

FINANCIAL SECTOR ADVISORY CENTER (FinSAC)

# Renewed supervisory challenges in light of tightened financial conditions and economic slowdown

May 9–10, 2023 | Vienna, Austria

Session 1: Challenges of the new environment:  
vision from banks

Presentations by:

Philipp Mayer – Erste Group Bank

Gábor Szigel Tamás – OTP Bank

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Erste Group Bank AG

Credit Underwriting FI and Sovereigns

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Gabor Szigel

Senior Internal Advisor, OTP Bank



RENEWED SUPERVISORY CHALLENGES IN LIGHT OF TIGHTENED  
FINANCIAL CONDITIONS AND ECONOMIC SLOWDOWN  
09/05/2023

# Challenges of the new environment: vision from banks

Philipp Mayer  
Erste Group Bank AG  
Credit Underwriting FI and Sovereigns

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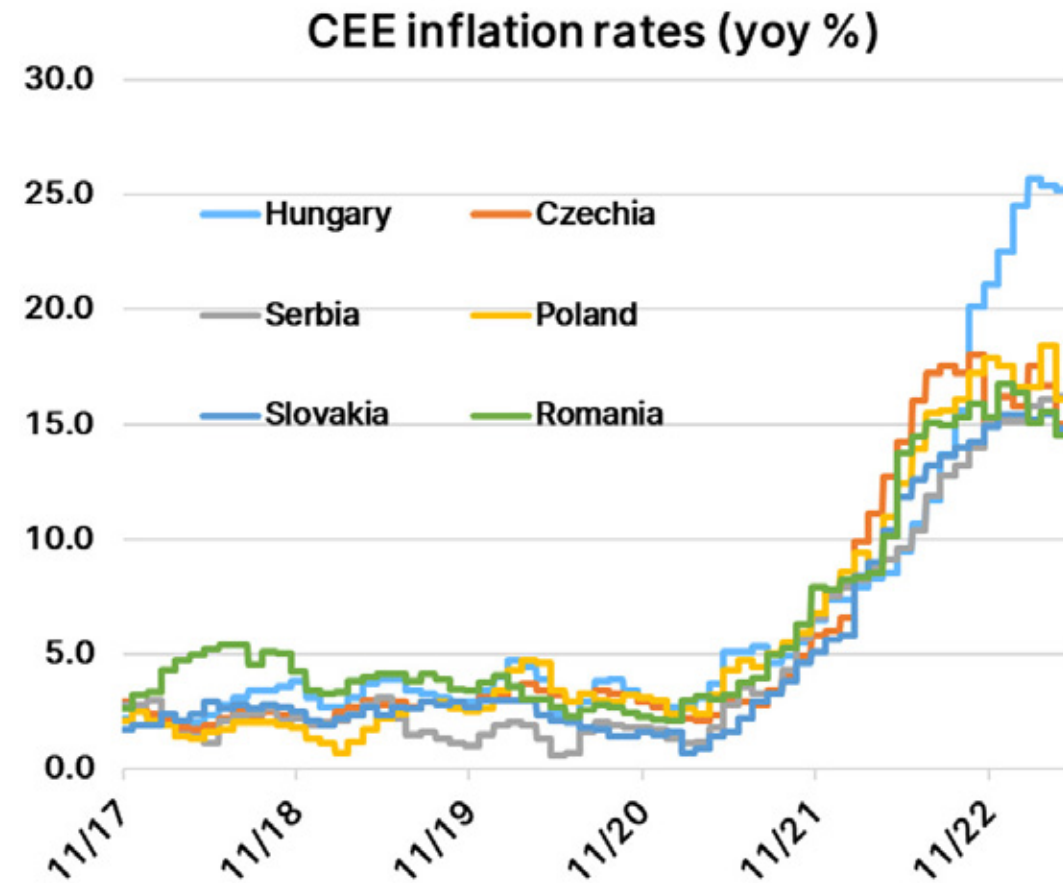
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# Multiple Challenges Ahead For CESEE But Manageable

Challenge	Pre-Pandemic and Pre-War	After
Interest rates / inflation	„Lower for longer“	“Higher for longer”?
Demography / Labour markets	Low unemployment rates	Increasing shortage of labour
Fiscal policy / Public debt	Widely prudent and low debt	Higher debt / scaling back support
Geopolitical + Political Risks	Overall low	Significant / Rising
Energy diversification/availab.	Widely seen as no issue	Of highest priority
Macroeconomic imbalances	Low but rising in 2020	Expected to be contained
Industry / Manufacturing	Very strong development	Underperformance
Operational Sanction Risk	Low	Increasingly important
Convergence	Continuously	To continue with some pause

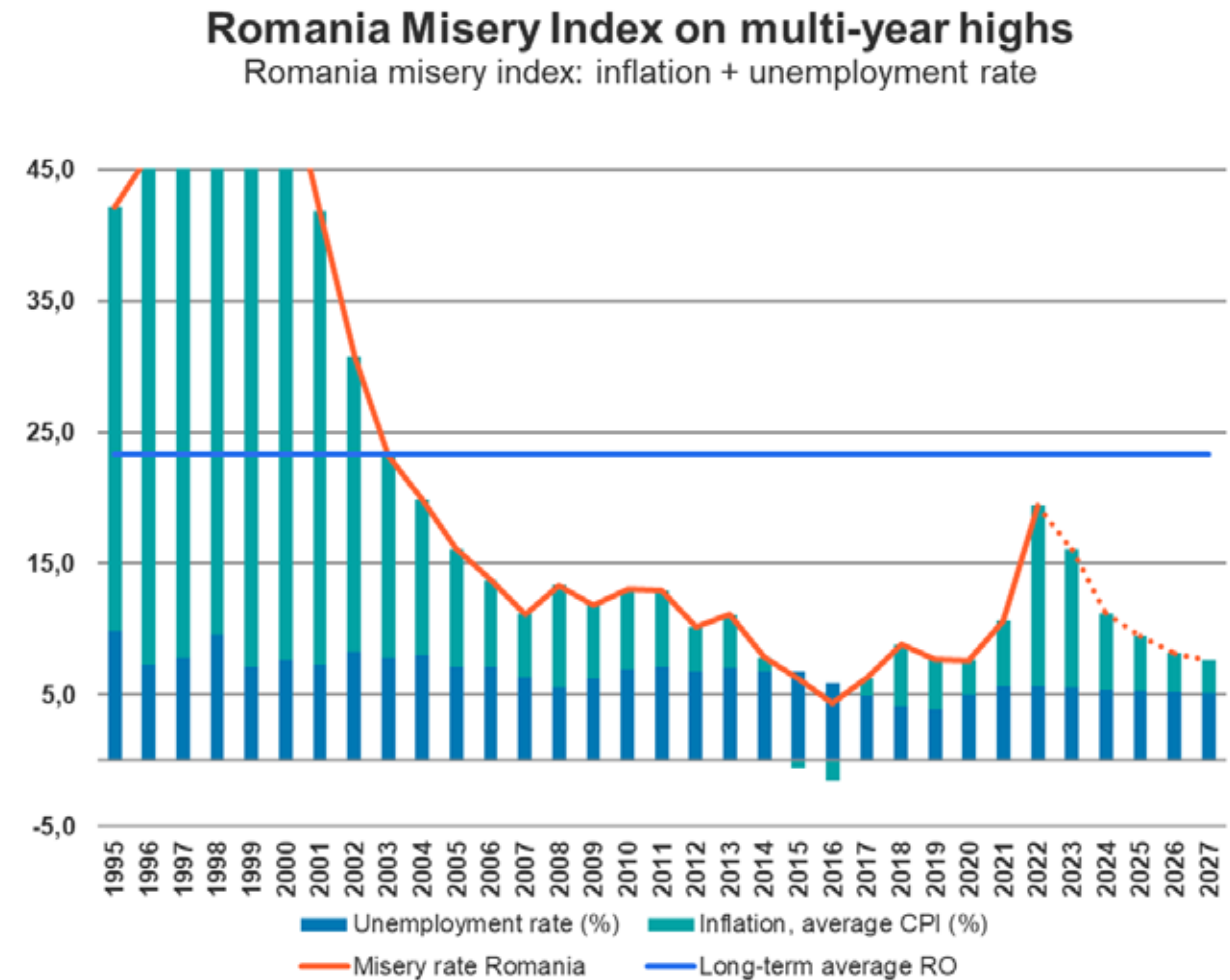
# Challenge 1: From "Lower For Longer" To "Higher For Longer"?

– Paradigm "lower for longer" unfolded



Source: Bloomberg / Erste Group.

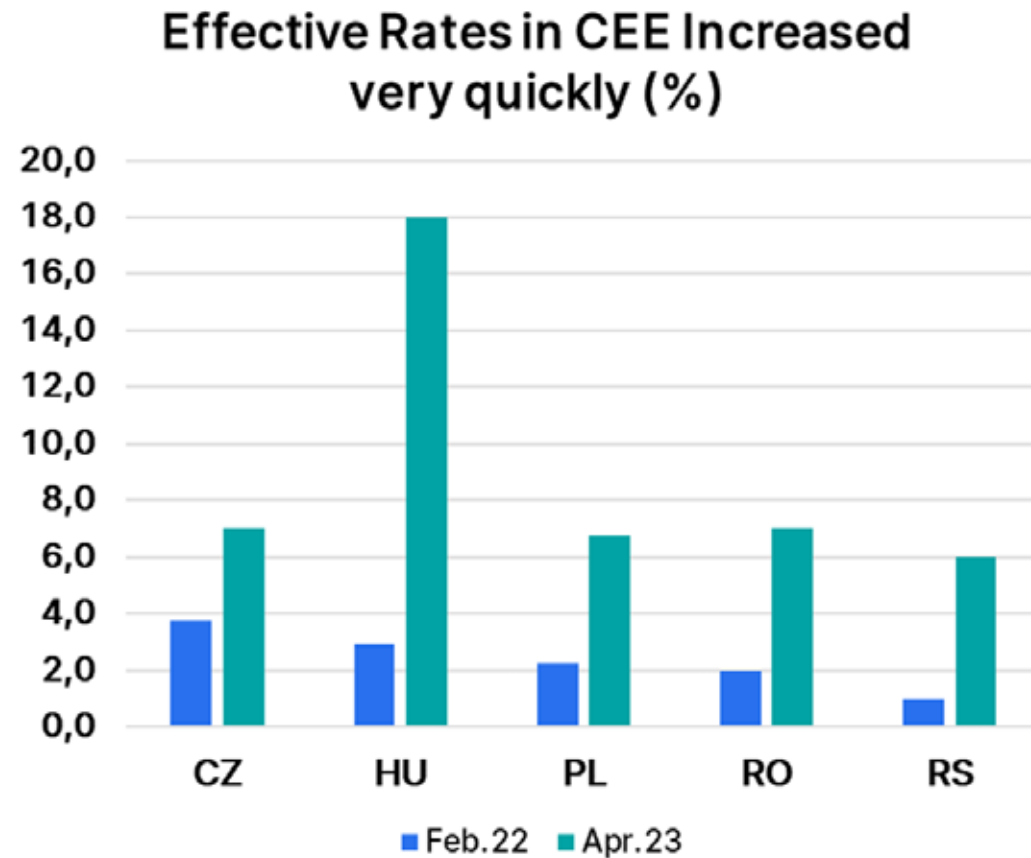
- Creating obvious potential issues for our customers



Source: IMF WEO April 2023 / Erste Group.

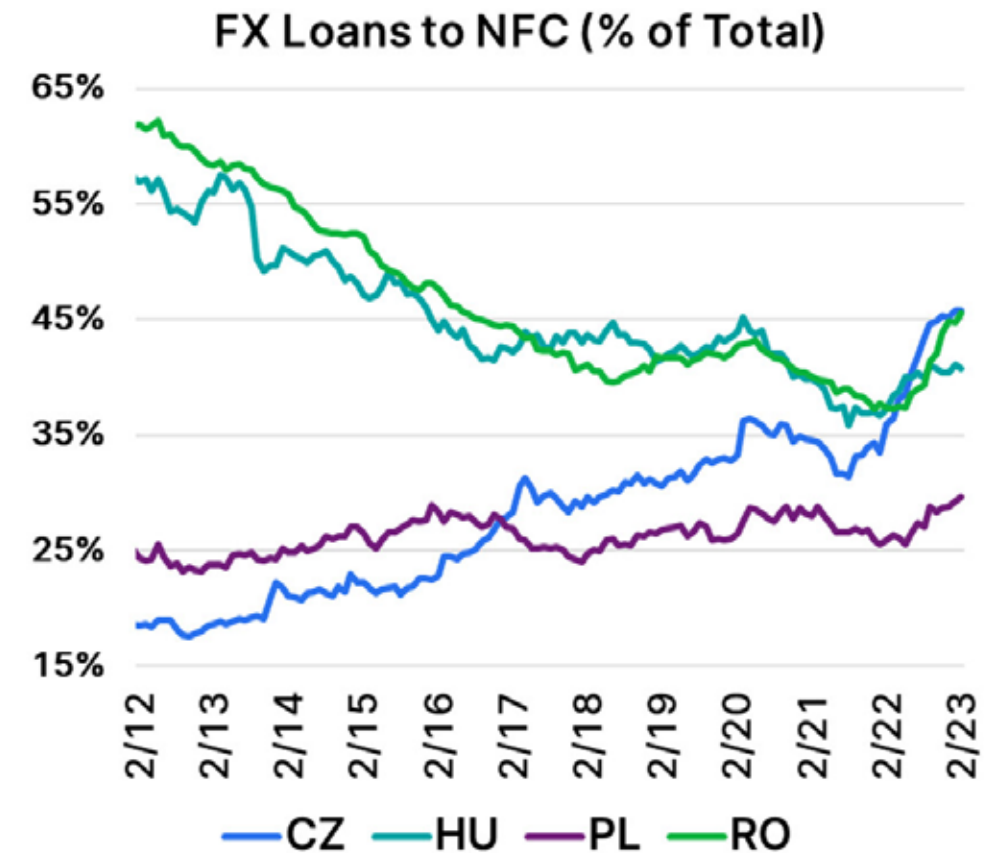
# Challenge 1: From "Lower For Longer" To "Higher For Longer"?

– Risk for "Higher for longer"?



Source: Bloomberg / Erste Group.

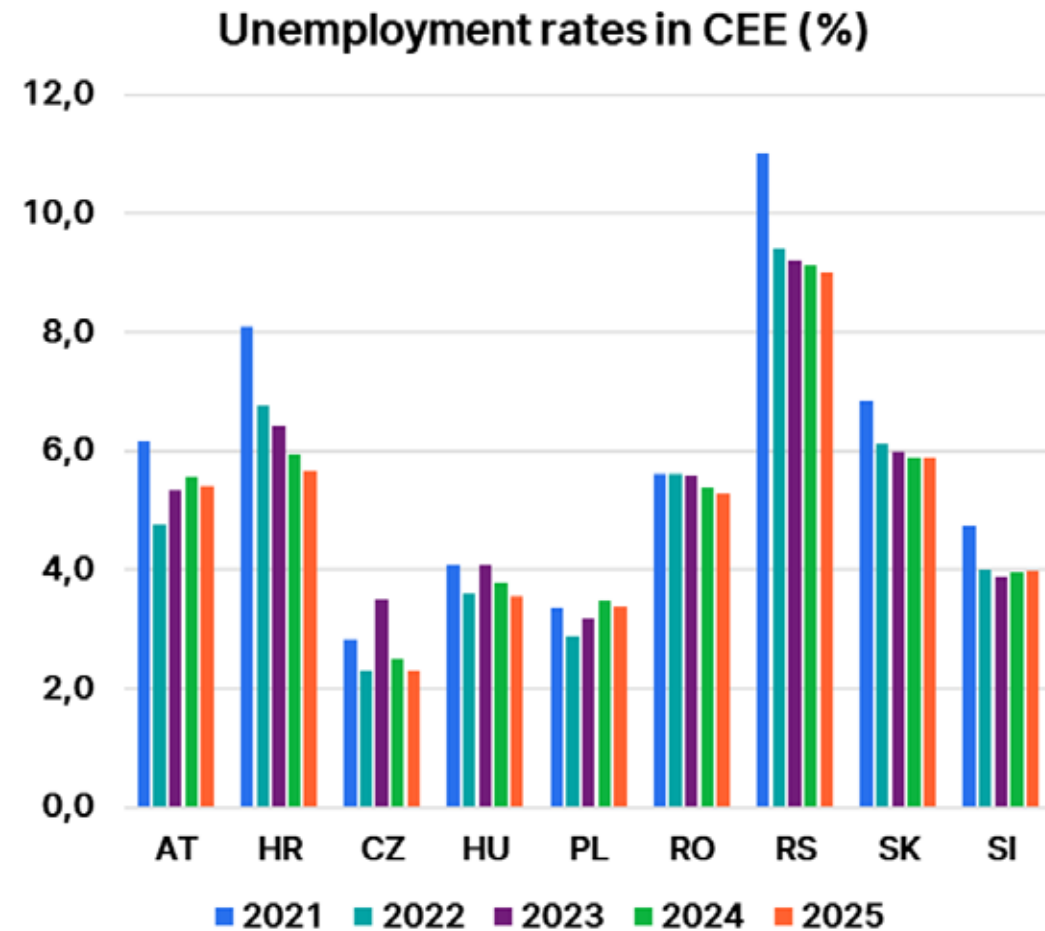
- Euroization given high interest rate differentials



Source: ECB / Erste Group.

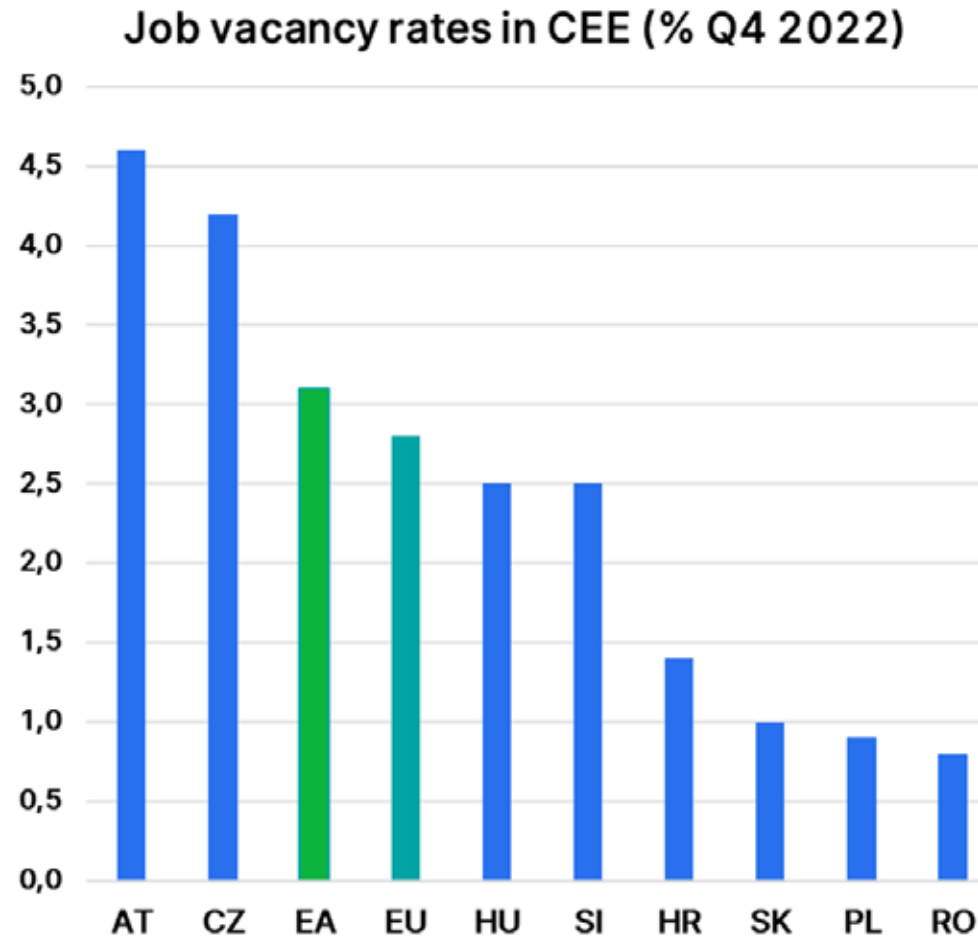
# Challenge 2: Demography And Labour Markets

– Labour markets tight and to remain tight?



Source: IMF WEO April 2023 / Erste Group.

- Finding qualified labour remains a major challenge

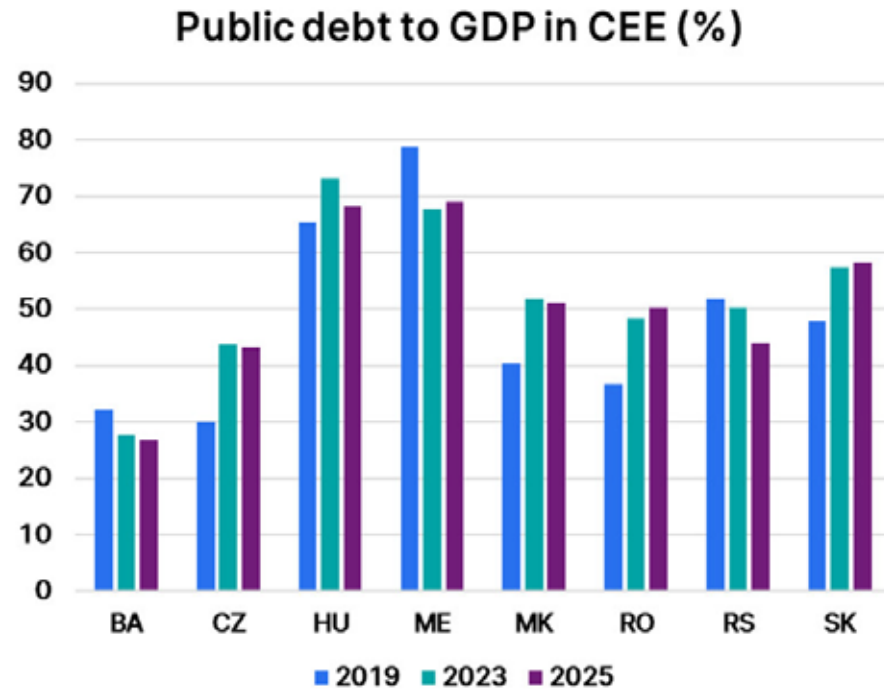


Source: Eurostat / Erste Group.



# Challenge 3: Fiscal Policy And Sovereign Risk

– Higher public debt levels

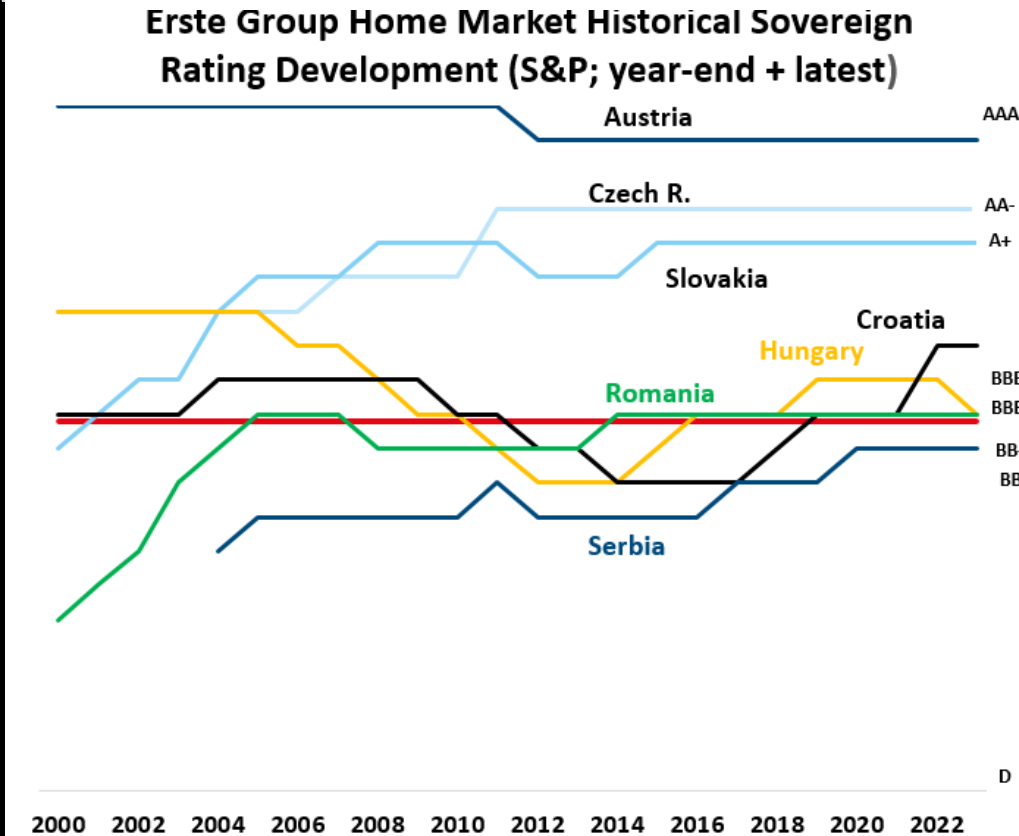


Source: IMF WEO April 2023 / Erste Group.

- Negative sovereign rating outlooks but so far stable ratings

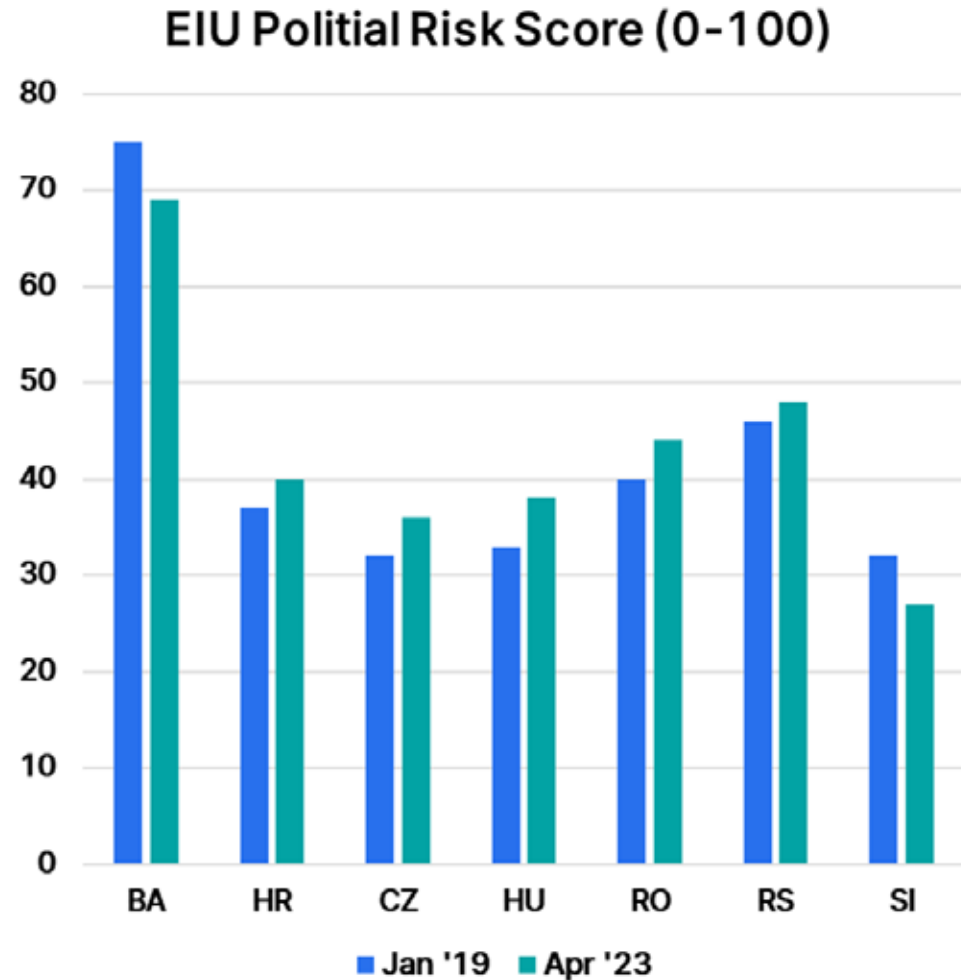
Sovereign	S&P	Moody's	Fitch
Austria	stable	stable	negative
Czech Republic	stable	negative	negative
Slovak Republic	negative	negative	negative
Hungary	stable	stable	negative
Slovenia	stable	stable	stable
Croatia	stable	stable	stable
Serbia	stable	stable	stable
Montenegro	stable	stable	n.a.
North Macedonia	stable	n.a.	stable
Poland	stable	stable	stable
Romania	stable	stable	stable

Source: Bloomberg / Erste Group.



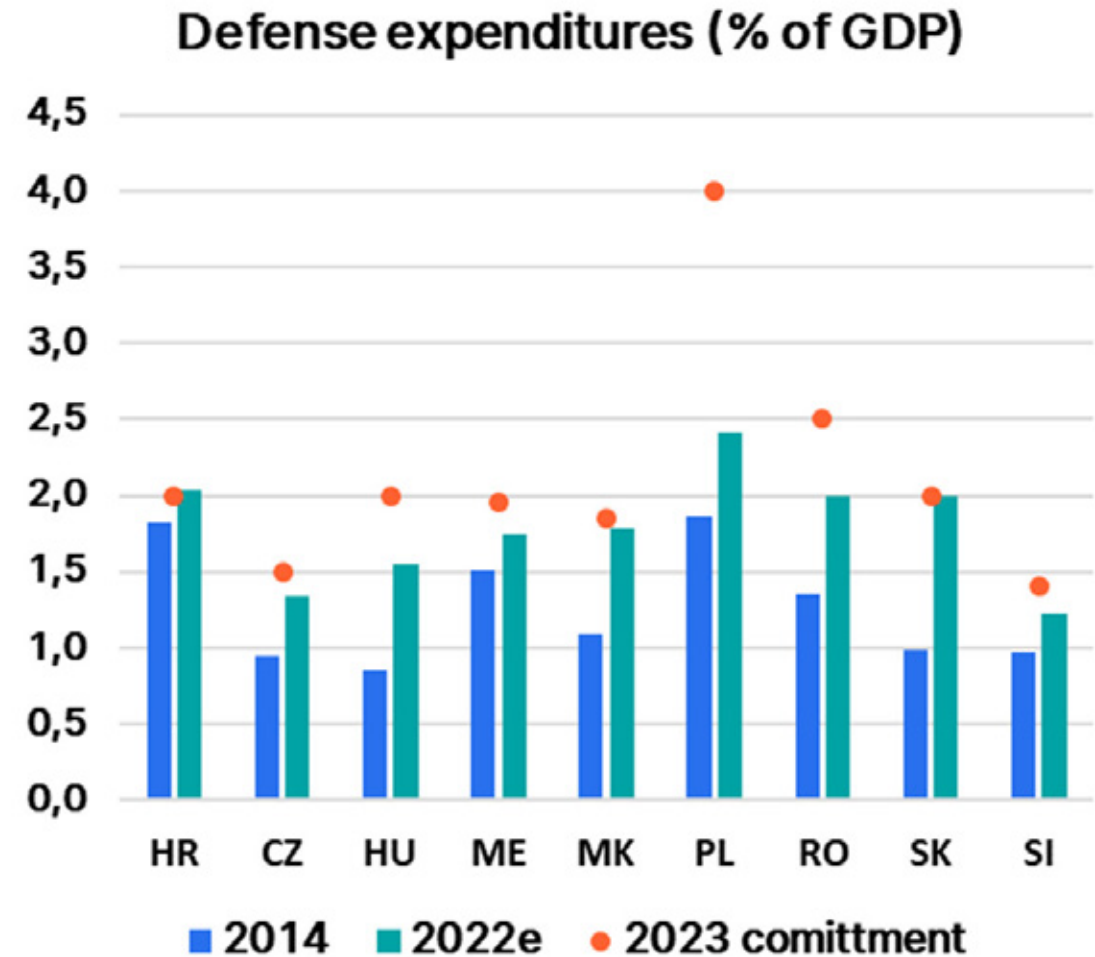
# Challenge 4: (Geo)-political Risks Back To The Region (1)

– Political risks rising in the region



Source: EIU / Erste Group.

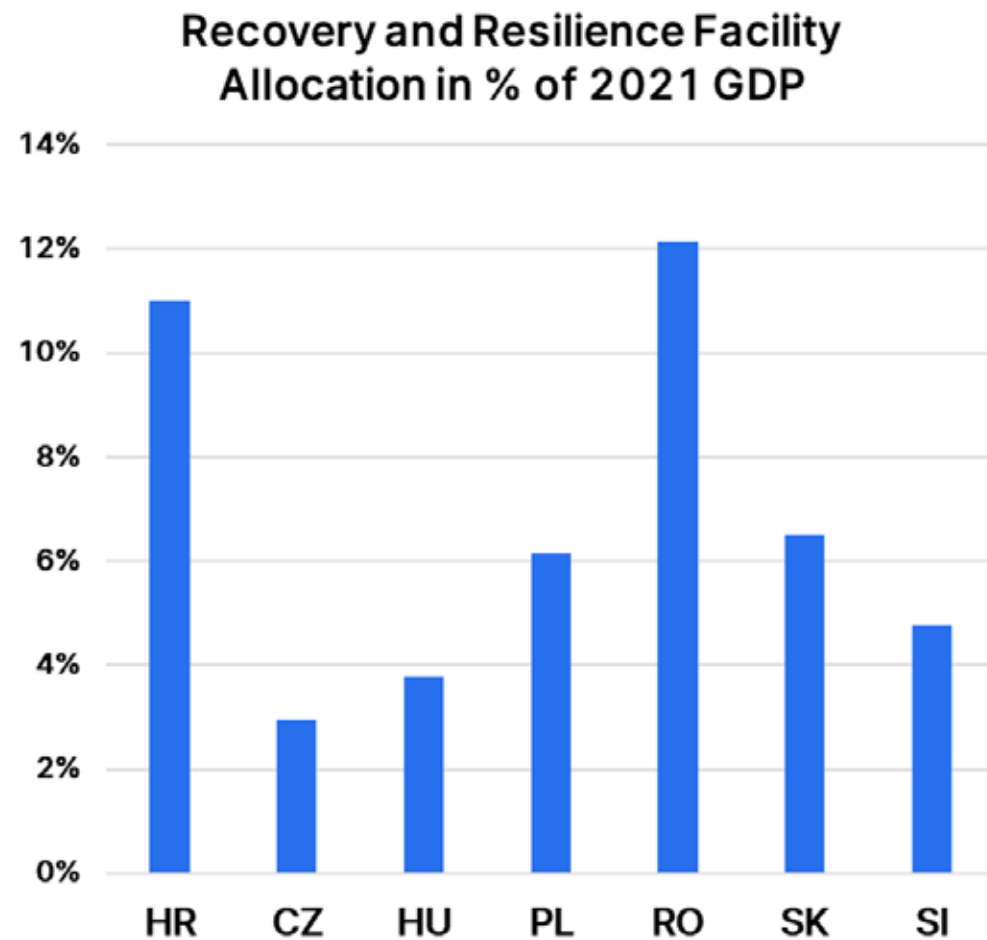
- Security expenditures rising strongly



Source: NATO / Erste Group.

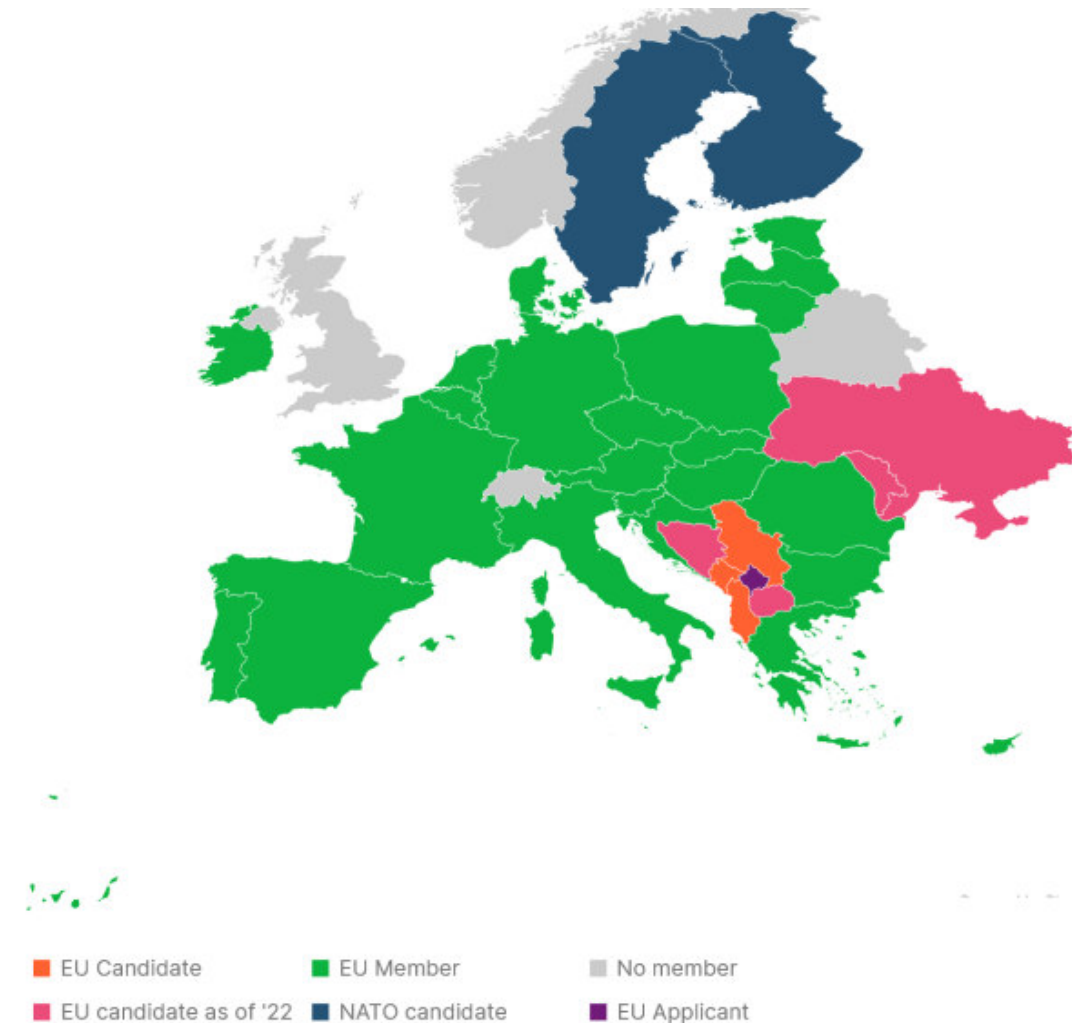
# Challenge 4: (Geo)-political Risks Back To The Region (2)

– New Institutions supporting



Source: European Commission / Erste Group.

- And new prospects for the region opening up



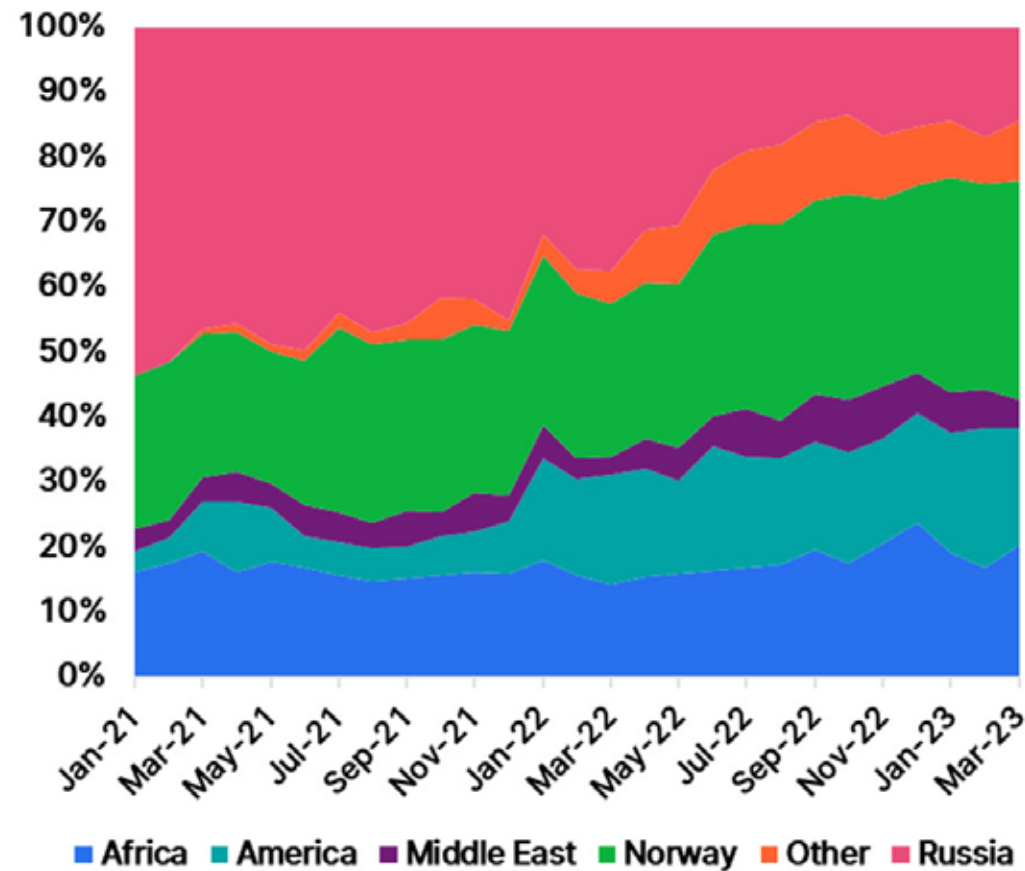
Source: Erste Group Research.

# Challenge 5: Energy Diversification And Security (1)

– Energy Diversification On-Going

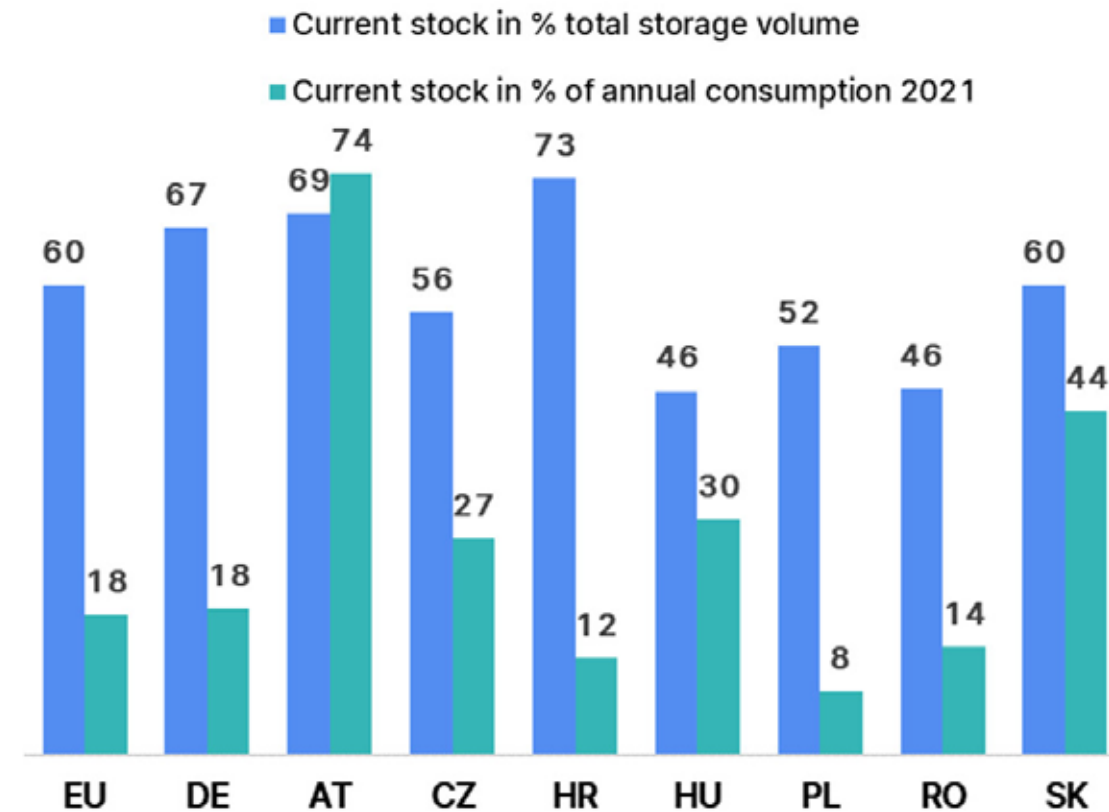
- Energy Security Increased In Importance

EU Gas Imports By Origin, Share in Total



Source: Eurostat / Erste Group.

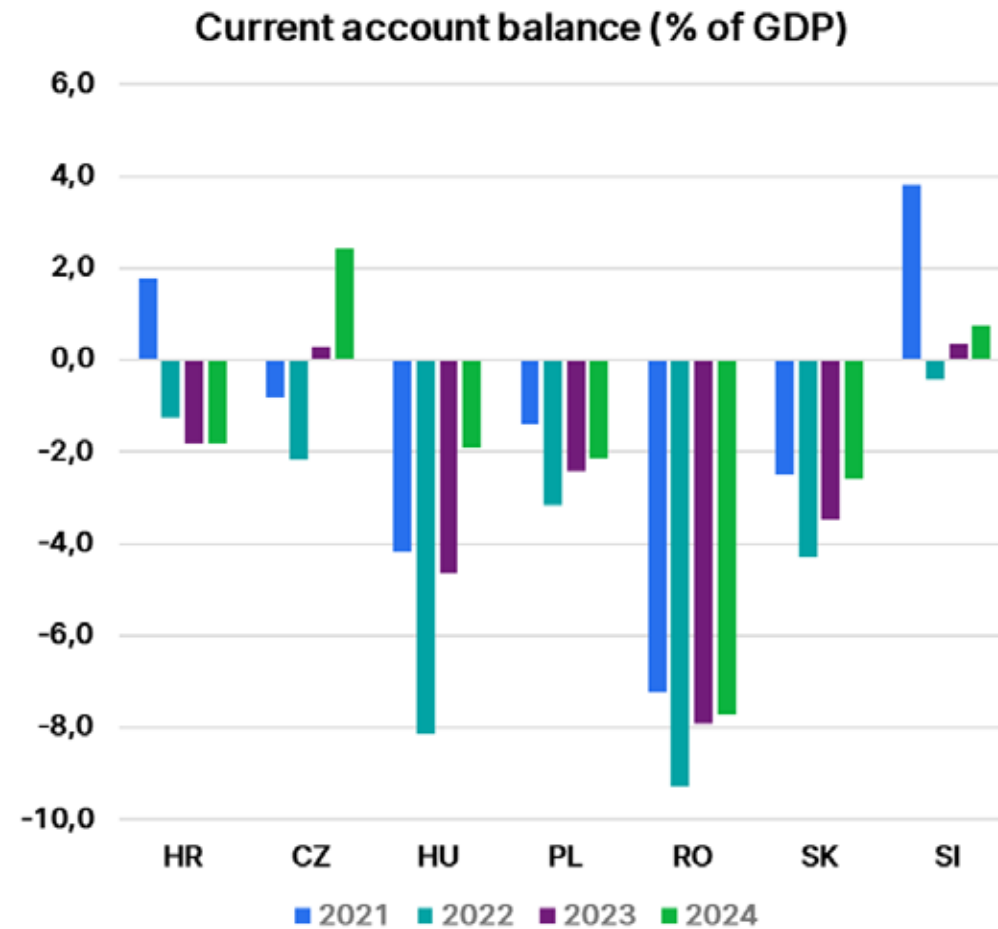
Gas Storage Levels, April 30th, 2023, in %



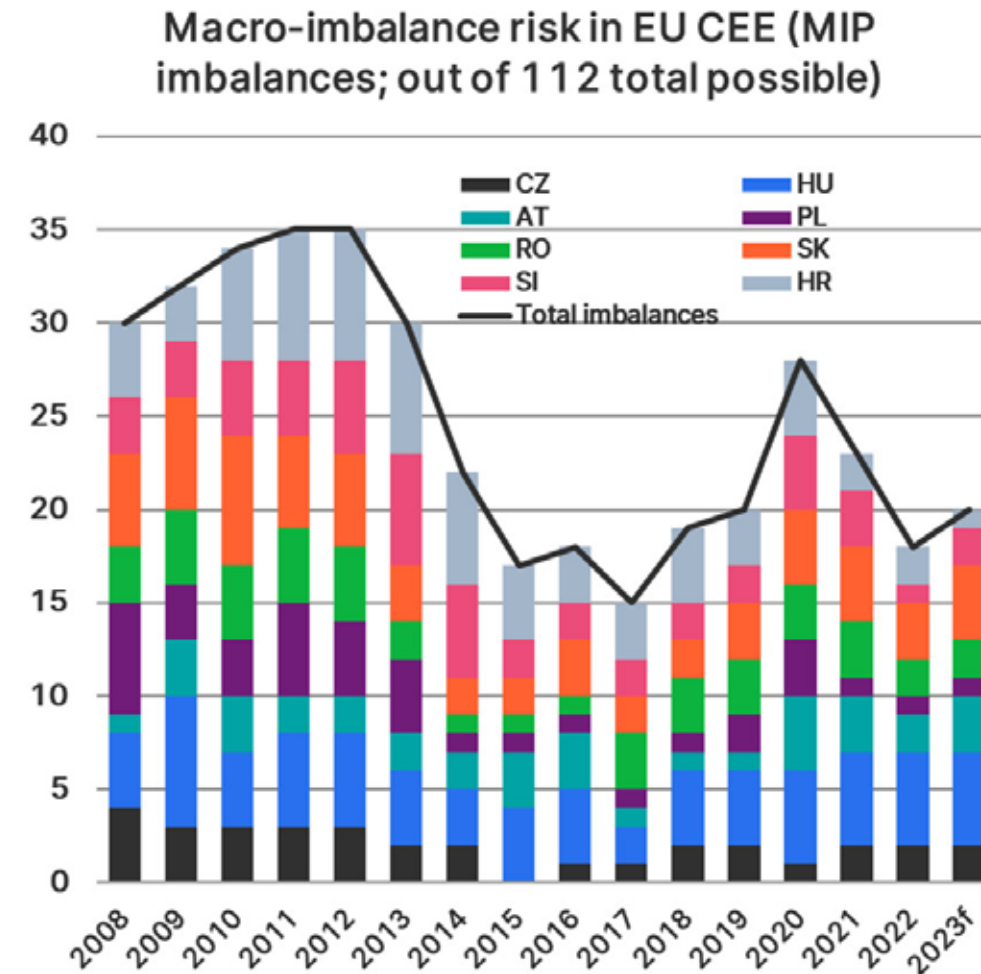
Source: GIE/AGSI / Erste Group.

# Challenge 6: Contain Macro-Economic Imbalances

– Current accounts improving again



- The multiple crises stopped the updrift in imbalances

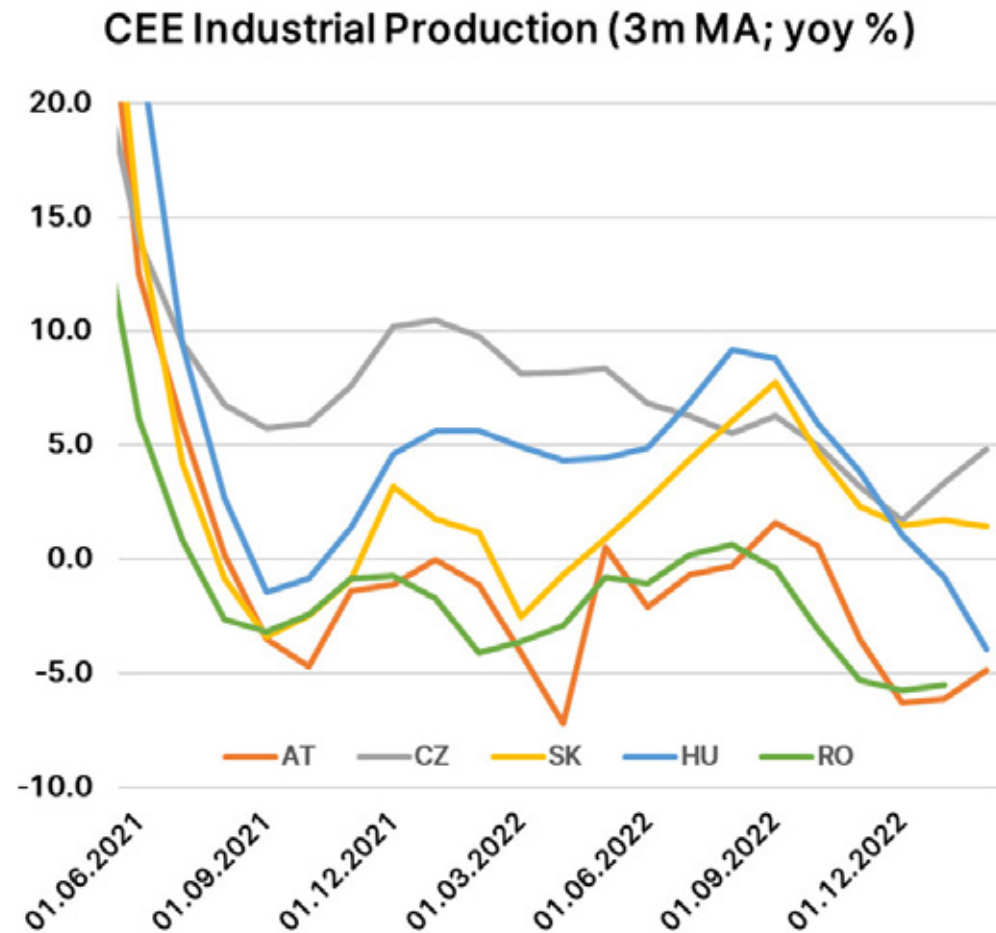


Source: IMF WEO April 2023 / Erste Group.

Source: Eurostat / Erste Group.

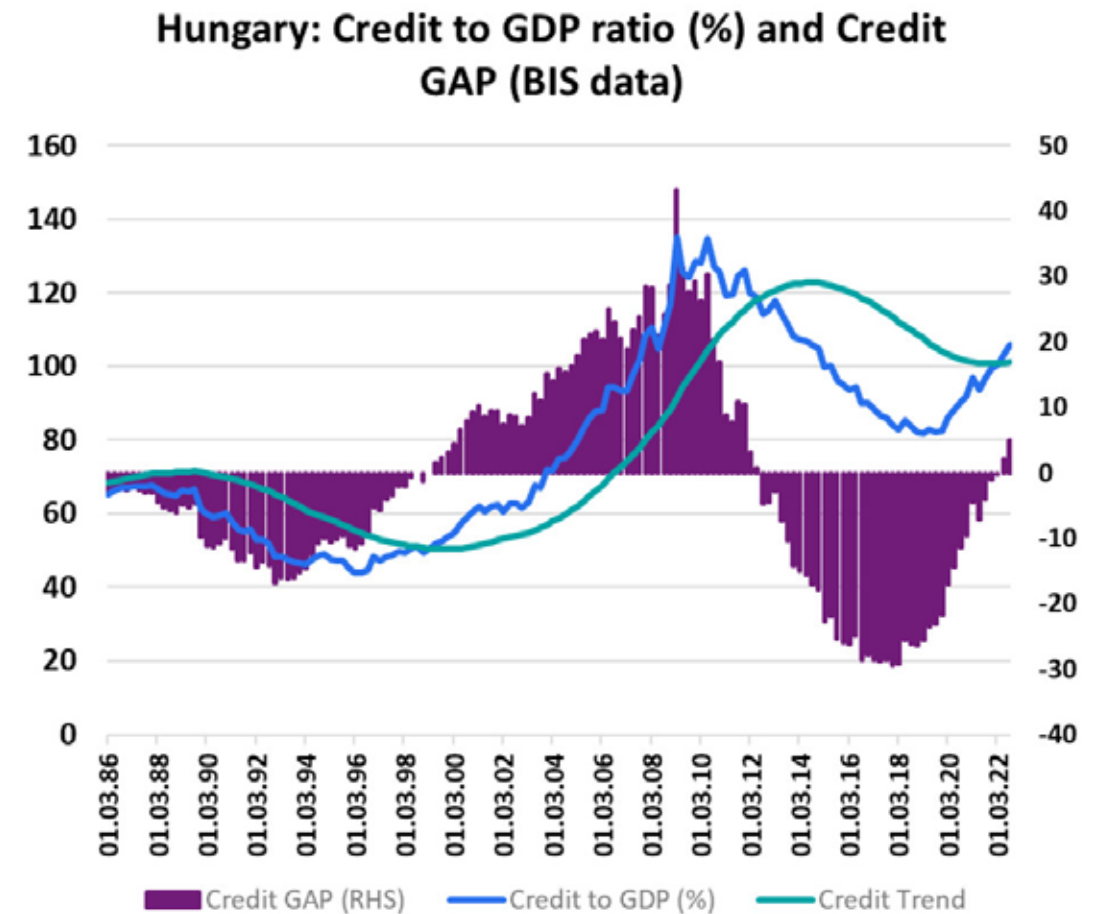
# Challenge 7: Industry Underperformance Going On

– Industry production keeps growth low



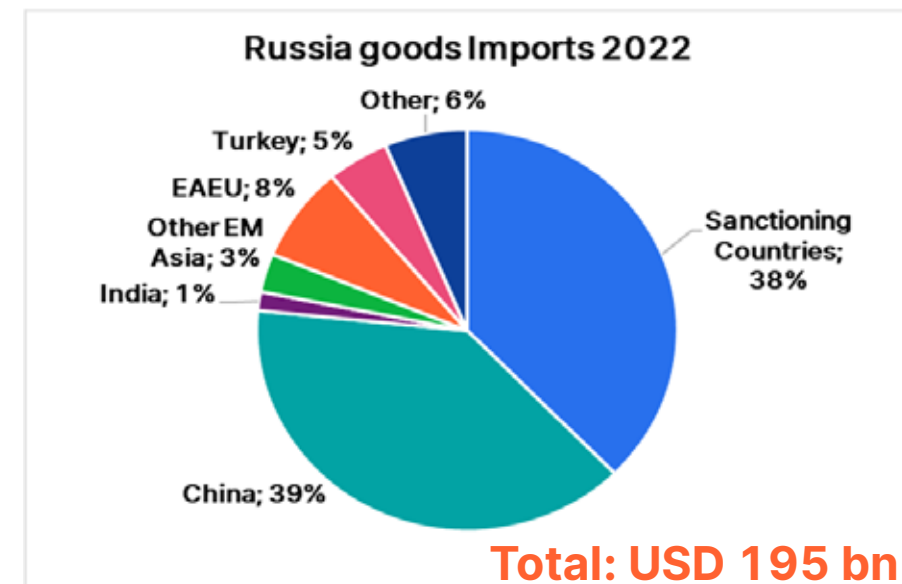
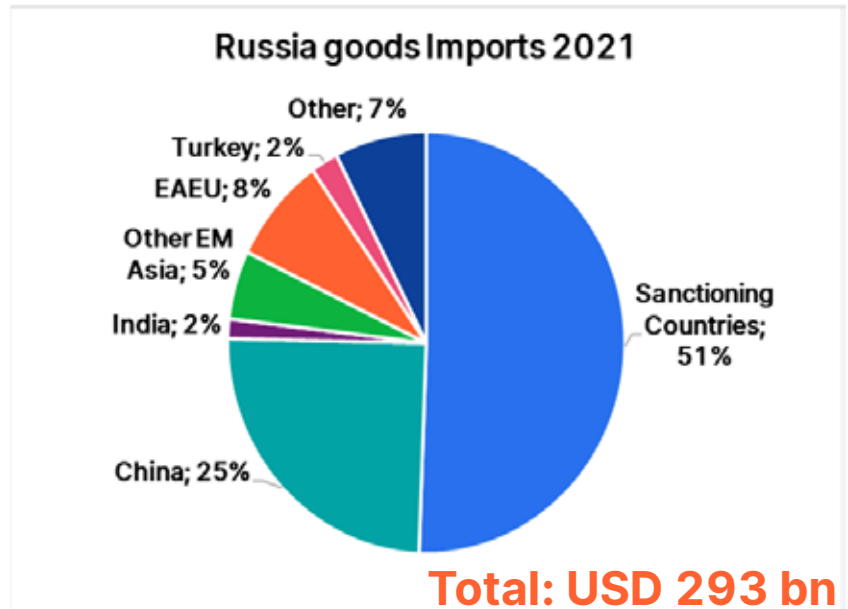
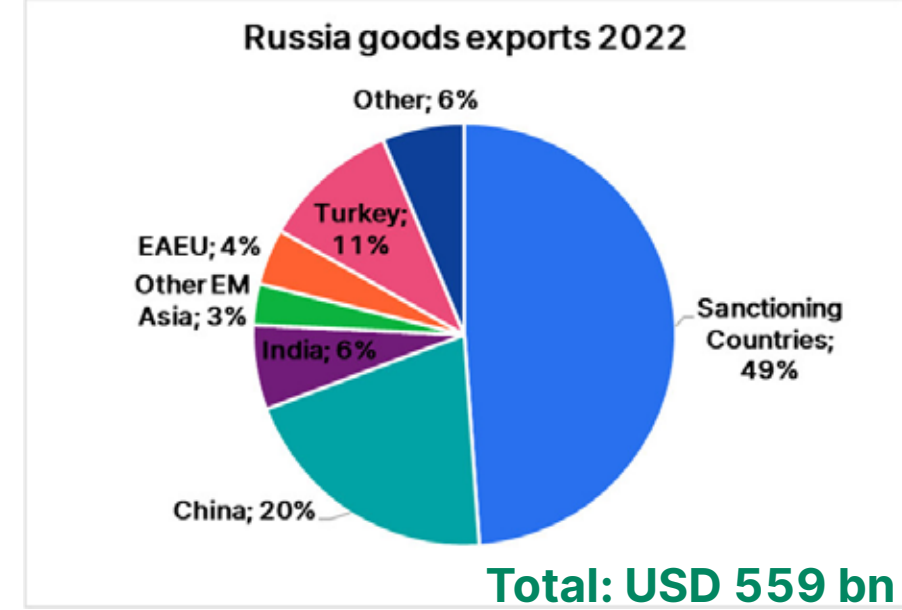
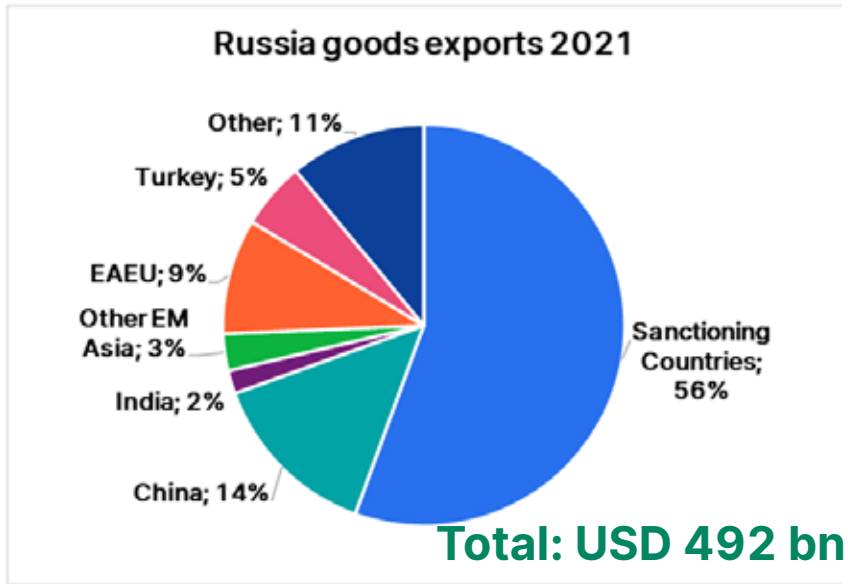
Source: Bloomberg / Erste Group.

- No excessive credit production over past decade



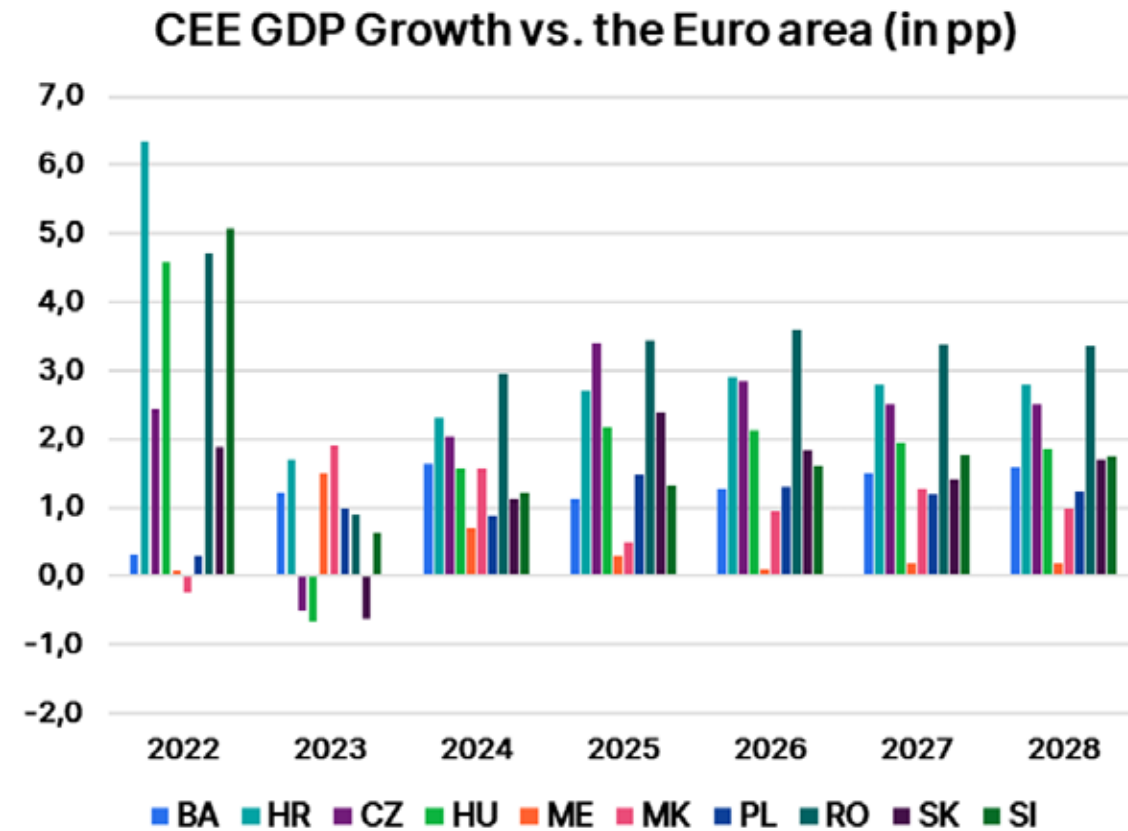
Source: BIS / Erste Group.

# Challenge 8: Secondary Sanction Risks



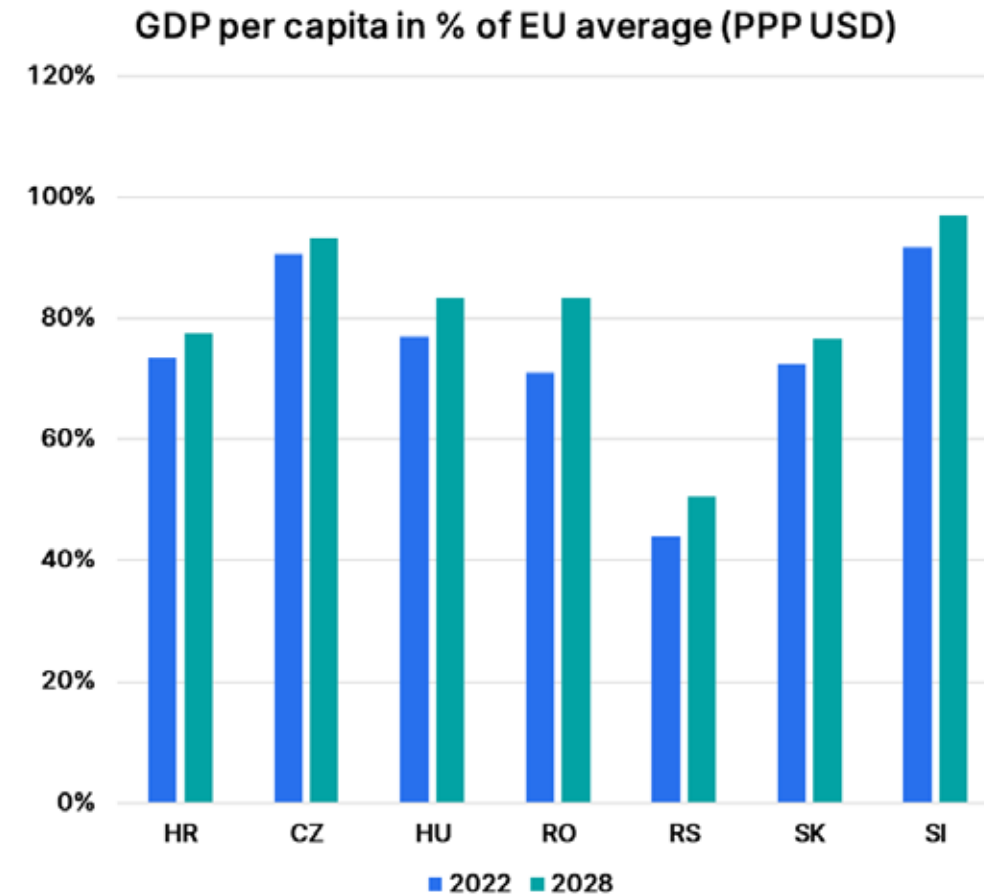
# Challenge 9: Keep Up Convergence

– Convergence story intact



Source: IMF WEO April 2023 / Erste Group.

- Some to reach EU average GDPPC until end of decade



Source: IMF WEO April 2023 / Erste Group.



# Multiple Challenges Ahead For CESEE But Manageable

Challenge	After	Cushion/Outlook
Interest rates / inflation	"Higher for longer"?	Rate cuts will be gradual
Demography / Labour markets	Increasing shortage of labour	Ukrainian labour integration
Fiscal policy / Public debt	Higher debt / scaling back support	Reduction in support necessary
Geopolitical Risk	Significant / Rising	EU / NATO unity increased
Energy diversification/availab.	Of highest priority	So far successful but risks remain
Macroeconomic imbalances	Expected to be contained	Economic slowdown supportive
Industry / Manufacturing	Underperformance	No excessive lending in past years
Operational Sanction Risk	Increasingly important	New tools for compliance
Convergence	To continue with some pause	Still many low hanging fruits

# Challenges in the times of high inflation and interest rates

Gabor Szigel (Senior Internal Advisor, OTP Bank)

May 9, 2023

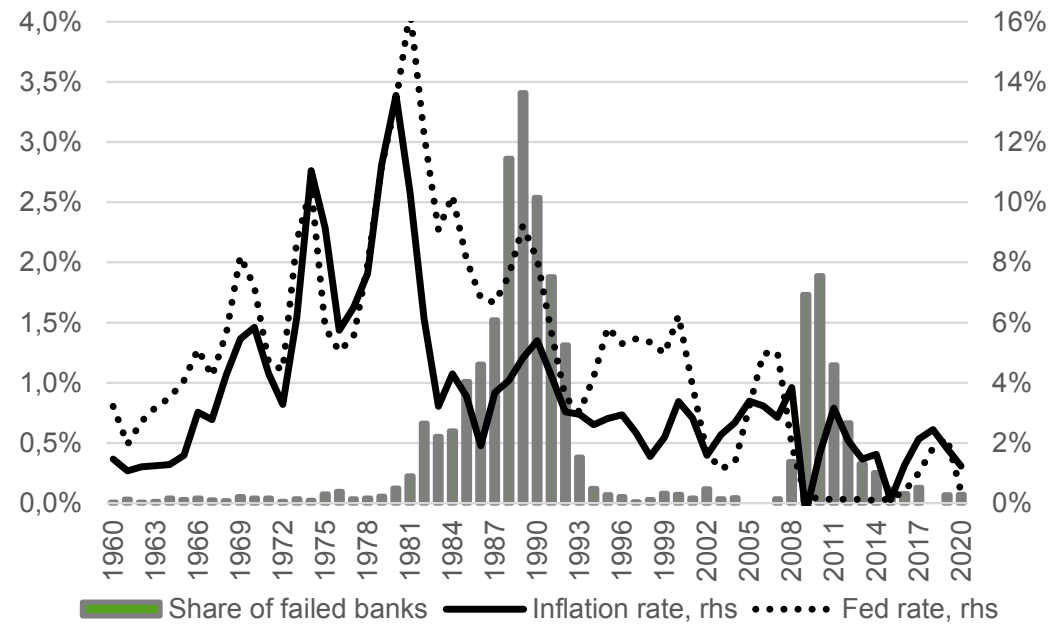


# What history tells us: high inflation / high interest environment might cause serious problems for many institutions while it is manageable on the systemic level



The savings&loan crisis of the 80s in the U.S.

**Chart 1: Share of failed banks\*, inflation and interest rates in the U.S.**

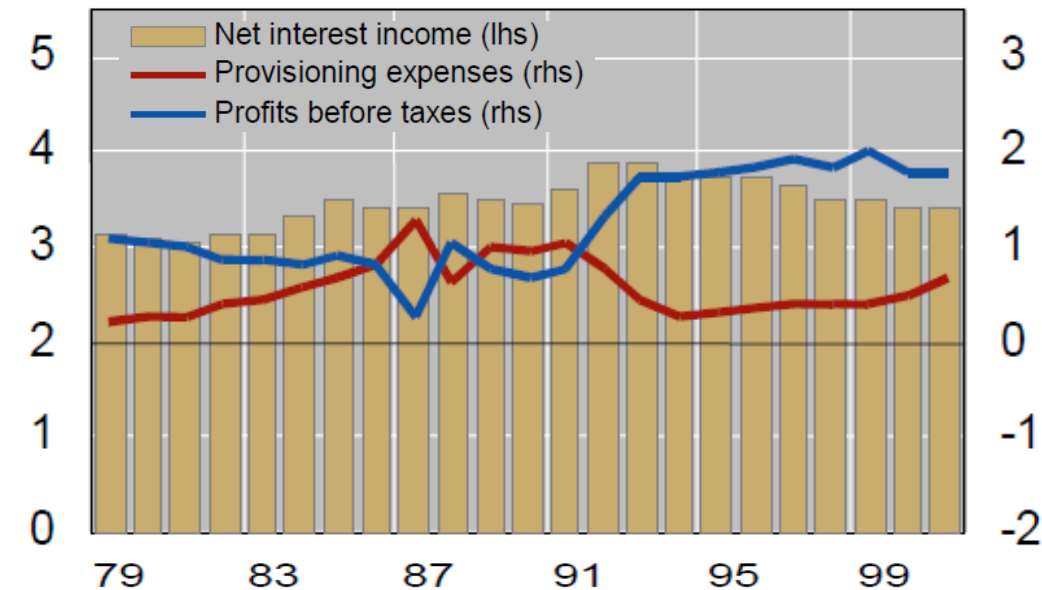


Source: FDIC. \*Notes: institution under deposit insurance, total number of saving banks before 1984 estimated by the presenter

### What is similar:

- Inflationary pressure
- High interest rates (compared to the previous periods)
- Stumbling real economy, halting (?) globalisation

**Chart 2: Net interest income, impairments and profits of U.S. banks as a % of their avg. balance sheet**



Source: William B. English: Interest rate risk and banks' interest margin, BIS Quarterly Review, December 2002, page 76

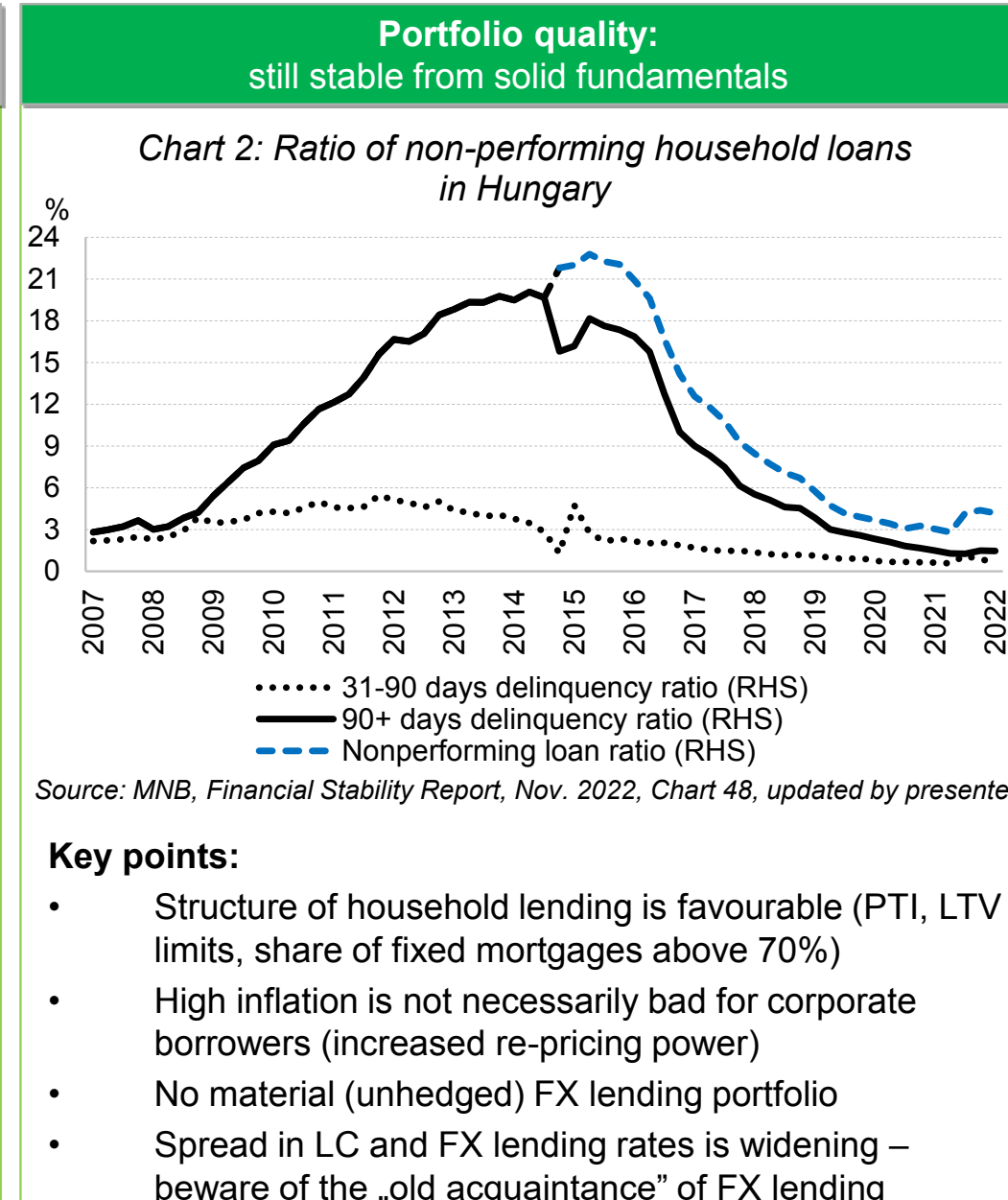
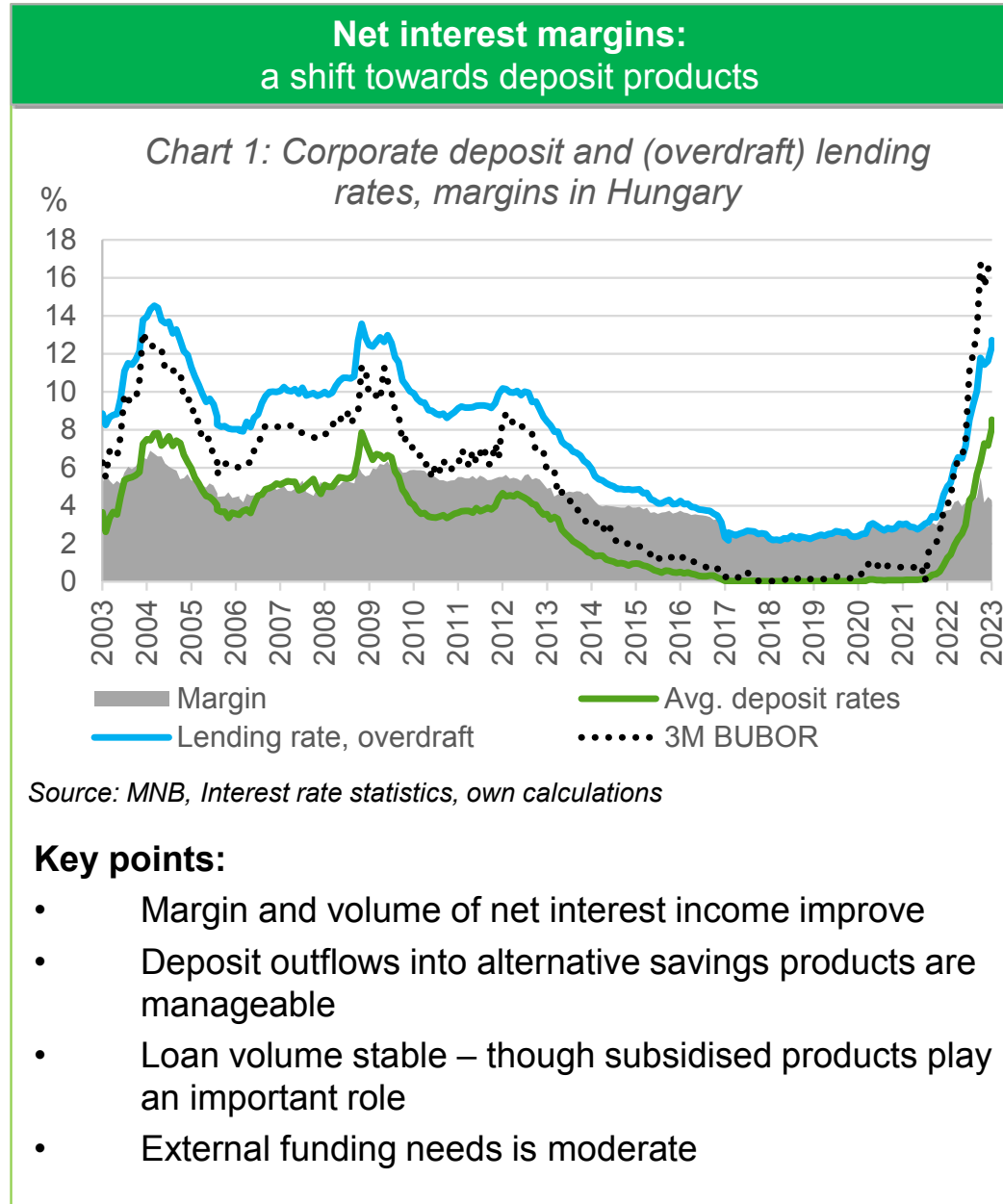
### What is different:

- Mostly (though not exclusively) institutions with specialised business model were hit back then
- No financial deregulation
- No supervisory forbearance
- Wider deposit insurance coverage
- More liquidity

# What the present tells us (with regard to Hungary&CESEE): net interest income and portfolio quality is stable; fundamentals are much better than in 2008/2009



## Selected figures of the Hungarian financial system:

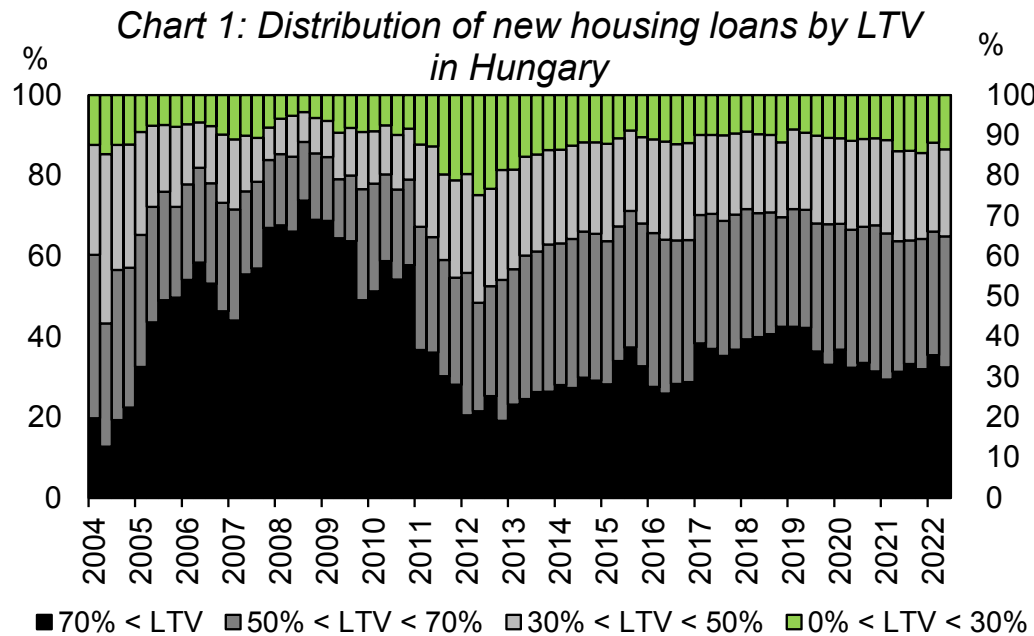


# What the present tells us (with regard to Hungary&CESEE): asset (real estate) prices might keep decreasing but leverage is not likely to become extensive. Sound business model and good management is a key



Selected figures of the Hungarian financial system:

## Asset prices: decrease is possible, but leverage seems to be manageable

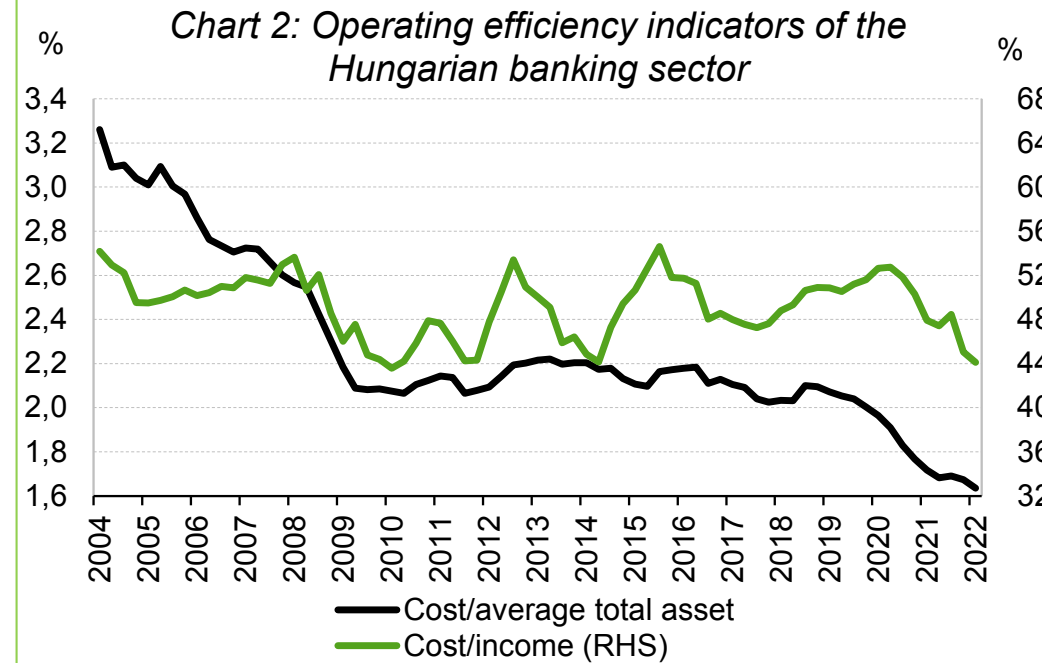


Source: MNB, Financial Stability Report, November 2022, Chart M35

### Key points:

- (Nominal) fall in real estate prices is happening, but
- Shocks to LTVs will not reach the level of the post-Lehman crisis episode (with 30-50% increase in FX loan volumes)
- Starting point LTV distributions are significantly more favourable

## Business models: effective, diversified operations remain key for success



Source: MNB, Financial Stability Report, November 2022, Chart M49

### Key points:

- Viable business model is key
- Efficiency of the banking system tends to improve during times of crisis (with good management)