CESEE-related abstracts from other OeNB publications

The abstracts below alert readers to studies on CESEE topics in other OeNB publications. Please see *www.oenb.at* for the full-length versions of these studies.

Ukraine's banking sector: still very weak, but some signs of improvement

Stephan Barisitz, Mathias Lahnsteiner

Ukraine has been undergoing a reform process, and the banking sector is certainly among the areas that have seen remarkable progress. The authorities started to tackle related-party lending (a long-standing structural impediment), resolved many undercapitalized banks and managed to restore a degree of confidence in the sector, as witnessed by the stabilization of deposits. As part of the banking sector clean-up, the country's largest credit institution was nationalized. This step contributed to considerable changes in the ownership structure, with the share of the state in total assets rising to about 50%. After the severe recession of 2014–2015, macroeconomic stabilization achieved with international support in 2016, if sustained, could pave the way for a resumption of lending. Yet, nonperforming loans (NPLs) have skyrocketed, credit risk is still very high, related-party lending is still a problem, resistance to reform remains stubborn, and economic recovery fragile, subject to political uncertainty. Further sound economic policies, progress with structural reforms (in particular with regard to the rule of law and corruption) and efforts to reduce NPLs appear essential to make a sustained banking recovery possible.

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What drives Austrian banking subsidiaries' return on equity in CESEE and how does it compare to their cost of equity?

Manuel Gruber, Stefan Kavan, Paul Stockert

This short study analyzes the relative profitability of Austrian banking subsidiaries in Central, Eastern and Southeastern Europe (CESEE) using two separate approaches. First, we address the subject from an accounting point of view based on a DuPont analysis. We dissect the return on (the book value of average) equity (ROE) to highlight how profit and loss drivers as well as financial leverage affected this profitability metric from 2004 to 2016. This prepares the ground for our second part, where we switch to a market perspective for the period from 2006 to 2016 to deduce the cost of (average) equity (COE) of these subsidiaries from the Capital Asset Pricing Model (CAPM) in order to compare the model-based profits that would be expected (i.e. demanded) by investors to those that have actually been realized. The analysis is complemented by a similar exercise for a peer group consisting of listed CESEE banks.

We find that the ROE dropped substantially during the global financial crisis and only started to recover in 2016. An accounting-based DuPont analysis reveals that – over the entire analyzed time span – this was primarily caused by a rise in risk costs at the onset of the global financial crisis and their strong improvement in 2016, as well as a continuous reduction of financial leverage. The negative contribution of a lower operating income margin and positive effects of an improved cost-income ratio roughly canceled each other out. We also provide a (cautious) medium-term outlook for the future development of the ROE of Austrian banking subsidiaries in CESEE, which is likely to depend on the balance between the weakened net interest income and reduced credit risk costs (that still have to prove their sustainability). When switching to a market perspective and the question of the subsidiaries' COE,

we find that the latter is substantially lower than often assumed, but still too high to be fully compensated by realized profits (except in 2016). In aggregate, other CESEE peer banks fared better, which was mostly due to their higher profitability. These results call for continued and persistent efforts to further improve Austrian banking subsidiaries' risk-return profile in CESEE.

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