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Crisis fallout: Cost of support for banking has yet to become clear

By James Shotter

Frozen assets: the head office of the nationalised Hypo AlpeAdriaBank International in Klagenfurt

By and large, the measures taken by Austria to support its banks in the depths of the financial crisis have worked.

Despite the turmoil to its east, its big cross-border lenders have come through the years since 2007 bloodied, but unbowed.

Three middle-sized banks ran into trouble. Over the next 12 months, the full cost of dealing with their problems – the subject of endless wrangling between Vienna and Brussels – is likely to become clearer. It will not be cheap.

The most prominent of the three, Hypo Alpe-Adria-Bank International, based in Klagenfurt in southern Austria, indulged in overambitious expansion into the Balkans in the early years of the century. This left it high and dry when the financial crisis hit. Austria nationalised the bank in 2009 because of its regional importance and pumped in €2.9bn in state aid. In September, the European Commission approved a plan to sell the bank's viable parts in Austria and the Balkans, and wind down the remainder.

The cost of this process is the subject of much debate. As it signed off on the winding down, the commission approved up to €5.7bn in further state aid and €3.2bn in liquidity support. There has been speculation that the costs could yet climb. In September, the Austrian central bank (ÖNB) was forced to deny a report that it had carried out a study suggesting the bill could reach €17bn.

Österreichische Volksbanken (ÖVAG) and Kommunalkredit, the other two distressed banks, continue to cause headaches. ÖVAG has stopped paying interest on the government's stake in it, while Kommunalkredit is being wound down after attempts to sell part of it failed.

The latter has so far received €2.5bn in public help and the EU has said that Austria can provide further assistance. Alois Steinbichler, chief executive of Kommunalkredit, says he hopes to avoid this.

"Assuming stable markets, we do not plan to go back to the government, unless the risk perception changes. But currently we don't see any need for further government support," he says, adding that even closing the bank overnight would leave "negative values" in its portfolio of just €1.1bn-€1.2bn.

Despite the uncertainty, the International Monetary Fund said in its annual review of Austria in September that it expected the cost of dealing with the problem banks to be "significant but manageable".

Domestic experts tend to agree. "We have lost a lot of time, particularly in relation to Hypo, Kommunalkredit and ÖVAG," says Vienna-based consultant Josef Christl, a former executive director of the ÖNB.

"The cost of dealing with these banks will be high, but I don't think it will be overdramatic in the sense that it will lead to a downgrade of the [country]. "And from the point of view of the public finances, [the cost] will not all fall due in the same year, which makes it more manageable."

A specialist group has been set up to ponder how to manage the wind-down at Hypo and is due to report soon. One idea is to establish a privately owned vehicle to run down toxic assets, which would keep additional debt off the state's books.

The big banks, such as Raiffeisen and Erste Group, have not shown much enthusiasm. "We are prepared to co-operate with the finance ministry," says Karl Sevelda, chief executive of Raiffeisen. "But we must not be overburdened."

Andreas Treichl, his counterpart at Erste, is even less enthusiastic. "Until now nobody asked me and I hope nobody ever will," he says.

Their reluctance is hardly surprising. Although the big banks are in reasonable health, building capital is currently a hot topic. Indeed, the IMF recommended in its review that Austria's big lenders bolster their capital buffers. Contributing to a wind-down vehicle would make this harder.

The issue is more pressing for Raiffeisen. Erste completed a €660m capital-raising in July that will allow it to pay back the €1.76bn in government funds that it received during the crisis. Raiffeisen has yet to follow suit.

The IMF's urging is based in part on its assessment that asset quality in central, eastern and southern Europe is deteriorating. It reckons that one in six loans are non-performing, though it concedes that it is hard to get a clear picture because of different reporting practices in different countries.

The European Central Bank's asset quality review, due before it takes control of supervising the eurozone's biggest banks next year, should provide greater clarity.

"I don't think there will be enormous new demands for capital, but one shouldn't underestimate the review, either," says Mr Christl.

Even if the ECB's asset quality review does not throw up any surprises, Austria's big lenders will continue to face a hard grind until stronger growth returns to central Europe and interest rates pick up.

Mr Sevelda reckons economic conditions should improve in 2014, but does not expect rate rises until 2015. Mr Treichl takes a similar line.

"It's frustrating not to be able to offer clients savings rates at which they don't lose money in real terms," he says. "We have 16m retail clients, but the longer the low interest rate environment continues, the more people will start to move into riskier investments. Losing money on no-risk investments is not good."