

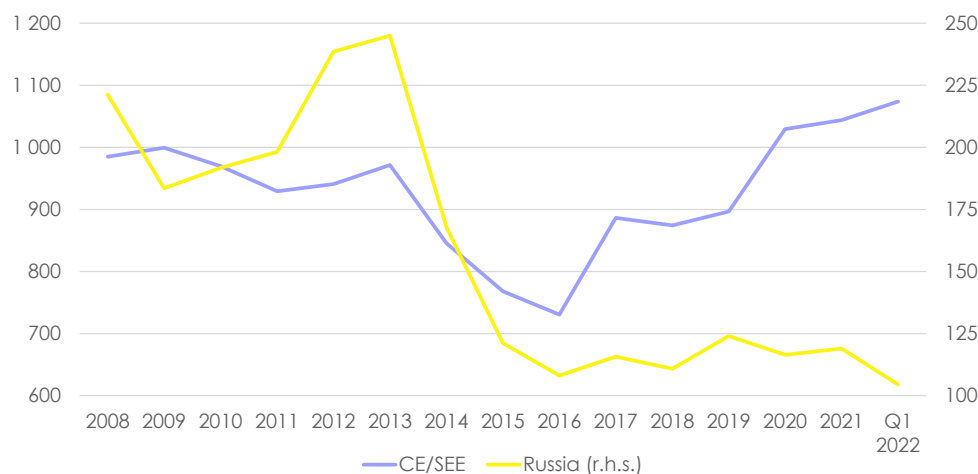
CEE Banking Watch: Russian risk reduction amidst solid growth in CE/SEE

Fresh BIS figures show that Russia exposures of Western/European banks are rapidly approaching the "new normal" low single digit exposure range coming from a relative portfolio share of 10%+ (being once on par with Poland or Czechia at ~20%). Over the next 6-12 months Western bank exposures towards Russia may approach 1998/99 or 2005 levels, the financial interconnectedness with the late Soviet Union is then possibly in further sight, over the next 12 months.

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CEE exposures Western banks (USD bn)



CE/SEE: PL, HU, CZ, SK, SI / BG, RO, HR, RS, AL, BA,

Source: BIS, RBI/Raiffeisen Research

Russian exposures ~8%@CEE banks - next target level 5-6%

At the beginning of the geopolitical escalation in and around Ukraine, we pointed out that **international banks**, incl. Western/EU banks, **reduced** their (**risk**) **exposure to Russia** in **recent years** and **structurally** since the annexation of Crimea (see **International & Austrian banks' position on Russia**). Geopolitical blindness is therefore not readily apparent here. Pure **cross-border exposures** towards Russia and those in **foreign currencies** have been substantially reduced in recent years (having been cut by 75% since 2013). **Local exposures** in **LCY** amounted to just 25% of total in 2013, currently standing at 50%+. The withdrawal of pure international lenders without strong local footprint also increased the relative share in Russian exposures of banking sectors like Italy, France and Austria to a stunning 50% share — now standing at 60%+ (Q1 2022). However, the sketched trends and ratios also imply that further exposure cuts will now come via cuts to local and LCY exposures at dedicated players with sizeable local exposures.

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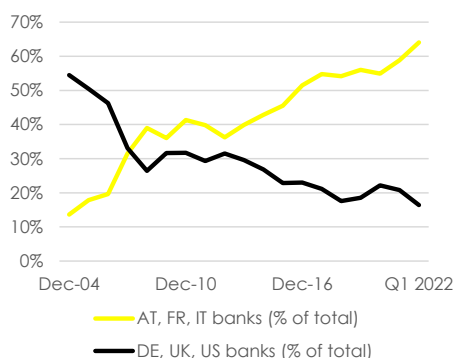
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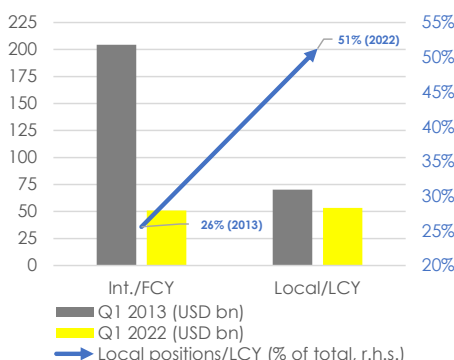
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RU: Exposures Western banks



RU: Int. and local exposures

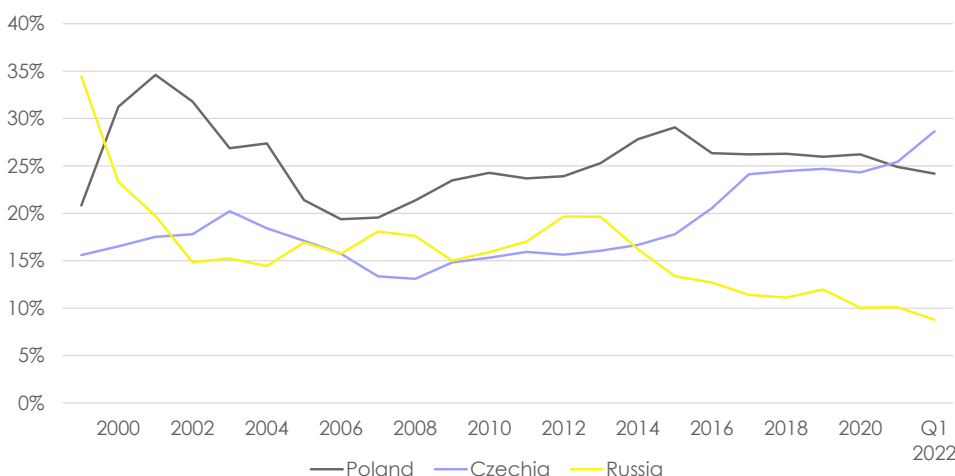


Source: BIS, RBI/Raiffeisen Research

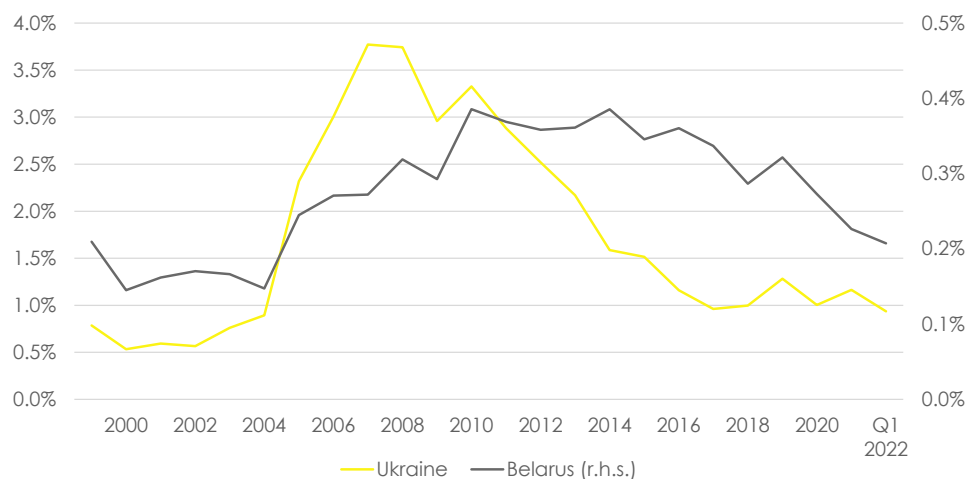
Source: BIS, RBI/Raiffeisen Research

Overall, **Russia's share in CEE exposures of Western banks** has fallen from almost **20%** in **2013/2014** (on par with Poland or Czechia) to an **average of 13%** in **recent years**. After reaching a historic low of just under 10% in 2021, the relative share at the **end of the Q1 2022** stands at around **8.7%**. The strong relative decline should also be assessed in the light of **solid growth rates in other CE/SEE exposure categories**, while **risk reduction** was also indicated in **Ukraine and Belarus**. However, the exposure decline of Western banks to Russia of just over 10% or just around **USD 15 bn** in nominal terms in **Q1 2022** is probably only the tip of the iceberg. After all, this drop does not include the market exit of the French SocGen (Rosbank) in April, which should shrink the exposure of Western banks to Russia by more than USD 15 bn alone. After all, French banks together with Italy (followed by Austria) were the European banks with the largest Russia exposures. Including further risk reductions in cross-border business (where caution was already exercised in recent years) plus above all **further reductions in local business activity** (with Western lenders staying more or less on the sidelines in terms of new lending plus active portfolio shrinkage of 15-25% YTD), **Russia exposures of Western banks** could thus amount to just under **USD 60-70 bn** at the end of Q2. That would be about the same value as in 2005 or back in 1998/1999 (!). Including further probable balance sheet expansions in the CE/SEE markets, the **relative share of Russia** in the portfolios of Western CEE banks may decline to **4-5 %** already in Q2 and Q3 2022. This would make the Russian banking market more or less as "important" as Croatia and less important than Hungary or Romania when looking at aggregated exposures at Western (CEE) banks.

Shares in CEE exposures (%)



Source: BIS, RBI/Raiffeisen Research



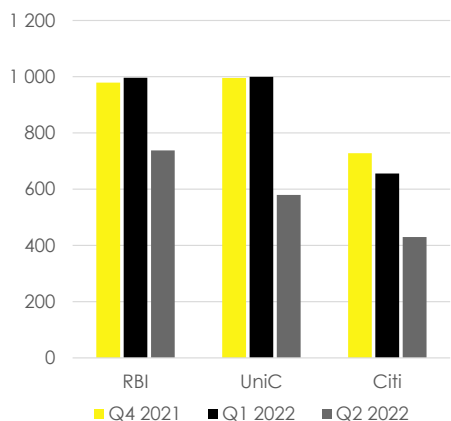
Source: BIS, RBI/Raiffeisen Research

Local business conditions and exit strategies

With close to **80%** of the **Russian banking sector** (measuring by asset size) under **strictest asset-freeze curbs** by the **US, UK or EU, foreign players** still active on the local market represent a **narrow strip of sanction-free area**. What may seem a potential competitive advantage for these banks, however, is actually a challenging position to manage in the sanctions crossfire and amid revisions of the strategic presence in Russia. Thus, with the prompt exit of SocGen, the units of other **remaining major foreign banking groups** in Russia (RBI, UniCredit, Citi) have also set their de-risking in train. In Q2 2022, the reported **loan portfolios contracted** by **20-40%** in nominal rouble terms against the total market decrease by some 7%. The declining business trend in the sanctions environment might be natural from the banks' perspective, especially as some of them (e.g. Citi, HSBC) are focused on servicing local subsidiaries of multi-national companies many of which are now leaving the market. This, however, causes disapproval by the government which endeavours to support the faltering economy, inter alia, by stimulating new lending. For now, the **Central Bank of Russia (CBR)** confirms **equal regulatory treatment** for all banks and refuses the intensifying calls to impose stricter control over foreign lenders (up to a takeover of their operations), but the regulatory pressure may rise. In particular, this concerns the aim to maintain a level playing field and avoid the effective **split** of the **banking market** into the **"sanctioned"** and **"non-sanctioned"** segments, which places foreign banks between a rock and a hard place as they operate under local legislation (which rejects external sanctions), while they must also follow compliance policies on the respective group level. Credit Suisse may become a showpiece here: in July the group was banned by a Moscow court from disposing of shares in its Russian units as an additional security measure to recover EUR 10 mn — the syndicated loan amount repaid by the borrower which Credit Suisse, acting as an agent, failed to transfer to the sanctioned Transcapitalbank. On a related note, the awaited regulatory response to the planned sale of HSBC's Russian business will be a litmus test whether orderly exit strategies are still conceivable. In the meantime, the active capital controls block foreign banks' access to the profits generated in Russia, which makes the **local units** even a more **standalone business**. Speaking of the wider picture, according to the balance of payment statistics dividends and distributed profits related to foreign direct investments in Russia (all industries) were yielding USD 20-50 bn per annum in the last decade, hence comprising notable amounts for some foreign investors.

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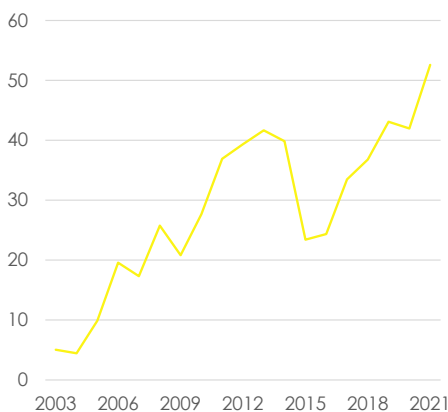
RU unit loans to customers*
RUB bn



*Russian exposure figure for Citi; converted to RUB based on CBR exchange rates

Source: Company data, RBI/Raiffeisen Research

Distributed profits from RU*
USD bn



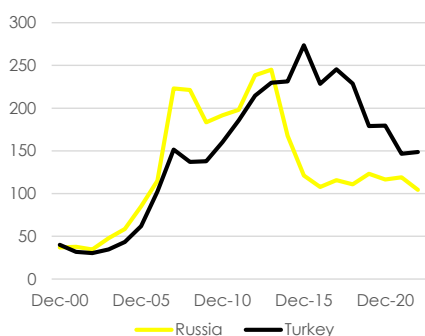
*primary income under direct investments, according to BoP of Russia

Source: CBR, RBI/Raiffeisen Research

Banking will arrive soon at Soviet Union times

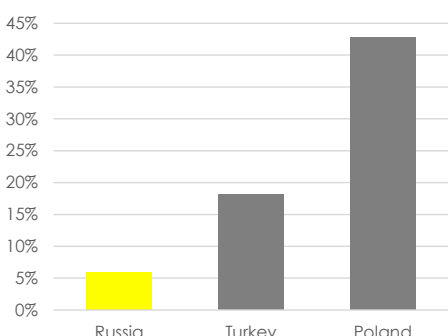
Taking the long-term view, unfortunately, **since 2014 Russia** has **maneuvered itself out** of the position of being a **key market** for **Western banks** like Czechia or Poland. Overall, the long-term withdrawal of Western banks from **Russia** (incl. recent changes and expected cuts from a 6-12 months perspective) is possibly even more dramatic than from **Turkey**, which is "only" plagued by "normal" macroeconomic crises. In terms of economic footprint, Western banks currently have more appetite for Turkey (!) than for Russia. In terms of European asset portfolios, the effect of the "Russia vaporization" is even more dramatic. According to latest ECB current account data, financial asset values vis-à-vis Russia fell by 12% in the first quarter (while the total share stands at 1.2% of euro area external assets). The securities position here even posted a loss of 50%. In the longer term, we see Western and European bank exposures shrinking to a similar dimension, i.e. a **low single digit exposure share**, while the long-cherished and still disproportionate interconnectedness with Russia in the European banking sector is unlikely to be maintained — current conditions unchanged. In light of expected (natural) exposure reductions in Q2 and further de-risking measures, the **total exposure of Western (European) banks** to Russia could soon be at or below the **level** it was in **Soviet times** according to international banking statistics, i.e. at **USD 30-50 bn**. Such a drastic exposure cut would be also in line and consistent with exposure cuts seen in **countries** being **heavily sanctioned** like **Iran** or **Venezuela**. In those cases tough sanctioning induced cuts to Western banking exposures by around 70-85% compared to pre-sanction peak times (depending on the exact measurement).

Cross-border claims
USD bn



Source: BIS, RBI/Raiffeisen Research

Cross-border claims
% of GDP



Source: BIS, IMF, RBI/Raiffeisen Research

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
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