixed monthly net cash flow from rental activity.

[26] The calculations are based on *pre-tax* figures for both commercial real estate investments and investments with a risk-free return. Furthermore, it is assumed that future consumer price index adjustments of rental prices are included in the estimated value of the commercial property (which in this example is NOK 100 million) and thus in the 4.5 per cent yield.

Chart 3.6 Difference between the yield on 'Oslo prime office' and the yield on 10-year Norwegian government bonds ('yield gap')



Last observation: end-May 2025. Sources: Akershus Eiendom, LSGE Datastream and Finanstilsynet.

Net rental income (the numerator in the yield equation) equals gross rental income less direct costs related to management of the commercial property ('ownership costs'). If the property is mortgaged, which is the case for a large proportion of Norwegian commercial properties, rental income must also cover net interest expenses. Based on the current interest rate level and 60 per cent debt financing, interest expenses will account for around 80 per cent of the 4.5 per cent yield ('Oslo prime office'). Based on the interest rate level prior to the interest rate hikes, all else equal, the corresponding share was around 25 per cent. In addition to ownership costs and net interest expenses, rental income must usually also cover a certain proportion of the CRE company's overheads, such as salary and administrative costs. The companies may also have some income from activities unrelated to rental.

Over time, CRE companies must invest to maintain their buildings and furnishings in a satisfactory and modern condition, aligned with the preferences and needs of their tenants. Commercial buildings must also fulfil climate requirements and other requirements that may change as time progresses. These investments can be financed on an ongoing basis through operations, by taking on debt that must be repaid, and/or by the owners injecting new equity.

To arrive at an estimate of the property's *total pre-tax earnings,* investors must deduct the above cost elements from net rental income.[27] Provided that the above and the subsequent assumptions are met, total pre-tax earnings can be calculated as follows (stylised example based on an investment in 'Oslo prime office')[28]:

(Estimated) value of the commercial property	NOK 100.0 million
Gross rental income (GRI)	NOK 4.95 million[29]
- Ownership costs (9 per cent of GRI)	NOK 0.45 million[30]
= Net rental income	NOK 4.50 million
Net yield	*4.50%*
- Net other costs (6 per cent of GRI)	NOK 0.30 million[31]

[27] If the property generates taxable gains, tax must also be paid.
[28] It should be emphasised that this is a stylised example and that the results may differ if the assumptions are changed.
[29] In the example, the yield is 4.50 per cent and the estimated value of the commercial property NOK 100 million. This means that net rental income is NOK 4.5 million. It is also assumed that ownership costs amount to 9 per cent of gross rental income, which in turn means that gross rental income is 4.5 / 0.91, i.e. NOK 4.95 million.
[30] As an example, *Entra ASA's* ownership costs accounted for around 9 per cent of gross rental income in 2024. Source: *Entra ASA*'s annual report for 2024. For small CRE companies, the cost of ownership is often higher. As an example, calculations carried out by RSM, an audit and advisory firm for the SME market, show that the median cost of ownership is 15 per cent of median rental income per square metre of office property. Source: RSM, ownership costs and overheads for commercial property (in Norwegian only)
[31] This cost component may vary between companies. For *Entra ASA*, property-related overheads less other income represented around 6 per cent of gross rental income in 2024. Source: *Entra ASA*'s annual report for 2024. For less centrally located commercial properties, the cost ratio is on average significantly higher. As an example, calculations carried out by RSM (see also footnote 30), median overheads represent 16 per cent of median rental income per square metre of office property. Source: RSM, ownership costs and overheads for commercial property. In this example, it is assumed that net other costs (overheads) come to 6 per cent of gross rental income.

- Necessary average annual investments	NOK 1.10 million[32]
= Earnings on the property before interest and tax	NOK 3.10 million[33]
Alternative earnings: Risk-free interest income before tax	NOK 4.09 million[34]

If the property is financed by a 60 per cent mortgage:

Earnings on the property before interest and tax	NOK 3.10 million
- Net interest expenses (6 per cent borrowing rate)	NOK 3.60 million
= Earnings on the property after interest and tax	- NOK 0.50 million
Alternative earnings: Risk-free interest income before tax	NOK 1.64 million[35]

Even though the property in this example is financed 100 per cent by equity, which means that there are thus no interest expenses, annual earnings before tax will be significantly lower than the yield on risk-free government bonds As an example, if the property is financed 60 per cent by debt, it will generate negative annual earnings before tax at the current average interest rate level . However, if *the value of* the property increases, the investors' total yield before tax could be positive.

In the years prior to the interest rate increases starting in autumn 2021, very low interest rates, rising property values and ample access to credit meant that many CRE companies took on a lot of debt. Most companies were able to service their debt, while investors generally received healthy yields on their real estate investments. Future developments are uncertain and depend on several factors, including interest rate trends, demand for office space and tenants' debt servicing capacity.

[32] It is assumed that one-third of the commercial property's value is attributable to buildings, furnishings, infrastructure etc., which are depreciated on a straight line basis over 30 years. This means that two-thirds of the property's value is linked to the value of the land, which is assumed to have lasting value in the sense that it is not subject to obsolescence, aging, etc.

[33] Net rental income less net other expenses less average annual investments. Most lease contracts include a rent escalation clause based on the Consumer Price Index (CPI). It is assumed here that future CPI adjustments of rents are reflected in the (estimated) property value of NOK 100 million.

[34] Assuming that the property is financed 100 per cent by equity and that the risk-free rate equals the yield on 10-year Norwegian government bonds as at 2 June 2025 (4.09 per cent).

[35] Assuming that the property is financed 40 per cent by equity and 60 per cent by debt (6 per cent lending rate), and that the risk-free rate equals the yield on 10-year Norwegian government bonds as at 2 June 2025 (4.09 per cent).

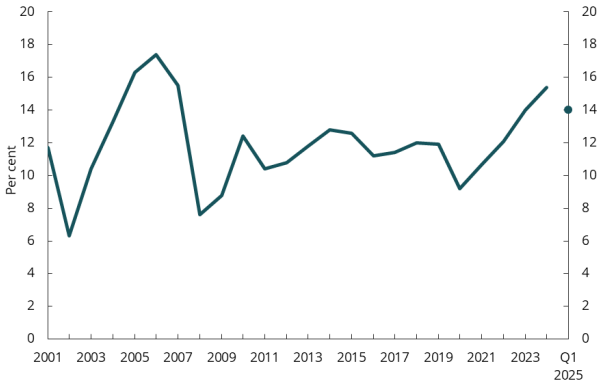
NORWEGIAN BANKS

Profitability, liquidity and solvency

Norwegian banks have enjoyed strong profitability in recent years (chart 4.1). Annualised return on equity at end-March 2025 was somewhat lower than at year-end 2024. The reduction can partly be explained by the fact that several banks recorded significant gains from the merger between Fremtind Forsikring and Eika Forsikring in 2024. On average, the volume-weighted return on equity was higher for Norwegian banks in the period 2002 to 2024 than for Swedish and Danish banks (chart 4.2). Norwegian banks' return has also been more stable over time, as measured by the standard deviation for the return on equity.

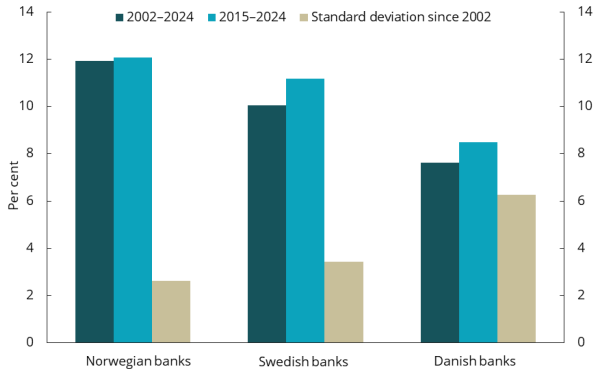
The last time the return on equity was at a similar level in Norwegian banks was during the years prior to the global financial crisis, after which the banks' return declined by close to 8 percentage points in the course of one year. Over time, effective competition may also contribute to reducing the banks' net interest income and result in a somewhat lower return on equity.

Chart 4.1 Annual return on equity in Norwegian banks



Figures for Q1 2025 are annualised. Source: Finanstilsynet

Chart 4.2 Return on equity in all Norwegian, Swedish and Danish banks

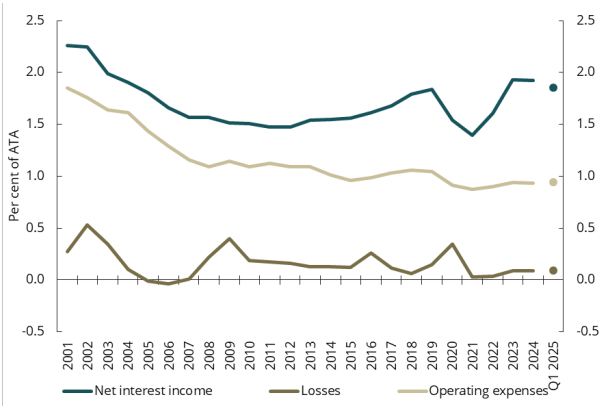


Sources: Finanstilsynet, Finansinspektionen (Swedish FSA) and Finanstilsynet (Danish FSA)

Even after the banks' net interest income stabilised in the first quarter of 2024, the rise in profits continued, driven by reduced operating expenses (chart 4.3). Annualised net interest income at end-March 2025 was somewhat lower than at year-end 2024.

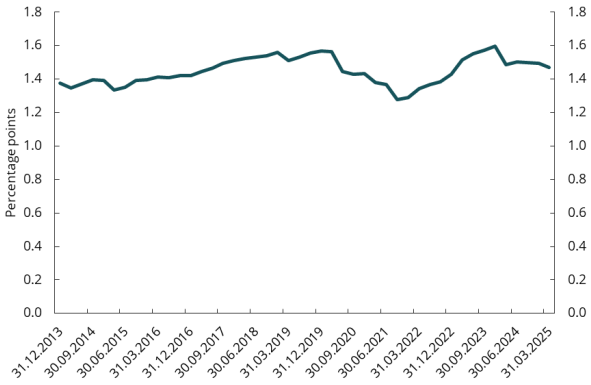
The difference between the average interest rate on banks' assets and the interest rate on banks' liabilities has narrowed slightly over the past two quarters (chart 4.4). At end-March, this difference was 2 basis points higher than the average for the period since 2014. A change of just a few basis points in this interest margin would have a significant impact on the banks' net interest income.

Chart 4.3 Annual profits in Norwegian banks in per cent of average total assets



Figures for Q1 2025 are annualised. Source: Finanstilsynet

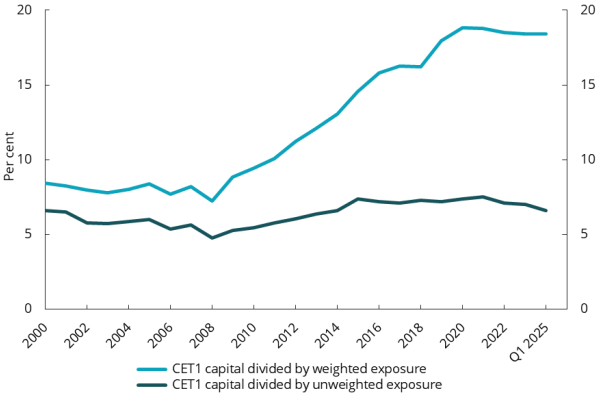
Chart 4.4 Difference between interest rate on banks' assets and interest rate on banks' liabilities



Figures for the 24 largest banks. Source: Finanstilsynet

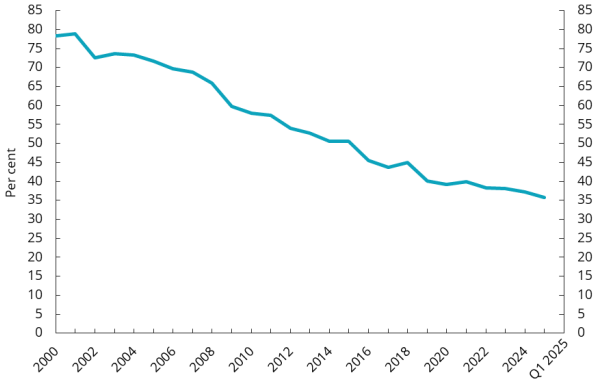
Measured by the leverage ratio, Norwegian banks' equity has remained stable over a long period of time (chart 4.5). As a share of total assets, common equity Tier 1 (CET1) capital came to 6.7 per cent in 1999 and 7.0 per cent at the end of 2024. The risk-weighted CET1 capital ratio has also been stable in recent years after a significant increase up until 2019. Risk-weighted exposure as a share of total assets (average risk weight) has fallen steadily over time (chart 4.6). Once the final part of the post-financial crisis reforms (CRR3) is implemented in Norway, the ratio of risk-weighted assets to total assets may change further.

Chart 4.5 CET1 capital divided by weighted and unweighted exposure



Source: Finanstilsynet

Chart 4.6 Risk-weighted exposure as a share of total assets

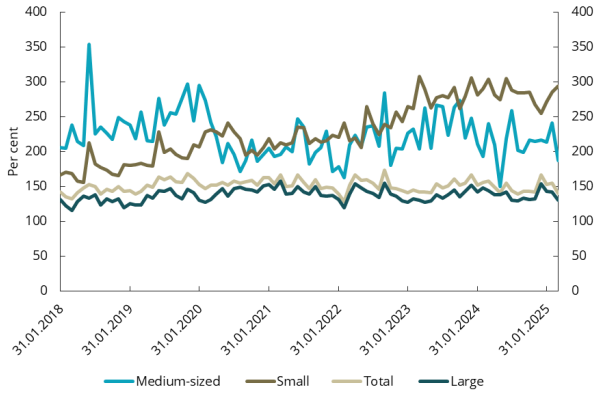


Source: Finanstilsynet

Liquidity and funding

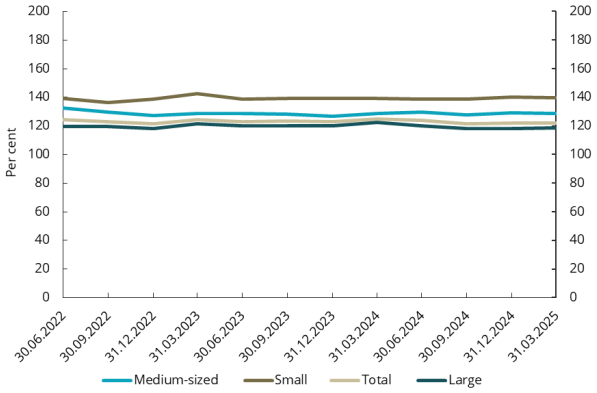
All Norwegian banks met the minimum liquidity reserve requirement (LCR) and the net stable funding requirement (NSFR) at end-March 2025 (charts 4.7 and 4.8). There is wide variation in banks' LCR values and thus also in their margins to the minimum requirement. The LCR for small and medium-sized banks is generally more volatile than for the large banks. Volatility occurs becauset changes in individual items have a greater effect on small banks and that large banks manage their liquid funds more actively. This probably partly explains why small and medium-sized banks have a wider margin to the minimum requirement. There is less variation between banks in the NSFR than in the LCR. This is partly due to the fact that the NSFR reflects the entire balance sheet, and that Norwegian banks' balance sheets mainly consist of deposits and loans. However, the large banks have a higher proportion of wholesale funding, which means that their NSFR is generally lower, since wholesale funding is weighted lower than deposits when calculating the NSFR.

Chart 4.7 Total LCR for Norwegian banks, weighted average



Source: Finanstilsynet

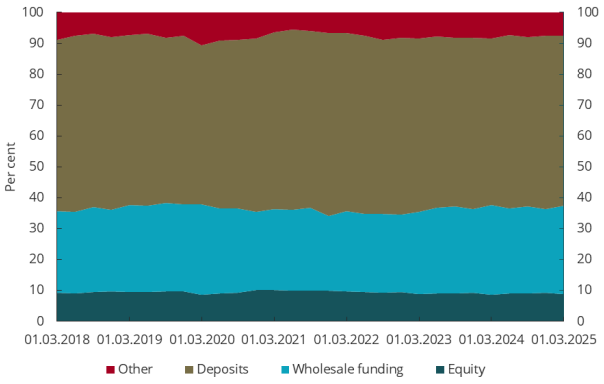
Chart 4.8 Total NSFR for Norwegian banks, weighted average



Source: Finanstilsynet

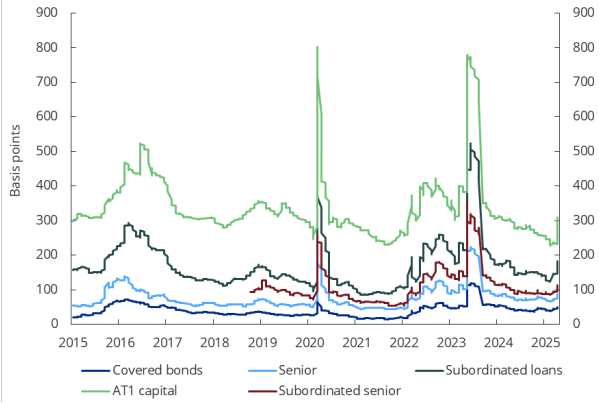
Norwegian banks are financed by deposits, wholesale funding and equity. The distribution between the different types of financing as a share of total assets has been relatively stable over time (chart 4.9). The share of deposits increased slightly during the pandemic years. Since the end of 2021, risk premiums for banks' long-term wholesale funding have increased (chart 4.10). Underlying money market rates have also risen. In combination with higher risk premiums, this makes it far more expensive to raise new funding now than a few years ago and increases banks' funding costs.

Chart 4.9 Banks' funding as a share of total assets



Source: Finanstilsynet

Chart 4.10 Risk premium on Norwegian banks and mortgage companies' 5-year bond funding over 3-month NIBOR



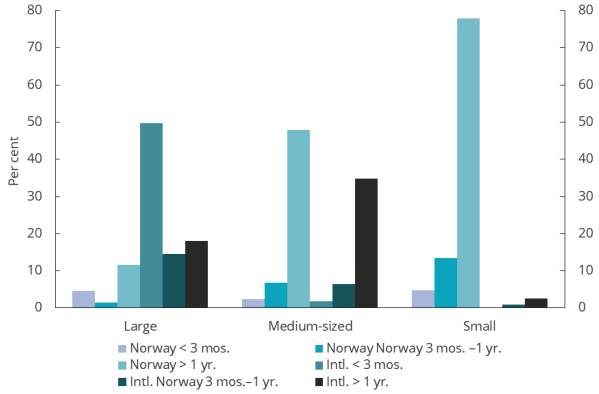
Source: Nordic Bond Pricing

The banks and mortgage companies' wholesale funding has a considerably shorter maturity than long-term loans to the banks' customers. Short maturities increase the refinancing risk, since the entity has to obtain new funding more frequently. Refinancing risk may entail both higher costs and difficulties in refinancing wholesale funding as it reaches maturity. Market turmoil and increased uncertainty could dampen investors' willingness to invest and pose a significant risk to Norwegian banks.

The maturity of a major part of Norwegian banks and mortgage companies' wholesale funding[36] is longer than one year (chart 4.11). Small banks' wholesale funding is also predominantly from Norwegian sources. In a historical perspective, domestic funding has been more stable during volatile times. The very high proportion of short-term funding from abroad for the group of large banks is largely driven by DNB Bank and stems partly from deposits from US money market funds and the bank's activity in the commercial paper market. Small banks predominantly rely on long-term funding from domestic sources, while the group of medium-sized banks primarily obtain long-term funding from both domestic and international sources. Norwegian banks and mortgage companies have generally had ample access to funding over the past few months.

[36] Including interbank activity.

Chart 4.11 Wholesale funding by maturity and domestic/international sources as at 31 March 2025



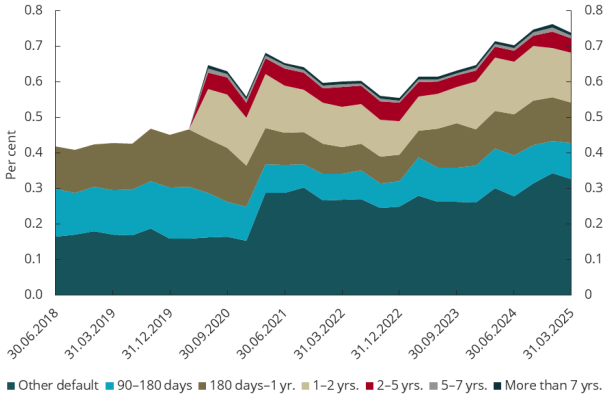
Source: Finanstilsynet

Credit risk

The share of loans to households classified as non-performing has increased slightly in recent years (chart 4.12). In relative terms, loans that have been non-performing for 2-5 years and 5-7 years show the most pronounced increase. These groups of non-performing loans have grown by 50 and 46 per cent, respectively, over the 12 months ending on 31 March, but from low levels. The majority of non-performing loans are in the category 'other default'[37].

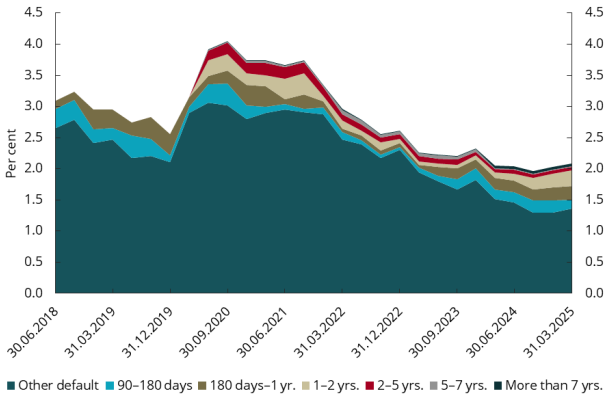
The share of non-performing corporate loans has been declining for an extended period (chart 4.13). This is due to a reduction in loans in the 'other default' category, which in recent years has accounted for almost all non-performing loans to the corporate market. Payment defaults have increased by 22 per cent during the past year.

Chart 4.12 Non-performing household loans by period of default



Data for default in excess of one year were available from 30 June 2020. Source: Finanstilsynet

Chart 4.13 Non-performing corporate loans by period of default

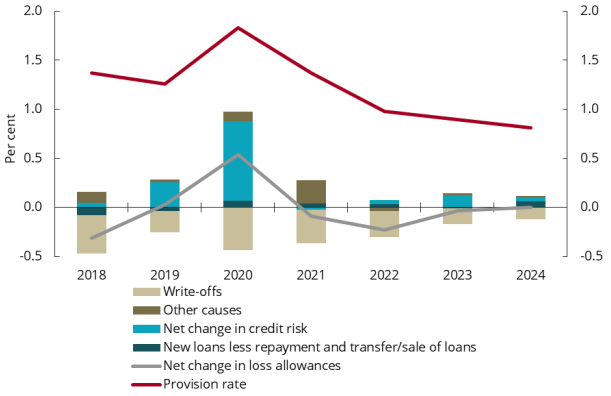


Data for default in excess of one year were available from 30 June 2020. Source: Finanstilsynet

The banks' loss allowances have been reduced in recent years (chart 4.14). Losses for a period comprise the net change in loss allowances and impairment losses on loans recognised directly in the income statement.

[37] These are loans where there is no payment default exceeding 90 days, but the bank considers them to be in default for other reasons.

Chart 4.14 Changes in loss allowances and provision rate



Source: Finanstilsynet

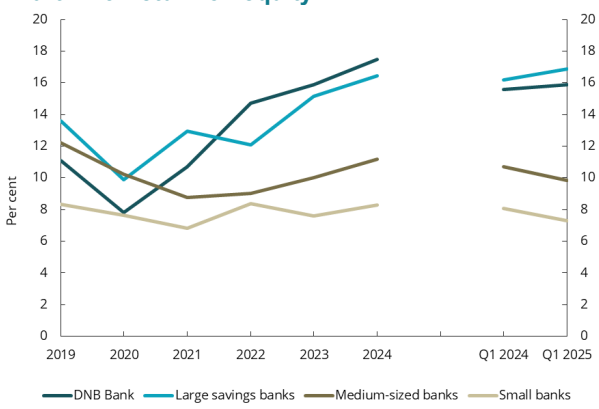
Developments in groups of banks

There are large differences between banks. DNB Bank stands out from most other Norwegian banks due to its wide range of operations. Since the bank is significantly larger than other banks, developments in DNB have a major impact on aggregated figures. Developments in profitability in recent years are therefore discussed below for three groups of banks[38] and for DNB Bank separately.

As shown in chart 4.15, all groups of banks have seen a marked improvement in profits in the years following the outbreak of the pandemic in 2020. DNB Bank and the six largest savings banks have recorded the strongest rise in profits. The same banks experienced the greatest decline in profits in 2020, mainly as a result of impairment losses on loans. During the period from 2021 to 2024, net loan losses were low for the large banks (chart 4.17). This is due to the fact that previous impairment losses were reversed and that there were limited new losses in the period.

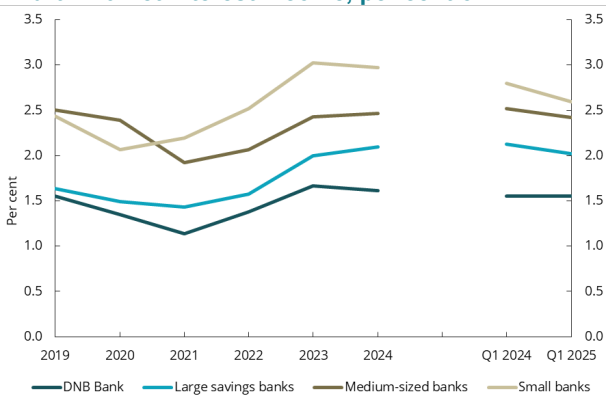
The rise in interest rates from the second half of 2022 contributed strongly to the improvement in the banks' profits from 2021 to 2024. The rise in net interest income was significant for all groups of banks (chart 4.16). Apart from in the largest savings banks, net interest income in per cent of total assets stabilised in 2024.

Chart 4.15 Return on equity



Source: Finanstilsynet

Chart 4.16 Net interest income, per cent of ATA



Source: Finanstilsynet

A positive trend in operating expenses and low losses have been the key drivers behind Norwegian banks' strong profitability (charts 4.17 and 4.18). However, both cost developments and, not least, cost *levels* vary considerably across banks. As shown in chart 4.18, total operating expenses have been fairly stable relative to total assets for large and medium-sized banks since 2020, while expenses have

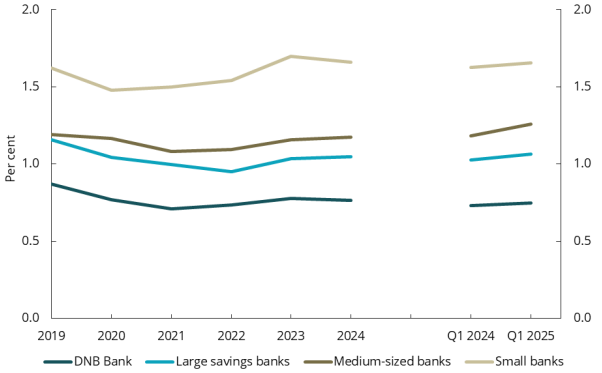
[38] Large savings banks: the five large regional savings banks, medium-sized banks: other banks with total assets in excess of NOK 10 billion, small banks: banks with total assets below NOK 10 billion.

risen more than total assets in the small banks. The increase for the small banks can largely be attributed to higher salary costs.

Chart 4.17 Loan losses, per cent of ATA

Source: Finanstilsynet

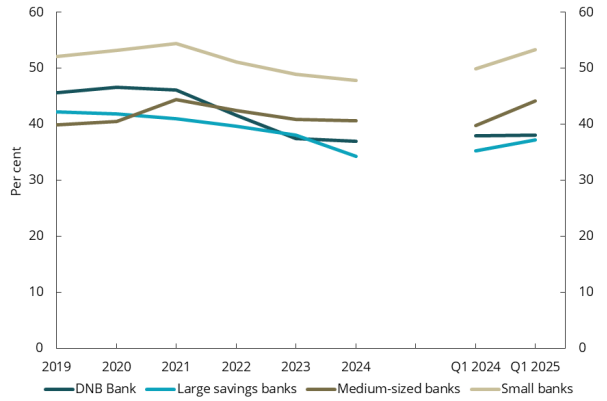
Chart 4.18 Operating expenses, per cent of ATA



Source: Finanstilsynet

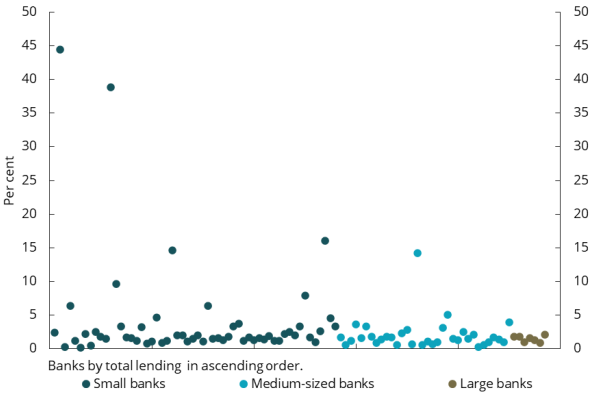
Measured as a share of operating income, operating expenses are significantly higher in small banks (chart 4.19). The largest savings banks have experienced a particularly positive trend in recent years and, on average, have a lower cost level than DNB Bank. Many years of streamlining and digitalisation have also contributed to Norwegian banks, as a group, maintaining a low cost level compared with banks in most other European countries.

Chart 4.19 Cost/income ratio



Source: Finanstilsynet

Chart 4.20 Non-performing loans as a share of total loans



Source: Finanstilsynet

Norwegian banks have recorded low losses as a share of total assets in recent years. However, non-performing loans have been higher in small banks as a group (chart 4.20). These non-performing loans are concentrated to a few banks. The level of non-performing loans is also generally low in most small banks.

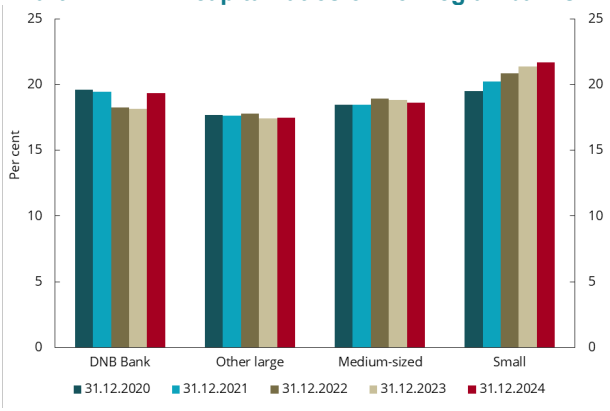
There are certain characteristics of small banks' loan portfolios that, over time, will result in higher volatility in losses and thus also higher expected losses. As an example, the portfolios are less diversified and have greater geographical concentration. In addition, small banks have a higher exposure to the construction industry, where loan losses have increased in recent years due to a sharp decline in housing investment.

Small banks have higher capital ratios and wider margins to the capital requirements than large banks when capital is measured both as a share of risk-weighted assets and as a share of unweighted assets (charts 4.21 to 4.24). This variability must probably be viewed in light of differences in owner-ship and funding structures.

Large banks often have better access to the capital markets and greater opportunities to raise equity and wholesale funding by issuing commercial paper, bonds and hybrid capital in domestic and foreign

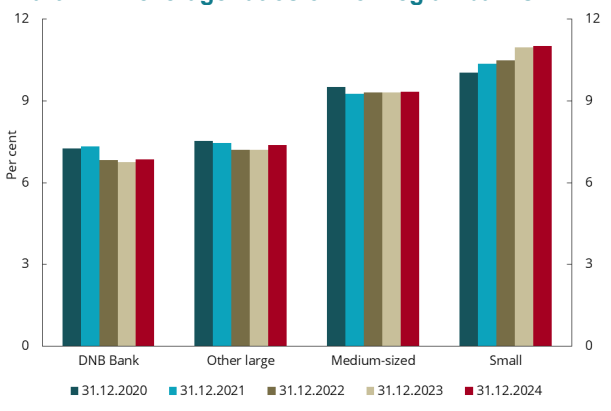
money and capital markets. This means that they usually have a more diversified funding structure than small banks, with a higher proportion of wholesale funding. Small banks often have less flexibility in their choice of funding sources and rely more heavily on deposits and equity for funding.

Chart 4.21 CET1 capital ratios of Norwegian banks



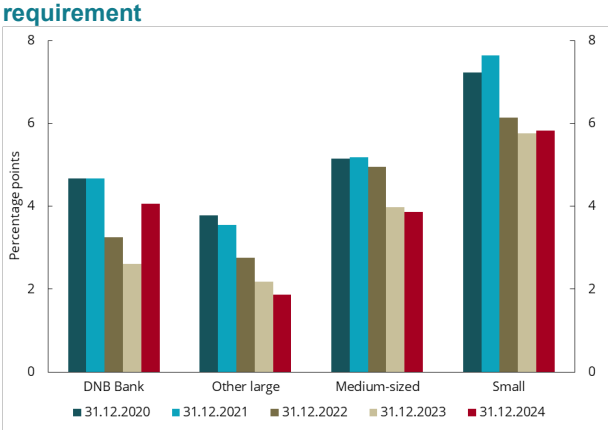
Source: Finanstilsynet

Chart 4.22 Leverage ratios of Norwegian banks



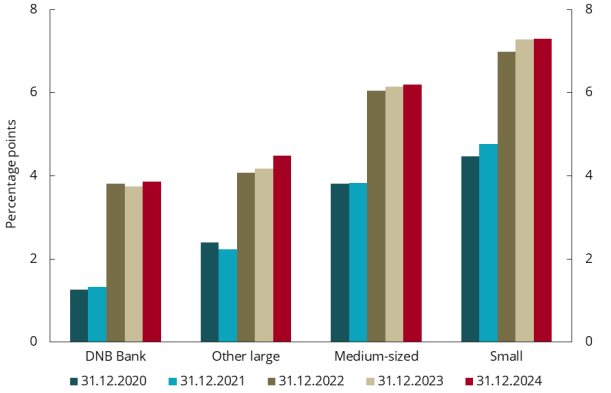
Source: Finanstilsynet

Chart 4.23 Median margin to the CET1 capital requirement



Source: Finanstilsynet

Chart 4.24 Median margin to the leverage ratio requirement



*The minimum requirement is 3 per cent. The buffer requirement of 3 per cent for systemically important Norwegian banks and 2 per cent for other Norwegian banks was dispensed with when the EU banking package (CRR 2 and CRD V) entered into force in Norway from 1 June 2022. Source: Finanstilsynet

Risk weights – calculation methods

The banks' capital adequacy can be calculated as a ratio of risk-weighted exposure and represents the denominator in the capital adequacy fraction. Risk weights are determined per exposure, either as fixed rates for different types of loans, the 'standardised approach', or based on the banks' own estimates of probability of default (PD) and loss given default (LGD), the 'IRB approach'.

Use of the IRB approach is subject to approval by the supervisory authority and entails comprehensive requirements regarding banks' underlying data, estimation methods and control systems, as well as the supervisory authority's oversight procedures. As an example, PD estimates in each risk category shall be based on default rates measured over good and bad years, while LGD shall reflect loss rates during a severe economic downturn. Margins of conservatism shall be added to the estimates to reflect the uncertainty of the estimation. For Norwegian banks, it is particularly challenging that the data underlying the estimates stem from a period of generally strong economic performance in Norway, with low levels of default and losses in the banking sector.

Residential mortgages

For the banks using the standardised approach, the changes to the capital adequacy framework (CRR3), which came into force in Norway on 1 April 2025, entail significantly lower risk weights for residential mortgages than under the previous regulations. For loans within 55 per cent of collateral value, the risk weight has been reduced from 35 to 20 per cent, while the risk weight for loans with a higher loan-to-value ratio gradually increases to 75 per cent[39]. In the previous regulations, the risk weight was 35 per cent for loans within 80 per cent of collateral value. The average risk weight for residential mortgages before support factors was just over 40 per cent for banks using the standardised approach at end-March 2025.

For the IRB banks, reported figures show that the risk weight for residential mortgages ranges from around 5 per cent for loans with the lowest measured risk to over 100 per cent for loans with high measured risk. The average risk weight for performing residential mortgages from Norwegian IRB institutions (including covered bond issuing entities) was 22 per cent at year-end 2024. CRR3 basically entails somewhat reduced risk weights for IRB banks as a result of an adjustment in the calculation formula.

Due to high risk in the housing market, which is not reflected in the IRB banks' data, the Ministry of Finance has increased the minimum requirement for the average risk weight from 20 to 25 per cent from 1 July 2025 in line with Finanstilsynet's advice. This level corresponds to the risk weight for a loan with a 60 per cent loan-to-value ratio according to the new standardised approach. The minimum level also applies to foreign banks' residential mortgages in Norway[40]. Banks with an average risk weight below the minimum level calculate an add-on to the total risk-weighted exposure amount. This will represent a minor change for Norwegian banks (which have average risk weights of 19-24 per cent) but will have a pronounced effect for one foreign bank operating in the Norwegian market. The Swedish Financial Supervisory Authority (Finansinspektionen) introduced a similar risk weight floor for residential mortgages in Sweden in 2018 and has announced that it will be retained for two years from year-end 2025.[41]

Corporate loans

With respect to corporate loans, the level of risk weights is generally higher and shows greater variation – both within each IRB bank and between banks – but the majority of loans have a risk weight between 10 and 80 per cent[42] (chart 4.25). Norwegian IRB banks' average risk weight for corporate loans ranges between 35 and 60 per cent among the banks using the advanced IRB approach with their own estimates of loss given default (LGD). Most Norwegian IRB institutions/banks use this approach, while one bank uses the foundation IRB approach and regulatory LGD estimates and has a somewhat higher risk weight.

CRR3 entails that the use of own LGD estimates is restricted for lending to the largest enterprises, and that there is somewhat greater scope for taking collateral into account in the regulatory LGD estimates. Furthermore, CRR3 includes somewhat stricter requirements for the lowest PD and LGD estimates but also reduced risk weights as a result of a technical change in the risk weight calculation. The Ministry of Finance has set a floor for average risk weights of 35 per cent.

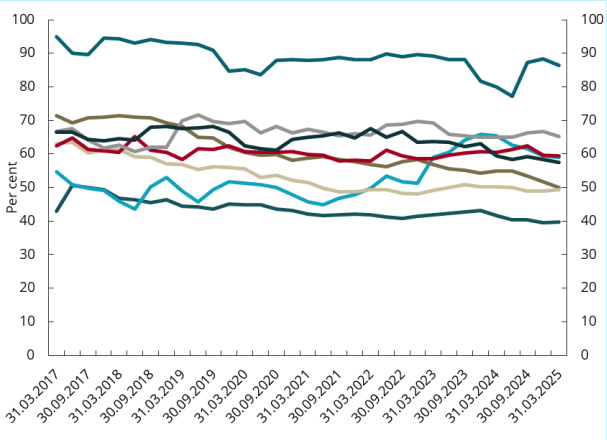
Within corporate lending, CRR3 is assumed to have a limited overall effect on Norwegian IRB banks' risk weights. Banks with extensive exposures to large corporates are assumed to get somewhat higher risk weights, while risk weights will be lower for the bank that uses the foundation IRB approach. Branches of foreign banks generally report lower risk weights for their corporate loans in Norway, and

[39] 75 per cent requires that the loan is categorised as a retail exposure; otherwise the weighting is 100 per cent.
[40] In order for the requirement to have effect for foreign institutions, the supervisory authority in their home country must have recognised the measure. The Nordic supervisory authorities and the European Central Bank have signed an agreement to recognise such measures.
[41] https://fi.se/sv/publicerat/nyheter/2025/fi-forlanger-riskviktsgolven-for-svenska-bolan-och-kommersiella-fastigheter/
[42] The 'support factor' that reduces the risk weights for loans to small and medium-sized enterprises has been taken into account.

several of these have an average risk weight below 35 per cent for exposures secured by commercial property and must therefore calculate an add-on to their total risk-weighted exposure amount.

Variations in risk weights across banks can be explained both by differences in the risk profiles of their portfolios and by divergent risk measurement methods. Comprehensive and detailed regulations and cooperation between supervisory authorities will reduce unintended variability in the banks' risk measurement. European authorities cooperate through the European Banking Authority (EBA), which prepares proposals for supplementary regulations and guidelines and compares (benchmarks[43]) the IRB banks' measurement methods and risk weights. The Nordic supervisory authorities and the European Central Bank cooperate on the supervision of banks operating in several countries and seek to reach agreement on regulatory understanding. For example, the Danish, Swedish and Norwegian supervisory authorities agree that default and loss observations from the Nordic banking crises in the 1990s must be reflected in banks' estimates.

Chart 4.25 Volume-weighted average risk weight for corporate loans in the eight Norwegian IRB banks



Risk weights are calculated without the support factor for lending to small and medium-sized enterprises. Source: Finanstilsynet

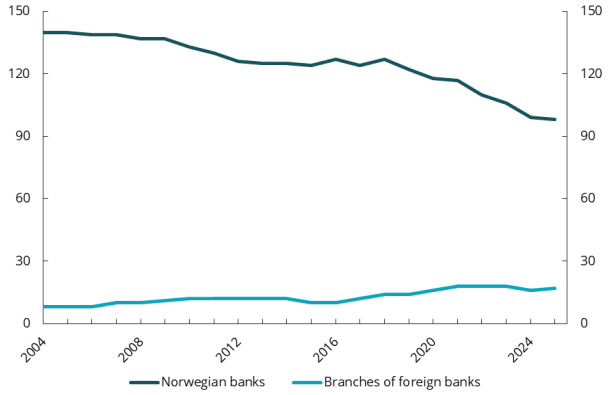
Structural developments in the Norwegian banking sector

Compared to most other European countries, Norway has a high number of banks. According to figures from the European Banking Federation, there are just under 19 banks per million inhabitants in Norway, while in 2023 there were 11 for the EU countries as a whole. Norway also has eight of a total of just over 100 IRB banks in Europe, which is a high number in relative terms.

For a long time, there has been a trend towards fewer Norwegian banks, largely as a result of mergers in the savings bank sector (chart 4.26). The establishment of a number of new banks targeting specific market segments, particularly SMEs, has not compensated for this development. At end-March 2025, there were a total of 99 Norwegian banks, 40 fewer than 20 years ago and 26 fewer than ten years ago. In addition, there were 16 branches of foreign banks. The largest Nordic banks in particular have extensive operations in Norway.

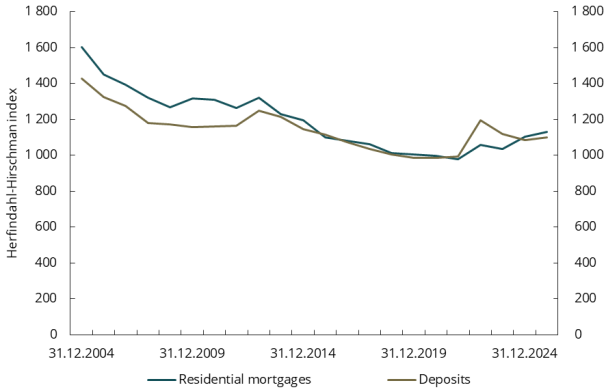
[43] The latest report, based on data from the end of 2023, is available here: 'The EBA publishes its annual assessment of banks' internal approaches for the calculation of capital requirements'.

Chart 4.26 Number of banks in Norway



Source: Finanstilsynet

Chart 4.27 Bank concentration in the personal customer market

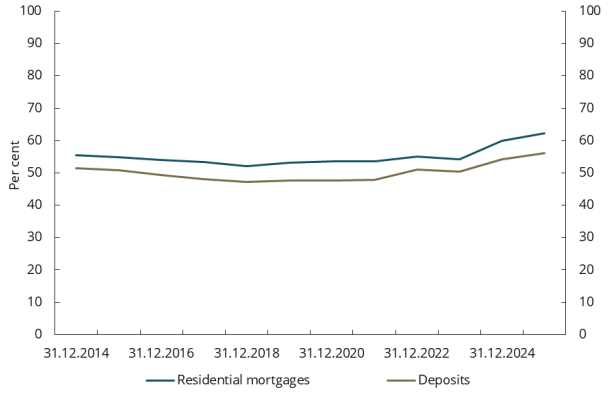


Source: Finanstilsynet

Over the past three years, there have been several mergers among large banks. DNB Bank took over Sbanken in 2022, and Sparebank 1 SR Bank and Sparebank 1 Sørøst-Norge merged to form Sparebank 1 Sør-Norge in the fourth quarter of 2024. Totens Sparebank was merged into Sparebank 1 Østlandet during the same quarter. In May 2025, Sparebanken Vest and Sparebanken Sør merged to form Sparebanken Norge, which became the second largest domestic bank in the Norwegian market, measured by total lending as at 31 March 2025. These large mergers have contributed to increased concentration in the banking market, as measured by the Herfindahl-Hirschman index (chart 4.27). For both deposits and residential mortgages, the concentration index is now at its highest level in almost ten years.

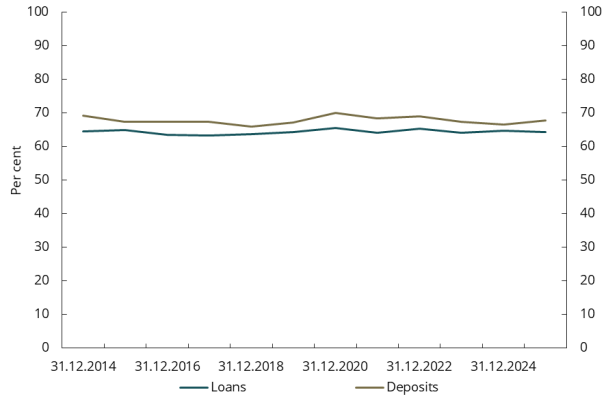
The combined market share of the five largest players has also risen in recent years, particularly in the personal customer market (chart 4.28). The increase reflects the merger of banks outside the top five into the group. In the corporate market, the largest banks' total market shares have been more stable (chart 4.29). Low growth in lending from the large Nordic banks' branches to corporate customers in recent years has contributed to a relatively stable overall market share for the five largest banks.

Chart 4.28 Market share of the five largest banks, personal customer market



Source: Finanstilsynet

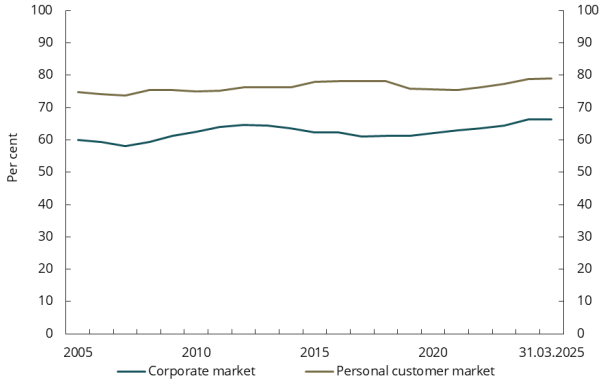
Chart 4.29 Market share of the five largest banks, corporate market



Source: Finanstilsynet

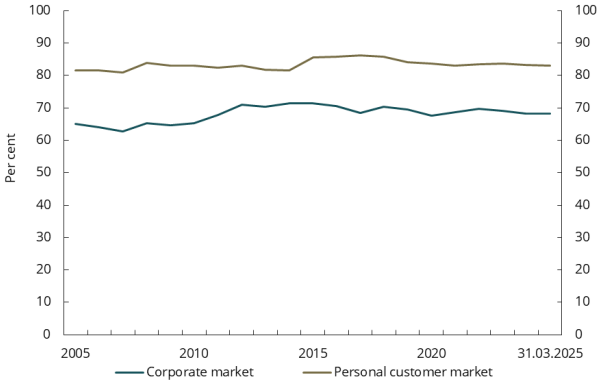
Norwegian banks' market shares in the domestic market have been stable over the past 20 years (charts 4.30 and 4.31). Their market shares are higher in the personal customer market than in the corporate market, and somewhat higher for deposits than for loans. At end-March 2025, Norwegian banks' market share of lending was at its highest level in 20 years in both in the corporate and the personal customer market.

Chart 4.30 Norwegian banks' market shares in the Norwegian lending market



Source: Finanstilsynet

Chart 4.31 Norwegian banks' market shares in the Norwegian deposit market



Source: Finanstilsynet

INSURERS AND PENSION FUNDS

Geopolitical uncertainty affects pension institutions' performance

The profitability of pension institutions (life insurers and pension funds) improved in 2024. The trend was reversed in the first quarter of 2025, driven by geopolitical uncertainty, warnings of increased tariffs and the risk of global trade conflicts. A fall in the value of equities contributed to a marked decline in returns for life insurers (chart 5.1). The return on the collective portfolio was 1 per cent in the first quarter of 2025, down from 9.8 per cent in the corresponding quarter the previous year. In the unit linked portfolio, where customers carry the return risk, the return fell from 38 per cent to -7.2 per cent. The significantly greater decline in the unit linked portfolio is due to a much higher proportion of equities in this portfolio.

Overall, Norwegian insurers and pension funds enjoy a strong solvency position. Life insurers' solvency ratio widened from 202 per cent when the Solvency II framework was introduced on 1 January 2016 to 280 per cent as at 31 December 2024 (chart 5.2). The increase in the solvency ratio in 2024 is mainly attributable to higher solvency capital, partly due to positive returns, a higher interest rate level and increased volatility adjustment.[44] At end-March 2025, life insurers' solvency ratio was 283 per cent.

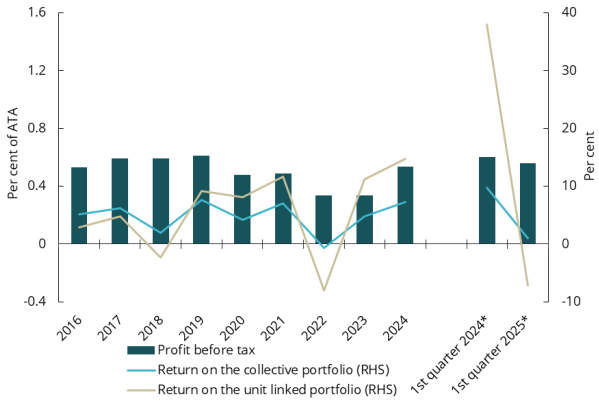
Pension funds’ solvency ratio widened by 3 percentage points in 2024 and stood at 178 per cent at the end of the year. The increase is attributable to higher growth in own funds relative to the increase in the solvency capital requirement. An increase in the buffer fund and higher Tier 1 capital (equity) were the main reasons for the increase in own funds, while a rise in equity prices contributed to a higher solvency requirement for equity risk.

For the 13 largest pension funds, which report each quarter, the overall solvency ratio was reduced from 180 per cent at the end of 2024 to 176 per cent at end-March 2025. Own funds were down NOK 1 billion, while the solvency requirement increased by a corresponding amount.

Life insurers' buffer fund was reduced by NOK 3.7 billion (0.6 per cent of ATA) in the first quarter of 2025 after increasing by NOK 22.9 billion (1 per cent of ATA) in 2024. A consolidated buffer fund allocated to policyholders has been introduced to give pension providers greater flexibility and stronger risk-bearing capacity, thereby enabling higher expected returns for policyholders. The policyholders' fund replaces the previous supplementary provisions and fluctuation reserves and can be used to cover negative returns.

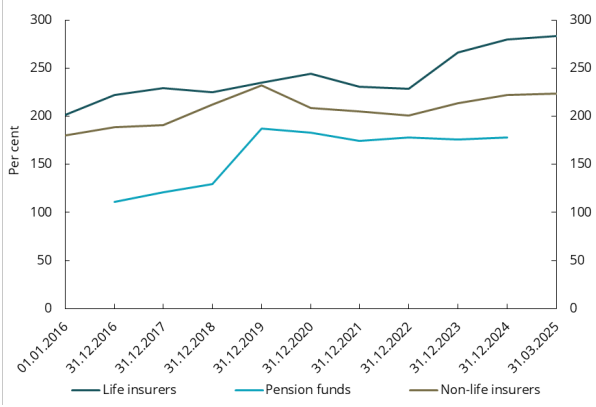
[44] Several Norwegian life insurers use EIOPA’s volatility-adjusted interest rate curve. This has resulted in an add-on to the risk-free interest rate and contributes to increasing the interest rate used to calculate insurance obligations.

Chart 5.1 Life insurers' profits and returns[45]



*Annualised return.
Source: Finanstilsynet

Chart 5.2 Solvency ratios of insurers and pension funds*

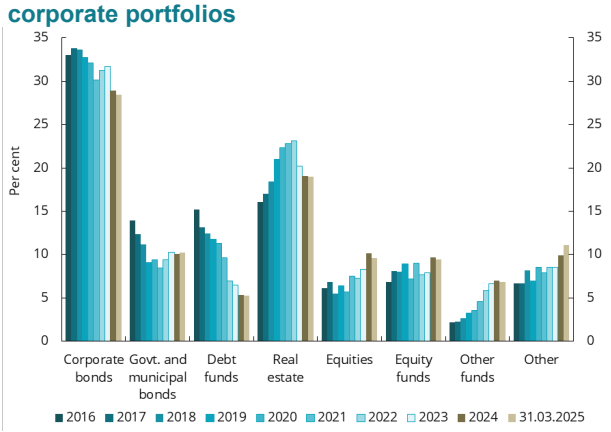


*The requirement for a solvency ratio above 100 for pension funds was introduced on 1 January 2019. The basis of the calculations was also changed. Source: Finanstilsynet

Life insurers have diversified portfolios

Life insurers' assets mainly comprise long-term investments in various sectors and different types of instruments. At end-March 2025, the total value of their investments was NOK 2 370 billion, a decrease of 1 per cent since the start of the year. There are significant differences in the distribution of investments on asset classes between unit linked portfolios and portfolios without investment choice (collective and corporate portfolios). Bonds account for the largest share of investments in the collective and corporate portfolios (44 per cent), while real estate and equities, including equity funds, account for the second largest shares (19 per cent) (chart 5.3). The proportion of bonds has been reduced by 4 percentage points since year-end 2023, and the proportion of equities has increased by 3 percentage points. Equities and equity funds are the largest asset class in the unit linked portfolio, accounting for 64 per cent (chart 5.4). In the first quarter of 2025, there was a 3 per cent decrease in value in the unit linked portfolio.

Chart 5.3 Investments in life insurers' collective and corporate portfolios



Source: Finanstilsynet

Chart 5.4 Life insurers' investments in the unit linked portfolio

Source: Finanstilsynet

The asset allocation in life insurers' international portfolios closely mirrors that of global benchmark indices. Approximately half of the investments in life insurers' collective and corporate portfolios are in international securities markets. The largest share is invested in the US, accounting for 16 per cent (NOK 248 billion) of total investments (chart 5.5). Of this, 28 per cent was invested in US equities

[45] The references to book and adjusted returns have been removed from the regulations on the calculation of return on capital in life insurers as a result of the introduction of regulations on the implementation of rules on buffer funds for private guaranteed pension products. Consequently, as from of 1 January 2024, only one return shall be calculated for the collective portfolio, corresponding to the previous adjusted return.

while 42 per cent represented indirect exposures.[46] In the unit linked portfolio, investments in the US account for 30 per cent, while approximately 32 per cent is invested in Norwegian securities.

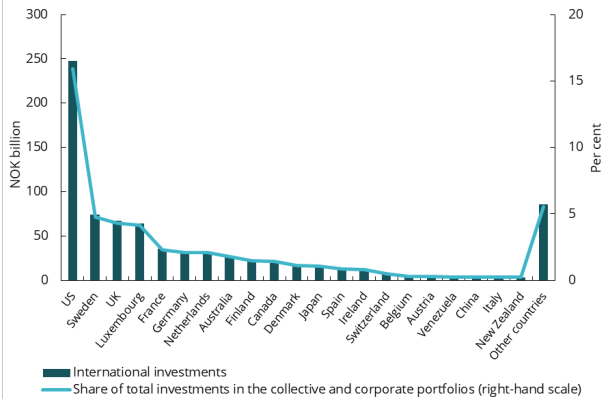
Norwegian life insurers are heavily exposed to the banking sector

Life insurers are mainly exposed to the financial sector, including the banking and real estate sectors (chart 5.6). Exposure to financing and insurance activities accounted for 52 per cent of total investments in the collective and corporate portfolios, of which 37 per cent was related to banking and credit activities, half of which in foreign companies. These investments are predominantly senior bonds and covered bonds (OMF), both generating regular cash flows.

Tariff barriers and weaker international growth prospects may result in heightened credit risk, higher risk premiums and declining bond values. Banks' loan losses may increase in response to weaker corporate earnings. The high exposure to the banking sector increases the likelihood that challenges faced by the banks will have an impact on life insurers' profitability and solvency. At the same time, life insurers' other investments may also be affected.

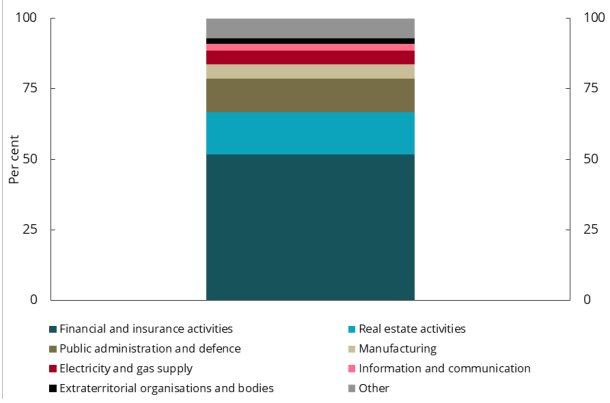
Firms in the manufacturing industry may be particularly vulnerable to trade barriers and increased tariffs. However, Norwegian life insurers have a limited direct exposure to this industry. Overall, the manufacturing industry accounts for 5 per cent of investments in the collective and corporate portfolios. The subsectors 'computer and electrical equipment industry', 'chemical industry', and 'pharmaceutical industry' represent the largest exposures.

Chart 5.5 International investments in life insurers' collective and corporate portfolios as at 31 March 2025



Source: Finanstilsynet

Chart 5.6 Exposures to various sectors in life insurers' collective and corporate portfolios as at 31 March 2025



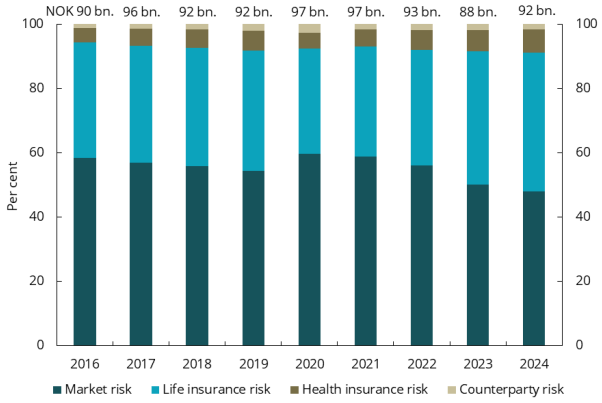
Source: Finanstilsynet

Higher equity risk in pension institutions

Life insurers are exposed to market risk through investments in bonds, equities and real estate etc., as well as through insurance obligations, including the guaranteed rate of return on guaranteed products. In 2024, market risk constituted 48 per cent of total risk (before deducting diversification gains) and was the largest risk component of the solvency capital requirement for life insurers (chart 5.7). Life insurance risk and health insurance risk accounted for 43 and 7 per cent of total risk, respectively, which is 2 and 1 percentage points higher than at the end of 2023. Counterparty risk was virtually unchanged, partly due to the high creditworthiness of counterparties.

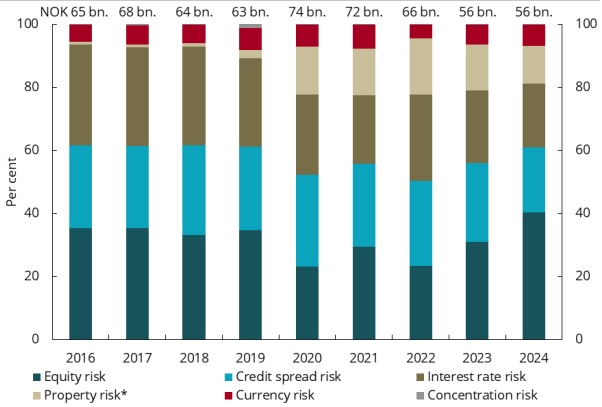
[46] Indirect exposure means an exposure via an undertaking's mutual fund investments (e.g. investment in an equity fund that has reinvested the capital in US equities). Direct exposure means investments in an asset located in the relevant region (e.g. US equities or government bonds).

Chart 5.7 Breakdown of life insurers' solvency capital requirement*



* Before deducting diversification gains.
Source: Finanstilsynet

Chart 5.8 Breakdown of life insurers' solvency capital requirement for market risk*



* Before deducting diversification gains. The increase in property risk and the reduction in equity risk as from 2020 are mainly a consequence of regulatory changes whereby investments in related real estate companies are no longer treated as equity risk when calculating insurers' solvency capital requirement but as property risk.
Source: Finanstilsynet

Equity risk remained the largest contributor to market risk for life insurers at year-end 2024 after a further increase of 9 percentage points to 40 per cent of total market risk (before diversification) (chart 5.8). The increase is partly attributable to the positive stock market trend in 2024, which pushed up the market value of the equity portfolio, and to a higher stress factor in the calculation of the capital requirement (equity price shock).[47] The adjustment mechanism increases the equity price shock when equity indices are high relative to the three-year average, and reduces it when the indices are low.

For pension funds, market risk also accounted for the largest share of total risk (before diversification) at 88 per cent at year-end 2024. The capital requirement for equity risk represented the far largest market risk, accounting for 52 per cent of total market risk (before diversification), followed by currency risk.

Currency risk in pension institutions

Pension funds and life insurers with public occupational pension schemes are exposed to significant market risk[48]. Currency risk is part of this risk. Pension institutions have achieved good returns over the past 15 years, partly due to the depreciation of the Norwegian krone.

Life insurers and pension funds generally hedge their investments in fixed-income securities in foreign currency. Hedging of equity investments in foreign currency has been less common.

Finanstilsynet notes that the pension funds' exposure to currency risk has increased in recent years, while the level of hedging appears to have been reduced. At year-end 2024, the market value of the pension funds' assets in foreign currency accounted for approximately 25 per cent of total assets, compared with approximately 18 per cent at year-end 2019, while hedging of currency risk is down from 55 per cent in 2019 to 24 per cent in 2024.[49] The pension funds' capital requirement for currency risk in per cent of the total capital requirement (before diversification) increased from 10 per cent in 2019 to 19 per cent in 2024. Life insurers that provide only public occupational pension schemes also reduced their level of currency hedging from 2019 to 2024.

[47] The equity price shock increased from 40 per cent for listed equities in OECD countries and 50 per cent for other equities as at 31 December 2023 to 42 and 52 per cent, respectively, as at 31 December 2024. The adjustment mechanism in the equity price shock implies that the shock varies from quarter to quarter depending on prior equity price developments, with the adjustment ranging up to +/- 10 percentage points from the standard shocks of 39 and 49 per cent, respectively.
[48] Life insurers' market risk associated with occupational pension schemes in the private sector is significantly lower than in public occupational pension schemes and is therefore not discussed here.
[49] The pension funds probably report only direct currency exposure and hedging, which means that hedging within investment funds is excluded. The total exposure to foreign fixed-income securities and equities accounted for 39 per cent of pension funds' total assets in 2019 and 45 per cent of total assets in 2024.

A low level of hedging contributes to higher profits in periods when the Norwegian krone is depreciating. At the same time, the undertakings' vulnerability increases when the krone exchange rate is appreciating.[50] Historically, the Norwegian krone has tended to depreciate during periods of significant market turmoil. However, undertakings should be cautious about using such a pattern as a basis for their risk management.

Solvency II review

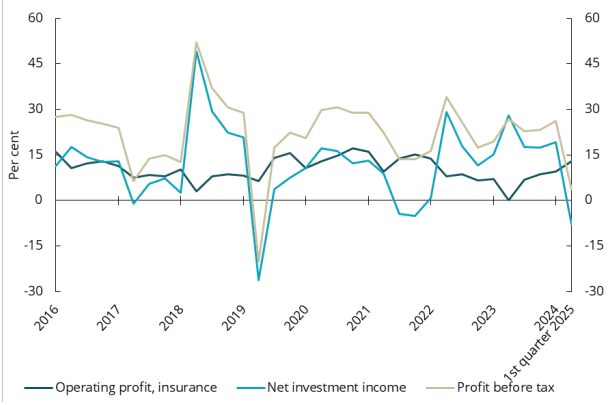
On 27 November 2024, the European Parliament and the European Council adopted changes to the solvency framework for insurance undertakings through amendments to the Solvency II Directive. Detailed provisions supplementing the overarching rules of the Directive will be laid down by the European Commission through amendments to Regulation (EU) 2015/35. Proposals for amendments to the regulation will probably be circulated for comment in the summer of 2025. The new framework will enter into force in January 2027. The amendments to the regulations are EEA relevant and require changes to Norwegian legislation. In light of the amendments to the Solvency II framework for insurers, Finanstilsynet will consider whether to make adjustments to the simplified solvency capital requirement for pension funds.

Developments at non-life insurers

A number of weather-related claims have resulted in weaker profitability for non-life insurers over the past two years parallel to strong cost growth. This led to tighter terms and higher premiums and deductibles, which helped improve the insurers' results in 2024 compared with the previous year (chart 5.9). In the first quarter of 2025, higher risk premiums on bonds and falling equity prices contributed to negative investment income and consequently a pronounced decline in pre-tax profits.

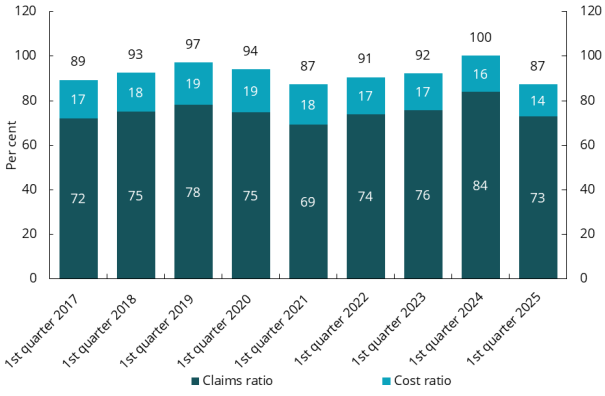
Profits from insurance activity improved significantly in the first quarter of 2025 compared with the previous year. The combined ratio, i.e. the sum of claims payment expenses and insurance-related operating expenses relative to premium income, was at the same low level in the first quarter of this year as in the first quarter of 2021 and clearly lower than in the first quarter of last year (chart 5.10). The lower combined ratio is mainly due to higher premium income and lower claims payments so far in 2025.

Chart 5.9 Overall profits of non-life insurers. Per cent of insurance-related income so far this year



Source: Finanstilsynet

Chart 5.10 Life insurers' total claims ratio and cost ratio (net combined ratio)



Source: Finanstilsynet

[50] The use of hedging instruments entails liquidity risk that the undertakings must also take into account.

STRESS TEST OF NORWEGIAN BANKS

Finanstilsynet conducts annual stress tests to assess the impact of a severe economic downturn on Norwegian banks' capital adequacy. The stress test for 2025 shows that Norwegian banks could fall below the CET1 capital requirement during a severe stress. The largest banking groups are hit particularly hard in this year's stress test as a result of reduced net interest income and increased loan losses.

Background for the stress test

In Finanstilsynet's annual stress tests of capital adequacy, the effect of various adverse events on the banks' profits and capital adequacy is estimated. The calculations illustrate how well banks will fare through such scenarios. The design of the stress tests seeks to capture the interaction between various risks present in the banks and in the economy as a whole. The calculations are based on the individual bank's financial statements and exposures. The projections are made by using the macro-econometric model NAM-FT[51].

The assessments in this chapter are based on a baseline scenario and a stress scenario. The two scenarios describe possible development paths for the Norwegian economy from 2025 to 2029. The scenarios do not represent forecasts of future developments. The probability of the stress scenario occurring is relatively low, but not zero.

Development of banking module in NAM-FT

The macroeconometric model NAM-FT has been extended to include 27 variables representing the combined income statement, balance sheet and capital adequacy of Norwegian banks. The model extension enables more comprehensive analyses of the interdependence between the real economy and financial markets on the one hand and the banking sector on the other hand. The extension thus provides an improved framework for macro scenarios, which are used in Finanstilsynet's model-based stress testing of Norwegian banks' capital adequacy and analyses of financial stability. Here, the model extension and the two variables for losses on loans to individuals and businesses, which have been included in NAM-FT since 2016, are collectively referred to as the 'banking module'.

Table 6.1 Variables in the banking module from the banks' income statement and balance sheet

Income statement	Balance sheet
Interest income	***Assets***
Interest expenses	Gross loans to personal customers
Net interest income	Gross loans to non-financial corporations
Net commission and fee income and changes in the value of financial instruments	Gross loans to other Norwegian and foreign customers
Other income, including dividends received	Gross loans to customers
Salaries, other costs and depreciation	Fixed-income securities
Operating profit	
Loan losses	***Liabilities and equity***
Pre-tax profit	Deposits from customers
Profit after tax	Wholesale funding
	Equity
Payment of dividends etc.	Total assets
Other equity transactions	

All variables are measured in NOK million.

[51] NAM-FT is based on the Norwegian Aggregate Model (NAM) and has been developed specifically with a view to stress testing of banks and analysis of financial stability. NAM was developed by Professor Gunnar Bårdsen (Norwegian University of Science and Technology) and Professor Ragnar Nymoen (University of Oslo). Documentation of NAM can be found at [51]Normetrics.no.

The variables in the banking module are listed in tables 6.1 and 6.2. More than two-thirds of the variables in the banking module are modelled using econometric equations, and about one-fourth are determined by definitional relationships. Both variables in the banking module and variables representing the real economy or financial markets are included as explanatory variables in the banking module. Two of the variables ('common equity Tier 1 capital requirement' and 'dividends etc. as a share of profits after tax') are exogenous, i.e. not explained in the model.

Table 6.2 Variables in the banking module from the banks' capital adequacy reporting and other variables

Capital adequacy	Other variables
CET1 capital	Dividends etc. as a share of profits after tax
Risk-weighted assets	Problem loans in per cent of gross lending, personal customer market
CET1 capital requirement	Problem loans in per cent of gross lending, corporate market
	Losses on loans in per cent of gross loans, personal customer market
	Losses on loans in per cent of gross loans, corporate market

'CET1 capital' and 'risk-weighted assets' are measured in NOK million. The other variables are ratios or stated in per cent.

The most important data sources are the banks' reported accounting figures (key figure reporting and ORBOF) and capital adequacy reporting (COREP). When using historical data, taken mainly from various publications from Statistics Norway, Norges Bank and Finanstilsynet, time series have been constructed for most of the variables in the banking module back to 1987.

So far, two feedback effects from the banking module to the other components of NAM-FT have been established. 'Banks' losses on loans to personal customers' is an explanatory variable (with a negative sign) in the equation for 'gross debt in the household sector', which in turn has an effect on the variables 'gross debt from domestic institutions held by households (C2)' and 'banks' gross loans to personal customers'. 'Share of problem loans[52] in the corporate market' is an explanatory variable (with a negative sign) in the equation for 'gross debt from domestic institutions held by non-financial firms (C2)', which in turn has an effect on the variable 'banks' gross loans to non-financial firms'.

Although the model extension is now included in the operational NAM-FT model, the development phase is not over. Ongoing efforts will focus on evaluation and further development, including the establishment of feedback effects from the banking module to other parts of NAM-FT, as well as the quality assurance of historical data.

Norwegian economy

Baseline scenario

In the baseline scenario, developments in the Norwegian economy are assumed to be largely consistent with the forecasts in Statistics Norway's Economic Survey 1/2025 and Norges Bank's Monetary Policy Report 1/2025 (table 6.3).

Table 6.3 Developments in key international variables. Annual growth in per cent unless otherwise stated

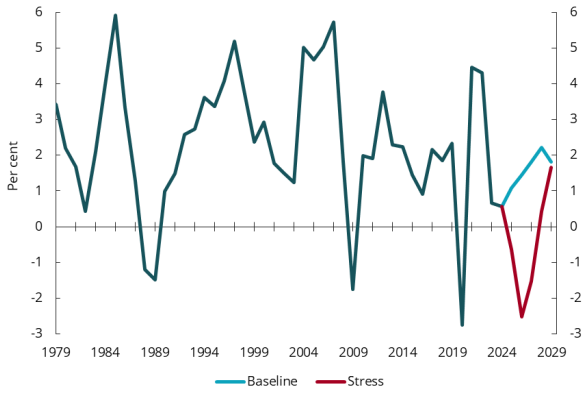
		2024	2025	2026	2027	2028	2029
Foreign consumer prices (trade weighted)	Baseline	2.8	2.2	2.3	2.2	2.1	2.1
	Stress	2.8	5.1	7.8	4.4	2.1	2.0
European 3-month money market rate	Baseline	3.6	2.3	2.0	2.1	2.2	2.4
(Euribor, level)	Stress	3.6	3.7	6.2	5.0	3.6	2.2
Oil price in USD (level)	Baseline	81	71	68	67	67	67
	Stress	81	67	60	60	60	60
Export market indicator (trade weighted)	Baseline	1.8	2.4	2.1	2.7	3.0	3.0
	Stress	1.8	-8.9	-10.5	-3.0	0.0	3.0

Sources: Statistics Norway and Finanstilsynet

[52] Problem loans are the sum of i) non-performing loans and ii) performing loans for which specified impairment losses/loss allowances have been recognised.

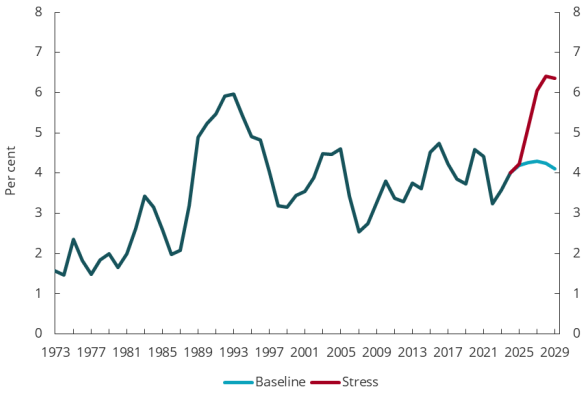
In the baseline scenario, consumer price inflation slows and is close to the central bank's inflation target at the end of the projection period. It is assumed that the policy rate will be reduced in line with Norges Bank's policy rate path in the Monetary Policy Report 1/2025. Following a weak trend in the Norwegian economy in 2023 and 2024, the growth in GDP for mainland Norway is expected to pick up in the period ahead but to remain below trend until 2026 (chart 6.1). Unemployment (LFS) remains at just over 4 per cent during the projection period, which is a slightly higher level than the historical average (chart 6.2). Developments in public demand are assumed to be in line with the projections in Statistics Norway's Economic Survey 1/2025. Moderate growth is expected in house prices and commercial property prices during the projection period (charts 6.3 and 6.4).

Chart 6.1 GDP for mainland Norway, year-over-year growth



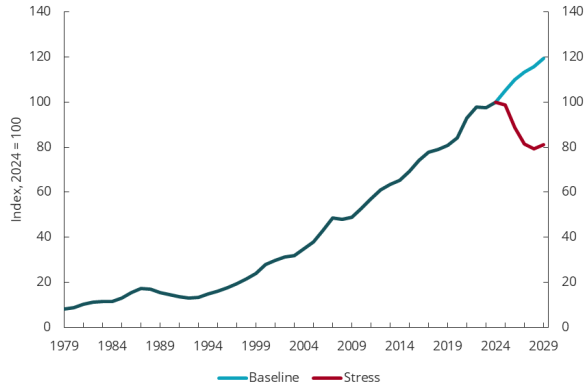
Sources: Statistics Norway and Finanstilsynet

Chart 6.2 Unemployment (LFS)



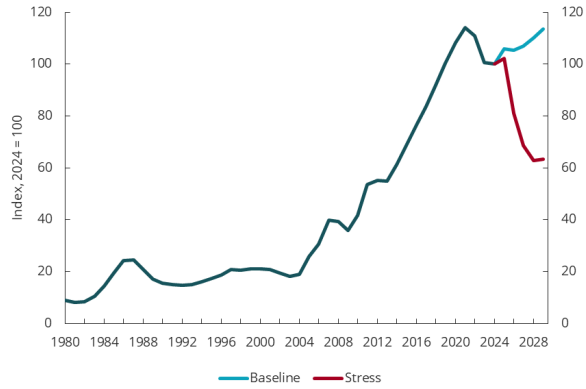
Sources: Statistics Norway and Finanstilsynet

Chart 6.3 House prices



Sources: Statistics Norway and Finanstilsynet

Chart 6.4 Commercial property prices

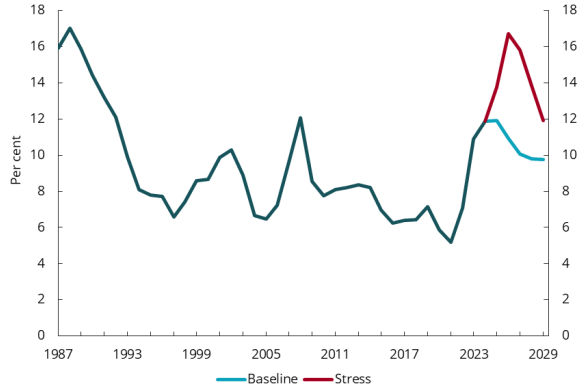


Sources: Dagens Næringsliv, OPAK, Entra and Finanstilsynet

Chart 6.5 Banks' average lending rate

Sources: Statistics Norway and Finanstilsynet

Chart 6.6 Households' interest burden*



*The interest burden is interest expenses in per cent of the sum of interest expenses and disposable income excluding dividends received.
Sources: Statistics Norway and Finanstilsynet

In the baseline scenario, banks' average lending rate is virtually unchanged from 2024 to 2025, and thereafter declines by approximately 1.2 percentage points (chart 6.5). As a result of high debt levels and continued high interest rates, households' interest burden remains stable at close to 12 per cent from 2024 to 2025 and thereafter declines to just below 10 per cent in 2029 (chart 6.6). During the projection period, growth in households' disposable income exceeds credit growth, and the debt burden is therefore reduced from 234 per cent in 2024 to 217 per cent in 2029. Banks' losses on loans remain low during the projection period in both the personal customer market and the corporate market.

Stress scenario

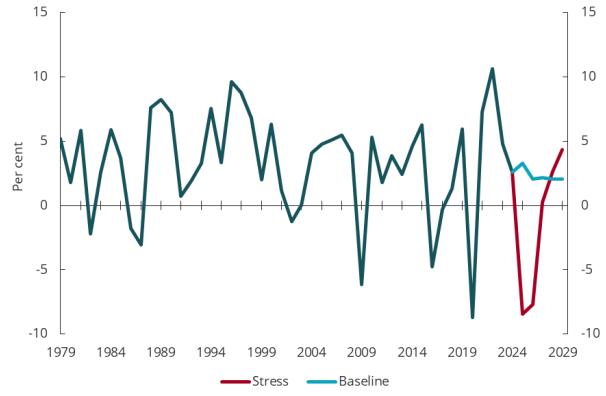
In the stress scenario, tariff barriers between countries are assumed to be high. This leads to elevated prices of imported goods and major disruptions in supply chains, contributing to inflationary pressures. Trade barriers put a damper on both international trade and oil prices. International inflation (trade weighted) is assumed to rise from 2.8 per cent in 2024 to 7.8 per cent in 2026 (table 6.3). Central banks are expected to raise their policy rates in an effort to curb inflation. This results in higher market rates, repricing in the financial and property markets and a setback in the global real economy.

Norway is strongly affected by international developments and experiences a substantial decline in foreign demand, higher import prices and increased tariffs on export goods. Exports of traditional goods and services therefore fall steeply (chart 6.7), contributing to a reduction in mainland GDP and corporate investment. In consequence of lower oil prices, there is also a more pronounced decline in oil investments than assumed in the baseline scenario. Imports decline, which helps moderate the downturn in the Norwegian economy

Lower oil price and increased international uncertainty contribute to a further depreciation of the Norwegian krone, which in turn drives inflation higher. In the stress scenario, consumer price inflation is up from 3.1 per cent in 2024 to 6.0 per cent in 2026 (chart 6.8). During the same period, the Norwegian money market rate (3-month NIBOR) rises from 4.7 per cent to 8.2 per cent.

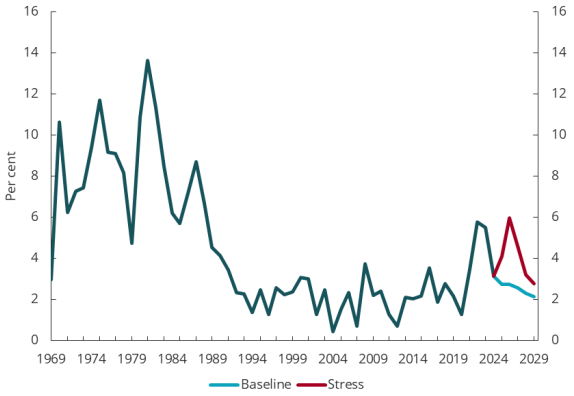
The banks' average lending rate is up from 6.5 per cent in 2024 to 9.6 per cent in 2026 (chart 6.5). Such an interest rate increase has major consequences for Norwegian households due to their high level of debt and the fact that more than 95 per cent of household debt carries floating interest rates. Households' interest burden rises from 11.9 per cent in 2024 to 16.7 per cent in 2026 (chart 6.6). This is higher than the interest burden during the global financial crisis and almost as high as the level during the late 1980s. The interest burden declines to 11.9 per cent in 2029. Higher lending rates also have major consequences for firms, whose interest burden increases from 14.6 per cent in 2024 to 21.6 per cent in 2026.

Chart 6.7 Exports from mainland Norway, year-over-year growth



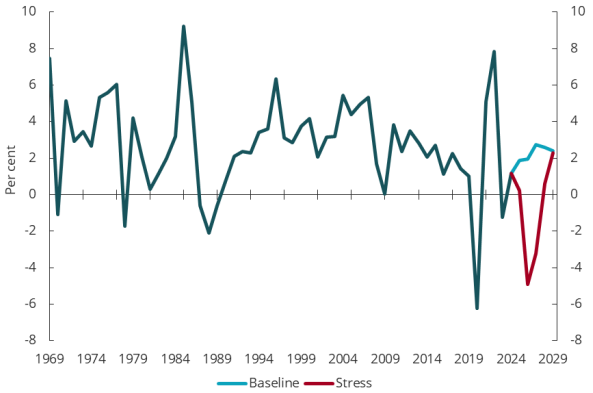
Sources: Statistics Norway and Finanstilsynet

Chart 6.8 Consumer price index in Norway, year-over-year growth



Sources: Statistics Norway and Finanstilsynet

Chart 6.9 Private consumption, year-over-year growth



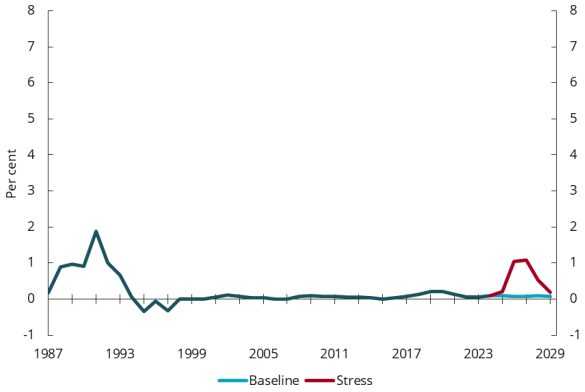
Sources: Statistics Norway and Finanstilsynet

Income growth exceeds the increase in household debt during the projection period, and the debt burden is reduced by 27 percentage points in the stress scenario, to 207 per cent in 2029.

Households' real disposable income declines in the first few years of the stress period, reflecting a high interest burden, lower employment levels and a reduction in real wages. This leads to a fall of 8 per cent in private consumption from 2024 to 2027 (chart 6.9). Combined with the decline in mainland exports and in oil and corporate investments, this puts a significant damper on economic activity in Norway. Public demand and exports of oil and gas are kept unchanged from the baseline scenario.[53] GDP for mainland Norway declines by 4.6 per cent from 2024 to 2027 before rising by 2 per cent in the course of 2028 and 2029 (chart 6.1). Unemployment (LFS) increases from 4 per cent in 2024 to above 6 per cent during the final years of the stress period (chart 6.2).

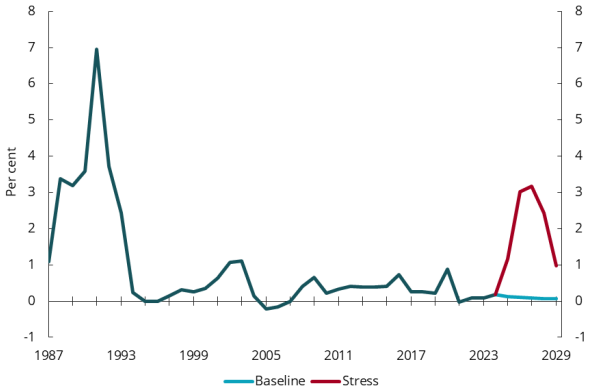
The economic downturn in Norway results in a pronounced fall in prices of residential and commercial property. Measured as an annual average change, house prices are down 21 per cent and commercial property prices 37 per cent in nominal terms from 2024 to their lowest level in 2028 (charts 6.3 and 6.4).[54] Overall, there is a decline of 54 per cent in the Norwegian stock market from 2024 to 2026.

Chart 6.10 Banks' losses on loans to personal customers



Source: Finanstilsynet

Chart 6.11 Banks' losses on corporate loans



Source: Finanstilsynet

Banks' losses on loans to both personal customers and firms rise in the stress scenario. Losses on corporate loans increase the most and represent the highest volumes (charts 6.10 and 6.11). Accumulated losses on corporate loans during the projection period come to 10.8 per cent of lending to this sector. For loans to personal customers, accumulated losses represent 3.0 per cent. Losses

[53] No fiscal policy measures are assumed to be implemented in response to the stress scenario, such as increased transfers to households and firms or a rise in public demand. This is a common assumption in stress tests of bank solvency, as the purpose is to analyse whether banks are adequately capitalised to withstand a severe economic downturn regardless of economic policy.

[54] By way of comparison, house prices in Norway fell by 24 per cent in nominal terms (measured as a change in the annual average) from 1987 to 1992. During the same period, prices of office premises were down 40 per cent.

in the stress scenario are high but clearly lower than the banks' losses during the banking crisis in the early 1990s. In the five-year period from 1988 to 1992, banks' losses on corporate loans came to 20.8 per cent and losses on loans to personal customers 5.7 per cent.

In the macroeconomic model NAM-FT, banks' loan losses are estimated on the basis of historical data covering the period 1987 to 2024. Household debt in 2025 is considerably higher than during the Norwegian banking crisis at the beginning of this period. In the stress scenario, households' interest burden increases to a level not observed since the late 1980s parallel to a rise in unemployment. In such a scenario, banks' losses on loans to households may be higher than projected. Losses on loans to non-financial corporations may also exceed the level in the stress scenario.

The banks' results in the baseline scenario

Due to strong profitability and low loan losses, the banks record good results in the baseline scenario. Finanstilsynet assumes that net interest income in per cent of average total assets will contract by 35 basis points during the first three years of the scenario and then level off. This is based on the assumption that net interest income will decline toward its historical average. Additional assumptions are a dividend payout ratio of 60 per cent and total tax on profits of 25 per cent.

Nevertheless, the banks record a healthy level of profits, and CET1 capital increases throughout the period. For the macro bank (the largest banking groups combined), the CET1 capital ratio increases from 18.6 per cent in 2024 to 19.2 per cent in 2029. The leverage ratio is up from 7.3 per cent in 2024 to 7.6 per cent in 2029.

The banks' results in the stress scenario

Assumptions underlying the stress test

Higher policy and market rates in Norway and abroad lead to higher funding costs for Norwegian banks. It is assumed that the banks choose not to raise lending rates in line with the increase in funding costs, partly due to reduced debt-servicing capacity among non-financial corporations and households. Seen in isolation, this means that interest expenses rise more than interest income, resulting in a reduction in net interest income. In this year's stress scenario, it is assumed that net interest income in per cent of total assets will decrease by 50 basis points in the first year and then remain constant during the last four years of the stress scenario.

It is assumed that net commission and fee income in per cent of total assets falls by 8 basis points in the first year of the stress scenario as a result of lower economic activity. No changes are assumed during the rest of the period. Administrative expenses follow the general trend for wage expenses from NAM-FT.

In consequence of the fall in stock markets and higher market rates, values in the banks' equity and bond portfolios decline. The changes in value are recognised in the income statement during the period. Other operating income, dividends and depreciation are unchanged. A slight increase in risk weights is also assumed as a result of heightened economic uncertainty.

The assumptions concerning the payout ratio and total tax on profits are the same as in the baseline scenario. In years with a net loss, dividends and tax are set to zero. Furthermore, it is assumed that the banks will not make any strategic moves or inject new equity from their owners during the stress period.

Distribution of loan losses between the banks

The banks' total losses on loans to personal customers and non-financial corporations, respectively, are calculated using Finanstilsynet’s macro model NAM-FT. In the model, loan losses are calculated as a percentage of total loan exposure for each of the years 2025–2029. Furthermore, banks' lending to personal customers and non-financial corporations is projected. The annual loss rate multiplied by the

total loan exposure constitutes the banks' total loan losses in NOK. Total loan losses are distributed between the banks by weighting the corporate portfolio by the estimated credit risk in non-financial corporations. Credit risk is calculated using Finanstilsynet's credit risk model (SEMKO). Losses on loans to personal customers are allocated to individual banks according to the respective bank's share of total lending in the personal customer market.

SEMKO is Finanstilsynet's bankruptcy and probability of default model. In SEMKO, the probability of bankruptcy (PB) for non-financial corporations in eleven industry groups is estimated as a function of their annual financial statements, entity-specific information and macroeconomic variables. By using estimates from NAM-FT for the macroeconomic variables in 2025–2029 and the corporations' most recent accounting figures, the PBs are projected in both the baseline and the stress scenario. The PBs are scaled to probabilities of default (PD) by calibrating them against the banks' average PDs per industry at year-end 2024.

Banks' risk-weighted assets were projected by using credit growth estimated from NAM-FT.

See also Risk Outlook June 2021 for a description of the methodology for the distribution of losses between the banks.

Stress test results for Norwegian banking groups

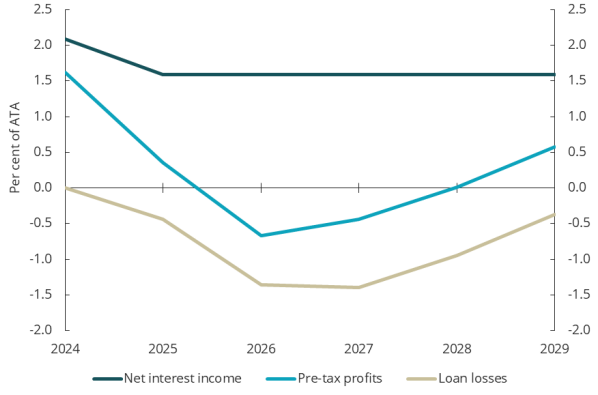
Finanstilsynet's stress test includes all Norwegian banks. The stress test for banking groups encompasses the largest banks in Norway. Branches of foreign banking groups are not covered by the stress test.

For the macro bank, the aggregate of the banks in the sample, net interest income in per cent of total assets declines from 2.09 per cent in 2024 to 1.59 per cent in the stress period. Net commission and fee income is down from 0.38 per cent to 0.30 per cent of total assets.

There are significant losses on corporate and household loans during the stress period. In 2026 and 2027, total losses on loans to the personal customer and corporate markets come to 1.36 per cent and 1.40 per cent, respectively, of total assets (chart 6.12). Due to higher interest rates and a declining stock market, aggregate losses in the market portfolio represent 0.23 per cent of total assets in 2026.

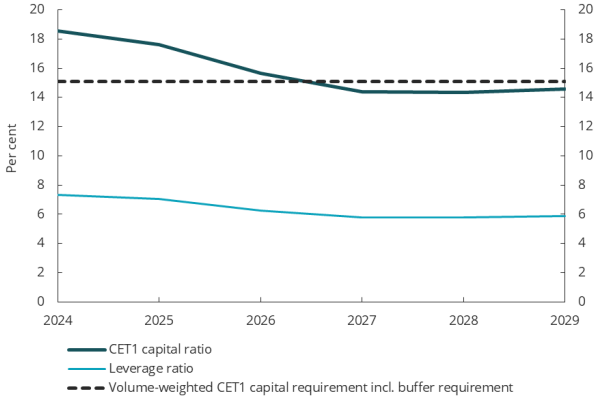
In consequence of lower income and higher costs, the macro bank records a pre-tax loss for the years 2026, 2027 and 2028. From 2024 to 2026, pre-tax profits decline from 1.62 per cent to minus 0.67 per cent of total assets. Negative results directly reduce the macro bank's equity, thereby impairing its capital adequacy.

Chart 6.12 Profits and main profit components. Norwegian banking groups. Stress scenario



Source: Finanstilsynet

Chart 6.13 Developments in capital adequacy ratios. Norwegian banking groups. Stress scenario



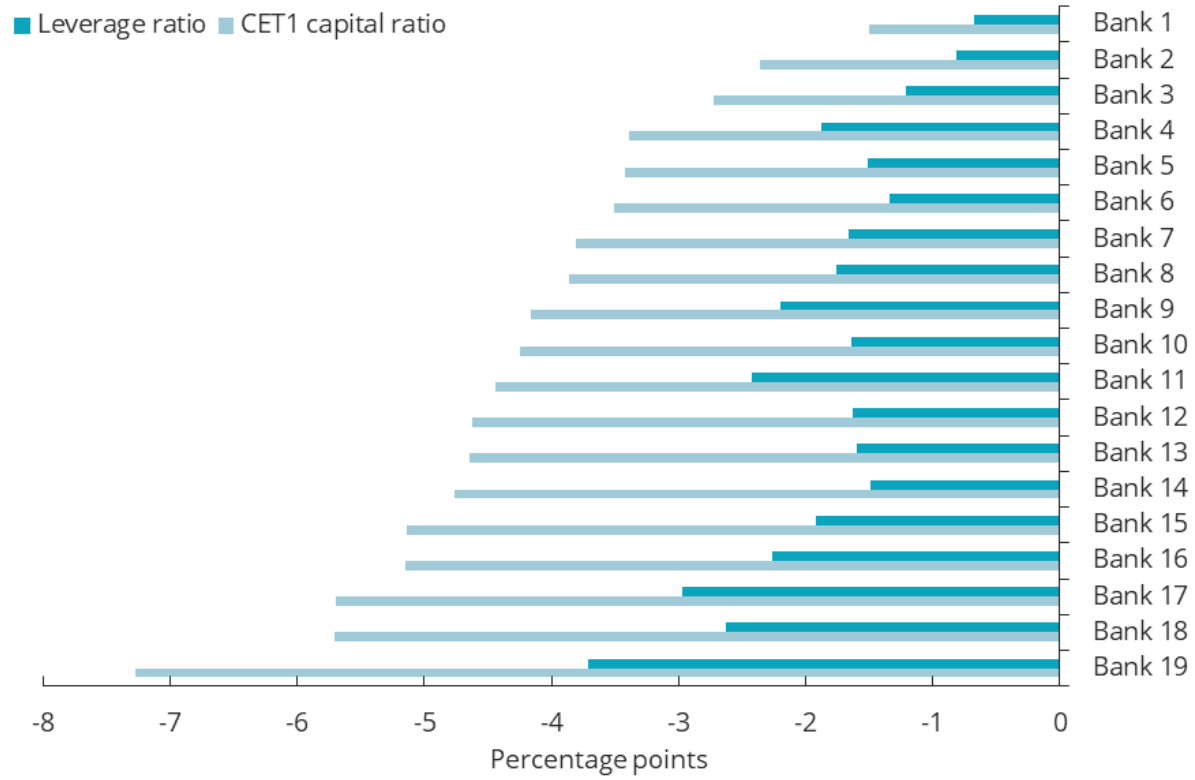
Source: Finanstilsynet

The CET1 capital ratio narrows from 18.6 per cent in 2024 to 14.4 per cent in 2028 (chart 6.13). The leverage ratio decreases from 7.3 per cent in 2024 to 5.8 per cent in 2028.

14 of the 19 banks included in the macro bank fall below the CET1 capital requirement.[55] Chart 6.14 shows changes in the CET1 capital ratios of individual banks. If the countercyclical capital buffer is set at 0, four of the 19 banks will not meet the CET1 capital requirement. None of the banks fall below the minimum leverage ratio requirement.[56]

Variations in the banks' results reflect their different starting points. Banks with higher CET1 capital ratios and wider income margins are relatively less affected in the stress scenario than banks with lower CET1 capital ratios and narrower income margins. In addition, banks with a higher probability of default in their corporate portfolio will account for a relatively higher share of loan losses than banks with a lower probability of default.[57]

Chart 6.14 Change in capital adequacy from 2024 to the minimum level. Norwegian banking groups. Stress scenario



Source: Finanstilsynet

Stress test results for other Norwegian banks

Other Norwegian banks (82 in total) mainly comprise small and medium-sized savings banks. The capital adequacy of these institutions is stress tested at single company level (parent bank). The same macro scenarios and largely the same methodology as for banking groups are used.

On average, the other Norwegian banks record net losses in 2026, 2027 and 2028. Pre-tax profits decline from 1.81 per cent of total assets in 2024 to minus 0.85 per cent in 2027. This weakens the CET1 ratio, which is down from 23.3 per cent in 2024 to 16.5 per cent in 2029, i.e. 6.8 percentage points. The leverage ratio decreases from 10.2 per cent to 7.1 per cent in 2029.

A total of 19 of 82 banks do not comply with the CET1 capital requirement, which reflects that most of the banks had a capital ratio that was far above the current requirement at the end of 2024. If the

[55] The total CET1 capital requirement comprises the minimum requirement, the buffer requirement and the Pillar 2 requirement.
[56] The minimum leverage ratio requirement is 3 per cent.
[57] See the box 'Distribution of loan losses between the banks' for more information.

countercyclical capital buffer is reduced to 0, 12 of the 82 banks will not meet the CET1 capital requirement.

About stress testing

Experience shows that there can be high systemic risk in the banking industry. This reflects the high debt-to-income ratio of many borrowers, the banks' exposure to the same risk factors and the inter-connectedness between financial institutions. Since risk measurements and risk-sensitive capital requirements are attended by considerable uncertainty and do not capture all relevant risk factors, the banks themselves and the supervisory authorities must exercise considerable judgement in assessing banks' capital needs.

Stress testing of the banks' results and capital adequacy supplements traditional risk measurements and risk weight calculations. Whereas risk measurement systems are based on assumptions about risk factors' probability distributions, an important aspect of stress testing is not to assume that risk factors follow given probability distributions. The rationale is that a significant portion of uncertainty cannot be modelled in the sense that probabilities cannot be linked to outcomes. Experience shows that crises can arise suddenly and unexpectedly.

The purpose of stress tests is to assess the consequences for banks and the banking system of an accumulation of events (scenarios) which are unlikely to occur. The scenarios often have characteristics that can be recognised from previous crises in some combination or another.

In the event of a serious setback in the Norwegian economy, the authorities will consider fiscal and monetary policy measures and possibly other measures to dampen the downturn and counteract detrimental effects on the economy and the financial system. It is beyond the scope of this type of stress test to consider what government measures should or could be implemented during a stress scenario in order to mitigate the effects.

Finanstilsynet's stress test tool is used both in assessments of financial stability and in assessments of individual banks’ capital needs.

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