Wide Angle Shot: Solid earnings and de-risking in CEE banking

Raiffeisen Research

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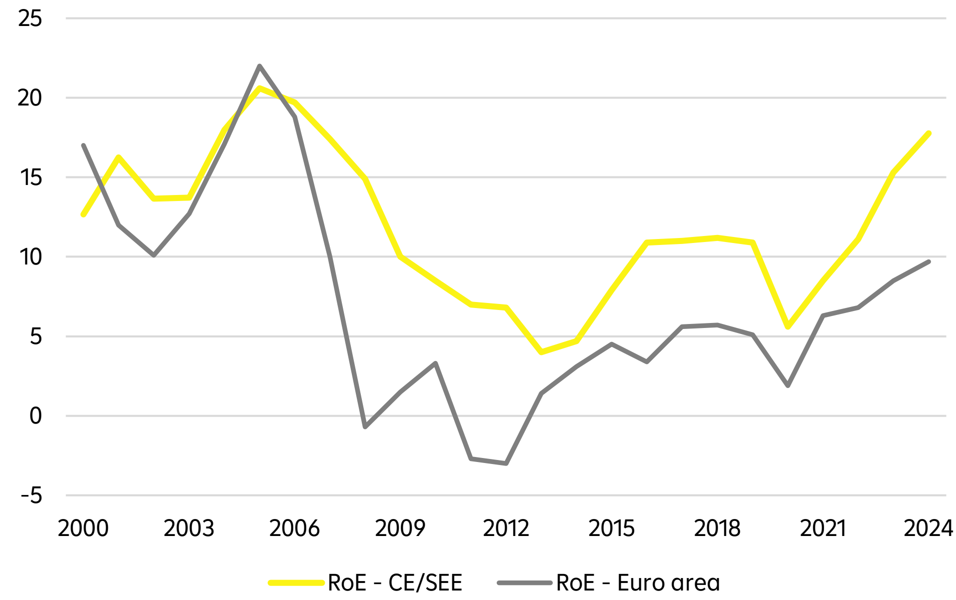
Solid performance of CE/SEE banking sectors has once again got analysts' pens flying. It was basic consensus that the earnings peak had been passed 2023. However, the CE/SEE RoE of 15-20% in 2024 defied expectations. In terms of regional exposures EU markets in CE/SEE are currently in the focus of major cross-border lenders, while a more cautious stance is observable in the Western Balkans. Following drastic cuts Russian exposures are stagnating at lowish and non-systemic levels, while dedicated CEE lenders stay committed to Ukraine. In total Austrian banks remain top dogs in CE/SEE in terms of local market share and cross-border business.

RoE banking sectors: CE/SEE vs. Euro area*



** H1 or 9M annualised value for 2024 depending on data availability; Weighted by sector assets for country groups: CE/SEE=CE5=CZ,HU,SK,PL,SI; SEE=RO,BG,HR,RS,BH,AL,KO*

Source: National sources, ECB, RBI/Raiffeisen Research

Key topics and general outlook

Despite inevitably rising pressures on **profitability**, **CE/SEE banking sectors** have managed to keep the bar high in 2024 with the **region's average return on equity (RoE)** gaining a vey solid **foothold above 15%**. The results of individual markets have become somewhat more dispersed throughout the year, however the general positive gap over the lenders of the Euro Area (EA) proved unbroken at 5-10pp. In fact the relative outperformance of the CE/SEE

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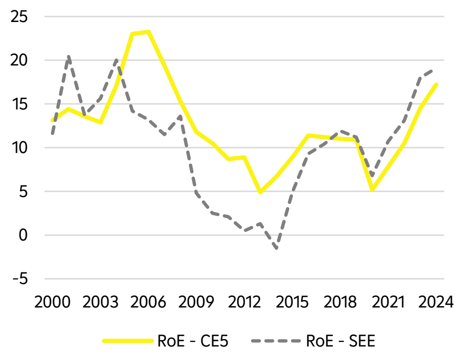
banking sectors vis-a-vis the euro area increased further in 2024 in comparison to an already solid 2023 reading.

Meanwhile, the **relative weight** of the **CE/SEE banking sectors** has increased to **5% euro area banking assets**, which marks a two-time growth since 2007. From this perspective, we can again speak about the CE/SEE region as a corner of resilience in European banking, while still offering catching-up potential in certain markets and market segments. The vantage in performance lies with the **risk-return profile** which played out very well at the past leg of the cycle, especially what concerns **SEE markets** that **yielded a ~20% RoE**. In Southeastern Europe, the regional RoE is even above the boom levels seen in 2007/2008. In Central European banking markets the regional RoE falls just a few percentage points short of these historical record levels, mainly driven by the strong **long-term market convergence** in the **Czechia** and **Slovakia** towards highly mature banking markets (incl. euro area entry in Slovakia). The **long-term favorable profitability** in **SEE** vs. **more mature CE markets** is reflected in SEE's ROEs, which in 2024 are well above longer-term averages, while in CE markets such as the Czechia or Slovakia they are currently even below (!) long-term averages (CZ 2024: 18.4% vs. long-term average 19.4; SK 2024: 10.4% vs. long-term average of 11.9%). In Romania, Croatia and Serbia, the RoE in 2024 of 17-22% should be seen in relation to long-term averages of 8-10%.

Same as in 2023, the banks' strong bottom line has been premised on the still mostly favourable (albeit clearly plateaued) lending margins paired with contained risk costs. The very solid regional risk cost development is based on robust macroeconomic developments in the CE/SEE markets, i.e. a partially self-sustaining upswing and record low unemployment rates. This combination has underpinned solid core earnings, thus compensating for persistent inflationary pressures on the OPEX base and additional tax expenses. The latter is becoming an entrenched issue, as in 2024 new **industry-relevant special taxes** kicked in on the Romanian, Slovenian and Slovak banking markets. Adding the already affected banking sectors of Hungary, Czechia and Poland, **special banking levies** now embrace about **85%** of **CE/SEE markets** measured by total assets. The levies differ in design in terms of tax rates, the tax base (revenues, "excess" income or the balance sheet) and duration, but they share a **common risk** of **turning into** an **open-end topic** as fiscal consolidation remains an uphill battle. Along the same lines go other changes to tax regimes, be it a general increase in CIT rates (e.g. in Slovenia) or additional **financial transaction levies**, as is the case in **Hungary** (increases starting H2 2024) and **Slovakia** (to be launched in Apr 2025). Some of this cost may be partly passed on to customers, for example what concerns the transaction levies in regard to legal entities, however the general onus of extra tax expense will be there for the sector in 2025 and beyond.

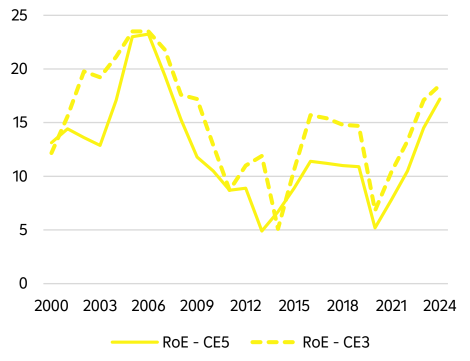
RoE CE-5 & SEE*



** H1 or 9M annualised value for 2024 depending on data availability; Weighted by sector assets for country groups: CE5=CZ,HU,SK,PL,SI; SEE=RO,BG,HR,RS,BH,AL,KO*

Source: National sources, ECB, RBI/Raiffeisen Research

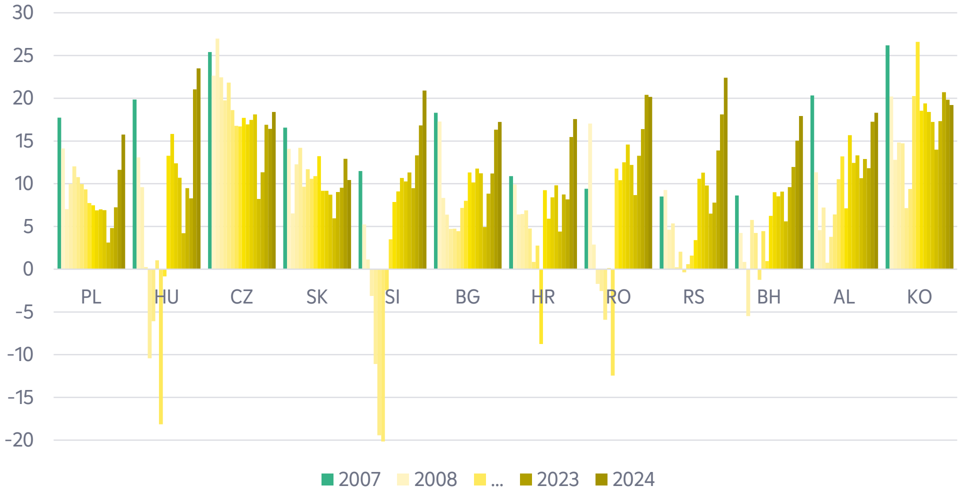
RoE CE5 & CE-3*



** H1 or 9M annualised value for 2024 depending on data availability; Weighted by sector assets for country groups: CE5=CZ,HU,SK,PL,SI; CE3=CZ,SK,HU*

Source: National sources, ECB, RBI/Raiffeisen Research

Return on equity in CEE 2007-2024 (%)



Negative values capped for SI (the lowest point was -90.3% in 2013)
Source: National sources, RBI/Raiffeisen Research

CE/SEE RoE: Current and long-term outperformance vs. euro area

From a regional perspective, the **banking sector profit pool** in **CE** is currently around **EUR 20 billion**, while in **SEE** it is **EUR 8 billion**. The profit pool is therefore currently adequately distributed along economic weightings (approx. 70% in CE, 30% in SEE). In principle, however, the banking sectors in SEE have performed slightly stronger than in CE over the last few years. The **profit pool** in **SEE** in **EUR terms** has **increased sixfold** when taking profits as of 2022-2024 compared to 2014-2016, while in **CE** it has **"only" tripled**. To some extent, there has also been a **disproportionate expansion** in bank profits. This is because, when calculated in the same way, economic output has only increased by a multiple of two. However, these figures do not necessarily indicate excess profits in the CE/SEE banking sectors. This is because bank profits only account for **1.15** to **1.3%** of **economic output**. In our opinion, these are not disproportionately high values. In addition, the long-term perspective must be considered. After all, the banking sector profits have now been well above the long-term average for two years; in the last ten years, there were also five and three years respectively with profits below the long-term average in CE and SEE.

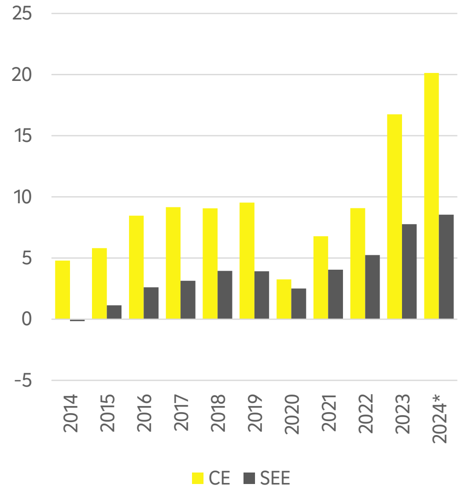
At **17-19%, Return on Equity** in CE/SEE is now at or close to the record levels of 2004-2007. Naturally, sector profitability in the euro area has also recovered. Meanwhile, the **return on equity premium** in **CE/SEE vis-a-vis** the **euro area** currently stands at almost **8 percentage points**. Over the past 25 years, such an outperformance was only achieved in five years (2007-2009, 2011/2012). From a long-term perspective the **RoE outperformance** in **CE/SEE** has been around **4 percentage points** vis-a-vis the euro area (RoE CE/SEE 2000-2024 ~12%, euro area 8%).

CE/SEE profit pool for the first time surpassing EUR 30 bn

In absolute figures, we speak about a record **~EUR 30 bn profit pool** generated by the **CE/SEE banking sectors** in **2024**, which, however, might have hit a **cyclical high** following the growing polarization among individual markets. A **prolonged pause** in the **monetary easing** in **Poland** fostered a spectacular comeback of local banks, which provided for almost **a third** of the **region's aggregated results** last year. This looks especially remarkable in the context of the continuing (albeit declining) provisioning against legal risks related to CHF loan portfolios. Many other CE/SEE markets, meanwhile, have seen a moderation of earnings, and we expect this trend to extend into 2025. Lower policy rates inevitably affect the banks' interest income via their relatively prompt translation to asset yields (**floating-rate contracts** constitute **>50%** of the **loan portfolio** in **larger CE/SEE markets**), which means that, on net, the pressure on the net interest margin (NIM) is there. Having said that, a more **cautious rate-cutting** that we foresee for 2025 in non-euro markets and a gradual

ECB easing should **rule out** any **cliff effects.** Moreover, banks defend their income through additional **investment** in **fixed-rate sovereign bonds** (exceed 20% total assets for larger banks in PL, RO, HU, HR), growing fee-generating business and hedging measures. Additionally, the **ample** and **low-beta deposit base** in the region (the average LTD ratio in CE/SEE is below 80%, SK is the only exception with >100% which does not constitute a negative outlier but rather aligns with the EA pattern) coupled with **significant improvement** in **borrowing terms** for **internationally placed MREL bonds** help manage funding costs. Altogether, we see the CE/SEE banks' NIM has basically plateaued in 2024 with a likely decline in 2025, though in a gradual manner. Essentially, this should still provide for a solid revenue base, as lower interest rates support business volumes, however the bottom-line trend will be also shaped by the cost of risk (some increase conceivable), OPEX inflation and special taxes, so the ultimate RoE will probably retreat from the peaks of 2023/2024.

CE/SEE banks' profit pool
EUR bn

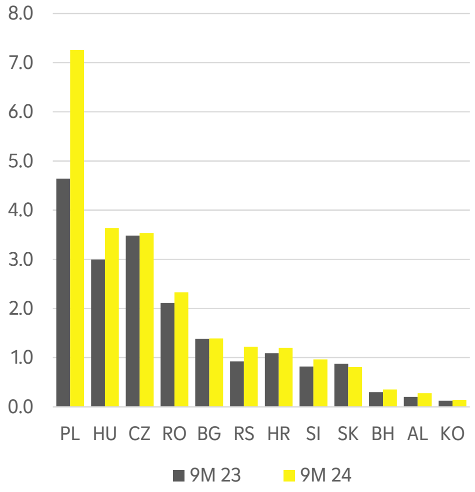


CE=PL,CZ,HU,SK,SI; SEE=RO,BG,HR,RS,BH,AL,KO; pre-tax values for RS and SI

** 9M 2024 LTM*

Source: National banks, RBI/Raiffeisen Research

CE/SEE banks' profit pool
EUR bn



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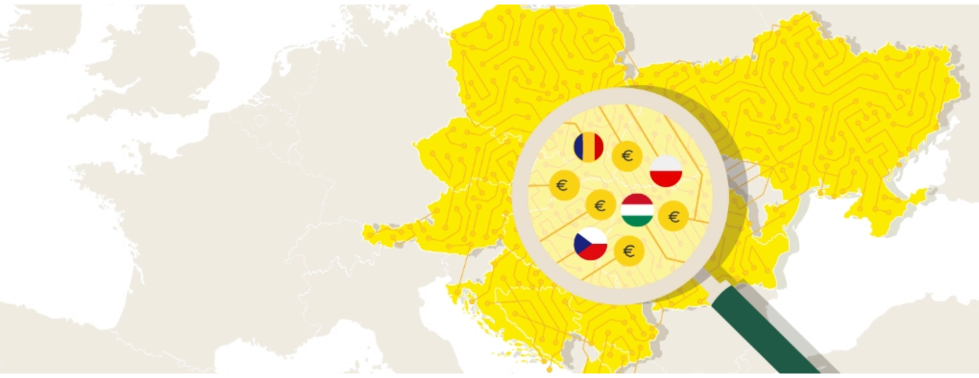
Source: National banks, RBI/Raiffeisen Research

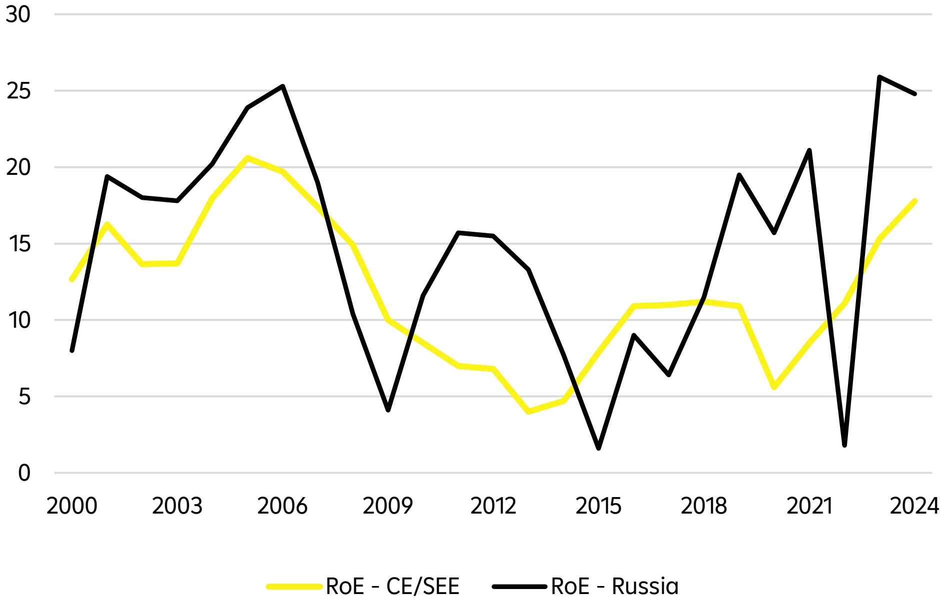
CEE exposures of Western banks - regional allocations to Russia, value of EU membership & geopolitics



The increasing **geopolitical complexity** and **uncertainty** is naturally also having an **impact** on **international banking business**, especially in **CEE**. At the beginning of the **war** in **Ukraine** and in the following months, this geopolitical escalation had a **substantial impact** on the **regional allocations** of **Western banks** operating in **CEE**. Russia exposures and, in particular, any kind of cross-border financing were once again cut back very quickly, despite the fact that the relative importance of Russia exposures in the CEE context as a whole has been declining for years (since 2013/2014, Crimea annexation). Leaving aside the reductions in Russia, related to the war in Ukraine and the sanctions imposed by the West, **Western banks** operating in CEE have positioned themselves to be **more risk-averse** in recent years. Since 2021, the **proportion** of **exposures** to **EU markets** rose from **88%** to over **90%** of total CEE exposures. Over a decade (since 2013/2024), this figure has climbed by almost ten percentage points, from **82-84%** to over 90%. During the same period, the share of Western banks' Russia exposure fell from almost 20% of their CEE exposure (before the annexation of Crimea) to 4% (2024).

The relative shifts outlined above ultimately reflect drastic rates of expansion and contraction over this period. **Western banks' CE/SEE exposures** to **EU countries** have **increased** by **40% since 2013/2014**, while **Russia-related** exposure has **fallen by 65%** (since 2014). In the 2010s, before the annexation of Crimea, the Russian banking market was indeed attractive for Western CEE lenders considering the low profitability of many CE/SEE banking markets in the aftermath of the global financial crisis, the following deleveraging in CE/SEE banking and in the context of the euro crisis. However, since 2014, the Russian market was no longer a "normal" market.

RoE banking sectors: CE/SEE vs. Russia*



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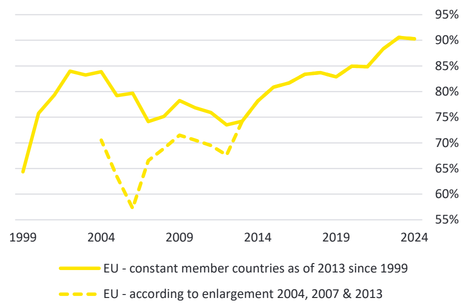
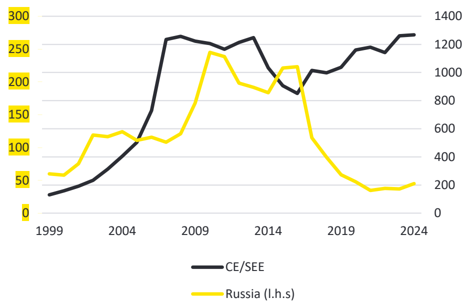
Source: National sources, ECB, RBI/Raiffeisen Research

Share EU markets CEE exposure*



** % of total; EU constant: PL, HU, CZ, SK, SI, RO, BG, HR share since 1999; EU enlargement according to factual enlargement data; Source: BIS, company data, RBI/Raiffeisen Research*

CE/SEE & RU exposures*



** USD bn; Source: BIS, company data, RBI/Raiffeisen Research*

In our view, the outlined development shows the **"financial" value** of **EU membership**. This trend can also be seen indirectly in the **exposures** of **Western banks** in the **Western Balkan countries**. These have remained more or less **constant** in recent years in both absolute and relative terms, despite the very positive economic development in the region, which is more favorable than in some EU countries in CE/SEE. Since 2013/2014, the exposures of Western banks to **Western Balkan countries** have increased by only around **5%** (vs. 40% in EU countries in CE/SEE). The cautious positioning of Western banks in the Western Balkans may well limit economic development in some areas, despite EU and IFI funding programs, and risk hedging instruments appear to be quite appropriate here. Furthermore, the developments outlined show how **important** a clear **EU perspective** for the **Western Balkans** is, as well as a de-escalation of remaining local conflicts. Especially since geopolitical meddling otherwise cannot be ruled out.

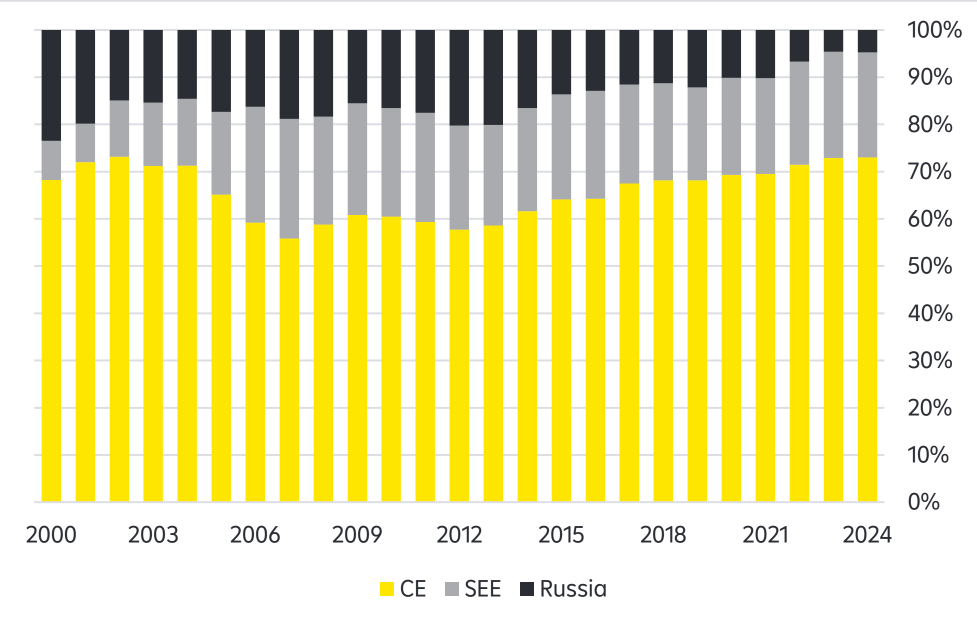
The **Russian share** of **total Western banks' CEE exposures** has fallen further from 10% in 2021 — an already a cautious positioning — to around **4%** (as of 2024). Now exposures tend to remain at this level for the time being. This is because Western banks' exposures to Russia have remained relatively constant over the last 12 months or since Q3 or Q4 2023. In our view, there are several reasons for this:

- **Market exit/no exit:** Apart from French Societe Generale, no Western bank with a significant market share on the local market in pre-war times, has managed a comprehensive market exit. To that extent, some local Russia business remains on the balance sheets of Western banks. In addition, a complete run-down or withdrawal of local business is proving difficult and cannot be implemented quickly. Whether the exit of RBI from Belarus can function as a blueprint for a potential exit from the Russian market has to be seen. In this respect, the French banking sector was able to reduce its exposure to Russia by almost 85% (compared to Q4 2021), compared to 50-60% for Western banks in aggregate.
- **Cuts to large-scale and cross-border financing:** Western banks have prioritized a rapid and drastic reduction of their international and cross-border business with Russia. In the categories relevant here, Russia exposures have fallen by 70-90% since Q4 2021 (cross-border business, guarantees, derivatives). In addition to the expiration and/or offsetting of positions, there has also been an active exposure swap between Western and Russian banks in some cases.
- **Remaining economic relations with Russia:** Despite comprehensive sanctions, the West and especially the EU continue to maintain certain economic relations with Russia. Currently, EU continues to export goods worth just over EUR 2 billion per month to Russia (in 2021, monthly export volumes amounted to approximately EUR 7 billion). Banking services are also needed for the remaining – albeit small – Russian business of Western companies. In this respect, it is not surprising that the exposures of Western banks to Russian banks, among others, were reduced to a significantly lesser extent than to other economic sectors. Recent ECB guidance and regulation (White listing certain clients/transactions) is framing the limited economic exchange, as it allows certain banking transactions after a review and approval process.
- **Limits of cutbacks reached:** Given outlined reductions since 2013/2014 and also since 2022, the Russian exposure of Western banks has reached a level where further reduction — without completely breaking off all economic relations and the local presence of some banks — would be extremely difficult. Ultimately, this can also be seen from the ratio of Western banks' exposure to Russia relative to Russia's GDP (BIS reported position in relation to GDP). Here we have reached extremely low levels of 3% of economic output in 2024. This is, of course, an extremely low level from a long-term perspective and in relation to other (comparative) countries. Some 10-15 years ago, this indicator in Russia was 15-20% of GDP, values that are currently seen in Brazil, Turkey or South Africa. Even in countries such as Argentina or large emerging markets such as China or India, BIS-reported foreign banking position vs. GDP stand at 10-15%. In the CE/SEE markets, where Western and foreign banks have a systemic relevance, this figure is as high as 30-40% or even 80-100%. From that perspective it is obvious that Western banks are not of systemic importance on the Russian market. In our opinion, a further drastic reduction in Western

banks' Russian exposure would only be achievable if there were a (controlled) more or less complete withdrawal of the remaining players. Whether this will be achieved is currently difficult to foresee. However, it is also obvious that there will be no return to the pre-war business model of larger Western banks that operated in Russia in any reasonable scenario and in the foreseeable future.

- **Lessons learned:** Western banks operating in Russia have been very risk-averse since 2014, even if an escalation such as that seen in the context of the war in Ukraine was not foreseeable. However, it is also true that European banks have retained a somewhat larger Russian business compared to Anglo-Saxon banks. A number of factors play a role here (e.g. stronger economic ties in Europe compared to the US, less critical view on Russia in some Western European countries plus close historic ties). However, it is true that in America, a greater skepticism towards Russia has prevailed for some time. In this respect, the market behavior of Anglo-Saxon banks, and especially of US banks, can be seen as a certain risk indicator. This is especially true in light of the geopolitical fragmentation of recent years and the possibility of further polarization under the current US president. In addition, the experience of Western banks with their Russian exposure shows that a market exit in a geopolitically tense situation is a difficult or even impossible undertaking and there are also clear elements of interest-driven politics at play here. Furthermore, Western banks are not only confronted with sanction risks but also with regulatory headwinds, which are politically understandable but where it is not always clear on what legal/regulatory basis they are occurring (see also the lawsuit against the ECB by UniCredit, which operates in Russia: **Case T-324/24: Action brought on 29 June 2024 – UniCredit v ECB**). In this respect, bank exposures in geopolitically sensitive regions entail a wide range of legal risks and are monitored with an increased (regulatory) vigilance (see also ECB Financial Stability Reviews, for example here: **Turbulent times: geopolitical risk and its impact on euro area financial** stability). In addition, Western banks and their local subsidiaries have also been confronted with legal action (freezing of assets and rights of disposition) and thus risks locally and before Russian courts (for example, the two major German banks, Citibank or Raiffeisen Russia).

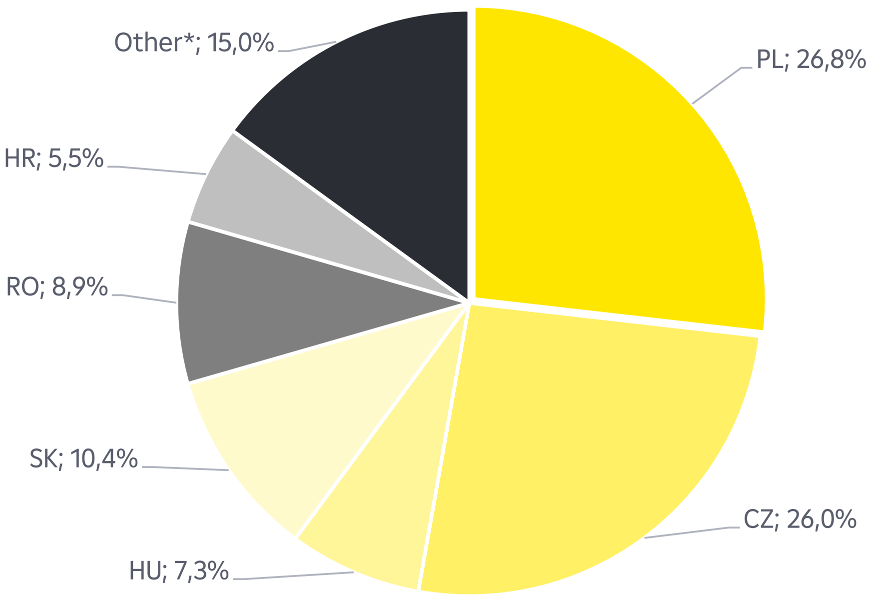
Regional shares CEE exposures Western banks (%)



Source: BIS, RBI Raiffeisen Research

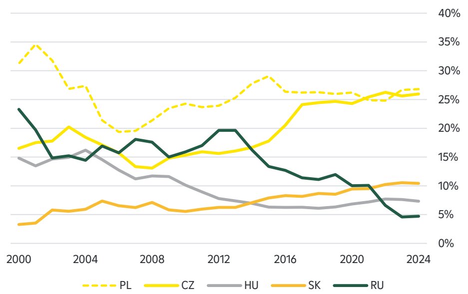
Of course, such a **drastic reduction** in **exposure** as in the case of **Russia** – in a larger CEE market – is **almost "unique"**. Only in the case of **Hungary** are somewhat similarly **drastic developments** visible over a longer period of time. At the beginning of the expansion of Western banks into Eastern Europe (2000), Hungary's share of CEE business was around **16%**. The low point for the Hungarian share was **6%** in 2018, since when slight market share gains have been seen. The relevance of the interplay between political and long-term market developments is also reflected in the appetite of western banks for their **Polish exposures**. For a long time, Poland (sometimes almost on a par with Russia) was the most important regional banking market in terms of the regional exposures of western banks. In the late 2010s, the **Czech banking market** overtook Poland in this respect due to the strong local presence of Western banks. Since 2023, Poland has once again been the most important banking market for Western banks in the region, driven by the country's solid economic development and a discernibly more investor-friendly policy orientation in certain economic sectors. **Slovakia** has developed into a key regional banking market for Western CEE banks in recent years compared to its initial starting point in the early days of the eastward expansion of Western banks into CE/SEE. Back in 1999 Slovakia accounted for 4.5% of CEE exposures at Western banks; as of 2024 this ratio stands at 10.4%

Shares CEE exposures Western banks (% of total)*



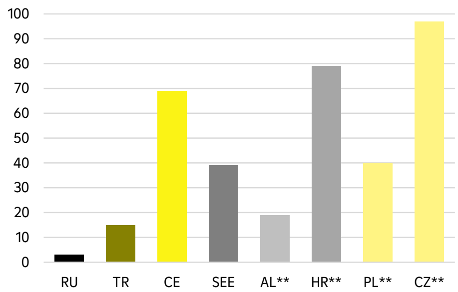
*Source: company data, BIS, RBI/Raiffeisen Research; * local and cross-border exposures; Other: all other SEE markets plus RU, UA, BY*

CEE exposures Western banks*



*Source: company data, BIS, RBI/Raiffeisen Research; * of total*

Int. banking exposure (% GDP)*



*Source: company data, BIS, RBI/Raiffeisen Research; * local & cross-border exposures; ** AL, HR, PL, CZ max & min values in SEE & CE*

After the adjustments made in recent years, we do not expect such drastic changes in the remaining CEE exposures. This is precisely because of the **high degree** of **concentration** of **CEE banking exposures** on **EU markets** that has now been achieved. In the long term, the share of **Western banks' exposure** to **Ukraine** could rise again. An increase from the current EUR 10-15 billion to around EUR 50-60 billion would be conceivable in the light of deeper EU integration. In light of the outlined trends and increased geopolitical vigilance, however,

we would not expect such a **rapid expansion** as in the early 2000s, when Western banks bet very heavily on Ukraine. At the same time, it should be emphasized that **Western banks** have kept their **Ukraine exposures constant** during the **last years of war**. Western banks' exposure to Ukraine currently stands at 8-10% of GDP, possibly a "better-than-expected" reading in light of the war situation the country is in as well as from a broader emerging markets context.

Regulatory & banking convergence SEE & Western Balkans

The **market share** of **foreign banks** in the **Western Balkans** rose from just under **35%** in 2000 to almost **94%** in certain countries of the Western Balkans in **2008**; in the entire region of **Southeastern Europe**, the corresponding increase in market share over the same period was from **67%** to **89%**. Since then, the aggregated market shares of foreign and Western European banks in Southeastern Europe and the Western Balkans have been declining noticeably again, to around **78%** in **both regions** at present. The noticeable market shift to the disadvantage of large Western European banks over the last decade and last few years is the result of many developments. Firstly, certain **players** active in the region have **exited** the **market**. Secondly, in recent years there has been a noticeable expansion of **local players**, while foreign players are acting very risk disciplined in the Western Balkans region. Risk policies at Western European banks are also determined by an increasing geopolitical risk awareness, while certain business are therefore more likely to migrate to local players. Thirdly, certain **localization** of **banking business** has opened up more opportunities for local players. For example, the share of foreign currency loans has fallen from 76% to 45% in the Western Balkans markets and from 90% to 73% in Southeastern Europe. In addition, local banks in some countries also receive a certain amount of political support in terms of consolidating the market, for example in Romania. However, trend developments like outlined above (increasing market share of foreign banks, followed by a consolidation; rise of foreign currency loans, followed by a consolidation later) can be also observed in other CE/SEE markets, following an initial peak in the expansion of Western banks to the CE/SEE region.

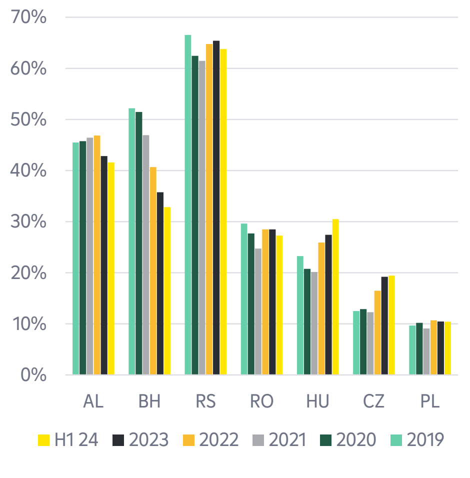
Euroization on the Western Balkans - well ahead of EU markets

Overall the Western Balkans is characterised by an **extremly high level of Euroization**. The very high degree of Euroization stems from a complex mix of various factors. Since the 1960s, there has been officially regulated labor migration (i.e. based on recruitment agreements) between Yugoslavia and Germany and Austria. As early as the 1970s, it can be assumed that there were almost 900,000 workers from Yugoslavia in Germany and Austria. Other significant migration to Western European "hard currency countries" took place in Switzerland and Sweden. In this respect, it can be assumed that in 1990 there were well over a million labor migrants from Yugoslavia in Western Europe. In addition to **long-standing out-migration, remittances, experiences** of **local macro-financial instability** and later on **high market shares** of **foreign banks** domiciled inside the euro area, operating locally, all those factors play a key role in the population's attitude towards holding euro cash and using the euro in the financial sphere. The financial liberalization in SEE and Ex-Yugoslavian Western Balkan countries in the 2000s possibly added to the adherence to high levels of Euroization. The large-scale entry of major foreign-owned Western pan-European CESEE banks in the 2000s and their readiness and willingness to bankroll the high degree of Euroization possibly contributed to a certain complacency regarding the high level of Euroization.

Lending in foreign currencies, and here almost exclusively in EUR, is of prominent importance in the banking sectors of the Western Balkans. Currently, the **share** of **euro loans** in the region averages **45-50% of total loans** (with peaks in Serbia of 65%, while in the rest of the region values around 40-45% are more likely to be recorded). This suggests that **lending in EUR** in **non-EU member states** is currently **significantly higher** than in an **EU member state** like **Romania**, for example, where lending in euros accounts for just under 30% of total loans. However, there has been a perceptible drop in foreign currency lending in recent years; in the Western Balkan countries, the corresponding share was still around 75% on average in 2009 and 67% in 2012. In Romania, the share of foreign currency loans fell from 58% (2008) and 63% (2008) to 31% (2022) over the same period. In this respect, the share of foreign currency loans in the Western Balkans has fallen slightly less pronounced than in Romania over the last decade. However, the still recognizable share of foreign currency loans in Romania also shows the **limits** of a **local currency strategy** (as is being pursued in Serbia, for example). In case of **Serbia** lending in Euros is currently more or less at the **same level** as in **Croatia back** in **2022**, one year ahead of the euro introduction.

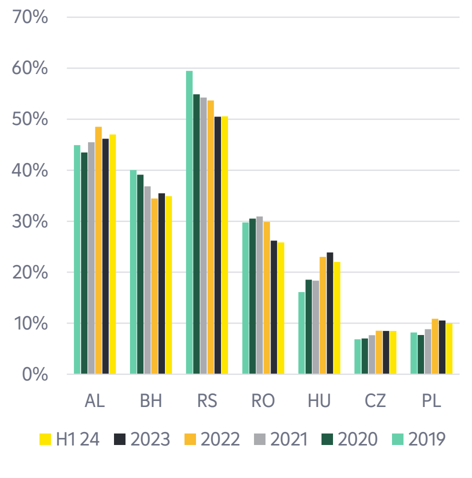
Overall, the **use** of the **euro in lending** in the **Western Balkan** countries is **very pronounced compared to EU member peers** (e.g. Romania) or current euro members like Croatia immediately ahead of the entry into the currency union. This applies even more since Romania, as an EU member, has a more credible, realistic, and imminent euro perspective than any EU accession candidate in the Western Balkans given recent convergence successes. In the non-euro area EU member states in CE (Czech Republic, Poland, Hungary) and Romania, the euroization of the credit business stands on average around 20% of all credits and thus significantly below the values observed in the economies and banking sectors of the Western Balkans. Furthermore, in the case of Hungary and Czechia, the euro-based loans are almost exclusively concentrated in the corporate segment. In this respect, the extent of the high degree of euroization on the Western Balkans is obviously very distinct in the CE/SEE context.

Loans euroisation (%)



Source: National banks, RBI/Raiffeisen Research

Deposit euroisation (%)



Source: National banks, RBI/Raiffeisen Research

In addition to the lending market, the **deposit business** in **foreign currency** and **euros** obviously needs to be analyzed as well. This is of relevance due to potential refinancing mismatches in the aggregated banking sector. In this respect, it comes as no surprise that the **euroization rate** on the **deposit side** in the Western Balkan countries also **averages** to at least **45%**, roughly the same level as the credit euroization ratio. There are, however, discernible misalignments at the country levels: in Serbia, for example, the euroization on the lending market is somewhat higher than on deposit markets, while in Albania the situation is the opposite. However, those country-specific constellation do not result in refinancing mismatches at the aggregate level because the sum of loans disbursed is currently lower than the deposit base in all Western Balkan countries (i.e. the loan-to-deposit ratio stands well below 100% on aggregate). However, the high degree of euroization can still create certain maturity mismatches as EUR-denominated loans are having much longer tenors than EUR-deposits, while long-term capital market refinancing in EUR is not an easy option for local lenders.

The remarkably **high degree** of **euroization** in the Western Balkan countries — coupled with the very high market share of **European** and **ECB-supervised EU banks** — implies that there are substantial challenges and **areas** for action and **collaboration** among **national** and **EU actors**. This very specific regional constellation must be well understood and addressed in the light of the (very) distant prospect of EU and euro membership. As a reminder: Bulgaria joined the EU in 2007 and has not entered the euro area as of today (2025).

Western Balkans: No exposure heavyweight at Western banks – although the latter have a systemic influence

When it comes to the **Western Balkans** the region has a very limited importance for regional exposures of EU/euro area banks in Southeastern Europe, accounting for around **4-5 percent** of **regional exposures** in the **overall CE/SEE region** and thus **17-20 percent of SEE exposures** of Western banks. The aggregated exposure of Western banks to the Western Balkan countries amounts to some 35/40 (2015) or up to 50 (2024) Euro bn (depending on the year of measurement). To put it into perspective: the aggregate exposure of the large Western CE/SEE banks to this group of countries is therefore equivalent to the balance sheet total of a large German savings bank. The exposure of Western and Western European banks in Croatia alone is over EUR 70 bn. Overall, no structural or disproportionate expansion of Western banks in the Western Balkans region is discernible over the last decade, even if the expansion in the overall SEE region in the early 2000s was quite remarkable. Geopolitical risks are possibly now capping the willingness to boost exposures. Nevertheless, the **(systemic) role** of **Western banks** in the region SEE and the **Western Balkans** should not be underestimated.

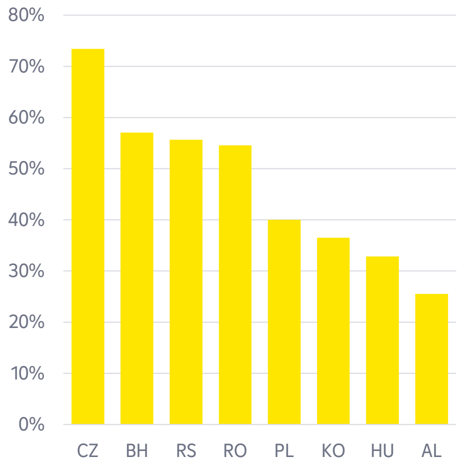
- Western European banks have contributed to a **rapid market development** in terms of best market practices, have boosted the overall degree of credit availability and have kept their **regional exposures** to the CE/SEE region and the Western Balkan countries **relatively constant** even in **challenging times**. In addition, a deleveraging — if necessary — was carried out in an orderly and drawn-out manner in CE/SEE. This applies particularly in comparison to crisis-ridden Southeastern European euro area countries, while out of five Vienna Initiative (1.0) countries, three had been out of the SEE region (Bosnia and Herzegovina, Romania, Serbia; plus Hungary and Latvia).
- Western European banks operating in the region offer many economic actors and customers a **compliance**-**safe** and **clean market access**, which is quite important for many Western investors in the real and financial economy. In this respect, Western banks often play an important role in the **development** of **local capital markets** and/or the establishment of local currency markets.
- Established Western European banks active in the SEE and Western Balkans region are **major partners** of **international development** and **promotional banks**, handling many regional promotional lending programs. Moreover, western European banks operating in the region, most of which operate across borders, can be important **aggregators** in a **region** that is **fragmented** overall. They enable foreign players operating there to carry out their banking business in a regionally efficient manner.
- **Western** and **ECB-supervised banks** act as important **transmitters** of **Western European legislation** and **regulation**. After all, the local entities are also subject to strict regulation at the consolidated level to a certain extent. In a certain way, the extra-territorial scope of the EU and SSM banking regulation is therefore also increasing via the high share of foreign banking sector ownership in SEE and the Western Balkans. Positive spillover effects of European legislation and regulation can be seen in areas of macro-

and micro-prudential regulation, stress testing or even more progressive agendas such as ESG-regulation or climate stress testing. In this context, it should be emphasized that via foreign-owned banks the US/EU sanctions against Russia and/or other international sanctions (such as those imposed by the US) also have a significant local impact on local economic actors. No major Western European bank or ECB-supervised bank can afford or risk the financial and reputational consequences of (structural) sanction evasion transactions being carried out via local subsidiary banks. However, negative spillover effects of Western-centered regulation on CE/SEE and Western Balkan countries (via the consolidated group approach) are equally conceivable and recognizable, as happened, for example, in the context of the euro area debt crisis and the EBA requirements implemented at that time and/or the front-loaded implementation of Basel III standards by financial markets.

- Financial authorities of Serbia, Bosnia and Herzegovina and Albania have been making strides in the **alignment** of **key banking regulations**, including the resolution regime (arrangement of first market-based and bilateral MREL financing in 2024) and new Anti-Money Laundering and Payment Service legislation. Stronger integration reduces fragmentation of the markets in the region, though it is also not devoid of (negative) byproducts, as is the case with the implementation of stricter consumer protection rules that result in limitations on loan interest rates (currently topical for Serbia). The positives, however, still outweigh in the longer run.

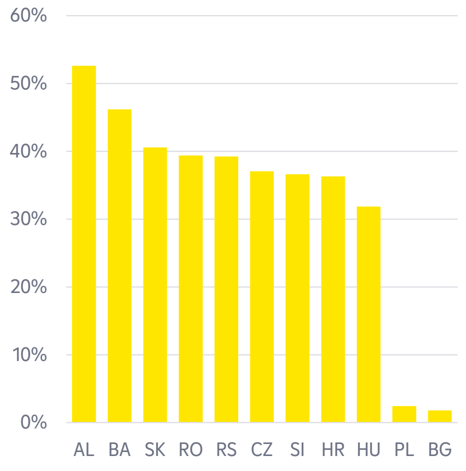
Despite a slight decline in the market share of foreign banks over the last decade, the market shares of EU banks and banking groups directly supervised by ECB in the Western Balkan countries remain between 25-55% and are in some cases even higher than the levels in EU countries such as Poland, Hungary or slightly above those in Romania. In fact, regarding this parameter, the Western Balkan countries are close to the levels in EU countries from Central and Eastern Europe, such as the Czech Republic or Slovakia, with **high market shares** of **foreign banks** in terms of the **market shares** of **ECB-supervised large banks** and their **local subsidiaries.** Overall, a systemic influence of ECB-supervised large banks can also be said to apply to the Western Balkan countries.

Banks (groups) supervised by ECB
% total sector assets



Source: National banks, company data, RBI/Raiffeisen Research

AT banks' claims on country residents
% total foreign claims, Q2 2024



Source: BIS, RBI/Raiffeisen Research

(In-)direct impact of ECB-supvervised banks on the Western Balkans

In summary, the **complex regulatory** and **market interdependencies** outlined above show the necessity of **close interaction** between **national** and **pan-European regulators/ central banks** in the CE/SEE region, while balancing national and European regulatory agendas. In this context, it is important to emphasize that the host countries Western lenders active in SEE and the Western Balkans have a natural preference for stable and well-regulated ECB-supervised EU/Euro area-based banks operating out of home countries with strong banking sectors and/or solid sovereign ratings. In regard to complex transmission channels of macro-financial (in-)stability the high market shares of Western European and ECB-supervised banks in SEE and the Western Balkans are of special relevance. De facto market shares in the range of 50%+ imply a responsibility on the part of the ECB for macro-financial stability in the region that goes beyond regulatory matters. In addition, the macro-financial vulnerability of the countries in the SEE and Western Balkans region is somewhat higher than in most EU countries in CE, as measured by the sovereign ratings, capital market access, the credibility status of the central banks and/or local currencies, and the potential for borrowing from the IMF (with or without conditionalities attached). Therefore, it is positive that ECB has been very active in recent years in terms of safeguarding local macro-financial stability, considering foreign currency positions and/or euro liquidity. In this context it is worth highlighting that ECB has boosted it toolbox to support and secure the macro-financial stability in highly euroized euro and/or EU candidate countries via offering repo- and swaplines. In recent years ECB established (precautionary) swap and repo lines with Croatia (ahead of the EUR entry), Bulgaria, Albania, Serbia, North Macedonia, Kosovo, Romania, Hungary, Poland (not all but some of those agreements are still in effect as of Jan 2025). The sketched evolution is positive and demonstrates an increasing **focus** on **macro-financial stability** by **ECB beyond** the **euro area**, e.g. in countries like Romania or the Western Balkans with significant European economic interests and/or European/Euro area banks. Not to forget the signs of increasing geopolitical meddling in Southeastern EU members and on the Western Balkans.

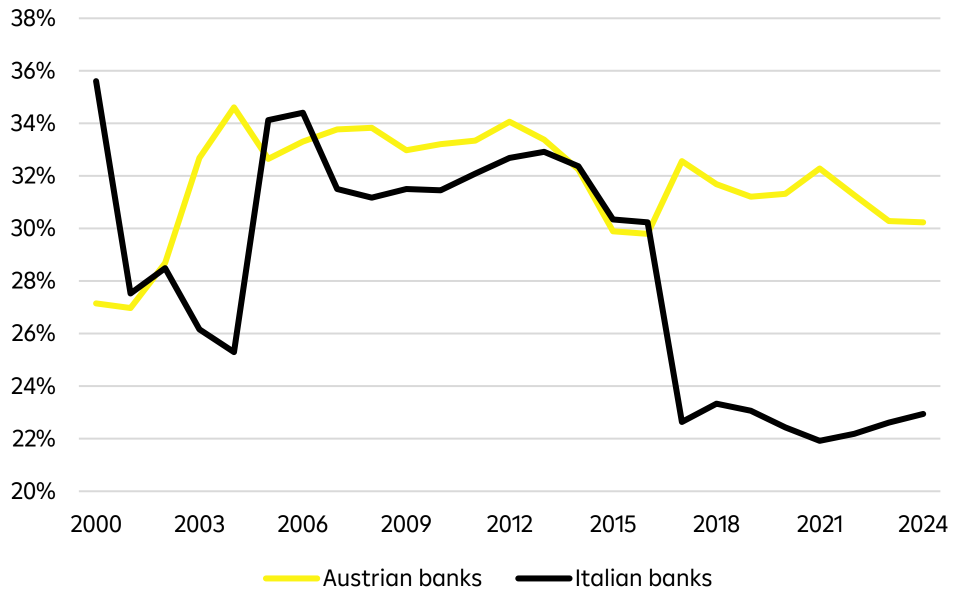
Overall, **well regulated cross-border banking integration** (incl. backstops offered by ECB) beyond the EU (like on the Western Balkans) offers substantial **long-term benefits**. Tailwinds for FDIs and foreign trade can be named among chief economic effects, while the alignment with EU's institutional and legal frameworks contributes to **greater resilience** in **local banking markets** and helps unlock access to the broader EUR-based investor pool.

Austrian banks: A leading force in CE/SEE banking

Large **Austrian CEE banks** and their **regional subsidiaries** account for around **20-30 per cent** of **regional banking business** in **CE/SEE**. This clearly confirms the position of Austrian banks as top dogs among the leading pan-European CEE banks. The market positioning of domestic banks is particularly pronounced in the CE3 markets of the Czech Republic, Slovakia and Hungary, as well as in Romania.

The fairly strong focus of leading Western banks in the region on the CE and especially CE-3 banking markets is evident from their aggregated market shares. In the CE-3 markets, the seven leading banks have a market share of 70% (compared to 65% in 2019). In SEE, the aggregate market share of the leading Western banks stands at "only" 56%. In the CE-3 markets, Austrian banks have aggregate market shares of 25% compared to 14% in the SEE region. In SEE, Italian banks have an aggregate market share of 22% compared to almost 15% for Austrian banks. With their aggregated market shares, Austrian banks remain market leaders among the major international banks operating in CEE and CE/SEE, with a market share of almost 30% compared to just over 20% for major Italian banks.

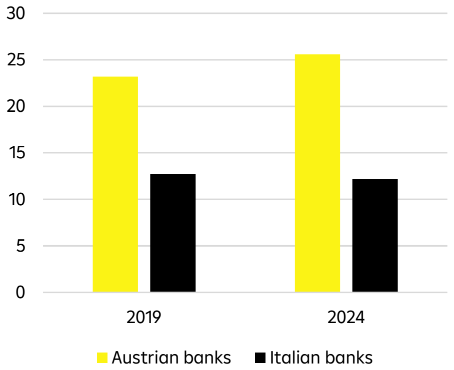
Market shares among Top CEE lenders (%)



** Austrian banks: Erste, RBI; Italian banks: Unicredit, Intesa*

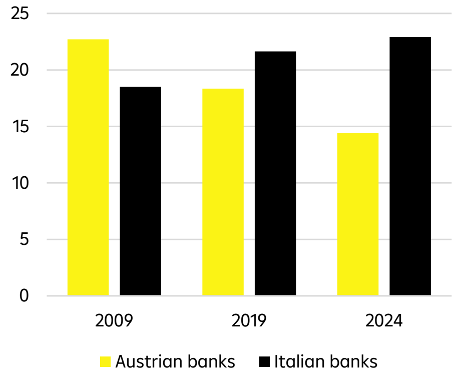
Source: national sources, company data, RBI/Raiffeisen Research

Aggregated market shares CE-3



Source: national sources, company data, RBI/Raiffeisen Research; CE3: CZ, HU, SK

Aggregated market shares SEE



Source: national sources, company data, RBI/Raiffeisen Research; SEE: RO,BG,HR,RS,BH,AL,KO

More details are to be found in the new edition of our Raiffeisen Research ***2024 CEE Banking Sector Report****. The CEE Banking Sector Report (available for registered users) is a well-established co-creation and annual flagship study of Raiffeisen Research. Once a year the entire Raiffeisen Research teams in CEE and Vienna analyze banking sector dynamics in the CEE region in detail. In addition to a granular country coverage with local flavor, we once again documented market shares, balance sheet totals and financials of the leading (Western) cross-border CEE banks. The same holds true for cross-country trends for market shares, business dynamics, asset quality and profitability.*

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Symbol	Date	Recommendation	Company
SK	25.10.2024	Under Revision	Slovakia
SK	28.03.2024	Under Revision	Slovakia
RO	16.12.2024	Not rated	Romania
RO	01.08.2024	Not rated	Romania
RO	13.03.2024	Not rated	Romania
HR	13.11.2024	Under Revision	Croatia
HR	08.04.2024	Under Revision	Croatia
BA	27.12.2024	Under Revision	Bosnia and Herzegovina
BA	07.08.2024	Under Revision	Bosnia and Herzegovina

BA	24.04.2024	Under Revision	Bosnia and Herzegovina
AL	17.12.2024	Under Revision	Albania
AL	26.06.2024	Under Revision	Albania
XK	11.12.2024	Under Revision	Kosovo
XK	18.06.2024	Under Revision	Kosovo
RU	22.02.2024	Under Revision	Russia
UA	09.08.2024	Under Revision	Ukraine
SI	28.08.2024	Under Revision	Slovenia

History of long term recommendations

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SK	25.10.2024	Not rated	Slovakia
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RO	01.08.2024	Not rated	Romania
RO	13.03.2024	Not rated	Romania
HR	13.11.2024	Not rated	Croatia
HR	08.04.2024	Not rated	Croatia
BA	27.12.2024	Not rated	Bosnia and Herzegovina
BA	07.08.2024	Not rated	Bosnia and Herzegovina
BA	24.04.2024	Not rated	Bosnia and Herzegovina
AL	17.12.2024	Not rated	Albania
AL	26.06.2024	Not rated	Albania
XK	11.12.2024	Not rated	Kosovo
XK	18.06.2024	Not rated	Kosovo
RU	22.02.2024	Not rated	Russia
UA	09.08.2024	Not rated	Ukraine
SI	28.08.2024	Not rated	Slovenia

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	Column A	**Column B**
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Hold recommendations	29.2%	33.8%
Sell recommendations	7.9%	4.6%

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Investment recommendation	Basis: All recommendations for all financial instruments (last 3 months)	Basis: Recommendations for financial instruments of all issuers, for which special services were rendered in the last 3 months
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Hold recommendations	61.8%	57.7%
Sell recommendations	11.8%	11.5%

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