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Banks face difficulties operating in central and eastern Europe

James Shotter Author alerts

For the past year, one of the biggest questions hanging over the Austrian banking system was how lenders would perform in the financial health checks carried out this autumn by the European Central Bank.

In the event, despite the volatile conditions in several of their key central and eastern European markets, Austria's banks came through the tests relatively unbloodied.

Five of the six lenders taking part in the so-called asset quality review and associated stress tests – including Erste Group and Raiffeisen Zentralbank, Austria's two biggest domestically owned banks, as well as the former trade union bank, Bawag PSK, and two regional Raiffeisen banks – passed comfortably.

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The one failure was widely expected: Österreichische Volksbanken (ÖVAG), a midsized lender that was partly nationalised after running into trouble during the financial crisis, was found to have an €865m capital shortfall. But as it had already announced that it would wind down the bulk of its business, markets were relatively unfazed.

"The situation at ÖVAG is perhaps a bit embarrassing for regulators, but it is not a problem in macroeconomic terms," says Josef Christl, a consultant and former director of the Austrian central bank. "It is not systemic."

To the relief of investors, who sent shares in both Erste and Raiffeisen soaring after the results were announced, the ECB did not find that any of the other banks needed more capital or to boost their provisions further.

"Overall it was a very good exercise," says Andreas Treichl, chief executive of Erste. "I think the result is sufficiently complete that it should help to restore trust in the European banking system."

Despite this successful review, however, 2014 has been tough for Austria's big banks. Although Bank Austria had a profitable first nine months, Erste Group warned in July it would make a net loss of up to €1.6bn, while Raiffeisen expects a net loss of up to €500m.

In Erste's case, the losses are due to big writedowns in its Romanian business, and a jump in provisions in Hungary, where the government has forced banks to compensate borrowers for what it sees as "unfair" conditions and changes.

Raiffeisen was also affected by the Hungarian government's treatment of foreign exchange loans, but its most pressing problem remains its exposure to Ukraine, where unrest in Donetsk and Lugansk has forced it to close most of the 80 branches of its Aval subsidiary.

Such setbacks have provoked a lively debate in Austria about the merits of the big banks' presence in central and eastern Europe – a region that yielded substantial profits before the crisis, but which has since proved more volatile.

€865m
ÖVAG's capital shortfall under the ECB's asset quality review

While some of the region's markets are likely to remain problematic, analysts say that others are still offering stable returns.

"There are some markets that are clearly very difficult at the moment, such as Ukraine and Hungary," says Richard Grieveson, an analyst at the Economist Intelligence Unit. "But there are others, such as the Czech Republic, Poland and Slovakia, which – even if they are not as profitable as they were before the crisis – still offer both economic and political stability."

Although Bank Austria is still trying to sell its Ukrainian unit, Karl Sevelda, chief executive of Raiffeisen, says an exit from the country

is not on the cards for his bank, as conflict has made potential buyers scarce. However, the group is reviewing all its options in Hungary.

€640m

Government tax levy cost to Austrian banks in 2014

There are no plans for Erste to leave Hungary, says Mr Treichl. But while the bank remains committed to its current set of markets, it is changing what it does in them. Mr Treichl plans to focus more on Erste's businesses with retail clients and SMEs, less on multinationals.

Away from their difficulties abroad, the main concern for Austria's banks is the special tax imposed on the sector by the Austrian government in the wake of the financial crisis. The tax is set to cost the sector around €640m this year.

However, after years of lobbying, there is growing realisation among policy makers that the levy is making it hard for banks to strengthen their capital position. Senior bankers are hopeful that a compromise can be found.

"The bank tax has lost its basis," says Mr Sevelda, arguing that justification for the levy – the chance that the state might have to bail banks out – is gone, as new EU rules give authorities the power to deal with failing lenders.

"So why are we still paying? This just weakens the banks. In Austria over 10 years, we are missing out on €6.4bn in capital."

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