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Banking: Former Soviet satellite states offer hopes of market growth

By James Shotter



Who goes there? A former guard passes through the gate that marks the site of the Austrian-Hungarian border

Central and eastern European states became an obvious target for Austrian banks when they began to open up to foreign investors following the collapse of communism.

Fierce competition in the relatively small Austrian market had left lenders' margins wafer thin, while the emerging economies of central Europe looked set to grow far faster than their western European peers for at least a generation. Austria's imperial past had also left the country with links with its neighbours.

That logic still holds. "There is no doubt it was the right step," says Herbert Stepic, chief executive of [Raiffeisen Bank International](#). "Raiffeisen without central Europe would be a completely different ball game."

Nonetheless, in the years since the financial crisis, the commitment of Austrian banks to central Europe has been tested by a potent combination of turbulent economic conditions and erratic political decision-making by governments in some neighbouring countries, particularly Hungary.

Yet, after an especially difficult 2011, when both [Erste Group](#) and Raiffeisen, Austria's biggest banks, were forced to make big writedowns, 2012 was, on the whole, a better year. Both banks made profits and passed the European Banking Authority's stress tests in the

autumn.

The prospects for the coming year are hard to divine, with the diverse markets of central and eastern Europe recovering at different rates.

"We expect a reduction of growth at least in the first two quarters of 2013," says Mr Stepic. "And we generally see non-performing loans, while still increasing, doing so only modestly."

"Russia is running strongly, Ukraine is not doing badly but is volatile. All in all, I expect moderate development but in reality the truth will only show when we have reached the half-year."

Andreas Treichl, chief executive of Erste Group, is similarly cautious. "Eastern Europe is not homogenous. You have different performances in the different countries," he says.

The "swing factor", he adds, is Romania, where Erste made a €294m net loss in 2012 but where it hopes to return to profit this year. "But our overall expectation is that most of the markets we are in will show a better performance than in 2012," he says.

Despite the uncertainty, the economic upheavals of the past few years in central and eastern Europe also present an opportunity for Austrian banks, says Josef Christl, former executive director of the Austrian central bank and now a banking consultant.

As the crisis has worn on, some foreign banks have scaled back their operations in the region. The most conspicuous retrenchment has been among Greek banks, says Mr Christl, but he adds that Belgian and German lenders are displaying greater caution than before the crisis. This dynamic, he believes, offers Austrian banks a chance to win market share.

Johan Ekblom, analyst at Bank of America Merrill Lynch, takes a similar view: "It will not be easy while growth is slow but, particularly in markets where Austrian banks have a lower share, there is scope for them to make gains," he says.

The woes at the eurozone's periphery, says Mr Christl, have started a "creeping shift in deposits" from southern to northern Europe. "Cyprus has sped this process up and Austria's banks should be among those that benefit. But the problem with receiving large quantities of deposits at the moment is that it is hard to invest them productively."

Alongside opportunities, 2013 will bring more challenges, particularly on the regulatory front. Erste and Raiffeisen have to repay

participation stakes taken by the government during the crisis, which will cut their capital reserves.

The effect will be bigger for Raiffeisen. Citigroup's Stefan Nedialkov estimates that, without the government stake, Raiffeisen's full Basel III core tier one capital ratio was just 6.8 per cent at the end of last year and will only rise to 8 per cent by the end of 2015. "At some point, Raiffeisen is going to have to boost its capital position," he says.

A further challenge to the cross-border model of Austria's big banks are European plans to introduce resolution regimes for the continent's lenders. Details have yet to be finalised but with the eurozone and non-euro countries moving at different speeds, Austrian bankers fret that they could end up subject to an unhelpful variety of rules.

This would be a particular concern if non-euro countries where Austrian banks have big operations, such as the Czech Republic or Hungary, opt not to join a future banking union.

"I don't know which of the countries that are not in the euro would be willing to join the banking union. That will cause us a problem because we will be split," says Mr Treichl. "And if we go into multi-entry resolution regimes, a situation where you basically have to ringfence your banks completely from the outside, you are going back to a completely national banking system. That's the end of the common market."

The final big question for Austria's banking system concerns three midsize banks – [Österreichische Volksbanken](#), Hypo Alpe-Adria-Bank and KA Finanz, which is the "bad bank" of Kommunalkredit – all of which got into trouble during the financial crisis and are now wholly or partly state owned. Under European state aid rules, the banks are due to be reprivatised but their condition is such that Austria has yet to carry this out.

In the long term, experts say Austria needs to shed, rather than preserve, struggling banks. "If Austria's banking structure were less congested, it would do the whole system more good than harm," says Mr Christl. "A certain amount of rationalisation is necessary."

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