Covered Bonds 2020 Outlook

Harmonization Set To Raise The Bar

Nov. 26, 2019

Antonio Farina
Adriano Rossi
Andrew South

Casper Andersen

S&P Global Ratings
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Key Takeaways

**Sustainability:** Several new entrants in the green and social space, with rising issuance

**Harmonization:** Higher standards for asset quality, disclosure, and supervision

**New markets:** Rapid expansion, with banks from countries such as Japan and Brazil issuing for the first time

**Issuance:** Despite issuers’ renewed access to cheap central bank funding, European covered bond issuance could rise 5%-10% in 2020, given high scheduled maturities

**Economic conditions:** Broadly supportive in Europe, despite a slowing economy. House prices expected to rise over the next two years, but at a slower pace

**Bank and sovereign ratings:** Covered bonds are fairly well insulated from the risk of bank downgrades, while sovereign ratings will remain a key credit driver, especially in Southern Europe
2019 In Review: Sovereign And Bank Upgrades Drove Rating Actions

Spain And Greece Sovereign Upgrades Triggered Most Covered Bond Upgrades

Most Covered Bonds Are Rated ‘AAA’

Source: S&P Global Ratings

Source: S&P Global Ratings
2019 In Review: Issuance Broadly Stable

Year-To-Date Issuance Up 3% At €117 Billion

The U.K., Italy, And Spain Grew The Most
Benchmark European investor-placed covered bond issuance, 2019 YTD, by country (bil. €)

Growth compared to 2018
- >15%
- Between +15% and -15%
- -15%<

2019 In Review: Sustainable Issuance Gains Ground

Issuance Held Up Despite Less ECB Buying
CBPP3 Holdings

Supported By The Rise In Sustainable Bonds

- **PKO Bank Hipoteczny**: 1st green covered bond in Central and Eastern Europe
- **Société Générale SFH**: 1st green covered bond in France
- **CAFFIL**: 1st social covered bond in France
- **KHFC**: 1st social covered bond in Asia
- **Nykredit / Realkredit Danmark**: 1st green covered bond in Denmark

Source: European Central Bank. Source: S&P Global Ratings

Source: S&P Global Ratings
2019 In Review: Harmonization Will Open Up New Markets

Harmonized Legal Framework Vote Is A Milestone But Still Work To Do

- First European Banking Authority (EBA) report published in July 2014
- Second EBA report published in December 2016
- European Commission (EC) releases consultation paper in September 2017
- European Parliament supports harmonization in July 2018
- EC releases directive and regulation proposal in March 2019
- European Parliament approves directive and regulation in April 2019
- Political agreement reached following triilogue discussion in February 2019

Issuers From New Jurisdictions Are Coming To The Market

Source: S&P Global Ratings.

Source: European Covered Bond Council.
Sustainable Covered Bonds: A Steady Rise

- Sustainable covered bond issuance is growing, with year-to-date issuance already 20% above that of 2018 full year.
- Green covered bonds account for approximately three-quarters of sustainable covered bond issuances, in line with the relative share of mortgage-backed covered bonds (typically inclusive of green covered bonds).
- However, social covered bonds have emerged as a key component in the ESG landscape, reflecting the potential positive social impact of public sector lending.

Recent Sustainable CB Issuances

<table>
<thead>
<tr>
<th>Issuance date</th>
<th>Issuer</th>
<th>ESG type</th>
<th>Maturity (years)</th>
<th>Size (bil.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>November 2019</td>
<td>CAFFIL</td>
<td>Green</td>
<td>10</td>
<td>€0.75</td>
</tr>
<tr>
<td>November 2019</td>
<td>DKB</td>
<td>Social</td>
<td>10</td>
<td>€0.50</td>
</tr>
<tr>
<td>October 2019</td>
<td>Sparbanken SOR</td>
<td>Green</td>
<td>7</td>
<td>€0.50</td>
</tr>
<tr>
<td>October 2019</td>
<td>SR-Boligkreditt</td>
<td>Green</td>
<td>7</td>
<td>€0.50</td>
</tr>
<tr>
<td>July 2019</td>
<td>Société Générale SFH</td>
<td>Green</td>
<td>10</td>
<td>€1.00</td>
</tr>
<tr>
<td>June 2019</td>
<td>PKO Bank Hipoteczny</td>
<td>Green</td>
<td>5.3</td>
<td>PLN0.25</td>
</tr>
<tr>
<td>May 2019</td>
<td>Nykredit</td>
<td>Green</td>
<td>3.4</td>
<td>SEK5.64</td>
</tr>
<tr>
<td>Mar 2019</td>
<td>Realkredit Danmark</td>
<td>Green</td>
<td>3.3</td>
<td>DKK0.10</td>
</tr>
<tr>
<td>Feb 2019</td>
<td>CAFFIL</td>
<td>Social</td>
<td>8</td>
<td>€1.00</td>
</tr>
<tr>
<td>January 2019</td>
<td>DNB Boligkreditt</td>
<td>Green</td>
<td>4.9</td>
<td>SEK9.00</td>
</tr>
<tr>
<td>January 2019</td>
<td>SCBC</td>
<td>Green</td>
<td>5.2</td>
<td>SEK6.00</td>
</tr>
</tbody>
</table>

YTD--Year to date, as of Nov. 15, 2019. Source: S&P Global Ratings.
Sustainable Covered Bonds: Drivers And Challenges In A Tug Of War

Drivers

- Reputational benefits
- Diversification of the investor base
- Creating favorable conditions for the funding of green and social assets

Challenges

- No common definition for the collateral backing sustainable covered bonds
- Sustainable covered bond programs are currently more expensive to set up and manage than an unsecured funding program
- There is (so far) no significant funding cost differentiation in the current low interest rate environment
Sustainable Covered Bonds: 2020 Issuance Expectations

- 2019 full year sustainable issuance is expected to be approximately €9 billion.
- For 2020, assuming that the topic of definitions is addressed, issuance should easily reach €11 billion, representing a 20% year-on-year growth.

Published in: “Are Covered Bonds Becoming More Sustainable?”, Sept. 6, 2019
In April, the European Parliament approved a legislative framework for the harmonization of EU covered bond legislations. The legislative package consists of a directive and regulation.

National authorities will have 18 months after the legislation is published in the Official Journal of the EU—expected before the end of this year—to transpose the directive into their national legislation and an additional 12 months to implement the new rules.

We expect that certain countries, such as Spain or Austria, will have more work to do to align their existing framework with the directive.

While we believe that the framework is broadly positive for the product, raising the standards for asset quality, disclosure, and supervision, we do not expect any immediate impact on our ratings.

New Markets: No Longer Just A European Affair

- Outstanding covered bonds grew by 8% in the last 10 years, but geographic distribution changed.
- While eurozone covered bond balances decreased significantly, notably in Germany, they grew in other European countries such as Denmark and Sweden.
- Covered bonds in Central and Eastern Europe (CEE) and new markets grew the most in the last years.

Outstanding Covered Bonds
As of December 2018

- Total: Up 7.7% since 2009
- Eurozone: Down 13% since 2009
- Other Europe: Up 26% since 2009
- CEE and new markets: Up 448% since 2009

- Hungary (€3.8 bil.), South Korea (€2.8 bil.), Turkey (€2.3 bil.), Japan (€1.0 bil.), and Brazil (€454 mil.). Source: European Covered Bond Council.

*Hungary (€3.8 bil.), South Korea (€2.8 bil.), Turkey (€2.3 bil.), Japan (€1.0 bil.), and Brazil (€454 mil.). Source: European Covered Bond Council.

S&P Global Ratings
Central And Eastern Europe: Harmonization Will Support Issuance

- Covered bonds are expanding rapidly in CEE, notably in Poland. We expect this expansion to continue, with new issuers accessing the market for the first time and further enhancements to some of the local frameworks.

- Issuers in the region have traditionally funded themselves with customer deposits and, in several instances, parent support from foreign banks. However, covered bonds are playing an increasingly important role in their funding mix. At the same time, we expect solid growth in mortgage lending in the region, which should support covered bond issuance.

- Several countries, such as Slovakia and Estonia, have recently amended or approved covered bond legislation. Estonia is also working with Lithuania and Latvia to create a pan-Baltic legal framework for the issuance of covered bonds.

- We expect the European Commission's recent legislative initiative on covered bond harmonization to further encourage local legislators to amend or approve frameworks aligned to best practices in established markets.

Outstanding Covered Bonds In CEE Grew By More Than 50% In The Last Five Years

Source: European Covered Bond Council.
Asia And Latin America: Credit Conditions Remain Supportive But Risk Looms

- Fed and ECB policy should be positive for capital flows in the near term. However, volatility could resurface and sour financial conditions for issuers in emerging markets, as trade and GDP slow and political risks mount.

- South Korea and Singapore pioneered covered bond issuance in Asia. While we expect them to remain the biggest Asian markets in the foreseeable future, other Asian countries could benefit from funding diversification through covered bonds.

- Sumitomo Mitsui Banking Corp. issued the first Japanese covered bond in November 2018, using a contractual structure. We believe that other lenders may follow suit due to the Japanese mortgage market’s size and local lenders' funding needs in foreign currencies.

- Although Brazil’s National Congress passed a dedicated covered bond legislation in 2015 and related regulation was approved by the central bank in 2017, banks only began testing this new instrument after the 2018 presidential election. We believe that the real test for the success of covered bonds in Brazil will be once issuers are allowed to issue public placements or cross-border covered bonds.

European Issuance Could Rise 5%-10% In 2020

Issuers’ renewed access to cheap central bank funding may substitute for some European covered bond issuance.

However, ECB asset purchases and ongoing negative yields could help spur supply.

Scheduled covered bond maturities are also set to rise by nearly 10% in 2020.

Even assuming flat net issuance, gross volumes could therefore rise modestly.

Eurozone Economy Is Slowing Further Amid Rising Uncertainties

- We expect the eurozone economy to slow further in 2020 to 1.1% growth, on the back of weaker external demand.
- We expect the ECB to lower its deposit rate by another 10 basis points in December 2019, and to be unable to raise rates until 2022.

**Germany And Italy Weigh On Economic Growth**

**Low Yields Pose Challenges To Banks**

*F--S&P Global Ratings forecast.*

Source: S&P Global Ratings.

Note--Actual yields are quarterly averages. F--S&P Global Ratings forecast.

Sources: S&P Global Ratings, Refinitiv.
Low Growth And Lower Rates In 2020

- Household consumption and construction will remain the main pillars of growth as unemployment remains low; inflation will be contained at 1.3% in 2020.
- Risks for growth and confidence also remain due to global trade tensions, Brexit, and political fragmentation.

### S&P Global Ratings' Eurozone Economic Forecast

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</thead>
<tbody>
<tr>
<td>Real GDP (% y/y)</td>
<td>2.0</td>
<td>1.9</td>
<td>2.7</td>
<td>1.9</td>
<td>1.2</td>
<td>1.0</td>
<td>1.2</td>
<td>1.3</td>
</tr>
<tr>
<td>Real exports (% y/y)</td>
<td>6.4</td>
<td>3.0</td>
<td>5.7</td>
<td>3.5</td>
<td>2.4</td>
<td>2.2</td>
<td>2.6</td>
<td>2.7</td>
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<tr>
<td>Real imports (% y/y)</td>
<td>7.5</td>
<td>4.2</td>
<td>5.0</td>
<td>2.7</td>
<td>2.6</td>
<td>2.9</td>
<td>3.1</td>
<td>2.9</td>
</tr>
<tr>
<td>Real fixed investment (% y/y)</td>
<td>4.7</td>
<td>3.9</td>
<td>3.8</td>
<td>2.3</td>
<td>2.8</td>
<td>2.1</td>
<td>1.9</td>
<td>1.8</td>
</tr>
<tr>
<td>Real private consumption (% y/y)</td>
<td>1.8</td>
<td>1.9</td>
<td>1.8</td>
<td>1.4</td>
<td>1.2</td>
<td>1.3</td>
<td>1.2</td>
<td>1.2</td>
</tr>
<tr>
<td>Real government consumption (% y/y)</td>
<td>1.3</td>
<td>1.8</td>
<td>1.5</td>
<td>1.1</td>
<td>1.3</td>
<td>1.2</td>
<td>1.2</td>
<td>1.2</td>
</tr>
<tr>
<td>CPI inflation (% y/y)</td>
<td>0.2</td>
<td>0.2</td>
<td>1.5</td>
<td>1.8</td>
<td>1.2</td>
<td>1.2</td>
<td>1.3</td>
<td>1.5</td>
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<tr>
<td>Unemployment rate (%)</td>
<td>10.9</td>
<td>10.0</td>
<td>9.1</td>
<td>8.2</td>
<td>7.6</td>
<td>7.4</td>
<td>7.3</td>
<td>7.2</td>
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<tr>
<td>Short-term interest rate (%)</td>
<td>0.05</td>
<td>0.01</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
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<tr>
<td>Long-term interest rate (%)</td>
<td>1.21</td>
<td>0.86</td>
<td>1.09</td>
<td>1.13</td>
<td>0.34</td>
<td>-0.01</td>
<td>0.24</td>
<td>0.51</td>
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<tr>
<td>Exchange rate ($ per €)</td>
<td>1.11</td>
<td>1.11</td>
<td>1.13</td>
<td>1.18</td>
<td>1.12</td>
<td>1.12</td>
<td>1.15</td>
<td>1.19</td>
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</table>

Europe's Housing Markets Lose Speed

- We forecast house prices will continue to rise over the next two years, but at a slower pace.
- Looser financing conditions should be broadly supportive of housing demand.
- Worsening affordability and less dynamic job markets will put a lid on house price growth.

House Price Inflation Is Slowing

Published in: “Europe's Housing Markets Lose Speed As The Economy Weakens”, Sept. 24, 2019.

S&P Global Ratings
Bank And Sovereign Ratings Trigger Actions On Covered Bonds

- Most of our rating actions on covered bond programs since 2010 resulted from issuer or sovereign rating actions and the application of new criteria.
- Collateral performance explains just 15% of rating actions, due to issuers’ willingness to support their programs and top up the cover pool when asset performance was weakening.

### Covered Bonds Rating Actions
By cause, 2010 - 2019

- Change in criteria (24%)
- Issuer rating action (35%)
- Sovereign rating action (22%)
- Collateral action (15%)
- Counterparty rating action (4%)

### Covered Bond Rating Transitions
2010 - 2019

<table>
<thead>
<tr>
<th>From</th>
<th>AAA</th>
<th>AA+</th>
<th>AA</th>
<th>AA-</th>
<th>A+</th>
<th>A</th>
<th>A-</th>
<th>BBB+</th>
<th>BBB</th>
<th>BBB-</th>
<th>BB+</th>
<th>Total</th>
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</thead>
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<tr>
<td>AAA</td>
<td>62</td>
<td>9</td>
<td>-</td>
<td>7</td>
<td>2</td>
<td>4</td>
<td>5</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>95</td>
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<tr>
<td>AA+</td>
<td>-</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2</td>
</tr>
<tr>
<td>AA</td>
<td>1</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<td>2</td>
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<tr>
<td>AA-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>A+</td>
<td>-</td>
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<td>-</td>
<td>1</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>63</td>
<td>10</td>
<td>-</td>
<td>8</td>
<td>2</td>
<td>6</td>
<td>5</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: S&P Global Ratings.
EMEA Sovereigns Outlook: Many Ratings Still Below 2009 Level

Slow Pace Of Recovery For European Developed Markets Sovereign Ratings

Outlook Distribution Balanced – But Mind The Brexit Gap

Source: S&P Global Ratings.
## Linger In The Low Zone: Top European Risks

<table>
<thead>
<tr>
<th>Risk level</th>
<th>Trend</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ELEVATED</strong></td>
<td></td>
<td>Weakening European political cohesion, political gridlock, polarization driven by populism and political uncertainty.</td>
</tr>
<tr>
<td><strong>MODERATE</strong></td>
<td></td>
<td>Italy: political situation, economic stagnation and eurozone slowdown, public finance sustainability.</td>
</tr>
<tr>
<td><strong>HIGH</strong></td>
<td></td>
<td>Disruptive Brexit: Negative economic impact on the U.K. and Eurozone; potential confidence shock.</td>
</tr>
<tr>
<td><strong>HIGH</strong></td>
<td></td>
<td>Rising protectionism given the unilateral policy changes, trade wars (Airbus decision, U.S. tariffs on European car exports).</td>
</tr>
</tbody>
</table>

Source: S&P Global Ratings.
EMEA Banks Outlook

Key Expectations
- The ratings bias is flat and likely to turn negative through 2020.
- In the absence of meaningful strategic initiatives to tackle costs and restructure, some banks’ business models will come under more pressure.
- Capitalization and asset quality should hold up, and we could see further asset quality improvement in some markets.
- Systemic banks will continue making progress in the buildup of bail-in buffers.
- The rationale for consolidation is stronger than ever, but most banks are unwilling to pursue it.

Key Assumptions
- The U.K. will not leave the EU without a deal.
- Economic growth will be modest, but the region will not enter into recession.
- The success of monetary policy actions in boosting growth will be limited in the absence of fiscal stimulus.
- Credit conditions will remain favorable and support refinancing and asset quality.

Key Risks
- A disruptive Brexit that leads to a severe economic downturn in the U.K.
- Economic growth challenges spread to eurozone countries other than Germany and Italy.
- A lack of a decisive response from banks to their low profitability.
- A build-up of asset bubbles, higher risk taking, or irrational pricing dynamics.

The Challenges Of **Low-For-Much-Longer Rates**

1. Low Profitability Is Becoming A Structural Issue

2020 projected ROE (%)

- Median: 6.8%

2. Banks Need To Tackle Their Costs

2020 projected cost-to-income ratio (%)

- Median: 59%

3. Risk Of Build Up Of Bubbles In Property Markets

4. Too Low Pricing For Risk In Corporate Europe

---

1. Projected 2020 return on equity for top 100 EMEA banks.
2. Projected 2020 cost to income ratio for top 100 EMEA banks.
3. Increase in nominal house prices.
Key Issues In EMEA Banking Systems

1. Germany: Profitability Is Under Pressure

Lending margin

2. France: Need To Address Inefficiencies

Cost-to-income ratio


UK GDP (volumes)

4. Italy: Workout Of Legacy NPAs

NPA to loans (right scale)

Cost of risk (left scale)

Estimated average credit losses over a cycle

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1. Lending margins are measured as the difference between interest rates for new business loans and a weighted-average rate of new deposits. Sources: ECB, S&P Global Ratings. 2. Inefficiencies measure based on the cost-to-income ratio (%). F--S&P Global Ratings forecast.
The Risk Of Downgrades Triggered By Bank Downgrades Is Fairly Limited

- The presence of unused notches of uplift reduces the risk of covered bond downgrades if we were to lower our rating on the issuing bank.
- French and German programs are more protected from the risk of bank downgrades.
- Spanish and Italian programs have less of a buffer to mitigate the effect of bank downgrades, and could be immediately affected by a sovereign downgrade.

Unused Notches By Country

- The presence of unused notches of uplift reduces the risk of covered bond downgrades if we were to lower our rating on the issuing bank.
- French and German programs are more protected from the risk of bank downgrades.
- Spanish and Italian programs have less of a buffer to mitigate the effect of bank downgrades, and could be immediately affected by a sovereign downgrade.

Source: S&P Global Ratings.
Germany And Austria Credit Trends: Rating Stability Prevails

Germany Still An Issuance Powerhouse
Benchmark investor-placed covered bond issuance

Sovereign Ratings

<table>
<thead>
<tr>
<th>Country</th>
<th>Rating</th>
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<tbody>
<tr>
<td>Germany*</td>
<td>AAA/ Stable</td>
</tr>
<tr>
<td>Austria</td>
<td>AA+/ Stable</td>
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</table>

Positive Signs Of Covered Bonds Upgrades

*Unsolicited rating. YTD--Year to date. Source: S&P Global Ratings.
Germany And Austria Economic Conditions: Housing Markets Are Heating Up

Economic And Housing Market Statistics

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<tr>
<td>Germany</td>
<td></td>
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<td></td>
<td></td>
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</tr>
<tr>
<td>Nominal house prices, % change y/y</td>
<td>8.4</td>
<td>6.2</td>
<td>6.2</td>
<td>5.3</td>
<td>4.5</td>
<td>3.8</td>
<td>3.3</td>
</tr>
<tr>
<td>Real GDP, % change</td>
<td>2.2</td>
<td>2.5</td>
<td>1.5</td>
<td>0.6</td>
<td>1.1</td>
<td>1.2</td>
<td>1.1</td>
</tr>
<tr>
<td>CPI inflation (%)</td>
<td>0.4</td>
<td>1.7</td>
<td>1.9</td>
<td>1.4</td>
<td>1.7</td>
<td>1.8</td>
<td>1.9</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>4.2</td>
<td>3.8</td>
<td>3.4</td>
<td>3.2</td>
<td>3.2</td>
<td>3.1</td>
<td>3.0</td>
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<td>Austria</td>
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<tr>
<td>Nominal house prices, % change y/y</td>
<td>6.3</td>
<td>1.6</td>
<td>4.7</td>
<td>4.9</td>
<td>4.9</td>
<td>5</td>
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<tr>
<td>Real GDP, % change</td>
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<td>2.7</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>CPI inflation (%)</td>
<td>1.0</td>
<td>2.2</td>
<td>2.1</td>
<td>1.8</td>
<td>1.9</td>
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<td>2.0</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>6.0</td>
<td>5.5</td>
<td>4.9</td>
<td>4.7</td>
<td>4.8</td>
<td>4.8</td>
<td>4.9</td>
</tr>
</tbody>
</table>


HPIs Are Rising Faster Than In Rest Of Europe

- Compared with international levels, we consider the risk of a sharp correction in house prices in Austria to be low in the medium term.
- For Germany, we forecast a gradual decline in real house price growth to 3.8% in 2021, from 6.2% in 2018. This gradual slowdown could come amid a somewhat weaker economic growth outlook. That said, we believe low and potentially declining interest rates, demand outstripping supply, and continued net immigration might sustain high house prices.
Germany And Austria Credit Outlook

Notwithstanding the mortgage lending growth, a meaningful increase in private sector leverage through 2021 is not likely. We will continue to see the industry's generally sound underwriting practices. Harmonization may prompt German issuers to begin adopting features seen in other European jurisdictions such as soft bullet structures, and higher loan-to-value (LTV) limits. Targeted long-term refinancing operations (TLTRO) continue to dampen German issuers' need to issue more covered bonds, although rising house prices could lead to increased issuance.

Growth Of German Mortgages Not Fully Transmitted To Covered Bonds

Austrian banks have conservative lending and underwriting standards. They broadly use mortgage covered bonds for funding, and low LTV ratios also stem from conservative mortgage lending standards required by Austrian covered bonds legislation. We estimate that lending and issuance will increase in line with lending growth. The new harmonization directive will likely mean a reformation of the current Austrian covered bond landscape, which may affect issuance depending on the final outcome.
Spain, Italy, And Greece Credit Trends: **Sovereign Ratings Trigger Upgrades**

**Spain And Greece Upgrades Lift Covered Bonds Ratings**

- **Sovereign Ratings**
  - **Greece**: BB-/Positive
  - **Italy**: BBB/Negative
  - **Spain**: A/Stable

**Most Covered Bond Programs Have A Stable Outlook**

- **S&P Global Ratings**
  - **Unsolicited rating. Source: S&P Global Ratings.**
  - **N/A--Not applicable. Source: S&P Global Ratings.**

---

*S&PC Global Ratings*
Spain, Italy, And Greece Economic Conditions: Growth Decelerates In Spain, Stagnates In Italy

Economic And Housing Market Statistics

<table>
<thead>
<tr>
<th></th>
<th>Greece</th>
<th></th>
<th>Italy</th>
<th></th>
<th>Spain</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Real GDP, % change</td>
<td>-0.2</td>
<td>1.5</td>
<td>1.9</td>
<td>2.0</td>
<td>2.5</td>
<td>2.7</td>
</tr>
<tr>
<td>CPI inflation (%)</td>
<td>0.0</td>
<td>1.1</td>
<td>0.8</td>
<td>0.6</td>
<td>0.8</td>
<td>1.2</td>
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<tr>
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<td>19.3</td>
<td>17.5</td>
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<td>14.5</td>
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<td>-0.5</td>
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<td>1.2</td>
<td>1.8</td>
<td>0.7</td>
<td>-0.1</td>
<td>0.4</td>
<td>0.6</td>
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<td>1.3</td>
<td>1.2</td>
<td>0.8</td>
<td>0.7</td>
<td>0.8</td>
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<tr>
<td>Unemployment rate</td>
<td>11.7</td>
<td>11.3</td>
<td>10.6</td>
<td>10.3</td>
<td>10.3</td>
<td>10.2</td>
</tr>
<tr>
<td>Nominal house prices, % change y/y</td>
<td>4.5</td>
<td>7.2</td>
<td>6.7</td>
<td>5.5</td>
<td>4.4</td>
<td>3.9</td>
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<tr>
<td>Real GDP, % change</td>
<td>3.2</td>
<td>3</td>
<td>2.6</td>
<td>2.2</td>
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<td>1.7</td>
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<tr>
<td>CPI inflation (%)</td>
<td>-0.3</td>
<td>2</td>
<td>1.7</td>
<td>1.1</td>
<td>1.4</td>
<td>1.4</td>
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<tr>
<td>Unemployment rate</td>
<td>19.6</td>
<td>17.2</td>
<td>15.3</td>
<td>13.9</td>
<td>13.3</td>
<td>12.7</td>
</tr>
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</table>

- House prices in Italy should contract further by 0.4% in 2020, on the back of a stagnating economy. Favorable affordability metrics and low borrowing costs will ensure that demand holds up in the more dynamic economic regions and that the overall fall in housing prices therefore remains mild.

- In Spain, resilient economic conditions and expansionary monetary policy should support housing demand and prices, but affordability is worsening. We therefore expect house-price inflation to decelerate to 5.5% this year and to 4.4% in 2020.

Affordability Worsens In Spain, But Is Better Than The Long-Term Average In Italy And Greece

Price-to-income ratio


S&P Global
Ratings
Spain, Italy, And Greece Credit Outlook

- Covered bond issuance should remain constrained by continued subordinated issuance to meet regulatory expectations on bail-in buffers, weak growth in funded assets, and the competition from TLTRO III.
- Spanish authorities have considerable work to do to align the local legislation to the harmonization directive recently approved by the European Parliament.
- Most outlooks on banks in the region are stable and the presence of unused notches should limit the impact of rating actions on issuers.
- Most ratings in the region are constrained by sovereign risk considerations. We expect rating actions on governments, if any, to remain a key trigger of covered bond rating actions.
France Credit Trends: **Covered Bond Ratings Are Stable**

**Limited Recent Rating Actions On Covered Bonds**

<table>
<thead>
<tr>
<th>Year</th>
<th>Upgrades</th>
<th>Downgrades</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
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<tr>
<td>2012</td>
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<td>2013</td>
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<td>2014</td>
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<td>2015</td>
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<td>2016</td>
<td></td>
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<tr>
<td>2017</td>
<td></td>
<td></td>
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<tr>
<td>2018</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td></td>
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</tbody>
</table>

*Unsolicited rating. Source: S&P Global Ratings.

**Sovereign Rating**

**France* ** AA/Stable

**Ample Headroom For Overcollateralization In French Mortgage Programs**

Available credit enhancement
Asset default risk
Market value risk

Source: S&P Global Ratings.
France Economic Conditions: **Weak Household Income Growth Constrains House Prices**

**Economic And Housing Market Statistics**

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<tbody>
<tr>
<td>Nominal house prices, % change y/y</td>
<td>1.5</td>
<td>3.2</td>
<td>3.3</td>
<td>3.4</td>
<td>3.1</td>
<td>2.7</td>
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</tr>
<tr>
<td>Real GDP, % change</td>
<td>1</td>
<td>2.4</td>
<td>1.7</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
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<tr>
<td>CPI inflation (%)</td>
<td>0.3</td>
<td>1.2</td>
<td>2.1</td>
<td>1.1</td>
<td>1.1</td>
<td>1.1</td>
<td>1.5</td>
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<tr>
<td>Unemployment rate</td>
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<td>9.4</td>
<td>9.1</td>
<td>8.8</td>
<td>8.8</td>
<td>8.7</td>
<td>8.7</td>
</tr>
</tbody>
</table>

_F--Forecast. y/y--Year on year. Source: S&P Global Ratings, Eurostat, OECD, INSEE._

We expect house prices in France to continue to grow steadily by 3.4% this year after 3.3% last year, but to gradually soften after that. Although borrowing costs will drop further with upcoming monetary policy easing, the current weaker economic environment points to less dynamic income growth. This will limit gains in property prices given an already high price-to-income ratio.

**Price Ratios: Household Income Limits Growth**

Source: S&P Global Ratings.
France Credit Outlook

- In 2020, we expect covered bonds to remain a primary funding source for French banks.
- Issuance should remain roughly stable as the dynamic French housing market (with transactions at an all-time high in May 2019) will provide ample collateral for covered pools. That said, covered bond issuance volumes will be offset by unsecured issuances – comprising senior non-preferred and senior preferred debt – and MREL eligible funding instruments.
- The high ratings on French banks, the stable outlook on all covered bond programs, and the presence of unused notches in the covered bond ratings reflect limited potential for rating actions on covered bond issuers.
- The "société de financement de l'habitat" (SFH) and "société de crédit foncier" (SCF) legal frameworks are in line with the EU harmonization directive, suggesting no immediate need for a revision. In the transposition of the directive into national legislation, the national legislator will need to address the issue of the extension conditions for soft-bullet maturities – just as in other jurisdictions.

**Issuance Has Stabilized**

Benchmark investor-placed covered bond issuance

YTD -- Year to date. Source: S&P Global Ratings.
No Recent Rating Actions On Covered Bonds

Sovereign Ratings

**Belgium***  AA/Stable

**Netherlands***  AAA/Stable

The Netherlands Has A Wide Issuer Base

*Unsolicited rating. Source: S&P Global Ratings*

Source: S&P Global Ratings.
Belgium And Netherlands Economic Conditions: House Prices Growth Is Stretching Affordability

Economic And Housing Market Statistics

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<tbody>
<tr>
<td>Nominal house prices, % change y/y</td>
<td>2.6</td>
<td>3.6</td>
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<tr>
<td>Real GDP, % change</td>
<td>1.5</td>
<td>1.7</td>
<td>1.4</td>
<td>1.1</td>
<td>1.3</td>
<td>1.4</td>
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<tr>
<td>CPI inflation (%)</td>
<td>1.8</td>
<td>2.2</td>
<td>2.3</td>
<td>1.6</td>
<td>1.7</td>
<td>1.8</td>
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<tr>
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<td>6</td>
<td>5.7</td>
<td>5.8</td>
<td>5.7</td>
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<tbody>
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<td>8.5</td>
<td>9.1</td>
<td>6.5</td>
<td>5.5</td>
<td>4.6</td>
<td>4</td>
<td></td>
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<tr>
<td>Real GDP, % change</td>
<td>2.1</td>
<td>3</td>
<td>2.6</td>
<td>1.7</td>
<td>1.6</td>
<td>1.5</td>
<td>1.4</td>
<td></td>
</tr>
<tr>
<td>CPI inflation (%)</td>
<td>0.1</td>
<td>1.3</td>
<td>1.6</td>
<td>1.8</td>
<td>1.1</td>
<td>1.8</td>
<td>1.8</td>
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<tr>
<td>Unemployment rate</td>
<td>6</td>
<td>4.9</td>
<td>3.8</td>
<td>3.3</td>
<td>3.2</td>
<td>3.2</td>
<td>3.2</td>
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</tr>
</tbody>
</table>

- In Belgium despite stretched affordability, we expect favorable economic and financing conditions will support house price growth. We forecast prices will rise by 3.0% this year and 2.4% in 2020.

- In the Netherlands we expect house prices to grow strongly by 6.5% this year and 5.5% in 2020. This marks a deceleration from 9.1% in 2018 due to worsening affordability and weaker growth. The price slowdown in Amsterdam should be sharper than in the rest of the country.

Price Ratios: Affordability Is Worsening

F—Forecast. y/y—Year on year. Source: S&P Global Ratings, Eurostat, Banque Nationale de Belgique, Kadaster, CBS Statistics Netherlands, OECD.
Belgium and Netherlands Credit Outlook

- In the Netherlands, we expect covered bond issuance to remain stable as the Dutch housing market is still dynamic with associated levels of mortgage lending. On the other hand, Dutch banks continue to use residential mortgage-backed securities (RMBS) issuances as a primary funding tool, somewhat limiting the growth potential for covered bonds.

- In Belgium, although new lending for housing loans has been solid in the past few years, covered bond issuance has been volatile as Belgian banks' funding needs have been reduced by the recourse to the TLTRO programs. Competition from TLTRO III will continue in 2020.

- The steady ratings on Belgian and Dutch banks, the stable outlook on covered bond programs (excluding Dutch conditional pass-through [CPT] programs, which don’t have outlooks), and the presence of unused notches in the ratings on bullet maturity covered bond programs leads to reduced potential for rating actions on covered bond issuers.

*S&PGlobal Ratings Year to Date data. Source: S&P Global Ratings*
**U.K. And Ireland Credit Trends:** Ratings Stable, But Brexit Still Looms

Recent Program Upgrades Concentrated In Ireland

[Graph showing upgrades and downgrades from 2010 to 2019]

*Unsolicited rating. Source: S&P Global Ratings.

**Sovereign Ratings**
- **U.K.***: AA/Negative
- **Ireland**: A+/Stable

**Stable Outlooks Prevail**
Covered bond outlooks – U.K. and Ireland

[Pie chart showing 83% Stable, 17% Negative]

*Source: S&P Global Ratings.*

Economic And Housing Market Statistics

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<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>U.K. Nominal house prices, % change y/y</td>
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<td>4.6</td>
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<td>3.5</td>
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<td>1.8</td>
<td>1.8</td>
<td>1.4</td>
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<td>U.K. CPI inflation (%)</td>
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<td>1.7</td>
<td>2.4</td>
<td>1.8</td>
</tr>
<tr>
<td>U.K. Unemployment rate</td>
<td>4.9</td>
<td>4.4</td>
<td>4.1</td>
<td>3.8</td>
<td>4.2</td>
<td>4.5</td>
<td>4.6</td>
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<tr>
<td>Ireland Nominal house prices, % change y/y</td>
<td>8.7</td>
<td>11.9</td>
<td>7.2</td>
<td>2.5</td>
<td>4</td>
<td>4</td>
<td>3.5</td>
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<tr>
<td>Ireland Real GDP, % change</td>
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<td>6.7</td>
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<td>3</td>
</tr>
<tr>
<td>Ireland CPI inflation (%)</td>
<td>-0.2</td>
<td>0.3</td>
<td>0.7</td>
<td>1</td>
<td>1.4</td>
<td>1.5</td>
<td>1.5</td>
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<tr>
<td>Ireland Unemployment rate</td>
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<td>5.8</td>
<td>5.2</td>
<td>5</td>
<td>4.5</td>
<td>4.5</td>
</tr>
</tbody>
</table>

- In the U.K., against the backdrop of Brexit uncertainty, we expect house price growth to stall at the end of this year, before recovering from 2020. In a disruptive no-deal Brexit, we would expect U.K. house prices to drop significantly.
- In Ireland, following the recent slowdown, we expect prices to rise more moderately, provided a disruptive Brexit is avoided. We forecast price rises of 2.5% this year, after a 7.2% rise in 2018.

Price Ratios: Future Depends On Brexit Deal

F--Forecast. y/y--Year on year. Sources: S&P Global Ratings, Eurostat, OECD, Department for Communities and Local Government, Central Statistics Office.

S&P Global Ratings
U.K. And Ireland Credit Outlook

- In the U.K., 2019 covered bond issuance continued to increase due mainly to banks’ need to find alternative funding sources after the end of the Bank of England’s Term Funding Scheme in 2018. On the other hand, U.K. banks continue to use RMBS issuances as a primary funding tool, which caps the growth potential for covered bonds.

- 2019 has also seen several U.K. banks taking advantage of funding through covered bonds with markets still being receptive prior to any potential Brexit-induced disruptions.

- In Ireland, covered bond issuance has been muted as Irish banks’ funding needs have been addressed by other funding sources—such as RMBS—and recourse to the TLTRO programs.

- The solid ratings on U.K. banks, stable outlooks on covered bond programs (excluding one public sector program), and the presence of unused notches—although limited in magnitude—in the ratings on covered bond programs points to a reduced potential for rating actions on covered bond programs. We may change this view if there is a no-deal Brexit (this scenario would cause rating actions on the issuing banks of two or more notches).

### U.K. Issuance Rising; Ireland Muted

Benchmark investor-placed covered bond issuance

<table>
<thead>
<tr>
<th>Year</th>
<th>Bil. €</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>35</td>
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<tr>
<td>2012</td>
<td>30</td>
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<tr>
<td>2013</td>
<td>25</td>
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<td>2014</td>
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<td>2015</td>
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<td>2016</td>
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<tr>
<td>2017</td>
<td>5</td>
</tr>
<tr>
<td>2018</td>
<td>0</td>
</tr>
<tr>
<td>2019</td>
<td>35</td>
</tr>
</tbody>
</table>

YTD--Year to date. Source: S&P Global Ratings

### LIBOR Phase-Out Under The Spotlight

A common issue affecting U.K. issuers is the LIBOR phase-out in 2021: While new issuances are already Sterling Overnight Index Average (SONIA) denominated, existing LIBOR-denominated bonds and related swaps need to be converted to SONIA. This activity has already started in 2019 and will continue being on most U.K. banks “to-do” lists in 2020.
The Nordics Credit Trends: Growth In Private Debt Is Supporting Issuance

Foreign Demand Is Increasing For Danish Covered Bonds

Norway And Sweden Domestic Currency Bonds Exceed Euro Issuance In 2019

YTD--Year to date. Source: S&P Global Ratings
# The Nordics Economic Conditions (I): Still Supportive Of Program Ratings Despite Headwinds

## Economic And Housing Market Statistics

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<thead>
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</thead>
<tbody>
<tr>
<td><strong>Denmark</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nominal house prices, % change y/y</td>
<td>N/A</td>
<td>2.9</td>
<td>3</td>
<td>3</td>
<td>2.5</td>
<td>2.2</td>
<td>N/A</td>
</tr>
<tr>
<td>Real GDP, % change</td>
<td>2.4</td>
<td>2.3</td>
<td>1.5</td>
<td>1.7</td>
<td>1.7</td>
<td>1.6</td>
<td>1.7</td>
</tr>
<tr>
<td>CPI inflation (%)</td>
<td>0</td>
<td>1.1</td>
<td>0.7</td>
<td>1.1</td>
<td>1.5</td>
<td>1.8</td>
<td>2</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>6.2</td>
<td>5.7</td>
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<td>5.2</td>
<td>5.1</td>
<td>5.1</td>
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<tr>
<td><strong>Sweden</strong></td>
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<tr>
<td>Nominal house prices, % change y/y</td>
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<td>-4.3</td>
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<td>2.2</td>
<td>3</td>
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</tr>
<tr>
<td>Real GDP, % change</td>
<td>2.7</td>
<td>2.1</td>
<td>2.4</td>
<td>1.5</td>
<td>1.8</td>
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<td>2.2</td>
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<tr>
<td>CPI inflation (%)</td>
<td>1.1</td>
<td>1.9</td>
<td>2</td>
<td>1.8</td>
<td>1.9</td>
<td>2</td>
<td>2.1</td>
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<tr>
<td>Unemployment rate</td>
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<td>6.7</td>
<td>6.3</td>
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<tr>
<td><strong>Finland</strong></td>
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<td></td>
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<tr>
<td>Nominal house prices, % change y/y</td>
<td>0.5</td>
<td>0.3</td>
<td>-0.6</td>
<td>0.8</td>
<td>0.9</td>
<td>1.2</td>
<td>N/A</td>
</tr>
<tr>
<td>Real GDP, % change</td>
<td>2.8</td>
<td>3</td>
<td>1.7</td>
<td>1.3</td>
<td>1.2</td>
<td>1.1</td>
<td>1.3</td>
</tr>
<tr>
<td>CPI inflation (%)</td>
<td>0.4</td>
<td>0.8</td>
<td>1.2</td>
<td>1.3</td>
<td>1.4</td>
<td>1.6</td>
<td>1.8</td>
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<tr>
<td>Unemployment rate</td>
<td>8.8</td>
<td>8.6</td>
<td>7.4</td>
<td>6.8</td>
<td>6.9</td>
<td>7</td>
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<tr>
<td><strong>Norway</strong></td>
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<tr>
<td>Nominal house prices, % change y/y</td>
<td>3.4</td>
<td>3.1</td>
<td>-2.1</td>
<td>0.3</td>
<td>1.2</td>
<td>N/A</td>
<td>N/A</td>
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<tr>
<td>Real GDP, % change</td>
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<td>2.3</td>
<td>1.3</td>
<td>2</td>
<td>2.3</td>
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<tr>
<td>CPI inflation (%)</td>
<td>3.6</td>
<td>1.8</td>
<td>2.7</td>
<td>2.3</td>
<td>2</td>
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<td>3.8</td>
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F--Forecast. N/A--Not applicable. y/y--Year on year. Sources: S&P Global Ratings.
The Nordics Economic Conditions (II): A Mixed Bag

1. House Prices Are Still Increasing In Denmark

```
Index (2006 = 100)

Year-on-year growth (%)


One-family houses

Owner-occupied flats

One-family houses (right scale)

Owner-occupied flats (right scale)
```

2. Norwegian House Prices Correction

```

The whole country

Oslo including Bærum

Bergen

Akershus excluding Bærum

Vestlandet excluding Bergen

The whole country

Oslo including Bærum

Bergen

Agder and Rogaland excluding Stavanger
```

3. Swedish House Prices Have Seen A Correction

```
Rolling 12-month price change

Sweden - Total

Sweden - houses

Sweden - flats

Stockholm - flats
```

4. Finland: House Prices Still Strong In The Helsinki Area

```
Index (2006 = 100)

Greater Helsinki

Whole country - Greater Helsinki

Tampere

Turku
```

1. Source: Denmark’s Central Bank.
3. Source: ValueGuard, HOX Index.
4. Source: Statistics Finland.
Nordics Credit Outlook

**Denmark: Interest-Only Issuances Decreasing**
Credit conditions have tightened significantly since the latest crisis. In 2014, the regulator introduced a 5% downpayment requirement for new mortgage loans. In addition, the regulator supervisory diamonds have set out aggregate limits for banks and mortgage institutes to proactively avoid future imbalances associated with credit growth, interest-only lending, short-term financing, and interest rate risks, among other guidelines. As each mortgage loan is traditionally matched with a bond in Denmark, we expect reduced issuance of interest-only covered bonds.

**Sweden: Household Debt Looks Set To Increase**
We expect the continued growth in debt to support further issuance in Swedish covered bonds. However, as in most jurisdictions, available liquidity is at an all-time high, which makes banks less reliant on further issuance. Finally, the new harmonization directive will require Swedish covered bond issuers to cover 180 liquidity. Although, we do not expect this to affect the market significantly, uncertainty could negatively affect issuance in 2020.

**Norway: Private Debt Growth Likely To Stabilize**
We believe that the house price correction over 2017 indicates that 2017 represents the peak and that household credit growth will likely slow down, which will lower covered bond issuance. More restrictive lending policies will continue to reduce funding needs. In addition, high household debt partly reflects the high share of home ownership in Norway, compared with countries with similarly high levels of household debt.

**Finland: Private Debt Expected To Grow**
We expect the demand for credit to remain moderate in the short term, despite the Finnish economy's still-sound-but-slowing growth. We forecast private sector credit will grow moderately by 4% annually. Thanks to household demand for loans, especially via mortgage loans and loans to housing corporations. This will in turn support further covered bond issuance. Over the past few years the growth in housing companies has accelerated, which could support covered bond issuance. That said, untapped potential remains as slightly more than half of Finnish households hold no debt at all.
Related Research

- Global Outlook: Banks Can Largely Fend Off Tougher 2020, Nov. 18, 2019
- Europe's Housing Markets Lose Speed As The Economy Weakens, Sept. 24, 2019
- Global Covered Bond Characteristics And Rating Summary Q3 2019, Sept. 10, 2019
- Global Covered Bond Insights Q3 2019, Sept. 10, 2019
- Credit FAQ: Are Covered Bonds Becoming More Sustainable?, Sept. 6, 2019
- When The Cycle Turns: How Would Global Structured Finance Fare In A Downturn?, Sept. 4, 2019
- S&P Global Ratings' Covered Bonds Primer, June 20, 2019
- Credit FAQ: Understanding The Role Of European Secured Notes In Funding SME And Infrastructure Lending, May 21, 2019
- Harmonization Accomplished: A New European Covered Bond Framework, April 18, 2019
- New Covered Bond Markets Set To Expand Amid Legislative And Market Developments, March 21, 2019
Analytical Contacts

Antonio Farina
Senior Director, Covered Bonds
+34- 91-788-7226
antonio.farina@spglobal.com

Casper Andersen
Director, Covered Bonds
+44-20-7176-6757
casper.andersen@spglobal.com

Adriano Rossi
Director, Covered Bonds
+39-02-7211-1251
adriano.rossi@spglobal.com

Andrew South
Head of Structured Finance Research - EMEA
+44-20-7176-3712
andrew.south@spglobal.com