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Banks consider how to contain conflict fallout

Ukraine implications

Escalation of unrest hinders quick exit, writes *James Shotter*

In January, Karl Sevelda, chief executive of Raiffeisen Bank International, was on a tour promoting the bank's planned €2.8bn capital-raising to international investors.

"If you had said to me then that three months later Ukraine would be teetering on the edge of war, I would have said you were dreaming," he says. "I have the feeling that both sides have almost stumbled into this conflict."

Despite its nightmarish qualities, the unrest in Ukraine is all too real and Austria's banks are in the thick of it. Fitch, the rating agency, concluded in a note in April that Austrian banks had, relative to equity, a greater exposure to Russia and Ukraine than all their European peers.

Raiffeisen has a gross exposure of €19.7bn to Russia and €3.8bn on a net basis to Ukraine.

Bank Austria, which is owned by Italy's UniCredit, has €11.9bn exposure to Russia and €1.6bn to Ukraine. Erste Group is not present in Russia, but has residual exposures of €435m in Ukraine, having sold its subsidiary there last year.

Both Raiffeisen and Bank Austria had planned to follow Erste out of Ukraine, but the crisis has made that more difficult. Bank Austria is attempting a sale, but Federico Ghizzoni, chief executive of UniCredit, admitted two weeks ago that progress had slowed.

Mr Sevelda says the conflict has put a sale of Raiffeisen's Aval subsidiary, which is Ukraine's fifth-biggest bank by credit volumes, on hold.

"It wouldn't make sense to try to sell at the moment, because the price would not be right," he says. "For now it is off the table, given the situation in Ukraine. In the medium and long term, I wouldn't want to make a prediction."

Remaining in Ukraine has not been a pain-free experience. Indeed, Mr Sevelda concedes that Raiffeisen had received a "black eye" in Crimea, which was annexed by Russia in March.

During the first quarter the bank closed and sold its 32 branches in the region, albeit at a small profit, Mr Sevelda says.

The situation in eastern Ukraine – the country's industrial heartland – where two regions declared autonomy after referendums on May 11, is also giving banking executives cause for concern.

So far, there have been temporary closures, but Raiffeisen has not had to shut any of its 84 branches permanently.

Despite such problems, Mr Sevelda puts a brave face on Raiffeisen's situation.

"We have a capital [adequacy ratio] of about 20 per cent. We are certainly one of the best, if not the best bank in the country.

"Lots of foreign companies keep their deposits with us."

However, Mr Sevelda concedes that the precipitous decline in the value of the hryvnia – which has fallen 25 per cent since February – and the volatile situation in Ukraine could lead to an increase in writedowns of Raiffeisen's Ukrainian assets.

It is not just Austria's banks that have an interest in developments in Ukraine. The country's big insurers, Vienna Insurance Group and Uniqa, have both been present in Ukraine for around a decade.

Unlike the banks, says Thomas Unger, an analyst at Erste Bank, the potential for losses at the insurers is limited, as they have not made loans that they need to recoup.

However, a prolonged crisis would still hurt, says Andreas Brandstetter, Uniqa's chief executive, because it would deprive the group of a medium-term growth opportunity.

Difficult as the situation in the Ukraine is for Austrian banks, it is small beer compared with the damage an impairment of their operations in Russia would cause.

Russia was the single biggest source of profits in 2013 for both Bank Austria and Raiffeisen. Bank Austria reported an operating profit of €783m, while Raiffeisen made €615m. Both banks have said they have no intention of pulling out of the country.

Russia has seen nothing like the turmoil that has convulsed Ukraine. The big unknown, however, is how the country might respond if the EU were to impose tough economic sanctions.

"If [Russian president Vladimir] Putin nationalised foreign banks, that would be an enormous shock," says Josef Christl, a consultant and former executive director of the OeNB, the Austrian central bank.

Yet, he adds, even if this doomsday scenario does not materialise the crisis is likely to put strain on the Austrian duo.

"First, the uncertainty is slowing growth and this could affect loan quality in Russia. Second, there is the depreciation of the rouble," he says.

"Given the amount of business Raiffeisen does in Russia, even a non-extreme scenario could be very painful."

Mr Sevelda says a sharp escalation is unlikely, so long as the conflict in Ukraine remains a local one.

Ewald Nowotny, governor of Austria's central bank, takes a similar view. He concedes, however, that the situation is volatile.

"These are high-quality banks, so the risks would be solely political risks," he says. "This is something that is very difficult to predict."

> 'It wouldn't make sense to sell at the moment, because the discount would be so high'