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## CEE – Austrian Banks Look beyond the Crisis

The Austrian economy has developed very successfully over the past few decades. Austria has grown to one of the most competitive economies worldwide, with a strong focus on exports, combining cooperation between the industrial sector and the banking sector. This has been the key for success. But aside from the strength of Austrian companies and economy being part of this story, a lot more can be attributed: Austria's engagement in Central- and Eastern Europe (CEE) has been the backbone of its prosperity. We have been pioneers and first-movers in the region, helping to develop the economies following communism. Helping develop those economies has been the engine for our success in the past and made us strong and experienced to overcome the current crisis. Our goal is to come out of the crisis stronger, in an ideal competitive position in our home markets, Austria and CEE.

Reading international newspapers today, one can easily get the impression that the Austrian economy and particularly the Austrian banking industry are overextended. Is this true that our engagement in CEE has been a mistake, like international experts tell us? Was it wrong to concentrate on Central and Eastern Europe? Here there is a clear answer: No, it was by no means the wrong decision!

### The Financial Crisis – a Global Crisis

First of all, the current financial and economic crisis is a global crisis. It is not a crisis purely focused on Central and Eastern Europe or on any other single region. The banking industry throughout the world has been harmed by this crisis and it is in no way only limited to banks engaged in these particular emerging markets.

I am convinced that Austria's involvement in CEE was a question of taking advantage of an opportunity of historic dimensions. Austrian banks were pioneers in this region. We have helped to establish a modern banking industry. Taking into account the proximity, a common history and culture, it was in our very own economic and political interests to support these particular countries during this important transition process.

Back in the year 1989, when the *iron curtain* fell, Austria was a successful economy. But our industry was very dependent on the German industrial sector. More than one third of Austrian exports went to Germany, as compared with only 5% to Central and Eastern Europe.

### CEE as Stimulating Factor

The Austrian industry accepted the chance to enter a new market of more than 300 million consumers. Over the past 20 years Austrian enterprises have directly invested more than EUR 50 billion in Central and Eastern Europe. This makes Austria number three regarding FDIs in this region after, Germany and the Netherlands. In 2008, 23% of Austrian exports were directed to this region.

All this came in line with fundamental changes in the Austrian industry. Labour-intensive production was relocated, competitiveness increased and production enlarged. A clear win-win situation for all parties evolved. Many Austrian companies became international players and in Austria alone some 500,000 additional jobs were created over this period. GDP per annum grew significantly more than in the previous years.

To put it all into a nutshell: for more than 20 years Central and Eastern Europe has, by no means, been a source

for fragility or asymmetric shocks, but rather a source for economic growth and prosperity for many countries; not just for Austria but also for the other European partners and even beyond.

### The Crisis as a Challenge

The current crisis is the most serious challenge faced by the CEE countries since the transition process began in 1989. As previously mentioned, the current crisis did not originate in the CEE region and is not limited to any country, sub-region or industry.

Although the negative impact of the current crisis for the CEE states is unquestionably strong, one should not lose sight of the fact that this is a truly global crisis that impacts all economies, both for developed and emerging markets.

So what is the impact for Austria and its banking industry? Austria's exposure to Central and Eastern Europe is approximately EUR 200 billion. More than 70% of this is located in EU Member States. Furthermore, more than 80% of all loans are covered by local deposits throughout the region.

This simple analysis makes the investment safer and clearly reduces the risk for Austria in total.

The current crisis has impacted the region while the CEE region's convergence process is still in a comparatively early stage: I think it is safe to say that in our industry, the region as a whole has only around one-third of that process behind it to date.

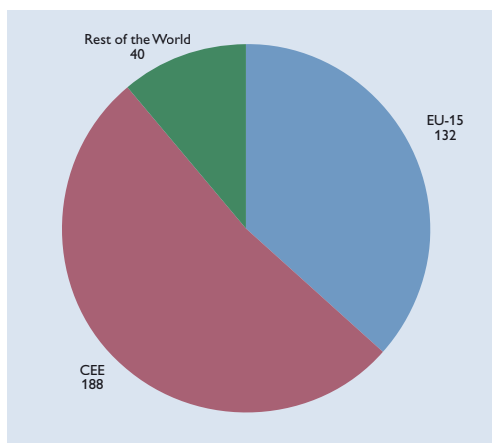
Also, for this reason we highly welcome international financial institutions and governments preparedness to provide relevant states in the CEE region with support when, where and how the individual states require it. At this point one should particularly mention the important actions taken by the International Monetary Fund. It has been a quick, strong and far-sighted support for CEE. This engagement is also working in close accord with the banking sector and the leading international financial institutions such as the European Investment Bank, the EBRD and the World Bank. This is exactly the help that is needed.

To ask, if the Austrian Focus on Eastern Europe has been a source for

Chart 1a

### Total Austrian Exposure

EUR billion

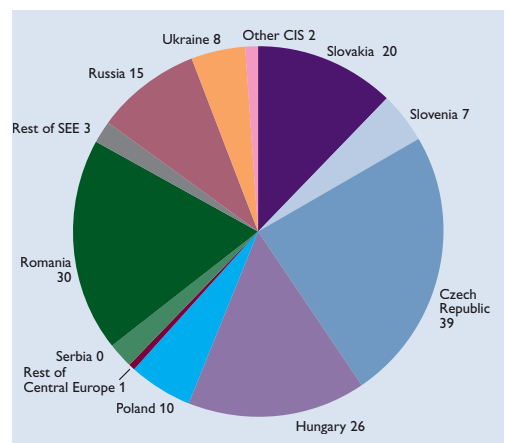


Source: BIS, Raiffeisen Research.

Chart 1b

### Austrian Bank Claims in CEE

EUR billion



Source: BIS, Raiffeisen Research.

fragility or asymmetric shocks today is not legitimate. The crisis did not emerge in those countries and is not restricted to those countries.

### High Potential for the Future

The facts are clear: If the Austrian economy does not want to reduce its scope and focus only on its domestic markets then there can be no alternative for the Austrian economy other than to pursue the opportunities offered by CEE's continuing transformation process. Central and Eastern Europe is an important and strategic market close to us with 300 million potential customers. This region remains a highly interesting and convincing market for banks: in the new Central European Member States of the European Union, 20% of adults still do not have their own bank account. In Romania and Ukraine, this figure reaches 50%. This just demonstrates the growth potential for the banking industry.

A further indicator for future growth potential is average income. In Austria the average monthly gross wage stands at EUR 2,868 (according to *wiiw Current Analysis and Forecast*; July 2009). In the new Central European Member States of the European Union, the average wage is EUR 900, in South-eastern Europe it is EUR 500 and in Russia EUR 470. Once the crisis is overcome, the inhabitants of this region will continue their efforts to reduce this gap. This bias will be further boosted in 2011, when states in Western Europe will open their own labour markets for the new Member States.

The *convergence story* has not come to an end. CEE remains interesting for the financial industry, for Austria and for Europe as a whole. The region still promises higher productivity growth than Western Europe, boosted by high

education standards and competitive tax systems. Favourable real exchange rates due to weak currencies offer opportunities for exporters.

The banking sector, compared to the EU average is underdeveloped. The CEE region will regain its role as Europe's *engine for growth* as the current crisis recedes over the next two to three years.

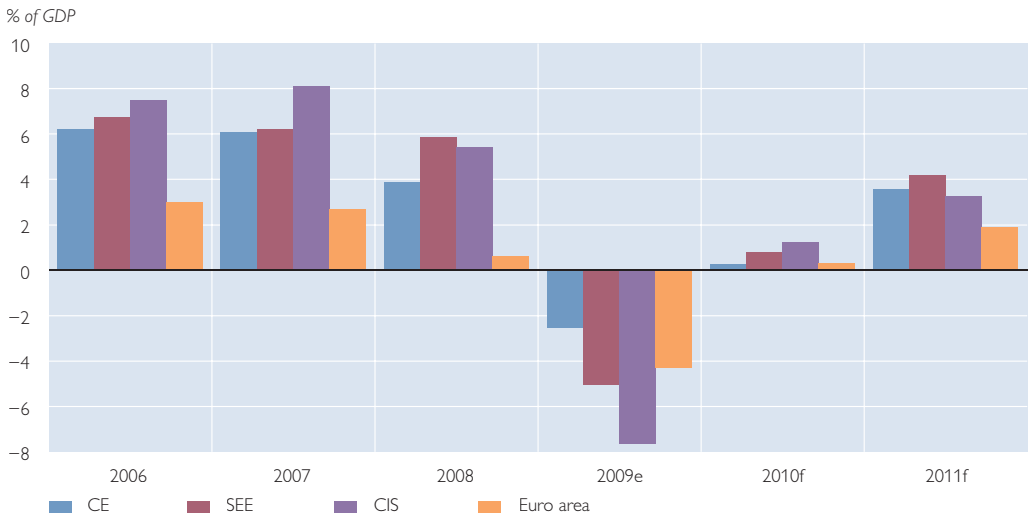
### CEE – Growth Engine for Europe

Looking to the future, the CEE growth engine is unlikely to outperform the advanced economies in Western Europe in the same proportions as it did in the past. However, that development is welcome, as it makes overheating less likely. The future growth differential is likely to be around 2 to 3 percentage points – compared to 3.5 to 4.5 percentage points in the past.



Finally: Could the Austrian Focus on Eastern Europe be a source for fragility or asymmetric shocks for the future? The answer remains clear: No, the opposite is true. Austria's focus on CEE is a source for growth and continues to provide promise for ongoing significant potential.

**Current Economic Situation**



Source: Raiffeisen Research, Thomson Reuters.

Yes, it was right to take advantage of this unique opportunity. It was the right decision to invest in these markets, and we remain committed to continuing this journey. Austrian banks, and the Austrian economy as a whole

made the most of this opportunity and have benefitted. Working together with these important CEE markets, the future of Austria will see us return to the path of growth.