CEE Banking Sector Report

May 2013

Commitment will be rewarded

- No deleveraging, banks support real economy
- Banks in CEE outperform those in Eurozone
- Strong profitability for the second year in a row
- Aggregate NPL ratio in CEE at 10.1%

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Executive Summary

- **Solid banking expansion in CEE in 2012 with total loan growth at 14.8% yoy, 2010-2012 real loan growth at 22%**
- **Regional Return on Equity (RoE) at 15-16%, well-diversified CEE banks well positioned to earn their cost of capital**
- **Changing competitive landscape (exiting niche players, re-pricing opportunities) supports committed players**

2012 total CEE loan growth at 14.8% yoy (in EUR-terms)

In terms of growth and profit, the banking sectors in the CEE region continue to outperform their Western European counterparts. Total 2012 loan growth in CEE came in at 14.8% yoy in EUR-terms. Another year of expansion brings the cumulative 2010-2012 real loan growth in CEE to 21.8%; in the Eurozone real loan growth was negative over the same period of time. Banks in CEE continue to benefit from growth opportunities and margins that are significantly higher than in Western Europe. The average Return on Equity (RoE) in the CEE banking sectors stood at 16% in 2012, while in Western Europe the average RoE just turned into low positive territory. In CEE well-diversified banks can earn more than their cost of capital, while Western European banking sectors currently do not offer comparable earnings potentials. Despite healthy annual trends, 2012 was a year of two halves: H1 2012 was characterized by decent growth. Conversely, in H2 2012 growth dynamics slowed down. This trend was mostly demand- rather than supply-side driven. Although in 2012 the aggregate NPL ratio in CEE inched just a notch higher versus 2011 (to 10.1%), in absolute terms NPLs in CEE increased by around 14% yoy. There are individual CEE markets with NPL ratios of 15-20%. However, in other markets NPL ratios remained in a range of 4-8%, almost unchanged vs. 2011. Hence, NPL levels of well-diversified Western European CEE banks do not look overly high. Challenges are arising from new banking regulations in Europe, and also in CEE, that have a certain protective bias. However, a full independence of national banking markets might not be feasible, especially in CEE, where (modest) current account deficits are likely to prevail. Besides, after all, banking is about intermediating between savings and investments.

Regional RoE at 16%

CEE offers a lot of opportunities for well-diversified players

Very diverging NPL trends and NPL ratio levels

As the economic cycle is expected to turn in 2013, we see an upside potential for lending in H2 2013. In terms of growth beyond 2013 CEE also suggests more opportunities compared to Western Europe. We expect the loan-to-GDP ratio for six to seven high-growth CEE banking markets to raise, which indicates strong earnings potential. The two largest CEE banking markets Russia and Poland are expected to lead. All banking markets with a strong growth potential represent 80% of the total CEE banking business, and 85% of the regional GDP. In 2012, the asset-based ranking of banks in EUR-terms is almost unchanged versus 2011. UniCredit, RBI, Erste, SocGen and KBC still form the five largest Western European CEE banks. Apart from large takeover transactions looming already in 2011 (Santander; RBI – Poland; Sberbank – VBI), we have observed several smaller divestments (UniCredit – Kazakhstan; KBC – Russia/Slovenia; Citibank and RBS – Romania; Commerzbank, Swedbank and Erste – Ukraine). Reducing L/D ratios again dominated business strategies, reaching levels, targeted to revive revenues. The aggregate profitability of major CEE banks has come slightly down due to slowing loan growth; pressure on net interest margins and the partial shift of the asset mix to more secured lending. The majority of banks reported weakening asset quality in 2012. In a few cases divestments were used to refurbish NPL ratios. Aggregate provisioning improved following a 2011 peak in Hungary, but with pressure from Romania, Ukraine, Slovenia and a moderate upward tendency in Poland.

Ranking of UniCredit, RBI and Erste as top players almost unchanged

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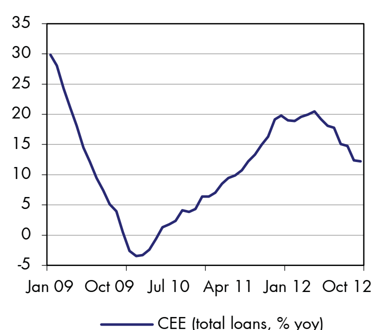
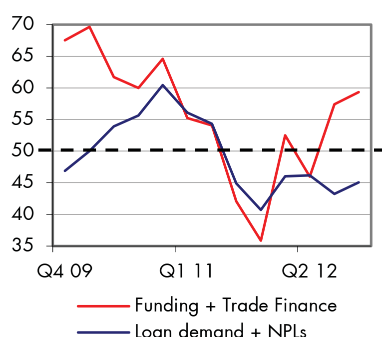
Introduction: Demand side constraints predominate in 2012

CEE: Loan growth decline in 2012



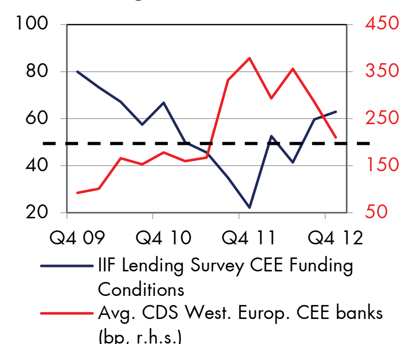
Source: National sources, Raiffeisen RESEARCH

IIF Lending Survey: CEE sub-indices*



** 50 = neutral mark; values below 50 = deteriorating conditions, values above 50 = improving conditions*
Source: IIF, Raiffeisen RESEARCH

CEE: Funding conditions*



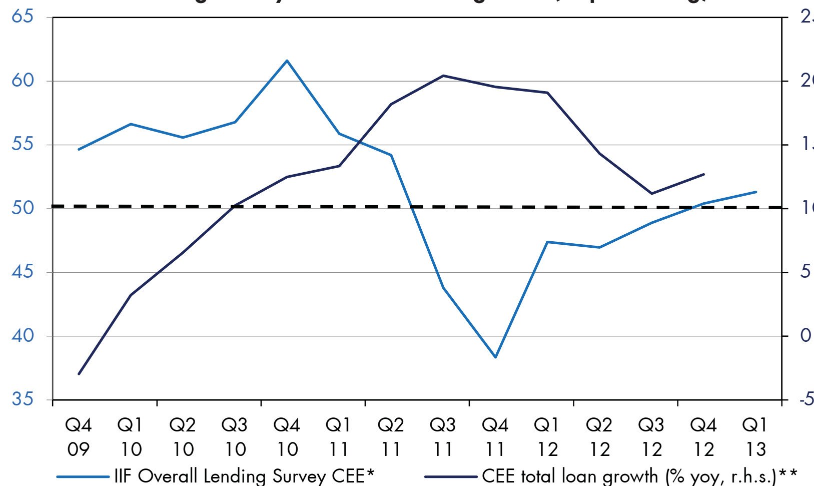
** 50 = neutral mark; values below 50 = deteriorating conditions, values above 50 = improving conditions*
Source: Bloomberg, IIF, Raiffeisen RESEARCH

According to the Emerging Markets Lending Survey published by the Institute of International Finance (IIF), loan demand in Central and Eastern Europe (CEE) rose in Q1 and Q2 2012, but decelerated or stagnated in Q3 and Q4 2012. A similar tendency was evident with regard to the expectations for non-performing loan (NPL) formation and realized NPL ratios. And as could be expected the preliminary conclusions of the lending survey represented a good indicator for the CEE banking sector results realized in 2012. It is therefore justifiable to regard 2012 as a year of two halves. In H1 2012, the CEE banking sector as a whole was still progressing smoothly and was characterized by decent loan growth and stabilizing asset quality. Indeed, in the first months of the year total CEE loan growth hovered around 20% yoy (in LCY-terms). This strong performance was due largely to solid economic and banking sector performance in key markets such as Russia and Poland, which started 2012 with loan growth rates at 27% yoy and 13% yoy respectively (in LCY-terms). However, in H2 banking sector dynamics slowed substantially across the entire CEE region, largely as a result of cyclical developments in the real economy. Accordingly, in Q4 2012 total loan growth in CEE softened to some 11-12% yoy (in LCY-terms). A tangible slowdown of the domestic economies of the larger markets such as Russia and Poland resulted in a marked deceleration of loan growth in both countries. In the Russian banking market, total loan growth in LCY-terms softened from 27% at the beginning of 2012 to some 19% yoy in the course of the year, while in Poland total loan growth plummeted from levels of around 12-13% yoy to around 1-2% yoy (in LCY-terms). The banking sectors in smaller economies such as the Czech Republic and Slovakia also followed the overall softening trend and CEE total loan growth in LCY-terms on an annual basis fell from approximately 19% yoy in 2011 to 12% in 2012 (real loan growth decreased from 9.8% to 6.8%). Conversely, owing to the strong performance of major regional currencies, CEE loan growth in EUR-terms actually rose marginally in 2012 as compared to 2011 (from 14.5% to 14.8% yoy). Nevertheless, the softening of CEE loan growth in LCY-terms, which is more closely correlated to developments in the real economy, resulted in slightly increased pressure on asset quality in some CEE banking markets. Thus, the aggregate NPL ratio for the whole CEE region inched up from 10% in 2011 to 10.1% in 2012. In absolute EUR-terms, total NPLs in the CEE region increased from some EUR 120 bn in 2011 to around EUR 135 bn in 2012, which constituted a rise of 14%. The asset quality trends in CE and SEE, where Western European banks are a dominating force, were somewhat more challenging, as the regional (CE+SEE) NPL ratio went up from 9.6% in 2011 to 10.7% in 2012.

As a rule, it is difficult to distinguish between supply and demand side factors with regard to banking sector developments. However, the softening of CEE loan growth in H2 2012 seems to have been driven more from the demand side, i.e. mirroring Western Europe's return to recession in H2 2012. This statement is supported by the fact that the cyclically more sensitive corporate loan segment, which represents 65% of total lending in CEE, softened quite considerably. In 2010 and 2011 loan growth in the CEE corporate segment still showed a strong recovery after a disappointing 2009. Loan growth in CE and SEE is definitely more closely linked to the loan growth inside the Eurozone (here correlations with the Eurozone loan growth trend are at 70-80%, while in Russia the correlation is roughly 20%). However, one should think about causalities before attaching too much importance to this interpretation (i.e. that weak banking sector growth in

Western Europe per se leads to weak developments in CE and SEE). We see the strongest transmission channel for the softening loan growth in CE and SEE in H2 2012 as being the strong dependency on Western Europe in the real economy. This idea is underpinned by the fact that more supply-side related factors such as the improvement of bank funding and overall capital markets conditions following the "Draghi announcement" in July 2012 that whatever measures are necessary to preserve the Euro would be implemented, did little to support the CEE banking sector growth in H2 2012. The financial market and overall funding conditions for Western European and Western CEE banks improved a great deal in H2 2012 (as indicated by declining CDS spreads for Western European CEE banks and some sub-indices in the IIF Lending Survey). However, this did not translate into stronger loan demand. By contrast, in H1 2012 CEE loan growth decoupled from the Eurozone loan growth trend, in spite of more intense pressure on the supply side than in H2 2012 (e.g. due to deteriorating capital market sentiment or regulatory pressure from the European Banking Authority (EBA) capital requirements on European banks). The significant impact of the demand side on loan growth can also be seen in CEE markets where banks are over-liquid (e.g. in the Czech Republic, Slovakia and Albania with loan-to-deposit ratios in the 60-90% range). Indeed, Russia was the only CEE country in which some supply side measures such as recent regulatory tightening, i.e. the outlook for quasi-Basel III implementation and limits on consumer lending growth, had a significant impact during H2 2012.

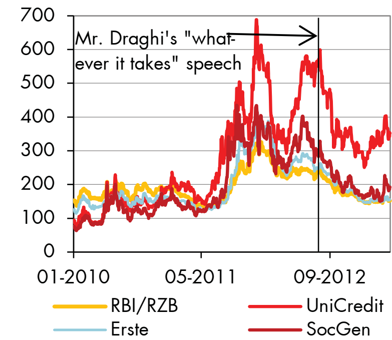
IIF Overall Lending Survey CEE vs. CEE loan growth (1 quarter lag)**



** CEE sub-index; 50 = neutral mark; values below 50 = deteriorating conditions, values above 50 = improving conditions, latest data point Q1 2013*
*** In LCY-terms, lag of 1-quarter compared to IIF Lending Survey (i.e. Q4 2012 Lending Survey figures plotted in relation to Q1 2013 loan growth outcome)*
Source: IIF, national central banks, Raiffeisen RESEARCH

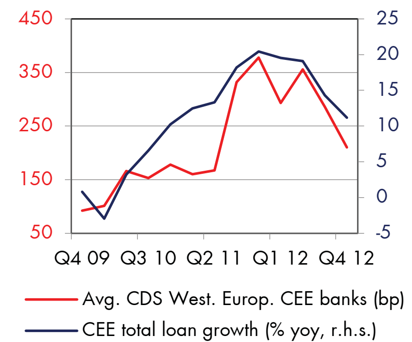
The division of the CEE banking sector into two halves, i.e. with one half characterized by highly profitable growth markets with good asset quality and the other by more stagnant markets with challenging asset quality conditions, continued in 2012. This division of the CEE banking sector into two halves is expected to continue for some time to come, while from a cyclical perspective the overall CEE banking sector outlook may improve in H2 2013. Interestingly the forward-looking IIF Lending Survey for CEE already signalled an improvement in Q1 2013 inching clearly above the 50 points level (with one of the strongest increases in the sub-index for loan demand). Given our current macroeconomic forecasts, we expect CEE loan growth of around 9-10% yoy (in EUR-terms) in 2013, with some additional growth potential in years to come.

ECB supporting CEE banks



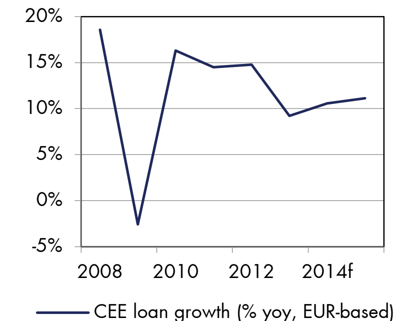
Source: Bloomberg, Raiffeisen RESEARCH

CEE: Funding vs. loan growth



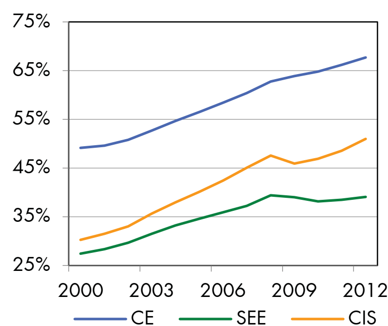
Source: Bloomberg, national central banks, Raiffeisen RESEARCH

CEE: Near-term growth outlook



Source: National sources, Raiffeisen RESEARCH

CEE: GDP per capita at PPP*



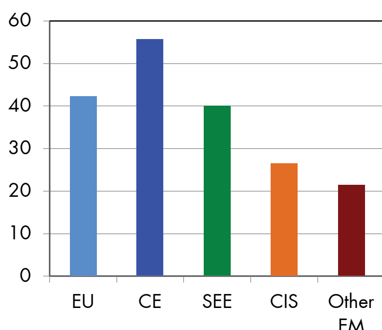
** of Eurozone*
Source: Eurostat, Raiffeisen RESEARCH

Definition of sub-regions and regional economic outlook

Before going into all details of the heterogeneous CEE banking sector developments we want to shed some light at our sub-regional definitions and regional economic trends. According to very heterogeneous economic and political structures we divide the CEE region into the three sub-regions: Central Europe (CE), Southeastern Europe (SEE) and the Commonwealth of Independent States (CIS).

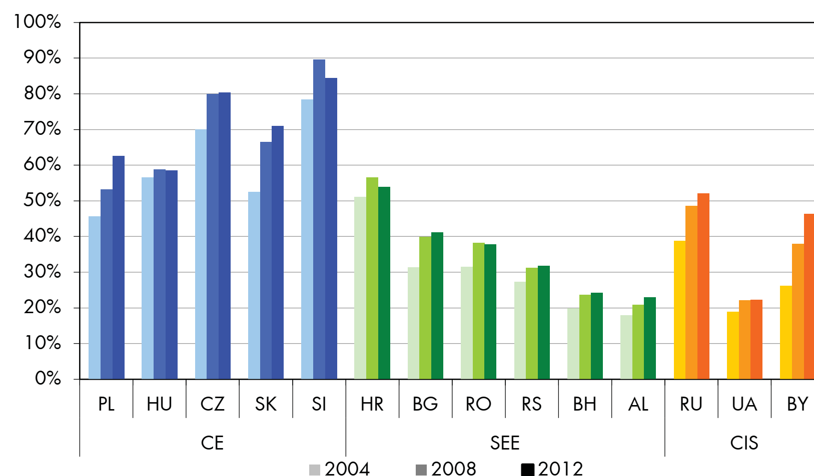
Central Europe (CE): This sub-region consists of five EU and OECD-members (Poland, Hungary, the Czech Republic, Slovakia and Slovenia). Slovakia and Slovenia are Eurozone members. All CE countries are characterized by a high level of economic development; some of them – like the Czech Republic, Slovenia or Slovakia – are considered Advanced Economies by the IMF. The CE sub-region's average GDP per capita at purchasing power parity (PPP) of EUR 18,200 is the highest in CEE (at market prices EUR 11,200). Given relatively high wealth levels, the CE region shows a high degree of resilience, which was also proven in the recent "Eurozone crisis" years.

Inward FDI stock (% of GDP)*



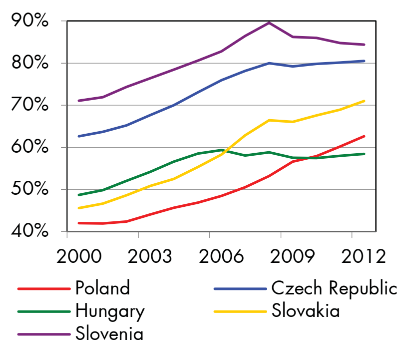
** Avg. 2007-2012*
Source: National sources, Eurostat, Raiffeisen RESEARCH

CEE: GDP per capita at PPP at the country level (% of Eurozone)



Source: Eurostat, IMF, Raiffeisen RESEARCH

CE: GDP per capita*



** of Eurozone*
Source: Eurostat, Raiffeisen RESEARCH

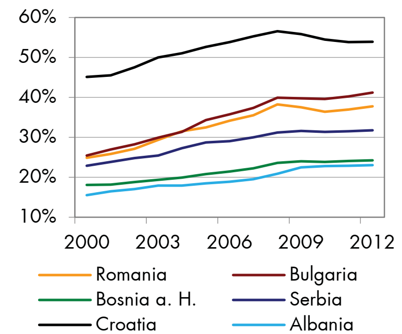
Over the past decades, nearly all CE countries attracted substantial Foreign Direct Investment (FDI) that helped to (re-)build strong industrial sectors. Powerful export-oriented industrial sectors also help to contain external imbalances in the CE region. Moreover, the industry sectors in CE are highly integrated with so-called "core" European countries like Germany, the Netherlands or Austria, which are the biggest investors in CE. Therefore, it comes as no surprise that GDP growth in the CE region – in line with "core" Eurozone countries – also slowed down in 2012. Moreover, the CE region still entered the year 2013 with a downward momentum in terms of economic growth – a tangible turn-around is only expected for H2 2013. Nevertheless, a full-blown regional recession (like inside the Eurozone) had been avoided. With regards to the long-term growth prospects, most CE countries have exploited the low-hanging fruits of European/EU economic integration (e.g. in terms of FDI and trade integration). The GDP per capita of Slovenia and the Czech Republic already stands at 80% of the Eurozone's average GDP per capita. Recent years have also shown that economic catching-up is not a one-way road and that political risks can escalate even in more solid CE countries like Hungary. Hungary has also shown no economic convergence vis-à-vis the Eurozone in recent years and as a consequence is now the poorest CE country, with an average GDP per capita (at PPP) that is below 60% of the Eurozone average. Due to unsustainable developments in the fiscal sphere and its banking sector, Slovenia has also shown no convergence in recent years.

However, other CE countries like Poland, the Czech Republic and Slovakia enjoy solid growth prospects. We therefore expect the average GDP growth of CE to reach levels around 2-2.5% in 2014 and 2015, resulting in an outperformance of the Eurozone by at least 1-1.5%.

Southeastern Europe (SEE): The SEE sub-region consists of seven countries which are characterized by stark economic and political divergences. According to our definition, SEE consists of the EU member states Romania and Bulgaria, the upcoming EU member state Croatia (EU entry scheduled for 2013) and four more countries from the Western Balkans – Serbia, Bosnia and Herzegovina, Albania and Kosovo (the latter will not be addressed in this report due to data constraints). Serbia, Bosnia and Herzegovina, Albania and Kosovo are at very different stages of their long-standing rapprochement towards the EU, but positive advancements could be registered recently. Although the SEE region is getting closer to the EU in political terms, the region is unquestionably still characterized by a certain economic backwardness compared to CE. The average GDP per capita at PPP in the SEE region stands at EUR 12,500, at market prices the GDP per capita is around EUR 6,000. In SEE, Croatia has the highest GDP per capita income (EUR 14,900 at PPP, or 54% of the Eurozone average); Bosnia and Herzegovina as well as Albania have the lowest average incomes (both around EUR 6,000-7,000 at PPP, 23% of the Eurozone average). Given lower wealth levels and still less mature institutional systems, SEE shows a lower degree of overall economic resilience than the CE region. From a structural perspective, the industrial sectors in SEE are not as strong as those in CE. This increases the risk of external (liquidity) shocks. Therefore, support was of more importance for the SEE than the CE region in recent years (as shown by IMF/EU support packages for Romania, Serbia and Bosnia and Herzegovina). As shown by a disappointing growth performance in recent years, the SEE region also had to sweat out some economic imbalances that had been accumulated at the later stage of the previous credit growth cycle. NPLs are by far the highest in the region and continued to rise by several percentage points in recent years (given established empirical relationships between the growth performance and NPL formation this has subtracted between 0.5 and 0.7 percentage points of GDP growth in each year since 2009). However, it is important to stress that SEE has shown a remarkable degree of structural reform and economic rebalancing in recent years (e.g. as shown by a massive correction of external imbalances). Therefore, we see a certain upside for GDP growth in 2013 compared to 2012 and 2011.

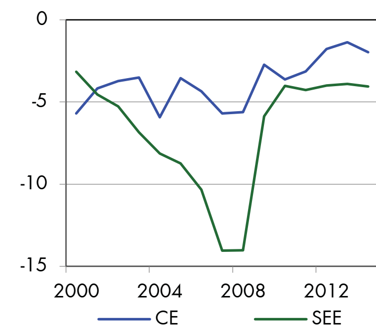
From a medium-term perspective, we expect average GDP growth rates in SEE at around 2.5-3.5% yoy. Such growth rates are far below the levels of 5-7% seen in the period of unbalanced economic growth between 2004 and 2007. As a consequence, the future income convergence in the SEE region will also be slower than in the last decade. Nevertheless, the region has not yet fully exploited all of the economic benefits that EU integration offers, some room for catching-up and high economic growth remains. However, the recent boom-bust cycles that drove current account deficits, inflation and credit growth in some SEE countries have also shown that the "speed limits" of convergence must be watched closely if sustainable wealth gains are to be attained. Recent economic developments in some SEE countries have also made evident that economic convergence is neither a one-way road nor easy to achieve. For instance, Croatia has not shown any convergence over the last 3-4 years and therefore illustrates that real and nominal convergence has to be backed by a structural one.

SEE: GDP per capita*



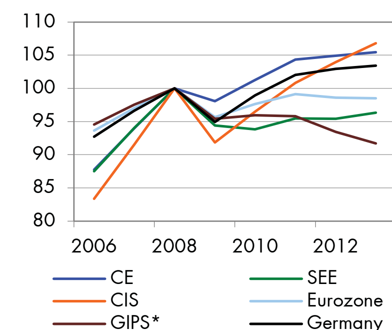
** of Eurozone*
Source: Eurostat, Raiffeisen RESEARCH

Current account balance (% of GDP)



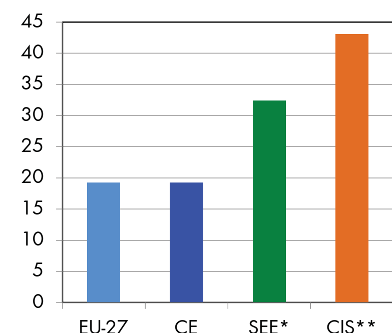
Source: National sources, Raiffeisen RESEARCH

Real GDP Index (2008=100)



** Greece, Italy, Portugal, Spain*
Source: National sources, Eurostat, Raiffeisen RESEARCH

Shadow economy (% of GDP)



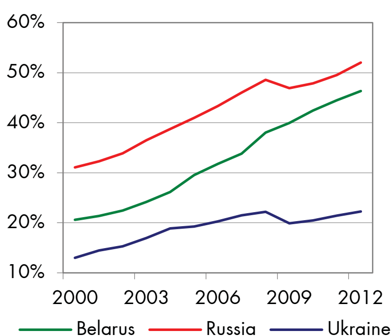
** BG, HR, RO, RS, ** RU, UA*
Source: Schneider (2012): The Shadow Economy in Europe, Raiffeisen RESEARCH

CEE: GDP growth forecasts (% yoy)

	2012	2013e	2014f
Poland	2.0	1.2	2.5
Hungary	-1.7	0.0	1.5
Czech Rep.	-1.2	-0.2	1.8
Slovakia	2.0	0.9	2.5
Slovenia	-2.3	-1.0	1.0
CE	**0.6**	**0.6**	**2.1**
Croatia	-2.0	-0.5	1.0
Bulgaria	0.8	0.5	2.5
Romania	0.7	2.0	2.5
Serbia	-1.7	1.0	2.0
Bosnia a.H.	-1.3	0.5	2.0
Albania	2.0	2.0	3.5
SEE	**-0.1**	**1.2**	**2.2**
Russia	3.4	3.0	3.0
Ukraine	0.2	1.0	3.0
Belarus	1.5	3.0	4.0
CIS	**3.1**	**2.8**	**3.0**
CEE	**2.1**	**2.0**	**2.7**
Eurozone	**-0.5**	**-0.1**	**1.5**

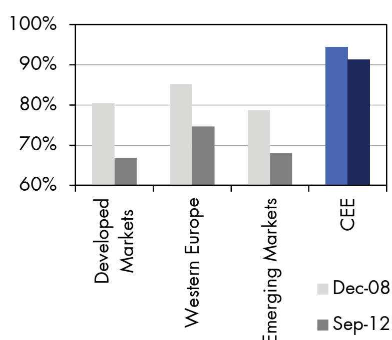
Source: National sources, Eurostat, Raiffeisen RESEARCH

CIS: GDP per capita*



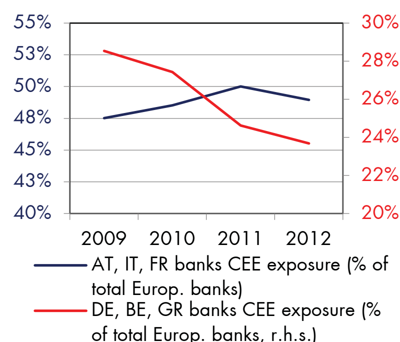
** of Eurozone*
Source: Eurostat, Raiffeisen RESEARCH

Global reach West. Europ. banks*



** Share of Western European banks in total global cross-border exposures; Source: BIS, Raiffeisen RESEARCH*

Diverging CEE commitment*



** Shares in total cross-border exposure of Western European banks; Source: BIS, Raiffeisen RESEARCH*

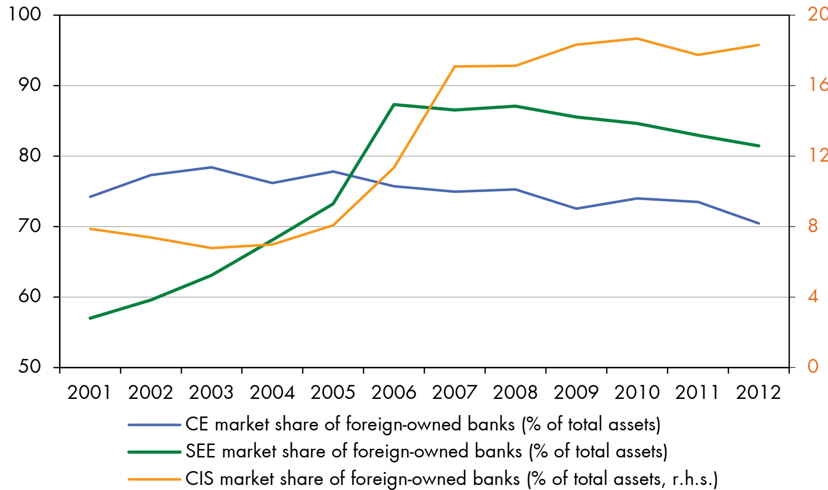
Commonwealth of Independent States (CIS): This sub-region consists of Russia, Ukraine and Belarus. Russia and Ukraine are the most populous CEE countries and Russia is the wealthiest CIS economy, with an average GDP per capita at PPP of around EUR 14,000. In contrast, the GDP per capita at PPP in Ukraine (some EUR 6,000) only amounts to roughly 20% of the Eurozone GDP per capita. The Russian and Ukrainian economies are both commodity-driven: In Russia, revenues from the oil and gas sector account for up to 50% of the state budget revenue and around 65% of all exports, while steel represents around 30% of all exports in Ukraine. The CIS region is less dependent on Western Europe (in terms of trade, capital flows, FDI) than the CE and SEE regions. Exports to the EU-27 account for less than 50% of Russia's overall exports and around 25% of Ukraine's exports (in CE and SEE, intra-EU trade dominates with around 90% of trade volume levels in smaller economies). Given that the CIS region has the strongest potential in terms of economic development among all CEE regions, we expect GDP growth in the range of 3% to at least 3.5% yoy in the years ahead.

In terms of wealth levels, the Russian economy has shown one of the strongest catch-up developments among major Emerging Markets over the last decade. Therefore, it comes as no surprise that we expect economic growth to moderate in Russia in the future, i.e. GDP growth rates are more likely to be in the range of 3-5% yoy (instead of a 6-8% growth rate in the past which is still visible in some other major Emerging Markets). The positive economic development over the last decade and important improvements in the "macro management" (e.g. in terms of increasing the exchange rate flexibility or moving to a credible "inflation targeting" regime) also helped to increase the resilience of the Russian economy substantially. Furthermore, fiscal stability remains an important issue on the political agenda, as indicated by Russia's return to a more rule-based fiscal policy. The increasing resilience of the Russian economy can help to mitigate some risks that may stem from an ever-looming oil-price shock. Nevertheless, Russia has to deliver further structural reforms to unlock the remaining growth potential. The Ukrainian economy remains one of the most volatile CEE economies and tail-risks remain due to devaluation pressure on the currency peg. Currently, policymakers are still trying to muddle through and an IMF deal remains an exit option. The resource-poor Belarusian economy represents a unique situation in the CIS region. The Belarusian economy remains state run like in "Soviet times" and is characterized by an increased dependency on cheap Russian energy and external funding. The limits of this growth model became obvious, as evidenced by Balance of Payments problems and depreciation of the domestic currency.

Ownership structure and market concentration

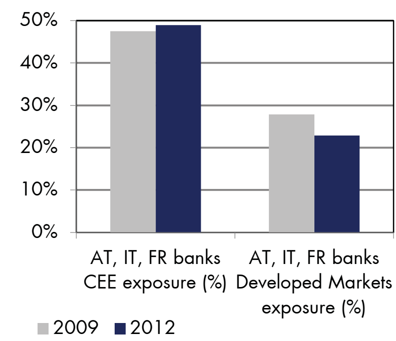
One of the major topics in the context of high foreign ownership by Western European banks in CEE has been the commitment of these banks to the region. This commitment has proven solid in recent years. There are no signs of a retreat of dedicated Western banks from CEE markets. The aggregated CEE exposure (consolidated foreign claims) of Western European banks remained more or less flat in recent years. At the same time, Western European banks (including some relevant CEE players) were reducing other international activities substantially. By year-end 2012, the aggregated CEE exposure of the three most important banking sectors for the region (Austria, Italy and France, representing some 50% of the total regional exposure of European banks or 45% of global cross-border CEE exposure) was more or less at the absolute level reached in 2009. In contrast, Western European banks in general (i.e. outside of Austria, Italy and France) reduced CEE exposures by 5-6% from 2009 to 2012. These modest cuts for the whole CEE region include substantial cuts in some cases (i.e. by some 10-20%). More general restructuring needs of some banks in Germany,

CEE: Presence of foreign-owned banks in the sub-regions



Source: National central banks, Raiffeisen RESEARCH

CEE commitment vs. global trends*

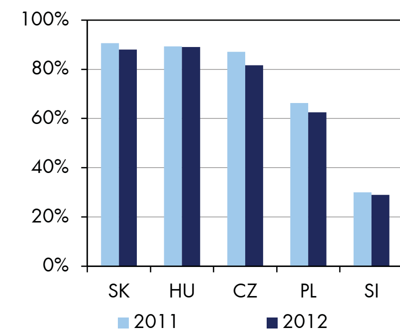


** Shares in total cross-border exposure of Western European banks*
Source: BIS, Raiffeisen RESEARCH

Belgium or Greece obviously had an impact on CEE. Given stronger cuts in the CEE region by other Western European banks, the relative share of Austrian, Italian and French banks in the total CEE cross-border exposure of Western European banks increased slightly in recent years (from 47.5% in 2009 to 49% in 2012). In contrast, the share of German, Belgian and Greek banks in the total CEE cross-border exposure of Western European banks decreased from 30% to around 25% in recent years. Moreover, the overall modest cuts by European banks in CEE (5-6%) still compare favorable against the massive cuts that were undertaken in the European banking sector and by Western European banks in general. Western European banks have substantially cut their international cross-border business in Developed Markets and Western European countries in particular in recent years, i.e. by 15-20% on average with cuts of up to 40% in case of Belgian or French banks. In terms of cutting overall international/cross-border business, the banking sectors of systemic relevance for CEE by and large followed global trends (i.e. international banks from Austria, Italy and France have cut other activities outside CEE by around 15-20% from 2009 to 2012). Given the sketched trends, the commitment of dedicated major Western European banks with a long-standing presence in CEE – despite a challenging regulatory and operating environment for Western European banks – is well reflected in international banking statistics. Moreover, these statistics also show that players with a small CEE presence (e.g. US, UK or Japanese banks that were a bit underrepresented in CEE compared to their other international activities) are seizing "niche player" business potentials in an opportunistic way. The share of the CEE exposure in total international activities of US, UK and Japanese banks increased from 7% in 2008 to around 14% in 2012, which translated into an exposure increase by some USD 50-80 bn.

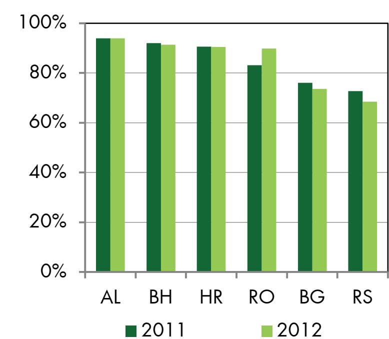
However, it is also clear that the overall positive development in terms of cross-border financing for CEE masks important intra-regional aspects like selective and substantial cuts by Western European banks in certain sub-regions or single countries like Hungary, Ukraine or Slovenia. Such developments may from time to time spark the public debate and draw the policy focus – nationally or at IFIs – on a specific country or region (for more details on the "Deleveraging Debate" in CEE see the following "Focus on"-section).

CE: Foreign-ownership*



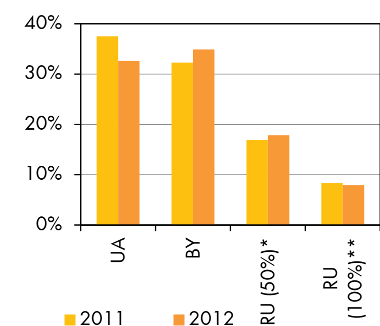
** % of total assets*
Source: National central banks, Raiffeisen RESEARCH

SEE: Foreign-ownership*



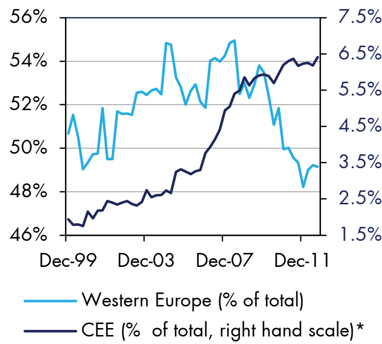
** % of total assets*
Source: National central banks, Raiffeisen RESEARCH

CIS: Foreign-ownership***



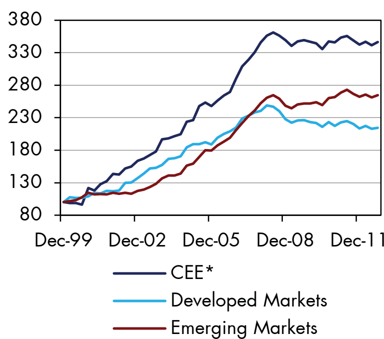
** Banks with over 50% foreign-ownership*
*** 100% foreign-owned banks*
**** % of total assets*
Source: National central banks, RBC-Rating, Raiffeisen RESEARCH

Shares in cross-border exposure**



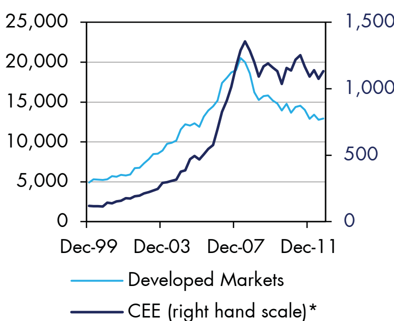
** CEE according to the definition of this report*
*** of Western European banks*
Source: BIS, Raiffeisen RESEARCH

Cross-border exposure Europ. banks**



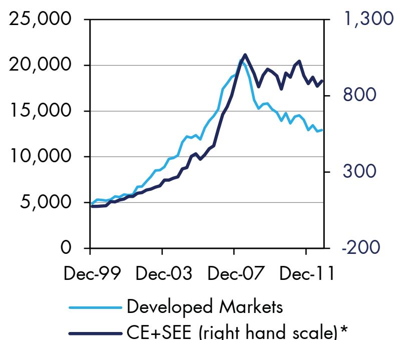
** CEE according to the definition of this report*
*** Dec 1999=100*
Source: BIS, Raiffeisen RESEARCH

Cross-border exposure Europ. banks**



** CEE according to the definition of this report*
*** in USD bn*
Source: BIS, Raiffeisen RESEARCH

Cross-border exposure Europ. banks**



** CE+SEE according to the definition of this report*
*** in USD bn*
Source: BIS, Raiffeisen RESEARCH

Focus on: The never-ending "Deleveraging Debate" in CEE

Given the systemic presence of Western European banks in the CE and SEE sub-regions there had been an extensive debate among academics and policy-makers about the deleveraging of Western European banks in CEE in recent years. This "Deleveraging Debate" was driven by fears that strong ("excessive") deleveraging of Western European banks within a short period of time might have disruptive effects for the economies in CE and SEE. The "Deleveraging Debate" in CEE is also mirrored in deleveraging reports/questionnaires produced by IFIs within the "Vienna Initiative" framework. In fact, CE and SEE economies are highly exposed to developments in the Western European banking sector given high foreign-ownership ratios (mostly by Eurozone banks) and a high dependence on cross-border banking flows in general. In terms of growth of cross-border exposures CE and SEE were the main beneficiaries among major Emerging Market regions from 2000 to 2008. Moreover, in CEE Western European banks have the highest share in cross-border banking flows compared to all other world regions. However, one has to be cautious when speaking about a deleveraging trend by Western European banks in CEE and the sub-regions CE and SEE in particular. Firstly, regional developments in cross-border banking flows to CEE are part of a bigger global (or at least European) picture. Secondly, one has to be cautious regarding indicators and regional aggregates. There are striking regional and intra-regional differences. Thirdly, parts of the modest cross-border funding reduction by Western European banks in CEE are driven more by structural factors (low credit demand, debt overhang) and not only by short-term market or regulatory pressure.

The CEE banking markets can definitely not easily separate themselves from global or broader European trends and it has to be acknowledged that Western European banks are currently shrinking cross-border exposures and are deleveraging big time on a global scale. Western European banks reduced cross-border exposures towards the US or Western European countries – other than their home country – substantially in recent years. The top four EU banks in the US reduced balance sheets in the US by around USD 400-500 bn from 2007 to 2012, which is more or less half the size of the total banking sector in CE and SEE. In case of Spain and Italy Western European banks reduced their cross-border exposures (from 2008 peak levels) by 60-70%. This resulted in cross-border banking outflows of USD 500-600 bn in both countries (close to USD 1,200 bn in total, or 35% of Italy's and Spain's GDP) within a short period of time (18 to 24 months). Given the sketched cuts at Western European banks it comes as no surprise that the share of cross-border business with the US or other Western European countries in total cross-border claims of Western European banks decreased by several percentage points in recent years (e.g. cross-border claims of Western European banks towards the US decreased from some 25% in 2007 to some 20% at the end of 2012, the share of Western European cross-border exposure decreased from some 55% to around 50% during the same period of time). In contrast, the share of CEE in the overall cross-border activities of Western European banks increased in relative terms in recent years (from 4% in 2007 to around 6% currently). Nevertheless, it cannot be neglected that the positive relative performance in the CEE region still caused modest funding reductions by Western European banks in absolute terms from its peak level in 2008. We identify funding reductions by some USD 200 bn for the whole CEE region (5% of regional GDP), some USD 100 bn in CE (11% of regional GDP) and USD 50 bn in SEE (13% of regional GDP) from the peak level in 2008.

In light of a challenging regulatory and operating environment for Western European banks, their modest reduction of cross-border exposures in CEE in absolute terms – and its increase in relative terms – should be seen as a positive development. Moreover, a modest decrease in cross-border exposures, spread over a reasonable period of time, should per se not be interpreted in a negative way. In fact, the modest reduction in cross-border exposures reflects increasing local refinancing (as shown by decreasing loan-to-deposit ratios), write-offs in some cases and more subdued banking growth prospects in some individual markets. Therefore, the modest deleveraging or funding withdrawal of Western European banks in CEE should be considered as an orderly rebalancing. Furthermore, one has to differentiate between deleveraging in terms of cross-border

(re-)financing and a so called asset based deleveraging. In CEE as a whole a modest deleveraging in terms of external financing can be observed rather than a clear asset based deleveraging. Exceptions within CEE are Ukraine and Hungary, where an asset based deleveraging by Western European banks can be observed (including the sale of subsidiaries in Ukraine).

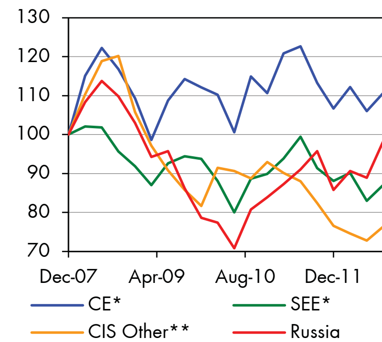
As already mentioned one has to be cautious with regards to the overall CEE figures when speaking about deleveraging trends. The CEE aggregate masks very heterogeneous regional and intra-regional developments. There are no signs of a deleveraging (either in terms of external financing or banking assets) in CE, where aggregated cross-border exposures of Western European banks are currently 10% above the levels of 2007 (i.e. there are countries with inflows like Poland or Slovakia and others with outflows like Hungary or Slovenia). In contrast, there are signs of a modest deleveraging in SEE (mostly in Bulgaria and Croatia, partially in Serbia and Romania), where aggregated cross-border exposures of Western European banks are 10% below their December 2007 levels. Developments in the CIS region are very heterogeneous. There are no signs of a deleveraging trend by Western European banks in Russia (although cross-border exposures had been a bit under pressure here in 2008/09 but are now increasing). In contrast, Ukraine experiences a secular deleveraging, driven by Western European banks.

If one takes September 2008 as a starting point for examining regional deleveraging trends the results look a bit more negative than with the starting point of December 2007. However, such a measurement would neglect that some of the deleveraging in recent years also reflects a correction of inflows during the very last "hot" phase of an excessive boom period. Moreover, refinancing conditions already started to dry up before September 2008, which caused some additional cross-border flows to CEE that were reversed later on. According to our estimates, Western European banks withdrew around 12% of the regional GDP as cross-border financing from CE and SEE on a cumulative basis when taking September 2008 as a starting point (with a peak level at around 16% of GDP in 2010). This is a certain amount of outflow but still looks modest compared to the cross-border funding withdrawal of Western European banks inside the Eurozone. Moreover, pre-crisis Western European banks accounted for cross-border inflows of around 100% of the regional GDP (on a cumulative basis from January 2000 to June 2008). In SEE, where cross-border banking outflows amount to some 13% of regional GDP (on a cumulative basis when taking September 2008 as a starting point) one has to take into account that cross-border banking exposures to the region amounted to 120% of GDP (on a cumulative basis from January 2000 to June 2008). Therefore, when speaking about Western European banks in CEE it has to be acknowledged that their regional activities did not start in 2007 or 2008.

As mentioned previously, there are no signs of a deleveraging trend by Western European banks in Russia and Poland, which are the two regional "gate-keepers" and high-growth markets of Western European banks. In fact, it looks more like the overall cross-border exposure of Western European banks towards CEE is currently fluctuating around a "new normal" (and the pre-crisis inflows are unlikely to return). Moreover, a modest deleveraging of Western European banks in some CEE markets should not be seen as too negative and is also a result of the pressure on Western European banks to allocate resources in a highly disciplined way. Furthermore, a stagnation or even modest reduction of cross-border exposures of Western European banks in certain CEE countries and challenging banking markets is likely to continue. Here a modest deleveraging is more driven by structural factors that are likely to persist for some time. A full financial cycle usually lasts much longer than business cycle fluctuations. Therefore, some CEE countries will remain in a modest deleveraging mode (that may result in stagnating or modestly declining loan-to-GDP ratios) following a strong pre-crisis expansion. Nevertheless, modest deleveraging of Western European banks in CEE in recent years represents a rebalancing of business models and funding structures, rather than a "cut and run" behavior some Eurozone banking sectors experienced in 2011 and 2012.

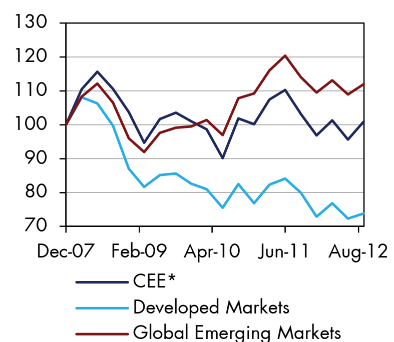
Gunter Deuber

Cross-border exposure Europ. banks***



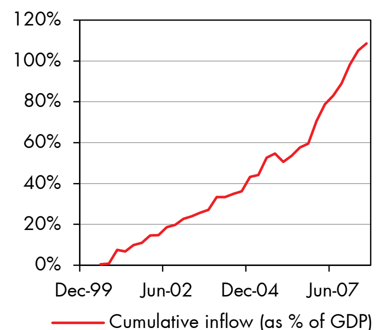
** CE, SEE according to the definition of this report*
*** CIS Other: Ukraine, Belarus*
**** Dec 2007=100*
Source: BIS, Raiffeisen RESEARCH

Cross-border exposure Europ. banks**



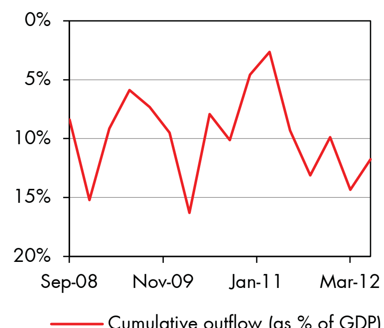
** CEE according to the definition of this report*
*** Dec 2007=100*
Source: BIS, Raiffeisen RESEARCH

CE/SEE: Bank inflows (% of GDP)*



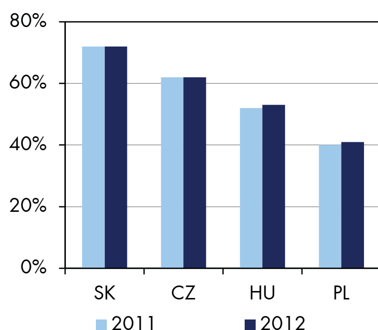
** Cumulative cross-border inflows (2000-2007); CE+SEE according to the definition of this report*
Source: BIS, Raiffeisen RESEARCH

CE/SEE: Bank outflows (% of GDP)*



** Cumulative cross-border outflows (2008-2012); CE+SEE according to the definition of this report*
Source: BIS, Raiffeisen RESEARCH

CE: Market share Top-5 banks

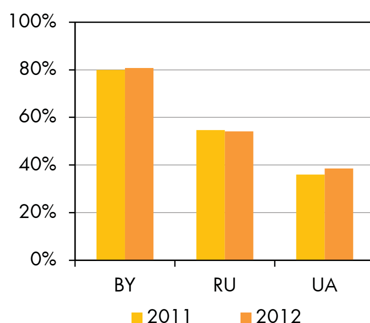


Source: National sources, Raiffeisen RESEARCH

SEE: Market share Top-5 banks

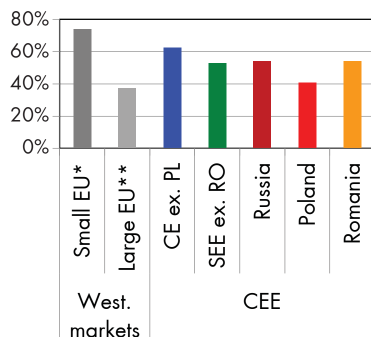
Source: National sources, Raiffeisen RESEARCH

CIS: Market share Top-5 banks



Source: National sources, Raiffeisen RESEARCH

CEE vs. EU: Market share Top-5 banks



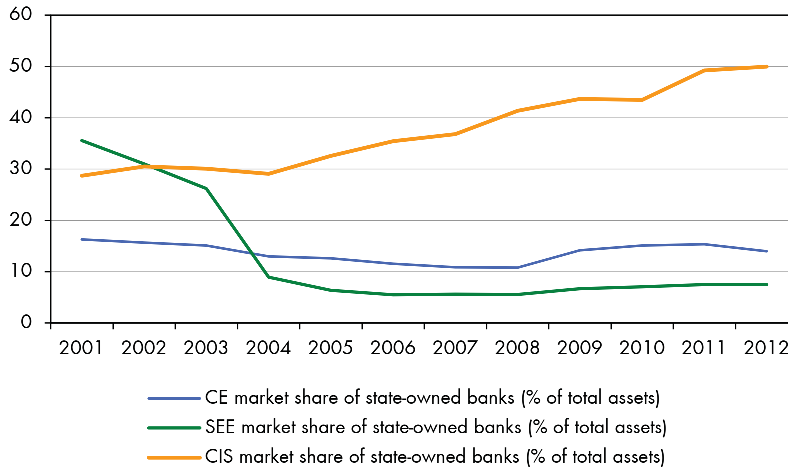
** SE, DK, BE, FI, NL*
*** DE, IT, ES, FR*
Source: National sources, ECB, Raiffeisen RESEARCH

As major Western European CEE banks remain committed to their CEE business it is a logical consequence that ownership structures have not changed much in the CEE banking sectors in recent years. Only in a few currently more challenging markets like Ukraine, Bulgaria, Serbia and – a bit surprisingly – the Czech Republic there were some shifts in terms of decreasing foreign-ownership ratios. All in all, the trend of slightly decreasing foreign-ownership ratios continued in 2012 across the region. However, in CE and SEE this slight decrease took place from very high levels and should not be considered as a "market exit". In case of SEE, the more cautious stance of foreign-owned banks follows a period of strongly increasing market shares during the pre-crisis boom phase (mostly driven by M&A activities), which usually is followed by some consolidation. Finally, it has to be acknowledged that foreign-owned Western European banks remain a dominating force in CE and SEE. On the CIS banking markets foreign-owned Western European banks are matching with locally-owned or strong state-owned competitors. This holds especially true in Russia, where "true" foreign-ownership ratios, focusing at 100% foreign-owned banks, are now below 10%, while state-ownership in the Russian banking sector has increased notably since the financial crisis in 2008/09. Up to a certain extent the slightly decreasing 100% foreign-ownership ratio in Russia also represents the legacies of strong M&A activities at leading Western European banks some years ago. In the CIS markets Russian banks are continuously becoming influential players, while the regional presence of Russian banks outside of the CIS still remains limited.

Market concentration ratios (measured as the market share of the top five banks) did not change much in 2011 and 2012 in CE and SEE. On average, the top five concentration ratios in the SEE banking markets remain some 10 percentage points higher than in CE. However, both regions are characterized by strong divergences. Top five ownership ratios are at above 60% in the Czech Republic and Slovakia, but closer to the 50% level or lower in case of Hungary and Poland. In SEE most smaller banking markets – with the exception of Serbia and Bulgaria – have top five concentration ratios in the range of 65-75%. The bigger Romanian market is characterized by a market share of the top five banks at around 54%. The CIS region is characterized by the most extreme divergences in terms of market concentration. In the Ukraine the top five banks command a market share of just 38%, while in Belarus the top five concentration ratio stands at around 80%. In case of the Ukraine and Belarus concentration ratios have not changed in a meaningful way in recent years. In contrast, on the Russian market the top five banks nowadays command a market share of 54% and this ratio has increased substantially in recent years (i.e. by around 10pp.). The increasing ownership concentration in the Russian banking sector is by and large driven by increasing state ownership, as both indicators are moving in tandem.

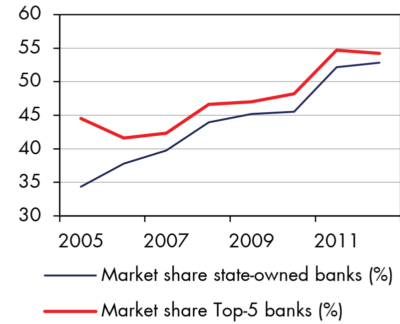
When compared to Western European banking markets, concentration ratios in the CEE banking markets are sending a diverging picture. In bigger Western European banking market's top five ownership ratios are in a range of 25-45%, while in the bigger regional CEE banking markets (like Poland, Russia, Romania) top five concentration ratios are above 50% on average. On contrast, in the other, smaller CEE banking markets the average market concentration ratio stands at some 60% on average, while top five concentration ratios in smaller Western European banking markets are in the range of 60-80%. Therefore, it seems that there is still some consolidation potential left in some smaller CEE banking markets with top five concentration ratios in the range of 50-60%.

CEE: Presence of state-owned banks in the sub-regions



Source: National central banks, Raiffeisen RESEARCH

RU: Ownership & concentration



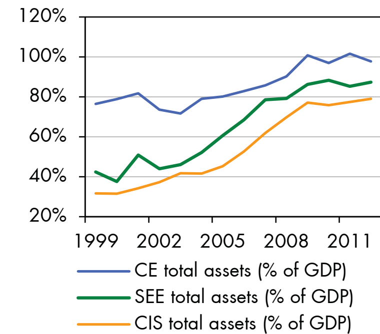
Source: CBR, RBC-Rating, Raiffeisen RESEARCH

Financial intermediation and asset growth

Financial intermediation levels, either measured as asset-to-GDP or loan-to-GDP ratio, did not change much in CEE in recent years, including 2012. On a regional basis, asset-to-GDP and loan-to-GDP ratios as of year-end 2012 are more or less at the levels of 2010. Therefore, in most CEE countries other than Russia (where the asset-to-GDP and loan-to-GDP ratio increased by some 3-5pp. from 2010 to 2012) the banking sector expansion was matching nominal GDP increases in recent years. Hence it is obvious that current developments in the real economy are having a much stronger influence on the banking sector performance than in the strong catching-up years before the crisis, where asset-to-GDP or loan-to-GDP ratios increased substantially and the elasticity between GDP and banking sector growth was well above a ratio of 1.5. Nevertheless, the more or less flat asset-to-GDP ratios in CEE still translated into a cumulative 2011 and 2012 asset growth of some 24% (in EUR-terms; +28% in LCY-terms); just as a reminder: cumulative 2011 and 2012 total asset "growth" inside Eurozone stands at negative -2.8%.

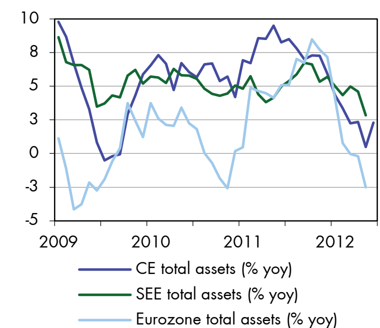
Given a very close relationship between developments in the banking sector and real economy, the softening of real GDP growth in CEE in H2 2012 also caused a visible deceleration in asset growth during that period. Total asset growth in the CEE banking sector (in LCY-terms) slowed down from some 18-20% yoy at the beginning of 2012 to around 11-12% yoy by the end of 2012. The loss in banking sector asset growth momentum throughout the year was relatively strong in CE as well as in the CIS countries Ukraine and Belarus, but fairly moderate in Russia. In SEE, the loss in asset growth momentum was less pronounced – from already low levels – in 2012. All in all, in EUR-terms the total annual 2012 CEE asset growth still came in slightly higher than in 2011 (13.5% yoy compared to 10.2% yoy in 2011). This performance was supported by a strong banking sector expansion in H1 2012 as well as the positive performance of CEE currencies (outside the SEE region) vis-à-vis the EUR in 2012. However, the overall CEE annual asset growth figure at around 13% masks very divergent regional dynamics. In the CE region, total asset growth (in EUR-terms) picked up only slightly from low levels in 2012 (6.7% yoy in 2012 compared to 3.3% yoy in 2011). The regional CE figures have a downside bias due to the very negative banking sector trends in Hungary and Slovenia. It is therefore worth mentioning that the healthier CE markets (excl. Hungary and Slovenia) posted a more solid total asset growth of 9% yoy in 2012 (in EUR-terms), compared to 5.4% in 2011. In EUR-terms asset growth in SEE even slowed down somewhat from 2.9% yoy in 2011 to 1.4% in 2012. In terms of asset growth the CIS region – driven by the strong Russian

CEE: Asset-to-GDP ratio trends



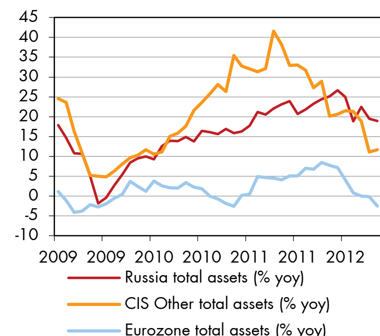
Source: National central banks, Raiffeisen RESEARCH

CE/SEE vs. EMU: Asset growth



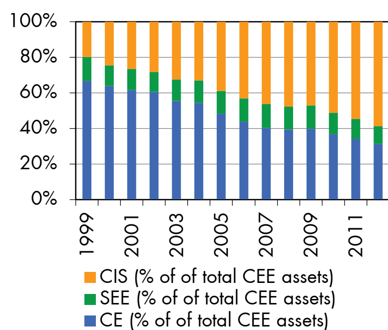
Source: National central banks, ECB, Raiffeisen RESEARCH

RU & CIS Other: Asset growth*



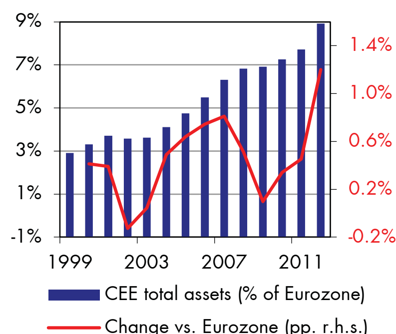
** CIS Other: UA, BY*
Source: National central banks, ECB, Raiffeisen RESEARCH

CEE: Relative banking sector size



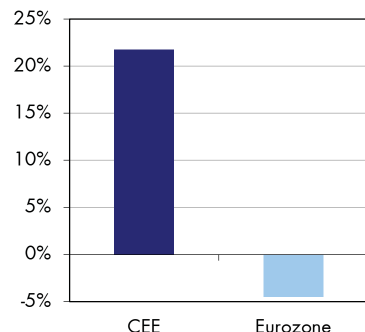
Source: National central banks, Raiffeisen RESEARCH

CEE vs. EMU: Asset-to-GDP catch-up



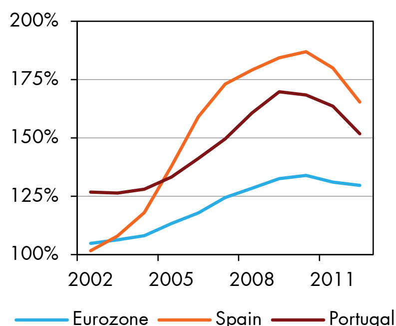
Source: National central banks, ECB, Raiffeisen RESEARCH

CEE vs. EMU: Real loan growth*



** Cumulative 2010-2012 nominal loan growth deflated with CPI and PPI (75% and 25% weight)*
Source: National sources, ECB, Eurostat, Raiffeisen RESEARCH

EMU: Deleveraging trend*

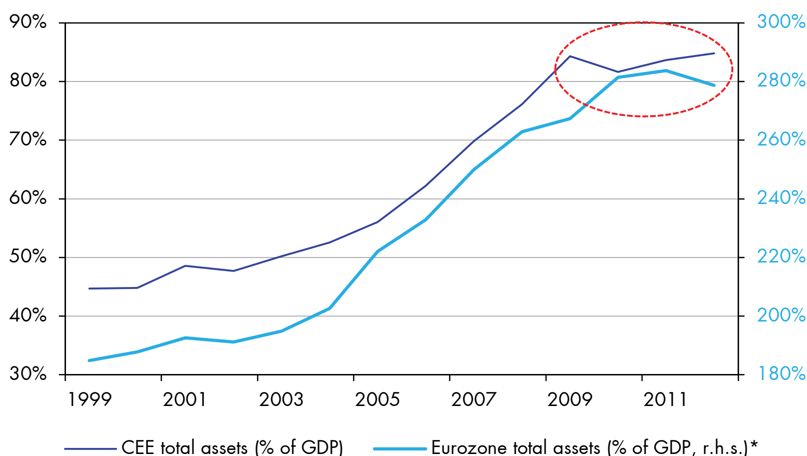


** Loan-to-GDP ratio (%)*
Source: National sources, ECB, Raiffeisen RESEARCH

market with an asset growth at 24% yoy in EUR-terms – clearly outpaced all other CEE regions in 2012, showing an annual asset growth of 22.3% (compared to 17.6% in 2011).

Given the continuing strong growth performance of the Russian banking market in absolute terms (which showed an increase in total asset growth up to 24% yoy in 2012 from 19% in 2011) and its clear regional outperformance, the share of the CIS markets (here Russia represents 90% of total assets) in total CEE banking assets continued to increase strongly in 2012. As of 2012, the CIS markets represent 60% of total CEE assets. The remaining 40% of CEE banking assets are split between the CE (30%) and SEE (10%) sub-regions. Some five years ago the relative share of the banking sectors of the CE and CIS region in total CEE assets was still more or less equal at 40-45%; the SEE banking markets represented around 13% of total CEE assets at that time. In terms of total assets, the gap between the still largely underpenetrated Russian banking market on a standalone basis and all other CE and SEE markets continued to widen strongly. In 2011, Russian banking assets surpassed the total CE and SEE banking assets by just EUR 60 bn. In 2012, this gap widened to around EUR 250-260 bn. Therefore, as of year-end 2012 Russia's banking sector represents 53% of total CEE banking assets, whereas all other CE and SEE markets together represent just 41% of those assets. In 2011, this relationship was still at 48% vs. 45% (Russia vs. CE+SEE). The relative decline of other banking markets than Russia in total CEE banking assets is supported by the fact that in selective challenging or saturated CEE

CEE vs. Eurozone: Long-term asset-to-GDP ratio trends



**excluding MFI business*
Source: National central banks, ECB, Raiffeisen RESEARCH

banking sectors like Hungary, Slovenia, Croatia, Bulgaria or Ukraine financial intermediation levels in relation to GDP (measured in terms of total loans, total assets or both) are currently stagnating or even on a slight decline. Such developments are reflecting already high financial intermediation levels in relation to the current income position (in some cases a legacy from the pre-crisis boom years) or challenging domestic market conditions like in Hungary, Slovenia or Ukraine (leading to an overall banking sector deleveraging, asset sales and write-offs). Similar weak financial sector developments are also visible inside the Eurozone, where the loan-to-GDP ratio decreased by some 5% (despite the fairly weak GDP dynamics) due to two years of financial disintermediation in 2011 and 2012. In some Eurozone countries like Spain, Portugal or Ireland the loan-to-GDP ratio even decreased by some 10-20% over the last 2 to 3 years, which matches the performance of hard hit CEE markets like Ukraine or Hungary. However, in other CEE markets, including major banking markets like Russia or Poland and other growth markets like the Czech Republic or Slovakia, financial intermediation

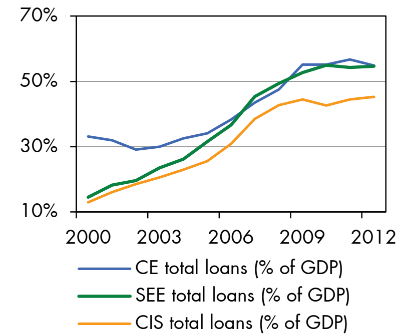
did not reverse in recent years. Therefore, the 2010 to 2012 cumulative real loan growth in CEE stands at some 20%, while real loan growth inside the Eurozone stands at negative -4.5% during the same period. Given such diverging developments between CEE and the Eurozone, the overall CEE banking sector size compared to the Eurozone, in terms of total loans, increased from 9.6% in 2011 to 11.1% in 2012. In terms of total assets the relative banking sector size in CEE compared to the Eurozone increased from 7.7% in 2011 to 8.9% in 2012. An annual change in these relationships by around 1 percentage point a year implies a strong relative performance, as such relative increases had been observed in the boom years 2005-2007 only. In terms of total assets the relative increase of the CEE banking sector size compared to the Eurozone was even the highest over the last decade, which once again shows the strong asset-based deleveraging inside the Eurozone compared to CEE. All in all, on a relative basis, the banking sector outperformance of CEE compared to Western Europe continued in 2012. Currently total banking assets in CEE are at EUR 2.339 bn (2012), which equals 9% of banking assets inside the Eurozone. In 2013 total banking assets in CEE are likely to surpass EUR 2.500 bn.

Lending structure and loan growth

In 2012, the relationship between annual CEE loan growth in LCY-terms and EUR-terms has changed compared to 2011. In 2011, total CEE loan growth had been higher in LCY than in EUR-terms (19% yoy in LCY compared to 14% in EUR-terms), driven by weaker CEE currencies in H2 2011, whereas in 2012 the annual CEE loan growth had been higher in EUR-terms than in LCY-terms (14.8% in EUR compared to 12.4% in LCY-terms). This development was supported by stronger currencies of major CEE economies in H2 2012 (with the exception of some currencies in SEE and the Ukrainian Hrywnja). The overall positive development of CEE currencies in H2 2012 was largely driven by a decreasing risk aversion on a global level and within the Eurozone, while in H2 2012 CEE loan growth in LCY-terms was (still) under pressure compared to H1 2012 due to dampened growth dynamics in many CEE economies.

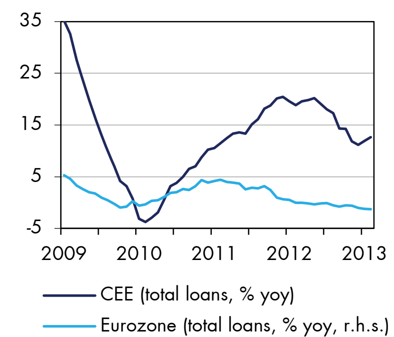
A quick transmission of weaker economic developments to a decline in banking sector growth usually comes along with deteriorating business conditions and gets reflected predominantly in corporate lending. Therefore, it is important to underline the significance of corporate lending (with a share of 65% in total loans) as the most relevant business segment for banks in CEE. However, the region-wide relationship between banking sector growth and corporate lending is slightly overstated due to the dominance of corporate lending in the CIS region in general and Russia in particular. Despite the recent surge in Russian retail lending (that started from an ultra-low level), corporate lending in Russia still represents around 70% of total loans. In the CE and SEE sub-regions, household lending has a somewhat higher share in total loans than in Russia and other CIS economies. Nevertheless, with around 50% of the total loan stock corporate lending also represents a substantial part of the loan portfolios in CE and SEE. The large weight of corporate lending with respect to total loan growth in CEE is also one of the main reasons for the cyclically driven slowdown of total loan growth (in LCY-terms) within the region in H2 2012. However, it has to be emphasized that a broad based regional "credit crunch" (either supply- or demand-side driven) has been avoided in CEE, despite a general lending growth decline. This is illustrated by a still fairly positive development within the CEE banking sector in H1 2012 and the positive trends in corporate lending in 2010 and 2011, and holds true even for the more challenging banking markets in SEE, where household loans were either shrinking or remained more or less stagnant in 2010 and 2011. Moreover, a dip of total CEE loan growth (in LCY-terms) into negative ter-

CEE: Loan-to-GDP ratio trends



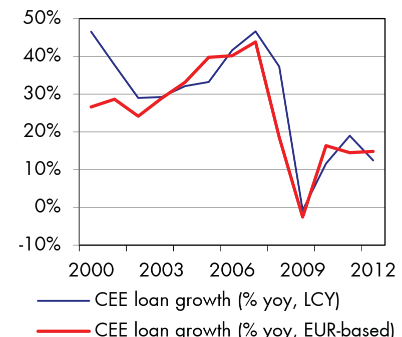
Source: National central banks, Raiffeisen RESEARCH

CEE vs. EMU: Total loan growth*



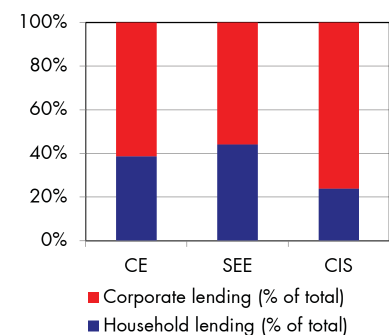
** Latest data value March 2013*
Source: National central banks, ECB, Raiffeisen RESEARCH

CEE: Loan growth LCY- vs. EUR-terms



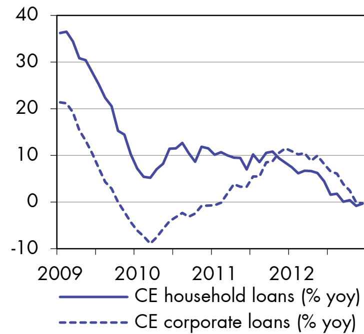
Source: National central banks, Raiffeisen RESEARCH

CEE: Business segment split



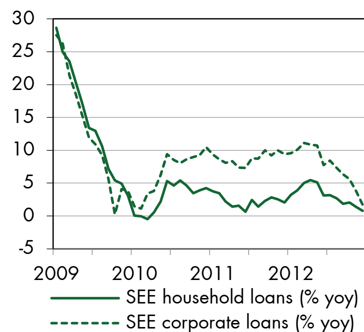
Source: National central banks, Raiffeisen RESEARCH

CE: Growth by business segments



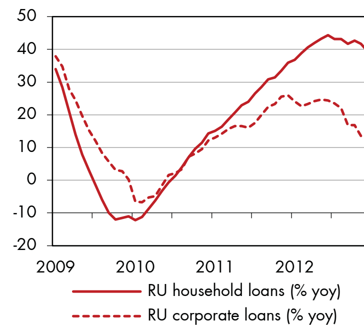
Source: National central banks, Raiffeisen RESEARCH

SEE: Growth by business segments



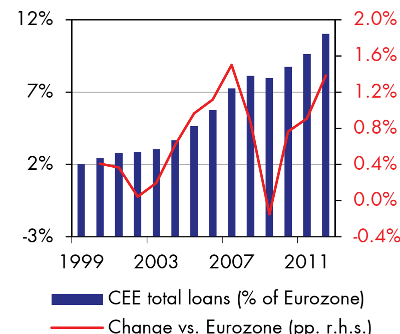
Source: National central banks, Raiffeisen RESEARCH

RU: Growth by business segment



Source: CBR, Raiffeisen RESEARCH

CEE vs. EMU: Loan-to-GDP catch-up

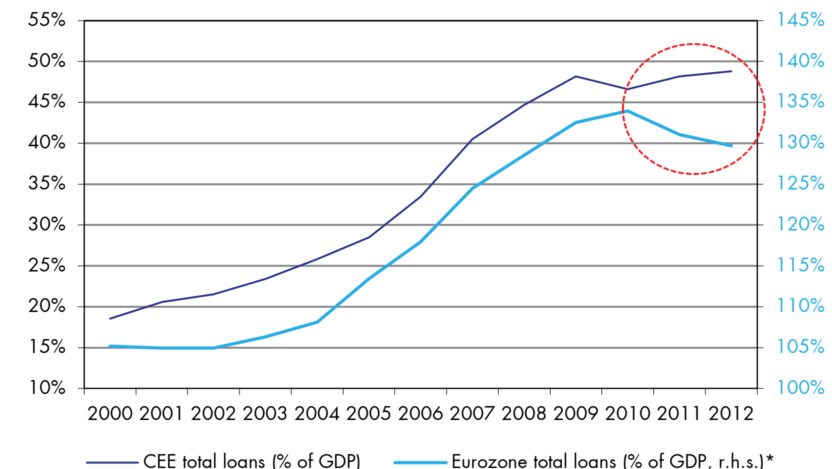


Source: National central banks, ECB, Raiffeisen RESEARCH

ritory – as it happened in late 2009 and early 2010 – has been clearly avoided in 2012. In contrast, loan growth within the Eurozone, where there is evidence of a complex supply- and demand-side driven "credit crunch", once again fell into the negative territory in late 2012 (similar to late 2009). Therefore, there is no reason to be too pessimistic about the cyclical softening of the CEE banking sector growth in H2 2012. In fact, the total loan growth differential between CEE and the Eurozone remained in double-digit territory in 2012. Moreover, there is no clear-cut regional trend of decreasing loan-to-GDP ratios across the CEE region on aggregate. In contrast the Eurozone on aggregate was characterised by a loan-to-GDP ratio decline in 2011 and 2012 (despite weak GDP growth).

The driving role of corporate lending behind the slowdown in total loan growth within the CEE region becomes clearly visible when analyzing the regional aggregates within different business segments in LCY-terms. In CE, household lending growth decreased from some 7-8% yoy at the beginning of 2012 to levels close to 0% at year-end, and corporate lending growth from double-digit readings at 11-12% also to levels close to zero (all figures in LCY-terms). As already stated in the chapter before, it is important to take into account the highly negative influence of the ongoing structural shrinkage of loan books in Hungary and Slovenia on the banking sector in CE. Excluding Hungary and Slovenia the regional CE banking sector performed better, with a decrease of household lending growth rates from 9-10% at the beginning of 2012 yoy to around 2% by year-end 2012. In the corporate segment the respective growth rates in LCY-terms for CE (excl. Hungary and Slovenia) would be 12% yoy (beginning of 2012) and 1-2% yoy (year-end 2012). Within the SEE sub-region and the CIS countries Ukraine and Belarus losses of momentum in corporate and household lending growth are even more pronounced – but in case of the CIS starting from higher bases. In SEE, household lending growth decreased from low single digit levels at the beginning of 2012 to more or less zero growth by the end of the year, while corporate lending growth came down from some 10% yoy to zero during the same period of time. In the CIS countries Ukraine and Belarus household lending growth came down from some 7-8% (beginning of 2012) to much lower single digit levels, while corporate lending growth decelerated from levels around 30% at the beginning of the year to levels around 15% yoy by year-end 2012. The Russian banking market was characterized by somewhat diverging developments in 2012: Corporate loan growth in LCY-terms also slowed down throughout 2012 (24% yoy beginning of 2012, 13% yoy year-end 2012), while household lending growth held up pretty well (i.e. expanding at monthly yoy growth rates in the range of 35-45% yoy in 2012). The major trends in the busi-

CEE vs. Eurozone: Long-term loan-to-GDP ratio trends



* Excluding MFI business
Source: National central banks, ECB, Raiffeisen RESEARCH

ness segment of mortgage lending are more or less matching the overall household lending trends across the CEE region. In CE and SEE, mortgage lending activity softened throughout 2012 (from growth rates of 10-12% yoy to around 3-7%), while in Russia mortgage lending activity grew by 30-40% yoy during the same period. The strong expansion of retail lending in Russia caused some regulatory action in 2012 targeting this business segment. As there were signs of unsustainable growth within the Russian retail lending market this targeted regulatory action came at the right time. Some softening of retail loan growth is already visible in high-frequency data. Anyhow, the post-crisis boom in Russian retail lending was still too short-lived to build up serious banking sector wide problems that may become visible "through the cycle" (e.g. in terms of asset quality or overleverage of customers).

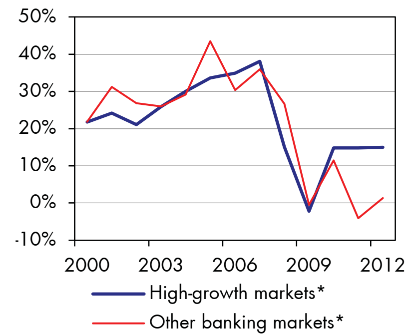
The sketched loan growth trends by business segments indicate that the softening in loan growth in CEE in H2 2012 (in LCY-terms) – mostly driven by the more cyclical corporate segment – mainly stems from demand-side constraints. However, a still high NPL stock in the Ukraine and still rising NPLs (from already high levels) in Hungary, Slovenia and some challenging SEE banking markets in 2012 (in most cases driven by both corporate and household NPLs) are also indicating additional and more structural demand- and supply-side constraints within a few CEE markets. It is clear that high NPL levels are indicating a certain debt overhang problem on the demand-side, as well as some earnings and risk cost problems on the supply-side (for more details on NPLs in the CEE region please see the "Focus on"-section on page 18). Therefore, it comes as no surprise that the year 2012 was not only characterized as "a year of two halves", i.e. due to diverging overall CEE banking sector developments in H1 and H2 2012. The division of the individual CEE banking sectors into two groups in terms of growth performance already visible since 2009 continued in 2012. The (potential) high-growth banking sectors in CEE (as defined in our 2010 and 2011 Banking Sector Reports)[1] posted a fairly strong average annual total loan growth of around 15% yoy in 2012 (in EUR-terms). This performance was more or less at the level of previous years and once again underscores the potential for a sustainable banking sector expansion well above GDP growth in these markets. In contrast, other CEE banking markets with already high loan-to-GDP ratios compared to current income levels and a weaker long-term growth potential posted an average annual total loan growth of 1.3% yoy following a decrease by 4.1% yoy in 2011. We believe that the current diverging performance of individual CEE banking markets (mostly based on their current stage of financial intermediation or "leverage") will be closed only very gradually over the years to come. Some support for currently underperforming CEE banking sectors might stem from a stabilization of NPL growth and NPL ratios as a consequence of a likely pick-up of the macroeconomic performance in the respective countries.

Loan-to-deposit ratios and deposit growth

In nearly all CEE banking sectors loan-to-deposit (L/D) ratios continued to stay well below the levels seen in the last pre-crisis boom years (2007-09). On an annual basis, the aggregated L/D ratio in CEE even inched a tad lower throughout 2012, dropping by 1pp. from 99% in 2011 to 98% by year-end 2012 (intra-year it had been slightly above 100%, when loan growth was still stronger in H1 2012). Currently, on aggregate even a slight deposit overhang can be observed. The downtrend in the CEE L/D ratio is visible for several years now and is backed by a solid deposit collection. This trend continued in 2012 and lower L/D ratios

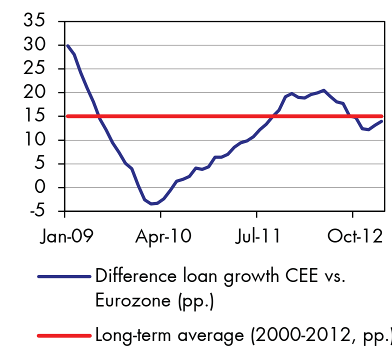
1 The six or seven CEE banking sectors in Russia, Poland, the Czech Republic, Slovakia, Romania, Albania and Serbia (the latter is a borderline case due to a strong increase of the loan-to-GDP ratio in recent years) are characterized by a strong potential to increase the financial intermediation (compared to GDP per capita levels) in the years to come (see page 23).

CEE: Loan growth divergence**



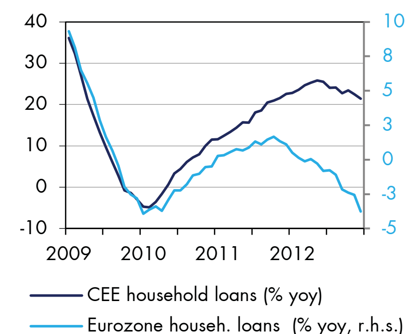
* High-growth markets: PL, CZ, SK, RO, RS, AL, RU; Other banking markets: HU, SI, BG, HR, BH, UA, BY
** Yoy loan growth rates, EUR-based
Source: National central banks, Raiffeisen RESEARCH

CEE vs. EMU: Growth outperformance*



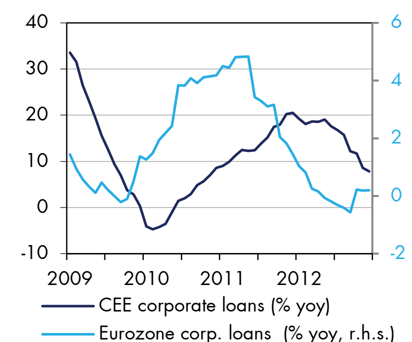
* Latest data value March 2013
Source: national central banks, ECB, Raiffeisen RESEARCH

CEE vs. EMU: Household loan growth



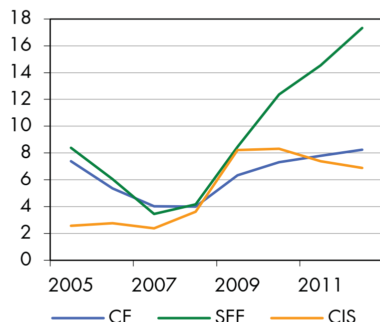
Source: National central banks, ECB, Raiffeisen RESEARCH

CEE vs. EMU: Corporate loan growth



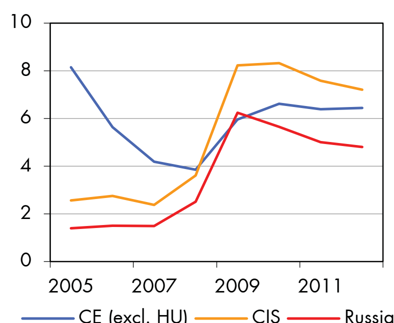
Source: National central banks, ECB, Raiffeisen RESEARCH

CEE: NPLs (% of total loans)



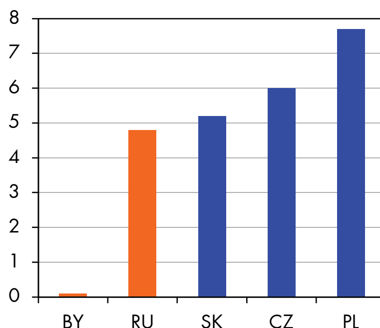
Source: National sources, Raiffeisen RESEARCH

CEE: NPLs (% of total loans)



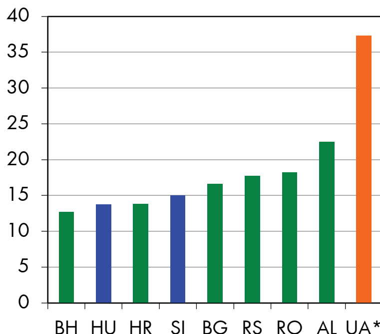
Source: National sources, Raiffeisen RESEARCH

CEE: Markets with NPL ratios < 10%



Source: National sources, Raiffeisen RESEARCH

CEE: Markets with NPL ratios > 10%



** based on IFRS estimates, official ratio much below that*
Source: National sources, Raiffeisen RESEARCH

Focus on: Non-performing loans in CEE

On average, non-performing loan (NPL) ratios in the entire CEE region were at 10.1% at year-end 2012, which represents a negligible increase from 10% by year-end 2011. It is worth mentioning that the NPL ratio in CEE is hovering around the 10% level since 2009. This development underscores our initial call that we are already closer to the NPL ratio peak or may have already reached it in some larger and more solid CEE banking markets (like Russia, the Czech Republic, Slovakia and Poland). Nevertheless, like in 2011 the CEE banking sectors were characterized by diverging regional and intra-regional NPL ratio and NPL formation trends in 2012. In some countries NPLs are stabilizing or slightly decreasing, while in other CEE banking markets NPL ratios are increasing. In CE the average regional NPL ratio stood at 8.2% end of 2012, in SEE NPL ratios were at 17% on average (with readings above 20% in some cases). In the CIS region NPLs are currently at some 7% (around 5% in Russia). In terms of NPL ratio increases, SEE has shown by far the strongest rise in 2012 (up to 17.3% from 14.5% in 2011), reflecting weak loan growth and still deteriorating underlying asset quality. In CE high NPL ratios in Hungary and Slovenia still have a significant negative impact on the NPL ratio of the region, as shown by the increasing gap between the CE NPL ratio with and without Hungary. Without Hungary the regional CE NPL ratio would have stayed around 6.4% in 2012 (driven by stable/declining NPL ratios in the Czech and Slovak banking sector). However, Poland has also shown a certain NPL ratio increase in 2012 (from 7.5% to 7.7%). In the CIS region the average NPL ratio was on a slight downtrend, from some 7.5% in 2011 down to 7% by year-end 2012. This development was driven by a decrease in the NPL ratio in Russia (down from 5% to 4.8% in 2012) and slightly improving NPL ratios in Ukraine. With regards to the NPL formation outlook (i.e. the NPL increase in absolute terms) and NPL ratios, H1 2013 could remain challenging, some stabilization might be visible in H2 2013. A stabilization of NPL ratios on more challenging CEE banking markets (in SEE, Hungary and Slovenia) might also support both the macroeconomic and banking sector performance in these markets. When looking at past changes in NPL ratios and the macroeconomic performance in CEE and other banking markets it seems to be realistic to estimate that a rise of the NPL ratio by 1pp. corresponds to a decrease in the GDP growth by at least 0.2-0.4pp.

The stable overall CEE NPL ratio trend should not distract from the fact that NPL volumes are still on the rise. The (estimated) total amount of NPLs in CEE increased from some EUR 110 bn in 2010 and EUR 120 bn in 2011 to EUR 135 bn in 2012, which translates into annual NPL stock growth rates of 9-15% yoy. Given the banking sector size of the individual CEE banking markets it is clear that all the eleven CE and SEE markets covered in this report together still represent a low amount of total NPL volumes – according to our estimates EUR 60-70 bn. Hence, it should not come as a surprise that there was hardly any large scale NPL selling activity in CEE in recent years – with the exception of Russia (some deals had been postponed due to pricing issues) and some minor deals in Poland. Moreover, in a lot of CEE markets NPL ratios remain at a level still manageable by individual loan restructurings and write-offs covered by earnings. However, in a few other CEE markets (in SEE, Ukraine, Hungary and Slovenia) fairly high NPL stocks and double-digit ratios in the range of 15-25% seem to become more and more a burden for the banking sectors and the economic recovery. In these markets joint efforts to tackle NPLs and to improve the NPL workout as well as transaction/selling opportunities by improvements of the legal and taxation framework might be reasonable. From a macroeconomic point of view a high and unaddressed NPL stock (i.e. waiting for a distant recovery of collateral values) can constrain the economic recovery (capital remains locked in unproductive use). From a medium-term perspective a high NPL stock may even lead to unintended structural developments, as not the most productive investments will be financed, but just the ones that do not need large scale and long-term debt financing. Therefore, a well-balanced NPL restructuring within some challenging CEE banking markets seems to be in the interest of all relevant stakeholders. Nevertheless, any NPL resolution has to factor in the currently reduced earning capabilities in some of these markets. However, we believe that centralized "bad bank" solutions (as in Slovenia) are not needed in other CEE countries.

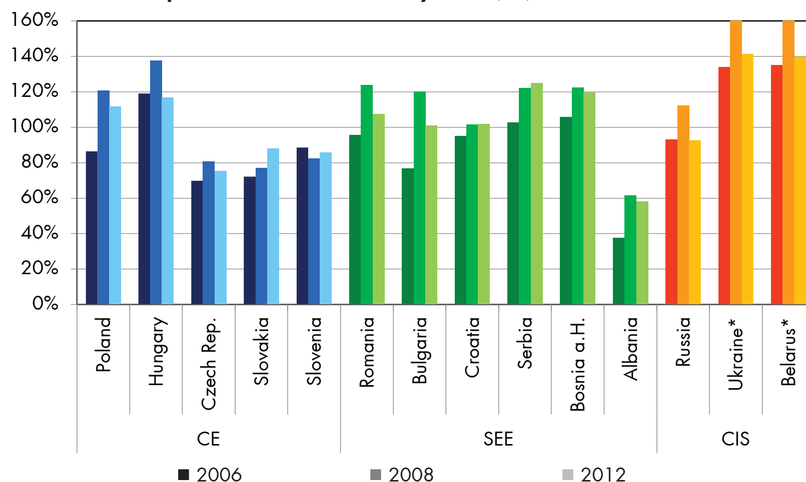
Gunter Deuber

were additionally supported by a slow-down of loan growth in H2 2012. All in all, the rebalancing of the L/D ratio in the CEE region in recent years is very impressive especially against the background of the year 2009, when at its absolute intra-year peak level the CEE L/D ratio stood at 124%.

In CE, the L/D ratio registered a noticable decline of 5pp. (from 106% in 2011 to 101% in 2012). In the SEE sub-region, the trend of declining L/D ratios also continued, leading to a drop in the L/D ratio by 3pp. (from 110% in 2011 to 107% in 2012). The L/D ratio in the CIS sub-region remained more or less stable at 96% compared to 97% in 2012. However, in this sub-region intra-regional divergences are more extreme than in any other CEE sub-region. The L/D ratio in the Russian banking sector fluctuated around 90-95% in 2012, with a slight uptrend throughout the year. In the banking sectors of Ukraine and Belarus L/D ratios continued their secular downtrend in 2012, posting a decrease by 10-20pp. in 2012 to levels around 140%. Although aggregated L/D ratios are at sound levels both in the entire CEE region and the major CEE sub-regions at present, there is still a need to closely watch L/D ratios in some individual banking markets. Some markets like Serbia, Bosnia and Herzegovina, Ukraine or Belarus still look a bit unbalanced according to their aggregated L/D ratio. In these markets adjustments are still required in order to promote self-funding. Nevertheless, the aggregated L/D ratio at 98% in the CEE banking sector as a whole shows that the current regulatory drive to increase self-funding in the CEE banking sectors is not a material growth constraint for the time being. However, the CEE L/D ratio – with some outliers on a country level – also shows the opportunities cross-banking can offer within the region – if there are not too many restrictions to up- and downstream funding and liquidity.

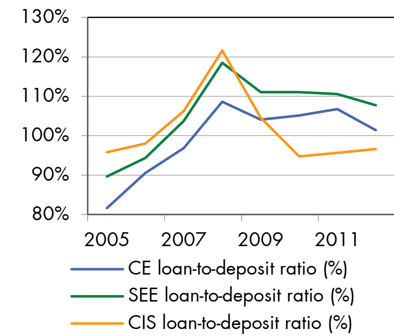
All in all, the relationship between loan and deposit growth has become much closer in CEE in recent years compared to the pre-crisis credit-boom years. From 2000 to 2007 the coefficient of correlation between loan and deposit growth had been at a level of just 0.5 to 0.7 on average. In fact, some countries with the highest L/D ratios even experienced the strongest credit growth in the pre-crisis boom years. Today, the relationship between deposit and loan growth at a country level has become more or less a perfect positive correlation in some CEE countries (i.e. with a coefficient of correlation between loan and deposit growth at around 0.9 to 1). This development reflects several trends in the CEE banking sectors: Firstly, a change in the business strategy of major Western European banks can be observed. Western CEE banks are favoring business models that are perceived as less risky or more sustainable by investors and home/host regulators. Currently,

CEE: Loan-to-deposit ratios at the country level (%)



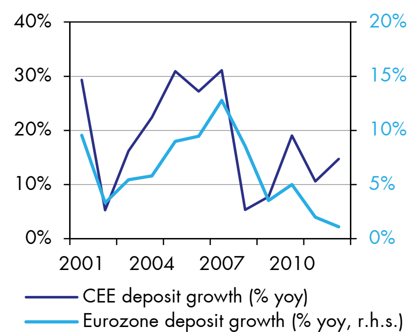
** Ukraine and Belarus with values above 160% in 2008; Ukraine: 205%, Belarus: 171%*
Source: National central banks, Raiffeisen RESEARCH

CEE: L/D ratio trends



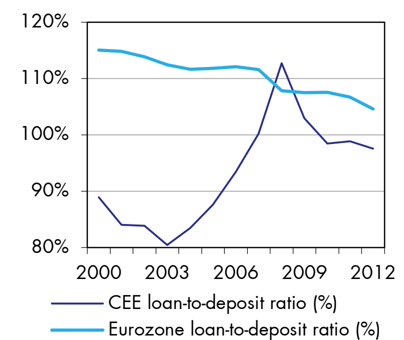
Source: National central banks, Raiffeisen RESEARCH

CEE vs. EMU: Deposit divergence



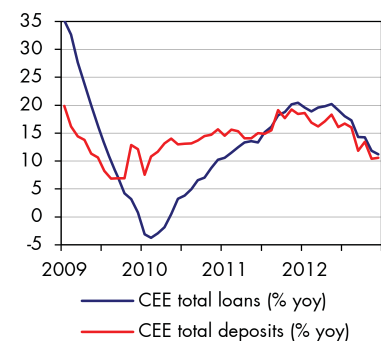
Source: National central banks, ECB, Raiffeisen RESEARCH

CEE vs. EMU: Long-term L/D trends



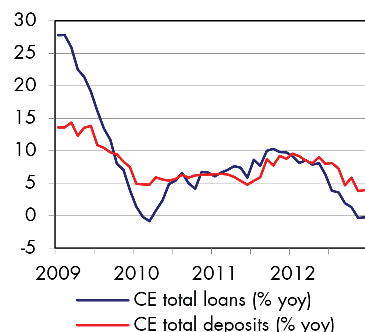
Source: National central banks, Raiffeisen RESEARCH

CEE: Loan vs. deposit growth



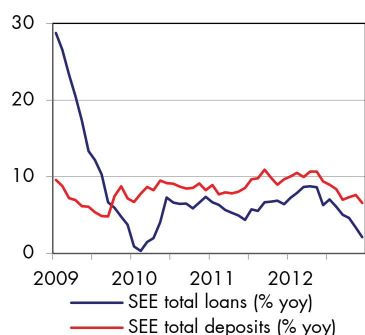
Source: National central banks, Raiffeisen RESEARCH

CE: Loan vs. deposit growth



Source: National central banks, Raiffeisen RESEARCH

SEE: Loan vs. deposit growth

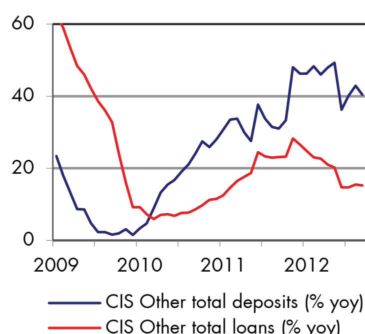


Source: National central banks, Raiffeisen RESEARCH

Russia: Loan vs. deposit growth

Source: CBR, Raiffeisen RESEARCH

CIS Other: Loan vs. deposit growth*



* *CIS Other: Ukraine, Belarus*
Source: National central banks, Raiffeisen RESEARCH

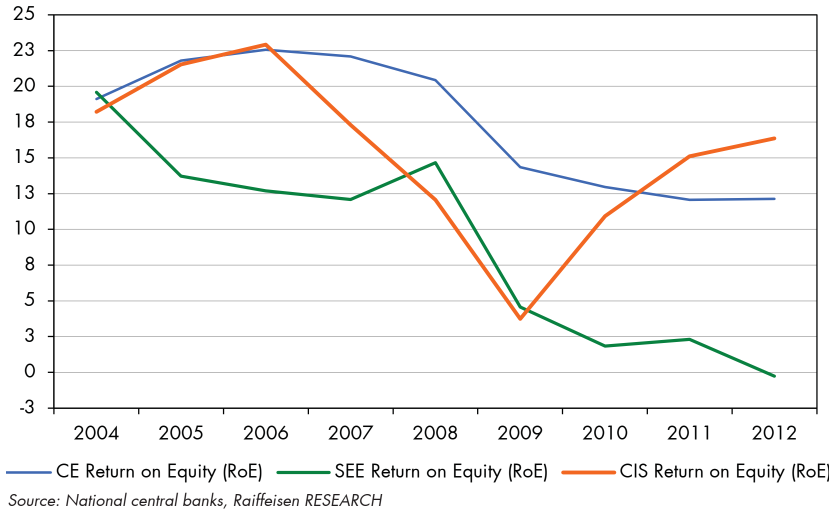
the so-called "Santander model" (i.e. each and every local subsidiary has to be more or less self-funded) seems to become the dominating operating banking model for (foreign) banks in CEE. Secondly, loan demand remains subdued in several CEE countries compared to the pre-crisis boom years and its longer-term average, while deposit growth remains closer to its longer-term average. The relative strong deposit collection performance in CEE becomes evident when comparing the regional CEE deposit growth with the respective developments inside the Eurozone. The overall CEE deposit stock currently represents 12.4% of the deposit stock of the Eurozone (as of year-end 2012) – an increase of 1.4 percentage points in 2012 yoy, that represents one of the strongest relative increases vis-à-vis the Eurozone over the last decade. Therefore, on average the CEE L/D ratio of 98% is now well below the Eurozone aggregate L/D ratio that also came down a bit in recent years (from 112% in 2007 to 105% in 2012). From a medium-term perspective, the recent downtrend in CEE L/D ratios reflects just a correction of brisk lending activity at the final stage of the strong banking sector expansion during the pre-crisis years. In the early boom years there had been still a significant deposit overhang in CEE – L/D ratios well above 100% had been a rather novel feature for the region. In contrast, L/D ratios for the Eurozone had always been well above 110% for the last decade or so.

The substantial rebalancing of the L/D ratio in CEE in recent years (i.e. a reduction by 15-20pp.) shows the high degree of balance sheet flexibility in the region, partially supported by shorter average loan maturities. Moreover, deposit collection in CEE showed a strong pick-up in 2011 and 2012 (following a more subdued expansion in 2008/09), a development not observed within the Eurozone, where deposit collection suffered from perceived banking sector risks that did not spill over to CEE. However, the currently sound L/D ratios and solid deposit collection in most CEE banking markets are also limiting the incentives for major foreign- or locally-owned banks to invest much in developing other funding sources. In contrast to the Eurozone, deposits therefore remain the most convenient and stable source of funding in CEE, where banks can also actively influence funding costs. In fact, banks inside the Eurozone will most likely increase their reliance towards deposit funding and get closer to the levels that are prevailing in CEE going forward. Nevertheless, the limited availability of other funding sources than deposits may become a bottleneck if loan demand picks up from current levels. The only exception might be Russia, as there are significant bank bond placements on national and international markets. Over the past two years the volume of outstanding bonds by Russian banks increased by almost 80%, reaching approximately EUR 29 bn as of year-end 2012. However, in percentage of the aggregate system liabilities this source of funding still remains moderate in Russia, just reaching 3% of the banks' total liabilities (year-end 2012).

Profitability indicators (Return on Equity, Return on Assets)

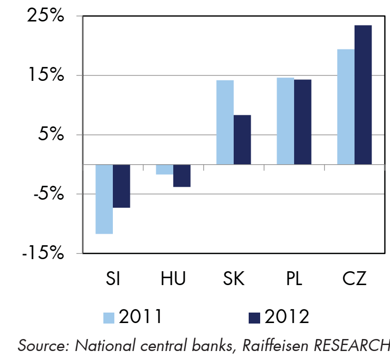
Given the challenging regulatory and macroeconomic environment in Western Europe and some CEE markets, profitability in the CEE banking sectors on aggregate remained at sound levels. All in all, the solid profitability readings in terms of Return on Assets (RoA) or Return on Equity (RoE) in 2011 were even slightly topped in 2012. The average RoE in the CEE banking sectors stood at 16% in 2012 (15% in 2011), the average RoA amounted to 1.9% in 2012 (1.7% in 2011). The solid aggregated profitability in CEE banking in 2011 and 2012 is clearly outpacing global Developed Markets and Eurozone banking profitability indicators. The global banking RoE was around 7-8% in recent years, inside the Eurozone the RoE turned into low positive territory in 2012 (around 3%), after being negative in 2011.

CEE: Long-term Return on Equity trend in the sub-regions (%)



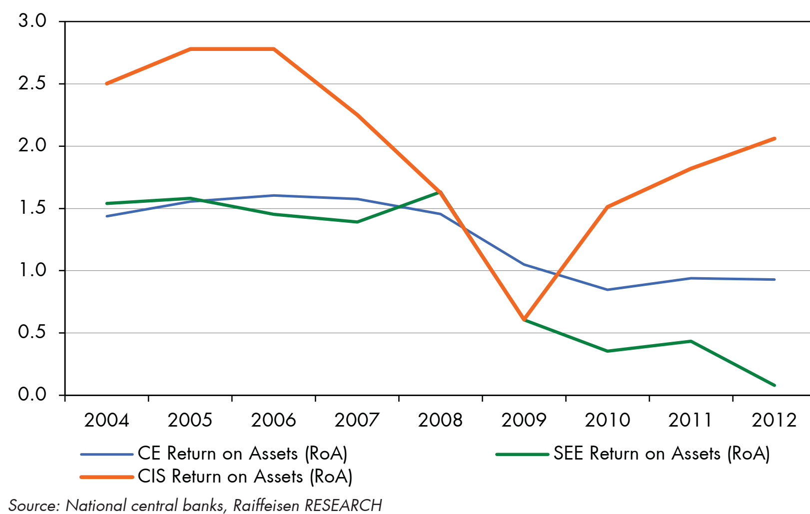
Source: National central banks, Raiffeisen RESEARCH

CE: Return on Equity (RoE, %)



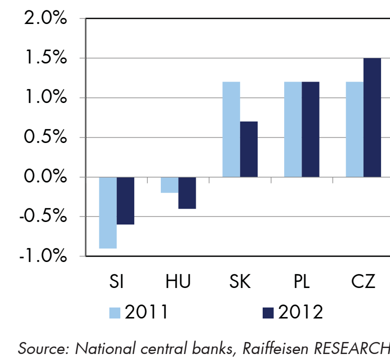
Source: National central banks, Raiffeisen RESEARCH

CEE: Long-term Return on Assets trend in the sub-regions (%)



Source: National central banks, Raiffeisen RESEARCH

CE: Return on Assets (RoA, %)



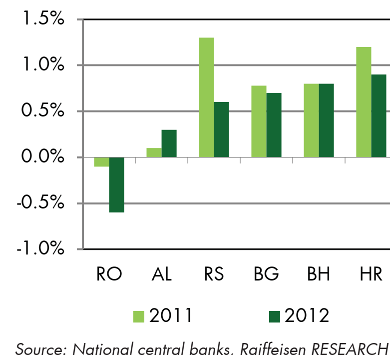
Source: National central banks, Raiffeisen RESEARCH

However, it is clear-cut that the solid profitability in CEE banking was largely driven by a few large and well-performing markets like Russia, Poland or the Czech Republic, where profitability increased in 2012 or remained at least at its solid 2011 levels. The Czech banking market was able to increase its profitability (RoE) to 23% in 2012 (from 19% in 2011), while in Poland and Russia profitability remained more or less at its 2011 levels (RoE in Russia increased to 18% in 2012 from 17% in 2011; RoE in Poland was at some 14% in 2011 and 2012). All in all, Russia, Poland and the Czech Republic remained the most profitable CEE banking markets, achieving an average RoA of 1.7-1.8% and an RoE close to 20% on average. The sound profitability performance of the CEE banking sector in 2012 was supported by a stable NPL ratio compared to 2011. The overall positive profitability performance of the CEE banking sector was also supported by the fact that the number of CEE banking markets with negative results (either RoA or RoE) decreased from four to three from 2011 to 2012. The Ukrainian banking sector turned from loss-making into positive territory in 2012; only the banking sectors in Hungary, Romania and Slovenia remained negative.

SEE: Return on Equity (RoE, %)

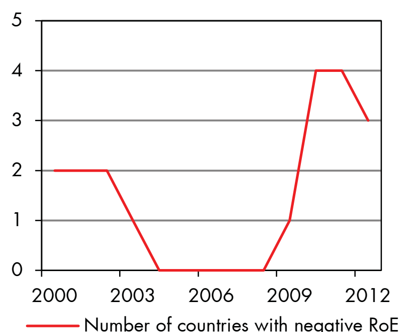
Source: National central banks, Raiffeisen RESEARCH

SEE: Return on Assets (RoA, %)



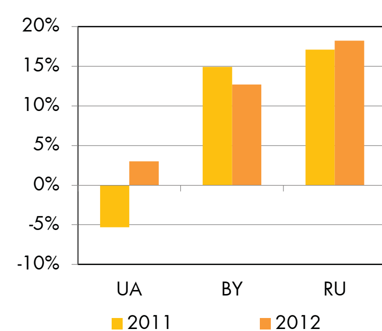
Source: National central banks, Raiffeisen RESEARCH

CEE: Challenging banking markets*



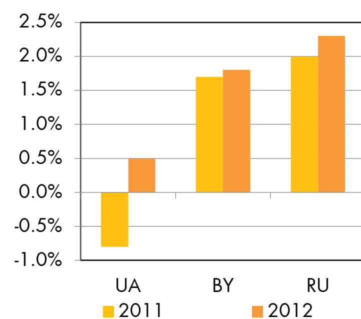
* out of 14 CEE banking sectors covered in this report (loss-making 2012: HU, SI, RO)
Source: National central banks, Raiffeisen RESEARCH

CIS: Return on Equity (RoE, %)



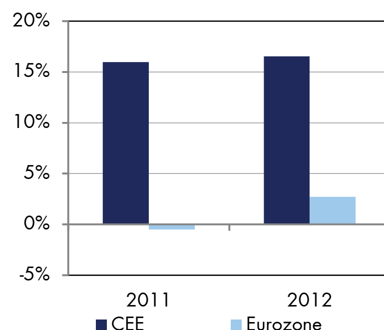
Source: National central banks, Raiffeisen RESEARCH

CIS: Return on Assets (RoA, %)



Source: National central banks, Raiffeisen RESEARCH

CEE vs. EMU profitability (RoE, %)



Source: National central banks, Raiffeisen RESEARCH

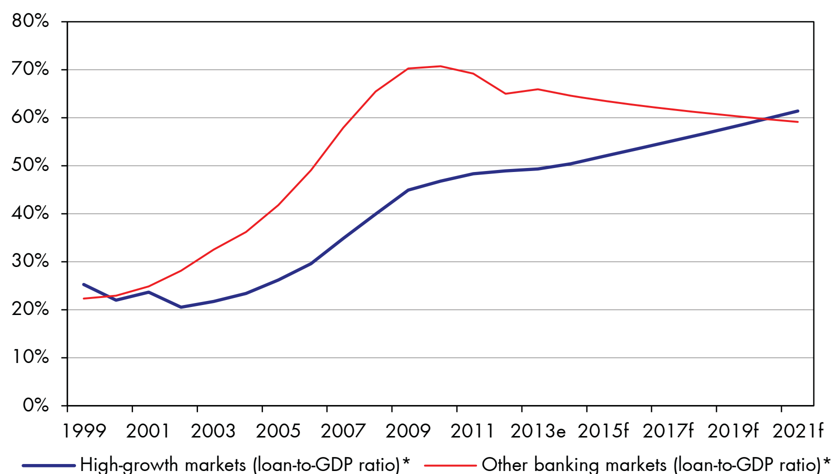
However, the strong overall CEE banking profitability reading is once again characterized by distinct regional and intra-regional differences. On average, the banking sectors in the CIS sub-region – driven by Russia and Belarus – remained highly profitable, pushing the average regional RoE and RoA to 16% and 2% respectively. As mentioned previously, the Ukrainian banking sector managed to return to profitability in 2012, posting a RoE at 3% and a RoA at 0.5% (following three years of negative RoA and RoE). In CE profitability indicators remained more or less at its solid 2011 levels in 2012 (RoE: 12%, RoA: 0.9%). Excluding the highly negative performance of the Hungarian banking sector – a large sector within the CE sub-region where profitability indicators had been negative for the second consecutive year in 2012 – the regional profitability indicators in CE would have been at 13.7% (RoE) and 1.1% (RoA) in 2012. That said, the business case for banking in CE and CIS is obvious: RoE readings are above the cost of equity (at least for solid banks). In SEE the revenue generation capacity continued to remain at low levels in 2012. For the entire SEE region the RoE was slightly negative (-0.3%) and the RoA close to zero. This negative performance can be largely attributed to substantial losses in the Romanian banking sector. Excluding the highly negative result in Romania, the average RoA and RoE in the SEE banking sectors remained more or less at the low levels seen in 2011, i.e. posting a RoA at 0.7-0.8% and an average RoE at 4-5%. From a medium- to long-term perspective, 2012 was already the fourth year with very low profitability readings in the SEE banking sectors on average (RoE in the range of 4-5%). This negative performance reflects high and still rising regional NPL ratios as well as subdued growth opportunities in new lending. Low profitability readings below the cost of equity (and below government bond yields in most cases), as observed in SEE, pose a challenging situation (e.g. in terms of securing new funding for the region or justifying the business case to investors/shareholders). Some relief may come from a stabilization of NPLs in 2013 and 2014.

Recent profitability trends in the CEE banking sectors also show that the very strong pre-crisis readings (with an average RoE above 20% in some years) are unlikely to be repeated in the foreseeable future. Growth opportunities on most markets are different to those in the years 2000-2007. Moreover, increasing regulation and higher operating costs are eating into the revenue generation capacity. This trend is unlikely to change and the pressure on the cost side will remain high. However, it is important to stress that the relative decrease in profitability within the CEE banking sector cannot be compared to the observed downfall on a global or Western European level. On a global level banking sector profitability has more or less halved in recent years; within the Eurozone the aggregated RoE of the post-crisis banking sector stands at less than one third of its pre-crisis level. By comparison, the difference between the pre- and post-crisis average RoE in the CEE region is less pronounced. The pre-crisis average RoE in the CEE banking sectors stood at 20% (2000-2007), the post-crisis average RoE at 14% (2008 to 2012). In the medium-term, an average RoE in the range of 12-15% can be considered sustainable within the CEE region. This expectation is based on the assumption that in Russia, where the 2011 and 2012 RoE at 17-18% was supported by very strong growth in the field of high-margin consumer lending, the RoE may weaken somewhat from its 2011 and 2012 levels (roughly to around 16% on average). However, this effect is likely to be partially compensated by a gradually improving profitability in Hungary, Romania and some other SEE markets.

Medium-term outlook: Where banks can grow in CEE

The numerous regional and intra-regional differences among individual CEE banking sectors outlined throughout this report illustrate that one cannot speak about one homogenous banking sector, or one growth outlook for the entire CEE region. This holds especially true with regard to the medium-term growth prospects, as financial cycles usually tend to last much longer than business cycles. Therefore, it is important to stress that in some cases parts of the very unique banking business opportunities in CEE, which existed some ten years ago, are considerably more limited today. In other words: in some CEE banking sectors many of the low hanging fruits in terms of "catch-up" (or very strong under-penetration) have disappeared. The estimated remaining fundamentally backed banking sector "catch-up" potential in terms of loan-to-GDP ratios for the entire CEE region (given corresponding GDP per capita levels) has more than halved, from 35% in 2000 to 15% in 2012. Nevertheless, in CEE banking markets like Russia, Poland, the Czech Republic, Slovakia or Romania loan-to-GDP ratios are still well below sustainable levels under consideration of current and future income levels. This correlation indicates a fundamentally backed and untapped long-term banking sector growth potential. As a consequence, a significant demand and therefore need for financial intermediation still exists within these potential high-growth CEE banking markets. In a medium-term perspective, banking sector growth in these markets is likely to perform well above GDP growth – if not capped by adverse supply-side developments. However, in a few other CEE markets like Slovenia, Croatia, Bulgaria or Ukraine there is some evidence that loan-to-GDP ratios are already close to or have even exceeded sustainable equilibrium levels (at current income levels) during the strong pre-crisis boom. In these markets the level of financial intermediation is also at relatively high levels compared to the current level in the Eurozone, when adjusted by the differential in income levels. Moreover, in some of these markets GDP growth prospects and the resulting future GDP per capita gains are unlikely to match pre-crisis levels.

CEE financial intermediation outlook: High-growth vs. Other banking markets



** High-growth markets: PL, CZ, SK, RO, RS, AL, RU; Other banking markets: HU, SI, BG, HR, BH, UA, BY*
Source: National sources, Raiffeisen RESEARCH

Going forward, we expect the average loan-to-GDP ratio within the group of high-growth CEE banking markets to increase in the years to come (from 50% at present to around 55% until 2017). In contrast, the average loan-to-GDP ratio in the other CEE banking markets is expected to remain more or less constant at around 60% of the GDP in the years ahead. In fact, even some modest downward bias seems plausible once GDP growth picks up in these markets. In terms of sustainable annual nominal loan growth rates, the outlined financial intermediation outlook implies an annual total loan growth in the range of 10-12% yoy

High-growth vs. Other CEE banking markets

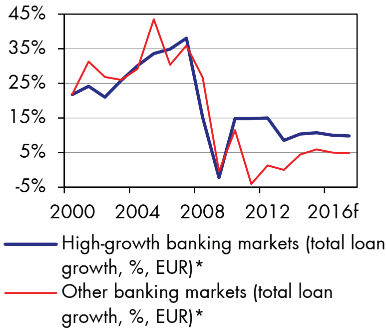
Given very different loan-to-GDP and GDP per capita levels in the 14 CEE banking markets we are covering, we tend to split these markets into two categories.*

High-growth CEE banking markets: These markets have a high medium-term growth potential and are characterized by a loan-to-GDP ratio that remains well below or at least at a fundamentally backed level compared to adequate long-term financial intermediation trends. According to this definition Russia, Poland, the Czech Republic, Slovakia, Romania, Albania and to a certain extent Serbia still tend to be significantly undersupplied in terms of bank services. In such a setting, banking sector growth may outpace GDP growth for a longer period of time and on a sustainable basis. In these markets, business strategies based on volume growth appear to be feasible from both a macroeconomic and macroprudential point of view.

Other CEE banking markets: These markets are characterized by fairly high loan-to-GDP ratios in relation to current income levels (either measured in comparison to the Eurozone or to longer term financial intermediation trends in Emerging Markets). Within such a setting banking sector growth is unlikely to strongly outpace GDP growth on a sustainable basis. In some of these markets loan-to-GDP ratios may even decrease slightly in the years to come. However, this does not indicate that there will not be any growth opportunities at all. Total nominal loan growth might develop just slightly below nominal GDP growth. However, there still might be a multitude of business opportunities apart from simple loan volume growth. Furthermore, a certain stabilization of loan-to-GDP ratios following a period of very strong growth – e.g. like it happened in Ukraine in recent years – may even help to restore the medium-term banking sector prospects.

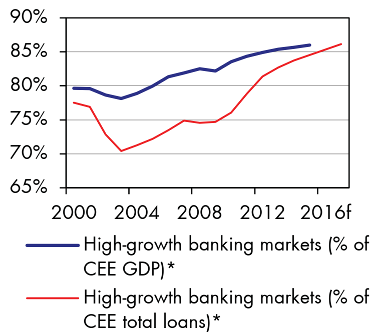
** Source: Raiffeisen RESEARCH 2011 CEE Banking Sector Report*

CEE: Long-term growth outlook



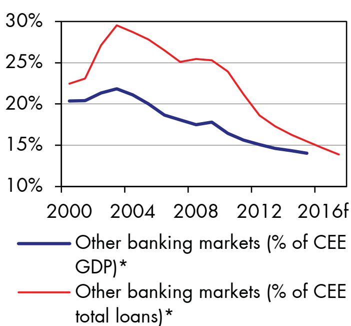
** High-growth markets: PL, CZ, SK, RO, RS, AL, RU; Other banking markets: HU, SI, BG, HR, BH, UA, BY*
Source: National sources, Raiffeisen RESEARCH

CEE: High-growth markets catch-up



** High-growth markets: PL, CZ, SK, RO, RS, AL, RU; Other banking markets: HU, SI, BG, HR, BH, UA, BY-*
Source: National sources, Raiffeisen RESEARCH

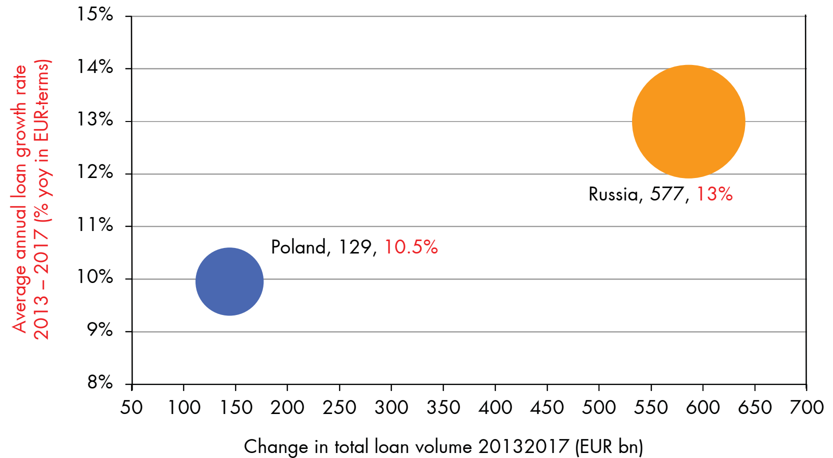
CEE: Moderation in Other markets



** High-growth markets: PL, CZ, SK, RO, RS, AL, RU; Other banking markets: HU, SI, BG, HR, BH, UA, BY-*
Source: National sources, Raiffeisen RESEARCH

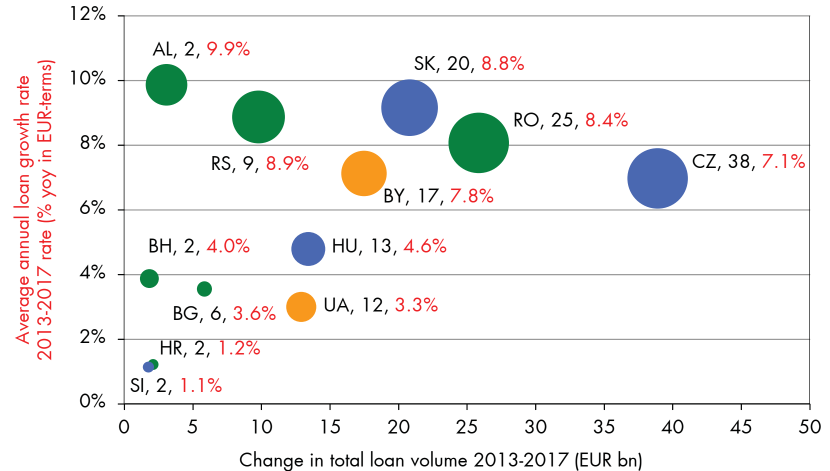
(in EUR-terms) in high-growth CEE markets, and some 4-5% in other CEE banking markets (with some of them heading towards the 6% level). Therefore, we also expect the overall CEE loan-to-GDP ratio to increase by at least 10% over the next decade (as the largest CEE banking markets are still high-growth markets). In contrast, it seems plausible that the loan-to-GDP ratio of the Eurozone may decrease by at least 20pp. on aggregate over the next 5 to 10 years.[2]

CEE: Long-term banking growth outlook top two volume growth markets



Source: National central banks, Raiffeisen RESEARCH

CEE: Long-term banking growth outlook outside Russia and Poland



Source: National central banks, Raiffeisen RESEARCH

The two by far largest CEE banking markets Russia and Poland are expected to come in at the top of the group of high-growth market. On the Russian and Polish banking markets an annual banking sector growth of 13% and 10% respectively (in EUR-terms from 2013 to 2017) appears to be sustainable; in LCY-terms, the respective potential annual average loan growth rates are at 14% and 9% respectively. The outlined growth outlook would translate into an increase of the total loan stock of around EUR 580 bn until 2017 in Russia, and another EUR 130 bn in Poland. The Russian and Polish banking markets are followed by the Czech Republic, Slovakia, Romania, Serbia and Albania, where a total annual loan growth in the range of 7-10% yoy in EUR-terms (6-9% yoy in LCY-terms) appears to be sustainable from a medium-term perspective (i.e. from 2013 to 2017). Within the larger regional banking markets in the Czech Republic, Slovakia and Romania this growth outlook would translate into a total loan stock

2 See for example McKinsey Annual Review of banking industry 2012.

increase of some EUR 80 bn over the next five years (CZ: EUR 38 bn, RO: EUR 25 bn, SK: EUR 19 bn). With estimated sustainable annual loan growth rates of around 1% yoy (in EUR-terms) Croatia and Slovenia show the least appealing medium-term prospects in terms of expected loan growth. In other CEE banking markets like Hungary, Bulgaria, Bosnia and Herzegovina or Ukraine growth prospects in EUR-terms also look less promising. In all these markets the average annual loan growth rate in EUR-terms is unlikely to exceed the 5% level yoy on a sustainable basis. However, the expected performance figures already factor in some currency effects that could turn a still solid loan growth in LCY-terms (as observed in the Ukraine) into lower outcomes in EUR-terms. The largest deviation between expected banking sector developments in LCY- and EUR-terms is observed in Belarus, where an expected nominal loan growth in LCY-terms of around 18% will only translate into a loan growth of around 6-7% in EUR-terms. Moreover, the latter figure can be subject to substantial currency volatilities, with potential downside risks. All in all, the expected growth of the aggregated total loan stock in all CEE banking sectors other than Russia, Poland, the Czech Republic, Slovakia and Romania would amount to around EUR 60 bn over the next five years.

CEE: Banking growth outlook 2013-17 (EUR- vs. LCY-terms) *

Country	Loan stock growth	Avg. annual growth	
	(EUR bn)	(yoy, EUR)	(yoy, LCY)
Russia	577	13%	14.4%
Poland	129	10.5%	8.9%
Albania	2	9.9%	9.7%
Serbia	9	8.9%	8.3%
Slovakia	20	8.8%	8.8%
Romania	25	8.4%	7.9%
Belarus	17	7.8%	19.4%
Czech Rep.	38	7.1%	6.1%
Hungary	13	4.6%	4.5%
Bosnia a.H.	2	4%	4%
Bulgaria	6	3.6%	3.6%
Ukraine	12	3.3%	7.8%
Croatia	2	1.2%	1.2%
Slovenia	2	1.1%	1.1%
Regions			
CE	201	7.1%	7.3%
SEE	45	6.4%	6.1%
CIS	607	12.1%	14%

** Countries sorted by average annual 2013-2017 expected yoy-growth rate in EUR-terms*
Source: Raiffeisen RESEARCH

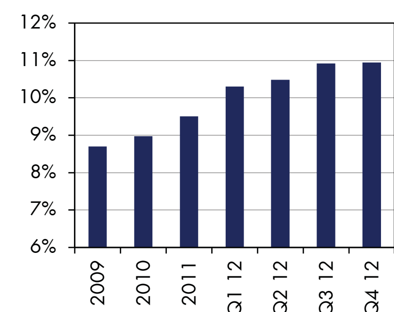
The sketched expected growth trajectories of high-growth banking markets and other banking markets in the CEE region imply an increase of the relative share of high-growth CEE banking markets from 81% of total CEE banking assets (2012) to around 86% by 2017. In contrast, the relative share of other CEE banking markets in total CEE banking assets will most likely decrease from some 19% (2012) to around 14% within the next five years. The highly differentiated banking sector growth prospects in the region are also well reflected in the current strategies of major Western European CEE banks. All of them are currently (re-)focusing their business strategies on markets like Russia, Poland, the Czech Republic and possibly Slovakia and Romania – depending on their individual strengths, network size and country presence. On the flip side of the coin, outright market exits or at least a streamlining of activities on less promising CEE banking markets like Ukraine, Hungary or Slovenia can be observed. The trend to more selective business strategies by large banking groups in CEE is expected to continue and could be an influencing factor on the overall future banking performance. However, our baseline loan growth estimates presented previously are not explicitly factoring in such rather supply-side related aspects. The fundamentally backed sustainable loan growth rates as outlined previously are derived from demand-side estimations based on the positive long-term relationship between financial intermediation (loan-to-GDP ratios) and economic wealth (GDP per capita) at a country level within a larger country sample that includes CEE as well as non-CEE economies and banking sectors (for estimations on potential adverse supply-side effects on loan growth in CEE see the "Focus on"-section on page 26).

Challenges and opportunities for banking in CEE

Challenges and opportunities for banking in CEE and for larger Western banks operating in CEE depend on the following aspects:

- Global and regional capitalization and funding issues
- Global, European and CEE-specific regulatory action
- Changes of the competitive landscape in the CEE banking markets

Capitalisation: Increased as required*



** Core Tier 1, average, sample of banks: Santander, RBI, Erste, UniCredit, KBC, Intesa, SocGen*
Source: Company data, Raiffeisen RESEARCH

Key challenges for European (CEE) banks are related to capitalization and long-term funding. These two factors are interrelated, the availability of both will shape the banking business in the future. A driving force for funding and capitalization are the Basel III norms, awaiting implementation in the coming years. Regulatory actions preceding their introduction have started and already put pressure on European banks. So far, capitalization was in the focus, but a closer focus on funding is to come.

Focus on: Estimations on potential supply-side constraints on CEE loan growth

Our baseline loan growth estimates outlined in the chapter "Medium-term outlook: Where banks can grow in CEE" are based on potential loan demand estimations at a given income level. If we want to estimate the magnitude of possible adverse supply-side effects in the region going forward, these baseline demand-driven estimates (based on the implicit assumption that potential loan demand will be finally and fully met) could serve as a fair starting point. When we subsequently analyze possible supply side-constraints we are able to define three major factors that may hamper loan supply in CEE in the future:

- **Less willingness** *or* **less capacity** of foreign-owned Western European CEE banks or other international banks to lend
- **High NPLs** *and* **low profitability** cause decreasing lending on the part of all banks (foreign-owned, locally owned)
- **Still high L/D ratios** on aggregate might hamper future lending activities on the part of all banks in a given CEE country

If we try to include these three factors into some reasonable supply-side capped loan growth estimates we have to take into account that the individual banking markets in CEE could be affected in a very different way (e.g. depending on varying market shares of foreign-owned banks, the level of NPLs or the aggregated L/D ratio). On the basis of the divergence of the CEE markets with regard to the three dimensions introduced previously we added supply-side related caps on the baseline loan growth forecast in each and every CEE country (e.g. that in a given country 5-25% of potential loan demand will not be met). The lowest caps (5% on the potential loan demand) were applied to markets like Russia, Poland, Slovakia and the Czech Republic. For markets like Albania, Belarus and Ukraine (in both cases factoring in supporting effects from state-owned banks and/or Russian banks) caps of 10-15% were applied. And for other CEE markets like Hungary, Slovenia and the rest of the countries in SEE we applied supply-side caps in the range of 20-25% on the potential loan demand. The resulting aggregated results on a sub-regional level would be the following:

- **CE: Potential annual loan growth (LCY-terms)** could be at least 0.5pp. lower in a scenario with adverse supply-side constraints than in our baseline demand-driven estimations down from 7.3% (baseline) to 6.8% yoy
- **SEE: Potential annual loan growth (LCY-terms)** could be at least 1.4pp. lower in a scenario with adverse supply-side constraints down from 6.1% (baseline) to 4.7% yoy
- **CIS: Potential annual loan growth (LCY-terms)** could be down by 0.5pp. in a scenario with adverse supply-side constraints down from around 14% (baseline) to 13.5% yoy

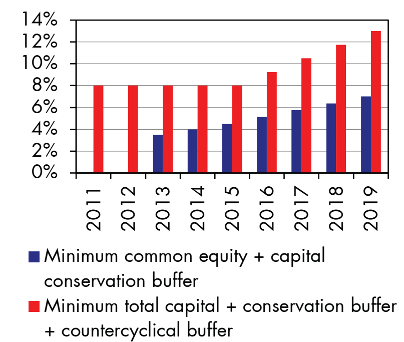
Although at first sight the above-mentioned figures do not appear very high, the possible impact of such supply-side constraints on loan growth should not be underestimated. Taking the average of past and recent elasticity between loan and GDP growth, the average CE potential GDP growth in the years ahead could be 0.5pp. lower in a scenario of adverse supply side constraints (down from 2.1% yoy to 1.6% yoy on an annual basis). The average potential SEE economic growth could be down by 0.4pp. (down from 2.5% yoy to 2.1% yoy). And in the CIS region the negative growth effect might be at some 0.6pp. (bringing average potential GDP growth down from some 3.5% to around 3% yoy). Although we do not consider region-wide adverse supply-side effects on the banking sector growth as a very likely scenario, the risks of such effects should not be underestimated. This holds especially true for some economies in CE (Hungary, Slovenia) and SEE (Bulgaria, Croatia, Bosnia and Herzegovina). However, it has to be emphasized that we are still confident with our baseline demand-side driven loan growth estimates. There are good reasons to assume that "through-the-cycle" a fundamentally backed and therefore sound credit demand in CEE will ultimately encounter stronger banks – local and international players with sufficient lending capacity.

Gunter Deuber

Weak economies in Western Europe and parts of CEE, unimpressive equity valuations for European banks (with market capitalization below book value), a shortage of retained earnings and the necessity to bear still high cost of risks have complicated options for large European banks (including the ones with significant CEE exposure) to strengthen their capital stock over the past 2 to 3 years. Nevertheless, European banking groups, including the ones with significant CEE exposure, managed to push capitalization ratios to levels compliant with the changing regulatory requirements. Banks were using ad-hoc market placements, balance sheet restructuring/optimization, and certain amounts of deleveraging or retained earnings to shore up their capitalisation. However, boosting capital ratios much further could be counterproductive. The introduction of multiple new capital norms as suggested by the Basel III framework will make it even more complicated. Additional capital buffers (capital conservation, countercyclical, global SIFI buffers and possibly "local" SIFI buffers as suggested by the "Austrian Finish") will drive capital ratios once again higher. The medium-term goal is to increase the minimum Common Equity Requirement (Core Tier-1 plus capital conservation buffer) to 7%, while total capital ratios might exceed 13%. For CEE it is of relevance that large Western European banking groups will be acknowledged

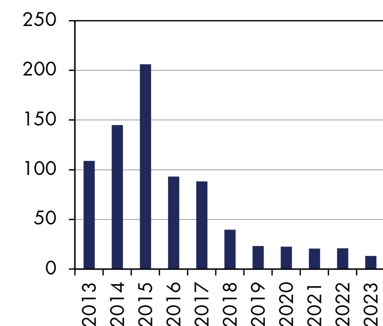
as a global or local SIFI. This will imply an additional capital burden of up to 3%. Under this framework, UniCredit and SocGen would be affected by a global SIFI regulation, and RBI and Erste by a local "Austrian" SIFI regulation. According to first estiamtes (global, local) SIFI regulation may decrease the RoE of affected banks by some 40-120bp. Under this scenario, the number one objective for large Western European (CEE) banks would be to secure adequate sources of capital accumulation. This does not only mean to accumulate sufficient equity and ensure adequate retained earnings. Banks will also have to reconsider the risk composition of their asset base in order to have RWAs in accord with new RWA weights defined by Basel III. As long as banks would have to comply with additional capital buffers, markets would actively be tapped – for hybrid instruments, contingent capital, and long-term debt. Another task will be to make sure that hybrids (existing and targeted placements) will be classified as "capital" by new regulation. However, the sources for capital generation will remain scarce and may become even scarcer. Markets are likely to get saturated with bank debt and equity issuance. Retained earnings may not fully compensate for this effect and the ability to profit from further balance sheet restructuring/optimization also has limits. Furthermore, there will be significant trade-offs between growing the overall balance sheet and capitalization ratios, as some additional capital requirements will be based on the overall size of the bank balance sheet. A certain relief may come from a further stretching of implementation dates for (at least parts of) the new regulatory framework. Stretching of implementation might be in the interest of all stakeholders, as too much conservatism of banks in terms of new lending may have negative spillovers on the economies they are lending in (for more details on adjustments to the regulatory environment see the info box on page 28).

Basel III capitalisation timeline



Source: Basel Committee on Banking Supervision; Raiffeisen RESEARCH

Refinancing: Largest European banks*



** Aggregate refinancing needs for the largest European CEE banks, EUR bn*
Sample of banks: Santander, RBI, Erste, UniCredit, KBC, Intesa, SocGen
Source: Bloomberg, Raiffeisen RESEARCH

The developments in the European banking landscape over the past two years indicate that particularly large banking groups are at the initial stage of adjusting their structures, risks and funding stocks (including capital) to a new economic and regulatory environment. Therefore, considerable issuance of bank debt and equity is likely in the years ahead. This holds especially true in case valuations for European banks in general and Western European banks with significant CEE exposure will improve. With regards to funding issues, we consider it as positive for Western European banking groups operating in CEE that their business models are already largely based on (local) deposit funding. Moreover, large Western European CEE banking groups with extensive branch networks in CEE are well placed to increase deposits in line with expected loan growth in the near future. In Western Europe deposit funding will become more important in the years ahead. It has to be seen to what extent this process will be influenced by the recent bail-in of creditors and large depositors in Cyprus. Going forward, the propensity to build up capital from retained earnings should also prevail, putting a constraint on potential M&A activity and – marginally – on dividend payouts of Western European (CEE) banks. Balancing all these partially contradicting goals will be particularly challenging for publicly traded banks.

All in all, we tend to think that the capital needs for the largest Western European banking groups in CEE that are needed to fund their future business growth are fairly limited (~ EUR 4-5 bn annually for all major players together). This amount could be fulfilled through retained earnings and opportunistic market placements once overall valuations of European banks are improving. On the funding side, we are currently also less concerned due to the solid regional deposit base and solid deposit collection trends. However, it remains to be seen to what extent deposit growth will be sufficient to fund a banking sector expansion in case economic growth picks up in CEE compared to the currently still fairly subdued levels.

If to compare Western European CEE banks with purely Western European/globally oriented banks there are also a number of challenges and opportunities determined by their geographical focus and business mix. As already shown within this report, Western European banks did not deleverage heavily in their CEE core business. However, this created certain disadvantages compared to other Western European investment/universal banks that slashed their balance sheets more actively (e.g. via outright asset sales or transfers to restructuring units), which brought a tangible relief on the capital side in some cases. Moreover, the business of large Western European banks in CEE, largely based on traditional lending, is mainly driven by net interest rate margins. Here we have seen earnings pressure on major CEE banking groups (like on Western European banks in general), while picking-up earnings from investment banking do not provide so much support for Western European CEE banks compared to (other) European investment and/or universal banks[3]. With regard to the operating environment, interest rates and currency risks might be also a bit higher for Western European CEE banks compared to other Western European banks. However, the remaining independence of many potential Eurozone candidates from CEE in terms of monetary and exchange rate issues also creates a lot of upside potential for banks operating in CEE. Although the overall NPL levels at the larger and well diversified Western European CEE banks do not look overly high, there are some CEE countries with high NPL stocks. This holds especially true for SEE. Here the issue of high NPL stocks has to be tackled very carefully going forward. If NPLs are prolonged for a long period of time (hoping for a recovery of loan quality and collateral values in the distant future), over-indebted firms and households cannot support an economic recovery. For this reason, some action to support loan restructuring and to speed-up NPL resolution (like increasing provision requirements) might be desirable from a macroeconomic point of view. However, such initiatives also have to take into account earnings capabilities in each and every market.

3 For a more detailled comparison between business models and challenges at Western European CEE banks and Western European universal and/or investment banks see Deuber/Shpilevoy (2013): Foreign-owned banks in CEE/CIS, in: European Investment Bank (2013): Banking in Central and Eastern Europe and Turkey

Front-loaded adjustments of European banks to dynamic regulatory environment

Although full implementation of the Basel III regulatory framework is still 5-6 years away, initial supervisory checks and measures by the authorities already compel the banks to adjust. Moreover, future measures are already front-loaded due to the overall market pressure on European banks. The steps already observed within the European banking landscape are the following:

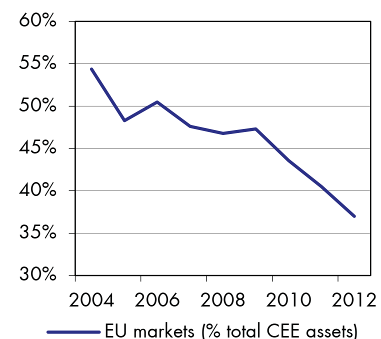
- **Issuance of new equity:** This has been done by some of the large Western European banking groups (including some with significant CEE exposure) – more placements are likely to follow. Currently it looks like banks still are adjusting their placements of equity, hybrids, or other long-term instruments (like contingent capital instruments – cocos).
- **Optimization of balance sheet and business lines:** Western European banks (including the ones with significant CEE exposure) are reshaping actively their organizational structures and geographical presence in order to optimize costs and RWAs. Banks rethink and redefine their business scope, geographical scope, and overall network size. Some groups have sold out or decreased their participation in certain subsidiaries or markets or decreased certain (capital consuming) business lines that are of less importance within the overall banking group or where post-crisis growth opportunities are well below pre-crisis levels. The overall optimization process also includes active balance sheet optimization.

The "evidence", as referred to by EBA with respect to European banks' capitalization in general, shows that by the end of 2012, the vast majority of European banks managed to comply with EBA's recommendations on capital issued in the autumn of 2011. This was achieved predominantly due to direct capital measures, i.e. retained earnings and capital attraction from the market. Deleveraging or balance sheet/RWA optimization took only a secondary importance according to EBA numbers. In particular, as disclosed by EBA, out of the total recapitalization amount achieved by the European banks, EUR 83.2 bn were related to direct capital measures and EUR 32.5 bn were achieved due to RWA impact. Other mitigating measures that had direct capital impact included the increase of minority interest, the disposal of goodwill, the reduction of loss provisions where applicable, the disposals of non-consolidated subsidiaries, and so on. Compared to their Western European peers without significant CEE exposure, there is certain evidence that Western banking groups operating in CEE had more potential gains from balance sheet/RWA optimization (due to the still more decentralized structure of their operations) that was actively used over the last 1 to 2 years. However, the potential from such measures has been largely exhausted.

Gunter Deuber, Elena Romanova

Banking regulation is becoming more complex and burdensome at the global and European level. One may even speak about a "regulatory fragmentation". The CEE banking sectors and Western European banks are feeling the impact from the dynamically changing regulatory environment. In fact, a lot of recent banking sector challenges on a broader European level are mostly driven by the need to increase the confidence into Western European banks with a global or Western European business focus and to stabilize Western European banking sectors. For Western European banks operating in CEE, the currently dynamic regulatory environment in Western Europe is of special concern as they are competing in markets in- and outside EU jurisdiction. In some CEE markets, Western European banks (or their local subsidiaries) might be subject to greater regulatory pressure than pure local peers. In fact, Western European banks operating in CEE have large and profitable subsidiaries on fast growing non-EU markets (like Russia for RBI, SocGen and UniCredit or Turkey for UniCredit). Currently, just 37% of CEE banking sector assets are located within the EU (five years ago this relationship had been at 50%). Moreover, the trend of disintermediation away from bank lending towards capital markets financing – visible in Western Europe – has its limits in CEE, although the attraction of capital markets financing is also increasing in CEE. However, this trend is limited to a few economies like Russia, Poland and possibly the Czech Republic. Furthermore, some current regulatory initiatives (in Western Europe or CEE) have some sort of self-insuring bias, i.e. putting a strong focus on domestic funding. However, an envisaged independence of each and every (small) national banking market might not be economically feasible. This holds especially true for CEE, where from a macroeconomic point of view (modest) current account deficits are likely to prevail for a certain period of time. These deficits are based on savings–investment imbalances on the national level and after all banking is about intermediating between savings and investments. Moreover, very strong nationally oriented banking regulation inside the EU also looks somewhat odd in times of working on a "Banking Union" in (Western) Europe. All in all, in terms of regulation the situation for Western European banks operating in CEE will remain challenging. They will be subject to EU regulatory moves and there are also additional country-specific regulations. Not to forget that a "Banking Union" in Western Europe could have some consequences for CEE (see the following "Focus on"-section on page 30).

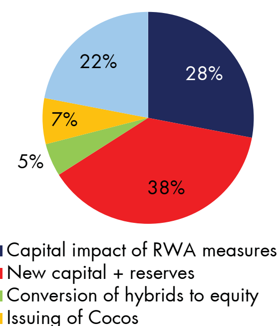
CEE: Banking markets inside EU



Source: National central banks, Raiffeisen RESEARCH

The past several years put a start to a gradual transformation of the banking landscape in CEE. Western European CEE banking groups with a larger or smaller regional presence started to actively restructure and adjust their regional presence. Economic and market conditions had been the prime source of these adjustments, while regulatory changes made the process more rapid and intense. The changes relate to the whole range of factors: organizational structures, geographical scope of activities, strengthening key market presence, overall business mix, involvement into commercial and investment banking, structure and sources of funding and the overall risk appetite of banks (as this is also relevant for RWA issues). The process of rethinking and reconsidering all these parameters has intensified over the last two years and there is evidence of the entire range of measures undertaken by large Western European banking groups active in CEE. We expect a continuation of this trend. These changes will be coming gradually, but might have a significant impact in the end. It seems that some less dedicated players are scaling down their overall CEE presence or revising their presence in certain business segments. There had been also outright market exits in some cases. For those committed CEE banking groups who withstand the sketched market trends, room for beneficial options might open up both on the asset and funding side as well as in terms of structural repricing opportunities. However, competition in the most attractive and "self-funding" CEE banking markets and

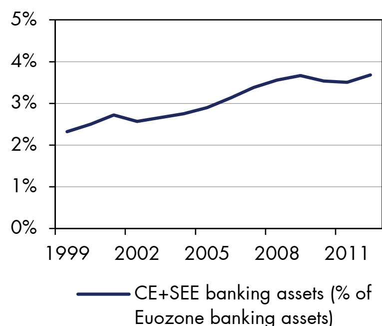
Impact of direct capital measures*



- Capital impact of RWA measures
- New capital + reserves
- Conversion of hybrids to equity
- Issuing of Cocos

** in boostig European banks' capitalisation*
Source: EBA, Raiffeisen RESEARCH

CE/SEE vs. EMU: Banking sector size



Source: National sources, ECB, Raiffeisen RESEARCH

business segments may also intensify going forward. The generally adopted business approach exercised by the largest CEE-exposed Western European groups in the past, which was about "growing everywhere", is now focusing on "doing the best where conditions are most promising". Correspondingly, the nature of competition changes as well – from being widespread within CEE, it is now converging to competing over the "juiciest chunks". Banks are targeting the most promising markets and business segments. Generally speaking, banks are focusing on through-the-cycle risks-reward relationships and favor markets where risks are lower or at least better manageable. It goes without saying that it becomes increasingly difficult for Western European banks to provide support to more challenging banking sectors given the overall volatile operating environment and increasing profitability demands from investors or shareholders. Therefore, less attractive CEE banking markets may suffer somewhat from the changing regional business strategies. However, it will be also difficult to exit such markets without significant losses. In this context it is worth mentioning that large Western European banking groups look somewhat overrepresented on the SEE banking markets. On some less developed CEE banking sectors or banking sectors where there are structural issues – like in SEE – a rationale for IFIs to support the further banking sector development remains. A low loan growth environment, partially driven by supply-side constraints, could have negative medium-term consequences. Such an environment may foster economic sectors that are just less dependent on large investments and financing, which might not be the most productive ones.

Focus on: "Banking Union" in (Western) Europe from a CEE perspective

In general, current Eurozone and/or EU members from CEE and all possible future EU member states from CEE should be interested in more banking sector cooperation and integration from a regulatory point of view. This interest in a so called "pan-European banking architecture" or "Banking Union" stems from the fact that de facto cross-border banking integration in the CEE EU member states and EU candidate states has gone much further than in Western Europe and these markets are more homogenous than banking markets in Western Europe (i.e. in CEE the gap between institutional and de facto banking integration is much larger than in Western Europe). Around 50-80% of banking sector assets in CE and SEE are foreign-owned and ownership is concentrated in a few countries. In contrast, major Western European banking sectors are characterized by foreign ownership ratios in the range of 10-20% on average. Moreover, the experience of CEE within the "Vienna Initiative" framework showed the fruitfulness of cross-border coordination (as negative banking sector risks and sovereign risk feedback loops like inside the Eurozone had been avoided). Furthermore, a more integrated banking architecture in Europe could help to reduce regulatory costs. This is of particular importance in CEE, where a lot of banking markets are small in size. It should not be forgotten that current regulatory moves are already squeezing profit margins in the banking industry. Moreover, an integrated banking architecture in Europe could help to avoid possible problems from regulatory arbitrage and would allow a knowledge and best-practice sharing in terms of regulation. Furthermore, a well-functioning "Banking Union" in (Western) Europe could help to keep the benefits of cross-border banking and international risk diversification on the table, which is definitely in the interest of CEE. Without a functioning "pan-European banking architecture" a risk of too much ring-fencing efforts by home and/or host country regulators or other unilateral limitations remains.

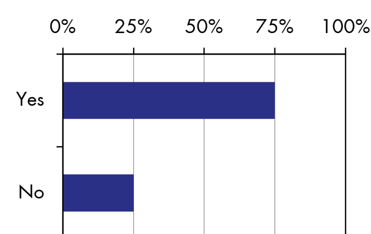
The envisaged new "pan-European banking sector architecture" will boost the role of the European Central Bank (ECB) as a central institution for banking oversight inside the Eurozone. The Single Supervisory Mechanism (SSM) at the ECB will become operational in 2013/14 and will function as a nucleus for an integrated banking sector architecture (with the goal to establish a joint Single Resolution Mechanism and a common deposit insurance at a later stage). However, the creation of a "pan-European banking architecture" centered on the Eurozone has some non-trivial implications for CEE and other non-Eurozone members like the UK or Sweden (not to forget the difficulties in separating monetary policy and oversight issues at the ECB itself). From a country perspective, a "Banking Union" membership offers the opportunity of bank recapitalization by the ESM (but this will remain most likely tied to the question of Eurozone membership). Furthermore, the "Banking Union" could help to extend the "lender of last resort" role of the ECB beyond the Eurozone (e.g. via accepting non-Eurozone government bonds as collateral for swap lines or refinancing), which was an issue in the first stage of the global financial crisis. However, there is also certain reluctance in CEE to join a "Banking Union" that is

mostly designed to fix current systemic problems in the Western European banking sectors at the very beginning. It is a reasonable position that CEE governments outside the Eurozone – that may join the SSM on a voluntary basis – first want to see how a new "pan-European banking architecture" can function. There are non-trivial implementation and coordination risks. It will be important to gain experience how legacy issues will be treated in practice and how ex-ante developed rules (e.g. in terms of burden sharing or binding home-host country issues) will be respected. The installation of a "Banking Union" can create serious "moral hazard" issues and in the end could be an agreement that suffers from the typical risks of an "incomplete contract". Moreover, some CEE countries also have stricter regulatory standards in place (e.g. in terms of capital requirements) than it is the case in Western Europe and hence a "Banking Union" membership with a harmonized regulation could dilute country-specific buffers. Furthermore, most CEE countries still outside the Eurozone are currently pursuing less ambitious Eurozone entry strategies. However, the benefits of joining a "pan-European banking architecture" with the ECB as the central institution are increasing substantially after joining the Eurozone. Therefore, it is crucial for current EU members from CEE to keep a new institutional "pan-European banking framework" as flexible as possible in order to allow initial opt-outs and the possibility to join at a later stage (even without becoming Eurozone member). This holds also true for future EU members from CEE. Furthermore, all non-members at the initial stage shall be further consulted in the process of developing the SSM and the overall "pan-European banking architecture". This is of importance to keep the EU single market (that may reach beyond the "Banking Union"). Moreover, future elements of the "pan-European banking sector architecture" (like a resolution fund or deposit insurance) can imply substantial fiscal transfers. The latter may create serious political obstacles. This holds especially true for CEE countries with much lower income and wealth levels than in Western Europe. Moreover, there remains a legitimate concern that the interests of CE and SEE and their relatively small banking sectors and economies (with total assets at some EUR 970 bn, which equals 3.7% of the Eurozone banking assets) may not find the appropriate attention within a large European "Banking Union" and at the ECB, and that the CEE countries might be easily outvoted at the ECB. For instance, a lot of subsidiaries or branches of Eurozone banks in CEE are small in size by Eurozone standards, but of high systemic importance for domestic financial systems. Furthermore, some CEE banking markets remain high-growth markets with a significant potential to deepen financial intermediation – at least compared to Western European countries – which may require other macro-prudential policy tools than within more saturated Western European banking markets. For instance detecting periods of "excessive" loan growth (e.g. via traditional statistical time-series analysis and filtering methods), which might be tackled via countercyclical capital buffers, is more difficult in less mature banking sectors. Or in other words: as financial cycles tend to last much longer than economic cycles, the regulatory stance in a broader "pan-European banking architecture" may not fit the still partially unsynchronized CEE business and financial cycles. Finally one has to say that despite all justified optimism coupled with the creation of a pan-European "Banking Union", some need for decentralized host/home country coordination will remain. A clear unity of supervision, resolution and fiscal responsibility at the European level is an unlikely scenario for the foreseeable future.

Gunter Deuber

Given all trends sketched, another round of larger expansion of Western banking groups in CEE in the years ahead looks unlikely. Such a trend may only arise when the biggest players feel very comfortable again in their financial and capital standing and their more refocused regional presence. However, already today Western European banks with a significant CEE presence and deep regional ownership links have to take care that their role in supporting the region remains well understood. In some CEE countries there is an increasing tendency to think about the possible benefits of a "renationalization" of banking. There is also an increasing discussion about a new future role of Russian or Turkish banks in CEE and there is some evidence that players from these countries are gradually scaling up their presence, with Russian banks in the lead. However, we think that up to now there is more talk about other banks entering CEE, than we see in reality. Most large Russian banks remain CIS-centred and only Sberbank has certain regional ambitions. However, the currently still limited presence will be difficult to scale up, as it takes years to expand in traditional bank lending via a large scale branch network in CEE. Moreover, the capacity of Russian banks for a brisk expansion is also increasingly limited by capitalization levels.

Assessment foreign-ownership CEE*

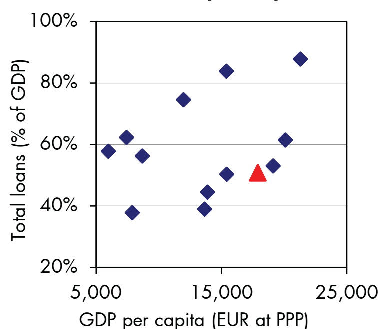


** % of total*
Source: Survey conducted at a regional CEE banking conference 22 of April 2013, BACEE Country and Bank conference, 22-23 April 2013, Budapest

Expected tangible recovery in 2013 to support banks

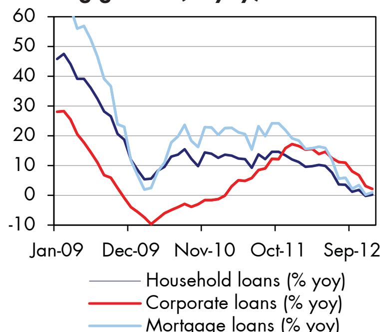
- **Noticeable decline in banking sector growth in 2012 due to unexpectedly weak domestic economy**
- **Structurally sound economy, supported by a sound banking sector, well placed to surprise on the upside in 2013**
- **Solid banking profitability in 2012, through-the-cycle one of the most stable and profitable CEE banking markets**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Poland vs. all other CEE markets
Source: NBP, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)*



** in LCY-terms*
Source: NBP, Raiffeisen RESEARCH

In 2012, Poland's domestic economy experienced one of the strongest setbacks in a decade or so. Hence, demand for bank products also slowed down substantially. Total loan growth decreased from around 13% yoy at the beginning of 2012 to 1-2% yoy by year-end 2012 (in LCY-terms); in EUR-terms, annual loan growth in Poland came in at solid 9.6% yoy due to a strong recovery of the PLN in H2 2012. In LCY-terms, household lending was stagnating yoy, with an all-time low in a decade, while corporate lending showed at least an increase of 2.0% yoy. Mortgage lending growth experienced the strongest relative decline (in LCY-terms), a trend that may continue in early 2013 due to the expiration of a state-sponsored support scheme. In the newly disbursed mortgage loans, PLN lending continued to outpace FCY lending (~90% of mortgages are now in PLN, from a low at 30% in 2008). Up to now, deposit supply was less affected by the weaker real economy than loan demand. Hence, the loan-to-deposit ratio decreased a tad (down from 116% in 2011 to 112% in 2012).

In 2012, profitability of Polish banks remained strong despite a decreasing loan growth momentum and a slight rise of the NPL ratio (up from 7.5% in 2011 to 7.7% in 2012). With 14.3% the RoE came in slightly below its 2011 level of 14.6%, while the RoA remained unchanged at 1.2%. In terms of profitability, the Polish banking sector was the third most attractive regional banking market in 2012, following Russia and the Czech Republic. Solid profitability – supported by still high key rates in 2012 – also translates into a high capacity to absorb potential shocks (CAR at 14.7% in 2012, up from 13.1% in 2011). From a medium-term perspective, the Polish banking market looks even more attractive than short-term profitability trends may indicate. From 2008 to 2012, Polish banks achieved the second-highest average annual RoE (15.9%) in the CEE region (after the Czech Republic but before Russia), combined with one of the lowest standard deviations (standard deviation of 4.3%). Therefore, many foreign (Western European) banks are focusing their regional growth strategies (either via organic growth or M&A) on the Polish market. From a short-term perspective, earnings prospects are slightly clouded, given the low rates environment as well as the remaining risk of a gradual rise in the NPL ratio in 2013. Nevertheless, in the light of the overall positive long-term market trends, the Polish banking sec-

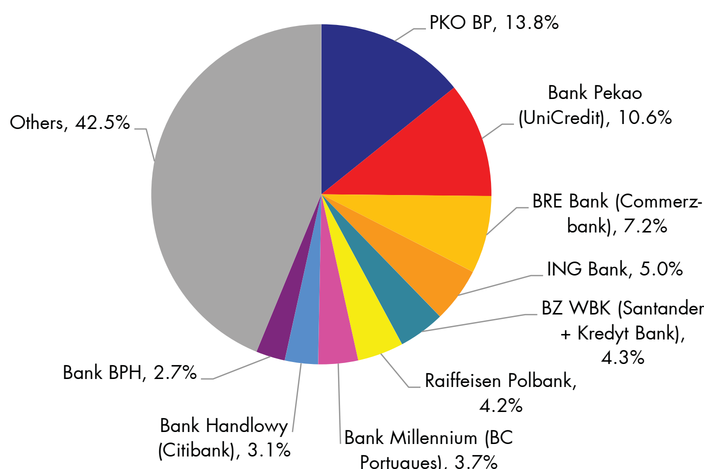
Key economic figures and forecasts

Poland	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	363	311	355	369	382	402	431
Nominal GDP per capita (EUR)	9,517	8,152	9,206	9,582	9,904	10,429	11,203
Real GDP (% yoy)	5.1	1.7	3.9	4.3	2.0	1.2	2.5
Consumer prices (avg, % yoy)	4.2	3.5	2.6	4.3	3.7	1.6	2.2
Unemployment rate (avg, %)	9.8	11.0	12.1	12.4	12.8	14.0	13.6
General budget balance (% of GDP)	-3.7	-7.4	-7.9	-5.0	-3.5	-3.4	-2.8
Public debt (% of GDP)	47.1	50.9	54.8	56.4	56.1	56.1	53.8
Current account balance (% of GDP)	-6.6	-3.9	-5.1	-4.9	-3.5	-3.0	-3.9
Gross foreign debt (% of GDP)	47.9	62.5	66.9	67.2	71.3	70.9	69.6
EUR/LCY (avg)	3.52	4.33	3.99	4.12	4.19	4.09	4.00

Source: National sources, wiiw, Raiffeisen RESEARCH

tor attracted some additional funding from Western European banks over the last 2-3 years. Current cross-border exposures of Western European banks towards Poland are up by some 30% if one takes the year 2008 as a starting point. However, strong profitability also strikes back. At present, the government is drafting a banking tax legislation that may be finalized in H1 2013. Going forward, a certain consolidation looks reasonable as the market share of the top five banks remains at fairly low levels – even when adjusted to the market size.
All in all, the Polish banking market is expected to remain one of the fastest growing and most competitive CEE banking markets. From a fundamental perspective, room to deepen financial intermediation remains. Furthermore, the Polish banking market offers a much more diverse range of attractive activities compared to some other smaller markets in CE and SEE, which is of special interest for large (international) banking groups with a universal banking model.

Market shares (2012, eop)*



** Per cent of total assets (H1 2012)*
Source: NBP, Raiffeisen RESEARCH

Key banking sector indicators

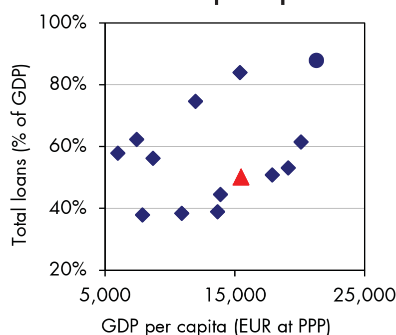
Balance sheet data	2008	2009	2010	2011	2012
Total assets (EUR mn)	261,401	273,965	292,755	312,693	330,973
growth in % yoy	12.1	4.8	6.9	6.8	5.8
in % of GDP	72.0	88.1	82.5	90.7	84.8
Total loans (EUR mn)	139,751	156,084	176,387	180,847	198,206
growth in % yoy	19.6	11.7	13.0	2.5	9.6
in % of GDP	38.5	50.2	49.7	52.5	50.8
Loans to private enterprises (EUR mn)	51,786	54,058	57,023	53,669	66,572
growth in % yoy	11.2	4.4	5.5	(5.9)	24.0
in % of GDP	14.3	17.4	16.1	15.6	17.1
Loans to households (EUR mn)	87,965	101,361	120,047	118,606	130,434
growth in % yoy	25.2	15.2	18.4	(1.2)	10.0
in % of GDP	24.2	32.6	33.8	34.4	33.4
Mortgage loans (EUR mn)	49,132	53,007	67,547	73,085	78,690
growth in % yoy	12.3	7.9	27.4	8.2	7.7
in % of GDP	13.5	17.0	19.0	21.2	20.2
Loans in foreign currency (EUR mn)	48,120	52,497	60,406	63,640	62,435
growth in % yoy	66.1	9.1	15.1	5.4	(1.9)
in % of GDP	13.3	16.9	17.0	18.5	16.0
Loans in foreign currency (% of total loans)	34	34	34	35	32
Total deposits (EUR mn)	115,800	138,058	156,647	155,741	177,091
growth in % yoy	2.5	19.2	13.5	(0.6)	13.7
in % of GDP	31.9	44.4	44.2	45.2	45.4
Deposits from households (EUR mn)	79,551	94,368	106,648	105,909	126,211
growth in % yoy	9.1	18.6	13.0	(0.7)	19.2
in % of GDP	21.9	30.3	30.1	30.7	32.3
Total loans (% of total deposits)	121	113	113	116	112
Structural information					
Number of banks	70	67	70	66	69
Market share of state-owned banks (% of total assets)	17	21	22	22	21
Market share of foreign-owned banks (% of total assets)	67	63	66	66	63
Profitability and efficiency					
Return on Assets (RoA %)	1.8	0.9	0.9	1.2	1.2
Return on Equity (RoE %)	23.6	13.3	13.7	14.6	14.3
Capital adequacy (CAR % of risk weighted assets)	10.7	13.3	13.7	13.1	14.7
Non-performing loans (% of total loans)	4.7	7.1	7.8	7.5	7.7

Source: NBP, Raiffeisen RESEARCH

Not yet out of the woods – further policy moves will be the key

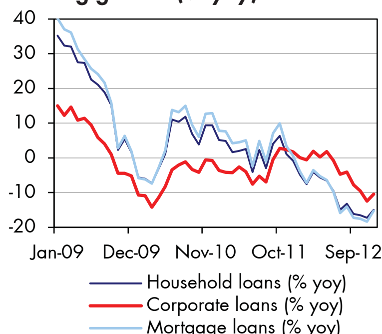
- **Asset-based deleveraging due to unfavorable market conditions, significant drop in exposure of Western European banks**
- **Negative RoE, partially driven by repayment schemes with moral hazard risks; rise of NPL ratio to end**
- **Poor banking performance increasingly in focus of policymakers, measures providing real lending incentives in sight**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Hungary vs. all other CEE markets
Source: MNB, national central banks, Raiffeisen RESEARCH

Lending growth (% yoy)*



** in LCY-terms*
Source: MNB, Raiffeisen RESEARCH

The Hungarian economy remained in recession in 2012. The continuous asset-based deleveraging process within the banking sector is aggravating the weak development. Given unfavorable domestic market conditions, Western European banks have reduced their exposure towards Hungary by around 30% since 2007. All in all, it becomes obvious that the Hungarian pre-crisis economic model (export growth accompanied by rising household consumption made available by a credit boom – most notably FX lending) has failed, and the economy got stuck in a painful rebalancing for several years already.

Net corporate loan transactions have been continuously decreasing since October 2008. This was the case in 2012 as well. Outstanding corporate loans dropped by 7% in 2012 (FX rate effects disregarded) – if we take the full four-year period (2009-2012), we observe the disappearance of one fifth of the total corporate loan stock. The situation is quite similar in the segment of household loans, where the deleveraging even got a push from the government sponsored early FX mortgage repayment scheme (from October 2011 to February 2012). On a positive note, LCY lending is growing while the FX loan stock is gradually melting away – but still 55% of the outstanding loans are denominated in FX. The banking sector is not only hit by the early repayment scheme, but also by a hefty banking tax (0.53% of total assets at year-end 2009, not factoring in profitability). The big blow for the sector was the government's decision to break an agreement, which was signed with the Banking Association. It was agreed not to impose further burdens and to halve the banking tax for 2013 (with the potential to fully eliminate it by 2014). Due to fiscal considerations, the government decided to keep the banking tax intact for 2013 and also to introduce a Financial Transaction Tax (0.2% on almost all transactions). At the same time, asset quality continued to deteriorate: At the end of 2012 the NPL ratio in household lending was 16.2% (3.1pp. increase in 2012) and in corporate lending 17.2%. Current trends show that NPLs may have reached a high in 2012 (no significant NPL rise over the last three quarters). Therefore, we expect a stabilization or mild decrease of the NPL ratio in 2013 (depending on loan growth trends).

Given the operating environment outlined, it is of no surprise that banking sector profitability massively dropped from pre-crises levels, and for the last two years it remained in negative territory. The very poor lending performance is increas-

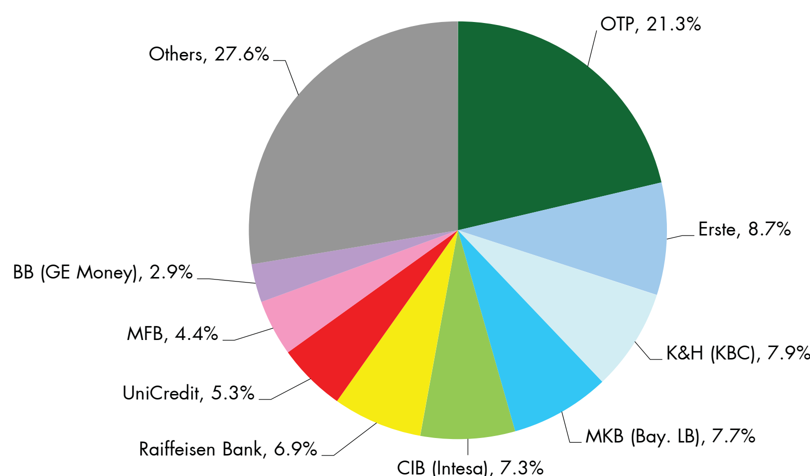
Key economic figures and forecasts

Hungary	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	106	92	97	101	97	97	104
Nominal GDP per capita (EUR)	10,503	9,122	9,660	10,140	9,729	9,809	10,455
Real GDP (% yoy)	0.9	-6.8	1.3	1.6	-1.7	0.0	1.5
Consumer prices (avg, % yoy)	6.1	4.2	4.9	3.9	5.7	2.3	2.8
Unemployment rate (avg, %)	7.8	9.8	11.1	11.0	10.9	11.1	10.7
General budget balance (% of GDP)	-3.7	-4.6	-4.3	4.3	-1.9	-2.9	-2.9
Public debt (% of GDP)	73.0	79.8	81.4	80.6	79.2	78.9	78.0
Current account balance (% of GDP)	-7.1	-0.2	1.1	0.8	1.6	1.6	2.1
Gross foreign debt (% of GDP)	116.9	150.1	143.0	132.5	126.8	119.1	106.3
EUR/LCY (avg)	251	280	276	279	289	298	290

Source: National sources, wiiw, Raiffeisen RESEARCH

ingly in the focus of policymakers. Therefore, the Hungarian National Bank (MNB) announced unconventional monetary policy measures in April 2013 – "Funding for Growth Scheme" (FGS) – that should facilitate lending. It remains to be seen to which extent the FGS can boost lending activity. However, unconventional monetary policy is no "quick fix" to kick-start an economy with structural problems (as seen in the UK in the context of the measures of the Bank of England). All in all, an intelligent policy mix that provides sufficient lending incentives (risk guarantee, tax allowance etc.) combined with a new agreement with the banks is very much needed. There were only small changes amongst the market players (as indicated by a stable foreign-ownership ratio). The biggest deal in 2012 was the government's purchase of DZ Bank's 38.5% share in Takarékbank. Calyon moved out of the market, other banks decided to streamline their operations and/or moved out of selected market segments (e.g. ING moved out of investment banking, BNP sold its private banking to Erste).

Market shares (2012, eop)



Per cent of total assets
Source: MNB, Raiffeisen RESEARCH

Key banking sector indicators

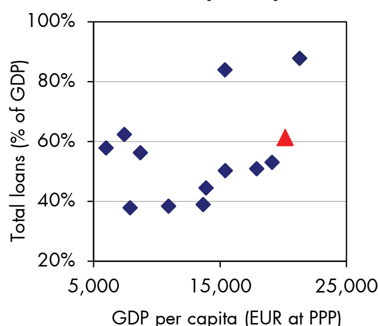
Balance sheet data	2008	2009	2010	2011	2012
Total assets (EUR mn)	125,212	124,888	121,268	111,934	107,899
growth in % yoy	15.9	(0.3)	(2.9)	(7.7)	(3.6)
in % of GDP	118.6	134.0	123.1	123.6	108.4
Total loans (EUR mn)	60,810	58,129	59,964	53,678	50,003
growth in % yoy	13.5	(4.4)	3.2	(10.5)	(6.8)
in % of GDP	57.6	62.4	60.9	59.3	50.2
Loans to private enterprises (EUR mn)	30,172	28,035	27,369	24,842	23,757
growth in % yoy	4.9	(7.1)	(2.4)	(9.2)	(4.4)
in % of GDP	28.6	30.1	27.8	27.4	23.9
Loans to households (EUR mn)	29,083	28,721	30,919	27,351	24,832
growth in % yoy	24.6	(1.2)	7.7	(11.5)	(9.2)
in % of GDP	27.5	30.8	31.4	30.2	24.9
Mortgage loans (EUR mn)	22,444	22,240	24,699	22,159	20,055
growth in % yoy	30.3	(0.9)	11.1	(10.3)	(9.5)
in % of GDP	21.3	23.9	25.1	24.5	20.1
Loans in foreign currency (EUR mn)	37,348	35,635	36,962	32,854	27,401
growth in % yoy	33.1	(4.6)	3.7	(11.1)	(16.6)
in % of GDP	35.4	38.2	37.5	36.3	27.5
Loans in foreign currency (% of total loans)	61	61	62	61	55
Total deposits (EUR mn)	44,117	43,630	42,742	40,449	42,856
growth in % yoy	4.0	(1.1)	(2.0)	(5.4)	6.0
in % of GDP	41.8	46.8	43.4	44.7	43.0
Deposits from households (EUR mn)	27,103	27,761	26,580	25,057	26,426
growth in % yoy	8.4	2.4	(4.3)	(5.7)	5.5
in % of GDP	25.7	29.8	27.0	27.7	26.5
Total loans (% of total deposits)	138	133	140	133	117
Structural information					
Number of banks	38	35	35	35	35
Market share of state-owned banks (% of total assets)	3.9	4.4	4.6	5.3	5.1
Market share of foreign-owned banks (% of total assets)	91	91	90	89	89
Profitability and efficiency					
Return on Assets (RoA %)	1.2	1.7	0.2	(0.2)	(0.4)
Return on Equity (RoE %)	15.2	10.1	2.3	(1.7)	(3.8)
Capital adequacy (CAR % of risk weighted assets)	11.1	13.1	13.3	13.5	15.7
Non-performing loans (% of total loans)	3.0	5.9	7.8	11.5	13.7

Source: MNB, Raiffeisen RESEARCH

Continued economic recession has modest impact on banks

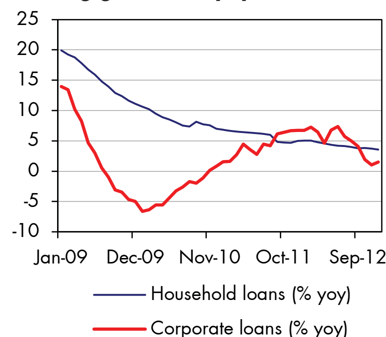
- Banking sector continued to grow despite a decrease in household and government consumption and investments
- Solid financing position (loan-to-deposit ratio at 75%) and strong profitability (RoE at 21%), supported by stable NPLs
- Medium-sized banks slightly gaining market share, foreign-owned banks remain focused on Czech market

Total loans vs. GDP per capita



Data for 2012, red triangle shows Czech Republic vs. all other CEE markets
Source: CNB, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)*



** in LCY-terms*
Source: CNB, Raiffeisen RESEARCH

In 2012, the recession of the Czech economy continued. The key interest rate was lowered to a technical zero. The Czech banking sector was strongly affected by the worse-than-expected economic developments. However, efficient and able to resist serious shocks, it once again showed a high degree of resilience. Despite the decrease of both household and government consumption in connection with a stagnation of fixed investment, the Czech banking sector still showed solid growth. Total loans increased by around 5% yoy, with the households sector accounting for 65% of this growth. Both the corporate and households sector were able to outpace last year's decent growth of deposits, with total deposits increasing by 10% yoy. The very solid loan-to-deposit ratio (decreasing from 79% to 75% in 2012) strengthens the Czech banking sector's independency from external financing. Nevertheless, the still prevailing economic uncertainty together with the fairly high unemployment rate led to a further deceleration of household lending. Therefore, the total amount of loans granted to households grew by 3.6% yoy only (in LCY-terms), especially due to a decline in consumer credits. In contrast, demand for mortgage loans remained fairly stable in 2012; the amount of newly granted mortgages grew by almost 10% yoy (in LCY-terms). The Czech banking sector remains highly competitive with good access to the local market, while other segments of the financial sector (e.g. mutual or pension funds) developed significantly slower so far. In terms of market shares, medium-sized banks showed an above-average performance, especially on the deposit side, where their share grew from 11.3% to 15.6%. The strong expansion of medium-sized banks also decreased the market share of foreign-owned banks to a certain extent. Nevertheless, the major top five banks kept their strong position with a market share of almost 57% in total assets. The current (Western) European discussion about a stricter regulatory framework for banks has not really affected the Czech banking sector so far, which is well capitalized and liquid. The capital adequacy ratio (Tier-1) increased by 16%, with highly liquid assets now representing almost 30% of total assets. Banks are still focusing on their asset quality, which becomes visible in the stable NPL ratio of 6.2%. Additionally, risk costs decreased substantially in comparison with previous years. The profitability of the Czech banking sector surprised positively with a net profit

Key economic figures and forecasts

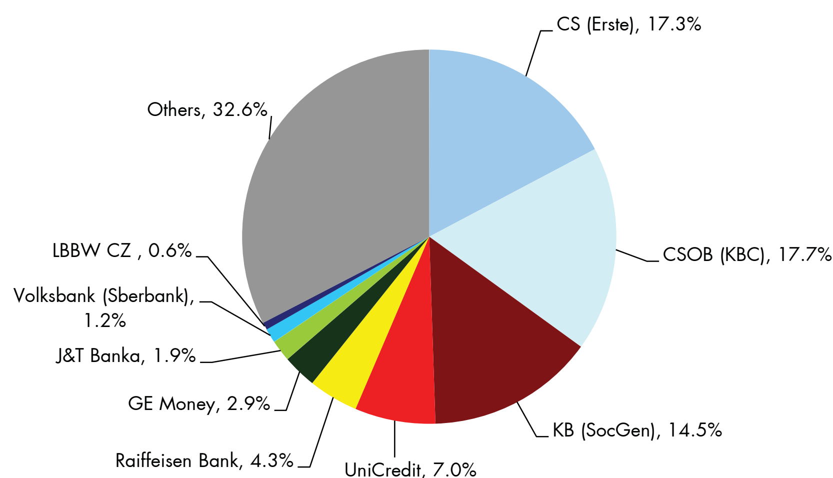
Czech Republic	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	154	142	150	156	153	154	164
Nominal GDP per capita (EUR)	14,785	13,573	14,302	14,890	14,559	14,618	15,507
Real GDP (% yoy)	2.9	-4.7	2.7	1.7	-1.2	-0.2	1.8
Consumer prices (avg, % yoy)	6.3	1.0	1.5	1.9	3.3	1.9	2.0
Unemployment rate (avg, %)	4.1	6.2	7.0	6.7	6.8	7.4	7.5
General budget balance (% of GDP)	-2.2	-5.8	-4.8	-3.1	-4.9	-3.0	-2.6
Public debt (% of GDP)	28.7	34.2	37.8	40.8	45.8	47.9	48.9
Current account balance (% of GDP)	-2.1	-2.4	-3.9	-2.8	-2.4	-2.1	-2.0
Gross foreign debt (% of GDP)	38.7	43.5	47.5	48.8	49.6	50.2	49.9
EUR/LCY (avg)	24.9	26.4	25.3	24.6	25.1	25.3	24.5

Source: National sources, wiiw, Raiffeisen RESEARCH

growth of more than 20%. This strong performance increased the 2012 RoE to 21.4%, which is the highest reading in the entire CEE region.

Domestic regulatory rules set by the Czech National Bank (CNB) are implemented without unexpected changes and all banks operating on the market are able to fulfill them. In connection with the ongoing instability within the Western European banking landscape, the CNB once again tightened the monitoring of the exposures of foreign-owned Czech banks to their parent groups. Currently it is difficult to anticipate a significant improvement of the economic conditions in 2013. However, the Czech banking sector is ready to face challenging developments. Changes in the pension system may lead to some ownership changes within the Czech financial sector, but no significant merger or acquisition is likely to be observed in the near future. For 2013, we once again expect a year of subdued loan growth, especially in the corporate segment, and a stable growth of deposits.

Market shares (2012, eop)*



Per cent of total assets (Q3 2012)
Source: CNB, Raiffeisen RESEARCH

Key banking sector indicators

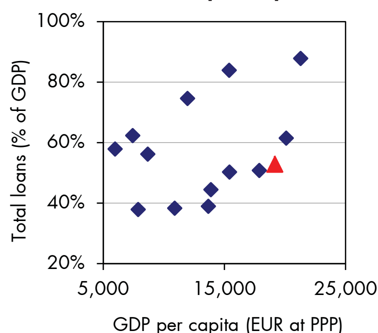
Balance sheet data	2008	2009	2010	2011	2012
Total assets (EUR mn)	154,375	159,476	172,917	178,721	189,990
growth in % yoy	10.6	3.3	8.4	3.4	6.3
in % of GDP	108.0	112.9	114.8	118.7	124.3
Total loans (EUR mn)	77,078	79,429	86,769	89,321	93,837
growth in % yoy	14.9	3.1	9.2	2.9	5.1
in % of GDP	53.9	56.2	57.6	59.3	61.4
Loans to private enterprises (EUR mn)	31,585	29,555	31,114	32,100	33,216
growth in % yoy	13.0	(6.4)	5.3	3.2	3.5
in % of GDP	22.1	20.9	20.7	21.3	21.7
Loans to households (EUR mn)	30,017	33,932	38,327	39,107	41,548
growth in % yoy	19.5	13.0	13.0	2.0	6.2
in % of GDP	21.0	24.0	25.4	26.0	27.2
Mortgage loans (EUR mn)	14,755	20,948	24,129	25,543	27,851
growth in % yoy	17.6	42.0	15.2	5.9	9.0
in % of GDP	10.3	14.8	16.0	17.0	18.2
Loans in foreign currency (EUR mn)	10,836	10,655	11,940	13,294	13,747
growth in % yoy	25.3	(1.7)	12.1	11.3	3.4
in % of GDP	7.6	7.5	7.9	8.8	9.0
Loans in foreign currency (% of total loans)	14	13	14	15	15
Total deposits (EUR mn)	95,334	101,955	111,280	112,944	124,352
growth in % yoy	7.1	6.9	9.1	1.5	10.1
in % of GDP	66.7	72.2	73.9	75.0	81.4
Deposits from households (EUR mn)	49,973	55,367	61,311	61,791	65,630
growth in % yoy	11.8	10.8	10.7	0.8	6.2
in % of GDP	35.0	39.2	40.7	41.0	42.9
Total deposits (% of total credits)	81	78	78	79	75
Structural information					
Number of banks	37	39	41	44	43
Market share of state-owned banks (% of total assets)	2.8	2.7	3.3	3.0	2.5
Market share of foreign-owned banks (% of total assets)	89	87	87	87	82
Profitability and efficiency					
Return on Assets (RoA %)	1.2	1.5	1.3	1.2	1.4
Return on Equity (RoE %)	21.7	25.8	21.9	19.4	21.4
Capital adequacy (CAR % of risk weighted assets)	12.3	14.1	15.5	15.3	16.4
Non-performing loans (% of total loans)	3.2	5.2	6.2	6.2	6.2

Source: CNB, Raiffeisen RESEARCH

Retail business supportive in challenging macro-environment

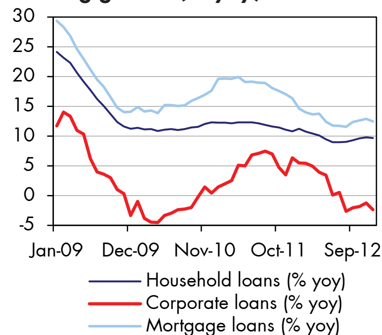
- **Contrary to retail lending, corporate loans declined in 2012**
- **Solid financing position (loan-to-deposit ratio at 88%) and stable NPL ratio**
- **One-off measures (increasing standard + extraordinary bank levy) and low rates pushed down profitability**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Slovakia vs. all other CEE markets
Source: NBS, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)



Source: ECB, Raiffeisen RESEARCH

The slowing real GDP growth – from 3.2% yoy in 2011 to 2.0% in 2012, with a fairly strong downtrend in H2 2012 – had a significant influence on the development of the Slovak banking sector. Total loan growth has decreased from close to 10% yoy to around 3.5% yoy. Moreover, GDP growth in 2012 was strongly boosted by a one-off increase of production in the automotive sector. However, this sector is to a lesser extent financed by domestic banks and therefore it comes as no surprise that corporate loans even posted a 2.4% decline in 2012. A stabilizing factor for Slovak banks, similar to the developments in previous years, had been retail lending. Loans to households rose by 9.6% yoy in 2012 mainly thanks to a strong growth in mortgage lending. The solid growth of housing loans – despite a period of weak economic growth – is underpinned by the highest housing affordability in the last ten years. The still favorable housing affordability is influenced by a moderate decrease of residential real-estate prices as well as decreasing average interest rates on new mortgage loans.

The deposit collection remained sound throughout 2012. Total deposits rose by 6.3% yoy in 2012 and the already solid loan-to-deposit ratio has further decreased slightly to around 88%. Worth mentioning is also the decrease in the NPL ratio to 5.2% of total loans, one of the lowest readings in CEE. The net profitability of the banking sector has decreased substantially by 27% to EUR 488 mn. One of the two main reasons was a tangible decrease of the net interest income compared to the previous year, for the first time in history. The second very negative impact on profitability was caused by a bank levy, which was doubled from the original proposal to around 0.4% of corporate deposits and also applied to retail deposits in 2012. Additionally, an extraordinary bank levy was implemented in Q4 2012. All in all, Slovak banks have paid EUR 170 mn in form of bank levies in 2012. In addition to the levy itself, the increasing interference by the government in regulating bank services and fees negatively influences the performance of banks in Slovakia. These developments even hit small and medium-sized banks and provoked the closure of three foreign branches of big international banks in Slovakia. UniCredit Bank, the fifth-largest lender in Slovakia, has announced its transformation to a foreign branch – the Slovak operations will be (partially) steered by the Czech UniCredit operations.

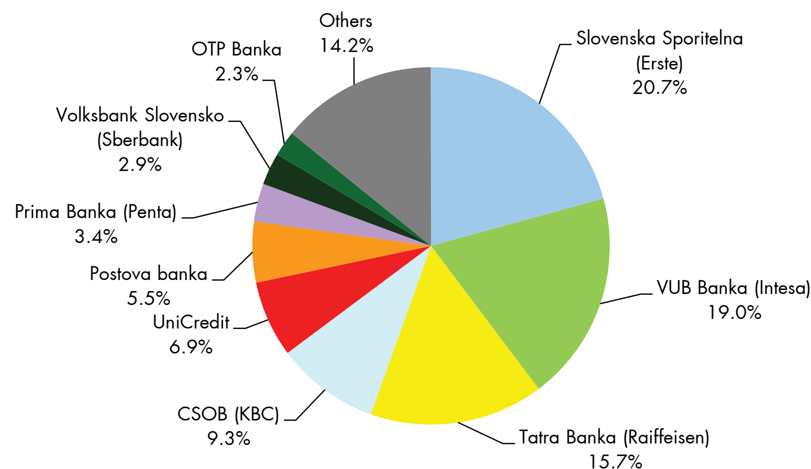
Key economic figures and forecasts

Slovakia	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	67	63	66	69	71	73	76
Nominal GDP per capita (EUR)	12,393	11,644	12,151	12,721	13,131	13,423	13,978
Real GDP (% yoy)	5.8	-4.9	4.4	3.2	2.0	0.9	2.5
Consumer prices (avg, % yoy)	4.6	1.6	1.0	3.9	3.6	2.2	2.5
Unemployment rate (avg, %)	9.6	12.1	14.4	13.4	13.9	14.2	13.6
General budget balance (% of GDP)	-2.1	-8.0	-7.7	-4.9	-4.7	-2.9	-2.4
Public debt (% of GDP)	27.8	35.4	41.0	43.3	52.2	54.9	55.8
Current account balance (% of GDP)	-6.0	-2.6	-3.7	-2.0	2.2	2.9	2.9
Gross foreign debt (% of GDP)	56.4	72.3	74.5	76.3	71.2	69.9	74.7

Source: National sources, wiiw, Raiffeisen RESEARCH

The performance of the Slovak banking sector in 2013 will probably not deviate much from the trends in 2012. The banking sector will most likely utilize its strong capital and liquidity position to increase lending in retail, while a certain cap on new lending activities in the corporate segment will be set by demand. Going forward, we expect that the net profit of the Slovak banking sector will again decrease somewhat compared to the year 2012. On the one hand, there is an ongoing shift in retail deposits to longer-term deposits; on the other hand, interest income is decreasing due to lower interest rates. These trends will probably lead to another decrease in net interest income for the second year in a row. Moreover, the banking sector might once again be negatively influenced by political initiatives; not to forget that Slovakia is within a group of eleven EU member states, which plan to introduce a Financial Transaction Tax. For smaller players extensive additional taxation and regulation may raise the question, if a presence on the Slovak banking market is feasible in the long run.

Market shares (2012, eop)*



Per cent of total assets (Q3 2012)
Source: NBS, Raiffeisen RESEARCH

Key banking sector indicators

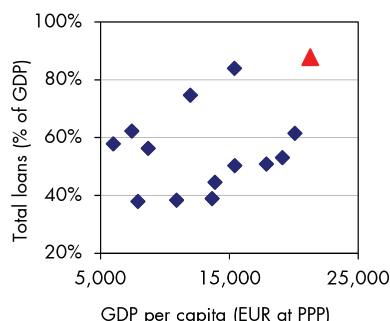
Balance sheet data	**2008**	**2009**	**2010**	**2011**	**2012**
Total assets (EUR mn)	62,838	53,028	54,695	55,775	58,086
growth in % yoy	27.2	(15.6)	3.1	2.0	4.1
in % of GDP	97.4	84.1	83.0	80.8	81.3
Total loans (EUR mn)	31,649	31,876	33,452	36,624	37,870
growth in % yoy	28.8	0.7	4.9	9.5	3.4
in % of GDP	49.1	50.6	50.8	53.0	53.0
Loans to private enterprises (EUR mn)	16,159	15,620	15,688	16,677	16,277
growth in % yoy	30.2	(3.3)	0.4	6.3	(2.4)
in % of GDP	25.0	24.8	23.8	24.1	22.8
Loans to households (EUR mn)	11,830	13,158	14,773	16,362	17,940
growth in % yoy	40.2	11.2	12.3	10.8	9.6
in % of GDP	18.3	20.9	22.4	23.7	25.1
Mortgage loans (EUR mn)	8,335	9,235	10,581	12,024	13,359
growth in % yoy	40.5	10.8	14.6	13.6	11.1
in % of GDP	12.9	14.6	16.1	17.4	18.7
Loans in foreign currency (EUR mn)	6,923	375	340	330	520
growth in % yoy	19.2	(94.6)	(9.5)	(2.9)	57.7
in % of GDP	10.7	0.6	0.5	0.5	0.7
Loans in foreign currency (% of total loans)	22	1.2	1.0	0.9	1.4
Total deposits (EUR mn)	40,986	37,541	39,642	40,426	42,980
growth in % yoy	27.5	(8.4)	5.6	2.0	6.3
in % of GDP	63.5	59.5	60.1	58.5	60.1
Deposits from households (EUR mn)	21,343	21,090	22,248	23,869	25,312
growth in % yoy	47.2	(1.2)	5.5	7.3	6.0
in % of GDP	33.1	33.4	33.8	34.6	35.4
Total loans (% of total deposits)	77	85	84	91	88
Structural information					
Number of banks	26	26	29	31	28
Market share of state-owned banks (% of total assets)	0.8	0.9	0.9	0.9	0.8
Market share of foreign-owned banks (% of total assets)	96	94	93	89	89
Profitability and efficiency					
Return on Assets (RoA %)	1.0	0.5	0.9	1.2	0.7
Return on Equity (RoE %)	14.1	6.5	12.3	14.2	8.3
Capital adequacy (CAR % of risk weighted assets)	11.1	12.6	12.7	13.4	15.8
Non-performing loans (% of total loans)	3.2	5.5	6.1	5.8	5.2

Source: NBS, Raiffeisen RESEARCH

Deleveraging continues – restructuring waits for implementation

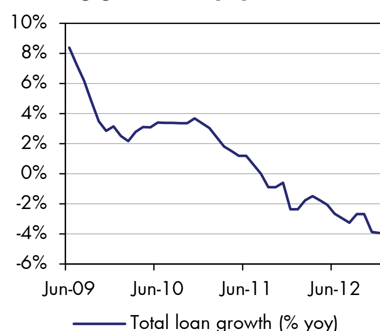
- **Banking sector continues to shrink in absolute and relative terms, loan-to-GDP ratio dropped by 10pp. from peak**
- **Cyprus banking sector bail-in crushed confidence, swift bad bank implementation will be key to anchor investor confidence**
- **Balance sheet restructuring in the banking and corporate sector to continue for some years to come**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Slovenia vs. all other CEE markets
Source: BSI, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)



Source: ECB, Raiffeisen RESEARCH

Slovenia's economy remained in recession in 2012. The banking sector partly accounted for this negative performance, but overall structural challenges remain the driving factor (partially comparable with some other Eurozone periphery countries). The NPL ratio increased to 15% in 2012, up from some 12% in 2011 (NPLs: EUR 7 bn; total overdue loans: some EUR 10 bn). Negative developments in new lending added to the severe asset quality problems. Loan growth is in negative territory since 2011, a tendency that was intensified in H2 2012. The considerable deleveraging in Slovenia's banking sector is reflected in a declining loan-to-GDP ratio (by 5-10pp. over the last two years), although GDP development was very weak. Slovenia's banking sector also experienced a sharp reduction in cross-border exposures of European banks by 40% from peak levels in 2008, which was both supply and demand driven. Although profitability improved slightly following a very negative year 2011, 2012 was the third consecutive year with a negative RoE and RoA. Hence, there is still a great need of restructuring within the banking system, including the installation of a bad bank (BAMC) currently under implementation. We consider the envisaged bad bank refinancing/issuance amount of EUR 4 bn as sufficient to stabilize the banking sector, if NPLs are acquired with a fair discount (i.e. 50-60%) and if there is no other material deterioration in asset quality. Nevertheless, uncertainties with regard to banking issues at the Eurozone level after the Cyprus events (i.e. how to structure a bail-out, which stakeholders to include) as well as political volatility in Slovenia are not helpful.

However, simple comparisons between Cyprus and Slovenia should be avoided. One of the few similarities is the low foreign ownership ratio (Slovenia: 30-35%, Cyprus some 20%). Hence, bank issues can have a huge impact on the public sector's balance sheet. Some banks in Slovenia also suffer from a brisk pre-crisis expansion and current NPL ratios are more or less similar to Cyprus. However, key differences dominate in our view. Slovenia's banking sector is not per se oversized. In Cyprus, banking assets are above 800% of the GDP and assets of domestic banks at 500%. In Slovenia, bank assets are at 120-130% of the GDP. Business profiles of Slovenian banks also differ substantially. Banks in Cyprus allocated 60% of their loans to non-residents, just 40% of deposits came out of Cyprus, 15-20% of deposits were raised in Greece and 35-40% from other

Key economic figures and forecasts

Slovenia	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	37	36	36	36	37	37	38
Nominal GDP per capita (EUR)	18,404	17,454	17,366	17,616	17,736	17,913	18,438
Real GDP (% yoy)	3.4	-7.8	1.2	0.6	-2.3	-1.0	1.0
Consumer prices (avg, % yoy)	5.7	0.9	1.8	1.8	2.6	2.5	2.3
Unemployment rate (avg, %)	4.4	5.9	7.3	8.2	8.8	9.0	8.8
General budget balance (% of GDP)	-1.9	-6.0	-5.7	-6.4	-4.0	-3.5	-3.2
Public debt (% of GDP)	22.0	35.0	38.6	46.9	54.0	65.0	67.0
Current account balance (% of GDP)	-6.2	-0.7	-0.6	0.0	2.4	2.7	1.3
Gross foreign debt (% of GDP)	105.5	113.2	114.3	111.0	111.3	111.1	110.5

Source: National sources, wiiw, Raiffeisen RESEARCH

non-residents. Moreover, this business model drew the attention in recent bail-out negotiations as parts of non-resident exposures are connected to tax evasion and off-shoring. In Slovenia, some 90% of businesses on the loan and deposit side are connected to the local market. There are no accusations whatsoever with regard to improper business practices. Banks in Cyprus also had large Greece sovereign exposures. In contrast, Slovenia's banks have negligible Eurozone periphery exposures. And finally, banks in Cyprus seriously suffered from the downgrade to "non-investment grade" of Greek bonds and their home country, making large bond holdings non-eligible for ECB refinancing. Even though rating pressure on Slovenia is increasing and further downgrades seem possible, we regard it as unlikely that Slovenia will be fully slashed into the non-investment grade space in the short- to medium-term. Without massive sovereign downgrades it is unlikely that Slovenia's banking system would need as much ELA-assistance as Cyprus did, where this led to the idea of massive restructuring needs at the ECB and in Brussels. All in all, we think that the banking situation in Slovenia is more comparable to Spain rather than Cyprus, i.e. we look for a gradual banking sector downsizing like in Spain (including a secular decline in the loan-to-GDP ratio at the macro-level and a large domestic bad bank solution at the micro-level). Nevertheless, market fears of a bail-in of creditors and depositors of purely locally-owned banks – that will be likely considered as non-systemic at an EU level – cannot be ruled out (not our baseline).

Ranking of banks (2012, eop)*

1	Nova Ljubljanska banka (State-owned)*
2	Nova Kreditna banka Maribor (State-owned)**
3	Abanka Vipa (Zavarovalnica Triglav/ Sava)
4	UniCredit Banka Slovenija (UniCredit)
5	SKB Banka Ljubljana (SocGen)
	...
10	Raiffeisen Bank Slovenia (RBI)

** 76.91% state-ownership in share capital*
*** 27.66% direct state-ownership in share capital*
Source: BSI, Raiffeisen RESEARCH

Market shares and shares in NPLs*

	Claims Non-MFIs**	NPLs**
Large domestic banks	59.6%	76.6%
Small domestic banks	9.0%	8.6%
Banks with majority foreign-ownership	31.4%	14.8%

** As of September 2012*
*** % of total*
Source: BSI, Raiffeisen RESEARCH

Key banking sector indicators

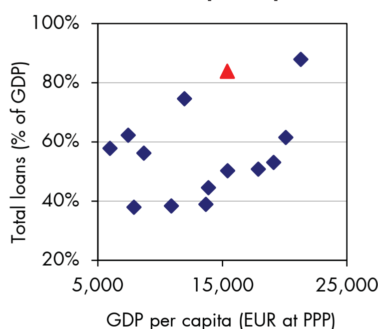
Balance sheet data	2008	2009	2010	2011	2012
Total assets (EUR bn)*	43.1	45.3	45.8	45.6	44.5
growth in % yoy	12.5	5.1	1.1	(0.4)	(2.4)
in % of GDP	115.8	128.0	129.5	126.3	126.3
Total loans (EUR bn)*	31.7	32.7	33.8	33.0	31.7
growth in % yoy	17.8	3.2	3.4	(2.4)	(3.9)
in % of GDP	85.2	92.4	95.6	91.4	87.8
Total loans incl. MFIs and state (EUR bn)	36.1	39.0	39.0	38.4	36.9
growth in % yoy	18.0	8.0	0.0	(1.5)	(3.9)
in % of GDP	97.0	110.2	110.3	106.3	102.2
Loans to private enterprises (EUR bn)	20.7	21.0	21.0	20.3	18.8
growth in % yoy	18.3	1.4	0.0	(3.3)	(7.4)
in % of GDP	55.6	59.8	59.7	57.0	52.1
Loans to households (EUR bn)	7.8	8.4	9.3	9.5	9.3
growth in % yoy	14.7	7.7	10.7	2.2	(2.1)
in % of GDP	20.9	23.9	26.5	26.3	25.8
Mortgage loans (EUR bn)	3.4	3.9	4.8	5.2	5.3
growth in % yoy	25.9	14.7	23.1	8.3	1.9
in % of GDP	9.1	11.1	13.7	14.6	14.7
Total deposits (EUR bn)*	19.1	20.0	20.8	21.3	20.9
growth in % yoy	4.8	4.5	4.1	2.5	(2.0)
in % of GDP	103.2	115.3	108.4	106.5	102.2
Total deposits incl. MFIs and state (EUR bn)	38.4	40.5	38.1	37.9	36.9
growth in % yoy	15.3	5.5	-5.9	-0.6	-2.6
in % of GDP	51.4	56.9	59.2	59.9	57.9
Total loans (% of total deposits)	166	164	162	155	152
Total loans incl. MFIs and state (% of total deposits)	94	96	102	101	100
Structural information					
Number of banks	19	19	19	19	18
Market share of state-owned banks (% of total assets)	18	48	47	55	58
Market share of foreign-owned banks (% of total assets)	24	22	22	30	29
Profitability and efficiency					
Return on Assets (RoA %)	0.7	0.3	(0.2)	(1.1)	(0.6)
Return on Equity (RoE %)	8.1	3.9	(2.4)	(11.7)	(7.3)
Capital adequacy (CAR % of risk weighted assets)	11.7	11.6	11.3	11.6	11.5
Tier-1 capital adequacy (%)	9.2	9.3	9.0	9.6	10.1
Non-performing loans (% of total loans)	4.2	5.8	8.2	11.8	15.0

** excluding MFI business; Source: BSI, ECB, Raiffeisen RESEARCH*

Downsizing continues – when does the consolidation start?

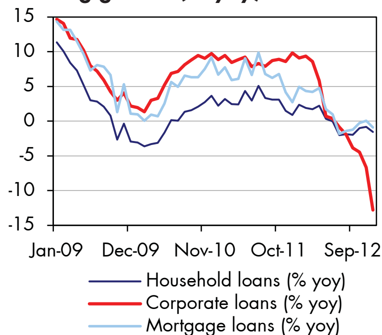
- **Household loan stock on a secular decline since 2009, driven by fast amortization of car loans**
- **Profitability constrained by challenging operating environment and upcoming regulatory changes**
- **Consolidation seems unavoidable as too many banks compete on stagnant market with low profit margins**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Croatia vs. all other CEE markets
Source: CNB, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)*



** in LCY-terms*
Source: CNB, Raiffeisen RESEARCH

The Croatian economy remained in recession in 2012. Following EU accession in July 2013, the business climate is not expected to improve immediately. Medium-term growth prospects for the banking sector are limited due to structural weaknesses in the real economy and an already high level of financial intermediation in relation to the income level.

In the household lending segment, the persistent deleveraging since 2009 has been caused by a fast amortization of car loans that will last at least until the end of 2014. Moreover, the announced introduction of a real estate tax already weakened the demand for mortgage loans. Consequently, depressed new lending causes a strong seasoning effect in existing loan portfolios. Despite the abandoning of indexation to CHF for new loans since 2008, 39% of existing mortgages are still CHF-linked. Although the EUR/HRK exchange rate has been fairly stable in recent years, instalments of loans indexed to CHF have significantly increased in HRK counter value and in relation to the income of an average debtor. Hence, the imbedded FX risk of CHF-indexed loans is materializing through the increase of the NPL ratio (in CHF mortgages the NPL ratio at 9.2% compared to 3.7% on mortgage loans indexed to EUR).

In the corporate lending segment, a significant drop in 2012 was caused by a transfer of loans granted to state-owned shipyards, by a transfer of a larger loan portfolio to a SPV (Special Purpose Vehicle) outside the local banking sector, and by a transfer of large corporate cross-border loans. In terms of low credit demand, the banking sector has responded to the one-off fall in loan volumes by decreasing the debt from parent banks. The refinancing of large corporate loans is expected to continue as long as the conditions in financial markets stay favourable. Therefore, the deleveraging of parent banks is also likely to continue, but at a slower pace. Since its peak level in 2008, the exposure of Western European banks towards Croatia has been reduced by around 30% (or USD 30 bn).

The implementation of new regulations governing pre-bankruptcy settlement, which is aimed at clearing up financial relationships among companies, started in October 2012. However, the detection and restructuring of insolvent companies or the termination of their operation is accelerating the recognition of bank losses. At the same time, the local regulator intends to implement more restrictive rules for loan classification in risk categories and for loan loss provisioning.

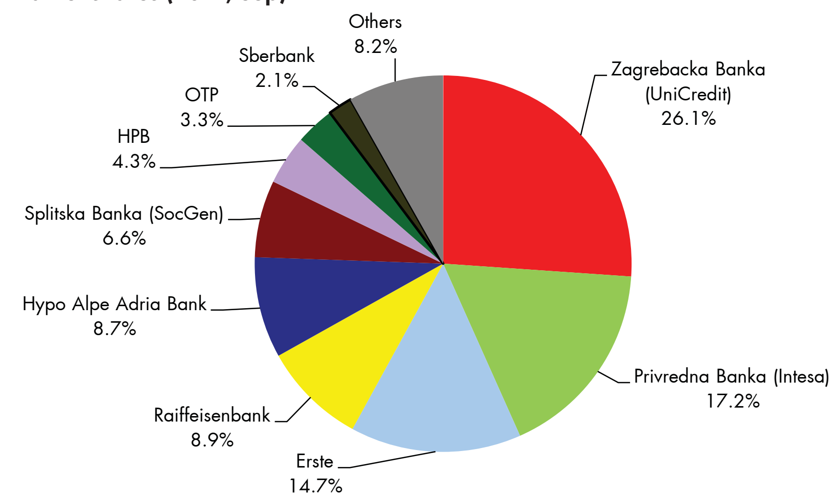
Key economic figures and forecasts

Croatia	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	48	45	44	45	45	46	48
Nominal GDP per capita (EUR)	10,722	10,111	10,045	10,475	10,517	10,801	11,352
Real GDP (% yoy)	2.1	-6.9	-2.3	0.0	-2.0	-0.5	1.0
Consumer prices (avg, % yoy)	6.1	2.4	1.1	2.3	3.4	3.2	3.0
Unemployment rate (avg, %)	13.2	14.9	17.4	18.0	19.1	19.3	19.1
General budget balance (% of GDP)	-1.4	-4.1	-4.9	-5.0	-4.1	-4.2	-3.8
Public debt (% of GDP)	29.3	35.8	42.2	46.7	54.0	58.1	60.6
Current account balance (% of GDP)	-9.0	-5.1	-1.1	-0.9	-0.3	-0.3	-0.5
Gross foreign debt (% of GDP)	85.4	101.0	104.6	101.7	100.5	98.9	96.5
EUR/LCY (avg)	7.22	7.34	7.29	7.43	7.52	7.55	7.50

Source: National sources, wiiw, Raiffeisen RESEARCH

The expected results are a further increase of risk costs and another round of decreasing profitability. Moreover, announced changes in the customer protection act should authorize the Finance Ministry to administratively set limits on interest rates, which could also influence future incomes on retail loans, especially mortgages. In the context of rising uncertainty resulting from legal changes and a low demand for loans and financial services, the profitability rates are not likely to improve soon. Hence, profits are to be sustained by cutting operating costs. In a strongly regulated industry like the banking sector, small banks are unable to lower operating costs significantly, so many of them record losses at present. A consolidation within the Croatian banking sector seems to be inevitable more than ever, as 22 out of 31 banks hold a market share of less than 0.7%. The six largest universal banks (members of Western European banking groups) will compete on a stagnant market, profit margins are therefore likely to be constrained.

Market shares (2012, eop)



Per cent of total assets
Source: CNB, Raiffeisen RESEARCH

Key banking sector indicators

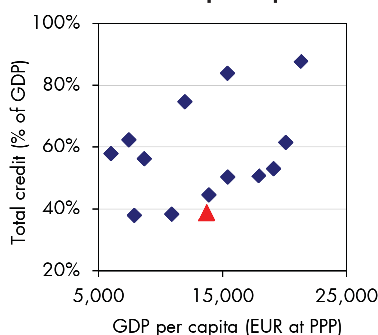
Balance sheet data	**2008**	**2009**	**2010**	**2011**	**2012**
Total assets (EUR mn)	50,619	51,854	53,028	54,283	53,068
growth in % yoy	7.5	2.4	2.3	2.4	(2.2)
in % of GDP	107.5	113.0	117.1	119.8	119.5
Total loans (EUR mn)	33,931	35,084	37,563	38,688	37,220
growth in % yoy	14.4	3.4	7.1	3.0	(3.8)
in % of GDP	72.0	76.5	82.9	85.4	83.8
Loans to private enterprises (EUR mn)	12,053	12,389	13,552	14,505	13,185
growth in % yoy	12.9	2.8	9.4	7.0	(9.1)
in % of GDP	25.6	27.0	29.9	32.0	29.7
Loans to households (EUR mn)	17,192	16,725	17,146	16,965	16,664
growth in % yoy	11.8	(2.7)	2.5	(1.1)	(1.8)
in % of GDP	36.5	36.5	37.8	37.4	37.5
Mortgage loans (EUR mn)	7,570	7,671	8,287	8,346	8,252
growth in % yoy	15.1	1.3	8.0	0.7	(1.1)
in % of GDP	16.1	16.7	18.3	18.4	18.6
Loans in foreign currency (EUR mn)	22,386	25,460	27,396	28,951	27,475
growth in % yoy	20.9	13.7	7.6	5.7	(5.1)
in % of GDP	47.5	55.5	60.5	63.9	61.9
Loans in foreign currency (% of total loans)	66	73	73	75	74
Total deposits (EUR mn)	33,412	34,742	36,462	37,496	36,550
growth in % yoy	6.2	4.0	5.0	2.8	(2.5)
in % of GDP	70.9	75.7	80.5	82.8	82.3
Deposits from households (EUR mn)	18,569	19,321	20,657	21,236	22,028
growth in % yoy	11.7	4.0	6.9	2.8	3.7
in % of GDP	39.4	42.1	45.6	46.9	49.6
Total loans (% of total deposits)	102	101	103	103	102
Structural information					
Number of banks	33	34	34	33	31
Market share of state-owned banks (% of total assets)	4.4	4.2	4.3	4.5	4.6
Market share of foreign-owned banks (% of total assets)	91	91	90	91	90
Profitability and efficiency					
Return on Assets (RoA %)	1.6	1.1	1.1	1.2	0.9
Return on Equity (RoE %)	9.9	6.4	6.5	7.0	4.8
Capital adequacy (CAR % of risk weighted assets)	15.2	16.4	18.8	19.2	20.6
Non-performing loans (% of total loans)	4.9	7.8	11.2	12.4	13.8

Source: CNB, Raiffeisen RESEARCH

Challenging 2012 – better performers preparing for the upside

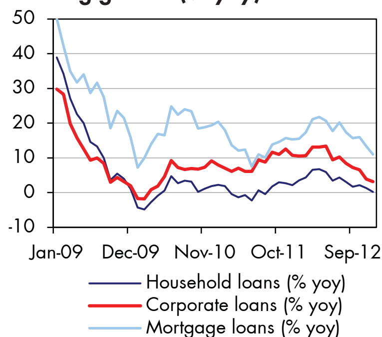
- **Low GDP growth, high inflation and weak RON hit financial position of households and companies**
- **Household lending suffering the most, corporate and mortgage lending outperforming**
- **Key foreign banks remain committed - less suffering foreign players gain market share (via M&A or organic growth)**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Romania vs. all other CEE markets
Source: NBR, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)*



** in LCY-terms*
Source: NBR, Raiffeisen RESEARCH

The recovery of the economy lost steam in 2012. Moreover, accelerated inflation and RON depreciation did not bode well for the financial position of households and companies. Moreover, banks also pursued cautious lending policies and loan growth remained weak in 2012, while NPLs continued their uptrend.

When adjusting for FX moves, the stock of total loans was more or less unchanged in 2012 (-0.1% yoy). The lending patterns from the previous years also prevailed in 2012: mortgage loans were expanding at decent levels (8.4% yoy) and corporate loans (+1.0%) performed much better than consumer loans (-6.1%). A governmental program named "First House" continued to support mortgage lending. Moreover, banks continued to increase their exposure towards the public sector by investing in government securities. The NPL ratio reached 18.2% by year-end 2012, a higher increase than in 2011. Therefore, provisioning constrained profitability of the banking system, which posted the largest loss within the last three years (EUR 476 mn). However, this had only a limited impact on the CAR (14.6%), given shareholders' support in the form of capital injections. Confronted with subdued loan growth, banks continued to downsize networks and staff (-6.1%). However, compared to some other hard-hit peers (e.g. Hungary, Ukraine), deleveraging by foreign banks has been orderly and of moderate size. This shows that key foreign banks continue to see Romania as a strategic market, but there are also certain balance sheet adjustments. Nevertheless, less suffering key foreign players are even seizing opportunities on the Romanian market and are gaining some market share, as indicated by the sale of the Citibank household loan portfolio to RBI or the announced sale of the RBS retail banking business to UniCredit. However, the substantial increase in foreign-ownership in the Romanian banking sector was "artificial" as it stems from the fact that Banca Transilvania has become majority foreign-owned following an aquisitions of shares on the Bucharest Stock Exchange (foreigners owned 47.7% of total equity and raised their stake to 50.6% in 2012).

In the short run it is unlikely that loan growth picks up significantly. Nevertheless, once the legacies of the very rapid pre-crisis expansion are mastered, financial intermediation in Romania is likely to increase. The Romanian Central Bank (NBR) remains active on the prudential side. At the beginning of 2012, lending stand-

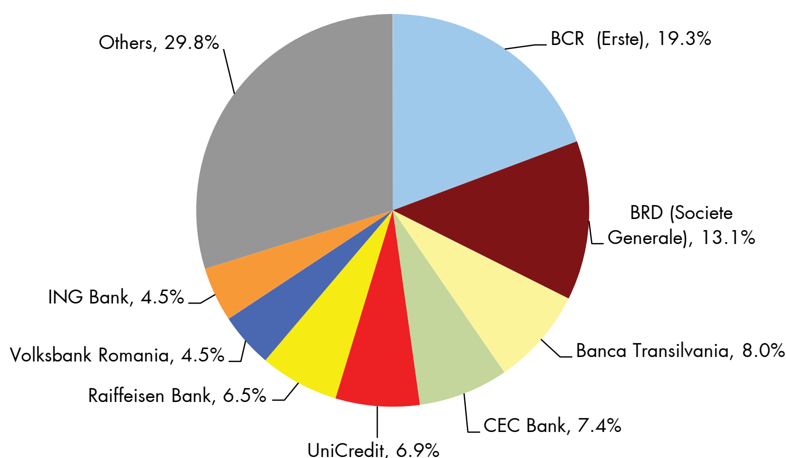
Key economic figures and forecasts

Romania	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	140	118	124	131	132	141	152
Nominal GDP per capita (EUR)	6,499	5,509	5,804	6,139	6,924	7,525	7,985
Real GDP (% yoy)	7.3	-6.6	-1.1	2.2	0.7	2.0	2.5
Consumer prices (avg, % yoy)	7.9	5.6	6.1	5.8	3.3	4.6	3.3
Unemployment rate (avg, %)	5.8	6.9	7.3	7.4	7.0	6.8	6.8
General budget balance (% of GDP)	-5.7	-9.0	-6.8	-5.6	-2.9	-2.8	-2.5
Public debt (% of GDP)	13.4	23.6	30.5	34.7	37.8	38.4	38.7
Current account balance (% of GDP)	-11.6	-4.2	-4.4	-4.5	-3.8	-3.0	-3.0
Gross foreign debt (% of GDP)	51.8	68.7	74.3	75.2	75.2	69.9	67.9
EUR/LCY (avg)	3.68	4.24	4.21	4.24	4.46	4.38	4.40

Source: National sources, wiiw, Raiffeisen RESEARCH

ards for unhedged FCY household borrowers were tightened. There are also plans to enforce tighter lending standards for unhedged FCY corporate borrowers. Key ratios for minimum reserve requirements were maintained at high levels (15% for RON loans, 20% for FCY loans), which indicates a high liquidity of banks through the NBR (alongside their sizeable government bond portfolios). The banks' shareholders were persuaded to keep a solvability ratio of at least 10% (above the legal requirement of 8%). Bank resolution legislation was amended in order to allow dealing with potential problematic banks (including the establishment of the bridge-bank/bad bank). The NBR has increased its vigilance on the collateral (re)valuation by banks. A collateralized interbank lending system will be put into place in order to smooth the interbank market. All these moves should strengthen the resilience of the banking system. Starting from January 2012, IFRS has replaced the Romanian Accounting Standards (RAS). To ensure a smooth transition, the new IFRS has some local particularities (prudential filters).

Market shares (2012, eop)



Per cent of total assets, preliminary data
Source: Ziarul Financiar, Raiffeisen RESEARCH

Key banking sector indicators

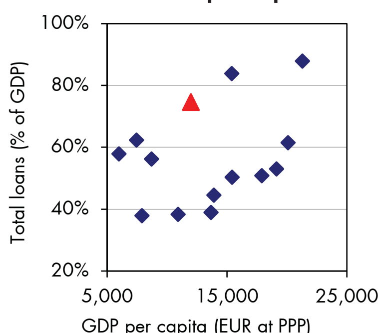
Balance sheet data	2008	2009	2010	2011	2012
Total assets (EUR mn)	85,190	86,202	89,906	90,925	91,409
growth in % yoy	18.2	1.2	4.3	1.1	0.5
in % of GDP	66.0	72.7	73.6	70.6	68.9
Total loans (EUR mn)	49,969	47,584	49,208	52,125	51,571
growth in % yoy	20.9	(4.8)	3.4	5.9	(1.1)
in % of GDP	38.7	40.1	40.3	40.4	38.9
Loans to private enterprises (EUR mn)	23,868	22,932	24,692	27,108	27,276
growth in % yoy	17.4	(3.9)	7.7	9.8	0.6
in % of GDP	18.5	19.3	20.2	21.0	20.6
Loans to households (EUR mn)	24,973	23,779	23,889	24,199	23,647
growth in % yoy	26.1	(4.8)	0.5	1.3	(2.3)
in % of GDP	19.3	20.1	19.5	18.8	17.8
Mortgage loans (EUR mn)	5,267	5,754	6,776	7,753	8,393
growth in % yoy	33.5	9.2	17.8	14.4	8.3
in % of GDP	4.1	4.9	5.5	6.0	6.3
Loans in foreign currency (EUR mn)	28,947	28,713	31,131	33,183	32,360
growth in % yoy	28.3	(0.8)	8.4	6.6	(2.5)
in % of GDP	22.4	24.2	25.5	25.7	24.4
Loans in foreign currency (% of total loans)	58	60	63	64	63
Total deposits (EUR mn)	40,352	42,803	44,843	46,866	48,006
growth in % yoy	7.9	6.1	4.8	4.5	2.4
in % of GDP	31.2	36.1	36.7	36.4	36.2
Deposits from households (EUR mn)	21,204	23,534	24,673	26,506	27,922
growth in % yoy	11.4	11.0	4.8	7.4	5.3
in % of GDP	16.4	19.9	20.2	20.6	21.0
Total loans (% of total deposits)	124	111	110	111	107
Structural information					
Number of banks	42	41	41	40	39
Market share of state-owned banks (% of total assets)	5.2	7.3	7.4	8.2	8.4
Market share of foreign-owned banks (% of total assets)	88	85	85	83	90
Profitability and efficiency					
Return on Assets (RoA %)	1.6	0.3	(0.2)	(0.2)	(0.6)
Return on Equity (RoE %)	17.0	2.9	(1.7)	(2.6)	(5.4)
Capital adequacy (CAR % of risk weighted assets)	13.8	14.7	15.0	14.9	14.6
Non-performing loans (% of total loans)	2.8	7.9	11.9	14.3	18.2

Source: NBR, Raiffeisen RESEARCH

Low loan demand and conservative lending policies dominate

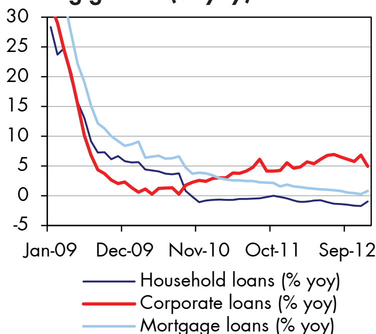
- **Conservative lending activity and solid deposit growth resulted in further strengthening of liquidity position**
- **Corporate lending continues to outperform the household lending segment**
- **Another rise in NPL ratio in 2012, but profitability more or less unchanged compared to 2011**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Bulgaria vs. all other CEE markets
Source: BNB, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)*



** in LCY-terms*
Source: BNB, Raiffeisen RESEARCH

In 2012, GDP growth slowed down to 0.8% yoy, mirroring the economic downturn in the Eurozone. As a result, the Bulgarian banking system had to operate within a challenging environment. Loan growth was subdued against the background of cautious lending policies, while NPL ratios continued to rise, even though more moderately than in 2011 (2012 NPL ratio at 16.6% up from 14.9%). On a positive note, conservative lending activity and a strong deposit growth – mainly provided by residents – boosted the overall liquidity within the banking system. Moreover, the sector maintained its high capital adequacy levels and still posted decent financial results.

Total assets grew by 7% yoy in 2012 to EUR 42 bn, given the sustainable growth of funds attracted from households. For the entire year, the loan portfolio of banks grew by 3% yoy (to EUR 30 bn). The slightly increased credit demand by corporate clients – mostly in agriculture, trade and processing industries – resulted in a decent 5% yoy growth in corporate lending (around EUR 20 bn in total). At the same time, retail loans dropped slightly in 2012 compared to 2011. This mainly reflects a decline in consumer lending, which is driven by the preference of households to repay their debts. The high propensity to save on the part of households contributed largely to the deposit base growth, moving up by 8% yoy. Nevertheless, deposit growth slowed down somewhat in H2 2012, mainly due to lower increases in the corporate segment. The Bulgarian banking sector registered a slight decline in the net profit, reaching EUR 290 mn in 2012, down from EUR 300 mn in 2011. Profitability was negatively affected by a lower interest income, while income from other sources continued to grow. The Bulgarian National Bank (BNB) continues to expect a lower potential for banks to generate income from core activities, which may force them to search for new products.

In 2012, the system resisted the unfavourable economic developments and maintained its solid capital and liquidity buffers significantly above the required minimum levels, although the capital adequacy ratio dropped to 16.7% in 2012, down from 17.5% in 2011. The sustainable deposit growth on part of households positively affected the financing structure and liquidity of banks, whereas the liquidity ratio, showing the ability of banks to repay debts, further improved to 26.0% from 25.6% in 2011. Profitability indicators in 2012, a RoA of 0.71% and a RoE of 6.8%, remained more or less at their 2011 levels, as indicated

Key economic figures and forecasts

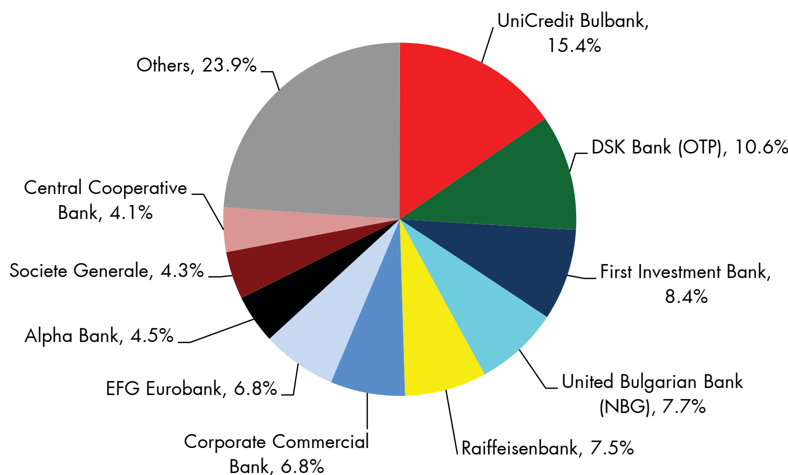
Bulgaria	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	35	35	36	39	40	41	43
Nominal GDP per capita (EUR)	4,658	4,618	4,804	5,264	5,453	5,663	6,001
Real GDP (% yoy)	6.2	-5.5	0.4	1.8	0.8	0.5	2.5
Consumer prices (avg, % yoy)	12.3	2.8	2.4	4.2	3.0	3.1	3.4
Unemployment rate (avg, %)	5.6	6.8	10.2	11.2	12.3	12.5	12.0
General budget balance (% of GDP)	2.9	-0.9	-4.0	-2.1	-0.5	-2.1	-1.7
Public debt (% of GDP)	13.7	14.6	16.2	16.3	18.3	17.8	19.4
Current account balance (% of GDP)	-23.1	-8.9	-1.5	0.3	-0.7	-1.6	-2.3
Gross foreign debt (% of GDP)	105.1	108.3	102.7	93.1	96.4	93.3	92.9
EUR/LCY (avg)*	1.96	1.96	1.96	1.96	1.96	1.96	1.96

** Currency Board to the EUR; Source: National sources, wiiw, Raiffeisen RESEARCH*

by the insignificantly lower financial results and the modest banking sector growth.

The total number of banks remained unchanged at 31 (24 universal banks and 7 branches of foreign banks), whereas more than 96% of the sector's total assets are controlled by privately-owned banks. The market share of local credit institutions grew to 26%, while more than 70% remain owned by foreign financial institutions (~3% of market share is with state-owned banks), mainly large Western European banking groups. There were no significant M&A activities. Following its integration into Credit Agricole, the Bulgarian subsidiary of Emporiki Bank Greece assumed the new name of Credit Agricole. Driven by the plans of a merger between the National Bank of Greece and Eurobank EFG, both local subsidiaries are expected to merge and form the second largest bank in Bulgaria. However, the merger is still subject to BNB approval (currently the transaction is on hold on the parent bank level in Greece).

Market shares (2012, eop)



Per cent of total assets
Source: BNB, Raiffeisen RESEARCH

Key banking sector indicators

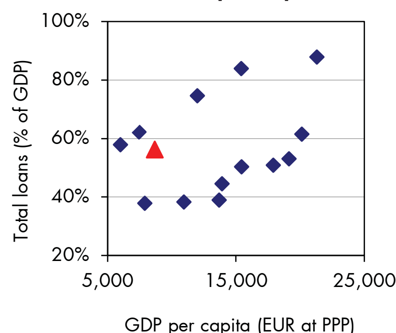
Balance sheet data	**2008**	**2009**	**2010**	**2011**	**2012**
Total assets (EUR mn)	35,566	36,234	37,695	39,273	42,138
growth in % yoy	17.7	1.9	4.0	4.2	7.3
in % of GDP	100.4	103.7	104.6	102.0	106.2
Total loans (EUR mn)	25,661	26,817	27,535	28,655	29,573
growth in % yoy	32.2	4.5	2.7	4.1	3.2
in % of GDP	72.4	76.8	76.4	74.4	74.6
Loans to private enterprises (EUR mn)	16,787	17,274	18,036	19,189	20,158
growth in % yoy	31.4	2.9	4.4	6.4	5.0
in % of GDP	47.4	49.4	50.0	49.8	50.8
Loans to households (EUR mn)	8,875	9,543	9,499	9,466	9,416
growth in % yoy	33.8	7.5	(0.5)	(0.4)	(0.5)
in % of GDP	25.0	27.3	26.3	24.6	23.7
Mortgage loans (EUR mn)	4,222	4,578	4,739	4,790	4,827
growth in % yoy	40.2	8.4	3.5	1.1	0.8
in % of GDP	11.9	13.1	13.1	12.4	12.2
Loans in foreign currency (EUR mn)	14,673	15,726	16,876	18,267	18,937
growth in % yoy	49.5	7.2	7.3	8.2	3.7
in % of GDP	41.4	45.0	46.8	47.4	47.7
Loans in foreign currency (% of total loans)	57	59	61	64	64
Total deposits (EUR mn)	21,339	22,132	23,994	27,000	29,275
growth in % yoy	7.5	3.7	8.4	12.5	8.4
in % of GDP	60.2	63.4	66.6	70.1	73.8
Deposits from households (EUR mn)	11,334	12,699	14,335	16,311	18,340
growth in % yoy	16.8	12.0	12.9	13.8	12.4
in % of GDP	32.0	36.4	39.8	42.4	46.2
Total loans (% of total deposits)	120	121	115	106	101
Structural information					
Number of banks	30	30	30	31	31
Market share of state-owned banks (% of total assets)	2.1	2.4	3.2	3.7	3.3
Market share of foreign-owned banks (% of total assets)	84	84	81	76	74
Profitability and efficiency					
Return on Assets (RoA %)	2.1	1.1	0.86	0.78	0.71
Return on Equity (RoE %)	20.5	9.3	6.73	5.76	5.34
Capital adequacy (CAR % of risk weighted assets)	14.9	17.0	17.5	17.5	16.7
Non-performing loans (% of total loans)	2.4	6.1	11.9	14.9	16.6

Source: BNB, Raiffeisen RESEARCH

Certain decoupling of banking sector from weak macroeconomics

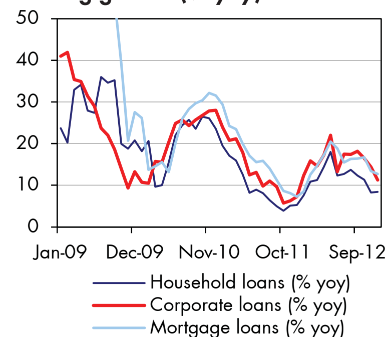
- **In contrast to regional CEE trend, lending recouped somewhat in H2 2012 (after government subsidy program)**
- **Certain macroprudential policy relaxations supportive for the banking sector**
- **Some M&A activity and consolidation expected, further loan-to-deposit rebalancing also needed**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Serbia vs. all other CEE markets
Source: NBS, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)*



** in LCY-terms*
Source: NBS, Raiffeisen RESEARCH

Serbia's fall into recession in 2012 was driven by several factors: weak local and external demand, a frozen IMF deal, and elections at several levels resulting in a prolonged formation of a functioning government. The overall dim picture was partially offset by a state-subsidized loan program that helped to stabilize the local economy.
The Serbian banking sector was facing a reduced loan extension in H1 2012 mostly due to an illiquid real estate sector, a further increase in NPLs and a less optimistic pre-election sentiment. Lending activity recouped somewhat in H2 2012 due to a government subsidy program, resulting in a disbursement of around EUR 175 mn in new loans in the corporate and retail segment. NPLs continued to rise throughout 2012, with an NPL ratio of 19.9% (Q3 2012). The highest NPL ratio of 28% was recorded in the SME segment, followed by NPLs in retail that grew slightly to 10.1% in the same period (Sept. 2011: 9.1%). On a positive note, the NPL ratio in corporate lending improved slightly to 23.7% in September 2012 (Sept. 2011: 24.6%). In order to stimulate retail loans, the Serbian National Bank (NBS) abolished the unified limitation of credit indebtedness by the NBS and enabled banks to make use of their own internal policies to manage the assessment of private individuals' creditworthiness, including the level of loan indebtedness up to which clients could be indebted. Although the CAR is still well above the minimum of 12%, it fell to 16.4% in September 2012 (Sept. 2011: 19.1%). However, this decline was largely driven by losses posted by one state-owned bank. Nevertheless, the overall profitability of the banking sector declined in 2012, with an RoE of 2.9% from January to September 2012 (Jan.-Sept. 2011: 6.5%). Key drivers were a decrease in interest income (-12.9% yoy) and commission income (-7.4% yoy), coupled with an increase in loan loss provisions of 7.7% yoy. State-owned banks are weighing negatively on the profitability of the whole sector. Only Komercijalna banka reported a profit in 2012, while the remaining nine state-owned banks posted significant losses due to loan loss provisions. Agrobanka was the first state-owned bank that faced bankruptcy in 2012; its assets and liabilities were ultimately transferred to Postanska stedionica. Razvojna Banka Vojvodine followed, and the procedure for a transfer of the banks retail loans and liabilities to Postanska stedionica is expected to be set up in H1 2013. With the exception of Komercijalna, all remaining state-owned banks will be pri-

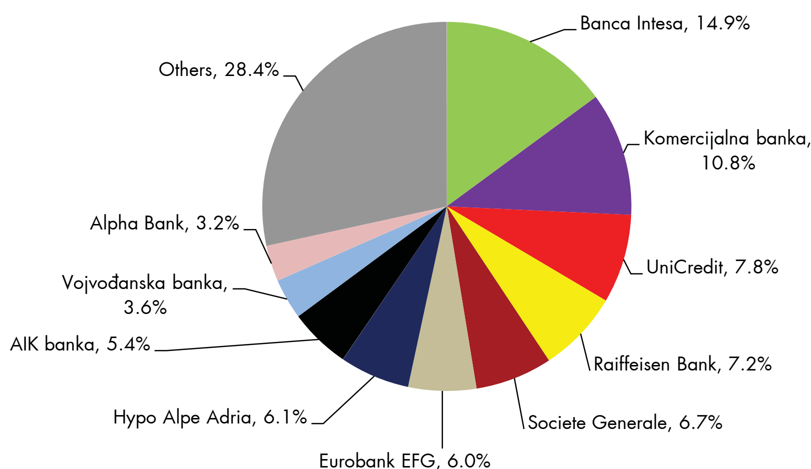
Key economic figures and forecasts

Serbia	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	33	29	28	31	30	33	36
Nominal GDP per capita (EUR)	4,444	3,955	3,841	4,336	4,084	4,583	5,029
Real GDP (% yoy)	3.8	-3.5	1.0	1.6	-1.7	1.0	2.0
Consumer prices (avg, % yoy)	13.6	8.2	6.3	11.3	7.8	13.0	9.0
Unemployment rate (avg, %)	13.6	16.1	19.2	23.0	26.0	26.0	24.5
General budget balance (% of GDP)	-2.6	-4.3	-4.8	-4.5	-5.7	-4.5	-4.0
Public debt (% of GDP)	26.9	34.1	43.2	45.8	59.7	61.2	59.9
Current account balance (% of GDP)	-21.6	-7.2	-7.4	-9.3	-10.7	-9.6	-9.6
Gross foreign debt (% of GDP)	64.6	77.7	85.0	76.7	86.9	84.3	80.9
EUR/LCY (avg)	81.5	93.9	103.0	102.0	113.0	113.9	114.8

Source: National sources, wiiw, Raiffeisen RESEARCH

vatized (a tender for Privredna banka Beograd was already announced). The Serbian banking sector is less affected by weaknesses of Greek-owned banks due to their lower presence compared to Bulgaria or Albania. Therefore, the market impact of more conservative strategies on the part of Greek-owned banks (who decreased their market share from 16% in 2008 to 14% in 2012) is of lower importance. The Serbian banking sector continues to run one of the highest loan-to-deposit ratios compared to CE/SEE peers (no tangible sign of rebalancing), which puts the sector in a more vulnerable position compared to its peers.

Market shares (2012, eop)



Per cent of total assets
Source: NBS, Raiffeisen RESEARCH

Due to still weak macroeconomic fundamentals and the ongoing reshuffling of the banking industry, loan growth in 2013 is expected to be driven by the continuation of the government subsidized loan program, which is predominantly oriented towards SME lending. Potential M&A activities will be heavily oriented around state-owned banks, with limited potential to attract new market entrants.

Key banking sector indicators

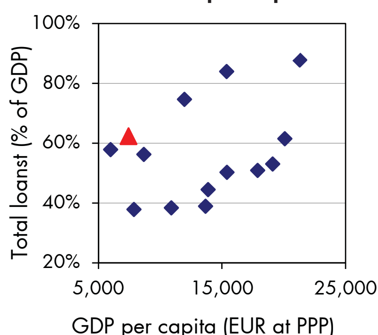
Balance sheet data	**2008**	**2009**	**2010**	**2011**	**2012**
Total assets (EUR mn)	21,632	24,362	25,984	27,732	27,826
growth in % yoy	2.1	12.6	6.7	6.7	0.3
in % of GDP	64.7	84.4	91.6	87.9	94.0
Total loans (EUR mn)	12,262	13,138	15,166	16,452	16,630
growth in % yoy	21.4	7.1	15.4	8.5	1.1
in % of GDP	36.7	45.5	53.4	52.1	56.2
Loans to private enterprises (EUR mn)	6,602	7,514	8,696	9,218	9,431
growth in % yoy	17.5	13.8	15.7	6.0	2.3
in % of GDP	19.8	26.0	30.6	29.2	31.9
Loans to households (EUR mn)	4,287	4,784	5,373	5,702	5,687
growth in % yoy	11.8	11.6	12.3	6.1	(0.3)
in % of GDP	12.8	16.6	18.9	18.1	19.2
Mortgage loans (EUR mn)	1,861	2,193	2,621	2,835	2,940
growth in % yoy	50.6	17.8	19.5	8.2	3.7
in % of GDP	5.6	7.6	9.2	9.0	9.9
Loans in foreign currency (EUR mn)	9,815	8,054	10,000	11,633	11,939
growth in % yoy	-	(17.9)	24.2	16.3	2.6
in % of GDP	29.4	27.9	35.2	36.9	40.3
Loans in foreign currency (% of total loans)	80	61	66	71	72
Total deposits (EUR mn)	10,019	11,408	11,894	13,100	13,311
growth in % yoy	(2.7)	13.9	4.3	10.1	1.6
in % of GDP	30.0	39.5	41.9	41.5	45.0
Deposits from households (EUR mn)	5,152	6,546	7,515	8,173	8,696
growth in % yoy	(2.6)	27.1	14.8	8.7	6.4
in % of GDP	15.4	22.7	26.5	25.9	29.4
Total loans (% of total deposits)	122	115	128	126	125
Structural information					
Number of banks	34	34	33	33	33
Market share of state-owned banks (% of total assets)	17.5	18.2	20.3	19.7	19.0
Market share of foreign-owned banks (% of total assets)	75	74	73	73	69
Profitability and efficiency					
Return on Assets (RoA %)	2.1	1.0	1.1	1.2	0.6
Return on Equity (RoE %)	9.3	4.6	5.4	6.0	2.9
Capital adequacy (CAR % of risk weighted assets)	21.9	21.4	19.9	19.1	16.4
Non-performing loans (% of total loans)	11.3	15.7	16.9	19.0	19.9

Source: NBS, Raiffeisen RESEARCH

Consumption smoothing via loans unlikely to continue

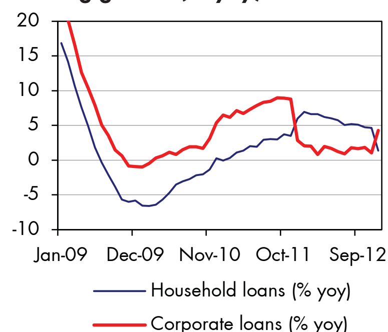
- **Weaker disposable incomes to some extent substituted by (still) rising indebtedness**
- **Therefore, potential for future loan growth is limited until sustainable economic recovery starts**
- **Increasing focus on asset quality may also cap lending activity from a near-term perspective**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Bosnia a.H. vs. all other CEE markets
Source: CBBH, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)*



** in LCY-terms*
Source: CBBH, Raiffeisen RESEARCH

The economy slipped into recession again in 2012 due to adverse external and internal developments. The political stalemate led to a continuation of the weak momentum in domestic demand and the transmission channel of the recessionary cycle from the Eurozone to the small and opened economy of the country was similar to the one seen back in 2009. As expected, the poor economic environment mostly affected corporate lending, mirrored in a growth rate of 1.8% yoy in 2012 (compared to robust 7.3% yoy in 2011). Retail lending proved to be much more resilient, with an average loan growth of 5.3% yoy in 2012. It seems that a weakening of disposable income and purchasing power, driven by record unemployment and negative real growth of wages, was to some extent substituted by a (still) rising indebtedness.

The weakening of economic fundamentals resulted in another round of asset quality deterioration. Limiting the NPLs while stabilizing balance sheets was therefore on the main agenda of local banks in 2012. The NPL ratio again increased to some 12.7% in 2012 (up from 11.9%). The banks' focus on the stabilization of NPLs in their respective portfolios in H2 2012 lead to a stable capital adequacy ratio of 16.7% in the same period. Additionally, banks were strictly focusing on cost control, resulting in a decent level of profitability. As at end of Q3, the consolidated net profit of local banks amounted to EUR 83.4 mn, an increase of 98% yoy. As a consequence, RoA and RoE went up to 0.8% and 6.4% respectively.

There were no major M&A activities in the domestic banking sector in 2012, with only one small local bank revoking its banking license after operating for more than ten years under interim administration. The number of banks went down to 28, which still leaves room for further consolidation in a concentrated market where the top three players are holding a market share of 52.3% (UniCredit, Raiffeisen and Hypo Alpe Adria Group – HAAG). However, 2012 was a year of aggressive market share acquisition by some medium-sized local banks such as Intesa, Sparkasse Bank and Nova Banka. In the medium-term, ongoing uncertainties and the restructuring on the part of HAAG's parent bank and Slovenian NLB (with two sizeable subsidiaries in Bosnia) should not be underestimated; negative

Key economic figures and forecasts

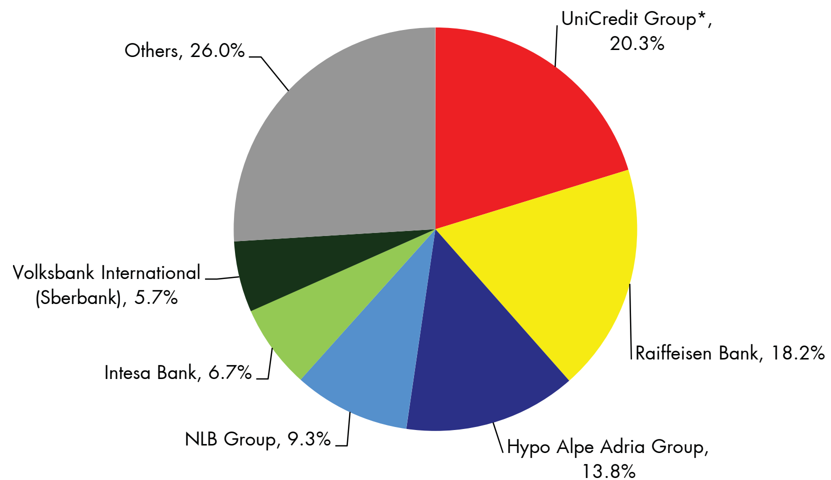
Bosnia and Herzegovina	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	13	12	13	13	13	14	14
Nominal GDP per capita (EUR)	3,314	3,222	3,298	3,416	3,424	3,515	3,671
Real GDP (% yoy)	5.6	-2.8	0.7	1.0	-1.3	0.5	2.0
Consumer prices (avg, % yoy)	7.4	-0.4	2.1	3.7	2.1	2.0	2.1
Unemployment rate (avg, %)	23.4	24.1	27.2	27.6	28.0	28.1	27.6
General budget balance (% of GDP)	-2.2	-4.4	-2.5	-1.3	-2.0	-1.5	-1.0
Public debt (% of GDP)	30.1	35.1	38.4	39.2	42.0	42.1	39.6
Current account balance (% of GDP)	-14.1	-6.6	-5.5	-9.5	-9.7	-9.8	-9.9
Gross foreign debt (% of GDP)	48.6	53.8	57.5	67.1	63.1	62.2	61.0
EUR/LCY (avg)*	1.96	1.96	1.96	1.96	1.96	1.96	1.96

** Currency Board to the EUR; Source: National sources, wiiw, Raiffeisen RESEARCH*

news but also short-term M&A activities might be observed in the future.

The considerable level of lending growth in recent years – despite the fairly weak underlying economic developments – limits the short-term growth potential in the banking sector. Therefore, the relatively weak economic outlook with another year of stagnation in 2013 leaves only limited room for lending growth in the low single digit range. Moreover, the overall banking sector penetration is also at fairly high levels: With a loan-to-GDP ratio at 62% (given a fairly low GDP per capita level), Bosnia and Herzegovina is clearly above financial intermediation levels in many peers in the SEE and CE sub-regions.

Market shares (2012, eop)



Per cent of total assets
** UniCredit Bank & UniCredit Bank Banja Luka*
Source: CBBH, Raiffeisen RESEARCH

Key banking sector indicators

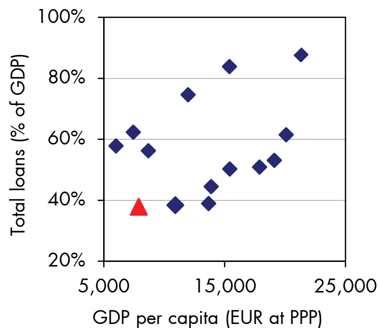
Balance sheet data	**2008**	**2009**	**2010**	**2011**	**2012**
Total assets (EUR mn)	10,762	10,696	10,828	11,196	11,416
growth in % yoy	7.8	(0.6)	1.2	3.4	2.0
in % of GDP	85.2	87.2	85.5	85.3	87.1
Total loans (EUR mn)	7,442	7,210	7,436	7,828	8,153
growth in % yoy	21.8	(3.1)	3.1	5.3	4.1
in % of GDP	58.9	58.7	58.7	59.7	62.2
Loans to private enterprises (EUR mn)	3,444	3,407	3,545	3,641	3,805
growth in % yoy	27.7	(1.1)	4.1	2.7	4.5
in % of GDP	27.3	27.8	28.0	27.7	29.0
Loans to households (EUR mn)	3,424	3,223	3,234	3,428	3,474
growth in % yoy	17.8	(5.9)	0.3	6.0	1.3
in % of GDP	27.1	26.3	25.5	26.1	26.5
Loans in foreign currency (EUR mn)	754	735	534	372	333
growth in % yoy	21.1	(2.5)	(27.4)	(30.2)	(10.5)
in % of GDP	27.1	26.3	25.5	26.1	26.5
Loans in foreign currency (% of total Loans)	10.1	10.2	7.2	4.8	4.1
Total deposits (EUR mn)	6,073	6,179	6,406	6,643	6,814
growth in % yoy	(1.8)	1.7	3.7	3.7	2.6
in % of GDP	48.1	50.3	50.6	50.6	52.0
Deposits from households (EUR mn)	2,661	2,895	3,315	3,605	3,913
growth in % yoy	0.8	8.8	14.5	8.7	8.5
in % of GDP	21.1	23.6	26.2	27.5	29.9
Total loans (% of total deposits)	123	117	116	118	120
Structural information					
Number of banks	30	30	29	29	28
Market share of state-owned banks (% of total assets)	0.9	0.9	0.8	0.9	1.0
Market share of foreign-owned banks (% of total assets)	95	95	93	92	91
Profitability and efficiency					
Return on Assets (RoA)	0.4	0.1	(0.6)	0.7	0.8
Return on Equity (RoE)	4.3	0.8	(5.5)	5.8	6.4
Capital adequacy (% of risk weighted assets)	16.3	16.1	16.2	17.1	16.7
Non-performing loans (% of total loans)	3.1	5.9	11.4	11.9	12.7

Source: CBBH, Raiffeisen RESEARCH

Deceleration driven by stricter lending policies and regulation

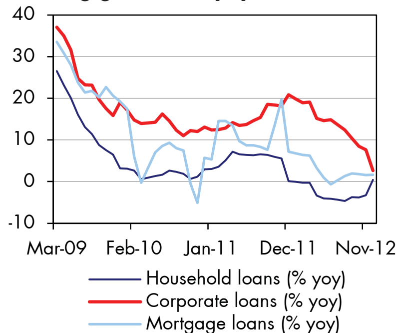
- **Macroeconomic weakness well reflected in banking sector trends**
- **High propensity to save supports strong liquidity position of the banking sector**
- **Conservative lending policies reflected in stagnation of NPL formation, NPL ratio may peak around current levels**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Albania vs. all other CEE markets
Source: NBA, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)*



** in LCY-terms*
Source: NBA, Raiffeisen RESEARCH

After a slow GDP growth hovering around 2% in 2012, the Albanian economy is expected to follow almost the same dynamics in 2013 due to low domestic demand and the ongoing economic weakness in the Eurozone periphery (Italy and Greece are important economic partners). The overall slowdown of the economy is well reflected in the deceleration of loan growth in 2012. Annual loan growth reached just 1.6% yoy, down from around 15% yoy in 2011. On the back of more conservative lending policies and new and stricter regulations and requirements, lending activity also experienced weak demand because of increasing uncertainties about short-term economic developments in the Albanian economy. Both businesses and consumers were reluctant operating in an economy that did not seem promising and vital.

For 2013, a moderate improvement of the dynamics within the Albanian banking sector is expected. Legal revisions aiming at the effectiveness of collateral execution are expected to soon pass legislation. Additionally, Albania's low interest rate should also have positive effects: The latest rate cut of 25bp by the Bank of Albania pushed domestic rates to an all-time low of 3.75% and the interest rate is expected to remain at this level. Moreover, the inflation rate is expected to be within the target range of 2 to 4% and the government promises to pay back businesses that are engaged in public investments. This measure is likely to improve the liquidity situation of businesses in the construction sector and therefore should affect the overall economic growth in a positive way.

The Albanian market is characterized by a strong propensity to save. This was also obvious in 2012, when household deposits increased by 8.4% yoy, even though this growth was slowing down. The deceleration was more obvious in Q4 2012, mostly in deposits in FCY, due to expectations for fewer remittances because of the stressed conditions in the host countries of Albanian emigrants like Italy and Greece. Nevertheless, the liquidity position of the banking sector remains very sound. This holds true for capitalization as well. The CAR stood at 16.2%, the loan-to-deposit ratio at 58% by the end of 2012. Moreover, there is still a lot of room for lending activity (given the solid loan-to-deposit relationship), as the loan-to-GDP ratio is at very modest 43%. However, this is not a short- but rather medium-term potential. The very fast growth of NPLs has been the main issue over the last few years. By the end of 2012, the NPL ratio reached 22.5%.

Key economic figures and forecasts

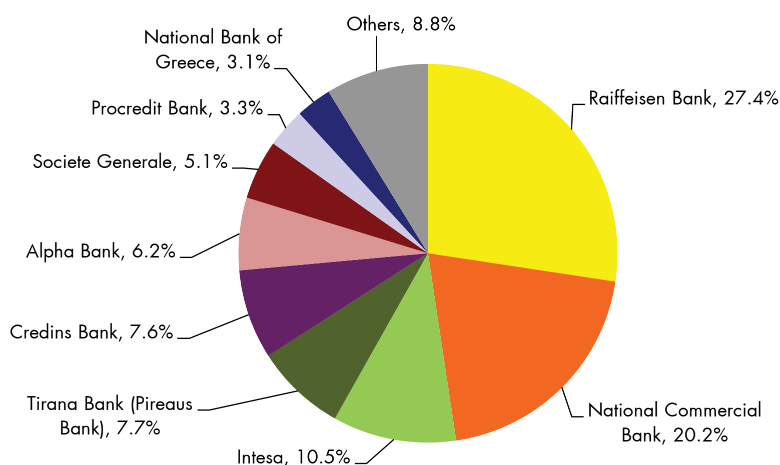
Albania	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	9	9	9	10	10	11	11
Nominal GDP per capita (EUR)	2,785	2,743	2,928	3,445	3,567	3,731	3,978
Real GDP (% yoy)	7.8	3.3	3.9	3.1	1.6	2.0	3.5
Consumer prices (avg, % yoy)	3.4	5.0	4.0	3.5	2.0	2.5	3.0
Unemployment rate (avg, %)	12.8	13.0	13.5	14.0	13.3	13.5	13.6
General budget balance (% of GDP)	-5.5	-7.0	-5.7	-3.5	-3.0	-3.0	-3.0
Public debt (% of GDP)	54.8	59.5	59.5	59.4	61.5	62.6	62.0
Current account balance (% of GDP)	-15.8	-15.6	-10.3	-11.3	-8.8	-9.1	-9.2
Gross foreign debt (% of GDP)	19.2	22.5	23.5	23.6	24.7	24.5	26.6
EUR/LCY (avg)	122.8	132.1	137.8	140.3	139.0	138.5	138.3

Source: National sources, wiiw, Raiffeisen RESEARCH

However, growth in NPL accumulation stopped in Q4 2012, indicating a good start in recuperating the ailing NPL environment. We believe this positive development is going to continue in 2013, as banks focus on the issue and better utilize their respective structures. Regardless of the high NPL level, the banking system remained profitable, posting a net profit of EUR 27 mn – more than five times the profit of 2011.

Spillovers from the very challenging situation of Greek-owned banks (accounting for 20-25% of the Albanian banking system) have been largely avoided. Although assets of Greek-owned banks in Albania are tiny from a Eurozone perspective – around 1% of the asset base of Greek parent banks – some of these banks experienced a certain funding stress in Albania. As a result, balance sheets of Greek-owned banks shrank substantially (their market share fell from 40% at the peak levels in 2008 to 19.7% in 2012) and weak lending growth also drove up their NPL ratios above the market average. Exposure cuts of Western European banks in Albania had been modest, coming in at 10% from peak levels (including cuts by Greek parents towards their subsidiaries in Albania).

Market shares (2012, eop)



Per cent of total assets
Source: NBA, Raiffeisen RESEARCH

Key banking sector indicators

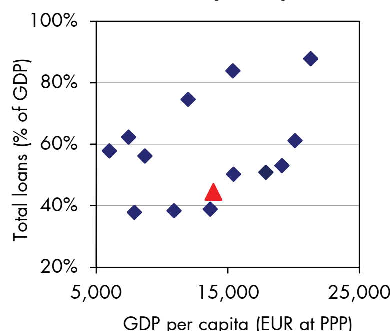
Balance sheet data	2008	2009	2010	2011	2012
Total assets (EUR mn)	6,738	6,424	7,139	8,063	8,626
growth in % yoy	10.5	(4.7)	11.1	12.9	7.0
in % of GDP	76.6	77.0	76.3	85.2	90.0
Total loans (EUR mn)	3,205	3,261	3,537	4,076	4,139
growth in % yoy	33.5	1.8	8.5	15.2	1.6
in % of GDP	36.4	39.1	37.8	43.1	43.2
Loans to private enterprises (EUR mn)	1,980	2,070	2,379	2,858	2,887
growth in % yoy	30.5	4.6	14.9	20.1	1.0
in % of GDP	22.5	24.8	25.4	30.2	30.1
Loans to households (EUR mn)	1,131	1,047	1,065	1,072	1,071
growth in % yoy	32.7	(7.4)	1.7	0.6	(0.0)
in % of GDP	12.9	12.6	11.4	11.3	11.2
Mortgage loans (EUR mn)	669	716	753	806	815
growth in % yoy	29.0	7.0	5.1	7.0	1.1
in % of GDP	7.6	8.6	8.0	8.5	8.5
Loans in foreign currency (EUR mn)	2,333	2,291	2,470	2,766	2,670
growth in % yoy	33.9	(1.8)	7.8	12.0	(3.5)
in % of GDP	48.6	51.5	53.3	60.7	64.9
Loans in foreign currency (% of total credits)	73	70	70	68	65
Total deposits (EUR mn)	5,211	5,032	5,885	6,651	7,104
growth in % yoy	0.7	(3.4)	17.0	13.0	6.8
in % of GDP	59.2	60.3	62.9	70.3	74.1
Deposits from households (EUR mn)	4,276	4,296	4,987	5,743	6,225
growth in % yoy	1.3	0.5	16.1	15.2	8.4
in % of GDP	48.6	51.5	53.3	60.7	64.9
Total loans (% of total deposits)	62	65	60	61	58
Structural information, profitability and efficiency					
Number of banks	16	16	16	16	16
Market share of foreign-owned banks (% of total assets)	94	94	94	94	94
Profitability and efficiency					
Return on Assets (RoA %)	0.9	0.4	0.7	0.1	0.3
Return on Equity (RoE %)	11.4	4.6	7.6	0.8	3.8
Capital adequacy (CAR % of risk weighted assets)	17.2	16.2	16.2	15.6	16.2
Non-performing loans (% of total loans)	6.6	10.5	14.0	18.8	22.5

Source: NBA, Raiffeisen RESEARCH

Sound performance in 2012 suggests further opportunities

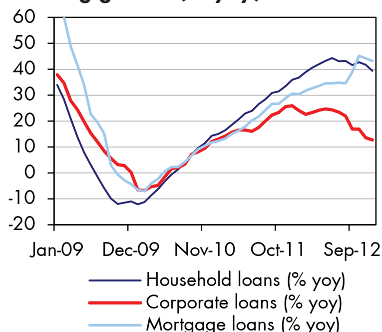
- **Russian banking sector outperforms most other CEE markets in terms of growth and profitability in 2011/12**
- **Positive momentum expected to persist in 2013, although with somewhat lower growth rates**
- **Dominance of state-controlled banks remains the key point in market share split**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Russia vs. all other CEE markets
Source: CBR, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)*



** in LCY-terms*
Source: CBR, Raiffeisen RESEARCH

During the recent years of post-crisis recovery, Russia's banking sector outpaced all major CEE peers in terms of growth. 2012 was another year of good performance: Nominal loan growth in LCY-terms remained in high double-digit territory and were matched (and fuelled) by a healthy deposit growth of 15% yoy. Additionally, household placements with banks outperformed, posting a 20% yoy increase for the second year in a row. Profitability remained sanguine and net interest margins stayed higher than elsewhere in CEE. We expect both growth and profitability to remain decent in 2013, but notice that both should come down somewhat to more conventional levels. This is fairly justified if to take into account high rates of consumer lending in Russia over the past two years. Besides, the downtrend in lending growth is a reflection of modest economic growth in H2 2012. The availability of international capital for Russian borrowers may also have added to decreasing corporate loan growth momentum domestically. Moreover, the new regulatory measures aimed to avoid a sharp increase of credit risks, should impose additional limits to high loan growth.

The major driver for lending and asset growth in 2012 remained the buildup of retail banking. Banks were competing for private depositors' money, and aggressively expanding retail and consumer lending facilities at the same time. Loans to households soared by 39% yoy in 2012 (LCY), following a 35% yoy increase in 2011. Corporate lending growth lagged behind, and was up "just" 12.7% yoy in 2012 (26% yoy in 2011). Fundamentally, the jump in retail lending was determined by a still low household loan penetration, which was at 9% of GDP back in 2010 and reached some 12% at the end of 2012. The key market-related factors were availability of funding, accounting for both depositors' and interbank money, and – above all – very high margins that the segment suggests. The boom of retail and consumer lending was to a large extent driven by state-controlled banks, which are also the largest banks in the system, have advantages in access to funding, and the possibility to be price setters on the retail deposit market. The dedicated Russian private consumer lenders alone do not have the weight to drive a market boom like we have experienced in 2011/12. Consumer lending expansion has contributed to good profitability ratios over the past two years (2.3% RoA in 2012, 2.4% in 2011, net interest margins averag-

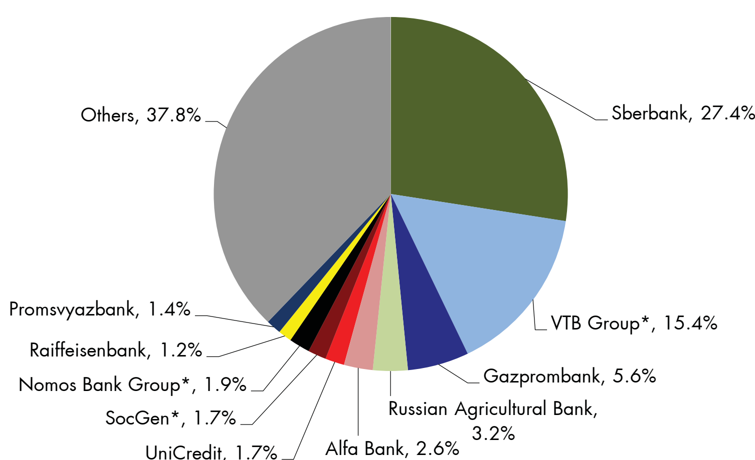
Key economic figures and forecasts

Russia	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	1,133	879	1,147	1,365	1,561	1,655	1,788
Nominal GDP per capita (EUR)	7,940	6,157	8,030	9,548	10,899	11,551	12,472
Real GDP (% yoy)	5.2	-7.8	4.5	4.3	3.4	3.0	3.0
Consumer prices (avg, % yoy)	14.1	11.8	6.9	8.5	5.1	6.2	5.8
Unemployment rate (avg, %)	6.3	8.4	7.5	6.6	5.7	6.0	6.0
General budget balance (% of GDP)	4.9	-6.3	-3.5	1.6	0.4	0.4	-1.0
Public debt (% of GDP)	6.5	8.3	9.3	9.8	10.5	11.0	11.5
Current account balance (% of GDP)	6.2	4.1	4.4	5.1	3.7	2.7	1.9
Gross foreign debt (% of GDP)	30.5	37.1	31.8	30.4	30.7	30.8	31.7
EUR/LCY (avg)	36.4	44.1	40.4	40.9	40.0	41.3	41.7

Source: National sources, wiiw, Raiffeisen RESEARCH

ing 5% for universal banks for both years). Looking forward, we expect the pace of retail lending to decrease from its elevated levels of 2011 and 2012, and drag profitability ratios somewhat downwards. A possible rise in funding costs, and potentially increasing cost of credit risk could be among suppressing factors (e.g. through-the-cycle consumer lending is not only a high margin, but also a high risk business). Besides, we evaluate strained capitalization as one of the key challenges. These constraints might also intensify due to the regulatory measures in process. The banks will be required to do extra provisioning for unsecured retail loans with high interest rates. Most importantly, the CBR intends to implement the Basel III capital requirements domestically within the next year or so.

Market shares (2012, eop)



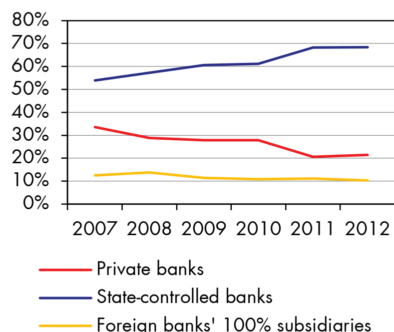
** VTB Group = VTB, VTB 24, Bank of Moscow, Transcreditbank; SocGen = Rosbank, Rusfinance and Deltacredit; Nomos Bank Group = Nomos Bank, Bank Khanty Mansiysk and 2 small regional subsidiaries*
Per cent of total assets
Source: RBC-Rating, Raiffeisen RESEARCH

Key banking sector indicators

Balance sheet data	2008	2009	2010	2011	2012
Total assets (EUR mn)	676,189	678,293	838,138	998,949	1,238,697
growth in % yoy	20.7	0.3	23.6	19.2	24.0
in % of GDP	67.9	75.8	73.0	74.6	79.4
Total loans (EUR mn)	398,805	371,425	449,946	558,325	693,248
growth in % yoy	16.6	(6.9)	21.1	24.1	24.2
in % of GDP	40.0	41.5	39.2	41.7	44.4
Loans to private enterprises (EUR mn)	301,867	289,057	348,669	425,119	499,671
growth in % yoy	16.4	(4.2)	20.6	21.9	17.5
in % of GDP	30.3	32.3	30.4	31.7	32.0
Loans to households (EUR mn)	96,938	82,368	101,277	133,206	193,577
growth in % yoy	17.2	(15.0)	23.0	31.5	45.3
in % of GDP	9.7	9.2	8.8	9.9	12.4
Mortgage loans (EUR mn)	30,650	27,214	32,119	38,992	52,838
growth in % yoy	80.2	(11.2)	18.0	21.4	35.5
in % of GDP	3.1	3.0	2.8	2.9	3.4
Loans in foreign currency (EUR mn)	98,704	88,157	99,615	114,462	118,308
growth in % yoy	26.9	(10.7)	13.0	14.9	3.4
in % of GDP	9.9	9.9	8.7	8.5	7.6
Loans in foreign currency (% of total loans)	25	24	22	21	17
Total deposits (EUR mn)	354,609	393,260	520,161	622,019	748,058
growth in % yoy	4.2	10.9	32.3	19.6	20.3
in % of GDP	35.6	44.0	45.3	46.5	47.9
Deposits from households (EUR mn)	142,540	172,512	243,423	284,881	356,550
growth in % yoy	(0.7)	21.0	41.1	17.0	25.2
in % of GDP	14.3	19.3	21.2	21.3	22.9
Total loans (% of total deposits)	112	94	87	90	93
Structural information					
Number of banks	1,108	1,058	1,012	978	956
Market share of state-owned banks (% of total assets)**	44	45	46	52	53
Market share of banks over 50% foreign-ownership (% of total assets)*	17.3	18.3	18.0	16.9	17.8
Market share of 100% foreign-owned banks (% of total assets)**	10.9	9.0	8.6	8.3	7.9
Market share of 100% foreign-owned banks (% of total loans)**	10.7	8.2	8.1	8.2	7.6
Profitability and efficiency					
Return on Assets (RoA %)	1.8	0.7	1.9	2.4	2.3
Return on Equity (RoE %)	13.3	4.9	12.5	17.6	18.2
Capital adequacy (CAR % of risk weighted assets)	16.8	20.9	18.1	14.7	13.7
Non-performing loans (% of total loans)	2.5	6.2	5.7	5.0	4.8

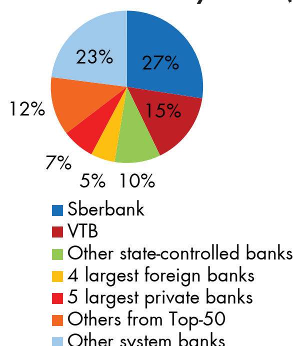
** As reported by the CBR, ** Raiffeisen RESEARCH estimate; Source: CBR, RBC-Rating, Raiffeisen RESEARCH*

RU: Market shares by assets (%)*



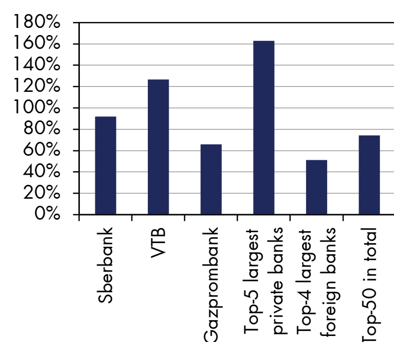
** within the Top-50 cohort*
Source: CBR, Interfax, Banks' data, Raiffeisen RESEARCH

RU: Market share by assets (2012)



Source: CBR, Interfax, Banks' data, Raiffeisen RESEARCH

RU: Asset growth (2009–2012)*



** selective banking groups, % over the period*
Source: CBR, Interfax, Banks' data, Raiffeisen RESEARCH

Focus on: State banks share increases; new players among top private peers

Russia's banking landscape continues to be dominated by large state-controlled banks. In the ranking, these banks are followed by the top foreign-owned banks, although the market share of foreign-owned banks in Russia posted a decline over the past few years. The group of the largest private locally-owned banks kept its competitive position more or less in 2012, although shifts are impressive within the group itself. In the medium term we expect the current market share split to remain at these levels. We expect only a marginal increase of the state banks' market share, a gradual decline of the "true" foreign-owned on-shore banks (with 100% ownership) market share, and a fairly stable market share of locally-owned private lenders. However, new leaders among privately-owned local banking groups could emerge.

The market trends sketched previously are supported by the enhanced credibility of the large state banks, an advantageous access to funding, their large size, extensive networks and the possibility to be price-setters on the domestic deposit and loan markets. All these factors supported the recent round of expansion of state-controlled banking groups. Sberbank, VTB, Gazprombank and the commercial banks within VEB group accounted for 53% of total banking assets as of end-2012. The increase of their market share by over 8pp. over the past five years was a trend provoked by crisis events. State-controlled banks were the major rescuers of failed private banks, and the system's safe havens, which gained the population trust to a large extent. Their ability to get state funding to meet the respective depositors' claims and to provide help to distressed corporate borrowers supported their advantageous position in terms of funding and determined their new role in Russia's post-crisis financial system. Therefore, it comes as no surprise that the retail lending (or consumer lending) boom of the past two years was also pioneered by the state giants. They have enjoyed a matching deposit base already in place and were able to tap international debt market, placing over two thirds of Russian total banking debt volume in 2011 and 2012. The inner dynamics within the state-controlled groups was also notable: Sberbank has created a joint venture with Cetelem to develop consumer banking; VTB has finalized the integration of Transcreditbank and Bank of Moscow and launched a consumer lending project as a separate entity called "Leto"; and VEB is actively developing its commercial banking subsidiaries – Sviaz Bank and Globex, as well as its small business lending arm, SME Bank. The dynamics underlines the active development of this category of banks and the willingness to advance in terms of technology and product lines. The growing market share of state-controlled banks increases the sector concentration and dampens competitive conditions. However, this trend is noticeable since the very beginning of Russia's modern banking system and reflects the concentrated structure of Russia's economy.
When analyzing the presence of foreign-owned banks and their involvement into the Russian market, we take into account only 100% subsidiaries and make the assessments based on bottom-up calculations. We therefore have figures, which are partially different from those published in official statistics, because the latter often base their evaluation on the domestic or foreign ownership of a financial institution on the legal jurisdiction of its prime shareholders, not the final beneficiaries. The latest years saw a gradual decline in the market share of "true" foreign-owned banks in Russia, which sled to around 8% of the total assets at year-end 2012. This trend is a result of two coinciding causes, both of which stem from foreign banks optimizing their capital on the group level. First, the expansion of foreign players in Russia was slower than that of their state-controlled and private peers. Second, a number of foreign

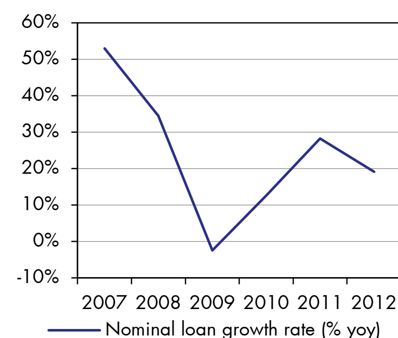
banking groups have reconsidered their presence in Russia. The examples are Santander leaving the market (2010); KBC's exit from its bank Absolut, Commerzbank sold out its minority stake in Promsvyazbank (2012), HSBC and Barclays closed their retail operations (2011); Swedbank will cease new business, and gradually amortise its existing loan portfolio in Russia; and Rabobank as well as Svenska Handelsbanken revoked their banking license (2011 and 2012 respectively). That said, it is likely that the statistics on foreign bank operations in Russia might continue to show a downwards trend. Furthermore, some foreign-owned banks were still in a consolidation phase after a phase of expansion via pre-crisis acquisitions. However, that does not mean that the involvement of the largest and most dedicated foreign banking groups in Russia is on a secular downtrend. The opposite might come true, in particular in corporate lending. The biggest Russian borrowers – natural monopolies and the largest systemic enterprises – have booked their largest loans with foreign banks at the location of the groups' headquarters. The information of the actual size of these deals is hard to assess, but for selective large banking groups the business related to Russia booked outside the country could reach three or four times the business booked inside the country. Moreover, it becomes obvious that the privately-owned Russian lenders – parts of their growth was at the expense of foreign-owned banks – cannot sustain their pace of growth of the last 1-2 years. Moreover, Russia remains a very profitable key market for the remaining dedicated foreign-owned banks. Therefore, the recent more defensive positioning of some Western European banks is likely to change once they have adjusted to the dynamic regulatory environment in their home markets.

Post-crisis, the Russian banking sector was marked by the emergence of new leaders among private Russian banks. Among the "old guard" only Alfa Bank retained its leader status in ranks. Some large private banks, like Uralsib or MDM, were losing positions in ranking, although remained within the Top-20. Among those who moved up in the rankings were, for example Promsvyazbank and Nomos, both entering the top ten. However, the names that really became loud over the post-crisis years were such groups as Otkritie Bank. This bank has adjoined several distressed regional banks, and – in case the ongoing deal between Otkrytie Financial Corporation and Nomos group would eventually result in the full-scale joint operations – it will become one of the leaders of the domestic banking landscape. Another fast growth story was Credit Bank of Moscow, driven by its strategic change towards consumer lending and short-term corporate financing. Other swiftly growing institutions were banks based in St. Petersburg: Rossia (up from rank 43 to rank 19 by assets over the past five years), Bank of Saint Petersburg (up from rank 24 to rank 15); and Vostochny Express (Orient Express) – a consumer lending bank, which reached Top-30 group in 2012 after rank 89 in 2007. Putting aside potential costs of risk accumulation due to an aggressive expansion of the mentioned entities, their leap into the private leaders' cohort remains impressive. These banks, however, remain niche players either geographically or by product lines, while it might only be Alfa Bank, which will remain a serious competitor – for state banks and the largest foreign peers.

As the brisk post-crisis bank lending recovery and consumer lending boom is gradually petering out (partially intended by recent regulatory changes), the ability to find a good balance between growth and quality should define the new winners on the Russian banking market in the coming years. This will be the key for future market gains regardless of the ownership.

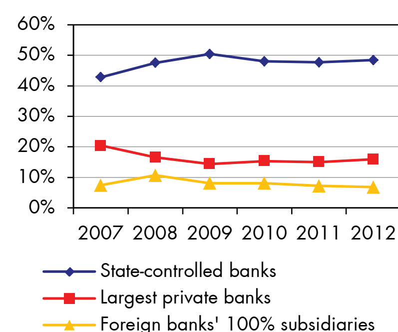
Elena Romanova

RU: Lending growth (LCY, % yoy)



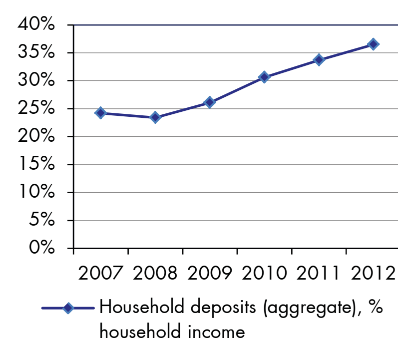
Source: CBR, Raiffeisen Research

RU: Shares in lending by ownership*



** based on a sample of Top-50 banks*
Source: RBC Rating, CBR, Raiffeisen RESEARCH

RU: Household savings increase*

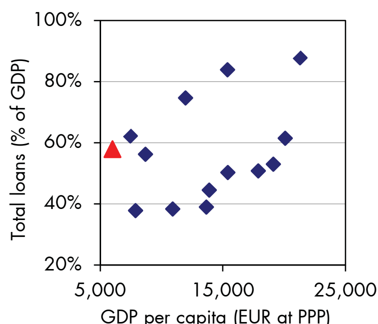


** Household propensity to save with the banks is increasing*
Source: CBR, Raiffeisen Research

Challenging macro environment, but a lot of deleveraging achieved

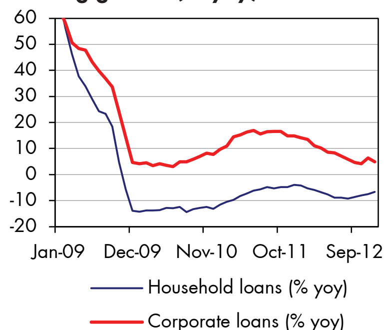
- **Slump in external demand and monetary tightening (to support currency peg) put pressure on banks**
- **Loan-to-GDP ratio decreased further, realigning with income level, which points to some upside in terms of future growth**
- **Loan-to-deposit relationship dropped further, which helps to decrease reliance on external funding**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Ukraine vs. all other CEE markets
Source: NBU, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)*



** in LCY-terms*
Source: NBU, Raiffeisen RESEARCH

Recent macroeconomic trends in Ukraine were clearly not supportive for the banking sector. Economic growth decelerated sharply amid a slump in external demand and a substantial monetary tightening, aimed at defending the currency peg that came once again under pressure in H2 2012. Consequently, high interest rates triggered almost a complete halt in lending activity (except short-term corporate and consumer lending). Total loan growth decelerated to around 2% yoy in 2012 (down from 9.6% in 2011). The loan-to-GDP ratio decreased further, gradually realigning with the country's per capita income levels: it stood at 57.9% at year end-2012, down from 60.4% a year before, and far below the peak of 78% reached in late 2008. Thus, the process of asset-based deleveraging continues and will take much more time than the process of economic recovery in the aftermath of the crisis. On a positive note, domestic deposits increased by 16% in 2012 against the background of a certain household income growth. The share of non-deposit funding in the Ukrainian banking sector was steadily decreasing in the post-crisis years, amid the shallowness of domestic capital markets and continued external deleveraging. Given the feeble loan growth and a strong deposit build-up, the loan-to-deposit ratio decreased from 162% to 143% within the last 12 months, returning to the level of July 2007. Western European banks reduced their cross-border exposure towards Ukraine by around 30% (a drop by nearly USD 20 bn) in the post-crisis years, which also reflects massive ongoing changes in the Ukrainian banking sector.

NPLs became less of a problem in the last two years amid the general economic recovery, a good performance of the new loan portfolio and the activation of loan write-off and sales processes. The official NPL ratio (Ukrainian accounting standards) fell to 8.7% at year-end 2012, although real levels (according to IFRS) are likely to be much higher, at around 30%. Going forward, even in case of mild recession and an exchange rate adjustment of 10-15%, we expect only a moderate uptick in NPL levels, given much lower FX exposure and tighter lending standards this time compared to the brisk expansion in the years 2004 to 2007. At the same time, direct FX risks loom high due to a large open short FX position of the banking system. According to estimates, it stands at nearly USD 5.0 bn at the moment, which means that a 10% depreciation of the UAH could immediately wipe out some 2.5% of the total regulatory capital of the banking system.

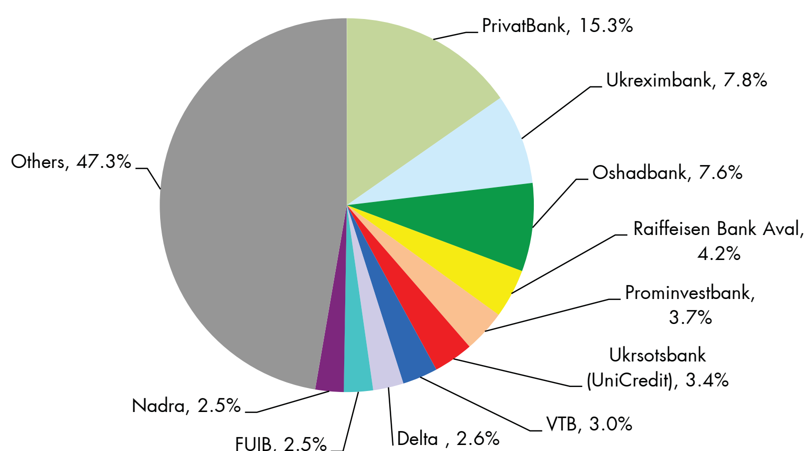
Key economic figures and forecasts

Ukraine	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	123	82	103	118	135	134	141
Nominal GDP per capita (EUR)	2,660	1,770	2,250	2,590	2,960	2,960	3,120
Real GDP (% yoy)	2.3	-14.8	4.2	5.2	0.2	1.0	3.0
Consumer prices (avg, % yoy)	25.2	15.9	9.4	8.0	0.6	1.8	7.5
Unemployment rate (avg, %)	6.4	8.8	8.1	7.9	7.7	7.5	7.0
General budget balance (% of GDP)	-1.5	-8.7	-7.5	-4.3	-5.5	-4.0	-3.0
Public debt (% of GDP)	20.0	34.6	40.0	36.0	36.8	38.0	38.5
Current account balance (% of GDP)	-7.2	-1.6	-2.2	-6.2	-8.3	-6.8	-6.4
Gross foreign debt (% of GDP)	56.4	90.7	85.9	76.7	76.8	79.4	80.4
EUR/LCY (avg)	7.7	11.2	10.5	11.1	10.4	11.4	12.2

Source: National sources, Raiffeisen RESEARCH

The Ukrainian banking system is still characterized by a very low degree of concentration and consolidation. However, ownership structures have changed quite strongly in the post-crisis years. In particular, the deteriorating economic prospects for Ukraine and the increasingly challenging environment in the home markets prompted an exodus of foreign banks – the share of foreign-owned (non-Russian) banks decreased from 40% of total assets to 20% in 2008 to 2012. Private domestic banks with aggressive growth strategies and valuable political connections mostly fill the gap (for more details see the "Focus on" section covering market share trends on page 60).

Market shares (2012, eop)



Per cent of total assets
Source: NBU, Raiffeisen RESEARCH

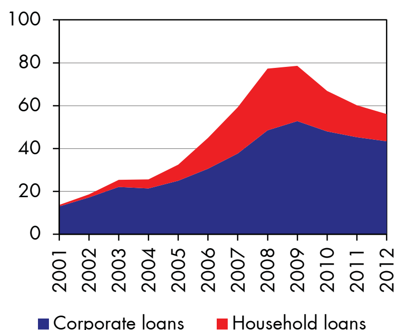
Given the prevailing uncertainties regarding the short- and medium-term macroeconomic outlook, the lack of long-term domestic funding and the weakness of the legal system, the near future does not look particularly bright for the Ukrainian banking sector. Loan growth might revive slightly in 2013, depending on monetary policy and exchange rate developments.

Key banking sector indicators

Balance sheet data	**2008**	**2009**	**2010**	**2011**	**2012**
Total assets (EUR mn)	87,086	76,697	88,167	101,788	106,339
growth in % yoy	7.2	(11.9)	15.0	15.4	4.5
in % of GDP	97.7	96.4	86.1	80.6	80.5
Total loans (EUR mn)	69,015	62,619	67,809	76,268	76,353
growth in % yoy	19.2	(9.3)	8.3	12.5	0.1
in % of GDP	77.4	78.7	66.2	60.4	57.8
Loans to private enterprises (EUR mn)	43,306	42,013	48,674	57,402	59,078
growth in % yoy	17.7	(3.0)	15.9	17.9	2.9
in % of GDP	48.6	52.8	47.5	45.4	44.7
Loans to households (EUR mn)	25,709	20,506	19,134	18,866	17,275
growth in % yoy	22.0	(20.2)	(6.7)	(1.4)	(8.4)
in % of GDP	28.8	25.8	18.7	14.9	13.1
Mortgage loans (EUR mn)	10,114	9,122	8,686	7,526	6,174
growth in % yoy	30.2	(9.8)	(4.8)	(13.3)	(18.0)
in % of GDP	11.3	11.5	8.5	6.0	4.7
Loans in foreign currency (EUR mn)	40,792	32,043	31,569	31,071	28,261
growth in % yoy	41.2	-21.4	-1.5	-1.6	-9.0
in % of GDP	45.8	40.3	30.8	24.6	21.4
Loans in foreign currency (% of total loans)	59	51	47	41	37
Total deposits (EUR mn)	33,646	28,555	38,767	46,806	53,995
growth in % yoy	(11.4)	(15.1)	35.8	20.7	15.4
in % of GDP	37.7	35.9	37.8	37.0	40.9
Deposits from households (EUR mn)	20,270	18,423	25,431	29,560	34,836
growth in % yoy	(9.1)	(9.1)	38.0	16.2	17.8
in % of GDP	22.7	23.2	24.8	23.4	26.4
Total loans (% of total deposits)	205	219	175	163	141
Structural information					
Number of banks	184	182	176	176	176
Market share of state-owned banks (% of total assets)	11	17	17	17	18
Market share of foreign-owned banks (% of total assets)	45	47	43	38	33
Profitability and efficiency					
Return on Assets (RoA %)	1.0	(4.4)	(1.5)	(0.8)	0.5
Return on Equity (RoE %)	8.5	(32.5)	(10.2)	(5.3)	3.0
Capital adequacy (CAR % of risk weighted assets)	14.0	18.1	20.9	18.2	18.1
Non-performing loans (% of total loans)*	17.4	33.8	42.0	40.0	37.5

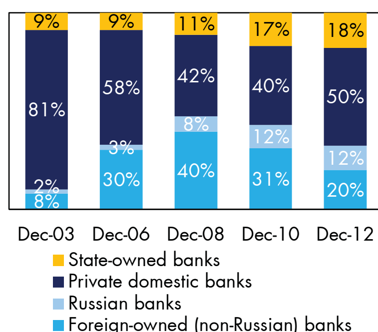
* Average of "unofficial" estimates based on IFRS estimates
Source: NBU, Raiffeisen RESEARCH

Ukraine: Loans (% of GDP)



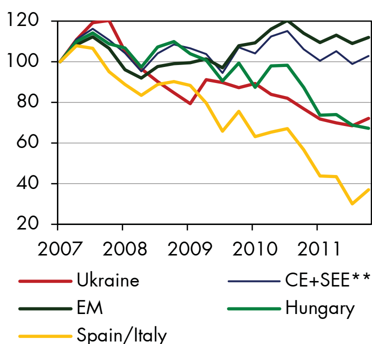
Source: NBU, Raiffeisen RESEARCH

UA: Market shares by ownership*



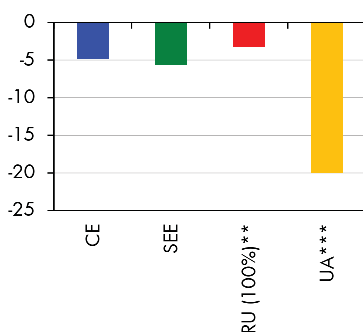
** in total assets*
Source: NBU, Raiffeisen RESEARCH

Cross-border exposure Europ. banks*



** Dec 2007=100*
*** CE+SEE according to the definition of this report*
Source: BIS, Raiffeisen RESEARCH

Market share losses (2008-12, pp.)*



** change in foreign-ownership ratio*
*** 100% foreign-owned banks*
**** Foreign-owned (non-Russian) banks*
Source: National central banks, NBU, Raiffeisen RESEARCH

Focus on: Changing market structure – Non-Western banks in the lead

The spectacular boom story of the Ukrainian banking sector in the years 2005 to 2007, which lead to an overheating and overshooting loan-to-GDP ratio, ultimately turned into a bust in 2008, following drastic changes in domestic and external economic conditions. Growing NPLs and strong deposit outflows resulted in the insolvency of more than two dozens of banks. The government had to step in and nationalize five ailing systemic banks.

Up until today, the banking system has not yet fully recovered and continues to be troubled by macroeconomic uncertainties, high cost of risk and the lack of long-term domestic funding. Banks are still confronted with low loan demand and squeezed margins. In recent years the Ukrainian banking sector also lost access to external funding and experienced an asset-based deleveraging, mostly driven by foreign-owned banks. Western European banks slashed their cross-border exposure towards the Ukraine from some USD 53 bn at its peak level in September 2008 to around USD 30 bn in 2012. Under these circumstances, the market structure of the banking system is undergoing significant changes. The most notable trend is the continuous decrease of the market share of foreign-owned banks. While the Ukrainian banking sector has been one of the major recipients of FDI since 2004, the situation has reverted now. The market share of foreign-owned banks fell to 32% as of end-2012 from 45% back in 2007. Excluding Russian banks, which continue to maintain a fairly strong market presence, the trend has been even more obvious: the share of foreign-owned (non-Russian) banks shrank to 20% of assets in 2012, down from 34% in 2009.

While on average foreign-ownership ratios in CEE experienced a modest reduction in recent years, Ukraine emerged at the top of this trend with a decrease of almost 20pp. since 2008. It is clear now that the very positive expectations of Western foreign banks regarding a potential rapid convergence, (at least) with more advanced CEE economies, have not played out. Hence, it is becoming more and more difficult for international banks to justify their presence in Ukraine to shareholders and other investors. The still relatively high leverage in the economy that was build up in the boom years, uncertain macroeconomic perspectives, a weak legal system (restraining bad loans enforcement) and the lack of a political anchor remain additional factors constraining banking business expectations. As a result, there were several outright market exits of European banks from Ukraine (e.g. Commerzbank, Erste or Swedbank), while most other (non-Russian) foreign players opt to downsize and streamline existing operations (e.g. focusing on particular market segments, such as consumers or multinational corporate customers).For more details on market exits please see table "Foreign banks' transactions in Ukraine's banking sector" on page 61.

Given a still subdued growth outlook for the banking sector in the years to come (at least subdued compared to pre-crisis times), we expect the market share of foreign-owned banks to shrink further. Thus, in 2 to 3 years the competitive landscape of the Ukrainian banking system will most likely very much resemble the situation of 2002/03. The sector will most likely be dominated by private local banks, while state-owned banks will control around 10-15% of the market. The role of foreign (non-Russian) banks will most likely be limited (i.e. commanding a combined market share of less than 10%) with a few large foreign-owned universal banks remaining. The gap left by exiting foreign banks is mainly filled by private domestic banks. The market share

of the latter expanded from 40% to 50% in the last three years. Apparently, local players have a different vision of the market prospects and continue to expand their balance sheets strongly. Moreover, the alleged increase in the scale of related party lending activities might also partly explain the increase in private banks' lending activity. The change in the political landscape in the aftermath of the 2010 presidential elections also promoted the backing of activities of some entrepreneurs with valuable political connections.

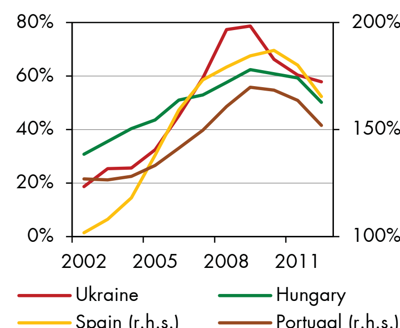
Worth mentioning are the positive medium-term implications for the remaining committed foreign-owned banks resulting from the sketched market trends. The remaining foreign-owned players are likely to be dedicated institutions that are prepared for a volatile and pure "Emerging Markets" style environment in Ukraine (pre-crisis some foreign-owned players may have underestimated the risks on the market). Decreasing competitive pressure among foreign-owned banks may also support a margin increase in their respective fields of operations.

Finally, the Ukrainian banking sector has delivered substantial adjustments as shown by a drop in the loan-to-GDP ratio by around 20pp. (from close to 80% of GDP in 2009 to around 58% of GDP in 2012) and a strongly decreasing loan-to-deposit ratio. If we try to factor in the sizeable shadow economy (estimated at least at some 30% of GDP) in our forecasting model for equilibrium loan-to-GDP ratios (given the current GDP per capita level), the loan-to-GDP ratio in Ukraine currently stands just 3pp. above a sustainable equilibrium level, compared to an overshooting by around 20pp. pre-crisis (without this uplift the distance would be still some 10pp.). The remaining foreign-owned players may catch the upside from the resulting possible increase in business opportunities as the period of much needed and very strong balance sheet restructuring and deleveraging in Ukraine may have come to an end.

Gunter Deuber, Dmytro Sologub

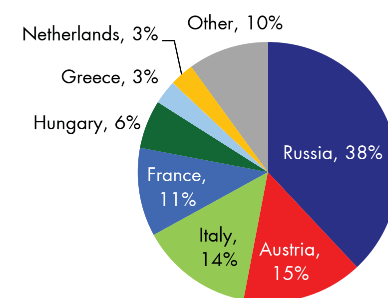
For a more detailled assessment of banking sector trends in Ukraine see also the Raiffeisen RESEARCH Special Publication "Ukraine Banking Sector Report – Down the rocky road, with no paradise in sight", 12 February 2013.

UA: Deleveraging in comparison*



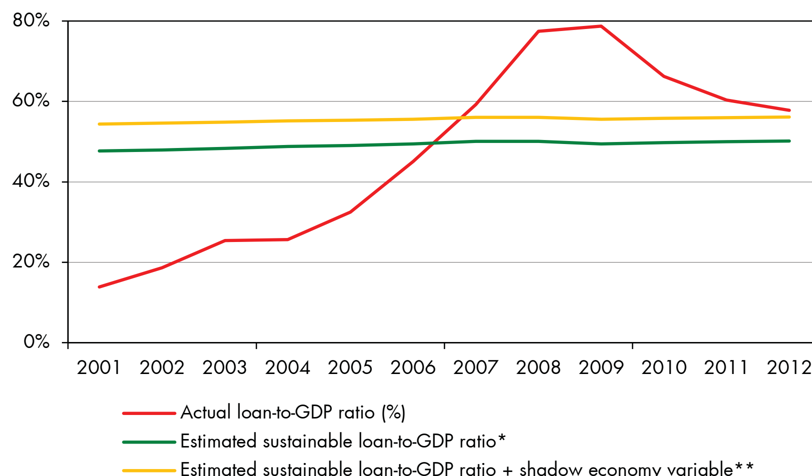
** Loan-to-GDP ratio (%)*
Source: National sources, ECB, Raiffeisen RESEARCH

UA: Foreign ownership structure*



** Share in total assets of foreign-owned banks, end-2012*
Source: NBU, Raiffeisen RESEARCH

UA: Loan-to-GDP ratio vs. estimations of fundamentally backed levels



** Based on positive relationship between loan-to-GDP ratio and income level in large sample of Emerging Markets*
*** Based on positive relationship between loan-to-GDP ratio and income level in large sample of Emerging Markets and factoring a 30% uplift for UA in terms of GDP due to a sizeable shadow economy (estimated at 30-40% of GDP)*
Source: IMF, World Bank, Raiffeisen RESEARCH

Foreign banks' transactions in Ukraine's banking sector (2010-2013)

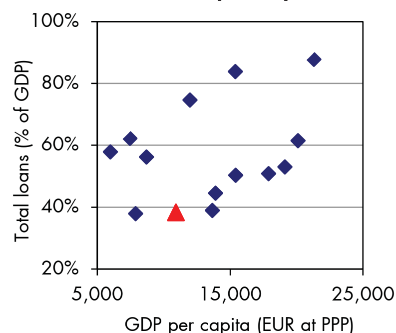
Date	Bank's Name	Owner	Buyer
Dec 2010	Home Credit Bank	PPF Group, Czech Republic	Platinum Bank
Dec 2010	Renaissance Credit	Renaissance Capital, Russia	SCM, Ukraine
Feb 2011	BG Bank	Bank of Georgia, Georgia	Individuals, Ukraine
June 2011	SEB	SEB Bank, Sweden	Individuals, Ukraine
Sep 2011	Volksbank	Volksbank, Austria	Sberbank of Russia, Russia
Nov 2011	Conversbank	Conversgroup, Russian Federation	Individuals, Ukraine
Dec 2011	Vostok Bank	Platinum Bank	Individuals, Ukraine
June 2012	Profinbank	Societe Generale, France	Alfa Bank, Russia
July 2012	Forum Bank	Commerzbank, Germany	SMART-Holding, Ukraine
Dec 2012	Erste Bank*	Erste Group, Austria	Fidobank, Ukraine
Dec 2012	Bank of Moscow*	VTB Bank, Russia	SMART-Holding, Ukraine
H1 2013	Swedbank*	Swedbank, Sweden	Delta Bank

** The deal is not closed yet; Source: Investment Capital Ukraine, Raiffeisen RESEARCH*

Return to more solid growth and profits

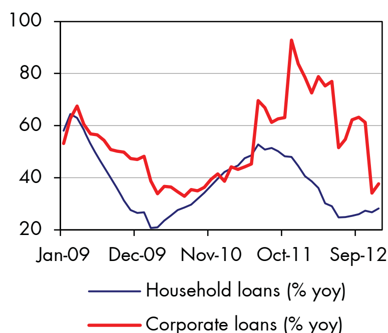
- **Improving macroeconomic resilience bodes well for the banking sector, posting solid profitability in 2012**
- **Robust intake of deposits in 2012 supports further strengthening of loan-to-deposit ratio**
- **Limits on borrowing in FCYs tightened in 2012, affecting parts of corporate loan business**

Total loans vs. GDP per capita



Data for 2012, red triangle shows Belarus vs. all other CEE markets
Source: NBB, national sources, Raiffeisen RESEARCH

Lending growth (% yoy)*



** in LCY-terms*
Source: NBB, Raiffeisen RESEARCH

The year 2012 has seen a return to macroeconomic stability manifested in a significant slowdown of inflation, a fairly stable currency, a rebalancing of external balances and a moderate GDP growth. The recovery of household incomes and higher FX proceeds generated by businesses benefiting from flourishing trade operations also supported the banking sector. The Belarusian banking sector registered a 70% increase in net earnings, pushing the RoE to 12.7%.
In 2012, total assets increased by a quarter, with the assets-to-GDP ratio amounting to 60% by year-end. The loan growth of 37% yoy (in LCY-terms) exceeded the official targets set at 17-23%, despite weaker administrative lending and high interest rates. Given the large gap between the financing cost in FCY and BYR (under the conditions of a stable BYR exchange rate), companies were increasingly switching to FCY loans in H2 2012. In response, the National Bank of Belarus (NBB) restricted FX loans to businesses in late 2012, but excluded loans for export/import operations and (recently) also investment loans. The regulatory move was aimed at dampening the very high loan growth and the existing high currency risks as well as limiting open FX positions. To recap, FX loans to households were banned in 2009. Non Performing Assets registered a slight increase according to local standards, but still remain at low levels of 5.5% thanks to a high payment discipline, government support and further credit expansion (the NPL ratio is in the range of 0.5-1% according to local standards).
The main contributors to the funding base were businesses and households, jointly accounting for over 50% of total banking system liabilities. On the other hand, the NBB reduced its funding support and foreign banks also demonstrated a lower funding appetite. The robust intake of deposits (total deposits up 47% yoy, household deposits up 60% yoy) continued amid, to a great extent, increased salaries, with BYR deposits growing twice as fast as FCY deposits. As a positive result, the loan-to-deposit ratio dropped from around 200% back in 2010 to 140% in 2012, thus adding to the resilience of the Belarusian banking sector.
The Belarusian banking sector remains highly concentrated and dominated by state-owned banks. Out of 32 banks, the top five banks account for 80% of the market. The market share of state-owned banks gradually decreased from 79% in 2008 to 65% last year. Russian banks continue to expand their presence, with a market share of around 25% of total assets and their increasing influence is

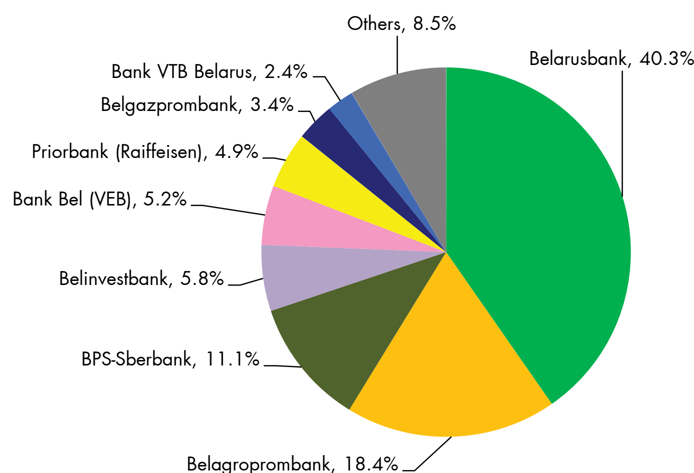
Key economic figures and forecasts

Belarus	2008	2009	2010	2011	2012	2013e	2014f
Nominal GDP (EUR bn)	41	35	42	43	49	53	57
Nominal GDP per capita (EUR)	4,300	3,700	4,400	4,500	5,200	5,600	6,000
Real GDP (% yoy)	10.2	0.2	7.6	5.3	1.5	3.0	4.0
Consumer prices (avg, % yoy)	14.8	13.0	7.7	53.2	59.2	20.0	17.5
Unemployment rate (avg, %)	0.8	0.9	0.7	0.8	0.5	1.0	1.0
General budget balance (% of GDP)	1.4	-0.7	-2.6	2.4	0.5	-1.0	0.0
Public debt (% of GDP)	12.9	22.2	23.3	48.5	31.5	31.0	30.3
Current account balance (% of GDP)	-8.2	-12.5	-15.0	-8.6	-2.9	-5.6	-7.3
Gross foreign debt (% of GDP)	26.4	43.6	50.9	61.1	52.6	47.5	48.7
EUR/LCY (avg)	3,142	3,894	3,951	6,900	10,700	12,300	13,700

Source: National sources, wiiw, Raiffeisen RESEARCH

going to continue – a consequence of the deepening economic integration between Belarus and Russia. Moreover, Belarus installed and launched a Development Bank in 2011 and increased its capital in 2012. The Development Bank extended its operations by taking on new loans from the balance sheets of state-owned banks (68% of the total credit portfolio) and new lending. Effective as of January 2013, changes in the regulatory environment include, among other things, the obligation to disclose full interest rates on loans to customers; the charge of commissions or fees of any kind is prohibited. In the medium-term, this could increase the transparency of the credit market and therefore stimulate the competition, and may help to gradually decrease interest rate levels. Furthermore, in 2012 the NBB introduced tighter capital requirements for local banks, which have to comply with these requirements until 2015. On a positive note there are major improvements of corporate governance standards like the introduction of independent members of the Supervisory Boards to chair new risk and audit committees or the disclosure of the full shareholder structures and beneficiary owners etc. Currently austerity commitments of the EurAsEC financial support package are set to restrain the banking sector expansion somewhat in 2013.

Market shares (2012, eop)



Per cent of total loans
Source: NBB, Raiffeisen RESEARCH

Key banking sector indicators

Balance sheet data	2008	2009	2010	2011	2012
Total assets (EUR mn)	20,726	20,281	32,104	24,019	28,328
growth in % yoy	56.3	(2.1)	58.3	(25.2)	17.9
in % of GDP	48.8	60.6	78.3	94.6	60.9
Total loans (EUR mn)	14,639	15,499	22,355	13,691	17,808
growth in % yoy	58.8	5.9	44.2	(38.8)	30.1
in % of GDP	34.5	46.3	54.5	53.9	38.3
Loans to private enterprises (EUR mn)	10,522	11,614	16,645	10,729	14,265
growth in % yoy	57.4	10.4	43.3	(35.5)	33.0
in % of GDP	24.8	34.7	40.6	42.2	30.7
Loans to households (EUR mn)	4,117	3,885	5,710	2,962	3,544
growth in % yoy	62.4	(5.6)	47.0	(48.1)	19.6
in % of GDP	9.7	11.6	13.9	11.7	7.6
Loans in foreign currency (EUR mn)	4,523	4,582	4,848	5,410	8,101
growth in % yoy	30.3	1.3	5.8	11.6	49.7
in % of GDP	10.7	13.7	11.8	21.3	17.4
Loans in foreign currency (% of total loans)	31	30	22	40	45
Total deposits (EUR mn)	8,570	7,978	10,831	9,093	12,743
growth in % yoy	34.1	(6.9)	35.8	(16.0)	40.1
in % of GDP	20.2	23.8	26.4	35.8	27.4
Deposits from households (EUR mn)	4,337	4,421	5,779	4,539	6,884
growth in % yoy	29.0	1.9	30.7	(21.5)	51.7
in % of GDP	10.2	13.2	14.1	17.9	14.8
Total loans (% of total deposits)	171	194	206	151	140
Structural information					
Number of banks	31	32	31	31	32
Market share of state-owned banks (% of total assets)	79	79	71	67	65
Market share of foreign-owned banks (% of total assets)	17	19	28	32	35
Profitability and efficiency					
Return on Assets (RoA %)	1.4	1.4	1.7	1.7	1.8
Return on Equity (RoE %)	9.6	8.9	11.8	14.9	12.7
Capital adequacy (CAR % of risk weighted assets)	21.8	19.8	20.5	24.7	20.8
Non-performing loans (% of total loans)	0.6	0.9	0.7	0.5	0.5

Source: NBB, Raiffeisen RESEARCH

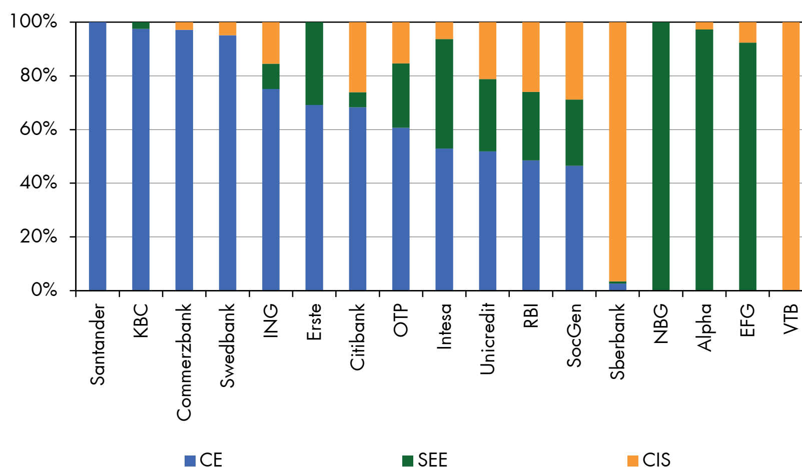
Market players in CEE

- **Largest international players remain committed to the region**
- **Slightly deteriorating earnings in 2012 vs. 2011 due to higher NPL ratios and further lowering of L/D ratios**
- **Non-core (smaller) divestments accelerated, minority share sales in 2013 (UniCredit, Sberbank, VTB, PKO, Santander)**

2012: Still moderate loan growth, slightly deteriorating earnings, but commitment to the region remains

In general, for international banking groups operating in the CEE region 2012 was another year of weak loan growth, improving funding balances and deteriorating profitability. Lower impairments and enhanced cost control could not fully compensate for declining core revenues. Before going into details we would like to note that currency appreciations against the EUR (e.g. end-of-period CZK +2,5% yoy; PLN +9% yoy; HUF +7,5% yoy; RUB +5%) helped the banks to a large extent on both the balance sheet and the Profit and Loss (P&L) accounts. With respect to the strategies of individual banks, the overall picture remained similar to 2011: Banks with a balanced mix of activities in Russia, Poland and Czech Republic were having a particularly good basis for volume and earnings stability, while those banks fully exposed to SEE and forced to rebalance SEE business (e.g. some Greek banks) were suffering significantly. Slovakia contributed solid profits for international banks, although the introduction of the national banking tax caused a slightly negative momentum. According to view of the majority of banks, Hungary and Romania are concordantly the most challenging markets. However, the prevailing political and economic conditions give hope that the worst is over. Significantly increasing losses in Slovenia did not have a material impact on volume growth and profitability of foreign banks, Croatia delivered solid but declining profits yoy, while Serbian earnings were stable but without a clear evidence of a sustainable recovery. Overall, the majority of international banks remains committed to the region, however country- and/or parent-specific circumstances have triggered some strategic re-shuffling: UniCredit exited Kazakhstan, reduced its stake in Poland and merged CZ/SK units; KBC, Erste and Commerzbank disposed of the CIS sub-region; the potential merger between EFG and NBG is still looming although highly uncertain after being recently postponed due to recapitalization need of both banks.

CEE: Regional asset allocation (%, year-end 2012)

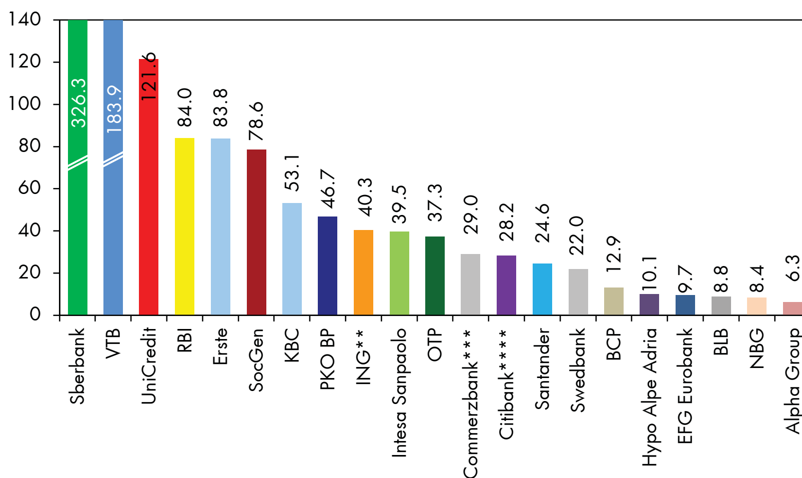


Source: Company data, national central banks

Slight tendency of shifting assets towards CE/smaller players exiting CIS

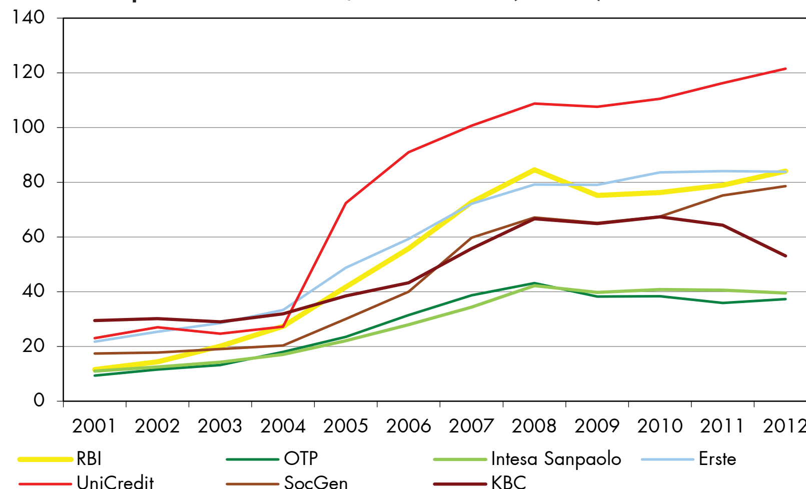
Santander remains the only Western European CEE bank with a focus just on CE (Poland) as of 2012. KBC is to follow a similar regional allocation in 2013 after signing agreement with investors about divesting its Serbian subsidiary in April 2013. Commerzbank should also be exposed only to CE countries in the near future. Swedbank has decided to discontinue its remaining operations in Ukraine and Russia and has signed a share purchase agreement regarding its Ukrainian subsidiary. After finalizing the sale of its Ukrainian unit, Erste exited the CIS region and tends to increase its CE presence in case an opportunity for a market entry in Poland opens up. UniCredit, RBI and Intesa show the most balanced CEE presence, followed by OTP, Citibank and ING. UniCredit has not officially declared any of its SEE countries as "core operation" – further SEE diluting might therefore follow in the medium-term. Sberbank has secured a small market share in CE/SEE with the acquisition of Volksbank International. VTB is a pure CIS bank with no announcements to diversify its presence in other CEE markets. Greek banks – NBG, Alpha and EFG Eurobank – are in fact solely domiciled in SEE, with Alpha and EFG Eurobank still only having marginal shares in CIS.

CEE: Total assets of international banks, consolidated* (EUR bn, 2012)



** considering also the announced but not yet finalized M&A activities*
*** CZ, SK, RO, RU as of 31 December 2011*
**** HU, CZ, SK subsidiary as of 31 December 2011*
***** CZ, RO, HU, BG, RU as of 31 December 2011*
Source: Company data, national central banks

CEE: Development of total assets, consolidated* (EUR bn)

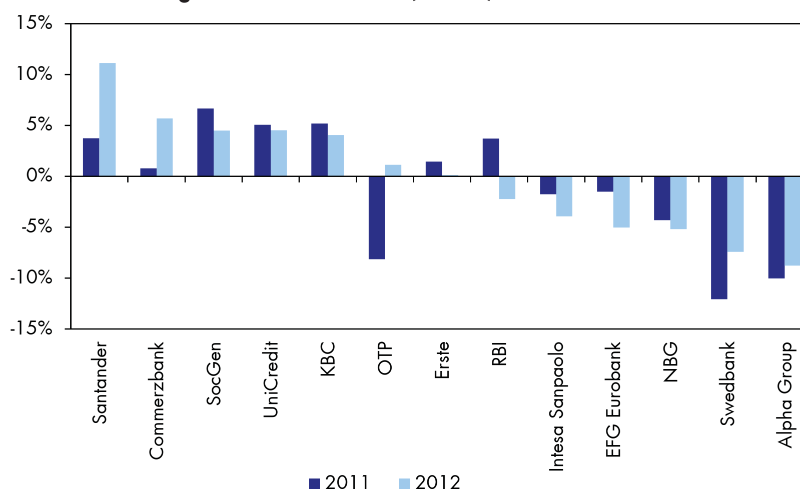


** considering also announced but not yet finalized M&A activities in 2012*
Source: Company data

Almost no changes in size ranking compared to 2011

The size ranking of international banks has remaind almost unchanged significantly in 2012 compared to the year before. The movements are mainly driven by country specific lending trends, a.m. currency movements and – to a lesser extent – by acquisitions/divestments, which have not dominated the ranking as much as in 2010/11 due to lower M&A transaction volumes. The top five banking Groups are still UniCredit, RBI, Erste, SocGen and KBC, followed by ING, Banca Intesa, OTP, Commerzbank and Citibank. KBC's Kredyt Bank sale to Santander as well as RBI's Polbank takeover have been already considered in our 2012 CEE Banking Sector Report, while further minor a.m. divestments, like KBC's Absolut bank stake (regulatory approval outstanding), Erste's exit from Ukraine or Commerzbank's divestment of Bank Forum have not played a substantial role in the ranking. This is also true for UniCredit, which after the disposal of its Kazakh operations still shows a gap of EUR 37.6 bn to the number two RBI. As of now, the potential tie-up between NBG and EFG Eurobank including their SEE units is getting more uncertain after being postponed given the recapitalization need of both banks. Hypothetically, a merger could create a combined unit, which might come closer to the top ten in the region.

CEE: Loan book growth 2012 vs. 2011 (in EUR)*



** adjusted for M&A activities*
Source: Company data

LCY appreciations inflated loan growth on major CEE markets

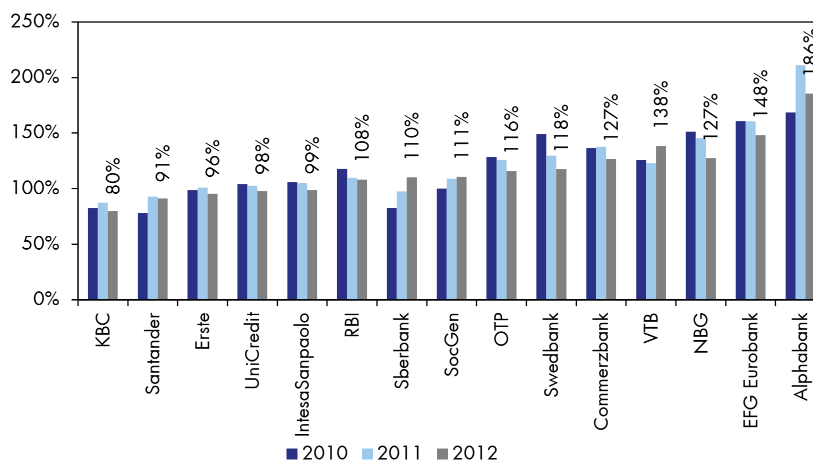
Santander's only presence in Poland has helped the bank to top the loan growth ranking, although this can mainly be attributed to the FX impact (e.g. in PLN terms the growth would only be 2% compared to the reported 8%). The same effect could be observed at Commerzbank, which increasingly was shifting its asset mix to Poland. SocGen posted also a robust growth thanks to its largest units in Russia and Czech Republic and no presence in Hungary. The overall loan performance of Unicredit and KBC in the range of a mid-single digit growth was predominantly caused by Poland, Russia and SEE (UniCredit), or solely by Czech Republic (KBC). RBI, Erste and OTP were broadly flat in EUR-terms – a positive volume/currency impact in Russia (high single-digit), Poland (high single-digit) and/or Czech Republic (more subdued but still positive) was eaten up by exposure cuts in Hungary and Slovenia while – in the case of RBI – also across large parts of SEE. Among the top four largest banks in the SEE sub-region, we observed quite heterogeneous lending approaches in 2012: UniCredit/SocGen had positive trends in Romania, Serbia and Bulgaria, and negative ones in Croatia, while RBI was more selective across the SEE landscape – the same holds true for Erste's BCR in Romania. Greek banks were again on the bottom of the ranks in terms of loan growth. Those banks are on their way to so-called "self-funded SEE operations", with material funding gaps, which will very likely be further reduced over the next years.

Loans and deposits, change 2012/2011 (in EUR-terms)

	Unicredit		RBI		Erste		SocGen		KBC		OTP		Intesa	
Country	Loans	Deposits	Loans	Deposits	Loans	Deposits	Loans	Deposits	Loans	Deposits	Loans	Deposits	Loans	Deposits
PL	9%	6%	96% (-1%*)	81% (5%*)			n.a.	n.a.						
HU	-10%	4%	-6%	8%	-13%	21%	n.a.	n.a.	-10%	4%	-1%	3%	-13%	0%
CZ	4%	13%	-2%	5%	4%	7%	7%	6%	9%	6%				
SK	-1%	14%	0%	0%	6%	5%			2%	14%	4%	11%	3%	1%
SI	-4%	29%	-6%	7%			-5%	1%					0%	15%
LT/EE/LV	-4%	30%												
BG	9%	13%	-3%	-1%			n.a.	n.a.	3%	26%	1%	4%		
RO	7%	17%	-5%	-3%	-3%	-7%	1%	2%			7%	38%	0%	20%
HR	-2%	6%	-8%	-3%	3%	3%	-6%	11%			0%	4%	-3%	2%
AL			0%	2%			11%	8%					0%	0%
RS	9%	21%	-10%	-3%	17%	3%	9%	11%			7%	13%	0%	0%
ME							26%	82%			-4%	-1%		
BH	4%	5%	-7%	-8%									0%	0%
KO			0%	-8%										
MK							2%	10%						
BY			13%	31%										
RU	10%	21%	7%	3%			5%	-9%			24%	30%	-13%	13%
UA	-15%	-1%	-13%	1%							-12%	4%	-25%	0%
MD							39%	13%						

** adjusted for the acquisition of Polbank*
Source: Company data

CEE: Loan-to-deposit ratios of regional segments (2010-2012)*



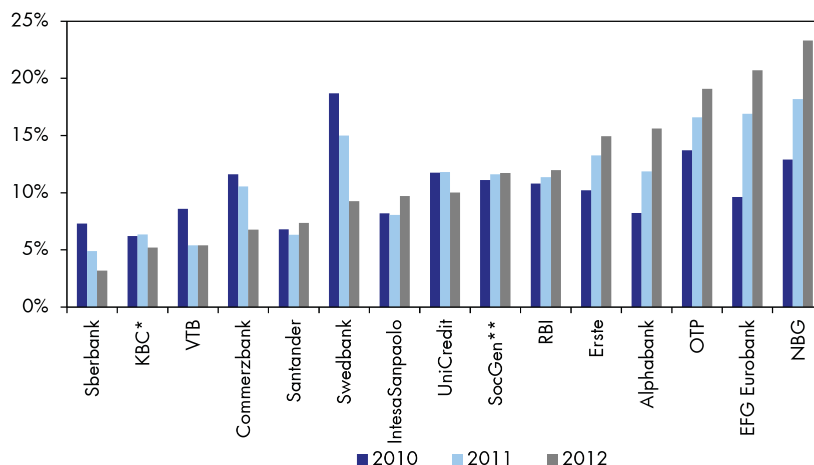
** adjusted for M&A activities*
Source: Company data

Further improvement of regional L/D ratios, but some banks target a trend reversal to support revenues

Decreasing L/D ratios or improving funding balances have continued in 2012 for the third year in a row by slow loan growth and more aggressive deposit collection. Apart from Russian players and SocGen (which is the only foreign bank with a decreasing deposit base in Russia) all international banks lowered their regional L/D ratios. Despite the highest decline reported by the Greek banks, they still show the weakest funding balances in CEE. For a majority of those banks a selective lending approach and optimized deposit growth should be the milestones in their respective business models also during 2013, with deposit generation being very much biased to the general situation on their home market. On the other hand, the majority of international players consider the current funding balances to be already at solid levels – also vis-à-vis the Austrian regulation's recommendation of cutting the L/D ratio for new business to 110% – and would like to see them rising again, particularly in order to support revenues and the overall profitability. From the perspective of several banks the trends are as follows: UniCredit has cut overall L/Ds apart from Poland where the bank rather

focused on the NIM than on deposit volumes. RBI reduced L/Ds in most of its markets apart from Russia and Poland where the inclusion of Polbank in 2012 pushed the L/D ratio up. Erste has massively cut L/Ds in Hungary, but increased it in Romania. SocGen visibly increased L/Ds in Russia (against the trend) and Serbia. And finally, OTP reduced its L/Ds across the entire region.

CEE: NPL ratios of international banks



** Serbian subsidiary not included*
*** NPLs of CZ, RO, RU*
Source: Company data

NPL ratios increased in 2012/in some cases CIS divestments polished up asset quality

We believe that the value of comparing NPL ratios between individual banking groups is very limited due to due to differently applied calculation methods and the limited availability of data (in some cases only for the most important subsidiaries or only on a regional level). We therefore recommend taking a close look on the evolution of asset quality within a particular bank over a specific period of time. Based on figures provided by the banks, we conclude that the overall NPL growth trend in 2012 was still a positive one, though in some cases this trend was interrupted by divestments in the form of CIS market exits. On a country level, Hungary was a weak spot for the second year in a row for almost all major players, but particularly weak for Banca Intesa which apparently followed a delayed clean-up of their loan book. The SEE sub-region and especially Romania were somewhat more harsh for Erste, OTP and SocGen, while in Croatia we observed the deterioration of asset quality on the part of Erste and RBI. In Serbia the asset quality was broadly stable, however without a clear indications on recovery from already high levels, apart from OTP which was historically far above the average. Similar to 2011, the Russian banking market proved to be robust in terms of asset quality – NPL ratios were diluted by above-average loan growth rates (especially RBI, SocGen and Sberbank). It is also worth mentioning that those international players which decided to divest/cut their exposure to CIS have also benefitted mostly in terms of overall regional NPL ratios: the divestment of Bank Forum by Commerzbank, KBC's exit and Swedbank's exposure reduction in Russia, or UniCredit's divestment of their Kazakh subsidiary are the most prominent examples in this context. The asset quality of Greek units in SEE deteriorated again, however the NPL ratio growth might indicate a slowdown of the new formation of bad loans.

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CEE: Finalised and ongoing transactions

Country	Target	Total assets (EUR bn)	Comment
Poland	PKO BP	47.4	Poland sold a total stake of 19.55% in two steps via the stock exchange (July 2012 and January 2013) at ~PLN 32 per share
	Bank Pekao SA	37.0	UniCredit sold 9.1% via accelerated bookbuilding in Jan 2013 at PLN 156 per share or 1.75x 2012 P/B
	BZ WBK	14.7	KBC/Santander sold a joint 21.4% stake (o/w KBC 16%) in the merged BZWBK-Kredyt Bank via a SPO in March 2013 at PLN 245 or 2.0x 2012 P/B
	DnB Nord	0.3	GetinNoble bank acquired the retail portfolio at PLN 5 mn
	Dexia Kommunalkredit PL	0.1	GetinNoble bank acquired 100% of the bank for PLN 57 mn or 0.7x BV
Romania	BCR	16.5	SIF 5 is expected to sell its entire 6% to Erste by the end of 2013 (acc. to the deal conditions) after other SIFs sold their joint 24% stake in 2012
	Citibank operations	0.1	Raiffeisen Bank Romania acquired the retail loan book of EUR 90 mn as well as deposits/AuM in 1Q 2013
	Bank of Cyprus	0.6	TLV and RBI were named among the bidders. The loan book is also exposed to the real estate segment. Recently the Central Bank of Cyprus rejected both offers. The deposits were transferred to the Marfin Bank Romania
	ATE Bank Romania	0.4	Owned to ~70% by Greek Piraeus Bank; the assets were transferred to Piraeus Bank Romania, while the branch network was sold to local investors
	Retail business of RBS Romania	0.3	Recently Unicredit agreed with RBS Romania to buy its retail and private banking business.
Serbia	KBC Serbia	0.3	KBC agreed with Telenor and SocGen to sell its Serbian unit: Acc. to local press, Telenor will acquire 100% stake from KBC and SocGen will purchase a part of the assets/liabilities
Slovenia	NLB	11.5	In-line with its exit strategy from non-core countries, KBC sold a 20% stake for EUR 2 mn or at loss of ~EUR 100 mn
Ukraine	Erste Bank Ukraine	0.9	Erste sold its subsidiary for EUR 63 mn and booked a loss of EUR 94 mn (pre-tax)
	Bank Forum	0.9	Commerzbank sold its 96% stake to Smart Group at a loss of ~ EUR 268 mn in 2012
	Profin Bank (UA)	0.02	SocGen sold its operations to Cyprus-based Xeronia Limited
	UniCredit	4.3	UniCredit announced to merge its two subsidiaries Ukrsotsbank and UniCredit Bank
	Swedbank Ukraine	~0.4	Swedbank signed a share purchase agreement regarding its Ukrainian subsidiary with Mr. Mykola Lagun, the majority owner in Delta Bank.
Russia/ CIS	Absolut Bank	2.7	KBC sold ist Russian subsidiary in 2012
	Promsvyazbank	17.1	Commerzbank finalised the sale of its 14.4% stake; gain of EUR 154 mn booked already in 2011
	Sberbank	374.4	The government sold a 7.6% stake for USD 5.2 bn in 2012
	ATF Bank (KT)	5.0	UniCredit agreed to sell its subsidiary in Kazakhstan at ~1.0 x BV in Q4 12 with ~EUR 260 mn negative impact on P&L and capital
	Belarusbank	n.a.	The former subsidiary of Rosbank (owned by SocGen) was sold to Russian Alfa Bank
Others	Emporiki Bank		Credit Agricole has sold its Greek subsidiary excl. SEE businesses to Alpha Bank
	UniCredit (CZ/SK)	16.7	UniCredit has announced to merge CZ and SK operations
	NBG-EFG Eurobank	n.a.	NBG has announced a merger with EFG Eurobank; the deal would also include SEE operations. In April 2013 the transaction has been suspended

Source: Banks, press articles, Bloomberg

CEE: Potential takeover candidates

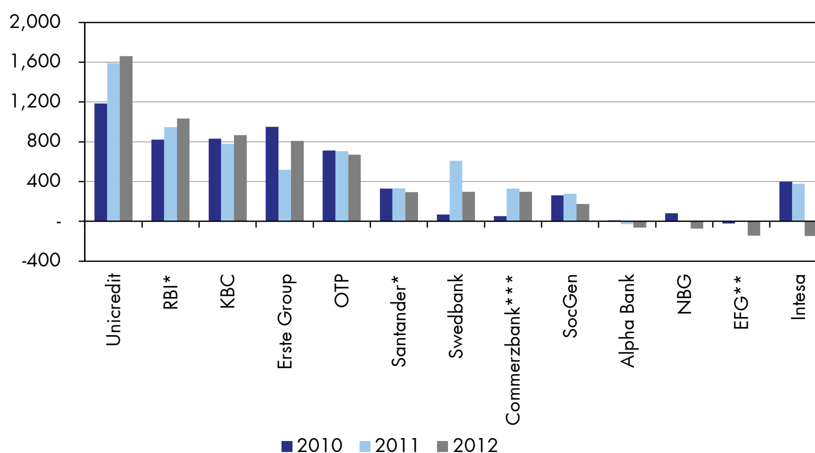
Country	Target	Total assets (EUR bn)	Comment
Poland	Bank Millennium	12.9	The most likely takeover candidate among the top ten banks; the parent BCP will start repaying state aid from 2014
	Nordea Bank	8.1	The bank is expected to be sold in the short term. There have been speculations that PKO and Erste may be possible investors
	Alior Bank	5.2	After the IPO in late 2012, a 30% stake by Carlo Tassara Group should be sold to strategic investors
	BNP Bank	5.1	Recent rumours that the French bank might consider exiting Poland
	BPH Bank	8.4	Subsidiary of GE Money Bank
	GetinNoble Bank	14.4	Owned by Leszek Czarnecki, no rumours at all currently, rather long-term takeover target
	PKO BP	47.4	Government is expected to dilute its current 31% stake further, very speculatively a long-term target
	BRE Bank	25.1	Subsidiary of Commerzbank. Recently Commerzbank re-affirmed its committment to Poland. Also very speculatively a long-term target depending on its parent bank's standing
Czech Republic	CSOB	37.3	Recent rumours that Polish PKO might be interested in the largest KBC subsidiary, which is less likely, in our view, due to the size. KBC has declared CZ as a core market
Romania	Banca Transilvania	6.6	No strategic investor: 10% owned by the Bank of Cyprus; ca. 15% by EBRD, a long-term takeover candidate
	Banca Carpatica	1.1	So far no clear information whether Anacap, a British private equity fund, is still interested in the assets; the owners are looking for a sale
	Nextebank (former Romexterra)	0.3	A deal to sell the bank to the private equity fund PineBridge collapsed in 2012 due to the Central Bank's reticence. According to media, MKB, the majority owner of Nextebank, is actively looking for another buyer.
	Marfin Bank	0.6	The bank is owned by the Cyprus Popular bank and is expected to be sold
Serbia	AIK Banka	1.4	A 20% stake changed hands from ATE to Piraeus Bank; no major strategic investor behind the group
	Komercijalna Banka	2.9	Country's No. 2 in size, EBRD holding 25% and the state 42%, strong retail network, rather a long-term target
Croatia	HPB	2.3	Croatian Postbank: the government has communicated its plan to privatise the last state-owned bank
Slovenia	Nova Ljubljanska Banka Group	11.5	As part of the privatisation strategy, the government will reduce the stake to 25%; recapitalisation and cleaning up of the loan book are currently on the agenda
	NKBM	4.8	As part of the privatisation strategy, the government will reduce the stake to 25%; recapitalisation and cleaning up of the loan book are currently on the agenda
Russia/ CIS	Bank Khanty Mansiysk	5.4	The majority is owned by NOMOS Bank. The remaining 44.2% stake will be tendered by the Khanty-Mansiysk government and might be a subject of the announced merger between Otkritie Bank and NOMOS Bank.
	VTB	178.0	Further privatisation of the government stake – which will be diluted from 75.5% to ~61% following the announced capital increase in April 2013
	Alpha bank	0.2	Alpha Bank plans to sell its small Ukrainian non-core assets
Others	Hypo Group Alpe Adria (SEE assets)	12.6	No change vs. last year: the group will be either put on sale as a whole or as individual parts with significant assets in RS, HR and BH. Recently Erste has been rumoured to be looking at Serbian assets, while Sberbank at the whole group
	Credit Agricole's SEE operations		Before selling Greek Emporiki Bank to Alpha Bank, Credit Agricole transferred direct control of assets in RS, RO and BG to the parent/the assets might become subject to divestment in the mid-term

Source: Banks, press articles, Bloomberg

Profitability

For the first time since the publication of this report we would like to provide an overview of the profitability of all major international banks in the CEE region. Before analyzing individual earnings and its geographical distribution it is worth mentioning that – similar to asset quality – detailed interbank comparison is rather impossible due to apparent differences in segmental reporting. We therefore recommend comparing the profitability of an individual bank in a particular time frame. Proportional pre-tax profit are weighted for the current stake in the particular subsidiary. We also tried to adjust the earnings for recognized book gains/ losses arising from divestments of a particular entity (KBC in SI and RU Commerzbank in CIS) or for any goodwill impairments (e.g. SocGen in RU) in order to focus exclusively on the quality of local operations. For Citibank, ING or GE Money we do not have any P&L data due to limited reporting on the respective CEE level.

CEE: Gross profit in the region (proportional, 2010-2012, EUR bn)



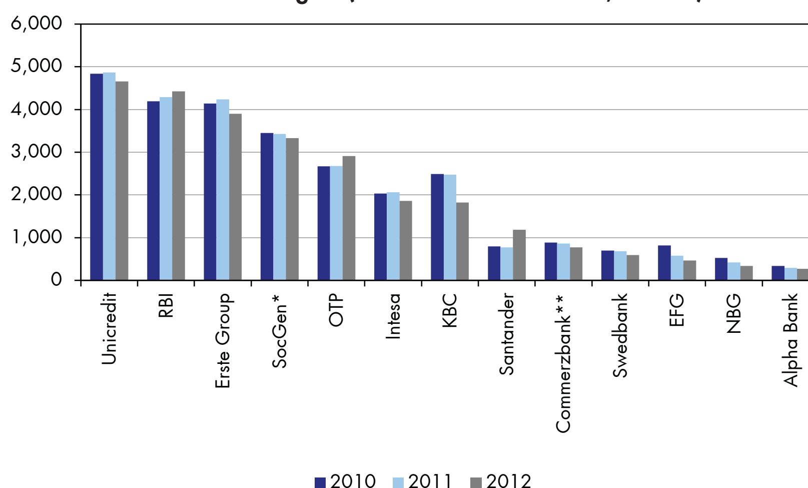
** Polbank (RBI) and Kredyt Bank (Santander) included in 2012*
*** Polbank not included since 2011*
**** contribution from CZ, HU, SK, RU assumed to be the same as 2011*
Source: Company data

The aggregate profitability of non-state owned international banks slightly deteriorated in 2012 vs. 2011

The aggregate profitability of the sample of banks which are part of this sector report (excl. Sberbank, VTB, PKO BP) were measured in nominal terms and showed a slightly deteriorating performance yoy contracting to the 2010 levels. Greek banks (Alpha, EFG, NBG) all sled into the negative territory across their SEE map and together with Swedbank faced soaring provisions in Ukraine, where the most rapid deterioration of earnings was reported in 2012. Among the larger CEE names, the year 2012 was particularly weak for two banks: Banca Intesa due to a still elevated provisioning level (unlike other banks which provisioned heavily in 2011!), a significant revenue decline in Hungary and a soaring loss in Ukraine. And SocGen, who posted the first loss ever in Romania in combination with almost zero profits in Russia, presumably influenced by below average asset quality. KBC and Erste (despite heavy losses in Romania in 2012) posted the highest regional growth rates in relative terms, which is mainly based on better results in Hungary (one-offs from FX mortgage repayment booked in 2011) and positive profit contributions from Czech Republic, while KBC additionally benefitted from a one-off effect from the internal sale of their insurance entity in the Czech Republic. OTP's Hungarian core segment has deteriorated further in 2012 yoy, but with positive momentum in Russia and with a rebound in Bulgaria the overall profitability was only marginally below the last year' level. Russia – RBI's main earnings contributor in 2012 – had compensated for modest CE segment results (integration costs in Poland, banking tax in Slovakia, loss in Slovenia), while RBI's SEE performance was quite robust yoy. The CEE result of Unicredit was slightly better yoy, posi-

tively affected by Russia, Czech Republic (base effect on bond impairment loss in 2011!) and Hungary (no losses at all during 2010–2012!) and pressured on smaller markets like Ukraine, Slovenia and Slovakia.

CEE: Core revenues in the region (consolidated 2010-2012, EUR bn)

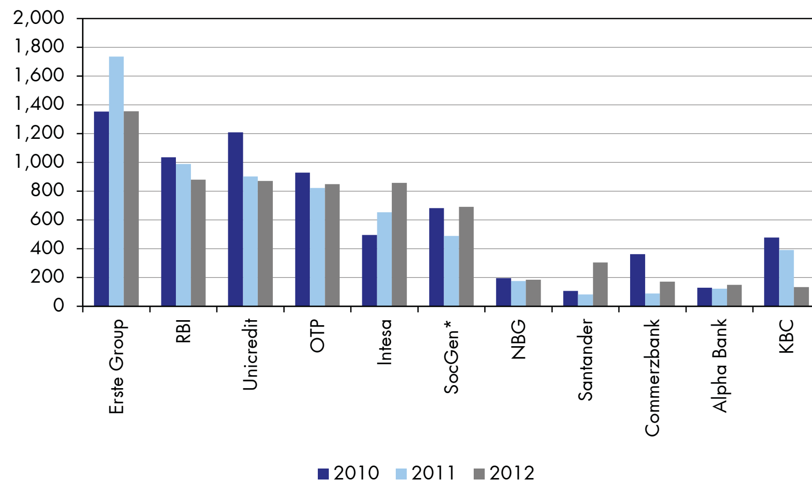


** includes partly Greek operation(Geniki bank)*
*** contribution from CZ, HU, SK, RU assumed to be the same as 2011*
Source: Company data

Revenues supported in Russia/ Czech Republic and Slovakia broadly stable/Poland with pressure after key rate cuts

When looking at core revenues (Net Interest Income + Fee & Commission Income) there was a pressure on NII from a lower rate environment while weaker F&CI was triggered by lower loan origination in H2 2012. Banks with a relatively strong presence in the CIS region (UniCredit, RBI, SocGen, OTP) were able to defend their overall consolidated revenues thanks to Russia, including revenues from Ukrainian operations, which all in all were stable in 2012 yoy. On the other hand, banks with a sole exposure in SEE (like Greek banks), additionally burdened by asset reductions and a more aggressive deposit growth, have clearly faced the strongest decline yoy. With regard to the CE region we observed a moderate negative downward trend in revenue growth, obviously more negative in Hungary and Slovenia than elsewhere. In Czech Republic, where Erste, KBC and SocGen run the largest banks, revenues have marginally eroded due to the pressure on the Net Interest Margin (NIM). A similar environment could be observed in Slovakia, where the top five banks Erste, Intesa, RBI, KBC and UniCredit reported a slight decrease in revenues on weaker NII and flat fee income yoy. In Poland, the positive revenue momentum has visibly come down during 2012, and following the massive key rate cuts since November 2012 this might weigh on the margin outlook throughout 2013. All in all, 2012 was a positive year for almost all foreign players (we note that RBI's and Santander's relative outperformance was inflated by the first time consolidation of Polbank and Kredyt Bank in 2012 respectively).

CEE: Risk provisioning in the region (consolidated 2010-2012, EUR bn)



** calculation includes RO, CZ, RU*
Source: Company data

Improvement in HU and worsening in RO/CE (excl. HU and SI) with stable to slightly higher risk provisioning/ heterogeneous picture in CIS

In times of slightly weakening revenues, risk provisioning has been the major profitability driver during 2012. Erste and KBC both have benefitted mainly from a Hungarian impairment peak in 2011, whereby Erste's cleaning-up of its Romanian exposure in 2012 has absorbed a lot of the leverage achieved in Hungary. RBI and UniCredit recorded quite similar positive trends driven by improvements in CE. On the one hand, the positive Hungarian momentum was partially neutralized by the Polbank-effect at RBI and by the adjustments to the corporate related cost of risk at UniCredit in Poland while both posted only marginally higher impairments in the Czech Republic and Slovakia. On the other hand, the improvements were driven by the moderate deterioration in SEE and, more importantly, by favorable provisioning levels in CIS with UniCredit benefitting from Kazakhstan's deconsolidation effect while RBI reported stable provisioning yoy. Banca Intesa booked higher provisioning in Ukraine, while SocGen was impacted by Russia and Romania, countries with by far the largest relative impairments. In the case of Santander, the sharply growing cost of risk yoy stem from the finalization of the legal merger with Kredyt Bank in early January 2013, or more precisely after the extraordinary revision of the former's loan book quality. Interestingly, Greek banks have not reported much higher provisioning levels in SEE during 2012, which points to the fact that it was rather their deleveraging effort which had a negative impact on the overall profitability.

Pressure on branch networks

It is evident that there was no bank with an expanding branch network in 2012. On average, the aggregate number of branches went down by 4% across the region. Obviously, the banks with divestment programs lost the most: KBC, Swedbank, Commerzbank and UniCredit. As a first step in its merger process Santander closed ten branches in Poland out of the envisaged 40 to 50 branches until 2015. Among Austrian banks it is worth mentioning that RBI increased its number of branches in Poland as a consequence of the takeover of Polbank, but has cut the presence in Ukraine, Hungary and Romania, while Erste reduced the number of units after the decision to sell their Ukrainian subsidiary. Intesa closed more than 100 branches in Ukraine, but has not yet decided to leave the country.

CEE: Market presence and networks of international banks

2012	PL	HU	CZ	SK	SI	EE	LV	LT	BG	RO	HR	AL	RS	ME	BH	KO	MK	BY	RU	UA	KZ	MD	GE	No. of countries	No. of outlets 2012
Sberbank		53	24	41	12						31		26		46			36	18947	208	41			11	19465
Raiffeisen Bank International	416	125	132	163	17				183	527	79	105	85		98	52		100	186	825	1 (leasing)	1 (leasing)		17	3095
UniCredit	1042	122	103	78	35	1	5	2	215	220	141		77		129				109	379				15	2658
Société Générale	n.a.		399		70				150	915	118	43	101	21			27		781			12	38	13	2675
Erste Bank		141	658	297						623	150		68											6	1937
Intesa Sanpaolo		108		242	54					86	211	31	199		54				76	259				10	1320
OTP		380		70					381	89	103		51	31					146	150				9	1401
VTB																		156	1378	125	24		24	5	1707
Santander	889																							1	889
KBC		226	322	121					51				57											5	777
EFG									194	249			108							55				4	606
National Bank of Greece									212	135		27	121				64							5	559
Alpha Bank									88	150		42	134				19			23				6	456
Commerzbank*	181	7	30	11															4					5	233
Swedbank						58	54	82											2					4	196

... Number of branches per country

... only leasing branches

** mBank branches (PL 94 branches, CZ 26 branches, SK 9 branches) not included*

Source: Company data

UniCredit

CEE operations of Unicredit secured the profit for the entire Group in 2012 and again confirmed their importance within the bank. While all other international operations booked a loss of some EUR 2 bn, CEE operations delivered a consolidated profit EUR 2.5 bn (not proportionated), despite the fact that only 26% of the Group revenues stem from CEE operations. UniCredit clearly defines its core markets: Poland, Russia, Czech Republic, Slovakia and Turkey. Driven by rationalization incentives and a better capital allocation, UniCredit announced to merge its Czech and Slovak subsidiaries as well as two Ukrainian units (Unicredit Bank and Ukrsotsbank). In the Baltics, all operations will be managed from one headquarters based in Latvia while the branches in Estonia and Lithuania should be closed. In the course of divestments, its Kazakh ATF Group was sold to KazNitrogenGaz LLP at ~1.0x BV in Q4 2012. Furthermore, UniCredit reduced the majority stake in its largest subsidiary Bank Pekao in Poland from 59% to just over 50% at the end of January 2013 via an accelerated book-building process. Recently Unicredit agreed with RBS Romania to buy its retail and private banking business (assets of EUR 230 mn, liabilities of EUR 230 mn). There are clearly no other divestments planned but in our view some of the non-core markets could be potential subjects for divestments in the mid- to long-term. In Russia UniCredit has been focusing on corporate lending and in its first step to get into the retail segment the bank set up a joint venture with Renault-Nissan, using their branch network for providing car loans. Surprisingly good was the performance in Hungary and Romania in 2012. The bank achieved this strong performance by good management and a defensive business model. Moderate losses were booked in Slovenia and Ukraine only. The outlook in terms of asset quality and profitability remains stable for all CEE subsidiaries. In addition, the bank expects to be able to increase the profitability in Russia and Poland in 2013.

UniCredit

	2012		
in EUR mn	Loans	Deposits	Pre-tax profit
Poland	24,297	27,837	881
Russia	12,462	13,479	556
Croatia	9,302	8,272	160
Czech.Rep.	7,340	9,197	147
Bulgaria	4,404	4,205	124
Romania	3,577	3,107	46
Hungary	3,300	3,527	90
Slovakia	2,914	2,859	17
Ukraine	2,404	1,725	-4
Slovenia	2,256	1,231	-16
Bosnia a. H.	1,477	1,604	39
Serbia	1,357	900	43
Baltics	603	397	1

Source: Company data

Raiffeisen Bank International

Raiffeisen Bank International remains committed to all CEE markets. However, significant rescaling of operations has taken place in Slovenia, where RBI (No. 10) aims to reduce assets and employees by two thirds. In Hungary the bank also focuses on improving the efficiency of operations. In April 2012, RBI closed the acquisition of Polbank and completed the legal merger at year-end 2012. Via the acquisition RBI was able to increase its branch presence from 116 to above 400 and at present targets to leverage the enlarged retail distribution platform. The management expects cost synergies of EUR 50-60 mn annually, to be fully realized by 2015. In March, 2013, Raiffeisen Bank Romania announced the purchase of Citibank's Romanian consumer portfolio consisting of 100,000 customers and EUR 90 mn in gross assets. The management expressed interest in market opportunities (like acquiring customers/portfolios of banks exiting certain countries) and underlined that the current positioning does not require additional growth via acquisitions.

RBI's CEE loan book contracted by 2% in 2012 mainly driven by more selective lending approach in SEE, the consolidation impact of Polbank while being positively influenced by the volume expansion in Russia (+7%). Most other subsidiaries reported contracting loan volumes in EUR-terms. For 2013 management expects to slightly increase customer loans and expects a net interest margin at the level of 2012 on a Group level. From the customer point of view, management plans to retain corporate customers as the backbone of its business and to expand the proportion of business volumes accounted for by the retail division.

Raiffeisen Bank International

	2012		
in EUR mn	Loans	Deposits	Pre-tax profit
Poland	10,451	7,901	6
Russia	9,669	9,609	599
Slovakia	6,645	7,233	134
Czech Rep.	6,380	6,319	99
Hungary	5,231	4,927	-162
Romania	4,226	3,781	101
Ukraine	3,715	2,646	60
Croatia	3,525	3,040	56
Bulgaria	2,883	2,156	11
Bosnia a H.	1,259	1,526	23
Slovenia	1,225	495	-24
Serbia	1,204	1,139	51
Albania	974	2,037	41
Belarus	869	872	46
Kosovo	428	514	15

Source: Company data

Erste Group

Erste Group

in EUR mn	2012 Loans	Deposits	Pre-tax profit
Czech Rep.	19,447	28,012	818
Romania	11,980	8,522	-333
Slovakia	7,093	8,413	237
Croatia	6,522	4,342	99
Hungary	6,430	4,654	-3
Serbia	569	497	9

Source: Company data

In 2012, management of Erste Group shifted its attention towards restructuring of the Romanian and Hungarian subsidiaries. In Romania the new management followed a more aggressive approach, targeting to return to profitability in 2013. Headcount was reduced by 10%, 45 branches were closed, the NPL coverage was improved by 8.5pp. to 58.6%, while the NPL ratio in the Romanian SME and Retail segments improved yoy from 22.7% to 28.3%. Also in Hungary the management started to implement a new strategy focusing on local currency lending and the reduction of parent company funding. In order to return to profitability, further restructuring measures were implemented (12% headcount reduction, closing 43 branches). As Ukraine is not considered to be a core market and given the relatively small size of the Ukrainian operation (total assets of EUR 676 mn i.e. 0.7% market share, 120 branches, 1,530 employees), Erste Group entered into an agreement with the owners of FIDOBANK, a group of companies ultimately controlled by Oleksandr Adarich, about the sale of Erste Bank Ukraine, for a cash consideration of USD 83 mn (about EUR 63 mn).

In recent months, the management expressed its interest in a market entry in Poland. Alior Bank, Nordea and Bank Millennium have been rumored to be possible candidates. However, the CEO stated that considering the current valuation of Polish targets compared to Erste's share price, Erste Group would remain only interested in Poland for a while. With regard to other countries management has stated its interest in Hypo Alpe Adria Serbia, but is emphasizing that such an acquisition has to be a real bargain and should not trigger additional capital requirements (RWAs of around EUR 750 mn at HAA Serbia).

Société Générale

Société Générale

in EUR mn	2012 Loans	Deposits	Operat. income
Czech Rep.	18,659	23,024	556
Russia	15,103	8,315	13
Romania	7,963	7,176	-184
Slovenia	2,271	1,540	n.a.
Croatia	2,259	2,052	n.a.
Poland	2,200	n.a.	n.a.
Bulgaria	1,511	1,154	n.a.
Serbia	1,372	991	n.a.
Montenegro	245	208	n.a.
Albania	242	367	n.a.
Georgia[1]	241	177	n.a.
Macedonia[2]	220	278	n.a.
Moldova	145	138	n.a.

1) as of 30 September 2012
2) as of 31 December 2011
Source: Company data

SocGen remains committed to the CEE region. Apart from CEE, South Africa and the Mediterranean are classified as its core foreign markets. In 2012, large-scale divestments have touched banking markets in other parts of the world (Geniki bank in Greece, TCW in the US and NSGB in Egypt) while only small divestments were carried out in CIS, namely in Belarus (sold to Alfa Bank) and Ukraine. Citing local media in Serbia, SocGen has signed an agreement with KBC Serbia about acquiring a part of its assets/liabilities (around EUR 0.3 bn). A general strategy of SocGen incorporates a 7% market share target on every CEE market and the focus on universal banking across the region. Despite its commitment we understand that the presence of SocGen in countries not matching these criteria could be uncertain. SocGen's most important markets are Russia, Czech Republic and Romania. Poland seems to be on the watch list and considered as interesting market but the current valuation of local banks is seen too high for further expansion. In Russia SocGen's operations are integrated into the RosBank holding with the main target to increase retail deposits and to achieve intra-Group synergies. By far the biggest CEE asset of SocGen is Komercni banka in Czech Republic. While KB was among best local banks in volume growth and flat earnings, SocGen's Romanian subsidiary BRD-GSG slid into the net loss for the first time ever due to soaring provisions. A goodwill impairment for its Russian subsidiary of EUR 250 mn in 2012 is also worth mentioning.

KBC

After being in an advanced stage of finalizing the remaining two divestments in Russia (agreement signed) and Serbia (according to the media agreement with Telenor and SocGen signed end of April 2013), KBC will focus on its core markets: Czech Republic, Slovakia, Hungary and Bulgaria. Recently, KBC has finalized the last two large transactions, namely the sale of the minority stake in NLB, Slovenia and in Kredyt Bank, Poland. Apart from declaring the four remaining countries as core markets for banking business, KBC Group wants to keep its bank insurance model running in all these countries. Quite solid total CEE loan growth in 2012 came from mortgages in Czech Republic and Slovakia, despite a negative effect from the Hungarian FX repayment program. In addition, the net profit of its "cash cow" CSOB in Czech Republic was boosted by the sale of the local insurance unit to the parent company KBC. The aim of this sale is to optimize capital structure within the Group. After losses in 2011, subsidiaries in Hungary and Bulgaria became profitable again. The bank expects positive earnings momentum to continue in 2013 for each particular market. Because of regulatory restrictions, KBC does not intend to expand its presence in CEE countries in the short-term.

KBC

	2012		
in EUR mn	Loans	Deposits	Pre-tax profit
Czech Rep.	18,578	25,053	677
Hungary	4,882	5,706	99
Slovakia	4,242	4,076	82
Bulgaria	673	909	16
Serbia	203	183	-8

Source: Company data

Intesa Sanpaolo

In 2012, Intesa Sanpaolo mainly suffered from high provisioning in Hungary and Ukraine, which drove the total CEE segment results into the negative territory. Nevertheless, the bank does not have a divestment program. The Group's strategy for the region comprises efficiency and asset quality optimization across CEE. The Polish banking market is in fact considered as attractive – the bank already took part in several previous bids for Polish banks – but currently no concrete takeover steps are likely. The bank is rather awaiting the final CRD 4 impact on the Group's regulatory capital, before deciding about possible new investments in the region. The best performing subsidiaries are those in Croatia, Serbia and Slovakia. Intesa is running a branch in the Czech Republic under the brand of the Slovak subsidiary VUB Bank. Russian operations are specialized on small businesses, therefore the growing momentum of this unit is limited; there are no plans to tap the retail market in a short- to medium-term horizon.

Intesa Sanpaolo

	2012		
in EUR mn	Loans	Deposits	Pre-tax profit
Slovakia	7,500	9,200	148
Croatia	6,600	6,400	171
Hungary	5,200	4,700	-441
Serbia	2,500	2,500	92
Slovenia	1,900	1,500	10
Russia	1,300	900	38
Romania	800	600	-25
Bosna a. H.	500	400	9
Albania	300	800	7
Ukraine	300	300	-98

Source: Company data

OTP Group

OTP did not change the setup of its CEE presence in 2012. Exiting non-core countries is currently not on the agenda. All in all, OTP reported a 2% contraction of its loan book in HUF-terms adjusted for FX effects. The L/D ratio declined by 8pp. on a Group level yoy, with the most remarkable adjustments in countries with a low deposit base (Ukraine, Romania, Russia and Serbia). Consumer lending business again proved successful, up 14% mainly driven by Russian operations (+31%), as did the start of consumer business in Ukraine. In both countries OTP focuses on consumer lending while reducing other segments (corporate lending, mortgage and car financing). At OTP in Hungary the bank reported a 7% decline in the loan book impacted by the early repayment of FX mortgage loans (mortgage loans -9% yoy). Still rising NPLs in Russia (NPL ratio up 5.5pp. yoy, against the sector trend) has put a question mark on OTP's consumer finance strategy. The management announced to redefine its product and sales/distribution strategy. Clients in the consumer loan market segment were obviously migrating from the POS segment where OTP ranks number two in Russia towards credit card loans or cash loans dominated by branch network banks. According to the recent statements from the bank, management is eyeing Hungary and some foreign markets for potential acquisitions.

OTP

	2012		
in EUR mn	Loans	Deposits	Pre-tax profit
Hungary	11,065	13,217	402
Bulgaria	3,913	3,349	94
Russia	2,885	2,022	208
Ukraine	2,236	832	9
Romania	1,343	531	-21
Croatia	1,202	1,395	16
Slovakia	999	1,023	-3
Montenegro	504	540	-13
Serbia	308	131	-17

Source: Company data

Commerzbank

2012			
in EUR mn	Loans	Deposit	Pre-tax profit
Poland	17,081	14,233	352
Czech Rep.[2]	1,185	539	n.a.
Hungary[2]	658	349	n.a.
Russia[1]	526	266	n.a.
Slovakia[2]	98	41	n.a.

1) as of 30 September 2012
2) as of 31 December 2011
Source: Company data

Commerzbank

After selling the minority stake of a Russian bank in 2011 and completing the exit from Ukraine (CoBa sold Bank Forum), the German bank is now predominantly focusing on the Polish market via the majority stake in BRE Bank, the fourth largest local bank. CoBa still runs operations in Hungary, the Czech Republic, Slovakia and Russia – altogether accounting for 16% of BRE Bank's size – and focuses mainly on SME customers. Those customers are separated from the CEE segmental results and are mainly funded directly by the parent company showing very high local L/D ratios. BRE Bank's mid-term strategy stipulates a further increase of its retail segment, rebranding it to mBank, achieving a gross RoE of some 15% and a gradual shift from direct FX wholesale funding to local deposits. In 2012, flat aggregated CEE revenues and higher provisioning were partly compensated by a stable development of costs, but overall profitability slightly declined yoy. After selling the 96% share of its Ukrainian subsidiary Bank Forum to the Ukrainian Smart Group in 2012, CoBa has kept only one representative office in Kiev. The total book loss from this sale amounted to EUR 268 mn and was booked in Q2 and Q4 2012, therefore the total reported result from CEE segment was negative. On the other hand, the 2011 profit was positively influenced by a one-off gain from the sale of 14.4% stake in the Russian Promsvyazbank.

(Banco) Santander

2012			
in EUR mn	Loans	Deposit	Pre-tax profit
Bank Zachodni/ PL	10,165	11,555	462
Kredyt Bank/PL	7,192	7,482	-33

Source: Company data

(Banco) Santander

(Banco) Santander is currently only present in Poland where it runs two separate banks: one incorporated after a legal merger between BZ WBK and Kredyt Bank (the operation merger has started in Q1 2013), and another one under the brand of Consumer Bank Polska. The merger process between BZWBK and KB is in its initial stage, which according to Santander's ambitious plan should create one of the most profitable and efficient banks in Poland in terms of revenues and cost synergies. The tie-up is planned to be finalized in 2015 and the new bank is the third largest in Poland at present. While the former BZ WBK is a universal bank, the merged KB (purchased from KBC via share swap with the latter disposing the stake in the new bank via SPO in March 2013) was rather a FX mortgage bank with a small SME portfolio. Santander considers Poland to be among the top ten core markets of the group. The current exposure to Poland is under 2% of total assets but the country contributed already some 4-5% of the group's net profit in 2012. From a mid-term perspective, Santander could be among those players with a more active role on the M&A front in the CE or even the CIS region.

Swedbank

2012			
in EUR mn	Loans	Deposits	Pre-tax profit
Estonia	6,142	5,360	180
Lithuania	3,916	4,078	117
Latvia	3,878	3,030	116
Ukraine	421	0	-123
Russia	350	41	7

Source: Company data

Swedbank

Swedbank is one of the biggest universal banks in the Baltics with a market share of some 28% and remains committed to this sub-region. Swedbank has decided to discontinue its remaining operations in Ukraine and Russia and has signed a share purchase agreement regarding its Ukrainian subsidiary with Mr. Mykola Lagun, the majority owner in Delta Bank. As a first step of a gradual cutback of operations in Russia and the Ukraine, Swedbank earlier exited the retail segment in both countries. All Ukrainian outlets were closed and today the Russian operation consists of one branch in Moscow and one in St Petersburg. As a consequence, the bank currently owns just a small corporate book in these countries. Funding of those loan books is secured by the parent bank. Baltic banking has recovered and remains an important market for Swedbank. In Estonia, which represents nearly half of Swedbank's Baltic lending portfolio, its market share stands at approximately 40%, in Latvia and Lithuania each at around 22%. Obviously, the bank does not plan any further expansion to other CEE countries. In terms of CEE profitability it is worth mentioning that this was heavily impacted by Ukrainian loan impairments.

National Bank of Greece and EFG Eurobank

The most important event for NBG was in fact the announcement of a merger with EFG Eurobank which could also have an impact on their SEE operations. However, in April 2013 the deal has been postponed, as both banks need to recapitalize in order to meet the Greek central bank's solvency criteria. Therefore, the final outcome of the merger remains highly uncertain. Nevertheless, according to the initial schedule the legal merge was expected in June 2013 with the operational merger starting straight afterwards with targeted 3 years of full implementation. In the SEE region earning synergies were estimated at EUR 70-80 mn, mainly on the cost side and to less extent from revenues/funding. Hypothetically, the "new NBG" would be among the top three banks in Romania, Bulgaria, Serbia and Macedonia and could come close to the top ten largest non-state owned international banks in CEE. Despite a weak operational performance there is no official divestment plan in the SEE markets (although disposals are not ruled out), but management has set up a restructuring program including a reduction of branches and staff. The ongoing deleveraging in SEE pushed total lending of NBG stand-alone down by 9% yoy. Coupled with the 2% increase in deposits over the same period, this contributed to a further improvement of the Group's L/D ratio, which should also continue in 2013. According to the bank, the funding gap including capital was closed at the end of 2012. The bank assumes a peak of the NPL ratio in 2013 and a slight decline of cost of risk this year. The Romanian market is seen as the most challenging at the moment. We observe similar deleveraging effects at EFG stand-alone as well. EFG remained profitable in Serbia while in other SEE countries the Group reported a net loss.

National Bank of Greece

	2012		
in EUR mn	Loans	Deposits	Pre-tax profit
Bulgaria	3,045	2,400	n.a.
Romania	1,936	800	n.a.
Macedonia	800	1,000	n.a.
Serbia	707	700	n.a.
Albania	223	200	n.a.

Source: Company data

EFG Eurobank

	2012		
in EUR mn	Loans	Deposits	Pre-tax profit
Romania	2,955	1,741	-67
Bulgaria	2,760	2,181	-64
Serbia	1,058	786	14
Ukraine	657	307	-30

Source: Company data

Alpha Bank

The restructuring of the Greek banking sector has affected Alpha Bank as well. Alpha acquired Emporiki Bank from Credit Agricole, however the SEE units of Credit Agricole were not a part of the deal. The SEE core markets of Alpha Bank are Romania, Serbia, Bulgaria and Albania. The subsidiaries in Ukraine and Macedonia are declared as non-core markets and might be a potential subject for future divestments, but so far there is no clear statement on this. The official wording with regard to its SEE operations is to run self-funded subsidiaries. That said, the aggregate funding gap of Alpha's Balkan units decreased by EUR 0.8 bn to EUR 1.8 bn over the last year. Further deleveraging is on the agenda in the medium-term as well. In general, gathering deposits has been pretty much influenced by the situation on the parent banking market particularly in H1 2012. After the elections in Greece in mid-2012, the environment has slightly improved. Alpha subsidiaries could materialize this stabilization in the form of a return to deposit collection across the SEE region, especially in Romania. The bank does not expect any turnaround in SEE profitability in the next period, which is mainly argued by the peak of NPLs being still ahead and by the before mentioned weak new loan origination in the favor of lowering L/D ratios (e.g. deleveraging to be continued). The idea of setting up a SEE holding with a minority participation of private/supranational investors has been off the table for almost about one and a half years.

Alphabank

	2012		
in EUR mn	Loans	Deposits	Gross profit
Romania	3,025	1,241	-22
Serbia	780	585	-15
Bulgaria	742	341	-23
Albania	377	450	2
Ukraine	101	58	n.a.
Macedonia	69	69	-4

Source: Company data

Sberbank

Sberbank

	2012		
in EUR mn	Loans	Deposits	Gross profit
Sberbank group[1]	258,967	236,832	10,699
Kazakhstan	2,650	2,596	n.a.
Ukraine[2]	2,091	1,320	n.a.
Czech Rep.[3]	1,783	1,503	n.a.
Belarus[3]	1,545	723	n.a.
Slovakia	1,333	1,378	n.a.
Hungary[4]	1,253	887	n.a.
Slovenia[4]	828	405	n.a.
Croatia[4]	740	747	n.a.
Serbia	651	257	n.a.
Bosnia a. H.	323	333	n.a.
Bosnia a. H. BL[4]	187	106	n.a.

1) whole group excluding Denizbank
2) including VBI acquisition
3) as of 30 September 2012
4) as of 31 December 2011
Source: Company data

The Russian Government sold its 7.6% stake in Sberbank via a Secondary Public Offering in a transaction, which amounted to USD 5.2 bn in Q4 2012, but has kept the majority holding of 50% plus one share without a concrete statement about further privatization steps. Sberbank follows a universal bank approach with a heavy focus on the retail segment. The share of the retail segment went up by 5pp. in 2012 to 28%. This increase was partially supported by the recent acquisition of Volksbank International (with one transaction Sberbank acquired seven banking licenses in CEE) and Deniz Bank in Turkey. Sberbank is the undisputed number one in Russia with a market share of 27%, or almost 22% in the entire CIS region. It stands for some 45% of the total Russian banking sector's net profit. Its market position in the investment banking segment was strengthened by the acquisition of Troika Dialog in 2011, while its retail presence was boosted by the foundation of a joint POS bank with Cetelem in 2012. In addition, a life insurance segment was set up. Sberbank has already fulfilled its 2014 targets of delivering sustainable RoE of over 20%, with 5-7% net income to be generated from the non-Russian market. There is no official plan for further CEE expansion, however Sberbank has been speculated from the market about to be interested in acquisitions across the region.

VTB

VTB

	2012		
in EUR mn	Loans	Deposits	Gross profit
VTB group[1]	126,081	91,070	2,861
Ukraine	2,328	1,088	
Kazakhstan[2]	349	239	
Armenia	321	188	
Belarus	296	405	
Georgia	157	103	

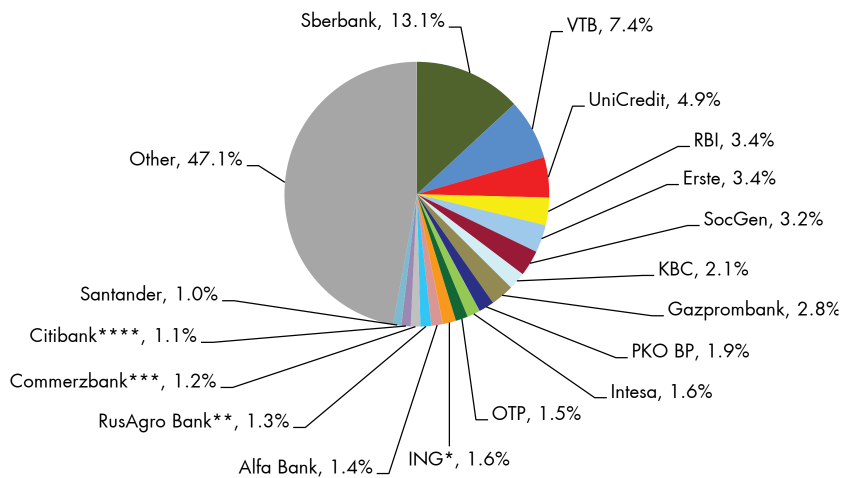
1) VTB total group
2) as of 30 September 2012
Source: Company data

VTB is a universal second largest state-controlled Russian bank. It does not focus on Corporate and Investment Banking solely. Its clear strategy is to increase retail banking (via PoS lending) in Russia. The official target market share of PoS plus cash loans is 25%, quite similar to Sberbank. For this purpose, VTB established a new subsidiary "Leto bank", aiming to attract mass but also low-income segments (over 8 mn new clients in 3-4 years) and with an envisaged branch network size of more than 1,000 units for the next 3-4 years mainly in „non-capital" regions. Despite its aggressive retail lending strategy, risk adjusted margins are still attractive (lending yields varying between 20-30%, while cost of risk are at 10%). VTB expects the total cost of risk to stabilize, also accounting for a certain pressure on the retail front (cost of risk of 10% to 15%). End of April 2013, VTB has announced the details on the capital increase worth USD 3.3 bn by selling 2.5 tn of new shares with the major purpose being the strengthening of the Tier 1 ratio. According to the bank, both existing and new investors made commitments fully covering the share sale, whereby the Russian State stake will be diluted from 75.5% to 60.9% which fits into the long-term privatization strategy of the government. The funding of VTB looks stable. The bank has worldwide possibilities to obtain funding in different currencies. Currently, the company does not intend to establish a footprint in CEE markets apart from the CIS region. VTB is interacting with CEE customers through international offices in Austria, Germany and Switzerland. Russia is the core-market and its Ukrainian investment represents the largest foreign subsidiary in the region, but is considered as quite a challenging undertaking.

Two new Russian names under top 15 CEE banks

In 2012, new Russian banks joined the list of the top 15 CEE banks, namely Alfa Bank and RusAgro Bank, with a market share of 1.4% and 1.3% respectively. This increases the number of Russian banks within the top 15 to five. With organic and M&A growth, Sberbank gained another 1pp. in the CEE market share yoy due to strong asset growth. Since 2009, the average growth of Sberbank's total CEE market share was at some 130bp p.a. Gazprombank and VTB both slightly gained 0.1pp yoy. On average, West European players lost 10-40bp yoy: Unicredit -10bp, Erste -40bp, RBI -40bp, SocGen -10bp, KBC -40bp, Intesa -20bp and OTP -10bp yoy. The largest Western European bank in CEE still remains Unicredit with a market share of 4.9%, followed by RBI and Erste, each at 3.4%. Société Générale is slightly behind with 3.2%. The divestment program of KBC caused the drop of its market share to 2.1%. The largest Polish state-controlled bank PKO BP (including its small subsidiary in Ukraine) holds a market share of 1.9%.

Market shares in CEE (in % of total assets, 2012)

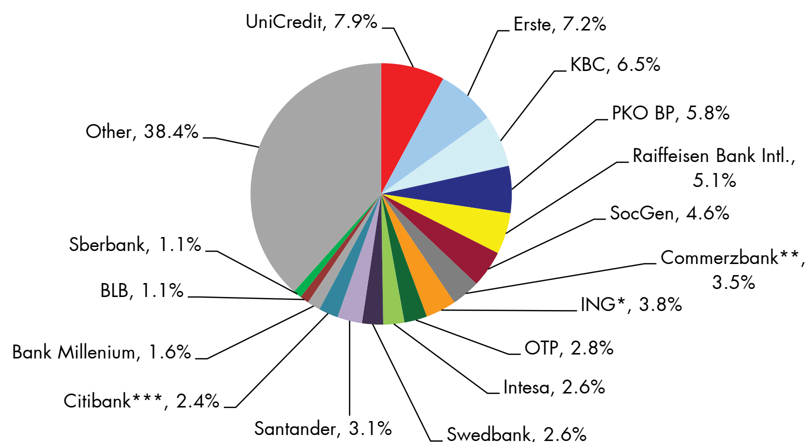


CEE: PL, CZ, SK, HU, SI, LT, LV, EE, RO, BG, HR, RS, MD, BH, AL, KO, MK, RU, UA, BY, KZ
** CZ, SK, RO, RU, UA as of 31 December 2011*
*** as of 30 June 2012*
**** as of 31 December 2011*
***** CZ, HU, RO, BG, RU as of 31 December 2011*
Source: Company data, national central banks

Polish presence is key for the market share in CE

From a sector point of view, aggregated banking assets in the CE region grew by 1.0% yoy in EUR-terms. The biggest part of this growth was contributed by Santander (+130bp additional market share yoy), Unicredit (+70bp), PKO BP (+40bp) and Commerzbank (+30bp). All those banks are significantly exposed to the Polish market. In addition, the good performance of the Polish market was inflated by the appreciation of the Zloty. The market share of other international players remained broadly flat during 2012, which is particularly observed at banks with a high exposure to the Czech Republic and Slovakia: Erste gained 10bp, RBI lost 10bp, KBC remained unchanged (the weak development in Hungary was offset by positive developments in the Czech Republic), and SocGen gained 20bp because of its solid volume growth in the Czech Republic. Among other names, OTP kept its market share stable yoy, while Intesa lost 10bp. The latest newcomers in the CE region, Santander and Sberbank, have a market share of 3.1% and 1.1% respectively.

Market shares in CE (in % of total assets, 2012)

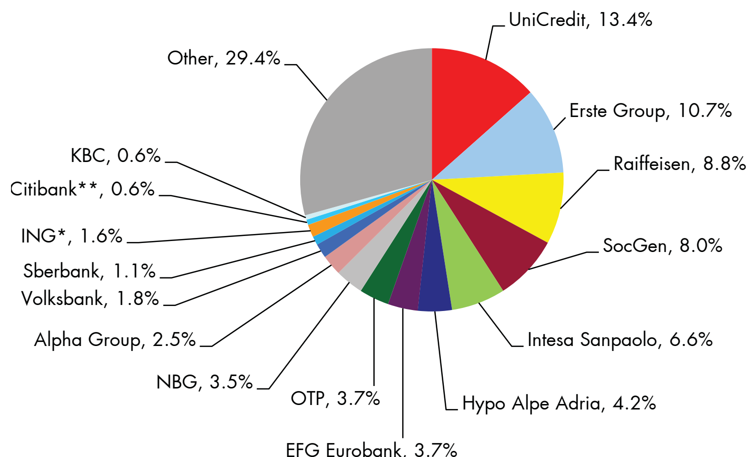


CE: PL, CZ, SK, HU, SI, LT, LV, EE
** CZ, SK as of 31 December 2011*
*** CZ, SK, HU as of 31 December 2011*
**** CZ, SK, HU as of 31 December 2011*
Source: Company data, national central banks

No big changes in SEE ranking

The SEE market is characterized by a relative high concentration. Unicredit is leading the market, with a share of 13.4% – an increase of 20bp yoy (with Croatia representing almost half of Unicredit's total SEE exposure). Due to a large exposure in Romania and Croatia as well as a smaller exposure in Serbia, the second biggest SEE bank is Erste Bank with a market share 10.7%, despite the decrease of 50bp yoy triggered by the Romanian market. The SEE market share of RBI dropped from 9.6% to 8.8%, but RBI still comes in third position in the asset ranking. SocGen's SEE market presence went down slightly by 10bp yoy (a decrease in Romania was partly neutralized by the growth in other markets). While UniCredit gained 20bp, Intesa lost 30bp mainly due to a weaker performance in Croatia. OTP gained moderate market share in SEE (+10bp) after increasing the assets in all SEE markets apart from Montenegro. We also observed the slowdown of market share decline on the part of Greek banks in the region: NBG lost 20bp, Alpha Bank lost 10bp and EFG Eurobank lost 40bp. Hypothetically, the merger between NBG and EFG Eurobank – which at the moment does not appear likely in the short-term - might create a bank with a total market share of 7.2% and therefore secure a top 5 position in SEE.

Market shares in SEE (in % of total assets, 2012)

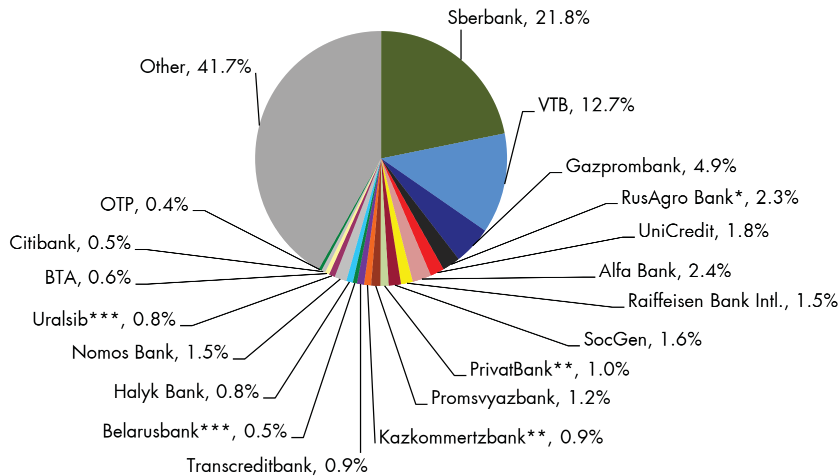


SEE: RO, BG, HR, RS, MD, BH, AL, KO, MK
** RO as of 31 December 2011*
*** BG, RO as of 31 December 2011*
Source: Company data, national central banks

UniCredit lost 50bp market share after signing agreement to exit Kazakhstan

The dominant player in the CIS region is still Sberbank, with a stable market share of 21.8%. VTB keeps the second position, with 12.7% of the market. The biggest Western-European player in CIS is Unicredit with a market share 1.8%, distorted by Kazakh's disposal and supported by an organic growth in Russia and Ukraine. All in all, the total CIS market share of Unicredit fell by 50bp yoy. The good performance of RBI's Russian subsidiary was offset by a weak performance of its Ukrainian subsidiary, decreasing the market share of RBI by 30bp yoy. SocGen consolidated all its Russian activities into the Rosbank Group with a market share in the CIS region of 1.6%. OTP managed to keep the market share stable at 0.4%.

Market shares in CIS (in % of total assets, 2012)



CIS: RU, UA, BY, KZ
** as of 30 June 2012*
*** as of 30 September 2012*
**** as of 31 December 2012*
Source: Company data, national central banks

Key abbreviations

EU-27 incl. Eurozone

Austria	(AT)	Greece	(GR)
Belgium	(BE)	Italy	(IT)
Denmark	(DK)	Latvia	(LV)
Estonia	(EE)	Lithuania	(LT)
Finland	(FI)	Netherlands	(NL)
France	(FR)	Spain	(ES)
Germany	(DE)	Sweden	(SE)

CEE Central and Eastern Europe

CE The markets in Central Europe

Czech Republic	(CZ)	Slovakia	(SK)
Hungary	(HU)	Slovenia	(SI)
Poland	(PL)		

SEE The markets in Southeastern Europe

Albania	(AL)	Croatia	(HR)
Bosnia a. H.	(BH)	Romania	(RO)
Bulgaria	(BG)	Serbia	(RS)

CIS The markets in the former Commonwealth of Independent States

Belarus	(BY)	Ukraine	(UA)
Russia	(RU)		

Other CEE countries

Georgia	(GE)
Kazakhstan	(KZ)
Kosovo	(KO)
Macedonia	(MK)
Moldova	(MD)
Montenegro	(ME)

GDP	Gross Domestic Product
PPP	Purchasing Power Parity
yoy	year on year
ytd	year to day
qoq	quarter on quarter
FX	foreign exchange
FCY	foreign currency
LCY	local currency
bn	billion
mn	million
BV	Book value
bp	Basis points
BIS	Bank for International Settlement
CAGR	Compound annual growth rate, average growth per year
CAR	Capital Adequacy Ratio
EBA	European Banking Authority
ECB	European Central Bank
EMU	European Monetary Union, Eurozone
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
excl.	excluding
IIF	Institute of International Finance
IFIs	International Financial Institutions
IFRS	International Financial Reporting Standards
L/D ratio	Loan-to-deposit ratio
NIM	Net interest margin
No.	Number
NPLs	Non-performing loans
OENB	Austrian National Bank
pp.	percentage points
RoA	Return on Assets
RoE	Return on Equity
SIFI	Systemically Important Financial Institution
SSM	Single Supervisory Mechanism

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